October 23rd, 2023

VERED WEALTH MANAGEMENT (CANADA) COMPANY LIMITED

This week we celebrated National Mulligan Day—a day everyone gets a 'do over' or a second chance. I'm sure there are plenty of golfers, weathermen, and others that have called for a mulligan every now and then. But unlike golfers, it is not often that economists are so far off in forecasting the timing of a recession. Yet this cycle, economists have been calling for a recession that, for two years, has yet to materialize. And that has many economists calling for a 'mulligan' with their forecasts, with a recession no longer the consensus forecast over the next 12 months. And with next week's 3Q GDP report shaping up to be a blockbuster number (the Atlanta Fed GDPNow is tracking a +5.4% growth rate), it is worthwhile to reiterate our thoughts on the economy and how we expect growth to unfold over the next year.

Key Takeaways

- Mild Recession Remains Our Base Case
- Headwinds Are Building For The Consumer
- Surging Borrowing Costs Pose A Risk

**A Mild Recession Is Still Our Base Case |** Economic activity continues to expand at a healthy pace, supported by a tight labor market and a resilient consumer. However, it is important to keep in mind that next week's GDP report will reflect economic activity that occurred in the July through September period, a time when consumers were enjoying the Summer of Revenge Travel II. And while growth has been stronger than expected, it can turn around very quickly. In fact, history has shown that over the last twelve recessions, the quarter before the economy enters a recession has seen growth up, on average, 2.6%. And with the market so focused on binary outcomes—recession or no recession—it is missing the bigger picture. And that is: growth will be much slower over the next nine months and lead to a mild recession. Here's why:

- **Headwinds Are Building For The Consumer |** The tailwinds that have driven consumer spending since the pandemic have faded. Excess savings have essentially evaporated. Borrowing costs are at their highest level in decades. And student loan repayments, which resumed on October 1, are taking a bite out of disposable income. Sure, consumers have jobs and income right now, but their ability to continue to consume indiscriminately is coming to an end. In fact, this was echoed in this week's earnings report by Bank of America's CEO, Brian Moynihan, who commented that consumer spending has slowed considerably and is running at levels consistent with the low inflation, low growth economy that existed prior to the pandemic. Credit card usage is up significantly (now above $1T), suggesting that some consumers are having a harder time making ends meet. And judging by the recent delinquency data, more Americans are starting to fall behind on their debt obligations. While we are not suggesting that consumption is going to fall off a cliff, a moderation in spending should be expected.
- **Surging Borrowing Costs Pose A Risk |** The rapid rise in interest rates over the last few months will pose another threat to growth. With mortgage rates now above 8%, credit card rates at their highest level on record and small business borrowing costs nearing 10%, future spending and capex decisions are going to require a higher level of scrutiny.* And with housing affordability now sitting at an all time low (and that is before the recent surge in interest rates!), residential real estate activity will likely remain frozen. This is starting to take a toll on home builder confidence again, which has fallen to its lowest level since January 2023. With more buyers getting priced out of the market and 30-year mortgage rates at a 23-year high, adjustable-rate mortgages (ARMs) are starting to make a comeback. These dynamics have pushed the share of ARMs on new loans to an 11-month high of over 9%. Business capex plans have also been impacted. In fact, a composite of regional Fed capex surveys shows that business capex spending plans over the next six months have fallen to their second lowest level in the post-COVID era.
- **Falling Confidence, Strikes And A Potential Shutdown |** Between higher interest rates, rising gas prices, a new war breaking out in the Middle East, and jittery financial markets, consumer sentiment is deteriorating again. In fact, the Conference Board's Expectations Index, which reflects consumers attitudes about the short-term outlook for the economy, the jobs market and income prospects, tumbled to its lowest level in four months—a level that historically signals a recession within the next year (according to the Conference Board). And with the availability of credit constrained as bank's tighten lending standards further and consumers become increasingly concerned about their financial outlook, a slowdown in consumer spending should start to materialize.* As a result, all eyes will be watching consumer spending patterns heading into the crucial holiday shopping season. Early indications from a recent Gartner survey suggest that holiday spending will be softer this year, with only 9% of respondents expected to spend more on gifts. Add in the possible disruptions from the ongoing autoworkers strikes (which is in its fourth week) and a potential temporary federal government shutdown in mid-November, and growth could look considerably weaker in the months ahead.

## ECONOMY

- Retail sales increased a more than expected 0.7% MoM—ending a very strong quarter for the US consumer.* This likely boosted economic growth in the third quarter of this year. Even the 'Control Group' subindex came in strong (+0.6% MoM), which will keep Federal Reserve (Fed) officials in a more defensive position to prevent any reacceleration in inflation.
- The 'limited inventory' and 'elevated mortgage rates' dynamic continues to plague the housing market with the index for Existing Home Sales plummeting to its lowest level (3,960k) since October 2010, while the Index's median price of homes increased.* The effects of this dynamic were also felt in the Housing Starts and Building Permits indices where both have trended lower since early last year. Finally, the NAHB's release for the Housing Market Index reflected the heavy toll that elevated interest rates have taken on homebuilders' confidence, as the Index reached its lowest level, 40, since January this year.
- **Focus of the Week:** We look to more housing reports next week which should remain reflective of the current high mortgage/low inventory environment. As such, we expect New Home Sales to be relatively stronger (due to low inventory of existing homes), while Pending Home Sales, a precursor to existing homes sold, to be weaker. In addition, 3Q GDP growth is released on Thursday, and we expect robust growth at ~2.6% QoQ (annualized). Maybe of more importance will be Friday's Personal Consumption Expenditure Price Index Report, which serves as the primary inflation gauge for the Fed, and we expect it to stay unchanged at 3.5% YoY.

### October 23 – October 27

| | | | | | |
|---|---|---|---|---|---|
| MON | | WED | New Home Sales | FRI | PCE |
| TUE | | THU | ECB Meeting<br>GDP (3Q23 1st est.)<br>Pending Home Sales | FUTURE EVENTS | 10/31 S&P/Case-Shiller Index<br>11/1 JOLTS, FOMC presser<br>11/3 Nonfarm Payrolls |

## US EQUITY

- Valuation risks remain top-of-mind for investors, as the upward pressure on oil prices, headline inflation and bond yields weigh on price-to-earnings ratios. Rising interest rates remain a big barrier for stocks to overcome, the flow argument being that competitive yields on shorter-term bonds have delayed the rotation of cash into the stock market for now.
- What should equity-dedicated investors do? On the upside, we continue to recommend the late-cycle Energy sector as a key beneficiary of buoyant oil prices, with any potential escalation of the Israel-Hamas war serving as a catalyst. On the downside, we believe those same forces mean gathering consumer headwinds and a reversal of fortune for the Consumer Discretionary sector. In other words, what's good for oil producers is bad for oil consumers.*
- **Focus of the Week**: Next week is the peak week of the 3Q23 earnings season with 43% of the S&P 500 market cap reporting results highlighted by mega caps MSFT, META, GOOG, and AMZN. These results, and more important, the forward guidance for Q4 will likely drive sentiment for the remainder of earnings season.

## FIXED INCOME

- The 10-year Treasury yield came within striking distance of the psychologically important 5.0% level this week.* The move higher in yields has gone much further than we expected, with the 10-year Treasury yield up over 60 bps since the Fed's September 19-20 FOMC meeting. Yes, economic data has remained remarkably resilient, but record short leveraged positions, an intense focus on fiscal issues and supply/demand factors have been a bigger driver of the back up in bond yields in recent weeks. The speed of the move has unnerved some policymakers, but Chairman Powell's suggestion that policy rates may not be restrictive enough left open the possibility for further rate hikes if the data warrants.
- In our view, the tightening cycle is coming to an end and as growth and inflation slow in the coming months, yields should begin to move lower. Admittedly, our 3.50% 12-month target appears a long stretch given the current level of yields and a sizeable rally is not likely to occur until the economic data starts to roll over in a meaningful way. But investors should not lose sight that interest rates are the most attractive they've been in decades. If rates can find their footing and stabilize here until the macro fundamentals move back in the driver's seat, bonds offer a good opportunity to earn reasonable income along the way.
- **Focus of the Week:** With supply concerns front and center of investors' minds, the upcoming 2-, 5-, 7- and 20-year auctions will be closely watched for the level of demand, particularly after last week's weak 30-year auction. The Bank of Canada and ECB also have policy meetings next week. No rate actions are expected.

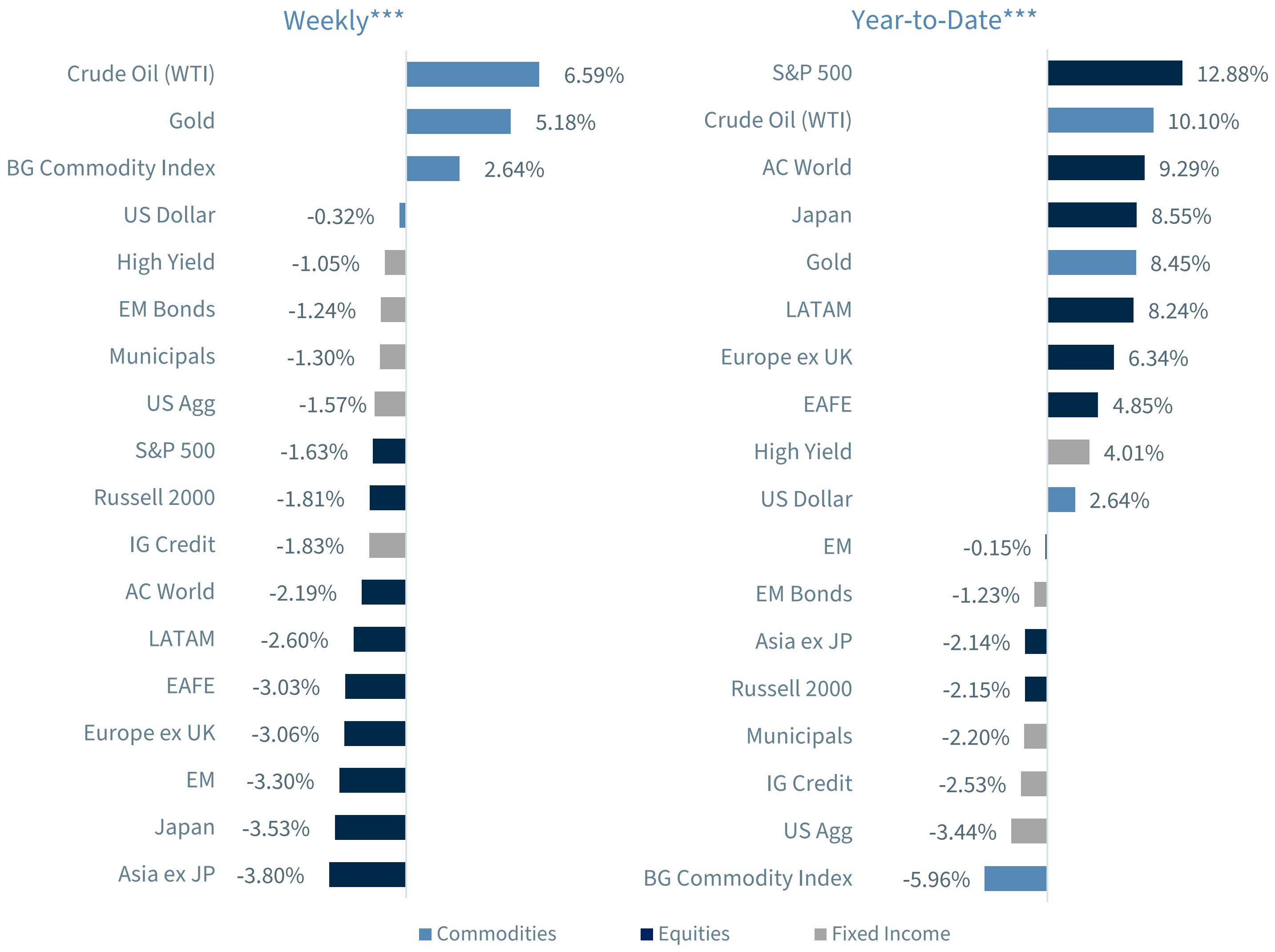
## POLITICS

- On Thursday night President Biden made his first Oval Office address following a visit to Israel and will be submitting a $100 billion request to Congress for additional support for Israel and Ukraine. However, ongoing uncertainty over the status of the Speaker of the House could add uncertainty to the process. Conversations in Congress have now shifted toward potentially granting Speaker Pro Tempore Patrick McHenry (R-NC) greater authority through January 3—which could raise the likelihood of successfully passing supplementary defense funding and stopgap government funding ahead of the November 17 deadline. House Judiciary Chair Jim Jordan (R-OH) remains in the race following several unsuccessful floor votes. At this stage, we view any additional defense funding as likely to be started in the Senate, with early indications from the Senate signaling a preference to tie Israel, Ukraine, Taiwan, and border actions together in a comprehensive bill.

## ENERGY/SECURITY

- Iran's sponsorship of Hamas means a breakthrough on energy with Tehran is unlikely, but a different OPEC member may see easing of US sanctions. This week, the White House signaled that certain sanctions will be lifted from Venezuela's oil industry. However, the fundamental problem with Venezuela's oil industry—whose production has fallen to a level lower than that of the UK—is not pressure from sanctions. Rather, the issue is that many skilled workers of the national oil company have fled the country amid record-setting inflation and political chaos. Likewise, following the past decade's nationalization/confiscation of energy assets owned by some international companies, it is difficult to imagine them wanting to return.

## Asset Class Performance | Weekly and Year-to-Date (as of October 19)**



# Weekly Data**

Data as of October 19

**US Equities**

| Index | Price | Weekly | MTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|---|
| S&P 500 | 4278.0 | (1.6) | (0.2) | 12.9 | 17.7 | 9.4 | 11.0 | 11.5 |
| DJ Industrial Average | 33414.2 | (0.6) | (0.3) | 0.8 | 9.8 | 5.8 | 5.6 | 8.1 |
| NASDAQ Composite Index | 13186.2 | (2.9) | (0.3) | 26.0 | 23.5 | 4.7 | 12.1 | 12.9 |
| Russell 1000 | 4498.3 | (1.7) | (0.4) | 12.5 | 21.2 | 9.5 | 9.6 | 11.6 |
| Russell 2000 | 4231.6 | (1.8) | (4.6) | (2.1) | 8.9 | 7.2 | 2.4 | 6.6 |
| Russell Midcap | 6931.5 | (1.9) | (2.5) | 1.3 | 13.4 | 8.1 | 6.4 | 9.0 |

**Equity Sectors**

| Sector | Price | Weekly | MTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|---|
| Materials | 480.1 | (2.1) | (2.9) | (0.4) | 10.7 | 7.4 | 9.9 | 8.0 |
| Industrials | 843.9 | (2.8) | (1.6) | 2.8 | 15.3 | 9.2 | 8.4 | 9.5 |
| Comm Services | 229.9 | (0.7) | 3.7 | 45.6 | 38.6 | 6.3 | 9.6 | 7.1 |
| Utilities | 297.8 | 0.0 | (0.5) | (14.8) | (5.0) | 0.5 | 4.8 | 8.0 |
| Consumer Discretionary | 1216.6 | (4.3) | (3.7) | 21.9 | 10.5 | 0.2 | 8.5 | 10.8 |
| Consumer Staples | 713.5 | 2.0 | (1.8) | (6.4) | 2.2 | 4.8 | 7.8 | 8.2 |
| Health Care | 1497.9 | (0.6) | (0.1) | (4.2) | 4.8 | 8.4 | 9.0 | 11.3 |
| Information Technology | 2951.8 | (3.0) | 1.6 | 36.9 | 40.6 | 13.3 | 20.5 | 20.1 |
| Energy | 703.3 | 4.8 | 1.3 | 7.5 | 12.5 | 52.9 | 10.5 | 4.8 |
| Financials | 544.3 | (1.2) | (1.3) | (2.9) | 5.2 | 12.2 | 6.5 | 9.0 |
| Real Estate | 206.3 | (4.0) | (3.2) | (8.5) | (1.2) | 1.0 | 4.2 | 6.1 |

**Fixed Income**

| Index | Yield | Weekly | MTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|---|
| 3-Months Treasury Bill (%) | 5.4 | 0.1 | 0.3 | 4.0 | 4.8 | 1.8 | 1.7 | 1.1 |
| 2-Year Treasury (%) | 5.2 | (0.1) | 0.1 | 1.2 | 2.1 | (1.2) | 0.8 | 0.6 |
| 10-Year Treasury (%) | 5.0 | (2.1) | (3.0) | (6.3) | (3.2) | (9.3) | (0.9) | 0.1 |
| Bloomberg US Corporate HY | 9.6 | (1.1) | (1.7) | 4.0 | 7.5 | 0.7 | 2.8 | 3.9 |
| Bloomberg US Aggregate | 5.7 | (1.6) | (2.3) | (3.4) | 0.3 | (5.9) | (0.2) | 0.8 |
| Bloomberg Municipals | -- | (1.3) | (0.8) | (2.2) | 1.0 | (2.5) | 1.0 | 2.2 |
| Bloomberg IG Credit | 6.4 | (1.8) | (2.5) | (2.5) | 3.0 | (5.9) | 0.7 | 1.9 |
| Bloomberg EM Bonds | 8.5 | (1.2) | (2.1) | (1.2) | 7.1 | (5.2) | (0.0) | 1.9 |

**Commodities**

| Index | Price | Weekly | MTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|---|
| WTI Crude ($/bl) | 88.4 | 6.6 | (2.7) | 10.1 | 4.6 | 29.1 | 5.0 | (1.3) |
| Gold ($/Troy Oz) | 1980.5 | 5.2 | 6.1 | 8.4 | 21.2 | 1.2 | 10.0 | 4.2 |
| Bloomberg Commodity Index | 106.1 | 2.6 | 1.2 | (6.0) | (4.6) | 13.0 | 4.3 | (1.9) |

**Currencies**

| Currency | Price | Weekly | MTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|---|
| US Dollar Index | 106.3 | (0.3) | 0.0 | 2.6 | (6.0) | 4.4 | 2.1 | 2.9 |
| Euro | 1.1 | 0.1 | (0.2) | (1.0) | 7.9 | (3.6) | (1.7) | (2.6) |
| British Pound | 1.2 | (0.6) | (0.5) | 0.9 | 7.9 | (2.2) | (1.4) | (2.8) |
| Japanese Yen | 149.9 | (0.1) | (0.5) | (12.0) | (0.1) | (11.1) | (5.6) | (4.2) |

**International Equities**

| Index | Price | Weekly | MTD | YTD | 1 Year | 3 Year | 5 Year | 10 Year |
|---|---|---|---|---|---|---|---|---|
| MSCI AC World | 649.3 | (2.2) | (1.1) | 9.3 | 17.5 | 6.1 | 8.0 | 7.6 |
| MSCI EAFE | 1979.0 | (3.0) | (2.5) | 4.9 | 20.9 | 4.6 | 4.5 | 3.7 |
| MSCI Europe ex UK | 2185.5 | (3.1) | (2.6) | 6.3 | 24.2 | 4.8 | 6.1 | 4.4 |
| MSCI Japan | 3329.8 | (3.5) | (2.7) | 8.5 | 22.3 | 1.9 | 3.1 | 4.3 |
| MSCI EM | 930.8 | (3.3) | (2.3) | (0.2) | 10.8 | (3.4) | 2.0 | 1.7 |
| MSCI Asia ex JP | 592.3 | (3.8) | (2.0) | (2.1) | 12.1 | (5.0) | 2.4 | 3.2 |
| MSCI LATAM | 2192.8 | (2.6) | (4.6) | 8.2 | 7.5 | 12.2 | 1.3 | (0.4) |
| Canada S&P/TSX Composite | 14090.8 | (0.8) | (1.0) | (0.2) | 3.6 | 5.9 | 4.6 | 3.9 |

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