

PERSPECTIVES & OUTLOOK

September 2022



Fed Aims to be "Sufficiently Restrictive"

The Fed finally seems to have convinced financial markets it is committed to higher interest rates. Jerome Powell on Aug. 26 said Fed policy will remain at "a level sufficiently restrictive to return inflation to 2%." A hawkish Fed is an obvious headwind for stocks.



US Dollar Reaches Parity with the Euro

The US Dollar has strengthened ~20% vs global currencies in the last 12 months, and recently achieved parity with the euro. A stronger dollar has been a big hurdle for International equities, although foreign stocks will benefit most when this trend reverses.



US Equity Valuations -30% from their Peak

As of Sept. 2, the forward P/E ratio for the S&P 500 was 16.7. The mid-June P/E (15.3) was the lowest since the pandemic panic (March 2020). US stock valuations are appropriately below their 5-yr (18.6) and 10-yr average (17.0), considering slowing growth.



History Suggests Reasons for Optimism

The first 115 trading days of 2022 (S&P -23%) made this one of the eight worst starts to a calendar year since 1928. In the other seven, US stocks were positive over the next 6 1/2 months every time, with the S&P gaining 18% on average through year-end.



Consumers, Companies Remain Strong

Consumers and businesses are well-positioned to weather an economic slowdown. Debt-to-income ratios are low. Wage growth is accelerating. Unemployment is < 4%. Corporate cash flows are up, banks are well-capitalized, and most debt is fixed at low rates.



Gas Prices Have Fallen from June Highs

The national average for gasoline rose above \$5 per gallon in mid-June before moderating to \$3.75/gallon in early September. Falling gas prices contributed to the stock market's recent rally, but prices remain 15-20% higher than they were a year ago.



What Happens to Stocks in a Recession?

There have been 17 bear markets since World War II. The S&P 500 declined by 31% on average. In the nine bear markets also accompanied by a recession, the average decline was 36%. At this year's mid-June low, the S&P had fallen 25% from its peak.



Cooling Housing Market Will Help Inflation

An exceptionally hot housing market has begun to cool. Sky high prices and lower affordability (30-yr mortgage rates near 6%) have already curbed demand. This will help restore some balance to residential real estate as well as slow inflation.