Email Body 11/4/2022

**What Is Happening and Where Are We At?**

Thanksgiving and Christmas are right around the corner, and I pray that you can give thanks for the blessings you have and are able to handle the inevitable struggles as they appear. Obviously, things have been difficult this year and many are concerned about the future. I am an optimist at heart and believe that just as the sun rises every morning, we will return to prosperity as a country and people, as we always have before. It is in our DNA to continue to strive forward and accomplish our goals. So, maintain a positive outlook and cherish your blessings.

We are now into our ninth month of the Federal Reserve’s (the Fed) quantitative tightening program of raising interest rates and reducing its substantial bond portfolio in a bid to reduce inflation. Unfortunately, since I believe inflation is a result of excessive money printing (i.e., excess money supply in the economy), reducing overall demand will only be partially effective. Inflation will only come into line with expectations when money supply is reduced to an amount appropriate for what the U.S. economy’s needs. Currently, the Fed is liquidating about $95 billion a month of its bond portfolio through both selling into the bond market and maturities. The cash the Fed receives for these sales/maturities is then effectively removed from the economic system. Given that the Fed added $4.8 trillion to its balance sheet since the pandemic started, it will take a little over four years to remove all the money created since March 2020.

The bottom line is that it is going to be awhile before we see 2% inflation, assuming Milton Friedman was correct that inflation is a monetary phenomenon. The good news is that the Fed has indicated it only needs to see inflation trending in the right direction (i.e., down) to consider pausing or stopping its interest rate increases.

In October we saw the equity markets advance on average about 6%. The reason for that optimism was apparently the markets’ belief that inflation was beginning to recede and that a Fed pause in interest rate increases was at hand. The Fed met this week and citing strong labor demand and still too high inflation expectations, it announced another 0.75% increase in the Fed Funds interest rate. The Fed’s post-meeting written statement was modestly dovish indicating that the Open Market Committee thinks slowing rate hikes may be called for soon. However, Jerome Powell, the Federal Reserve Chairman, in his press conference reiterated his commitment to achieve price stability (i.e., low inflation) raising interest rates as far as he must.

All eyes continue to be on the Federal Reserve to gauge its reaction to the November and December inflation reports due out shortly. The financial markets have already priced in about another 1.00% increase in interest rates and maybe even a mild recession. Most economic measures have moderated (housing is tanking) heading in a downward trajectory, but we are not in a standard recessionary pose yet. The financial condition of businesses and consumers is still solid, but in my opinion the labor market is beginning to crack. I predict significant layoffs over the next few months.

Here is why. The Bureau of Labor Statistics (BLS) comes out every month with two measures of employment levels and trends, the establishment survey, and the household survey. The establishment survey samples business payrolls and is subject to various adjustments (i.e., seasonality, estimates for non-respondents, etc.). The household survey samples actual households and is not adjusted at all. Since March 2022, the establishment survey has indicated that over 2.5 million jobs have been created. The household survey puts that number at 150 thousand. Interestingly, the only time gaps between the establishment and household surveys of this magnitude have occurred in recent history were in the Presidential election years of 2012 and 2016. I trust the household survey because its growth matches the change in total employment figures from March to now.

Coincidentally, the October unemployment rate rose for the first time in months to 3.7%. If my judgment that we will begin seeing more layoffs soon is correct, then unemployment will begin rising more quickly over the next several months. Historically, positive market performance tends to be felt more consistently a few weeks or a few months after unemployment begins to arc upward. I assume this is so because the Federal Reserve at some point stops raising interest rates or even decreases them to staunch job losses and recession.

Accordingly, I think we are closer to the end of the Fed’s rampage then we were a few months before. There is still a risk that financial markets may continue to decline more if the Fed decides to raise interest rates beyond the 1.00% increase, I indicated previously was priced in. However, assuming there is no institutional calamity, I believe the equity markets will begin their upswing sometime next year as the economy recovers and the Federal Reserve pauses its interest rate regime.

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.

This month Brad McMillan prepared a video commentary on October’s market performance and his economic outlook. I encourage you to view it to get another perspective. You can access it at this link - <https://player.vimeo.com/video/766224486>

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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