ZANETTI FINANCIAL, LLC

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Where Is The Recession?

“There will be bear markets about twice every 10 years and recessions about twice every 10 or 12 years but nobody has been able to predict them reliably.”
~ John Templeton, Legendary Investor (1912-2008)

Happy Monday Everyone!

I had a recent conversation with a client the other day. Let’s call him Joe. Joe and I were talking when he said, “I know we are overdue for a recession, Walt, but why hasn’t it happened yet?”

Joe and I had a great conversation that I thought you all might enjoy to be a part of.

Basically, I outlined what I see are red flags that warn of an oncoming recession. I've seen several of these flags for a while, but they're getting more visible as time goes by. Let's break out some of the bigger red flags:

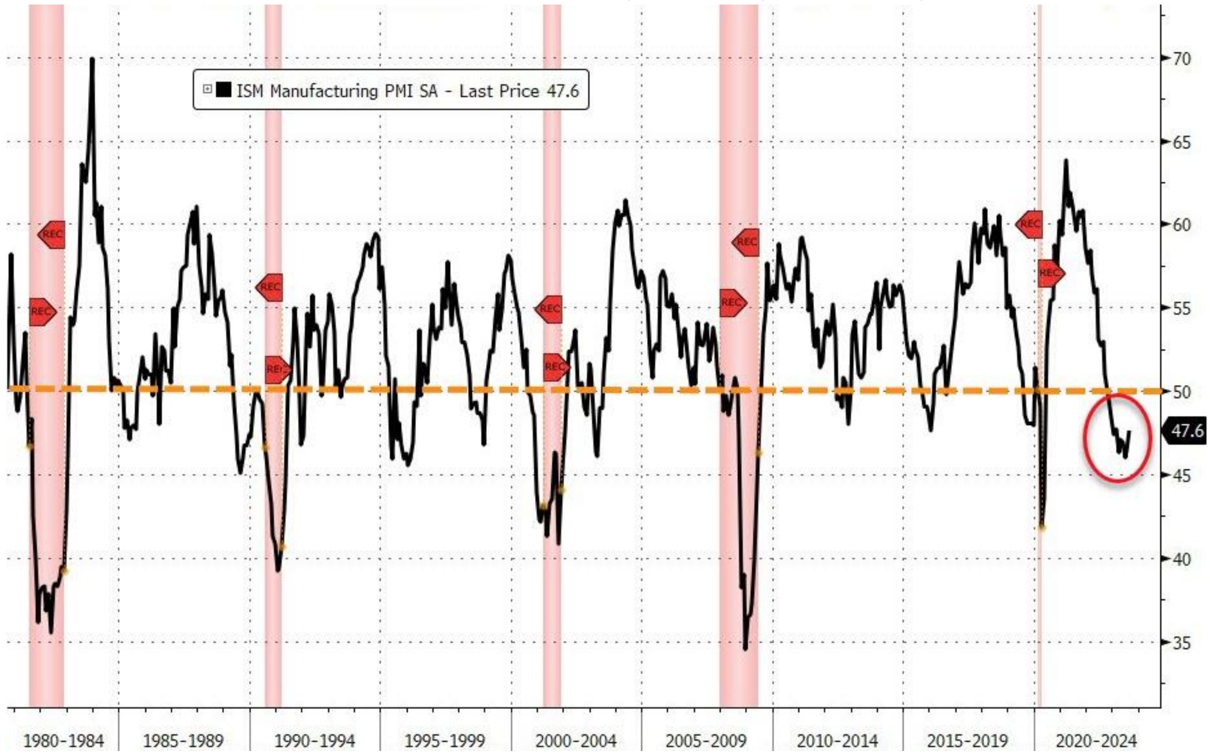
1. Consumer confidence is down to 80.2% - historically, 80% is just about the breaking point right before we go into a recession. See the chart below.

2. Consumers are buying fewer big-ticket items like furniture and jewelry. They're also downgrading food purchases – switching from pricier beef purchases and buying chicken instead. We've even seen consumers buying more canned chicken and tuna recently.
3. Credit Cards are getting maxed out. One of the good things that came about from all of the stimmy checks during Covid was that the American consumer used that extra money to not only buy stuff, but also pay down their credit cards. Unfortunately, that trend has reversed and we recently set a new national record for credit card debt – we surpassed $1 Trillion. Meanwhile, personal savings went from record highs

during Covid and are getting close to record lows now.

4. Credit is tightening. What does that mean? That's "finance speak" for banks are slowing down on lending. Why are banks becoming reluctant? Because rates are increasing – and bank loans that are repricing are still out for jury on whether or not the borrowers are going to be able to handle the new higher payments. In the meantime, they're being cautious about digging the hole they might be in deeper. When banks tighten their lending there is a ripple effect. Borrowers borrow less money, which means less money gets spent out in the economy. When less money is spent, it's across the board: buying homes or cars; going out to eat; buying new clothes; etc. And all the people who make a living selling products and services (which is everybody not employed by the government) bring home less.
5. Corporate bonds are maturing. This relates to the last item. When bonds mature, they get repriced at the new rates. Those rates are higher. This means businesses will have higher interest expenses. If they're selling less "stuff" and their interest expense is increasing, that means their profit margin is shrinking. Those are called earnings. And if earnings are dropping, so will the stock prices.

6. Manufacturing is still in a slump. Orders are falling in manufacturing due to high costs (Thanks a lot, inflation!). There's also fear that purchasing will slow down, so manufacturers aren't pre-making their goods – just-in-case.



7. The Conference Board's U.S. Leading Economic Index is down. In fact, this is its longest decline since the Great Recession of 2007 and 2008. The index is based on 10 components, ranging from stock prices and interest rates to unemployment claims and consumer expectations for business conditions. This indicates that economic activity is

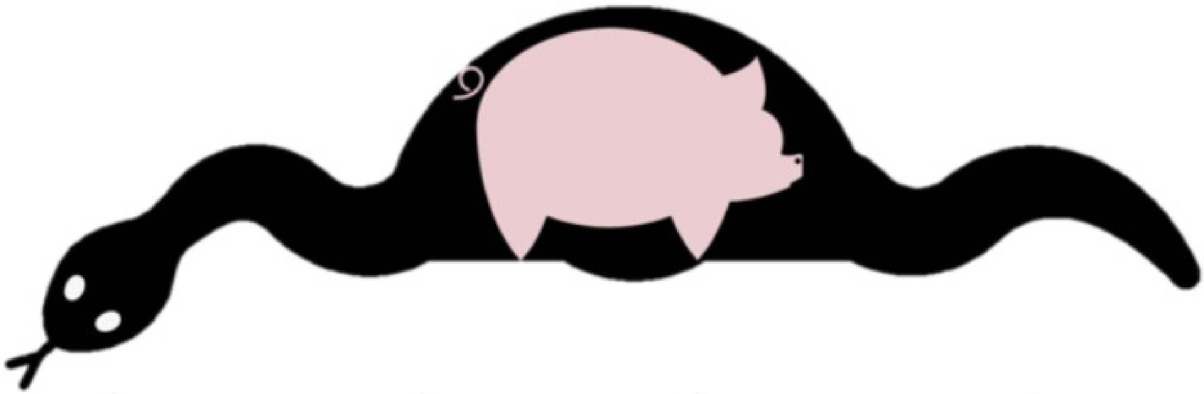
likely to decelerate.

8. The Yield Curve is still inverted. This is probably one of the most famous of the “classic” recessionary signals. Investors should be paid more for taking a long-term risk than they should for a short-term risk. That’s why the yield on a 10-year Treasury is supposed to pay a higher yield than a 2-year Treasury. When this is not the case, (and it’s currently not) it’s called an inverted yield curve, and it has long been considered a sign that a recession is coming. Look at the following chart. When the black line goes below the yellow dotted line, that’s an inversion. You can see that the past several recessions (the red highlighted columns) came just after the yield curve had inverted and then returned to a

"normal" yield curve.

9. Inflation is sticky. It's been harder to get that genie back in the bottle than the Fed had assumed. The Fed has raised rates 11 times since March of 2022 in an effort to reign in inflation. It's worked (as we discussed last week), but not perfectly. In fact, inflation ticked up last week as you can see in the next chart. All this to say, the Fed probably won't start lowering rates anytime soon.

So, why no inflation yet? Simply put, I think it's because of all the stimmy funds that came into the economy. It's taking a while for the economy to digest all of that dough. Imagine a python eating a pig. It takes a while.



And with that, dear reader, you have been made privy to Joe and my conversation. To sum up, I'd say, hold on – it's coming.

Your I-Used-To-Be-Addicted-To-Soap-But-I'm-Clean-Now Financial Advisor,
Walt

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