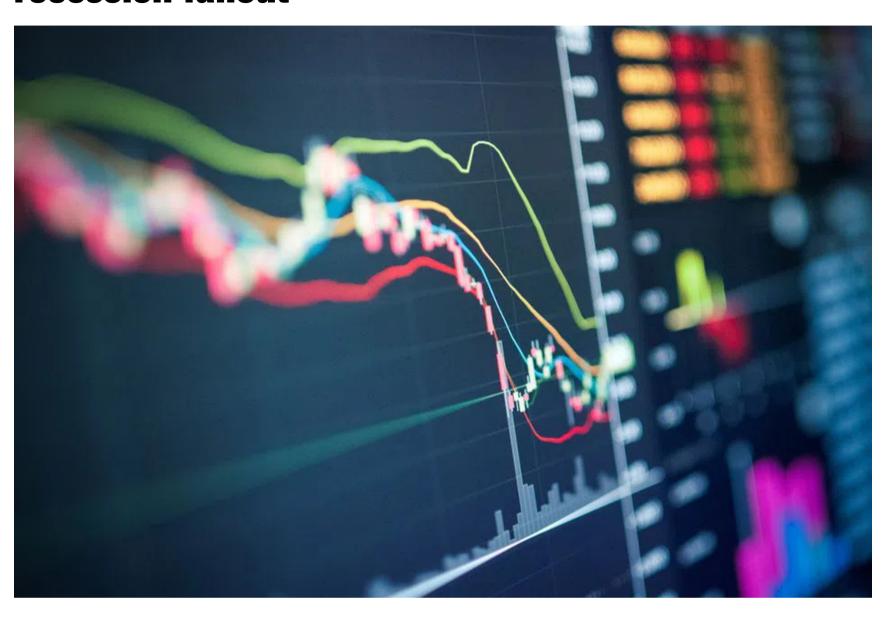


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As Fed battles inflation, financial advisers brace for recession fallout



Advisers are adjusting clients' portfolios to weather the recession that could result from the central bank's response to spiking prices.

September 19, 2022 By Jeff Benjamin













Whether or not the <u>U.S. economy is already in a recession</u>, financial advisers and market watchers are bracing for the fallout from the move toward higher interest rates that the Federal Reserve will be leaning on to combat inflation hovering at a 40-year high.

"For the first time in 14 years we are dialing back risk a wee bit for our more aggressive portfolios to a more moderate balanced mix for the time being, while not making any changes to our more moderately conservative allocations," said Jon Ulin of Ulin & Co. Wealth Management.

"In January, we had already chainsawed our average portfolio duration to two years to help mitigate bond losses and are leaning more on value and defensive sectors with stocks, while increasing overall cash from 2% to 8%," Ulin added. "Now would be as good a time as any to shore up your portfolio strategy, rebalance and make any needed adjustments before worse weather hits.

Kashif Ahmed, president of American Private Wealth, is also referencing efforts to batten down the hatches ahead of what could be the economic reality of the Fed's seemingly tardy efforts to manage inflation.

But because recessions often arrive before consumers notice the pain of things like layoffs, Ahmed said the fear of recession can be the biggest problem.

"In an economy so dependent on consumer spending, persistent talk of a recession may make the recession inevitable," he said. "Consumers will be so spooked that it is coming, they will stop spending."

In terms of preparing for a recession, Ahmed advises "ensuring you have an emergency stash of money that is easily accessible."

"As for your portfolio, if you don't already have a sensible, balanced lineup, tune it up now," he said. "Defensive stocks like consumer staples, utilities and health care hold up better during times of economic stress, simply because everyone needs them."

Kevin Brady, vice president at Wealthspire Advisors, said any adjustments in preparation for a coming recession should be deliberate to avoid the trap of trying to time the market or economic events.

"The stock market can act in unpredictable ways, meaning I can be right about the economics of a looming or current recession but wrong about how stocks react in the near term," Brady said. "Because markets are always forward-looking and potentially irrational in the short term, a recession becomes a poor decision point for portfolio changes by itself."

Context is key, said Stuart Katz, chief investment officer at Robertson Stephens.

"It's hard to time the markets, especially when half of the S&P 500 Index's strongest days over the last 20 years occurred during a bear market," he said. "Investing carries the inherent risk of exposing our psychological foibles and the emotional impediments that can get in the way of rational decision-making."

Paul Schatz, president of Heritage Capital, is still in the camp that the recent period of negative economic growth was more of an anomaly than an actual recession, which is not to suggest that he thinks the U.S. economy is on solid ground.

"I still think that the recession is at least a quarter or two away, but it is coming," he said. "Regarding the portfolio, what's happening right now is very much against what happens in history. Because of soaring inflation, we have both stocks falling hard and bonds seeing the single largest decline in history as well as the longest decline in history."

Schatz said that if he were constructing a portfolio from scratch today, it would include low-volatility stocks like utilities and consumer staples paired with short-duration fixed-income exposure.

Tim Davis, partner at Davis Executive Wealth Management Group with Steward Partners, has been loading client portfolios with exposure to managed futures, which is a strategy known to thrive in volatile times.

"We continue to get into territory that nobody has been in for the last 100 years," he said. "We just saw the first six months of the year as the worst six months for stocks and bonds in the history of this country."

Managed futures strategies, which have the flexibility to go long and short stocks, bonds, commodities and currencies, have helped Davis add some diversity to client portfolios this year.

"This is a situation where you can't just sit on your hands and wait for the ship to right itself," he said. "The hope was the Fed would be done raising rates by the end of the year, but now that's off the table."

Even though he's prepping client portfolios for the fallout from an aggressive Fed tightening cycle, Davis believes the economy is set up for a milder recession.

"You look at the landscape today; we have 100 million job openings and a 3.5% unemployment rate," he said. "It's tough to envision a severe recession in an economy where everybody who wants a job has a job."



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