# The Quarterly Perspective

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ABOUT

Harman Wealth Management

At Harman Wealth Management, we provide private, advanced, independent planning and investment management to individuals, families, and institutional clients.

We value in-depth economic research, evidence-based investment methods, and rigorous risk management. We are committed to insightful, objective solutions, and always working solely for the best interest of our clients.

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## When Negative Consumer Sentiment is at Odds with Positive Economic Reports.

Delving into the Question, "If the Economy is so Bad, Why are Markets Moving Up?"

### The Economy's Confusing Conundrum

As if the investing world isn't confusing enough, investors are now finding themselves in the middle of a battle of competing narratives. On one front, consumer sentiment still sits at historically pessimistic levels. In general, when surveyed, a majority of consumers view the economy as bad and getting worse. According to a Gallup May 31st survey, their Economic Confidence Index dipped to an abysmal -34. Compared to the last twenty-eight years, the reading was only worse on two occasions, in 2022 when inflation growth was at its worst, and at the depth of the 2008 financial crisis. When asked about the economic outlook, 70% of respondents viewed the economy as getting worse.

Policy leaders and economists offer a contrary story, arguing the economy is strong and performing well. They cite a historically low unemployment rate at 4% and strong GDP growth at 3%. They add the current inflation reading of 3.1% is historically modest even though it hasn't met the Federal Reserve's target of 2.0% yet. Furthermore, they point to the equity markets performing at new highs.

*"The best answer is that both sides are technically right. The key is understanding that each viewpoint is entirely accurate depending on who is making the statement."*

So, what gives? How are investors supposed to make sense of it all? Is the state of the economy good or bad?

### Which Narrative on the Economy is Accurate?

The best answer is that both sides are technically right. The key is understanding that each viewpoint is entirely accurate, depending on who makes the statement.

To most Americans, interacting with "the economy" relates to asking about their employment, wages, and, most of all, spending. The experience is very much defined by the household budget. Prices are far higher than three years ago in practically everything, and it is causing a lot of financial pain. Every transaction, from groceries and retail outlets to fuel, insurance, and repairs, serves as a daily reminder.

While incomes for some have grown and markets are up, the vast majority are making hard adjustments to permanently higher prices compared to three years ago. It would be a complete mistake to dismiss consumers and argue they don't understand the economy, as some policy leaders have attempted.

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Meanwhile, to an economist or policy leader, the health of the "economy" relates to the functioning of markets. Above-average job growth and a low unemployment rate prove the labor market is strong. Personal consumption is still growing well, and as a result, GDP is strong. With

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access to capital, businesses are investing in future growth, proving lending markets are functioning well. Finally, there is the U.S. stock market. While not every sector has fully rebounded from the sell-off of 2022, most have and continue pushing new highs. All in all, to an economist, the current profile is highly consistent with a "good" economy."

## Lessons from the Messaging

The first lesson for investors is that consumer surveys and opinion polls tend to lag behind economic turning points. Likewise, pain-related assessments tend to be felt more deeply and held onto for longer. This is why most consumers believe the economy remains in recession long after a technical contraction has ended. Because of this lag, investors should understand consumer sentiment as a contrarian signal. Perhaps it is better to show caution when consumers feel great and look for opportunities when they are expressing despair.

Policy leaders should also humble themselves over this episode of inflation. History will show the 2010s as the lowest decade of inflation in the last eighty years.[1] Rather than a gradual twist in fundamentals, it was policy that caused the greatest loss of purchasing power in over forty years. The damage to low-income and fixed-income households should be a stark reminder of how menacing inflation can become.

Finally, investors must understand markets tend to move irrespective of current consumer sentiment. Seasoned market strategist Richard Bernstein reminds investors that markets often move based on assessments of "better or worse" not "good or bad." Bernstein's simplified rule explains why markets can surge upward long before people actually feel "good" about the economy.

## What Does it Mean for Investors?

When it comes to investing, words and concepts often carry complex nuances below the surface. In other words, you can't take everything at face value. Today's consumers are justified in their frustration. They have every right to express their dissatisfaction over the damage of high inflation and not be told they don't understand the economy. Investors, on the other hand, would be wise to understand the trends for what they are. In spite of recent inflation, consumers are still very resilient, and economic growth is still powering through.

Sources:
1 U.S. Bureau of Labor Statistics


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# Fed Cautiously Balancing Between Two-Sided Risks as the First Interest Rate Cut Looms

## Powell Makes the Case for Rate Cuts Soon

*"More pointedly, though, Powell acknowledged inflation isn't the only risk at hand. With higher interest rates tightening down on the economy, there is also a risk of labor markets weakening sharply if rates remain too restrictive for too long."*

After more than two years of a serious inflation battle, the Federal Reserve is laying out the case for its next move – a very welcome cut to baseline interest rates.

*"we're well aware of the two-sided risks here, let me just say. We, understand that if we wait too long, that could come at the cost of economic activity, of employment, of the expansion. We understand that if we move too quickly, we could end up undoing a lot of the good that we've done and have to then start over, and it could be very disruptive.*

*Jerome Powell*
*FOMC Press Conference, June 12*

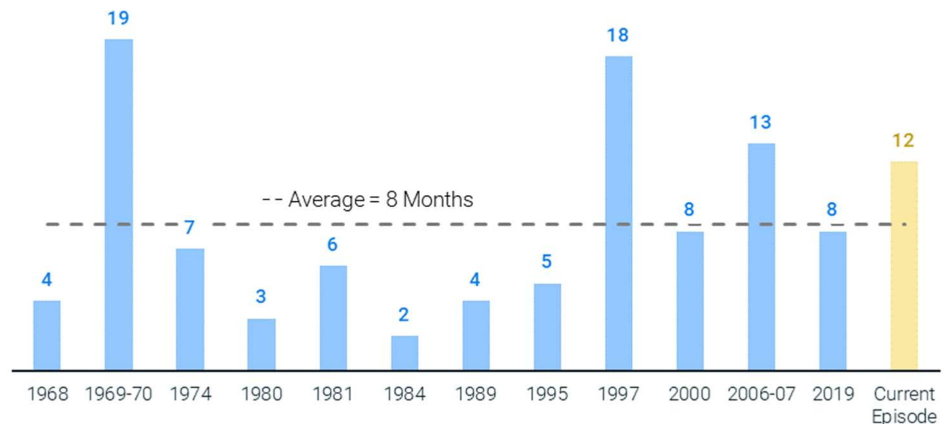
For over a year, FOMC Chairman Jerome Powell held steady that the Fed would maintain interest rates at restrictive levels for an extended time. In essence, rate cuts were off the table until the committee was "fully confident" inflation would sustainably reach its 2% target. His recent testimony in front of Congress on July 9th signaled a very welcome shift in the Fed's stance.

Powell pointed to supply chains finally catching up to demand and improved balance in labor markets. Despite an early-year scare in the inflation trend, recent data releases have shown inflation trending back down.

More pointedly, though, Powell acknowledged inflation isn't the only risk at hand. With higher interest rates tightening down on the economy, there is also a risk of labor markets weakening sharply if rates remain too restrictive for too long.

The softening stance was well received. Already, markets have jumped ahead, expecting the first rate cut in September with another following by year-end.

From a historical perspective, the Fed has indeed exercised resolve in sticking to its restrictive policy. More than a year has passed since its final rate hike last July, making it one of the longest duration gaps before changing its policy stance.

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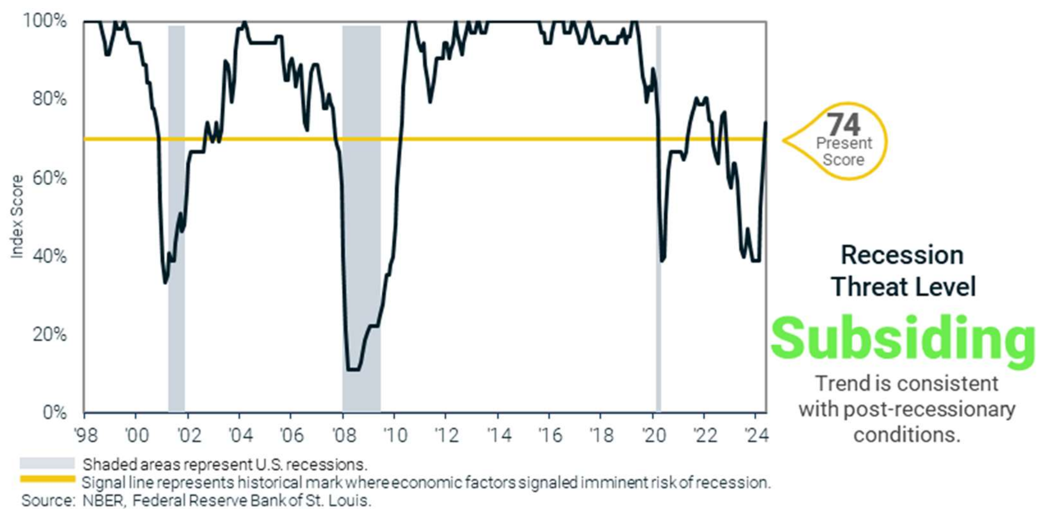
*"…trends are very much aligned with further economic growth. Real GDP is up a solid 2.9% from a year ago."*

## Business Cycle Risk Profile

- The latest index value is consistent with recovery conditions, whereby elements restabilize after economic strain.
- While the economy still has pockets of distress, trends are very much aligned with further economic growth. Real GDP is up a solid 2.9% from a year ago.
- Employment continues to operate as a primary growth driver. Monthly trends show average job growth well above average from the expansion of 2009 to 2019.
- Slowdowns in housing, trade, transportation, and manufacturing look to be bottoming and positioning for return to growth as interest rates eventually ease.
- The Fed's planned rate cuts will help both business activity and investor sentiment in the back half of 2024.




Interpreting the Index Score:

- The index score measures nine economic factors that have demonstrated co-movement with the deteriorating conditions of the past seven recessions dating back to 1970.
- When the index score is at 100, it means all nine of the factors are measuring at levels consistent with past economic expansion.
- When the index score is below 100, it means that one or more of the weighted factors has moved to a level consistent with past economic contractions.
- In aggregate a score of 70 or higher is interpreted as a composite profile consistent with past economic expansion. A score lower than 70 is interpreted as a composite profile consistent with past economic contraction.
- Markets can, and sometimes do, demonstrate volatility even though the economic factors are measuring consistent with expansion.

## Interested in Adaptive Business Cycle Investing?

Today's markets, economies, and policies are more complex than ever, challenging investors on what to watch and when to take action.

At Harman Wealth Management, we understand sound investments are uniquely supported by the conditions that favor them. And, when conditions change, so do the investments that benefit.

That's why we conduct rigorous and disciplined tracking of the U.S. business cycle. We also track the cyclical factors that shape our investing environment, like currencies, commodities, and rates. We embrace a world where investing dynamics are constantly evolving and believe it's imperative to have an investment strategy that adapts with it.

With Adaptive Business Cycle Investing we invest consistent with business cycle forces, aligning investments with the conditions driving returns in the present, rather than chasing what worked in the past.

## About Harman Wealth Management

At Harman Wealth Management, we provide private, advanced, independent planning and investment management to individuals, families, and institutional clients.

We value in-depth economic research, evidence-based investment methods, and rigorous risk management. We are committed to integrative advanced planning by aligning investment objectives with business cycle opportunities and risks.

At Harman Wealth Management, our aim is to help clients realize their goals within a disciplined, insightful, and rewarding relationship.

For more information about Harman Wealth Management or investing with the business cycle, contact us at 281-719-8601.

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Investing involves risk including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values. Past performance is no guarantee of future results. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment.

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The Standard and Poor's 500 is an unmanaged index generally representative of the U.S. stock market and cannot be invested in directly.

In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. Bonds are also subject to other types of risks such as call, credit, liquidity, interest rate, and general market risks.