

Jittery Markets Focus Squarely on the Fed

The holiday-shortened week brought an abbreviated slate of economic releases, *none of which made much of an impact on the financial markets*. Instead, the markets are focused on next week's FOMC meeting, where committee members are expected to tee-up the first quarter point rate hike for mid-March. However, it's not the widely-expected announcement of the initial 25 bp rate hike that's unnerved the financial markets, but rather an expanding range of policy possibilities that now include a faster tapering plan, as much as 100 or 125 bps of total tightening in 2022, a larger 50 bp hike if inflation doesn't settle down, and the start of balance sheet reduction later this year. All of these scenarios, which would have seemed farfetched six weeks ago, will likely be discussed at next week's meeting.

The FOMC has been in a blackout period this week, meaning committee members are prohibited from communicating publicly until after next Wednesday. Last week, a parade of Fed speakers found podiums, all were of like-mind, pledging to combat inflation with a range of tools. The markets have had a week to consider what this could mean, but won't have answers until Chairman Powell's post-meeting press conference. In the meantime, the bond market has priced-in four rate hikes for 2022.

This week's discounted economic news included unexpected jumps in both housing starts and building permits for December, weaker-than-expected existing home sales and a spike in weekly unemployment filings.

The warmest December on record probably contributed to the +1.4% rise in housing starts last month. The 1.702 million unit annualized pace topped the 1.65 million median forecast and pushed total starts for 2021 to a 15-year high. New starts last month were concentrated in multifamily units, as has been the case all year. For 2021, single family starts were up over 12%, while multifamily starts climbed 20% as builders chose to focus on more profitable projects.

Building permits, a proxy for future starts, rose +9.1% in December to a 1.873 million unit annualized pace, crushing the 1.7 million unit forecast. In isolation, the increase in starts and permits is quite positive for the housing market, but with inventory still painfully low and lengthy construction delays being commonplace, supply will continue to lag demand for the foreseeable future, keeping extreme pressure on home prices.

Existing home sales fell -4.6% in December to an annualized unit pace of 6.18 million, a four-month low. For the year, (subject to revision) there were 6.12 million existing homes sold, a +8.5% increase over 2020 and the highest total since 2006. This total would have been considerably higher if more homes were available. The number of listed homes remaining on the market at the end of December was just 910,000, the lowest in 22 years of record keeping. The hope for 2022 is that the COVID wave will recede, allowing more homeowners to list their property.

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Director
512.481.2012
greg.warner@hilltopsecurities.com

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Mortgage rates, which have been climbing since August, have accelerated over the past four weeks. The 30-year fixed rate mortgage, *according to Freddie Mac*, averaged 3.56% during the week ending January 20, up from 3.05% in mid-December and 2.77% in early August. Higher borrowing rates (along with rising home prices) have traditionally slowed home sales, but given the increased number of investors and cash buyers in the market, higher rates are less likely to impact demand.

On the employment front, initial jobless claims for the week ending January 15, rose by 55k to 286,000, a three-month high. This increase is likely due to the record number of workers being affected by the recent COVID surge, and given the tightness in the labor market, is unlikely to establish a trend.

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Market Indications as of 1:54 P.M. Central Time

DOW	Down -288 to 34,427 (HIGH: 36,800)
NASDAQ	Down -258 to 13,896 (HIGH: 16,057)
S&P 500	Down -49 to 4,433 (HIGH: 4,797)
1-Yr T-bill	current yield 0.55%; opening yield 0.55%
2-Yr T-note	current yield 0.99%; opening yield 1.02%
3-Yr T-note	current yield 1.27%; opening yield 1.30%
5-Yr T-note	current yield 1.55%; opening yield 1.57%
10-Yr T-note	current yield 1.75%; opening yield 1.79%
30-Yr T-bond	current yield 2.07%; opening yield 2.11%

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