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Letter from Dan

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I am happy to tell you that you can now watch or read my mid-quarter letter at your convenience! We are glad to give you the choice of your preference!

The question we are asked the most is: Where is the stock market going from here? The S&P 500 is up about 27% since the beginning of the year, on top of a 18.4% return in 2020 and 31.49% in 2019. Crazy! Do we need to worry?

First, let's get an understanding of how the stock market ran up so far, so fast. In 2019, we were coming off a year that the Fed raised rates four times and people were worried about a global slowdown and a trade war with China. Instead, the Fed lowered interest rates 3 times and the tech sector took off, led by Apple and Microsoft. With lower interest rates, investors poured money into the stock market, leading to more gains. In 2020, we were crushed in the first quarter by the pandemic, but the government came through with unprecedented fiscal stimulus to support businesses and keep people on their feet. With the ensuing recovery, the government support served to add fuel to the stock market surge, leading us to where we are now.

Next, let's look at some of the issues that are present today:

- Supply chain shortages- Everyone has heard of how it is taking so long to get a new car, furniture, toys, etc. Think about it a little- it is not so much a shortage due to slow manufacturing and shipping alone, but more due to high demand. A retail store owner says that he has about the same amount of inventory as in other years, it is just selling faster because people have money to spend.
- Labor shortages- This one has been around since before the pandemic, but now maybe is worse. The pandemic has led to earlier retirements, employee burnout and displaced workers. Stress led to people quitting their jobs and, in some cases, government assistance helped them stay home. We suspect many just simply do not want to return to work. Perhaps immigration can help, like it has done so often in the past.
- Inflation- The breakthrough in higher wages, with increasing prices has given us higher inflation rates than what we have had in decades. We can see it at the grocery store, at restaurants and at the gas pump. Feels good to get a big pay increase- not so good for seniors on a fixed income. Inflation can be good for the stock market, but rising interest rates can diminish bond returns.

What is coming up next?

- Different government stimulus- The big infrastructure/social/environmental bills being passed by Congress will not give a short-term jolt to the economy, but rather provide long term employment and additional opportunities for those who want to get ahead. How we are able to handle the big deficits over time remains to be seen.
- Action by the Fed- Chairman Powell already announced the slowdown of the Fed buying Treasury bonds to keep interest rates lower and to help growth. We also expect the Fed to raise short term interest rates two or three times in late 2022, to control rising inflation. All necessary actions.
- Slowdown of the economy from an unsustainable 5.5% growth in 2021 to around 3% for 2022. Remember when 3% growth was unheard of- we couldn't get above 2.5% GDP growth.

- Supply chain returns to "normal"- Because of increased efforts to get goods to market and a reduction in demand, the supply chain issues we see today will work itself out over the next twelve months. But we will also see changes- more manufacturing in the US rather than overseas, more orders placed well in advance of the actual delivery (think new cars, refrigerators, furniture) and even more online sales.

So…… Where is the stock market going from here?

Still upward, but at a much slower pace. Government spending will help support the stock market, but Fed actions to raise short-term rates will put a damper on growth. Unemployment will remain low, meaning people will have money to spend, just not as much as the past few years. The pandemic will recede, but will people feel better? The next election will come in a year and we will see what that brings. The world has changed (again) and we will keep moving forward to the next normal.

To repeat, we do not expect a big stock market crash- some volatility, but no sustained drop. Bonds will be a tougher investment as rates increase and demand possibly decreases. But we will need to re-examine our spending habits and adjust to higher prices so that we do not put excess pressure on investment income or stop saving for the future. 2022 could be like 2018- flat, with slow growth, but be optimistic! Life can return to being less stressful, if we look to the things that are really important.

Enjoy your holidays!

Dan