Zanetti Monday Missive 2022.11.14
Ch-Ch-Ch-Ch-Changes

"Turn and face the strange."
~ David Bowie

Hello, Everyone!

Associating change and strange seems very appropriate doesn't it? :>)

Most people know (or sense) something is wrong. On the surface though, all seems somewhat normal. Covid panic is over. The stock market is rising. President Biden tells us the economy is strong. Treasury Secretary Yellin says inflation will soon be tamed.

Still, something nags.

Clients think/feel/sense something is off. They want to know "when" is all the "change and strange" going to manifest.

And since we at Zanetti Financial tend view the world through the lens of money, here is what is nagging from our perspective.

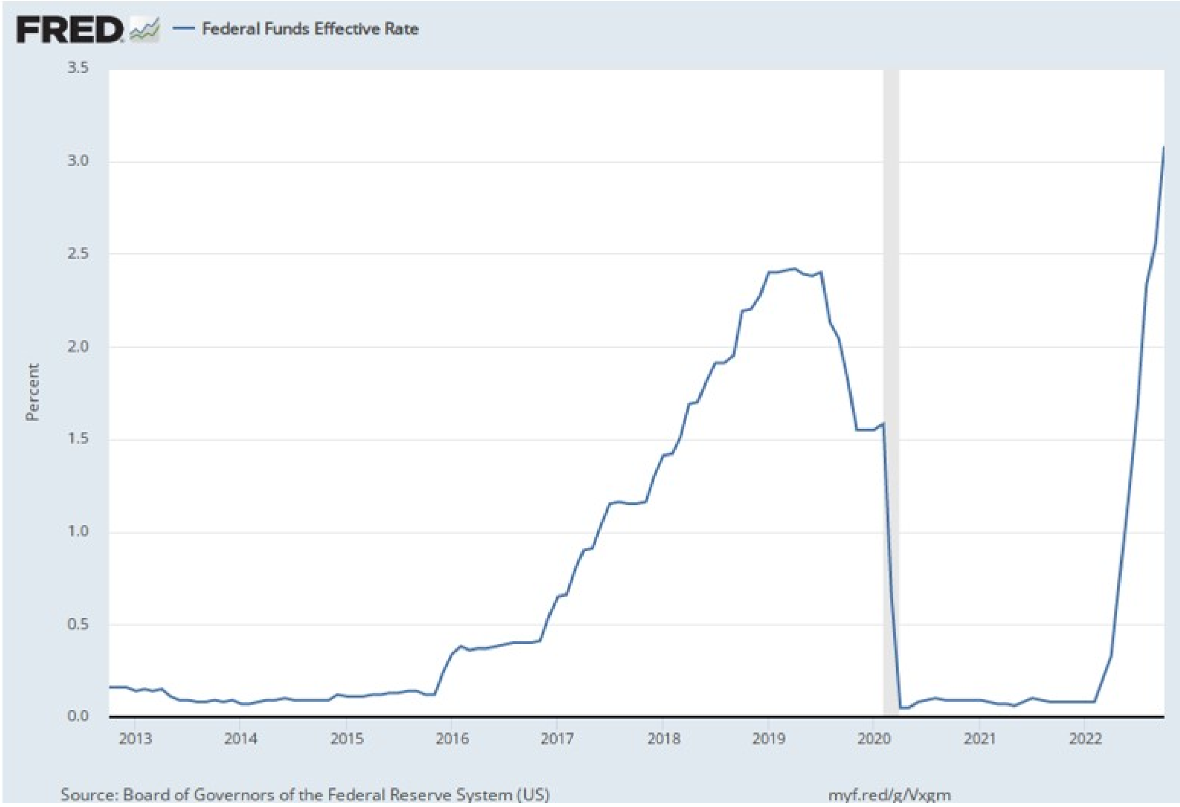
Recently we have opined how Fed Chairman Powell's rate hikes were acting like a wrecking ball in the world economy. The euro, yen, yuan, & pound are all unraveling in the wake of the rising dollar. Questions arise:

- How long can the US economy grow if our trading partners are all suffering?
- When will Powell's actions reverse and turn against the US economy?

For some answers, let's look at some charts. (Oh, the credit for much of what follows goes to Adam Taggert and Mike Maloney based on a podcast they did last week.)

This chart shows the percent change of the three-month Treasury bill (think of this in the manner of how fast did 3-month CD rates rise). **<u>It is a speed/acceleration chart.</u>** Never has a three-month T-bill rate moved so far so fast.

<u>Here is the main point. It is not that rates are rising…it is the rate of change that matters.</u>



Here is why rate of change is important.

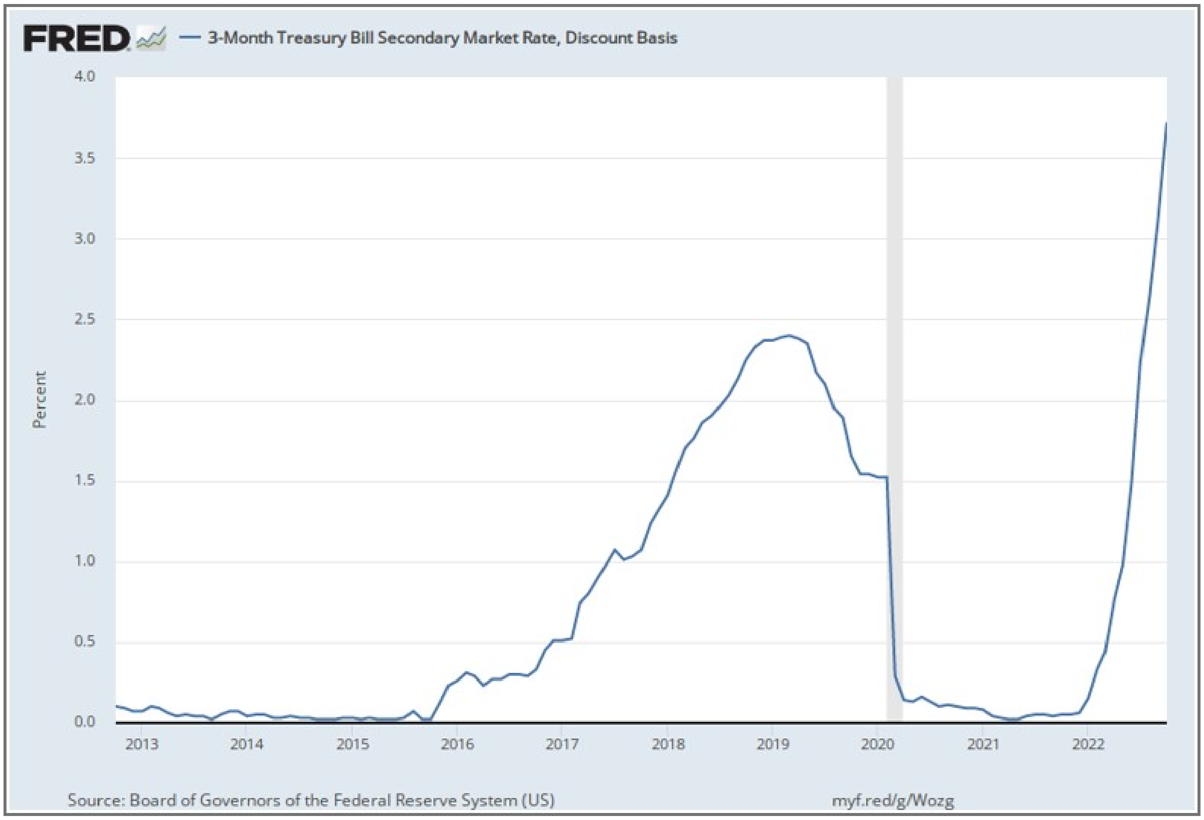
Suppose I gave you 50 hot dogs and told you you had 6 months to eat them all. No problem. But what if I told you, you had 6 minutes (!) to eat them all. And then I started shoving them down your throat. You would probably choke. Unless, of course, you are one of those professional Nathan's hot dog eaters, which most of us aren't.

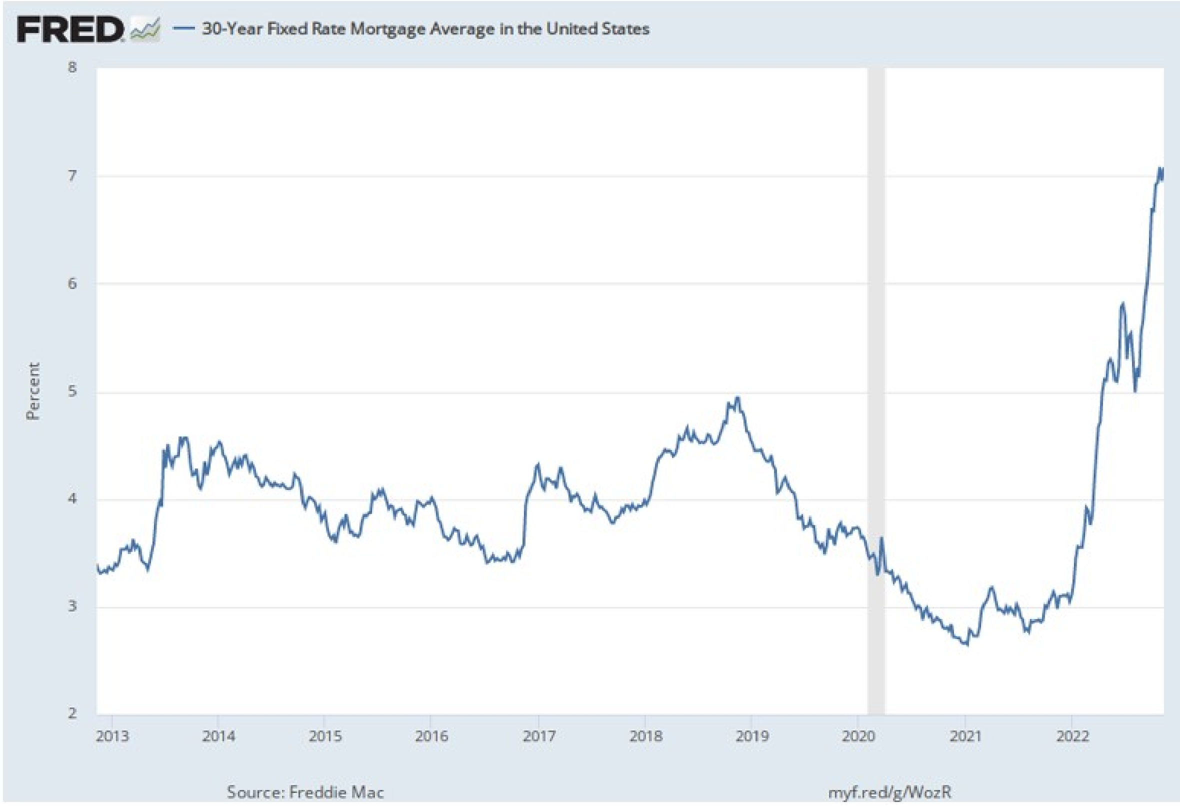
What Chairman Powell is doing is so fast and so intense, it is making the economy choke. More on that later.

The next two charts depict the Fed Funds Rate and the Mortgage rates.

The fed funds rate is the interest rate that banks, savings and loans, and credit unions charge each other for overnight loans. And you can bet that if banks are charging each other more, they are passing those costs on to their customers in the form of higher interest rates on things like credit cards, home loans, and car loans.

And, most of us are keenly aware of mortgage rates---where $1.3 trillion of home equity evaporated in the third quarter of 2022. Ugh.





The two charts above only go back 10 years, but these rate increases are eight times faster than any time since the Fed started tracking these numbers in the 1940's.

Fed Chair Powell's intent is clear. He wants to reign in the excesses of trillions of printed dollars. The "printing" began post Lehman in 2008-2009 and accelerated ($7 trillion in 20 months!) with the Covid crisis of 2020-2021.

All that cash acted like a drug in the financial system. And many were happy to get addicted. Now we are going cold turkey. I guess you can do that. But if you cut off an addict's drug too fast, the detox shock may kill him.

So, now we circle back to the question of, "When?"

Obviously, not yet.

The stock market is the midst of its yearly “Santa Claus rally” heading into year-end. The mid-term elections almost guarantee gridlock. That means government won’t get in the way of the economy for the next two years. The dollar stands supreme.

However, unlike an addict who will feel the cold-turkey effects almost immediately, the economy will adjust more slowly. There is lag time between event and consequence.

Historically, it takes around 9-12 months before the effects of the first rate hikes manifest in the real world. And since the big rate hikes occurred in 2022, we won’t experience the full brunt of the shock waves until 2023.

And remember, Powell didn’t do just one rate hike this year. He has done several. Fast. We will soon feel rate hike #1. And without knowing what the previous rate hikes will do, he is already promising more.

Let’s do one last analogy and call it a day….errr missive.

Let’s say you are walking down the road minding your own business. Your local high school football coach sees you walking about a mile ahead of him. He wants to slow you down. So, he tells one of his linebackers to catch up to you and tackle you.

Then, just for fun, two minutes later he sends another linebacker to ensure you’re stopped. Then, he waits two more minutes and sends a third. And then a fourth. And then a fifth.

If the first linebacker doesn't stop you, there is pretty good chance the second one will. But coach can't call back the third, fourth, and fifth linebackers. They are already on their way. Chances are you are going to end up a pancake in the middle of the road.

The Fed has unleashed the linebackers in the form of rate hikes.

Signed, Your Now-That-The-Elections-Are-Over-I'm-Remarkably-Happy-To-See-Car-Commercials-Again Financial Advisor,

Greg

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