



Zanetti Monday Missive 2022.07.18 Why The Fed Is Wrong

**“Generals are always prepared to fight the last war.”
~ Winston S. Churchill**

Hello Everyone

I's been awhile since I've been on KKOB radio with Bob Clark. Oh, those pesky campaign laws!

Today's missive is meant to reinforce a theme that the Federal Reserve is pursuing the wrong path to stop inflation.

Mr. Churchill was right. Fighting the last war is a common theme in military history. A general harkens back to some previous hero's victory and thinks, "I can do that, too. And

I'll then be a hero."

But, of course, every war is different.

Last month, Fed Chair, Jerome Powell, declared Paul Volker was his hero. Uh oh.

Paul Volker was the Fed Chair when inflation raged in the 70's and early 80's. And Volker's remedy was to crush inflation via ultra-high interest rates. And it worked. Prosperity followed. Volker is still studied at business schools. A hero.

But, or course, every war is different.

I hope today's missive gives you an alternative view of the "economic war" that lies ahead.

KKOB Radio Interview:

Bob Clark: Greg, it's nice to have you back...and my guess is you are doing a victory lap.

Last year.....before you announced your run for governor....you said:

- Inflation was coming.
- It would be far bigger than most expected.
- And that it wasn't going to be "transitory."

You said, "invest in things that can't be printed"....food, energy, commodities, and so on.

And you were right.

With that said, the Fed is now hiking interest rates. So now...

- The economy is slowing down,
- Oil prices are coming down.
- And, many are even talking about deflation.

So, are you shifting now toward deflation? Or, are you sticking with your inflation theme?

Greg: Yes.

Bob, if you think things are confusing now....just wait.

I believe we will have inflation and deflation at the same time.

We'll have inflation in the things we need---think food and energy. And deflation in the things that make us feel rich--think home values and stocks.

And, Bob, some financial chaos is coming because our financial leaders have misdiagnosed the root cause of our inflation. They are fighting the last inflation war.

Bob: And by financial leaders you mean the Federal Reserve and the Biden Administration, right?

Greg: Right. Bob, the last "inflation war" was in the 1970's.

Back then, Unions were much stronger. They were consistently demanding double digit pay increases. And getting them. Of course, that meant the prices of the products they made went up. So, workers wanted additional pay raise to keep up.

The other inflation factor then was what we call “money velocity.” Bob, inflation encouraged people to spend money as soon as they got it. “Hurry, honey, go out and buy stuff before prices go up!”

But, Bob, spending fast and furious like that led to an overheated economy. Again, that fed inflation.

Bob: So, this is why they hiked interest rates. They wanted to slow the economy down.

Greg: Exactly. Eventually, the prime rate hit 20%...which slammed the US into the biggest recession we'd had since the Great Depression.

The good side though was this. CDs started paying 16%-18% interest. And people said, “Hey I shouldn't be spending, I should be saving.”

Plus, it's hard to ask for a pay raise in the middle of a recession.

Thus, higher rates broke the back of inflation. And, under Ronald Reagan, one the longest economic expansions in US followed.

But Bob, this isn't the 1970's.

Let me ask you this: Do you see workers getting 15%-20% pay raises? And do you see an overheated economy right now?

Bob: No on both counts. I see fast food places paying more to get workers, but I also know lots of people who haven't had a raise in years.

And the economy is doing OK---- but it isn't on fire.

Greg: That's what I mean by our leaders are fighting the last war.

Today's inflation is being driven by.....scarcity.

Covid and the War in Ukraine are creating new economic and military alliances:

- The old order is being challenged.
- Supply chains are still disrupted or broken.
- Energy flows are shifting from west to east.
- Food production is in flux and shrinking.

Bob, across the board, there just isn't as much "stuff."

Scarcity. So, the stuff that's left costs more.

And now (a la the 70's) they are hiking interest rates and trying to stop inflation by slamming us into a recession.

But, Bob, recessions lead to bankruptcies, less production, more unemployment. In short, their remedy will lead to more scarcity of stuff we need like food,

energy and finished products.

Bob: Meanwhile, recessions also mean falling home prices and struggling stock markets. Which is what we are also seeing now.

So, I think I see what you mean. You believe we are heading toward inflation in the things we need, and deflation in the things that makes us feel rich.

Greg: Right. We have weak, ineffective, and economically-ignorant leadership.

So, we can either rail against it, or take action. I vote for action.

Invest in the areas that are inflating. Rising costs in energy, materials, food, and even precious metals may not feel so good as a consumer, but as an investor....not so bad. You want the price of your product going up.

Meanwhile, be wary of the cookie-cutter investment programs. They're not working.

And with that. I know I'm out of time.

Bob: Nice report. How do people reach you?

Greg: My number is 505-250-3754. Or, go the website at zanettifinancial.com.

Signed, Your Maybe-The-Goal-Shouln't-Be-To-Clean-Up-The-Mess-Our-Politicians-Created-But-To-Clean-Up-The-Mess-That-Created-Our-Politicians Financial Advisor,

Greg

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Our mailing address is:
5120 San Francisco Rd NE
Suite A

Albuquerque, NM 87109

505-858-3303
