The Crescent Group

(214) 775-6401
us.rbcwm.com/thecrescentgroup

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Carsten Frederiksen, CFP®
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6401
NMLS#: 1321563 City National Bank

Paul Hendershot
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6430
NMLS # 1370978 City National Bank

Andrew Ielmini, CPFA®
Financial Advisor
Direct: 214-775-6448

Lindsey Vickers, MBA
Senior Registered Client Associate
Direct: 214-775-6458

The Crescent Group website

April 2023 Crescent Commentary

During April, we saw more evidence of moderating inflation in the U.S., as the March inflation report showed prices increased 5% over the previous year. This marks the latest in a series of monthly moderating of inflation that began last June, when inflation peaked at 9.1%. It also shows that the Fed's policy of increasing interest rates in order to reduce inflation has thus far worked.[(1)]

Amid the Fed's campaign to lower inflation by increasing interest rates, the media has spent the past year or so obsessing over how much the economy is slowing and whether we're headed for a recession. Well, of course the economy is slowing – that's the stated goal of the Fed's policy for the past year. We now know that our government provided too much stimulus to the economy during the pandemic, which caused our economy to become overheated. And we're now correcting that problem. Will we have a recession? It's guaranteed. Why? A recession is always guaranteed to occur at some point. When? No one knows. We could be in one right now, or we could have one in five years. Or both. Or neither. No one knows when or how deep, but we'll always have another recession. And our nation will move past it to greater prosperity, just as we always have.[(2)]

If we have a recession over the next couple years, what impact will it have on your investments? That depends on what causes the recession and what assets you own. Last year's interest rate increases caused the U.S. bond market to fall 15%. The average recessionary stock market decline has equaled 24% since 1946. Last year in October, U.S. stocks reached a decline of 27% from the highs, so stocks have already experienced the pain of an above average recession. Private investments get marked to market but valuations can only ignore public markets for so long. The big picture that we're communicating is that investment markets have already experienced the pain of a recession, and so a lot of the recession expectation is already priced into markets. From a big picture standpoint, the data show that investors will do better if they avoid trying to invest on the basis of short-term economic predictions and instead stick to an investment strategy rooted in long-term expectations. That's what we're focused on helping you do right now.[(3)(4)(5)]

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One constant with investment markets is that there's always something to worry about in the news headlines. Whether it's rising interest rates, inflation, bank failures, or a recession. One worry from earlier this year that resurfaced in recent weeks is continued negotiations regarding our nation's debt ceiling. The House passed a bill to raise the debt ceiling on April 26th, although the bill is not expected to pass the Senate. Observers worry that if the debt ceiling isn't lifted sometime in June, the U.S. will default on its debt. There are a few key points to keep in mind about this.[(6)]

First, any failure on the part of the U.S. government to pay Treasury principal or interest on time would result from an administrative political delay, and not the financial inability to pay. The U.S. is not Argentina, and we would expect financial markets to reflect that fact. In a scenario where politicians fail to raise the debt ceiling in time, there would likely be a strong financial market reaction which would cause politicians to act quickly to raise the ceiling. The result would be a delay of payment, not a failure to pay. The Fed and Treasury would do whatever it takes to calm markets. Similar to when Powell said the Fed issued an unlimited guarantee during the COVID-19 crash. And similar to the U.S. guaranteeing all Silicon Valley Bank deposits in March. It's definitely not a perfect solution, but we've seen this movie enough times to know how it ends. We would move past this situation and on to greater prosperity, just as we always have in our country.

Second, it's highly unlikely we get to the point of crisis. The Treasury has a contingency plan developed by both the Fed and Treasury during the 2011 debt ceiling negotiations. Under this plan, there would be no default on Treasury securities. As securities mature, the Treasury would pay the principal by auctioning new securities for the same amount, and thus avoid issuing new debt above the debt ceiling. Tax receipts would be more than enough to cover interest payments on debt. This plan requires the Treasury to delay payments on all other obligations – payments to agencies, contractors, Social Security beneficiaries, Medicare providers, etc. This priority of payment could result in legal challenges, although the legal challenges would provide time for politicians to understand the seriousness of resolving the debt ceiling, and we're confident that they would resolve it.[(4)]

The U.S. has thrived despite a continuous stream of unprecedented crises. Since 1900, we faced two world wars, the Great Depression, the Cuban Missile Crisis, the assassination of a U.S. President, the Vietnam War, double-digit inflation in the 1970s, the stock market crash of 1987, the savings and loan crisis, war with Iraq, the bursting of the 1990s technology bubble, the 9/11 terror attacks, war in the Middle East, the bursting of the 2000s home price bubble, the Great Recession, the downgrade of the U.S. credit rating, and COVID-19, just to name a few. The fact is that crises are a part of life. We will continue to stumble our way to greater prosperity. The best thing you as an investor can do is own a mix of assets with a proven track record of enduring through unprecedented crises, and maintain a long-term view. We will continue to help you do that.

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Paul Hendershot | Carsten Frederiksen, CFP® | Andrew Ielmini, CPFA | Lindsey Vickers, MBA

Sources:

(1) CNBC
(2) Time
(3) Yahoo Finance
(4) The Wall Street Journal
(5) RBC
(6) Reuters