

Covid or Inflation... Which Will Last Longer?

Although both Covid infections and inflation may have peaked, we doubt either is going away. Inflation trends coupled with the Federal Reserve actions and our elected officials' political maneuvers will push and pull against each other, leading to another volatile year in 2023.

Inflation may be falling, but it is likely to remain stubbornly above the Fed's targets.

The Federal Reserve can slow the economy by raising interest rates, but their tools primarily affect demand. The Fed has no mandate nor tools to counteract supply shortages. Below, we show areas of short supply and posit various scenarios that could counteract them (most are far out in the future).

- **Shortage of workers**
 - Congress and administration can change immigration policy
- **Shortage of housing**
 - Can get fixed over time with housing construction
- **Shortage of energy and other materials**
 - Tax policy to encourage oil and gas exploration
 - Focus on nuclear as a clean option
 - More efficient battery storage to store solar energy
 - New technologies such as fusion
 - New oil field discoveries

These shortages create price pressures in major areas of the economy, and as long as they are unsolved, it will be difficult for the Fed to reach its 2% inflation target.

Both international and domestic politics may thwart the Fed's fight against inflation.

National security issues are front and center for the U.S. and other nations.

- **Countries and companies now want to manufacture strategic goods in politically secure domains.**

For the United States, this change generally means a higher cost of production. We have already seen it with semiconductor plant construction in Arizona and Apple moving part of its supply chain to Vietnam. We wouldn't be surprised to see onshoring of drug manufacturing.
- **China, Russia and Saudi Arabia are moving away from the dollar in international trade. A weaker dollar is inflationary for the U.S. economy.**
 - The Russian oil embargo and sequestering of Russian funds held in the U.S. has increased the Russians' inclination to trade in local currencies.
 - China and Saudi Arabia are setting up mechanisms to trade oil using the Yuan, signaling the end of the petrodollar and negatively affecting the role of the dollar as a reserve currency.



Political power plays in the U.S. House of Representatives will cause increased domestic policy turmoil.

- Kevin McCarthy, in order to be voted Speaker of the House, promised 3 seats on the powerful Rules Committee to the far-right Conservatives.
- If the debt ceiling isn't lifted in 2023, the U.S. government will not be able to pay its bills. The Rules Committee has tremendous power over this process, and the three new members want to use the debt ceiling deadline as leverage to cut spending. We could be looking at another scenario like 2011, where markets were disrupted while congress battled it out.

If these other forces impede the Federal Reserve's goal of reducing inflation, a recession is likely. Key market signals of impending recession have already occurred:

- The Fed, in keeping with its mandate, is unlikely to stop raising interest rates (and/or keeping them elevated) until inflation nears its 2% target *or something breaks*. Fed Chair Powell keeps Paul Volcker's book 'Keeping At It' on his desk.
- The yield curve has been inverted for some time with the 3-month Treasury bill yield well above the 10-year treasury note yield. In fact, the 3 month/10 year curve is negative 116 basis points, the deepest inversion since 1981 and a reliable recession indicator.
- Leading economic indicators, lower manufacturing activity, falling consumer confidence, and rapidly falling money supply growth all point to a recession.



To learn more about why an upcoming recession may be unique, listen to our latest podcast.

(Click on the link in Nest Egg! or listen on Apple, Spotify or wherever you listen to podcasts.)

Going forward...

- Markets bottom in recessions, often providing a good entry point for stocks.
- On the other side of a recession, we believe the drivers of performance will be different than the recent past.
 - If the dollar weakens as we expect, emerging markets may finally outperform. We like India.
 - Commodity stocks will continue to outperform due to world population growth coupled with underinvestment in new supply and the lack of alternatives. We like energy, nuclear, copper and fertilizer stocks.
 - Higher interest rates make growth stocks relatively less attractive, all things considered. We continue to prefer value stocks.
- Finally, the push of the Federal Reserve and the pull of inflation promises another volatile year with rotations only fun for traders...which we are not. While there is turmoil ahead, we will get through this and guide you and your portfolio on the other side.

Contact Us:

Lisa James

lisa@2xwealth.ingalls.net

212-269-7758

Lori Zager

lori@2xwealth.ingalls.net

212-269-7757

The material included herein is not to be reproduced or distributed to others without the Firm's express written consent. This material is being provided for informational purposes, and is not intended to be a formal research report, a general guide to investing, or as a source of any specific investment recommendations and makes no implied or express recommendations concerning the manner in which any accounts should be handled. Any opinions expressed in this material are only current opinions and while the information contained is believed to be reliable there is no representation that it is accurate or complete and it should not be relied upon as such. Investing involves risk, including loss of principal, and no assurance can be given that a specific investment objective will be achieved.

The Firm accepts no liability for loss arising from the use of this material. However, Federal and state securities laws impose liabilities under certain circumstances on persons who act in good faith and nothing herein shall constitute a waiver or other limitation of any rights that an investor may have under Federal or state securities laws.

2x Wealth Group is a team at Ingalls & Snyder, LLC, 1325 Avenue of the Americas, New York, NY 10019-6066. If you would like to unsubscribe, please [click here](#).



INVESTMENT MANAGEMENT
FOR WOMEN BY WOMEN

2xwealth.ingalls.net