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A Manner Restrained

Three score and a decade she reigned
With class and a manner restrained
Her people were clear
They held her quite dear
Her passing has left them quite pained

Financial markets in the UK are closed today in honor of Queen Elizabeth II's recent passing and today's funeral services. She was the longest serving monarch in England's long history, and the one with, likely, the greatest number of admirers. She represented England, and then the UK, with the utmost class and was widely respected by leaders around the world. She also served as a link in time to a more genteel era of society, arguably the last recognizable person who was able to do so. The future is truly here and, unfortunately, feels very much like it is untethered from the past. And as George Santayana explained to us all, "*Those who cannot remember the past are condemned to repeat it.*" Will any world leader remember the past now that the final link has disappeared? I fear the fourth turning* may well accelerate going forward.

While last week we learned that inflation
Was not yet prepared for cessation
This week it's Chair Jay
Whose words will hold sway
And drive every market quotation

Last week we learned that the inflation story was likely not going to dissipate as quickly as the growing narrative seemed to suggest. Tuesday's CPI reading was clearly hotter than expected and the market response, a sell-off in risk assets alongside rising Fed funds expectations, was quite natural as the narrative needed to be adjusted. The question at this point is, what happens next?

At this point, 75 basis points is baked in and there is a 22% probability of a 100bp rate hike. All weekend I read and heard about the mistake that the Fed is making by tightening rates as quickly, and as steeply, as the current trajectory, and that the Fed is going to cause a recession. My

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response to those who think the Fed is overdoing it is, they know that, but they don't really care right now. One of the key problems for the Fed is the optics of their actions, especially given their history since Alan Greenspan was Fed Chair. While everyone knows that Volcker needed to respond to the rapid inflation of the 1970's, and he did not care if he was reviled for doing so, once the 'Maestro' took over, it was a one-way street for Fed Chairs, easy money at the slightest hiccup in the economy. Thus, rather than simply addressing liquidity questions during a crisis, the Fed suddenly became far more interventionist. The result was the inflating of several different asset bubbles (tech stocks, real estate) which led to increasingly dramatic selloffs when those bubbles popped.

Powell's problem now is that with inflation having returned to the fore, it takes a different mindset to address the issues of the day. Powell, along with a number of other FOMC members, have already explained that a recession was possible, if not likely, and they were comfortable with that outcome. At the same time, given the constant outcry regarding the speed with which prices have been rising, it would be impossible for the Fed to do nothing. They tried that with the transitory narrative, and we all know how well that worked out. So, nothing is going to stop them for now. Ahead of the meeting there is no data of note that is likely to change opinions, so I am in the 75bp camp. Arguably, the bigger question is what will they do in November? It is still early days for that discussion, and we will see another NFP and CPI print before they meet again, so there is really no way to anticipate without that key information.

In the meantime, though, risk assets, especially equities, seem likely to come under further pressure as the slowing global economy undermines corporate earnings. Ask yourself this: what if China's zero covid policy remains in place long after the Chinese Communist Party congress next month? President Xi could easily decide that the level of control the policy offers him over an unwieldy population is worth slower growth. In that situation, would corporate earnings rebound quickly? I would argue not as a key engine of global growth would be idling rather than revving. The point is current earnings expectations could easily be marked down substantially, by 20% or more, and that would not favor owning equities. While we have no way of knowing what will happen, my view is that current market pricing is not taking account of an outcome of that nature, and that means there is far more downside potential. Having lived through several bear markets, I assure you the bottom is not in while investors are discussing dip buying. The bottom only arrives when investors don't even want to discuss the market.

And, right on cue, markets are in the red this morning as both stocks and bonds are under pressure. Following the selloff in the US on Friday, Asia (Nikkei closed, Hang Seng -1.0%, Shanghai -0.35%) all fell and Europe is no different (DAX -0.65%, CAC -1.3%, UK closed). US futures are pointing lower as well, with all three major indices at least -0.75% at this hour (7:20am). There was vanishingly little data released so this seems to be a continuation of the selling seen last week with concerns growing over the future of the economy. On that note, the Atlanta Fed's GDPNow forecast fell sharply to +0.5%, a full point lower than the previous day's reading, and a harbinger of future weakness.

As to bonds, the only market where there are no sellers are Gilts as the market there is closed. Otherwise, it is universal with Treasury yields higher by 5.3bps, Bunds (+5.3bps), OATs (+5.9bps) and BTPs (+9.0bps) as buyers are fleeing this sinking ship. Until inflation is well and truly under control, it is hard to get very bullish the bond market.

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Commodity prices are also responding to growing recessionary concerns with oil (-2.6%) breaking to its lowest level since late January, while NatGas (-3.7%) is also under pressure and back at $7.50/ MMBtu. Metals markets are falling sharply (Au -0.8%, Ag -1.4%, Cu -1.55%) with only aluminum holding steady as the LME is closed today.

Finally, the dollar continues to lead the pack as there has been no change in the view of higher USD interest rates on both an absolute and relative basis. The FX market continues to be the only one that truly believes the Fed, although equity traders are starting to get the message. But let's take another slightly offbeat view of the FX markets for a moment; what if currency markets are not so much a representation of interest rate differentials but rather a representation of countries' relative energy wealth/availability? So, the US, which is at worst, energy neutral, and arguably a bit of an exporter, remains the strongest of the majors when compared to the Eurozone (massive energy importer), Japan (massive energy importer) and the UK (massive energy importer). While more work needs to be done on this idea, it would certainly argue for a permanent level of USD strength. Consider that Germany relied on the importation of $20 billion of cheap natural gas to create $2 trillion in product value. If $20 billion becomes $120 billion, that operating leverage is going to hurt!

Ok, actual daily movement shows the dollar stronger virtually universally with the NOK (-0.85%), tumbling on the back of weaker oil prices and NZD (-0.65%) and AUD (-0.55%) feeling the pain of commodities in general. CHF (-0.15%) is the best performer in the bloc. In emerging markets, ZAR (-0.8%) is weakest followed by MXN (-0.55%) and CNY (-0.4%) as the commodity meltdown is hurting the first two while the PBOC is finding it ever harder to control the renminbi as the combination of weakening economic activity and their efforts to support such via easier monetary policy is very difficult to overcome. I see a test of the two-year ago dollar highs of 7.1850 in our future.

On the data front, not that much ahead of the Fed, but we do have a lot of central bank meetings:

Tuesday	Housing Starts	1450K
	Building Permits	1609K
Wednesday	Existing Home Sales	4.70M
	FOMC Rate Decision	3.25% (current 2.50%)
Thursday	BOJ Rate Decision	-0.10% +YCC at 0.25%
	BOE Rate Decision	2.25% (current 1.75%)
	Initial Claims	216K
	Continuing Claims	1408K
	Leading Indicators	-0.1%

Source: Bloomberg

And that's really it. All eyes will be focused on the Fed but let's not forget all the other central banks meeting this week as well. However, nothing has really changed the longer-term view at this point, so keep that in mind when hedging.

Good luck and stay safe
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The Fourth Turning by William Strauss and Neil Howe

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