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JULY 2022

# MARKET PERSPECTIVE

## Man on a Mission

*By James M. Walden, CFA*

### DASHBOARD

- Business Cycle (yellow)
- Trend (red)
- Valuation (green)

Under the Federal Reserve Act, the Fed has been given what is referred to as its "dual mandate": to pursue the economic goals of maximum sustainable employment and price stability.

The unemployment rate in the United States in June 2022 was 3.6%, just a tick higher than the lowest unemployment rate in at least 50 years of 3.5%. So, it's safe to say that the Fed has achieved its first goal.

However, the Fed is way off the mark on the second one. Headline CPI hit 9.1% in June, the highest in four decades. We've already discussed in detail some of the drivers of today's elevated inflation. But it's increasingly clear that while tremendous stimulus from both the Fed and Congress was essential to prevent a severe Covid-related economic decline, it was too much and lasted too long.

For a time, the Fed described elevated inflation as "transitory," ascribing it largely to snags in global supply chains that would eventually be resolved. But the Fed has changed its tune as inflation has spread to other parts of the economy, including wages. In response, the Fed has raised its benchmark interest rate three times so far this year, including a 0.75-percentage-point hike in June, the largest since 1994. As of this writing, financial markets expect a roughly equal chance of either another 0.75-point increase or a full point increase at the Fed's July meeting.

The Fed now faces a dilemma. To tame inflation, the Fed must slow the economy down by reducing demand via higher interest rates. If it doesn't tighten policy enough, it will fail in bringing down inflation. But if it tightens too much, it could easily tip the economy into recession.

So where does the Fed stand on balancing a dual mandate that is currently out of balance?

On June 29, 2022, Federal Reserve Chairman Jerome Powell was quoted as follows during a discussion at the European Central Bank's annual economic policy conference:

> *"Is there a risk we would go too far? Certainly, there's a risk. The bigger mistake to make—let's put it that way—would be to fail to restore price stability.*
>
> *"There's a clock running here. The risk is that because of the multiplicity of shocks, you start to transition into a higher-inflation regime. Our job is literally to prevent that from happening, and we will prevent that from happening."*

We're not in the business of predicting recessions. But we see evidence piling up of at least a meaningful slowdown in economic growth, and the Fed won't stop until it's convinced it has brought inflation down to an appropriate level.

We remain positioned defensively across most client portfolios as we continue to work to mitigate potential downside. We don't know when or where financial markets will bottom. We will likely miss some of the upside over a short term on any meaningful rally. But in the current environment, we think that's a prudent trade-off to make.

## Bullish

- Significant pent-up consumer demand
- Strong jobs environment
- Relatively healthy consumer finances
- China's economy reopening
- Reasonable equity valuations

## Bearish

- High global inflation
- The Fed and other global central banks tightening
- Slowing economic growth
- Russia/Ukraine war and other geopolitical concerns
- Equities in a downtrend

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*Partner and Chief Investment Officer*

As Partner & Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner & management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.



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