CAPSTONE
WEALTH ADVISORS

Outlook on the Markets

MID-YEAR WINTER 2022 ISSUE

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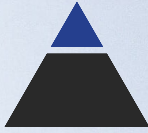

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Capstone Wealth Advisors is pleased to release our Mid-Year Outlook on the Markets written entirely by our advisory team. Our outlook is based on our views and philosophies as we see them impacting financial markets, and your money. Current trends, economic indicators and in-depth analysis is at the core of what we do. We monitor and analyze economic trends to help our clients have a clear understanding of the direction the economy is headed and how that impacts your portfolio strategies.

We have six offices throughout the Pacific Northwest, utilizing a team approach to provide continuity for your asset planning needs. Our investment committee meets weekly to discuss current economic events, market trends, asset allocations and more. By using a disciplined and methodical approach to investing, we remove the noise and emotion from your investment portfolio and allow you to focus on the things you love and enjoy most.

> Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves.
>
> — Peter Lynch —

Financial markets historically cycle through different phases throughout their lifespan and investors who consult the historical analysis of financial markets will find a technical answer as to when bull markets end. Market history suggests anywhere from 4 - 11 years is normal. By most accounts, we are somewhere in the middle to the later stages of this current economic cycle. The continuation of pre-pandemic economic trends means investors should be mindful of the risks inherent in the latter days of a long bull market. Most economists are expecting strong but slowing economic growth in 2022 and have lesser expectations for 2023.

Looking ahead, the risks are clearly defined; global economic growth is slowing, especially in China. Central banks across the globe are planning a gradual reduction in monetary stimulus measures. Stock, bond, and real-estate valuations are elevated across the board, and inflation that is stubbornly elevated. How financial markets respond to these threats remains to be seen but ultimately investors should remain focused on their long-term goals and resist temptations to become too defensive during times of increased volatility.

Inflation

Historically elevated inflation levels have been plaguing stocks at the end of 2021, but the US Federal Reserve expects the current inflation figures to regress closer to its 2% goal by the end of 2022 or early 2023. Many on Wall St question this perspective, citing labor shortages and broken supply chains as primary reasons for inflation to persist longer than Federal Reserve officials are expecting. Central bank officials expect higher inflation rates, driven by COVID-related distortions, to ease in the coming quarters but have become less certain on the timing. Ultimately both the Fed and Wall St expect the currently high levels of inflation to fade overtime, the debate simply remains as to when.

If you are worried that higher inflation is here to stay, keep three things in mind.

First, some inflation can be healthy. It allows companies to raise prices and enhance profitability in ways they may not have been able to in recent years. It also helps banks and commodity-based companies which have struggled in a low inflation, low interest rate world.

Second, even during times of higher inflation, stocks and bonds have generally provided solid returns to investors. It is mostly when inflation is at extremes levels – above 6%, or negative – that financial assets have performed poorly.

Third, long periods of elevated inflation are rare. We have not seen persistently high inflation numbers since the ultra-high inflation of the 1970s, and in hindsight it is clear that was a unique period. Deflationary pressures (negative inflation) have often been more difficult to tame.

For the vast majority of time over the past 100 years, inflation in the US has remained below 5%. More recently, in the aftermath of the 2007 - 2009 financial crisis, inflation struggled to even reach the fed's 2% target goal despite massive stimulus measures and historically low interest rates.

Facts to Consider

- **The S&P/Case-Shiller Home Price Index** reported that national home prices continue to increase at a fast rate. The index currently sits at 279 for October 2021, boasting an 18.4% increase over the previous year. We continue to see very strong growth at the city level. All 20 cities saw price increases in the previous 12-months from October 2021. October's increase ranked in the top quintile of historical experience for 19 cities, and in the top decile for 17 of them. As was the case last month, however, in 14 of 20 cities, prices decelerated – i.e., increased by less in October than they had in September. (1)

- **The Conference Board Consumer Confidence Index®** increased again in December, after an upward revision in November. The Index now stands at 115.8 (1985=100), up from 111.9 (an upward revision) in November indicating economic expansion is likely to continue into 2022 despite serious headwinds. (2)

- **The Institute for Supply Management's Manufacturing PMI ® Index** reported the manufacturing sector grew in December, with the overall economy achieving a 19th consecutive month of growth, although at a slower rate than previous months. The December Manufacturing PMI® registered 58.7%, a decrease of 2.4% from the November reading of 61.1%. The U.S. manufacturing sector remains in a demand-driven, supply chain-constrained environment, with indications of improvements in labor resources and supplier delivery performance. Shortages of critical lowest-tier materials, high commodity prices and difficulties in transporting products continue to plague reliable consumption. Coronavirus pandemic-related global issues — worker absenteeism, short-term shutdowns due to parts shortages, employee turnover and overseas supply chain problems — continue to impact manufacturing. However, panel sentiment remains strongly optimistic, with six positive growth comments for every cautious comment, down slightly from November. (3)

- **The National Federation of Independent Business** reported small business owners continue to struggle to increase their workforce, with 25% of owners saying labor quality was their top business problem in December. "The labor shortage is holding back the small business economy as owners work to retain their current employees and attract employees for their open positions," said NFIB Chief Economist Bill Dunkelberg. "A record-high number of small business owners are raising compensation to help retain and attract new employees." (4)

- **The Bureau of Economic Analysis** reported Personal income increased $90.4 billion (0.4%) in November according to estimates released today by the Bureau of Economic Analysis. Disposable personal income (DPI) increased $70.4 billion (0.4%) and personal consumption expenditures (PCE) increased $104.7 billion (0.6%). The estimate for November personal income and outlays reflected the continued economic recovery and government response to the COVID-19 pandemic. (5)

- **The Bureau of Labor Statistics** reports the official unemployment rate (U-3) seasonally adjusted in December was 3.9%. The U-6 unemployment rate, a more comprehensive measure of unemployment, was at 7.3% in December which is a significant improvement from the December 2020 rate of 11.7%. While it is encouraging to see the overall levels of unemployment decrease, it should also be noted that many people have decided to leave the workforce since the pandemic began. Until these figures are reflected in the data, which they currently are not, the "official" unemployment rate will be skewed and appear lower than it actually is. (6)

- **CBOE Volatility Index (VIX)** has experienced significant volatility over the last six month. The high over the past six months was 31.12 December 1st, 2021. The index sits at 20.61 as of early January 2022. (7)

International & Emerging Markets

The International Monetary Fund (IMF) is calling for 5.2% growth in the United States and 4.3% in Europe. China's economy is slowing, and lending is tightening in the real estate sector. We believe China GDP growth will be considerably lower than the consensus forecast of 5.6%. That coupled with a highly unpredictable political environment in China makes any investment difficult to justify from a risk versus reward standpoint when compared to US stocks.

Cryptocurrency Markets

The cryptocurrency markets wrapped up another volatile year. Many popular cryptocurrencies like Bitcoin and Ethereum reached all-time highs, before dramatically pulling back at year-end. Despite its volatility, cryptocurrency continues to advance forward into the mainstream with many major institutions and companies accepting crypto purchases on their network. 2021 was also the year that saw Bitcoin become a legal tender in El Salvador. Despite very choppy markets, experts are expecting the popularity of cryptocurrency to continue to rise, and many are maintaining price targets of $100,000 by the end of 2022 for Bitcoin, with many of the alternative coins riding that wave. Bitcoin surpassed $1 trillion in total market value for the first time in 2021.

What does all this mean to you and your portfolio?

As stated in our last Outlook on the Markets, we anticipated that "…continued economic growth will sustain into the end of 2021 and possibly carry over into 2022, but it will likely be accom-panied with episodes of heightened volatility along the way." We reaffirm that perspective and would expand on it to place focus more directly on the pace and manner by which the Federal Reserve executes its plan to stop stimulating our economy and begin raising interest rates. Our team believes we are still in an economic expansion but now see its end approaching – most likely occurring in 2023. In the current environment we are maintaining our core positions in Large US companies, however we are reducing the exposure to riskier areas of that space – as they tend to underperform other assets in the later stages of economic cycles. As business and economic cycles change, so does our focus on investing. For more conservative portfolios, we are favoring dividend paying stocks, companies with pricing power and Treasury Inflation Protected Securities (TIPS) as a means to provide lower volatility.

To our valued clients, your investment portfolios already reflect our investment philosophy. As market conditions change, we will continue to proactively implement portfolio adjustments as part of our investment process.

For those of you who are not currently a client, we invite you to schedule a complimentary consultation with our team. We can discuss the current economic outlook in greater detail and specifically how it might affect your existing portfolio. If you would like to schedule, please call our office directly at (877) 739-6007 or email us at info@capstonewealthadvisors.com.

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