



"To plant a garden is to believe in tomorrow."

~ Audrey Hepburn

Summer 2023

Quarterly Booklet

Summer 2023

ONE DAY
IN JULY

Issue XXIV

A Note from our Founder

In 1982 MIT professor Paul Samuelson quipped that “the stock market has predicted nine out of the last five recessions.” Today, we may have another case of prognostication gone wrong! For the past year hands have been wrung about the unavoidable recession and the importance of girding one’s portfolio for the downturn. Many investors tried to time the market and batten down the hatches. People rejiggered positions and bought CDs. The bears stoked anxiety.

But the skies may be looking sunnier! We can’t know if this will continue, but consumer sentiment is rising, inflation is falling (though it needs to fall further), markets are rising, and job creation is strong. A new industry, artificial intelligence, is emerging from its formative era, sparking a new investment cycle.

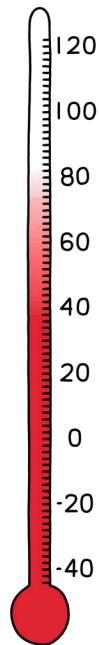
Perhaps this is all fitting for the season.

- Dan Cunningham



Temperature Check: Interest Rates and Inflation

Inflation rose 4% during the year leading up to the end of May. The pace of price increases had been decelerating for the prior eleven months, but May's reading marked the slowest growth in over two years. This is a sign that the Fed's historically aggressive streak of consecutive rate hikes since March 2022 are finally starting to cool off the economy despite the healthy labor market. In response, the Fed's rate-setting committee unanimously voted to hold interest rates steady at their mid-June meeting, which should give prior rate increases more time to work their way through the economy. Although inflation has improved markedly from its 9.1% peak in June 2022, it is still a far cry from the Fed's 2% target; the Federal Open Market Committee signaled up to an additional 0.5% of hikes for the rest of this year.



Sources:

CNN.com, "The Fed holds rates steady, pausing its rate-hiking campaign." 14 Jun 2023

nytimes.com, "Car prices, a root of pandemic inflation, are settling down." 13 Jun 2023

Are recession fears beginning to dissipate?

Despite continued economic uncertainty so far this year, the mood is considerably less grim than it was at this time last year. In our Summer 2022 Quarterly Booklet, we reported that the University of Michigan's U.S. Index of Consumer Sentiment had fallen to a record-low score of 50 as the inflation rate soared to a 40-year high and the Fed began increasing the pace of their interest rate hikes in earnest. Around that time, the majority of U.S. economists were predicting a recession in 2023. One year later and the case for a recession this year is receding, largely due to a stubbornly robust labor market and residual household excess savings built up during the Covid-19 pandemic.

Labor Market

Not only did employers add 339,000 jobs in May, a larger-than-expected gain, but the Bureau of Labor Statistics also revised job growth numbers from the prior two months significantly upward (217,000 for March and 294,000 for April). What's more, the data indicates that many people who are getting laid off are quickly landing new jobs. The unemployment rate did rise by 0.3 percentage points to 3.7%, but that level remains historically low. An economy that creates more than 200,000 jobs per month does not sound like a recessionary environment.

Sources:

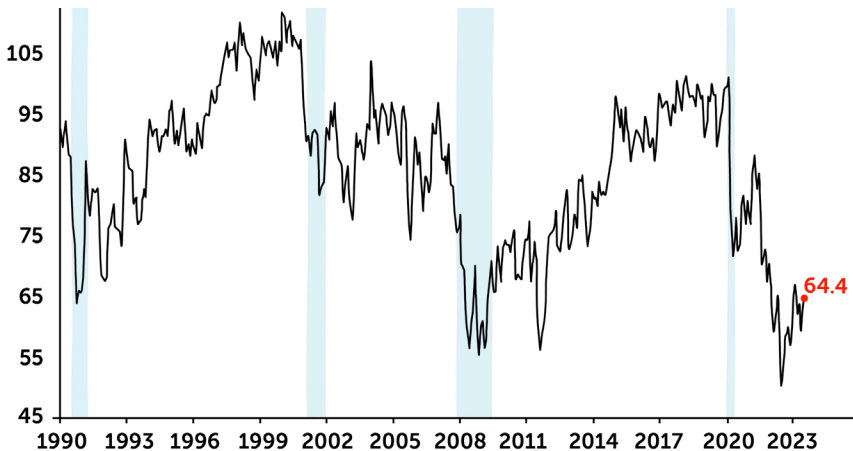
CNN.com, "The case for a 2023 US recession is crumbling," 5 June 2023

money.usnews.com, "Recession 2023: What to Watch and How to Prepare," 13 Jun 2023

Consumer Sentiment

In stark contrast to this time last year, the University of Michigan's consumer sentiment survey improved 9% in June, bringing sentiment levels 29% higher than last year's record low. Despite the improvements, sentiment does remain low by historical standards.

Index of Consumer Sentiment



Shaded areas indicate recessions

Source: University of Michigan Surveys of Consumers, Results for June 2023.

Excess Savings and the Proverbial “Soft Landing”

We may avoid recession this year, but a shrinking U.S. economy still remains a possibility for 2024. The Fed’s crusade against inflation is hitting the economy with a lag, meaning it’s likely we have yet to see the full effect of the streak of rate hikes. However, recent accelerating job growth, as well as the considerable excess savings that remains on household balance sheets, should help keep the economy afloat.

A recent publication by the Federal Reserve Bank of San Francisco, “The Rise and Fall of Pandemic Excess Savings,” looks at consumer spending patterns related to the unprecedented buildup of savings resulting from pandemic-related lockdowns and generous government fiscal support. U.S. households began slowly drawing down these savings during the last few months of 2021. The trend picked up considerable speed during 2022 and moderated slightly during the first quarter of 2023. Despite the rapid drawdown of consumer savings, the study estimates that there is about \$500 billion of excess savings remaining in the economy, which should be enough to support household spending at least into the fourth quarter of this year or possibly longer if consumers begin to slow spending.

Source: Federal Reserve Bank of San Francisco, “The Rise and Fall of Pandemic Excess Savings.” 8 May 2023

Aggregate personal savings versus the pre-pandemic trend

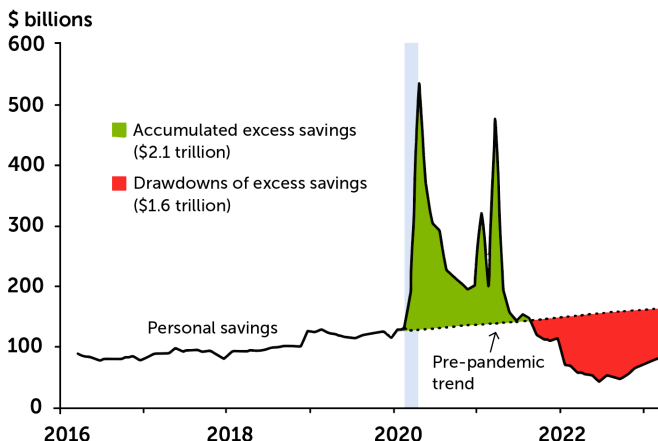


Chart Source: Bureau of Economic Analysis and Federal Reserve Bank of San Francisco. Excess savings calculated as the accumulated difference in actual de-annualized personal savings and the trend implied by data for the 48 months leading up to the first month of the 2020 recession as defined by the NBER.

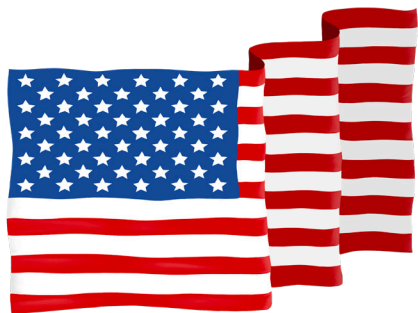
The Consumer's Role

In last summer's booklet, we discussed noted economist Robert Shiller's notion that recessions could be a self-fulfilling prophecy if pessimistic consumers, investors, and companies prepare for a downturn by slowing their spending. Shiller argues, "The fear can lead to the actuality." As mentioned, consumer spending did slow down in the first few months of this year. However, declining prices and recent jobs growth together with improving sentiment and residual excess household savings may be just the recipe we need to keep consumers spending enough to stave off the recession.

Source: cnbc.com, "Nearly all Americans cut back on spending due to inflation, CNBC survey finds," 14 Jun 2023

Stocks Rally

As of June month end, the S&P 500 stock index has recovered all the losses it suffered since the beginning of the Fed's cycle of tightening monetary policy last year. Many investors are getting in on the current rally despite a year's worth of repeated forewarnings of an imminent slowdown in the economy. This behavior suggests a widespread assumption that any recession will be mild.



Sources:

Bloomberg.com. "Wall Street Isn't Buying What Powell, Economists Are Forecasting." 15 Jun 2023

S&P 500 returns: Yahoo Finance

“This economy is incredibly resilient, despite all the slings and arrows – despite the banking crisis, rate hikes, the debt ceiling. For this year, given these jobs numbers, it’s hard to see a recession. Increasingly, the odds of a recession this year are fading. A lot of economists who have called for a recession are now in the uncomfortable position of pushing back the start date.”

Mark Zandi

Chief Economist at Moody’s

Quote Source: CNN.com. “The case for a 2023 US recession is crumbling.” 5 June 2023

Asset Allocation vs. Asset Location

You've heard of asset allocation—the investment strategy aimed at balancing risk and reward. This is the tool that establishes the optimal proportion of stocks vs. bonds in your long-term investment plan. But what about asset location? Asset location is a lesser-mentioned investing practice intended to minimize taxes across an entire portfolio. It is the process of determining which investments should be placed into which accounts according to the various tax treatments. The consequences of overlooking this tool can be costly, as taxes have the potential to significantly shrink retirement income.

Last year, Vanguard faced lawsuits from three investors in its target-date funds. The plaintiffs claimed that Vanguard violated its legal duties by triggering painfully large surprise tax bills. These investors were holding the target-date funds in their taxable accounts rather than in 401(k) plan accounts or IRAs, which would not have faced the same tax consequences. They claimed that Vanguard failed to sufficiently warn them that target-date funds are designed for tax-advantaged accounts.

A good financial advisor should help you optimize for taxes across account types and, when it comes time to spend down your retirement savings, design the optimal withdrawal schedule, including analysis around when to file for Social Security. The goal is to minimize taxes while maximizing income.

Sources:

fa-mag.com, "Why Asset Location Trumps Asset Allocation For Retirees," 3 Feb 2022

cnbc.com, "Vanguard created big tax bills for target-date fund investors, lawsuit claims," 15 Mar 2022

Beware Summertime Fraud

Elder financial exploitation is defined as “the illegal or improper use of an older adult’s funds, property, or assets.” The AARP Public Policy Institute reported that financial exploitation more than doubled since mid-March of 2020. On top of that, fraudulent activity tends to rise in the summer months.

AARP also reported that nearly three-quarters of the annual \$28.3 billion that older Americans lose due to financial exploitation is stolen by someone that the victim knows (e.g., family, friends, or caregivers). Here are a few tips to help keep your assets safe:

1. Protect your personal information, including your social security and account numbers.
2. Use complex, lengthy passwords, and use a different password for each login. Do not share your passwords.
3. Limit the personal information you share on social media, as it makes it easier for fraudsters to impersonate you or someone you may legitimately be doing business with.
4. Designate a Trusted Contact on your investment accounts.
5. If someone calls you unexpectedly claiming to be from the government, your bank, or another service provider and asks for personal information, hang up and call back at a phone number that you know to be legitimate.

Source: fa-mag.com, “Older Americans Robbed Of \$20 Billion A Year by People They Know.” 15 Jun 2023

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ONE DAY IN JULY

77 College Street, #3A
Burlington, VT 05401

www.onedayinjuly.com
(802) 503-8280

"And so with the sunshine and the great bursts of leaves growing on the trees, just as things grow in fast movies, I had that familiar conviction that life was beginning over again with the summer.

— F. Scott Fitzgerald

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