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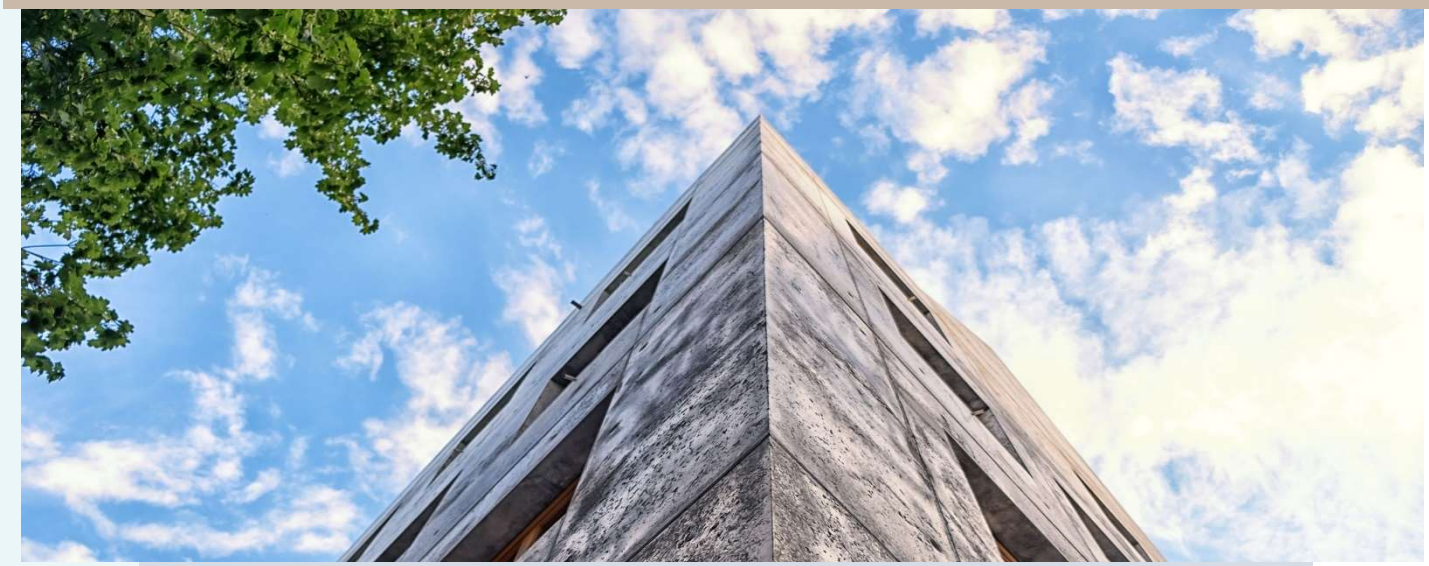
Economic Indicators | February 2022 | By Kim W. Suchy



Fed Chair Powell certainly has his hands full. Much like Captain Chesley ("Sully") Sullenberger, who navigated the landing of a US Air flight with failed engines into the Hudson River in 2009, Fed Chair Powell must steer monetary policy into a soft landing for the economy. Monetary policy has been the punchbowl of economic growth for several years and now it looks like "last call".

Prior to, and after, the last Fed meeting, the markets have been attempting to figure out the timing, magnitude and impact of the Fed's next rate increase and asset purchase reductions. Given the broad range of educated guesses, only to be embellished by the talking heads to the point of unreasonableness, the markets have been reacting and generating a great deal of volatility. One thing is clear however, the Fed is committed to fighting inflation and with that comes higher interest rates.

Higher rates are not good for growth stocks or longer-term bonds as they are particularly sensitive to changes in rates and rates increase, the present value of future earnings declines and prices fall. Technology stocks, those trading at high multiples of future expected revenues, have been hit particularly hard as investor algorithms discount these revenue streams and trigger sales of these stocks. Regarding bonds, sales are often triggered when rates rise because prices fall as more attractive yields surface elsewhere as replacements.

The question is why is the 10-yr Treasury yield still well below 2%? The answer is that German and Japanese bond investors are buying US bonds because their yields are at or below zero. The insatiable foreign demand for longer term Treasury purchases is helping to keep the longer end of the yield curve from rising. Further, the 2-yr Treasury has risen .7% since Powell's announcement that the Fed will be initiating a Fed fund rate hike. So, are market forces displacing some of the Fed tightening tools? It certainly appears that way. Perhaps Powell's hawkish tenor was meant to initiate market action. The next few weeks will give us more clarity but if the upward sloping yield curve stabilizes, it may provide a better path to a smooth landing.

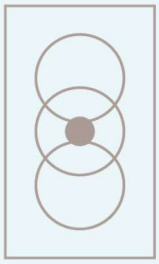
Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- The N.Y. Federal Reserve said a survey of consumers (national survey of 1300 households) show that median household spending is expected to increase 4.6% in 2022 – the biggest increase since the survey began in 2015. Households plan to spend more on food, clothing, housing, utilities and transportation, all of which are sensitive to inflation. Asked what they were doing with the unexpected windfall in income, 49% said the money would be saved or invested. An additional 31% said the money would be used to pay down debt. Consumers also plan to rein in these purchases in the first 4 mos. of 2022, as they wait out price increases to see if they ease.

- We had historic monetary support for our economy in 2020 and 2021. That's easing now, but the economy remains in good shape. One of the benefits is strong tax revenues. Now, the Fed will tighten and raise rates causing less monetary stimulus in 2022-23. The flip side of this is that states are benefactors of strong tax revenues and the federal government is still paying many pandemic expenses via Covid-relief programs. Thus, states have ample cash (my Illinois readers may find exception here), and will likely see governors (those up for reelection this year) looking to cut taxes and/or provide new spending programs. So, we may see tightening at the federal level but more stimulus at the state level.

    - Consider, Louisiana Governor Jon Bel Edwards fresh off a $700M budget surplus fiscal year released his 22-23 budget which includes raises for K-12 teachers, $1.1B for infrastructure and a boost in funding for the state's universities. The state is expecting to end FY2022-23 with an $853M surplus, despite the increased spending.



NEUTRAL DEVELOPMENTS

- The National Assoc. of Homebuilders (NAHB) reports that unseasonably mild weather boosted housing starts in December, but the outlook is murky. NAHB's chairman states, "NAHB analysis indicates the aggregate cost of residential construction materials has increased almost 19% since December 2020. Policymakers need to take action to fix supply chains. Obtaining a new softwood lumber agreement with Canada and reducing tariffs is an excellent place to start."

    - Note, building permits, a good leading indicator of housing starts, advanced for the 5th time in 6 mos., by 9.1% in December and 17.5% over the period to an 11-mo. high of 1.873M homes.

- Bespoke Investment Group issued a report last week entitled, "Small Cap Death Cross," showing that the Russell 2000's 50-day moving average crossed its 200-day MA. The good news is that this "death cross" has happened 21 times since 1980, and the subsequent median return of the Russell 2000 was +1.42% a month later, +3.18% three months later, +5.82% six month later, and +11.9% a year later.

- Standards and Poor's research notes that the climb in wages remains a concern for both business and, of course, the Fed. Avg. hourly earnings increased by 0.6% mo./mo. in December and were up 4.7% on a yoy basis. Although labor costs are rising, workers are not necessarily seeing more in their bank accounts. As overall inflation hit a 39-year high in November, real wage gains are negative, and households' purchasing power is being squeezed.

- Companies that are returning money to shareholders via dividends are outperforming the non-payers over the last 2 mos. This same dynamic took place in the back half of the 1960s and the 1970s (periods of rising rates and inflation) that saw modest price appreciation and dividends accounting for greater than 50% of total returns.

NEGATIVE DEVELOPMENTS

- The message from both December CPI and PPI reports is inflation was not horrible in December, but it was still far too high. Producer price increases slowed in December from the previous two months, but monthly gains are still elevated. Declines in food and energy prices kept increases in the overall index low but core price momentum is still strong. As with the recent CPI report, December PPI will keep the Fed focused on wrapping up its tapering in March and start hiking rates thereafter.
    - There was a strong whiff of stagflation in these inflation reports as December's retail sales and industrial production fell 1.9% and 0.1%, respectively, on a m/m basis. Contributing to this downbeat scenario is Omicron. While less deadly than the Delta variant, it has been spreading much more quickly, resulting in more and more workers calling in sick to work. This development may prolong the period of supply-chain disruptions, which could depress economic growth while further boosting inflation.
    - There are extreme quarantine measures underway in China including shutting down factories, which will disrupt global supply chains and boost prices further…China wants a safe environment since they are hosting Olympics in February.
- Rent inflation is likely to move higher this year because the median price of an existing single-family home is up a 32.3% over the past 24 mos. through November. As a result, many first-time homebuyers have been priced out of the market, driving the demand for rental properties higher. Rising interest (mortgage) rates will also reduce the affordability of housing and this will drive rents higher too.
- The University of Michigan's Consumer Sentiment Index (CSI) dipped from 70.6 in December to 68.8 in early January—its 2nd lowest level in 10 years, with November's 67.4 the lowest. The report notes that while new Covid variants have contributed to this pullback, rising inflation is also an important factor. Three-quarters of consumers ranked inflation, compared with unemployment, as the more serious problem facing the country.
- The Labor Department reported that new unemployment claims surged to 286K in the latest week, up sharply from a revised 231K in the previous week. Continuing unemployment claims also rose to 1.6M compared to a revised 1.55M in the previous week.
    - Note, the escalated infection rate of Omicron continues to impact the supply of laborers that are calling in sick or not returning to the workforce. This condition of widespread worker disruption and ongoing Covid protocols only produces additional shortages, resulting in a potential increase in inflation.

THE MARKETS

January was an ugly month as Fed concerns, Ukraine and Omicron disruptions sent most stocks deeply into negative territory. Large cap growth and small cap segments of the market took the brunt of the pullback. Energy and financials were bright spot sectors while technology, health care and consumer discretionary sectors suffered to the downside.

As painful as they are, corrections are a normal part of market behavior; it just feels awful when we're in the middle of one. Lately, many investors forget about them as soon as the market recovers. Consider that the SP500 endured a 10% down-shifts in 2020, before that 2018, preceded by another in 2016. Still, the SP500 has returned investors over 110% since January of 2016. Although painful at times, staying the course on longer term asset allocation commitments (as opposed to selling out and timing when to get back in) has certainly paid off.

Keep in mind that this pullback is not a substantive change of direction in our economy. It's merely a recalibration where the market will value companies with decent cash flow, pricing power and a wide moat around its business at a better price (dividend payers) than those with speculative earnings profiles (technology). Over the last two or three months, fundamental data – housing, retail sales and consumer sentiment – have exceeded expectations…that is good ballast for the markets. Further, as we find ourselves in the middle of corporate earnings announcements, the results thus far suggest that a moderate economic expansion underway.

On the international front, the European markets held up reasonably well while the Asian markets (ex. Hong Kong) were weak. Crude oil continues to surge as cold weather across the globe and modest increases in production activity have fueled an increase in demand. Crude jump 15.3% last month and has now logged a 63% increase in price /bbl over the last year!

U.S Index	Last Month (% return)	One-YR (%)
S&P 500	-6.3	19.2
Dow Jones	-4.0	16.2
NASDAQ Comp	-10.0	12.1
Russell 2000	-11.5	-5.4

International Index	Last Month (% return)	One-YR (%)
Euro Stoxx 50	-3.4	18.5
Hang Seng	2.3	-17.6
Germany	-3.3	13.7
Nikkei	-6.4	-2.2
FTSE – U.K.	-0.3	15.8
China Shanghai	-6.6	-3.5
Crude Oil	15.3	63.3

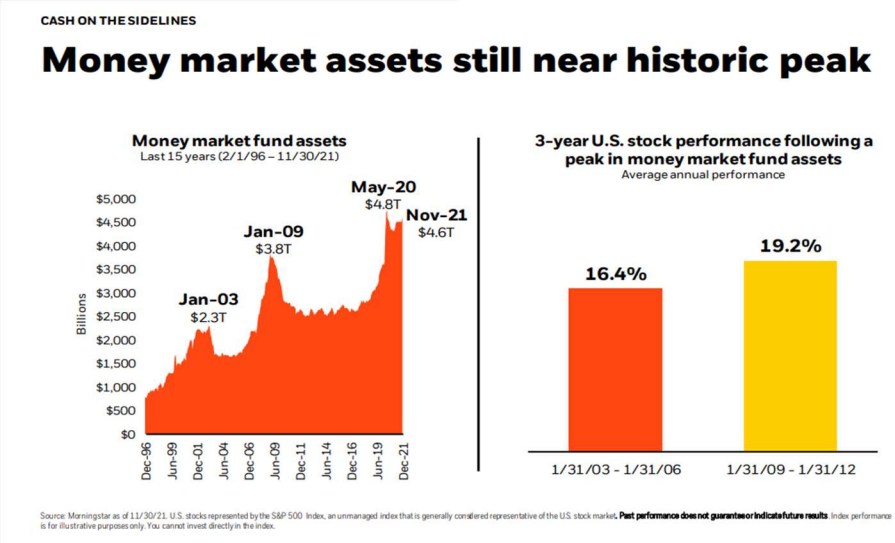


CHART OF THE MONTH – MONEY MARKET FUNDS

In Blackrock's "Student of the Market" for January 2022, they highlighted the amount of money that is being held in money market funds (or as they say "cash on the sidelines"). In May 2020, in the wake of COVID, money market assets topped at $4.8T. In November 2021, money market assets stood at $4.6T. Looking back historically during peaks in money market assets, stock performance has been favorable over the following three years.

When money market funds peaked at $2.3T in January 2003, the S&P 500 rose 16.4% annualized over the next three years. Then in the wake of the financial crisis, money markets peaked at $3.8T in January 2009 and stocks returned 19.2% annualized over the next three years.

Holding cash in your portfolio, whether accumulated dividends or a permanent strategic position, is always a good strategy. Stock valuations will ebb and flow and can create decent entry points. Having cash on hand will facilitate rebalancing and can help take advantage of attractive pricing.

Source: https://www.blackrock.com/us/financial-professionals/literature/investor-education/student-of-the-market.pdf

PLANNING CALLOUT – 529 Plans

Although college tuition inflation has subsided over the past decade, 529 Plans remain as one of the most powerful higher education planning tools. This tax-deferred and tax-free distribution mechanism (for education) will help lessen the burden on families entering their children or family member into college. Utilizing a 529 can help combat inflation, compound tax-deferred growth, and instill peace of mind to incur large expenses down the road (tax-free). When funding begins early in the child's life, the more years the money can compound leading to more favorable results. Last, utilization of this vehicle will lessen or eliminate the future burden of high interest student loan liabilities.

For more information about 529 Plan's please visit our website page:

https://www.csamg.com/529-Lesson-Plan-High-Scores-for-529-Plans.c238.htm

NEWS YOU CAN USE

An internal survey done by Zoom Video Communications of 4,900 Americans showed that more than two-thirds want the choice of where to work. About 85% who worked remotely want it to stay that way. The same survey showed just 1% preferred to work full time in an office, with over half leaning toward flexible, hybrid work. Approximately 3 million professional jobs went permanently remote in Q4 2021. Permanent remote represents 18% of work arrangements, but by the end of 2022, that number is expected to be close to 25%, according to data collected by Ladders.

https://www.marketwatch.com/story/zoom-is-returning-to-the-office-but-most-workers-arent-coming-back-11642602828

Glassdoor released their "50 Best Jobs in America" for 2021, which scoring model equally weighs earnings potential, overall job satisfaction rating, and number of job openings. Java developers, who typically work at startups focused on the creation of web applications to market was ranked #1, with a median base salary of $93,000, 4.2 out of 5.0 job satisfaction rating, and 10,103 job openings. Data scientists were #2 ($113,736 median annual base salary) and product managers at No. 3 ($121,107), enterprise architects at No. 4 ($131,361) and devops engineers at No. 5 ($110,003).

https://www.glassdoor.com/List/Best-Jobs-in-America-LST_KQ0,20.htm

Prices for cryptocurrencies, from the stalwarts such as Bitcoin and Etherum to more exotic tokens, have wiped out $1.35 trillion in value globally since reaching all-time highs in early November, or nearly half the total market. The slide accelerated in 2022 as investors have fled risk-assets for safe harbors amid the current macro uncertainty. The January selloff wiped $500 Billion off the crypto market cap alone.

https://www.bloomberg.com/news/articles/2022-01-21/crypto-meltdown-erases-more-than-1-trillion-in-market-value

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

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