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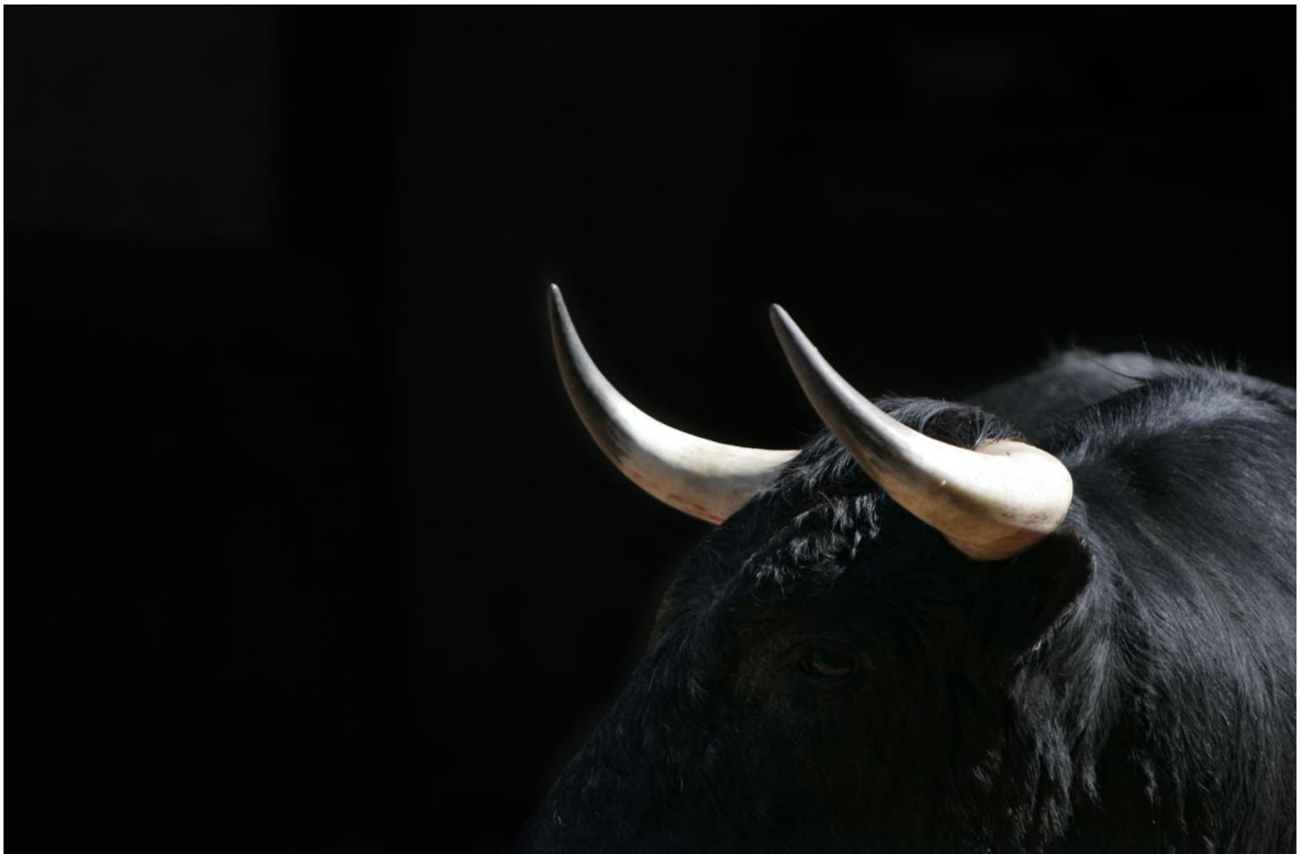

THE BULLISH RECESSION

September 2022

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The Bullish Recession – Eight Different Ways to Introspect.

September 2022

Summary

We believe that the "impending" recession is counterbalanced with strong economic data and once we start to peel the layers, we see a slightly different picture than what the grave headlines attempt to convey. There are indeed some outliers in the Western markets, notably UK, where many households are going to have a miserable fall and winter. But in general, most markets will quickly recover from the current uncertainty and continue to strengthen the global economy.

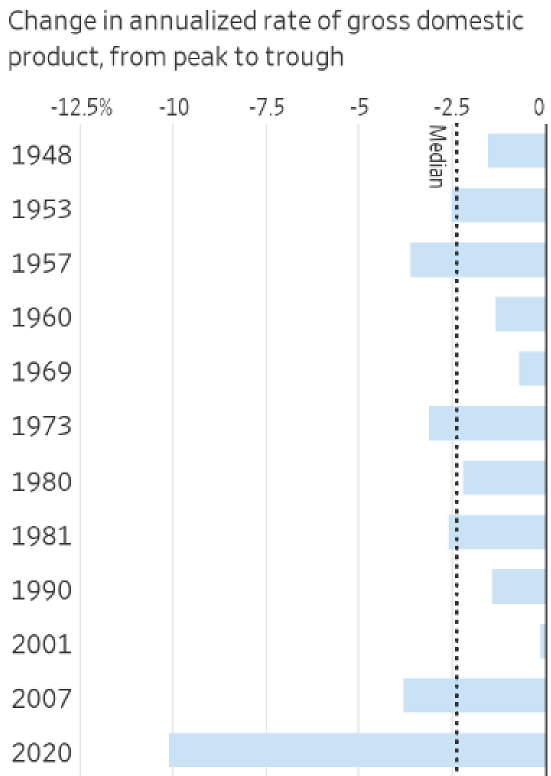
1. The little things.

In Greater London, the cost of car wash, which I'd consider discretionary spending, has gone from £9 to £12 over the last year. And current wait times exceed pre-COVID wait times. Handymen are too busy to accept lower offers for simple jobs and most builders are still busy for the next 6 months.

The Russia-Ukraine war has supposedly impacted the price of oil and, rationally speaking, the increased cost of fuel should have impacted people's driving habits and their eventual car washes. It hasn't.

2. No GDP impact.

The US National Bureau of Economic Research (NBER) has identified 12 recessions dating back to 1948, or one approximately every six years. The NBER committee examines a range of economic data including gross domestic product, employment, household income, consumer spending, retail sa les and industrial production. The panel considers those figures in tandem.



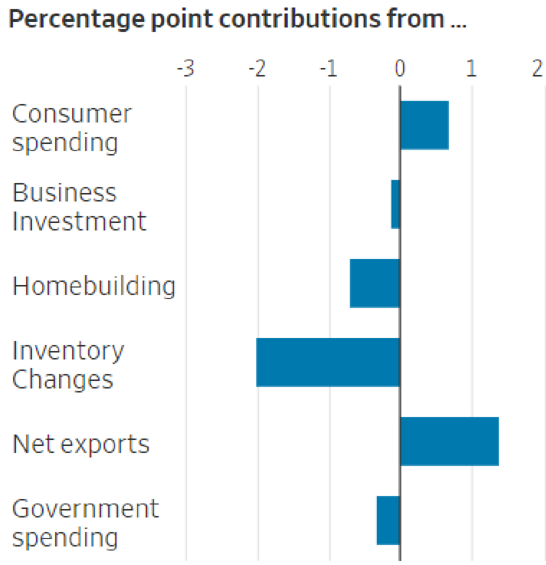
Note: Recessions listed by the year they began.

Source: Bureau of Economic Analysis.

Contrary to general misconception, two consecutive quarters of falling GDP is NOT a recession. That's a rule of thumb that sometimes appears in news articles and, according to the International Monetary Fund, is used by many analysts and commentators around the globe. But, in the U.S., it has no bearing on the committee. The pandemic-induced downturn lasted just a few months but certainly qualified as a recession in the committee's eyes because of its severity. Alternatively, a modest decline in output over six months would likely not meet the panel's definition because the panel only considers "significant" declines in economic activity.

The second quarter reading of the change in US gross domestic product showed a decline of 0.9% from the previous quarter, when the economy shrank by 1.6%. We believe that indicates an economy that is transitioning to more steady, sustainable growth. An important part of that contraction was the result of firms slowing the expansion of their inventories. Businesses stocked up aggressively at the end of 2021 to get around supply-chain problems and in some cases in anticipation of robust consumer spending. In recent months, after realizing they had overstocked, many have slowed orders to suppliers and filled sales out of existing inventories, meaning less national output.

Slower inventory accumulation subtracted 2 percentage points from output in the second quarter, according to the Commerce Department, meaning GDP would have grown had businesses not been trimming their stockpiles.

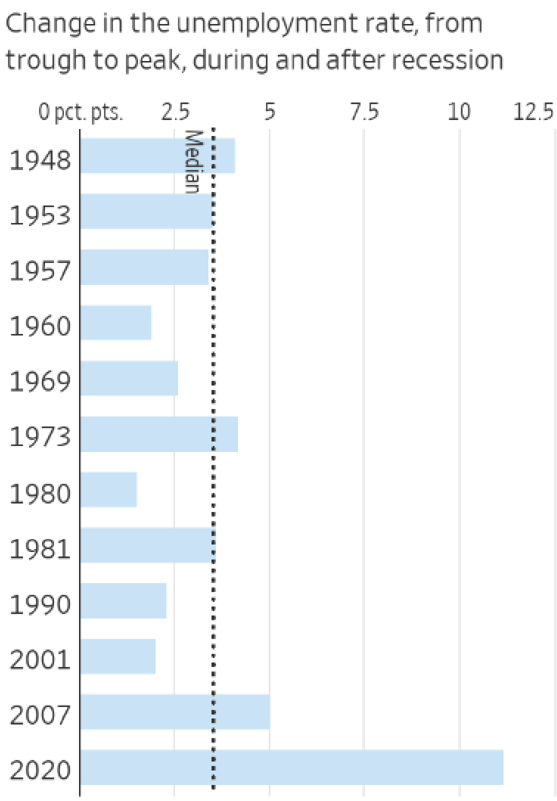


Source: Federal Reserve Bank of Atlanta, for Q2 2022.

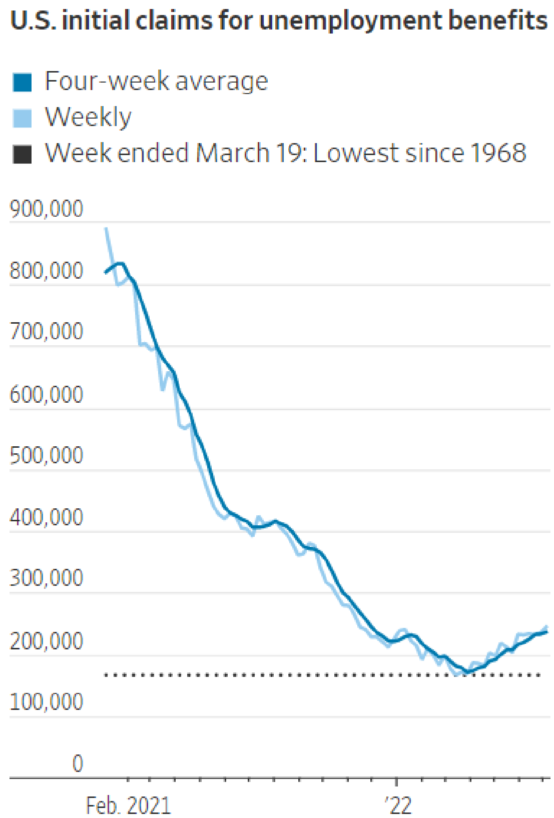
Consumer spending, which accounts for two-thirds of economic output, expanded at a 1% annual rate adjusted for inflation. Business investment, another important growth driver, contracted at a 0.1% annual rate after expanding at a 10% rate in the first quarter.

3. Immense consumer demand.

The nightmare stories of Heathrow are now common. Employment typically falls during recessions as companies lay off workers and stop hiring until the outlook improves. When employment falls, people have less money to spend on discretionary spending, and vacations is one of them. That didn't prevent Heathrow passengers to flock in such large numbers that the airport had to limit number of passengers per day to 100,000 passengers. Heathrow introduced a limit of 100,000 daily departing passengers on July 12 and said at the time that the measure would stay in place for two months. The airport said airlines need to hire ground staff more aggressively to help overcome persistent travel disruptions, warning that a cap on flights to ease the chaos might have to stay in place for at least another year. They further added that airlines need to shape up and replenish their depleted ground-handling resources and that Heathrow itself had done its fair share of hiring in the past six months. When was the last time you heard that airports and airlines are denying passengers (i.e., revenues) because there is a recession!



Note: Recessions listed by the year they began.
Source: Bureau of Economic Analysis.



Note: Seasonally adjusted.
Source: Labor Department.

4. Large fund raises.

Venture capital is on track to register its largest fundraising year on record despite the market correction. So far this year, VC funds in the US have closed on $137.5 billion, just shy of 2021's full-year total of $142.1 billion, according to PitchBook data. LPs have been overwhelmed by an unprecedented number of VC firms returning to market earlier than expected with larger fundraises. The fundraising environment turned out to be, on the whole, less difficult than predicted at the start of the downturn. While the 2nd half of the year may not see as much activity as the first half, there are little signs of a significant downturn in outlook for venture capital.

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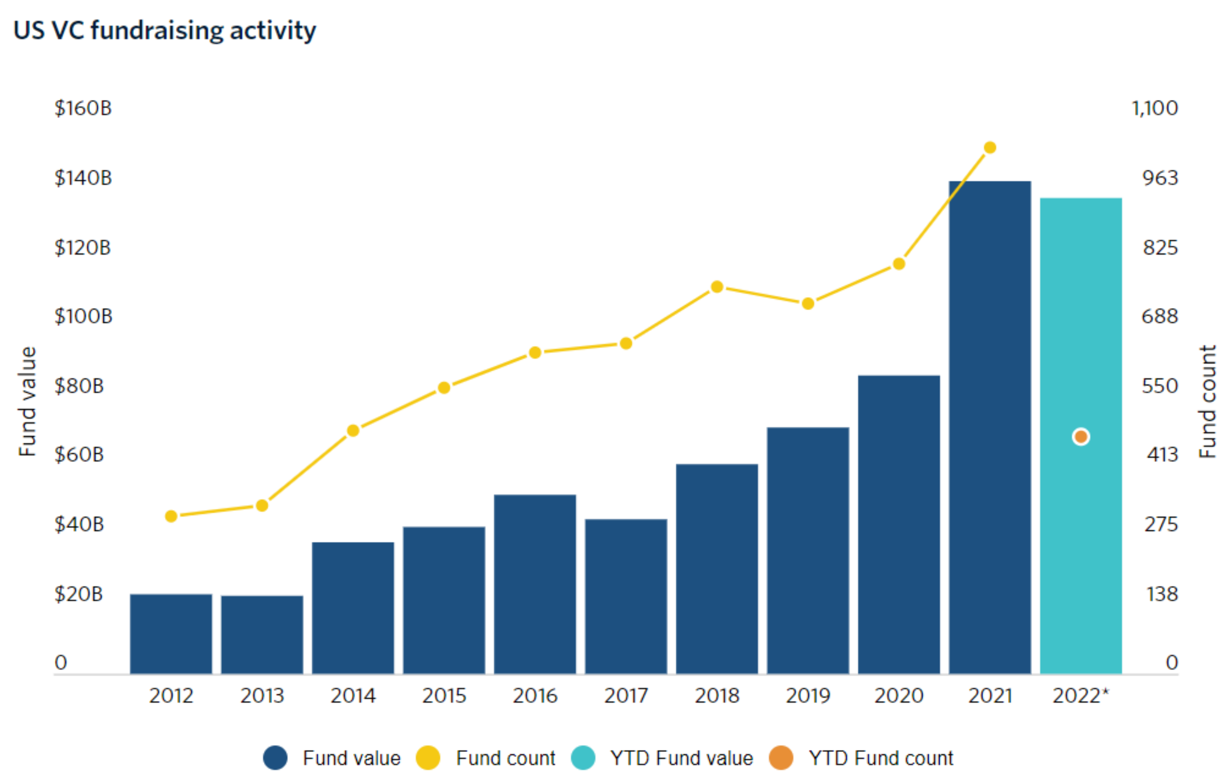


Note: July 2022*

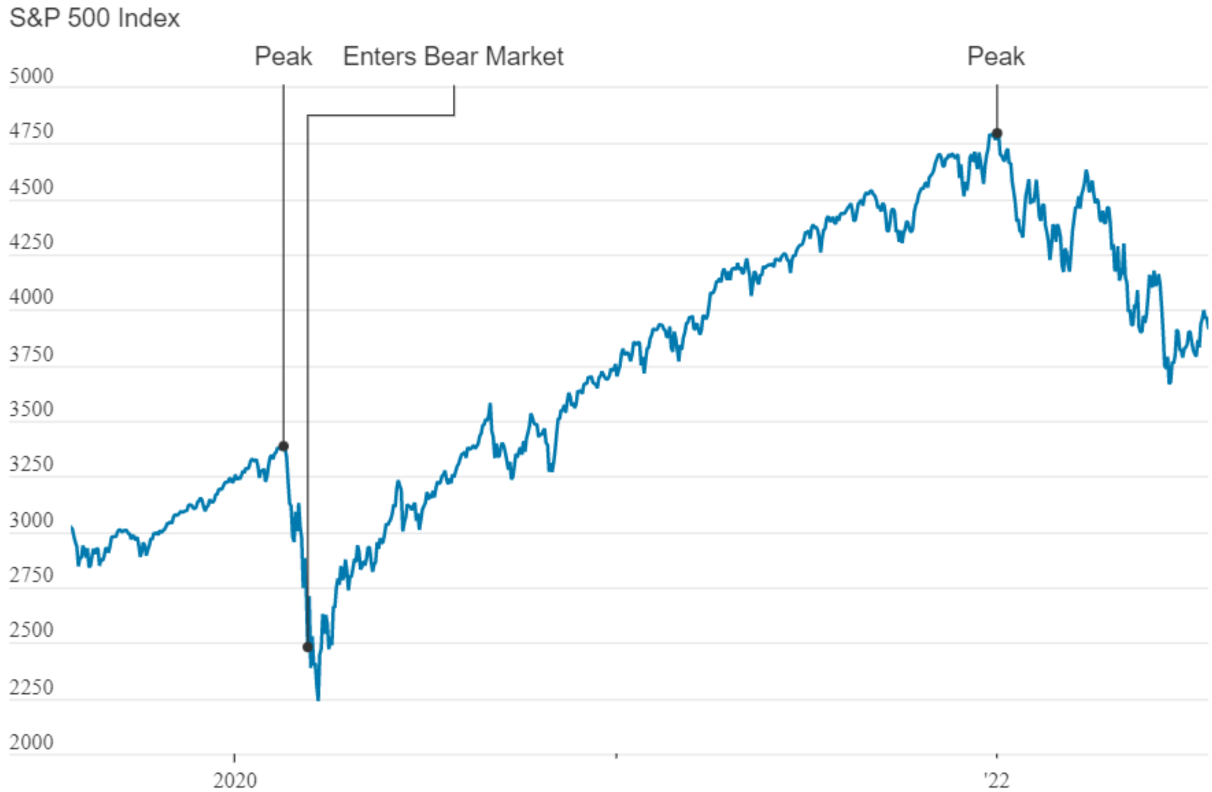
5. Bear market fallacy.

But what about the falling stock market?

The benchmark S&P 500 stock index has fallen into what investors call a bear market. Stocks enter a bear market when widely followed indexes such as the S&P 500 or the Dow Jones Industrial Average sink 20% from their high points. There is nothing official about the determination. The designation is a shorthand way for Wall Street to mark when markets have taken a tumble. It also gives investors a moment to reflect on how the current action in markets compares to previous downdrafts.

Many investors believe bear markets end only after formerly overvalued stocks finally become bargains again. It just isn't so.

In March 2009, in the pit of the global financial crisis, stocks traded at more than 13 times their longer-term earnings, adjusted for inflation, according to data from Yale University finance professor Robert Shiller. That was only about 20% cheaper than the average all the way back to 1881. Although stocks didn't seem like a statistical bargain at the time, they went on to gain roughly 15% annually over the next decade. All this shows the folly of trying to figure out when stocks have hit bottom.



Source: FactSet.

The S&P sectors constitute a method of sorting publicly traded companies into 11 sectors and 24 industry groups. Following is our take on which sectors are doing alright and which aren't. Broadly speaking, of the 11 industry groups, 10 seem to be doing well enough.

Sectors	Outlook for H2 2022
Information Technology	Good
Health Care	Good
Financials	Neutral
Consumer Discretionary	Neutral
Communication Services	Good
Industrials	Good
Consumer Staples	Good
Energy	Good
Utilities	Good
Real Estate	Poor
Materials	Good

6. Money in your pocket.

With the cost of attending higher education ballooning and household wages sputtering over the last few decades, more families have had to turn to loans to cover their children's college bills. Average student loan balances at graduation have almost tripled since 1980, from around $12,000 to more than $30,000 today. The Biden administration is considering wiping out hundreds of billions of dollars in student debt. The country's outstanding education debt balance now exceeds $1.7 trillion and poses a larger burden to households than credit card or auto debt.

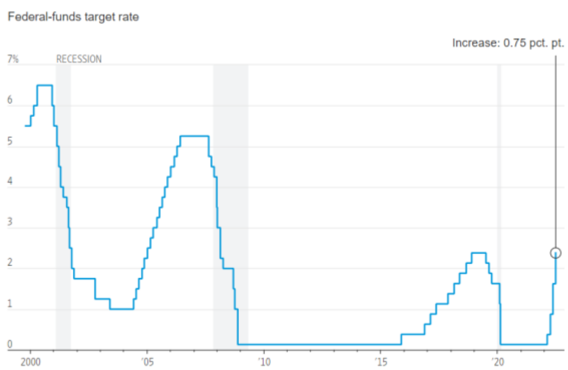
One of the arguments for forgiving student loans is that millions of borrowers will never pay off their debt anyway.

According to a rough estimate by higher education expert Mark Kantrowitz, just about half of federal student loan borrowers, or 20 million people, were in repayment prior to the pandemic. A quarter — or more than 10 million people — were in delinquency or default. Many others had applied for temporary relief for struggling borrowers, including deferments or forbearances.

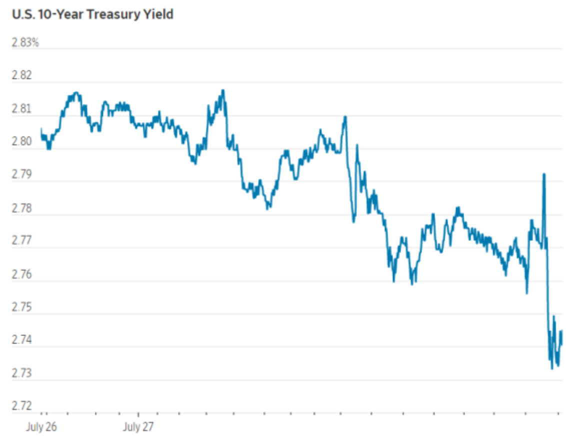
Whether this student loan forgiveness is a political bribe is up for debate, but it doesn't negate the fact that at least some 40 million people will have more money in their pockets to spend in the coming months.

7. No long-term divergence from Fed Funds Rate.

The Federal Reserve continued a sprint to reverse its easy-money policies by approving another unusually large interest rate increase and signaling more rises were likely coming to combat inflation that is running at a 40-year high. Officials agreed unanimously Wednesday to lift their benchmark federal-funds rate to a range between 2.25% and 2.5%. But markets rallied after the meeting because Fed Chairman Jerome Powell offered fewer specifics about the magnitude of upcoming rate rises and hinted at an eventual slowdown.



Source: Federal Reserve



Source: Tullet Prebon

Most investors considered the Fed's rate increase, which brought its target to a range of 2.25% to 2.5%, a foregone conclusion. But Treasury yields fell as Chairman Jerome Powell spoke to reporters after the meeting. Through the market's 3 p.m. settlement, the yield on the 10-year Treasury note fell to 2.731%, from 2.786% on Tuesday, according to Tradeweb. The two-year yield, which is even more sensitive to expected Fed policy, fell to 2.968%, from 3.041% a day earlier. We don't see a material divergence between the Fed Funds Rate and the 10-year Treasury, which implies that, in general, investors expect to rates to be range-bound over the longer term.

8. Expanding $1 Stores.

Retailers opened over 4,200 stores midway through 2022 in the US (outpacing 1,766 announced store closings). Heightened demand for in-person shopping — especially of the affordable kind — saw dollar stores (followed by other low-price leaders like Aldi and Five Below) top the openings list. Brick-and-mortar stores continue to be key to engaging consumers and play an important role in retailers' omnichannel strategies.

Top retailers by announced U.S. store openings

Year-to-date; As of June 24, 2022

Retailer	Openings	New retail space
Dollar General	1,102	11.7m sq. ft.
Family Dollar	393	4.1m
Dollar Tree	206	2.5m
Aldi	155	2.5m
Five Below	147	1.3m
TJX Companies	133	3.8m
Burlington Stores	113	5.1m

Data: Coresight; Table: Simran Parwani/Axios

Source: CBInsights