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Behind all the minute-to-minute lurches is a stock market that is somewhat forward-looking. But that's the problem, as in six month's time the easy money that has supported stock prices for so long, will be gone. More, the torrid rate of economic growth coming out of the pandemic will be replaced with slowing growth and corporate profits will be squeezed by decelerating revenue growth and from rising wage costs. No wonder markets are so jittery. Central banks have changed their position on inflation, and now see the issue as more entrenched than transitory.



The U.S. Federal Reserve has been clear in its position that they are willing to introduce a series of interest rate increases, if that is what is necessary to bring inflation under control. Higher rates reduce the present value of future corporate cash flows, making shares less valuable. The effect is especially marked for the shares of tech companies, which are priced for profit growth long into the future. Understandably, the NASDAQ is off to its worst January ever.

Valuations are also high, with prices at a steep 36 times earnings. Market moves to the downside can be seen as part of the market mechanism where stocks incorporate all known information into share prices, and rise and fall accordingly. Formerly high flying growth stocks are particularly vulnerable to re-pricing, as evidenced by Netflix and Zoom, both of which have fallen sharply year-to-date.

The Economist

Froth coming out of equity markets that were too extended on valuations is routine stuff, though never welcomed by investors. So what would it take to improve the market mood? Well, for starters Omicron may prove to be the final wave of the pandemic, and assuming it fades, so might the labour bottlenecks behind much of the recent inflation. This would reduce the pressure on central banks to raise interest rates, allowing the market to begin to move upward -albeit more slowly.

We've got eleven months yet to go, so a miserable start to 2022 does not mean the year should be written off yet. Staying focussed and being patient is always helpful during times such as this, as is the reminder that holding stocks means holding them for the long run.

As always, call me at any time with any questions and thanks for reading!

Martin  
1-519-546-5088

MARTIN WEILER, FINANCIAL ADVISOR  
FIRST CAPITAL FINANCIAL / WORLD SOURCE FINANCIAL MANAGEMENT INC  
50 CORESLAB DR. DUNDAS, ON L9H 0B2  
P: 519-829-1331 F: 833-869-8042  
MARTIN@FCFCORP.CA

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