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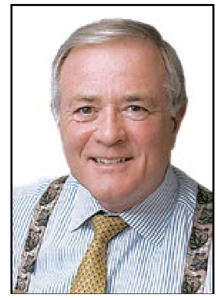
William Rutherford

November was one to remember | Opinion

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As we arrive at the end of the year, all eyes still turn to the Fed. Interest rates continue to be the focus. The 10-year Treasury has declined 80 basis points from the beginning of November, when it had been flirting with rising over 5 percent, to reach a recent low of 4.2 percent.

The stock market responded with a robust rally, which broke a three-month losing streak. November lived up to its winning reputation, with monthly gains of nearly 8.8 percent for the Dow, 8.9 percent for the S&P 500 and 10.7 percent for the Nasdaq. Historically, November is the best month of the year for the stock market, and December is third, according to the Stock Trader's Almanac.

The market was able to push higher, despite Federal Reserve Chairman Jerome Powell saying that talk of cutting interest rates is "premature" and that more hikes could still happen. Many equity and bond investors assumed the Fed was done with its tightening cycle now that inflation and job growth have shown signs of moderating. Both sectors rallied, pushing the 10-year Treasury to its lowest level in years.

Proof that the Fed's battle with inflation is working came when the central bank's key inflation gauge continued its downtrend. The core PCE (Personal Consumption Expenditures) price index, which excludes the food and energy sectors, in October rose 0.2 percent for the month and 3.5 percent year over year. Both gains were lower than estimates. Furthermore, the ADP National Employment report showed that private payrolls in November increased by 103,000 jobs, which was below economists' expectations of 130,000 and below the 250,000 jobs generally thought necessary to replace jobs lost. Good news for the bulls. Softening job creation means less upward pressure on wages – a key component of inflation.

According to recent reports, inflation in the richest economies slowed to 5.6 percent, down from 6.3 percent in September and the lowest in two years, further adding to the belief that interest rates were high enough. However, Chairman Powell's announced target for inflation is 2 percent, so we have a long way to go to achieve his goal. It is no wonder Powell warned that it might be necessary to raise rates again.

Why is there all this fixation on inflation? First, inflation is insidious and can eat away at purchasing power without one noticing. The more there is, the more persistent it becomes. It grows silently. It feeds on itself.

When I lived in Germany in the 1960s, the Germans still talked about the runaway inflation of the 1920s. My secretary told me how her family had a cow, which they decided to sell. They went to town and sold the cow. With the proceeds, they intended to buy a dress for the mother. But her mother could not find any dress she liked, so they went home. The next day they went back to town but found they could afford only a pair of shoes. However, they could not find shoes that her mother liked, so they went home again. The next day they returned to town but now all they could afford to buy was an egg, so they bought an egg. I called this story: how to turn a cow into an egg. Inflation got so bad in Germany at times that you would need a wheelbarrow full of money to buy groceries. Many people thought that runaway inflation was one of the causes of World War II. People like Powell, with responsibility for the stability of the world's largest economy, spend a lot of time worrying about inflation.

On the other hand, those people who think about such things also believe that a little bit of inflation is a good thing. They think it is important to avoid deflation. Japan experienced a long decade of deflation, which was very damaging to its economy. So, it is difficult to thread the needle. It is a big job to get it right. A little bit of inflation (about 2 percent) keeps the economy well-oiled, or so it is thought.

What is an investor to do? In general, it is better to own real assets in times of inflation. In fact, Bitcoin and gold have risen steadily, with gold reaching an all-time high and Bitcoin at a 20-month high. Gold tends to be in favor in times of global uncertainty and war, which we certainly have. And Bitcoin has risen on the expectation that an exchange-traded fund may soon be available. Courageous investors could go into debt and buy things, such as real estate and collectibles. They would be betting that their things would hold value, while their debt would decline in value and therefore be easier to repay. However, that is an aggressive position to take. And I don't recommend it.

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