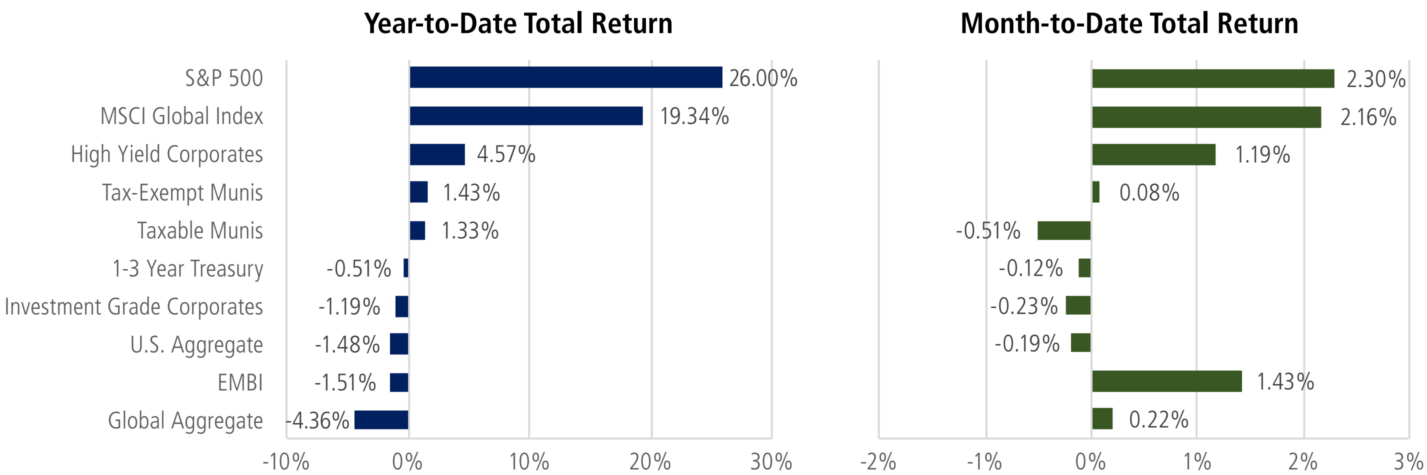
Week Ending: **December 17, 2021**

On The Good(s) List

Economic Overview:

A key part of our forecast in 2021 was the idea that consumers would return to spending on services as vaccines enabled them to participate in activities inhibited by the pandemic. And while spending on services has picked up relative to 2020 levels, spending on goods remains well above pre-pandemic trend. Turns out, this shift in consumer behavior has been responsible for many of the economic woes we've seen this year, most notably inflation. Why has it had such a large impact? Well, some goods, particularly durable goods, take longer to create, meaning the supply is relatively inelastic compared to demand. Add in a shortage of port and warehouse workers around the world due to rolling waves of the virus, and you've got one big mess. The key question moving forward will be whether this change in consumer behavior will be more persistent or whether we'll see a delayed return to services just as goods producers' supply is catching up? We caution against extrapolating too much from the unique pandemic episode.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

- **High Yield:** We are closing in on the end of 2021, and at risk of a jinx, it appears that the high yield bond market will post its 11th positive absolute annual return in the 13 years since the Global Financial Crisis. The broad market has returned 4.6% this year, and in a year where interest rates rose, high yield bonds proved once again to be a nice diversifier for fixed income portfolios.

- **Corporates:** It's a wrap for investment-grade (IG) corporate new issue supply in 2021. It was a historic month as a record $63 billion came to market in the first two weeks of December putting year-to-date supply at an impressive $1.38 trillion beating out estimates that called for roughly $1.25 trillion in the beginning of the year. With the potential for three rate hikes in 2022, we may be in for a very busy new issue calendar in Q1.

- **Securitized Products:** 2021 was a record year for structured product new issuance, led by over 100% increases in the collateralized loan obligation (CLO) and commercial mortgage-backed securities (CMBS) sectors. Collateral performance was strong across sectors with low corporate and consumer defaults, reductions in homeowner mortgage forbearance, and better-than-expected commercial real estate delinquencies. Home price appreciation is expected to be positive next year, while consumer performance is expected to normalize with the roll off of government stimulus.

- **Municipals:** While U.S. Treasury rates rallied in reaction to the latest Federal Open Market Committee (FOMC) decision to increase the speed of its taper, municipals remained unmoved. Municipal bond fund flows saw a decline in comparison to the previous week, which marked its 40th consecutive week of positive flows and brought the total inflows for this year to roughly $82 billion. Municipal performance is expected to remain robust through January 2022.

- **Equities:** U.S. equity markets fell for the third time in the last four weeks on continued concerns about the Omicron variant and tightening monetary policy. Market volatility stayed elevated as the overall tone remained risk-off with the energy and technology sectors leading markets lower while traditionally defensive sectors like health care, REITs, consumer staples, and utilities posted gains.