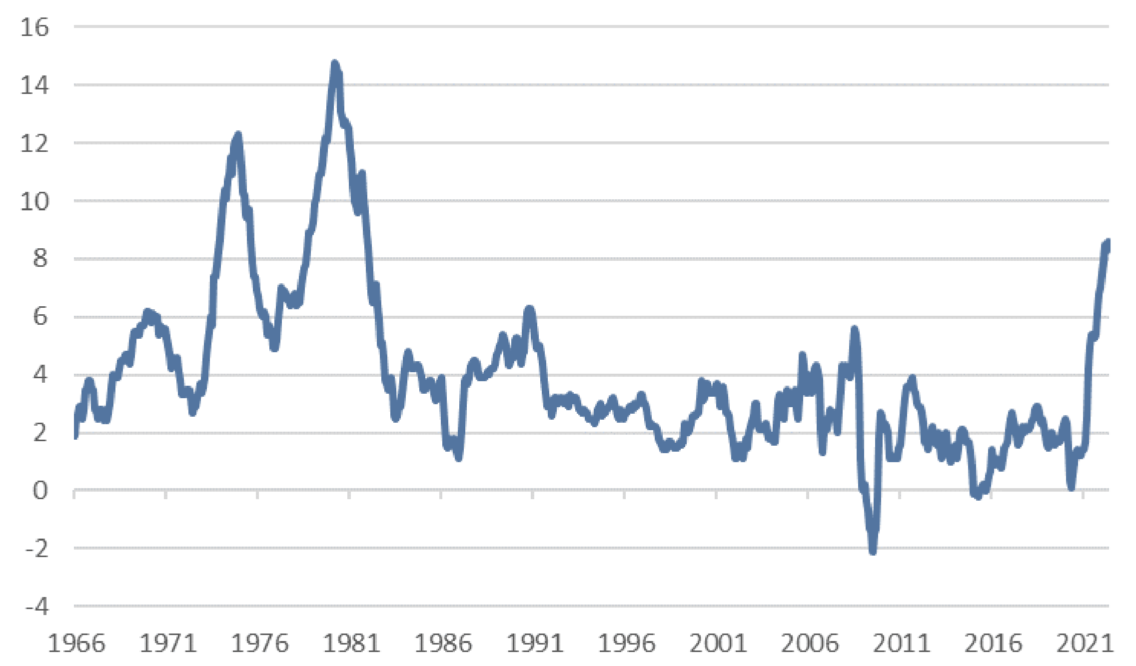
WEEKLY UPDATE
June 13, 2022

MARKET COMMENTARY

Fig. 1: Inflation remains far too high; Consumer Price Index, Year-Over-Year Change (%)



Source: Bloomberg, Mill Creek. Data is as of 5/31/22.

On Friday, we learned that the Consumer Price Index increased 8.6% in May (Fig. 1). This is the highest annual rate of change since 1981.

Our View:

1.) Some prognosticators, including Atlanta Fed President Raphael Bostic, have recently suggested the Fed might pause rate hikes in September. We believe that possibility is completely off the table. The Fed is more likely to hike 50bps in September than pause.

2.) When it became clear that inflation was not responding to policy changes in 1979, Paul Volcker surprised markets by tightening monetary policy during an unscheduled Saturday night press conference. The media called it Volcker's Saturday Night Special. A "Powell Special" is on the table and could come as early as the FOMC meeting this week. A 50bps hike is the base case on Wednesday. A 75bps hike is now on the table.

3.) The Fed's playbook is now entirely focused on inflation. Growth won't matter until inflation is under control, even if it requires a recession to get there.

4.) We believe 3.25-3.5% now represents a reasonable level for the 10-year Treasury over the second half of this year. The housing market should continue to slow quickly, but low inventories will support prices.

5.) A deep, 1981-type recession isn't a given and a "softish landing" or shallow recession remains possible. Volcker took over during horrendous economic conditions. Today, economic growth remains above trend, consumer balance sheets are healthy, and we continue to see a record number of job openings.

From a Markets Perspective:

1.) A repressive, hawkish Fed will be a headwind for virtually all investment markets, but we're starting to see emerging opportunities.

2.) For example, equity valuations have declined to reasonable levels. US large-cap equities are now trading at roughly the average forward price-to-earnings ratio of the last decade. International developed market equity and global small-cap equity valuations are one standard deviation cheap.

3.) High-quality bond yields are at decade highs. We believe municipal bonds and Treasuries will reassert their value as safe haven investments in an uncertain growth environment.

4.) High Yield corporate bond spreads have increased from 280bps to 450bps this year. We're monitoring this market for an entry point once spreads exceed 500bps.

QUICK LINKS

- What's Ahead for Credit Spreads
- June Update: Cracks in the Foundation
- Global Small-Cap Stocks Present Attractive Opportunity for Investors
- Behind the Curve

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