The Quarterly Perspective

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ABOUT

Harman Wealth Management

At Harman Wealth Management, we provide private, advanced, independent planning and investment management to individuals, families, and institutional clients.

We value in-depth economic research, evidence-based investment methods, and rigorous risk management. We are committed to insightful, objective solutions, and always working solely for the best interest of our clients.

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Labor Shortage part of the Big Distortions in Post-Covid Economy.

Jobs Growth Likely to Drive the Economy Forward Despite Lag in Employment.

A strange twist has entered the employment picture in the post-COVID economy. In light of the fastest post-recessionary jobs recovery ever recorded, the evidence suggests it could be even better... Consider the following:

The U.S. has already seen a tremendous snapback in Jobs:

- Following the catastrophic collapse in employment last April, the U.S. has added back more than 14.7 million jobs. It is the fastest pace in U.S. history, and more than three times as fast as the former 12-month high.[1]

Job openings continue to be exceptionally high.

- S&P 500 companies are not just growing jobs, they currently have 39% more jobs openings than the pre-pandemic high in March of 2021.[2]
- The U.S. Bureau of Labor Statistics monthly survey of Job Openings shows the current amount of job openings at 9.3 million jobs. That figure is 22% higher than the previous high recorded over the last twenty years and almost matches the number of people who report as unemployed.

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Staffing Shortages are Impeding Growth.

- According to the NFIB surveys, small businesses set a new record high each of the last four months for number of unfilled job openings. Additionally, 60% of the respondents reported suffering through a staffing shortage. Of that group, 80% reported lost sales opportunities.

So, What's It Mean For Investors:

The labor shortage phenomenon is just one of many distortions arising from the economic turnaround since early 2020. In light of the shortage, investors should realize this is an "upside" problem characterized by too much growth at too fast a pace. Compared to the last recovery where growth was fragile and arguably too slow, our current return-to-work hurdles are the preferred problem to have. Investors can take ease in understanding it is merely preventing the economy from returning at top-end speed and not posing a serious threat to halting the economy.

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In time, the many reasons preventing a return to work will fade. COVID fears will eventually subside, children will return to school, and extended unemployment benefits will expire. The key takeaway is that employers are aggressively increasing their labor force and feeding the positive loop growing the economy.

Source:
[1] Bureau of Labor Statistics.
[2] S&P DJ Indices According to the S&P 500 LinkUp Jobs Index
[3] U.S. Bureau of Economic Analysis.

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“June ‘s CPI release revealed inflation reaching 13-year highs at 5.3%, but the metrics were based off of the shutdown lows of last year.

“Consumers are spending at an astonishing rate of 33% higher than pre-pandemic levels. Prior to the pandemic, it took seven years to grow consumption at this rate.”

Inflation is Notably High, But the Fed Still Maintains It’s Temporary

Thirteen-year high in inflation may be peaking for now.

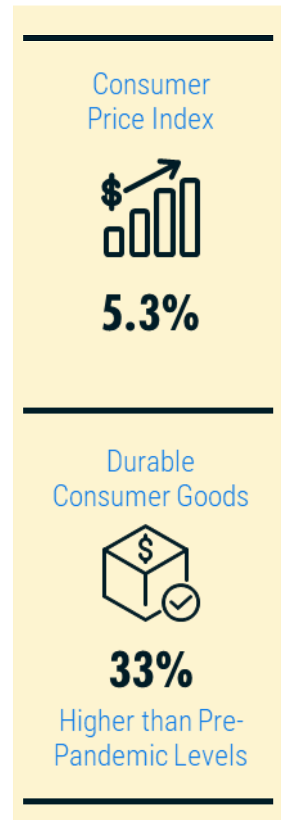
For a myriad of reasons, rising inflation has been viewed as a long-time nemesis to a thriving economy. Hence, after the latest numbers showed inflation at a 13-year high, the noise buzzing about inflation is amplifying.

For some, alarm bells are ringing, and its necessary for the Federal Reserve to take action. In contrast, Fed chairman Jay Powell is maintaining his resolve, asserting current high levels are temporary. As a result, the Fed has continued to advocate riding through this current episode without any kneejerk reactions. Their position is contingent on three arguments.

1. **THE “BASE” EFFECT, IT'S SIMPLE MATH.**
   Inflation is most commonly measured by its annual rate of change. It makes sense then, extreme lows would be followed by extreme highs one year later. Indeed, June ‘s CPI release revealed inflation reaching 13-year highs at 5.3%, but the metrics were based off of the shutdown lows of last year.[1] As the year progresses the one-year lookback will be off of a more normalized base. The clear expectation is that inflation will drop back down to a more normal pace.

2. **SUPPLY CHAIN DISRUPTIONS.**
   Whether it's semiconductors or lumber, part of the problem causing higher prices is related to manufacturing and distribution chains. Speculation abounds as to why shortages are persisting, but its apparent re-ramping up production has been more difficult than expected. Similarly, as workers return, it is expected many of these kinks in the supply chain will be resolved.

3. **PENT-UP DEMAND.**
   Compounding inflation matters is the huge release of pent-up demand for consumer goods. Without access to the normal types of services, consumers turned their attention to buying things. Consumers are spending at an astonishing rate of 33% higher than pre-pandemic levels.[2] Prior to the pandemic, it took seven years to grow consumption to this level. As a result of the demand surge, pricing power has turned in favor of the sellers.



Source:
[1] U.S. Bureau of Labor Statistics
[2] U.S. Bureau of Economic Analysis

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Three Big Reasons Not to Fear a Market Correction in 2021.

Stocks have been on a resilient run since October.

"The latest snapshot shows $2.4 trillion more in checking and savings accounts than last year. It equates to a 200% increase from pre-pandemic levels and points to a large portion of stimulus money that hasn't even rolled into action yet."

It's been quite a run for markets since bouncing off the lows of 2020. For some it's almost too good to be believed. Even though the economy is recovering at an exceptional pace there are pockets of fear worried the next big market correction may be lurking around the corner. While it is important to recognize market volatility can appear at surprising moments. The overall picture shouldn't necessarily foster deep worries. As evidence, we point to three supportive developments that could offer perspective on market pullbacks for the remainder of 2021.

1. **THE RECOVERING ECONOMY HAS UNUSUAL STRENGTH.**

First, investors should understand market pullbacks of negative 10% or worse can happen in any type of economic condition. Nonetheless, the economy does matter. Market corrections historically are less severe and bounce back faster when the economy demonstrates accelerating growth. This is particularly relevant for our conditions in 2021. Already, the early pace of growth is revealing the strongest improvement in GDP in more than 38 years.[1]

2. **THERE IS STILL A LOT OF MONEY ON THE SIDELINES.**

For investors waiting for a large market pullback, they may be underestimating just how much money is still on the sidelines. The latest snapshot shows $2.4 trillion more in checking and savings accounts than last year. It equates to a 200% increase from pre-pandemic levels and points to a large portion of stimulus money that hasn't even rolled into action yet.[2]

3. **IT MAY HAVE ALREADY CORRECTED.**

One of the interesting, and favorable, developments for the stock market so far this year, is how major areas of the market have moved in a less coordinated fashion. For investors, this higher-than-normal dispersion can have a benefit. When markets behave in this way, it lowers the chance of a major prominent pullback. Additionally, under the surface, many sectors have already experienced notable pull backs greater than -10%. A quick inventory has shown market declines in numerous pockets of the market, including technology, consumer discretionary, pharma, biotech, cloud computing, and even small cap stocks.[3]

Source:
1 U.S. Bureau of Economic Analysis
2 Board of Governors of the Federal Reserve System
3 Stockcharts.com

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“Since last June, the U.S. has produced three successive quarters of positive GDP growth and has effectively recaptured its former GDP high.”

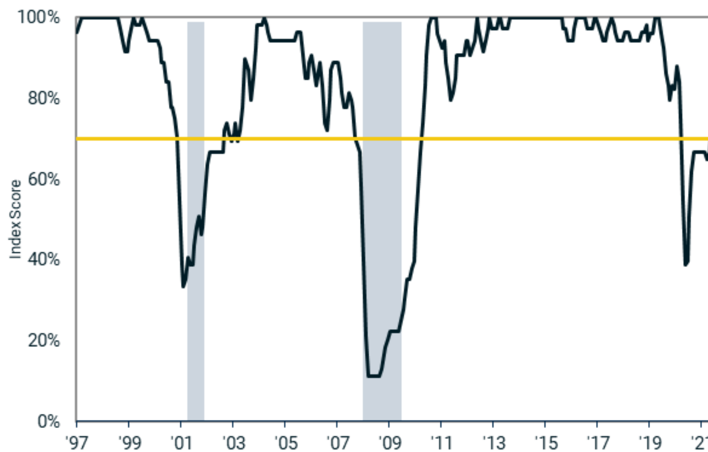
Business Cycle Risk Profile

- The systemic risk index is scoring consistent with a recovery. Employment factors lag while inflation is seeing near-term pressure.
- Since last June, the U.S. has produced three successive quarters of positive GDP growth and has effectively recaptured its former GDP high.[1]
- GDP expectations for 2021 are ranging between +5% to +7% growth.[2]
- Through the first half of 2021, manufacturing scores have soared, indicating a high rate of current growth. New orders remain elevated and customer inventories appear depleted.[3]
- The Business Cycle Dating Committee declared the official end of the COVID recession as of April, 2020. Therefore, a new expansion commenced in May. Data shows persistent improvement in incomes, employment, production and sales.[4]

Source:
1 U.S. Bureau of Economic Analysis
2 Atlanta Federal Reserve, New York Federal Reserve
3 ISM
4 NBER Federal Reserve Bank St. Louis

Alphalytics Research Economic Systemic Risk Index

Three Month Average, Weighted Diffusion Index



70 Present Score

Confirmed Recovery

Factors consistent with a recovering economy:

- Home Completions
- New Orders
- Durable Goods
- Retail Sales
- Yield Curve
- Continuing Claims

Shaded areas represent U.S. recessions.
Signal line represents historical mark where economic factors signaled imminent risk of recession.
Source: NBER, Federal Reserve Bank of St. Louis.

Interpreting the Index Score:

- The index score measures nine economic factors that have demonstrated co-movement with the deteriorating conditions of the past seven recessions dating back to 1970.
- When the index score is at 100, it means all nine of the factors are measuring at levels consistent with past economic expansion.
- When the index score is below 100, it means that one or more of the weighted factors has moved to a level consistent with past economic contractions.
- In aggregate a score of 70 or higher is interpreted as a composite profile consistent with past economic expansion. A score lower than 70 is interpreted as a composite profile consistent with past economic contraction.
- Markets can, and sometimes do, demonstrate volatility even though the economic factors are measuring consistent with expansion.

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Interested in Adaptive Business Cycle Investing?

Today's markets, economies, and policies are more complex than ever, challenging investors on what to watch and when to take action.

At Harman Wealth Management, we understand sound investments are uniquely supported by the conditions that favor them. And, when conditions change, so do the investments that benefit.

That's why we conduct rigorous and disciplined tracking of the U.S. business cycle. We also track the cyclical factors that shape our investing environment, like currencies, commodities, and rates. We embrace a world where investing dynamics are constantly evolving and believe it's imperative to have an investment strategy that adapts with it.

With Adaptive Business Cycle Investing we invest consistent with business cycle forces, aligning investments with the conditions driving returns in the present, rather than chasing what worked in the past.

About Harman Wealth Management

At Harman Wealth Management, we provide private, advanced, independent planning and investment management to individuals, families, and institutional clients.

We value in-depth economic research, evidence-based investment methods, and rigorous risk management. We are committed to integrative advanced planning by aligning investment objectives with business cycle opportunities and risks.

At Harman Wealth Management, our aim is to help clients realize their goals within a disciplined, insightful, and rewarding relationship.

For more information about Harman Wealth Management or investing with the business cycle, contact us at 281-719-8601.

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In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. Bonds are also subject to other types of risks such as call, credit, liquidity, interest rate, and general market risks.

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