STRATEGAS SECURITIES, LLC

Economic Outlook
Mar. 8, 2022

Don Rissmiller
212-906-0134
drissmiller@strategasrp.com

Please see the Appendix for Important Disclosures

GEOPOLITICS = EUROPE RECESSION, BUT FED TO PUSH AHEAD NOW

- Germany already looks to be in recession.
- Matters for multi-national EPS, but U.S. GDP trickier call.
- U.S. labor market is overheating (eg, weekly initial claims).
- So, European recession unlikely to stop a hawkish Fed.

DEMAND, BOTTLENECKS, INFLATION, TIGHTENING

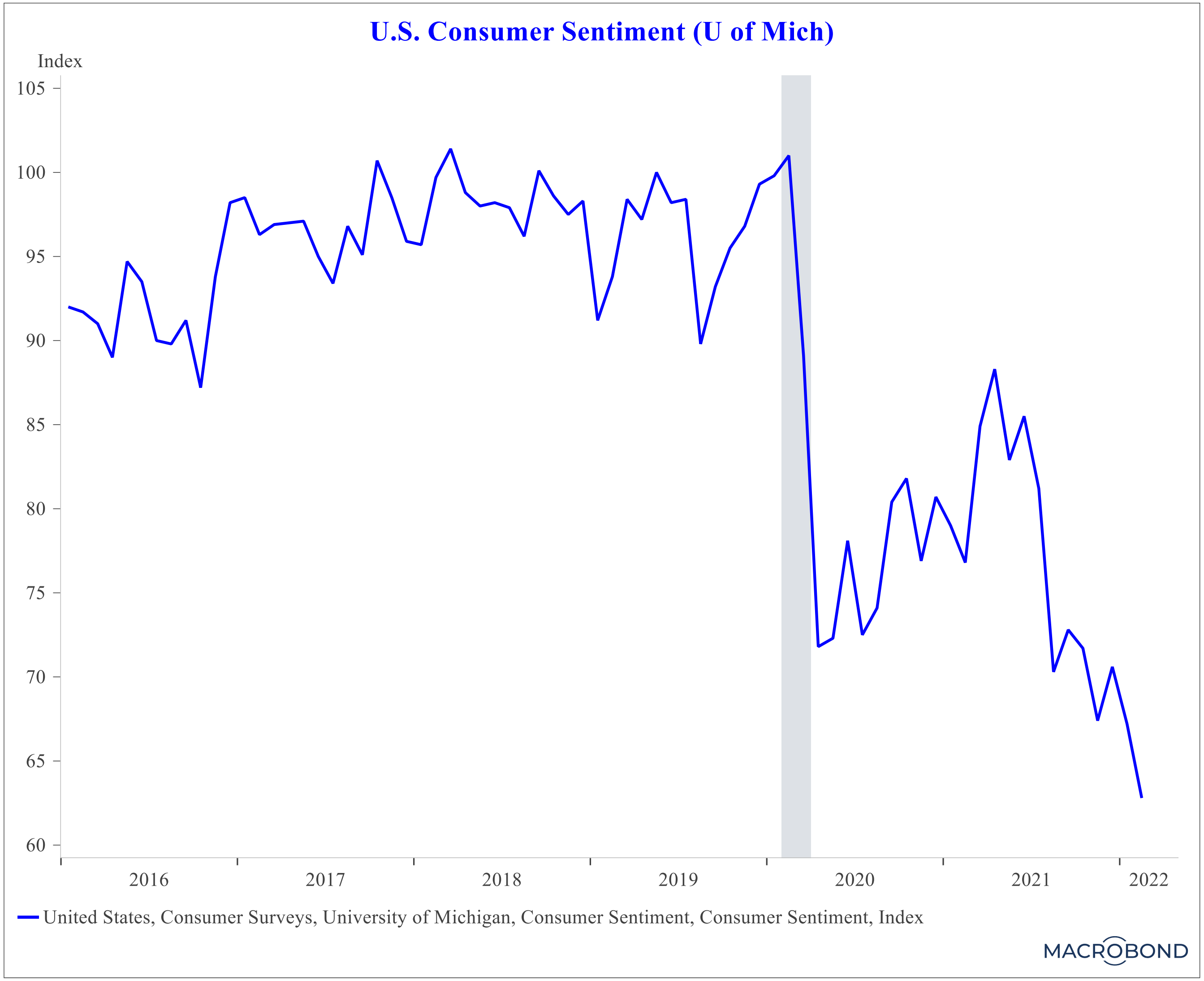
- Choppy GDP: 2Q up/ 3Q down/ 4Q up/ 1Q down (est).
- But with inflation now sticky.
- So … 2022 central bank tightening (rates + QT).
- Then a 2023 slowdown.

		2021				2022				2023			
	4Q	1Q	2Q	3Q	4Q	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
Real GDP Q/Q % AR	4.5%	6.3%	6.7%	2.3%	7.0%	1.0%	**3.5%**	**2.7%**	**1.0%**	**0.7%**	**1.0%**	1.8%	2.5%
Core CPI Q/Q % AR	1.9%	1.4%	7.8%	5.3%	5.6%	5.5%	**3.5%**	2.2%	2.6%	2.5%	2.0%	1.9%	2.0%
Fed Funds EOP	0.3%	0.3%	0.3%	0.3%	0.3%	0.5%	1.0%	1.3%	1.5%	1.8%	2.0%	2.0%	2.0%

F = Forecast; EOP = End of Period, a = actual

Note: Fed forecast lists top of expected range 2015:4Q forward.

THE WAY WE'VE RECOVERED, SOMETHING IS OFF



STILL NOTABLE REASONS FOR CONCERN

"We show consumer expectations indices from both the Conference Board and the University of Michigan predict economic downturns up to 18 months in advance in the United States, both at national and at state-level. All the recessions since the 1980s have been predicted by at least 10 and sometimes many more point drops in these expectations indices."

- *Blanchflower & Bryson, NBER #29372,* **10/2021**

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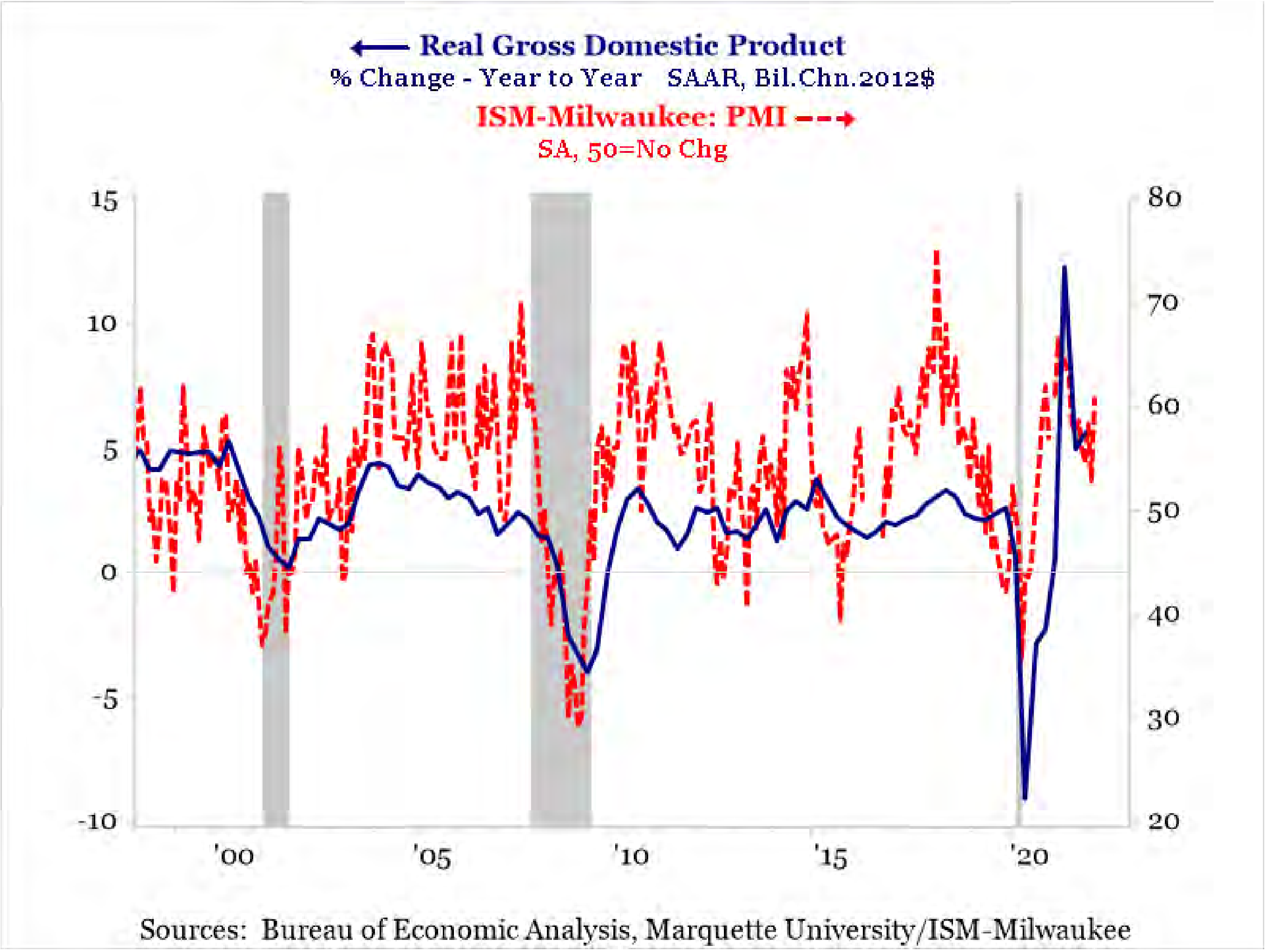
A HEALTH CYCLE VS. BUSINESS CYCLE

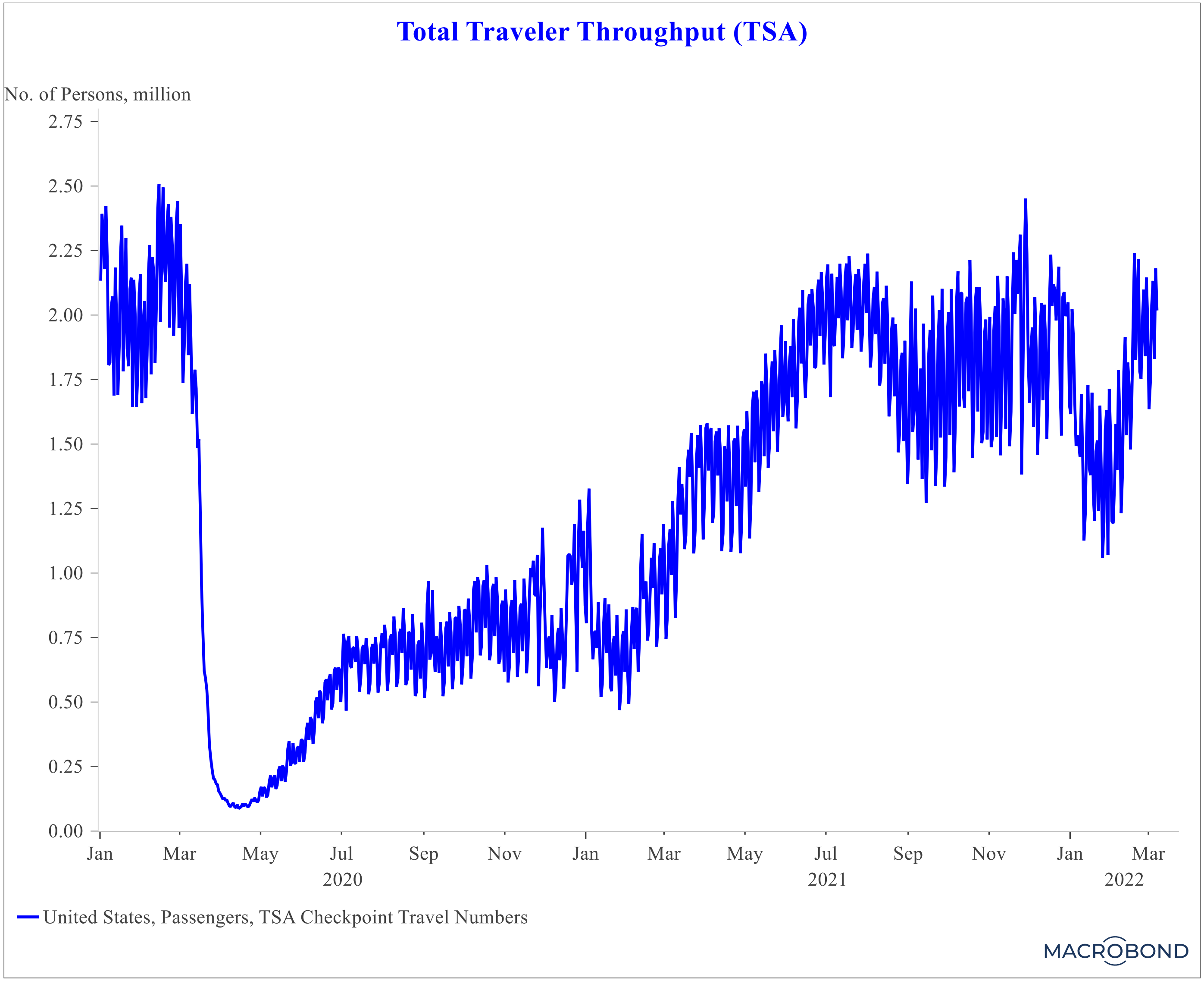
- Typical biz cycle driven by durable goods & financial crises.
- *Not this time*: both supply & demand shocks.
- Core goods prices surge
  - Product & transportation bottlenecks.
  - U.S. labor bottleneck (participation rate down).

- **To avoid recession: joint effort (Fed + private sector).**

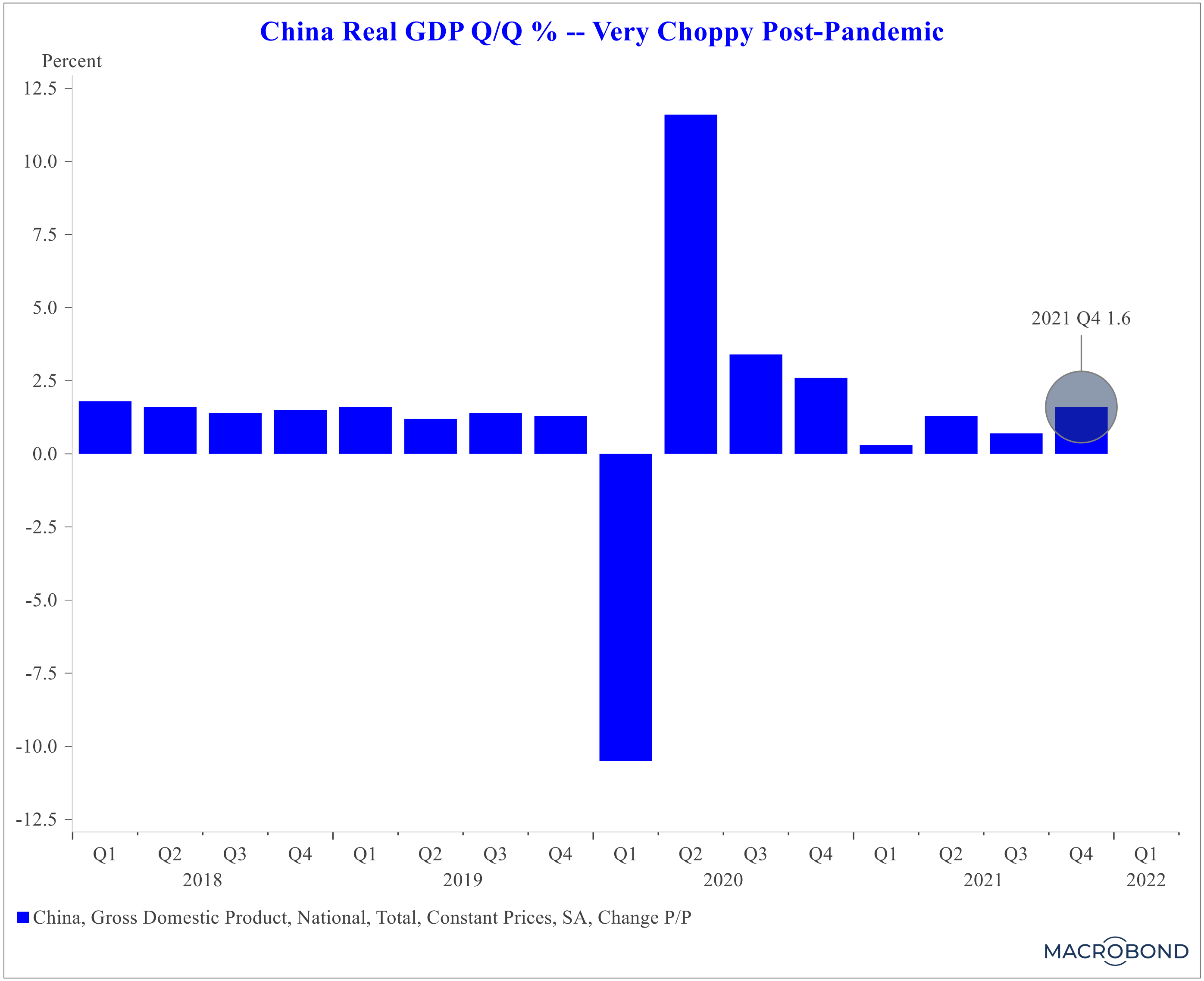
DURABLE GOODS / FINANCIALS DRIVE TYPICAL BUSINESS CYCLES



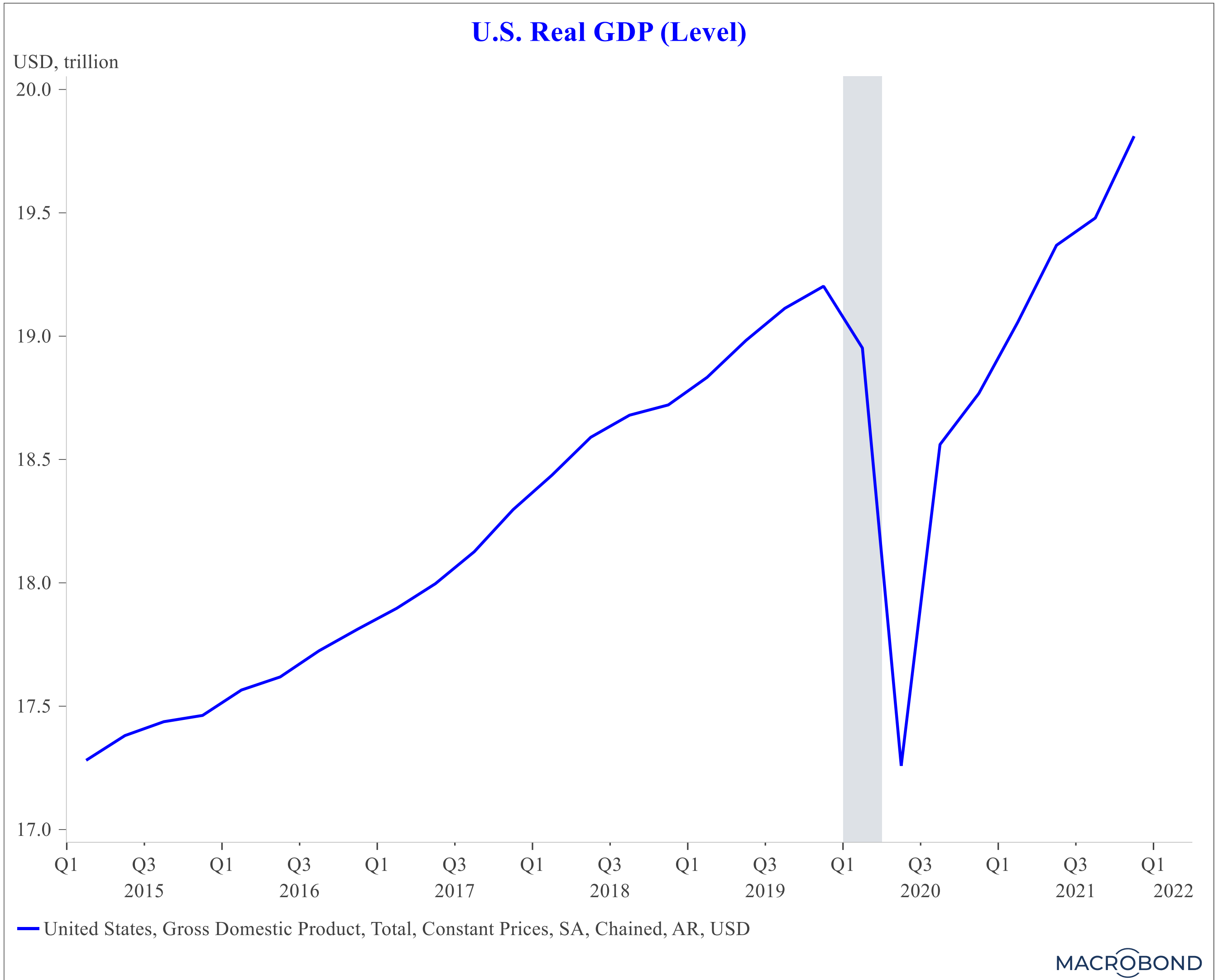
TIMELY DATA HAS BEEN CHOPPY



CHOPPY DATA GLOBALLY



TRUE, THERE HAS BEEN A U.S. REAL GDP RECOVERY

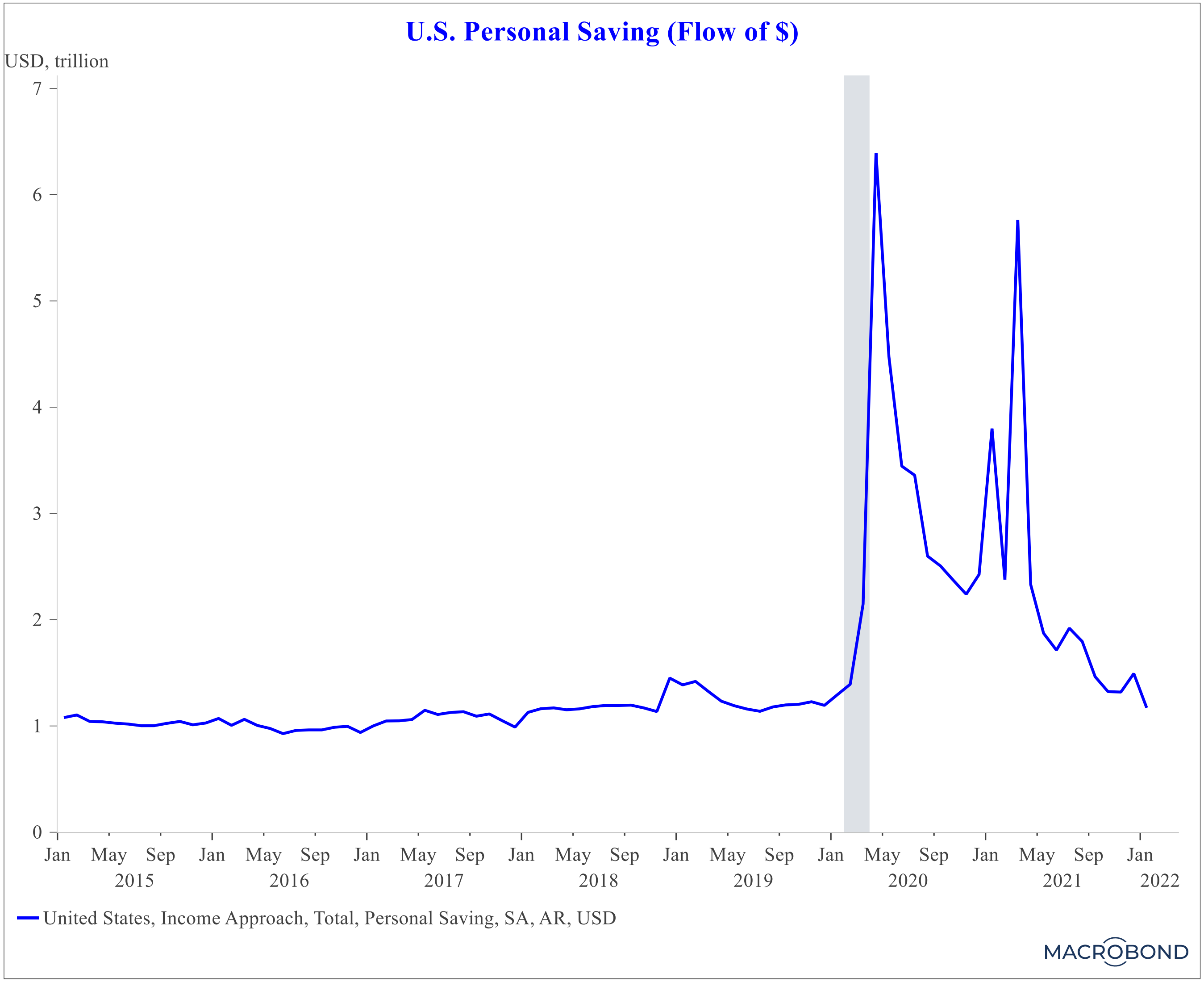


WATCHING LEVEL CHARTS: JOBS

SO … HOW DID WE GET GDP vs. JOBS?

1. No financial cascade yet this time (monetary action)
2. Jobs cut were lower pay (health crisis = in person *services*)
3. Income replacement was substantial (fiscal action)
4. Goods sales (in store + *online*) recovered quickly
5. Permanent job loss was capped
6. Saving remains / consumer balance sheets overall healthy

U.S. SAVING IS STILL SUBSTANTIAL



QUICK ACTION AVOIDED A FINANCIAL CASCADE

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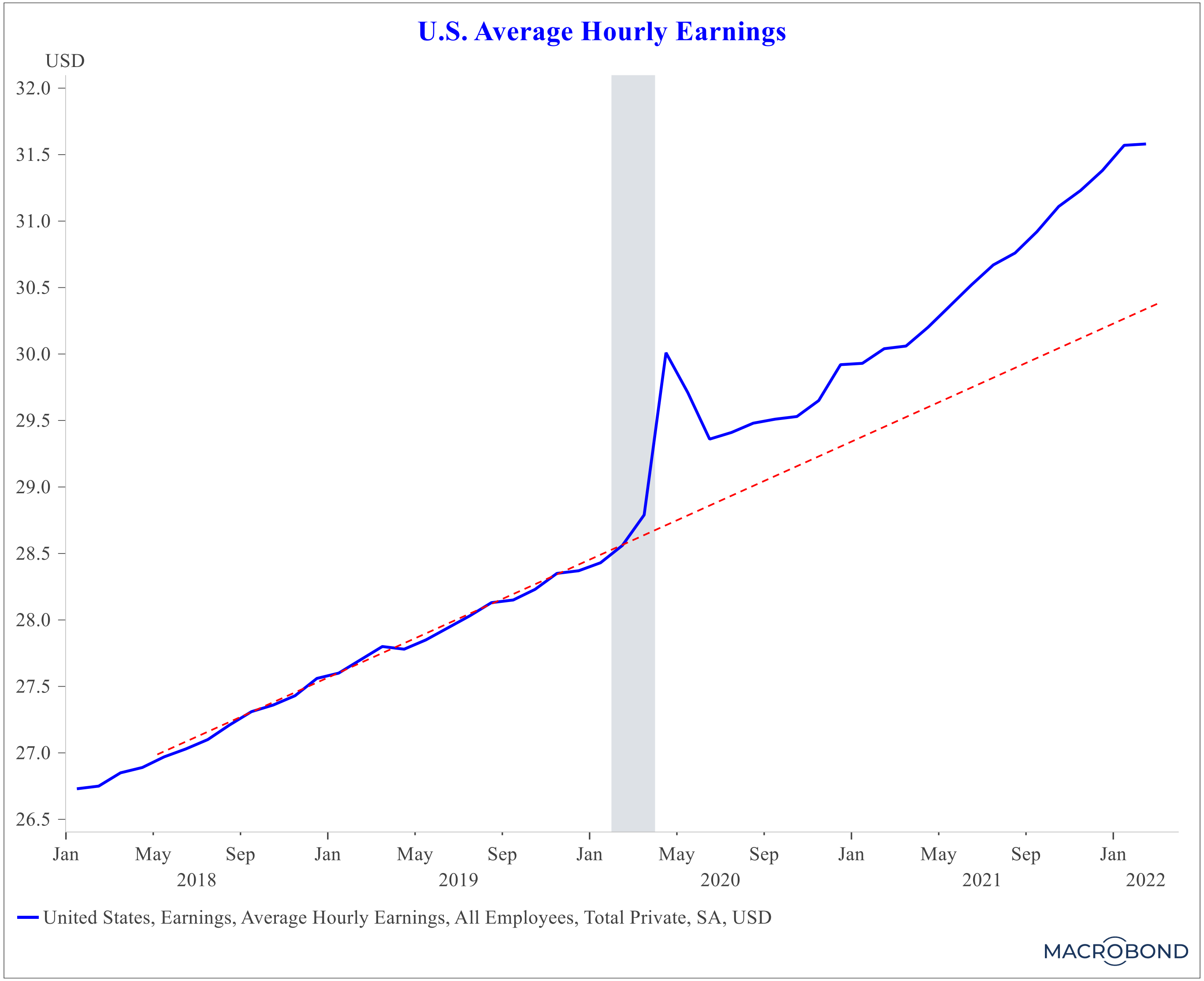
AN ODD CYCLE:

Harvard Study Indicates High-End Consumer Cut Back, Yielding Lower-Pay Job Losses

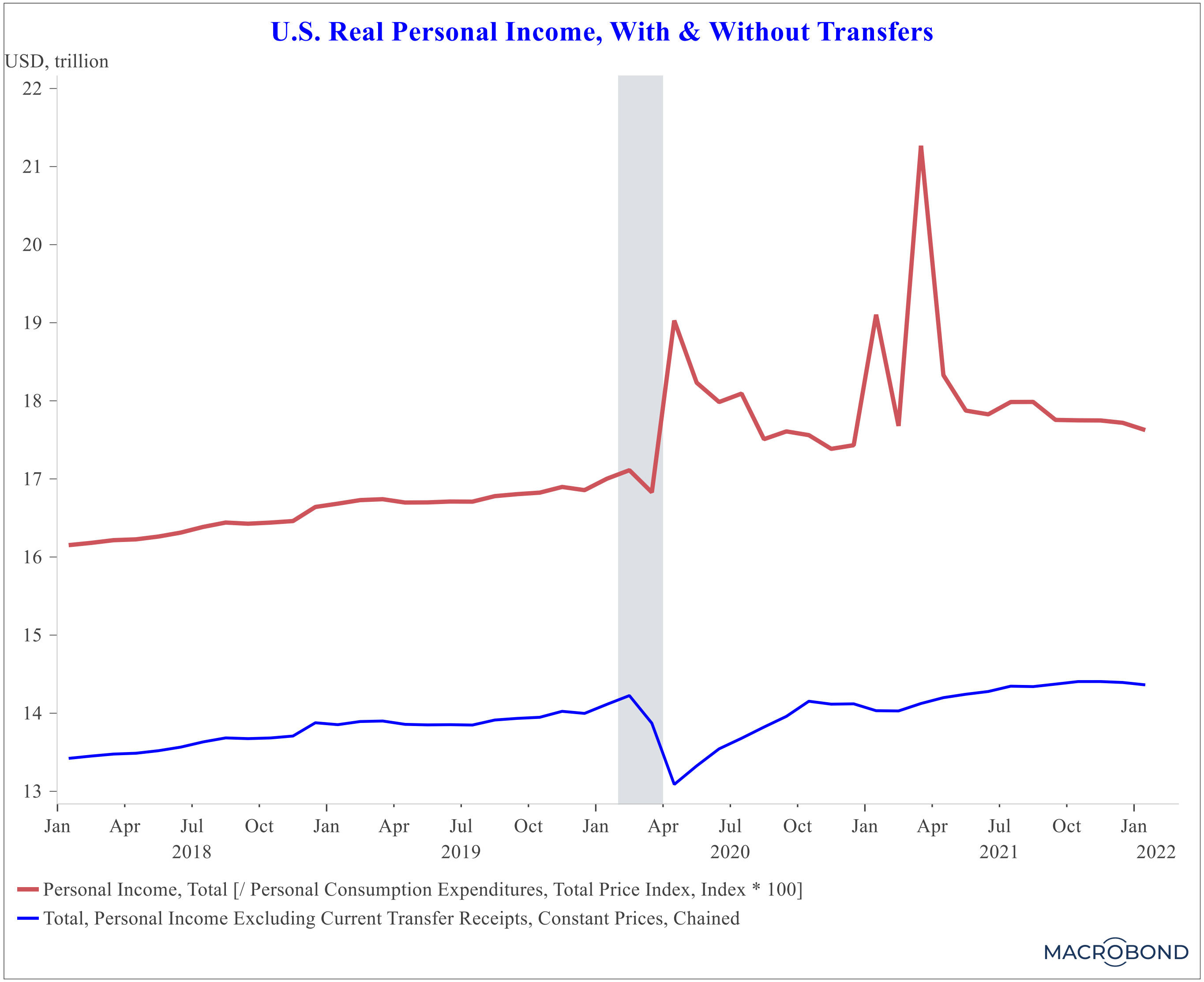
"[H]igh-income individuals reduced spending sharply in mid-March 2020, particularly in areas with high rates of COVID-19 infection and in sectors that require physical interaction. This reduction in spending greatly reduced the revenues of businesses that cater to high-income households in person, notably small businesses in affluent ZIP codes. These businesses laid off most of their low-income employees, leading to a surge in unemployment claims in affluent areas."

Chetty, Friedman, Hendren, Stepner, **6/17/20**

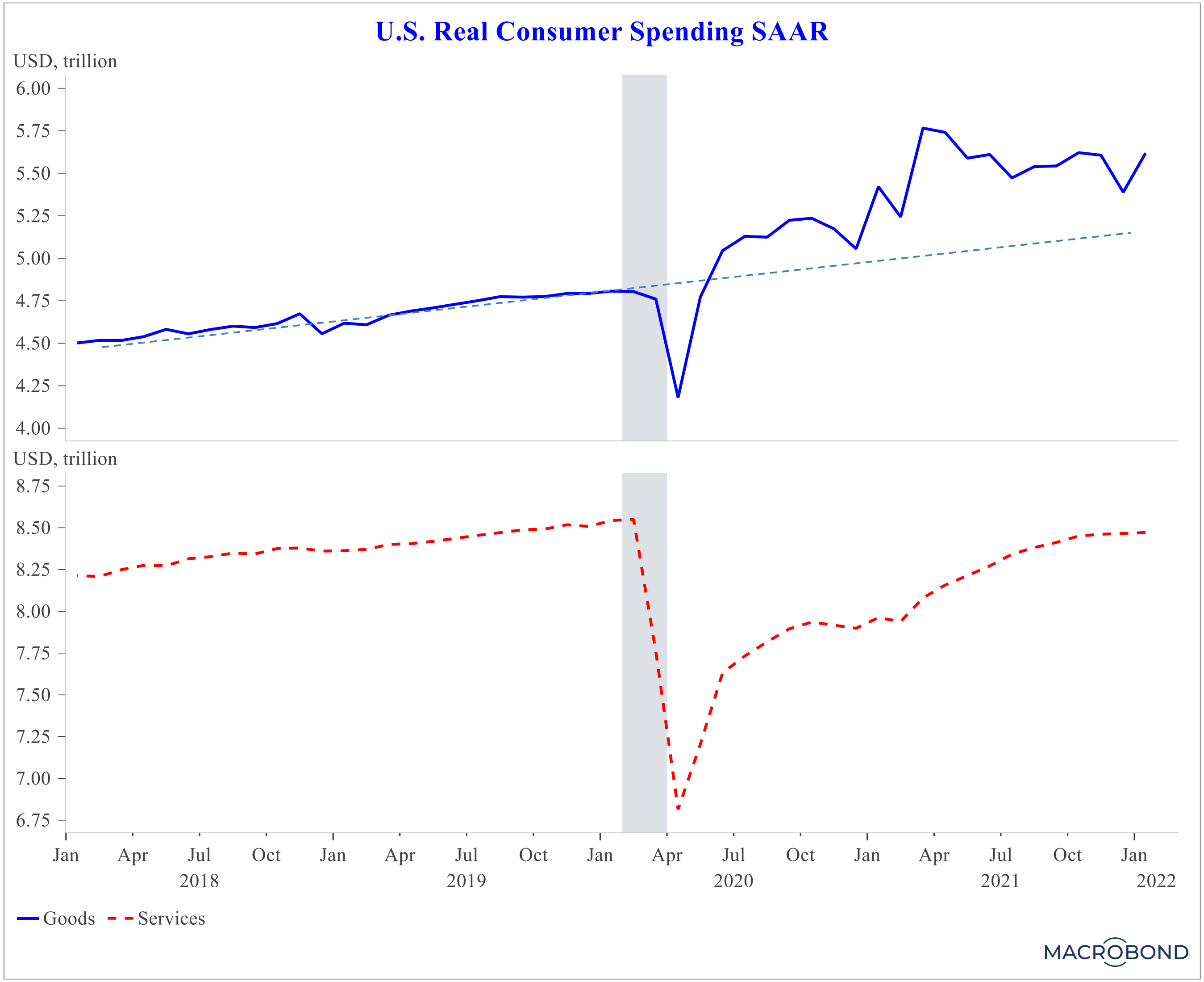
AVERAGE PAY: MIX SHIFT, THEN UP FURTHER



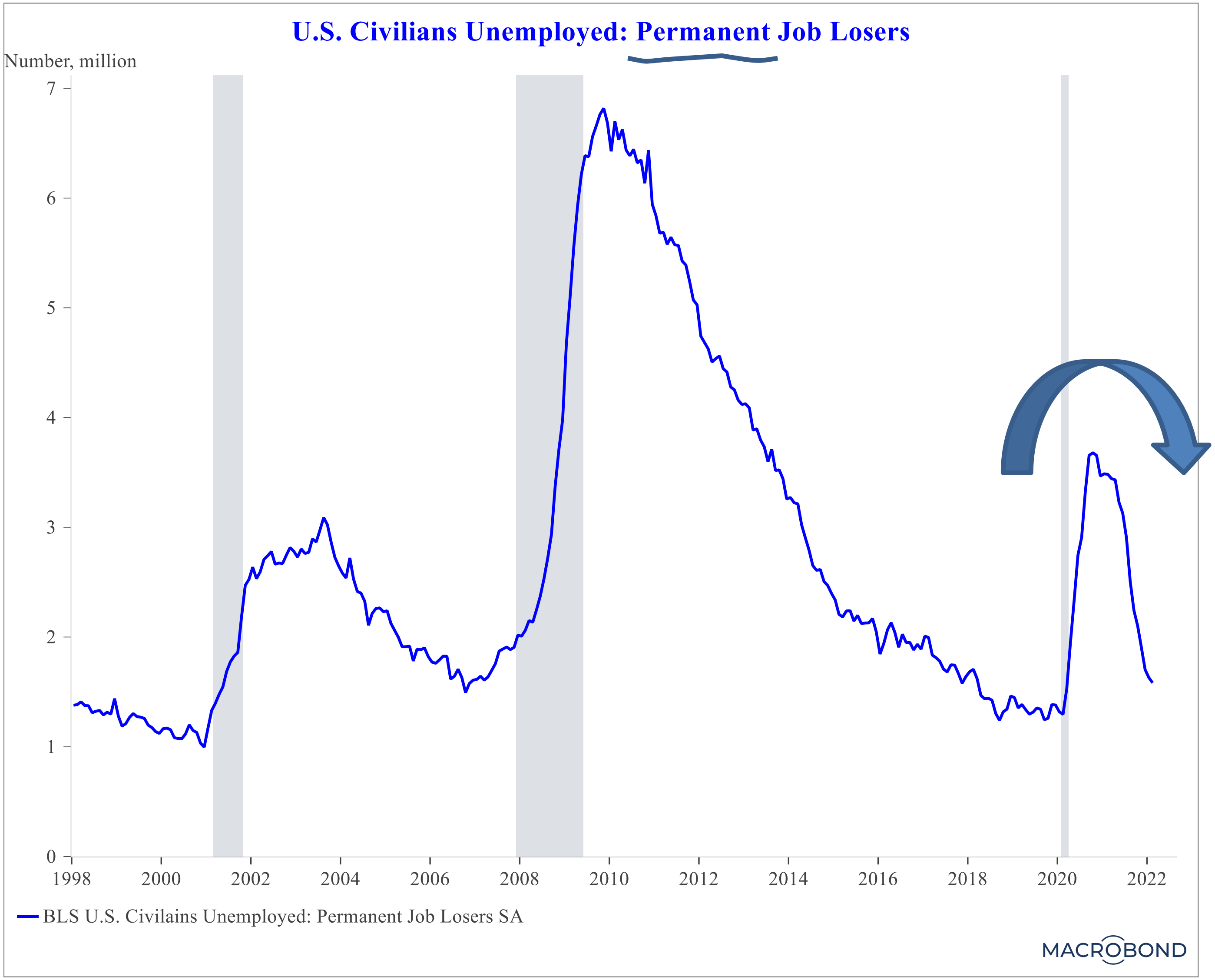
INCOME REPLACEMENT HAS BEEN KEY



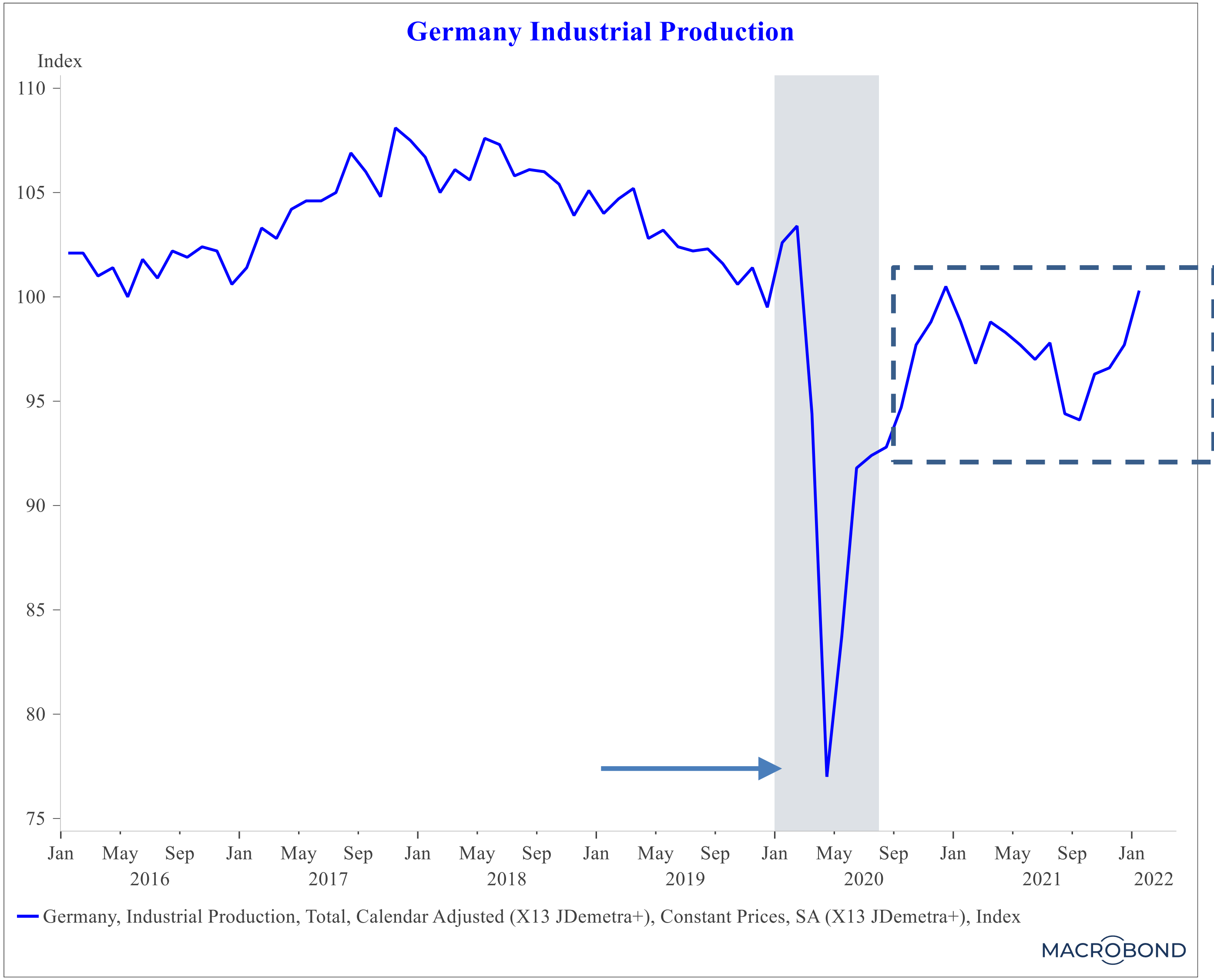
FISCAL STIMULUS TO CONSUMER: GOODS > SVC



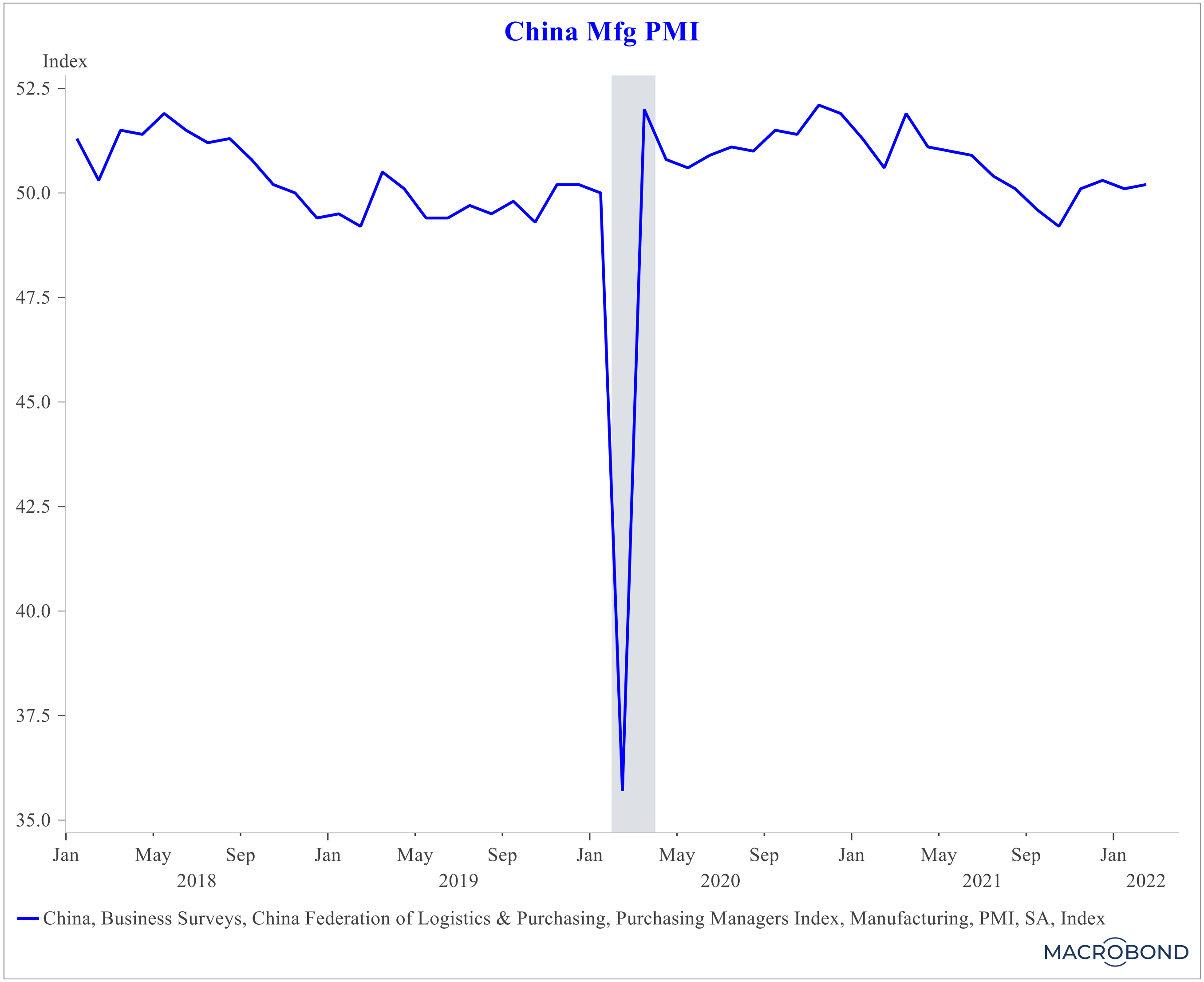
PERMANENT JOB LOSS VS. FURLOUGHS



THE HIT HAS BEEN GLOBAL IN SCOPE



GLOBAL HIT: MFG VS. SVC



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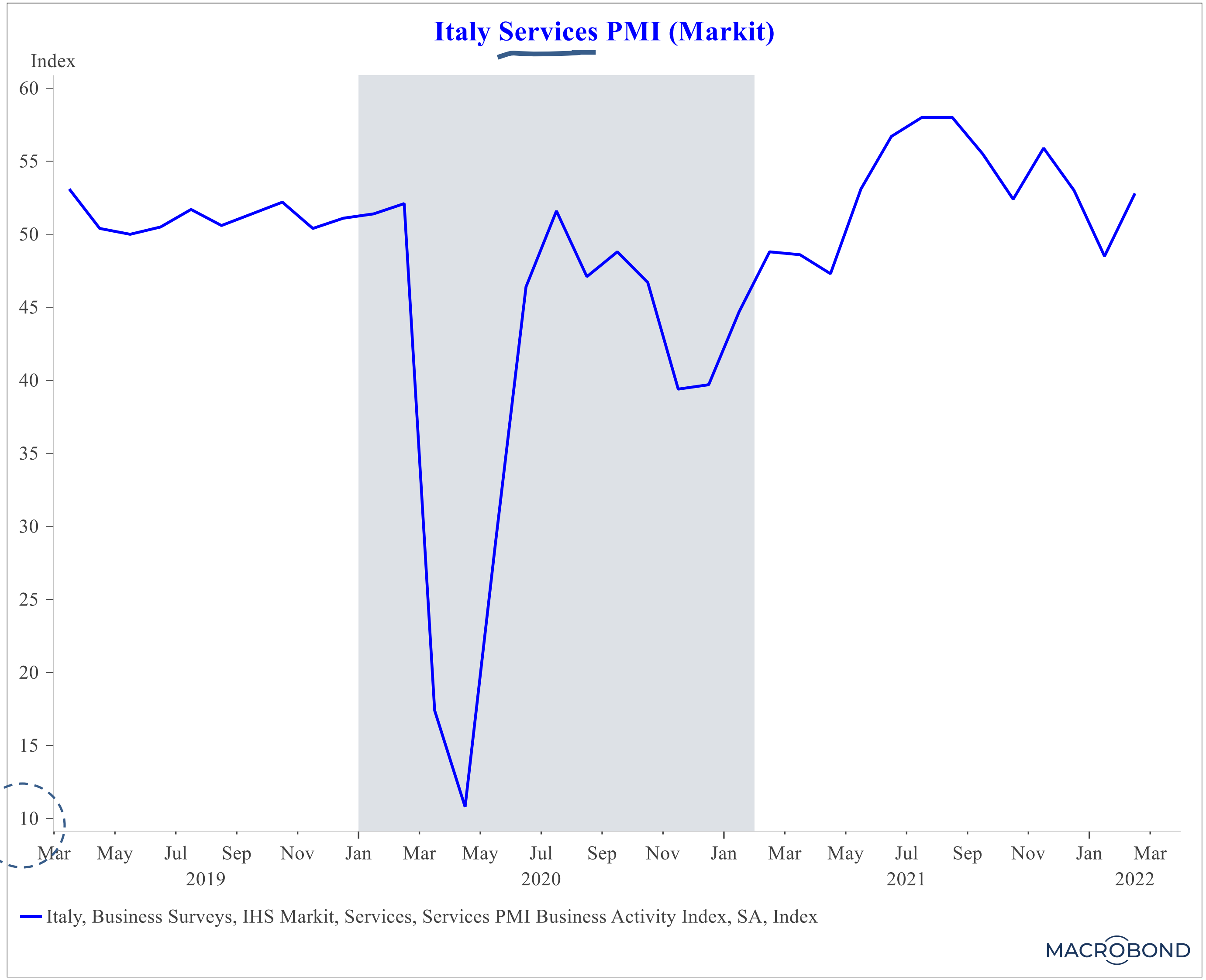

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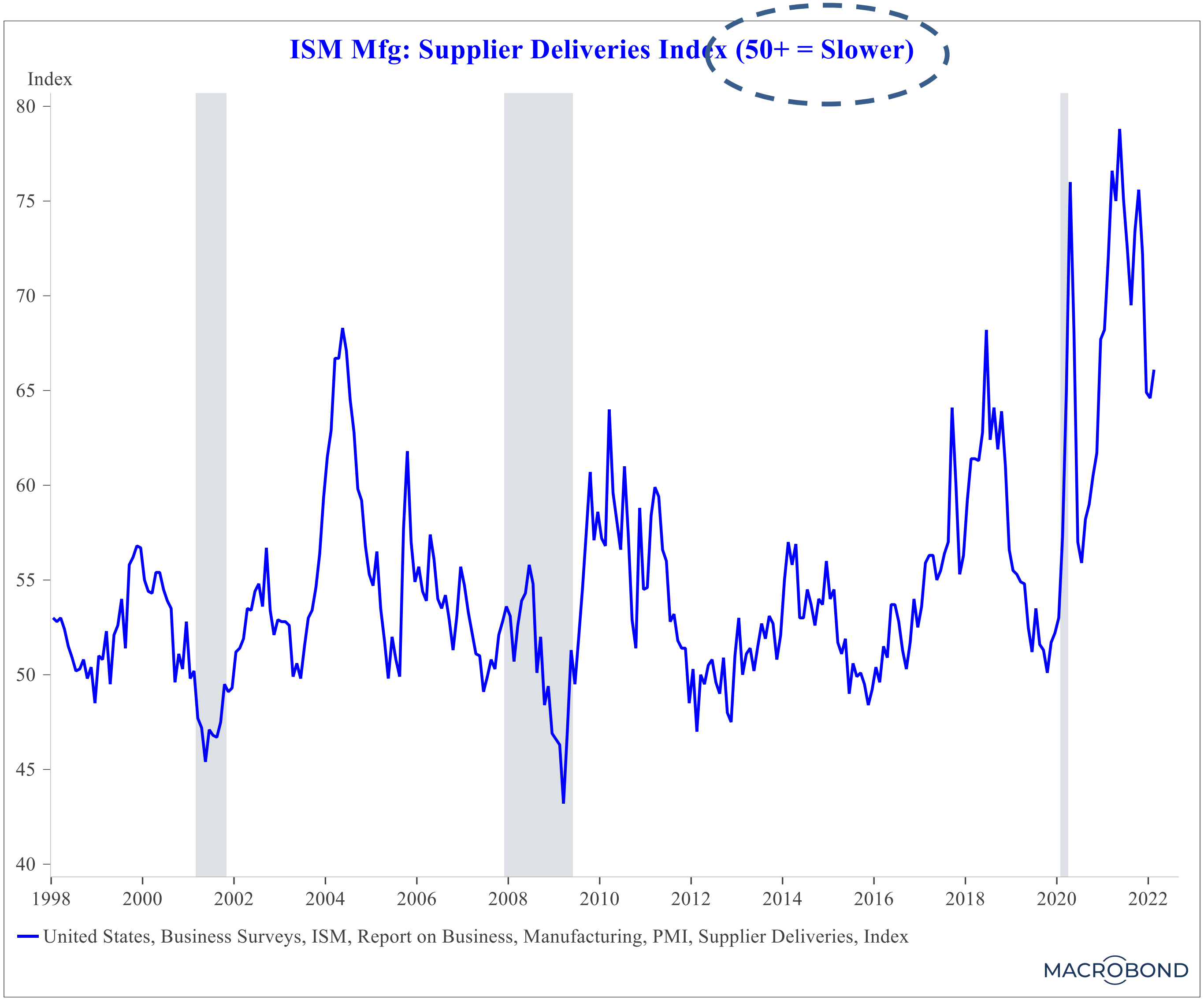
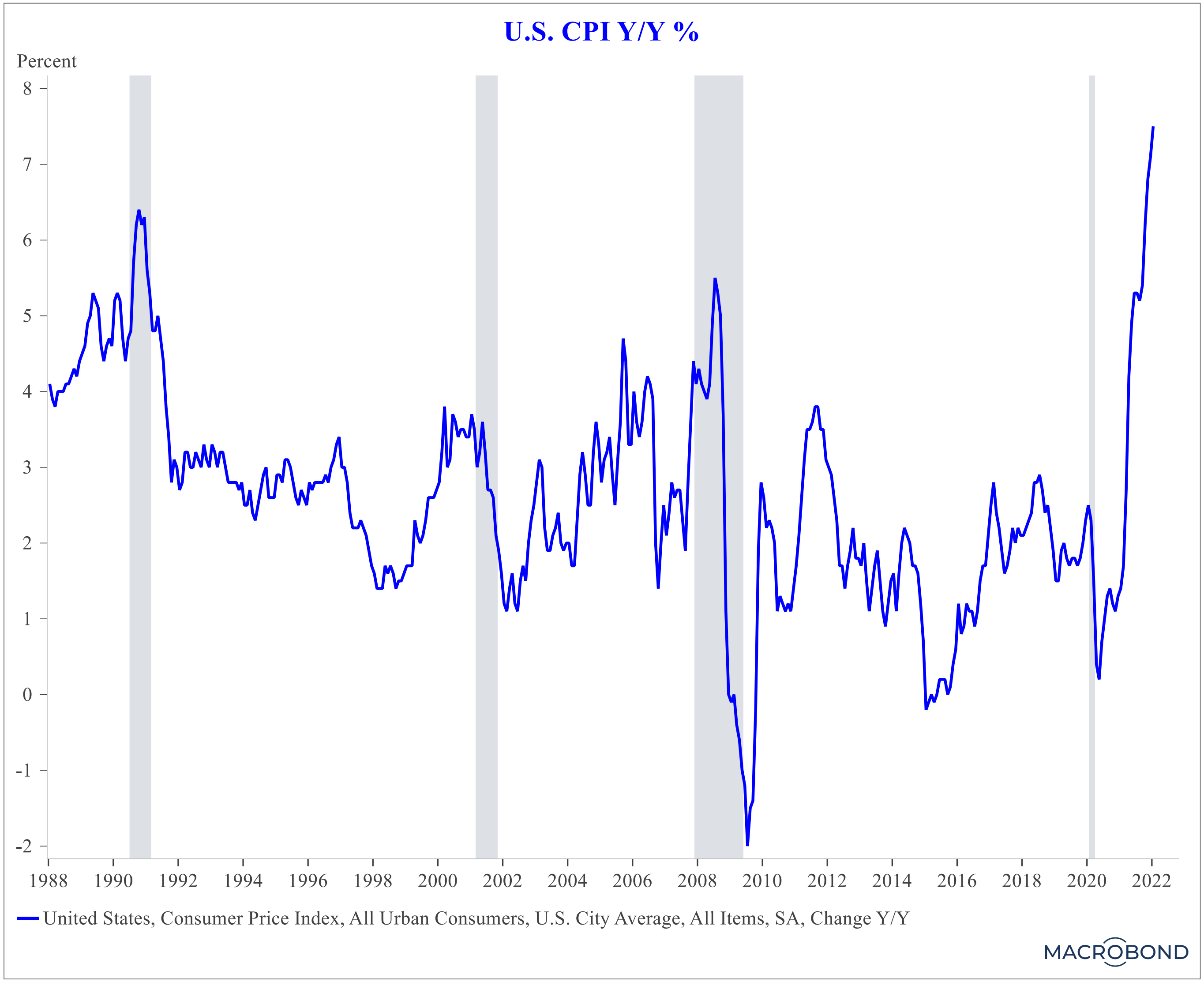
SUPPLIER DELIVERIES HAVE SLOWED



INFLATION: NOT LOOKING TRANSITORY YET



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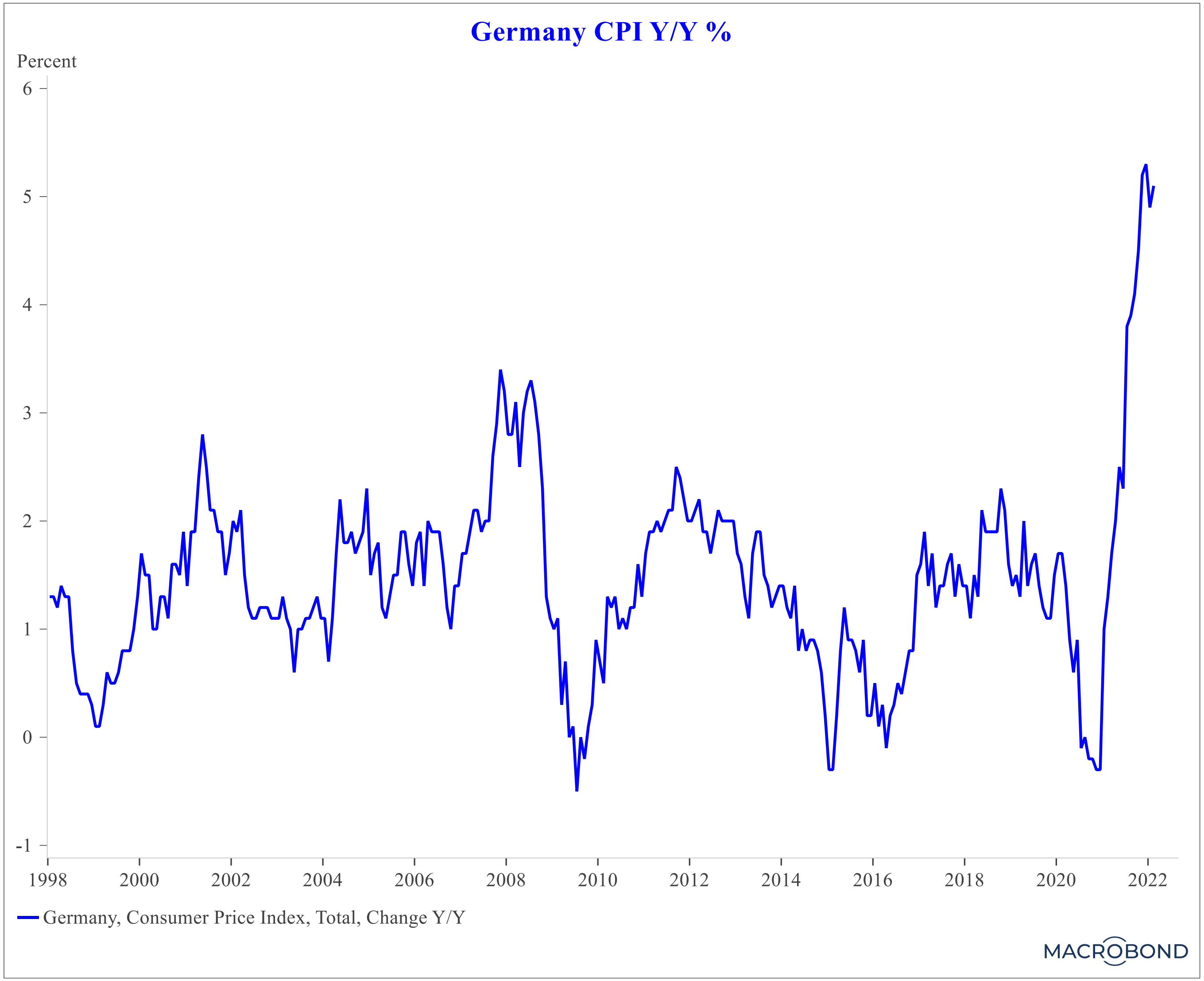
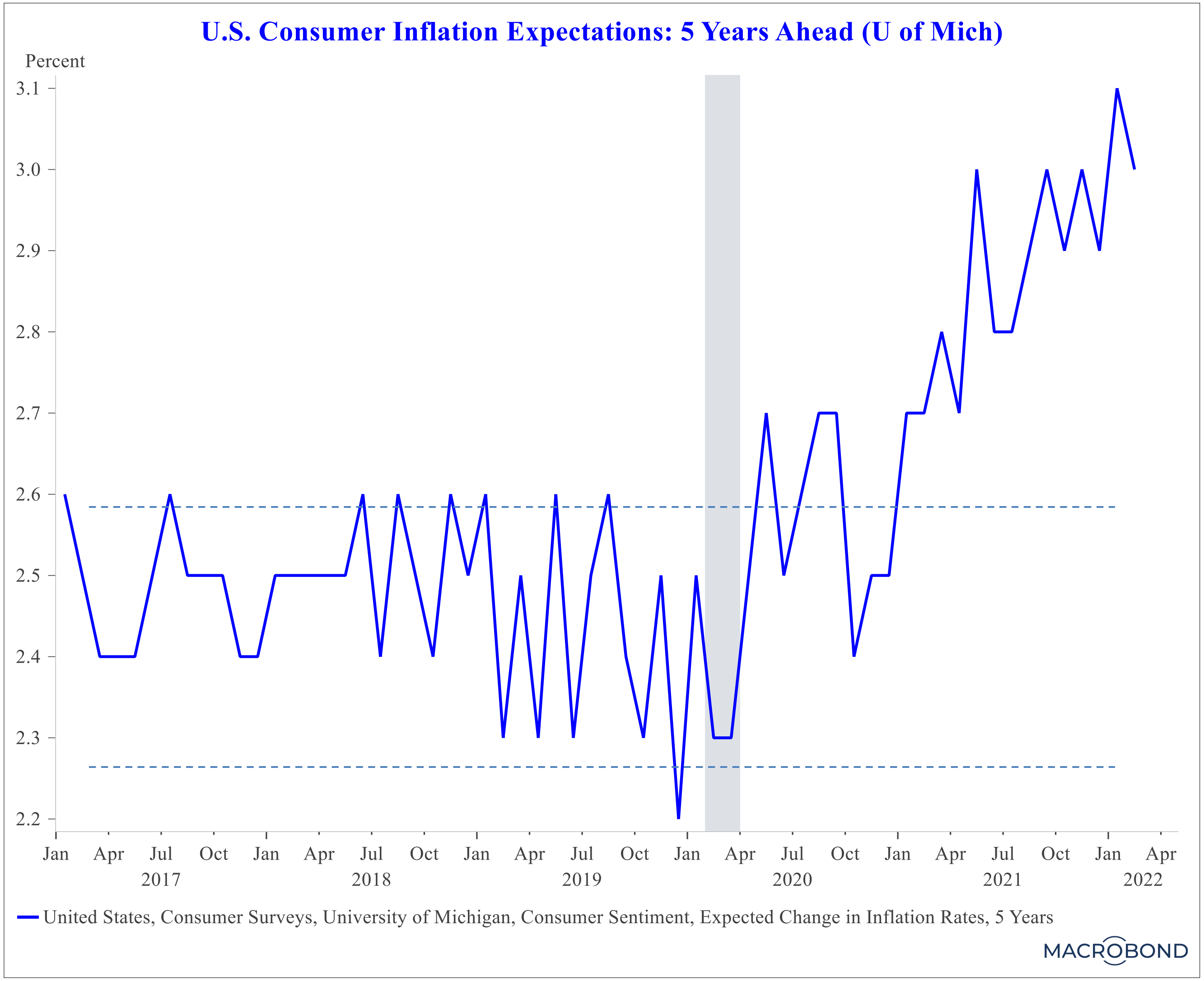


IS INFLATION "STICKY": EXPECTATIONS



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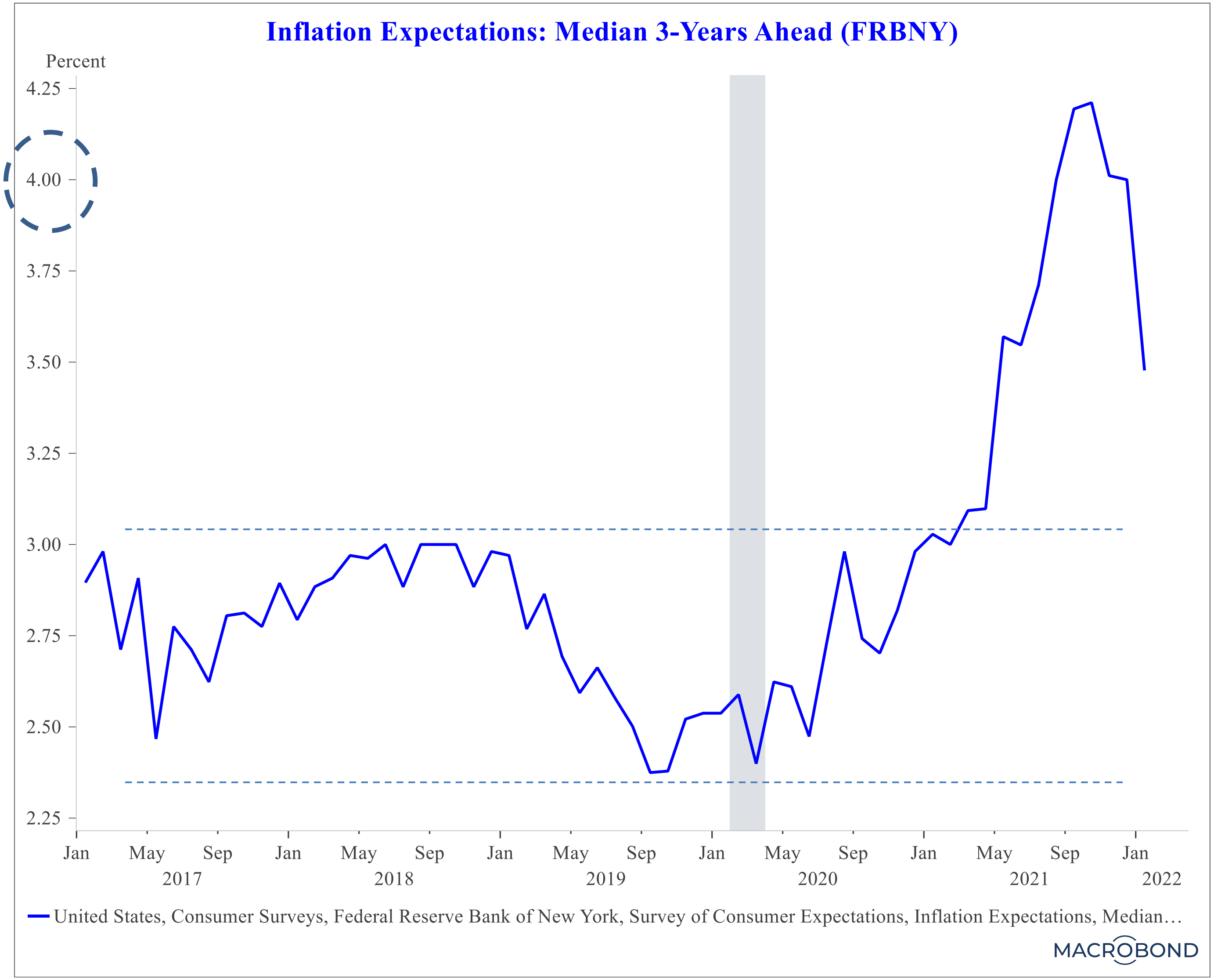

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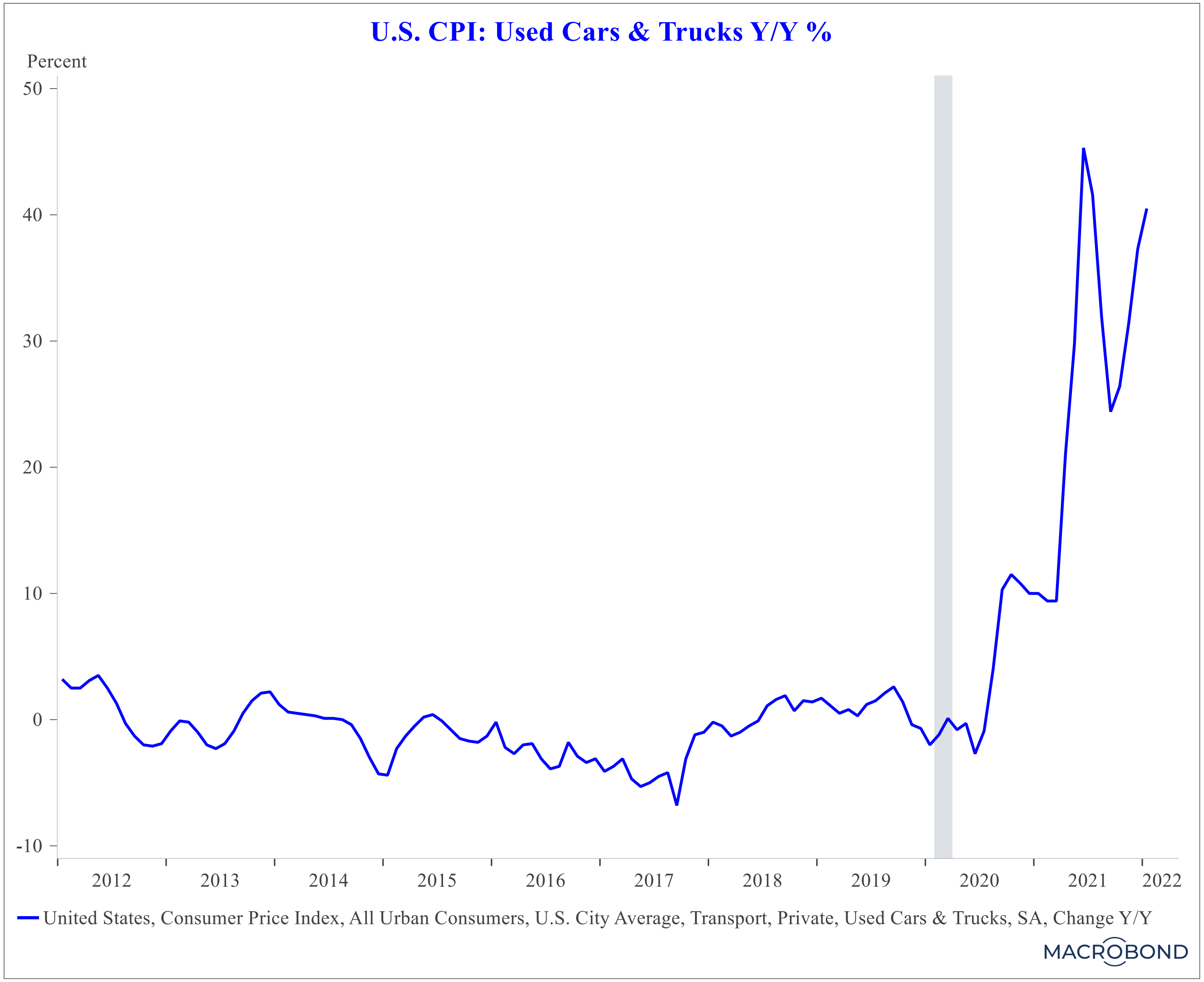
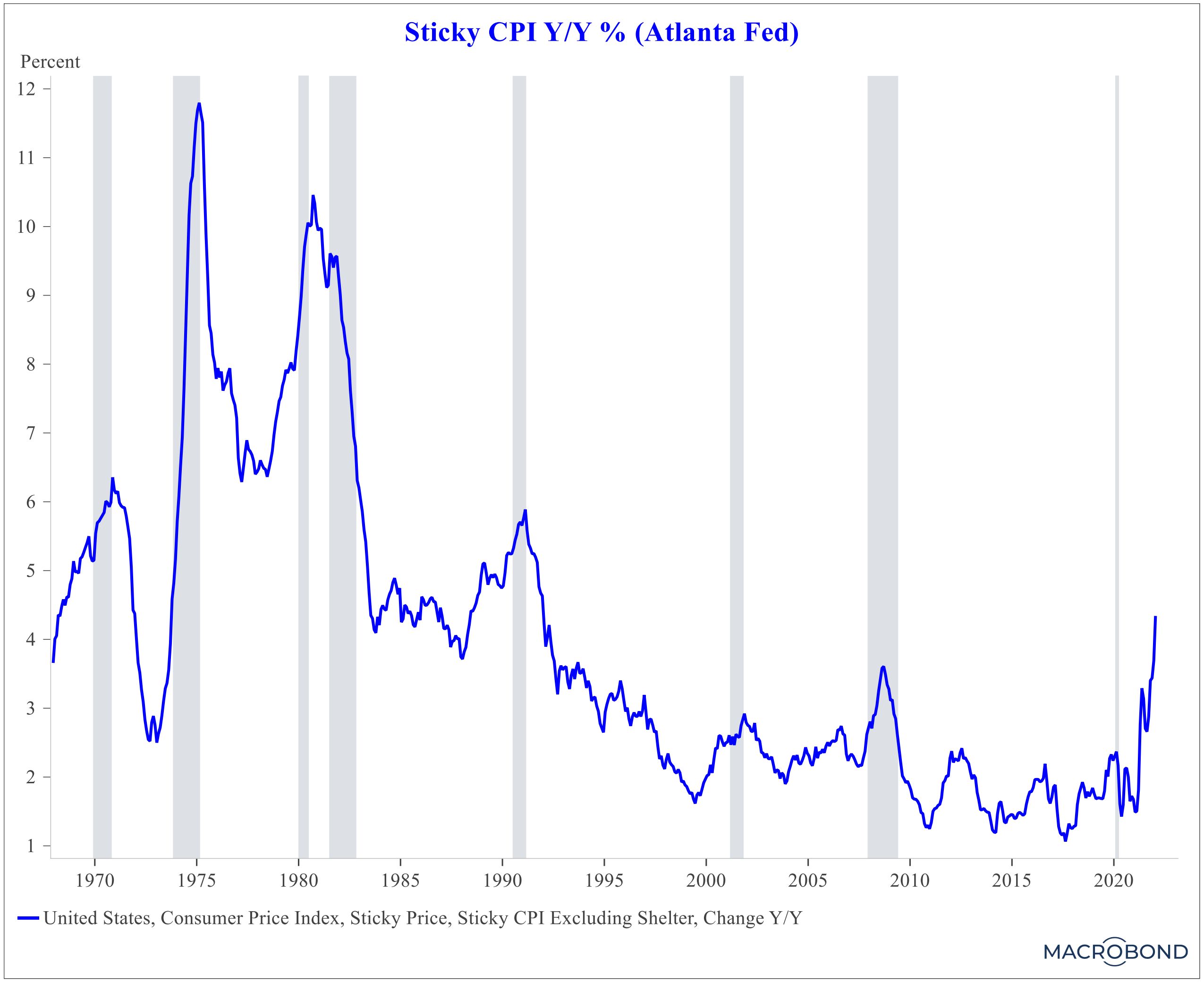
RE-OPEN NOTABLE IN SOME CPI COMPONENTS



ALTERNATE "CORE" MEASURES MATTER NOW



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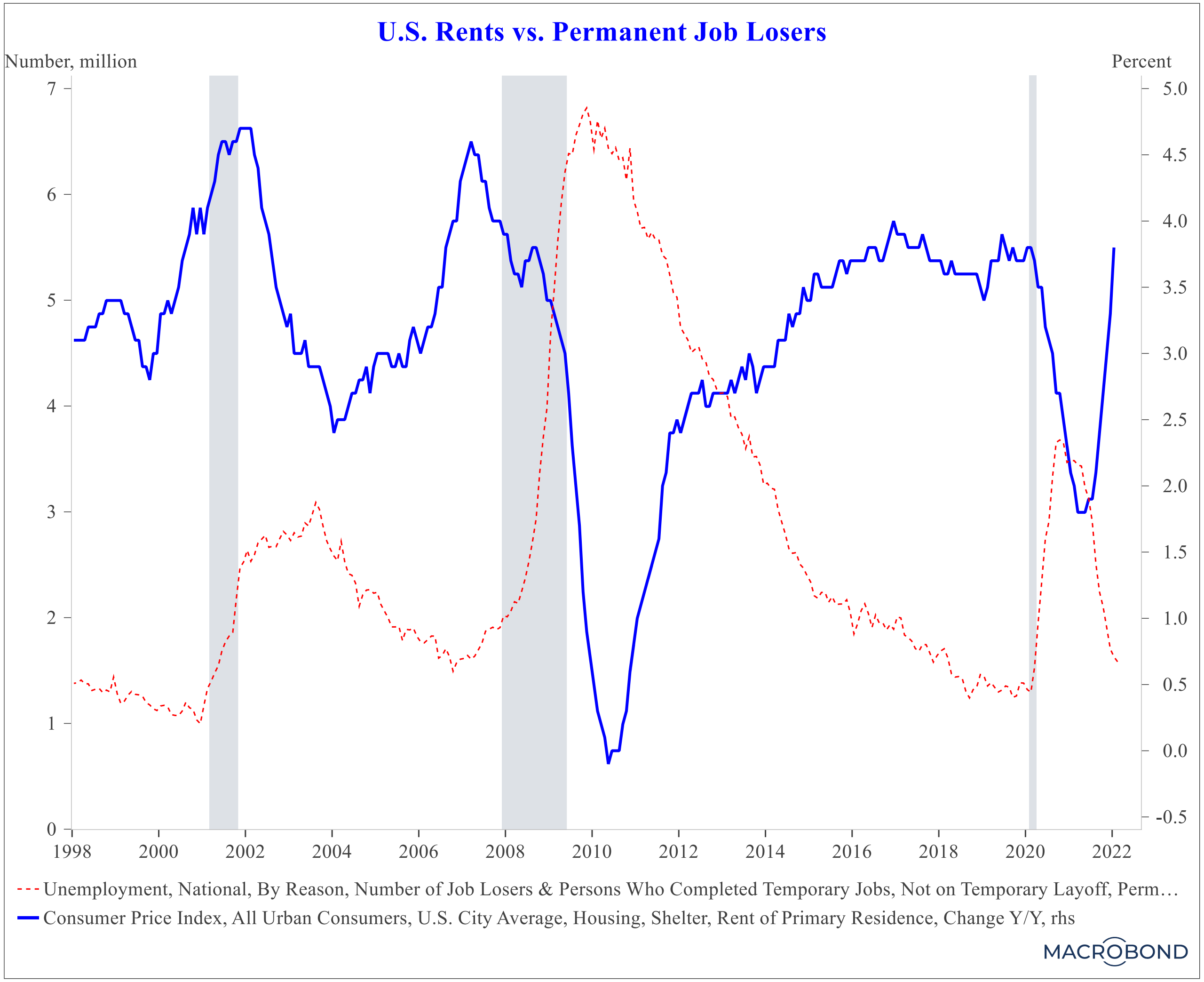
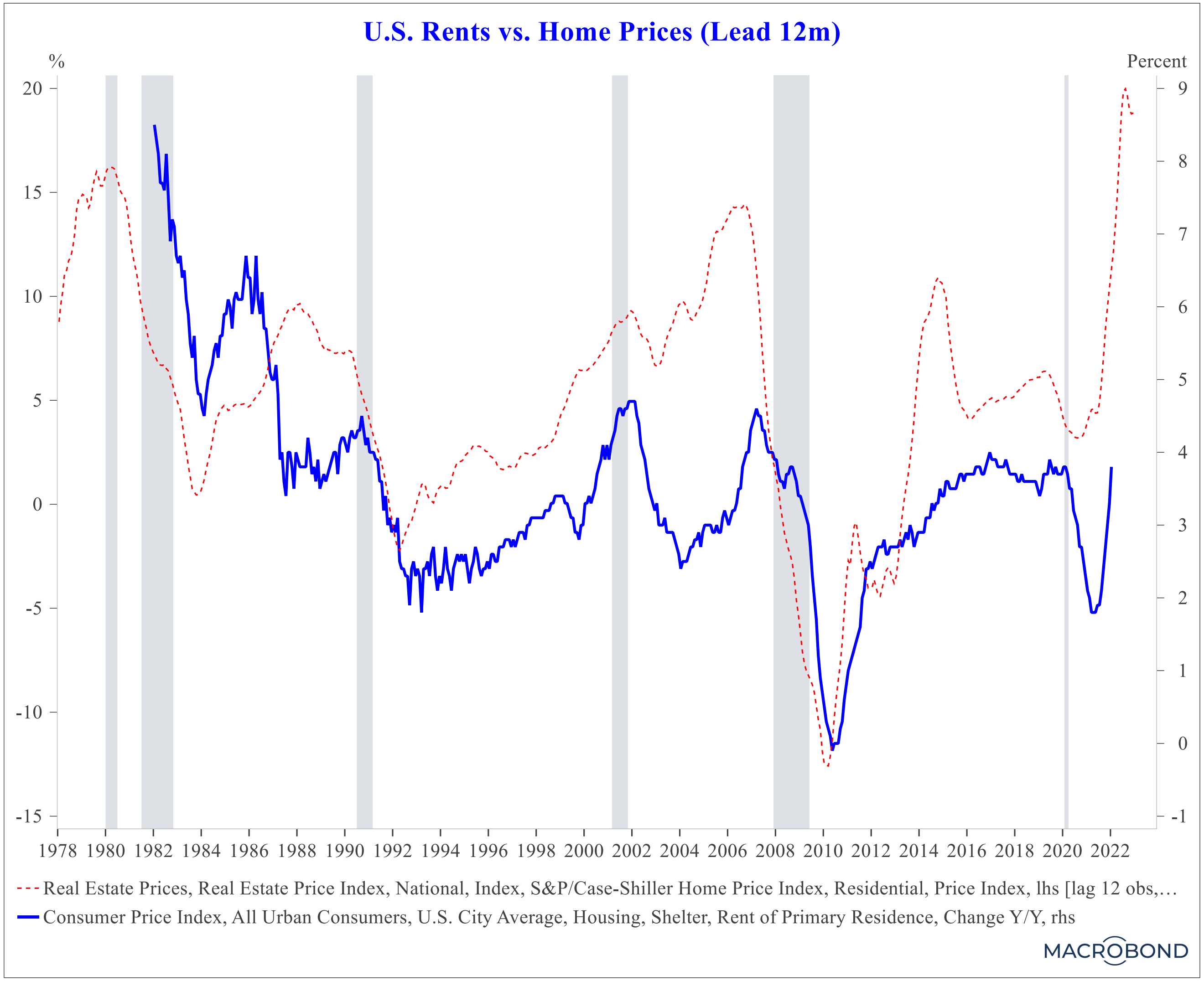
WATCH RENTS + WAGES GOING FORWARD



WATCH RENTS + EGREGIOUS HOME PRICES



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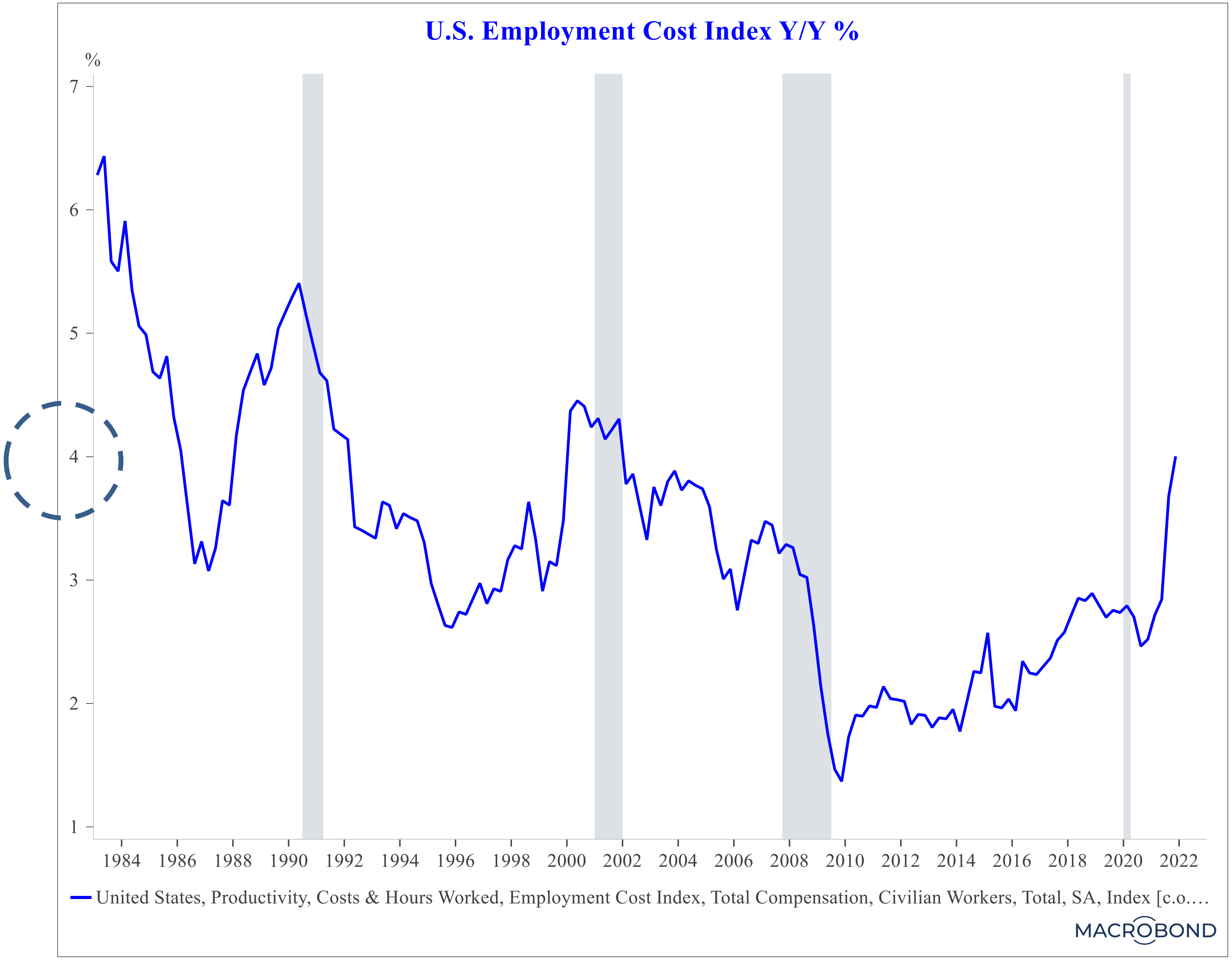
U.S. WAGES (DOWNWARD STICKY) ARE RISING



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MONETARY STIMULUS: QE CAN'T FIX SUPPLY

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THE FED CAN'T DO THIS ALONE … NEEDS HELP

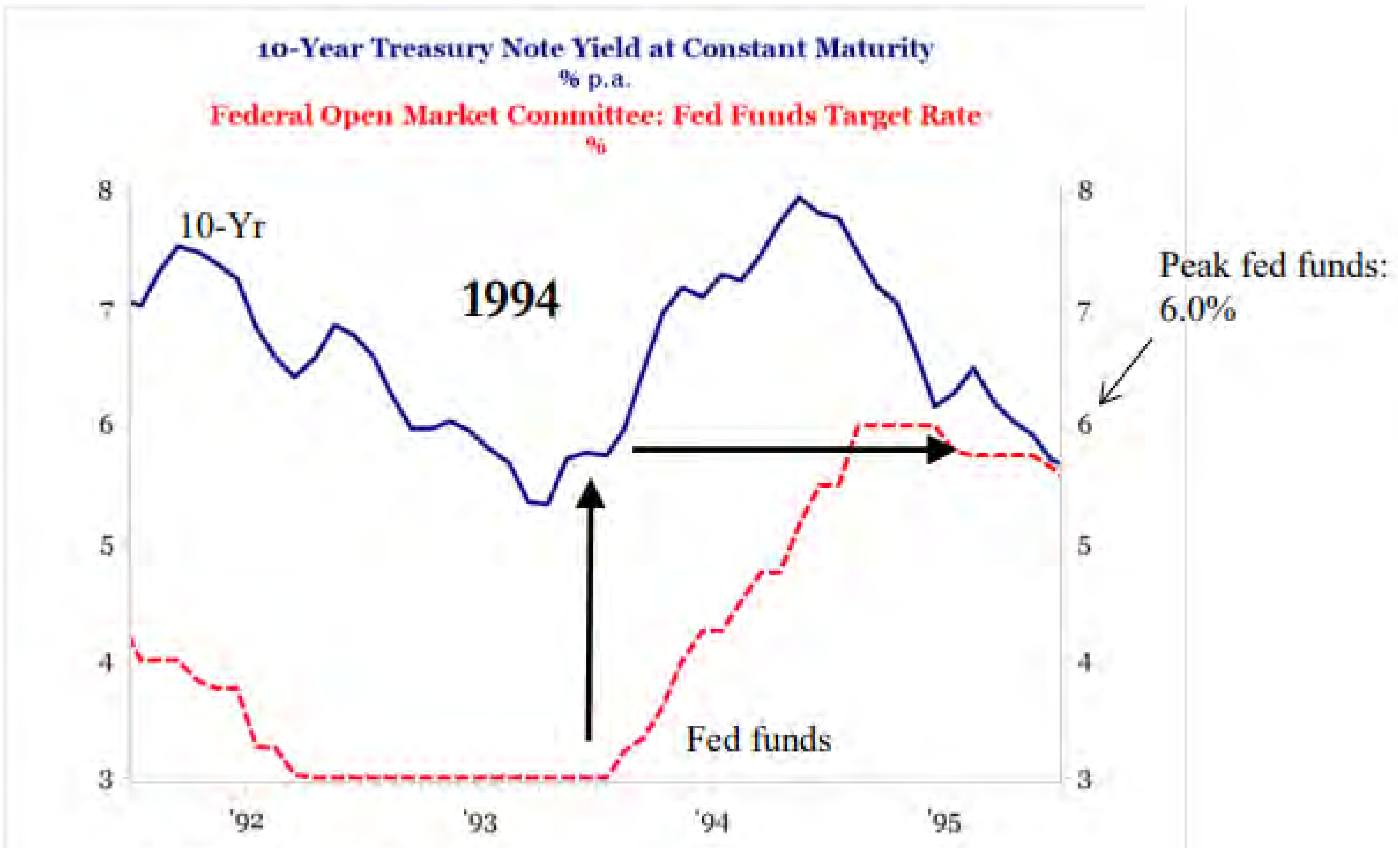
3. Monetary transmission mechanism in the FRB/US model: Full-model simulated effect of a 1 percentage point fall in the federal funds rate

Percent

Item	Response at end of year 1	Response at end of year 2
	Change from baseline	
Financial markets		
Yield on 10-year Treasury bonds	–.3	–.5
Stock market prices	8.8	12.7
Exchange rate value of the dollar	–2.2	–4.9
Aggregate activity		
GDP (chain-weighted 1992 dollars)	.6	1.7
Unemployment rate	–.2	–.7
Consumer price inflation rate	.2	.6

Source: https://www.federalreserve.gov/pubs/bulletin/1999/0199lead.pdf

HOW FAR FOR FED NORMALIZATION?



Source: Federal Reserve Board

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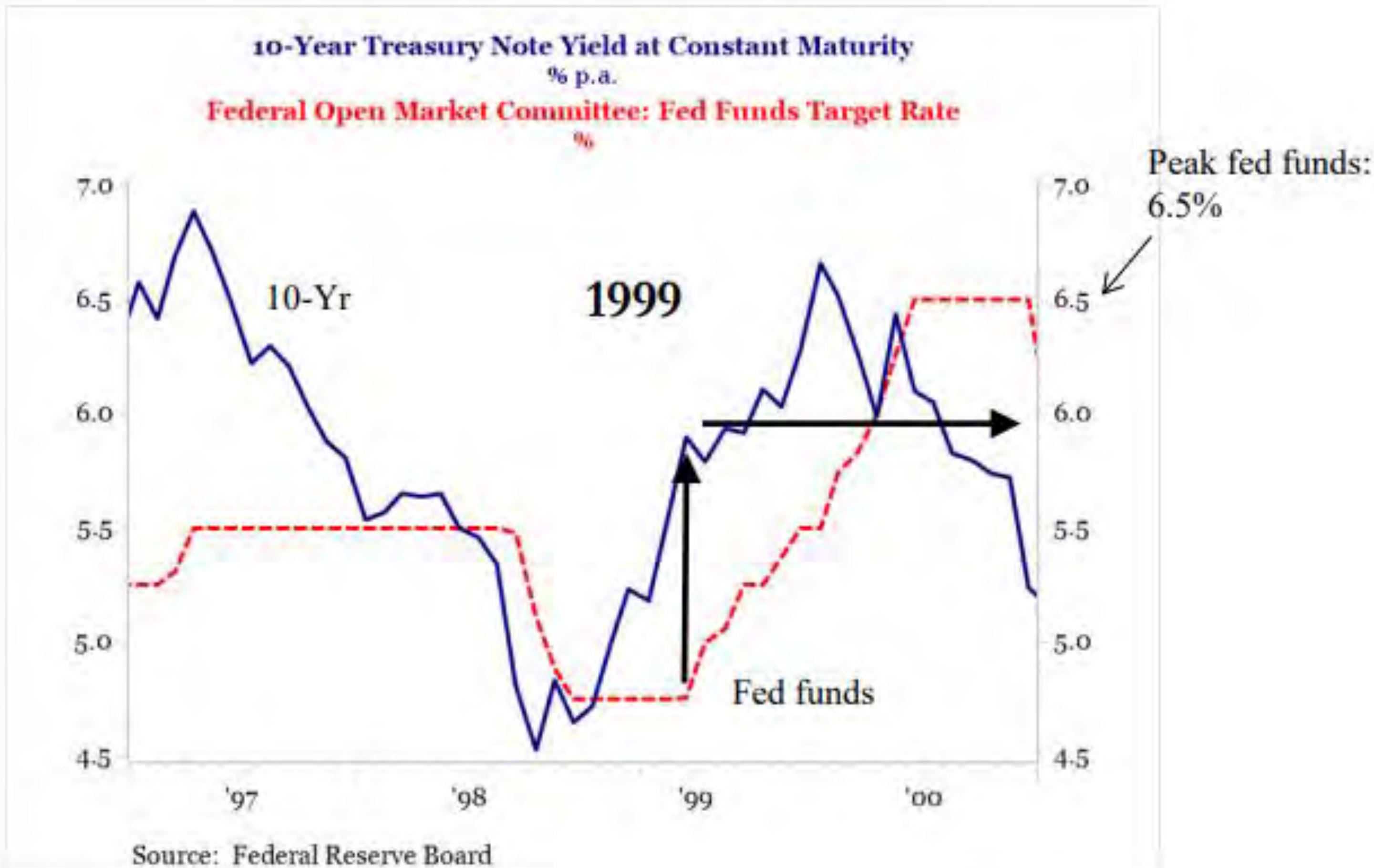

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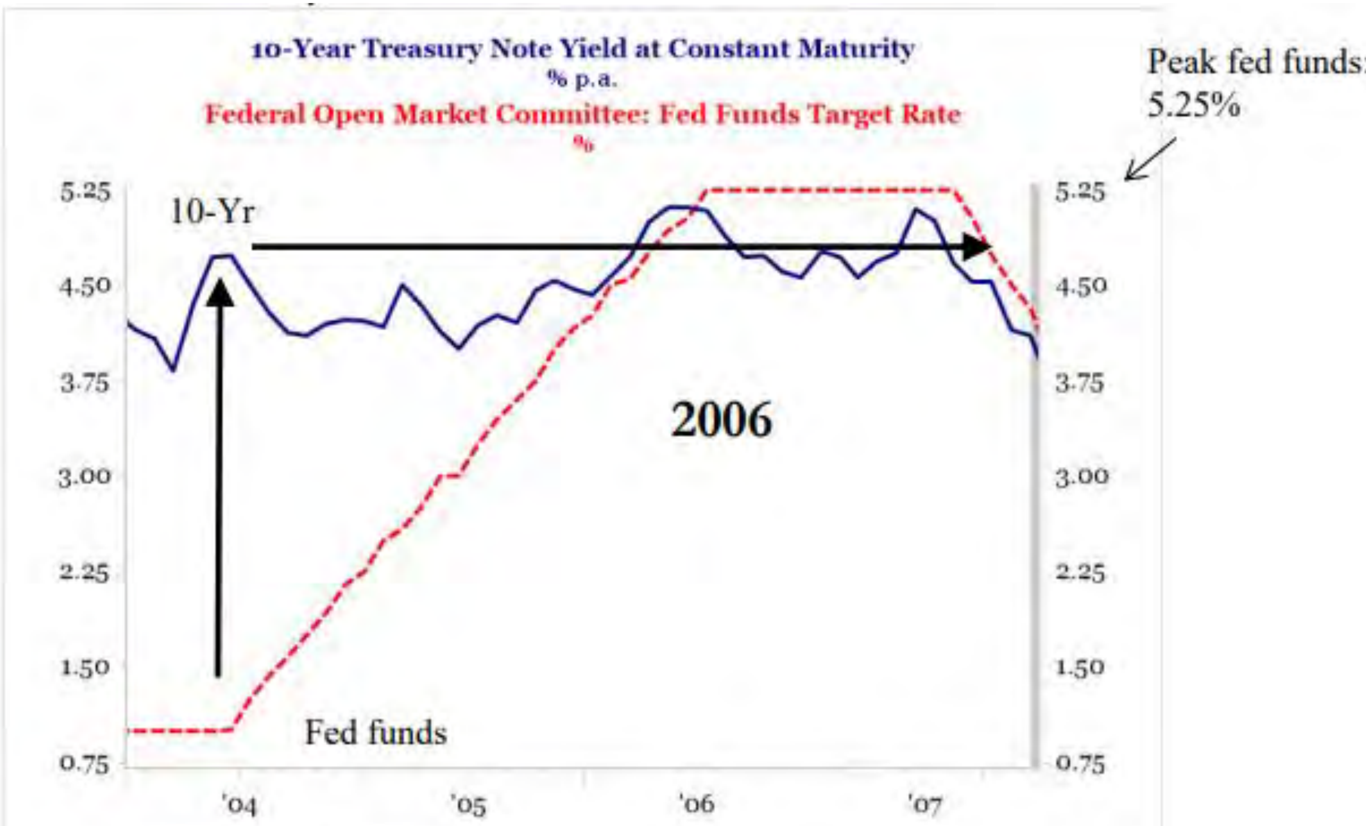

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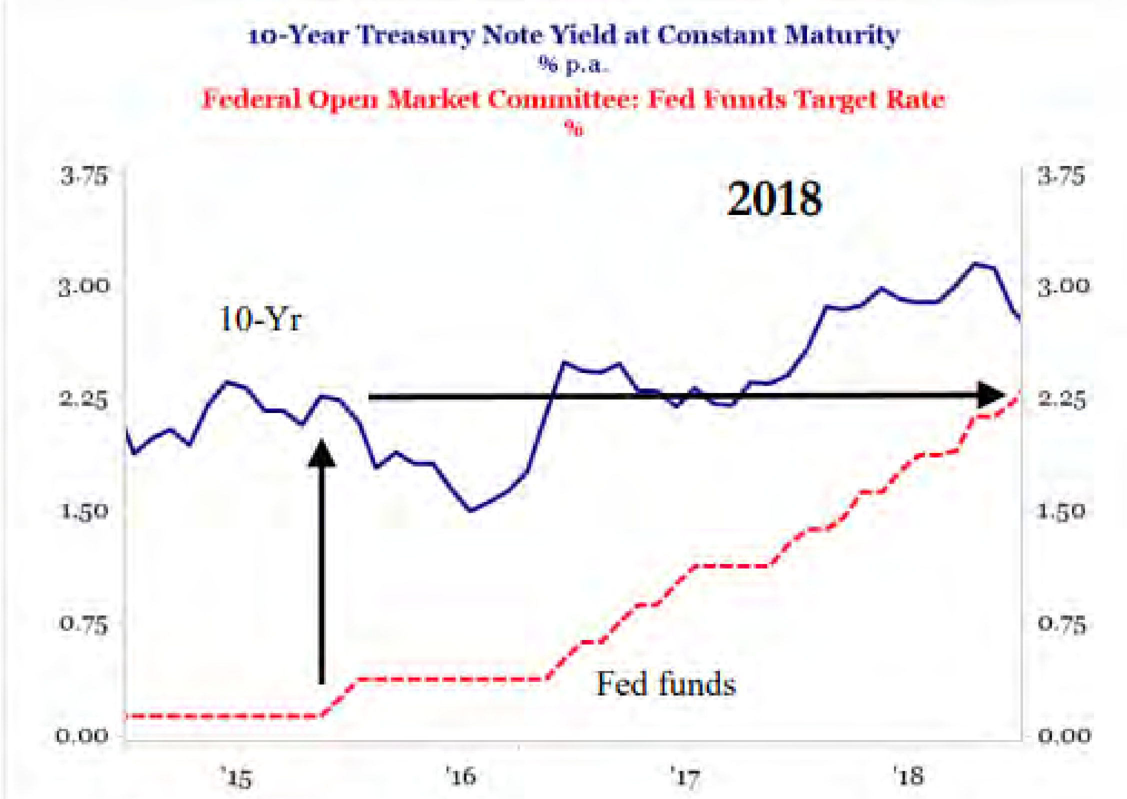

Source: Federal Reserve Board

Peak fed funds: 2.25%-2.5%

PRIVATE SECTOR NEEDS TO HELP THE FED:
4 Main Bottlenecks We're Monitoring

1. Product (eg, semis, autos)
2. Transportation (eg, ports, school buses)
3. Labor
4. Energy

"Ketchup Bottle" model of the economy …

Plenty of Problems in China, But Exports Up

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U.S. LABOR BOTTLENECK IMPROVING … SLOWLY

- Significant retirements, many now not in the labor force

ECONOMIC RESEARCH
FEDERAL RESERVE BANK of ST. LOUIS

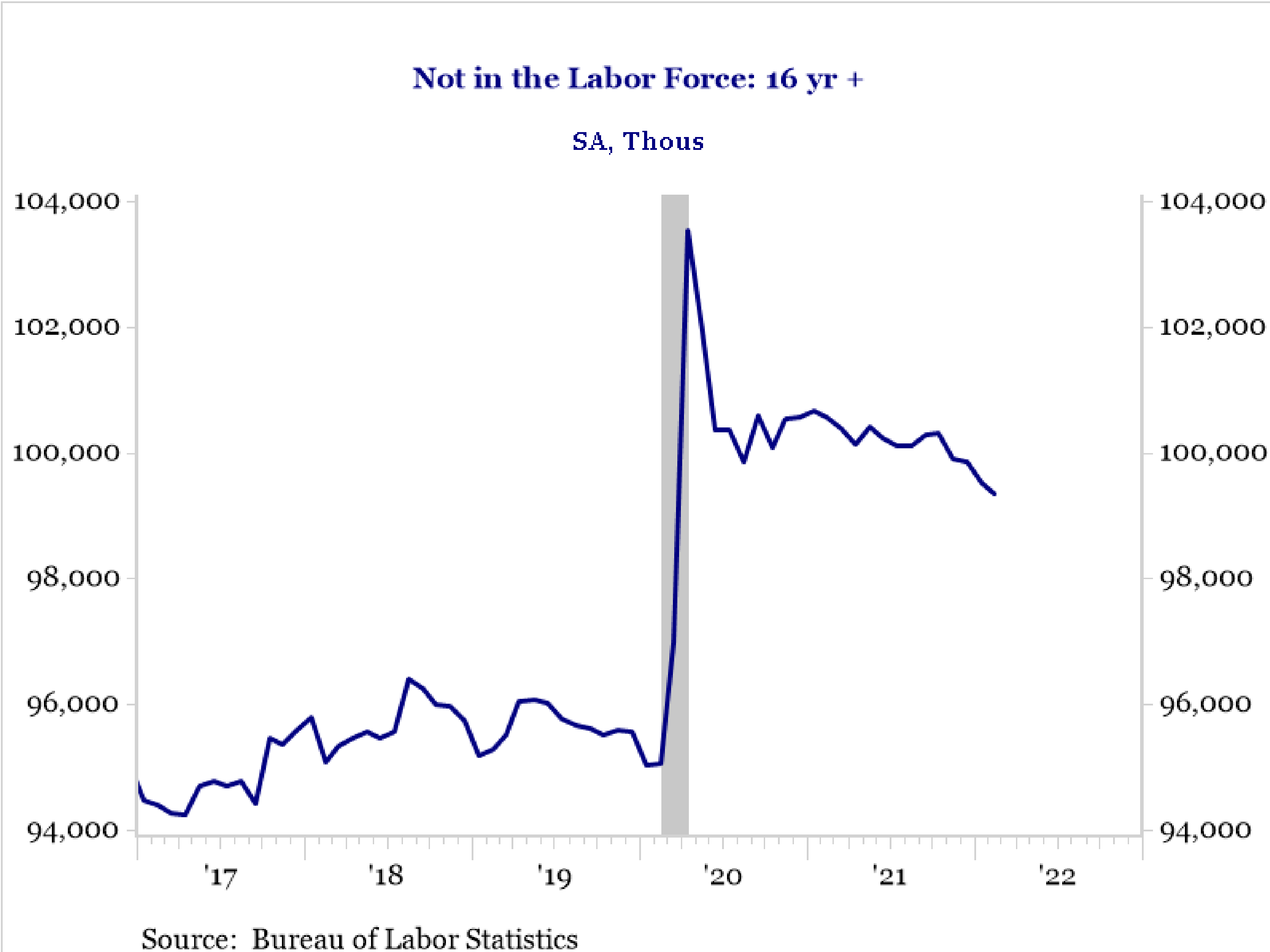
2021, No. 25

The COVID Retirement Boom

by Miguel Faria e Castro

This looks more structural.

U.S. LABOR BOTTLENECK IMPROVING … SLOWLY



WHAT'S WRONG WITH THE U.S. LABOR MARKET

Factors Affecting Labor Supply:

Pandemic mortality (small)

Pandemic health impairment

Early retirements

Unwillingness to take a "non-essential" job

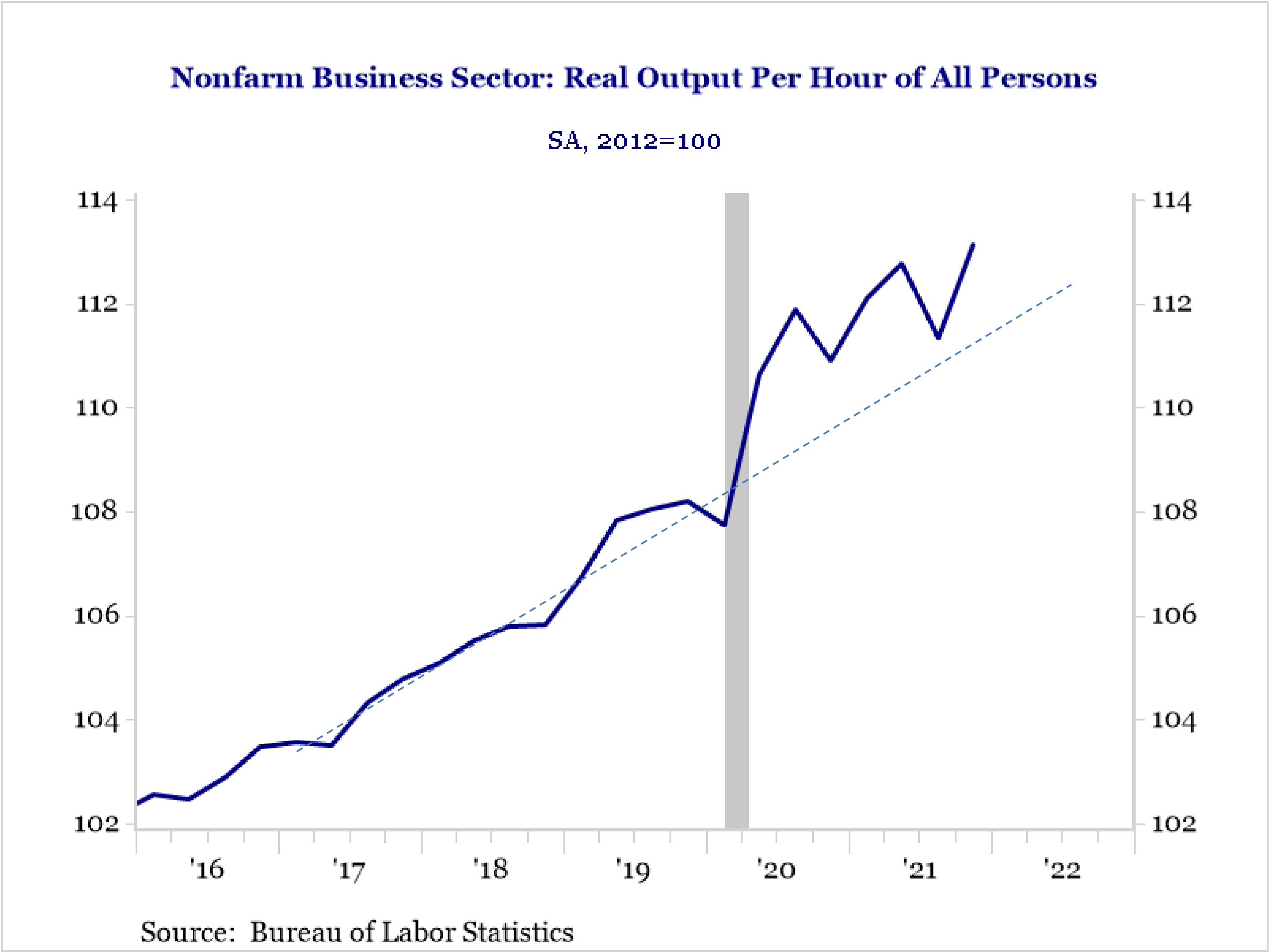
Schools closing/threatening to close

Disincentives w/ expanded jobless benefits

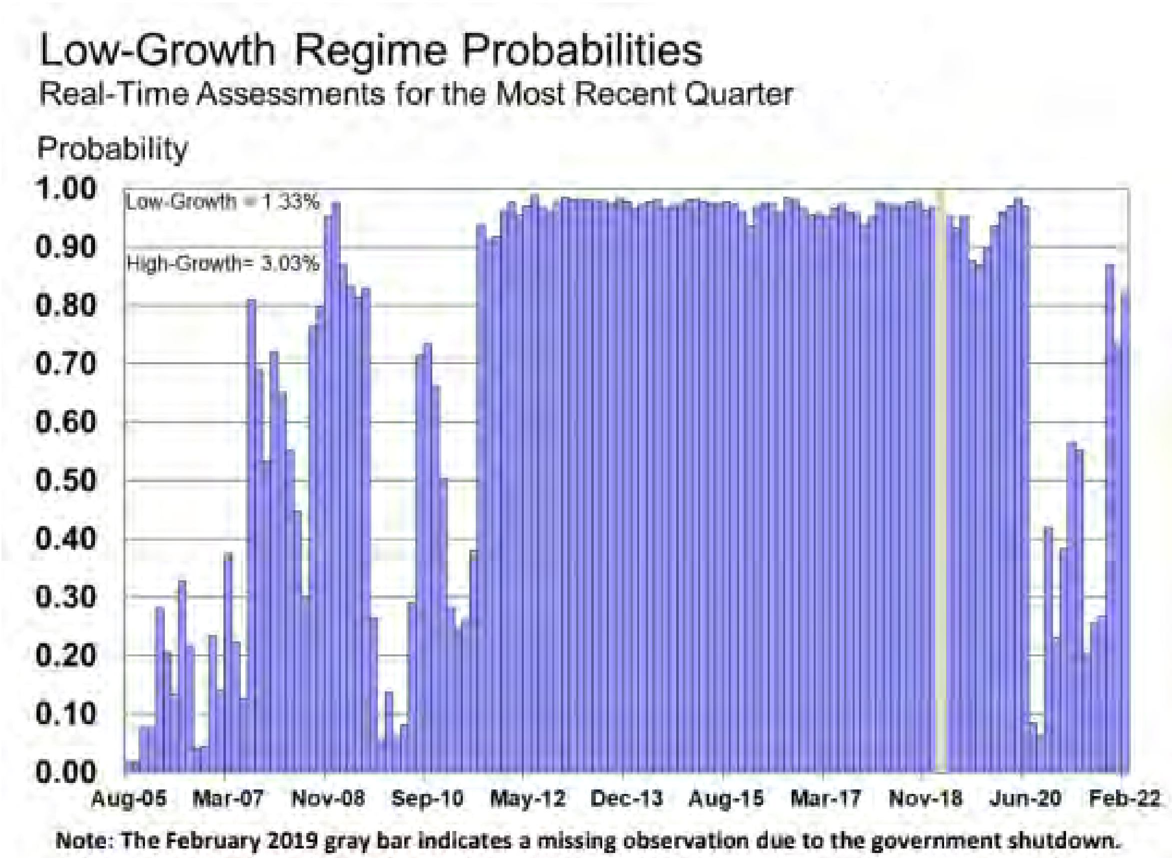
Vaccine mandates & layoffs

Basically an "all of the above" answer …

WATCHING PRODUCTIVITY TREND NOW

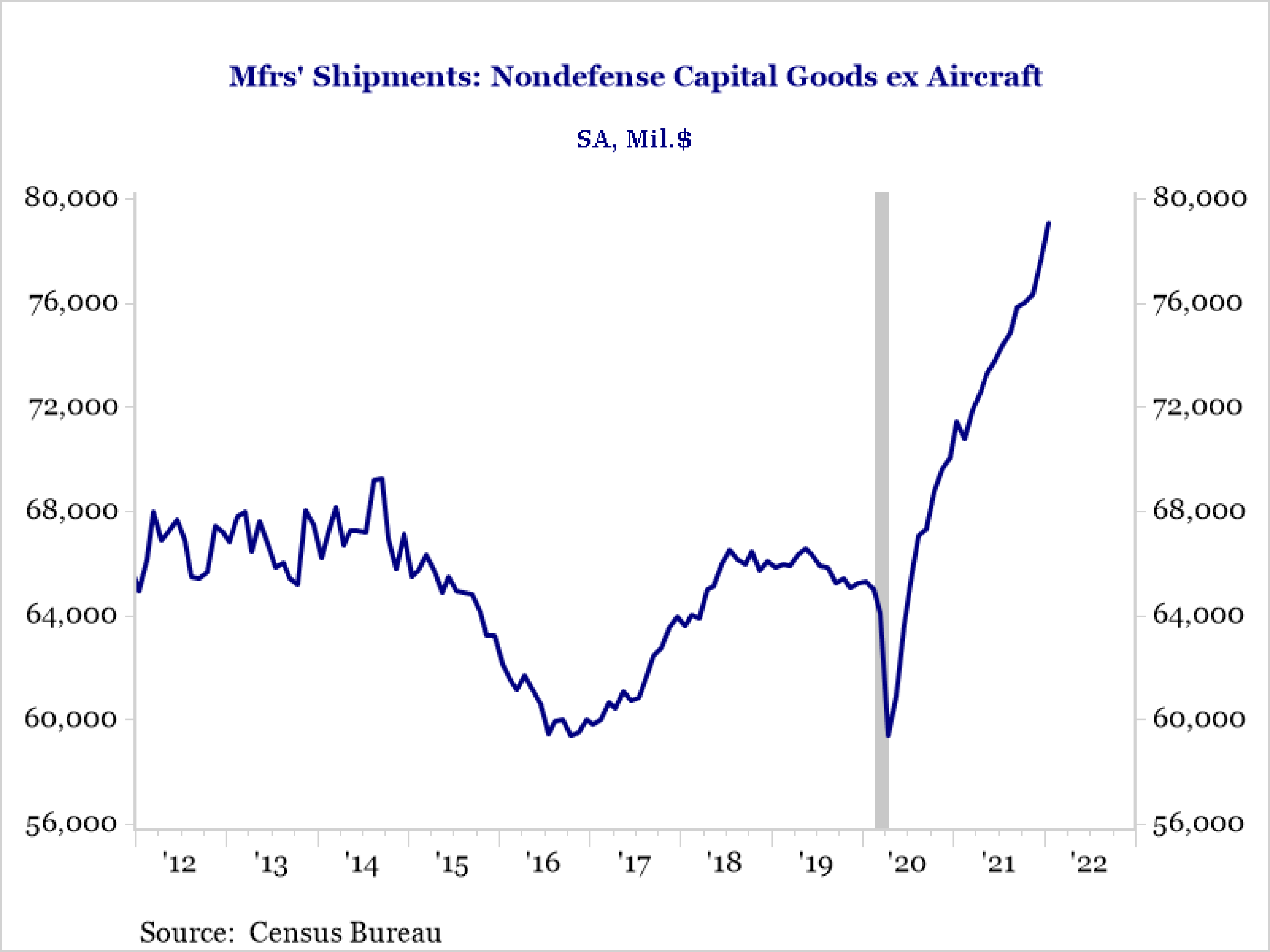


KAHN-RICH MODEL CAN HELP LOOKING FORWARD



Source: https://www.newyorkfed.org/research/current_issues/ci12-8.html

CAPITAL-FOR-LABOR SUBSTITUTION?



SUMMARY: PATH TO A MID-CYCLE SLOWDOWN

- Wage data (especially the Employment Cost Index) remain key for our forecast. A "nimble" Fed will pay attention.
- <u>There remains a pathway to a soft landing in the economy</u>, if the private sector helps the Fed get inflation under control in 2022 (limited China factory interruptions, manageable geopolitical shocks to energy, limited new bottlenecks on the U.S./Canada border, U.S. labor supply continues to show up).
- Our base case remains a 2023 mid-cycle slowdown (50% odds). But the message of the U.S. yield curve seems to be that the second-most-likely outcome is that continued inflation surprises drive the Fed to overdo tightening (as they try to be nimble), and growth falters (35% odds). The curve is not inverted yet, but we are paying close attention. An upside surprise case would involve productivity increasing and growth proving robust (15% odds).

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