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Weekly Market Commentary
May 9th, 2022

April Showers Aren't Bringing May Flowers

The Fed will keep its foot firmly on the brake to avoid steering into the ditch.

The Fed raised rates by 50 basis points (0.50%) last week, the first hike larger than 0.25% in 22 years. The largest takeaway from the meeting was that the Fed is committed to following through on aggressive policy tightening in the coming months to catch up with the inflation curve. It's likely that the next two meetings will also feature 50-basis-point rate hikes, along with an active approach to reducing the size of the Fed's balance sheet.

At the same time, Fed Chair Powell signaled that monetary policymakers are not yet inclined to accelerate the aggressiveness with even larger rate hikes. The Fed acknowledges the need to forge ahead with tightening despite the potentially punitive effects on the economy. However, this suggests that the Fed still sees a window of tightening that is sufficient to bring down inflation without deliberately and completely snuffing out the expansion.

In 1980, the Fed deliberately forced the economy back into recession to stamp out persistently and excessively high inflation. It did so by taking the federal funds rate from 10% to 22%[1]. By comparison, 1994 featured an aggressive tightening phase in which the Fed took its policy rate from 3% to 6% in roughly a year, without producing a downturn in the economy. The market is currently pricing in about a 2.5% increase in the fed funds rate this year.

The Fed will have to remain committed to steady rate hikes in the coming months to establish credibility in fighting inflation. Not doing so would risk inflation expectations becoming unhinged. We think this will, to a degree, come at the expense of economic vibrancy and financial-market enthusiasm, but we still see a reasonable case for a "soft landing" scenario. There are notable differences today, but 1994 and 2018 are credible examples of such a scenario. We think last week's Fed announcement supports our view that the central bank will take an aggressive approach upfront to create space for more flexibility later in the year as the impacts of initial tightening are assessed.

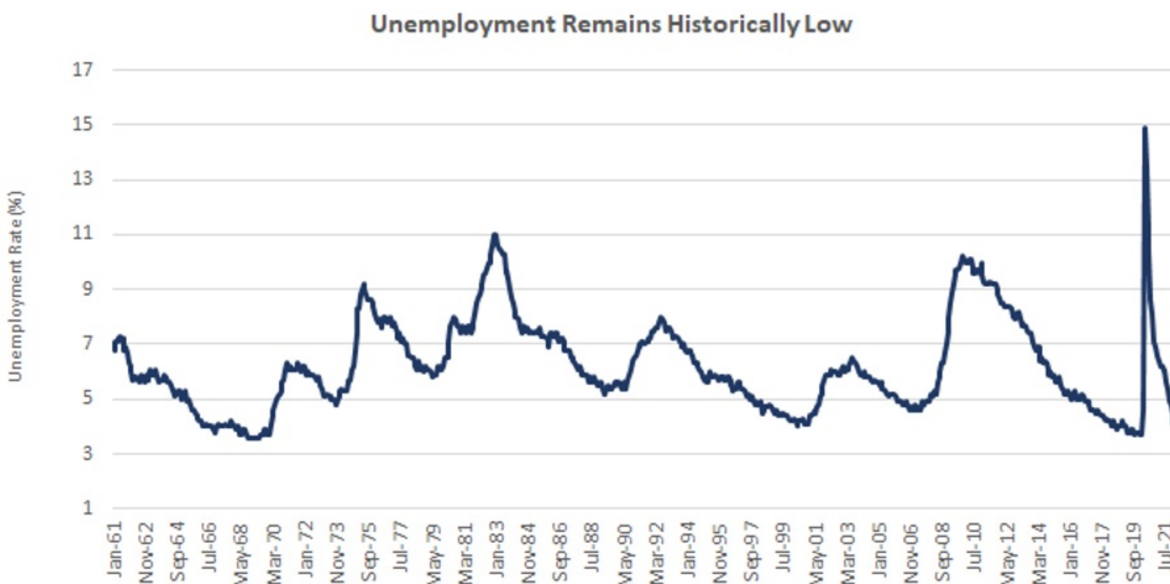
The market is pricing in a recession. We think risks are rising, but a recession is hardly guaranteed.

The economy is slowing due to a combination of factors, including the fading boost from last year's stimulus checks, rising consumer prices that are dampening real wages and consumption, and ongoing supply bottlenecks. The recent pullback, along

with last week's reaction to the Fed meeting, appears to be pricing in a consensus view that a recession is imminent. Don't dismiss these risks. One area of note is housing, which should be particularly impacted by the Fed's actions. We've already seen mortgage applications drop as rates have jumped, and we expect the pace of housing-price gains to simmer from the recent boil (which, by the way, would have the silver lining of reduced inflation pressures stemming from rising shelter costs).

All that said, there is still plenty of evidence that the expansion can advance amid the sturdy headwinds from the Fed. In particular, the most powerful driver of economic activity, the labor market, remains a source of optimism. Last week's jobs report showed a 428,000 increase in payrolls in April, on par with the gains of the previous month and extending the streak of monthly job growth above 400,000 to 12 consecutive months. The unemployment rate held steady at 3.6%, just a tick above the half-century low.

The effects of Fed tightening have yet to seep their way fully through the economy, but we don't think the implications of a healthy labor market should be overlooked, which seems to be the case now. Looking back at the recessions that began in 1980, 1990, 2001, and 2007, the unemployment rate bottomed, on average, 13 months before a recession. Moreover, the unemployment rate rose by at least 0.5% (and an average of 0.6%) before each of those recessions began. We think current unemployment has room to move lower from here, but we think an uptick in the jobless rate would be a requisite for an upcoming recession. While this is not improbable, we think tightness in the labor market can endure this year, helping offset softness in other areas of the economy.



Source: FactSet

This chart shows that the unemployment rate has fallen sharply and remains low compared to historical standards.

The bulk, but not all, of the rising-rate path has been traveled.

One of the unique aspects of this market pullback has been the simultaneous declines in both stocks and bonds. This has sparked concerns among bond investors that the year-to-date declines are just the beginning. There's no denying it has been an abnormal and painful period of fixed income returns, but the yield curve is now pricing in significant rate hikes from the Fed this year. To the extent the Fed does not

have to sign up its rate-hike plans beyond current expectations (which will require inflation to start to moderate soon), interest rates don't have to take another dramatic leg higher from here.

Yields have historically peaked slightly before the conclusion of the Fed-rate-hike cycle1. Given the evolution of increased transparency and communication around Fed policy relative to past cycles, we think rates could reach a peak in advance of prior experiences. Thus, we think we're closer to the peak than the bottom. Longer-term rates may have more room to go given the upward influence of the upcoming balance-sheet runoff from the Fed, but our analysis suggests something around 3.5% could represent a peak for 10-year Treasury yields. Nevertheless, anticipate more moderate moves in yields as we advance, and don't see interest rates pulling back meaningfully until the end of the Fed's rate hikes is within sight.

It's unlikely the Fed is going to reverse course in the near term, meaning that we doubt bonds will see an immediate snapback. This does not, however, mean bonds should be avoided right now.

(Source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	32,899	-.24%
S&P 500 Index	4,123	-.22%
NASDAQ	12,145	-1.54%
MSCI EAFE	1,993	-.99%
10-yr Treasury Yield	3.13%	6.83%
Gold	$1,883	-.74%
Bonds	$101.57	-1.26%

Source: Reuters/Wall Street Journal

As Inflation Pushes Up, Here's What Americans Plan To Buy

Federal Reserve Chair Jerome Powell may have said it best when he addressed the public at a Wednesday press event following the Federal Open Market Committee's half-point rate hike.

"Inflation is much too high," he said. "We understand the hardship it is causing, and we're moving expeditiously to bring it back down."

The Fed is raising interest rates to rein in the economy as consumers grapple with the largest price increases seen in 40 years. Inflation is starting to have an impact on people's spending expectations over the coming months, with 61% of Americans saying they're worried about their financial situation, according to a survey of more than 1,000 adults conducted by Toluna from March 23 to 29.

Many Americans now expect they'll have to spend more on a range of purchases,

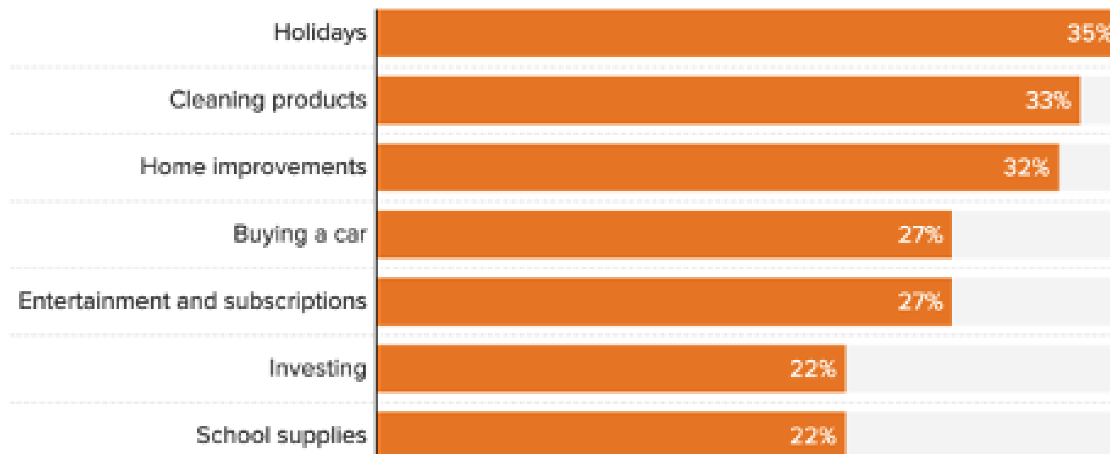
from personal care and home improvements to experiences such as vacations.

"Just like any other time you have a change in situation, such as a change in your job or you're planning to buy a home, it's a great time to review your expenses for the past three to six months," said Roger Ma, a certified financial planner, founder of New York-based Lifelaidout and author of the book, "Work Your Money, Not Your Life: How to Balance Your Career and Personal Finances to Get What You Want."

How to adjust

Paying the price

Where Americans expect to spend more as inflation continues



Source: Toluna survey of more than 1,000 American adults. Respondents could select more than one category.

Doing such an audit of your recent spending can help you ensure that you know where your money is going and recalibrate if it's being directed away from your financial goals.

Because inflation is pushing up prices so rapidly, Ma suggests both checking in with your spending and revising your budget frequently.
"Plan it out a couple of months at a time," he said.

In addition, because inflation is so broad-based, people may have to get creative in finding ways to trim their budgets. Ma noted that he's seen clients cancel some subscriptions, as well as change their grocery shopping lists — from buying more generic items instead of brands to swapping pricier steak for less expensive chicken, or even foregoing meat entirely.

Clients are saying "I was getting this fancy milk, but I'm fine with getting the grocery brand milk," he said. "People are totally making these types of decisions to make it fit within their budget."

The good news is that many consumers are already making the spending changes they need to adjust to rising prices.

More than half of Americans said they're willing to try new brands of food and drinks, cleaning supplies, and personal care products to keep costs down, and about a quarter have already made a switch, according to the Toluna survey.

Earnings Highlights This Week

Under Armour: Under Armour reported an unexpected loss and sales below estimates as the company grappled with global supply chain challenges and Covid lockdowns in China. The athletic apparel retailer's stock fell as it also issued profit guidance that came in below Wall Street estimates. Also on Friday, rival Adidas said that its growth in 2022 will come in on the low end of a forecasted range due to a "severe impact" from coronavirus-related lockdowns in China.

Adidas: First-quarter currency-adjusted sales shrank by 3% worldwide, to 5.3 billion euros ($5.58 billion), while profit from continuing operations fell 38%, to 310 million euros, it said on Friday. In Greater China, sales collapsed by 35% in the first quarter; for the year, revenue is expected to fall significantly due to store closures and strong traffic declines.

Nikola: Nikola's revenue was higher than Wall Street expected. Nikola expects to ship 300 to 500 battery-electric semi-trucks in 2022. Its fuel cell truck is on track to begin production next year.

Shopify: Shopify on Thursday reported first-quarter results that fell short of Wall Street's expectations. The Canadian company also announced it would buy logistics start-up Delivery for $2.1 billion, the largest acquisition in its history. Shopify also said revenue growth would be lower in the first half of the year, as it navigates tough pandemic era comparisons.

Wayfair: Wayfair reported larger-than-expected losses in the first quarter as shoppers scaled back their spending on the home category. Wayfair reported its count of active customers in the first quarter of 2022 declined 23.4% from a year ago. Wayfair also announced its chief financial officer, Michael Fleisher, is set to retire early next year.

News and Notes

Should You Be Fossil Free In Your 401(k)?

Is the idea of divesting your 401(k) from fossil fuels gaining traction?

- Most people don't know what they invest in inside of their 401k- Divesting of fossil fuels are becoming more popular.
- Even Harvard, the largest of any university endowment of $41.9 billion finally divested of fossil fuels.
- The country of Ireland pledged to dump its investments in coal, peat, and gas.

How do I know if my 401(k) investments are fossil-free?

- One of the best things to do is go to fossilfree.org and you can list a fund in your 401(k) to see how dirty it really is. Also, get the best-rated fund on this site!
- Fossil free means a fund doesn't own or have the following:
- The top 200 owners of fossil fuel reserves, coal companies, oil and gas companies, and 30 of the largest publicly traded companies who own coal-fired power plants.

What's the easiest way to divest of fossil fuels in your 401(k)?

- Many 401(k)'s now offer something called a 'Brokerage Link' or a self-directed brokerage account.
- This allows you to keep the money in your 401(k) but move your assets into a brokerage account where you can buy almost anything you want.
- You may want to consider looking at funds such as Parnassus Endeavor Fund or The Calvert International Equity Fund- both leading fossil fuel funds.

What other ways are there to divest of fossil fuels in your 401(k)?

- If you are lucky, your 401(k) will have a least one fund or maybe to two for you to directly invest fossil-free.
- You will want to ask your financial advisor or the 401(k) provider of the best option if you don't have a direct choice. Often the default is a target-date retirement fund.
- Just remember, fossil-free funds carry risk as well and you can lose money.

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