Wellington Shields

January 2022

# Quarterly Market Strategy Report

## A Year of Reckoning

A year ago, we stated that despite denials from the Federal Reserve Board and the administration, inflation would become a big problem for consumers and the securities markets in 2021. We did not believe that rising prices would be transient or mild because monetary and fiscal policy had remained too stimulative for too long. Investors managed to ignore inflation for most of 2021, but at the December 2021 FOMC meeting, with consumer prices rising 6.9% year-over-year and producer prices for finished goods rising more than 13% year-over-year, Chairman Jerome Powell did accept the existence of inflation. He stated quite clearly that monetary policy needed to change in 2022 and that quantitative easing would end by March and interest rates could increase two or three times this year. This is a pivotal switch.

### Fed Policy in the Crosshairs

However, the Federal Reserve appears to be behind the curve in terms of fighting inflation since big price hikes are now widely accepted and widespread. As a result, the shift from easy to tightening monetary policy might need to be longer and more frequent than if it had begun sooner. And though this policy adjustment will be the big challenge for investors in 2022, it is a necessary move. The asset inflation seen in housing, commodities, securities, energy, and all forms of collectibles has been the result of too much money chasing too few goods and this is due to the Fed feeding the banking system with too much cash. The alternative would fuel an asset bubble environment.

Quantitative easing and/or falling interest rates have usually been a positive for equities and this is the source of the Wall Street adage "Don't Fight the Fed." The end of quantitative easing (QE) has no predictive value for equities. However, one could say that without quantitative easing equities no longer have the wind at their back and would need a new catalyst to move higher. What is more likely to pose a problem for equities is the Fed's transition from historically low to higher interest


Summary

The Fed's tightening policy shift will be the big challenge for investors in 2022. Investors should focus on companies that can not only survive, but thrive, in an inflationary environment. We find these characteristics in energy, financials, and staples. Technology stocks remain a core holding, but a better buying opportunity may materialize later in 2022.


*"Inflation is taxation without legislation."*

– Milton Friedman
*American economist, statistician, and recipient of the 1976 Nobel Memorial Prize in Economic Sciences*


**Wellington Shields & Co. LLC**
140 Broadway, 44th Floor
New York, NY 10005
212.320.3000
wellingtonshields.com

rates. Bonds and stocks compete as investments, therefore as interest rates rise, the pendulum of risk shifts from bonds to equities. Higher interest rates raise the bar for equities in valuation models.

## INVESTING IN A CHANGING ENVIRONMENT

In an era of rising inflation and higher interest rates, equites can still perform well but portfolios may need some adjustments. It is important to note that inflation and interest rates pressure high PE stocks since they represent the highest-risk segment of the market. This explains the recent selling pressure in high-flying tech stocks. In 2022, investors should look to protect portfolios from these risks. The best insulation would be balanced portfolios that include stocks with earnings shielded from the pressures of inflation, price earnings multiples at or below the S&P 500 average, and stocks with dividend yields greater than 1.5%.

In an era of rising inflation and higher interest rates, equites can still perform well. But inflation and interest rates tend to put pressure on high PE stocks since they represent the highest-risk segment of the market.

A number of sectors should do well in 2022 despite rising prices and interest rates. For example, energy stocks have been the beneficiaries of inflation. The sector recorded a gain of 47.7% before dividends in 2021 which made them the best performing sector in the S&P 500. However, gasoline demand should continue to increase as the pandemic fades and the United States Energy Information Administration (EIA) expects global consumption of petroleum and liquid fuels to increase by 3.5 million barrels per day in 2022 to average 100.5 million barrels per day. It follows that energy sector earnings should be strong in 2022. Moreover, energy stocks tend to have low PE multiples and many stocks have dividend yields that are double the current rate in the 10-year Treasury note.

Financial stocks are another sector that can not only weather inflation but do well as interest rates rise. Banks, in particular, can benefit from a steepening yield curve. Assuming COVID-19 and its variants fade into history in 2022, global economic activity will expand, and financial stocks will benefit from this increased activity. In addition, the sector tends to have modest valuation multiples and solid dividend yields. But note that as the world of finance continues to change, so does the composition of the S&P financials sector. Many fin-tech stocks were added to the S&P financial sector in December, such as PayPal (PYPL - $187.60), Fiserv Inc. (FISV - $108.83), and Jack Henry & Associates (JKHY - $169.75). Although bank stocks tend to have healthy PE multiples and yields, these new additions will have higher earnings growth potential but higher PE multiples. This will raise the average PE and lower the yield of the overall sector.

Balanced portfolios should include stocks with a predictable earnings stream shielded from inflation, price earnings multiples at or below the S&P 500 average and dividend yields greater than 1.5%.

Consumer staples should also fare well in a volatile and changing environment. Staples are a defensive play that should demonstrate growth as the global economy recovers. Valuations for staples are modest, and the yields are above average. Note that in December S&P

**Wellington Shields & Co. LLC**
140 Broadway, 44th Floor
New York, NY 10005
212.320.3000
wellingtonshields.com

added Target Corp. (TGT - $230.78), Dollar General (DG - $238.37), and Dollar Tree Inc. (DLTR - $140.96) to its staples sector. We find these interesting additions. In an environment of rising inflation, when households are acutely price sensitive, these three retailers are known for providing quality products at low prices. They are attracting consumers from all income brackets. Again, investors should be looking for companies that can not only survive, but thrive, in an inflationary environment.

THE TECHNOLOGY SECTOR

Technology stocks may come under pressure in 2022 as interest rates rise. But, in our view a correction in the technology sector would provide a long-term buying opportunity. In other words, be patient when adding technology stocks to portfolios.

A sell-off in the technology sector would provide a long-term buying opportunity. In other words, be patient in adding to technology portfolios.

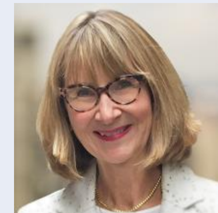
As a final note, history has shown that three consecutive years of double-digit gains – as seen in the S&P 500 and Nasdaq Composite index -- have been followed by a down year. This implies the S&P 500 and Nasdaq Composite index, which are heavily influenced by the largest market capitalization stocks, may come under pressure in coming months. But declines are a normal part of any equity cycle. The S&P 500 has more than doubled since the March 2020 low without as much as a 10% correction. A correction in the next twelve months should be viewed as a healthy and stabilizing event for the longer term.

*Closing prices as of 1/7/2022

*Disclosure: The information herein has been prepared by Dudack Research Group ("DRG"), a division of Wellington Shields & Co. The material is based on data from sources considered to be reliable; however, DRG does not guarantee or warrant the accuracy or completeness of the information. It is published for informational purposes only and should not be used as the primary basis of investment decisions. Neither the information nor any opinion expressed constitutes an offer, or the solicitation of an offer, to buy or sell any security. The opinions and estimates expressed reflect the current judgement of DRG and are subject to change without notice. Actual results may differ from any forward-looking statements. This letter is not intended to provide personal investment advice and it does not consider the specific investment objectives, financial situation and the specific needs of any person or entity.*

*This communication is intended solely for use by Wellington Shields clients. The recipient agrees not to forward or copy the information to any other person without the express written consent of DRG.*

*Copyright © Dudack Research Group, 2022.*
*Wellington Shields is a member of FINRA and SIPC*



**Gail M. Dudack**
*Gail M. Dudack is the Chief Market Strategist both at Wellington Shields and its Dudack Research Group division, an independent institutional research firm, she founded, that provides economic, fundamental, quantitative, and technical strategy and tools to mutual funds, hedge funds, and private money managers.*

**Wellington Shields & Co. LLC**
140 Broadway, 44th Floor
New York, NY 10005
212.320.3000
wellingtonshields.com