
Weekly Market Flash

Good News, Bad News

June 3, 2022

In the long run, a healthy economy and a healthy stock market go together. In shorter cycles of activity, though, the correlation between the two is inherently unpredictable. It's always worth remembering that economic reports are by nature backwards-looking, while markets look ahead to what might lie in store in the future. Just this week, for example, there has been a spate of relatively good news about the economy as reflected in consumer confidence (still fairly high despite rising prices), manufacturing and non-manufacturing business activity, and finally today's monthly jobs report showing better than expected payroll additions with an unemployment rate of 3.6 percent. Markets have been somewhat cool to the news, though, particularly in early trading this morning following the jobs report.

Hopes for a Pause

Right now the sentiment on Wall Street might be more favorably disposed to anything that shows the economy is not overheating. "Peak inflation" and "peak Fed" have been twin rallying points for whatever bouts of good feelings have countered the overall negative trend in stock prices thus far this year. This hopeful narrative rests on the idea that core inflation may be gradually turning lower and thus making it easier for the Fed to bring its monetary tightening program to a conclusion sooner rather than later (which indeed has a measure of support from some recent inflationary readings).

Last week there was a particularly optimistic take on this narrative when Atlanta Fed president Raphael Bostic opined that the Fed might take a bit of a time out in September after raising rates in June and July to assess the situation. Bostic in no way intended to suggest that the central bank was ready to throw a bone to the stock market, yet "Fed pause" made for a hearty rallying cry as markets headed into the long holiday weekend. If the Fed could conclude by as early as September that things are on the right course, then it would be on track to gently wind down its series of interest rate hikes without pushing into the restrictive territory that would raise the probability of a near-term recession.

Cometh the Hurricane

The sequence of data releases this week suggests it may be too early to bank on the peak Fed narrative. A number of economists have pointed out that the current combination of unemployment below four percent and inflation above four percent is entirely consistent with the conditions for an economy that is overheating. Today's jobs report in particular suggests that the weird labor market, with 1.9 job vacancies for every unemployed American, has not yet worked itself out (although the report did show that wage gains are still relatively contained).

The fact is, conditions in the current economic cycle really have no precedent in previous cycles of expansion and contraction. We are just two years out from the last recession – which was both the shortest and the deepest recession on record since the end of the Second World War, created entirely by the deliberate decision to shut down the economy in response to the pandemic. That recession was followed by multiple fire hoses of money injected into the economy – which in turn was followed by the X-factors of war in Ukraine and the ongoing vagaries of Covid variants eliciting different policy responses in different parts of the world, most notably China and its zero tolerance measures.

The uncertainty all this creates is what prompted JPMorgan Chase head Jamie Dimon this week to warn that an “economic hurricane” is likely to hit our shores sometime before the end of 2023. That sounds dire as a headline, but the subtext was more nuanced. Dimon made clear he does not know whether that hurricane will be of the manageable Category 1 variety or a more devastating Cat-5 kind of event. And that is sort of where things are right now, with lots of uncertainty, not much in the way of helpful precedents, and an inability to process economic data as either good news or bad news. The one constant in all this is volatility, which more than anything else demands discipline and patience.

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