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I had a major crush on Davy Jones

Many reasons to expect inflation to remain low for longer (... Jones? Think The Monkees).

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[*Editor's Note: Because my ghost writer and I didn't do so well coordinating our vacations, I will be offering three weekly specials the rest of this month. This first one is about inflation.*]

For years, I have been challenged constantly on my view that inflation is likely to remain low for longer than many expect. Not anymore! What has changed? The mid-1960s could be instructive. There are numerous parallels between now and then. It, too, was a period when unemployment was low, government debt was rising and the Fed was accommodative, yet prices were constrained and term premiums—the extra yield investors seek above short-term Treasuries to offset the inflation risk of locking money up in longer-term instruments—were negative.

It also was the last time the 3-month/10-year Treasury curve inverted without foretelling a recession. Why? Because of all the fiscal juice associated with President Kennedy's tax cuts and President Johnson's spending on the Vietnam War and War on Poverty—who cares about a mild yield curve inversion when Uncle Sam is on a binge! This time around, it's the Trump tax cuts and 2018's bipartisan 2-year agreement boosting discretionary outlays. *Indeed, since 1950, the direction of fiscal policy—and not the yield curve—has a perfect 10-for-10 record of recession forecasting.*

Now as then, inflation and in particular inflation expectations are well anchored, keeping the 10-year Treasury yield range-bound around 2.50% despite an expansion just months away from setting a record. The core PCE Index, policymakers' preferred inflation measure, has remained at or below the Fed's 2% target for most of the past decade, occasionally reaching it before falling back again. The latest report showed it slowing to a 1.6% annualized pace.

Wages have been rising but remain muted, with average hourly earnings continuing to run well below historical norms for this stage of the cycle and the Employment Cost Index moderating in this year's first quarter. All of this has the term premium at its most negative in 57 years even with green shoots sprouting in both China and Europe, and growth picking up at home. Overseas, the disinflation story is even stronger, with negative-yielding sovereign debt recently moving back above $10 trillion. Spooky, don't you think?

Why is inflation staying so muted amid all this stimulus and unemployment near a 50-year low? San Francisco Fed President Mary Daly cites disruptions—she calls them "wedges"—in the historical linkages between the behavior of the labor market and prices. One wedge, she says, is the growing use of alternative forms of compensation, such as free transportation, flexible workweeks and help with student loan repayment, none of which are captured in traditional measures used to track wages and salaries.

A gargantuan wedge is the combination of declining unionization, increasing automation and growing globalization, all of which have made it harder for workers to push for higher pay and companies to pass along rising costs. A potential revival in productivity-enhancing capital expenditures fueled by 2017's tax reform, along with deflationary technological and demographic forces such as the "cloud" replacing expensive servers and routers, and lower-cost millennials taking over for retiring baby boomers.

To be sure, we're always watching for potential inflation surprises. Ned Davis Research cautions that shelter prices have been climbing, and that both a dollar that may be stabilizing and big drops in apparel and medical commodity prices that may be one-offs

could be masking budding cyclical pressures. It is worth remembering that the go-go 1960s' guns-and-butter fiscal policy eventually did ignite inflation (along with the Arab oil embargo that caused oil prices to soar).

These factors are most likely dwarfed by the previously cited structural forces continuing to exert downward pressure on inflation. This "good disinflation" provides a constructive environment for credit-oriented bonds and a bullish backdrop for equities, as declining term premiums driven by low inflation are supportive of risk assets generally and equities in particular. There's no reason to think this will change in the foreseeable future. So, who was your favorite Monkee?

WHAT ELSE

I'm thinking home-building stocks Millennials (ages 23-38) are exhibiting "adult" attributes as they overtake baby boomers as America's largest adult-aged generation. Bank of America says *72% of this 91+-million cohort view home ownership as a top priority. It makes them feel "mature, more responsible" and "more like an adult."* Millennials are expected to be the economy's dominant driver through early 2040 as they enter the "young family" stage of their lives (35 to 44), ramping up spending on everything from housing and cars to clothes, food, services, even health care. Ned Davis Research says incomes and spending in this phase of life tend to jump 25% on average.

'We're in a secular bull market—why can't we just enjoy it?' The three super bull markets in modern times (1925-1929 U.S., 1985-1989 Japan and 1995-1999 U.S.) had economic backdrops similar to now, mainly solid growth and low inflation. (Shout-out to my Phoenix Barron's top advisor friend!)

Maybe with fries. But salad? I don't think so My hometown Kraft Heinz has released another flavor combination to its condiment lineup: Kranch, a combination of ketchup and ranch.

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DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Personal Consumption Expenditure (PCE) Index: A measure of inflation at the consumer level.

The Employment Cost Index (ECI) is a quarterly measure of compensation costs for U.S. businesses.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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