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Regans' Notes

Market Concerns

A recent term used to describe fear of an undesirable future economy is **Anti-Goldilocks Economy** (An economy that will be both too hot in terms of inflation and too cold in terms of growth). In view of these worries, we believe it is worthwhile to review a few key topics affecting the market:

- The Federal Reserve (Fed) pivoting to a tighter monetary policy of raising interest rates.
- The largest invasion since World War II occurring in Europe.
- Gasoline prices spiking to a 14-year high and many other basic commodity prices increasing rapidly. *Source: Riverfront Investment Group*
- The Consumer Price Index (CPI) is up 7.9% from a year ago. ***Source:*** *BLS*
- Fear of higher tax rates that are likely to slow economic growth.
- Fear of a wealth tax, which we do not expect to achieve legislative approval in the near future.

Eventually the bull market will come to an end. Perhaps, some exogenous factor or black swan will cause an economic strain or crisis. Perhaps, perhaps, perhaps but **we do not think we are in bubble territory currently. We also think most of these headwinds are already priced into the market.**

Yes, someday the bull market will come to an end, but not all bear markets are the same. Some are short in duration and some last longer. Some are shallow and some are deeper. We do not expect any to be forever. **We think it is more likely that a normal correction will come first.**

US Economy Still Growing

A look in the rear-view mirror serves as a reminder that the US economy is still growing. With worries about growth ahead, we believe it is important to examine the US economy.

- **The unemployment rate is back to pre-pandemic levels, 3.6%** vs 3.5% in February 2020, just before the shutdown from the pandemic. *Source: Bureau of Labor Statistics*
- **Corporate profit margins remain above average, and earnings are still growing.** Current FactSet estimates are for profit margins for S&P500 companies to be around 12% for the first quarter of 2022, which is above the five-year average. *Source: RiverFront Investment Group*
- **Purchasing Managers Indexes (PMIs) remain above 50 which bodes well for growth.** *Source: Institute for Supply Management*
- **Consumer spending is holding up well despite inflation worries.** January retail sales rose 3.8%, month to month, which was the strongest increase since March of 2021 and raises retail sales to the highest level since the government started tracking the data in the early 1990s. *Source: RiverFront Investment Group*

Our Base case is that the US does not have a recession in the next 9-12 months, but we also believe risks of recession have clearly risen. We believe markets can move higher by year end.

Fiscal Response Fiscal Expansion Demand Stimulated

Our bullishness on the US economic outlook is mainly based on the historic stimulus of $5.3 trillion provided over the last two fiscal years in response to the pandemic by the federal government. *Source: JP Morgan Asset Management*
This is roughly a fourth of the total US economy Gross Domestic Product (GDP) of $21 trillion.
Source: US Bureau of Economic Analysis

In effect, the stimulus policymakers airdropped into the economy is roughly equivalent to the economies of California, Texas, and Florida combined. *Source :Google*
One result of this unprecedented coordination of fiscal and monetary policy was, the Federal Reserve more than doubled the size of its balance sheet to nearly $9 trillion. *Source: Board of Governors of the Federal Reserve system (2/16/22)*

Now the economy faces the unintended consequences of this grand experiment, including inflationary pressures and supply chains overwhelmed by stimulated demand. We do not think all the newly printed greenbacks will simply vanish.

When the service side of the economy revs up, as we expect it will later this year, consumer spending will get recycled again and again in the economy.

This dynamic is in contrast to goods consumption, where spending is often exported to the lowest-cost producer globally.

We expect to see a shift in spending from goods to services and believe it will reduce much of the "transitory"

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We expect the reduction in goods inflation to be offset by inflationary pressures in wages and rents which the Fed, by tightening monetary policy and dampening aggregate demand, is better able to affect.

We think the substantial savings and higher than usual cash positions of US consumers, corporations, and state and local governments will prove very valuable in dampening recessionary risks.

Housing Recovery

The residential construction recovery is important to our economic recovery outlook. We think the tailwinds of both household formation and demographics will continue to encourage strong demand for many kinds of housing. We believe this can go a long way toward sustaining a robust economic cycle. Residential construction has a tremendous economic multiplier effect. In a report published by George Mason University based on 2019 data.

- Every dollar spent on residential construction outlays is estimated to increase GDP by $3.08 and personal income by $1.08.
- Every $1 million in direct outlays related to residential construction is estimated to just under 22 jobs.

Interest Payments on Debt

Federal debt in the US spiked to nearly $30 Trillion following the COVID-19 related stimulus. Falling interest rates ensured that this increase resulted in but a trivial increase in the nation's debt service. The US government's average interest rate for all interest-bearing debt was roughly 1.5% as of January 2022. *Source: US Treasury Department.*

Long Term Problem

If that rate increases by 1%, it implies a roughly $300 billion increase in interest expense compared to the $2 trillion in individual income taxes collected in 2021. *Source: US Treasury Department—Fiscal Year 2021 Data*

Policy makers will face some tough choices in the future. The US does have the privilege of being able to print its way out of troublesome interest payments. Reducing other parts of the annual budget are some of the other possibilities.

First Trust Advisors L.P. believes the solution is to "cut spending, cut tax rates, cut regulation, and tighten money enough to stop inflation."

While this problem is not immediate, we think it is similar to the problem with Social Security--- unpopular politically, needing to be addressed, but will likely be postponed until a crisis arrives.

In the long run, we think "Stein's Law" may apply. "***If something cannot go on forever, it will stop***." Herbert Stein was an economist and a former chairman of the Council of Economic Advisors for two presidents.

Our Mission

Achieve superior results for our clients by providing institutional level investment management and consulting services.

What We Do

We help clients realize their vision of the future with personalized investment planning.

Our client specific strategies use independent, full-time professionals to research and manage portfolios for long-term growth of assets.

Our services include:

- **Over 50 years of experience** in both up and down markets.
- Independent, objective advice from professionals with the expertise you need to help you achieve your goals.
- Investment strategies appropriate for **long-term, serious, core money.**
- Asset allocation strategies customized to fit clients' unique needs, risk tolerance, and time horizons.
- A disciplined investment process.
- Portfolios that attempt to provide **more consistent returns with reduced volatility** over time.
- **Seek out, screen, and hire** high-quality money managers to run portfolios of individual securities.
- **Ongoing review** of the chosen managers' process, personnel, and investment decisions and report their performance quarterly.
- Replace managers when necessary.

Clients have trusted us for decades to provide their investment services.

We continue to grow and appreciate your introductions to friends and family. Our target markets are clients just like you – individuals, foundations, endowments, retirement plans, and corporations.