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Investment Institute

Market Commentary

Weekly perspective on current market sentiment — **January 12, 2022**

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Last week's S&P 500 Index: -1.9%

Adjustment process

Key takeaways

- As the economic and market cycle moves forward, investor concerns over inflation and possible Federal Reserve (Fed) reaction will likely inject further volatility into the market.
- We believe investors should adjust to these conditions and seek to take advantage of opportunities as they are presented.

We are now officially in the part of the cycle where the Fed is shifting to normalize its policy, following nearly two years of historically large liquidity supports to the economy. We all knew this time was going to come, but as is the case in most cycles in the past, we prefer to not think about it too much until we are forced.

So, historically, the result of these factors moving from the back burner to the front burner has been uncertainty, which further results in periods of equity and bond market downside volatility. As has certainly been the case in the stock rally environment we have seen since the March 2020 pandemic lows, this is usually mostly if not completely out of line with what investors have been conditioned to in the period prior to these issues moving to the forefront.

We have talked about conviction many times in the past. In our view, now is the time for conviction. This is when investors get tested in a cycle. Technology stocks have taken it on the chin over the past six weeks or so after being one of the best-performing sectors for the first 11 months of last year. And the Nasdaq Composite Index, intraday on Tuesday of this week, touched and briefly traded through support at the 200-day moving average but rallied back to finish positive on the day. When at the daily lows, the index was close to 10% off its mid-November 2021 all-time record high. Note that economic conditions provide the Information Technology sector with support that we believe merits a favorable rating. Opportunity was and is knocking on the door in our opinion. The S&P 500 Index, on the other hand, was down less than 5% from its record high at the intraday lows on Tuesday. So, we believe opportunity exists in the broader market as well, once again, if you have conviction.

In addition, the yield on the 10-year Treasury note has jumped higher from its early December lows as recent Fed minutes drove home the notion that our central bankers are more concerned about inflation and how long these price pressures might last relative to their stance just a few months ago. Granted, the 10-year yield is still well below 2%, but when you see a 40-basis-point (0.40%) pop in just five weeks, it tends to grab the attention of market participants. And that certainly has been the case.

The economy and Fed policy is in a transition phase. Worries of potential Fed mistakes and higher interest rates often unnerve investors at this point in the cycle. Economic and earnings growth concerns come to the forefront. COVID-19 headwinds also come into play. Investors need to go through a mental adjustment process and realize the road ahead is likely to feature a few more bumps than the one traveled over the past 20 months. We think these bumps can offer opportunities.

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Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

Definitions

NASDAQ Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the NASDAQ Stock Market.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market.

An index is unmanaged and not available for direct investment.

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