



Market Commentary: Inflation: Local and Global Factors – What Is in Store for 2024 December 2023

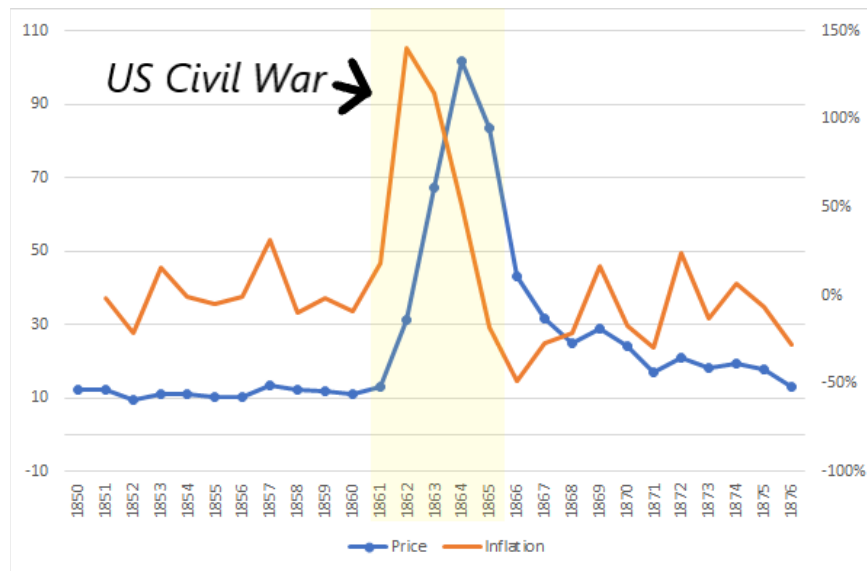
Mongol Empire Khagan-Emperor Kublai Kahn wanted to be more like his dad and grandpa, Genghis Khan, spurring on wars that he, unfortunately, did not win.¹ Win or lose though, wars are expensive, and one way Kublai Kahn dealt with those expenses was to print money, increasing the money supply.² This *resulted in inflation*.

Roughly 500 years later, America had its one and hopefully only, civil war. Due to a naval blockade by the North, cotton exports plummeted, *resulting in inflation*. The price skyrocketed, going from 11 cents a pound in the 1859-60 season to 101.50 cents a pound in 1863-64.³

One cause of inflation is due to an increase in money (more dollars chasing the same amount of goods) while the other is due to a decrease in supply of a needed product. Covid wreaked havoc with respect to both these causes of inflation. Geo-politics was the second of the one-two punch with the Russian invasion of Ukraine in early 2021.

In this commentary, we explore some of the risks inherent in our general US positioning, future inflationary concerns due to local and global factors, and where we think we are currently in the inflation narrative.

Cotton Prices 1850 - 1876⁴



¹ [The Mongol Dynasty | Asia Society](#) – For a great podcast on the Mongol empire, which has a savage reputation but should also be recognized for some of the sophistication they had in managing an Empire, I highly recommend Dan Carlin’s hard core history: [Hardcore History 43-47 – Wrath of the Khans Series \(dancarlin.com\)](#)

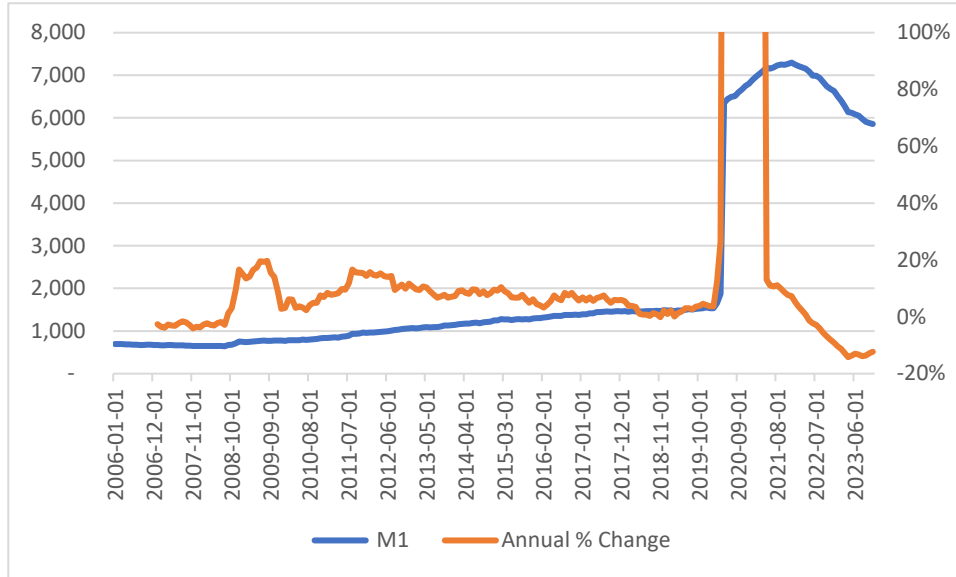
² [Genghis Khan’s grandson introduced paper money—and inadvertently tanked the Mongol Empire - Big Think](#)

³ [earl2.pdf \(sailsinc.org\)](#) as found on: [united states - How did the US abolition of slavery affect the cotton exports? - History Stack Exchange](#)

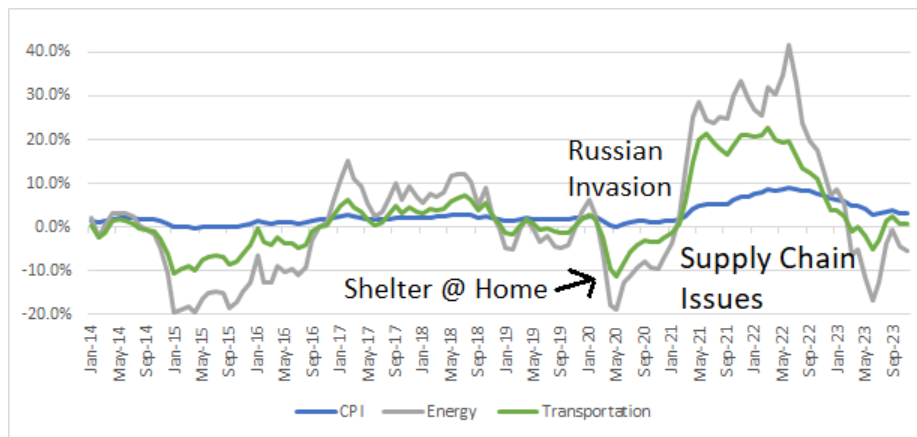
⁴ [earl2.pdf \(sailsinc.org\)](#) as found on: [united states - How did the US abolition of slavery affect the cotton exports? - History Stack Exchange](#)



Money Supply (M1) Growth⁵



Effects of Disruption on Inflationary Measures⁶



America the Beautiful

Blessed with a bounty of natural resources, an enviable geographic location, and strong governmental institutions, America is well-positioned to maintain its mantle as a global leader. A mature, consumer-driven, first-world economy further supported by the US dollar being the world’s principal reserve currency allows for reasonable, consistent growth. Meanwhile, food and increasing energy security have allowed for relatively minor bouts of inflation. While, like most developed countries, we are aging, we have the luxury of

⁵ [Real M1 Money Stock \(M1REAL\) | FRED | St. Louis Fed \(stlouisfed.org\)](https://fred.stlouisfed.org/series/M1REAL)

⁶ [U.S. Bureau of Labor Statistics \(bls.gov\)](https://www.bls.gov/)



being a preferred place to live on this planet with a great history regarding immigrants. That means we have control of our working population to avert terrible population pyramids like that of Japan, Russia, and China. What can go wrong?!

US Politics

While we do have strong governmental institutions, we tend to be a divided nation brought together from time to time in moments of need (WWII, Dream Team, 9/11, etc.). There are simply too many different constituents, lifestyles, backgrounds, and belief systems in our country to have the unification of a homogenous, small tribe. There are positives and negatives to these characteristics but one of the negatives, which seems to be amplified by social media, is the current state of our political parties. 2024 is an election year and it can get quite ugly.

Discussion Point: Electoral College vs Popular Vote

We are in an election year, and it is worth noting that (1) America has consistently been in a state of divide and (2) we are lucky to have incredible governmental checks and balances – those founding fathers were sharp!

I did not realize how close we were as a nation to converting to a popular vote in 1970. [The Man Who Saved the Electoral College](#)⁷ is an excellent read that highlights some of the reasons it is worth sticking to the Electoral College process. It was certainly an eye-opening and convincing read.

An excerpt (from 1970): *“For example, voting fraud, and the prospects of vote challenges and recounts, are ever-present risks in any large election system. The Electoral College system insulates those risks: Incentives for fraud are limited to close contests in a few large states, and challenges and recounts are limited to toss-up results in states that have turned out to be decisive to the national outcome. But under direct popular election, temptations for vote-stealing would exist in every precinct (there are more than 178,000 of them), and would grow dangerously throughout the west on election nights when eastern returns were close. And recounts would not be isolated – they could yield a few valuable votes even in districts where the raw vote was lopsided, so a recount anywhere would encourage tit-for-tat challenges across the country. Close presidential elections would be prone to extended post-election periods of political instability, with far-flung challenges and counter-challenges, litigation, rancor, and government paralysis.”*

Neither party over the last 20 years has done much of an effective job in balancing our budget during what has been considered a peaceful period. Does our political system have the ability to singlehandedly lower our debt rating or shake the confidence of our global partners in our ability to properly manage the world’s reserve currency and US debt?

⁷ <https://www.nationalaffairs.com/publications/detail/the-man-who-saved-the-electoral-college?ref=thebrowser.com>





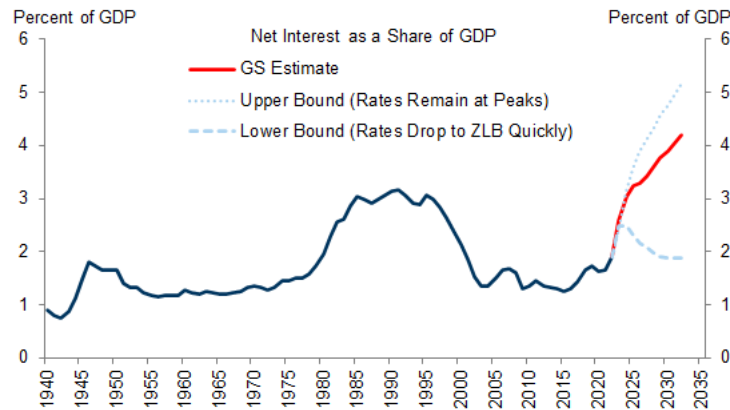
US Debt

The world feels increasingly dangerous:

- Russia – Ukraine fighting to a stalemate;
- Regional conflicts on edge in the Middle East, with the Houthis, yet another Iran proxy, holding the Red Sea hostage; and
- China battling enough issues domestically that perhaps changing the narrative by taking some action in Taiwan is not a crazy prospect.

Add increasing material climate events and it is not hard to see the US needing to spend more on global security.

Meanwhile, yields touching levels not seen in two decades will increase our debt servicing costs on top of increasing societal costs related to healthcare, Social Security, and the like. [Note our May 2023 Market Commentary: Are US Debts Too High?](#)⁸ for more insights. As seen below, the expectation, at least by Goldman Sachs, is that we will surpass the historically high debt interest obligations as a percent of GDP of the 1980s.



Source: Office of Management and Budget, Goldman Sachs Global Investment Research

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It is not a pretty picture.

Geopolitics

When cotton prices skyrocketed during the US Civil War, other countries quickly acted to fill the void. Egypt was the big winner, capturing a large share of the market. When American cotton came back online and prices reverted to pre-Civil War levels, Egypt suffered dramatically for a variety of reasons, eventually leading to British control.

Covid reverberations + geopolitical tensions are leading to a change in the world order. Previously, China was the world's manufacturer with the US leading in policing the waterways. Between the highlighted risks in the supply chain and the mutually evolving uncoupling

⁸ <https://www.fountainheadam.com/wp-content/uploads/2023/06/Market-Commentary-2023.5.pdf>

⁹ [Interest Expense: A Bigger Impact on Deficits than Debt \(Krupa/Phillips\) \(gspublishing.com\)](#)



of the US - China relationship, the world will have new winners and potential losers. Mexico and India are two well positioned countries. How will they fare? Saudi Arabia is looking to transition to a more diversified economy, similar to what has been accomplished by some of its Gulf neighbors. How will it do?

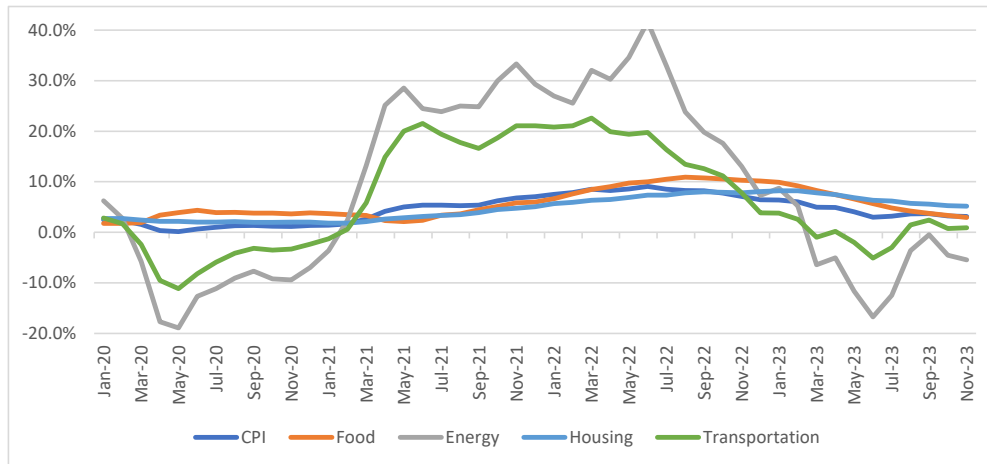
The world is attuned to what is going on in the Red Sea (note last month's commentary), but not quite as much to the extreme drought affecting the Panama Canal, which handles 46% of containers moving from Northeast Asia to the US East Coast¹⁰.

A shift in trade partners in addition to conflict and global warming can have a significant negative effect on inflation in 2024.

Conclusion

We painted quite the picture of what can go wrong. However, over the last 6 months, inflation as measured by CPI has averaged 3.3%, well below the 8.2% average experienced one year ago. And, as noted in recent commentaries, softening wage growth, expected declines in housing-related inflation data, and further stabilizing of supply chains all point to reasonable expectations of maintaining and even lowering inflation towards Fed-stated goals of 2%.

Annual % change of the Consumer Price Index (CPI) and Some of its Major Components¹¹



At the same time, the Fed has increased interest rates and lowered money supply somewhat while also reducing the Fed balance sheet, all of which provides it with more tools to combat future softness in our economy.

In summary, the most recent trend in inflation is positive though a number of aforementioned risks can disrupt this. We, at Fountainhead, are closely analyzing markets with this in mind in weighing the positive yield environment with the risks of further bouts in inflation.

We wish everyone a healthy, wealthy, and happy New Year.

¹⁰ [The Panama Canal is enmeshed in a crisis that's disrupting global trade. But it will take years and billions of dollars to fix | Fortune](#)

¹¹ [U.S. Bureau of Labor Statistics \(bls.gov\)](https://www.bls.gov)



FOUNTAINHEAD INSIGHTS

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