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**Where Does the Economy Go From Here?**

I have lived in San Diego long enough to know that just because temperatures have dropped a bit in September, it does not mean they cannot rise again later this month and October. Regardless, enjoy the respite. Schools have started back, and the highways are clogged again. Business as usual and pretty much for the economy as well.

I have always held that as long as the economy continues to grow, the financial markets will reflect that fact, eventually if not sooner. Second quarter economic news came in strong and now that second quarter sales and earnings reports are completed, I am happy to report that 79% and 67% of reporting companies exceeded analyst’s earnings and sales estimates. These numbers are in line with past quarter performance reporting and indicates that companies continue to grow sales and profits in this higher interest rate and inflation environment.

Two months into the third quarter the numbers indicate that the lagging effect of the Federal Reserve Bank’s interest rate increase may finally be taking hold. Job growth and consumer confidence is still solid as reflected in increased retail spending. Unemployment has spiked up to 3.8% (e.g., which is still low) because of the addition of over 700,000 new job seekers entering the workforce in August. While expanding the labor pool is always good, it coincides with a small uptick in auto and credit card delinquencies. With higher food and energy prices across the board, people are finding it harder to make those payments.

Based on the information I have seen so far economic growth is starting to slow compared to the first half of the year. However, the economy is still on track to continue growing although at a slower pace. This is good news for inflation concerns, especially considering there was a slight uptick in July/August due to increase energy costs. Core inflation (i.e., excluding food and energy) continues to trend down. Market indices and the bond markets were down in the low single digits in August reflecting investor concern about risks. August is also a traditionally volatile month as a significant number of participants tend to be away on vacations leaving a very thinly traded market where trades that wouldn’t otherwise be noticed, have outsize effects.

Going forward, all eyes are on the Federal Reserve bank. Chairman Powell in his July Jackson Hole conference remarks still held a slightly hawkish tone indicating that the Fed was still open to raising interest rates if the data warranted. The Fed Funds futures market indicates there is a 93% chance the Fed stands pat in its September meeting. November and December futures are sitting at around 44% chance for a 0.25% increase. Assuming economic growth continues to slow and given the futures markets, it appears more likely than not that the Federal Reserve is done raising interest rates. More likely is that the Fed will keep rates in place at this level for awhile until it is satisfied that inflation will not spike back up.

Accordingly, risk taking is more likely to be rewarded than not going forward, especially with respect to long-term oriented investment funds. Risks remain in that inflation could return, the war in Ukraine could escalate and China continues to be a wild card, although less so than earlier in the year. Nothing is ever guaranteed, but the longer you can remain invested, the better your chances for a good result. Hang in there and let’s see together what the future brings.

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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