SANCTUARY ASSET MANAGEMENT

CIO CORNER

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A WORD FROM
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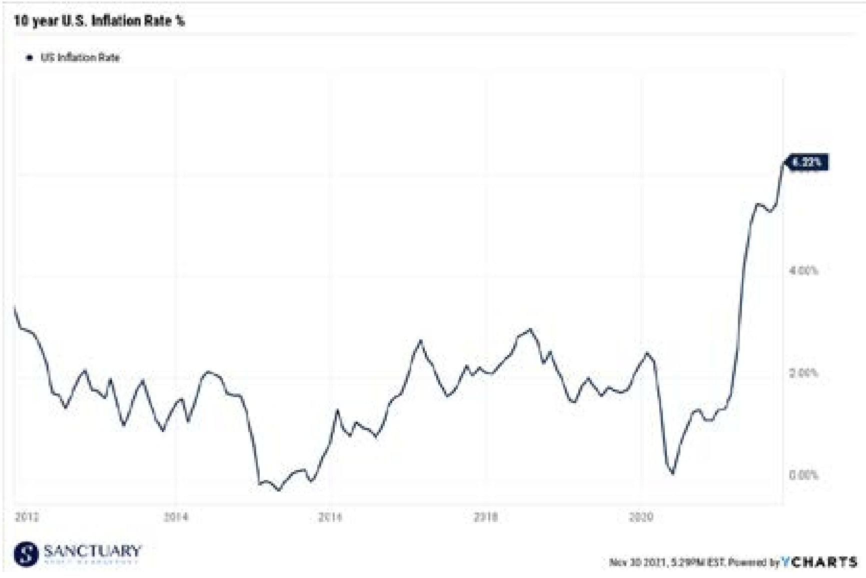
As we move into December, investors will focus on the impact of the new Covid variant, Omicron, the Fed, persistent supply-chain challenges and rising inflation as the last month of 2021 gets underway.

The stock market fell sharply on month's end in November, as risk sentiment was first pressured by the Omicron variant and then by commentary from Fed Chair Jerome Powell. The Fed Chair signaled that the Fed would consider speeding up its withdrawal of bond purchases as he admitted that inflation risks indeed have increased.

Closing the month of November, the VIX (volatility) moved significantly higher as markets contend with yet another Covid-19 variant, Omicron. Additionally, markets had to grapple with rhetoric from freshly renominated Fed Chairman Powell stating that the central bank could increase the monthly reduction of its bond purchases, better known as tapering.

Until the day after Thanksgiving, U.S. equity markets were basking in one of the best earnings season performances in the last decade as the S&P 500 had risen nearly 2% on the month until Black Friday abruptly halted its rally. For the month, the S&P declined 0.8%, while the Dow slid 3.7% and the Nasdaq squeaked out a 0.25% gain. The Russell 2000 cratered 4.3% lower in November, its worst month since March 2020. Let's remain calm though, the S&P 500 remains higher by nearly 22% for the year-to-date through month end.

Not Transitory: The Q&A portion of Fed Chair Powell's testimony before the Senate Banking Committee provided some market-moving insight. In my opinion, either Powell made an error in his messaging, or he deliberately provided a hawkish surprise to the marketplace. He assessed that the risk of persistent inflation has risen and that the factors pushing inflation upward will linger well into next year. He also elaborated on concerns that the virus could reduce people's willingness to work in person, which would impede progress in the labor market and intensify supply-chain disruptions.



Articulating high inflation as a risk to returning to full employment, the Fed Chief admitted (or confessed) higher prices have spread more broadly. In his closing remarks, Fed Chair relayed that it is a good time to retire the word "transitory" for describing the current inflationary environment and that it may be appropriate to discuss at the next meeting. This hawkish tone may have caught some investors offsides, but this hawkish pivot may eventually be digested as a market positive since it most likely reveals the Fed's forecast of continued strength in our economy.

Supply-Chain: Global supply-chain woes are beginning to recede, but shipping, manufacturing and retail executives say that they do not expect a return to normalcy until mid-next year and cargo will continue to be delayed if Covid-19 outbreaks disrupt key distribution hubs. An easing of supply-chain bottlenecks would allow production to move towards meeting sensational demand and would certainly lower logistics costs. If sustained, that would help alleviate the upward pressure on inflation consumers have endured.
Omicron: Omicron was first identified in South Africa last week and much remains unknown about it, including its ability to elude vaccine protection. Scientists are racing to determine its severity, transmissibility and whether it evades current vaccines. Dr. Anthony Fauci, President Joe Biden's chief medical adviser, said it would likely take two to four weeks to learn this critical information about the variant.

Bond Yields Dip: The safe-haven allure of U.S. Treasuries reignited after the recent bout of volatility splashed into stocks. The yield on the 10-year Treasury was as high as 1.69% on the month before the risk-off sentiment in stocks sent yields back below 1.5%. The long end of the Treasury curve (10-year notes & 30-year bonds) posted its biggest monthly decline in yields since July, as investors assessed a possibly faster-than-expected tapering timeline from the Federal Reserve and threats posed by the Omicron variant. My lonely forecast for the 10-year note to remain tethered to 1.50% in 2021 has indeed come to fruition. These continued lower rates and inexpensive borrowing costs for companies have translated into a very positive input for our U.S. economy.

Earnings Season: Q3 earnings season is just about done, and it is another in a string of strong earnings seasons that has exceeded analysts' estimates by many metrics. The tremendous outperformance is another sign that some doses of inflation are actually stimulative for corporate profits despite the challenges imposed in labor shortages and supply-chain bottlenecks.

Consumer Strength: Solid retail sales data suggests excess savings and rising wages have helped Americans sustain healthy consumption despite mounting inflationary pressures and falling confidence levels, which was reflected in the latest University of Michigan Sentiment survey (Boo Michigan!). As a rule of thumb, a strong consumer bodes well for economic activity as household expenditures account for roughly 70% of GDP. All in this Holiday Season, consumers plan to spend $997 on average for themselves and their families this year, (source: National Retail Federation's annual survey) down from the pre-pandemic high of $1,047 in 2019. As shoppers spread out their holiday purchases amid ongoing concerns about Covid, about 45% of consumers are tapping so-called "buy now, pay later" services for their holiday shopping to spread out their expenses. Despite a small decrease of 1.4% YoY, I was encouraged to see that consumers spent $10.7B on Cyber Monday.

Speeding Up: The Fed said at its November meeting that it would begin reducing its purchases of Treasuries and mortgage-backed securities by $15 billion a month and that it planned to conclude its program in mid-2022. But Powell said on Tuesday that he expects the Fed to discuss increasing the pace of the reductions at the central bank's December meeting. The pace will most likely be doubled to a $30 billion per month reduction. Remember, tapering is not the same thing as the Fed unwinding its $9 trillion balance sheet. Its balance sheet will remain quite swollen and wildly accommodative in 2022, no matter how hard those darn TV pundits try to paint hawkish wings on our friend, Fed Chairman Powell.

Positioning: The Holiday Season has officially kicked off as my sources in Texas have told me that Rich Williams has consumed his first Peppermint Mochas from Starbucks. In all seriousness, I do not want to diminish the potential severity of the Omicron variant, but I am rather optimistic that the recent panicked selling pressure in equities has been unwarranted. Overreactions historically have presented opportunity. With one month left in the year, the opportunity is to rebalance and reconsider how your client exposure lines up with the New Year now tangibly on the horizon. Owning quality companies, being thoughtful on sector exposure as well as remaining balanced between growth and value should provide a smoother risk profile in equites for 2022. I remain bullish and I do anticipate a Santa Claus rally. In addition to rebalancing, I believe now is a time to better understand correlation as well as the efficacy of non-correlation inside your portfolios. An overweight to Alternatives is being embraced as 2022 and the New Year will most likely bring consistent and dislocated volatility.

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