A View from the Bevy – 4Q21

Market Overview

At this time last year, the widespread introduction of vaccines to combat Covid-19 provided optimism that life would return to the pre-pandemic norm. Unfortunately, 2021 instead delivered new strains of the virus, and the U.S. and the rest of the world are still struggling to reach herd immunity. On the virus front, we find ourselves facing a similar level of uncertainty as we did a year ago.

An equally familiar experience played out in the performance of stocks. However, while there is a similar feeling of déjà vu that 2021 was like 2020, here it is a positive feeling. The markets were able to shrug off Covid-19 uncertainty and move higher in an impressive fashion. Volatility did increase in December when investors were digesting Omicron news and comments from the Federal Reserve, but the markets were able to overcome the uncertainty and rally into Christmas and New Year's (before retreating slightly on the last two trading days of the year). As shown in the table below, the U.S. once again led the world.

Stock Market Indices	4th Quarter	2021
S&P 500	11.03%	28.71%
S&P 500 (Equal-Weight)	9.01%	29.63%
Dow Jones Industrial Average (DJIA)	7.87%	20.95%
NASDAQ Composite	8.28%	21.39%
Russell 2000	2.14%	14.82%
MSCI World	7.77%	21.82%
MSCI World ex U.S.	3.14%	12.62%
MSCI Emerging Markets	-1.31%	-2.54%

Source: AJO. Data supplied by FactSet Research Systems.

The S&P 500 Index closed at a record level 70 times during the year, and this broad index of stocks outperformed the NASDAQ Composite for only the second time in the past eleven years. The reason? Technology stocks, while still performing well for the year, underperformed the broader market, proving to be a drag on the overall performance of the NASDAQ. Many of the stay-at-home stocks that had fueled the 2020 surge in the technology sector lagged as the economy reopened. On the other hand, entertainment and travel stocks were key beneficiaries throughout 2021, and volatile trading in December notwithstanding, had impressive runs for the year.

The market has also been buoyed by the return of stock buy backs, which have steadily increased since being slashed early in the pandemic. The top five companies accounted for almost 30% of the total, led by four technology stocks (Apple, Meta Platforms, Alphabet and Oracle); the fifth was Bank of America. Technology stocks generally have the largest cash flows, which enables them to buy back large amounts of stock.

Outlook

Despite the current uncertainty over the Omicron strain, we are optimistic about the growth prospects for the U.S. economy and, in turn, the stock market in 2022. While Omicron cases are spiking throughout the world, it appears that the strain is less dangerous and causing fewer hospitalizations and deaths than Delta, especially among the fully vaccinated.

While inflation is likely to persist through at least the first half of the year, corporate balance sheets have remained strong, and the profit outlook remains positive as companies have been able to pass along cost increases to consumers thus far. We expect that the global supply chain issues will start to ease by mid-year as manufacturers work through the backlog of orders, hopefully without additional shutdowns as the world transitions to treating Covid-19 as endemic.

Uncertainties do remain, however, and we expect volatility to remain high. The outlook for the labor markets remains uncertain, and Omicron, given the high level of transmission, is likely to cause disruptions in the near-term. For example, the airline industry has been hit particularly hard the past few weeks, as the virus has hit flight crews and caused thousands of cancelled flights during the busy holiday season.

The biggest source of uncertainty, however, is likely to be U.S. Federal Reserve (Fed). Persistently high inflation data has forced the Fed to reassess their timeline for increasing short-term interest rates, and they have signaled multiple rate hikes for 2022. The market tends to be on edge during periods when the Fed is increasing interest rates, so we are expecting elevated levels of volatility this year. Stocks can still perform well in this kind of environment, and we expect that to be the case in 2022, but selloffs could be exacerbated as investors overreact to new information.

Keep in mind that the market is always spooked by uncertainty, and there are always unexpected twists and turns that must be dealt with. Our message as always is to stay the course with your investment strategy, as difficult as volatility and down days may be. Remember that it is time in the market that matters, not timing the market. Those who panicked and sold when Covid-19 first hit are likely still on the sidelines and have missed out on the 2020 and 2021 rebounds.

Diversification and having a portfolio individualized to your goals and risk tolerance levels is another key. Please let us know if you experience any life events that impact your overall financial position so that we may help you make any necessary adjustments to keep your investment portfolio on track. As always, we are here to answer any questions.

We wish all of you and your families a happy, healthy, and prosperous new year.

Of Interest: Is Bigger Always Better?

As some companies grow to become among the largest on the stock market, the performance that got them there can be quite impressive. FAANG stocks (Facebook, Apple, Amazon, Netflix, and Google) as well as Microsoft and Tesla are a few recent examples of such companies. But just because the largest companies gain attention in the headlines, it does not mean that they can maintain superior performance over the long-term.

It is important to remember that there are two components to investment returns: the expected return and the unexpected return. Expectations about future performance are already incorporated into market prices today. While positive news may add additional price appreciation, unexpected changes can be unpredictable and add uncertainty.

Historically, it has not been unusual for the market to be concentrated in a handful of stocks, many considered “high-tech.” While the definition of “high-tech” is constantly evolving, firms dominating the market have often been on the cutting edge of technology. AT&T, General Motors, and General Electric, for example, have historically each ranked in the top 10 largest stocks in the U.S. for multiple decades.

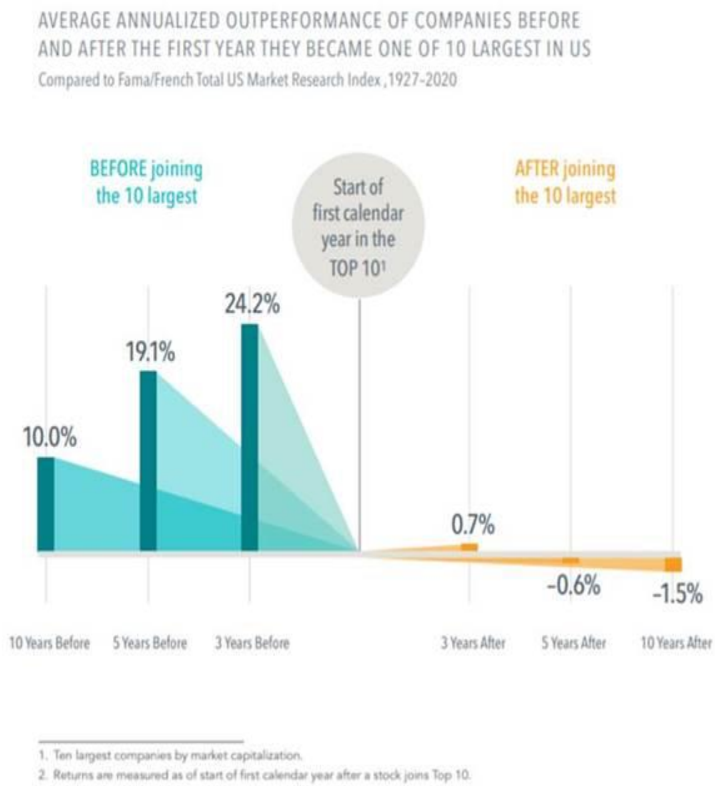
AT&T offered the first mobile telephone service in 1946. General Motors pioneered innovations such as the electric car starter, airbags, and the automatic transmission. General Electric built upon the original Edison light bulb, contributing to breakthroughs in lighting technology, such as the fluorescent bulb, halogen bulb, and the LED.

Historically, firms that have joined the impressive list of Top 10 largest stocks enjoyed a strong run up on their way but have on average lagged the market in subsequent years. As shown in Exhibit 1, The average annualized return for these stocks over the three years prior to joining the Top 10 was nearly 25% higher than the market, but in the three years after, the edge was less than 1%.

And five years after joining the Top 10, these stocks were, on average, underperforming the market. Extend the time frame out to 10 years and the gap was even wider – a stark turnaround from their earlier advantage.

To a degree, anxiety about missing out on an opportunity is inevitable. But investing this way can lead to a dangerous cycle of emotions and trading. Fear of missing out can lead to buying securities to chase recent performance, which can lead to panic selling if that performance doesn’t continue.

Exhibit 1



Source – Dimensional Fund Advisors

Fortunately, there are ways to curtail the nervousness around missed opportunities. Global diversification can help, as being diversified can help you capture the performance of FAANG stocks as well as the next generation of FAANG stocks, whomever and wherever they may be.