



# Southern Capital Perspective

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## IS THE LONG-AWAITED RECESSION GOING TO HAPPEN?

by Terry E. Nager, CFP®, CLU®, ChFC®

Most economists and stock market gurus had predicted a recession for the US and the world to happen in 2023. However, the recession has not shown up, so the predictions have been shifted to late 2023 or 2024. The justification for the predictions is well-founded and is clearly laid-out in the following lengthy quote from Zanny Minton Beddoes: Editor-in-chief, *The Economist*. She articulates it better than I could.

*The editors of the Collins English Dictionary have declared “permacrisis” to be their word of the year for 2022. Defined as an “an extended period of instability and insecurity,” it is an ugly portmanteau that accurately encapsulates today’s world as 2023 dawns. Vladimir Putin’s invasion of Ukraine has led to the biggest land war in Europe since 1945, the most serious risk of nuclear escalation since the Cuban missile crisis and the most far-reaching sanctions regime since the 1930s. Soaring food and energy costs have fueled the highest rates of inflation since the 1980s in many countries and the biggest macroeconomic challenge in the modern era of central banking. Assumptions that have held for decades—that borders should be inviolable, nuclear weapons won’t be used, inflation will be low, and the lights in rich countries will stay on—have all been simultaneously shaken.*

This litany of serious problems certainly has the potential of triggering a global recession. Why then has it been delayed, or has it been completely eliminated?

The reason for the delay is probably attributable to the enormous amount of money created and distributed by the Fed as well as the other major central banks around the world (think PPP loans and stimulus checks). Trillions of dollars were given to

people with not much to spend it on. Therefore, people accumulated this money and when the Covid restrictions were lifted, they began to spend the money that they had even if they did not have the income to support their new lifestyle.

It has been estimated that there was about \$2.5 trillion of this stimulus money in consumer's hands and that now it has been spent down to about \$1 to \$1.5 trillion. If half of the money is still there, then what's the problem? The problem is the people with low-paying jobs or no jobs have depleted their savings and are now racking up credit card debt to maintain their living expenses. It has been said that up to 60% of Americans are in this predicament. This situation does not bode well for the economy since about 70% of US GDP is dependent on the consumer.

The stats and the future look awful, so why aren't we deep into recession? The credit card spending and the other 40% of consumers with good jobs or accumulated wealth are continuing to spend (think of the crowds at the beach and the restaurants). This situation cannot go on indefinitely, but for now the economic downturn has been delayed.

Another aggravating factor has been inflation, especially for the 60% who are supplementing their living expenses with debt. Over the last 2.5 years the cost of living, due to inflation, has increased 10 to 12%.

On the plus side is the low unemployment rate, indicating that almost anyone who wants a job

can get one. This should help some of the 60% to get a job, a second job or a higher paying job. However, there are some clouds on this horizon since high tech and financial firms have laid off a significant number of workers.

It is important to note that not all of the experts are negative. Dr. Ed Yardeni (prominent investment strategist and economist) says that we have been in a rolling recession and now we are in a rolling recovery. He does not believe that the Fed will push us into a recession because he feels that the stubborn inflation will eventually yield, and the Fed will be able to stop the rate increases. Additionally, he says the \$75 trillion of pent-up net worth that is in the hands of the Baby-boomers will prevent the economy from crashing into a recession.

Finally, let's look at the direction of the GDP. Year 2022 quarter 3 GDP was 3.2%, 2022 quarter 4 GDP was 2.6%, 2023 quarter 1 GDP was 2.0%, 2023 quarter 2 GDP expected to be 1.0%, 2023 quarter 3 GDP expected to be -.1%. The actual track record and the expectations indicate a steadily declining GDP which represents declining economic activity. The weakening economic numbers could signal the technical definition of a recession which is two negative GDP quarters in a row.

### **TO CONCLUDE**

There are more factors on the recession being likely side than not. The geo-political, the economic and the Fed with the inverted yield curve, provide fertile ground for a recession. Yet, the massive amount of money that is still

out there can continue to hold off the effects of a recession. Our best estimate at this time is that there will be an economic slowdown that will be labeled a recession.

### **October 2022 SCS Newsletter Excerpt**

### **A Different Strategy for These Uncertain Times**

In the previous section, we described a situation that could go either way from a turn to the upside to a significant market decline. This type of market is extremely difficult to deal with; consequently, we needed to have a more novel approach to navigate these choppy waters. Whichever position we might take, we have to consider the question, "What if we are wrong?"

There is an investment vehicle that fits the description of what is needed. It is called a Buffered ETF. It provides downside protection, yet still has the ability to benefit from a rising market. The downside protection is 15% and the upside potential is in the 15% to 16% range. This investment vehicle is issued at the beginning of each month and matures one year later. If at the end of the year the S&P is 15% down or less, then there will be no loss for the investor. However, if the loss was 20%, then the investor would lose 5% (20-15)

Alternatively, if the market is higher one year later, then the investor will benefit to the extent of the gain up to the cap (15-16%). If the market was up 20%, the investor would be capped at the 15-16% level. The tradeoff, giving up some upside for the downside protection in this uncertain economic time appears to be well worth it.

### **OUTLOOK**

The first half year was positive in spite of the negativity surrounding the expectation of an oncoming recession. The market returns were mostly provided by tech stocks involved with AI (artificial intelligence). The broader market most likely represents more potential with less risk because it is fairly valued in contrast with the big tech stocks which are richly valued.

The second half of the year is very difficult to predict in light of the mixed signals that were highlighted in the body of this newsletter. Our approach is to add to our positions in what are called buffered ETFs (see October 2022 newsletter- excerpt included). If and when normalcy returns, we will phase out the buffered products. Until that time comes, we will benefit from some downside protection while still being able to participate in the bulk of the upside. As always if the investment environment changes then we will adapt to the circumstances.

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