A Perspective on the Market

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As we head into the last quarter of an uncertain, volatile year in the markets, Strategas CEO Jason Trennert addresses some of the pressing questions that Baird clients have been asking.

Jason Trennert
Chairman and CEO
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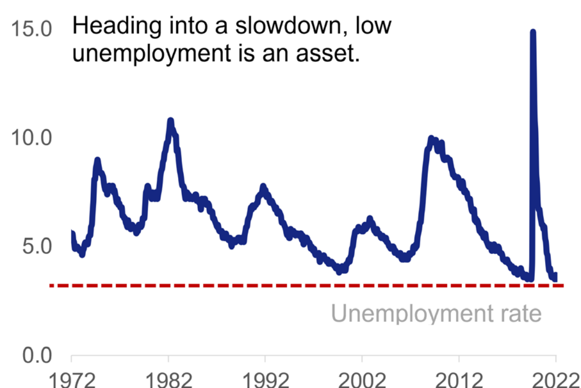
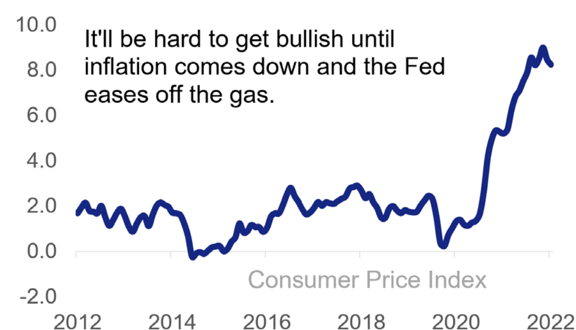
Inflation and rates continue to drive economic and market volatility; how are you thinking about those two factors over the next year? There is a *chance* inflation has peaked. Mortgage rates have increased, which will likely lead to a decline in housing prices, and items like used car prices have come off the boil. Having said that, there are more structural inputs—such as wages and energy prices—that could keep inflation higher for longer. More importantly, the Federal Reserve seems deadly serious about addressing inflation. We see very little wiggle room in Fed comments about their commitment to controlling inflation. So, to us, it's still going to be challenging for a time until that changes.

What are your odds for recession—and if we get one, how might it stack up with recessions of recent history? Our Chief Economist Don Rissmiller has the odds of a recession at about 50% in 2023 and 50% in 2024. That puts our odds at about 75% for a recession at some point over the next two years. It's rare to get the so-called "soft landing" scenario that everyone is looking for. When the Fed is tightening and inflation is this high, it's very hard to avoid recession. However, our starting point is better this time around. We are close to full employment at a 3.7% unemployment rate, and so it wouldn't necessarily have to be as deep a downturn as in recessions past. It's unfortunate for anyone to lose a job but we have a chance to get through a recession with peak unemployment at only around 6%. That would limit the extent of the pain.



Strategas recently reduced its S&P 500 earnings estimate for 2023. What prompted that, and how should investors think about a drop in earnings? I think it's likely that we'll have a difficult next couple of years for equity returns. This year is obviously terrible, and while next year is unlikely to be as bad, we may not return to double-digit market gains until we get through this cycle and the Fed can start easing. On earnings, we've never had an economic recession without also having a decline in earnings. The average decline is ~30% but it may not be as deep this time because inflation is higher and a recession may be shallower. But either way, with lower earnings and multiples unlikely to expand, it could well be challenging for a time.

Strategas has been clear-eyed all year about market weakness and the conditions behind it. What would get you more bullish on stocks? One of our hallmarks at Strategas is that we're humble in our forecasting. We've been doing this long enough to remember times when we missed the mark. We just try take in new information and change when the facts change. From here, what would lead us to be more bullish would be a significant decline in inflation and/or a more dovish Fed. Another bullish indicator could be something like an attitude shift among industrialized countries regarding energy policy. A more measured perspective on fossil fuel use as we transition to renewables might make it easier to weather the economic storm and take the temperature down in terms of recession.



Ultimately, the market is a discounting mechanism and will start to bounce before the depths of the recession are over, but we think there's some time left before we see that kind of turn.

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