Mesirow

Capital Markets Brief

Blake Anderson
Senior Managing Director
Institutional Sales & Trading

Bing Hsu
Senior Vice President
Institutional Sales & Trading

Mark Whitaker
Managing Director
Institutional Sales & Trading

S&P 500
QTD: -4.89% | YTD: -23.88%

Treasury 10Y
QTD: -5.95% | YTD: -17.29%

Muni AAA 10Y
QTD: -2.98% | YTD: -13.12%

DXY
QTD: 7.10% | YTD: 17.19%

Dow
QTD: -6.17% | YTD: -19.72%

NASDAQ
QTD: -3.91% | YTD: -31.99%

Euro Stock 50
QTD: -2.96% | YTD: -19.83%

Bloomberg APAC
QTD: -10.78% | YTD: -25.84%

Introduction

The third quarter of 2022 has been one of persistent anxiety for investors, a global community that traditionally seeks, and rewards, stability. Decades-old norms for sovereign borders, political rectitude, price-efficient energy markets and politically modest central bank behavior have been overturned.

Regular readers of this Brief will have been prepared for market volatility in 3Q22, as markets strain to price inflation, interest rate risk, global macro political risk and volatility/liquidity premia into their price structures. Investors got the full measure of those concerns in this quarter.

In a timely piece of research, the NY Fed paper (R**) presented on September 26th highlights the concept of financial instability potentially standing in the way of the Fed's pursuit of the "natural real interest rate" after a long period of nominally low rates, as we have experienced. In layman's terms, the paper theorizes that financial instability manifests itself *before* Fed interest rate moves raise rates to an inflation-neutral level.

This is not to bog our readers down in financial minutia, but to alert investors to this emerging structural phenomenon. Our readers know that we believe the actions of an overly accommodative Federal Reserve Board have distorted economic balance. The risks of reversing years of excess monetization and Fed balance sheet expansion have embedded risk into their use of traditional tightening (inflation fighting) disciplines. We believe that this R** is worthy of more focus from capital markets professionals.

"Just like the natural rate of interest provides a benchmark for monetary policy in terms of macroeconomic stability, r** is meant to provide a benchmark for financial stability: if the real rate in the economy is at or above r**, the tightness of financial conditions may generate financial instability. Like the natural interest rate, the financial (in)stability real interest rate is state dependent: it evolves with the conditions of the economy, and in particular with the degree of imbalances in the financial system."

"We show that as the banking sector becomes more leveraged, the financial stability interest rate becomes lower. This has implications for monetary policy, in that even relatively low levels of the real interest rate could trigger financial instability."

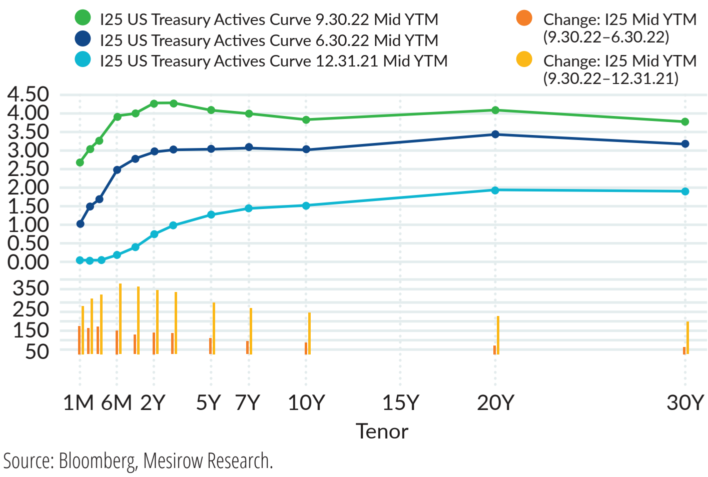
– Akinci, Benigno, Del Negro andt Queralto NY Fed 11.20*

*https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3727406#

In short, the Fed may have boxed itself. If wage inflation persists, if energy inflation persists, and if core inflation measures continue to flirt with 5%, the Fed is likely facing a Hobson's choice: risking systemic financial instability or fighting inflationary pressures successfully. The much longed-for "soft landing" is growing harder to achieve.

The Treasury curve inverted further, with 3-month T-bill yields rising 162bp versus plus 60bp for the 30-year. The July rally, a classic whipsaw, added blood to the water as many professional investors took the bait and chased temporarily falling yields. If the Fed finds itself boxed by signs of market instability, experienced investors should be alert for the following: nominal rate hikes on the front end of the curve and (as quietly as possible) Quantitative Easing on the long end to re-inject liquidity into a nominally tightening financial system. A flatter (more inverted) yield curve is the obvious result of a move like this. However, the principal result will be market confusion over "mixed signals" and a very negative reassessment of the Fed's real inflation-fighting bona fides. This scenario would not play out well for capital market investors in search of stability. It is never healthy to drive capital market professionals into an obviously conflicted choice: "Fight the Fed" or ignore the economic fundamentals. This is a recipe for market volatility.

CHART 1: **TREASURY ACTIVES CURVES FOR 6.30 & 9.30**



Source: Bloomberg, Mesirow Research.

Underlying all this turbulence is the specter of inflation, both real and imagined. The energy price spike has been real enough. Russian expansionist aggression ran right over European Community energy policy dreams. Western Europeans, most notably Germany, built their energy future on an inherently unstable Russian natural gas foundation. Implicitly, they constructed their geo-political defense strategy upon that same foundation, leaving them next to no effective leverage when Ukraine's border was violated February 24th. While Brent crude has dropped 22% over the period, German delivery natural gas increased 48%. The sabotage of the NordStream2 pipeline, if in fact carried out by the Russians themselves, represents the act of an autocracy that has abandoned political, social, and economic norms in desperate pursuit of regime survival. It serves as just one of many examples of commodity risk.

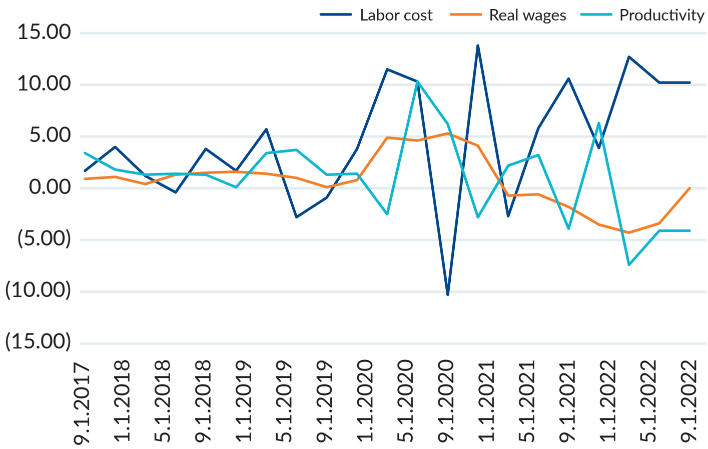
The war-restricted delivery of Russian and Ukrainian grain drove a mid-summer spike in grain prices, since modestly eased, thus building additional inflationary pressure into consumer prices.

While commodity prices capture the headlines, and more importantly, drive consumer inflation expectations, labor market wage pressure is likely to become a market force that does not quickly self-correct. Households experiencing declines in real wages during the second and third quarters will be pushing, individually and through their unions, for relief in the form of aggressive wage demands. For a real-world supply chain example, US national rail unions flexed their bargaining and political muscle, with help from the White House, threatening the fragile post-pandemic supply chain and making demands that the Secretary of Transportation pushed the rail carriers to meet. The result was an immediate 14% increase compounding to 24% through 2024, with annual $1000 cash bonuses. This settlement creates a generous inflationary model for organized labor contemplating the next contract cycle.

So, while the visible commodities like oil, steel and lumber have corrected to trading levels below their 50, 100 and 200 day moving averages, as efficiently discounted markets should, labor markets will struggle to price post-Covid wage pressure. Natural gas, given its current supply and distribution challenges, will continue to drive inflation, as will its derivative, electricity. A steady news diet of battlefield video from Ukraine, gasoline and diesel price updates and stories of cold homes and dark factories in western Europe (and at home) will keep investors on edge as markets price the bad news in real time.

But wage pressure, embedding itself into the economy while hiding in plain sight, demands the closest scrutiny. The chart below supports our concern. The 3-month real interest rate, hand calculated at -5.4%, remains remarkably accommodative. 1-year and 10-year real rates at +1.365 and +.71% respectively are hardly the strong anti-inflationary medicine of the Volcker era.

CHART 2: **LABOR COST, REAL WAGES & PRODUCTIVITY YOY**



Source: Bloomberg, Mesirow Research.

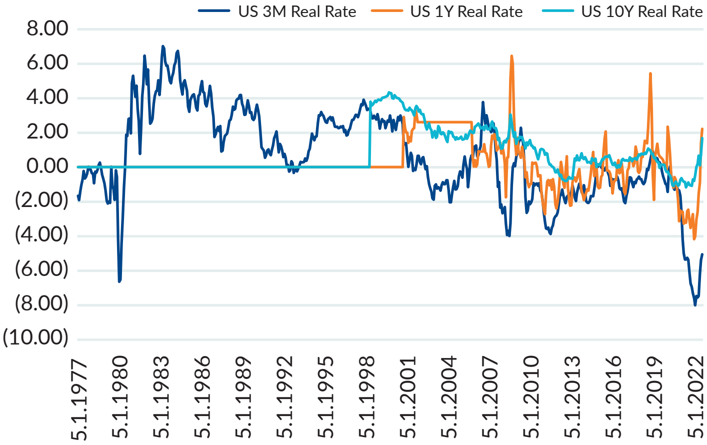
Nominal unit labor costs have been rising dramatically since 3Q20, while the growth rate for Real Weekly Earnings has been falling over the same period. More ominously, the trend for Real Wages turned *negative* in 2Q21. So, as difficult as it is to set aside goods and services inflation rates at current inflation levels, households are feeling a squeeze in actual purchasing power *before* they fill the gas tank or home heating oil tank, buy groceries, or pay an electric bill that has nearly doubled in many states.

Against this backdrop of spiking food and energy prices, labor productivity is falling; the last three measures being -7.3% in June, -4.6% in August and -4.1% in September. Rising nominal wage costs in the context of falling productivity and diminished *real* purchasing power makes a bitter economic cocktail going into a midterm election cycle.

So, the economic stability that investors crave is likely to be out of reach for several quarters. Yet, capital markets continue to price in a relatively modest Fed tightening cycle. Given the post-pandemic labor markets, supply chain dislocations, post-Russian invasion turmoil, highly disrupted energy markets and extremely uneven Fed performance, wise investors will remain cautious, pricing volatility and liquidity premia conservatively as they invest opportunistically.

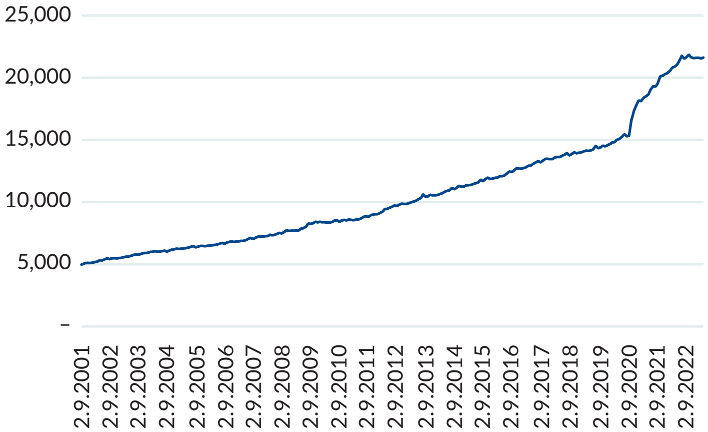
There is nothing simple about executing this one sentence strategy. Whether the risk of rising rates is expressed in duration aversion in the capital markets, or as cap/discount rates in the real estate or equity markets, the geo-political risks inherent in "shorting" a commodity are as potentially ferocious as being long. Imagine a short Treasury position should Russia launch a tactical battlefield nuclear weapon toward an arms depot along the Polish border. Consider, *very carefully*, the fiasco in the Gilt markets last week, as derivative leverage spiraled into a liquidity panic, while collateral calls induced forced selling, the classical negative feedback loop. The current market environment remains treacherous.

CHART 3: **US 3M, 1Y & 10Y REAL RATES**



Source: Bloomberg, Mesirow Research.

CHART 4: **US M2 (BN)**

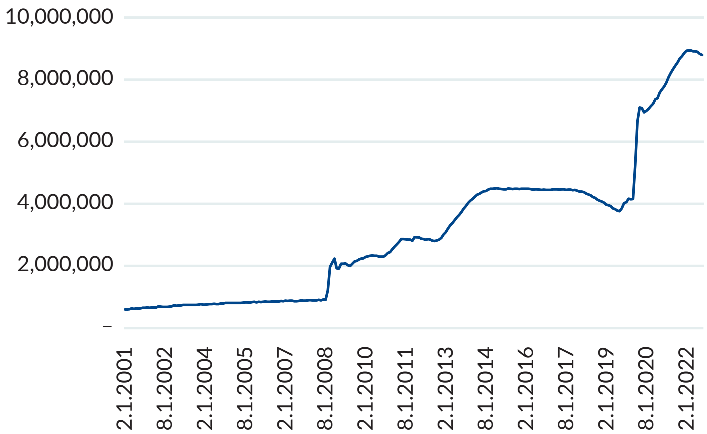


Source: Bloomberg, Mesirow Research.

While the investing public monitors the daily interest rate chatter on business television, professional investors are trying to divine how much excess monetary liquidity is already built into the global monetary system and how it will be safely unwound. The M2 money supply chart (Chart 4) is a Milton Friedman nightmare expressed as Federal policy. Keynesians would be inclined to offer facile explanations for an acceptable level of risk.

But the real monetarist's horror is the unprecedented and opaque expansion of the Federal Reserve Balance Sheet (Chart 5). How much leverage has this $4T+++ liquidity torrent added to the financial system? How will it be safely drained in the current volatile and potentially fragile market environment?

CHART 5: **FED BALANCESHEET (MM)**



Source: Bloomberg, Mesirow Research.

Charts 4 and 5 highlight the challenge that the Fed created for itself when it deviated from its traditional inflation fighting metric in August of 2020. Having given itself a wide degree of discretion in interpreting its own traditional inflation signals, the Federal Reserve Board quickly found itself well behind the inflation curve. In losing the high ground on inflation expectations built into the economy, the Fed lost control of the interest rate narrative for the first time since the 1979 Volcker-led rate cycle.

With inflation soaring to levels not seen in decades, the Fed is still accommodative.

CHART 6: **PPI YOY**

Source: Bloomberg, Mesirow Research.

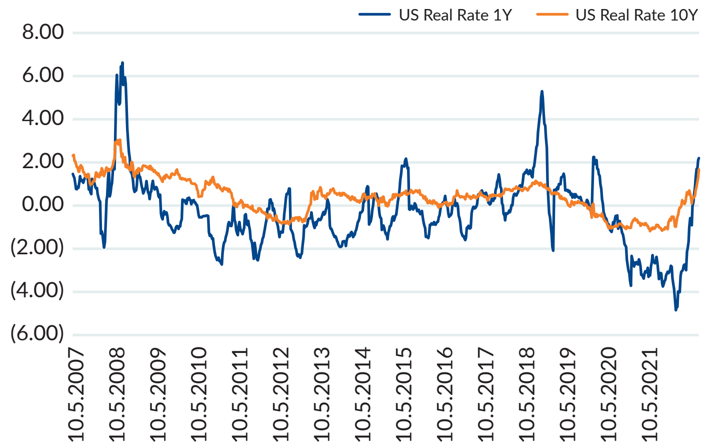
Inflation numbers, while declining, are still at levels not seen since the post-Vietnam, pre-Volcker era. While PPI and CPI numbers have routinely shocked economists and professional investors throughout 3Q, real US households are forced into very tough kitchen table choices as inflation erodes purchasing power while leaving real wages and American families behind the curve.

CHART 7: **CPI YOY**

Source: Bloomberg, Mesirow Research.

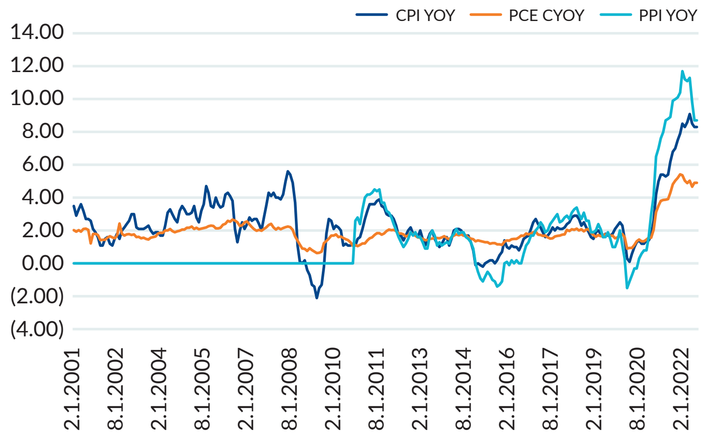
Five tightening moves into this cycle, the Fed has barely arrived at positive real interest rates. Even Core CPI, the Fed's favorite inflation metric, is well above target at an annualized rate of 6.32% as of the last release (8.22).

CHART 8: **US REAL 1Y & 10Y RATES**



Source: Bloomberg, Mesirow Research.

CHART 9: **CPI YOY, PCE CORE YOY & PPI FINAL DEMAND YOY**

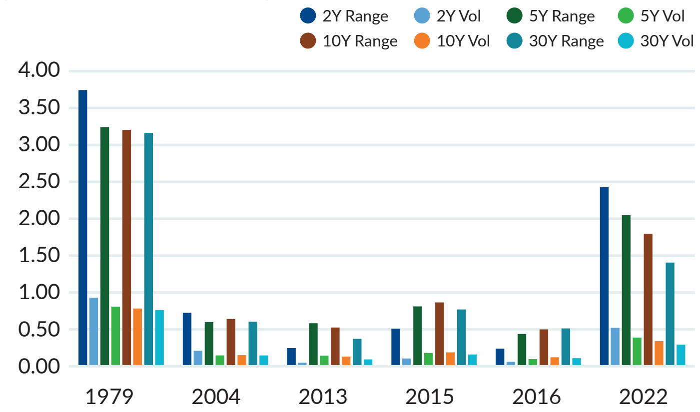


Source: Bloomberg, Mesirow Research.

Managing volatility has been a challenge for investors across the capital markets. Liquidity has been difficult to find and to price in all markets, including the US Treasury market.

CHART 10: TREASURY YIELD RANGE & VOLATILITY ACROSS CURVE

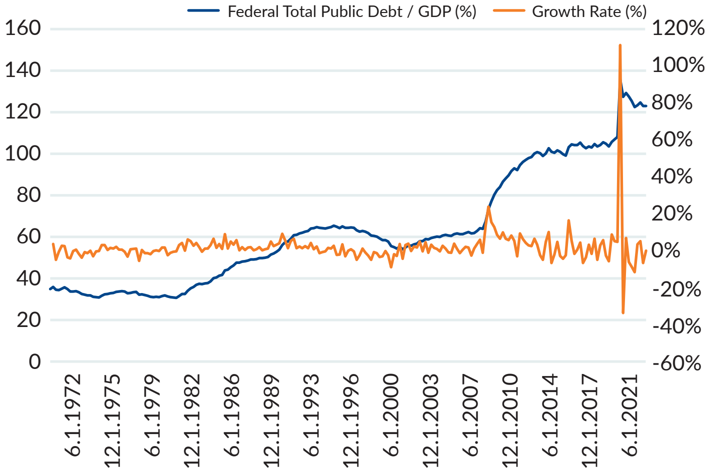
(6 Month Post 1st Hike)



Source: Bloomberg, Mesirow Research.

The graph above shows the extent of Treasury volatility. Markets have not experienced these levels of volatility since the 1979 cycle. The fact that the Fed Balance Sheet drain is an unprecedented liquidity challenge, one that is proceeding more slowly than expected because of technical factors, should keep the capital markets on high alert.

CHART 11: FEDERAL TOTAL DEBT / GDP (L) & ANNUAL GROWTH RATE (R)

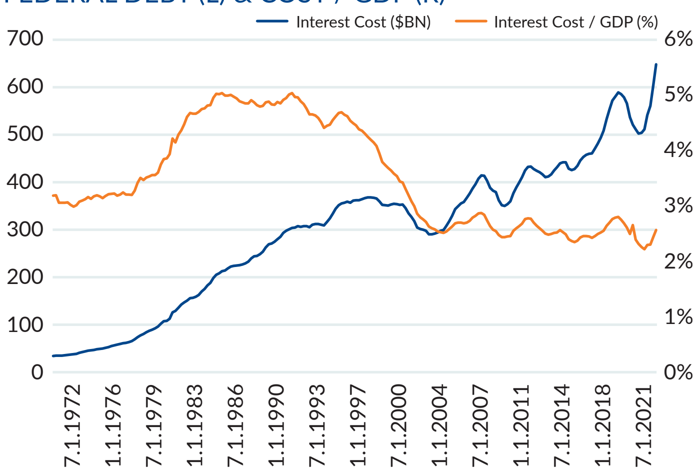


Source: Bloomberg, Mesirow Research.

Federal Debt/GDP (Chart 11) has flirted with WW2 levels, the result of a federal debt tsunami in the wake of the economic shock associated with Covid 19. Current data places the US at 124% of GDP, an economic neighborhood we associate with the weaker Southern European economies.

Leaving the public policy merits aside, basic politically neutral economic doctrine does not favor falling labor productivity, dramatically rising levels of wage and price inflation, energy price spikes, unprecedented levels of public debt and a Federal Reserve that has been caught on the back foot throughout this cycle.

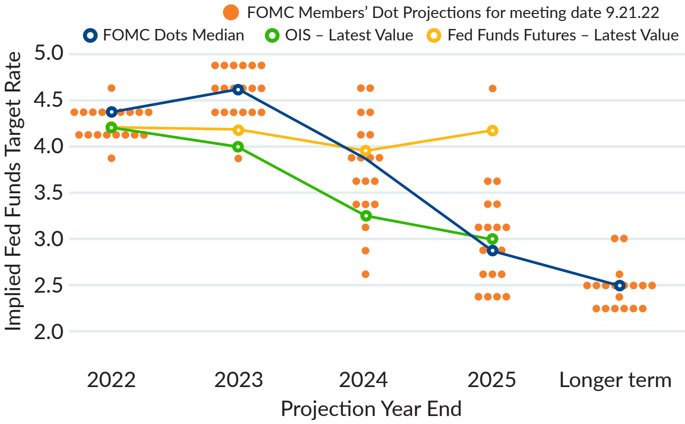
CHART 12: ANNUAL INTEREST COST OF SERVICING FEDERAL DEBT (L) & COST / GDP (R)



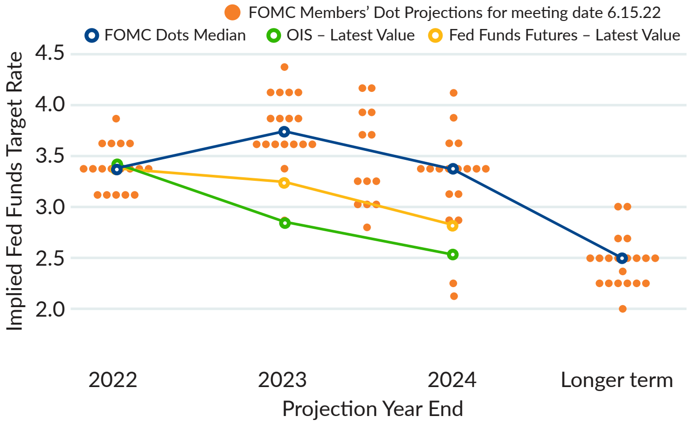
Source: Bloomberg, Mesirow Research.

Chart 12 (above) gives capital markets investors a glimpse of the slowly increasing structural cost of our current federal debt burden. This chart does not look forward into a rising rate and slowing economic environment. It does not capture the full measure of the Federal Reserve balance sheet expansion.

CHART 13 A & B: YIELD CURVES 1.22.22, 6.30.22, 9.30.22



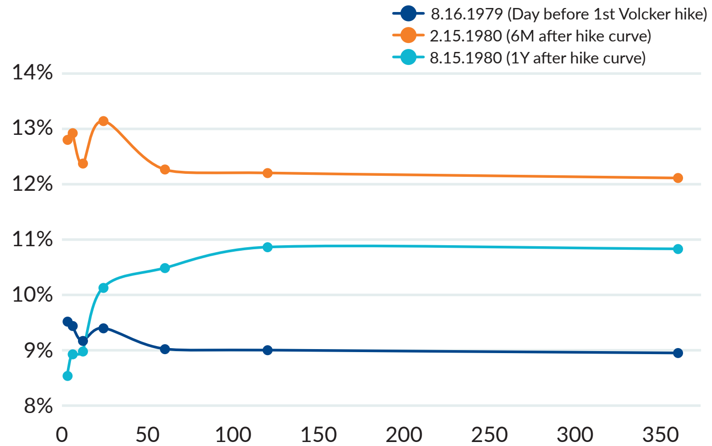
Source: Bloomberg, Mesirow Research.



Source: Bloomberg, Mesirow Research.

Compare these two Dot Plots, 2Q vs 3Q, to see how modestly the Fed Is addressing the inflation risk our economy faces (Chart 13A and Chart 13B). While the consensus rate expectations expressed by the Board's central tendency have risen in 2024 by 50-70 basis points, the Fed is still well behind the market in addressing inflationary fears and Fed policy responses. This disconnect is likely a root source of market uncertainty and resulting price volatility.

CHART 14: '79–'80 BEFORE / AFTER VOLCKER HIKE TREASURY CURVES



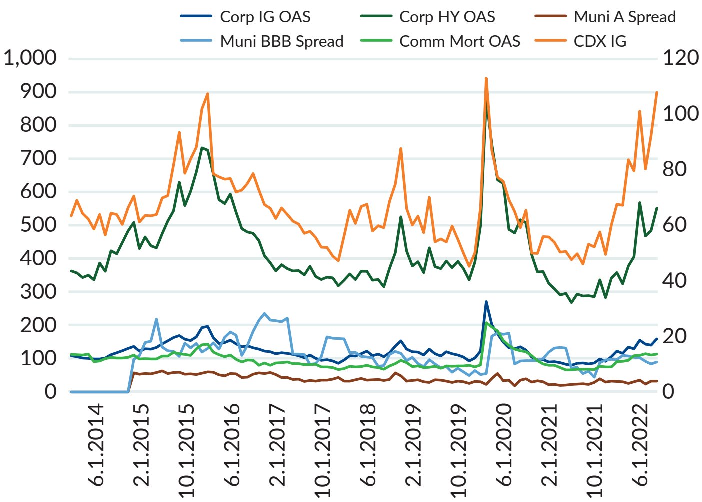
Source: Bloomberg, Mesirow Research.

Chart 14 makes this point. Markets came to believe Volcker's tough talk when he followed through with politically fearless tightening action. Do this cycle's investors believe in a positively sloping yield curve in March 2023? Markets are saying no.

Does the NY Fed's R** metric suggest that Volcker-style inflation fighting is an economically unstable option in this long-term, Fed-distorted low-rate environment? This is not just a technical argument between sophisticated economists about the spread between R* and R**.

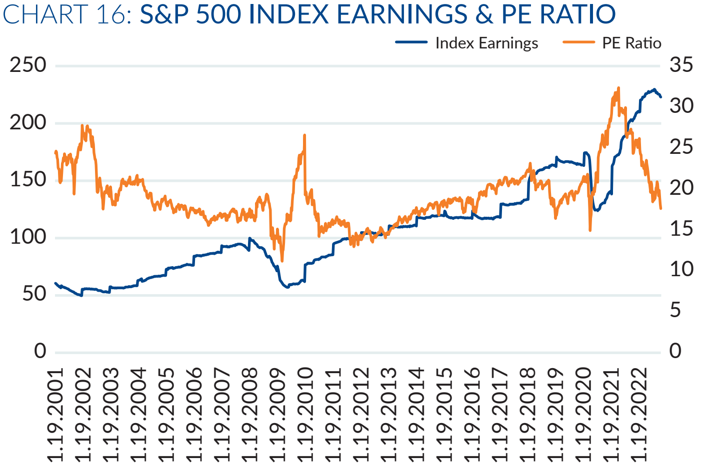
In the real-world economy, the market's perception of the Federal Reserve Board's *deep* commitment to inflation fighting is at least as important as the econometric tools employed by Wall Street to forecast the results of that commitment.

CHART 15: **CASH BOND CREDIT SPREADS (L) & CDX IG SPREAD (R)**



Source: Bloomberg, Mesirow Research.

CHART 16: **S&P 500 INDEX EARNINGS & PE RATIO**

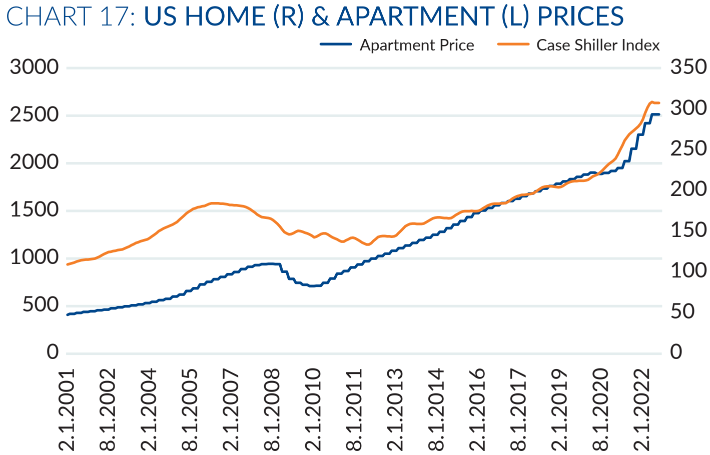


Source: Bloomberg, Mesirow Research.

Credit spreads continue to widen, reflecting investor concern as the Fed tightening regime slows the economy and restricts credit access. HY CDX metrics are distorted by changes in the index, but trends are widening. Regional stresses will come into play. Domestically, Florida and South Carolina will have significant storm-related credit strains as a result of Hurricane Ian. In Europe and the UK, energy supply and price dislocations will have a significant effect on industrial production and individual credit quality. Expect wider credit spreads to ripple through most markets.

Chart 16 describes a relatively strong consensus around corporate earnings (potentially optimistic given the cost-side pressures in the data), but increased caution reflected in the decline to a 18.1 P/E ratio. Arguably, these mixed signals indicate a lack of investor conviction. Equity market valuations have trended toward bear market levels throughout the quarter, notwithstanding several head-fake rallies. Technology companies have been the epicenter of valuation pain, especially early-stage companies not yet generating positive free cash flow (much less, short of achieving sustainable bottom line profits) as rising discount rates and restrained top-line growth assumptions hammer valuations. Small Cap and early tech companies are suffering in this “risk-off” equity market.

CHART 17: **US HOME (R) & APARTMENT (L) PRICES**



Source: Bloomberg, Mesirow Research.

Chart 17 tells the story of the liquidity fueled, easy money asset boom that has been rolling along since 2012. The Fed has been remarkably overgenerous with the punchbowl.

End-of-quarter data suggest that the single-family real estate party is ending. Anecdotal neighborhood data points have been the center of every late summer cocktail party.

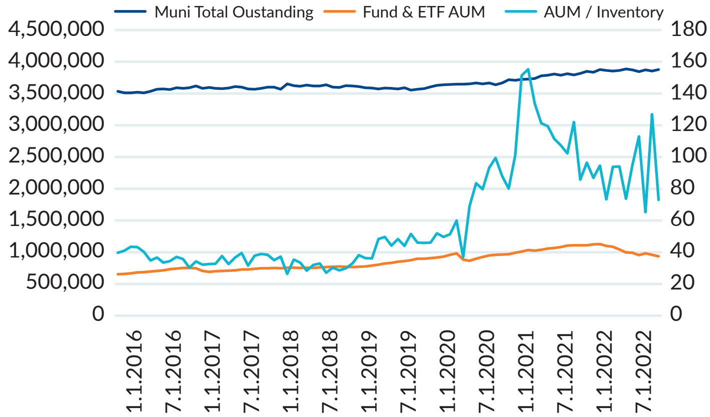
This trend has been highly regressive. Wealthier Americans who own hard assets have benefited greatly. Poor and younger Americans, those most likely to rent, have received no benefit in the asset run-up and are shouldering the burden of scarce rental unit supply and rising monthly rental prices.

The residential real estate story will play out over the next year as mortgage rates, now north of 6%, continue to peak and the single-family market rolls over. This is likely to be locally and situationally realized. Florida and the Carolinas are likely to be the center of a public policy debate as post-hurricane rebuilding plans are proposed. The nexus of climate change and ocean-front development, especially high-end development along barrier beaches, is a can that gets kicked down the road after every major disaster. Will this rebuilding effort be different?

Finally, the public policy debate about rental housing inflation and affordability, and the political tension around it, is likely to play out in both the mid-terms and in the next Presidential cycle. The working poor experiencing declining real wages will likely make their economic insecurity a “hot” issue.

The millennial generation, who can’t seem to catch a cyclical economic break, have delayed household formation and most have experienced very limited individual or collective benefits of home ownership. There is likely a generational grievance seeking political expression in the next cycle. Watch closely.

CHART 18: **MUNICIPAL TOTAL OUTSTANDING, FUND & ETF AUM (L) & AUM / INVENTORY (R)**

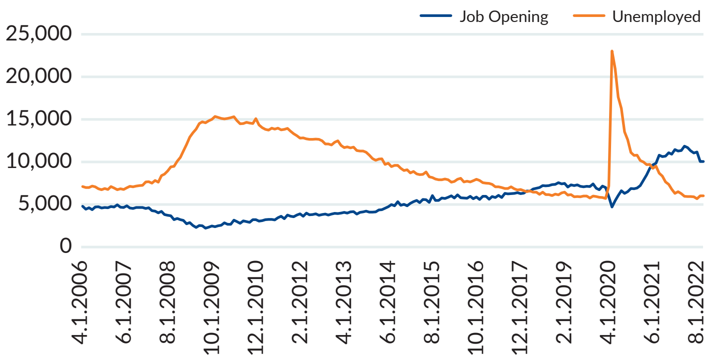


Source: Bloomberg, Mesirow Research.

It has been a very rough quarter for the tax-exempt market as fund outflows have exceeded $100B YTD. For a “long-only” market that operates without an efficient hedge, this negative flow environment has driven price volatility amidst a daily struggle for institutional trading liquidity. The result has been a negative price feedback loop, as mutual fund investors unhappily digest monthly NAV declines of 15–20% or more (even higher for HY funds). Not a good look for a traditionally conservative class of retail investors.

The chart above is a proprietary metric we use to track market liquidity. The tax-exempt market has never fully recovered from the collapse of March 2020. The current data on assets under management versus “Street” liquidity, at 73X is down from 126X (a lower multiple is a stronger reading), a major shift in 30 days. This ratio volatility does not indicate that Munis have returned to their traditional position as a low-risk, safe-haven market for retail investors. The pattern is choppy and shows a clear break in stability since 2Q20; AUM are declining (-$100B YTD) and “Street” inventory levels are volatile as trading desk commitment to this market ebbs and flows. The wounds of spring 2020 have not healed.

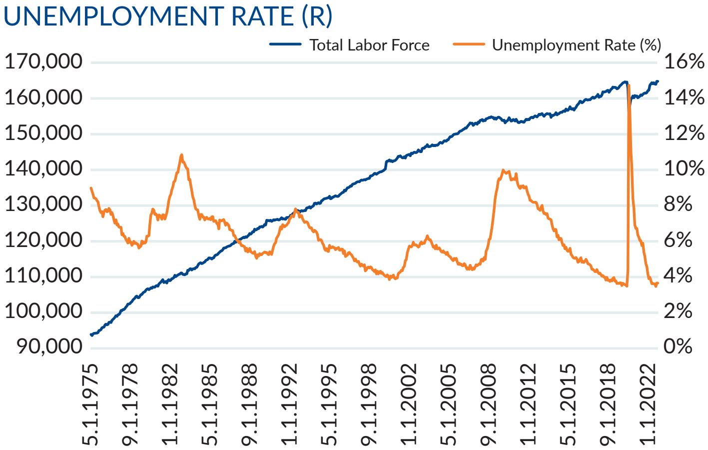
CHART 19: UNEMPLOYED & JOB OPENINGS (000)



Source: Bloomberg, Mesirow Research.

Every quarter we highlight the national shame of the mismatch between job openings and unemployment (Chart 19). We track a consistent 5,000,000+ worker shortage. Talk with any service or hospitality employer about their business plans and the labor shortage is far and away their most acute concern. Obviously, this trend is inflationary on its face. But it appears to be a structural problem that does not have a short-term solution.

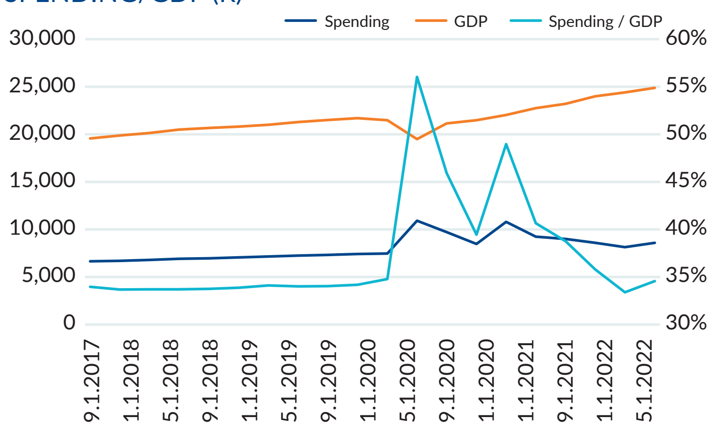
CHART 20: TOTAL LABOR FORCE (L) & CALCULATED UNEMPLOYMENT RATE (R)



Source: Bloomberg, Mesirow Research.

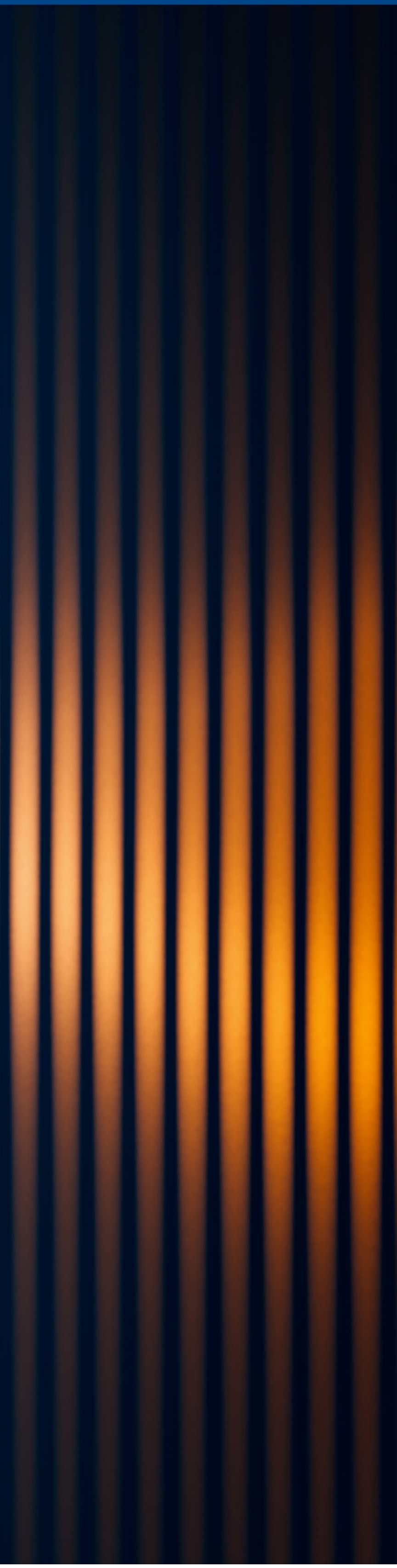
Are Charts 19 and 20 the result of education gaps, job skills shortfalls, lack of worker mobility, or all of the above? A Fed-induced rising unemployment rate will trim wage inflation pressure at the margin (at great individual cost) but the 5-6,000,000 potential workers who can't find productive employment will not be easily re-acclimatized to the culture of work in the wake of Fed tightening and higher rates.

CHART 21: GOVERNMENT SPENDING, GDP (L) & SPENDING/GDP (R)



Source: Bloomberg, Mesirow Research.

Chart 21 describes a government spending pattern that has moderated from the 2020-21 peaks, but spending is still growing and remains above trend as a percentage of GDP. This is stimulative and potentially inflationary as Treasury fiscal demands consume capital and crowd out non-government borrowers in a rising rate regime.



Conclusion

As always, we conclude this Brief with a review of the fundamental questions facing US and global capital markets.

The effect of the Covid-19 pandemic

In the United States, Covid-19 cases are statistically trending down from a July spike, but new case infection rates remain higher than at the end of 1Q22. Vaccination rates in the US have stalled at 80% (first dose) and 65% fully vaccinated.

Globally, there are 13.2mm active cases, and more than 6,500,000 Covid-19 related deaths over the course of the pandemic. Europe stands out with a 34% infection rate, the highest among the continents.

While death rates are down dramatically due to vaccination programs and the availability of therapeutics, Covid remains an ongoing drag on global health and economic vitality.

For our purposes, the legacy of Covid on fiscal and monetary policies across the developed world is still playing out. Pandemic-driven fiscal stimulus programs are running out, while the sovereign debt burdens build, an ongoing challenge to be managed downward. Central Bankers have expanded their policy influence into national economic life in an unprecedented way. Markets are uncomfortably afloat on the residual monetary bubble of aggressive stimulus. The choppy and volatile behavior of capital and equity markets suggests that professional investors do not have the tools to price the risks inherent in draining this monetary bubble. While there was general policy convergence among leading central bankers in the early stages of the pandemic, expect policy divergence and resulting volatility in the aftermath of Covid. Global asset inflation is broad and real but will correct unevenly. Wage, supply chain and energy price inflation are with us for the intermediate future.

Liquidity in sovereign markets should not be taken for granted during this tightening cycle. The United Kingdom established this risk last week, beyond all doubt. Currency markets are violently pricing these moving risks.

Are the markets working to price risk efficiently?

Volatility is the price we pay as market distortions correct themselves. Chart 10 reinforces this point relative to the generally stable US Treasury market. The 1979 Volcker tightening period is the only comparable modern rate cycle in terms of volatility.

The strains in the currency markets, particularly Sterling, reflect the challenges central bankers face. Political instability in the UK and the recent far right turn of the Italian electorate suggest that the economic pressures we have discussed are breaking into the political realm, as can be expected.

The bear twist in the US Treasury curve (Chart 1) reflects the capital markets' deep concern about long-term growth and short-term inflationary pressures. Given the embedded nature of wage and energy inflation, expect capital markets to continue to struggle in a high volatility environment. 3Q has been a painful period for fixed income investors.

US equity markets clearly reflect fear crowding out confidence at this stage of the tightening cycle. Proper discount and cap rates are unclear to professional investors and the market gyrations reflect this, although the negative returns over 3Q in US equities have been modest.

Real estate markets are generally impacted by rising rate structures, but the impact of rates on different sub-markets, structures and localities will be highly divergent. A period of creative destruction will create both risk and opportunity for disciplined and thoughtful investors.

Expect a period of significantly divergent returns across the markets over the intermediate term.

Are Central Bank and government policy responses balanced and proportionate?

Ask a Brit that question this week and you will get a very strong response. Now, well into the Covid pandemic, we can see in hindsight that the answer is generally *no*, across the globe.

The United States Federal Reserve has manifestly been economically dovish and politically compliant throughout. The Fed appears to be playing, and talking, catch-up, but their ongoing level of conviction is unproven. Thus, market participants face less clarity and more volatility in the intermediate future.

European central bankers, excepting the BOE, appear to be acting on first instinct to socialize their way through the multiple crises facing them. However:

- Inflation is real
- Existing energy policies have failed utterly, leaving economic and national security crises in their wake
- Energy challenges will dog Europe for the next decade
- Food security is directly related to energy and defense policy crises. Energy is a major input to fertilizer production. Global food is hostage to energy inflation. The risks of food insecurity are never distributed evenly.
- Russian revanchism affects European, Middle Eastern, and global grain markets directly. Ukraine is traditionally Europe's (and the Middle East's) breadbasket. Russian farm production is also critical to balance global supply. The February 24 invasion of Ukraine is a direct blow to global food production and is highly inflationary.
- As mentioned above, the Russian invasion dramatically spiked input costs for fertilizer production in terms of both energy and raw chemical inputs.
- Food price inflation is likely embedded for the intermediate future.

Are the impacts of policy responses creating market distortions or masking unrealized risk?

Once again, the answer to both questions is **yes**.

The market activity during the third quarter of 2022 and the negative returns retail investors will see when they read their October statements for equity, bond, REIT, or commodity funds (excepting energy) invite a long, complex and granular explanation of why yes, well beyond the scope of this paper.

The New York Fed research on R**, cited above, applies a disciplined intellectual rigor to the market and economic issues we consider in this 3Q Brief.

So, in summary, we will focus on three critical market issues and on one incalculable risk:

First, the three L's: leverage, liquidity and labor.

As the British Exchequer inadvertently proved last week, there is hidden leverage throughout the financial system (this time it was derivatives, again) and unwinding this leverage creates shocking and unexpected liquidity risks. Liquidity and (hidden) leverage are inextricably linked to the monetary and central bank balance sheet expansions that began in 2012 and spiked in the first government responses to Covid-19. Unwinding this accommodative expansion of money and phantom capital is fraught with unknown risks. In the US, we have a Federal Reserve FOMC attempting to reverse course and draw a hard line *without the benefit of market credibility!*

This makes their task infinitely harder.

Leverage and liquidity gaps are driving up rates, widening credit spreads, re-pricing real estate (early stage here) and will ultimately drive divergent market returns as these emerging risks are priced.

As noted above, upward pressures on the price of labor currently show no signs of relief. Wage inflation is likely embedded within the economy for the intermediate future.

Can this labor imbalance change with a wave of earnings-driven corporate layoffs or a massive construction downturn? Yes…

Is there immediate structural relief from labor pressure visible in the traditional metrics? Not one easy to spot in 3Q22.

Amidst this creative destruction, wise investors will have the opportunity to capitalize on divergent returns. There will come a time to lock in long duration fixed income assets. Tax-exempt income at 100% of Treasuries will likely offer attractive relative value at that stage, assuming that supply-demand balance has stabilized.

There will come a time, towards the end of the Fed tightening cycle, to overweight equities. There is a time to thoughtfully invest in baseload energy assets, in the absence of a breakthrough on storage technology (which will come). The equity technology market will likely be a stock-picker's dream as winners and losers diverge.

While real estate markets generally respond negatively to a rising rate regime, some markets will outperform as post-Covid social patterns are established. They may include distribution and supply chain assets, ex-urban (but broadband rich) residential markets and non-ocean-front luxury residential markets, especially those pockets with excellent educational amenities. The demographic demand for attractive rental housing stock will likely create interesting investment opportunities (suburban legacy mall conversions for example?).

And then there is Russia…

We have written that a badly wounded geo-political enemy is more dangerous than a strong one, and Russia appears committed to proving this point. Since February 24th, we have witnessed a critical disruption of global food and energy markets, destruction of European energy policy, and disregard for post WWII notions of border security and international law.

Putin's reckless inhumanity and lack of wisdom have affected every market and overturned countless assumptions regarding a stable global economic regime. And thus, Putin stands as the biggest continuing threat to orderly markets. At this moment, he can overturn every concept of "normal."

Putin likely believes he will not lose; not cannot, **will not**. What does this mean?

We do not know what the leadership around him, those who pull the levers of power on command, believe.

Tactical nuclear weapons were developed to address asymmetric military threats. NATO flexed them for decades as a live threat to stand up to the massively superior Warsaw Pact conventional forces lined up against the west. It worked beautifully. That said, the west has established a working precedent for showing the tactical nuclear card effectively.

It is not our purpose to discourse on foreign policy. It is our purpose to call out investment risk. The wise investor will eschew leverage, will hew to high quality assets, will rent his/her liquidity to the market opportunistically and with considered intention, and will keep long positions or short hedges that may be subject to "headline risk" to a bare minimum as the markets struggle every day to price risk in real time.

"Suppressing inflation over the past decade, and more, has obviously not been without cost. To fritter away this substantial accomplishment by failing to contain inflationary forces that may emerge in the future would be folly."

– Alan Greenspan before the Economic Club of New York 4.19.93

About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with offices around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Global Investment Management, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture. To learn more, visit mesirow.com and follow us on LinkedIn.

Contact us

Blake Anderson
617.235.1423
blake.anderson@mesirow.com

Bing Hsu
312.595.8912
bing.hsu@mesirow.com

Mark Whitaker
312.595.6535
mark.whitaker@mesirow.com

The S&P 500 Index is a stock market index tracking the stock performance of 500 of the largest companies listed on stock exchanges in the United States and constructed to provide a comprehensive and unbiased barometer of the U.S. equity market.

The credit default swap index (CDX) is a financial instrument composed of a set of credit securities issued by North American or emerging market companies. Currently, the CDX contains 125 issuers and is broken down by two different types of credits: investment grade (IG) and high yield (HY).

A proprietary yield curve Municipal Market Data (MMD) AAA Curve provides the offer-side of AAA-rated state general obligation bonds (GO). The MMD analyst team determines the inclusion of bonds. The MMD AAA curve represents the MMD analyst team's opinion of AAA valuation, based on an institutional block size of $2 million-plus market activity in both the primary and secondary municipal bond market.

US Real Weekly Earnings Index is the weekly earnings of US employees, adjusted for inflation. They provide insight into what an average individual is earning per week and thus is the primary measure of wage growth in the United States.

An exchange traded fund (ETF) is a type of security that tracks an index, sector, commodity, or other asset, but which can be purchased or sold on a stock exchange the same as a regular stock.