The Market Deals With Another Fed Funds Increase and Adjusts to it Well

By Bob Deitrick, CEO of Polaris Financial Partners
Wednesday August 3rd, 2022

Last week the market had a lot of news and data to digest. We witnessed another 75-basis point rate hike in as many months, a flood of tech earnings and an airline takeover battle where Jet Blue will acquire Spirit Airlines. The market also enjoyed the fact that the Fed appears to be on top of inflation for the first time in months which is why the market responded favorably last week.

Last Wednesday, the Fed raised rates for the second month in a row in their effort to fight inflation. Fed Chair Jerome Powell would not say how much rates may increase in September; however, he made it clear they are waiting to see what the economic numbers show between now and then which leaves the door open before making their next key decision. The Fed made these moves as the economy contracted for the 2nd quarter last week allowing some pundits to say we're in recession. I believe, however, that a strong labor market and healthy consumer spending signals we may weather this storm. As for the economy - job creation continues, unemployment claims show the job market is growing, household finances are strong, consumers are spending, and businesses are growing. People are distrustful and concerned about gas prices, but the good news is, as we predicted, gas prices have fallen in the past month and you can buy gas at the UDF, BP and Sheetz stations in Powell, Ohio for $3.23 to $3.29 per gallon today! Some of that has to do with the new Sheetz coming into Powell, as Tom Harper shared with me to attain market share, but the good news is gas prices are falling. The all-important tech sector, which we favor, saw a slowdown in earnings last week among the FAANG stocks; however, Amazon, Google and Apple beat their forecasts and Microsoft issued an upbeat outlook for the remainder of the year.

The economic news was daunting last week; nonetheless, the market responded favorably. The S&P 500 was up 10.2% for the month of July and the all-important tech sector was up 13.8% for the month. Not too shabby given how poor things were in June. We believe the tech sector will continue to rebound; albeit we may see some volatility in September and October which are historically the worst and most volatile months of the year respectively.

The Fed has been a dollar short and a day late on dealing with inflation. Why were so they negligent one may ask? The decision makers at the Fed saw inflation data coming in "hot" for months before they acted to slow down monetary policy that was clearly stimulating the economy. A chorus of analysts and policymakers finally chimed in last week saying they had made a "mistake". That is the "understatement of the year" in my view. Treasury Secretary Yellen conceded the misdiagnosis came from her department, and from the Fed. They admitted the word "transitory" was a poor choice of words… to that I say, "no kidding." Having said that, it now appears now the Fed may be ahead of the curve. It's the Fed's task to tame inflation which has been running at a pace not seen since 1983. They are hiking rates to slow things down. Last week, the market concurred with what they are doing+.

Reining in inflation may take more aggressive monetary policy from the central bank as we get into the fall. However, if inflation continues to recede and if the more important core inflation number begins to acquiesce, we will see a more dovish Fed moving forward. Maintaining price stability and maximizing employment are the Fed's top responsibilities. As I said earlier, jobs are plentiful which may give the Fed cover to rates but to slow down the pace of increases going into next year.

So where do we go between now and year end? The first half of this year has been like the movie Misery – it has been painful to watch especially the scene where Annie Wilkes hobbles Paul Sheldon so he can never walk again... However, the market is showing signs of resilience and we may be at a crossroads with inflation. In 1982, the bear market ended after the Fed raised rates to historic levels and we saw a rally in late summer of 1982 and the inflation driven bear market was erased in four months. Companies have had solid earnings this quarter despite a COVID inventory correction, a rise in the dollar and two quarters of negative GDP, yet 70% of companies have beaten their numbers this quarter. The S&P 500 closed at 4,155 today as oil prices fell to $90.81 per bbl. The market may close higher by year end if core inflation subsides. We may see the S&P in a range between 4300 to 4700 by year end. This happens if the CPI numbers decline which the futures market is predicting. If the dollar weakens and we get the tailwind from declining gas prices and consumer sentiment improves, we may skim over the waters of recession and not fall in. A recovery by Christmas is a real possibility.

Steve and Carol Polsley at Huntington Park at our PFP Annual Night Out at the Ballpark in 2020

PFP remains optimistic the floor is not going to fall out beneath us as it did in 2008 or in 2002. The market's reaction to last week's news is encouraging. We are watching these events closely on your behalf and will keep you apprised every few weeks as we move to the close of 2022.

Our next client appreciation event will be our "Annual Night Out at the Ballpark" at Huntington Park on Saturday September 3rd at 12:00 noon. Gates will open at 11:15 am. Please RSVP to Steven or myself as we can only hold 96 in the Tansky Suite. We will have a great time and look forward to seeing you there! Enjoy the balance of the summer!