Fiducient Advisors, Nonprofit Investment Stewards Podcast
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Predictions for 2022 That Can Affect Your Investment Portfolio with Bob Doll

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs, and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:26] Now onto the show. Hello, and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo. Great as always to be joined by Devon Francis. I always felt that you could call out financial advisors, economists, even weathermen, because they make all sorts of predictions and then never revisit them to share how well or poorly they've done.

[00:00:49] That's one of the many reasons why I admire today's guest. He's a financial expert who puts it all on the line. He tells you specifically what he expects and then you better believe he comes [00:01:00] back very publicly and tells you where he did well. And maybe where there were some misses on his forecasts. So, you're about to hear predictions for where the market's headed, what will happen with inflation and a whole lot more.

[00:01:12] But first Devon, great to be with you. Great to be with you, Bob. We are so excited today to have a true powerhouse and leader in the investment community on the show, Mr. Bob Doll, he is the chief investment officer of Crossmark Global Investments. Bob is a financial services industry veteran and at Crossmark, he leads the firm's investment office.

[00:01:35] Previously, Bob was chief equity strategist and senior portfolio manager at Nuveen Asset Management. And he earlier served as chief equity strategist at BlackRock. Bob makes regular appearances on CNBC, Bloomberg and other outlets. And he's become known, as you mentioned, Bob, for publishing a set of 10 predictions, which forecast key themes and risks driving equity markets and the global [00:02:00] economy.

[00:02:00] Bob, we are so thrilled to welcome you to the show. Thanks for coming. Devon, thank you for the opportunity. I'm looking forward to it. Bob, just terrific to be back with you in touch with you. And, and maybe we could begin before we jump into your 10 predictions with your role and how you attempt to help investors navigate these markets.

[00:02:20] Certainly. So, at Crossmark Investments, uh, we are a faith-based from managing values-based products. And the essence Bob is a belief and an observation that increasingly investors want to line up their investments with their values, whatever those values are. And so, our goal at Crossmark is to create products, mutual funds, and separately managed accounts.

[00:02:46] That fit the needs of that audience. And I'm having a good time overseeing the investment operation, managing money, large cap US. I have a suite of SMAs and mutual funds that I manage and, uh, trying to get the [00:03:00] word out of who we are, what we do and how we can help investors. Terrific. Well, Bob, let's start with the economy and where you see things headed in the US economy this year.

[00:03:11] So, we think we're going to have another good year, not as great as last year, as you know, Bob, last year was the best economic growth measured by GDP since 1984. And long-term growth in the US is around 2% real. We think 2022 will be somewhere between the two, call it three and a half, 4% growth, still a great year for the history books. Inflation, the same thing.

[00:03:41] Less than the picked up pace if I can call it that in 2021. But more than the long-term average that we've seen. Call inflation three-ish for 2022. So, Bob, you mentioned a bit about the equity market outlook. How about return expectations for bonds? Yeah. Also, sadly, [00:04:00] we think 2022 will be like 2021, meaning you're going to lose money in most bonds.

[00:04:07] We pick on the ten-year treasury since that's the benchmark. And if we're accurate, that's a money loser this year. That will be the first back to back years, 21 and 22 where that instrument lost your money since the 1950s. And the reason for that is, uh, as you can imagine, Devon, interest rates creep higher because the economy is pretty good.

[00:04:30] Inflation's read its ugly head and the fed has a lot of work to do. So, Bob, I know you called for a correction in stocks in 2022. And even though it's early in the year, I think we can pretty much check that box off. So, first of all, kudos to you and secondly, what do you expect now? Yeah, we, we thought coming into the year that it was going to be a tug of war.

[00:04:51] In fact, this was our theme for the entire 10 predictions, a tug of war between earnings tailwinds and valuation [00:05:00] headwinds. And of course, in the length of January, we've mainly focused on the latter. The valuation headwinds. Our view was that the consensus arguing that stocks would move up with earnings this year.

[00:05:12] Was missing the fact that you can't argue for a price earnings ratio of 22 times earnings where we were on December 31st, if interest rates and inflation are rising. So, we expected this tug of war. Volatile, side-wise, frustrating. The bull's frustrating to the bears. And I think that's what is going to be. Our year-end target published in December was 4,500, which made us look horribly bearish.

[00:05:41] But, uh, 2500s above, uh, where we spent most of January. And Bob has your thought evolved at all on that? Not really, Bob. Look, we did not expect that the correction would come so fast and furious in the month of January, we thought it would [00:06:00] evolve during the course of the year. And look, valuations are a bit more reasonable now.

[00:06:06] And, uh, fourth quarter earnings are coming in reasonably good, but not as good as the last bunch of quarters. So, I think that tug of war I've just described is probably the way we're going to have to view this this calendar year. And we'll have some big rallies. Don't get me wrong. I don't want to come across as bearish, but I think we'll also have setbacks as investors digest.

[00:06:27] The amazing bull market that we've seen over the last few years, not withstanding the pandemic. That makes sense. And Bob, I didn't see it in any of your 10 predictions, but obviously, we're still in the midst of a pandemic here. And just curious if that factors at all in any way into your predictions and how you think things might unfold this year.

[00:06:49] Yeah. So, I'm no epidemiologist and therefore, um, don't have any science around what I'm about to say. Having read and read and read some more as I suspect you have, my [00:07:00] view is this isn't going away, that we're going to learn to live with Corona virus and its various forms and mutations and variants.

[00:07:09] But we don't think that it will hamper growth on a longer period of time. It will have impact for example, this first quarter, because of the most recent variant isn't going to be as good as it would have been, had we not had that? So it will be on investor's minds, but we don't think it's going to paralyze the economy as it did when we first closed it down.

[00:07:32] Fair enough and, and jumping back to stocks and perhaps drilling down a little bit, let's talk a little about the old growth versus value stocks subject. And here, I think some praise is in order, based on the predictions you made at the onset of the year, but perhaps you can share your prediction what's happened and really what you expect from this point forward.

[00:07:53] Yeah, we expected value stocks to beat growth stocks. And you were kind to point out that uh, that's happened in spades [00:08:00] in the start of the year. In fact, in our recent weekly commentary, uh, we've erased half the deficit, that is value has outperformed growth by so much already this year, that half of what we look for for the whole year has already happened, and we're going to get rallies and growth will probably lead those rallies and that value will come on again.

[00:08:21] It's just the value stock is so cheap compared to growth stocks. And as it, or more importantly, in an economy that's good where interest rates rise, that is a high correlation with value stocks winning. That's good to know. And it's interesting to put it in perspective that value stocks have made up half of the deficit that they were at.

[00:08:43] I haven't heard it in those terms. So, we talked about growth versus value. How about small versus large cap stocks? Yeah, this is the toughest of the three pair that we talked about, the third pair being cyclical versus defensive stocks. As you [00:09:00] know, small stocks tend to be more cyclical than large stocks.

[00:09:05] And again, back to our economic view, this could be another good year. That's probably a year where the cyclical side of those small stocks which incidentally are very cheap compared to big stocks. It gives them some tailwind. In down markets, uh, small stocks, almost always underperformed. So, I don't want to sound like we're talking out of both sides of our mouth because we're looking for a sideways chop where those small stocks have a chance of doing well.

[00:09:36] And Bob, there is a lot happening in terms of energy and then financials and, and utilities and so on. And maybe you just want to talk a little bit about your thoughts on and really expectations in various sectors this year. Certainly Bob, as you know, we always have a prediction that talks about sectors especially in a year where we think the [00:10:00] market's not going to have a big positive or negative return.

[00:10:03] You've got to make your money by getting the tactical moves right. And being in the right places and sectors one way to address that. Our preferences for financial and energy stocks over and against utilities and communication services year to date, as you know, energy stocks have done very, very well.

[00:10:22] Financials have been above average also. So, we're off to a good start. Financial is our favorite sector at this juncture, they benefit from an improving economy for a little more lending, from rising interest rates. They're pretty inexpensive. Their balance sheets are in good shape. So, there are lots of ways to win in the financial sector.

[00:10:43] And energy, despite their run so far this year, it's a simple supply and demand story as is usually the case with energy. If you get supply and demand right. On the demand side, we have a globe that's improving with some emphasis of countries outside the United [00:11:00] States. And we have a supply situation that is more limited for economic and a lot of political reasons.

[00:11:07] So the path of least resistance so far for the underlying commodity oil has been to the upside. And we suspect that oil remains firm. So Bob we've kind of covered the domestic landscape, talked about market cap, large versus small, talked about style, growth versus value, let's shift to geographic areas.

[00:11:30] And what do you expect from foreign stocks relative to US stocks? Well, I think the right question for all investors to ask is, will international markets ever outperform the US again? The lead that the US has had in the last decade has been extraordinary. There was only one year in the last 10 where international beat the US.

[00:11:51] So we think it's time for a repeat of that one year. International stocks tend to do better when the economy of the globe [00:12:00] is doing better. Remember, the United States stock market is the most defensive stock market in the world. We have more companies and industries that are somewhat independent of the economy.

[00:12:10] We have more growth companies. So, when the economy gets moving, the cyclical nature of non-US markets tend to do better. Icing on the cake would come if we get some weakness in the dollar and we're expecting that, uh, the dollar has been strong for longer than many of us thought. The dollar is viewed as defensive.

[00:12:33] And this is not a defensive environment. As inflation moves higher, that tends to cause people to move to other currencies. The size of the US trade, the current account, the budget deficit. When we run balances like that, it's often in an environment where the currency is weakening. And then I would add to that, that valuation.

[00:12:56] While it doesn't matter much in the short run, it certainly is in our can. [00:13:00] Uh, European stocks are six or seven PE points cheaper than the US. Japan, seven points cheaper. Emerging markets, nine points cheaper. We're not sure that that discount for international makes sense. And Bob, when you talk about foreign stocks, developed and emerging, do you have any preferences or just thoughts in general in terms of geography on the developed front, but then specifically you talk about trailing specifically on the emerging market front.

[00:13:31] Any thoughts there? I start by saying that consensus earnings growth expectations for the US, the Eurozone, Japan and emerging markets is about the same. Uh, eight, 9% for 22 and eight, 9% for 23. So, there's no big earnings differential, Bob, and that's an important point given all the other things I said.

[00:13:55] Within the Eurozone, uh, we think that, I should say within non US, the Eurozone [00:14:00] is the area we are most interested in. It's an out of favor area, and we think there's some economic turn coming. Germany is the biggest and easiest way to play it. And that makes sense to us. The emerging markets, well, you know, there's China and then there's everybody else.

[00:14:15] Although everybody else is a little bit too big of a paintbrush, we like the Pacific rim, the countries that serve big and fast-growing China and India. So, let's talk interest rates for a moment. Obviously, we've seen an increase in interest rates. What do you expect for the balance of the year? Higher, uh, but irregular.

[00:14:36] So, let's start with the ten-year out, the curve. Clearly, um, you know, for, for, for listeners, to repeat what's happened, the 10-year treasury yield was 50 basis points. One half of 1% at the height of the pandemic. And by the end of 2020, was at 93 basis points. And by the end of 21, a hundred and [00:15:00] fifty basis points at 1.5%, we're already knocking on the door of two and we think we'll be comfortably in the twos before this year is over.

[00:15:10] If interest rates rise the same case this year as they did last, which is a good simplifying assumption, that would get the 10-year yield to 2.09%. Then there's the fed and the fed is, I don't, can't remember in my career a faster pivot. You know, if we did this podcast, uh, around Labor Day, we be debating of the fed.

[00:15:32] The Fed's going to raise rates at all in 2022? And now of course the debate is, is it going to be four times, five times, six times, seven times? So it's clear that the fed is behind the curve. Some would argue the fed is never been further behind the curve than they are today. So, they have a lot of work to do. And therefore, interest rates will hopefully creep, meaning not gallop higher.

[00:15:59] And [00:16:00] Bob, along with interest rates, you mentioned inflation briefly earlier and they're often, but not always, linked. Can you drill down a little bit more on your expectations for inflation? Yeah. Bob, thanks for bringing up inflation. This, to me, is the most important issue for what's going to happen to financial markets this year.

[00:16:19] So we had the pickup in inflation at all levels. We wrote a white paper back in September when the fed was still trying to convince us that inflation was transitory. And we argued, there are three pieces to inflation. I will maintain that argument. One, there is a piece that is transitory, that will slowly disappear.

[00:16:38] Thankfully. Two, there's inflation related to the supply shortages that we've seen in so many places. We believe and hope that will solve some of those issues in calendar 2022. And then, most ominously, there is, I'm going to call it core or structural inflation. Somebody said, how do I see that? I say, go buy a car, [00:17:00] go rent a car, go buy an apartment, uh, or buy a house or rent an apartment, go to the grocery store, go fill up that car with gasoline.

[00:17:09] And if you don't experience an inflation from 12 months ago, I think you're out to lunch. Getting that out of the system because it's now back with wage rate gains, including some unbelievable union settlements. I think inflation is here to stay. So ironically Bob, inflation during the course of this year, will fall because remember, it's at 7%. We think we'll end the year at three to 4%.

[00:17:36] And a lot of people think it's going to be lower than that, or head lower than that into 2023. So, the jury is out on inflation. It is going to take some time to figure it out. And knowing that stocks are, are in fact real assets. Righ? And generally do okay in other than a spiking inflationary environment. Does your most recent point about inflation will [00:18:00] actually be rolling off of a high?

[00:18:02] Will that just uh, sort of be an anomaly here and not break what you would normally expect? Or does that have the view this any differently on how equities will perform in the inflation setting you laid out? Yeah, I, you're right on. And that is to say we had inflation for, seems like forever, for kind of one to 2%, occasionally in the low twos.

[00:18:23] And now all of a sudden we wake up and consumer prices are up 7%. Uh, it's where are they going to settle out? And most observers argue it will fall during the course of this year, but my guess is we're going back to three and a fraction, not two or less than two. So, the jury, to repeat, is still out on inflation and it's going to be a while till we know.

[00:18:47] I think what we'll watch carefully is what do corporations say in their quarterly releases about inflation and cost pressures? And the third quarter earnings, which we saw in the fourth [00:19:00] quarter reported obviously, corporations passed on cost increases very easily. But now that we're reporting fourth quarter earnings, it's not so uniform, that is, there's some companies are saying, you know, our margins got hit a little bit because there are cost pressures.

[00:19:15] So it's going to come and it's going to go. And I think it is the biggest risk we have for financial markets. It's why interest rates move up some and PE ratios move down some. Remember, the fed funds rate 0%. That connotes an emergency. And we add one, but that emergencies long since passed. So, it's time to get on with it.

[00:19:40] So we've talked very broadly about the investment landscape, but up until this point, we've ignored the political landscape. So let's shift to politics. What do you expect in the political realm, particularly with regard to upcoming elections in Congress? So, our 10th prediction is always a political one.

[00:19:58] This year, it is Republicans gain at [00:20:00] least 20 to 25 house seats and narrowly win the Senate. If accurate, this will be the eighth out of the nine last elections where Americans kick the bums out. Whoever's in power gets kicked out of office. We haven't seen that kind of string in 150 years. So, uh, frustration with politicians, the ones that are in power, is very high.

[00:20:24] If in fact we're right and the Republicans recapture Congress, Joe Biden's economic plan is on life support. It won't last much longer. They got a couple of months here to try to get something done. And then after that, it's going to be, uh, the old um, you know, standoff, if you will, which markets often like.

[00:20:46] Part of the reason we're more cautious on the market than we've been in recent years. One, the second year of the four-year cycle, that is this year, has the biggest drawdown in those four years, 19% on [00:21:00] average. And secondly, I don't want to get too technical here, but the S and P 500 is going up three quarters of the time. If you only look at midterm election years, which this is.

[00:21:11] The S and P has gone up to 62% of the time. But if you only look at midterm elections in the first term of a president, only 44% of the time. So, in this year, it would be, if this is the only thing you know, more than 50% chance stocks go down. So, it's among the reasons we're a little more cautious. So, Bob we've covered a lot today, but we've done a lot of quick hits.

[00:21:35] So given the fact that our listeners include not only nonprofit leaders, but also investment committee members and a whole host of folks, is there anything you'd like to touch on in more depth or do you have any recommendations or key points you might want to leave with the audience? Uh, so, well, three things come to mind very quickly.

[00:21:54] One, buy low, sell high, and if you couldn’t figure that out, please call me. [00:22:00] Number two, I come back to the theme. We've had an amazing bull market, both in stocks and bonds. Again, not withstanding the interruption during the pandemic. We think it's not going to be that case this year. It's going to be tough to make money.

[00:22:16] We're gonna have to be a little more tactical. I didn't say you have to be a trader, just a little more tactical, which means if you have some money earmarked for stocks, wait for a down period to put it in. And if you need to take some money out, try to have the patience for an up period before you do that withdrawal.

[00:22:32] And my third point, which is related is, and we're about to put a white paper out on this. Future returns in stocks and bonds are unlikely to be anything like we've seen over the last frankly four decades. We've had a 40-year bull market in bonds, when interest rates went from double digits to not far from zero, and that allowed valuations in the stock market to skyrocket. We think there [00:23:00] is some return to more normalcy.

[00:23:04] When you start with valuations, high profit margins for corporations at the high end, it can be tough to make a lot of money this decade. So, we think returns will be more like half of what they've been. So, stocks have had a 10% compound return since the S and P 500 started in 1926, next 10 years, maybe half of that, which is, uh, sobering for those who've gotten used to double digit returns.

[00:23:26] It sure is, Bob, and I, I know as a CIO, money manager, putting out these 10 predictions, you're thinking about these things all the time, but I also believe, I know you were, and probably still are serving on various boards and committees. If you were to put on your investment committee cap for a nonprofit, or maybe not even an investment committee, just a, a leader at a nonprofit organization, given what you just said about sobering, expected returns.

[00:23:57] I know you don't practice behavioral finance. [00:24:00] But any other thoughts coming from that stewardship role that you might share with folks? Yeah, I, I think, it's, you know, don't, don't be greedy. Not that, uh, most people are, but it's easy to get into that pattern. What we've told people at a practical level, you know, if, if you're, whatever your equity target is, if you've not touched it for a while, you've probably crept above that target.

[00:24:25] And of course the corrections taking care of some of that recently, but, you know, don't hesitate to rebalance back to target. And if the market goes straight up, at least you've got a bunch in there. And if it doesn't, you'll be glad you made that move. Fixed income I think is going to be the most challenging over the next bunch of years as quote, we normalize interest rates, which means if I can find some alternative investments that I cannot understand that fit in the pool of assets I'm responsible for, that, uh, don't significantly increase the risk of my portfolio.

[00:24:58] Again, Bob. [00:25:00] Alternative investments are some that increase your risks, some that decrease your risk. I'm interested more in that second category. If you can find some things that uh, look like, behave like fixed income returns, fixed income volatility, but don't have interest rate risk. That's a good place to look.

[00:25:18] So Bob, we have really appreciated the insight that you've shared with our audience. Before we let you go, we'd love to learn a little bit something about you as a person. So outside of your very demanding work, uh, efforts and also your volunteer efforts, what do you truly enjoy doing? Well, I, I want to underscore the volunteer efforts.

[00:25:38] I'm on 10 boards, all nonprofits. Almost all faith-based. So I get a lot of enjoyment and satisfaction out of serving there. I also direct the choir at our church and play piano in Oregon. So that's just a wonderful, can I call it escape or some might say a rest, uh, from, uh, from what I do [00:26:00] every day.

[00:26:00] Uh, and, and, and that's, that's a blast. And other than that, uh, trying to keep up with my wife and my kids keeps me pretty busy. I think that might be a world record, serving on 10 boards while you have a full-time job and a wife and family and serve as choir director. I think you might've just taken on the mantle of busiest man alive. Certainly, on our podcast, right?

[00:26:23] Yes, absolutely. So, thank you so much for joining us today. You have shared such great expertise and, you know, it's really fun to do this kind of prediction-based episode. If folks want to learn more or access resources, where might they go for that? Uh, Crossmark's website, Crossmarkglobal.com. Terrific.

[00:26:45] Bob. Well, thank you so much on behalf of myself and Devon, this has been terrific. We're really glad you joined the show. My honor and privilege. Thanks for calling on me. Thank you. And as always, a big thank you to our listeners. As Bob was talking about market [00:27:00] volatility, it is heating up and may generate concern for those of you who oversee endowment or foundation portfolios. Fiducient Advisors has a resource, and I'm telling you, we are here for you.

[00:27:10] Feel free to reach out to me or Devon on LinkedIn, right? The links in this episode show notes. So, to all you good stewards, thanks for investing time to help your nonprofits prosper. We'll connect with you soon on the next episode. Thank you for listening to the Nonprofit Investment Stewards podcast. Click the subscribe button below to be notified of new episodes and visit fiducientadvisors.com for more information.

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[00:27:51] Always seek the advice of qualified professionals familiar with your unique circumstances.