BILLS ASSET MANAGEMENT

BAM MARKET NOTE

JANUARY 7, 2022

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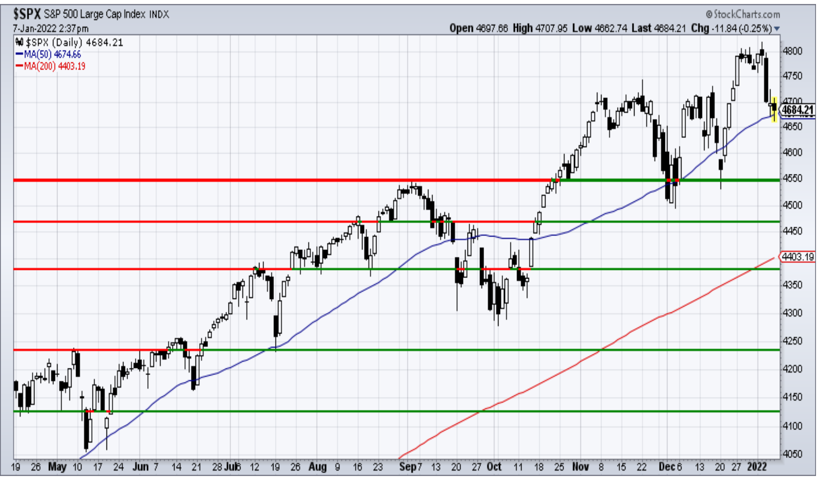
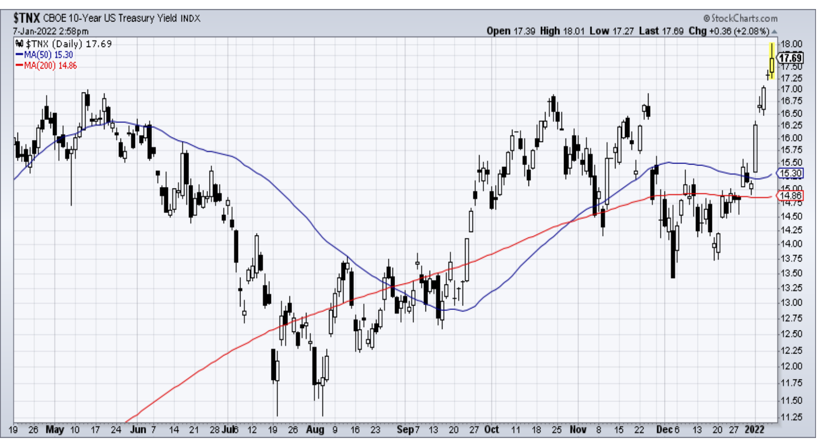


Santa left the party right on cue as the market turned down on the 3rd trading day of the year. The S&P has fallen over 2% over the last 3 days. The Nasdaq has taken the brunt of the selling as it is down over 5% over those same 3 days. The shift from growth stocks to value stocks is something to watch and may be an emerging trend for 2022. The S&P, Nasdaq and Russell 2000 are all at important support levels. The S&P is testing its 50-day moving average today. A break of support by any of the indices could lead to another leg down. After the strong end to 2021, a period of some corrective action is not unexpected. What happens next week will be more instructive. Be careful.



While there are some in the media that doubt that the Fed will actually begin a rate hike cycle, the bond market certainly is pricing in rising rates. The 10-year treasury yield has risen from 1.51 to 1.77 just this week. The anticipated rise in rates has made energy and financials among the early leaders in 2022. Interest sensitive sectors will be ones to watch as the Fed likely embarks on raising rates in the coming months.

Our Point

The release of the Fed meeting minutes earlier this week showed a much more cohesive Fed with all Fed governors unanimously agreeing that interest rates hikes were needed sooner rather than later. The market (particularly growth stocks) were taken aback by the unanimity and sold off in response. Many market participants seemed to have not believed Chairman Powell from earlier in December! It now looks like the first rate hike could come as early as March. We'll see what level of conviction the Fed has and what level of market decline they may be willing to accept to achieve their policy goals. In year's past, the Fed consistently backstopped the market with monetary policy but with inflation (not surprisingly the Fed removed transitory from their recent minutes) continuing, the Fed may be forced to choose the lesser of two evils. Today's weak but inconsistent job report adds to the Fed's conundrum. While jobs created were well below estimates, the unemployment rate did tick downward indicating a tight labor market. This is the time of the year when all the market pundits issue their forecasts and predictions for the year. Forecasts have ranged from doomsday to a new leg up in the bull market. The reality is that there are too many unknowns for ANYONE to make any reasonable prediction. Will the pandemic subside? Will the Fed actually raise rates or will data keep them from doing so? Will Congress flip in the November elections? Will inflation continue to rage on? Those are among the known unknowns but that does not even begin to factor in what other true unknowns will present themselves in 2022! There will certainly be surprises that nobody sees. We won't pretend to know the future and will leave that folly to the pundits. Instead, we will continue to respond to market conditions and do our best to stay on the right side of the market. As we mentioned in last week's note, we pared some of our risk by selling some of our equity positions. Should the current weakness persist, we will sell more. Once the market stabilizes, we will begin to seek out new opportunities. Until then, we are happy with our reduced exposure. Enjoy your first cold weekend of 2022!