Weekly **Market** **Commentary**

THE WEEK IN REVIEW: Jan. 2 - 8

New year, old problems – and same solutions

The first trading week of 2022 was not a good one. The initial few days were pretty good as we returned to work after the holidays, with markets posting new record highs. Then Wednesday rolled around and the Federal Reserve released the minutes from its final meeting of 2021. Given all that has transpired since the last meeting, a two-week-old transcript shouldn't have provided any surprises – but it did.

Yes, we already knew the taper was going to be more aggressive and possibly end as early as March of this year. We were also prepared to expect short-term rates to rise two or three times in 2022, likely increasing from 0.00% to 0.50%-0.75%. This plan means that the Fed would stop adding liquidity as the economy strengthened and slowly tighten borrowing cost as we reach a new state of equilibrium. In this "perfect scenario," the market doesn't skip a beat or lose its mojo and the economy begins to function organically without being propped up by cheap money and unprecedented Fed support.

It all sounds good in theory, but what wasn't mentioned until the minutes were released is that Fed officials believe they should also consider the unwinding of their nearly $9 billion balance sheet. That little tidbit sent markets reeling midweek, with the Dow swinging from being up nearly 200 points to ending down nearly 400 on Wednesday.

The week didn't get any better from there. The market continued its decline as the yield on the 10-year Treasury touched 1.80% and the December jobs number came in at half of the consensus estimate (more on that below). The 10-year Treasury is an important market barometer, and last week the 10-year yields were the highest we've seen in a year. Keep in mind that it's not just the Fed that can move rates; the markets can – and will – also have a hand in what happens with rates. The big difference is that the market doesn't need any official policy meeting; it meets nearly every day, and it can move very quickly. This is why we should continue monitoring the 10-year as it gets closer to 2%. Once it moves past that, the likelihood of market turmoil may increase significantly.

We're entering a new year with the same problems, including COVID, inflation and a slowing economy with less consumer confidence. Yet the solutions appear to be the same: potential restrictions that can further slow the economy, proposals for more government spending (which would lead to more inflation) and a Fed whose actions and comments could make the markets much more volatile in 2022.

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Jobs, narrow markets and inflation

The December jobs report came in at +199,000, far below the expectations of +422,000 and the lowest increase in 2021. President Joe Biden touted the reduction of the unemployment rate, which came in at a pandemic-era low of 3.9%. The problem is that we still have nearly 11 million job openings, and a record number of people are quitting their jobs.

The markets tried to come back on Friday on the hopes that the weaker jobs number may hold the Fed back from aggressively pursuing a rate raise. However, higher bond yields and the fact that we only added 199,000 jobs in December may indicate potential problems for the economy in the months ahead. It's also important to remember that the Fed has moved to the opposite side of the equation, so there doesn't currently appear to be any help in the form of liquidity there. If anything, liquidity may be even scarcer thanks to inflation, which is currently running at 7%. Even if the Fed raises short-term rates to 2% (which is likely), it may not ease inflationary pressures anytime soon. If the Fed moves more aggressively, it risks tanking the economy and those 11 million jobs that need filling may quickly evaporate due to the rising cost of doing business.

The narrowness of the market is also a current concern. The S&P 500's top seven are all technology stocks and constitute over 25% of the index. (You can argue if Amazon and Tesla are tech companies or a retailer and car manufacturer, but most folks would say they're tech companies.) In any event, these same companies have thrived in low-interest rate environments and will most likely suffer as rates increase. Last week, Apple became the first company to exceed a $3 trillion market cap, just a little more than three years after becoming a $1 trillion company. The top five S&P 500 companies accounted for over 40% of the S&P 500's 2021 return. If rates outpace these companies' ability to adapt, the markets will likely falter – just as we saw happen last week in the tech-laden NASDAQ.

7 companies constitute 25% of the S&P 500

As of Nov. 23, 2021

1. Microsoft (MSFT): 6.43%
2. Apple (AAPL): 6.36%
3. Amazon (AMZN): 3.92%
4. Tesla (TSLA): 2.36%
5. Alphabet Class A (GOOGL): 2.22%
6. Alphabet Class C (GOOG): 2.09%
7. Meta (FB), formerly Facebook, Class A: 2.05%

Source: Investopedia

Coming this week

- Fed Chair Jerome Powell and other Fed officials will give speeches next week and may offer more insight on what they're thinking about their plans for tightening the balance sheet.
- On Wednesday, we will get the Consumer Price Index (CPI) reading for December. Inflation is expected to keep marching upward; the surprise here will be if we see the rate actually decrease. (Doubtful.)
- Producer Price Index (PPI) will be reported on Thursday. (PPI looks at costs producers pay to make products and are an indicator of future consumer prices; if the price to make something goes up, then the price to the consumer will also go up.) And the Fed will report its balance sheet at the close of day.
- Finally, retail sales, business inventories and consumer confidence will round out the week. Any strength will be a welcome respite, especially as U.S. consumer confidence is flagging and spending is stalling. If that engine sputters, we could be in for more economic turbulence.

Have a great week!

Tom Siomades, CFA®
Chief Investment Officer
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Weekly Numbers

Index Performance Returns %					
	1 WK	YTD	1YR	3 YRS	5 YRS
S&P 500	-1.87%	-1.87%	22.96%	22.41%	15.48%
NASDAQ	-4.53%	-4.53%	14.30%	29.84%	22.02%
DJIA	-0.29%	-0.29%	16.72%	15.47%	12.66%

Interest Rates:		
	1/7/2022	12/31/2021
UST 10-YR Government Bond Yield	1.76%	1.52%
Germany 10 YR	-0.040%	-0.140%
Japan 10 YR	0.135%	0.069%
30 YR Mortgage	3.43%	3.27%
Oil	$78.96/ppb	$74.68/ppb
Regular Gas	$3.38/ppg	$3.38/ppg

All data as of Jan. 7, 2022

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