Strategy

JefMacro Weekly—Alternative Realities; Stagflation out, Goldilocks in

August 6, 2022

Key Takeaway

GREED & fear sees markets ignoring recent data not positive for the peak inflation narrative. Maintains base case of a more pragmatic Fed approach to the 2% target in medium term. Aneta says time to scrap the recession narrative and replace it with "stronger for longer." Sherif is inclined to sell rally eventually but would be patient for now as he expects both growth and inflation concerns to reemerge. Global Strategy sees more downside to growth assumptions.

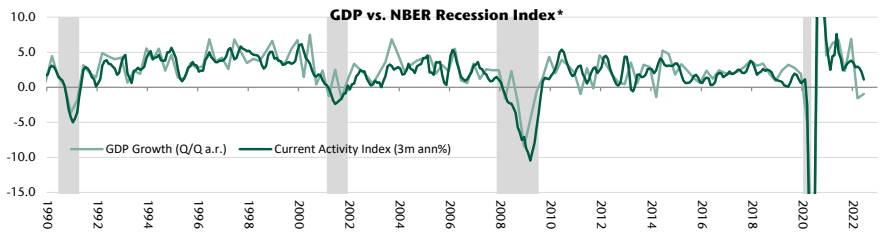
GREED & fear—Markets are completely ignoring recent data, which is not positive for the peaking-out-of-inflation story. While we may have seen the peak in inflation, at least near term, it hardly signals a Fed victory over inflation. The key medium-term issue remains whether the Fed really intends to try and get inflation back below 2% or whether it will in due course signal a more pragmatic/flexible approach to that 2% target. The latter is still GREED & fear's base case, but it is too premature for such an admission right now.

Aneta Markowska—It's time to scrap the recession narrative and replace it with "stronger for longer." Stagflation is out, Goldilocks in. We believe there is a persistent component to inflation from housing and labor shortages, which will not be resolved soon. We expect these two forces to put a floor under core CPI around 4%. But, commodity prices and supply chain issues are vanishing, and will cause headline inflation to slow sharply in the next 3-6 months. This should still allow the Fed to slow the pace of hikes to 50bps at the September meeting.

Sherif Hamid—We think the squeeze is likely to continue, thus we wouldn't be inclined to sell the rally yet. Still, as valuations compress and sentiment/positioning continue to normalize, we think the risk/reward of credit is getting worse. Unless something dramatically changes as to the Fed liquidity withdrawal cycle or the inflation picture, we expect both growth and inflation concerns to reemerge as we move into 4Q. With that view in mind, we will be inclined to sell this rally eventually, we would just be patient.

Global Strategy—The question is whether bond & equity markets have priced in the worst of the rout in growth and policy tightening required to quench the inflation. Probabilities suggest that there is more downside to growth assumptions, but the rate of inflation is set to decelerate. Earnings estimates are still to be cut, but the bond rally has put a floor on valuations, at least temporarily.

Despite two back-to-back GDP declines, this does not look like a real recession



Source: Haver, JEF Economics. *Average 3m annualized groth rate of the 6 coindicent activity meaasures used by the NBER's Business Cycle Dating Committee.

JefMacro

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^Prior trading day closing price unless otherwise noted.

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