

The Bottom Line

Relevant Insights for the Savvy Investor

APRIL 2022

Navigating a Soft Landing Is Hard

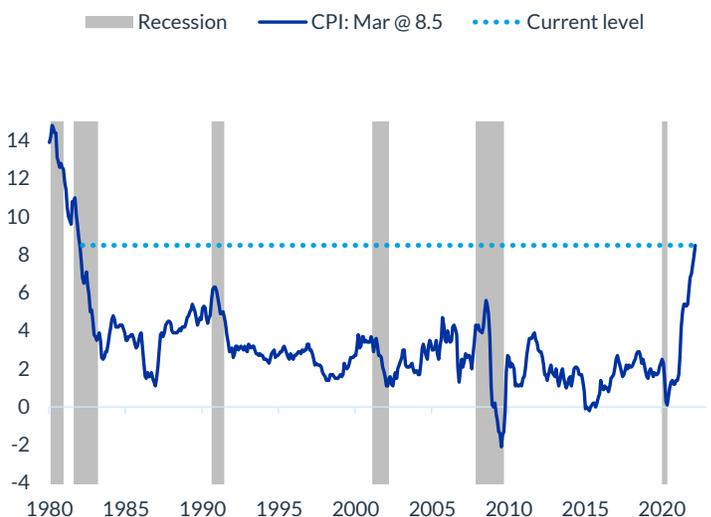
Managing a change in the direction of monetary policy is very difficult, more so when turning hawkish. If the Fed moves too slowly, the economy has to deal with the severe consequences of high inflation for too long.

Move too quickly, and there is a risk of putting the economy into a recession. Powell is attempting to navigate a “soft landing,” which occurs when the Fed raises interest rates enough to bring down high inflation by slowing economic growth but not enough to put the economy into a recession (a “hard landing”).

With the consumer price index at 8.5% (chart one), well above the Fed’s target rate of 2.0%, the Fed is strongly committed to taking steps that will reduce inflation. For shorter-term interest rates, the Fed plans to raise the federal funds rate to 1.9% by year-end, higher than the level it was before the pandemic started (chart two). For longer-term interest rates, the Fed plans to reduce the size of its bond holdings. During the

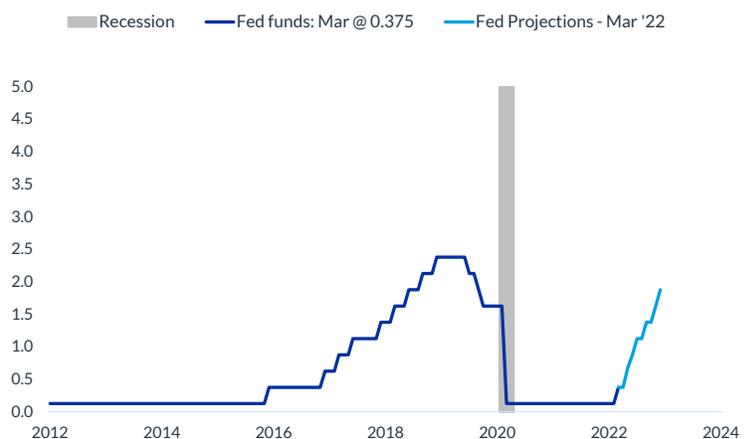
CHART 1: Consumer Price Index

% change, y-o-y, seasonally adjusted



Source: Bureau of Labor Statistics, March 2022.

CHART 2: Fed Funds and Neutral Fed Funds (%)



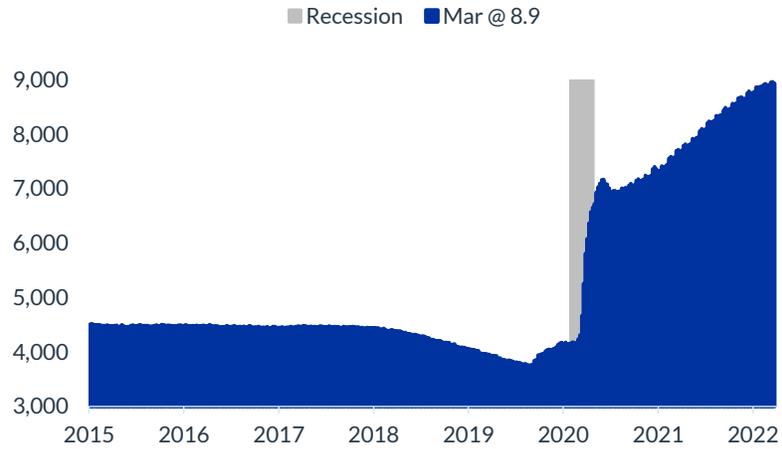
Source: Federal Reserve, March 2022.

Non-deposit Investment Products: ■ are not FDIC insured ■ are not Bank guaranteed ■ may lose value

pandemic and aftermath, the Fed aggressively bought Treasury securities and mortgage bonds to help drive down intermediate- and longer-term interest rates. They amassed almost \$4.5 trillion in bonds (chart three). It worked; interest rates came down, and households could refinance debt at a lower level, providing a higher level of cash flow that could be used for spending, which drove economic growth. That is no longer needed, so the Fed will allow some of those bonds to mature each month, which will help put upward pressure on longer-term interest rates.

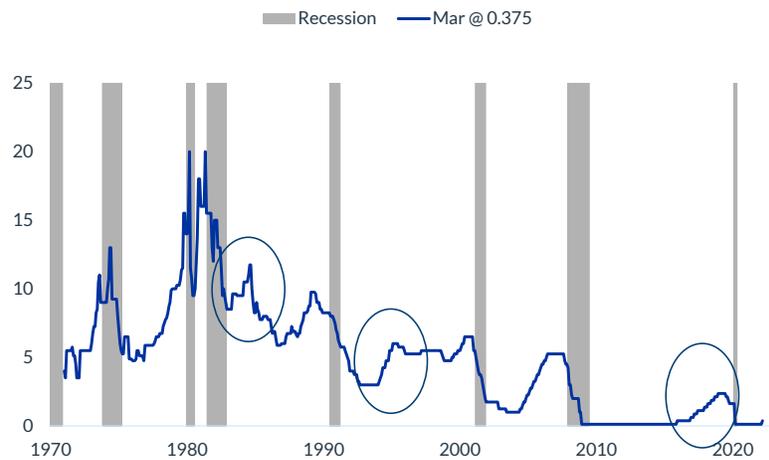
Powell recently cautioned that “monetary policy is a blunt instrument not capable of surgical precision.” Nevertheless, he also stated that the Fed managed soft landings in 1965, 1985 and 1994. Most economists think the Fed was on track for achieving a fourth soft landing ahead of the pandemic (chart four, data only goes back to 1971).

CHART 3: Fed Balance Sheet
\$, trillions, not seasonally adjusted



Source: Federal Reserve, March 2022.

CHART 4: Median Federal Funds Rate (%)



Source: Federal Reserve, March 2022.

Market Trends

US equity markets have rebounded approximately 6.5% from March lows, climbing several walls of worry, including the ongoing war in Ukraine, higher inflationary pressures and an increasingly more aggressive Fed. Given positive fundamentals, we continue to see scope for modest gains over the next 12 months. However, we expect markets will remain volatile as investors attempt to navigate a more balanced landscape of risks, and further pullbacks ahead are possible until the uncertainty surrounding these key concerns subsides.



LABOR

Payroll growth continues to grow at a rapid pace, which is being supported by more people reentering the labor force.¹



THE FED

The Fed plans to push up short- and longer-term interest rates in an effort to slow the economy and inflation.²



HOUSING

A combination of higher home prices and rising mortgage rates is causing mortgage payments to move significantly upward.³



CONSUMER SPENDING

The pace of growth in household spending has slowed in recent months, which is helping to bring the economy back into balance.⁴



INFLATION

The CPI hit a 40-yr high of 8.5% y-o-y but is expected to start declining over the course of this year.¹



SERVICE SECTOR

With receding cases of Omicron and workers returning to the office, demand for services, like restaurants, is picking up.⁵

Sources

1. Bureau of Labor Statistics
2. Federal Reserve
3. Bankrate.com, National Association of Realtors
4. Bureau of Economic Analysis
5. Institute of Supply Management

Index Definitions

CPI: The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.

Important Disclosures

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