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June
2022

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Resolute Connections

In this month's newsletter *The Fed and the Bear* reviews the painful transition the Federal Reserve is forcing on the economy as it tries to tame inflation, while *Recession or Blip?* discusses an "impending recession" being bandied about in the press, and by many economists. Whether we are in a recession isn't known until months after it has begun, or ended, which means sticking to your plan for the foreseeable future is likely the optimal course of action.

If you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

The Fed and the Bear

By now, you know that the U.S. Federal Reserve Board raised the so-called Fed Funds rate by three quarters of a percent—the largest increase since 1994. You may also have heard that the size of the increase took everybody by surprise—a list that includes economists, pundits, journalists and professional investors. The news drove the markets, already teetering on the edge, into bear market territory—defined as a 20% drop from previous highs.

The stated reason for the rate increase is to squeeze inflation out of the economy. The logic is somewhat complicated, but the simple explanation is that inflation occurs when too much money chases too few goods. Raising rates will make it more

expensive to borrow, diminishing purchasing power on credit, which could (eventually) result in less borrowing, which could (eventually) slow down consumer spending.

But of course, consumer spending is a huge component of economic growth, so less spending will slow down the entire economy—at a time when it has already recorded a full quarter of negative growth. And by making borrowing more expensive, the central bank is also reining in corporate spending, which is another contributor to economic growth. In fact, some economists believe that the economy was running 'hot' for the past decade, because companies could fund their operations with cheap money, and unprofitable companies could stay afloat because they could always borrow enough to get by. The almost-free money allowed 'distressed' companies to rack up $49 billion in obligations that might need to be structured or face default.

If you look at the bigger picture, the American economy has experienced something quite extraordinary; for more than four decades interest rates were falling, until they finally fell down to zero (short term) or near zero (longer-term) and had no more room to fall. The Fed action has built on a reversal of that trend, sending mortgage rates to their highest level in nearly 14 years.

If you want to second-guess the Fed economists with their Ph.Ds., you might wonder whether curbing inflation is worth the collateral damage of negative economic growth, diminished consumer spending and reeling investment markets where confidence in the future is shaken. Their answer is likely to be that sooner or later they had to take away the punch bowl that led to the economic equivalent of drunken excesses—the stock market boom, exorbitant cryptocurrency valuations, meme stocks, special purpose acquisition companies, soaring housing prices, and the alarming rise in the cost of living. They might have been more gentle about it, but we all know that economic booms eventually lead to busts, which weed out unprofitable or poorly-run companies and ultimately deliver a healthier economy and, for investors, provide opportunities to buy stocks at a discount.

The Fed has challenged all of us, whether we run companies or manage our monthly budgets, to endure a painful transition that was probably inevitable, and take our medicine all at once rather than gradually over a longer period of time. Yes, the

medicine tastes terrible right now. Let's hope it provides the cure that the U.S. central bank is hoping for, and that this will lead us into the next economic expansion and a new bull market.

Recession or Blip?

You're likely reading about an "impending recession," which sounds kind of scary, especially for those of us who remember the Great Recession of 2008-9. The question right now is: are we already in a recession, or just experiencing another bump in the roller coaster?

A recession is defined as a three-consecutive-month decline in total economic activity—the Gross Domestic Product, or GDP—that leads to at least 1.5% overall decline, and at the same time, unemployment reaches 6%. This has happened 33 times since our government began keeping score in 1854, so it's not particularly unusual.

Recently, we met one of the inputs in the definition of a recession. According to the U.S. Bureau of Economic Analysis, the U.S. economy recorded a rather significant 1.5% decline in overall growth in the first three months of 2022, led by decreases in motor vehicle sales and utility activity. But we are very far from the unemployment rate 'target'—unemployment today is running at about 3.6%. And, of course, there are those other two months of decline that would need to happen.

Based on historical data the Great Recession was a small blip on the overall growth trajectory of the U.S. economy, but the start of the pandemic delivered a huge blow to growth, followed by an almost equally remarkable recovery. The current decline looks fairly moderate, although of course we never know the next data point on any of these data scales.

The U.S. is hardly alone in its first quarter malaise; overall, the GDP of the world's developed economies rose by just 0.1% over the first three months of the year, with Italy, Japan and France all experiencing moderate declines. The persistence of the Omicron Covid variant, continuing supply chain snafus and, of course, the war in Ukraine all seem to be temporary factors—although it must be admitted that many

economists thought of them as temporary months or even years ago. Consumers and business in the U.S. are still spending and investing; if that changes, then the recession predictions might—at some point we can't predict—come true.

Source:
Bob Veres Inside Edition Newsletter

For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.

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