The Hawkish Fed Scares Investors

The Fed minutes from their December 14-15th meeting, released yesterday, show a heightened concern with inflation. There is little doubt after reading the minutes the Fed is growing increasingly hawkish. They seem intent on raising rates more aggressively than previously thought and shrinking their balance sheet at the same time. This week's labor data, as we discuss below, will only intensify their concerns.

Markets are not happy with the Fed growing more hawkish. The Fed is slowly being put into a corner where they must weigh their desire to fight inflation with the negative effects of removing liquidity from markets. The graph below shows December Fed Fund Futures fell 7.5bps yesterday and are now implying a 50/50 chance of a fourth rate hike by the end of 2022.

[dmc]

What To Watch Today

Economy

- 7:30 a.m. ET: **Challenger Job Cuts**, year over year, December (-77% prior)
- 8:30 a.m. ET: **Trade Balance**, November (-$81 billion expected, -$67 billion)
- 8:30 a.m. ET: **Initial Jobless Claims**, week ended January 1 (195,000 expected, 198,000 during prior week)
- 8:30 a.m. ET: **Continuing Claims**, week ended January 1 (1,680,000 expected, 1,716,000 prior week)
- 10:00 a.m. ET: **ISM Services Index**, December (67.0 expected, 69.1 prior)
- 10:00 a.m. ET: **Factory Orders**, November (1.5% expected, 1.0% prior)
- 10:00 a.m. ET: **Factory Orders excluding transportation**, November (1.1% expected, 1.6% prior)
- 10:00 a.m. ET: **Durable Goods Orders**, November final (2.5% expected, 2.5% prior)
- 10:00 a.m. ET: **Durable Goods Excluding Transportation**, November final (0.8% prior)
- 10:00 a.m. ET: **Capital Goods Orders Non-defense Excluding Aircrafts**, November final (-0.1%)
- 10:00 a.m. ET: **Capital Goods Shipments Non-defense Excluding Aircrafts**, November final (0.3%)

Earnings

- **Constellation Brands Inc.** (STZ) to report earnings of $2.73 on revenue of $2.28 billion
- 7:00 a.m. ET: **Walgreens Boots Alliance** (WBA) to report earnings of $1.36 on revenue of $33.014 billion
- 8:15 a.m. ET: **Bed Bath & Beyond Inc.** (BBBY) to report earnings of $0.00 on revenue of $1.949 billion

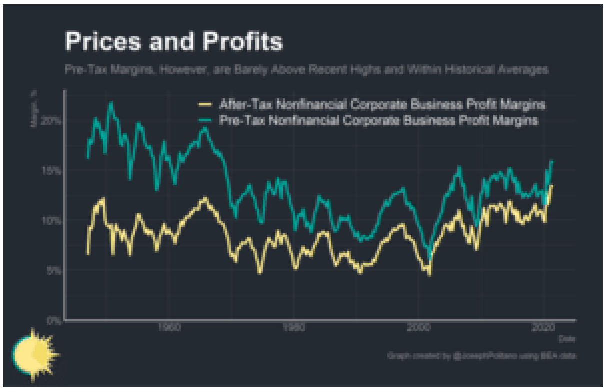
Check Out Our 2022 Outlooks

Speaking of a more hawkish Fed, we review that risk and more in our outlooks for 2022.

- **2022 Outlook Part 1- Tailwinds Shift To Headwinds**by Michael Lebowitz
- **Market Outlook For 2022 - Risks To The Bullish Thesis** by Lance Roberts

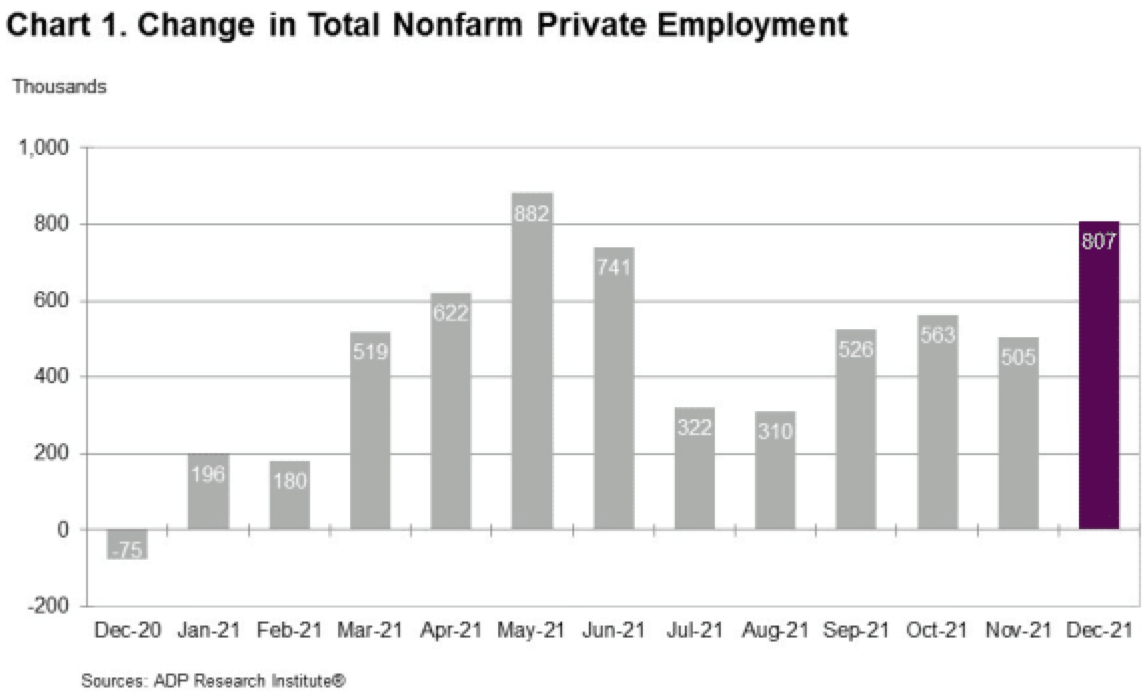
Corporate Profit Margins and Our Outlook

The graph below, courtesy of @JosephPolitano, shows that pre and post-tax profit margins are at the highest levels since the 1970s. Given the tendency of margins to oscillate, we should expect profit margins to normalize over the next year or two. Given valuations are at extremes, any pressure on profits will push valuations to further extremes barring lower prices. Rising profit margins were a tailwind in 2021 that may likely become a headwind in 2022.



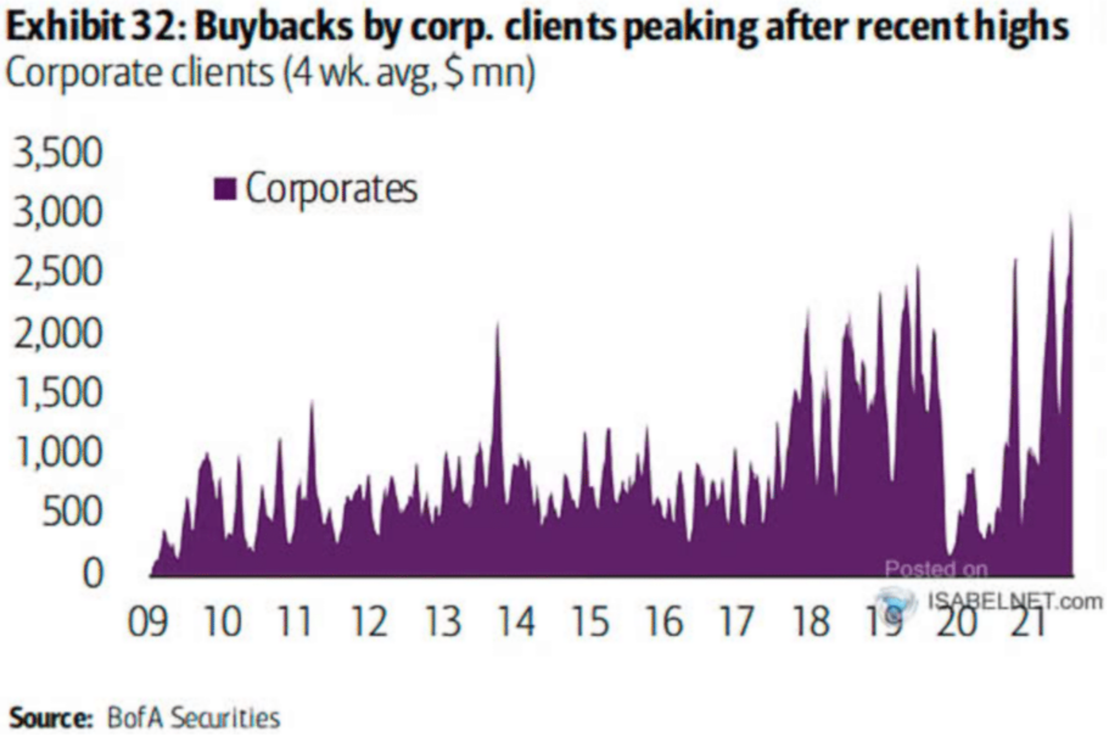
ADP Fires a Warning Shot Over the Fed's Bow

The ADP private-sector jobs report shows there 807k jobs added in December, more than two times expectations. This and Tuesday's JOLTs data point to a red-hot labor market. It is worth noting that the labor market is still 4 million jobs short of pre-pandemic levels. However, based on the number of job openings and the quits rate, many of the people who left the workforce are doing so voluntarily. If the BLS confirms the ADP print, the market may begin to price in a more aggressive Fed in terms of rate hikes. They should be concerned that growing wage pressures will result in companies raising prices to offset the higher wages.



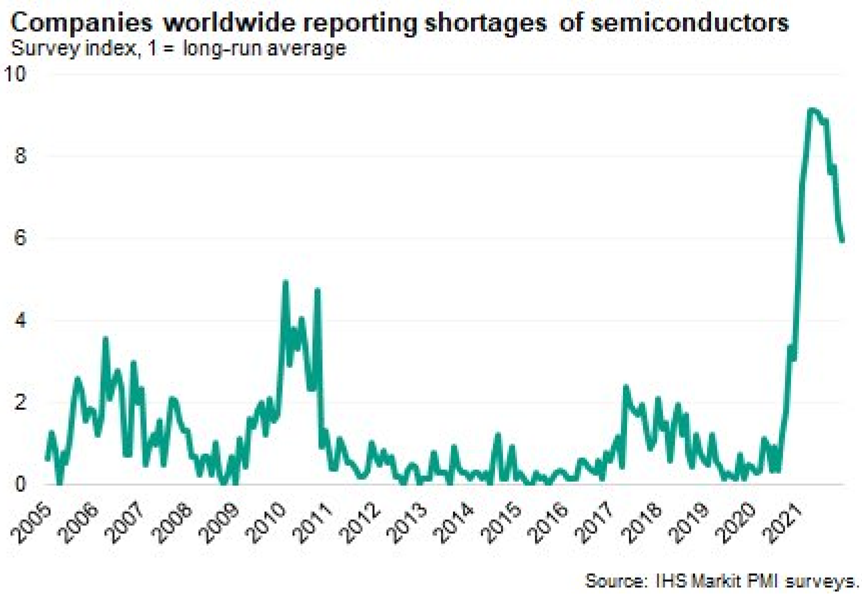
Corporations Keep Buybacks Going

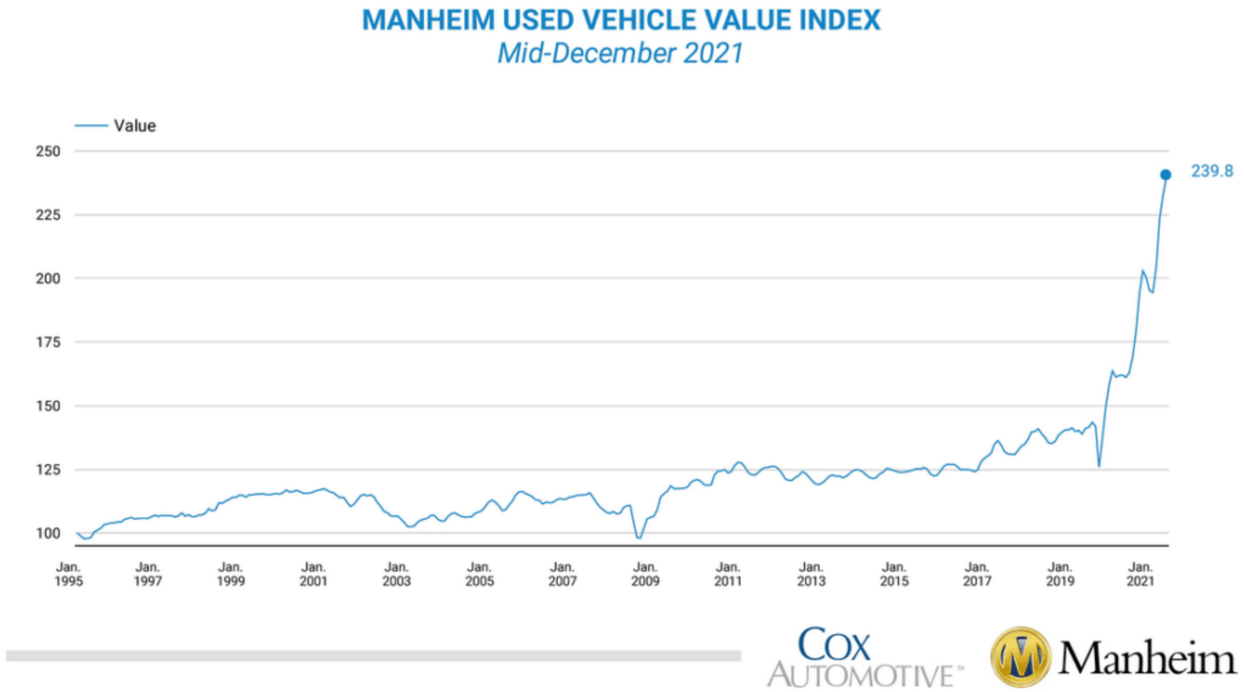
Corporations keep doing what they do best, buying back their own shares. As noted previously, stock buybacks have accounted for nearly 40% of the market's rally since 2011. While that doesn't seem to be changing anytime soon, higher interest rates and tighter Fed policy could change attitudes. Such is certainly something worth watching. With a more hawkish Fed looming, will corporations rethink their repurchase programs?



Is the Semi Shortage Ending?

The first graph below provides a hopeful sign that the shortage of semiconductors is finally peaking. The deficit of chips has most notably affected the auto industry, which has greatly limited production. The side effect of their collective actions has been a shortage of new cars, resulting in more demand for used vehicles. At the same time, fewer trade-ins are crimping the supply of used cars. As a result, used car prices have risen appreciably, as shown in the second graph. We are hopeful the first graph is another sign inflationary pressures, especially concerning automobiles, may finally be abating.





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