

Weekly Market Insights

December 12, 2022

A Difficult Week for Markets with an Interesting One to Follow

Financial Markets

This past week was a difficult one for investors. Both equity and fixed income markets suffered losses. In the equity markets, the Utilities sector was a relative outperformer, falling 0.27%. The Energy sector performed the worst, falling 8.30%. The story is old hat—fear of the Fed surprising the market and raising rates another 75 basis points rather than the hinted at 50 basis points. Friday's Producer Price Index rose 0.4% from the prior month, which was more than investors expected. The year-over-year rate still declined, but this appeared to fall on deaf ears.

This week, all eyes will be on the Fed's Open Market Committee Meeting. We do not believe Chairman Powell led investors astray in his recent remarks. It will be of interest for investors to look carefully at the soon to be released Dot Plot.¹ This is, by no means, a great statistical model developed by the Fed staff but rather an indicator of each Fed member's view of the future.

The Economy

Last week, we wrote about important legislation that must be passed before the new Congress convenes. The country remains sharply divided. The President's party has a narrow majority in the Senate, while the opposition has a small majority in the House. This is not an ideal make up for dramatic legislation, but some legislation must be passed. Primarily, they must pass a budget resolution. The entire world will be paying attention. Since the United States' government has never defaulted on its financial obligations, no one knows how the global economy would react. No doubt, it would be better for this to remain unknown.

As we wrote last week, we remain quite concerned about trade. There are two groups in Congress that have spoken out against open trade. Fascinatingly, they are two groups that one would never guess would agree on anything. They are the far right of the Republican Party and the progressive left of the Democratic Party. To be clear, there really isn't legislation or discussion suggesting truly free trade. It's just a matter of how open a trade policy should be.

The country is suffering in a battle to control inflation, and fair trade is an inflation fighter. The matter of trade balance is very confusing in today's world of highly complex products. For example, the Boeing 737 MAX airliner uses parts from 600 suppliers across more than 70 countries. Trade is just another example, along with the budget, of complex, controversial legislation that must be passed.

If there is a concern about high paying jobs for U.S. citizens, Congress should look at the distribution of income to educational level, and, perhaps, put more money into education.

Last week, we wrote about the possibility of India being the next great economic power. India has many attributes that could make it so. What holds the country back is manmade and reversible. India is a large country geographically with an equally large population. A significant portion of the population is well educated and entrepreneurial. Alas, they have some serious manmade problems, one of which was treating its own states like they were different countries. Not too many years ago, for one Indian state to send goods to another, it had to

¹FOMC members place dots on the dot plot denoting their projections for future interest rates in subsequent years and in the longer run. Usually, the overall FOMC outlook for interest rates in any given year is reported as the median of the dots that show up on the dot plot.

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pay cross-border taxes. They have changed that now, but it was very difficult. India has a long way to go, but the potential is enormous. The United States has a reasonably good relationship with India, and it makes sense to strengthen it. Can India be the next China? Perhaps.

Conclusion

We feel the Federal Reserve is on the correct path, but there are far too many unknowns to be very confident. The war in Ukraine clearly stands out. As we wrote earlier, what happens with legislation could be very impactful. Employment is a matter the Fed is concerned with, so the mystery about the lackluster labor participation rate or the case of the disappearing work force is of great importance.

Of course, the most important problem at the moment is defeating inflation and not driving the country into a recession. Here, the Fed is on the right track. We continue to think a mild recession or slowdown is likely. This week's Fed announcements will bear close scrutiny!

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