Brainard Scares Investors with QT

In Monday's Commentary, we wrote: *"Keep an eye on Fed speeches for any guidance on QT and closely track the market's reaction to such comments."* A day later, Fed President Lael Brainard delivered. Brainard discussed the pressing need to *"get inflation down*" in a speech on Tuesday. More pertinent to investors, she mentions QT and starting it *"as soon as our May meeting.*"

The market fell, as circled below, on Brainard's hawkish quotes. It wasn't necessarily the May start date concerning investors but more likely the pace of QT. Per Brainard: *"Given that the recovery has been considerably stronger and faster than in the previous cycle, I expect the balance sheet to* ***shrink considerably more rapidly*** *than in the previous recovery, with* ***significantly larger caps and a much shorter period to phase in the maximum caps*** *compared with 2017?19.*" For more on QT please read *Fed Liquidity Drain Is Coming*.



[dmc]

What To Watch Today

Economy

- 7:00 a.m. ET: **MBA Mortgage Applications,** week ended April 1 (-6.8% during prior week)
- 2:00 p.m. ET: **FOMC meeting minutes**

Earnings

- *No notable reports scheduled for release*

Market Trading Update - Consolidation Continues

After Brainard shook investors with comments about more aggressive QT, stocks and bonds both took a turn for the worse. However, despite the selloff, the market remains in consolidation above support and is beginning to work off the short-term overbought condition. This has been our expectation for the last few days, what we are watching for carefully is a break of support that would suggest a retest of March lows. We remain cautious currently.

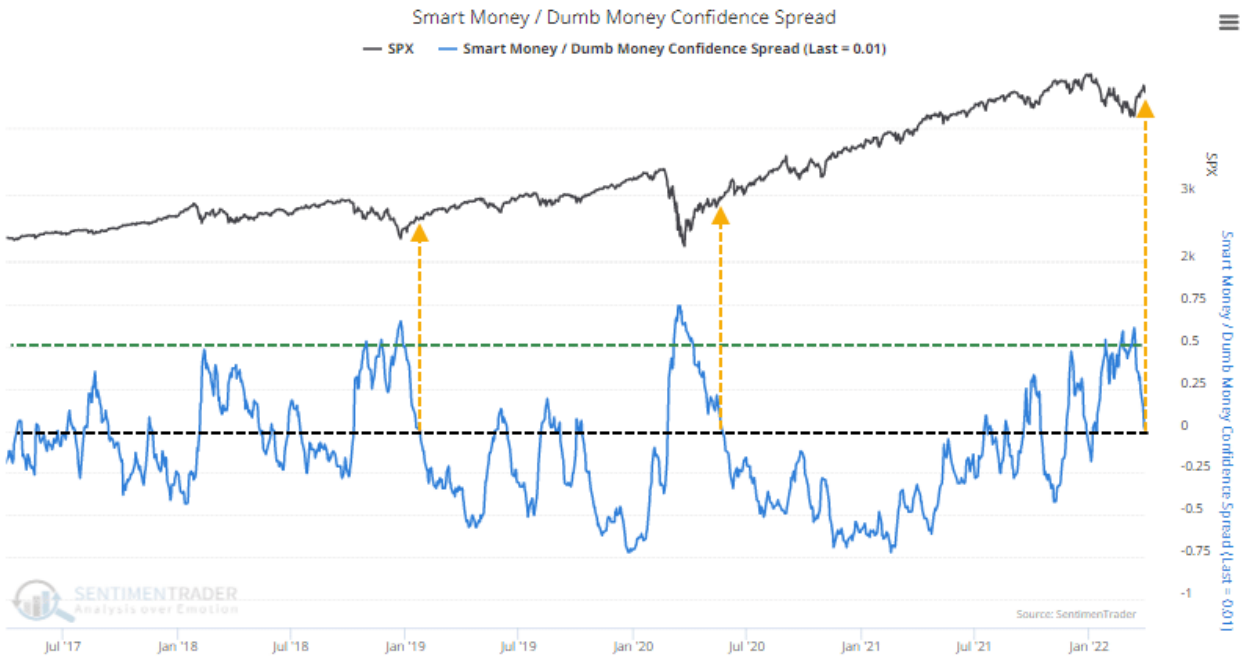


Dumb Money Takes Control

"For the first time in months, Dumb Money is about to be more confident than Smart Money that stocks will rally.

Starting in late February, Dumb Money Confidence was well below Smart Money Confidence, and the spread between them exceeded 50%. Essentially, that suggests that investors who tend to be most net long near market troughs were 50% more confident that stocks would rally over the next several months. The Backtest Engine shows that this does, indeed, happen about 82% of the time.

Over the past 5 years, the spread has gone back to neutral after a reading of 50% or great only twice." - Sentiment Trader



The Current Inflation Is NOT Putin's Fault

*"**While president Joe Biden and his administration call it Putin's price hike, the US Bureau of Labor Statistics reports that over the last twelve months, the all items index increased 7.9 percent before seasonal adjustment.** The reported twelve-month increase has been steadily rising and is now the largest since the period ending January 1982. The all items less food and energy index rose 6.4 percent, the largest twelve-month change since the period ending August 1982. The energy index rose 25.6 percent over the last year, and the food index increased 7.9 percent, the largest twelve-month increase since the period ending July 1981." - Mises Institute*



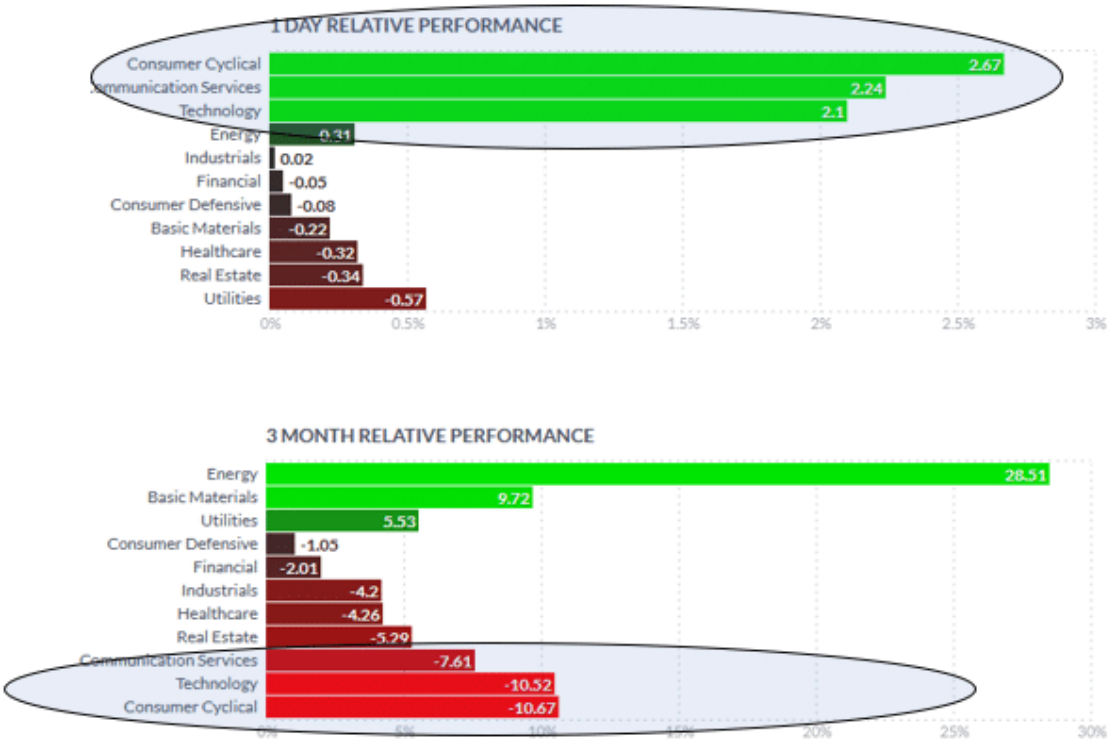
*"**When additional money is introduced into the economy as a result of increased government spending, it leads consumers to increase their consumption of final goods due to their increased money balances.** As demand for final goods increases,*

> *producers of final goods look to purchase more primary order goods and various other intermediate goods, whose scarcity then increases due to increased competition among producers, which leads to an increase in these goods' prices."*

Simply, free money isn't free. More importantly, if Brainard does get her way, she may soon find out what a *"Fed policy error"* looks like.

Sector Performance Flip In The Making?

On Monday, the S&P 500 rose nearly 1%, yet a large majority of the underlying sectors were lower on the day as shown in the top graph below. Interestingly, only three sectors are responsible for Monday's gain: Staples, Communications, and Technology. The second graph shows those sectors were the three worst performing sectors in the first quarter. Is Monday's action a new trend? Might it be a sign that inflation expectations are finally falling? If so, we should see confirmation in lower bond yields. However, the wide dispersion of returns and weak bond trading might just be the remnants of quarter-end rebalancing? Time will tell.

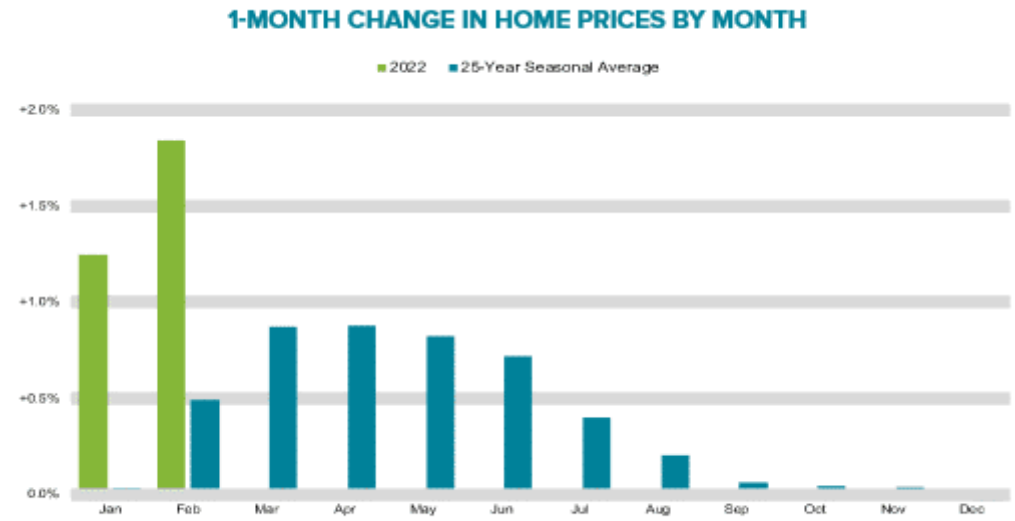


Mortgage Trouble Brewing

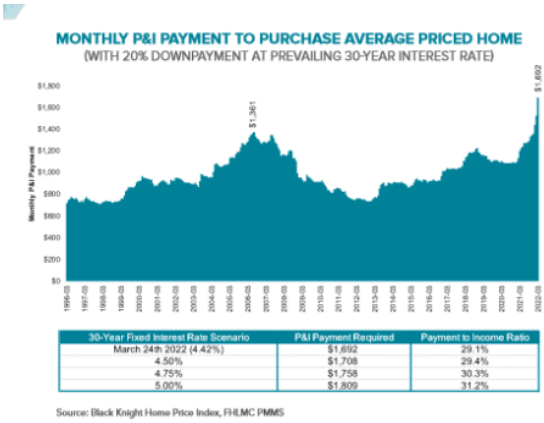
Black Knight's latest Mortgage Monitor points out some interesting facts about the housing market. For starters, *"the average home price has now increased in value by more than 34% since February 2020, **with appreciation continuing to reaccelerate** after a brief slowdown last fall."* The graph below shows that this year's change in home prices dwarfs historical monthly changes. We remind you that housing accounts for a third of CPI.

As we share in the second set of charts, home buyers are chasing prices higher, despite surging mortgage rates. In doing so, they are taking on more risks. The second graph on the left shows the monthly P&I payment for an average-priced home is now higher than in 2004-2007. Per Black Knight: *"it now takes 29.1% of median household income to make that P&I payment, up from 19.3% just 15 months ago."* The second graph on the right shows that the payment to income ratio

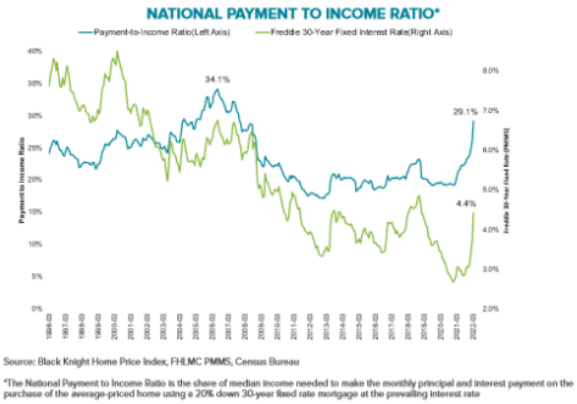
is the highest in the last 25+ years, excluding a brief period in 2006. The Black Knight report is found HERE.



Source: Black Knight Home Price Index



Source: Black Knight Home Price Index, FHLMC PMMS



Source: Black Knight Home Price Index, FHLMC PMMS, Census Bureau

*The National Payment to Income Ratio is the share of median income needed to make the monthly principal and interest payment on the purchase of the average-priced home using a 20% down 30-year fixed rate mortgage at the prevailing interest rate

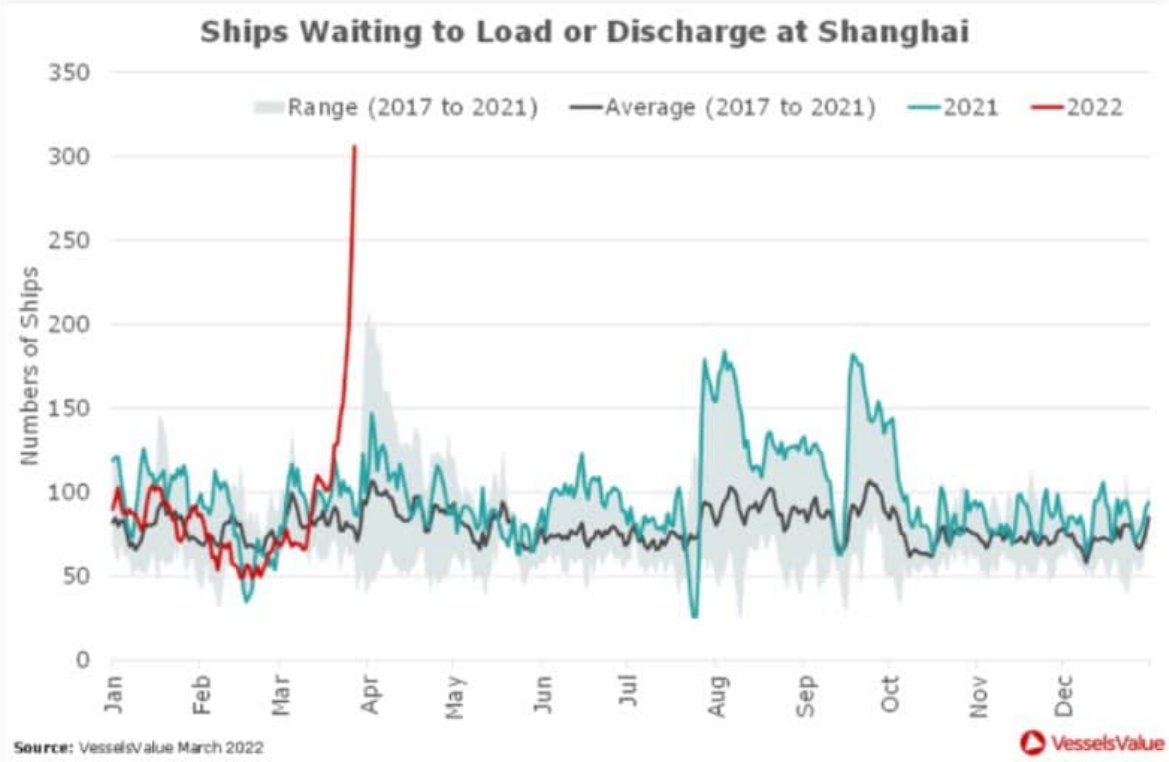
Trouble In Shanghai

Surging global inflation rates have been a function of stimulus-led demand and post-Covid economic recovery on the demand side and supply line shortages on the supply side. While demand and supply appear to be slowly normalizing, the graph below points to another brewing supply line problem. For perspective, consider the port of Shanghai is the world's largest port. Per Wikipedia-

> "In 2010, Shanghai port overtook the Port of Singapore to become the world's busiest container port. Shanghai's port handled 29.05 million TEU, whereas Singapore's was a half-million TEU behind. Shanghai handled 43.3 million TEU in 2019. Shanghai is one of only 4 port cities in the world to be categorized as a large-port Megacity, due to its high volumes of port traffic and large urban population." (*TEU or twenty foot equivalant unit is a standarzied in metal container used on ships trains and trucks*.)

Due to a new outbreak of Covid and a zero-tolerance policy, the city of Shanghai is shut down. While the port remains open, the lockdown significantly reduces traffic in and out of the harbor. Given the importance of the harbor in worldwide trade, this incident will prove to be yet another

factor reducing the supply of needed finished and unfinished goods throughout the world.



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