Financial Market Turmoil: Special Market Update

September 24, 2022

This week stocks across the board fell again and major indices either breached the June 2022 lows or came very close to those levels. Some market technicians hoped that a rally from this level could signal a double bottom and encouraged investors to buy into the markets after near-record declines. The problem is that the Federal Reserve announced another 75-basis point increase in short-term interest rates this week taking the target rate to 3.00% - 3.25%. The scary proposition was that the Fed seemed to be in a hurry to get inflation down to the 2% level before it relents on this policy. In our previous Weekly Missives, we have warned that hawkish Fed policy would cause increasing disturbances in financial markets. Not only did equity markets tremble at the latest policy announcement, but bond markets declined and interest rates surged. Of particular note is that 30-year mortgage rates reached 6.67%, more than twice as high as the 3.06% they were only a year ago. While the Fed battles inflation, the world is battling the onset of a recession due to the war in Ukraine and a Russian induced shortage of oil and natural gas that threatens Europe particularly as we enter the fall and winter months. Will the Fed's stringent credit market strategies push the U.S. in the same direction?

August and September are, on average, relatively bad months for stocks and this year is no different. The good news is that September is almost over and many of the inflation signals have been moderating of late. On September 23rd, the price of oil dropped below $80 a barrel, bringing its year-to-date gain down to less than 5%. Natural gas fell below $7 per British Thermal Unit but is still up a whopping 83% so far this year. Strangely, given the inflationary environment we are experiencing, the price of gold is down nearly 10% -- not really an inflation hedge! Another factor that will put downward pressure on inflation is that many companies over-inventoried and will find themselves forced to liquidate goods at lower prices. In other words, there are numerous signs that dumping $5 trillion+ in stimulus on an economy shrinking from Covid-related shutdowns would be too much and the resulting inflation should have been expected. Today, the government response should be a commitment to stabilize the economy and not focus on inflation alone. The recent, rapid fall in equity markets usually gets the attention of policy makers and lower inflation may pressure Fed policymakers to relent as they did in early 2019 after one quarter of raising the fed funds rate.

What is unusual in this period of post-pandemic, economic policy is that unemployment is low, job openings are in the millions and minimum wages are rising at unusual rates. Target announced they will be hiring 100,000 workers for the Christmas season; while Walmart indicated it had previously stocked up on employees. Rising interest rates also increased interest payments on certificates of deposit. Over the past year the yield on a five-year CD fell to a low of 0.41%. As of Friday, that rate has risen to 1.92%, an increase of almost 400%. Investors in CDs, as well as other short-term money market instruments, have benefited from rising rates, potentially adding to an increase in consumer spending.

While the war in Ukraine will cause international economic problems, the U.S. is benefiting from European companies moving here due to the energy problems there. International investors are looking at rising yields in the U.S. relative to other countries and a surge in the value of the dollar this year could make U.S. markets suddenly more attractive. Other than the Fed's reaction to inflation and the uncertainty of the war in Europe, we do not see any fundamental reasons for further dramatic declines in the stock market. History tells us that October is mixed for stocks, but November and December are generally good months. After the November elections, less uncertainty could usher in a year-end equity rally.