VOLATILITY HAS ARRIVED

Bryce Gill
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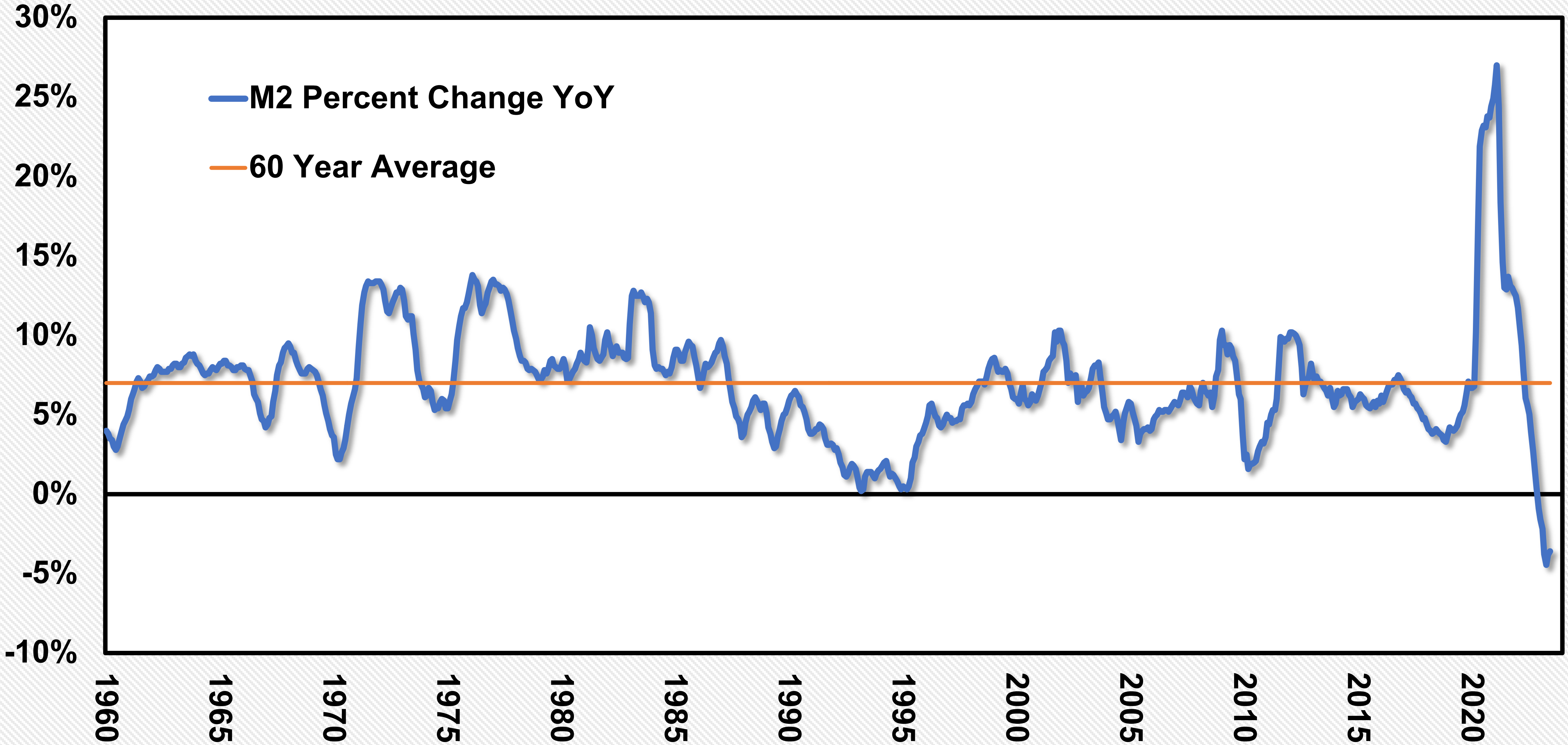
First Trust Advisors

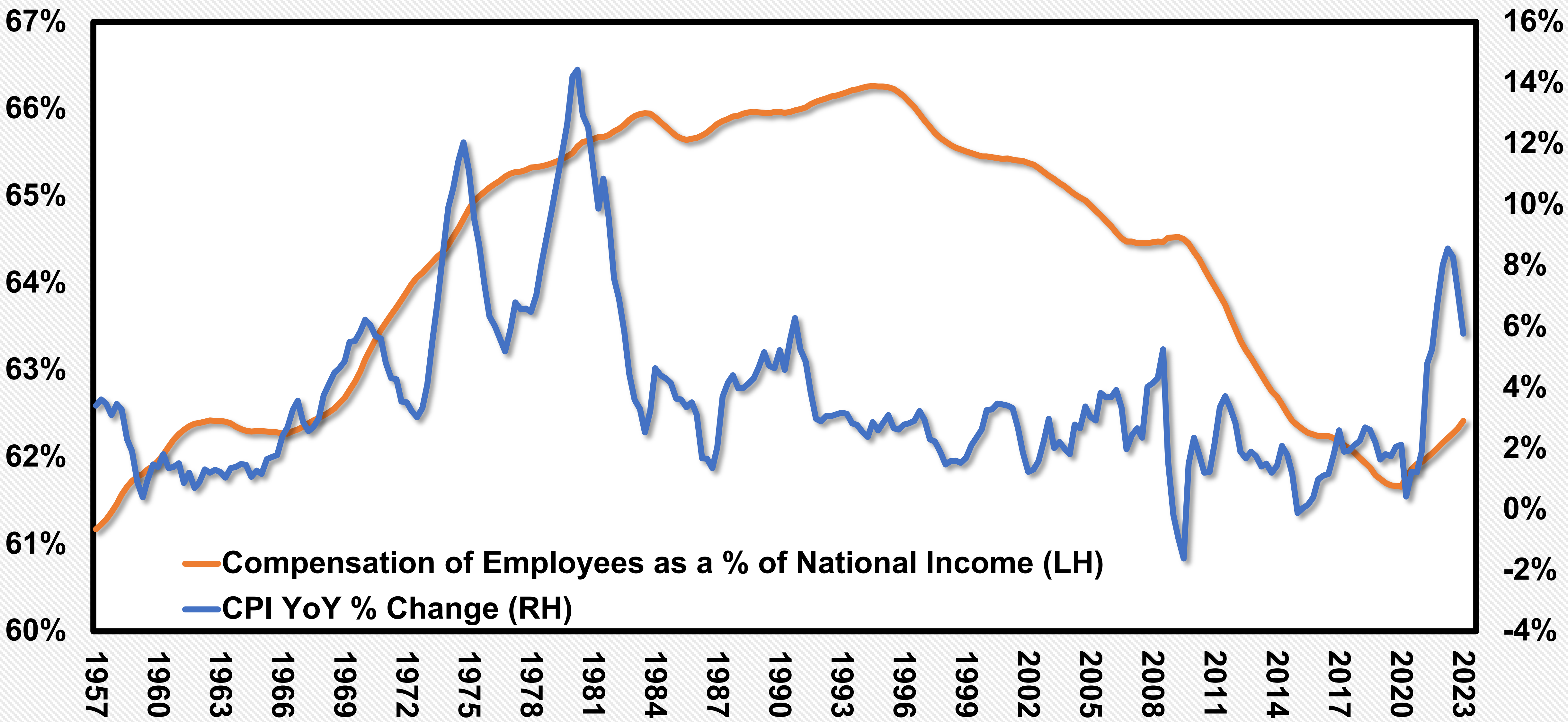
First Trust

The Monetary Tailwind is Ebbing



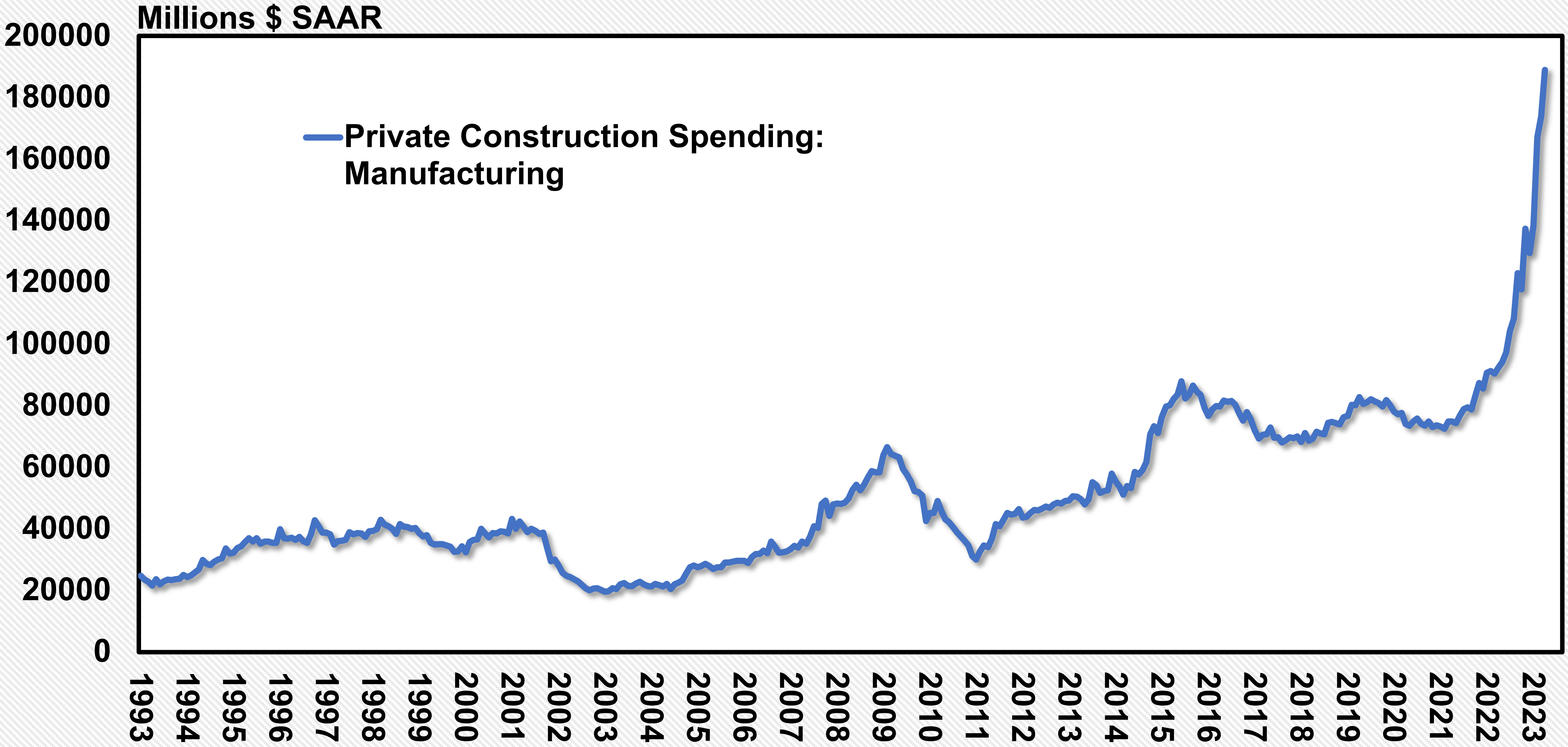
Source: Federal Reserve Board, Monthly Data Jan 1960-Jun 2023

Tide is Turning on Employee Bargaining Power



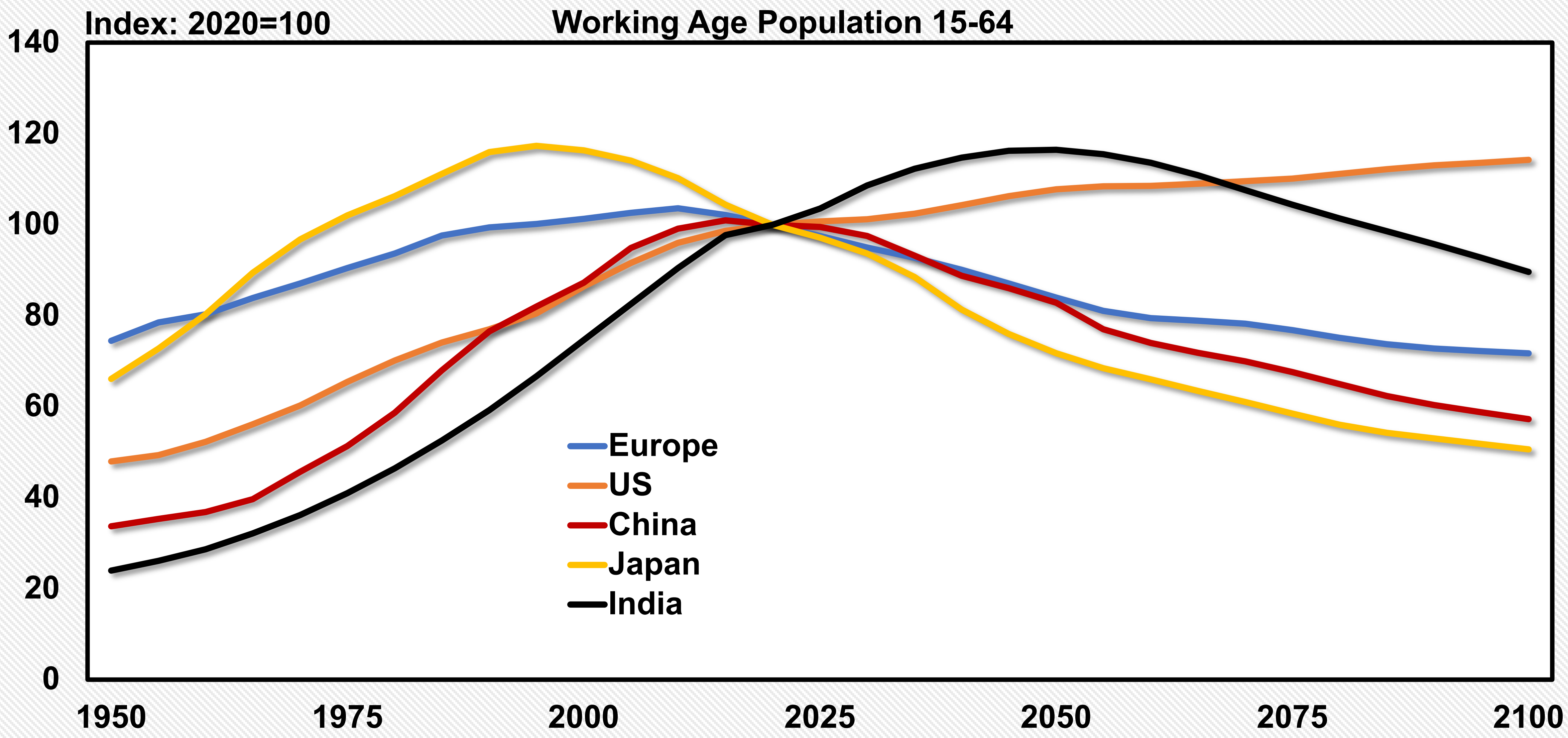
Source: US Census Bureau, Bureau of Economic Analysis, Quarterly Data Q1 1957- Q1 2023

The Reshoring Boom



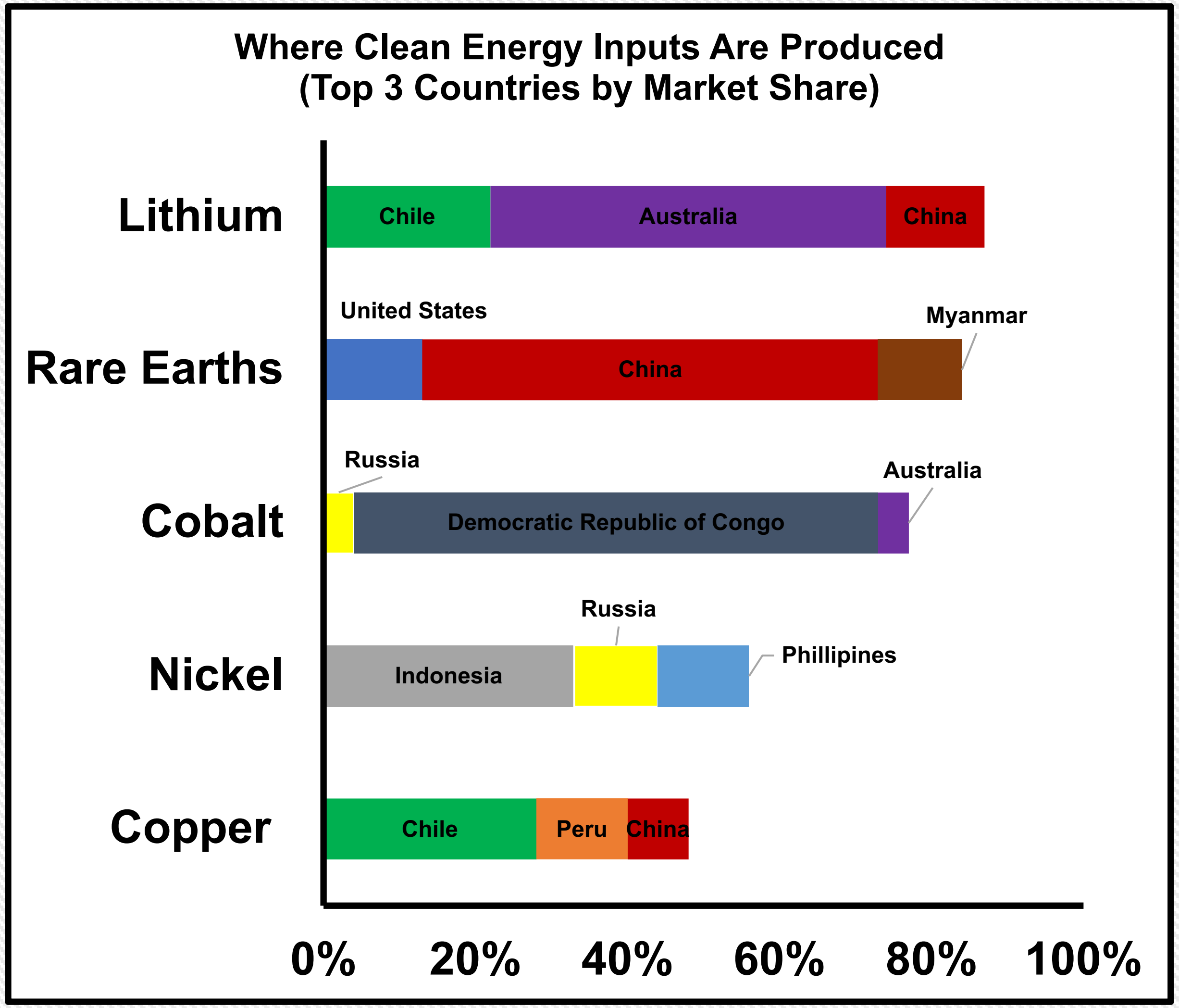
Source: US Census Bureau, Monthly Data Jan 1993 - April 2023

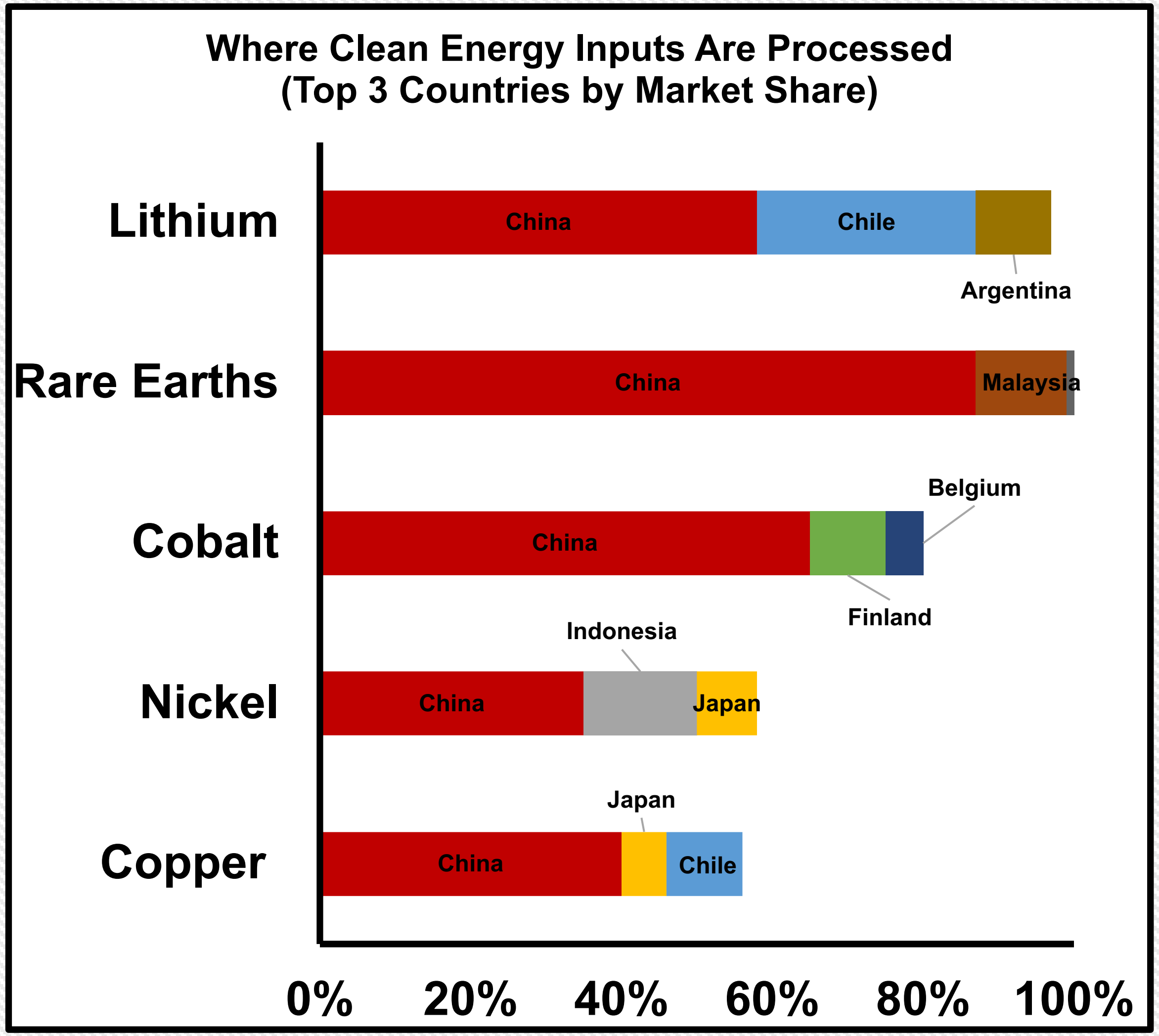
The Big Picture



Source: United Nations, Annual Data 1950-2100

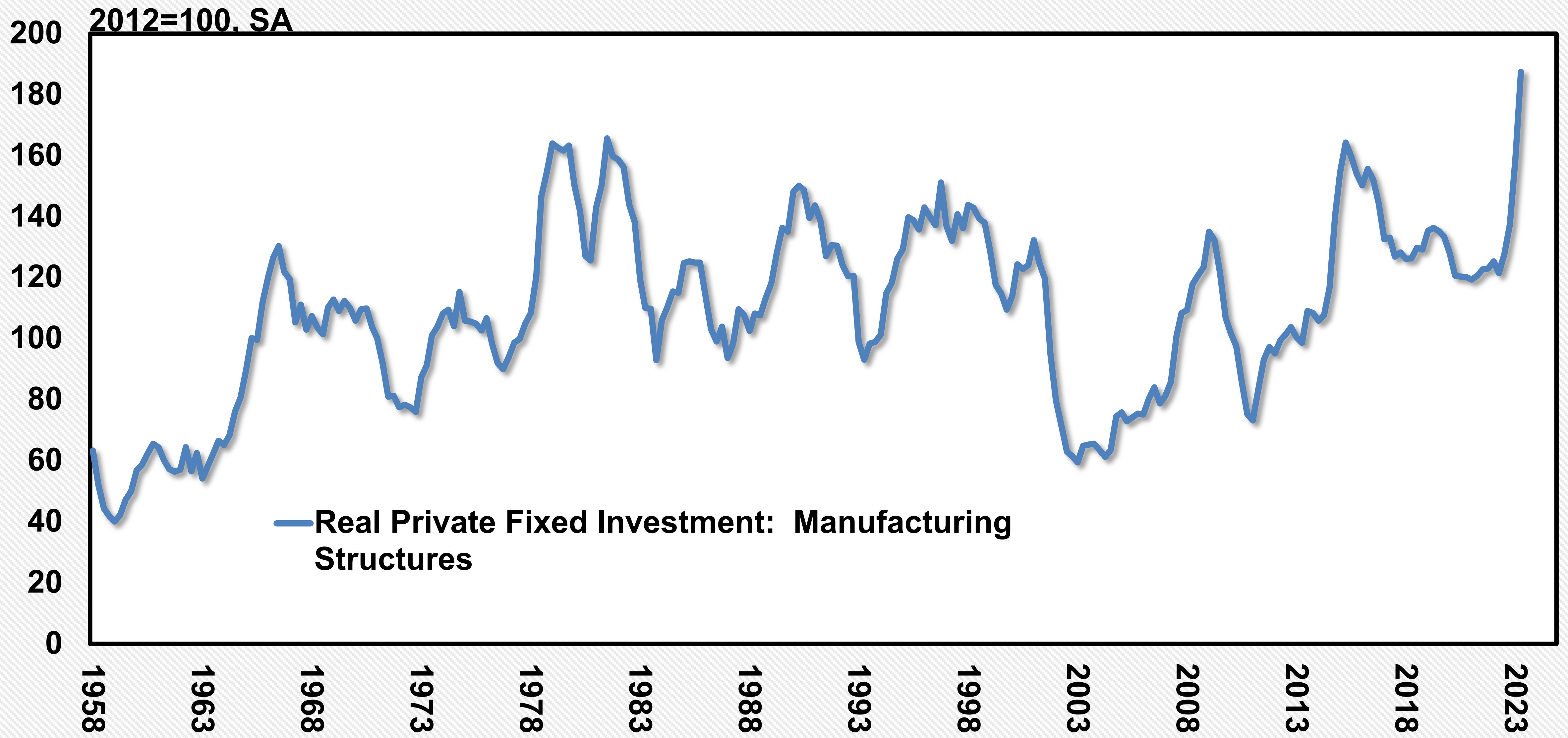
Realities of the Green Supply Chain





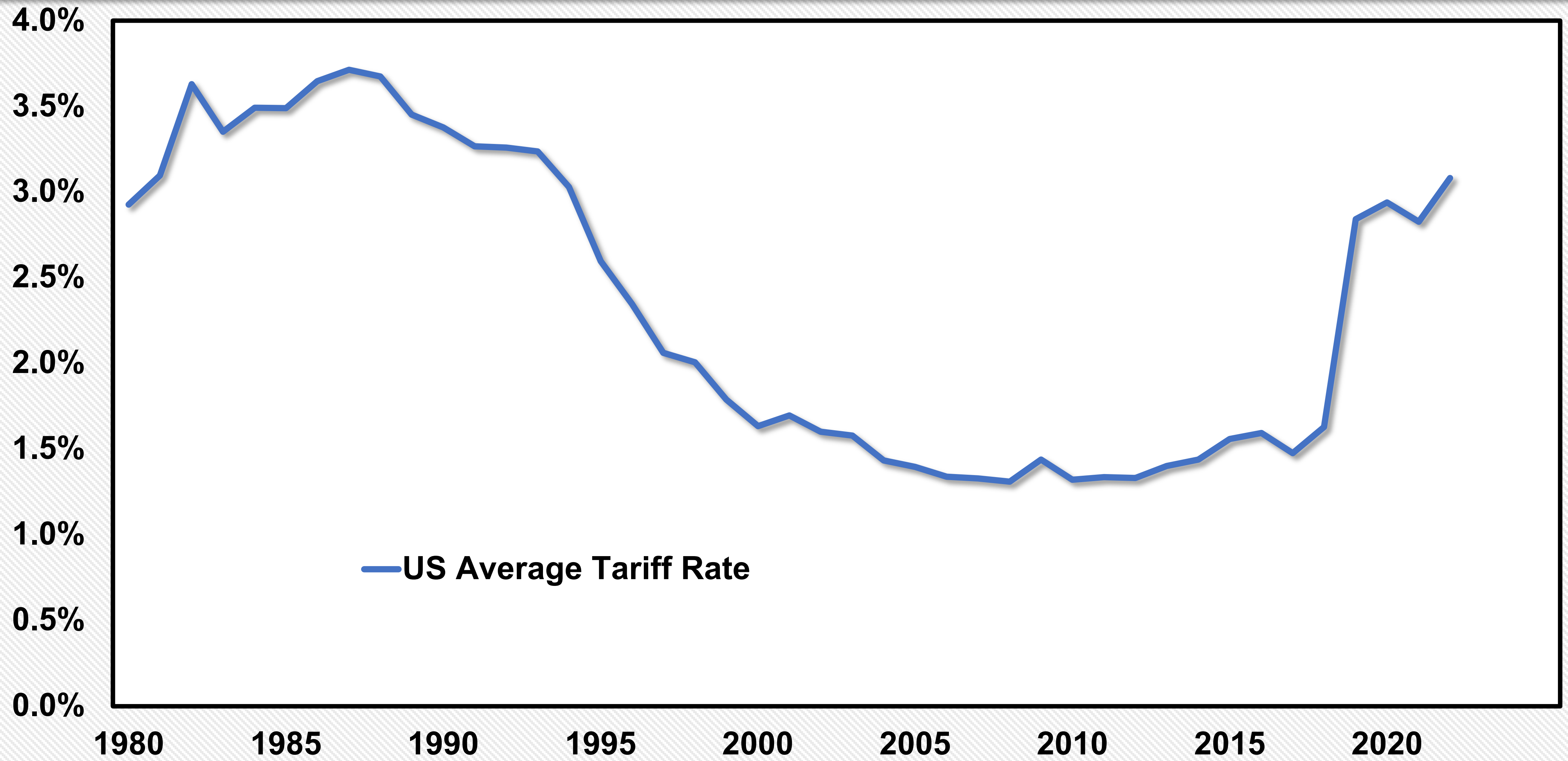
Source: International Energy Agency, 2019 Data

Investment in Manufacturing at a Record High



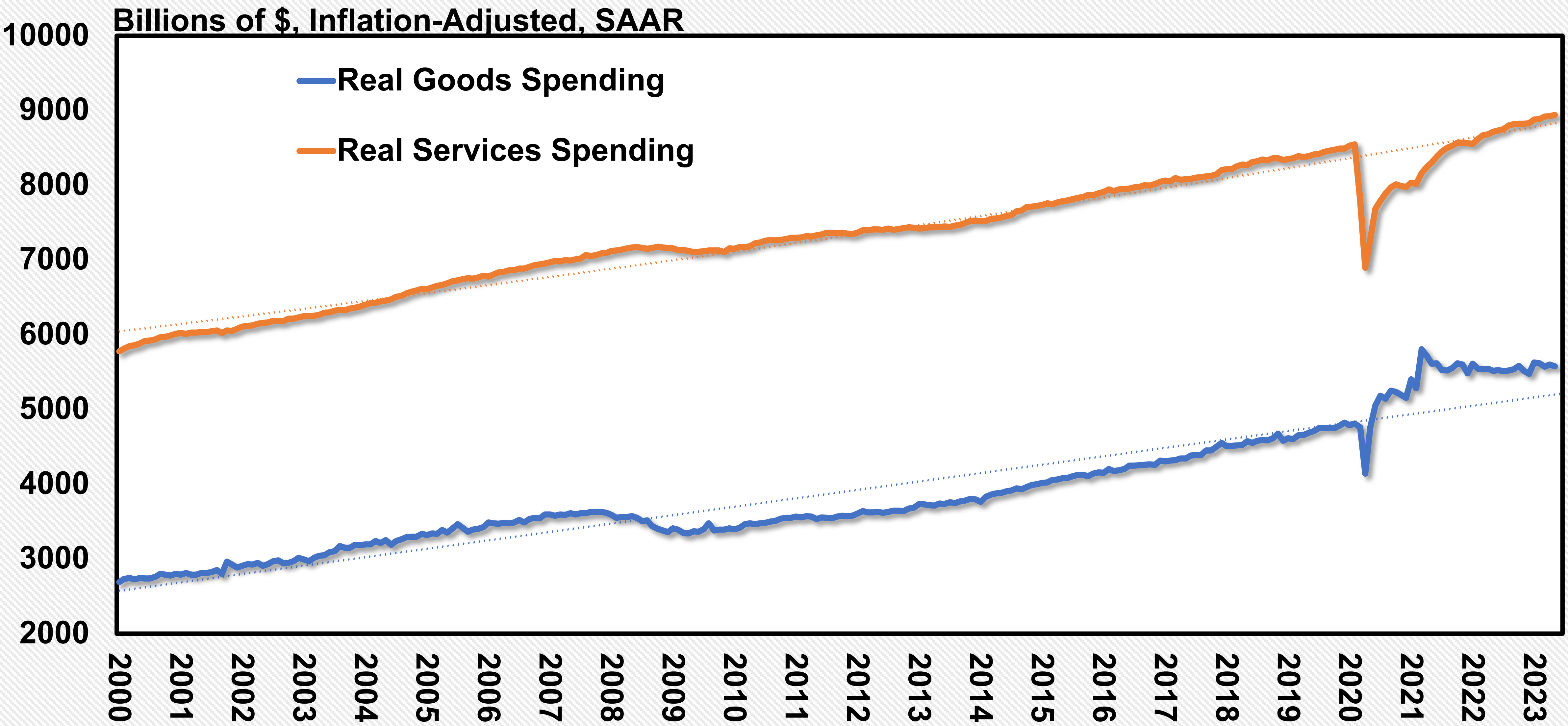
Source: Bureau of Economic Analysis, Quarterly Data Q1 1959 – Q2 2023

Return of Protectionism



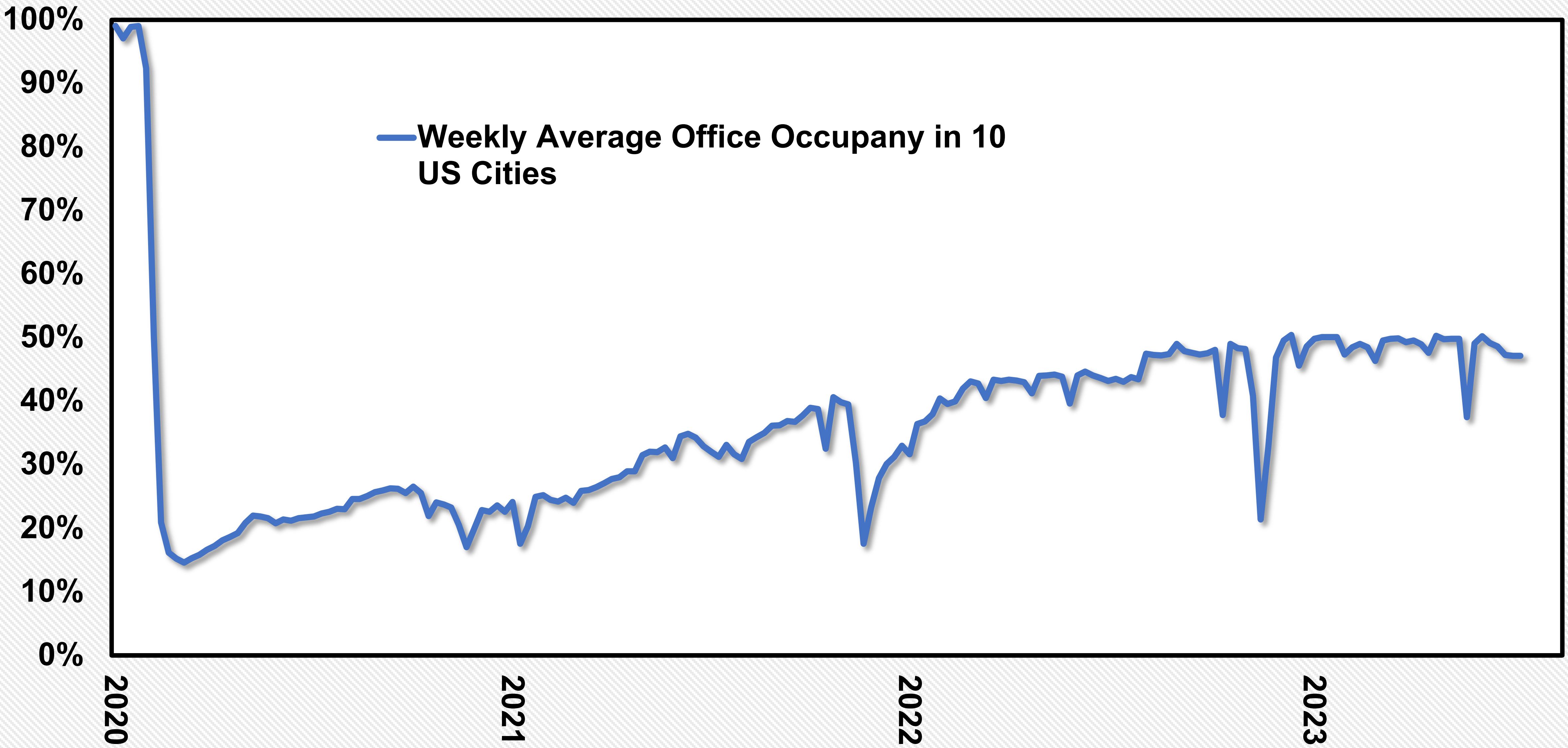
Source: US Treasury, US Census Bureau, Annual Data 1980-2022

The Fastest Shift in Spending Preferences in US History



Source: Bureau of Economic Analysis, Monthly Data Jan 2000-May 2023

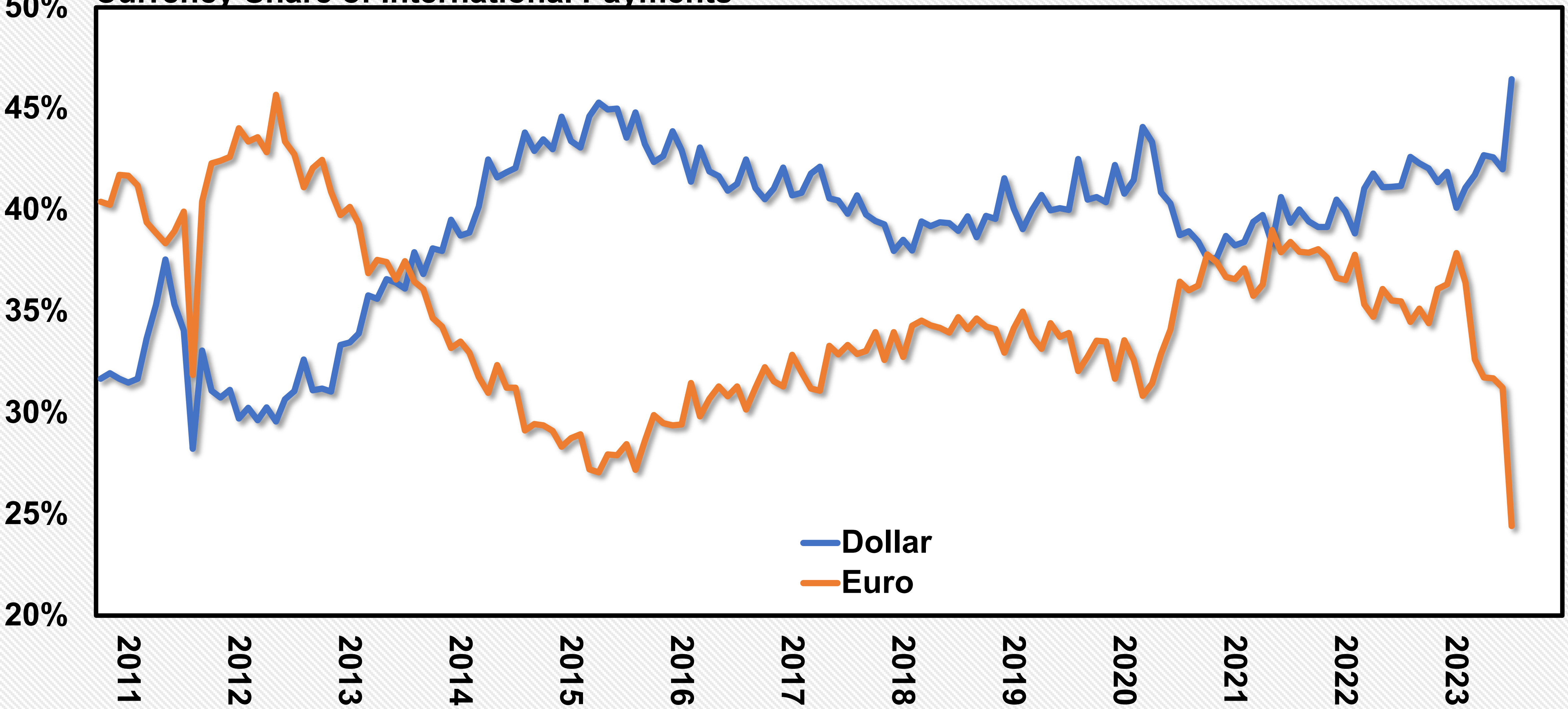
Trouble For Commercial Real Estate?



Source: Kastle Systems, Bloomberg, Quarterly Data Q1 2020- Q3 2023

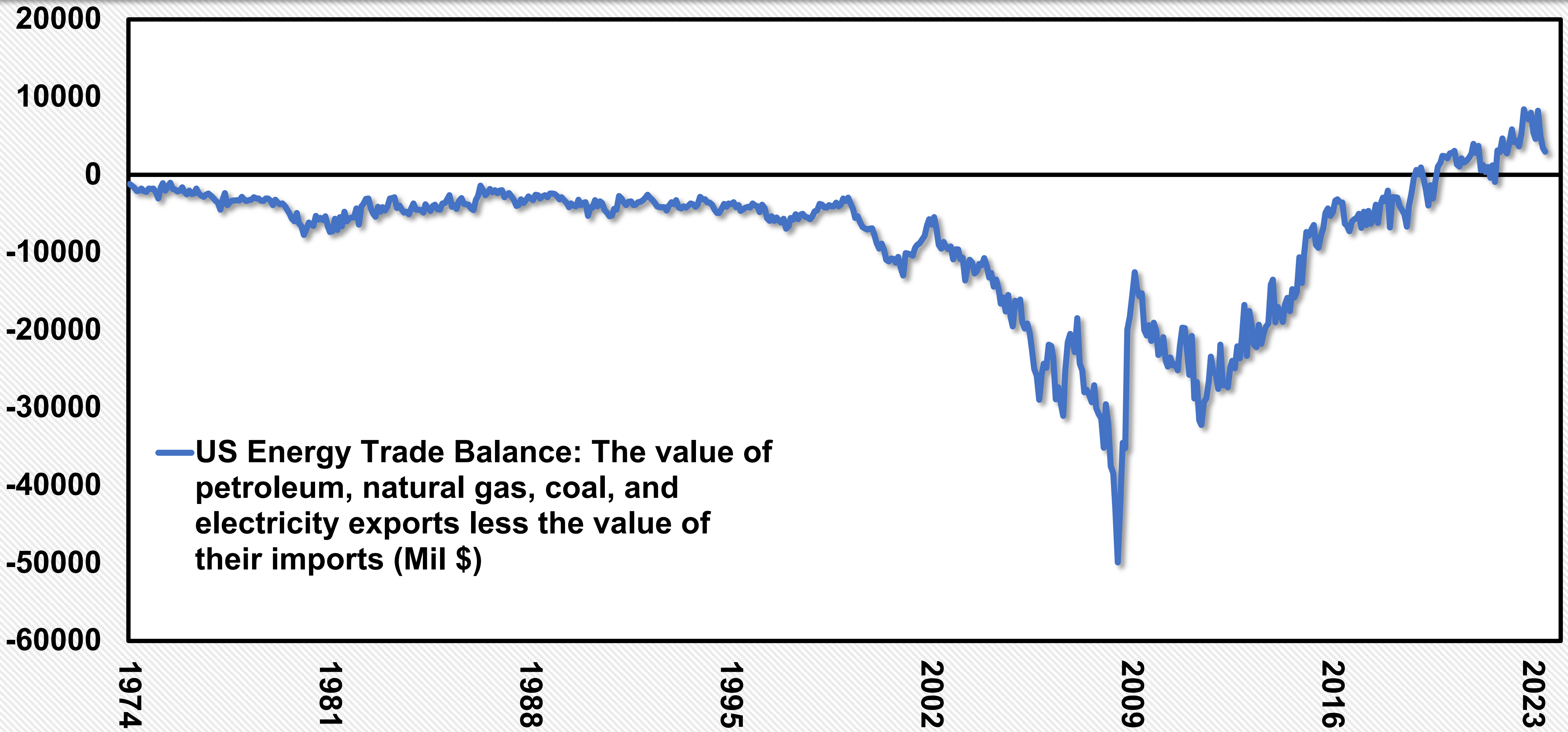
Dollar Remains the Reserve Currency

Currency Share of International Payments



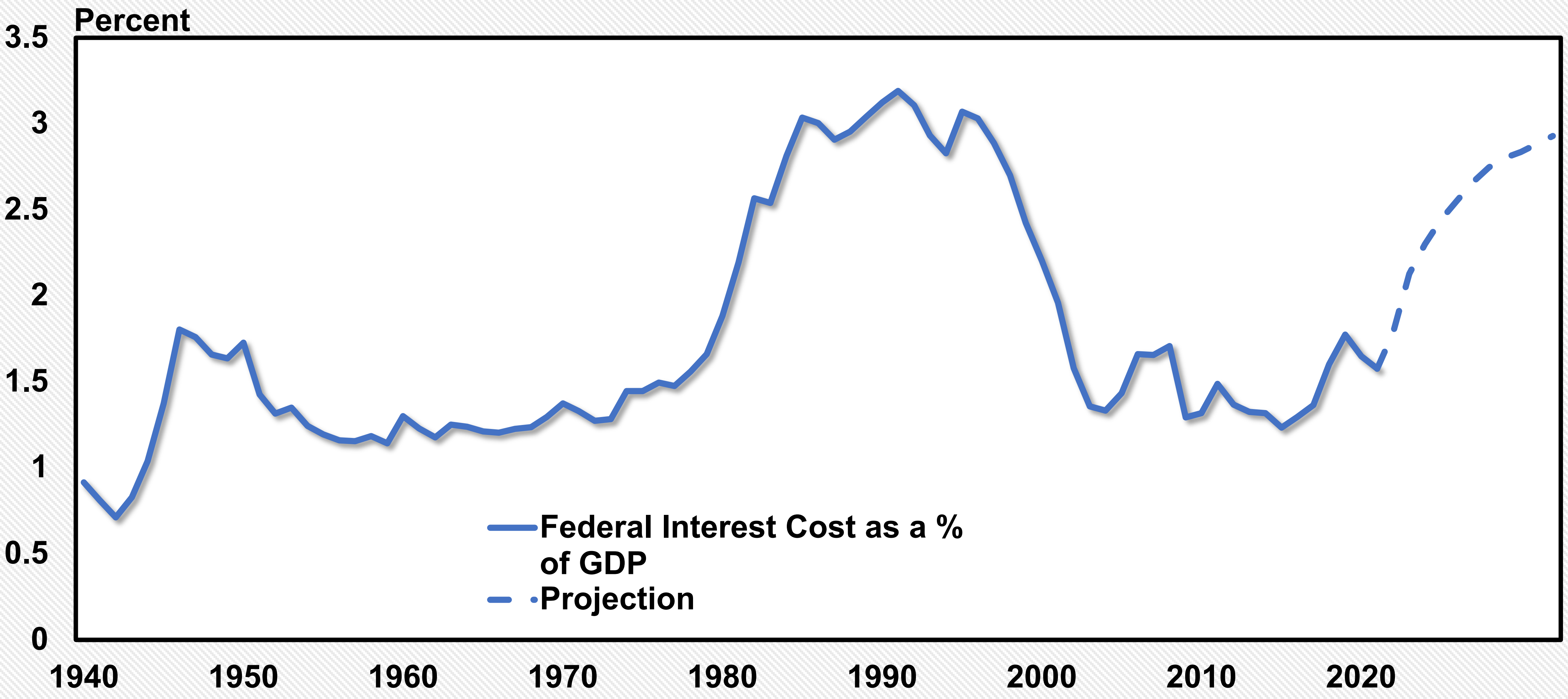
Source: SWIFT, Bloomberg, Monthly Data Oct 2010- July 2023

End of the Petro-Dollar?



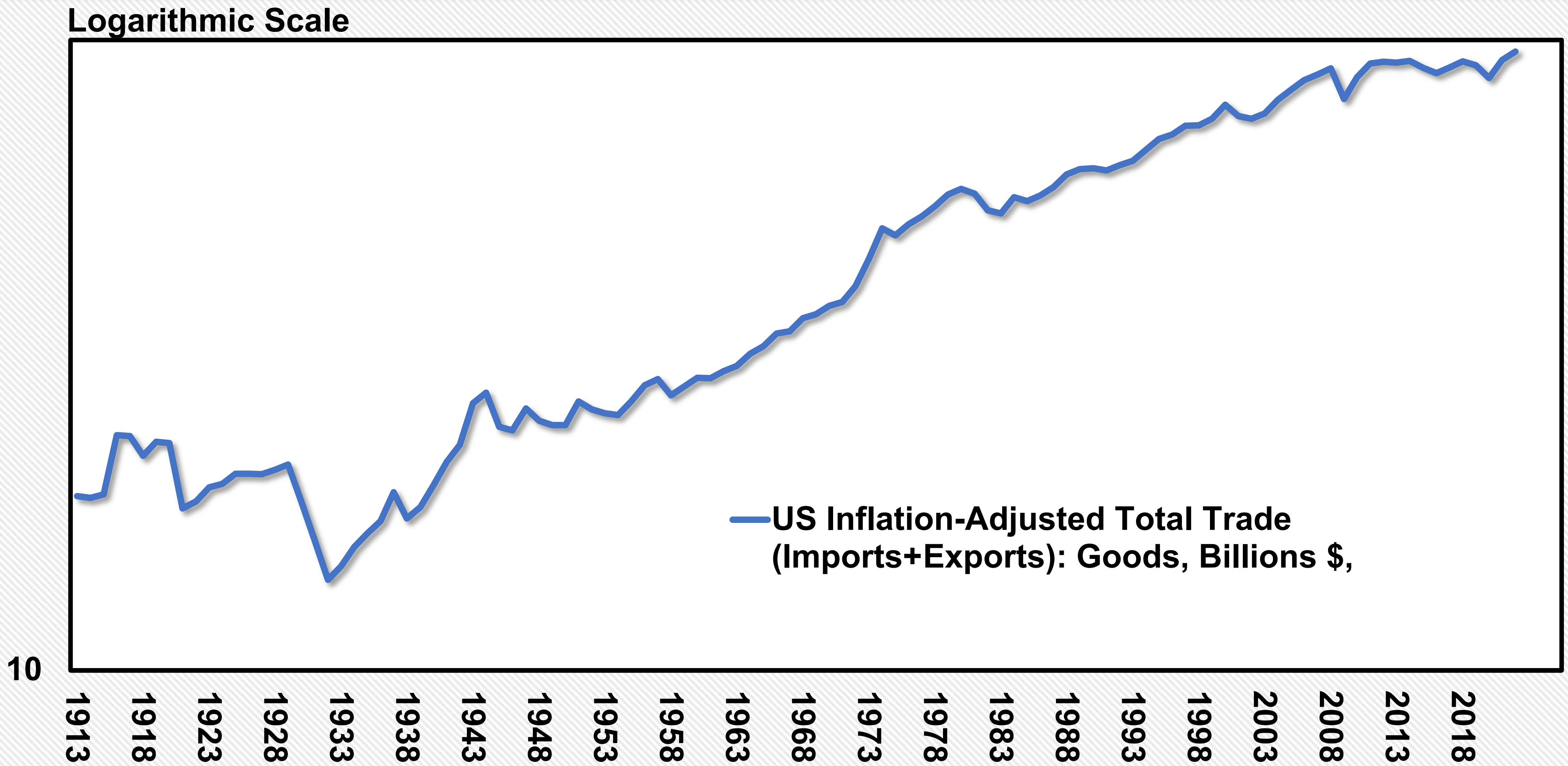
Source: US Census Bureau, Monthly Data Q1 Jan 1974-Jun 2023

Interest Costs are Relatively Low Versus History (For Now)



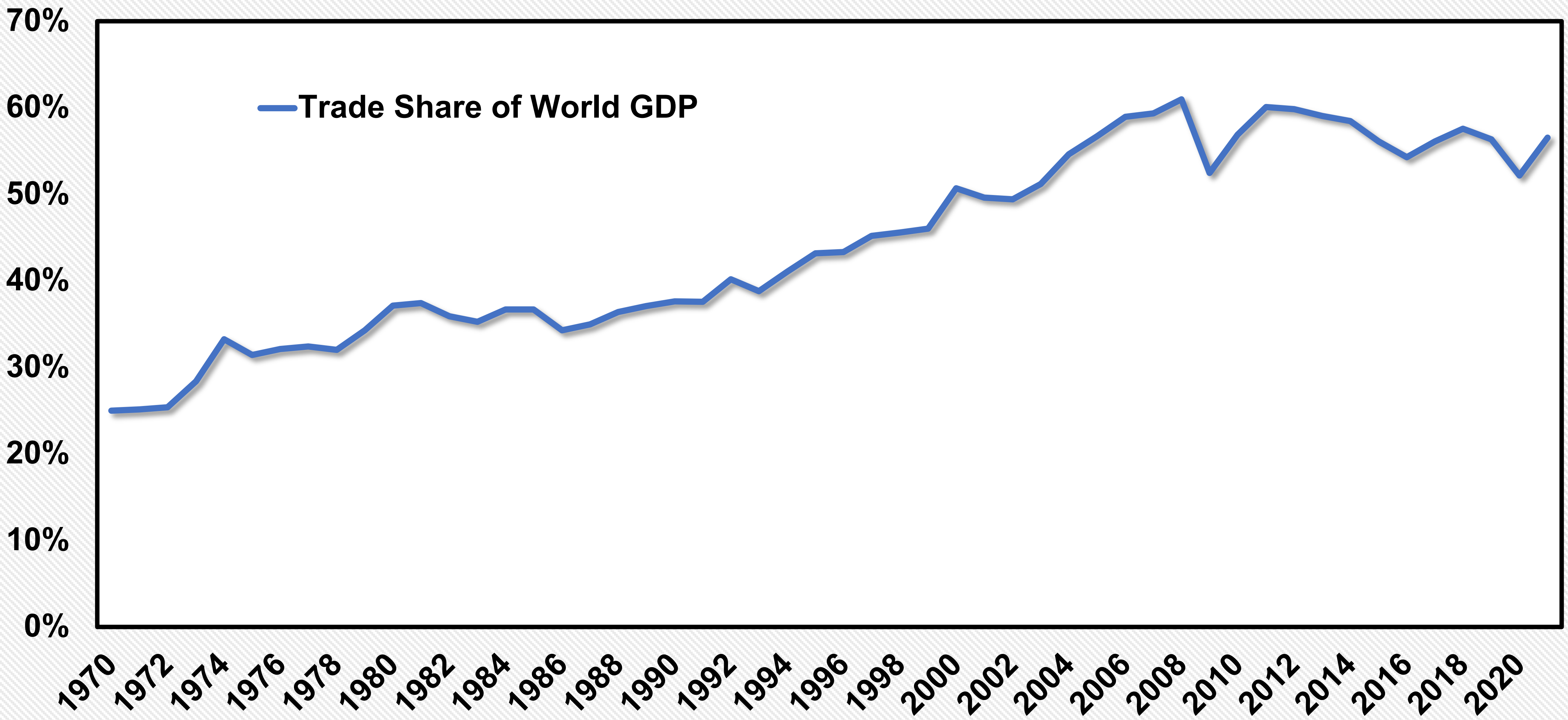
Source: Office of Management and Budget, Annual Data 1940-2021, Projection 2022-2032

The History of Globalization in One Line



Source: US Census Bureau, Annual Data 1913-2022

Deglobalization Has Begun



Source: World Bank, Annual Data 1970-2021

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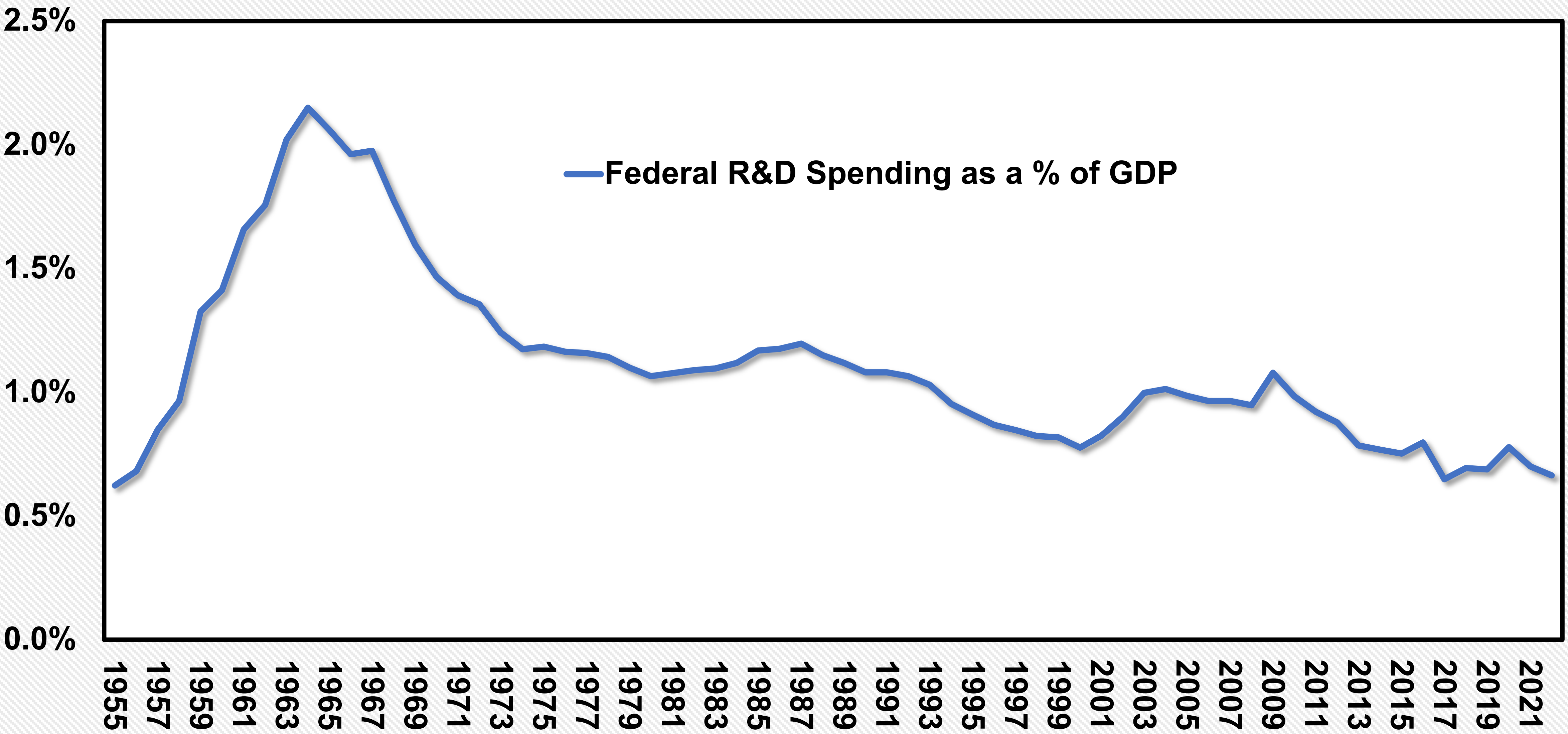
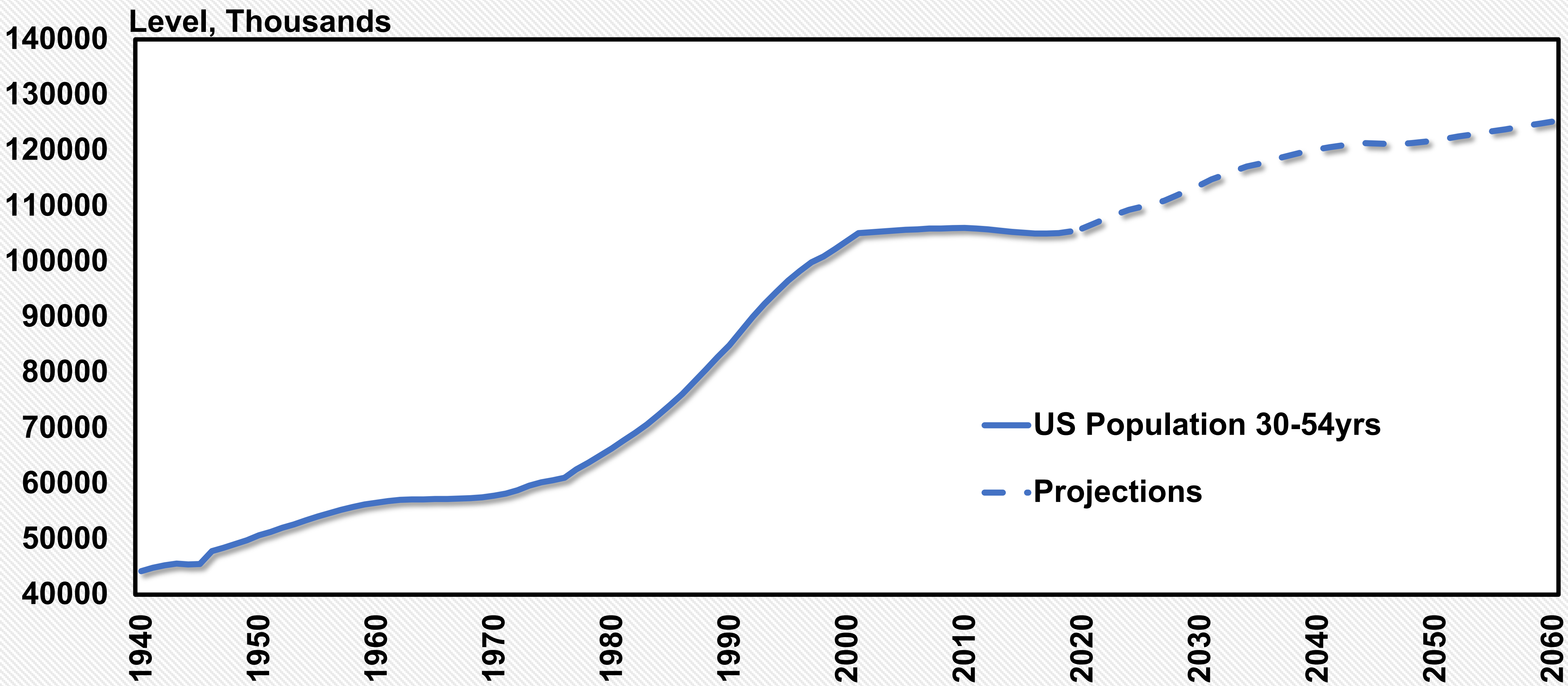
Return of Industrial Policy?



Source: National Center for Science and Engineering Statistics, Annual Data 1955-2022

Millennials Set to Drive US Growth



Source: US Census Bureau, Annual data 1940-2021, Projections 2022-2060

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Monday Morning OUTLOOK

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November 21, 2022

The Aftermath Economy

We will forever believe that locking down the economy for COVID-19 was a massive mistake. There is virtually no evidence that death rates were lowered by government mandates and lockdowns.

Business activity in certain sectors would surely have slowed as individuals protected themselves from COVID: think hotels, cruises, restaurants & bars, amongst other services. But the government didn't have to aggravate the problem by applying a version of medical central planning. Doctors, epidemiologists, and scientists can be very good at coming up with treatments, cures, and vaccines, but they're not equipped to weigh trade-offs that involve costs outside the medical arena, like loss of income or basic freedoms.

There is clear evidence that closing schools caused a harmful loss of learning, which could affect the incomes of future workers for decades, while paying people not to work has warped the labor force.

Economically, the United States ran up about $5 trillion in additional debt and boosted the M2 measure of the money supply by more than 40% during the pandemic, which caused a 40-year high in inflation. In turn, this inflation led politicians to release hundreds of millions of barrels of oil from the strategic petroleum reserve in an attempt to temporarily reduce energy prices.

In other words, the US enters the decades ahead with more debt, less spending power, an undereducated population, and less petroleum put aside for national defense. The US has made the future riskier.

At the same time, no one can know exactly what the near-term future looks like. Right now, the conventional wisdom is that the US faces a recession. Normally, we would disagree with the conventional wisdom, but this time we agree. Unwinding COVID policies will be painful.

Most people think that a recession is coming because the Federal Reserve is lifting interest rates. Last week, the US yield curve was inverted with 2-month Treasury bills yielding more than 30-year notes, suggesting that long-term investors think the Fed has gone too far.

Obviously, raising interest rates has hurt the housing market and imagining more economic damage to other sectors as these rate hikes bite seems straightforward. However, this is the first rate-hiking cycle in an inflationary environment under an "abundant reserve" model of managing monetary policy. The Fed has held interest rates artificially low for a very long time, and at least for now, the entire yield curve is still below current inflation rates.

But the real reason we expect a recession is that COVID policies severely distorted the economy. For example, from February 2020 through September 2022, real personal income increased just 2.6%, while real personal consumption climbed by 6.6%. And this happened with fewer people working because of lockdowns and overly generous unemployment benefits. We estimate that Americans have worked about 30 billion fewer hours during the past 2½ years than would have happened if COVID had never hit.

Yet, federal tax receipts hit 19.6% of GDP in 2022, a near record high, in spite of the lockdowns, while corporate profits jumped 23% between the end of 2019 and the second quarter of this year.

The US borrowed from future generations and handed out pandemic benefits that more than replaced lost earnings. Then it taxed the economic activity that this borrowing created, and kept small businesses closed in many states, while large public companies remained open. The result is that spending, profits, and tax receipts were all artificially lifted above normal. The whole economy got distorted and is still untwisting from those distortions.

It's as if the US economy had a car accident and the emergency responders injected it with morphine. As this morphine continues to wear off – via rate hikes and smaller deficits – it is hard for us to imagine that these above normal trends will continue. In other words, a recession is in the cards.

And with that recession, profits are likely to fall. The combination of lower profits and higher interest rates create a headwind to markets and turbulence for investors.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-23 / 7:30 am	Initial Claims – Nov 19	225K	**222K**		222K
7:30 am	Durable Goods – Oct	+0.4%	**+0.2%**		+0.4%
7:30 am	Durable Goods (Ex-Trans) – Oct	+0.0%	**+0.2%**		-0.5%
9:00 am	New Home Sales – Oct	0.570 Mil	**0.566 Mil**		0.603 Mil
9:00 am	U. Mich Consumer Sentiment- Nov	55.0	**55.5**		54.7

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2023 Year-End Outlook

S&P 500: 3,900 – Dow: 33,000

Don't be fooled by our year-end forecast. This year, we see "a low for the S&P 500 of about 3,200. However, stocks are likely to bottom within the first few months of the recession as investors realize this is not another Financial Panic like in 2008-09. That would give stocks room for a rally late in the year even if a recession continues, as equities see the light at the end of the tunnel ..."

Monday Morning Outlook: S&P 3,900 - Dow 33,000

GDP: -0.5%

"Our forecast is that the US economy enters a recession around mid-2023 ..."

Monday Morning Outlook: S&P 3,900 - Dow 33,000

"We think growth will undershoot the Fed's forecast in 2023. Instead of growing 0.5% in 2023, we expect real GDP will shrink about 0.5% ..."

Monday Morning Outlook: Still Unprecedented

Unemployment: 4.5%

"We expect something like the recessions in 1990-91 or 2001, when the unemployment rate went up about 2.0 to 2.5 percentage points, not like the soaring unemployment of the Great Recession or the 2020 Lockdown ..."

Monday Morning Outlook: We're Not Already in a Recession

Inflation: 4%+

"For 2023, the Fed is forecasting inflation of 3.1%. We think inflation will overshoot: ending next year above 4.0% ..."

Monday Morning Outlook: Still Unprecedented

Home Prices: -5% – -10%

"We expect a total decline, peak-to-bottom in the 5-10% range, nothing like the 25% drop in 2006-11 ..."

Monday Morning Outlook: The Housing Outlook for 2023

Corporate Profits: -10%

"The bottom line is that while stocks suffered [in 2022] from higher interest rates, the greatest headwind in 2023 should be lower profits ..."

Monday Morning Outlook: S&P 3,900 - Dow 33,000

10-Year Treasury Note Yield: 4.0% – 4.5%

First Trust Economic Team

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Forecasts as of January 2023.

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