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“Slower, But Still Pretty Fast”

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We caught up recently with our chief investment strategist at Nuveen, Brian Nick, for a conversation on markets and the economy:

“We are at an inflection point in two important respects; first, 4Q was the best quarter of 2021 from a GDP perspective. Last year growth was 5.5%, best since 1984. But even if we only get half of that rate of growth in 2022, it would still be above trend since the GFC. But the other inflection point has been the hairpin turn by the Fed. We went from one 2022 hike, maybe, back in September to 4 or 5 hikes as of today!

“It’s certainly gotten the attention of markets, starting with a tantrum in January. Everything’s selling off in unison with nowhere to hide. Markets are adjusting to a new regime with a more hawkish Fed, new valuations and a different set of winners and losers than we saw last year.”

How do we get back to normal? “We need more Covid normalization. People are buying a lot of stuff, paying up for goods, including food and energy. The sheer volume of things people are buying is really high, putting pressure on supply chains. Those did pretty well last year, producing more around the world, but demand just grew too fast. And that’s why we saw prices for goods going up.

“We started to see more of a rotation into services at the end of the year, but that’s going to likely slow because of Omicron. Just didn’t need another excuse for a buying spree on goods. Inflation now will stay around longer.”

What about labor costs and shortages? “We need more workers coming into the labor force. We still have millions, ages 25-54, who were working in March 2020 and aren’t now. Some might feel it’s not super safe having consumer facing jobs right now.

“That’s putting upward pressure on wage inflation which, unlike supply chain issues that will eventually work out, is stickier. A smaller labor force translates to costlier workers eating into profit margins. More people than ever are quitting their jobs, but more people than ever are getting hired. Many who quit are immediately finding jobs paying more money. When will the Fed intervene to forestall a wage-price spiral, the textbook way inflation becomes systemic?”

Finally, Brian, how does the timing of private credit look given inflation and rates? “Markets are focusing on the ‘slower’ part of our message, rather than ‘still pretty fast’. When we come out of this and the Fed settles on a more normal rate of interest (extremely low by any measure before 2008), these tantrums will result in good market performance for credit.

“Now we need to keep investors composed. There’s an advantage to having a less liquid asset that doesn’t go through another period like we had in January.

“If you can keep a cool head there are really good economic outcomes at the other end of this. That includes above-trend economic growth, disinflation (which will be good for asset performance), and a long expansion ahead. The markets for now think the Fed has a lot of credibility to land this plane with a soft landing.”