Have you ever received a gift you didn't actually want? Well, investors got just such a gift recently – the kind *nobody* wants. We're not talking about an ugly sweater or a pair of socks. We're referring to a new bout of market volatility, just in time for the holidays.

(Quick recap in case you haven't been following the news. The Dow fell over 900 points the day after Thanksgiving – giving a whole new meaning to the term "Black Friday" – and then it slid a further 650 points on November 30.)[1]

So, what's the cause of this winter wobble? Three familiar characters from our ongoing pandemic drama: COVID-19, inflation, and the Federal Reserve. In this message, we'll recap what's going on and then discuss what we as investors can do about it. Let's start with…

The Omicron Variant

On November 26, the World Health Organization announced the discovery of a new variant of COVID-19 designated as *Omicron.* What we know: It was first discovered in South Africa, and it contains "an unusually large number of mutations" from the original virus.[2]

Here's what we *don't* know: Is Omicron more contagious? Is it more virulent? Can it evade the protection offered by vaccines? Scientists are racing to find the answers, but until they do, the rest of us must wait.

When it comes to the markets, what we know prompts investors to buy, but what we *don't* spurs the impulse to sell. The markets *hate* unknowns. When faced with too many – especially on such an important subject – the reaction tends to be fear and panic. That's especially true here. You see, any answers scientists come up with will inevitably lead to more questions. For example, if Omicron is more contagious, will it lead to fresh lockdowns and restrictions? Will that derail the economic recovery? If so, would that also overturn the bull market?

Another unknown: How will Omicron affect our second character, inflation?

Inflation

As you know, inflation has risen sharply in 2021. While inflation doesn't *directly* impact stocks as much as, say, bonds, it can still spook investors. That's because higher inflation typically leads to higher interest rates – more on this in a moment – which can cut into corporate profits. Inflation can also increase the *cost* of doing business, such as hiring new employees or purchasing new equipment. This eats into profits further still.

With Omicron, experts are trying to figure out what the new variant will do to inflation. There are three possibilities.

First, if Omicron were to cause an economic slowdown – and remember, that's still a *big* "if" at this point – then that would likely *dampen* inflation. (Remember, inflation increases when demand outpaces supply.) But if demand were to *fall*, inflation would, too. Unfortunately, an economic slowdown is not the remedy anyone would choose to fight inflation.

The second possibility is the exact opposite: Omicron could make inflation worse. Imagine that Omicron *doesn't* require a new wave of restrictions here in the States. In that case, the economy probably wouldn't

be affected too much. But there's more to the world than the United States. If other nations – those with a lower percentage of vaccinated citizens, say – were to get hit hard by Omicron, it could further snarl supply chains. Given that supply is already struggling to keep up with demand, that would be like trying to put out a fire with gasoline.

The third possibility: Omicron turns out to be manageable and has little to no effect on inflation or the economy. Keep an eye on this space!

In the meantime, though, *these* unknowns are giving our third character a major headache.

The Federal Reserve

Ever since the pandemic began, the Federal Reserve has tried to prop up the economy by keeping interest rates near zero. But with inflation on the rise, the Fed recently signaled plans to wind down their stimulus efforts. Their reasoning? The economy is strong, and inflation doesn't seem to be going away, so it's time to start raising interest rates. (Higher interest rates tend to cool off the economy, because they prompt people to *save* their money instead of spending or borrowing it. A cooler economy decreases inflation, and things gradually go back to normal.)

The problem is the stock market has become accustomed to the Fed's low interest, "easy money" policies. Low interest rates mean that many securities, like bonds, simply don't provide the same return on investment as they would in a high-interest-rate environment. That drives more into the stock market to get the returns they need. Higher interest rates could potentially reverse this trend. That's why investors don't like any talk of the Fed "tapering" their stimulus program.

On Monday, November 29, the Chairman of the Federal Reserve announced the possibility that tapering might happen even sooner than investors thought.[3] That was too much for investors handle, preoccupied as they already were with the Omicron variant.

And now you know why the markets delivered a big, ugly pile of volatility on our doorstep. There wasn't even a bow on it!

So, what do we do?

we were thinking about how best to answer this question when we came across another headline: The start of the 2021 World Chess Championship in Dubai. Then it hit us. The best way to describe what we as investors should do is by comparing it to what the top chess players do.

The best chess players are *masters* at calculating possibilities. ("If I move my Bishop here, he'll have to move his Queen there, which means I can move my Knight...") In some ways, they think like computers, and indeed they often *use* computers to figure out the best moves to play.

But no human can calculate everything. There are occasions when the position is just too complex to predict every possible outcome. In some cases, they literally don't have *time* to calculate, and must make a move with only seconds on the clock. In a sense, chess players, like investors, are *always* operating under uncertainty.

When this happens, chess players rely on *principles* instead of *predictions.* They make decisions they know to be fundamentally sound, even if they can't calculate the result. They don't react emotionally. They don't guess. They rely on years of training and experience, knowing that, more often than not, their overall strategy will see them through.

Analysts, pundits, the Federal Reserve – they're all trying to calculate. But *no one* can calculate everything, which is why *no one* knows exactly what the future holds. As a result, too many investors fall back on emotional guessing as they try to navigate unknowns. Hence, the big selloff right after Thanksgiving.

We're not going to do that. Right now, the markets are beset with unknowns. Since we can't calculate every possible outcome, we're going to rely on *principle* instead of *prediction.* We know that volatility is always temporary. We know that none of these unknowns are actually new – investors have been wrestling with them for a year now. (Just swap "Omicron" for "Delta".) And we know our long-term strategy has helped you get closer to your long-term goals. In other words, we've put our pieces on good, sound squares – and we'll continue to do so moving forward.

That way, you'll be giving yourself the kind of gift *everyone* wants: Financial confidence.

In the meantime, our advice is to enjoy the holiday season! We hope it's a wonderful one, filled with family and good cheer. As always, let us know if you have any questions or concerns about your portfolio. We are always happy to talk with you!

Happy Holidays!

Sincerely.

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[1] "Dow drops 650 points on growing omicron fears, Powell taper comments," *CNBC,* https://www.cnbc.com/2021/11/29/stock-market-futures-open-to-close-news.html

[2] "SARS-CoV-2 Omicron variant," *Wikipedia,* https://en.wikipedia.org/wiki/SARS-CoV-2_Omicron_variant

[3] "Powell: The Fed May wind down its stimulus sooner than expected," *CNN Business,* https://edition.cnn.com/business/live-news/stock-market-news-113021/h_59fd45577438f2211df2aedffcea26d9

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