Email Body 6/9/2023

**The Economy, the Markets, the Federal Reserve and the Road Ahead – Part 2**

It looks like I got ahead of myself in stating in my last note to you that summer had arrived. Clouds, clouds, and more clouds combined with chilly air sure gives the impression that winter does not want to let go. Hopefully, summer is just delayed and will arrive shortly. Interesting things have happened in the last month, but nothing so substantial that my base case for a positive market outlook is changed.

Technically, this past week we have entered a new bull market phase with the major market indexes sustaining more than 20% gains from the market lows in October 2022. The bad news is that much of that gain was generated by seven large tech companies creating what some call a “skinny” bull market. That leaves this bull market’s gains susceptible to Federal Reserve Bank shenanigans if they should decide to resume raising interest rates which tech stocks hate. The good news is that as long as the economy continues to expand, that may encourage the rest of the stocks in the market indexes to “catch up” creating a more broad-based advance.

Currently, the Fed Funds futures markets place the odds of the Fed standing pat next week and not raising interest rates another 0.25% at 73%. Fed watchers have been tracking the various Fed Governors’ speeches in the last few weeks and have noted mostly dovish comments indicating a majority favor a pause to gauge the effect of the fastest interest rate increase regime in modern history. While the decline in inflation from recent reports has slowed, I do not think there is enough data out yet to justify an increase in interest rates. Accordingly, I am in the stand pat camp.

Recent fiscal and economic news is relatively mixed leaving us in that famous Goldilocks not-to-hot, not-to-cold environment. Fortunately, Congress and the administration were able to kick the debt ceiling dilemma down the road which has positive and negative points. Positive in that an immediate crisis of confidence is avoided, negative in that it gives the Federal Reserve room to raise interest rates if it feels the need.

Unemployment remains low and jobs growth is surprisingly strong. The services side of the economy continues to remain in expansion territory but is trending down. Manufacturing reported its eighth straight month in contraction while real estate activity seems to have bottomed out and is trending up. The treasury yield curve remains inverted (i.e., short-term rates higher than long-term rates) for the eighth consecutive month (i.e., a recession indicator). Consumer sentiment and spending remain in slightly positive territory. Business surveys indicate a positive but cautious outlook going forward. Market valuations are at or very near long-term averages.

What the future holds, no one can be sure of. That being said, I believe the market lows in October of 2022 are likely the lows for this cycle. I also believe that absent a surprise resurgence of inflation, the Federal Reserve is mostly done raising interest rates but will continue its policy of reducing its bond portfolio by $95B a month. While a general recession as it is usually defined is possible, it is not likely in the near future. Historically, the markets have an upward bias over time, and I expect this trend to continue over the coming months.

Brad McMillan, Commonwealths’ Chief Investment Officer has a video presentation in which he provides his thoughts about the markets for June. It is about four minutes so if you have the time, I encourage you to watch it to see another perspective. See <https://player.vimeo.com/video/832380887>.

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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