In the Markets Now

A dose of optimism

We believe in the old saying: a picture (or list) is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

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TEN TAILWINDS FOR THE US MARKETS AND ECONOMY

The investing world has been a bit gloomy lately. Despite the recent pop in the stock market, the combination of war in Ukraine, historic inflation, and an increasingly aggressive Federal Reserve has investors on edge. And perhaps rightfully so – these are meaningful headwinds to a stock market that is already up 70% in the last three years. But I am optimistic (hint: long-term investors kind of have to be), so I thought it would be worthwhile to list ten tailwinds at investors' backs.

1. **The US consumer is strong (and our economy is 70% consumption).** Just over the last two years, we've seen: consumers accumulate over $2T in excess savings, debt near multi-decade lows as a % of income, retail sales up 27% since Feb. 2020, and household net wealth above $150T for the first time. Consumers hate inflation, but they're well-positioned to deal with it.

2. **The labor market is hot.** To the tune of 11+ million job openings, weekly unemployment filings at 53-year lows, wage growth surging, and labor force participation rate rising. A hot labor market may stoke inflation, but it also boosts consumer strength.

3. **Reopening potential.** Covid-19 is not going away, but we're learning to live with it. Hotel occupancy, mobility, and air travel are at or near pre-Covid levels, and trending up. Delta Airlines just logged its two busiest days for sales in its 100-year history. We expect pent-up demand for services to be a big theme in the coming year.

4. **US companies.** "S&P 500 sales rise with inflation, and since the beginning of the year, expectations for 2022 nominal GDP have risen from 7.5% to 8.7%" (Credit Suisse). Further, despite cost inflation, forward S&P 500 earnings estimates are rising. Pricing power and productivity are shining through, and credit spreads (a sign of potential market stress) are in check.

5. **Monetary policy.** Interest rates are still low, and will likely stay below the Fed's "neutral zone" until 2023. Money growth remains elevated. And as our friends at Strategas note, monetary policy works with a lag, so easy policy today could have lingering effects into next year. Further, stocks have historically done quite well in the 12 months after a cycle's first rate hike.

6. **Housing.** Both housing starts and permits to build new homes hit 16-year highs in 2022. Despite mortgage rates rising, homebuilding is likely to remain supported by lack of supply. Further, a large-scale shift is already in motion, spurred by Covid-driven relocation and millennials entering prime buying years. A strong housing market is a boon to the economy.

7. **China is easing.** The world's second-largest economy is cutting rates and easing policy at time when most of the world is aggressively tightening. China is the S&P 500's second biggest geography by sales and still our biggest trading partner.

8. **Investors are bummed.** This has shifted a bit as markets have bounced, but (per survey data) investors remain bearish, cash holdings remain elevated ($5T in money market funds), and uncertainty indexes remain high. This is a bullish indicator.

9. **Relative valuation.** Though interest rates are rising, stocks remain a good value versus bonds. Both the S&P 500 earnings yield (profit divided by price) and shareholder yield (dividends + buybacks) are above the 10-year Treasury yield.

10. **Long-term performance of the market.** The biggest reason for optimism is market's time-tested ability to perservere through wars, crises, inflation, and more. The S&P 500 is up ~370,000% over the last 75 years. It has never had a negative return over a 15-year period, and an 80/20 mix of stocks and Treasuries has never had a negative return over a 10-year period. Though the market's long-term outperformance is occasionally marked by pockets of uncertainty, fear, and panic, the productivity of our companies and economy has always eventually shone through.

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