Key Questions

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Where Do Things Stand As We Approach the End of the Year?

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

In early December 2022, we outlined our thoughts for 2023 by asking a question: “Was a pound of medicine worth an ounce of cure?” Deliberately playing off of the adage “An ounce of medicine is worth a pound of cure," we were suggesting that in spite of forceful actions taken by the Federal Reserve (the Fed) to lower inflation, their efforts were only having a relatively modest impact.

At the time of our writing, we observed that “headline” inflation, which reached 9% in July 2022, had receded to 6.5% by year end. Similarly, “core” inflation (which excludes volatile but important components such as food and energy prices) had fallen nearly 100 basis points to 5.7% by December. Both readings revealed that progress was being made. But we felt that such progress was inadequate and well above the Fed’s stated inflation target of 2%.

Accordingly, we believed that the Fed would continue raise interest rates in 2023. While we thought that the pace of rate hikes would moderate along with inflation, we leaned against the consensus view that interest rates would be reduced; “a pause is probable, but a pivot is not,” we stated at the time.

On this score, we were largely correct: inflation has fallen steadily throughout the year, and the Fed’s rate hiking campaign has moderated in tandem. Still, wages have remained elevated, which is now highlighted as a reason for the Fed to keep rates “higher for longer.” Although the Fed’s 2% objective is closer at hand, the goal has not yet been met.

Turning to economic growth, 15 months ago, we stated that “a recession was a likely outcome… but not a forgone conclusion.” Noncommittal as this statement was, we acknowledge our cautious outlook was too cautious, and the economic picture today is brighter than we envisioned in late 2022.

In fact, the economy has proven more resilient than most all forecasters envisioned. Therefore it is worth exploring the factors behind the economy’s resilience and attempting to answer how much longer they might persist.

In simplistic terms, faster-than-expected spending has fueled this year’s better-than-expected growth, and such spending has come in many forms. Excess savings from Covid-related stimulus has continued to lift spending; ongoing pent-up demand (especially for services and experiences) has boosted spending; ongoing labor market imbalances have made wages “stickier,” resulting in greater purchasing power thereby boosting spending; and, despite proclamations over fiscal restraint earlier this year, government spending (stemming from the Inflation Reduction Act and CHIPS and Science Act) has also jolted the economy.

While we acknowledge that “a force in motion tends to stay in motion,” and the aforementioned sources of economic momentum will not reverse quickly, we do believe that as we start preparing to turn an eye to 2024, today’s economic momentum will fade. Furthermore, this will coincide with higher interest rates, causing the price of

credit to rise, along with other forces causing the availability of credit to slow.

To some extent, this slowdown is already materializing: wage increases have been trending lower; job hires and job openings have slowed; and prices on several goods and services are being reduced. In addition, Americans' excess savings are being depleted; the Federal Reserve is removing liquidity from the economy; and the cost for many traditional sources of financing are rising and/or are being constrained.

All of this said, while the cautious stance we articulated late last year may have been overly cautious, we continue to believe it is warranted. And by the time we write our 2024 Outlook, such caution may be vindicated.

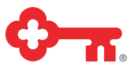
Given this, we continue to advise maintaining a "Neutral to Risk" posture, implying one's portfolio exposure to equity risk should be closely aligned with its strategic asset allocation targets. We also affirm a strong bias for owning high-quality securities and incorporating "New Portfolio Tools" where appropriate to further enhance a portfolio's diversification.

Resources:

2023 Outlook: Was a Pound of Medicine Worth an Ounce of Cure?

Thursday, 6/15/2023 - FOMC Update: Hawkish Pause, Hawkish Messaging, and the Committee Signals More Rate Hikes to Come

For more information, please contact your advisor.



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