Ropes Wealth Says Soft Landings Don't Last Forever

My parents will be married 50 years this Saturday. That's quite an accomplishment in this day and age. While 1974 might have been a good year for a white wedding, it was not a good year for the economy. The world economy was faced with a trilemma unprecedented in postwar history, namely, the simultaneous aggravation of inflation, an oil price shock, and a decline in economic growth from 7.2% to -2.1%. Unemployment rose above 7%, consumer confidence plummeted, and the nation's financial markets dove by -48%. President Nixon let the economy take its course while preoccupied with a scandal that finally forced him from office. President Ford took over in August, but Ford, Congress, and the Fed struggled to set a plan for a course correction and things didn't get better until 1976. Then, yours truly was born, and the rest is history.

Besides sending a love note to my mom and dad, I share this story because it is fairly remarkable that our most recent bout with inflation and a pandemic ended in a soft landing. Fed Chair Jay Powell and the rest of the Federal Open Market Committee (FOMC) should be taking a victory lap but have been reticent to do so for fear that just when they declare victory, a downshift will occur. We are all walking around on eggshells, a bit in disbelief that we did not earn a painful recession and somehow the S&P 500 Index hit 5,500 this week.

Could it really be the case that we landed ever so softly? Why is it then that we are all waiting uneasily for the other shoe to drop?

It is because soft landings, like hard ones, do not last forever. We, like the market, are trying to divine where we go next, and if a slowdown or a speed up lies ahead of us.

Taking stock of this week's economic data, it would seem to be the former. After a year of robust consumer spending despite elevated prices for many goods and services and high interest rates, Tuesday's retail sales report carried signs of a consumer pullback. May's 0.1% month-over-month increase in overall retail sales followed a downwardly revised -0.2% decline in April. Excluding automobiles, sales fell -0.1% in May, contrary to forecasts for a gain of 0.1%. Motor vehicle and parts dealer sales rose as did sporting goods and clothing, the government said. However, furniture, building materials, food and beverages, and food services sales all declined. Surprisingly, given the summer travel season has begun, gasoline sales also dropped.

The Commerce Department reported May housing starts rose at a seasonally adjusted annual rate of 1.277 million, down -5.5% from April and -19% below the same month in 2023. Building permits, the precursor to starts, fell -3.8% in May, now down almost -12% over the last three months. Also, the Philadelphia Federal Reserve's General Activity Index, a measure of manufacturing activity in the region, dropped to 1.3 in June, its lowest level since January though still above zero and in expansion territory. Notably, the Philly Fed report indicated a slowdown in the job market and future expectations: *"Most future activity indicators remained positive but suggest less widespread expectations for overall growth over the next six months."*

On the flip side, industrial production for May came in stronger than expected, rising +0.9% last month after no change in April, with particular strength in nondurable goods manufacturing and utilities usage.

What are all of these mixed economic signals telling us about the next landing? Likely that central banks will be forced to keep interest rates higher than pre-pandemic to tackle persistent inflationary pressures. There will be higher inflation, higher interest rates, and lower growth due to supply constraints. And for this reason, markets may continue to be oh so narrow. While we are all exhausted of the AI rally, comparisons to the dot-com bubble are misplaced given the profitability of these mega-cap tech companies. But they are expensive, and it is discouraging to see so many other companies languish without direction in this so-called “Goldilocks” economy. Of course, they have real competition with short-term bond yields offering such compelling returns especially when the Fed is telegraphing higher-for-longer.

Like my parents 50 years ago at the altar, you have to make a commitment to an investment plan you can live with no matter what the next landing may be. While 2024 may feel less uneasy than the economic and market conditions of 1974, they would be the first to say you have to brace yourself to weather the hard times, savor the good times, and manage the everything in between, with love, laughter, and maybe even a little bit of luck too.

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