1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

January 24, 2022

A difficult week for investors

Financial Markets

U.S. equity markets fell this past week for the third consecutive week. The S&P 500 and the Dow had their worst week since April 2020 as investors shed risk assets. There were a number of reasons for this behavior, some old others new. The primary reason is the fear that high inflation will not only stay with us, but might accelerate. This of course will force the Fed to tighten, but not excessively. This is not exactly unique, and it has occurred many times in the past. If this concern is not new, what is new? The domestic political situation is disturbing, and, if not frightening, it certainly is not a confidence builder. Internationally, the belligerence of Russia just adds to investors' concerns.

We wrote last week about the tremendous trading power some market entities have. This continues to be a factor.

The Dow lost 4.58%, the S&P 500 lost 5.68%, and the NASDAQ lost 7.55%. Although there are serious concerns for the economy and, therefore, investors, at times they can behave with a herd mentality and miss the more sanguine possibilities.

The Economy

We believe the fear of inflation and the Fed's response is the primary motivator of investors. Although we analyze inflation and monetary policy very closely, we do not feel the United States is on a course for continued hyperinflation and interest rates so high that they choke the economy.

Clearly, inflation has been extraordinarily high, and, if it remains this high, it would be damaging to the economy and force the Fed to move dramatically. It is important to analyze why inflation is so high and persistent, which is, of course, precisely what the Federal Reserve is doing. The current inflation in the United States is caused by a supply problem, as well as the unusual labor shortages and abnormally high rate of wage growth in the U.S. No one knows exactly why this is actually happening. The big question economists are wrestling with is whether the scarcity of labor is temporary or permanent. Supply chains have been severely disrupted by COVID, and freight transportation has come close to a halt. These problems, although difficult, appear to be improving. As the supply chain challenges slowly resolve, the excess demand in the system will be relieved.

This would take the pressure off the Fed and relieve the concerns of investors. Due to abnormally low rates because of COVID, the Fed will continue to raise rates, but certainly not enough to drive the economy into recession. Of course, the Fed has erred in the past by tightening too much too soon, and drove the economy into a recession, so investors must be aware of this possibility.

While thinking about the Federal Reserve, observers should expect a healthy battle over the President's three expected nominees for positions at the Federal Reserve.

Weekly Market Insights (cont'd)

The argument will and should be—what is the role of the Federal Reserve? The Fed's role is about monetary policy and bank regulation.

Conclusion

Equity markets appear to be in correction mode and will likely remain volatile. Corrections are reasonably common, and, although uncomfortable, investors should behave the opposite of the market and remain calm, and treat corrections as opportunities. Beware evangelical spokesmen for economic collapse.

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