Email Body 8-2-2022

**Recession, A Question of When and How Deep, Not If.**

My recently retired (though still busy) wife and I returned from Alaska last week. It is amazingly beautiful and still wild in most of the state. Combined we hiked over one hundred (100) miles and saw bears, moose, deer, porcupines, sea otters and eagles. Pictures will be up on our website in the next couple of weeks. This trip confirmed my conclusion from last years’ blast through Alaska that float planes are the way to go (e.g., sorry cruisers). The real Alaska beyond the port stops is truly an experience worth exploring.

THE ECONOMY

While I was up north the last two weeks, second quarter GDP data was released indicating that the U.S. economy contracted by 0.9%, annualized. Immediately, some pundits pounced and declared a recession was in full swing while others (including the current administration) are withholding determination until more data is reviewed. Regardless, whether we are in a recession or not is irrelevant. The more pressing issue is what direction the economy is going in and how far will it go down that path.

Clearly, for a variety of reasons the U.S. economy as measured by GDP has contracted (e.g., 1.3%, annualized) over the last six months. Combine that with a Federal Reserve raising interest rates and a recession is inevitable if not now, then soon. The good news is that there are many factors that point to a base case of a mild recession (i.e., as compared to the financial crisis in 2008). Consumers are still spending, employers are still hiring, consumer and private sector companies balance sheets are exhibiting relatively higher cash levels and lower debt, banks are in excellent shape and stock market valuations are at or below 25-year averages.

The main risk in the near term is whether inflation proves resistant and invites more sharp interest rate hikes from the Federal Reserve. I am beginning to see some softening in the *rates of growth* of consumer spending and production and the housing market is clearly weakening. Commodity prices have pulled back and gasoline prices have fallen as U.S. oil production is back at 2019 levels. Most agriculture and metal prices are lower then where they were at the start of the year.

The S&P 500 Index is up 8% from its mid-June lows, interest rate spreads on corporate bonds have narrowed (i.e., long-term interest rates are flat to declining which is positive for bond prices) and outflows from the municipal bond market have stopped, indicating a level of confidence in the direction of municipal interest rates. While the bond markets have priced in another full 1.00% rate hike by the end of the year, the recent rally in bonds and stocks seems to indicate that the markets do not believe a severe recession is likely. This view assumes that inflation has or is topping out and will recede and precludes the Federal Reserve from implementing more significant interest rate increases which could cause overall aggregate demand to collapse. I will continue to observe and report what I see as I watch the Federal Reserve try to thread the proverbial needle.

Accordingly, I continue to recommend that for long-term oriented investments, you maintain your current allocation strategies if your risk profiles and time horizons remain long-term (i.e., 4-5 years or more).

Make sure that funds you know you will need in the short-term are safe to relatively safe from volatility and that your long-term oriented investments are well diversified and subject to risk and volatility levels you are able to be comfortable with. If you have any questions or concerns about these things, please call me to discuss them further.

Brad McMillan has weighed in on the recession question in the attachment to this email. He is a little more sanguine on the outlook than I am, but see what you think. Brad is managing principal and chief investment officer at Commonwealth Financial Network®, where he chairs the Investment committee and is the primary spokesperson for the firm’s investment divisions. Check out the attachment to this email.

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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