

# Wentz Weekly

January 10, 2022

## Quantitative Tightening On the Horizon



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We make remarks about the Fed in many of our newsletter and the clues they provide on future policy moves because of the significant impact it has on the markets and our economy. Last week, the 10-year Treasury yield moved almost 30 basis points higher (0.30%) to end the week at 1.77% for its highest level since last March. While not a large move in nominal terms, it is a big move relatively speaking. In addition, shorter term bond yields moved to their highest levels since February 2020 as investors continue to price in the chance of several rate hikes this year. As the economy bounced back from the Covid-induced recession, supply unable to keep up with strong demand created inflationary pressures that pushed inflation to its highest levels in 40 years while the labor market is the strongest it has been since February 2020 and arguably longer. Those two issues are top of mind for Fed members, given the Fed's mandates it was given by Congress of stable inflation and full employment.

Mid-2021, when the economy was making significant progress on achieving those goals, investor's initial focus was when the Fed would wind down its asset purchases (in other words, when it would end quantitative easing). Then recently it was about when the Fed would begin raising interest rates. With inflation proving to be more persistent and the labor market near pre-pandemic levels with wage pressures building, the question now is when will the Fed will begin Quantitative Tightening – where it starts reducing its holdings of those securities it purchased over the past two years, which results in tighter financial conditions and lower liquidity. The conversation was expected as some point, but the minutes of the most recent Fed meeting that were released last Wednesday showed the Fed was already having the conversation, resulting in an immediate move higher in yields and sparking a selloff in high growth stocks. In addition, Friday's employment was a disappointment from a headline number with just 199,000 jobs added in December, but wages accelerated, growing 0.6% in the month and now 4.7% higher compared to this time last year. This gave investors more reason to believe a move by the Fed to tighten financial conditions will happen sooner rather than later, continuing a selloff in high growth stocks. These high growth companies are expected to make much of their profits in the future and discounting those cash flows to today using a higher interest rate results in a lower value and lower share price. These are reasons why we continually say volatility will persist into 2022, and why we continue to favor value over growth.

According to the Department of Labor 199,000 payrolls were added in December, well below the average estimate of 450,000 and follows November's disappointment of 210,000 (however October and November were revised higher by an additional 141,000 jobs). Through 2021 job growth averaged 537,000 per month. About 18.8 million jobs were added since April 2020, but there are still 3.6 million less employed compared to pre-pandemic levels. Leisure/hospitality saw the most job gains in December with 53,000, followed by professional services +43k, manufacturing +26k, construction +22k, and transportation +19k, while others saw little or no change. The household survey found those unemployed declined by 483,000 to 6.3 million, closer to the pre-pandemic number of 5.7 million. The labor force participation rate was unchanged at 61.9%, but still 1.5% below February 2020 levels which may be the one single factor that explains the lack of workers.

A telling stat of how the labor market is so tight is the average work week of 34.7 hours, higher than usual. This reflects employer's difficulties in finding skilled workers. In place of finding that new worker, employers are asking their existing staff to work longer hours. But the most significant data point from December's report was the acceleration in wage growth. The average wage grew double the expectation at 0.6% with wages up 4.7% compared to the same month a year prior. High wage growth is looking to be more persistent, and if that is the case, is something to pay attention to when it comes to monetary policy. Higher wages generally lead to higher inflation as employers look to pass that cost on to the consumer instead of having it eat into profits.

The market for automobiles had an unusual year in 2021 with the industry selling 14.98 million vehicles in the year, just 283,000 more than what was sold in 2020. We are confident the sales figure would have been much higher, maybe have even breaking the 2016 high of 17.5 million, if it wasn't for the massive semiconductor shortage. When the pandemic began many semiconductor manufacturers cut production as the economy came to a standstill. Then, due to the work from home movement, there was a surge in demand for PCs like laptops and other electronics, causing manufacturers to shift production from chips that go into cars to chips that go into computers and other electronics. As consumers began to return to normal activities the demand for cars improved and soon enough demand far outstripped supply, making the situation worse was car dealerships not having the inventory due to the chip shortage from semiconductor manufacturers. This resulted in a spike in prices for new and used cars. Used car prices were up as much as 42% in July (when comparing to a year prior) with new car prices up over 10% from a year earlier. The sharp rise in car prices will likely continue as long as there continues to be shortages in the industry.

## Company News

- Advanced Micro Devices unveiled a new graphic processing unit to better compete with Nvidia in the GPU space. Management said it looks to ramp up supply throughout the year amid "extremely strong" demand. Separately, there were reports that the antitrust review from China regulators on AMD's planned acquisition of Xilinx is close to being finished.
- Ford said it is planning to double the production of its electric F-150 Lightning pickup trucks. The company said it has nearly 200,000 reservations and now plans to produce 150,000 per year.
- AT&T and Verizon mutually agreed to delay the rollout of its new 5G service after pressure from the Transportation Department. There are concerns the frequency that 5G uses could interfere with the aviation industry and the frequency the cockpit data system uses. Separately, AT&T reported more HBO subscribers, with 73.8 million, than it had forecasted and 3.2 million net postpaid additions, the highest additions in over a decade.

## The Week Ahead

The calendar gets busy this week after several weeks of being light on events. Fourth quarter earnings season will kick off later in the week while there are two large industry conferences – the ICR Conference, one of the biggest retail events of the year, and the JPMorgan Healthcare Conference. Notable companies reporting earnings this week include Tilray on Monday, KB Homes on Wednesday, Delta Air Lines on Thursday, and a wave of big banks including JPMorgan, Wells Fargo, Citigroup, and BlackRock on Friday. Notably on the economic calendar are two inflation readings – the consumer price index on Wednesday where the consensus sees a 0.4% rise in prices (after a 0.8% increase in November) and the producer price index on Thursday. Also on the calendar is weekly jobless claims Thursday, and a wave of reports Friday including December retail sales, industrial production, business inventories, and results from the University of Michigan's consumer sentiment survey. In Fed news, Jerome Powell will be in front of the Senate Banking Committee for his renomination hearings.

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