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Booms & Busts Report

It is clear now that, when the bean counters, later this year, announce a Recession, they will likely point to **this quarter** as to when it started.

Germany (4th largest economy and 2nd or 3rd largest manufacturing nation) is already in Recession. Its economy has been contracting since Q3 2022.

Is your investment/pension portfolio prepared?

Shares and Corporate Bonds are teetering on the edge of the cliff, hanging by their fingertips. So, that's probably 80% of your overall portfolio then...

So how bad is it, Jonathan - you may ask (warily and suspiciously and/or laughingly)?

Shockingly bad.

AT LEAST AS BAD AS 2008!
The difference though is, then, it was primarily a financial markets' crash. The actual economy didn't fare terribly badly.

This time it's markets AND the economy! (Your portfolio AND your business / job!)

This is the May 2023 Booms & Busts Report. I publish these, free, every two months.

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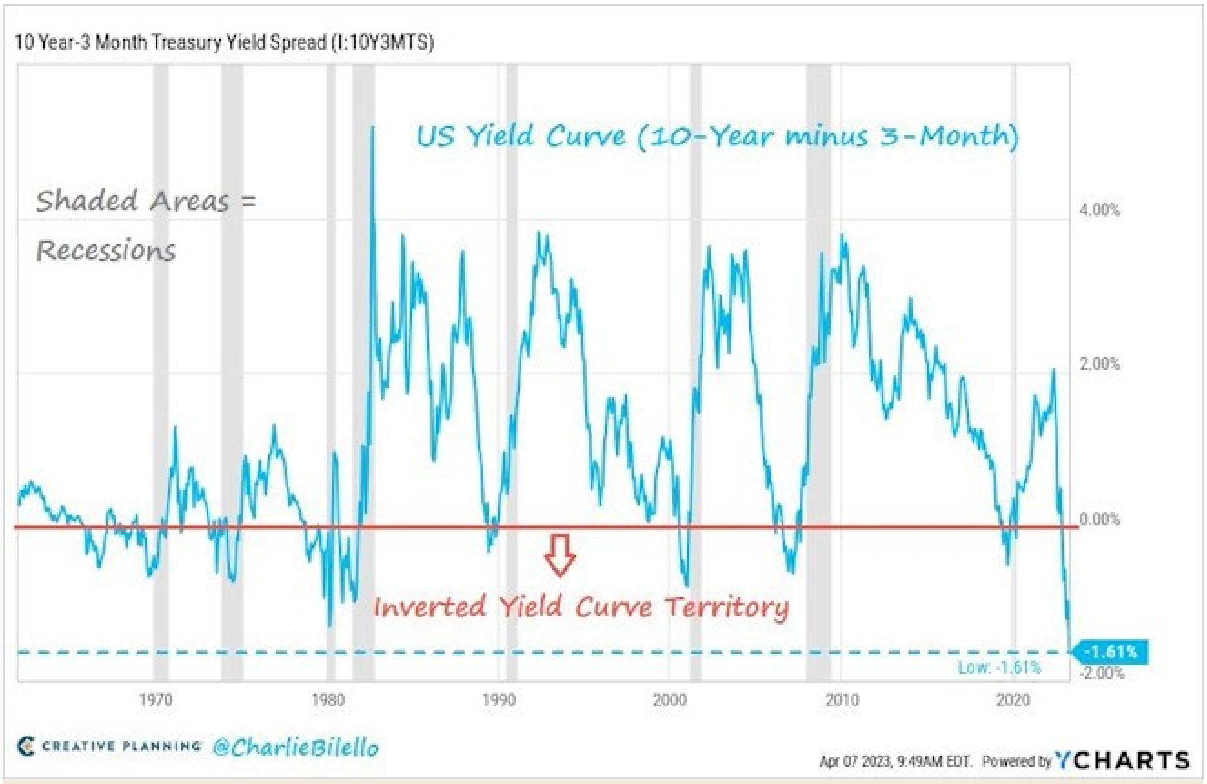
In this edition of The Booms & Busts Report:

- **Yield Curve**
- **Recession**
- Germany
- Extremely tight money
- Jobs, hours worked
- Bankruptcies
- Corporate Profits
- Mortgages
- Small Caps Vs Mega Caps
- What can you do?

Ayn Rand:

"We can ignore reality, but we cannot ignore the consequences of ignoring reality."

HUGE Inverted Yield Curve



When the long term borrowing rate falls below the short term rate, we call it Inverted, as you would normally expect long term rates to be higher than short term rates.

The above is the US Government 10 YEAR borrowing rate Vs the 3 MONTH (effectively the Cash - ie the Base or FED Funds) rate.

Except for once, in the 1960s, every other time the yields inverted, within around a year, there was an economic recession (the grey columns). So that's seven out of eight times the yield curve inversion forecasted, correctly, a recession.

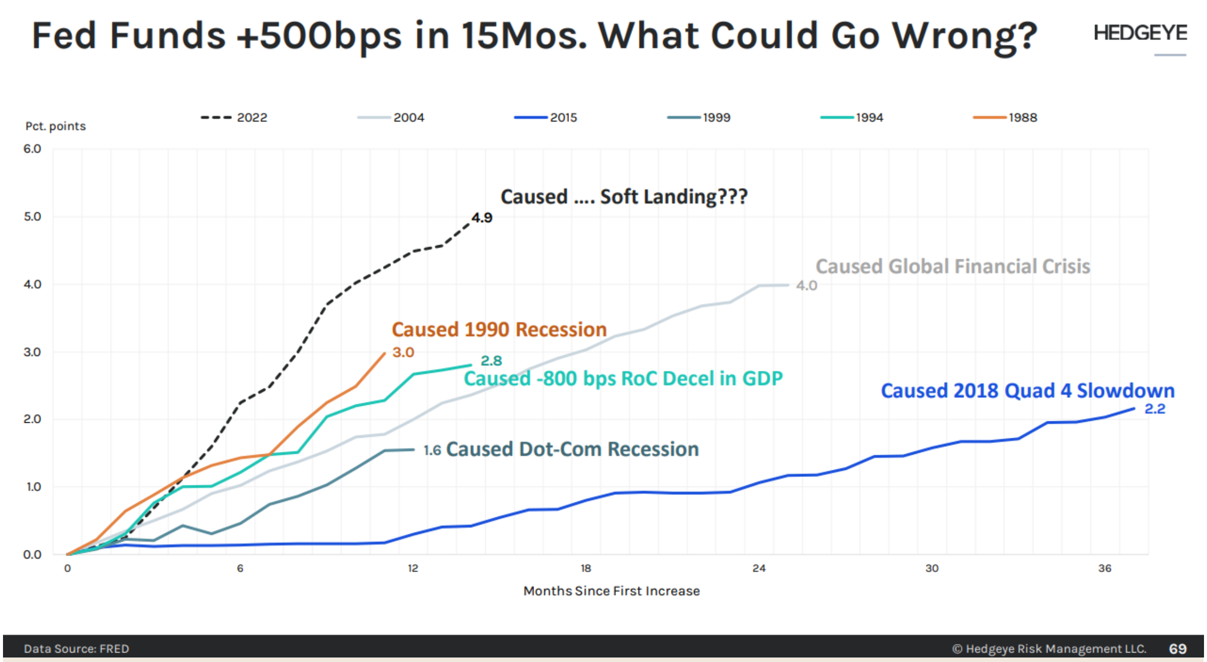
In the current cycle, the yields inverted last July. So that's the best part of a year.

Note also, ominously, **the yields are more inverted than at any time since the 1960s!** The financial markets fear, greatly, what is coming.

A recession is coming... assuming it's not already here. It will be a doozy. YOU HAD BETTER BE PREPARED.

Look, you can't have a society, that only survives on oceans of debt, then raise the short term rate, from 0% to 5% - in the US but is there anywhere materially different? - in just 14 months and it doesn't create enormous financial and economic pain.

US FED Funds Rate (Base Rate) and past recessions.



The above shows the current move in short term rates (in black dotted) and the last cycles' rate rises and what happened, as a result. See top bar legend.

You will note we have just had the steepest and largest rate rise in decades...

And the shills - the media (especially the arch misinformers BBC and Facebook), the politicians, the bankers, the property people, and of course central bankers - all tell us we will have a 'Soft Landing'. Laughable, if it wasn't so serious how they are outright lying. (What else do they lie about?)

Germany, for example, has already had two consecutive negative GDP prints (falling size of the economy) in Q4 22 and Q1 23. Thus, they say that Germany has officially entered recession. Surely, therefore, that means the whole of the EU is in recession or on the brink of.

Had you heard that the largest economy on our continent is in recession? How is that even possible, if you hadn't?

The same practically everywhere.

We are in or heading to a global economic recession. This will be the first in some 20 years. It's long overdue.

They say the 2008 crash (the so-called Great Financial Crash) was caused primarily because the banks stopped lending on home mortgages. House prices crashed so banks lent less. Vicious spiral. We had 'tight money'. Not 'loose' as we have had for most of the last 45 years.

Do you believe we have had huge house price growth because we are an island? So is Australia.

Because of a dense population. So is India.

Or large land masses can't have house prices soar for 'ever'? Australia!

Demand? But no one can define what it means.

Too little building? In the UK, we'd have to build 10 million homes for it to have a material and sustainable downward effect on prices. Do you want that?

Without a) easy / loose money AND b) decades of falling borrowing rates we would not have had the house price explosion of the last...45 years.

Take one away and house prices rise more slowly or stop rising.

Take both away and house prices fall.

House prices have been falling for months.

In the US, there is a national vacancy rate of around 23% of Commercial Real Estate (CRE) space, in the METRO areas (cities and more densely populated).

Twenty Three Percent.

Currently, no rent is being received on over 20% of all the important CRE space in the US. Just think about that.

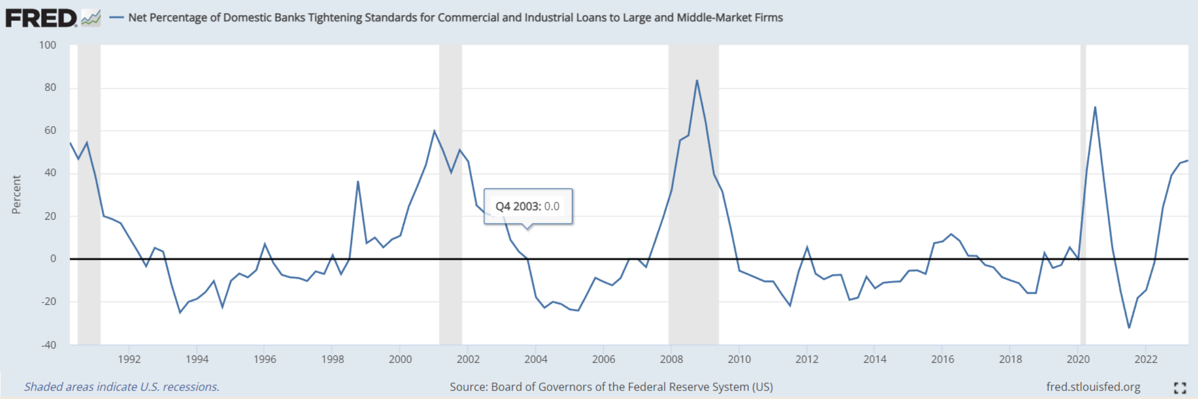
What does that do to landlords' wealth? Ability to pay commercial mortgages? To property funds? To Private Equity, which holds some 30% of all US CRE.

To Banks. Smaller banks (up to $250 Billions of assets - hardly small) hold 70% of the US CRE mortgages. Hence, why bank after bank, since March, has just being going bust. There will be more. Many more probably.

By two years from now, a whopping $1,500Billions ($1.5Trillions) of CRE mortgages need to have been reset. Not going to happen if there's no rent, negative equity and / or the bank has gone bust.

Far too little, far too late, the banks have been tightening the lending.

Federal Reserve data of bank lending standards



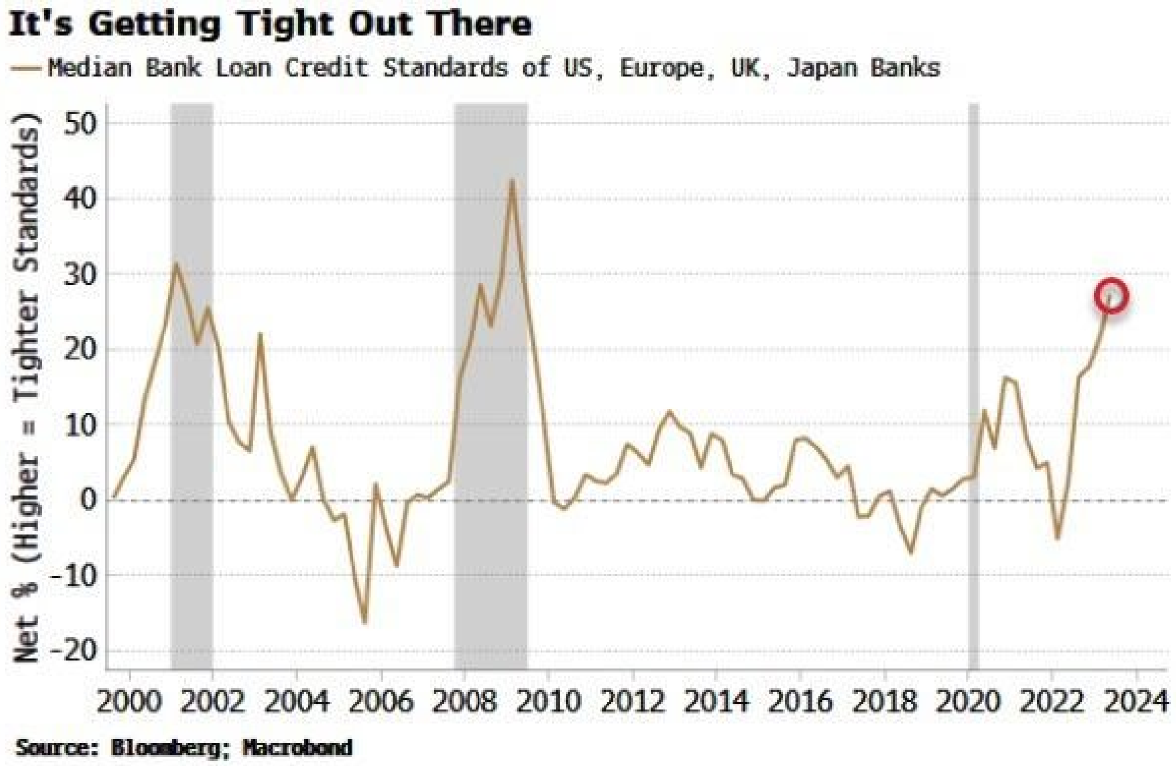
Since the beginning of last year, bank lending standards have been tightening. A year later, the banks start going bust (hence, too little, too late).

Lending standards are now practically at recessionary levels (grey columns denote recessions). You will note that, since the late 1980s (the history of the data) bank lending standards have been far more loose than tight. But when they tighten they tighten far harder than they are ever loose.

If banks aren't lending as they were then this has a detrimental effect on property and on the economy. This is what you get when you live in a society dependent on oceans of debt.

Just the US?

Tight lending across the world.

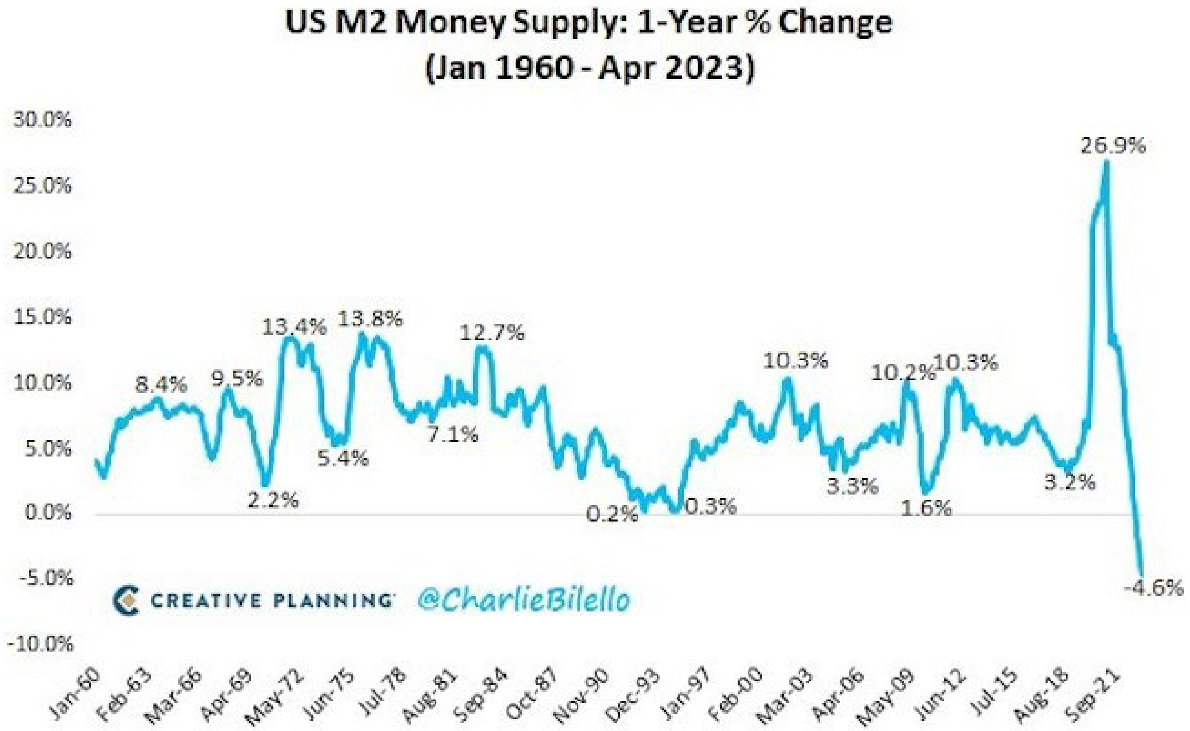


It's the same right across the developed world.

Rising borrowing rates and falling lending. The perfect couple for economic recession.

Liquidity, in general, is tighter that at any time in our lifetimes.

The **US Money Supply** has fallen 4.6% over the last 12 months, the largest year-over-year decline on record (M2 data goes back to 1959). In fact (not shown), this is the fastest pace of money supply destruction since **January 1933**.

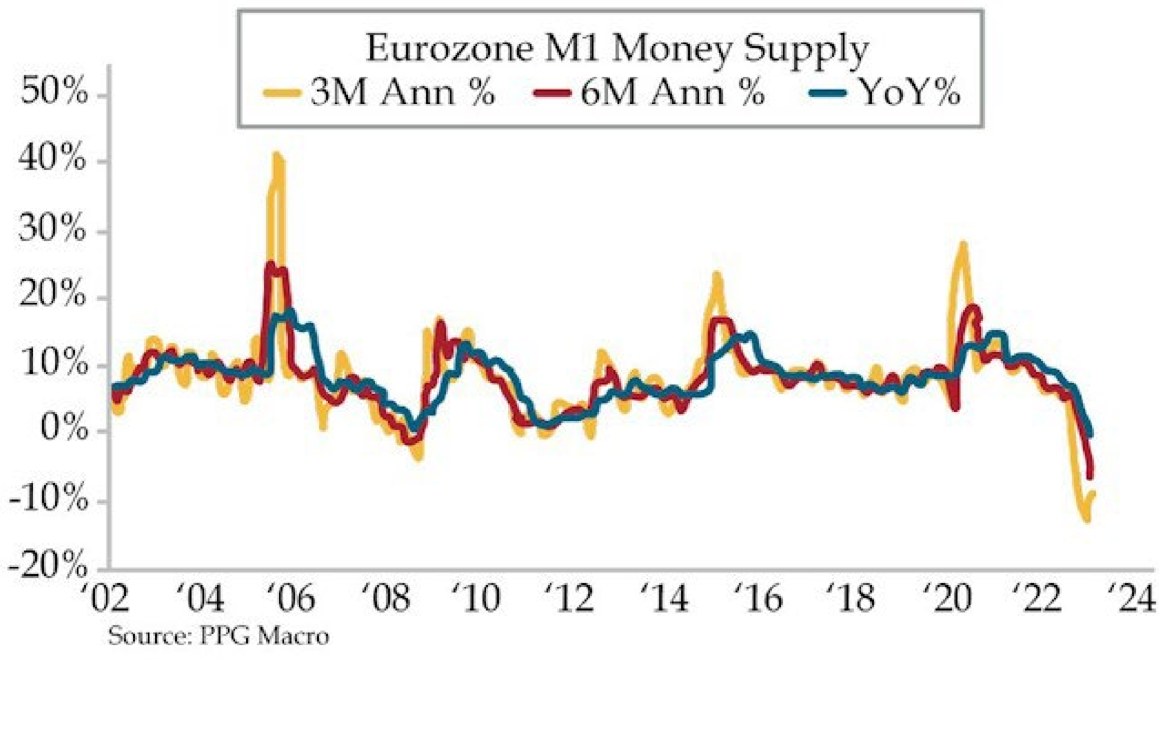


Tightest money since 1933.

We haven't had a fall in the supply of money in over 60 years.

Only in America?

EU Money Supply

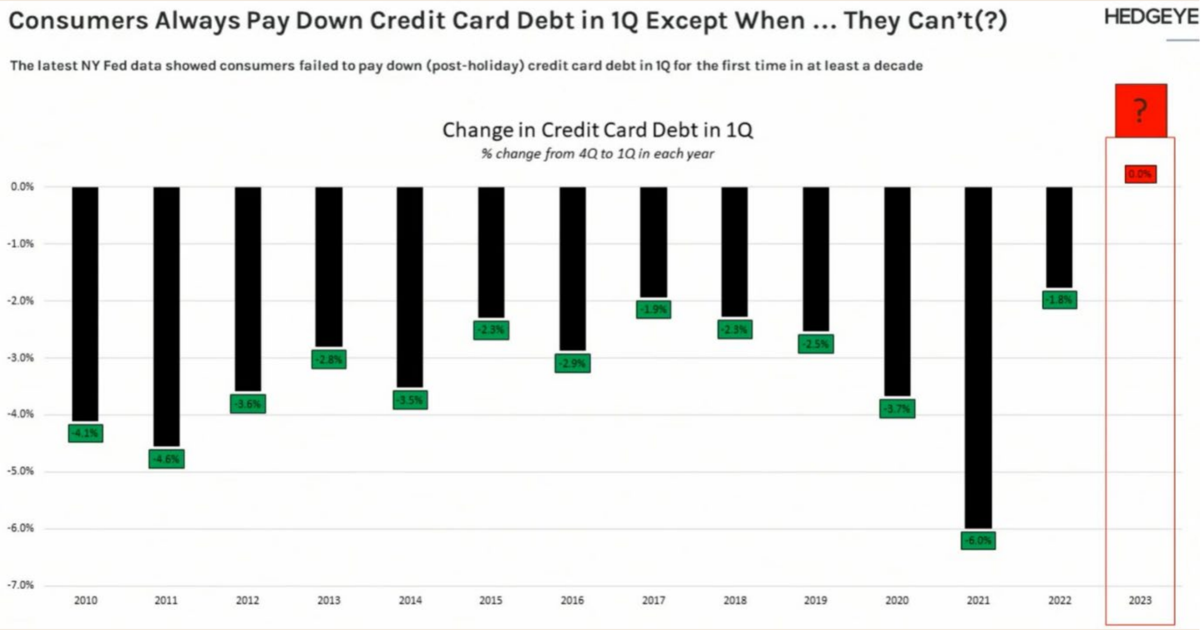


EU Money Supply has just gone negative, year on year (in blue) and heading further down. It hasn't been negative since the data started being collected 20 years ago.

Still believe we are in for a soft landing?

Consumers are of course feeling the pinch. You will recall I informed you 50m new credit cards were taken out last year, in the US, for a population of 325m. And, of course, last year is when borrowing rates soared.

US Credit Cards balances not being paid down!



Every year, from 2010 to 2022, credit card balances were paid down/off in Q1, after employees received their Xmas bonuses etc, the self employed worked out their year's profits.

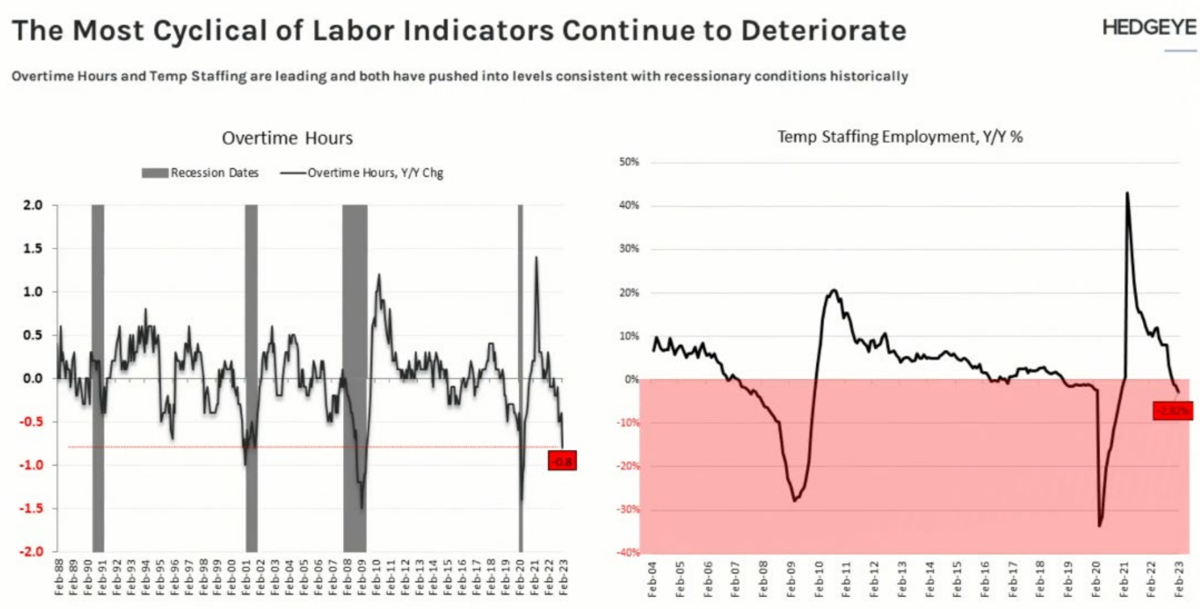
Not in 2023. Balances rose.

Surprise surprise, consumers' bad debts to banks on credit cards and car financing have soared. Up 70% over the last year.

So banks are being hit by commercial AND household borrowers. So far, unemployment hasn't risen, according to the bean counters. (I believe it has, as you will see below.) WHEN it does, officially, watch residential mortgages go bad as well!

Heading to recession, three things occur in the jobs market:

1. First, the number of hours worked / overtime plummets. Experienced staff are kept on, with lower pay. The last thing an employer wants to do is get rid of quality employees.



Overtime hours worked are falling year on year. As we have seen for each of the last four recessions.

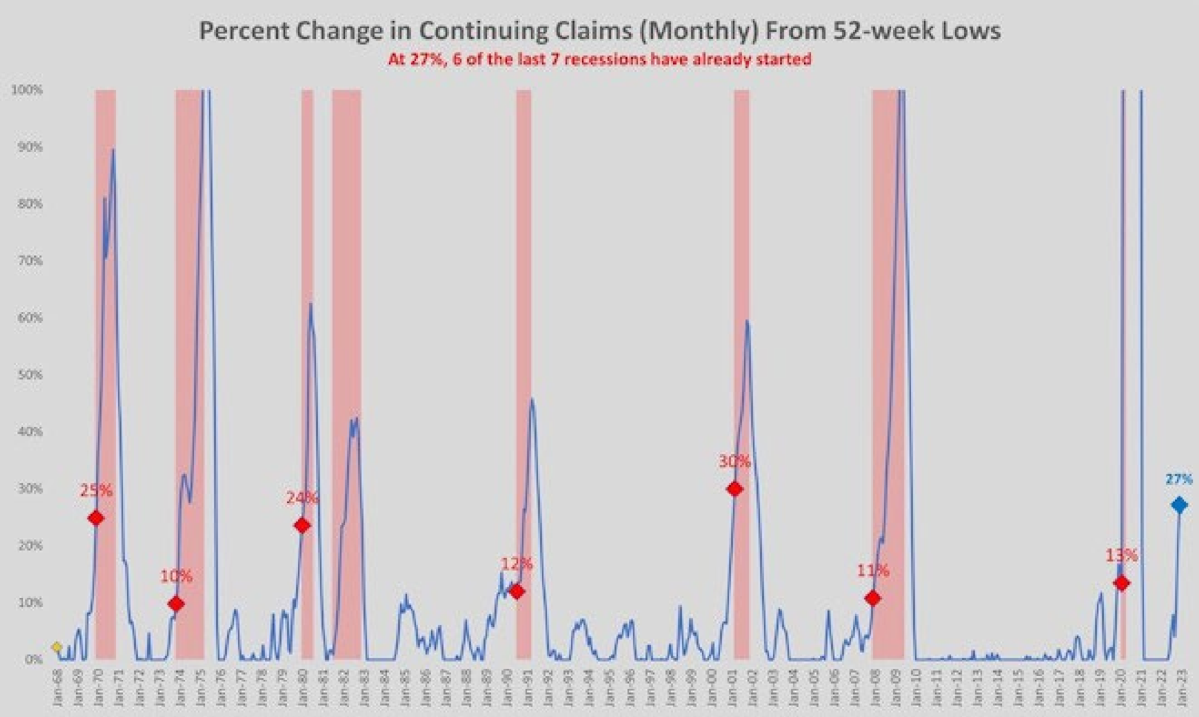
Also, temporary staffing is falling, year on year. As in the last two recessions.

The above charts are only up to February, when the data was most recently updated. These statistics will get very much worse and, likely, have done already, in the last three months.

2. Job Vacancies fall. If there is less work, there is no need to seek new staff.

3. Unemployment rises / soars. Only after everything else has been cut or made more efficient do companies eventually let quality / experienced staff go.

Then you know you are in recession. Of course, you may been in recession already but you didn't know it.



Continuing Claims are those for insured unemployment benefits. The red diamonds indicate when recessions started. As it says, we are now at 27% off the lows and, by or before that level, 6 of the last 7 recessions had started. We will go much higher than 27% higher.

Likely, the recession has already started.

Why is he showing us eight bankruptcies in a month? Big deal!

In May 2023 - so far - eight bankruptcies of at least $500M!
Do you think they employed a few people, now not working?

And five each in April and March. 27 so far this year.

27 companies with bad debts of over $500m have gone bust just in the last four to five months. And there's a lot more to come.

And then add on all the others below $500m.

How does that affect the banks?
Lending?
Mortgages?
Unemployment?
Retail sales?

The economy?

Well, it's obvious.

Corporate profits are falling (obviously). Nearly all listed companies have reported quarterly results and the aggregate is a sizeable fall in profits year on year. Down some 20%.

Do you think there might be 'an event' similar to the bankruptcies of AIG and Lehman Bros about to occur?

Or perhaps just many, many Northern Rocks and Bear Stearns?

It's not going to end until it ends. And there is NOTHING on the horizon, looking like it's riding in, wearing a white hat and packing a silver 45 Smith & Wesson.

Even US Federal tax receipts are falling, year on year. Down 6% at this point. This only happens in recessions, looking back over 60 years.

One final point.

I was asked if we are heading to Economic Depression.

Actually, we have been in Depression for over 15 years. Defined as Slow or No Growth over an extended period.

And any growth we have had has come from... more and more and more debt - household, corporate and of course government - and huge net immigration.

You can achieve anything with a huge increase in the population and huge increase in debts.

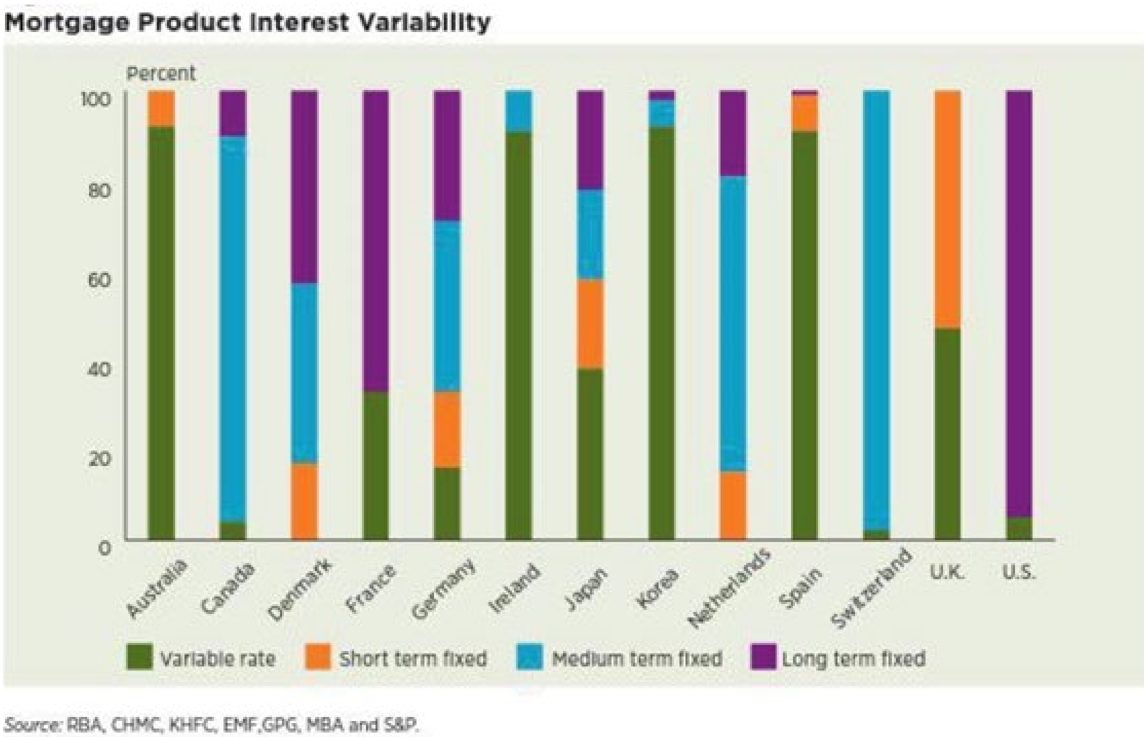
Except, as we know, better transportation, healthcare, education, housing, equity, societal harmony, standards of living etc...

Enough of the recession.

In a sense.

Mortgages.

I found this to be a fascinating chart. It compares various countries' approaches to mortgage debt.



What we see are how short or long terms are mortgages in various countries.

In Australia, the first country shown, almost all mortgages are variable rates.

Whereas the US, on the other end, almost all mortgages are long term fixes (30 years, normally).

Short term fix means 2 or 3 years.
Medium term means 5-10 years.

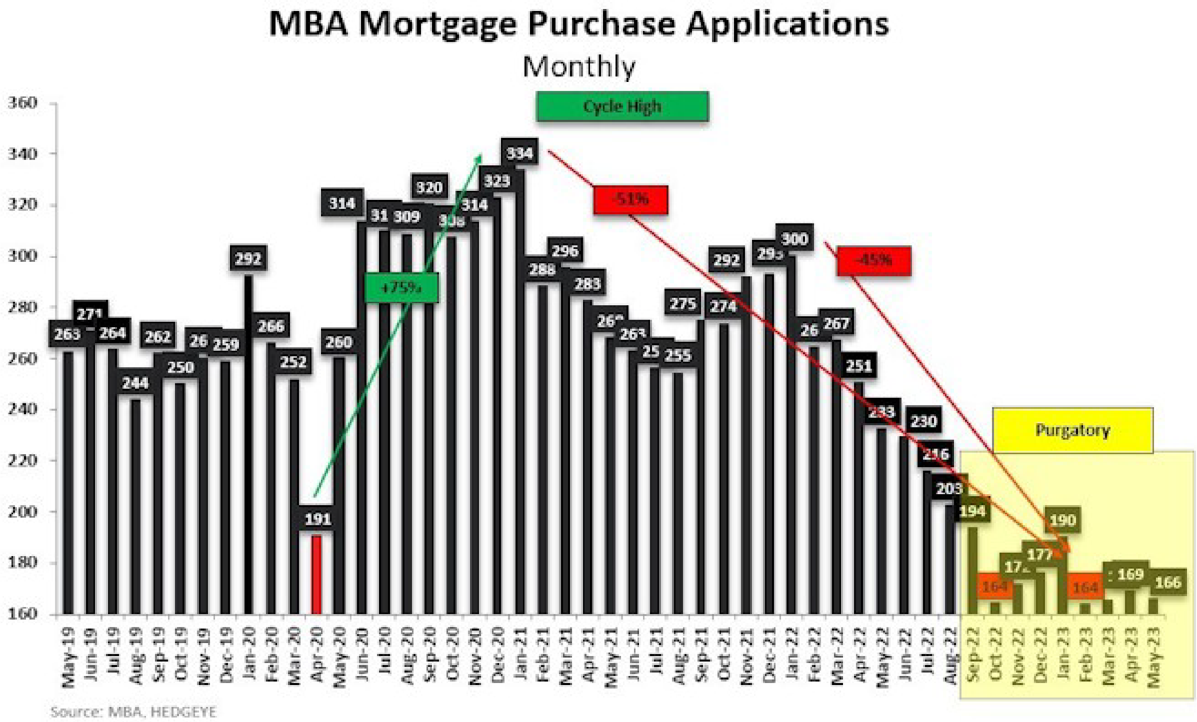
Ireland, Korea and Spain are also primarily variable rates.

The UK is short to medium term fixes, entirely.

In other words, you would expect the countries on variable rates to see their house prices tumble, as rates have soared in the last year. And their economies to be hit hard too.

Switzerland, Canada (largely), France and the US mortgage market should not be hit so badly, unless unemployment soars... which it probably will. The fact is, if your borrowing cost is fixed at a very low rate, for several or many years you should be ok but pulling out the stops and tightening belts. Their economies won't be saved if mortgage holders spend less but at least homes will not be taken back so much as elsewhere is indicated.

It also means that most folk will not be able to trade up. They will be forced to stay in those homes for a very long time.



The number of mortgage applications has plummeted over the last year. Why would you leave a mortgage at sub 2% and, voluntarily, take on a different mortgage, above 4%? You wouldn't. So, you stay put.

There will be a year or three of reckoning for British mortgage holders. This and next year their fixes will come to an end and they will have to remortgage at much higher rates. Not pretty if you previously maxed out your mortgage and/or you are earning less now or unemployed, or both...

This state of affairs will continue for years as 5-year fixes end. Negative for consumer spending for years.

In the next six months, over a million mortgages will come off the low fix. They are on sub 2% rates. They should expect them to reset above 4%...

Incidentally, the US Dollar Index (against a basket of currencies) has risen 4% over the last few weeks. It appears to be resuming its bull market which paused several months ago.
When financial markets' participants are nervous they sell 'shares' and go to Cash. Global participants go to their currency of choice when they have a negative outlook for shares - the US Dollar.

Well, fine Jonathan but I'm ok thanks. My investment/pension portfolio is up so far this year. My investments must be insulated, somehow. (I don't really understand them but my guy says I have nothing to worry about. And things ARE better than last year.)

Is that really what you're thinking?
With your retirement pot, you are this cavalier?

Or, you are thinking - well what can I do about it?

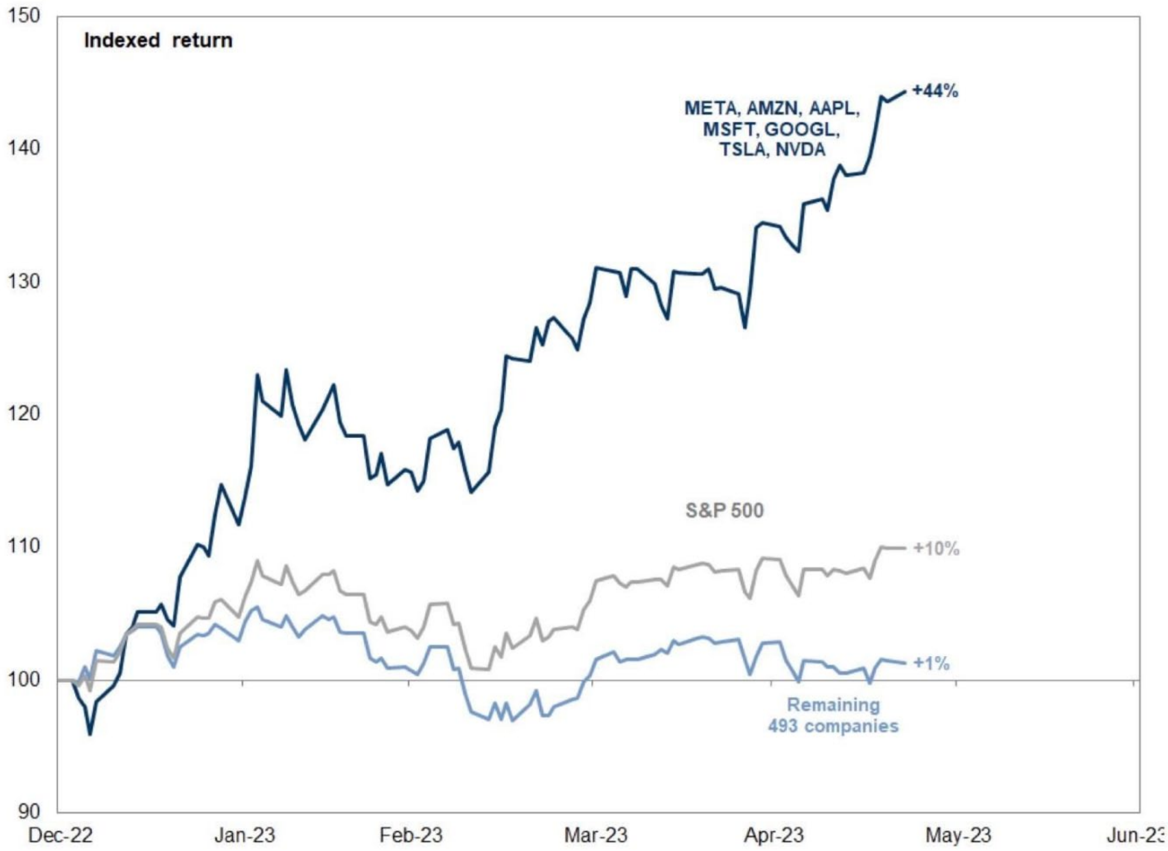
Look at the 'stock market'. Here, depicted as both the mega cap **S&P 500** and next 2000 companies, **Russell 2000**, indices.

These indices are broadly similar to the FTSE 100 and the FTSE 250 in the UK.

Since two years ago, the Russell is down markedly. These companies represent well the actual US economy. The index, now, is at lows. There is a major leg down still to come.

The mega cap companies index, the S&P 500, is back up, quite strongly, since the end of last year. Hence, your exposures to large corporates have helped your portfolios. You believe they will stay up? Does your guy believe they will stay up? (If so, get a new guy.)

Look deeper into the S&P 500.



Since December, 493 of the 500 are flat (well ok, up 1%).

Seven of the 500 are up 44%. These seven are a huge weighting in the index. Microsoft and Apple, together, make up a huge 14% of the index. Disproportionately, they affect the index due to their relative capitalisations.

Just **last week**, Invidia (a $700Billion company) announced its quarterly results. In the same session, it soared 30%, to nearly a Trillion Dollars. A company that makes just $4Billion a year in profits.

Think about that. A mega cap company - not a $10Million start up - shoots up 30% in one session. $250Billion. Which affects the index as a whole.

How sustainable do you believe all this is?

First, if 'your guy' is telling you all is well then ask him/her about anything above. Then consider the response.

Second, what can you do? Well your guy ought to know.
YOUR PORTFOLIO ADVISER / MANAGER! YOU PAY THEM TO TAKE THE APPROPRIATE ACTIONS.

And the correct response should be: Move to assets that do well in disinflation or perhaps even deflation (by H1 2024).

And do not accept, for one moment, that there is nothing you can do. Not. For. One. Moment.

Or, ask me. It costs nothing to contact me. I'll give anyone half an hour of my time.

Finally, those in the 'hoping and praying' section are looking for the central banks to cut the short term interest rates. That will help, won't it?

Empirically, during a bear market, when the Federal Reserve FIRST cuts rates, on average, the stock market has continued to decline for another 300 days. About a year...

I advise clients on Wealth Advice and Later Life Advice all over GB and, indeed, on four continents.
“We advise you based on what we would do, were we in your shoes, given what we know."
Call me personally to see how we can help you.

I think most folk do not realise the sizeable risks and opportunities in investment markets.
They will. But will they have benefitted or lost from the actions taken?

Follow me on Twitter @j0nathandavis where I frequently comment on current issues, markets and economics and where you will see day-to-day thinking, and sometimes big picture.

Thank you for reading. I hope you found it interest and, perhaps, useful.
If you have any queries over any of the issues raised call me or email by clicking ***here***.

With kind regards

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