February 14, 2021

Weekly Viewpoint

Inflation Deflates the Markets

Performance for Week Ending 2.11.2022

The Dow Jones Industrial Average (Dow) finished down 1.00%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) lost 1.05%, the Standard & Poor's 500 Index (S&P 500) dipped 1.82% and the Nasdaq Composite Index (NASDAQ) slumped 2.18%. Sector breadth was negative with 9 of the 11 S&P sector groups closing lower. The Communication Services sector (-3.86%) was the worst performer followed by Technology (-2.91%) and Real Estate (-2.76%). On the upside Energy (+1.75%) and Materials (+1.14%) bucked the trend.

Index*	Closing Price 2/11/2022	Percentage Change for Week Ending 2/11/2022	Year-to-Date Percentage Change Through 2/11/2022
Dow	34738.06	-1.00%	-4.40%
Wilshire 5000	44660.30	-1.05%	-7.84%
S&P 500	4418.64	-1.82%	-7.29%
Nasdaq	13791.15	-2.18%	-11.85%

Market Observations: 2/7/22–2/11/22

The major market indices finished the week lower as solid fourth quarter earnings were outweighed by expectations of more aggressive rate hikes by the Federal Reserve following a hotter than expected read on consumer inflation. It appears that investors are becoming more fearful of the Fed's 'response to inflation' versus actual inflation. In other words, the probability of a policy mistake (overtightening) has gone up, which, in turn is raising fears that the Fed could tip the economy into a recession. While that is certainly not their goal, Fed officials will really need to 'thread the needle' to get the pace and level of rates correct. To compound matters, the spread between benchmark 10-year and 2-year note yields has narrowed to just 44 basis points, moving closer towards 'inversion' an event that has historically foreshadowed recessions. Bloomberg's World Interest Rate Probability (WIRP) tool now shows that the fed fund futures market is now fully discounting six rate hikes over the course of this year.

Inflation Keeps Inflating … The Labor Department reported that the consumer price index in January rose 7.5% year over year, higher than forecast and the biggest jump since February 1982. Core CPI, which excludes food and energy, rose 6% year over year, slightly higher than estimates and the biggest increase since August 1982. Following the report, St. Louis Fed President James Bullard said he supports raising interest rates by a full percentage point by the start of July — including the first half-point hike since 2000 — in response to the CPI data. "I'd like to see 100 basis points in the bag by July 1," Bullard, a voter on monetary policy this year, said in an interview.

… and Weighing on Sentiment: US consumers remained lackluster in their assessments of the economy as the University of Michigan's consumer sentiment index plunged another 5.5ppts lower to 61.7 in early February – the lowest reading since October 2011. The decline in consumer confidence, despite the sharp drop back in Covid cases, seems to underscore that consumers are far more concerned about the impact of higher inflation. Confidence fell sharply for higher income households, suggesting that the recent declines in equity prices probably played some role, but the far bigger factor appears to be persistently high inflation, which is weighing on purchasing power, particularly for big purchases, and leaving households more pessimistic over their personal finances.

Q4 EPS Season: Despite some high profile earnings misses, overall fourth quarter earnings season continues to trend at a better than forecast pace. Through Friday, 359 members of the S&P 500 have released results with 76% surprising to the upside. Aggregate earnings growth is up 26.9% on a year-over-year basis, solidly ahead of the 19.5% pace that analysts were forecast at the start of the year. On the sector level, all eleven of the S&P sector groups have delivered positive growth with the strongest gains coming from cyclical sectors like Energy, Industrials and Materials.

Outlook – Glass Still Half Full: Despite the rocky start to the new year and cloudy near-term visibility, our positive view on the equity market remains intact. While volatility is likely to remain elevated and the pace of gains relative to recent years are likely to slow, we feel the macro environment over the course of the year should remain supportive and provide a sturdy backbone for additional upside. The US economy remains on firm footing and growth in the quarters ahead is expected to remain above trend. The US consumer is in good shape and savings rates remain above pre-pandemic levels, suggesting that as consumers become more comfortable with the economic recovery and Covid cases continue to decline, pent up demand will be unleashed. Earnings expectations also suggest solid forward growth. Based on consensus expectations from Bloomberg, earnings are forecast to grow by 7 percent this year followed by 10 percent growth in 2023.

The Week Ahead: With the growing prospect of much more aggressive monetary tightening the FOMC meeting minutes from January will be in focus, as will various speakers for their views on the future path of policy. Most notably we will hear remarks from St. Louis Fed President Bullard, Cleveland Fed President Mester, Chicago Fed President Evans and Fed Governor Waller. It will be busy week on the data front with the January producer price index in the spotlight. Other reports of interest include; the February Empire manufacturing index from the NY Fed, retail sales for January, housing starts during January, jobless claims, January existing home sales, and the index of leading economic indicators for January. Fourth quarter earnings season will begin to wind down with just 59 members of the S&P 500 expected to release results.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.