

Ivory's Economic Outlook

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"Sometimes you have to play a long time to be able to play like yourself".

Miles Davis, Musician

When my son was a junior in college and still on payroll I waited until the last minute to open his tuition invoice. Unbeknownst to me, however, an administrative error tacked on an additional \$6,000. Faced with a looming deadline and the possibility that my namesake would be unregistered for classes I paid the inflated bill with the assumption that I would receive a future credit.

The next semester's bill had no such credit and when I called the school for clarification a very nice woman told me the school had wired the money to my son several months earlier and asked if I had any further questions. My son did not return any subsequent text messages. He did not return any of my calls. He knew this day was coming and was probably still spending my (cuss word of choice) money.

I was still under the illusion that he would have a good chunk left because he'd always been very responsible. But then a fraternity brother asked if my son had a girlfriend. Then he asked if she was pretty and then I showed him a picture of the young couple and then he matter of factly said "the money's gone; all of it".

He was correct. My son confirmed during break that every penny had been spent and braced himself for what was to come. In his mind anything could have happened, including a felony. I told him that I wasn't angry because I would have done the exact same thing. Unfortunately for him, I continued, I did not do it and since he made a grown man decision he would have to pay the grown man price. He was presented with two options: give me back my money with his summer internship income or find someone else to pay for his final year of college.



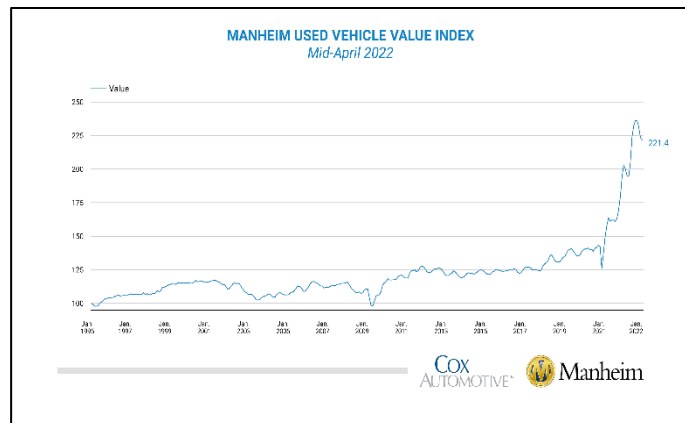
To his credit he repaid every dime, finished college in eight semesters and now has a great job. This is what happens when wayward actors experience immediate consequences for bad behavior. More importantly, he knew for certain that I would not hesitate to administer original gangsta justice and will think twice about spending somebody else's money in the future without their expressed written permission.

For the past 15 years the Federal Reserve has refused to hold what has been billed as a free market accountable for their actions and now has a spoiled child with no coping skills on its hands.

Any time the economy or stock market found itself on the wrong side of right, here they come with a bailout disguised as loose monetary policy. Uncle Sam, the shameless enabler that he is, finds himself forever fearful of angering donors and voters, one being far more important than the other. This puts investors in

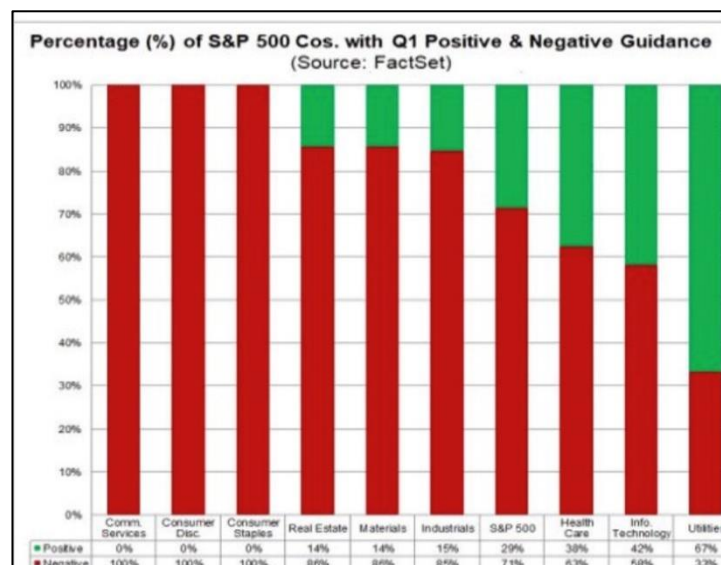
an almost untenable position: pretend this is all normal behavior and ignore your academic training or be the middle-aged man who constantly cries wolf.

But let's not miss the broader point - just because nobody knows when the wolf is coming doesn't mean the wolf ain't coming at all. As late as last year the Fed claimed inflation was transitory, which is to say it'll all go away on its own and consumers wouldn't have to spend \$87 for a piece of salmon, four apples and a bowl of soup at the grocery store. They made this proclamation in a year when oil prices would increase by more than 60%, car prices went parabolic, and national rent costs jumped by 14%ⁱ.



The Fed's original mandate from the Federal Reserve Act of 1913 suggests it should let the air out of the bubble to address inflation concerns, but rising interest rates slow the economy down and the economy is already showing signs of exhaustion. To add context, last year the economy benefited from \$1.3 trillion in stimulus moneyⁱⁱ, or 6% of GDP, that it won't get this year and has already declined at a 1.4% annualized pace in the first quarterⁱⁱⁱ. Real wage growth is negative because if you get a 5% pay increase and inflation is 8% you just took a 3% pay cut that destroys demand for goods and services when consumer spending represents 70% of our economy. This is reflected in quarterly earnings growth being negative 7.7% as of this writing^{iv}.

The Fed is a day late and several trillion dollars short to address inflation and now we have disinflation. Sure, prices will continue to go up, just not at the same rate. For instance, oil would have to be \$144 a barrel to maintain the same inflationary pace. The Manheim index that tracks car prices is going down and the rate that rents are increasing has plateaued. The point I'm trying to make is the Fed is reversing years of financial engineering and stock market coddling at the worst possible time for stocks - when the economy and inflation are both decelerating at the same time.



Greg Tate was an American writer known for his elaborate and sinuous analysis of music and entertainment. To read his work is to experience what James Baldwin would write if he went to a jazz concert and watched Miles Davis rise from the dead and change the face of music for a sixth time. He would often compare musicians from different eras, the old school navigating the limits of what they could get away with, the evolution of hip hop, how some horns blow and others blare (and why).

In “Flyboy in the Buttermilk” he wrote “How slick a hustle these brothers have pulled in mainstreaming their models for middle-American consumption can be seen in Wynton’s having gotten over reprising the Miles of Nefertiti and Prince taking over like the Hendrix of Woodstock and not the Hendrix forced to disband Band of Gypsies and hook the Experience up to an artificial respirator”.

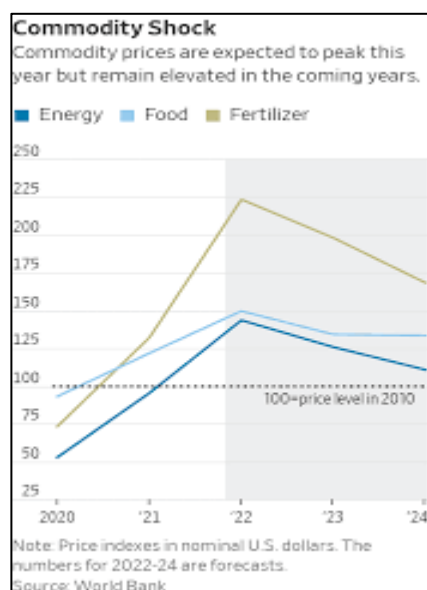
His work invades your personal space without being offensive because at the very least it’s entertaining, and besides, it’s too complicated to offer an appropriate rebuttal. I mean, what do you say to the assertion that “Hip Hop being more than a cargo cult of the microchip, it deserves being debated on more elevated terms than as jazz’ burden or successor”.

Sector Name	2022 YTD	Index Weight	Contribution
S&P 500*	-6%	100%	-6.04%
Energy	47%	4%	1.24%
Consumer Staples	5%	7%	0.31%
Utilities	8%	3%	0.20%
Materials	0%	3%	0.01%
Health Care	0%	14%	-0.01%
Real Estate	-2%	3%	-0.05%
Industrials	-3%	8%	-0.26%
Financials	-3%	11%	-0.28%
Consumer Discretionary	-11%	12%	-1.37%
Communication Services	-18%	9%	-1.81%
Information Technology	-14%	27%	-4.02%

Source: S&P Dow Jones Indices. Date as of Apr. 20, 2022. Table is provided for illustrative purposes only. Past performance is no guarantee of future results.

By the same token, our financial markets are a function of what’s happened in the past, even if they evolve at their own pace to account for the outside influence of the Fed. Right now we see long-term bond rates going up which until recently made bond prices go down faster than stocks. That’s because the bond market thinks the Fed will stay true to its word and raise rates and the stock market thinks the central bank will pivot like always and give Wall Street another bag of that fake money, even if salmon, granny smith apples and soup prices rise faster than the stock market.

The reason I believe many investors have yet to digest the gravity of our current environment is because the S&P 500 hasn’t experienced the same drawdown as the Nasdaq. Keep in mind that the S&P 500 includes defensive sectors like real estate, utilities and consumer staples that are largely absent from the Nasdaq. These are asset classes that outperformed the market in December 2018, the last time the Fed threatened to reduce its balance sheet when GDP and inflation were both decelerating. It’s worth noting that these positions faced headwinds in the first quarter of 2019 when the Fed changed its mind and returned the punch bowl.



There are no winners when the central bank is confronted with a prisoner's dilemma, a situation where two completely rational individuals might not cooperate, even if it appears that it’s in their best interests to do so. Instead, they allow future consequences to become more and more pronounced to avoid far less pain in the present.

For instance, the Fed has been buying bonds to pump money into the economy since 2008 and now proposes to shrink its \$9 trillion balance sheet. It’s one thing to let those bonds mature and not refinance them, but if they sell the bonds to remove money from the economy and cool inflation, not only would the private markets have to absorb this supply of bonds, but the United States Treasury would have to compete with the Fed when they sell their own bonds to the public to pay for deficit spending. Guess what happens to mortgage and credit card interest rates that affect middle income consumers as much as any inflation?

This is the pinch that the Fed is in and why I thought this year would be messy. If I knew the Fed would absolutely follow through with their resolve to reduce inflation I might avoid technology stocks and other high-risk assets altogether while significantly overweighting bonds, gold, utilities, REITs, consumer staples and cash. Like the stock market, however, I know Fed Chairman Powell can make an announcement during any speech, any interview, or any meeting that remotely suggests he won't raise rates and the market would rebound. I'm not panicked because these things will sort themselves out. Besides, wealth never disappears, it just shifts.

In the coming months you will likely hear a louder chorus of pundits discussing a potential recession, a slowing economy, negative earnings growth, and the geopolitical risks of the 3rd largest producer of wheat invading the 9th largest producer^v who now cannot harvest what they planted last year or plant for next year. You might stumble across a headline or two that claim energy prices are a significant cost component of food production.

My father used to say "you can pay me now or you can pay me later" and by all accounts America has chosen to pay later. We'll fix our roads later, we'll cease spending money we don't have later, we'll stop incarcerating the free markets with central banking activities later. Despite all of these economic uncertainties and middle-aged men deathly afraid to cry wolf, there's one thing we all know for certain: you can't borrow time.

BREAKING NEWS: Wall Street analysts believe most clocks are broken.

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The S&P 500 is an unmanaged index which cannot be invested into directly. This index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Bitcoin and other cryptocurrencies are a very speculative investment and involves a high degree of risk. Investors must have the financial ability, sophistication/experience and willingness to bear the risks of an investment, and a potential total loss of their investment. Information provided here is for informational purposes only and is not intended to be, nor should it be construed or used as investment, tax or legal advice, a recommendation, or an offer to sell, or a solicitation of an offer to buy, an interest in cryptocurrency. An investment in cryptocurrency is not suitable for all investors.

ⁱ Rental Market Tracker: Rents Rise 14% in December – Biggest Jump in Over Two Years; Redfin; 1/21/22

ⁱⁱ What's in Congress's \$1.9 trillion covid bill: Checks, unemployment insurance and more; Washington Post; 3/10/21

ⁱⁱⁱ U.S. GDP fell at a 1.4% pace to start the year as pandemic recovery takes a hit; CNBC 4/28/22

^{iv} Hedgeye Research

^v Food and Agriculture Organization of the United States