CONWAY• JARVIS LLC
Investment Outlook

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Update

Stocks End the Quarter with a Whimper

This week the market limped into the close of the quarter with stock prices taking a breather for several reasons. First among them are concerns over persistent supply chain constraints that have impaired the delivery of goods, pushing prices higher, and driving the inflation narrative. That could account for the recent surge in the 10-year treasury yield that typically weighs heavy on the Growth issues that have been leading the market higher this year. As a result, we're seeing a shift in market leadership away from high P/E Growth to more rationally priced Value/Cyclical stocks such as we saw in Q1 of this year. Investors are left asking if this is just another shift in market leadership or the prelude to something beyond a correction? At this writing it appears to be the former.

In addressing that question, we look to the simple proposition presented by the trajectory of the economy. Are we seeing an expansion or contraction ahead? We still view the economy as expanding, albeit it at a slower and uneven pace compared to the prior 12 months. It has stumbled a bit in its reopening and response to the resurgence in demand for goods and services. Labor shortages, transportation bottlenecks, and challenges in acquiring components has resulted in anecdotal scarcities of goods, higher prices, raising fears of persistent high inflation. *We see this as a problem that monetary policy alone can't resolve.* Policies and regulations borne out of a response to the pandemic have added friction to the smooth transport and delivery of goods to consumers. Demand is surging, supply is wanting. Critics of the Fed propose higher interest rates as a remedy to higher prices. Higher interest rates from the Fed will not facilitate the delivery of goods currently languishing on the docks and ships anchored at ports around the US.

The Fed has already announced its intent to remove the economy from life support (QE) by tapering its bond purchases. We welcome that as an indication the economy is on a path to reaching escape velocity. Chairman Powell has estimated we're still a year or two away from seeing any adjustment to key interest rates. Rather than viewed as a positive development, that has ignited speculation over the Fed's competency in addressing inflation and whether he will be reappointed to his position. We're among those professional investors who believe he should and that the Fed is spot on with its approach. Yes, inflation will overshoot the Fed's mandate for price stability, but only for a while and this is certainly not a repeat of 70's-style persistently high inflation.

We're fond of the adage "The cure for high prices is high prices". That's appropriate here and portends an organic tempering of demand as prices are eventually deemed "too high". Another cure is a resurgence in supply that can meet current demand. Hopefully that will become a priority for fiscal-policy makers in Washington. Monetary policy has done all it can and should. Stay tuned.

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