For 40 years, policy makers inhabited a dismal world which believed that faster economic growth was bad and a higher unemployment rate was good. These notions, which stem from the view that rapid economic growth causes inflation, spawned a mind-set in which every boom was seen as a bubble in the making -- the current boom included. But the evidence that I see does not suggest a bubble; rather, it indicates that we have at last arrived in a new-era economy, one in which information technologies and sound money fuel long-term, noninflationary growth.

It has taken too many years for the market to understand Milton Friedman's insistence that inflation is a monetary phenomenon. Simply put, Mr. Friedman said that inflation was a result of too much money chasing too few goods. It is only when a central bank pursues higher economic growth through currency depreciation that we end up with inflation. In contrast, when rapid economic growth emanates from confidence in the stability of money, less government regulation, and lower marginal tax rates on economic gains, then faster growth actually helps to reduce inflation because it results in more goods to be chased by the same amount of money. Stock market investors have now come to realize that our economy can grow at a 3% to 4% rate while inflation approaches zero, and thus that there should be no reason for the Federal Reserve to raise interest rates. Indeed, the economy appears vibrant enough to expand well into the future, notwithstanding recent setbacks in Asia, Russia and Brazil.

But investors do face risks. First, there is the risk of being in the market if economic policy, and consequently economic performance, were to deteriorate. Second, bears may yet scare too many investors out of a very good market. So far, the bears have missed the 135% rise in the Dow Jones Industrial Average over the last four years; they may yet miss the next 135% rise.

The bear-market case rests largely on the assumption that we are repeating the bubble-crash scenario of New York in 1929 and Tokyo in 199. But market bubbles have more to do with the fickleness of economic policy than with that of investors. The Great Depression lasted as long as it did because of a deflationary monetary policy followed by protectionist tariffs and a New Deal that stifled normal market-based recovery patterns. The same holds true for Japan's economic woes today.

The bull-market case, by contrast, rests firmly on the belief that sound money is here to stay and that it has helped create a new-era economy in which high-tech industries make earnings gains that justify ever-higher valuations. This new era had its origins in October 1979 when the Federal Reserve began moving toward a policy of sound money, but did not become a reality until as late as 1994, when marketing strategists no longer factored pricing power into their calculations, prompting inflation to fall to a near-zero rate.

Besides abandoning pricing power, the new-era economy is undergirded by a managerial focus on enhancing shareholder value by cutting costs, an approach made possible by information-age technologies. As the power of these technologies makes itself felt, capital goods become much more flexible substitutes for labor. The increase in capital-goods productivity increases capital-goods investment and augments labor productivity. The economy can therefore grow much faster while cost cutting makes price stability the norm.

But the new-era economy cannot really fly so long as monetary-policy makers cling to the notion of a speed limit on growth. If the Fed attempted
to hold economic growth to some estimate of the employment rate, then new-
technology capital-goods investments would be limited and inflation would rise.

What is the evidence that we are now living in a new-era economy? Five characteristics -- markedly at variance with previous patterns -- stand out:

1. A much faster sustainable growth rate than previously expected. It is now apparent that in 1998 we completed the third consecutive year of 4% growth, and there is good reason to believe that this rate will last through 2000. Faster economic growth has brought faster profit growth -- profits have risen as a proportion of gross domestic product to 10% from a low point of 5.5% in the early 1990s -- which adds immensely to shareholder value.

2. A decline in inflation to near zero. Business attention to cost cutting means that price-level stability may require the Fed to be as alert to deflation as it is to inflation.

3. Longer economic expansions, with the economy in recession a much smaller proportion of the time. For workers, this means a much better job market even while more companies feel free to downsize their work forces.

4. Unemployment rates trending lower. New-technology capital enhances labor productivity, pulling wage rates higher, and at the same time provides substitution of capital for labor so that labor markets never become as tight as suggested by the unemployment rate.

5. Tax receipts that rise faster than projections. This means widespread and sustained budget surpluses at the federal, state and local levels.

Everyone should love this new-era economy. And as long as the Fed focuses its attention on the price level rather than on economic growth and unemployment rates, the new era will continue.

The results are apt to be so awesome that the Fed should face little political pressure to change course. That does not mean a continued drop in interest rates; it means instead that higher or lower interest rates will be consistent with rapid growth and low inflation.

Yet the new-era economy could easily come undone. Protectionist sentiment turned into legislation would certainly be the death knell of this bull market. Then there is the risk to the high-tech entrepreneurial economy posed by the Justice Department's case against Microsoft. However these developments play out, the price of gold will provide an early warning signal if there is an unacceptable risk of either deflation or inflation.

In the meantime, reform that shifted the tax burden away from savings and toward consumer spending could improve the current rate of economic growth. Providing an unlimited and universal Roth IRA is one way to boost the returns to saving, enhance investment and productivity growth, and reduce the trade deficit. Freeing investment income from taxation would lower the cost of capital, increase labor productivity and provide for a significant rise in the wages of workers. For now, however, we may be too busy savoring the fruits of this new-era economy to do very much to bring on the next.

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