HERITAGE
WEALTH MANAGEMENT
Learn. Share. Prosper.

The biggest story over the past 12 months must be the U.S. Federal Reserve (the Fed) changing its policy stance from one of lower for longer to raising rates to try and stave off runaway inflation. We all felt the impact of the Fed raising rates at the fastest pace in recent memory in our investment portfolios. We are now seeing the collateral damage it is causing within the financial system both here and abroad through several large bank failures. In his public statement last week, Chairman Powell said that inflation is still a larger risk than the recent bank failures. Inflation is continuing to come down, and we are beginning to hear many Economists screaming for the Fed to pause on raising rates further. Financial conditions within the U.S. are getting very tight and we are beginning to see banks pull back on lending. There are reasons to believe that inflation will continue to come down as the U.S. economy continues to slow from its post-pandemic boom: 1. Americans have spent most of the additional savings they accumulated during the pandemic, 2. Most of the emergency financial support measures put in place during the pandemic have stopped, 3. Housing prices continue to come down and rents have begun to follow suit – affecting the "rent equivalent number" that makes up 30% of the CPI (Consumer Price Index), and 40% of the Fed's core inflation number.

What does this all mean for us as we go forward? With interest rates rising, we can now expect higher returns from our "safer" investments (i.e., Bonds, money markets, CDs). Fidelity's money market account was yielding almost 4.3% as of last Friday, Government Bonds were yielding over 4%, and high-quality Corporate Bonds over 5%. We really have not seen rates like these for the better part of this 21st century. This will help to increase our overall expected return on our portfolios.

These tighter financial conditions may cause more volatility in equity markets as the economy continues to slow, and businesses grapple with the rising cost of capital. Will this cause the U.S. economy to dip into a recession? The Fed raising interest rates too far is historically the number one cause of recessions. I do feel that if we were to dip into a recession, it will not be deep or long. We do not typically enter a recession with full and growing employment, with strong corporate earnings and balance sheets, with U.S. households financially sound, and most banks being well-capitalized.

This year will continue to be part of the "Great Normalization". The global economy was shut down because of the pandemic, the system was then flooded with money, then there were global supply chain issues, commodity shortages, the Russian invasion of Ukraine, and the re-opening of China this year. You cannot just flip a switch and expect a $90 trillion global economy to start working overnight. We have also had to deal with all the added money that was "dumped" into the western economies during the binge of pandemic stimulus. This is the broad definition of inflation, too much money chasing too few goods (think housing during the pandemic shutdowns). Global supply chains have come a long way towards normalizing, and with the Fed's tightening of financial conditions, we are well on our way to removing the excess liquidity (money) dumped into the system during the pandemic. This last step may cause more collateral damage like the recent bank failures we have seen. Our economy will work through this process, and we will enter a new period of growth. We must remember this as long-term, plan-focused investors.

Please share any comments with us.

Brett Carleton, CFP®, ChFC
HERITAGE WEALTH MANAGEMENT
4400 POST OAK PARKWAY, STE 2510
713-871-7800
brett@heritageplanners.com