Weekly Wire

JANUARY 31, 2022

BRINKER CAPITAL INVESTMENTS

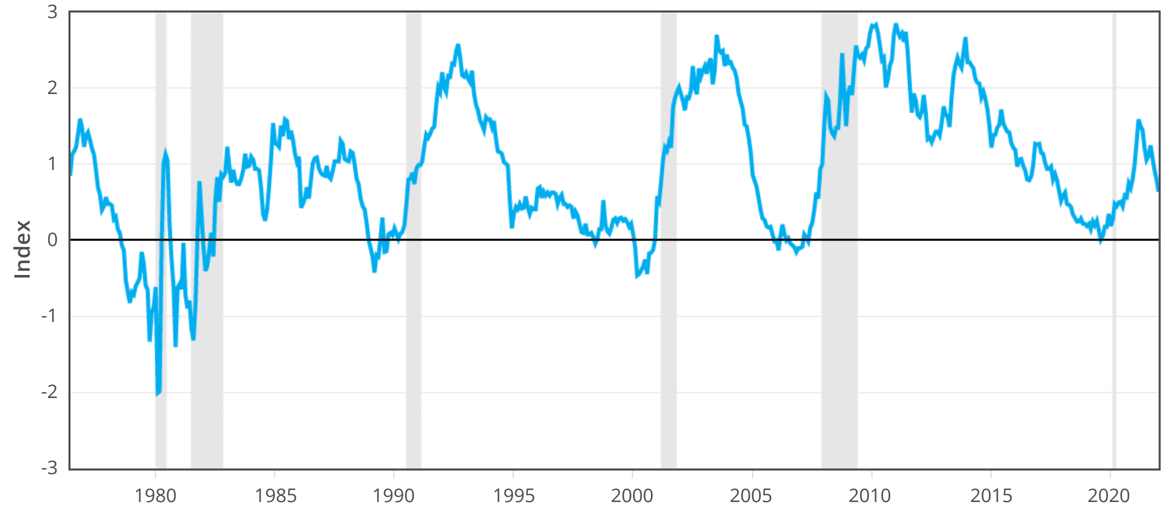
Can the Fed Stick the Landing?

The Federal Reserve has a dual mandate; full employment and price stability—which, if you think about it, is a tricky thing to solve for. If everyone who wants a job has a job, there is likely to be ample demand for labor, pushing up wages specifically and inflation broadly. At the same time, if prices are flat to only marginally higher, it is likely economic growth is modest and many folks who want to work can't find work.

While the Fed has a dual mandate, it emphasized getting the labor market back to full strength as we came through the worst of the pandemic, putting in place a historically supportive policy construct (rates at zero, $120 billion a month in securities purchased). That move likely helped push our unemployment rate back below 4% but also likely helped create today's high inflation. Comfortable that the labor market is at, or close to full employment, and concerned that high inflation might become entrenched, the Fed is pivoting to a more restrictive policy construct (the securities purchase program wound down by March, rates likely moving higher in March and balance sheet reduction likely commencing this year). While we think the Fed's pivot is justified, it has unnerved Wall Street as investors want the Fed to tame inflation but worry that effort will bring the economic expansion to an end (higher rates have historically been the catalyst for recessions as the cost of capital becomes more expensive and investment and spending slow).

How will we know if the Fed can tame inflation without upending the economy? Many of us will be paying attention to the US Yield Curve, particularly the spread between the yield on the US 2 Year Note and the yield on the US 10 Year Note. When the yield of the latter is above the yield of the former, it's usually an indicator of a healthy economy, but if the yield of the latter is below the yield of the former – or the curve is inverted – it's usually an indicator of a coming recession. While the spread between the yield on the US 2 Year Note and the yield on the US 10 Year Note has narrowed, it remains positive, and the curve remains positively sloped (see chart). We remain hopeful the Fed will be able to rein in inflation in 2022 without putting the economy into a recession.

10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity



Stocks, bonds, and commodities (1/28/2022)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	4431.85	-7.01%	-7.01%	19.32%
MSCI AC World ex USA	327.60	-4.86%	-4.86%	0.19%
MSCI EAFE	2201.56	-5.76%	-5.76%	3.65%
MSCI EM	1191.14	-3.32%	-3.32%	-10.41%
Bloomberg Barclays US Agg	102.26	-2.36%	-2.36%	-5.97%
Crude Oil WTI	87.66	16.55%	16.55%	67.93%
Natural Gas	4.93	38.46%	38.46%	92.08%

Treasury rates (1/28/2022)

	Price	Yield
2Y	99.11 / 99.1	1.205
3Y	99.05 / 99.0	1.409
5Y	99.11 / 99.1	1.634
7Y	99.31 / 99.3	1.754
10Y	96.10 / 96.1	1.787
30Y	95.07 / 95.0	2.090

Weekly reports

This week (1/31/2022)

- Nonfarm Payrolls Jan
- Unemployment Rate Jan

Week of 1/24/2022

- Consumer Confidence Jan 113.8
- Q4 GDP SAAR Q/Q 6.9%

Brinker Capital Market Barometer

MID-JANUARY 2022

The US economy is on track for solid growth to start the year as we expect the impact from the Omicron variant to be more transitory. The labor market continues to improve, with the unemployment rate falling to 3.9% and wage growth increasing meaningfully. The housing market is very strong and helped by favorable supply and demand dynamics. Monetary policy remains accommodative; however, we are watching for persistent higher inflation that could force the Fed to adopt a more hawkish stance on rate hikes, and possibly quantitative tightening, in 2022. Fiscal policy is less of a tailwind this year, and we do not see a high likelihood of either a large-scale stimulus package or sweeping tax increases. With economic growth more broad-based, we expect another strong quarter of growth in corporate profits, which is supportive of equities. Longer-term Treasury yields edged higher recently; however, we are far from levels that would impact the economy and equity markets. Although a couple of factors slid into neutral territory in January, the weight of the evidence still leans largely positive, aligned with our modest overweight risk positioning across portfolios. We expect elevated market volatility as we experience normalization of liquidity and policy, a backdrop that is favorable for our active approach.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum			●		Market breadth has deteriorated
Trend	←		●		Major indexes below 200-day moving averages but looking oversold
Investor sentiment	→			●	Put/call ratios moved to extreme; survey data show decline in % bullish
Seasonality			●		Seasonality relatively weaker to start mid-term election year

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy			●		Fiscal drag a headwind in 2022; major stimulus unlikely but pressure on Democrats to act
Monetary policy				●	Fed has pivoted to rate hikes in 2022, but balance sheet still supportive
Inflation		●			Persistent high inflation may cause Fed to adjust timeline; weighing on sentiment
Interest rate environment				●	Treasury yields have edged higher but still far from impacting economy or markets
Macroeconomic				●	Economy strong (e.g. housing, consumer spending); Omicron impact is transitory
Business sentiment				●	Small business confidence remains at elevated level; labor shortage a concern
Consumer sentiment			●		Survey data negative but not in sync with consumer behavior
Corporate earnings				●	Broad-based strength in earnings although pace of growth should decelerate
Credit environment				●	Corporate credit spreads remain well behaved; credit conditions supportive

LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation		●			Equity valuations above long-term averages but not a near-term driver
Business cycle				●	In an economic expansion period with positive GDP growth since 3Q20
Demographics			●		Emerging markets with more favorable trends overall than developed markets

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