

The '80s vs. Today

Are We Still Livin' on a Prayer?

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About This Session

The DeLorean fires up and takes you to a time in history influenced by war, inflation, supply chain bottlenecks, rising rates, and recession concerns. The younger population is wondering if their wages will keep up with inflation, middle-aged folks are wondering if they'll ever be able to afford a home, and the older people are wondering if their decimated retirement portfolios will last them during their golden years. Are you in the 1980s or did you never leave the 2020s? Join us for a lively history lesson that offers wisdom for today, told through a first-hand perspective of what it was like to navigate record-high interest rates in the '80s. After this session, you're sure to walk away from the '80s with more than great music and iconic fashion.

When you complete this session, you should be able to:

- List the differences between the economic challenges of the '80s and today.
- Define the relationship between interest rates and inflation.
- Identify three takeaway lessons from the financial environment of the '80s.



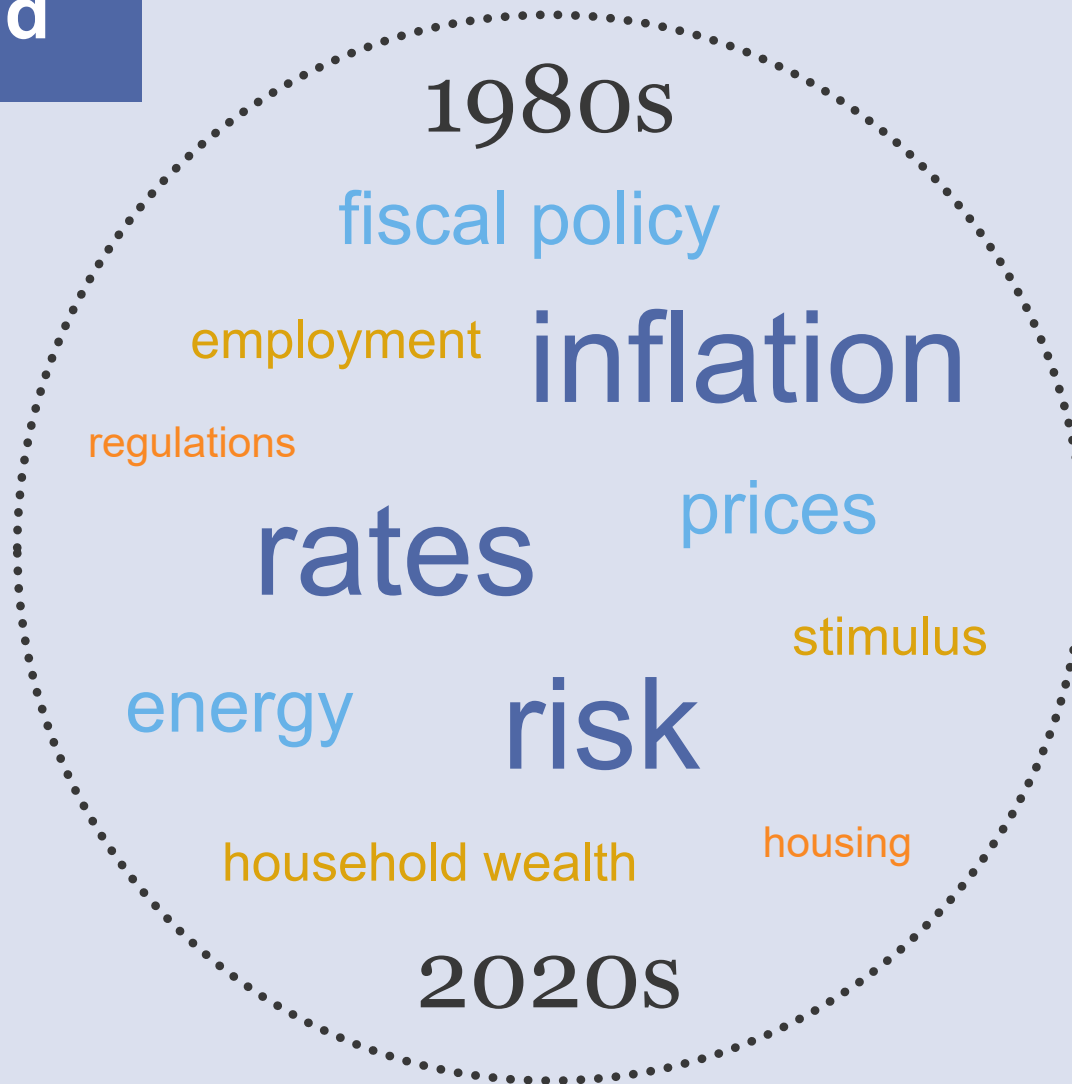
Is It From the '80s or Today?



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Trends Come Back Around



Big Picture of Each Market Environment

1980s

- ▶ Inflation had been spurred on by oil prices, currency speculations, supply chain bottlenecks related to union strikes, and a wage-price spiral.
- ▶ With Arthur Burns as Chairman, the Federal Open Market Committee (FOMC) hiked rates to 12.5%, matching inflation. Gross domestic product (GDP) dropped from 5% to 0%. In response, the FOMC lowered rates to 5%. GDP recovers but inflation does not drop below 5%.
- ▶ Paul Volcker was appointed as Chairman in August 1979 when inflation was nearly 12% and GDP was decelerating. The FOMC hiked rates up to 20% in early 1980. Rates stayed above 7.5% until 1986, when inflation had stabilized between 2.5-5%.

2020s

- ▶ In 2012 (after the global financial crisis), the FOMC imposed a target inflation rate of 2%. Low inflation relative to the 2% target permitted rates to stay low for a long period of time.
- ▶ The COVID-19 pandemic caused a brief and extreme recession. In response, the FOMC dropped rates to ~0%. Congress passed several fiscal policy measures.
- ▶ In the wake of the COVID-19 pandemic, the lack of supply caused a tight labor market while fiscal stimulus spurred spending on goods. The FOMC labels inflation as “transitory” due to supply chain bottlenecks. Spending shifted toward services.
- ▶ The Russian invasion of Ukraine spiked commodities prices and the FOMC began hiking rates. The persistence of inflation throughout 2022 pushed the FOMC to enact its most aggressive rate hiking cycle ever.

Recurring Theme: Inflation

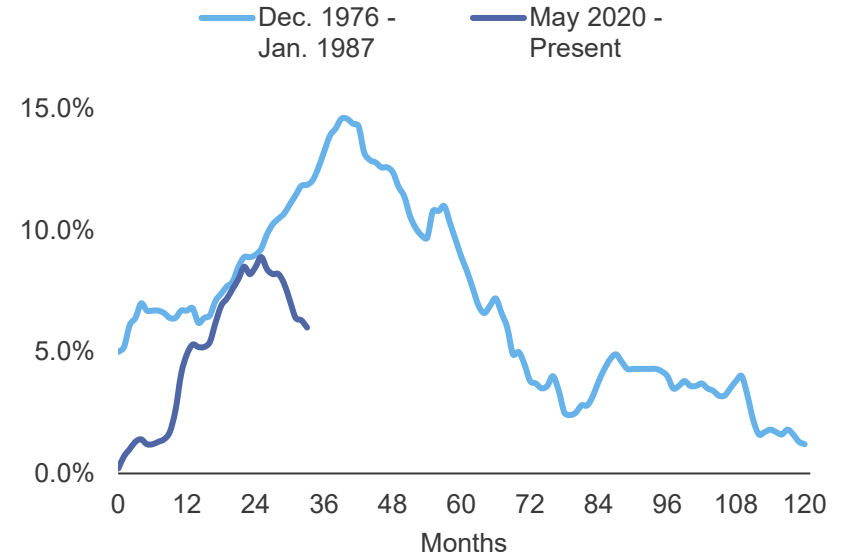
Complicated inner workings
and hard to navigate



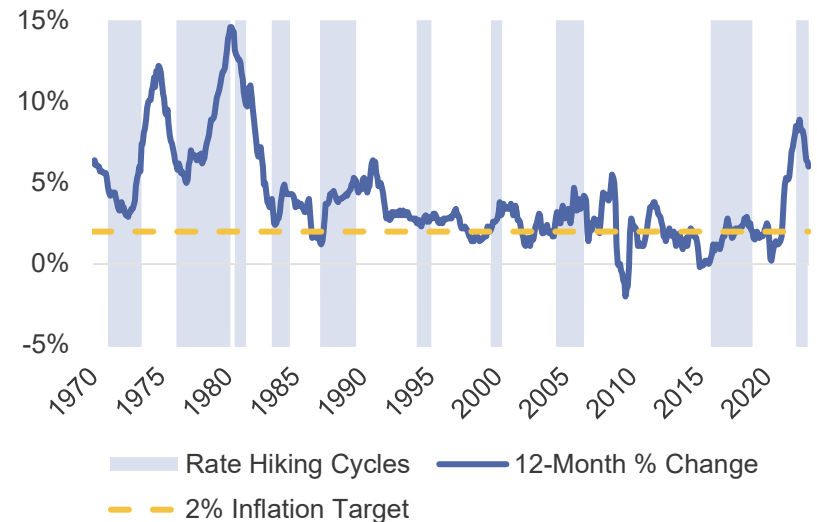
Inflation Targets Have Changed

- ▶ The FOMC has adjusted its inflation targets over time:
 - ▶ Before 2012: **0-4%**
 - ▶ Since 2012: **2% over the longer-term**
- ▶ In 1979, inflation was nearly 12%. Federal Reserve (Fed) Chairman Paul Volcker wanted to:
 - ▶ Lower inflation to 4% by 1983 – accomplished in Dec. 1982
 - ▶ Lower inflation to 0% by 1988 – came close in Jan. 1987 (at 1.2%) but not achieved until 2009.
- ▶ Post-1990, rate hiking cycles were infrequent as inflation became tamer with a more targeted inflation approach by the Fed.

The Great Inflation vs. Today



Inflation During Rate Hike Cycles



Source: CPI Inflation Rate from Bureau of Labor Statistics.

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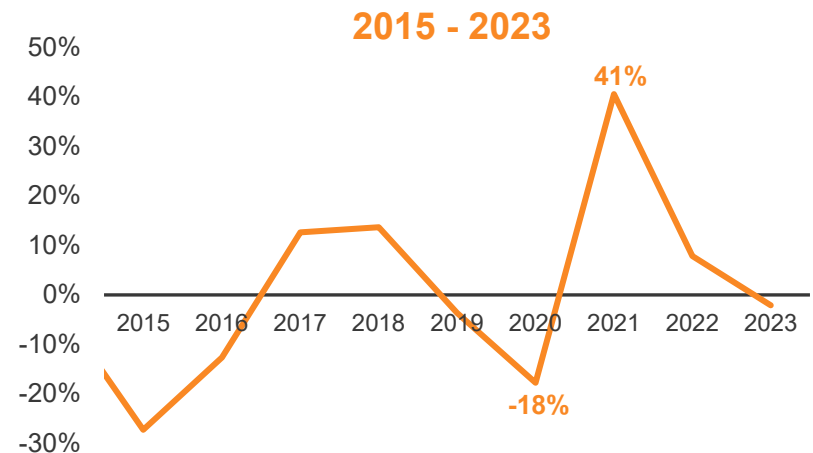
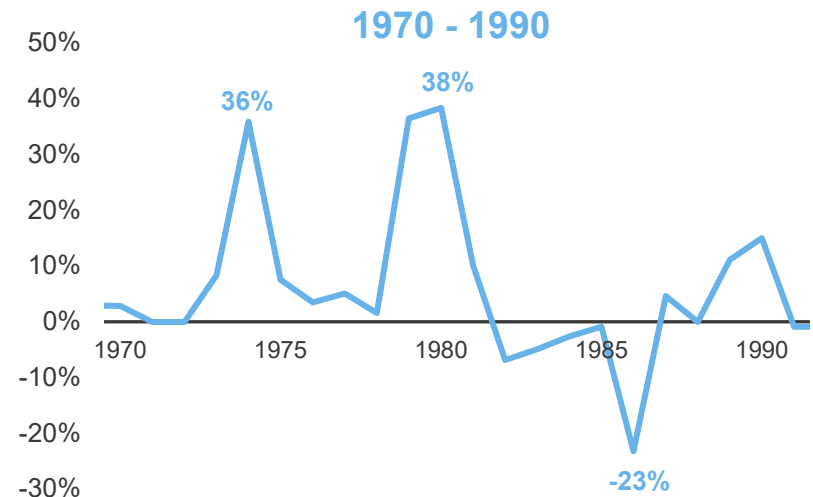
Energy Prices Are Still a Volatile Driver of Inflation

- ▶ 1973: Organization of the Petroleum Exporting Countries (OPEC) embargo caused prices to rise due to **lack of supply**.
- ▶ 1979: Iranian revolution caused prices to spike due primarily to **increased demand** as people sought to stock up out of fear.
- ▶ 1986: Prices crashed due to **oversupply** – a result of adjustments from an undersupply in the '70s – combined with a **fall in demand** and recession.
- ▶ 2021: Prices were shocked from the **demand hike** via the pace of recovery post-COVID.

Energy prices tend to decrease during recessions due to a lack of demand (vice versa for booms).

Though the U.S. energy market is volatile, its strength as a producer of energy keeps it largely insulated from supply/demand shocks abroad.

YoY Change in Gas Prices

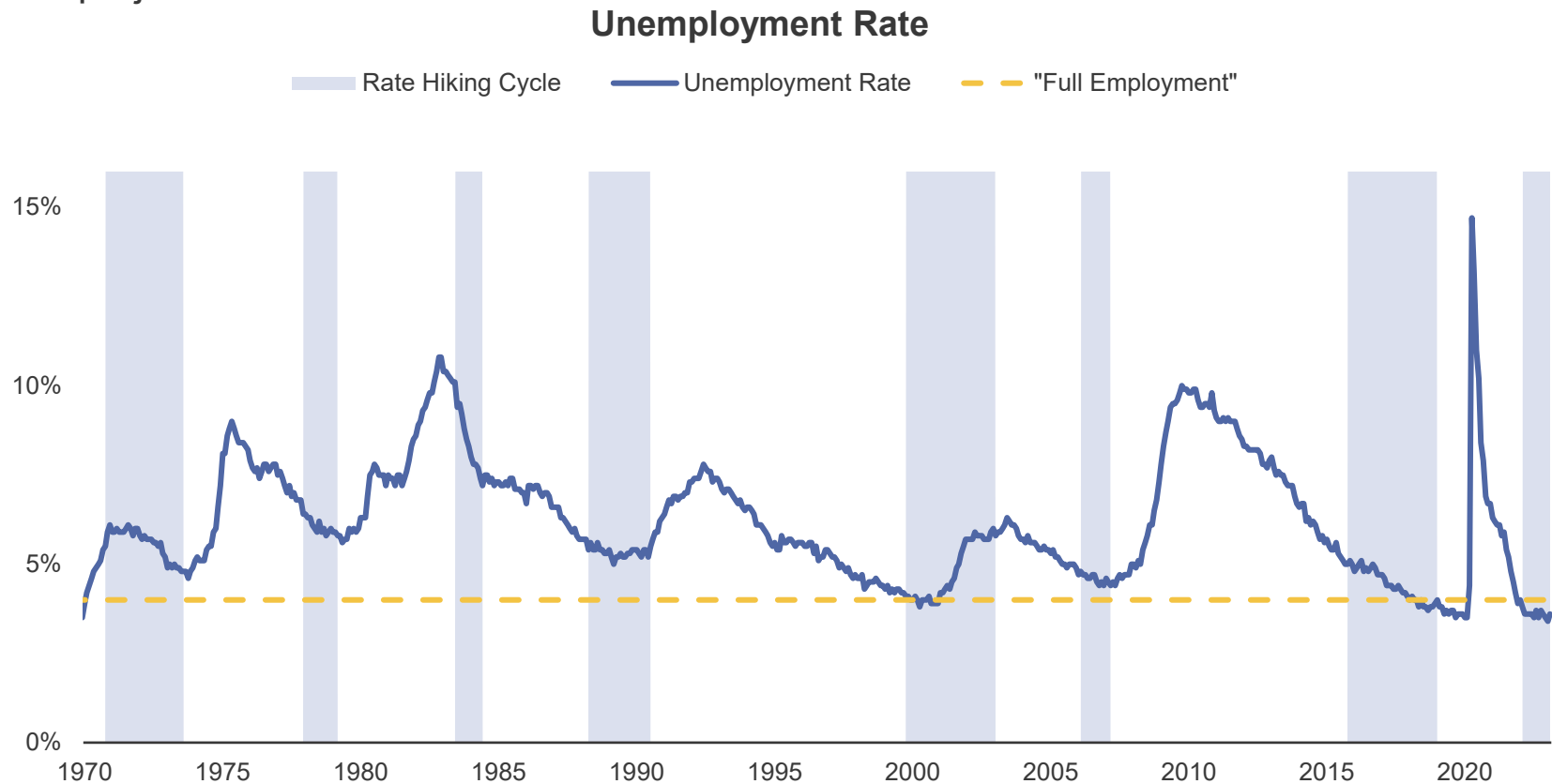


Source: Gas Prices from Bloomberg.

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Tight Labor Markets Raise Wages, Adding to Inflation

- ▶ Rate hikes typically occur during times of low/falling unemployment.
- ▶ The current unemployment rate is below the Fed's long-run "full employment" projection.



Source: FRED.

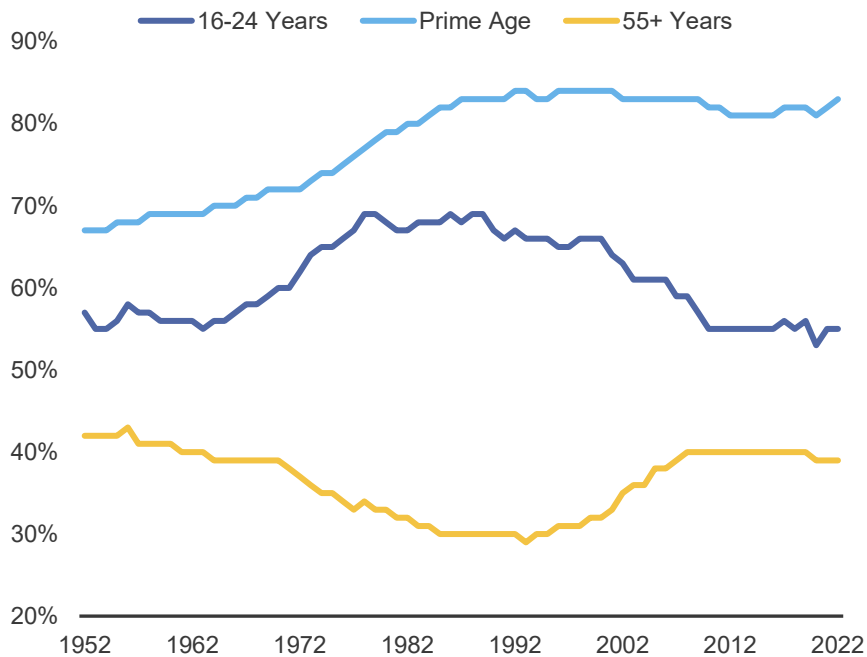
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A Decelerating Labor Force Can Lead to Inflationary Pressures

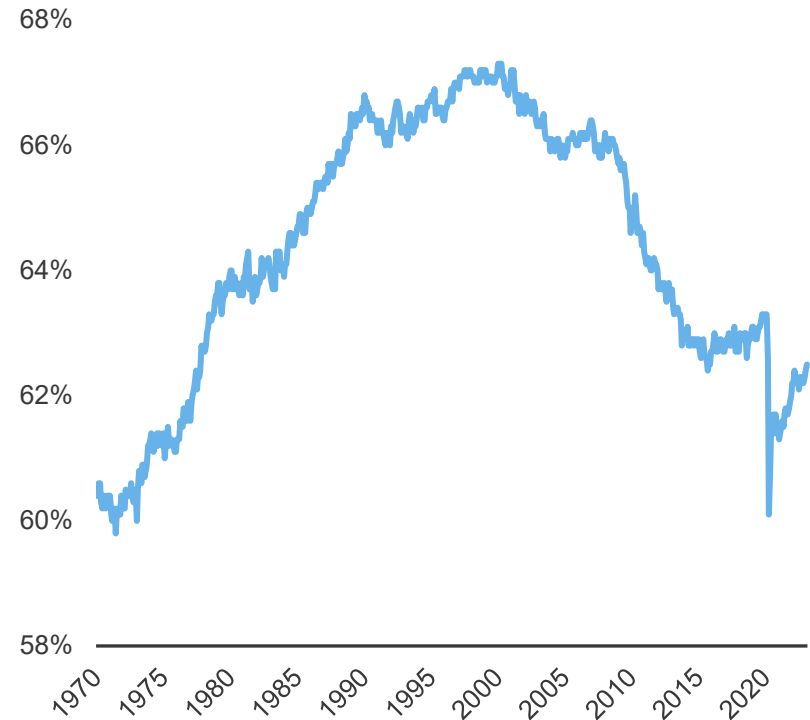
- ▶ The 1970s/80s showed a dramatic drop in the number of retirement-age workers, as did 2020.
- ▶ Many workers exited for retirement during the COVID-19 pandemic.

- ▶ Union strikes throughout the 1970s also stagnated labor force participation growth.
- ▶ Population ageing is the largest single factor for declines in the labor force participation rate since 2000.

Labor Force Participation by Age



Labor Force Participation Rate



Source: Bloomberg.

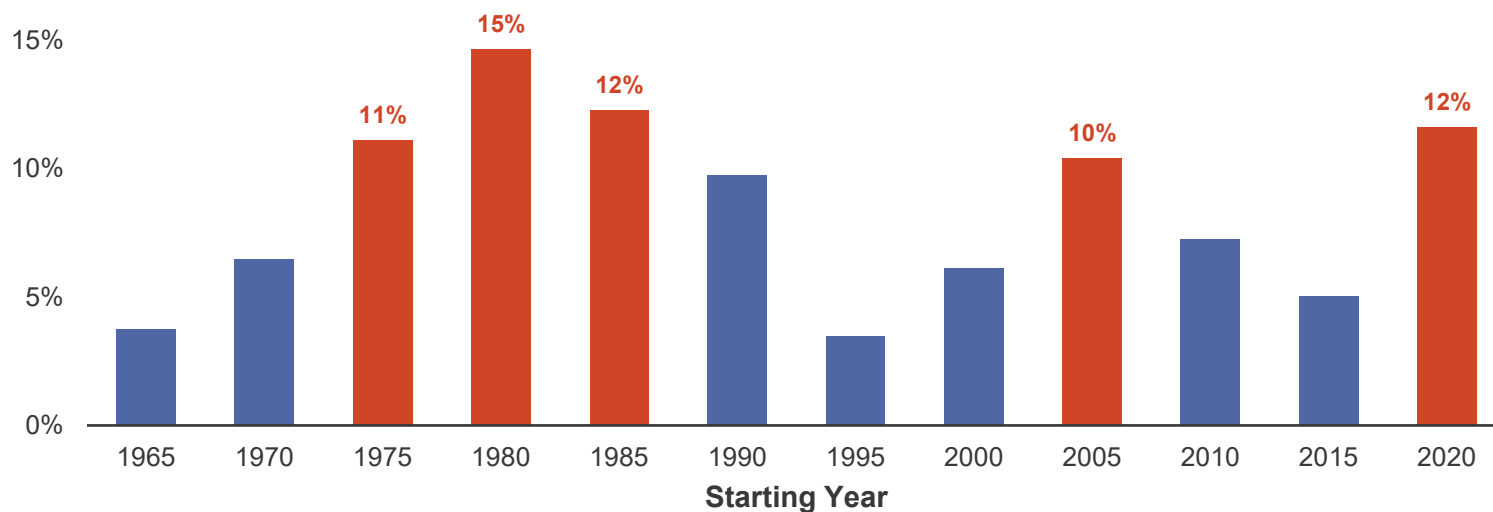
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Fiscal Stimulus Creates Price Pressures

- ▶ During the '80s, President Regan's tax cuts and military spending outweighed cuts to social programs, raising the federal budget deficit from \$74 billion in 1980 to \$221 billion in 1986.
 - ▶ Throughout COVID-19, approximately \$5 trillion in stimulus was injected into the economy while it was locked down.
 - ▶ In 2022, the Inflation Reduction Act was passed primarily to lower energy costs by funding clean energy investment with \$370 billion of federal dollars.
- ▶ Since 1965, there have been five 5-year periods of national debt growth greater than 10%: periods starting in 1975, 1980, 1985, 2005 and 2020-present.

Fiscal stimulus increases money supply in the economy, naturally increasing price pressures.

Annualized Growth of National Debt by 5-Year Period



Source: FRED, Federal Debt: Total Public Debt as of October 2022.

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Recurring Theme: Fed Action

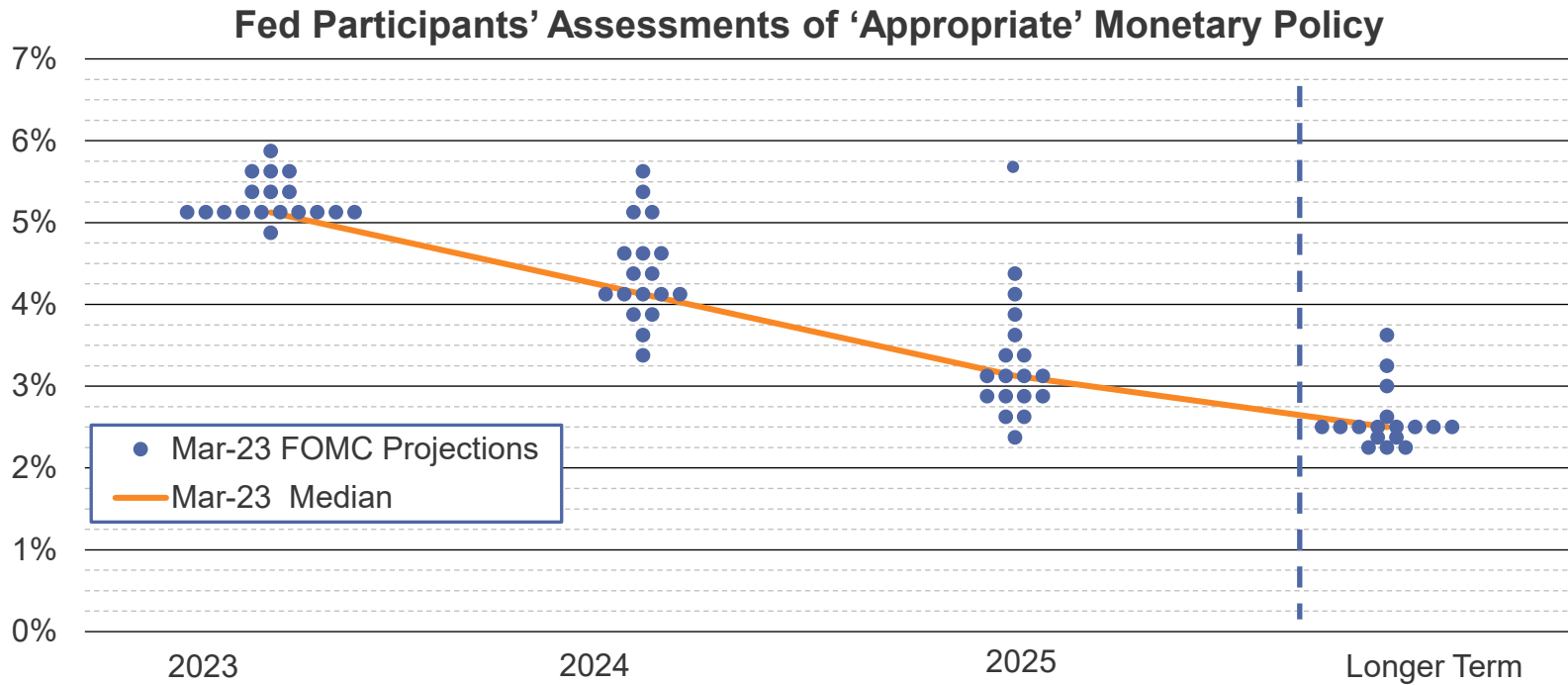
Tinkering and pulling levers to
see what works



Fed Signaling Has Evolved

Source: Fed Funds Upper Bound from Bloomberg.

- ▶ Prior to 1994, the FOMC did not release moves in the overnight rate.
 - ▶ Instead, the markets calculated FOMC moves.
- ▶ In 1998 the FOMC began communicating the likely direction of future policy.
 - ▶ Information flow and “Fed speak” could now be used as additional tools at the Fed’s disposal and has helped support the Fed’s credibility.

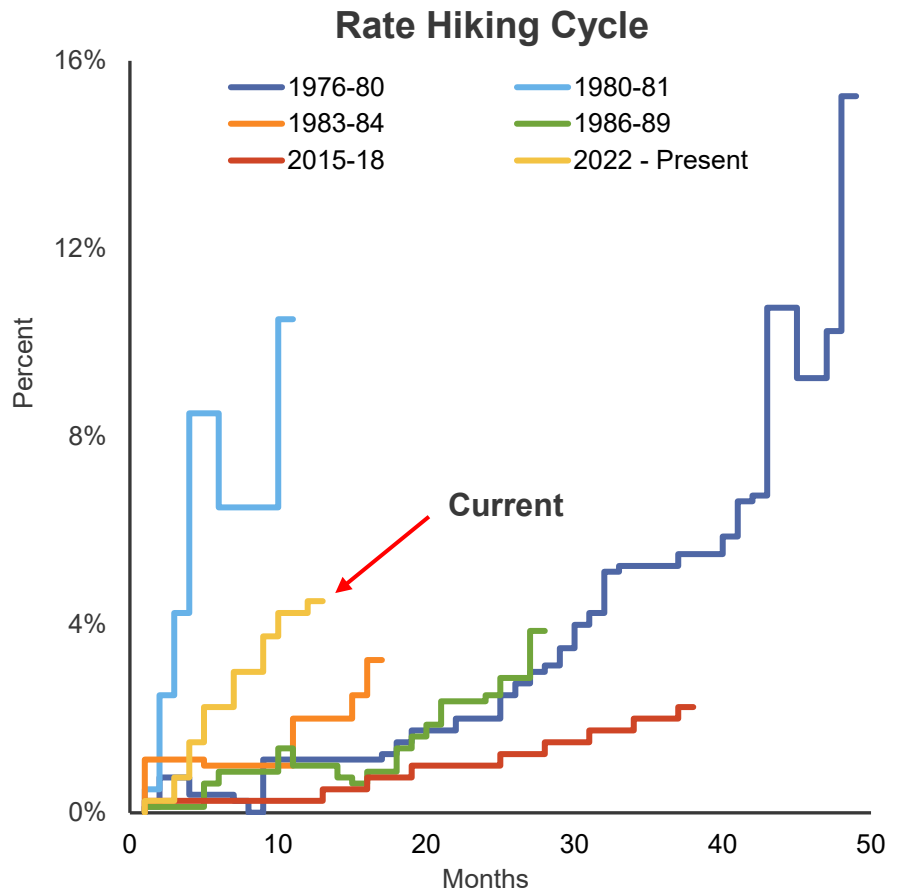


Source: Federal Reserve and Bloomberg. Individual dots represent each Fed members’ judgement of the midpoint of the appropriate target range for the federal funds rate at each year-end.

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Pace of Rate Hiking Cycles

- ▶ The current hiking cycle has had the fastest pace since the Volcker era in the early '80s.
- ▶ Pace is not the only factor to consider in hiking cycles – duration is also key.
- ▶ The amount of time rates are above a long-term goal plays a large role in overall economic health.

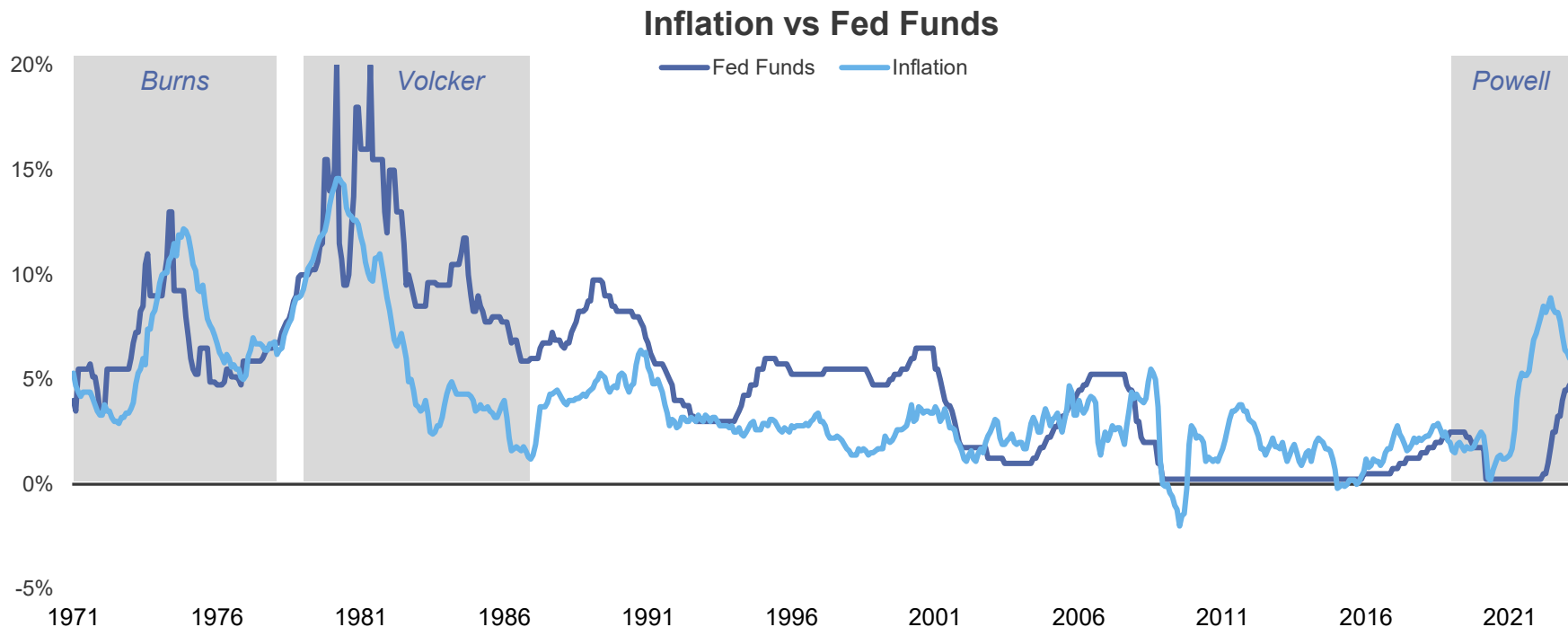


Source: Fed Funds Upper Bound from Bloomberg.

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Whose Path Will Powell Follow, or Somewhere in the Middle?

- ▶ With Arthur Burns as Fed Chairman, the FOMC hiked rates but **backed off** when the economy showed signs of slowing.
- ▶ With Paul Volcker as Fed Chairman, the FOMC **hiked rates much higher** to quell inflation, but at a cost to the economy (negative GDP and unemployment peaked at 10.7%).
- ▶ With Jerome Powell as Fed Chairman, the FOMC labeled real inflation as transitory and **delayed hikes**.
- ▶ Fixed income markets have had dramatically worse performance for Chair Powell as the hiking cycle started at **0%** rates vs. the **5%+** rates for Burns and Volcker.



Source: Fed Funds Upper Bound and CPI from Bloomberg.

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Recurring Theme: Deregulation

The industry's version of
going back in time



Bank Deregulation Followed Rising Rates

1982 Regulation Q

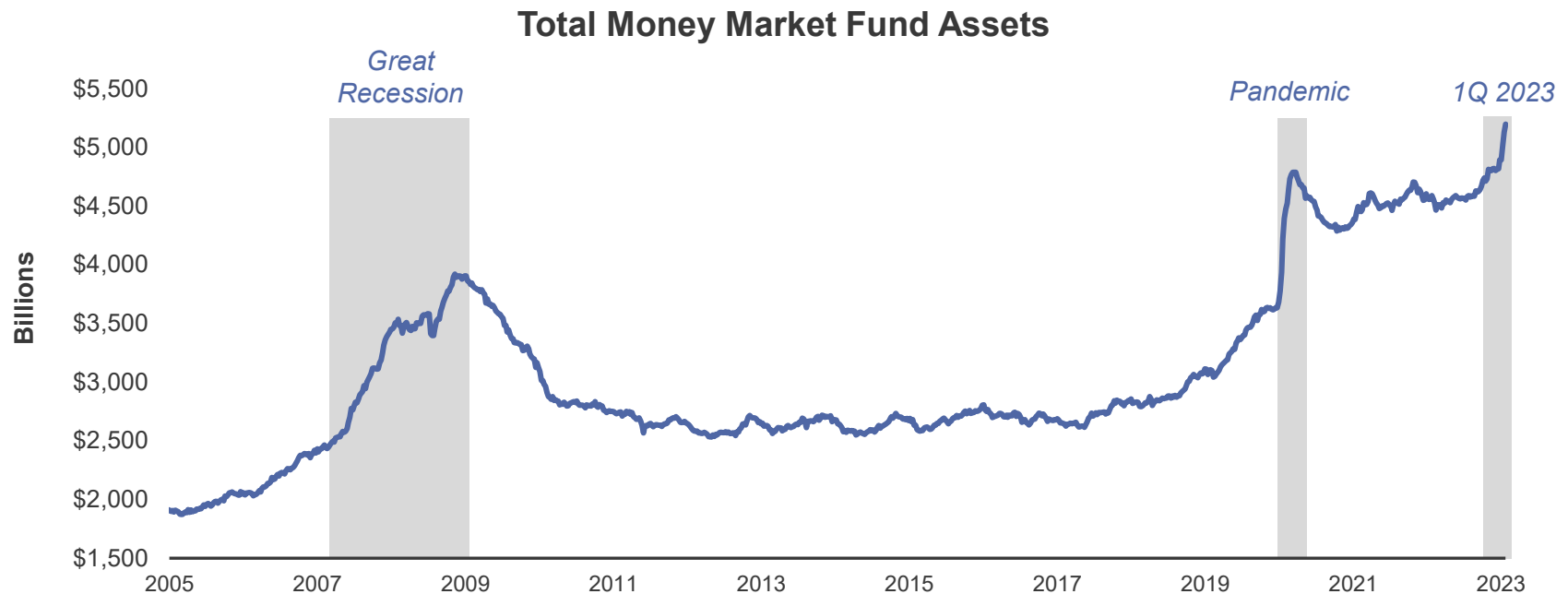
- ▶ **Preceding Environment:** Rising interest rates.
- ▶ **Deregulation:** Congress passed law removing Regulation Q (loan-to-value requirements and interest rate caps for banks), creating a hunt for the highest rate among depositors.

2018 Dodd-Frank

- ▶ **Preceding Environment:** Rising interest rates.
- ▶ **Deregulation:** Congress rolled back Dodd-Frank threshold for the strictest regulations on banks with total assets of \$50B to \$250B.

Money Market Funds Became Attractive to Investors

- ▶ With rates forced higher due to inflation along with other factors such as market uncertainty, higher-yielding money market funds have historically become a favorable alternative for investors.



Source: Bloomberg, ICI, and Moody's.

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What To Take Back (to the Future) With You

- ▶ Inflation was a crucial input to economic stability. The Fed's limited and blunt tools to achieve price stability led to higher rates.
 - ▶ The FOMC now uses a targeted approach to help create long-term stability for inflation and interest rate expectations.
- ▶ The Fed's focus and how policies are communicated have evolved over the years, dependent on who is the Fed Chair.
 - ▶ Maintaining credibility at the Fed is extremely important. Without it, future policy communications hold less weight, resulting in potentially higher rates and the possibility for added economic uncertainty.
- ▶ Tight labor markets and financial stimulus created inflationary price pressure.
 - ▶ Elevated rates and a strong labor market may create opportunity to capture additional yield.
- ▶ Interest rate cycles played a key role in deposit flows over time.
 - ▶ Managing portfolio duration and maintaining diversification help manage risk.



Thank you!
Questions?

Contact us



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