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PWM Weekly Observations

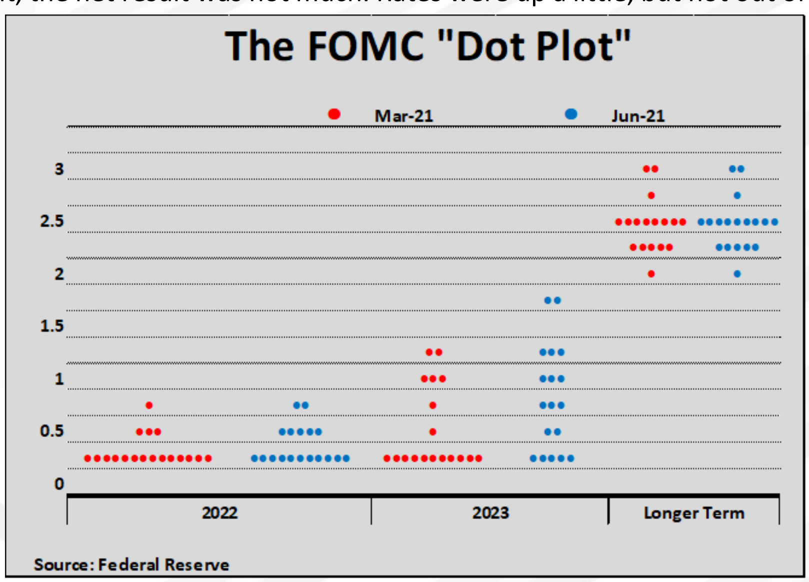
June 19, 2021

Dot Plots and Ink Blots

- **The Dot Plot indicates that the Fed is becoming more likely to raise interest rates, albeit, not soon.**
- **For all practical purposes, the Dot Plot might just as well be a Rorschach ink blot.**
- **Divining the interest rate future from a series of dots is a probably a fools' errand.**

The markets were effectively paralyzed early this week in anticipation of the Fed releasing its latest forecasts, most important of which is the 'Dot Plot', which is the interest rate forecast of the 18 individual members of the FOMC. These estimates are submitted anonymously, so that there is no bias derived from identification.

What the market was waiting for with baited breath was an indication of how the Fed perceived the current spate of inflation. The Fed has championed the transitory inflation narrative, while a group of famous investors (such as Paul Tudor Jones and Jeff Gundlach) have bellowed their belief that inflation is likely to be persistent. Although the market tussled with the Fed's outlook a bit, the net result was not much. Rates were up a little, but not out of line with recent experience. In similar fashion, stocks were down a little bit but also not out of line with recent experience.



Our perspective is that the Fed forecast was pretty much in line with what we, and most everyone else, already knew. Simply stated, inflation is up and it is up beyond where the Fed (and investors) are comfortable, but some of the major culprits, like lumber and used car prices, are obviously transitory, or at least mostly so. The result is the Fed is not particularly concerned at the moment.

So, what did the ink blots, excuse us, dot plot, tell us? The big news was the median estimate for the 2023 Fed funds rate changed in the last 90 days. Back in March, the consensus was that interest rates in 2023 would be unchanged at 0 to 0.25%. Now, the dot plot consensus (i.e., median estimate) is that Fed Funds will be 0.5% to 0.75% in 2023. The implication is that there will be two 0.25% rate increases in 2023. Translation, rates are now forecast to be going up a bit sooner than previously forecast.

The change in forecast is not insignificant, especially after only three months' time. We suspect that possibly the most important lesson is that this group of economists, arguably among the best in world at their craft, don't have a particularly good grasp on what is happening in the economy. Three months ago, they certainly did not anticipate this!

Before the Alan Greenspan era, the Fed was a secretive group that made pronouncements without warning. When the Fed made changes, markets quickly reacted, and found a new equilibrium. In effect the Fed was Oz, the great and powerful. Today, the Fed's effort to be transparent has exposed them as the mere mortal behind the curtain. Each 90 days, they seem to prove that they know little, if anything, more than the rest of us. The Fed has great financial power and it is still generally a mistake to fight the Fed when they are on a certain course, but we also need to understand that, like Oz, they are pulling the levers with about the same knowledge as everyone else. As a result, the corollary to 'don't fight the Fed' should be 'don't trust the Fed'. The Fed likes to say that they saved the world back in 2008 when the sub-prime crisis hit, and in 1998 when Long-Term Capital Management nearly brought down the financial system, but it's like a firefighter setting a blaze so he can extinguish it. Their job is not to save us from a serious financial problem after the fact, it is to save us BEFORE the fact, and on that score, they have failed.

In another 90 days, we will have a new ink blot, sorry, dot plot. Whether that forecast will call for higher or lower rates is a toss-up. Follow progress in the world over the next 90 days and your forecast will likely be reasonably close to the experts. Just another reason why we don't try to time markets.

What We're Reading

- ***The Looming Battle Over Remote Work***
- ***Bipartisan Infrastructure Plan Gains Support, Boosting Odds***
- ***Jobless claims show surprise increase to highest level in a month***
- ***The Fed moves up its timeline for rate hikes as inflation rises***
- ***U.S. housing starts rise less than expected in May; building permits fall***
- ***Commodities from copper to corn tumble on China crackdown, rising dollar***
- ***U.S., EU Forge Closer Ties on Emerging Technologies to Counter Russia and China***
- ***T. Rowe Price Midyear Market Outlook***
- ***How 'Chaos' In The Shipping Industry Is Choking The Economy***
- ***A Far-Flung Taiwan Island Risks Triggering a U.S.-China Clash***

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Markets This Week

It was an ugly week for stocks. While the Initial reaction to the Fed's rate outlook was modest, it picked up momentum late in the week and most broad Indexes closed significantly lower. The exception was the NASDAQ and growth, which closed modestly higher, but that was not intuitive. Faster growth and higher inflation go hand in hand, which would normally imply that the re-opening trade should have continued to do well. It didn't. Likewise, the prospect of higher rates, which has caused growth stocks to weaken over the last few months suddenly had the reverse impact. Figuring out markets is not easy.

It was similar story in the bond market, where the prospects of higher rates would normally send bonds reeling. Not this time. Bonds had a good week, especially long-term Treasury Bonds and high-grade corporates. The search for yield has pushed yield spreads to record or near record lows.

The one place that followed form was the dollar, which would be expected to rise if interest rates rise, and the dollar was stronger on the week, which pushed gold lower.

US Equities	1 week	YTD	Fixed Income	1 week	YTD	Sector Breakdown	1 week	YTD
S&P 500 (SPY)	-2.21%	11.34%	20+ Yr. Treasuries (TLT)	2.40%	-7.26%	Consumer Disc. (XLY)	-0.61%	7.25%
Dow (DIA)	-3.52%	9.36%	Barclays US Aggregate (AGG)	0.05%	-1.98%	Info. Technology (XLK)	0.08%	9.51%
NASDAQ (QQQ)	0.41%	9.35%	Intermediate Municipal (MUB)	-0.17%	0.59%	Financials (XLF)	-6.20%	20.03%
Russell 1000 Growth (IWF)	0.53%	9.01%	US Corporate Bonds (LQD)	0.50%	-2.16%	Health Care (XLV)	-0.65%	9.46%
Russell 1000 Value (IWD)	-4.14%	13.31%	Barclays US High Yield (HYG)	-0.22%	1.22%	Utilities (XLU)	-3.04%	2.99%
Vanguard Mid-Cap (VO)	-2.54%	11.93%				Industrials (XLI)	-3.77%	12.83%
Vanguard Small-Cap (VB)	-4.15%	12.45%				Energy (XLE)	-5.40%	39.71%
						Materials (XLB)	-6.25%	12.00%
International Equities	1 week	YTD	Commodities	1 week	YTD	Consumer Staples (XLP)	-3.02%	2.55%
MSCI EAFE (EFA)	-3.06%	7.62%	Commodities (PDBC)	-2.85%	27.33%	Comm. Services (XLC)	-1.54%	16.66%
MSCI Emerging (EEM)	-1.92%	4.95%	Gold (GLD)	-6.15%	-7.53%	REITS (VNQ)	-3.13%	20.55%
						Homebuilders (XHB)	-3.35%	21.88%

The table above is an analysis of the weekly and year to date returns of various markets/sectors that we follow (More RED = worse performing markets/sectors; More GREEN = best performing markets/sectors). Source: IEX Trading & PWM Research.

Retirement Planning:

How An HSA Can Be a Lifesaver In Retirement Planning.

There's little not to like about a Health Savings Account (HSA). They allow you to invest and withdraw money for health care expenses.

Tax Planning:

Biden's capital gains tax increase proposals make tax planning tougher.

Proposed changes in capital gains taxes under the Biden Administration are worrying investors and their tax advisors, especially the possibility of making them retroactive.

Estate Planning:

[*Here's how to decide who's a good fit for executor of your will.*]

On top of choosing an executor — the person who ensures your wishes are carried out at death — it also is important to name decision-makers for your finances and health care in case you reach a point in life when you cannot tend to those things yourself.

Health:

Why is gardening so good for your mental and physical health?

With a growing body of research backing the idea that gardening can have measurable benefits to both mental and physical health, barely a week goes by in the horticultural press without a story on the positive impact it can have.

Entrepreneur:

How To Overcome Every Entrepreneur's Challenge: Fear Of Taking A Risk.

Thriving entrepreneurs don't stay in their comfort zones. If you want to be one, pushing yourself outside the space you're used to must become a non-negotiable part of your personal and professional growth.