Abner Herrman & Brock
asset management

"Surprise, Surprise!"
April 2024 Market Outlook

The Federal Reserve (the Fed) has continued to use historical experience to forecast economic growth and manage inflation, relying on the same policies that were successful many years ago. Unfortunately, the Fed has been repeatedly surprised that its actions have not slowed the rate of inflation as much as it expected. As keen as the Fed may be to lower interest rates, neither the inflation rate nor the recent economic data has cooperated. In fact, recent data suggests an increase in the inflation rate and a growing US economy despite the Fed raising interest rates and reducing its balance sheet.

Why are the tools that were effective years ago not as effective today? The post pandemic economy is meaningfully different from the pre-pandemic period. Mark Twain is credited with the expression, "history doesn't repeat itself, but often rhymes." In the case of managing inflation in an economy that has structurally changed, a new innovative approach may be required. Adapting to a new environment often requires a new perspective forged with courage and creativity. The Fed's tools of historical success to contain inflation occurred during a period that was very different than today's US and world economy.

We have written about the shifts in the US economy in prior letters, but it bears repeating. The US economy today is far different when compared to the late 1970's and early 1980's when the previous period of concerningly higher inflation occurred. Today, we are a service-based as opposed to a manufacturing-based economy. A service economy is less capital intensive, therefore less impacted by changes in interest rates. Additionally, our economy is now supported by a larger number of government spending programs than in the past. These spending programs assist ever-widening groups of the population which in turn contributes to economic growth. Hybrid work and modern technologies such as AI and machine learning are providing productivity, cost savings and greater spending power to corporations and consumers alike. The acknowledgement of these dramatic changes in our economy demands consideration and greater analysis from the government officials who are responsible for the mandate of providing economic stability.

In fairness, there are more questions than answers. Higher short-term interest rates may be helping the economy by providing higher returns for investors. It is possible that the impact of government spending is more than offsetting the effect of higher interest rates and the reason is the inflation rate has not yet slowed to the Fed target of 2%. In the future, will productivity derived from artificial intelligence applications hamper the impact of monetary and fiscal policies?

The US economy has demonstrated resilience particularly supported by a strong labor market. Therefore, it is likely that both the economy and the inflation rate will remain stronger than expected for a longer period. The breadth of the stock market has expanded from only a handful of technology companies to include a broader number of information technology stocks as well as those in the financial services, industrial, and energy sectors.

Fixed Income portfolios are tactically positioned in a ladder of shorter maturities. More recently, we have increased the duration of portfolios to secure higher rates of return now available for longer as we recognize the possibility of interest rates above the rate of inflation.

In only three months, 2024 has already been a remarkable year. The largest earthquake in New York City since 1884, a total solar eclipse that will not reoccur for twenty years and both the Dow Jones Industrial Average and the S&P 500 reaching record highs during the first quarter. This year will also be historic because it is the largest global election year in history with more than sixty countries voting in presidential, legislative, or local elections. November's US Presidential election is the first rematch since 1956 and offers two candidates with diametrically opposed policy paths. AHB is cognizant of the differences as we identify investment opportunities, and we seek attractive investments that will not be contingent on either policy direction.

Our AHB investment team remains dedicated to the task of monitoring, evaluating, analyzing, and anticipating change to achieve the investment objectives of client portfolios. We also remain focused on optimizing investment returns while limiting volatility during these periods of unprecedented change.

Thank you for the confidence that you have placed in our firm. We appreciate and recognize the importance of this decision.

Sincerely,

AHB Investment Team