Year-End Commentary: What Has Happened and What May Be Ahead

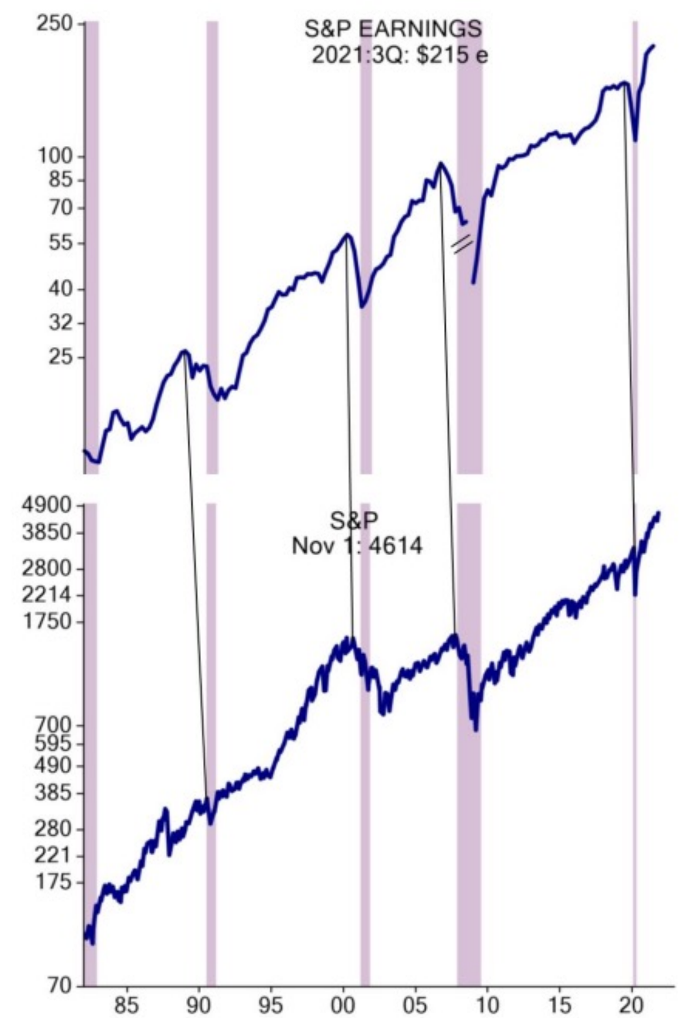
As we discussed in September, US stocks were the beneficiaries of a liquidity influx into the global capital markets courtesy of unprecedented levels of monetary and fiscal stimulus. Since that time, liquidity has been reduced but is still very high historically. Investors remain eager to invest in good and well-managed companies. We anticipated a strong recovery and rebound from a pandemic-induced collapse. As the 3rd quarter unfolded, corporate profits were even stronger than anticipated back in September.

Looking ahead, it's our view today that the economy is likely to remain strong as reopening continues, supply chain problems recede, inventories are rebuilt, and the unprecedented surge in Consumer Net Worth flows through the economy. This all should lead to further increases in corporate profits, the fundamental driver of stock prices.

WHAT HAPPENED IN Q3 2021?

US Equity indices continued to rise through the 3rd quarter, despite a surge in the COVID Delta variant through the summer and fall seasons and resulting disruptions. The US economy continues to grow on the back of consumer demand and monetary stimulus despite building supply chain constraints.

Economic growth drives corporate earnings, which in turn drives stock valuations. With GDP strongly rebounding, S&P 500 companies showcased significant earnings strength during the 3rd quarter. With nearly all the S&P 500 companies having reported for the quarter, 81% reported a positive earnings surprise and 75% of them reported a positive revenue surprise, according to Factset. The S&P 500 price has historically closely followed S&P 500 earnings, and we expect a positive Q4. We believe this bull market still has room to increase despite heighted valuations and volatility.



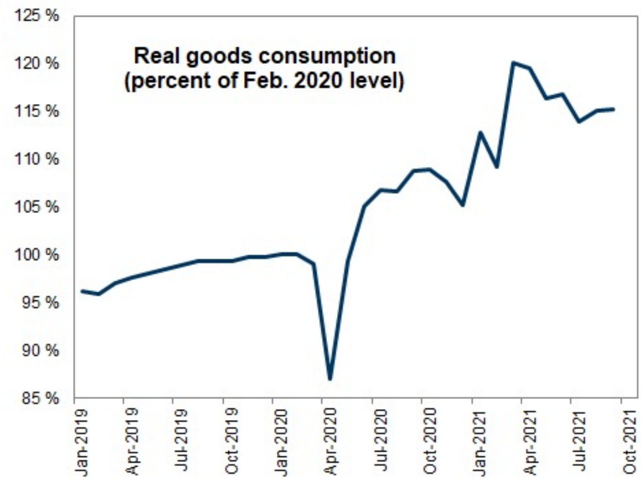
Source: Evercore ISI

THE CONSUMER KEEPS TRUCKIN':

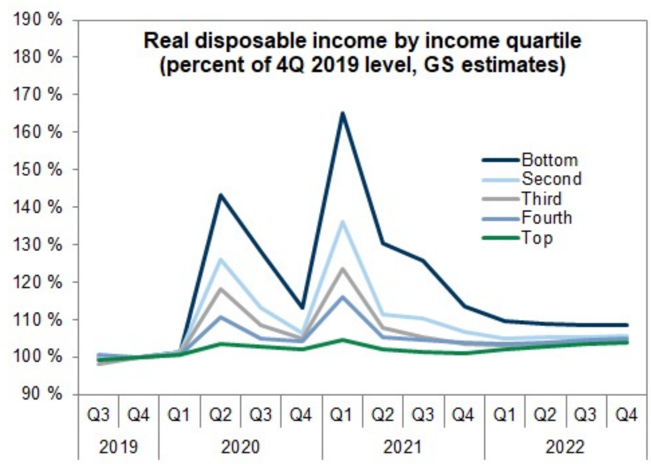
The official expiration of several Federal stimulus programs in September (extended unemployment and tax rebates) hasn't dampened consumer demand. Strong demand in the face of rising prices has been attributed to the strength of the consumer's balance sheet. People may be feeling wealthy based on appreciation of home values and investment assets, commonly referred to as the "wealth effect." Goods consumption is 15% higher than the pre-pandemic level, and disposable incomes are also higher across all demographics. The percentage change in disposable income is greatest with the lower to middle class and the increased purchasing power from these groups has likely helped move the economy forward.

INFLATION:

Cost of living and inflation have grabbed headlines in recent weeks as the CPI rose 6.2% year-over-year in October, the highest uptick in years. We saw an acceleration in costs across the board with wages, rents, pricing power, and inflation expectations all rising. Federal Reserve Chairman Powell and Treasury Secretary Yellen have been saying the current spike in prices is transitory. Consensus among economists today is that inflation will ease by mid-2022 and the Fed does not want to act prematurely by raising rates too much/too soon, if at all.



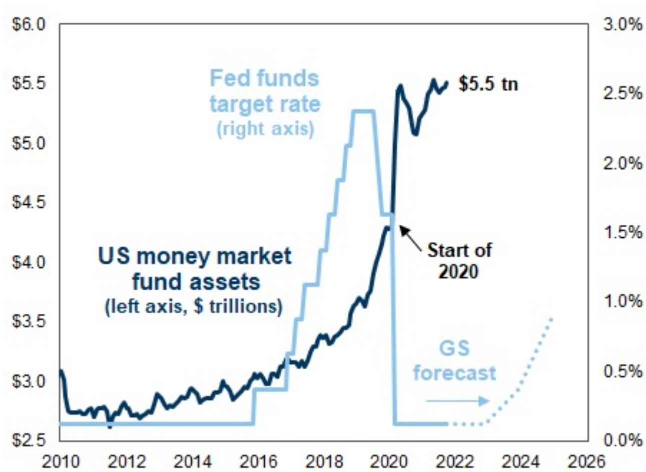
The current inflation environment is primarily driven by two core factors: supply chain issues and government policy. These two factors will be the driving forces affecting inflation for the next year or so given what we know today. However, it is quite difficult to predict what will unfold. If the Fed pursues good policy and supply chain issues sort themselves out, we should get inflation back towards the Fed's long-term 2% target. The other scenario would be that supply doesn't improve and the Fed makes poor decisions, meaning inflation would sustain at a higher rate. This would create a bigger problem to solve down the road.



Supply chain disruptions have affected virtually every industry. Elevated consumer demand, a tight labor market, and COVID outbreaks have combined to put unprecedented pressure on global supply chains. This has not only driven increases in logistics costs and delivery speeds but has also challenged the ability for goods producers to source input materials at reasonable costs. Supply chain disruptions will eventually subside, in our opinion.

WHAT TO LOOK FOR IN 2022:

The combination of rapid money growth, earnings growth, and "there is no alternative" should keep the S&P 500 rallying. Households and corporations will be key sources of demand for US equities in 2022. Cash on the sidelines has increased while rates have remained low, and this will help raise US equity markets as this cash is deployed.



Source: Goldman Sachs

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The S&P 500 Index is a capitalization-weighted index comprised of 500 stocks chosen for market size, liquidity and broad industry group representation within the U.S. economy. Index returns represent gross returns, and are provided to represent the investment environment during the time periods shown and are not covered by the report of the independent verifiers.

All returns, valuation and estimate data provided by Factset.

Source: Goldman Sachs