Wentz Weekly

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Volatility Picks Up As Powell Turns More Hawkish

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The headline all week may have been the emergence of a new Covid variant, labeled Omicron, but our belief on what was driving the volatility and markets 1.22% lower by weeks end was Fed Chair Powell's comments in his testimony to Congress. Powell likely gave a preview of the Fed's next meeting December 14-15. Chair Powell clarified how the Fed used and viewed the word "transitory" to describe inflation, instead of meaning temporary the Fed's purpose of the word was to say it "won't leave a permanent mark in the form of higher inflation," saying it was time to retire the word. Regarding taper, Powell said since the last meeting inflation has shown elevated pressures and labor market indicators have shown rapid improvement, making it appropriate to wrap up tapering "perhaps a few months sooner." At the current pace the Fed will end its $120 billion in monthly asset purchases completely by June. Our expectation is the Fed will, instead of tapering by the current $15 billion per month, will increase its taper to $20-$30 billion per month, ending taper in four to six months instead of eight. While this may not sound like a large difference, the market took it as a slightly more aggressive and hawkish stance and increases the probability the Fed begins raising rates even sooner. The Fed Funds futures market, according to the CME FedWatch Tool, is now pricing in a 30% chance of a rate increase at its March meeting and a 42% chance at its May meeting, up from 18% and 30% respectively, just prior to Powell's testimony.

The comments and more hawkish view by Powell come at a time when the world is still trying to figure out the severity of the new Omicron variant. In prior instances like this, or new "waves" of covid cases, the Fed remained on the cautious side. In the face of covid worries, Powell kept his hawkish stance rather than remaining cautious until more is known, indicating to us the Fed believes the economic risk is diminishing with each new wave or variant. Calming investors on the covid front by mid-week was comments from covid vaccine makers vaccines will still be effective along with reports from doctors in South Africa, where the Omicron variant was first discovered, saying symptoms have only been mild while hospitalizations remain low amid a tripling in case count. As we have mentioned hospitalizations and deaths are the more important factors but with the Fed wanting to push its foot harder on the brake pedal, we are putting more weight on the cautious side but still favor U.S. equities. Lately, investors have gotten use to the market going up every day. With several negative catalysts the past week, algorithms kicked in exacerbating the downside and volatility picked up with the VIX reaching its highest level since January. As mentioned in previous newsletters, expect this volatility to continue as we close out 2021 and adjust to a tightening Fed policy

The Department of Labor said payrolls rose by 210,000 in November, below the consensus expectation of 520,000 additions, while September and October were both revised higher (positive revisions seen in 7 consecutive months). This year has averaged a strong 550,000 new jobs per month, however still 6.9 million Americans are considered unemployed, higher than the pre-pandemic number of 5.7 million. Job gains were broad based but disappointing in the report was retail losing 20k. The unemployment rate fell to 4.2% from 4.6% as an additional 1.136 million people were considered employed, according to the household survey. The U-6 unemployment rate, which includes those who are not looking for a job but want a job, fell 0.5% to 7.8%. Another welcoming sign is about 594k people entered the labor force driving the participation rate to 61.8% for the highest level since early 2020. Wages cooled in the month, rising 0.3% after a 0.4% and 0.6% increase in the prior two months, and the average wage is now up 4.8% from a year ago, slowing from 4.9% in October. From a headline perspective, it was a little disappointing, but from progress in the labor market the data looks good with more people entering the labor force including the additional 1.136 million people that were counted as employed, now just 3.584 million below peak Feb 2020 levels.

Evident by some of the trading patterns last week, Americans (and investors) are uncertain on how much to fear the Omicron variant after a slew of comments by many CEOs. It began with the World Health Organization naming Omicron a variant of concern and remarks by health experts that Omicron may be more transmissible with vaccines offering less protection. Then early last week Moderna's CEO said its vaccine will see a sharp drop in effectiveness against the new variant, along with data from Merck saying its antiviral pill reduces the risk of hospitalization and death by 30%, lower than the 50% effectiveness in the prior study. Investors were relieved somewhat a day later after BioNTech CEO (partner of Pfizer) said there was no need to freak out and its vaccine will still prevent severe disease from Omicron. It is still very early and a lot is still unknown with the lack of enough cases to draw conclusions. However, early data that shows symptoms are mild at worst and hospitalizations remain low despite a spike in cases is encouraging

Congress reached a deal late in the week to keep the government funded through mid-February, avoiding a government shutdown but essentially kicking a longer-term solution down the road. Congress is nearing its winter recess and still would like to pass its Build Back Better reconciliation bill, raise the debt limit, secure nominations and pass a defense legislation bill prior to its break. The defense bill stalled in the Senate, but the House is working on a compromise and is now expected to include a measure on the debt limit. The Build Back Better reconciliation bill includes some of the more contentious issues and it appears Democratic Senator Manchin remains opposed to such spending, so we see this as most likely to be pushed into 2022.

Company News

- Boeing's effort to have its 737 MAX jet back in service in China is one step closer after the Civil Aviation Administration of China approved the plane for airworthiness after completing a review of the design changes Boeing has made. The plane has been grounded for almost three years after two deadly crashes.
- According to a Bloomberg report, Apple is telling supplier that demand for its iPhones has weakened and it may not make up for missed holiday sales for its new iPhone 13 caused by component shortages.
- Fintech and payments company Square announced it will change its name to Block to better represent its businesses and focus on developing blockchain technologies. The ticker symbol "SQ" will not change and the company expects the change to officially take effect December 10.

The Week Ahead

The corporate calendar will be light of events this week but investors will have plenty to digest with economic data, the Fed's potentially new policy path, and the new omicron variant. On the earnings calendar, a few notable reports this week include; MongoDB on Monday, AutoZone and Toll Brothers on Tuesday, GameStop and Campbell Soup on Wednesday, Broadcom, Chewy, Costco, Oracle, Lululemon on Thursday, and Academy Sports Outdoors on Friday. McKesson and Southwest will hold its investor day on Wednesday while CVS and Tyson Foods will hold theirs on Thursday. On the economic calendar trade date will be released on Tuesday, followed by the job opening and labor turnover survey on Wednesday. Weekly jobless claims are expected to remain near the 220,000 level on Thursday. Wrapping up the week on Friday is the University of Michigan's consumer sentiment report, where we are looking for a bounce back from last month's big disappointment, along with the consumer price index. The current consensus sees inflation remaining hot with a 0.7% monthly increase and a 6.8% year-over-year increase in November.