May 12, 2022

Economic Update

The Federal Reserve's extraordinary measures of Quantitative Easing and unprecedented $6 trillion fiscal stimulus due to the pandemic resulted in the creation of "free" money and a false market for the past two years. Now, inflation is eating away on consumer savings; real wages are declining and we still have major supply shortages. Historic times indeed!

The Federal Reserve has always been behind the curve in dealing with inflation. The Fed's reluctant strategy – keeping interest rates at zero for too long and buying trillions in bonds has created a bubble. Now, the Fed is trying to play catch up, with the last interest rate increase of .50% and the promise of more rate increases to follow. Rates have to rise to the point that unemployment starts to rise in order to get inflation to subside. Right now, rates are well below where they need to be to achieve the goal of stopping inflation, and the stock market still has not fully reflected the reality of what is coming. The Fed needs to take these painful steps to curb inflation, however, tightening money into a slowing economy has the earmarks of a recession.

Inflation is at a 40-year high – still over 8%. Current CPI numbers released May 11th showed 8.3% inflation down from 8.5%. However, this 0.2% decrease doesn't really seem to matter when you look at how the price of orange juice increased 9.61% in one week and 15.67% in one month. Overall, grocery store prices were up 10.8% compared with a year earlier – the most increase in nearly 42 years! We all feel the inflation as we do our daily shopping and know it is higher than the 8% the government is stating.

First quarter GDP growth was -1.4% indicating our economic growth is slowing. This type of headline would typically generate a negative reaction from the markets. However, the same day the GDP number was announced, the Dow Jones Industrial Average Index (DJIA) *soared* over +628 points; S&P 500 over +85 points. There is no economic playbook or rational thinking that can relate the increase in the stock market when the negative GDP number clearly shows slowing growth.

The average 30-year mortgage rate climbed to its highest level since 2009 at 5.57%– causing mortgage purchase applications and pending home sales to decrease to their lowest levels since May 2020. While it is true that there is still pent-up demand for homes, the affordability needed to continue to drive sales is simply not there.

Year to date the Indexes are all off – S&P 500 down -17.53%; Dow Jones Industrial Average down -12.66% and the Nasdaq down -28.03%. We have begun to experience major market volatility and index swings. An intra-day market swing of 6% in the index only happened two other times – in 2000 before the market crash and 2008 before that particular market crash. Investors are in for a wild ride as this will likely be normal market activity as we continue into the summer months.

As we've mentioned in past newsletters and reviews, we have been anticipating an economic downturn for some time and have therefore been repositioning portfolios to have less market risk. With the aforementioned information and real economic data, we recommend continuing our conservative approach during these unchartered times.

As always, we at Kapusta Financial Group, would like to thank you for the trust and confidence you place in our team.

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