MORNING BRIEFING
January 24, 2022

Superbubble Bursting or Just Another Panic Attack?

Check out the accompanying chart collection.

(1) Grantham's superbubble. (2) Is the fourth superbubble bursting? (3) Back to 2500 on S&P 500? (4) Eight counterpoints. (5) The causes of bear markets. (6) The case against a recession. (7) Air is coming out of speculative bubbles without adverse economic consequences. (8) A correction in MegaCap-8 valuations. (9) Sentiment getting very bearish. (10) Geopolitical risks. (11) Panic Attack #73 is all about the Fed, and it might linger. (12) What does the Fed's balance-sheet runoff mean for the Treasury and for liquidity? (13) Movie review: "Munich: The Edge of War" (+ +).

YRI Monday Webinar. Join Dr. Ed's live Q&A webinar on Mondays at 11 a.m. EST. You will receive an email with the link to the webinar one hour before showtime. Replays are available *here*. Dr. Ed's presentation lasts about 15 minutes with another 15 minutes for Q&A.

Strategy I: Superbubble? We all know the stock market adage "Don't fight the Fed." Might a corollary be "Don't fight Jeremy Grantham"? Grantham co-founded GMO in 1977 and is a member of GMO's Asset Allocation team, serving as the firm's long-time investment strategist. He reputedly is awfully good at spotting stock market bubbles.

On January 20, he posted a very bearish analysis titled "*Let the Wild Rumpus Begin*." In it, he warned, "Today in the U.S. we are in the fourth superbubble of the last hundred years." What makes it a "superbubble" are the presence of bubbles in four asset classes—housing, equities, bonds, and commodities. Grantham rightly blames the Fed for inflating these bubbles. His underlying adage seems to be "Don't fight the Fed when it is inflating a bubble; but be ready to run for the hills when the bubble inevitably bursts." In his opinion, it's time to start running. That seems to be very good advice now that the Fed is getting set to tighten.

Grantham identifies three past superbubbles, all of which sent the stock market reeling. The first was the Great Crash during the Great Depression, when the S&P 500 plunged 86% from September 7,1929 through June 1, 1932. The second was the Tech Wreck, when the Nasdaq lost 78% from March 10, 2000 through October 9, 2002. The third was the Japanese Bubble, when the Nikkei 225 dropped 80% from December 29, 1989 through April 28, 2003.

The current bubble is the fourth, according to Grantham. The S&P 500 peaked at a record high of 4796.56 on January 3 this year, while the Nasdaq peaked at a record high of 16,057.44 on November 11, 2021 (*Fig. 1*). Through Friday's close, they are down 8.3% and 14.3%. Grantham predicts a drop "in the current case to a trend value of about 2500 on the S&P 500, adjusted for the passage of time, from whatever high point the market might reach." That would be down 43% from Friday's close and down 48% from the recent record high.

Grantham is a very knowledgeable student of market history. He does make numerous good, but unsettling, points in his analysis. Here are a few of my counterpoints:

(1) *Cause and effect of bear markets.* Bear markets are usually caused by recessions. Recessions are usually triggered by credit crunches and/or soaring oil prices. Credit crunches are usually the result of tightening monetary policy. Of course, the bursting of a speculative asset bubble can also cause a recession, as happened during the Tech Wreck and the Great Financial Crisis. The technology sector led the economic downturn during the former event when Y2K-related spending on tech fell at the start of the millennium and dot.coms ran out of cash, and the housing industry led the latter event's recession when home prices plunged.

It's hard to imagine that the Fed will cause a credit crunch by raising the federal funds rate. It is widely expected that this rate will be up to 1.00% by year-end 2022 and 2.00% by year-end 2023. One reason that's hard to imagine, as we have observed recently, is that there's probably $3 trillion of excess liquidity in M2, as measured by its latest reading and the pre-pandemic uptrend in this series (*Fig. 2*). It's also hard to see inflation becoming so intractable that the Fed is forced to push the federal funds rate up to recession-causing levels, i.e., a "Volcker 2.0" scenario.

By the way, in my opinion, the Great Depression and the Great Crash in the stock market were the results of a very specific development: Congress enacting the Smoot-Hawley Tariff in May 1930. The Dow Jones Industrial Average plunged 47.9% from its record high on September 3, 1929 to the year's low on November 13. From there, it rebounded 48.0% through April 17, 1930. It was down only 5.1% on a y/y basis, suggesting that the Great Crash wasn't so great! But the worst was ahead, as the stock market started to anticipate the passage of the tariff bill. (For more on this topic, see Chapter 2 of *Predicting the Markets*.)

(2) *Low odds of a recession.* A recession this year seems unlikely. Consumer spending is

likely to slow during the first half of this year because by now pent-up demand for consumer goods has been met and then some. The Omicron variant of the Covid virus is causing lots of workers to call in sick, which is a source of economic weakness, especially for both the demand and supply of consumer services. But assuming that the result is herd immunity, the demand for services should soar during the second half of this year. And, of course, there is lots of pent-up demand for motor vehicles that could boost the economy later this year.

Meanwhile, a slowdown in consumer spending on goods would be a welcome opportunity for businesses to replenish depleted inventories. The chronic shortage of labor is likely to continue to fuel spending on capital goods and technologies to boost productivity.

(3) *No recession in LEI or CEI.* The Index of Leading Economic Indicators rose 0.8% m/m during December to yet another record high (*Fig. 3*). The Index of Coincident Economic Indicators fully recovered to its pre-pandemic record high by October 2021 (*Fig. 4*). The previous six expansion periods (i.e., post-recovery) lasted 67 months on average.

(4) *Speculative excesses.* Grantham rightly observes that there have been lots of speculative excesses in the stock market. They include the hype over Cathie Wood's ARK ETFs that are loaded with mostly high-tech companies that have the potential to disrupt lots of businesses in the future but have no earnings in the present. Those that have any earnings at all were insanely overvalued at some points. But the air has been coming out of that bubble. The ARK Innovation ETF rose 158% from March 23, 2020 to its peak on February 11, 2021. It is down 54% since then through Friday's close. This has happened without any adverse consequences for the rest of the market or for the economy.

The air has also been coming out of the "meme" stocks owned by the Robinhood crowd and the stocks of SPACs (special purpose acquisition companies, a.k.a. "blank-check" companies) as well as the cryptocurrency bubble, also without any dire impact on the rest of us.

I don't see speculative excesses in the commodity pits, as does Grantham. Instead, I see strong demand attributable to the rebound in global economic activity from the initial depressing impact of the pandemic lockdowns. I agree that a 30% increase in home prices over the past two years resembles an inflating bubble; but there's a serious shortage of housing inventory relative to the demand, so prices are being driven up mostly by would-be homeowners, not speculators.

I also agree that the bond market looks very bubbly, with the 10-year US Treasury bond yields ridiculously low relative to the growth rate of nominal GDP (up 9.8% y/y through Q3), especially its inflation component (up 4.6%). However, we all know that. And yet, the bond yield remains under 2.00%.

(5) *A correction in MegaCap-8 valuations.* Over the past several months, Joe and I have noted that valuation multiples are historically high for the S&P 500, particularly its Growth component and especially the MegaCap-8. They've been that way since mid-2021.

From January 3 through Friday's close, the forward P/E of the S&P 500 dropped from 21.5 to 19.6. Leading the decline was the drop in S&P 500 Growth's forward P/E from 28.5 to 24.6. The MegaCap-8, which accounts for about half of the market cap of the Growth index, tumbled from 33.8 to 29.8 over the same period (*Fig. 5* and *Fig. 6*).

The MegaCap-8 have accounted for much of the S&P 500's elevated forward P/E. Excluding them, it was 19.1 on January 3 and down to 17.6 on Friday (*Fig. 7*). Those are not valuation multiples that suggest a superbubble, in my opinion.

Last week and ytd, the market cap of the S&P 500 fell $2.2 trillion (-5.7%) and $3.1 trillion (-7.7), the MegaCap-8 dropped $932 billion (-8.1) and $1.4 trillion (-12.0), and the S&P 500 excluding the MegaCap-8 (float-adjusted) fell $1.4 trillion (-4.9) and $1.9 trillion (-6.2). For all of 2021, the divisor adjusted market cap of the S&P 500 rose $8.6 trillion (26.9), the MegaCap-8 rose $3.3 trillion (37.5), and the S&P 500 excluding the MegaCap-8 (float-adjusted) rose $5.7 trillion (23.7) (*Fig. 8*).

Data provided by our friend Howard Silverblatt at S&P Global show that the MegaCap-8 accounted for 40.2% of the decline in the total ytd return of the S&P 500. They also happened to be the top eight contributors to the decline. In other words, we are mostly witnessing a rerating correction in the MegaCap-8's valuations.

(6) *No bubble in SMidCaps.* Meanwhile, there's not even the appearance of a bubble in SMidCaps (i.e., the S&P 600 SmallCap and S&P 400 MidCap indexes). As their earnings soared during 2021, their stock price indexes stalled, resulting in significant declines in their forward P/Es down to 14.5 and 13.7 on Friday (*Fig. 9* and *Fig. 10*). They remain extraordinarily cheap, in our opinion.

(7) *Sentiment.* The weekly Bull/Bear Ratio (BBR) compiled by Investors Intelligence was down to 1.59 during the January 18 week from 4.00 at last year's peak during the July 13

week (*Fig. 11*). The way the market traded this past week, the BBR likely fell closer to 1.00, which in the past has been a remarkably good buying indicator (*Fig. 12*). The market does seem poised for a significant rebound, perhaps after the end of the latest FOMC meeting and Fed Chair Jerome Powell's press conference on Wednesday.

(8) *Geopolitics and oil.* As I mentioned above, past spikes in oil prices usually seemed to have forced the Fed to tighten until a recession ensued. That could happen again given all the geopolitical risks that could cause such a scenario. A war between Israel and Iran will continue to loom over the Middle East. Iran supports insurgents in Yemen who have launched occasional attacks on the oil facilities in Saudi Arabia and most recently in the United Arab Emirates. Russia may invade Ukraine, with consequences for Russian oil and gas exports to the West.

On the other hand, with the price of a barrel of oil now over $80, I expect to see more oil production in the US. It has been hovering around 11.0 million barrels per day, about 2.0mbd below its pre-pandemic record high. Corrections triggered by geopolitical crisis have tended to be buying opportunities in the past.

Strategy II: Panic Attack #73 Could Last Awhile. Joe and I are adding the current stock market selloff to our *list of panic attacks* that have occurred since the bull market in stocks began in March 2009. It is #73. We reckon it started on January 5, when the Fed released the minutes of the December 14-15 FOMC meeting. The minutes turned out to be more hawkish than investors expected, as Melissa and I discuss in the next section. So in our list, we are identifying the triggering event as a "taper tantrum."

Most of the previous panic attacks didn't last very long. This one could linger for a while. There were three previous taper tantrums. The first one happened in May 2013, the second at the start of 2016, and the third during the last three months of 2018. During those previous three taper tantrums in the financial markets, the Fed had room to back off because inflation was so low, and it did so to calm the markets. That's not likely to happen today because inflation is a serious problem.

Consider the following recent inflation news:

(1) *Regional inflation indicators.* Debbie and I still expect to see a peak in the inflation data by the spring as consumer demand for goods slows and supply-chain disruptions abate. We are somewhat encouraged to see that in the two regional business surveys available so far for January, both the prices-paid and prices-received indexes continued their sideways

moves of recent months, albeit at record-high levels (*Fig. 13*). They're the surveys conducted by the Federal Reserve Banks of New York and Philadelphia. Their two indexes reflecting the supply-disruption issue are mixed: New York's delivery time index was down in January, while Philly's unfilled orders index rose in January (*Fig. 14*).

(2) *Home prices and rent inflation.* The median price of single-family existing homes slowed a bit to 16.1% y/y through December from the record high of 24.5% during May (*Fig. 15*). The median is up a whopping 31.5% over the past 24 months (*Fig. 16*). Rising mortgage interest rates are also reducing the affordability for first-time homebuyers, who might choose to rent instead. Rent inflation has already rebounded in recent months (*Fig. 17*).

For now, the Fed's course of action has turned increasingly hawkish since last year as inflation turned out to be more of a problem than Fed officials expected. There is already debate among Fed watchers over whether the first of the coming rate hikes might be 50bps rather than 25bps. In any event, the 2-year US Treasury note yield now slightly exceeds 1.00%, signaling that that's where market participants expect to see the federal funds rate by the end of 2022 or by early 2023 (*Fig. 18*).

The Fed: Abnormalization. What exactly was it about the *minutes* of the December 14-15 FOMC meeting released on January 5 that so unnerved investors, triggering the fourth taper tantrum in stock and bond markets since the start of the current bull market during March 2009?

Investors were not surprised to read that the Fed would stop its bond buying program by the end of March and that hiking the federal funds rate might start right after the March 15-16 meeting. That had been well telegraphed in the past and was widely expected.

The big surprise was that the minutes noted that participants discussed "the appropriate conditions and timing for starting balance sheet runoff relative to raising the federal funds rate." Furthermore, "[a]lmost all participants agreed that it would likely be appropriate to initiate balance sheet runoff at some point after the first increase in the target range for the federal funds rate."

Was "runoff" the triggering word? It was mentioned 10 times in the minutes but not at all in the previous meeting's *minutes*. Perhaps the frequency or matter-of-fact way in which "balance-sheet runoff" was mentioned took investors aback? Or was it simply the fact that tapering timing details were being worked out that brought the reality home to investors? Powell did say outright during his post-meeting press conference on December 15 that the

FOMC had discussed when to start reducing the Fed's balance sheet during the meeting.

Now consider the following implications of the Fed's balance-sheet runoff:

(1) *The trillion-dollar runoff.* Within the next 12 months, $1.14 trillion of the Fed's Treasuries will mature. That averages around $95 billion per month. The Fed has changed course from buying $80 billion per month last year. So in effect, the Treasury market will have to absorb $175 billion per month in securities on average over the next 12 months.

The question is: Why is the 10-year US government bond yield still below 2.00%? The only obvious answer is that German and Japanese investors are buying US bonds because their yields remain around zero.

(2) *The impact on the money supply.* How will this runoff of the Fed's balance sheet affect liquidity in the economy? It could slow the growth rate of M2, much as the Fed's earlier balance-sheet expansion had boosted this monetary aggregate.

When the Fed purchased $80 billion per month of Treasury bonds last year, both its assets and liabilities increased by that amount. The assets and liabilities of the commercial banks involved in the transactions also increased. These transactions resulted in more demand deposits, which represent the liabilities of commercial banks. The banks also showed an identical increase in their cash assets, which were deposited with the Fed, called "excess bank reserves," and represent the Fed's liability matching the increase in its bond holdings.

Got that? Now, this year, the Fed will soon stop buying bonds and start to let its Treasury portfolio run off as the securities mature at an average pace of roughly $95 billion per month. So the commercial banks' demand deposits will no longer be boosted by the Fed's bond purchases. Instead, the Fed's new policy will weigh on the growth of demand deposits and M2.

Movie. "Munich: The Edge of War" (+ +) (*link*) is based on a historical novel about the events surrounding the Munich Agreement on September 30, 1938. Germany, the UK, France, and Italy agreed to the annexation of the Czechoslovak borderland area named the "Sudetenland," home to more than 3 million people, mainly ethnic Germans. Adolf Hitler announced that it was his last territorial claim in Europe. British Prime Minister Neville Chamberlain declared that the deal would guarantee "peace for our time." Most of Europe cheered the deal that was expected to avert a major war. Hitler had lied, and the rest is history. The agreement is widely viewed as a historical cautionary tale about appeasing dictators. It could be very relevant today if NATO appeases Russian President Vladimir Putin’s demands about Ukraine.

Calendars

US: Mon: IHS Markit M-PMI & NM-PMI Flash Estimates 56.7/55.0; Chicago Fed National Activity Index. **Tues:** Consumer Confidence 111.8; Richmond Fed Manufacturing Index 14; S&P Case-Shiller HP Composite 1.0%m/m/18.0%y/y; API Weekly Crude Oil Inventories. (Bloomberg estimates)

Global: Mon: Eurozone, Germany, and France C-PMI Flash Estimates 52.6/49.2/54.5; Eurozone, Germany, and France M-PMI Flash Estimates 57.5/57.0/55.5; Eurozone, Germany, and France NM-PMI Flash Estimates 52.2/48.0/55.3; UK M-PMI & NM-PMI Flash Estimates 57.7/53.9; Australia CPI 3.2% y/y; Buba Monthly Report. **Tues:** Germany Ifo Business Climate Index, Present Situation, and Expectations 94.7/96.1/93.0; UK CBI Industrial Trend Orders 22; Japan Core CPI 0.7% y/y; BOJ Summary of Opinions. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index tumbled 5.8% last week to 8.8% below its record high on December 27. The index ranked 48th of the 49 global stock markets we follow in a week when 8 of the 49 countries rose in US dollar terms and the AC World ex-US index dropped 1.9%. Canada was the only country to trade at a record high in dollar terms during the week. EM Latin America was the best-performing region last week, with a gain of 1.2%, followed by BRIC (-0.1%), EMEA (-1.0), and EM Asia (-1.4). EM Eastern Europe (-5.2), was the biggest underperformer, followed by EMU (-2.3) and EAFE (-2.1). Chile was the best-performing country last week, rising 5.6%, followed by Colombia (5.5), Brazil (3.8), Hong Kong (3.3), and South Africa (1.6). Among the 27 countries that underperformed the AC World ex-US MSCI last week, Argentina fared the worst, with a decline of 10.1%, followed by the US (-5.8), Russia (-5.6), New Zealand (-5.5), and Israel (-5.5). The US MSCI ranks a depressing 47/49 so far in 2022, with its 8.3% decline well behind the 1.3% drop for the AC World ex-US. EM Latin America is the best-performing region, with a gain of 4.9%, ahead of BRIC (1.6), EMEA (0.9), and EM Asia (0.4). The laggards: EM Eastern Europe (-8.3), EMU (-2.5), and EAFE (-2.2). The best country performers so far in 2022: Chile (15.3), Peru (11.4), Colombia (9.3), South Africa (8.6), and Brazil (7.7). The worst-performing countries: Russia (-11.7), Denmark (-11.3), the US (-8.3), New Zealand (-7.7), and Sweden (-7.6).

S&P 1500/500/400/600 Performance (*link*): All three of these indexes posted their biggest weekly declines since early 2020. LargeCap fell 5.7% last week, slightly better than the 6.8% decrease for MidCap and the 7.6% decline for SmallCap. LargeCap is now 8.3% below its record high on January 3. MidCap ended the week 10.9% below its record high on November 16, and SmallCap weakened to 12.5% below its November 8 record high. None of the 33 sectors rose last week, down from just nine rising in each of the prior two weeks. LargeCap Utilities was the best performer for the week, albeit with a decline of 0.8%, followed by LargeCap Consumer Staples (-1.5%), MidCap Utilities (-2.8), SmallCap Utilities (-2.8), and LargeCap Real Estate (-2.9). SmallCap Energy was the biggest underperformer last week, with a decline of 12.2%, followed by MidCap Materials (-9.4), SmallCap Consumer Discretionary (-9.3), LargeCap Consumer Discretionary (-8.5), and MidCap Tech (-8.2). In terms of 2022's ytd performance, all three indexes are lower so far; LargeCap's 7.7% decline is less than those of SmallCap (-8.5) and MidCap (-8.7). Just three of the 33 sectors are positive so far in 2022. Energy dominates the top performers: LargeCap Energy (12.8), MidCap Energy (5.0), SmallCap Energy (3.7), MidCap Financials (-1.3), and LargeCap Consumer Staples (-1.6). The biggest ytd laggards: SmallCap Health Care (-14.4), MidCap Health Care (-14.0), SmallCap Consumer Discretionary (-13.2), MidCap Consumer Discretionary (-12.3), and LargeCap Consumer Discretionary (-12.2).

S&P 500 Sectors and Industries Performance (*link*): None of the 11 S&P 500 sectors rose last week, but seven outperformed the composite index's 5.7% decline. That compares to a 0.3% decline for the S&P 500 a week earlier, when two sectors rose and four outperformed the index. Utilities was the best performer, albeit with a decline of 0.8%, ahead of Consumer Staples (-1.5%), Real Estate (-2.9), Energy (-3.1), Health Care (-3.4), Industrials (-4.4), and Materials (-5.4). The worst performers: Consumer Discretionary (-8.5), Communication Services (-7.0), Tech (-6.9), and Financials (-6.4). The S&P 500 is down 7.7% so far in 2022, with one sector in positive territory and six ahead of the index. The best performers in 2022 to date: Energy (12.8), Consumer Staples (-1.6), Financials (-2.3), Utilities (-3.8), Industrials (-4.4), and Materials (-7.3). The ytd laggards: Consumer Discretionary (-12.2), Tech (-11.4), Real Estate (-9.5), Communication Services (-9.1), and Health Care (-8.2).

S&P 500 Technical Indicators (*link*): The S&P 500 tumbled 5.7% last week, and weakened considerably relative to its 50-day moving average (50-dma) and 200-day moving average (200-dma). The index closed below its 50-dma for a third week and was below its 200-dma for the first time in 82 weeks. The S&P 500's 50-dma moved lower for a second week, as the index dropped to a 21-month low of 5.8% below its falling 50-dma from 0.4% below its rising 50-dma a week earlier. That compares to a 27-week high of 4.9% in early November and its prior 11-month low of 2.0% below in early October. The index had been mostly trading above its 50-dma since late April 2020; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index fell below its 200-dma for the first time in 82 weeks last week, dropping to a 20-month low of 1.0% below its rising 200-dma from 5.2% above its rising 200-dma a week earlier. That's down sharply from its prior 11-month low of 5.0% above at the beginning of October and a nine-week high of 10.8% above in early November. That also compares to 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered on March 23—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators (*link*): Three of the 11 S&P 500 sectors traded above their 50-dmas last week, down from six a week earlier. The three sectors still above their 50-dmas are Consumer Staples, Energy, and Utilities. That compares to just two sectors above in early October. The same three sectors still have rising 50-dmas, down from seven sectors a week earlier. Looking at the more stable longer-term 200-dmas, five of the 11 sectors were above that measure, down from 10 a week earlier. The five still above their 200-dmas: Consumer Staples, Energy, Financials, Real Estate, and Utilities. For perspective, back in April 2020, just one sector (Health Care) was trading above its 200-dma. Notably, Energy's 200-dma finally turned higher in mid-December 2020 after mostly falling since October 2018.

US Economic Indicators

Leading Indicators (*link*): "The US LEI ended 2021 on a rising trajectory, suggesting the economy will continue to expand well into spring," said Ataman Ozyildirim, senior director of economic research at the Conference Board. "For the first quarter, headwinds from the Omicron labor shortages, and inflation pressures—as well as the Federal Reserve's expected interest rate hikes—may moderate economic growth." (Jobless claims climbed for the third week last week, rising from 200,000 during the week ending December 25 to 286,000 by mid-January as the Omicron variant continued to disrupt the job market.) Leading indicators has posted only one decline since April 2020, jumping 0.8% in December and 19.2% over the 20-month period to another new record high. Eight of the 10 components of the LEI rose in December, with only consumer sentiment (-0.08ppt) falling, while the average workweek was unchanged. The biggest positive indicators were posted by building permits (0.27), jobless claims (0.23), interest rate spread (0.17), and the ISM orders diffusion index (0.12), with the leading credit index (0.04), real core capital goods orders (0.02), real consumer goods orders (0.01), and stock prices (0.01) minor contributors. The Conference Board expects growth to slow to 2.2% this quarter and is forecasting 3.5% for all of 2022.

Coincident Indicators (*link*): The Coincident Economic Index (CEI) climbed to yet another record high in December 2021; it rose in eight of the past 12 months—recording only one decline; three months were unchanged. The CEI advanced 0.2% in December and 3.2% y/y, with three of the four components moving higher in December. Here's a look at how the four components performed in December: 1) Real personal income less transfer payments (+0.07ppt) accounted for the biggest contribution to the CEI, increasing in December for the seventh time in 10 months, by 0.2% m/m and 2.2% over the period—virtually matching October's record high. 2) Payroll employment (+0.04) was considerably below expectations again in December, while payrolls once again were revised higher for previous months. Total payroll employment advanced only 199,000 (half the expected 400,000 gain) in December, while revisions to November and October payrolls were revised higher for a net gain of 141,000. Total payroll employment has recovered 18.8 million jobs since bottoming last April, though is still 3.6 million below its pre-pandemic level. 3) Real manufacturing & trade sales (+0.04) advanced for the fourth month, by a total of 1.3%, after falling four of the prior five months by 2.2%. It's within 1.0% of March 2021's record high. 4) Industrial production (-0.02) unexpectedly fell in December (from November's two-year high) as manufacturing production was hindered by supply shortages and unseasonably warm weather triggered a drop in utilities output. Headline production slipped 0.1% following a two-month jump of 2.0%, as declines of 0.3% and 1.5% in manufacturing and utilities output, respectively, more than offset a 2.0% advance in mining production. Pushing manufacturing output lower was a 1.3% drop in motor vehicle production in December, due to a shortage of computer chips, following wide swings of +12.8% during the two months ending November and -9.2% during the two months ending September.

Regional M-PMIs (*link*): Two Fed districts (New York and Philadelphia) have reported on manufacturing activity for January and show the manufacturing sector slowed for the second month, rising at half December's pace and one-third of November's—as activity in the New York region stalled after 18 months of positive readings. The composite index eased to 11.3 from 23.7 in December and 35.0 in November—which was not far from last April's record high of 38.3; it was at 16.8 a year ago. Manufacturing activity in the New York (to -0.7 from 31.9) region was slightly negative, while growth in the Philadelphia (23.2 from 15.4) region picked up steam after growth was more than cut in half in December. The new orders (6.5 from 20.4) measure was also impacted by negative growth in the New York (-5.0 from 27.1) region this month, while new orders growth in the Philadelphia (17.9 from 13.7) area was slightly faster—after slowing appreciably in December from November's 47.4. Jobs (21.1 from 27.7) growth remained at a relatively healthy rate in January, though growth slowed in both the Philly (26.1 from 33.9) and New York (16.1 from 21.4) regions—Philly's was at a record high in December. Turning to prices, the prices-paid measure in the New York region eased for the second month, from 83.0 in November to 76.7 by January, while Philadelphia's gauge accelerated to 72.5 this month after slowing from 80.0 to 66.1 last month. New York's prices-paid measure was at a record high 83.5 last May, while Philadelphia's was at a cyclical high of 80.7 last June. Both the New York (to 37.1 from 50.8 in November) and Philadelphia (46.4 from 62.9) prices-received measures slowed for the second successive month—New York's from a record high and Philadelphia's from close to its record high of 63.8 in the mid-1970s.

Existing Home Sales (*link*): "December saw sales retreat, but the pullback was more a sign of supply constraints than an indication of a weakened demand for housing," said Lawrence Yun, NAR's chief economist. "Sales for the entire year finished strong, reaching the highest annual level since 2006." The 4.6% retreat in existing home sales during December to 6.18mu (saar) followed a three-month surge of 10.2%. Single-family sales contracted 4.3% at the end of 2021 to 5.52mu (saar), after climbing 11.2% during the three months through November, while volatile multi-family sales dropped 7.0% to 660,000 units (saar) after a 4.4% gain and a 2.9% loss the prior two months. Regionally, total sales fell in all four regions during December as well as on a y/y basis: West (-6.8%m/m & -10.2%y/y), South (-6.3 & -5.3), Northeast (-1.3 & -15.7), and Midwest (-1.3 & -2.6). There were 910,000 units on the market during December, down 18.0% from November and 14.2% y/y—with 79% of the homes sold during December on the market for less than a month. The yearly percent change in the median existing home price is below recent peaks in all regions, though is on a sharp accelerating trend in the South, up 20.2% y/y, nearing its record rate of 22.4% in May, while the 6.3% rate in the Northeast is the slowest since mid-2020. Prices in the Midwest (10.0% y/y) and West (8.4) are up from their recent lows of 7.7% for both during October.

Global Economic Indicators

Eurozone CPI (*link*): December's CPI headline rate accelerated for the sixth month, from 1.9% in June to a record-high 5.0% y/y in December, matching its flash estimate. The rate was at -0.3% at the end of 2020. Looking at the main components, once again energy (25.9% y/y) posted the largest gain, though it did ease a bit in December after accelerating steadily from -8.3% in November 2020 to a record-high 27.5% during November 2021. The rate for food, alcohol & tobacco (3.2) has increased sixfold from 0.5% in both May and June, while the rate of non-energy industrial goods increased from -0.5% in December 2020 to 2.9% y/y by December 2021—which was the highest since the early 1990s and not far from its record high of 3.5% during March 1992. Of the top four Eurozone economies, rates for Spain (6.6% y/y) and Germany (5.7) were above the headline rate of 5.0%, while rates for Italy (4.2) and France (3.4) were below.

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