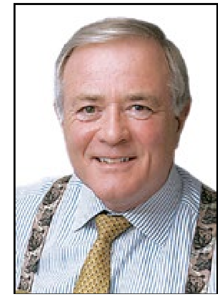
DJC
THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON


William Rutherford

OP-ED: When good news is bad news

Published Dec 9, 2022

To begin this month, the jobs report showed solid growth. The U.S. Department of Labor reported ongoing demand for workers, despite the Federal Reserve's effort to slow the economy and cut inflation by raising interest rates. Employers added 263,000 jobs, even as layoffs in the tech sector grabbed headlines.

But what would seem to be good news for the economy turned out to be bad news for the equity and bond markets. Why the disconnect? Well, for one thing, a strong job market must mean the economy is strong. But a strong economy is not what the Federal Reserve wants.

The Federal Reserve wants the economy to slow. The Fed wants the rate of inflation to be about 2 percent, yet it is far from there just now. The Fed is willing to punish the economy to slow the pace of inflation. The Fed's chosen method of crushing the rate of economic growth is to raise interest rates. The Fed continues to signal its determination to follow this path. So far, it has had minimal success.

There is a price to be paid for higher interest rates. The equity and bond markets don't like higher rates; if rates go up, stock and bond investments tend to drop in value. So, when the jobs report went up, market values went down. Some observers believe high interest rates could result in a recession. Others hope that even if there is a recession in 2023, the economy would have a "soft landing" and not a "hard landing." All of this makes financial markets very nervous. Hence markets stumbled, bringing full circle to the good-news-is-bad-news scenario.

In addition to interest rates, oil prices have risen. Such increases are inflationary too, since petroleum is used not just for fuel but also in a wide variety of consumer and industrial products. Vladimir Putin's war on Ukraine is the principal cause of the increases, and they do not appear to be going away soon. Neither do the other oil-producing countries appear willing to increase supply on world markets to offset the reduced supply from Russia. Rising oil prices mean more pressure on the Fed. Rising margin debt is another negative sign for the markets, as the debt must be repaid, usually at the most inopportune time – i.e., when securities prices are down.

Expanding virus infections are affecting China, which is bad for the global economy. With all the bad news affecting the global economy, it is a puzzle where and how to invest. An old adage says it is better to have time in the market than market timing. It has proven effective over the years. Some investors believe that a Santa Claus rally is possible. Sometimes December is in fact a good month for stocks. The strength of the market suggests this December might be good too, despite all the bad news. Perhaps this time bad news is good news. The Fed could pause its rate increases, which would encourage the markets. With no election to pressure the Fed, it might lighten its foot on the interest rate accelerator.

I believe the Fed will keep up its pressure, but not so much as to push the economy into a full-blown recession. However, fine-tuning policy to achieve this is usually only apparent in hindsight. A policy mistake by the Fed could cause a recession. I think there will be a mild recession sometime in the first or second quarter of 2023. Many things could change that scenario. Among possible game changers: a pause or change in direction for the Putin war, further stimulus by the executive or legislative branches, and a further indication of companies' earnings resilience.

For now, investors should own a well-diversified portfolio of quality stocks and maintain a long-term investment horizon.

William Rutherford is the founder and portfolio manager of Portland-based Rutherford Investment Management. Contact him at 888-755-6546 or wrutherford@rutherfordinvestment.com. Information herein is from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. Investment involves risk and may result in losses.

The opinions, beliefs and viewpoints expressed in the preceding commentary are those of the author and do not necessarily reflect the opinions, beliefs and viewpoints of the Daily Journal of Commerce or its editors. Neither the author nor the DJC guarantees the accuracy or completeness of any information published herein.