THE DANA VIEWPOINT

January 28, 2022
Dow: 34,725

Correction

That's something we haven't had to talk about in a while. The S&P 500 Index has been on a fairly relentless path upward since the beginning of the COVID-19 shutdown in March of 2020. Through all of the twists and turns of the battle against the virus, through shutdowns and partial reopenings, through the discovery and rollout of vaccines, the market has trudged higher. We have had slight pullbacks in the S&P 500 that have lasted days or weeks, but the market has always resolved higher. Most of the dips are not even worth noticing – declines of a few percent lasting a few days. Until this month, the largest decline for the S&P 500 was slightly over 5% in September and early October 2021. Following that decline, it took exactly twelve trading days for the S&P 500 to reach a new high. By the end of 2021, it is possible that all of the non-believers had been swayed and had now purchased equities. When everyone is 'in' the market, there is no dry powder left to provide support when the market dips.

We have had turns in relative favoritism between value and growth companies over the last year. Value outperformed in the first half of 2021, only to see growth companies make up the difference and end the year ahead. Higher valuation growth companies have borne the brunt of the current correction. The S&P 500 is down about 7% this month, but the NASDAQ and small cap indexes have fallen somewhere in the mid teens. Maybe this represents a long-anticipated change in leadership, but it is far too early to tell. When the market climbs steadily, regardless of events, investing appears easy. Anyone can be successful. Buy and hold, buy the dips, etc. Corrections have a tendency to alarm investors and cause them to think short-term which can lead to mistakes and costly long-term decisions.

Future actions by the Federal Reserve seem to be a key concern of investors. The Fed is still buying securities in the open market, pushing dollars into the economy. They suggest that they will stop by March, allowing maturities to run off and their balance sheet to shrink. There are numerous constraints on potential Fed action, on both the stock and bond sides of the ledger. Although this correction seems normal, if it were to snowball into something larger, that would get the Fed's attention and might cause them to walk back their rhetoric or postpone action. The Treasury market also must "allow" them to take action. The entire Treasury curve provides market feedback on expected Fed action. Ideally, the ten year Treasury yield creeps up methodically, and the two year Treasury increases as well. Normally, the Fed does not begin raising rates until the yield difference between two and ten year Treasuries is 1.5% or

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more. Right now, the difference in those two yields is less than 1%. The two-year yield is at 1.15%, which would seem to allow for a couple of Fed rate increases, but if the ten-year Treasury yield moves down from 1.8%, it doesn't leave much room before the yield curve becomes inverted. We believe they will begin raising rates in March as long as the stock market and ten-year yields do not fall further from here.

We continue to believe there is still room for further economic expansion in this cycle. Omicron cases may be peaking, and it has shown to be a more virulent but less deadly strain. Demand in the housing and auto sectors is still strong, which is typically a very positive sign for the economy as a whole. Consumer credit balances have been paid down significantly over the last two years, so there is room for an expansion in spending, even at levels consistently above income levels. Fourth quarter GDP was 6.9%, boosted by a recovery in inventories. Full-year GDP was 5.6%, and the trailing three-year average is 2.9%, a respectable growth rate that includes the COVID-19 trough. Fourth quarter wages grew at over a 5% annualized rate, which should help support consumer confidence and spending. We are also confident that the beginning signs of a market turn from growth to value will provide an expanded range of potential investment opportunities for our portfolios. On the fixed income side, our prudent strategies provided strong relative performance in 2021, and higher interest rates will provide opportunities to earn higher income in the future.

Random thought: "A market downturn doesn't bother us. For us and our long term investors, it is an opportunity to increase our ownership of great companies with great management at good prices. Only for short term investors and market timers is a correction not an opportunity." - Warren Buffet

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