Ridgetop Wealth Management
Market Update – February 2022

Predictions

We began our 2022 Market Outlook with the statement, "While our expectation is that 2022 will be a positive year from start to finish, we have a fairly high degree of confidence it is going to be a bumpy ride along the way." Well, the market has obviously not disappointed on the latter. January was one of the worst starts to a year going back to 1929. In addition to the drop we experienced, volatility has also dominated. On Monday January 24th, the intraday decline on the S&P 500 was -3.99% and -4.90% on the Nasdaq, only for both to close higher for the day[1]. Such reversals have occurred less than a handful of times throughout history.

So we now know we got the latter part of our 2022 expectations correct, but what about the positive returns for the year?

What We are Seeing Now

January's pullback served to improve valuations, price in bad news about Fed rate hikes and future corporate earnings, and for the first time since May of 2020 investor sentiment fell into the pessimistic zone. This very well could all be part of the bottoming process in a short lived, yet unpleasant correction. Historically, when investor sentiment has gotten as low as it was in January, it has meant positive returns for the S&P 500 for up to six months later[2].

Unfortunately, we cannot yet conclude that the correction has run its course. Tech has rebounded from its lows and global market breadth is improving, but what we need to see is positive breadth thrust indicators (which occur when a high percentage of stocks rally in unison) before we have conviction that a sustained rally is under way. We have had some really strong trading sessions over the last several days, but we want to see a 10:1 up day, with advancing volume 10 times declining. If/when we see two 10:1 up days without an intervening 10:1 down day, we would be happy to proclaim the bull market has a new lease on life. Until then, unfortunately, the verdict is still out.

When Good News Can Be bad

The labor market is very strong and the unemployment rate is extremely low. There is arguably explosive consumer demand and the economic data continues to be strong. Good for main street, but unfortunately not Wall Street. It is counter intuitive but a high unemployment rate has historically been consistent with strong double digit gains for stocks in the months ahead[3]. Currently, we have the opposite situation which suggests we are late in the in the economic cycle and obviously the Fed is going to be far less friendly. With as tight as the labor market is, you can get entrenched in a wage-price spiral; whereas, companies raise prices because they have to pay higher wages, and employees demand higher wages because of increased prices – creating a self-perpetuating feedback loop. Often times this cycle only ends as a result of an economic recession.

Inflation

Inflation was out of control towards the latter half of 2021. It hit highs not seen since the 80s and early 90s. While money supply has been "loose" to say the least, much of the increase in the consumer price index (CPI) had to do with supply chain issues as we dug out of Covid restrictions globally. While not a widely held belief, we believe inflation is likely currently peaking. Yes, wage inflation is going to be a headwind but easing supply chain issues point to inflation moderating in the coming months. While the

Fed will no doubt be tightening, if we are right and CPI subsides, they will not need to be as aggressive with rate hikes as many market participants predict. This would be very positive news for equity and bond investors alike.

A Look Forward and Backward

January was not fun, but pauses to refresh are healthy and normal. Going back to 1980, 31 of the last 41 years have been positive for the stock market. But, the average intra-year drop is 14.3%[4] per year. Corrections are normal. The lack of volatility that we experienced during the latter half of 2020 and throughout 2021 while enjoyable, is the exception and not normal.

We will end where we started: Are the equity markets going to finish the year higher than they started? Overall, the earnings outlook is still solid, with the global tech sector on track for earnings growth of around 15%[5]. Our base case remains that the negative impact of Fed tightening in 2022 will be more than offset by continued corporate earnings growth. Yes, it is still extremely possible that despite all the headwinds we are inundated with by the media that the market forges ahead this year. There will be more bumps and bruises to come but we are still giving this bull market the benefit of doubt for now.

While we expect our market outlook is spot on, hopefully Punxsutawney Phils' predictions are not, and Spring is right around the corner.

Sincerely,

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