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FINANCIAL SERVICES, INC
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989 W Washington St., Suite # 101
Marquette, MI 49855
(906) 226-8711
www.mommaerts-mahaney.com

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Upon Further Review

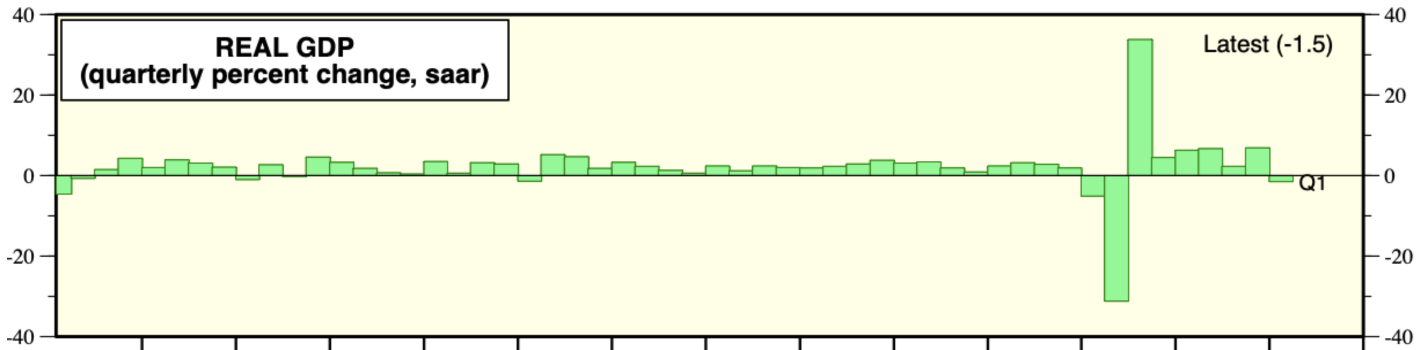
Jon C. Mommaerts	Robert Kea	J. Matthew Tuccini	Jason J. Rolling
Certified Financial Planner®	Chartered Financial Analyst	Certified Financial Planner®	Financial Advisor

Advancements in technology have greatly improved how we watch sports. High-definition flat-screen T.V.s provide sports viewers with incredible clarity of every play. It even allows the viewer to rewind their T.V. and rewatch the winning play in super slow-mo. An unintended consequence of this development was viewers were able to slow down the replay beyond what a human could process in real-time and observe whether the referee/official/umpire made the correct call. This was a welcomed development in overturning obvious incorrect calls, but it also has created hesitancy for sports fans to cheer in real-time. Close plays leave us holding our breath until the video replay confirms the call on the field. Game officials watch the replay of the winning touchdown, then address the fans with "upon further review…….."

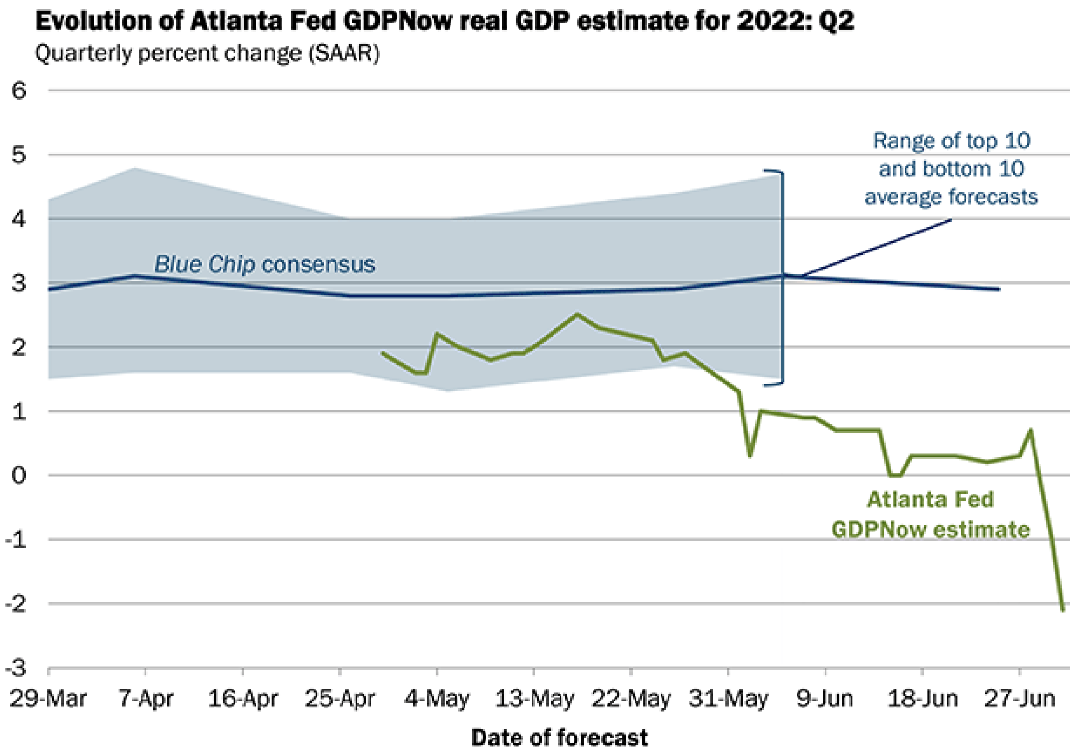
If your team just scored the winning touchdown, you are hoping the initial call stands. If your team just lost the game, you are hoping for the call on the field to be overturned. We've often commented that we find the definition of *recession* arbitrary. We've gone so far as to start our own dictionary of economic terms we find to be arbitrarily defined and not overly useful in determining the state of the economy and financial markets. As a reminder, a recession is generally defined as "two consecutive quarters of negative GDP (Gross Domestic Product) growth".

The Bureau of Economic Analysis (BEA) calculates U.S. GDP on a quarterly basis. They make their initial call on economic growth roughly two weeks after each calendar quarter ends. They then revise that call two more times before providing us with their final estimate of GDP. We don't get their final estimate of GDP until a full quarter has passed. We just received Q1's official GDP number. BEA's

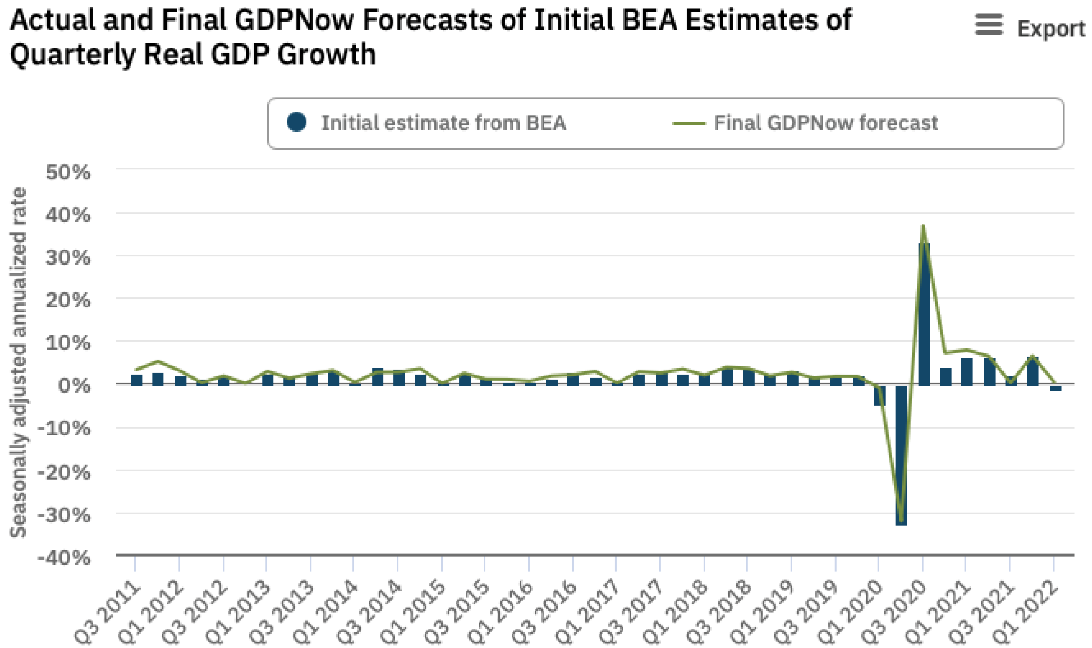
initial call was that Q1 quarterly GDP was flat, upon further review, they revised this number down to -1.5% for Q1.



We now officially have one-quarter of negative GDP. The Federal Reserve Bank of Atlanta developed an econometric model that MMFS watches very closely. It is called the GDPNow model and is the Federal Reserve's best estimate of real-time GDP. The green line shows the Fed was consistently estimating 2% GDP growth for most of the second quarter. Recently this forecast has dropped dramatically to -2%. (The blue-chip consensus is a survey of economists that the Fed deems as the most reliable domestic economists. Changes in their GDP estimates tend to lag the GDPNow forecasts.)



The plummeting GDPNow forecast is quite concerning. GDPNow has consistently provided a solid estimate of real final GDP. Although we will not get the BEA's first estimate of Q2 GDP until tomorrow, given the historical accuracy of the GDPNow forecast, there is a very high probability it will be a negative estimate.

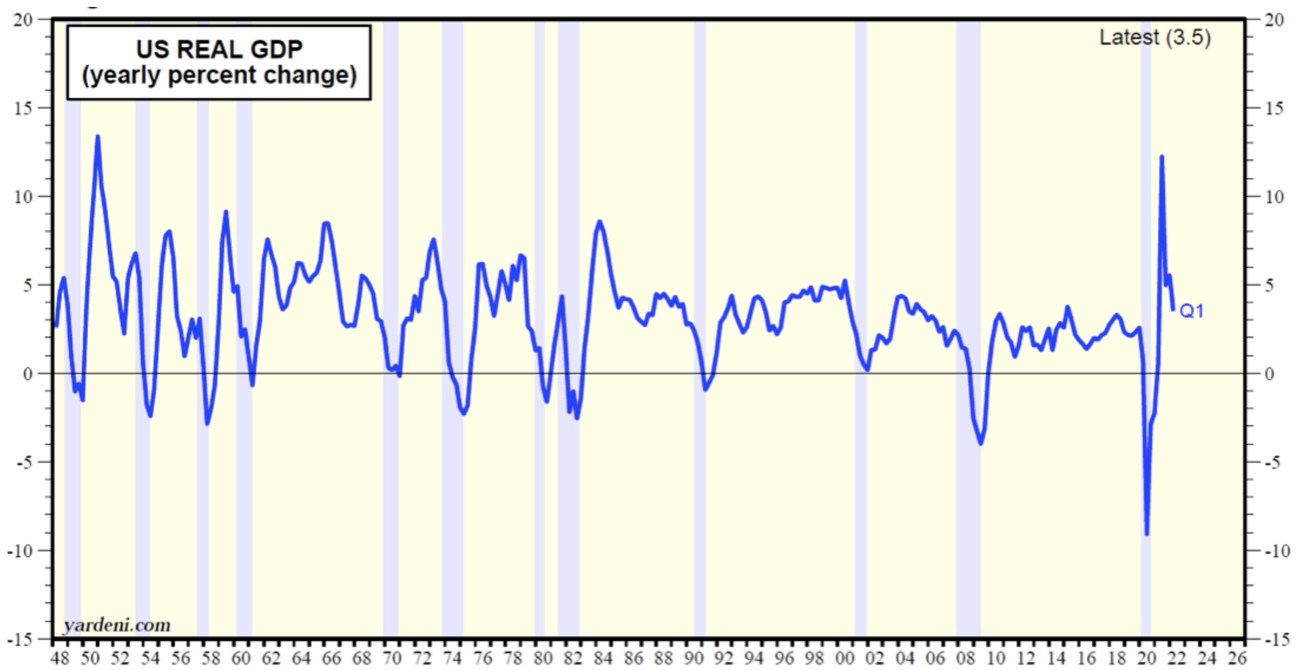


If so, it's always been our understanding, and most everyone else's understanding, this would mean we are in a recession. Not so fast, upon further review……

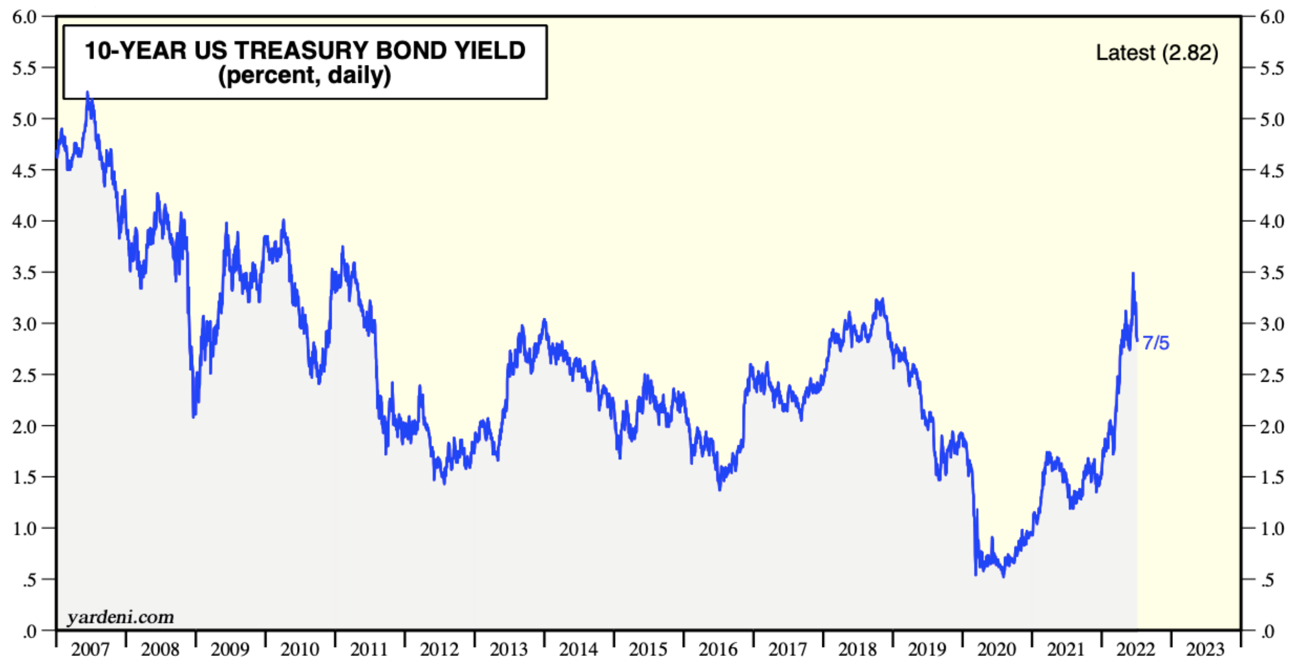
The NBER (National Bureau of Economic Research) gets the final say on whether or not a recession has occurred. Prior to Tom Brady's non-fumble against the Oakland Raiders in the Snow Bowl, virtually no football fan had ever heard of the "Tuck Rule". The obscure Tuck Rule overturned what most everyone thought was a game-ending fumble by the Patriots. The Patriots then went on to win that game in overtime and eventually win that year's Super Bowl. The NBER has its own version of the Tuck Rule.

More specifically, the NBER's *Business Cycle Dating Committee* makes the final determination on whether we've had a recession. It can overturn a recession call. According to the NBER: "The NBER's definition emphasizes that a recession involves a significant decline in economic activity that is spread across the economy and lasts more than a few months..... a recession must influence the economy broadly and not be confined to one sector, the committee emphasizes economy-wide measures of economic activity."

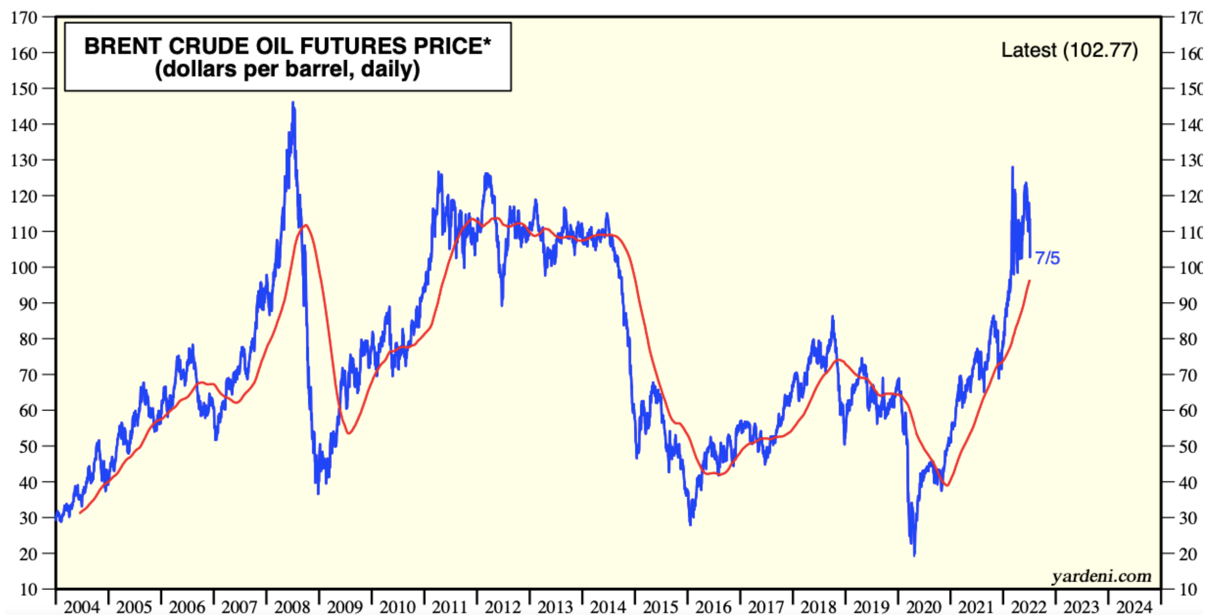
We will spare you, and ourselves, any more talk on what officially constitutes a recession. We wouldn't be shocked to see the NBER override the recession call. We suppose it gives the opposing political sides something to argue over. Our view is that the official definition doesn't much matter. We see the economy as being in a mild retraction, not a systematic contraction. YOY GDP growth remains decent. Q1 was 3.5% and Q2 will likely be in the flat range before recovering in Q3. We have been unable to identify a systematic issue with the economy. There are no signs of asset bubbles, credit crunches, etc. Our current sub-optimal economic conditions are primarily due to fiscal and monetary overstimulation of the economy and the subsequent need for the Federal Reserve to temporarily slow growth in order to dampen inflation. We also think overly ambitious, at least in the near-term, energy policies have contributed to slower growth. (A quick note on that below). The bottom line is our domestic economy needs to work off the excess pounds it put on during the stimulus holidays.



A mild retraction in economic growth should help to moderate inflation without crushing corporate earnings. We believe Industry analysts are still overly bullish while investors remain overly bearish. Uncertainty causes volatility. We think it is likely that we have seen stock market lows for this business cycle contraction and expect a slow, albeit volatile, move higher over the next year. 10-Year Yields have also dropped significantly since peaking at 3.56% in late June. Our range for 10-Year Yields remains at 2.50% to 3.50%, although we think it's doubtful we will revisit the top end of this range anytime soon. There is a good chance we will be revising the top end of this range down to 3.25% in the very near term.



A quick thought on oil and energy policy - We often repeat the age-old adage from the commodity pits, "the cure for high commodity prices is, high commodity prices". On occasion, we've received feedback that our use of this adage is overly simplistic and we are ignoring geopolitics, energy policy, government regulation, etc. We disagree that we are ignoring these issues. These complex issues are all encompassed within the supply and demand of commodities. Our argument is that we don't have to explicitly identify and examine each issue independently. When prices go up, supply increases, and demand decreases. The magnitude and timing of these adjustments are impacted energy policies, but eventually, consumers buy less of a good that has become more expensive and producers produce more of a good that has become more expensive. That's why commodities have and continue to be a lousy investment. It's also why we've consistently argued that predictions of $200 a barrel oil are folly.



Last week, JPMorgan's Energy Analyst warned that oil might reach $380 a barrel. They cited Russia slashing oil production due to sanctions. Another age-old adage is, 'if at first you don't succeed, try, try again". We suppose it could be considered admirable that not succeeding to deliver upon their $200 a barrel forecast hasn't deterred energy analysts from try, trying again.

We hope your summer is off to a good start and everyone enjoyed a wonderful Fourth of July week. We are continuing to monitor market conditions and adjust portfolios accordingly. Q2 earnings season kicks off today and we also get initial GDP and inflation numbers tomorrow. We will continue to communicate a little more frequently until we return to a less volatile market environment. We are always available if you'd like to discuss your portfolio in greater detail.

The MMFS Team

<u>Jon C Mommaerts, CFP®</u>: Jon is a Principal of Mommaerts Mahaney Financial Services, Inc. He has over 30 years of experience working with professionals and those about to retire. He is a member of the Financial Planning Association, as well as a member of the Preferred Financial Advisors.

<u>J. Matthew Tuccini, CFP®</u>: Matt has over 17 years of experience working in the financial services industry with vast experience in retirement planning, tax strategies, and financial planning.

<u>Robert Kea, CFA</u>: Bob has over 30 years of experience in portfolio management. He was a founding member and Co-Head on Putnam's Asset Allocation Group, which managed $12Bn in both retail and institutional assets.

<u>Jason Rolling, Financial Advisor</u>: Jason has been in the financial services industry for the past 15 years. His financial experience includes retail banking, consumer & commercial lending, bank management at the local, regional and SVP level, wealth management, and financial planning.

Mommaerts Mahaney Financial Services, Inc. provides advisory services through ERTS Wealth Advisors, LLC, a registered investment advisor.
989 W. Washington Street, Suite 101 Marquette, MI 49855
(906) 226-8711