STENGER FAMILY OFFICE
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Time to Hit the Brakes

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The Fed raised interest rates by 0.25% on March 22nd rather than 0.50% like many economists expected. Either way, the market didn't care at all. We continue using the analogy of the Israelites wandering through the wilderness before they could enter the promised land. Economically speaking, I believe we're in a similar situation until the Fed pauses rate hikes or processes a few cuts. At the same time, we haven't seen the market drop 20% or more like some doom and gloomers have suggested, despite the current perceived "banking crisis."

While SVB and First Republic offer a glimpse into what can go wrong when the Fed raises rates too aggressively, we firmly believe these are isolated issues attributable to bad management. A great deal of market panic that exists right now appears to be investors who remember the last banking crisis and assume today is no different. While not everything is perfect, one key difference in 2008 & 2009 was the mark-to-market accounting rule that turned a small problem into a big problem. As soon as that accounting rule went away, the market almost instantly recovered. At the bottom of the panic of 08, banks were the best investment if you kept buying the dips. We think today is no different. While not every bank is worth buying, some of the selloff is overblown and a lot of well managed companies are trading for dirt cheap multiples.

SVB may not be the canary in the coal mine the media is hoping for, but that doesn't change our opinion that the Fed should stop rate hikes and give investors more clarity on where things are going. Problem is, they really have no idea where things are going themselves. In the past, we've referenced the relationship between consumer inflation (CPI) and producer inflation (PPI). Typically, PPI leads CPI by 3 to 6 months. This makes sense intuitively as well. When business input costs go up, end consumer prices rise and vice versa. Further, PPI lags monetary supply by about 18 months. Right now, M2 is down about 5% from all time highs and PPI is down 8%.

All acronyms aside, bottom line is inflation is set to drop at nearly the fastest rate in history. Like Dr. Jeremy Siegel pointed out, the Fed should stop raising rates until they fully understand the effect rate hikes have had on the economy. Liquidity is flowing out of the system so rapidly, no one really understands how quickly things could slow down if the Fed doesn't soon pivot.

In the 80's, Volcker didn't mind being the bad guy and raised rates aggressively to combat the print and spend 70's. Powell doesn't seem quite as sure of himself and hasn't given investors clarity on the future. If rates stabilized around 4-5%, no one would really care in the long run. Bond returns would level off around 5-6% per year and stocks would produce normal 8-10% long run returns. In the end, no one knows if rates should be 2, 3, 4 or 5%. The target Federal Funds rate is literally made up. What really makes a difference is congressional fiscal policy.

Until we reign in spending and have common sense in D.C., we'll continue facing the same problems year after year. Both Republicans and Democrats deserve an equal share of the blame and need to be checked by the Federal Reserve rather than allowed to do whatever they want. Politics aside, Ronald Reagan in the 80's helped us to return to "normal" fiscal policy and so did Bill Clinton in the 90's. We're optimistic that Americans should eventually return to the middle politically and return to voting with their pocketbooks.

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