Cadence Bank Podcast: In Good Companies

Episode #3: It's the Economy, Stupid: The Fed, Economic Policy, and You

You turn on the news, you flip open the morning paper and there it is: the economy. It's up, it's down, it's sideways. GDP, the S&P, ABCDEFG. It can be hard to understand what you're seeing. But of course, this stuff matters—especially if you have a business. So how do you make sense of it all?

Luckily for you, there's people like Tell Alessio, Treasurer at Cadence Bank. Tell reads economic reports for a living and translates them so that mere mortals can understand. On this episode of In Good Companies, we're breaking down the economy—what is it exactly? What makes it healthy or unhealthy? How can you tell a short-term blip from a long-term trend?

Tell will also guide us through the surprisingly accessible world of economic policy. Who's actually running things, and what does "running things" even mean? Is inflation bad? What can you interpret from federal interest rates? And what is "reverse repo"? More importantly, we'll cover how these terms might affect your business, and how you can time important moments in your company lifecycle with these trends to maximize return.

It might seem intimidating, but don't worry, we'll quantitatively ease you into it. This is economic policy for everyone. So listen on!

Episode Transcript

Patrick Pacheco: So, do you have a degree in economics?

Tell Alessio: I do not. My degree is in mathematics.

Patrick Pacheco: So I have a BS in economics, which is probably appropriate.

Tell Alessio: So then maybe I should be interviewing you.

Patrick Pacheco: No, I doubt that. I think I forgot all of that. yeah, I'm the worst of both worlds. I'm a lawyer and an economist.

SFX: Theme music

Patrick Pacheco: I'm Patrick Pacheco and you're listening to *In Good Companies* from Cadence Bank, the podcast where we answer the toughest questions facing your business and guide you through the company life cycle from start to sale and success to succession.

SFX: Music sting

Patrick Pacheco: Do you remember "It's the economy, stupid!" the rallying cry of the first Clinton campaign? It turns 30 next year, but no matter how old you are, the economy still makes many of us feel stupid. The economy is big and it's confusing. And the policies that control it can be even more mystifying than the thing itself. But it's not as scary as it seems, and you don't need an advanced degree to know what's important. If you can understand a few key factors, you can adapt your business to whatever the economy throws your way. Our guest today explains those factors for a living. Tell Alessio is a Treasurer at Cadence Bank. It's his job to study changes in the economy and fiscal policy and the effect they'll have on us. We caught up with Tell to learn about common misconceptions, monetary policy, and why he's hopeful about our current economic situation. So right off the bat, let's kind of define our terms. Tell, when we reference the economy, what are we talking about?

Tell Alessio: When we think about the economy, we think about really production, distribution, and consumption of goods and services. We're talking about the things that we all do, day in and day out, to produce for our families and for our community, as well as, kind of the services that we consume, not just the commodities, but more specifically also the services that we do.

Patrick Pacheco: So what wouldn't fall under the economy, as far as measuring? What might be a double counting or something that just doesn't fall under the definition of economy?

Tell Alessio: Yeah. Sure. So really, I think about when you think about capital markets, so like equity markets and fixed income markets, these are markets that allow capital to flow. And they're almost a derivative of the actual economy there they're representative of asset values, but they're not the actual economy's behavior. They're more an opportunity for capital to flow efficiently throughout the economy, but they don't actually, they're not representative of the economy itself. So, when you think about equity markets, with the S&P or the Dow, or you think about what bond funds are doing or municipal funds, those aren't actually the economy. They're a market representative of how the economy might be doing, but the economy itself is the supply and demand structure. That's allowing those companies and those investments to yield fruit.

Patrick Pacheco: So that's why, I guess that's why sometimes the market seems a little bit out of sync with the economic conditions.

Tell Alessio: Entirely. The other piece of that is that the markets typically anticipate, or at least have a perspective to anticipate. And sometimes those anticipations aren't accurate.

Patrick Pacheco: For some of our listeners that don't have a background in finance or economics, what are some of the factors that help us evaluate the health of the economy, both locally, nationally, and globally?

Tell Alessio: Yeah, we use a lot of economic data for that. So that's unemployment rates, job openings, job loss. Gross domestic product is probably the most common measure of growth of an economy and the size of an economy. And then we really look at inflation rates. So, what are prices doing? And those are the pillars of how and how healthy an economy is.

Patrick Pacheco: There's plenty of misconceptions floating around about the economy. Chief among them? Inflation. So, inflation sometimes is a four-letter word. I think it's—if you think of it this way, it allows you to move up to a more expensive neighborhood without ever moving. I guess that's a positive of inflation, but what is inflation is it always a bad thing? Is deflation a good thing Fill us in a little bit on, on inflation and how we should think about it.

Tell Alessio: So inflation really has to be held in context. When you think about inflation, it's really about purchasing power and quality of life. If prices of goods and services are moving up in price faster than inflation, if it's having a bigger impact there than it is, say, on wages, on what people are paid, then you're losing purchasing power. And it feels like the inflation is impacting your life in a negative way. However, in a lot of cases, for individuals that have assets, they can kind of benefit from an inflationary environment because typically those assets are financed with debt and when prices of assets increase, the debt does not increase in value. And so, there's a kind of common misconception that all inflation is bad and that's not necessarily the case, but it is unequal in how it distributes its impact.

Patrick Pacheco: Employment, I guess that's affected people as well. I've heard the current situation referred to as "The Great Resignation." How has employment affected the economy? Did the economy affect employment or is employment now affecting the economy?

Tell Alessio: So, I would say employment affects the economy. And it's really all about participation. And what we've seen over the past couple of years is a serious reduction in the amount of people participating in the economy by national standards. We've had about a 2-3% drop in participation in the labor force. And that's a combination of things. It's partly demographics: we've got an aging workforce, so we have more people retiring. And then we've also got some cultural changes happening, more people preferring to stay home caring for family members, caring for families or elderly. And then you add on to that some other cultural changes that, we just aren't sure what is going to happen. Like young adults living at home who have kind of postponed their participation into the workforce. There's those kinds of cultural things that are also happening and what we're really trying to, what I'm trying to understand as we get through this cycle is, do we actually, can we attract those workers back to the labor force so that we have growth in our economy?

Patrick Pacheco: Okay, so that you made my heart skip a beat there, Tell, because I have a 12-year-old and a 16-year-old. So, I'm hoping they don't follow suit with the rest of the young adults that are apparently staying at home.

SFX: Music transition

Patrick Pacheco: We've talked a little bit about what makes an economy healthy. So, I wanted to know how does our stack up right now? And more importantly, down the line?

Tell Alessio: Yeah, I'm in my opinion, healthy economies are ones that provide equal opportunity participation and that's where individuals have valued work to do, and they're rewarded commensurately. We have, we need efficient and stable supply chains and we need efficient allocation of capital. And that typically comes with transparency. And so, I would say the us in general is a pretty healthy economy in, in, in most normal environments. We've, you know, most have said that the risk, the great recession that we saw in 2008, took a long time to recover. And we started to see that recovery sort of the couple of years before COVID hit, which kind of reset us back down into a different environment. But I kind of like to look at long-term trends. And I think in the long-term trend, the US economy is still very competitive on a global scale and is providing that opportunity. I think what's challenging is that, that the economy is so well-developed and we have such a complex skills requirement and change is so constant in our economy that the transfer of skills and the continued training that's required throughout a career now is what's putting a little bit of a dampener on how successful we could be long-term. And that's where I think we need to make some investment. To be sure that we maintain that competitive edge and keep the economy healthy.

Patrick Pacheco: Does every economy, has every generation faced the same things or is the economy today different? Yeah, everybody probably thought theirs was different, but things such as artificial intelligence and the amount of outsourcing that goes on and you always hear about the wealth gap, has that significantly changed the way this economy functions?

Tell Alessio: There's an old adage that came out of the technology industry called Moore's law, which kinda talks about the rate of change and how fast, and it was really related to the speed at which we developed processor chips, that each time they went back to process a chip, they were able to double the processing speed faster and faster. And that same perspective is kind of been brought to the larger economy in a lot of different ways. When you have things like the internet, it is different for this generation, I think dramatically. And back to that skills issue, that skills transfer it's pretty easy, if you're a construction worker to go work in a restaurant, but if you're a computer programmer and you get outsourced to India or to China for your job, it's more difficult for you then to turn around and become a bioengineer or a chemical engineer. That takes a continued skills transfer that's longer term and not always as easily adopted by the employment, by the way.

Patrick Pacheco: With something as big as the economy, it's not always clear who's in charge. There's the Fed, Congress, the President, maybe Alexander Haig. I asked Tell, when it comes to economic policy, who's driving the bus?

Tell Alessio: Yeah, the Federal Reserve Board is driving the bus on monetary policy. The Fed governors are appointed by the President. They're nominated by the President and then they're confirmed by the Senate. And so, in the context of who gets on the board, there's obviously influences from the executive and legislative branches. However, the Fed is really an independent institution. Once those governors are established, they set that policy, that monetary policy. The people who are on that board are educators, they're practitioners and they serve with a dual mandate, which is: full employment and price stabilization. That's the Fed's mandate. And I think that they do that in conjunction with fiscal policy. So, Congress spending, that gets, you know, through the House and the Senate. And when you put those two things together, they clearly talk for the best interests of the economy and the country. But at the same time, you, a lot of times when we have an environment like today where maybe the Congress is not as readily open to working with one another, they kind of leave the Fed out there without the fiscal backing they need and that's the environment where I think the Fed has a lot more leeway to take action because we don't have the same fiscal response.

Patrick Pacheco: So how does the Fed do this? What tools they have available to, to actually control or actually drive monetary policy?

Tell Alessio: So, they really have a couple of different transmission mechanisms is what I'll call them. Interest rates are the first one. They set a rate of interest that banks can deposit money with them. What's critical about that is that interest rate that is a risk-free rate of interest. That kind of level-sets all the other investments, that investment returns that are required, that an investor would require. And so that's probably their primary, or at least historically has been their primary transmission mechanism. They've always had this communication driver where they announced what they think is going to happen, and that helps craft their message about where the economy should be going and encouraging the markets to kind of follow and get people on board with that predictive behavior.

Patrick Pacheco: I want to pause and give just a little explainer on these interest rates. The Federal Reserve sets interest rates for what banks can earn on any overnight deposits with them of excess cash they had. This, in turn, helps banks determine their interest rates for loans to customers. When the economy is struggling, the Fed often lowers interest rates to make it easier for people to borrow money, which keeps people buying homes and starting businesses, and generally stimulates the economy. So, struggling economy equals lower interest rates. Recovering economy often equals higher interest rates. Okay, back to Tell.

Tell Alessio: So communication's the second. And then what they really expanded dramatically or really initiate an expanded in the great recession was this quantitative easing policy whereby they actually purchase investments in the open market, through their open market operations and by buying bonds in the market, they're able to further bring down rates on risk-free assets or less risky assets. And that, helps to not only level-set investors' expectations about what a return should be and provides financing that's much more affordable, it also creates money supply and allows for a freer and more openly liquid environment, which is kind of what you want during a crisis. During the COVID response, they've greatly expanded their quantitative easing policy. And they've actually tripled the size of their balance sheet in the process, and which is kind of unprecedented. So, they initiated that during the great recession, they went through three waves of it to recover from the great recession and then they were kind of set for about three or four years. And then once COVID hit, they really ramped up their activities there.

Patrick Pacheco: It's Patrick, cutting in again to give a very quick and dirty explainer on quantitative easing. Quantitative easing is another way the Fed injects money into the economy in times of trouble. If you think about it, you can only lower interest rates so far. Right now in the US, the interest rate is 0-0.25%. With quantitative easing, they are, in a way, printing money for themselves. They then use that money to strategically buy securities and assets on the open market, typically from banks, which puts new money into the market. When banks have more money, they're more able to offer long-term loans. And the more banks that have money, the more competitive those loan rates are for borrowers. Of course, there are other reasons, but you'll have to ask, Tell about those.

Tell Alessio: Then the other two mechanisms that I'm going to mention are kind of, are relatively new and actually in the past year. And they are the reverse repo and the repo programs that the Fed has participated in. They've always had a repo program, but it's been pretty nominal, very small, very limited participants. But in the spring, they really opened that up to asset managers and broker dealers, not just banks and really opened it up to money market funds. And the size of those programs has been driven up pretty dramatically. And it's another way for them to control short-term interest rates. They've set a floor of five basis points. And they've set a ceiling of 25 basis points so that they always kind of could control how much cash is going to earn. One of those reasons they did that is because they're fighting zero rates. Interest rates are fickle. And I say that, because there's a curve, right? So, interest rates are not just the front end, which the Fed controls very handedly, but then the longer-term interest rates of five years, 10 years. And while the Fed has some influence in that, through their quantitative easing program, those rates are really driven, especially the long end by long-term investors, like insurance companies and, and pension funds who are really looking at what is inflation, what is long-term growth versus kind of the short-term where the Fed really does have a lot more control on short-term rates.

Patrick Pacheco: So, we have the Fed controlling the short-term. We have pension funds and other big investors controlling the long-term. How much does this policy actually control what the economy is?

Tell Alessio: A good bit, quite frankly. For example, if you're an investor, let's just say a bank. And your alternative is to try and find an investment that makes the highest return for your shareholder. And you can go to the Fed and you can invest your money today. The interest on reserve balances is 15 basis points, so 0.15%. And that is a risk-free investment. Then in the context of everything else that a bank wants to invest in, the risk that we would take on has to be above that 0.15% interest. Two years ago, the Fed funds rate was at 2%. And so I could invest at risk-free at 2%. If I wanted to go out and look at a mortgage loan, then I would expect a mortgage loan to price well above that 2% rate. Today we're at 0.15%. I don't need a mortgage loan to be priced as high because my alternative is so much lower. And so that's really how they provide a benchmark for lower-cost financing in the environments where they want borrowers to be able to, borrow.

Patrick Pacheco: The Fed often does its most public work in times of crisis. So what have they done recently when outside forces threaten the economy?

Tell Alessio: When the 2008 recession happened, the Fed knew that they didn't have enough tools in their toolbox. And so, after 2008, they kind of developed a whole bunch of additional programs for the next crisis. And when COVID came in, they basically pulled that tool book out and said, “Let's create these programs.” There was a pretty significant announcement in March of 2020, from the Fed. They opened up a host of different lending programs for middle market borrowers, for investment grade borrowers so that everyone had access to liquidity. The quantitative easing piece that they increased—their balance sheet was about $2.5 trillion when the COVID crisis happened. We're sitting at $8.5 trillion and they're growing a couple hundred billion every quarter. And so, they really did the unprecedented in the, in, in the response to COVID. I liken the quantitative easing story—If you go back through history a little bit, the first, global economy, or really the first developed economy to work on quantitative easing was the Japanese. They came out with a quantitative easing type of program as did the EU, and they had some moderate success with it, which is why the Fed really used that activity during the 2008 crisis. I think that was an expansive phase for the Fed. And when COVID struck, they took the opportunity to go all in, in that policy. And, it clearly settled markets. It's created an awful lot of money. Supply liquidity is exceptionally cheap and available. I think part of the challenge they have now is how do they kind of rebalance to a more normalized operation?

Patrick Pacheco: so these wheels are turning round and round in Washington, but you own a business in Georgia or Louisiana. So as an entrepreneur, how do you keep up with all of this?

Tell Alessio: Yeah, there's a lot of change, like I said, in our policy behaviors, whether it's tax policy or, or fiscal policy. And I would say one of the most important things is to read. I do, I have, I benefit and I'm blessed with an awful lot of research and I, we get covered by nearly 30 broker dealers. We have five or six economic research pieces that we get daily, if not weekly. And so, I get a lot of, we get a lot of content on my team. We're able to kind of digest. A lot of information, but what's important about that is understanding the perspective that information comes from. You know, government economic releases are generally unbiased. They're just data. There are clearly some calculation methods that people may pick at on how they present data. But in general, that information is unbiased and. And then there's a lot of credible publications that have good stories, but you’ve really got to pay attention to what the bias might be or what the implied intent and how they deliver that content. I find that I read a lot of Bloomberg News, a lot of Financial Times, the Wall Street Journal, and then those independent economic research. And it's helpful to have a variety of opinion. And then to be able to kind of distill down what you think is credible and unbiased.

Patrick Pacheco: So I, I always, I used to tell people, especially 2008, 2009, stop watching the stock shows that are on all day and stop looking at your account every day. How often should business owners be looking at these things? If you look at it every day, it seems like you just you're gonna drive yourself crazy. But yeah, how often is enough, but not so much that you're thinking the world's ending tomorrow every single day?

Tell Alessio: These trends don't change fast. The fundamentals of an economy take time to move. And if you're keeping up with it annually, maybe quarterly, but really annually is often enough, especially if you're a long-term investor, you're looking at a re a retirement plan or something along those lines. Markets, like I said early on, could be kind of fickle. And they're not necessarily, those trends are not, especially the one-off events are not necessarily related to the fundamentals of the economy. And I think if you're looking and you're a measured investor, annually is frequent enough and quarterly is probably easily enough.

Patrick Pacheco: Okay. So we've got, you've given us some good sources to go to. The information on what's happening. So now I read it, so that's great. But it's one thing to read it. It's another thing to understand exactly what it's saying. Bloomberg and the Wall Street Journal and Financial Times, and it's, I've read all this stuff, but how do I interpret it? How do I know what the effect on me is going to be? Are there any resources to help?

Tell Alessio: Yeah, this is a great opportunity to go get coffee with your financial advisor, with your banker. If you can spend 15 to 30 minutes, they usually live and breathe this information like we do, and they can give you some perspective on what you're reading and what you're seeing, and they can really help you interpret what it is that you, what it is that you're consuming. I would say that I do that with my peers, that it's great to read something and understand it and think I have it figured out, but it's always great to bounce it off of somebody else. So I would fully really encourage, especially small business owners—like you said with the talking heads on TV, about the economy there's a lot to consume, but if they can take a few minutes to sit down with their financial advisor and really help that will really help them understand what's material and important.

Patrick Pacheco: Given all of this, how much should economic policy factor into your business? Should it be a daily concern? What's the right balance?

Tell Alessio: So good business model tends to work in almost every environment. And so, I would say that in general, what's important is when you're thinking through your business, don't get overwhelmed by, “This year we've got a 5% tax increase,” but that being said, one policy and change shouldn't drive necessarily how you define how you’re thinking about your business. You should definitely prepare for those things, whether that's when you issue debt. Think about trying to find that in the lower interest rate environments, but what's important about that is making sure that you are looking at what your risks are for your company and how you can mitigate those with the financial instruments that are available to you. And so I would say worrying about the economy in the context of your business is really more important on a local level than it is on the national level.

Patrick Pacheco: How about business life cycle? is there a difference depending on where you are in the lifecycle of your business, if you're “thinking about starting a business” versus “just started it and I'm looking for funding” versus “I'm in the blowing and going and growth stage”, or “I'm getting ready to sell” is there any time where it's more important to, to look or less?

Tell Alessio: Yeah, I would say that this past year, for example, we've had, there's a lot of transactions in the market because valuations are really high because of all the money supply we have. And those values, those high valuations, coupled with the expectation that taxes are going to increase. Have resulted in a lot of business owners taking the opportunity to sell out or to exit, and to capitalize on the investment that they've made. So I would say that in selling your business, probably timing's more critical because you're looking at a single point in time. when you're starting your business, I think it's less important as long as you have, like, I was talking about a local economy, as long as you have the labor market that you need and you've got not too much headwind on your commodity goods and those kinds of things. I think then you're not as sensitive to it as you are when you're selling the business in the end.

Patrick Pacheco: Tell can quote you endless statistics, but as they say, “There's liars, damn liars and statisticians.” I wanted to get his honest opinion as someone who thinks about the economy all the time. Let me just ask you about you personally. How are you feeling about the economy when you wake up in the morning and you drink your cup of coffee? And I know the first thing you think about is “How's the economy today and how's it affect Cadence Bank and Tell Alessio.” When you have that conversation, what are you telling yourself?

Tell Alessio: So I actually feel pretty good about it. And, I'm not, I'm not ignorant to some of the challenge that we have, especially related to COVID. But I think about where we were before COVID hit and I'm a true believer in kind of longer-term trends, and I think we were headed in the right direction. And I think that once we get through this kind of dip, whether you consider the dip, the labor, participation issue or the supply chain disruption we've had, once those things kind of flushed through on a temporary basis, I think we're really going to be in a pretty solid footing. Especially the amount of fiscal and monetary support that's been brought to bear. And I can say from Cadence Bank's perspective, there's a lot of opportunity out there. Like I said, liquidity is so available. Capital levels are so high that it's just a recipe for a lot of growth on the back end of this COVID experience.

Patrick Pacheco: The economy can seem overwhelming, but it doesn't have to be. Just understanding a few of the key mechanisms in place can help you come to your own conclusions and help you make the decisions that will be best for your business. And like Tell said, you don't have to do it alone. Talk to your banker or your financial advisor. They're getting information all the time and can break down what it means for you. We started this episode off by saying, “It's the economy, stupid.” We'd like to seal it with a KISS. That's “Keep it simple, stupid.” I'd like to thank Tell Alessio, Treasurer at Cadence Bank. One of the nicest, smartest people I work with here, and that's really saying something.

Tell Alessio: It was my pleasure. Thanks, Patrick. It's always a pleasure talking to you.

Patrick Pacheco: It's not always a pressure Tell. Come on. When I'm asking for more interest rate credit, it's not that much of a pleasure. *In Good Companies* is a podcast from Cadence Bank member, FDIC equal opportunity lender. Sheena Cochran is our production coordinator, our executive producer is, Danielle Kernell with the writing and production from Andrew Ganem and sound design and mixing by Alex Bennett at Lower Street media.I am your host, Patrick Pacheco. If you've made it this far, and you got something out of the episode, why don't you go out and give us a five-star rating in your podcast app? It's the best thing you can do to help the show grow and reach more people and join us next week, because when you're with us, we're *In Good Companies*.

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