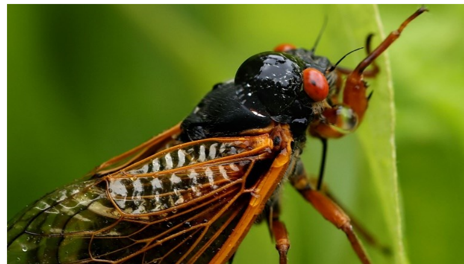
BCWM
PROVIDING PEACE OF MIND

Emerge, Make Noise, and Die

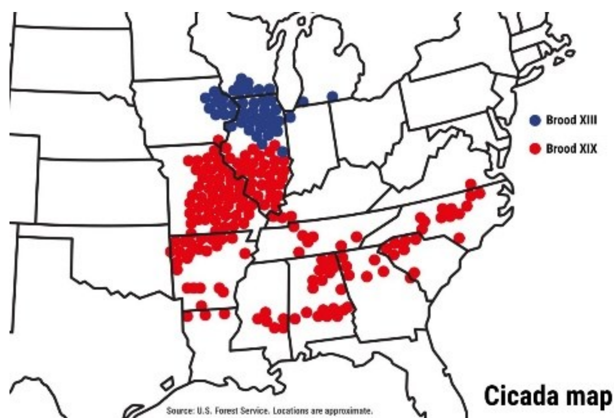
This year is witnessing the emergence of two massive broods of cicadas (pronounced sə-kādə): Brood XIX and Brood XIII. These cicada populations stay underground for 13 and 17 years, respectively, and live off the sap of tree roots. Then they come out for six weeks to make a lot of noise, mate, and die while their offspring go back underground to repeat the process.



Typically, they don't face much competition from each other, but every 221 years, both broods come out at the same time. The last time they emerged simultaneously was in 1803. Thomas Jefferson was president and had just made the Louisiana Purchase, which, it turns out, included just a tiny bit of what ended up being Louisiana.

And the next time we will see both broods of cicada come out together it will be the year 2245 ♪"If man is still alive / If woman can survive / They may thrive . . ."♪ (Zager and Evans 1969).

So, this is a once-in-a-multi-generational event – one that, unless you are an *entomologist*, you may be fine doing without. And, judging by the map below, if you happen to live in Missouri or Illinois, you may want to plan a summer vacation far from home.



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If only business cycles were as predictable as cicadas. Or even predictable at all. Economic cycles (and stock markets) are truly obvious only in hindsight. Predicting *what* is going to happen is one thing. Predicting *when* it is going to happen is another.

And when a recession doesn't occur for an unusually long time, investors can become complacent . . . casual . . . maybe even bold. *Is the business cycle dead?* Of course not. It is often said that economic expansions don't die of old age, they are murdered. Eventually something will cause our economy to shrink and markets to drop. We are constantly trying to figure out what that might be, looking for harbingers of the next recession.

In our private client webinar last month, we highlighted how a steady flow of relatively *good* economic data had buoyed stock prices. And less than 24 hours later that flow started to sputter.

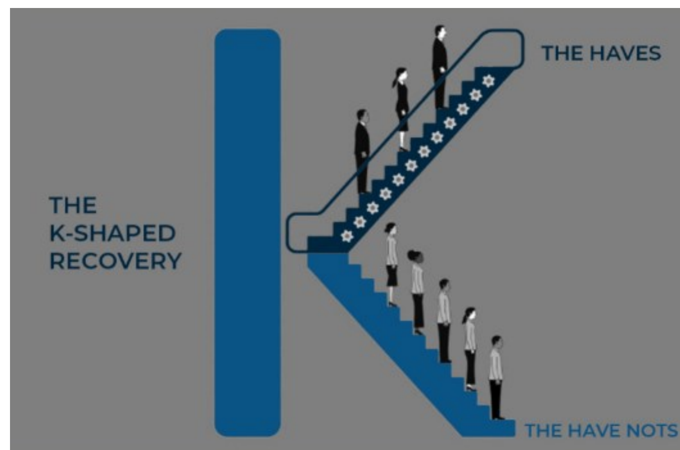
Economic growth in the first quarter of 2024 was surprisingly weak. Gross Domestic Product (GDP) increased 1.6%, but most economists had expected 2.5%. Even the most pessimistic forecast (1.7%) wasn't pessimistic enough. This letdown comes after six consecutive quarters of solid economic growth.

Consumer confidence took a dip as well. There are two widely followed metrics, and one of them dropped to a two-year low. Not a welcome sign for an economy that depends on . . . checks notes . . . consumer spending.

How about the labor market? Well, the April jobs number also missed the mark. We added only 175,000 jobs, the fewest this year.

These figures do not suggest a recession is on our doorstep. (As a side note, Europe just recently pulled itself OUT of a recession.) But the data does suggest it is more of a mixed bag.

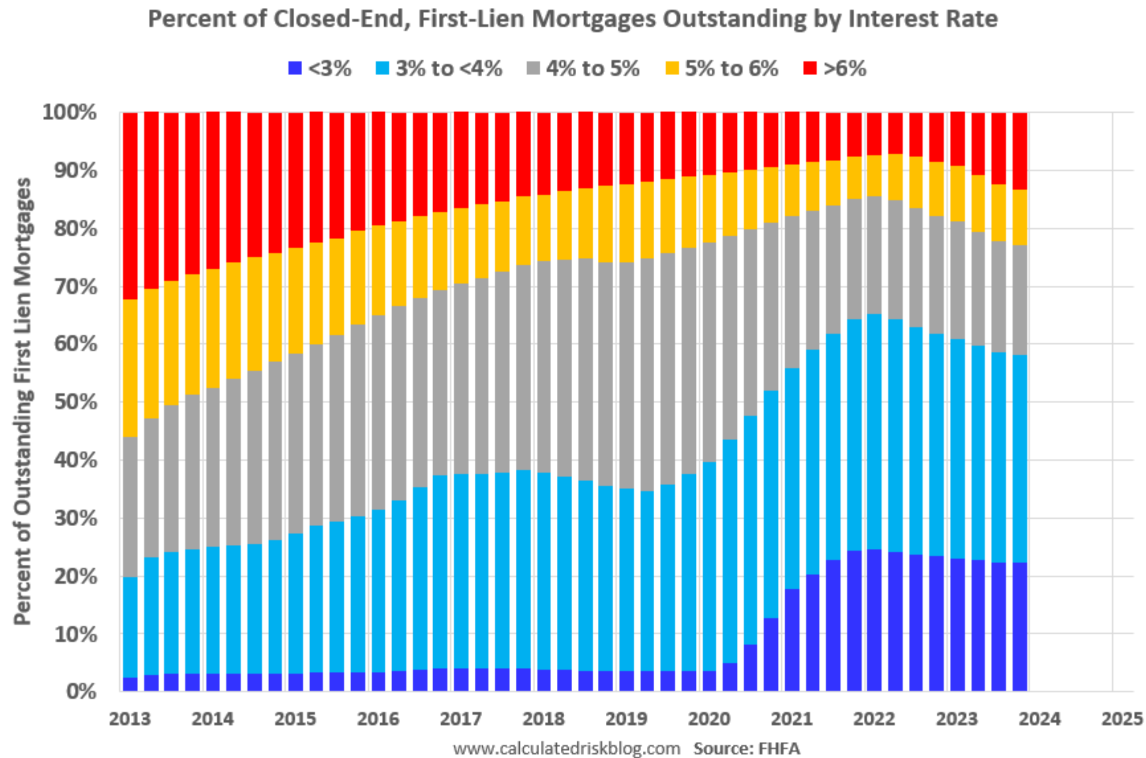
This mixed data might have something to do with the way our economy has recovered from COVID – with the "haves" further distancing themselves from the "have nots." This is often referred to as a "K-shaped" economic recovery.



For example, those in the lower income brackets are struggling much more with the high prices left behind by the massive spike in inflation. Meanwhile wealthy people own more assets and the value of those assets have increased substantially, most notably home values. Those who didn't own a home missed out on this windfall entirely.

Today, buying a home is especially difficult for first timers. For many aspiring home buyers, elevated home prices combined with high interest rates make mortgage payments simply unaffordable. Making matters worse, fewer homes are on the market because current homeowners are reluctant to leave their low-rate mortgages behind.

The chart below shows the breakdown of mortgages by interest rate. Over half of borrowers have a rate below 4% (the dark-blue and light-blue bars). And a vast majority have a rate below 5% (adding in the gray bars).



Today, the rate for a new mortgage is significantly higher (about 7%), so the reluctance to take on this higher rate has homeowners effectively trapped. They don't want to get rid of their low rate, so they can't move . . . therefore fewer homes are up for sale . . . and this low supply keeps upward pressure on prices . . . making it even MORE difficult for first-time buyers. A vicious cycle.

We know the cicada broods don't emerge from the ground until the soil temperature reaches 64 degrees. What interest rate will be just right for those reluctant home sellers to emerge?

Once upon a time, back in the day, bumpers on automobiles were just that . . . bumpers. They bumped into things when you or someone else had unfortunate driving experiences. When you dented your bumper, the shop simply took off the old one and replaced it with a new one. The total cost included a new bumper and a couple hours of labor.

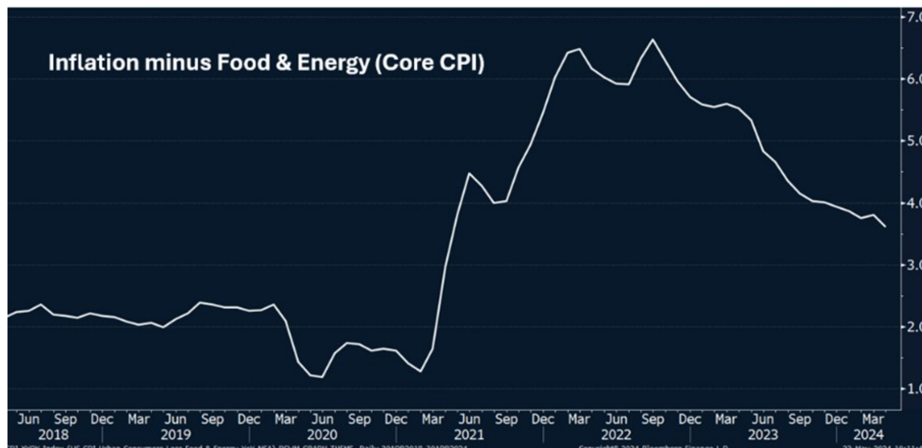
Today, the cost of replacing a "bumper" has become prohibitive. All the sensors and cameras, which help reduce the frequency of collisions (allegedly), have dramatically increased the *cost* of collisions. Today's bumper is a computer system that is very expensive to replace.

Auto insurance companies have taken notice and increased car insurance premiums accordingly. Believe it or not, this expense has been a significant component of inflation the past couple of years. The good news is that future increases should not be nearly as dramatic as the most recent ones. This is yet another reason to believe that the worst of inflation is mostly behind us and that the slow downward trend will continue.

In our April webinar, we illustrated how the inflation rate is artificially high because the numbers being used for the largest component – shelter – are stale. If you use real-time data, the inflation rate would be much lower. This isn't speculation but a natural outcome of the official measurement catching up with reality.

The data began to better match reality last week, when April inflation numbers were released. The headline inflation number came in at 3.4%. But even better, "core" inflation also dropped. This number strips out the two most volatile categories of inflation (food and energy). Policymakers tend to key in on this measure because it helps them see past short-term price swings and focus on the underlying spending trends and inflation pressure.

Analysts were worried that core inflation was getting stuck near 4% and that the Federal Reserve's progress in bringing inflation back down to 2% had stalled. So, it was welcome news that the number had actually declined to a three-year low and that the disinflationary trend is still intact.



Markets have responded favorably. Interest rates declined and bond prices have increased. The Dow hit an all-time high, recently peaking above 40,000 for a few hours.

It's no coincidence that, as stocks are hitting all-time highs, people are feeling good. Maybe even bold. Last week witnessed the return of the "meme stock" investors (the ones that congregate on message boards and, as a joke, buy stocks of failing companies).

Like cicadas, these investors suddenly emerge in large numbers, make a lot of noise, and then die off.

At least we know the cicada nuisance won't come back for another 221 years. Meme stock buyers? Who knows?

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