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Don't Mistake "Data Dependent" with Discipline

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It gives me no pleasure but, in my 40+ years as an investment professional, I cannot recall a more hapless and dissatisfactory Fed Chairman. Jerome Powell's flipflops are too many to count and they come with breathtaking rapidity. It was not too many weeks ago when central-bank officials believed they would be able to reduce interest rates several times beginning mid-year 2024. And as early as the end of March when stocks were hitting all-time highs, Powell said he thought "financial conditions are weighing on the economy." Huh?

When you rely on backward looking data that is subject to significant revisions, you guarantee you will always be behind the real story of where the economy is going. As the great Wayne Gretzky said, "Skate to where the puck is going, not where it has been." But the Fed in their collective wisdom declared "data dependence" in Jackson Hole in 2020. And the rest is history. Skating to where the puck has been will continue to result in Fed Flipflops, so flipflop to your heart's content dear Chairman.

The Federal Reserve employs over 400 Ph.D. economists, yet the committee presumably shifted to "data dependence" to get out of the fraught estimation business. But to this observer, visibility has evaporated, and policy volatility has increased, obviously not the intended consequence. Perhaps this is what prompted Joseph C. Sternberg to opine in *The Wall Street Journal* **"Why Is the Federal Reserve Always Surprised by Inflation?"** Sternberg's conclusion? The Fed's primary model of the economy which is based on 500 variables plugged into 170 equations does not "adequately account for the effects of fiscal policy." The Federal Government has spent "$10 trillion in cumulative deficit spending since the start of 2020" and as we have written since July of 2021 in **Mr. Magoo's Washington** and **Mr. Magoo's Washington Redux,** profligate fiscal spending fanned (and continues to fan) the flames of inflation, turning a controlled burn into an inflation wildfire. The rate of change (Wall Street's focus) has indeed come down significantly from over 9.0% to the 3.0% range (depending on your chosen metric) but sticky inflation remains elevated—over 4.5%—and cumulative price increases have risen on average 20% since 2020 (the average American's focus). Deficit spending continues.

Final word on the Fed: as Sternberg observes, "one of the things that makes the Fed's broken economic models so embarrassing is that the central bank keeps talking about them." Oh, how I long for the good old days when the Fed kept its collective mouth zipped and we were left parsing comments from Chairman Greenspan like the following: *"I know you think you understand what you thought I said, but I am not sure you realize that what you heard is not what I meant."* Now that is Fed speak for the ages!

Focus on earnings and earnings are telegraphing a slowdown…so far. This week is critical.

The theme so far for Q1 earnings is a beat on earnings, slowing revenues and reduced guidance. The industrials so far have been disappointing. Consistent with a slowing economy and a soft landing.

- **FAST (Fastenal)** missed on revenues and eps and reported fastener sales down -4.0% year over year with prices decelerating at a rapid pace. Fastener sales are a close reflection of manufacturing and construction. This on the heels of increased onshoring and the manufacturing PMI hitting expansionary territory for the first time in years.
- **SNA (Snap-On)** also missed big on sales but beat on eps. The share price was punished.
- **PLD (Prologis)** (an industrial REIT) trimmed guidance on macro impacts—high interest rates, increased supply—pushing vacancies up.
- Last night **CDNS (Cadence Design Systems)** disappointed, **TSM (Taiwan Semiconductor Manufacturing)** gave cautious guidance. **PG (Proctor & Gamble)** raised prices to support earnings, but volumes were down. **PEP (PepsiCo)** is facing the same fate. We are watching.

If the economy is slowing that may be good news for Fed watchers. We continue to rely on our 1990s analogy which we have written about extensively for over a year. Despite higher levels of inflation (on average 3.0% during the decade) and a ten-year which averaged 5.0%-7.0%, geopolitical shock and a war, a labor shortage, an inverted yield curve, soft landing for the economy and productivity improvements which allowed the economy to grow at a nice, non-inflationary clip, stocks enjoyed enviable returns. The Fed raised rates aggressively in 1994, cut three times in 1995, then let it ride.

All of this reinforces our (currently unpopular) view that investors should focus on reliable earners like technology and consumer discretionary (LTI is also overweight in industrials and energy). We added to the names in the fall of 2022 when the market had written off technology for dead. And, again in 2023. That has worked out well.

Large, profitable technology companies, for example, are beneficiaries of higher interest rates. Just take a gander at their balance sheets. In 2023 interest and investment income rose threefold to $1.6B for META, GOOGL's haul increased 78% to $3.9B. AAPL, META, AMZN, MSFT and GOOGL held 23% of aggregate corporate cash among S&P 500 companies. Meanwhile, their corporate debt has declined. These are the new defensive companies in our view.

And despite handwringing over valuations, we are not in euphoria territory. See the following table from our friends at Alpine Macro. And note the yield on the 10-year during the periods featured.

Magnificent 7	Forward P/E	Tech's Four Horsemen	March 2000 P/E	Nifty Fifty	1972 P/E
Meta	24	Intel	41	Coca-Cola	46
Amazon	36	Cisco	100	McDonalds	71
Apple	26	Dell	57	Texas Instrument	40
Google	21	Microsoft	51	IBM	36
Microsoft	34			Xerox	46
Nvidia	35			Polaroid	95
Tesla	61				
S&P 500	**21**	**S&P 500**	**28**	**S&P 500**	**19**
10-Year Treasury Yield	**4.6%**	**10-Year Treasury Yield**	**6.2%**	**10-Year Treasury Yield**	**6.5%**

Source: Alpine Macro, April 17, 2024

Labor market may be softening. Full-time jobs are down 284K year over year in March. And the average work week is down, part-time jobs are up, wages are rolling over and real wages are below pre-pandemic levels. ISM services and manufacturing employment is still contractionary. Many put great hope in the JOLTS which shows 8.8MM in job openings but the survey, like so many, is flawed, with a response rate that has dropped from 75% to 35%. We are watching. So far, consumer spending remains intact.

What does all this mean? We are using weakness to add to high quality names. We reiterate our investing theme of old economy companies embracing this new industrial revolution of digitization, generative AI cloud computing and the suppliers of the picks and shovels.

General Disclosures

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