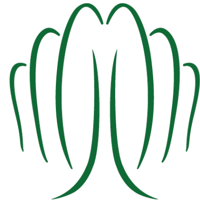


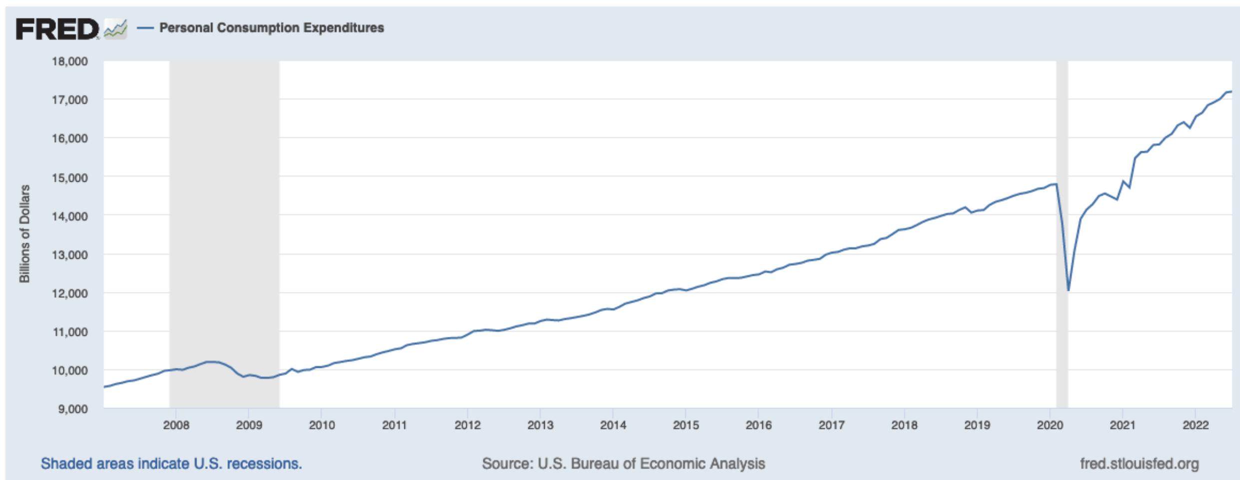
A Tale of Two Realities. It's complicated!
May be a Recession in Mood only?!

Let's look at three charts that do a pretty good job of showing us, if not explaining, the current state of the economy and markets.

On the one hand, consumer sentiment is lower than we saw during the 2008/9 recession. The mood, is bad. This reflects what we are feeling and the market is more often than not a reflection of our feelings and emotions than the health of the economy.

On the other hand, household balance sheets are strong.

Consumption continues to be strong, buoyed by low unemployment. The Federal Reserve is tackling consumption with higher interest rates (increased borrowing costs) and targeting a 4.1% unemployment rate.

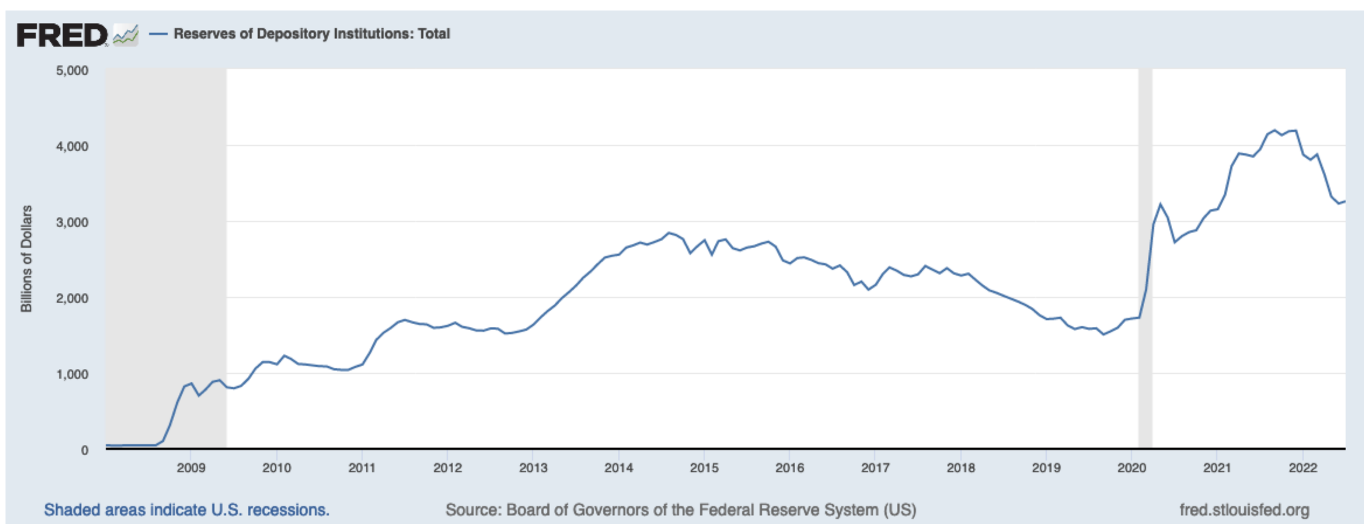


Inflation is high (driven by demand, slow to recover supply chain issues, COVID stimulus, the invasion of Ukraine, and low unemployment) July CPI YoY 8.5% (Core 5.9%) and August CPI 8.3% YoY (Core 6.3%) and resilient. Rent/rent equivalents, food and manufacturing components being the primary drivers of current inflation. With the Federal Reserve increasing interest rates to combat that inflation, households are feeling the dual pinch of a complicated economic picture.

The Federal Reserve walks a fine line between the hard economic numbers on the ground and what is acceptable for society and politicians. Where we are in the moment: the Fed has taken the hard stance that inflation is a bigger risk, and if left unchecked will hurt households and corporations more than rising interest rates.

What is behind the Fed's certainty of the resilience of our economy?

- Oil prices have retreated to early January levels and gasoline prices continue to come down.
- Business' performance is slowing but not showing any signs of consistent or severe contraction.
- Bank deposits are high and, unlike 2008, the banking system in the US and Developed world is strong.



- Unemployment is at an all-time low with full participation by 64-and-under age group.
- Mortgage rates are increasing and forcing some potential home buyers and investors out of the over-exuberant housing market, however 30-year fixed mortgages remain under the 40 year average of 7.7%. You could say we are returning to a more normal housing market, but that return is certainly not a comfortable transition for many.

The only thing to be said is that the economy is complicated and complex with no one or even subset of numbers providing a clear picture. The Fed is focused on aggressively bringing inflation down close to its 2% - 3% target levels in the next 6 to 9 months. To achieve that, the Fed is targeting a 4.1% unemployment rate – look for some additional layoffs - and a GDP growth rate slowed from last year's 5.9% growth to a more sustainable 3.5% - 4% GDP growth. Interest rates will continue to increase until we see a clear declining trend in inflation.

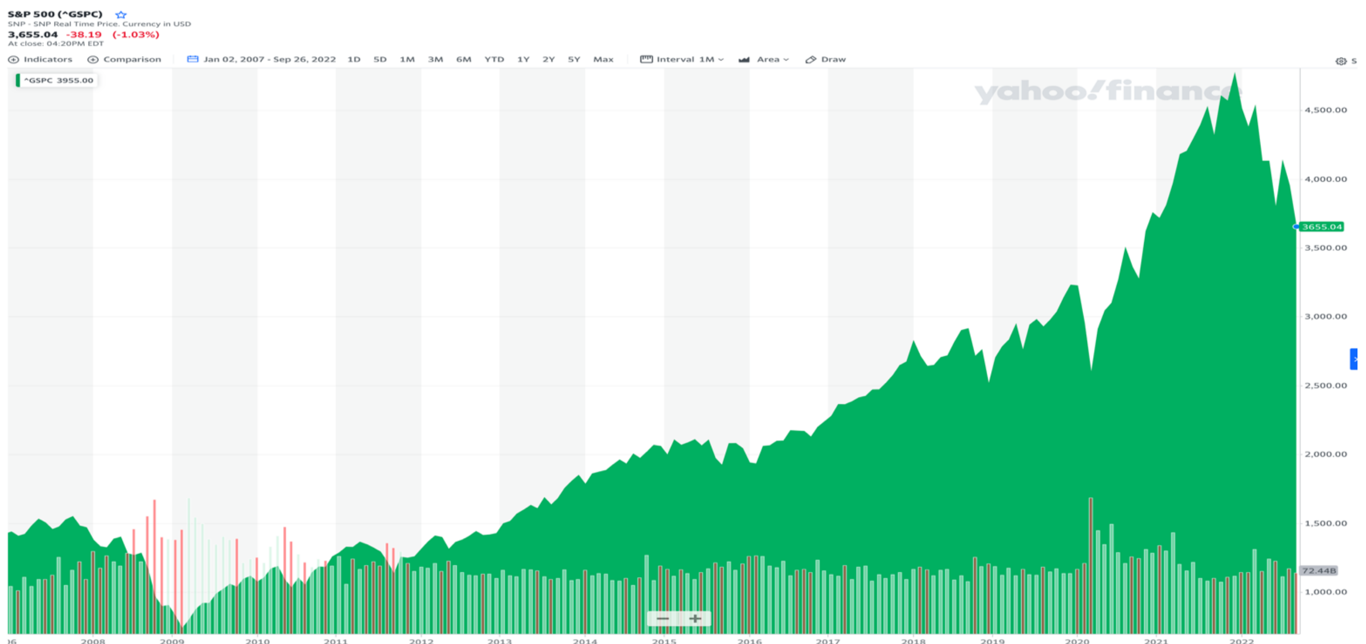
In many ways, this period is a return to normal after a period of financial ease for so many.

What about the markets?

"*Look at the Markets to tell you about the health of the economy…..Aaaah, NEVER do that!*" Kai Ryssdal, Marketplace NPR.

What about the Markets? Look again at the consumer confidence chart. The mood is bad and that is reflected in the stock market. The stock market is an emotional thing. BBC headline went so far as to speculate "*Is The US Talking itself into a Recession?*"

Coming off the all-time market high on 12/27/2021, the S&P 500 has corrected -23% from its peak, that is a -15.3% year-on-year decline after a string of significant up years: S&P **2019** 31.49%, **2020** 18.4%, **2021** 28.71%. It is unsettling and to some down-right scary.



Between January 1928 to now, the S&P 500 could be expected to have a 5% decline 3.4 times a year, a 10% decline at least once every year, a >15% decline every 3 years and a 20% or more decline every 5 to 6 years.

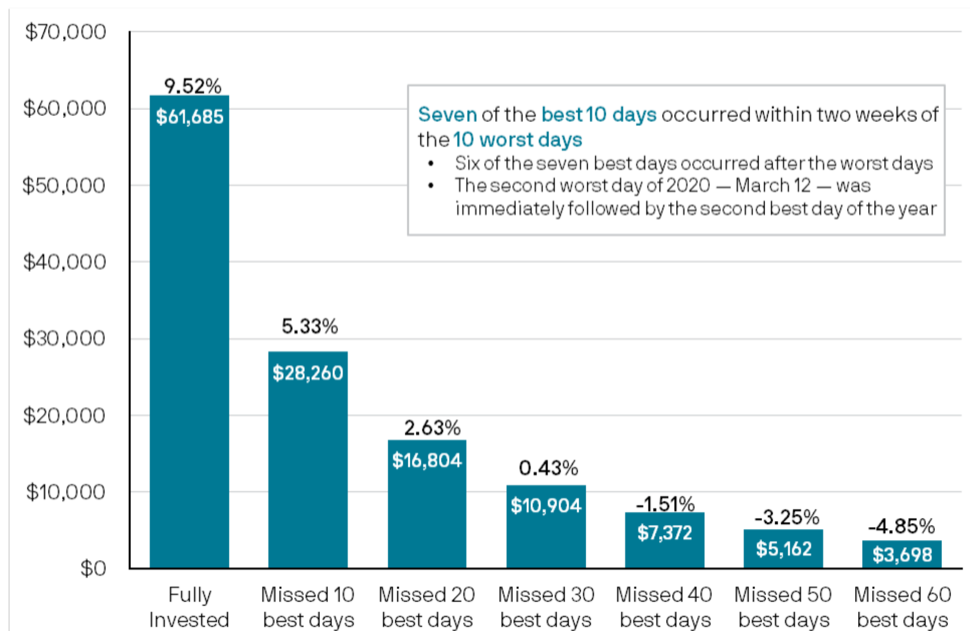
This is normal market behavior. For that level of volatility, investors received a long-term annualized return of approximately 8%.

Every market environment presents opportunities. Today's markets are volatile and our usual safe-haven, bonds, are also struggling as interest rates rise. So, what CAN we do to benefit your portfolios during these difficult market times:

- Down markets present opportunities to do tax-loss harvesting (Creating a tax-loss by selling a holding while simultaneously buying an equivalent investment. Creating a loss to use against taxes while remaining in the market)
- If you have cash, now is an opportune time to deploy that cash into stocks and real asset investments while the market is low.
- At Willow Grove Advisors, we have tactically deployed a Floating Rate Note fund since December 2021 to help mitigate the impact of rising interest rates by shifting your bond allocation into bonds with coupons that periodically adjust to prevailing interest rates. We also deploy a high yielding infrastructure fund and Inflation Protection funds to provide some hedge against inflation.

The question arises "Should I go to cash". This would certainly make some investors **feel** better, however what is the financial downside to that strategy?

- About 4.5% to 5% of the "Performance" or upside to your portfolio's value comes from Dividends and Interest. These are paid to you regardless of the "Mark-to-Market" (Closing value at the end of the day of the underlying holdings in each of your funds) value of your portfolio. Going to cash, which pays between 0.01% and 2.5%, would be giving up between 2.5% and 4.99% income.
- Then the most impactful question arises: "When do I get back into the market?" Missing significant rallies can extend your recovery significantly or permanently.



Plan to stay invested

Losses hurt more than gains feel good. Market lows can result in emotional decision making.

Taking "control" by selling out of the market after the worst days is likely to result in missing the best days that follow. Investing for the long term in a well-diversified portfolio can result in a better retirement outcome.

Speak to your advisor to make sure you have the "planned cash" you will need over the coming months and then sticking with the investment plan is the best course of action. Our assessment is that the market will rally

as we see inflation slow, signaling to the Fed to ease up or end interest rate hikes. As always, please do not hesitate to reach out with any questions or concerns regarding the implications for your portfolio and plan.

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