COMMENTARY

The first quarter of 2024 saw inflation continue to fade into the rear view mirror, the current 3 – 3.5% range being a two-thirds reduction from the recent peak. Economic growth continued to moderately slow while job creation churned along at 250,000 per month, and fourth quarter GDP numbers were reported at 3.4%. Stock prices rose while bond prices fell, a phenomenon noteworthy in that while it is the way capital markets are expected to function, it has been the exception more than the rule in recent years.

There was another unique phenomenon, a record in fact, which occurred during the first quarter of 2024. The U.S. Treasury's key yield curve has been inverted, meaning short term rates are higher than long term rates, for the longest period of time on record, according to Reuters News Service on March 21st, 2024. The current inversion, traditionally a signal of overly tight monetary policy and an upcoming recession, began in mid-2022 and now exceeds the record 624 day inversion that took place in the late 1970s. It is interesting to take a look at the economic landscape in the 1970s to contrast with the markets of today. The term that is most closely associated with that economic era is "stagflation," which describes an economy that is experiencing both stagnant growth and high inflation. Unemployment was rising and sentiment was extremely poor. It was in this environment that Yale economist Arthur Okun created the misery index, a measure of the sum of the inflation rate and the unemployment rate. The higher this measure, the greater the misery felt in the economy and vice versa. The 1970s also saw the end of the Phillips Curve as a major tool of economic policy. Phillips, an economist, studied unemployment in the U.K. from 1861-1957 and posited that there was a tradeoff between full employment and inflation—as unemployment fell, inflation would rise. Thus, if the Federal Reserve increased the money supply or the Federal Government increases spending, the stimulation will bring down unemployment but prices will also rise as the additional supply of money competes for the same pot of goods and services. The University of Chicago economist Milton Friedman challenged the underpinnings of the Phillips Curve and argued that inflation-adjusted wages are the most important input and that supply and demand would adjust to the real price of labor.

Happily we see dramatic differences between these two time periods. In 2024 we have pent up demand for goods and services, rising real wages, and anticipated reductions in short term rates in the near future. Goods inflation is moderating, while services inflation, particularly shelter, remains sticky due to limited supply as well as potential housing stock waiting on the sidelines for rates to come down. 1978 was the era of stagflation, high unemployment, high inflation and a slowing economy. The misery index was at worst during the 1930s and 1970s reaching over 25%. After the Second World War the index fell to a low of 3.5% and has been below 10% for the last two decades —leaving all of us feeling a bit less miserable.

Other news from the 1st quarter of 2024 includes the U.S. Federal Reserve maintaining the current Federal Funds rate of 5.25%-5.5% citing the underlying strength of the economy and fears of reigniting inflation. Additionally, market breadth improved, meaning that sectors other than the 2023 standout, technology, experienced gains in the first quarter. According to FactSet statistics, 73% of S&P 500 companies exceeded earnings estimates and 4th quarter earnings growth was up 4.4% year over year. Finally, the Bank of Japan raised interest rates from negative 0.1% to a small positive range of 0.0%-0.1% which was the first time since 2007. Japan's Nikkei Average finally rose to levels not seen since (wait for it) 35 years ago – patient money indeed.