Summary

Economic data for the week included a much stronger than expected employment situation report for January, as well as a pullback in the ISM manufacturing and services indexes, although the two still lie solidly in expansion.

Global equity markets bounced back last week, with decent economic data and some improvement in the Covid caseload. Bonds fell back across the board, as interest rates continued to tick higher, along with the consensus opinion that central banks will be raising rates through 2020. Commodities gained ground again last week, led by crude oil prices, with high demand continuing to surpass more limited supply.

Economic Notes

(0) The **ISM manufacturing index** for January declined by -1.2 points to 57.6, a tenth higher than the 57.5 level expected by consensus, and still in strongly expansionary territory. (Any reading over 50 signals expansion, with over the 55 level being especially strong.) Of the 18 industries represented, 14 demonstrated growth. The production and new orders components declined by several points, but remained solidly in expansion, while employment improved by almost a point, further into expansion. In other areas, supplier deliveries improved, implying logistical issues had eased from the prior month, while prices paid gained again to higher levels. As has been the case routinely in recent months, underlying manufacturing metrics remain strong, but have been held back by logistical constraints.

(0) The **ISM services/non-manufacturing index** in January fell by -2.4 points to 59.9, but did exceed the median forecast of 59.5. As with the manufacturing index, this continued to indicate strong expansion. Several underlying metrics fell back, including business activity down -8 points, employment, and new orders, although all remained solidly in expansion (near 60 levels in most cases). Supplier deliveries rose, while prices paid fell by over a point. Anecdotal notes indicated that omicron was a primary culprit during the month, with labor shortages specifically being a problem in satisfying consumer demand. Economic spending has been making a steadier rotation from goods-only, during the depths of Covid lockdowns, to services as activity normalizes to an increasing degree.

(-) **Construction spending** for December rose 0.2%, falling short of the 0.6% increase expected, although there were some minor upward revisions for the prior month. Private residential spending gained over a percent, which offset declines of 1-2% for public residential and non-residential.

(+) The government **JOLTS** report for December showed a rise of 150k to 10.925 mil., exceeding the median forecast of 10.300 mil. The month was led by a 133k increase in hotel/food service jobs (89% of the total), in keeping with a continuation in improvement for that lagging sector. The job openings rate was an unchanged 6.8%, the hiring rate fell by two-tenths to 4.2%, the layoff rate fell a tenth to 0.8%, while the recently-watched quits rate fell by a tenth to 2.9%. Interestingly, quits continue to fall further for the more cyclical construction and hotel/food categories, demonstrating greater worker choice.

(+) **Initial jobless claims** for the Jan. 29 ending week fell back by -23k to 238k, which fell below the 245k level expected. **Continuing claims** for the Jan. 22 week declined by -44k to 1.628 mil., just above the median forecast of 1.620 mil. It appears the early January omicron-based claims have begun to taper off, as have year-end seasonal effects, perhaps. Claims fell primarily in CA, KY, and OH, which imply manufacturing effects.

(-) The **ADP private employment report** for January fell by -301k, contrary to expectations of a 180k gain, including a downward revision for the prior month. Services jobs led with the bulk of the decline (-274k), of which 55% were in leisure/hospitality—this points to the impact of Covid omicron as a detractor. Jobs in goods production also fell by -27k, with declines in most sectors. Due to the unique nature of the results, it's possible year-end seasonal adjustments may have played a larger role than usual.

(+) The employment situation for January came in far better than consensus, in contrast to low expectations during the month based on the negative impact of high Covid omicron variant cases holding back activity and hiring. (However, private estimates were all over the place, pointing to the futility of near-term employment guesses in the first place, probably more than any other economic data point. Later revisions also complicate the effort.)

Nonfarm payrolls rose by a surprise 467k, which far exceeded the median forecast of around 150k, although some expected even negative results. The proportion of these jobs being private service-providing was larger than usual, coming in at 444k, with significant recovery gains in leisure/hospitality (151k), professional/business services (86k), retail (61k), and transportation/warehousing (54k). Good-producing jobs were far less, at 13k higher for manufacturing, while construction jobs fell -5k. There were methodological adjustments for 2022 as well, which may alter the final numbers to some extent at first. Importantly, the November and December payroll numbers were revised significantly higher, by a total of 709k—rounding out the positive trend of the last several months.

The **unemployment rate** actually rose slightly, by a rounded tenth of a percent, to 4.0%, as the labor force participation rate also increased from the prior month (by 0.3%). The entry of more job seekers is seen as a positive development, as the puzzle of the 'missing workers' has baffled economists. The U-6 underemployment figure continued to improve from 7.3% to 7.1% for the month. The household survey did show a very large amount of unpaid absences (gain of 763k), although the overall labor size rose by 1.4 mil.; however, after statistical adjustments these weren't as meaningful.

Average hourly earnings rose by 0.7% to $31.63, exceeding the expected 0.5%, representing a gain of 5.7% over the past year. Average weekly hours fell by -0.2 to 34.5. There is some speculation by economists that recent wage gains have been a catalyst for incenting more potential workers to move back into the labor force.

Earlier in the week, **nonfarm productivity** for Q4 was shown to have risen at an annualized rate of 6.6%, reversing course from the -5.0% of Q3, and beating expectations of 3.9%. The year-over-year rate rose by 2.0%. **Unit labor costs** for Q4 rose by a quarterly annualized rate of 0.3%, below the median forecast of 1.0%, and well under Q3's 9.3% increase. The year-over-year increase fell back to 3.1%—far below current inflation levels.

(+) The Federal Reserve **Senior Loan Officer Opinion Survey** for Q4, released in January, showed a continuation of stronger loan demand, and also easier lending standards generally. For commercial, industrial, and multi-family residential loans, standards eased a bit, while demand strengthened. The primary reasons for easier terms appeared to be competition from other banks and other lenders (noted by nearly 95% of respondents). Commercial real estate standards eased in the quarter, for both residential and non-residential properties. Demand for residential and construction/development loans strengthened, but that for non-residential weakened. Residential mortgage loan credit standards continued to ease in all categories, including subprime (where this equated to the percentage of banks with tighter standards declining). Consumer installment loans and credit cards saw easier standards, with credit card demand sharply higher, while auto loan demand fell back. The credit card demand component is interesting, when coupled with tight labor markets and rising wages, but also high durable goods inflation, which may play a part.

Market Notes

Period ending 2/4/2022	1 Week (%)	YTD (%)
DJIA	1.06	-3.35
S&P 500	1.57	-5.47
NASDAQ	2.41	-9.84
Russell 2000	1.74	-10.78
MSCI-EAFE	2.10	-3.75
MSCI-EM	2.53	-0.84
Bloomberg U.S. Aggregate	-0.95	-3.05

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
1/28/2022	0.19	1.15	1.61	1.78	2.07
2/4/2022	0.23	1.31	1.78	1.93	2.23

U.S. stocks continued to rebound from -10% correction territory, with gains through late in the week. However, sizable earnings misses from technology names, in particular, put a damper on the positive sentiment—Meta Platforms (Facebook) in particular was down by -25% at one point, due to falling user growth. Markets were a bit mixed in response to the surprisingly good Friday employment report, with more jobs meaning a more solid economy, but also a more solidified foundation for a Fed jumping-off point for an interest rate hike in March.

By sector, energy again led the way up 5% upon higher oil prices, followed by positive results from financials and consumer discretionary stocks. Communications lagged, down over -1%, in keeping with sentiment around Meta Platforms noted above. The slowdown in users for stocks such as Netflix and Meta are not too surprising, with such high additions in users during 2020-21 less likely to repeat at the same trajectory. Real estate was down slightly, along with higher interest rates.

Earnings expectations are more in focus than normal, now that 2021's easy gains are behind us. Per FactSet, as earnings season for Q4-2021 progresses and 56% of firms reporting, it appears cyclical sectors industrials and materials have stayed in the lead, with overall expected S&P 500 earnings growth having ticked up to 29%. Profit margins are remaining at a solid 12.4% as well. Coupled with still-historically low interest rates, these strong margins are part of the rationale for allowable higher stock price valuations.

Foreign stocks gained largely in line with U.S. equities in developed nations, although emerging markets fared about a percent better. While several domestic markets in Asia were closed for the lunar New Year, tracking indexes/ETFs fared positively in those nations, as well as improvement in Russia. Despite the conflict with Ukraine, higher petroleum prices offset some of the negative sentiment, in addition to ongoing negotiations.

The Bank of England raised rates for the second time in the last few months, by another quarter-point to 0.50%, noting that it will also be easing out of owning corporate bonds. Interestingly, half of the committee wanted to raise by a half-percent, due to rising inflation pressures (the U.K. and Europe have consistently been more sensitive to these fears than the U.S.)—dissenters on the committee often appear before the media afterward to discuss their opinion, which doesn't happen with the FOMC. As in the U.S., the turn from dovish policy (with no expected hikes) to hawkish (4-5 assumed hikes) for 2022 has been swift. The Japanese central bank on the other hand, has been in no rush, as inflation has remained contained, at a 0.5% year-over-year rate in December.

U.S. bonds lost ground across the board last week, as interest rates ticked higher across the yield curve (10-year treasury ending at just under 2.00%); the exception was floating rate bank loans, which fared positively. Foreign bonds were mixed despite a sharply weaker dollar (with strengthening in the euro and U.K. pound more of a factor, due to their more hawkish central bank policy announcements last week).

A precarious milestone was reached last week, as the U.S. total national debt topped $30 tril. That's roughly 125% of GDP, and expanded largely due to Covid-based spending over the past two years. There seems to be no magic solution to this high number, with hopes that regular normalization will cause the ratio to drift lower in coming years. However, slower growth based on demographic factors could make that more challenging than in the past. The key concern—as with any individual, corporation, or government—is that a higher debt load will erode lender confidence, and lead to higher market-demanded interest rates. The saving grace is that many other developed nations are in the same boat of high debt, and America remains the 'cleanest dirty shirt' in the laundry, as it's been described.

Commodities continued to gain ground in all groups, led by energy, while metals also saw lesser improvement. The price of crude oil rose by over 6% to over $92/barrel, with OPEC deciding to gradually increase production—not to the larger degree markets had hoped. Separately, a deal was struck with Qatar to provide natural gas to Europe (to lower the reliance on Russia) in return for being offered 'associate membership' in NATO—a unique development to say the least. This combination of factors, and lower incentives to produce more domestic oil, pushes the chances for higher oil prices asymmetrically upward.

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, HSBC, 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.

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