Persistence

Key words capture investor attention at certain times. Most recently, "transitory" was used by policymakers to describe the recent high rate of inflation. "Transitory" now has transitioned to "persistence" as recurring data suggested that higher inflation may be here for longer. The struggle between transitory and persistence plays out with other key factors. Most recently, a new variant reinforced the persistent nature of the coronavirus. Persistent supply chain issues and lagging employment cloud the outlook for economic activity ahead. A review of persistence in some important variables can provide perspective for investing yet ahead.

PERSPECTIVE

The now repeated discovery of a new variant indicates that coronavirus may persist well into the future. Financial markets, government authorities and the public at large reacted with concern to the new Omicron variant. Chart I shows reason for concern as well as a glimmer of hope. Global new COVID cases are on the rise once again with the level of the resulting peak yet to be determined. If the level is below the prior peak, a more positive virus outlook will be confirmed. If not, a cautionary posture will prevail. At the same time, the pattern of new COVID mortalities is quite favorable and likely will remain so as medical breakthroughs continue.

Employment dislocations have arisen during the pandemic, but will they continue? Chart II shows trends in the U.S. under-employment rate (BLS #U-6) since its inception in the mid-1990s. This measure includes the total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons. From its peak resulting from the Great Recession, a downtrend in the rate persisted until sharply reversed by policy and behavior responses to the pandemic. The pandemic spike proved to be short-lived and the rate has quickly approached the prior low level. A break below that level would indicate that dislocations have run their course. Unlike earlier, and given current labor market dynamics, upward wage pressures could persist and further exacerbate inflation rates.

U.S. monetary policy has persisted in an accommodative posture for much of the 21st century-to-date. Chart III shows the long view of the federal funds rate, the key monetary policy indicator. For all but a brief period from early 2006 to late 2007, the rate has been well-below the long-term average. And for much of the past 13 years, Fed policy has kept the rate close to zero. As the Fed itself has abandoned the characterization of higher inflation as transitory, so too it is likely that historically low interest rates will not persist much longer. The Fed will need to navigate an uncertain policy balance to restrain inflation while supporting continuing real economic growth.

CHART I

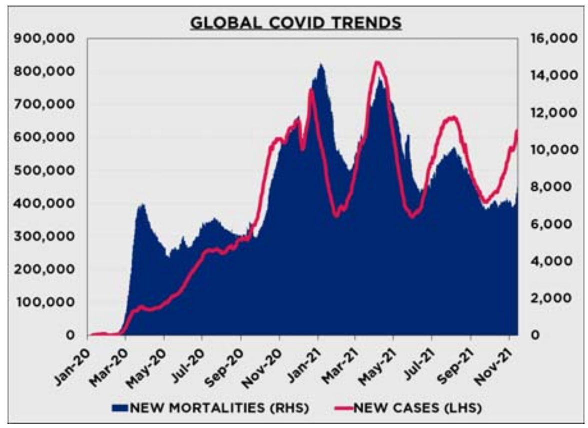


CHART II

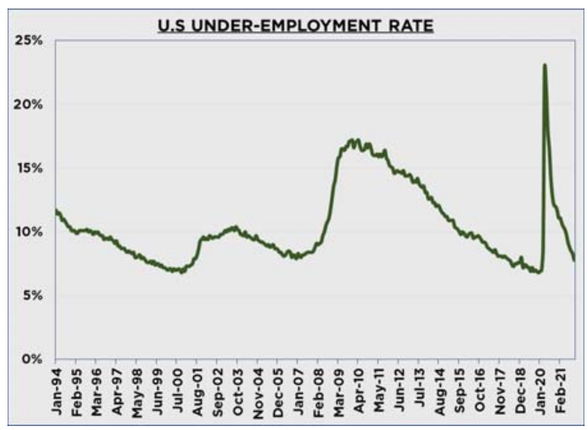
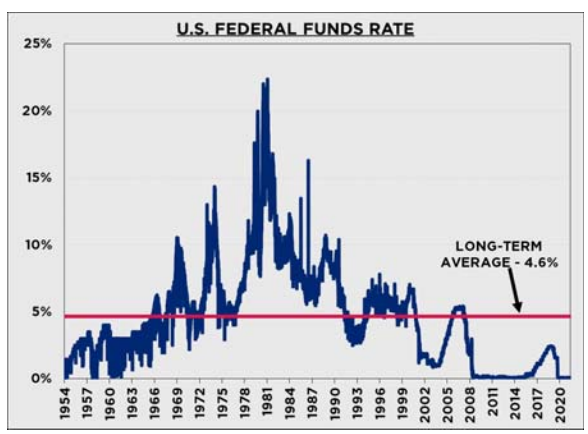


CHART III



INVESTMENT IMPLICATIONS

Differentiating trends which are persistent from those which are transitory is important for setting effective portfolio strategy. Unfortunately, the distinction only may be clear well after markets have adjusted. As a result, portfolios must be managed with this uncertainty in mind. While investment goals, time horizons and risk tolerance may shift over time, there likely is persistency to be found and to which portfolio strategies should be directed.