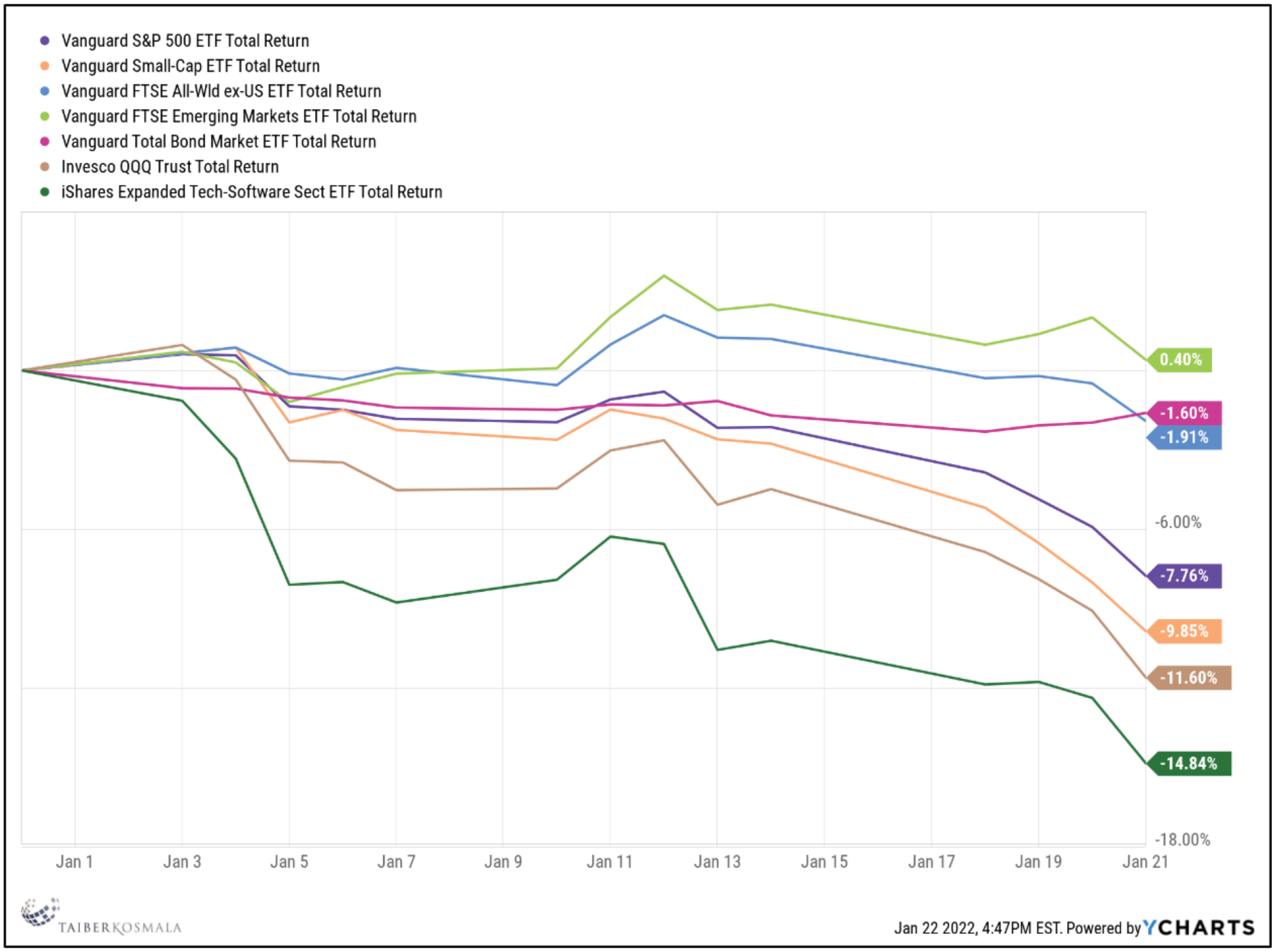
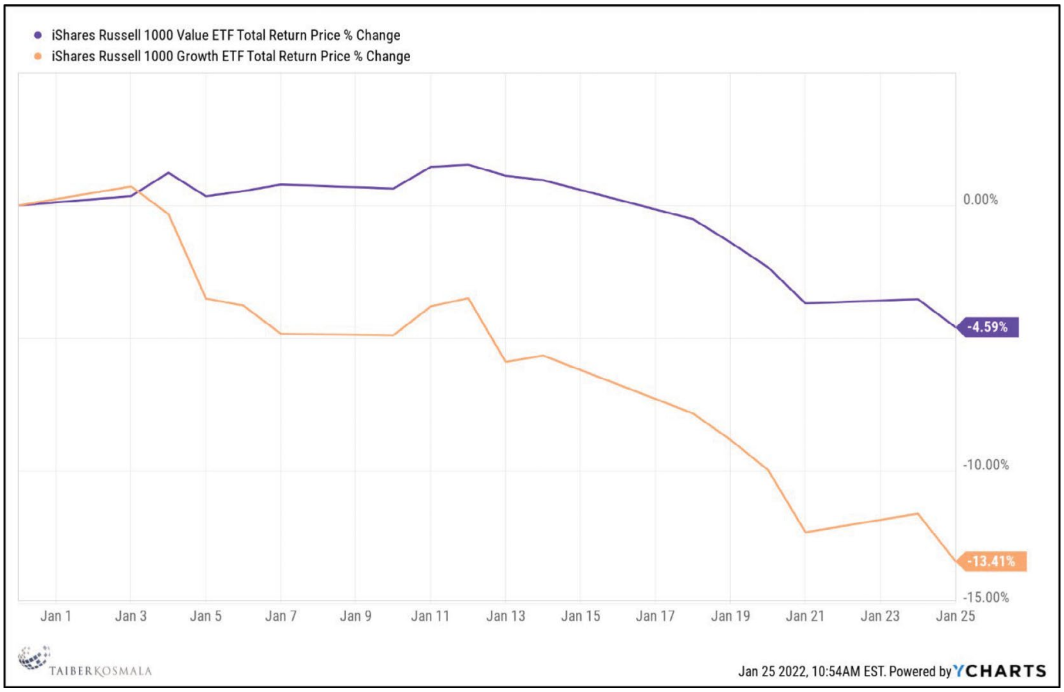
FLASH COMMENTARY
January 25, 2022

January 2022 Market Volatility

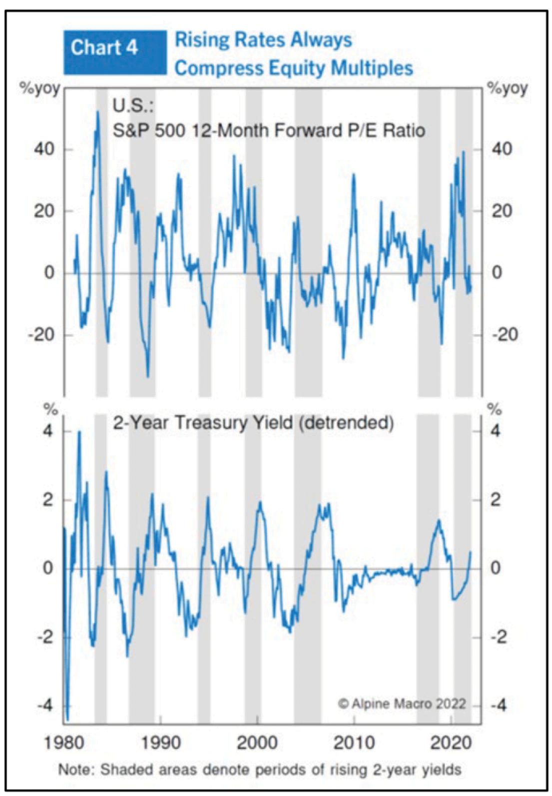
After a year of benign volatility, financial market volatility reverted to the mean to start 2022. Despite reaching all-time highs on January 4th, markets quickly reversed course after Federal Reserve Chair Powell's confirmation hearing just one week later (January 11th). FOMC meeting minutes revealed an end to the "transitory" inflation language that has been prevalent since the Spring of 2021, as well as the potential for more interest rate hikes than initially expected by both the market and the Fed. Growth and Information Technology names started to sell off as longer-term interest rates rose from 1.52% at year-end to over 1.8%, a level not seen since the start of the pandemic. So far this month, the US equity market is off 7.5%. In the last 30 years, we've seen monthly declines of that magnitude 16 times. Of those 16 occurrences, 9 took place during recessions. In other words, quick and significant declines of 7.5%+ usually occur in recessions. As we will highlight, the US economy is not in recession nor is the likelihood of a recession imminent. For the six episodes (excepting the current one) of monthly declines without an accompanying recession, the average return two months later was 7.74%. All of this is to say, we remain constructive on stocks relative to bonds.



All markets have borne the brunt of this selloff, but the biggest laggard has been the tech complex. Since the start the year, the disparity between value and growth has also been pronounced.



This makes sense because as interest rates rise, equity multiples tend to compress, leading to under-performance from higher valuation names (as measured by the price to earnings).



Source: Alpine Macro Research

Corrections in the growth/tech names tend to not matter longer-term as the Nasdaq has historically rebounded from these bouts of interim market volatility.

Also, consecutive down days for the Nasdaq have typically meant positive returns over the next 1- and 3-months when the economy is not in a recession.

Nasdaq Composite 4 Consecutive 1%+ Declines

Date	1%+ Drops in a Row	4-Day % Chg	Next Day %	Next Week %	Next Month %	Next 3 Months %
10/19/1978	4	-6.17	-2.67	-7.25	-10.64	-2.02
10/31/1978	4	-8.29	3.18	1.54	3.21	13.23
3/10/1980	4	-7.49	0.56	-2.82	-5.36	6.43
10/19/1987	4	-17.16	-9.00	-17.02	-12.07	-5.51
8/21/1990	4	-7.72	-1.27	0.84	-4.02	-7.10
12/12/1997	4	-6.96	0.00	-0.77	0.79	15.80
8/31/1998	4	-16.62	5.06	10.78	12.98	30.03
10/8/1998	4	-12.13	5.17	13.52	30.82	65.20
4/13/2000	4	-17.31	-9.67	-0.89	-1.88	15.49
12/15/2000	4	-12.00	-1.08	-5.14	4.34	-29.99
2/22/2001	4	-12.06	0.78	-2.74	-14.09	-0.07
5/14/2001	4	-5.31	0.18	10.74	1.91	-4.79
9/20/2001	4	-13.24	-3.25	-0.69	13.62	34.81
7/23/2002	4	-12.04	4.98	9.37	14.66	6.56
8/5/2002	4	-10.28	4.44	8.36	7.16	12.83
10/7/2002	4	-7.77	0.88	9.03	25.17	27.89
11/12/2007	4	-8.53	3.46	0.36	3.37	-8.13
10/6/2008	4	-10.94	-5.80	-1.00	-4.45	-11.30
12/24/2018	4	-8.71	5.84	7.64	15.69	23.42
1/21/2022	4	-6.83	?	?	?	?
		Average	**0.09**	**1.78**	**4.28**	**9.62**
		Median	**0.56**	**0.36**	**3.21**	**6.56**
		% Positive	**57.9%**	**52.6%**	**63.2%**	**57.9%**

Source: Bespoke

A similar story could be told for the S&P 500.

The S&P 500 Index Moves Into A Correction, But That Isn't Always Bad

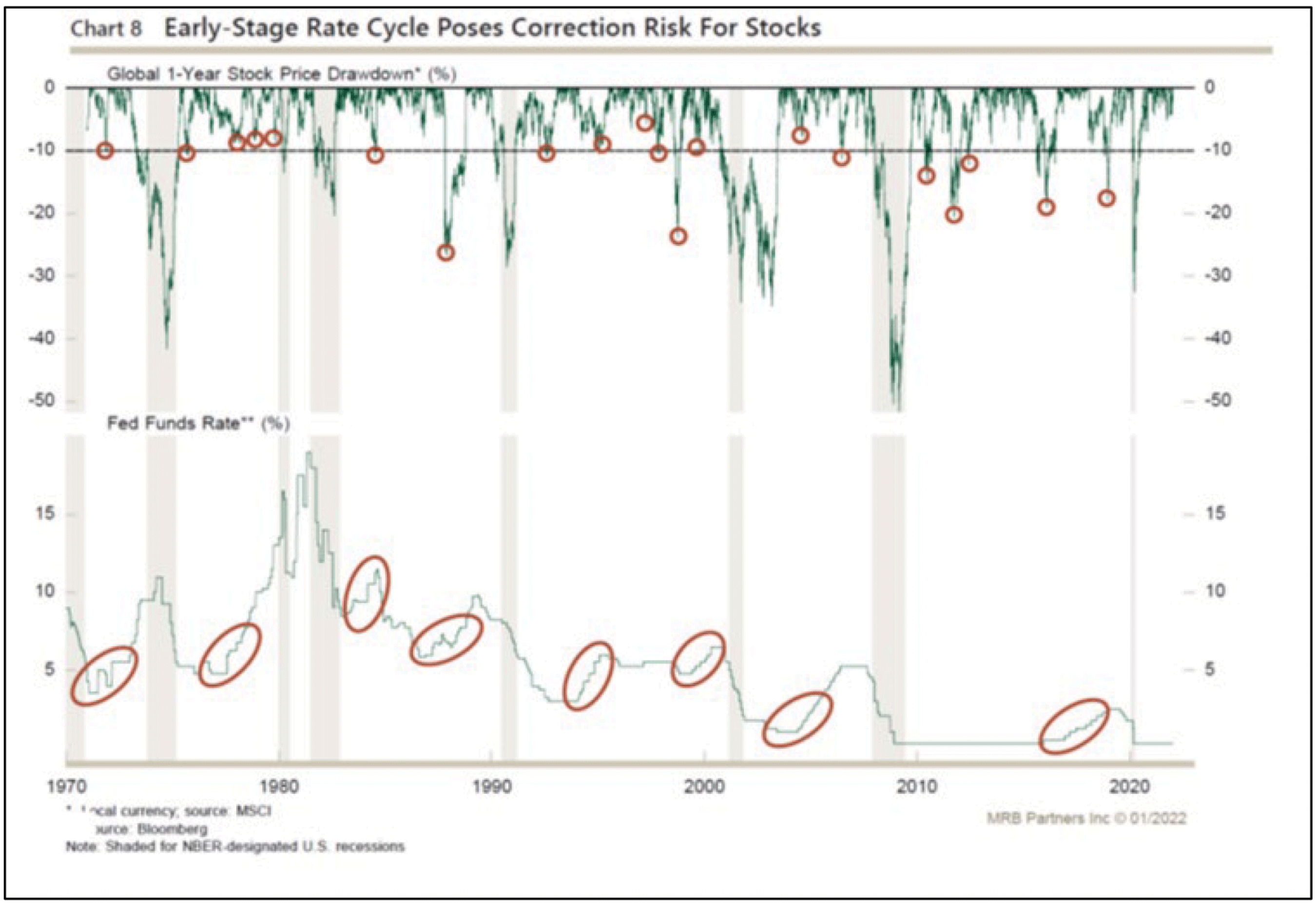
S&P 500 Index Performance After Fastest Corrections (Less Than One Month)

		S&P 500 Index Future Returns		
Date	Days To 10% Correction	Next Three Months	Next Six Months	Next Twelve Months
10/11/1955	12	9.7%	17.7%	14.8%
10/27/1997	14	11.5%	24.8%	21.5%
8/14/1998	20	5.2%	16.9%	25.2%
4/14/2000	15	11.3%	1.3%	-12.1%
2/8/2018	9	5.5%	10.6%	5.0%
2/27/2020	6	1.7%	16.8%	27.9%
1/24/2022	14*	?	?	?
Average		7.5%	14.7%	13.7%
Median		7.6%	16.8%	18.1%
% Positive		100.0%	100.0%	83.3%

Source: LPL Research, FactSet 01/24/2022 *Set to happen today

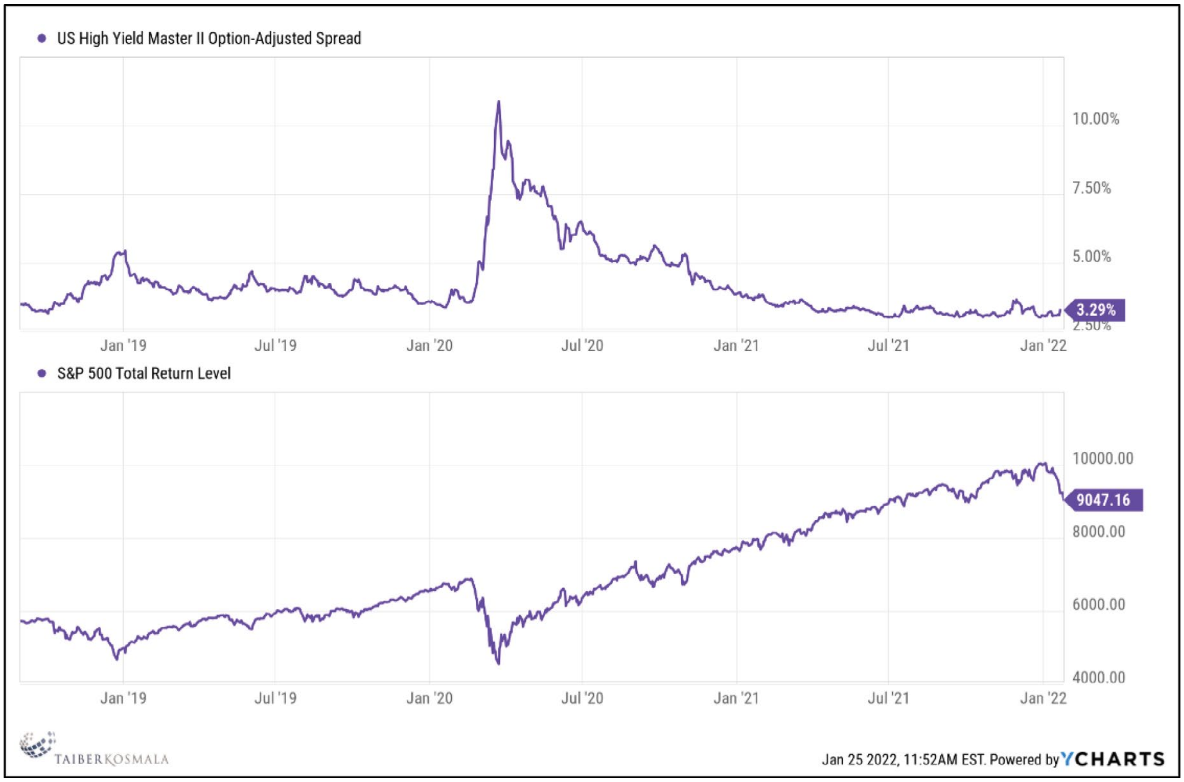
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

We remain constructive on the stock market and do not believe recession is imminent. Markets are typically prone to more corrections during the ordinary course of interest rate tightening campaigns.

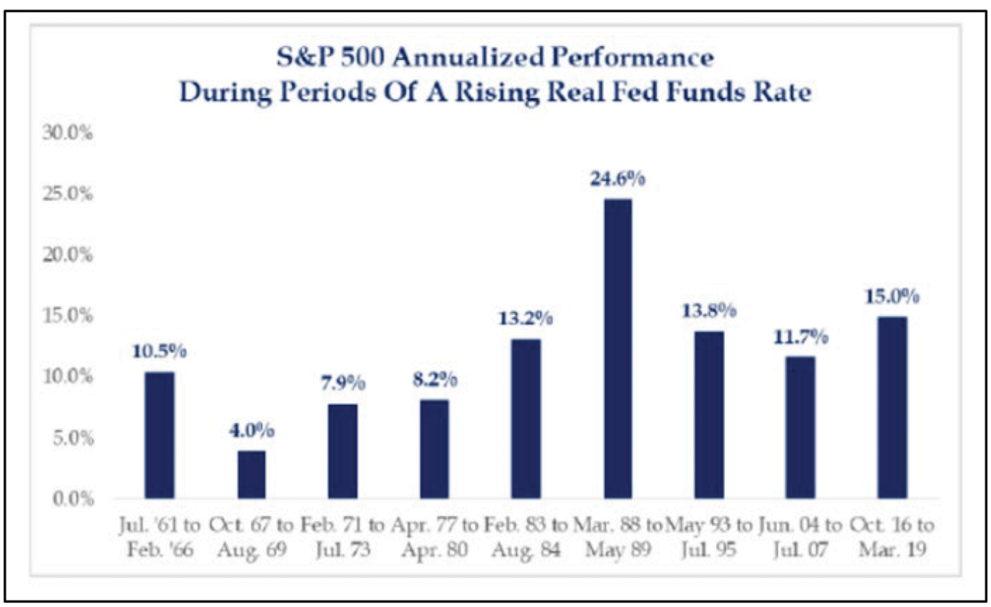


Source: MRB Partners

Importantly, credit spreads are not signaling impending signs of a more substantive corrective phase for financial markets. High yield credit spreads have historically been one of the best proverbial canaries in the bear market coal mine.



As illustrated above, financial markets have historically overreacted to the initial stages of Fed tightening campaigns in anticipation of a policy error (over-tightening); however, tightening cycles since 1961 have exhibited positive returns for equity markets.



Source: Strategas

BIG GAINS HISTORICALLY FOLLOWED INITIAL FED RATE HIKES

Date of Initial Fed Rate Hike	Next Bull Market Peak	S&P 500 Gain	Number of Years
9/11/58	12/12/61	49%	3.3
7/1/63	2/9/66	37%	2.6
4/23/71	1/11/73	16%	1.7
7/18/75	11/28/80	51%	5.4
8/22/80	11/28/80	12%	0.3
8/8/83	8/25/87	112%	4.0
3/24/94	3/24/00	229%	6.0
6/30/04	10/9/07	37%	3.3
12/16/15	2/19/20	63%	4.2
	Average	67%	3.4
	Median	49%	3.3

Source: LPL Research, FactSet, Federal Reserve 01/12/22

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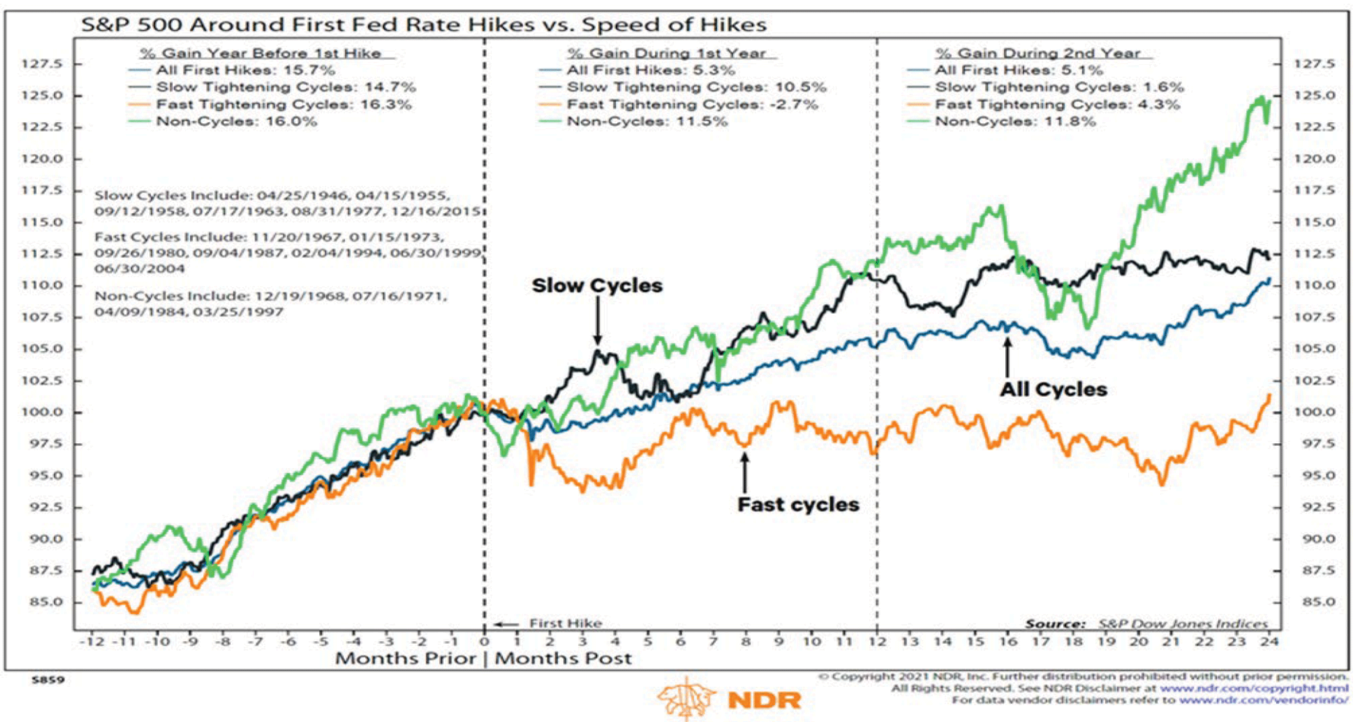
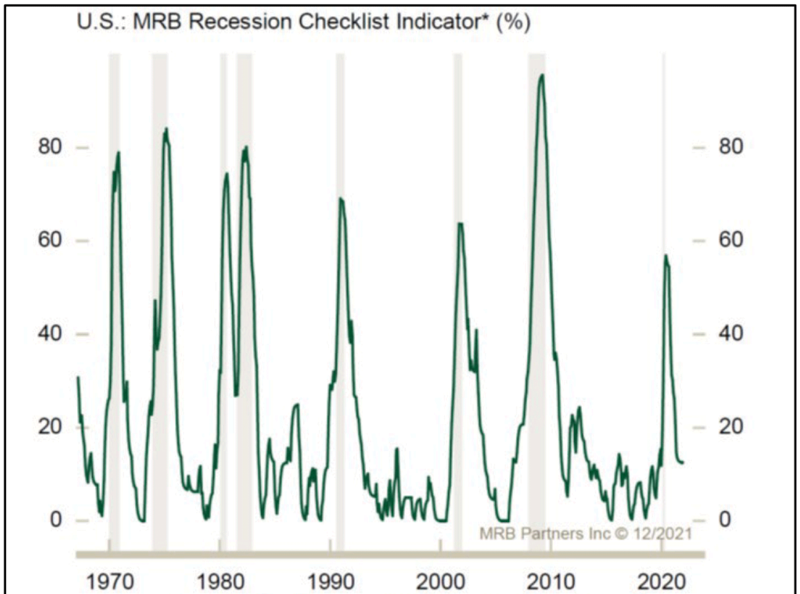
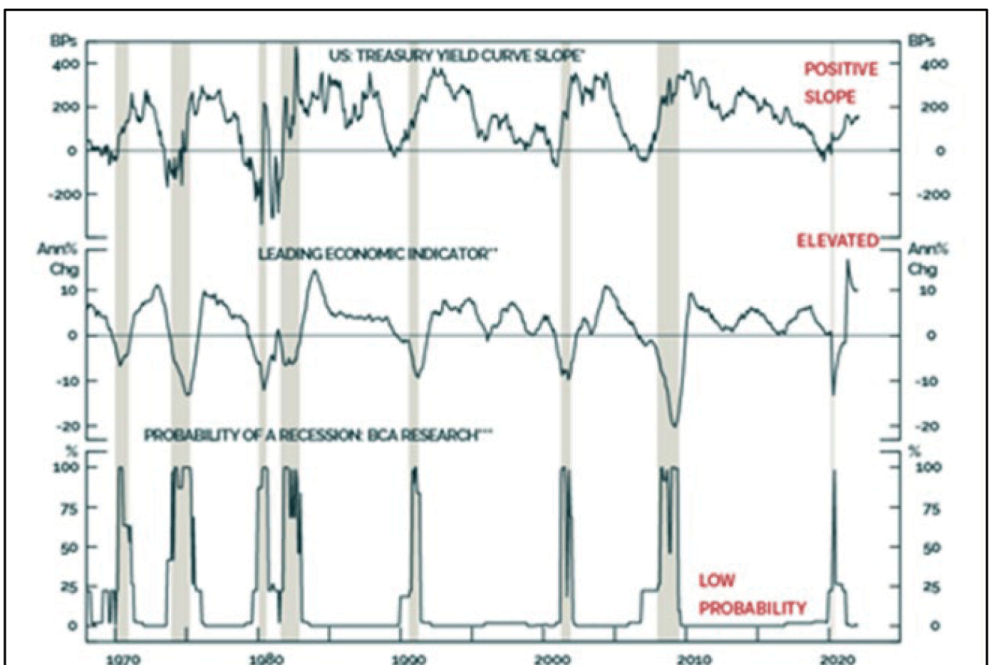
Ultimately, the pace of the Fed tightening is what matters most. The FOMC meeting on the 26th will shed light on how Powell and company see the future interest rate path shaking out and will validate or remove current market fears.



Recession indicators are still elusive given strong corporate earnings growth, improving consumer confidence and expanding manufacturing and service PMI readings. Bear markets without accompanying recessions are extremely rare. Recession indicators from two premier economic research firms (Macro Research Board and Bank Credit Analyst) are highlighted below.



* Smoothed; percent of bearish components in Table 1 of the MRB U.S. Research Highlight, U.S. Recession Risks Are Still Low, July 5, 2016
Note: Shaded for NBER-designated U.S. recessions



* 10-YEAR TREASURY YIELD LESS 3-MONTH TREASURY YIELD.
** SOURCE: THE CONFERENCE BOARD.
*** BASED ON VARIABLES WITH STRONG RECESSION PREDICTION POWER: LEI, FED FUNDS RATE, INFLATION EXPECTATIONS, UNEMPLOYMENT RATE, CRUDE OIL PRICES, CREDIT SPREADS, YIELD CURVE AND COINCIDENT INDICATOR. SOURCE: BCA CALCULATIONS.
NOTE: SHADED FOR NBER-DESIGNATED RECESSIONS

Source: Bank Credit Analyst

#	Component	What To Look For	Triggered?
Financial Markets			
1	Moody's Corporate Aaa Spread	Rising decisively	✗
2	S&P 500	Annual growth below 0	✗
3	VIX Volatility Index	Rising above 30	✗
Credit Markets			
4	Mortgage Lending Standards	Above 0	✗
5	Real C&I Loans And Leases	Annual growth below 0	✓
6	Bank Option-Adjusted Spreads	Rising decisively	✗
7	Non-Mortgage Consumer Delinquency Rates	Rising	✗
8	Euro Area 3-Month LIBOR/OIS Spread	Rising decisively	✗
Consumer Spending			
9	Personal Savings Rate	Rising decisively	✗
10	Consumer Confidence: Present Situation	Below its long-term moving average	✗
11	Real Core Consumer Spending	Annual growth falling decisively	✗
Labor Market			
12	Unemployment	Rising decisively	✗
13	Initial Unemployment Insurance Claims	Rising decisively	✗
14	Goods-Producing Employment	Annual growth below 0	✗
15	Hiring Intentions	Falling decisively	✗
Macro			
	Conference Board's Economic Indicators:		
16	Leading	Below its moving average	✗
17	Coincident	Below its moving average	✗
18	Manufacturing Industrial Production	Annual growth below 0	✗
19	ISM Manufacturing Index	Falling below 47	✗
20	ISM Nonmanufacturing Index	Falling below 52	✗
21	Real Residential Investment (level)	Falling decisively	✓
Global Macro			
22	Global Export Volume	Annual growth below 0	✗
	Euro Area Bank Credit:		
23	Household Sector	Annual growth falling	✗
24	Nonfinancial Corporate Sector	Annual growth falling	✓

Source: Macro Research Board

As the market awaits further clarity from the Fed regarding the eventual pace and magnitude of balance sheet reductions and interest rate increases, we counsel clients to stay the course of adhering to their established strategic asset allocation policy. The volatility assumptions of most well-crafted portfolios include periods like the current one; it is normal and expected. The fact that volatility has been so benign for such an extended period has fostered complacency among some market participants. If managed well, periods of interim volatility often represent opportunities to lean into the strength and rigor of a well-designed diversified investment portfolio.

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