Lynx Capital Group Ltd

Disciplined Strategic Investment Management

http://www.lynxcap.com

Market outlook as of January 2022

"I can calculate the movement of stars, but not the madness of men."

This famous quote was spoken by Sir Isaac Newton (1652- 1727) after he lost his fortune in the South Sea Bubble in 1721. He was widely recognized as one of the greatest mathematicians and physicists of all time and among the most influential scientist. He was most famous for discovering gravity, and calculus.

While we feel that most of the U.S stock market is fairly priced, especially due to extremely low interest rates curtesy of the Federal Reserve, there remain "pockets" of the market where manias are alive and well. Crypto currencies of which there are now currently over 7800, NFT's, Robin Hood Crowd bidding up stocks such as Gamestop and AMC into nose bleed territory have played havoc with the market. Currently there are twice as many tech stocks that trade at greater than 10 times sales (not earnings!) than at the peak of the Dot.com bubble in 2000.

As a student of the stock market, it amazes me how "bubbles" keep recurring. One can look back at the first documented bubbles. The Dutch Tulip Mania that gripped Holland in 1630's, Then the South Sea Company Bubble in 1719/20. The euphoric recent bubbles in the USA were the Dot.com of the 1990's and the U.S Housing bubble ending with the Lehman Collapse in 2008.

Outlook for 2022

Forecasting markets is always a humbling business, as no one can predict for sure. All one can do is focus on areas that look compelling and deemphasize sectors that have run up a lot. As always, at best it's like shooting at a moving target and one must periodically recalibrate or be able to completely change directions as the facts change.

We are presently constructive on the stock market for 2022 as the net positives outweigh the negatives. While there are pockets of excessive speculation, there are many stocks and sectors that still offer good upside potential along with income possibilities. There are almost no signs of an impending recession, which is strongly correlated with bear markets. While we expect the economy to slow, the US GDP is still expected to expand by over 3% for 2022. Europe is expected to be even higher.

The federal reserve is still accommodative with historically low interest rates which are still stimulative but is starting to transition from a very aggressive policy to NORMAL as they see the economic recovery taking hold, but with signs of inflation.

The key driver of the U.S economy, "The U.S Consumer" has never been in better shape. Households have accumulated more than $2.3 trillion in savings over the course of the pandemic. Both household and corporate investment spending is expected to stay robust.

Our biggest concern is Inflation for the following reasons.

- Inflation is already running hot, well above what the Fed has expected.
- Rising wages – "great resignation" employees are quitting in record numbers as they are able to easily find another job with better pay and/or benefits. We are also seeing a rising number of strikes for pay raises.
- Housing Squeeze – Owners' Equivalent Rent and Rent of primary residence comprise 31% (23.6 & 7.6%) of CPI index, and we don't see an end in sight due to housing shortages.
- Globalization was a hugely deflationary force is now waning as countries are trying to bring back jobs onshore.
- Climate Change - costs of decarbonization will be high. Electric vehicles use 6-7 times more minerals than internal combustion vehicles.
- Aging and retiring Baby Boomers, lack of workers, increased pension and healthcare costs are all inflationary.
- Government Spending - $525 billion American Rescue Plan and more in the works.
- Supply Chain logjam is slowing availability and increasing costs of items which is inflationary.

The last bout on inflation was in the very early 80's and that was for a very short period. Most current investors and market strategists have never actually seen inflation let alone know how to navigate through it. While the Fed strongly believes the current elevated readings are transitory, we are skeptical and think that it will prove to be more persistent for the reasons stated above. Many institutions are actually completely off guard to this threat. Banks are still issuing fixed rate long term mortgages. Life insurance policies will become less valuable (as they would need to be linked to inflation), owing money at a fixed rate would be a good thing especially for a real estate investor. We may be wrong, but it would be prudent for investors to start thinking of the possibility and have a plan to invest accordingly.

We think the Fed will remain fairly "dovish" and rather keep policies in place until they are sure the economy is out of the woods on the Covid front. They would prefer to see full employment and are loath to risking a recession that would cool the economy and raise unemployment. They have "telegraphed" three rate hikes for 2022 which is already priced into the market. The Fed is also "boxed in" with an already strong dollar, raising rates could strengthen it further which would act as a further drag on the economy.

We think the "FANMG" (Facebook, Amazon, Netflix, Microsoft, Google) are amazing companies but cannot continue pulling most of the performance of the markets as they have accounted for and outsize share of the market’s gains for the last two years. We as always, favor blue chip dividend growth stocks, especially now that bond returns are harder to come buy when the Fed is raising rates.

Portfolio thoughts going forward.

We are adopting a more market weight allocation to big tech as we believe valuations are elevated and will be under pressure if and when interest rates rise. We expect average returns from markets, but see good opportunities for stock selection, especially for value and quality and dividend-oriented investments. Financials and high-quality companies with solid earnings remain featured in many of our strategies. Speculative areas of the market are already in bear market territory (like SPACS), as the bias grows towards higher -quality companies, which is the backbone of our investment philosophy.

As stated previously, we still feel very optimistic as quality, dividend paying stocks hold up well during modestly inflationary periods. While inflation tends to be bad for speculative stocks, dividend paying companies have tended to payout rates higher than inflation. They also tend to be growing their payouts faster than inflation. Many dividend stocks in sectors such as healthcare, financials, and consumer staples can successfully increase prices when commodity prices increase. Those companies are then able to increase payments with the additional cash flow.

It is always advisable to review one’s individual circumstances and tolerance for risk. If any of your financial circumstances have changed, or you want to adjust your portfolios risk profile we always encourage you to contact us should you want to make any changes to your portfolio allocation.

As always, please feel free to contact us with any questions or concerns.

Brian Chait

President, January 12th, 2022

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