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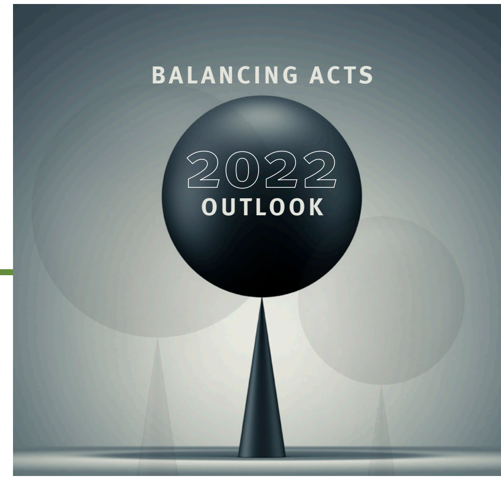
MARKET SIGHT LINES



Outlook 2022 Spotlight #1:
Our Views Looking Forward

By Michael O'Keeffe, *Chief Investment Officer*

This week my team and I published our Stifel Outlook 2022 report and video, and we look forward to discussing the report at a client webinar next week. We titled the report, "Balancing Acts," as we're seeing balancing acts all around: the Federal Reserve (Fed) is looking to tighten just enough to rein in inflation without threatening recovery; governments must balance any pandemic shutdowns with their economic and human costs; companies will balance pricing decisions given rising costs; and the U.S. and China will try to strike a balance between cooperation and competition. With these balancing acts, we see the forces that contributed to the robust recovery fading in 2022 so that overall, individuals, businesses, and the economy will increasingly have to stand on their own.

In this first Sight|Lines of 2022, we spotlight one topic from our report: our views looking forward.

Economic Growth

Our 2022 forecast for U.S. GDP growth is 3.5%-4.0%, still well above trend. We see this growth driven by a strong consumer, higher capital expenditures, and businesses rebuilding depleted inventories. At this point in the recovery, the consumer is in a good place, with household net worth reaching all-time highs and trillions of dollars sitting in savings. We expect some excess savings to be spent on deferred demand as consumer confidence improves further.

Interest Rates and Inflation

Inflation has been elevated, with a 4.4% estimated rise in the core PCE price index in 2021, for example. Many see supply chain and other frictions from the economic reopening driving costs higher, and some worry that fiscal and monetary policy has been too aggressive. Inflation may remain elevated in the first half of the year as we move past the winter surge in coronavirus cases and supply chain disruptions take time to resolve. We expect inflation to decrease gradually through the year and likely settle below 3% by the end of 2022. Given anticipated Fed rate hikes, we see interest rates modestly higher through the year, with the 10-year Treasury yield ending 2022 at 1.75%-2.0%.

Monetary Policy

Late in December, we discussed the Fed's monetary policy in The Fed's Balancing Act Begins. Monetary policy has been highly accommodative, given elevated asset purchases and a fed funds rate near 0%. But the Fed started tapering asset purchases, which will end soon. And it has signaled its intent to hike rates in 2022, with the majority of Fed officials seeing three hikes this year. We see the Fed doing just that, instituting three 0.25% hikes as a means to rein in recent higher inflation.

Fiscal Policy

Our Outlook 2022 report includes an article from Stifel's Chief Washington Policy Strategist, Brian Gardner, titled *Balance of Power: Washington Policy*, which we'll cover in a future Sight|Lines spotlight. Brian's discussion includes a review of fiscal policy. Of course, our federal government passed numerous fiscal relief packages over the last couple of years, with two significant bills passing in 2021: the American Rescue Plan and the Infrastructure Investment and Jobs Act, but Congress failed in passing President Biden's signature spending bill, Build Back Better (BBB). As we look into 2022, Brian sees the passing of BBB as possible, but not certain. So, if BBB passes, we expect to see an incremental boost to economic growth. But either way, we see the economic impact of fiscal stimulus fading in 2022 and more in 2023.

Equity Markets

This year, we see a continued, strong economy supportive of modestly positive equity market returns. We expect profit margins to remain healthy, but some companies and sectors may see pressure from supply chain issues and rising wages. A policy misstep, either fiscal or monetary, could lead to periods of uncertainty. Volatility will likely be higher than in 2021, a common outcome as midterm elections approach. We may even see a correction, or multiple mini-corrections, during the year. Nonetheless, we believe we are still in the first half of a new economic cycle and forecast the S&P 500 to end the year at 5,005, reflecting a total return of 7%.

Our Bull and Bear Scenarios

As has been our practice, we share our thinking on bull and bear scenarios that may unfold. While factors like asset valuations, geopolitics, and even climate change can drive volatility, we profile three key factors that we believe will most influence which scenario unfolds: the pandemic, inflation, and policy. The path of the coronavirus pandemic is key. A future troublesome variant can be cause for concern, but reaching herd immunity a huge positive. Calming inflation supports economic and market growth, but sustained higher inflation would be a significant headwind, and fiscal and monetary policy will continue to influence economic and market results.

Conclusion

We're positive looking forward but see economic growth slowing and equity market volatility increasing. The pandemic, inflation, and policy will remain in focus. We invite you to check out the Stifel Outlook 2022: Balancing Acts report and video, and invite you to join us at our client webinar next week.

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