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Weekly Commentary

Issue No. 21 | JUNE 6, 2022

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# Macro View

*By Hubert Marleau*

## What Is the Situation?

Submitted June 3, 2022

On June 1st, the Fed started to deploy quantitative tightening (QT). Barron's wrote on Wednesday: "For the next 3 months, the Fed will stop reinvesting the proceeds from its $9 trillion of bonds to reduce the balance sheet by $47.5 billion each month. After Labour Day, the Fed will step up the tightening process to a $95 billion per month rate of reduction." According to people in the know, the Fed's QT plan is equivalent to a single 25 bps increase in the policy rate. It does not sound like much, but it should intensify the ongoing monetary deflation cycle by potentially keeping the money supply at bay. There's no doubt interest rates are going higher. The Fed is going to move very quickly, following the lead of the Bank of Canada. Last Wednesday, the Canadian central bank raised its own policy interest rate by 50 bps to 1.75% and said it was prepared to act even more forcefully if needed.

A decelerating expansion of the money supply will help reduce spending on durable goods and housing activity, hence core inflationary pressures. Indeed, the core gauge of consumer prices has already eased to a 6.2% gain in the year through April, a slow process that should now continue in months to come, along with several indicators of real activity. In this connection, equity markets are pricing in this overall slowdown, but not a recession. Since 1971, when Nixon did away with the Bretton Woods formula, bear markets have occurred only when recessions set in. That only happened once in 1987 and was a fluke: a trading accident, which does not really count. The S&P 500, meanwhile, has corrected by as much as 19% on concerns that a recession is in our midst.

**So are we heading into a recession?**

For many observers, a recession is a "fait accompli." The bad vibes are concentrated in the new Fed policy, the war in Ukraine, turbulence with COVID, and sky high energy prices. I wrote last week that I had not fallen for the above prognosis and had discounted the perceived permanence of these macro effects on the

# Macro View cont.

*By Hubert Marleau*

economy. First, the Fed will deploy rate hikes fast so that it can rid itself of the tightening process expediently. Second, opposition to the Russian invasion is flagging as the West is feeling Ukraine fatigue along with abating fear of Putin. Thirdly, China is leaving the lockdown in Shanghai and introducing a plethora of infrastructure projects with incentives, finance and liquidity. And fourthly, Russia is finding new markets, with Saudi Arabia prepared to raise production if Russian oil output were to fall substantially.

It does not take a genius to know that the performance of the economy is cyclical, which means a recession is forthcoming. But when? Timing is the big thing. At this time one is not imminent.

Unemployment is low, wage rates are rising, balance sheets are strong, savings are still excessive, and job growth is continuing. All this is going on while most leading economic indicators are not contracting, just slowing, compared to other signs of economic health. ISM numbers for both the manufacturing and service industries are still expanding, albeit at a lower pace, but comfortably. Meanwhile, the economy added 390,000 non-farm jobs, extending a year-long streak of strong gains. Since there was nothing to change the narrative, it is unlikely that we are about to enter a contraction period anytime soon.

**What is the stock market outlook?**

I'm not ready to throw in the towel because the evidence is still sparse that a malicious recession is upon us. The stock market has been subjected to valuation re-adjustments that are unlikely to result in an earnings downturn. Should this idea hold, the Fibonacci calculator should be one's guide. It's an indicator for a stock market, based on mathematical formulas governed strictly by human emotions. 3838 is the likely low for the S&P 500. Interestingly, Marko Kolanovic, JPMorgan's chief market economist contradicts his peers at other large investment banks. He is constructive on risk assets, forecasting that the broad market will recoup all its losses by year end.

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PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188
F. +1 (514) 397-0199

1 St. Clair Avenue East Suite 504
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110
F. +1 (647) 343-7772

www.palos.ca