

INVESTMENT COMMENTARY & OUTLOOK

January 2022

As 2022 has commenced, a rotational correction out of many powerful growth stocks into beaten up value stocks has been the New Year surprise. This is referred to as a “mean reversion rally” and will not be sustainable. In fact, most value rallies fizzle within four to six weeks. This time around, the initial weakness in NASDAQ this year caused CNBC’s Jim Cramer to tell investors to sell growth and buy value stocks. So far this year, energy and financial stocks have been the leaders. However, the biggest problem we have with Jim Cramer’s value declaration is that it will soon be “every stock for itself” when the fourth-quarter announcement season commences.

Fortunately, the fourth-quarter announcement season has arrived and we have already seen relative strength in our dividend growth stocks and well as many of our growth stocks. So we remain confident that, in the wake of wave after wave of better than expected quarterly sales and earnings announcements, our fundamentally superior stocks will resurge and benefit from persistent institutional buying pressure.

Semiconductor stocks are expected to announce the strongest quarterly results. We should add that at the Consumer Electronics Show (CES), most of the latest and greatest consumer products, like televisions, virtual reality, video games, 5G and electric vehicles, all now require more high-powered semiconductor chips. We remain excited for many of our favorite semiconductor stocks and look forward to the upcoming earnings announcements.

America’s appetite for electronic items likely caused the trade deficit to soar in November. Specifically, the Commerce Department reported that the trade deficit rose to \$80.2 billion in November to near an all-time high. Imports surged 4.6% to \$304.4 billion in November, while exports rose only 0.2% to \$224.2 billion. The good news is that robust consumer demand is still positive for GDP growth.

The Atlanta Fed revised their fourth-quarter GDP estimate to an annual pace of 7.4%, which is just down slightly from its previous estimate of 7.6%. Naturally, this strong fourth-quarter GDP growth is setting us up for a truly outstanding fourth-quarter announcement season.

The bad news is the financial media cannot see the forest for the trees and continue to spook investors. The latest scare occurred when the December Federal Open Market Committee (FOMC) minutes were released. Specifically, these FOMC minutes revealed some anxiety with statements like lifting short-term interest rates “sooner or at a faster pace than participants had earlier anticipated.” However, other FOMC officials thought that the Fed should reduce its tapering (e.g., quantitative easing) before raising key short-term interest rates. So translated from FedSpeak, the Fed is still not expected to begin raising key short-term interest

rates, namely the Federal Funds rate, until March or later. So, in the end, the financial markets are grossly over-reacting to a 0.25% short-term interest rate hike that was fully anticipated.

We believe the Fed has fulfilled its Congressional unemployment mandate in the wake of the December unemployment rate, declining to 3.9% in December, down from 4.2% in November, as the labor force continues to shrink. Interestingly, the Labor Department announced that 3% of all workers quit their jobs in November, up from a 2.8% quit rate in October. This higher-than-normal quit rate is predominately associated with lower priced jobs and is likely indicative of a tight labor force looking for higher wages elsewhere. Despite a shortage of workers, average hourly earnings rose 4.7% in the past year and are not growing as fast as inflation.

Overall, as the fourth-quarter announcement season heats up, we are expecting a very strong January, characterized by higher trading volume as well as stunning sales and earnings announcements. Interestingly, thanks to political gridlock, the private sector is expected to dominate GDP growth in 2022. Inflation is expected to persist, but may moderate somewhat in the second half of 2022. Ironically, the current inflationary environment is helping to boost our growth stocks, which remain a great inflation hedge.

In our opinion, the Fed will remain accommodative in 2022 and Goldilocks will continue. The U.S. dollar is strong, because compared to Europe and Japan, the U.S. has stronger GDP growth as well as higher absolute interest rates. Although the Fed is in the early innings of Modern Monetary Theory (MMT), which is the seemingly unlimited money printing that both Japan and continental Europe have pioneered, we still have positive interest rates in the U.S. which is attracting foreign capital and helping to strengthen the U.S. dollar. This international buying pressure represented 69% of the bids at the most recent 10-year Treasury auction, which is why the Fed can steadily reduce their quantitative easing in the upcoming months.

There is one more important detail to mention, amidst all the reports that billionaires, like Elon Musk and Microsoft's CEO, are selling a record amount of stock, what is not being reported is that stock buybacks hit a record high in the third quarter and were also likely strong in the fourth quarter. Wall Street does not care if it sells stocks or bonds. Right now, due to dismal post IPO performance in 2021, it appears that new stock offerings will suffer, but corporate bond offerings will likely remain robust, so stock buybacks are expected to remain strong.

SUMMARY

As any stock market climbs higher, the leadership typically becomes more narrow. So the institutional buying pressure is anticipated to chase fewer stocks as year-over-year comparisons become more difficult. Our fundamentally superior dividend growth and growth stocks are poised to continue to breakout as market leaders.

January is a seasonally strong month, which is typically propelled by higher trading volume and fueled by new pension contributions. This seasonal strength, plus positive sales and earnings in the wake of very strong fourth quarter GDP growth, should act as a "one-two punch" to propel our fundamentally superior dividend growth and growth stocks significantly higher.

What was most impressive about the NASDAQ rebound since December 20th is how our growth stocks rebounded on light trading volume, which brings up the question, How will they perform on higher trading volume? We expect nothing less than a spectacular “melt up” on higher trading volume in January.

This year is expected to be characterized by a passive Fed that will keep Treasury bond yields well below inflation. Although the Fed is expected to increase short-term interest rates, based on the Federal Funds Rate, from 0% to 0.75%, the fact that interest rates will remain below inflation is expected to continue to cause millions of new investors to turn to the stock market in search of inflation protection as well as higher yields. In other words, a Goldilocks environment of “low interest rates and steady growth” is expected to persist.

In late 2022, the stock market will become increasingly distracted by the mid-term elections, where the leadership in Congress is expected to change. Ironically, if the Biden Administration decides to cooperate with the new Congress, like Bill Clinton worked with Newt Gingrich, it could save Joe Biden’s legacy. In the end, Wall Street loves gridlock and the political environment is suddenly becoming especially favorable for growth stocks.

What is also favorable is that since the federal deficit is now approaching \$30 trillion, the Fed cannot raise interest rates sufficiently to squelch inflation, since the interest on the federal deficit now exceeds the annual budget for the Defense Department. As a result, inflation is expected to remain abnormally high, which is great news for growth stocks and other inflation hedges, like residential real estate.



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