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Watching the paint dry

Nobel Memorial Prize-winning economist Paul Samuelson famously stated that "investing should be dull, it shouldn't be exciting; investing should be more like watching paint dry or grass grow". The fundamentals on which valuations are derived change slowly and rarely do they develop in a straight line. Markets tend to have knee-jerk reactions to noisy headlines of data releases, which end up having little impact in terms of altering the outlook.

A good example of this has been the market response to the economic data of late, especially in the US, culminating with the consumer price index (CPI) report[1] for January. The CPI report showed the 12-month core inflation rate ticked down for the 10th consecutive month, the 15th time in the last 16 months, however, it was a smaller deceleration than anticipated.

Markets interpreted this as a sign that prices were proving to be stickier than they had assumed. This combined with the continued signals of general resilience of overall economic activity, would mean the US Federal Reserve (Fed) was going to delay the unwind of its aggressive interest rate tightening that began in 2022. At the start of the year, the first policy interest rate cut was fully priced for March but has now been pushed back to June and the magnitude of cuts expected by year-end has now been cut in half.

The question, therefore, is: has anything materially changed since the start of the year that warrants a rethink of the outlook and any related investment thesis? The answer is: not yet.

Despite the significant deceleration in inflation with much of the low-hanging fruit being picked, the macroeconomic momentum has persistently been firmer than expected. This stability has long pointed to the road ahead seeing comparably gradual yet persistent progress that would result in inflation moving within a range of official inflation targets in the second half of this year.

Accordingly, the aggressive repricing of rates late last year against increased expectations of imminent pro-active rate cuts by the Fed seemed misplaced, while the recent developments in the market appear to have brought consensus more in line with the Fed's latest "dot plot[2]." The "firm" January data does not alter these views, particularly given that the verve in overall prices was largely driven by a handful of components that historically have been subject to meaningful beginning-of-the-year price adjustments and tend to normalize in subsequent months. Also, signs of further disinflation in consumer and producer prices outside of the US (including significant trade partner Canada[3]) may well temper upside risks.

As the saying goes, one month does not a trend make. As it stands, despite all the noise, the economy appears to remain on the same, gradual path toward lower interest rates. Watching progress requires patience, akin to watching the paint dry, as the outlook unfolds.

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[1] U.S. Bureau of Labor Statistics, Bureau of Labor Statistics, Economic News Release, *Consumer Price Index Summary*, February 13, 2024, https://www.bls.gov/news.release/cpi.nr0.htm

[2] Board of Governors of the Federal Reserve System, Monetary Policy, *Summary of Economic Projections*, December 13, 2023, https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20231213.pdf

[3] Statistics Canada, The Daily, *Consumer Price Index, January 2024*, February 20, 2024, https://www150.statcan.gc.ca/n1/daily-quotidien/240220/dq240220a-eng.htm?HPA=1

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