A Chilling End to November

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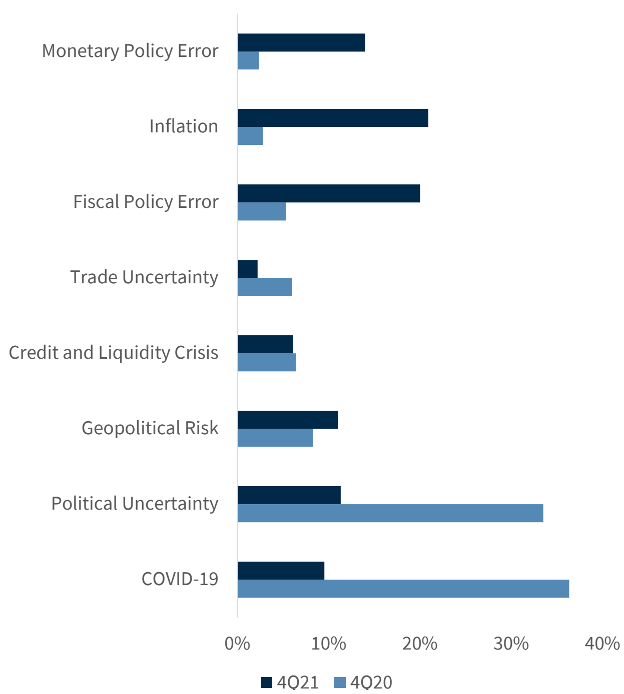
Continuing the weakness experienced over the last week, equity markets traded lower again today as the S&P 500 has declined ~3% from the recent high notched just seven trading days ago (November 18). The recent pullback in the market is primarily driven by two factors: the increase in COVID concerns and the Federal Reserve (Fed) potentially tightening monetary policy faster than previously expected. Our latest thinking on the market is below.

COVID: New Cases and New Variants

Markets have become more concerned about the recent headlines surrounding COVID. Investors had looked past COVID in recent months and focused on the potential to return to more normal lives. This was reflected by the results from our most recent Quarterly Investment Strategy Sentiment Survey. While COVID was the biggest concern at the start of the year, it had fallen to sixth place as of the end of September. But now, news of rising cases, shut-downs and new variants resurrected fears that the return to normal was premature.

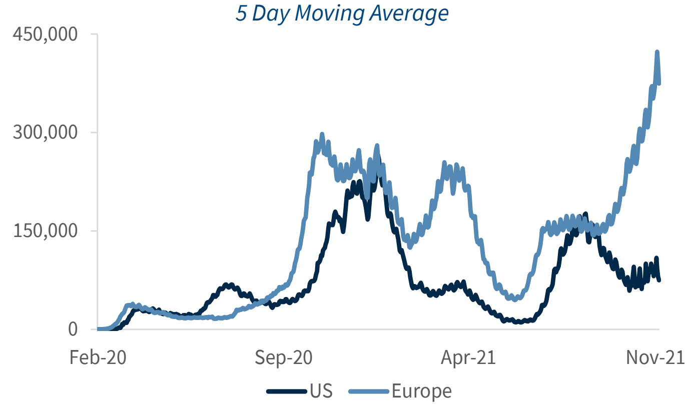
Survey Results: Biggest Concern in 4Q20 vs. 4Q21



Source: Raymond James Investment Strategy Survey, as of 11/30/2021

COVID cases have increased both in the US and abroad, with some European countries (e.g., Austria, Germany) instituting additional restrictions as cases have quadrupled within the region. While cases have increased to just shy of 100,000 per day in the US (which may be underestimated due to at-home testing), the US has remained resilient as evidenced by strong employment, spending, and mobility data. Our view remains that the surge is more seasonal as families gather (more inside gatherings as weather turns cold) for the holiday season and that the economic impact will be more limited as the tools to deal with COVID (e.g., social distancing, masks, vaccines, and therapeutics) are better known.

COVID-19 Daily New Cases
5 Day Moving Average



Source: FactSet, as of 11/30/2021

The new variant is on everyone's radar now that it has been labeled a "variant of concern" by the World Health Organization (WHO). However, we cannot emphasize enough that its transmissibility, severity, and its evasiveness against our current toolbox of vaccines and therapeutics remains uncertain at this time. Even the medical experts—from the CDC to Moderna to Pfizer to Oxford—have varying opinions. The best case scenario is that the variant does not become mainstream (best outcome) or that symptoms are mild and existing vaccines provide protection against the most severe outcomes such as hospitalization and death (most likely outcome). The worst case is that the efficacy of vaccines significantly decreases and hospitalizations and deaths spike. However, even this scenario, while tragic, has a path to improvement as new vaccines would likely be introduced at an expedited pace. We will continue to monitor its progress and would avoid making knee-jerk reactions to portfolio allocations based on these headlines as there is not yet enough evidence to provide clarity.

Fed Policy: Taper Tantrum

In testimony today in front of the Senate Banking Committee, Fed Chair Powell acknowledged the possibility of the Fed discussing an accelerated pace of reducing its bond purchases (currently at a $15 billion/month rate and expected to end by June) at the December FOMC meeting. As we have stated since midyear, the bond buying by the Fed—quantitative easing (QE)—should have already been tapered in a swifter fashion. Why? Because all of the goals of QE—increasing confidence, narrowing credit spreads, raising asset prices, and reducing market volatility—were successfully achieved months ago. In addition, with the government issuing less debt, the need for the Fed to buy Treasury securities to keep interest rates low is no longer necessary. Thus, it is prudent for the Fed to put this tool back in the toolbox and save it for the next 'emergency'. So we remain comfortable with the Fed tapering its purchases and an acceleration in the pace is consistent with our view.

However, if the acceleration in the completion of its bond buying is a prelude to a much more rapid rise in the lifting of the fed funds rate, that is a different story. But we think that view is unfounded. Our view remains that the Fed will be patient and pragmatic in raising interest rates. Could the Fed raise interest rates earlier than the end of 2022/early 2023? Yes, but that would be because economic growth—powered by the consumer—is increasing growth faster than our 3.5% GDP forecast for 2022. Faster growth is a good thing for earnings and equities and would not cause us to waver on our optimistic outlook over the next twelve months.

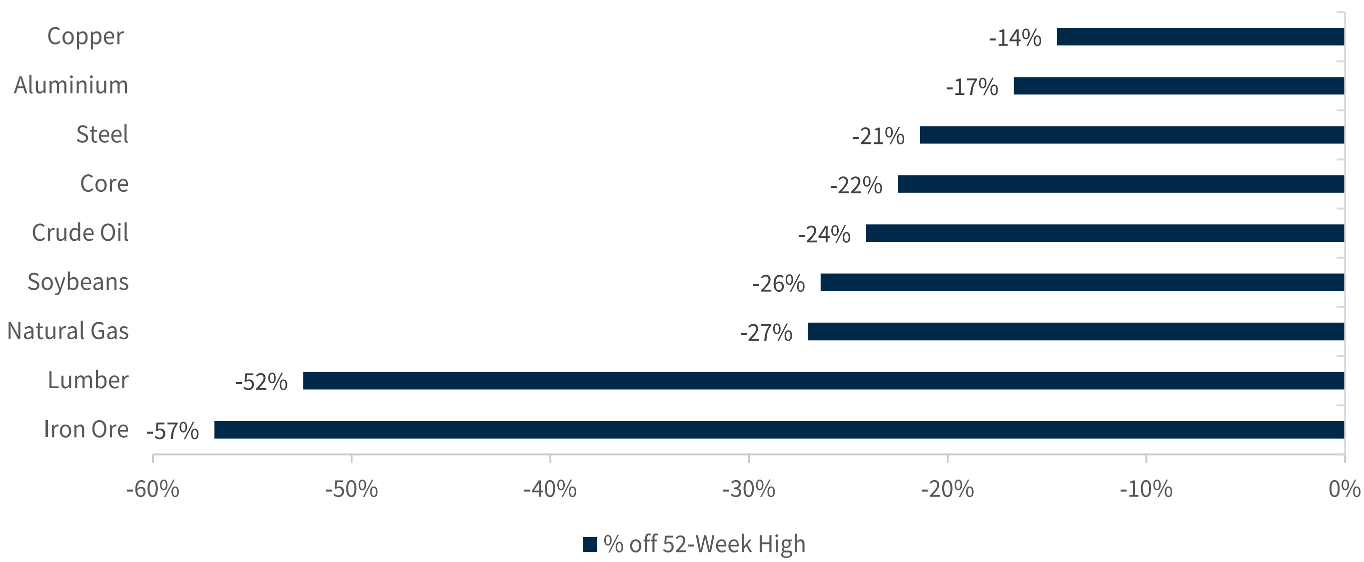
Inflation remains a wildcard that could arguably cause the Fed to raise rates more aggressively. But again, our research and data suggest that we are in the process of seeing inflationary pressures peak (over the next few months) and dissipate as we move further into 2022. In fact, we would not be surprised if the 'inflation story' turns into a 'disinflation story' by this time next year. Some of the factors that support this view include:

- **Supply Chains** – There are signs of easing supply chain constraints, evidenced by long-dwelling containers at the port of Los Angeles and Long Beach declining ~40%, car manufacturers signaling that the chip shortage is starting to normalize, and retailers such as Walmart and Target highlighting that their shelves are stocked for the holiday season. We expect investment in the supply chain to continue to alleviate bottlenecks going forward.

- **Crude Oil Price Relief** – After rising to the highest level (WTI: $84/bbl) in seven years, crude oil is down over 25%. This should provide relief at the gas pump, as the national average gas price is currently above $3.50/gallon.

- **Commodity Prices Falling** – The decline in commodity prices has not been solely contained to the oil market, as iron ore, lumber, natural gas, soybeans, corn, and steel have all declined more than 20% from recent highs.

Commodity Prices Decline



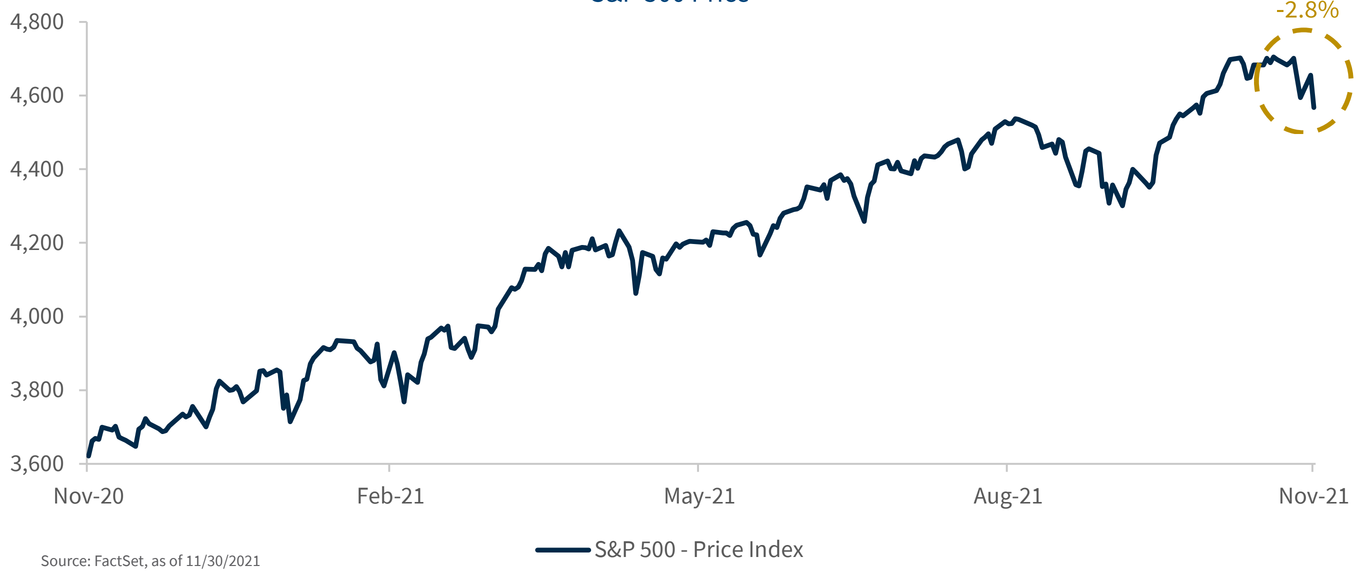
Source: FactSet, as of 11/30/2021

Bottom Line:

Market volatility has increased because market participants had become complacent with risks surrounding COVID and the Fed. The volatility we are experiencing is not unusual as markets tend to experience at least three pullbacks of 5% or more annually and if we get to 5% this time (currently only ~3% from record high), it would be the second pullback of this magnitude this year. The timing is a bit surprising as seasonally, year end is typically the strongest part of the year for the equity market, but seasonality is not the best long-term indicator of performance.

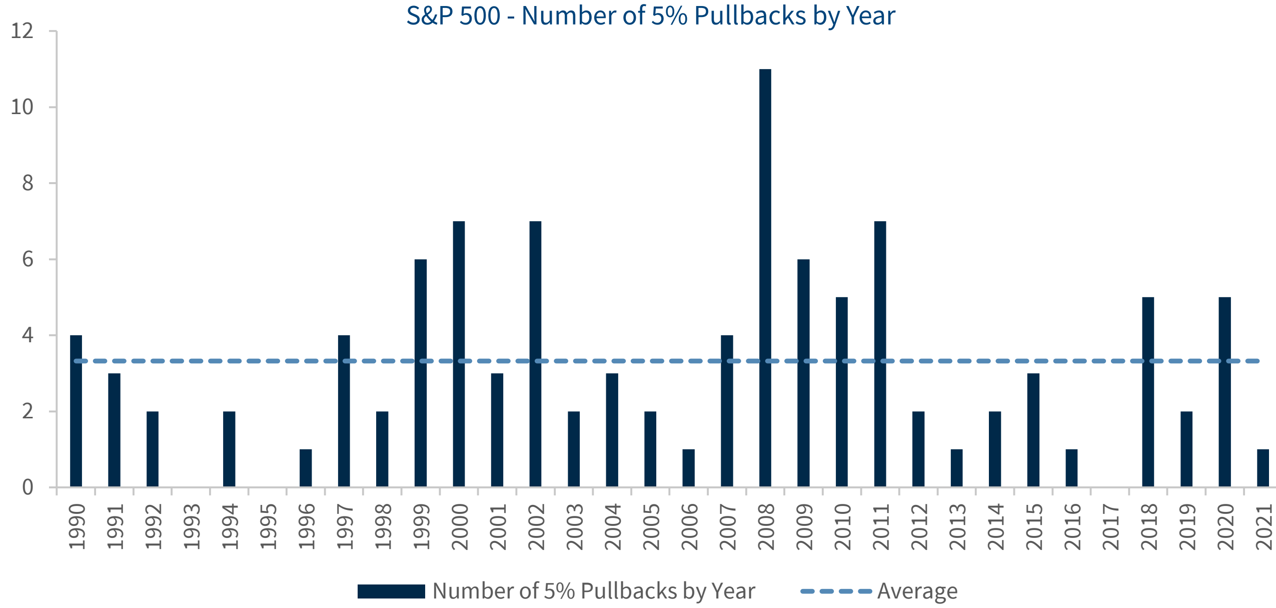
Overall, given our robust view on the economy and earnings, we remain confident that equity prices will recover and move higher in 2022, albeit at a slower pace relative to 2020 and 2021. As a result, we view pullbacks as opportunities to invest in our favored equity sectors. However, valuations at current levels do not leave much of a buffer to absorb the realization of potential longer lasting risks from things like COVID. We will continue to provide timely updates as warranted.

S&P 500 Price



Source: FactSet, as of 11/30/2021

S&P 500 - Number of 5% Pullbacks by Year



Source: FactSet, as of 11/30/2021

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