Monthly Market Review

November 2021

What happened in November?

The MSCI All Country World Index declined **-2.4%** in November, and the Barclays US Aggregate Bond Index gained **+0.3%**. Broad commodities endured their worst month of performance since March 2020, falling **-10.8%**, whereas gold appreciated **+2.0%**.

Equity market volatility increased following the emergence of Omicron and the Fed pivot, but our outlook for risk assets remains favorable.

On November 24, the COVID-19 Omicron variant emerged in South Africa. Initial reports suggest that it is likely more transmissible than the Delta variant, although there is limited evidence to conclude that its symptoms are any more severe than that of Delta. We will continue to weigh the potential impact this new variant may have on economic activity as more data is released, but we are currently optimistic that Omicron will more likely serve as a speed bump as opposed to something that will derail the economic recovery.

To add fuel to the fire, only days after Omicron emerged, the Fed communicated that it is time to retire the word transitory when referring to inflation and that it will begin to taper asset purchases faster than they anticipated, setting the stage for possible interest rate hikes by mid-2022. The combination of these two events incentivized market participants to demand protection (via purchasing puts) heading into next Wednesday's FOMC meeting, which in turn caused equity market volatility to increase, as the VIX (aka the fear gauge) rose above 30 for the first time since January.

We believe equity market participants are well hedged heading into the FOMC meeting, which reduces the likelihood that equities will experience significantly more downside from here; it's more likely that these hedges will serve as fuel for another rally if they need to be unwound.

Although economic growth is slowing from a rate of change perspective, absolute levels of growth remain elevated, and we believe the risk of reentering a recession in the next 12 months is low. If this view is correct, history suggests that equities will likely generate positive performance notwithstanding the slowdown in growth (see Chart of the Month).

Under the surface, a deleveraging is occurring in high-flying growth stocks.

Although the global equity market is only slightly off from its all-time-high, much more pain has been endured by crowded growth stocks of companies that have little or no profitability. Since the start of November, Cathie Wood's widely followed ARK Innovation ETF is down **-17.5%**, and the Morgan Stanley Crowd Index has fallen **-11.3%**, suggesting that a significant amount of the

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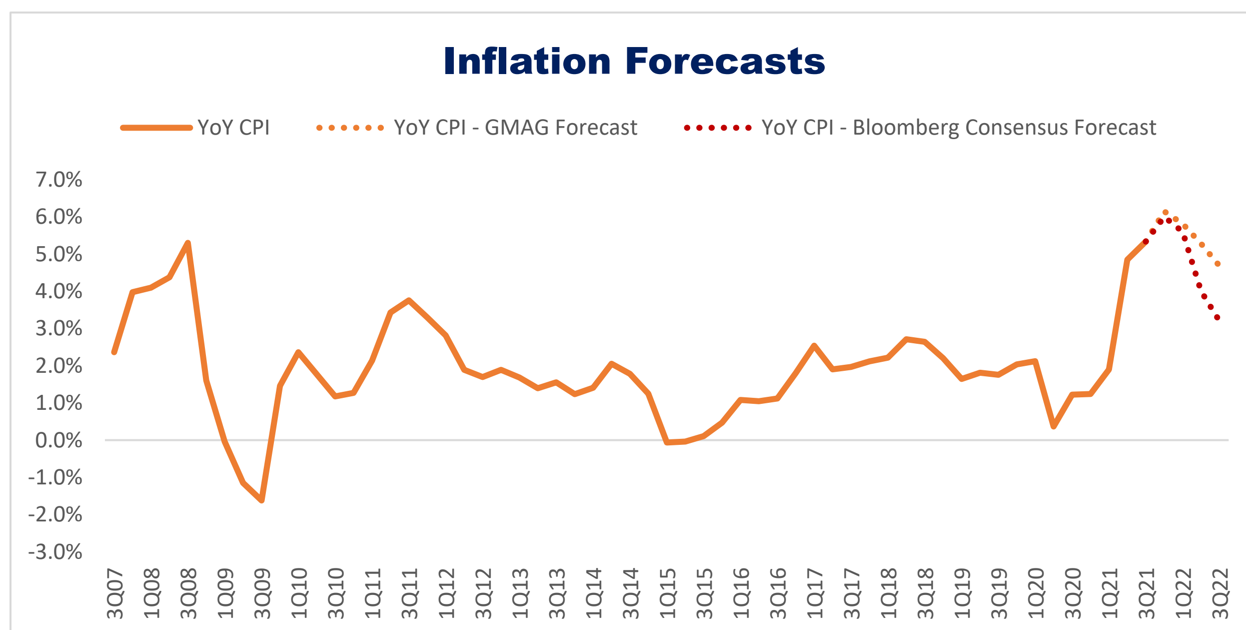
capital that had been pouring into these stocks in the hopes of generating big returns is now flowing out.

Whether the vicious sell-off in these crowded stocks presents a buying opportunity or is a sign that there is more pain ahead for this subsector of the US equity market is unclear. But we would prefer to see the prices of these types of stocks stabilize before we would consider adding to them.

The decline in commodity prices may provide an opportunity to add to inflation hedges.

The arrival of Omicron caused market participants to temper their expectations for aggregate demand, which in turn has pulled down inflation expectations. Furthermore, the more hawkish tone from the Fed exacerbated this reaction, and in tandem, these factors caused a sharp drawdown in commodity prices during the past two weeks.

Although we believe inflation will begin to decelerate in 1Q22 (see inflation forecasts below), this pullback could provide an opportunity to increase our exposure to inflation hedges, like commodities, in case inflation persists. Supply chain pressures will likely continue for the next several months, and they could intensify if lockdown protocols are reinforced in certain countries.



Positioning Highlights

Although equity valuations are elevated, our economic outlook remains constructive, and thus, we favor remaining overweight risk assets.

- **Maintain overweight exposure to equities.** We favor increasing exposure to equities as the economic recovery progresses.
- **Increase exposure to growth stocks within equities.** We favor increasing exposure to growth stocks, given our expectation that high economic growth will persist while inflation remains under control. In contrast, we favor reducing exposure to cyclical stocks because of evidence that the reflation/recovery trade may be nearing its end.

- **Maintain underweight exposure to defensive assets but less so than before.** We favor maintaining an underweight posture in defensive asset classes (e.g., fixed income) because we expect defensive assets to underperform while economic growth remains elevated. However, we tactically favor increasing exposure to long-term treasuries and defensive equity sectors in the near term because decelerating growth and inflation (from a rate of change perspective) could provide opportunities for defensive assets to outperform in the coming months and quarters.

Chart of the Month

Historically, even in environments where growth is slowing (i.e., stagflation, disinflation, deflation), average equity returns have been positive so long as the economy is not in recession.

		Avg Quarterly Return by Regime			
		Non-Recessionary		Recessionary	
Asset Class	**Category**	**Stagflation**	**Disinflation / Deflation**	**Stagflation**	**Disinflation / Deflation**
S&P 500	Equity	2.3%	2.7%	-6.0%	-8.2%
Consumer Discretionary	Equity	2.2%	3.1%	-6.1%	-6.2%
Consumer Staples	Equity	1.4%	4.1%	0.3%	-5.0%
Energy	Equity	3.0%	1.1%	-2.3%	-12.4%
Financials	Equity	2.8%	3.9%	-11.5%	-11.0%
Healthcare	Equity	1.4%	5.0%	-3.1%	-5.2%
Industrials	Equity	2.4%	3.3%	-6.8%	-10.2%
Technology	Equity	3.7%	1.9%	-6.1%	-8.7%
Materials	Equity	1.7%	1.7%	-5.3%	-7.0%
Utilities	Equity	4.8%	4.5%	-3.1%	-8.0%
Russell 2000	Equity	1.3%	2.3%	-3.8%	-9.1%
Pipelines	Equity	2.9%	3.3%	-2.4%	-8.7%
MSCI Emerging Markets	Equity	0.3%	1.4%	-8.7%	-5.5%
FTSE NA REITs	Equity	2.9%	4.8%	-2.7%	-8.1%

Source: Bloomberg, GMAG Research

Disclosure: Regimes are evaluated based on quarterly statistics for US gross domestic product and US consumer price index. “Average Return” represents the arithmetic average return for the specified asset class during each quarter from 1992 through 2020.

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