



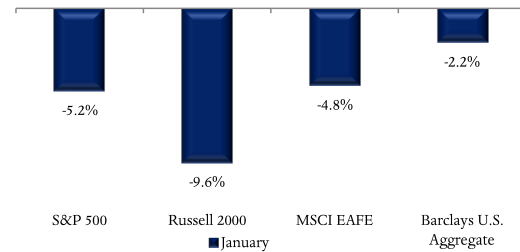
## MARKETS

Global equity markets started the year off on a downward note, after a strong end to 2021. Revelations about how the US Federal Reserve bank plans to reign in percolating inflation, as well as political tensions between Russia and Ukraine, led to a sharp increase in volatility. The S&P 500 declined -5.2% in January, while the tech-heavy Nasdaq and the smaller capitalization Russell 2000 indexes dropped by -9.0% and -9.6%, respectively. High multiple growth stocks came under the most severe selling pressure, given the fear of tightening liquidity. Value oriented stocks (especially financials) proved to be defensive given that their business models typically benefit from rising government bond yields. This combination contributed to the largest monthly outperformance of value versus growth in more than 20 years.

Overseas, the MSCI EAFE index declined -4.8%, aided by resilient European stock markets (Stoxx Europe 600 -3.8%). Meanwhile, Asian equities struggled as seen by Japan's Nikkei 225 (-6.2%) and China's Shanghai composite (-7.7%). Emerging market stocks, which offer the most reasonable valuations, outperformed, ending January down -1.9%.

Bond markets also fell last month, largely a function of inflation and the Fed's plans to combat it. The benchmark 10-year US Treasury note yield rose from 1.48% at year-end to as high as 1.88% mid-month before settling January at 1.77%. Similarly, the 2-year Treasury rate increased +41 basis points to 1.18%. The Bloomberg Barclays US Aggregate index declined by -2.2%.

Commodities provided better protection against the current inflationary backdrop, continuing to rally in January. Brent crude oil reached \$90 a barrel for the first time since October 2014, driven by falling oil stockpiles in the US, and Russian sabre rattling.



## GEOPOLITICS

Russia has reportedly amassed over 100,000 troops near its border with Ukraine, threatening invasion. In exchange for de-escalating, Russia has demanded a ban on Ukraine's admission to the North Atlantic Treaty Organization (NATO) and a reduction of NATO troops and military equipment in eastern Europe. The United States and other NATO allies rejected these demands and have warned Russia of retaliation, if military action is taken. Other assistance has been deployed to Ukraine, including small arms and other defensive weaponry. Given ongoing concerns, Western allies are also preparing what appear to be the most aggressive collection of economic and financial sanctions ever assembled, to deter Russian president Vladimir Putin from taking aggressive actions. They include targeting Russia's economic elite and the money it has parked abroad, as well as potentially exiling Russia's banking system from international payment systems. In addition, the US and the EU have discussed imposing very stringent technological export controls, aimed at Russia's industrial base and its capacity to innovate. However, the most politically and economically sensitive arena is the energy sector. Russia is heavily reliant on energy exports as a source of foreign reserves, while the EU depends on their gas for 40% of its power consumption. Any disruption in the flow would involve pain on both sides. The conflict risks further deterioration of US/EU - Russia relations, and potential military escalation.

## UNITED STATES

Macro US data has once again painted picture of an economy going through transition. January's flash-purchasing managers' indices (PMIs) continued to signal expanding economic activity, with the manufacturing index at 57.6% (lower by a modest 1.2% from the prior reading) and the services component at 59.9%, (down by 2.4%), dampened by Covid-19's Omicron variant. As a consequence, December retail sales contracted -1.9% month-on-month, while spending on airline travel and lodging declined sharply, well into January. These pullbacks should prove transitory as infection rates abate. Following 6.9% annualized GDP growth in Q4, we expect a significantly lower pace in the current quarter, before re-accelerating in Q2.

US consumer inflation climbed to 7% year-on-year in December, which is the highest level since 1982. Inflationary pressure was broad based across goods and services. Producer prices rose 9.7% during the same period, close to the previous highs. Intermediate goods continue to face a variety of supply constraints ranging from input materials, transportation and labor. The January employment report was also notable. There were 467,000 new jobs created, as well as an impressive 700,000 upward revision for the prior two months. In addition, wages climbed by 5.7% encouraging new entrants into the labor force. The participation rate climbed to 62.2%, leading to a 4.0% unemployment rate. These statistics show that the US labor market has experienced its fastest ever recovery.

Fed Chair Jerome Powell pointed out that the US economy is much stronger today than it was in 2015, just before the last interest rate hiking cycle, indicating that these differences might have important implications for the appropriate pace of policy normalization. The Federal Reserve is on track to end its bond purchase program and increase the Fed Funds rate in March. In addition, the FOMC is now actively looking to reduce its inflated balance sheet. Recently markets began pricing in an additional two rate hikes from the Fed, for a total of five quarter point increases in 2022.

## January 2022 Economic Statistics

	Jan-22	Dec-20	Dec-19
Federal Funds Target Rate	0 - 0.25%	0 - 0.25%	1.50-1.75%
Consumer Confidence Index	113.8	88.6	126.5
Manufacturing PMI Index	57.6%	60.7%	47.2%
Unemployment Rate	4.0%	6.7%	3.5%
JPY/USD	115.10	103.24	108.61
USD/EUR	1.1233	1.2213	1.1210
Gold/oz.	\$1,796.47	\$1,896.49	\$1,517.01
Oil (WTI)/bbl	\$88.15	\$48.52	\$61.06

## EUROPE

Eurozone consumer sentiment and economic activity data have been surprisingly resilient against a backdrop of rising Covid infections across member states. January's manufacturing PMI rose to 58.7%, an encouraging sign, with the new order sub-index indicating further growth potential. The supplier's delivery times index improved for the third consecutive month to 26.6%, suggesting supply constraints are easing, albeit very gradually.

The most recent reading of eurozone inflation rose to a record 5.1% year-over-year, mainly driven by rising food and goods prices. However, the recent spike in energy prices is likely to be a catalyst for further acceleration. As a result, financial markets pulled forward expectations of a tightening in eurozone monetary policy, forecasting a rise in the ECB's deposit rate to negative -0.25%, from its current rate of -0.5%, now priced in by December.

The UK economy hit a soft patch due to the spread of Omicron. Retail sales fell 3.7% sequentially in December, and service PMIs declined. Consumer sentiment also suffered on the back of higher energy bills and rising taxation. Headline inflation rose to 5.4% in December and the unemployment rate registered 4.2%. Persistent inflationary pressure and further tightening of the labor market have resulted in the expectation of five interest rate hikes from the Bank of England by the end of the year.

## ASIA

China's economy continued to slow in Q4, showing real GDP growth of 4.0% year-over-year, driven by weak domestic demand. Fixed asset investment decelerated to 4.9% and consumer sentiment was lackluster, with retail sales growing by a meagre +1.7% in December. Reduced mobility, on account of Covid outbreaks and lockdowns, as well as supply constraints, dampened consumption. The property sector also dragged on near-term growth as housing prices fell -0.3% and real estate investment declined -13.1% year-over-year. In contrast, China's external sectors remained in good shape. Export growth continues to annualize over 20%, thanks to robust fixed asset investments in manufacturing. The trend towards reduced growth has led to more accommodative stimulus policies, in direct contrast with the West.

## OUTLOOK

The transitory inflation narrative that assuaged markets in 2021 has been abandoned by the Federal Reserve as it pivots to a hawkish stance. While Quantitative Easing will soon turn into Tightening, the Fed appears to be behind the curve. Financial markets are pricing that the lowest peak in interest rates (2.0%) since the 1950's will be sufficient to tame inflation. Further, gridlock in Washington has led pundits to expect that fiscal stimulus will wane. The Build Back Better package, featuring \$1.8 trillion in spending (over 10 years), funded by \$1.5 trillion in taxes, appears to have a reduced chance of being approved, with the risk that it will have to be downsized. These liquidity holes are likely to impact assets broadly, especially given that the economy is more resilient at present. On the other hand, supply shortages are set to fade in the relatively near term, as the pandemic subsides, easing inflation pressures. Combined with recovering labor markets, the process of post-pandemic normalization should lead to robust consumer spending amid moderate price increases. This backdrop should be supportive of global economic growth over the intermediate term.

The current inflationary impulse will likely lead to corporate revenue growth acceleration. Profits are also poised

to rise, but will be partially offset by increasing costs. The associated rise in interest rates has begun to remove some froth off the highest valued (and heretofore best performing) growth stocks, as discounted future cash flows are worth less in the current environment. Conversely, central bank tightening, and the associated increases in bond yields, are generally beneficial for value stocks. We would not be surprised to see these market trends continue for as long as tightening monetary policies are in force.

January provided a stark warning to investors that in times of heightened inflationary risks, bonds provide less protection to portfolios than in recessionary periods, and do not diversify stock portfolios during risk-off episodes. Fixed income investors have enjoyed decades of declining interest rates and robust total returns, thanks to global central bank stimuli on the back of deflationary tendencies. Risk averse investors are now faced with negative real (after inflation) returns on their bonds. Looking ahead, in the absence of central bank easing, and with the prospect that cash will soon be offering some yield, investors could be less willing to purchase long-duration government debt, potentially significantly steepening the yield curve. As such, we continue to suggest the avoidance of long duration bonds, in favor of short maturity and variable rate securities.

With economies and corporate profits on an upward trajectory, amid strong demand and rising prices, equities still have room to advance. Importantly, there is the potential for returns to be broader based than what has been witnessed over the past several years when a handful of stocks provided the lion's share of returns. Thus, we believe that actively managed strategies have the propensity to outperform going forward. Our favored equity managers are well equipped to navigate the current market environment. Further, we retain a positive view of hedged credit, as well as inflation protected investments such as real estate, energy exploration, and water infrastructure. For long-term investors seeking to capitalize on trends in technology we believe the current pullback in the sector is a worthy entry point into our Nordic Technology and Innovation Fund.

Important Disclosure and Terms of Use: Property of Papamarkou Wellner Asset Management, Inc. For targeted distribution only and not a solicitation. This report may not be displayed, reproduced, distributed, transmitted, or used to create derivative works in any form, in whole or portion, by any means without express written consent by Papamarkou Wellner Asset Management, Inc. or its operating subsidiary, Papamarkou Wellner & Co., Inc. MEMBER: FINRA/SIPC. All opinions expressed within unless otherwise stated are those of Papamarkou Wellner Asset Management, Inc. based on the most recent market, security, and economic data available.

Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.