Prairie Wealth Advisors Insights

By Craig Hundt Sr. | June 2022

Dear Friends,

It seems that now the not so obvious of 2021 has become obvious in 2022. The word "transitory" is no longer spoken as we deal with the reality that inflation is real, and the supply chain issues will take years to fix. It is almost like someone flipped a light switch at the beginning of the year to change the mood of the markets. Only this time, the bond market has been included with market value declines, something that has not happened in many years. Depending on which marker index you follow, drops for the Dow and S&P 500 have been in the 10-20% range with the Nasdaq/QQQ having been down over 25%. Meanwhile, the bond markets have experienced declines in the 5-10% range with some lower grade bonds declining even further.

So where do we go from here? I would say that the number one influencer of market direction for the stock market will be inflation. If inflation numbers stay high the markets will worry about the Federal Reserve getting more aggressive with raising short-term interest rates. Higher short-term interest rates influence so many factors that then go on to cause valuation resets in the stock market. It will be difficult for the stock market in general to go back to its old price levels until we know that the Fed is done raising interest rates, or at a minimum, anticipates it. Add in the geo-political issues and mid-term elections this fall, be ready for extreme volatility to be with us for most of the rest of the year.

The bond market on the other hand might just stabilize for the remainder of the year. Longer term interest rate (7+ years) tends to anticipate the economy slowing down ahead of when the economic numbers actually show that is happening. So, what we may see occur with interest rates is an inversion in the yield curve, a phenomenon when short term rates are higher than long term rates. Something that traditionally does not occur with interest rates and generally happens when the Federal Reserve manipulates short rates to slow the economy down. There are some early indications that the higher interest rates that we are experiencing are affecting the housing markets and consumer spending. We will know a lot more in three or four months as to what the current rate increases have done to slow things down.

Looking forward to the last half of the year, here is my list of what I will be watching to see if our current downward trend shifts, and our economic outlook can start the path toward a positive trend.

1. Federal Reserve

The Fed will meet in June and July and the markets expect them to raise short term rates (the discount rate) a ½ of a percent each time they meet. If this occurs, short-term rates should be at approximately 2% by the end of July. This is where I believe the crossroad will be as far as "where do they go from here". Many Wall Street people say that there are several increases after that, I say let us wait and see.

As I mentioned before, we are already seeing a "cause and effect" from the initial rate increases. I think that the next two will be even more noticeable for the economy. What to watch for in the future for a shift to the positive trend is when the Federal Reserve makes a pivot towards a more "dovish" rate increase outlook. That historically has been a benchmark of the change in the Feds policy when they stop raising and actually start to lower interest rates.

2. Geo-Political

The Ukraine war has turned out to be a surprise that really was not a surprise. Russia's leader Putin had been eyeing his expansion in Ukraine for many years using it as a bargaining chip with the European Union (EU) and United States with no resolve. The real surprise is the Ukrainian people and their willingness to fight to save their country. Something the European Union should be very thankful for in slowing Russia's aggression to the west.

Continued on reverse side...

Now as we approach the fourth month of the war, what global economic impacts can we watch for? The first is certainly the price of oil and energy costs. Gasoline prices are at record highs and like increases in interest rates, this is a contraction for consumer spending which leads to slower economic growth. The second would be the wars effect on agriculture and commodity prices. Ukraine is one of the world's largest producers of grain products, especially to Europe and the Middle East, the disruption the war has caused for shipping and producing grains, has had a dramatic increase in those prices. Costs that take money from people's pocketbooks that might have been spent on other items. What to watch for regarding a positive change in Ukraine would be a meaningful ceasefire or announcement from Russia that they have accomplished their mission and stop at the eastern front that they have built. Any movement that would show a de-escalation of the war would most likely change the tone of oil and commodity prices. Both of which would take pressure off higher inflation and thereby help the Federal Reserve with their higher interest rate inflation dilemma.

Bottom line for investors:

Many economic fundamentals need to sort themselves out over the next several months. We have yet to see meaningful reductions in corporate earnings, housing prices declining, or higher unemployment rates. Activity that tends to happen when the Fed raises rates. As we wait to see results, I recommend being patient. If you are nervous, then review your investment allocation and determine your cash flow needs for the rest of the year. It is okay to make adjustments if you will sleep better at night. I am just not a believer in "you're all in" or "you're all out" with your portfolio when it comes to investments in the stock market.

So, feel free to email me or call me to schedule a time to talk, and as always, thank you for trusting Prairie Wealth Advisors, Inc. in helping you with your wealth planning needs.

Best Regards,

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