THE DANA VIEWPOINT

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Almost There

Are we there yet? Ok maybe we are there. The “there” being the end of the Federal Reserve interest rate increases. Inflation is coming down, the economy is still growing, unemployment has not increased meaningfully, and the consumer may still have purchasing power to spare. So, what is the next challenge for the market? There are always possible threats on the horizon, but here are a few of the current headwinds and tailwinds.

Jerome Powell overdoing the rate increases has been our primary concern, as most of you know from past Viewpoints. The Fed Funds rate has been increased 10 times, for a total of five percentage points, in the last 15 months. The speed and magnitude of the increases has slowed, but that has been no less worrisome, as monetary policy works with a lag. On the plus side, S&P 500 corporate earnings fell during 2022 but are showing a recovery in the first two quarters of 2023. The unemployment rate has remained below 4% for the last 17 months, even as rates have increased significantly. This certainly demonstrates economic resiliency.

We must chuckle as Jerome Powell takes credit for lowering inflation as he as much as told us all that the economy and the job market had to be slowed in order to conquer inflation. Yet inflation has slowed while the job market has remained robust and economic growth has turned positive. Better update your rulebook, Jerome.

Although the news has been good so far, we must keep an eye on economic indicators, as rate increases affect the economy over time. So far, some slight slowing in employment cost indexes and payroll growth should give the Fed some pause, and manufacturing has definitely slowed this year. We need some slowing to rein in the Fed, but not so much that it slows profit growth and dampens consumer confidence. So far, the economy seems to be settling in that Goldilocks sweet spot.

The Goldilocks soft landing scenario is reflected in earnings. Company reports beat analyst estimates by a fair margin in the first quarter and are doing the same in the second quarter. This is driving the market. You can almost feel the bears and the underinvested participants being pulled in and forced to buy over the last few weeks. This is what drives bull markets. Prices go up faster than earnings as price to earnings ratios expand. A number of popular bearish strategists are being forced to concede to the market’s

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strength. Many of these analysts had a following because they were bearish last year and correct, but the perma bear approach doesn't work with a dynamic economy that is continually evolving and adapting.

Once the market moved up 20% off the October 2022 low, the S&P 500 Index was officially declared to be in a bull market. The average increase from that point, before another bear market, is 100%. Sure, there can be corrections or unforeseen events that can drive a new bear market, but another 100% gain without a 20% pullback is the historical baseline.

The bond market is also behaving as if economic growth has legs. The ten-year Treasury yield has begun to move up, seemingly signaling decreased chances of a recession near term. Corporate yield spreads to Treasuries have also stayed in a narrow range, reflecting the perception that companies can afford to repay their debt, even if they have to borrow at higher current rates. It certainly is rewarding to invest client bond allocations in quality securities yielding 5-6% now that rates are higher.

So, if the Fed is able to complete this rate increase cycle without pushing the economy into recession, we are willing to concede mission accomplished, and we would be happy to let another actor other than Jerome Powell take center stage. Maybe someone will step-up and address the concerns raised by Fitch in their latest downgrade of US debt.

Random Thought: "I did not succeed in life by intelligence. I succeeded because I have a long attention span" - Charlie Munger, Vice Chairman of Berkshire Hathaway

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