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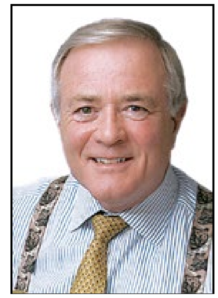

William Rutherford

OP-ED: Bulls and bears fight it out; who will win?

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After a strong, early-summer rally in the stock market, August saw a sharp drop. Now, at the start of September, which is historically the worst month of the year for equities, we must pause and reflect on the market direction.

Despite high inflation, the Ukrainian war, and supply bottlenecks, the economy has remained stronger than expected. The rally was supported by some good news: Profits have been better than expected. The jobs market remained robust in July. The total number of U.S. job openings was set to remain historically high, according to the Labor Department. The Conference Board's Consumer Confidence Index climbed to 97.4 in August. The U.S. Manufacturing Purchasing Managers' Index remained flat, with construction spending down slightly. The U.S. unemployment rate is expected to remain at a 50-year low of 3.5 percent. The price of gas at the pump fell roughly 40 cents from the prior month, according to GasBuddy. These factors and others made the case for the bulls.

The bears' case was more direct: The Federal Reserve has taken a strong stand against inflation. Chairman Jerome Powell has made various statements about the evils of inflation and the unacceptably high level of inflation. Up until August, his pronouncements had little impact. Then, at the annual Economic Policy Symposium in Jackson Hole, Wyoming, Powell made a much stronger statement about inflation. He forecast a Fed policy determined to beat inflation. He said that households and businesses would suffer from higher interest rates and was undeterred by that prospect. No longer did he see inflation as "transitory."

Powell demonstrated that he was willing to raise interest rates high enough to break the upward momentum of inflation. He was willing to raise them high enough to bring a slowdown in the economy and higher unemployment. He seemed very determined. But will It last? It will take considerable political will to do what he wants to do. Does he have the courage?

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The Federal Reserve is supposed to be independent, but will it be able to withstand the political pressures caused by an economic slowdown? We are entering the third year of a four-year election cycle. Typically, the party in power, whichever one it is, likes to run with a strong economic backdrop and not a slowdown. Thus, politics have a strong impact on economic policy. Typically, the party in power wants to pump up the economy with government spending and easy money. This time probably won't be different. Such policies are counter to the Fed's tightening approach. Who will win? The timeworn mantra is "Don't fight the Fed." That will probably be true this time too.

If the Fed gets what it wants with a shrinking economy, one can expect a Republican sweep of elections. The Democrats fully understand the risks and will do what they can to push back on the Fed.

We probably end up with a restrictive Fed policy, but not so restrictive as the Volcker years. The economy remains fairly strong, with employment showing remarkable strength. So, it is the economy versus the Fed, and which one wins? Put your money on the Fed. Yes, the Fed has fewer moving parts, but its tools are so powerful that they are the ones that count the most.

As we work through this painful inflationary cycle, we will come out stronger on the other side.

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