HIGHLIGHTS

- Interest rates spiked across the curve, with the 10-year finishing at 1.76%, its highest levels since January of 2020, and was up from 1.52 just seven days earlier, following the release of the Fed-minutes. Higher rates and a more aggressive potential Fed path forward were the primary reason markets have sold-off to start the year.
- The market is now pricing in three rate hikes, with an 80% chance the first hike comes as early as March 2022.
- Growth names continued to come under significant pressure as valuation concerns continue to come into focus with higher rates and a more hawkish fed.
- Even as Technology names continue to sell-off, over the past 30 years there have been four distinct periods of rate hike cycles. Over the rate hike cycles, Technology has been the best performing sector in the S&P 500, averaging just under 21% annually.
- According to Bloomberg, more than 40% of the companies in the NASDAQ Composite have had their market values cut in half from their 52-week highs with many stuck in bear market territory.
- Friday's job report did little to inspire investors, as the headline employment number missed expectations, with the U.S. only adding 199K jobs versus 450K consensus.
- After five straight declining sessions in the S&P 500, its longest streak in more than three months, buyers seemingly emerged in Monday's (1/10/22) session, with an intra-day rally that almost wiped-out equity losses. The rally seen in the session came as JPMorgan's Marko Kolanovic called the downturn "overdone".
- In Europe, some countries expressed concerns over economic consequences if Russia is heavily sanctioned by the United States. The Euro STOXX index dropped 0.50% last week, with technology down 4.56%.
- In China, property developers face $197 billion worth of liabilities in January according to Bloomberg, roughly enough to cover maturing bonds, coupons, deferred wages, and trust products.
- In Japan, the Yen hit its lowest level since January 2017 amid interest rate bets. The NIKKEI 225 index dropped 1.09% last week.

MARKET COMMENTARY

LAST WEEK

It was a busy week to start the New Year as both equity and fixed income markets closed broadly lower with interest rates rising across the curve. The NASDAQ was the major underperformer and lost the most ground (4.53%) over the course of the week, after the Federal Reserve appeared to take a more hawkish stance according to the release of their minutes from the last meeting of Fed officials.

Source: Bloomberg as of 01.11.22

The potentially more aggressive path forward for rates caused them to spike with the U.S. 10-year treasury yield finishing at 1.76%, its highest levels since January of 2020 and up from 1.52% just seven days prior. A more aggressive Federal Reserve along with a sluggish jobs report did little to inspire market participants, especially coming after a year that saw the S&P 500 gain more than 28% with all 11 sectors closing higher.

FACTOR AND SECTOR PERFORMANCE

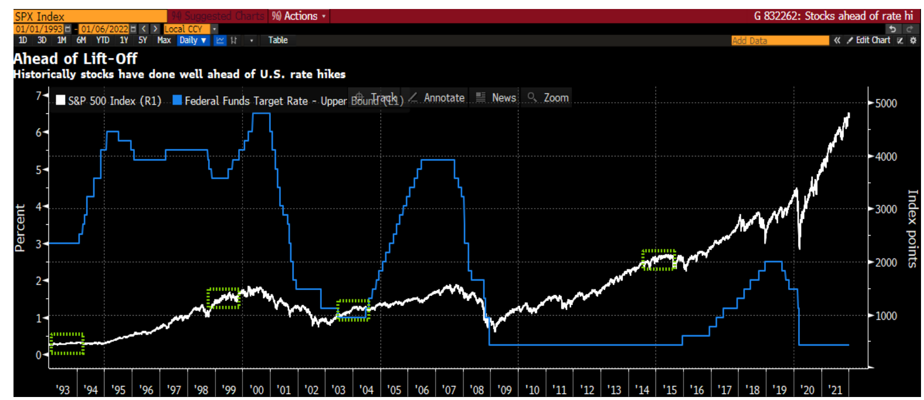
Growth names meaningfully underperformed value on the week, by 5.6% with large technology, semis and software names coming under significant pressure. Healthcare was also a big laggard with weakness in managed care names, while Communication Services underperformed with weakness in Mega-caps Netflix (-10.2%), Facebook (-1.4%), and Google (-5.4%). Consumer Discretionary lagged with underperformance in heavyweight Amazon, homebuilders, retailers and restaurants; although autos and various re-opening plays such as cruise lines and hotels fared better than most names in the space.

BOND YIELDS

Perhaps the biggest story on the week was the backup in yields as they spiked across the curve, being driven by higher real rates with inflation expectations remaining largely unchanged. Although there were several factors behind the rise in rates, the largest component seems to be the Fed's pivoting of their function now versus during the pandemic. As the Fed continues to taper its previous $120B/monthly purchases, the big question remains, who will step in to offset the demand the Central Bank has absorbed. With bond purchases by the Fed slowing, other market participants may require higher yields, only putting further upward pressure on rates.

After the more hawkish takeaway from the December FOMC meeting, the market now is pricing in an 80% probability that the first-rate hike may be as early as the March 2022 meeting, with investors fully pricing in three rate hikes before the end of the year.

According to the group's (Federal Reserve) official estimate, the 10-year treasury yield is expected to reach 2.1% or more by the end of 2022. Since 1993, the S&P 500 Index has gained an average of 2.5% in the three months prior to the Federal Reserve's first-rate hikes. If history is any indication, the most recent pullback due to the increase in rates may be overdone.

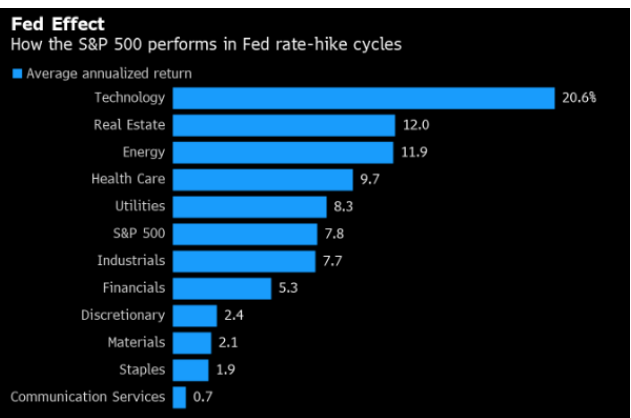


Source: Bloomberg as of 01.11.22

GROWTH COMING UNDER FIRE

With growth names sharply selling off, news and media outlets have been highlighting stories focusing on the pullback which has mainly been attributed to:

- Higher rates
- A potentially more aggressive Fed
- Exacerbated longstanding valuation concerns



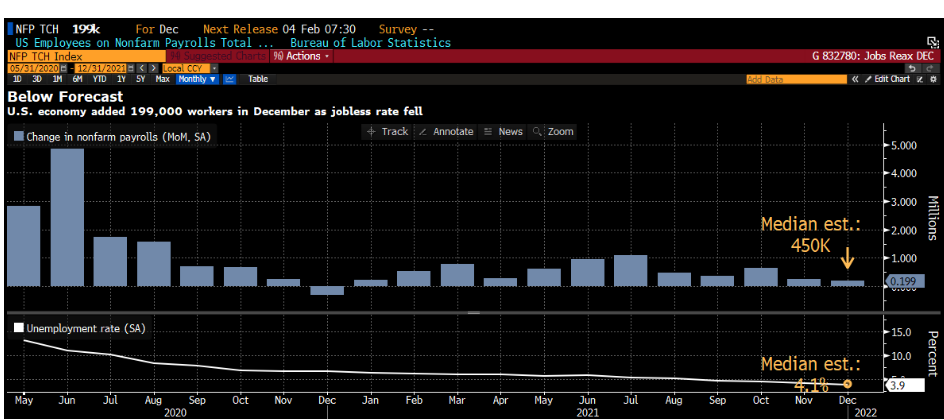
According to Bloomberg, more than 40% of the companies in the NASDAQ Composite have had their market values cut in half from their 52-week highs, with many stuck in a bear market. However, despite a significant sea of red underneath the surface, broader indexes are still managing to trade near all-time highs.

Source: Strategas Securities, Bloomberg as of 01.11.22

Currently the Tech sector's weight represents 29% of the S&P 500 at the end of 2021, which is still below the 33% seen at the height of the tech bubble. However, over the past 30 years, there have been four distinct periods of rate hike cycles by the Federal Reserve. Generally, on average, Technology has been the best performing sector, gaining on average just under 21% annually. Real Estate, Energy and Healthcare are the next best performing; however, their annualized average returns are significantly lower.

FRIDAY'S JOB REPORT & ECONOMIC DATA

Friday's job report was mixed from the Fed's perspective in regards to their employment mandate. Only a disappointing 199,000 jobs were added in December, 250K jobs lower than expectations. The positive headline number for the unemployment rate fell to a better than expected 3.9%, the lowest since the pandemic when it stood at 3.5% in February of 2020. Additionally, adding to the economic data was the release of ISM manufacturing which fell to 58.7 in December versus 61.1 the month prior and was the lowest since January of 2021.



Source: Bureau of Labor Statistics, Bloomberg as of 01.11.22

THIS WEEK

Domestic equities ended lower, but finished off their worst levels as "dip buyers" emerged for seemingly the first time during the five-day selloff, the S&P 500's longest losing streak since September. After the S&P 500 sunk 2% in early Monday morning trading and the NASDAQ declined about 3%, buyers stepped in right before 11am ET sparking a rally that almost wiped out all losses across equity indexes.

The NASDAQ did in fact turn positive late in the day, and was the only index to finish slightly higher (by 0.05%) following last week's pullback of ~5% to start the year. The NASDAQ Composite is now 8% below its November 52-week high. Early in the session as markets sold off there were five puts for every three calls on the QQQ, before retreating to becoming equally balanced, according to Alin Rosin of Oppenheimer & Co. When all was said and done, the Dow Jones finished lower by 0.45%, followed by the Russell 2K (-0.40%), and S&P 500.

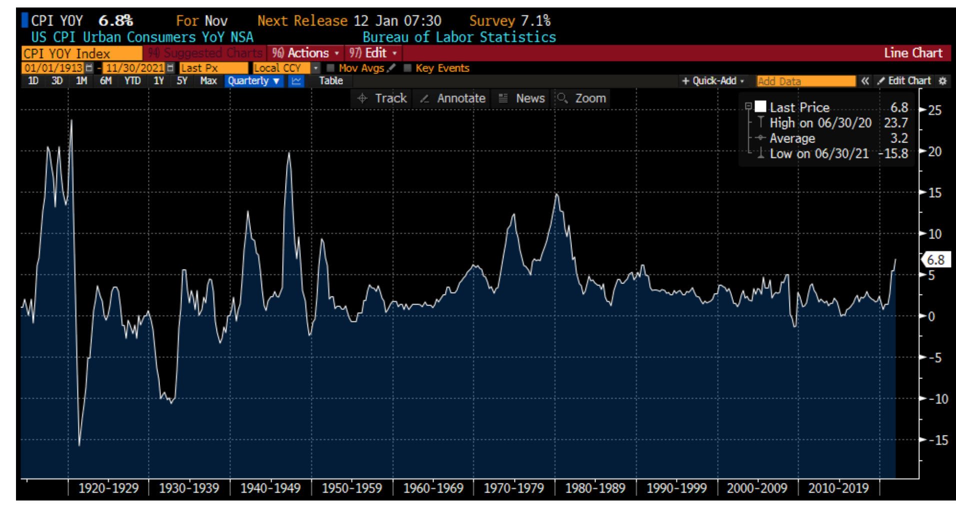
Source: Bloomberg as of 01.11.22

The mid-day bounce underneath the surface was impressive after the Tech sector was amongst the best performing on the session. Consumer Staples, Industrials and Materials were amongst the worst underperformers, showing that the spaces that lagged most last week had the most significant bounce on Monday. Adding to the intra-day reversal was strategist Marko Kolanovic of JPMorgan, who said in a note mid-day that the downturn was overdone, adding it was time to "buy the dip", arguing that higher rates would not derail the bull market as "policy tightening is likely to be gradual".

Investors have been on edge as of late, ditching expensive Technology stocks with the Federal Reserve preparing to raise interest rates more aggressively than previously thought, coupled with the resurgence of COVID-19 globally, which looks to potentially threaten economic

growth. However, even as the Omicron variant spreads exponentially throughout the U.S., the main reason for the lackluster start to the year appears to be the Central Bank's plans to raise rates at least three to four times this year in order to combat the highest inflation levels seen in the last four decades.

CPI, a key measure of U.S. inflation is set to be released on Wednesday with expectations that inflation pressures have continued to increase further in December. Expectations call for CPI to jump to 7.1%, versus the month prior of 6.8% when it touched its highest levels since the first quarter of 1982.



Source: Bureau of Labor Statistics, Bloomberg as of 01.11.22

INTERNATIONAL

The Bloomberg World index declined 1.84% as the rotation from growth to value stocks shook markets. Information technology was the worst performing sector, down over 5%, while energy and banks were the beneficiaries of asset inflows. The JPMorgan Global Manufacturing PMI remained flat at 54.20 in December while the global Services PMI weakened from 55.60 in November to 54.60 in December. Yields are rising across markets, reflecting the ongoing transition from an accommodative monetary policy to a tightening cycle.

EUROPE

In Europe, some countries expressed concerns over economic consequences if Russia is heavily sanctioned by the United States. According to Bloomberg, "The Biden administration and U.S. allies are discussing possible export controls on Russia, including curbs on sensitive technology and electronics, to be imposed if President Vladimir Putin seizes more of Ukraine". The European Union (EU) is Russia's biggest trade partner, accounting for 37% of the country's global trade. The EU is also reliant on Russia for its oil and gas, as 25% of the bloc's oil imports is sourced from Russia. The U.S. will hold talks with Russia this week to attempt to find a peaceful resolution. The Euro STOXX index dropped 0.50% last week, with technology down 4.56%.

In the United Kingdom (UK), a survey conducted by Bank of England shows that companies plan to raise prices by 5% in the next year to offset rising costs. This price inflation will come on top of the 5% hike exercised last year. Bank of England expects consumer prices growth to reach 6% by spring 2022 before coming down thereafter. In the real estate market however, mortgage lenders anticipate a slowdown in the housing market this year amid rising taxes, interest rates, and utility bills. Last year, house prices rose at the strongest pace since 2004. The FTSE 100 index gained 1.11% last week.

APAC

In China, property developers face $197 billion worth of liabilities in January according to Bloomberg, roughly enough to cover maturing bonds, coupons, deferred wages, and trust products. Beijing authorities asked property developers to meet their obligations by month-end to reduce the probability of social unrest. Guangdong province officials organized meetings between state-owned enterprises and distressed developers to discuss potential mergers and acquisitions. In the broader economy, retail sales remain subdued due to COVID-19 restrictions. In December the Manufacturing PMI ticked up to 50.30 from 50.10 a month earlier. The Shanghai Composite index declined 1.27% last week, despite a 5.34% rebound from the real estate sector.

In Japan, the Yen hit its lowest level since January 2017 amid interest rate bets. David Forrester, Senior FX strategist at Credit Agricole said "the transition to a more normal global economy in 2022 will lead to a normalization of monetary policy by several central banks, including the Fed". Japan was an outlier in December monetary policy meetings as Bank of Japan pledged to keep an ultra-loose monetary policy while the rest of the world started to dial back Pandemic stimulus and raise interest rates in some cases. In November, consumer prices rose 0.6% year-over-year while producer prices rose 9%, the strongest cost pressure in 41 years. The NIKKEI 225 index dropped 1.09% last week.

Source: Bureau of Labor Statistics, Bloomberg as of 01.11.22

EMERGING MARKETS

In South Korea, The Markit Manufacturing PMI climbed to 51.90 in December from 50.90 a month earlier. According to survey provider IHS Markit, "The final round of 2021 survey data epitomized the supply-constrained narrative we've seen develop this year. Given South Korea's prominence in the automotive and electronics industries, substantial improvements in global supply chains will be required before we see a meaningful acceleration in manufacturing growth." Exports grew 18.35% year-over-year, moderating from a 32% annual surge a month earlier. The KOSPI index declined 0.76% last week, with services down 7.71%.

In India, IHS Markit Services PMI rolled over from 58.09 in November to 55.53 in December. The sharp increase in new business and output in December was partially offset to reduced staff and inflationary pressure. Business confidence hit a four-month high as executives are increasingly confident about the demand outlook for 2022. The IMF sees India growing faster than China in 2022 (8.5% vs 5.6%) as the government remains keen on providing economic support to hardest-hit businesses. The Reserve Bank of India's medium-term inflation target is 4%. The Nifty 50 index gained 3.54% last week.

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