

Regans' Notes

What Happened to the Recession??

“Unprecedented” actions by government—locking down the economy, printing, borrowing, and spending trillions of extra dollars artificially boosted economic activity. As these artificial actions wear off, we expect a recession to appear.

In the fourth quarter of 2022, retail sales, industrial production and other data suggested the economy was hitting a wall. Then January happened. Retail sales, manufacturing production, and nonfarm payrolls all surged. We think several factors, some not recurring, are responsible. These include:

The US had unusually warm January weather. The national average temperature was 35.2 degrees, the fourth highest for any January in the “Lower 48” states in the past thirty years. *Source: First Trust Advisors, L.P.* Fewer plants closed due to weather, new home foundations could be dug, and more people could comfortably shop, dine, travel, and enjoy various entertainment.

Social security recipients (of which retirees make up an overwhelming share) received an 8.7% cost-of-living adjustment this year – the single-largest increase in more than four decades. That is helping support spending, according to new research from Bank of America. Their data shows faster spending growth of cards this year among households more likely to receive those payments, relative to those that don't. Also, household card spending was up 5.1% in January 2023.



Accept Uncertainty

Currently there is much debate focusing on inflation, the Federal Reserve (The Fed), economic growth, and so on. We think this supports an approach to investing which accepts uncertainty. After all, how many good “fortune tellers” are there?

Accepting uncertainty leads investors away from portfolios tailor-made for specific scenarios and towards solutions that attempt to control risk and offer likely returns even in volatile times.

There are times when tilting a portfolio towards a forecast can make sense. An easy example is positioning for a recovery in a recession once small bits of good news—green shoots—start to emerge. Some successful investors can point to past wins based on an accurate forecast.

We think it is a fallacy, however, to assume that all, or even most points in time offer that type of opportunity. In particular, we view the current market outlook to be the most uncertain in memory.

Current Situation

The bond market has the yield curve more inverted than it has been in the last 40 years. At the end of 2022, the two year Treasury was yielding more than the 10 year (4.4% vs 3.9%)

Source: Miller Howard Investments.

Typically, investors demand a higher interest rate for longer duration bonds to compensate for potentially missing out on more attractive investments that may develop. Pessimism from the bond market is loud and clear.

Historically, drops in the ISM Manufacturing Purchasing Managers Index have frequently led or coincided with recessions and has been dropping since March 31, 2022.

Source: Miller Howard Investments

Many are expecting a recession in part because of The Fed's interest rate increases. These increases alone do not always guarantee a recession. Higher rates have a significant impact on the economy through the housing sector. The question of whether this sector (2% of GDP) is big enough to pull the whole economy into recession is not known.

The Department of Labor reported January construction job openings dropped by 240,000 from December, or nearly 50%, to 248,000. This was the largest-ever monthly decline in construction job openings in the data series that stretches back roughly 20 years. *Source: Axios Markets 3/9/23.*

However, overall job openings, dipped only slightly in January, suggesting the overall economy remains strong.

Source: Department of Labor and Axios Markets 3/9/23.

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Major Differences from 2008-2009 Recession

Adjustable-rate mortgages are much less common today compared to when the housing bubble peaked in 2006. In 2006, roughly one third of new mortgage applications were adjustable-rate. After 2009, the vast majority of homeowners obtained a fixed-rate mortgage, with a rate well below prevailing mortgage rates. *Source: Miller Howard Investments.*

We do not expect foreclosures to surge to post-2008 levels unless unemployment increases substantially. This appears unlikely as we are seeing more job openings than unemployed people.

The baby boomer generation worked longer than previous generations, but then decided in large numbers to retire during the pandemic. Combined with lower immigration, labor supply is tight, making it easy to find a new job.

The consumer today is much less leveraged with debt than in the past. The stimulus checks have actually resulted in historical cash balances for households, currently averaging about \$24,000 (household per capita). *Source: Miller Howard Investments.*

The business sector has a higher percentage of their debt in long-term bonds which have a fixed rate of interest as compared to short-term bank debt. *Source: Miller Howard Investments.*

The Future Opportunities/Risks

Investing is about the future, not the past. Given rising rates, we do not see P/E expansion as a reliable source of returns going forward. Adding to the high uncertainty in the economic environment only strengthens the argument to avoid excessive risk, seek quality and growth with adequate diversification, and include a fixed-income strategy.

Obscured by the negative headlines that dominated 2022 were some astounding technological advancements. A very significant event late in 2022 was the successful test to ignite a fusion reaction that, for the first time, required less energy than it produced. The ability to harness fusion technology for any meaningful application, including as a source of clean energy, may be decades away. But this development, already recognized by many as one of the great technological achievements of the past century, moved the fusion energy needle in a significant way – from a pipedream to a very real possibility. *Source: Time Magazine*

That's what the future is all about. Scores of new innovations and developments emerged in 2022. These included breakthroughs that allowed an upgrade in the capabilities of artificial intelligence such as ChatGPT. Also, we saw medical advances like drugs that show signs of effectively addressing obesity and Alzheimer's. *Source: Minneapolis Portfolio Management Group, LLC*

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Our client specific strategies use independent, full-time professionals to research and manage portfolios for long-term growth of assets.

- **Over 50 years of experience** in both up and down markets.
- Independent, objective advice from professionals with the expertise you need to help you achieve your goals.
- Investment strategies appropriate for **long-term, serious, core money**.
- Asset allocation strategies customized to fit clients' unique needs, risk tolerance, and time horizons.
- A disciplined investment process.
- Portfolios that attempt to provide **more consistent returns with reduced volatility** over time.
- **Seek out, screen, and hire** high- quality money managers to run portfolios of individual securities.
- **Ongoing review** of the chosen managers' process, personnel, and investment decisions and report their performance quarterly.
- Replace managers when necessary.

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