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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **December 9, 2021**

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Last Week's S&P 500 Index: -1.2%

2022 portfolio ideas

Key takeaways

- Some of the ideas we think are key for portfolios in 2022 include our preference for U.S. assets, investments that can perform well in a higher-inflation environment and being careful when it comes to yield-sensitive financial instruments.
- We believe incorporating these ideas into portfolios will serve investors well in 2022.

We just published our *2022 Outlook* titled "Which Way to the Recovery?" report focusing on the asset classes and sub-sectors of those asset classes that we find favorable given our forward view of the economy. We thought it would be a good idea to reinforce a few of the portfolio ideas we highlight in that report. These are broader themes that are reflected in the portfolio allocations we have chosen based on an investor's risk and return objectives. More risk-averse investors tend to choose portfolios with more U.S. large-cap equity and U.S. bond exposure than more aggressive investors, who typically are willing to put more funds into international stocks and bonds as well as smaller-cap (higher-risk) domestic equities.

Near the top of the ideas list for next year is our recommendation to favor U.S. financial assets over international ones. The reasons? In our opinion, global growth in 2022 will likely be less synchronized than we might have anticipated at this point in the recovery. Economic growth here at home is likely more dependable and stronger than many international regions. As a result, U.S. corporate earnings should post robust growth and lead to attractive equity returns relative to their international counterparts. We currently rate U.S. large-cap equities as most favorable and developed international equities as most unfavorable. We also favor U.S. mid-cap equities, which also tend to do well under a higher-than-trend inflation scenario.

Another idea that we believe is important in the current environment is focusing on asset classes and sectors that can perform well when inflation is higher than average. While we believe inflation will decelerate next year relative to this year, we think cost pressures will remain well above prepandemic levels and higher than the longer-term average. Commodities can help add returns to portfolios as broad exposure to this asset class tends to do well when inflation is high. Input costs higher than their pre-COVID levels and should continue to benefit as the world re-opens and recovers. Cyclical sectors such as Industrials and Financials should also benefit from economic improvement and somewhat higher inflation and interest rates.

And finally, we want to remain cautious on yield-sensitive assets such as bonds. We have long favored stocks over bonds. We look for interest rates to drift higher over the coming year, which tends to create headwinds for fixed-income returns. We carry an unfavorable rating on the yield-sensitive Utilities sector. We favor the Financials sector as it offers above-average yields and typically benefits from rising rates and an improved economy. We also favor high-yielding midstream energy companies and floating-rate bank loans for investors seeking income.

Keep these ideas in mind when constructing an investment portfolio or reviewing an existing portfolio. We think they will serve you well in the coming year.

Risks Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Floating rate loans are generally considered to have speculative characteristics that involve default risk of principal and interest, collateral impairment, borrower industry concentration, and limited liquidity.

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