The Fed must end its long-running love affair with the markets. It needs to be over, and here are several reasons why the Fed needs to end it.

In 1977, the band Fleetwood Mac released one of its most successful albums - Rumours. The song Chains was a big hit for the group. It was a mish-mosh of band riffs. You sort of can tell near the end that it was one big old jam session. In the beginning, the baseline, the lyrics are clean.

Confidentially, it's one of my favorite tunes, but halfway through, I've had enough of hearing it, and I'm ready to move on. Allegedly, the inspiration for the lyrics was the drawn-out breakup between Stevie Nicks and Lindsey Buckingham.

The Fed's easy-money tune has been a rich melody for risk assets, but I'm at the point where the notes are clashing, and it's time for them to prepare to exit the stage. Furthermore, this coupling is more drawn out than Hallmark Channel's holiday movie lineup.

Here are several reasons why the Fed needs to break the chain with stock markets.

Inflation Isn't Transitory. It's Permatory.

A new Fed mandate *must be* drawn-out and creative definitions because the word transitory has stretched, morphed, pulverized into something I don't recognize. So, I took it upon myself to create a new word. **Permatory.** The kind of inflation that never goes away yet is still considered 'transitory' by the Fed, a price point that's painful and not so temporary. But, listen, just like the central bankers and the Executive branch of government, I can hold my own when it comes to tossing a word salad. The exercise was fun. Until I shopped for groceries and noticed the prices, I realized that permatory would be painful for most Americans.

I mean, if the dictionary means anything anymore, here's the current definition (without the intervention of Jerome Powell), of transitory per Miriam-Webster:

Definition Of *T*ransitory

1: brief duration**:** TEMPORARY the *transitory* nature of earthly joy 2: tending to pass away**:** not persistent.

So, transitory means temporary.

I guess earthly joy is temporary. Life is fleeting. So, I think the Fed's definition of transitory realistically can last a lifetime. Good for them, not so good for consumers. Frankly, I don't expect inflation to be as horrific as the 1970s when a top-of-the-line stereo system costs $600. However, it will make us squirm in the wallet, more than we've squirmed in a long time.

The Atlanta Fed's inflation project is an ongoing initiative. The theory behind sticky price inflation is that specific consumer prices change infrequently; thus, they incorporate expectations about future inflation more effectively than prices that change frequently.

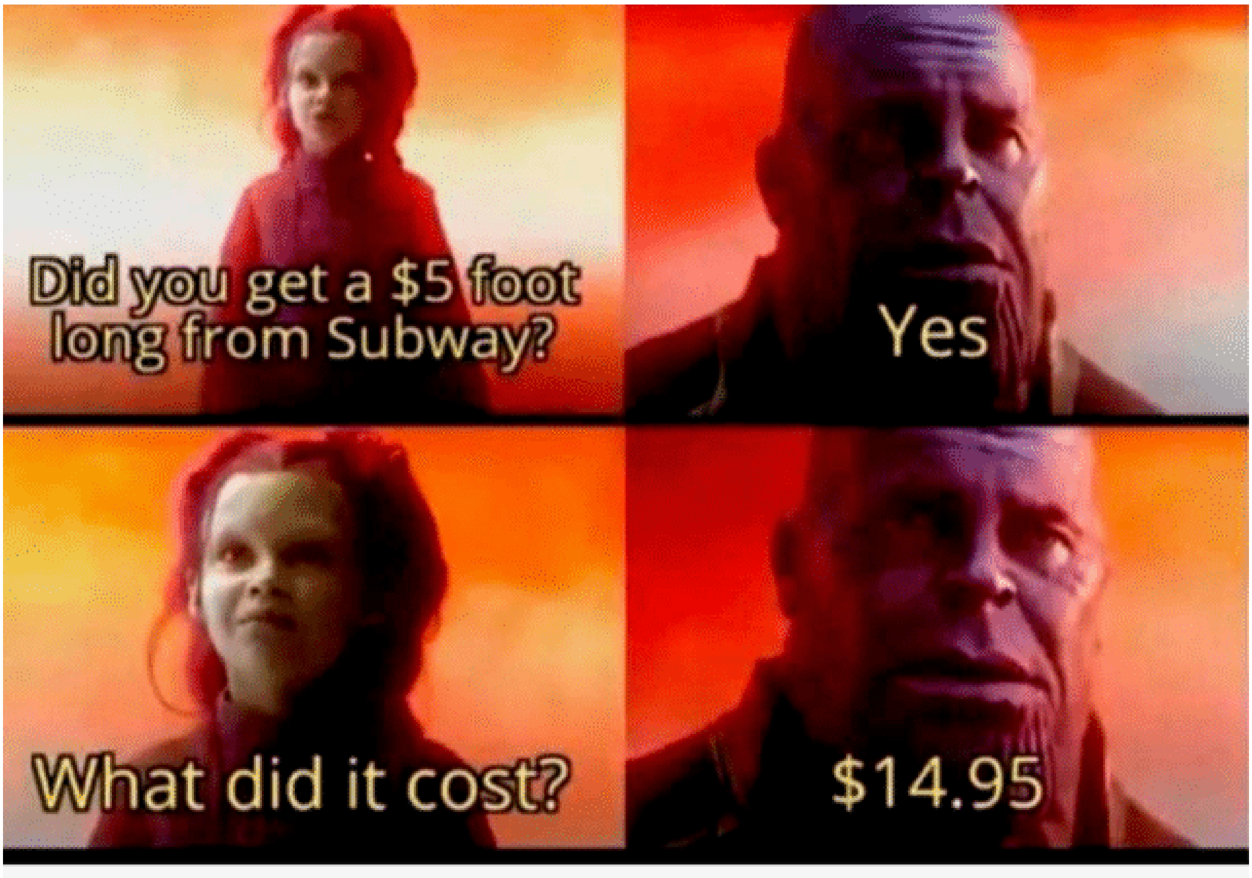
Per The Atlanta Fed:

While some economists wrestle with the question of what, exactly, causes prices to be sticky, others have taken on the tedious task of documenting the speed at which prices adjust. The most comprehensive investigation into how quickly prices change that we know of was published a few years ago by economists Mark Bils and Peter Klenow.

Bils and Klenow dug through the raw data for the 350 detailed spending categories used to construct the CPI. They found that half of these categories changed their prices at least every 4.3 months. Some categories changed their prices much more frequently; price changes for tomatoes, for example, occurred every three weeks. And some goods, like coin-operated laundries, changed prices on average only every 6• years or so.

As of September 14, 2021, the sticky-price consumer index increased 2.6% (on an annualized basis) in August. However, consumers know that prices for many goods and services have increased at least twice that percentage. As a result, consumer price hikes have inundated business headlines. Kimberly-Clark, Unilever, Chipolte, Proctor & Gamble. Name the company, and I'll show you sticker shock!

Even Subway is in on it!



Sticky-price items include personal care products and services, food away from home, rents, water, trash collection services, medical care services, recreation, motor vehicle maintenance, and repair. Flexible price items (not sticky) include fuel, car rental, meat, poultry, fish, eggs, fruits, vegetables, new and used vehicles, cereals, and bakery products.

Will Flex Become Sticky? It's A Possibility.

Candidly, I believe several flex-price inflation categories are at risk of becoming sticky, including fuel and food products. Longer-term political initiatives to 'motivate' consumers to go green will lead to sustained higher prices for meat, poultry, fish, and eggs. Ostensibly, real wage growth (adjusted for inflation) will remain stubbornly negative, thus distressing lower and middle-class household budgets.

Structural issues, including political headwinds coupled with a growing need for energy, will keep oil and gas prices moving higher. However, don't expect OPEC to cooperate either. Instead, they'll maintain their output steady in the face of rising demand, ostensibly keeping prices uncomfortable for all of us.

Per www.apartmentlists.com's National Rent Report for October, the national MEDIAN rent has increased by an astounding 16.4% since January. As rents are considered sticky, I wouldn't expect prices to contract much. Also, the Federal Reserve Bank of New York does a good job mapping changes to regional and national home prices. Year-over-year, as of July, median home prices are higher by an eye-popping 23% when wages are higher by roughly 3%.

For example, in Houston's Harris County, home prices rose close to 11% through the same period. Estimates are for prices to moderate or pull back modestly. However, not enough to provide inflationary relief. Currently, the Federal Reserve Bank of Atlanta estimates that the median U.S. household needs 32% of its income to cover mortgage payments, the highest percentage since 2008!

RIA'S Financial Guardrails Take The Emotion Out Of Home Purchases.

By the way, one of our financial tenets at RIA is that a mortgage payment should not breach 20% of net household income. We're not budging on the guardrail or the advice. It's discouraging for those who want to purchase a primary residence. However, our goal is to make sure consumers are not house and cash flow poor. We suggest most clients and their children who come to us for guidance postpone their purchase until they can increase their down payments and prices cool off. It takes discipline to wait. Discipline builds wealth.

Also, the outlook for 2022 wages is far from rosy. Per SHRM. Org: pay raises in the U.S. are returning to pre-pandemic levels, but rising prices mean higher salaries aren't likely to keep pace with inflation. The median total U.S. salary increase budgets for 2021 are three percent, on par with the previous ten years, and projections for 2022 are also 3 percent.

Fiscal Stimulus Is Coming.

No, it's not Paul Revere! Instead, here's the second of three reasons why the Fed must break the chain with stock markets.

Regardless of supply chain disruptions, which may be temporary, there is a renewed focus on fiscal stimulus and robust benefits to households, including aggressive child tax credits. I wouldn't be surprised if a universal basic income benefit arrives on our shores within the next decade.

The monetary stimulus in the form of quantitative easing especially is not inflationary. However, long-term fiscal stimulus will raise the Fed's overall baseline inflation, which means they will need to increase short-term rates in the face of sustained higher unemployment and lower economic growth. *Stagflation anyone?*

It's time for the Fed to **break the chain** with markets because inflation due to fiscal stimulus is indeed a sustained threat. Consumers' real wages (adjusted for inflation) will remain negative, thus welcoming additional fiscal relief. A balancing act is imminent as perhaps the Fed can adjust rates accordingly as the fiscal side takes over for them.

Candidly, this chain is going to be captivating to monitor as Powell sweats to sever it. After all, the Fed has morphed into some underground social justice enterprise graced with unspoken mandates to combat racism and wealth inequality. But, of course, one can say the Fed is the reason for wealth inequality in the first place since its policies fuel stock prices.

Conversely, lower rates have helped the majority of households take on more debt, purchase larger homes, and allow them to live above their means. So how will rising rates affect those families? If the federal government sends them checks, probably not much!

Market Valuations Must Adjust To Economic Reality

Here's the last of the reasons why the Fed must break the chain with stock markets.

Personally, I'm sort of tired of 20-year-old market pundits telling me that bear markets are a thing of the past. Perhaps they're correct. However, they'll be a point where *buy the dip because the Fed will bail us out* is not going to work, and today is as good a day as any. The Fed has allowed speculation to run rampant. Price distortion plagues every asset class. Investors are buying up virtual land and invisible artworks. It's time for the insanity to stop. The reward-with-no-risk chain that permeates markets must be severed.

The Federal Reserve must halt emergency action. However, in the face of sustained inflation and the greater probability of additional fiscal stimulus, they'll have little choice but to move quickly to increase short-term interest rates too. If Powell has the political will to do so, that is. Even the mention of imminent short-term rate increases will adjust risk asset prices accordingly.

Bond markets have been foretelling about the future state of global economic growth. But, as much as financial pundits who suffer from chronic Recency Bias lament how GDP will indefinitely trend above average, bond yields and the nation's debt burden tell a different story.

Debt To GDP Is Rising

Germany's Ifo economic institute recently cut its growth forecast to 2.5% for 2021 due to supply bottlenecks lasting longer than expected. Carmen M. Reinhart and Kenneth Rogoff, who in their seminal tome *This Time Is Different* and various studies, including Growth in a Time of Debt from 2010, provide evidence that *over the past two centuries, debt above 90 percent gets typically associated with a mean growth of 1.7 percent versus 3.7 percent when debt is low (under 30 percent of GDP*). Readers should know that since then, Rogoff has changed his tune. Debt is now a good thing. He references the effects of the pandemic as a reason for the change of heart. However, the numbers are the numbers; the research remains valid.

Keep in mind; the United States stands at roughly 128% national debt to GDP. The bond market has been indicating all along that once the pandemic growth spurt concludes, GDP would return to sluggish moderation. We are on the way. The Federal Reserve Bank of Atlanta's GDP Now forecast has collapsed to 1.3% as of October 5.

It's time for the Fed to break the chain with risk assets. This love affair is strained. They have overstayed their welcome, but the damage is done. As a result, the Fed has trained an entire generation of new stock investors to be overconfident and oblivious to risk. Overall, it sends the wrong message and could be a recipe for disaster.

At RIA, we estimate formidable headwinds to future market performance. We estimate future returns to be more in line with GDP. Interestingly, Bank of America believes future long-term market returns will be harmful for the first time since 1999. Although we're not as dire with our estimates, we do think future returns will be challenging to say the least.

What Are Investors To Do?

What should an investor do in the face of why the Fed must break the chain with stock markets? Here are three ideas:

1) Manage Expectations.

A 5% pullback feels like 10%. A 10% correction feels like a bear market. Volatility is the price of admission to participate on the ride of risk assets. Stock investors must reassess their risk attitude with a fresh perspective. A perspective that includes the Federal Reserve no longer there to bail us out. Underneath the surface, the Fed's mandates appear to be broadening. Central banks are being reshaped to become social justice warriors that don't bode well for stock investors.

Consequently, Powell is too old school. A progressive new chair will likely replace him: A central banker who is not subservient to stock markets. Listen, it could happen. Regardless, based on stock performance this year, it's best to rebalance, take some risk off the table, reallocate to growth AND value stocks.

2) Establish A PRR: Personal Rate of Return.

Looking to beat an index such as the S&P 500 is a mindless goal, especially when investors do not comprehend the risk they may be taking to do it. Don't fulfill your ego. Instead, focus on financial milestones such as college savings and retirement. Meeting or exceeding these goals takes awareness and understanding of a personal rate of return or a PRR. A PRR is a return YOU and YOUR family require to meet goals. How do you establish a PRR? By completing a comprehensive financial plan - One that examines the rate of return needed to hit your financial benchmarks. Then, it's best to compare annual portfolio returns to a PRR, not some market index that has nothing to do with your life or legacies.

3) Speculate Wisely.

Want crypto? Great. Seek metals? OK! How about land in the Twilight Zone? Well, that's fine, I guess. However, investors should define boundaries when considering speculative ventures. For example, we partner with clients who participate in speculative investing only with money they're willing to lose.

I know investing on a risk-adjusted basis sounds a lot like "eat your vegetables." I know that sometimes we want dessert, and we want it before the main course. Anything in life is acceptable in moderation and when rules are applied. But, hey, I'm human. Sometimes I take chocolate over broccoli too!

Intuitively, with the emphasis on additional fiscal stimulus and the heat of inflation, some of which I believe is structural now, it feels like the Fed will have no choice but to become more aggressive about exiting easy monetary policy.

As a result, we should brace for the repricing of stocks.

The political demonization of the Fed along with reduced liquidity should make for an interesting 2022.

Fleetwood Mac's famous tune is about a turbulent breakup. The severing of the chain between the Fed and markets will be volatile, unsettling, and fraught with drama. Just like a song but not as enjoyable.

I think I'll write my song to describe next year. I'm no Stevie Nicks, but I think my working title is coming along nicely: Buckle In.