BULLS&BEARS

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Third Quarter 2023

Late Cycle

With all the talk about recession, it's easy to forget that we are not there yet. Rather, we are still in the so-called late-cycle phase of the business cycle when financial markets are often volatile, but stocks can still rise, as they have in recent months.

The economy continues to show late-cycle characteristics including a tight labor market and higher interest rates. Meanwhile, indicators that track profits, inventories, credit, housing, manufacturing, and consumer behavior all suggest that economic growth is slowing.

The late-cycle is a phase of the business cycle, which is the name that economists give to the pattern of changes in economic activity that take place over time. In the late cycle, economic activity often reaches its peak. Growth slows but remains positive. Rising inflation and a tight labor market may lead the Federal Reserve to raise interest rates, and corporate earnings may decline. The late cycle ends when economic activity contracts and the economy enters recession.

While late cycles have historically preceded recessions, the economy has also taken an average of a year and a half to move from the start of the late cycle into those recessions. The current late cycle began in the summer of 2022.

Max Restriction

The Federal Reserve elected not to raise the fed funds rate at the June FOMC meeting -- its first pause since the rate-hiking cycle began in March 2022. The Fed did raise rates by a quarter-point hike at the July meeting.

The Fed has three remaining meetings, in September, November, and December. Exiting the June meeting, Chairman Jerome Powell used language suggesting the Fed was open to two more potential hikes by year-end. Analysis of the CME FedWatch tool suggests that investors believe that the July hike may have marked the end of the rate-hiking cycle. The percentage of investors expecting the Fed to stand pat is 89% for the September meeting, 61% for the November meeting, and 59% at the December meeting.

At the December meeting, 8% of investors believe the Fed could cut rates by a quarter point. Still, in the wake of the July CPI and PPI reports, that percentage is down for December and now non-existent for November.

If the Fed believes its work is done, it may not raise rates again in 2023. But if inflation stalls on its way to 2%, investors may perceive the Fed as having paused as opposed to being finished. More important, if inflation stalls above the target range, the Fed becomes less likely to begin a rate-cutting cycle early in 2024. And to at least some degree, rate cuts in 2024 are priced into the stock market in 2023. We will be paying close attention to overall consumer inflation, and particularly the overhang from shelter costs, as the remainder of 2023 plays out.

Labor Resilience

The labor market remains solid but does appear to be moderating. Nonfarm payrolls have grown by an average of 278,000 per month over the first six months of 2023, lower than the average of 399,000 for all of 2022. The unemployment rate was at 3.5% for July, moderating from 3.3% in June. Annual wage growth is at a 4.4% pace as of July, below PCE core inflation and below the fed funds rate. The lagging Job Openings & Labor Turnover Survey (JOLTS) reported that job openings declined marginally in June to 9.582 million, their lowest level since mid-2021, from 9.616 million in May. But that's still down 20% from a record 12 million job openings in March 2022. There are now 1.6 job openings for every unemployed worker.

Long after it was supposed to have slowed, the U.S. employment economy remains strong, even if it has downshifted from 2022. Unemployment is low, and hourly wage growth is now approximately tracking the annual change in inflation; and inflation is below the Fed fund rate central tendency. Though the labor market doesn't currently indicate a recession, it usually is the last data point that remains strong right up to the end of the late-cycle period.

Please contact us at 1-855-829-7192 if we may be of assistance.

Market Indicators

6/30/23	Year-to-Date Change
S&P 500	16.89%
NASDAQ	32.32%
Russell 2000	8.09%

Interest Rates	6/30/23	12/31/22
10-Year Treasury Note	3.84%	3.88%
3-Month Treasury Bill	5.32%	4.42%

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