

Summary

For the final week of 2021, sparse economic data included a continued rise in national home prices, although pending sales fell back. Jobless claims continued to show downward improvement.

Global equity markets ended the year on a positive note last week. Bonds were mixed, as interest rates were little changed. Commodities gained more ground, with help from a weaker dollar and hopes for continued demand recovery.

Economic Notes

(+) The **Chicago PMI** came in at a reading of 63.1 for December, up 1.3 points from the prior month, and beat the 62.0 level expected. This continued to represent a high level of expansion, with stronger production and new orders numbers. (Normal cycle peaks over the past several decades have fallen in the 65-70 range, with any number greater than 50 indicating expansion.) However, order backlogs, employment, and supplier delivery readings fell back in December. The employment number was pulled down by a difficulty in finding enough hires to fill empty positions, per the ISM. Shipping and trucking delays persisted during the month, with some firms building larger inventories as a buffer in response. At the same time, prices paid pulled back from highs. Interestingly, but unsurprisingly, the anecdotal question for the month, which asked about the biggest challenge to executing plans for the holiday season, solicited the top three responses of global supply shortages, logistics, and staff shortages. The Chicago PMI and ISM manufacturing measures tend to correlate, with both showing economic strength, but are down a bit from cycle highs.

(0/+) The **S&P/Case-Shiller home price index** of 20 key U.S. cities rose 0.9% in October, which met the median forecast. Every city experienced a gain for the month, led by near-2% results in Miami, Tampa, and Las Vegas. The year-over-year gain decelerated by -0.7% to a still-robust 18.4%. This was led by Phoenix and Tampa, which gained 32% and 28% for the trailing year, respectively.

(+) The **FHFA house price index** for October rose 1.1%, beating the consensus expectation of 0.9%. The only declining region was New England, down -0.3% for the month, while the East South Central (KY, TN, MS, AL) and Pacific areas were up 1.7% each. Here also, the year-over-year changed decelerated, by -0.4% to a 17.4% rate. There appears to be some deceleration in the pace of home price growth in some regions, although that isn't necessarily apparent from the strong national figures. Homes for sale continue to be in short supply, which has kept prices high from focused demand. These higher prices have now carried over into the rental market, along with the expiration of some Covid-based moratoriums.

(-) **Pending home sales** fell by -2.2% in November, contrary to median expectations calling for a 0.8% increase. Every region experienced a drop, with the Midwest down over -6%, while the Northeast was little changed on the high side. The trailing 12-month gain ticked up to 0.2%. As pending sales tend to be a precursor for future existing home sales, this points to a bit of a slowing.

(+) **Initial jobless claims** for the Dec. 25 ending week fell by -8k to 198k, below the 206k consensus estimate. **Continuing claims** for the Dec. 18 week fell by -140k to 1.716 mil., as opposed to expectations for a rise to 1.868 mil. Claims results were mixed by state, with no dramatic results. Overall, despite the usual seasonality quirks this time of year, claims continue to tick downward in a positive direction to near-record low levels.

Market Notes

Period ending 12/31/2021	1 Week (%)	YTD (%)
DJIA	1.08	20.95
S&P 500	0.87	28.71
NASDAQ	-0.05	22.18
Russell 2000	0.21	14.82
MSCI-EAFE	0.89	11.26
MSCI-EM	1.04	-2.54
Bloomberg U.S. Aggregate	0.16	-1.54

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2020	0.09	0.13	0.36	0.93	1.65
12/24/2021	0.07	0.71	1.25	1.50	1.91
12/31/2021	0.06	0.73	1.26	1.52	1.90

In the final week of the year, the traditionally hoped-for ‘Santa Claus rally’ continued, on fairly low holiday volume. The S&P 500 reached another new record, while the calendar year gain for 2021 ended at just under 30%. By sector, a unique mix of winners included materials, as well as defensive utilities and consumer staples; communications ended the week as the only losing sector. Real estate outperformed all other groups, gaining nearly 4% on the week. Aside from common year-end positive sentiment, it increasingly appears that the Covid omicron variant has resulted in far less severity in illness (and perhaps even powers up a stronger immune response against other variants). This reduction of uncertainty, with the worst case being overwhelming hospital admissions (which are still high), seems to be the primary driver of market mood as the year comes to a close.

Every sector made money in 2021, led by strong recoveries in energy and real estate, upwards of 50%, while technology and financials also fared well with gains over 30% each. Returns tended to follow earnings expectations during the recovery, as would be expected at this point in the cycle. Large cap stocks nearly doubled the return of small caps in 2021, with the valuations for the latter looking increasingly attractive in relative terms.

Real estate, partially a sub-set of the larger equity universe, but also its own asset class, saw index gains of over 40% (the best calendar year since 1976, as measured by the FTSE NAREIT All Equity REITs index). This appeared to be a recovery in conditions from the trough of 2020 doldrums for real estate occupancy, with housing price gains trickling into apartment rents, continued strength in industrial, and a strong recovery in malls, as conditions didn’t end up nearly as bad as some had feared.

S&P 500 company revenue and earnings expectations for 2022 continue to normalize, compared to the robust recovery result from 2021. Per FactSet, revenues declined by -1% in 2020, only to rebound by an estimated 15% for 2021, with 2022 expectations declining to the 7-8% range. Earnings are experiencing a similar, but more dramatic pattern—2020 declines of -10% are followed by an anticipated 45% increase for 2021, and 9% gain in 2022. While the see-saw of the past few years is dramatic, estimated 2022 gains remain at a higher-than-average level (compared to 5% earnings growth over the past decade). While revenue growth continues to recover, profit margins are also running a few percent higher. The cyclically-sensitive energy, industrials, and materials sectors led the recovery in 2021, and are leading expectations for the coming year for the most part. This reiterates the recovery in ‘value’, despite continued lower valuations based on the uncertainty of Covid and Federal Reserve effects on the economy—especially the pace of slowing back toward normal. Technology and consumer discretionary stocks aren’t necessary performing badly, however, with strong expected earnings into next year as well. Earnings are expected to decline for financials into next year, however, although rising interest rates may help net interest margins should they come to pass. A common adage is that stock prices follow earnings. While valuations remain elevated in some segments of the market, positive earnings growth has tended to be a positive indicator for the probability of positive equity returns.

Foreign stocks fared positively as well last week, with Europe and the U.K. performing in line with the U.S., emerging markets a bit below with lesser returns, while Japanese stocks lost ground. As in the U.S., positive news surrounding the lessened severity of the omicron variant appeared to drive returns as much as any other factor. However, overall cases remain extremely high, prompting several governments to continue to impose work-from-home restrictions. In 2021, foreign stocks in developed markets earned positive returns in line with historical averages (MSCI EAFE up 11%), these again were dwarfed by U.S. equities. The MSCI Emerging Markets index declined over -2% for the year, reflecting concerns with the strength of the Chinese economy. These results were somewhat skewed by currency considerations, though, as markets in Europe and the U.K. gained 20% in local terms, prior to adjustment for the stronger dollar for U.S. investors. (As an aside, there appears to be a rising consensus that the dollar is at least a bit expensive, compared to other currencies. Should that situation reverse, and the dollar weaken, it would act as a performance-enhancer for foreign assets.)

U.S. bonds were mixed last week, with small gains in treasuries, while corporate credit fell back—with the exception of floating rate bank loans, which gained. Foreign bonds were mixed despite the tailwind of a weaker dollar. The year was a rare negative one for fixed income, as measured by the Bloomberg U.S. Aggregate index, the first since 2013. Interestingly, the bond index has never suffered back-to-back negative years since its 1976 inception (the Bloomberg U.S. Credit index only had this occur once, in 1979-80). Although both segments lost ground, credit outperformed government slightly in 2021, with the help from yield spreads. However, niche areas such as floating rate bank loans earned positive returns in the mid-single digits, as they followed rising interest rates. Municipal bonds also fared positively, due to a lower supply of bonds available (localities don't need the money, thanks to their Federal fiscal stimulus received), and high demand for tax-efficient assets. Foreign bonds were mixed, with USD-hedged developed market debt earning minor declines along the same lines as U.S. bonds, while unhedged debt fell back upwards of -10% for the year due to the impact of the U.S. dollar rising over 5% during the year.

Commodities ticked higher last week, with gains in energy and metals offsetting declines in agricultural products. The price of crude oil rose by 2% to end the year at just over \$75/barrel, with continued better sentiment surrounding non-severity of the Covid omicron variant, which points to stronger demand. Last year represented another strong year for commodities broadly, with supply constraints, restocking, and an expectation for stronger demand as the global economy gets back on track pushing prices higher—beating even U.S. equities in 2021.

Have a good week and Happy New Year.

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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.