Geoffrey Lenk 508-428-1645

John Ladner 508-420-1684

LENK LADNER
Investment Solutions

MARKET COMMENTARY June 10, 2022

Dow Jones Industrial Avg	34,678.35	Standard and Poor's 500	4530.41
2022 (YTD) -4.1%	1st Qtr. -4.1%	2022 (YTD) -4.6%	1st Qtr. -4.6%

The Current Challenge – "When new money is created on a grand scale, it must go somewhere and have some major consequences. One of these will be greatly increased volatility and instability in the economy and financial system." – J. Anthony Boeckh, PhD, Chairman, Bank Credit Analyst.

Unfamiliar Territory - Bewildered investors are looking around to see who opened the trap door that resulted in their investments plunging to current levels and to determine if their investments are in danger of further weakness. After three years of impressive gains in the stock market, the tide began to turn in the first quarter with a decline of 4.6 percent. Unfortunately, the slide has only accelerated since the end of the quarter. The extent of the pain is evident as the Standard & Poor's 500 fell for seven consecutive weeks which has not happened for 21 years. There are several factors contributing to this unnerving performance, but one stands out – inflation.

Forgotten Enemy of Prosperity – Many may have vague memories of their experiences with inflation a generation ago. Yes, inflation has not been this bad in 40 years. One memory from that period was the Arab oil embargo when high gas prices resulted in long gas lines. A prolonged period of high inflation followed, which lasted more than a decade. In addition to rising inflation, interest rates soared resulting in home mortgage rates topping fifteen percent. Those sky-high mortgage rates were a direct result of policies implemented by the Federal Reserve Board Chairman Paul Volker, who President Ronald Reagan selected to stem the rise in inflation. Volker was ultimately successful, however the economy had to endure a period of painful adjustment. It was rather a gloomy period marked by little "real" growth because of the corrosive effects of inflation. The term "stagflation" became the term used to describe an economy grappling with high inflation and a stagnant economy. Now the country appears to be on the verge of revisiting that gloomy period. The test is to see if our leaders in Washington are willing to exhibit the same courage as President Reagan and Chairman Volker did.

Problem Ignored Too Long? - The country is already experiencing increases in inflation across a wide range of goods and services. Topping the list are prices at the gas pump and at the grocery store. These price increases are felt by every consumer, but the disconcerting aspect of the rapidly rising energy and food prices is the ripple effect. The spectrum of industries affected by increases of oil and natural gas prices is extensive. The list includes electricity generation, home heating and air conditioning, production of plastics and other oil-based products, as well as all modes of travel and transportation and this only scratches the surface. Consider that inflation has been dormant for more than 20 years, so it is an unrelatable concept to millennials and Gen-Zers, many of whom will be voting for the first time in a few months. Will they hold President Biden and his administration responsible or do they accept the pronouncements from the White House that inflation is due to COVID, Putin, or even Trump? Yes, some responsibility can be attributed to all three, but those most responsible can all be found in Washington, D.C today. They are the President, the Federal Reserve Bank and its Chairman, and the Democrat Congress. To quote from the old Pogo comic strip, "We have met the enemy, and he is us."

Best Energy Solution? – The catalyst for the current energy predicament was the decision by President Biden to make his green energy initiatives a top priority as soon as he was inaugurated, while at the same time making a concerted effort to reduce the nation's dependence on fossil fuels. Now gas prices have nearly doubled and electricity prices are surging as well. Consumers will be irate when they see their air conditioning bills this

summer and even more upset when they receive their first heating bill next winter. However, curing the illness (i.e., inflation) will require us to take the medicine, which will slow the economy.

Federal Reserve to the Rescue? - The Biden Administration and the Congress have yet to develop an effective plan to address the inflation issue, so the task has been passed to the Fed. The politicians in Washington and the Fed tried to mask the rising inflation by describing it as transitional – wrong! Compounding the challenge for the Federal Reserve (i.e., the Fed) is their quiver is nearly empty. They have already shot their two most useful arrows. First, they shot the "quantitative easing" arrow, which means they lowered interest rates to encourage businesses and consumers to borrow and spend money, and thereby boost the economy. The second arrow was a massive purchase program of Treasuries and mortgage-backed securities, which were added to the Treasury's balance sheet. Banks and other financial intermediaries were flooded with liquidity. These actions combined to lift the economy out of the pandemic-related slump. The expansion was kicked into overdrive by Congress and the administration as they passed three aid packages last year, including the American Rescue Plan and the Infrastructure Plan totaling nearly four trillion dollars. This combination created an additional surge in demand for goods and services, which added fuel to an already overheated economy. However, the Fed failed to recognize the free money blitz resulting from federal government COVID relief checks and the extended period of very low interest rates buttressed consumer savings. It also encouraged some risky behavior. The result was a valuation bubble in real estate and the stock market.

Now it is necessary to relieve the pressure created by all the excessive stimuli. What does this entail? The Fed will need to reverse course by switching to Quantitative Tightening (i.e., Q.T.). The Fed will employ a number of complex maneuvers all aimed at draining the system of as much of the excess liquidity in the system as possible without tipping the economy into a recession. Both President Biden and Treasury Secretary Janet Yellen admitted this past week they did not anticipate inflation becoming as bad as it has and there is nothing they can do to improve the situation. Their leadership put us in this predicament, but they have no apparent plan to remedy the problem.

Impact on Markets – if the previous comments appear gloomy, their impact is readily apparent in the performance of the stock and bond markets this year. Returns for both markets have been negative so far this year with the sole exception of energy stocks. It is not difficult to determine why they have been doing well. The economic outlook is dominated by dark, threatening clouds, so a quick market recovery is unlikely. A recent CNBC survey of corporate C.F.O. s (i.e. Chief Financial Officers) predicted the country will slide into a recession in the first half of next year. If the economy continues down this path, the stock market will continue to struggle. The bond market faces obstacles as well. As part of its program to address inflation, the Fed revealed a schedule of interest rate increases for the rest of the year. Two increases have already occurred and two more are expected this month and next month. More increases are in store unless the economy shows greater weakness. The impact of these increases has already been seen in 30 year mortgage rates, which were less than three percent at the start of the year, but now have reached 5 ½ percent. Other borrowers will also be impacted. These higher rates do benefit savers and investors in new bond issues because rates on such investments have increased since the beginning of the year. However, investors owning bonds, bond funds or bond ETFs before this recent rise in rates have likely seen a decline in value because as interest rates rise, principal values decline.

Stand Pat, Unless ... - It is important to keep in mind, investing inherently involves risk. Remember bear markets and recessions are followed by bull markets and economic expansions. Major adjustments to one's holdings in reaction to the recent correction may reduce personal stress in the short run but limit the ability to recover when conditions improve. What might trigger such a change in direction? A most consequential election will occur in less than five months. Some pollsters are suggesting the Democrats are likely to lose control of the House of Representatives and the Senate is a toss-up, so they could lose that as well. If even one of those outcomes occurs, Washington will grind to a halt and the President will become a lame duck. Even politicians like to take summer vacations, so expect the hard campaigning to be delayed until after Labor Day. Enjoy your summer. JML