CONWAY• JARVIS LLC
Investment Outlook

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Update

The Fed: Any Landing Will Do

The investment community has spent considerable time pondering whether the Fed will be able to craft a soft landing for the economy as it battles inflation. On Wednesday Jerome Powell erased any doubt as to whether avoiding a hard landing was a priority for the FOMC as many, ourselves included, had thought. It's not. The hike of the Fed Funds rate by 75bp and the chairman's statement that followed made it evident that the priority is to stick a landing, any landing, in restoring price stability, regardless of the effect on the economy. That significantly raises the *probability* of recession in the next year. The only questions remain as to the depth and duration of that recession and to what extent that outcome has already been priced into the stock market. The answers to those questions hinge on the results from the October and January earnings seasons that lie ahead.

A *lowering* of earnings growth is currently priced into stocks. A *negative* growth rate hints of a deeper and longer recession, one that will almost certainly prompt traders and programs to sell, while testing investors' adherence to their long-term strategies in the face of an even more extended bear market. The one wild card, barely mentioned outside of a fleeting reference from Chairman Powell, is the run-off of securities from the Fed's balance sheet that began in the Spring and has hit full speed in September. Analysts have estimated the longer-term effect to be a 50 to 100bp hike in fixed income market rates that can boost the effect of the board's rate hikes. That, if it continues, can bring *tapering* and an eventual *pause* in rate hikes more proximate.

As we write today, the S&P 500 is testing the previous bear market low we witnessed in June. Whether we eclipse that low to the downside by a significant margin depends on the quality of earnings, the flow of inflation data in the remainder of the year, and how the FOMC reacts. The Fed has meetings scheduled for November and December. That doesn't preclude announcing an unscheduled gathering if conditions dictate since Powell reiterated the board's continued data dependency and resolve to "Finish the job". By that he means snuffing out any expectations of persistent inflation and seeing both Headline and Core CPI firmly launched on a track back toward its mandated level of 2%.

While stocks are currently reflecting the cost of reducing inflation, the underlying companies and investors who own them will benefit greatly from the return of price stability. Cash flow from dividends and interest continues and has been enhanced by the return of bonds as a competing asset class as rates have risen. Diversified investors with a longer-term investment horizon should be looking beyond recession to the next cycle. The market will begin to reward them at the first signs of the Fed tapering or pausing its rate hikes. Clues to how soon that happens will be revealed in the fourth quarter. Stay tuned.

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