



BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

The Fed Still Has Work To Do: Investment and Economic Review December 2022

Bob Carlson

Editor, *Retirement Watch*

800-552-1152

www.RetirementWatch.com



No Place to Hide in 2022

- **Record monetary expansion 2020-2021**
- **Leads to highest inflation in 40 years**
- **One of fastest monetary tightenings ever**
- **Bad year for financial assets**
- **Both stocks and bonds declined**
- **Economy, labor market remained strong**
- **Investors followed the old playbook**



A Case for “Sticky Inflation”

- **Some supply, temporary issues**
- **Big Issue: Demand exceeds supply**
- **Labor market is tight**
- **Wage growth highest in decades**
- **Balance sheets improved in pandemic**
- **The Fed needs to stifle demand**



Is 4% the Inflation Low?

- **Globalization might have peaked**
- **No longer cheap global labor**
- **Higher taxes, regulations, climate change**
- **Demographics: Aging populations**
- **Global government debt, deficits**
- **Lower innovation, productivity**
- **Trends were ending before pandemic**



Follow the Lags

- **Sensitive financial assets react first**
- **Liquidity-sensitive sectors are next:**
 - **Housing, tech, speculative, leveraged**
- **Rest of economy slows later**
- **Labor market usually lags**
- **Inflation peaks after recession**



The Fed Usually Overreacts

- Eased too much
- Inflation credibility at stake
- Doesn't want a repeat of the 1970s
- Has to reduce demand significantly
- Bear market rallies extend tight policy
- Will increase rates at slower rate
- Still reducing balance sheet



The Stock Market Bottom

- **Bear markets aren't' straight lines**
- **Bear market rallies are common**
- **Hussman: Fast and furious**
- **Currently tracking typical bear market**
- **Could be another 20% or more to go**
- **Monetary policy changes first**



Nominal vs. Real

- **Real is after adjusting for inflation**
- **Didn't matter for a long time**
- **Nominal can increase when real declines**
- **Rates, earnings, GDP, etc.**
- **Can have recession with positive nominal GDP**



BOB CARLSON'S

Retirement Watch

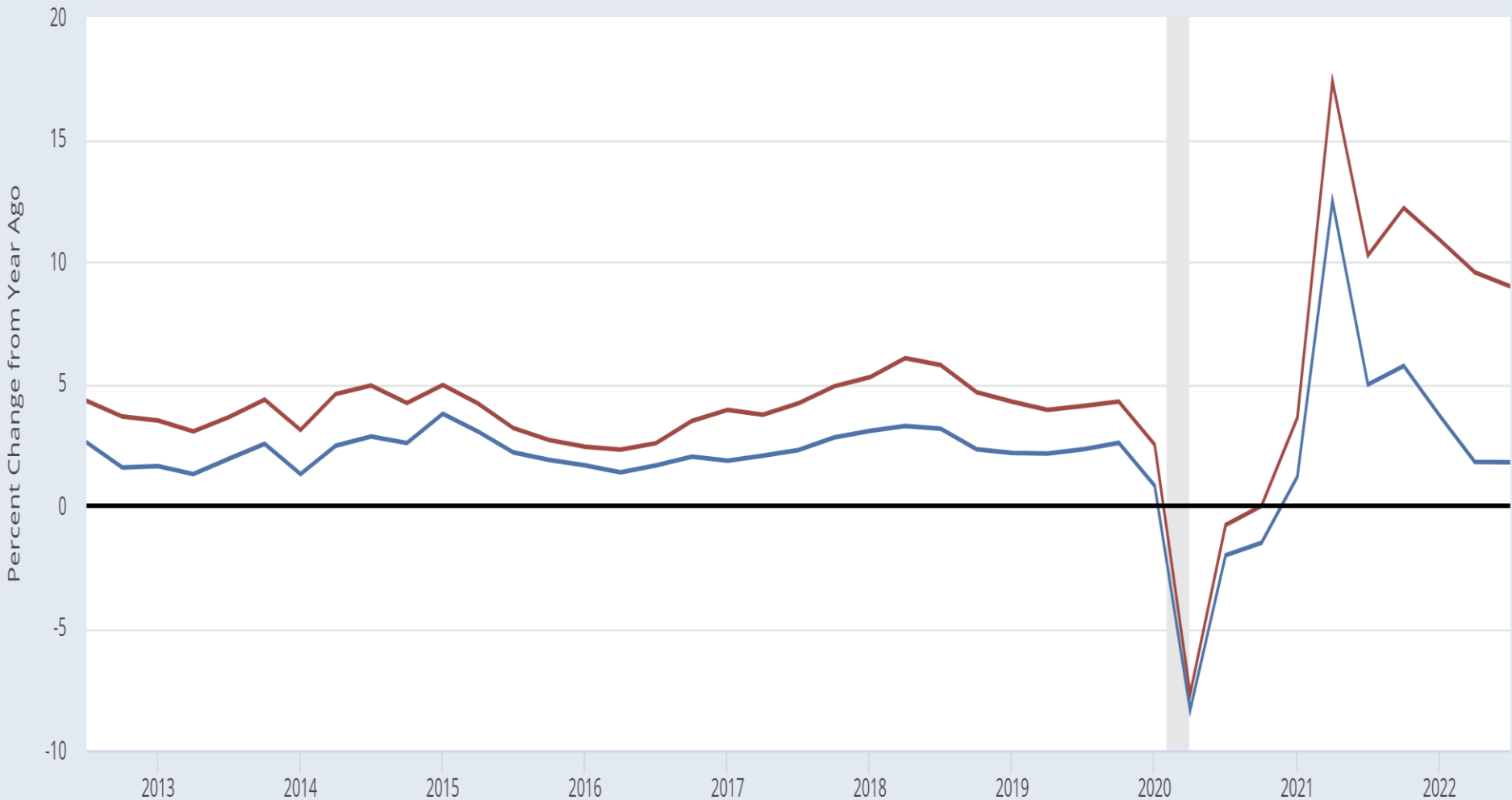
SPOTLIGHT SERIES

FRED



— Real Gross Domestic Product

— Gross Domestic Product



800-552-1152

www.RetirementWatch.com



BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

FRED



— 10-Year Real Interest Rate

— Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis



800-552-1152

www.RetirementWatch.com



Spotting Turning Points

- **No perfect indicator**
- **Follow multiple factors**
- **Consider a transition for portfolio**
- **Focus on recession early warnings**



BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

Monetary Base-Total

7000000

6000000

5000000

4000000

3000000

2000000

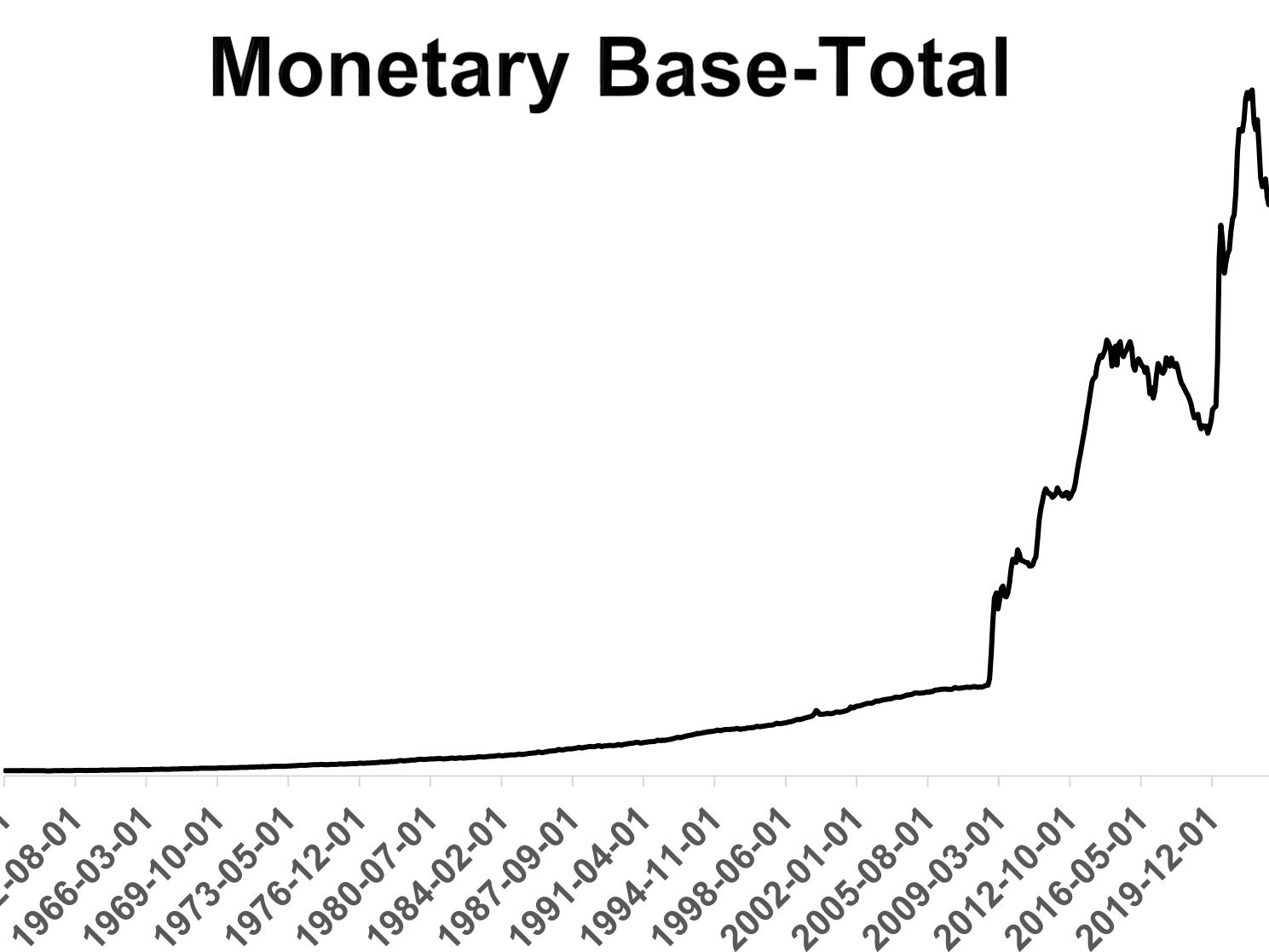
1000000

0

1959-01-01
 1962-08-01
 1966-03-01
 1969-10-01
 1973-05-01
 1976-12-01
 1980-07-01
 1984-02-01
 1987-09-01
 1991-04-01
 1994-11-01
 1998-06-01
 2002-01-01
 2005-08-01
 2009-03-01
 2012-10-01
 2016-05-01
 2019-12-01

800-552-1152

www.RetirementWatch.com



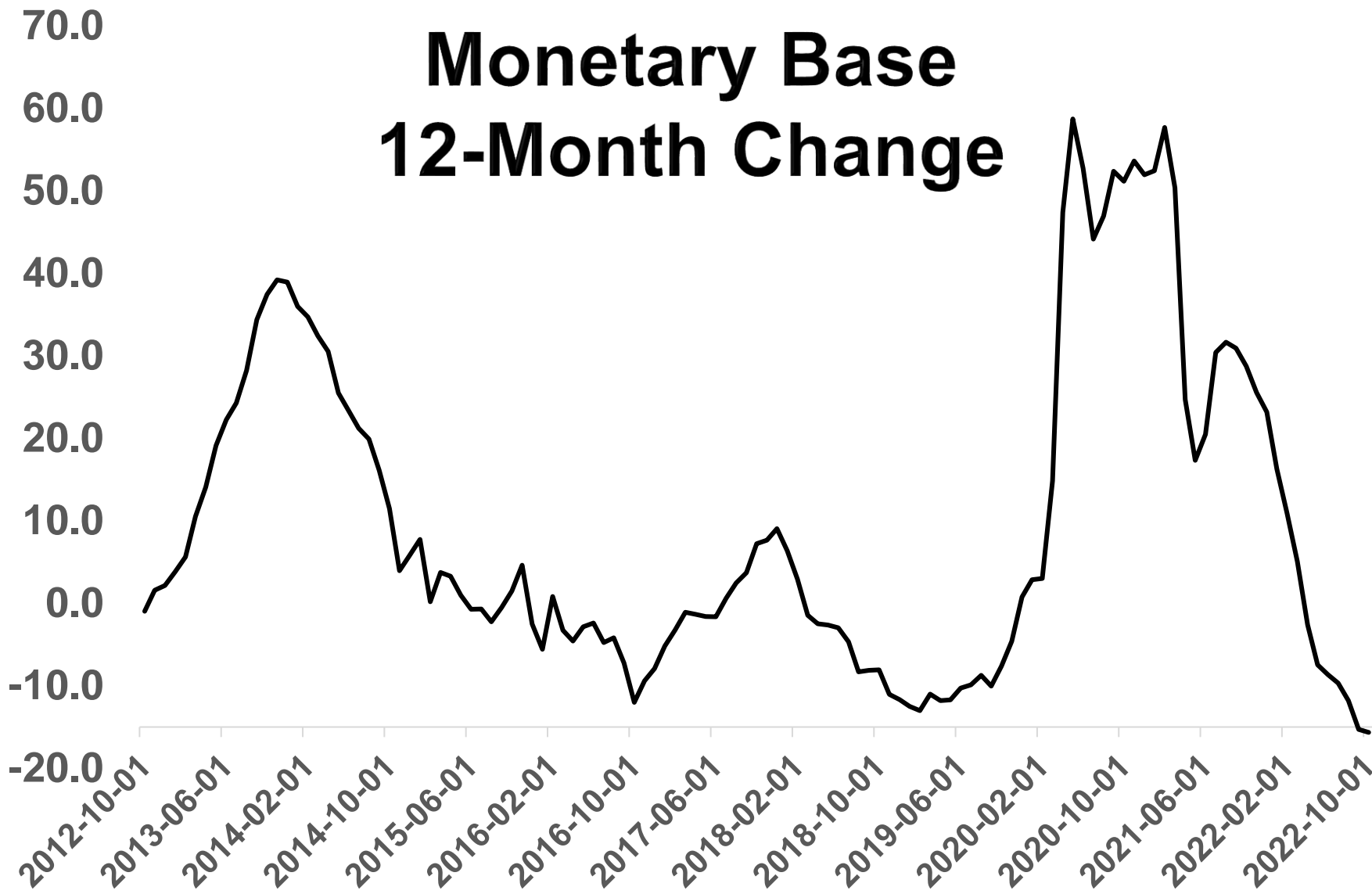


BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

Monetary Base 12-Month Change



800-552-1152

www.RetirementWatch.com



BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

3-Month Treasury Yield



800-552-1152

www.RetirementWatch.com

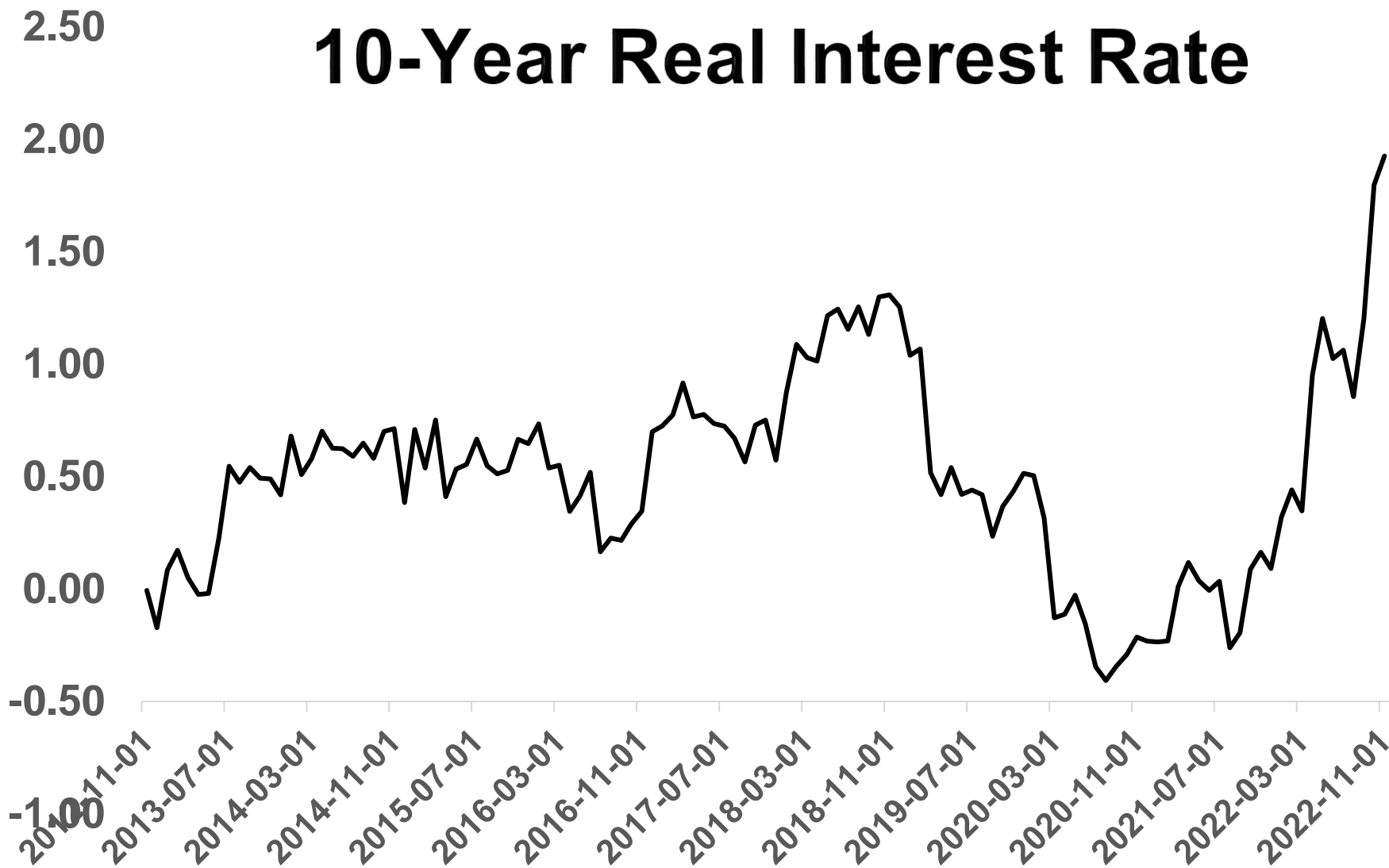


BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

10-Year Real Interest Rate



800-552-1152

www.RetirementWatch.com

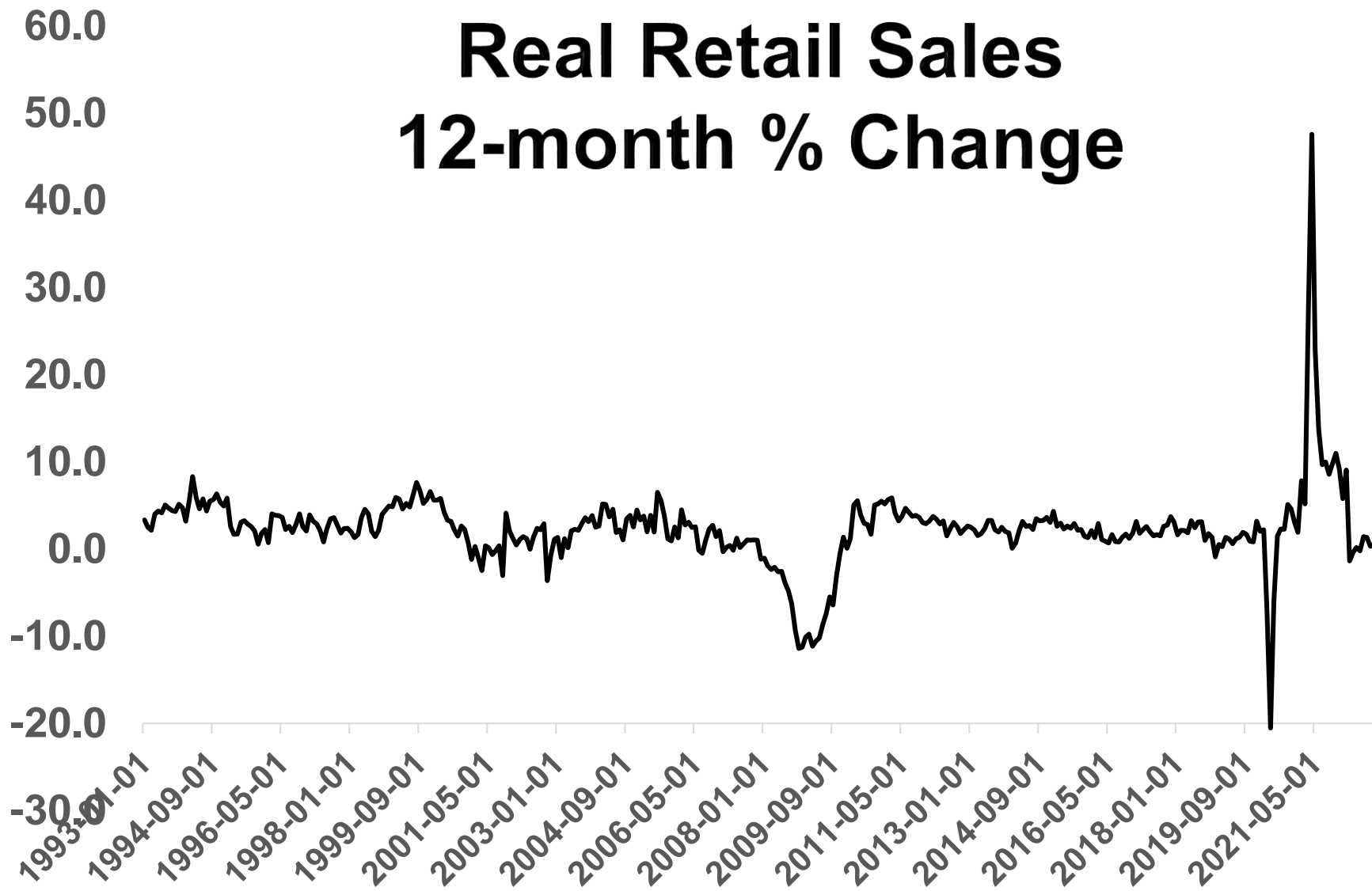


BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

Real Retail Sales 12-month % Change



800-552-1152

www.RetirementWatch.com

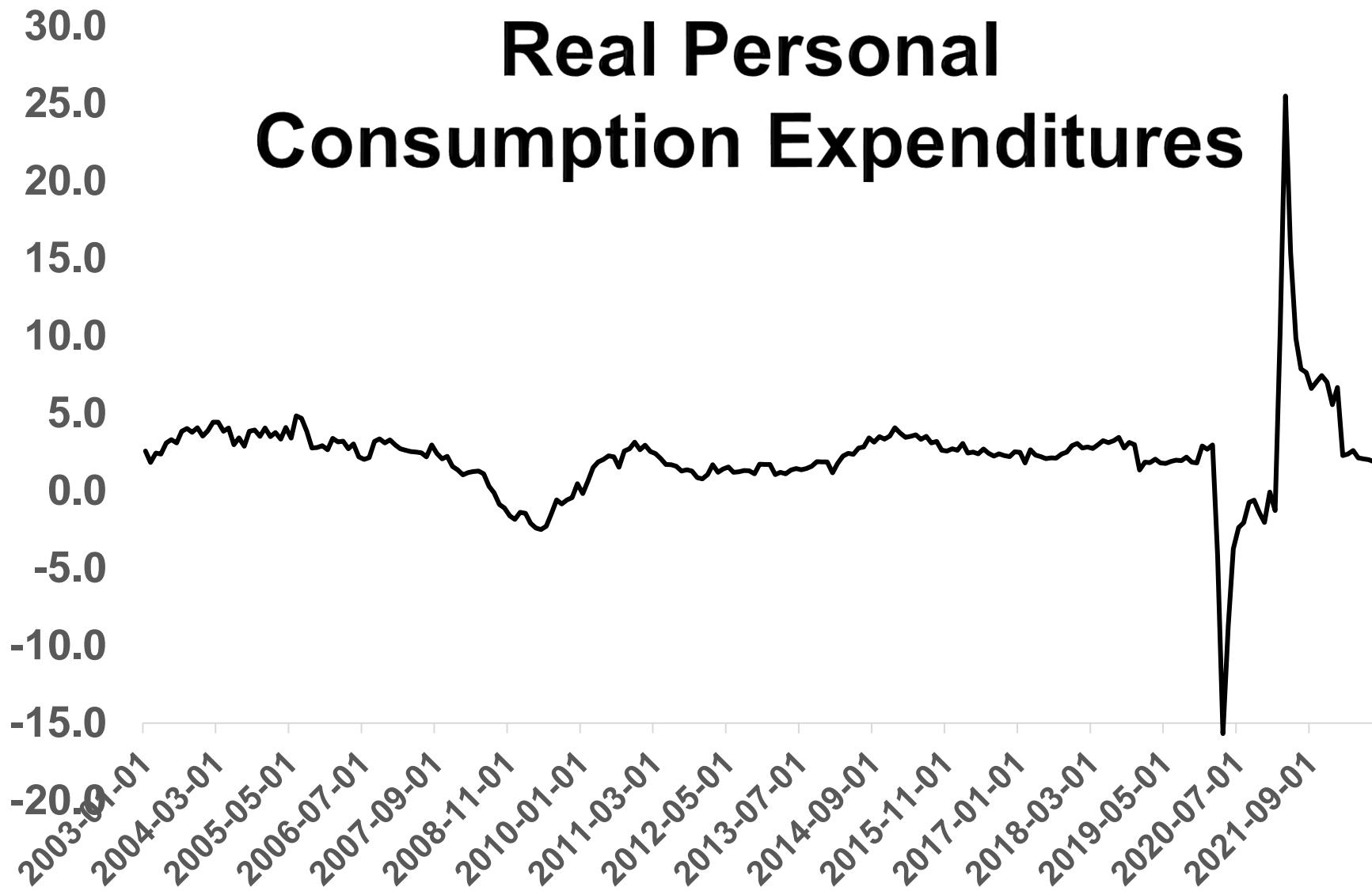


BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

Real Personal Consumption Expenditures



800-552-1152

www.RetirementWatch.com

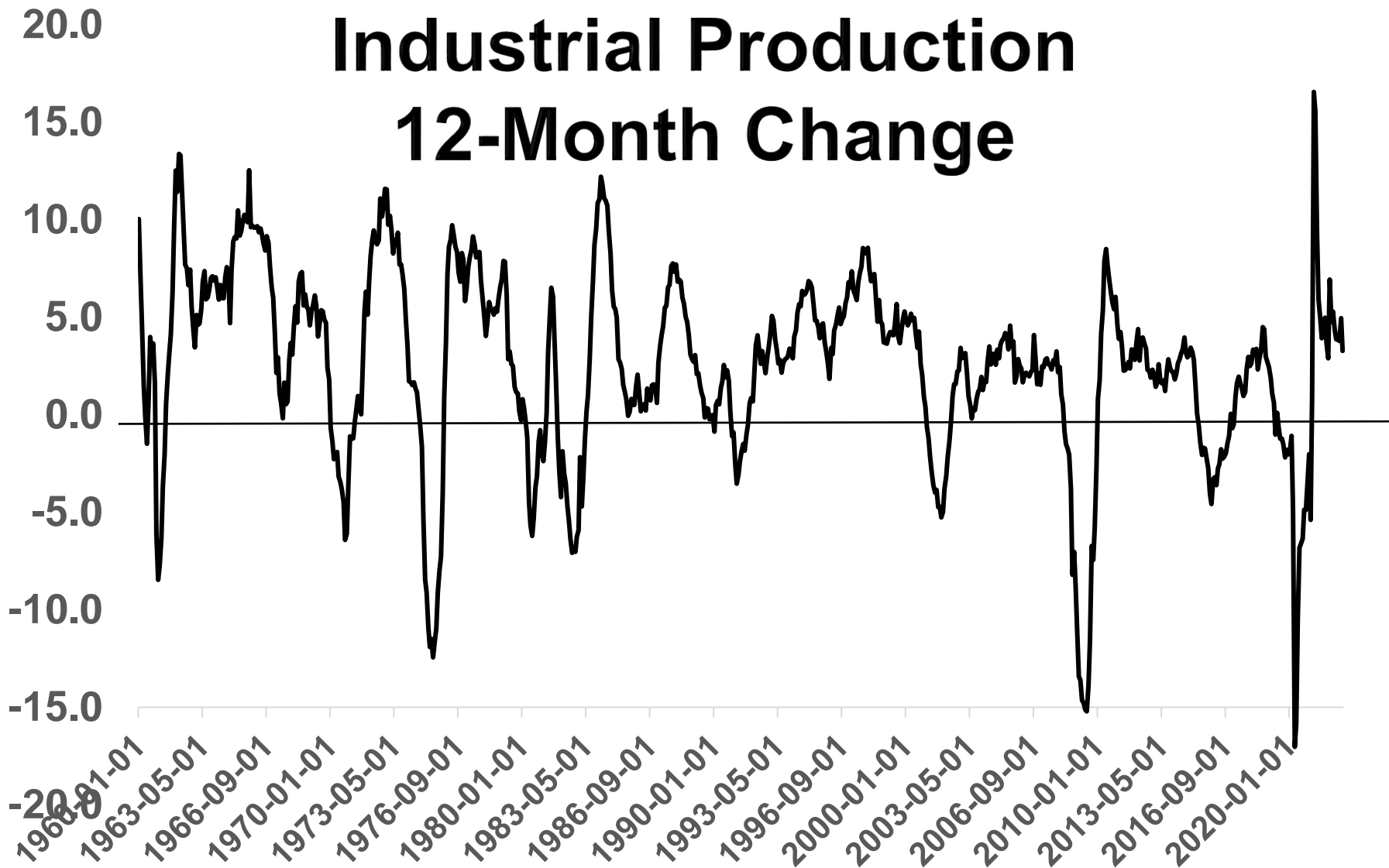


BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

Industrial Production 12-Month Change



800-552-1152

www.RetirementWatch.com

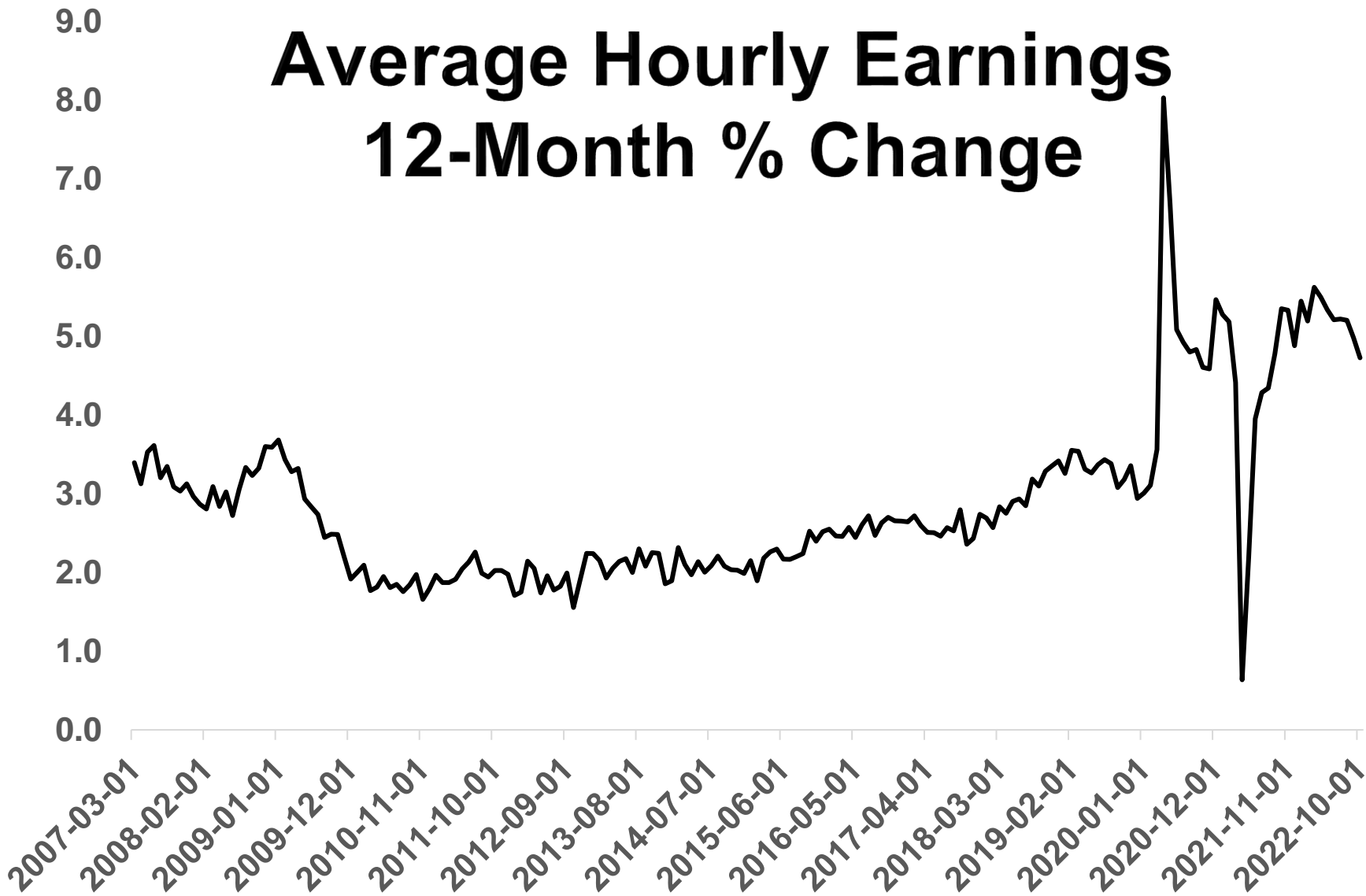


BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

Average Hourly Earnings 12-Month % Change



800-552-1152

www.RetirementWatch.com



BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

20500

20000

19500

19000

18500

18000

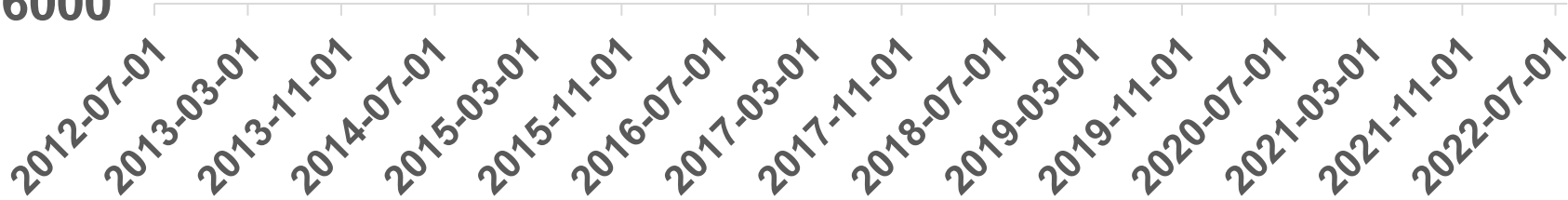
17500

17000

16500

16000

Real GDP



800-552-1152

www.RetirementWatch.com

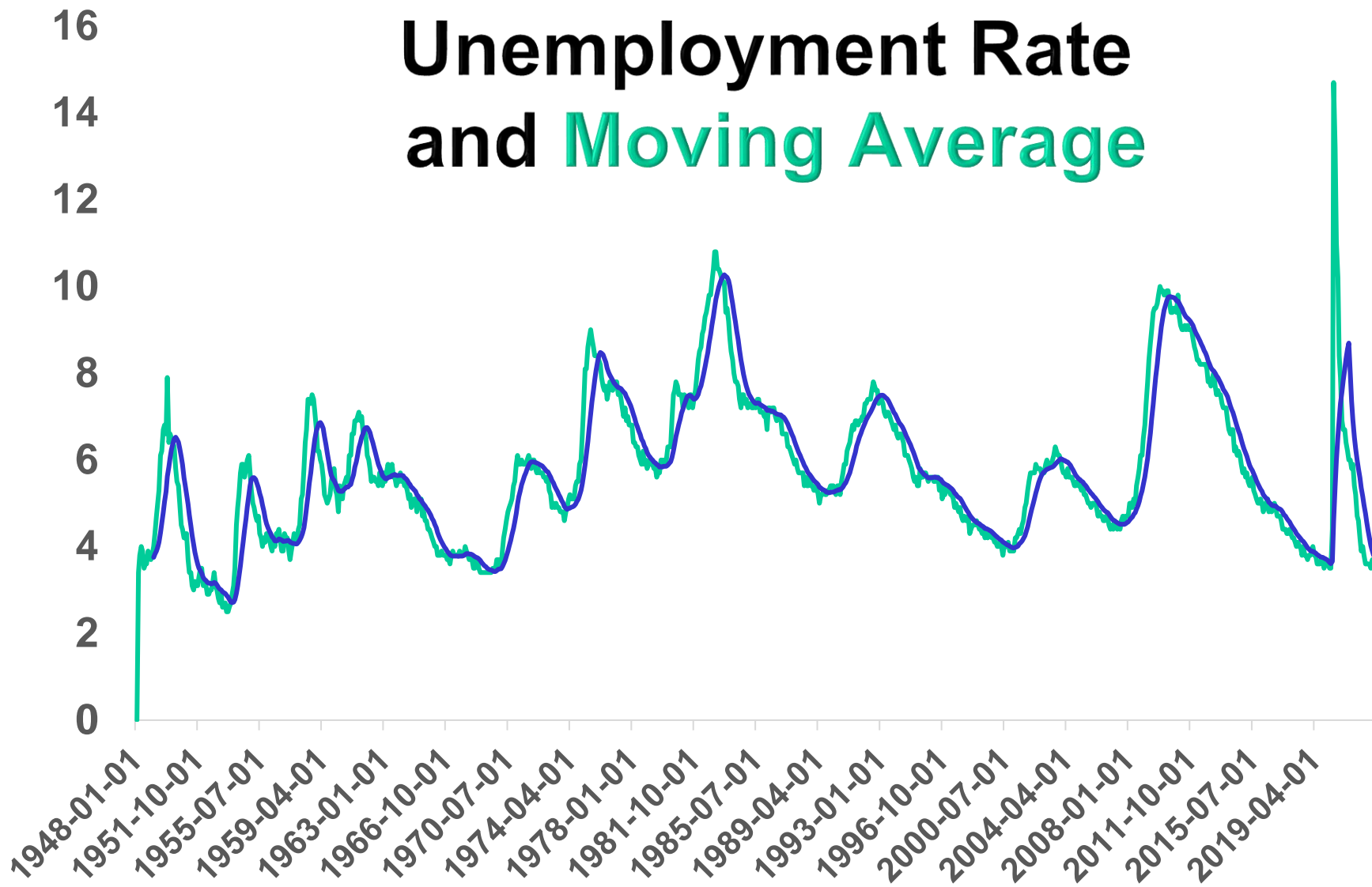


BOB CARLSON'S

Retirement Watch

SPOTLIGHT SERIES

Unemployment Rate and Moving Average

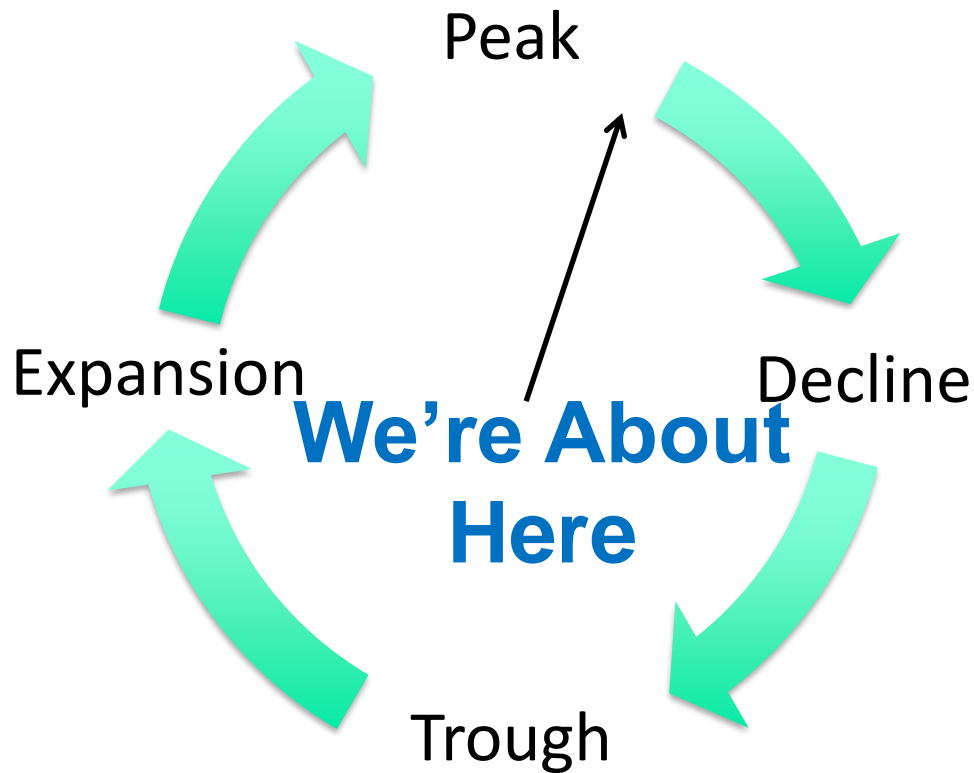


800-552-1152

www.RetirementWatch.com



Market / Economic Cycle





What Markets are Pricing

- **Slightly lower corporate earnings**
- **Steady economic growth**
- **Fast fall in inflation**
- **Easing by Fed soon**
- **Early peak in interest rates**
- **Don't recognize new environment**



The Gold Conundrum

- **Gold peaked in August 2020**
- **Higher interest rates**
- **Strong dollar**
- **Long-term inflation expectations count**
- **Geopolitical conflict, uncertainty matter**
- **Stagflation would help gold's price**



The Unstable China Pillar

- **Past driver of global growth**
- **Change in national goals**
- **Economy not as high a priority**
- **Conflicts with U.S., Europe**
- **Debt and housing problems**
- **Severe Covid policies**
- **Demographics**



What Will Be The Next Crisis?

- **Tighter monetary policy = Crises**
- **U.K. pensions**
- **Digital currencies, FTX**
- **Will it be systemic?**
- **How will policymakers react?**



Likely Outlook

- **Sticky inflation, Fed settles**
- **Lower real growth, decent nominal growth**
- **Gradual slowing into 2023, 2024**
- **Steady tightening into 2023, 2024**
- **Mild recession, or steep one?**
- **Fed less concerned about financial assets**



How to Invest

- **Bad for financial assets**
- **Commodities probably peaked or peaking**
- **Reduce risk, margin of safety**
- **Sell short**
- **Invest in cash flow**
- **Flexibility**
- **Diversification**



Long-Term Factors to Consider

- **Enormous debt**
- **Internal conflicts**
- **Geopolitical conflicts, especially China**
- **Rise of nationalism**
- **Acts of nature/climate change**
- **Demographics**
- **Are we running out of commodities?**