MORNING BRIEFING
November 29, 2022

Anxious Index

Check out the accompanying chart collection.

Executive Summary: If the economy is in for a hard landing next year, it would be the most widely anticipated recession ever. The Philly Fed's survey of forecasters, the *WSJ*'s survey of economists, and even the Misery Index that reflects the sum of unemployment and inflation rates point to a recession. … But we think this time is different. There's been no broad-based credit crunch, liquidity is ample, consumer incomes are growing, multi-family housing remains strong, capital spending does too, and fiscal stimulus has been gushing. Real GDP shouldn't contract in such an environment but grow, slowly but surely. We're in the soft-landing camp.

Monday's Webchat. Monday's live webchat covered lots of ground. The only problem is that the charts weren't showing on some participants' computer screens. So I re-recorded it with the charts showing this time. Please find the replay *here*.

US Economy I: Anxious Index Is Anxious About 2023. Yesterday's *Morning Briefing* was titled "2023 Is Coming!" It mostly compared our economic outlook for next year to our perception of the consensus outlook for 2023. The major difference is that the consensus is expecting a hard-landing economic recession, while we are expecting a soft landing. Real GDP is more likely to be up than down next year, but the growth rate is likely to be relatively slow.

Our contrarian instincts give us more confidence in our "growth recession," or "mid-cycle slowdown," scenario. A recession next year would be the most widely anticipated downturn on record. Consider the following:

(1) *Philly Fed's Anxious Index.* The Philadelphia Federal Reserve Bank's *Survey of Professional Forecasters*, which started during Q4-1968, includes the Anxious Index, which is the probability of a decline in real GDP (*Fig. 1*). The survey asks panelists to estimate the probability that real GDP will decline in the quarter in which the survey is taken and in each of the following four quarters. The Anxious Index shows the probability of a decline in real GDP in the quarter after a survey is taken. For example, the survey taken in Q4-2022 yielded an Anxious Index reading of 47.2%, which means that forecasters believe there is a 47.2% chance that real GDP will decline in Q1-2023. That reading is the highest since Q2-

2009. The probability of a recession over the next four quarters was 43.5%, the highest on record (*Fig. 2*).

The Philly Fed notes: “The index often goes up just before recessions begin. For example, the first quarter survey of 2001 (taken in February) reported a 32 percent anxious index; the National Bureau of Economic Research subsequently declared the start of a recession in March 2001. The anxious index peaks during recessions, then declines when recovery seems near. For example, the index fell to 14 percent in the second quarter of 2002, when economic indicators began improving.”

(2) WSJ*’s recession probability survey.* *The Wall Street Journal* has conducted quarterly surveys of economists—in January, April, July, and October—since April 2021. From the mid-1980s through 2002, the survey was conducted twice a year. From 2003 through March 2021, its frequency was monthly. The panel includes more than 70 academic, business, and financial economists, and the makeup of the panel has evolved over time. The name and affiliation of each economist, as well as their latest indicator forecasts, are included in the Excel spreadsheet available with each survey.

According to the *latest WSJ survey* during October: “On average, economists put the probability of a recession in the next 12 months at 63%, up from 49% in July’s survey. It is the first time the survey pegged the probability above 50% since July 2020, in the wake of the last short but sharp recession. Their forecasts for 2023 are increasingly gloomy. Economists now expect gross domestic product to contract in the first two quarters of the year, a downgrade from the last quarterly survey, whereby they penciled in mild growth. On average, the economists now predict GDP will contract at a 0.2% annual rate in the first quarter of 2023 and shrink 0.1% in the second quarter. In July’s survey, they expected a 0.8% growth rate in the first quarter and 1% growth in the second. … Economists’ average forecasts suggest that they expect a recession to be relatively short-lived. Of the economists who see a greater than 50% chance of a recession in the next year, their average expectation for the length of a recession was eight months. The average postwar recession lasted 10.2 months.” (The survey of 66 economists was conducted on October 7–11.)

(3) *Misery Index.* The Misery Index is the sum of the unemployment rate and the yearly percent change in the Consumer Price Index (*Fig. 3*). It was relatively high, at 11.4%, during October because inflation has soared over the past year. The unemployment rate tends to be at cyclical lows just before recessions, as it is now. The Misery Index tends to rise during recessions and to peak around the end of recessions. It has a similar relationship to bear

markets in the S&P 500 (*Fig. 4*). It may have peaked in June, confirming our view that the latest bear-market bottom might have been made on October 12.

US Economy II: The Brief Case for a Soft Landing, Again. As we explained in the Monday, November 21 *Morning Briefing*, this time may be different—i.e., a recession might not be a foregone conclusion—if the economy turns out to be more resilient to the Fed's monetary policy tightening cycle than in the past. That optimistic view is certainly contrary to the prediction of the Index of Leading Economic Indicators, which has been falling since February through October (*Fig. 5*). It is also contrary to the inversion of the 10-year-versus-2-year yield-curve spread since the summer (*Fig. 6*). Consider the following this-time-is-different points:

(1) *No credit crunch so far.* In the past, inverted yield curves tended to predict financial crises, which triggered widespread credit crunches, which caused recessions (*Fig. 7*). This time, the financial crises have occurred in cryptocurrencies and in the ARK, meme, and SPAC stocks. Yet the credit system remains resilient, as evidenced by the small increase in the allowance for loan and lease losses at commercial banks (*Fig. 8*). Commercial bank loans rose $1.3 trillion y/y to a record $11.9 trillion through the November 16 week (*Fig. 9*).

(2) *Ample liquidity.* A few economists are ringing the alarm bells about the 1.5% decline in M2 since it peaked at a record high of $21.7 trillion during March through October (*Fig. 10*). Nevertheless, we estimate that it is currently at least $2 trillion above its pre-pandemic trendline. Demand deposits in M2 are up a staggering $3.5 trillion since February 2020 (just before the pandemic lockdowns) to $5.1 trillion in October (*Fig. 11*).

The y/y change in M2 has been closely tracking the 12-month sum of the personal saving rate (*Fig. 12*). The recent weakness in both reflects the excess liquidity accumulated by consumers since the start of the pandemic.

(3) *Consumer incomes are growing.* The labor market remains tight. Payroll employment is up 4.1 million ytd through October to a record high (*Fig. 13*). Average hourly earnings for all private-sector workers rose 5.0% y/y through September, while the PCED inflation rate was 6.2%, showing that inflation-adjusted wages have been stagnating for the past year (*Fig. 14*). But we expect that price inflation will soon moderate and fall below wage inflation, boosting real wages. Revolving credit is up $152.4 billion y/y through September, and there is plenty of excess saving, as noted above.

Except for autos, most of the pent-up demand for consumer goods has been satisfied.

While consumer spending on goods in real GDP has been essentially flat, it remains above its pre-pandemic trendline (*Fig. 15*). Consumers clearly have pivoted to spending more on services.

(4) *Housing's mixed message.* There is a credit crunch in the single-family housing market, as evidenced by the freefall in mortgage applications to purchase a new or existing home (*Fig. 16*). Housing affordability has collapsed this year as mortgage rates soared and home prices remained near record highs because of scarce inventory of homes for sale. However, the multi-family housing sector remains strong as developers scramble to meet booming demand for rental apartments. Multi-family residential construction accounts for about 50% of total residential construction.

(5) *Capital spending.* As we reviewed at the beginning of last week, industrial production of business equipment remained strong during October, with output of industrial and technology equipment leading the way higher (*Fig. 17*). Output of business computers and communication equipment both rose to record highs (*Fig. 18*).

(6) *Fiscal stimulus.* There's certainly lots of economic stimulus in the fiscal policy pipeline. In July 2022, Congress passed the CHIPS Act of 2022 to strengthen domestic semiconductor manufacturing, design, and research; fortify the economy and national security; and reinforce America's chip supply chains. The act invests $280 billion in the chip sector and includes semiconductor manufacturing grants, research investments, and an investment tax credit for chip manufacturing.

With the signing of the Infrastructure Investment and Jobs Act on November 15, 2021 and the Inflation Reduction Act this August, congressional lawmakers capped a historically productive year when it comes to transportation policy. The two landmark bills will invest nearly $700 billion in infrastructure, research activities, and related programs that either directly touch the transportation industry or promise to benefit it. In addition, all that federal spending likely will attract even more commitments from states, localities, and the private sector.

Calendars

US: Tues: Consumer Confidence 100.0; S&P Case-Shiller HPI 20-City Index -0.7%m/m/14.4%y/y. **Wed:** Real GDP & GDP Price Index 2.7%/4.1%; Core PCED 4.5%; ADP Employment 200k; Job Openings 10.3m; Pending Home Sales -5.0%; Goods Trade

Balance -$90.2b; Chicago Fed PMI 47.0; Wholesale & Retail Inventories; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production; Beige Book; Powell; Cook. (Bloomberg estimates)

Global: **Tues:** Eurozone Business & Consumer Survey 93.5; Consumer, Services, and Industrial Sentiment -23.9/2.0/-0.2; Germany CPI 0.1%m/m/11.3%y/y; Spain CPI; Canada GDP 1.5%; Japan Industrial Production -1.5%; China M-PMI & NM-PMI Flash Estimates 50.0/48.0; De Guindos; Schnabel; Bailey; Schlegel; Mann; Kearns. **Wed:** Eurozone CPI Flash Estimate 10.4% y/y; Germany Import Prices -1.7%m/m/22.7%y/y; Germany Unemployment Rate 5.5%; France GDP 0.2%; France Consumer Spending -0.9%; France CPI; Spain Retail Sales; Italy GDP 0.5%q/q/2.6%y/y; Italy CPI 1.4%m/m/12.0%y/y; Japan Housing Starts -1.3%; Caixin M-PMI 48.9; European Central Bank Non-Monetary Policy Meeting; Pill; Noguchi. (Bloomberg estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): LargeCap's forward earnings rose again last week, but MidCap's was down for a tenth straight week and SmallCap's for an eighth. For a 22nd straight week, none of these three indexes had forward earnings at a record high. LargeCap's is 4.1% below its record high at the end of June and up slightly from a 36-week low in early November. MidCap's is at a 35-week low and 5.9% below its record high in early June; and SmallCap's is at a 37-week low and 7.3% below its record high in mid-June. Forward earnings momentum continues to fade. The yearly rate of change in LargeCap's forward earnings was down to a 20-month low of 4.2% y/y from 4.6% a week earlier; that's down from a record-high 42.2% at the end of July 2021 and up from -19.3% in May 2020, which was the lowest since October 2009. The yearly rate of change in MidCap's forward earnings was steady w/w at a 20-month low of 9.3% y/y. That's down from a record high of 78.8% at the end of May and compares to a record low of -32.7% in May 2020. SmallCap's was down sharply w/w to a 22-month low of 2.3% y/y from 3.6%. That's down from a record high of 124.2% in June 2021. It had been at a record low of -41.5% in June 2020. Companies have been beating consensus estimates quite handily since the Q2-2020 earnings season, causing analysts' consensus earnings forecasts for 2022 to 2023 to improve instead of decline as is typical, but their forecasts have been heading lower lately for both years. Here are the latest consensus earnings growth rates for 2022 and 2023: LargeCap (5.9%, 5.0%), MidCap (14.5, -2.9), and SmallCap (9.6, 2.2).

S&P 500/400/600 Valuation (*link*): Valuations rose last week for all three of these indexes.

LargeCap's forward P/E rose 0.3pt to a three-month high of 17.5 from 17.2, and is now up 2.4pts from its 30-month low of 15.1 at the end of September. That compares to a four-month high of 18.1 in early August and an 11-year low of 11.1 during March 2020. MidCap's forward P/E rose 0.3pt w/w to a seven-month high of 13.6 from 13.3, up 2.5pts from a 30-month low of 11.1 at the end of September. That compares to a record high of 22.9 in June 2020 and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E also rose 0.3pt w/w, but to a seven-month high of 13.0 from 12.7. That's up from a 14-year low of 10.6 at the end of September and compares to a record low of 10.2 in November 2009 during the Great Financial Crisis. That also compares to its record high of 26.7 in early June 2020 when forward earnings was depressed. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017; MidCap's current 22% discount to LargeCap is near its biggest since September 2000. SmallCap's P/E was below LargeCap's for a 119th straight week. That's the longest stretch at a discount since 1999-2002; SmallCap's current 26% reading is near its biggest discount since February 2001. SmallCap's P/E has been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 76th straight week; the current 5% discount is an improvement from its 9% discount in December but remains near its lows during 2000-01.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Since the Q3-2020 earnings season, analysts as a whole have been raising their consensus forecasts for future quarters instead of lowering them as is the norm through the earnings warnings seasons. That six-quarter streak of positive revisions throughout the quarter officially ended with Q1-2022, and the declines have accelerated considerably for Q3-2022. In the latest week, the Q3-2022 S&P 500 earnings-per-share blended actual rose 7 cents w/w to $55.99, and is now 5.9% below its $59.49 forecast at the start of the quarter. The S&P 500's blended Q3 earnings growth has weakened q/q to 3.9% y/y from 9.9% in Q2 on a frozen actual basis, and to 4.3% from 8.4% on a pro forma basis. Just four sectors have recorded double- and triple-digit percentage growth in Q3-2022, and five have y/y declines. That compares to Q2-2022's count of four sectors with triple- and double-digit growth, two with a single-digit gain, and five with a y/y decline. Looking ahead to Q4, a 0.4% y/y decline is expected for the S&P 500, with just four sectors expected to record positive y/y earnings growth and seven expected to decline. Here are the S&P 500 sectors' latest expected earnings growth rates for Q4-2022 versus their blended Q3-2022 growth rates: Energy (72.8% in Q4-2022 versus

140.8% in Q3-2022), Industrials (42.3, 19.7), Real Estate (6.9, 14.8), Utilities (5.0, -7.1), S&P 500 (-0.4, 4.3), Consumer Staples (-3.4, 1.1), Financials (-3.7, -16.4), Health Care (-6.4, 1.5), Information Technology (-7.8, -0.6), Consumer Discretionary (-14.1, 13.1), Materials (-21.3, -8.8), and Communication Services (-20.9, -26.1).

S&P 500 Sectors Net Earnings Revisions (*link*): The S&P 500's NERI was negative for a fifth month in November and weakened for the 14th time in 16 months. NERI fell to a 29-month low of -15.5% in November from -13.1% in October. It had been negative for 13 straight months through July 2020 due to the pandemic shutdown. The 23-month positive streak that ended in June had exceeded the prior 18-month positive streak during the cycle that ended October 2018, when NERI reached a tax-cut-induced, then-record high of 22.1% in March 2018. November's reading compares to a record-high 23.1% in July 2021 and an 11-year low of -37.4% in May 2020. Energy was the only S&P 500 sector with positive NERI in October, the lowest count since April-July 2020 and down from two in September and October. Eight sectors had NERI readings at post-pandemic two-year lows during the month as all but three sectors had NERI weaken m/m. Among the lowest readings in November, Communication Services was negative for a 13th month, Consumer Staples for a ninth, and Consumer Discretionary and Health Care for an eighth month. Here are the November NERIs for the S&P 500 and its sectors compared with their October readings: Energy (3.6% in November [28-month low], down from 10.1% in October), Utilities (-3.8 [28-month low], 1.9), Consumer Staples (-8.9, -14.0 [28-month low]), Financials (-11.1 [29-month low], -9.3), S&P 500 (-15.5 [29-month low], -13.1), Real Estate (-15.6 [19-month low], -6.4), Consumer Discretionary (-16.9, -19.4 [28-month low]), Industrials (-17.5 [28-month low], -13.4), Health Care (-18.1 [29-month low], -11.5), Information Technology (-19.0 [29-month low], -15.0), Communication Services (-20.7, -23.5), and Materials (-29.6 [29-month low], -27.1).

S&P 500 Sectors Net Revenue Revisions (*link*): The S&P 500's NRRI weakened in November for an eighth straight month and was negative for a fourth month following two years of positive readings. It has weakened m/m in 12 of the past 15 months, and dropped to a 29-month low of -11.2% from -8.7% in October. Before the 24-month positive streak ended in August, it had been negative for 21 straight months. That positive streak exceeded the prior 19-month streak during the cycle that ended in October 2018, when NRRI reached a tax-cut-induced then-record high of 14.7% in March 2018. November's reading compares to a record-high 25.9% in August 2021 and an 11-year low of -35.8% in May 2020. Four of the 11 S&P 500 sectors had positive NRRI in November, down from five in October and from all 11 positive during July-October 2021. Consumer Discretionary and Consumer Staples were the only sectors to have NRRI improve m/m. Seven sectors had NRRI

readings fall to post-pandemic lows during the month. Communication Services was negative for a 13th straight month, followed by Health Care at eight months and Consumer Discretionary at seven. Here are the November NRRIs for the S&P 500 and its sectors compared with their October readings: Utilities (12.6% in November, down from 17.8% in October), Energy (5.4 [25-month low], 14.5), Real Estate (4.5 [19-month low], 10.5), Consumer Staples (3.4, 1.2 [27-month low]), Financials (-1.2, 1.8), S&P 500 (-11.2 [29-month low], -8.7), Industrials (-13.1 [28-month low], -11.3), Consumer Discretionary (-14.4, -16.7 [28-month low]), Health Care (-15.3 [29-month low], -10.8), Materials (-15.9 [28-month low], -12.4), Information Technology (-19.1 [29-month low], -15.2), and Communication Services (-25.2 [30-month low], -22.4).

US Economic Indicators

Regional M-PMIs (*link*): Five Fed districts (New York, Philadelphia, Kansas City, Richmond, and Dallas) have now reported on manufacturing activity for November and indicate a contraction for the seventh successive month, though manufacturing activity fell at a slightly slower pace this month, at -8.9, after widening from -5.5 to -10.8 in October. *Manufacturing* activity in the New York (to 4.5 from -9.1) region swung from negative to positive, while activity in Philadelphia (-19.4 from -8.7) contracted at more than double October's pace, and Dallas' (-14.4 from -19.4) declined at a slightly slower pace this month. Meanwhile, activity in both the Kansas City (-6.0 from -7.0) and Richmond (-9.0 from -10.0) areas fell at roughly the same pace as last month. *New orders* (-13.3 from -11.8) contracted for the sixth month, but the decline has widened for the second month from September's -8.3 reading, led by a decline in the Dallas (-20.9 from -8.8) area that was more than double October's shortfall. Billings in the Philadelphia (-16.2 from -15.9) region contracted at a pace similar to last month's, while the decline in orders in the Kansas City (-12.0 from -16.0) and Richmond (-14.0 from -22.0) areas were slower than last month's. Orders in the New York (-3.3 from 3.7) area moved from expansion to contraction, though the rate of decline was much slower than in the other two regions. *Employment* (5.4 from 11.3) increased at roughly half last month's pace, as factories in the Philadelphia (7.1 from 28.5) and Dallas (5.9 from 17.1) regions hired at a considerably slower pace, while New York's (12.2 from 7.7) hired at a slightly faster pace; hirings in the Kansas City (unchanged 3.0) and Richmond (-1.0 from 0.0) regions held steady.

Regional Prices Paid & Received Measures (*link*): We now have prices-paid and -received data for November from the New York, Philadelphia, Richmond, Dallas, and Kansas City regions. (Note: The New York, Philadelphia, Dallas, and Kansas City measures

are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures.) The *prices-paid* measure slowed to a 23-month low of 46.5, easing steadily from 87.5 in April—which was little changed from the record high of 88.5 last November. The New York region saw a slight acceleration for the second month to 50.5 this month, after easing from a record-high 86.4 in April to a 21-month low of 39.6 in September, while Philadelphia's (35.3 from 36.3) was little changed this month after easing from a cyclical high of 84.6 in April (which wasn't far from its record high of 91.1 in the 1970s) to a 21-month low of 29.8 in September. Kansas City's measure has been on a steep downtrend since its recent peak of 83.0 in April, slowing to a 27-month low of 22.0 this month, while Dallas' (22.6 from 32.0) slowed to a 27-month low this month, down from its record high of 83.3 last November. Richmond's eased to a 17-month low of 101.9 since reaching a record-high 150.1 in May. Turning to the *prices-received* measure, it accelerated for the second month to 38.8 this month from September's 18-month low of 35.0; it was at a record high of 60.6 in March. New York's prices-received measure accelerated to 27.2 this month from a 21-month low of 22.9 last month; it was at a record high of 56.1 in March. The Philadelphia measure picked up for the third month, to 34.6, after slowing from last November's 62.9 peak to an 18-month low of 23.3 during August. Meanwhile, Kansas City's gauge edged up to 19.0 after easing from a record high of 57.0 in April to 13.0 in October—which was the lowest since December 2020—while Richmond's picked up to 99.1 after slowing from a record-high 103.1 in June to 86.2 in October. Prices-received in the Dallas region slowed to a two-year low of 13.9 this month, down from last October's record-high 50.9.

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