Market Perspectives

1st Quarter 2022

2022 Market Outlook

The start of 2022 looks like a continuation of several points of note from the previous year. The economic recovery, supply chain shortage, D.C. agenda, and the energy transition are expected to make some waves this year.

The Economy and the Shaky Ground Ahead

As we inch toward economic recovery, we should still expect some roadblocks. Two major items are expected to impede progress: inflation and Federal Reserve policy. Economists are projecting this year to be even more volatile than 2021 due to these factors.

Higher inflation and its associated effects like will play a vital role in how the Fed handles its economic policy. This situation will present a challenge to the Fed because waiting too late to raise short-term interest rates can bring its own set of consequences. Inflation could become grounded, thus slowing economic growth.

With that, major components of the GDP like consumer spending and business fixed investing have risen annually by over 11%. Although the near-term inflation is expected to rise, the long-term expectations are still on par with the Fed's goal.

A Brighter Outlook on Supply Chains

Amid the economic roadblocks, the supply chain short fallings seem to show some signs of resolving. Major ports are seeing substantial progress in correcting logistical issues even though they are nowhere near efficiency prior to COVID. This progress has allowed companies to catch up on orders which should calm some inflation fears.

Even when the Fed's policies shift this year, the bottleneck situation should continue to ease.

Expectations from Washington in 2022

As is typical, the market is expected to react closely to the activity in DC. Agenda items are expected to center around the inflation issue, midterms, the regulatory agenda, and several policy proposals.

Historically, the midterm elections are closely watched as both parties aim to control Congress. This cycle, key Senate races to watch will be in: Arizona, Georgia, New Hampshire, Nevada, Florida, Ohio, Pennsylvania, and Wisconsin.

As for regulatory changes, that topic is still up in the air and will likely affect specific industries and companies.

The policy agenda for this year will include the U.S. competitive strategy on China, regulations for large technology companies, voting rights legislation, labor statistics, and U.S. cannabis policy.

The Building Energy Transition Trend

In the decade prior to 2021, the energy sector was a poor performer in the U.S. equity market. That trend has since reversed since 2021, with the sector up 60%, and that is likely to hold.

In terms of oil, increasing vaccination rates and OPEC returning to pre-pandemic production levels are responsible for part of this headwind. West Texas Intermediate (WTI) crude is forecasted to end 2022 at $80/bbl, with its yearly average hovering around $75/bbl.

The pandemic has pushed the energy transition further with no plans of slowing down. The combination of political/regulatory reasons like the U.N climate conference and technological reasons surrounding the utilization of low carbon energy sources (solar, wind, and electric vehicles) are just some of the biggest waves leading the charge.

Questions

If you have any questions about these topics, please let our team know.

Economic Snapshot

The economic recovery is expected to continue in 2022, balancing out any future bumps in the road. Some changes, such as working from home and a shift in spending from services to goods, are likely to be long lasting. Higher inflation and more aggressive Federal Reserve policy are key risks. Increased labor force participation could add some upside to the growth outlook, but that remains uncertain.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	GDP growth is expected to moderate (relative to the strong pace of 2021) but remain above a long-term sustainable pace in 2022.
	EMPLOYMENT	Nonfarm payrolls are still below where they were before the pandemic, but labor demand is strong. Better wages should lure many of those on the sidelines back into the workforce.
	CONSUMER SPENDING	Job and wage growth should be supportive, although wages are generally not expected to keep pace with inflation (implying some reduction in consumer purchasing power).
	BUSINESS INVESTMENT	Outside of commercial real estate, business fixed investment is expected to remain strong, supported by continued strength in earnings.
	MANUFACTURING	Supply chain difficulties, materials shortages, and labor issues have continued, restraining output growth in a number of industries, but we should see some improvement in 2022.
	HOUSING AND RESIDENTIAL CONSTRUCTION	Housing demand remains strong and mortgage rates are still relatively low. However, shortages of labor and materials have restrained supply and higher home prices have reduced affordability.
	THE DOLLAR	The dollar is likely to be stronger. Central bank policy is a key factor in the near-term currency outlook and the Fed should be more aggressive in tightening.
	REST OF THE WORLD	A mixed bag. The spread of the virus, containment efforts, and the distribution of vaccines has varied widely.
NEUTRAL	LONG-TERM INTEREST RATES	Bond yields normally rise in an economic recovery, but yields are even lower abroad, adding downward pressure. While inflation is higher in the near term, we should see it move back down in the next year or so.
	FISCAL POLICY	A reduction in fiscal stimulus (compared to the massive levels of 2020 and 2021) will subtract from GDP growth in 2022, but the impact should be more than offset by increased private-sector demand.
UNFAVORABLE	INFLATION	Higher and persistent. Price increases have broadened in recent months. We ought to see some rollback in prices of consumer durable goods in 2022, but inflation in services (including rents) is more worrisome.
	MONETARY POLICY	The Fed is expected to raise short-term interest rates by the middle of the year (perhaps sooner). The risk of a monetary policy error has increased.

Raymond James, "2022 Outlook" *Investment Strategy Quarterly,* Pg. 6-14, 25-59 Web.

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