CONWAY• JARVIS LLC
Investment Outlook

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Update

The Market Responds to the Shift in Monetary Policy

These first two weeks of the year in the stock market have, so far, gone according to script as the Fed begins to remove the punch bowl. We're seeing a slight bump in volatility as market participants shift their focus, and capital, from high-priced, large-cap Growth (mostly Tech) issues to the opportunistically-priced Cyclicals that typically perform well in a late-cycle expansion. Diversified *investors* with a long-term view need only make minor adjustments to portfolios while *traders,* lacking both diversification and patience in the short-term, are making significant shifts in their holdings. This is a rational response to what is anticipated to be a period of less accommodative monetary policy and tighter credit.

In past cycles where tightening begins, stocks with elevated P/E multiples generally under-perform their lower P/E counterparts due to the negative effect of higher interest rates on a dollar of earnings. Lower earnings usually result in a lower stock price. Typically, the greater the P/E, the greater the multiple shrinkage. This explains the divergence of index performance in the first weeks of '22. The NASDAQ, laden with lofty P/E mega-caps, has under-performed both the DOW and the S&P 500 by a significant margin.

Concurrently, the traditional *cap-weighted* S&P 500 has under-performed its *unweighted* equivalent as last year's mega-cap market leaders fade from prominence. This is evidence of what we think is a *temporary* recalibration of price to earnings growth for some great companies whose stock prices exceeded rational valuation measures. As investors with a long-term investment horizon, we can hold and wait for earnings to catch up to reclaim today's prices or higher. Traders don't have that luxury.

Year-to-date, the major indexes are down slightly with the NASDAQ leading the decline at -6.34%, followed by the S&P 500 down -3.22% and the DOW at -2.8%. While maintaining our typically cautious optimism for 2022, we see a less robust investing landscape ahead if inflation persists and as liquidity is drawn down by the Fed. We're among those investment professionals looking for stocks to post mid-to-high single digit returns for the year. While there has been a decided shift as to *which* stocks to own in the market, there is no evidence of investors, or traders, heading for the exit or another asset class. Stay tuned.

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