# Where's the Recession?

October 2023

- **Early expectations for a potential recession have been met with mixed economic indicators**
- **The impact of higher interest rates on the economy is not yet fully resolved**
- **Consumer spending is a large driver of economic activity, but excess consumer savings has been declining**

## Background

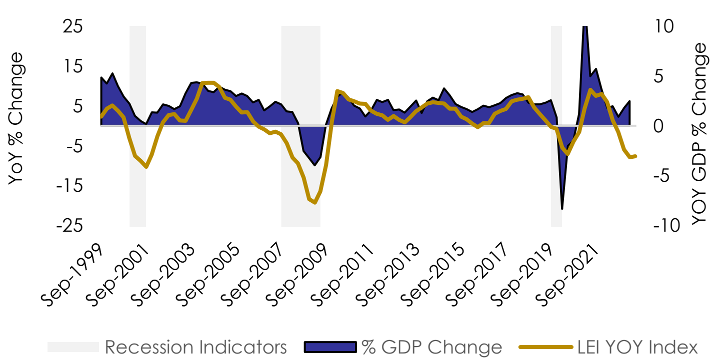
Investors have been looking for a recession amidst rising interest rates and expectations for slowing growth, but continued growth in much of the economy and resilient investment performance in 2023 has made for a very murky economic puzzle going forward. Exogenous factors such as geopolitical instability, deglobalization, and continuing risk of a US government shutdown add complicating risk factors to the economic outlook.

## Higher Rates, Resilient Growth

The current trajectory of Fed rate hikes began in March 2022, and continued unabated until the pauses this year at the June and September meetings. The Fed's own future projection for the Federal Funds Rate, commonly called the "dot plot," suggests Fed members continue to expect another rate hike before the end of this year. Market pricing suggests this view is not widely shared by all investors though. Persistently optimistic expectations around potential rate cuts have not panned out this year. Futures markets are presently pricing in greater than 50% probabilities that the Federal Funds Rate remains at its current level well into 2024, at which point rate cut expectations start to enter into the picture to balance out the expectations for further hikes. While inflation has slowed in recent months, US GDP continues to demonstrate positive growth, and the Fed recently upgraded its expectations for GDP growth in 2023 and 2024. The Fed may yet engineer the soft landing that market participants would like to see, but history suggests this has often been an elusive goal.

One gauge of recession likelihood is the Conference Board Leading Economic Index (LEI) for the US. This index currently suggests the US economy could be at risk for a recession despite positive GDP growth. The LEI has been in decline since mid-2022.

**Conference Board Leading Economic Index**

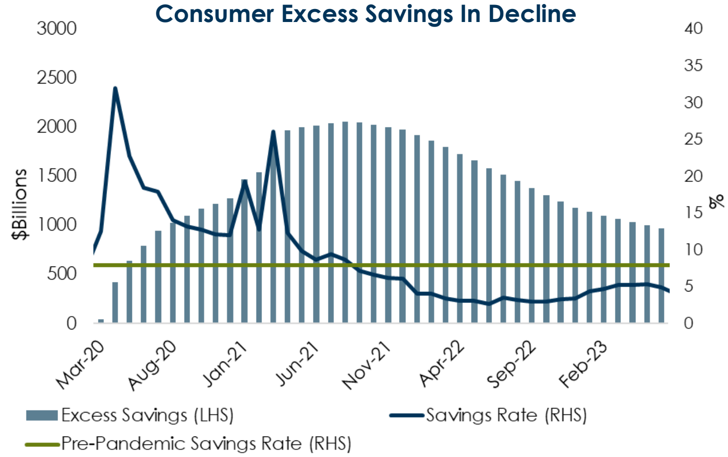



*Source: The Conference Board, Bloomberg, ACG*

## Consumer Impact

Consumer behavior is a strong driver of US economic activity, and incoming data suggests there are seeds for a consumer slowdown. Recent reports have indicated default rates on consumer debt are rising. The resumption of student loan payments will reduce some consumers' ability to service their debt and may put negative pressure on overall consumer spending. Consumer savings increased during the Covid pandemic, but as time goes on, excess savings are declining, which could lead to a depletion of the spending capacity that has helped maintain economic activity since the onset of Covid.

**Consumer Excess Savings In Decline**




*Source: Bloomberg, ACG*

## Factors We Can't Measure

Omnipresent geopolitical tension always presents the possibility of unexpected exogenous shocks to the economy. Current events may fuel reduced economic cooperation between some nations, reorganization of strategic relationships, and continued efforts toward deglobalization and onshoring of vital production capacity. A potential US government shutdown in November could also impact the domestic US economy. Investors may have expected to see one of these factors already further impact markets or the economy, but risks remain in this category.

## Hiding Out in Money Markets

The inverted yield curve has incented investors to migrate into money market funds and other short-duration investments. With yields in excess of 5% and limited risk, not to mention the banking concerns following the collapse of SVB, investors saw an opportunity to allocate to an asset that might insulate against the other risks present in the market. Data from the US Treasury Office of Financial Research shows that assets in money market funds increased by 17% year-to-date through the end of August 2023. There is risk to over-allocating though to an asset with limited upside potential. An inverted yield curve is not "normal," since investors should be compensated for the risk of longer-term investments with term premium, making this an arguably temporary circumstance. Predicting short-term interest rate movements is challenging at best, so investors need to have a plan for how they will move back into risk assets.

## ACG's Position

Data and history suggest we might face economic headwinds, but every moment is unique and history and data do not predict the future. Investors should remain focused on long-term goals while remaining cognizant of the potential for additional market volatility. As always, we at ACG aim to assist clients in building nimble portfolio allocations that will capitalize on market developments.

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