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FALL Economic Forecast

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BUSINESS TIMES | Investor Roundtable

Our panel of top professionals looks at the financial markets and talks about what the future of investing might hold.

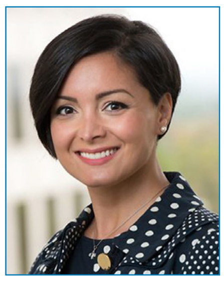
MEET THE PANEL

Harrison Croff
First Vice President, Wealth Management & Portfolio Manager
UBS

Tom Fisher
Senior Vice President & Chief Investment Officer
Montecito Bank & Trust

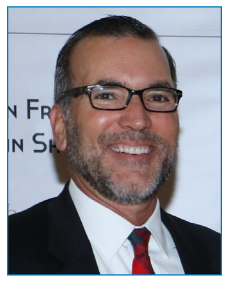
Scott Hansen
Senior Vice President & Regional Director
Wells Fargo Wealth Management

Falko Hörnicke
Senior Vice President & Senior Portfolio Manager
U.S. Bank Private Wealth Management



Ayla Kalani
Executive Director and Head of the Westlake Village Office
J.P. Morgan Private Bank

Todd Lowenstein
Managing Director and Chief Equity Strategist
Highmark Capital Management



Stephen MacIntosh
Investment Advisor and Director of Financial Planning
Argyle Capital Partners

The pandemic continued to lead the stock market on a winding path with ups and downs along the way as current events and advancements in COVID-19 treatment blazed through the country and the larger world. The Pacific Coast Business Times asked seven local experts on what next year might hold for the market and for its investors, touching on subjects like inflation, cryptocurrency and socially-minded investing.

By Henry Dubroff
Staff Writer

Question: With U.S. equity markets hitting record highs in the face of inflation, another possible COVID winter and Fed tapering, what's your outlook for the year ahead?

Croff: Strong equity markets and rising bond yields reflect the strong economic growth we have seen in 2021. One potential concerning aspect of the rapidly expanding economy is the higher level of inflation than we had grown accustomed to. Higher prices are being driven by an exceptional switch in spending from services to goods, which are much more prone to COVID-induced supply chain disruptions. With safe and effective vaccines, and more recently, therapeutics, we expect spending on services to normalize as COVID recedes. Lockdowns are increasingly unlikely going forward. This should help with supply chain issues. We expect the Federal Reserve to slow their asset purchases and eventually, begin to raise short-term interest rates. Investors will need to contend with several new challenges: higher taxation, negative real interest rates, and moderately higher inflation. Proper risk management and financial planning will be crucial going forward.

Fisher: The U.S. economy continues an impressive recovery from the sharp recession caused by the global pandemic. We expect the 2022 economic growth rate to be in the range of 4% to 4.5%, down from this year's expected growth of 5.5% or more. Supply chain issues, key shortages and tight labor markets are expected to continue into the first half of 2022. These factors have created sharp increases in inflation at both the producer and consumer level. We believe inflation pressures will continue to broaden, particularly into the services area. The market and the Fed's forecast both expect slightly higher short-term interest rates by the end of 2022. We favor bonds with shorter maturities and strong credit quality. For 2022, we expect stocks to outperform bonds as recession odds are low and interest rate increases are expected to be modest. We favor increasing allocations to Value, European and Asian stocks. After three years of double-digit gains, our expectations for stocks are for lower, single-digit returns next year.

Hansen: In our opinion, the stock market appears to be on track for a multi-year climb: We believe the balance of this year and next will sustain a powerful, ongoing macroeconomic and investment mosaic, featuring a weakening U.S. dollar, rising commodity prices, strong global equity returns, falling equity and bond volatility, low interest rates, and a robust fiscal stimulus push.

Given this evolving and dynamic environment we prefer stocks over bonds with emphasis on U.S. over international. A key theme driving our outlook is an economy running at a better than average rate this year and next. The process of inflation readings topping out will likely continue in coming months, but we forecast inflation decelerating next year — but still remaining above pre-pandemic levels. A key risk is inflation staying higher for longer than we anticipate, forcing the Fed to act sooner with the magnitude of greater potential of interest rate hikes.

Hörnicke: Despite strong stock market returns in 2021, we retain our "glass half-full" orientation for equity performance looking into 2022, though we anticipate returns to be more subdued yet volatile compared to those experienced thus far. All 11 of the S&P 500 sectors have generated positive returns this year demonstrating a broad market participation, which is typically indicative of a market that is poised to move still higher. Additionally, valuation remains in a territory that can be considered acceptable, i.e., elevated yet short of extremes. The S&P 500 index is trading at approximately 21 times its estimated 2021 earnings, which is above the long-term average but well below the dot-com era of the early 2000s and pre-pandemic extremes in 2019. The biggest potential impacts in 2022 remain inflation (transitory or not), Federal Reserve policy (bond repurchasing/interest rates), consumer confidence/sentiment, and business capital spending.

Kalani: We definitely see a path to a post-pandemic world, albeit a winding one. Vaccines are enabling the world to move towards living with COVID-19, which will continue to have localized, not broad, impacts on the global economy and markets. We are solidly in a "mid-cycle" environment, which we expect to last for years. A bulletproof U.S. consumer looks set to spend, productivity gains were likely made during the pandemic, and the Fed's new framework will help extend the cycle. Inflation has surged, but we think it will cool into next year. While not cheap, equities are attractive relative to bonds, and earnings growth can drive upside. We see opportunities in quality equities, real assets, dynamic active managers, and healthcare innovation. Bonds are at risk of a rise in interest rates. We believe investors should be wary of excess cash and should consider trimming high-yield and core fixed income.

Lowenstein: We are transitioning from a turbo-charged V-shaped recovery to a slower but solid growth path with decent runway. We expect 5% to 6% GDP growth in 2021 and 3% to 4% growth in 2022, which is above trend growth for the next couple of years. We are sanguine on the outlook and believe a self-reinforcing expansion is underway. Favorable tailwinds include peaking delta variant cases, resilient corporate earnings, and more fiscal policy stimulus. Significant headwinds delaying the recovery include peak cyclical activity fading, a China slowdown, inflation risks, and government policy change which could unhinge markets expecting easy credit conditions. Investment returns may be moderate going forward, so investors will need to be patient, selective, and discerning. Company fundamentals will be the dominate driver of returns, offset by multiple contractions due to normalization of interest rates. We favor the cyclical, economically sensitive areas of the market and the international markets which have lagged.

MacIntosh: In our view, the most likely outcome for 2022 is that the economy continues humming, even though the stock market may have gotten a bit ahead of itself. It seems reasonable to suggest that the economy might need to "catch up" to the market over the next year. While upside for the market may be tempered, due to so much economic growth and recovery already being priced in, it also doesn't feel like the ingredients for another major downturn are present. While it's true that investors are engaging in some speculative behavior, personal balance sheets are healthy, interest rates (and therefore debt servicing costs) are low, both employment and wages are ticking higher, and the Fed has indicated they will remain accommodative until we reach full employment. It's a good time to be a bull.

QUESTION: Is there enough weakness around Facebook or any other Big Tech stock to make you nervous? Does Big Tech continue to reign in the S&P 500?

Hansen: As demonstrated recently, media headlines often make for periods of short-term volatility in the Big Tech sector. Such volatility can naturally create nervousness, particularly with short-term and less sophisticated investors. However we believe that big names in tech are very well positioned with the cash, data and technology to adjust quickly to changes in their competitive environment. Additionally, there are calls for more oversight from lawmakers and regulators as Big Tech expands its influence. Such ligation and regulation is slow moving and does not pose a near-term threat to firms. Big Tech will continue to be a market leader near-term.

Question: Crypto is getting a lot of media attention. What is the proper place for cryptocurrency in the individual investment portfolio?

Lowenstein: The jury is out on whether or not crypto belongs in portfolio asset allocations. The underlying blockchain technology is powerful and will play a pivotal role as a payment system, for supply chain tracking and verifications, etc. As a currency, it competes against the government's ability to print and circulate money. When you compete against government, Big Brother usually wins. We've seen crackdowns at an increasing rate. Ultimately, we expect government and industry to embrace blockchain and cryptocurrencies. But barriers to entry for cryptocurrencies are low. The price of Bitcoin today reflects speculation and it remains unanchored to any intrinsic value.

Question: Funds that focus on Environmental, Sustainable and Governance (ESG) investing have been putting up impressive numbers. Is this now a viable path to better returns?

Kalani: Incorporating ESG criteria into investing is as much about doing well, as it is about doing good. ESG investing has created powerful portfolio opportunities for investors, and those opportunities are being created at the forefront of change. Individuals, corporations and policymakers are shifting the ways in which they make decisions, which is impacting overall public behavior. Consumers, on the other hand, are voting for these changes with their wallet. ESG is affecting the investment landscape where sustainability propels investment opportunities with return potential, and we expect the demand for sustainable funds to continue to increase.

Hörnicke: ESG has been one of the most significant trends to be embraced by the investment industry. Recent numbers have been impressive, and despite a limited history today, we have more data and better tools for analyzing that data. That has helped ESG go from a niche area only a few years ago to being mainstream today. Going forward, manager selection is key for identifying solutions expected to perform in-line/better than non-ESG strategies.

Croff: We see sustainable investing as a core component in any portfolio. Markets have not been fully pricing in good governance from an environmental or social aspect. More regulation will force companies who are behind the curve to catch up to their ESG friendly peers, causing headwinds. There is an advantage to considering these issues as both a risk factor and an opportunity set for investors going forward. Overall, we view sustainable investing as more than not owning "bad" companies. Rather, our clients are interested in using the wealth they have created to improve society and the world more broadly.

Fisher: ESG or Impact investing is popular with younger investors, women and many nonprofit investors. Initially, socially responsible investing was purely exclusionary, such as eliminated "sin stocks" from portfolios. Today companies are rated on a multitude of criteria including environmental and social factors but also diversity and inclusion, controversies (Facebook, China), carbon scores and many others. Top index providers such as BlackRock, Vanguard and State Street are becoming much more active in emphasizing ESG across their holdings. We believe this is a permanent shift and that ESG or Impact investments can perform similarly to market benchmarks. The caveat is not eliminating too much of the available investment universe. An ESG investor may prefer "clean energy" to traditional energy but does not eliminate the entire sector.

MacIntosh: When I started working on "Wall Street," I was sternly advised by the older, "wiser" CIO at the wire house where I worked at the time, "I wouldn't lead with ESG." I had a strong feeling he was wrong. This year, Morningstar reported that their ESG indexes outperformed during 2020 and, more importantly, over the past five years. They also reported their ESG indexes enhanced downside protection. The claim that performance will be sacrificed if one pursues a portfolio that is aligned with their values is increasingly being proven wrong.