Transcript for ARC September 16, 2022

Title: The Trouble With Tightening

Subject: Fed's tight money policy
Theme: The fed's tight money policy will cause more harm than good.
Contrast: The Fed's tight money policy is the road to pre-pandemic prosperity.

Hi everyone, welcome back to Finance Friday on the ARC-UK YouTube network. I'm HardmoneyJim.

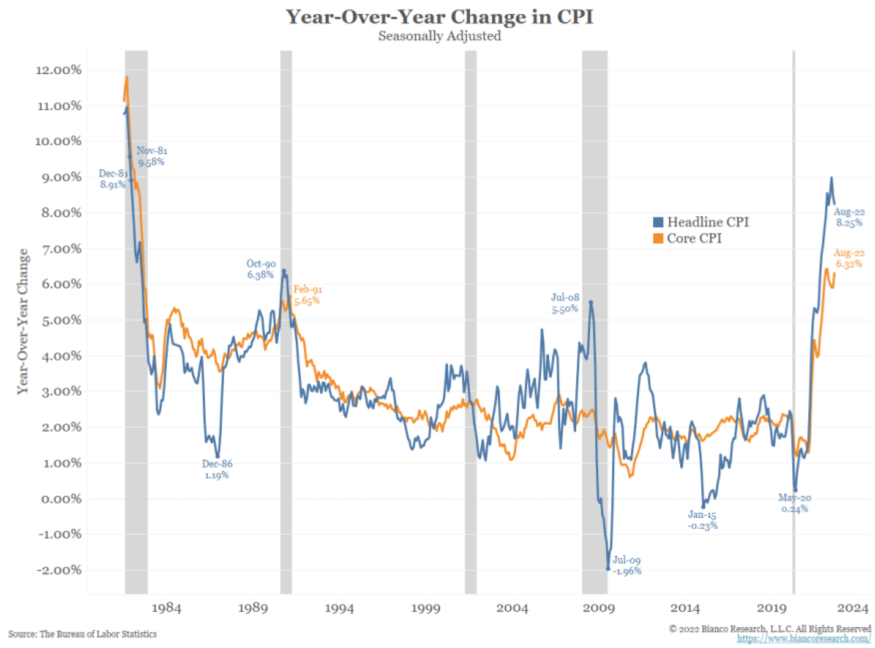
Today, September 16, 2022, is my Mom's 100th birthday! We lost her a few years ago at age 97, but I was lucky to have her in my life, so happy birthday, Mom!

I'm chatting with you today from my home in Jackson Hole, where the seasonal tourists are vanishing, the bears are foraging, the temperatures are dropping, and the leaves are starting to turn yellow and red – all right on mother nature's schedule. It's the perfect time of the year here, and if you ever have a chance to visit this part of Wyoming this time of year, bring your sweater and you are not likely to be disappointed.

However, on other fronts, there's been lots of disappointment lately, mainly in the stock market. Let's start today's chat by discussing a dramatic day in the stock market on Tuesday this week, something you might have noticed if you own stocks in your 401k plan – and of course, if you have a 401k plan you are almost certainly exposed to stocks in some form.

Before we get into it, a word on terminology I'm going to use today. As you know, I think it is incorrect and misleading to refer to consumer price increases as "inflation," because in my view inflation is an excessive increase in the money supply caused by the government, and increasing consumer prices are just one result of inflation. But today, with the understanding from you that you know where I stand, I'm going to use the term "CPI Inflation," which most economists think is actual inflation. Using "inflation" this way is conceptually wrong, but it is more convenient and time efficient because that's the term everyone else uses, so please don't think I have sold out and that I am sleeping with the enemy.

In preview, here is the game plan for today. I'll start by highlighting the big plunge in the stock market this week that marks a change in the way most investors view the importance of high CPI inflation. Investors are changing their estimate of future CPI inflation, and this also changes their estimate of how aggressive the Fed will be in raising short-term interest rates. We'll talk about how the Fed thinks about inflation and why they are required to think the way they do. And how the Fed thinks about inflation will dictate what they do about it. Finally, I'll try to explain what I think the Fed's priorities are, what they will do, what will be some of the important outcomes in the investment markets. So that is our roadmap for today.



With that introduction out of the way, here's what happened this week. On Tuesday, September 13, the Bureau of Labor Statistics reported the CPI increase for August. The index increased 8.3% from August 2021 to August 2022. The 8.3% increase was 0.2% percent higher than the Wall Street consensus estimate of 8.1%, down from 8.5% in July. Wall Street consensus was that CPI inflation was headed sharply downward, and along with that was the hope that the Federal Reserve would not feel compelled to raise interest rates so much that it would guarantee a recession.

On the bad CPI news, the Dow Jones Industrial average promptly crashed 4% in one day and the Nasdaq and S&P500 did even worse. This was the biggest one-day downward move in the market since the initiation of the lockdowns at the start of the pandemic, back in March of 2020. Listening to the talking heads on Bloomberg TV, it felt like pure panic.

Where exactly was the CPI inflation? Consumer prices overall rose only 0.1% in August, after being flat in July. But the overall August 21 to August 22, year-on-year decline was almost entirely the result of falling energy prices. Gasoline fell 10.6% and fuel oil 5.9% - in just one month.

But the reduced energy prices were not enough to offset higher prices in almost everything else. So the 12-month inflation rate in August at 8.3% was down from July's 8.5%, but still higher than the 8.1% most economists had expected.

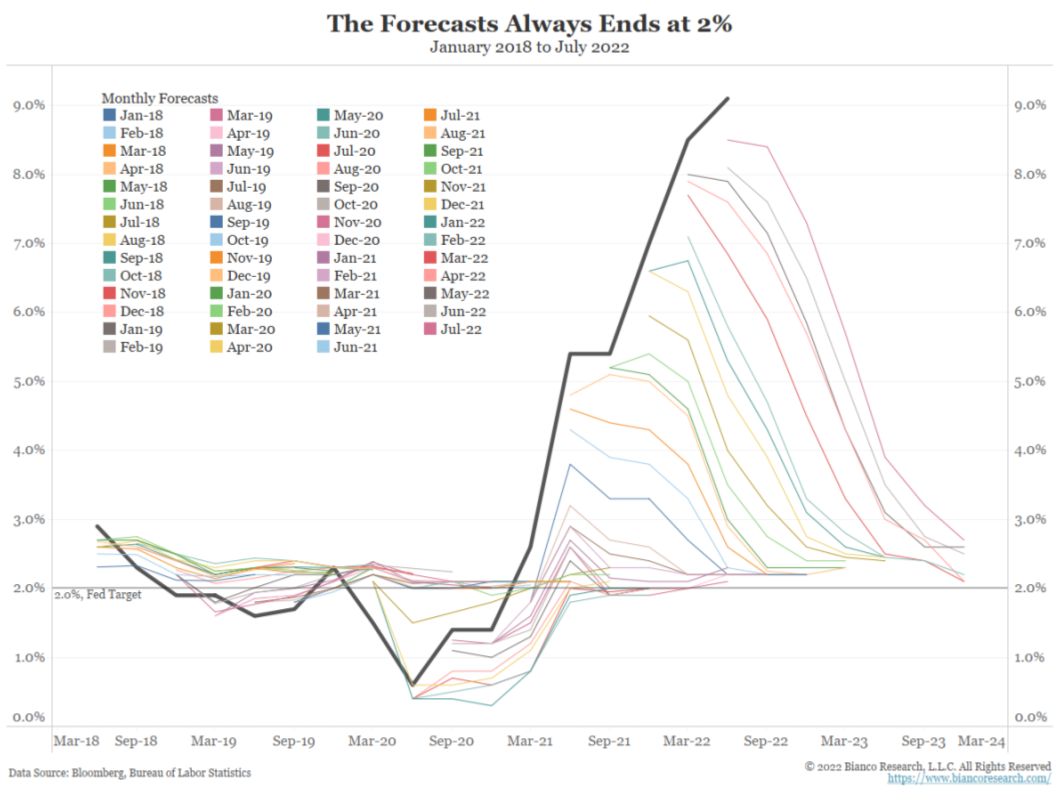
Food prices were the biggest problem for consumers. Grocery prices rose 0.7% in August and are up 13.5% from a year ago. Retailers generally reported that they see higher prices ahead.

The so-called core CPI prices, consumer prices excluding food and energy, also were up 0.6% in August alone or 6.3% over the past year. Consumer inflation continues to run through sectors of spending that are not directly affected by commodity prices, in the way that gasoline is directly affected by the price of crude oil. For example, the prices of services like healthcare are continuing to rise. Services excluding energy services are now 6.1% more expensive than a year ago. Owners' equivalent rent, the CPI report's proxy for shelter, continued to rise at 0.7% in the month and 6.2% for the year.

Still, the overall CPI inflation was lower than last month and only missed expectations by 0.2% Why would the market react so strongly to what seems like a rounding error in the CPI?

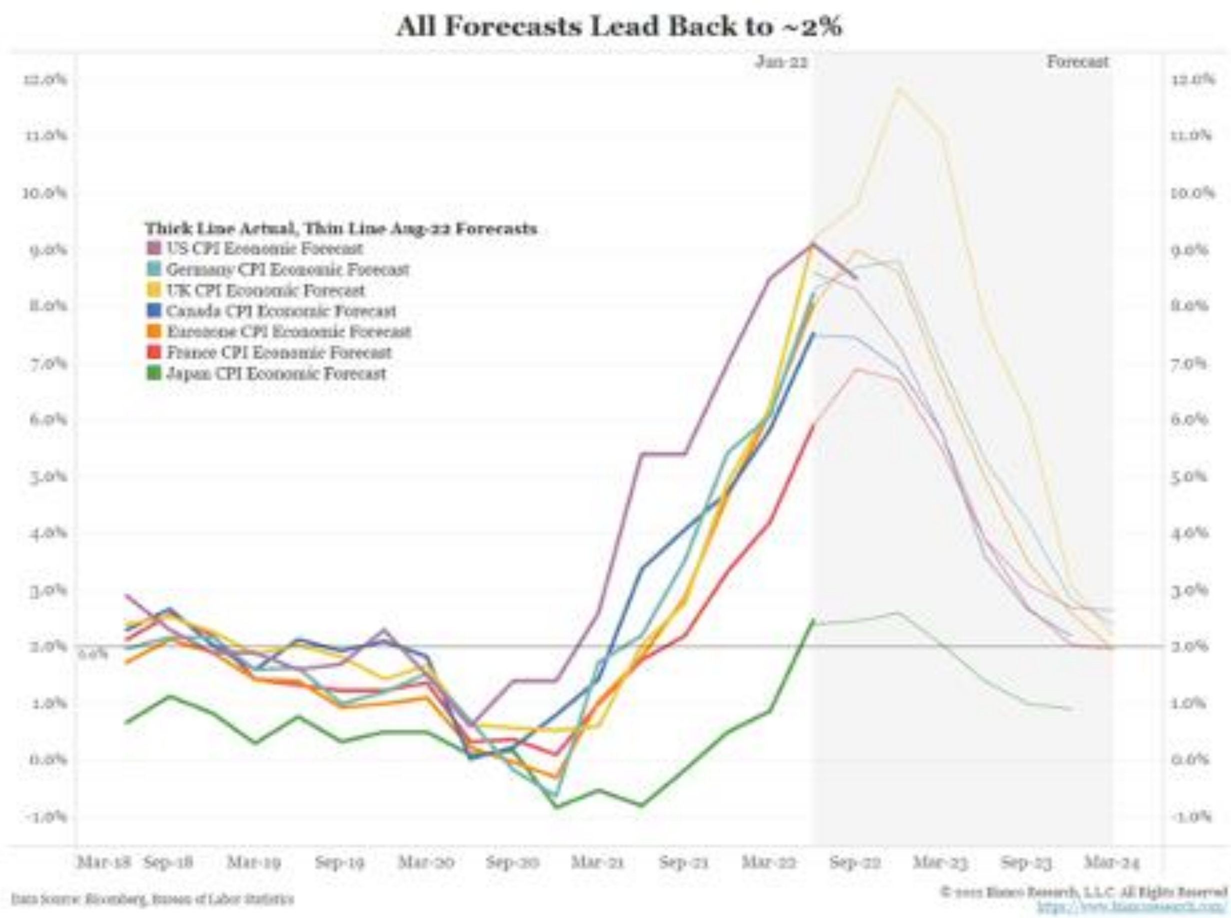
It's usually hard to tell what news is moving markets, but in this case, the reason seemed clear. 8.3% signaled to market participants that CPI inflation is not moderating as fast as expected. Even more important, the so-called core prices and services – those less volatile than energy and food – seem to be moving up persistently; they are not receding, signaling that the Federal Reserve will be forced to maintain and perhaps even intensify its tight money policies. Tight Fed policies mean the Fed will raise short-term interest rates higher than previously expected and may hold them higher for longer than originally anticipated. Tighter money means less money sloshing around the economic system to buy stocks and bonds.

So it seems clear the market was surprised by the inflation number and reacted with a big sell-off in both the stock and bond markets. The dominant view on Wall Street and among most economists is (or until Tuesday, the view *was*) that high CPI inflation is temporary and will return to the Fed's target of 2% within a couple of years. It looks like that has changed.



I have showed you charts like this before, but they are worth studying again. These data result from a monthly poll of about 70 Wall Street Economists. The results are averaged and presented here by Bianco Research, and I think this is great work, kudos to Jim Bianco and his data scientists. The dark black line is the reported CPI inflation number, and the stringy colored lines are the consensus prediction of CPI from that point on. What it shows is that month after month, no matter how hot the CPI comes in or how surprised these economists are by the results, they go right back to their old bias. If CPI inflation is below the Fed's 2% target, as in Sep of 2020, they think it will revert back upward to 2%. If inflation is above that 2% target, it will always revert to the target. No matter how high CPI inflation goes. These economists think inflation "right now" is always the highest it is going to be, and inflation will trend right back to the Fed's promised 2% number within a year or two. They nearly all think this way, and they do not seem to change their minds. Look how persistent this pattern is, month after month. Talk about groupthink!

Now, lest you think it is only Wall Street economists that want to be stubbornly wrong month after month, here is a composite poll of non-US economists forecasting inflation in the non-US countries. The pattern is the same. I guess they all went to the same school.



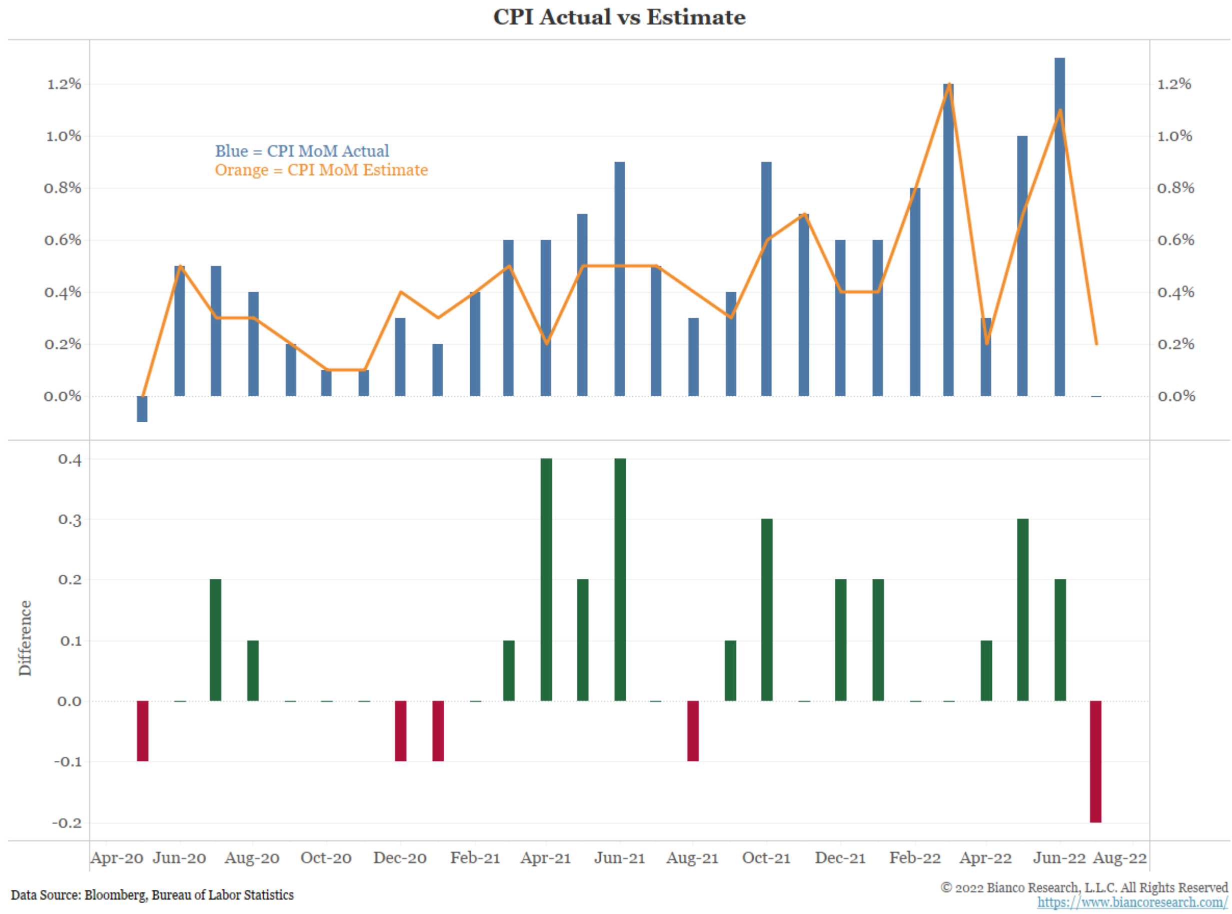
These economists have clearly thought that the Fed has CPI inflation firmly under control. Why do they think this? Partly because the Fed did seem to have CPI under control from 2010 to 2019, even as they were engaged in massive QE, that is, money creation. (Refer back to the CPI chart)

These economists apparently see no connection between the rapid expansion of money supply and the increase in consumer prices. They do, after years of asset price increases, widely acknowledge the effect of Fed QE on asset prices, like stocks and real estate. But they seem to think these rising consumer prices are due to supply chain problems from the pandemic and energy shortages due to Russia's invasion of the Ukraine. So to many of them, CPI increases are just "pandemic inflation" or "Putin's inflation." Therefore they think that after a few years, when these crises have passed, we're all going back to the 2019 pre-covid economy, when consumer prices were rising at less than 2% per year. That's when it took only a few weeks to get a new electric bike from China. It now takes several months from China if you can get it at all, and the shipping rates have gone from $1500 per ton to $10,000 per standard container (TEU) and are now back down to "only" $5000 per TEU, but they think this is all temporary. Once the war is over and the supply chain problems are ironed out, they think, everything will get back to normal.

But I think they are wrong about this, because since the pandemic, we have now have very different demand patterns and different supply patterns. Different demand patterns result from things like more people working from home, less business travel, more personal air travel, people moving from the city to the suburbs, and so forth. Different supply patterns result from the continued lockdowns in China, the disruption of fuel and food supply from Russia and Ukraine. So we have different supply, reduced supply, a different mix of goods and services demanded, all of which disrupts what used to be a well-functioning, highly specialized, just-in-time supply chain. And all this change in the demand and supply patterns is further complicated by an unprecedented wave of newly created money, force-fed to individuals and corporations under a badly mismanaged pandemic.

So, simply put, we have less stuff, interrupted by logistics problems, being chased by record amounts of money. All of this disrupts normal pricing, causes economic miscalculation, breeds business mistakes, delays, uncertainty, and as a result, higher costs. I don't think most economists believe we have an obsolete supply chain that needs to be changed, not just fixed, and they also do not agree that there is a long-term problem of too much money in the system. I think this is why they have seen CPI inflation as temporary, but now I think they are starting to change their view on this. That, I think, is what this week's terrible market action is telling us.

There is other evidence that the market has been overly optimistic about inflation.



Here is a pretty good representation of that over-optimism. The graph shows composite estimates of Wall Street economists for each month's inflation number. As you can see by the long green lines, which are the difference between the expected and the actual CPI increase, they have typically estimated a number significantly lower than the number that is eventually reported. This is systematic over-optimism, in my view. As I have explained, this view results, in part, from their belief that CPI inflation is driven by product shortages and supply chain problems that can be fixed quickly. I doubt this, as I have said.

So this latest CPI print demonstrates that higher prices may be more persistent than many thought. The next question is, what will the Fed do about this? To understand what they will do, to understand what they are thinking, let's go to the words of their boss. Here is what Fed Chair Powell said in his brief speech right here in Jackson Hole a few weeks ago, on August 22.

> **"Restoring price stability will take some time and requires using our tools forcefully to bring demand and supply into better balance. …While higher interest rates, slower growth and softer labor market conditions will bring down inflation, they will also**

bring some pain to households and businesses….These are the unfortunate costs of reducing inflation.”

So the Fed will “forcefully” depress demand to bring it into balance with supply. And Powell acknowledges this forcefulness will cause pain to households and businesses, which he says is “unfortunate.” He said the Fed must continue to raise interest rates and keep them elevated to bring the worst CPI inflation in decades back under control.

Powell admits that a tighter interest rate stance will be tough on workers and will slow economic growth. However, he thinks that not acting would allow price increases to become a more permanent feature of the economy and cause even more pain down the road.

Now I have said before, and I will reiterate today, that I think the Fed is committed to raising short-term interest rates until they get the CPI back to their famous 2% goal, and I want to explain why I think this is still their intention.

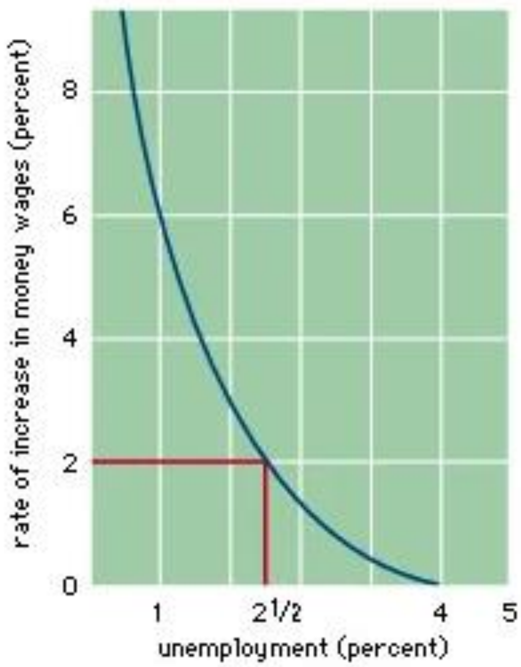
JOURNAL ARTICLE

The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957

A. W. Phillips

Economica
New Series, Vol. 25, No. 100 (Nov., 1958), pp. 283-299 (17 pages)
Published By: Wiley

To explain the Fed’s worldview, we should understand an economic device called the Phillips Curve, a 1958 invention of a mediocre economist named Phillips, a guy who would probably not even be known if not for the unfortunate endurance of his famous curve. This slide shows the title and heading of his paper, easily obtained on the internet if you want to search and read it.



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And here is the device itself, the famous Phillips Curve! It's major virtue is not that it tells us how the world works, but how the Fed thinks.

Supposedly the curve describes a real-world tradeoff between inflation and employment. Phillips's theory states that increases in wages and prices (along the vertical axis) are related to the unemployment rate (the horizontal axis) and this relationship is defined by a curve, a mathematical function. The lower the unemployment rate, the higher the annual growth rate of wages and prices. The curve will tell you what that rate of inflation will be. Conversely, the higher the unemployment rate, the lower the growth rate of wages and prices will be. Just stay on the curve and you will know. Note that the tradeoff is not a straight line, but a horizontal asymptotic curve, meaning there is a kind of "sweet spot" in the middle where the tradeoff between unemployment and price inflation is optimal.

So the idea is if price and wage increases are too high, say at 6%, and unemployment is very low, the Fed can raise rates to dampen the economy, lower the demand for labor, lowering wages increases while pushing unemployment higher. Note that the lowering of wage increases is synonymous to them with lowering inflation.

This dubious theory, the epitome of technocratic economic central planning, was an outgrowth of Keynesian economic thinking, and for decades it had credibility among mainstream economists.

But the inflation of the 1970s blew this theory to bits. During the 1974–75 period, overall prices and wages increased while at the same time the pace of economic activity declined and unemployment went up. Economists labeled this unexpected event “stagflation,” meaning low growth, high unemployment, and high inflation all at the same time.

Likewise, in 1979 there was a large fall in economic activity with accompanying increases in the CPI. More stagflation. By December 1979, the yearly growth rate of industrial production was zero while the CPI grew at 13 percent.

I won't go into the full economic refutation of the Phillips Curve, as it we don’t have time. Still, if you’re interested, I recommend you read George Reisman’s rebuttal of the Phillips Curve in his book *Capitalism*. Just check in the index under Phillips Curve.

So the Phillips Curve is just wrong, and everyone now knows it**.** Still, this is how the fed thinks things work. Why does the Fed believe in this paradigm, even though it has been discredited?

Because it is their bureaucratic imperative. Why does the entire bureaucracy at the EPA believe life-giving carbon dioxide is killing the world despite mountains of evidence that this is false? Because they are hired and paid by the government to think this, and their positions are validated by law, no matter how stupid that law is. This is what I call the bureaucratic imperative.

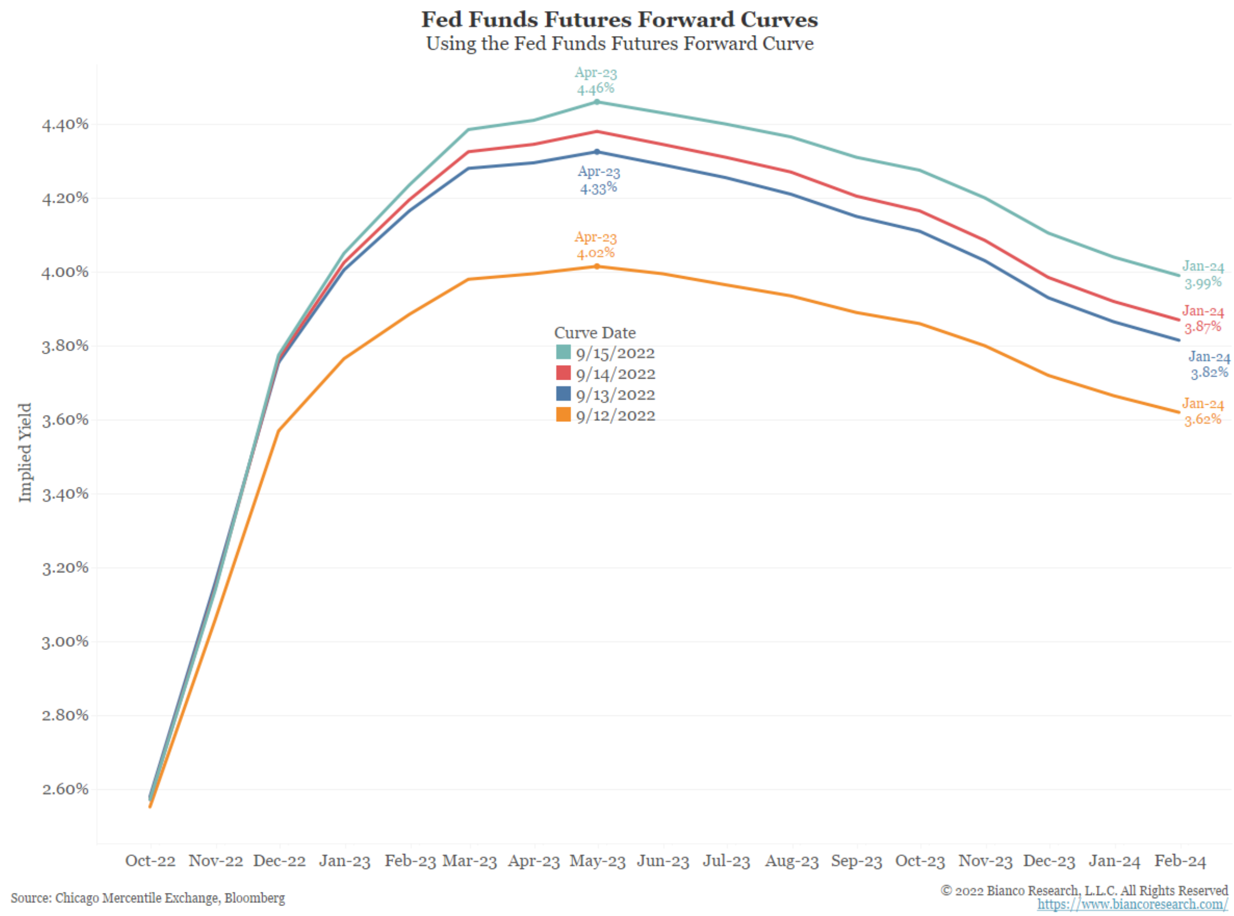
Here is what happened. Even though the Phillips Curve theory was not very credible, Congress passed the Humphrey Hawkins legislation in 1977 that legally validated the Phillips Curve by giving the Fed a mandate to promote full employment and stable consumer prices, the two axes of the curve. The Fed was handed the challenge, defined by law, of optimizing this alleged tradeoff between unemployment and CPI inflation. The Fed’s mandate was by a law based on unsound economics. According to this law, they are allowed to manipulate interest rates and money supply to influence unemployment and inflation.

So, whether the Phillips curve analysis is correct or not, or whether their tools are effective, the Fed has a *bureaucratic imperative* to fight the inflation battle as defined by law with the tools congress has provided by law. Never mind the collateral damage to the economy caused by imposing artificial interest rates and unproductive money creation.

The point of this excursion into the Phillips Curve is to show how the Fed *must* look at the problem of inflation. They are *required* to see inflation as a rise in consumer prices that can be traded against unemployment. They are *obligated* to manipulate two economic variables, price inflation, and unemployment. To do this, they have two legal tools: control of short-term interest rates and the ability to influence the money supply. They are practically commanded to believe in the phony Phillips Curve paradigm.

The only question is how aggressively they will employ these tools in response to the data they observe. Not what they will do but how aggressively they will do it. This is, I believe, the Fed’s starting point in their thinking pattern. And armed with this Phillips curve paradigm and their interest rate and monetary tools, they have vowed to be aggressive in fighting CPI inflation, and I take them at their word.

So now it appears more and more investors are starting to believe the Fed's promise to raise rates aggressively for several more sessions. How high will the Fed push short-term rates?



This chart shows investors' prediction of short-term rates using interest rate futures contracts from the Chicago Mercantile Exchange. It's a report on what commodities traders are doing with their money. As you can see, their bets on higher interest rates have risen as the inflation data has come in, as these traders are more confident the Fed means what it says.

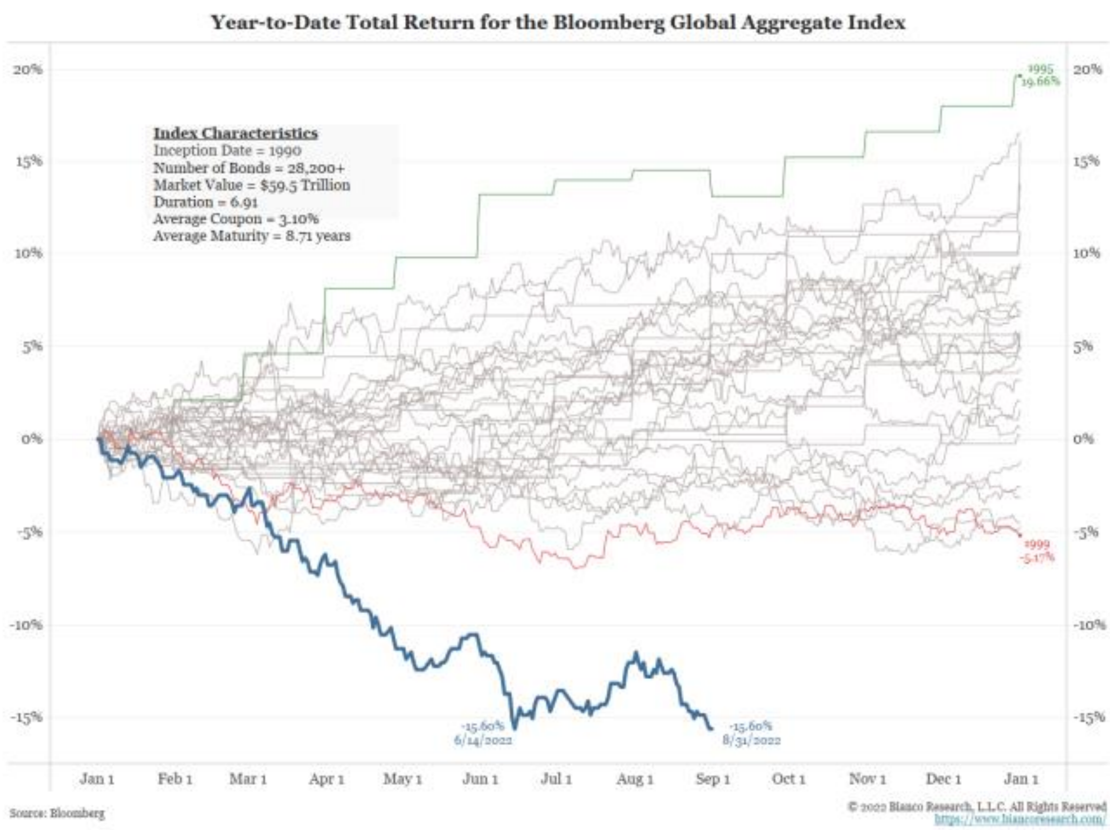
On Wednesday, the day after the 4% crash, Ray Dalio, a successful and influential hedge fund operator (Bridgewater Associates LLP), wrote a very bearish piece on LinkedIn predicting the Fed will have to raise short-term rates to at least 4.5% to kill demand enough to suppress CPI inflation.

He wrote: "It looks like interest rates will have to rise a lot (toward the higher end of the 4.5% to 6% range)." "This will bring private sector credit growth down, which will bring private sector spending and, hence, the economy down with it." He added that a mere increase in rates to about 4.5% would lead to a nearly 20% plunge in equity prices.

Because of Dalio's strong reputation and influence, I suspect his article marks a turning point in sentiment. I guess many more investors will now capitulate to the view that both interest rates and unemployment must rise to restore price stability.

Of course, as Dalio points out, higher interest rates are bearish for corporate earnings, investment in production, bond prices, stock prices, mortgage rates, and house prices, you name it.

To give you an idea of what rising interest rates have already done to bonds around the world, here is an update on the total return, year to date, of the Bloomberg Worldwide Aggregate Bond Index.



You've seen this chart before, and note that the losses year to date had set a new record, worse than when they bottomed in June.

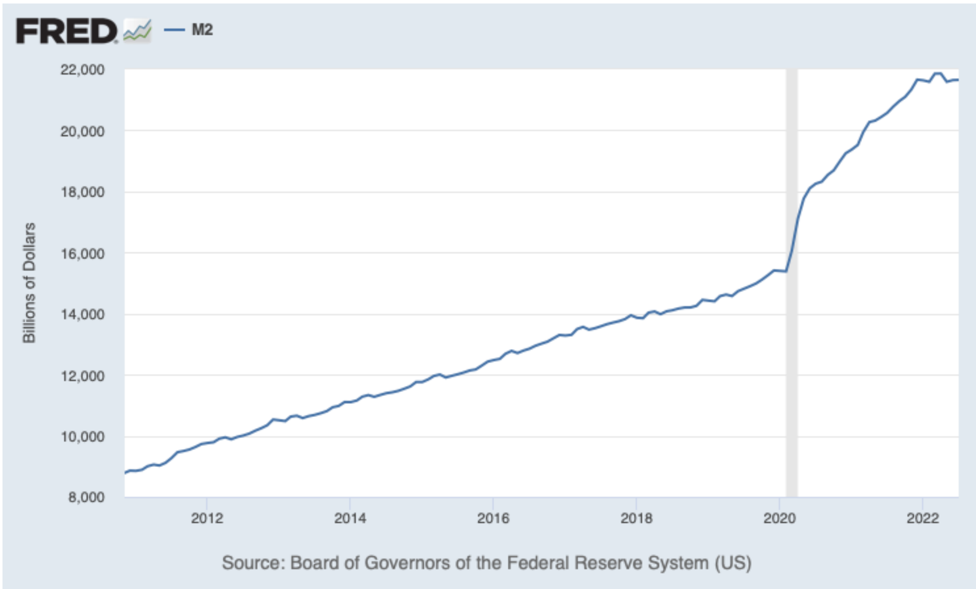
We have never seen a bond market perform this poorly since the inception of this index in 1989. Nowhere near this badly. Barring a miracle, we will see the worst bond returns in history in this calendar year. And all this is from a couple of hundred basis points increase in bond yields, instigated by the Fed, and duly copied by other central banks, except Japan. It is the mirror image of falling rates. If the Fed raises short-term rates from the current 2.5% to the 4.5 to 6% range, the losses will likely worsen, and the effects on everything from portfolio value to investment decisions could be profound. So far, this carnage has not deterred the Fed from its aggressive program.

The stock market doesn't look much better. Here's a screenshot of the S&P500 index taken this morning (September 16). The market is down about 20% from its January peak. If Ray Dalio is right about a further 20% drop, we'd be going down to where levels were around midway through 2019. Even that would not be historically cheap, so I will not be surprised to see even lower levels before the stock market bottoms out.

So, I agree with Dalio. My expectation is that inflation will be persistent; therefore, the Fed will continue to tighten aggressively, and the resulting high-interest rates and slower money supply growth will put a big damper on stock prices. That is my logic, but it depends on whether CPI inflation will persist for some years.

So, I need to explain why I think CPI inflation will persist.

First, I agree with some economists like Jim Bianco who say the changes in demand and supply patterns have radically changed due to the governments' pandemic policies and other global developments. To recap, the work-from-home trend, all by itself, is a game changer, causing a change in demand patterns. Then you have the de-globalization due to international conflicts with China and Russia. And you have the energy shortages caused by green energy policies all over the world. Other than the increasingly aggressive moves of China and Russia, these problems are self-inflicted wounds by the U.S and other Western nations. These physical supply and demand issues are big factors in keeping costs high and preventing production from catching up with the higher demand caused by excessive money creation. So I agree with many economists that supply and demand factors are different in the long run, and these factors will prolong the trend of higher consumer prices.



But I think there is more to the persistently high CPI story than these supply constraints and these changing supply and demand patterns. The other essential part of the story is the unprecedented growth in the money supply, and here is that familiar chart from the Fed to remind us how big the broad supply growth has been in the last few years. Unlike some economists, who downplay the role of money creation, I think there's a good chance that all the money printing the Fed has done since the pandemic started will have powerful upward effects on the CPI that may last for years.

To justify that expectation, let's revisit a chart created by Lyn Alden. I showed you this chart back in June, I think.

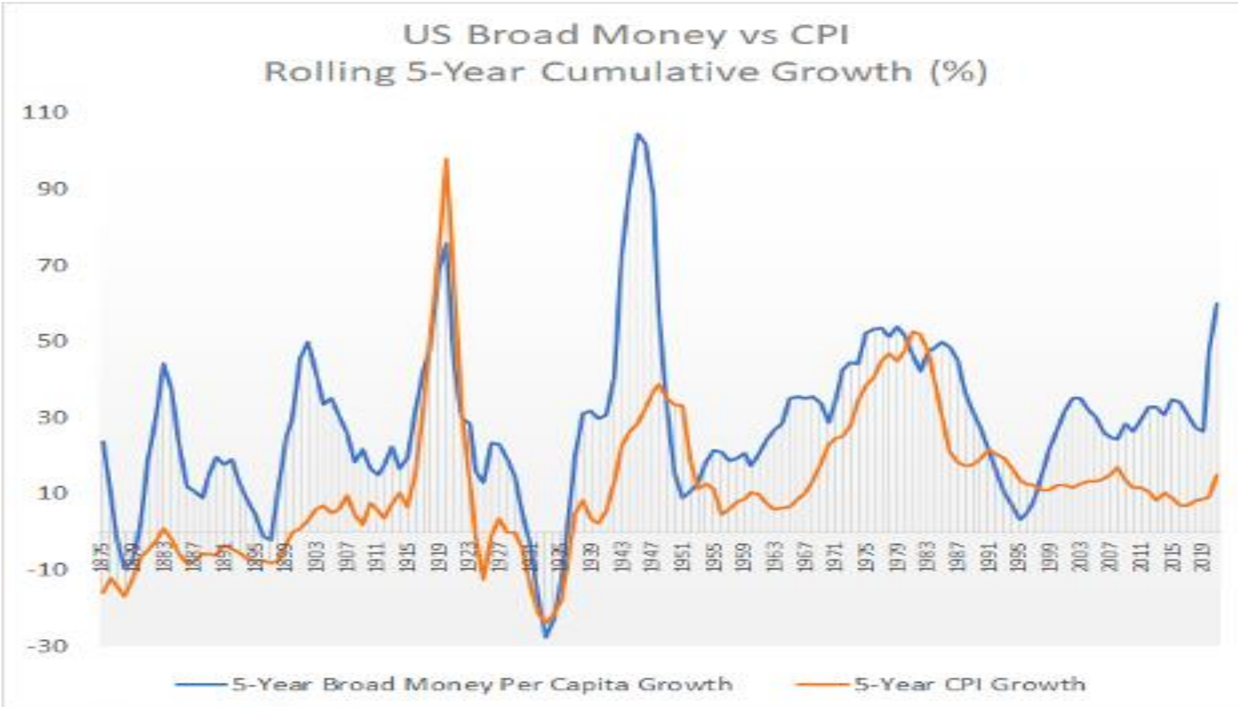


Chart Source: LynAlden.com
Data Sources: macrohistory.net, St. Louis Fed
Òscar Jordà, Moritz Schularick, and Alan M. Taylor. 2017. "Macrofinancial History and the New Business Cycle Facts." in NBER Macroeconomics Annual 2016, volume 31, edited by Martin Eichenbaum and Jonathan A. Parker. Chicago: University of Chicago Press.

This chart requires a little heavy lifting so let's pause to study it for a minute. You have seen it before. Each point on the blue line represents the cumulative percentage growth, over the previous five years, of the broad money supply, or M2. (Recall that M2 is basically bank deposits plus currency in circulation, together, they constitute the money we spend on consumer goods.) So, for example, look to the middle of the chart at the tall blue peak. It says that in about the year 1946, over the previous five years, M2 had grown by over 90%. About 2-3 years later, according to the orange line, the cumulative five-year CPI growth was about 30%. That is an average of about a 6% per year increase in the CPI over that five-year period.

Now look to the right to the next lower but fatter blue peak, at about the year 1977. In 1977, the cumulative growth in M2 per capita was a little over 50%. Three years later, in 1980, according to the orange line, the incremental five-year growth in the CPI was a little less than 50%. That is an average annual CPI increase for those five years of, say, 9%. (a little hard to tell from this graph, I admit, and I do not have the raw data.) The late 1970s and into 1981 was the last big episode of persistently high CPI inflation – until today.

This chart suggests that CPI increases follow money supply increases over time, with a 2-3 year lag. This is logical, as increased money supply increases demand, which puts upward pressure on prices.

Now look at the far right on the chart and consider today, September 2022, as we have just started to experience the highest annual CPI growth since that previous big CPI inflation episode of the late 70s, about 40 years ago. As of late September 2022, the five-year accumulation of M2 is up about 60%. (the blue line on the right of the chart is not up to date, I calculated that five-year M2 increase based on current Fed data.) If, two or three years from now, the five-year cumulative CPI is only up half of that 60% increase, say by 30%, that would imply an average of 6% annual CPI increase over that five years, that is, from 2021 to 2026. So with only about one year of 8+% CPI inflation under our belt, there's good reason to think we still have a lot of embedded CPI inflation ahead of us due to this huge cumulative increase in the broad money supply. At least that is what the history of this chart suggests.

Although admittedly speculative and imprecise, this kind of estimate makes Ray Dalio's upper-end assessment of a 6% fed funds rate look entirely reasonable and maybe too low because, historically, it takes a fed funds rate higher than the CPI rate to bring the CPI down.

I hope I explained that clearly. This is not a prediction for advice purposes. Still, I am personally acting on this high CPI inflation scenario as my expectation in my personal financial planning and my private affairs. I am working as if high CPI inflation will be with us for several years to come, even though it may have already peaked.

The Fed, through Jay Powell, has said it will raise rates enough to kill CPI inflation. I believe Jay Powell because I think the Fed is highly motivated to continue on this tight monetary course for several reasons.

First, controlling inflation is the Fed's assigned task under the Humphrey-Hawkins legislation of 1977. They are also tasked with maintaining "full employment." But Powell sees the strong labor market and thinks he has room to work before he ultimately kills employment and the economy. He can trade off many jobs to get CPI increases under control. <u>So, to repeat, institutional duty, or "bureaucratic imperative," is the Fed's motivation number one.</u>

Second, the Fed needs to regain its reputation and credibility. The Fed completely missed this current CPI inflation episode, they are embarrassed, and their jobs and even the existence of the Fed may be on the line if they do not stay the course until CPI inflation goes way down. <u>So credibility and job security is motivation number two.</u>

Third and finally, the stock market and other asset prices are now not as crucial to the Fed as they once were. Over the last 12 years, the Fed stepped up asset purchases and lowered interest rates every time the stock market has downward. The asset markets (meaning stocks and bonds) responded positively. Market players learned to "buy the dip," and it worked. But during all these last 12 years, Powell did not have roaring CPI inflation to stand in his way. He learned, or so he thought, and the market learned, that he could step on the monetary gas without causing CPI inflation. But ultimately, he was wrong, as the last year of high CPI inflation has shown. Powell knows that CPI inflation is political dynamite. High consumer inflation causes regime changes. He does not dare fail to fight it. So he is now much less concerned about the level of prices in the asset markets than he used to be. He is now more concerned with the guy wearing jeans on Main Street than with the guy in pinstripes on Wall Street. If he has to choose between the two, I am betting he will decide to let Wall Street suffer. <u>So political pressure to keep the pitchforks in the barn and out of the peasants' hands is motivation number three.</u>

So, how high will rates have to go? I don't profess to know with any certainty. The paradox of Fed policy is that higher rates can dampen consumer demand but also kill investment demand, including the need to hire people. So by trying lower the rate of consumer price increases, the Fed may also damage the productive foundation of the economy. As Von Mises said, it is like running over someone with your car and then trying to fix it by going into reverse and backing up over the dead body. Simply reversing the course of easy money does not fix the problem you created with that easy money. Oddly, mainstream economists don't seem troubled with this contradiction.

I should add that there is no reason a free economy cannot have growing employment and stable prices or even declining prices. We have seen it before. We should just let markets work. That means letting interest rates find their natural level through competitive price discovery and stopping unproductive money creation. And it means patience and confidence in markets. In other words, it means policies that we are <u>not going to see</u> out of this Fed and this administration. Doing nothing is not an option for them.

So I don't know how high rates will have to go, but I suspect they will go high enough that something – some industry, sector, or maybe several important companies – will break and brush with bankruptcy. But I don't think the Fed or any Administration, red or blue, will let an important company go bankrupt and reorganize with more efficient capital and less debt, even though that would be the most healthy thing for the economy in the long run.

And that brings me to the last expectation I have, which I have mentioned before and will repeat. Over the last 2-3 years, the Fed has become much more aggressive and active in its money-creation policies. As Jim Grant has remarked, radical monetary policy spawns even more radical monetary policy, and that's what we have seen at the Fed. Lev Menand's book, *The Fed Unbound,* which I reviewed several podcasts ago, documents this increasing activism very well. I expect to see more of it: more targeted lending to specific firms that are in trouble, or more direct asset purchases of the debt or even the equity of troubled firms, from the Fed, just as we saw during the pandemic.

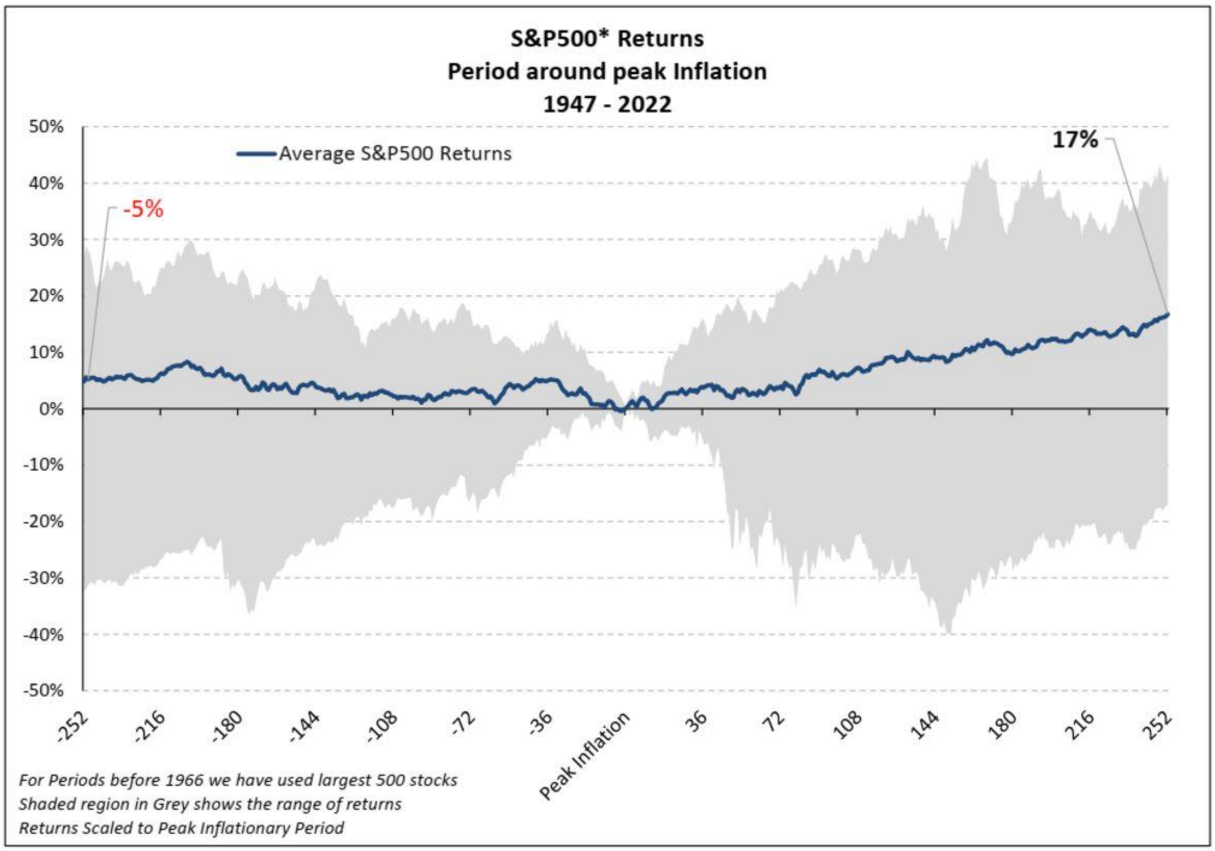
The Fed may let some less important zombie companies go bankrupt as the economy weakens. But the Fed and the Treasury will not let American Airlines or a major tech company go down any more than they would have allowed a significant bank to go down during the great financial crisis. To them, these big important companies will be too big to fail. So, I expect the Fed and the federal government to intervene directly in those companies if they get into trouble. In anticipation, I am calling this potential policy "selective reflation." It is just logical to me that this is what they will try next.

For lack of time and space, I have not commented on the Fed's announced policy of so-called Quantitative Tightening, mainly letting some of their Treasury and MBS holdings mature, which will shrink the fed's balance sheet. That process is beginning in earnest, and we'll if for discussion another day.

END

Bonus Chart: How does the stock market perform after inflation peaks? If inflation peaked at 9+% a few months ago, history says the next year is likely to show positive stock market gains. Beware, however, the historical variation (shaded area) is huge.

EXHIBIT 5 : **The S&P 500 has outperformed in the past over one year holding periods post-peak inflation**



Source: Factset, CRSP, Bloomberg, OECD, Investopedia, Bernstein Analysis