CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

January 7, 2024

A New Year Begins
Review and Preview

Inflation falls and bond prices rise. The Fed's inflation-fighting campaign is succeeding..

As 2023 began, the Fed was nine months into an exceptionally aggressive round of monetary tightening, occasioned by the very high rate of inflation that began in 2021. By March 2022, when the Fed began its work, the year-over-year inflation rate, as measured by the Consumer Price Index (CPI), had reached 8.5%. It reached 9.1% in June 2022, before it began to recede. As 2023, began, the rate of inflation had decreased to 6.5%. (The CPI most recently measured 3.1%, rapidly approaching the Fed's target rate.)

Because of the intensity of the Fed's monetary tightening, it seemed to many, if not most, observers that the US economy would tip into recession in 2023. At least through the first nine months of 2023, the economy continued to expand and the recessionary part of the economic cycle still lay ahead. (We will learn soon how the US economy fared to the year end.) By July 2023, the Fed had raised the Federal Funds rate, a short-term rate that it directly controls, from the 0% to 0.25% range that prevailed before the Fed tightening began to 5.25% to 5.50%. (This represents the most aggressive Fed tightening in more than 40 years.) At present, Fed funds remain at the 5.25% to 5.50% level and, throughout the autumn, Fed governors insisted that the Fed funds rate would remain 'higher for longer.' (For fuller discussion, see my November 27th *Core Comments.* Total securities held by the Fed are now $7.2 trillion, down from the $7.8 trillion reported in November.)

Forecasts. Those expecting a recession in 2023, myself included, seem to have forgotten or ignored the remark of John Kenneth Galbraith. As he put it, "There are two kinds of forecasters: those who don't know and those who don't know they don't know." In a recession—which surely will come—the economy contracts, stock prices fall and bond prices rise. In 2023, stock prices rose in two steps. The first was from March to July, after the Fed stepped in to forestall further bank failures and artificial intelligence (AI) came into focus, especially with ChatGBT. The second stage of stock market advance began in October 2023 and continued to late December. This latter advance seems to have been predicated on the notion that the Fed was nearing the end of its monetary tightening and would begin cutting rates in the first or second quarter of 2024.

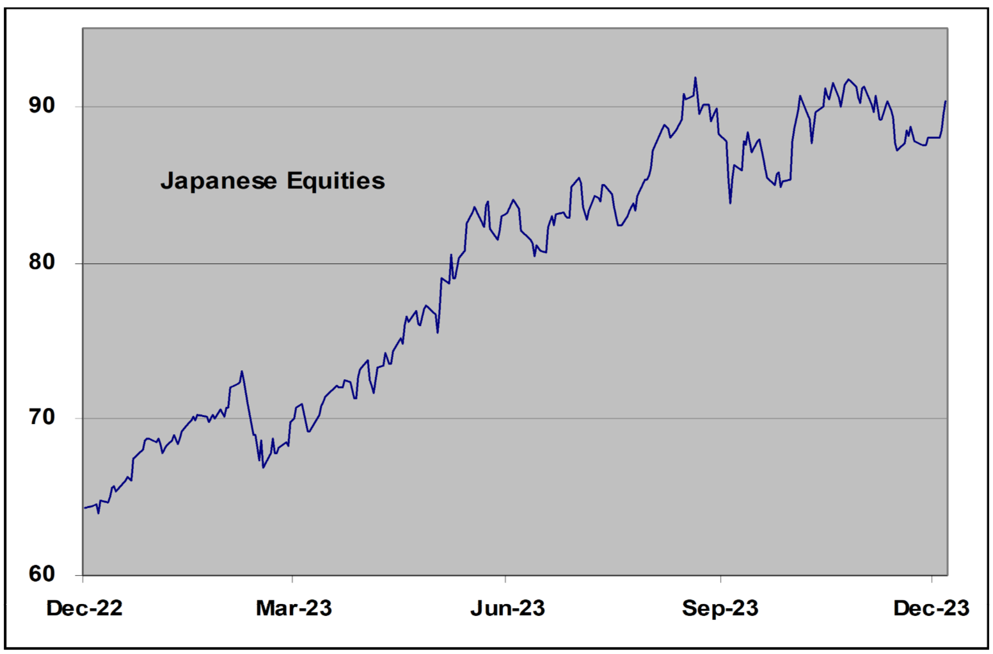
By

Jack Mayberry

The bond market, particularly United States Treasury bonds, fell into mid October, then began a strong rally, based on the same notion that the Fed would begin easing conditions in 2024. In his December press conference, Fed chair Jerome Powell lent credence to this view, referring to progress on the inflation front. His remarks occasioned an acceleration in the Treasury bond rally.

Thud. In the very short trading year so far—a mere four days—some Fed governors have pushed back against the inference that investors seemed to draw from Mr. Powell's December remarks. These Fed officials suggested that the market's views of the timing and extent of Fed monetary easing were unlikely to be realized. With these comments, both stocks and bonds fell sharply in price. We shall observe how things unfold from here.

Core's investments. Because of my expectation of a 2023 recession, we held a position that would appreciate as stocks fell, but, of course, fall as stocks rose. This proved to be a poor investment for us 2023; happily, I reduced the position as the year rolled on, and it is a rather small one now. Core's other equity positions are three and they have all done very well. Going into 2023, we held a position in a US pipeline fund and added to it in 2023. We took positions in Japanese and in Indian stocks during the course of 2023. All three positions produced returns in excess of 20 percent in 2023; to my mind, prospects for these three continue to be quite favorable. The nearby chart shows the return of the Japanese investment we hold.



Our Treasury bond position is substantial and shows a very good return since October. Mindful of Galbraith's' comment about forecasters, I believe that we will be glad to own these Treasury bonds.

We retain a large position in a Treasury securities money market fund. This yields more than 5% at present, a favorable return in the context of inflation, now around 3% and falling. When the Fed does begin to cut interest rates, this fund's yield will fall. But, if the rate of inflation continues to fall as the Fed cuts rates, the 'real' return of this fund—that is the return after inflation—will remain favorable. Core's final position is in gold, which is trading very near its all-time high in price. In the context of the world's two hot wars and the likely decline in interest rates, this continues to seem like a good holding.

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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
info@coreasset.com