Wentz Weekly

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S&P 500 in Correction… Thoughts on the Markets

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The slow start to 2022 for equity markets was made worse last week after the S&P 500 and NASDAQ fell another 5.7% and 7.6%, respectively, for the week with both now in correction territory. As we mentioned last week, stocks needed another strong earnings season to continue the move higher in the face of changing/tightening Fed policy, and through the first two weeks have got the opposite. With several disappointing results – first from banks on higher costs/lower loan growth, then news that Peloton has halted production based on weak demand, and finally from Netflix that subscriber growth is slowing – the selloff intensified through the week.

The result was the worst week for the S&P 500 since March 2020, when the pandemic shut the economy down. This time around, conditions are much different. In addition to a slow start to earnings season, markets are still adjusting to new Fed policy and this tends to bring volatility and weakness in stocks. The Federal Open Market Committee will hold its first meeting of the year this week where we expect an announcement on the end of its Quantitative Easing program by March and communicate the beginning of the rate hike cycle while hinting to the beginning of a balance sheet runoff shortly after. The market is pricing this expectation in with an 89% chance of a 0.25% rate increase in March and increasingly pricing in a 0.50% increase, according to the CME FedWatch Tool, causing the 10-year Treasury yield to move higher, reaching a high of 1.87% after starting the year at 1.49%. The 30-year Treasury yield has stayed in a low 2% range but has the potential to move higher with any speak of a balance sheet runoff, which could cause more selling in high growth and technology names. In addition, historically in the three months prior to the beginning of a Fed tightening cycle, the market experiences at least one 5% pullback.

While a 10% pullback may sound like a cause for concern, it is important to keep in mind how we got here, how often this occurs, and that this is normal for the markets. The S&P 500 has averaged a return of 24% over the past three calendar years and has more than doubled its March 2020 lows. Historically the index experiences four pullbacks of at least 5% and sees at least one pullback of at least 10% every 222 trading days (once every year). Seasonality is also a factor and we are in a seasonally weak part of the year, which is exacerbated with the market coming off a 26.9% return from the previous year. However, the economy remains strong and we still believe we are in the middle of a secular bull market – the consumer is still flush with cash, unemployment is nearing a cycle low, company's profits are at record levels, the yield curve is still positively sloped, and spreads remain very narrow. This all goes along with our 2022 themes – markets will experience an increase in volatility with value outperforming growth. This is the story for the first three weeks of the year and we expect will continue to be the story for 2022.

China's economy slowed to a 4% growth rate in the fourth quarter, after a 4.9% increase in the third quarter, as the country continues to take strict measures to slow the spread of the Omicron variant. The developing economy grew 8.1% in 2021, topping officials' growth target of at least 6%. The slowdown in the second half of the year reflects tougher comparisons from the 12-months prior, but also reflects slowing demand due to covid, the global supply chain issues, its declining birthrates and the troubled property sector. In effort to maintain momentum into 2022, its Central Bank made several moves last week to boost demand by lowering two of its key benchmark lending rates, its first of such moves in two years. Throughout 2021, China took a more aggressive stance on regulation, cracking down on sectors such as technology, education, and real estate. Amid slowing growth, and with a politically important year for leader Xi Jinping who is expected to seek a third term, the government is looking to take the different approach in 2022.

US home sales hit a 15-year high in 2021 as demand for homes remained high amid low interest rates. In 2021, existing home sales totaled 6.12 million for an increase of 8.5% from 2020 and the highest level since 2006. December's annualized sales pace was 6.18 million, down 4.6% from November, driven by more of a supply constraint than anything. The inventory of homes at the end of the year was 910,000 units, down 18% from November and down 14% from the end of 2020. Unsold inventory makes up just 1.8 months supply at the current pace, one of the lowest rates ever. Homes sold at the highest values ever and faster than ever with many homes going under contract within a week of going on the market. The low supply/high demand environment is making affordability worse. The median price of an existing home was $358,000, up nearly 16% from a year ago, with price increases widespread. The strong demand is being driven by pandemic-related effects as more people work from home and are willing to live further from the city, while interest rates remain historically low. Momentum is strong but with rates on the rise, the prime 30-year mortgage rate already moving higher, and markets experiencing volatility, 2022 could be more challenging for the housing market than the prior two years.

Company News

- Shares of SoFi jumped last week after regulators approved its application to become a bank holding company (through its proposed acquisiton of Golden Pacific Bancorp). The company says it will allow it to lend at more competitive rates and enhance its products and services.
- Ford said it is reclassifying $900 million in its non-cash gain on its investment in Rivian as a special item and therefor updated its 2021 EBIT guidance, while also reporting other special items charges, causing its stock to drop. Separately, Ford is suspending orders for the Maverick, its electric pickup, due to its inability to meet its backlog amid strong demand.
- After receiving interest from several activist investors, Kohl's has reportedly hired Goldman Sachs as an advisor on a potential deal.

The Week Ahead

The calendar shows a busy week between earnings reports, economic data, and the Fed meeting. At least one-fifth of S&P 500 companies will be reporting quarterly results this week including from Apple and Microsoft. Other notable reports include: IBM and Halliburton on Monday, Verizon, GE, Johnson & Johnson, and American Express Tuesday, AT&T, Boeing, Tesla, Intel, and Lam Research on Wednesday, Visa, Dow, McDonald's, and Western Digital on Thursday, and finally Chevron, Caterpillar, and Colgate on Friday. The economic calendar is busy as well with several housing reports, consumer sentiment reports and consumer reports. Tuesday and Friday will see two different consumer sentiment reports where we should learn more about the consumers thoughts on inflation, the home price index on Tuesday followed by new home sales on Wednesday, the first revision on fourth quarter GDP on Thursday (economists are expecting a 5.7% annualized growth rate in the quarter), and ending with the personal income and spending report on Friday. It is also Fed week – the FOMC will meet this week with a policy announcement and press conference on Wednesday afternoon. Policy is expected to remain the same for now, but we should get many comments on how and when the Fed looks to tighten policy to control inflation.