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Market Update: November 2021

Global equity markets declined in November, with domestic and foreign stocks down 1.5% and 4.5%, respectively. For the first eleven months of the year, global stocks have returned about 14% ... with U.S. stocks alone providing returns in excess of 20% year-to-date.

The month ended with rising concerns over Federal Reserve Chairman Jerome Powell's comments about a quicker "tapering" of the central bank's bond buying program, as well as the impact of the latest Covid-19 variant, Omicron. It could very well be weeks before we know the actual severity of this latest variant.

The markets have already priced in a strong recovery, so this element of uncertainty is negative. But it is unlikely to be a repeat of the beginning of the pandemic.

Alvin Tan, RBC Capital Markets – WSJ 11/28/21

During a recent Senate hearing, Chairman Powell suggested that the Fed might accelerate the reduction of its asset-purchase stimulus program, which increases the potential for interest rate hikes sometime during the first half of 2022. Remember, the Fed intends to completely end its asset purchase program before it begins to lift interest rates from their near-zero levels.

The risk of inflation has increased.

Jerome Powell, Federal Reserve Chairman – WSJ 11/30/21

The Organization for Economic Cooperation and Development (OECD) just released the last of four reports on the economic outlook. The Paris-based research firm now expects consumer-price inflation in the U.S. to average 4.4% in 2022, up from its 3.1% forecast released in September.

The OECD cited imbalances in the demand for and the supply of energy and semiconductors, as well as workers. There is also a growing fear that households and businesses will come to expect that higher inflation will persist ... which could ignite a vicious cycle of higher price increases and wage settlements.

There's a lot of questions and markets don't like uncertainty.

Larry Milstein, R.W. Pressprich & Co. – WSJ 11/28/21

Consumer prices in the Eurozone increased by 4.9% in November, the fastest annual rise since records began in 1997.

The Eurozone economy is expected to slow over coming months as some governments impose fresh lockdowns to curb rising Covid-19 infection rates, a slowdown that the spread of the new Omicron variant is likely to deepen and prolong.

Paul Hannon – WSJ 11/30/21

The number of people filing new claims for unemployment benefits remains at pandemic lows. The declining level of jobless claims reflects a tight labor market, where employers are trying to hire and retain workers who are quitting jobs at record rates. Still, total U.S. employment remains about three percent lower than prepandemic levels ... or approximately four million fewer workers.

The Fed has two mandates, to promote maximum employment and price stability, but now it's a little tricky. What if the two goals conflict or pull in different directions?

Priya Misra, TD Securities – WSJ 11/30/21

The Labor Department just reported (December 3) that the U.S. economy added 210,000 jobs in November. The number is well below expectations and significantly less than the 555,000 monthly average so far this year. However, a separate survey of households released the same day showed

that 1.1 million more people were employed in November than in October.

While these two surveys have conflicted in the past, these differences are difficult to reconcile. Some are attributing the inconsistencies to “seasonal adjustments”, as well as reduced response rates from employers during the pandemic. Taken together, however, the end result may just be a loosening labor market, with higher participation and declining rates of unemployment.

This suggests that some combination of improving employment opportunities, waning Covid-19 worries and lower levels of government support drew people into the labor force last month. That is a hopeful sign that the job market is starting to loosen – or at least that it was, before the Omicron variant struck.

Justin Lahart – WSJ 12/4/21

Coordinated monetary and fiscal stimulus enabled the economy to bounce back quickly from the pandemic. But while the response sustained or even increased income levels, it could not make up for the supply that those income levels would have produced.

The federal government put \$6 trillion directly in the hands of consumers, much of it regardless of need. State and local governments also restricted many retail and service businesses, like restaurants and hotels, theme parks, travel, and other “experience”-related industries. So, consumers, unable to spend on services, demanded more goods – roughly 15% more than our logistical infrastructure had ever produced and delivered ... Throw in supply chain problems and you get inflation in goods.

John Mauldin, Thoughts from the Frontline – 11/20/21

Supply-chain bottlenecks are showing some signs of relief. Energy shortages and Covid-related factory closures are easing in Asia, while major U.S. retailers say they have imported most of their holiday needs. Ocean freight rates are also off record levels.

A survey by Oxford Economics, including “country experts” covering 45 economies, found that almost all believe supply-chain disruptions have peaked or will peak by the end of this year.

Globally speaking, the worst is behind us in terms of the supply-chain problems.

Louis Kuijs, Oxford Economics – WSJ 11/21/21

Manufacturing activity picked up in China, with the purchasing managers index moving from contraction to expansion levels. Still, new orders remain soft, and the service sector continues to decelerate.

All of this adds up to a weak recovery at best (for China) in early 2022 – if exports hold up and further significant policy support for the economy is forthcoming.

Nathaniel Taplin – WSJ 11/30/21

The major drag on China’s economy continues to be the real estate sector. While housing sales have stabilized, they have settled in at lower levels. Commercial housing space sold is down about 20% from the previous year and shows no signs of rebounding.

China’s property boom saw many developers borrow heavily to fund rapid growth. There are thousands of Chinese developers, with many going public. According to S&P Global Market Intelligence, there are more than 100 companies with a combined market value of \$242 billion trading on Hong Kong’s stock exchange.

With credit now scarce and sales on the decline, international investors have been recording considerable losses. While Evergrande Group has

been the posterchild for this financial excess, at least four other developers have defaulted on their dollar bonds in the past few months.

From a standing start in the late 1990s, the rapid growth of China's private housing market created many ambitious, founder-led companies that sucked in capital and vacuumed up land, betting that home and land prices would keep rising.

Industrywide annual revenue jumped to the equivalent of about \$1.9 trillion, government statistics show, or about 26 times what it was in 2000.

Quentin Webb – WSJ 11/28/21



So, where are interest rates ultimately heading? Some economists suggest there are basically two ways this could play out and either way, the outcome could mean trouble for investors.

The first scenario suggests that the groundwork already exists for a wage-price spiral which will require aggressive tightening by the Fed.

They (the Fed) have created a mess they need to clean up.

Ed Yardeni, Yardeni Research – Barron's 11/28/21

Under the second scenario, the Fed does not aggressively tighten, forcing businesses, consumers, and investors to adjust to a *new normal* of higher core inflation.

Low interest rates are effectively supporting today's high asset values ... in both stocks and real estate. Some economists believe our economy has become too sensitive to high asset valuations ... arguing that rising rates could puncture asset bubbles and create deflationary pressures.

The inflationistas who have been calling for inflation over the past decade are like dogs with a bone, and they just won't let go. The risk runs the other way ... If we get mean-reversion in equities and housing, which are where they are because of interest rates, you're going to have some humdinger of an asset deflation.

David Rosenberg, Rosenberg Research – Barron's 11/28/21

The economy is closing out the year from a position of strength, as long as Covid-19 remains in check. Looking into 2022, we expect to see relief from supply-chain disruptions and some easing of inflationary pressures, as businesses staff-up and rebuild inventories.

With asset values at historically high levels, investors will have to lower their return expectations and anticipate ongoing volatility. Unless you are in possession of a crystal ball, remain humble. Diversification and discipline will continue to be the foundations for your success.

I don't think we're that smart, I don't think we are that diligent.

Charlie Munger, Associate of Warren Buffett – Barron's 12/3/21

The holiday season is a time to count your blessings. I know I am extremely fortunate to have a wonderful family, close friends, and the opportunity to live and work in a community that I love so much.

I can't thank you enough for your ongoing support, and I hope you all have a Happy, Healthy, and Safe Holiday Season.

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