BARRON'S

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MARKETS | ROUNDTABLE

Expect a Tough Year for Stocks but Lots of Opportunities for Bargain Hunters, Barron's Experts Say

By Lauren R. Rublin   Updated Jan. 15, 2022 10:43 am ET / Original Jan. 14, 2022 10:44 pm ET

Illustration by Alvvino

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Goodbye, punch bowl. We're going to miss you. As the Federal Reserve prepares to drain liquidity from the financial system to cool the inflation that its policies partially stoked, Wall Street's pandemic-era party appears to be ending. Stocks, bonds, crypto, you name it—almost every asset class has hit a rough patch since 2022 dawned, and things could get worse before they begin to get better.

That's the consensus of the 10 investors on the *Barron's* Roundtable, which met this year on Jan. 10, on Zoom. The group looks for inflation to rage and stocks to stumble in the first half of 2022, as the Fed begins to raise interest rates, although the year's second half could bring more stability and positive returns. Their forecasts for the S&P 500 index range from a double-digit loss for the year to a gain of 8% or so, plus dividends, with most panelists in the middle.

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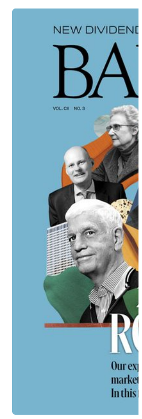
Here's another prediction: 2022 will bring "the revenge of the investment nerds," as one of our panelists put it, and the other nine readily agreed. In other words, momentum investing is out with the punch bowl. Making money will require instead the sort of deep research into company fundamentals that our panelists favor, plus the bargain-hunting instincts they possess.

This week's Roundtable installment, the first of three, features our panelists' economic outlooks and market views. It also includes the investment picks of Todd Ahlsten, chief investment officer of Parnassus Investments, in San Francisco, and lead portfolio manager of the Parnassus Core Equity fund [ticker: PRBLX], and Sonal Desai, chief investment officer and portfolio manager at Franklin Templeton Fixed Income, in San Mateo, Calif. Todd is an exuberant champion of "great American companies'' with wide moats, lengthy growth runways, and admirable environmental, social, and governance, or ESG, characteristics. Sonal illustrates once again how to find income in an arena that today offers little.



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**2021 Barr
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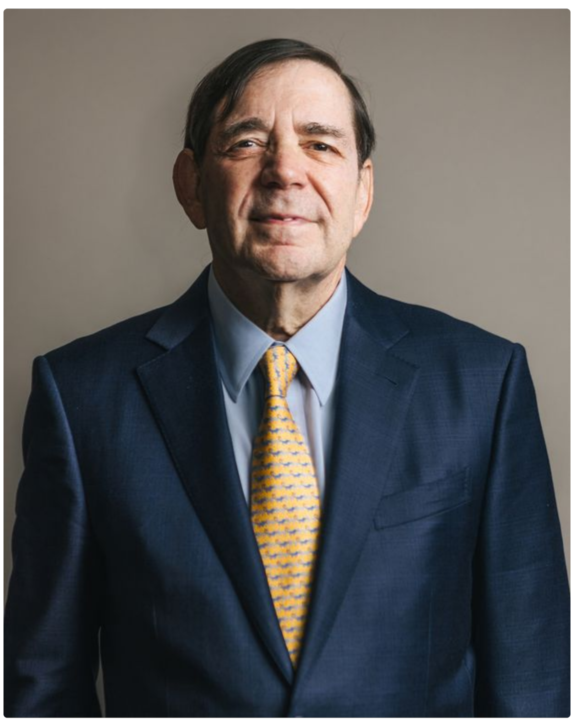
David Giroux, chief investment officer of T. Rowe Price Investment Management, and manager of the T. Rowe Price Capital Appreciation fund [PRWCX] joins the Roundtable this year. His words, and everyone's, are worth savoring. You'll find them in the edited transcript below.

***Barron's*: Last year was a rough one for humanity and a great one for the markets—much better, in fact, than anyone here predicted. This year, the markets are off to a less auspicious start. Scott, what lies ahead for the U.S. economy and investors?**

Scott Black: Real gross domestic product should grow on the order of 3.8% to 4%. That's a good backdrop. Corporate profits, as defined by S&P 500 companies, will be up 9%. The big problem I see is that the Federal Reserve has been way behind the curve in dealing with inflation. Former Fed Chairman Ben Bernanke did a good job of supporting the economy during the financial crisis of 2008-09. Jerome Powell, the current Fed chairman, did a good job two years ago in responding to the Covid pandemic and economic shutdowns. But inflation is now running close to 7%, the highest it has been since the early 1980s. The Fed's failure to control it is going to have a deleterious effect on the market.


Scott Black, founder and president, Delphi Management, Boston
Photograph by Angela Owens

At the time of the financial crisis, the Fed's balance sheet was about $850 billion. Today, it is $8.8 trillion. The national debt has surged to $29 trillion, and the debt-to-GDP ratio is close to 1.3 times, both all-time highs. The Fed was reluctant to raise interest rates sooner because it feared killing economic growth.

Also, higher rates raise the interest expense on the national debt. Every one-percentage-point increase in rates adds about $290 billion of federal interest expense, so the Fed had an incentive to cap rates at today's very low level. Given the current rate of inflation, the 10-year Treasury theoretically should yield closer to 3.5%-4%, not 1.8%. That would add $580 billion of interest costs to the budget, and the country would have no money left for discretionary spending. So, the underpinnings of the economy are pretty good, but high inflation doesn't bode well for the market.

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We'll discuss equity valuations later, but I'll note that operating profit margins peaked in the second and third quarters of last year at a little over 13%. That is probably as good as it's going to get because of wage inflation and supply-chain disruptions.

Sonal Desai: Echoing Scott's comments, I want to make six points.

Only six?

Desai: I'll start with six. At the start of last year, I expected a vaccine-induced economic boom. While the vaccine rollout was as fast as could have been expected, vaccines weren't as game-changing as we would have liked. That, combined with some of the subsidies included in the $1.9 trillion of fiscal spending at the start of last year, produced a sharper labor shortage than we expected.

Sonal Desai, CIO and portfolio manager, Franklin Templeton Fixed Income, San Mateo, Calif.
Photograph by Mary Beth Koeth

Second, I was far too sanguine about supply-chain problems. I thought they would pass. Now I am on the pessimistic side regarding how long these issues will last. Third, the inflation dynamics are different today. Monetary policy remains very loose and will stay so for a while. On the demand side, households are sitting on nearly $3 trillion of savings. At the same time, the supply side is constrained. Inflation could have more staying power. I see inflation trailing off in the second half of the year, but overall it is going to surprise on the upside.

Fourth, as Scott suggested, we have regime change at central banks. For more than a decade, they favored the markets over the economy. They could do so because we

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had low-ish stable growth and very low inflation. Now we're going to see the opposite, and the markets aren't prepared. The bond market is pricing in maybe 150 basis points [1.5 percentage points] of rate hikes over a two-year period. That isn't consistent with the inflation outlook or the Fed's own dot plot.

And points five and six?

Desai: My fifth point is that China is going to be a source of volatility. Any thought that the Biden administration would dramatically reduce tensions with China was unrealistic. Furthermore, China's zero Covid policy means we are potentially going to get unpredictable starts and stops in supply-chain dynamics.

My last point is that we have had more than a decade of low market volatility, largely because of the large amount of liquidity in the financial system. We are at the start of a multiyear period, if not a decade, in which the markets will have to learn to reprice risk, because the consequence of a decade's worth of extremely easy central-bank policy has been the distortion of prices and the mispricing of risk. The coming period is going to be a difficult one. I anticipate a rocky multiyear adjustment period resulting from the combination of high valuations and the unwinding of central banks' easy money that has distorted risk assessment and capital allocation in markets for over a decade.

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Good points, Sonal. Now, do we have an optimist in the crowd?

Todd Ahlsten: I'll take some of that side. There has been an obsession with the distortions caused by the size of the Fed's balance sheet and negative real interest rates. Nine trillion dollars of central-bank balance-sheet growth and $5 trillion or $6 trillion of fiscal stimulus has really boosted GDP growth over the past year or so. I see a big shift coming in the investment narrative from a focus on the central bank's balance sheet to a focus on companies' intrinsic value. Cash flows, business fundamentals, and valuation considerations will be a greater driver of returns in 2022 as the Fed potentially contracts the balance sheet. For investors, this year could look like 2018.


Todd Ahlsten, CIO and lead portfolio manager, Parnassus Core Equity fund, Parnassus Investments, San Francisco
Photograph by Karen Santos

Remind us what 2018 looked like.

Ahlsten: We could see a quick 20% drawdown in stock prices. There is a lot of fear in the market. But once we get through that kind of drop, inflation will probably begin to moderate, and the business environment will remain quite prosperous. Stock prices could recover by year end. There is an amazing amount of innovation in this economy to invest behind, which people seemed to have forgotten about in the past two weeks. There's autonomous driving, artificial intelligence, the Internet of Things, edge computing, precision agricultural innovation, and genomics, to name just a few.

We've got to make sure we're focused on that. Wall Street is fixated on the Fed. Entrepreneurs view things differently. They say, "If I can't make money with all this liquidity and a federal funds rate at 1%, I should go out of business." As I've told you before, my dad was a pilot at TWA. He got laid off in 1980 when the fed-funds rate was pushing 20% and the airline parked a fleet of Boeing 707s because we were in a recession.

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We look for the fed-funds rate to top out around 2% in the current cycle, which is still incredibly positive for intrinsic-value investing and companies seeking a return on capital. We expect GDP to grow by 2.5% to 3% this year. Growth will be slowed by Fed tapering. Inflation will stay stubbornly high; it might end the year around 3%, which is a bit above trend, and get back on trend in 2023. S&P earnings could rise by 8% to 14% and the market's price/earnings multiple could contract a bit, but the S&P could still have a positive year.

— Todd A

Remember that the stocks with some of the biggest weights in the index— Apple [AAPL], Facebook [now Meta Platforms , FB], Alphabet [GOOGL], Amazon.com [AMZN], Microsoft [MSFT]—are just incredible businesses. This is a great time not to overlook innovation, because you will miss it and buy it too late. I am leery of falling into the value trade just when the economy might start to slow later this year.

Abby has raised her Zoom hand. That's very polite! Please join the conversation.

Abby Joseph Cohen: Todd and I agree on many topics, but I'd like to back up the conversation to talk more about the economy. I'm a data nerd. Many of today's headlines, but not those in *Barron's*, are just wrong. They take an overly simplistic view of what is happening. The inflation data, for one, overstate what's going on. I recognize that there has been an increase in core inflation, and that wages are rising. But we have to recognize that much of the increase in measures like the government's consumer price index comes from factors that are one-time events. There has been a huge increase, for example, in the price of used cars. Well, families don't buy cars every year. There has also been an increase in home prices, but homes are not recurring purchases. We are going to see inflation data come down. Keep in mind that the CPI last year was also boosted by the sharp rise in energy prices. With crude oil already having reached about $80 a barrel, prices aren't going to rise to that same extent this year.

Abby Joseph Cohen, professor of business, Columbia University, Graduate School of Business, New York
Photograph by Philip Vukelich

The labor market also merits attention. The only comparable period I can find in which economic data were as prone to ongoing and significant revisions is the 1990s. The data we get from the government are based on sampling techniques. Almost by definition, the companies sampled are the ones that were important when the survey was constructed and not necessarily the most important or fastest-growing now.

If the economy is undergoing structural change, as it did in the 1990s, and the sample doesn't keep up, mismeasurements will occur. In the 1990s, this led to a dramatic undercounting of GDP. And today, it means that the companies in the establishment survey may not be those creating the strongest jobs growth. This would help to explain the wide gulf we've been seeing between the establishment and household employment surveys. The establishment survey suggests that people aren't coming into the labor force as rapidly as indicated by the household survey. The establishment survey has been upwardly revised almost every month during the past year. Also, some of the jobs being reported in the household survey may be in nontraditional employment, such as freelance jobs.

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— Abby J

We should examine the labor-force participation rate, as well. Looking at the aggregate participation rate doesn't give you the right picture. Many baby boomers are leaving the job market after gains in their retirement portfolios, and Covid has also pushed people to re-evaluate their lives and quit. The more important participation rate to look at is in the core group of workers ages 25 to 54. That cohort, provided by the Bureau of

Labor Statistics, hasn't shown the same sort of ongoing deterioration.

Now, let me give you some expectations. I foresee a slowdown in GDP growth this year. That's not surprising because the base went up substantially last year, and comparisons with 2020 were easy. In 2022, GDP growth on the order of 3%, or perhaps a bit more, seems achievable. We are going to see changes in public policy: Fiscal policy won't be as friendly as it was, and others have mentioned the change in monetary policy. The Fed will raise the policy rate three or four times during the course of the year. I don't expect the entire yield curve to shift upward as the Federal Reserve raises short-term rates. We will see smaller increases in intermediate and long Treasury yields, and these are the durations which influence the rates at which businesses borrow. The policy rate has been awfully low, close to zero, and rates on intermediates and longs have already moved up.

David Giroux, CIO, T. Rowe Price Investment Management and portfolio manager, Capital Appreciation fund, T. Rowe Price, Baltimore
Photograph by Stephen Voss

Now David has raised his Zoom hand. Please chime in.

David Giroux: I agree with a lot of what Abby and Todd have said. I expect inflation to moderate dramatically throughout this year and into 2023. Some of the areas with massive supply/demand imbalances, such as used cars, rental cars, and appliances, will probably come into better balance in the second half of 2022 and 2023. The other big story of 2021 was earnings growth. We will see 45% to 50% earnings growth in 2021 and even 25% to 30% growth, relative to 2019 earnings.

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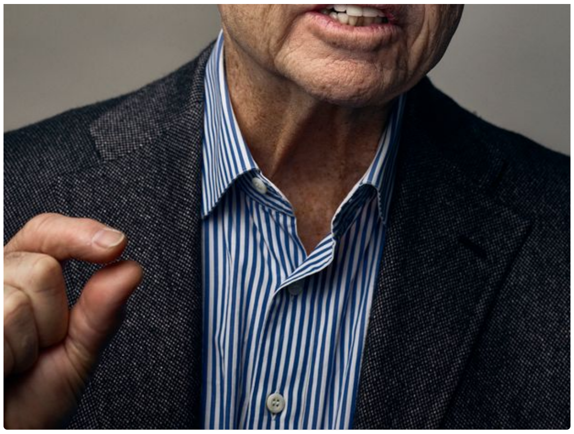
— David (

Finally, GDP growth this year probably will be slightly above trend. But once we get into 2023, a lot of the fiscal stimulus put into the economy will have been spent or invested, and we expect GDP growth to be back to, or even below, trend. It is really hard to grow U.S. GDP faster than 2% in an environment where the working-age population is essentially flat and projected to be flat for the next decade.

William Priest: I like to do a SWOT analysis, looking at strengths, weaknesses, opportunities, and threats. On the threat side, where I focus a fair amount of my time, I wonder whether politics are more important than we think. Do our capital markets require democracy in order to function effectively? Democracy to me is seriously threatened, not just in this country, but around the world. The individual’s right to vote is an essential element of this. Institutions have always been important to the evolution of economic growth, but it was liberal democracy and the scientific revolution that changed everything. If you start to threaten the underpinnings of our democracy, I’m not sure the capital markets can do well. I would also argue that CEOs and boards of directors are going to have to stand up, along with others in the U.S., to support the fundamental right to vote. Without it, capital markets will come under a lot more repression.

What do you see on the opportunity side?

Priest: The supply-chain disruptions are largely temporary. With regard to inflation, high prices cure high prices; people buy less, and eventually prices fall. And on Covid, the rapid spread of the Omicron variant might help us get to herd immunity, but we don’t know



William Priest, executive chairman and co-CIO, Epoc Investment Partners, New York
Photograph by Rick Wenner

that yet. We've talked about the possibility that the Fed will raise rates three times this year; Goldman Sachs expects four rate hikes. The present-value effect on future earnings is going to be a negative.

This year, corporate earnings should be decent. But I worry when I look at the fundamental underpinnings of our society; we don't want to lose the system that made us great, and I think it is under serious threat.

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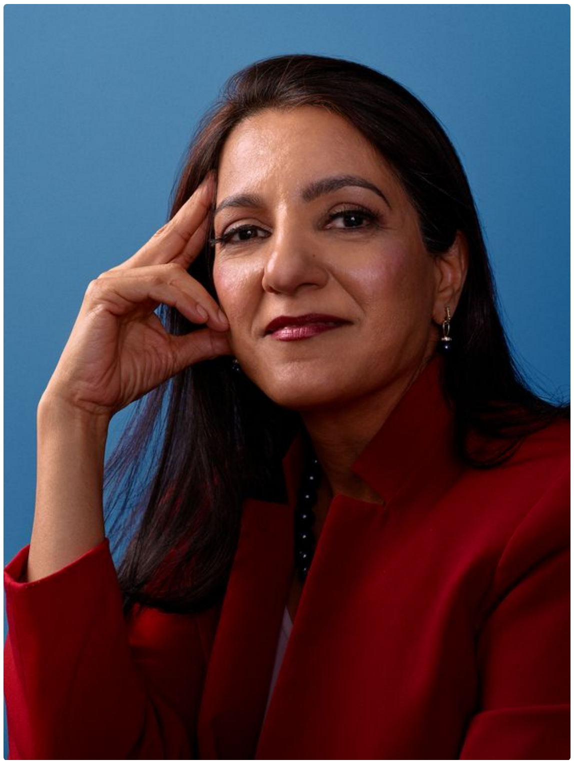
— William

Ahlsten: Capital goes where it is treated best, and we still have a really good democracy in the U.S, despite the risks you see. Also, investor participation in proxy voting, and awareness of ESG issues, are exploding. These are positives for capital flows and investment in innovation.

Rupal J. Bhansali: Politics affects markets in the very long run, but let me take this back to the topic of the day, which is inflation. We shouldn't get carried away with recency bias. The inflation numbers are running hot, and there is a feeling that inflation will persist. But what if disinflation returns? Could it be that inflation has persisted because Covid has persisted? The San Francisco Fed published a chart showing that Covid-sensitive inflation is running at 5%, but non-Covid-sensitive inflation is around 2%, as it was prepandemic.



Rupal J. Bhansali, CIO and portfolio manager International & Global Equities, Ariel Investments, New York
Photograph by Rick Wenner

In future years, secular forces such as debt, demographics, and digitization could prove deflationary, which would be worse for markets than the current inflation. High debt levels mean we have borrowed from the future to consume today. Unless debt levels continue to go up, demand levels will come down and reduce demand, which implies deflation. This is not theoretical; it played out in practice in Japan, where no amount of monetary or fiscal stimulus could prevent deflation.

Baby-boomer retirements and workforce resignations also curb demand, leading to deflation. And the work-from-anywhere workforce, an outgrowth of Covid, can also be deflationary because it can lead to lower wages. Since wage inflation is the most persistent type of inflation, if it can be deflated, it's a big deal.

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— Rupal

The wild card is climate change, which could prove inflationary. Combating it, through carbon taxes or other mechanisms, could increase the cost of producing many things. Only time will tell whether inflation or deflation prevails. But we need to think about different scenarios, and not bet on a single scenario playing out.

Cohen: I want to address three critical factors that will impact the economy. No. 1, half of the 20 most costly climate-related events of the past 40 years occurred in the past four years. This is a problem that is accelerating and becoming much more expensive from an economic perspective, not to mention the human toll involved.

No. 2, labor-force growth was the one factor that helped drive U.S. economic growth ahead of Europe's and Japan's over the past two decades, and half of our labor-force growth came from immigration. Our current national policy discourages not only immigrants at the lower end of the wage scale, but also foreign students and those who come here with specialized visas and skills that we need. No. 3, we shouldn't be too complacent about the positive impact of Covid vaccines because there has been such uneven distribution and takeup. I'm not going to address domestic political issues, but in many parts of the world either vaccines aren't available or distribution channels don't exist. If we don't do a better job of getting people vaccinated around the world, ongoing variants will afflict us.

Henry, what do you make of this discussion—and the economic outlook?

Henry Ellenbogen, CIO and managing partner, Durable Capital Partners, Chevy Chase, Md.
Photograph by Mary Beth Koeth

Henry Ellenbogen: I'm always reminded, when I read the previous year's Roundtable, of just how hard it is to predict the future. Two years ago, none of us predicted Covid. Last year, no one predicted the levels of inflation that we're seeing now, although some of us talked about the risk of inflation.

I agree with David that inflation will moderate for a bunch of reasons in the second half of the year. Specifically, the record amount of stimulus is going to come down. It's important to realize that private enterprise was essentially competing with government stimulus for workers. Plus, rent moratoriums contributed to unemployment. Labor markets will slowly thaw this year, as people work down their savings—built up from stimulus and enhanced unemployment—and rent and mortgage relief get depleted.

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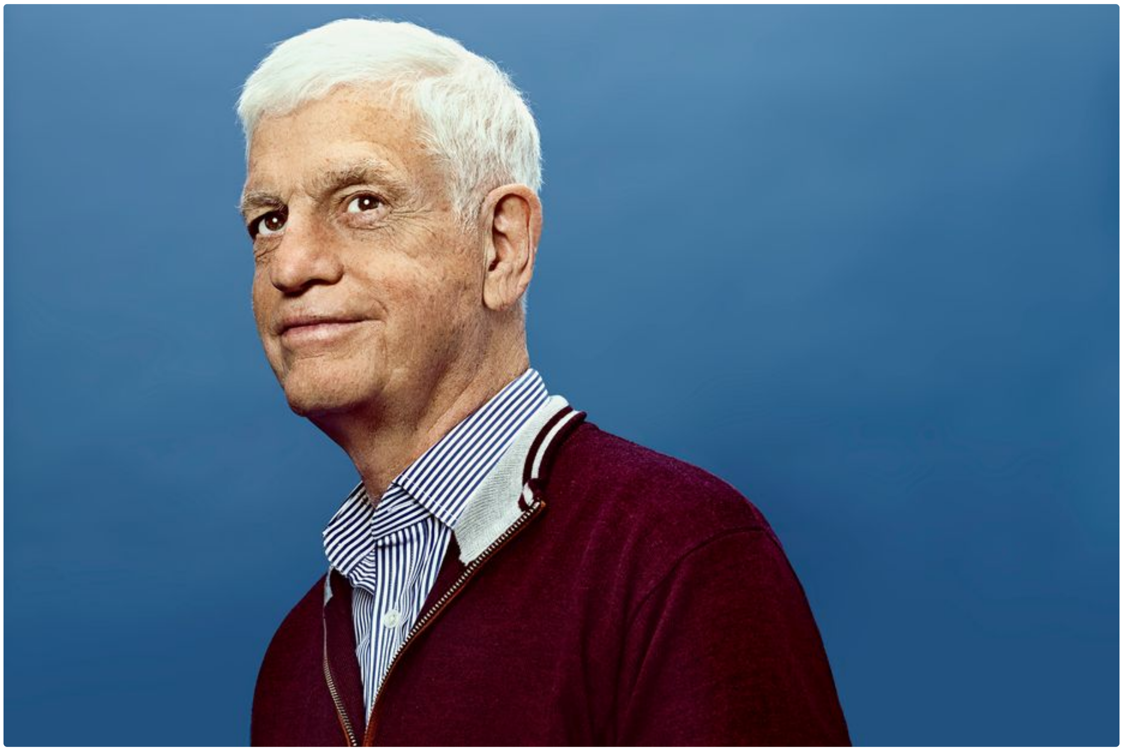
Also, as a result of the pandemic, there has been a significant change in how and where Americans want to work. I discussed this at last year's Roundtable, and the past year has confirmed it: We are on the move in ways we haven't been in many years. People largely are moving to the Southern and mountain states, and Florida and Texas.

What are the implications?

Ellenbogen: We are monetizing the scale of America. As we move from high-cost to low-cost locations, that unlocks productivity. In addition, as people spread out, companies need to innovate to serve them. That means innovating not only on digital platforms but also digitizing the U.S. enterprise. That speaks to deflation. It also unlocks innovation. As people move away from medical centers, we are seeing telemedicine increase. We need to provide better education and training remotely. Last year, in recommending Intuit [INTU], I discussed the spread of remote tax and accounting services around the country. What is happening in America is unique. Most other countries are just countries. We are basically a continent.

Mario, what do you expect from the new year?

Mario Gabelli: I don't focus as much on real GDP. I focus on nominal GDP, which impacts nominal corporate revenue and earnings. When companies report fourth-quarter 2021 results over the next few weeks, the numbers will be terrific. These results should buttress the U.S. market as the Fed accelerates its tightening.



Mario Gabelli, chairman and CEO, Gamco Investors, Greenwich, Conn.
Photograph by Guerin Blask

Where do we see opportunity? The auto industry has a long runway. There are a million cars on dealers' shelves, down from an average of three million. At some point, inventory has to be rebuilt. We need more houses, too, as people move around the country because of remote work, Covid, to escape crime, or because of SALT [the inability to deduct high state and local taxes from federal tax payments]. The aerospace sector will be strong, too, as should the agricultural ecosystem.

The question we should ask is whether we are going back to what happened in the U.S. following World War II, when there was huge pent-up demand for goods like there is now, or whether we are entering a period of structural inflation like the 1970s. The consumer and the industrial sector will keep the economy humming. The federal government will be spending less, but state and local revenue growth and spending are accelerating.

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Meryl, give us your take.

Witmer: Many of our companies increased prices around year end for this first quarter, so I would expect inflation to moderate starting in the second half. But I don't have much else to add from a macro perspective.

In that case, let's move on to the markets. How should equity and fixed-income

investors be positioned this year?

Desai: I'm the token fixed-income person on the panel, and I would argue that fixed income is one of the least attractive areas to invest in this year. I'm also the only person here who is worried about inflation, and I don't think it's recency bias, as I've been worried about it for a year and a half. Deflation is the dog that didn't bark. We had the worst financial crisis in almost a century in 2008. We heard nothing except that deflation was coming. It never did, and I don't see it coming now.

Meryl Witmer, general partner, Eagle Capital Partners, New York
Photograph by Mary Beth Koeth

Finding the income part of fixed income has become increasingly difficult. You have to take on more risk to get any quantity of income. I am not going long duration. Protecting investors from inflation will be the focus of my picks. There are many ways to do this indirectly, with commodities, energy, and such. I am not an equity expert. I would love to hear the panel's views on how rising interest rates are going to impact growth stocks. Won't rising rates deflate the value of future profits? It's one reason I would tend to rotate toward value.

First, tell us where you see the federal-funds rate and the 10-year Treasury yield ending the year.

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Desai: A 75-basis-point hike is baked in. We might get a 100-basis-point increase, depending on what inflation looks like. I come back to this: Rate hikes are a political question. Before the November election, the Fed needs to be seen to be doing something. The pressures on the Fed are coming from a very different place than we've seen in the past 10 years. As for the yield on the 10-year Treasury note, it could go well above 2.5%. We are going to get a lot of volatility because the Fed won't come in and bail us out every time bond yields rise. The dream scenario for the Fed is a slow crawl upward to 2.5%, and maybe even a higher range. The short-term market is pricing in 150 basis points in Fed rate increases, and effectively nothing after that. I don't see that as the end of the hiking cycle.

That has implications for growth stocks, as you note. Let's turn to our growth-stock

mavens, Todd and Henry.

Ahlsten: We are still constructive on the stock market. We expect the Fed to lift rates three or four times this year, but when the yield on the 10-year hits 2%, the long end of the bond market will almost be doing the work for the Fed. This will slow the economy in the second half of the year, and inflation will come down.

Value has done well out of the gate, but growth stocks could come back strongly in the second half as the yield curve flattens. People will rediscover that they want to own innovative companies, not slow-growth, narrow-moat, old-economy companies. Areas like semiconductors could do really well. Semis are 60 basis points of the global economy but bring intrinsic value to the table. Hyperscaled software providers, and innovative companies in healthcare, life sciences, and life-science tools all could do well as the economy slows. The second half could be almost the mirror image of the first half. The S&P 500 could end the year up by mid- to high-single digits.

Ellenbogen: I agree directionally, but might differ on magnitude. The first half of the year will be weaker. Assuming we bend the curve on inflation, the second half looks positive. It could be a neutral to slightly positive year for the market.

One reason growth stocks have been weaker so far this year is because there was a lot of speculation in growth markets toward the end of last year. We had about 300 initial public offerings in 2021. It has been reported that two-thirds closed the year lower than their IPO prices. Also, 500 SPACs [special purpose acquisition companies] came to market. Investors are having a tough time sorting out which are the real growth companies because of the huge supply of new growth companies. As earnings are reported, they will suss out which companies have true underlying growth drivers.

Also, building on my earlier comments, companies will need to have a very strong culture to retain employees, because it is easy now for white-collar employees to change jobs without leaving the house. In addition, consumers and businesses care about the social responsibility of the companies they invest in, and companies are going to need to be authentic in their treatment of all stakeholders. If they aren't, you'll see market shares change meaningfully. Stock-picking will be increasingly important as people digest these additional factors.

Cohen: Per Henry's point, I changed jobs two weeks ago. I am now a professor at Columbia University in the Graduate School of Business. I can say, as a professor and former chair of the CFA Institute, that I believe this year will see the revenge of the investing nerds. Unlike in recent years past, we will see that diversification, stock selection, and risk control matter. Last year, many on this panel indicated that we thought bonds were overpriced. High inflation has provided a catalyst to get bond prices closer to where they should be. That will have a meaningful impact on equity valuation. I see a modest compression in the market's price/earnings ratio this year. S&P 500 earnings will grow about 8% for the year, but the P/E will come down a bit, producing modest gains for stocks. I expect the increased volatility we're already seeing to be a feature all year.

It is also important to recognize that some of the bizarre things that happened in 2021 ended in 2021. The incredible enthusiasm for IPOs and SPACs cooled off. Equal-weighted indexes began to outperform the market- cap-weighted indexes. For much of the year, just a handful of stocks were responsible for the bulk of the indexes' performance. This year, investors will need to pay attention to valuations, absolute and relative, and dig into companies' underlying fundamentals, while they worry less about momentum.

That's our kind of nerd.

Black: I would avoid fixed income like the plague. As for stocks, the S&P 500 closed on Friday [Jan. 7] at 4677. Using estimated 2022 operating earnings of $220, the market's P/E multiple is 21.2. That's expensive by historical norms—the average is around 16-17—but not when you have today's low nominal interest rates. The S&P 500 and Nasdaq Composite are capitalization-weighted. As of Friday's close, the five largest stocks in the S&P 500 had a 22.4% weighting. The top 10 accounted for 28.8% of the index. The top five stocks in the Nasdaq had a 40.2% weighting. Eight of the 25 biggest S&P stocks had a multiple of 30 times 2022 estimated earnings. Estimated earnings growth for the S&P is only 9%. I don't see any multiple expansion, as many of these companies are expensive to begin with.

I follow small- and mid-caps, as well. The small-cap Russell 2000 trades for 17 times forward earnings, but 39% of the companies in the index have no earnings. Thus, the Russell's true P/E is about 28 times, as is the Nasdaq's.

Markets will be choppy this year. Assuming current multiples or a slight multiple compression, stocks could have 5% to 8% upside. Plus, the S&P 500 has a 1.2% dividend yield. Investors should look for companies with rising earnings that you can buy at value prices. You want companies that are going to generate free cash, with nominal revenue and earnings growth far in excess of nominal GDP growth.

People have mentioned the housing sector. Housing starts are excellent, but the stocks have been bombed because of concerns about rising mortgage rates. If mortgage rates rise to 4%, affordability goes down. Many home builders are selling at five to seven times earnings, but you want to avoid interest-rate-sensitive areas. Banks, on the other hand, could get a windfall in earnings-per-share growth as the yield curve steepens.

I would avoid speculative companies like Snowflake [SNOW], Airbnb

[ABNB], and CrowdStrike Holdings [CRWD]. They have a runway, but they don't have a moat. If rates go up, stocks like these could fall sharply.

David, what is your assessment?

Giroux: In the three years before the pandemic, the 10-year yield averaged about 2.45%. We're still 70 basis points below that. I would make a bet that the 10-year doesn't get above 2.5% in the next year. There are signs of excess in certain growth stocks. But if you look at the biggest companies in the S&P 500, Facebook is trading at a discount to the market, based on 2023 estimated earnings. Google parent Alphabet [GOOGL] is trading at the same multiple as the average industrial conglomerate. Some of these growth stocks are attractive from an earnings perspective. I expect the market could rise by low- to mid-single digits this year.

Overall, if earnings growth decelerates and the Fed raises rates, it's not a great backdrop for equities. Bonds are more attractive than they were two or three months ago, as yields have risen nicely, but as a multi-asset investor it makes more sense to take duration risk in the equity part of my portfolio than in fixed income. The asset class today with the most attractive risk/reward profile is leveraged loans. I've taken leveraged loans to 12% of my portfolio from about 1% in 2018. Leveraged loans are the one asset class in fixed income that tends to rise in value in a rising-rate environment. Even without the Fed having increased rates, they are earning yields of 4% to 4.5%. They're at the top of the capital structure, floating rate in nature, and mostly high-quality companies. If rates rise, yields could go to 5% to 5.5% or more.

Rupal, let's hear from you.

Bhansali: The biggest risk to the markets this year is a multiple derating that will affect both growth and value stocks that have gone up a lot. It will be worse for risk assets, meaning junk bonds and junk equities. There is also opportunity in the market; you can make money by picking steady growth over heady growth, and good companies whose stocks are out of favor. My forecast implies a double-digit decline in U.S. markets (S&P 500 and Nasdaq 100) because EV/Ebit [enterprise value to earnings before interest] multiples are at historic highs, even though we'll see an increase in earnings.

Does anyone see a double-digit increase this year in the S&P 500? Let the record

register a resounding silence. And let's move on to Bill.

Priest: Rupal characterized it well: The big issue is a P/E multiple derating due to rising interest rates. There is also an existential political risk to the market around the question, "Does market efficiency require a democracy in order to operate optimally?" I agree with Todd that growth names will do better in the second half of the year. If I had to pick a number, I'd say the S&P will be plus or minus 7%. The risk of error is to the downside this year.

Mario, how do you see the year unfolding?

Gabelli: The global value of equities is $121 trillion. The U.S. represents $53 trillion, and the biggest six or so U.S. stocks, by Scott's math, are about $12 trillion. [Fed Chairman Jerome] Powell will be confirmed for a second term. Is he going to say the Fed needs to run off the $9 trillion of Federal Reserve money in the system, which is 35% of GDP? That's what we're thinking about.

How is the chairman of the Federal Trade Commission going to think about mergers? You've got SPACs, private-equity firms, and strategics wanting to do deals—plus lots of financial engineering, such as spinoffs. How does this deal activity work with the FTC's likely new approach? How does this activity impact investor psychology? That is another issue. The same regarding the Federal Communications Commission and media deals.

Then there is the issue of market mechanics. Brokerages like Robin [HOOD] need to do a better job of educating customers about how to trade options and buy on margin. How do you deal with the volatility tied to the momos, algos, quants [momentum, algorithmic-, and quantitative investors], and buyers of the S&P and ETFs? These are issues, too.

We expect the market to continue to adjust to Fed policy, with rising interest rates and Fed tightening offset by higher earnings. After the market shock of the Fed's early action, stocks could end the year unchanged as the 2022 election is over. The first half of the 2023 economic outlook in China and Europe will be brighter.

Meryl, you don't favor market forecasting, but surely you have a view.

Witmer: What has been noticeable in the past year is extreme volatility in individual stocks. Looking at my world of stocks, there are some values, but not a ton. That leads me to think this should be a flat year, all-in. I see the risk of fear coming into the market if we don't have a new tranche of investors into crypto. If the music stops and crypto tanks, there could be a contagion into the stock market. It could set up a good buying opportunity.

Cryptocurrencies and other novel assets have won many fans in the past few years. Have we any here?

Black: I am not a believer in cryptocurrencies; the U.S. dollar is a better reserve currency. But I am an art collector. NFTs [nonfungible tokens] are selling at Christie's and Sotheby's for north of $50 million. You can own a decent Monet or Cezanne for less and hang it on the wall. The NFT craze in the art market is reaching the heights of delirium.

Cohen: About 90% of trading in crypto has nothing to do with economic transactions. It involves crypto holders selling to other crypto holders. Much of the remaining 10% is used for questionable activities by people who think they are flying under regulatory or law-enforcement scrutiny. Many are finding that they are not. The interest in crypto has been easing in recent months. If you looked only at the full year, you're missing the bigger picture. Cryptocurrencies had a strong first half of 2021, and an unattractive second half.

Desai: Any asset class subject to the fact that one person can make a statement and change the value of the asset by a significant amount is a complicated proposition for fundamentals-based investors.

Priest: Money performs three functions. It is a unit of account, a medium of exchange, and a store of value. Cryptocurrencies aren't a store of value, in my view. However, in the near future, we will see central banks introduce digital currencies that will meet the requirement of a "store of value." China could have one next year, and there is a good chance that Europe beats the U.S. to the issuance of a CBDC. There are many reasons to have a central bank digital currency, including greater transparency of its use and greater efficiency in targeting the effects of monetary policy.

Ellenbogen: Central bank digital currencies are going to be a threat to the banks.

Priest: An excellent book on the topic is *The Future of Money: How the Digital Revolution Is Transforming Currencies and Finance*, by Eswar Prasad, a professor at Cornell. Also, *DeFi and the Future of Finance,* by Campbell R. Harvey, Ashwin Ramachandran, and Joey Santoro, is a must-read on this subject.

Cohen: [Holding up a copy of *The Future of Money*] Prasad is also a Fellow at the Brookings Institution and has been my guru on the subject for a while. One point he makes that I find interesting is that once central banks issue digital currencies, what is the economic argument for having unregulated digital currencies that are backed by nothing?

We'll save that question for another Roundtable. Now, let's hear your stock picks. Todd, you're first.

Ahlsten: We are looking to invest in great American innovators in these uncertain economic times. I am excited to share six names today. The first is Deere [DE]. The stock is trading at $380 a share. When I first pitched it two years ago, it was in the $170s. I pitched it last year at $290. It has been a fantastic compounder. The first leg of the story was based on the agricultural-equipment upgrade cycle. The fleet was old, and as farmers upgraded, profitability would be on the rise. Now we are rolling through what we think is a decadelong story centered on innovations in precision agriculture. Plus, Deere has one of the best last-mile dealer networks.

We think Deere's stock can return an average of 15% over the next three years, which implies a $550 stock price in 2024, inclusive of a 1% dividend yield. It trades for 18 times estimated 2025 earnings. We expect that the company can grow earnings at a 12% annualized rate for the next four years, given the strength of the ag-equipment upgrade cycle, and drive margin growth through its technology. Deere has doubled its operating income since 2019. Let's talk about that: The take rate on precision ag is getting into an S-rate adoption curve as combines are turned into data centers, connected to spectrum, and connected to Deere's operations centers. As a result of data optimization, farmers are using less pesticides and fertilizers, and producing crops with less water. Deere is a great ESG story.

Todd Ahlsten's Picks

Company / Ticker	Price 1/7/22
Deere / DE	$378.65
Fiserv / FISV	108.83
Mastercard / MA	369.65
Adobe / ADBE	510.70
Applied Materials / AMAT	150.81
Danaher / DHR	295.67

Source: Bloomberg

The precision-ag business within Deere is hard to unpack because the company doesn't fully disclose the numbers. We think it was about a $2 billion business last year, on its way to $3 billion in 2023. Long term, the TAM [total addressable market] could be upward of $50 billion, if you think about the crop yield improvement.

Deere spent $8 billion cumulatively on research and development, or about 4% of sales, in the past five years. Later this year, it will be shipping autonomous tractors. It spent $250 million last year to buy Bear Flag Robotics, which retrofits tractors with Lidar technology. In 2017, it bought Blue River Technology for $305 million; it specializes in computer vision technology. It is rare to find a wide-moat company with Deere's type of innovation. Plus, investors benefit from an upward turn in the commodity ag cycle.

Why did the stock plateau last year? And, are there other precision-ag companies that investors should consider?

Ahlsten: Deere returned about 20% last year, so it had a pretty good year, although it traded sideways when prices for commodities like corn sold off in the second half. We also own Trimble [TRMB], which makes software for precision agriculture.

Next, I'm recommending Fiserv [FISV] and Mastercard [MA], two legacy payments companies that will benefit from this year's economic growth. Fiserv is a payments and financial-services company. Merchant-acquiring struggled last year because the focus was on companies like Square [now Block, SQ], and Stripe and buy now, pay later outfits. The legacy payments companies had a good year, but got left behind by the euphoria about this new wave of payment services. As a result, Fiserv is a bargain, trading at 17 to 18 times this year's earnings. The company can grow the top line by 7% to 9% a year long term, and earnings per share by 10%. We see a return of 15% a year over the next three years, implying a $165 stock price in 2024, compared with a recent $108. Fiserv could earn just shy of $10 a share in 2025.

About 42% of Fiserv's business is merchant acceptance, or enabling merchants to process credit-card transactions. We feel this business can grow by high-single digits. It has some really good customers—for example, seven of the top 10 U.S. grocery chains. The company's Clover platform, which you might have seen at point of sale, is also growing rapidly. Clover is underappreciated, relative to Square. Another 38% of the business is payments, or products that help banks issue credit cards. That's a mid-single digit grower. Finally, fintech is 20% and growing by mid-single digits. Fiserv is going to buy back a lot of stock this year. It can grow earnings for a long time.

What is your case for Mastercard?

Ahlsten: Mastercard is a fantastic opportunity. We expect a 12% return per year in the next three years, and we have a $525 price target, up from a recent $370. The stock has a price/earnings multiple of 36 times this year's estimated earnings. Mastercard could earn $20 a share in 2025, so it is compounding earnings at a 25% annual rate. It can grow sales at a high-teens rate for a long time. It has 80 million merchant partners and 2.9 billion cards. Acceptance of these cards has doubled over the past five years.

Mastercard has a good global mix: 69% international versus 31% domestic. Cross-border travel was down in the past two years. It could be fantastic this year. Visa [V] is a fantastic opportunity, as well, but Mastercard will grow faster because it has a higher exposure to international travel than Visa. We think of Mastercard as a reopening play. At Mastercard, 45% of every dollar made drops down to the bottom line. We have owned the stock since 2010. Sometimes, it is hard to stay in great compounders; 2020 was challenging as the economy slowed and people curtailed cross-border travel. Last year, some noneconomic payments businesses got funded and challenged the company's moat. But we think the moat is as wide as it has been in a long time.

Black: Visa sells for less than 27 times expected earnings. Mastercard's multiple is higher by seven points. How do you justify that valuation?

Ahlsten: That's a great question from a value guy. We like the earnings growth and wide moat, and the prospects for a cross-border recovery and an economic reopening. We are willing to pay up for quality and see a decadelong runway ahead. We're comfortable with the valuation, which probably speaks to the difference in our investment styles.

Could buy now, pay later become a meaningful business for Mastercard or Visa?

Ahlsten: The business model will need to be proven out. We question how innovative it is, and it is in part a byproduct of low interest rates. Mastercard's installment payments are a play on that.

Speaking of great American companies, Adobe [ADBE] can earn its way through this uncertain time. The stock was $700 a couple of months back. It is around $520 now. It sold off with the growth-to-value rotation. Adobe did a great job during the pandemic, and there has been a bit of pumping the brakes on pandemic beneficiaries as we shift to the new normal. But long term, Adobe is one of the best companies in the S&P 500.

Adobe has a $250 billion market cap and trades for 37 times trailing earnings and 32 times forward free cash flow. Why do we like it at these valuations? It has some of the best digital-media software assets in the world, such as Photoshop and InDesign. This business accounts for 73% of sales and has a long runway as we move to the cloud and digitize. The surface area that Abode touches with its wide-moat and tremendous-network-effect products is almost unrivaled. Its investment in the cloud benefited from the pandemic. Digital media and document creation isn't a fad. It's an essential and irreplaceable part of the marketing and tech spend for a lot of companies.

We expect Adobe to return 12% a year in the next few years. The stock could rise to $725 over three years and trade at a multiple of 30 times forward earnings. Adobe could earn $24 a share in 2025. It is compounding earnings and free cash flow at a 20% annual rate. The top line is growing at a midteens rate, and the TAM is expanding. The company has a monopolistic share in a lot of digital media creation. Last year, there was some pushback as some smaller design-tool companies launched products. There will always be niche products coming to market, but the surface area that Abode touches and scales is unrivaled. The company is spending $2.5 billion a year on R&D, while delivering 44% free-cash-flow margins. We are very excited about that opportunity.

Ellenbogen: What is your view on Figma and Canva? These are private digital graphic-design companies that are starting to get scale. Will they impact Adobe's growth rate, or is the end market growing even faster?

Ahlsten: It's a great question. For sure, there are emerging competitors, but the TAM is so large that we expect Adobe to power through. The company continues to innovate and invest and in some ways match the competition. They aren't standing still.

Applied Materials [AMAT] is another stock I recommended last year. The stock traded in the mid-$90s. Now it is about $150 a share. We think the next stop is $200-plus sometime in the next three years as earnings power crosses $10-plus a share. When you think about Applied Materials, you hear a lot about the waves of compute—5G, autonomous driving, precision ag, hyperscale, the Internet of Things, the metaverse, Web 3.0. AMAT is one of the only holistic ways to play the increasing intensity of semiconductors across the economy and computing. ASML Holding [ASML] would be another.

AMAT touches nearly every semiconductor built today. It is one of the classic picks and shovels of the digital economy, innovating down to three nanometers and bending the laws of physics and materials-science innovation. Semiconductors will be roughly a $600 billion industry this year in a near-$100 trillion global economy. Over time, the industry will garner more economic rent, just as software has. AMAT is in a great spot. We think wafer-fab equipment spending will approach $100 billion in the next three years. AMAT is tracking 59 fab projects globally, which represents $300 billion of future capital spending. Wafer-fab equipment sales were up roughly 40% last year. We think they'll be up another 10% this year to $90 billion, crossing $100 billion next year. The semi industry grew 26% last year to top roughly $500 billion-plus. It could pass $600 billion this year.

AMAT has exposure to foundry and logic spend. Foundry wafer starts should be up 7% this year. We don't see an oversupply situation. AMAT is also exposed to the NAND and DRAM memory sector. In thinking about areas of innovation, AMAT uses the acronym PPAC, or power, performance, area, cost. There are just so many places to innovate. The company is building 15,000 tools on recurring revenue streams for services, which is approximately 20% of the business. China is around 34% of the business. We expect that to be more flattish this year. But for Taiwan, South Korea, the U.S., and Japan, this is almost becoming a national security asset.

What is your sixth pick?

Ahlsten: Nick Saban, the head football coach at the University of Alabama, is one of the all-time great coaches. I deeply admire what he has built. Danaher [DHR] is our Nick Saban stock in the Parnassus Core Equity fund. It has a $215 billion market cap, and is one of the highest-quality makers of life-sciences tools in the world. Danaher practices continuous improvement in everything it does, and hires great people. It owns great brands such as Beckman Coulter, and Pall, in filtration. They bought GE 's biopharma business, and that has exploded their business in bio production. Danaher is like the Berkshire Hathaway [BRK.A] of life sciences and bio production.

We see the stock at like $425 in three years, up from $300 recently. The company could earn $15.25 a share by 2025, and sell for 28 times earnings. Danaher has exposure to great end markets and very wide moats. We like the fact that 52% of revenue comes from life sciences and 32% comes from diagnostics. Seventy-five percent of this revenue is recurring. The crux of our thesis is that the core business is accelerating at a 7% to 8% annual rate. The company continues to make tuck-in acquisitions.

I want to focus on Danaher's biologics and bio-processing businesses, which are just under 30% of revenue. In medicine, a major shift under way is the use of biologics [drugs made from biological sources]. We have seen a 50% increase in the development of monoclonal antibodies in the past five years. Helping to produce those products is right in Danaher's wheelhouse. The development of gene and cell therapies has grown tenfold since 2015. No. 3, these emerging high-growth areas of innovation are very focused on bio-production capacity, which is a huge growth driver. No. 4, Cepheid is their best-in-class diagnostics brand, with some fantastic assets. Does this sound too good to be true?

We're glad you asked.

Ahlsten: Danaher grew earnings 50% last year. The next few years will see slightly lower growth as Covid vaccine production and testing slow. We have vaccine-related revenue roughly flat this year, and testing revenue down 14%. Next year, vaccine revenue could fall 30% and testing revenue could be down 53%. That's a 6% growth headwind for 2023, but we want this pandemic to go away. We expect Danaher to earn $10.41 a share this year and $10.65 next year. By 2025, earnings could be $15.25 a share.

I've given you six great American companies that could do well this year, despite what happens with the Fed, the economy, and inflation. Looking out three years, we expect to sleep well with these names.

Sweet dreams, and thank you. Now, let's hear from Sonal.

Desai: I so enjoy listening to all of you. You have such interesting stories. I don't have nice stories; I just have a macroeconomic view. As I have said, my concerns on the inflation and interest-rate front are probably a little greater than those of most people on this panel.

Gold was one of my picks over the past year and a half. It has done poorly. The price fell about 4%, partly due to Covid, as jewelry demand collapsed, particularly in India. The other problem is that although we got inflation, it looks like the Fed is going to react and raise rates. Gold hasn't reacted to inflation because it is less attractive if the Fed raises rates.

From a portfolio perspective, there are different ways to hedge against inflation. For that reason, I started moving toward real estate in the middle of last year. All of my picks are funds. First, I want to highlight a private real estate fund, Clarion Partners Real Estate Income fund [CPREX]. It is a Franklin Templeton fund. Clarion offers direct access to institutional-quality private real estate, with daily pricing. These are commercial real estate properties with the scale and balance-sheet quality that institutional investors demand. It's hard to come by such assets as a retail investor.

The fund has direct investments in commercial real estate and real estate securities. It is backed by long-term real estate contracts and taxed as a real estate investment trust, which has investment benefits. The retail fund has been around only since 2019, but Clarion has a 30-year track record serving institutional clients. The portfolio's target allocation is 60% to 90% private real estate and 10% to 40% public real estate securities. It invests in warehouse, apartment, office, retail, and other property sectors.

Sonal Desai's Picks

Fund / Ticker	Price 1/7/22
Clarion Partners Real Estate Income / CPREX	$12.10
Franklin High Yield Tax-Free Income / FHYVX	10.45
Global X US Infrastructure Development / PAVE	28.35
Lazard Global Listed Infrastructure Portfolio / GLFOX	16.30
Parametric Commodity Strategy / EAPCX	6.34
SPDR Blackstone Senior Loan / SRLN	45.65
Franklin Income / FRIAX	2.52
Franklin Equity Income / FEIFX	31.95

Source: Bloomberg

Why is real estate a good hedge against inflation?

Desai: Landlords generally have the ability to raise rents under better economic conditions, and they have been doing it. That raises property values. Then, many real estate leases are contractually allowed to have rent bumps, which are linked directly to higher inflation rates. Third, higher inflation means that construction materials, labor, land costs, and other factors that go into new real estate development are more expensive.

Black: Sonal, do they have much exposure to high-rise office towers in Boston, San Francisco, and New York? Those markets are weak right now.

Desai: This fund doesn't have exposure to these markets. They have a lot of exposure to the Sunbelt states, to which people have been migrating. That is a part of their thesis.

Next, I'd like to reiterate my call on municipal bonds, which I have had for a while. Given the scale of fiscal expansion we've seen, we're going to need to look at the tax-free space. I am recommending the Franklin High Yield Tax-Free Income fund [FHYVX]. It gives you a 12-month yield of 3.69% [as of Dec. 31]. I'm trying to gear many of my picks toward generating some income, but it is embarrassing how little fixed income can be generated. The rationale behind my preference for munis is the very strong financial position in which state and local governments find themselves. Despite Covid, their coffers are full. You've got increasing demand for munis domestically because of the prospect for higher taxes, and surprisingly, there is increasing demand internationally. Supply is constrained in tax-free munis, which also makes them attractive.

My third theme is infrastructure. I'm recommending the Global X U.S. Infrastructure Development exchange-traded fund [PAVE]. It provides exposure to infrastructure spending in the U.S. through companies that provide materials, equipment, and expertise to build and repair domestic transportation infrastructure. Especially after passage of the infrastructure bill, this is a good place to be. The fund was launched in 2017 and now has about $5.5 billion in assets. Performance has been excellent, but it generates little income. If you are more interested in income, you might look at the Lazard Global Listed Infrastructure Portfolio [GLFOX]. It has 60% exposure to Europe, and yields 4%. The Lazard fund is also a pick.

What else do you like?

Desai: I remain bullish on commodities. Rather than gold, I would look at the Parametric Commodity Strategy fund [EAPCX]. It is a quantitative fund, using a rules-based, top-down strategy. It has a disciplined process and a long-tenured team. The fund is divided into 25% agriculture, 27% energy, and 23% industrial metals. The rest is tied to precious metals, livestock, and so on. Inflation is one of my greatest concerns, and this is yet another way to try to hedge your portfolio against it. For something more traditional, with an eye to income, I'm recommending the SPDR Blackstone Senior Loan ETF [SRLN]. It generates income of 4.45%. We expect interest rates to go up, and bank loans should benefit.

Next, the Franklin Income fund [FRIAX], which I have recommended in the past, has a 12-month yield of 4.52%. It takes a flexible investment approach, investing primarily in blue-chip value stocks and high-yield bonds, but also diversifying across equity-linked notes and convertible bonds. Currently, it is about 66% equities (roughly 44% common stock, 20% ELNs, and 3% preferred and convertibles) and 31% fixed income with a greater concentration in high yield. It is basically a balanced portfolio that should deliver fixed-income-style performance topped off a bit by equities.

Traditionally, I talk about one equity fund. This time, it is the Franklin Equity Income fund [FEIFX], focused on large-cap value. I expect large-cap value to do well in the first half of the year. The fund invests mainly in income-oriented blue-chip companies with good growth potential and sustainable competitive advantages. It also offers exposure to growth stocks, such as Amazon.com [AMZN], by using equity-linked securities.

Sonal, what is your view of Chinese sovereign bonds?

Desai: In multisector portfolios, we have increased our exposures to Chinese sovereign bonds, but China's zero Covid policy is going to lead to volatility in GDP growth. I wouldn't put all of my eggs in the China basket. I usually recommend an Asia-focused fund; I recommended Matthews Asia Growth [MPACX] last year, which historically had strong performance, and it did not perform well, in large part because of its overweight in China. Emerging markets offer a lot of opportunity, but the key themes I'm focused on this year are much more U.S.-focused.

What do you think of TIPS [Treasury inflation-protected securities] as an inflation hedge?

Desai: With TIPS, you end up taking on duration risk. If there is a selloff in Treasuries, TIPS won't deliver, given the embedded duration. Also, the Fed owns about a quarter of the TIPS market and can distort returns with the stroke of a pen.

Thank you, Sonal.

Corrections & Amplifications:

MasterCard has a price/earnings multiple of 36 times this year's estimated earnings. A previous version of this article incorrectly put that number at 26. In addition, Applied Materials has exposure to logic spending. A previous version of this article incorrectly termed it lodge spend.

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