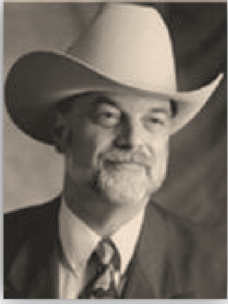

THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

We wrote, way back in June, that, in our experience, bear markets do not end until the last vestiges of optimism have been wiped away, the news media is saturated with negativity, and there has been what market veterans refer to as "capitulation," as the last short-term investors bolt for the door. We also noted that none of those things had happened as the stock market hit a low point back then and then started to climb. In this case, we hate to have been right, but we were. The S&P 500 Stock Index (SPX) fell 4.65% for the week as it found its way to a new low for 2022, around 3647.83 on Friday at about 3:00 PM before inching back up to 3693.23 to end the day. That close leaves it down 22.95% from its high in early January but still up less than 1% from the bottom it hit in June. It remains up over 65% from its low in March of 2020, and up a still impressive 31% from this point three years ago. The CRSP Mid-Cap Value Index, not to be out slumped by its bigger cousin, fell 5.36% for the week to 2171.39 and is now down 16.4% from its January high and 11.57% from last year at this time.

The move in the stock market was dwarfed by, and conceivably caused by, the yield increase in the U.S. 10-year Treasury note as it climbed to 3.69%. Considering that the 10-year note yield was 1.45% a year ago, that is a huge 154% increase in interest rates in only one year. With the 2-year Treasury note yielding 4.2%, its highest yield in over 15 years, the Treasury yield-curve is now even more inverted than it has been, raising its recession warning flag even higher. Amplifying the economic slowdown signs ever further, the price for a barrel of West Texas Intermediate crude oil (WTI) slid over 7% to below $80 and was at $79.16 as the week ended, leaving it only 7% higher than it was last year at this time.

The Economy

As usual, there were a lot of economic news stories this week, but they were background noise when compared with Chairman Jerome Powel's post Federal Reserve Board press conference. In it he once more emphasized that the Fed was going to raise interest rates until it was convinced that high inflation was "behind us" and that he "wished there were a painless way to do that" but "there isn't." He also repeated that he hoped for a "soft landing" but that he did not know whether the interest rate increases would generate a recession or how severe it would be. Other Federal Reserve officials projected short-term rates, which now are at 3% to 3.25%, would rise as high as 4.4% by the end of the year and probably peak at 4.6% in 2023.

Federal Reserve members are projecting that core inflation will fall to 4.5% by the end of the year, leaving the Fed's short-term rates still perceived as "stimulative" as they likely will still be lower than trailing one-year inflation. From there officials are projecting that inflation will fall to 3.1% in 2023 and 2.3% in 2024 before falling to just above 2% in 2025. With Fed rates as high as 4.6% in 2023, if inflation is down to between 3.1% and 2.3%, interest rates should finally be higher than inflation and slow economic growth, which is the goal in the Federal Reserve's policy. Along the way, those same Fed officials warned that they expect unemployment to rise from its current near-record low of 3.7% to around 4.4%.

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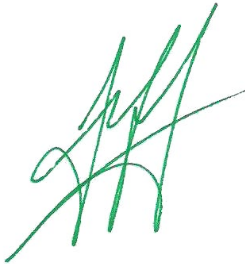
At about the same time as all this was happening the Conference Board, the generally accepted arbitrator of when and if we are in a recession (usually well after the fact) published its Index of Leading Economic Indicators (LEI). The LEI has now been falling for six consecutive months, dropping 0.3% in August. The commentary included the sentence, "Economic activity will continue slowing more broadly throughout the U.S. economy and is likely to contract." as the LEI declined past the point it refers to as a "recession signal."

Then came the mixed signal. The Labor Department published a "good-news" release that the market immediately saw as "bad news" because it indicates the economy is still charging ahead at near full throttle. New unemployment claims for the week ending on September 17 were only 213,000. Moody's economics suggests a weekly number of 285,000 would indicate that job growth has leveled off to only accommodate new entries into the labor market and thereby cease to drive employment costs upward. The concern is that with job growth still on a tear, the Fed may have to drive us into a recession to slow price increases.

Our key takeaway from all that data and projections was that a 4.6% short-term rate in 2023 sounds quite benign. In an economic environment where trailing one-year inflation was recently around 9%, a Fed rate of half that much seems anything but extreme. We remain of the opinion that barring some external economic shock any recession generated because of higher interest rates will be modest, but as Niels Bohr reportedly said, "Prediction is very difficult, especially if it's about the future."

Until next week, as always, we remain hard at work individually designing, monitoring, and researching fiduciary investment portfolios for you, our clients and our sole employers, as well as striving to provide the best investment advice and service humanly possible.



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