Seventy2 Capital
Wealth Management

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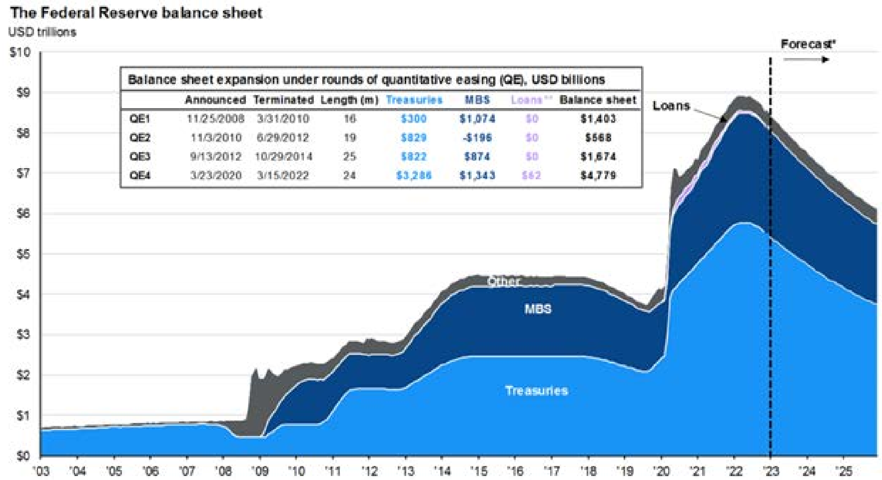
Market Commentary:
The End of Easy Money

It seems like we have been living through crazy times the last few years, but the larger abnormality may be the decade before it. At least from the sense of monetary policy. After the financial crisis of 2007-2008, when traditional measures failed, the Fed put forth what may be one of the largest economic policy experiments in the history of the US: Quantitative Easing. This tool includes large-scale asset purchases by the central bank of U.S. Treasuries, federal agency debt, and mortgage-backed securities. By taking these bonds off the market, it replaces them with cash, tremendously increasing the liquidity in the system. More money in the system means consumers and businesses alike can access capital at low (close to 0%) rates of financing. And so began more than a decade of "easy money."

This easy money environment which has allowed businesses to leverage up and consumers to increase spending has overheated the economy, causing the inflation problem we see today. We have already seen the Fed raise rates substantially over the last year, and although we have seen some disinflation (particularly in the goods sector), the latest reports on the labor market and inflation suggest that the Fed is not winning the battle fast enough. Getting down to their 2% inflation target seems nearly impossible. Rhetoric from Fed officials in the last couple of weeks has shown their frustration. They may be gearing up to enact even more aggressive policy. That means that we could not only be looking at a 50bps rate hike at the next Fed meeting (this was thought to be off the table over the last few months), but also a reversal of the monetary policy experiment they put forth over a decade ago: Quantitative Tightening.



Source: FactSet, Federal Reserve, JP Morgan Investment Bank, JP Morgan Asset Management. Data as of January 31, 2023.

A rapid reduction in the size of the balance sheet will reduce the liquidity available in markets. It will likely cause some things that are bent to break. This would likely be a shock to financial markets and could flow through in many forms; it could mean a rapid rise in consumer financing rates (mortgages, auto loans, personals loans) as the well of capital runs dry and individuals must pay more for liquidity that remains. It may mean more bankruptcies or credit events in corporate America. We have seen some of this earnings slowdown already, as many Fortune 500 companies have lowered their forward guidance on the top and bottom lines.

Within portfolios, we recommend staying defensive in this volatile market and not chasing names that have appreciated substantially to start the year. We favor allocations to energy, financials, and healthcare with a focus on profitability, cash flow generation, and lower debt ratios. Now that the era of "easy money" has ended, an active eye on individual companies becomes even more important. Passive indexing has experienced its best decade on record, something unlikely to continue going forward in this new environment we find ourselves in today. Nonetheless, we find ourselves on the cusp of a new age in America – innovation is thriving at a pace we have never seen before. Between the application of artificial intelligence, advancements in genomics, and the implementation of automation to new and old industries alike, there is a tremendous amount of opportunity for investors looking forward.

As always, please do not hesitate to reach out to your financial advisor with any questions or concerns.

-The Seventy2 Capital Team
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