# First Quarter 2022 Market Outlook

**Our Outlook**

| | 2020 | 2021 Est | 2022 Est | 2023 Est | 2024 Est |
|---|---|---|---|---|---|
| GDP Growth [1] | -2.3% | 5.4% | 2.8% | 1.7% | 1.8% |
| Change in Consumer Prices [2] | 1.3% | 7.3% | 5.8% | 3.3% | 2.3% |
| Fed Funds Target Rate [3] | 0.25% | 0.25% | 1.00% | 2.00% | 2.25% |
| 5-Year Treasury Yield [3] | 0.36% | 1.26% | 1.70% | 2.40% | 2.75% |
| 10-Year Treasury Yield [3] | 0.92% | 1.51% | 2.75% | 3.20% | 3.25% |
| S&P 500 EPS | $138 | $209 | $220 | $232 | $246 |

**Last Month's Rates and Returns**

| December 31, 2021 | Value | One Month Change | YTD | 1 Year Change |
|---|---|---|---|---|
| Fed Funds Target (Upper) | 0.25% | -- | -- | -- |
| 2-Year Treasury Yield | 0.73% | +21 bp | +61 bp | +61 bp |
| 5-Year Treasury Yield | 1.26% | +11 bp | +90 bp | +90 bp |
| 10-Year Treasury Yield | 1.51% | +7 bp | +59 bp | +59 bp |
| SNL 30Yr Fixed – U.S. Avg. | 3.16% | +3 bp | +15 bp | +15 bp |
| S&P 500 Index* | 4,766 | 4.48% | 28.71% | 28.71% |
| S&P Midcap 400* | 2,842 | 5.08% | 24.76% | 24.76% |
| S&P Small Cap 600* | 1,402 | 4.53% | 26.82% | 26.82% |
| S&P SuperComposite 1500* | 1,086 | 4.52% | 28.45% | 48.45% |
| S&P 500 Growth* | 3,377 | 2.48% | 32.01% | 32.01% |
| S&P 500 Value* | 1,548 | 7.08% | 24.90% | 24.90% |
| World ex US, net ** | 299 | 4.13% | 7.82% | 7.82% |
| Liquid Alternatives *** | 184 | 0.71% | 4.68% | 4.68% |
| BB U.S. Aggregate * | 105 | -0.26% | -1.54% | -1.54% |
| Crude Oil – WTI Near Term | $75 | 13.64% | 55.01% | 55.01% |
| Bitcoin **** | 47,950 | -16.77% | 66.33% | 66.33% |
| Gold – Near Term | $1,828 | 3.04% | -3.47% | -3.47% |

** = Total return **= MSCI ACWI ex US *** = Wilshire Liquid Alternative Index **** = FT Wilshire Bitcoin Blended Price*

Security National Bank's Wealth Management Department authors a monthly economic forecast that provides our Investment Committee and the bank's Funds Management Committee background assumptions for use in investment decisions. We are pleased to share our economic outlook with you. Please be advised our crystal ball is just as clouded as other prognosticators and that all forecasters have poor track records. Throughout this report, we will use the abbreviations: FRB for the Federal Reserve Bank and

Prepared by Damian Howard January 10, 2022

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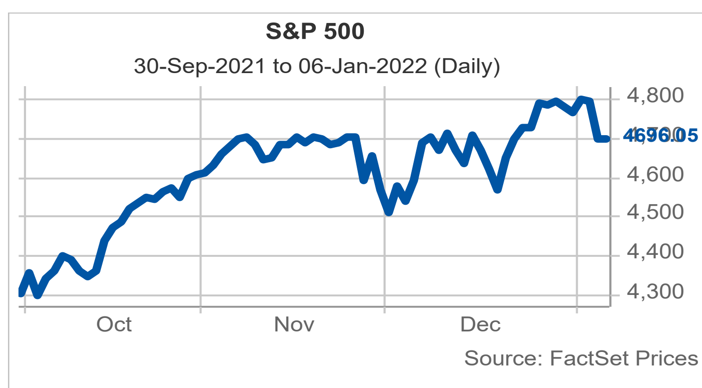
FOMC for the Federal Open Market Committee. The FOMC is part of the FRB that meets eight times per year to set monetary policy.

We will use the terms nominal and real. Nominal values are measured in terms of money. Things that are counted in the real world, including retail sales, personal income and expenditures, are usually reported in nominal dollars. Corporate earnings and sales are reported in nominal dollars. Real values are adjusted for inflation, nominal values less inflation. Real values enable comparisons that are not distorted by inflation. GDP numbers are usually reported as real growth.

We would like to point out our projections are based on what we think monetary and fiscal policymakers will do, not what they should do.

**Santa Claus Rally**

After a brief Omicron variant scare, the stock market managed to post an impressive rally into the end of the year.




For the entire month, quarter, and year, the S&P 1500 index was up 4.52%, 10.71%, and 28.45%.

Value stocks outperformed growth stocks by 4.56% during December but lagged by 7.11% for all of 2021. Small Cap stocks bested their larger brethren by 0.05% for the month but trailed by 1.89% for the full year.

For December, consumer staples were the best performing sector, while consumer discretionary stocks trailed the most. For the full year, energy stocks led the way with a 54.64% return, while utilities trailed the pack with a 17.67% return.

As shown in the table below, U.S. stocks have posted fantastic returns over a very long time. With the power of compounding, a 9.68% annualized return over twenty years is equal to a 535% total return. $10,000 invested in the S&P 1500 index twenty years ago would be worth $63,467. U.S. stocks have generated significant wealth for those who have been fully invested.

| S&P 1500 Annualized Total Return | | | | | | |
|---|---|---|---|---|---|---|
| One Year | Three Years | Five Years | Seven Years | Ten Years | Fifteen Years | Twenty Years |
| 28.45% | 25.63% | 17.95% | 14.66% | 16.35% | 10.66% | 9.68% |

When doing your financial planning, please do not assume the next ten years are going to be as profitable as the last ten years. Returns for the last three years are substantially higher than the longer-term average. Returns tend to revert to the mean. This means future returns may be significantly lower than the recent past.



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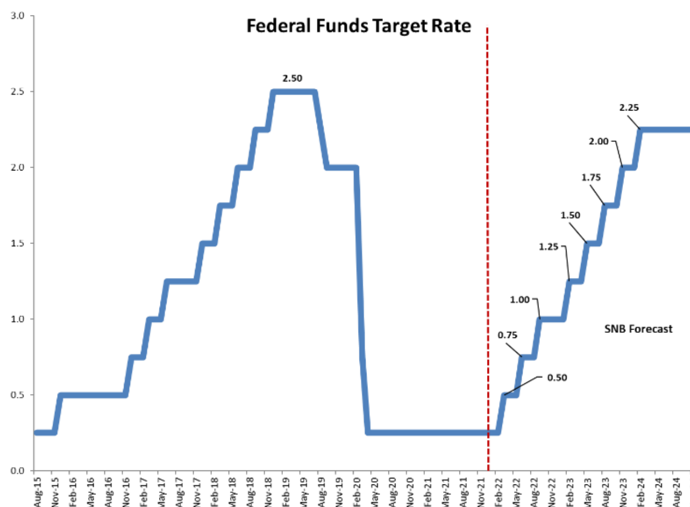
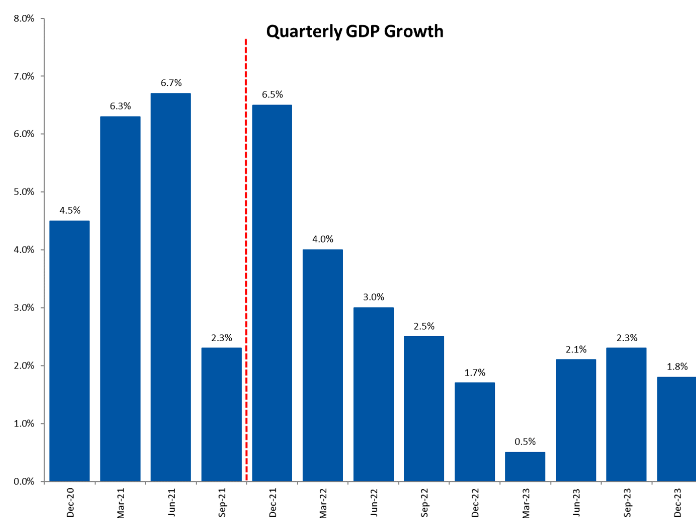
### Latest Estimates of Rate Hikes

With inflation far above the FRB's target and labor markets substantially healed and close to maximum employment, we expect the FOMC to begin raising interest rates at its March meeting. The futures market puts the odds of a rate hike on March 16th at 65.2%. The FRB is likely to raise rates two other times in 2022, in June and September.

We expect inflation to remain above target levels throughout 2022. This should keep the FRB on a quarterly rate hike schedule. We have penciled in a pause during their December 2022 meeting. At that time, we suspect the FRB will start shrinking their bloated balance sheet. They are likely to restart their rate hikes in February 2023. Rate hikes will continue until the Fed Funds Rate reaches 2.25% in early 2024, two years from now. The neutral Fed Funds Rate is probably between 2.0% and 2.5%. At that level, monetary policy is neither accommodative nor restrictive.

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We acknowledge our forecast has changed dramatically and will likely change significantly in the next couple of months. It is only one likely scenario. The most recent Omicron variant may prove to be more economically disruptive than currently thought. Supply chain issues may improve faster than expected or may further worsen. Inflation expectations may slip their tenuous mooring. We have incorporated a relatively swift response by the FRB in our most recent forecast. It is however measured and stops at what we believe the neutral rate is. If inflation persists longer than anticipated, then the FRB will need to increase rates faster and higher than envisioned. The result would be



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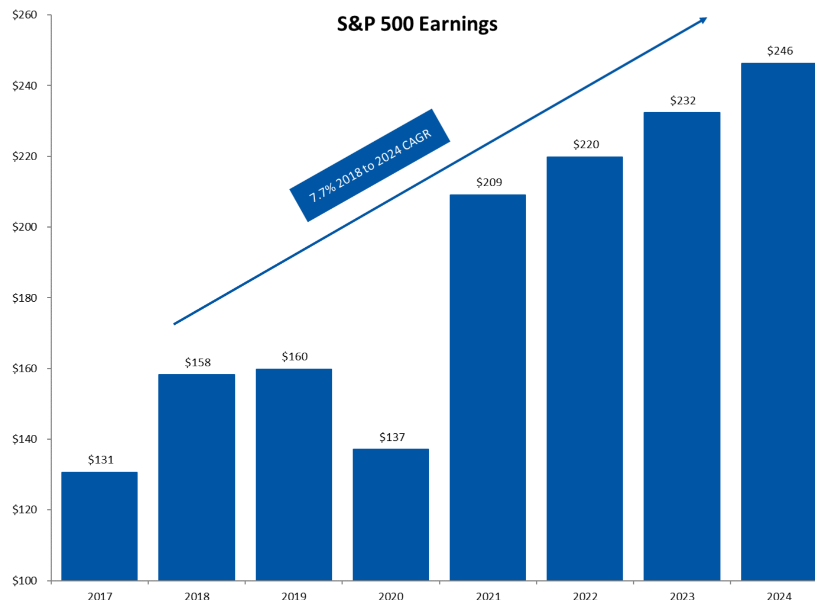
a recession in 2024, accompanied by a bear market starting in the summer of 2023. This is our bear case scenario.

**Earnings Season**

Public companies will start reporting earnings shortly. Consensus fourth quarter earnings for the S&P 500 are expected to be $52.41, up 26.2% y/y. Revenue per share is expected to be $411.18, up 13% y/y. We are a bit more optimistic with earnings of $52.93 and revenue per share of $441. Net margins will fall from 12.9% in 3Q to 12.0% due to wage and material pressures.

For 2022, we expect S&P500 earnings to grow by only 5.1% to $220, versus a consensus of $226.04, as wage growth and material costs squeeze margins. We expect full-year profit margins to fall from 12.7% to 11.9%, while down, this is still above pre-pandemic levels.




We expect more modest earnings beats this quarter. Analysts have likely caught their models up to reality, and fewer massively positive surprises usually result in more limited stock price gains. The key theme for this quarter will be supply chain issues, input cost inflation, and the ability to pass the higher cost along to customers.

We expect portfolio returns to be more modest this year. Over the last three years, our 60/40 portfolio index had a total return of 11%. U.S. stock prices face the headwinds of slowing earnings growth, high valuations (P/Es), and rising interest rates. We expect total U.S. stock returns to be in the low single digits. We expect returns for fixed income investments to be negative low single digits as rising interest rates more than offset the meager coupon fixed income offers. If our expectations play out, a 60/40 portfolio should be barely positive. We will strive to do significantly better. We caution our investors when doing your financial planning, please do not assume the next ten years are going to be as profitable as the last ten years.

Security National Bank's Wealth Management and Private Banking staff have joined to form the Security National Bank Private Client Services division. Combining this team allows us to deliver an integrated approach to building your wealth and enhance your overall banking experience. You may notice our job titles have changed to reflect the combination.

Finally, we are pleased to announce that Angelica Mora has joined our team as Wealth Management Administrative Assistant! Angelica's email is amora@snbomaha.com and her direct dial is 402.449.0964. You will likely see emails from her. If you cannot reach us, please feel free to contact Angelica.



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Please see the obligatory disclosures at the bottom of each page and the end of this report.



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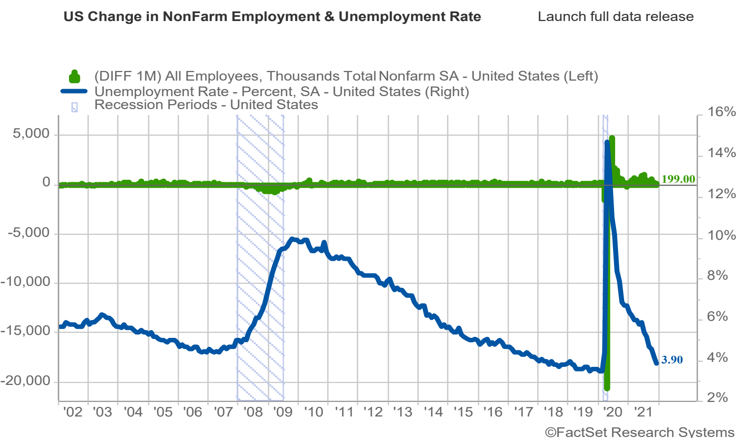
Since 1977, the Federal Reserve has operated under a mandate from Congress to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" – what is now commonly referred to as the Fed's "dual mandate." For this reason, we always start our economic review with employment followed by inflation. We then review other factors that drive our economic outlook.

**Employment**

For the second month in a row, the jobs report disappointed. The U.S. Bureau of Labor Statistics (BLS) reported that the economy added 199,000 jobs in December versus the consensus estimate of 400,000 new jobs added. The total non-farm payroll for October was revised up by 102,000 and the change for November was revised up by 39,000 for a combined upward revision of 141,000.




The unemployment rate fell to 3.9%, and the number of unemployed persons decreased by 483,000 to 6.3 million. Prior to the pandemic, the unemployment rate was 3.5%, and unemployed persons numbered 5.7 million. By these measures, the labor market has substantially healed.

The participation rate held while the employment-to-population ratio rose.

The private sector added 211,000 jobs. Notable job gains occurred in durable goods construction (up 22,000), manufacturing (up 20,000), professional and technical services (up 37,000), and leisure and hospitality (up 53,000).

Employment in state and local government, excluding education, declined by 13,000. Nursing care facilities lost 5,200 employees, and hospitals lost 5,100 employees. These three sectors were the first to institute vaccine mandates and are having difficulty attracting talent in a red-hot labor market.

The BLS reports statistics from two monthly surveys. The household survey measures labor force status, including unemployment, by demographic characteristics. The establishment survey measures non-farm employment, hours, and earnings by industry. There can be some differences in the numbers. The household survey puts the change in employment at a gain of 651,000 jobs while the establishment puts the change in employment at 199,000. The household survey put the cumulative job losses since February 2020 at 2.9 million or 1.8% of then-existing jobs. The establishment survey puts the cumulative losses at 3.6 million.

The unemployment rate decreased 0.3% to 3.9%. The large drop in unemployment versus a disappointing number of jobs added stems the unemployment rate derived from the household survey showing a gain of 651 million jobs. The number of officially unemployed persons fell by 483,000 to 6.3 million. The broader U-6 unemployment rate fell to 7.3% from 7.7% the previous month.

The participation rate held steady at 61.9%. The participation rate was 62.7% in February 2020. The employment-to-population ratio rose by 0.2% to 59.5%. This number was 61.1% in February 2020. If the employment-to-population ratio were to return to the February 2020 level, the number of employed persons would increase to 160.4 million, and an additional 4.4 million jobs would be added for an increase of 2.9%.



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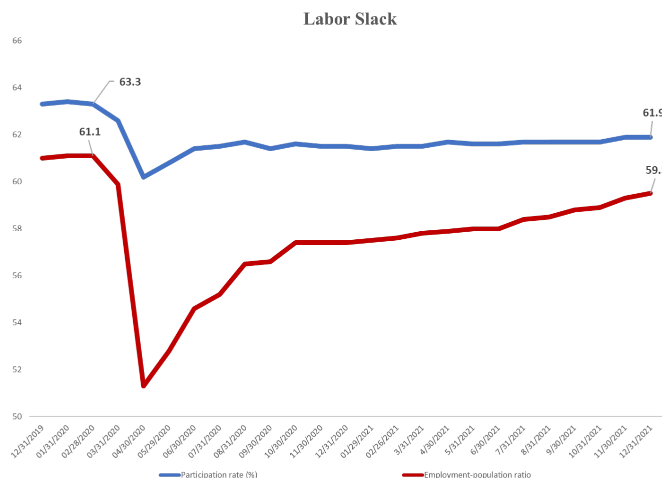
In December, 3.1 million persons reported that they had been unable to work at all or worked fewer hours at some point during the month because their employer closed or lost business due to the pandemic. This measure is down from the 3.6 million reported last month. 15.9% of those individuals received at least some pay from their employers for hours not worked.

Last month's average hourly earnings (wages) grew by $0.19 per hour to $31.31. Since pre-pandemic February 2020, wages have increased $2.80 per hour, or 9.8%. The average workweek held steady at 34.7 hours. Average weekly earnings are up $6.60 or 0.61% from the previous month, 4.7% y/y, and 10.8% from February 2020. Average weekly earnings were $1,086 ($56,496 annualized) versus $1,038 ($53,970 annualized) last year and $981 ($50,998 annualized) in February 2020.

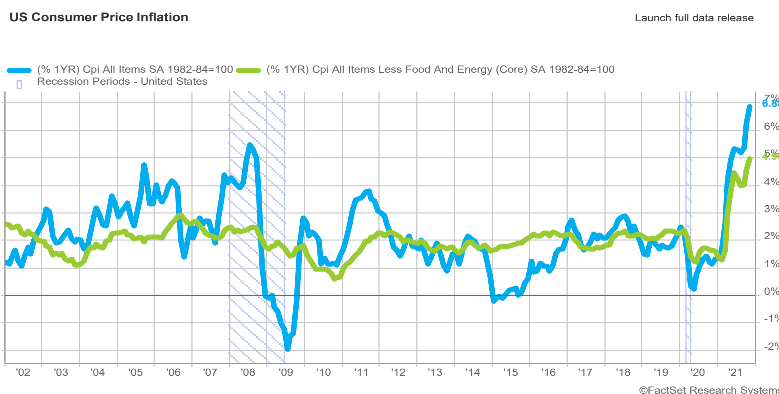
The economy remains only 3 to 5 million jobs below its pre-pandemic level. Based on average gains of the last three months (365,000 jobs per month added), it will take eight to 13 months for the labor markets to reach pre-pandemic levels. Historically, the FRB would be at a neutral interest rate by then. We view 2.25% as a good approximation of a neutral Fed Funds Rate and forecast it will be at only 1.0% when the economy reaches full employment.




Interest rates will not reach neutral until February 2024, a full year after the economy reaches full employment. If we had our druthers, the FRB would quicken the pace to a neutral stance. As we mentioned earlier, our outlook is not based on what we believe fiscal and monetary policymakers *should* do but the path they are likely to take. We believe the financial markets are most likely be ahead of the FRB in forecasting the pace rate hikes. A quickening of the pace should not trigger a steep selloff this time around. The risk is that the FRB faulters and delays the pace of rate hikes until they must raise them high enough to cause a recession.

## Inflation

In November, inflation decelerated slightly, increasing 0.8% versus 0.9% the month before. Consumer prices are up 6.9% y/y and an annualized rate of 7.8% over the last six months. The report was slightly worse than expected. In December, investors' expectations for inflation, tapering, and initial rate increase have shifted to persistent, faster, and sooner. The November inflation report reinforced this shift.



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Used car prices rose 2.5% in November. The Manheim Used Vehicle Index which measures wholesale prices, climbed to new heights, increasing 3.1% in the first 15 days of December compared to the previous month. The Index is up 48.9% y/y. The value of used cars increases as the automotive chip shortage drags along. Higher used car prices are likely to again fuel inflation in future inflation reports.

Rent of shelter increased by 0.5% during November and is up 3.9% y/y. We expect shelter costs to remain high throughout 2022 rising to the 7.0% y/y range. Statistics will eventually catch up with reality. According to RealPage, apartment rents are up 13.9% y/y for move-in leases and 8% for renewals. Occupancy is at an all-time high of 97.5%, indicating continued robust demand. In addition to soaring rent, home prices are up nearly 18.4% y/y. Shelter rent is 32% of the overall CPI basket. The under measurement of shelter rent may be understating inflation by 1%.

FRB moves to ditch the term “transitory,” increase the taper’s pace and move up the initial rate increase has steadied inflation expectations. Five-Year Breakeven Inflation Rates spiked from 2.5% to 3.1% in October and November. The 5-Year Breakeven Inflation Rate implies what market participants expect inflation to be in the next five years, on average. This rate remains above pre-COVID levels, indicating continued unease around the FRB’s ability to manage inflation over the short term.

Five-Year, 5-Year Forward Inflation Expectations imply that inflation will average 2.2% from 2027 thru 2031. This rate implies that market participants expect the FRB will be able to reestablish price stability. Market-based measures of inflation such as breakeven should be viewed with some caution. The FRB’s bond-buying continues to distort interest rates.

The FRB prefers the Personal Consumption Expenditure (PCE) as its measure of inflation. Due primarily to differences in how health care costs are allocated between employers and consumers, the PCE tends to run 0.30% below the CPI.



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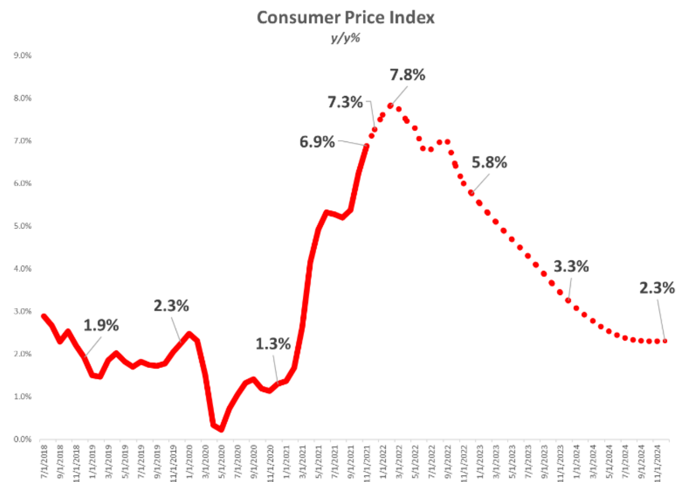
Please see the chart on the right for our latest inflation forecast. We expect monthly inflation to have peaked in October and year-over-year measures of inflation to peak in February. The rate of inflation should fade (disinflation) as supply chains normalize and the spike in energy prices annualizes.

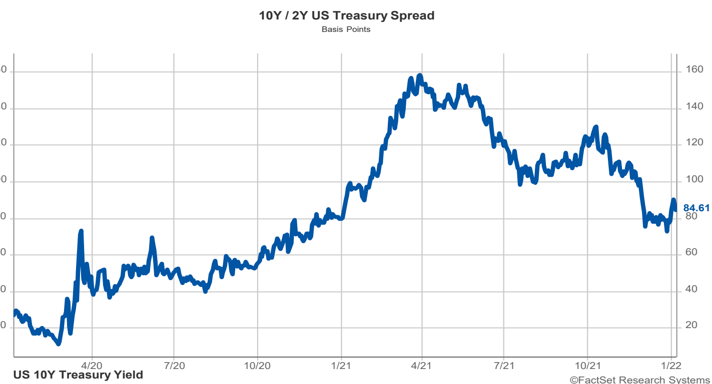



We expect inflation to return to the FRB's target level of 2.3% (2% PCE) but not until the end of 2023, with y/y inflation not achieving the FRB's target until the end of 2024.

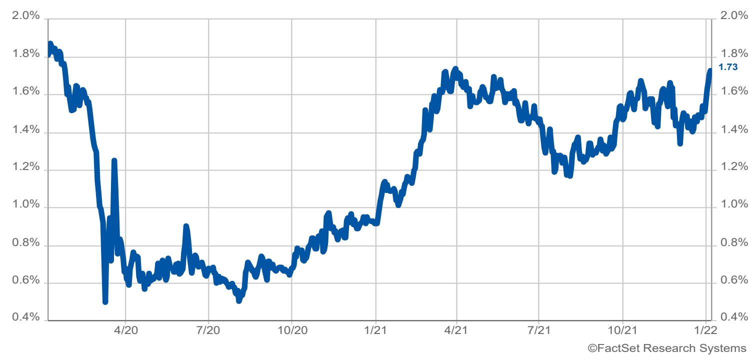
One of the risks to this outlook is the FRB board composition. The central bank has a seven-member board of directors, with three open seats currently. The President may decide to dramatically shift the FRB's leadership to a more dovish stance. The revamped FRB may tolerate a higher inflation rate and pursue a slower course to normalization. This will result in the FRB allowing an inflationary spiral to develop. It will then be forced to dramatically raise rates, causing a recession. This is our bear market scenario.

## Credit Markets

The yield curve ultimately rose during December after flattening initially. The 10-year Treasury rate rose to 1.49%, from 1.45% previously, while the 2-year Treasury rate rose from 0.62% to 0.72%. The Bloomberg Barclays Aggregate lost 0.26% during the month, with a -0.49% driven by capital depreciation (price return) and 0.23% of income.




The credit markets were flat during the month. The Bloomberg Barclays (BB) US Corporate Investment Grade Index produced a total return of -0.08%, comprised of 0.29% from income, offset by a negative 0.37% price return. Credit spreads tightened modestly by 0.07% to 0.92%. The index has an interest rate sensitivity of 8.6-years (effective duration).

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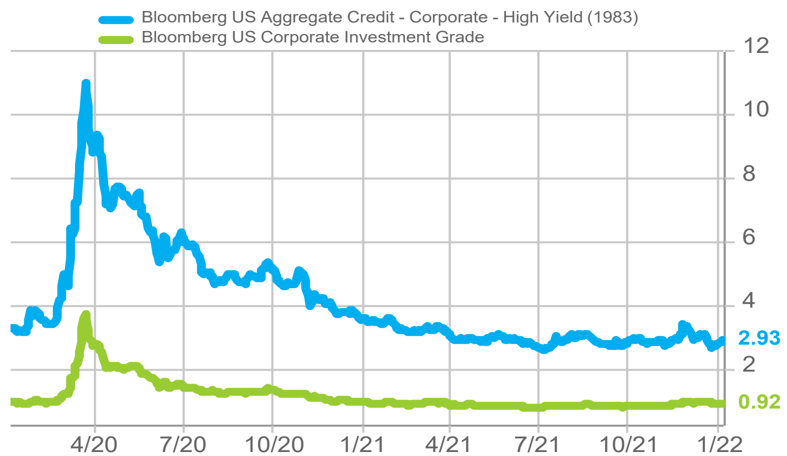
The BB High Yield Index, comprised of corporate bonds with below investment grade ratings, rallied slightly in the month with a total return of +1.87%. The index provided 0.46% of income during the month and 1.41% of positive price return Credit spreads compressed by 0.44% to 2.93%, materially below long-term averages. The index has a 3.9-year effective duration.




At its December 15th meeting, the FRB made a strong anti-inflationary pivot on its tapering and rate hike policies. Markets now expect tapering to be completed in Q1 2022 and anticipate three rate hikes this year.

With the continued appetite for yield and an apparent investor approval of the Fed's projected policy for 2022, credit markets strengthened into the year, ending at tight valuations. As noted above, we expect the economic recovery to continue and the pace of rate hikes to be gradual, limiting volatility and preventing a substantial widening of credit spreads. 2021's back-up in rates led to the worst performance of the BB Aggregate Index since 2013 with a negative 1.54% return. Back-to-back years of negative returns are rare in fixed income, but the preannounced interest rate hikes and the highest inflation prints in approximately 40 years suggest fixed income markets will be challenged this year with return assumptions as "coupon-minus." We believe fixed income still provides a strong source of portfolio diversification and plays a role in diversified investment portfolios. Looking ahead to a monetary tightening cycle, we're selectively and gradually shorting the interest rate sensitivity of fixed income portfolios, aiming to achieve the delicate balance between interest rate risk and yield potential.

**The Consumer Sector**

Income is growing for the American consumer. Unfortunately, inflation is eating these gains. When adjusting for inflation, consumer purchases are down. Consumers have begun to draw down the massive nest egg established since the pandemic's start. We look for the savings rate to fall a bit further as consumers draw on some of the excess savings to support continued consumption. While the jobs market is hot, consumers' confidence is shaken by the spike in inflation.



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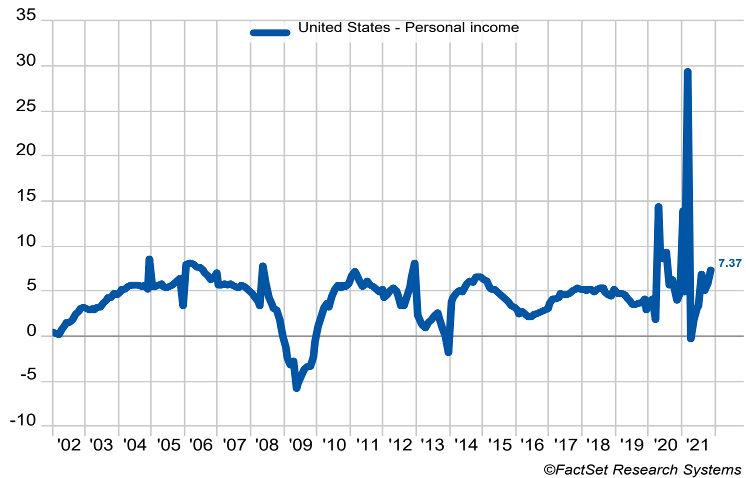
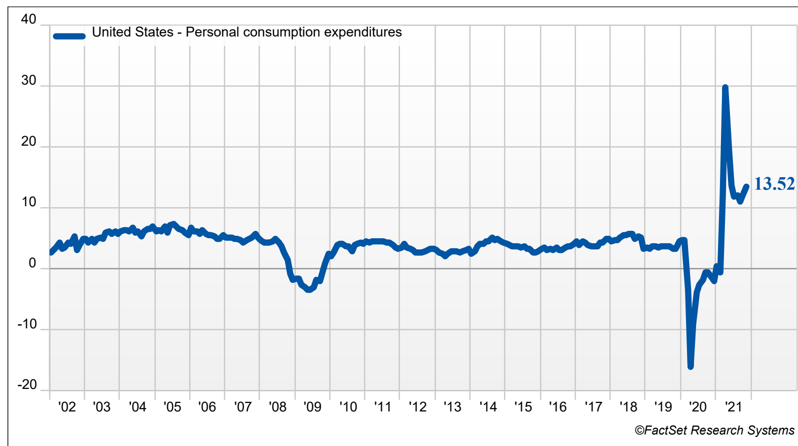
WEALTH MANAGEMENT

Personal income rose 0.4% in November. Government transfer payments rose 0.8% during the month, as payments from the Provider Relief Fund (PRF) sent checks to health care providers, more than offsetting the 18% drop in unemployment benefits. Since March 2021, unemployment benefits are down 93%. Personal income, excluding government transfer payments, rose 0.4% m/m. The Consumer Price Index (CPI) rose 0.8% during November. As a result, real income fell 0.4% during the month.




Private sector wages and salaries were up 0.5% m/m, up 10.0% y/y, and up 11.4% from February 2020. Proprietors' income fell 0.3% m/m, was up 7.9% y/y, and was up 5.3% from February 2020. This line does contain the impact of PPP and farm income assistance and can be volatile as support payments roll off the books. Interest and dividend income were up 0.3% m/m, up 2.9% y/y, and down 0.2% from February 2021. The drop in interest and dividend since February 2021 primarily reflects the lower interest rate environment as interest income is down 1.9%.

During September, consumers saved 6.9% of disposable income. Over the last two months, the savings rate has been below its pre-pandemic Consumer level. Consumers have begun drawing down their excess savings to support their current spending level. We estimate that consumers continue to have $2.4 trillion in excess savings or about 16.4% of annual purchases of goods and services. About a third of this savings is likely to be spent over the next year or so as consumers look to maintain their level of spending.




Personal consumption expenditures (PCE) were up 0.6% for the month. Purchases of durable goods fell by 0.6%% m/m, led by a 1.3% decrease in new vehicle sales and a 1.1% fall in recreational goods. Purchases of non-durable goods rose 0.5% m/m with gasoline purchases up 4.6%. Purchases of services rose 0.9% m/m. Air travel was up 6.0% as more people returned to travel. Gambling services were up 2.5% as ever-present radio and television entice more people into sports gambling. Most other service categories were up less than 2%.



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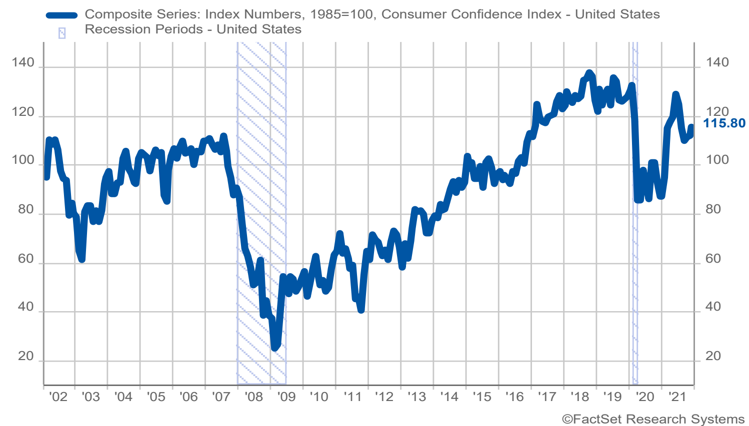
On a real basis, after subtracting out the impact of inflation, consumer expenditures were down 0.2% m/m. Purchases of real durable goods fell 1.0% m/m. Real purchases of non-durable goods fell 0.7% m/m and real purchases of services rose just 0.4% m/m. High prices are impacting goods and services purchased.

The Consumer Confidence Index, compiled by the Conference Board, rose 3.9 points to 115.8. Expectations were for a small loss of confidence. Consumers' perception of the present situation fell slightly while expectations for six months hence rose. The present situation component fell 0.3 points to 144.1. The forward-looking expectation component rose a robust 6.7 points to 96.9.

Respondents' perception about current business conditions fell as the net sub-index (good-bad) rose to -6.9 from -9.4 the previous month. Consumers' outlook about business conditions in six months improved as the net sub-index (better - worse) rose to 8.8 from 6.0 the previous month. Consumers appear to be concerned about supply chain issues, inflation, and shortages. They view these issues as transitory and improving off the bottom.




Consumers' perception of the labor market softened but remain near record territory. The current conditions net employment sub-index (plentiful - hard to get) fell to 42.6 from 44.7 the previous month. Consumers' perception about employment conditions in six months improved smartly as the net sub-index (more jobs – fewer jobs) rose to 10.3 from 3.8 the previous month.

Consumers' perception about their household income in six months weakened slightly as the net sub-index (an increase in income – a decrease in income) fell to 6.5 from 7.2 the previous month. While down slightly, more households believe their economic circumstance will improve. This is a requisite for continued economic growth.

Consumers' expectations for inflation twelve months hence moderated a bit. Consumers forecast inflation will be 6.9% in twelve months. Inflation expectations were 7.3% last month, 6.0% last year, and 4.4% two years ago. Consumers' inflation expectations are elevated and appear to remain stable. The FRB is correct in shifting its concern from full employment, including all underrepresented groups, to worrying about inflation.

Consumers' expectations of interest rates in twelve months rose as the net sub-index (higher interest rates – lower interest rates) rose to 53.4 from 48.8 the previous month. Consumers are preparing for higher interest rates. The FRB's rate plan has been well telegraphed and understood by consumers. The likelihood of a rate shock is quite low.

In January and March 2022, the U.S. will anniversary the two large stimulus checks, making year-over-year comparisons difficult. While m/m figures will show growth, y/y results will likely be 5% to 6% lower.



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In other words, the statistics continue to be messy and can lead to exaggerated headlines by the 24/7 news channels. Please do not be misled by such fearmongering.

**The Business Sector**

The Institute for Supply Management (ISM) produces a monthly report on manufacturing and the non-manufacturing (service) sectors. The reports are sentiment-driven and can be influenced by current events. Nonetheless, they do provide real-time clues to what is happening.

December's non-manufacturing index fell 7.2 points from November's all-time high to 62.0. Activity in the services sector has grown for nineteen months in a row. While the index registered a pullback from November's record-breaking reading, the growth rate remains strong. The broad-based expansion continues. The initial impact of the Omicron surge is shown in the data, especially in new orders activity. Supply chain issues may be easing but continue to be a headwind.

The business activities/production component fell 7.0 points to 67.6. Fifteen industries reported an increase in business activity for the month. Three industries reported a decrease in activity. The new orders component fell by 8.2 points to 61.5. The large drop in new orders illustrates the service sector's sensitivity to the ebbs and flows of the COVID-19 virus. Even after the large decline, a 61.5 reading continues to point to healthy growth. Thirteen industries reported an increase in orders. Three industries reported a decrease in orders.

| Non-Manufacturing Sector | Direction | Rate of Change |
|---|---|---|
| Business Activity / Production | Growing | Slower |
| New Orders | Growing | Slower |
| Employment | Growing | Slower |
| Supplier Deliveries | Slowing | Slower |
| Customer Inventories | | |
| **Non-Manufacturing Sector** | **Growing** | **Slower** |
| Industries Expanding | 16 | |
| Industries Contracting | 1 | |

The employment index fell by 1.6 points to 54.9, indicating that employment grew in the service sector for the sixth consecutive month. Eleven industries reported an increase in employment. Three industries reported a reduction in employment. Comments from respondents included "The 'Great Resignation' is hitting us, and we're struggling to backfill positions. With fast food restaurants offering sign-on bonuses and high pay for entry-level jobs, businesses are reviewing policies and incentive programs. They are finding there are not enough potential employees in the pipeline and employees leave for other opportunities at higher wages.

The supplier deliveries component fell by 11.8 points to 63.9. A reading above 50 percent indicates slower deliveries, while a reading below 50 percent indicates faster deliveries. Fifteen industries reported slower deliveries. No industry reported faster deliveries.

Prices paid for materials and services increased at a modest pace. The price component rose 0.2 points to 82.5, the third-highest reading. All eighteen industries reported higher costs.

As a frame of reference, a reading above 50 indicates expansion; a reading below 50 indicates contraction. Readings approximating 50 indicate the same level of activity.



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The manufacturing index fell 2.4 points to 58.7, coming in lower than expected. The above-50 figure indicates the manufacturing sector has expanded for nineteen straight months. The miss was for all the right reasons as large price reductions and the supplier deliveries sub-indices accounted for most of the drop.

The production component fell 2.3 points to 59.2. The new orders component fell to 60.4 from 61.5 the previous month. The employment component rose 0.9 points to 54.2, indicating expanding manufacturing employment. Eight industries reported employment growth. Five industries reported a decrease in employment.

Supplier deliveries to manufacturers worsened at a dramatically slower pace as the sub-index fell 7.3 points to 64.9. Fourteen of eighteen manufacturing industries reported slowing deliveries. Two industries reported faster supplier deliveries. The ISM expressed the view that "Deliveries slowed at a slower rate compared to the previous month. The index continues to reflect suppliers' difficulties in meeting panelist companies' demand, but for the second straight month, supply chain performance is moving toward a more appropriate balance with demand. Capital expenditure lead times continue at modern-era records. Production materials lead times registered a 5-percent improvement from the prior month but remain at near-record levels. The Supplier Deliveries Index, Prices Index and material lead times softening in November and December indicate progress against the supply/demand imbalance,"

The Prices Paid sub-index fell 14.2 points to 68.2, indicating raw material prices have increased for the 19th consecutive month slower. Sixteen industries reported increased prices for raw materials. One industry, Petroleum and Coal Products, reported paying decreased raw material prices.

Manufacturing demand remains strong as price pressures and supply chain issues fade.

| Manufacturing Sector | Direction | Rate of Change |
|---|---|---|
| Production | Growing | Slower |
| New Orders | Growing | Slower |
| Employment | Growing | Faster |
| Supplier Deliveries | Slowing | Slower |
| Customer Inventories | Too Low | Slower |
| **Manufacturing Sector** | **Growing** | **Slower** |
| Industries Expanding | 15 | |
| Industries Contracting | 3 | |

Global PMI surveys indicate economic activity slowed a bit in December. Manufacturing output continues to increase as supply chains begin to normalize. August appears to have been the bottom of this most recent soft patch. At the same time, the Omicron wave is putting a damper on service activity. Globally, growth may have sped up to a 6% annualized growth rate during the fourth quarter. While economic momentum remains strong in the manufacturing sector, activity in the service sector appears to be waning, especially in Europe.

**J.P. Morgan global PMI summary**

| | | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Output | Total | 52.5 | 53.3 | 54.5 | 54.8 | **54.3** |
| | Manufacturing | 51.9 | 52.1 | 51.5 | 52.5 | **53.3** |
| | Services | 52.8 | 53.8 | 55.6 | 55.6 | **54.6** |
| New orders | Total | 53.2 | 53.5 | 54.3 | 54.1 | **54.0** |
| | Manufacturing | 53.6 | 54.0 | 53.7 | 53.2 | **53.4** |
| | Services | 53.0 | 53.4 | 54.6 | 54.5 | **54.2** |
| Future output | Total | 65.8 | 67.1 | 65.2 | 67.2 | **67.3** |
| | Manufacturing | 64.1 | 64.2 | 63.3 | 64.3 | **63.7** |
| | Services | 66.5 | 68.2 | 65.9 | 68.3 | **68.6** |
| Employment | Total | 51.6 | 51.6 | 52.7 | 52.6 | **51.6** |
| | Manufacturing | 52.0 | 51.4 | 51.7 | 51.3 | **51.6** |
| | Services | 51.5 | 51.7 | 53.0 | 53.1 | **51.6** |
| Output prices | Total | 57.3 | 58.1 | 60.3 | 59.5 | **59.0** |
| | Manufacturing | 60.1 | 60.9 | 63.7 | 61.3 | **59.8** |
| | Services | 56.3 | 57.1 | 59.0 | 58.8 | **58.7** |

Source: J.P. Morgan, Markit

Prepared by Damian Howard January 10, 2022

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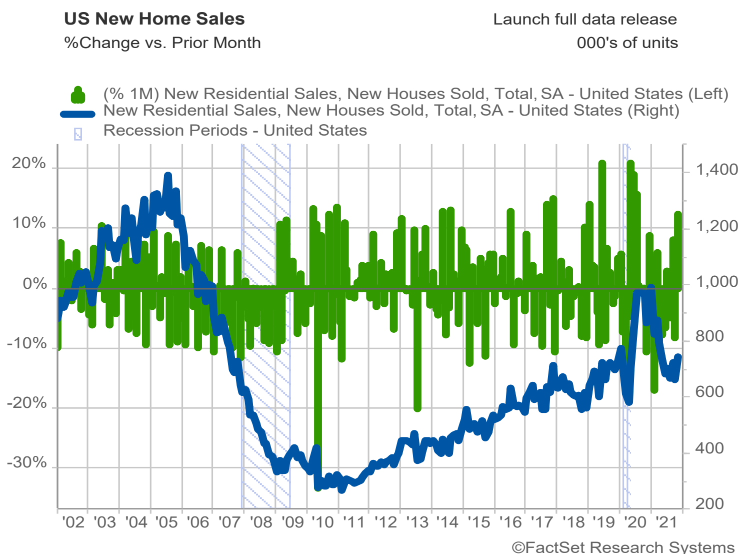
Pricing pressures appear to be beginning to fade. While still increasing, prices are rising at a slower rate. October may have been a peak for inflation. We do not see falling prices, just inflation rates or disinflation. The U.S. and global economy will likely experience above-trend growth in the first part of the year, with more trend-like growth in the latter half of 2022.

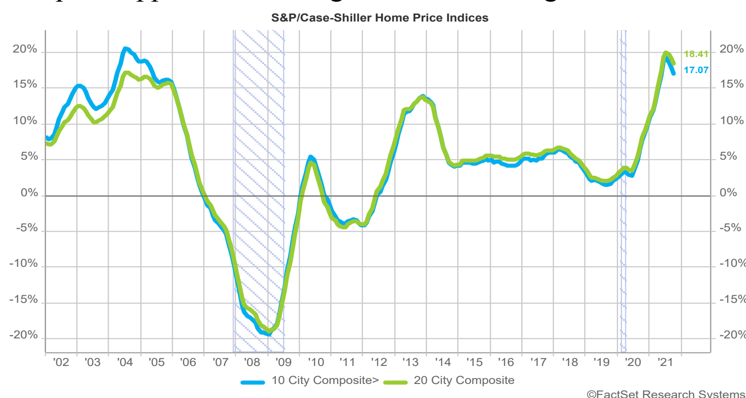
**The Housing Sector**

New home sales rose to a 744,000 seasonally adjusted annual rate (SAAR) in November from a revised 662,000 pace the month before. While up 9% from June's lows, new home sales are well below the 993,000 pace set in January.




Homebuilders started construction on 87,300 single-family homes last month (not SAAR). They completed 74,700 homes with 762,000 homes under construction. The number of single-family homes under construction was up 29% from the previous year. The number of homes under construction continues to grow as builders face longer construction times. One large publically traded homebuilder stated that supply chain issues have lengthened the build cycle by four to six weeks.

The housing market is healing but not back to full strength. Tight supply coupled with ample demand continues to put pressure on home prices. Home price appreciation is high but decelerating. The median price of a new home is up 19% y/y to $417,000.




Employment in residential construction and related trades fell by 10,300 in December but is up 74,000 y/y. Total employment in residential construction and related trades is up 4.3% from December 2019 (same month, pre-pandemic), while total economy-wide employment is down 2.0% over the same period. While home builders continue to face labor shortages, they have been more successful than average in attracting talent.

October's existing-home sales rose to a 6.4 million annual rate, up 1.9% m/m, but down 2.0% y/y. The supply of existing homes for sale was 1.1 million, down 13.3% y/y. Strong demand coupled with low supply has led to strong home price appreciation. Prices, as measured by the Case-Shiller 20-City Home Price



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Index, increased by a strong 18.4% y/y. While quite high, home price appreciation seems to be decelerating, having peaked in May at 1.84% m/m, October's 0.9% m/m increase marks four straight months of deceleration.

Mortgage rates are likely to rise along with the general level of interest rates. We do not believe rates will rise far enough to choke off the housing recovery. A large publicly traded homebuilder recently stated that a 1.00% rise in mortgage rates would impact a high single-digit percent of customers. They would either need to find more income, come up with a higher down payment, or switch to a different type of loan. Demand continues to exceed supply by a wide margin. Home-price appreciation should slow to a more tolerable 4% to 6% annual pace.

We believe the housing sector will be a source of strength for the next several years.

We welcome your comments and suggestions. Please feel free to contact our team or me directly. Please see the obligatory disclosures listed below.

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