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The Economy Is Not Homogeneous

Measuring the economy as if it was a single entity is difficult.

Not only is it a network of immense complexity, but it is a result of the combination of the actions of millions of people who act on their own behalf, many with differing objectives.

Just as the internal complexity of the network changes with time, the actions of the participants may change as their objectives are modified as they live their individual lives.

Jobs may disappear, new ones may emerge. Businesses may operate with fewer employees and modify their services or shrink their footprint to serve fewer customers.

Other businesses may decide to focus on the work-from-home crowd and change their structure entirely.

All of these differences may require a new modeling of the indices economists use to measure economic activity.

A newly organized business structure may not be accurately represented by the former legacy metrics, and this could represent opportunity for those who can appreciate the changes.

In my opinion, many of the components that we currently use to analyze the economy are of questionable value.

One of my least favorites is the CPI. [1]

It determines the rate of inflation by examining the monthly change in prices on shelter, energy, food, clothing, and transportation.

The report on May 2023 listed the components relative importance as:

Shelter:
Rent of primary residence 7.542 % [1]
Owners' equivalent rent of residences 25.432 % [1]
Food:
Food at home 13.436 % [1]
Other food at home 2.345 % [1]
Food away from home 4.804 % [1]
Energy:
Gasoline 3.459 % [1]
Electricity 2.511 % [1]
Apparel:
2.565 % [1]

I think that the OER, the owner's equivalent rent is the most obvious anomaly. If one owns their home outright or has a fixed rate mortgage, the monthly variation in the theoretical alternative value that could be obtained by renting it to another party is probably of no interest to anyone except an economist. In my opinion, no homeowner, contemplating their monthly budget considers this variation, yet it is the single biggest item in the CPI at 25.432 %. [1]

Even 'food', at 20.585 % seems to me an excessive proportion of a family budget, but could certainly be accurate for lower quintile earners, just as 3.459 % for gasoline could be undercounted for those with a long commute to work.

This data can represent elements to be used as components of an investment decision. To me, what is of more importance is the degree of connection it has to the reality of human behavior that will result.

In a consumer based, free market society, the actions of the individual can be of supreme importance to the success of any endeavor and individual motivations can be complex.

It might be satisfying to have simple explanations for complex situations, but I suggest that simple solutions may not accurately reflect reality or lead us to actionable courses of behavior.

Simple solutions are rarely available to solve complex problems. Even Einstein looked in vain for a 'Unified Field Theory'. Humans have been described as 'questing beasts', animals who search for answers. In economics and the stock market this questing can lead to volatility.

Although this can be upsetting to some, it is, in my opinion, normal.

Broad measures of the economy or even those of specific sectors rarely give the information needed for a business owner to create an actionable business plan.

What I think could be more important than collecting a multitude of data specifics on various economic components in order to create an all- encompassing model of the market similar to a 'unified field theory', is to rely more on so-called behavioral economics.

Behavioral Economics describes how people behave in their economic and consumer decisions. It's Nobel Prize winning founders, Daniel Kahneman, Richard Thaler, Robert Shiller, among others, have written on economics and the psychology that leads to decision making in economic matters. An important aspect of these economic decisions is enthusiasm. [2]

In December 1996 Federal Reserve Chairman Alan Greenspan used the phrase, 'irrational exuberance' to describe what he then thought was an overheating stock market. It continued expanding for another three years. [3]

Exuberance, optimism, and enthusiasm in the prospects for the future can help move the economy forward. Investors with a positive outlook may have the capability to overcome those whom a former vice President once labeled as the 'nabobs of negativism'.

What may make a difference is the specificity of those enthusiasms.

As usual, we have investment ideas that we think may be used to take advantage of the current economic environment.

Please call to discuss which of these may be applicable for your individual goals.

Sincerely,

James P Dretler

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1. Bureau of Labor Statistics, Economic News Release, Consumer Price Index, https://www.bls.gov>cpi.
Consumer Price Index: Examines the weighted average of prices of a basket of consumer goods and services.
2. 'What Is Behavioal Economics? Theories, Goals, and Applications https://www.investopedia.com/terms/terms/b/behavioraleconomics.asp
3. Reflections on Greenspan's "Irrational Exuberance" Speech after 25 Years | Cato at Liberty Blog, https://www.cato.org/blog/reflections-greenspans-irrational-exuberance-speech-after-25-years

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