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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Working Through the Process

After the Inflation Highs of 2022, the Fed is Still Attempting to Steer the Economy Back to a New and Better Normal.

Last October in the Fall 2022 *Quarterly Perspective*, we addressed the question “What will it take to turn the economy around?” With six months having gone by, we can now offer an update.

> *“…chairman Jerome Powell acknowledged the good news of “disinflation” at work in the economy. However, he also made it clear the inflation fight is not over yet...”*

Containing Inflation

On a number of fronts, progress in inflation is evident. The headline data shows a peak at 9.1% last June, with the annual rate of change now down to 6.0%.[1] At the Fed’s February meeting, chairman Jerome Powell acknowledged the good news of “disinflation” at work in the economy. However, he also made it clear the inflation fight is not over yet.

On an annual basis, the largest improvements are seen in fuel, autos, and produced goods.[2] For some items, it means prices are now lower than last March. On others, it means price climbs are more subdued and leveling out.

Perhaps most interesting is the trend rate in inflation since the Fed finally engaged in a serious fight last summer. Since June, the annualized run rate for CPI All Items is 3.5%.[3]

The progress hasn’t gone unnoticed. Since June, the University of Michigan Consumer Sentiment Index has trended up in seven of the last nine months.[4]

Not all inflation metrics are flashing green, though. Most concerning is housing, still climbing even though both home prices and mortgage rates have apparently peaked. Unfortunately, the CPI method for housing inflation has a long lag. Until it tops out and begins a steady path downward, the Fed will remain guarded.

Finding a Stopping Place for Interest Rates

Throughout 2022, the Fed repeatedly raised expectations for their target interest rate. In Powell’s terms, they were searching for a “sufficiently restrictive” rate that could successfully bring inflation back down to their 2% goal.

The good news now is the Fed appears to be finalizing rate hikes. After the last Fed meeting, the committee maintained 5.1% as their target. It leaves the Fed flexibility for one more rate hike if they deem it necessary in May.

If one believes that investors hate uncertainty, then the pending pause on rates should be helpful for investor sentiment. Ending the hiking cycle will allow markets to normalize around the 5% interest rate mark. Furthermore, it puts the Fed one more step closer to eventually lowering rates, something markets are pricing in for as early as this fall.[5]

Facing an Economic Slowdown

For much of 2022, the anticipated result of high inflation and climbing interest rates was a very consequential slowdown. To the surprise of many, that type of economic outcome simply has not

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"Also notable was the persistence in consumer spending. Yes, habits have shifted, but consumers are still spending faster than the rate of inflation."

materialized yet. Even the Fed recently acknowledged the surprising strength of both businesses and consumers.

Leading the charge is job growth, adding two million jobs back to the economy in just the last six months alone.[6] Big gains were seen in the services sectors, especially health care, education, government, leisure, and hospitality. The technology sector lost jobs over the last six months, consistent with the major headlines of 2022. But, so far, the layoffs appear confined to this sector and are not widespread.

Also notable was the persistence in consumer spending. Yes, habits have shifted, but consumers are still spending faster than the rate of inflation. The most significant change is the shift from goods to services. Shortly after the COVID shutdowns, Americans splurged on manufactured goods while going on a home-buying spree. In 2022, the appetite for services returned as consumers regained access to many things unavailable during the shutdown.

Nonetheless, many economists still believe the economy faces a future threat. They argue the newer, higher interest rate environment takes time to stifle demand. They are counting on slower job growth and for some industries to begin layoffs by mid-year. If true, it sets up a bad news-good news conundrum. Should demand falter enough, it could lead to an increase in unemployment. But slowing demand could very well also lead to softer inflation, helping the Fed reach its goal, and allowing it to quickly support the economy through lowering interest rates.

What Does it Mean for Investors?

Seasoned investors understand challenging times are always part of the journey. Moreover, the environment of the last year has reminded investors that even in the most optimistic or pessimistic climates, the markets can surprise in the other direction. A year ago, the Russian invasion of Ukraine was an unexpected development, worsening commodity markets, global supply chains, and inflation. Policy leaders responded with aggressive interest rate hikes. Yet, in the face of growing pessimism, the U.S. economy has performed resiliently.

The solution to navigating such challenging times doesn't have to be difficult. One, be cautious of certainty and embrace diversification. Two, maintain a long-term view. And, three, remember challenging periods do end and opportunities eventually emerge. Be ready when they do.

Sources:
1 Bureau of Labor Statistics
2 Bureau of Labor Statistics
3 Bureau of Labor Statistics
4 University of Michigan: Consumer Sentiment©
5 CME Group
6 Bureau of Labor Statistics

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Fast Facts on a Highly Unusual Job Market

The Labor Market Continues to Post Unprecedented Trends.

The economy continues to produce an interesting mix of unusual employment trends. Despite expecting the labor markets to soften, the economy is showing the opposite. On more than one front, economists are noticing trends that haven't been seen for decades or are unprecedented altogether.

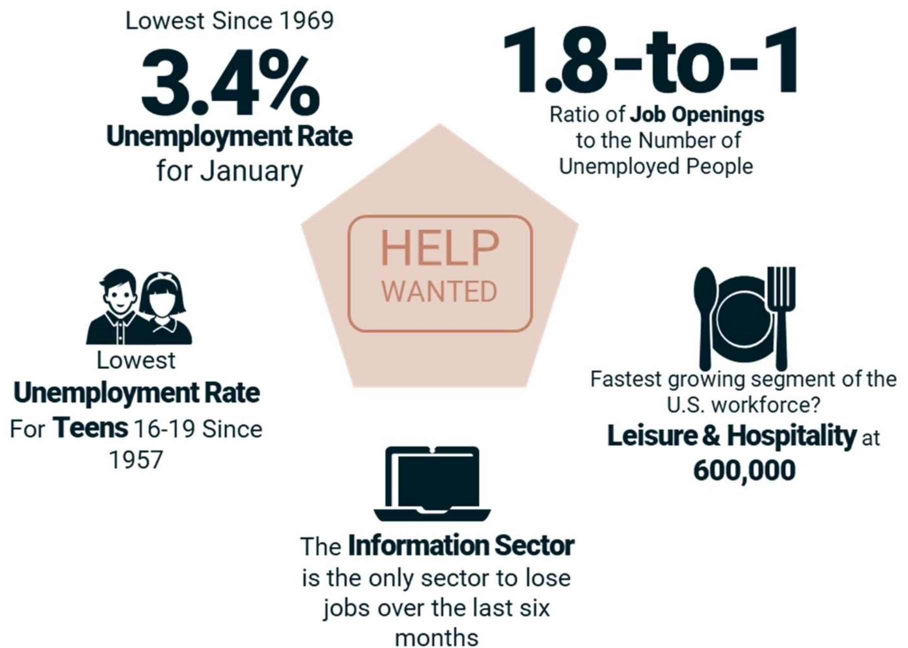
"...On more than one front, economists are noticing trends that haven't been seen for decades or are unprecedented altogether."

Here are three overriding themes unique to the moment:

"SUPER"-TIGHT LABOR MARKET: A "tight" labor market develops when there are plentiful jobs but workers are scarce. January's 3.4% unemployment was the lowest since 1969, suggesting it is the tightest labor market in over 50 years. However, there appears to be more to the story. In December the ratio of job openings to the number of people declared "unemployed" was two to one. Since, then it has come down, but still remains too high.

MORE WORKERS, PLEASE: Two major developments shrunk the labor force following the COVID shutdown. First, there was a rapid increase in retirements from senior workers. Second, shutdowns slowed legal immigration. Hungry for workers, employers have enticed teens into the labor force. There are nearly 450,000 more teen workers than pre-COVID.

CROSS CURRENTS: Big tech gathered headlines in 2022 with ominous layoffs. But, by all measures, these remained confined to the information sector. The U.S. workforce, in total, continues growing at a strong pace, while the information sector has declined for three consecutive months.



Sources: All items sourced from the U.S. Bureau Of Labor Statistics

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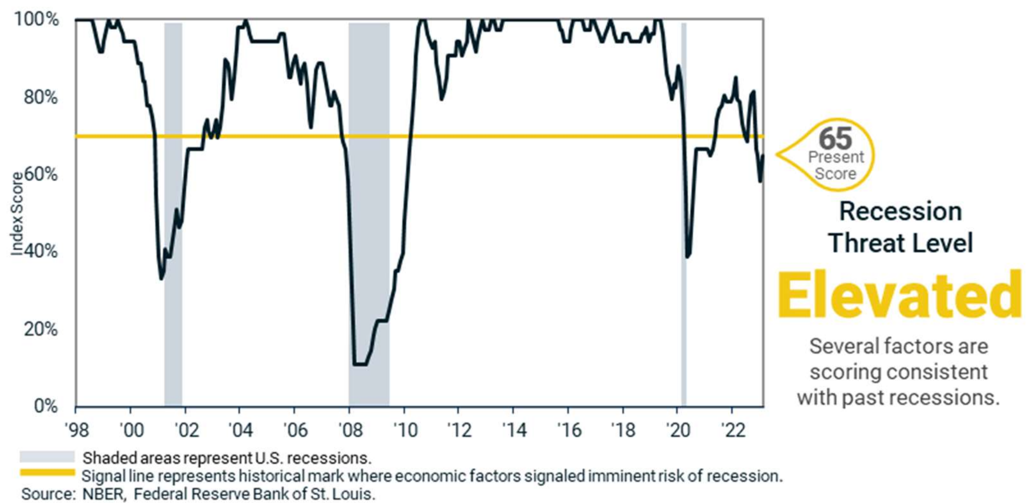
Past Performance is No Guarantee of Future Results

"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.
- Underlying factors are still sending mixed messages. Inflation metrics, which were problematic for 21 months, have unflagged.
- Labor markets are incredibly tight. Duplicating the improvement of 2022 will be difficult.
- The slowdown in housing and the corresponding impact on consumer durable goods could be bottoming soon as mortgage rates fall and demand starts to revive.
- The Fed appears near its peak tightening phase. Long-dated bonds have declined from their recent highs. Lower interest rates could be very helpful from here.
- 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.

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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