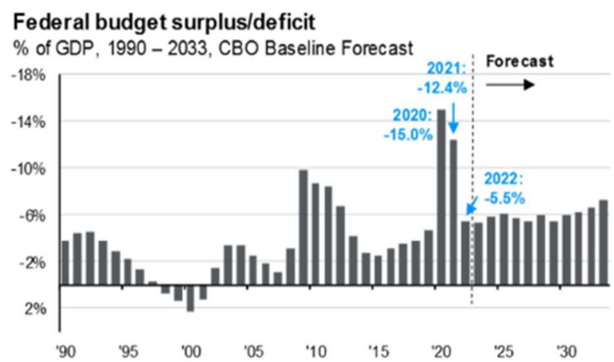
COLORADO FINANCIAL MANAGEMENT®
A Lido Company

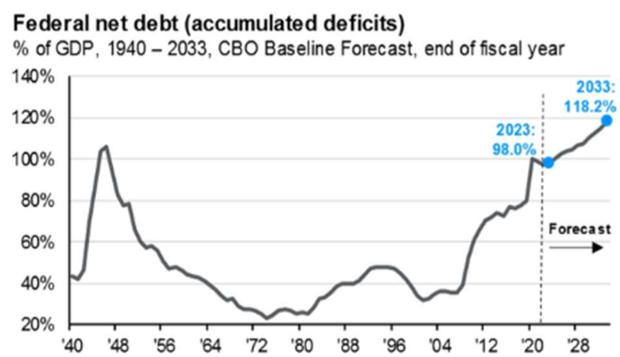
May 25, 2023

Dear Clients and Friends,

Two things that the market is now concerned about will be resolved – the debt limit and rate hikes. The debt limit will be increased, and the Fed will stop raising interest rates. We don't know exactly how or when, but we can be confident it will happen.

On the first matter, the debt limit, this is likely another period of political theater. Congress is dysfunctional. They rarely get something done unless there is a crisis. If there is none, they manufacture one. For those of you who are unfamiliar with this issue, here is a brief description. The U.S. has a law that limits the amount of debt the federal government can borrow. Every few years we reach the limit, and the government has to increase it. We are the only major country in the world that has such a law. It's similar to your credit card limit. If you reach the limit you can't borrow more. The difference between us and the government is that the US government is a going concern, whereas an individual is not. That is why they are able to issue new bonds to pay off older debt, and there currently is no limit of demand for our bonds. The only issue is the debt limit.

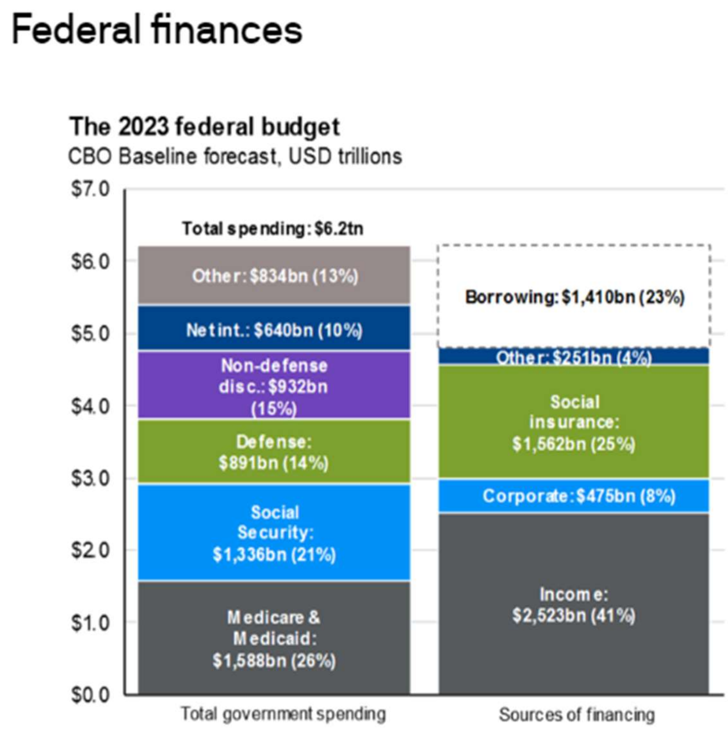




One thing lost in the debate is that government spending increases due to inflation whether Congress increases spending or not, and as you know inflation has been running high the last couple of years. On $6 trillion of spending an increase of 4% or 5% due to inflation means spending is going to increase. On top of that, interest rates have increased. On an annual basis from an income statement point of view, it's only the interest expense that

4840 Pearl East Circle, Suite 300E, Boulder, CO 80301
P (303) 443 2433 W colofinancial.com

matters. Over the last decade because rates were so low, our interest cost was low despite the fact that the level of debt was rising. It is now about 10% of the budget and it will go higher.



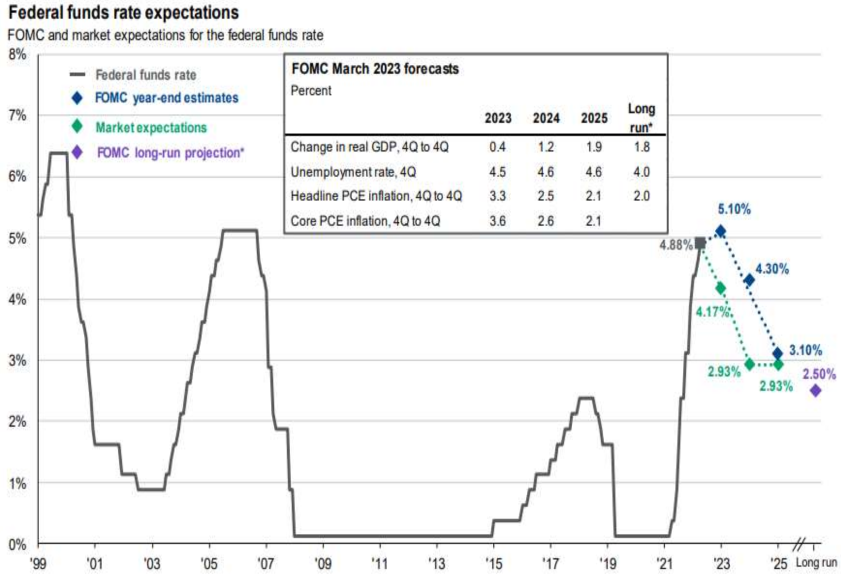
There is no argument (from me) that the government needs to control its spending, and we need to have an honest conversation about it. Look at where the spending is… about half is from social security and Medicare/ Medicaid. Look at the income side… only 25% comes from social insurance (Medicare & SS taxes). It's a huge mismatch.

I don't want to pick sides in the debate between spending and revenue. Truth is both sides are right, and both sides are wrong. They are using tweets and sound bites to sway public opinion.

So, after more drama an agreement will be made and the debt limit will be raised. They are flirting with serious repercussions, however. I'm not in the camp that believes there will be a complete meltdown, but the US enjoys enormous advantages because the US dollar is the world's reserve currency. It is why we can borrow so much and why interest rates are as low as they are. This is not guaranteed to always be the case. The British pound was the dominant currency for a century. It was only because of WW2 that the dollar rose to prominence.

A balanced budget law is not a good idea. Deficit spending during a crisis such as the pandemic or a recession helps the economy recover; but the budget should get closer to neutral during normal times. As shown in the chart above, the government normally runs a deficit. A 2% deficit target would be sustainable. However, the current 6% deficit is not.

As a wage earner and small business owner in the financial services industry, I pay the highest taxes possible. There are no loopholes like there are for real estate, manufacturing, oil and gas, carried interest, accelerated depreciation, etc. I don't want to pay more in taxes (nobody does), but to solve this problem we can't take all revenue discussions off the table. Every tax deduction or credit we give is less revenue that the government needs to balance its books.



In regards to the Fed and interest rates, the market believes (and I agree) that they are nearly done with rate hikes. As shown in this chart, the market thinks the Fed will be reducing rates possibly as early as this year. I am less inclined to believe this. You can see in the three previous cycles (2000, 2008, 2020) that the Fed did in fact lower rates very quickly. But those periods were marked by significant financial and economic events… the tech bubble/bust, the Great Financial Crisis, and the Covid pandemic. Currently, the economy is growing despite the sharp increase in interest rates. I think the more likely expectation is that rates stay higher for longer, but just as night follows day rate hikes will slow the economy and eventually the Fed will lower rates. In fact, it has already slowed from 2.6% in Q4 to an estimated 1.3% now.

Longer term rates have already begun anticipating a slowing economy and falling inflation. Ten year treasury rates peaked last year at 4.25%. They fell to 3.5% and have recently risen to about 3.75%. As I have pointed out in the past and shown in this chart, rates tend to find a

level and stay there for a while until the facts change. It appears to me that rates will remain in the 3.5% - 4% range as long as the economy keeps tracking in the 1% to 2% range.

And finally, I think stocks are also likely to remain range bound for somewhat longer. With

the economy slowing but still growing earnings are expected to be flat this year compared to last. Valuations are above average. Put it all together and I can't see a compelling reason for the market to advance. Whether it falls will depend on whether the economy can slow enough to reduce inflation, but not fall into a significant recession.

At the end of the day it's the economy, earnings, valuation, and interest rates that determine the returns we get from financial markets. The Fed and Congress have an influence, but they are not the sole determinants. The focus on the debt ceiling and Fed rate hikes will pass.

Happy returns,

Brad

Brad Bickham, CFA, CFP
Director, Investments – Mountain West
Colorado Financial Management | Lido Advisors

And Your Entire Colorado Financial Mgmt. Team

This document provides only commentary and is not intended to meet objectives or suitability requirements of any specific individual.

Standard and Poor's Index: S&P 500: The S&P 500® is an unmanaged index that is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available US market capitalization.

Colorado Financial Management, LLC, a Lido company ("CFM") is an SEC-registered investment adviser. Please note that SEC registration does not denote any particular competence or ability and no inference to the contrary should be made. For complete information on the services we provide and our fees, please review our Form ADV at adviserinfo.sec.gov, call (303) 443-2433, or mail us at 4840 Pearl East Circle, Suite 300E, Boulder, CO 80301.

The information contained herein reflects CFM's views as of the date of this newsletter. Such views are subject to change at any time without notice due to changes in market or economic conditions and may not necessarily come to pass. CFM has obtained the information provided herein from various third-party sources believed to be reliable but such information is not guaranteed. Any forward-looking statements or forecasts are based on assumptions and actual results are expected to vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision. CFM is not responsible for the consequences of any decisions or actions taken as a result of information provided in this newsletter and does not warrant or guarantee the accuracy or completeness of this information.

Past performance is not indicative of future performance. The information in this report is for informational purposes only and should not be relied upon as the basis of an investment or liquidation decision. Nothing in this report shall be construed to be a solicitation to buy or offer to sell any security, product or service to any non-U.S. investor, nor shall any such security, product or service be solicited, offered or sold in any jurisdiction where such activity would be contrary to the securities laws or other local laws and regulations or would subject CFM to any registration requirement within such jurisdiction. All content herein has been obtained from sources deemed to be reliable, but is subject to unintentional errors, omissions and changes without notice, and is not warranted as to its accuracy or completeness. You should not rely on the information contained herein, and should rely solely on, and carefully read, the appropriate offering and related subscription materials relating to any specific investment product before making any investment decision.

Not all investments are suitable for all clients. It should not be assumed that any security listed or any recommendations made in the future will be profitable or without loss, including risk of loss of principal, or will equal any prior performance. All investments involve the risk of potential investment losses including the potential risk of loss of principal as well as the potential for investment gain. Further, the prior performance figures indicated herein represent portfolio performance for only a short time period and may not be indicative of the returns or volatility each portfolio will generate over a long time period. The performance of the portfolios should also be viewed in the context of the broad market and general economic conditions prevailing during the periods covered by the performance information. Any references to future returns/risk are not promises of the actual return the client portfolio may achieve. Before investing, investors should seek financial advice regarding the appropriateness of investing in any securities of investment strategies discussed. Not all investments are suitable for all investors.

There may be tax or legal consequences to certain investments and CFM does not provide tax or legal advice, and it is strongly encouraged that a potential investor consults with tax and legal counsel prior to making any investment.

For further information, please visit:
S&P Index: S&P 500
Fed Yield curves: U.S. Department of the Treasury