CORRIGAN FINANCIAL, INC.

Market Update: January 2022

U.S. stock values dropped nearly 6% to begin the new year, with large blue-chip stocks down around 5% and small companies off nearly 10% for the month of January. Technology stocks, as measured by the Nasdaq Composite, declined 9% for their worst January performance since 2008. Domestic value stocks, as well as foreign equities, saw more modest declines of just over 3% for the month.

> **Stocks have been pressured primarily by a growing realization that the Federal Reserve is preparing to increase interest rates. The kind of growth-oriented, high-multiple tech shares that led the market higher during the pandemic tend to underperform when rates are on the rise.**
>
> **Eric J. Savitz – Barron's 1/31/22**

The yield on the benchmark 10-year U.S. Treasury Note ended the month at 1.8%, up from 1.5% at the end of December. By definition, rising rates are a headwind for stock valuations. They render future earnings less valuable, increase debt service costs for corporations, and make bonds yields more attractive.

Investors are showing their concerns over rising rates by reducing exposure to so-called *risk assets* … such as meme stocks, cryptocurrencies, and SPACs (special purpose acquisition companies). In addition, a widely watched basket of unprofitable technology shares has lost almost a quarter of its value in just the last two months.

> **In response, investors are changing strategies they have ridden for almost two years, rattling stocks, bonds and cryptocurrencies, all of which soared during the age of pandemic stimulus.**
>
> **Zuckerman/Banerji/Wursthorn – WSJ 1/27/22**

U.S. Gross Domestic Product (GDP) expanded by a 6.9% annualized rate during the fourth quarter of 2021. While household spending saw only modest gains, most of the advance was attributed to companies rebuilding their depleted inventories. Excluding the inventory buildup, output grew by a more modest annual rate of 1.9% during the quarter.

> **Put otherwise, American businesses produced more than they sold in the fourth quarter, and since GDP is a measure of production, that counts as a plus.**
>
> **Justin Lahart – WSJ 1/27/22**

Before the pandemic, retailers held 1.4 months-worth of sales in their inventories. That ratio stood at only 1.1 at the end of November, so there is still room for inventories to grow. Economists expect U.S. economic growth to continue, although at a more modest pace.

> **The U.S. has learned to adapt to the new world of variants and continues to produce.**
>
> **Beth Ann Bovino, S&P Global Ratings – WSJ 1/27/22**

For all of 2021, U.S. economic output grew by 5%, which is the strongest annual growth rate in nearly four decades … and quite a rebound from the 2.3% output decline in 2020. Two forces drove growth last year: fiscal stimulus (cash sent by Congress directly to households) and loose monetary policy. However, both of these influences are on the decline, as households spend down stimulus monies, and the Fed gets ready to raise rates.

The Fed's preferred measure of inflation, the Commerce Department's personal consumption-expenditures index, rose 4.9% from a year earlier … the biggest increase since September 1983. Household incomes are also on the rise, with employers spending 4% more on wages and benefits last year.

The labor market remains tight. Job openings and worker turnover remain at or near historical highs, while employer layoffs have reached all-time lows. Overall, the number of jobs far exceeds the number of available workers … leaving workers with tremendous leverage.

> **More and more people left their jobs to find greener pastures as strong demand for workers resulted in a job-switching boom. The result was wages growing at a rate the U.S. labor market hasn't seen in well over a decade.**
>
> **Nick Bunker, Indeed – WSJ 2/1/22**

Historically, the Fed has started to tighten monetary policy on a preemptive basis. But now, *instead of anticipating*, the Fed finds itself *having to react* to already high inflation rates.

> **This is normally where the Fed wants the economy to be when it finishes tightening, not when it starts. The Fed is thus so far behind the curve that it needs to get interest rates up almost irrespective of what incoming data say about the economy or inflation.**
>
> **It's been a long time since the markets had to grapple with a Fed behind the curve and unwilling to commit to an interest-rate path. It's a recipe for unpleasant surprises …**
>
> **Greg Ip – WSJ 1/27/22**

Let's not forget the Fed's massive $9 trillion bond portfolio, which has doubled since the pandemic and now weighs in at 40% of U.S. GDP. Bond purchases are designed to support asset prices … thus creating a *wealth effect* on the economy. Reducing the Fed's portfolio will have the opposite effect. The Fed has yet to give guidance on when, or at what pace, it expects to reduce its balance sheet.

The U.S. national debt has passed the $30 trillion milestone as of January 31, according to the Treasury Department. The total debt includes amounts held by the public as well as intragovernmental balances. Since the start of the pandemic, the total debt balance has grown by approximately $7 trillion.

> **The milestone of $30 trillion in debt should be a giant red flag for all of us about America's future economic health, generational equity, and role in the world.**
>
> **Michael Peterson, Peterson Foundation – WSJ 2/1/22**

The fiscal year ended (September 2021) budget deficit of $2.8 trillion equates to more than 12% of total U.S. GDP, according to the Congressional Budget Office. While many consider the debt burden to be manageable because of low interest rates, it could certainly constrain the government's ability to respond to future emergencies.

> **By one measure, every percentage point increase in rates adds $100 billion a year or more to debt costs. That must be financed either with more taxes or more debt. In Washington's fantasy world, spending is a free lunch. It isn't, as eventually Americans, if not politicians, will learn the hard way.**
>
> **The Editorial Board – WSJ 2/2/22**

China's economy continues to weaken, as manufacturing and services activity slows and home sales remain soft. Beijing's zero-Covid policies, along with policy measures to rein in *capitalist excesses*, are weighing heavily on economic growth. The International Monetary Fund (IMF) recently reduced its forecast for China's economic growth to 4.8% for all of 2022.

> **China has come a long way in recent years, but in the process generated both enormous debt and massive inequality.**
>
> **The economy must grow, but it must grow more equitably. President Xi Jinping, then, is caught between the competing**

> **imperatives of growth and equality. It's the same tightrope Chinese leaders have walked for centuries.**
>
> **George Friedman, Geopolitical Futures – Thoughts from the Frontline 1/22/22**

China is also witnessing a decline in productivity growth according to the IMF report. This negative trend is attributed to greater state intervention in China's economy. State-owned enterprises are generally considered to be only 80% as productive as private firms.

> **This should be a banner week for Chinese President Xi Jinping. His country is celebrating the lunar new year, the most important holiday in the Chinese calendar, and the Beijing Winter Olympics open Friday. If Mr. Xi isn't enjoying the festivities, that may be due to fresh signs the economy is in trouble – which is largely his fault.**
>
> **The Editorial Board – WSJ 2/1/22**

Treasury yields are back to prepandemic levels … but, somewhat surprisingly, so are stock valuations. Based on forward looking earnings, U.S. stocks are currently sporting valuations that are close to where they were in February 2020.

> **To look at stock valuations, the pandemic might never have happened. As things stand, though, the bumpy start to 2022 looks more like stocks losing their pandemic premium than an omen of a potential bear market.**
>
> **Jon Sindreu – WSJ 2/1/22**

Speaking of bumpy starts, consider these dramatic market moves:

- Facebook parent Meta lost more than $232 billion in value in one day (Feb 3). That is the *biggest one-day drop* in value in the history of the U.S. stock market.
- The following day (Feb 4), Amazon recorded the *largest one-day gain* in market value ($191 billion) for a U.S. company.

The Friday (Feb 4) "Jobs Report" also caught us all by surprise. The Labor Department reported U.S. payrolls grew by 467,000 in January, blowing away the consensus estimate of 150,000. Payroll totals for November and December were also revised up by a whopping 700,000.

> **Overall, the job market is strong, particularly in the face of omicron. It's hard to find a weak spot in this report.**
>
> **Kathy Jones, Charles Schwab & Co. – CNBC 2/4/22**

Much like the Goldilocks fairy tale, the U.S. economy finds itself operating at a level that might be considered "too hot", increasing the probability the Fed could raise rates 5 times in 2022 … with the possibility of a 50 basis-point hike in March.

Volatility is on the rise … which is a reflection of escalating economic, political, and geopolitical uncertainty.

> **It isn't investments that get tested in turbulent markets; it's investors … I think the best investment of 2022 is likely to be discipline.**
>
> **Jason Zweig – WSJ January 2021**

Expect ongoing volatility in a rising rate environment, but remember that successful investors always remain disciplined and humble.

Daniel G. Corrigan, CPA/PFS, CFP®