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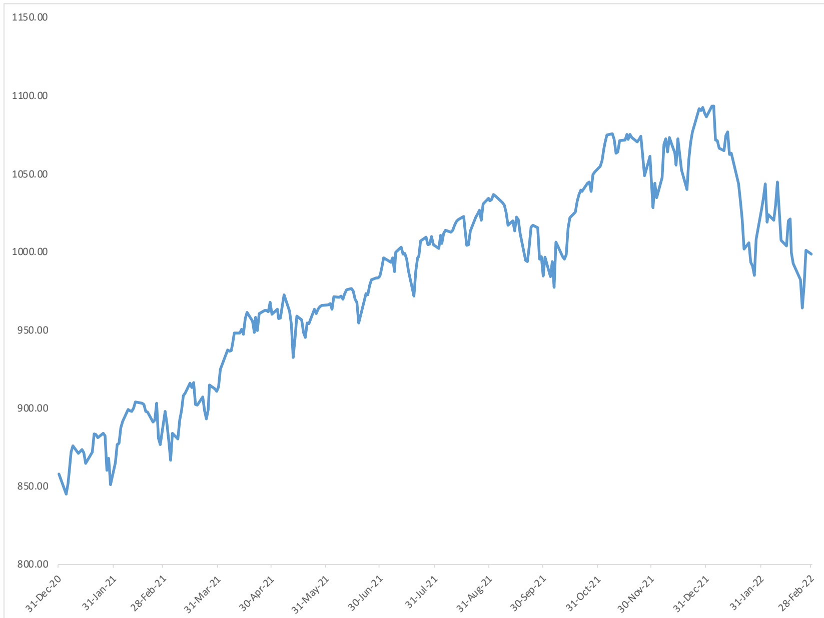
Equities

Through February 28, 2022, the S&P 1500 Index is down 7.86% for the year after falling 2.67% in February. The graph of that index from December 31, 2020, shows that the decline of 2022 simply gave back the gains of the fourth quarter 2021. The drop in 2022 is the result of a one, two punch of a jolt of inflation and the Russian invasion of Ukraine. The uncertainty over inflation involves guessing how much tightening the Federal Reserve (Fed) will do. The uncertainty over Ukraine centers around fallout from the sanctions placed on Russia.

S&P 1500 Index, 12/31/20 - 2/28/22



The data quoted represents past performance, which is no guarantee of future results.
Source: Bloomberg

As for the Fed and monetary policy, it can range from accommodative to neutral to tight. Accommodative, often referred to as easy, would be when the money supply (M1) is growing faster than average, such as the last twelve months when it grew 14.3%. Neutral would be when the money supply is growing at a rate close to its historic average of 6%. In times of tight monetary policy, the Fed slows the growth of the money supply to near zero or even negative. With the Consumer Price Index (CPI) gaining a startling 7.0% in 2021 many analysts and investors believe the Fed will have to move to the tight side, which would risk recession. We disagree and believe that simply moving to a neutral monetary stance will be adequate to get inflation in the modest, tolerable range.

The table below shows the forecasts from a Bloomberg News survey of economists and suggests they apparently agree with us that inflation will abate in a year. They are calling for the jolt to last two years and then a return to lower levels. If their forecasts are correct, the Fed will not need to go to tight monetary policy, as neutral will probably be adequate.

Survey of Economists

	2018	2019	2020	2021	2022	2023	2024
CPI (Y-O-Y)	1.9%	2.3%	1.4%	7.0%	5.1%	2.5%	2.2%

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We enter March with a market Value/Price (V/P) ratio of 1.10 and, based on earnings forecasts, the potential for value to grow over the next couple of years. The second table shows a Bloomberg News survey of analysts who forecast earnings. It begins with the pandemic shutdown, self-induced recession of 2020 and is followed by the huge surge in 2021, a product of monetary and fiscal stimulus. The analysts are calling for above average growth in 2022, then tapering the next two years closer to historic normal levels. These analysts can be wrong, and they can change their minds, but as of now, there is the potential for stock valuations, in general, to grow over the next couple of years.

Y-O-Y EPS Growth Rates

Year	Large 500	Mid 400	Small 600
2020	-19.3%	-20.1%	-39.4%
2021	58.4%	99.7%	228.6%
2022	15.0%	17.1%	20.0%
2023	10.0%	8.5%	13.1%
2023	9.6%	9.4%	8.4%

The data quoted represents past performance, which is no guarantee of future results. *Source: Bloomberg*

Bonds

The yield on the 10-year Treasury note has increased from a short term low of 1.35% in early December to around 1.80% to end January. While the yield has moved higher with the recent jolt of inflation, the yield remains many percentage points below the inflation rate of 2021. We can see the yield inching higher, but we do not fear a rapid spike. We are favoring short term maturities.

Summary

Many analysts who believe inflation will persist and/or get worse state that the Fed is too late, should have tightened sooner, and is "behind the curve," so to speak, regarding inflation. Those commentators seem to be grandstanding to us and we disagree. Our research finds that just a few situations on the supply side contributed to the recent inflation. The Fed does not have any monetary tightening tool that increases the supply of goods and services. We are focused on value and trying to filter out the headline-grabbing commentary regarding inflation.

For more in depth discussions on Inflation and the Federal Reserve, there are chapters in my book with the primary title "Unloved Bull Markets." It is to be released by Wiley February 15, 2022.

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