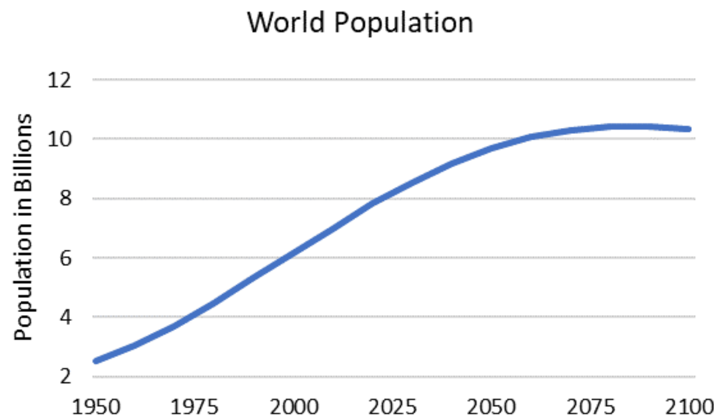
August 2, 2023

Market Musings

A newsletter brought to you by Victoria Capital Management, Inc.

VOL. 6, ISSUE 8

Global economies will continue to expand to meet the needs of an exploding global population. The following projection suggests investment in companies that provide for the needs of this expansion will benefit for many years to come. The question is what companies will be best at accommodating that growth.



Does Monetary Policy Work?

Since March of 2022, we have been subject to a Federal Reserve that is committed to reducing inflation to 2% and has raised interest rates 10 times. Last month was no different as rates were raised by 25 basis points to a target range of 5.25-5.50%. This is the sharpest increase in interest rates in 40 years! This increase took place even though consumer price inflation increased at an annualized rate of 3% -- not far from the Fed's target. Moreover, PPI, which measures producer price inflation, came in at an annualized rate of 0.1%. So, where is the inflation? The likely reason for the increase is that higher interest rates are supposed to slow the economy so that demand dissipates, unemployment rises and prices fall. Unfortunately for the Fed that is not what is happening. For starters, the economy continues to grow at a reasonable 2.0-2.5% rate. Unemployment remains near historical lows and the participation rate, the rate at which eligible members of the workforce seek employment, is rising. For months, economists forecasted a recession; two quarters of declining GDP (gross domestic product). The latest forecasters are backing off that projection even though such projections were based on this tighter Federal Reserve policy. Remember, as the Fed raises interest rates, it is transferring money from borrowers to savers. Higher rates on floating rate savings instruments translate into billions of dollars of more spending power. Budget deficit watchers are upset that higher interest rates on government securities will require the federal government to pay more in interest on newly issued debt, but those payments will go to savers who are likely to spend it and keep the economy growing. If the Fed, as threatened, continues to raise rates, savers will get more income and spend more. The economy will not slow down under that strategic plan.

Fed watchers are warning that the economy will slow down because M2, a measure of the money supply, is shrinking. Yet one major component of M2 is savings deposits. Yet interest paid on bank savings accounts is lagging the run-up in interest rates paid by money market funds and other floating rate instruments. These securities continue to increase the interest rate on their accounts not included in M2. The bottom line is do not worry about warnings over the shrinkage in M2. These traditional tactics of affecting the economy through manipulating interest rates may be tested in the coming months.

"Yesterday's home runs don't win today's games."

- Babe Ruth

Market Commentary

Just when we thought the stock market would take a breather during a scorching summer, the markets got hotter! As we closed out July, the stock market rally broadened out with the S&P SmallCap 600 gaining 5.5% and the S&P MidCap 600 rising 4.1% compared to the 3% return for the S&P 500. The NASDAQ continued its blistering run and is now up 37% year-to-date. The Dow Jones Industrial Average eked out a gain and is up a little over 7% so far this year. Foreign stocks as measured by the MSCI All Country World ex-US index are up almost 12% while emerging markets are up more than 9% for the first seven months of this year. Bonds were little changed with the 10-year Treasury yield hovering around 4% and the dollar was essentially flat.

U.S. retail sales in June rose 1.5% on a year over year basis, but all that growth can be attributed to online sales and inflation

(source: US Census Bureau)

Market Musings represents the views and opinions of VCM and does not constitute investment advice, nor should it be considered predictive of any future market performance. Data are from what we believe to be reliable sources, but cannot be guaranteed.