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The Fed has Entered the Room

Global Markets and Regions

	1st QTR	2022 YTD
US	-5.30%	-5.30%
Developed Europe	-7.20%	-7.20%
Asia	-7.40%	-7.40%
Emerging Markets	-6.90%	-6.90%

US Markets

	1st QTR	2022 YTD
Dow 30	-4.10%	-4.10%
Large Cap Cos.	-4.50%	-4.50%
Mid. Cap Cos.	-4.80%	-4.80%
Small Cap Cos.	-5.60%	-5.60%
Bonds	-6.07%	-6.07%

The Federal Reserve has a mandate to "promote effectively the goals of maximum employment and stable prices." Their primary tools are raising or lowering the Federal Funds rate and adding to or reducing the systemic supply of money, otherwise known as Quantitative easing or tightening. They are an independent government agency and not subject to short term changes in the political makeup of the other branches of government. They don't control all interest rates but effectively influence how the market sets other interest rates. When the Fed acts or even discusses acting, the economy and the markets react. The Fed has indicated they are ready to act with significant measures to stabilize prices by raising rates and reversing Quantitative easing.

We've been experiencing significant inflation recently. There is a rather long list of proximate causes for that inflation, some of which can be laid off on the Federal Reserve and other global Central Banks. They have had a lot of assistance from Government fiscal policies. COVID distortions have also contributed. Excess money is the fuel for the inflation fire. But when inflation reaches a certain point, the Fed has the power to provide a "solution". The Fed solutions often can lead to a significant economic slowdown and recession. The first quarter of 2022 the markets have begun to grapple with that potential intervention. Policy that had been supportive of prices could become suppressive.

The global response to COVID shutdowns has been monetary and fiscal stimulus on a massive scale. This is on top of decisions made by the Fed and Central banks after the Great Recession of 2008 to adopt more accommodative monetary policies with goal of supporting their economies, so this policy predates COVID.

The US government and the Fed have responded to COVID in the manner of our global partners with trillions of dollars of unemployment relief, extended unemployment relief, rent relief, business loans and more. This has significantly expanded the money supply. If you remember, the stated goal was to raise the inflation rate to 2% as a way of supporting stable long-term growth. It appears in some ways they have done their job too well. But we now have a situation where interest rates are substantially below the inflation rate. This is not sustainable.

We've witnessed as the economy reopened, shutdown related shortages of goods and services result in a mis-match of supply and demand. Prices of just about everything have gone up as a consequence. Monetary and fiscal policies have suddenly become part of the problem rather than the solution. For instance, decisions of our Government on Energy policy have exacerbated the problem by driving fuel prices higher. A war involving one of the world's largest energy producers has added to upward pressure on prices as gas and oil are still the primary driver of all prices. Ping pong government policy making just adds to the confusion. There is not much in the way of coordination or cooperation of fiscal policy and monetary policy at the moment.

Through all of this, the US economy is still expanding. Europe is in recession; again. They are also dealing with a war. Asia is still having significant COVID and non-COVID related economic growth problems. Latin America is a mixed bag of growth and stagnation. At present, the US economy isn't stalling. It's still growing, but at a decreasing rate. We are the best of the rest.

Through all of this, companies are still finding ways to grow earnings and revenues. This is a remarkable achievement given the circumstances. The first quarter earnings season is about to begin and forecasts are optimistic. The fourth quarter of last year saw good earnings and sales results, which are the ultimate determinate of stock prices.

The market's recent swoon has been pronounced. The Nasdaq reached bear market depths of minus 20% plus when measured from its price peak in November of 2021. The other broad indices have had similar declines. Stock prices have noticed that things are a little out of kilter. If the world can get its act together without the Fed having to go to extremes in fighting inflation, they should be able to respond favorably.