VOLATILITY HAS ARRIVED

Bryce Gill
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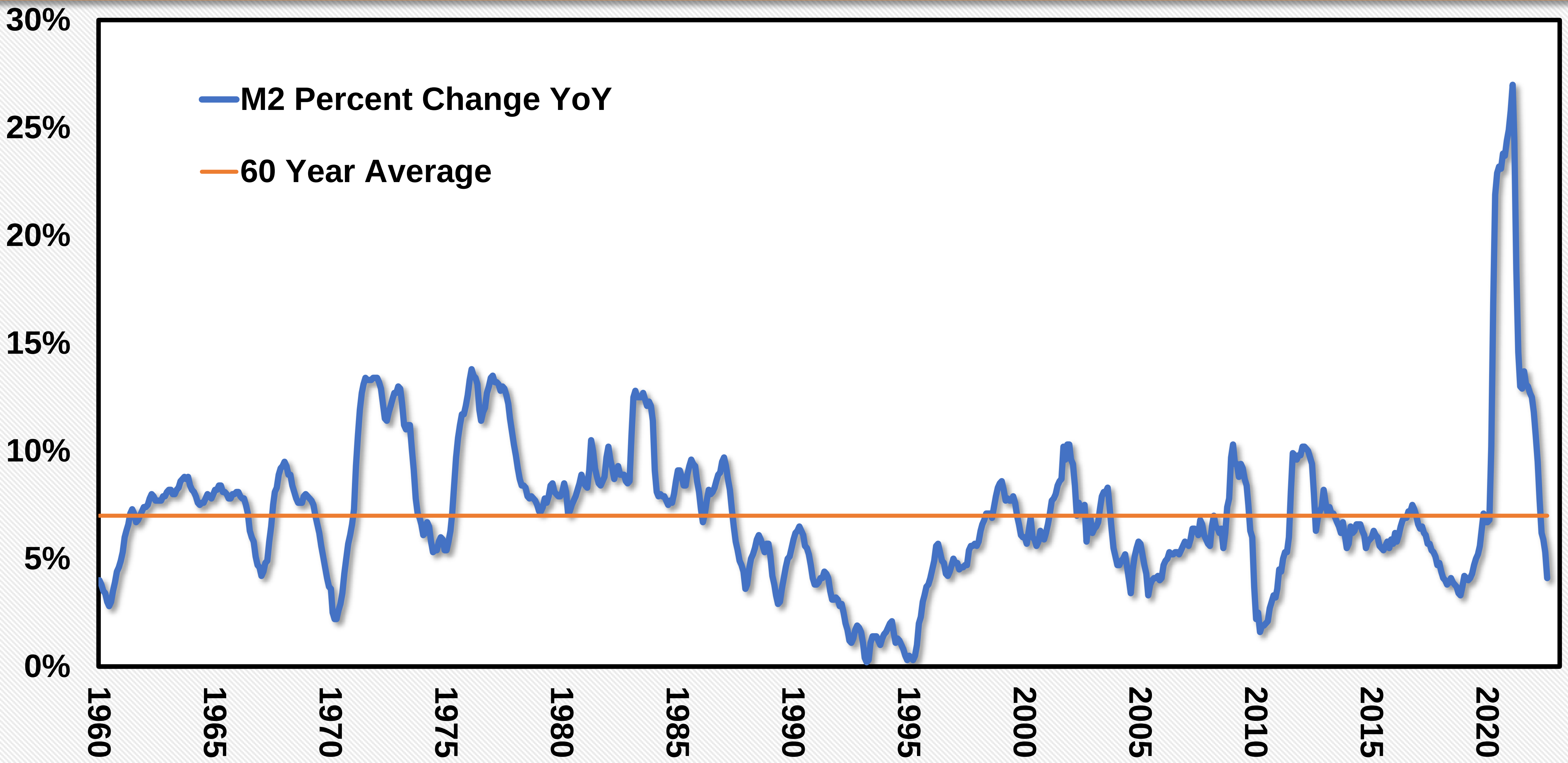
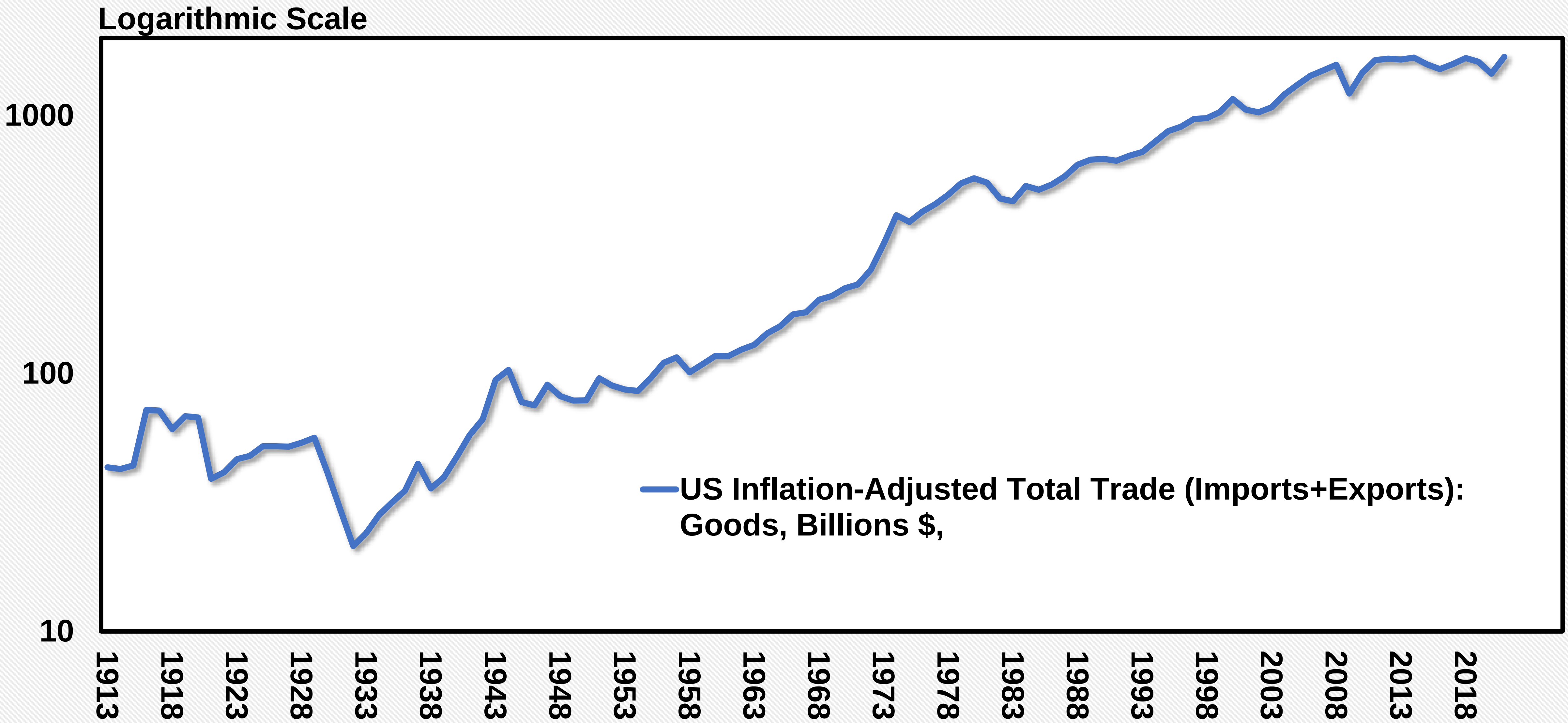
The Monetary Tailwind is Ebbing



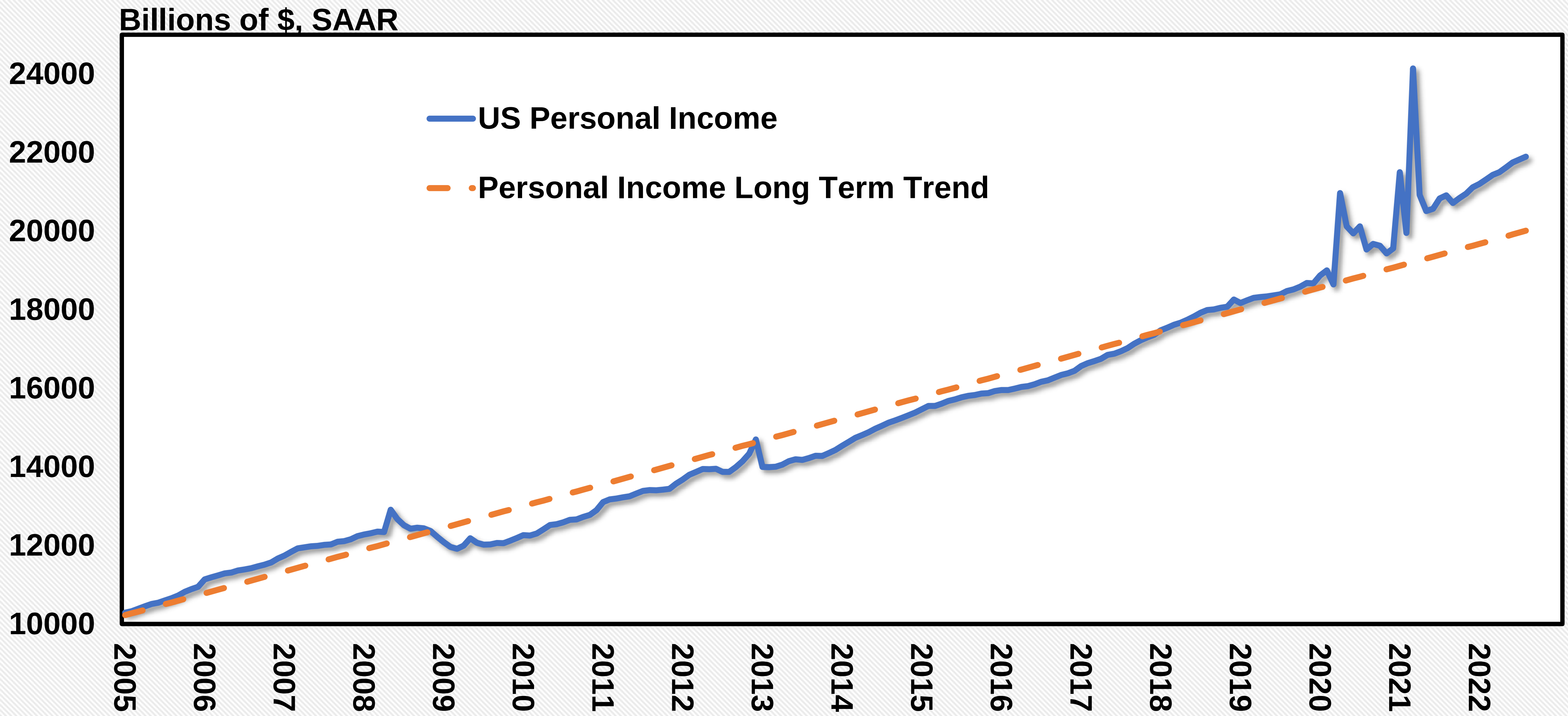
Source: Federal Reserve Board, Monthly Data Jan 1960-Aug 2022

The History of Globalization in One Line



Source: US Census Bureau, Annual Data 1913-2021

A Recession Unlike Any Other



Source: Bureau of Economic Analysis, Monthly Data Jan 2005 – Aug 2022

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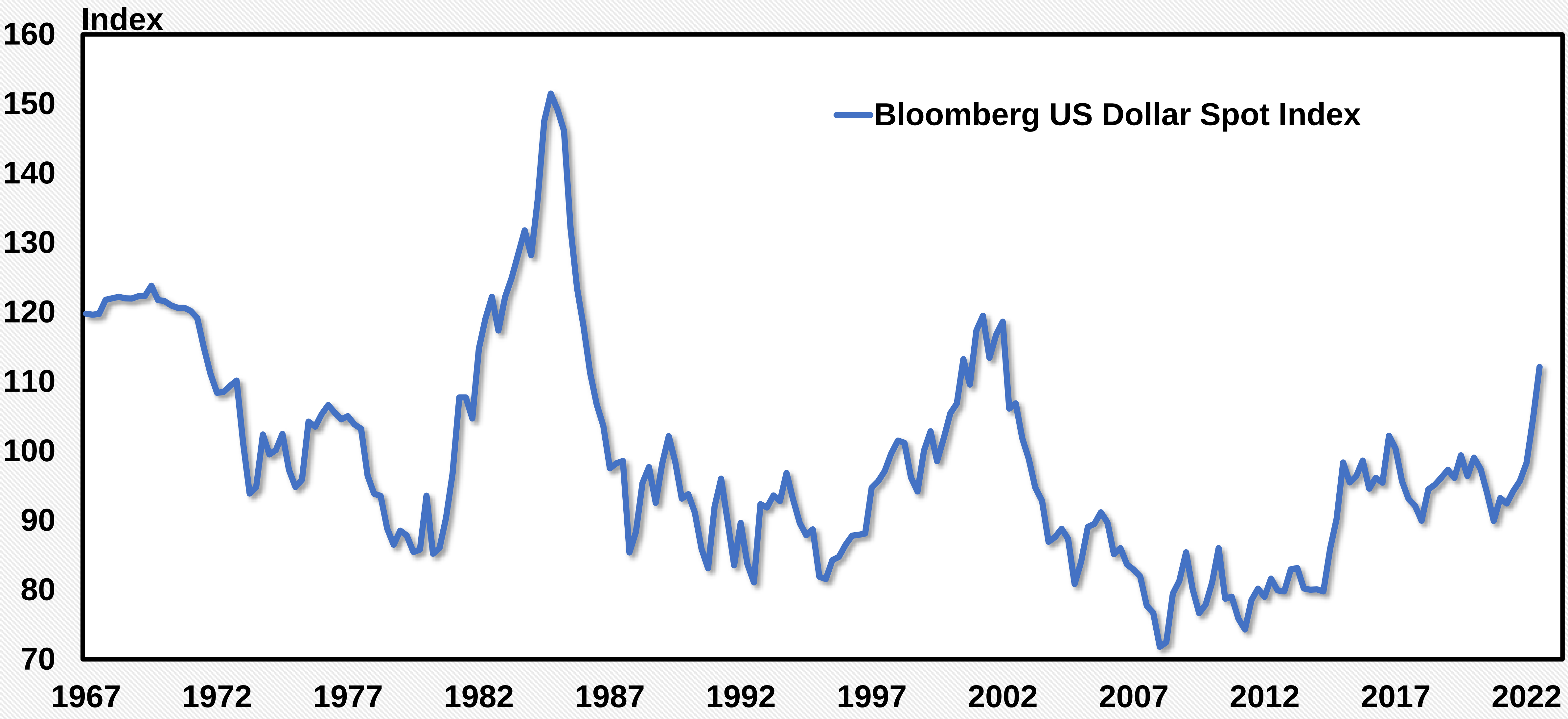
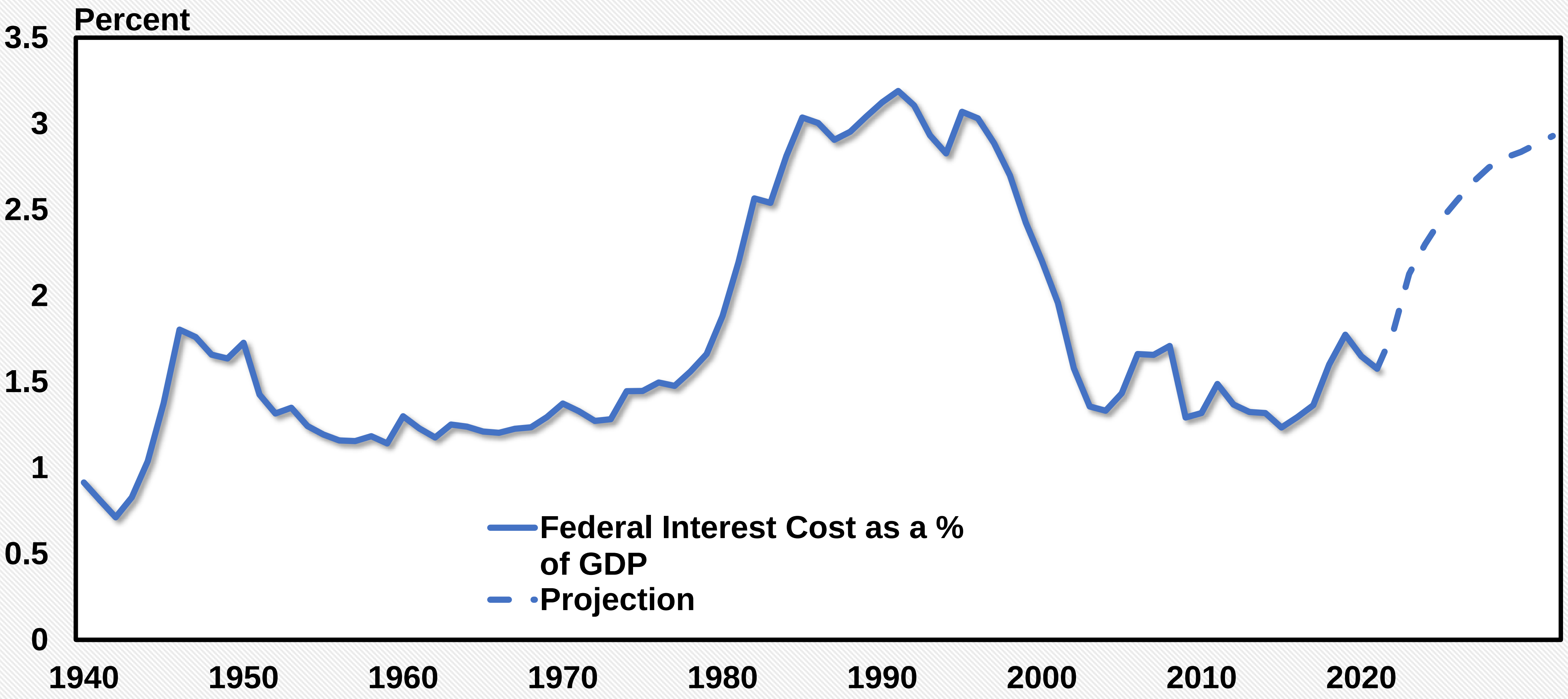
Why Volcker Isn't Making a Comeback



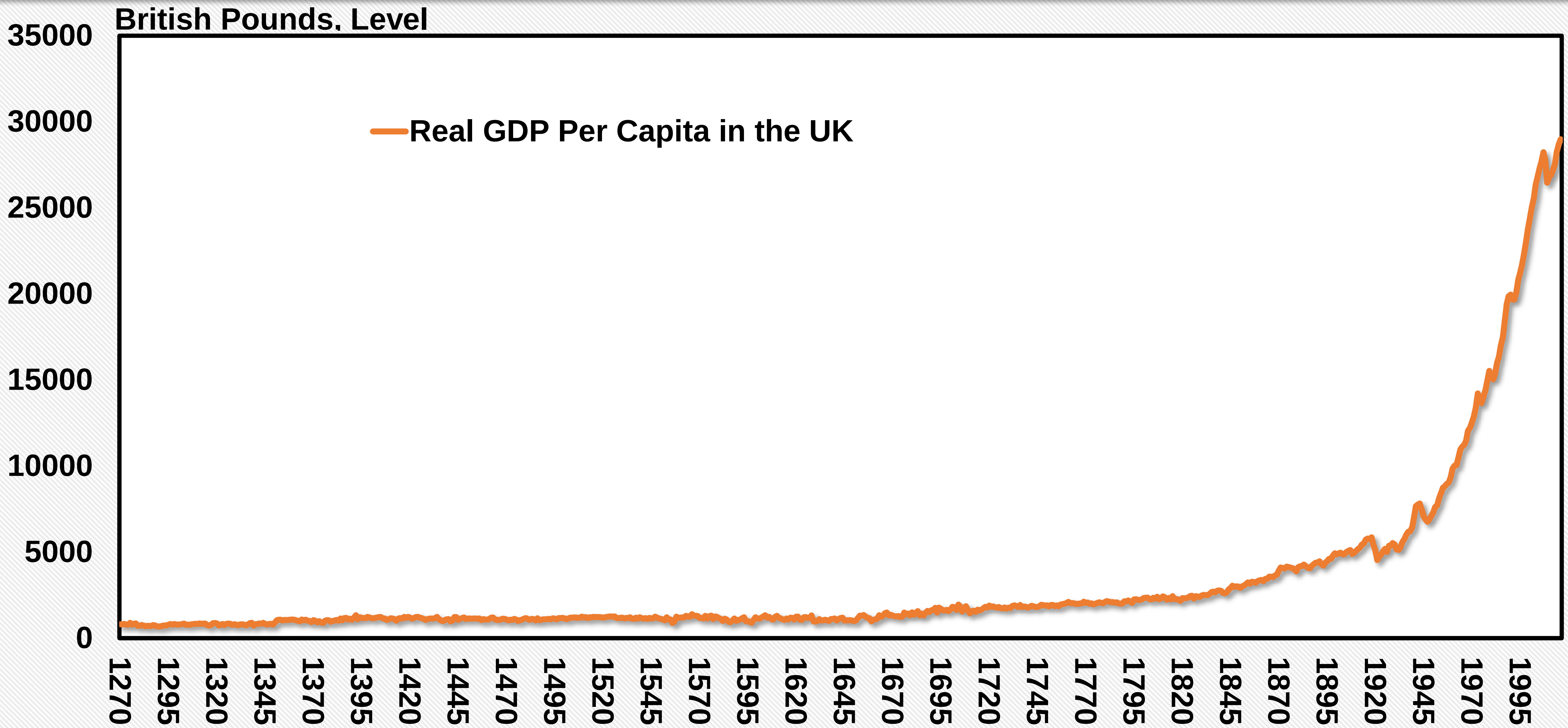
Source: Bloomberg, Quarterly Data Q1 1967-Q3 2022

Interest Costs are Relatively Low Versus History (For Now)



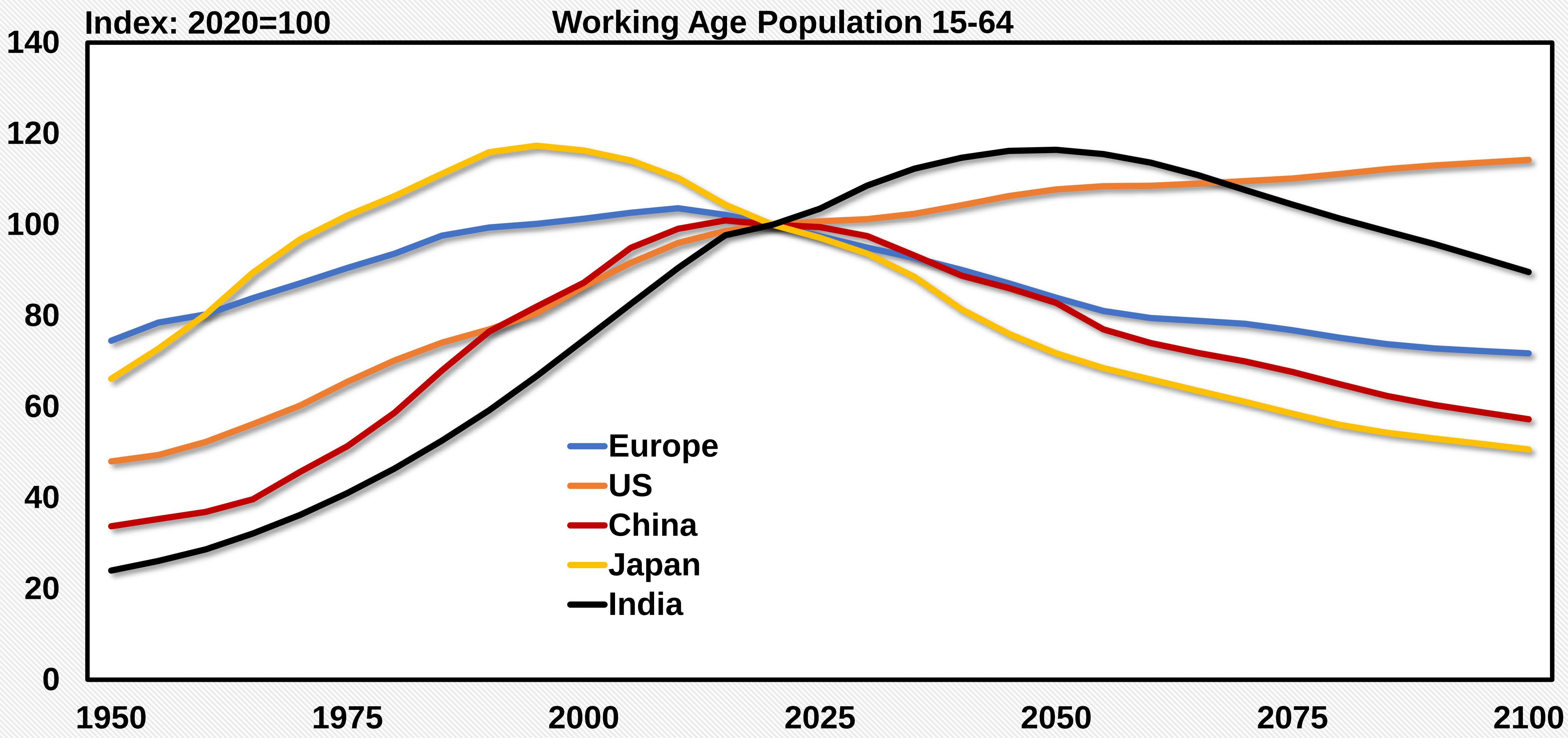
Source: Office of Management and Budget, Annual Data 1940-2021, Projection 2022-2032

The Economic Miracle



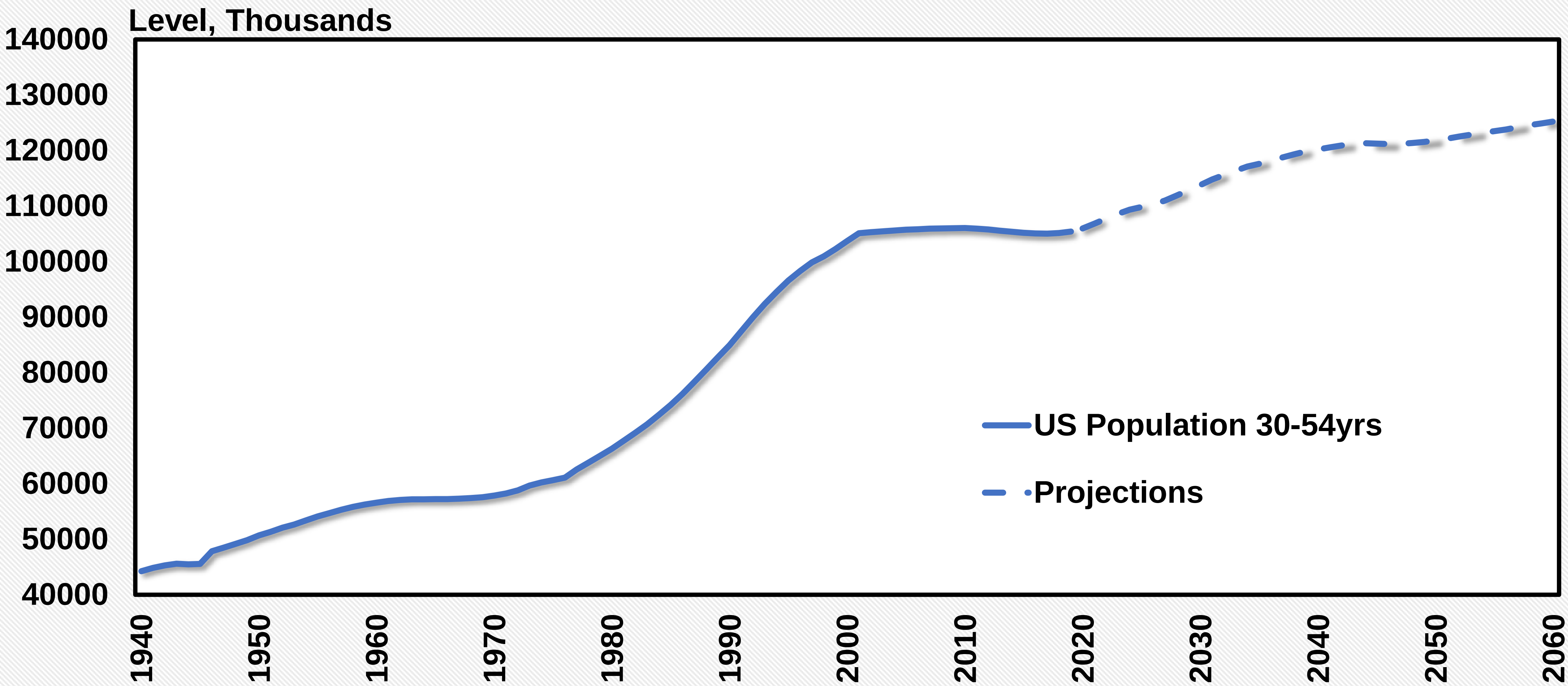
Source: Bank of England, OurWorldinData.org

The Big Picture



Source: United Nations, Annual Data 1950-2100

Millennials Set to Drive US Growth



Source: US Census Bureau, Annual data 1940-2021, Projections 2022-2060

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Monday Morning OUTLOOK

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*
Andrew Opdyke, CFA – *Senior Economist*
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S&P 5,250 – Dow 40,000

We were bullish in 2021 and bullishness obviously paid off. As of the Friday close, the S&P 500 is up more than 25% so far this year. Meanwhile, a 10-year Treasury Note purchased at the end of 2020 has generated a *negative* total return, as interest earnings have been more than offset by capital losses.

The reason we were bullish a year ago even amid widespread fears about COVID-19, is because we stick to fundamentals, assessing fair value by using economy-wide profits and interest rates, what we call our Capitalized Profits Model. And, one year, later, we are still sticking with fundamentals. Our year-end 2022 call for the S&P 500 is 5,250 (up 11.4% from last Friday), and we expect the Dow Jones Industrial Average to rise to 40,000.

The Capitalized Profits Model takes the government's measure of profits from the GDP reports, discounted by the 10-year US Treasury note yield, to calculate fair value. Corporate profits for the third quarter were up 20.7% versus a year ago, up 22.3% versus the pre-COVID peak at the end of 2019, and at a record high.

The key question then becomes what discount rate should we use? If we use 1.50%, roughly the current 10-year Treasury yield, our model suggests the S&P 500 is grossly undervalued. But, with the Federal Reserve still holding short-term interest rates at artificially low levels, the 10-year yield might be artificially low, as well.

So, to be cautious, we plug in some alternative higher long-term interest rates. Using third quarter profits, it would take a 10-year yield of about 2.75% for our model to show that the stock market is currently trading at fair value. And that assumes no further growth in profits.

We expect the 10-year Note yield to finish 2022 in the vicinity of 2.00%. Nonetheless, we have chosen to use a more conservative discount rate of roughly 2.50%. Using third quarter 2021 profits, that creates a fair value estimate for the S&P 500 of 5,250. And this does not take into account higher profits in the year ahead.

The bottom line is that although we remain bullish, we are not quite as bullish as in recent years, projecting an increase in stocks of 11.4% from Friday's level. We haven't had a 10% correction in 2021, and, although we never try to time the market, we wouldn't at all be surprised by one happening at some point in 2022. Moreover, the stock market is likely to grapple with either higher short-term rates in 2022 or, in the alternative, a Federal Reserve that is even further behind the inflation curve, risking a higher peak for short-term rates sometime in the future.

Another issue is the battle between fading fiscal stimulus and a gradual return to normalcy. The budget deficit will still be very large this year even if the Democrats-only "Build Back Better" proposal doesn't pass. But the deficit will be much smaller than the past two years. That will generate a short-term headwind for growth. Meanwhile, more businesses should be getting back to normal and small business start-ups gradually replacing businesses that were killed off by overly strict COVID rules.

On net, this adds up to a scenario that is likely to be constructive for equities. We've been bullish since 2009 but we are not perma-bulls. There are clouds on the horizon, and at some point in the next few years, we may be (temporarily) bullish no more. In the meantime, though, the clouds are on the horizon, not overhead. Equities have further to run.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-14 / 7:30 am	PPI – Nov	+0.5%	**+0.6%**		+0.6%
7:30 am	"Core" PPI – Nov	+0.4%	**+0.3%**		+0.4%
12-15 / 7:30 am	Retail Sales – Nov	+0.8%	**+0.8%**		+1.7%
7:30 am	Retail Sales Ex-Auto – Nov	+0.9%	**+1.1%**		+1.7%
7:30 am	Import Prices – Nov	+0.7%	**+0.3%**		+1.2%
7:30 am	Export Prices – Nov	+0.5%	**+0.8%**		+1.5%
7:30 am	Empire State Mfg Index – Dec	25.0	**27.3**		30.9
9:00 am	Business Inventories – Oct	+1.1%	**+1.2%**		+0.8%
12-16 / 7:30 am	Initial Claims – Dec 12	198K	**194K**		184K
7:30 am	Housing Starts - Nov	1.565 Mil	**1.570 Mil**		1.520 Mil
7:30 am	Philly Fed Survey – Dec	30.0	**27.6**		39.0
8:15 am	Industrial Production – Nov	+0.7%	**+0.7%**		+1.6%
8:15 am	Capacity Utilization – Nov	76.8%	**76.9%**		76.4%

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L.P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.


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630-517-7756 • www.ftportfolios.com January 3, 2022

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. It's 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
afternoon	Total Car/Truck Sales – Nov	13.1 Mil	**12.0 Mil**		12.9 Mil
afternoon	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

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L.P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.

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Source: First Trust Monday Morning Outlook: S&P 5,250 - Dow 40,000, December 13, 2021; 2022: Moderate GDP, Persistent Inflation, December 20, 2021; Welcome to 2022: The Winds of Change, January 3, 2022.