CONWAY• JARVIS LLC
Investment Outlook

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Update

Inflation Headlines Weigh on Stock Prices

As you might expect, the Fed's recent announcement generated an abundance of speculative headlines and opinions from market watchers that served as a catalyst for the recent drawdown in stock prices. By drawdown we mean a not-so-surprising correction for the NASDAQ and the S&P 500, down 17% and 12% at their respective lows. At the same time, we saw the small-cap Russell 2000 slide into bear market territory, down 21% at its recent low. The DOW was resilient, off less than 8%, as traders moved into selected Cyclicals at bargain prices. With the correction box having been checked, the indexes have rallied a bit this week on generally robust earnings news.

Choosing not to wait for actual economic data, a number of analysts and media types have broadcast their predictions for this year. Most are well-reasoned and feasible while others are simply outlandish. Falling into the latter category is BankAmerica's call for *seven* rate hikes this year. The respected analysts that we follow are anchored around an estimate of *two or three* increases at most. We find that to be the most likely outcome in a year where Quantitative Easing is replaced by Quantitative Tightening as the Fed begins to offload the bonds purchased in the past two years from its balance sheet. Our prediction? There will be interest rate increases only IF the data warrants.

That begs the question of whether we'll soon see the same easing of inflation pressures that Europe is already experiencing. If so, the stock market is likely to weather a rate hike or two as a step toward normalcy rather than a prelude to a hard landing for the economy. Thursday brought the latest inflation numbers. The year over year increase in the Consumer Price Index ("CPI") was 7.5%, the biggest jump since 1982. The month over month increase remained level at .6%, well below October '21's .9%. That hints of some, however slow, easing of the supply chain gridlock responsible for the surge in prices. We're focused on the monthly change as are those who see that data point as suggestive of Peak Inflation having arrived. There will be another report just prior to the March Fed meeting and that could spell the difference between a 25 basis points hike in rates and one of 50bp that some have predicted.

Stock prices retreated a bit on the inflation data but the drawdown was cushioned by continued good earnings news and the emergence of the Peak Inflation narrative. That should provide a footing for a period of base-building in the indexes. Regardless of what action the Fed takes, we see it as a natural response to an expanding, demand-driven economy hampered by exigent conditions on the supply side that will abate over time. In the present case, the less-is-more approach to tightening is the favored course. Aggressive rate hikes in the short-term is a recipe for recession, not a remedy for supply-constrained inflation. Stay tuned.

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