*Please note: This is a transcription so there may be slight grammatical errors.*

Mike Vogelzang:

We all know what to expect when we pull up at a traffic light: red, yellow, green, maybe an arrow or two. But what happens when a driver encounters an unusual set of signals? This is the type of confusing environment that investors are facing today.

As we pass the midpoint of 2023, we're studying today's economic and market signals. Right now, some are green, some are yellow, and there are even a few red. We're also analyzing what the remainder of the year might bring and which color light is likely to appear at the next intersection.

Signals showing green lights are thankfully quite plentiful. There are a number of bullish dynamics that may point to a so-called soft landing, where a recession is just a temporary traffic slowdown and maybe avoided altogether.

The first green light is the state of consumers. Encouraged by a strong labor market, they're still spending freely. Although we've seen excess savings shrink and credit-card balances have grown, strong wages, along with higher interest income, have kept the registers ringing.

Second, we've seen some earlier risks resolve. The stress in the banking sector that emerged in late March has been largely contained, and the debt ceiling showdown reached a successful conclusion, or at least, it was kicked further down the road.

And finally, emerging artificial intelligence technology, AI, has reinvigorated investors with the promise of productivity and revenue enhancements across many sectors of the economy. This optimism drove the tech-heavy NASDAQ Index to its best first half ever, even better than during the dot-com era of the late 1990s.

Combined, these positive signals drove the stock market to double-digit gains for the first half of the year, but as always, there are reasons to be cautious.

First, although inflation has moderated, core inflation, the Federal Reserve's key indicator, remains stubbornly high. This only makes the Fed more nervous as it tries to avoid a 1970 scenario where inflation cools for a bit only to accelerate again.

In June, we saw distinct signs of economic acceleration, even after the massive increases in Federal funds rates. Sticky inflation suggests further rate hikes from the Fed and tighter monetary policy. This has massive implications for businesses and consumers.

Investors have taken moderating inflation as a green light to accelerate into more risky territory. While this more optimistic viewpoint may seem like a good thing, too much optimism can be a flag for caution. That's because excess optimism creates the environment in which asset bubbles form or other risky behavior is rewarded. With stock valuations quite high compared to history, excessive investor optimism is a flashing yellow signal.

Finally, we have the supply of money, also known as liquidity, or simply the amount of cash flowing through the financial system: the grease in the gears of the economy. Several factors are driving down the money supply, from higher borrowing costs and tighter lending standards at banks to the reversal of pandemic-era fiscal and monetary policies. As liquidity dries up, risky assets such as stocks and even housing feel the impact of downward pressure on prices.

So where do we go from here based on these mixed signals? We're in uncharted territory for sure. This economy and market, distorted by the onset and then the response to the pandemic, has already shattered long-held patterns. We expect more to come.

For example, over the past 75 years, the economy has never seen two consecutive quarters of negative economic growth without entering a recession, but that pattern was broken in 2022 when the economy shrugged off two consecutive negative quarters only to return to more normal levels of economic output.

Another example: the economy has never entered recession with the labor market as strong as it is today. On the other hand, the economy has never not entered a recession with an inverted yield curve. That is when long-term interest rates provide a lower yield than short-term rates.

Today, we have a strong labor market and an inverted yield curve, so it seems like that one of these never-befores is destined to be broken. In this environment, you can't simply rely on your GPS to get you where you're headed, and you won't find a map on your phone for this set of challenges and opportunities.

With such a wide range of possible outcomes, the best course is to remain invested and diversified, but also to take advantage of opportunities to reduce risk where appropriate. As always, investors should keep their eyes on the road, aware of their long-term destination, and along the way, it's best if we all pay attention to those traffic lights.