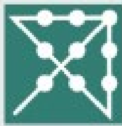
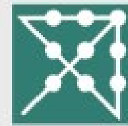


Yardeni Research



MORNING BRIEFING
January 31, 2022

'Humble & Nimble'

Check out the accompanying chart collection.

(1) The case for a neck brace. (2) The S&P 500 may have adjusted for this year's tightening round, but we're pushing 5200 target into early 2023. (3) Record forward earnings and profit margins for all major S&P indexes. (4) The air has come out of several speculative bubbles without serious consequences. (5) Three measures of sentiment. (6) BBR is bearish, which is bullish. (7) VIX in correction territory. (8) Credit yield spread remains calm. (9) Nothing new decided at latest FOMC meeting. (10) March FOMC meeting should be decisive. (11) The Fed's runoff issue. (12) Soft landing ahead? (13) Movie review: "The Power of the Dog" (- -).

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: Get a Neck Brace. Joe and I each purchased a neck brace last week to deal with the volatility in the stock market. You can find a *full selection* of them on Amazon. We are bracing for more volatility during the first half of this year. We now expect that the S&P 500 will continue to trade sideways between 4200 and 4500. It should rise to about 4800 by the end of this year, leaving the index essentially unchanged for the year. We are moving our 5200 target from year-end 2022 to mid-2023.

The main source of the volatility is the Fed, which is flogging the equity markets with the prospect of tighter monetary policy. As Melissa and I discuss below, the Fed is making a tough transition from easy to tight monetary policy more painful and possibly more prolonged than it has to be. We reckon that "the beatings will continue until morale improves," as the saying goes.

Nevertheless, the markets have gotten the message and have already adjusted to the possibility of four to seven whiplashes of 25bps each through the end of this year. Morale is very low, which often augurs for better times, at least on a short-term basis (in between the whiplashes). The first whiplash hasn't even been inflicted yet. Consider the following market adjustments to the anticipated pain:

(1) *Treasury yields.* At 1.15% on Friday, the 2-year US Treasury note yield is anticipating four to five 25bps hikes in the federal funds rate this year (*Fig. 1*). The 10-year minus 2-year Treasury yield-curve spread continues to narrow, suggesting that the Fed won't have to raise rates much to slow the economy and subdue inflation (*Fig. 2*).

(2) *Forward P/Es.* The forward P/Es of the S&P 500 along with both its Growth component and the MegaCap-8 stocks (i.e., the eight highest-capitalization stocks in the S&P 500, which are included in the Growth component) are down sharply since the start of this year (*Fig. 3*). ("Forward P/E" is the multiple based on forward earnings, or the time-weighted average of analysts' consensus estimates for this year and next—which we calculate because they more closely match the earnings prospects that investors make decisions upon than do analysts' annual estimates.)

Joe and I had thought that excess M2 liquidity would keep forward P/Es elevated. They remain relatively high, but much less so than they were last year. The forward P/Es of the S&P 400 (i.e., MidCaps) and S&P 600 (SmallCaps) are also down sharply (*Fig. 4*).

(3) *Forward earnings.* The good news is that the forward earnings of the S&P 500 Growth index has continued to soar to record highs (*Fig. 5*). The forward earnings of S&P 500 Value has been lagging behind that of Growth, but the former also has been climbing to record highs. Just as impressive is that the forward earnings of the S&P 400/600 indexes have been rising even faster than that of the S&P 500 since mid-2020 (*Fig. 6*).

There's more good news about the stock market's fundamentals: Forward profit margins (i.e., derived from analysts' forward earnings and revenue estimates) have remained either at or near recent record highs for the three S&P 500/400/600 indexes, at 13.3%, 8.5%, and 7.2% as of the January 20 week (*Fig. 7*). The same can be said about the forward profit margins of the S&P 500 Growth and Value indexes, at 18.9% and 11.1% during the January 20 week (*Fig. 8*).

(4) *Speculative bubbles.* In our opinion, the Fed has succeeded in taking a great deal of air out of the various speculative bubbles in the financial markets—including ARK Innovation ETFs, meme stocks, SPACs (special-purpose acquisition company stocks), and the MegaCap-8 stocks. That has occurred without any significant consequences for the functioning of the financial markets and without any adverse impact on the economy, which reduce the chances of a recession and a bear market in the S&P 500.

(5) *Technicals.* Over the weekend, I checked in with one of my favorite technicians, Joe

Feshbach. We worked together during the 1980s at Prudential-Bache. He sees an important market top, particularly in the Nasdaq. In that context, he sees volatility continuing with lots of short-term rallies and selloffs. He believes the stock market is no longer driven by momentum. He recommends that investors (not traders) maintain larger cash positions to opportunistically buy stocks on weakness. He sees a short-term rally in bond prices before they head back down. Feshbach observes that the dollar's chart has been bullish for a while and remains on an uptrend.

Strategy II: Assessing Bearishness. Joe (Abbott) and I track a number of sentiment indicators. They include ones that are especially usefully in assessing sentiment in the stock and bond markets and more generally in the economy. Our three favorites are Investors intelligence's Bull/Bear Ratio (BBR), the S&P 500 VIX, and the yield spread between the high-yield corporate bonds composite and the 10-year US Treasury yield. They are highly correlated and collectively are useful for gauging the degrees of bullishness and bearishness in the financial markets and sentiment about prospects for the economy. Consider the following:

(1) *Bull/Bear Ratio.* From a contrarian perspective, Joe and I have found that drops in the BBR to 1.00 and below have been very good stock market buy signals in the past. We thought the ratio might have gotten that low last week following Monday's capitulation selloff to an intraday low of 4229.93 on the S&P 500. It did get close, at 1.31 (*Fig. 9*). The S&P 500 closed at 4431.85, up 0.8% on a one-week basis but still 7.6% below its record high on January 3.

You wouldn't know that last week started out as a risk-off week based on the performance derby of the S&P 500 and its 11 sectors last week, listed here from best to worst: Energy (5.0%), Information Technology (2.3), Financials (1.3), S&P 500 (0.8), Health Care (0.7), Communication Services (0.5), Real Estate (-0.2), Consumer Staples (-0.4), Materials (-0.9), Consumer Discretionary (-1.0), Utilities (-1.4), and Industrials (-1.5). (See last week's *Performance Derby*.)

(2) *VIX.* The S&P 500 VIX is highly correlated with the inverse of the BBR (*Fig. 10*). Both are very volatile. Both are elevated currently, consistent with their patterns during past stock market corrections (*Fig. 11*).

(3) *High-yield credit spread.* Also highly correlated with the S&P 500 VIX is the high-yield corporate credit spread (*Fig. 12* and *Fig. 13*). Both tend to soar during recessions and bear markets. While the VIX is in correction territory, neither are signaling a recession. We tend

to give more weight to the high-yield credit spread when assessing the prospects for a recession and a bear market (*Fig. 14*). This spread remains remarkably subdued. So it isn't signaling either an imminent credit crunch or recession.

The Fed I: Powell's Indecisive Pivot. If I, Dr. Ed, were head of the Fed, I would push the FOMC to raise the federal funds rate by 100 bps to 1.00% at the March 15-16 meeting of the Fed's policy-setting committee meeting. I would explain that the financial markets already have discounted such a hike, as evidenced by the rise in the 2-year US Treasury yield from less than 0.25% during the first half of last year to 1.15% on Friday. I would announce that that will be all the tightening to be expected for the next six months—so no more rate hikes or any runoff of the balance sheet either. Maturing securities will be replaced with new ones.

Of course, Fed Chair Jerome Powell is more cautious than that and makes more incremental moves. He has to be, since he must deal with his reality rather than my fantasy. In his *press conference* on Wednesday, January 26, he said that the FOMC will be "humble and nimble." He came across as remarkably indecisive. In fact, it's not at all clear what the committee did during its two-day meeting. Consider the following:

(1) *Reiterating December decision to end QE4.* The word "decision" appeared 17 times in the transcript of Powell's presser. Almost all mentions were in the context of "the committee has not made decisions." Powell indicated that the ONLY decision made at the January 25-26 meeting of the FOMC was to reiterate the decision made at its December meeting to stop buying bonds by March: "The Committee … agreed to continue reducing its net asset purchases on the schedule we announced in December, bringing them to an end in early March."

(2) *No decision on first rate hike or path of hikes.* But surely, the FOMC made a decision to start raising the federal funds rate in March too? Nope: "We haven't made a decision yet, and we'll make that decision at the March meeting." Powell acknowledged that "the Committee is of a mind to raise the federal funds rate at the March meeting, assuming that conditions are appropriate for doing so." No decisions were made on the size of rate increases or the precise path of those increases.

(3) *No decision on balance sheet runoff.* What about the runoff of the Fed's balance sheet? Powell said, "Surveys show that market participants are expecting a balance sheet runoff to begin, you know, at the appropriate time sometime later this year perhaps. We haven't made that decision yet."

(4) *So what's all the commotion about?* The financial markets concluded that Powell's indecisiveness won't last long, since he characterized the labor market as "very, very strong right now" and said that the "strength will continue." Indeed, the words "strong" and "strength" appeared 26 times in the transcript to describe the performance of the economy. The word "inflation" appeared 71 times, mostly in the context that it is too high. It was described as "persistent" eight times—e.g., "Right now we have inflation running substantially above 2 percent and … more persistently than we would like." The word "transitory"—used frequently to describe inflation in Powell's 2021 pressers—was notably absent.

(5) *Bottom line.* Notwithstanding Powell's ambiguity, the financial markets concluded that his presser was more hawkish than expected. Fed watchers have raised their forecasts for the number of rate hikes this year: Last summer, most expected one or two hikes during H2-2022; now five is the consensus, starting in March. A few outliers now expect a 25bps hike at each of the seven remaining FOMC meetings this year.

Those forecasts may be too aggressive, especially if the Fed also commences to reduce its balance sheet. Melissa and I are sticking with four 25bps rate hikes this year.

The Fed II: The Runoff. Since the December 14-15 minutes of the FOMC minutes was released on January 5, we've often observed that investors were spooked that the FOMC discussed shrinking the Fed's balance sheet as securities matured and starting to do so sooner rather than later. "Almost 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. However, participants judged that the appropriate timing of balance sheet runoff would likely be closer to that of policy rate liftoff than in the Committee's previous experience."

Running the balance sheet down so quickly along with raising the federal funds rate and halting bond purchases might constitute too extreme a U-turn from easy to tight monetary policy. It's jarring to think that within the next couple of months the Fed will no longer be purchasing $80 billion in Treasury bonds and $40 billion in mortgage-backed securities (MBSs) and might also be letting its $1.4 trillion portfolio of Treasuries under one-year maturities run off at an average monthly rate of $95 billion (*Fig. 15*).

Will the FOMC decide to phase in the runoff so that the Treasury doesn't suddenly have to raise an extra $175 billion per month in the market? As noted above, no decisions have been made on this, adding to the uncertainty that has been unnerving stock investors.

Why don't bond investors seem as perturbed? The 10-year US Treasury yield remains below 2.00% notwithstanding the prospect of persistent inflation, tighter-than-expected monetary policy, and an increased supply of bonds (*Fig. 16*). The answer may be that the Fed continues to buy Treasuries and MBSs for now. From the final week of last year through the January 26 week, the Fed's holdings of Treasuries and MBSs have increased $55 billion and $49 billion (*Fig. 17*).

We still expect to see the 10-year Treasury bond yield rise to 2.00% by mid-year and 2.50% by the end of this year. It should move higher toward those levels once Powell and the FOMC start making some real decisions.

US Economy: Soft Landing? Real GDP rose 6.9% (saar) during Q4-2021. The GDP deflator rose 5.8% y/y during the quarter. That combination can be described as an "inflationary boom." For the current quarter, Debbie and I expect real GDP growth to slow to 2.5% while inflation remains hot, a scenario that can be best described as "stagflation."

So which will it be for 2022—a continued inflationary boom or stagflation? How about a soft landing with real GDP growing 2.5%-3.0% and inflation cooling off to 3.0% by the end of this year? That's our forecast. Consider the following recent developments:

(1) *Consumers.* Inflation is eroding both personal income and consumer spending (*Fig. 18* and *Fig. 19*). In addition, consumers satisfied lots of their pent-up demand over the past two years, especially for goods, with the assistance of three rounds of government relief checks. On the other hand, they probably have lots of pent-up demand for autos as well as services.

(2) *Inventories.* The slowdown in consumer spending late last year seems to have given businesses, especially wholesalers and retailers (including auto dealers), an opportunity to rebuild their depleted inventories during Q4-2021 (*Fig. 20*). Inventory rebuilding should continue to be a source of strength during Q1-2022.

(3) *Capital spending.* Chronic labor shortages are fueling a capital-spending boom. We can see that in the latest record high during December for nondefense capital goods orders and shipments excluding aircraft (*Fig. 21*).

(4) *Inflation.* December's PCED was released on Friday (*Fig. 22*). It shows that the headline and core inflation rates on a y/y basis rose 5.8% and 4.9%. Leading the way higher last year were goods prices, especially durable goods, which rose 10.5%, led by used and new car prices (up 61.0% and 12.0%). Our relatively optimistic outlook for inflation is predicated

in large measure on our expectation that durable goods price increases will start moderating soon.

Movie. "The Power of the Dog" (- -) (*link*) is a Western that takes place in Montana but looks like it was filmed in New Zealand, because that's where it actually was filmed. The film has been widely acclaimed but seemed a bit off, not only geographically. I found it to be slow and self-absorbed, almost on purpose so that the ending would make it all worthwhile. There are some interesting character developments, but they were probably more interesting in the 1967 novel from which the film was adapted.

Calendars

US: Mon: Dallas Fed Manufacturing Index; Chicago PMI 61.7; Loan Officer Survey; George. **Tues:** ISM M-PMI & Price Index 57.5/79.5; IHS Markit M-PMI 55.0; Job Openings 11.075m; Construction Spending 0.6%; API Weekly Crude Oil Inventories. (Bloomberg estimates)

Global: Mon: Eurozone GDP 0.3%q/q/4.7%y/y; Germany CPI -0.3%m/m/4.3%y/y; Italy GDP 0.5%q/q/6.2%y/y; Spain CPI 1.3%m/m/6.7%y/y; Japan Household Confidence 36.9; Japan Unemployment Rate 2.8%; Japan M-PMI 54.6; Australia Retail Sales 3.9%; RBA Interest Rate Decision 0.10%. **Tues:** Eurozone, Germany, France, Italy, and Spain M-PMIs 59.0/60.5/55.5/61.5/56.0; Eurozone Unemployment Rate 7.1%; Germany Retail Sales -1.2%m/m/-0.6%y/y; Germany Unemployment Change & Unemployment Rate -8k/5.2%; France CPI; UK M-PMI 56.9; UK Nationwide HPI 0.6%m/m/10.8%y/y; Canada GDP 0.4%m/m; ECB Bank Lending Survey; Buch, Lowe. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index rose 0.7% last week to 8.2% below its record high on December 27. The index ranked fourth of the 49 global stock markets we follow in a week when seven of the 49 countries rose in US dollar terms and the AC World ex-US index dropped 3.7%. None of the countries traded at a record high in dollar terms during the week. EM Latin America was the best-performing region last week, with a gain of 0.2%, followed by EM Eastern Europe (-0.6%), EMEA (-0.6), and EAFE (-3.6). BRIC

(-5.5) was the biggest underperformer, followed by EM Asia (-5.1) and EMU (-3.8). Argentina was the best-performing country last week, rising 10.3%, followed by Brazil (3.0), Russia (0.9), the US (0.7), and Hungary (0.5). Among the 17 countries that underperformed the AC World ex-US MSCI last week, New Zealand fared the worst, with a decline of 7.9%, followed by China (-7.8), the Netherlands (-7.6), Poland (-6.5), and Korea (-5.6). The US MSCI ranks 38/49 so far in 2022, with its 7.7% decline behind the 4.9% drop for the AC World ex-US. EM Latin America is the best-performing region, with a gain of 5.2%, ahead of EMEA (0.3), BRIC (-4.0), and EM Asia (-4.8). The laggards: EM Eastern Europe (-8.9), EMU (-6.2), and EAFE (-5.8). The best country performers so far in 2022: Brazil (11.0), Chile (9.4), Peru (9.3), Colombia (9.1), and Hungary (6.4). The worst-performing countries: New Zealand (-15.0), the Netherlands (-14.4), Denmark (-14.0), Sweden (-12.3), and Russia (-11.0).

S&P 1500/500/400/600 Performance (*link*): Two of these three indexes fell last week. LargeCap was the sole gainer with an increase of 0.8%, ahead of the declines for MidCap (-0.6%) and SmallCap (-0.8). LargeCap is now 7.6% below its record high on January 3. MidCap ended the week 11.4% below its record high on November 16, and SmallCap weakened to 13.2% below its November 8 record high. Twelve of the 33 sectors rose last week, up from none rising a week earlier. SmallCap Energy was the best performer for the week with a gain of 6.2%, followed by LargeCap Energy (5.0%), LargeCap Tech (2.3), MidCap Energy (1.8), LargeCap Financials (1.3), and SmallCap Consumer Discretionary (1.3). SmallCap Industrials was the biggest underperformer last week, with a decline of 2.5%, followed by SmallCap Tech (-2.3), MidCap Industrials (-2.2), MidCap Communication Services (-2.2), and MidCap Consumer Staples (-2.2). In terms of 2022's ytd performance, all three indexes are lower so far; LargeCap's 7.0% decline is less than those of SmallCap (-9.3) and MidCap (-9.3). Just three of the 33 sectors are positive so far in 2022. Energy dominates the top performers: LargeCap Energy (18.4), SmallCap Energy (10.1), MidCap Energy (6.9), LargeCap Financials (-1.0), and MidCap Financials (-1.8). The biggest ytd laggards: MidCap Health Care (-15.1), SmallCap Health Care (-14.8), SmallCap Tech (-13.9), LargeCap Consumer Discretionary (-13.0), and MidCap Tech (-12.7).

S&P 500 Sectors and Industries Performance (*link*): Five of the 11 S&P 500 sectors rose last week, but only three outperformed the composite index's 0.8% gain. That compares to a 5.7% decline for the S&P 500 a week earlier, when all sectors fell and seven outperformed the index. Energy was the best performer with a gain of 5.0%, ahead of Tech (2.3%) and Financials (1.3). The worst performers: Industrials (-1.5), Utilities (-1.4), Consumer Discretionary (-1.0), Materials (-0.9), Consumer Staples (-0.4), Real Estate (-0.2), Communication Services (0.5), and Health Care (0.7). The S&P 500 is down 7.0% so

far in 2022, with one sector in positive territory and five ahead of the index. The best performers in 2022 to date: Energy (18.4), Financials (-1.0), Consumer Staples (-2.0), Utilities (-5.1), and Industrials (-5.8). The ytd laggards: Consumer Discretionary (-13.0), Real Estate (-9.7), Tech (-9.4), Communication Services (-8.6), Materials (-8.2), and Health Care (-7.5).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 0.8% last week, and improved slightly 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 fourth week and was below its 200-dma for a second week after being above for 81 straight weeks. The S&P 500's 50-dma moved lower for a third week, as the index improved to 4.4% below its falling 50-dma from a 21-month low of 5.8% below 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 was below its 200-dma for a second week, but improved to 0.3% below its rising 200-dma from a 20-month low of 1.0% below 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*): Just two of the 11 S&P 500 sectors traded above their 50-dmas last week, down from three a week earlier as Utilities fell below. The two sectors still above their 50-dmas are Consumer Staples and Energy. That compares to just two sectors above in early October. The same two sectors and Energy still have rising 50-dmas, unchanged from a week earlier. Looking at the more stable longer-term 200-dmas, seven of the 11 sectors were above that measure, up from five a week earlier as Health Care and Tech moved back above in the latest week. The other five sectors 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.

US Economic Indicators

GDP (*link*): Real GDP expanded a larger-than-expected 6.9% (saar) during the final quarter of 2021—triple Q3's 2.3% and more than a percentage point above the 5.5% expected gain. It was the fastest quarterly growth since the 33.8% Q3-2020 rebound from the Covid-related recession—boosting GDP growth for all of 2021 by 5.7%—which was the fastest since 1984! (The surge in inflation last year boosted the growth rate in nominal GDP to a double-digit 10.0% for full-year 2021.) Real inventory investment accounted for just over 70% of the gain in real GDP last quarter, posting its first accumulation in a year—with a wide $240.3 billion swing to +$173.5 billion during Q4 from -$66.8 billion during Q3—suggesting an easing of supply-chain disruptions. According to the BEA, the increase in Q4 inventories was led by retail inventories—mostly motor vehicles & parts dealers, as well as wholesale durable goods inventories. Real consumer spending was solid, accelerating 3.3% (saar) during Q4 following Q3's 2.0% gain. The acceleration was nearly entirely driven by services consumption (4.7%, saar), while goods consumption (0.5) edged just slightly higher—all durable goods. Real nonresidential investment expanded 2.0% during Q4, led by intellectual property products (10.6), with equipment (0.8) spending a distant second—more than offsetting the double-digit decline in structures (-11.4). Trade was neutral in Q4's real GDP report, as both real exports (24.5) and imports (17.7) posted double-digit growth during the quarter. Real residential investment (-0.8) contracted for the third quarter, though the decline has narrowed steadily from Q2's 11.7% drop. Meanwhile, government outlays contracted 2.9% (saar) last quarter as a decrease in defense spending pushed federal government (-4.0) outlays lower, while the decline in state & local governments (-2.2) spending was mostly education driven.

Contributions to GDP Growth (*link*): Real Inventory investment was the biggest positive contributor to real GDP growth during Q4, followed by consumer spending, with real residential investment and real government spending negative contributors. Here's a look at the contributions from highest to lowest: 1) Inventory investment (+4.90ppts) contributed positively to real GDP growth for the second quarter—after subtracting from growth during H1-2021—all nonfarm (+4.90). 2) Real consumer spending added 2.25ppts to Q4 GDP growth, up from the Q3 amount but below the major contributions of 7.92ppts and 7.44pts made during Q2 and Q1, respectively. Services consumption (+2.12ppts) contributed positively to Q4 growth, while goods consumption (+0.13) had little impact—with durable goods consumption (+0.14) accounting for the slight uptick. 3) Real nonresidential investment added 0.28ppt to Q4 real GDP, as a positive contribution from intellectual property products (+0.53ppt) more than offset a negative contribution from structures (-0.30); equipment (+0.05) investment was just a minor contributor. 4) Real net exports (0.00)

had no impact on economic growth last quarter, with exports (+2.43) adding and imports (-2.43) subtracting by identical percentage points. 5) Real residential investment (-0.0.3ppt) subtracted from GDP growth for the third quarter, but barely. It had contributed positively from Q3-2020 through Q1-2021. 6) Government (-0.51) spending was a negative contributor to Q4 growth, with federal (-0.27) and state & local (-0.24ppt) spending both a drag on growth last quarter.

Personal Income & Consumption (*link*): Personal income continued to climb heading into 2022, though consumer spending lost speed, reflecting supply-chain disruptions and Covid-19 infections; inflation continued to surge. Personal income advanced a smaller-than-expected 0.3% in December, slowing from gains of 0.5% and 0.6% the prior two months. Wages & salaries continued to reach new record highs, increasing for 19th month since bottoming in April 2020; it was up 0.7% m/m in December and 23.4% over the period since the bottom. Meanwhile, personal consumption expenditures took a step back, falling 0.6% in December—its first decline in 10 months, as a 2.6% slump in goods consumption more than offset a 0.5% increase in services. Within goods, both durable (-4.1%) and nondurable (-1.7) goods consumption fell during the month. Personal saving rose by $133.4 billion to $1.44 trillion in December, with the saving rate climbing to 7.9% from a recent low of 7.1% in October. The personal consumption deflator continued to climb, rising 0.4% in December. Real consumer spending contracted 1.0% in December, following a 0.2% downtick in November—the first back-to-back declines since the final two months of 2020—on widespread weakness. Real spending on consumer durable and nondurable goods sank 4.9% and 2.1%, respectively, while real services consumption (0.1) barely budged.

Consumer Sentiment Index (*link*): The Consumer Sentiment Index (CSI) deteriorated further during the second half of January, falling from both the December and the early January levels. The CSI dipped to 67.2 at the start of 2022 from 70.6 in December and 68.8 in early January—to its lowest level in just over a decade—averaging just 70.0 the past six months. The CSI averaged 82.9 during H1-2021. Both the present situation (to 72.0 from 74.2) and expectations (64.1 from 68.2) components moved lower—the former to the lowest since August 2011 and the latter falling back toward November's 63.5, which was the lowest since October 2013. (They were at 73.2 and 65.9, respectively, in early January). The report notes, "The current slump was due to two sharp declines separated by a brief interlude of rising optimism." The Delta and Omicron variants were major factors behind the recent decline, though consumers numbered rising inflation and falling incomes among their top concerns—with confidence in government policies the lowest since October 2014. The report warns that consumers may "misinterpret the Fed's policy moves to slow the economy as part of the problem rather than part of the solution. The danger is that consumers may

overreact to these tiny nudges, especially given the uncertainties about the coronavirus and other heightened geopolitical risks."

Durable Goods Orders (*link*): Both core capital goods orders and shipments continued to set new record highs yet again in December. Nondefense capital goods orders ex aircraft (a proxy for future business investment) has increased every month but one since bottoming last April, though December's (+0.04%) move up was barely noticeable; these orders have soared 32.1% since bottoming during April 2020. Core capital goods shipments (used in calculating GDP) has also climbed every month but one since last April's bottom, jumping 1.3% in December and 30.2% over the period. Orders for total durable goods dipped 0.9% in December, after climbing six of the prior seven months by 9.1%, reflecting a drop in orders for commercial aircraft and communications equipment. Excluding transportation, durable goods orders has increased in 19 of the past 20 months, up 0.4% in December and 36.0% over the period to a new record high. Orders for electrical equipment, machinery, fabricated metals, and primary metals all remain on steep accelerating trends, while orders of motor vehicles & parts and nondefense aircraft & parts have been in volatile flat trends recently.

Regional M-PMIs (*link*): Four Fed districts (New York, Philadelphia, Richmond, and Kansas City) now have reported on manufacturing activity for January and show the manufacturing sector slowed for the second month, rising at half November's pace, as activity in the New York region stalled after 18 months of positive readings. The composite index eased to 13.6 from 21.3 in December and 25.7 in November. Manufacturing activity in the New York (to -0.7 from 31.9) region was slightly negative, while growth in the Richmond (8.0 from 16.0) area was cut in half. In the meantime, growth in the Philadelphia (23.2 from 15.4) region picked up steam in January after being more than halved in December, while Kansas City's (24.0 from 22.0) held around December's pace. The new orders (8.2 from 20.0) measure was also impacted by negative growth in the New York (-5.0 from 27.1) region, along with slower growth in both the Richmond (6.0 from 17.0) and Kansas City (14.0 from 22.0) regions this month; 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. Meanwhile, jobs growth slowed again in January, to 17.6 from 23.1 and 25.8 the previous two months. Growth accelerated in the Richmond (24.0 from 18.0) region and slowed in the remaining three—Philly (26.1 from 33.9), New York (16.1 from 21.4), and Richmond (4.0 from 19.0)—though Philly's held near December's record high.

Regional Prices Paid & Received Measures (*link*): We have prices-paid and -received data for January from the Philadelphia, New York, Kansas City, and Richmond regions, and

it's a mixed bag. (Note: The Philadelphia, New York, and Kansas City measures are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures.) The prices-paid measure for Richmond (to 143.2 from 139.8) reached another new record high this month, while Philadelphia's gauge accelerated to 72.5 in January after slowing from 80.0 to 66.1 in December. Meanwhile, New York's measure eased for the second month, from 83.0 in November to 76.7 this month, while Kansas City's (64.0 from 67.0) eased to a 12-month low; they were both at record highs of 83.5 and 88.0, respectively, last May. Richmond's prices-received (112.7 from 82.6) gauge also jumped to a new record this month, while Kansas City's (49.0 to 46.0) accelerated a bit but remained below May's record high 57.0. Meanwhile, 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.

Pending Home Sales (*link*): "Pending home sales faded toward the end of 2021, as a diminished housing supply offered consumers very few options," said Lawrence Yun, NAR's chief economist. "Mortgage rates have climbed steadily the last several weeks, which unfortunately will ultimately push aside marginal buyers." The Pending Home Sales Index (which tracks sales when a contract is signed but the transaction has not yet closed) contracted for the second month in December by 3.8% m/m and 6.0% over the period to 117.7, after rebounding 7.5% in October; these sales were 6.9% below last December's level. In every region, sales declined in December on both m/m and y/y bases. Here's a regional look at pending home sales in December: West (-10.0% m/m & -16.2% y/y), Midwest (-3.7 & -1.2), South (-1.8 & -3.9), and Northeast (-1.2 & -10.5). Yun notes that even with December's slowdown in transactions, 2021 was an overall great year for housing in terms of sales and price appreciation. Home construction climbed the final three months of last year, leading Yun to forecast that home inventory will continue to improve, contributing to slower home price gains in 2022; he expects housing starts to rise to 1.65mu this year and home prices to increase 5.1%.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Index (ESI) for both the EU (-1.4 points to 111.6) and Eurozone (-1.1 points to 112.7) moved lower again in January, down 5.0 points and 4.9 points, respectively, from their July highs of 116.6 and 117.6.0. Among the largest EU countries, January's performance was mostly lower with

ESIs in Italy (-6.1 points to 110.6), Poland (-4.2 to 102.0), France (-2.8 to 110.9), and the Netherlands (-1.3 to 104.5) falling, while ESIs for Germany (+0.8 to 112.3) and Spain (+0.6 to 108.9) eked out small gains. For the overall Eurozone at the sector level, retail trade confidence improved in January for the third time in four months, to 3.8, back near its recent peak of 4.7 in June. Meanwhile, construction confidence contracted for the first time in six months, slipping to 8.1 in January—after rising steadily from 4.0 in July to a record-high 10.1 by December. Service confidence dropped for the second month from 18.2 in November to a nine-month low of 9.1 in January, while consumer confidence fell for the fourth month to -8.5 in January from -4.0 in September—though January's barely budged from December's -8.4.

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