THE DANA VIEWPOINT

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Demand is not the Problem

We have heard a lot about the demand side of the economy from the Federal Reserve this year. However, we almost never hear about the other side – the supply side. Jerome Powell has said that we have to lower demand in order to bring the economy into balance and bring inflation under control. Powell wants to inhibit demand by slowing growth in employment. He has said economic growth is too high, and he wants the unemployment rate to be higher than it is now to help keep wage pressure low. He essentially wants more Americans to struggle in order to reduce inflation.

"We are tightening the stance of policy in order to slow growth in aggregate demand. Slowing demand growth should allow supply to catch up with demand and restore the balance that will yield stable prices over time. Restoring that balance is likely to require a sustained period of below-trend growth." -Jerome Powell, 11/30/22

This is not the kind of help the U.S. economy needs.

Why not try and grow the economy by finding ways to help increase the supply of goods and services? Make it easier for businesses to hire, rather than more difficult. End the Covid emergency declaration at the Federal level, which will end the expansion of support programs that took place during Covid. These measures will increase the incentive to work, and decrease the disincentives to work. Those who are out of the workforce see their skills and habits erode over time, making it more difficult for them to reenter the workforce, at least at a job level that is equivalent to that which they had when they left the workforce. The goal should be to increase incentives to be in the labor force. Child tax credits should not be refundable, which means that you receive the payment even if you don't have income and don't pay Federal income taxes. Refundable credits are disincentives to work, they decrease the labor force, and increase inflation.

If businesses know that Powell is trying to slow the economy, they will try and front run the slowdown. Businesses will try and reduce costs and reduce output in anticipation of the reduction in demand. Companies will try and match supply to future expected demand in order to preserve profit margins. Some of this may have happened already, as it appeared that inventories rose to uncomfortably high levels during the summer at some companies, and they were forced to make adjustments. Powell assumes he can reduce demand and supply will stay the same as he says in the quote above; this is not true. Witness the layoffs announced by many large companies this fall. One ugly possible result of both supply and demand decreasing can be stagflation, a condition where the economy slows but prices do not come down. Less spending on the fiscal side can help avoid this outcome.

(CONTINUED ON REVERSE SIDE)

There is more evidence that the economy is bending, not breaking. Gasoline prices have moved down significantly, and the housing market has slowed towards more normal levels of price growth. Year over year home price growth has slowed from over 20% to below 10%, and may continue to slide due to higher mortgage rates. Existing home sales have slowed significantly, but new home sales have actually moved back up over the last two months to pre-pandemic levels. Auto sales have actually increased recently, as companies attempt to ramp up production to meet demand. Retail sales ex-gasoline have slowed.

Despite these signs of slowing, GDP for the third quarter was revised up to over a 3% annual rate, and may run stronger than that in the fourth quarter. For the last two months Core CPI has printed at the lowest levels in over a year. All of this is incrementally good news for the stock and bond markets over the intermediate term. Every month where inflation shows signs of slowing while the economy remains resilient looks more like a soft landing, and moves us closer to the end of the Fed rate hiking cycle. It also decreases the chances of a major Fed mistake. The Fed has already said that increases will slow, although they will not comment on any potential rate cuts. Fears of a recession and lower corporate profits in 2023 still run high, which is the main reason the S&P 500 is having a difficult time moving above the 4000 level. The Nasdaq index may be forming a stealthy bottom, as more than two thirds of the members of the index are outperforming the overall index.

In the fixed income markets, intermediate and longer rates have stabilized, providing positive returns for the quarter even as short rates have continued to move up. Most fixed income portfolios can now earn 4-5% annually, which supports total returns and provides a buffer against price volatility.

2022 has followed the uncertainty of the pandemic years of 2020 and 2021, but has been no easier to navigate. We continue to adjust portfolios to current market conditions and work to anticipate future potential scenarios. A 2022 highlight was Dana Investment Advisors once again being named the best place to work in investment management among companies with 50-99 employees. 2022 was our 11th straight year of receiving such National recognition and is a true reflection of the wonderful team and culture you've enabled us to build. This recognition and Firm environment have enabled us to attract and retain an amazingly talented and dedicated team here to serve you. It is our privilege to guide our clients' assets, and it is a responsibility we take very seriously. We thank you for your business, and look forward to our continued partnership in 2023.

We wish peace on earth and a Happy New Year to everyone.

The Pension and Investments Best Place to Work article link is here:

https://www.danainvestment.com/wp-content/uploads/PI-2022_BPW_Dana.pdf

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