

# CORE *Comments*

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

September 25, 2024

## **Quiet, with some Turbulence in the forecast**

As we enter autumn and approach the consequential election, both bonds and stocks are rising in price. It is entirely possible that, as this contested election comes closer, markets will become more volatile. In early August, there was a tremendous spike in volatility occasioned by Japan's central bank's unexpected change in direction of its monetary policy. Things settled down in a short time and last week's action by the Federal Reserve did not upset markets. The Fed's action was meaningful; it ended its long process of monetary tightening and cut the interest rate it directly controls. By this action, the Fed joined several other major central banks in easing monetary policy. But the absence of market reaction was notable in that the Fed cut rates by 0.50% without having telegraphed the size of the cut prior to the meeting. Typically, the rate change is 0.25%, unless the Fed has made clear from pre-meeting speeches of its intent to act differently.

In cutting the Fed funds rate by a half percent, the Fed has begun a process of monetary easing that will probably continue for more than a year. Fed funds, now standing within the range of 4.75% to 5.00%, are still much higher than the presumed neutral rate, that is, the rate that neither restrains nor stimulates economic activity. Accordingly, the Fed's present policy is still damping economic activity. The Fed's dual mandate includes stable inflation (considered to be two percent) and maximum employment. The Fed has seemingly (and appropriately) declared victory in its effort to bring inflation down and has explicitly shifted its attention to the labor market.

Indeed, this is the right focus for the Fed; the employment market is weakening. The term used to describe the Fed's goal in its monetary policy is 'soft landing,' that is a slowing of the economy that does not result in a recession. (Recession is a hard landing, that's for sure.) Whether a soft landing will be the result of the two years of concerted monetary tightening and the recently begun monetary easing remains to be seen. The historical precedent for monetary tightening as extreme as this recent round is recession. So far, the recession has been delayed but whether one is at hand remains to be seen.

*By*

*Jack Mayberry*

Fed policy always operates with a lag in time. That is, its effects are not instantaneous; the effects of Fed actions generally manifest months or years later. Unemployment has risen in the last year and job vacancies have decreased. Neither of these presage good times ahead. It is likely that the Fed's decision last week to make the large half percentage point decrease in the Fed funds rate rather than the usual quarter point cut was driven by fear that the rather extreme monetary tightening increased the risk of recession.

The Fed's job is important. It is not easy.

One aspect of the Fed's decision last week has already had an effect on our investments: we have held our cash reserves in a mutual fund that invests in short-term Treasury paper. Over the last year and more, its yield has been somewhat more than five percent, an attractive real return—real return meaning the return after taking into inflation into account. As inflation fell over the last year, the real return of this fund has risen steadily. After last week's rate cut by the Fed, the annualized seven-day yield of the fund has fallen from just above five percent to 4.77%. Oh well, with inflation now hovering just above two percent, we still enjoy a 'real' return of about 2.5%.

In this week, we have adjusted our holdings, having sold half of our short position in small US stocks and purchased a position in utilities. Utilities have enjoyed quite a strong run so far this year and more lies ahead. Utilities are a well-known defensive position, in that people keep the lights on even if they cut down on other expenditures. Moreover, utilities are also a significant play on artificial intelligence ("AI"). We earned a good return earlier this year with our Nvidia investment, Nvidia being the maker of the highly-prized semiconductors and software for AI. The work involved in AI requires significant electrical power and is driving demand that utilities companies supply. The utilities investment will not blow out the lights (pun intended), but its defensive characteristics and high yield will benefit us if and as the stock market falters. And as the power supplier for the burgeoning AI work, it has good prospects for continued growth.

Meanwhile, our investments in gold, in Indian equities, and in US pipelines continue to appreciate. Prospects for our long-term Treasury bond investments are very good. As the Fed lowers short-term interest rates, long-term rates fall apace and the prices of long-term bonds rise. It is entirely reasonable to expect a total return of fifteen percent or more in coming months as the Fed cuts rates and, should a recession befall us, the return will be greater.

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CORE ASSET MANAGEMENT

PO Box 1629  
108 Caledonia Street  
Sausalito, California 94966  
(415) 332-2000 • (800) 451-2240  
fax (415) 332-2151  
[www.coreasset.com](http://www.coreasset.com)  
[info@coreasset.com](mailto:info@coreasset.com)