

This ain't no party, this ain't no disco, this ain't no fooling around - 02/16/2023

These are complicated times. Serious fires are raging all across the financial markets. The HY new-issue market has largely shut down over the last couple weeks, 5yr MBS have now transformed themselves into 15yr securities, biotech stocks are probing 5-year lows, and many high-profile tech stocks are down 80-90% from the peaks. There is enormous pain across both the fixed income and equity markets. And there are very few signs that the pressures will ebb anytime soon.

Much to the surprise of many investors, the firefighters quartered at 20th & Constitution Avenue, who have bravely doused so many market infernos over the last 25 years, are nowhere to be found. In fact, they are clandestinely cheering behind the scenes, hoping these flames will do just enough demand-side economic damage to solve their supply-side inflation woes. It's a dangerous strategy for sure, but with an 8-handle CPI inflation rate, they have no other option. A controlled monetary policy-induced back-burn is needed, something which drives demand down sharply without burning down the entire house.

Now, it's easy to get caught up in the day-to-day ugliness these fires bring as the screens display one market meltdown after another. But it is important to remember that after the flames subside, the rejuvenation begins. It is, of course, impossible to time the bottom. However, there will be one - there always is.

That said, this inflation purge will likely take a fair amount of time. I doubt the Fed wants to go with an aggressive large-scale conflagration, given that that brings a higher probability of losing control. They would rather withdraw the stimulus in a measured and calculated way, keeping a close eye out for any signs of uncontrollable financial backdrafts.

Then, after all is said and done, the economy and financial markets will come out stronger and healthier. The pain needs to be taken now to ensure long-run inflation expectations do not become unanchored. The Fed knows this. And they know exactly how to do it. It's not complicated, it's just unpleasant.

So as you look at those screens and wonder why the firefighters won't come to the rescue, understand that this is all happening for the greater long-term good. Preserving credibility and having the ability to act aggressively when the economy goes into a major downturn requires today's tough actions. This is a war against inflation. A war to preserve a 40-year track record of inflation-fighting success. Sadly, though, this is what life during wartime feels like.

With that in mind I'll end today with some lyrics from that 1979 Talking Heads classic "Life During Wartime":

This ain't no party
This ain't no disco
This ain't no fooling around
No time for dancing
Or lovey dovey
I ain't got time for that now

Good luck trading!!