STENGER FAMILY OFFICE
Weekly Insights
Ep. 142 | March 7th, 2024

Where's the Cut?

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Only 5% of economists expect a Fed rate cut at the March meeting compared with 65% just a few months ago. Expectations are down dramatically after some hot inflation prints, including stubborn rent prices as we predicted. In fact, we think rents could keep rising significantly, even after a few small pullbacks. Politicians on both sides of the aisle started backing the Fed into a corner in 2020 and 2021, printing insane amounts of new dollars into the economy. Like Milton Friedman warned, "Inflation is always and everywhere a monetary phenomenon." Or simply put, too many dollars chasing too few goods. The Fed's mistake was waiting far too long to raise rates. By the time rates started rising, the damage was already done.

Now, the Fed is the middle of a total and utter mess – cut rates and risk an inflationary resurgence (Arthur Burns in the 70's) or keep rates too high for too long and create a major employment crisis. Already we've watched companies layoff large amounts of people in hopes of protecting margins the rest of 2024. In addition to UPS cutting 12,000 and Citi cutting 20,000 workers, 38% of business leaders surveyed by Resume Builder think layoffs are likely later this year. In a normal economic cycle, layoffs lead to demand weakening, deflation, and ultimately a recession. Yet, the current environment is anything but normal.

Think through what's happened the past 4 years. First, COVID strikes and we shut down the economy. Millions are paid to stay home and not work and global trade plummets. Everyone who used to travel, eat at restaurants, or meet people at business conferences sat at home smoking meats, riding (or not riding) their Peloton, and fixing their kitchens and bathrooms. Then we pummeled the economy with 40% more dollars. Demand for goods spiked and excess cash was spent paying down debt or buying crypto. All along the way, interest rates were zero, allowing us to buy cars and houses for rock bottom prices. Then we re-open the economy, people have less debt than ever, cash in the bank, making more money than ever before. All of this is true for companies too – large S&P 500 Index companies have more cash than they can spend, earning 5% risk free.

In nearly every sense, government policy has created unintended consequences that no economist can truly understand. 40% of homeowners currently have no mortgage. Of those who do, 65% pay less than 4% in interest. With mortgage rates near 7%, it's likely the rental inflation problem persists far longer than most realize. Further, companies flush with cash are so worried about doom and gloom, overpreparing for a rainy day, money has been sucked from investment and now sits mostly in cash on the balance sheets of the top 50 S&P 500 companies. As we've pointed out, the top 50 companies are in better shape than most U.S. banks. Because companies and wealthy individuals are somewhat debt free and flush with cash, economic growth is likely to continue for a while. Luxury good stocks such as Ferrari and Louis Vuitton are near all-time highs, not indicative of an impending collapse (not a recommendation to buy/sell).

Our opinion is that the Fed will only cut rates materially after some serious labor market pain. It's sad to see, but the bigger government gets, the more it crushes the little guy and entrepreneurs. Exactly the opposite of what's promised, the bottom 10% always pays the price for ridiculous print and spend policy. In other words, *"There Ain't No Such Thing As a Free Lunch."* Eventually, the bill for the insanity of the past 4 years will come due, it's just a matter of time. Unemployment will spike, demand will weaken, a recession will occur. But remember, stocks are a forward-looking indicator of what's to come. By the time you react, it will already be too late. Stocks correct *before* recessions and make new highs *before* the economy recovers.

While no one has a crystal ball, we think there's plenty of room left to run before a recession happens. As such, the stock market could keep making new highs for a few years before becoming a bubble. Our advice is to stay the course throughout the entire cycle and remember stocks go up more than they go down. A correction is coming at some point, but attempting to time it is a fool's errand.

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