The Outlook: May 15, 2023

Sticking with something simple.

The vast crowd of betting folks (who indeed drive the market every day) focuses most of its attention on just one or two of the most vivid "Nightmares of the Moment" or "Rainbows of the Moment." There are always many Nightmares or Rainbows in sight . . . but the crowd makes its living by guessing which of them will strike its fellow bettors as most powerful. (Everyone in the market crowd, remember, mainly tries to read the minds of everyone else in the crowd, each day asking herself: "What might trigger people's fear or greed today?")

For a good year now, the answer to that question has been Inflation. Everything seems to hinge on it . . . in the minds of the bettors: how much higher and faster interest rates might rise; how much weaker Main Street might get as a result; how much damage Main Street weakness might inflict on company profits and cash flows. So the lion's share of the crowd's daily scrutiny has gone to this kind of picture for a year or more:

40 years ago that scrutiny was always aimed at "M1" and "M2": measures of the money supply. A shocking level of inflation seemed stuck in place; the Fed was fighting it with high interest rates; and the Fed's aim was to slow down money supply growth, by a lot. So everyone looked at every possible wrinkle and variation in money supply facts, hoping to win the next bet on whether "M" would fall the next month, and how much. It was very much like today, only instead of "M" we're all watching variations on the CPI.

There are some very capable people doing some of the looking, and disagreeing about what each day's picture means for the future. That includes two of Outlook's favorite economists: Brian Wesbury and Scott Grannis. Mr. Wesbury thinks Inflation will be snarling at us for a long time to come, and will trigger a recession soon. Mr. Grannis thinks Inflation is almost dead already, but just doesn't know it. He is waiting (pessimistically) for the Federal Reserve to wake up to that fact and cancel the "Rate Hikes Forever!" campaign.

At Outlook we like Mr. Wesbury very much; but we think Mr. Grannis has it right this time. The picture up there, courtesy of Mr. Grannis, highlights in green his startling observation:

"Over the past 6 months, the CPI less shelter is up at a mere 1% annual rate."

"Minus shelter" matters a lot, because 30% of the CPI is an imaginary number called OER (Owner's Equivalent Rent), which tries to guess the changing costs of housing for America as a whole. Mr. Grannis' logic is simple: Lockdown and its calamitous aftermath saw an incredible rocket in home prices (as we all know.) The formula for "OER" is tied to home prices, but with a long lag of 12 – 18 months. Those home prices peaked in early-2022, and have begun falling . . . slowly. So "OER" and the CPI will also peak and begin a long, gradual fall in the near future. Mr. Powell and his brain trust at the Fed aren't recognizing that logic yet . . . but they will have to, over the next 6 – 9 months, as the CPI and all its variations fall enough to make them see it.

We think Mr. Grannis has it right. We also think Main Street (especially Outlook's exceptionally strong few blocks of it) is so strong it won't be damaged, much, by the time it's taking Mr. Powell and team to "see those facts." Finally, we think that even if we're wong it won't matter: our companies are mostly valued cautiously or pessimistically by Wall Street; they're immensely strong; and they'll climb toward more profits and cash flows in the 3 to 5-year future, just as they've been doing over the 10 to 20-year past.

Our logic (like Mr. Grannis') is pretty simple, isn't it? It has worked rather amazingly well for a very long time, and we're sticking with it.

Outlook Capital Management, LLC
125 S. Wilke Road, Suite 200E
Arlington Heights, IL 60005
847-797-0600

The remarks above aren't a general recommendation to buy or sell particular securities. Such decisions should only be made in the context of an investor's own circumstances. Stocks and bonds carry the risk of loss.