Summary

Economic data for the week included a disappointment in December nonfarm payrolls, although the unemployment rate continued to improve. ISM manufacturing and services both fell back for the month, but remained solidly in expansion. Minutes from the Dec. Fed meeting showed a more hawkish tone than did the original statement released at the time.

U.S. equity markets fell back along with higher yields, hawkish Fed meeting minutes, and higher commodity prices. Foreign stocks fared better, with mixed results. Bonds fell back sharply, as a result of higher long-term interest rates. Commodities gained, due to a geopolitical-based spike in energy prices.

Economic Notes

(0) The **ISM manufacturing index** for December fell back by -2.4 points to a still-expansionary level of 58.7, yet fell short of consensus expectations of 60.0. Underlying results were mixed, with weaker production and new orders, although each remained solidly in expansion, around the 60 level for each. Employment gained a point, further into expansion. High readings in supplier deliveries and prices paid saw declines (the largest in a decade for the latter), which pointed to improvement in logistics conditions. Overall, all but three of the 18 industries surveyed showed growth. While not at peak levels, ISM manufacturing continues to show signs of strong underlying economic growth. The demand is certainly present, with the ability to satisfy the demand being the factor in numbers lower than they otherwise might be.

(0) The **ISM services/non-manufacturing index** for December declined by -7.1 points to 62.0, below the expected 67.0 reading. Despite the decline, the headline figure remains robust, and expansionary, with the decline apparently largely due to an especially-strong November just coming back to earth. The underlying components reflected the headline figure, with business activity, new orders, and employment all down at least a few points, but remaining in expansion. As with manufacturing, supplier deliveries fell, which noted that logistical issues were stronger than the prior month. Prices paid, though, ticked up slightly to the 82.5 level, which is quite high.

(0/+) **Construction spending** in November gained 0.4%, but fell short of expectations calling for 0.6%, although this also continued an upward revision for prior months. Private residential spending showed the strongest gains, at nearly a percent; public residential fell back by -3%.

(-) **JOLTS job openings** declined by -529k in November to 10.562 mil., below the median forecast calling for 11.079 mil. While openings fell across the board, roughly half of the overall monthly drop was in hotels and food services, notoriously Covid-related. The job openings rate fell back by -0.4% to 6.6%, while hiring rose a tenth to 4.5%. The layoff rate was unchanged at 0.9%, while the closely-watched quit rate rose by 0.2% to 3.0% (with private employment quits reaching an all-time high). These numbers continue to reflect a repairing and robust job market, with the balance increasingly tipped to employees and jobseekers.

(+) The **ADP private employment** rose by 807k in December, representing a dramatic gain from the prior month and nearly doubling the consensus expectation of 410k, although the November number was revised down by -50k. The services sector represented 669k (83%) of the monthly result, of which a third was in leisure/hospitality. Jobs in goods production rose by 138k as well. Construction jobs are now a few percent above their pre-pandemic level, while manufacturing still remains -2% below.

(-) **Initial jobless claims** for the Jan. 1 ending week rose by 7k to 207k, above the median forecast of 195k. **Continuing claims** for the Dec. 25 week also rose, by 36k, to 1.754 mil., well above the 1.678 mil. level expected. Claims rose most dramatically in CA, while GA experienced a large decline; other states were mixed. Again, year-end seasonality effects could be continuing to play a role in recent week results.

(-) The employment situation for December came in weaker than expected in some respects. Recent government figures may need to be taken more with a grain of salt than usual, due to delays in data collection, causing a greater reliance on estimates. It appears the report may have been impacted by early omicron variant cases, which are likely to carry into January.

Nonfarm payrolls rose by 199k, sharply below the 450k expected, and even below the tempered 249k November result. However, these did include upward revisions totaling 141k for the two prior months. In the December details, leisure/hospitality rose by 53k, professional/business services by 43k, manufacturing by 26k, and transportation/warehousing by 19k—all rose at a slower pace compared to November. Government jobs fell by -12k. Industry breadth was the lowest in a year.

The **unemployment rate**, on the positive side, fell by -0.3% to 3.9%, stronger than the expected improvement of only a tenth. This measure has continued to experience strong improvement, approaching the recent pre-Covid cycle low of 3.5% from Feb. 2020. The U-6 underemployment measure also fell, by -0.4% to 7.3% (also close to the Feb. 2020 reading of 7.0%). The household survey tied to this showed a gain of 651k, which is a strong reading given no change in the labor participation rate. Based on these results, which are watched and quoted by the Fed, the magical land of 'full employment' may be near. As noted by the BLS, the number of unemployed persons has fallen by -4.5 mil. to 6.3 mil. in 2021—a substantial improvement—although not yet at the Feb. 2020 low of 5.7 mil.

Average weekly earnings rose by 0.6%, above the 0.4% expected. However, the year-over-year pace decelerated from 5.1% to in November to 4.7%, yet above the 4.2% expected by consensus. Average weekly hours were unchanged at 34.7.

(0/-) The minutes from the **December FOMC meeting** implied that members viewed March 2022 as a good ending date for their treasury/mortgage asset purchases. The language of the minutes was far stronger than that of the official FOMC announcement at the time or press conference (noting that both can be used not only as formal documentation, but also as tools to communicate policy 'tweaks'). Quotes to note included 'some participants judged that a less accommodative future stance of policy would likely be warranted', and 'should convey a strong commitment to address elevated inflation pressures.' The latter comment is important as an acknowledgment of inflation becoming more of a problem than simply transitory, as it was described in earlier meetings.

Additionally, it appears that the runoff of the Fed's balance sheet may begin sooner after the ending of bond purchases than expected. Essentially, this means the Fed would no longer be reinvesting proceeds of maturing bonds they own, as well as could be selling bonds outright (although more of the former than the latter most likely). In so doing, a shrinking of the balance sheet would provide implied additional tightening (by removing loosening), which could serve to postpone or even replace some actual rate hikes. Why the differentiation? Continuing to reinvest proceeds of maturing treasury/mortgage bonds still represents 'accommodation', albeit a smaller amount, which would run counter to any rate increases happening at the same time—the effects of these opposing policies would counteract each other. It's expected that the balance sheet run-down may happen at a faster pace than in past cycles, although this is a sensitive process to be balanced with natural supply/demand dynamics for these bonds to ensure supply doesn't overwhelm demand, causing interest rates to rise more than desired.

However, rate hikes are still expected (with March remaining the base case for the first hike), with a variety of economists being of the opinion that it could be 2-3 by December. Of course, these are dependent on the paths of Covid, inflation, and economic growth conditions. A worsening of the pandemic, while not the base case, would slow these plans, while continued high inflation becoming more systemic could accelerate the tightening.

Market Notes

Period ending 1/7/2022	**1 Week (%)**	**YTD (%)**
DJIA	-0.25	-0.25
S&P 500	-1.83	-1.83
NASDAQ	-4.52	-4.52
Russell 2000	-2.91	-2.91
MSCI-EAFE	-0.29	-0.29
MSCI-EM	-0.47	-0.47
Bloomberg U.S. Aggregate	-1.53	-1.53

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2021	0.06	0.73	1.26	1.52	1.90
1/7/2022	0.10	0.87	1.50	1.76	2.11

U.S. stocks started the New Year on a mixed note, with Wednesday's Fed minutes pointing to perhaps a quicker pace of money tightening than initially expected, causing stocks to react to the downside for the week. Small cap stocks underperformed large cap by a percent. Rising Covid cases and hospitalizations from the omicron variant, notably abroad but also in the U.S., continued to weigh on sentiment. While is appears less severe, economic damage from potential absences is also significant.

By sector, energy stocks gained over 10% along with higher oil prices, followed by a 5% increase in financials, in keeping with higher interest rates. All other sectors were flat or negative to varying degrees, with technology and health care each down -5%, resulting in the largest Nasdaq decline in 12 months. Real estate also lost -5%, being sensitive to that same increase in yields.

Foreign stocks were mixed, with the U.K. and Europe positive on the week, while Japan fell back. Developed market equities were less affected by rising U.S. yields, although inflation also rose in the Eurozone and activity slowed. Emerging markets were flat on net, with mixed results across nations. Conditions in China were also mixed, with some economic measures faring better than expected, while property companies continue to face liquidity problems, and lockdowns due to a 'zero tolerance' Covid policy intensify. The latter is significant, notably with reports that Chinese-developed vaccines are far less effective generally. Impacts on manufacturing and trade flows remain to be determined.

U.S. bonds lost ground last week significantly, as the minutes from the December Fed meeting pointed to a more hawkish policy than assumed previously, as noted earlier. Markets adjusted to expectations, with the 10-year treasury rising by a sharp 0.25% to 1.75% (close to the highest level since the pandemic started). Credit fared slightly better, while floating rate bank loans ended as the only positive group. Foreign bonds also lost ground, particularly in emerging markets, although the dollar was little changed for the week.

Commodities gained on the week, led by the energy sector, while industrial metals and agriculture also fared positively; precious metals lost several percent along with interest rates rising. The price of crude oil rose by 5% to just under $79/barrel. Government protests in Kazakhstan, which have turned violent, as the result of rising fuel prices, have led to unrest in the region and higher petroleum and uranium prices (as the country is responsible for nearly half of global production of the latter). Production outages in Libya also added to supply concerns.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.