

July 2023

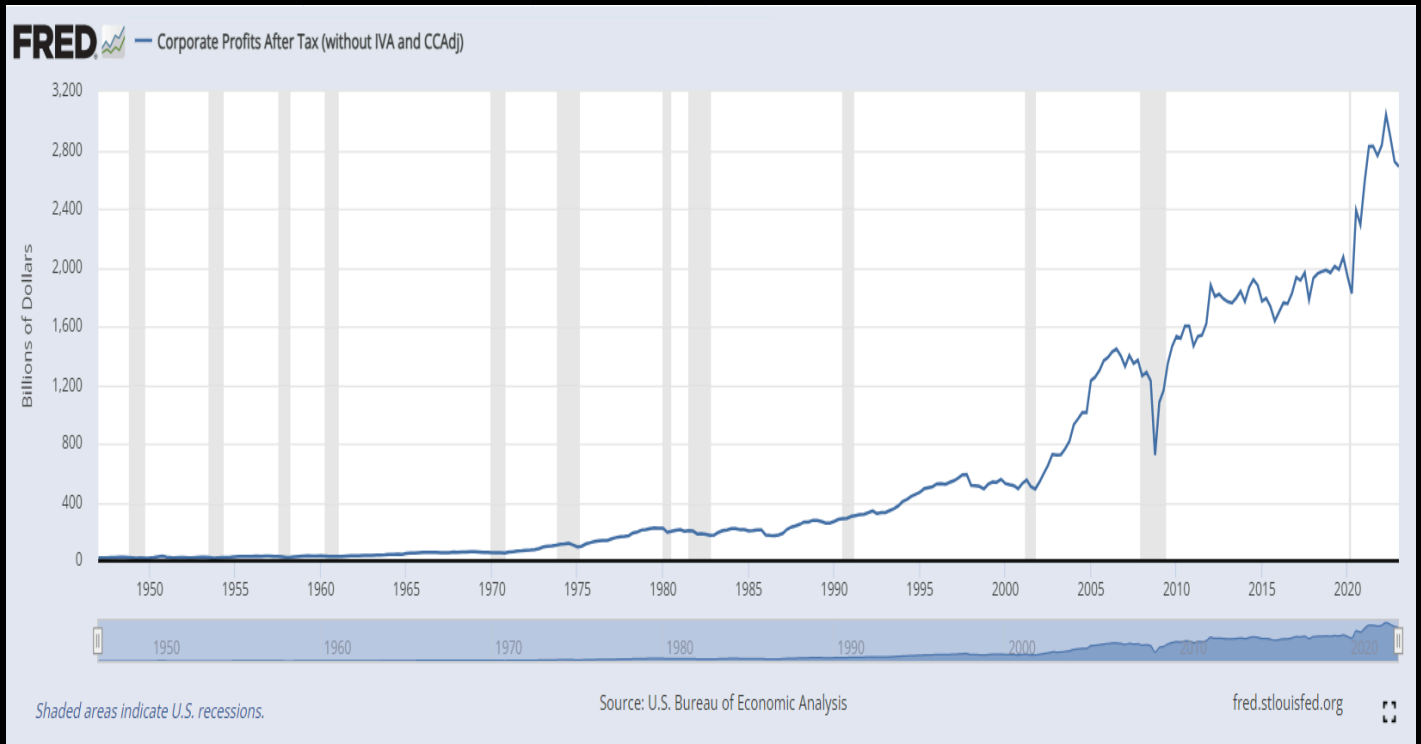
## Stuart thank you for being a subscriber

Blue = their thoughts, Orange = mine

Presently, there is little doubt that the consensus view is that a recession risk is not high. Yet we're already in a profits recession, an industrial recession, and a Gross Domestic Income (GDI) recession. Additionally, we're also in government tax receipts recession. Federal revenues YOY are down 10%, with personal income tax receipts crashing by 21% vs the first nine months of fiscal 2022. (There are unusual factors in play, particularly in California, that may be distorting tax collections currently.) As a result, the government deficit is up by almost \$900 billion compared to last year. The Congressional Budget Office (CBO) warns that budget performance is despite a drop-off in Covid-related spending. These have come down by \$265 billion versus last year. One prime reason why is that cost-of-living adjustments (COLAs) on entitlements like Social Security and Medicare are boosting federal outlays by roughly \$250 billion.

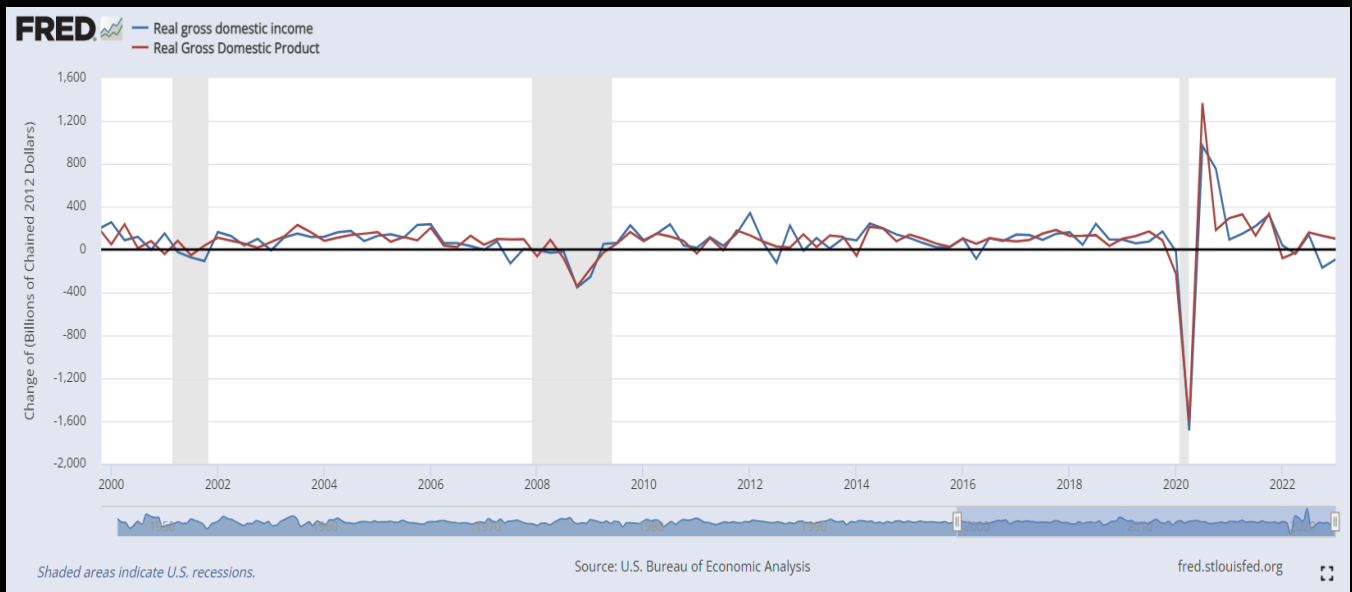
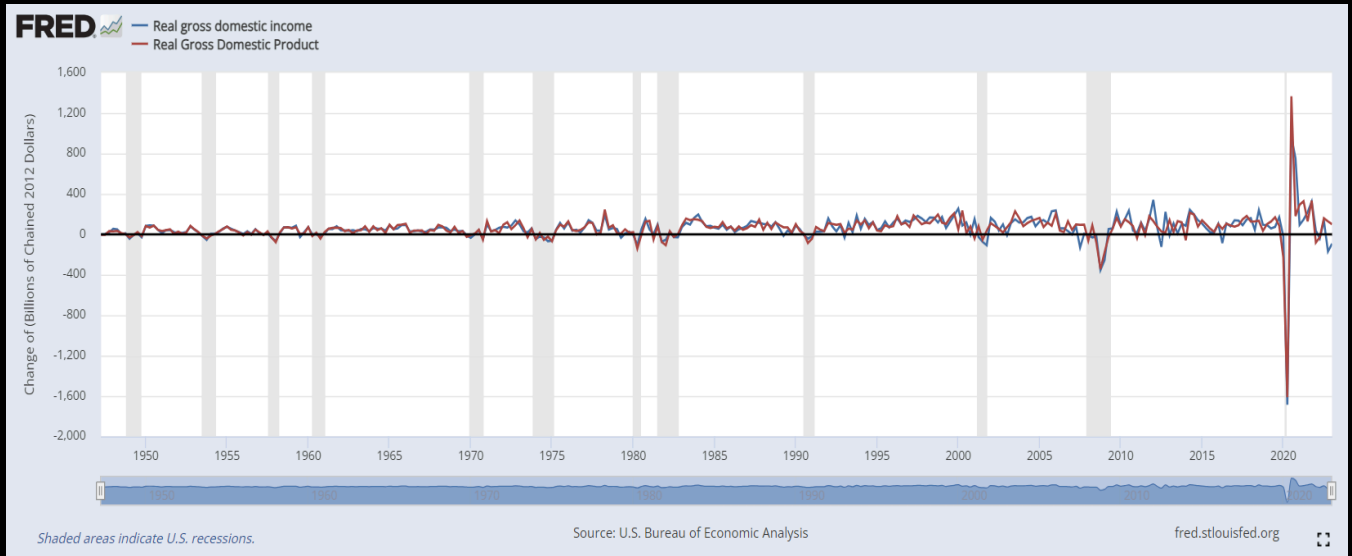
The long-deferred consequences of unfunded entitlements are now upon us. And as of Thursday another rating agency downgraded the US credit rating, [thank you politicians](#).

In a healthy economic growth environment, tax revenues typically increase while government spending tends to decline. However, today's situation is a complete reversal of this trend. And corporate profits are deteriorating.

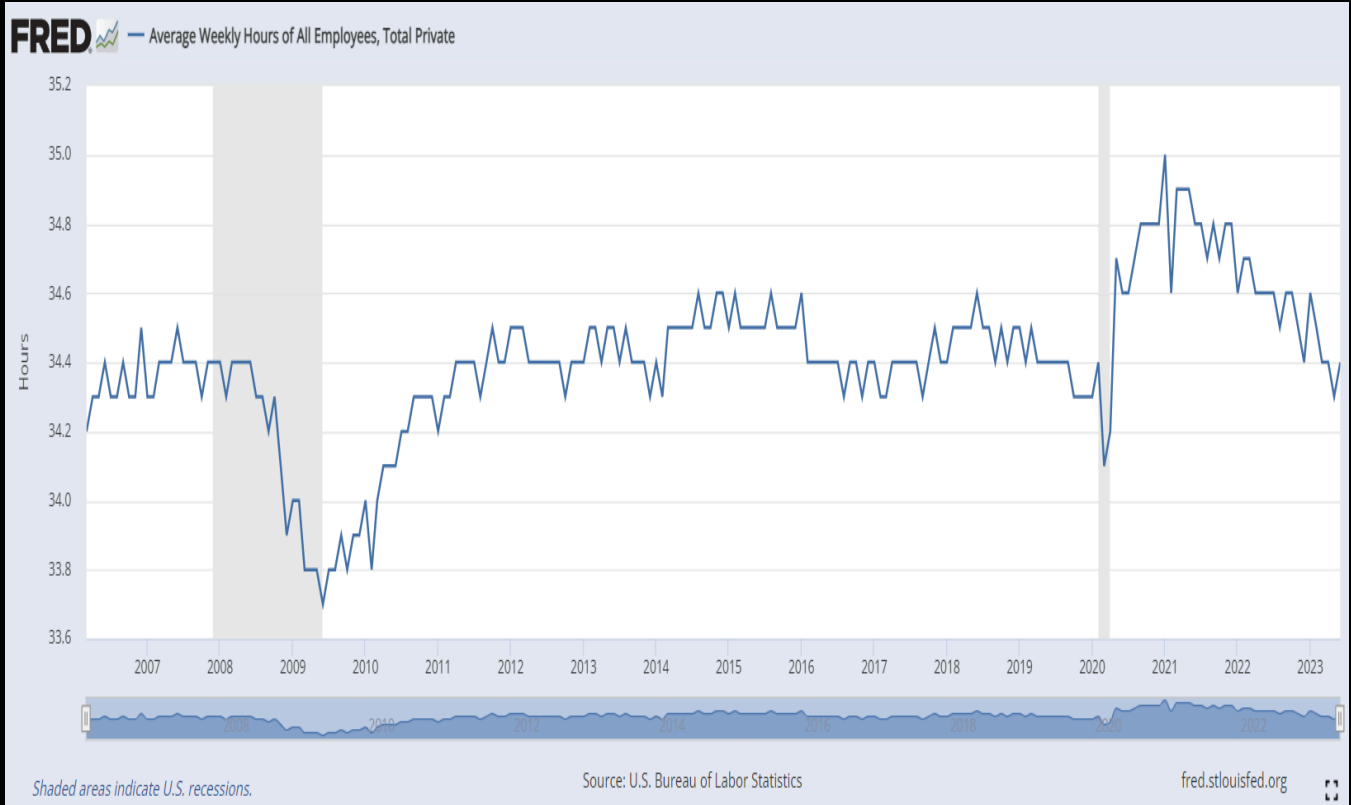


[Corporate Profits After Tax \(without IVA and CCAdj\) \(CP\) | FRED | St. Louis Fed \(stlouisfed.org\)](#)

Gross Domestic Income is falling. Not what I would expect for a booming stock market. More detailed below.



Hours worked is an earlier indicator of employment than the lagging indicator Unemployment. Below you can see a decline in the last years. I think this is starting to be reflected in the unemployment numbers.



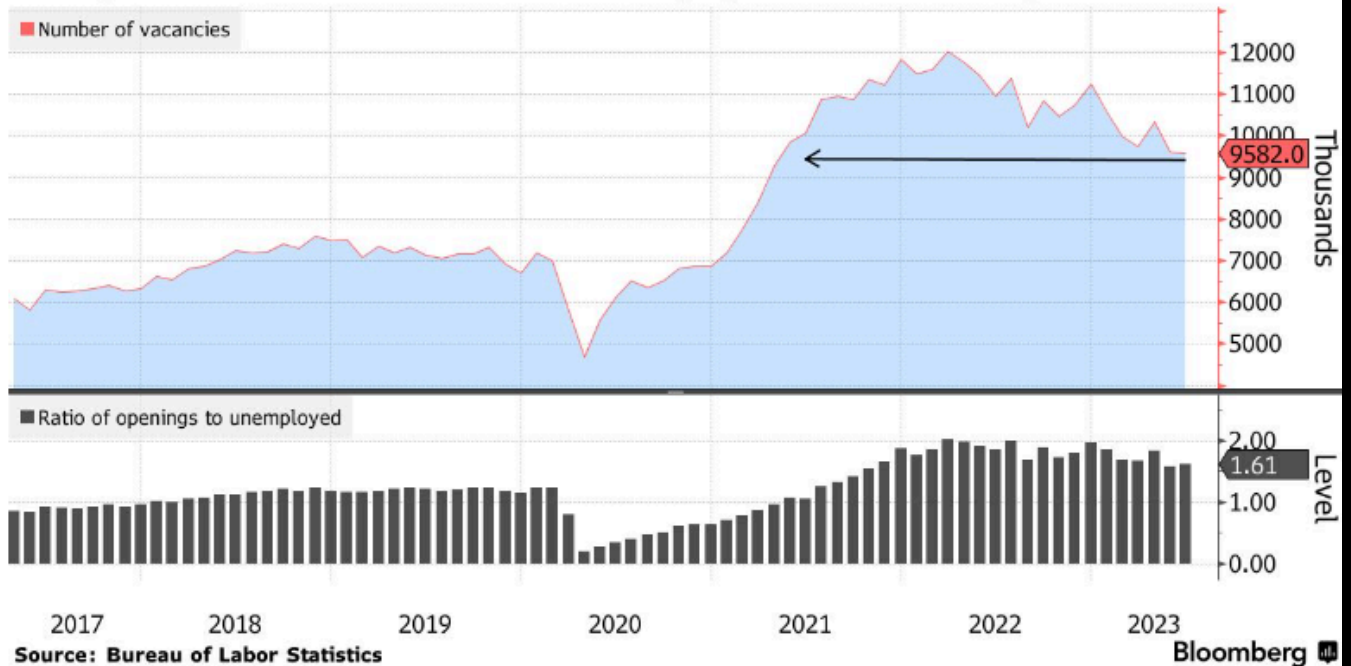
[Average Weekly Hours of All Employees, Total Private \(AWHAETP\) | FRED | St. Louis Fed \(stlouisfed.org\)](#)

Average weekly hours relate to the average hours per worker for which pay was received and is different from standard or scheduled hours. Factors such as unpaid absenteeism, labor turnover, part-time work, and stoppages cause average weekly hours to be lower than scheduled hours of work for an establishment. Group averages further reflect changes in the workweek of component industries. Average weekly hours are the total weekly hours divided by the employees paid for those hours.

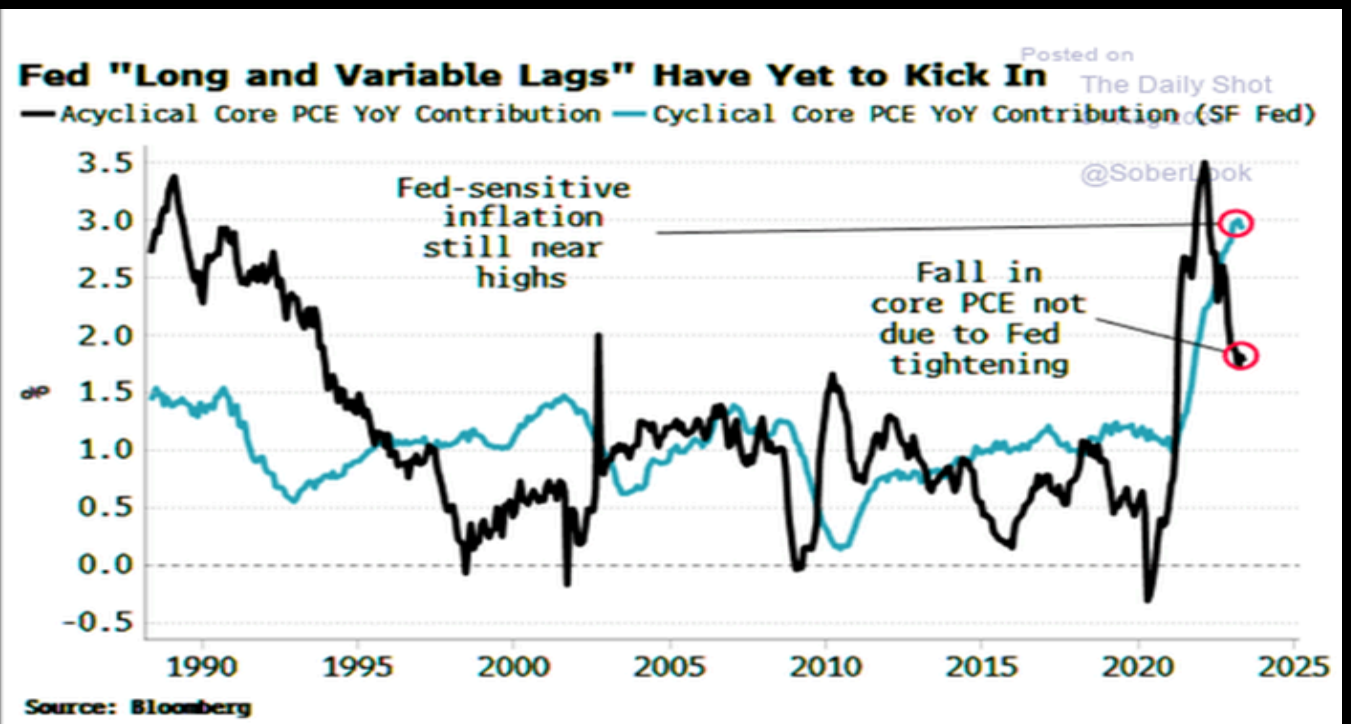
On 08/01/23 we had the job opening report.

# US Job Openings Fall to Lowest Since 2021

## Closely watched ratio of vacancies to unemployed was little changed



Rate hikes are slow to hit the economy. Unless something is "different this time", it never seems to be, markets will contract.



Source: [Simon White, Bloomberg Markets Live Blog](#)

How much will they contract? I'm not that smart, but the folks over at Trading Economics have an opinion. It looks to me like they think the DJ30 will drop about 10.44%. I'll bet the NDX and Russel 2000 will be more. Based on Wednesday's pull back, the NDX was 2X down from the DJ30, so let's just say a 20% drop as a guess. I do think that after the next pull back we see the next bull market.

Markets	Actual	Q3/23	Q4/23	Q1/24	Q2/24
<b>Stock Market (points)</b>	35559.51	34520	33605	32715	31846
<b>Currency</b>	101.92	103	105	106	108
<b>Government Bond 10Y (%)</b>	4.03	4.07	4.19	4.31	4.43

[United States Forecast \(tradingeconomics.com\)](https://tradingeconomics.com)

## Strategy Update:

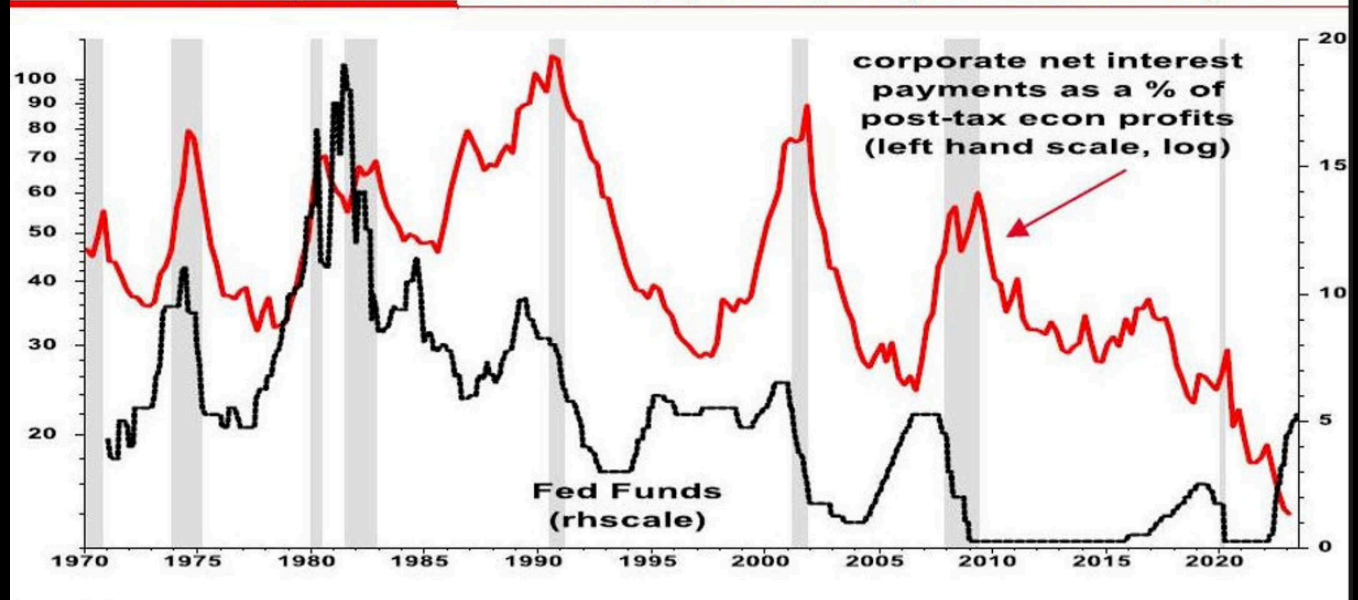
- ST NDX was adjusted to be more conservative and hopefully improve returns by lowering losses. For the month of July, it returned 33.80% on 45 trades.
- RST NDX SIM strategy was revamped to slow trading down. For July it posted a profit of 87.97% on 30 trades. I'm still running the old version, for comparison it returned 86.72% on 80 trades. Slightly lower profits and more trades. More testing to be done, but it looks like the revamped version will go to live trading.
- JTMA NQ is another SIM strategy I built. July was good at 59.97% profit on only 24 trades. Again, the strategy is designed to pick up larger directional movements with less trading. Testing will continue.
- Keep in mind that I trade futures and for the NQ (NDX), which all strategies above are based on, it has 20X leverage.

## In the News:

1.

List member Stanley sent me this article about corporate debt. A big positive for the equity markets is that they have a locked in cost of capital, at least for a while. This mainly applies to larger companies that floated bonds when money was cheap. I don't know, but I wonder how many small to medium size companies were able to get longer term financing, I'll bet less. Small to medium size firms employ a lot of people in the USA.

## US nonfinancial corporate net interest costs (% post-tax profits) are the lowest in 60 years



Source: Datastream

['Something very strange' explains why a US recession has been delayed \(msn.com\)](#)

And there is a bullish outlook for the end of the year.

## S&P 500 Year-End Price Targets

Majority of Wall Street firms have revised upwards their estimates for 2023

Firms	As of January	As of July
Bank of America	4,000	4,300
BMO	4,300	4,550
Barclays	3,725	4,150
BNP Paribas	3,400	3,400
Cantor Fitzgerald	4,100	3,500
Citigroup	4,000	4,000
Credit Suisse	4,050	4,700
Deutsche Bank	4,500	4,500
Evercore ISI	4,150	4,450
Fundstrat	4,750	4,825
Goldman Sachs	4,000	4,500
HSBC	4,000	4,600
JPMorgan	4,200	4,200
Morgan Stanley	3,900	3,900
Ned Davis Research	4,300	4,500
Oppenheimer	4,400	4,400
Piper Sandler*	3,225	3,700
RBC Capital Markets	4,100	4,250
Scotiabank	3,900	4,200
Societe Generale	3,800	4,300
22V Research	4,100	4,600
UBS	3,900	3,900
Wells Fargo	4,200	4,200

Source: Data from firms compiled by Bloomberg

Note: \*Estimate reflects midpoint of 3,600 to 3,800 forecast range

Bloomberg **Opinion**

Bloomberg/Authors

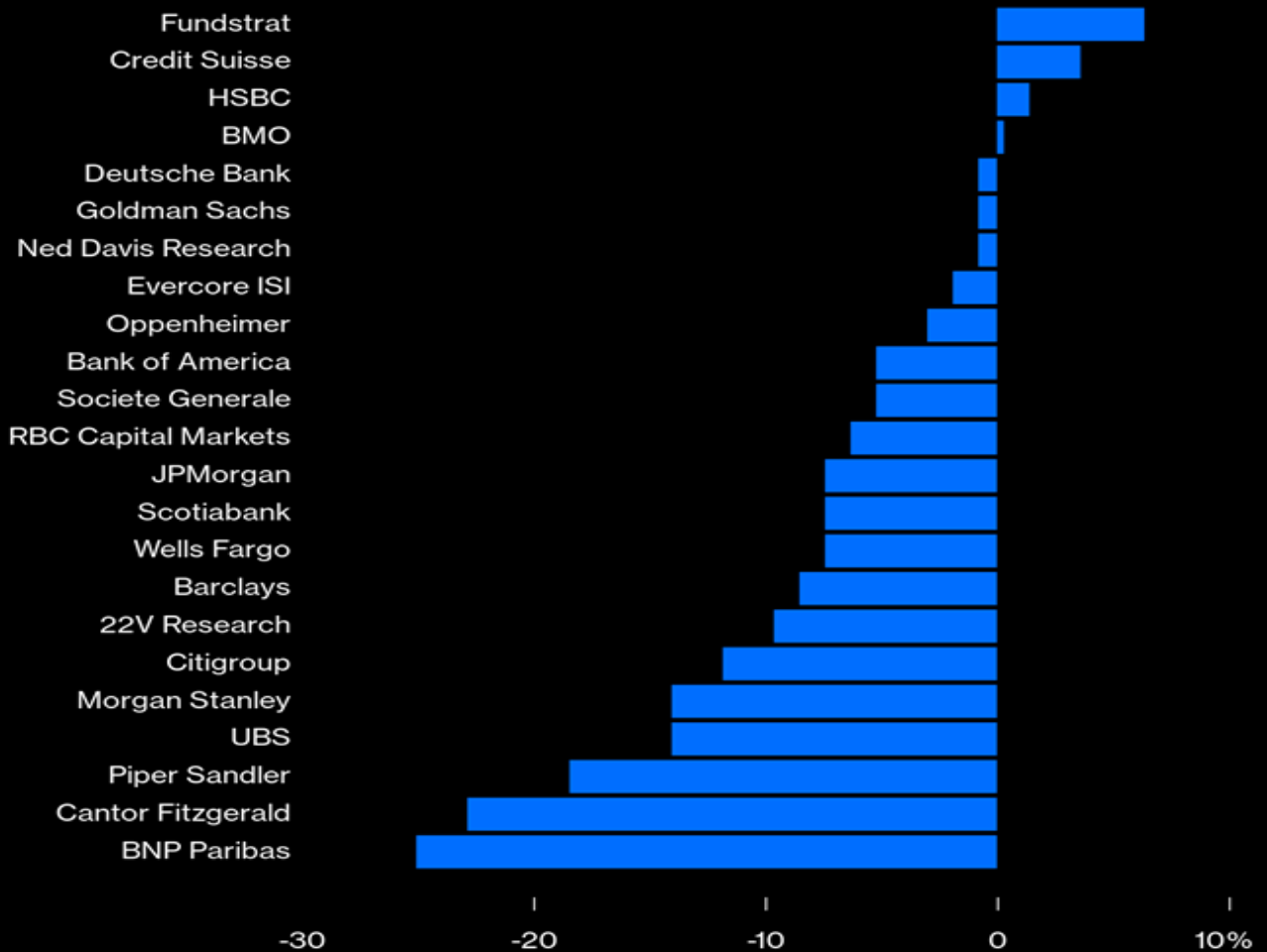
3.

And then not so bullish.

## Strategists Brace for the Worst

Their estimates imply serious falls for the S&P 500 in the next five months

■ Predicted Performance by Year-End



Source: Bloomberg

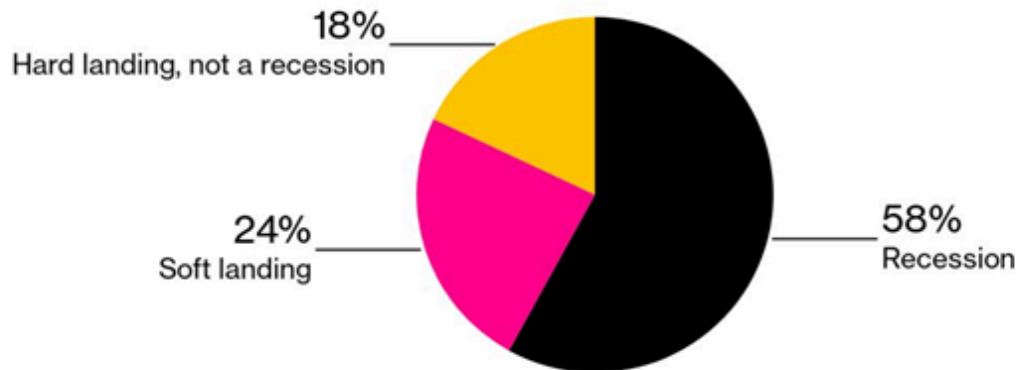
Bloomberg Opinion

### 4.

The economists in the Bloomberg survey have become gradually more optimistic about the outlook for the US economy, but a majority of 58% still forecast a recession in the next 12 months, down from 63% in the June survey and 67% in April.

## Most Economists Expect a US Recession Within 12 Months

About a quarter see a continued expansion with a soft landing



Source: Bloomberg News survey of economists July 13-18  
Economists were asked if US would have a recession in the next 12 months

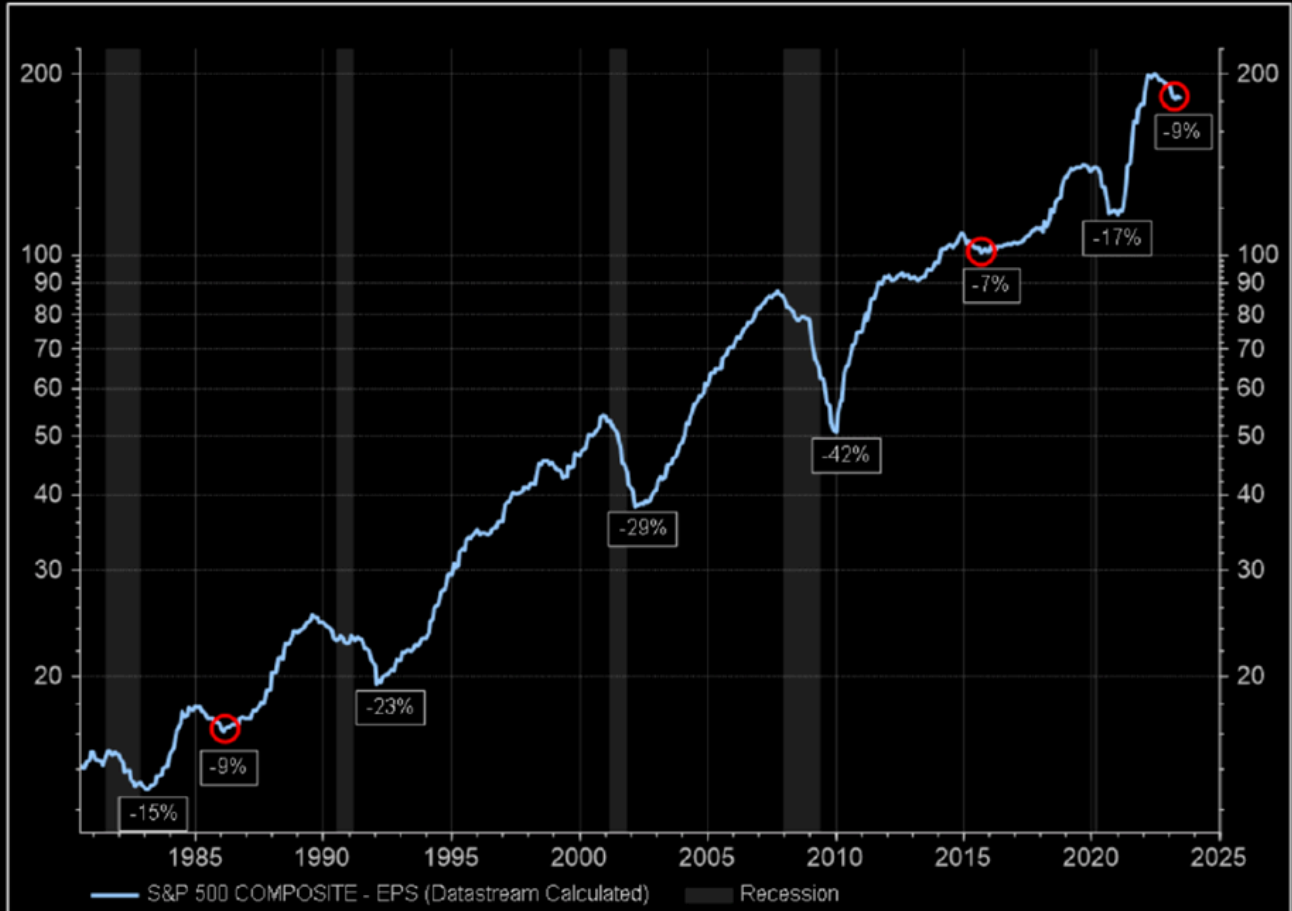
Bloomberg

5.

### Earnings if (IF) there would be a recession...

Typically, in a recession, earnings fall by at least -20% (-27% real) and that's even if we exclude the GFC, when S&P 500 EPS declined by -42%. Thus far, S&P 500 EPS is down -9% since the June 2022 high. EPS has never fallen more than -9% without then developing into a full-blown recession (red circles).

## Chart 6: S&P 500 earnings per share (EPS)



Macro Strategy

6.

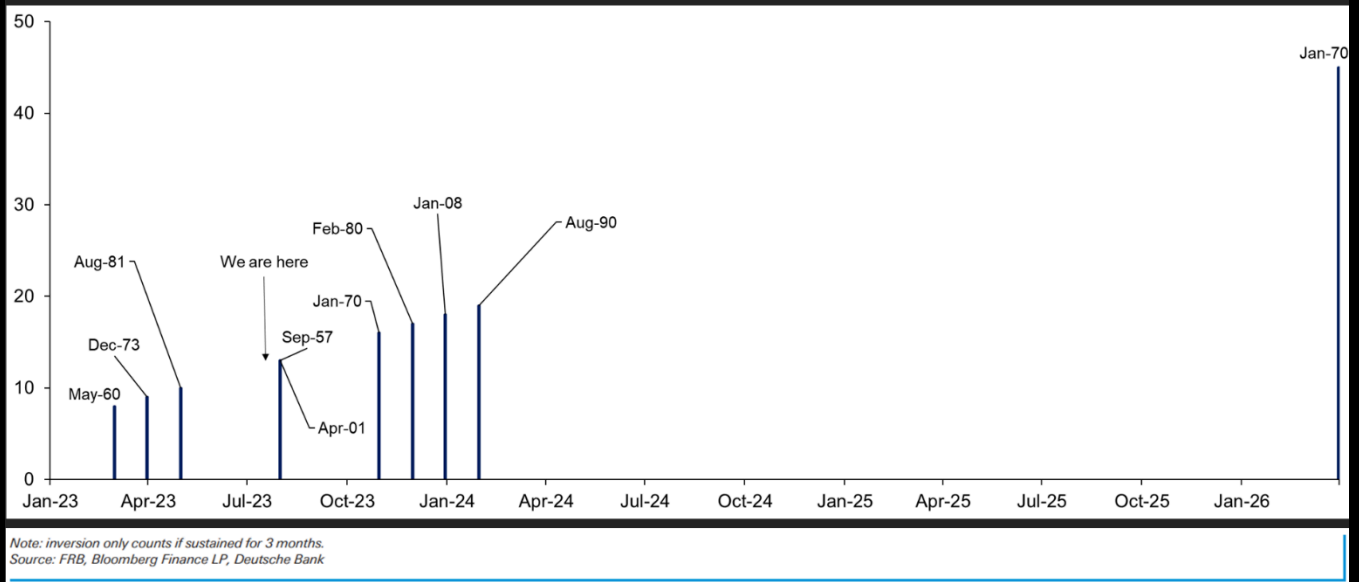
**Jim Reid of DB says:** The US 2s10s yield curve has historically been the most accurate predictor of a US downturn over the last 70 years. No US recession has ever occurred without an inverted curve occurring first. The only false alarm was in the mid-1960s when due to rising inflation, the market was expecting a hiking cycle in 1966 that didn't materialize partly due to a falling equity market and also concerns over rising unemployment. As a result, the curve eventually re-steepened back into positive territory and the looser policy than expected helped avoid a recession. However, inflation reignited in 1967 and the Fed had to hike more aggressively later in the decade and the next inversion in 1968/69 restored the usual lag between inversion and recession (started January 1970). The difference to today is that the inversion is largely due to the 500bps of hikes already seen rather than the promise of it.

Today's CoTD looks at the historical lag between the yield curve inversion and recession, and works out when the downturn would occur if this cycle behaves like those of the past 70 years. We count an inversion event as one where the inversion lasts for 3 months so we don't start it if there's a briefer inversion before that threshold is reached.

Of those 10 inversions that all preceded recessions (including the separate events before the 1970 recession), the lag would have already led to 3 rolling over between March and May of this year. 2 more

would lead to a recession in August and then 4 more between November 2023 and February 2024. So, we're around a third of the way through the historical window of March 2023 - February 2024 for 9 of the past 10 cycles. The closer we get to the end of Q1 next year without a recession, the more the chances of this time being different. Until then we're playing dodgeball.

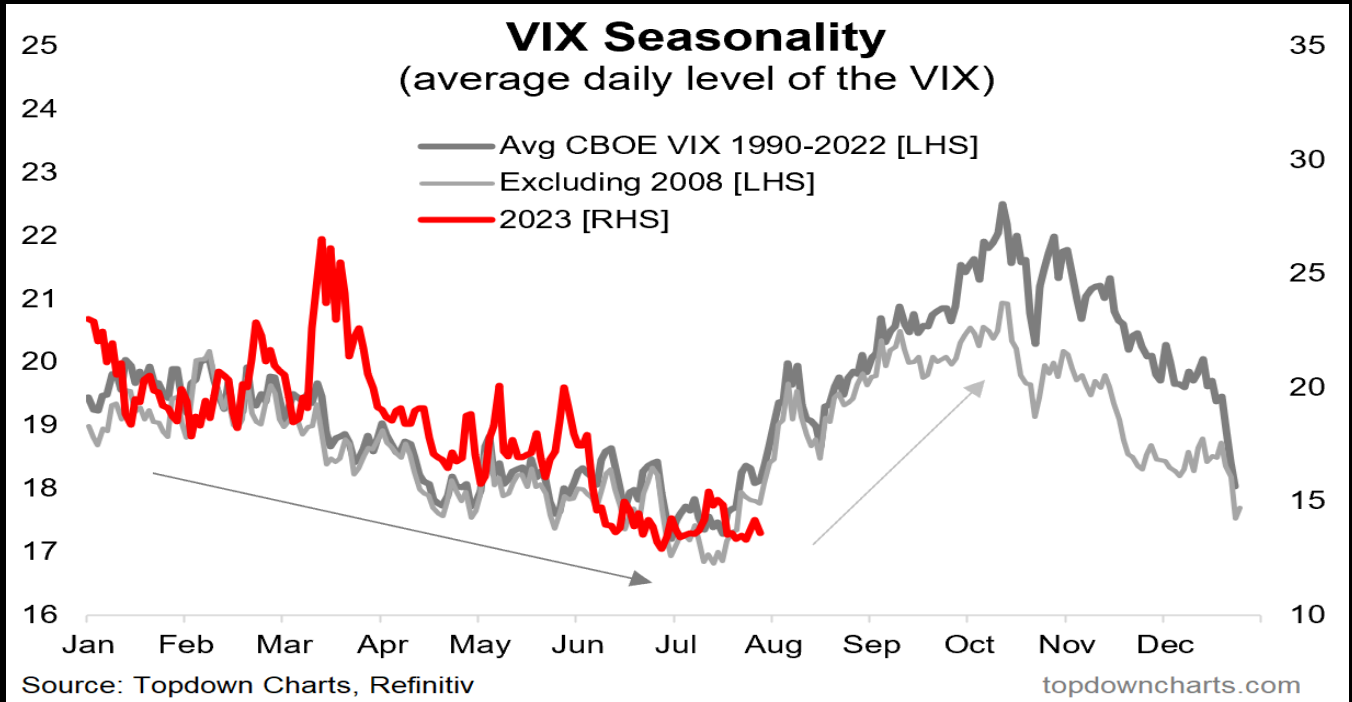
Figure 1: When would the next US recession occur if the lag between the US 2s10s inversion and recession matches previous cycles?



<https://www.db.com/disclosures>

## Volatility Seasonality

Top Down Charts 'Tis the Season to be Volly: Indeed, the seasonal tendency is for higher volatility around this time of the year; climaxing around October. With sentiment increasingly frothy, valuations back to expensive levels, and still murky macro, the path higher may not be as smooth or simple as it seems.

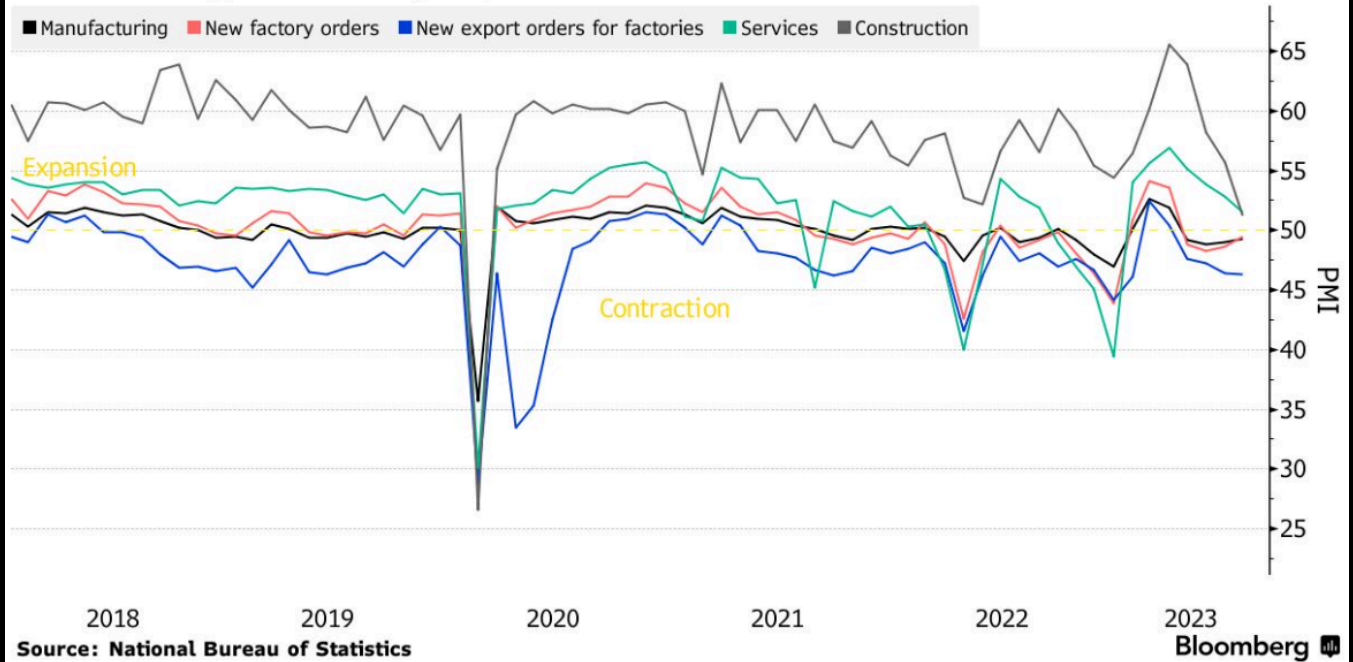


Source: [@topdowncharts](#) [Topdown Charts](#)

8.

China is the second largest economy, it is slowing. That said, they will stimulate again to try to rescue their property / business sectors, it will not work long term.

## China's Economic Activity Loses Steam Manufacturing contracts again, services sector wanes



[China Manufacturing Keeps Shrinking, Weighing on Economic Recovery - Bloomberg](#)

9.

Interesting stats on household debt ranked by GDP. I would have thought some of those at the top of the list would not be there.

## U.S. Household Debt Not as High as in Most Other Developed Countries

Country	Percentage of GDP, Fourth Quarter 2022
Switzerland	128.3
Australia	111.8
South Korea	105.0
Canada	102.4
Hong Kong SAR	96.0
Netherlands	95.0
New Zealand	94.5
Sweden	87.9
Thailand	87.7
Denmark	86.0
United Kingdom	83.5
Norway	77.4
<b>United States</b>	<b>74.4</b>
Japan	68.2
Luxembourg	67.2
Malaysia	66.8
France	66.2
Finland	65.8
Portugal	61.5
China	61.3

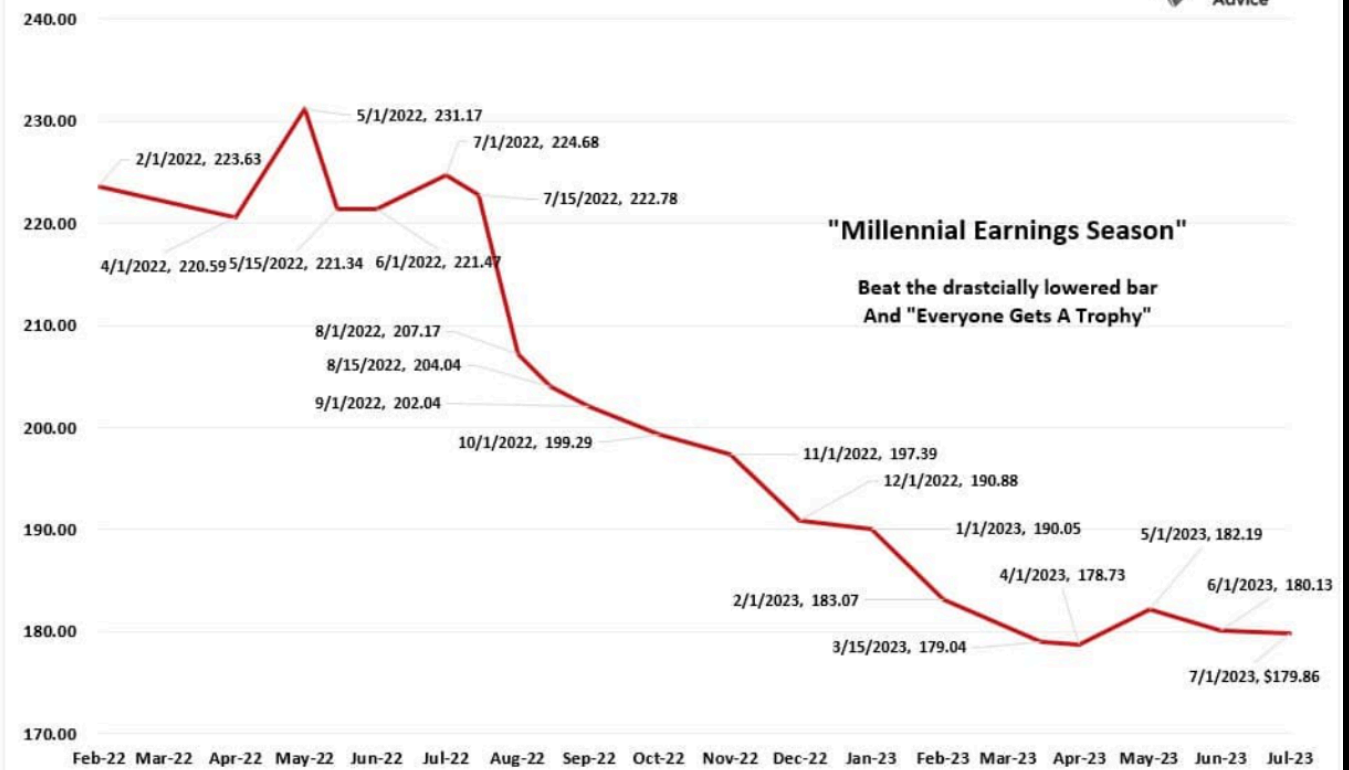
Source: <http://stats.bis.org>

[www.HSDent.com](http://www.HSDent.com)

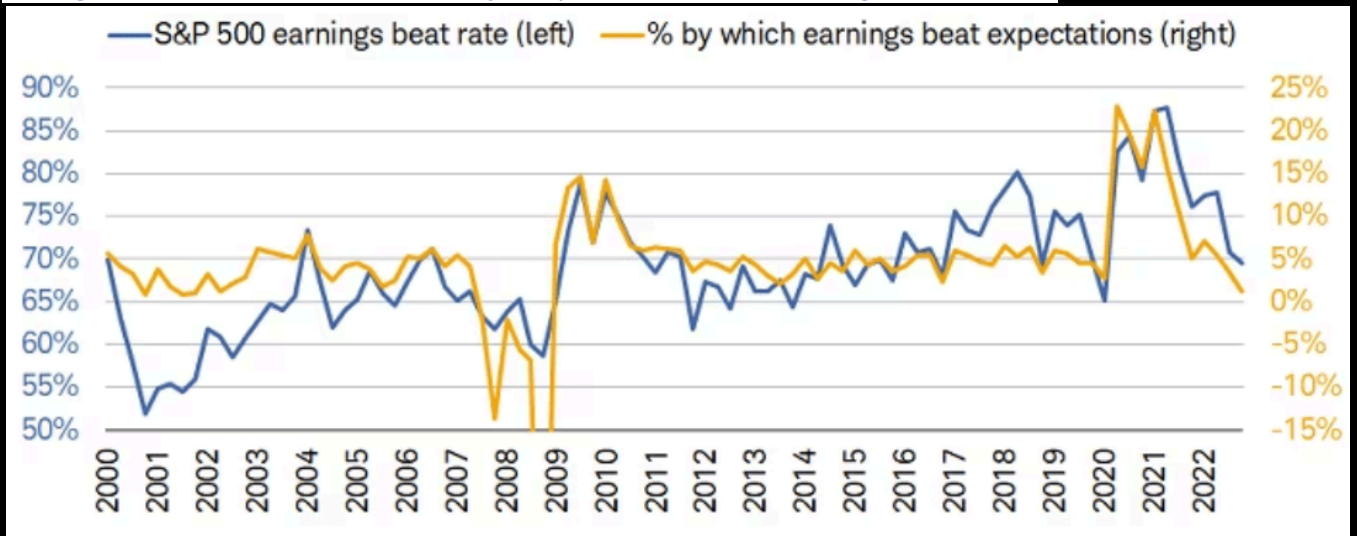
10.

How do companies keep beating analyst estimates, the analysts keep lowering estimates.

Analysts Estimates For Q2 - 2023 Over Time



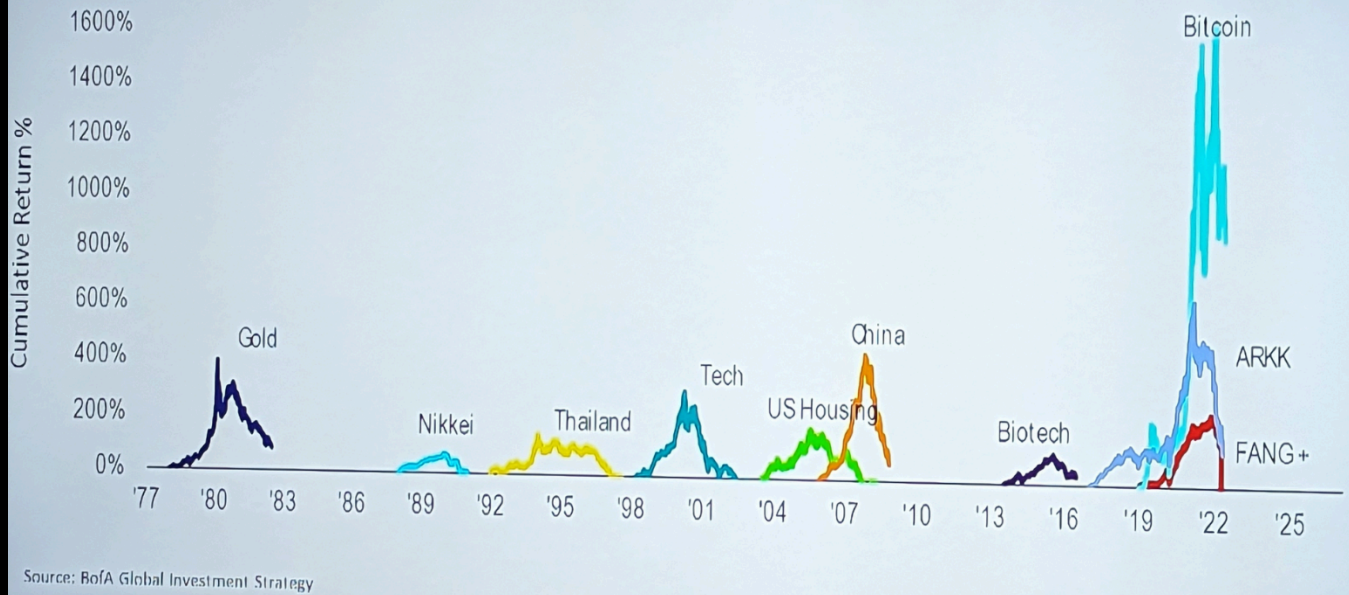
*"An easy way to see this is the number of companies beating estimates each quarter, regardless of economic and financial conditions. Since 2000, roughly 70% of companies regularly beat estimates by 5%. Again, that number would be lower if analysts were held to their original estimates."*



11.

I was watching Bloomberg Invest and saw this chart. Nice history of asset bubbles. Is it missing AI?

## History of asset bubbles



### 12.

The quickest lag between hiking and a recession was the 11 months between the hiking cycle that began in August 1980 that resulted in a recession in July 1981. The equivalent lag this time would have taken us to February this year. The Fed hiked 600bps in that first (and only) year of that cycle, the only one bigger than the current cycle.

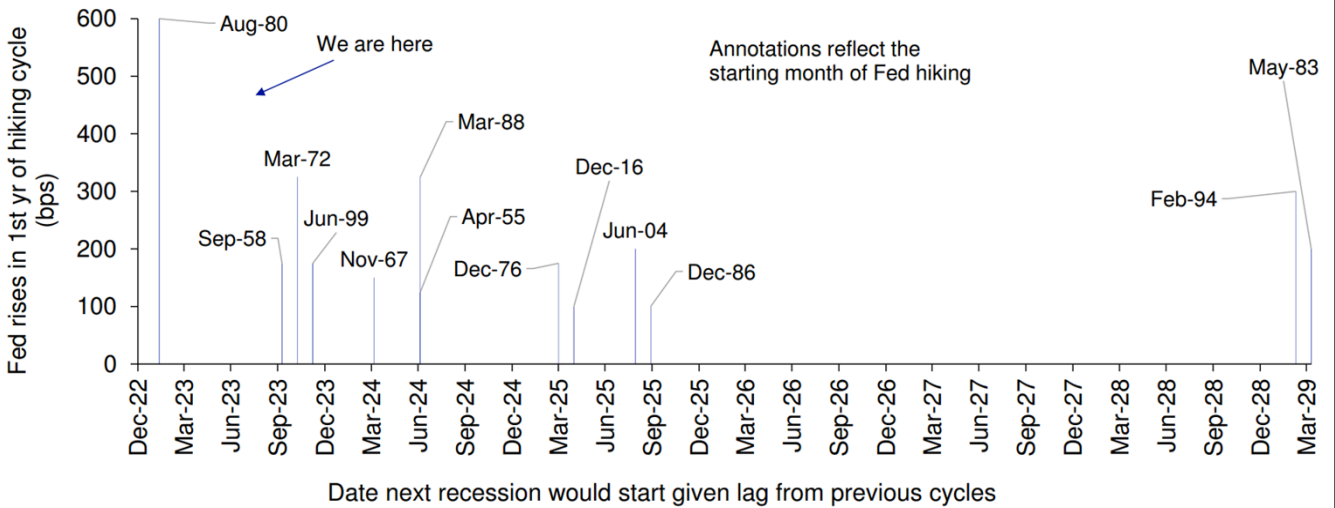
Of the 13 hiking cycles here, only this 1980-81 cycle turned into a recession less than 19 months after the start of the hiking cycle. So a recession now (16 months on from the first hike) would still be very early. However, a further 3 turned over between 19-21 months later which transposed onto this cycle takes us to Q4 this year. A further 3 rolled over 25-28 months later which would be the equivalent of April to July 2024. That takes us to 7 out of 13. A further 4 rolled over between the equivalent of March 2025 and September 2025.

The final two would have taken until 2029 to cause a recession and, in planetary terms, it looks more like Pluto on this scale.

Caveats to this analysis include the fact that interest rate rises may not have been the major cause of the recession. For example, the 1973 oil crisis when prices quadrupled due to an embargo swiftly led to a recession. Most recently, the Covid-19 pandemic was the cause of the 2020 recession. In addition, business cycles have gotten longer in the last 40 years. Countering that, the 450bps of hikes we saw in the first year of this rate hike cycle was the second-most aggressive in this post-WWII sample.

So, inflation is falling fast, and the data is holding up, thus improving the chances of a soft landing. Beware of the lag though.

Figure 1: When would the next US recession occur if the lag between the first hike in a cycle and the recession matched previous cycles?



Note: Hiking cycle criteria starts when we see >100bps in a year. So initial hikes in 2015 (25bps in a year) and 1963 (50bps) are eliminated  
 Source: FRB, Bloomberg Finance LP, Deutsche Bank

Jim Reid: <https://www.db.com/>

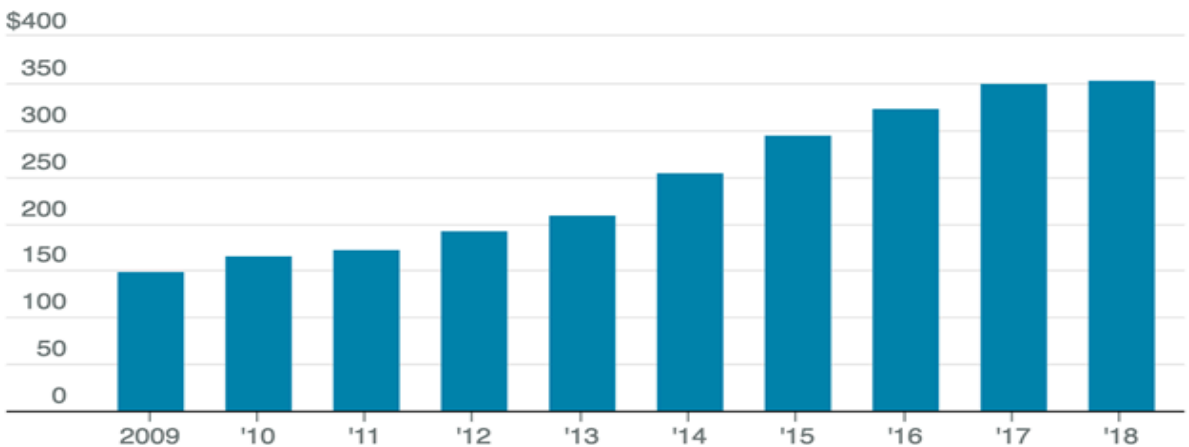
13.

It does seem logical to me that the largest buyer of medications should have the right to negotiate prices, after all, that is how capitalism works.

### Upping Your Meds

The amount Medicare pays for drugs had doubled since 2009.

#### Average net price of brand-named drugs obtained through Medicare Part D



Note: All prices in 2018 dollars.

Source: Congressional Budget Office, Jan. 2022 report

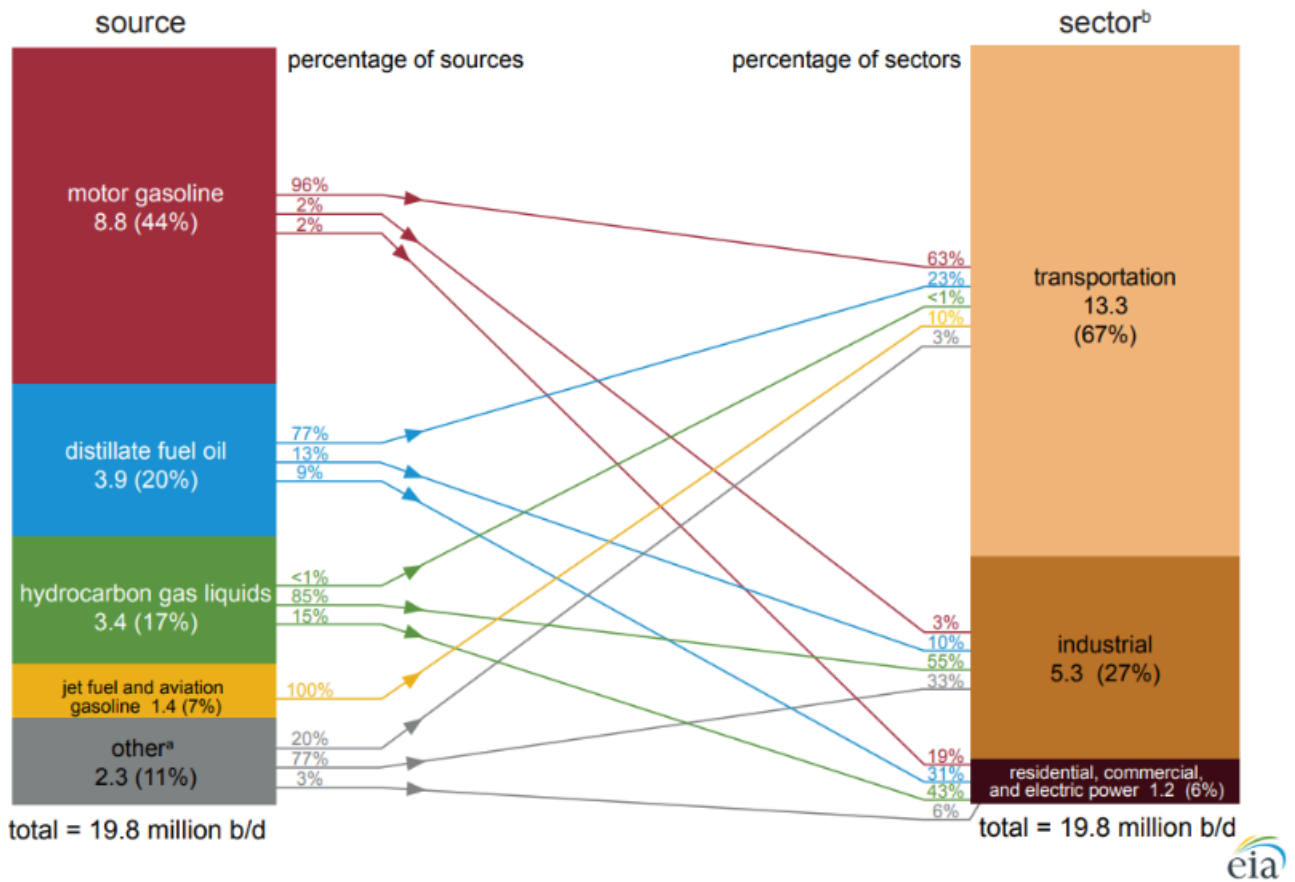
[https://www.barrons.com/articles/drug-costs-pricing-dogs-humans-1479e10e?mod=past\\_editions](https://www.barrons.com/articles/drug-costs-pricing-dogs-humans-1479e10e?mod=past_editions)

## Food for Thought:

I have shown this chart from the EIA in the past, but it seems some list members do not understand that the majority of oil used in the USA is for transportation. IMHO, if the USA can transition to EV's over time as battery technology get better, then the dependence on foreign governments (Middle East, Russia, etc.) lowers which in turn strengthens the USA as we are the largest consumer of oil. Also, the cost to produce oil has increased in the last decade and thus those producers breakeven will be harder to obtain as demand starts to fall and prices lower. And Big Oil is investing heavily into the sector [Chevron Considers Lithium Production in Latest EV Bet by Big Oil - Bloomberg](#)

### U.S. petroleum products consumption by source and sector, 2021

million barrels per day (b/d)



Sources: U.S. Energy Information Administration (EIA), *Monthly Energy Review* (April 2022), Tables 3.5, 3.7a, 3.7b, and 3.7c.

Note: Sum of components may not equal total due to independent rounding. See "Extended Chart Notes" on next page.

<sup>a</sup> Includes asphalt and road oil, aviation gasoline blending components,

lubricants, kerosene, petrochemical feedstocks, petroleum coke, residual fuel oil, still gas (refinery gas), special naphthas, waxes, unfinished oils, and miscellaneous products.

Also includes renewable fuels, excluding fuel ethanol.

<sup>b</sup> Industrial, commercial, and electric power sectors include primary energy consumption by combined-heat-and-power (CHP) and electricity-only plants in the sector.

## How much petroleum does the world consume?

Total world consumption of petroleum in 2019 was about 100.37 million b/d.

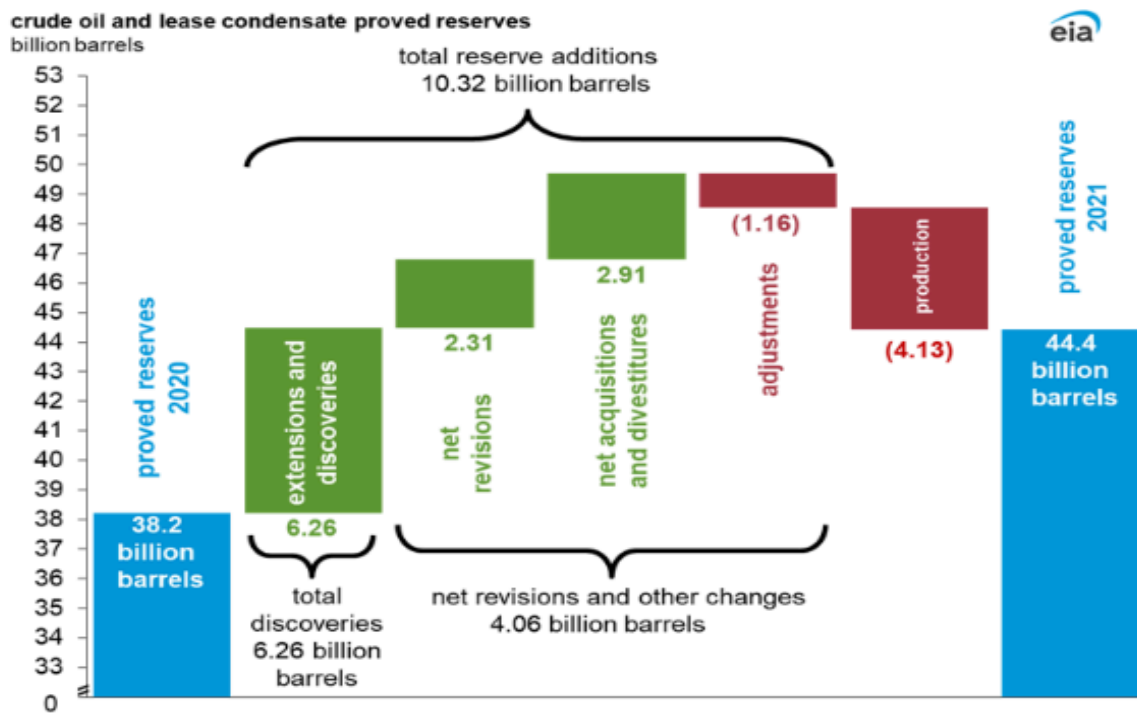
The five largest petroleum-consuming countries, and their percentage shares of total world petroleum consumption in 2019, were:

20.5%	14.0%	4.9%	3.7%	3.7%
United States	China	India	Japan	Russia

[Use of oil - U.S. Energy Information Administration \(EIA\)](#)

I'm not an oil expert, but I understand math. If the USA has 44.4B barrels of proven oil reserves, and we use 19.8M barrels of oil per day, that equates to  $(19,800,000 * 365) = 7,227,000,000$  per year in consumption. So how long can we survive on USA oil,  $(44,480,000,000 / 7,227,000,000) = 6.2$  Years. Of course, we import oil which extends that time frame, but if there was a breakdown in world affairs and the US relied on its own oil, EV's make a lot of sense.

**Figure 9a. Changes in the proved reserves of U.S. crude oil and lease condensate, 2020–21**

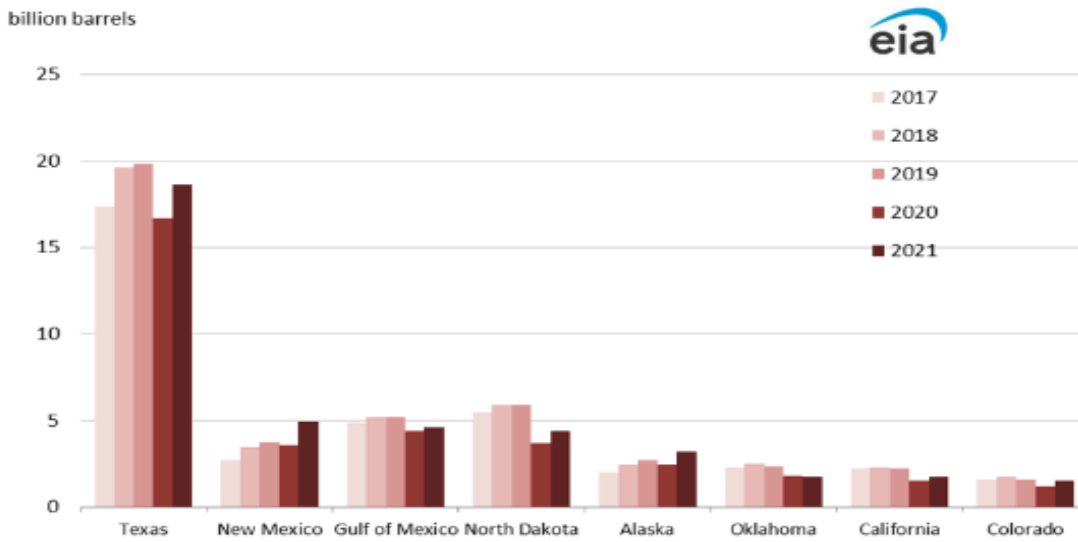


Data source: U.S. Energy Information Administration, Form EIA-23L, *Annual Report of Domestic Oil and Gas Reserves*  
 Note: Component columns may not add to total because of independent rounding. Y-axis has a nonstandard scale.

[Proved Reserves of Crude Oil and Natural Gas in the United States, Year-End 2021 \(eia.gov\)](#)

Texas has an economics interest against EV's. Will be interesting to see Elon Musk's influence in Texas.

Figure 2. Proved reserves of the top eight U.S. oil reserves states and regions, 2017–21



Data source: U.S. Energy Information Administration, Form EIA-23L, *Annual Report of Domestic Oil and Gas Reserves, 2017–21*  
Note: Oil reserves include crude oil and lease condensate. *Gulf of Mexico* represents the federally owned offshore portion of the Gulf of Mexico. Although not a state, it is an important U.S. oil and natural gas producing region.

[Proved Reserves of Crude Oil and Natural Gas in the United States, Year-End 2021 \(eia.gov\)](https://www.eia.gov)

## The End



Cheers,

Stuart [415-674-4004](tel:415-674-4004) 3 R's of life – Rethink, Reevaluate, & Reallocate

"Bulls make money, bears make money, pigs get slaughtered."

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