Market Strategy
by STRATEGAS A BAIRD COMPANY

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A Perspective on the Market

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With equity and fixed income markets off to a remarkably rough start this year, Strategas Chairman and CEO Jason Trennert answers a spate of questions that Baird has heard from clients.

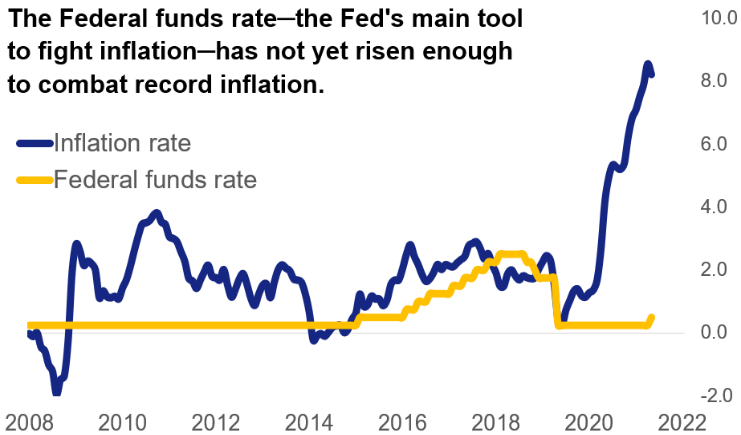
Jason Trennert, Strategas
Chairman and CEO

Do you expect this heightened volatility will continue? I think it's likely that the volatility will continue because I don't think the Fed is anywhere near its neutral rate. Inflation (based on CPI) is over 8%, and the Fed funds rate is only 0.75%. There's a lot of room for the Federal Reserve to keep tightening, and there are going to be increased concerns about the potential of recession next year. **Be sure to check out our key market takeaways.**

What is your thinking on inflation and the Federal Reserve? Can the Fed stick the soft landing? The Fed has a chance to stick the landing, but the longer inflation goes, the more difficult it is to rein in. And it's a moving target. The Fed is getting aggressive (tightening) now but was still buying securities (easing) in March. Their problems are compounded by that late start. Past that, we have supply chain issues, an enormous amount of monetary stimulus in the system, and even discussions about states and localities providing stimulus to consumers to counteract inflation. Unfortunately, I think a lot of those efforts will be counterproductive.

Given global supply chain problems, how are you thinking about geopolitical tension? The tailwind for disinflation that we've seen since the early 2000s (i.e. globalization) is likely over. It's difficult to describe globalization as dead, but there are a lot more concerns about its effects now than there were just a few years ago. There's also skepticism about whether trade can make other countries more "Western," especially after the pandemic and the Russian invasion of Ukraine. So in our opinion, a good portion of that "peace dividend" is going to go the other way. That's how we're thinking geopolitical concerns could impact inflation, bond yields, and earnings multiples.

The Federal funds rate—the Fed's main tool to fight inflation—has not yet risen enough to combat record inflation.



How do you reconcile a hot domestic labor market and fairly strong S&P 500 earnings with the rising probability of recession? The consensus 2023 earnings estimate for the S&P 500 is around $250. We have it at more like $235, and even that may be optimistic. The labor market is tight as a drum but profit margin pressures will make it more difficult for companies to add workers at the pace they have been. A combination of higher inflation, Fed tightening, and weaker labor markets should ratchet up recession concerns. That doesn't mean recession is a foregone conclusion, but I think the increasing odds of it stem from the Fed letting inflation get out of control.

What is your outlook for equity markets over the rest of 2022? We feel strongly that clients should stick with high quality companies that trade as a multiple of earnings and cash flows (as opposed to a multiple of sales) and that distribute cash back to shareholders via dividends or share repurchases. Because of inflation, we'd be wary of companies that don't return money to shareholders and that are trading as a multiple of sales. In our **Sector Allocation** and **Asset Allocation** notes we detail our thinking.

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