Downside Risks Abound As Soft Landings and Recessions Initially Look Alike

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A Record Rise in Fed Funds

The Fed has increased rates at the fastest pace in more than four decades.

Source: FRB, Haver, SMBC Nikko
Historic Curve Inversion

The deeply inverted yield curve signals recession and less credit creation.

Source: Bloomberg, FRB, SMBC Nikko
Getting Back to Normal

The yield curve steepens only when the Fed cuts.

Sources: Federal Reserve, Haver, SMBC Nikko
When Will the Fed Cut?

On average over the last five cycles, the Fed has cut rates eight months following their last hike.

Sources: FRB, Haver, SMBC

Date of First Ease

Number of Months From Last Hike to First Ease

Average = 3 months

Average = 8 months

Source: FRB, Haver, SMBC Nikko
Fewer Sectors Hiring

Last month just 52% of private industries were hiring, a new post-pandemic low.

Source: BLS, Haver, SMBC Nikko
Another Job Metric Already Negative

While volatile the Household Survey is arguably better at capturing inflection points owing to is changing monthly sample.

Source: BLS, Haver, SMBC Nikko

Private Industry Payrolls: Wage and Salary Workers

Change 000s

Jan  Feb  Mar  Apr  May  Jun  Jul  Aug  Sep  Oct

2023

Source: BLS, Haver, SMBC Nikko
Recession happens every time the unemployment rate rises 50 basis points from its cyclical trough.

Source: FRB, Haver, SMBC Nikko
Current Cycle vs. Past Cycles

Unemployment is finally rising.

Source: FRB, Haver, SMBC Nikko
Tightening Into A Downturn

Leading Economic Indicators are declining rapidly.

Source: Conference Board, FRB, Haver, SMBC Nikko
Massive Balance Sheet Losses

Record Fed tightening has decimated commercial bank capital.

Unrealized Gains/(Losses) on Investment Securities as Percent of Bank Capital

Source: FRB, Haver, SMBC Nikko
Nowhere To Hide

The drop in value has been in both security accounts.

Source: FRB, Haver, SMBC Nikko
Tightening Credit Conditions

Banks are still tightening standards at a recessionary level.

Fed Senior Officers Survey: Banks Tightening C&I Loans to Large & Medium Sized Firms

Source: FRB, Haver, SMBC Nikko
Falling Net Interest Payments

Some large businesses have locked in historically low rates.

Sources: Federal Reserve, BEA, Haver, SMBC Nikko
Small Business Blues

But this has not been the case with small businesses.

Source: NFIB, Federal Reserve, Haver, SMBC Nikko
Higher Interest Payments

Consumer non-mortgage interest payments haven risen sharply too.

Source: FRB, Haver, SMBC Nikko
Soaring Borrowing Costs

Consumers are facing the highest interest rates in over two decades.

Source: FRB, Freddie Mac, Haver, SMBC Nikko
Households are struggling to obtain credit.

Source: FRB, Haver, SMBC Nikko
A Return to Trend?

Goods spending is well above its pre-pandemic trend.

Sources: BEA, NBER, SMBC Nikko
Homes Are Expensive!

Affordability has declined to a multi-decade low.

Source: FRB, Haver, SMBC Nikko
Collapse In Transactions

Pending home sales are at all-time lows.

Source: FRB, Haver, SMBC Nikko
Massive Disconnect

Construction employment is extremely elevated relative to current housing demand.

Source: FRB, Haver, SMBC Nikko
Parallels With The 1970s

The Fed does not want to repeat the mistakes of the 1970s by easing rates too soon.

Source: FRB, Haver, SMBC Nikko
Parallels To The 1940s

But what if today’s environment is more like the post-WWII era?

Source: FRB, Haver, SMBC Nikko
Declining Quits Signals Lower Wage Costs

The quits rate is back to pre-pandemic levels.

Sources: BLS, Haver, SMBC Nikko
Inflation – Goods Prices vs. Import Prices

China is exporting deflation.

Sources: BLS, Haver, SMBC Nikko
Receding Acyclical Inflation

There are no bottlenecks in the global supply chain.
Rent Relief Coming

Rents have yet to slow due to the nature of the BLS’ index construction. However, rental data from the Cleveland Fed suggests the opposite.

Sources: Cleveland Federal Reserve, BLS, Haver, SMBC Nikko
Inflation – Core Services ex Housing

The “super core” is easing.
Labor Market Normalizing

The labor market is retreating to its pre-pandemic trend, following three years of overheating.

The Normalizing Beveridge Curve

Sources: BLS, Haver, SMBC Nikko
There are widely varying estimates of R-Star.
Surging Treasury Term Premium

The large increase in term premium is doing the Fed’s work.

Term Premium Estimate

Source: FRB, Haver, SMBC Nikko
Stable Inflation Expectations

The bond market remains sanguine on inflation.

Sources: Bloomberg, FRB, SMBC Nikko
Whither Fair Value?

The 10-year treasury note is oversold.
Big Rally But Not Yet

When the Fed is done tightening the yield on the 10-year note falls about 100 basis points within six months.

Source: FRB, Haver, SMBC Nikko
Fellow Travelers

Stocks generally trend with liquidity.
Equities have not been this overvalued relative to Treasuries since the late 1990s tech bubble.

Sources: BLS, Haver, SMBC Nikko
Buying The Dip

Future returns lag when exposure is high.

Source: FRB, Haver, SMBC Nikko
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