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JUNE UPDATE
May 31, 2022

MARKET COMMENTARY

It is economic orthodoxy that monetary policy works with "long and variable lags." In plain English, the mainstream economic belief is that a Fed hike today doesn't fully impact the economy for 12-18 months – hence ongoing worry that the Fed is hopelessly behind the curve.

Changes to the Fed's toolkit, including forward guidance (aka "talking"), bring this assumption about long policy lags into question. While the Fed only began raising the Fed Funds rate in March and will not begin balance sheet tapering until June 1st, forward guidance about future policy actions led financial conditions to tighten significantly in January, February, March, and April. We're already seeing the impact.

For example, the housing market is showing signs of a slowdown. New home sales fell in April to a seasonally adjusted annual rate of 591,000 (Fig. 1), well short of expectations, and months of new home supply jumped to 9, which is well above the normal range of 4-6 months (Fig. 2). Realtor.com also reported that inventory has increased 9% year-over-year. This housing slowdown is a necessary precondition for the Fed to fight excess demand and inflation, and it will also be an important indicator of the health of the economy as we work through the tightening cycle.

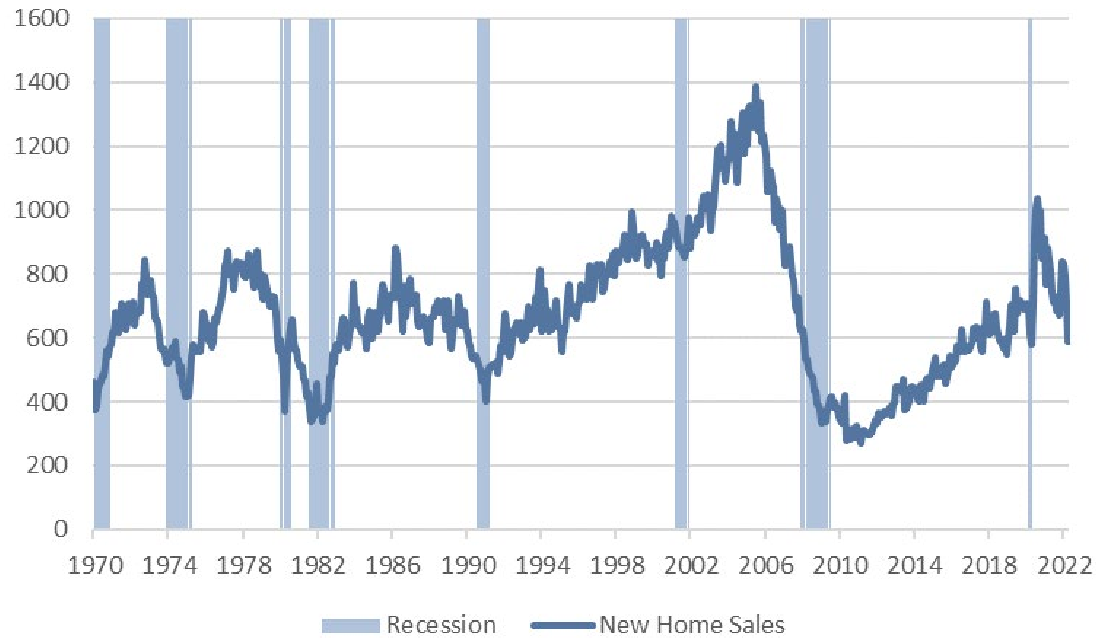
May Market Review

- Interest rates generally declined while credit spreads increased during May. Taxable and tax-exempt bond portfolios appreciated overall.
- After peaking mid-month, the US Dollar has declined slightly over the last two weeks.
- Global equities were volatile but relatively flat through May 27th. US equities trailed international developed market equities but outperformed emerging markets.
- The S&P 500 Index is trading at 17.5x forward earnings.

Our Perspective

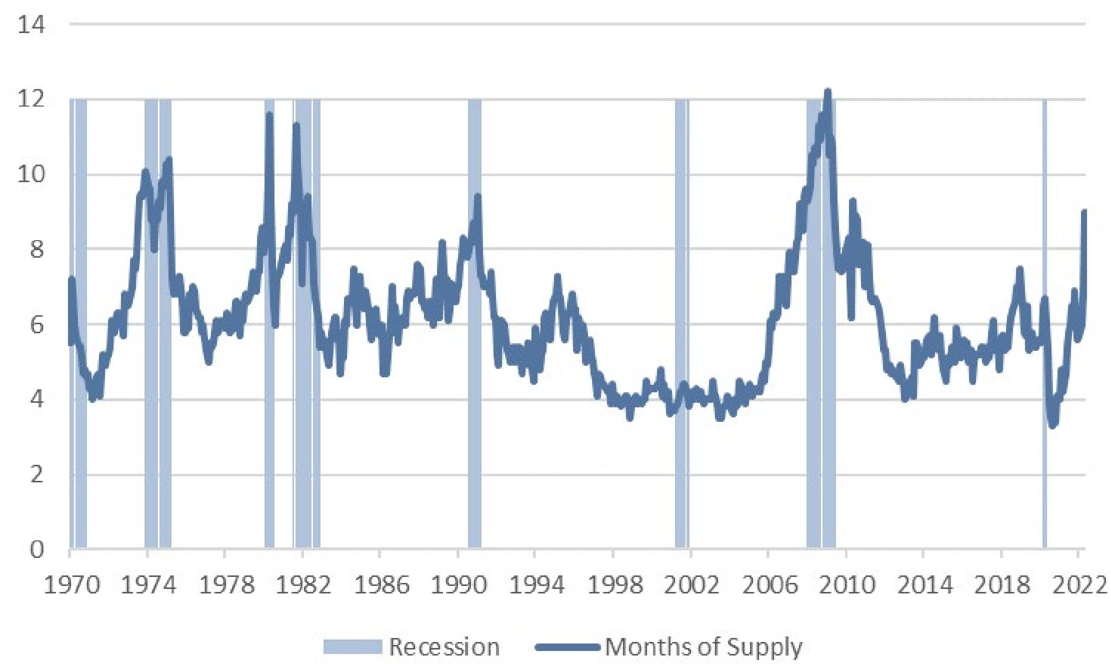
- We drew an analogy between 1979-1982 and today's environment during our Market Update Video on May 19th. Paul Volcker created the playbook for subduing inflation, and Jerome Powell is executing it once again.
- The Fed will want to wait until early fall before signaling a shift in their outlook, but indications of peak inflation could be a catalyst for a relief rally in risk assets.
- We believe markets are now underestimating the likelihood of sustained hikes through the end of 2022 and into 2023.

Fig. 1: New Home Sales



Source: Bloomberg, Mill Creek.

Fig. 2: Months of New Home Supply



Source: Bloomberg, Mill Creek.

QUICK LINKS

- Global Small-Cap Stocks Present Attractive Opportunity for Investors
- Behind the Curve
- Earnings Yields Better-Than-Expected Results
- May Update: Domestic Gross Panic?

This week's contributor: *Michael Crook, CAIA*