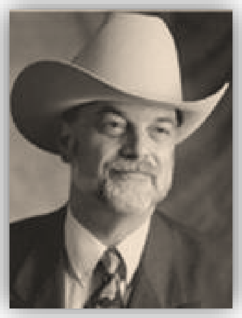

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Jeffrey W McClure CFP® *Jacob A McClure* CIMA®

PO Box 1029 / 918 N. Main Street
Salado, TX 76571

(254) 947-1111
(800) 914-7526

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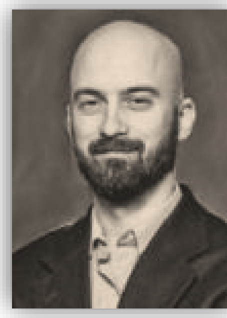

jeff@tpwc.com

jake@tpwc.com

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) for the week ending on the 14th declined 1.55% to close at 3583.07. That leaves the SPX down 25.24% from its high in early January, and about 20% lower than at this time last year. On the other hand, it is also over 60% higher than it was in March of 2020 and 21% higher than it was three years ago. Whether the market is up or down depends entirely on your time frame. Our other index, the CRSP Mid-Cap Value Index fell 0.29% to close at 2117.73 and is now down 18.46% this year. Once again, reading the headlines a person could easily have imagined that there was a market crash Thursday morning, followed by a major bull market surge on that same day. The reality though was that not much changed. The stock market seems to have priced in the economic drag caused by an anticipated 0.75% interest rate increase at the Fed meeting in November and further rises after that taking short term rates to the upper 4% range.

Reflecting the fact that interest rates are driving the train in market actions, the yield on the 10-year U.S. Treasury note surged past the 4% line three times in the week before finally stabilizing at 4.025%. Unfortunately, the 2-year yield rose to 4.48% leaving the Treasury yield curve still quite inverted and warning of a recession, probably next year. Much of the volatility in bond yields and prices, which move inversely to the yield, was the amazingly volatile and dysfunctional pricing of bonds (gilts) in the United Kingdom as the government there faces a major recession while inflation is in the double digits. Meanwhile the price per barrel of West Texas Intermediate crude oil (WTI) fell slowly and steadily over 8% to $85.61 despite threats by Russia and Saudi Arabia to cut oil production.

The Economy

The Labor Department issued its monthly report on September's Consumer Price Index (CPI) mid-week and as expected, it was not a pretty picture. First the top-line 12-month trailing CPI came in at 8.2%. Dropping down to the "core" inflation numbers, which are more stable, the CPI rose 6.6% over the last year. We tend to focus on the core CPI as it changed over the past couple of months, and there the increase was about 0.4% per month which equates to an annual inflation rate of about 5%. Since the Fed wants inflation (price increases) to be reduced to about 2%, that means they have a long way to go.

We have addressed this before, but the immutable law of supply and demand states that when demand exceeds supply, prices will rise. It takes years to increase supply in an economy as large and diverse as ours, so if we want the price increases to slow down, we need to reduce demand. The primary source of demand in our economy is consumer spending. With wages rising at 5% per year, it should not come as much of a surprise when the cost of goods and services are also rising at about the same rate. Why are wages rising at 5%? Well, companies are expanding and want to hire more workers than we have in the jobs market. Since the demand for workers is higher than the supply, the price, expressed as wages, rises. The Fed's job then is to reduce the demand for workers and that means slowing the growth of the companies that are doing the hiring. Expanding companies tend to borrow money to pay for the expansions. Higher interest rates on borrowed money should slow things down.

The complication is that there is a lot of momentum in our economy. It typically takes six to eighteen months for an increase in interest rates to show up as slowed corporate expansion. So, the big question is, "How far will the Fed need to raise interest rates to slow things down and will they raise them too far, and bring the economy to a screeching halt?" Trying to guess what rate will slow demand without crashing the economy is as much art as it is science. The bright side to this is that the last time we had inflation this high, back in the early '80s, Chairman Volker fully intended to create a recession, and we got one. This time around, the members of the Federal Reserve Board are making it quite clear that they do not see a need for nor want a recession, but we might get one anyway.

Economists surveyed by Bloomberg put the odds of a recession in 2023 at 60% but there is good news to be found in the consensus of those economists. They also believe any recession we get will be relatively mild. There is more good news to be found in the fact that the stock market appears to have already priced in a mild to moderate 2023 recession. Since the traders who move the markets already were expecting a high inflation report and for the Fed to raise interest rates 0.75% in November to about 4%, with smaller increases thereafter and topping at about 4.75%, the CPI news this week resulted in very little change.

Despite all the hysteria, we remain optimistic for the longer term. As we have written before, the rest of the world wishes they had our problems of too many jobs, too much income, and an economy running too fast.

Until next week, we are here for you and hard at work at our fiduciary duties, providing the best possible service, finding the best investments and individually designed portfolios for you and your unique situation and always ready with unbiased fiduciary advice for you when you need it.

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