MARKET INSIGHTS

from Ziegler Capital Management

Monthly Market Commentary: February 2022

The S&P 500 returned -5.17% in January, a contrast to December's return of 4.48% and calendar year 2021's return of 28.71%. Small cap stocks, as measured by the Russell 2000, returned -9.63% in January, also in contrast to December's return of 2.23% and the 14.82% return in 2021. Large Cap Value outperformed Growth in January with the Russell 1000 Value returning -2.33% and the Russell 1000 Growth returning -8.58%. This contrasts with calendar year 2021 where Growth outperformed Value with a return of 28.27% versus 25.16%. In January, the Russell 2000 Value returned -5.83% and the Russell 2000 Growth returned -13.40%. Small Cap Value outperformed Small Cap Growth considerably in calendar year 2021 with a return of 28.24% for Small Cap Value versus Small Cap Growth at 3.17%.

Financial news headlines continue to be led by the Federal Reserve's revised inflation commentary and taper comments, a likely increase in the Federal Funds rate in March, geopolitical tension between Russia and Ukraine, as well as supply chain disruptions that are trickling down and are having a broader effect on U.S. companies and their consumers. The spike in COVID-19 cases and hospitalizations in late December and early January has subsided, and the number of people who have received at least one dose of a COVID-19 vaccine continues to increase. According to the Centers for Disease Control (CDC), 72.4% of the United States population over 12 years old is fully vaccinated against COVID-19, with 84.9% of the population having received at least one dose as of January 28th. While COVID-19 cases and hospitalizations show substantial or high levels of transmission, reports are that the Omicron variant has less severe symptoms but a high degree of transmissibility.

Returns by Sector

	S&P 500		Russell 2000	
Sector	CY 2021	Jan. 2022	CY 2021	Jan. 2022
Communication Services	21.57	-6.21	14.70	-12.29
Consumer Discretionary	24.43	-9.68	26.09	-10.65
Consumer Staples	18.63	-1.37	20.79	-8.97
Energy	54.64	19.10	71.66	8.43
Financials	35.04	0.06	28.28	-3.40
Health Care	26.13	-6.76	-16.69	-15.95
Industrials	21.12	-4.73	23.72	-10.34
Information Technology	34.53	-6.89	15.84	-14.18
Materials	27.28	-6.84	25.34	-7.16
Real Estate	46.19	-8.50	28.34	-7.77
Utilities	17.67	-3.27	11.02	-5.40
TOTAL RETURN	28.71%	-5.17%	14.82%	-9.63%

Source: Bloomberg

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ABOUT ZCM MARKET INSIGHTS

A series that provides a glimpse of our internal thought process through current topics affecting our clients and colleagues.

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The $1.0 trillion infrastructure package that focuses on bridges, roads, railways, and broadband internet was signed into law by President Biden on November 15th. Funding will be distributed over a five-year period and puts $550 billion of new funds into transportation, broadband, and utilities. This includes $110 billion in roads, bridges, and other major projects. The American Families Plan remains in limbo with reports it may be broken into smaller bills in hopes to secure passage of parts of the larger bill. In recent negotiations, several of President Biden's campaign promises have been abandoned, such as providing free community college and clean electricity standards. Programs such as the expanded Child Tax Credit and expanded Medicaid that were initially going to be permanent will instead expire in a year or two. To pay for his plans, President Biden's proposals include raising the top income tax and capital gains rates, increasing corporate taxes, and expanding the Internal Revenue Service's collections.

Real gross domestic product (GDP) increased at an annualized rate of 6.9% in the fourth quarter of 2021 according to the "advance" estimate released by the Bureau of Economic Analysis (BEA). The increase in GDP reflects increases in private inventory investment, exports, personal consumption expenditures (PCE), and nonresidential fixed investment that were partly offset by decreases in both federal, state, and local government spending. Imports, which are a subtraction in the calculation of GDP, increased during the quarter. The increase in private inventory investment was led by the wholesale trade and retail industries. Within the retail industry, inventory increases by motor vehicle dealers was a leading contributor. The increase in exports reflected increases in both goods and services. The increase in exports of goods was widespread with leading contributors including consumer goods, industrial supplies and materials, and foods, feeds, and beverages. The increase in exports of services was led by travel. The increase in PCE primarily reflected an increase in services that was led by health care, recreation, and transportation. The increase in non-residential fixed investment primarily reflects an increase in intellectual property products that was partly offset by a decrease in structures. The decrease in federal government spending is primarily from a decrease in defense spending on intermediate goods and services. The decrease in state and local government spending is from decreases in consumption expenditures that was led by compensation of state and local government employees and in gross investment that was led by new educational structures. The increase in imports primarily reflects an increase in goods that was led by non-food and non-automotive consumer goods and capital goods.

According to the U.S. Bureau of Labor Statistics, the unemployment rate fell to 3.9% in December from 4.2% in November. The number of unemployed fell to 6.3 million people from 6.8 million people in November. In December, notable job gains occurred in leisure and hospitality, professional and business services, manufacturing, construction, and transportation and warehousing. Both measures continue to fall and are significantly lower than their April 2020 highs and are now approaching their February 2020 pre-pandemic levels of 3.5% and 5.7 million people. The labor force participation rate of 61.9% in December was unchanged from November's revised reading. It has remained in a narrow range of 61.4% and 61.9% since June 2020 with the last two readings the highest rate in that period.

The U.S. savings rate was 7.9% in December, increasing from a revised upward 7.2% in November. The long-term average savings rate is approximately 9% after its stunning peak of 32.2% in April 2020.

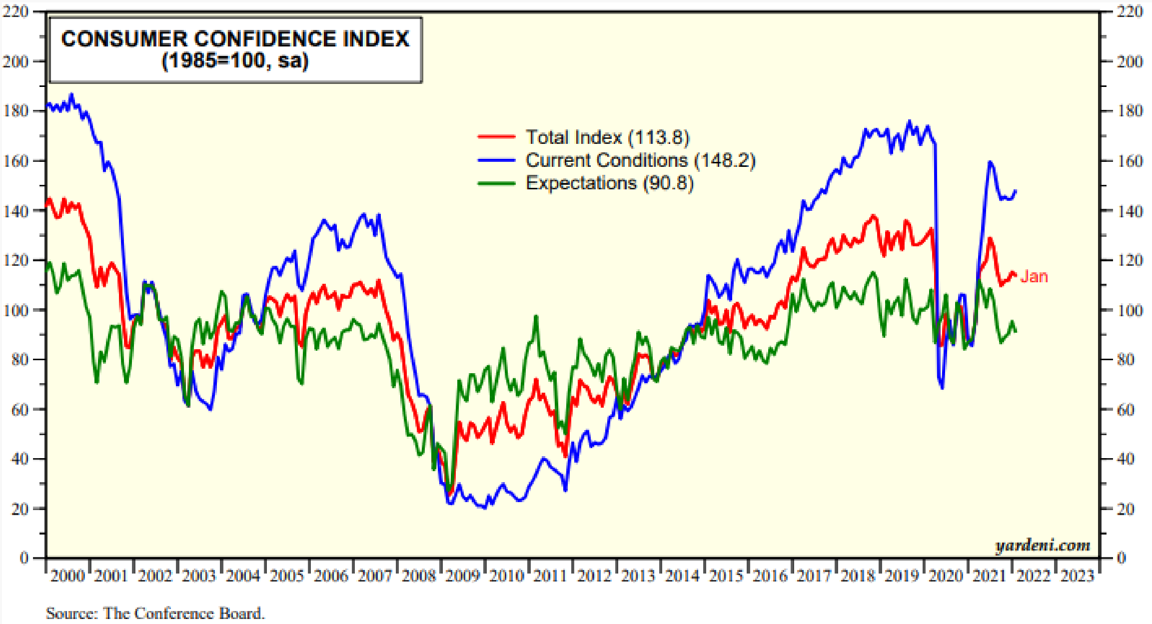
Personal income increased $70.7 billion (0.3%) in December according to estimates from the BEA. Disposable personal income increased $39.9 billion (0.2%) and personal consumption expenditures decreased $95.2 billion (0.6%). The increase in personal income in December primarily reflected an increase in compensation that was partly offset by a decrease in proprietors' income. Within compensation, the increase reflected increases in private and government wages and salaries. Within proprietors' income, nonfarm and farm income decreased. Government social benefits decreased slightly, reflecting the reduction of pandemic-related stimulus programs that ended in December.

The Federal Reserve held interest rates in a range between 0 and 0.25% at its January meeting but reiterated its commitment to withdrawing its pandemic-era market stimulus policies with rapidly increasing prices. “With inflation well above 2% and a strong labor market, the Committee expects it will soon be appropriate to raise the target range for the federal funds rate,” the Federal Open Market Committee said in its most recent statement. In early November, the Fed agreed to reduce its $120 billion per month bond purchases by $15 billion per month, paring back to $90 billion in December. At their mid-December meeting, the Fed said it would further accelerate the wind-down by reducing purchases by $30 billion per month. As a result, the Fed will purchase $60 billion in Treasury and mortgage securities in January, putting the program on track to end by March.

The Fed released a document outlining its objectives for shrinking its balance sheet, noting that this process will “commence after the process of increasing the target range for the federal funds rate has begun.” Chairman Jerome Powell said that the Fed would unwind its asset holdings on a set schedule, allowing the process to operate in “sort of in the background.” Chairman Powell indicated that the Fed would allow maturing assets to roll off its balance sheet with a bias toward holding primarily Treasury securities. Fed Funds rate adjustments will be the primary way that the Fed responds to changes in its economic outlook. Chairman Powell further noted that this economic expansion was different from past ones, with “higher inflation, higher growth, a much stronger economy — and I think those differences are likely to be reflected in the policy that we implement.”

Consumer Confidence decreased in January to 113.8 from a revised downward 115.2 in December. Consumer Confidence recently reached a peak of 128.9 in June 2021. According to a statement from the Conference Board, “Consumer confidence moderated in January, following gains in the final three months of 2021. The Present Situation Index improved, suggesting the economy entered the new year on solid footing. However, expectations about short-term growth prospects weakened, pointing to a likely moderation in growth during the first quarter of 2022. Nevertheless, the proportion of consumers planning to purchase homes, automobiles, and major appliances over the next six months all increased. Meanwhile, concerns about inflation declined for the second straight month, but remain elevated after hitting a 13-year high in November 2021. Concerns about the pandemic increased slightly, amid the ongoing Omicron surge. Looking ahead, both confidence and consumer spending may continue to be challenged by rising prices and the ongoing pandemic.” The Present Situation Index (based on consumers’ assessment of current business and labor market conditions) improved to 148.2 from a revised upward 144.8 in December. The Expectations Index (based on consumers’ short-term outlook for income, business, and labor market conditions) declined to 90.8 in January from a revised downward 95.4 in December. According to information from the BEA, the consumer is responsible for approximately 70% of the U.S. economy.

Consumer Confidence



The Bloomberg U.S. Aggregate Bond Index returned -2.15% in January on the heels of a -1.54% return in 2021. The 10-Year U.S. Treasury ended January at 1.78% after ending December at 1.51%. It has increased dramatically since hitting an all-time low of 0.54% in July 2020. The 2-Year U.S. Treasury and 10-Year Treasury spread ended January with a spread of 60 basis points (2-year: 1.18% and 10-year: 1.78%). As of December 31st, the spread was 78 basis points with the 2-Year at 0.73 % and the 10-Year at 1.51%. Option Adjusted Spreads (as represented by the Bloomberg Corporate Index) ended January at 106 basis points, 14 basis points wider than the December month end reading of 92 basis points. Spreads peaked in 2020 at 373 basis points on March 23, 2021, concurrent with the equity market lows.

West Texas Intermediate (WTI) finished January at $88.15 per barrel, increasing 17.3% from December's closing price of $75.21 per barrel. WTI increased 58.9% in 2021 after beginning the year at $48.40 per barrel. WTI is significantly higher than April 2020's close at $18.84 per barrel during the Saudi/Russia price war.

The Volatility Index (VIX) ended January at 24.83, increasing 44.2% from the December month end reading of 17.22. The VIX increased during the month due to the market turbulence over inflation, potential increases in interest rates and concerns over the geopolitical issues between Russia and Ukraine. The VIX peaked during the month on January 24th at 38.94. It remains considerably lower than the March 16, 2020 COVID-19 pandemic peak of 82.69. The long-term average of the VIX is approximately 20.

We actively monitor the capital markets and are prepared to respond accordingly. As we have stated in the past, we continue to advise our clients to adhere to their long-term plans and objectives.

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