Sauberan & Co.

Economic Update – April 2022

“There is a Silver Lining…”

The events of the past 2 years have created economic/social conditions unlike any in our lifetime.

1) **Supply Chains - The 2020 Global shutdown caused unprecedented disruptions in production/distribution and are further complicated by the war in the Ukraine and recent lockdowns in China’s largest cities.**

2) **Stimulus - The monetary stimulus, outside WWII, was beyond anything we have ever seen, magnitudes greater than the “2008 Great Financial Crisis”. Combined with #1 (shutdowns), the record stimulus has created significant distortions in the Global economy and financial markets!**

3) **Inflation - Production issues, supply chain disruptions, and to a lesser extent monetary stimulus, have led to inflation rates we haven’t seen in more than 40 years!**

4) **Higher Interest Rates - A Federal Reserve that is attempting to “fight inflation” by putting a “square peg in a round hole” – in other words the Fed doesn’t have the “tools” to reduce inflation caused by a lack of supply. Higher interest rates combined with higher prices (reduced supply) are a “DOUBLE THREAT” to the Global Economy!**

5) **Strong US Dollar - Furthermore, and maybe more damaging, the Federal Reserve’s resolve to “fight inflation” (raise interest rates) while all other major Central Banks (China, Japan, EU) are still “easing” has strengthened the US Dollar to levels we haven’t seen in 20 years!!!**

6) **Record Levels of Debt – A “strong” US Dollar is bad for the Global Economy and the majority of US Corporations. The Global Economy does business in US Dollars (countries & companies), a stronger US Dollar makes it harder to repay US Dollar debt because earnings are in local currencies which are declining against the US Dollar. Same is true for International US Corporations, they earn money overseas in foreign currencies which are converted back into US Dollars, therefore reducing profits!**

The start to 2022 is very unusual, especially in the bond market, for several reasons…

1) **The increase in the 10-year Treasury Yield from 1.43% to 2.93%, in just 4 months, is the quickest and largest interest rate increase in more than 20 years!**

2) **Interest rates are "self-regulating", the economy will continue to expand as long interests don't get too high – the question is what's too high? It depends on many factors, however, too much debt is the ultimate determinate!**

3) **Three times in the past 10 years or so, the Fed attempted to increase interest rates. Each time the 10-year Treasury Yield reached 3% (or slightly above) the Economy weakened and/or the Fed backed down and reversed course. Each time the 10-year Treasury Yield fell back below 2%, two of those times yields reversed in 3 months!**

4) **Late 2008, during the last significant recession (March 2020 doesn't count), the 10-year Treasury Yield fell 175 basis points in 2 months – in other words during recessions money runs to safety!!!**

5) **An Inverted Yield Curve is when yields on shorter term bonds move higher than the yields on longer dated bonds. *A yield curve inversion has occurred before every recession, 100% of the time! The 2 Year Treasury Bond Yield and the 10 Year Treasury Bond Yield inverted near the end of March.* On average the yield curve will invert about 18 months after the Federal Reserve begins to raise its overnight lending rate (Fed Funds Rate) – this time it took only *2 WEEKS!!!***

   (NOTE - A normal yield curve pays lower interest on shorter dated bonds and higher interest on longer dated bonds. In late March the yield curve inverted, the 2 Year Treasury Bond Yield was 2.75% and the 10 Year Treasury Bond Yield was 2.5%.)

Summary

Despite the $5 trillion of stimulus and $4 trillion in Federal Reserve support the Economy has not fully recovered from the events of the past few years. The number of employed in the US is still 1.5 million below Jan 2020, not to mention the 1 million jobs or so that we would normally add each year in a healthy economy! Industrial production, the core of the economy, is below 2018 levels.

The greatest risks remain in the inflated assets prices driven up by the unprecedented stimulus, the stock market, real estate, autos/trucks and most durable goods.

"The Silver Lining …"

The Federal Reserve raising interest rates has led to every recession in the past 40 years! The first indication of the next recession was reported this morning with GDP down -1.4% in Q1 2022.

Although the Fed has only raised the Fed Funds Rate 25 basis points the bond market has done the "heavy lifting" and the "damage is done"!

Whatever the scenario the gain in bonds will likely be quick and substantial!!!

I am interested in your thoughts/comments,

Charles