The Quarterly Perspective

Searching for a Turning Point

Nine Months into a Market Downdraft and Investors Are Wondering, "What's It Going to Take to Make Things Better?"

Without a doubt, 2022 has offered a perplexing experience for just about every kind of investor. First inflation, then Russia, then gasoline, then food, and don't forget interest rates. At nine months into the year, the series of obstacles keep coming with almost no safe haven.

Even though declines are accepted as sometimes part of the ride, many long-term investors are wondering, "what will it take to turn it around?"

First, no matter what we offer as an answer, there are no guarantees when it comes to markets – stocks or bonds. What we rely on is a long-term history showing that tough times do, indeed, pass. Eventually, recovery ensues, and stability returns. So with that in mind, we can point to two fundamental factors where reversals can make the environment a lot more supportive.

"The Fed's latest rhetoric reveals just how resolute they are in bringing inflation down to moderate levels and why."

Inflation Must Sustainably Fall

A year ago, the Fed was gravely mistaken in its response to climbing inflation. At present, in an effort to catch up, they are mindfully determined. The stated objective is to drive the core inflation metric, the PCE Index, back down to an annual growth rate of 2.0%. The most recent reading was 6.3%, revealing a substantial amount of progress to be made.

The Fed's latest rhetoric reveals how resolute they are in bringing inflation down to moderate levels and why. A short history lesson teaches policy leaders to stamp out inflation as quickly as possible to avoid prolonging its menacing effects. It is a given that long-term growth and stable job markets go hand-in-hand with moderate and low inflation.

In executing its commitment to follow through, the Fed warned that pain may be ahead for both households and businesses as they move interest rates into "restrictive" territory. Through their *Statement of Economic Projections*, the Fed has even implicitly acknowledged its willingness to let unemployment move up in order to reach its inflation objectives.

Fortunately, encouraging signs are already emerging. Oil and gasoline prices are trending down. Likewise, core commodities like copper, lumber, corn, and soy are also declining from early-year highs.[1] Shipping and freight data reveal easing cost pressures as bottlenecks subside.[2] Inflation forecasts show modest improvement for the rest of 2022 and more significant drops during the first half of 2023. Should inflation follow such an improving path, then it lays the groundwork for the Federal Reserve to change its restrictive policy stance.

The Fed Must Find a Stopping Place for Rate Increases

The current bout of inflation found the Fed critically ill-prepared for a ready fight. By leaving the base interest rate at zero for too long, rates were far from an effective level to impede soaring demand. As a result, rate increases in 2022 have occurred at the steepest level since 1981.

For months, Fed Chairman Jerome Powell aimed to bring rates back to an *appropriate* level. However, on September 21st, Powell shifted to rates at a "*restrictive*" level as the FOMC raised their expected Fed Fund rate to 4.50% by the end of 2022.

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Along with the founder of Harman Wealth Management, Dean Harman, Riggs also heads Alphalytics Research, a subscription-based research service to investment professionals across the U.S. The service emphasizes rigorous and robust data analytics in the context of the U.S. business cycle.

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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The more important question is, "are more recessionary forces on the way?"

These aggressive interest rate climbs have unnerved investors as future stock earnings and revenues are at risk. With the uncertainty of how high the Fed will go with rates, it is nearly impossible to pinpoint the impact on corporate America. If, though, the Fed finds its interest rate ceiling sooner rather than later, it may serve as a basis to improve overall sentiment and for stocks to regain their footing.

What Does it Mean for Investors?

At Harman, our goal is to help clients manage through the full business cycle - during both the good times and the periods that aren't so good. In June, our proprietary metrics signaled a shift in the risk environment leading us to take a more defensive stance with Harman Wealth managed portfolios. Still today, portfolios are positioned defensively to reduce downside exposure. We continue to monitor conditions rigorously on the inflation front and especially on the policy front.

Sometimes investors need to be reminded of the fact that these types of rough conditions do eventually end. Therefore, while maintaining caution is our current stance, we also diligently look for the turning point. History has demonstrated that attractive market returns commonly followed some of the most challenging periods.

Source:
1 Stockcharts.com
2 Cass Transportation Index Report, Aug. 2022

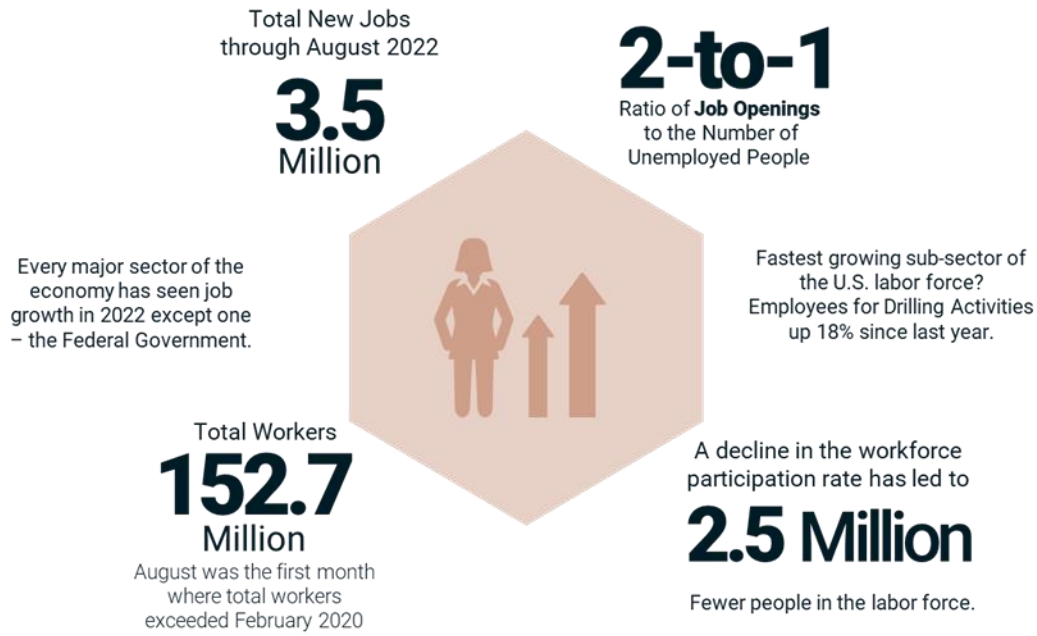
"Even with higher interest rates and a slowing economy, the pace of job growth has been remarkable."

The Conundrum of Strong Employment

Jobs Continue to Grow at Twice the Rate of the Last Expansion

Amazingly, the jobs market has been notably resilient so far in 2022. Even with higher interest rates and a slowing economy, the pace of job growth has been remarkable. Over the last three months, the labor force saw an increase of 380,000 jobs per month, nearly double the monthly average from 2011 to 2019. Employers seem to be struggling with growth, too. A report on the number of job openings shows over 11,000,000 open jobs – a 50% increase over the highest level pre-Covid.

While worries about the economy persist, the jobs market may be the rescuing force to keep the economy afloat. Check out the following notable facts below.

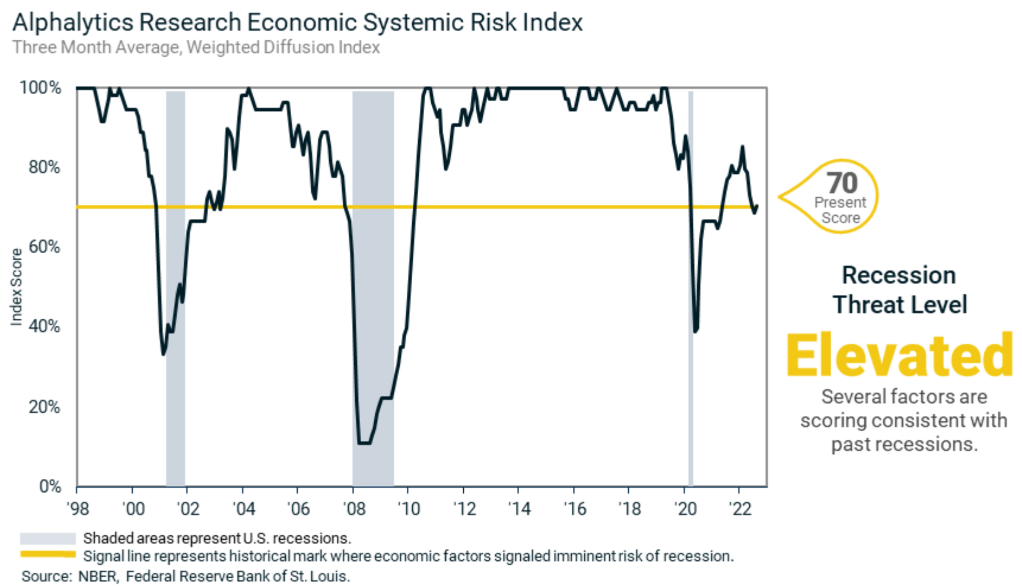


Source: All items sourced from the U.S. Bureau of Labor Statistics

"The index score is teetering at the threshold line for conditions consistent with an economic recession."

Business Cycle Risk Profile

- At its current level, the index value reflects an elevated risk of a recession.
- The index score is teetering at the threshold line for conditions consistent with an economic recession. The present time resembles the climate of 2003 when a recession was eventually avoided.
- Some measurements of inflation are starting to turn and offer an encouraging path. Manufacturing prices, oil, gasoline, and lumber are all improving.
- In response to late-year inflation, the Fed is on a "restrictive" path with further interest rate increases expected ahead. These increases may likely slow the economy in a year that has already incurred slower growth.
- The economy has demonstrated resilience in several areas, including manufacturing, consumer demand for services, and employment growth.



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

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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Investing involves risk including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values. Past performance is no guarantee of future results. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment.

Please note that individual situations can vary. Therefore, the information presented here should only be relied upon when coordinated with individual professional advice.

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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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