CAPSTONE
WEALTH ADVISORS

Outlook on the Markets

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CAPSTONE
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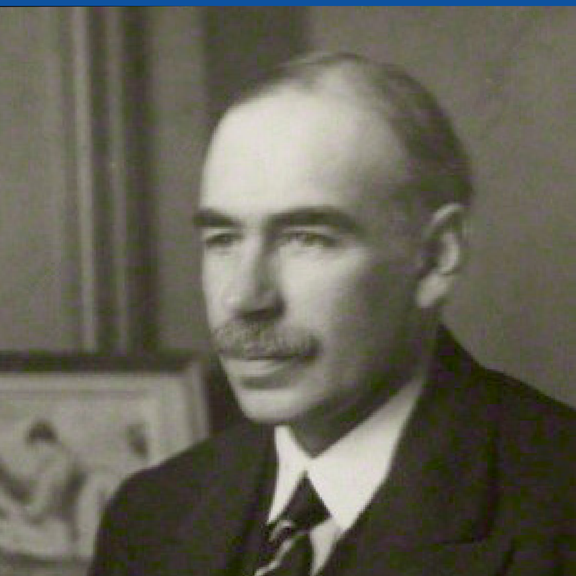
Capstone Wealth Advisors is pleased to release our Mid-Year Outlook on the Markets written entirely by our advisory team. Our outlook is based on our views and philosophies as we see them impacting financial markets, and your money. Current trends, economic indicators and in-depth analysis is at the core of what we do. We monitor and analyze economic trends to help our clients have a clear understanding of the direction the economy is headed and how that impacts your portfolio strategies.

We have six offices throughout the Pacific Northwest, utilizing a team approach to provide continuity for your asset planning needs. Our investment committee meets weekly to discuss current economic events, market trends, asset allocations and more. By using a disciplined and methodical approach to investing, we remove the noise and emotion from your investment portfolio and allow you to focus on the things you love and enjoy most.



Markets can remain irrational longer than you can remain solvent.

– *John Maynard Keynes* –

Navigating the Economic Paradox: Booming Indicators Clash with Recession Alarms

As we approach the end of Q3 2023, the U.S. economy continues to send mixed signals perplexing even the most astute market analysts and policymakers. As the tale of two economies unfolds before us, the looming question remains: Are we on the brink of a recession, or in the middle of an economic boom?

An unsettling recession forecast comes from the New York Federal Reserve, placing a 70.81% probability of a recession occurring between now and May 2024. This has been a historically accurate sign and should be taken seriously. Since 1970, a recession has occurred in every situation following this probability crossing above a 30% threshold. Given the New York Federal Reserve is forecasting the probability to surpass the 30% threshold in November 2023 and peaking at 70.81% in May 2024, the alarm bells are now ringing louder than ever. [1]

Adding to recessionary concerns is the Leading Economic Index (LEI), a composite designed to forecast future economic trends. The LEI has been on a downward trajectory for the past 20 months. Historically, the longest it has ever fallen without triggering a recession is 20 months (2007-2009). On average, this index peaks about 10.6 months before a recession begins, suggesting we're well overdue.

The U.S. Treasury Bond Yield Curve, a historically reliable recession indicator, has been inverted since June 2021. A Yield Curve inversion is when the difference between the 10-year treasury rate and the 3-month rate turns negative, it's often a sign of a looming recession. This configuration has preceded every recession since 1960, making it difficult to dismiss this warning.

The national average for 30-year fixed mortgages currently sits at 7.5% for an +800 credit score, and over 8% for borrowers with at 700 credit score. Additionally, Consumer Credit Card Debt has for the first time exceeded the $1 trillion mark, with an average interest rate surpassing 20% APY. Consumers appear to be overextended, a concerning sign when combined with other recession indicators.

In stark contrast to these warnings are several bullish indicators. The Federal Reserve Bank of Atlanta's GDP Now model is predicting an impressive 5.6% GDP growth for Q3 2023, following a 2.1% reading for Q2 2023. Meanwhile, the U-3 Unemployment Rate has remained under 4% since January 2022, currently sitting at an enviable 3.8%. Inflation, although currently sitting at 3.2%, has been tamed considerably since its peak at 9.1% in June 2022. Additionally, the S&P 500 has entered into a technical Bull Market in October 2022.These indicators normally suggest a booming economy, far from the brink of recession.

Facts to Consider

- **The S&P/Case-Shiller Home Price Index,** widely recognized as the gauge for home price movements, reported that national home prices have begun to increase since January 2023 after a brief decline late last year. The index is currently sitting at 308.25 as of June 2023. Many economists believe the impact from mortgage rates at 23-year highs has yet to be fully reflected in the numbers. [2]

- **The Consumer Confidence Index®** declined in August to 106.1, from a downwardly revised 114.0 in July. The Present Situation Index—based on consumers' assessment of current business and labor market conditions—fell to 144.8 from 153.0. The Expectations Index— based on consumers' short-term outlook for income, business, and labor market conditions—declined to 80.2 in August, reversing July's sharp uptick to 88.0. Expectations were a hair above 80—the level that historically signals a recession within the next year. Although consumer fears of an impending recession continued to recede, we still anticipate one is likely before yearend.[3]

- **The Purchasing Managers Index (PMI)®** for manufacturing contracted for the 10th consecutive month, registering at 47.6%, 1.2 percentage points higher than the 46.4% recorded in July. Regarding the overall economy, this figure indicates 10th month of contraction after a 30-month period of expansion. While the U.S. manufacturing sector shrank again, the uptick in the PMI® indicates a slower rate of contraction. The August composite index reading reflects companies managing outputs appropriately as order softness continues, but the month-over-month increase is a sign of price stability. [4]

- **The National Federation of Independent Business** reported 40% (seasonally adjusted) of small business owners reported job openings they could not fill in the current period, down two points from last month and the lowest level since February 2021. Seasonally adjusted, a net 36% of owners reported raising compensation in August, tying June's reading, and marking the lowest reading since May 2021. A net 26% of owners plan to raise compensation in the next three months, up five points from July.[5]

- **The Bureau of Economic Analysis (BEA)** reported Personal Income increased 0.2% (at a monthly rate) in July. Disposable Personal Income, Personal Income less personal current taxes, increased less than 0.1% and Personal Consumption Expenditures (PCE) increased 0.8%. The increase in current-dollar personal income in July primarily reflected an increase in compensation that was partly offset by a decrease in personal current transfer receipts. In summary, Personal Income went up 0.2% but Personal Consumption went up 0.8% [6]

- **The Official Unemployment Rate** in the US, known as "U-3", stands at a seasonally adjusted 3.8% in August. A more comprehensive measure of unemployment known as "U-6", was at 7.1% in August 2023 which is a minor increase from August 2022 rate of 7.0%. [7]

- **Real Gross Domestic Product (GDP)** increased at an annual rate of 2.1% in the second quarter of 2023. In the first quarter, real GDP increased 2.0%. The updated estimates primarily reflected downward revisions to private inventory investment and nonresidential fixed investment that were partly offset by an upward revision to state and local government spending.[8]

- **CBOE Volatility Index (VIX)** has seen quite some volatility over the past couple years and has continued a steady decline since October 2022 with a high of 32.02. The index sits at 16.90 as of late September 2023. [9]

- **Playing in the Oil Patch:** The US Strategic Petroleum Reserve is currently at its lowest level in 40 years and plans to restock the reserves have been halted by the Biden Administration. This comes at a time when Saudi Arabia and Russia have both agreed to extend a 1.3 million barrel per day cut of production through December 2023. The current price for Brent Crude is near $90 per barrel.

An additional layer of complexity comes from geopolitical uncertainties. The ongoing war in Ukraine is a critical external factor, posing threats to global economic stability and trade. This situation adds another variable to economic forecasts, with potential repercussions that could either catalyze or exacerbate current domestic economic conditions.

The Chinese economy, the world's second largest, is showing signs of weakening, mainly due to an overbuilt, debt-ridden property sector. Trouble for China's economy could stretch on over the long-term as it faces poor growth prospects. China officially slipped into deflation over the last quarter, thanks to demand failing to revive itself amid a so-far disappointing economic reopening after its COVID related lockdowns.

So where does this leave us?

We are in an economic paradox, a tug-of-war between booming metrics and highly accurate historical recession indicators. On one hand, we have classic signs of an overheating economy, illustrated by the high GDP forecasts, low unemployment rates, and a bullish stock market. On the other hand, long-standing recession indicators are flashing red. It might signify a transitional economic phase, a move toward a new equilibrium, or perhaps a bubble on the edge of bursting.

As the end of 2023 nears, our economic situation warrants investors to use caution when engaging stocks. Policymakers must thread the needle carefully; the wrong policy move could tip the economy in a negative direction. The convergence of recession indicators has historically been too significant to ignore, making every economic decision from this point a calculated risk. The path ahead is uncertain, and it would be prudent for everyone to buckle up for what might be a bumpy ride.

What does this mean for you and your portfolio?

The simultaneous presence of bullish stock market trends and historically reliable signs of an upcoming recession has created a unique and precarious economic landscape. While these conflicting data points make the near-term economic forecast less certain, they undeniably amplify the risk profile for financial markets. In such an environment, a strategic focus on high-quality, dividend-paying U.S. companies offers a buffer against unpredictable market swings. Clients with lower risk tolerance should be aware that the stakes are currently high. If the economy leans into one scenario over the other—be it a recession or a sustained boom—the consequences could be starkly divergent, affecting your investments in different ways. As we tread through this period of heightened economic ambiguity, it's essential to prepare for multiple contingencies, while also remaining agile to respond to unfolding events.

To our valued clients, your investment portfolios already reflect our investment philosophy. As market conditions change, we will continue to proactively implement portfolio adjustments as part of our investment process. For those of you who are not currently a client and would like to learn how we can help assist you in your retirement planning and investment management during these challenging times, we invite you to schedule a complimentary consultation with our team. We can discuss our current eco nomic outlook in greater detail and specifically how it might affect your existing portfolio. If you would like to schedule, please call our office directly at (877) 739-6007 or email us at info@capstonewealthadvisors.com.

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