TD Capital 2022 Outlook
January 24, 2022

After a strong year in the stock market, in which the S&P 500 returned in excess of 28%[1], our focus has now shifted to 2022 and the opportunities and obstacles that lie ahead. The market's outperformance of expectations in 2021 has most economists and analysts calling for lower returns going forward, and issues such as COVID, economic recovery, inflation, and elections weigh on investors' minds. These are all issues that we are watching as we make decisions about how to position our clients' portfolios.

The roll out of vaccines at the beginning of 2021, combined with pent up consumer demand and excess cash as the result of government stimulus provided a windfall for corporations last year. Heading into 2022, we see that consumer demand remains elevated, but issues within the supply chain have contributed to inflation levels that we have not seen in over 40 years. As supply chain issues are worked out over the course of the coming year, we anticipate that inflation will begin to subside, although we do not expect a return to pre-pandemic levels in the near future.

Employment remains another factor contributing to the current inflationary environment. As COVID-related stimulus made its way to recipients, employees have had the ability to search for new career paths and higher-paying jobs, resulting in upward pressure on wages for many employers. As the impact from government stimulus payments winds down in 2022, employment is expected to rise. This, coupled with strengthening supply chains, should lead to a continued increase in inventories and some additional downward pressure on inflation.

Further, we do not anticipate significant increases in government spending in 2022, as legislators tend to be hesitant to vote on significant tax increases in election years. While a scaled back version of the Build Back Better plan could still be on the table, it is unlikely that we will see anything close to the level of spending in the original plan.

We are also watching the Fed closely in 2022 as it both winds down quantitative easing measures it took in response to the pandemic and weighs increasing interest rates. Quantitative easing, or the purchasing of bonds (primarily Treasuries and mortgage-backed securities) by the Fed, is designed to both inject liquidity in the economy and drive long-term interest rates lower. The Fed is currently scheduled to end the purchasing of these bonds in March and has been gradually decreasing the level of purchases each month. It has yet to signal whether it will keep its balance sheet steady for some time before beginning to offload some of these bonds. The Fed has also signaled that it could raise short-term interest rates as many as three times over the course of 2022, an action that would negatively affect bond pricing and further put downward pressure on inflation.

While we at TD Capital believe that both the employment environment and supply chains look to improve in 2022, we recognize that inflation will likely remain elevated, albeit not at its current levels. We also recognize that recent market outperformance suggests muted returns over the next few years, although we still believe that remaining invested in equities is the favorable strategy for hedging against inflation. We invite those of you who are interested to view the Research/Insights section of our website to see the economic and market trends that we track on a regular basis. Our Market Snapshot, updated at least twice annually (and more frequently when called for by market conditions), looks at various indicators related to valuations, technicals, and the economy to help steer our thoughts around portfolio construction, and the Fixed Income Landscape plots the yield and duration of the various fixed income categories throughout the year.

We look forward to serving you in 2022 and beyond.

Your TD Capital Team

Sources:
1. S&P 500 Total Return USD Index, Vanguard Portfolio Analytics, https://advisors.vanguard.com/advisors-home

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