JAMESSON associates

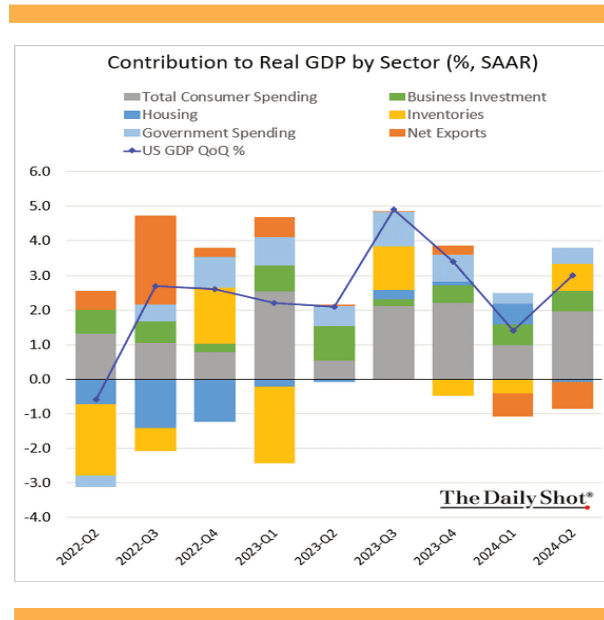
Fall 2024

Recent Economic Events

The American economy is still disproving the pessimists. GDP accelerated in the second quarter and is poised to continue to grow solidly over the current three-month period. At the same time, inflation has continued to ease, albeit not to the Federal Reserve's stated target. These facts, in isolation, should indicate that the FOMC will either leave rates unchanged at their upcoming meeting or actually increase them further. However, the key portions of the Humphry-Hawkins legislation instruct the Federal Reserve to pursue a dual mandate: price stability and full employment. These goals are, of course, in direct conflict.

For the last two-plus years, the price stability portion of the mandate has been the singe-minded aim. With signs that the job market is softening, full employment enters the frame. There is some disagreement as to whether the labor statistics are signaling a return to a more balanced situation or one of concern. There is no disagreement that the picture is less positive for workers than it has been. In spite of this, consumers are feeling better about things than they did earlier this year and are proving it by, well, being consumers.

Second quarter GDP rose by 3%, more than doubling the 1.4% gain in the first quarter. As per usual, the consumer was the main driver of growth. Both business investment and government spending added to the gain while net exports, once again, proved negative. Inventories, which had subtracted from first quarter figures, turned positive in the second. Current expectations for the third quarter are running between 2% and 2.5%, depending on which forecast you consider.



Inflation has clearly slowed from the 2022 spike, but it seems to have plateaued in the range of 2.5% to 3%. If this pace of price gain were to continue for the next few years, it would be good news. However, it may not be good enough for a Federal Reserve that has a stated target of 2%. This being the case, why is there an overwhelming expectation of lower short-term rates?

The market has concluded that inflation is low enough and trending in the right direction, so the job market has moved to the front burner. The unemployment rate has increased almost 1% from its low point and job growth has slowed significantly. Not only that, but the preliminary annual revision to job creation was lower by a substantial 818,000, knocking the average monthly gain from May 2023 to May 2024 down to about

Recent Economic Events-continued

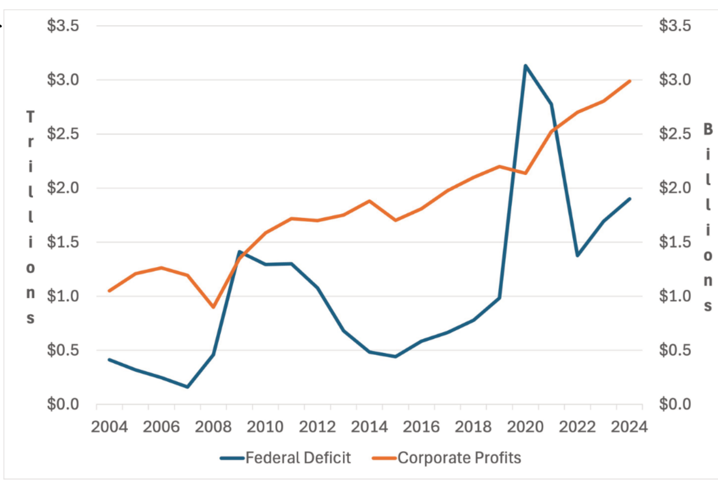
175,000. It is likely that the overestimation of new jobs has continued since the springtime. Other evidence of labor market cooling includes an uptick in new claims for unemployment insurance and a drop in both average hours worked and job openings. The August job report showed 142,000 new jobs created, unemployment at 4.2%, and hours worked totaling 34.3.

In the face of a less robust situation for workers, it is somewhat surprising that consumer confidence is at a six-month high and that personal consumption jumped by .5% in July, up 5.3% year-over-year. But perhaps I shouldn't be surprised, as the American consumer continues to show resilience. Walmart and Target reported unexpectedly upbeat results. Anyone traveling on the NYS Thruway over the Labor Day weekend was confronted with nearly bumper-to-bumper traffic (lower gasoline prices helped) and restaurants and sports venues continue to boom.

Most of the US economy's statistics are as good as or better than expected. We enjoy slowing inflation and a still-solid job market. The Federal Reserve may very well have achieved the elusive soft landing, but to be sure they are now directing the narrative to the second half of their dual mandate: jobs. On inflation, they seem to echo the words of Senator Aiken who famously advised LBJ to "Declare victory and come home."

Commentary

Hello, I'm the Federal Debt. I have bulked up and now total roughly $35 trillion or about 123% of GDP. But like Rodney Dangerfield, "I get no respect." Economists, pundits, and market analysts, regardless of their political ideology, are signaling that bad things are bound to happen because of me. They worry about the interest that Washington pays on my behalf which has grown to rival the defense budget. They think my market dominance will limit what others can borrow and blame me for high interest rates. I think it's time for a rebranding. I may even head over to TikTok to make my case.



Consider my positive traits. I was instrumental in helping to win World War II; I have provided retirement benefits and medical care for millions of older Americans. Every time the economy tumbles into a recession, I am at the ready. When my close relative the Federal deficit goes up, so do corporate profits.

Lucky for me economists just don't get elected, so it's no wonder that the rhetoric from our Presidential candidates offers nary a word of deficit reduction. Mr. Trump never met a dollar he didn't want to borrow, and his proposed economic plan reflects

Commentary -continued

those priorities. Ms. Harris plans on extending President Biden's legacy — when in doubt, spend. The former President proposes to make his 2017 tax cuts permanent ($4 trillion over 10 years), eliminate taxes on Social Security benefits ($1.2 trillion), and cut the corporate tax rate to 15% ($600 billion). Vice President Harris wants to expand various tax credits for families and children and health care ($2.2 trillion) and provide financing help for first-time home buyers (over $100 billion), while increasing the corporate tax rate to 28% ($1.1 trillion revenue gain). Trump net debt increase: $5.8 trillion; Harris $1.2 trillion. Far from putting me on a diet, both candidates expect to build on the close to $2 trillion annual additions to my totals.

Of course, we would need a sweep of Congress and the White House by one party or the other to achieve the full measure of fiscal imprudence.

I, for one, am hoping for a sweep, not a divided government like we had with those rascals Clinton and Gingrich. Had their standoff on spending and tax cuts continued for another decade, I would have been history. Fortunately, thanks to hanging chads in Florida, President Bush and his Republican Congress saw to it that fiscal responsibility was relegated to the dustbin of history. Dick Cheney famously stated, "Reagan proved that deficits don't matter." Got to love the guy even if he has retreated to an undisclosed location.

Democrats finally got the message. Neither President Obama nor Biden made any real attempt to rein in the deficit. Both have contributed to my sizable girth.

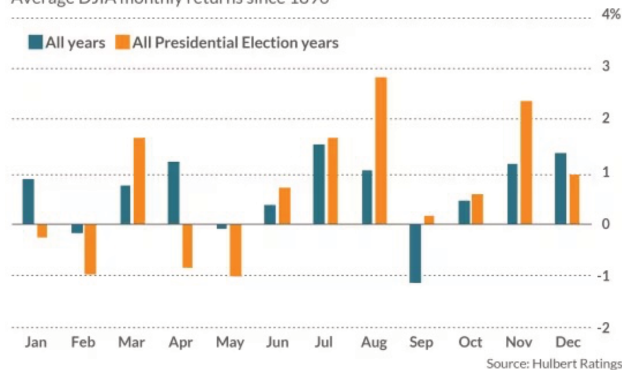
I am as American as apple pie. I am US Government Debt. Hear me roar! ⌶

Market View

What happens when the Fed cuts rates? It depends on whether a recession has begun or is soon to do so. If the Fed is reducing rates to fight a jump in unemployment and a drop in GDP, it seldom is wise to buy stocks. However, in the mid-1980s and mid-1990s, rate cuts while the economy continued to grow proved quite beneficial to equities.

If you believe that a recession is on the horizon, it's time to reduce your equity exposure to your core holdings. The proceeds from the sales should move towards high quality fixed income. After the rate cuts have run their course (say springtime 2025), the process can be reversed.

If, like me, you see a soft landing in your crystal ball, a different approach is called for. The history of interest rate cuts to normalize rates rather than rescue the economy suggests that the stock market is likely to advance. Lower rates help support the



Market View -continued

economy, allowing profits to continue to grow. Presidential election years are also positive for equities, but there is plenty of volatility until Election Day is in the rear-view mirror. Current valuations are elevated in anticipation of rate reductions, so I believe that the best way to proceed is to buy on weakness rather than jumping in with both feet.

Bonds have rallied nicely over the summer but may be ahead of themselves. If the economy stays on a positive path, the Fed is likely to be more measured in reducing rates both on timing and magnitude. This suggests to me that much of the price appreciation in bonds is behind us and that coupon collections will be the main driver of returns. Consequently, I remain convinced that the best risk/reward in fixed income is in the two-to-three-year area. High quality corporates in that maturity range make sense.

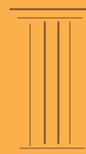
The Chinese economy is clearly in trouble and the idea of using exports to revive it is creating tensions around the globe. Prices for industrial inputs like iron ore, copper, and oil are under downward pressure. Agricultural products are also falling as growing conditions have been quite good this year. Sooner or later, commodities will bottom, but until China stabilizes, I would stay away. That said, it appears that there is a strong demand for precious metals with gold hitting new highs and silver on the upswing.

Volatility is usually a boon to alternative investments like crypto currencies, but that has not been the case recently. Instead of following gold to new highs, bitcoin and its brethren have stalled or fallen in price after the initial euphoria over ETF approvals. This is an area to avoid for now.

September and October are not the best months of the year for risk assets, but things typically turn around in the last two months of the year. I would advise caution in all investment decisions over the next two months. By Veteran's Day, we should have a much clearer picture of the Fed's course of action and the likely political direction in 2025. That would be the time to take a bolder approach to your investments.

Editor's Note

Susan and I spent a very hot four days in Athens, Greece, celebrating our anniversary (42nd). We played tourist by climbing up to see the Parthenon, witnessing the changing of the guard in full traditional costume, and visiting different museums. One of the most fascinating was the Museum of Ancient Greek Technology. (Ancient is the adjective modifying "Greek Technology" not just an "Ancient Greek" like me.) It included musical instruments, replicas of war machines, water pumps, and Plato's alarm clock (ask about it when you see me). However, a trip to Europe wouldn't be complete without a story about the iPhone map program. After our trek up to the Acropolis, I looked for an alternative walk back down to our hotel. Off we went along a narrow sidewalk with cars whizzing by. While we walked down a long hill, our time to the hotel didn't budge. As a reminder, when you want to walk, be sure to switch from driving on the app.



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