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One of the most remarkable attributes of 2021 was not just that global equity markets appreciated 18.5% despite rapidly rising inflation, but that fixed income markets resisted from responding as adversely as history may have indicated. Both equities and fixed income securities have traditionally struggled when the threat of inflation is present. Perhaps the reason investors' behavior broke with tradition is because the 6.8% inflation rate for the twelve months ending last November is expected to fall back to 3.0% to 3.5% in the year ahead, according to many economists. Another unforeseen change is the accelerating decline in the global population growth rate after the pandemic lockdown. If this trend persists, longer term labor force, productivity growth and inflationary trends will change course.

Other trends that are also important to investors will likely develop in 2022. The Federal Reserve has been suppressing interest rates for a prolonged period but is preparing to reverse its position. Fed Chairman Jerome Powell just announced that the U.S. economy is both healthy enough for and in need of tighter monetary policy. Consequently, investors are expecting four 0.25% fed funds rate hikes this year. The fed funds rate is the interest rate that member banks borrow from each other overnight. Bond prices always move before any fed funds rate announcement. In the past, yields have risen 3-4 months before the first rate hike, then stabilized 1-2 months afterwards. Consistent with history, government, corporate, and mortgage bond yields have already begun moving even though the Fed isn't expected to announce the first rate hike until March 16. Likewise, other countries' central banks are also expected to adjust rates higher. Complicating the 2022 outlook is the Fed's planned tapering of monthly fixed income securities purchases and reduction in debt, which could indirectly raise interest rates as well.

Less certain is how rising interest rates will impact the U.S. and foreign economies. Investors especially worry that our government's policymakers will become (or already are) complacent, responding too little and/or too late in managing our economy. If this is the case, barring other circumstances, low interest rates are anticipated to surge. The concern is justified because investors have seen repeatedly that stocks and bonds perform well in disinflationary environments but struggle in both periods of stagflation and high inflation. The U.S. is now a maturing economy, incurring changing economic growth, inflationary and interest rate trends. Furthermore, global supply chain and many other COVID pandemic related issues remain unresolved. And not to be overlooked is the uncertainty surrounding mid-term elections. So accurately forecasting the future is expected to be even harder than before. As a result, the margin of error in attempting to foretell upcoming events can also prove more costly. It will be worth watching if this year's projected global economic growth moderates to the expected 4.3% after 5.6% in 2021, both above historical norms. Also warranting close monitoring are upcoming corporate profit announcements versus forecasts of 7% growth. Comparisons to last year's record earnings will likely influence interest rate decisions and in turn impact capital markets in 2022.

Market participants are not assuming 2022 will resemble anything close to the last year that sent stocks soaring. Nor are they anticipating the same narrow stock leadership. This year, money is rapidly moving into Energy, Financials, and Health Care at relative bargain prices, and out of Technology companies at much higher valuation levels where they often struggle to advance. Circumstances surrounding today's uncertainties are expected to make for a more volatile year, with bigger and more frequent market corrections. Yet Wall Street is expecting another positive year for equities, in the range of 7%-10%. Regardless of shorter-term performance, the outlook for investors is promising when adhering to a procedurally prudent process. Stocks have risen 74% of the time over all 5-year rolling periods and 97% of the time over all 10-year periods since 1925. Post World War II, the probabilities are even more impressive.

The team at ICC wishes you and your family continued good health, happiness, and prosperity. We look forward to the new year with a continued focus on accomplishing all that is important to our valued clients.

Sincerely,

Randy

Randy Garcia
Chief Executive Officer