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Market Musings

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

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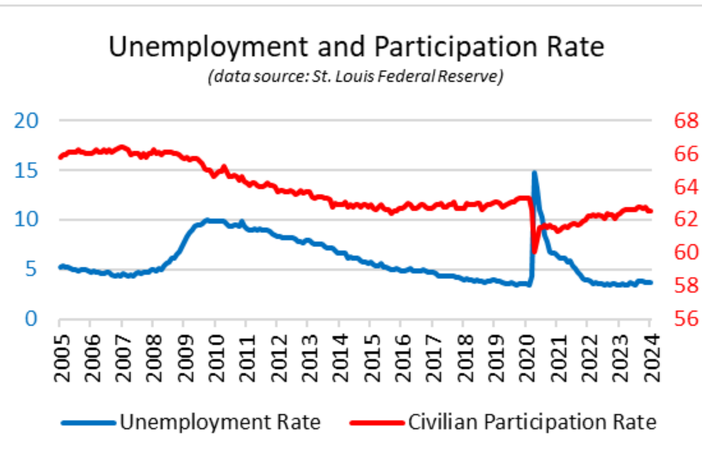
This exhibit tracks changes in unemployment as a percentage and the participation rate before and after the pandemic. Even though the Fed has raised rates at a record pace, there has been no discernible negative impact on employment.



Upsetting the Normal Business Cycle

Over the past year or two, the consensus economic forecast was for a recession, a term used to describe at least two-quarters of declining gross domestic product (GDP). The traditional concept behind this term is that the economy goes through what is known as a “business cycle” whereby the economy begins to recover from either weak business conditions or government policies that slowed economic growth. Examples of restrictive government policies include higher interest rates that slow borrowing and lending or an increase in tax rates that withdraw funds from the private sector. At the beginning of a recovery, there is usually a reversal in government policies, and interest rates are lowered to stimulate loan growth and increased spending. The economy expands because of these policies and continues to grow until such a time when growth is so strong that demand for goods and services increases and prices begin to rise causing inflation to increase. At this point, fiscal and monetary policies are reversed, and the economy is forced to slow down and, in some cases, fall into recession. These events are cyclical with differing durations depending on the economic conditions at that point in time.

For those of you still with us, the recent pandemic may have changed the traditional path of the above-defined business cycle. The federal government’s response to the pandemic was unusual but was done to control the economy to fit into an acceptable combination of growth and inflation. As inflation peaked early in 2023, the policies of the Federal Reserve focused on rapid increases in interest rates to slow the economy. There were fears among market participants that a high interest rate policy would cause a rapid increase in unemployment, a characteristic that has accompanied past periods of tight money. However, this expectation was never realized as employment has remained in an uptrend while the unemployment rate has remained remarkably low. Just at a point where one would expect to see the economy skidding into negative territory, GDP has been growing for three quarters (including an expected first quarter GDP growth rate of about 3%! Inflation has declined even though the Fed stopped raising interest rates in July 2023. So, maybe the traditional “business cycle” is dead. Food for thought.

“Face reality as it is, not as it was or as you wish it to be. ”

- Jack Welch

Market Commentary

During February, financial markets seemed to process the fact that the Federal Reserve’s interest rate policy remains uncertain and that interest rate cuts are in question. The S&P 500 gained 5% for the month, which was just the 11th time in the index’s history since 1928! For the month, Mid and Small-cap stocks rallied by 6% and 3%, respectively, but the latter is still in the red for the first two months of the year. All sectors in the S&P finished in the green. Domestic bonds were slightly down for the month while the U.S. Dollar rallied against its major competitors, most notably the Japanese yen. Overseas equity markets had mostly positive returns with strong results from China, Israel, and Italy.

According to Harvard University, a record 12.1 million renter households - or 27% of all renters - were severely cost-burdened at the end of 2022, meaning they spend more than 50% of their income on rent and utilities.

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