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Amadeus Wealth Alternatives
Your Compass to Alternative Investments

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In this week's recap: Recession concerns rising.

Weekly Economic Update

Presented by Ed Papier, May 23, 2022

THE WEEK ON WALL STREET

Recession fears grew last week following weak earnings reports from major retailers, sending stocks lower.

The Dow Jones Industrial Average fell 2.90%, while the Standard & Poor's 500 lost 3.05%. The Nasdaq Composite index dropped 3.82% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, gained 0.84%. [1,2,3]

TRENDING LOWER

Stock prices remained in a downtrend, capped by a sell-off on Wednesday following a succession of disappointing earnings reports from several major retailers. Despite solid April retail sales and industrial production data, weak economic numbers from China and shrinking profit margins at U.S. retailers fanned recession fears throughout the week.

Rising yields, which have been an overhang to the markets in recent weeks, turned lower as investors appeared to move cash to bonds from stocks. But lower yields did not help stock prices, which closed out the week with a volatile trading session.

CLOUDY PICTURE WITH RETAILERS

Investors received a mixed message from the retail sector. April's retail sales increased 0.9% from March, signifying that consumer spending remained strong. But it was difficult to determine from the retail sales report whether the increase was a function of higher retail prices or a resilient consumer. [4]

It was also a big week for earnings reports from some of the nation's largest retailers. Results were disappointing as retailers struggled with supply chain issues, higher costs, and misaligned product mix. Some retailers indicated a drop in the number of transactions, suggesting that shoppers reduce purchases due to higher prices on essential items.

THE WEEK AHEAD: KEY ECONOMIC DATA

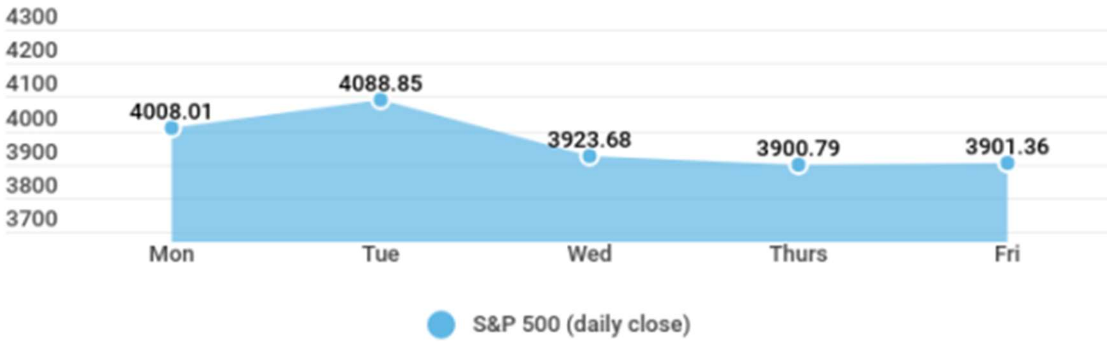
Tuesday: Purchasing Managers' Index (PMI) Composite Flash. New Home Sales.
Wednesday: Federal Open Market Committee (FOMC) Minutes. Durable Goods Orders.
Thursday: Gross Domestic Product (GDP). Jobless Claims.
Friday: Consumer Sentiment.

QUOTE OF THE WEEK

"Be who you are and say what you feel, because those who mind don't matter, and those who matter don't mind."

BERNARD BARUCH

Market Index	Close	Week	Y-T-D
DJIA	31,261.90	-2.90%	-13.97%
NASDAQ	11,354.62	-3.82%	-27.42%
MSCI-EAFE	1,958.61	+0.84%	-16.16%
S&P 500	3,901.36	-3.05%	-18.14%



	Treasury	Close	Week	Y-T-D
	10-Year Note	2.78%	-0.15%	+1.26%

Sources: The Wall Street Journal, May 20, 2022; Treasury.gov, May 20, 2022
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, May 13, to Friday, May 20, close. Weekly performance for the MSCI-EAFE is measured from Friday, May 13, open to Thursday, May 19, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

The official U.S. debt of $27 trillion is 130% of GDP, but "off-balance-sheet debt" from Social Security and Medicare totals another whopping $76 trillion. All-in U.S. debt is $103 trillion, which is 490% of GDP.

Can the government realistically print $100 trillion? In theory, the government can print all it wants, but it needs to stop when all that money causes serious inflation. There is a limit to how much money can be printed, and we've reached it.

Money is "printed" when the Treasury issues bonds. If those bonds do not clear the market, the Federal Reserve buys them. Lately the Federal Reserve has been buying most of the Treasury's new issues.

Starting with quantitative easing (QE) in 2009, the government has printed $16 trillion through 2022 so far. This has caused inflation to become serious at 8.5% and rising. The inflation bear has been poked and it's furious.

The irony is that the Fed has been charged to fight the problem it helped to create. As cowboy wisdom advises, "When you find yourself in a hole, stop digging." The Fed has been manipulating bond prices to keep interest rates low, executing its zero-interest-rate policy (ZIRP). Now it will have to "taper," meaning it will allow interest rates to increase.

Rising interest rates are bad for stock and bond markets. Unmanipulated, interest rates will average 3% above inflation, so 11% in an 8% inflationary environment. A 9% increase from 2% to 11% will cause 10-year bond prices to plummet 54%.

Stock prices will also fall because security analysts will discount future earnings at higher rates. That's what happened in 2013's taper tantrum. Stock prices fell in response to tapering, so the Fed backed off. But this time backing off will fuel the inflation fire that the Fed is supposed to extinguish. The Fed is apparently between a rock and a hard place.

Some say the Fed will opt to maintain ZIRP, allowing inflation to soar. Which will the Fed choose, controlling inflation or interest rates? It can't do both.

You may have heard the investment manager commercial: "You deserve a tailored portfolio, not a cookie-cutter strategy." And you probably thought this comment was disingenuous since the manager does what every manager does – match you up to an off-the-shelf model.

Most, if not all, money managers and consultants use model portfolios, and most use bonds to limit risk. Low-risk models hold a lot of bonds and high-risk models hold a lot of stocks.

In the next few years, as interest rates rise and bond prices fall, low-risk models will lose more than high-risk models when bond prices fall more than stock prices. Model-portfolio performance will be topsy turvy, disappointing investors.

Buddha said, "Impermanence is eternal." The world is always changing. The stage is set for rising inflation that will force up interest rates, and rising interest rates will burst the stock market bubble. A stock market correction is long overdue.

Most of our 78 million baby boomers are in the risk zone spanning the five years before and after retirement when investment losses can irreparably ruin the rest of life. They are especially vulnerable to what lies ahead. They might consider protecting against losses and inflation with assets like TIPS, commodities, precious metals, and alternative investments not correlated with the stock and markets.[5] The latter can include private debt, private equity and real estate on a primary and secondary basis, equipment and aircraft leasing, direct and co-investments, venture investing, direct secondaries, options trading (to hedge long positions), multi-alternative, General Partner interests, litigation finance, energy, and other special situations.

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Know someone who could use information like this?
Please feel free to send us their contact information via phone or email. (Don't worry – we'll request their permission before adding them to our mailing list.)

CITATIONS:
1. The Wall Street Journal, May 20, 2022
2. The Wall Street Journal, May 20, 2022
3. The Wall Street Journal, May 20, 2022
4. The Wall Street Journal, May 17, 2022
5. advisorperspectives.com/articles/2022/05/13/our-debt-cannot-be-inflated-away?topic=alternative-investments