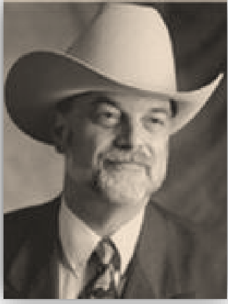

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The stock market, as represented by the S&P 500 Stock Index, broke its three-week series of rises to decline to 4166.46, down 1.91% for the week but still up 10.92% year-to-date. Credit for its retreat from record-setting weekly closes was attributed to Jerome Powell, Chairman of the Federal Reserve. He stated rather clearly that the Fed would at some point do what everyone knew they would do, taper down the bond purchases that have kept interest rates artificially low and, sometime in 2023 likely begin gradually increasing short-term rates above zero. His press conference was on Wednesday, but it took until Friday for stock traders to react. The Wall Street Journal reported that the word on the street was that traders were pulling back out of fear that the Fed was likely to control inflation before it got out of hand. Note that the last pullback we had in the market, almost exactly one month ago, was reportedly out of fear that inflation was about to get out of control and the Fed might be asleep at the switch. If a bull market climbs a wall of worry, then this pullback looks like good news. The CRSP Mid-Cap Value Index dropped a whopping 5.11% as some of the "recovery trade" money bolted for the hills but remained up over 15% year-to-date. Part of the market angst was also reported to stem from the staggering losses in stocks like Tesla and other recent hot issues as well as even more dramatic losses in Bitcoin and other cryptocurrencies.

The Yield on the 10-year U.S. Treasury note fell to 1.437% after having risen to over 1.6% before the Fed announcement as the bond market continued to signal that it considered long-term inflation not something to be concerned about. The real yield on the 10-year note (nominal yield minus expected inflation) rose again for the week, suggesting the bond market thinks future economic growth will be strong. Seconding that opinion, the price of West Texas Intermediate crude oil turned in its fourth consecutive week of gains, rising to $71.55 per barrel.

The Economy

The headline economic news for the week was mostly centered around the press conference held by Federal Reserve Chair, Jerome Powell. Prognosticators had been operating under the assumption that the Fed would leave short-term interest rates at near zero through 2023 and the news that loans and deposits might be charged or pay a small interest fee, had some reeling. Companies surviving on near zero interest loans pending the perhaps future date when they might earn a profit were the first to feel the impact. The announcement that the Fed was "thinking about thinking about" when to taper the bond purchases that have kept longer term interest rates low and charge banks interest to borrow marked the beginning of a return to normal monetary policy, a process that will likely take years.

For those who have not been following this drama closely, the roaring recovery from 2020's pandemic-induced economic and market slump has been fueled by two prime sources. First, the three stimulus programs, two in 2020 and another this year, have boosted the spending power of both consumers and small businesses but the effects of those programs are now winding down. Yes, we Americans still have record levels of savings, but the inflow from the government is over. The second source of fuel was the flooding of the monetary system with cash, forcing commercial borrowing interest rates down to record lows. First corporate earnings soared, driving the stock market higher as well-above expected profits became the norm and small and large investors found themselves with an abundance of money to buy stocks. Meanwhile the yield on bonds has remained far below projected inflation. The

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results in our economy were not unlike a critically ill patient being given steroids and glucose. The U.S. economy is not well yet though. We still need to hire about seven or eight million people to get back fully on our feet, but the Fed is of the opinion that will happen before the end of 2022. Thus, so the reasoning goes, it is time to talk about considering starting to take the patient off life support.

The current vital signs suggest that may be good. The Federal Reserve announced on the 15th that U.S. manufacturing production increased 0.9% in May, at 10.8% annualized rate, an excellent number that would have been a lot bigger if we had enough computer chips to build all the cars and trucks on backorder. The median estimate of 2021 gross domestic product (GDP) growth from Federal Reserve Board members is now 7% while Moody's is now estimating second quarter GDP to be at an annualized rate of 10.5%. Note that inflation for 2021, now estimated at around 3.4%, has been subtracted from those GDP numbers. Real, after inflation, business investment is tracking at about 16% per year. Retail sales are up at an annualized rate of 33% over the last three months.

In short, we are in a booming recovery with the bond market anticipating about 2.36% annual inflation over the next ten years and an annual GDP for the near future running at the highest level since Ronald Reagan was president. The market is fully priced for this economy, so don't expect further double-digit gains in the near future but do be prepared for wobbles and a possible correction as we work our way through this most unusual economic recovery.

Until next week we remain steadfastly determined to provide the best service, financial advice, and portfolio management to you, our clients, and sole employers!

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