Email Body 2/28/2023

**The Outlook For 2023**

I hope you are doing well as we move into next month and the onset of “spring” on March 20. Right now, with the colder than usual weather here in San Diego and the rest of the country, it appears Punxsutawney Phil’s prediction of six more weeks of winter this year was spot on. Its sad to say that the financial markets seem to agree. Let’s dig in.

Last month I indicated that all eyes remain on the Federal Reserve and the actions it is taking to address inflation. Specifically, everyone that makes up the markets will continue to review all the economic data available to try to ascertain how the Federal Reserve will react. This necessarily leads to a situation where good news on the economic front is bad news for the markets.

After the Federal Reserve raised the Federal Funds rate a quarter-point at its January meeting, data points came out showing a strong jobs market and rising retail spending by the private sector for January. Both trends point to a positive economic direction which the markets interpreted to mean that the Federal Reserve was likely to continue raising interest rates. To exacerbate the issue, in the following weeks inflation data came out for January indicating that inflation was not falling as much as expected.

I previously indicated that because I believe inflation to be the result of too much money creation during the pandemic, it will prove to be stickier or longer lasting than many expect. Transitory forces such as supply chain logistics and pent-up demand have largely receded. What is needed now is for the Federal Reserve to remove excess money from the economic system. They are doing just that at the rate of $95 billion per month. However, when you consider that the Federal Reserve created $5 trillion in new money between 2020 and 2022, it will take a few years. So, expect inflation to very slowly recede to 2% over the next 3-5 years.

This outlook does not mean that the financial markets cannot have positive returns. Already the bond markets have reacted to the Fed’s rate hikes with the 10-year treasury approaching 5% and the 90-day T-bill already over 5%. If my finance professors were right, those risk-free rates of return should eventually be reflected in investor’s expectations for higher stock market returns. Right now, while we are in the midst of a Federal Reserve rate hike season of unknown length, the markets will continue to be volatile, moving up and down in reaction to the news of the day. Eventually, the Federal Reserve will stop or reverse its rate hikes and the stock market will resume its upward trend bias as a result of those investors higher return expectations.

Attached to this email is a note penned by Brad McMillan, Commonwealth’s Chief Financial Officer. In it he illustrates that over the last six months the stock market, while moving like a roller coaster, has ended up very near where it started. Resilient in the face of rate hikes, price spikes and the war in Ukraine, such is the nature of the beast. Keep in mind that the stock market has an upward bias in the long-term which reflects the long-term growth expectations for our economy. The markets will recover and recoup losses eventually.

Just to remind you, FEMA has declared most of California (including San Diego County) a disaster area. In recognition of that declaration the IRS has automatically extended due dates for all 2022 returns and payments to October 16, 2023. This also includes 2023 estimated tax payments due April 18, June 15, and September 15. Confirm this with your tax preparer and make any adjustments you need to.

I continue to recommend for long-term oriented investments, that 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.

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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