The Year-End Stock Market Rally

December 27, 2021

In December, the stock market swoon suggested that there was going to be coal in our stockings. Yet when looking at the decline we find that supply and demand plays a big role in where stocks go in the short-term. From our perspective, the mid-month selloff was partially attributable to investors over the age of 71 taking their RMDs (Required Minimum Distributions) from their retirement accounts. Since this requirement was absent in 2020 due to Covid, there might have been increased distributions this year. Once that pressure on stock prices passed, the market recovered and reached new record highs near yearend as measured by the S&P 500.

History tells us that the broad stock market rally is a good indicator of the direction of the economy. As the year ends, the economic evidence continues to signal a vibrant 2022. One important factor that directly affects the stock market is that companies are experiencing a wealth of riches due to rising sales and tax cuts that benefitted the bottom line. This wealth is being translated into stock buybacks of record amounts. The Wall Street Journal reports that stock repurchases will hit $850 billion, up 63% from last year and up 16.6% from 2019. Looking at companies in the S&P 500, their cash holdings were $3.78 trillion. Companies also paid out a record quantity of dividends to shareholders during the year and this trend is likely to continue into 2022. We monitor earnings expectations for a broad list of companies and, for the most part, find that analysts continue to raise earnings estimates for next year and 2023.

An extensive number of commentaries regarding the rising tide of the Omnicom variant has contributed to further volatility in stock prices. At the same time, the pharmaceutical industry continues to introduce a variety of new products that are designed to either immunize or treat this ailment. Recently the FDA approved the use of two pills that treat the symptoms of the disease making infections less deadly. If these ongoing breakthroughs continue, fears will be lessened, and serious cases will fall accordingly. For investors, this might mean that the companies that benefited from the virus will no longer be as important to the economy as they were before. Similarly, the companies that were penalized by the virus could be big winners in 2022. As was the case in 2000 in the aftermath of the Y2K crisis, there was an important shift in market leadership. A similar shift could be in the making as we enter the New Year. The best strategy under the possibility of this scenario is to remain well diversified and participate in the overall growth of the economy.

The naysayers are out again as the New Year is about to begin. The culprit for 2022 is supposedly the Federal Reserve that will spoil the good times by raising interest rates. When the Fed raises interest rates, it shifts wealth from borrower to saver. What happens when savers get more money? Spend it! While we will always be faced with short-term volatility when investing in stocks, the outlook for 2022 is very favorable. Happy New Year!!