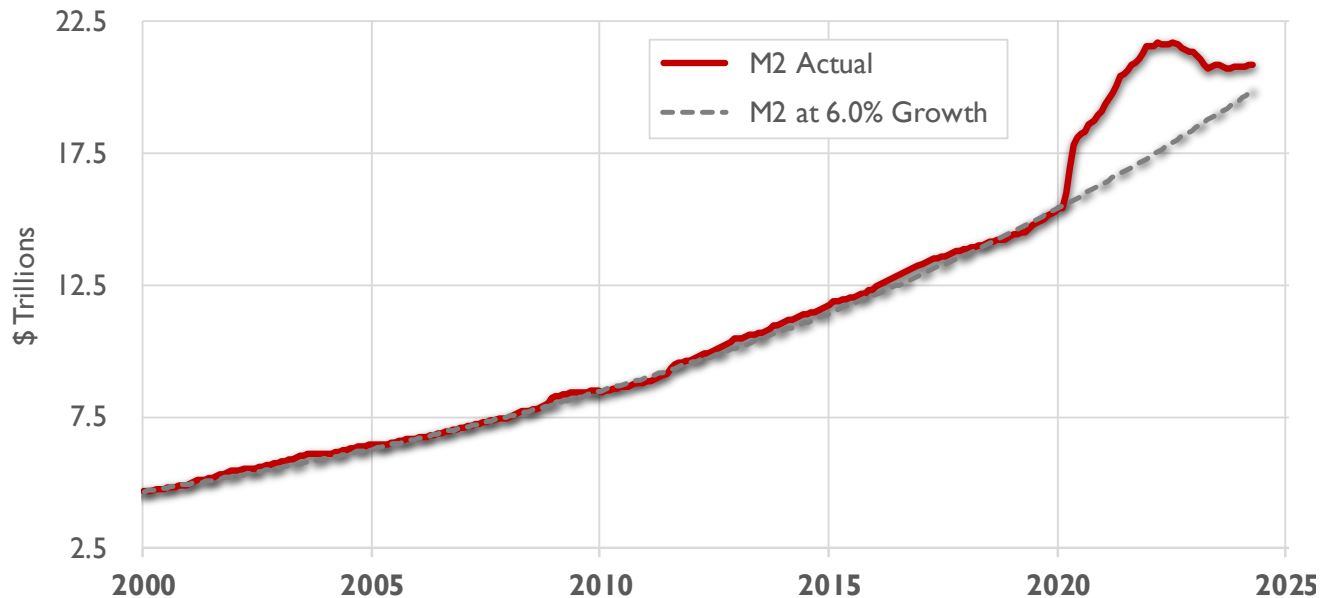


Participants in capital markets have been laser focused on inflation and the Federal Reserve’s interest rate policy decisions over the past few years, with investors and the media trying to anticipate what impact labor market reports, economic health, and inflation readings will have on the Fed’s actions. A far simpler yet effective way of looking at these issues is to focus on the money supply.

**ACTUAL M2 MONEY SUPPLY VERSUS A 6.0% TARGET GROWTH RATE (JAN 2000 – MAR 2024)**



Source: Federal Reserve Bank of St. Louis FRED – M2SL April 1, 2024 (<https://fred.stlouisfed.org/series/M2SL>)

The chart above shows the actual money supply circulating in the economy, as measured by M2, versus an annual monetary target growth rate of 6.0%. From 2000 to 2019, these two lines tracked closely, but then the Fed pumped trillions of dollars of excess money into the economy to try to offset the economic shutdown in response to the COVID-19 pandemic.

The bedrock of all capital market activity is the underlying productive output of the economy, which is measured as Gross Domestic Product, or GDP. As the economy grows, which has historically been about 3% per year, the money supply must also grow. If the money supply did not grow with the economy, it would cause deflation and choke off investment in productive economic activity. However, when the money supply grows at a rate above GDP growth, there isn’t enough productive investment for all the cash and thus prices increase, and we experience inflation. Or in other words, too many dollars chasing too few goods and services.

Excess M2 money peaked at the end of 2022 at \$4.2 trillion, which was 24% above the target money supply, and has since narrowed to about \$0.9 trillion, 5% above target. Once the actual money supply comes back down to target, inflationary pressures should subside. If recent trends continue, the money supply would be back to target in September 2024. Investments depend on a stable and growing economy and money supply. So, while everyone else is parsing Fed statements, target interest rates, employment, wages, and a slew of other topics, keep your eye on the money supply and your long-term investments in a well-managed growth portfolio to outpace inflation.

# behavioral ADVISOR

## From the Behavioral Viewpoint

What is going on?

1. **Myopia and Availability Bias** – The market and pundits have myopia, focus on a single thing, and extrapolate meaning from it. Availability bias puts ideas even more into focus and they generate a life of their own and carry more weight than they deserve.
2. **Fallacy of Control** – We want to believe we can understand the economy, predict policy, forecast market response, and make a good investment decision. These mechanisms are part of a complex system with countless variables and largely unpredictable and random outcomes in the short run.
3. **Transference and Fight or Flight** - Inflation causes real trade-offs in our everyday life, as we experience the higher cost of goods. This is compounded by fears of economic turmoil, often fueled by the media. This financial uneasiness is transferred and creates a need to control our investments, which can lead to costly short-term emotional mistakes.

What can we do?

1. Ignore the noise and move beyond market myopia and focus on your personal situation and long-term plans. Develop a needs-based plan that separates short-term and long-term investments. Adjust plans as necessary and stay fully invested over time.
2. Build a strategy-diverse equity portfolio that can be resilient in a variety of market conditions and is designed for the long-run. Give resources allocated to growth the time necessary to mature and achieve expected long-term results.
3. Work with an experienced financial advisor, who has been through different market environments. They can provide perspective and coaching to help stay on track and remain focused on long-term goals.

## Behavioral Finance straight to your Inbox

Behavioral Viewpoints features new topics each month which are intended to help advisors and investors gain a deeper understanding of how behavior shapes the investing landscape.

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