1050 Park Avenue, Suite 6A, New York, NY 10028

July -August 2023 Macro Commentary

CHARYBDIS and SCYLLA – Descending Into The Whirlpool

Charybdis is a sea monster living in a dangerous whirlpool in a narrow sea channel with another legendary monster- *Scylla* - on the other side. The Greek *Scylla* and *Charybdis* legend symbolizes choosing between two difficult situations as sailors are pulled into the Tyrrhenian Sea vortex.

Asset managers, both big and small, are also facing two monsters. Investors strangely feel compelled to buy long-duration bonds, despite the upsized auction offerings through year-end and the doubling of note and bond offerings in 2024. Government debt is well over 100% of Gross Domestic Product, leading to a steepening of the yield curve as investors belatedly demand an inflation premium. The curve is inverted today, but investors will demand more yield for longer-term bonds, given higher inflation uncertainty finally becoming a reality. *Duration* is the first monster.

The other monster is *Hope*. The overwhelming belief is that the Fed will always play the white knight like they recently did with the regional bank crisis. Duration and Hope are the metrics used by too many registered investment advisors. Both monsters tumble out of the robes of greed and ignorance.

Remember the "inflation is transitory" advocates and "the Fed will pivot believers?" Both vehemently criticized the Fed for over a year, aided and abetted by the pundits on display on the CNBC Entertainment Network. Most of these experts have never seen an entire fixed-income bear market and believe ZIRP (Zero Interest Rate Policy) was a normal state of affairs. Core Consumer Price Index based inflation is still running at twice the rate consistent with the Fed's long-term target and is also above the rate implied by the Fed's most recent inflation forecasts. This is being exasperated by the "price-price spiral**,"** where companies hike their prices beyond the increase in their costs to boost profits.

Undoubtedly, despite the overwhelming number of economists who predicted we would already be in a recession this summer, things do not look too bad. First quarter gross domestic product (G.D.P.) grew at a 2% rate in the first quarter, a sharp uptick from the previously reported 1.3% growth. It also marks the second upward revision since the first reading in April initially showed 1.1% growth, and consumer sentiment is at its highest level since September 2021. I am also guessing that most of you already spent $19.50/ticket for either Barbie or Oppenheimer.

Many believe inflation has been permanently muted despite factors that point to longer-term, more endemic, and seemingly unending global problems. It is not only about our local economic metrics or the Fed's ability to "control" inflation. Russia recently pulled out of a worldwide grain deal that allowed Ukrainian grain exports to pass through Black Sea ports, while India, the largest rice exporter (40% of world rice exports), banned non-basmati white rice exports. This will eventually push up food prices worldwide. Also, expect Chinese officials to respond to Washington's efforts to curb China's access to advanced computer chips by restricting the export of critical raw materials needed to manufacture high-performance semiconductors. China produces 60% of the world's germanium and 80% of the world's gallium. It also dominates the supply chains for rare earth elements.

Again, we warn investors not to ignore the growing labor movement looking to catch up after decades of inflation-induced wealth erosion. In 1980, C.E.O.s were paid about 42 times as much as the average employee; in 2021, they were paid 399 times as much. The wealthiest one percent of Americans are worth more than the two hundred and ninety-one million who make up the bottom ninety percent. This cannot be ignored. We have "Bidenomics," which entails immense government spending juxtaposed against protectionists, crony capitalists, isolationists, and ultra-nationalists - both sides more intent on fighting a culture war than on re-building our middle class and our free enterprise system.

The number of significant U.S. strikes involving 1,000 workers or more fell from 187 to 16 between 1980 and 2021, while union membership roughly halved to a record low of 10.1 percent in 2022, according to the labor department of Labor. Finally, new unions have struggled to secure the employment contracts necessary to create gains for workers, and the formation of bargaining units has slowed. Large-scale strikes of blue-collar workers were once common in the U.S. before Ronald Reagan fired more than 11,000 striking air traffic controllers in 1981. The event emboldened employers to fire their striking workers, thus weakening the unions' biggest weapon. This is about to change.

Strikes will be the national theme for 2024-5. Shipping experts warned that airline pilots and flight attendants could intermittently threaten strikes that could delay millions of daily deliveries, including Amazon.com orders, electronic components, and lifesaving prescription drugs. This could reignite supply-chain snarls that stoke inflation. Last year Delta Air ratified a contract giving pilots 34% over the next four years. More to come.

A few weeks back, roughly 160,000 unionized actors went on strike for the first time in 43 years. They joined 11,500 already striking screenwriters, who walked out in May over similar concerns, including the threat of artificial intelligence. Actors and writers had not been on strike at the same time since 1960.

Teamsters are renegotiating the country's largest private sector union contract - delivery service U.P.S. and its 340,000 US-based drivers and package handlers. The union is demanding universal pay raises, the end of the two-tier pay system, and the installation of air conditioning into trucks, where given increasing temperatures, many have become ill, while a few have died.

A little more than a week after contract talks between U.P.S. (which represents about 25% of all parcel volume) and the union representing 340,000 of its workers broke down, U.P.S. said it would begin training nonunion employees in the U.S. to step in should there be a strike, which the union has vowed to do if no agreement is reached by the end of this month. Given that blue-collar jobs currently make up about 70% of all part-time jobs in the U.S., this will not simply end with our Amazon packages being delayed. Labor is back, and reducing/hedging your fixed-income portfolio - now - may prove to be the right decision.

George Lucaci
FolioBeyond, LLC
www.foliobeyond.com
glucaci@foliobeyond.com
908-723-3372

1050 Park Avenue, Suite 6A, New York, NY 10028

Definitions

Duration: measures a bond price's sensitivity to changes in interest rates. The longer a bond's duration, the higher its sensitivity to changes in interest rates and vice versa.