RJO Previews and Perspectives for Friday, Dec 31

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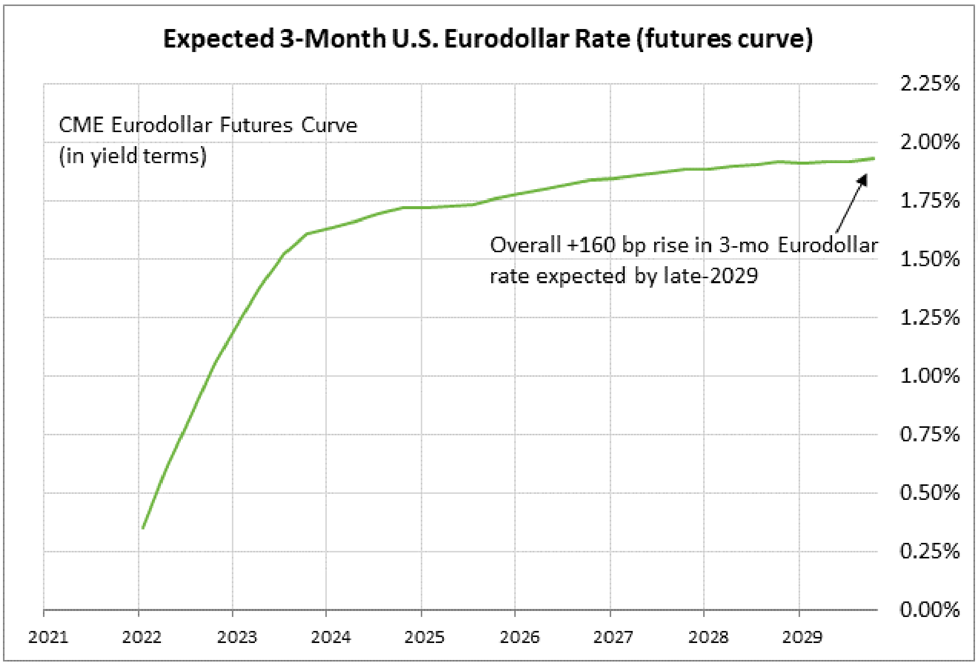
Weekly market focus -- The markets next week will focus on (1) the pandemic situation as the omicron variant spreads quickly, (2) further analysis of how quickly the Fed might raise interest rates in 2022, (3) next week's economic calendar that features the Dec unemployment report on Friday (payrolls expected +400,000), and (4) any news about whether Democrats will be able to rebuild the Build Back Better bill after Senator Manchin's rejection.

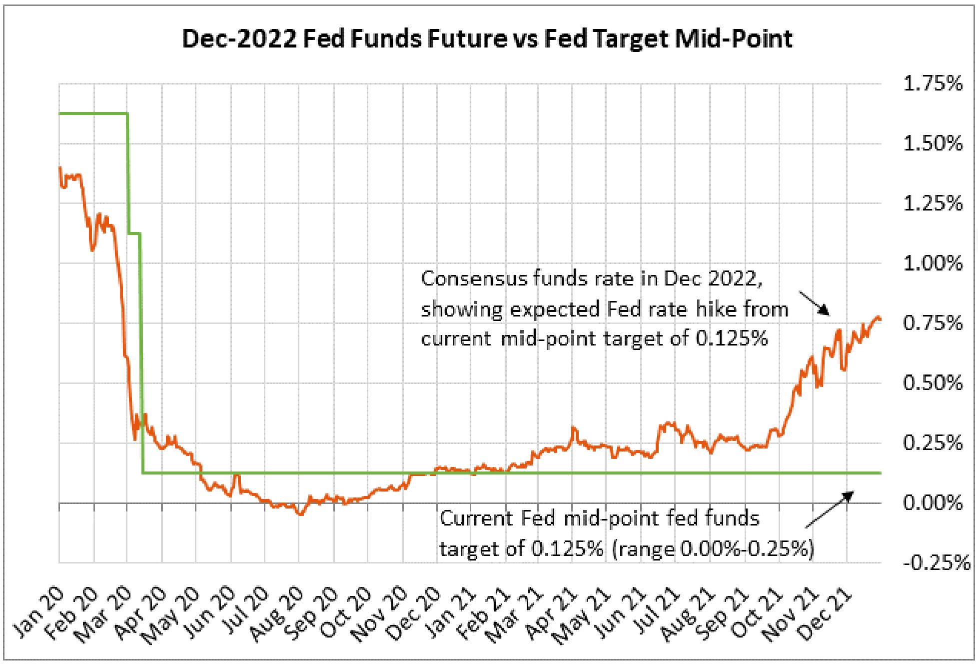
Markets take hawkish view of Fed policy despite omicron -- The markets are taking a hawkish view of Fed policy as the incoming scientific data reduces the concern about the omicron variant.

The Dec 2022 federal funds futures contract on Thursday (on a yield basis) closed at 0.765%, which was just 1.5 below Wednesday's 1-3/4 year high of 0.78% and reflected expectations for an overall +69 bp rate hike during 2022 from the current effective federal funds rate of 0.08%. However, that is still 14 bp less hawkish than the Fed's dot-plot that is forecasting a rise in funds rate to 0.90% by the end of 2022.

The Fed, at its recent Dec 14-15 FOMC meeting, made a decisive statement about its inflation resolve by doubling the pace of its QE tapering, thus ensuring that it could start raising interest rate as soon as the March 2022 FOMC meeting. The Fed in 2022 currently anticipates one rate hike per quarter in Q2 through Q4.

However, the Fed might not have to raise interest rates that quickly in 2022. The omicron surge will take a toll on the U.S. economy in early 2022. In addition, Senator Manchin's blow-up of the BBB bill means that, as of now, there will be no extra fiscal stimulus in 2022 to prop up the economy.





Markets await the return of Congress in early January -- Congress this week was still on holiday recess. The Senate will return to Washington on January 3, while the House is scheduled to return on January 10.

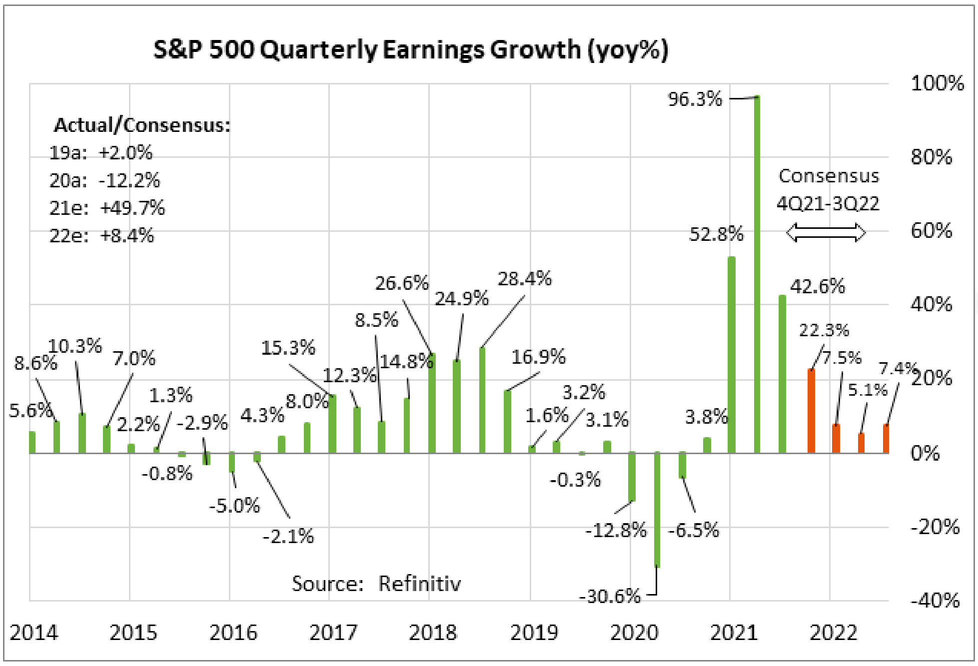
The main item of business for Senate Democrats is to see if there is a way forward on the $1.75 trillion Build Back Better bill after Senator Manchin rejected the bill. It remains to be seen whether Senate Democrats can come up with some smaller bill that can get Mr. Manchin's vote and the vote of every other Democratic Senator. That process is expected to take a matter of weeks or even months.

The other main agenda item for Congress is to pass an omnibus spending bill to fund the government for the remainder of the fiscal year. Congress has only until February 18 to pass an omnibus spending bill because the current continuing resolution expires on that date.

The debt ceiling is off the market's plate for at least the next year after Congress earlier this month gave its final approval to a debt ceiling increase that will last until early 2023.

Earnings surge will start to fade in Q4 -- Q4 earnings season is right around the corner, with several major Wall Street banks scheduled to release earnings during the week of Jan 10-14. Notable earnings reports next week include Teledyne on Tuesday; and Constellation Brands, Walgreens, and Conagra on Wednesday.

The consensus is that earnings growth for the S&P 500 companies will decelerate to +22.3% y/y in Q4 from +42.6% in Q3, according to Refinitiv. Earnings growth is then expected to decelerate further to +7.5% y/y in Q1, +5.1% in Q2, and +7.4% in Q3. On a calendar year basis, SPX earnings growth is expected to decelerate to +8.4% in 2022 from +49.7% in 2021.



Stock market is on shaky ground as omicron surges -- The U.S. stock market has rallied sharply in the past two weeks despite the fact that new U.S. Covid infections have surged to a record high. The stock market will be on shaky ground until there is a peak in the omicron surge.

Dr. Fauci yesterday ventured a guess that the omicron surge might peak in late January. Dr. Fauci based his optimism on the quick peak seen in South Africa, the epicenter for the omicron variant.

Public authorities are so far relying on vaccinations and testing to try to muddle through the current Covid surge. However, if hospitals start to be overwhelmed with new Covid patients, then public authorities may have no choice but to start imposing some restrictions. The U.S. and global economies, in any case, are likely to take a hit as many people decide on their own to stay home to avoid getting infected.

The 7-day average of new U.S. Covid infections on Wednesday reached a new record high of 301,957, which was up +80% w/w and +252% since December 1.

The markets are encouraged that the hospitalization and death rates from Covid have been limited compared with the surge in new cases. However, the markets will keep a close eye on the hospitalization and death rates since those are lagging indicators and will likely rise in the coming weeks.

On the brighter side, the U.S. vaccination rate continues to climb, which will provide at least some protection against the omicron variant. Bloomberg reports that 61.9% of the total U.S. population has now been fully vaccinated, and 19.4% have received a booster shot. In the past week, the U.S. has administered a daily average of 1.18 million doses.