On March 17th, 2022 the Federal Reserve hiked interest rates for the first time since the pandemic. The Fed raised their benchmark fed-funds rate a quarter of a percentage point to a range between 0.25% and 0.50%. Inflation at that time was 8.3% and rising. The labor market was incredibly strong: Payroll additions were 436,000 in March 2022 and the unemployment rate was at a multi-generational low of 3.6%. In the words of Federal Reserve Chair Jerome Powell: "That's a very, very tight labor market – tight to an unhealthy level, I would say". The Fed was trying to bring down inflation without causing a recession that would lead to mass unemployment. The Fed would go on to increase interest rates 11 times to where they are now: in a range between 5.25% and 5.50%.

The fed-funds rate is an overnight interbank lending rate that influences a wide variety of consumer, and business, debt. Rates on mortgages, credit cards, savings accounts, car loans, and corporate debt rose sharply in the following two years, in the hopes that higher rates would slow down economy activity just enough to bring down inflation while not causing a sharp increase in unemployment. This is a scenario called a "soft landing".

This brings us to where we are now: Using the Fed's preferred measure of inflation, inflation in June of 2024 was down to 2.5%, very close to the Fed's target inflation rate of 2%. Unemployment has ticked up to 4.3% and hiring has slowed to 114,000 jobs added in July of 2024. What's more amazing is that U.S. (real) GDP growth for the second quarter of 2024 was 2.8%. In other words, through restrictive monetary policy the Fed has been able to bring down inflation while not causing a sharp increase in unemployment and while maintaining a respectable pace of growth for the economy. A soft landing seems all but certain at this point.

And that is a very good thing because it's looking like we can use those lowered interest rates. The data that is most often looked at in assessing the state of the economy are lagging economic indicators. A lagging indicator is a statistical indicator that changes after macroeconomic conditions have already changed. This means that these data provide investors with the state of the economy either as it is now or, and this is more common, how it was at some point in the past. Let's take for example unemployment: while it's great to see the unemployment data come in as expected, the data itself tells us how the labor market was performing in the prior month, it does nothing to inform us of the labor markets current state. The same goes for corporate profitability, GDP, industrial production, measures of inflation, and consumer spending. The data that are coming in now are showing us that a slow down of the economy is happening and, without a decrease in interest rates coming soon, the economy might slow us down enough to put us in a recession.

Investors have to come to their own conclusions as to what they think the future holds. Some market participants trade off one month's worth of data while others wait to see a trend of maybe three month's data before making investment decisions. In the short-term speculators will try to position themselves ahead of the market based on their interpretation of these lagging indicators. This type of short-term speculation causes periods of increased volatility, much like what we have been experiencing lately.

From our perspective, as long-term investors who do not participate in such short-term speculation, we are left to ride out the waves until we reach calmer water and boy, we are becoming very good at surfing. At the time of this writing the S&P 500 is up 8.7% year-to-date, which is an amazing number if you consider the amount that had to

go right in order to achieve it. This return number represents the market's sober optimism regarding the state of the economy and that clearer waters (and lower interest rates) are just ahead.

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