Email Body 4-19-2021

Last week I spent a few days in Oregon with my wife and we hiked the “Trail of Ten Falls” in Silver Falls State Park which is approximately 8.7 miles in length. The waterfalls were amazing, and we even were able to go behind four of them. Spring flowers are also in full bloom and left us feeling rejuvenated. Visiting some of the 700+ wineries in Oregon also did not hurt. We had a lot of good economic news and reasonably good medical news over the last week that positively impacted the financial markets. We will explore that news along with the concerns I have and am tracking. I encourage you to get out and enjoy the weather. Get some sun (great for vitamin D) and enjoy the flowers. Stay safe and be with your family and friends!

Covid-19 conditions continue to improve as vaccinations continue to expand. San Diego County has seen its seven-day average virus case rate fall modestly to its lowest level this year. California also saw its seven-day average virus case rate fall to its lowest level this year. Covid-19 hospitalizations in both San Diego County and California are at their lowest levels since the beginning of the pandemic and are trending lower. Vaccinations combined with those who were previously infected with the virus and recovered appear to be moving us closer to a state of herd immunity. Over 1.74 million San Diego County residents (about 53% of the County population) and 17.0 million California residents (about 42% of the state population) have received at least their first vaccine shot. This represents an 8% increase from seven days ago in the total people in California who have received at least their first vaccine shot. From a medical perspective this is all good news and assuming the trends continue, a positive for the economy and the financial markets.

Economic news last week was mostly positive trending. Weekly initial jobless claims dropped to 576,000 compared to 769,000 last week and economist estimates of 700,000. March retail sales climbed 9.8% compared to forecasts of a 5.8% increase. It also represents second highest level of monthly sales growth ever. Industrial production increased by 1.4% representing a rebound from February’s weather-related decline. Manufacturing output in March also rose by 2.7% representing increased confidence in future orders. March’s home building permits rose by 2.7% and March housing starts soared by 19.4%. Finally, the University of Michigan’s consumer sentiment survey reported an increase from 84.9 in March to 86.5 in April. This is the highest level this indicator has reached since the start of the pandemic. The positive economic trends illustrated here represent good news for the financial markets.

The main concerns I have about the current state of the financial markets are inflation and interest rates. Most people trust that the Federal Reserve and the U.S. Treasury are correct in thinking increases in inflation and interest rates are temporary because of short-term labor shortages and supply chain problems. Additionally, policymakers believe if inflation rises too much, that they have the tools to deal with it. I am not optimistic that this is the case. Consider that real GDP growth is positive, corporate earnings are strong, commodity prices are rising, official unemployment is at 6.0%, down from a peak of 15% and vaccines are becoming widely available. The U.S. output gap-which is a measure of what the economy is producing compared to its potential-is estimated to be $760 billion over the next three years. The new $1.9 trillion Covid relief legislation recently passed is almost three times the output gap. This means we likely have a lot more cash sloshing around the financial system than is necessary meaning inflationary pressures may potentially be more significant than expected. If inflation expectations continue to rise, interest rates will follow suit. Trends often progress further than the consensus expects. If 10-year Treasury yields rise above 2.5% expect market volatility. Historically, Treasury yields above 5.0% are correlated to negative stock market movements. We are a long way from that, but that does not mean the ride will not be bumpy.

Make sure your portfolio strategy is consistent with your cash flow needs. Assets significantly exposed to risk (i.e., the stock market) need at least a four-to-five-year time horizon to remain invested. Assets with a shorter time horizon should be exposed to less risk depending on your specific situation.

There is no commentary by Brad McMillan, Commonwealth’s Chief Investment Officer this week. I will forward anything he puts out to you as soon as possible.

I am always available to you via phone, zoom conference or in person. I encourage you to remain optimistic and to do what you can to contribute to growing the economy. 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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