MV CAPITAL MANAGEMENT

Weekly Market Flash

If It's Late August, It Must Be Jackson Hole

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Late August means different things to different people. The last chance for a relaxing week at the beach before the new school year begins. Putting up the college flag on the front lawn in anticipation of the upcoming football season. Endless variations on recipes for those fresh tomatoes, straight from the garden. And for finance nerds like ourselves who closely follow the twists and turns of monetary policy, it's Jackson Hole time. At their annual gathering in the shadow of the majestic Grand Tetons of Wyoming, the world's leading central bankers pair cowboy hats with their sober business suits and ponder how their policies should meet the present economic moment. The highlight of the week, always, is the Friday speech by the chairperson of the US Federal Reserve, closely watched by market observers for clues about where interest rates and the economy at large might be headed.

The Time Has Come

On many occasions, Jay Powell is circumspect and vague about the Fed's specific policy direction. Not this year. "The time has come for policy to adjust" said Powell, just a minute or so into his speech this morning. For markets, there was no ambiguity to parse in that pronouncement. Barring something truly extraordinary transpiring between now and September 18, when the Federal Open Market Committee next meets, that meeting will result in an easing of the target Fed funds rate. By how much? Clearly, the Fed chair was not going to go that far. Our baseline assumption is that the FOMC will cut rates by 0.25 percent at the September meeting, with a reasonable likelihood of two more cuts of the same magnitude in this year's remaining meetings on November 6 and December 18.

That assumption, of course, is subject to new data received between now and then. Powell expressed a high degree of confidence that inflation is on a sustainable trajectory to reach the Fed's two percent target – a level of confidence missing from recent post-FOMC press conferences. The trickier issue now is the other side of the central bank's dual mandate: employment. Unemployment has ticked up in recent months and now stands at 4.3 percent, almost a full percentage point higher than where it was a year ago. Powell did note today that, at least for the moment, higher unemployment is more a function of new entrants to the labor market than of widespread layoffs (a point we have also made in recent commentaries, most notably a few weeks ago when the market freaked out over the softer than expected July jobs report). Still, the Fed does not want to see labor market conditions turning notably worse, and that would appear to be the driving factor behind Powell's clear assertion that the time to act is now.

The Sinking of the Good Ship Transitory

Powell injected a note of humor into his speech, one that also reflected an attitude of humility that was pleasing to see. Three years ago, the Fed was prominent among institutional voices arguing that the inflation that had started to build up in 2021 was of a "transitory" nature, brought about by temporary supply chain dysfunction during the pandemic and the (so it was thought) equally temporary spike in demand as housebound Americans used their government stimulus checks to purchase new Peloton machines and backyard grills and whatnot. By the end of that year, however, it was clear that this bout of inflation was going to be anything but transitory. The experts were wrong. As Powell humorously put it in his speech, "the good ship Transitory was a crowded one, with most mainstream economists and advanced-economy central bankers on board." The Fed had to pivot, and in March 2022 they commenced the monetary tightening policy that brought the Fed funds rate to the 5.25 – 5.0 percent target range where it sits today.

Beyond the nautical humor, there was an important message in Powell's speech for all of us with skin in the game. The experience of the pandemic economy was like nothing else that had gone before it. Never in all the decades of recorded macroeconomic data had there been a contraction in GDP that deep, followed by a rebound as robust as the one that occurred in the space of just two quarters in 2020. None of the economic models employed by mainstream economists could countenance the rapid drop in inflation that occurred after its June 2022 peak happening alongside an environment of historically low unemployment. In many ways the Fed and other central banks were flying blind as they tried to navigate consumer prices and the labor market back into some kind of balance. Fortunately, they kept their focus on reaching their targets and managed to ignore much of the second-guessing and periodic freak-outs bubbling up in the markets during this period.

Powell finished his speech on this note: "The limits of our knowledge – so clearly evident during the pandemic – demand humility and a questioning spirit focused on learning lessons from the past and applying them flexibly to our current challenges." Well put. All of us in this business could stand to bring a similar attitude of open-mindedness, humility and willingness to adapt as we carry out our work on a daily basis.

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