Argent Capital Management LLC

RE: INVESTMENT COMMENTARY FOR PERIOD ENDING DECEMBER 31, 2022

FROM: ARGENT CAPITAL MANAGEMENT

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"When the Fed jams the brakes,
someone goes through the windshield."
- Wall Street Adage -

The over-riding theme for 2022 was inflation, for as Will Rogers noted, "Letting the cat outta' the bag is a whole lot easier than puttin' it back in." As a result, it was a poor year for investors, with negative returns for stocks, across the board. There were China headwinds, supply chain issues, the largest conflict in Europe since the end of World War II, a crypto-market meltdown and dramatically higher energy costs.

Amidst it all was *inflation*, and the need to unwind some of the expansive fiscal and monetary policies of the Covid era (2020 – 2021). For its part, the Fed is attempting to do something it has not had to do in years - increase interest rates (which removes excess liquidity from the economy) to slow inflation without causing a severe recession.

It is fascinating how quickly the Fed had to pivot in early 2022. Just thirteen months ago, the Fed was still adamant that inflation was "transitory," a passing fad. Against a growing crowd of doubters, they, as recently as December 2021 predicted ***no*** interest rate increases for the 2022 year. One is reminded of the Scotch-Irish prayer, "Lord, grant that I might always be right, for thou knowest I am hard to turn."

"It's just a correction. The fundamentals are still good."

To their credit the Fed did turn, and with such vigor that by year-end 2022 seven increases to the Fed Funds Rate had occurred. That is 4.25% of interest rate increases in aggregate, taking it to its highest level in fifteen years, and additional increases seem to be on the way. So, the issue as we enter 2023 is what will it take for the Fed to curtail their current aggressive interest rate stance?

For the Fed, there are three components to watch relative to cooling economic growth and reducing inflationary pressures.

- First, the Fed wants to see evidence that the price of *goods*, such as those for cars, furniture and appliances, is slowing. Indeed, data over the past six months indicates some slowing is occurring, with the second-half 2022 decline in commodity prices particularly telling.
- Second, the price of *services*, which is reflected in such items as the cost of health care, dining and travel, needs to see a significant slowdown. Again, there seems to be progress on this front, but there is clearly a ways to go.
- Finally, the Fed would like to see *unemployment* rising, an unpleasant medicine for the labor market which they consider necessary to reduce pressures for wage increases. We are indeed seeing some layoffs in the tech world, but jobless claims remain stubbornly low.

"My broker jumped out a window, but that's small consolation."

In summary, there is good news, although not enough to get to the low inflation levels ultimately desired and thus, creating a conundrum for the Fed. They know their actions take months, sometimes years, to reflect their full impact. As they read the tea leaves for the future, how do they guard against easing (reducing interest rates) too soon, versus being overly restrictive (increasing interest rates) and creating a deeper recession than necessary? It is, to say the least, not an easy task. And that is why it will likely be the big story for 2023, as the Fed walks the tightrope between *too much* and *too little*.

We are prone to viewing most glasses half-full, and, indeed, we see this one that way. However, we are oddly in a market where bad news is good news, and good news is bad news. If unemployment goes up, it is bad news for those losing their jobs, but it demonstrates to the Fed that their actions are working and that further interest rate hikes may be unnecessary. Thus, good news for the long-term health of the economy. Likewise, for corporate earnings. If they stagnate or decline, it is bad news for the business, but good news for the Fed and future inflation figures.

We see this good news bad news convolution lasting for some time, perhaps the entire year. However, markets tend to turn upward long before positive news is reported, so the guessing-game now is when investors will have confidence that stock prices have declined far enough to look attractive for investment.

Peter Lynch of Fidelity fame says, "The key to making money in stocks is not to get scared out of them." He knows equity markets cannot be timed and that the future is not predictable. Markets tend to be manic depressive, it is often either feast or famine, and markets do move quickly. Thus, by the time the news is getting better, markets have usually already recovered. Many today who hold cash equivalents probably

feel comfortable. Our advice – don't. History tells us stock markets periodically give us twenty to fifty percent off sales, and such a sale is currently occurring. The sale will continue . . . until it doesn't, and no one knows when that will be. The year 2023 will certainly have both disturbing and exhilarating news, including some in areas we have not even thought about. However, knowing markets bottom before news gets better means we will keep it simple and stay invested for the inevitable rally to come.

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