Highlights and Insights

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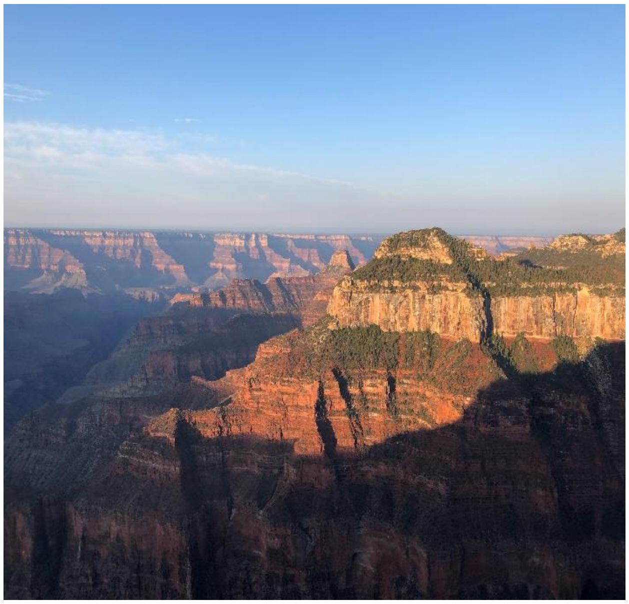

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Market Musings

The Well-Worn Bearish Narrative

Some say it is a chaotic and frustrating time to be an investor. Rising employment and wages and resilient consumer spending are offset by rising inflation driven mostly by volatile commodity markets and supply chain disruptions. Higher corporate earnings estimates are being met by declining price-earnings multiples. And the Russia-Ukraine conflict raises unknown and unknowable geo-political risks. Stock prices inevitably were lower to reflect such a dismal environment.

All the bearish headlines have been overwhelming and lay the foundation for investors to get trapped in "confirmation bias", the tendency to put more weight on information that supports a pre-existing view. There are many analysts and investors committed to the outlook that the global economy is declining, and stocks are headed for a massive move lower, and the Federal Reserve (the "Fed") can make it worse.

It goes like this: Since the end of the second World War, the Fed has never successfully engineered a decline in inflation that was running more than 4% that didn't result in a recession. This was because they had to break either the economy or the financial markets to reverse the previous cycle's household wealth gains so as to reduce consumer spending and prices.

But the Fed's recent public pronouncements about their future intentions, while only raising the Federal Funds rate to a range of .50% -.75% so far, have already forced 10-year bond yields up from 1.5% to 3% this year, causing the worse drop in bond returns since the middle of the 19th century. And most speculative equity positions have been wiped out such as the 78% decline from its high in Cathie Wood's Ark Innovation Fund (ARKK) and cryptocurrency index fund Bitwise (BITW) falling from $100 to $15. Both the Nasdaq[1] and the Russell 2000[2] have declined by 30*%. The Fed has already broken a lot of things*. All of this has tightened financial conditions already.

So, is it highly unlikely that the Fed will push as hard as the market has already discounted? In fact, the Fed's favorite inflation gauge, the personal consumption deflator (PCE), excluding food and energy, already peaked in February on a year-to-year basis.[3] And the worry about surging wages pushing up inflation may be premature, as average hourly earnings have been declining on a year-to-year basis for the past three months.[4] Existing and new home sales are falling sharply, and housing inventories have risen to a 9-month supply as mortgage rates are near 5%.[5] Real income growth is negative and anecdotes from Amazon, Walmart and Target suggest retail inventories are close to being fully replenished even as overall consumption growth is decelerating.

All of this suggests a lower glide path for inflation, the size and extent of monetary tightening, and the diminished odds of stocks making a "massive move lower".

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1. The Nasdaq Composite is a capitalization-weighted index that includes almost all stocks listed on the Nasdaq stock exchange and is heavily weighted towards companies in the information technology sector.
2. The Russell 2000 Index is a small-cap stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.
3. Source: Bureau of Economic Analysis.
4. Source: Bureau of Labor Statistics and Tradingeconomics.com.
5. Source: National Association of Realtors and Tradingeconomics.com.