

Populism's Economic Kryptonite

By Tim Pierotti

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“Who are you going to believe, me or your lying eyes” Chico Marx

If there has been one consistent through-line between the previous and the current White House administrations, it has been inflation. It has been the persistent, unyielding and insidious rise in the cost of living for Americans. Blame can be focused in many directions: excess fiscal spending, tariffs, an overly accommodative Federal Reserve, activist Treasury Secretaries, shrinking labor supplies and the excess demand driven by the wealth effect of rising asset prices. All have played a role. The political impact of the diminution of the average American's spending power has also been consistent.

Last year's Presidential election threw out the Democrat incumbents in a manner well beyond what the pundits believed possible. The recent off-cycle Governor's races also stunned political observers as the incumbent party lost Governor's races in purple states by hefty double-digit margins. In both time frames, market gains were robust and unemployment, by any historical comparison, was remarkably low and yet the incumbent party got throttled.

The inflation problem that the current administration and the GOP broadly face approaching the midterm's is clear, but the solution is not. What exactly should these policy makers do to both bring down inflation, without inducing a recession, and get themselves reelected? One simple thing they can do is on the tariff front. Secretary Bessent recently signaled that tariffs on soft commodities like coffee and bananas that will never be produced domestically will be removed. That was an easy one. Other choices will be far more difficult. The President strongly believes in tariffs, so it is hard to imagine that we will see a broader capitulation on that front. That is a problem, because even if you believe that tariffs are a “one-time price reset”, (we do not) the process of tariffs being absorbed by importers and then passed onto consumers is something that will transpire over several quarters. In other words, tariff inflation, even with the most benign assumptions, will continue to push cost of living higher well into next year as we approach the midterms. The Fed can ignore the tariff driven inflationary pressures all they want, but consumers don't have that luxury.

When it comes to the Fed, the President may be “the dog who caught the car”. He and Secretary Bessent have largely succeeded at influencing the Fed to run the economy hot through cuts to the Fed Funds Rate and some members indicating that they would intervene should the curve materially steepen which has helped keep a lid on mortgage rates. The problem is that, while risk assets love an accommodative Fed, the trade-off has been real costs to consumers continuing to accelerate. Given cost of living is the number one topic for voters, it might make more sense for the President to indicate to the career ambitious Governors that rates might be just fine where they are until there is some clear indication that inflation is falling toward the 2% target.

There is also the very real political problem that prices don't really ever come down outside of very ugly recessions. So, all politicians will talk about lowering prices even though the best they can really do is slow down the rate of change. If the box of Cheerio's that you used to buy for \$5 is now \$7, the fact that the price is now only rising slowly isn't something that makes the consumer feel any better. Most voters don't realize that the cost of prices actually falling is an economic environment nobody wants to live through.

The previous administration tried to convince Americans that inflation wasn't really a problem because wage growth was outpacing the rate of inflation. Clearly that didn't work. The current administration has taken a different approach by simply making the counterfactual argument that prices really are coming down, and it's just the media and deep state technocrats in the BLS that are convincing people that inflation persists. Neither strategy works. For four years now, our mantra has been consistent: the several decades of falling inflation and falling inflation volatility is



over. What economists refer to as The Great Moderation of Inflation is now in the history books and a new regime of greater inflationary pressures driven by labor scarcity, protectionism, and bloated sovereign balance sheets is upon us. Politicians can make matters worse as frankly the previous and current administrations have proven, but the challenge of a rising cost of living will and ever-widening wealth bifurcation is not going away. It will be beyond difficult for any politician to win an election prescribing the necessary medicine of much lower budget deficits and a Fed that actually takes the 2% inflation target seriously, but that is exactly what is needed.
an effective Fed put.

About Tim Pierotti:

Tim Pierotti is a renowned equity researcher and the Chief Investment Strategist for WealthVest. Tim's goal isn't to offer another opinion. Tim aims to provide clear insights into macroeconomic trends and topics shaping markets, interest rates, and the economy, so advisors are ready for their next client conversation. Tim leverages his experience as a hedge fund analyst, portfolio manager, and equity researcher at some of the world's largest financial institutions. Tim hosts "WealthVest: The Weekly Bull & Bear," a popular podcast for financial advisors highlighting key market updates.

About WealthVest:

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