BBA Monthly Promontory

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BRAUN-BOSTICH & ASSOCIATES
WEALTH TRANSFORMED

January 2019

The Recession that Refreshes

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The spasms of buying and selling we are grappling with today have little to do with a still-vibrant domestic economy than it is about fear.

Like the weather, economic cycles, have become hazardous and highly unpredictable. As this space has argued in the past, our $300 trillion financial economy (source: Deutsche Bank) - the estimated value of global foreign exchange transactions, which dwarves the world's global output of goods and services of some $65 trillion (source: Bundesbank) - has produced ruinous asset bubbles that have vexed both the Federal Reserve Bank and financial regulators.

Decades ago, when manufacturing was a primary growth engine, the Fed managed economic cycles by raising and lowering interest rates and bond yields moved accordingly. During the expansionary phase of the five major recessions from 1954 to 1975, for example, the yield on the 10-year Treasury bill rose as the Fed raised interest rates to preempt economic, and, in turn, asset inflation.

Since then, the financial-economy tail has been wagging the brick-and-mortar economy dog. Because its late-cycle excess does not figure in data like retail sales, or goods and services-based inflation figures, the consequences of asset bubbles have been particularly malign.

The double-dip recession of the 1980s was the longest and deepest on record among post-war contractions; the early 2000 recession, a product of the tech bubble, spread through much of US industry and the recovery that followed was generally jobless; the last recession was the most damaging economic crisis in nearly a century. And from the looks of things, some investors are preparing for just another reckoning.

Let me be clear. Not only do we at Anfield anticipate steady growth this year, we are taking advantage of market volatility to scoop up undervalued assets.

My point is the spasms of buying and selling we are grappling with today have little to do with a still-vibrant domestic economy than it is about fear: of the end of cheap money after a decade of record-low interest rates; of divided government and outraged constituents (which stripped of our human recency bias is much more the norm than we are all willing to admit); of slowing growth and political risk in strange parts of the world; and, perhaps most acutely, of failure by the Fed to tame a mutant economic cycle before it turns out as its recent predecessors did.

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If this benign outlook holds, we regard the end of this historically long economic expansion as less of a recession than a pause that refreshes.

Of course, these are valid concerns. There is, however, every reason to believe that the next recession will be a mild one. For one thing, the economy is already showing signs of a deliberate slowdown, as if it was looking for a place to land, ideally softly. At the same time, the markets are refreshingly free of the kind of toxic instruments that brought down investment banks, property developers and both mature and emerging markets, like a reaper. The only asset class that comes close this time around is the $1.3 trillion global leveraged loans market, which has become popular among companies that are heavily indebted or have weak credit ratings. Thankfully, however, the Fed, along with JPMorgan, the International Monetary Fund, and other parties have proactively identified leverage loans as “excessively speculative instruments.”

Speaking of the Fed, we believe the Powell doctrine - the chairman’s sustained administration of modest interest rate hikes - will be vindicated as the world’s largest economy normalizes monetary policy. More than ever, we support the bedrock principle of Fed independence and proactivity.

If this benign outlook holds - and we are prepared for a variety of scenarios - we expect the eventual end of this historically long economic expansion will be less of a recession than a pause that refreshes as we prepare for the next ascent. But, as Russell Crowe put it in Gladiator, “but not yet... not yet.”

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