February 27, 2023 Update

Good morning. It was school vacation for those of us in New England last week, so my family and I were able to go down and enjoy sunny and warm Charleston, SC which was a treat. Even though we own a home in Hilton Head, SC, where I am fortunate enough to visit more frequently thanks to remote work capabilities and more clients in the Southeast for our practice, I had not yet had a chance to explore Charleston and I was not disappointed! Even though I was out of the office, I was still checking in daily.

At the end of 2022, we provided a glimpse of what would be driving the markets in 2023 which can be seen here Its The Data, Stupid!. As the title implies, it's all about the economic data and specifically anything linked to inflation. At just about 2 months in, it appears as if our No Landing call is coming in to focus. There are 2 main drivers behind this:

1. Unemployment – The February Unemployment Report showed an incredible 517,0000 jobs created and a decline in the unemployment rate which is great for the economy but bad for the inflation hawks at The Federal Reserve
2. Core PCE (Personal Consumption Expenditures) – The report showed an increase of .6% in the month of January which shows that inflation is still with us and due to this being one of the Federal Reserve's favorite inflation gauge's, that put pressure on stock on Friday

Add this up and it appears that the U.S. economy has continued to defy the expectations of many with the consumer remaining strong, spending continuing in the services sector and no recession in sight – which is exactly what the No Landing scenario is. While this may seem good, in today's world good is bad because it means higher rates from here and higher rates for longer which increases fears of a Hard Landing down the road.

According to Barron's, the reasons for the economy continuing to chug higher are:

- Excess Consumer Savings
- Strong Labor Market
- Strong Demand for Travel & Leisure
- Years Of Low Rates (think fixed rate mortgages which are immune to higher short-term rates)
    - According to Morgan Stanley, 90% of mortgages in the U.S. are fixed rate!

The challenge for the Federal Reserve it clear: People need to stop spending money for inflation to come down and that is not happening. The data has put us in the position of becoming more defensive with our equity allocation while keeping our fixed income allocation unchanged. The silver lining for the bond market is, unlike last year, yields are much higher and more attractive now and investors are getting well compensated in the form of higher yields. Even if rates rise further from here, it won't have nearly the negative effect it did last year when we were lifting off from a floor of zero. Looking further out, in the event of a Hard Landing, longer dated bonds with higher yields could be very attractive in a more significant slowdown.

Before I get accused of being too negative on the market, it is worth mentioning that there have been some serious positives over the last few months. As Tom Essaye recently pointed out in the 7's Report:

1. Economic activity remains resilient
2. Earnings have held up better than investors feared (at least so far)
3. Disinflation is occurring and the peak in inflation is behind us
4. The Fed is much closer to an end to rate hikes than a beginning.

Add it all up and the playbook from last year is still useful today. When the data changes, we will change with it which can cause us to be more defensive in our portfolios when it's needed and more offensive when it is called for. Right now we are cautious and our allocation reflects that. We always welcome your feedback or questions. Have a great week!

Regards,

Tim

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