WisdomTree MINDS ON THE MARKETS


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May 23, 2022

The Fed has only raised rates twice this year and hasn't even begun to pare down its balance sheet yet, but that hasn't stopped the markets from growing increasingly concerned that Powell & Co. will make a policy mistake. Indeed, a mistake of tightening monetary policy too much and ultimately pushing the U.S. economy into a recession.

Based upon past rate hike episodes, one could certainly argue that this potential outcome should be considered. In fact, as we've written over the last few weeks, this time around, the Fed is sailing into uncharted waters with 50-bp rate hikes and quantitative tightening (QT) about to take place simultaneously. One can't help but have some skepticism that the Fed will not hit a sandbar somewhere along the way in the process.

If one looks at recent Fed commentary, it becomes readily apparent that the policy makers seem reasonably confident a negative outcome will not come to fruition. Chair Powell acknowledged that "sometimes the landing is a little bumpy" but also stated that he sees "us as getting through this fairly well." Taking it one step further, St. Louis Fed President Bullard (an FOMC voting member this year) doesn't see a recession this year, and it also isn't his "base case for 2023." We don't want to be too harsh of Fed critics, but investors could be forgiven for having their doubts, considering Powell & Co. were not all that long ago telling us that inflation was "transitory."

One of the recent warning signs that caught the markets' attention was another decline in the University of Michigan's Consumer Sentiment Index to a fresh decade low. The subsequent headlines warned of a softening in retail sales as a result. However, the latest retail sales data underscored that perhaps it's better to watch what consumers do rather than what they say. The April Advanced Retail Sales report posted a solid gain on top of a sizeable upward revision to the March increase, underscoring the point that the U.S. consumer is still a positive force to reckon with.

Perhaps more interesting and a little bit under the radar was the better-than-expected showing for the April Industrial Production report, where output posted a robust gain of 1.1%, or more than double the consensus forecast of a 0.5% increase. Besides the headline number, some of the underlying details were also encouraging, namely the 3.9% increase in motor vehicle production, which followed on the heels of a rather sizeable gain of 8.3% in March. This could be a potential sign that semiconductor shortages have eased. Excluding motor vehicles, overall output has also risen for three consecutive months.

This is not to say there aren't headwinds out there; of course, there are. Headlines will be written about forecasters seeing the odds of a recession at about 30% over the next two years. However, the U.S. economy has already shown its resiliency. It is also starting this tightening cycle from a good position, with a very healthy labor market setting as an important underpinning.

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