ECONOMIC REVIEW

January 2022

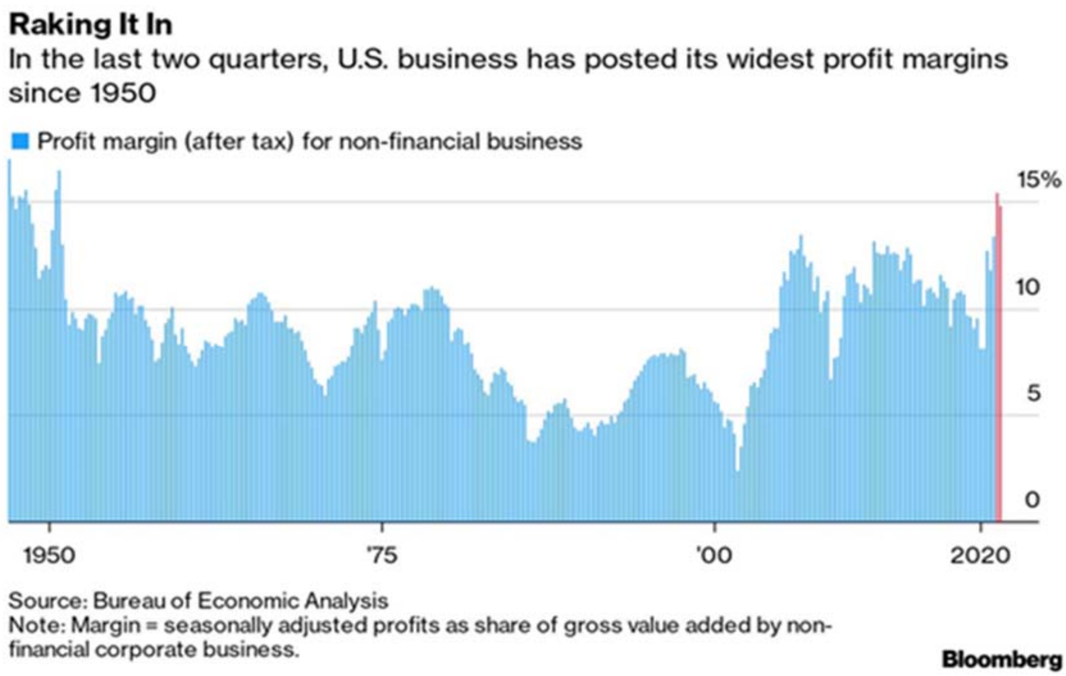
Economic Growth Should Soften But Remain Strong In 2022: The U.S. economy is expected to grow 3.9% in 2022, down from 5.6% in 2021, though still considerably ahead of the pace of the last decade of pre-COVID years, during which the economy averaged 2.3% growth. Similar trends should be seen globally, with GDP in developed countries expected to slow to 3.9% this year from 5.1% in 2021. Growth is expected to slow further in 2023, to 2.5% both domestically and globally.

Corporate earnings growth should return to more normal levels in 2022, following 2021's spectacular growth of 65%, with 9% growth expected in the U.S. Small companies should experience much faster earnings growth this year, at 31%.

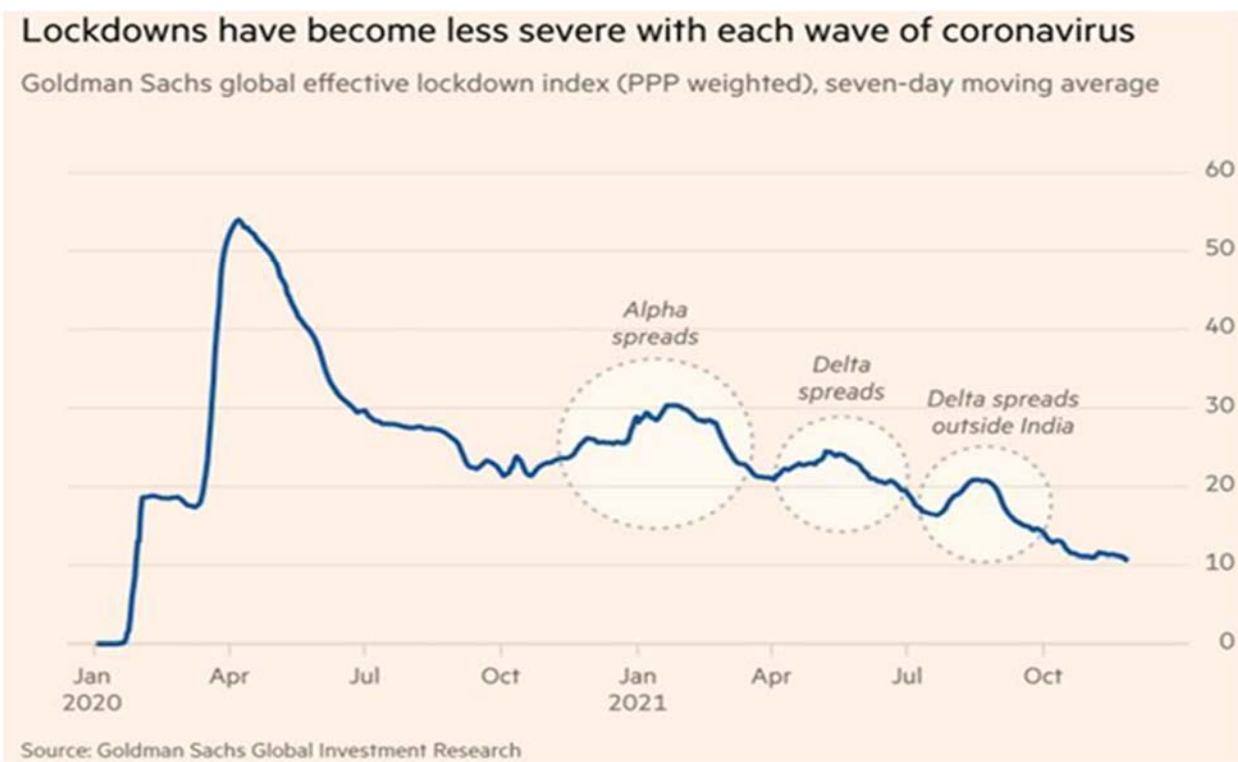
International company earnings have outpaced those in the U.S. during the recovery, largely because they declined more during the COVID-related downturn. Earnings growth over the next 3 to 5 years is expected to be 12% per year internationally vs. 10% annually in the U.S.

Source: JP Morgan

Profit Margins Are Surging: Corporate profit margins are at their highest level since 1950, although persistent inflation eventually could put a dent in these margins. One reason for increasing profit margins is that companies have been having trouble hiring, so employment costs have not kept pace with revenues.



<u>COVID Hits 2-Year Mark</u>: COVID remains a significant unpredictable variable in any economic forecast, though each wave of the virus has led to fewer economic lockdowns and less detrimental economic effects.



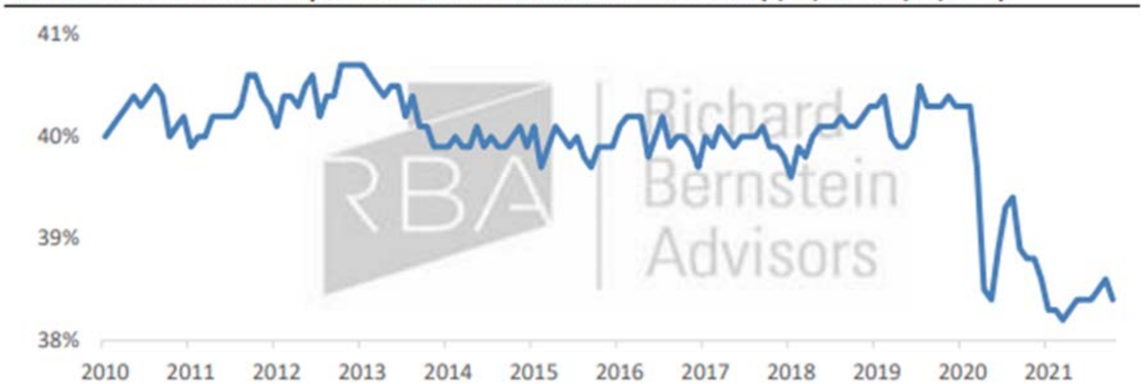
Source: Financial Times

<u>Jobs Are Hard To Fill</u>: Companies are continuing to have difficulty hiring, with staff shortages in many industries. There are currently 6.9 million people unemployed in the U.S. and 11.0 million job openings.

Wages are rising in many industries as the high school and college-age cohort benefits most, with recent wage growth near 10%.

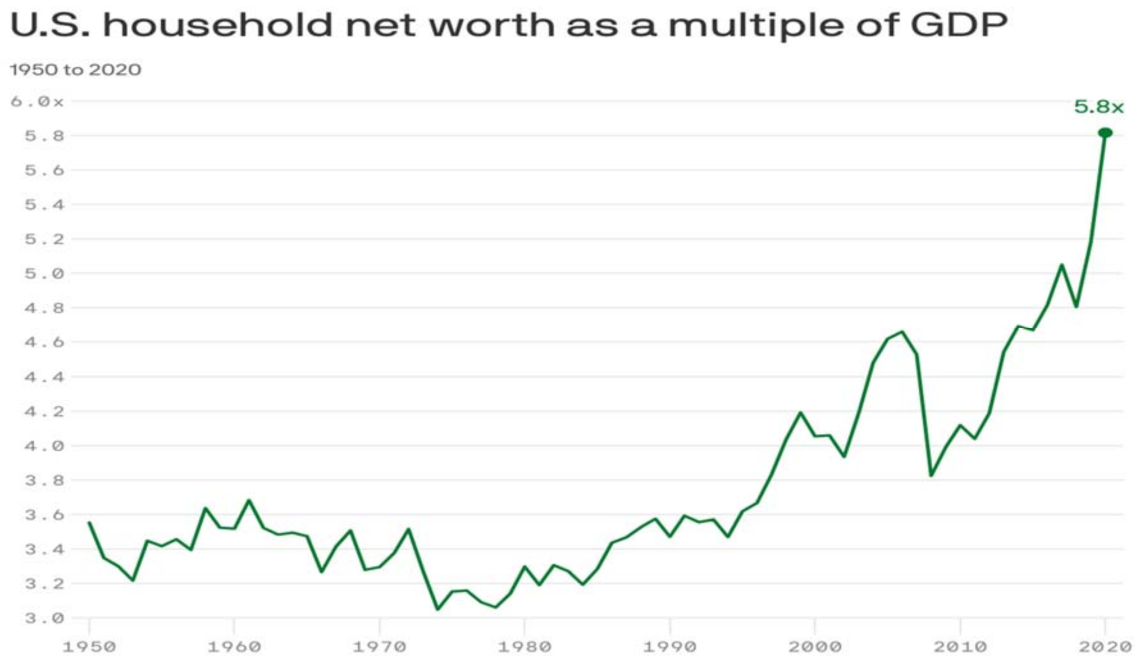
Five million people left the labor force over the past two years, and many have yet to return, especially older workers who may have chosen to retire early.

Chart 6: US Labor Force Participation Rate 55+ Yrs is the lowest in a decade (1/31/2010-10/31/2021)



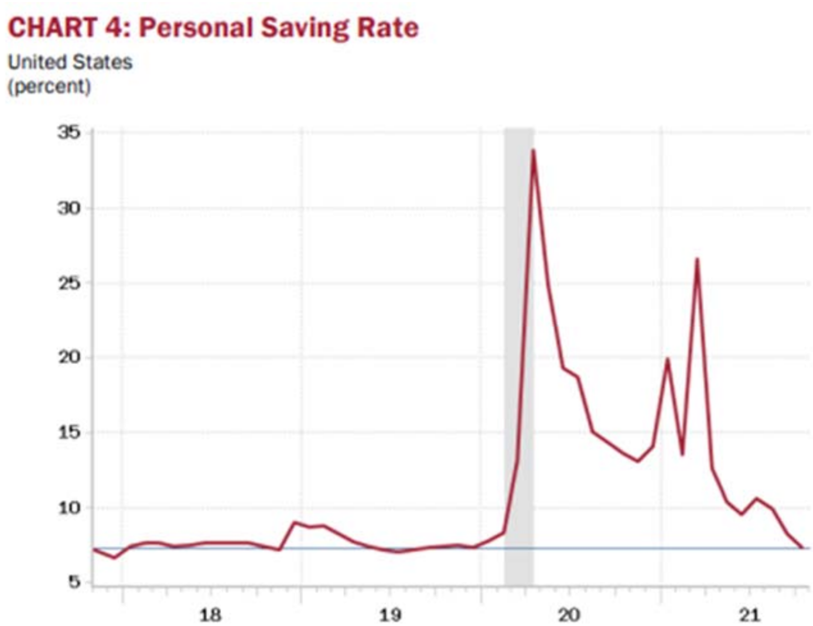
Source: Bloomberg, Bureau of Labor Statistics via Richard Bernstein Advisors

<u>Households Are Recovering</u>: In aggregate, U.S. consumers are recovering economically from COVID. Household net worth has surged to an all-time high, helped by strong stock market returns and sustained growth in real estate values.



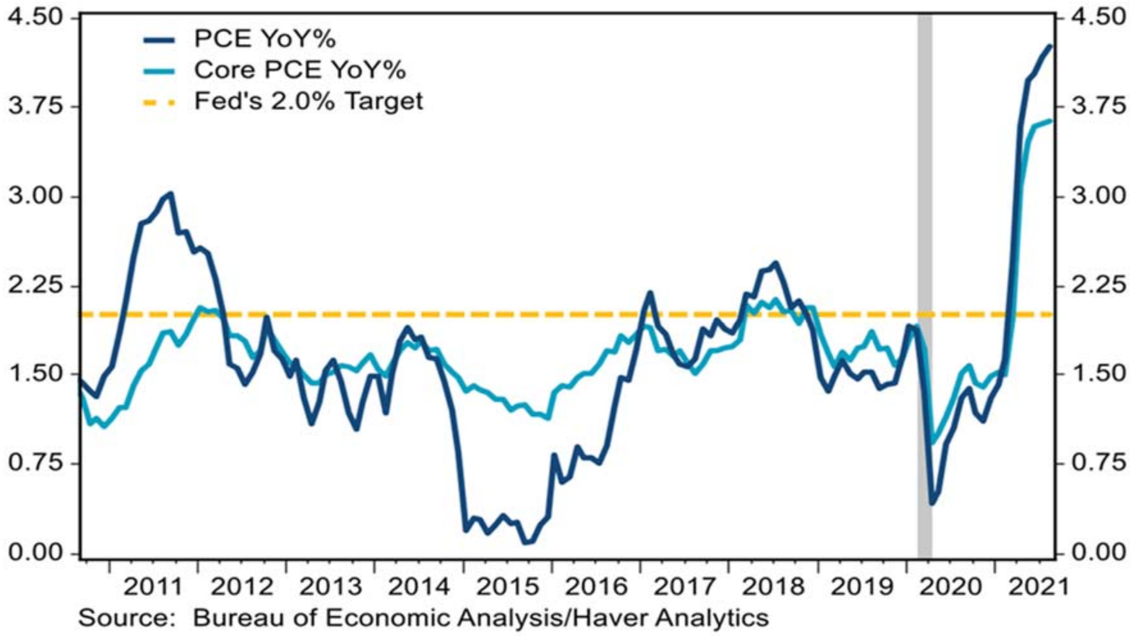
Source: Natixis

Personal savings rates have returned to pre-COVID levels, after spiking in 2020.



Source: Haver Analytics, Rosenberg Research via Natixis

<u>Inflation Is Not Easing Up</u>: The Consumer Price Index (CPI) recently hit 6.8%, the highest level since 1982, indicating that the inflation shock is not yet abating. Consensus expectations are for the CPI to increase 4.7% in 2021, followed by 4.4% in 2022 and 2.4% in 2023. Thus, it may take a couple of years to return to some level of pre-COVID normalcy. Personal Consumption Expenditures (PCE) continue well above the Federal Reserve's target for inflation.

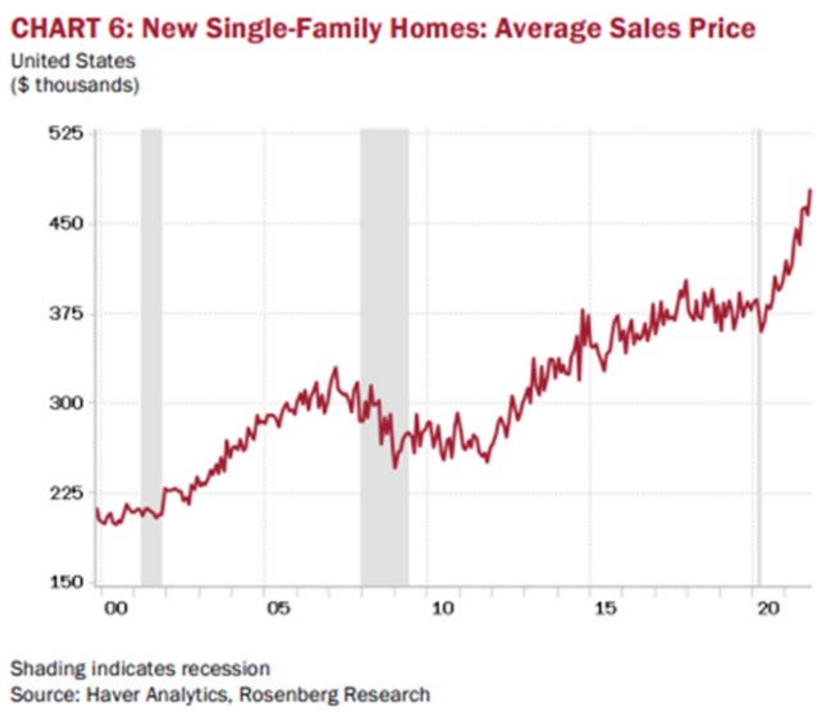


Product shortages persist and are taking longer than expected to return to normal, although there are some recent signs of improvement. Chip shortages could take another 18 to 24 months to work out. Companies continue to struggle to source components, so inventories-to-sales ratios remain historically low.

Source: Federal Reserve Economic Data (FRED)

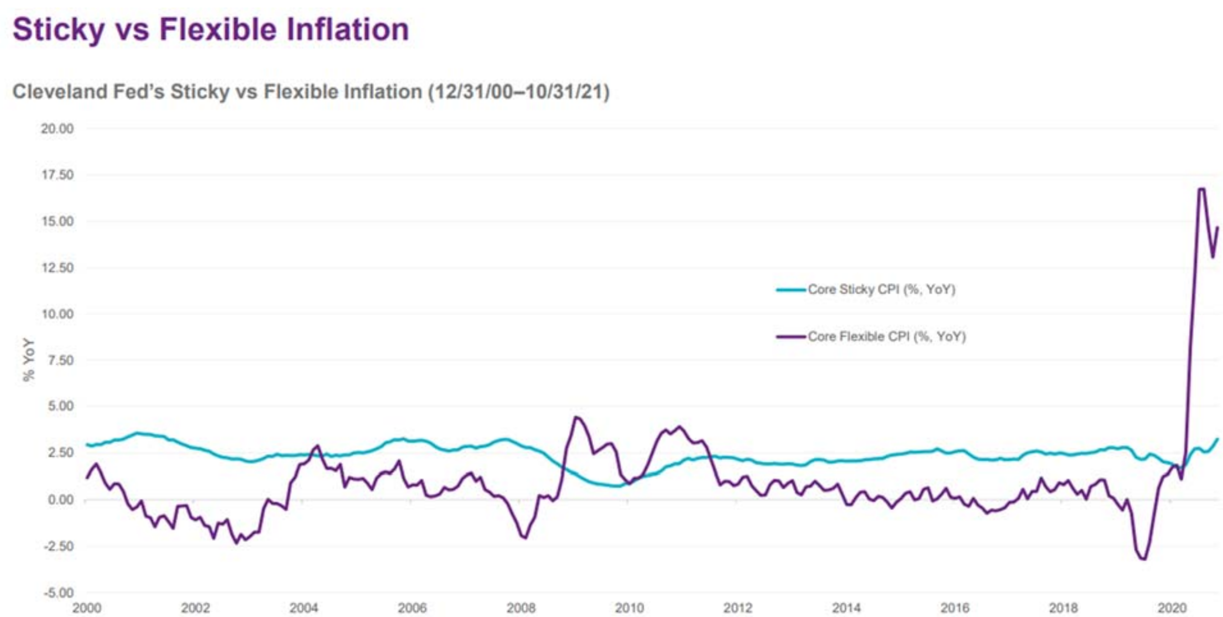
Some inflation is due to supply disruptions, while some is due to increased demand, particularly for goods.

Used car prices continue to rise as new cars remain hard to find. Housing prices have also surged, partially fueled by increased demand from investors. The number of homes purchased by investors has nearly doubled in the past six months. Also, commercial real estate prices increased 16% in 2021.



When Will Inflation Subside?: Some factors causing inflation are likely temporary while some could be longer-lasting. Supply chain disruptions ultimately should prove transitory, although they are taking longer to work through than expected. Other factors contributing to higher inflation could persist, including behavioral changes such as a return to one-income families from two, more labor power, the desire for more flexible work schedules, and a decline in globalization. Other structural factors could contain inflation longer term, such as aging demographics and technological innovation. Thus, inflation can be expected to settle in at a higher level than over the past decade (which has been below 2%), but without hyperinflation.

Prices defined as "sticky" tend to adjust more slowly and have therefore increased much less than "flexible" prices, which adjust quickly to changes in supply and demand. Sticky prices can be found in areas like wages, rent, and healthcare, while examples of flexible prices include gas prices, airfare, and hotel room rates. As shown here, most recent inflation has been in flexible prices, while sticky prices are just beginning to trend upward.



Source: Natixis

The Federal Reserve is Finally Responding: After saying for many months that inflation is only transitory, the Federal Reserve indicated in December that it will raise rates sooner than previously anticipated in light of persistently high inflation. The Fed first will remove some stimulus by slowing the pace of its bond purchases, then will move forward with rate hikes. The Fed anticipates raising rates three times in 2022, most likely beginning in spring or summer.