Week in Review

Equity Markets:
The S&P 500 ended the week down 1.8%, influenced by a higher-than-expected CPI reading and geopolitical concerns with the situation in Ukraine. The markets started off strong the first 2 days of the week, looking to continue its string of strength the past few weeks. The hot CPI led investors to shift their focus to the pace and extent of potential rate hikes. As news began reporting that it is likely Russia will invade Ukraine, the decline in the stock market accelerated and caused oil to jump to the highest level since 2014. Oil finished the week at over $93 per barrel, and continued its strong YTD run; up almost 25%.

Earnings were a positive contributor for the week. So far, 77% of S&P 500 companies have beat analysts' earnings expectations, according to FactSet. This is slightly higher than the 5-year average at 76%. Although this quarter's numbers are not at the same pace as previous quarters, it would not be realistic to expect the recent surge to continue well beyond long-term average. If the trend continues, this remains a positive sign. Growth was eventually going to slow. Current numbers will no longer be compared to the time period where the global economy was essentially shut down. Earnings alignment with historical averages is a sign that companies are still healthy.

Fixed Income Markets:
The 10-yr treasury closed at just under 1.92% but hit a very critical level last week. It finally broke through the 2% barrier and closed above 2% for the first time since August of 2019. The main driver of this was the CPI reading. The concerns have shifted from if/when the Fed will raise rates to a question of how much. There are analysts that believe a 0.50% hike could be coming in March; and St. Louis Fed President James Bullard's comments have investors worried about how hawkish of a stance the Fed may take. Bullard stated he would like to see a full percentage increase of the Fed Funds rate by July, and should consider a rate hike before the March meeting. James Bullard is only one member of the Fed, and won't be the only decision maker, but his comments alone were enough to increase the concerns of many investors.

Economic:
The CPI was the major headline for the week. January's CPI was 7.5% year over year inflation. This is the highest reading since 1982. For perspective, the inflation rate for 2019 was 1.8%. Indications are pointing to inflation that has peaked, or may be peaking very soon. Shipping costs have declined since last year, according to the Baltic Dry Index. And, according to the ISM Supplier Deliveries Index, shipping times have been improving after the spike in 2021.

Looking Ahead

Equity Markets:
The equity markets will require time to work through the current economic environment. No cycle is identical, and the markets need time to acclimate to various factors. It is apparent that inflation, and a higher rate environment (one that we never experienced in the post great recession cycle), will need time to play out. Volatility is likely to remain high while valuations adjust as Fed policy speak turns to action.

Earnings season is heading into the final innings and, if trend continues, will be a successful one when looking at historical averages. The days of outsized earnings growth numbers are likely over and results closer to historical averages should be the expectation going forward.

Fixed Income Markets:
The 10-yr moved into the range we expect to see for the intermediate term, 2% to 2.25%, before retreating after news of the potential invasion of Ukraine by Russia. We still believe the 10-yr is likely to fall into range for the remainder of the year. The fixed income markets are pricing in almost seven rate hikes. This would be a very bold move by the Fed, and could cause downside pressure on the equity markets. The Fed is very likely going to raise rates multiple times this year, but seven hikes is not the base case, in our view.

The rate structure we experienced during the peak of the pandemic was not sustainable long-term. We still hold the stance that the likelihood of the 10-yr reaching the high single digits, or anything close to what the 1970's looked like, is very unlikely. There are still many long-term factors we believe will keep rates suppressed. These include an aging population, deflationary factors such as technological disruption that increases productivity, and the debt levels around the globe. A higher interest rate climate is likely in years to come, but we believe peak levels beyond 3-4% would unlikely be surpassed, as we expect a lot of volatility along with it.

Economic:
The Producer Price Index and Import Price Index releases will happen next week. These readings should develop a more complete picture around inflation through the entire economy. Manufacturing reports from Philadelphia and New York will garner attention as well. We will also see the January Leading Economic Index, January housing starts, building permits and existing home sales released next week.

See following page for important disclosures

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