Nolte Notes

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If April showers bring May flowers, what would April storms on Wall Street bring? The worst start to a year in over 60 years which has investors on their back heels wondering if the worst is still ahead. Interest rates have jumped by 2% on the two-year treasuries over the last six months, even though the Fed has only increased rates by a quarter of one percent. The Fed meeting and even more so, the press conference afterwards on Wednesday will set the direction for interest rates the rest for the year. The economic data is showing some growth with a still, heavy dose of inflation. Can the Fed thread the very narrow needle of slowing inflation without dumping the economy into a recession? This week may provide some answers beyond selling in May and going away.

Don't do as I do, do as I say is usually heard from those in authority, whether a parent or politician. That saying is turned around a bit on Wall Street. Watch what people do and not what they say. That usually means to discount the usual survey data points and focus on actual spending. That spending is clouded by higher prices. So, while the last consumer spending numbers looked good, when you back out the higher prices paid, the numbers were flat. GDP was negative during the quarter due to unusual factors, although estimates were for some growth. Earnings season has been mixed for reasons that have tended to be company specific rather than industry trends. Demands for goods and services continue to be strong and consumers are willing to accept higher prices. However, labor demands remain at the forefront, whether in higher wages or in flexible hours. Supply chains are an issue for some companies, while others struggle with overall demand. A slowing economy may be a benefit in getting supply and demand back in balance.

The usual relationship between stocks and bonds has broken down this year. Historically when stocks have done poorly, bonds have provided a cushion. This year, bonds have declined right along with stocks. Even the long-term bonds have dropped nearly 20%. There are a few instances in the past to compare and the results are mixed at best. The more negative would be for valuations to return to normal ranges, projecting a decline of another 10-20%. The brighter side would be bond yields to stabilize and further buoyed by solid earnings. This would mean a positive return for stocks between now and year end. Both are possible and monetary policy may hold the key to the path markets take from here. Not to place a too high emphasis on this week's meeting, but much may get determined at this Fed meeting.

Leaning more toward value and away from technology, with a healthy dose of cash has been a good combination so far this year. But the usual mantra of selling in May and going away will be a typical headline this week. Although the last 40 years have not followed that script. In fact, May itself has been strong when the markets were weak coming into May. The markets have yet to find any good footing this year and remain very volatile, which may not subside during the coming month. Hopefully that volatility will be toward the green vs. the red that has been the characteristic of the year so far. The coming week, as highlighted above, should be an exciting one for investors. Once the Fed has spoken, it is possible to make some better investment decisions about the remainder of the year. If the door remains open to larger and persistent rate increases, expect the markets to have a rough go the remainder of the year. If they discuss some possibilities of pausing their rate increases, the markets have an opportunity to rally. Either way, the shift toward value and away from growth should persist well beyond the Fed meeting.

What was supposed to be a sleepy week ahead of the Fed meeting was anything but quiet. The unusual relationship between stocks and bonds should dissipate with bonds taking their place as a defensive investment for poor performing stocks. Financial conditions remain accommodative and should support stocks. The historical record would suggest that the markets may be in for a better second half than what has been experienced so far year to date.

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