

# Dilemma

Policymakers around the world are facing a difficult choice. Inflation has accelerated rapidly and its forward trend is uncertain. Less accommodative monetary policies have been embraced as cures. The hope is that higher interest rates will slow economic activity enough to curb inflation while limiting the impact on activity and employment. Orchestrating this so-called “soft landing” is difficult at best as monetary policy alone does not dictate aggregate supply and demand forces in the economy. A most recent example has been the impact of supply chain disruptions which were not a function of monetary policy. A review of key variables can provide perspective for investing amidst the dilemma at hand.

## Q PERSPECTIVE

For much of the last 30 years, inflation as measured by the Consumer Price Index (“CPI”) rose at a steady pace as shown in **Chart I**. That steady pace ended in 2020, and the CPI has been on a sharply higher trajectory ever since. The forces driving the CPI higher appear to be dislocations arising during the pandemic and fiscal policies that followed. The pandemic did disrupt economic relationships among both supply and demand factors. Personal spending habits changed and then changed again. Goods and services were in short supply and adjustments could not be made in a timely fashion. Stimulative fiscal policies exacerbated demand beyond a point. The net result was higher prices.

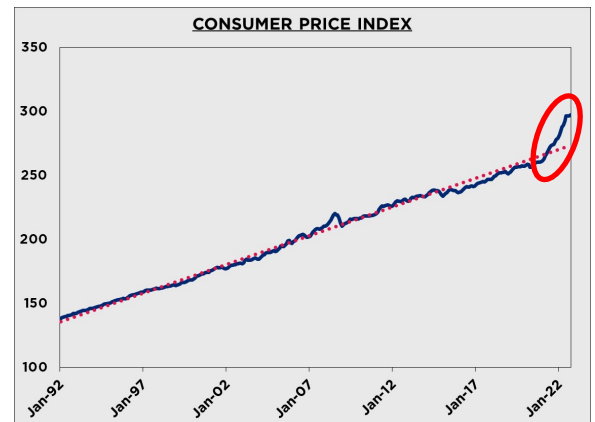
Employment is a key indicator of the health of an economy. Non-farm payrolls is a preferred measure of U.S. employment. As shown in **Chart II**, payrolls have oscillated higher over the past 30 years until the abrupt disruption of the pandemic. While the recovery has been dramatic, payrolls just have returned to pre-pandemic levels. At the same time, job openings continue to far outpace available workers. The pandemic certainly has influenced this outcome as workers have re-prioritized their employment preferences. Faced by strong demand, businesses have responded with higher wages. Even at that, however, wage growth has lagged inflation. As a result, the need to slow inflation is clear but challenging with employment forces not in equilibrium.

The U.S. stock market as measured by the Dow Jones Industrial Average (“DJIA”) has moved irregularly higher over 30 years as shown in **Chart III**. Bear markets of early 2000s tech bubble and of the Great Recession of 2008-2009 appear surpassed by that of the pandemic. Another bear market is at hand as high valuations boosted in part by low interest rates now are challenged by the ending of the accommodative regime. Valuations have corrected but markets tend to overshoot on the downside as well as the upside. While the outcome of inflation reduction and its impact on the economy and corporate earnings remain inconclusive, so will uncertainty for the DJIA.

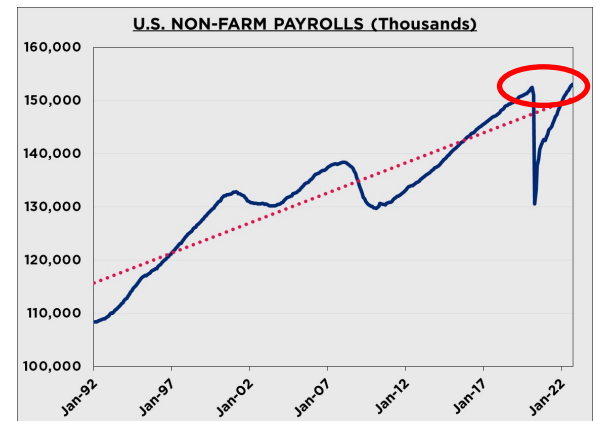
## INVESTMENT IMPLICATIONS

Difficult policy decisions bring market uncertainty and dilemmas for investors. How long will a bear market last and how deep will be the correction? How long will a recovery take to restore lost value? Should portfolio risk be reduced and when should it be increased once again? At challenging times such as now, the first investor priority is to fully understand goals, time horizons and risk tolerance so as to address any difficult choices that may arise. These choices are within one’s control whereas market cycles most certainly are not.

**CHART I**



**CHART II**



**CHART III**

