THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

Our dear old Index, the S&P 500 (SPX), turned in another excellent week, soaring 1.45% to close at 5634.61, leaving it up an astonishing 18.13% this year, 27% from a year ago and about 26% from three years ago. Our other watched index, the CRSP US Mid Cap Value Index, was even more jubilant, rising 2.46% for the week to 2805.84 and is now about 12% higher this year and up over 19% from this time last year.

On the other side of the market, the benchmark 10-year U.S. Treasury note closed, yielding 3.81%, while the 30-year bond was paying 4.10%, and the 1-month T-bill held steady with an annualized interest rate of 5.51%. From the 2-year maturity at 3.90% to the 30-year bond at 4.10%, the yield curve is now positively sloped for the first time in two years. West Texas Intermediate crude oil (WTI) settled down to $74.91 per barrel after a threatening climb toward $80 earlier in the month.

The Economy

In the background, well behind the headlines about political candidates and soaring stock markets, some critical things have been happening. At the Kansas City Federal Reserve Bank's annual symposium (a big event for economists), Fed Chairman Jay Powell stated, "The time has come for policy to adjust," which means lower short-term rates are at hand. In context, he suggested that the Fed will begin decreasing its benchmark Fed Funds Rate downward from its current 23-year high of 5.25-5.5 percent in its mid-September meeting. He also warned that while the direction of short-term rate moves was clear, the frequency and degree of the reductions would be data dependent. Lower interest rates on short-term loans are generally considered to increase the profitability of publicly traded companies, so there was rejoicing on Wall Street.

Behind the headline though, something quite different was happening. The Bank of England and the European Central Bank have lowered short-term rates by a quarter percent. Thus, global interest rates might decline, but that may not be the case. Beyond the very short-term rates lie the longer-term interest rates from which loans for automobiles, mortgages, and industrial equipment are set. Those rates are strongly affected by rates on longer-term Treasury securities, with the ten-year note being the benchmark. As the world's largest holders of intermediate-term government securities, the Federal Reserve and other G-7 countries' central banks' buying or selling in the open government securities markets are the foundation for those rates. During the pandemic and the recession that followed, the Fed and other central banks purchased vast amounts of U.S. government bills, notes, and bonds. The Fed reports having about $4.4 trillion worth of those securities plus about $2.3 trillion worth of mortgage-backed securities and other bonds totaling $7.1 trillion, making it the 800-pound gorilla in the bond market. For comparison, according to Statista, China holds a total of about $771 billion, and Japan holds about $1.2 trillion in U.S. government debt.

That was factual background; now for the real news: According to Bloomberg, the U.S. Fed, the Bank of Japan, the Bank of England, the EU Central Bank, and others are all quietly moving to "shrink their balance sheets." During the pandemic and afterward, when economies were in danger of a serious contraction, those banks bought bonds on the open market, lowering longer-term interest rates and flushing dollars into the global economy. When things had

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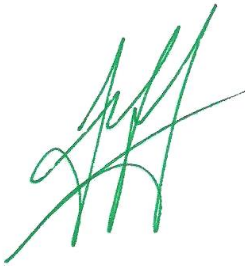
stabilized, those same central banks began to sell longer-term bonds back into the market. The Fed began to sell in late 2022, causing mid-to-long term rates to rise, but recently, the last holdout, the Bank of Japan, joined the selling process. That selling of bonds does the opposite of buying bonds, it pulls cash out of circulation. The net result? Yes, the Fed will almost certainly be reducing short-term rates gradually, beginning in mid-September, but at the same time, it and the other central banks will be selling government and government-backed longer-term holdings, effectively raising longer-term rates. If so, expect the yield curve to finally return to a positive slope with short-term rates lower and longer-term rates higher. That shift in the yield curve may be bullish for stocks but not for bonds.

In the domestic economy, Target (TGT) reported a 3% increase in same-store sales in the last quarter, following Walmart (WMT) reporting an increase of about 5%, suggesting the American consumer is still charging ahead and both companies forecast rising sales for the rest of the year. That elusive and much-forecasted recession is getting harder and harder to locate. U.S. economic growth still appears to be moderating to a sustainable rate and has plenty of steam left.

Until next week, be assured that we are working hard at our mission of providing the best possible service, fiduciary advice and portfolio management.

Your obedient servants,



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