PEAPACK PRIVATE
Wealth Management

The Weekly
Economic & Market Recap

January 14, 2022

1/14/2022		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	35,911.81	-319.85	-0.88	1.76	-1.17	15.88
S&P 500	4,662.85	-14.18	-0.30	1.30	-2.17	22.85
NASDAQ	14,893.75	-42.15	-0.28	0.65	-4.80	13.58
S&P MidCap 400	2,782.64	-10.50	-0.38	1.40	-2.09	13.65

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.96	Euro/Dollar	1.14	0.75
5-Year	1.55	Dollar/Yen	113.79	-1.60
10-Year	1.79	GBP/Dollar	1.37	0.81
30-Year	2.13	Dollar/Cad	1.25	-1.01

Source: Bloomberg/FactSet

What Caught Our Eye This Week

About 11.4 million people were enrolled in the Affordable Care Act program in 2020. One of the goals of the Biden administration was to help people obtain quality health insurance. This week the Centers for Medicare and Medicaid (CMS) reported that as of January 3rd there were 14.2 million new enrollments or renewals of coverage through the program. Florida leads the nation with over 2.5 million enrollments followed by California and Texas with just over 1.7 million each. The increase in enrollments is mainly attributed to the hefty enhancement of the federal premium subsidies passed by Congress last March (part of the coronavirus relief package known as the American Rescue Act) as well as the increase in advertising for the program by the Biden administration. The signups close Saturday, January 15th and some experts expect a last-minute surge in signups. A new federal report showed that the enhancements passed under the American Rescue Plan Act not only lowered premiums for consumers but also impacted cost-sharing such as deductibles. However, the boosted subsidies are going to expire after the 2022 coverage year unless Congress renews them. The Build Back Better Act proposed extending them again for several years but remains stalled in Congress.

Economy

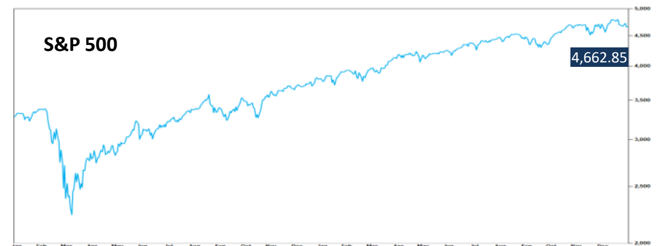
The economic headliner this week was once again the Consumer Price Index (CPI), which was released on Wednesday. The CPI in December rose 0.5%, which was a tenth above expectations. Over the past twelve months, the CPI has increased 7.0%. This is the fastest pace in nearly four decades and the third straight month in which inflation has exceeded 6%. The "core" CPI also increased, rising 0.550%, and is now up 5.5% year-over-year. Used vehicle prices led the way surging 3.5%, energy prices declined 0.4%, and food prices gained 0.5%. Over the past twelve months, used vehicle prices have soared 37.3%. On Thursday, the Producer Price Index (PPI) posted an increase of 0.2% in December, the slowest pace since November 2020. Year-over-year, these prices are up 9.7%, the fastest since records began in 2010. Much of the PPI's deceleration came from a drop in energy prices, which declined 3.3% last month. Finally, on Friday, retail sales for December came in much weaker than expected. Total sales declined 1.9%, as furniture sales dropped 5.5%, and non-store sales plunged 8.7%. The "control" category, which excludes food service, autos, gas and building materials, fell 3.1%.

Fixed Income/Credit Market

Intuitively, impending rate increases coupled with the Fed taper might have moved investors away from short-term assets and into longer-duration assets, particularly since the consensus is for a flatter yield curve. However, year-to-date the reaction has been quite different. Net fund flows for ultra-short and short-term assets increased a combined $2.1B which equates to a market cap (MC) increase of 1.3%. Coincidentally, intermediate and long-term assets experienced combined net outflows of approximately $2.1B, a market cap decrease of 3.4% collectively. Net fund flows by asset class show the most money migrating into aggregate bond funds at $1.3B but for a market cap increase of just 0.3%. Bank loan funds had the largest market cap increase at 4.4% (+$840 million). Corporate and government bond funds experienced net outflows of $4.3B (-1.3% MC) and $1.1B (-0.6% MC), respectively. By rating class, high yield bond funds lost 1.4% of their market cap with net outflows of $1.6B. Investment grade funds were not impermeable to outflows at -$1.1B or -0.3% in terms of market cap.

Equities

Domestic equities struggled for a second consecutive week with all three major indexes posting declines. Stocks staged a mid-week rally which many viewed as investors "buying the dip" due to perceived oversold conditions; however, the rebound was short-lived. The S&P 500 declined 1.42% on Thursday as investor sentiment turned negative with the recent backup in interest rates and an increasingly hawkish Federal Reserve. Furthermore, commentary from some U.S. companies cited near-term headwinds due to inflation, supply chain constraints and labor shortages. On Friday, Q4 2021 earnings season kicked off with a few of the major banks reporting. According to FactSet, the blended earnings growth rate estimate for the S&P 500 is 21.8%. If 21.8% is the actual growth rate for the quarter, it will mark the fourth straight quarter of earnings growth above 20%. Year-to-date, value stocks have significantly outperformed their growth counterparts with the Russell 1000 Value and Russell 1000 Growth returning +0.89% and -5.68%, respectively. The best performing sector this week was energy up 5.22%. Real estate underperformed posting a 1.98% decline.



Our View

The fundamental question for investors is the forward path of inflation. Inflation measured by the Consumer Price Index rose 7% year-over-year in December, which is the highest level in 40 years. The general view is that inflation will soon peak and gradually decline toward the Federal Reserve's average target over the next twelve to eighteen months. Proponents of this point of view expect supply chain constraints and disruptions to resolve, people to reenter the workforce as the Covid virus situation lessens, and consumer spending to diminish as the impact of fiscal stimulus becomes less of a tailwind. The base effect, or the math of how the inflation metric is calculated, will make inflation appear to be moderating, just as the base effect caused inflation to appear to be exploding higher last spring. We believe that inflation will moderate for many of the reasons listed above, but it is also evident that the Fed is behind the curve regarding inflation. We have commented that the current Fed, which generally leans more dovish, would weigh full employment over inflation. So, we now have the unemployment rate below 4% and the CPI at 7%, with Fed funds effectively at 0%. Too much fiscal stimulus in response to the pandemic created the inflation problem, but the Fed remaining overly accommodative for too long has made matters worse. In any event, inflation is the Fed's problem now. Higher rates are warranted at this point in the economic cycle. The Fed and financial markets expect at least three Fed fund rate hikes this year. The realization that monetary policy will be dramatically different is causing interest rates to adjust and a rotation within the equity market. Higher levels of volatility can be expected as we go through this period of adjustment. The real issue, and the longer-term consideration for the markets, is the rate that inflation settles at in the second half of 2022. If inflation remains at an uncomfortably high rate, the Fed will need to be more aggressive, and the chance of a policy mistake that flips the economy into a recession goes up materially.

COMING UP NEXT WEEK		Consensus	Prior
01/18 Empire State Index SA	(Jan)	24.0	31.9
01/19 Housing Starts SAAR	(Dec)	1,650K	1,679K
01/20 Philadelphia Fed Index SA	(Jan)	22.5	15.4
01/20 Existing Home Sales SAAR	(Dec)	6,390K	6,460K
01/22 Leading Indicators SA M/M	(Dec)	0.80%	1.1%

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