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Weekly Market Commentary
July 11th, 2022

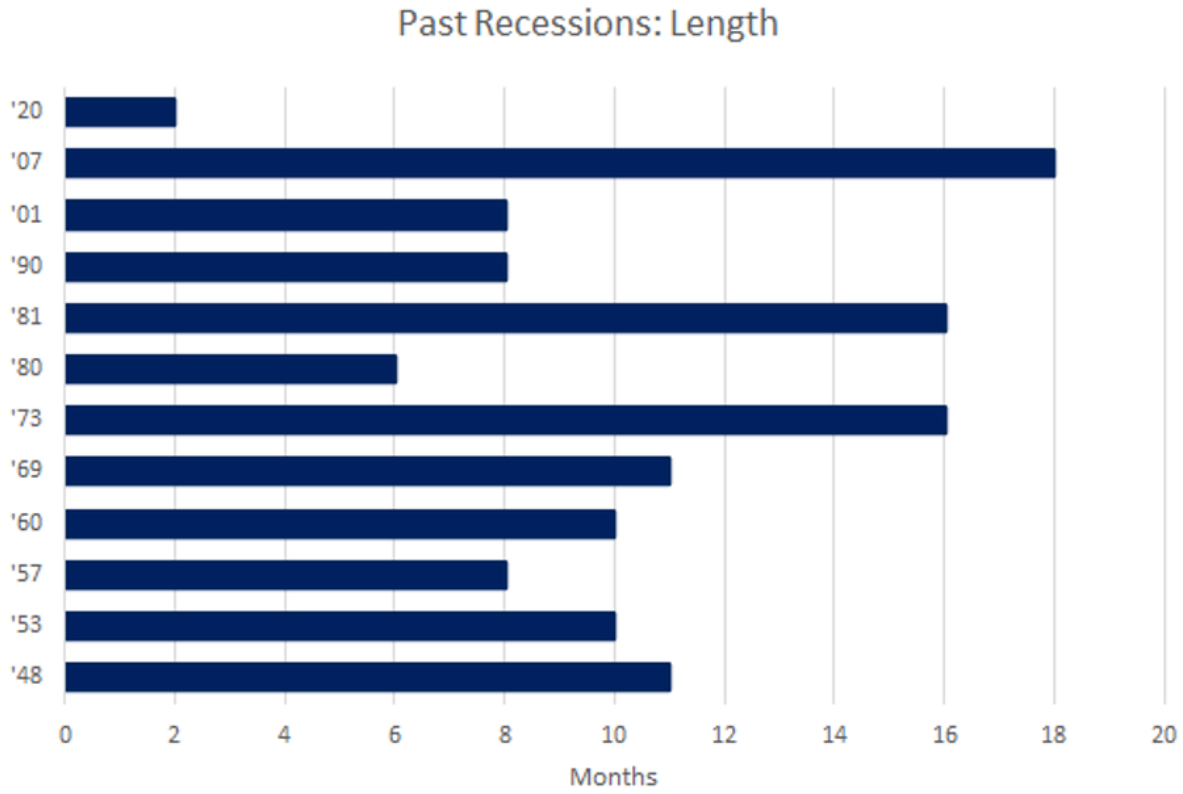
A Look at Recessions: What to Know and Do

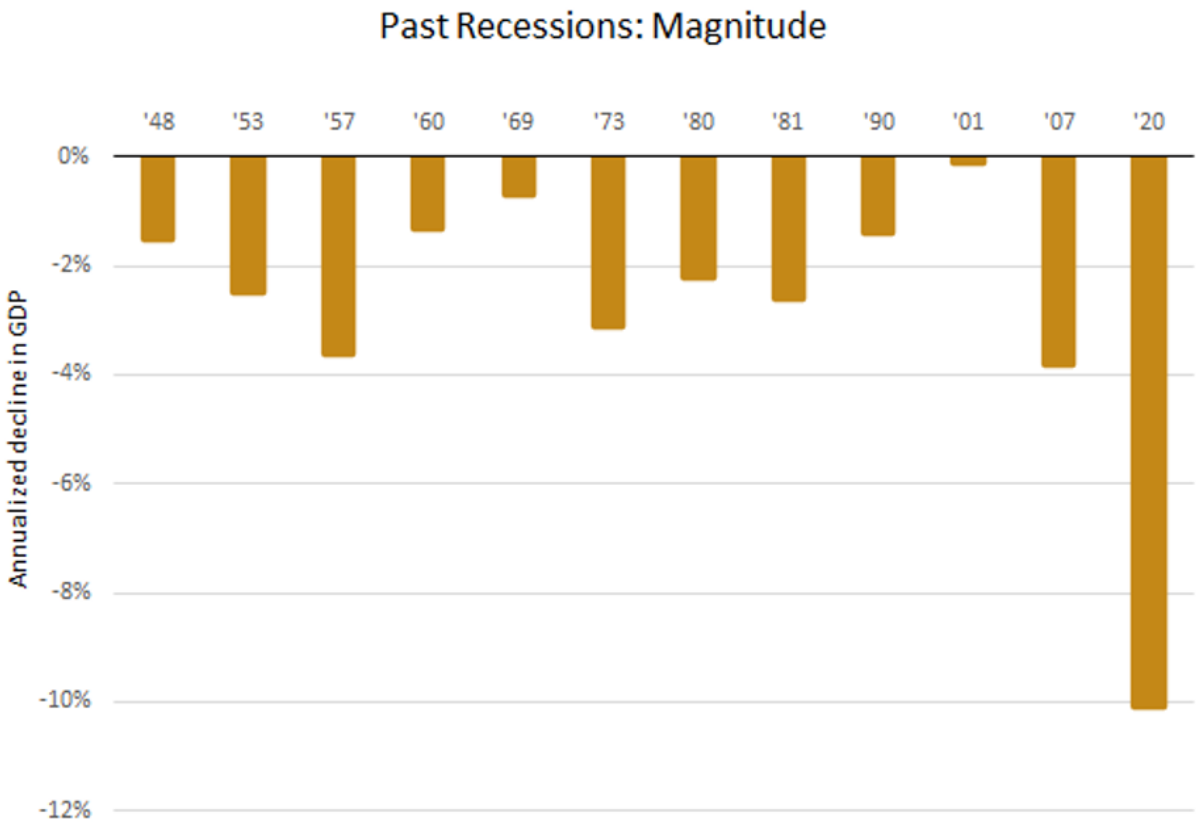
If there is safety in numbers, then the chorus of headlines citing an imminent recession is coming from Fort Knox. There is no dismissing the potential for, or the implications of, a recession, but we think the litany of calls for the economy's demise may be too dour. For one, reliable fundamental indicators are signaling that a downturn is more probable, but not inevitable. Two, if a recession transpires, the starting point of strength and the underpinnings of economic activity suggest it could be shallow. And three, the markets are already pricing in a rather pessimistic outlook, suggesting investors can take a more optimistic approach. Here are some perspectives on recessions that can be useful in navigating the path ahead:

Recession Stats

- Since WWII, there have been 12 official recessions, an average of one about every six and a half years.
- Recessions have lasted an average of 10 months, though their depth and duration have varied. Excluding the pandemic in 2020, downturns in '57, '80, '90, and '01 were the shortest, all lasting eight months or less. Recessions in '73, '81, and '07 were the longest, each extending more than 15 months.
- The mildest downturns began in '69 and ‘01, with GDP declining less than 1%. The downturn in 1969 was prompted by simultaneous fiscal (Vietnam War deficits) and monetary (rising inflation) policy tightening, while the 2001 contraction was largely driven by a downturn in business investment (dot-com bubble burst) and the 9-11 attacks. Prior to the pandemic shutdown, the deepest recessions that saw GDP decline by more than 3% started in 1957 (tightening monetary policy), 1973 (stagflation, oil embargo), and 2007 (global financial crisis).

Figure 1. Recessions are, on average, 10 months long, but have varied in length and magnitude.



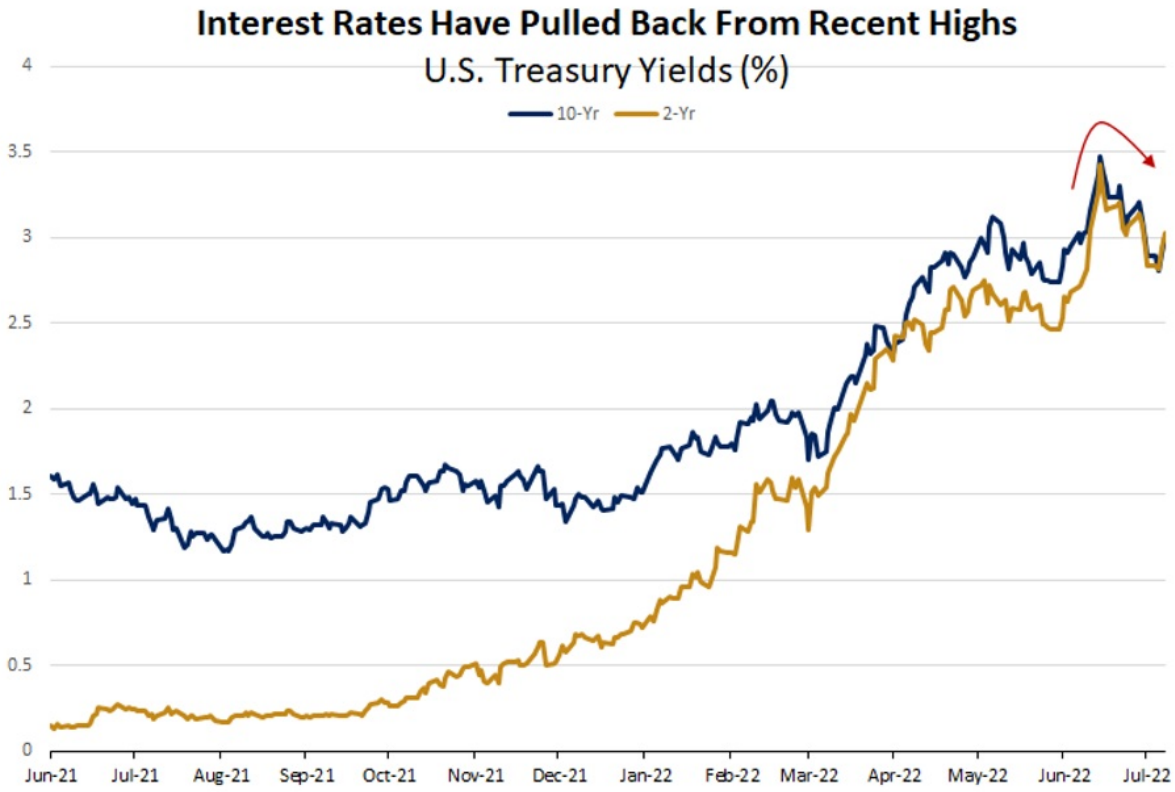


Source: FactSet.

These two charts show the length of recessions in months, with the longest in 2007 at 18 months and the shortest in 2020 at 2 months, while the average is around 10 months and the magnitude of recessions with 2020 being the most severe at -10%.

The trend in inflation and interest rates holds the key to the economic outlook. The upcoming June consumer price index (CPI) report is likely to show that headline inflation remains elevated, thanks to still-high oil prices last month, keeping the Fed on track for another outsized rate hike in July. Tightening Fed policy is a typical catalyst for recessions, so the threat of rate hikes shouldn't be downplayed. On a

positive note, the rate of inflation is headed lower, but it's the catalyst for that moderation that will be the differentiator. Either inflation will decline because a recession emerges (demand is reduced significantly), or inflation will decline because of an improvement in supply along with declining commodity prices, which have fallen sharply recently. The former would be more punitive to near-term equity-market performance, but both scenarios would ultimately allow the Fed to let its foot off the brake later this year, which we think will be a catalyst for a more persistent rebound. Treasury yields have pulled back from their June highs, supporting our view that the outlook for inflation is softening somewhat.



Source: FactSet. Past performance does not guarantee future results.

If a recession comes, how severe would it be?

If a recession were to emerge, we believe it would be shallow, in large part due to the strong starting point at which we're entering this phase of weakness, as well as the healthy shape of household finances.

A tight labor market - With consumer spending accounting for 70% of the economy, there is a connection between the labor market and the magnitude of the downturn. The five recessions in which the unemployment rate rose by less than 2.5% ('60, '69, 80, '90, '01) were also among the mildest, with GDP declining by an average of just 1.3%. Conversely, the recessions that involved above-average increases in the unemployment rate ('73, '81 and '07) were among the deepest downturns, with GDP contracting by an average of 3.2%. We doubt the labor market will remain unscathed, but the existing historically high amount of job openings (though likely to come down as we progress) will probably provide some cushion against rising unemployment. Meanwhile, households are still sitting on more than $2 trillion in accumulated savings. This combination will offer support to consumer spending, which supports the case for a milder downturn. This was the case in the 2001 recession when consumer spending was resilient and damage to the labor market was

Less consumer indebtedness - The red-hot housing market is certainly vulnerable, as

higher interest rates sap demand. But residential investment is currently less than 5% of GDP, just slightly above the 50-year average, which could help limit the downside impact housing may have on the economy. Housing investment was notably higher entering recessions in the mid-'70s, early-'80s and '08, adding to the decline in output during those contractions. Moreover, the measure of household debt payments as a percent of disposable income is still near its lowest in 40 years, meaning a downturn won't be exacerbated by a sharp phase of consumer deleveraging (like 2008/2009).

Lower inflation expectations – Inflation is high now, but inflation-expectation data indicate it's not anticipated to remain so for an extended period. Inflation is not yet entrenched, which means the Fed still could bring it down by bending the economy, not breaking it, as was the case in the early-'80s. When inflation expectations failed to come down meaningfully following the 1980 downturn, the Fed was forced to send the economy forcibly back into a deep and long recession to break the back of inflation more structurally. We don't think such an adjustment is required at this stage, meaning we don't have to repeat the experience of the early-'80s, even though the current inflation environment is sparking comparisons to that period.

What does it mean for the market?

Recession-driven bear markets have declined by an average of 35%, which would suggest more downside in the event of a recession. However, the most severe market declines have been associated with recessions driven by or accompanied by popping asset bubbles or financial shocks. If we exclude the bursting of the dot-com bubble, the global financial crisis, and the pandemic shutdown, and look at recession-driven bear markets associated with more traditional declines that were prompted by Fed rate hikes and cyclical slowdowns, bear-market declines have averaged roughly 27%. With the S&P 500 falling more than 21% at one point this year, this suggests to us that most of the pain may be behind us.

Past experiences around downturns suggest investors have reason to be optimistic and opportunistic if the proper viewpoint is maintained. Historically, the stock market has bottomed, on average, four months ahead of a recession's end, meaning investors don't have to wait for the "all clear" to see better market returns. Stocks, on average, peak five months before a recession and the market experiences the most pressure early, typically starting its recovery within recessions. Moreover, stocks gain steam as downturns end, with the S&P 500 posting an average gain near 20% in the 12 months following the end of a recession.

(Source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	31,339	.8%
S&P 500 Index	3,899	1.9%
NASDAQ	11,635	4.6%
MSCI EAFE	1,841	-.2%
10-yr Treasury Yield	3.08%	.2%
Gold	$1,742	-3.81%
Bonds	$101.28	-1.0%

Source: Reuters/Wall Street Journal

Earnings Highlights This Week

Samsung: Samsung shares rose on Thursday, dragging Asian chipmakers higher after the South Korean technology giant posted "better than feared" earnings guidance for the second quarter. Samsung's earnings guidance came against a backdrop of pressure on chip stocks, given supply chain disruptions and rampant inflation that threatens consumer demand. The South Korean tech giant allayed some of those fears, leading to a rally in chip stocks such as TSMC, United Microelectronics Corporation and SK Hynix. But analysts warned of headwinds for the second half of the year.

Levi Strauss: Levi Strauss reported fiscal second-quarter earnings that exceeded analyst estimates. The clothing retailer reaffirmed its 2022 guidance for net revenue to increase 11% to 13% compared to 2021.

Foxconn: Taiwan's Foxconn, the world's largest contract electronics maker, raised its full-year business outlook on Monday thanks to strong sales of smartphones and servers despite concerns of slowing demand due to rising inflation. Like other global manufacturers, the Taiwanese firm has grappled with a severe shortage of chips, which has hurt smartphone production including for its major client Apple, partly due to COVID-19 lockdowns in China. Foxconn said it was optimistic about its business in the third quarter, adding it could see "significant growth" compared with a year earlier.

News and Notes

Were Your Parents Wrong About Money?

Your Parents Said: Go To College And Get A Degree

- 44 million borrowers owe 1.6 trillion in debt- average student loan debt is now $29,200- is it really worth it?
- Is educational debt good debt anymore??

Your Parents Said: Get A Good Job And Work Your Way Up The Ladder

- Blue Collar Jobs – pay is rising due to low unemployment, also specialties such as coding school now. Some blue-collar jobs pay more than $100,000.
- Telecommuting is rising: 20% to 25% spend some time working out of the house- and people change jobs more frequently.

Your Parents Said: Save For A Down Payment And Buy A Home

- Millennials want to be more mobile, and Pew Research found in 2018 that 88% of millennials live in metropolitan areas where you have more

renters. Homeownership is now more expensive than renting for 1st time in 15 years.

- Average home price Millennials plan to spend $325,000 -with rising credit card debt and massive student debt.

Your Parents Said: Settle down, get married, and have kids

Work dynamics are changing women have more options and not all are choosing to have kids.

- More Millennials are choosing to have life/work/fun balance today as opposed to enjoying it 'all in retirement like their parents.
- Marriage is happening later in life.

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