Morris Capital Advisors, LLC

Investment Commentary
December 31, 2021

What a Long, Strange Trip It's Been

I'm not a big Grateful Dead fan, but I'm sure that the line above, from their song "Truckin" is recognizable to both dedicated and casual fans alike. It should be, because apparently it has been performed by the group more than 520 times in concert. It's immediately recognizable because it succinctly encapsulates an idea that we can relate to so easily. Who hasn't struggled to work through some challenge that defies a simple solution through twists and turns that seem to stretch forever?

In many ways, the financial markets have been on a long, strange trip. Since the Great Financial Crisis in 2007-8 we have been on a financial experiment that employed novel and untested macro-economic policies involving central bank intervention in the financial markets and government intervention in the economy. The trip has become all the more strange as the impact of the COVID pandemic and policy responses added another layer of distortion on the global economy and financial markets. The result has been labor shortages, a sharp resurgence of inflation, supply chain imbalances, and a rapid escalation of non-traditional investment assets. We now begin an unwind of these policies without a clear understanding of the impact on our fragile economy and financial markets.

Despite the uncertainty, stock market performance has been impressive. The markets struggled in September, as concerns regarding the potential for a government shutdown and proposed tax increases weighed on investors. The uncertainty was compounded as a series of negative earnings pre-announcements raised concerns about corporate profitability. The markets turned upward in October as the shutdown was avoided, major tax increases were removed from proposed legislation, and reported corporate earnings were better than expected. The markets stumbled in November as pandemic concerns resurfaced, but finished the year with an impressive rally as the Fed reassured the markets by effectively conveying policy changes that would reduce financial stimulus and address inflation concerns. The policy moves, combined with data demonstrating that the severity of recent COVID cases were much lower, pushed many of the major stock indices to new highs by quarter-end.

For the full year, the four major stock indices posted positive returns, with the S&P 500 outperforming the Nasdaq for the first time since 2016. The Russell 2000 small-cap index underperformed as the prospect of reduced fiscal and monetary stimulus, and the prospect of higher interest rates, weighed on these smaller companies. Growth stocks outperformed value stocks once again, but as the year progressed and the potential impact of policy changes became a concern, value names began to show signs of a rebound. The shift was hardly enough to reverse the trend that has been in place since the Fed began its quantitative easing policy after the Great Financial Crisis, buy it could signal a shift in market leadership away from the mega-cap growth names that have dominated the market over the past several years.

Since the Great Financial Crisis the Fed has kept interest rates artificially low by injecting massive amounts of liquidity into the economy. This has had the effect of lowering the cost of capital and encouraging companies to borrow to fund marginally profitable projects or stock buybacks. At the same time, the Federal government enacted numerous major stimulus programs that have provided cash for increased consumer spending which accounts for two thirds of GDP. A little understood result of the Federal stimulus was the perverse effect on labor availability as stimulus cash reduced work incentives. Labor constraints arose just as supply chain disruption reduced the availability of raw materials, raised commodity prices, and constrained production. The Federal government and Federal Reserve may have engineered the strong rebound from the pandemic lows, but it remains to be seen if this is a lasting recovery or a "pull forward" of demand that will not survive the removal of stimulus and higher interest rates. The Fed will need to move cautiously as it implements its policy shift and it may be possible that the Fed will need to be much less aggressive in its implementation than initially intended. Based on the experience of previous Fed policy shifts, the transition may increase uncertainty as the Fed adjusts its policy actions in an attempt to manage market reactions.

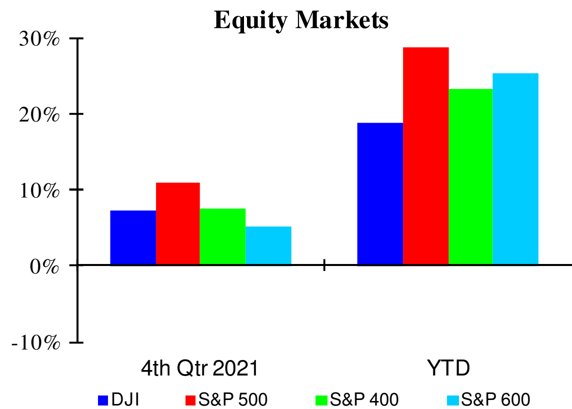
As the economy transitions from the stimulus-induced rebound to a more moderate economic expansion, we could continue to see a shift from the high growth mega-cap names to companies with strong fundamentals and reasonable valuations. We know that the immediate impact of those policy changes are beyond our control and that our best course of action is to focus on the investment discipline that has guided us successfully through difficult markets in the past. We believe that company fundamentals matter and that an investment strategy built on that belief has the best opportunity for success over the long term. We will continue to search for companies that demonstrate the potential to grow revenue and earnings despite the complexities of recent events. We aim to invest in those companies whose shares are priced attractively relative to those fundamentals. We believe that well diversified investment portfolios based on this philosophy will be successful no matter how long and strange the trip might be.

Sincerely,
Daniel A. Morris

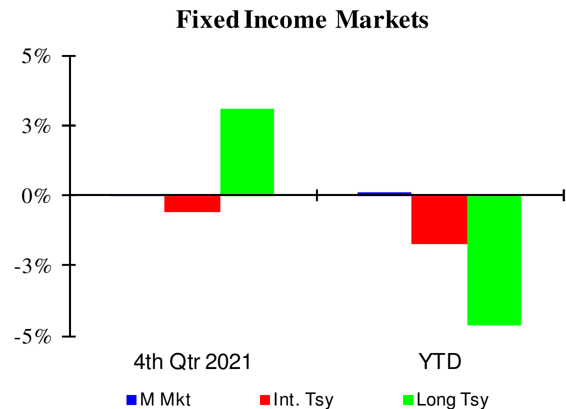
Market summaries on reverse page

Morris Capital Advisors, LLC

Market Summary
December 31, 2021



The stock market rallied during the 4th Quarter of 2021 rebounding from weakness in September caused by investor concerns about slowing economic growth, rising inflation, and uncertainty about the timing of Fed policy shifts. The strength of the rebound was impressive, especially in light of the fact that many of the concerns that had weighed on the market remained unresolved. The returns were not uniform across the board as large-cap stocks outperformed small-cap stocks, while large-cap growth stocks outperformed value stocks, but growth underperformed value in the small-cap space. The weakness in the small-cap sector, combined with growth stock underperformance could be an indication that investors remain concerned about the potential for rising inflation and slowing growth.



The bond market reflected many of the same investor concerns regarding rising inflation, slowing economic growth, and the potential for a shift in Fed policy. Yields among shorter-dated maturities rose sharply as the market anticipated interest rate increases and a tapering of Fed purchases of US Treasury and mortgage-backed securities in the open market. Yields on longer-dated maturities declined driven by concerns that a less accommodative Fed will trigger an economic slowdown. The rise in short-term rates, coupled with the decline in long rates, served to “flatten” the yield curve which is often an indicator of an economic slowdown.