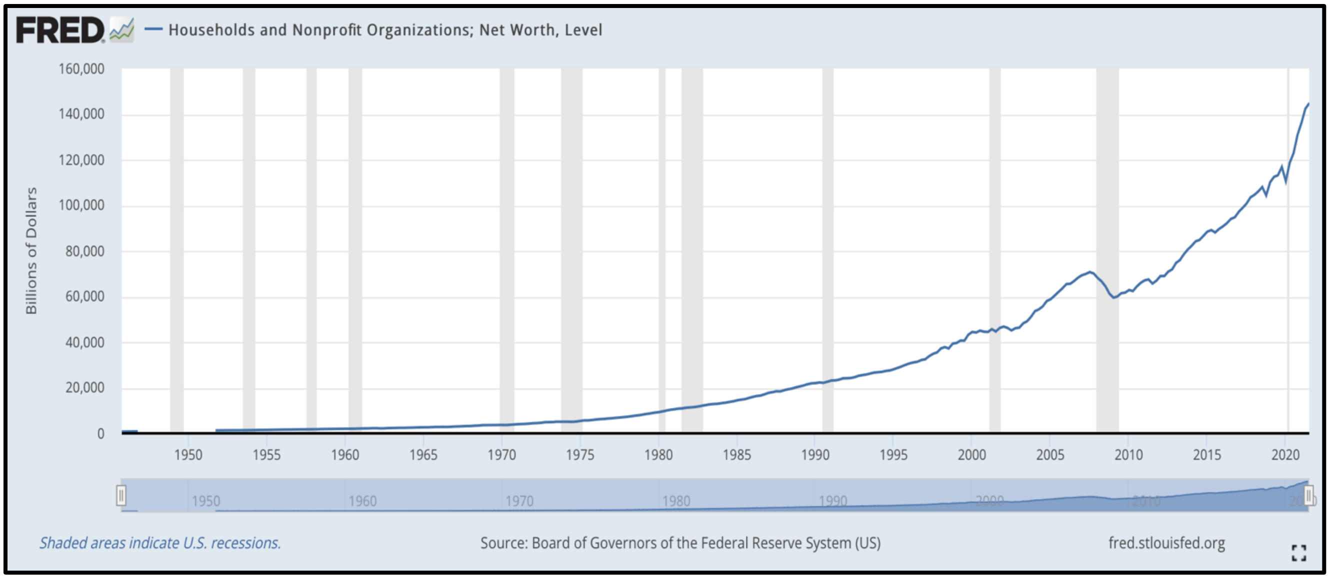
January 2022

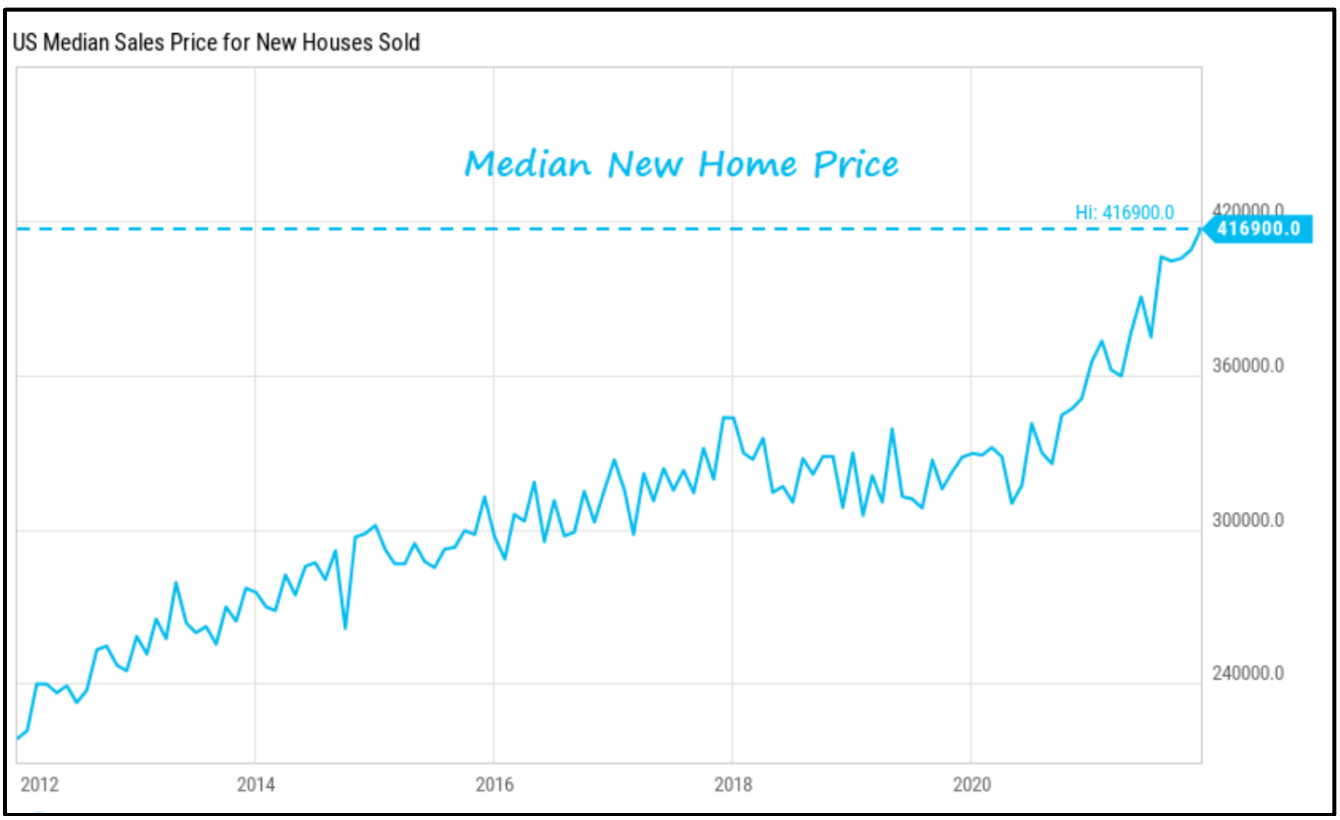
Everybody had a good year
Everybody let their hair down
Everybody pulled their socks up
Everybody put their foot down
Oh yeah, oh yeah

I've Got A Feeling – The Beatles
https://www.youtube.com/watch?v=hOfV1sGIj2I

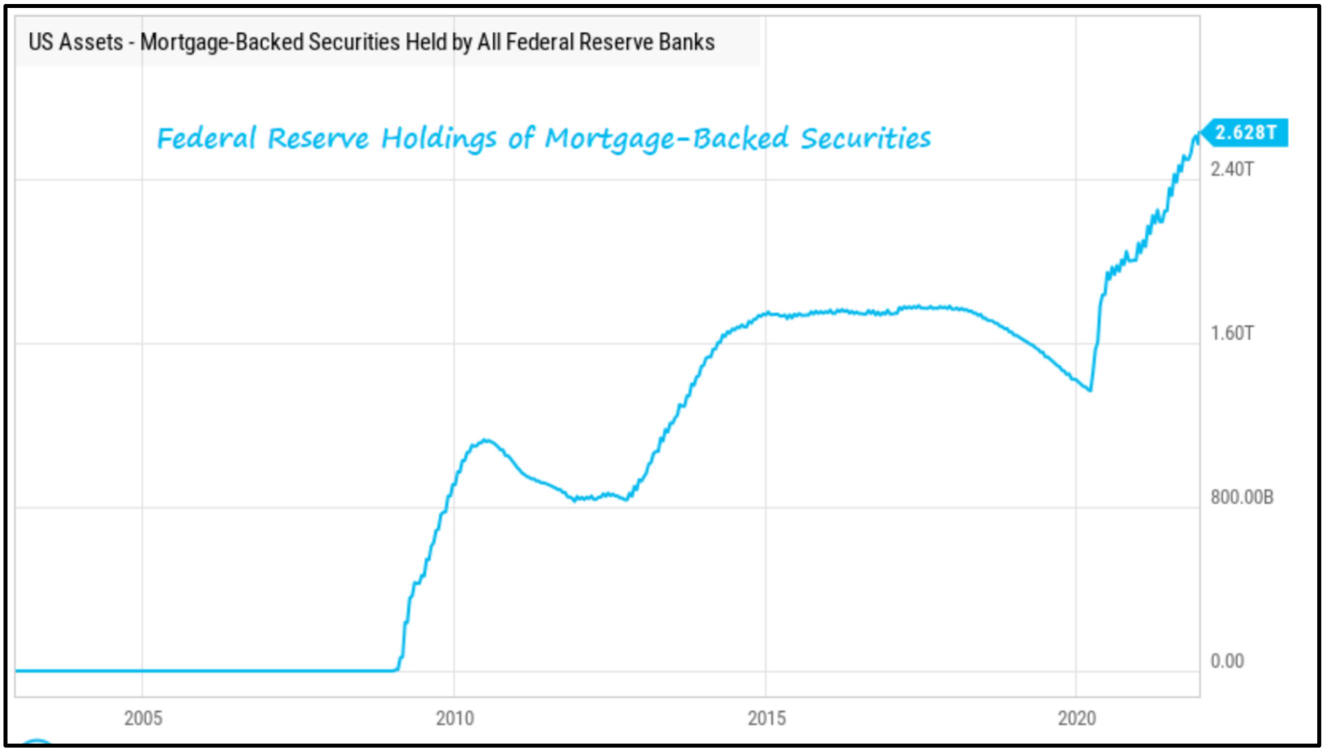
What a year! When it came to the stock market or your real estate, ***"Everybody had a good year"***. I know that sounds absurd when we're dealing with a global pandemic, but the numbers don't lie. This updated chart from the Federal Reserve shows a 17.7% explosion in U.S. Household Net Worth in 2021.



A big part of that Net Worth explosion came from the appreciation in housing. **Home prices are up 19% over the last year**, and have risen nearly 100% over the last ten-years from an average of $214,000 to $417,000 currently.



To the uneducated eye this looks a lot like inflation, but if you live in the ivory tower of the Federal Reserve, it is merely a transitory bump. How else can you explain the fact that even though the Fed talks about tapering their bond buying, they are still buying about $40 billion in mortgage-backed securities per month.

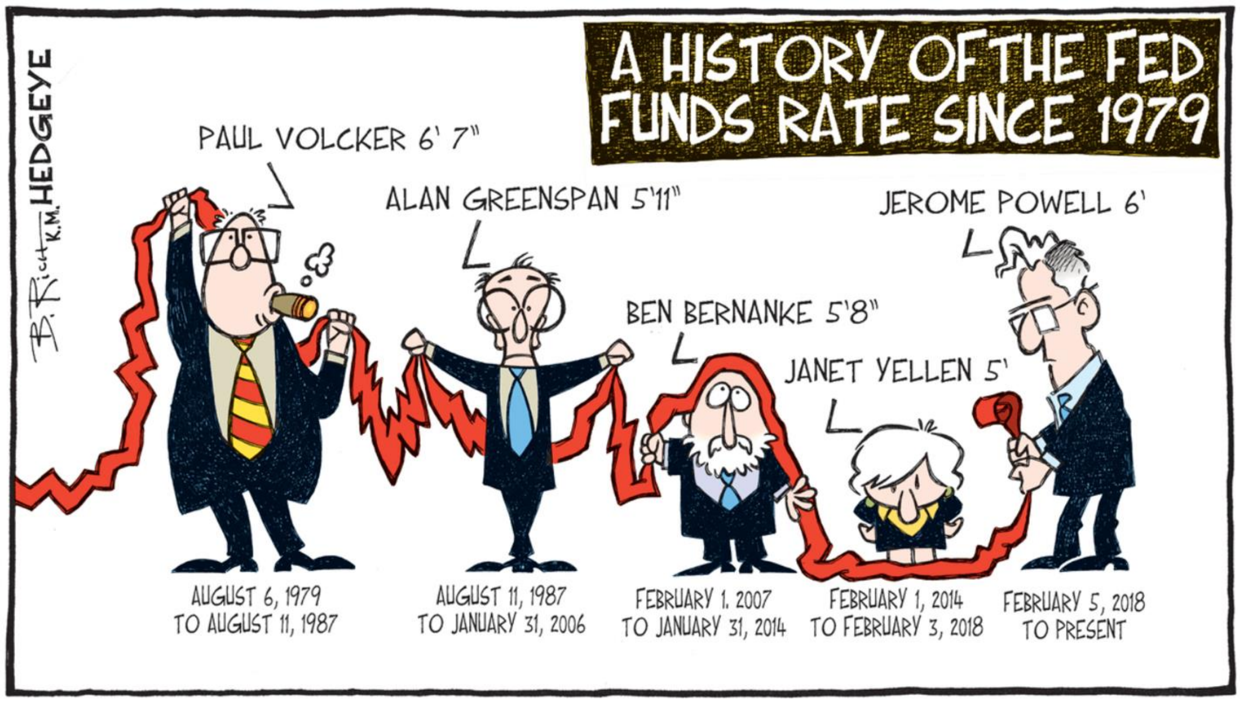


To be fair, the Fed has become more willing to accept the fact that inflation is probably more permanent than transitory and they are planning on stopping the bond buying by the end of the first quarter, and starting the process of raising rates around that time also. Of course, an uneducated skeptic like myself might question why they are waiting several more months before actually tightening? Fortunately, someone else asked Chairman Powell that exact question during his December 15 Press Conference.

December 15, 2021 Chair Powell's Press Conference PRELIMINARY

CHAIR POWELL. So, on the first part of your question, which is, why no stop purchasing now, I would just say this, we've learned that we're – in dealing with balance sheet issues, we've learned that it's best to take careful sort of methodical approach to make adjustments. Markets can be sensitive to it. And we thought that this was a doubling of the speed. We'll – We're basically two meetings away now from finishing the taper. And we thought that was the appropriate way to go. So we announced it and that's what will happen.

This is a key statement, and the first time a Federal Reserve Chairperson has publicly admitted that the Fed has another mandate**. We know that the Fed's two stated mandates are stable prices and maximum employment**. **These mandates are now officially joined by the third mandate, keep asset prices (namely stocks) from collapsing**. This so-called **Fed-Put** has been with us since Alan Greenspan used it during the 1987 stock market crash. It had been a temporary tool used to backstop markets in times of turmoil by cutting interest rates, providing liquidity, and more recently buying securities. But as Chairman Powell now admits, the Fed needs to make sure that their actions don't upset the stock market too much.



Why is this so important? Because it changes how investors perceive risk taking. If you know the Fed has your back you are much more willing to take on the risk of the stock market. If interest rates are going to remain near zero (or low single digits) then why own bonds? If you know that the downside in stocks is limited then why own stodgy value stocks versus sexy growth stocks? Why own small-cap stocks when the Fed is focused on the big equity indexes? Why own international stocks when the Fed is focused on U.S. stocks?

Is it still prudent to diversify away from the S&P 500 if the Fed is focused on making sure that the S&P 500 isn't going to experience too much turmoil?

This is probably the most important question facing investors and investment advisors. For decades we have preached diversification because segments of the market would go through cyclical swings and reversion-to-the-mean. No one area of the investment universe would consistently be the best performer. But that was before the Fed adopted a permanent Fed-Put. I'm not saying that the S&P 500 will never go down or that it will always be the best performing asset class, but it gets harder and harder to bet against it by diversifying away from it. Here are the returns for 2021:

	2021 Total Return	10-Year Annualized Return
S&P 500	**28.75%**	**16.44%**
Core US Aggregate Bond	**-1.77%**	**2.79%**
High-Yield Bonds	**3.75%**	**5.23%**
Large-Cap Growth	**27.34%**	**19.30%**
Large-Cap Value	**26.51%**	**13.74%**
Small-Cap	**17.56%**	**14.15%**
International Stocks	**11.46%**	**7.92%**
Emerging Market Stks	**-3.62%**	**4.73%**

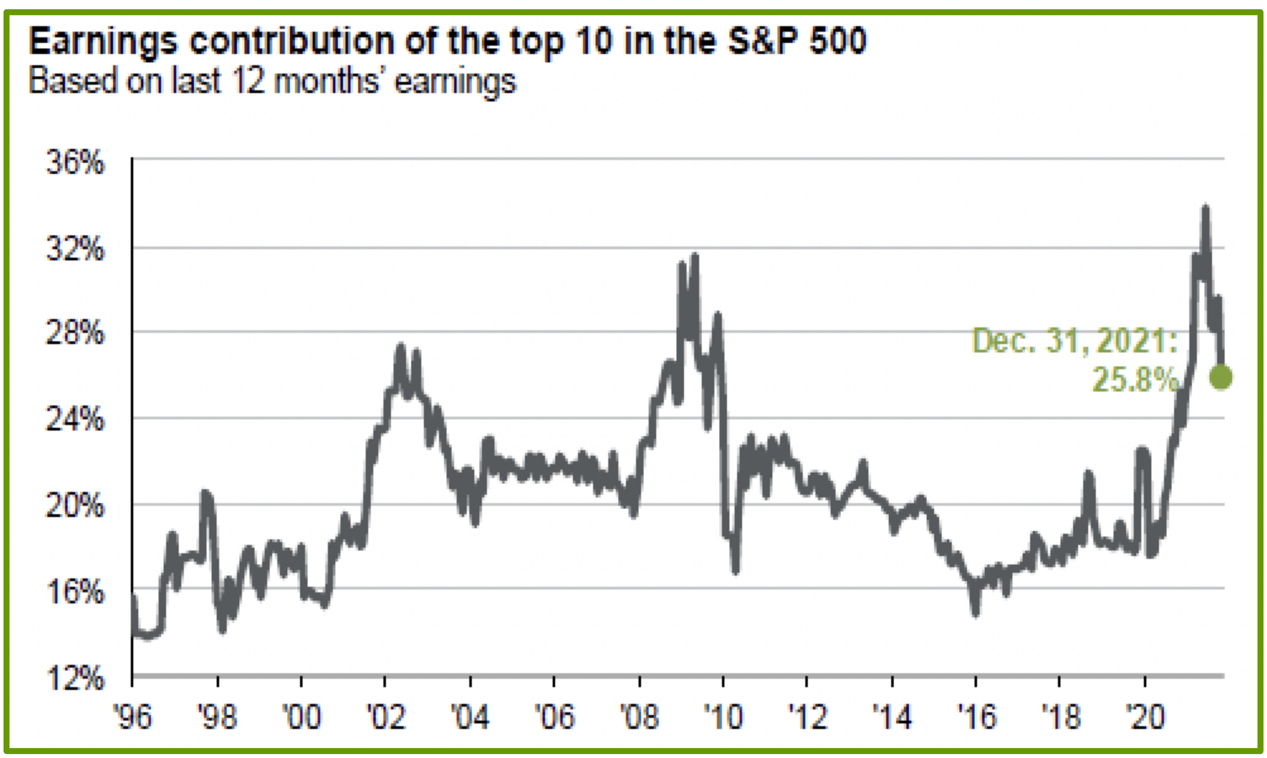
If the S&P 500 is the preeminent asset class, then we should probably take a closer look at it. There are actually 505 stocks in the S&P 500 because several stocks have dual share classes like Berkshire Hathaway and Alphabet (Google). The stocks are weighted by market capitalization. The largest stock is Apple with a market-cap of $2.92 trillion and an index weight of 6.86%. The smallest stock is Gap Inc with a market-cap of $6.68 billion and an index weight of 0.009%.

Since the S&P 500 is market-cap weighted, the best performing stocks get a larger weighting while the worst performers get a smaller weighting. Here is a list of the top ten stocks:

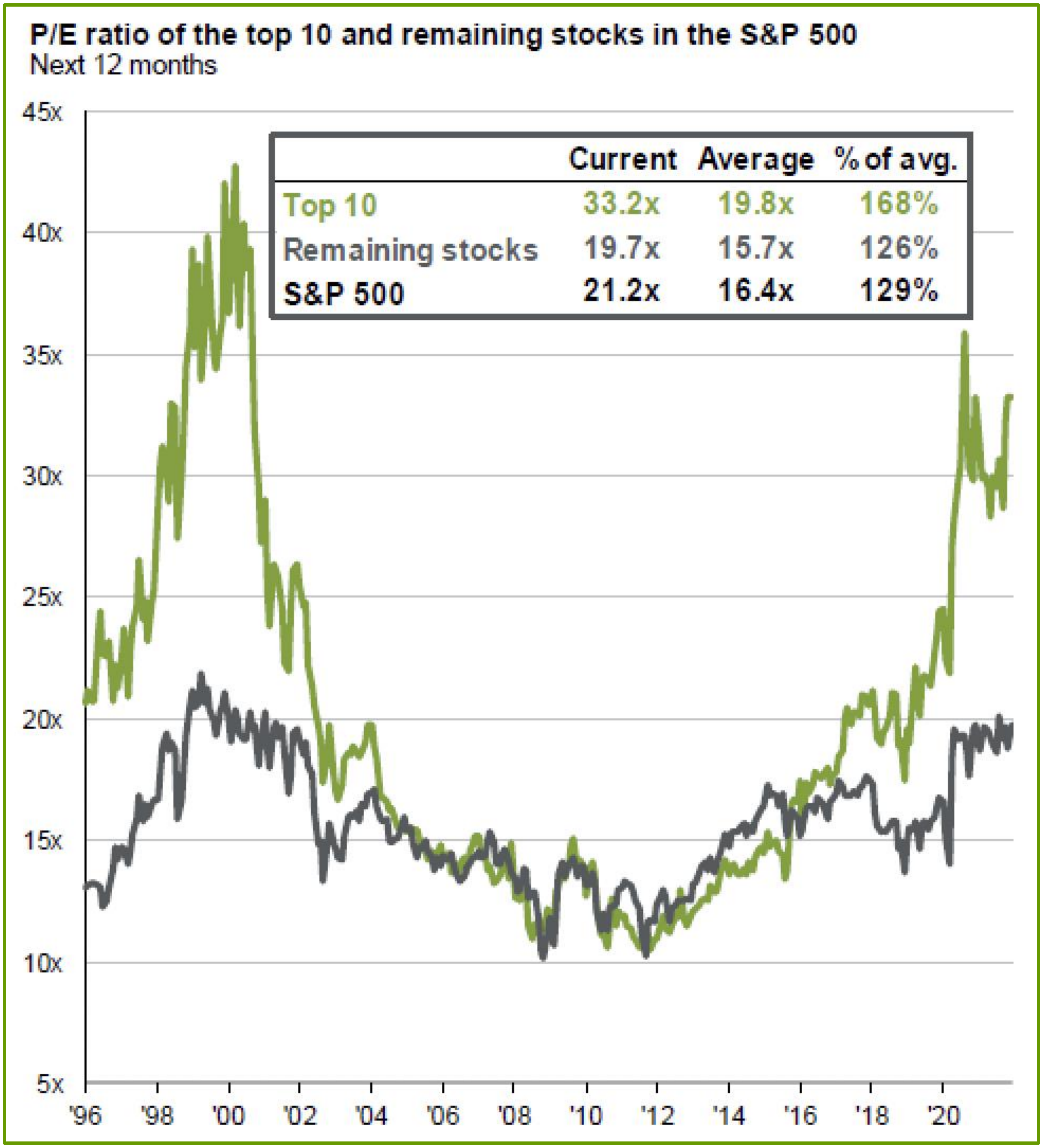
Top 10 Stocks in S&P 500	Weight in Index
Apple	**6.86%**
Microsoft	**6.29%**
Alphabet (Google)	**4.19%**
Amazon	**3.63%**
Tesla	**2.15%**
Meta Platforms (Facebook)	**2.01%**
NVIDIA	**1.83%**
Berkshire Hathaway	**1.36%**
UnitedHealth Group	**1.17%**
JPMorgan Chase	**1.16%**
Total	**30.65%**

So, when you buy the S&P 500 over 30% of your money is going into these ten biggest stocks, 29% is in the next 50, so nearly 60% of your money is in the top 60 names. The remaining 440 stocks account for about 40% of your investment. **Last year these top 10 stocks accounted for 47% of the S&P 500's 28.75% return!** This concentration in the top ten stocks is the largest in history, and you can see how it has really accelerated in the last eight years.

These top ten stocks also account for about 26% of the S&P 500's earnings.



And have a higher valuation.



	Current	Average	% of avg.
Top 10	33.2x	19.8x	168%
Remaining stocks	19.7x	15.7x	126%
S&P 500	21.2x	16.4x	129%

So, as we enter 2022, coming off such a financially rewarding 2021, why don't we feel better? In fact, according to the University of Michigan Index of Consumer Sentiment reading of 70.6, **American's are more miserable than any time since 2008**, when we were in the throes of a global financial crisis and stocks were down 38%, not up 27%. Of course, this sour mood can be explained by the relentlessness of Covid-19 and its variants, our deep political divides, and surging inflation. Will 2022 be the year Consumer Sentiment rises to catch up to the stock market, or will the stock market fall to align more with Consumer Sentiment? Or maybe they meet somewhere in the middle. No one knows. For now, I'm appreciative of my Fed Put, my record high net worth, and my health.

Everybody had a hard year
Everybody had a good time
Everybody had a wet dream
Everybody saw the sunshine
Oh yeah, oh yeah

Watching the Beatles documentary *Get Back* on Disney+ was one of my special moments this holiday season. At first, I was a bit antsy about starting an eight-hour documentary, but soon found myself relaxing and looking forward to the next day as *Get Back*'s pleasures started to bubble to the surface. We're invited to be one of their pals, perched quietly on an amp, listening to them mess around. They make small talk about headlines from the paper or jokes about famous people on TV. It's very meandering, and also oddly soothing.

Another thing that I found truly amazing was watching a song that I've listened to for decades (*Get Back*) come into existence. In Episode 1, Paul McCartney is strumming a guitar, messing around with an idea as Ringo and George look on while waiting for John to arrive. Paul keeps playing with the words, but watching him muster *Get Back* out of thin air is like nothing I've ever seen before. One second, the song doesn't exist; the next, he's playing it and improvising the lyrics, bringing it into being by sheer force of will. The fact that Ringo Starr is sitting opposite yawning and Harrison looks equally bored suggests McCartney did that kind of thing a lot. For those of us seeing this for the first time, it looks like some kind of witchcraft. If you're a music fan I highly recommend hanging out with this documentary.

I wish you all the best in this New Year. Take care and be careful out there.

Chris Wiles, CFA

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