Oak Tree "Short-term Economic Update"

Wednesday, November 24th, 2021

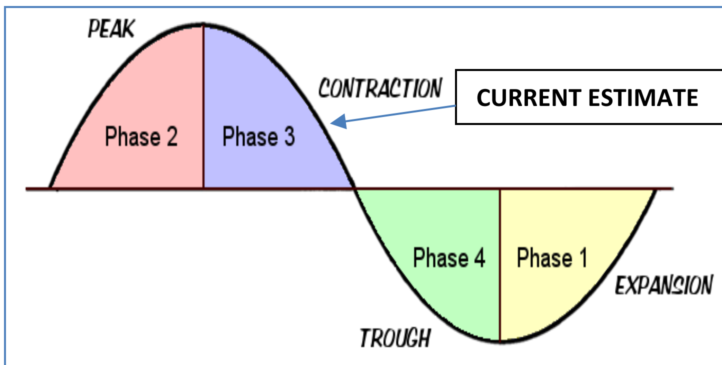
Author: Brad Olson

"*Your Money, OUR Economy:* They're Linked"

"There is no evidence that the **business cycle** has been repealed."— **Alan Greenspan**

{This is why, at Oak Tree Financial Services-Brookfield, we closely follow the nation's four-phase business cycle!}

OVERVIEW: Economic indicators reflect the business cycle seems to be in Phase 3. In this phase the economy is still strong as businesses keep rebuilding inventories. We normally see commodities and interest rates peak. History shows that next, we see the inventory-to-sales ratio bottom, inflation rise, credit conditions worsen and earnings at a peak growth rate. Stocks are usually in a bull market propelled by increased liquidity and strong earnings. Rising inflation, home prices, and interest rates eventually hinder consumer confidence and become a headwind against earnings, the economy, and the stock market. The business cycle continues downward in to Phase 4, then finally transitions to Phase 1 when inflation, home prices, and interest rates decline, and consumer confidence rises.



Phase 1	***Expansion*** - When the economy starts growing again and GDP (Gross Domestic Product) is increasing at the fastest rate.
Phase 2	***Peak*** – the point when you see most growth of GDP, and the economy is its highest level. GDP increase constant
Phase 3	***Contraction*** (Recession) - When the economy starts slowing down and GDP decreasing at an increasing rate
Phase 4	***Trough*** - When the economy hits bottom and GDP decrease constant

Key: (Red = Concerning Indicator; Green = Positive Indicator; Yellow = Positive but Concerning Indicator)

- **Consumer sentiment - Sinking** Consumer sentiment measured by the University of Michigan keeps sinking. The sharp rises in inflation, particularly and gas prices are reducing consumers' purchasing power. Consumer sentiment is an important leading indicator of the economy. It usually peaks before a period of very slow growth or recession. The current level of consumer sentiment is normally found when the economy is in a recession.
- **Manufacturing employment - Strong** Manufacturing employment rose a firm 3.1% y/y in October. Average weekly hours, however, showed no change in the same period. The message is: Manufacturers feel they can handle the current workload with the current manpower without adding overtime.
- **Construction - Weakening** The decline in home affordability, soaring home prices, and loss of purchasing power due to rising inflation is causing construction to decline. This trend is confirmed by the weakness of lumber prices.
- **Auto sales - Sinking** Auto sales have been sinking. They are another important leading indicator of the business

(more)

cycle. Historically a decline in auto sales leads a period of economic weakness or recession. Auto sales seem to follow the same pattern as consumer sentiment.

- **Commodities - Pausing** Commodities are generally weak in response to the decline of the business cycle indicators. Gold prices have stabilized, reflecting softer economic growth.
- **Inflation - High and rising** Producer prices of finished goods and commodities, and consumer prices jumped 12.5% y/y, 22.2% y/y, and 6.2% y/y respectively. Inflation has well surpassed the FOMC's (Federal Open Market Committee's) 2% target, with the headline PCE (personal consumption expenditures*)* price index rising +0.3% m/m and +4.4% y/y in September. The core PCE deflator also rose to +0.2% m/m and +3.6% y/y. ***The October CPI report showed consumer prices rose at their fastest pace since 1990*** as supply chain issues showed little signs of abating. Headline CPI came in well above expectations at +0.9% m/m and +6.2% y/y, while Core CPI rose 0.6% m/m and 4.6% y/y. Further increases in shelter costs and an acceleration of inflation across a broad range of sectors point to the continued impact of supply chain shortages and a pickup in stickier components of inflation.
- **Interest rates - Declining** The decline in the business cycle indicator points to lower bond yields and higher bond prices. They continue to reflect a multi-year Washington easing policy that may be helping to fuel inflation. At its November meeting, the FOMC officially announced its plans to taper its net asset purchases by $15-billion per month beginning in mid-November. The statement language was somewhat optimistic, acknowledging the slowdown in economic activity, but also that the delta wave is receding. Notably, the Fed appears to be putting a bigger emphasis on reaching maximum employment as a necessary condition for rate hikes. It's important to note that tapering is not tightening, and while purchases will slow in the months ahead, the balance sheet will continue to expand until settling at about $9-trillion by mid-2022.
- **The Dollar – Strengthening** The dollar is responding to economic weakness, as we see the US Dollar continue to strengthen in response to the decline of business cycle indicators.

The business cycle - The economy is showing signs of strength thanks to the attempt by manufacturers to replenish depleted inventories. This strength is further reflected by solid employment growth. The relentless rise of inflation and business costs, however, are seriously hindering the expansion and increasing market risk. History shows us a weak economy and volatile markets follow a protracted rise in inflation. Consumers will become defensive because of the loss of purchasing power. Businesses will become cautious as rising input costs attack profitability. This is a process well under way and may be further stressed by the global economic weakness that is beginning to emerge.

Here are some risks that we are watching:

- **The COVID Delta variant and global vaccine delays could slow the economic recovery.**
- **Inflation could spike and not be as transitory as the Fed had hoped.**
- **Extremely accommodative monetary and fiscal policies could lead to a boom-bust recession.**

Bottom line – We will design an asset allocation correlating to your ability to handle risk, your time frame and your goals. Then, moving forward, we will adjust that allocation to take advantage of where we are at in the cycle.

The material presented is for informational purposes only. It is not intended as financial advice, and you are encouraged to seek such advice from your financial advisor. The content is derived from sources believed to be accurate. Neither the information presented nor any opinion expressed constitutes a solicitation for the purchase or sale of any securitiy. All information and opinions are that of Oak Tree Financial Services, LLC-Brookfield, WI and not that of Woodbury Financial. Securities and investment advisory services are offered through Woodbury Financial Services, Inc. (WFS), member FINRA/SIPC. WFS is separately owned, and other entities and/or marketing names, products or services referenced here are independent of WFS.

Oak Tree Financial Services, LLC
13555 Bishops Court, Suite 255, Brookfield, WI 53005.
Phone: 800-757-6837
Educational Website: *OTFSllc.com*
Email: info@OTFSllc.com
Educational Facebook Page: https://www.facebook.com/13555BishopsCourt255