Email Body 1-31-2022

**Will the Federal Reserve Derail the Restart?**

Well, the holiday season has passed, and we are moving forward full throttle into the new year. There is reason to be both optimistic and concerned on the economic front while the medical picture looks to be improving. We will visit both areas below, however, keep in mind that my first rule of investing is know what you are trying to achieve and the timeframe you have available. The more time you have to invest, the more risk you can afford to take and vice versa. Hopefully, you have made some New Year’s resolutions and you are making progress on them. Sheri, my wife, and I made a commitment to walk, run or dance 2022 miles this year to help us stay as fit as we can. So far, we are at 176 miles through yesterday. If you get a chance, let me know what you are doing this year to keep a New Year’s resolution.

COVID-19 UPDATE

The Omicron variant as I am sure you have already heard is clearly the most transmissible and most likely the least deadly of the Covid-19 viruses. Cases in California skyrocketed beginning the third week of December topping out at over 143,000 in one day on January 10, 2022. The good news is that case levels are falling rapidly as we speak. Even better is that hospitalizations are about a third of prior spikes and deaths are about 10% as measured by case fatality rates. What is interesting is that San Diego County began tracking statistics by vaccination status at the beginning of October 2021. Since then, about 52% of cases, 44% of hospitalizations and 24% of deaths with Covid-19 were attributed to those deemed fully vaccinated. San Diego County is a microcosm of California. So, I presume, were California to release similar data, we would see similar percentages statewide. Of course, covid-19 may not be the primary cause of hospitalization or death, but this does seem to indicate that the virus is becoming endemic and that we need to start thinking about how we are going to live with it. The good news is we no longer need worry about severe restrictions from our government entities on our ability to have a functioning economy. Most, including the CDC, acknowledge they had no efficacy in combatting virus spread.

ECONOMIC NEWS

I believe we are transitioning to a new era of higher interest rates and higher inflation from a period of low interest rates and low inflation. This transition creates uncertainty and volatility which is clearly evident in the financial markets this past month. The recent drawdown in the stock market is modest compared to previous years but is consistent with the uncertainty generated by a tightening Federal Reserve, higher inflation numbers and increased geopolitical risks. The financial markets have effectively front-loaded pricing of about six rate hikes by the Federal Reserve over the next two years. The question markets have is, will the Federal Reserve go further than what interest rate increases have been priced in to quell inflation. Only time will tell.

My current view is that equities are poised for modest gains and bonds are likely to experience flat to modest losses. Given valuation metrics, sales and earnings growth will be the primary drivers and outperformance should come from companies with pricing power to overcome inflation pressures. About one-third of the S&P 500 companies have reported fourth quarter earnings with an average growth rate of 24%, which is out of this world. However, forward looking guidance has been muted due to the effects of inflation on cost structures and the looming Federal Reserve liftoff of interest rates in March.

The U.S. economy ended 2021 with a strong showing of 5.75% growth in GDP. Consumer confidence and demand remains strong, business credit is flowing, and capital spending is beginning to rise. Accordingly, a recession in the next twelve months remains unlikely and investment funds with a long-term time horizon (i.e. 4-5 years) should be in a risk-on position. Risks to this outlook reside primarily with the Federal Reserve. Should it interpret inflation as being more persistent and a more significant long-term danger, interest rates may be increased further than expected to decrease overall demand. Other shorter-term geopolitical shocks (i.e. Russia and China) may increase volatility, but these tend to be shorter-term anomalies.

As always, I recommend you take stock of your financial situation and make sure that funds you plan to expend in the next three to four years are invested in a more conservative posture than your long-term oriented investment assets. Doing so will enable you to ride through the inevitable volatility caused by short-term shocks and unexpected pitfalls that characterize daily life. I have attached to this email an analysis by Brad McMillan, Commonwealth Financial Network’s Chief Investment Officer of last week’s announcement by the Federal Reserve. It provides some useful insights into market thinking and reactions.

I am always available to you via phone, zoom conference or in person. I look forward to talking with you over the next few weeks. If you have any questions or if we can be of any help, please do not hesitate to contact Linda or me.

As always, stay safe and healthy!

*Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

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