STIFEL

2022 1st Quarter Outlook

With a month behind us and well into earnings season, for the most part companies seem to be doing fine. So far 72% of the S&P 500 has reported, and earnings surpassed estimates by 7.7%.

Markets are very discerning though, and conventional wisdom holds that companies need to beat estimates on both top and bottom lines while guiding higher into future quarters. Misses are brutally dealt with and questioned by analysts who then typically lower their numbers and reduce price targets.

The big question in a higher interest rate world is who can still grow and at what rate. It should all get sorted out, but I believe higher multiple growth stocks will need to show their value.

Interest rates are expected to go higher because the Federal Reserve (Fed) needs to curb inflationary pressures created by pandemic stimulus as well as pandemic supply chain disruptions. Stimulus is going away and disruption should get resolved. In time, I believe this will get sorted out.

Commodity input costs are a contributor to inflation, but increased labor costs are a big contributor too. The labor pressures will continue to affect overall costs and likely take longer to settle down. Technology and innovation should help labor costs over time, as they always have, but near-term labor pressures will be an inflationary push. The Fed wants some inflation, just not too much too quickly.

So, where does this leave us? One of the three tenants I have always stuck with is, “don’t fight the Fed.” With the Fed now shifting gears and becoming less accommodative, it seems prudent to reduce risk this coming year. I’m not advocating being out of equities, but do feel it’s more important than ever to know what you own. Reasonably valued dividend-paying stocks make sense. Again, in higher multiple stocks, you will really need to know what you own and why you own it. Even when the rate increases are done this year, the Fed is still committed to reducing its balance sheet, which has ballooned to $9 trillion. This is the result of the Fed buying massive amounts of commercial and mortgage-backed loans to help the economy recover. Indications are that as these bonds mature, the Fed will simply let them roll off, shrinking the balance sheet. The bottom line is that we are losing a powerful accommodative partner, at least for now. I believe that the Fed would stand ready with going back to the same accommodative practices given the right situation.

Another of the three tenants is “the trend is your friend.” The market trend has been generally good, and it’s been generally good to be a participant. We will see if the trend flattens out through this correction, which could end up leaving a lot of sideways action this year. I guess you could say a new friend.

The final tenant is “beware of the crowd at extremes.” I don’t sense an extreme in either direction now but do worry that all the stimulus created, which found its way to stocks and real estate, could lead to trades getting unwound if choppy flat trading persists. I’m just not sure how patient some of these investors will be with sideways markets. That could lead to more choppy, flat trading at best or a new bottom. We will see how it all plays out.

Barry Bannister, Head of Institutional Equity Strategy at Stifel, has been calling for a test of 4200 points on the S&P this year. We got as low as 4224 on January 24 before this recent lift, but bottoms are usually not made with one test, so I would not be surprised to revisit that level soon. Barry also sees another big rally out there taking us to new highs in a few years coupled with, yes, massive Fed stimulus.

Another source I follow, JTL Market Technicals, includes Alan Shaw, who ran technical research for Smith Barney 40 years ago. They published a long-term study which calls for a major bottom this year. Again, we will see how it plays out, but I’m erring more on the cautious side these days.

To conclude my first quarter comments, I leave you with a quote from Alan Shaw.

“There are only two kinds of investment losses—loss of opportunity and loss of capital. There will always be opportunities, but a loss of capital is much more difficult to recoup.”

Thank you for your confidence in me and Stifel,

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The Standard & Poor’s 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.
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