Monday, June 6, 2022

Good morning:

Equity indices gave back about 1% of its prior week's gains last week as traders continue to try to read the tea leaves in hopes of predicting the market's next move. The environment remains unsettled, dominated by fears of recession or run-away inflation. Thanks to more people rejoining the labor force, businesses added a better than expected 390,000 non-farm jobs in May, particularly in much needed areas of leisure and hospitality, construction, and education. Overall, unemployment remained at 3.6% for the third consecutive month.

Stocks are opening strongly to the upside today, recouping much of last week's decline as the market awaits a few key pieces economic data later in the week. Perhaps most crucial is the May CPI report. After a smaller decline than anticipated in April, this closely watched gauge of price inflation may indicate the pace of upcoming Fed rate hikes. However, the inflation rate is merely the *rate of price increases* over time. Therefore, prices could remain at current elevated levels and the CPI would decline. The Fed may be happy in that scenario, but the average American will likely still feel the sting of recent price hikes on nearly everything.

There will also be another Consumer Sentiment survey released this week that is likely to reflect the souring mood that many of us feel this year. Spending trends seem to have shifted from goods to services as the pandemic ends and consumers create new demand for travel and entertainment. With fuel prices at all-time highs, this summer's travel season will clearly be expensive. And finally, the declining stock market may have a *reverse* wealth-effect prompting some to curtail spending during this market correction. Ironically, this may help the Fed in their efforts to cool down the economy and orchestrate a soft-landing.

Whether the landing is soft or rather bumpy remains to be seen. The Fed now admits they were wrong in underestimating the extent that inflation would take hold, as well as how long they waited to act. Since virtually every product we buy is transported by a ship, train, or truck (often all three) that runs on diesel, the key to curtailing inflation in the near term will be based on whether energy supplies can be increased to meet surging demand. Until that is allowed to occur, it is likely that energy prices remain high or go higher. Therefore, we should not expect gas prices to come down meaningfully any time soon.

These various issues and risks, and their potential repercussions are the key drivers behind the moves of short-term traders. Just as markets tend to overshoot on the way up, they often overcorrect on the way down. Only after more information is known, and cooler heads prevail, can stocks find their fair value and resume trading on longer-term fundamentals. The sharp declines seen across equity markets this year may have priced in a far worse outcome than we will see. While it will take a fair amount of time and work for the Fed to bring inflation down from 8% to its stated goal of 2%, we believe they will ultimately be successful. Despite their recent volatility, we believe equities should continue be the best performing asset class over the long-term.

Have a great week!

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Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US
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