Nolte Notes

By Paul Nolte, CFA

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“Well, here’s another nice mess you’ve gotten (us) into.” In describing the current economic conditions, Fed Chair Powell admitted what everyone has known for some time, inflation is not transitory and may require a bit more aggressive Fed policy. From a quicker tapering of the bond purchases to maybe raising rates quicker in 2022, the markets are reacting negatively to the thought that the very easy monetary policy that has been in place for the past 20+ months is coming to an end. The employment report on Friday was the exclamation point on the strong economic data. While the total number of “jobs created” came in at half of what was expected, the employment rate dropped to the lowest levels since the start of the pandemic. Wage growth remains well above 5% annually. The coming week we’ll get a read on consumer prices as well as how many folks are quitting jobs. With the money that has been pushed out by the government over the past two years, many, especially older workers, have decided to leave the workforce entirely. It is a Covid effect on the job market that is likely to have an impact for many years to come.

The change in tone from Chair Powell coincides with the economic data coming in “hotter” than expected and a huge boost to GDP estimates. Based upon the Atlanta GDP model, estimates are for over 8% economic growth in the fourth quarter. Much of the supply chain problems can be attributed not to the lack of workers (yes that is part of the issue) but the huge jump in demand for goods. Looking at retail sales, historic growth has generally moved between 3-7% growth vs. year ago levels. Even coming out the recession in ’08, retail sales briefly touched 10% annual growth. Today that growth has been over 10% nearly the entire year with the most recent reading at almost 15%. With demand so far above historic trends, even accounting for the economic shutdown of a year ago, it is little wonder that prices are rising. This will be the Fed’s biggest challenge over the coming year or two; how to cool the economy without pushing it into another recession.

The number of stocks making new yearly lows has expanded to a level last seen during the depths of last March’s decline. Volume has increased with the market decline. On the NYSE, three consecutive days of declining volume exceeding advancing volume by at least three times has usually marked at least a short-term bottom in prices as investors bail on the market. Some of the measures of momentum and selling pressure are at levels usually seen around market bounces as well. So, just maybe the Santa rally is still in place. Worries about the Covid variant is also having some impact on stocks as investors fear reinstatement of some forms of economic restrictions. Hopefully lessons have been learned over the past year as we deal with the residual impacts from the virus and shutdowns.

The bond market is signaling a slowing of economic activity in 2022. Whether that is driven by the Fed or just the ending of various government support programs, the market move is unmistakable. So too is the change in difference between junk yields and government bonds. The change in the bond market is worth watching over the coming weeks to confirm the signal and by extension, a deeper reaction from the stock market.

The recent decline in stocks has impacted the growth part of the market more than value. Having been the darlings since last March’s bottom, growth stocks have been all the rage. The valuation differences between growth and value in the largest stocks hasn’t been seen since the late ‘90s. During the years following the market top in 2000, value, small and international stocks all did well in both absolute terms as well as relative to the broad market averages. Whether the coming years will be a 20+ year reprise of the tech wreck we’ll only see in a few years. But investors should do well to focus on the neglected parts of the market that still have solid fundamentals and underappreciated growth prospects.

The harsh decline in growth stocks over the past few weeks that has bled into the broader market may be setting up for the highly anticipated Santa Claus rally. If coal gets delivered, 2022 could be a tough year.