THE FINANCE COUPLE™

TWO PERSPECTIVES WITH ONE FOCUS... YOU

A Relevant Recession

March 2022

"An economist is an expert who will know tomorrow why the things he predicted yesterday didn't happen today." – Lawrence J. Peter

Recession; there, I said it. The one word most people, especially the politicians, are either trying not to say or trying to say will not occur. But this doesn't make sense; isn't recession a natural, though painful, part of every business cycle? Oh, that's right, I almost forgot that the government, in all its wisdom, not only tried to save us from economic covid calamity but also tried to make sure there either was no recession in 2020 or that no one felt it (noble and debatable at the same time).

The reality is that, not unlike bankruptcy, recessions happen to be an important part of a capitalistic and competitive system; unfortunately, there will be some winners and some losers in the process, but it helps set us up for future growth. Again, not unlike the legal system here in the U.S., it may be a bad process, but it's still the best in the world. (Not for nothing, but I certainly could sound off on the fact that we have probably disillusioned a generation of kids by awarding every one of them a medal no matter the effort - but that's a rant for another day).

I bring all this up because there are more than a few issues that could push us into recession. Aside from the horrific invasion of Ukraine by Russia, which has terrible humanitarian and economic consequences, we are also dealing with inflationary pressures that haven't been felt for almost forty years. It's a foregone conclusion that the Federal Reserve will be raising interest rates by at least 1% this year if not more. Further, the Fed is shifting from QE (quantitative easing) to QT (quantitative tightening); where QE basically had the government, ironically enough, buying the very bonds it was issuing, QT entails decreasing that inventory.

So, with the Fed now owning about a third of the U.S. Treasury and mortgage market, and increasing its balance sheet to over 40% of gross domestic product, QT could be an interesting proposition – and as everyone may know, I don't like interesting! Especially when the current Fed chairman admits that "[b]alance sheet [policy] is still a relatively new thing for the markets and for us." In fact, there is little to no historical precedence for what happens during QT.

As scary as all this may seem, we need to take a step back and evaluate the other side of the coin. First, paraphrasing the quote above, we tend not to know we are in a recession until after the fact; typically economists only tell us in hindsight what we have already experienced. Second, just because we currently have high inflation does not mean we are in a new hyper-inflated era. In fact, gasoline prices have experienced almost 0% inflation over the last fourteen years since we were

paying $4/gallon in 2008 (and energy consumption now accounts for less of our total spending than it did in the hyper-inflated 70's). This isn't to say it doesn't hurt to pay more today for gas than it did yesterday, but a little perspective can help. Third, remember that we have been in a bond bull market for over 30 years where interest rates have steadily declined (remember, bond prices tend to rise when rates fall, and vice versa). Accordingly, an increase in rates to where they were three or even ten years ago may simply be a normalization to historical averages. Fourth, along this same line, tighter monetary conditions (through increasing rates and/or QT) may help cool inflation while also diminishing the purchasing power of consumers, which in turn may push more people (back) into the workforce and help reduce wage and supply chain pressures.

As always, we are not advocating for an optimistic nor pessimistic approach – as we've said many times before, you should proactively get ready for good times and bad, in good times and bad, to allow yourself the ability to make objective, non-emotional decisions (which can be actionable or non-actionable). We also cannot forget that the economy is very much like a massive cruise liner that can turn in different directions, but will do so very slowly. This is one of the many reasons why the markets are discounting mechanisms, looking into the future 3-6 months rather than reacting to today or tomorrow's news. For example, we knew months ago that Russia might attack Ukraine – it doesn't make it right, but the markets would have already priced in that possibility or eventuality. And if you think the markets have acted worse than imagined after the invasion, it may simply be a matter of an overpriced market looking for a reason to correct.

At this point, our best guess (and every look into the future is by definition a guess) is that this is a correction rather than the popping of the bubble that we have been talking about for the last twelve months or so. We think the real shoe drop will be out another year or two – but again, no one knows this answer, and circumstances will change as the Russia/Ukraine war drags on. But if I have a choice to be optimistic or pessimistic, knowing that my mental state of mind will not decide what actually happens in the unknowable future, then I choose to be optimistic. We believe things will get better here and abroad sooner rather than later, and, just as courage is only ever found in the face of danger, we believe a silver-lining to this terrible war is that a divided community, in the U.S. and abroad, are uniting to support a free people in Ukraine fighting for their lives and their democracy.

Thank you for your friendship, your trust, and your referrals - and have a great Spring!

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