Waiting for Godot

A widely watched indicator on Wall Street did the unthinkable last year as the dreaded inverted yield curve raised its ugly head signaling a recession was on its way. In normal economic times, longer-dated treasuries yield more than shorter-dated treasures. However, when the 2-year treasury started yielding more than the 10-year treasury in the spring of 2022, an "inverted yield curve" was triggered. Why does this happen? It occurs when investors become nervous about an economic slowdown and would rather own 10-year treasuries rather than stocks. Since the yield curve inverted, news organizations, Wall Street strategists and financial experts have warned us daily that a recession is coming soon. Sometimes it feels like the Samuel Beckett play, *Waiting for Godot*. The Protagonists spend all their time trying to meet Godot, but Godot never shows up. Is this recession ever going to show up?

The argument for this inevitability and even a "hard landing" recession is straightforward. Inflation is stubbornly high, the Federal Reserve continues their relentless raising of interest rates, housing is slowing, companies are beginning to lay off workers, manufacturing and industrial data has fallen off and turmoil in the regional bank sector, exemplified by the failure of Silicon Valley Bank, all point to a tightening of lending standards and a big slowdown in the economy. When this recession comes, the thought is that corporate earnings will materially decline and so will the stock market. Yet with all of these recession indicators flashing warning signs, the economy is holding up relatively well and jobs are resilient though job openings are slowing.

Could the economic scenario be more nuanced? As we know, the stock market discounts economic events well ahead of time. It's no secret that growth stocks were down terribly in 2021 and 2022, many down 50-70% or more during that period. The S&P 500 was down over 18% last year. Could it be that these equity declines have already taken into account a future slowdown? Complicating it more is the fact that the economy is not monolithic. The semi-conductor chip companies have spent the last year or more trying to work off a huge over-supply of chip inventory and declining demand in personal computers and other areas. This vital industry may have already gone through a recession and might be seeing brighter times ahead, especially if artificial intelligence continues its momentum. Housing has been very slow stifled by mortgage rates ratcheting up to the 6.5%-7% level. In contrast to this

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weakness is the strength seen in areas such as aerospace and travel and leisure. Orders for new planes have rebounded from Covid shutdowns and people are traveling at very healthy rates even as business travel has remained only 40% of its pre-pandemic level. The nuance is that the economy appears to be experiencing a "rolling recession"; a recession affecting certain industries while others are still strong.

As stated in previous quarterly letters, we believe many of the worries of a slowdown, inflation, war, and other "terribles" are well-known and, to some extent, discounted by the markets. The Fed may continue raising rates, but the markets are anticipating that this tightening cycle will soon be coming to an end. As we know from the play, *Waiting for Godot*, Godot never does arrive. The two main characters end up wasting time in a useless endeavor. Those in the market waiting and frozen by the coming recession have missed a sizeable rally since last October. We continue to see opportunities in this environment. Will the most anticipated recession materialize? Only time will tell.

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