MARKET UPDATE

JUNE 2022

Goldilocks and the 3000 Bears

3000 to 1 feels the right ratio for bears versus bulls as we enter the summer. Long running investor sentiment indicators, asset management positioning data and stock market trading indicators are all at levels post major traumatic events (September 11th, March 2020 Covid epidemic). 3000 is also the level on the S&P 500 that the most vocal of negative commentators seem to be predicting. That would entail a further 25% fall from here after the 20% fall we just had which is already one of the worst starts to a year for the US market in History. This extreme negative emotion however is now at odds with the positive evidence building.

Although the war in Ukraine and recent Chinese covid lockdowns have exacerbated the issues facing investors this year, the expected sharp tightening of central bank policy is at the heart of all the drama. When inflation in the US proved to be more political than transitory the Federal reserve forced about 3 years of tight policy into the market in 3 months. It is therefore why we take most comfort from the fact that all the evidence is indicating that we are at peak inflation and therefore peak policy tightening. The policy tightening cycle could be over even before it begun. The bond market in the last 6 weeks has begun to reduce the number of rate hikes it is expecting this year. Commentary from Fed Officials now mentions “pausing in September” or “cutting rates in 2023”, representing a sharp softening in tone from earlier in the year. Bond market indicators of longer-term inflation expectations have cratered, back to where they were late last year and when the market was 20% higher.

Over half the inflation surge in the US was driven by excess demand for durable goods. Consumers had excess savings, stimulus payments in their pockets and couldn’t spend money on experiences such as travel so they bought “stuff”. Cars, TV’s and home furnishings, items which for 40 years have been adding to the secular deflation the west has faced surged in price as this one-off excess demand could not me met as the eastern supply chains were still closed. This has all begun to normalise. Recent high-profile retailers in the US have warned they have too much of this inventory now as US consumers habits normalise and begin to spend more on services as the globe re opens, normalising the balance between spending on goods and services. Every supply chain indicator, from freight rates, lead times, trucking rates and corporate commentary speaks to normalisation.

The labour market has also begun to normalise. The US reopened and went on a hiring binge as retailers, fintech, logistic companies to name but a few all extrapolated that initial surge in demand too far forward. This led to over hiring, overpaying and an unemployment rate of 3.5%. An “unsustainably hot” market in the words of Jay Powell. This has begun to self-correct as dozens of the largest employers in the US, from Amazon to Walmart impose hiring freezes to right size their businesses to the more normal environment they will face going forward. Although this may see the unemployment rate tick up (from a record low of 3.5%) it will see wage inflation dissipate which takes even more pressure off the Fed to tighten policy, which as highlighted earlier is at the root cause of the problems faced.

With sharp declines in stock markets the recession word gets whispered. When Walmart profit warn and blame the consumer the recession word is screamed form the roof tops. Low margin retailers like Walmart face huge issues as the consumers habits have switched rapidly but the consumer themselves is booming. Corporate commentary from airlines, hotels, luxury goods, make up companies , and clothing retailers exposed to high end experiences and fine dining proxies point to a surging consumer and a strong summer ahead. Pent up demand, high savings, low levels of debt, wage inflation and strong asset market returns are continuing to override the cost-of-living crisis.

Continued on next page

T: +353 1 670 2500 | e: info@merrion-investments.ie | **www.cantorfitzgerald.ie** | Cantor Fitzgerald House 23 St Stephen’s Green, Dublin 2.

Cantor Fitzgerald Ireland Ltd is regulated by the Central Bank of Ireland and is a member of Euronext Dublin and The London Stock Exchange.

Strategy & Outlook *Continued*

The US has already printed one negative quarter of GDP growth, it will probably print a second giving economists their technical signal of a recession. This data though must be taken with a pinch of salt. Last year the US economy grew 7%, all distorted from Covid as we opened and closed economies at will skewing year on year stats. Despite this “recession” corporates continue to generate record profits, record margins and are still surprising analysts who continue to upgrade their profits forecasts for the year (a highly unusual stat as we usually start a year too optimistic and must downgrade profit estimates).

There are issues to be addressed. There are always issues to be addressed as an investor; Food price inflation, Chinese property collapse, Chinese covid lockdowns, Geo Politics. The bigger problem for markets has been people confusing normalisation with recession and one off covid led inflation with structural stagflation. The structural forces which led pre covid to prolonged period of low rates, low inflation and strong asset price returns in the western world are slowly re establishing themselves. There used to be a phrase for this scenario, but the 3000 bears are so loud right now its hard to remember it.

WARNING: Past performance is not a reliable guide to future performance.

WARNING: The value of your investment may go down as well as up.

Merrion Capital Investment Managers Limited (trading as Merrion Investment Managers) is regulated by the Central Bank of Ireland and is regulated by the Central Bank of Ireland and is a Member Firm of Euronext Dublin and the London Stock Exchange.

© 2021 Morningstar, Inc. All rights reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

T: +353 1 670 2500 | **e:** info@merrion-investments.ie | **www.cantorfitzgerald.ie** | Cantor Fitzgerald House 23 St Stephen’s Green, Dublin 2.

Cantor Fitzgerald Ireland Ltd is regulated by the Central Bank of Ireland and is a member of Euronext Dublin and The London Stock Exchange.