CETERA® INVESTMENT MANAGEMENT

COMMENTARY

May 18, 2022

This Market Volatility Isn't Going Anywhere

- Market volatility continues as financial markets watch earnings, economic data and the Fed.
- Concerns about the consumer and corporate profits drove today's drop.
- Our base case continues to be that the economy can withstand these headwinds.

Today, equities had one of their worst selloffs since 2020. Triggering this pullback was a disappointing earnings report from a major retailer. In the report, management commented that unexpectedly high costs (including freight and transportation), inventory impairments, and markdowns to address lower discretionary product sales would hurt profit margins going forward. Investors took this as a sign that corporate profits, especially in the retail sector, would struggle on elevated inflation and weaker consumer spending. While we agree that consumer spending will shift, and likely weaken to an extent on these worries, we do believe that the fundamentals for the consumer remain solid and this is a possible overreaction.

The consumer is so important to our economy as it represents about 70 percent of economic output. Headwinds from a more aggressive Federal Reserve (Fed) and higher borrowing costs will impact the consumer. However, the consumer is coming from a solid fundamental base, as noted in a once-in-a-generation strong labor market, low debt-to-income levels, and still-elevated savings levels.

Evidence has emerged that consumers are starting to change their spending habits on elevated inflation levels and higher borrowing costs. However, there is so much positive evidence to the contrary. For example, yesterday's April retail sales report showed proof that the consumer remains resilient in the face of these headwinds. Not only was March's data revised upward from 0.5% to 1.4%, April's report also showed strong sales throughout. For example, at auto dealerships, consumers are buying cars and they are now better able to find them as the auto industry's parts shortage is showing clear signs of improving.

While the April retail sales report is just one indication that the economy is fundamentally solid enough to withstand an aggressive Fed trying to rein in inflation, there is other evidence to support this. For example, on the economic front, the continued rebound in manufacturing, helped by supply chains improving and companies striving to rebuild depleted inventories, and the surge in business equipment investment helps our base case that a 2022 recession is not in the cards. On the inflation front, we are seeing some moderation in goods inflation and a pick-up in labor force participation levels that should help continue lessen wage growth pressures. Potentially less inflation pressures may lead to the Fed being less aggressive than the markets currently anticipate. If the Fed proves less aggressive, the impact from higher interest rates on the economy might be less.

Overall, like the Fed, the financial markets are watching data very carefully to gauge how fast monetary stimulus can be removed. We remain committed to our base case that the economy and financial markets are facing headwinds, such as higher borrowing costs, but the economy is strong enough to withstand the shock of higher rates. Yes, it will be difficult and the daily slew of economic data and earnings reports will create bullish optimism and bearish fears driving market swings like today. But, we remain confident that an economy coming off of a very strong economic base, a still-strong consumer experiencing a once-in-a-generation labor picture, and overall supply chain improvement and strong business spending will help support a rebound in inventory rebuild production. It is important to work with your Cetera financial professional through this volatile market and to ensure your risk tolerance is aligned with your allocation. While we don't recommend timing the market, history has shown that a deep market correction can potentially offer a good long-term entry point, particularly for investors than have remained on the sidelines.

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