Checking in on recent market volatility: Has the outlook changed?

Tylar Lunke:

Hello everyone, and welcome to a real time market update from RBC Wealth Management. We're recording this on Thursday, January 27, 2022. My name is Tylar Lunke and I lead the Managed Portfolio Strategies team. And I'm joined today by Janet Engels, head of the Portfolio Advisory Group. I want to say thank you to everybody for joining us today. And our goal is really to provide some perspective on the recent market activity, including what's gone on the last couple weeks. Is there an impact to our outlook? And then we'll close around portfolio positioning. So Janet, welcome. And let's just get right into it. With the S&P off roughly 10% since the start of the year and much of that within the last week plus or so, it feels quite different than it did at the end of 2021. So simply what's going on?

Janet Engels:

Yes, it certainly has been a very different start to the year than the way we ended the year. Just a point of reference, if you think back to 2021, we had the longest post trough rally since the 1960s, with the S&P 500 up over 110% since those March lows of 2020 with relatively low volatility. So as we come into this year, we can't point to a single factor that has come into play, but there have been a number of different factors. And I think we all know the market does not like uncertainty. So let's look at a couple of those factors. First of all, there's been ongoing inflation pressures. I think we all feel that, and there have been signals from global central banks, including our own Federal Reserve, that policy, monetary policy could be tightened more aggressively than previously expected by the markets.

Janet Engels:

I think the second factor is bond yields, and we often look at the 10-year Treasury in the United States. Bond yields have moved higher quite quickly. We're now just under 1.8%, but that's a pretty significant move since the beginning of the year. The other is we're in the early stages of the reporting season. So keep in mind, we're still just a few weeks into the reporting season, but this early season has shown a couple of mixed results from companies. Really not necessarily the numbers being mixed, but the comments that we're getting from companies is they are citing inflation as a challenge. So not only wage pressure, but the issues with margins overall.

Janet Engels:

So we'll be watching that very, very closely as we move throughout this fourth-quarter reporting season. There have also been indications, I think we've all read that omicron has had a bigger impact on economic activity, temporarily constraining economic activity, but more importantly, we've been looking for the opportunity for supply chains to open up and more normal labor activity. And with the spread of omicron, that has been put on the back seat a little bit. We'll add in one other factor, you sprinkle a little geopolitical concern, and all of those factors have contributed to this pullback in the market and higher volatility.

Tylar Lunke:

So certainly a number of factors to consider, and that really frames up and provides a bit of context. So why don't we think back a couple weeks ago, we had the opportunity to do an audio recording around the 2022 Outlook. And given the recent market activity, has our view changed at this point?

Janet Engels:

No, our view has not changed. If you recall, during that audio clip, we really tried to categorize 2022 as a year of shifting gears. That's the term I like to use. And what does that really mean? What we said is that economic growth would go from great because we were in the midst of that recovery and now into expansion in the U.S. Economy, and economic growth would moderate or become good and probably a bit bumpy in terms of activity.

Janet Engels:

Second, we said that inflation should moderate towards the latter part of the year, as we start to get those supply chains opening up and we're against difficult, more easy comparisons, but we also said that inflation would likely stay uncomfortably high even as it moderates. We said that earnings would also moderate. Again, that's sort of like with the economy. We grew earnings rapidly, or corporations grew earnings rapidly in 2021 and that would moderate this year.

Janet Engels:

We expected that central bank policy was going to shift again into a new rate cycle. Why? Because the U.S. economy has recovered. And also because inflation is running a bit higher than is expected or warranted in the Fed's view. With any new cycle, there are always questions and uncertainty if the Fed is one, either behind the curve, or two, will they move more aggressively. And we have to remember that tightening is not a tight monetary policy. So as I look at the fundamentals that we laid out for 2022, we do not believe that anything has materially changed thus far.

Tylar Lunke:

Good. Thank you for walking through the summary. I love the analogy of shifting gears from great to good. And I know you like that as well. So we'll move on to one kind of final question here, and that's more the direct practical connection to portfolios. So does this view, and as you just laid out there, does it impact our positioning within portfolios and specifically our equity overweight?

Janet Engels:

No, it does not. We remain modestly overweight equities, and that's what we said just a few weeks ago. Our view is that this economic expansion is intact. And as such, if no recession gives stocks the benefit of the doubt. So as the economic expansion is still intact, there is a reason to have a constructive outlook for stocks. At this stage, all seven of our U.S. leading indicators of recession are giving readings consistent with an economic expansion having further to run, despite any of these concerned over inflation or central bank policy. We do expect though a more modest year of returns after an outsized year of returns in 2021. And we did anticipate that we would see some more volatility. We'll remind investors that pullbacks are the normal course of any market cycle. So again, for us, we're modestly overweight equities and believe that 2022 will be another year of positive returns.

Tylar Lunke:

Well, thanks, Janet. Yeah, just as you summarize no real changes to portfolio positioning or the outlook, and that's certainly reassuring given everything that's taken place recently. And so just to close things out here, I want to make sure that everybody knows that we published a real time market update in response to this volatility earlier in the week. It's linked from the communication for this recording~~.~~ Also, I want to give you a heads up, in the coming weeks, there will be additional articles published within the Global Insight Suite, addressing market volatility. So keep an eye out for those as well. And thank you again, for Janet and her perspective today. Thank you for your time. If you have any questions about your investments, we would encourage you to stay in touch with your RBC financial advisor. And as we said before, thank you all for the time. Take care and have a great day.

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