CONWAY• JARVIS LLC
Investment Outlook

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Update

The Fed Offers a Clue to Policy Timing

The star of last week's Jackson Hole Economic Symposium was Fed Chairman Jerome Powell. He offered guidance as to the Board's policy response to the ongoing recovery and the inflation attendant to it. Indications are that the Fed will begin to reduce bond purchases before year end. We noted in our most recent Update that, in effect, the economy was reaching the point of not needing life support in the form of Quantitative Easing. We welcome that as a sign of successfully recovering from last year's recession.

We also view inflation, in moderation, as another good sign. The current high level of price increases can be attributed to supply chain disruptions that followed last year's shutdown and difficulty in reviving employment rolls in some sectors of the economy. Both should abate over time as companies adapt but are factors considered in the Fed's approach to maintaining price stability as part of its mandate. Chairman Powell was careful to make a distinction between tapering and the FOMC making actual revisions to the Fed Funds and Discount rates. While tapering appears to be on the menu for 2021, it by no means dictates the timing of when the Fed will begin to normalize those key interest rates. Indications are that price *instability* will be secondary to employment as a factor in determining when rates will be normalized.

The stock and bond markets responded positively to last Friday's announcement, unlike the Taper Tantrum we witnessed in 2013. We believe the difference lies in the current level of fiscal stimulus currently being injected into the economy. The markets always welcome copious amounts of liquidity into the economy regardless of the source. It allows the Fed to, in essence, hand off to Congress the burden of doing the heavy lifting of the recovery. That was not the case in 2013 as monetary policy was the only available tool in the box and tapering was then viewed as a premature removal of support for a tepid economy. Not so today.

Lastly, there's been a lot of hand wringing over the current high level of inflation and whether it's transitory or will persist in the long run. Economists and market strategists have difficulty in defining "transitory". We see it in the present as any flare-up of price increases occasioned by temporary, solvable supply constraints within the context of an expanding economy. That's the best we can do in terms of a definition and what we expect to see forthcoming from a rational and adaptive economy such as ours. The inflation we fear and last seen in the late 70's was the product of the oil embargo, the wage/price spiral, and policy errors from the Nixon and Carter administrations. It fell upon Paul Volcker in 1979 to put an end to persistent inflation by triggering a recession with record high interest rates in order to reduce the money supply and attain price stability.

That cure was painful because of the delay in treating the cause of the problem. This Fed Board and those of Bernanke and Yellen have preempted the need for such a radical measure. They've implemented rational policy on a timely basis, independent from elected officials. For that reason, investors and the markets should have little fear of a policy error coming from the Fed despite the assertions of market "experts" and those on CNBC intent on selling drama and advertising. Pay no attention or change the channel when assessing your portfolio strategy and the threat of inflation. Stay tuned.

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