The Year Ahead: Market Drivers for 2022

Stocks again scored solid gains in 2021, despite formidable obstacles. Whether or not the bull run continues in 2022 will depend on a number of factors -- some known and others not.

The S&P 500 index has advanced over 100% since its March 23, 2020, low.*

Once again, the stock market has proven resilient in the face of adversity. For 2021, the major U.S. equity benchmarks -- the S&P 500, the Dow Jones Industrial Average (DJIA), and the NASDAQ Composite -- scored healthy gains, with all three at or near their all-time records at year-end. This, despite an ongoing pandemic, rising inflation, global supply chain disruptions, and widespread labor shortages. In fact, since COVID first appeared in early 2020, strong stock market performance has humbled even the most ardent naysayers, driven in part by a new generation of retail investors.

But it's a tough act to follow. Where stocks go from here will depend on many different factors. Below are the major market drivers to consider as you assess your portfolio's prospects for 2022.

COVID

The greatest driver of stocks in the foreseeable future is also the smallest. The COVID-19 virus has already undergone many mutations, bringing us Delta and now Omicron variations. Both caused significant, if temporary, swoons in the financial markets during 2021. Although most developed countries have vaccinated significant portions of their populations, vaccination rates have slowed or stalled in many areas. And rates in the third world -- where Delta and Omicron strains were first detected -- remain low. So the prospect for continued waves and additional, potentially more transmittable or deadly strains is likely. Investors should expect COVID-related volatility to continue through 2022, especially as new strains are discovered or travel bans and other restrictions are imposed.

Inflation and Interest Rates

An uptick in inflation in mid-2021 was widely expected, given the downturn a year earlier. But it was thought to be short-lived. Yet prices have continued to rise, growing to an annualized rate of over 6% in November. Although most economists do not anticipate a return to a '70s-style stagflation, many suspect that inflation may stick around longer. Fed Chairman Jerome Powell shared that sentiment in December, when he announced that the Fed would end its pandemic-era bond purchases in March, paving the way for three quarter-percentage-point interest rate increases by the end of 2022. Should inflation persist and interest rates rise, investors can expect stock prices to respond negatively, as they have in previous rate-hike cycles. But the effect is likely to be uneven, affecting some stocks more than others.

U.S. Economy

After the severe disruptions of 2020, the American economy rebounded in 2021, recording robust growth in the first half of the year, aided by unprecedented fiscal stimulus. But GDP growth slowed in the second half, coming in at just 2.1% in the third quarter. The drop reflects labor shortages, supply chain bottlenecks, and weaker consumer spending. That said, the U.S. economy remains fundamentally strong, with unemployment below 5%. The recently passed infrastructure bill and the Build Back Better Act -- if passed -- should further boost the economy. For 2022, expect markets to respond to monthly economic data releases as always, but as market drivers, these may take a back seat to inflation and interest rates.

Global Economy

Like the U.S., much of the rest of the world continues to rebound from the severe lockdowns and closings that characterized the worst of the pandemic. The global economy is currently predicted to grow 4.9% in 2022 -- a heady pace by historical standards.[1] But that prediction has been tempered by persistent supply chain disruptions and other lingering pandemic-related issues. China, the world's manufacturing powerhouse, has seen a slowdown in its economy, largely due to strict lockdowns and border closings associated with its zero-COVID policy. Yet it is still expected to record solid growth in the coming year. All told, investors can expect to see a continued global economic recovery, but one mitigated by labor shortages and lingering supply chain disruptions. And of course, the pandemic could throw a wrench into the works at any time if more virulent strains of COVID arise.

The Unforeseen

As the global pandemic aptly demonstrates, there is always the risk of something coming out of the blue. A natural disaster. A financial meltdown. A war. Or, on the positive side, a breakthrough invention, a major discovery, a cure for COVID. It is often such unforeseen events that wind up being the principal drivers of stock prices.

Although there is no way to anticipate such events, or to predict the course of the other risk factors discussed here, it's wise to expect the unexpected by limiting your exposure to risk. As you plan for the coming year, consider your investing goals and keep a long-term perspective. And work with a professional to see how to best position your portfolio for an ever-changing market dynamic.

*As of December 13, 2021. Source: Google Finance.

[1]International Monetary Fund, World Economic Outlook, October 2021.