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WEALTH ADVISORS

TRUST MATTERS.

May 2023

Point of View – Economy – Markets

Important Information

The views and opinions expressed are those of the speaker and are subject to change based on factors such as market and economic conditions. These views and opinions are not an offer to buy a particular security and should not be relied upon as investment advice. Past performance cannot guarantee comparable future results.

Important Information

Performance quoted is past performance and cannot guarantee comparable future results; current performance may be higher or lower.

Results shown assume the reinvestment of dividends.

An investment cannot be made directly in an index.

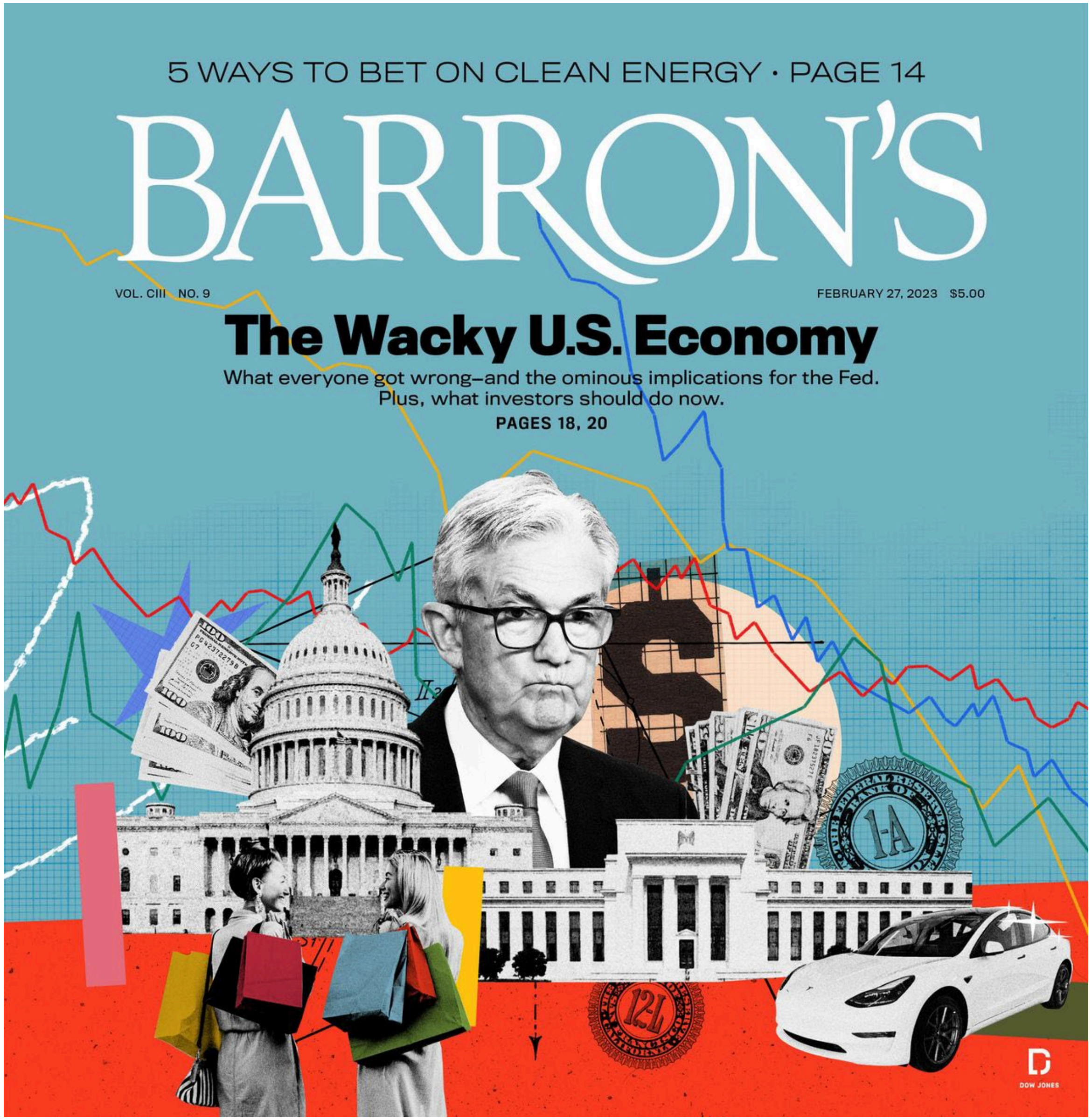
Investments with higher return potential carry greater risk for loss.

Investing in small companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

Foreign securities have additional risks, including exchange rate changes, political and economic upheaval, the relative lack of information about these companies, relatively low market liquidity and the potential lack of strict financial and accounting controls and standards.

Investing in emerging markets involves greater risk than investing in more established markets such as risks relating to the relatively smaller size and lesser liquidity of these markets, high inflation rates, adverse political developments and lack of timely information.

Fluctuations in the price of gold and precious metals often dramatically affect the profitability of the companies in the gold and precious metals sector. Changes in political or economic climate for the two largest gold producers, South Africa and the former Soviet Union, may have a direct effect on the price of gold worldwide.



Source: *Barron's*, February 27, 2023.

Diverging Data

Bad news

- LEI
- Inverted yield curve
- Weak manufacturing PMI
- Weakening services PMI
- Weak housing starts

Good news

- Strong hiring data
- Strong Q1 GDP
- Strong Q2 GDPNow forecast
- Strong S&P Global survey
- Strong April car sales
- Retail sales up in April
- Oil down
- Consumers still have cash – M2
- Strong corporate balance sheets
- Strong bank capital
- Inflation is moderating

Bad news

- LEI
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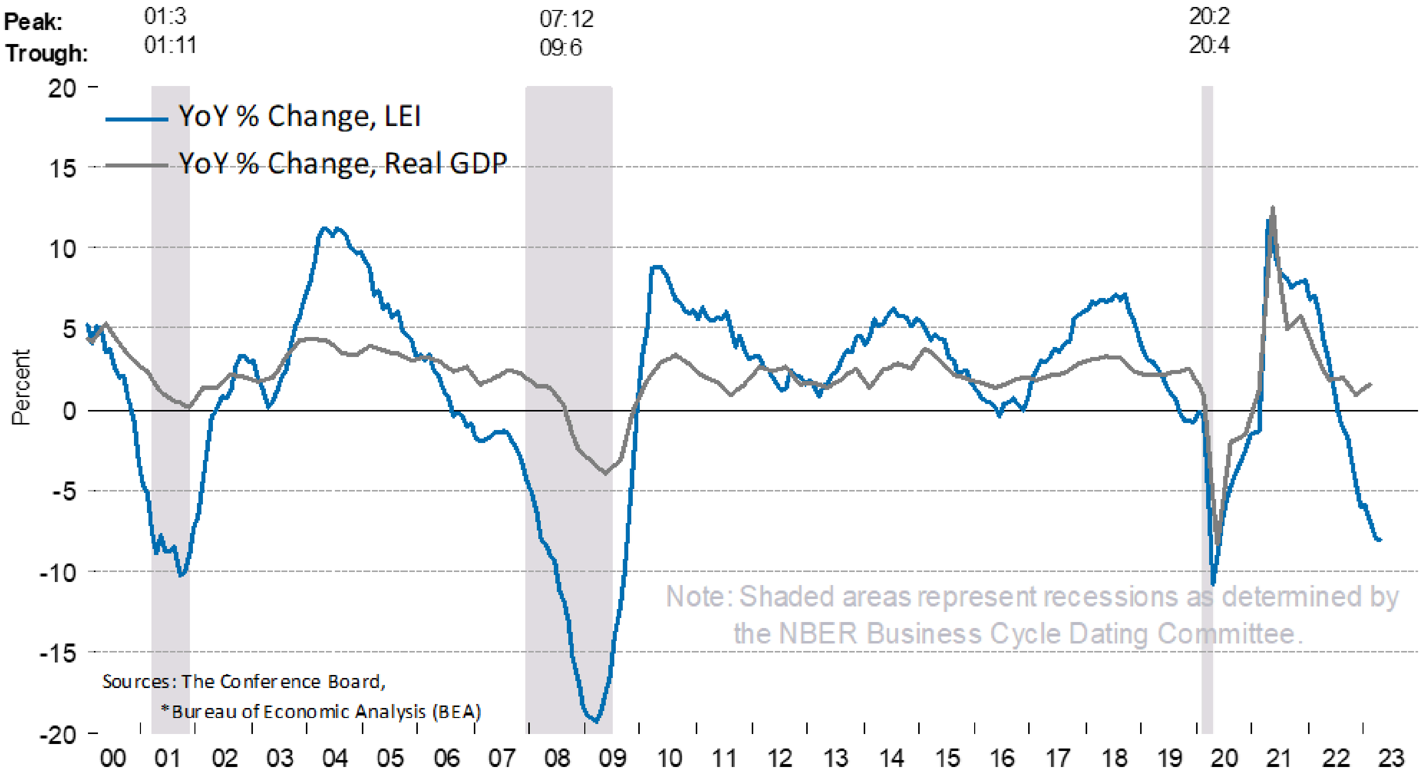
- Weak housing starts

Economic data

U.S. index of leading economic indicators – signaling recession



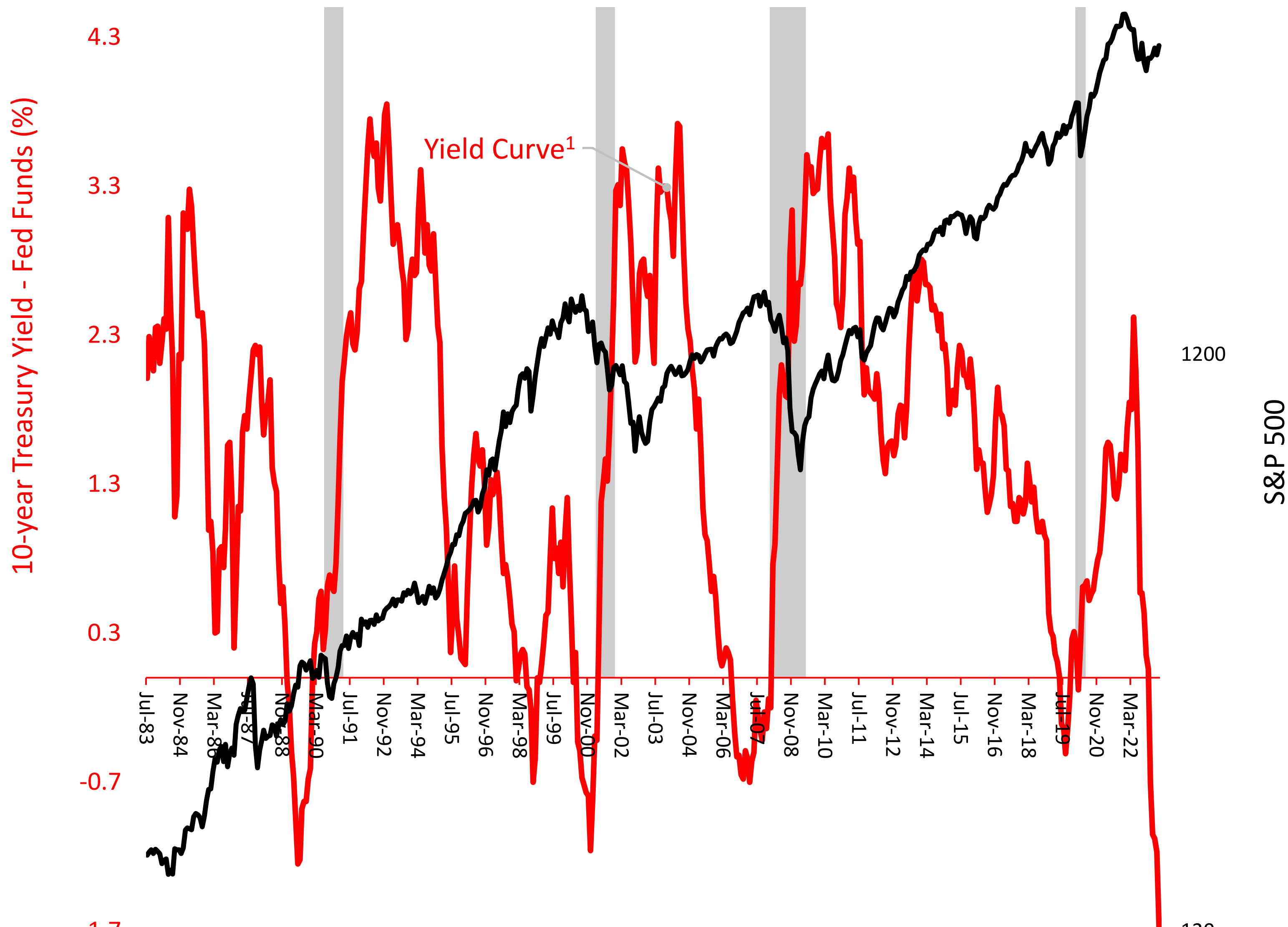
"The LEI for the US declined for the thirteenth consecutive month in April, signaling a worsening economic outlook. … The Conference Board forecasts a contraction of economic activity starting in Q2 leading to a mild recession by mid-2023."

This chart shows how the LEI has definitively rolled over well in advance of the last recessions.

The Conference Board Leading Economic Index® (LEI) components: 1) average weekly hours worked, manufacturing; 2) average weekly initial unemployment claims; 3) manufacturers' new orders – consumer goods and materials; 4) ISM index of new orders; 5) manufacturers' new orders, nondefense capital goods; 6) building permits – new private housing units; 7) stock prices, S&P 500; 8) Leading Credit Index™; 9) interest rate spread; 10-year Treasury minus fed funds; 10) index of consumer expectations.
Source: ©The Conference Board. Data through April released May 18, 2023.

Federal Reserve policy

Yield curve vs. the S&P 500



When the yield curve has inverted the economy has usually turned down into recession with a lag of a year or more.

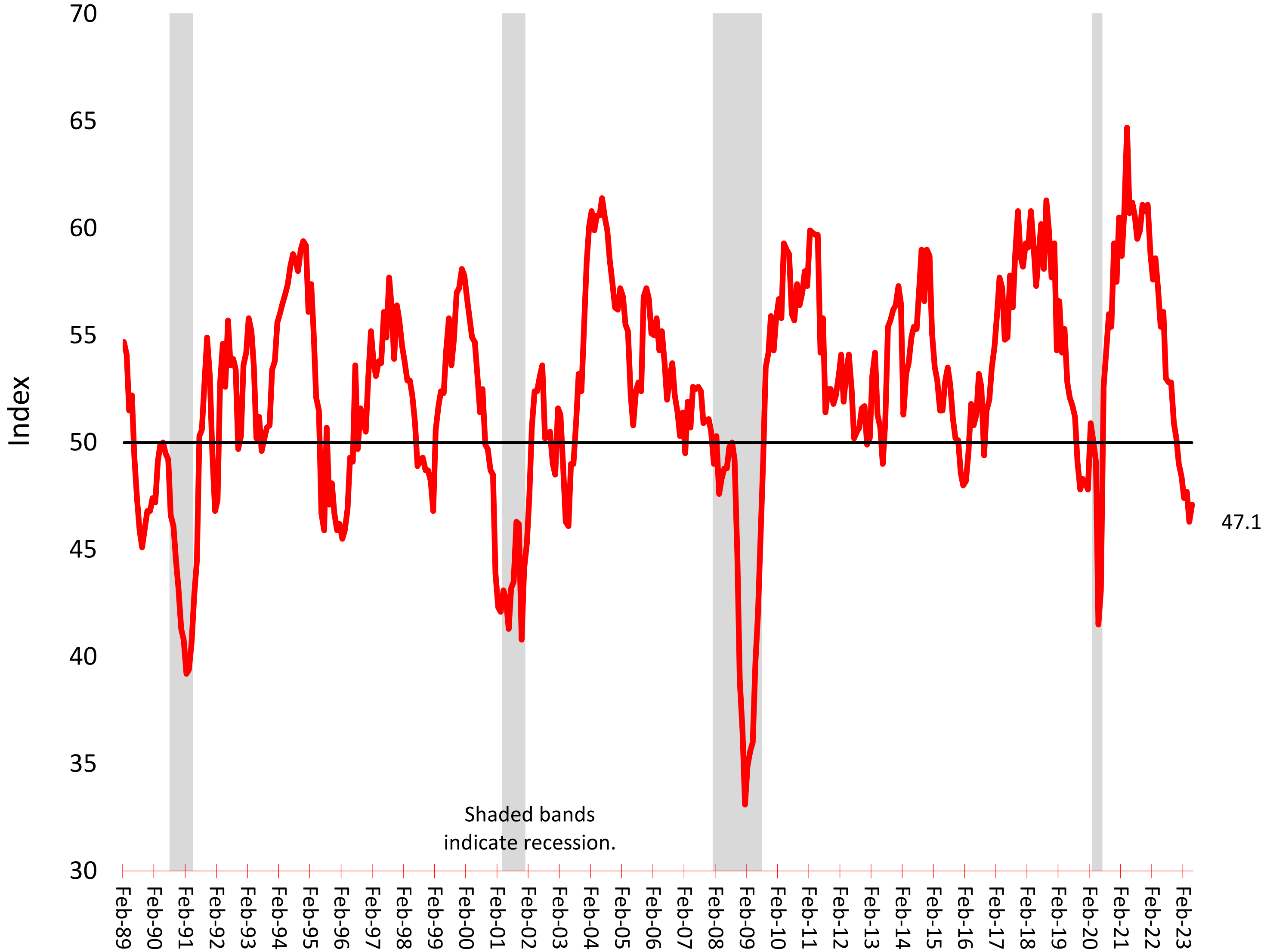
Today, the yield curve is inverted.

Sources: NBER, Federal Reserve and Standard & Poor's. Data through April 2023.

[1]The interest rate on the 10-year Treasury bond (long term) minus the fed funds rate (short term).

Economic data

ISM manufacturing PMI



April at 47.1.

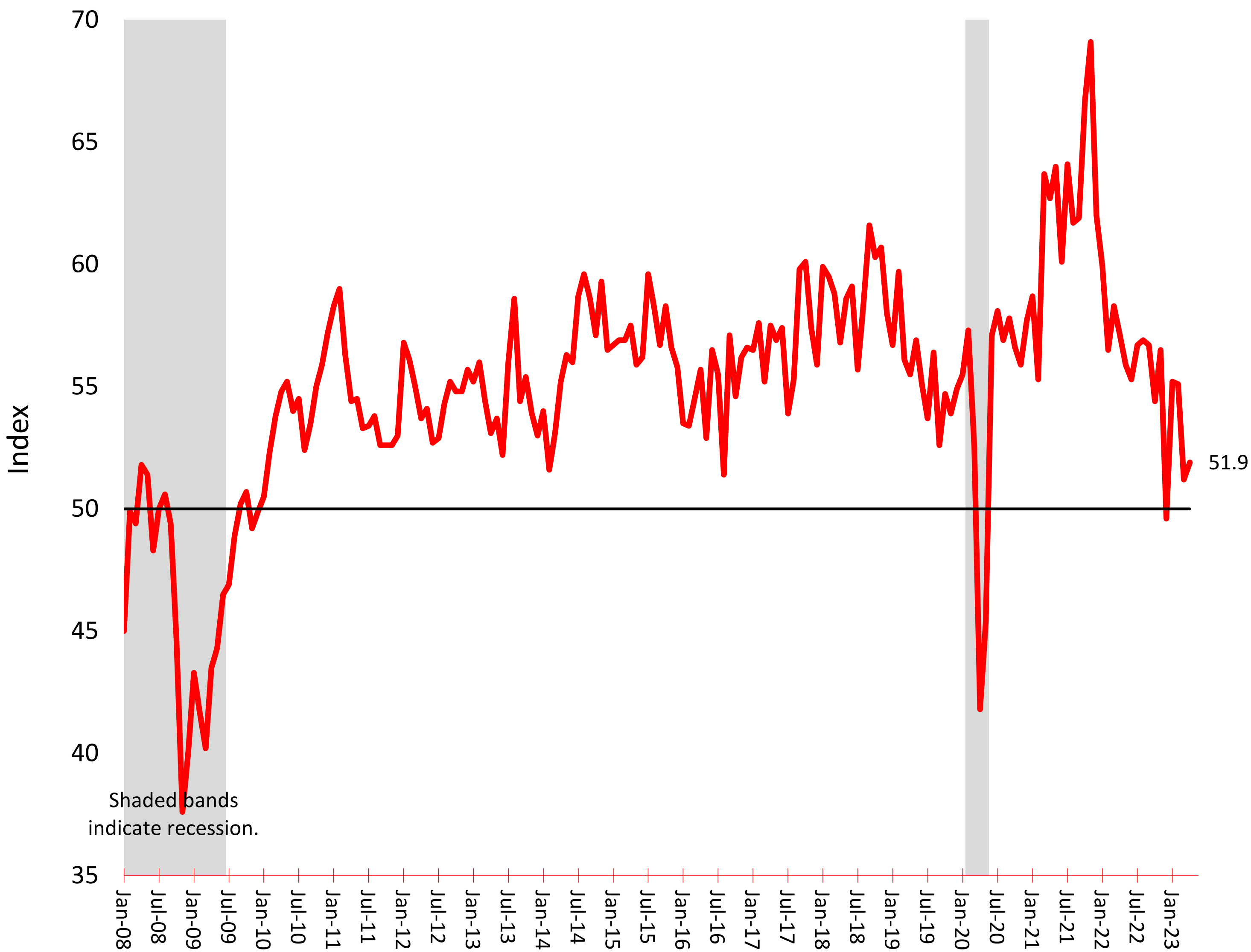
April new orders 45.7.

Note the historic volatility in the manufacturing PMI.

Note how this indicator has slumped well below 50 even during periods of strong economic expansion, eg. 1995, 1999, 2003, 2013, 2016.

Source: Copyright 2023, Institute for Supply Management. Data through April 2023.
ISM: “A reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting. A Manufacturing PMI® above 48.7 percent, over a period of time, generally indicates an expansion of the overall economy.”

ISM services PMI



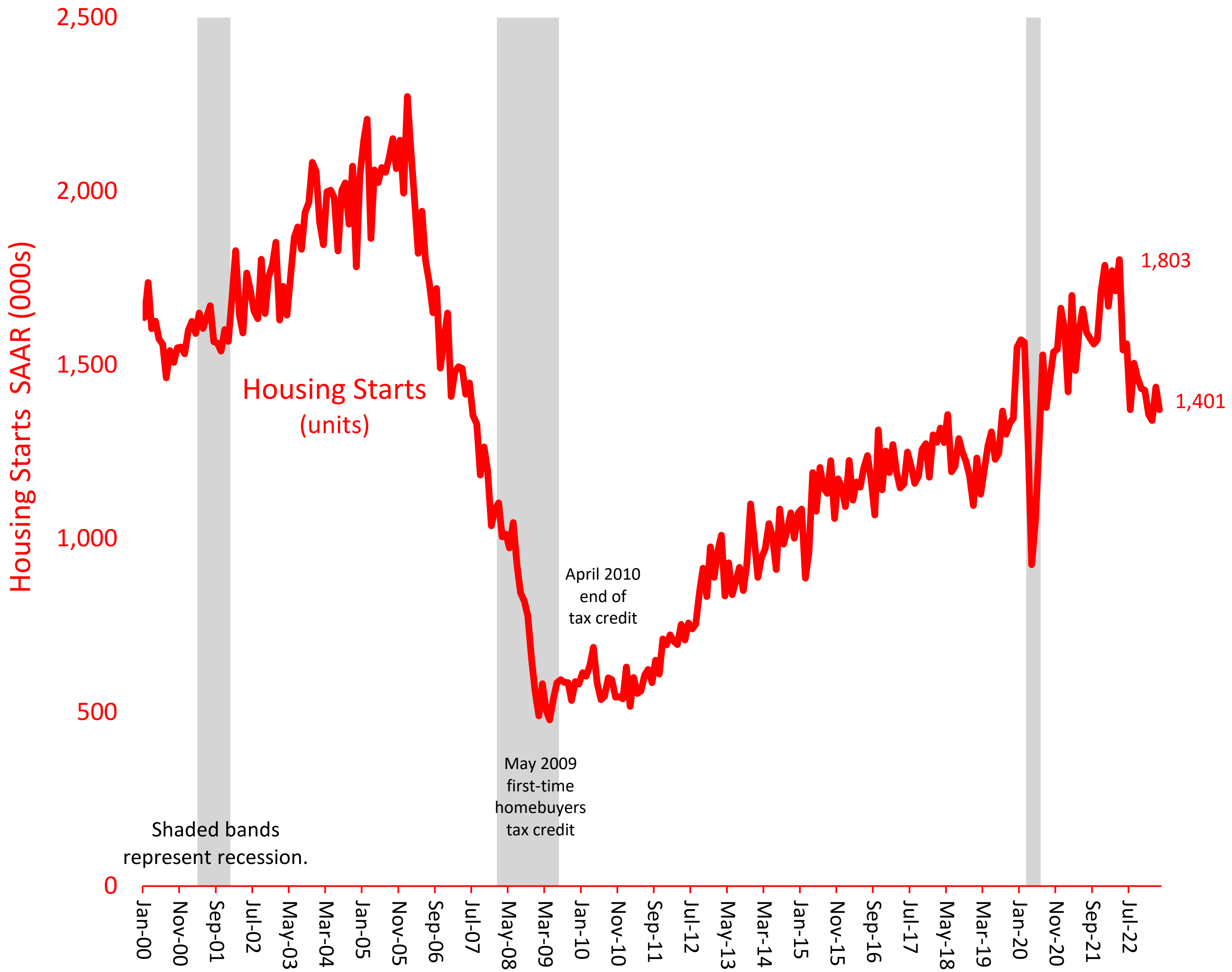
April at 51.9.

April new orders 56.1.

Services comprise 89% of the U.S. economy[1] and 91% of total nonfarm jobs.

Source: Copyright 2023, Institute for Supply Management; data through April 2023. This data series was created in 2008. ISM: “A reading above 50 percent indicates that the services sector economy is generally expanding; below 50 percent indicates that it is generally contracting.” “A Services PMI® above 50.1 percent, over time, generally indicates an expansion of the overall economy.” [1]Value added as a percent of GDP.

Housing starts



1.401 million in April.

April permits at 1.416 million.

"Housing starts also remain(ed) well below the projected rate of 1.6 to 1.8 million that is consistent with long-term demographics and the replacement of the existing housing stock (Herbert, McCue, and Spader 2016)." [1]

Sources: BEA and U.S. Census Bureau. Data through April 2023.

[1] *Economic Report of the President*, Council of Economic Advisors, February 2018

Good news

- Strong hiring data
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- Strong Q2 GDPNow forecast
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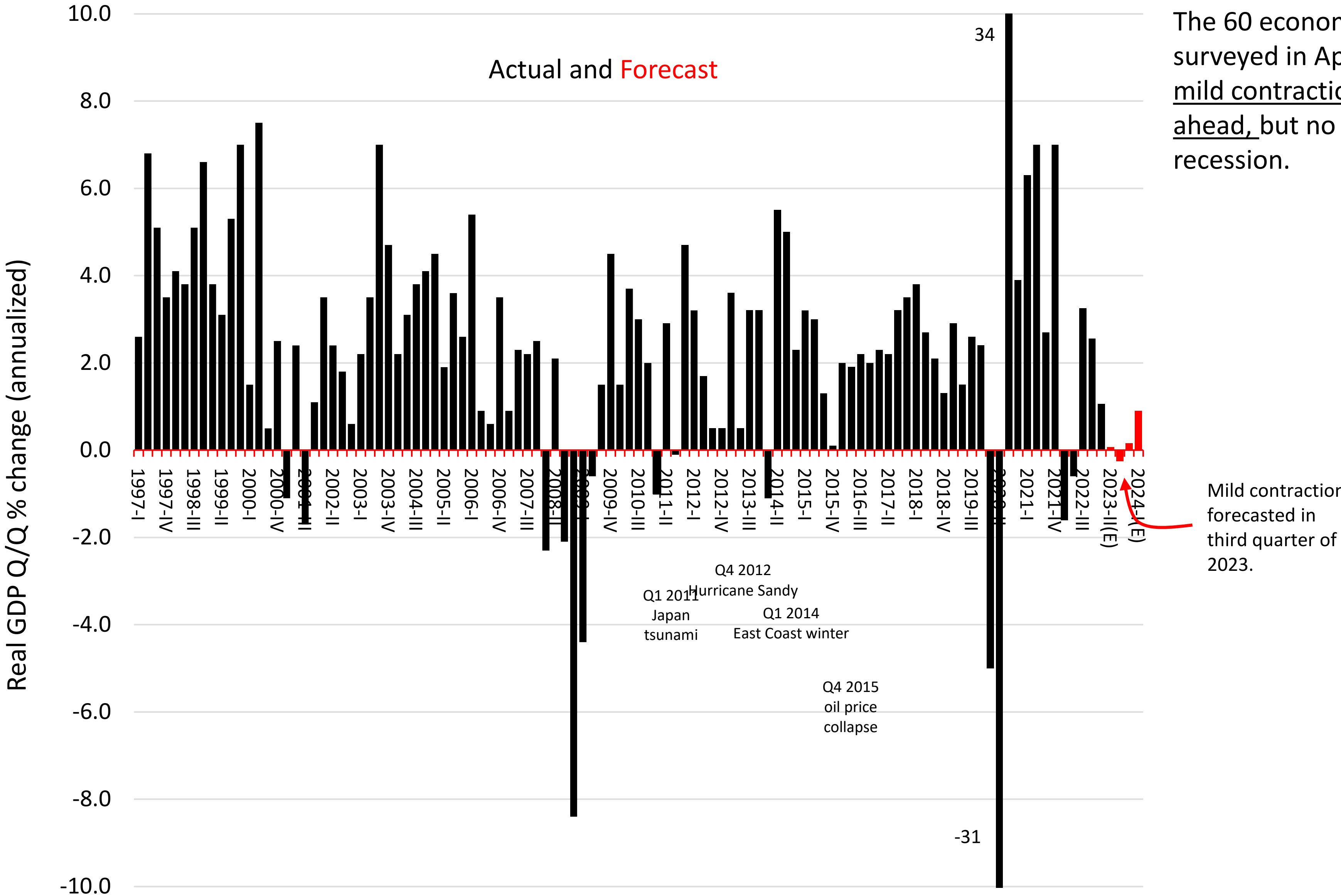
- Inflation is moderating

Consensus GDP forecast

GDP



The 60 economists surveyed in April see mild contraction ahead, but no recession.

Sources: Bureau of Economic Analysis, actual quarterly data through March 2023. *The Wall Street Journal* survey released April 2023.

Strong demand for services

THE WALL STREET JOURNAL.

U.S.'s Growth Rate Hits 13-Month High

Economic output in the U.S. posted the sharpest rise this month since April 2022, according to data firm S& P Global's surveys of purchasing managers released Tuesday. The gain was led by service-providing businesses, which reported stronger demand for travel, dining out, and other leisure activities. The improvement was offset by cooling activity among U.S. manufacturers.

"While service sector companies are enjoying a surge in postpandemic demand, especially for travel and leisure, manufacturers are struggling with overfilled warehouses and a dearth of new orders as spending is diverted from goods to services," said S& P Global economist Chris Williamson.

Source: *The Wall Street Journal.* "U.S.'s Growth Rate Hits 13-Month High" by Paul Hannon and Harriet Torry. May 24, 2023.

GDP forecast

Atlanta Fed's GDPNow forecast

Latest estimate: 2.9 percent — May 17, 2023

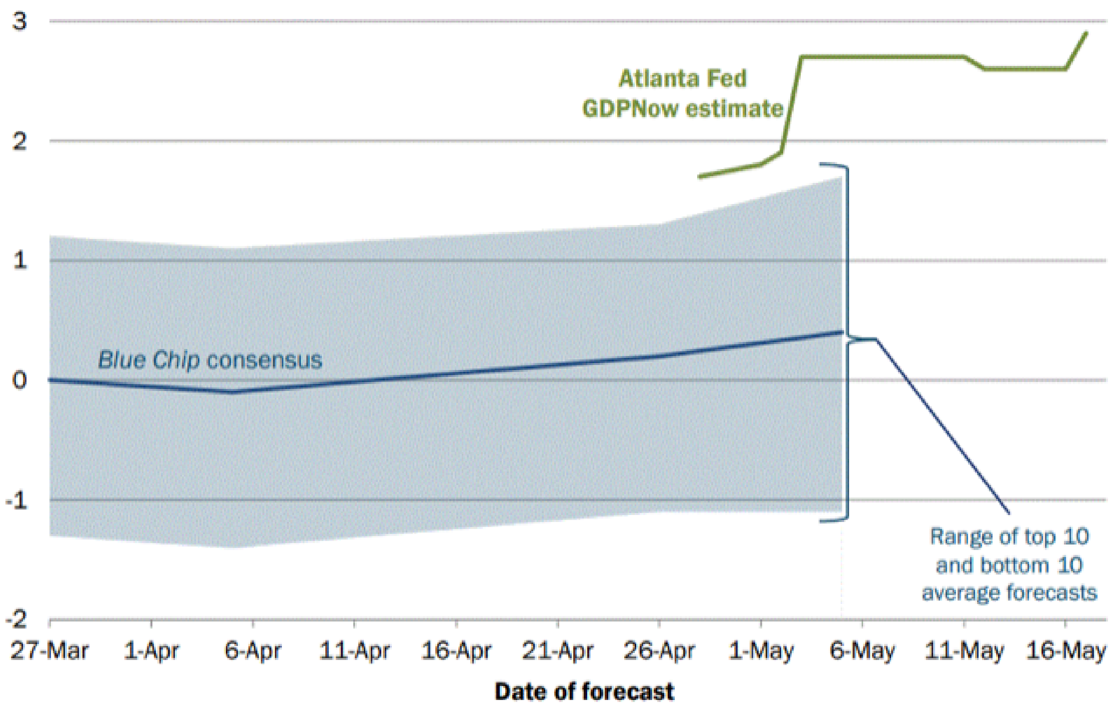
The GDPNow model estimate for real GDP growth (seasonally adjusted annual rate) in the second quarter of 2023 is **2.9 percent** on May 17, up from 2.6 percent on May 16. After this morning's housing starts report from the US Census Bureau, the nowcast of second-quarter real residential investment growth increased from -6.3 percent to 0.6 percent.

The next GDPNow update is ***Friday, May 26****. Please see the "Release Dates" tab below for a list of upcoming releases.*

GDPNow is much higher than Blue Chip consensus.

Evolution of Atlanta Fed GDPNow real GDP estimate for 2023: Q2

Quarterly percent change (SAAR)



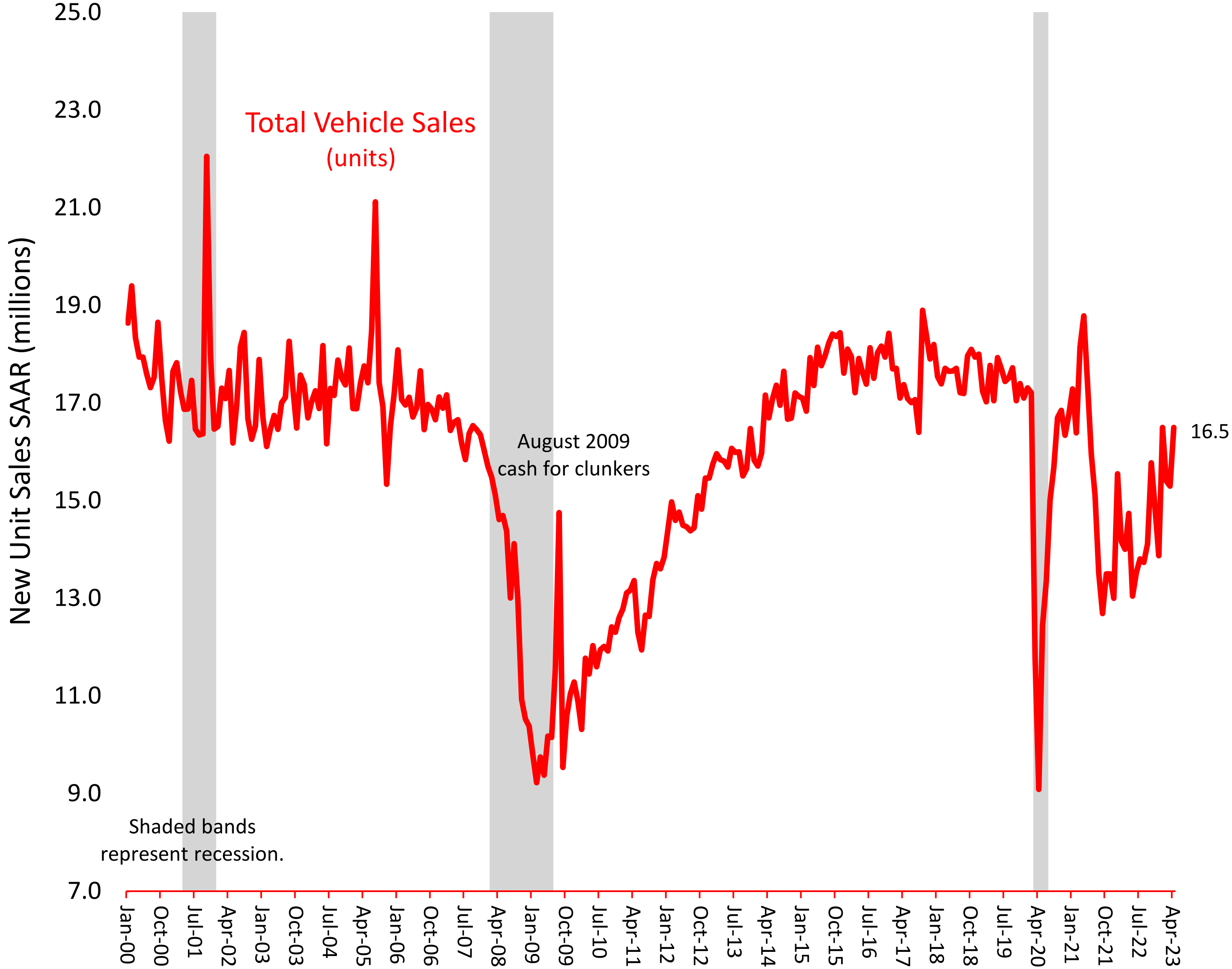
Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Source: Federal Reserve Bank of Atlanta, May 17, 2023.

Economic data

Vehicle sales



Car sales recovering.

Sources: BEA. Data through April 2023.

Retail sales

THE WALL STREET JOURNAL.

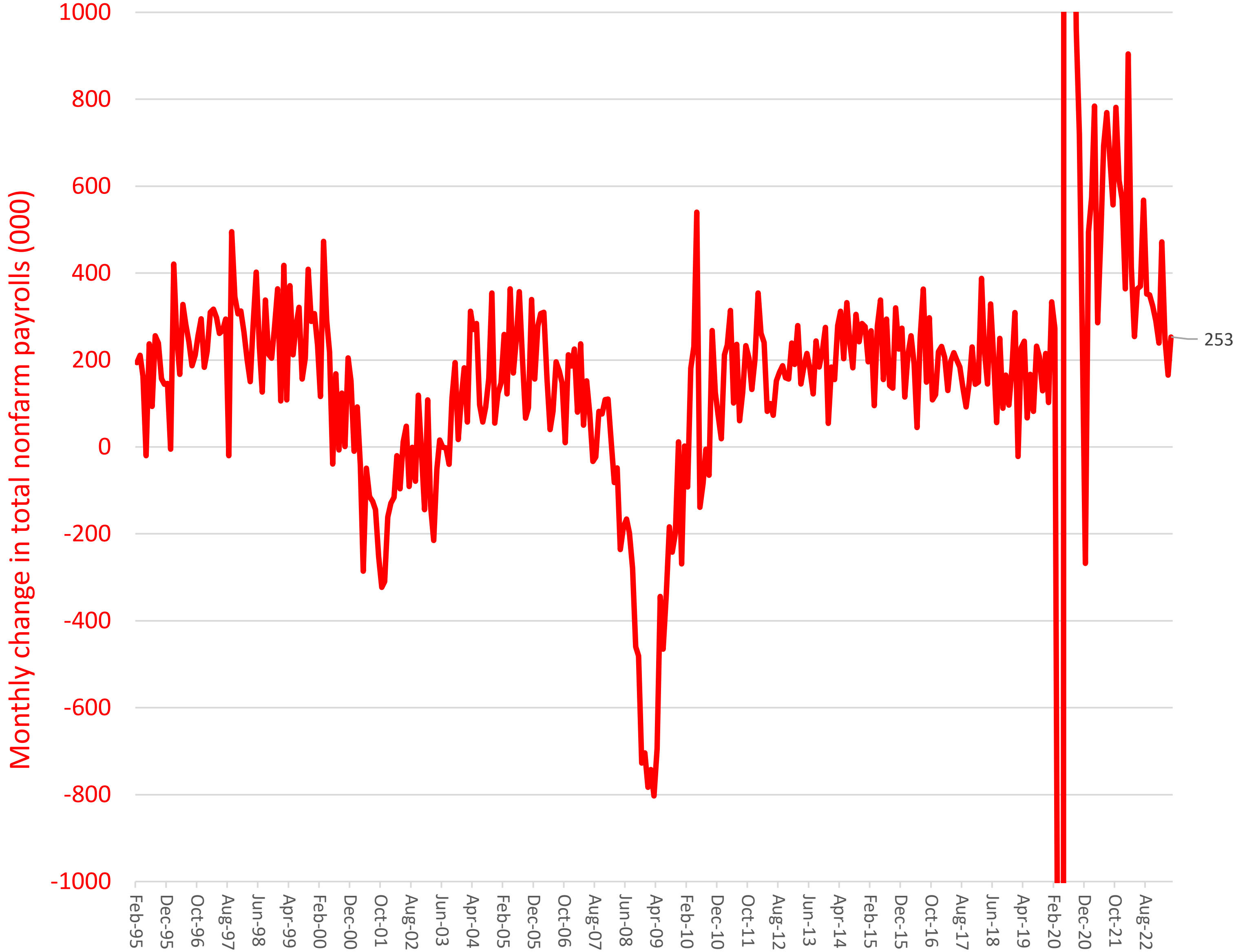
Retail Sales Climb for First Time in Months

Americans boosted their retail spending in April for the first time in months, a sign of consumers' continued resilience despite high inflation and rising interest rates.

Source: *The Wall Street Journal.* "Retail Sales Climb for First Time in Months", by Gwynn Guilford and Sarah Nassauer. May 17, 2023.

Economic data

Net new job formation

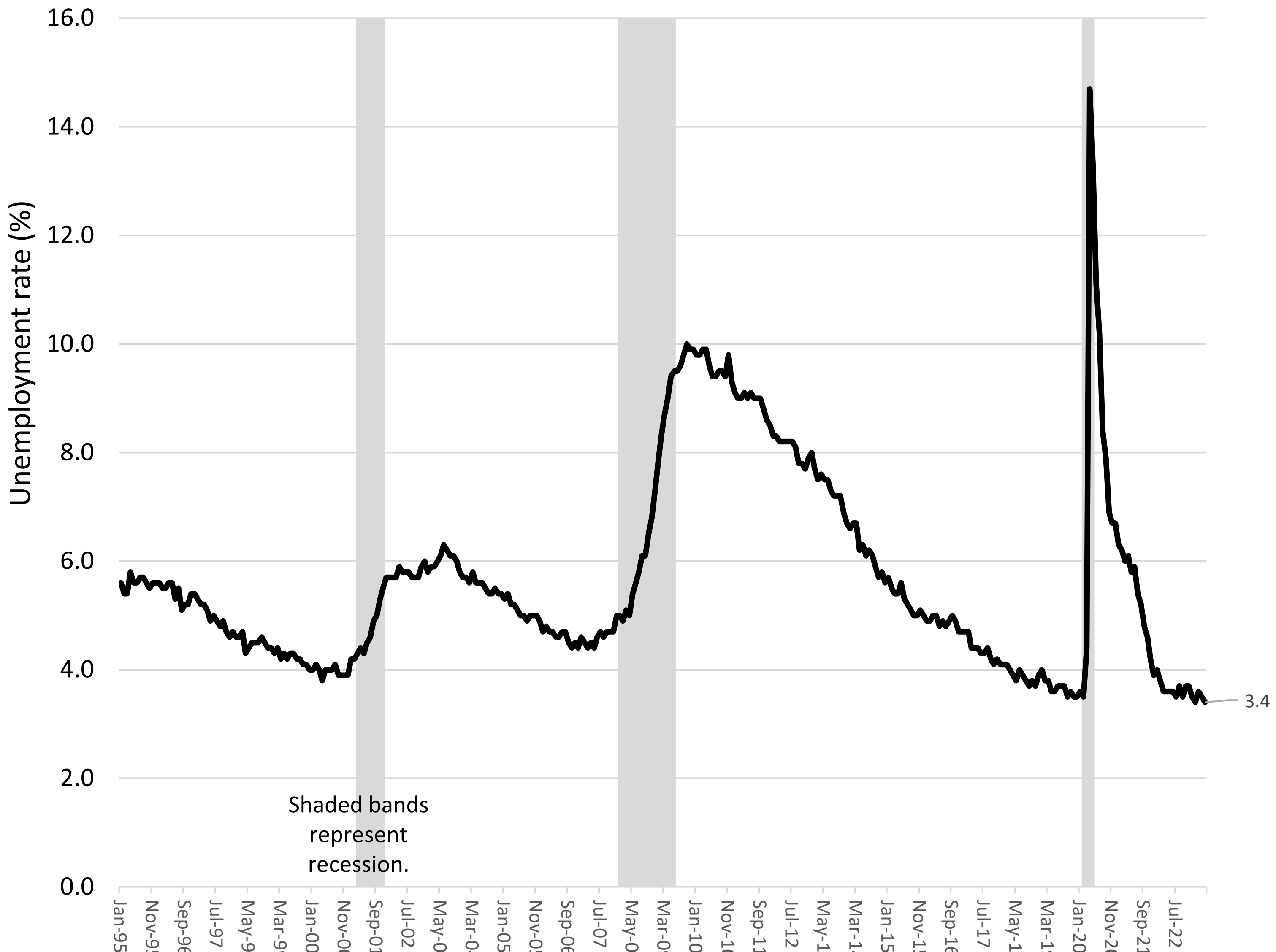


253,000 jobs gained in April on the establishment survey.

Source: Bureau of Labor Statistics. Data through April 2023.

Economic data

Unemployment rate

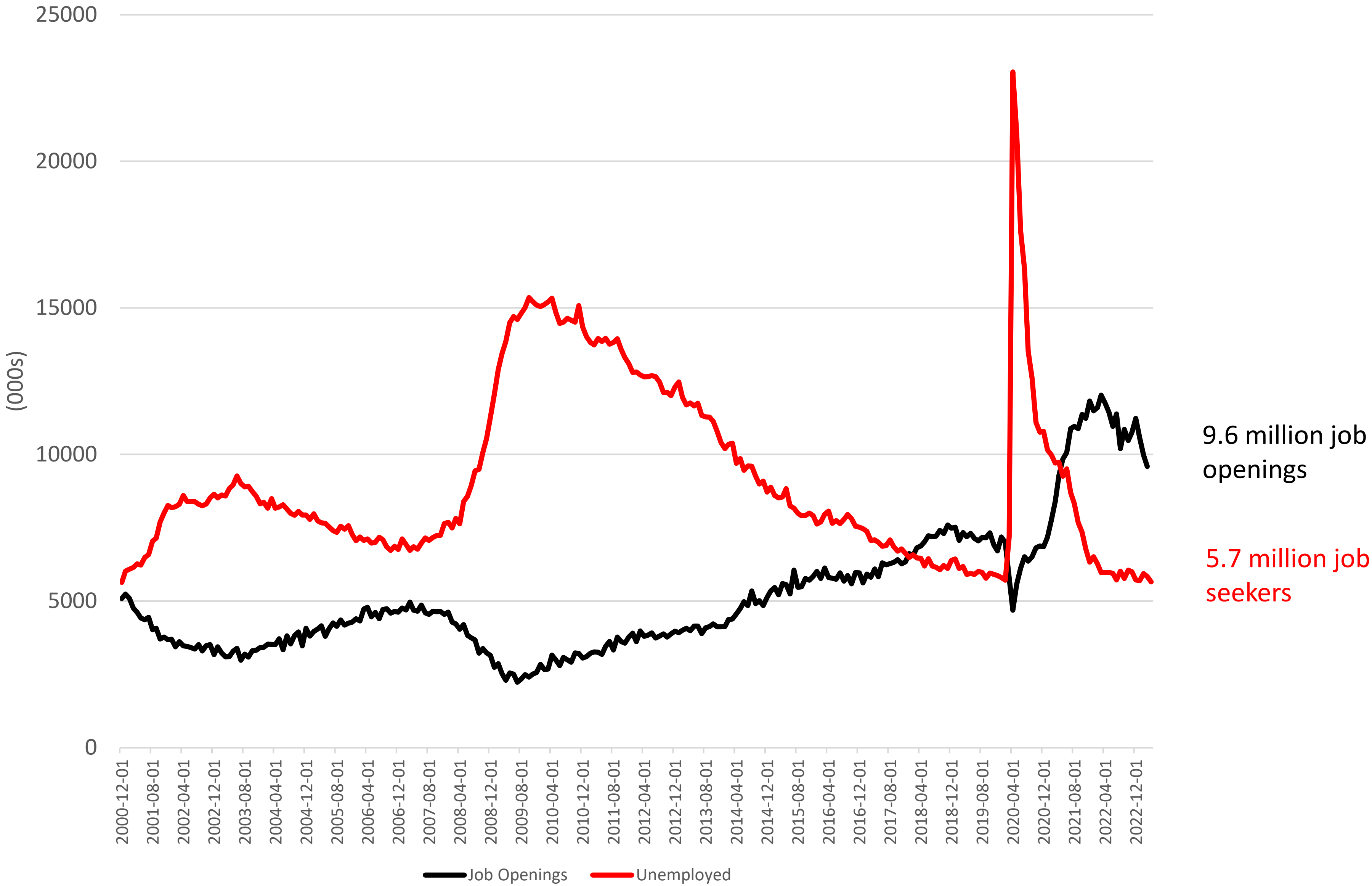


3.4% in April.

Source: Bureau of Labor Statistics. Data through April 2023.

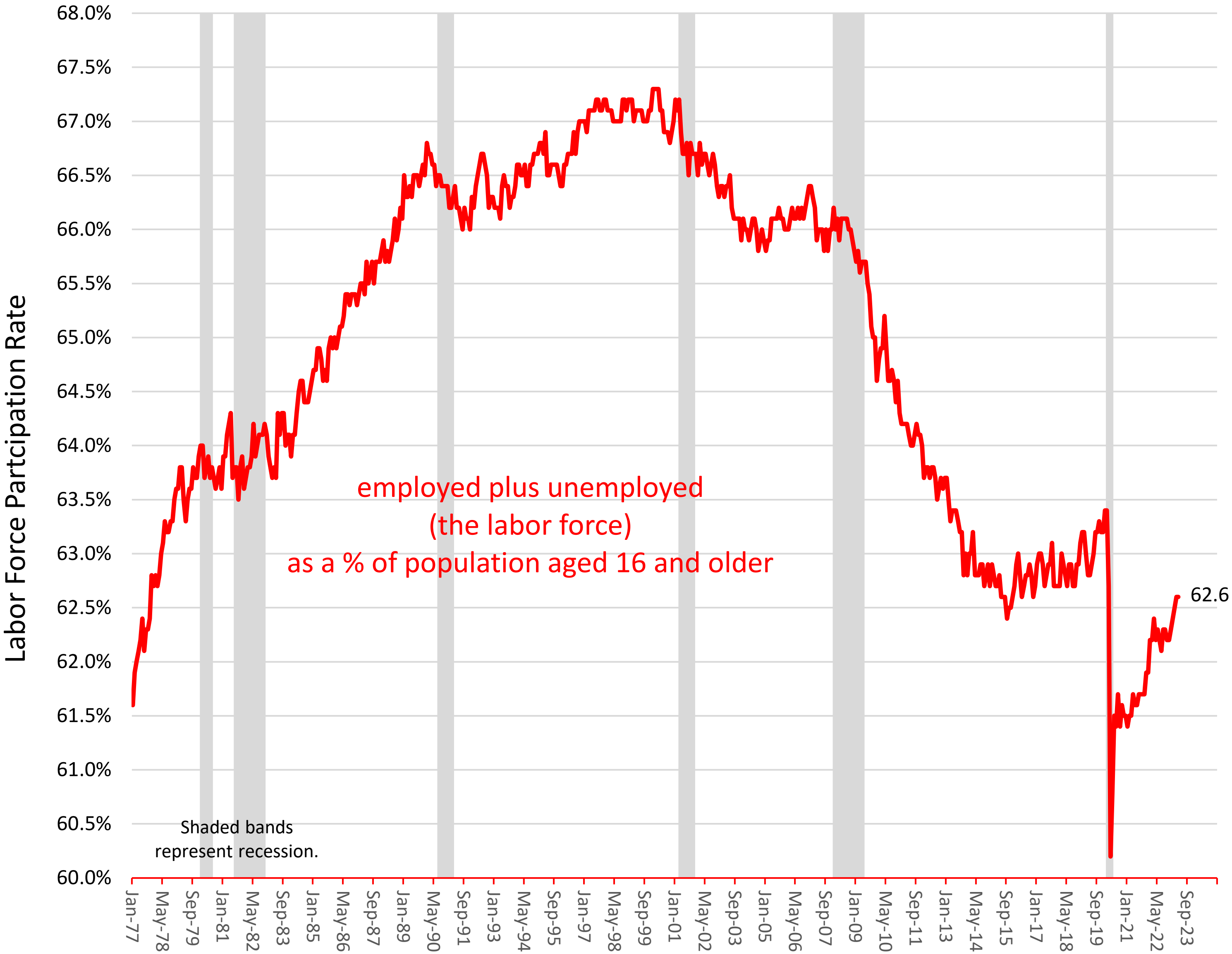
Economic data

"Excess demand" for labor – this time is different



Source: Bureau of Labor Statistics. Data through March 2023 for job openings, April 2023 for unemployed.

Labor force participation rate[1] – recovering from Covid



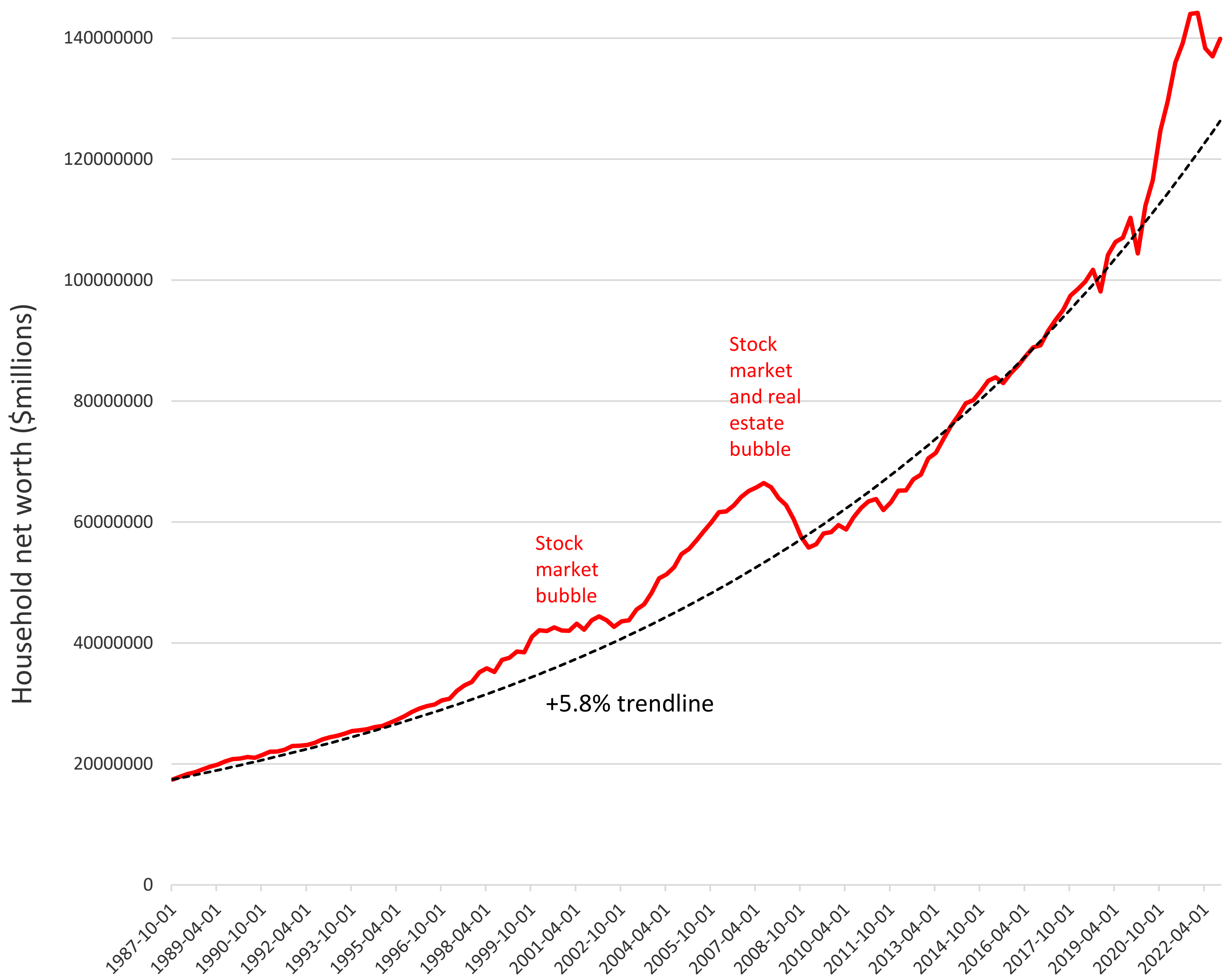
Americans were joining and staying in the labor force in increasing numbers … until Covid-19.

A reduction in immigration and a surge in retirements have subtracted from the labor force.

Source: BLS. Data through April 2023.

[1]Labor force participation rate: the proportion of the civilian noninstitutional population 16 years of age and older either at work or actively seeking work.

Household net worth – the wealth effect



Household net worth surged.

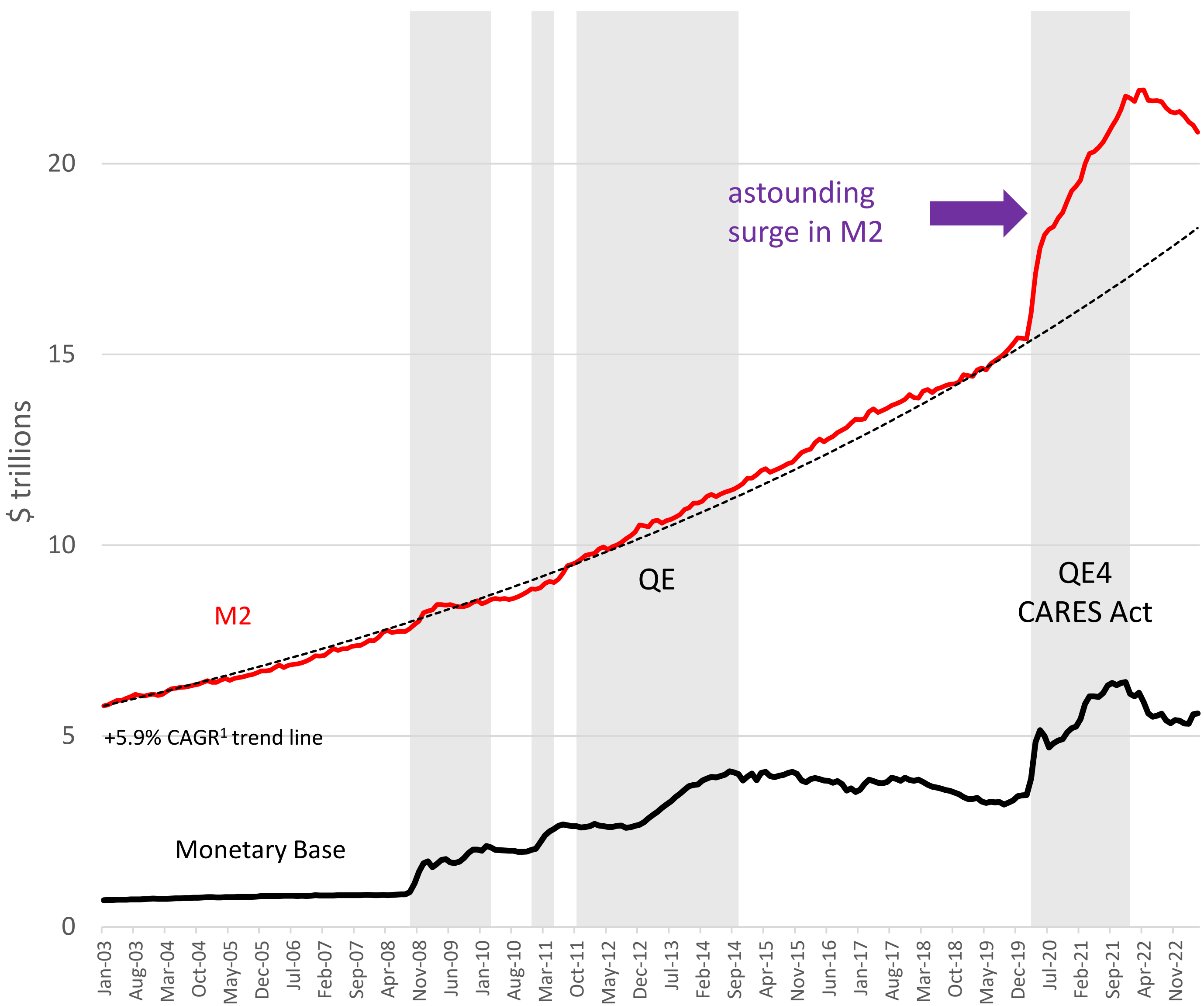
Source: Federal Reserve, FRBSL. Quarterly data through December 2022, released March 9, 2023.

Financial obligations ratio

Source: Federal Reserve. Quarterly data through December 2022.

This measure shows that percent of monthly after-tax income that the average household pays for fixed recurring monthly obligations, such as a mortgage, car payment, utilities, real estate taxes, etc.

The monetary base and the money supply



M2: currency held by the public plus checking, savings and money market accounts.

A quadrupling of the monetary base with QE did not affect M2 growth. <u>The CARES Act and subsequent stimulus did</u> … by putting money directly into consumers' and businesses' accounts.

Monetary base: currency in circulation plus reserve balances (deposits held by banks in their accounts at the Federal reserve).

Source: Federal Reserve, statistical release H.6. Data through April 2023.
[1]CAGR = compound annual growth rate.

Consumers’ cash balances declining

THE WALL STREET JOURNAL.

As Savings Shrink, Spending at Risk

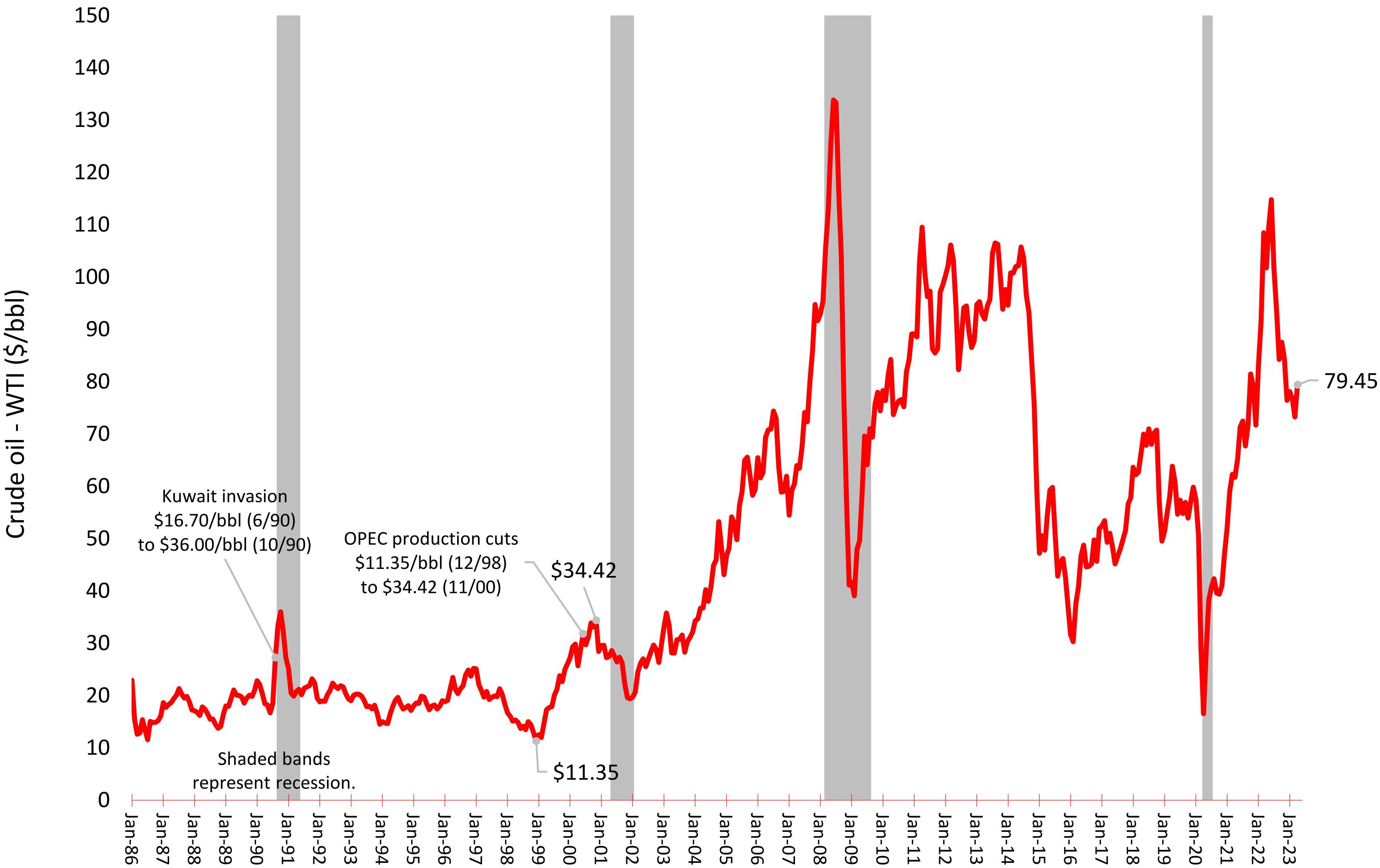
It is the $1.7 trillion question for the U.S. economy: How long can the savings consumers built up during the pandemic keep their spending going?
The answer: about nine to 12 more months.

Economists estimate that headed into the third quarter of this year, households still had about $1.2 trillion to $1.8 trillion in “excess savings”—the amount above what they would have saved had there been no pandemic.

Source: *The Wall Street Journal*, “As Savings Shrink, Spending at Risk”, Harriet Torry. November 21, 2022.

Oil

WTI spot crude oil prices



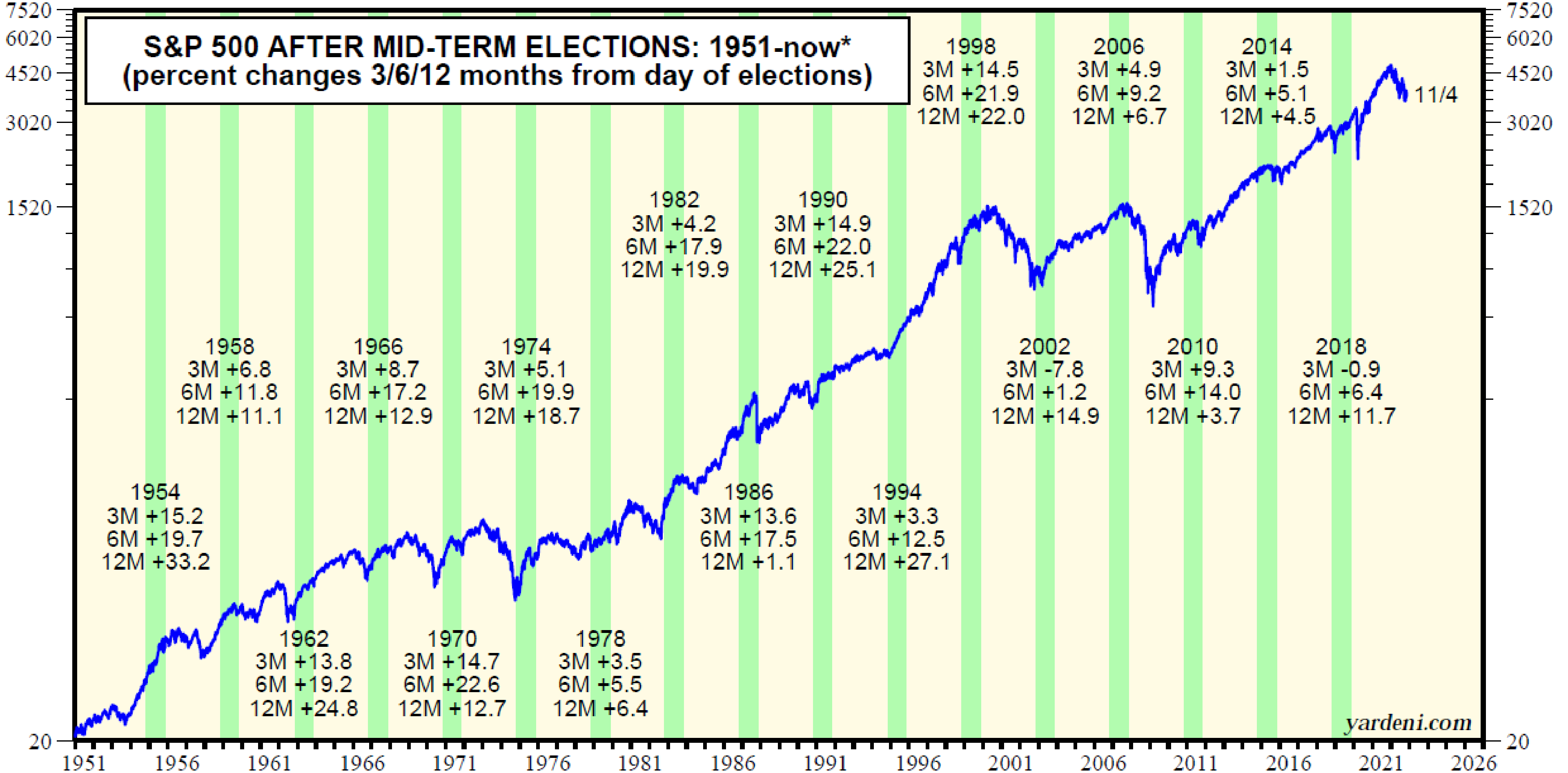
Source: U.S. Energy Information Agency. Data through April 2023.

Stock Market

- mid-term election years
- bear market
- stocks vs. recessions
- “parabolic” is normal
- 2023/2024 earnings estimates
- P/E multiple

S&P 500 and mid-term elections

Figure 3.

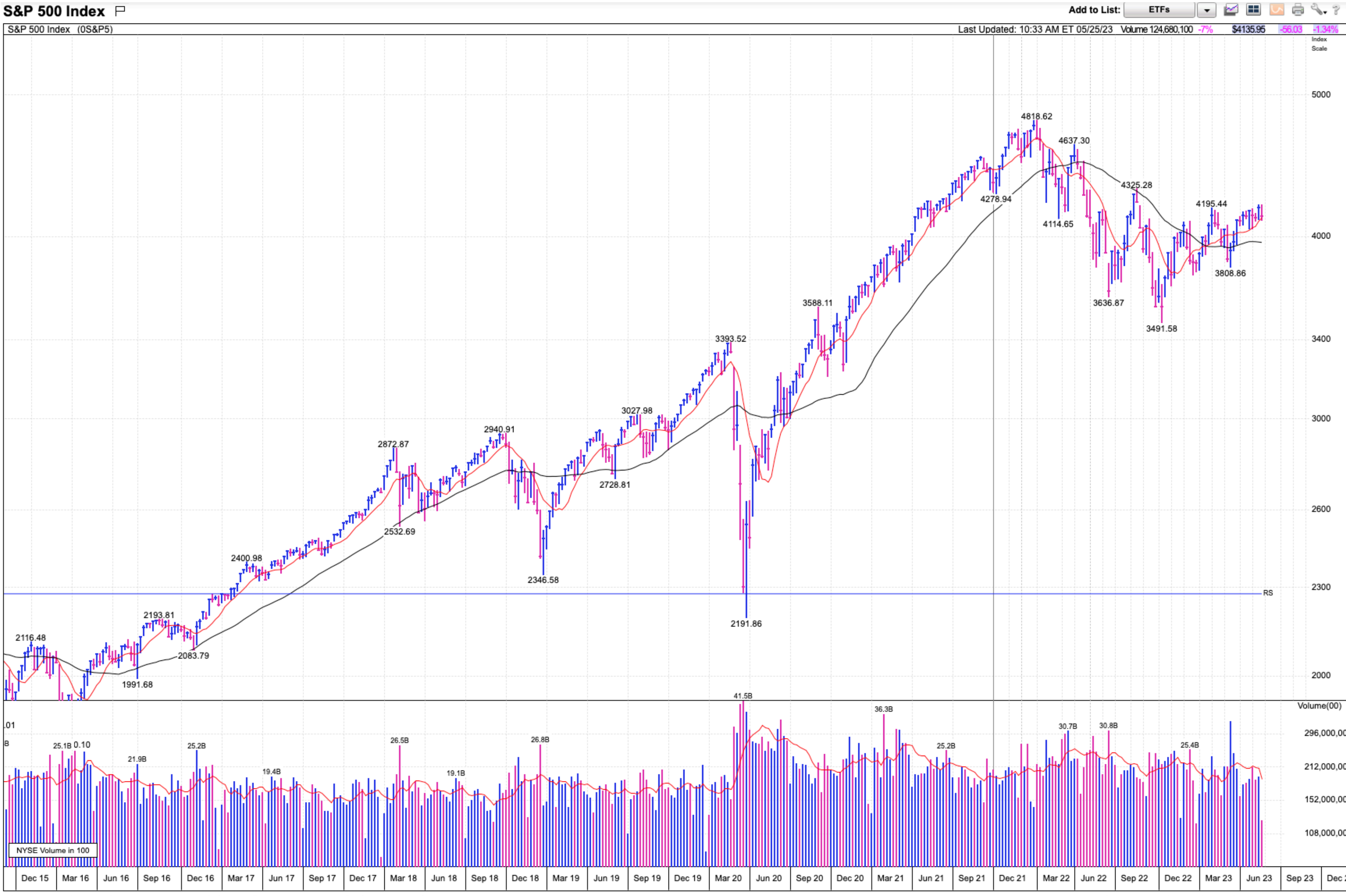


* S&P 500 up (down) during 12-month span following election day in green (red) shaded area. Prior to 1969, markets were closed on election day, therefore used "latest close" for those dates.
Source: Haver Analytics, Standard & Poor's, YRI calculations.

Source: Yardeni Research, Inc., with permission. November 6, 2022.

Stock market

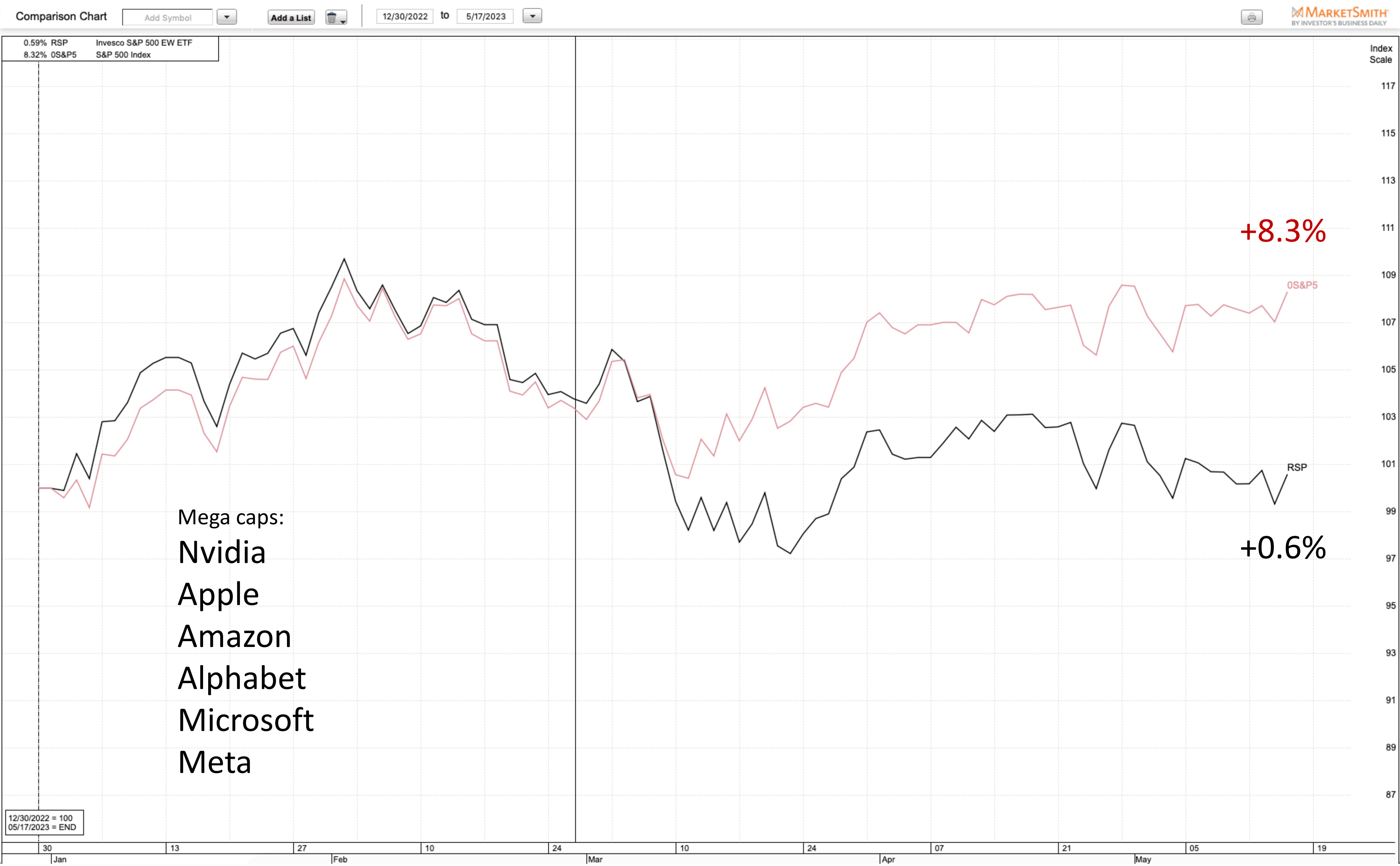
S&P 500



Source: Standard & Poor's and MarketSmith, Inc. Data through May 25, 2023.

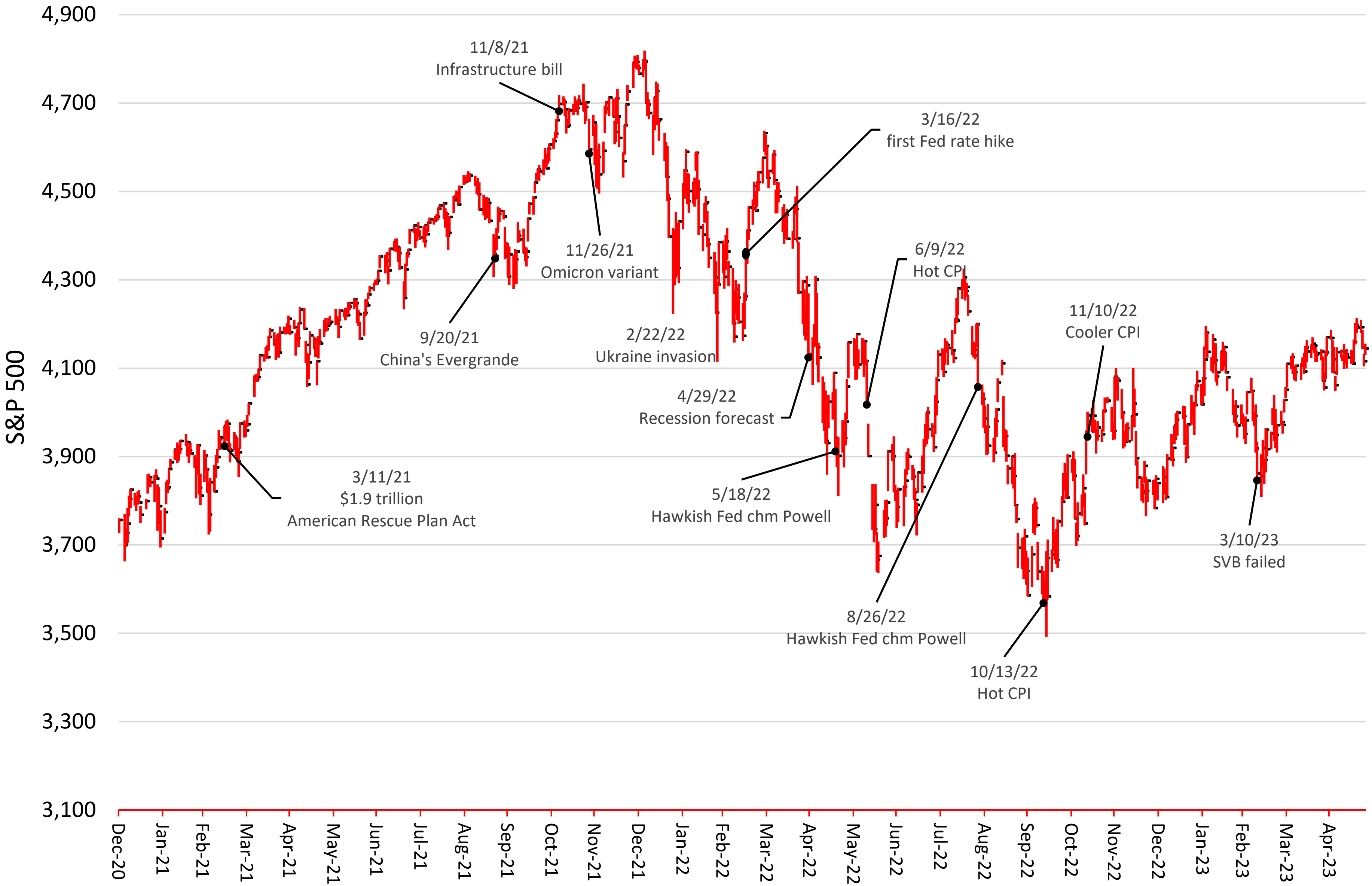
Stock market

S&P 500 vs. S&P 500 equal-weighted



Source: Standard & Poor’s and MarketSmith, Inc. Data through May 17, 2023.

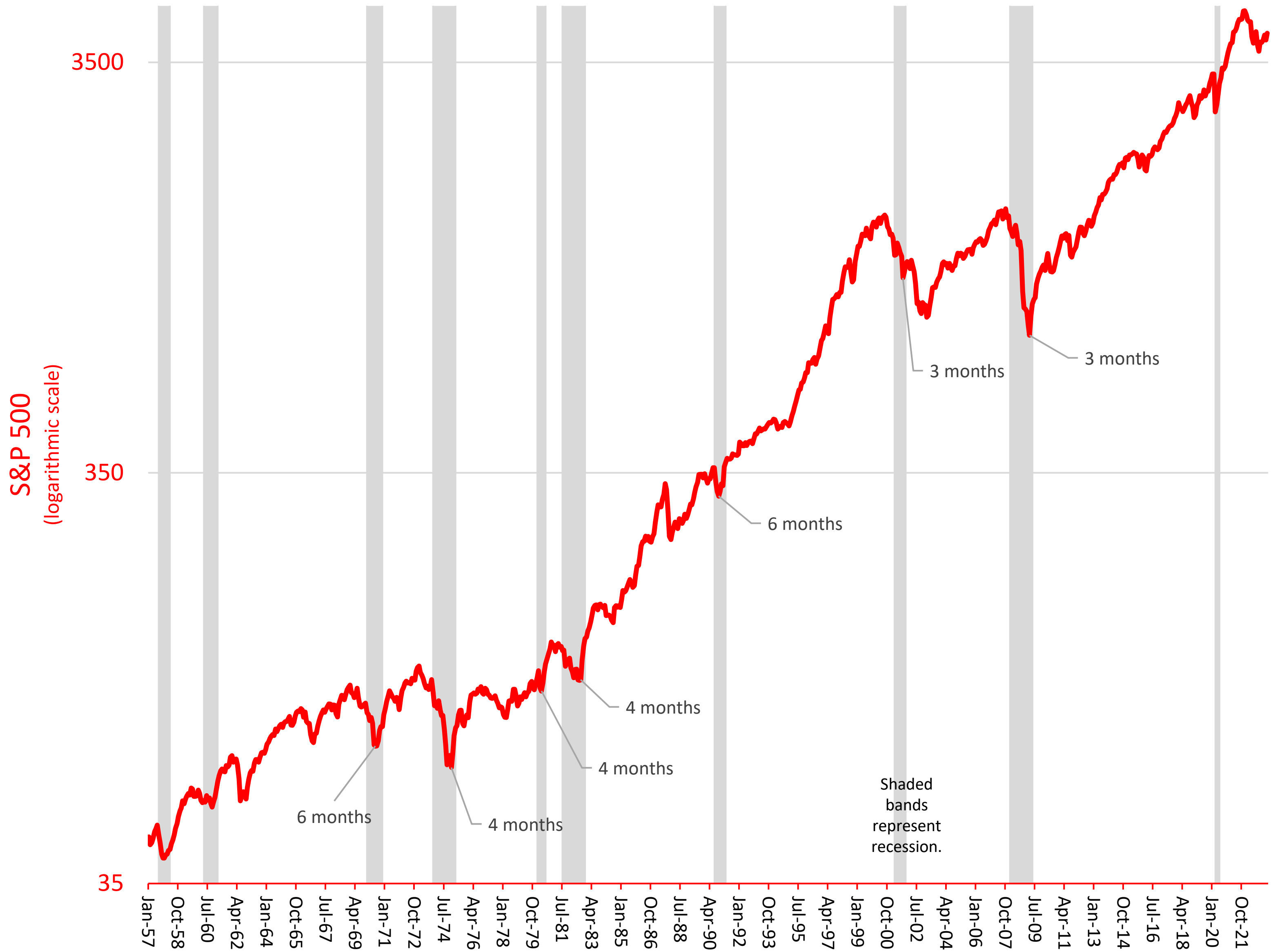
S&P 500



Source: Standard & Poor's. Data through May 25, 2023.

Stock market

S&P 500 vs. recessions

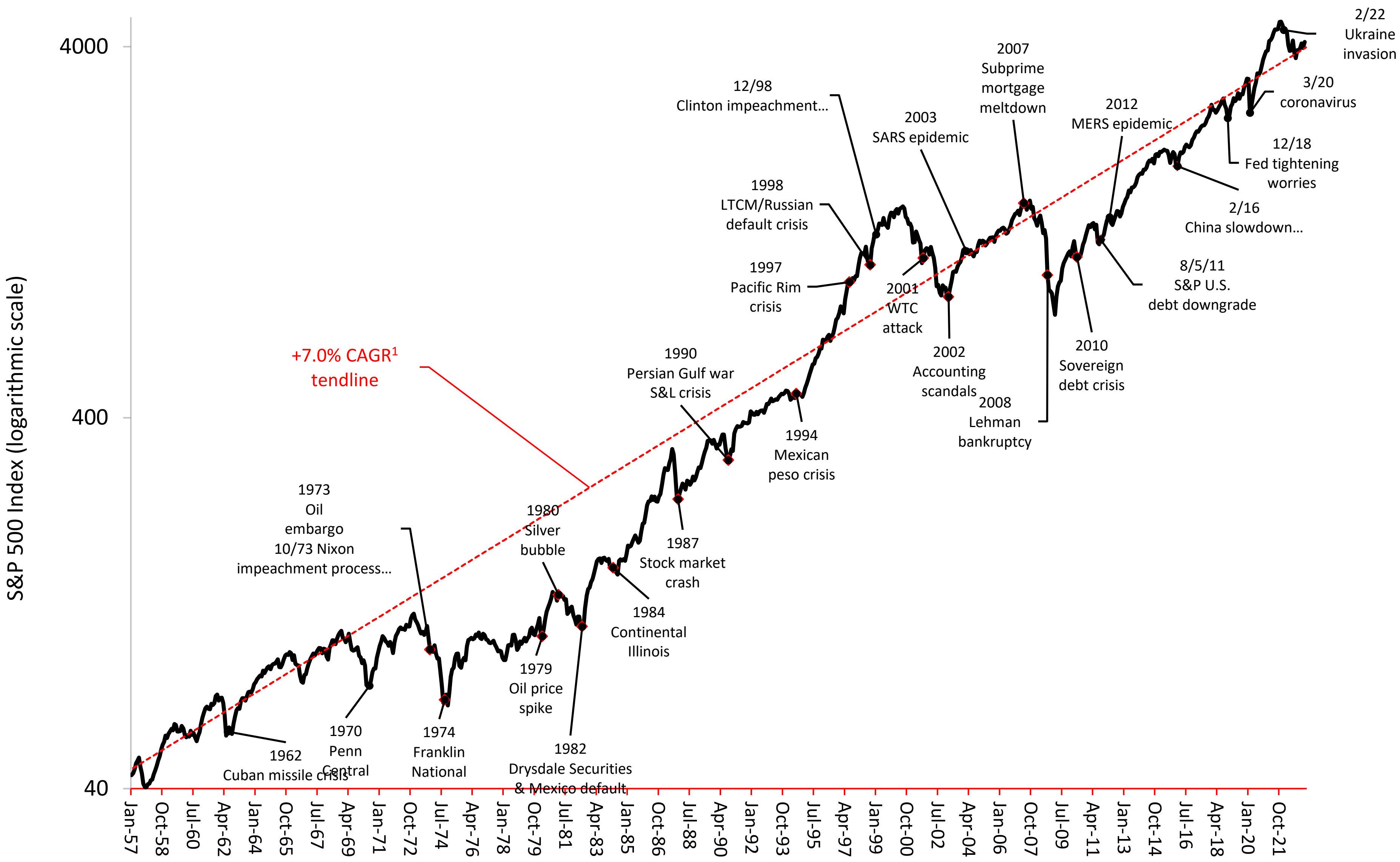


Big declines are associated with recessions.

Stocks often bottom months before recession-end.

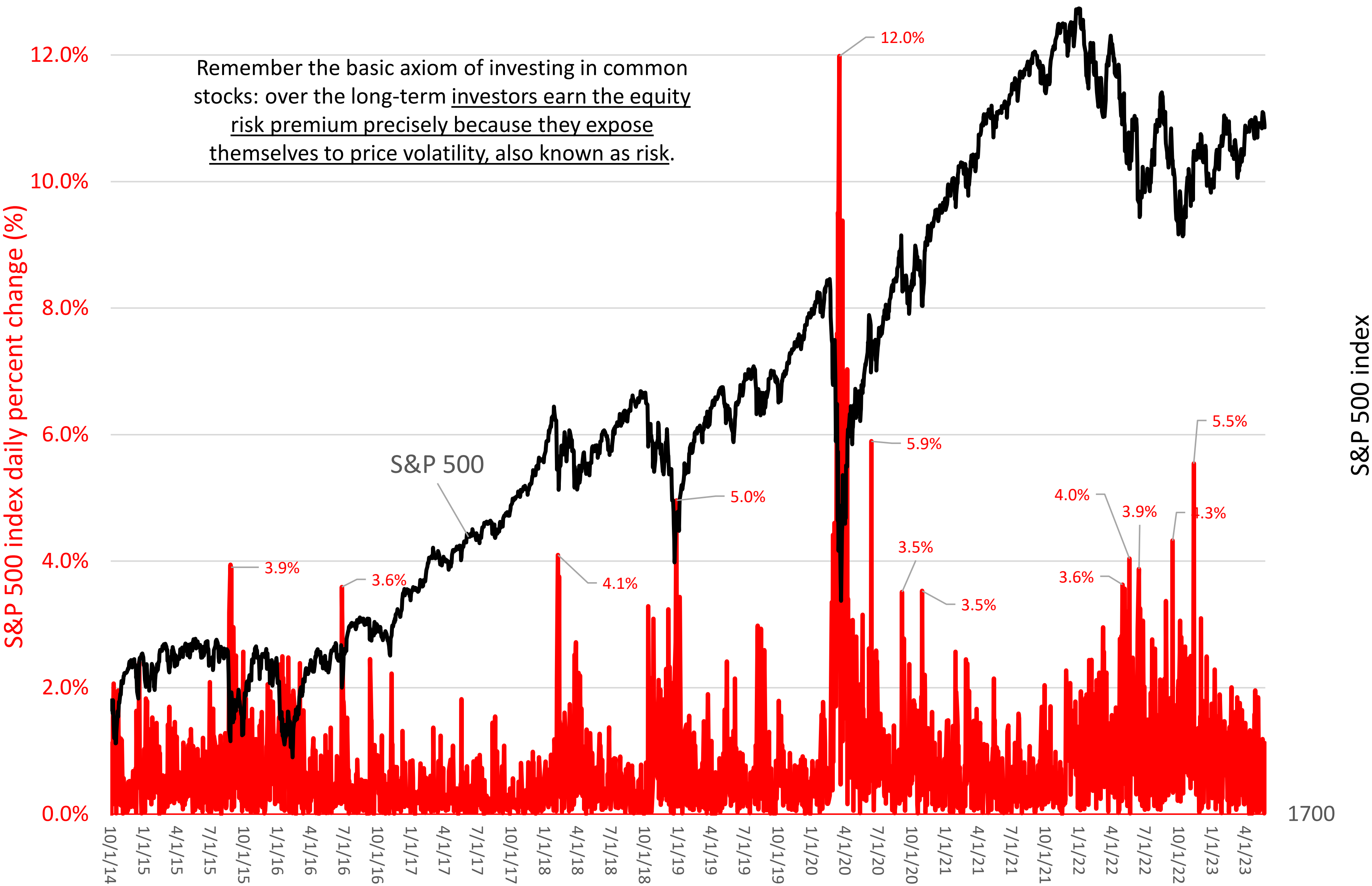
Source: Standard and Poor's Corporation, National Bureau of Economic Research. Data through April 2023.

S&P 500 and crises



Source: Standard and Poor's. Data through April 2023. [1] Compound annual growth rate.

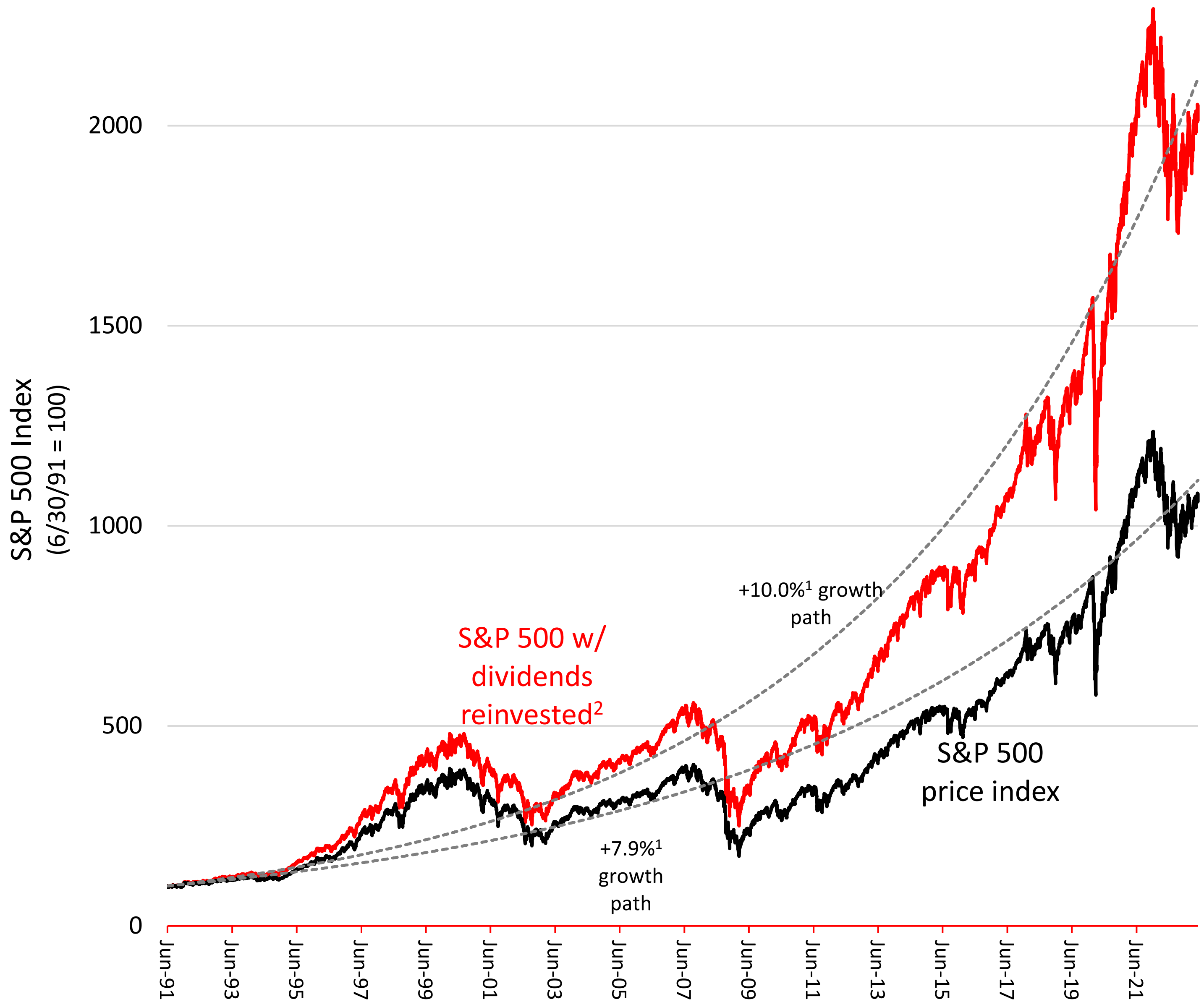
S&P 500 volatility



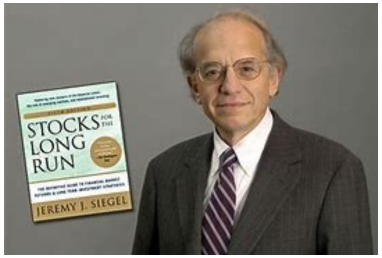
Source: Standard & Poor's, data through May 24, 2023.

Stock market arithmetic

Total return = 7.9% earnings-driven price + 2.1% dividends reinvested



+10% per year S&P 500 total return over the last 30 years is in line with the stock market's long-term returns going back to 1926, or back even further to 1871.[3]



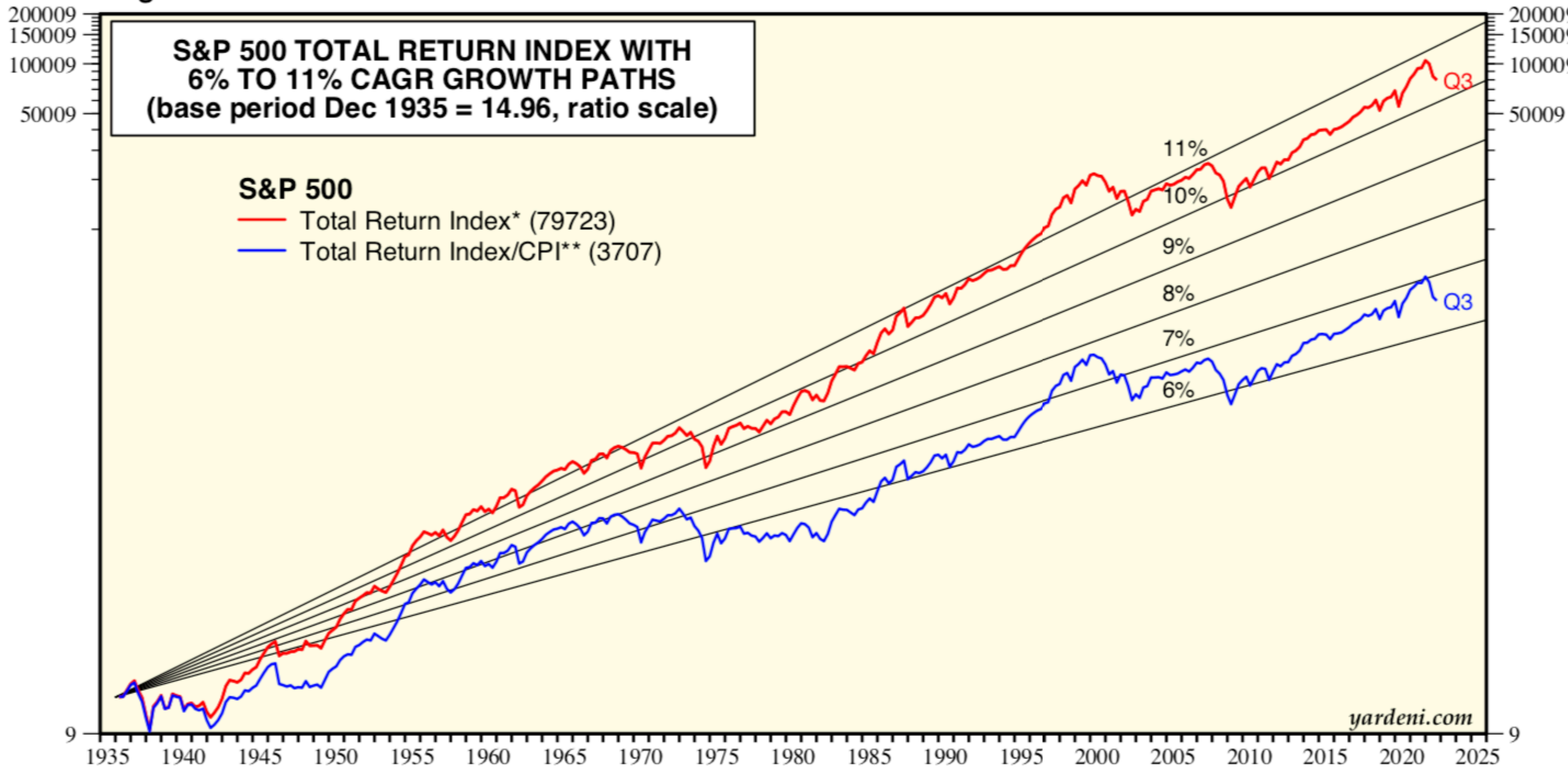
Source: Standard and Poor's. Data through May 24, 2023.[1] Compound annual growth rate. [2] S&P 500 total return index.
[3] per Professor Jeremy Siegel's seminal *Stocks for the Long Run*, first published in 1994.

Total return = 7.9% earnings-driven price + 2.1% dividends reinvested

Source: Standard and Poor's. Data through May 24, 2023. [1] Compound annual growth rate. [2] S&P 500 total return index.

Total return and real total return

Figure 6.

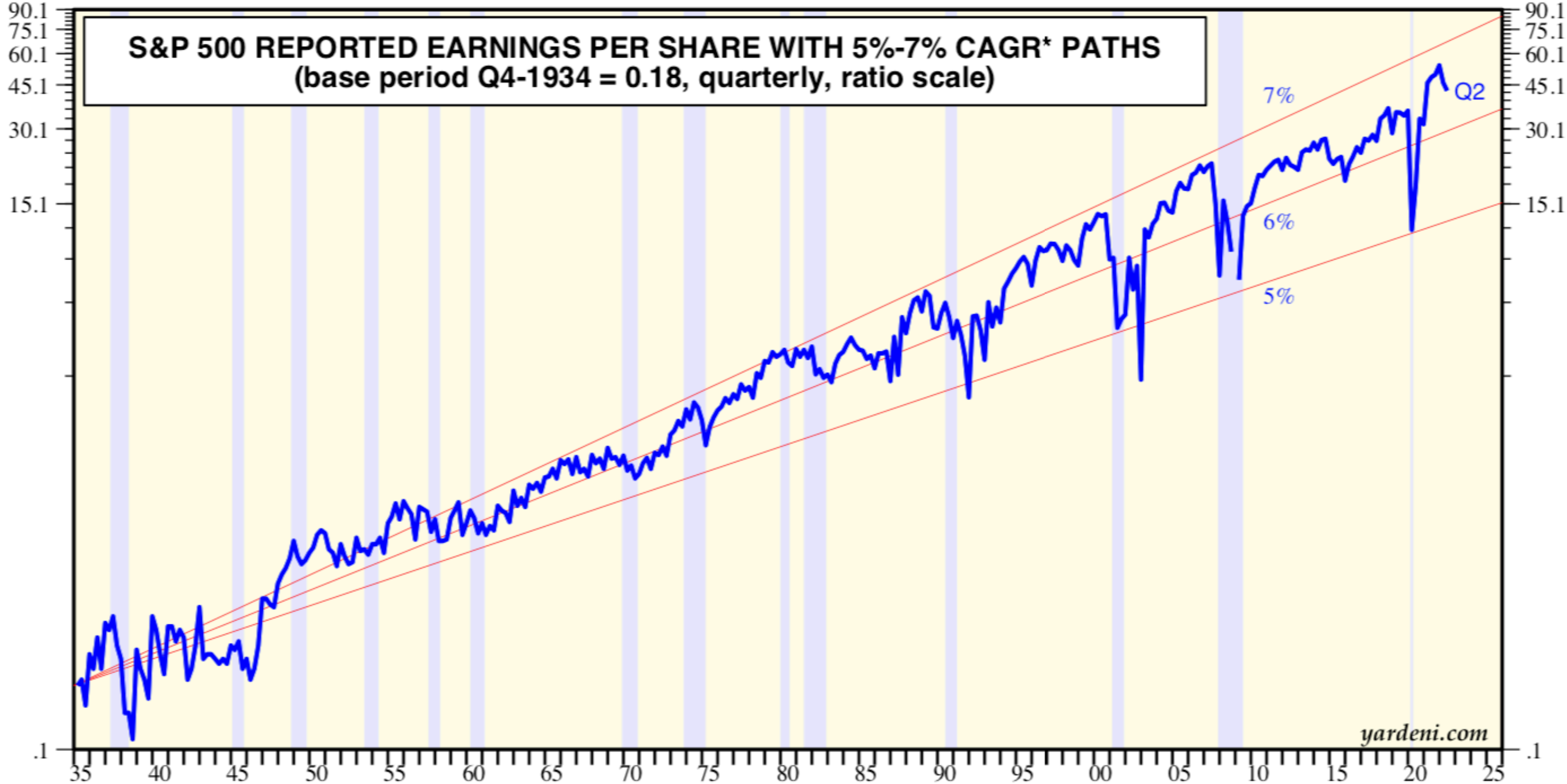


* Includes reinvested dividends.
** Using last month of quarter CPI. Compounded monthly using base value.
Source: Standard & Poor's.

Source: Yardeni Research, Inc., with permission.

85 years of S&P 500 earnings growth

Figure 9.

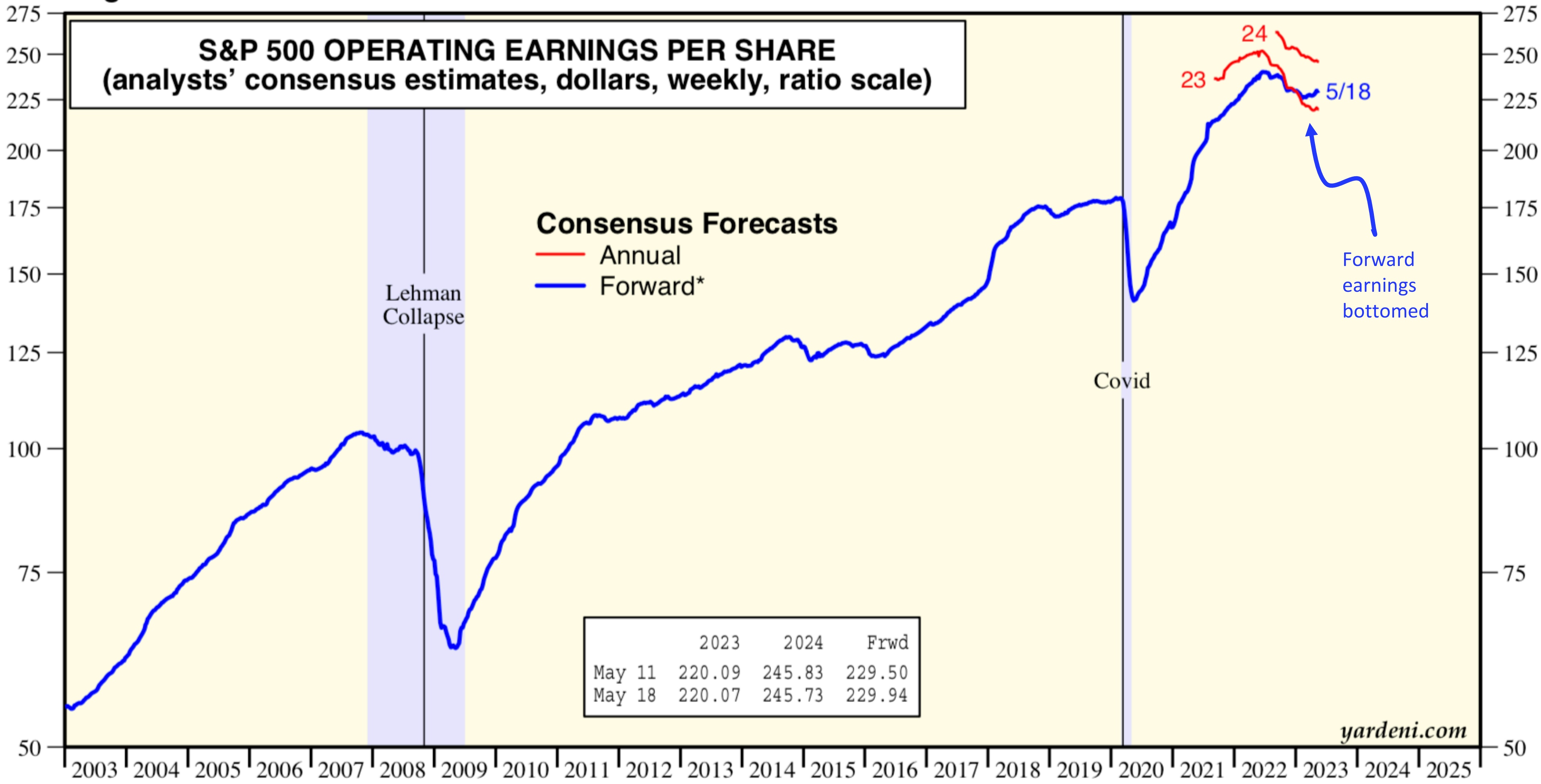


* Compounded annual growth rate from base value using monthly data. Q4-2008 not shown because of large negative value.
Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Standard & Poor's.

Source: Yardeni Research, Inc. with permission.

S&P earnings estimates

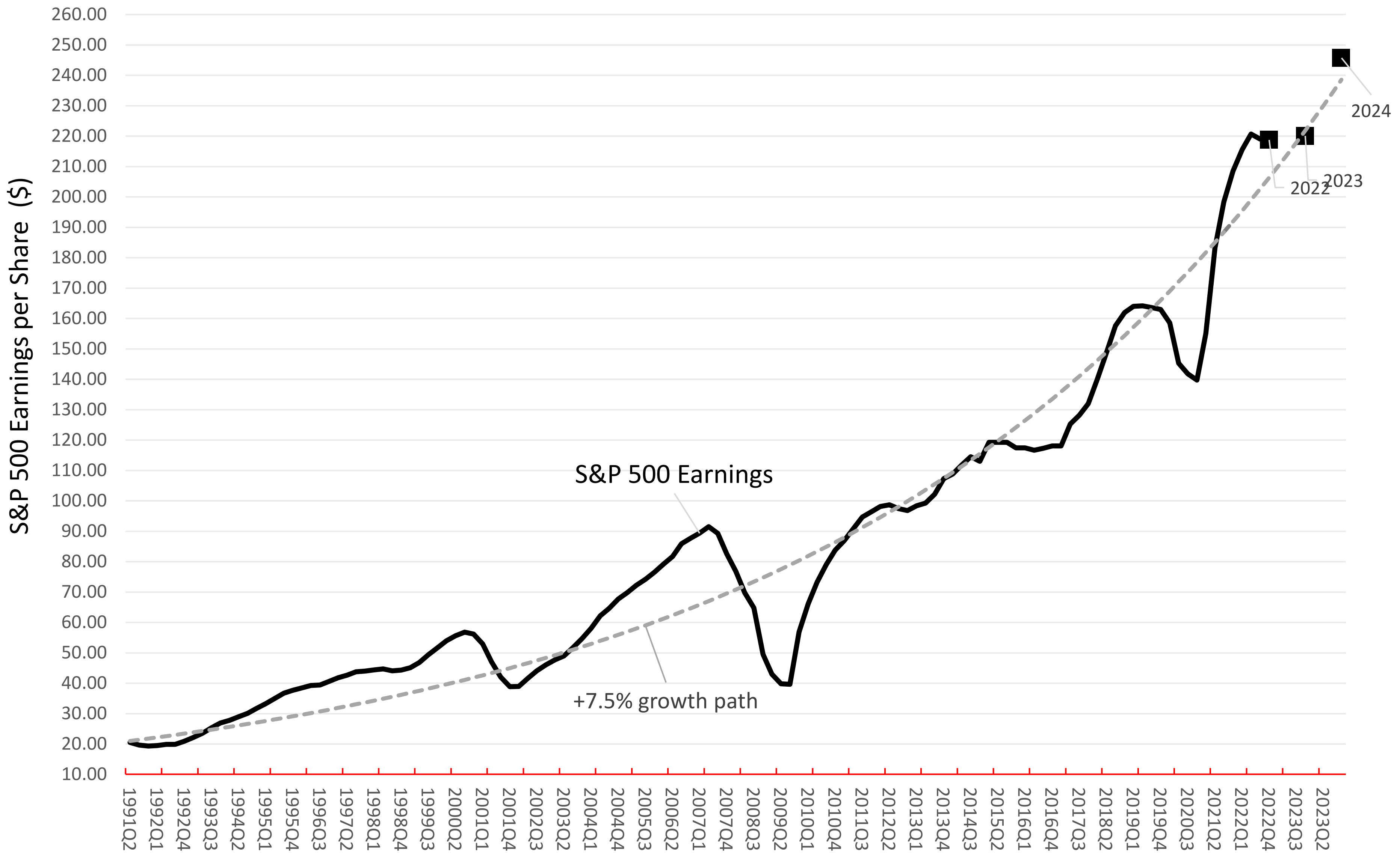
Figure 4.



* Time-weighted average of analysts' consensus estimates for S&P 500 operating earnings for current year and next year.
Note: Shaded areas are recessions according to the National Bureau of Economic Research.
Note: Lehman collapsed 9/15/2008. COVID-19 = WHO declares global pandemic on 3/11/2020.
Source: I/B/E/S data by Refinitiv.

Source: Yardeni Research, Inc., with permission. May 23, 2023.

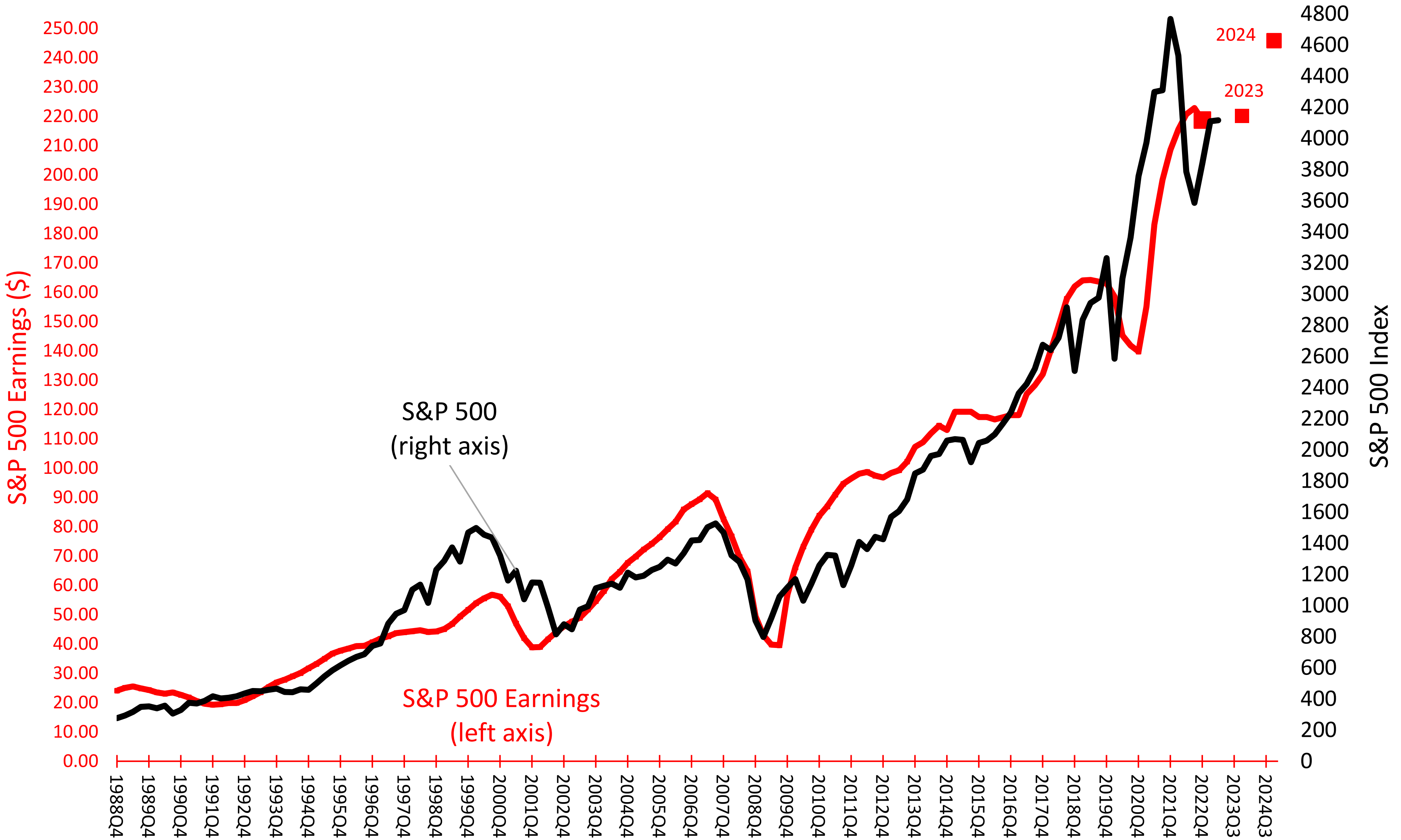
S&P 500 earnings – actual and I/B/E/S estimates



2022 (estimated), 2023 (estimated) and 2024 (estimated) bottom-up S&P 500 operating earnings per share as of May 23, 2023: for 2022(e), \$218.71; for 2023(e), \$220.07; for 2024(e), \$245.73. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S for actual and estimated operating earnings from 2015. Standard and Poor's for actual operating earnings data through 2014.

Valuation

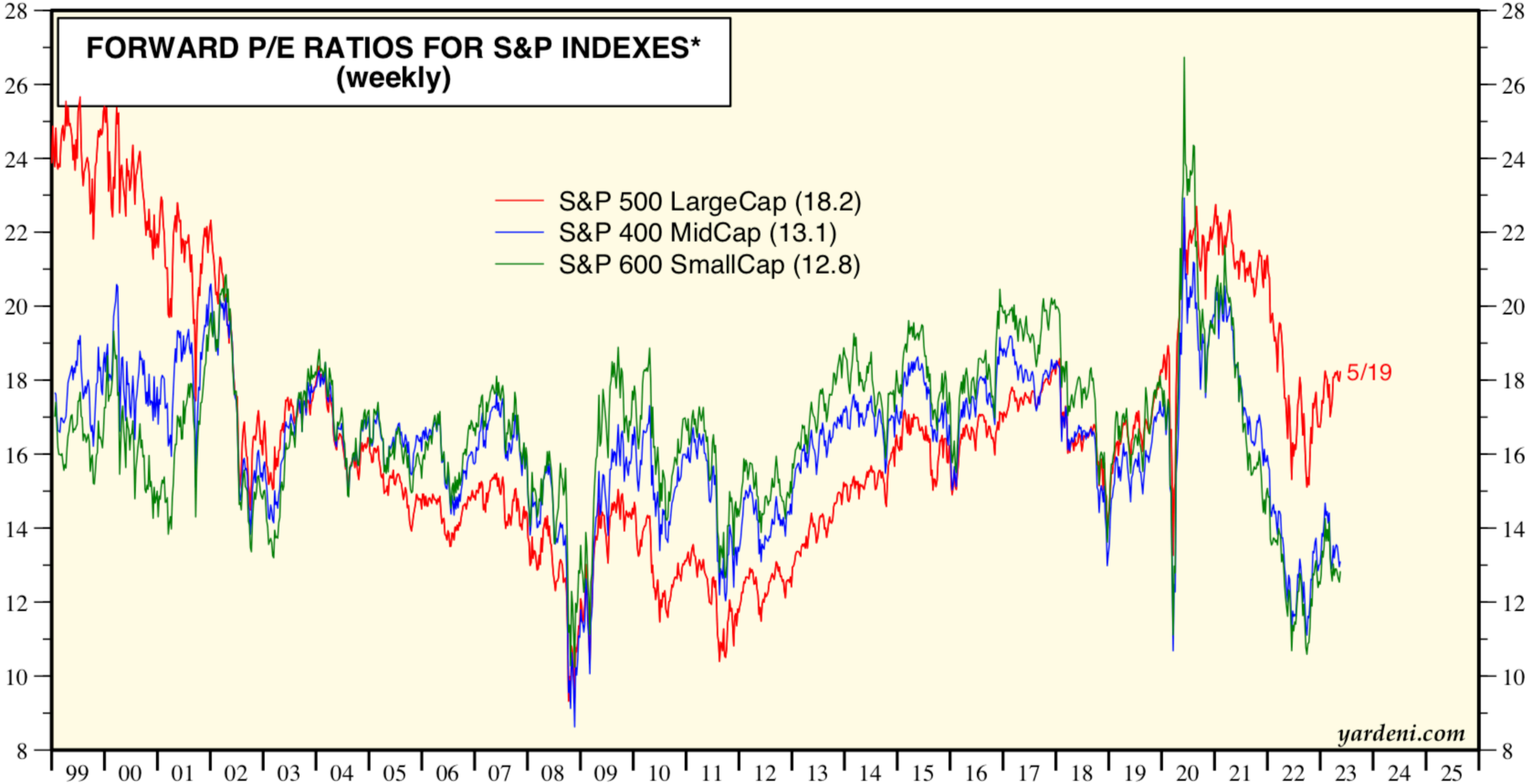
S&P 500 vs. actual and I/B/E/S estimated earnings



2022 (estimated), 2023 (estimated) and 2024 (estimated) bottom-up S&P 500 operating earnings per share as of May 23, 2023: for 2022(e), $218.71; for 2023(e), $220.07; for 2024(e), $245.73. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S for actual and estimated operating earnings from 2015. Standard and Poor's for actual operating earnings data through 2014; index price data through May 24, 2023.

S&P 500 index forward P/E ratio

Figure 16.



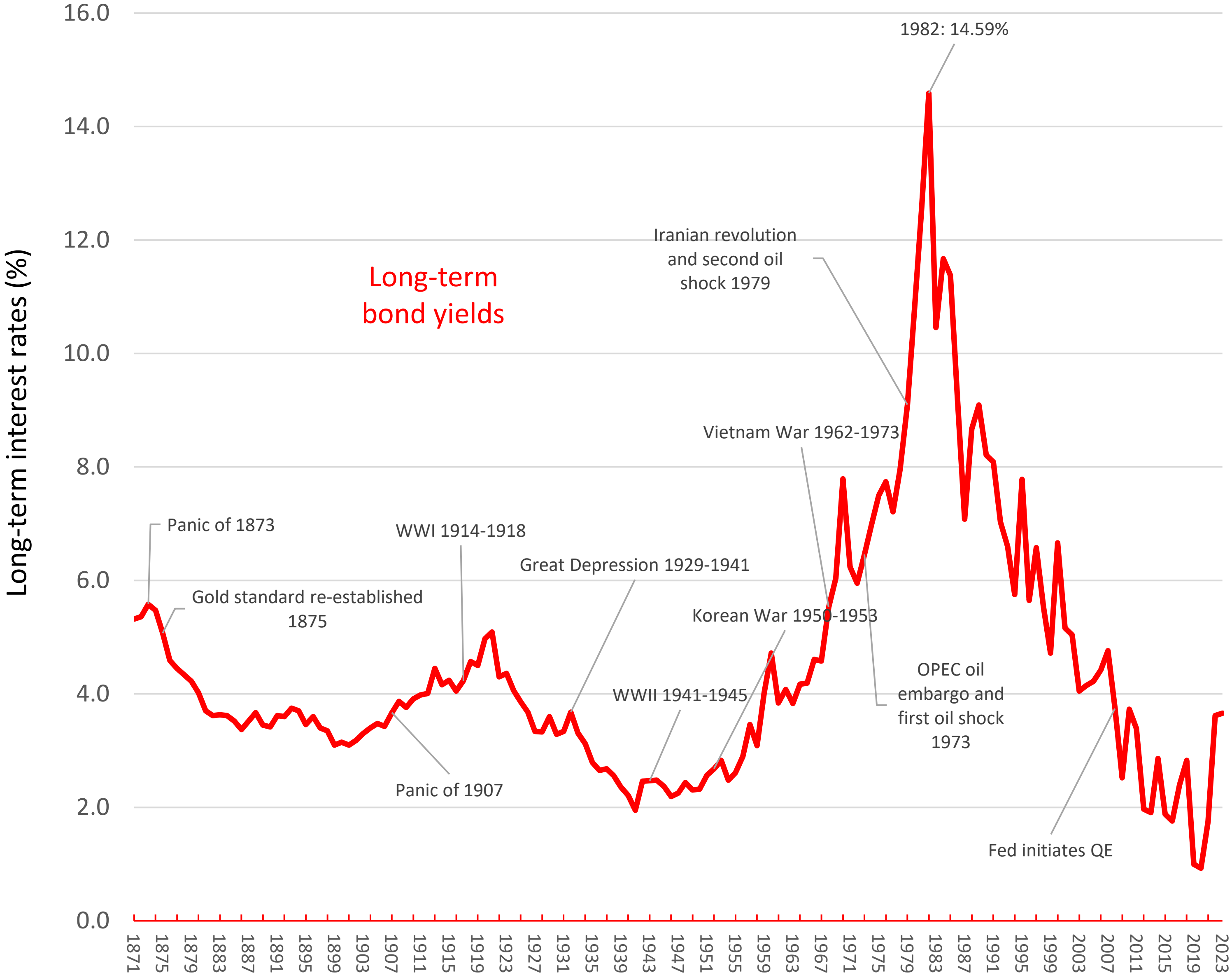
* Price divided by 52-week forward consensus expected operating earnings per share.
Source: I/B/E/S data by Refinitiv.

Source: Yardeni Research, Inc., with permission, May 23, 2023.

Bond Yields

- Normal yields by historic comparison

U.S. Treasury bond yields



Rising from the lowest long-term interest rates in U.S. history.

Source: Online Data Robert Shiller, data through 2016; 10-year U.S. Treasury bond yield data from 2017; data through April 2023.

Federal Reserve

- Hiked rates
- Inverted the yield curve
- Special liquidity facility
- Forecasting no growth

Quarter-point hike on May 3, 2023

THE WALL STREET JOURNAL.

Fed Boosts Rates to 16-Year High

Central-bank officials signal they could be done tightening after 10th straight increase

Source: *The Wall Street Journal.* "Fed Boosts Rates to 16-Year High", by Nick Timiraos. May 4, 2023.

Powell pause

THE WALL STREET JOURNAL.

Fed Was Divided on a June Rate Pause

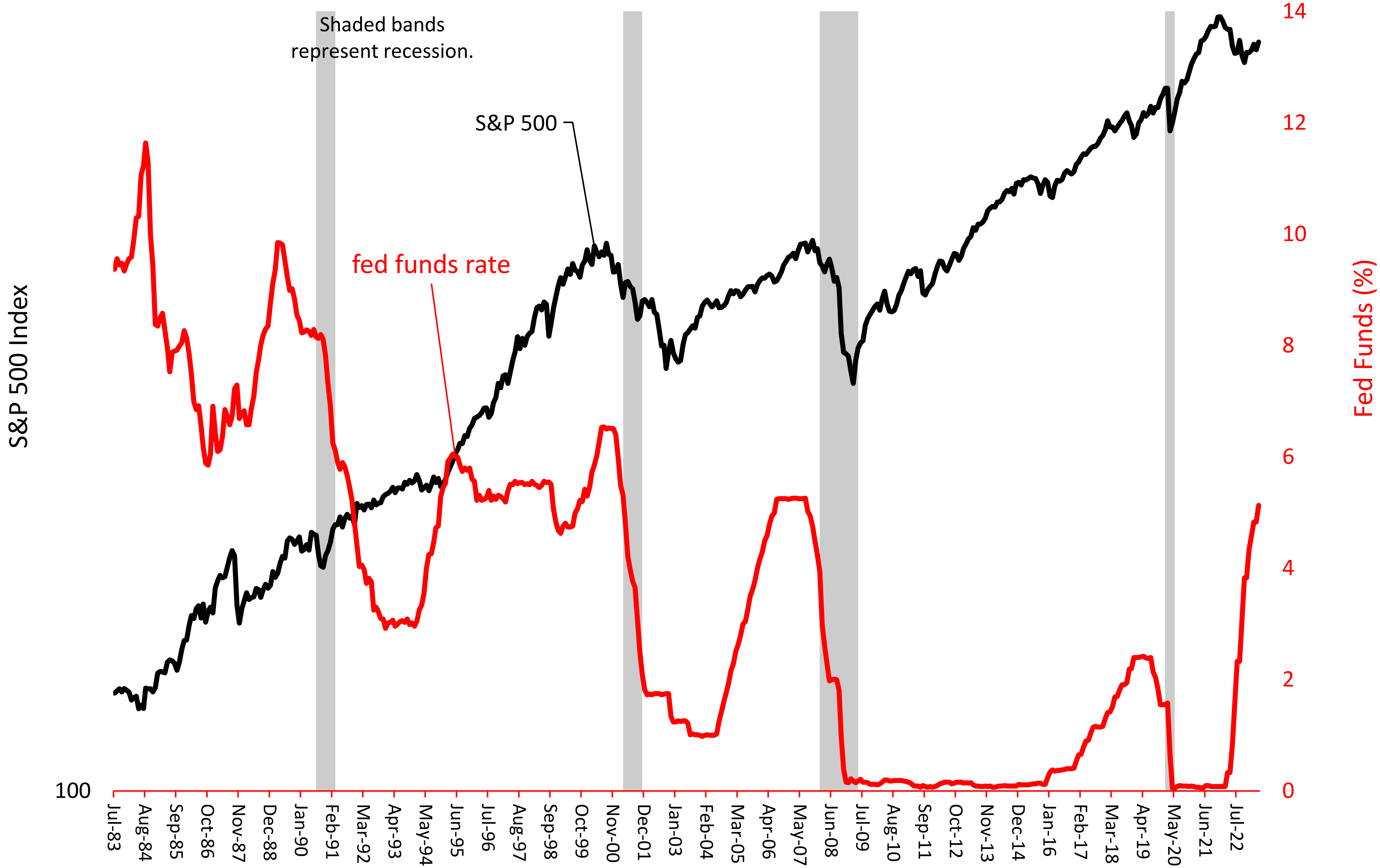
… But others, including Powell, have hinted that they might prefer skipping a rate rise in June to assess the effects of their past increases and the banking-sector strains.

“We’ve come a long way in policy tightening, and the stance of policy is restrictive, and we face uncertainty about the lagged effects of our tightening so far and about the extent of credit tightening from recent banking stresses,” Powell said last week at a conference hosted by the central bank.

Source: *The Wall Street Journal.* “Fed Was Divided on a June Rate Pause”, by Nick Timiraos. May 25, 2023.

Stock market

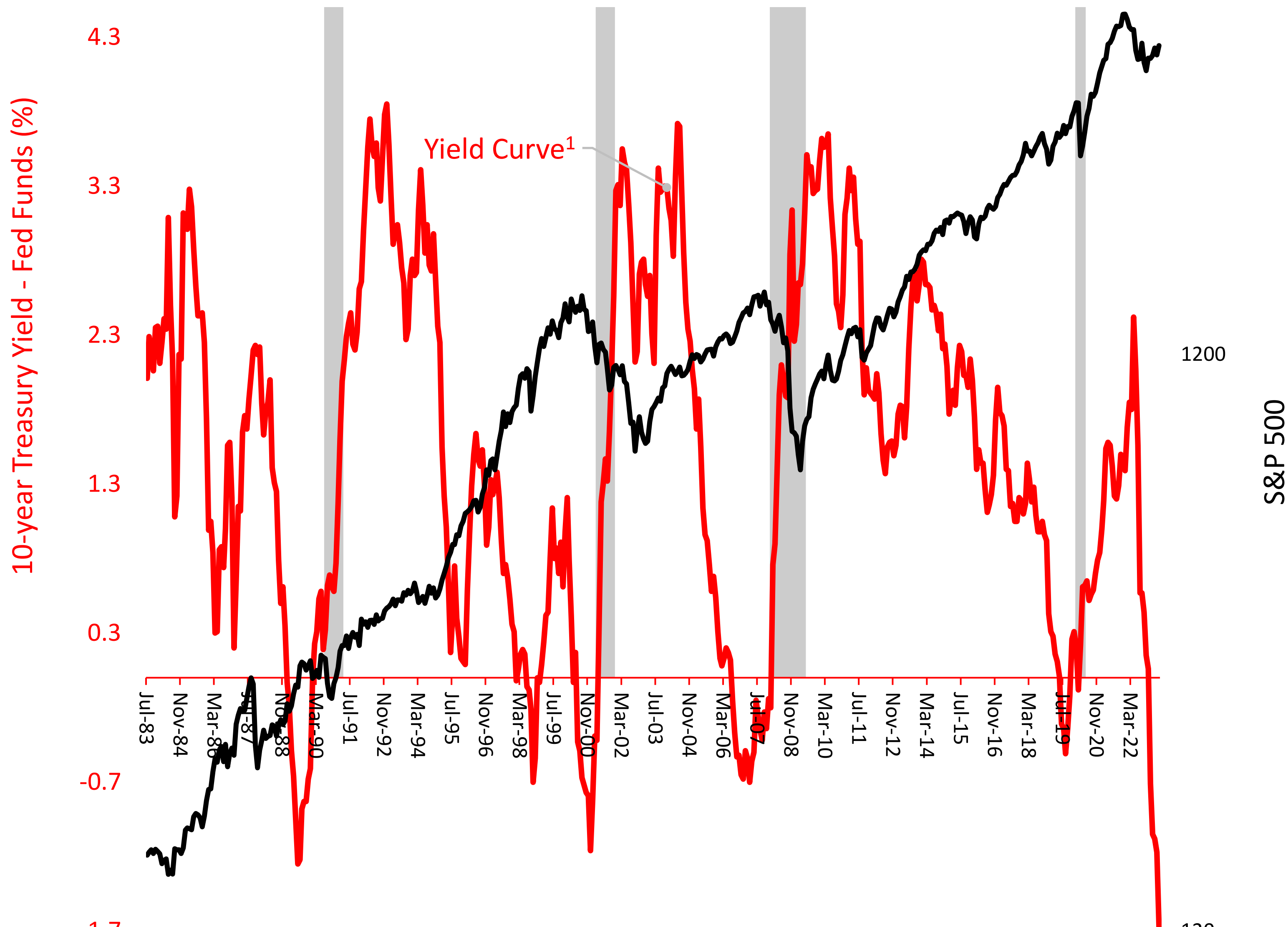
S&P 500 vs. fed funds rate



Sources: Federal Reserve, Standard & Poor's. Data through April 2023.

Federal Reserve policy

Yield curve vs. the S&P 500



When the yield curve has inverted the economy has usually turned down into recession with a lag of a year or more.

Today, <u>the yield curve is inverted</u>.

Sources: NBER, Federal Reserve and Standard & Poor's. Data through April 2023.

[1]The interest rate on the 10-year Treasury bond (long term) minus the fed funds rate (short term).

Bank Term Funding Program

March 12, 2023

Federal Reserve Board announces it will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors

For release at 6:15 p.m. EDT

Share

To support American businesses and households, the Federal Reserve Board on Sunday announced it will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors. This action will bolster the capacity of the banking system to safeguard deposits and ensure the ongoing provision of money and credit to the economy.

The Federal Reserve is prepared to address any liquidity pressures that may arise.

The additional funding will be made available through the creation of a new Bank Term Funding Program (BTFP), offering loans of up to one year in length to banks, savings associations, credit unions, and other eligible depository institutions pledging U.S. Treasuries, agency debt and mortgage-backed securities, and other qualifying assets as collateral. These assets will be valued at par. The BTFP will be an additional source of liquidity against high-quality securities, eliminating an institution's need to quickly sell those securities in times of stress.

Source: Federal Reserve, March 12, 2023.

Banking crisis

Economic fallout

Source: *CNBC* live, March 22, 2023.

Economic fallout

THE WALL STREET JOURNAL.

Fed Boosts Rates Amid Bank Turmoil

Estimates of just how much any credit contraction could reduce hiring, economic activity and inflation were "rule-of thumb guesswork, almost, at this point. But we think it's potentially quite real, and that argues for being alert as we go forward," Mr. Powell said at a news conference after the conclusion of the Fed's policy meeting. Later, he said, "it could easily have a significant macroeconomic effect."

Source: *The Wall Street Journal.* "Fed Boosts Rates Amid Bank Turmoil", by Nick Timiraos. March 23, 2023.

Central tendency forecast

For release at 2:00 p.m., EDT, March 22, 2023

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, March 2023

Percent

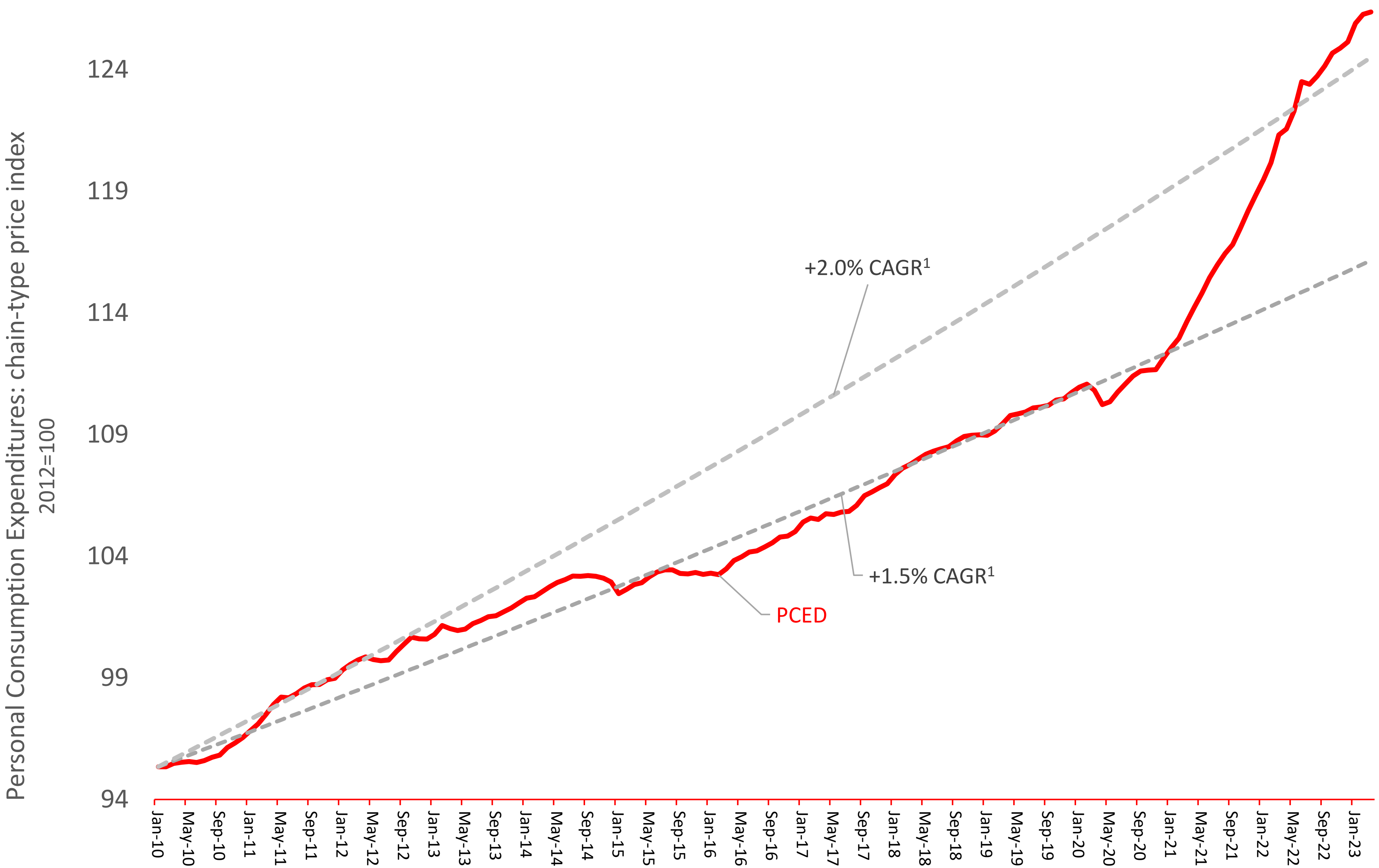
Variable	Median[1]				Central Tendency[2]				Range[3]			
	2023	2024	2025	Longer run	2023	2024	2025	Longer run	2023	2024	2025	Longer run
Change in real GDP	0.4	1.2	1.9	1.8	0.0–0.8	1.0–1.5	1.7–2.1	1.7–2.0	-0.2–1.3	0.3–2.0	1.5–2.2	1.6–2.5
December projection	0.5	1.6	1.8	1.8	0.4–1.0	1.3–2.0	1.6–2.0	1.7–2.0	-0.5–1.0	0.5–2.4	1.4–2.3	1.6–2.5
Unemployment rate	4.5	4.6	4.6	4.0	4.0–4.7	4.3–4.9	4.3–4.8	3.8–4.3	3.9–4.8	4.0–5.2	3.8–4.9	3.5–4.7
December projection	4.6	4.6	4.5	4.0	4.4–4.7	4.3–4.8	4.0–4.7	3.8–4.3	4.0–5.3	4.0–5.0	3.8–4.8	3.5–4.8
PCE inflation	3.3	2.5	2.1	2.0	3.0–3.8	2.2–2.8	2.0–2.2	2.0	2.8–4.1	2.0–3.5	2.0–3.0	2.0
December projection	3.1	2.5	2.1	2.0	2.9–3.5	2.3–2.7	2.0–2.2	2.0	2.6–4.1	2.2–3.5	2.0–3.0	2.0
Core PCE inflation[4]	3.6	2.6	2.1		3.5–3.9	2.3–2.8	2.0–2.2		3.5–4.1	2.1–3.1	2.0–3.0	
December projection	3.5	2.5	2.1		3.2–3.7	2.3–2.7	2.0–2.2		3.0–3.8	2.2–3.0	2.0–3.0	
Memo: Projected appropriate policy path												
Federal funds rate	5.1	4.3	3.1	2.5	5.1–5.6	3.9–5.1	2.9–3.9	2.4–2.6	4.9–5.9	3.4–5.6	2.4–5.6	2.3–3.6
December projection	5.1	4.1	3.1	2.5	5.1–5.4	3.9–4.9	2.6–3.9	2.3–2.5	4.9–5.6	3.1–5.6	2.4–5.6	2.3–3.3

Source: Federal Reserve, March 22, 2023.

Inflation

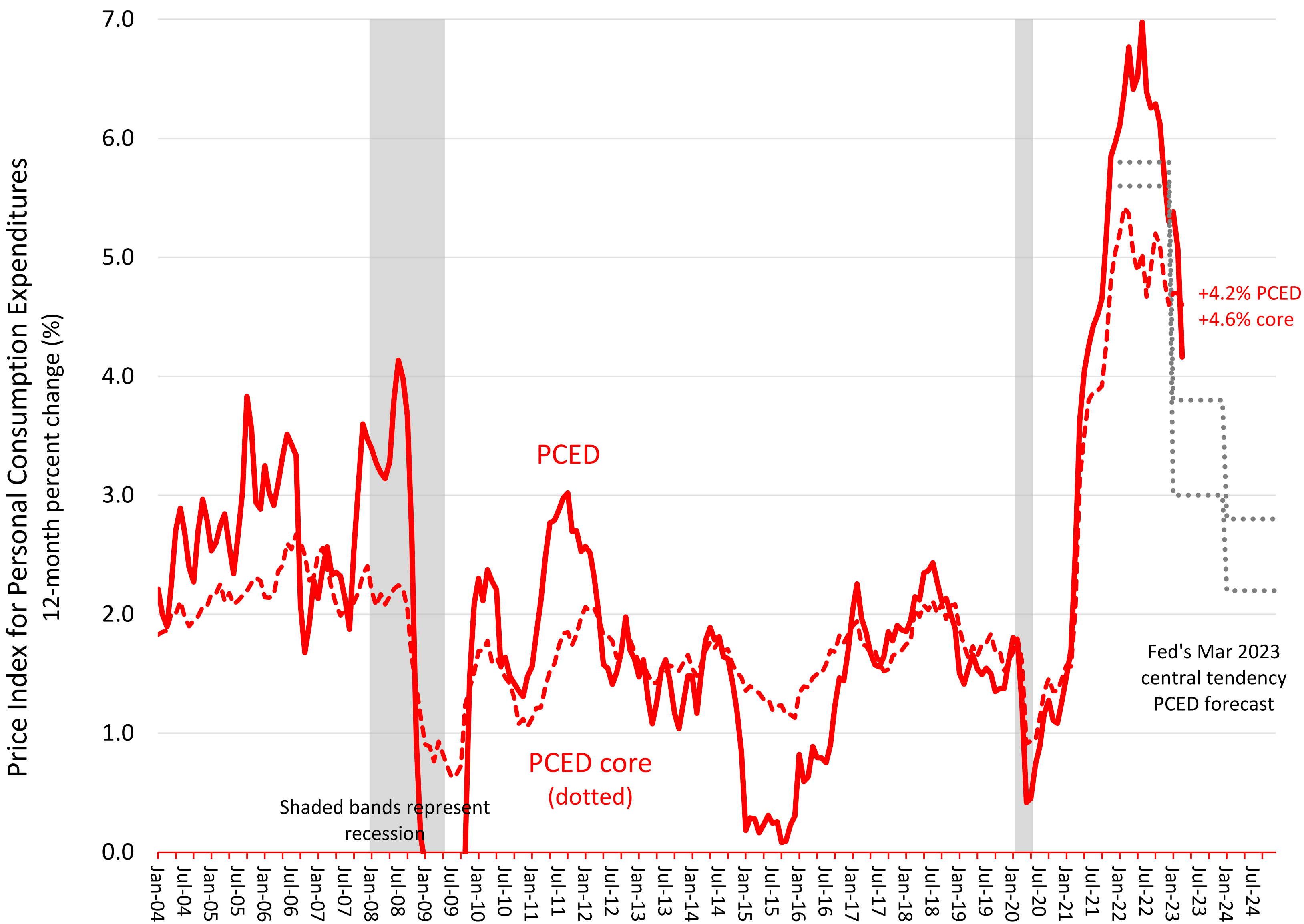
- ➢ Year-over-year headline PCED +4.2%, +4.6% core
- ➢ M2 driving inflation
- ➢ Inflation expectations (TIPS spread) falling

PCED – headline



Source: NBER, Federal Reserve Bank of St. Louis. Data through March 2023.

PCED – headline and core

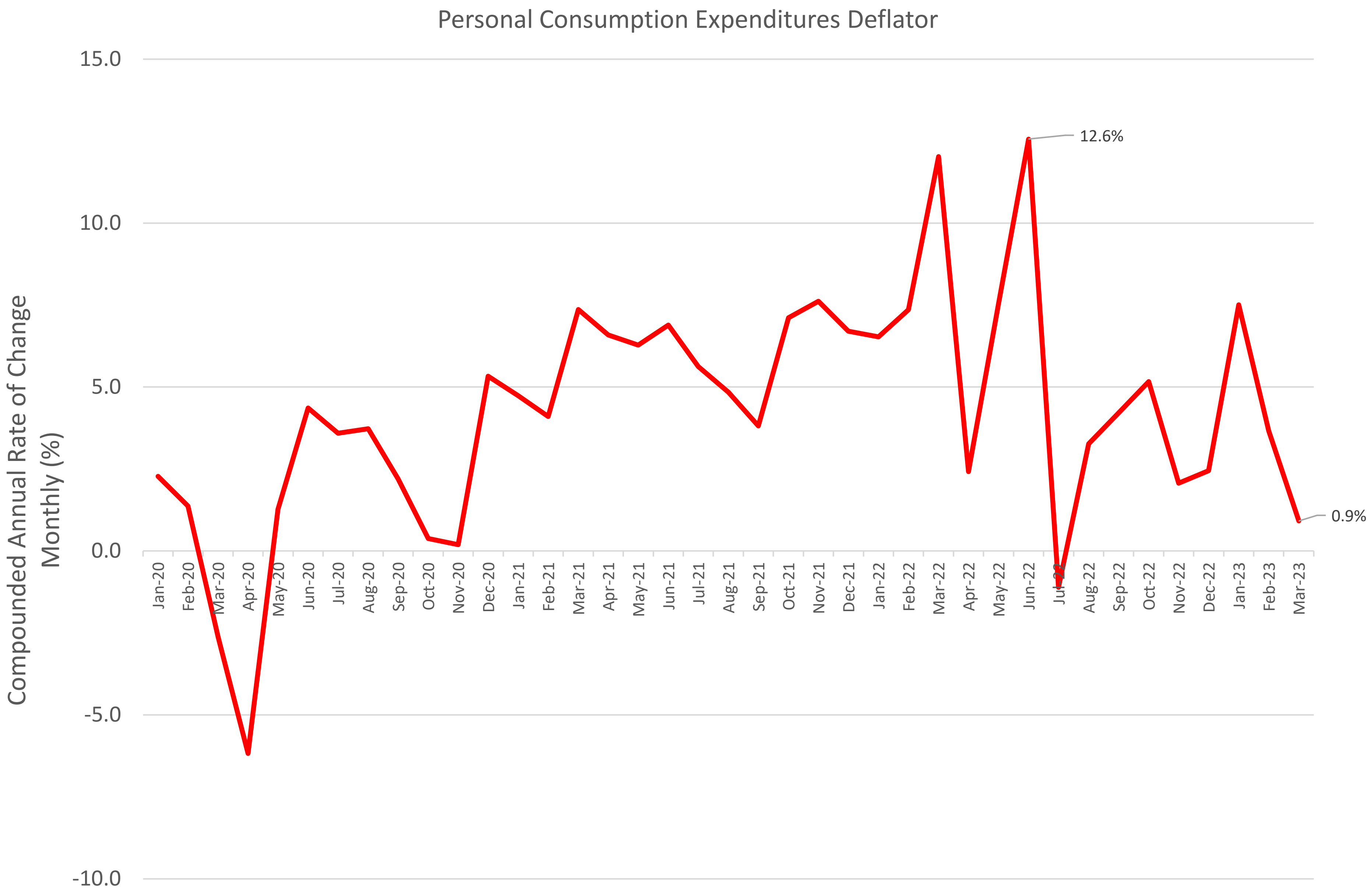


Inflation peaked, following the post-Covid surge.

Source: NBER, Federal Reserve Bank of St. Louis. Data through March 2023.

Inflation

PCED – monthly rate of change annualized

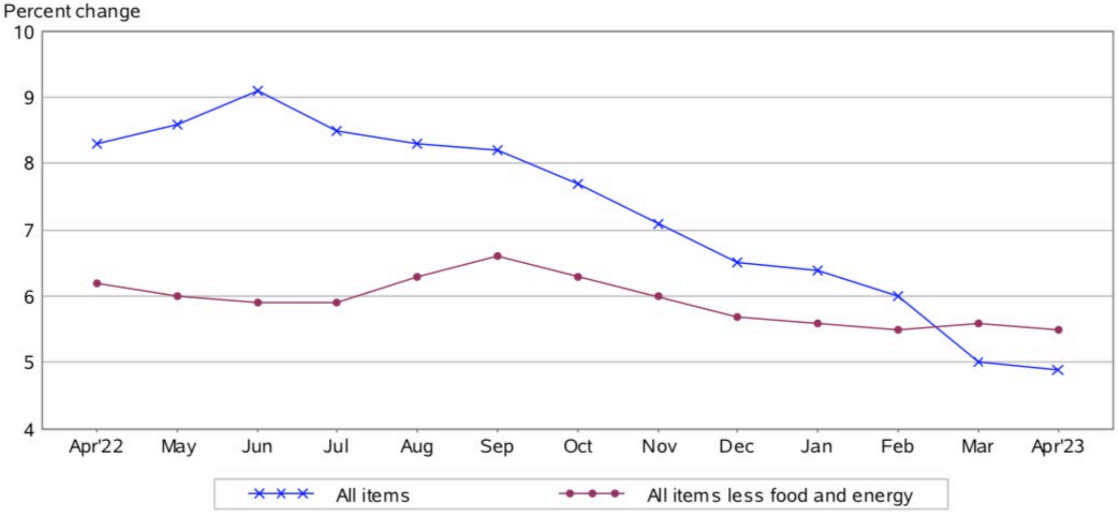


Source: Federal Reserve Bank of St. Louis. Data through March 2023.

Inflation

CPI – headline and core

Chart 2. 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, Apr. 2022 - Apr. 2023



Up +5.5% y/y in April.

Up +4.9% y/y in April.

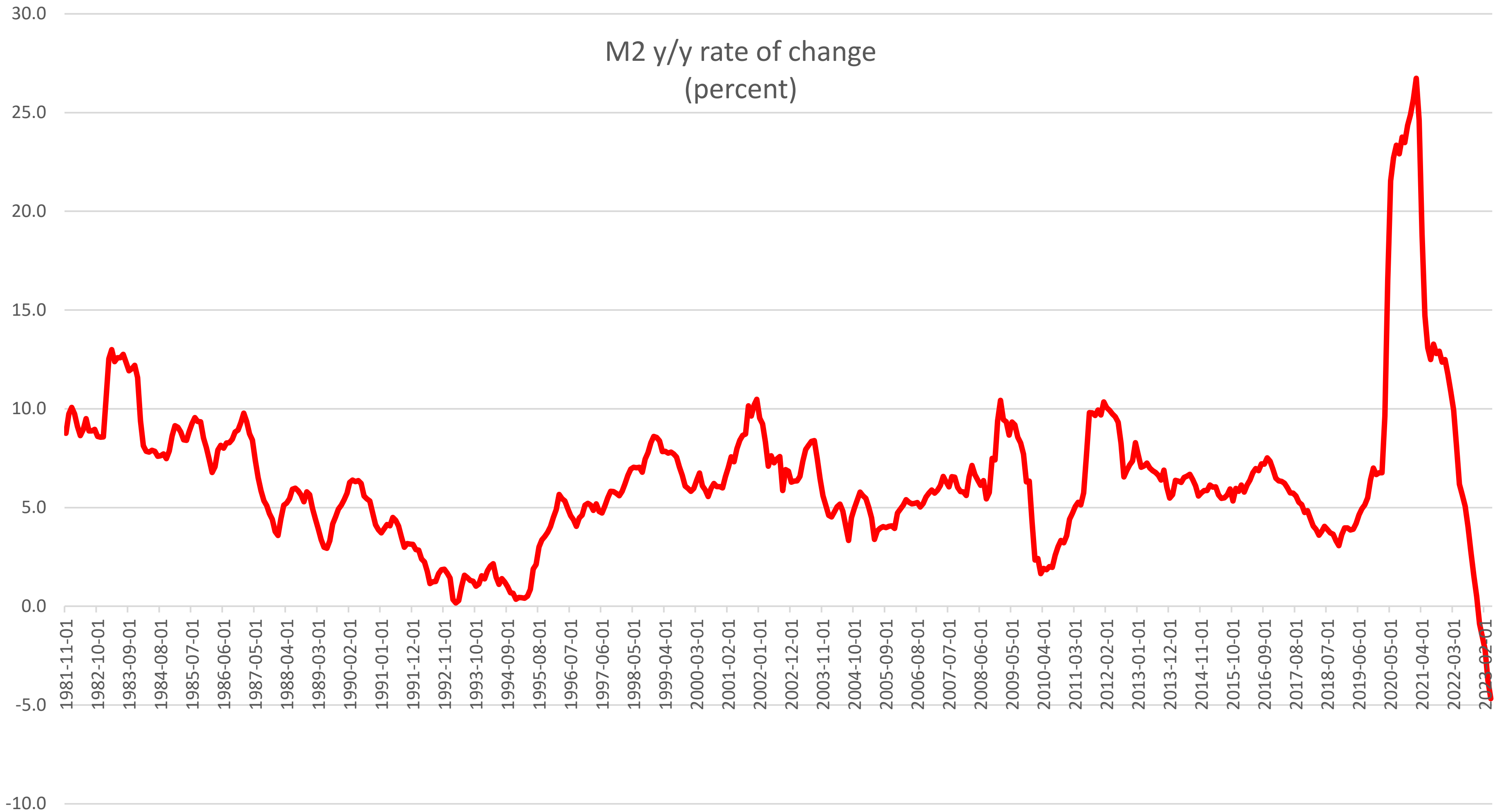
Table A. Percent changes in CPI for All Urban Consumers (CPI-U): U.S. city average

	Seasonally adjusted changes from preceding month							Un-adjusted 12-mos. ended Apr. 2023
	Oct. 2022	Nov. 2022	Dec. 2022	Jan. 2023	Feb. 2023	Mar. 2023	Apr. 2023	
All items	0.5	0.2	0.1	0.5	0.4	0.1	0.4	4.9
Food	0.7	0.6	0.4	0.5	0.4	0.0	0.0	7.7
Food at home	0.5	0.6	0.5	0.4	0.3	-0.3	-0.2	7.1
Food away from home[1]	0.9	0.5	0.4	0.6	0.6	0.6	0.4	8.6
Energy	1.7	-1.4	-3.1	2.0	-0.6	-3.5	0.6	-5.1
Energy commodities	3.7	-2.1	-7.2	1.9	0.5	-4.6	2.7	-12.6
Gasoline (all types)	3.4	-2.3	-7.0	2.4	1.0	-4.6	3.0	-12.2
Fuel oil[1]	19.8	1.7	-16.6	-1.2	-7.9	-4.0	-4.5	-20.2
Energy services	-0.7	-0.6	1.9	2.1	-1.7	-2.3	-1.7	5.9
Electricity	0.5	0.5	1.3	0.5	0.5	-0.7	-0.7	8.4
Utility (piped) gas service	-3.7	-3.4	3.5	6.7	-8.0	-7.1	-4.9	-2.1
All items less food and energy	0.3	0.3	0.4	0.4	0.5	0.4	0.4	5.5
Commodities less food and energy commodities	-0.1	-0.2	-0.1	0.1	0.0	0.2	0.6	2.0
New vehicles	0.6	0.5	0.6	0.2	0.2	0.4	-0.2	5.4
Used cars and trucks	-1.7	-2.0	-2.0	-1.9	-2.8	-0.9	4.4	-6.6
Apparel	-0.2	0.1	0.2	0.8	0.8	0.3	0.3	3.6
Medical care commodities[1]	0.0	0.2	0.1	1.1	0.1	0.6	0.5	4.0
Services less energy services	0.5	0.5	0.6	0.5	0.6	0.4	0.4	6.8
Shelter	0.7	0.6	0.8	0.7	0.8	0.6	0.4	8.1
Transportation services	0.6	0.3	0.6	0.9	1.1	1.4	-0.2	11.0
Medical care services	-0.4	-0.5	0.3	-0.7	-0.7	-0.5	-0.1	0.4

Source: BLS. Data through April 2023.

Federal Reserve policy

The money supply – y/y rate of change



Source: Federal Reserve Bank of St. Louis. Data through April 2023.

M2 vs. inflation

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Why Inflation Is on the Way Down

Yet the relationship between money-supply growth, as measured by M2 and subsequent inflation has been statistically near-perfect in the pandemic era, with a 13-month lag. Year-over-year M2 growth began to accelerate during the pandemic recession in April 2020, and core inflation started to accelerate 13 months later, in May 2021. M2 growth peaked at a history making, off-the-charts 27% in February 2021, and core CPI peaked 13 months later, in March 2022. Both M2 growth and core CPI have been falling every month since their respective peaks.

Experience is proving, 40 years after Friedman taught Volcker, that inflation is still a monetary phenomenon.

<u>If the relationship with inflation continues, core inflation will be at only 2.3% in 13 months, in June 2023</u>.

Source: *The Wall Street Journal*, July 26, 2022. Opinion section. Author: Donald L. Luskin.

M2 vs. inflation

THE WALL STREET JOURNAL.

Get Ready for Deflation

The record increase in the money supply caused by $6 trillion in pandemic relief payments in 2020 and 2021 unleashed the present inflation.

The aggressive tightening regime the Fed has undertaken, including an unprecedented four back-to-back 75-basis-point rate increases, deserves little credit for the recent decrease in inflation. The drop has been caused primarily by the sharp slowing in money-supply growth resulting from the end of federal pandemic stimulus payments.

Slowing money growth now is interacting with higher rates, and the result is contraction. M2 has shrunk 4.63% in the past year. This is the only contraction in U.S. history, so there is a lot we can't predict here, but it would be extraordinary if such a contraction didn't result in deflation, just as the large money-supply increase two years ago resulted in inflation.

Source: *The Wall Street Journal*, May 24, 2023. Opinion section. Author: Donald L. Luskin.

Demand shock plus fiscal stimulus

THE WALL STREET JOURNAL.

Why Did Inflation Take Off ? Two Top Economists Answer

For two years, debate has raged over what caused the highest inflation since the 1980s: government stimulus or pandemic-related disruptions.

Now two top economists have an answer: It’s both. Pandemic-related supply shocks explain why inflation shot up in 2021. An economy overheated by fiscal stimulus and low interest rates explain why it has stayed high ever since.

The study, released Tuesday, is by Ben Bernanke, former chair of the Federal Reserve, and Olivier Blanchard, former chief economist of the International Monetary Fund.

Source: *The Wall Street Journal*, May 24, 2023. “Why Did Inflation Take Off? By Greg Ip.

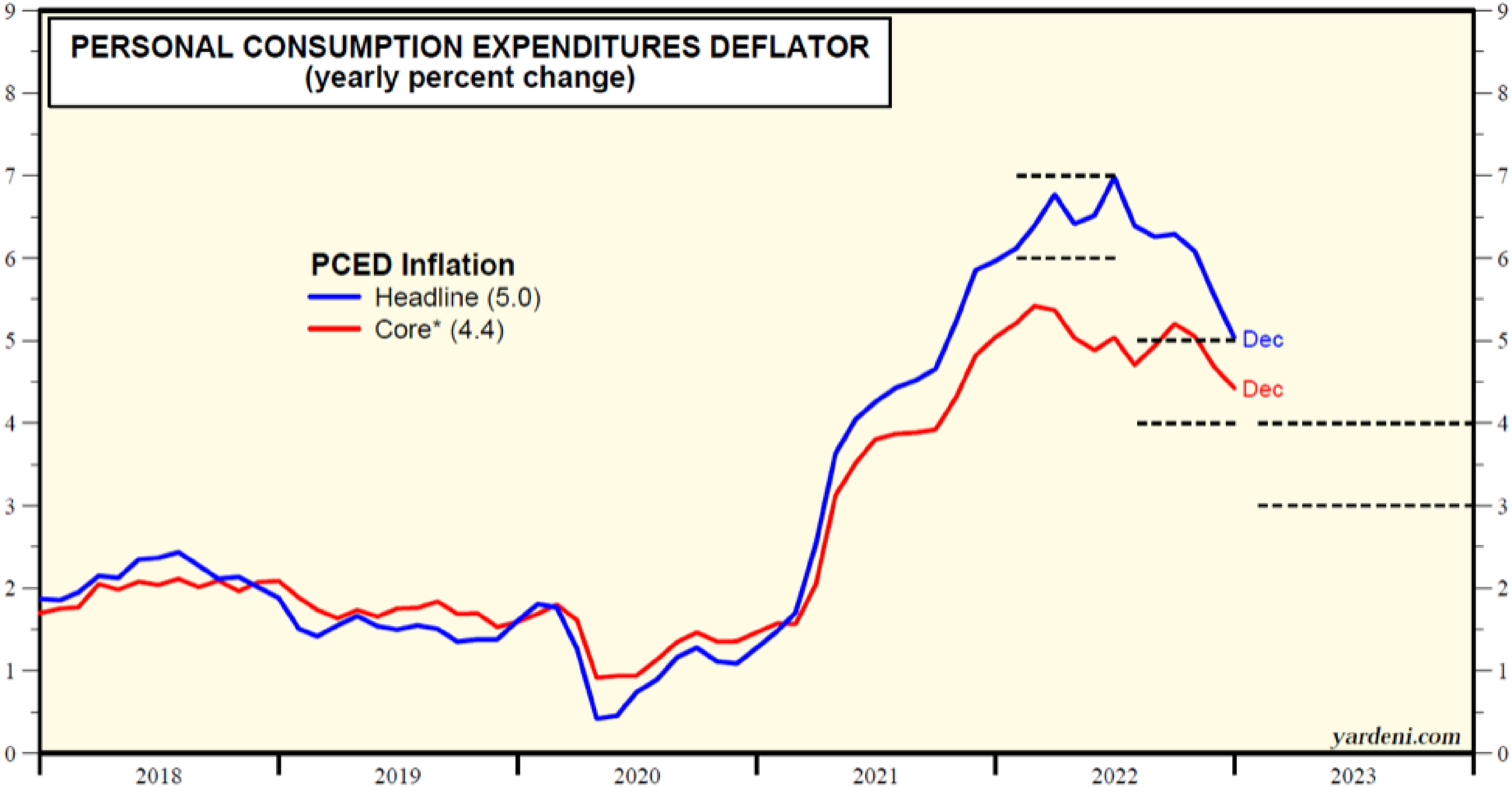
Economy

Demand shock for goods drove inflation

Sources: Bureau of Economic Analysis, quarterly data through March 2023.

Ed Yardeni's inflation forecast

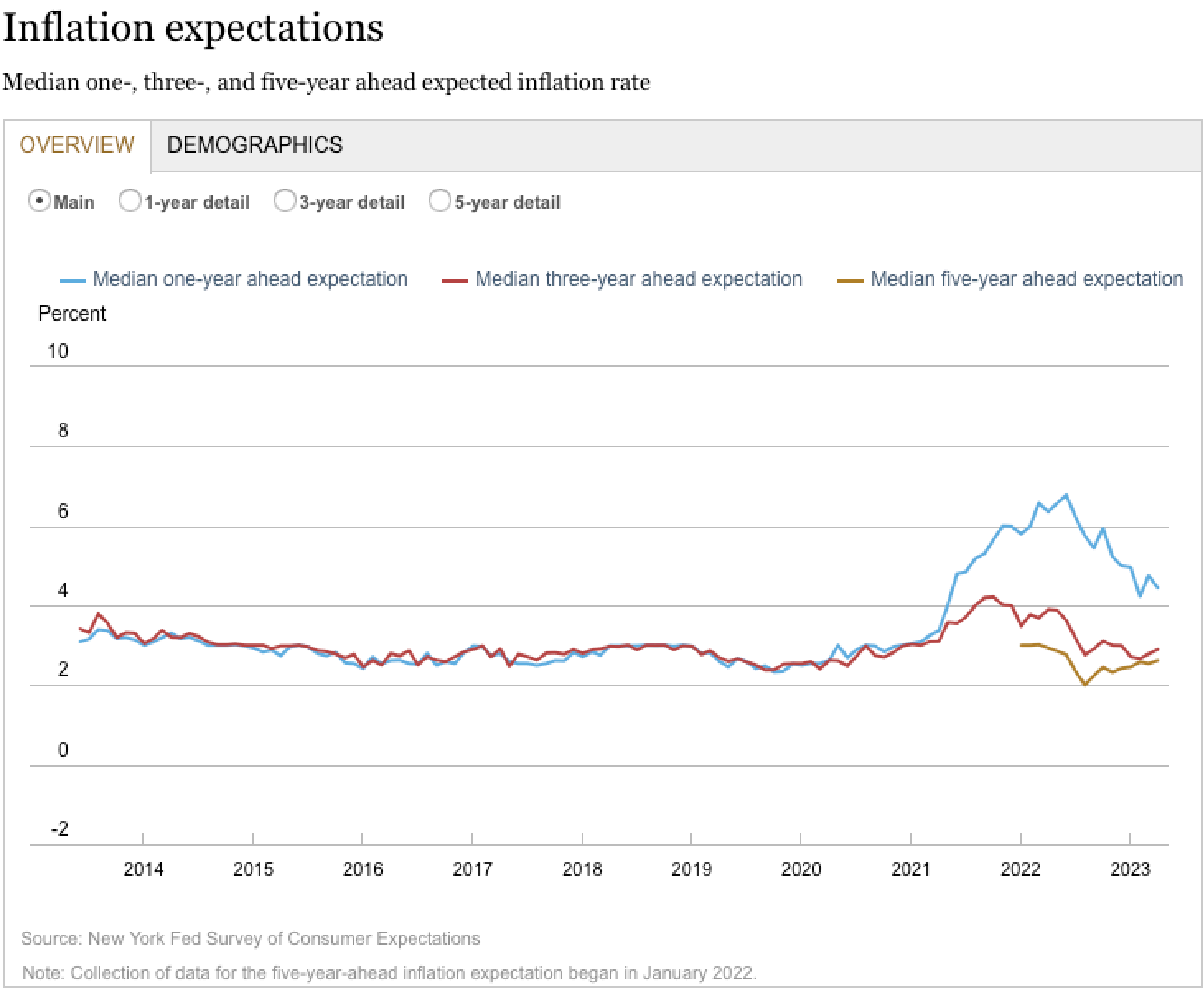
Figure 25.



* Excluding food & energy.
Note: Dashed ranges are YRI forecasts for headline PCED inflation rate.
Source: Bureau of Economic Analysis.

Source: Yardeni Research, Inc., with permission, January 30, 2022.

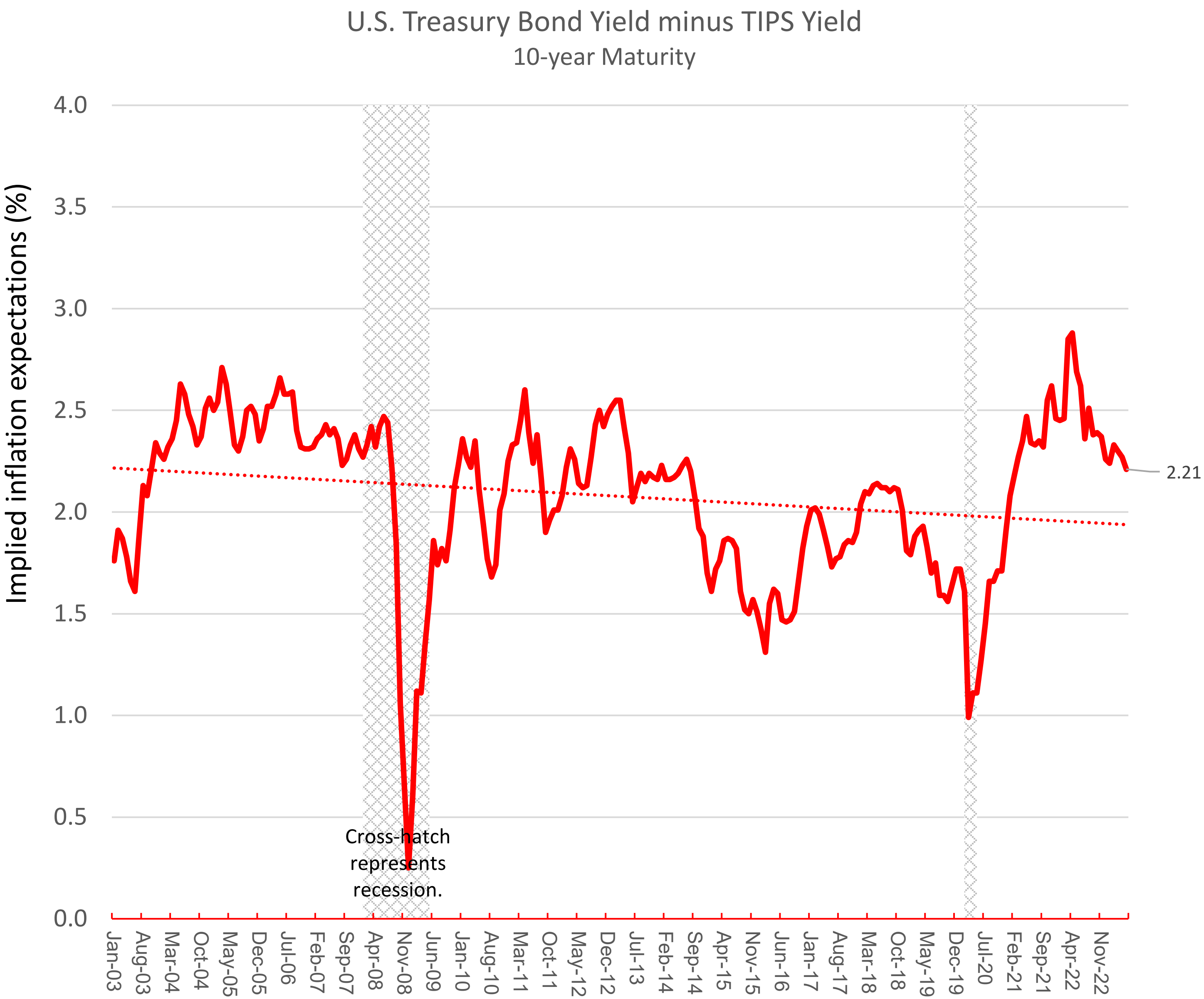
Inflation expectations



Consumers expect substantially moderating inflation.

Source: Federal Reserve Bank of New York, *Survey of Consumer Expectations*. Data through April 2023.

Inflation expectations



The difference between the nominal 10-year Treasury bond yield and the TIPS yield gives the market's opinion for a 10-year inflation forecast.

It had been trending lower for 15 years but has moved higher post-Covid.

Source: Federal Reserve. Data through May 2023.

Federal government debt

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Default on U.S. Debt Is Impossible

In reality, the U.S. *can't* default on its debt.
Section 4 of the 14th Amendment is unequivocal on that point: "The validity of the public debt of the United States, authorized by law, . . . shall not be questioned." This provision was adopted to ensure that the federal debts incurred to fight the Civil War couldn't be dishonored by a Congress that included members from the former Confederate states.

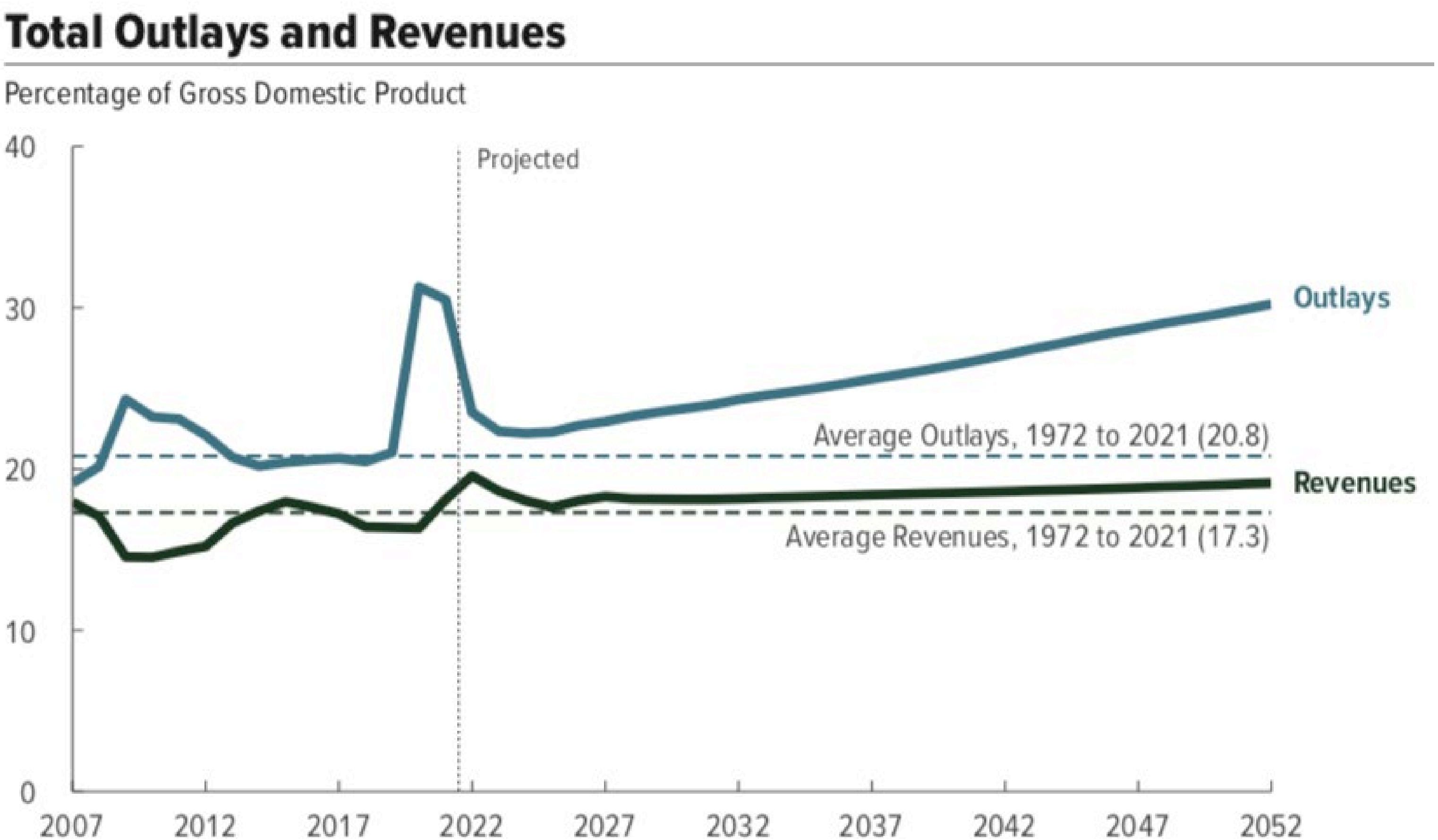
The Public Debt Clause isn't limited to Civil War debts. As the Supreme Court held in *Perry v. U.S.* (1935), it covers all sovereign federal debt, past, present and future.

Those who warn of default confuse debt payments with other spending obligations.

There's no question enough money would be available: The government collects roughly $450 billion a month in tax revenue, more than enough to cover the $55 billion or so in monthly debt service.

Source: *The Wall Street Journal*, "Default on U.S. Debt Is Impossible", by David B. Rivkin Jr. and Lee A Casey. February 21, 2023.

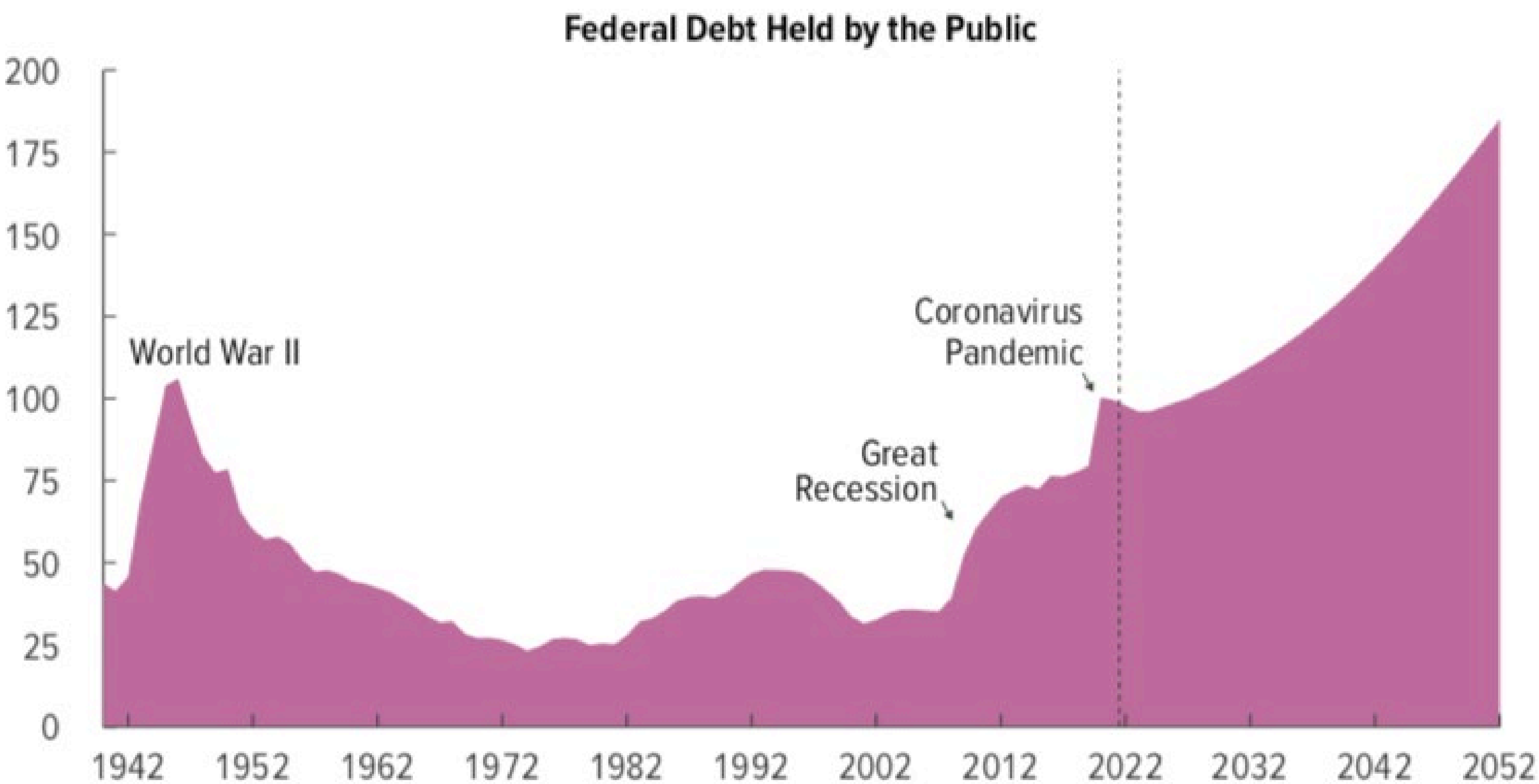
Federal revenues and outlays through 2052



The gap widens significantly over 30 years.

Source: Congressional Budget Office, *The 2022 Long-Term Budget Outlook,* released July 2022.

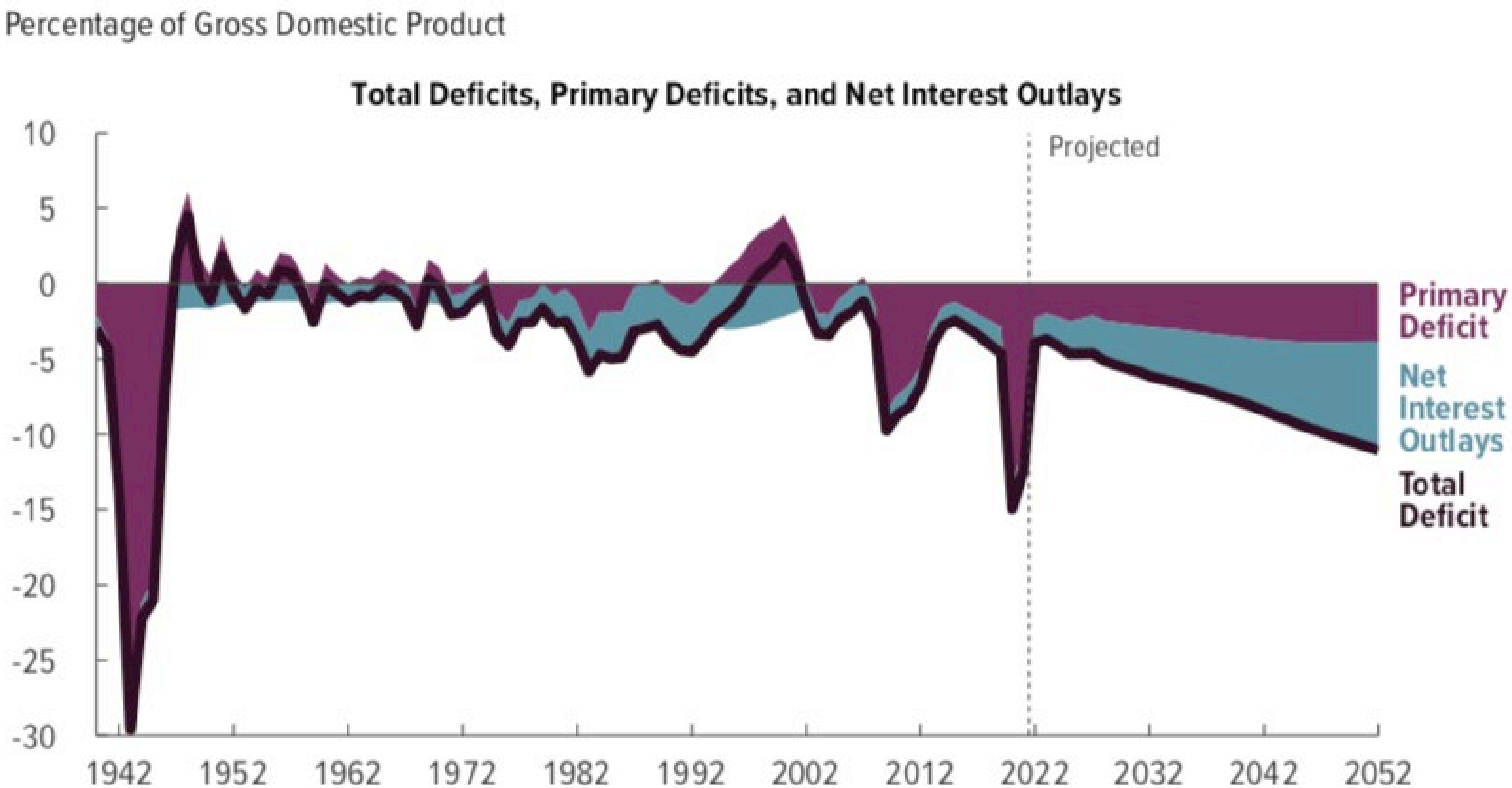
Federal debt % of GDP though 2052



Debt/GDP grows significantly over 30 years.

Source: Congressional Budget Office, *The 2022 Long-Term Budget Outlook,* released July 2022.

Federal deficits % of GDP though 2052



Net interest becomes the major part of deficits.

Source: Congressional Budget Office, *The 2022 Long-Term Budget Outlook,* released July 2022.

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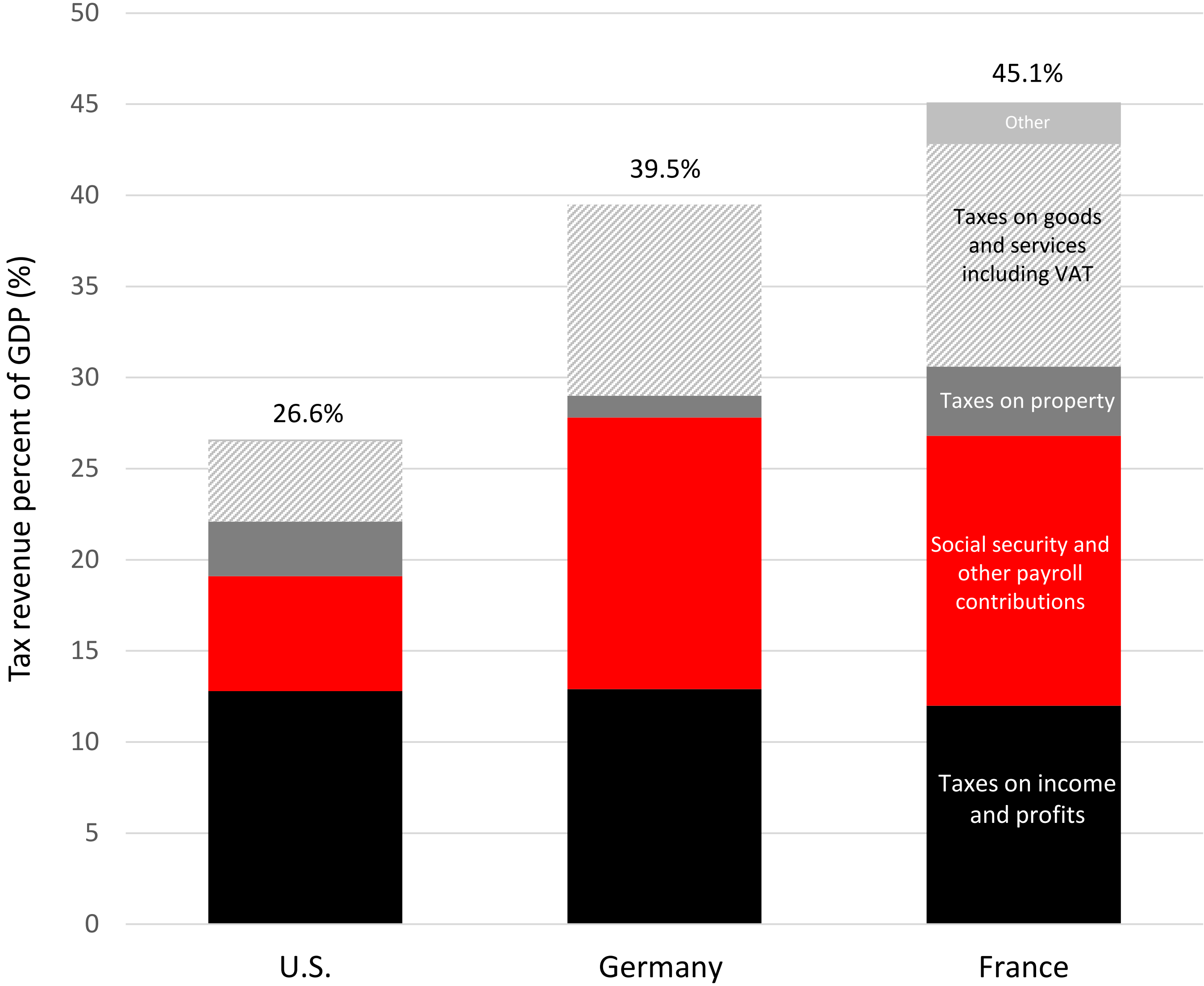
What the 14th Amendment Really Says

"I'm looking at the 14th Amendment, as to whether or not we have the authority. I think we have the authority," Mr. Biden said at a press conference ending the G-7 meeting in Japan. "The question is: Could it be done and invoked in time that it could not—would not be appealed and, as a consequence, pass the date in question and still default on the debt. That's a question that I think is unresolved."

Source: *The Wall Street Journal*, "What the 14th Amendment Really Says", Review & Outlook, May 22, 2023.

Tax structure U.S. vs. France and Germany



The U.S. has a much lower total tax burden and takes a very different approach to raising tax revenues compared to most other developed economies.

Source: OECD Revenue Statistics 2022, published November 30, 2022. Data for 2021.

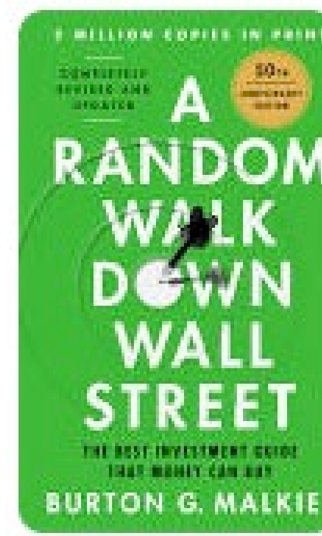
Active vs. passive

BARRON'S

***Barron's:* Do you still think your hypothetical chimpanzee is better than the experts?**

Burton Malkiel: I believe more strongly in my hypothesis today than I did 50 years ago.
… year after year two-thirds of the active managers are outperformed by a simple index fund. And the one-third that win in one year aren't the same as the one-third that win in the next year.
When you compound the returns over 10 years, or 20 years, these Spiva[1] reports show that 90% of the active managers are outperformed by a simple index fund. The same results hold in international markets and the bond market.
I'm not saying that no one can outperform. But when you try to go active, you are much more likely to be in the 90% of the distribution where you underperform, rather than the 10% where you outperform.

Burton G. Malkiel
Princeton professor and author



Source: *Barron's*, "50 Years On, He Still Favors Index Funds", February 13, 2023.
[1] S&P indices versus active management.

Active vs. passive

BARRON'S

Squeaking By

Despite Warren Buffett's stock-picking prowess, Berkshire stock has only managed to keep up with the S&P 500.

	1-Yr Return	5-Yr Return	10-Yr Return	20-Yr Return
Berkshire	0.6%	11.0%	12.0%	10.3%
S&P 500	0.5	11.1	12.2	10.1

Note: Five-, 10-, and 20-year returns are annualized

Source: Bloomberg

Source: *Barron's*, "It's Time to Bet on Buffet's Stock Again", May 1, 2023.

Important Information

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The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice.

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