The Advisor

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Market Update - Fourth Quarter, 2023

SOFT LANDING? At the end of September, the Fed released their most recent Summary of Economic Projections. For the Fed's part, they project another rate hike this year, fewer rate cuts next year and ultimately, restrictive monetary policy out into 2026. This is the "higher for longer" narrative you may have been hearing in the financial media.

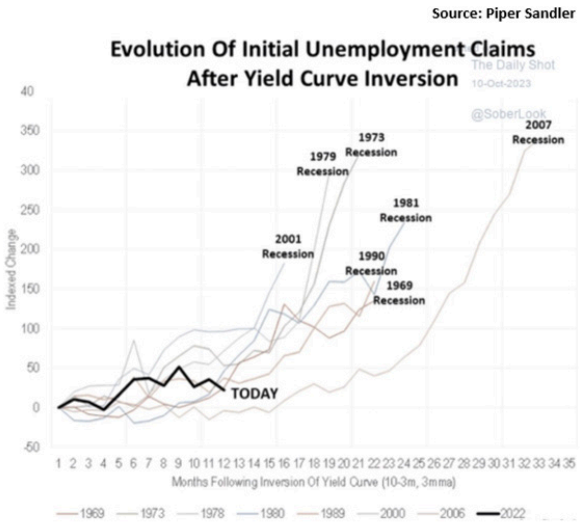
Digging deeper into the data we can see the Fed's calculus of doubling their GDP forecast for 2023 and raising 2024's, as well. The unemployment rate barely moves, hovering around the long-run rate of 4% into the foreseeable future. Inflation, meanwhile, glides perfectly down to the Fed's target of 2%, but not until 2026.

Summary of Economic Projections Source: Federal Reserve, AIMA
Median

	2023	2024	2025	2026	Longer run
Change in real GDP	2.1	1.5	1.8	1.8	1.8
June projection	1.0	1.1	1.8		1.8
Unemployment rate	3.8	4.1	4.1	4.0	4.0
June projection	4.1	4.5	4.5		4.0
PCE inflation	3.3	2.5	2.2	2.0	2.0
June projection	3.2	2.5	2.1		2.0
Core PCE inflation	3.7	2.6	2.3	2.0	
June projection	3.9	2.6	2.2		
Federal funds rate	5.6	5.1	3.9	2.9	2.5
June projection	5.6	4.6	3.4		2.5

To recap, the Fed projects raising their benchmark rate again this year and keeping it at restrictive levels for years to come while GDP slightly dips below trend, unemployment barely budges and inflation continues its slow decline to 2%. If there was ever a definition of a soft landing for the economy – you just read it.

While there are several explanations underpinning projections of a soft landing the strongest one is rooted in the labor market. A low unemployment rate means people have jobs; that's a good thing considering consumer spending makes up about two-thirds of U.S. GDP. That said, there is one caveat we need to discuss. The chart immediately to the right shows how unemployment claims have fared after the yield curve inverts. Currently, the 10-yr treasury minus the 3-month treasury is inverted and it has been since last October. Keep in mind, inversion is not a normal or healthy condition for the yield curve. A holder of a 10-year UST should receive a higher yield versus holding a 3-month UST – not the other way around.



Looking closer at the chart, today's labor market is right in-line with those under similar conditions in the past. The path of unemployment claims from here, going forward, looks a bit more, shall we say, steep if history is a guide. But should we even use history in this case?

When the spread between the 10-year minus 3-month UST goes negative, meaning the curve is inverted, a recession has followed. And in a recession, unemployment claims rise. However, despite the perfect historical record, it's important to understand an inverted yield curve does not cause a recession. The inversion is a reflection of underlying economic conditions and the probable path of future monetary policy actions; it is saying conditions are too restrictive. In other words, the curve inversion is a signal, not a cause, of underlying recession-like behavior and risk-off conditions that exist in the real economy that will force the Fed to lower their benchmark rate in the future.

The above point is precisely what the mainstream misses by taking such a myopic view of the Fed and its policy influence. There is little doubt the Fed plans to maintain a higher for longer rate posture. That's not the question. The bond market is saying (expressed through the yield curve inversion) that real economic conditions will make it extraordinarily difficult, if not impossible, for the Fed to maintain a higher for longer policy stance. The question should be, will the curve inversion be right, again, and recession comes home to roost or will this time be different and a soft landing prevails?

'73 Recession: November 1973 – March 1975

The New York Times
https://www.nytimes.com › 1973/09/03 › archives › eco...

ECONOMISTS SEE A 'SOFT LANDING' WHEN BOOM ENDS

Sep 3, 1973 — **Liebling**, a senior. Treasury economist, recently spelled out some of the "strengths" in the **economy** that "were absent in earlier episodes ...

'81 Recession: July 1981 – November 1982

The New York Times
https://www.nytimes.com › 1981/09/19 › business › dow...

DOW FALLS 3.90 MORE, TO 836.19

Sep 19, 1981 — An Improved Outlook?: The prospects for a **soft landing** for the **U.S. economy** and the markets look better than they have in months. Our columnist ...

'90 Recession: July 1990 – March 1991

Washington Post
https://www.washingtonpost.com › 1989/11/05 › a-sof...

A SOFT LANDING FOR ECONOMY IS NOW AT HAND

Nov 5, 1989 — The notion of a "**soft landing**" for the **economy**, as opposed to a crash, arose because **the Federal Reserve**, the nation's central bank, ...

'01 Recession: March 2001 – November 2001

GlobeSt
https://www.globest.com › sites › globest › 2000/12/12

Economic Soft Landing, Strong Housing Likely in 2001, ...

Dec 12, 2000 — **Economic Soft Landing**, Strong Housing Likely in **2001**, Reports NAR · WASHINGTON, DC-According to the National Association of Realtors, though home ...

'07 Recession: December 2007 – June 2009

International Monetary Fund
https://www.imf.org › News › Articles › 2015/09/28

IMF Survey: Soft Landing Ahead for U.S. Economy

Aug 6, 2007 — IMF Survey: **Soft Landing** Ahead for U.S. **Economy**. IMF Survey online. August 6, **2007**. United States should return to potential growth rate near 3 ...

This brings us to 2023 - 2024:

CNBC

As economists point to a 'soft landing' for the U.S. economy, here are 3 financial risks for consumers to watch

Forecasts for a recession have turned to predictions for a "soft landing" for the U.S. economy. Here's what that may mean for individuals.

1 month ago

Don't shoot the messenger. We're not presenting the above stroll through headline history as a scientific study proving a recession is guaranteed. We are pointing out nearly every single time the 10Y – 3M curve inverts the mainstream comes to the rescue with the soft landing narrative.

Maybe this time is actually different. Maybe the yield curve signal and other data pointing towards a contraction is wrong. Maybe the economy is capable of absorbing higher real-rates for longer without much impact to the labor market.

We are not trying to predict the commencement or even occurrence of a recession and we do not try to time markets. We do believe historical perspective is valuable - not for determining precise outcomes but for gauging probabilities and in this case, the potential path forward into year-end and 2024.

We remain focused on managing risk by capitalizing on the opportunity in the yield environment and maintaining prudent, if not hedged, equity exposure. This blueprint has worked well in 2023 and we remain committed to helping our clients navigate the market and economic cycles to achieve long-term financial well-being – whether this time is different, or not.

To our clients, thank you for the opportunity to serve your investment needs and please do not hesitate to contact us if you experience any material changes in your personal situation or would like to discuss any specific matters.

To our other readers, if you would like a complimentary review of your investment accounts or any other financial matters, please do not hesitate to contact us. As fiduciaries, we will happily provide you with an unbiased opinion based on your specific situation.

Lastly, follow us on social and let's connect!

AIM Associates
Ables, Iannone, Moore & Associates, Inc.
A Registered Investment Advisory Firm

419 Montgomery Street
Savannah, Georgia 31401
Phone: 912-777-4128 • Fax: 912-777-5943
Toll Free: 866-815-6004, www.aimainc.com