JANUARY 18, 2022

Weekly Market Update

General Market News

- The yield curve saw modest flattening last week. The short end of the curve continued its move higher and the long end of the curve held steady. The U.S. 2-year Treasury yield increased another 9.7 basis points (bps), closing at 0.967 percent. The 10-year Treasury yield increased 0.6 bps while the 30-year Treasury yield actually fell 0.2 bps. This news may indicate that the move in yields is approaching a near-term ceiling as appetite from investors keeps bond yields in check at this level. We will see if this trend continues and expands to the short end of the curve in the future.

- Global equity markets showed mixed performance last week as investors questioned whether we saw peak inflation with Wednesday and Thursday's Consumer Price Index (CPI) and Producer Price Index (PPI) reports. The Nasdaq Composite Index outperformed the Dow Jones Industrial Average despite the Russell 1000 Growth underperforming the Russell 1000 Value 1.03 percent. Elsewhere, the MSCI EAFE outperformed the S&P 500 and MSCI Emerging Markets Index outperformed all areas, posting a gain of 2.57 percent. Dollar weakness and a potential rate ceiling helped the region. Energy was a standout performer as West Texas Intermediate crude rose 6.2 percent. Communication services and technology also performed well as growth stocks rallied. The worst-performing sectors were REITs, consumer discretionary, and utilities.

- On Wednesday, the CPI report for December was released. Consumer prices rose 0.5 percent, down from the 0.8 percent increase we saw in November but slightly above economist estimates. On a year-over-year basis, consumer prices increased 7 percent in December, which was in line with expectations. This represents the highest level of year-over-year consumer inflation since 1982. Core consumer prices, which strip out volatile food and energy prices, rose 0.6 percent in December and 5.5 percent on a year-over-year basis. This was slightly higher than economist estimates for a 0.5 percent monthly and 5.4 percent year-over-year increase. Consumer prices experienced upward pressure throughout 2021, fueled by high levels of pent-up consumer demand, thin business inventories, and tangled global supply chains. Looking forward, the Federal Reserve (Fed) is expected to focus on combating inflation in 2022 as the central bank works to normalize monetary policy.

- Thursday saw the release of the PPI report for December. Producer prices increased 0.2 percent, down notably from the revised 1 percent increase we saw in November and below estimates for a 0.4 percent increase. On a year-over-year basis, producer prices increased 9.7 percent in December, which was slightly below estimates for a 9.8 percent rise. Core producer prices, which strip out the impact of volatile food and energy prices, increased 0.5 percent in December and 8.3 percent on a year-over-year basis. Similar to consumer prices, producer prices have been pressured this year due to supply chain constraints. Producers have also had to contend with rising material and labor costs, which contributed to the increase in inflationary pressure throughout the year.

- On Friday, the December retail sales report was released. Retail sales were disappointing, as headline sales dropped 1.9 percent against calls for a more modest 0.1 percent decline. This marks the first month with declining sales since July, and

General Market News (continued)

it's a sign that rising medical risks and inflationary pressure weighed on consumer spending to finish the year. The declines were widespread, as 10 of the 13 categories in the report showed a drop in sales, led by an 8.7 percent drop in nonstore sales. Core retail sales, which strip out the impact of auto and gas sales, fell 2.5 percent against calls for a 0.2 percent decline. Despite the miss against expectations in December, earlier strength in consumer spending growth throughout the quarter and year helped blunt some of the disappointment from this report. This will be a widely monitored release in the coming months, given the importance of consumer spending on the pace of the overall economic recovery.

- We finished the week with Friday's release of the preliminary estimate of the University of Michigan consumer sentiment survey for January. Consumer sentiment fell more than expected to start the new year, dropping from 70.6 in December to 68.8 to start January against calls for a drop to 70. This result, which brought the index close to its recent low of 67.4, signals continued consumer unease. The larger-than-expected drop was largely due to a decline in the future expectations subindex. Future expectations declined, in part, due to rising inflation expectations, as 1-year and 5-year consumer inflation expectations increased, despite messaging from the Fed that the central bank is committed to combating inflation in the new year. The current conditions subindex also declined, which was likely due to the rise in case growth we've seen because of the Omicron variant.

Market Index Performance Data

EQUITIES

Index	Week-to-Date	Month-to-Date	Year-to-Date	12-Month
S&P 500	−0.29	−2.11	−2.11	25.49
Nasdaq Composite	−0.28	−4.79	−4.79	15.32
DJIA	−0.88	−1.13	−1.13	18.71
MSCI EAFE	0.18	0.10	−0.11	9.22
MSCI Emerging Markets	2.57	1.84	2.09	−5.41
Russell 2000	−0.79	−3.67	−3.67	2.86

Source: Bloomberg, as of January 14, 2022

FIXED INCOME

Index	Month-to-Date %	Year-to-Date %	12-Month %
U.S. Broad Market	−1.82	−1.82	−2.60
U.S. Treasury	−1.77	−1.77	−3.00
U.S. Mortgages	−1.49	−1.49	−2.53
Municipal Bond	−0.93	−0.93	0.56

Source: Morningstar Direct, as of January 14, 2022

What to Look Forward To

On Tuesday, the National Association of Home Builders Housing Market Index for January was released. Home builder confidence dropped modestly to start the year, as the index fell from 84 in December to 83 in January against calls for no change. This is a diffusion index, where values above 50 indicate expansion, so this result signals continued construction growth despite the decline. Home builder confidence has remained in solid expansionary territory following the expiration of initial lockdowns in 2020. Since then, high levels of home buyer demand and a lack of homes for sale have supported faster construction growth. Home builder confidence sits well above pre-pandemic levels, signaling more construction growth in the months ahead. The continued strength of home builder confidence is impressive, given the headwinds caused by rising material and labor costs for home builders. Today's report indicates a healthy housing sector to start the new year.

Speaking of new home construction, Wednesday will see the release of the December building permit and housing starts reports. These measures of new home construction are expected to show a modest decline, following larger-than-anticipated increases in November. Permits are set to drop 0.7 percent in December, after rising 3.6 percent in November. Starts are set to go down 1.7 percent, following an 11.8 percent surge in November. These reports can be quite volatile on a month-to-month basis. Throughout the pandemic, however, the pace of new home construction has remained above pre-pandemic levels. Record-low mortgage rates and a desire for more space due to the pandemic have supported a surge in home buyer demand. Because existing homeowners were hesitant to put their homes up for sale, newly built homes sold quickly throughout 2021.

We'll finish the week with Thursday's release of the December existing homes sales report. Existing home sales are set to decline 0.8 percent, following a better-than-expected 1.9 percent increase in November. Still, the pace of sales is expected to remain well above pre-pandemic levels despite the anticipated drop. In fact, if estimates prove accurate, existing home sales would be up 12.6 percent on an annual basis, compared with the pre-pandemic high recorded in February 2020. Looking forward, the low supply of homes for sale as well as rising prices and mortgage rates may serve as a headwind for significantly faster growth of existing home sales. If we continue to see sales near current levels, however, they would signal a healthy housing sector.

Authored by the Investment Research team at Commonwealth Financial Network.