INVESTMENT STRATEGY INSIGHTS

# Recession: Are We There Yet?

**July 18th, 2022**

## Recession Lesson: What, When and Why

- Typical recession definitions have yet to be hit, but investors should underweight market (equity) risk as the likelihood rises

## Inflation's 2022 Peak Delayed Again

- Inflation and the Fed's actions are key factors to watch to determine how the economic/market environment unfolds

## Earnings Upbeat, but Shifting

- If earnings begin to turn over, there may be further downside in this bear market, justifying an underweight risk



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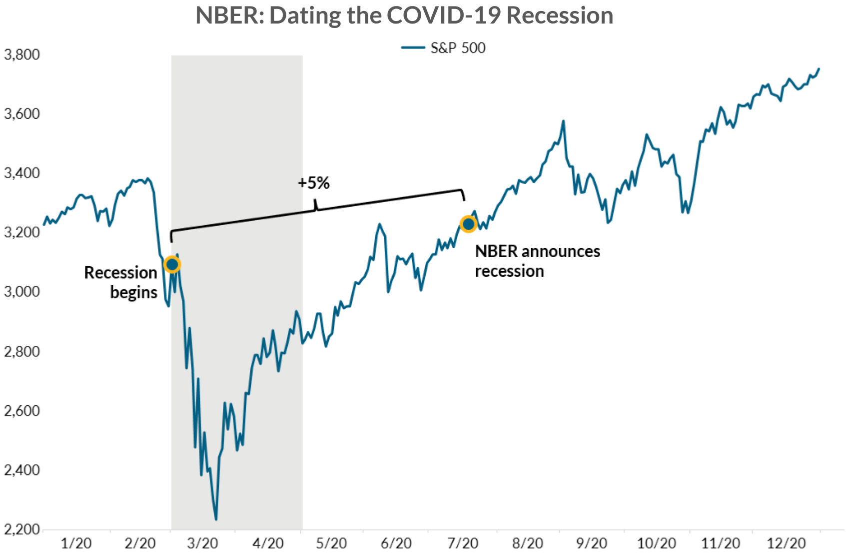
## Recession Lesson: What, When and Why

- **Recessions 101: The 2-Quarter Rule.** Concerns are growing that the U.S. is heading toward a recession. A widely-accepted definition of recession is two straight quarters of negative real GDP growth. GDP growth was negative in Q1, setting up the potential negative-two-quarter scenario, but that first quarter result was more a reflection of strong imports than broad-based weakness. Further, a consensus of economists currently place Q2 growth at a still-positive 1.1%, although there are now some outliers expecting a more dire outcome.
- **Recessions 102: The NBER Delay.** The NBER*, the organization responsible for officially dating recessions, defines a recession differently, as a “significant decline in economic activity that is spread across the economy and that lasts more than a few months.” The NBER uses a broad set of monthly data series, including nonfarm payrolls, personal consumption spending and industrial production, to date recessions for use in historical economic studies, not real-time use. As a result, their call for the start of a recession, historically, has proven far from timely and not very useful for concurrent investment decision-making.
- **Recessions 103: Leading Indicators.** With the economy now in the late stage of the cycle, leading indicators continue to show signs of slowing economic growth. Glenmede’s U.S. LEI**, which seeks to provide estimates of expected GDP growth over a 6–12-month window, is picking up on broadening signs of economic turbulence ahead, contracting meaningfully into negative territory. Meanwhile, Glenmede’s Recession Model is now projecting a 50% chance of recession within the next 12 months. With that said, the economy may be headed toward a more benign recession given the lack of excesses built up in the system.

*Typical recession definitions have yet to be hit, but investors should underweight market (equity) risk as the likelihood rises*

*National Bureau of Economic Research
**Leading Economic Indicator

## Chart of the Week:




Source: Glenmede, FactSet Data through 12/31/2020
Shown in the left panel is the performance of the S&P 500 Index from 2007 through 2010, with the gray bar representing the period of recession associated with the Great Financial Crisis and the yellow highlighted dots representing the beginning date of that recession and the date on which the National Bureau of Economic Research (NBER) announced the recession had officially begun. Shown in the right panel is the same data for the year 2020 and associated COVID-19 Pandemic recession. The S&P 500 is a market capitalization weighted index of large cap stocks in the U.S. Past performance may not be indicative of future results. One cannot invest directly in an index.

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## Inflation's 2022 Peak Delayed Again

- **June's CPI Print.** Inflation reached a fresh peak in June, with headline CPI growing to 9.1% on a year-over-year basis, well above consensus. Both headline and core CPI, with month-over-month gains of 1.3% and 1.0%, respectively, hit annual growth rates not seen since the early 1980s. While rising gas prices were responsible for nearly half of the increase in the headline CPI, it would be a mistake to interpret the report as driven by only a few outliers. In fact, almost all the major components in core CPI increased in June, with exceptions for a handful of reopening sectors including housing and airline fares.
- **Inflation Expectations.** The Cleveland Fed's Inflation Nowcast shows July's month-over-month CPI reading is tracking at 0.4%, a level that is still above the Fed's target range of 0.0-0.3%. Longer-term market-based inflation expectations, meanwhile, have continued to ease, with 5-year inflation, as implied by TIPS and inflation swaps, hitting 2.5% at the end of last week, down from its April peak of 3.5%.
- **Fed's Next Moves.** June's CPI report implies that it would still be premature for the Fed to take its foot off the brakes on its unfolding rate hike cycle, as it likely solidifies the case for another 75-basis point increase later this month. Notably, markets are now pricing in a 30% chance of a full percent rate hike, which raises the odds that the Fed will need to take rates beyond neutral. Accordingly, the fed funds futures market is pricing in a path with the curve peaking at 3.5% in March of next year and declining into the latter half of 2023. All else equal, a faster pace of rate hikes and a higher terminal rate on fed funds increases the odds that a soft-landing gives way to recession in the U.S.

*Inflation and the Fed's actions are key factors to watch to determine how the economic/market environment unfolds*

## Earnings Upbeat, but Shifting

- **Q2 '22 Earnings Preview.** Another earnings season kicked off last week, providing some of the first glimpses of profit trends for the first half of 2022. With 8% of companies reporting so far, the blended year-over-year earnings growth estimate for the S&P 500, which combines actual results with consensus estimates for firms that have yet to report, currently sits at 4.8%. The driving forces of growth are likely to be inflation-sensitive sectors such as energy, industrials, materials and real estate.
- **Earnings Consensus Upbeat So Far.** Despite the economic uncertainty surrounding the Fed's campaign to cool inflation, earnings estimates have so far appeared unphased. For example, consensus earnings per share for the S&P 500 in 2022 remains near its all-time high of $230. However, Glenmede's Leading Economic Indicator, which tends to directionally inform on the path of corporate profits on a forward 6-month, has dipped into negative territory, suggesting there may be downside risk to earnings as the odds of recession rise.
- **Revision Trends Shifting.** Though the headline earnings consensus has remained relatively resilient, fewer analysts are raising estimates and more analysts have begun lowering earnings estimates. On a 90-day basis, the percentage of analysts who are raising guidance for the average of years 2022 and 2023 (across all sectors in the Russell 1000) fell to 44% from 59%, with relatively similar reductions seen in revenue estimates as the current reading sits at 41% down from 56%. Given the inflationary backdrop and expectations for an aggressive Fed tightening cycle, forward guidance will be an important factor to observe throughout the year.

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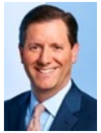

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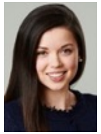

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