

Welcome to 2022: The Winds of Change

Welcome to 2022! We can't imagine a more transformative year for America. After two years of unprecedented government actions, the winds of change are blowing hard. The economy has been buffeted by short-term factors since 2020; this year, long-term fundamentals should re-assert themselves as the most important drivers of economic and financial performance.

First, the obvious: COVID and COVID-related rules should have much less influence on our lives twelve months from now than they do today. Seems like everyone knows someone who has tested positive (vaccinated, or not). Cases are at record highs, but hospitalizations and deaths are not. This is good news.

Second, President Biden's Build Back Better plan to increase entitlements and taxes seems mired in the DC muck. It's still possible that a plan totaling something like \$1.5 trillion or more gets passed. But we think that's unlikely. More likely? Either nothing at all, or a much smaller bill. Put yourself in the shoes of relatively moderate Democrats in Congress – being forced to vote on tax hikes in an election year is difficult, and reluctance is going to grow every week as 2022 unfolds.

Third, the mid-term election in November could dramatically limit the ability of the Biden Administration to get much done in 2023-24. Given the history of mid-term elections as well the election returns in 2021 (gubernatorial and state legislative races in New Jersey and Virginia, as well some races elsewhere), the most likely possibilities seem to be either a GOP Wave or a GOP Tsunami. Either would mean no more tax hikes and that all legislation would have to be bipartisan to pass, which should mean lots of gridlock.

Fourth, look for an economic contest between waning fiscal "stimulus" packages, rising employment and healing supply chains. The excess demand from massive government spending will decline in 2022, while supply chains appear to be healing. Business inventories are finally rising again (they need to do so after falling dramatically in 2020 and earlier in 2021) and it's hard to imagine chipmakers not ramping up production to meet enormous demand.

Fifth, the Federal Reserve has its work cut out for it. Its most recent "dot plot" suggests three rate hikes this year (25 basis points each) and the futures market for federal funds agrees. The big question is whether Fed policymakers have the guts. Given that the Biden Administration is trying to pack the Fed with as many doves as they can appoint, we'd take the "under," and think the Fed will probably raise rates only twice this year.

Sixth, it's important to watch profits, which are at an all-time high. Remember, some of the strength in corporate results of late is due to temporary and artificial government spending blowouts. Meanwhile, more jobs, lower unemployment, and lower participation could mean higher wages take a slice out of corporate earnings. We still expect profit growth of 10% or more in 2022, but this is well below what we saw in 2021.

And last, of course, are the wildcards: Will China invade Taiwan? Will Russia invade Ukraine? We think the former is very unlikely, with the possible exception of some tiny uninhabited islands off the coast of Taiwan. The latter? If your name isn't Vladimir Putin, you don't know the answer. Either of these could cause a temporary sell-off, but neither would change the fundamentals. The winds of change are still tailwinds.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-3 / 9:00 am	Construction Spending – Nov	+0.7%	+0.7%	+0.4%	+0.2%
1-4 / 9:00 am	ISM Index – Dec	60.2	60.3		61.1
<i>afternoon</i>	Total Car/Truck Sales – Nov	13.1 Mil	12.0 Mil		12.9 Mil
<i>afternoon</i>	Domestic Car/Truck Sales – Nov	10.7 Mil	9.5 Mil		10.4 Mil
1-6 / 7:30 am	Initial Claims – Jan 1	199K	198K		198K
9:00 am	ISM Non Mfg Index – Dec	67.0	67.6		69.1
9:00 am	Factory Orders – Nov	+1.5%	+1.2%		+1.3%
1-7 / 7:30 am	Non-Farm Payrolls – Dec	400K	390K		210K
7:30 am	Private Payrolls – Dec	370K	370K		235K
7:30 am	Manufacturing Payrolls – Dec	33K	25K		31K
7:30 am	Unemployment Rate – Dec	4.1%	4.0%		4.2%
7:30 am	Average Hourly Earnings – Dec	+0.4%	+0.4%		+0.3%
7:30 am	Average Weekly Hours – Dec	34.8	34.8		34.8
2:00 pm	Consumer Credit – Nov	\$22.5 Bil	\$22.0 Bil		\$16.9 Bil