Ropes Wealth Offers a View with Both Hands

President Harry Truman once pleaded: “Give me a one-handed economist. All my economists say ‘on the one hand . . .’, then ‘but on the other . . .’” With much respect to President Truman, the current economic picture is offering us two hands full of different economic data: credit conditions tightening much faster and harder than expected; and inflation and employment defying declines, which may cause the Fed to hold monetary policy tighter for longer. Unfortunately, whatever hand we pick may be headed to the same place: recession.

On the topic of credit conditions, this week the Federal Reserve released the results of its April 2023 Senior Loan Officer Opinion Survey on Bank Lending Practices. This often-overlooked report made headlines as investors tried to discern if tighter credit conditions were slowing economic activity and by how much. The report noted, “on balance, tighter standards and weaker demand for commercial and industrial (C&I) loans” and “for all commercial real estate (CRE) loan categories.” The number of banks tightening standards on C&I loans to small firms rose from 43.8% to 46.7%, a level only seen inside of previous recessions. “Standards tightened for all consumer loan categories,” excluding government-guaranteed mortgages. In response to a special question on why banks tightened credit conditions “on all loan categories” last quarter, “banks cited a less favorable or more uncertain economic outlook, reduced tolerance for risk, deterioration in collateral values, and concerns about banks' funding costs and liquidity positions.” Looking ahead, “banks most frequently cited an expected deterioration in the credit quality of their loan portfolios and in customers' collateral values, a reduction in risk tolerance, and concerns about bank funding costs, bank liquidity position, and deposit outflows as reasons for expecting to tighten lending standards over the rest of 2023.” This report is made even more concerning against the backdrop of continued volatility in regional bank stocks that is keeping investors guessing about which bank will fail next. Worse still, the debt ceiling drama has consumers and creditors increasingly worried that political brinkmanship could take us right over the edge in just a few short weeks as compromise remains elusive.

In contrast, April’s stronger-than-expected employment report, notching a gain of 253,000 jobs and a drop in the unemployment rate to 3.4%, perpetuates the Fed’s own description of an extremely tight labor market. Meanwhile, inflation data continues to run hotter than we hoped at this stage, despite all the increases in interest rates. To that point, the Consumer Price Index (CPI) showed prices remain higher by 4.9% year-over-year, well above the Fed’s inflation target of 2%. The Producer Price Index (PPI) was more improved, with prices up only 2.3% year-over-year. Even so, businesses remain bottlenecked, though maybe less by goods inflation or supply chain issues. Instead, they are stymied by challenges in the labor market, or so we heard in this week’s National Federation of Independent Business (NFIB) survey of small companies which reported its lowest sentiment reading since 2013. The NFIB cited finding quality labor as the single biggest problem facing small businesses, after months of highlighting inflation. Without any real downward momentum in inflation data and a still tight labor market, the Fed will have to maintain tight policy, or risk their credibility if they move to the sidelines. And investors should not underestimate the Fed's resolve in fighting inflation: their unanimous decision to raise rates in May speaks volumes about their focus.

Thus, no matter what hand is dealt, or what poison we pick, recession may be inevitable. For this reason, we have been urging for weeks to set aside dollars needed in the short-term in high quality bonds and money markets, as well as to take required minimum distributions from retirement accounts and to move forward with family and charitable gifts while markets are cooperating. We are reinforcing balance in your portfolios in the allocation to both stocks and bonds, embracing diversification (for example, have you noticed that non-U.S. markets are quietly leading U.S. markets in returns this year?), and emphasizing quality in individual security and manager selection.

We are not abandoning your overall plan as we are mindful that a resolution of the debt ceiling or a pause or shift in Fed policy could be a major catalyst to compound market gains in 2023. Recession, while perhaps inevitable, may be shallow enough such that all the hand wringing over debt ceilings, inflation, and interest rates could fall away as investors look past the short-term to the future. Or maybe not. Either way, we are preparing with both hands to guide you through to the other side of these challenges with all the care and focus you deserve.

Thank you as always for your interest in our investment commentary and a sincere Happy Mother's Day to all the wonderful women who have touched our lives.

If you would like to speak personally with a member of our team at any time, please click **here**.

The information set forth in this communication is presented by Ropes Wealth Advisors LLC ("Ropes Wealth") a wholly owned subsidiary of Ropes & Gray LLP. The contents are for informational and educational purposes only and are not intended as investment, legal or tax advice. Please consult with your investment, legal or tax advisor concerning any specific questions you may have. Ropes Wealth cautions the reader that past results are not indicative of future performance. The historical return of markets generally and of individual assets classes or individual securities may not be an accurate predictor of future returns of those makers, asset classes or individual securities. Ropes Wealth does not guarantee the accuracy and completeness of any sourced data in this communication.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600