LOOKING FOR RECESSION CLUES IN ALL THE WRONG PLACES?

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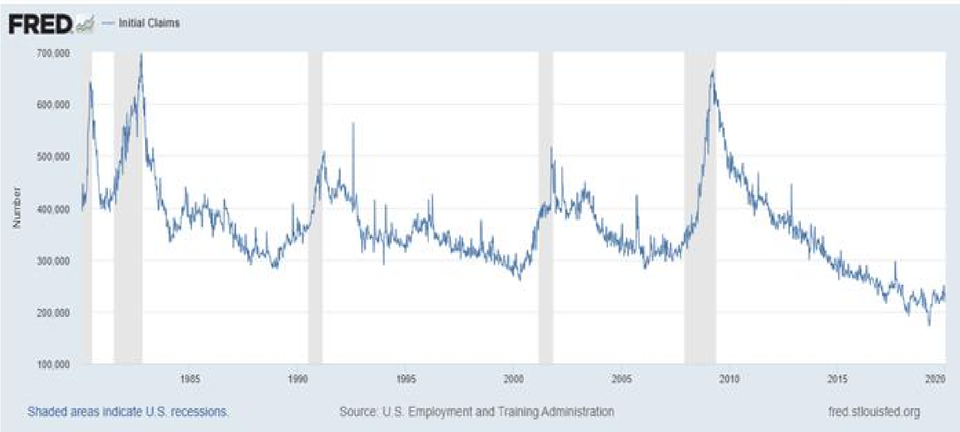
How quickly the narrative has shifted back and forth in the money and bond markets. Over the last month—if not week—or so, the focus has gone from concerns of 40-year inflation to the possibility of a recession. Unfortunately, it looks like investors, as well as the Fed, are going to be confronted with this debate for the foreseeable future.

Chair Powell laid out in unequivocal terms last week that the Fed's primary goal is to reduce inflation pressures, and the policy maker's commitment is "unconditional." This is exactly what has the markets fearful; i.e., the Fed will raise rates too high and ultimately push the economy into a recession. If there is a "silver lining" in the outlook, it's the fact that the economy was in a healthy, if not rather solid, position in some sectors as the Fed rate hikes got underway. However, the odds of a "policy mistake" do appear to be elevated, and the markets "have seen this movie before."



Source: St. Louis Fed, as of 6/24/22.

That brings us to the "clues" aspect of the analysis, or what leading economic indicators to observe, perhaps more closely than others. The May Leading Economic Indicators Index posted its third consecutive monthly decline, but it was very heavily concentrated in only three of the ten components that make up the overall gauge: stock prices, building permits and consumer expectations. Interestingly, these are the three areas that have garnered the most attention lately.

Now to the positive side of the ledger, specifically weekly jobless claims. Admittedly, there have been some increases of late, but the rise has come off the lowest reading since 1968. In fact, the level as of this writing—229,000—remains on the low end of the scale on a historical basis. To provide perspective, the long-run average since 1980 stands at 388,200, well above its present level. The current reading is even below the five-year pre-pandemic average of about 245,000, which itself was low historically.

Jobless claims appear to have a good track record as a leading indicator of economic downturns as well. As the graph illustrates, using 1980 again as our starting point, the level of claims turned decidedly to the upside before each of the prior four non-COVID-19-related recessions. In addition, the absolute level of claims was far higher than where it currently resides prior to the other downturns, when 350,000 to 400,000 readings were prevalent. Although not shown here, claims didn't start moving higher before the "COVID-19 recession" until the lockdown got underway.

Conclusion

This blog post was not meant to officially forecast a recession one way or the other but rather to offer some guidance on what investors could look to when determining where the economy could be headed. While the "known unknown" is that the Fed will be raising rates at least for the remainder of this year and potentially into 2023, the investment landscape promises to be a "fluid" one and, as we've seen in the Treasury market of late, more than likely a volatile one as well.

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Bond : A fixed-income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental).

Inflation : Characterized by rising price levels.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Volatility : A measure of the dispersion of actual returns around a particular average level. .