THE FINANCE COUPLE™

TWO PERSPECTIVES WITH ONE FOCUS... YOU

Top of the Mind Questions

October 2023

"My greatest strength as a consultant is to be ignorant and ask a few questions."
- Peter Drucker

2023 has seemed to be a year of transition (some good, some bad) for many people, so in honor of that we have decided to take a different tact this month. Instead of talking about something that is top of the mind for us, we want to address what seems to be top of mind for others. So below are three questions that Wynne and I have been hearing from acquaintances, strangers, and clients.

Question #1: What is happening to bonds, why, and will it continue?

Answer: Let's start with the basics. First, there is an inverse relationship between interest rates and price when it comes to bonds or fixed income; typically, when rates go up then prices go down, and vice versa. Further, if there is weak demand or additional supply, then price tends to go down and rates go up; conversely, if there is strong demand or less supply, then price tends to go up and rates go down.

Over the past eighteen months, the Federal Reserve has been trying to tame inflation and slow the economy down by raising interest rates, thus decreasing the value of issued fixed income. The Fed has also been engaged in quantitative tightening, allowing billions of dollars in treasury and agency bonds to mature without replacement; this weaker demand helps decrease prices and increase rates.

However, the Fed may be starting to lose control of this price/rate dynamic to the bond market, which could make the direction of rates, and consequences therefrom, less clear. The bond market, a collective of institutional and individual investors, anticipates where the economy will be in the future and adjusts the value (and thus rates) of bonds accordingly (please be aware I am simplifying for brevity's sake). And don't forget that this collective anticipation and value adjustment by the bond market will certainly be influenced by the massive deficit Democrats and Republicans alike have built up over the last twenty years; the interest cost from the deficit's financing may cause an increase of treasury/agency bond issuance (an increase of supply), once again decreasing price and increasing rates.

This is why we think higher rates may persist, and confound many people who hope higher rates will not continue; as always, the future is unknown and unknowable, and we hope to be wrong here.

Question #2: Is a recession on the horizon?

Answer: From all accounts there certainly should be, but it does not appear to be in the cards for the next 0-12 months, much less is it currently happening. Although the Fed has raised rates more than ten times in the last 18 months, the economy seems to be doing quite well. Headline inflation has fallen from about 9% to 3% year-over-year, unemployment remains historically low around 3.6%, and spending remains higher than average. Mix in the fact that the housing market is finally slowing down, rental prices seem to be cooling, and prices at the gas pump continue to fall, and you have a fairly healthy situation that speaks to either no recession or a soft-landing recession.

But things could change in a hurry due to several different issues, such as: runaway spending combined with historically low tax rates, a massive federal deficit, multiple global wars or skirmishes, and the end of covid-induced governmental stimulus which includes the resumption of student loan payments (as an aside, we do not believe there is any such thing as debt forgiveness but rather debt shifting from one person, such as a student, to another person, such as a taxpayer). And remember, for the last hundred years or so, recessions have always made regular appearances since they tend to be a painful yet natural and cleansing part of every business cycle. Accordingly, there seems to be a lot of uncertainty, to a point that I have never seen in the twenty-eight years that I've been in this business.

Question #3: What should I do now?

Answer: Although this may be an important question, it may also be the toughest for some to hear. The reality is that if you have not been proactive in getting ready for good times and bad, during good times and bad (as we always advocate), then you may have no choice but to make some changes at an inopportune time. Hopefully this is not the case. But if it is, then please take it slow and remember that there is never any boat to be missed in our opinion - and every day/week/month will be followed by another day/week/month that can make you forget the previous one. We also caution everyone against making short-term adjustments that can hamper your long-term plans. Accordingly, it may not make sense to sell a long-term security such as stock based on a short-term perspective (we advocate only buying or owning stock if you have a minimum of ten years or more to hold the security).

I hope this question-and-answer newsletter was enlightening and helpful. And for one last tidbit, we thought we'd share what we believe is the best answer to give people who ask us what they should do. If you are not a client, then the answer is usually, "I don't know". Since we pride ourselves on being true comprehensive "advisors" (in contrast to salespeople who may really just sell a product or strategy), we can only give proper advice after we have asked a lot of questions to learn as much as possible about you and your overall situation. Thus, we thoroughly agree with Peter Drucker that a good consultant is only as good as the questions he or she asks.

We hope you have a great start to Fall, and thank you so much for your friendship and trust!

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