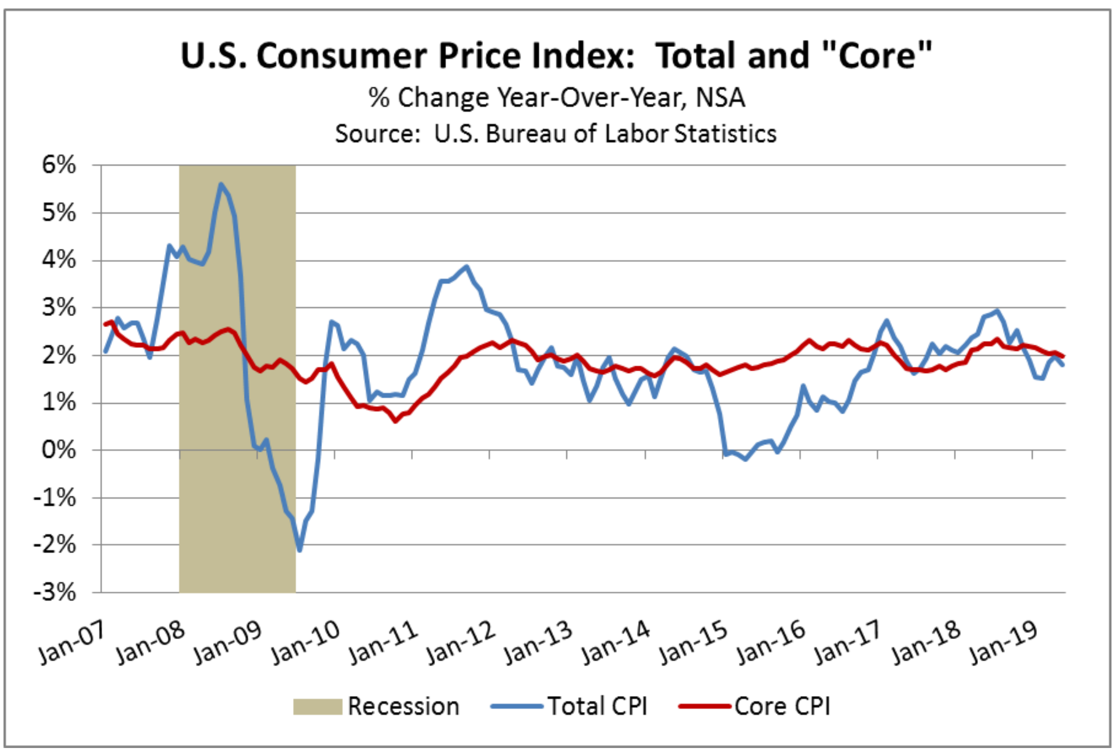
Economic Chart of the Week
June 12, 2019

In recent months, we've stressed that a key problem for the U.S. economy is that inflation-adjusted interest rates rose dramatically last year and now remain too high for the economic fundamentals. Even though the markets are more focused on the disruptions related to trade policies, we think those issues merely exacerbate the problem of excessively tight monetary policy. The question is whether and when the Federal Reserve might finally start cutting interest rates to deal with the problem.

Today's chart shows one development that could eventually help persuade the Fed to start cutting rates. In data today, the May consumer price index (CPI) was up just 1.8% from the same month one year earlier, falling short of the Fed's inflation target of 2.0%. Excluding the volatile food and energy components, the May "core" CPI was right on target, but the chart makes clear that inflation by both measures is still trending downward. While it's true that the Fed policymakers actually prefer a separate measure of inflation – the "core PCE price index" (not shown on the chart) – that gauge typically runs a bit weaker than the CPI, and it's also trending downward. In other words, all the major inflation indicators seem to be signaling weaker demand and waning price pressures, which we think will help prompt the policymakers to start cutting rates as early as this summer. The problem is that monetary policy affects the economy with a lag. The rate hikes in 2018 are probably still slowing the economy today, and any rate cuts this summer won't really help until late 2019. The economy therefore is at risk of an unwanted slowdown that would likely cut into corporate profits and stock prices, so we continue to gradually reduce our exposure to riskier assets across our various strategies.

Patrick Fearon, CFA
Lead Portfolio Manager



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