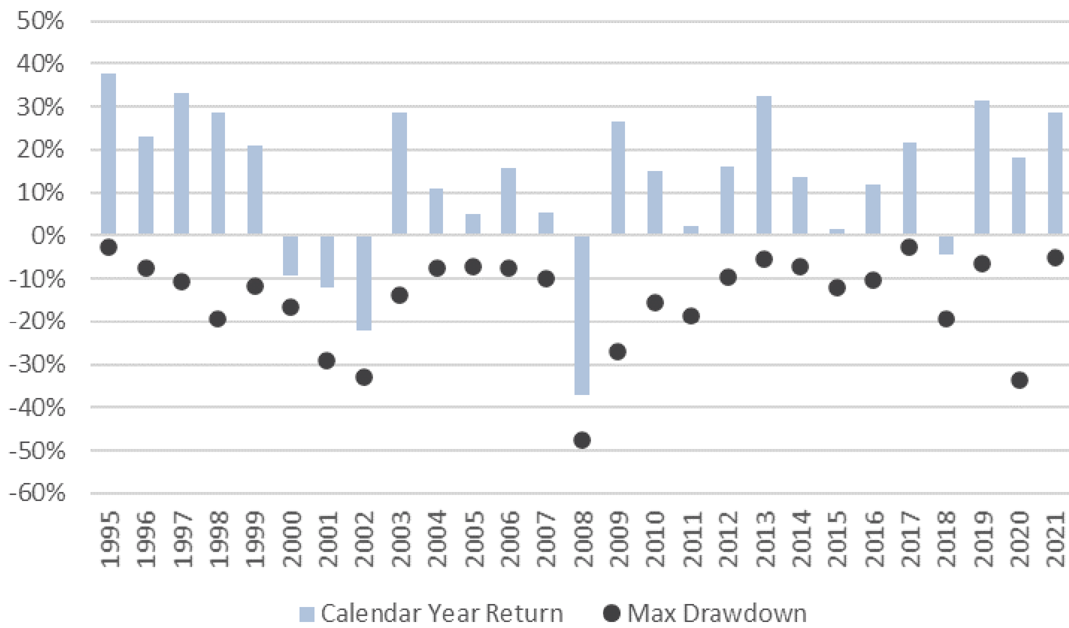
MILL CREEK
Our values appreciate yours

WEEKLY MARKET UPDATE
January 31, 2022

MARKET COMMENTARY

Fig. 1: 5-15% corrections are commonplace
Annual S&P performance and max intra-year drawdown



Source: Bloomberg, Mill Creek.

What has happened in equity and bond markets so far this year?

1. Bond market yields have risen quickly and equity market volatility has increased.
2. US equities, international developed market equities, and emerging market equities have declined -7.9%, -5.7%, and -3.3% year-to-date.
3. Growth equities have been the hardest hit, declining 11.6% this year.

Why are bond yields rising?

1. In our Year Ahead report, we predicted a "Hurry Up" phase of global central bank actions against inflation. That phase has begun. For example, market participants have priced in three additional Fed rate hikes for 2022 (five total for 2022) and a faster end to quantitative easing. Dovish members of the FOMC are speaking out about the need to fight inflation and even President Biden focused on the Fed's role in stabilizing prices during his recent press conference.
2. Most of the recent yield increase has come from rising real yields (e.g. mostly reflecting a normalization of monetary policy), not rising inflation expectations.

Why are equity markets correcting?

1. We believe most of the broad-based equity sell-off can be attributable to rising interest rates. Long-duration bonds have also sold off 5-10% or more.
2. Additionally, many of the "retail favorites," like meme stocks, stay-at-home stocks, and speculative technology companies, have declined as investors reconsider their long-term prospects in a post-COVID world.

Are we concerned about the current equity correction leading into a bear market?

1. While we don't attempt to market time, it is important to note that intra-year equity market declines of 10% are normal (Fig. 1) and do not foreshadow a bear market.

2. Additionally, the macro backdrop remains intact:
    - The Fed is behind the curve but are no signs of high inflation expectations becoming entrenched longer term.
    - US nominal GDP growth will likely remain above trend (5% versus 3-4% trend) this year.
    - The dollar remains strong and corporate credit spreads remain historically low.
    - Household income growth and balance sheets remain strong.

3. Even so, the Fed has fallen even further behind the curve by delaying rate hikes to March.
    - Aggregate wages and salaries, one of the main indicators we're watching as a bellwether for inflation, continue to grow at 9% year-over-year.
    - We remain concerned that inflation will not moderate this year and will continue to overshoot in the second half of the year. We gave this scenario a 50% likelihood in our Year Ahead and believe the likelihood of such an outcome has probably increased if anything.

4. In addition to inflation and rising rates, there is a range of geopolitical risks, policy risks, and economic risks we are monitoring. Proper asset allocation remains the first and most important step in risk management and we will continue to adjust portfolios as warranted by market conditions.

QUICK LINKS

- **Risk Monitor: Domestic Politics**
- **Risk Monitor: Supply Chain Disruptions**
- **Risk Monitor: Inflation**
- **Q1 2022 Outlook**
- **Year Ahead 2022: Hurry Up and Wait**
- **House View Summary**

This week's contributor: *Michael Crook, CAIA*