WEEKLY ECONOMIC UPDATE AUG. 26, 2024

Stocks notched a solid gain as dovish comments from Federal Reserve officials boosted the market's recovery from early August lows.

The Standard & Poor's 500 Index rose 1.45 percent, while the Nasdaq Composite added 1.40 percent. The Dow Jones Industrial Average picked up 1.27 percent. The MSCI EAFE Index, which tracks developed overseas stock markets, gained 2.98 percent.[1,2]

Dovish Week

Stocks started the week strong, rallying after Wall Street welcomed dovish comments from Minneapolis Fed President Neel Kashkari. The S&P 500 and Nasdaq each posted gains on Monday–the 8th consecutive winning session. The Dow rose for the 5th session in a row.[3,4]

From there, markets traded in a narrow band until Wednesday afternoon when minutes released from the July 30-31 FOMC Meeting revealed more dovish comments. On Thursday, stocks dipped ahead of Fed Chair Jerome Powell's annual Jackson Hole, Wyoming, speech.[5,6]

Well-received comments from Powell on Friday boosted markets, with all three averages closing higher.[7]

MARKET INSIGHTS

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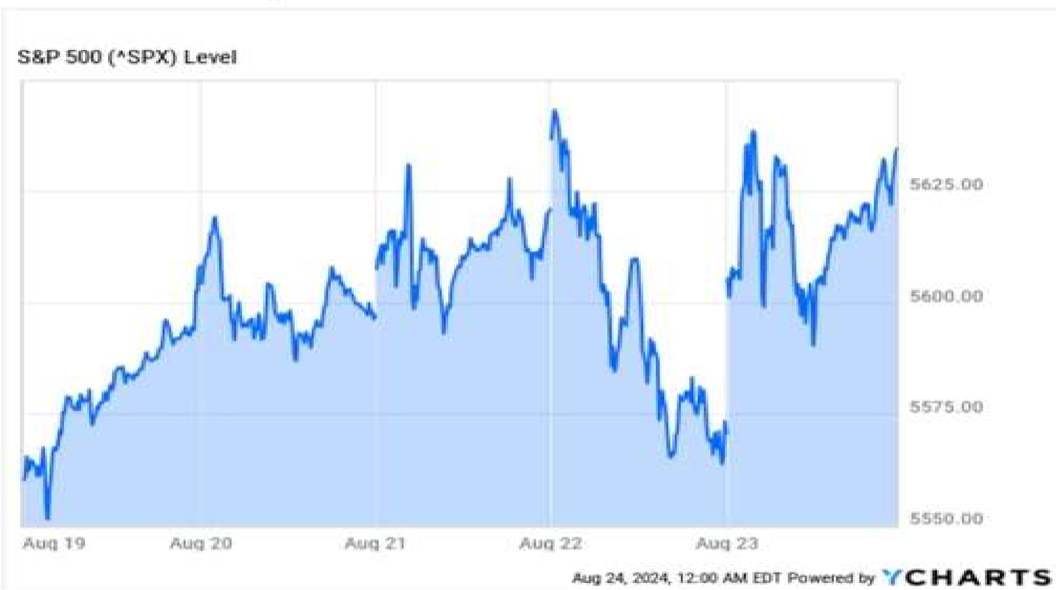
Weekly Market Insights (WMI)

Major Index Return Summary

Name	1M TR	YTD TR	1Y TR	5Yr TR
Dow Jones Industrial Average	0.88%	9.32%	21.11%	72.07%
MSCI EAFE	2.23%	10.60%	20.54%	53.53%
Nasdaq Composite	-2.07%	17.93%	31.45%	129.6%
S&P 500	0.24%	17.84%	28.86%	106.7%

S&P 500 Daily Close



10-Year Note Review

Indicator Name Date	Latest Value	1M Ago 3M Ago 1Y Ago	1M Change 3M Change 1Y Change
10 Year Treasury Rate 08/23/24	3.81%	4.25% 4.47% 4.19%	-10.35% -14.77% -9.07%

“The Time has Come”

The Fed’s annual symposium for global central bankers started Friday morning with Fed Chair Powell’s much-anticipated speech. Citing the risk of the labor market cooling even further, he said, “the time has come for policy to adjust.”

Investors responded favorably, with the remaining question being how significant a rate cut might be. Powell kept that door open, adding that “the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks.”[8]

This Week: Key Economic Data

Monday: Durable Goods.

Tuesday: Consumer Confidence. Case-Shiller Home Price Index.

Wednesday: Fed Official Raphael Bostic speaks.

Thursday: GDP. International Trade in Goods. Jobless Claims. Pending Home Sales.

Friday: Personal Income and Outlays. Consumer Sentiment.

Quote of the Week

“Nothing can be more welcome than depriving government of its power over money and so stopping the apparently irresistible trend towards an accelerating increase of the share of the national income it is able to claim,”

– F.A. Hayek, 1976

Of Note

Inflation was raging in 1980 and again in 2022. How the government measures inflation has changed, and you will be amazed at the difference.

Calculating the inflation rate has changed over time as the methods and techniques used to measure inflation have evolved. News reports in our current era of inflation sometimes refer back to the economy under President Carter. At that time, inflation reached a high of about 14%.

Inflation played a large role in his political future. President Carter's economic net approval rating was -8 points in a January 1978 CBS News poll. President Carter's rating was the lowest around this point in a presidency before President Biden's reached -13 points. Is inflation that much better now than it was during the Carter era? Perhaps the biggest difference is how we measure inflation now compared to 1980.

How the inflation rate is calculated impacts many aspects of our lives. Two prime examples impact the federal workforce—at least when an individual retires. The amount of the annual cost of living adjustment (COLA) is determined by the inflation rate. The inflation rate also determines the amount of any increase in

Social Security payments. Keep in mind that Social Security amounts may vary on whether a retired federal employee is in FERS or the older CSRS system.

Since 1980, the Bureau of Labor Statistics (BLS) has changed the way it calculates the Consumer Price Index (CPI) in order to account for the substitution of products and improvements in quality.

What does this mean? At a personal level, the Social Security increase in 1980 was 14.3%. In 2022, the Social Security (and COLA) increase was 8.7%. The difference would not have been this large had earlier methods of calculating inflation still been in place.

The Consumer Price Index for All Urban Consumers (CPI-U) is the index used to generally report the inflation rate in our country. The all-items index as calculated by BLS increased 5.0% for the 12 months ending in March. This was the smallest 12-month increase in inflation since the period ending May 2021. CPI data are used for calculating increases in payments to Social Security beneficiaries, food stamp recipients, military and federal Civil Service retirees and survivors, and children on school lunch programs. The higher the inflation rate, the more money the government spends on meeting the cost of these programs.

According to Shadow Government Statistics, instead of a 5% inflation rate as of March 2023, the inflation rate would have been closer to 14.1% using the old methodology (1980-based).

BLS argues that the changes it has made over the last three decades more accurately reflect a true change in the cost of living. For example, BLS writes on its website:

Hedonic quality adjustment is one of the techniques the CPI uses to account for changing product quality within some CPI item samples. Hedonic quality adjustment refers to a method of adjusting prices whenever the characteristics of the products included in the CPI change due to innovation or the introduction of completely new products....The CPI obtains the value estimates used to adjust prices through the statistical technique known as regression analysis. Hedonic regression models are estimated to determine the value of the utility derived from each of the characteristics that jointly constitute an item.

Is Inflation Accurately Reported? Inflation is one of the most important economic indicators affecting the purchasing power and living standards of consumers. Some experts argue the official measure of inflation (the CPI) is not accurate and does not reflect the true cost of living for most Americans. They claim that the CPI understates inflation by using flawed methods and assumptions, such as:

• Substitution: The CPI assumes that consumers can switch to cheaper alternatives when prices rise, which may not be realistic or desirable for some goods and services.
• Quality adjustment: The CPI adjusts for changes in the quality and features of products over time, which may overstate the benefits and understate the costs of technological

improvements.
• Housing: The CPI uses a measure called owners’ equivalent rent (OER) to estimate the cost of housing for homeowners, which may not capture the actual changes in home prices and mortgage payments.
• Weighting: The CPI assigns different weights to different categories of goods and services based on their share of consumer spending, which may not reflect the preferences and needs of different groups of consumers.

According to some alternative measures of inflation, such as the ShadowStats Index, the actual inflation rate is much higher than the official CPI. For example, as noted above, in March 2023, the CPI showed an annual inflation rate of 5%, while the ShadowStats Index showed 14.1%. These alternative measures use different methods and data sources to calculate inflation, such as:

• Actual prices: The alternative measures use actual prices paid by consumers for a fixed basket of goods and services across different cities, instead of relying on surveys and estimates by government agencies.
• No adjustment: The alternative measures do not make any adjustments for substitution, quality, or seasonality, which may distort the true changes in prices over time.
• Housing: The alternative measures use actual home prices and mortgage payments to measure the cost of housing for homeowners, instead of using Owners’ Equivalent Rent (OER).
• Weighting: The alternative measures use different weights for different categories of goods and services based on their

importance and impact on consumers, instead of using a fixed weighting scheme.

The implications of underreporting inflation are significant. For instance, underreporting inflation may:

- Erode the value of savings, pensions, and Social Security benefits for consumers, especially for low-income and elderly groups who rely on fixed incomes.
- Distort economic policies and decisions by policymakers, businesses, and investors, who may underestimate the risks and challenges posed by inflation.
- Reduce economic growth and productivity by discouraging investment, innovation, and consumption.

For those who may be cynical of how these changes may impact the political class, it is less politically damaging to some elected officials to have inflation reported at 5% instead of 14%. Also, many government expenses are based on the CPI and, therefore, any lowering of the CPI has a significant effect on future government expenditures. No doubt, those receiving Social Security, or a government annuity would prefer a 14% increase to 8.7%. Finding money to pay for this differential would be very difficult, however.

It is important to have a reliable and accurate measure of inflation reflecting the reality and diversity of consumer experiences. Perhaps the retirees in the 1980's and 1990's received a higher payment than they should have because inflation was not being calculated the way it is today. Generally, the changes in inflation calculations have probably depressed reported inflation. The concept of the CPI has moved away from measuring the cost of living needed to maintain a constant standard of living. The newer method of calculation measures the cost-of-living expenses rather than the rise in prices.[9]

Footnotes and Sources

1. The Wall Street Journal, August 23, 2024
2. Investing.com, August 23, 2024
3. The Wall Street Journal, August 23, 2024
4. The Wall Street Journal, August 19, 2024
5. MarketWatch.com, August 22, 2024
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7. The Wall Street Journal, August 23, 2024
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9. fedsmith.com/2023/04/19/inflation-severity-depends-how-its-measured/