2022

Investment Outlook

AE WEALTH MANAGEMENT

Markets rocketed to new highs in 2021, avoiding a significant correction despite a host of challenges related to the ongoing pandemic.

But the optimism that propelled markets upward in the first half of the year dimmed in the second half, overshadowed by sky-high inflation, critical supply chain issues and concerns about new COVID-19 variants. Economic uncertainty and a lack of big news leaves investors with a big question as we enter 2022: What happens next for markets?

Key Takeaways

- After growing by 6.5% in the first half of the year,[1] U.S. gross domestic product (GDP) slowed considerably in the third and fourth quarters. Economists expect that trend to continue into 2022, forecasting 3.8% GDP growth in 2022.[2]

- Inflation will likely remain high in the first half of the year, despite the Federal Reserve's plans to taper bond purchases. Interest rate raises following the taper's conclusion could mitigate inflation, although it's currently unclear when those raises will occur – and how much rates will rise when they do.[3]

- The pandemic will continue to be a wild card through the end of 2022. News regarding emerging variants, vaccine efficacy and potential new treatments could create volatility in markets.

- Inflation and lackluster consumer spending could squeeze companies' earnings, while rising interest rates would likely make it more expensive for consumers and businesses to borrow money.

Headwinds & Opportunities in the Coming Year

After setting multiple new records between January and November,[4] U.S. markets ended 2021 at a stalemate. Investors were barraged with a steady stream of negative headlines in the last quarter, rendering the heady optimism of early 2021 a memory. Concerns regarding the omicron variant and ongoing supply chain issues seem to have left everyone wondering if anything could propel markets forward into the new year.

Although markets will battle significant headwinds well into 2022, we also see opportunities for investors who are willing to ride out increasing volatility and uncertainty. Here's our view on five key areas to watch over the next 12 months.

The Headwind: Slowing Economic Growth

U.S. gross domestic product grew by an average of 6.5% in the first half of 2021, spurred by vaccine distribution and reopenings across the country.[5] Despite faltering growth in the third quarter, analysts forecast total GDP growth of 5.6% year-over-year in 2021.[6]

Will we see similar growth in the next year? Most likely not. Investors should anticipate lower GDP growth in 2022, with expectations calling for an annual growth rate of 3.8%.[7]

The Opportunity: The balance between GDP growth and inflation is a delicate one. Slightly lower year-over-year GDP growth could help tame inflation, while an increase in GDP helps us lower unemployment rates and boost corporate earnings.

The Headwind: Inflation and Interest Rates

After pumping a massive amount of liquidity into the economy over the past two years, the Federal Reserve has finally changed its tone on raising interest rates. The Fed plans to taper its bond-buying program by $30 billion a month, reducing its holdings by $150 billion by April 2022.[8] The Fed has also shifted from its position of keeping rates at or near zero to considering three potential rate increases in 2022.

However, will the Fed's taper and rate increase come soon enough? The annual inflation rate was at 6.8% in November 2021, the highest it's been since June 1982.[9] Until interest rates rise, the U.S. could continue to experience higher-than-usual levels of inflation. However, if the taper and rate hikes are too aggressive, we risk derailing a weakening economy and plowing into a recession.

The Opportunity: If inflation comes down more quickly than expected, that could be good news for stock markets, due to a decrease in the cost of goods and potential increase in consumer spending. Rising interest rates could also offer more alternatives for investors, particularly in bonds. We anticipate the benchmark 10-year U.S. Treasury to surpass 2% yield this year for the first time since mid-2019.[10] We will be keeping a close eye on bond markets, which may see a quick and harsh movement to the upside in yields as the bond market comes to grips with inflation, rising interest rates and the end of Fed accommodation.

The Headwind: COVID-19

As we enter the third year of the pandemic, most health care experts agree that the COVID-19 virus – with all its existing and future variants – will stay with us for a while. The emergence of omicron, the latest variant, in the latter part of 2021 thwarted many companies' plans to bring workers back to the office and sent some students back to remote learning.

The debate around vaccine mandates will continue to rage over the next several months. If courts uphold mandates and employers let go of workers who don't comply with vaccine requirements, we could see the unemployment rate tick back up from its relatively low November rate of 4.2%.[11]

The Opportunity: The FDA recently authorized antiviral treatments from Pfizer and Merck to be prescribed to those at high risk who contract mild or moderate cases of COVID-19, though supply of the drugs is expected to be limited until production ramps up.[12] It's also unlikely that the U.S. will see the same level of restrictions and shutdowns experienced in early 2020, leading to less vulnerability for the overall U.S. economy.

The Headwind:
Continued Supply Chain Disruptions

The global supply chain was stretched thin in the back half of 2021, and disruptions will persist as we continue tackling the backlog. Americans will likely see ongoing supply issues in everyday items – including groceries, toiletries and gas – as well as bigger purchases such as vehicles. In fact, some analysts predict supply chain issues extending well into 2023.[13]

The Opportunity: Analysts expect global oil production to outpace demand in the coming months. They're projecting the price of gas to fall below $3 per gallon in 2022,[14] although oil prices could hit $125 per barrel in the short-term.[15]

Inventory could also increase in the housing market, which has been red-hot throughout the pandemic. Other industries that would benefit from a reduction in bottlenecks: automotive, electronics and other businesses with complex supply chains.

The Headwind:
Political Maneuvering

The coming year will contain potential for market disruptions from geo-political sources, including Russia, China, Iran and North Korea. Domestic politics could also spur market volatility, particularly as we move closer to mid-term elections in the second half of the year.

The Opportunity: There is a strong possibility that Republicans could swing control of both houses of Congress their way in the mid-term elections. With a Democrat in the White House, a congressional powershift could be a good thing for the economy, since it practically guarantees no new spending in Washington.

Investing Basics in Any Environment

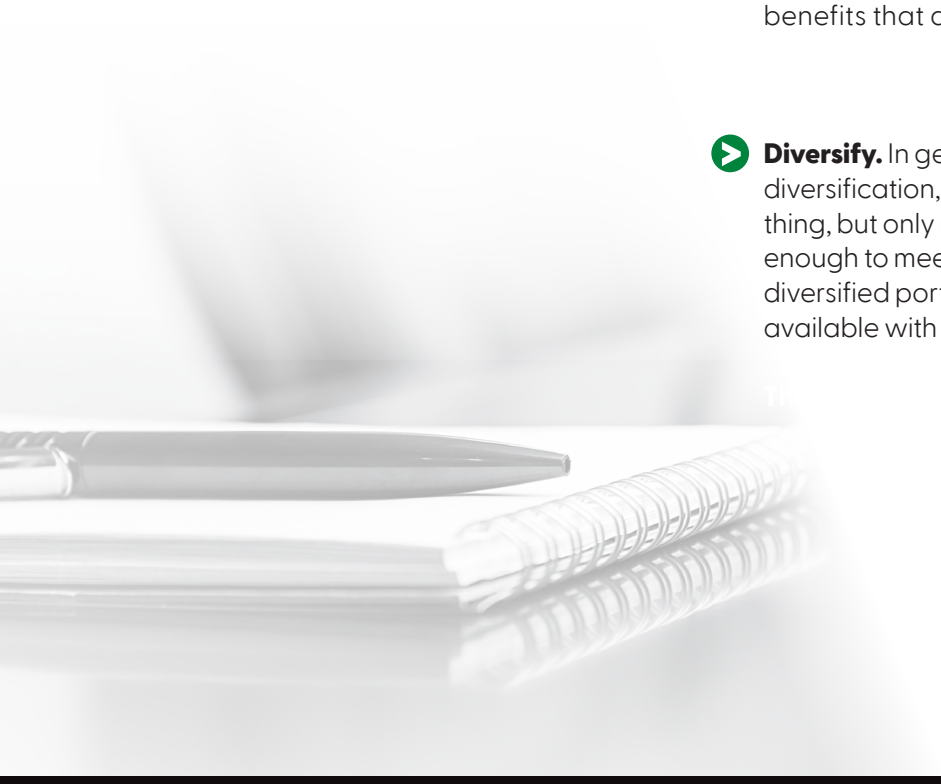
These perennial ideas are best practices for investing – no matter what shape the economic environment takes.

Save more. Retirement planning often entails a lot of time and energy devoted to considering asset allocation plans, withdrawal strategies, needs analysis and more. But more attention should be diverted to how much money investors save – and where and how to save it.

Saving is the most fundamental and important component of successful investing. Aggressive saving allows individuals to take advantage of compound interest. The best thing any of us can do for ourselves and our families' futures is to save more.

Seek out low fees. Fees are a leading factor in the success or failure of any investment. Even a 0.5% annual fee can reduce a portfolio's value by $10,000 over 20 years. Choosing lower costs (when the product is right for the investor) can have residual benefits that add up over the life of an investment.

Diversify. In general, the greater a portfolio's diversification, the lower its riskiness. Lower risk is a good thing, but only if the portfolio's potential return is healthy enough to meet the investor's needs. Fortunately, a well-diversified portfolio captures most of the potential upside available with much lower volatility.



- **The "political trade" is a threat.** Basing your investment decisions on politics is usually a recipe for disaster. Those who love or hate any given political person, party or policy should guard against letting politics dictate investment decisions.

- **Remember that "personal volatility" is dangerous.** Trying to time the market is also almost always a bad idea. Attempting to guess when the market will move – either up or down – is not an investing strategy; it's just luck.

- **Maintain a sense of where you are.** Good investing requires exceptional self-awareness. Dealing with risk doesn't just mean knowing how much tolerance investors have for pain when markets are uncooperative. It also means understanding how much risk one can take in their investments to maximize growth without jeopardizing financial goals. Every investor needs to know and understand their personal tolerance for risk and its relation to their financial journey.

- **Build guaranteed income.** Guaranteed income is a building block for retirement income. Volatile markets provide effective reminders that stocks can – and do – lose money despite their unmatched long-term value. Diversification in retirement planning always makes sense, and a long-term financial plan should include a mix of assets that work together to achieve your goals for retirement.

Final Thoughts

In our view, the first part of 2022 will probably look much the same as 2021. There is currently nothing new on the horizon with promise to push markets to higher levels, especially early in the year. Given that we haven't had a meaningful correction in over a year, it seems probable that markets will experience a 10% to 20% pullback at least once in 2022. However, opportunities abound – and investors could see markets jump another 10% from current levels by the end of the year.

Our advice is to make sure you are positioned appropriately and allocated in alignment with your risk tolerance and goals. Rely on your financial advisor to answer your questions and help ease concerns when volatility strikes and markets dip. The best strategy is to remain cautious and patient. There are still too many "what-ifs" and "wait-and-sees" to say definitively which direction markets will go, particularly in the first half of the year.

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