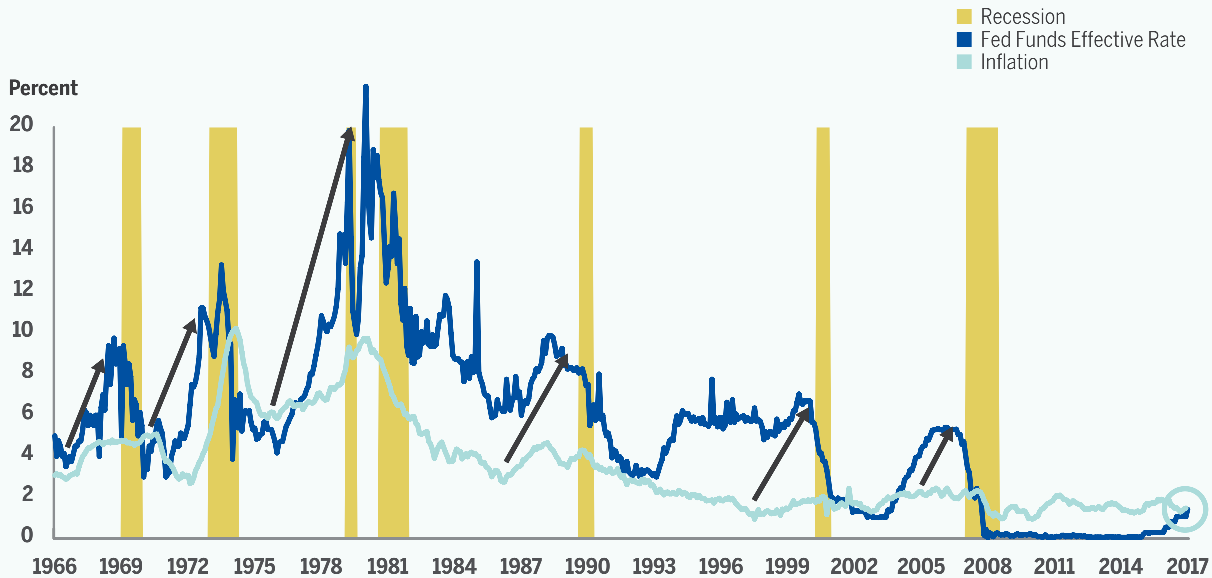
Leading Indicators Signal Stability

Currently a number of forces are weighing on inflation in the U.S., allowing the Fed to be patient in its tightening path. Given that every major recession of the past 75 years has followed significant Fed Funds rate tightening or inflation acceleration, or both, we believe a recession is not imminent.

Short-Term Interest Rates and Inflation Below 2%



Source: FactSet as of December 2017. Inflation represented by PCE. Price Index ex-food, year over year.

- Short-term interest rates and inflation remain subdued, which does not signify a near-term recession, according to historical patterns.
- Interest rate increases have come slowly—less than one third the typical pace. Additionally, the market usually does not peak until the Fed is done raising rates and the Fed believes it still has a substantial amount of tightening to do in order to normalize rates.
- Innovation is a primary mitigant of inflation. Because we live at a time when consumers can easily compare prices across purveyors of goods, businesses tend to keep their prices down in an effort to remain competitive.
- Contemporary labor dynamics also favor a low inflation environment. As older and generally costlier employees retire, businesses replace them with younger and cheaper workers, which keeps wage pressures down.
- Lastly, globalization also depresses wage pressures by making scores of workers from around the world accessible to U.S. employers. An ever abundant labor pool prevents demand for labor from oustripping supply and keeps inflation from heating up.