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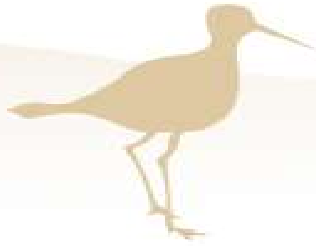
Sandpiper Capital



500 E. Plume St #109
Norfolk, VA 23510
(757) 679-9781

www.sandpiper-capital.com

Gleanings

Back to reality

Market Returns Annually

Index	2019	2020	2021	YTD
S&P 500	31.5	18.4	28.7	-20.3%
ML 1-5 yr Gov't/Corp	5.1	4.7	-.9	-4.6%
EAFE (Dev Fgn Mkts)	22.0	7.8	11.3	-19.5%
Emerging Markets	1.0	18.5	-2.5	-18.4%

If 2020 and 2021 were remarkable in their capacity for market excesses, 2022 and 2023 will likely be remembered as sobering times indeed. With half the population living paycheck to paycheck and pandemic protections set to expire, the government is only just beginning to address the pervasive inflation that their previous largesse has precipitated. While meg-yachts and private jets have been selling in record numbers, Target, Walmart and Amazon are warning that they are already seeing a significant drop in sales. We can anticipate many more rate hikes before the Fed sees the results it wants, i.e.; rising unemployment that curbs employment costs and cuts inflation. The financial markets have begun to anticipate the coming recession with a fairly robust decline across all asset classes, but especially in the riskiest, most inflated securities with which so many people had been previously enamored. In the chart below, I've tracked some of these assets, including a "Meme" stock index from that security's creation last November. With the "x's", I'm offering my estimate of where the bottom of the markets might be as well its prospects out some years in the future.

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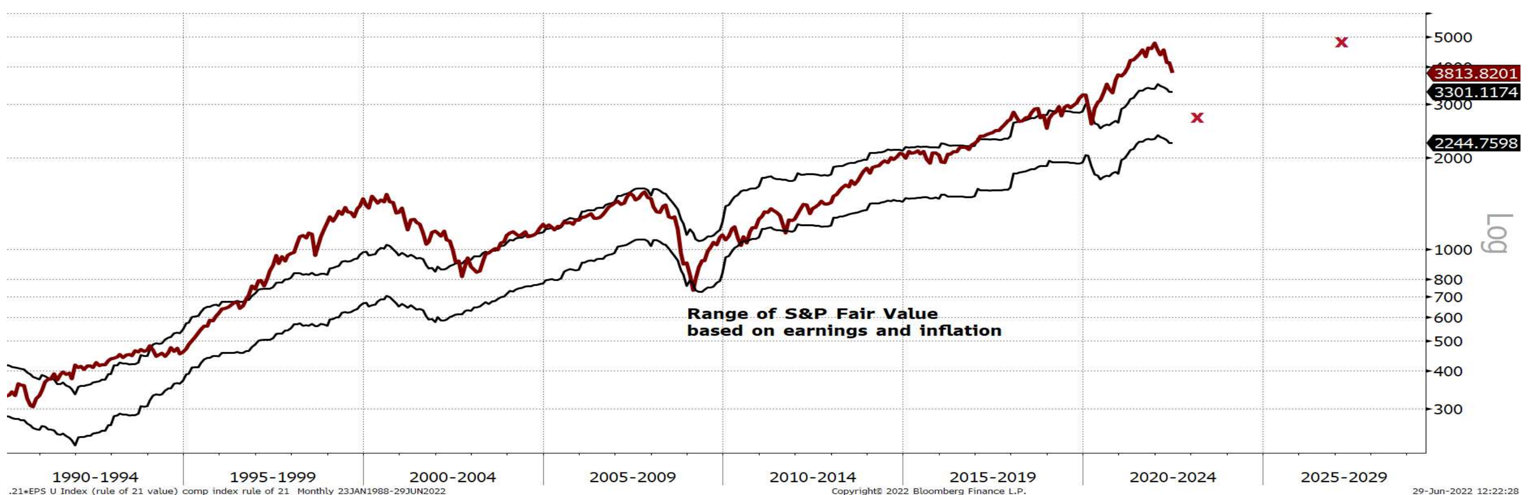
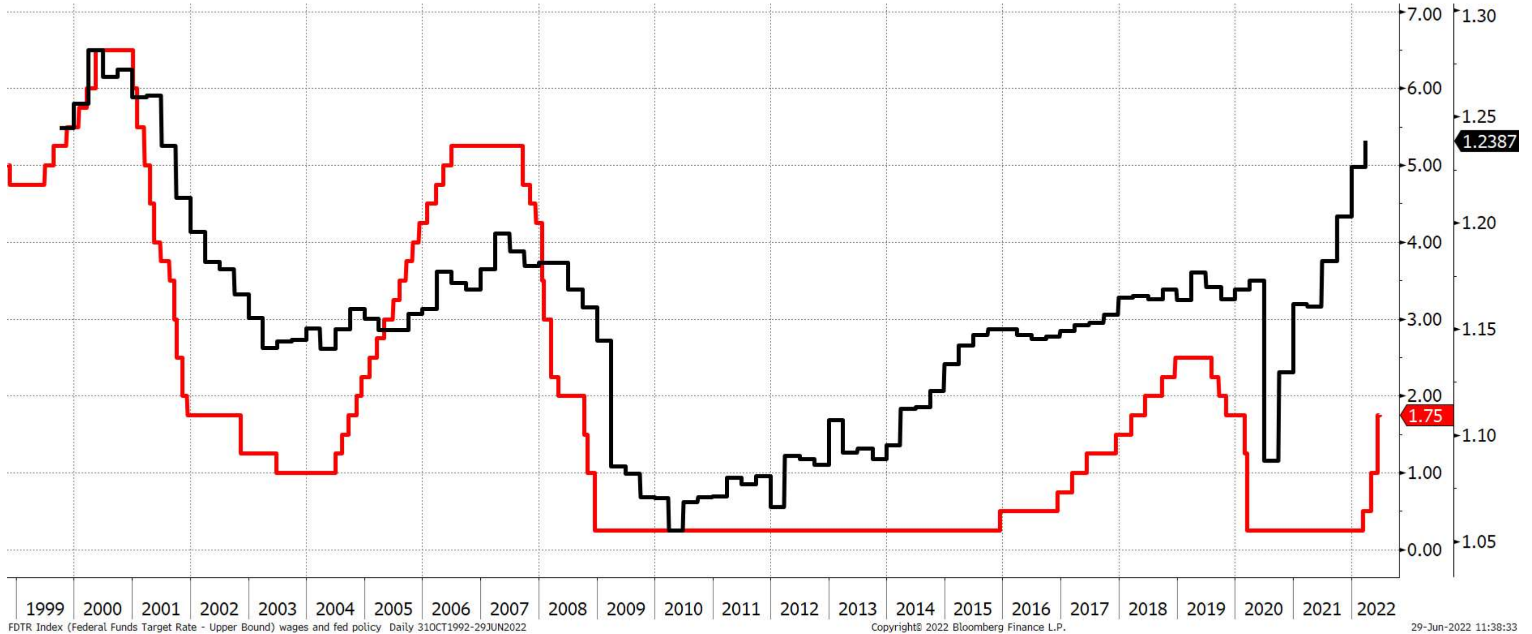
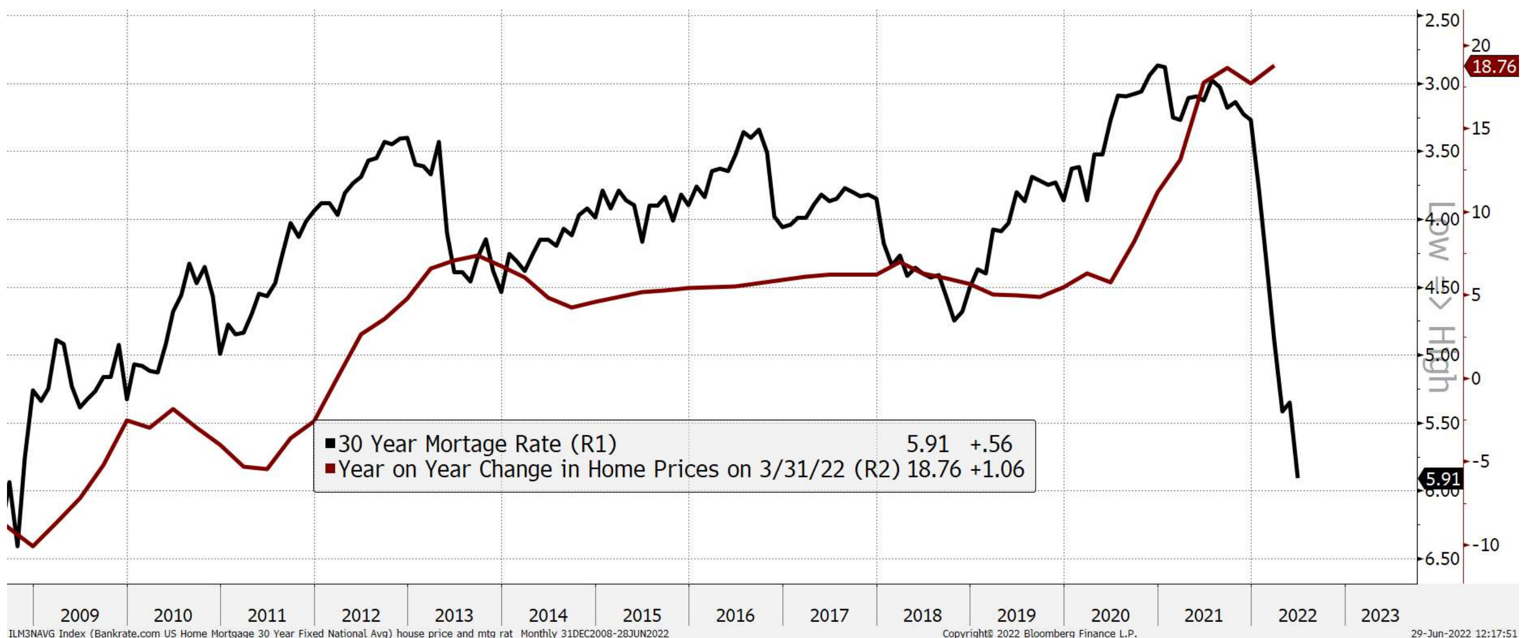


Much of what happens to the markets depends upon the path of the Federal Funds target rate. By raising the cost of fed funds, the Federal Reserve influences all rates, restricting the economy when it wants and stimulating it at all other times. The graph below shows the trend of wages (in black) versus the fed funds tare (in red). Currently market participants are projecting a peak in the fed funds rate next year of about 3.3% (against 1.75% currently). With wages rising at the fastest pace in twenty years, 3.75% to 4% seems quite a bit more likely.



While the financial markets won't like higher than anticipated rates, neither will the housing market. In the chart below are mortgage rates and the annual rate of change in single family house prices. Lower mortgage rates (the axis runs high to low) stimulate demand by making homes more affordable with a lag of six months to a year. The drastic rise in rates this year has yet to show any affect but history implies something like a 5 to 10% drop in prices late this year. That said, the overwhelming impetus over the last twenty years has been to support prices with low rates. When the dust settles from this round of tightening, we can expect many more years of low, low rates.



Tom Lukic