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COVID, COVID, COVID!

Global Markets and Regions

	4th QTR	2021 YTD
US	7.98%	25.59%
Developed Europe	5.04%	16.68%
Asia	-2.90%	1.12%
Emerging Markets	-2.15%	-3.62%

US Markets

	4th QTR	2021 YTD
Dow 30	8.06%	20.75%
Large Cap Cos.	10.56%	15.90%
Mid. Cap Cos.	7.84%	24.50%
Small Cap Cos.	5.54%	26.69%
Bonds	-0.11%	-1.56%

COVID is the "crisis" that won't quit. Somewhat like in the 1993 movie Groundhog Day starring Bill Murray, every day repeats the same events over and over in a surreal continuous loop until Murray's character sees a way of turning the situation to his advantage. Maybe we are just living a movie.

Coronavirus cases worldwide reached 284.77 million. COVID deaths topped 5.43 million. Coronavirus cases in the U.S. have hit 54.6 million with deaths above 843,000. New COVID cases continue to spike, setting fresh highs worldwide and in the U.S., Omicron is far more infectious than previous COVID variants, but also far-less likely to cause illness, especially among the vaccinated. Is the situation turning to our advantage?

The year 2021 ended with pretty good results for U.S. equity investors. In the year of COVID, how did this happen? Gross Domestic Product (GDP) advanced at a 5.5% rate, unemployment fell to 4% and corporate earnings growth advanced at around 40%. A lot of that growth was fueled by huge increases in government spending and extremely expansionary monetary policy.

"Free" money was everywhere from PPP loans to extended unemployment benefits to rent and loan relief. The economy reopened and lockdowns ended, a least in some parts of the country. Consumers and businesses responded with a huge spending spree. This has not been a normal business cycle, but then little has been normal the last two years. What will 2022 bring?

Most forecasters conclude that economic growth should continue to be strong. Their predictions range from 4% to 5% GDP growth. This is above the long term historical growth trend. Corporate earnings are forecast to continue to grow at around 9%. This is well below the blowout 2021 performance but still above the long term earnings growth trend of 8%.

Both the U.S. economy and U.S. corporations have historically been quite good at long term growth. Stocks may be at the higher end of their historic valuation ranges, but their continued ability to grow earnings seems to justify the values, for now. So what could possibly go wrong other than the extremely unnatural and unprecedented times we live in suddenly returning to “normal”?

The rest of the global economy is not faring nearly as well as the U.S. economy. China in particular has been experiencing a series of financial crises that have dramatically slowed their growth rates and may push them into actual recession. They are the second largest economy in the world and a big source of demand for commodities as well as finished products. In a globalized economy, lead by a number of U.S. multi-national corporations, this is a distinct risk. Europe and emerging markets are also not faring well. Their reliance on exports, to China in particular, and their obsession with hard lockdown policies in response to COVID have undermined their economies. The U.S. still has the best performing and most fully integrated economy in the world.

International tensions are rising. Russia is threatening to invade Ukraine and is using access to energy sources as policy leverage with the European Union and NATO. China is continuing to exert pressure on Taiwan and other independent nations in the Far East. Policies regarding the Middle East are changing. Any of these and other points of conflict could develop into market upsetting events.

Inflation is becoming a major problem. COVID policies have resulted in major supply chain disruptions. Shortages in semi-conductors and other parts have upset auto manufacturing. Products are routinely missing from shelves in grocery stores. Gasoline prices have risen by over 30%. The Federal government has deficit spent nearly $6 trillion dollars in the last two years. Their attempts to borrow and spend more will only add more upward pressure on prices.

The COVID policy responses of Government stimulus and easy monetary policies appear to be coming to the end of their economic usefulness. Could the Fed spoil the party? Yes - eventually. But before that happens, monetary conditions would have to transition from “easy”, what we have now, all the way to “tight”, which is a considerable distance down the road. This is what is currently being discussed, but there is no consensus of official opinion regarding how and when this is to be done. Historically when the Fed takes these actions earnestly, the economy and markets respond accordingly.

The coming year could bring the winds of change. In the meantime, the economy is still growing, American corporations are still delivering profits, and anyone who wants a job can find a job. Whether that job will pay what if takes to continue the spending cycle is yet to be seen. Groundhog Day continues. The movie had a happy ending. Maybe we’ll have one too.