MARKET OBSERVATIONS
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INVESTMENT COUNSEL

Long-Range

Long-range for many investors rarely extends beyond the next twelve months. Perhaps this just reflects market volatility which can render outcomes woefully inaccurate quite quickly. Likely, it also reflects the reality of horizons over which investors are evaluated. Long-range analyses tend to be the purview of economists and policymakers. This does not mean the forecasts in such analyses are irrelevant. Hopefully they are used across the spectrum of market participants as they can provide important perspectives. The perspective here provides some long-range assessments for key economic and market variables. While economic and market variables are not perfectly correlated, an understanding of their interactions is important. As a result, a look at long-range projections relative to historical outcomes certainly is warranted.

PERSPECTIVE

Economic growth includes employment, wages, corporate earnings and stock profits. Chart I shows real economic growth since WWII. The five-year frequency was chosen so that available forecasts out to 2036 could be incorporated. With one exception, five-year economic growth rates for the 50 years from the end of World War II ranged between 2.5% and 3.5%. The exception was the sharp snapback in growth for the five years ended 1966. A different outcome emerged after 2006. There was no notable snapback following the very slow growth ended 2011. Subsequent growth has averaged closer to 2%, and remains at or near that rate for the following 10-year forecast horizon. The implication is for all things to be slower – employment, wages, earnings and profits.

Rates of inflation have been much more volatile than rates of economic growth. This difference is clear when comparing Chart II and Chart I. The Federal Reserve has identified 2% as its desired rate of inflation. Based on the historical reality prior to 1991, this rate would seem to have been more aspirational than achievable. It took a decade to bring relief from the high inflation of the 1970s and early 1980s. But the subsequent outcome was inflation averaging less than 2% from 1996 through 2021. The inflation forecast is for rates slightly above 2%. If such an outcome is achieved, policymakers will consider their efforts a success, and rightly so.

Much investor focus is placed on the Federal Reserve and its policymaking activity. Its key policy rate, the federal funds rate ("FFR"), is followed closely. Trends in the FFR along with its forecasted average for the ten years through 2036 are shown in Chart III. The extent to which policy was used to bring down earlier high inflation is clear. The FFR was driven well-above its longer-term average and maintained there for an extended period. From 2001 through today, the FFR has been well-below its longer-term average. The impact of this policy decision on economic growth and inflation are less clear, as growth rates for each have remained below average. The implication is that the level of interest rates has had less impact on the economy.

CHART I

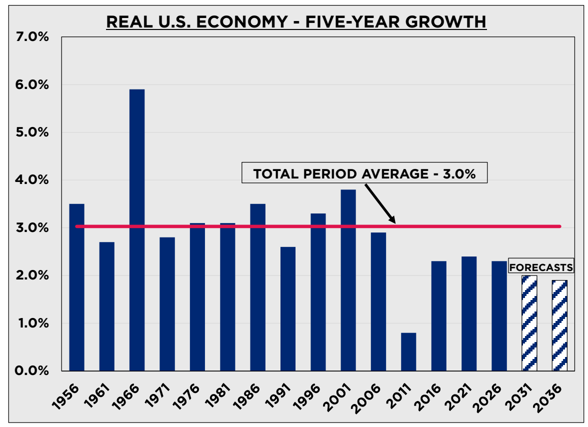


CHART II

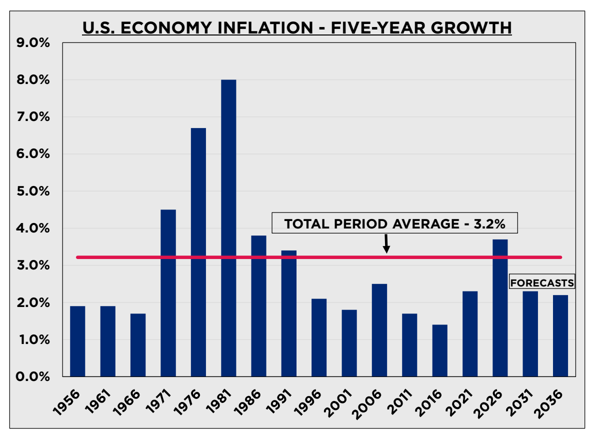
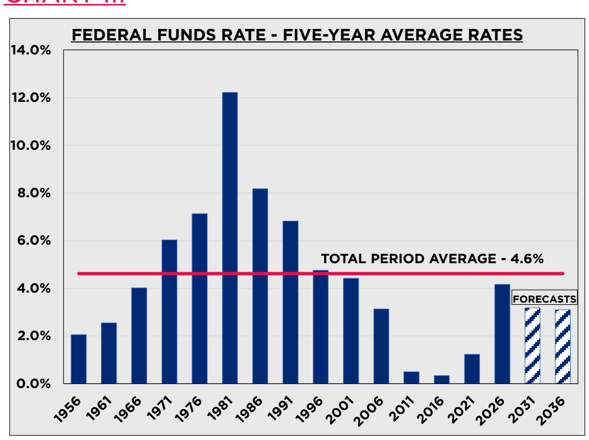


CHART III



INVESTMENT IMPLICATIONS

The 10-year forecasts used in this analysis were provided by Blue Chip Financial Forecasts. These long-range forecasts are updated semi-annually. Current projections are little changed from those of six months ago. A key change from much of the past is the current Federal Reserve focus on lowering the FFR when it likely will soon be 100 basis points below its long-term average. On the one hand, affordability can improve for purchasers of cars and houses where borrowed funds likely are used. However, income for savers would be diminished. The impact on the markets and the economy remains to be seen.