Market Commentary

The Quarter in Review – 4Q 2021

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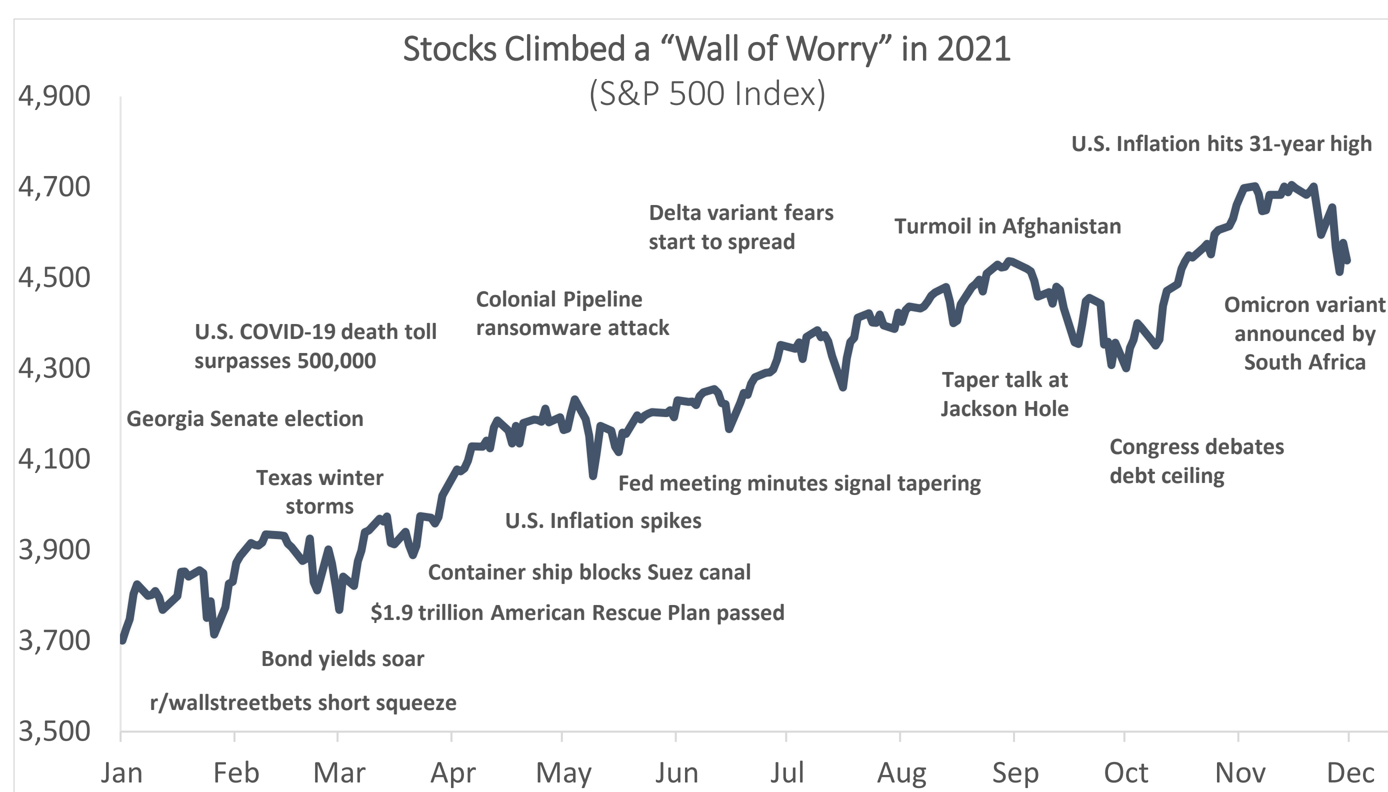
Performance

Stocks continued to climb a “wall of worry” during the fourth quarter and most major indexes finished the year at or near all-time highs. An improving labor market, robust consumer spending, and continued accommodative monetary policy were enough to offset concerns surrounding Covid, the new Omicron variant, supply chain disruptions, and rising inflation. In Washington, the $1.2 trillion Infrastructure Investment and Jobs Act was singed into law, and a deal was reached to avert a crisis over the debt ceiling limit, but the Build Back Better bill fell victim to intra-party politics and will need to be revisited in 2022. The Federal Reserve (“the Fed”) finally announced a shift in policy in December, but stocks barely skipped a beat. The S&P 500 led the major U.S. indexes with an impressive +11.03% return for the quarter, while the tech-heavy NASDAQ and the DJIA were up “only” +8.45% and +7.87%, respectively. Non-U.S. equities continued to struggle in comparison as the MSCI EAFE Index gained +2.74% and the MSCI Emerging Markets Index declined by -1.24%.



*Source: Maryland Capital Management; S&P Global, Inc.; S&P 500® Index as of 12/03/21**

ABOUT THE FIRM

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Yields were range bound throughout much of the quarter, unable to breakout to new highs. The main movement over the past three months was a decline in yield levels at the end of November into the first week of December. The 10-Year U.S. Treasury bond finished the quarter essentially where it started, with a yield of 1.51%. With the small change over the three-month period, the Barclays Intermediate Government/Credit Bond Index and the Barclays 5-Year Municipal Bond Index posted returns of -0.57% and +0.04%, respectively. With multiple interest rate hikes now anticipated for 2022 and 2023, the bond bull market may finally be coming to an end.

Inflation No Longer “Transitory” - Fed Pivots To Tighter Credit

In addition to the Santa Claus rally that stocks experienced at the end of the year, there was more good news on the economic front. According to data from MasterCard, 2021 holiday sales rose +8.5% compared to last year. This was the fastest pace of growth in seventeen years and occurred despite the Omicron wave the country experienced at the peak of holiday shopping season. On the labor front, weekly jobless claims were 198,000 for the week ended December 25th. This was below the expected figure of 205,000 and near the lowest levels seen since 1969. According to ADP, private job growth totaled 807,000 in December, more than double the anticipated result. The unemployment rate has now dropped to 4.2%, a major improvement from the lockdown-induced 14.8% peak level reached in April 2020. At the end of December, 3Q 2021 U.S. GDP was revised up to +2.3% growth, and the Atlanta Fed forecast +7.6% GDP growth for 4Q 2021. This positive activity is welcome, but the overall demand for goods is contributing to higher prices for consumers. The most recent data from November showed that two widely-followed inflation indicators, the Consumer Price Index (CPI) and the Personal Consumption Expenditure (PCE) Index, grew +6.8% and +5.7%, respectively. This represents the fastest rate of growth for both in nearly forty years and is well above the Fed’s 2% target.

As we wrote last quarter, any changes in Fed officials’ public comments and language from meeting minutes will be heavily scrutinized in the coming months for any clues forecasting policy change. The Fed spent most of the year insisting that the inflationary pressures we all experienced were transitory, in their words meaning, “it would not leave a permanent mark in the form of higher inflation.” At the last meeting in mid-December, they conceded this was no longer the case by announcing their decision to speed up the taper of the asset-purchase program. In the press release that followed, the word inflation was mentioned seven times. While they indicated that, “the path of the economy continues to depend on the course of the virus,” they also admitted that “supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation.” Chairman Powell and his colleagues also indicated there could be as many as three interest rate hikes in both 2022 and 2023. According to economists surveyed by Bloomberg, this represents the biggest shift ever in the “dot plot,” a tool the Fed uses to signal its outlook for the path of interest rates. While this turnabout was dramatic it was not unexpected and markets took it in stride, perhaps because more rate hikes could have been predicted or simply that the uncertainty of timing was finally removed. According to the Chicago Mercantile Exchange (CME) Group’s FedWatch Tool, which analyzes the probability of FOMC rate moves for upcoming meetings, current futures pricing is predicting a 57.2% likelihood of a hike in March 2022 and a 59.7% chance they will add two more by the end of the year.

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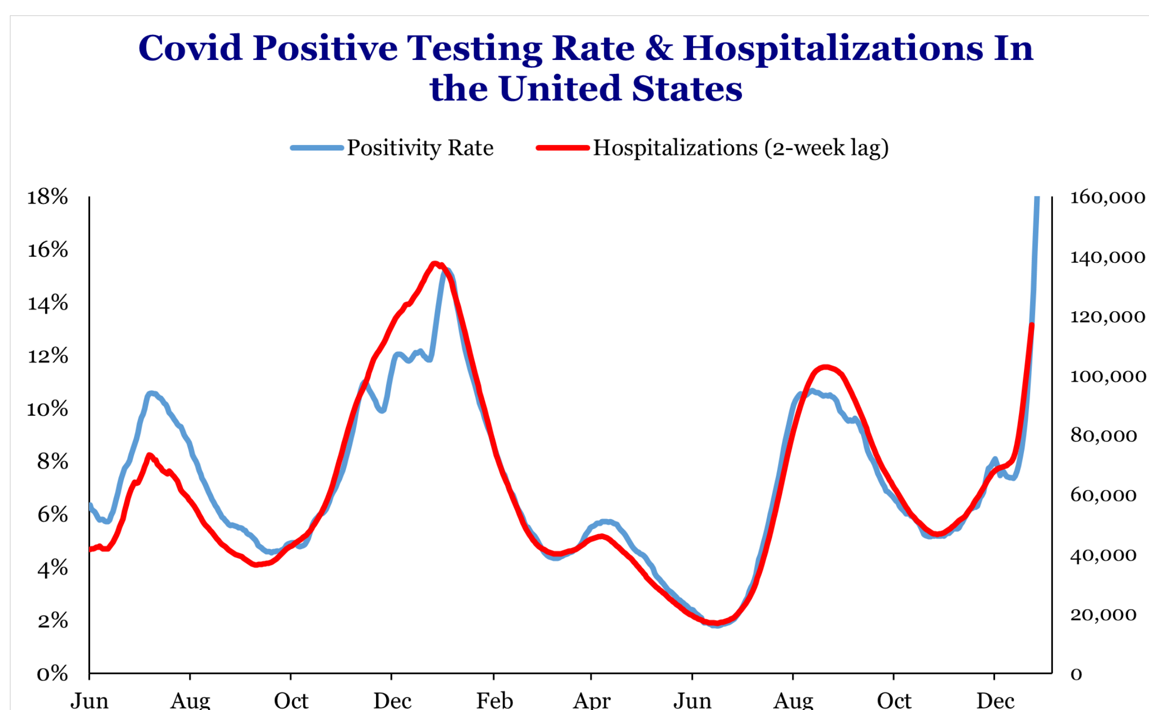
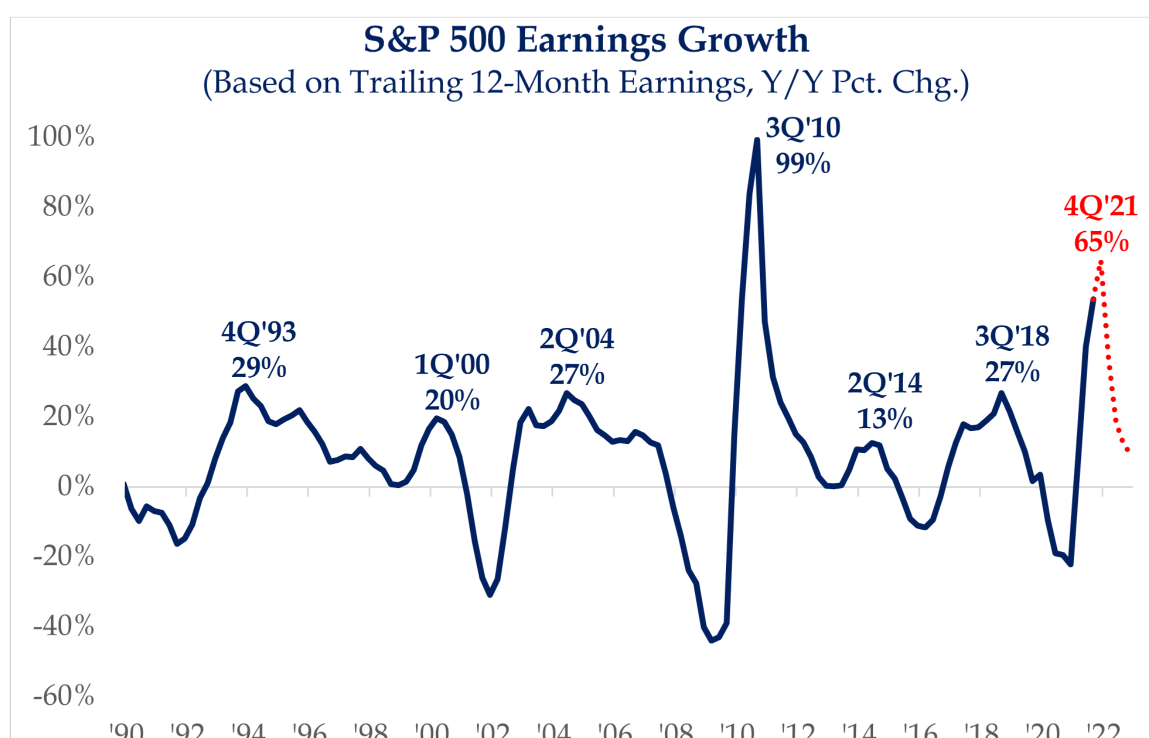
Omicron

As we enter the new year, and our third year dealing with this pandemic, the U.S. has set a new single-day record with over one million new Covid infections, obliterating the previous record. The new highs are coming post-Holiday celebrations, amidst colder weather, and as the Delta and Omicron variants circulate simultaneously. Omicron has spread rapidly around the world since it was first identified in South Africa in November. Amid the biggest surge to date, the seven-day average of new Covid cases in the U.S. is approaching 500,000. According to data tracked by Johns Hopkins University, this is the highest such metric of any country. The frustrating thing for many is that this is happening now, after the "15 days at home" campaign to slow the spread, masking mandates and social distancing frameworks to "flatten the curve", and a mass vaccination campaign resulting in more than 243 million people, 73% of the U.S. population, receiving at least one dose of the Covid vaccine. The silver lining in all this, as of now, is that hospitalization and death rates are not rising as dramatically as cases. We can only hope that the mutation to a more highly transmissible, yet milder strain is the beginning of the end for this contagion.

The Centers for Disease Control (CDC) recently cut the recommended number of days that people isolate after being infected with Covid to five days from ten, explaining "the change is motivated by science demonstrating that the majority of SARS-CoV-2 transmission occurs early in the course of illness, generally in the 1-2 days prior to onset of symptoms and the 2-3 day after." The recommended quarantine period for those exposed to Covid was also changed. If unvaccinated, the new guidance suggests a five-day quarantine followed by five days of strict mask use. Individuals that have been vaccinated and boosted do not need to quarantine following an exposure but should wear a mask for ten days from the contact. The initial change in guidance did not include a requirement to get a negative test before leaving isolation, but that is now being considered. While not without some controversy, the new guidance opens the door for those impacted to return to work and school more quickly and is overall less disruptive to people's lives after being infected, whether they are symptomatic or not.



Source: Strategas Research Partners



Source: Strategas Research Partners

Outlook

With the recent Covid surge prompting staffing challenges, returns to virtual learning, countless flight cancellations and other disruptions, economists have started to lower their expectations for U.S. GDP growth in 2022. Mark Zandi, Moody's Analytics Chief Economist, downgraded his 1Q 2022 U.S. GDP forecast to 2.2% growth from 5.2% as he "can see the economic damage mounting going into the first quarter." While the new spike in the virus is the most pressing current concern, other building blocks in the current "wall of worry" include: inflation, rising geopolitical tensions with Russia, China and Iran, President Biden's approval ratings, and the upcoming mid-term elections. Two things that concern us are equity indexes being too top-heavy and the realization that equity valuations need to decline if interest rates and inflation move meaningfully higher. The ten largest companies in the S&P 500 make up approximately 30% of the index, the highest reading on record. The historical average is closer to 21%. Apple, with a $3 trillion market cap, is now 7% of the index, the largest single-issue ever in the index. Based on year-end data from FactSet, the current forward 12-month P/E multiple for the S&P 500 is 21.2x. Still not as high as the record 24.1x level set in 4Q 1999 before the tech bubble burst, or even 22.6x at the end of 2020, but well above its five-year average of 18.5x. Going back to 1950, the average S&P 500 P/E multiple when inflation was between 0-2%, was 18.6x. But when inflation is in the range of 2-4%, that average declined to 17.4x, and the 4-6% inflation range equated to a 15.1x PE multiple. The math is pretty simple: using round numbers, if the S&P 500 annual earnings power is $200, every multiple point lower could equate to a 200-point (-4%) decline in the index.

4Q 2021 earnings season is upon us, and estimates are robust. According to FactSet, the expected earnings growth rate for the quarter versus the same period one year ago is +21.3%. If that number is realized, it would mark the fourth straight quarter of earnings growth above +20%. This pace of growth will naturally begin slow. This is due to the fact that the past several quarters were coming off trough levels of earnings from when the economy shut down in early 2020. That said, the expectations are still very healthy based on normal, historical comparisons and standards. 2022 S&P 500 revenue growth is expected to be +7.5%, with earnings growth of +9.2%.

We look forward to a future, "back to normal," economic cycle and market that rewards the stocks of companies we identify through our analysis as having superior fundamentals and attractive growth prospects. Our hope for the new year is for positive developments on the Covid front, no escalation in geopolitical tensions, and less partisan politics in Washington. Mid-term election years have a history of sharp sell-offs and very strong rebounds. We also know from studying market history that most of the annual return in mid-term election years comes at the end of the year, after the election(s) in November. So, we expect some heightened volatility and moments that could test investors' nerves but do ultimately expect positive returns for stocks in 2022. We remain committed to adding value for our clients, and steadfast in our pursuit of delivering competitive risk-adjusted returns across MCM's various investment strategies. Thank you for the continued confidence you have placed in us. As always, do not hesitate to let us know if you have any questions or concerns.

Market Commentary

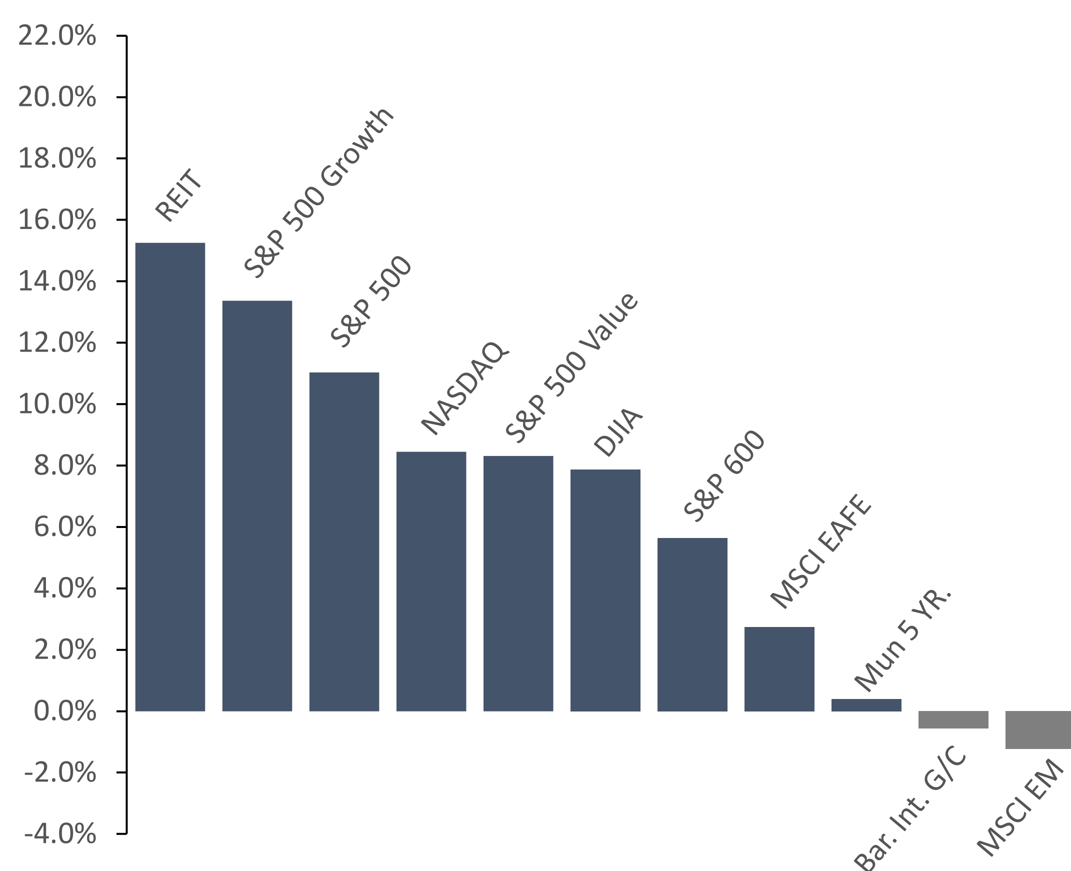
The Quarter in Review

Ranked by 4Q 2021 Performance

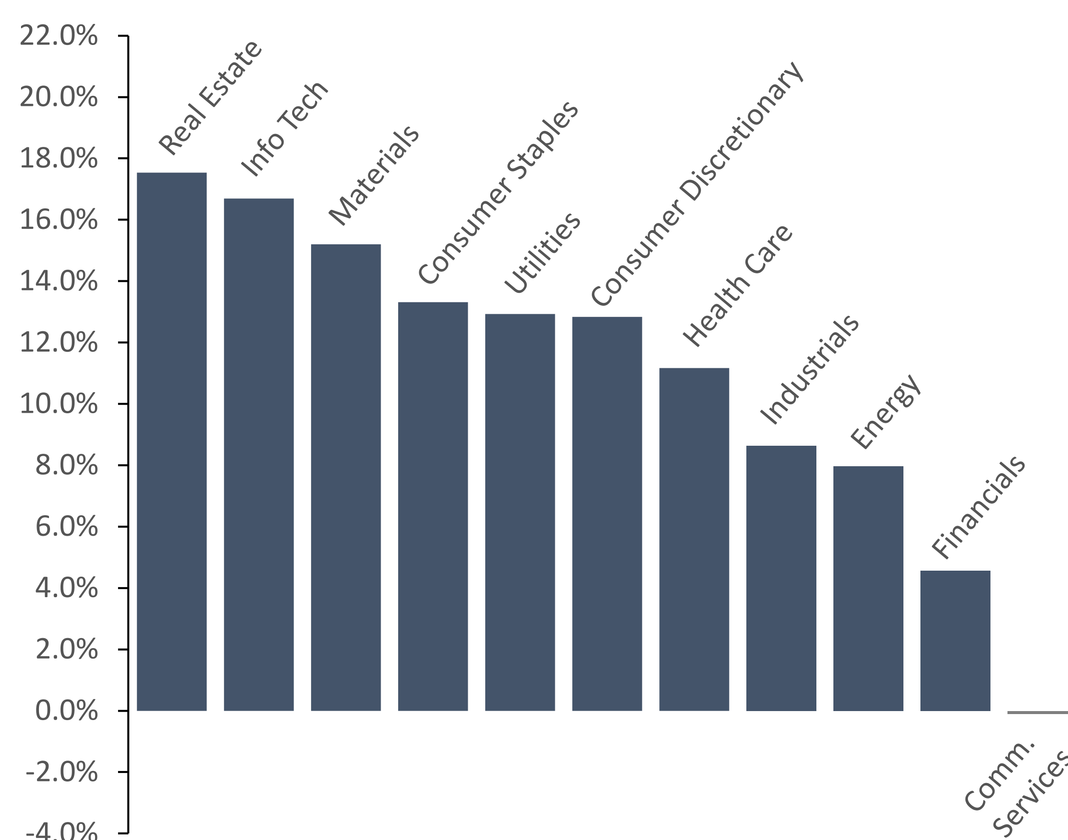
Major Market Indices	***Oct***	***Nov***	***Dec***	***Qtr***	***YTD***
NAREIT All REIT	6.92%	-1.28%	9.18%	15.25%	39.88%
S&P 500 Growth	9.08%	1.42%	2.48%	13.37%	32.01%
S&P 500	7.01%	-0.69%	4.48%	11.03%	28.71%
NASDAQ Composite	7.29%	0.33%	0.74%	8.45%	22.18%
S&P 500 Value	4.59%	-3.26%	7.04%	8.31%	24.90%
DJIA	5.93%	-3.50%	5.53%	7.87%	20.95%
S&P 600 (Small Cap)	3.43%	-2.29%	4.53%	5.64%	26.82%
MSCI EAFE (International)	2.48%	-4.64%	5.13%	2.74%	11.78%
Barclays Cap Muni Bond – 5 YR	-0.29%	0.20%	0.13%	0.04%	0.34%
Barclays Int G/C (Bond Ind)	-0.56%	0.12%	-0.13%	-0.57%	-1.44%
MSCI Emerging Markets (EM)	1.00%	-4.07%	1.92%	-1.24%	-2.22%

U.S. Industry Groups	***Oct***	***Nov***	***Dec***	***Qtr***	***YTD***
Real Estate	7.55%	-0.86%	10.23%	17.54%	46.19%
Information Technology	8.17%	4.35%	3.38%	16.69%	34.53%
Materials	7.63%	-0.49%	7.57%	15.20%	27.28%
Consumer Staples	3.89%	-1.10%	10.29%	13.31%	18.63%
Utilities	4.73%	-1.65%	9.64%	12.93%	17.67%
Consumer Discretionary	10.94%	1.97%	-0.25%	12.84%	24.43%
Health Care	5.16%	-3.00%	8.98%	11.17%	26.13%
Industrials	6.88%	-3.50%	5.33%	8.64%	21.12%
Energy	10.36%	-5.09%	3.08%	7.97%	54.64%
Financials	7.30%	-5.68%	3.33%	4.57%	35.04%
Communication Services	2.83%	-5.16%	2.53%	-0.01%	21.57%

4Q 2021 Index Returns



4Q 2021 Industry Group Returns



Source: FactSet

S&P Global, Inc.; S&P 500® Index data as of 12/03/21. The S&P 500® Index is unmanaged and cannot be invested in directly. Graph created by Maryland Capital Management for Illustrative purposes only.* ***Past performance is no guarantee of future results.*