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Market Update - Federal Reserve

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We thought this would be a good time to recap what has been happening in the markets, and with the FED, since the first of the year. We've had a few questions from those carefully watching the markets swing, not just daily, but intra-day. This kind of move can cause a bit of uncertainty and fear. The markets have been searching for direction, and we have been seeing quite a bit of broad-based buying as the indices hit day lows. I think we can agree that it is extremely difficult to pick the exact bottom of a cycle, and with that, we will certainly see continued volatility.

In 2021, the Federal Reserve myopically indicated it expected to begin raising rates in late 2023. I recall at that time, we believed it to be a dubious remark at best. Since then, the pace of expected raises has gone from 2 by 2022 year-end, to 3, 4, now 5 are expected. And, not just that. The FED indicated it would begin selling off its more than $8Trillion balance sheet of bonds – yes, that is Trillion with a "T". This is their attempt to slow down the incredible rate of inflation. Currently, we are sitting at 40-year highs in the inflation measure. There is some concern that the moves have come too late and will not be able to contain hyperinflation and may hurt the return to normal economic activity.

Recently, the Bureau of Labor Statistics reported the rate of inflation (CPI) at 7%. This is an extremely high report. And, we've been hearing and seeing actual numbers for certain goods at a much higher rate; goods that cannot be substituted. Items such as gasoline, natural gas, and building materials are just a few that we have seen an increase in the last year of between 20% and 50%!

One issue of concern is the way CPI has been calculated has not been consistent. Over the past 30 years, the government has changed the way it calculates inflation more than 20 times. These 'methodological improvements' to the CPI are said to give a more accurate measure of consumer prices. However, these changes could also be a convenient way to include or exclude certain products that give favorably low results. If we were to use the same methodology for CPI that was used in 1980, our inflation rate would be closer to 15%, and if the 1990 methodology was used, it would be near 12%.

GDP recently came in at 6.9%. On the surface, this seems like a good, strong indicator of the economy. Unfortunately, some believe that this number is misleading as the supply chain is still struggling, and this number includes an enormous amount of restocking shelves that haven't been able to be filled for some time now.

Lastly, the markets haven't priced in the effect of a Russian invasion of Ukraine. It is believed if this were to happen, energy prices would immediately spike, causing heavy pressure on stock prices of companies tied to energy prices (Shipping, land transportation, manufacturing, etc.), and further pushing inflation numbers higher.

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What does this all mean?

Continued volatility in the equity markets as well as the bond markets. We expect this to continue until we get clarity on the pace and effect of the FED rate hikes and balance sheet reduction. Further, markets tend to be volatile in a mid-term election cycle – just one more piece of fuel to throw on the fire…

We continue to monitor, make changes, and avoid the areas we are unsure of. The result is the portfolios at this time are not in the structure they would be in a normal year and remain more defensive with a higher cash holding than we would like to have long term. As we see results of FED moves and European issues along with some clarity on midterm elections, we will begin normalizing our portfolio holdings (if all goes as expected).

Please reach out should you have additional questions or wish to discuss further.

Thank you,

~ Your SharpePoint Team

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