Economic & Investment Outlook – Fourth Quarter 2022

Not much has changed since the date of our last *Economic & Investment Outlook* on June 30th. The S&P 500 Index closed at 3,785.38 on June 30 and as of this writing on October 5th closed at 3,770.38. Volatility in the interim continued, however, and is likely to remain. The following excerpt from our earlier *Outlook* summarized the market's run for the last several years:

From 2008 to 2021, the S&P 500 (with dividends reinvested) compounded at +17.6% annually. At its peak this past January 3, the Index was up seven times from its low. This was one of the greatest runs in the whole history of American equities. Moreover, the Index's compound return over the last three of those years—2019 through 2021, encompassing the worst of the coronavirus plague—shot up to +24% annually.

But when inflation soared late last year, it became evident that equities' exceptional increase over those three years had been fueled to some important extent by an excess of fiscal and monetary stimulus, mounted to offset the economic devastation of the pandemic. In summary, the Federal Reserve created far too much money, and then left it out there far too long.

And since inflation, as Milton Friedman taught us, is always and everywhere a monetary phenomenon, we investors now find ourselves having to give back some of the extraordinary 2009–2021 market gains, as the Fed moves belatedly to sop up that excess liquidity by raising interest rates and shrinking its balance sheet.

Yes, the war in Eastern Europe and supply chain woes of various kinds have exacerbated inflation, but in our judgment they're irritants: monetary policy (seasoned as well with a bit too much fiscal stimulus) got us into this situation, and monetary policy must now get us out. If an economic slowdown over a few calendar quarters is what it takes to stamp out inflation, it would be by far the lesser of the two evils.

Not only have the markets not moved much since last quarter, but there is no additional clarity around the status of recession, whether inflation is anticipated to dissipate, and whether supply chain challenges and the war in Eastern Europe are any closer to coming to an end. This uncertainty drives the expectation for two possible scenarios as explained below.

Two Possible Outcomes for the Economy and Markets

Discussions of out-of-control inflation and a possible recession have been heard on news channels for the last several months. If kept under control, inflation is healthy for the economy as long as it does not increase more than 2-3 percentage points each year. Recessions are considered an unavoidable part of the business cycle and occur when a nation's economy experiences negative gross domestic product (GDP), rising levels of unemployment, and falling retail sales.

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The stock market is considered a forward economic indicator, having a remarkably strong record of moving downwards in anticipation of economic slowdowns and upwards before an economic recovery actually begins. The exact timing and magnitude are unpredictable, however, which prevent investors from being able to successfully time the markets.

Over the coming months, the Federal Reserve will utilize certain economic tools to fight inflation. The ideal scenario would be that through a delicate management of the economy, with mild interest rate increases, the economy avoids a recession, but still manages to bring inflation to more desirable levels. This result is known as a “soft landing”. In this case, the markets may be “oversold”, having declined further than investors would expect for this economic scenario. A recovery could be on the way in a very short period.

If, however, a recession occurs, then the current market levels seem appropriate. The stock market, having already dropped 20-plus percent this year, could continue to maintain close to its current level, and not suffer substantial additional declines. It could take several weeks, or possibly months, before the recovery begins, however. In either scenario, it is reasonable to expect that between now and year-end, the markets would be advancing once again.

Total Wealth Planning’s diversification and tactical asset allocation reduced the amount of loss in portfolio values as compared to the performances of the equity market indexes

On a relative basis, Total Wealth Planning’s managed portfolios outperformed the equity indexes throughout the year and, importantly, are positioned for future growth. Historically, when rebounds occur, they do so in powerful sporadic spurts without notice and without regard to the presence of a recessionary economic environment. For example, the most significant decline in the last fifty years was from 1973-1974 when the index of small companies declined -30.90% and -19.95%, respectively. The climate at that time was similar to today in terms of high inflation, but the country was also experiencing a severe recession. These results were followed by extraordinary gains from 1975-1983, when the same index increased +52.82%, +57.38%, +25.38%, +23.46%, +43.46%, 39.88%, +13.88%, +28.01% and +39.67%. It is impossible to forecast the timing and the strength of the future rebound, but inevitably it will occur. Attempts to predict and time the markets most often prove foolish and costly.

Prudent Portfolio Management Integrated with Comprehensive Financial Planning Provides the Best Long-Term Results

As described in previous communications from Total Wealth Planning, we advocate a proven Nobel Prize-Winning Approach for managing our client’s investment portfolios. By maintaining consistent exposure to a diversified array of 15-20 individual asset classes, clients’ investment portfolios will have every opportunity for growth. By making tactical shifts, over and above periodic rebalancing and profit-taking opportunities, we seek to add value, especially during periods of elevated volatility. At Total Wealth Planning, our team of financial planning and investment management professionals work closely together to ensure that opportunities for adding value to your financial situation are not overlooked. In our opinion, wealth building and preservation must include not only investment management, but also financial

planning activities, such as cash management, debt management, tax planning, risk management, college funding, retirement planning, and estate preservation.

Please contact us at any time with question or comments.

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