Market Perspectives

4th Quarter 2021

Market Outlook

This year has been marked by some of the fastest economic growth in nearly 40 years. Raymond James Chief Investment Officer Lawrence Adams equates progress this year to a mountaintop when “the best views come after the hardest climbs.” Although things have improved, it is important as we close the year to watch how fiscal policy shifts the economy and Biden’s infrastructure deal takes shape.

The Economy and Fiscal Policy

The Fed aims to support the economy through 2 tools: fiscal policy and monetary policy. While both influence economic behavior, monetary policy focuses on short – term interest rates while fiscal policy concerns tax and spending policy. During a recession, spending is reduced (due to job and income loss) and that starts a cycle of further job loss and less spending. Fiscal stimulus is used in these situations to support demand until the conditions improve.

In 2020 and 2021, $5.2 trillion in fiscal stimulus was used to the combat effects of the pandemic. An important question that has arisen is: should investors be worried about climbing federal debt as a result? The good news is the government does not operate like a household so as long as the government can borrow then make payments on the existing debt, increasing interest should not be a problem.

While fiscal support has helped demand, the heightened supply chain issues caused by the Delta variant and labor shortages in the US have created a new roadblock to economic recovery. The nature of this pandemic has led to several manufacturing and port shutdowns across Asia, limiting the product supply to the US. We can see the light at the end of the tunnel of this historic global supply chain issue but it is still distant.

Biden’s Infrastructure Plan and The Fall Agenda

President Biden's infrastructure plan will face more significant tests as a bipartisan deal gets closer to being reached. The results of what happens with this plan will determine how the market reacts but the top concern in the short-term will be the debt limit. Experts feel the mostly likely scenario is a deal passed with an overall economic package near $1.85 trillion, using tax increases along with other revenue changes to counterbalance a large section of the funding.

Paired with the infrastructure package, critical fiscal deadlines are on the agenda this fall. Democrats initially attempted to pair the debt limit increase with a funding bill but that increased government shutdown concerns. Although concerns remain high, a pathway to using the reconciliation process is not out of the question. The outlook is on this situation still remains hopeful that a solution to the debt ceiling debate is reached, without breaching the fiscal cliff.

The political activity this fall with the infrastructure plan and other important fiscal deadlines will certainty play a role in the new year as the country gears up for the 2022 midterm elections.

Questions

If you have any questions about the economic outlook, or Biden’s infrastructure package, please let our team know.

Economic Snapshot

US economic growth was blistering in the first half of the year (stronger than the GDP figures would suggest, held back by a reduction in inventories and a wider trade deficit). The Delta surge has stalled the recovery in consumer services, but that's likely to be temporary. Growth in consumer spending and business investment was expected to moderate (though remain at a strong pace) even before the Delta surge, partly reflecting a reduction in fiscal stimulus. Inflation pressures remain persistent, but are still expected to be transitory. The Fed is on track to gradually reduce monetary accommodation.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	GDP growth moderated, following outstanding strength in the first half of the year, partly reflecting an impact from the Delta variant. Growth should remain relatively strong in 2022.
FAVORABLE	EMPLOYMENT	Nonfarm payrolls have continued to rebound, but still have a long way to go. While demand for labor is strong, labor force participation has been slow to rebound, reflecting fear of the virus, childcare issues, and early retirements.
FAVORABLE	CONSUMER SPENDING	Wage growth is supportive of consumer spending. Lower vehicle sales reflect supply constraints (semiconductor shortage), but retail sales are still trending about 12% higher than the pre-pandemic trend.
FAVORABLE	BUSINESS INVESTMENT	Capital goods orders and shipments exhibited an exceptionally strong trend in the first half of the year, fueled by robust growth in corporate profits. The pace is likely to moderate in the near term.
FAVORABLE	MANUFACTURING	Growth in new orders has remained strong, fueled by the pandemic shift toward goods. Supply chain difficulties and labor issues have continued, restraining output growth in a number of industries.
FAVORABLE	HOUSING AND RESIDENTIAL CONSTRUCTION	Housing demand remains strong and mortgage rates are low. However, shortages of labor and materials have restrained supply and higher home prices have reduced affordability.
FAVORABLE	THE DOLLAR	With the Fed now on a path of reduced monetary stimulus, the dollar is expected to appreciate against the other major currencies.
FAVORABLE	REST OF THE WORLD	A mixed bag. The spread of the virus and the distribution of vaccines has varied widely; however, vaccine mandates in many countries will help their economies recover more rapidly.
NEUTRAL	INFLATION	Production bottlenecks and materials shortages have been more intense and have lasted longer than expected. Problems are likely to continue into 2022. Inflation in services has risen, but more moderately.
NEUTRAL	MONETARY POLICY	The Fed is expected to begin tapering the monthly pace of asset purchases later this year, in a process likely to end around the middle of next year. The Fed isn't debating interest rate hikes, but those may come in early 2023.
NEUTRAL	LONG-TERM INTEREST RATES	Bond yields normally rise in an economic recovery. Fed asset purchases have helped keep long-term interest rates from rising much, but we may see an increase ahead of Fed tapering.
NEUTRAL	FISCAL POLICY	A reduction in fiscal stimulus (compared to the massive levels of 2020 and 2021) will subtract from GDP growth over the next few quarters, but should be more than offset by increased private-sector demand.

Raymond James, "Letter from the Chief Investment Officer" *Investment Strategy Quarterly*. Pg. 2, Web.

Raymond James, "Economic Outlook: Fiscal Policy Beyond the Pandemic" *Investment Strategy Quarterly*. Pg. 4-7, Web.

Raymond James, "Biden's Agenda: Defining Fall Policy Spring-Infrastructure, Fiscal Cliffs, and American's Global Role *Investment Strategy Quarterly* Pg. 12-14, Web

Raymond James, "Q&A: COVID-19 Update" *Investment Strategy Quarterly* Pg. 15, Web.

Raymond James. "Economic Snapshot" *Investment Strategy Quarterly*. Pg. 17, Web.

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