Five Minutes with Commerce Trust's Chief Economist – Scott Colbert
1/13/22

Scott Colbert:

Good afternoon. We thought we'd take five minutes today to talk about our Outlook for 2022, which is out in the print view version. And mostly we'd like to talk about where our biases are and where our strongest convictions are as we enter the beginning of the year.

Number one, we're convinced that this economy is still on a roll and economic growth is likely to exceed 4% as the year progresses. The key drivers of that, of course, are ultra-low interest rates, which are worth about an 18-month impact, the ongoing fiscal stimulus and budget deficit spending that we still have, the built-up excess savings that the consumers have, almost two and a half and, by some measures, $2.7 trillion, which will begin to, if you will, trickle back into the economy. Two and a half trillion dollars, by the way, is basically 10% of GDP. So, you can see that's quite a tailwind. The wealth effect that we have from rising stock market prices and home prices, and most importantly, the key driver to the economy is always jobs, jobs, jobs. And jobs are going to grow probably by as much as two to two and a half percent this year.

Wages and salaries will continue to grow probably at about the 5% pace that they did last year. And if you think about it, two and a half percent more jobs, 5% more salary, that's seven and a half percent more GDP offset by whatever inflation we have. This is where we come up with real GDP growth of about 4%. So we're very convinced that the economic expansion continues.

Number two, the bad news of course is because our ongoing strong economy, the Federal Reserve is now going to have to take some of this massive accommodation that they've provided during the pandemic away. We've been telling you for quite some time that the market was probably under discounting how soon and how forceful the Federal Reserve would have to be, largely because inflationary pressures have been stronger than the Federal Open Market Committee expected. As it sits here today, the market is expecting three to four rate hikes. We'll lean on the four rate hikes beginning in March, probably in March, June, September, and December rate hiking, a process that will drive short term interest rates up 1%. We also think this will impact longer term interest rates, largely because they will begin to address their quantitative easing (QE). While they've tapered and (are) not adding to their QE purchases this year, they will likely begin to let this balance sheet, if you will, run off, which adds more debt into the markets. More debt, same number of buyers, should mean that longer term interest rates rise as well. They're already up about 25 basis points this year.

And that leads us to our third conviction, which is that we should still remain short bonds. We are underweight, fixed income securities, largely because the interest rates are so low, but we're also short in maturity to provide some defense to a rising interest rate environment when bonds tend not to do well. The average bond fund was down a little bit last year.

Number four, we are underweight international assets. We're about as underweight international assets as we ever have been. We're only at about 50% of our typical market weight of international assets. The big reason for this is we expect the U.S. economy to continue to increase at a faster pace than the average international economy. Secondly, because the Federal Reserve will be raising interest rates and our rates are already higher than most other places, this brings money towards the U.S. dollar, making the dollar stay firm. And of course it's very difficult for international assets to do well when the dollar is doing well on a relative basis. The third thing would be is that while the international markets have remained cheap and basically underperformed the U.S. market, the big damage has come in the emerging markets with China.

And China appears to continue on this, what we'll call financial crackdown, internally focused with the "shared prosperity" thought that they have. And it's very difficult for the emerging markets and even the international markets to perform when China continues to languish. Chinese stocks, on average, the free market flow was down about 27% this year and they might not be negative this year, but it's going to be tough for them to catch up.

Number five, we have a bias towards midcap stocks. We all know that the S&P 500 has kind of beat the rest of the market and it's being driven by those mega cap stocks, particularly those NASDAQ type stocks that you all know of. The midcap stock market though has been doing yeoman's work, it's up nearly as much as the S&P 500 and we think that there'll be better values there on a going forward basis.

And then finally, we do expect the equity market to improve on a year-over-year basis. That is probably our toughest call because of course we've had three consecutive years of double-digit growth. Stocks are up nearly 100%, but stock markets pretty much typically take the initial start of a Federal Reserve rate hiking process pretty well. In general historically, stock prices do move up. Second, we've had precedent where you've had as many as five years of consecutive double-digit returns. And the most promising part is that we think earnings are likely to grow this year eight to 10%, which is still a little bit better than consensus.

So we're still long stocks. We're still fully invested in a portfolio and have yet to underweight that market. We'll be back in a couple of weeks to talk about shorter term outlooks and any changes to our long term outlook.

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January 13, 2022
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