Reilly Financial Advisors

THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – DECEMBER 2021

U.S. Markets and Economy

he Bulls got Christmas, with the S&P 500 Index up over 4% for the month. The Bulls also got the year: by December 31st, the S&P 500 Index had risen 27% in 2021, with the NASDAQ up 21%, and the Dow Jones Industrial Average up 19%. The S&P 500 Index has now risen 113% since its bear-market low set in March 2020. This stupendous rise took place against a background of wave after wave of the coronavirus washing over the U.S. and the world. While Omicron, the latest (but not necessarily the last) of these Greek lettered variants, has pushed daily case counts in December to new records around the world, the US economy has continued to march forward on the strength of consumer demand (fueled by both trillions in accumulated savings built up during the pandemic and extremely low interest rates), increases in government spending (trillions for the American Rescue Plan and for infrastructure), and the gradual reopening of the economy and healing of the labor market. Corporate profits have been soaring.

Epidemiologists now expect the latest wave of the virus will peak in mid-January, amid increasing evidence that Omicron is more transmissible but also much less severe than its close relative, Delta. Its impact on the economy should be smaller, too, since the virus has to contend with a partially vaccinated and boosted populace. Although Omicron has mutated in ways that allow it to slip past even the defenses of the fully vaccinated, it seems to have lost the ability to attack the lungs of its victims. With Omicron outcompeting all other variants, this could mean that humanity is one step closer to driving the pandemic down to the endemic level, as with the seasonal flu.

The economy has continued its recovery in the fourth quarter just ended. Economists at the non-partisan Conference Board estimate that real GDP grew at an annualized rate of 6.5% in the quarter, which has helped push the unemployment rate down to 4.2% in November (December's unemployment rate will be announced in early January). This dramatic fall from early 2020's levels of 15-20%, has been accompanied by steadily rising wages and large numbers of unfilled vacancies. For 2022, the Conference estimates that the economy will continue to expand, albeit at a slower pace than 2021. At the same time, however, the rate of inflation, no matter how it is measured, has increased to between 4 and 6%, which is the highest rate in decades. Many Americans thus see their wage gains eroded by inflation, which may account for some of the

Outlook

Economic growth and corporate profit growth should both moderate in 2022, as the Fed taps on the brakes and the economy approaches “full employment.” This constructive economic environment, with gradually falling inflation, should give the bull market support for a continued rally in 2022, although not at 2021’s breakneck pace. Short-term selloffs will certainly crop up as traders react to virus news, inflation news, and the approaching 2022 mid-term elections in the US.