THE PRIVATE CLIENT GROUP
BALANCING LIFE & WEALTH

ECONOMIC & MARKET INSIGHTS

An Executive Summary for January 2022

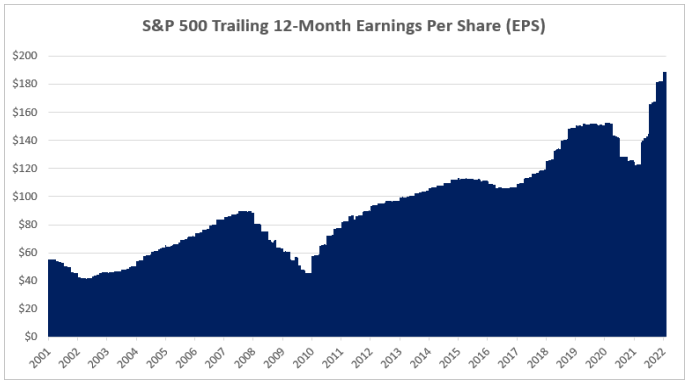
The new year began inauspiciously, with global equity and bond markets both declining. Commodities proved to be a diversifier, benefiting from strong price gains, particularly in energy. The market downturn was driven by signs that major central banks are poised to reverse the monetary stimulus that has supported the global economy and capital markets during the coronavirus pandemic. Political tensions between the U.S. and Russia, and rising Omicron rates in some countries, also weighed on investors. While economic growth and corporate earnings surpassed expectations in 2021, rising inflation and interest rates, ongoing supply shortages, and an antagonistic geopolitical environment portend a more difficult year ahead.

The U.S. economy grew at a 6.9% annual rate in the fourth quarter, driven by a surge in services spending and inventories. The end of COVID-related fiscal spending, the residual drag from the Omicron variant, and potential inventory reductions may cause economic growth to decelerate in 2022. Recent consumer spending and retail sales have been lower than expected and consumer sentiment is at its weakest level in over 10 years. While business activity is still expanding, it has fallen in the U.S. and Europe. China, which has taken a tough approach to suppress a recent increase in COVID cases, could roil the global economy. However, the recent pick up in construction spending, increase in the labor force, and heightened spending on services as daily life continues to normalize should sustain the economic expansion.

There is growing concern that the U.S. Federal Reserve has been too slow to respond to the surge in demand and inflation. The inflation rate is outpacing forecasts, jumping to 7% in December – its highest level since June 1982. The Fed's preferred inflation measure, core PCE, rose 4.9% year-over-year in December, more than double the 2% target. While the supply shortages that boosted prices are likely improving, increases in wage costs and housing may be more sustainable. The labor market remains tight and demographic trends limit the supply of new workers. Likewise, shortages of labor, materials, and land in some areas, should prolong the housing boom. Recently, the Fed has clearly indicated it is poised to take aggressive action to tame inflation, including multiple interest rate hikes, the end of asset purchases, as well as steps to shrink its balance sheet. Central banks in other countries have already started to tighten their monetary policy or have announced their intentions to do so, pushing up global yield curves.

All major bond sectors declined in January due to higher government yields and wider credit spreads. U.S. interest rates increased across all maturities, but the yield curve flattened as short-term yields rose more than long-term equivalents. Treasuries outperformed taxable spread sectors and municipal bonds. Non-U.S. investors searching for yield and safe income have boosted Treasuries, particularly at the long end of the curve. U.S. bonds generally underperformed global bonds although the U.S. dollar gained against most currencies. U.S. corporate investment-grade debt produced the lowest returns, partially due to longer duration and elevated new issue supply. Municipal funds experienced their first net outflow in almost two years, which was caused by a retrenchment in dealer liquidity and an upswing in new issuance. The pullback in municipal prices has made the sector more attractive relative to Treasuries and the tax-equivalent yield is materially higher than taxable sectors.

Global equity market declines were led by U.S. equities. Emerging markets stocks outperformed developed markets but with wide dispersion across countries. Brazil and Chile posted double-digit gains while China and Russia were thwarted by heightened domestic and political risks. Small-cap stocks have underperformed large-cap stocks for several months. Growth sectors, including technology and consumer cyclicals as well as healthcare, saw the steepest declines. Value stocks, which tend to be less impacted by rising interest rates than growth stocks, outperformed. Energy was the only sector with a positive return. Energy-oriented stocks and commodity futures surged amid rising oil prices, strong inflation and potential supply disruption from the Russian/Ukraine conflict. Technical factors exacerbated price volatility with poor liquidity and heavy selling activity from index-oriented ETFs. A mixed earnings season, with several high-profile misses in consumer and financial stocks, also startled investors. The end of the month saw some relief, as volatility subsided and technology stocks led a robust bounce-back.



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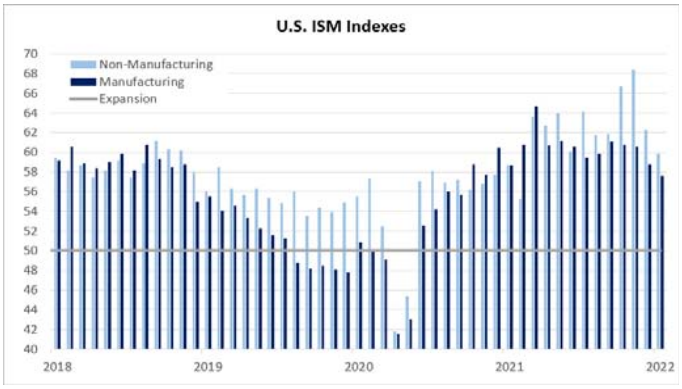

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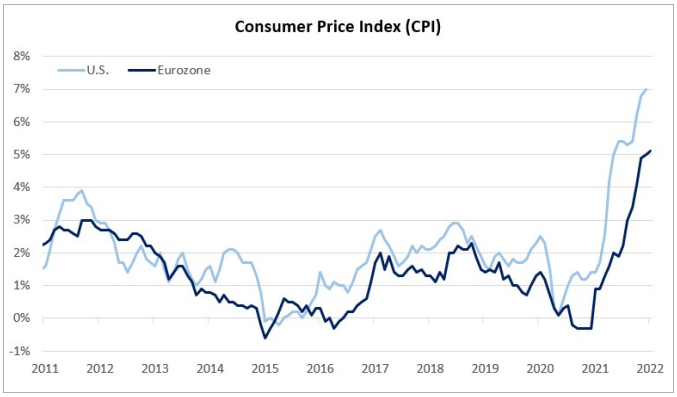
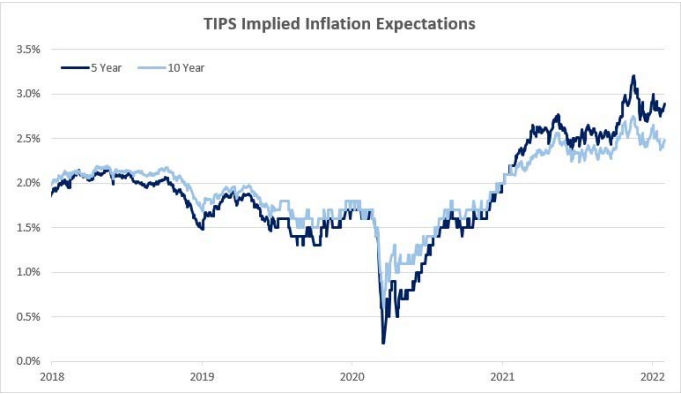


U.S. Bureau of Labor Statistics



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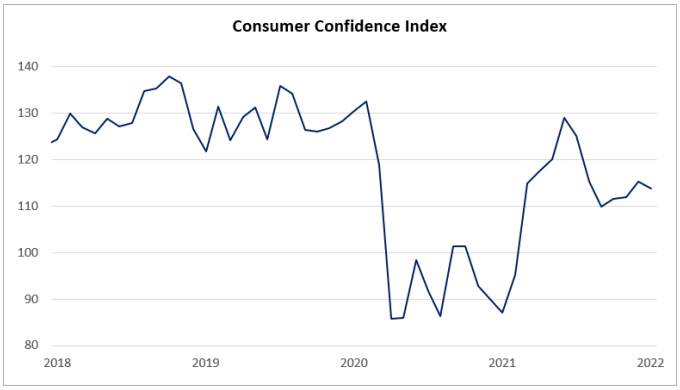
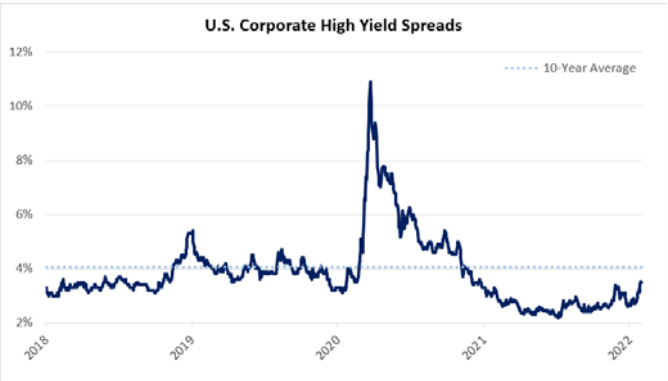


Conference Board



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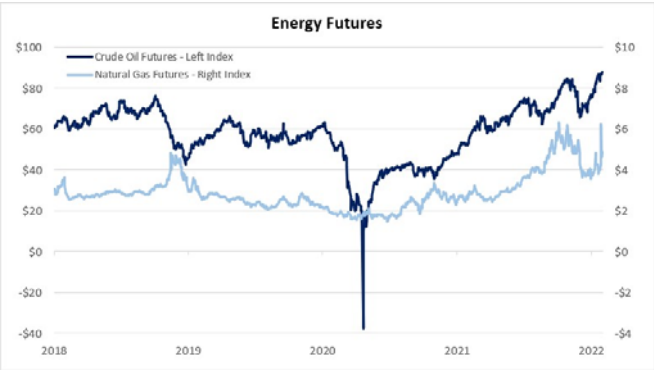

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