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DON'T FIGHT IT

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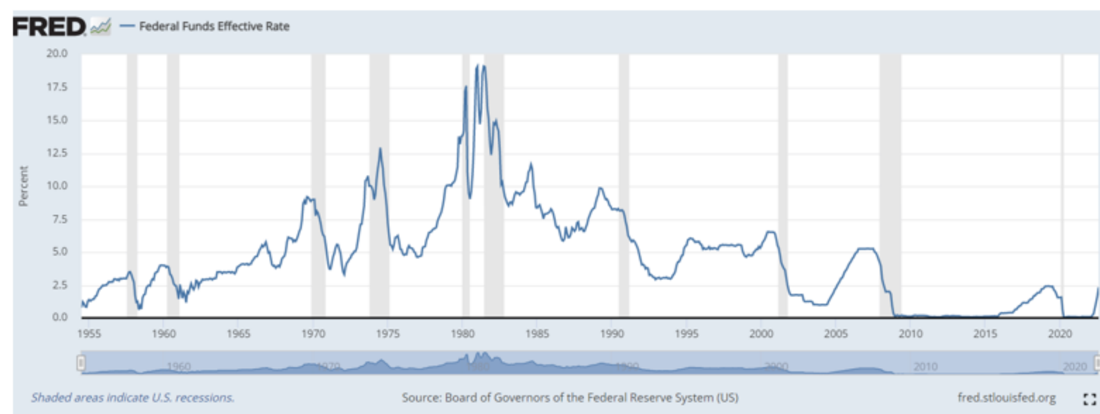
By Brahm Satov

Many in the industry are familiar with the saying, "don't fight the Fed". But what exactly does that mean? In general, it means that when the Fed is trying to stimulate the economy, one can invest in stocks, but when the Fed is trying to slow the economy or fight inflation with higher rates, one should be largely moving to the sidelines. In essence, don't invest in the general stock markets when the Fed is trying to fight inflation and slow the economy, like it is now, just "don't fight the Fed".

In my opinion the road ahead could be expected to be more bumpy than usual. With reflexive rallies that may look like they are for real and sell-offs that are painful to anyone long the markets. So long as central banks maintain their hawkish stance (a hawkish stance is one that will prioritize lowering inflation and likely raising interest rates despite the potential loss of some jobs), I believe the markets will continue to be under pressure. Furthermore, it is my opinion that central banks have become far more important to the economic cycle in recent years as Keynesian economics has become ingrained into the system. I would go as far to say that it appears as if central banks are in control of the economic cycle. In our hemisphere, it is certainly all about the U.S. Central Bank, the Federal Reserve, or in short, the "Fed". It is not that the Bank of Canada is not important but given the difference in the size of the respective economies, we understand who dictates the direction of things. Although the U.S. has not reported outright job losses, Canada has already lost a total of 113,500 jobs from June to August this year, and the U.S. has already had 2 consecutive quarters of negative GDP growth, often considered a recession.

For those who enjoy a little walk down memory lane, British economist, John Maynard Keynes developed a macroeconomic theory amid the Great Depression in the 1930s. It posits that increased government spending and lower taxes stimulate demand and can pull an economy out of recession/depression. It is my contention that central banks have actualized this theory in an extreme way, not just by lowering interest rates, but also injecting cash directly into the economy through quantitative easing and other policies. In my opinion, the economy has now become addicted to this stimulus in one form or another to such a degree that without it, the economy will likely see contraction. Although some may attribute a good or bad economy to the governing President or Prime Minister, in my opinion it has very, very little to do with them, I would go as far as to say that they are almost inconsequential, instead it has much to do with these central bankers and currently the U.S. Fed's Jerome Powell is directing the economy.



Given the recent steep incline in the fed funds rate, it can be no surprise that the stock and housing markets as well as the general economy has come under pressure. For those who are sitting with more cash than usual, I commend you, well done, as I do think we will likely see some bargains when it comes to buying great businesses at good prices. Moreover, it is my opinion that we are closing in on the end of central bank tightening, and when that happens, I expect bonds to rally and gold to rediscover its allure. But until then, please "don't fight the Fed!".

Sincerely,

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