# The Long Run

**INVESTMENT LETTER**
**JANUARY 2022**

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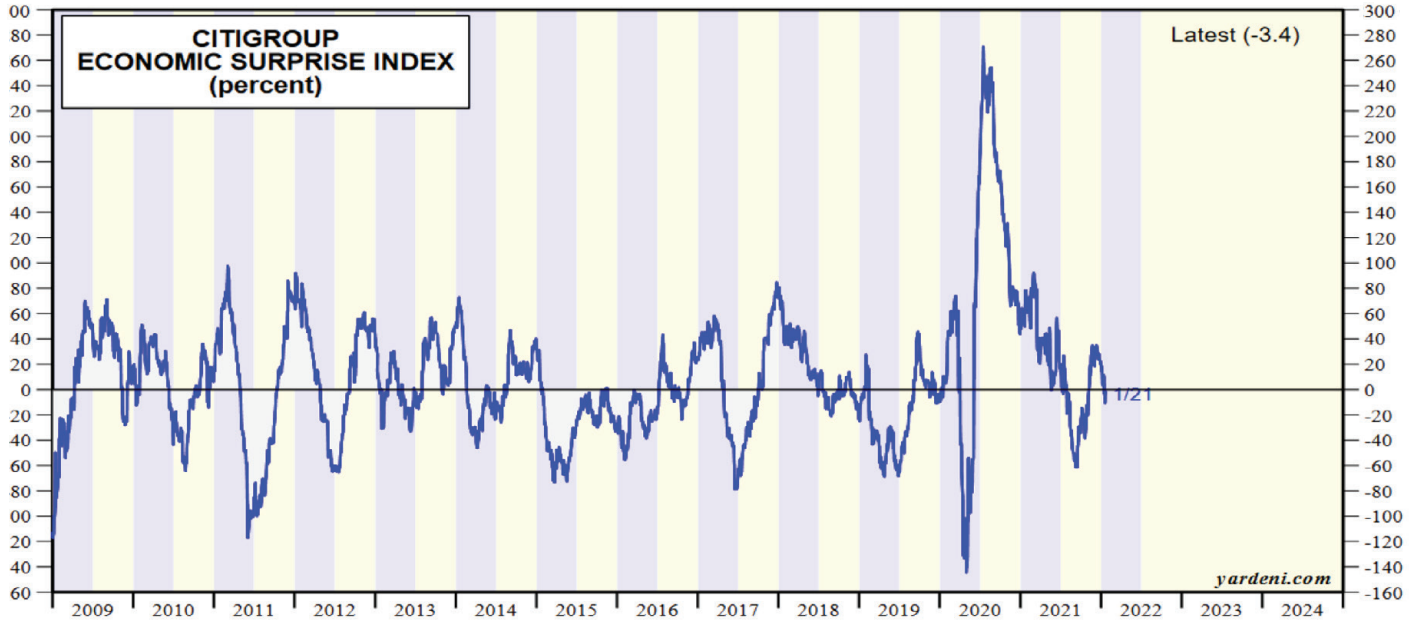
*"We like lists because we don't want to die."*
*—Umberto Eco*

Despite most expectations, stocks continued their death-defying run last year and the S&P 500 finished the year with its second best three-year winning streak in history, bested only by the late 1990s tech bubble. In the face of the highest inflation in 40 years, an acceptance of the Federal Reserve raising interest rates, and another year of coronavirus restrictions, the S&P 500 soared 28.7%. The stocks of lower quality *value* companies, particularly oil firms and banks, led this surge. Given that we avoid companies with poor long-term outlooks, your account underperformed this past year — although results over the past several years have been strong.

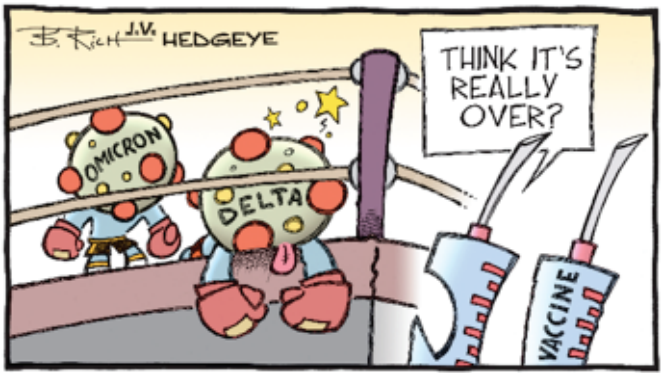
What is likely to occur in 2022? It is certainly not lost on us that the last time the markets had such a strong three-year return during the 1990s technology bubble, it went on to plummet 54% from 2001 to 2003. Is it time for this bull market to die? Stocks have dropped 10% in the first month of the year, and investors are justifiably growing nervous. The Citigroup Economic Surprise Index (see below) has recently turned negative, indicating that most economic reports are starting to disappoint. Investors are fearing a reprise of 2018 when the economy started to weaken and the Federal Reserve began to raise interest rates, sending stocks into a downward spiral.




Note: Blue shaded areas are first half of each year.
Source: Citigroup.

While the probability of a poor year for stocks is higher than it has been for many years, we still find our list of reasons for the bull market in equities to *not die yet* to be adequate. We continue to transition away from some higher-priced technology stocks to better values elsewhere. We also see the potential for positive surprises in the following areas:

1) The Omicron COVID-19 variant is following past patterns of intense outbreaks and then quick declines. According to a study just published in *The Lancet*, as of January 17, Omicron waves were peaking in 25 countries, and in 19 states in the U.S. The study also indicates that, by March 30, 50% of the world will have been infected with Omicron.[1] Given the milder effects of this virus — and the encouraging news from two studies that it seems to provide immunity against the more deadly forms — experts are now saying we may be moving from a pandemic to a virus that is endemic. What this means for the economy is that the likelihood of shutdowns and quarantines is diminishing, and life should continue to move closer to *normal*. As *The Lancet* article concludes, "after the Omicron wave, COVID-19 will return but the pandemic will not."



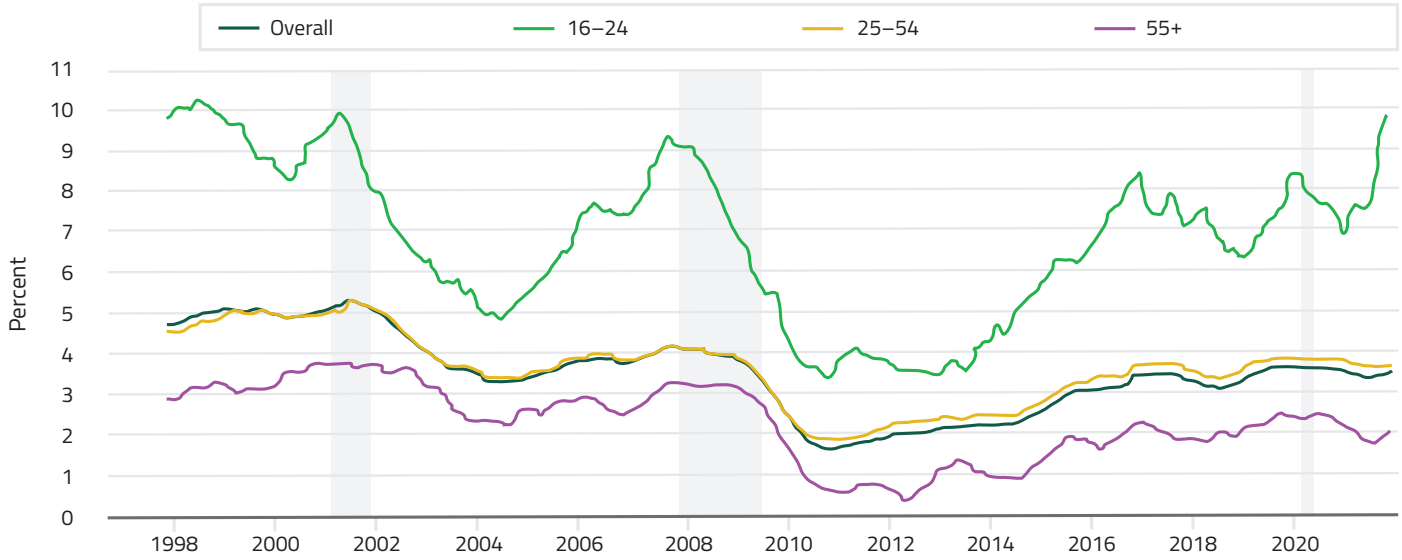

2) Perhaps the biggest question facing the markets and the economy this year is whether or not inflation is peaking. In an unusual twist, even Democrats are becoming inflation hawks and encouraging the Federal Reserve to raise interest rates. We continue to believe that much of the past year's spike in inflation was due to supply chain disruptions and that these are in the process of being resolved. The fourth quarter GDP report indicated a huge inventory buildup at retailers. We assume this reflects shipments that didn't arrive in time for the holidays — and will lead to heavy price discounting this year. Meanwhile, the Federal Reserve has not yet satisfied its goals for *inclusionary* full employment, in which unemployment rates for all racial groups reach their pre-pandemic levels. We believe there is room for inflation to be less severe than anticipated, and we expect the Federal Reserve to raise rates at a slower pace in the coming months than is currently forecasted.

3) Fear is currently gripping the financial markets, which we view as a healthy feature. According to a Rasmussen poll,[2] we entered the year with 48% of Americans calling the boom year of 2021 "poor," rating it the worst in the history of the polling — other than 2020. The most speculative portions of the market — SPACs, IPOs, meme stocks, and profitless story stocks — are down 60%–85% from their highs. Even everyone's favorite speculation, Bitcoin, has dropped more than 40% from its November 2021 high. Removing these speculative excesses is generally healthy and creates better opportunity for purchasing well-run, earnings-driven companies. We have not seen a 10% correction in the market, which normally happens every year or so, since the beginning of the pandemic. As daily opinion and speculation give way to the real news that earnings reports will be providing over the next several quarters, we believe there will be many opportunities for good research and careful stock picking to find success in a less COVID-constrained world.

4) While most discussion on wage increases continues to be negative, we continue to believe this is a positive, under-appreciated trend. Over the past several years, wages for workers at the bottom of the income scale have been rising faster than for management. This is a healthy trend for economic growth. While economists will point to something called the Phillips Curve that says that low unemployment will lead to higher wages, which will result in slower economic growth, we see little evidence of this in history. Higher pay, particularly for those lower on the income scale, should lead to more sustainable growth.[3] Janet Yellen, current Secretary of the Treasury, has even authored a study on this belief.[4]

**Wage Growth Tracker by Age**

12-month moving averages of median wage growth, hourly data




Sources: Current Population Survey, Bureau of Labor Statistics and author's calculations.

As Umberto Eco said, "Wherever you look in cultural history, you will find lists." While our list of positives is clearly shorter than it has been at any point in the last several years, we do not believe the current bull market for financial assets is dead. Rising interest rates, inflation, and valuations are all changes from a year ago — and all leave us with a more balanced outlook list. As a result, we will continue to seek a more conservative equilibrium in your portfolio, moving from higher-priced growth stocks to larger concentrations in more reasonably valued assets serving real needs in society. RM

[1] Christopher J.L. Murray, https://www.thelancet.com/journals/lancet/article/PIIS0140-6736(22)00100-3/fulltext

[2] The Rasmussen poll results were taken from the January 4, 2022 report written by Don Luskin at TrendMacro. https://trendmacro.com/system/files/reports/20220104trendmacroluskin-4s.pdf

[3] Justin Wolfers and Jan Zilinsky, https://www.piie.com/blogs/realtime-economic-issues-watch/higher-wages-low-income-workers-lead-higher-productivity

[4] George A. Akerlof and Janet L. Yellen. https://www.jstor.org/stable/2937787



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