COMMENTARY

Q2 2023

Looking through the lens of hindsight, the events of the past few years are quite logical. In all, close to $5 trillion in liquidity was created in short order. The Federal Reserve contributed both by slashing the federal funds rate to 0 – 25 basis points and by open market purchases of securities to the tune of $120 billion per month over 2.5 years. Additionally, Fiscal programs including the massive PPP/CARES program created liquidity through stimulus. Government policy acted as a potent cure for the pandemic shut downs and avoided economic disaster, but the price of the cure was inflation. When the supply of goods is constrained at the same time that the money supply explodes, and consumers have access to very low borrowing costs, prices are forced up, this is inflation. The antidote to this has been slow moving but effective. Beginning last October, the Federal Reserve began draining the supply of money from the economy, having raised interest rates by 5% and indicating further increases in order to battle inflation. However, the addition of the banking scares that we saw earlier in the year led financial institutions to enact their own form of tightening, reducing their lending and adding inflation-fighting medicine which has put inflation worries behind us in many industries. A note: while price levels remain high, inflation measures the rate of change in prices and that figure has come down dramatically. Again, negative money supply growth, a more nervous consumer facing high price levels, and mostly recovered supply chains have the effect of stabilizing inflation levels.

The economy is doing well and never slid into a dramatic contraction – unemployment is at 3.7% and participation rate in the work force has improved. However, corporate earnings growth is misleading because of accrual accounting. Firms have been storing excessive earnings from the second half of 2020 through 2022 and are bringing these earnings back, effectively smoothing out the earnings growth curve, and leaving us with 78% of companies reporting that they have exceeded earnings per share estimates.

Several sectors are benefiting from a wave of macro factors. For instance in housing there continues to be supply/demand imbalances due to a myriad of factors including people feeling trapped by their low mortgage rate, inheritance, and changing attitudes over home ownership and debt learned in pandemic times. Technology has become the major positive stand out in 2023 because of the opening of China, a generally weak dollar improving exports, and excitement over the promise of artificial intelligence. The commercial (office and retail) real estate market is unfortunately seeing a 1991-style contraction led by higher borrowing rates and tighter lending practices, decreased occupancy and inability to raise rents as well as the post-pandemic work environment.

Finally, as predicted, after months of stalemate, a debt ceiling package was passed only days before a looming Armageddon. The $31.4 trillion debt limit was suspended through January 1st, 2025 so we can all relax now while owing $31.4 trillion and growing.