March 14, 2022

“The Bitch Is Back” was a top song in 1974 by Elton John. Why bring it back now? That bitch could be inflation, that is back and has politicians grabbing for the “WIN” (Whip Inflation Now) buttons. Buttons that President Ford used to acknowledge the high rates of inflation. Today the administration is pointing toward Russia as the cause of the inflationary problems that are staring everyone in the face. The seeds for inflation today were planted a couple of years ago, by cutting rates to zero and flooding the financial market and economy with money. Core inflation rates were at multi-decade highs beginning in April of ’21 and have been rising ever since. Russia has only exacerbated an already rough situation that the Fed is finally beginning to acknowledge. Their meeting this week will finally start the process of “normalizing” interest rates. Given the current rate of inflation, that level could be much higher than many are expecting. Complicating the situation, the economy is already showing signs of slowing. Additionally the Fed has never hiked rates with a yield curve this flat since the bad old days of Paul Volker, when he slayed inflation with rates well north of 10%. Yep, the bitch is back, and it will be difficult to get rid of this time.

Much of the economic data took a back seat to the news from Ukraine and the geopolitical news surrounding the war. Consumer prices came in just shy of 8% and may go higher still as the impact from higher commodity prices works its way into the economy. Not surprisingly, consumer sentiment fell last month as prices began to spike. Slowly there is a shift in psychology from “when will I get this delivered” to “how much am I going to pay for it”? Within the inflation data too has been a slight shift toward the services and away from goods. Used car prices dipped ever so slightly, while airfare and live entertainment are showing signs of rising as mandates are being generally lifted. Wednesday will be a big day, as the Fed will announce a hike in rates and the news conference following by Chair Powell will likely set expectations for future increases. Along-side the economic news and Fed announcement will be the ongoing war in Ukraine. For as long as that continues, commodity prices will likely continue to rise, albeit at a bit slower pace than the parabolic rise of the past month.

The bond index has fallen nearly 5% so far this year as interest rates rise. Even last week, as stocks fell, bond prices also fell. Is there safety anymore in bonds? Are they still an alternative to stocks? Yes, and yes are the short answers. Individual bonds have a certain maturity when face value will get paid out, so in those cases, the losses are temporary. For bond mutual funds and ETFs that do not have maturities, their losses continue to pale compared to stocks. Short-term bonds and those that are “inflation protected” have done well in this environment. The rougher part of the market has been those tied to corporate and high yield bonds which act more like stocks than bonds. Bonds are still a good stock market offset, if not always providing positive returns.

The themes of this year continue to play out. Technology related issues have struggled as investors shift toward more “value” parts of the market. Surprisingly too, small US stocks have performed well, likely due to their being sheltered from international trade issues. Companies that are providing improving cash flows, dividends and are valued near their long-term valuation ranges are also doing well. Of course, basic materials and commodities continue to rise at a crazy pace, as the energy sector within the SP500 has already jumped 35+% this year. Given the significant rise in a short time, it may be a good opportunity to begin taking some of those gains off the table. By selling some of the winning positions, it will provide some cash to take advantage of other parts of the market that have been beaten down to the point of providing good long-term value. Unfortunately, the geopolitical news will continue to dominate sentiment on Wall Street for the foreseeable future.

There are still some good hiding places to be invested while the storms of war and higher interest rates blow over. Some extra cash is not a bad thing, however selling everything and waiting until a “better time” may keep investors from recognizing the beginning of the next inevitable leg higher for stocks.