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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Economic Growth Still Evident While Markets See a Correction

There is no denying it, market corrections are hard.

In the prior Quarterly Perspective (distributed on January 11th), we cautioned investors to emotionally prepare for more volatility in the coming year. While investors can never know exactly when or how the pullbacks arrive, 2022 was set to be rockier than 2021.

So, here we are. What started as a more normal market pullback in January has now extended into a full-blown correction. Furthermore, the Russian invasion of Ukraine plus policy adjustments from the Federal Reserve have shaken confidence.

So, with uncertainty rising, here is what we know; despite how we might feel:

The Economy is Still Consistent with Growth. This was confirmed just in the last week by the following new data:

- **JOBS:** Monthly job growth was 428,000 for April. To give some perspective, that is very strong…higher than any single month during the growth years from 2010 to 2019.[1]
- **JOBS:** So far, in the first four months of 2022, the economy has added over 2 million jobs.[1] In real terms, these are people who are making and spending more money than last year, which can propel economic growth upward.
- **MANUFACTURING:** Manufacturing is consistent with growth. For March, Manufacturing New Orders were up +14.0%. If adjusted for inflation, they are still up +5.6%. That is higher than all but 7 months from 2012-2019 (pre-pandemic).[2]
- **CONSTRUCTION:** Total construction spending is still high through March. Led by residential home-building, total spending is up +11.7% year over year.[3]
- **BORROWING AND LENDING:** Fourth quarter data showed a historically low debt-to-income ratio, meaning consumers are far from the debt bubble days of 2008.[4] Instead, consumers have the capacity to borrow more if needed and banks are still welcoming more loans with loose standards. Again, this is helpful for future growth.

Interest Rate Increases Shouldn't be Feared.

For the last 40 years, the Fed has followed a repeatable pattern in recessions. To re-stimulate the economy, they artificially push rates down during a recession. Next is the accommodation phase, whereby rates are kept low for another year or two. Finally, upon a stronger economy, they bring them back to a new normal. This is a standard process. Raising interest rates now is part of the same process that has been in place for decades.[4]

Federal Reserve Policy is Adapting. Although the Federal Reserve miscalculated on inflation last fall, they are moving now.

- **RISING INTEREST RATES CAN HELP.** To avoid a housing bubble similar to the early-2000s climbs in housing prices need to slow. Since last June, the average annual increase in home prices has steadied at 19% annually, a rate that is unsustainable. A healthier long-term rate would be 4%-6% per year. So, yes, mortgage rates need to be higher to restore balance in the housing market.[5]
- **CONSTRUCTION BACKLOG:** There is a bulge in the category "homes in the construction phase," now up +27% from last year.[3] Meanwhile, the pace of home completions has not picked up… pointing to supply chain backup. If this can clear, then help is on the way.

Continued to next page.

Inflation Could be Topping Soon.

- Last year, the biggest leaps in auto prices occurred in April, May, and June, making a huge impact on headline inflation. Since February, the data shows used auto prices flattening. If continued, it means the big monthly jumps from last year will be replaced with smaller moves this year in April, May, and June; and thus, one of the strongest factors pushing inflation up will begin to fade. In just three months, there may be a real sense that inflation has topped out and has begun its downward path.[6]

"In just three months, there may be a real sense that inflation has topped out and has begun its downward path."

So, What Does It Mean For Investors:

There is never such a thing as a perfect economy. Or, stated differently, all economies have problems. The difference from one to another is based on the various problems and challenges at hand. Ten years ago, the economic challenges were similarly daunting but very different in nature from today. Coming off the housing and debt bubble, the economy struggled with sufficient growth as consumers paid down debts and the housing market worked through its bulge of foreclosures. Today, it is supply chain constraints compounded by surging demand.

For investors wanting a cure, the focus should be on continued economic growth – something that still looks encouraging in spite of disconnected sentiment. More jobs equate to more income, more consumer spending, more demand, and more productivity. Likewise, it leads to more corporate earnings. It is the clearest way to heal the market. And, as of now, the data still supports growth.

Source:
[1] Bureau of Labor Statistics (BLS)
[2] Institute of Supply Management
[3] U.S. Census Bureau
[4] Federal Reserve
[5] National Association of Realtors
[6] BLS

A Short History on Market Corrections

The unwelcomed turbulence of long-term investors.

With uncertainty rising and lots of terminology being tossed around, it seems timely to offer a quick review and history of how to classify various types of market declines.

Key Points About Market Corrections:

- A **Market Correction** is defined as a decline of -10% to -20% in the price of an investment from its most recent high.
- The timing of market corrections is idiosyncratic, meaning they have no regular pattern or consistency. Since 1990, the S&P 500 index has seen lengths of four to seven years without a single correction. The S&P 500 index has also seen market corrections in three successive years.
- More ordinary pullbacks of -5% to -10% usually occur two to three times per year in a normal growth year. They usually have less emotional intensity than market corrections.
- Market corrections usually have an aggravating event or climate that heightens emotions and worries investors.
- Market corrections usually occur after significant run-ups in the market. Nine of the last eleven market corrections occurred after a 25% or higher climb in the S&P 500. Such was the case last year.
- Market corrections are different in nature than market declines that coincide with an economy in recession, which are usually much more severe and longer in duration. The last three recessions were in 2020, 2008-09, and 2001.

As a reminder, in the last growth expansion from 2009 to 2019, there were five market corrections in the S&P 500. In each of the situations, the climate was fearful. But, ongoing growth prevailed.

Source: stockcharts.com

<table>
<tr><th>Primary Year of Correction</th><th>Level of Decline</th><th>Chief Catalysts/ Concerns</th><th></th></tr>
<tr><td>2010</td><td>-16.0%</td><td>Monetary Policy
European Union</td><td rowspan="5">Average Climb
12- Months After the Trough Across All Five Corrections

+25.9%</td></tr>
<tr><td>2011</td><td>-19.4%.</td><td>Debt Ceiling,
U.S. Debt Downgrade
Monetary Policy</td></tr>
<tr><td>2015</td><td>-14.2%</td><td>Too Much Oil Surplus,
Falling Oil Prices</td></tr>
<tr><td>2018,
Early Spring</td><td>-10.2%</td><td>Treasury, Fiscal Policy</td></tr>
<tr><td>2018,
Late Fall</td><td>-19.8%</td><td>Monetary Policy, Trade Policy/Tariffs</td></tr>
</table>

Source: stockcharts.com

"After a period where prices are stable and low, it can be quite uncomfortable adjusting to big increases. But, just as in the past, it doesn't have to lead to growth stopping."

High Oil Prices? Strangely, We've Been Here Before

High Oil Prices Similar to 2011-2014

While nobody welcomes higher oil prices, and it hurts at the pump, it may not be as ominous as it seems. Why is this the case? Well, in some sense, we've been here before.

In the last growth expansion, the U.S. suffered through a bout of high oil prices. From 2011 to mid-2014, the average price per barrel for West Texas Intermediate Crude bounced around in a tight band from $90 to $109. Over the full three and half years, a barrel of oil averaged $96.

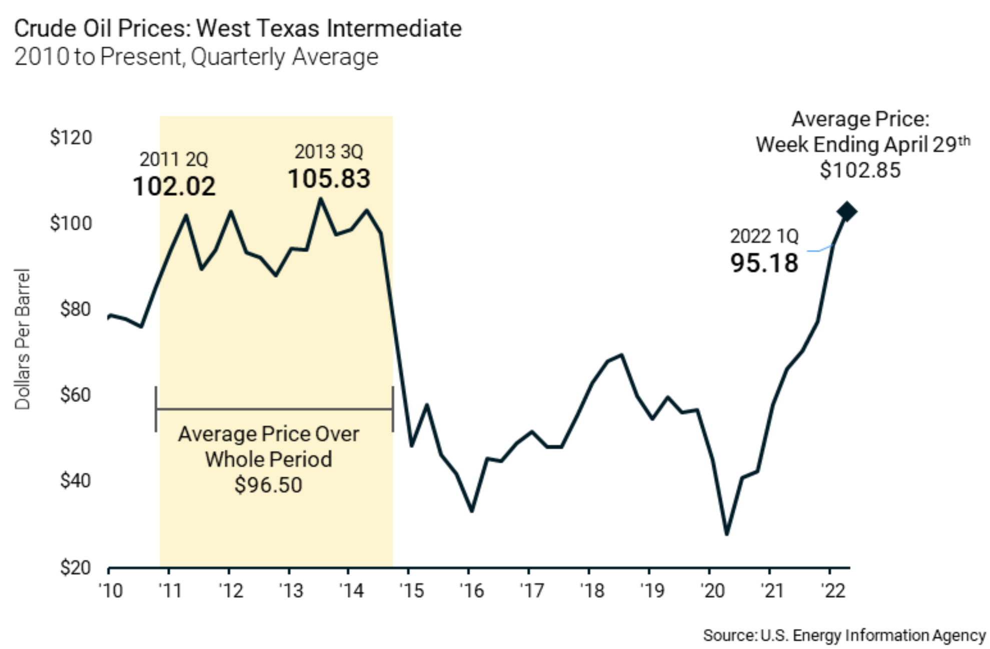
Now, fast forward to current events. Since the Russian invasion in mid-February, crude prices averaged $105 for March and receded a bit in April, averaging $101.78.

What Can We Learn From This?

Anyone who has been around a while knows energy prices go through constant ups and downs. All in all, consumers tend to normalize their spending around energy prices. After a period where prices are stable and low, it can be quite uncomfortable adjusting to big increases. But, just as in the past, it doesn't have to lead to growth stopping.

There is another important point to note. Since U.S. oil production surged over the last decade, a vast majority of dollars spent on energy consumption stay within the U.S. Money spent here stays here, and that, too, is helpful for growth.

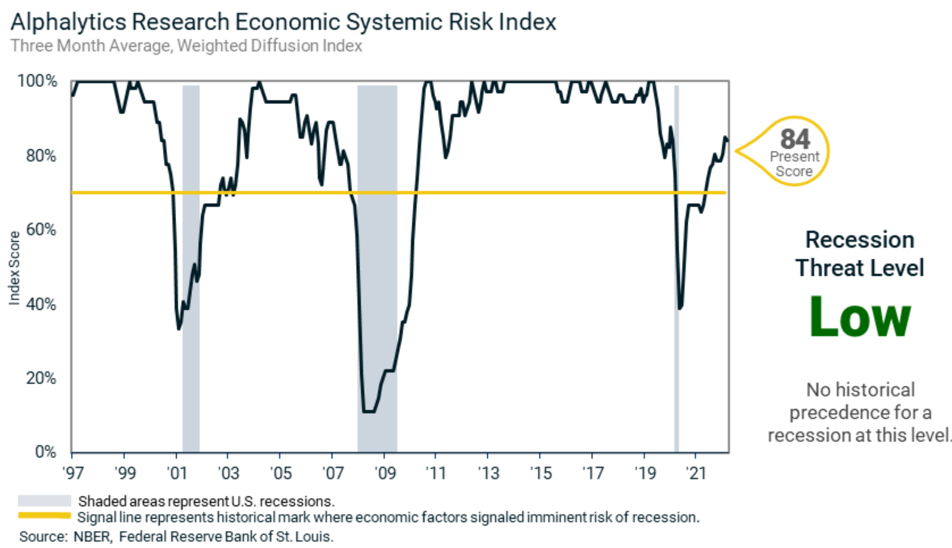
Source: U.S. Energy Information Administration (EIA)



At its current level, the index value reflects no historical precedence for a recession.

Business Cycle Risk Profile

- So far in 2022 more than 2 million jobs have been added back to the economy. The labor force is now less than 1% away from eclipsing its pre-pandemic level.[1]
- Inflation at 8.6% is the highest in 42 years. Distortions in the auto market and rising commodity prices continue to pull the overall figure up.[1]
- Scores from the ISM manufacturing index are indicative of a growing economy.[2]
- The U.S. dollar is up more than 7% over the past year. A strong dollar is helpful in countering inflation.[3]
- At its current level, the index value reflects no historical precedence for a recession.



Source:
[1] Bureau of Labor Statistics
[2] Institute of Supply Management
3 Federal Reserve

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.

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

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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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The Standard and Poor's 500 is an unmanaged index generally representative of the U.S. stock market and cannot be invested in directly.

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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