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Hard Landing or Soft Landing?

Global Markets and Regions

	3rd QTR	2023 YTD
US	-1.90%	13.50%
Developed Europe	-3.60%	8.60%
Asia	-2.50%	4.10%
Emerging Markets	-2.50%	2.20%

US Markets

	3rd QTR	2023 YTD
Dow 30	-1.30%	2.70%
Large Cap Cos.	-3.26%	12.96%
Mid. Cap Cos.	-4.33%	4.09%
Small Cap Cos.	-4.88%	0.88%
Bonds	-3.20%	-0.96%

What kind of Recession are we going to get; hard or soft? The near-term fate of stock and bond markets hinge on the outcome. We are presently experiencing a déjà vu moment in the markets where stocks and bonds decline together as interest rates rise and the Federal Reserve reiterates its intention to keep conditions tighter for longer. How will the economy hold up this time around? What will be the impact on corporate earnings? We are seeing that commercial credit availability is contracting. Home affordability is still an issue. Higher interest rates have made consumer credit levels appear unsustainable, but nothing has really broken yet.

Macro-economic statistics are contradictory, but contain enough positives to balance the negatives. We have the Federal Bank, the US central bank, actively trying to slow the economy down. They are trying to finesse some sort of recession with the goal of taming inflation. Globally, central banks are engaging in similar strategies. Their economies are either in recession or fluctuating between recession and no or low growth.

The World Trade Organization (WTO) has warned that Central Banks run the risk of triggering a full-blown Global recession with interest rate polices intended to reach their 2% inflation targets. Corporate earnings are the obvious collateral damage along with stock prices. Investors have to deal with volatility. It could only be a matter of time before Central Banks break markets.

Longer term trends are also becoming more of an immediate concern to markets. The inflation that is currently driving market volatility is primarily a consequence of the tsunami of government spending starting, but not ending, with Covid Pandemic spending. The Federal Reserve didn't authorize the government spending and the continuing government spending, but it has become their job to clean up the excesses, the most obvious of which is inflation.

Their tools are higher interest rates and other restrictive monetary policies. If inflation is primarily a monetary phenomenon, The Federal Reserve has largely achieved their goals by dramatically reducing M-2 money supply and bringing the inflation causing surplus closer to being in balance. Headline inflation is actually beginning to fall. At this point, inflation is not driving interest rates higher -- the Federal Reserve is.

This is not a new game and has going on both in the US and globally for a long time and in earnest for the last 15 to 20 years. Markets are beginning to worry about the cumulative long-term consequences of these policies on the core health of the broader economy. This worry is exacerbated by the glaring dysfunction of the US political system. I guess we can take some comfort in the fact that the rest of the world is worse.

Over all, the US economy has held up pretty well through all of this. We are still the largest, most fully integrated economy in the world. How we do matters to everyone. We are entering earnings season, which is where the consequences of all the market's concerns are revealed. Right now, forecasts are for modest continued earnings growth. That would be a calming development. Markets get volatile when surprised. We saw that in the first quarter of this year when a few otherwise "healthy" banks suddenly failed. They proved unable to successfully navigate the Federal Reserve's unprecedented rapid hike of interest rates. It turned out to be a bank specific issue and not a system wide issue.

Unprecedented may be getting a bit over used in describing events, but it isn't inaccurate. After last year's vicious bear market, a boring predictable earnings season would be welcome.

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