January 24, 2022

REGIONS ASSET MANAGEMENT

WEEKLY MARKET COMMENTARY

What We're Watching

MARKET UPDATES

January 21, 2022: Recorded Leadership Discussion Featuring: Regions Chief Economist, Chief Investment Officer and Chief Market Strategist.

January 28, 2022: Join the upcoming live Regions Market Update.

KEY OBSERVATIONS

Stocks: Weakness Persists Amid Monetary Policy Uncertainty. Global equities have kicked off the new year on shaky footing, but that's been especially true in the U.S., largely due to heightened uncertainty surrounding the path forward for monetary policy. Year-to-date, the S&P 500 is lower by 7.7% and is now 8.7% below its intra-day record high reached on January 4. Weakness in growth stocks has been particularly pronounced year-to-date, exhibited by the 12.2% decline in the Russell 1000 Growth index which has underperformed the Russell 1000 Value index by 8.5% in just three weeks' time. Expectations for fed funds rate hikes have shifted meaningfully since December as the fed funds futures market was pricing in two or three quarter-point hikes this calendar year and in just one month's time is now projecting four or potentially five in '22. We expect volatility in stocks and interest rates to persist as clarity surrounding how aggressive the FOMC will need to be in normalizing monetary policy is likely to be lacking for months to come, leading investors to frequently reassess what they are willing to pay for longer duration growth stocks. Abroad, the MSCI ACWI ex U.S. Index is lower by 2.1% year-to-date after selling off into the weekend and, in what is perhaps the biggest surprise so far in the new year, the MSCI Emerging Markets (EM) Index is higher by 1%. At the country level, the United Kingdom has been a standout performer within developed markets, while Brazil and China have contributed to EM's gain.

Bonds: Yields On Long-Term U.S. Treasuries Back to Pre-COVID Levels; Corporate Credit Reasonably Well-Behaved Despite Risk-Off Tone. Last Tuesday, the 10-year U.S. Treasury yield closed at 1.87%, its highest closing yield dating back to January 8, 2020, and the 30-year yield closed at 2.18% on the same day, its highest closing yield since January 23, 2020. Upward pressure on bond yields to start the year has been a global phenomenon as the 10-year German bund yield made a run at 0.00% mid-week before catching a bid into the weekend, ultimately ending the week at -0.07%. From a positioning perspective, market participants started the year shorting U.S. Treasuries in a big way, betting on lower prices and higher yields, and had been pressing those bets over recent weeks, which served to intensify the move higher in yields globally. However, last Friday, the 10-year U.S. Treasury yield fell 7 basis points to close the week at 1.76% as market participants bought Treasuries as economic growth concerns made the rounds, while others moved to take profits by covering short positions in advance of this Wednesday's FOMC meeting. We expect interest rate volatility to persist as market participants parse FOMC Chair Jerome Powell's post-meeting comments for clues as to just how aggressive the Committee may ultimately be when attempting to normalize monetary policy over coming quarters.

WHAT WE'RE WATCHING

- The Conference Board's Consumer Confidence Survey for January is slated for release Tuesday and is expected to fall to 110.5 from 115.8 in December.
- The Federal Open Market Committee (FOMC) will hold a closely monitored meeting on Wednesday. Fed funds futures are now pricing in between four and five quarter-point rate hikes in '22, and market participants will undoubtedly parse Chair Jerome Powell's post-meeting comments for any indication as to how the Committee plans to proceed once the tapering of bond purchases wraps up in March.
- Preliminary Durable Goods Orders for December are released Thursday and are expected to fall 0.35% month over month after rising 2.6% in November versus October.
- December Personal Consumption Expenditure (PCE), the FOMC's preferred measure of inflation, is slated for release Friday. PCE for December is expected to show a 0.4% rise relative to November after rising 0.61% in November versus October. Core PCE, which excludes volatile food and energy prices, is expected to have risen 0.44% in December after a 0.46% rise in November relative to October.
- The University of Michigan Consumer Sentiment Index for January will be released Friday and is expected to fall to 68.3 from 68.8 in December.

	Price/Yield	Total Return (%)					
	1/21/2022	1 Week	1 Month	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	34265.37	-4.55	-3.38	-5.63	11.96	13.93	14.08
S&P 500	4397.94	-5.67	-5.31	-7.66	15.76	20.10	16.24
NASDAQ	13768.92	-7.55	-10.23	-11.98	2.42	25.37	21.04
Russell 2000 Index	1987.92	-8.07	-9.69	-11.44	-6.24	11.63	9.40
MSCI World ex US	2306.35	-1.79	0.73	-2.14	7.51	11.80	9.24
MSCI EM	1244.31	-0.97	3.55	1.03	-9.29	9.75	9.71
Bloomberg US Aggregate	2.03	0.05	-1.69	-1.77	-2.53	4.17	3.19
Bloomberg Global Aggregate	1.47	-0.19	-0.81	-0.94	-4.98	3.22	3.11
Bloomberg US Corporate	2.66	-0.13	-2.20	-2.50	-2.32	6.47	4.70
Bloomberg 10-Year Muni	1.34	-0.51	-1.41	-1.46	-0.63	3.98	3.82
Bloomberg High Yield	4.83	-0.68	-0.99	-1.54	2.99	6.92	5.73

	Price/Yield						
	1/21/2022	1 Week Ago	1 Month Ago	12/31/2020	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	0.05	0.05	0.05	0.05	0.04	2.41	N/A
30 Year Mortgage (average rate)	3.68	3.52	3.19	2.88	2.88	4.48	4.15
2 Year Treasury (yield)	0.99	0.96	0.66	0.73	0.12	2.61	1.19
10 Year Treasury (yield)	1.75	1.77	1.48	1.51	1.10	2.78	2.47
30 Year Treasury (yield)	2.06	2.11	1.89	1.90	1.87	3.09	3.05
WTI Crude (closing price)	85.14	83.82	71.10	75.33	53.00	53.60	52.33
Brent Crude (closing price)	87.90	87.17	72.85	77.24	55.68	62.04	55.04
Gold (NYM $/oz)	1831.80	1816.50	1787.90	1827.50	1865.30	1281.30	1204.30

Source: FactSet

WHAT HAPPENED LAST WEEK?

Stocks: Weakness Persists Amid Monetary Policy Uncertainty.

Global equities have kicked off the new year on shaky footing, but that's been especially true in the U.S., largely due to heightened uncertainty surrounding the path forward for monetary policy. Year-to-date, the S&P 500 is lower by 7.7% and is now 8.7% below its intra-day record high reached on January 4. Weakness in growth stocks has been particularly pronounced year-to-date, exhibited by the 12.2% decline in the Russell 1000 Growth index which has underperformed the Russell 1000 Value index by 8.5% in just three weeks' time. Expectations for fed funds rate hikes have shifted meaningfully since December as the fed funds futures market was pricing in two or three quarter-point hikes this calendar year and in just one month's time is now projecting four or potentially five in '22. We expect volatility in stocks and interest rates to persist as clarity surrounding how aggressive the FOMC will need to be in normalizing monetary policy is likely to be lacking for months to come, leading investors to frequently reassess what they are willing to pay for longer duration growth stocks. Abroad, the MSCI ACWI ex U.S. Index is lower by 2.1% year-to-date after selling off into the weekend and, in what is perhaps the biggest surprise so far in the new year, the MSCI Emerging Markets (EM) Index is higher by 1%. At the country level, the United Kingdom has been a standout performer within developed markets, while Brazil and China have contributed to EM's gain.

• International equity indices have fared well on a relative basis year-to-date as they skew more toward cyclical, 'old economy' sectors that can potentially benefit from higher interest rates, while having less exposure to secular growth sectors such as information technology that see valuations compress as rates rise. We remain constructive on Europe, specifically, and earnings estimates for Eurozone equities have trended higher early in the new year, which, if sustained, could continue to act as a magnet for capital from the U.S. over coming quarters.

• Last Tuesday, technology behemoth Microsoft (MSFT) announced a $68.7B all-cash acquisition of video game maker Activision Blizzard (ATVI). Microsoft paid a nearly 50% premium to the previous closing price for Activision, a move highlighting just how much cash large and mega-cap technology companies have on hand and can potentially deploy as growth stock valuations come down to more attractive levels. M&A activity may at some point provide support for valuations for unprofitable small and mid-cap technology companies, but with a valuation reset ongoing, potential acquirers are likely to be in no rush to rummage through the bargain bin.

• The American Association of Independent Investors (AAII) survey taken on December 29, 2021 showed 37.7% of respondents were "bullish," on stocks over the next six months, just shy of the 38.0% average "bullish" reading since 1987. Fast forward to last Wednesday's survey release, and there has been a pronounced shift in sentiment as just 21.0% of respondents were "bullish," while 46.7% were "bearish." Notably, the July 30, 2020 survey was the last time the percentage of respondents that were "bullish" was below 21%, and the S&P 500 is higher by 38% since that date. We view sentiment indicators such as the AAII survey as nice to know, not need to know, but at extremes such as last week's reading, they can act as a decent contrarian indicator, and in this case, a potentially positive one for equity bulls. Sentiment swings such as this are what contrarian investors like to see as market bottoms are often elusive until everyone throws in the towel and there is no one left to get "bearish." Notably, last Thursday, both the S&P 500 and Russell 2000 attempted to rally, but were unable to hold onto gains, ultimately closing sharply lower on the day. Thursday's price action leads us to believe this was little more than a short covering rally amid oversold conditions, not long-only investors adding to or initiating positions. Among other indicators, we're on the lookout for a spike in the CBOE Volatility Index, or VIX, above 30 to indicate that sentiment is washed out and that the S&P 500 is sufficiently oversold and that the bottoming process has run its course.

Bonds: Yields On Long-Term U.S. Treasuries Back to Pre-COVID Levels; Corporate Credit Reasonably Well-Behaved Despite Risk-Off Tone.

Last Tuesday, the 10-year U.S. Treasury yield closed at 1.87%, its highest closing yield dating back to January 8, 2020, and the 30-year yield closed at 2.18% on the same day, its highest closing yield since January 23, 2020. Upward pressure on bond yields to start the year has been a global phenomenon as the 10-year German bund yield made a run at 0.00% mid-week before catching a bid into the weekend, ultimately ending the week at -0.07%. From a positioning perspective, market participants started the year shorting U.S. Treasuries in a big way, betting on lower prices and higher yields, and had been pressing those bets over recent weeks, which served to intensify the move higher in yields globally. However, last Friday, the 10-year U.S. Treasury yield fell 7 basis points to close the week at 1.76% as market participants bought Treasuries as economic growth concerns made the rounds, while others moved to take profits by covering short positions in advance of this Wednesday's FOMC meeting. We expect interest rate volatility to persist as market participants parse FOMC Chair Jerome Powell's post-meeting comments for clues as to just how aggressive the Committee may ultimately be when attempting to normalize monetary policy over coming quarters.

• It's been a rough start to the year for investors in investment-grade and high yield corporate bonds as the Bloomberg Corporate Index is already lower by 2.5% and the Bloomberg U.S. High Yield Index has fallen 1.5%. Waning demand for riskier bonds comes as little surprise given the impact that uncertainty surrounding FOMC policy over the coming year has had on stock prices and riskier assets broadly. Prior to last Friday anyway, credit spreads had been well behaved as the bulk of the damage done to corporate credit had been caused by the sharp rise in Treasury yields year-to-date. However, as yields on long-term Treasuries fell sharply last Friday amid a broader risk-off move across markets, the option adjusted, or credit spread over the U.S. Treasury curve for the Bloomberg U.S. High Yield Index moved higher by 14 basis points on the day, and the yield-to-worst (YTW) on the index rose 12 basis points to 4.83% - a level last seen in November of 2020. Given our expectation that defaults will remain low this year, higher yields should draw buyers back into corporate debt, but given the historical linkage between stocks and high yield bonds, investors may wait for signs of stabilization in stocks before stepping in.

Source: Bloomberg, FactSet

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