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**Are We At An Inflection Point for the Economy and Markets?**

Finally, we seem to be coming out of the rainy, cold season into warmer weather here in not so sunny southern California. Hopefully, all the rain and snow we have had, while a blessing in terms of a super bloom of flowers, will not result in mud slides and other debacles to the physical infrastructure of the state. We have enough problems with potholes and repair crews blocking streets.

Ultimately, it is the production, if not the future prospect, of earnings gains that drives the stock market up or down. Analysts and other market participants review in detail individual company situations and the economic environments they operate in to come to conclusions about sales and earnings prospects. Put these reviews together across all publicly traded securities and you have a broad market outlook.

Right now, we are at the beginning of sales and earnings reports by publicly traded companies for the first quarter of 2023. Analysts have been more pessimistic than usual in their first quarter outlooks largely due to concerns about the impact of the Federal Reserve’s rate hikes and the possibility of a recession in the next six to nine months.

In my opinion their concerns are not un-warranted, but they may be overdone. Clearly, we are beginning to see the effects of the interest rate increases in in broad sectors of the economy. Home prices have declined for nine straight months and existing home sales declined in March. New home building permits rose but multi-family housing permits are tanking. Manufacturing has been in contraction for five months and retail sales in March declined 1% more than the 0.4% decline analysts expected. Employment strength continues to surprise with almost 1.7 job openings for every unemployed person. Debt levels on a per capita basis remain near historic lows and debt payments as a percentage of disposable income remains near long-term lows. Long-term treasury interest rates with maturities of 5 years or more continue to remain well below 4% indicating that the bond market believes inflation is a short-term issue.

With fixed rate mortgages floating between 6% and 7% and unemployment near 3.5%, the private sector is in decent shape to weather any storm should it appear. Given this environment, it is hard to imagine a scenario where a severe recession occurs with 7-8% unemployment and interest rates approaching 9-10%. I believe the Federal Reserve has one more 0.25% rate hike that it may elect to implement during the rest of this year. After that it will pause for a long time. That will be a positive signal to the investment community. Considering that the S&P 500 index is up 15.5% since its October 13, 2022 low, I believe the financial markets agree as well.

Even if a recession occurs (e.g., about a 30% chance at this point), I believe it will be mild and is likely already priced into the stock and bond markets. Funds oriented to long-term should remain invested at risk appropriate levels. The stock market in particular is well positioned to continue its rise even if a mild recession were to appear.

Attached you will find a piece by Brad McMillan, Commonwealths’ Chief Investment Officer. In it you will find some interesting analysis that supports the thesis that the analysts predicting sales and earnings declines from the first quarter are over-pessimistic. Assuming that is the case it may reflect that we are at the beginning of economic recovery and a return to positive stock market returns.

I am always available to you via phone, zoom conference or in person. I look forward to talking with you over the next few weeks. If you have any questions or if we can be of any help, please do not hesitate to contact Linda or me.

*Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

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