THE DEFINITION OF INSANITY

Albert Einstein has been accredited having said:

“The definition of insanity is doing the same thing over and over and expecting different results”

Well, the same belief (hope) has been showed by equity markets in projecting that the Federal Reserve of the United States would pivot its monetary policy. The financial markets thought to hear the cavalry (to save them) by believing/hoping that inflation had reached its peak and that thightening would be a thing of the past. The Fed will not abandon Wallstreet. Insane!

Since May we could observe three such „HOPE“ rallies . And 3 times the hopes for a pivot had to be shredded.

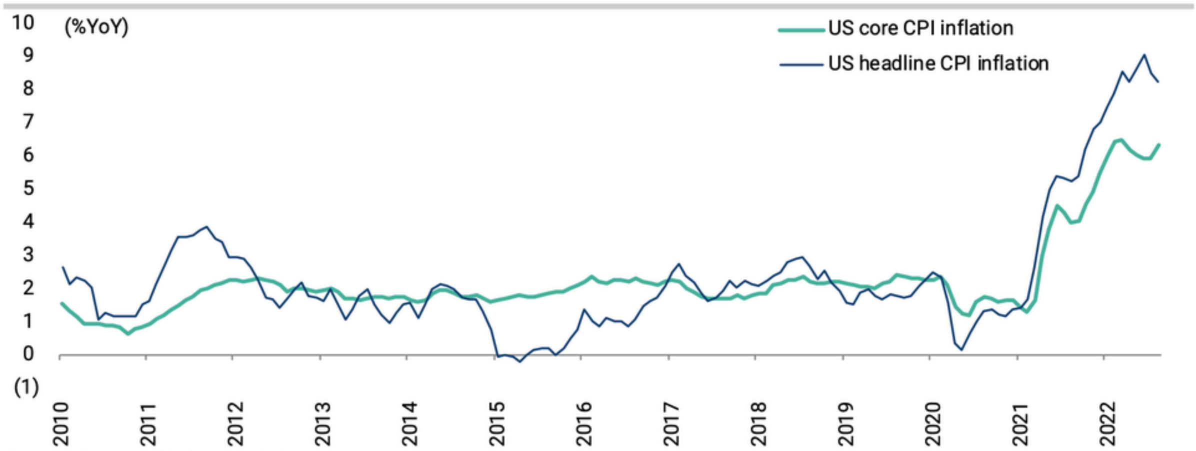
Last week it was the publication of the latest inflation figures that pulled the carpet under the equity markets. Not only were the inflation figures higher , but statistics gave signals that inflation was stubborn and well anchored.

The main argument why we believe that there is no chance that Fed chief Jay Powell does consider anything else than raising rates is:

There is no cavalry

Inflation data for month of August shocked the markets. CPI (Consumer Price Index) at 8.3% was higher than expected.. He was slightly lower than July (8.5%) however this mild retreat was due to lower energy prices (mainly gas at the pump). The core rate that excludes energy and food increased to 6.3% compared to 5.9% the previous month:

Exhibit 1: US headline and core CPI inflation

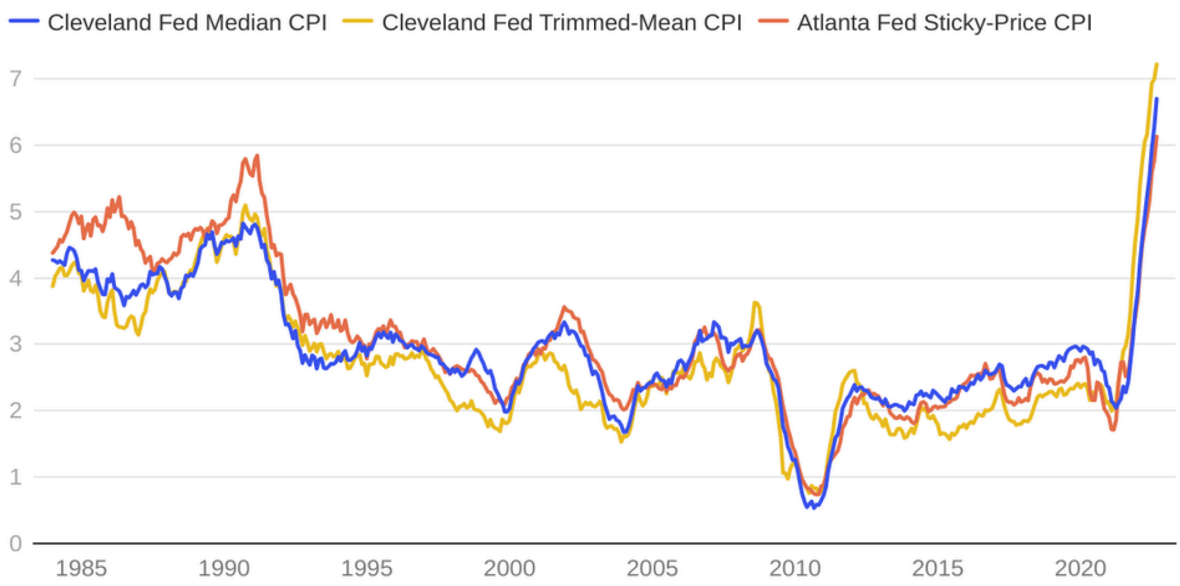


Source: Bureau of Labor Statistics

Clevland and Atlanta Fed data (trimmed) also showed higher inflation with no peak in sight:

Inflation permeates the whole US economy

Change over previous year (in%)



Source: Bloomberg

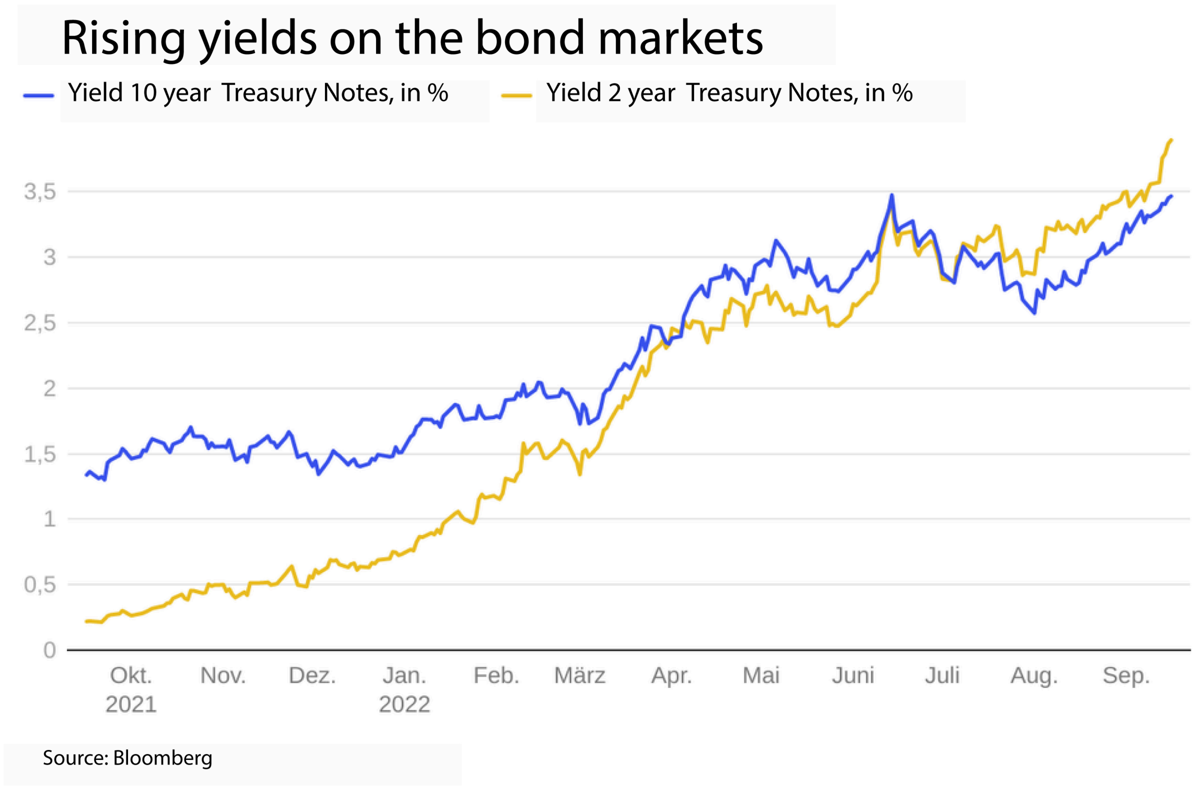
Inflation is not something that disappears quickly. She is well anchored in the system and cannot be attributed to bottlenecks in the supply chains. Presently prices in the services sectors are the ones that are moving higher.

Exhibit 4: US core goods and core services CPI inflation

Source: Bureau of Labor Statistics

The news caught Wall street on the wrong foot. Nasdaq fell 5% on Sept 13, with the other indeces right behind.

Bond markets endured heavy selling with 10-y treasury yield climbing to 3.45%.



It is hard to explain why the equity markets were so optimistic 2 weeks ahead of the announcement of CPI data. All the more after Powells speech end August in Jackson Hole where he did not leave a doubt that the Fed would take the fight against inflation very seriously.

For Feds next meeting on 9/21 futures markets consider a further fat raise of 75 bp with the possibility of 100bp (24% probability).

For the remaining 2 Fed meetings in 2022 (11/2 and 12/14) markets expect raises in fedfunds of 75bp resp. 50bp which would bring Fed fund rate to 4.25-4.5% by the end of the year.

Wallstreet should understand by now that it is insane to hope for a Powell pivot before inflation is tamed.

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