MARKET REVIEW & OUTLOOK

November 2021

Breaking News

- Volatility, which picked up at the end of November, has spilled into December. The reasons are broadly covered in the discussion below.

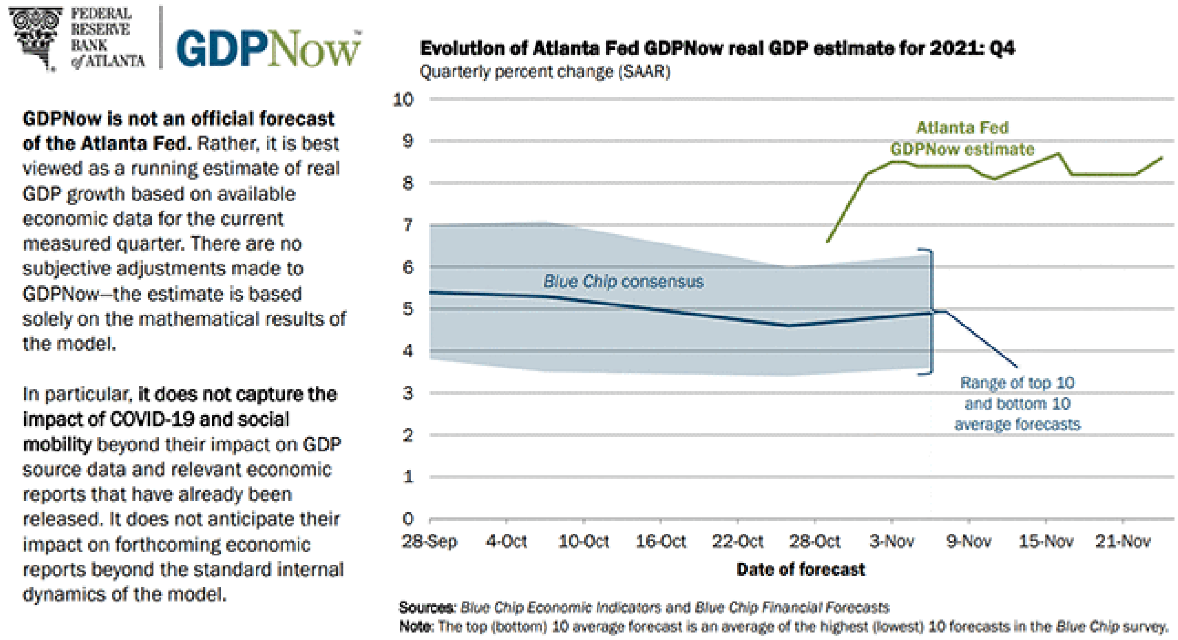
Back to our regularly scheduled programming…

KEY TAKEAWAYS

- Well, the month finished off with quite a bang. The October strength carried into November; the middle of November digested the recent large gains. The “quiet” period was anything but this year as the Omicron variant hit on Black Friday. It was more than shoppers that were busy that day. By Monday the market interpreted comments by Fed Head Powell as dovish for monetary policy, then Tuesday he removed the word “transitory” from inflation and the market sold off.
- Interest rates spent the month on a rollercoaster with a lot of ups and downs. The above referenced statement by Fed Head Powell, which included completing bond purchases quicker than previously stated, lead to a strong rally in yields, ending near the low yield of the month.
- D.C. has been awfully quiet the last couple of weeks, but that can’t last much longer with the budget and debt ceiling deadlines quickly approaching along with the Senate weighing in on the Congress passed Build Back Better bill.

The U.S. Economy

The second release for 3rd quarter GDP came in modestly higher at 2.1%, but that is old news. We are now deep into the 4th quarter, which doesn’t really feel any different than last quarter, but the consensus and GDPNow tracker are expecting a barn burner as shown in the chart on the next page. We would guess that many of these forecasters are holding their collective breath that the omicron variant passes quickly, or they will likely be quickly reducing their expectations.



Source: https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

The fixed income markets traded in a wide choppy range as both strong inflationary prints as well as speculation on what the Fed would say about tapering bond purchases. Again, the Fed telegraphed that the taper would be starting next month and stuck to that plan. Yields then bounced back and forth further weighing whether the Fed was making a policy error. The last 3 days of the month highlighted the uncertainty. The Friday announcement of the Omicron variant lead to a sharp drop in yields, by Monday Powell made comments that the variant risks are to the downside on both the economy and inflation. The broad markets started pricing in a return to dovishness by the Fed and saw yields rally, but then in testimony Tuesday to the Senate, Powell stated that the economy is strong, and inflation is no longer transitory and that accelerating the pace of tapering would be discussed in December. This "shocking" announcement lead long term yields to close near the lows of the month. The overall decline in longer term base Treasury rates provided a tailwind for high quality fixed income. The result for High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, was a nice gain of +0.30%. The U.S. 10-year Treasury bond yield ended the month near the low at 1.44%, down from October's close of 1.56%.

Stocks started the month with very strong gains across the board leading people to have very high hopes for the "Santa Claus"/year-end rally. The bloom started coming off the rose starting over the weekend leading into the week of November 8th. A confluence of events finally took their toll on the board markets, except for Apple, sorry the S&P 500, (Apple has become so large and continued rallying into month end holding up the S&P 500). The combination of Europe's rising corona virus case count, the stubbornness of continued high oil prices along with economic releases highlighting the escalating inflationary pressures was too much for the global indices, ex the S&P 500 which closed very near an all-time high before Black Friday. Apple closed at an all-time high to close the month up over 10%, by contrast the Russell 2000 small cap index had already declined by over 5% before Black Friday.

The Dow Jones Industrial Average slid -3.73%, the S&P 500 eased -0.83%, and the small cap Russell 2000 fell -4.28%. The international markets traded in a similar fashion as the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index dropped -4.67%, and the MSCI Emerging Markets iShares Core ETF Index fell -3.96%.

In November, we saw a wide dispersion in the winners and losers.

The best performers were…

- Technology: +5.33%
- Consumer Discretionary: +3.03%

The worst performers were…

- Energy: -5.01%
- Industrials: -3.56%
- Financials: -3.40%

Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

The strong rally from September through October finally ran into resistance. First it was discussions of talks with Iran resuming and builds in crude supplies. That dovetailed into the White House jawboning high gas prices and coordinated a global release of long-term strategic reserves, which interestingly lead to a relief rally on the day of the announcement. The nail in the coffin for oil in November was the announcement of the Omicron variant of the corona virus, which was the catalyst for one of the largest single day declines in crude oil.   The current NYMEX WTI Crude Oil futures settled at $66.18 and posted a drop of over 20% from the prior month close of $83.57 a barrel. The price for RBOB gasoline was also weak on the back of the resumption of lockdowns in Europe mid-month and accentuated with the Omicron variant, posting a loss of almost 17%. With the winter season in full swing and signs of widening lockdowns, the risk of higher gas prices seems unlikely until at least spring.

The Rest of the Data

The October ISM Manufacturing Index slid modestly 0.3 points to 60.8 from September's reading of 61.1. Additionally, the ISM Services Index surged to 66.7 from 61.9 in October, vaulting to a new all-time high. The prices paid component again increased from last month in both surveys, which suggests that inflationary pressures are continuing to strengthen. Any reading above 50 generally indicates improving conditions. Consumer confidence decreased to 109.5 in November, which compares to a downwardly revised figure of 111.6 in October. The unemployment rate dropped again, coming in at 4.6% and the economy added a very robust 531,000 jobs in October vs. consensus of 450,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.9% in October, accelerating the reversal of the late summer respite, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index increased to +6.2% on a non-seasonally adjusted basis, the highest since November 1990. The CPI ex Food and Energy, since nobody eats or drives, 😊 jumped to 5.3%, the highest since August 1991. Overall, these numbers show an economy on solid footing with clear levels of higher inflation that are gaining steam, which is probably what finally forced the Fed and Powell to admit that inflation does not appear to be only transitory. The improved economic forecast along with the continued inflationary pressure likely sees the end of Fed tapering bond purchases before June. If the outlook at that point looks similar, the Fed may set the stage for an interest rate hike the market was pricing in before the scare of the Omicron variant. The next couple of months merit close observation for continued inflation pressures and the path of the corona virus.

Summary

Well for months we have seemed like a broken record, but the Fed finally gave the record player a bump and we now hear a different tune. The economy continues to be moving along, though the exact level of positive is a bit nebulous. The big question of how many months/quarters defines transitory has finally ended with Fed Head Powell announcing Tuesday that transitory is no longer the proper definition of today's inflationary pressures. That pronouncement kicked off the likelihood of tapering the bond purchases faster and seems to open the door for interest rate hikes occurring sooner than the current 2023 guidance from the Fed. If that shock wasn't enough, another variant of the corona virus was announced on top of the fact that Europe was already reengaging lockdowns. So, the level of uncertainty, which seemed high already, turned it up another notch in the last few days of November. The ramification of these developments is not fully clear at this point. On one hand rising interest rates are expected to hamper economic growth, though widespread country lockdowns would have a dampening effect on growth as well. So, we will have to monitor the situation and see if lockdowns bring about more global fiscal and monetary stimulus or just slower growth, which then likely knocks a leg out from the inflation stool.

However, after digesting all of that, we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation vs. corona virus variants, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to march higher, we will capture some of those gains and reallocate to less volatile high-quality bonds. If the equity markets enter a period of negative performance, we have dynamic investment vehicles that utilize rules-based defense mechanisms to reduce the risk of the portfolio. Further, if the market gets too extended on the upside, some of the vehicles will capture partial gains and wait for the extension to correct.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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