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And The Bear Plays On

Global Markets and Regions

	3rd QTR	2022 YTD
US	-4.70%	-24.80%
Developed Europe	-10.10%	-28.40%
Asia	-11.60%	-27.10%
Emerging Markets	-11.40%	-26.90%

US Markets

	3rd QTR	2022 YTD
Dow 30	-6.20%	-19.70%
Large Cap Cos.	-4.90%	-23.90%
Mid. Cap Cos.	-2.42%	-21.57%
Small Cap Cos.	-5.16%	-23.05%
Bonds	-4.76%	-15.34%

The bear market that began this year continues to depress asset prices. Stocks and bonds have turned in their worst performance since at least 2008. The average bear market lasts about 10-15 months. Bull markets can go on for years. That time disparity is one of the reasons bear markets are so jarring. All bear markets in history have eventually yielded to bull markets and new high prices. So, we have something to look forward to.

Bear markets are a regular market feature. Like storms, bear markets vary in length and intensity. This bear market appears to be more hurricane Ian like, rather than just a regular storm. All storms end. The damage is done and the rebuilding to new highs begins.

The Federal Reserve is usually, but not always, the proximate cause of bear markets. Their job, after all, is to promote stability in prices and the job market. Their tools for the task are interest rates and money supply. They are currently using those tools to drain liquidity from the markets. Their current actions in raising interest rates and reducing money supply induce investors to sell or at least not buy stocks. The knock-on effects to the economy of slower growth of incomes through slower and eventually negative job growth also reduce the liquidity that supports stock prices. The conditions for a bear market are set.

The current Fed response has been particularly robust this time due to inflation accelerating way above long-term trend lines. We haven't seen inflation rates this high since the 1970s. The Fed has literally slammed on the brakes with the fastest interest rate increases in history. Why?

The economist Milton Friedman famously said: “Inflation is always and everywhere a monetary phenomenon, in the sense that it can be produced only by a more rapid increase in the quantity of money than in output.” Given that the Government’s response to the COVID shutdowns was to flood local governments and institutions with money and literally deposit money into individuals bank accounts, the monetary conditions for inflation were set.

Supply chain disruptions (remember them?) without reduced demand set the inflation table in 2020 and 2021. Our decision to restrict energy production has been particularly ill-timed, especially in light of the Russia/Ukraine conflict. Housing, transportation and food are the majority components of the Consumer Price Index (CPI). Increased energy prices have supercharged inflation in those sectors.

At present, The Fed is the only combatant in the war on inflation. They are doing a lot of damage. The fiscal (Government) polices of spending and debt leave the Fed as the only tool in use right now. The current spending policies are not a new development and have been a bipartisan policy for a long time. We are at a point where the cumulative national debt and the interest paid on it may actually serve as a restraint on the Fed, though a little restraint on the part of governments would make the task of taming inflation easier. That does not seem to be part of the current conversation, but that can change. For now, the Fed has the task to themselves and stock and bond prices are collateral damage for the time being.

The good news is that, like storms, this will eventually pass. Market sentiment is about as negative as it has ever been. People and investors are paying attention and don’t like what they see. While that may seem obvious given what we are going through, it is historically a sign that things have gone about as far as they can go in one direction. Given where we are in the evolution of this bear market, time may be trending in favor of investors. The fourth quarter of 2022 would be a good time to change that direction.

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