



**BLUE GRANITE CAPITAL, LLC**

## **INVESTMENT COMMENTARY, JANUARY 2022**

Greetings!

2021 resulted in surprisingly strong stock market performance. For the third year in a row, the S&P 500 Index finished with a double-digit gain supported by massive stimulus and robust consumer spending. Last year the S&P 500 recorded 70 new daily highs (the second most ever), and its 3-year cumulative gain of 78% is extraordinary by any standard. The best news is that your investments have grown in lockstep with these remarkably strong returns.

Looking into 2022, we remain mindful of Covid's disruptive aspects. The virus will likely control headline news and affect consumer behavior and economic growth well into the year. The effects of this are currently manifested in supply chain issues, massive labor shortages, and the Fed's interest rate deliberations to combat inflation. With trillions in economic stimulus behind us, consumer's resources and their appetite for continued spending remain a big test for growth in GDP and corporate earnings throughout the year ahead.

The Fed has finally sided with our presumption the economy's highest level of inflation in 40 years is not 'transitory,' and they must now attempt to balance full-employment objectives with a more hawkish monetary policy. A more aggressive Federal Reserve Bank is poised to raise interest rates in the face of manufacturing and shipping bottlenecks, and something akin to runaway government spending and rising national debt. We've been critical of the Fed for underestimating the impact of inflation for too long. At their December meeting, the Fed at last acknowledged that inflation is no longer temporary and a problem that requires intervention in the form of higher interest rates. The Fed seems to be stuck between and rock and hard place. Either try to rein in inflation and risk stalling economic growth or remain accommodative and let inflation run high to support the economy and financial markets. It will be difficult to accomplish both, and either option will have economic and political ramifications.

In our opinion, inflation (which has increased 7% over the past year) is the most pressing issue that we are facing. Gas, food, car, furniture, and especially rent prices have escalated during the past year and hit consumers where it hurts. Rent alone represents 30% of the cost of living, an amount which is likely to climb as the eviction moratorium ends and rapidly rising home prices fuel the demand for rental units.

Despite a current unemployment rate at decades lows, over 11 million unfilled job openings have led to labor shortages which are causing global delays in manufacturing, shipping, and related supply-chain logistics. Job openings far outstrip the pool of available workers, especially due to the exodus of millions who are leaving the workforce at historical rates. This 'Great Resignation' has led to a shortage of labor that is contributing to wage inflation as companies compete for workers to fill job openings. The consequence of this could ultimately slow hiring, hurt profitability, and impact stock market performance of publicly traded companies.

Through this prism, we are mindful of potential volatility due to historically high stock valuations and changes to the domestic and global factors that we have described. Our expectations are for lower levels

of appreciation this year than we experienced in 2020 and 2021. Even in strong economic cycles, stocks experience declines of 10% or more on a regular basis. The benefit of such a selloff is that it reduces the speculative nature of the equity markets and provides Blue Granite the opportunity to deploy cash in the portfolios into both stocks and sectors that have been overly and unfairly punished from the decline. Please be assured that we closely monitor all manners of variables that may impact our portfolio strategy to protect your principal while providing prudent appreciation.

As a parting thought, while much is said about the current challenges of investing in a low interest rate environment, we'd like to highlight the benefits of your portfolios. 95% of the stocks that you own pay dividends, and most have yields significantly higher than the yield on the 10 Year Treasury Note (currently 1.85%). So, in addition to being invested in a high-quality portfolio of stocks, the dividends generate an above average income stream and many of these companies tend to increase their dividends annually. We view this as an increasing, added return on your investment. Dividend-paying stocks also tend to be more conservative and more defensive during stock market declines which helps to mitigate market risk and smooth out volatility. We believe these attributes of our portfolio strategy position you well for the coming year.

Please contact us if you have any questions and, as always, we thank you for your support.

With warmest regards,

Scott, John, Dave, Richard, & John