

# LayLine Broadcast EView

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## **Recession, in a Word**

I was going to just wish everyone a wonderful finish to summer and let it go at that. Instead, given the acrimony around the term “recession” and its meaning, I thought I would ramble on a bit about what determines a recession. Let me start with a short primer on several of the various ideas of what is a recession.

- 1) From my Econ 101, recessions are part of the business cycle. They happen when there is a prolong decline in investment combined with a decline in consumption that ultimately leads to declines in income and employment.
- 2) The NBER (National Bureau of Economic Research) is the group who officially decides the dates, start and finish, of each recession. They suggests recessions are a significant decline in economic activity, spread across the whole economy, resulting in declines in income, employment, consumption, and production.
- 3) From the bond market, it’s an inverted yield curve, 2yr to 10yr, that signals a recession is coming
- 4) According to common market commentary, two consecutive quarters of negative GDP growth signals a recession is currently underway or unavoidable.

The first two points serve well as ways to define what is a recession and the second two points are more operational in nature.

Looking at the first two points, there are broad similarities, such as their negative effect on income and employment. The first point suggests it’s a decline in investment and consumption that leads to declines in income and employment. The second does not suggest a cause, but rather that a host of negative economic activity combines, likely in different ways, to result in declines of income, employment, consumption and production. The NBER actually states that there is “no fixed rule” in their determination of when a recession starts and when it ends. This is perhaps the reason why there has been so many difficulties expressing when a recession occurs.

The third and fourth points are of value to policy makers and business executives that need to make sometimes far-reaching decisions based on today’s expectations of future economic growth on how to allocate precious and valuable capital and resources, both money and people. For example, it would be less than timely for a business to decide to do a lot of hiring as the economy careens off into a recession. For policy makers, it would be less than advantageous to pull back support of the social safety net at the outset of a downturn in income and employment. Waiting until months after a recession has ended, what the NBER does by design, to make planning decisions based on whether we are, or are not, in a recession is counter intuitive.

This is why the third and fourth points are termed operational. While neither are perfect in their clairvoyance, each is right often enough and do provide a timely fair warning for decision makers to base their planning decisions on. The inverted yield curve is quite accurate in predicting a

recession, just not on the exact timing of when one will arrive. Two quarters of negative GDP growth is not always present for each recession, but we have always had a recession after two quarters of negative GDP. Again, the timing is difficult to predict, the occurrence of, not so much

So where are we now according to the above criteria. We have had two consecutive quarters of negative GDP growth and the 2 – 10 yield curve continues to be massively inverted, check those two off. Consumption and investment makes up almost 3/4 of the calculation for GDP (the rest is government spending and net exports). With GDP down the first two quarters this year we can assume that investment and consumption have declined and that it's been over a long enough time period to call it prolonged. That leaves income and employment, and this is where the divergence of claims for or against the US being in a recession currently resides. Personal Income as measured by the BEA (Bureau of Economic Analysis) for most of 2022 has been rising, and as we saw a week ago from the jobs report, employment continues to be strong. These two metrics of a recession are suggesting we are not currently in a recession.

In summary, the two operational definitions (3 and 4) suggest we are in, or are soon to be in, a recession. The two definitions (1 and 2) of what a recession is are not complying with the determination of the operational definitions. It's legitimate to ask, how can the US have a recession when employment is so strong and income is rising? No wonder there is such disagreement as to what a recession is or isn't and we haven't even started with the when, how long, how deep a recession may be, or even if there will be one. I will leave you with this, having been through more than a few recessions, they are all different, and regardless of how they are defined, in a word, they are all bad.

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