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By the Way

Monthly commentary from Jack Way

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"We are navigating by the stars under cloudy skies"

The Jackson Hole Economic Symposium brings together central bankers from around the world to discuss trends in finance and in particular, interest rate policies. It has lost a lot of its luster over the years as the old behaviour of bankers to keep secret much of their internal discussions and decisions left Jackson Hole as one of the few opportunities for the rest of us to catch a glimpse of what their thinking was. That has now evolved, given endeavours for more transparency, to today where policies are much more open and its hard on any given day to avoid bumping into a banker pontificating on the current economic environment. At any rate, the conference had little impact on markets. Keynote speaker, FED Chairman Powell remained adamant rates would stay high to continue the fight against inflation, but at least he was no more hawkish than expected. I did take notice of one of his quotes: "We are navigating by the stars under cloudy skies." I applaud him for his candor and couldn't agree more.

I did learn a new word this month; "nowcasting". Central bankers are data dependent these days and as a consequence are trying to anticipate changes in that data without waiting for it to be reported. It's an obvious play on the word "forecasting" which is felt to be too slow in providing useful and precise answers. By using various sources that are released more quickly and more frequently (the unemployment rate and trade balance might be two) and adding some algorithms and artificial intelligence to the mix, they hope to supply more immediate information for policy decisions. As an example the Atlanta office of the FED publishes an ongoing estimate of GDP called GDPNow.

Much as Chairman Powell expressed a lack of clarity in reading the current economic environment, Joe Weisenthal of Bloomberg wrote, "The trajectory of the U.S. economy remains highly ambiguous. There's enough data out there to support just about any narrative, from soft landing to recession to ongoing overheating." He hits the nail on the head and ambiguity is never a good thing in investing. We can take some comfort that at worst the U.S. is the so-called cleanest dirty shirt amongst global economies. The Citi Economic Surprise Index shows the U.S. consistently beating estimates, while Europe misses forecasts, sometimes quite badly. China continues to struggle whether through disappointment or deliberate policy to slow the economy.

The Fed's efforts to put the brakes on inflation seem to be finding success, without so far at least, crushing the economy. Consumer spending continues to support growth as a tight labour market and accumulated savings provide the wherewithal for folks to keep buying. However, the signs of a slowdown in the consumer's ability to keep up the pace are numerous. In July, personal income was up 0.2% while consumer spending rose 0.8%, which obviously can't continue forever. Mortgage rates at 7.5% are a headwind, although a majority of U.S. mortgages are 30-year fixed rate loans that average 3½%. Other costs eating into everyone's budget include gasoline and grocery prices; higher credit card rates; and student loan repayments are back in force. The trick will be can the glide path of the economy be slowed enough to defeat the inflationary forces without hitting stall speed and crashing into a recession. A final note on recent GDP growth; the July release indicated growth of 2.1% in the second quarter, revised down from 2.4% originally reported a month earlier. Historically a series of such downward revisions has led to lower future results.

Inflation is relatively benign, if only because after last year's double digit rates today's 3-4% appears not so bad. The Personal Consumption Expenditures Index increased 3.3% in July after rising 3% in June. Wage inflation is of particular concern in the longer term so a cooling in average hourly

earnings is welcome and the slight increase in the unemployment rate from 3.5% to 3.8% may indicate less stress in the labor market is on the horizon (although most of the increase came from more people looking for work, the so-called "participation rate"). To look back again, history would tell us inflation rarely goes in one direction only but comes in waves. We shouldn't let our guard down.

Over the first 8 months of 2023 the S&P 500 was up 17.5%, which is in the top 20% of historic results. The summer doldrums, as usual, brought low volumes and some weakness. After a brief encouraging period in late spring, where breadth was widening and more stocks were moving higher, by the end of August we were again in a market where 75% of the increase in price this year was due to the 10 largest stocks in the Index. Like Mr. Powell and Mr. Weisenthal, I find it difficult to take a strong stand on the future. I do think meeting, beating, or missing expectations, not the actual reported numbers, will be the main market driver. In my opinion, expectations are high and as such the risk is to the downside, but don't ask me when. An old portfolio manager and role model of mine once said if he went to his Bay Street tailor and they were sold out of cashmere overcoats he would sell stocks on the basis everyone was doing too well. Today I'm thinking of measuring it in Ferrari's; the waiting list is over 3 years for cars and 1/3 of the orders are from people under 40. Sounds like everyone is doing okay.

Fixed income securities remain popular and an alternative to equities. In 2008 there were only 61 bond ETF's holding $145 billion; today there are over 600 funds with $1.4 trillion in assets. As the lethargy in stock markets dragged on in August, the inflows to money market funds (and their 5%+ payout) were 9 times that of equity funds. The S&P return of 17.5% this year hasn't been enough to cause a mass movement back to stocks. If you are of a contrarian bent the Bloomberg Aggregate Bond Index (known as the AGG, it's an Index measuring performance of a broad spectrum of investment grade bonds) has not seen a new high in 37 months; the previous record was 16 months.

The ugliness that is bound to surround the 2024 U.S. Presidential election is already beginning. Biden's age and poor approval rating versus Trump's indictments promise grand if unpleasant theater. That's the current matchup, but there's lots of time for the participants to change; we can only hope. Trump's absence at the first Republican Debate and his arrest and mug shot have somewhat improbably solidified his position as the leading candidate. It is worthy of note that 80% of the Republican primaries will be over before Trump verdicts become public.

Internationally the standoff between the U.S. and China continues with each jockeying for position to attract other countries into their circle of influence. China gained a significant advantage at the recent BRICS Summit; founding members Brazil, Russia, India, China and South Africa appear to have added Argentina, Egypt, Ethiopia, Iran, Saudi Arabia and the UAR to the organization. Definitely a coup for China and Russia.

We must beware of the overuse of heuristics, those simple rules of thumb or shortcuts that cause us to react impulsively to information thinking we've seen this before and we know what will happen next. Keep in mind the old quote attributed to Mark Twain; "It ain't what you know that gets you into trouble; it's what you know for sure that just ain't so".

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