CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

April 10, 2022

A Difficult Beginning

Can the war get worse? Probably.

This year will long be remembered as a truly awful one. For the first time since the Second World War, a war on European soil began. As the weeks since the February 24th invasion pass, we learn of the increasingly horrific toll that Russia imposes on Ukraine, its innocent civilians, its cities, hospitals, homes, train stations, theaters and more. One can only admire the resolve, ingenuity and spirit of Ukraine; will it be enough to prevail against Mr. Putin's destructive impulses? In Chechnya, in its second war from 1999 to 2009, Russia dealt very harshly with civilians and the rebels. In Aleppo and elsewhere in Syria, during Russia's actions in the middle of the last decade, many civilian areas, including hospitals, were subject to missile strikes from Russian forces and the formidable city of Aleppo was largely destroyed. Many of its unfortunate residents were killed; others we displaced from their homes. This appears to be Mr. Putin's strategy in his new adventure. As Pope Francis asked today, what does Russia gain from planting its flag on the ruins of Ukrainian cities?

Ukraine has been a significant supplier of wheat, other food products and many important minerals to the rest of the world. Russia's invasion has cut off planting of this year's intended wheat harvest. Its actions on Ukraine's Black Sea ports have essentially stopped the export of much-needed products to the rest of the world. This leads to significant shortages of grain in Africa and the Middle East and heightens already high inflation in food and other products for all of us.

The Fed becomes aggressive in its rhetoric.

From this flows the increasingly strident rhetoric from the highest-ranking officials at the Federal Reserve, declaring that monetary tightening will be significant this year. After characterizing inflation as transitory for much of last year, Fed governors have come to recognize that, at the very least, they must promise rapid and firm action to address this. Recent inflation reports show prices rising at levels not seen for several decades. Anyone buying food or putting gasoline in a car observes this. Even 'doves' on the Fed (those generally in favor of loose monetary policy), including Lael Brainard, who soon will be the Vice Chair of the Fed, have spoken very recently of the need swiftly to raise the short-term rates controlled directly by the Fed and swiftly to reduce the Fed's balance sheet. Recall that, to counter the shut downs of March and April 2020 that arose from the pandemic, the Fed vastly increased its buying of Treasuries and mortgage-backed securities. Now, according to Fed governors, the holdings by the Fed will shrink, as maturing securities 'roll off' without replacement purchases of other securities and, perhaps, by outright sales of its existing holdings.

By

Jack Mayberry

Some history: After the (so-called) Great Financial Crisis of 2008 and 2009, the Fed, under then-Chair Ben Bernanke, began the process of Quantitative Easing by purchasing more Treasuries and mortgage-backed securities, increasing its holdings from about $800 billion to about $4 trillion. Under Janet Yellen, who succeeded Mr. Bernanke as Fed chair, and then under Mr. Powell, who succeeded Ms.

Yellen, the Fed attempted in the last decade to reduce its holdings. After Mr. Powell's declaration in December 2018 that the Fed's decrease of its holdings was on 'auto-pilot,' the 20 percent decline in the S&P 500 that autumn into late December put an end to that. The 'Powell-pivot,' as it has come to be known, put a swift end to Fed monetary tightening and, within some months and the 2019 'repo crisis,' led straightway—pre-pandemic— to another round of Fed monetary easing. The Fed's holdings of securities now total $8.9 trillion.

Bill Dudley, the high-ranking former Fed official explains what lies ahead.

Telling commentary comes from Bill Dudley, president of the Federal Reserve Bank of New York—the most important one—from 2009 until 2018 and vice chairman of the Federal Open Market Committee. (Mr. Dudley is now a private citizen.) This is a man who knows the Fed, knows what it does, and knows what he is talking about. He has made the point in his recent writings on Bloomberg and in interviews that the Fed will need to tighten monetary policy considerably in order to bring inflation down to appropriate levels. The effect of tighter monetary policy will necessarily be an increase in unemployment and lower stock market prices.

In December 2018 and January 2019, after the 20 percent decline in the S&P into Christmas, Mr. Powell changed course—the 'Powell pivot'—and loosened monetary policy. This leads many to believe that the Fed will not be able to tighten monetary policy as now forecasted by Fed governors and expected by financial markets. This has been my view. But, as I read Lael Brainard's recent speech and Mr. Dudley's essays, and listen to Mr. Dudley's interviews, I come to the view that, because inflation is so high, the Fed must and will keep tightening in the coming year so as to prevent the persistent levels of inflation that we endured in the late 1970s and early 1980s. Paul Volker brought inflation down then, but only by virtue of two deep recessions in the early 1980s. Such may lie ahead. Mr. Dudley suggests that this will be the outcome. We shall learn in the fullness of time.

Core's investments. Given the factors discussed above, you will not be surprised to read my report that this has been a very difficult investment period. As the year began and before Mr. Putin's misadventures in Ukraine, I anticipated a bad period for the stock market, because of its extremely high valuations and because of the Fed's plan to tighten. We held small positions in equities, but rather larger positions in high-grade long-term bonds, including US Treasuries. As the Fed sharpened its rhetoric, our bond positions declined in price. We have sold some 60 percent of our positions in Treasuries since the year began, but have still sustained losses, as you will see from our quarterly reports. We have taken a small position in a commodities fund, on the notion that commodity prices will rise further as the war grinds on. There is the (hoped-for) possibility that Germany and other European countries will stop buying Russian oil and gas. We have also made an investment in a US oil pipeline fund, offering very stable and high dividends. Under consideration is an investment in Canada, a substantial producer of wheat and also of oil and other minerals that Ukraine has supplied. On a happy note, our utilities investment has gone from strength to strength and stands at an all-time high, with a meaningful dividend. Similarly, our investment in gold has risen well this year.

We have a very large position in cash and short-term bonds. This is 'dry powder,' to employ a wartime metaphor. My expectation, whether following Mr. Dudley's line of thinking or the 'Powell pivot' outcome, is that we will, before too long, be offered investment opportunities at lower and at much more favorable prices than now prevail. Despite the investment difficulties of these first months of 2022, very good offerings will be available to us as the year goes forward.

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