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Dear Valued Investor,

Stocks have gotten off to a tough start in 2022. Why has the market pulled back and what might we see going forward?

We think the most important thing to remember is that periodic stock market volatility is entirely normal. Historically, the S&P 500 Index has averaged three pullbacks of 5% or more per year and one correction of more than 10% annually. Investors have grown accustomed to steady, consistent gains over the past couple of years which makes the current bumpy ride feel more uncomfortable. After only a single 5% pullback in 2021, we have been anticipating more volatility in 2022.

But even though volatility is normal, it is usually responding to something. Stubbornly high inflation, higher interest rates, and less support from the Federal Reserve are getting most of the blame, and probably deservedly so. Supply chain disruptions and some economic weakness because of the Omicron variant of COVID-19 are also playing a role. Additionally, market history tells us that stock market action in mid-term election years (which we're in now) are historically quite volatile and most gains tend to happen in the back half of the year.

While we expect inflation to start improving soon and the impact of the virus to fade, the Fed has shifted its priority to controlling inflation. That signal of less support for the economy has made markets nervous. The good news is that the Fed is prioritizing inflation because the economy overall is in pretty good shape. Since that's usually true when the Fed starts to hike interest rates, the S&P 500 historically has had solid performance (on average) in the year before and after the first rate hike of an economic expansion.

Importantly, we still remain confident corporate America has enough earnings power left in the tank to support stock market gains. There are challenges facing corporate America this earnings season, including supply chain disruptions, wage and other cost pressures, and the COVID-19 Omicron variant. But while it is still early in earnings season, corporate earnings are growing strongly and companies are mostly optimistic about the future.

This pullback in the S&P 500 could easily go to 10% or even a little more. Remember, the average maximum drawdown in a positive year for stocks is 11%. But based on the still solid overall economic and earnings backdrop, our expectation is that the inflation clouds will soon start to clear. And with the stock market's historically solid track record early in Fed rate hike cycles, we wouldn't expect this pullback to go much further.

Here's to a successful and healthy 2022. Please contact your financial professional with any questions.

Sincerely,

Ryan Detrick

Chief Market Strategist
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