Small-Cap Stocks Struggle Again

The Russell 2000 Small-Cap Stock index continues to struggle. On Wednesday, it fell 1.56% and is now down 9.2% for the year. The index is flat since the beginning of 2021. The S&P 500 is up about 30% since 2021. Many Russell 2000 Small-Cap stocks struggle in the current environment. They tend to lack pricing power, therefore are unable to offset higher wages, interest rates, and inflation. If the economy weakens and the Fed raises rates, we suspect many Small-Cap stocks will continue to struggle versus larger-cap stocks. Also from a technical perspective, the graph below shows the Russell 2000 is on the verge of breaking lower from its one-year trading range.

[dmc]

What To Watch Today

Economy

- 8:30 a.m. ET: **Initial Jobless Claims**, week ended January 15 (225,000 expected, 230,000 during prior week)
- 8:30 a.m. ET: **Continuing Claims**, week ended January 15 (1.563 million expected, 1.559 million prior week)
- 8:30 a.m. ET: **Philadelphia Fed Business Outlook**, January (19.0 expected, 15.4 prior)
- 10:00 a.m. ET: **Existing Home Sales**, December (6.43 million expected, 6.46 million during prior month)
- 10:00 a.m. ET: **Existing Home Sales**, month over month, December (-0.5% expected, 1.9% during prior month)

Earnings

Pre-market

- 6:55 a.m. ET: **Travelers** (TRV) to report adjusted earnings of $3.84 on revenue of $8.69 billion

- 7:00 a.m. ET: **American Airlines** (AAL) to report adjusted loss of $1.48 on revenue of $9.41 billion
- 7:35 a.m. ET: **Northern Trust** (NTRS) to report adjusted earnings of $1.81 on revenue of $1.65 billion

Post-market

- 4:00 p.m. ET: **Netflix** (NFLX) to report adjusted earnings of 88 cents on revenue of $7.71 billion

Market Very Oversold - Look For A Bounce To Rebalance

Notwithstanding the small-cap stock struggle, the border market is now deeply oversold and extended to the downside. As shown below, the S&P 500 is now trading more than 2-standard deviations below the 50-dma with our indicators now in deeply oversold conditions. Such is usually a good setup for a counter-trend bounce.

While the market selloff has been fairly brutal, it has not violated support at the December lows, nor the uptrend. Therefore, be careful making emotionally driven changes to portfolios. Look for a counter-trend rally back to the 50-dma to start rebalancing risk and raising cash levels.

Chart Courtesy of SimpleVisor.com

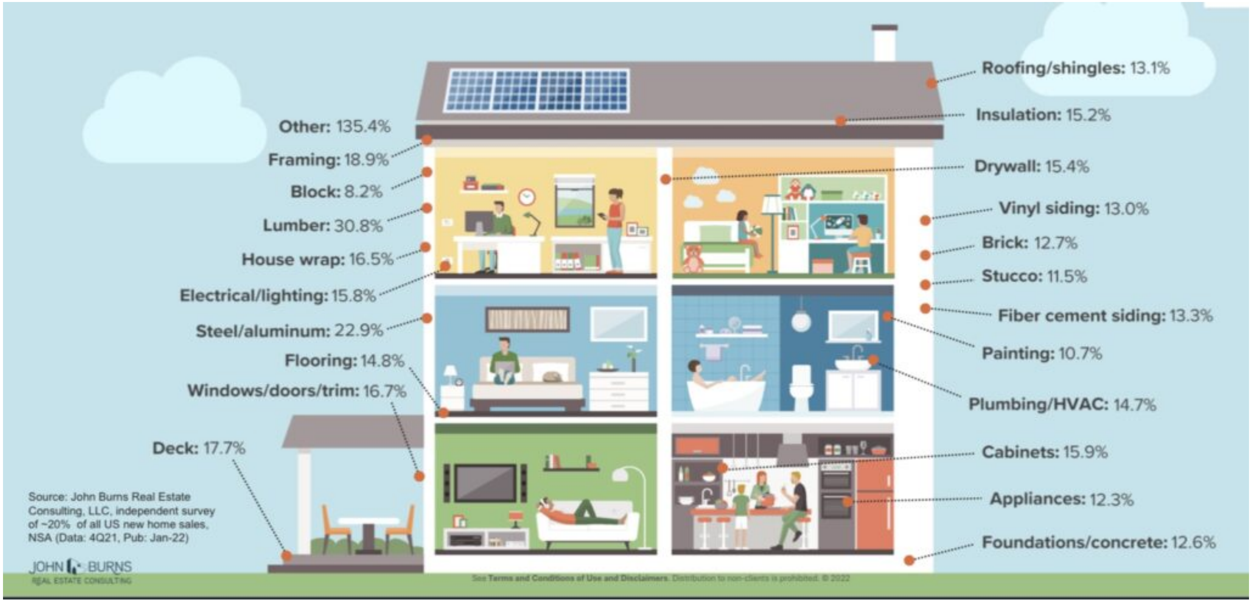
Three Minutes On Markets

Why Fed rate hikes aren't good for Energy stocks.

https://youtu.be/VneVrBV1uts

New Home Construction, Inflation, and Homebuilder Stocks

The picture below shows that double-digit inflation affects every primary product used to construct new homes. The prime question facing homebuilders and makers of those goods is whether they can pass higher costs on to new homebuyers. Further, adding to the pressure on homebuilders is higher mortgage rates. Homebuyer affordability has fallen by nearly 10% over the last few months due to higher mortgage rates, leaving buyers with less wiggle room to pay up for a house.



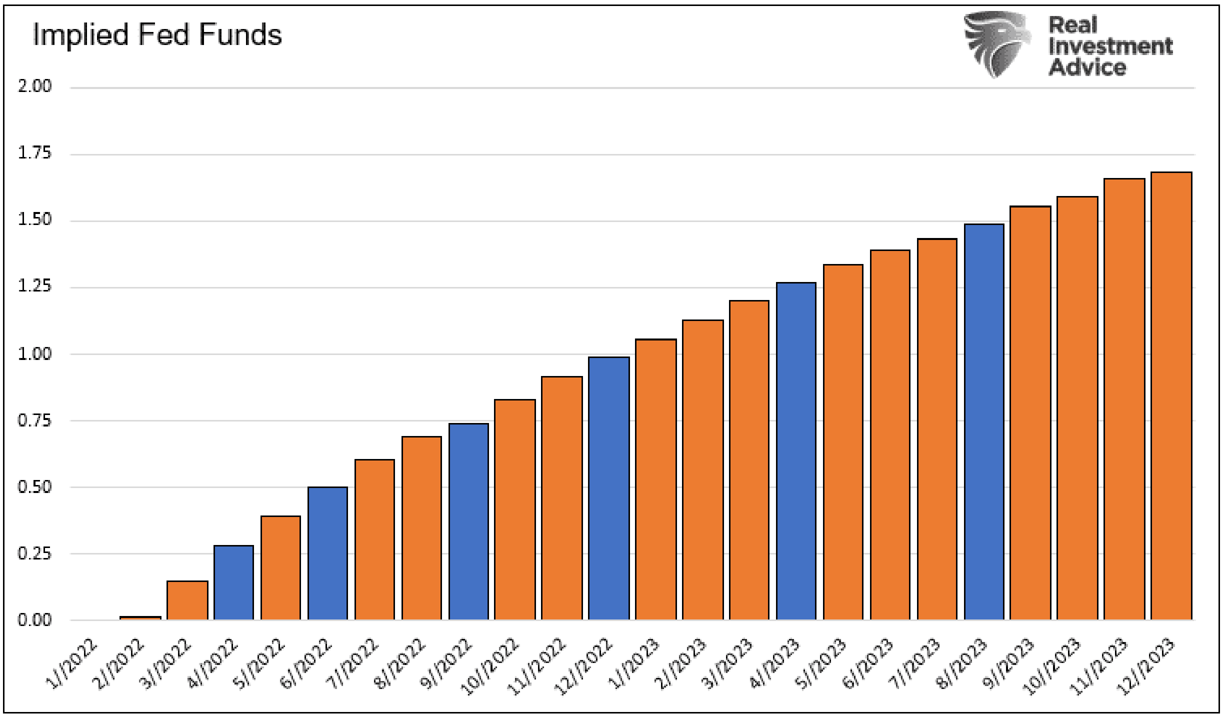
HomeBuilders (XHB) - Housing Starts and Permits

Wednesday's data on housing starts and new building permits were robust. Starts reached 1.702 million, a 12% increase from the prior month. Permits, a good proxy for future starts, rose 9.1% from the preceding month. The data point to an increase in new homes available in the second half of 2022.

The SimpleVisor graph below shows XHB, the homebuilder ETF, is up over 50% from the pre-pandemic highs. Given the combination of inflation and higher mortgage rates, along with the sharply rising future supply of new homes, we would exercise caution trading this sector and many of its underlying stocks.

Four Interest Rate Hikes in 2022

The Fed Funds Futures chart below shows there are four 25bp interest rate hikes priced into the market for 2022. The blue bars represent the month when the first hike or each additional hike is fully priced in. According to the graph, we could have two rate hikes before summer starts and a total of six through the summer of 2023. While we show the first expected hike in April, it is actually in March. due to the timing of the March FOMC meeting and the fact that Fed Funds contracts cover the entire month. The math actually implies a 20% chance the Fed raises rates by 50bps at the March meeting.



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