The Economist Who Cried Recession

In the fairy tale, the boy who cried wolf was ultimately right, but no one listened by the time that the wolf was there. Too many mistakes led the villagers to doubt the boy, so they didn't respond to the actual warning.

I, like many economists, expected a recession earlier this year. I had to back off those calls as the data continued to come in better than expected. Any signs of the "lagged and variable" impact of rate hikes didn't seem to materialize. Additionally, those who had doubted the recession got more confident and those still considering that a recession was possible had to reconsider. As all of this was occurring, the "**soft landing**" mantra took over.

According to **Google trends**, "soft landing" started seeing increased interest in early July and peaked the week of August 20th. It has dropped steadily since then, and maybe it is **time to start questioning how soft the landing will be.**

As we go through some data, you will see that it is not clear to me that we are destined to have some form of a recession, but I do think that we better be prepared to listen to any potential warnings. The villagers ultimately lost their flock because they didn't listen when they should have. Maybe we need to be thinking about that possibility.

For now, I like owning bonds and stocks. I think that the recent run-up in rates (which have already started to come down) will continue to come down, which will help risk assets (stocks and credit spreads).

But, for the 10-year yield to get below 3.9%, it is going to require some recession fears to surface, which will not be good for stocks.

Lies, Damned Lies, and Statistics

Just two weeks ago, we highlighted Lies, Damned Lies, and Statistics. In this report, we tried to identify some potentially "confusing" data.

While some short-term trends in **consumer credit** are concerning, they don't appear to be so bad in the long run. Which trend will win out?

The **China** trade isn't working and my belief (increasing in intensity almost daily) is that any major improvement in China will come at the expense of the U.S. (China selling their brands or pushing commodity prices higher – see China's Next Move).

Generative AI seems to be helping risk assets again (based on some market leaders), but for how long?

If you missed our inaugural X Report, I recommend it because it is an intriguing take on AI and space.

Jobs

We touched on **jobs** in that report, and we had to mention "**recession**" in Friday's instant reaction to the jobs data. Overall, we characterized the report as "**Goldilocks"**, but the fine line between a healthy and unhealthy slowing of the economy may be difficult to see ahead of time. Maybe those who need jobs are sensing that it is more difficult to find one, so they better start looking now.

The Sahm Rule (I still don't understand why economists insist on calling things "rules" that are at best conjectures) states that the U.S. is in a recession if the 3-month moving average of the unemployment rate rises by 0.5% or more from its 12-month low. The 3-month low was 3.5% at the end of April and is currently at 3.65% (so only a 0.15% increase). One thing about the Sahm Rule is that it supposedly doesn't predict anything. It just tells us that we are likely already in a recession if the rise occurs.

JOLTS was weak across the board. The PMI data, which came in better than expected overall, still signaled a contraction.

The jobs data seems to fit well into the "economist who cried recession" theme as the data isn't yet recessionary (not by a long shot), but the trend is not your friend here.

Et Tu, Covid?

I hoped never to have to think about COVID again, but I am hearing from people (who aren't typically alarmists) that this new strain is something to watch. A new strain (that may have mutated so much that earlier vaccinations are less effective) could be problematic. The fact that it is ramping up as we head into the winter months could be another problem.

Could this new strain slow down the return of "work from office"?

I have felt that increased pressure to be in the office will help commercial real estate, which in turn helps the banks and the broader market. I'm keeping an eye out for any signs that this trend, which is gaining traction, gets derailed.

Wanting to ignore Covid and being able to ignore it are two different things. For now, I'm watching it mostly because the warnings that I've heard are not from the people who cried wolf at every stage of the pandemic.

India

I need to do more work on this, but the "**commodity super cycle**" risk that I associate with a rapidly rising India seems to be generating more interest. It is far from my base case, but increasingly it seems difficult to fathom that we talk so much about inflation and so little about India. It is the most populous nation on earth and has a business sector that is benefitting from companies moving out of China.

Bottom Line

I like being long bonds and risky assets until the 10-year goes below 3.9%.

By then, any squeeze should be over, and we can go back to fretting about the Fed and "higher for longer" and could see a resurgence of hard landing stories.

I'm not crying recession yet, but I'm sensing that I soon will be.

Good luck and I hope that you all had a great summer and have an awesome rest of the year!

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