WEEKLY MARKET UPDATE, JANUARY 10, 2022

GENERAL MARKET NEWS

• The yield curve moved higher across the board last week, and a noticeable shift across all maturities also occurred. The U.S. 2-year Treasury yield opened the week at 0.743 percent and closed 12.7 basis points (bps) higher at 0.870 percent. The U.S. 10-year Treasury yield increased 25.7 bps to 1.769 percent. Finally, the U.S. 30-year Treasury yield moved 21.2 bps higher, closing at 2.117 percent. Higher rates spooked equity market investors as the Federal Reserve's (Fed's) meeting minutes indicated it would be more aggressive with raising rates and tapering asset purchases.

• Global equity markets were down across the board last week as Treasury yield curve rates shifted higher. This resulted in high-flying technology and consumer discretionary names—including Microsoft (MSFT), NVIDIA (NVDA), Alphabet (GOOG/GOOGL), Amazon (AMZN), Netflix (NFLX), Adobe (ADBE), and SalesForce (CRM)—being sold off. Real estate, technology, health care, communication services, and consumer discretionary were among the hardest-hit sectors. Outperforming sectors included energy, financials, industrials, consumer staples, and materials. The market is punishing names that have benefited from the Fed's actions during the pandemic, including the purchase of mortgage-backed securities, which have reduced mortgage and other interest rates and powered growth in technology and health care. The equity market appears to be playing with higher rates and inflation, which shows uncertainty over whether the Fed or inflation will win out in the short term and in 2022.

• On Tuesday, the Institute for Supply Management (ISM) Manufacturing survey for December was released. This widely monitored gauge of manufacturer confidence declined by more than expected during the month, as the index fell from 61.1 in November to 58.7 in December against calls for a more modest drop to 60. This is a diffusion index where values above 50 indicate expansion, so this result still signals growth for the manufacturing industry. Manufacturer confidence was supported in 2021 as lessened restrictions on business activity and the overall economic recovery allowed for increased factory production throughout the year. High levels of business confidence have historically supported faster levels of business spending growth, so December's result is a good sign for business spending as we kick off the new year.

• Wednesday saw the release of the December Federal Open Market Committee meeting minutes. These minutes were highly anticipated due to the central bank's announcement that it would be cutting the level of its monthly asset purchases by more than initially expected in the months ahead. This announcement signaled that the Fed is committed to normalizing monetary policy sooner than originally anticipated. Economists and investors were looking forward to the release of the minutes in order to gain insight into what factors caused the Fed to increase the pace of the asset purchase tapering. The minutes showed that Fed members were concerned about the high inflation rates throughout 2021, and the attempt to normalize monetary policy more quickly was due, in part, to fears about continued inflationary pressure in 2022. The minutes also contained preliminary discussion about the Fed's balance sheet and potential steps to lower the Fed's Treasury bond holdings in the years ahead. While it's too early for any firm commitment for balance sheet reduction from the central bank, the preliminary discussions indicated that some Fed members viewed the end of 2022 as a potential start date for balance sheet reductions, which would be another step toward normalizing monetary policy.

• On Thursday, the November international trade balance report was released. The report showed that the trade deficit increased by less than expected, with the gap rising from a revised $67.2 billion in October to $80.2 billion in November against calls for further expansion to $81 billion. This brought the monthly trade deficit to its second-largest level on record, trailing only September's $81.4 billion deficit. The increase in the deficit was driven by a surge in imports during the month, as retailers tried to stock up for the important holiday season. Imports increased 4.6 percent, which was more than enough to offset the 0.2 percent increase in exports. Trade was a net drag on economic growth in the third quarter, and the deficit in November indicates that the headwind may continue into the fourth quarter. Looking forward, global economic recovery is expected to help lead to a more normal trading environment.

• Thursday also saw the release of the ISM Services index for December. Service sector confidence dropped by more than expected, as the index fell from 69.1 in November down to 62 in December against calls for a more modest decline to 67. This larger-than-expected decline left the index in healthy expansionary territory, as this is another diffusion index where values above 50 indicate growth. That said, service sector business owners noted a slowdown in new orders, which was likely due to the uncertainty caused by the Omicron variant. Despite the decline in confidence during the month, the employment component of the report showed that service sector businesses continued to hire in December, which was an encouraging sign for future service sector growth.

• We finished the week with Friday's release of the December employment report. The report showed that 199,000 jobs were added during the month, which was down from the upwardly revised 249,000 jobs that were added in November and below economist estimates for 450,000 jobs. While the miss against expectations was disappointing, the monthly job figures have been subject to high levels of revisions over the past few months, as the October and November job reports were revised up by a combined 141,000 jobs. Additionally, the underlying data showed further signs of improvement, as the unemployment rate fell from 4.2 percent to 3.9 percent against calls for a more modest drop to 4.1 percent. This marks an impressive improvement, as the unemployment rate fell from 6.7 percent in December 2020 to 3.9 percent in December 2021. Given the relatively low unemployment rate and continued wage growth, the report is expected to support the Fed's decision to increase the pace of its asset purchase tapering in the months ahead.

WHAT TO LOOK FORWARD TO

Wednesday will see the release of the Consumer Price Index for December. Consumer prices are expected to increase 0.4 percent during the month, down from a 0.8 percent jump in November. On a year-over-year basis, the estimates are for 7.1 percent growth, up from a 6.8 percent rise in November. Core consumer prices, which strip out volatile food and energy prices, are expected to go up 0.5 percent during the month and 5.4 percent year-over-year. Tangled supply chains, lean business inventories, and high levels of pent-up consumer demand led to higher-than-anticipated consumer inflation throughout much of 2021. These inflationary pressures are expected to remain in play toward the end of the year. Given the recent actions and commentary from the Fed, many economists believe the central bank will move more swiftly to combat inflation in 2022. We may see a more hawkish Fed than currently expected.

On Thursday, the Producer Price Index for December is set to be released. Producer prices are also expected to increase 0.4 percent, following a 0.8 percent rise in November. As for headline year-over-year producer inflation, the calls are for a rise of 9.8 percent in December, slightly higher than November's 9.6 percent year-over-year gain. Core producer prices, which strip out food and energy prices, are expected to go up 0.4 percent during the month and 8 percent year-over-year. As was the case with consumer prices, producer prices were pressured throughout 2021 due to supply chain constraints. Additionally, rising material and labor costs contributed to rising inflationary pressure felt by producers throughout 2021. If estimates prove accurate, this report would support the Fed's anticipated plans for more aggressive policy in 2022.

Friday will see the release of the December retail sales report. Retail sales are expected to decline 0.1 percent during the month, following a 0.3 percent increase in November. If estimates hold, this report would mark the first drop for sales since July 2021. It would be a sign that rising medical risks in December weighed on consumer spending. Throughout most of last year, consumer spending growth was positive, supported by improvements on the public health front that allowed the easing of state and local restrictions. Although widespread shutdowns are not anticipated at this time, it's possible the recent rise in case growth will negatively affect consumer spending in the short term. Given the importance of consumer spending to economic growth, this release will be widely monitored. Economists will use it to gauge the impact of recent case growth on spending and the overall economic recovery.

Friday will also see the release of the December industrial production report. Industrial production is expected to increase 0.3 percent during the month, following a 0.5 percent gain in November. If estimates hold, this report would mark three consecutive months with improved production. November's solid result was supported by an increase in factory production and manufacturing output. Manufacturing production rose 0.7 percent in November, and economists expect that result to be followed by a 0.4 percent uptick in December. Capacity utilization in November reached the highest level since December 2018, and further improvements are expected in December's report. Throughout the pandemic, producers have been slower to recover compared with consumers. Still, we've seen steady progress in getting production back to pre-pandemic levels. Overall, if estimates prove accurate, this report would mark a solid result. It would show that production continued to recover to end the year, supported by high levels of consumer and business demand.

We'll finish the week with Friday's release of the preliminary estimate of the University of Michigan consumer sentiment survey for January. Consumer sentiment is expected to decline slightly from 70.6 in December to 70 to start the new year. If estimates hold, this report would bring the index close to the recent low of 67.4 recorded in November 2021. Consumer sentiment dropped toward the end of last summer and remained well below pre-pandemic levels throughout the year. Consumers cited rising inflationary pressure as the major driver of the collapse in sentiment. The survey has, however, taken on a notable partisan split. Republican respondents expect significantly higher levels of inflation in the short and intermediate term compared with democrats. These disparate inflation expectations have caused overall confidence levels to diverge. Republican consumers had an overall sentiment level of 45.6 in December 2021, while democrats registered 90.8, marking one of the largest gaps on record. Looking forward, further progress in getting inflation under control will likely be needed before we see a notable improvement in overall consumer sentiment.

Equity Index	Week-to-Date	Month-to-Date	Year-to-Date	12-Month
S&P 500	–1.83%	–1.83%	–1.83%	24.02%
Nasdaq Composite	–4.52%	–4.52%	–4.52%	13.87%
DJIA	–0.25%	–0.25%	–0.25%	18.68%
MSCI EAFE	–0.29%	–0.29%	–0.29%	7.54%
MSCI Emerging Markets	–0.47%	–0.47%	–0.47%	–7.47%
Russell 2000	–2.91%	–2.91%	–2.91%	5.24%

Source: Bloomberg

Fixed Income Index	Month-to-Date	Year-to-Date	12-Month
U.S. Broad Market	–1.53%	–1.53%	–2.13%
U.S. Treasury	–1.61%	–1.61%	–2.75%
U.S. Mortgages	–1.13%	–1.13%	–2.05%
Municipal Bond	–0.70%	–0.70%	0.90%

Source: Morningstar Direct

Disclosures: Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. All indices are unmanaged and are not available for direct investment by the public. Past performance is not indicative of future results. The S&P 500 is based on the average performance of the 500 industrial stocks monitored by Standard & Poor's. The Nasdaq Composite Index measures the performance of all issues listed in the Nasdaq Stock Market, except for rights, warrants, units, and convertible debentures. The Dow Jones Industrial Average is computed by summing the prices of the stocks of 30 large companies and then dividing that total by an adjusted value, one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies. Dividends are reinvested to reflect the actual performance of the underlying securities. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index. The Bloomberg US Aggregate Bond Index is an unmanaged market value-weighted performance benchmark for investment-grade fixed-rate debt issues, including government, corporate, asset-backed, and mortgage-backed securities with maturities of at least one year. The U.S. Treasury Index is based on the auctions of U.S. Treasury bills, or on the U.S. Treasury's daily yield curve. The Bloomberg US Mortgage Backed Securities (MBS) Index is an unmanaged market value-weighted index of 15- and 30-year fixed-rate securities backed by mortgage pools of the Government National Mortgage Association (GNMA), Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (FHLMC), and balloon mortgages with fixed-rate coupons. The Bloomberg US Municipal Index includes investment-grade, tax-exempt, and fixed-rate bonds with long-term maturities (greater than 2 years) selected from issues larger than $50 million. Basis points (bps) is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1 percent, or 0.01 percent.

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