Amadeus Wealth Alternatives 1345 Ave. of the Americas 2nd Fl., New York, NY 10105 www.amadeuswealth.com

212-697-3930

Edward Papier, CIMA®, CFF

ep@amadeuswealth.com

In this week's recap: Volatile week as Fed speaks of multiple rate hikes.

Weekly Economic Update

Presented by Ed Papier, January 17, 2022

THE WEEK ON WALL STREET

Deteriorating investor enthusiasm for high-valuation growth companies and a mixed start to the fourth-quarter earnings season made for a volatile week.

The Dow Jones Industrial Average lost 0.88%, while the Standard & Poor's 500 slipped 0.30%. The Nasdaq Composite index fell 0.28% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, gained 1.31%. [1,2,3]

STOCKS STRUGGLE

Stocks were under pressure all week as investors grappled with higher bond yields and talk of possibly four rate hikes this year. Initially, intraday declines would bring out buyers and pare the losses. Investors were particularly heartened by Fed Chair Powell's congressional testimony on Tuesday that softened the hawkish tone found in the minutes of the Federal Open Market Committee's December meeting.

After digesting the hot inflation reports released mid-week, stocks were unable to resist the selling pressures on Thursday. A weak retail sales number, a resumption in the rise in yields, and mixed earnings from some of the big money center banks weighed on the market during Friday's trading.

INFLATION AND THE FED

Inflation reports last week continued to reflect upward momentum in consumer prices. The Consumer Price Index posted a 7.0% year-over-year jump–the biggest increase since 1982, while the Producer

Price Index rose 9.7% from a year earlier–the fastest pace since 2010 when the index was reconstituted.[4,5]

Markets responded calmly as both numbers were in the neighborhood of expectations and the monthly increase for each moderated from previous single-month increases. The price pressures are expected to remain in the face of continuing supply chain constraints and wage growth. The pace and persistence of price increases may influence the speed at which the Fed may tighten in the year ahead.

THE WEEK AHEAD: KEY ECONOMIC DATA

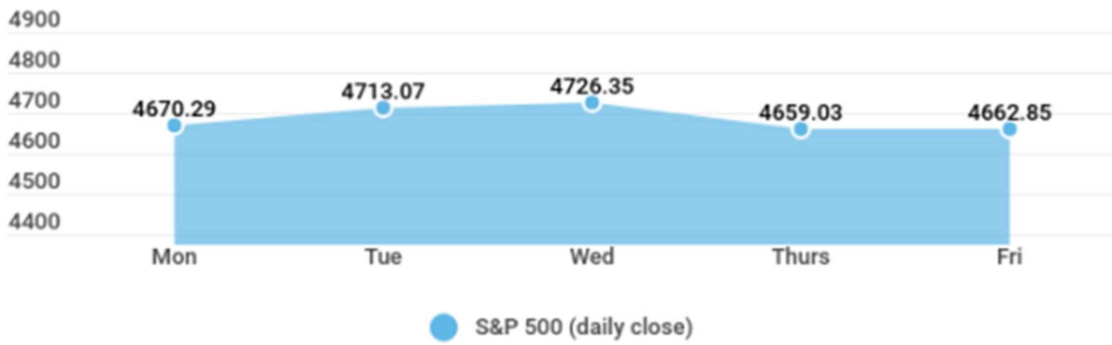
Wednesday: Housing Starts.
Thursday: Jobless Claims. Existing Home Sales.
Friday: Index of Leading Economic Indicators.

QUOTE OF THE WEEK

'A lie doesn't become truth, wrong doesn't become right, and evil doesn't become good, just because it's accepted by a majority"

BOOKER T. WASHINGTON

Market Index	Close	Week	Y-T-D
DJIA	35,911.81	-0.88%	-1.17%
NASDAQ	14,893.75	-0.28%	-4.80%
MSCI-EAFE	2,359.59	+1.31%	+1.01%
S&P 500	4,662.85	-0.30%	-2.17%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.78%	+0.02%	+0.26%

Sources: The Wall Street Journal, January 14, 2022; Treasury.gov, January 14, 2022
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, January 7, to Friday, January 14, close. Weekly performance for the MSCI-EAFE is measured from Friday, January 7, open to Thursday, January 13, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

"Market Breadth" has narrowed substantially in recent months. Goldman's Breadth Index hit its maximum level of 100 in April 2021 and has since fallen to the current near-record low level of 16. [6]

What is Market Breadth? Market Breath indicators analyze the number of stocks advancing relative to those that are declining in a given index or on a stock exchange, such as the New York Stock Exchange or Nasdaq. Positive market breadth occurs when more stocks are advancing than are declining. This suggests that the bulls are in control of the market's momentum and helps confirm a price rise in the index. Conversely, a disproportional number of declining securities is used to confirm bearish momentum and a downside move in the stock index.

Certain breadth indicators also incorporate volume. They will not only look at whether a stock is advancing or declining in price, but also at the volume of those moves. This is because price moves on larger volume are considered to be more significant than price moves on lower volume.

Key Takeaways include:

- Market breadth looks at the relative change of advancing to declining securities in a market.
- Market breadth indicators may forewarn of reversals and uncover strength or weakness in the movements of an index that are not visible simply by looking at a chart of the index. This occurs when the indicator diverges from the index.
- Indicators may look at advance and declining stocks, volume, the number of stocks reaching certain hurdles, and other metrics.

Market breadth refers to how many stocks are participating in a given move in an index or on a stock exchange. An index may be rising yet more than half the stocks in the index are falling because a small number of stocks have such large gains that they drag the whole index higher. That appears to be the case today where the five most popular tech names - AAPL, MSFT, NVDA, TSLA, GOOGL - have contributed 51% of S&P 500 returns since April.

Market breadth indicators can reveal these relationships and warn traders that most stocks are not actually performing well, even though the rising index makes it look like most stocks are doing well. Volume may also be added into these indicator calculations to provide additional insight into how stocks within an index are acting overall.

Market breadth attempts to find how much underlying strength or weakness there is in a given stock index. By assessing the strength or weakness, which isn't plainly visible by looking at a chart of the index, technical traders gain insight into what the index may do next.

Traders use market breadth indicators to assess the overall health of a market/index. Market breadth indicators can sometimes provide early warning signs of a drop in the index or forecast a coming rise in the index.

Despite their usefulness to technical analysts, market breadth indicators are poor timing signals. They may provide signals way too early or may not forecast an index reversal that does occur.

Here is a sampling of frequently used market breadth indicators:

- Advance-Decline Index: This indicator, also known as the A/D line, calculates a running total of the difference between the number of advancing and declining stocks. Traders typically look for divergence between the indicator and a major market index, such as the

S&P 500. For example, if the S&P 500 is rising and the A/D index is falling, it indicates the current uptrend in the index may be losing its momentum. On the other hand, if the S&P 500 is falling and the A/D index is rising, it suggests that the move lower in the index may be about to reverse.

- New Highs-Lows Index: The new highs-lows indicator compares stocks making 52 week highs to stocks making 52-week lows. A reading below 50% indicates that more stocks are reaching their lows compared to stocks that are reaching their highs and could signal a move into a bear market. Contrarian investors may use this market breadth indicator to buy or sell stocks when it gives extreme readings, such as below 30% or above 70%.
- S&P 500 200-Day Index: Traders can use this index to see what percentage of stocks in the S&P 500 are trading above their 200-day moving average. A rising indicator above 50% indicates broad market strength. Similar to the new highs-lows index, traders often look for extreme readings to find overbought and oversold conditions in the broader market. Short-term traders who want a more sensitive moving average to provide earlier signals can use a 50-day index that shows what percentage of stocks are trading above their 50-day moving average.
- Cumulative Volume Index: This indicator measures volume. Stocks that rise have their volume added to the positive volume. Stocks that declined have negative volume. The indicator keeps a running total of whether the overall volume is positive or negative, and by how much, and is used in a similar fashion to the A/D line.
- On-Balance Volume: This indicator also looks at volume, except up or down volume is based on whether the index rises or falls. If the index falls, the total volume is counted as negative. If the index rises, the total volume is negative. Each day is added or subtracted from prior readings to give a running total. It is used in a similar way to the A/D line. [7]

It's been noted that following periods of sharply narrowing market breadth, similar to the recent experience, equities have historically exhibited weaker-than-average returns and deeper drawdowns. Specifically, since 1980, there have been 11 episodes in which market breadth has narrowed by as much during a 6-month period as it did from April to October 2021. This dynamic also occurred in Sept 2007, May 2015, and Sept 2018, among others. Following most of these episodes, the S&P 500 generated a below-average return over the subsequent 1, 3, 6, and 12 months. The S&P 500 also experienced sharper peak-to-trough drawdowns in the months following these episodes. As an aside, record index concentration is both a cause and a symptom of a narrow market. The market-cap weight of the 10 largest stocks in the index has increased for each of the past 7 years and now registers at 31%, the highest level since at least 1980.

Investors frequently ask whether there is an elevated likelihood of a larger drawdown in the coming months. Concerns include virus spread, higher-than-expected inflation, continued supply chain difficulties, and highly valued corners of the market. The most commonly asked question about risks faced by investors relates to the potential impact of accelerated Fed tapering. And while everyone is fixated on the Fed's "turbo taper", doubling the pace of tapering to $30BN, Morgan Stanley, which has long been bearish on risk assets believes this news will trigger market chaos over the next 3-4 months. [6]

Ed Papier may be reached at 2126973930 or ep@amadeuswealth.com
www.amadeuswealth.com

Know someone who could use information like this?
Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:

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