Ropes Wealth Sizes Up Sales, Ceilings, and the Notion of a "Skip"

Economic news has been average to dismal this week, with weakness noted in retail sales, housing, and regional manufacturing surveys. Investors looked through it all, and markets rose across the board, recovering from some recent volatility. To wit, retail sales rose just 0.4% in April, half of the expected 0.8% gain. Results were mixed across sectors, with online sales and activity at general merchandise stores the biggest positive contributors while sales at sporting stores dragged the most of the four categories that saw activity decline. Existing homes sales fell again this month, resuming the prior year's trend of consecutive monthly declines. Indeed, with the exception of February, the number of existing home sales has slumped in 14 out of the last 15 months, leaving them down over 23% year-over-year. The reacceleration in declines is not surprising as rates have rebounded, and mortgage rates are about twice as high as they were at the end of 2021. It was also notable that home prices moved lower with the median home price falling by 1.7% year-over-year, which is the largest drop since January 2012. That said, any price drop will be restrained as inventory remains scarce and homeowners with mortgage rates below current rates stay on the sidelines. Finally, regional Fed surveys of activity from New York and Philadelphia showed contraction and worsening business conditions, which reinforces the string of data showing a Q2 GDP slowdown is imminent.

Meanwhile, it is hard not to open up a newspaper (dating myself: I should say scroll through your phone updates?) or turn on the news these days without seeing a worrisome story about the debt ceiling debate. To be clear, the U.S. has enough revenue to pay all bondholders, but a roughly $1.5 trillion deficit this year means that if the debt ceiling isn't lifted, it won't be able to pay all of its obligations, which include entitlement payments under Medicare, Medicaid, or Social Security.

We've been here before, and as we have seen in the past, we think an agreement will be reached and that all bond payments will be made on time. We also think it's very unlikely that any payments on entitlements will get delayed. Much more likely is that Congress and the White House will agree on some sort of framework to hold the line on increases in discretionary (non-entitlement) spending. Maybe they will also agree to form some sort of bipartisan commission to review proposals to reform entitlements, which will then go nowhere.

In the past ninety years, non-defense government spending has grown ten times faster than GDP, and that trend is unlikely to change anytime soon. According to the Congressional Budget Office, this year Social Security, Medicare, Medicaid, and other health-related entitlement programs will cost the federal government 10.8% of GDP. Thirty years from now these same programs will cost 14.9% of GDP. To be sure, tax revenue is scheduled to be higher, too, due to the expiration of some of the tax cuts enacted in 2017 as well as "bracket creep" (incomes tend to rise faster than inflation, resulting in a larger share of income getting taxed at higher marginal tax rates). But the gain in revenue relative to GDP is less than one percentage point, which is well below the expected increase in spending. At some point, the U.S. will need to either reform entitlement programs or raise future taxes to pay for them. In other words, brace yourself.

On Thursday Dallas Fed President Lorie Logan was speaking about the conflicts in current economic signals and floated a new approach for the Fed when it comes to monetary policy: a meeting skip. She said, "The data in coming weeks could yet show that it is appropriate to skip a meeting. As of today, though, we aren't there yet." Atlanta Fed President Raphael Bostic likewise introduced the idea in a speech this week, saying "a pause could be a skip or it could be a hold." The Fed is threading a needle these days, trying to maintain a balance between their dual mandate to maintain price stability and maximize employment. Inflation's stickiness continues but so does the risk of a slowdown as the ripple effects of the banking crisis has further tightened credit conditions for consumers and business owners.

Against this backdrop, stocks were resilient, sensing momentum in debt ceiling negotiations and grateful for an earnings season that was largely better than predicted. But then, little had been expected of those reports. Week after week, we have encouraged you to take care of what you need for cashflow in the shorter-term and stay balanced in your investment plan. With stocks and bonds making a comeback, portfolios are rebounding nicely and there is no reason to overextend. To quote Joni Mitchell, “I’ve looked at life from both sides now/From win and lose and still somehow/It’s life’s illusions I recall/I really don’t know life at all.” We must look at our financial plans with both sides contemplated and avoid getting sucked into illusions, overly optimistic or pessimistic, and focus on our goals first.

Thank you as always for your interest in our investment commentary. Thank you also for all the expressions of support and enthusiasm for our news this week about our exciting future path. On behalf of the Ropes Wealth team, we are humbled and so grateful for your trust and confidence. Cheers to the future!

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

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