Key Questions

November 30, 2021

Is There a Silver Lining to the Market Volatility From the Omicron Variant?

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

The day after Thanksgiving delivered increased market volatility rather than a traditional Black Friday.

Indiscriminate selling pushed major stock market indices down by over 2%. Small stocks, commonly viewed as more economically sensitive, sunk nearly 4%. Meanwhile, volatility spiked, and as traders fled from stocks and other risky assets, they sought safety in government bonds, bidding prices up and driving yields lower, as illustrated by the 10-year Treasury yield, which rapidly retreated from a pre-holiday high of 1.70% to 1.47%.

The market decline was attributed to the discovery of a new coronavirus variant, named omicron, first detected in South Africa. According to various sources, omicron is spreading at a rate significantly greater than previous variants (e.g., delta and beta), thus causing alarm and triggering the market sell-off.

There is certainly much we do not know, but we think omicron will delay the full recovery from COVID-19, not derail it. Transmissibility and vaccine efficacy will be key things to watch.

If current vaccines help mitigate disease risk in a new variant, less cause for concern exists. If not, a silver lining could be that discovering each additional variant expedites future evaluation and potential development of an additional vaccine.

What are our thoughts on how this may affect the markets and the economy?

Although market breadth was waning before omicron, the US economy was displaying considerable momentum and enjoyed five significant tailwinds:

1. Stimulus priming the pump
2. Robust employment gains
3. Healthy balance sheets
4. Strong spending trends
5. Booming profits

Omicron creates additional complexities and uncertainties, including the possibility of greater transmissibility and a weaker response to vaccines. This likely will be known in the next two to six weeks, as will its severity (i.e., hospitalizations and fatalities).

Our initial thinking, ***based on limited data***, is that even though omicron could have a material economic impact based on the World Health Organization's assessment that it will spread more rapidly compared to delta, it may be more likely that the new variant will be less severe. Hence, the COVID recovery will be delayed, not derailed.

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Travel restrictions already have been imposed and could intensify, thus crimping holiday travel and likely even Olympic-related travel, especially since we are in peak virus season. These restrictions will cause the most significant delay to the recovery. They will also exacerbate labor shortages and supply-chain issues, further distorting inflation readings.

On a positive note, vaccinations and exposures to COVID are well underway, possibly limiting a worst-case scenario. Also, human ingenuity is already on the move, and one of the major benefits of mRNA technology is its ability to pivot quickly. (One drug manufacturer even suggested it could deliver a new vaccine within 100 days and have large quantities available within months).

Economically, this also may cause the Federal Reserve to be “on hold” for longer, although Fed futures markets suggest this is unlikely. At the same time, the economy is displaying considerable momentum, which should provide some important support for risk assets.

And, while we would not be surprised to see an increase in market volatility, we continue to advise overweighting equities and maintaining a bias to cyclicals vs. defensives.

The final silver lining is that volatility and market declines are inevitable and remind us that investors should avoid short-term reactions, stay focused on their financial plan, and remain invested for the long term.

For more information, please contact your advisor.

About the Author

Brian Pietrangelo leads the effort responsible for enhancing the communication and effectiveness of investment strategies, guidance and solutions tailored to our clients’ unique needs. He works directly with our Chief Investment Officer to support sound investment strategies for private and institutional clients and the delivery of solid risk-adjusted investment performance.

He has more than 25 years of experience in areas of leadership, investment strategy, investment research/manager due diligence, client relationship management, asset management and product development. Brian joined Key Private Bank in 2021 and his prior tenure included serving clients and the business for Charles Schwab and Merrill Lynch.

He earned his Bachelor’s Degree in Finance from Miami University (Ohio) and his MBA from the University of Dayton. He also attended the University of Chicago Booth School of Business Executive Education program and holds both Accredited Investment Fiduciary (AIF®) and Certified Investment Management Analyst (CIMA®) designations as well as previously having the FINRA Series 7 license.

Publish Date: November 30, 2021

210714-1142677-1218683195