STONEBRIDGE
Capital Advisors

The Stonebridge Market Commentary
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Equity Commentary

The last month of 2021 has begun, and all has been made clear.... not. Every challenge that we faced a year ago is still hanging out there, in many cases worse. We have a new variant of the Covid virus, titled Omicron. And yet, the markets are at all-time highs.

On the other hand, and there is always another hand, earnings have been better than expected. The economy is still strong, unemployment is getting better, and the markets always look forward where better times are continually expected.

On the other, other hand, we have higher interest rates, oil prices, inflation, supply bottlenecks, and of course, the new Covid variant. Had enough? Wait, there's more. Congress needs to pass a budget in a couple of days or face running out of money. Congress seems to be deadlocked, and the President's poll numbers are diving.

On the other, other, other hand, with the panic over the Omicron variant, oil prices have dropped, interest rates have diminished, and the market has taken a hit since the Friday before Thanksgiving. We also are on the verge of approving new anti-viral treatments that could tamp down the virus's virulence.

We have seen a spike in volatility over the last few days as November waned with all of this as background. Some of it came as the Omicron variant became known on Friday. Monday saw a rebound, and then on Tuesday, November 30, we had testimony by Chairman Powell and Secretary Yellen before Congress that may be the spike in inflation was not so temporary and that maybe they would have to speed up the tapering of Fed purchases of bonds. Got all of this? So, as usual, there are a lot of cross-currents.

Some of these are likely to live longer than others, but which ones will prevail? No one knows, of course.

That brings up an additional observation; much of this stuff is political, which is typical of new administrations and Congresses. Everyone comes into office with a bunch of swell ideas they are sure will help the economy, or the public, if enacted. Therefore, much of it can be ignored as it will often not see the light of day. The government moves slowly, if at all, because there are a ton of embedded interests standing in the way. This is a feature of the system, not a flaw. For investors, this makes our job easier. We can concentrate on what makes the best mix of companies for the long run and can ignore a lot of what comes along in the news cycle for the most part.

Index	1-month	YTD
S&P 500	(0.83%)	21.59%
DOW	(3.73%)	12.67%
NASDAQ	0.25%	20.56%

Fixed Income Commentary

The Federal Reserve has begun to wind down its bond-buying program. It is now expected to increase the pace of its taper in the coming months, with inflation starting to run hot. During much of the month, interest rates moved higher before rallying back the last few trading days on Omicron fears. We likely face a modest shift to higher rates in the coming year as the Fed eases off the gas pedal on accommodative policies and eventually increases the Fed Funds rate.

Despite the potential headwinds on the horizon, timing fixed-income markets is no easier than trying to time the stock market. One of the most significant perils is not just being wrong on your timing but ignoring the cost of waiting to invest once yields are eventually higher, even if you are right. Specifically, if you get lucky and rates do rise at some point in the future, roughly in line with your prediction, how much more in yield will you need to pick up on that future bond investment to make up for the lost income while waiting in cash until it happens?

If rates rise by a substantial amount, you may recoup it, but how long might you have to wait for that opportunity? Alternatively, you can structure a portfolio that is invested, producing income and also defensively positioned to best manage volatility associated with rising rates. Either a barbell or a bond ladder approach, positions a portion of principal to be returned in the near term, while also positioning a portion further out in longer maturities to maximize overall yield. The near-term maturities offer reinvestment opportunities at higher rates when interest rates rise. Using premium coupon bonds, particularly in the longer maturities, can maintain value better than par or discount coupon structures in a rising rate environment.

Perhaps most important, whether using a bond ladder or a barbell strategy is managing your duration to lessen interest rate risk. We have been structuring moderate duration income-producing portfolios through this low-interest-rate environment for just that reason.

Sources: Data sourced through Bloomberg, Morningstar, StockCharts

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