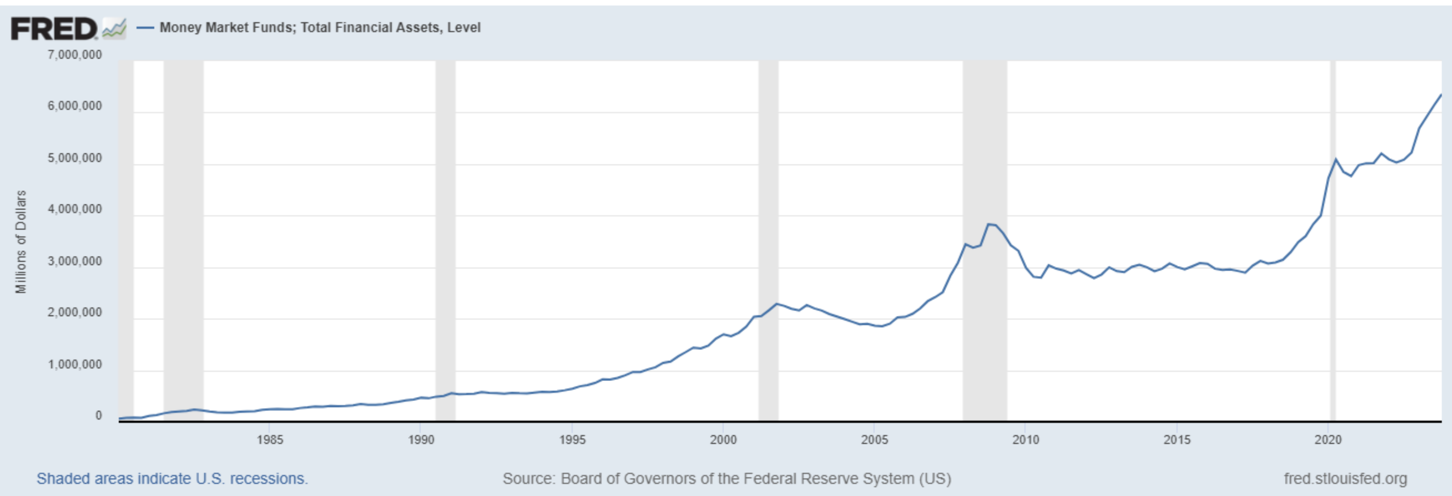
# The Great… Reacceleration?

Q1 2024 Client Letter

If we were to tell you at the beginning of 2022 that the Fed funds rate would be sitting at over 5% in 2024, equity markets are back to breaking fresh all-time highs almost daily all while the labor market remains stubbornly tight, no one would have believed us. Part of this can be attributed to an unprecedented amount of liquidity that flooded the system in 2020 and 2021 which is still trying to nestle itself into financial markets and income producing investments. Since November last year, when the Fed announced that they were going to take a more dovish policy stance, we have witnessed the best S&P 500 rally in the last 60 years. This happened with record amounts of money piling into money market funds (see chart below of the $6.36 trillion), which represents potential fuel to asset prices as many people have been on the sidelines during the equity market recovery over the last year.




Another factor contributing to this backdrop of strong stock market performance has come from the top companies in the index (notably tech companies) driving the indices higher, which was discussed in our previous newsletter. But what exactly does it mean when stocks are trading UP as inflation data is starting to look worse, or has gone from decelerating on a year over year basis to potentially reaccelerating? Aren't we told that stocks are supposed to sell-off when inflation expectations start to rise again? To us, this means that market participants believe the Fed is bluffing and they may implicitly settle for a higher inflation target. They can go ahead and cut rates while disinflation has stalled above their official target of 2%, or maybe not cut rates at all this year. Whatever the case may be, we believe the Fed knows if they cut rates, that means more liquidity throughout the system, which means more inflation, which means they'll have to raise rates again. The whole cycle repeats itself. There are still two interest rate cuts priced into the forward curve for 2024 and the latest CPI inflation reading (on 3/12) showed headline inflation remaining quite sticky right around the 3% level (which is 50% above the Fed's 2% target). The report also showed acceleration in the services sector (>70% of the economy) which is quite notable, all while liquidity continues to expand. At a very high level, the economy has continued to surprise to the upside. Good luck getting outsized outperformance from bonds relative to stocks if both the economy and inflation is reaccelerating, of course unless there is a severe recession.

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Case in point: bonds are fixed contracts (debt) where an investor hopes to receive their principal back upon maturity and interest payments along the way. Investors in the stock of quality companies (equity) that have products and services with pricing power can at least match or hopefully outpace because of the company's ability to raise cash flows and pass their higher "costs" onto consumers. This is the sole reason why we're constantly on the lookout for companies that are leaders in their respective industries – the moat of the company actually INCREASES in a tougher overall profit environment, as long as solid execution from management continues. What we are seeing on a large scale, across nearly every industry in the US, is the consolidation of equity all the way from mom-and-pop shops and startups straight into the hands of the biggest industry players. Why have most investors, economists, and market commentators gotten the current macro environment so wrong over the last two years? One quick answer might be that there has been quite a noteworthy divergence taking place between fiscal and monetary policy over that timeframe. Monetary policy, what the Fed controls through overnight interest rate policy, has remained tight all while the fiscal side (Congress and the Executive Branch) have shown no indication of slowing in terms of their frivolous spending. The Fed has been blamed for a lot during the years, but they are simply trying to clean up the mess that the US Government helped create in the first place. As everyone well knows, Congress has their "checkbook" out and is ready to spend no matter the cost. In 2023 alone, the US Government ran a $2 trillion deficit. And this is in a time of peace with no recession. Welcome to a new era of fiscal dominance!

We believe there will always be a full menu of risks present in financial markets and the global economy. One of the sneakiest, underrated risks that is often overlooked is the risk of losing real purchasing power, year after year, decade after decade. The importance of preservation and expansion of one's purchasing power over time cannot be overstated. You can spend time worrying about what the Fed's next move will be and probably lose a ton of sleep over the current trajectory of US Government spending. While we do not have a firm view on what the Fed will do, we're paying close attention to the environment. Either way it seems constructive for assets, especially energy, industrials, technology, and healthcare that benefit from this current era of fiscal dominance. At CenterPoint, we are driven every day to guide individuals, families, and companies by helping to manage their financial futures accordingly to their own goals and objectives. Warren Buffett famously said that "the stock market is a device for transferring money from the impatient to the patient", and he certainly has the track record to back him up on this statement. We take pleasure in investing, planning, and walking alongside each one of you throughout the years.

Sincerely,

Dan Grant Jordan

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