Graves Light Lenhart
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Graves Light Lenhart November '21 Market Commentary

Post-Thanksgiving Indigestion

Market Overview:

To round out the month, any sigh of relief that the pandemic was turning the corner to becoming endemic was quickly postponed. Concerns about the Omicron strain coupled with less-than-transitory inflation and accelerated tapering by the Fed roiled markets during the last three days of the month. While the jury is still out on the potential severity of outcomes due to the Omicron variant, what we've learned from the Delta variant is that it's difficult to arrest the spread. What the *market* has learned throughout the pandemic, however, is that stringency measures (i.e., lockdowns) wreak the most economic damage, with individual countries having vastly different reaction functions. From an investor's perspective, the emergence of the Omicron strain has looked much like an "echo" of what was witnessed in July when the Delta variant's pervasiveness also triggered a selloff which was initially similar in magnitude, as rates declined and "stay-at-home" stocks outperformed those which would otherwise benefit from a sustained economic reopening. In the case of the Delta-induced selloff, both stock prices and bond yields headed higher over the rest of the summer through the end of November, as markets concluded that the available vaccines worked to combat this specific variant. In the coming weeks, investors should learn whether they're any match for Omicron.

On the economic front, the labor market showed signs of sustained improvement, as evidenced by the initial drop in initial unemployment claims to 199,000. This marked the first time that claims have been below 200,000 since November, 1969. We continue to highlight that while monthly labor data has been choppy, directional trends remain on the right track. The November release, in tandem with the Federal Reserve's preferred inflation measure (core PCD deflator) rising +4.1% year-on-year in October, has underpinned the Fed's heightened rhetoric to accelerate its tapering timeline. In light of elevated and more sustained inflationary pressures, the Fed may need to raise interest rates sooner than officials were initially expecting. This represents a stark change in tone as inflation readings point to price pressures being more persistent as opposed to short-lived. By extension, Chairman Jerome Powell told Congress in his first testimony since being re-nominated to run the Fed that it was time to retire the word "transitory". In many ways, transitoriness ultimately proved to be transitory, as the Fed commences the Great Unwind of its unprecedented monetary stimulus unleashed at the precipice of the pandemic.

Asset Performance:

The unsettling backdrop weighed on stock market indices around the world, with volatility spiking amidst thin post-holiday trading volumes. Domestically, the S&P 500 posted a total return of -0.7%, as performance within the market's subcomponents was highly varying and once again, spurred by COVID-19 developments. To this effect, The S&P 500 Top 50 – representing the largest constituents by market capitalization – eked out positive returns during the month while the S&P SmallCap 600 declined by -2.3%. There was a noteworthy divergence observed during the latter portion of the month. As underlying segments of the domestic market continue to uncouple, valuation gaps have become increasingly palpable. According to Yardeni Research, the difference in price for which investors are willing to pay for 52-week forward earnings for Large-cap stocks (20.8x) and Small-cap stocks (14.8x) is currently at the highest level observed in over 20 years(!).

Key US Index Returns	YTD '21	November '21
S&P 500	+23.2%	-0.7%
Nasdaq	+21.3%	+0.3%
Dow Jones Industrial Average	+14.6%	-3.5%

Relevant Fixed Income Yields	YE 2020	November '21
US 10-Year Treasury Note	0.92%	1.44%
Investment Grade Corp. (C0A0)	1.8%	2.3%
High Yield Corp. (H0A0)	4.2%	4.9%

Source: Factset as of 12/01/21

Bond market performance was largely mixed, as intra-month interest rate movement was highly erratic. Going into the final week of the month, the US 10-year Treasury rate sprung as high as 1.67%, only to recoil to 1.44% at month-end. Once again, the trajectory of this key benchmark rate continues to be highly linked to sentiment surrounding COVID-19. The policy-sensitive 2-year Treasury rate was equally sporadic but trended upward for the month as markets began to price in a less dovish Federal Reserve in 2022. The confluence of "risk-off" trading and interest rate volatility boded poorly for High Yield bonds – otherwise known as "junk bonds" – with the Merrill Lynch US High Yield index experiencing its worst monthly performance for the year, declining 1.0%. Separately, broad-based commodity indices posted losses, driven by a month-end plunge in oil prices amidst Omicron concerns.

Closing Thoughts:

As we enter the home stretch of the calendar year, we remain keenly aware of the evolving investment landscape that lies ahead for 2022. There is no shortage of risks on the horizon: inflation, monetary policy pivots, pockets of euphoria, unsolved COVID-19 concerns…the list goes on. While uncertainty remains heightened, we remind our clients that dealing with the market's "unknowns" is constant when navigating the investment universe. Hence, what really matters isn't necessarily what we do or do not know about the future, but rather it's the decisions that we make along the way.

Warm regards,

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