Week in Review

Equity Markets:
The markets started off the new year in the red. The S&P 500 was down 1.8% as we saw a strong rotation back into value and cyclical stocks. Mega cap growth and technology had another rough week. The Nasdaq was down ~4.5% for the week. A spike in interest rates was the major driver for downward pressure. The minutes from the December Fed meeting were released on Wednesday, and it appears the markets are not fully prepared for the apparent policy shift that is being conveyed by the Fed.

Fixed Income Markets:
The 10-yr Treasury ended the week at ~1.76%. This is the highest level since the start of the pandemic. Rates jumped on the back of the Fed minutes from their December meeting being released. The minutes revealed the aggressive posture from the Fed in their intent on dialing back stimulus that helped the economy push through the pandemic.

The market anticipated interest rate hikes and tapering of the bond purchase program in 2022. What wasn't known was the timing of the actions. The Fed minutes revealed that not only will the Fed accelerate the taper, but will likely start reducing their balance sheet earlier than expected. When reducing the balance sheet, which currently stands at $8.3 Trillion, the Fed will let securities mature and not invest the proceeds. With the first expected rate hike around March, the Fed could start reducing their balance sheet shortly after.

The pace of reduction is also at the top of most market participants minds. The minutes stated that "the appropriate pace of balance sheet runoff would likely be faster than it was during the previous normalization episode". The economy may not be in the clear from the pandemic, but the Fed believes the economy is strong enough to withstand this and does not need the additional support that has been provided since March 2020.

Economic:
Job numbers disappointed on Friday with just under 200,000 jobs created in December, well below the anticipated 422,000. The pace of job creation may have slowed to end 2021, but there were still bright spots from the report. The unemployment rate fell to 3.9% which was better than expected; this reading is the lowest since February 2020.

Looking Ahead

Equity Markets:
Interest rates were a major driver for the stock market last week, and we see this continuing. A rapid rise in interest rates is not positive for the equity markets in the short term. If we continue to see a steady climb in rates, volatility should be expected as the markets digest a higher rate environment.

Technology and growth stocks may be challenged going forward if we continue to see rates climb at a fast pace. This is due to investors' risk appetite shifting due to the belief that profit growth will be subdued by higher interest rates (i.e. financing costs). It's important, however, to be mindful that not all technology stocks are created equal with varying degrees on the valuation spectrum. The rotation into more economically sensitive sectors and value stocks could have strong tailwinds if rates continue their march higher. Having a well-diversified portfolio with exposure to all sectors of the market is important at all times, but especially now. It is nearly impossible to time when a strong rotation will happen, and when it does, it is usually very swift. Over a full market cycle, missing these rotations can be detrimental to an investor's total return, and that is why we believe maintaining these exposures is so important through the good and bad.

Fixed Income Markets:
Many believe we have reached a pivotal point in the fixed income markets. The heavily followed 10-yr treasury rate is at the highest level since the pandemic began. Rates have moved upwards and challenged the current levels but retreated back down on multiple occasions over the past year. The Fed's recently announced, less accommodative stance, could be the catalyst to keep rates moving higher. Interest rates will be heavily watched since they are likely to have the largest impact on the markets in the near term.

Economic:
Many important economic numbers will be released this week. The most watched reading will happen on Wednesday when the CPI is released. Inflation was the hot topic for the last of half of 2021. The most recent CPI reading was the highest in 3 decades, 6.8% YOY. A milder reading would be welcomed by markets. We will also see readings for PPI, Export & Import Price Index, retail sales, and a preliminary number on consumer sentiment.

See following page for important disclosures

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