CLEAR CREEK ADVISORS

# POLICY INTERVENTIONS

Market Review **AUGUST 2022**

"Markets have experienced a large degree of both fiscal and monetary policy intervention since the pandemic started."

Market valuations pivoted in the middle of August after having a stretch of gains from the fifty-two-week lows in June. The Federal Reserve's annual summit in Jackson Hole, Wyoming concluded and the Fed had some harsh words for markets. In addition, a couple of new fiscal initiatives occurred in August. While the Fed works to squash inflation, the government continues to embark on more inflationary spending. The US Congress passed a significant piece of legislation in August, which the President quickly signed into law. The Inflation Reduction Act passed the House and won in the Senate due to the Vice President's tie-breaking vote. The bill, a lighter version of Build Back Better, focuses on clean energy investments, among other things. At a minimum, hopefully, it can bring some much-needed upgrades to our country's aging infrastructure and technology.

Nonpartisan economists believe the Inflation Reduction Act will reduce the government's deficit. Hence, that's why the bill gets its name, because of expectations that deficit reductions are disinflationary. According to the Congressional Budget Office (CBO), new taxes on corporations will fund the energy and climate bill. However, most of the significant deficit cuts won't begin until 2027 based on the CBO's estimates. Therefore, and unfortunately, a lot can change between now and then politically, which could cause the reductions to never see the light of day.

Since the first stimulus checks, inflation continues to challenge American households sixteen months later. In August, consumer prices were eight and a half percent higher than a year ago. However, the White House ran with a story saying August experienced no inflation, which gave markets a bit of a chuckle. Technically, they were correct reporting the zero percent change on a month-over-month basis. However, inflation still alive and well. Many experts think it may even turn higher before it falls. Their reasoning stems from how housing costs or "owner-equivalent rents" are computed in consumer prices. Real-estate costs show up with a lag, and the recent increase in the median house value may cause inflationto tick up again.

As the Fed wrapped up the Jackson Hole summit, the Fed's Chairman left with some strong words, such as the Fed's commitment to "forcefully" work to restore supply and demand and how the Fed will "keep at it" until inflation moderates. He even said households and businesses may experience "some pain" during the process. As a result, interest rates across the entire spectrum of maturities began to shift higher. Stock and bond prices declined in the days and weeks that followed. Some now think the Fed has to destroy demand by starting a recession since no reasonable solutions exist for increasing the supply of available goods and services. Although Congress passed the CHIPS Act to help address the semiconductor shortage, demand continues to harness more attention instead of solving supply-related problems. For instance, the President recently delivered an executive order to forgive a specific portion of student debt for income earners under a certain threshold. Now, maybe, the economic benefits of helping young adults afford their first homes or start families sooner will more than offset the costs placed on taxpayers. But, perhaps there are better policy tools to help borrowers, like allowing people to file for bankruptcy on student debt.

Markets have experienced a large degree of both fiscal and monetary policy intervention since the pandemic started. The fiscal side continues to pass new laws that increase spending. Meanwhile, the Fed is tightening down on interest-rate sensitive markets. For example, the Fed has stopped buying the government's debt. For the first time in a long time, markets might relearn how government deficits crowd out private investment in the form of higher interest rates. Thankfully, today's fiscal and monetary policies may work better than those in the late 60s and 70s, since the current monetary policy is tightening while fiscal policy is expansionary. Unlike the current environment, deficit spending and monetary expansion were in full effect in the 60s and 70s, which led to the abnormally high level of inflation during that time. It took aggressive action by Chairman Volker to knock inflation back down. It appears Chairman Powell knows these lessons of the past. That may set the stage for some short term pain, but the long term gains will hopefully far exceed the costs.

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| Asset Categories | US STOCKS | FOREIGN STOCKS | US BONDS | FOREIGN BONDS | HARD ASSETS | HYBRIDS |
|---|---|---|---|---|---|---|
| Monthly | -3.45% | -3.58% | -1.67% | -1.54% | -4.82% | -1.28% |
| Year to Date | -15.13% | -20.87% | -8.10% | -14.95% | -10.57% | -12.80% |

*DATA USED IS SOURCED FROM MORNINGSTAR®, DATE ENDING AUGUST 31, 2022.

## US STOCKS

US Stocks closed August back in negative territory, after a relatively strong run up in prices earlier in the month. Most of the broad US stock market segments fell by nearly -3.5% in the month. As a result, year-to-date losses re-trenched to roughly -15%. However, this year's losses still reside above the lows from June. The losses are quite similar from large-caps to small-caps since the beginning of the year.

## FOREIGN STOCKS

Foreign Stocks performed similarly to domestic stocks in August. The month finished with losses that averaged -3.58%, which dragged year-to-date returns to -20.87% on average across all foreign stock categories. Small-caps performed relatively worse in August on losses of -5.37% compared to the other foreign stock market segments such as emerging markets, which experienced losses of -0.29% for the month.

## US BONDS

US Bond prices dropped again as interest rates rose in August. The only bright spot was floating rate bank loans, closing August with a 1.24% gain. Almost all other bond assets sold off during the month. As a result, treasuries and corporates exceeded monthly losses of -2%. Even inflation-protected bonds fell another -2.19% in August. Average bond losses now hover around -8.10% year-to-date, with corporate bonds performing relatively worse.

## FOREIGN BONDS

Foreign Bonds were mixed in August. World bonds weakened as global interest rates rose in developed economies. World bonds lost another -3.10% in August. They weighed negatively on the entire category. World bonds are now down -13.90% year-to-date. On the other hand, emerging market bonds are down -16.01% this year. Investors must have been attracted to the increased yields emerging markets offer since the emerging market bond returns closed the month relatively flat.

## HARD ASSETS

Hard Assets directionally correlated with stocks in August. Specifically, Real-estate investment companies fell between -6% and -7% last month. That caused them to re-enter a bear market this year. Precious metals (gold) lost another -8.41% in August, which reduced its year-to-date performance to -27.16%. Energy has acted as the only hedge against stock market declines this year, with master limited partnerships in energy generating a 23.56% return since the beginning of the year.

## HYBRIDS

Hybrid Asset losses in August were milder and mixed relative to other asset categories. Convertible bonds closed flat last month but, so farthis year, have lost -14.77%. Unfortunately, preferred stocks experienced more significant monthly losses of -2.59%. Moreover, preferred stocks are down -10.83% from the start of the year, which is relatively better than many other investment markets.

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