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WEALTH

JANUARY 2022 MARKET RECAP

ANDREW MURPHY, CFA
Co-Chief Investment Officer

The stock market stumbled to begin the year as the S&P 500 declined by -5.2% in January; the worst monthly performance since March 2020. On a closing basis, the S&P reached a new all-time high on January 3rd before narrowly missing a correction (-10% drop) and declining by -9.7% through January 23rd. From there, the market staged a solid +4.4% rally in the last two trading days of the month.

- **Market Cap**: Large Caps (-5.2%) outperformed Mid (-7.2%) and Small Caps (-9.6%).
- **Style**: Value (Russell 1000 Value:-2.3%) exceeded Growth (Russell 1000 Growth:-8.6%).
- **Sector**: Only two were positive for the month with Energy (+19.1%) and Financials (+0.1%) as the leaders, and Real Estate (-8.5%) and Consumer Discretionary (-9.7%) as the laggards.
- **Yields**: The 10-Year Treasury increased by 27 basis points to 1.78%.
- **Fixed Income**: The Bloomberg Barclays US Aggregate Bond index (Agg) decreased by -2.2%.

The market weakness was mainly due to increased expectations the Fed will begin to tighten monetary policy quicker than expected. Since the start of the year, the market forecast has shifted from 3 to 5 rate hikes in 2022 – this is a substantial shift in monetary policy expectations in a short amount of time. Our view heading into 2022 was that the markets and the economy would be forced to stand on their own, which means decreased levels of monetary and fiscal stimulus leading to decelerating rates of economic and corporate earnings growth. To use an analogy, the Fed is working to remove the training wheels a bit earlier than anticipated, and the markets wobbled in response.

2021 was notable for the lack of volatility as the S&P 500's largest peak-to-trough decline was only -5.2%. Since 1928, the S&P 500's largest annual peak-to-trough decline has averaged about -15%. Since we know that the stock market does not move in a straight line forever, we prepared for volatility by taking profits and shifting portfolios more defensively as the markets moved higher. We suspect that volatility will continue to be prevalent as markets continue to adjust to an environment without significant monetary support. We will highlight that the S&P 500 has increased in 11 of the last 12 periods when the Fed was increasing rates. Thus, the Fed tightening monetary policy does not mean that stocks cannot increase, it just likely means that the ride will be bumpier.

The markets have several major events over the next month, including, the OPEC+ Meeting (2/2), January Employment Report (2/4), CPI Inflation (2/10), FOMC Minutes from the 1/26 Meeting (2/16), US Government Funding Expiration (2/18), and PCE Inflation (2/25). We will continue to apply our time-tested investment process based on risk management, asset allocation, and security selection to utilize any volatility as an opportunity to reposition portfolios.

As we have done in the past, we will provide an update on the major factors driving the market:

Monetary Policy

The January FOMC meeting was the key event in the month as the Fed signaled that they will soon start tightening monetary policy by raising interest rates and decreasing the size of their nearly $9 trillion balance sheet. Expectations for the magnitude of Fed tightening have shifted significantly over the past few months as inflation readings continue to remain elevated.

Interest Rates: The federal funds rate has been at a range of 0% to 0.25% since March of 2020. The Fed has telegraphed that the first rate hike since the pandemic will likely occur at the upcoming March meeting. During the January FOMC press conference, Fed Chair Powell commented that, "I think there's quite a bit of room to raise interest rates without threatening the labor market." The market interpreted Powell's comments to mean the Fed is about to embark on a steady rate hiking cycle and has now priced in five rate hikes in 2022.

Balance Sheet: Since the pandemic, the Fed's balance sheet has expanded by about $4.5 trillion to nearly $9 trillion. The balance sheet grew mainly due to the Fed's quantitative easing program which was designed to pump liquidity into the financial system and keep long-term interest rates low. The Fed is now planning to end the quantitative easing program in March and will soon announce the details of how they will reduce the size of their balance sheet. Most market participants expect the balance sheet runoff to start around the summer of 2022.

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Our takeaway from the latest Fed meeting is that it seems like Chair Powell and the committee want to raise rates a few times, start the balance sheet runoff process, and then reassess where the economy and inflation stand. While the market interpreted his press conference as the beginning of a significant rate hike cycle, Fed Chair Powell used words like "adaptable" and "nimble" to discuss future policy rather than laying out a specific plan. Whether or not the Fed raises rates five times this year will depend on if inflation readings and the markets. The Fed will hold off on rate increases if inflation starts to decelerate or the markets have a significant decline. Fed Chair Powell has demonstrated that he is data dependent and will quickly change policy as the economy and markets evolve.

Inflation

Inflation readings continue to run at their highest levels in decades due to supply chain bottlenecks, surging energy prices, and pent-up demand.

The Fed's preferred inflation measure (Core PCE inflation) increased by +4.9% Y/Y in December, well above the target of about 2%. For most of 2021, the Fed argued that the increase in inflation was transitory and would naturally dissipate by the end of the year. The Fed has now reversed course and is getting ready to tighten monetary policy to bring inflation under control.

We are still trying to combat the current rise in inflation by holding little cash in portfolios, avoiding long-term bonds, and overweighting equities of companies that are able to grow their cash flows, earnings, and dividends. Please see our ***June Client Question on Inflation***, where we detailed how the data is calculated, why the Fed cares about and targets inflation, and the impact it has on various asset classes (cash, fixed income, and equities). In our ***December Client Question – Revisiting Inflation***, we thought it would be helpful to outline three potential scenarios for how inflation could impact the economy and stock market in 2022, provide an update on supply chain bottlenecks, and look at the latest readings of various inflation measures and forecasts.

Economic Data

Real GDP is still estimated to increase by +5.7% in 2021 and +3.8% in 2022.

Labor Market: The labor market continues to exhibit signs of recovery as the latest Bureau of Labor and Statistics Employment report showed an increase of +199,000 jobs in December. Since the start of the pandemic, the labor force has lost about 3.5 million jobs, while the latest Job Openings and Labor Turnover Survey (JOLTS- December) reported over 10.9 million job openings. The January employment report, which will be released on February 4th, is expected to show the impact of Omicron with a forecast of only +1
50,000 jobs and the unemployment rate staying flat at 3.9%.

While inflation, supply chain issues, covid, and fading stimulus will remain an overhang, the economy is on solid ground supported by a recovering labor market and strong consumer.

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JANUARY MARKET RETURNS

US Equity										
Index	**2022**	**2021**	**2020**	**2019**	**2018**		**3-Year**	**5-Year**	**10-Year**	**20-Year**
S&P 500	-5.17%	28.68%	18.39%	31.48%	-4.39%		20.68%	16.76%	15.40%	9.30%
Russell 3000	-5.88%	25.64%	20.88%	31.01%	-5.25%		19.90%	16.09%	15.01%	9.45%
Dow Jones Industrial Average	-3.24%	20.95%	9.72%	25.34%	-3.48%		14.46%	14.61%	13.42%	9.14%
Nasdaq	-8.96%	22.21%	45.05%	36.74%	-2.81%		26.18%	21.66%	18.98%	11.66%
S&P 400	-7.21%	24.73%	13.65%	26.17%	-11.10%		14.52%	11.01%	12.59%	10.16%
Russell 2000	-9.63%	14.78%	19.93%	25.49%	-11.03%		11.95%	9.66%	11.31%	8.84%
Russell 1000 Growth	-8.58%	27.59%	38.49%	36.39%	-1.51%		26.41%	22.26%	18.01%	10.45%
Russell 1000 Value	-2.33%	25.12%	2.78%	26.52%	-8.28%		13.80%	10.46%	12.26%	8.23%
International Equity										
MSCI Index	**2022**	**2021**	**2020**	**2019**	**2018**		**3-Year**	**5-Year**	**10-Year**	**20-Year**
EAFE	-4.83%	11.26%	7.82%	22.01%	-13.79%		9.33%	7.85%	6.93%	6.36%
Europe	-4.86%	13.54%	7.89%	23.20%	-16.90%		10.40%	8.54%	7.47%	5.69%
Japan	-5.07%	1.71%	14.48%	19.61%	-12.88%		7.60%	6.60%	7.30%	5.78%
China	-2.95%	-21.72%	29.49%	23.46%	-18.88%		3.02%	7.28%	5.75%	11.43%
Emerging Markets	-1.89%	-2.54%	18.31%	18.42%	-14.57%		7.19%	8.29%	4.16%	9.30%
ACWI ex US	-3.69%	7.82%	10.65%	21.51%	-14.20%		9.08%	8.03%	6.18%	6.82%
US Fixed Income										
Bloomberg Barclays Index	**2022**	**2021**	**2020**	**2019**	**2018**		**3-Year**	**5-Year**	**10-Year**	**20-Year**
Aggregate	-2.15%	-1.54%	7.51%	8.72%	0.01%		3.66%	3.08%	2.58%	4.17%
Treasury Bills	0.00%	0.04%	0.54%	2.21%	1.83%		0.86%	1.07%	0.58%	1.21%
Corporates	-3.37%	-1.04%	9.89%	14.54%	-2.51%		5.55%	4.48%	4.11%	5.30%
Securitized MBS/ABS/CMBS	-1.48%	-1.04%	4.18%	6.44%	0.99%		2.36%	2.28%	2.15%	
High Yield	-2.73%	5.28%	7.11%	14.32%	-2.08%		6.25%	5.40%	6.21%	7.64%
Munis	-2.74%	1.52%	5.21%	7.54%	1.28%		3.50%	3.46%	3.20%	4.31%
US Equity Sectors										
Index	**2022**	**2021**	**2020**	**2019**	**2018**		**3-Year**	**5-Year**	**10-Year**	**20-Year**
Technology	-6.89%	34.52%	43.88%	50.29%	-0.29%		36.26%	29.12%	22.21%	12.11%
Real Estate	-8.50%	46.14%	-2.17%	29.00%	-2.23%		15.05%	12.84%	9.79%	
Industrials	-4.73%	21.10%	11.05%	29.32%	-13.32%		14.13%	11.37%	12.84%	8.55%
Energy	19.10%	54.35%	-33.68%	11.81%	-18.10%		7.05%	2.77%	2.81%	7.35%
Consumer Discretionary	-9.68%	24.43%	33.30%	27.94%	0.82%		20.21%	17.91%	17.67%	10.89%
Communication Services	-6.21%	21.57%	23.61%	32.69%	-12.53%		19.20%	10.61%	11.15%	6.53%
Consumer Staples	-1.37%	18.63%	10.75%	27.61%	-8.39%		16.26%	11.08%	12.24%	9.47%
Utilities	-3.27%	17.67%	0.52%	26.35%	4.11%		11.80%	10.75%	11.09%	8.85%
Materials	-6.85%	27.28%	20.73%	24.58%	-14.70%		19.11%	12.47%	10.82%	9.42%
Financials	0.06%	34.87%	-1.76%	32.09%	-13.04%		17.16%	13.15%	15.36%	5.39%
Health Care	-6.76%	26.13%	13.45%	20.82%	6.47%		15.40%	15.42%	16.00%	9.12%
Calendar Year Returns							**Annualized Returns**			

SOURCE: Bloomberg

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The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Russell 3000 Index is a market-capitalization-weighted equity index maintained by FTSE Russell that provides exposure to the entire U.S. stock market. The index tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities.

The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.

The S&P Midcap 400 Stock Index is an unmanaged index generally representative of the market for the stocks of mid-sized US companies.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The prices of small cap stocks and mid cap stocks are generally more volatile than large cap stocks.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following developed country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

The MSCI Europe Index captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe. With 445 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 322 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

The MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 709 constituents, the index covers about 85% of this China equity universe. Currently, the index includes Large Cap A and Mid Cap A shares represented at 20% of their free float adjusted market capitalization.

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of the Americas, Europe, the Middle East, Africa and Asia. The MSCI EM Index consists of the following emerging market country indices: Brazil, Chile, Colombia, Mexico, Peru, Czech Republic, Egypt, Greece, Hungary, Poland, Qatar, Russia, South Africa. Turkey, United Arab Emirates, China, India, Indonesia, Korea, Malaysia, Philippines, Taiwan, and Thailand.

The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 27 Emerging Markets (EM) countries. With 2,354 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

The Bloomberg Barclays Capital U.S. Credit Bond Index measures the performance of investment grade corporate debt and agency bonds that are dollar denominated and have a remaining maturity of greater than one year.

The Bloomberg Bloomberg Barclays Capital US Corporate High Yield Bond index is an index representative of the universe of fixed-rate, non-investment grade debt.

The Bloomberg Barclays Insured Municipal Bond Index is a total return performance benchmark for municipal bonds that are backed by insurers with Aaa/AAA ratings and have maturities of at least one year.

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