

# Weekly Market Insights

January 31, 2022

## The dreaded emotion of uncertainty

### **Financial Markets**

Although investors were rife with economic and political uncertainty, equity markets closed this past week in positive territory for the first time this year. This was led by a surprisingly strong earnings report from Apple, the world's largest company. There are several serious concerns troubling both analysts and investors. For the first time in quite a while, COVID was not among them. The future behavior of the Federal Reserve is now the prominent concern, followed by inflation, interest rates, and earnings. Those four areas of concern are so interrelated that they are almost one. The others are the U.S. domestic agenda, Russian aggression, and China. There are other problems, of course, but these stand out.

Equity markets ended the week with the Dow gaining 1.34%, the S&P 500 gaining 0.77%, and the NASDAQ gaining 0.01%.

### **The Economy**

The United States economy is growing at a strong pace, employment is near capacity, incomes of workers are growing at an above-average rate, and interest rates are low. Sounds like the ideal environment? Wrong!

The problem is each on its own is positive, but together they spell inflation. The Federal Reserve has a number of responsibilities including conducting national monetary policy, maintaining orderly markets, supervising and regulating banks, and maintaining financial stability. Some are contradictory. This is where they are now, trying to

balance orderly markets while containing inflation. They do this by conducting monetary policy, which, in this case, means raising interest rates. History is replete with Fed efforts to raise interest rates in an attempt to control inflation, only to spur a recession. This is what many market analysts fear, and it is a legitimate concern. There is very little agreement about how far the Fed is willing or needs to go to bring inflation back to acceptable levels. Clearly, no one knows, not even the Fed. One question analysts wrestle with is the relationship between inflation and employment. Employment is tight, and employers are finding it difficult to attract more staff. As in any market, scarcity produces higher prices, and that produces wage inflation. There is another interesting situation happening in the labor market—it is shrinking. The labor participation rate<sup>1</sup> fell with the onset of the pandemic, and it has not recovered. It is obvious that the Fed faces a difficult tradeoff between employment and inflation, and that is only one problem. The very overarching fact is that no one at the Fed wants to start a recession.

There is a very full economic agenda facing a divided Washington. How it turns out is anybody's guess. This, of course, is part of the uncertainty problem.

Russian aggression is clearly a significant concern with serious economic consequences. However, the question of if and when exists in the bailiwick of politicians. If hostilities do occur, it will be easier to judge the economic effects.

<sup>1</sup>The labor force participation rate is the proportion of the working-age population that is either working or actively looking for work. Represents the relative amount of labor resources available or the production of goods and services.

# Weekly Market Insights (cont'd)

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## **What to Watch**

This Thursday, President Biden's Fed nominees begin their hearings. It should prove to be very interesting. There are many questions—are they qualified, what do the nominees and the Senate believe is the role of the Fed, and what effects will partisan politics have? It should be a very interesting and important event.

## **Conclusion**

As the heightened volatility of the financial markets suggests, coming to a firm conclusion is difficult, and achieving a consensus is even more so. We agree that the Federal Reserve will tighten monetary policy throughout the next year and perhaps longer. We do think they will be cautious. They will continually gauge the financial markets and the economy, trying not to overplay their hand.

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