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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One Year into a New Growth Expansion, What to Expect Now.

After the longest expansion in history, last year's COVID-induced recession re-started the U.S. economy into a new business cycle.

With the benefit of hindsight, we can now see the U.S. economy ended an unprecedented recession in abbreviated fashion in 2020 and restarted the business cycle with a brand new expansion[1]. After a full year in, and with sustainable growth established, it's time to recalibrate expecations ahead.

Another Extended Period of Growth.

A record of U.S. growth shows the economy moving in cyclical patterns. In other words, years of expansionary growth are followed by economic contractions, and thus, completing a cycle. These cycles are irregular in length, but are, nonetheless, recurrent and have been identfied all the way back to the 1850s.

Since 1980, the average duration of these growth periods has grown considerably. In fact, the last four expansions have averaged 8.5 years.[1] Realize that if this present expansion were just average, the U.S. economy would reach 2028 before incurring another recession. While the length of the new expansion is not pre-determined, the odds are favorable for sustained growth for many years ahead.

> *"The compounding effects of rising asset values and government stimulus drops have supercharged consumption habits."*

Expect An Upshift in GDP Growth.

While the last decade saw the longest expansion in history, it was also characterized by slow and anemic growth. This new expansion, however, is starting out in a completely different macro-economic environment. Households just expereinced a savings boom, and consumers are no longer carrying the over-indebtednes left over from the real estate bubble.[1]

Demographics have shifted more favorably, too. Millenials, as a collective unit, are larger than the baby boomers. They are just now maturing into their peak earning years, starting families, and buying homes. Their naturally accelerating spending patterns will assist GDP growth in the coming years.

Consumers Ready to Spend More.

It's not just millenials who will be spending more. The compounding effects of rising asset values and government stimulus drops have supercharged consumption habits.[1] In essence, consumers are increasingly confident and secure, and, therefore, ready to spend.

Higher Inflation as a Consequence.

Inflation is a factor of supply and demand, and, quite simply, the U.S. is seeing a lot of demand. Even with the temporary surge in mid-year inflation, consumers have shown they can maintain high demand in the face of rising prices. Demand for workers is up as well, contributing to wage inflation. Currently, there are four job openings for every three people who say they are unemployed.[2] When employers have to compete, wages begin to rise.

So, What's It Mean For Investors?

Often, it's a simple matter of human nature for fear and protectiveness to linger long after a shocking event. While many investors are still mistrusting markets and and holding onto risk aversion, the business cycle lens can help guard against mistakes.

It is also important to understand this present business cycle is starting in a much different place than the last. Instead of the persistent fragility of 2009 to 2012, we are likley to see the opposite. Consumers are operating from a position of strength, ready to upgrade GDP growth and support a newly found optimistic outlook ahead.

Source:
[1] NBER
[2] BLS

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Past Performance is No Guarantee of Future Results

Rapid Progress Evident as Economy Reaches "Fully Recovered" on Many Fronts

Economy quickly moves to new highs one year after COVID recession.

"As of the second quarter, the U.S. is now back to into new high territory for national output.[1]"

As Americans continues to wrestle with the future of COVID policy, the underlying economy is persevering, and coming back at a torrid pace. Indeed, the concerning expectations for a prolonged and slow recovery haven't materialized. Instead, on the back of unprecedented intervention, the U.S. economy is surpassing remarkable milestones indicating just how fast it is returning. Consider the following:

Recapturing all-time highs in real GDP was quite an achievement, especially considering the dreadful expectations first assumed.[1]

As of the second quarter, the U.S. is now back to into new high territory for national output. This was achieved in just six quarters, this strongly outpaced the recovery following the 2008-09 recession which took a full three years. [1]

Retail sales were one of the quickest economic elements to recover post-shutdown. With services unavailable, Americans went on a spending spree for stuff.

Even after services reopened, the desire for purchasing goods maintained momentum. Expenditures on goods is still 34% higher than February of 2020.[2]

By now, everyone already knows about the home buying surge following the initial COVID shutdown. Perhaps less well known is the response from home builders. Residential construction has exploded upward by nearly 27% from February, 2020.[3] Even more is still on the way. As of August, permits were up still 11% from pre-pandemic levels.[3]

It's not just consumers who are spending. Businesses are too. With so much consumer demand, businesses are ramping up for growth in a hurry.

In an effort to increase production, core capital goods are 15.3% higher than February of 2020.[2]

Source:
1 U.S. Bureau of Economic Analysis
2 U.S. Census Bureau
3 U.S. Dept. of Housing and Urban Development

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"...employers are responding to the massive amount of potential demand that will take the economy even higher if they are able to increase production and activity.

Job Distortions Continue in Unusually Tight Labor Market

Employers struggle with labor shortage.

An unanticipated side effect to the consumer boom is that employers across the spectrum seem to be in a sudden dash to grow. Of course, it is intuitive to assume most businesses want to bring back workers after the forced shutdowns of a year ago. However, that alone doesn't explain the whole picture.

For one, employers are already doing more with less. As of June, the U.S. workforce was -4.5% smaller than December of 2019, yet real GDP had reached higher levels. So, it is not necessarily about getting back to the pre-pandemic economic levels. Instead, employers are responding to the massive amount of potential demand that will take the economy even higher if they are able to increase production and activity.

Four Fast Facts on the Labor Shortage

1 Job Openings

+56%

Higher than Pre-Pandemic Levels

2 Labor Force

+30%

More jobs than people who are unemployed.

3 Labor Force

-4.5% smaller labor force than pre-pandemic

Almost 3 million less workers.

4 Employment Growth

On pace for adding > 5.5 Million Workers

Most job additions in U.S. history.

Source: All data from the U.S. Bureau of Labor Statistics

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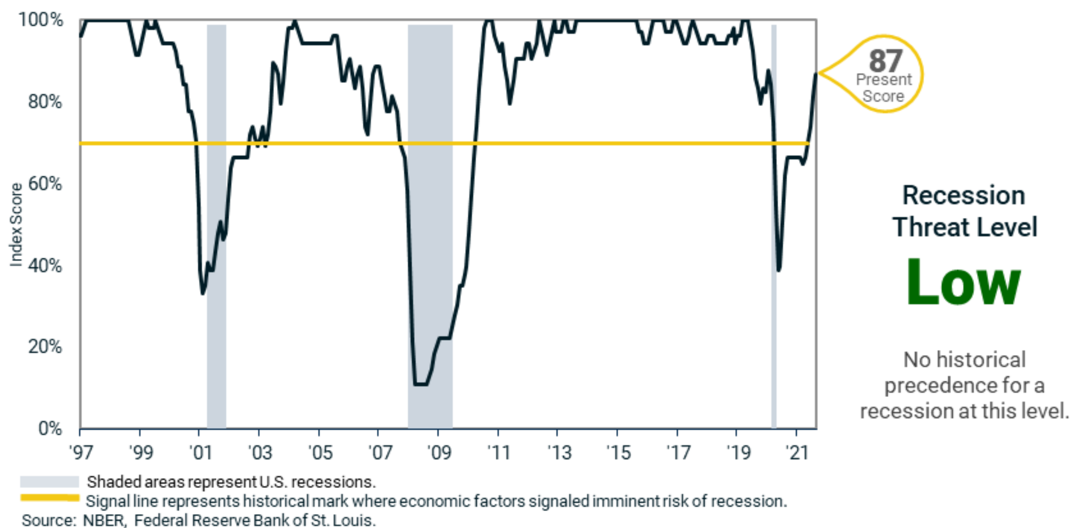
"Since last June, the U.S. has produced three successive quarters of positive GDP growth and has effectively recaptured its former GDP high.[3]"

Business Cycle Risk Profile

- The index continues to climb in a typical post-recession pattern and is highly consistent with strong historical growth.
- Several underlying metrics are pointing to economic strength. Manufacturing new orders remain high and retail sales are persistently elevated.[1] Home completions have slowed due to supply disruptions but could easily re accelerate in the coming year.[2]
- For 2021, real GDP is expected to be at the highest level since 1983.[3]
- Supply chain problems are hindering growth in 2021 and are likely deferring growth into 2022.
- With the economic recovery exceeding expectations, the Federal Reserve is preparing to pull back on accommodation and move toward normalization.

Source:
1 ISM PMI
2 U.S. Census Bureau
3 U.S. Bureau of Economic Analysis

Alphalytics Research Economic Systemic Risk Index
Three Month Average, Weighted Diffusion Index



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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