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DOLL'S DELIBERATIONS

WEEKLY INVESTMENT COMMENTARY

2021 experienced amazing earnings growth which powered equities higher offset only slightly by rising inflation and interest rates. COVID variants entered the mix at a few points along the way creating some volatility and style rotations. Market headlines at times were dominated by short squeezes in meme stocks without lasting impact. Treasury yields ironically reached their high for the year in March (1.75% for 10-year Treasuries) and cyclicals stocks beat defensive stocks handily.

As things currently stand, we will achieve 6 out of 10 predictions accurately for 2021, a bit below our long-term average of 7-7.5 out of 10. Here is a brief rundown of the 2021 predictions:

1. U.S. REAL GDP INCREASES AT ITS FASTEST PACE IN TWENTY YEARS.

Not only is growth better than any time in the last twenty years, it is better than any year since 1984. Real GDP looks to be coming in at around 5% for calendar 2021, exceeding what we thought might be a hurdle of 4.1% in 2000. (Growth in 1984 was 7.2%.) The source of the upside has been the re-opening of the economy stimulated by unprecedented fiscal and monetary aid.

2. INFLATION APPROACHES 2% AS THE 10-YEAR U.S. TREASURY YIELD REACHES 1.5%.

This is the prediction that garnered the most attention in the early part of the year. 2% inflation and 10-year Treasury yields of 1.50% seemed far-fetched to many when inflation was calm at less than 1.5% and December 31, 2021 ten-year yield was 0.93%. Needless to say, even our bearish outlook was exceeded by the highest inflation rate in almost 40 years and a rise in the 10-year Treasury yields to above 1.75%.

3. THE U.S. DOLLAR SINKS TO A FIVE-YEAR LOW.

Not only has the dollar not hit a five-year low, instead it rallied on the strength of the U.S. economy and the rise in interest rates attracting capital to the U.S. Perhaps more accurately, the dollar didn't strengthen, but other important currencies weakened (of course producing the same outcome.)

4. STOCKS REACH A NEW HIGH FOR THE TWELFTH CONSECUTIVE YEAR, BUT FAIL TO KEEP PACE WITH STRONG EARNINGS GROWTH.

Stocks hit many new highs during the course of 2021, mainly propelled by earnings growth exceeding expectations by amounts never seen before. As of this writing, the S&P 500 is up approximately 25%, while earnings for the calendar year are projected to increase by 40%. Earnings growth has surprised due to strong revenue growth and increasing profit margins.

5. STOCKS OUTPERFORM CASH, BUT CASH OUTPERFORMS BONDS FOR THE FIRST TIME SINCE 2013.

Not since 2013 has this order of finish occurred. As interest rates crept irregularly higher, almost all bonds have lost money this year, thereby underperforming cash. The rise in interest rates has had a negative impact on stocks, but earnings growth as noted above has more than compensated.

6. VALUE, SMALL AND NON-U.S. STOCKS (ESPECIALLY EM) OUTPERFORM GROWTH, BIG AND U.S. STOCKS.

We struck out on this prediction (stay tuned for 2022 predictions!) Growth stocks triumphed over value stocks again, as earnings growth for secular growers was superb, and the back half of the year COVID variant worries caused investors to favor growth over value. Big stocks outperform small stocks (again!) as investors pushed up valuation for big (especially mega cap) stocks virtually all year long. Similarly, U.S. earnings growth dwarfed earnings growth elsewhere enabling U.S. stocks to win vs. international once again.

7. HEALTHCARE AND FINANCIALS OUTPERFORM ENERGY AND UTILITIES.

Energy and financial stocks recorded the best sector performances in 2021, but unfortunately in that order. And while healthcare beat utilities, the magnitude of beat wasn't strong enough to overcome the energy over financials headwind. Importantly, cyclical sectors (energy and financials) beat the defensive sectors (healthcare and utilities).

8. U.S. FEDERAL DEBT RISES TO MORE THAN 100% OF GDP ON ITS WAY TO AN ALL-TIME HIGH

Admittedly, this was not the most difficult prediction to make. Federal debt soared even more than we expected as trillions of dollars were passed on to consumers and businesses both from Trump and Biden passed legislation. Eventually (who knows when?) this extreme borrowing will haunt the U.S. (perhaps via a declining dollar). This issue will be exacerbated if/when interest rates rise notably.

9. THE U.S./CHINA COLD WAR CONTINUES, BUT THE CONVERSATION BECOMES QUIETER AND MORE MULTILATERAL.

It seems as though the U.S. and China have virtually no common interests. This was evidenced by the Biden-Xi summit that occurred in November. Sadly, the two countries seem on a collision course over the next several years. However, in the meantime, the dialogue has become a bit quieter and more multilateral.

10. DESPITE POLARIZATION, PRESIDENT BIDEN, SENATOR MCCONNELL AND MODERATE FORCES ACHIEVE SOME COMPROMISE LEGISLATION.

This prediction was doomed in January when the two Georgia Senate runoff elections went to the Democrats (we anticipated a Republican would win at least one of the seats) creating a 50-50 tie, with Vice President Harris the deciding vote for the Democrats. At that point, partisan rhetoric and bickering increased as President Biden didn't "need" Senator McConnell or other Republicans to negotiate a compromise. Of course, a significant bi-partisan infrastructure bill was passed late in the year.

2022 is looking to be more challenging for investors, as the Fed and other central banks progressively unwind accommodative policy in response to the ongoing economic recovery/expansion and elevated inflation readings. While economic and earnings growth are likely to be good, a "too-high" inflation backdrop and rising real interest rates suggest less positive and more volatile conditions for investors than have prevailed since the pandemic lows.

The next issue of Doll's Deliberations will be released on December 31, 2021 at 4PM ET outlining our best efforts for 2022 predictions. In the meantime, we at Crossmark wish all of you a very happy holiday season and best wishes for 2022.

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