

Weekly Market Insights

January 18, 2022

Investors react to continued inflation

Financial Markets

Financial markets continue to adjust to higher interest rates. This is the second week of equity declines. Not only did the fear of higher interest rates spook investors, but they also had to digest disappointing earnings reports from JP Morgan. There are plenty of reasons for concern from investors beyond a JP Morgan earnings miss—COVID, of course, continued high inflation, a confusing labor participation rate, problems with supply chains, transportation issues, an unsettling domestic political situation, Russia, and, as always, the Fed. This array of obstacles will keep investors on edge for some time. There are positive aspects to them, but they will take time to play out.

The Dow fell 0.88%, the S&P fell 0.30%, and the NASDAQ fell 0.28%.

Economics

As we wrote earlier, there are plenty of concerns for investors to contemplate. The first is COVID, and that remains a wait and see problem. A low and falling unemployment rate taken by itself would suggest increasing wage pressure, ultimately leading to higher prices and inflation. However, the issue interfering with that logic is the falling labor participation rate. As various pandemic-related government subsidies are eliminated and savings are depleted, the participation rate may start to expand, and this should reverse itself. Both supply chain and transportation issues are the primary sources of inflation at this time. There is increasing data arguing that both problems are dissipating, relieving inflationary pressures.

Domestic politics is increasingly important. That seems obvious, but it deserves special mention for a number of reasons. The most obvious is that the more hostile the political environment becomes, the more nervous both investors and economic participants will be. At the center of the debate is the Build Back Better bill. We have written quite a bit about the pros and cons of this legislation. Whether this passes and in what form will have an important effect on the economy. The United States is also now entering mid-term elections. An already highly charged Washington will almost surely become more fractious. Getting anything through Congress will be a herculean feat, and Hercules, for the moment, appears absent.

Before we move on from government, we need to discuss the Federal Reserve. Of course, the mere mention of the Fed leads thoughtful people to the topic of money supply. We have written a lot about how we think the Fed will handle the money supply and interest rates. Furthermore, we believe Chairman Powell and the Fed have done an excellent job and will continue to do so, but 2022 brings an interesting situation before the Fed, the President, and the Senate. The President has nominated three new candidates for important Fed positions: Sarah Bloom Raskin, a former Fed Governor, for the top regulatory job, Lisa Cook and Phillip Jefferson, as Board Governors, both academics. All are intellectually qualified, but there are some interesting questions. The main question is a larger one—what is the Fed's realm? Most likely, all three would pass muster in ordinary times, but these are not ordinary times. The hearings will be interesting indeed.

Weekly Market Insights (cont'd)

Conclusion

If the paragraphs above appear to be a laundry list to readers, that is correct. We tried to lay out what to expect, and we will write extensively about each in the future. We are always interested in what our readers' concerns and questions are, so please don't hesitate to contact us. In the meantime, we remain positive but a bit cautious on the market.

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