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January 2022: Market Review

Global equities briefly moved into correction territory in January (-10% drawdown) before rallying over the last two days to minimize mark-to-market losses experienced during the month. The S&P 500 Index declined -5.2% in January while the Dow Jones Industrial Average was down “only” -3.2%. The NASDAQ Composite had the weakest returns this month, falling -9.0% during the month. The most prominent reason for the market weakness appears to have been comments from Federal Reserve chairman Jay Powell that sparked fears that the Fed may be behind the curve, forcing a rapid increase in rates to tame inflation. Coupled with these interest rate fears were concerns over the speed of the Fed’s plans for tapering their purchases of Treasuries and mortgage-back securities, the geopoltical possibility of a Russian invasion of Ukraine, and the latest covid variant, Omicron, spreading rapidly throughout the world pushing infection rates above record highs. Although this new variant has shown to be less fatal than expected and many countries have begun to lift restrictions. In December, inflation in the U.S. rose +7.0% from the prior December, the highest yearly rise since 1982.

Within domestic equities, value stocks outperformed growth stocks and larger cap stocks declined by less than smaller cap issues. The Russell 1000 Value Index fell -2.3% while the Russell 1000 Growth Index dropped -8.6%. The Russell Midcap Value Index depreciated -4.2% while the Russell Midcap Growth Index declined -12.9%. The Russell 2000 Value Index was down -5.8% versus a decline of -13.4% from the Russell 2000 Growth Index. Value began the year with a sizable lead over growth style equities as the gap between high and low equity multiples narrowed. Within commodities, WTI crude oil rose to $88 per barrel versus $75 at the beginning of the month, a +17.2% increase, partially driven by Russia amassing troops along their Ukrainian border. Gold closed the month at $1,795 per ounce, down, interestingly, from $1,828 from the previous month.

International equity indices declined as well but by less than the U.S. equity market for January. The MSCI ACWI ex-U.S. Index fell -3.7% while the MSCI EAFE Index dropped -4.8%. The MSCI Emerging Markets Index (-1.9%) outperformed developed markets this month as central banks in emerging markets countries had previously increased interest rates and have been more willing to address inflation relative to developed market central banks. Brazil (+12.9%) and Saudi Arabia (+9.3%) contributed to relative performance and China (-3.0%) outperformed developed markets. U.S. and Russia tensions remain elevated as the statlemate with Ukraine could pose a substantial threat to energy markets.

U.S. fixed income markets also fell during the month as Treasury yields increased in response to the hawkish Fed signals. Powell noted that it “may become warranted to increase the federal funds rate sooner or at a faster pace than participants had earlier anticipated.” This more aggressive stance toward monetary policy has made investors cautious of a potential misstep in timing or magnitude of policy decisions. The yield on the 10-year Treasury ended the month at 1.79%, considerably higher than last month’s close of 1.52%. The Bloomberg U.S. Aggregate Bond Index fell -2.2% in January, the worst one-month return for the index since November 2016, while the Bloomberg Treasury 20+ Year Index declined -4.3%. Additionally, the Bloomberg Corporate High Yield Bond Index depreciated -2.7%.

The acceleration of price increases forced the Federal Reserve to pivot to combat inflation (and do so more quickly than previously expected) and came with equity markets priced expensively by historical standards. Geopolitical disputes and another COVID-19 strain added to the downward pressure on equity prices. Despite the decline in markets, the overall economy appears relatively healthy as fundamentals have remained generally positive (e.g., estimated real Q4 2021 GDP rose at an annualized rate of 6.9%, unemployment fell to 3.9% in December, and intermediate Treasury yield curves remain positive). However, this unique business cycle has moved to a new phase with uncomfortably high inflation and rising interest rates. The fear of higher interest rates hit more speculative portions of markets (high P/E technology stocks, SPACs, and cryptocurrencies) harder in January but likely will harbor higher volatility and lower returns for all risk assets after a strong decade of significantly higher than average investment returns.

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Disclosures

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