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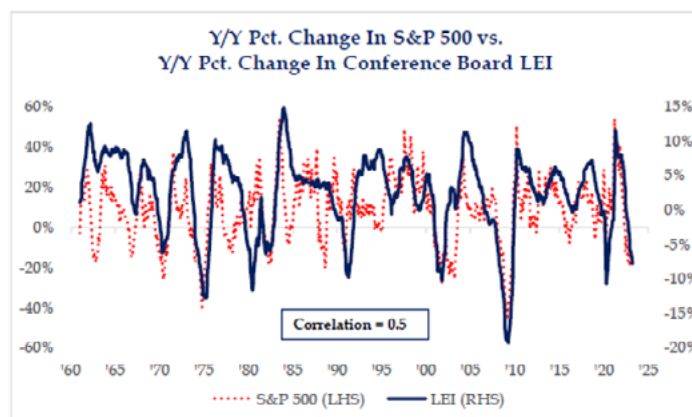
A Pollyanna* Market?

If you just landed from Mars and we told you that three good sized U.S. banks had failed, the Federal Reserve had raised rates 5% in 13 months, the yield curve had been inverted since last year, the latest Senior Loan Officer's Survey showed banks less willing to lend while already at recessionary lending levels, and according to Treasury Secretary Janet Yellen, we are within two weeks of the government running out of money to pay its obligations, would you believe the S&P 500 is up about 9% thus far this year?

While the equity market displays optimism, especially in large tech stocks, forward-looking indicators are far more pessimistic.

1. The Conference Board Index of Leading Economic Indicators (LEI) fell in March for the twelfth monthly decline, now down 7.8% year over year. This is a magnitude never seen outside of recessions.

LEI CONTINUES TO POINT TO ECONOMIC WEAKNESS A CHALLENGE FOR EQUITIES BROADLY



Strategas Securities, LLC – Investment Strategy

2. As a recession gauge, continuing unemployment claims are a somewhat better indicator than the headline initial jobless claims. As of the week of April 10th, continuing claims were up 22.1% from the year earlier. Any rise in continuing claims greater than 10% on a year-over-year basis has never occurred outside of a recession.

*A byword for someone who has an unfailing optimistic outlook like the character from Ellen Porter's 1913 novel.

- We have discussed inverted yield curves and their predictive power in past blogs. The New York Federal Reserve uses a 'recession probability indicator' which is their proxy for an inverted yield curve. It is defined as the three-month Treasury bill yield minus the 10-year Treasury note yield. As you can see in the chart below, spikes in this indicator have been associated with recessions.

NY FED RECESSION PROBABILITY INDICATOR BREACHES 50 FOR FIRST TIME SINCE NOVEMBER 1981

4/24/23



Strategas Research

What do we expect for corporate profits and revenues?

- There has never been an inverted yield curve setting that did not also foreshadow a recession in corporate profits.
- The Fed's most recent Senior Loan Officer's Survey (SLOS) showed a further tightening of already recessionary lending standards in this quarter. Changing lending standards are a good predictor of future bank lending and corporate revenues. So, one would expect both to decline significantly by year-end.

Employment and consumer spending have been a bright spot thus far - the primary reason markets have remained positive.

However, as you can see from the chart below, the banks' willingness to lend to consumers is dropping, and we would expect spending to follow.

BANK WILLINGNESS TO LEND TO CONSUMERS DECLINING



Strategas Economics

The Debt Ceiling and the upcoming X Date could disrupt markets.

Earlier this month, Janet Yellen said the U.S. government will run out of money to make payments as of June 1, 2023 (called the 'X date'). While brinkmanship about raising the debt ceiling to allow Government funding violently disrupted markets in 2013, equity prices don't tend to react until a few days away from X date. Dan Clifton from Strategas Research Partners summarizes the situation perfectly:

"Policymakers often talk about default on the U.S. debt during debt ceiling debates, but the threat of an actual default of the U.S. debt is an extremely low probability. We (believe) this is a political argument designed to pressure the other side into moving forward on the debt ceiling and/or their preferred attached policies. In reality, the U.S. government has more than enough cash flow to pay interest even if the 'default date' is reached.

Should Congress fail to raise the debt ceiling, the government would have enough money for Social Security, Medicare, Defense, and interest. Other government spending would come to a halt, which is akin to a government shutdown.

In this current cycle, the prioritization of government spending would be short lived, as the Treasury expects new tax revenue on June 15th and new extraordinary item cash on June 30th, which can cover through the end of July. As such, we see little chance of default even if Congress does not act.

The debate right now is "how" to raise the debt ceiling, not "whether" and that is an important distinction. In our view, the most likely outcome would be a cap on discretionary spending, rescinding of unspent COVID funding, and energy permitting reform...(it) is not a straight line. Policymakers may fail before they succeed."

So, is a recession looming?

Recently, when asked whether the U.S. economy would go into a recession, Fed Chair Jerome Powell said, "It is possible that this time really is different." He noted "...We've raised rates by five percentage points in 14 months and the unemployment rate is 3.5%, even lower than where it was when we started."

But, We Say – If it Looks Like a Duck, Swims Like a Duck, & Quacks Like a Duck, it Probably is a Duck!

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