Email Body 7-21-2021

**Economic Recovery is Still on Track, But Inflation is Becoming a Concern**

I am finally fully back from a seventeen-day trip to Alaska. We visited five national parks, hiked over fifty-five miles (including three miles on a glacier), stayed in thirteen different lodgings, took twelve different flights (the float planes were awesome) and saw an amazing number of animals and scenery. While the vastness and serenity were wonderous to experience, I also could not ignore the raw power of nature and the danger that is ever present for the unprepared. The same can be said with todays economic and market environments. It has been nice to watch the economy and the real estate/stock markets recover losses and move forward over the last year, but we may be setting the stage for future turbulence. The boy scout motto, “be prepared” is the best advice anyone can give today.

Going forward I will continue to track Covid statistics for as long as the CDC, the California State Department of Health and San Diego County continues to release data. Given the ***currently*** declining nature of the importance of Covid with respect to economic outcomes, I anticipate eventually eliminating all Covid discussion later this year. While certain government actors and media outlets try to whip up fear about the “delta variant”, the reality is that while it is more virulent, it is also resulting is less hospitalization and death then its other virus cousins. In terms of Covid policy, outcomes (i.e., hospitalizations and deaths) should be the determinants rather than case levels. Currently, in California and San Diego County, Covid hospitalizations are at about 11% of the January 2021 peak. Nationally, we are at about 17% of the January peak. Already, I am seeing at both the State and National level, the rate of hospitalizations to cases beginning to decline. My sense is that government handwringing and media buzz about the delta variant are likely more about convincing people to inoculate than to drive one-size fits all policy prescriptions. While local government subdivisions (i.e., counties and States) may implement some Covid mandates (e.g., Los Angeles County) based on their local situation, I do not anticipate any major actions that will broadly stymie the economy.

From my perspective the biggest news over the past few weeks is the continued rise of inflation as measured by the consumer and producer price indices. Annualized June figures released last week came in at 5.4% and 7.3%, respectively. Both figures were above analyst estimates and surprised markets. Combine with “delta variant” headlines and you have a perfect recipe for volatility. When I drilled down on these numbers the only thing that was concerning was that 60% of the increase was due to the service sector. Given that labor costs are the biggest input component of the service sector, I suspect the wage growth this area is experiencing is going to cause inflation to be a little stickier than the Federal Reserve expects. While we have experienced officially measured inflation in the 0%-2% range in the past ten years, I suspect going forward we are more likely to see inflation land in the 2%-4% range for a few years.

The Federal Reserve’s stated mission is to achieve price stability and full employment. To do that it uses its control over short-term interest rates and money creation to impact the economic environment. Currently, the Fed is maintaining near zero short-term interest rates and is printing money to buy U.S. bonds at the rate of $120 billion per month. This all in an effort to drive unemployment down and support asset prices (i.e., real estate, stock market, commodities, and crypto currency). The cost of doing this is that eventually the dollar will decline in value relative to other currencies as inflation expectations become imbedded in market psychology. Considering that the dollar is the world’s reserve currency, The Federal Reserve cannot allow the dollar to slide too far. The result will be that the Fed will have to begin raising rates and reducing/eliminating bond purchases. The problem is that they may have to do this sooner than their stated plan of raising rates in 2023. Of course, this would negatively affect all asset markets to differing degrees.

Since no one knows when the markets will break, to what degree they will break and for how long it will go on, it is important to be prepared for this eventuality. Investment strategy should be based on a portfolio’s objectives, ability to tolerate volatility and its investment time horizon. Assets you intend to utilize or spend in the near-term (i.e., 1-3 years) should be exposed to less risk depending on your specific situation. Assets that can remain invested over a longer time frame (i.e., 4-5 years) should stay the course and remain invested consistent with your investment goals and risk profile. Successful investing is not about timing the market. Its about being able to ride through the inevitable volatility that creates the opportunity for outsized 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.

As always, stay safe and healthy!

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