September 2, 2022

Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Bitcoin	Gold	Crude Oil
31,659	3,967	11,785	1,814	3.27%	19,851	$1,706	$86.36

Investment Strategy Report

Fed Doesn't Seem To Get It – Inflationary Pressures Are Easing

After bottoming in mid June, stocks staged an impressive rally during the second half of June and into July. The rally continued into the first part of August as the S&P 500's total gains from the June lows reached 17.6%. The Nasdaq's rally was more impressive and even began a new bull market, as its gains reached a total of 23.3%. The stock recovery was sparked by economic data indicating that inflation was easing which resulted in falling interest rates. With inflation less of a concern and with what seemed like a healthy economy, as evidenced by a strong job market, stocks took off.

This stock market uptrend came to a screeching halt last Friday (Aug. 26th) when Fed chairman Jerome Powell spoke at the Jackson Hole economic conference. His basic message was that the Fed would remain vigilant in fighting inflation, and was prepared to raise interest rates and keep them high for an extended period of time in order to accomplish that. What!? Did the Fed not see that the signs of decelerating inflation? As I pointed out last month, prices of everything from oil to cars to grains and industrial metals were all coming down. At the time of his talk, the yield on the 10 year Treasury was about 3.0%. With the Fed funds rate at around 2.5%, an increase in this rate of another .25% or .50% might be reasonable. But Fed governors this past week were talking about raising the Fed Funds rate to 4.0% or higher and keeping it at that level next year, with no plans to cut rates.

The last thing the stock market wanted to hear was that the Fed was bent on over-tightening and sending the economy into a recession. Following Powell's comments, stocks cratered. The S&P 500 last Friday dropped 3.4% and the Nasdaq was hit even harder, falling 4.1%. Stocks have continued to slide since then, as the air has been let out of the stock market recovery balloon. So at this point, should investors stop trying to fight the Fed and get more defensive, or will the Fed at some point get the message and engineer a soft landing for the economy?

Yesterday on CNBC, Wharton Professor Jeremy Siegel pointed out that over the past 30 days, 27 inflation indicators have been reported and of those, 26 have shown inflation to be lower than expected. He went on to say that yesterday's ISM Price Index report looking at the last 2 months showed the second biggest decline in the price index in 70 years. He added that the Case Schiller Housing report showed that real estate prices are now falling, but that this data won't hit the CPI index for a few months. And lastly, he stated that over the past 4 months, there has been no growth in the money supply, a very rare occurrence. He summed it up by saying that inflation is moving down and that if the Fed doesn't over-tighten, markets can do well.

Economist Ed Yardeni was on the same show yesterday and echoed much of what Professor Siegel said. He stated that energy prices and used car prices are falling, and eventually, this data will be reflected in the CPI. He believes that much of inflation was due to supply chain issues and that these problems are already being corrected. He feels that the S&P 500 can end the year at 4,305 (about 9% higher from here) and that technology companies should do well as technology will help to increase productivity, as businesses strive to deal with a tight labor force.

There are many technical indicators that suggest that the buying thrust that stocks experienced from mid June to mid August would argue for a continuation of the market uptrend. One was reported in StansberryResearch.com (8/30) and states that when a market rally erases more than 50% of a bear market loss, than the market will not fall to new lows. They point out that the recent rally in the S&P 500 regained 57% of the overall bear market losses. Since 1950, there have been 10 bear markets and in each one (100% of the time), an erasure of 50% of the losses meant that the rally was a resumption of an uptrend and not a bear market rally.

There will be some additional inflation data that will be reported between now and the end of the month when the Fed has its next meeting and will decide on interest rate hikes. Hopefully they will get the message on inflation. *Jeff Feldman*