CONWAY• JARVIS LLC
Investment Outlook

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Update

Earnings Season Remains Center Stage

An impressive start to the earnings season remains so as we approach its end. The results are driving stock prices higher, leaving all the major indexes at record levels. As expected, tapering was formally announced by the Fed at this week's FOMC meeting. This was seen as too little or too late of a response by a few market experts and media types who have predicted an impending era of hyperinflation. We're not in that camp. Instead, we're among those looking for inflation to moderate along with GDP growth as the economy normalizes in the post-COVID period. We're also paying more attention to those very few analysts who have warned of *stagflation*. For those who missed the 1970's, that's a condition where you have rising prices in a slowing economy. The culprit then was a constricted supply of foreign oil, raising fixed costs for manufacturers and prices for consumers. Needless to say, the financial markets don't react well to stagflation. As of now, we're only mentioning this as something we're watching.

As for tapering, it's the rational policy response to a recovering economy no longer requiring emergency treatment. Next, comes *normalizing* interest rates. That's where the Fed determines that the economy has recovered sufficiently to absorb the effect of moving key interest rates from near zero back to the 1.0%-1.5% range. That's further down the road, late next year or early 2023. It's something we welcome but that the markets and investors sometimes find stressful. The market response is also dependent on the fiscal policy initiatives in effect at the time. At present, we have few clues as to what sausage will eventually be produced in Washington.

For now, we expect nothing more than only moderate inflation in the long-term as the economy settles into a stable range of GDP growth and CPI moderates. Critics of the Fed's gradual approach to removing life support from the COVID economy conveniently overlook the recent GDP data showing the economy grew only at a tepid 2.0% in the third quarter. That's the acceptable level we became accustomed to from 2010 through 2018. However, when compared to Q2's 6.7% growth rate, it should grab investors' attention. So far, it hasn't. If the CPI number, currently 5.4%, doesn't moderate by quarter's end we could see the stagflation narrative gain traction among analysts and investors.

It's not inflation that worries us, it's the policy response to it. We have no concerns about monetary policy. We're fans of the Fed and Chairman Powell as they have been clear and transparent in shaping expectations for policy adjustments. Investors appreciate that. Until we get a clear picture of what fiscal policy initiatives emerge from Washington, we'll forego making any pronouncements about any change to the long-term trajectory of the economy. At present, the legislative process is stalled as competing wish lists collide in Congress. We take that as a sign that any policy enacted may avoid a lurch in either direction that could disrupt the recovery or the market's trajectory. Stay tuned.