

A low-angle, upward-looking perspective of several modern skyscrapers with glass facades, reaching towards a bright blue sky with some white clouds. The perspective creates a sense of height and architectural grandeur.

Payden & Rygel

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# **Macro Memes & Mind-Viruses: Our 2023 Economic Outlook**

March 17, 2023

“Financial Fridays”

Florida Local Government Investment Trust

Presented by The Payden Economics Team



# Payden: Who We Are

## OUR FIRM

### ESTABLISHED IN 1983

Los Angeles-based, offices in Boston, London, Milan

### \$133 BILLION AUM

A fully-resourced and flexible firm

### ONE GOVERNANCE CENTER

Clients have direct access to business owners

### 100% EMPLOYEE OWNED

## OUR CULTURE

### GLOBAL PERSPECTIVE ON INVESTING

Regardless of benchmark

### COLLABORATIVE APPROACH

Sharing best ideas, constructive debate

### EXCEPTIONAL RETENTION

of talented people and clients

### ALIGNMENT OF INTERESTS

Fully focused on our clients

## OUR GLOBAL REACH

### ★ PAYDEN & RYDEL OFFICES





## *What My Mom Thinks We Do...*



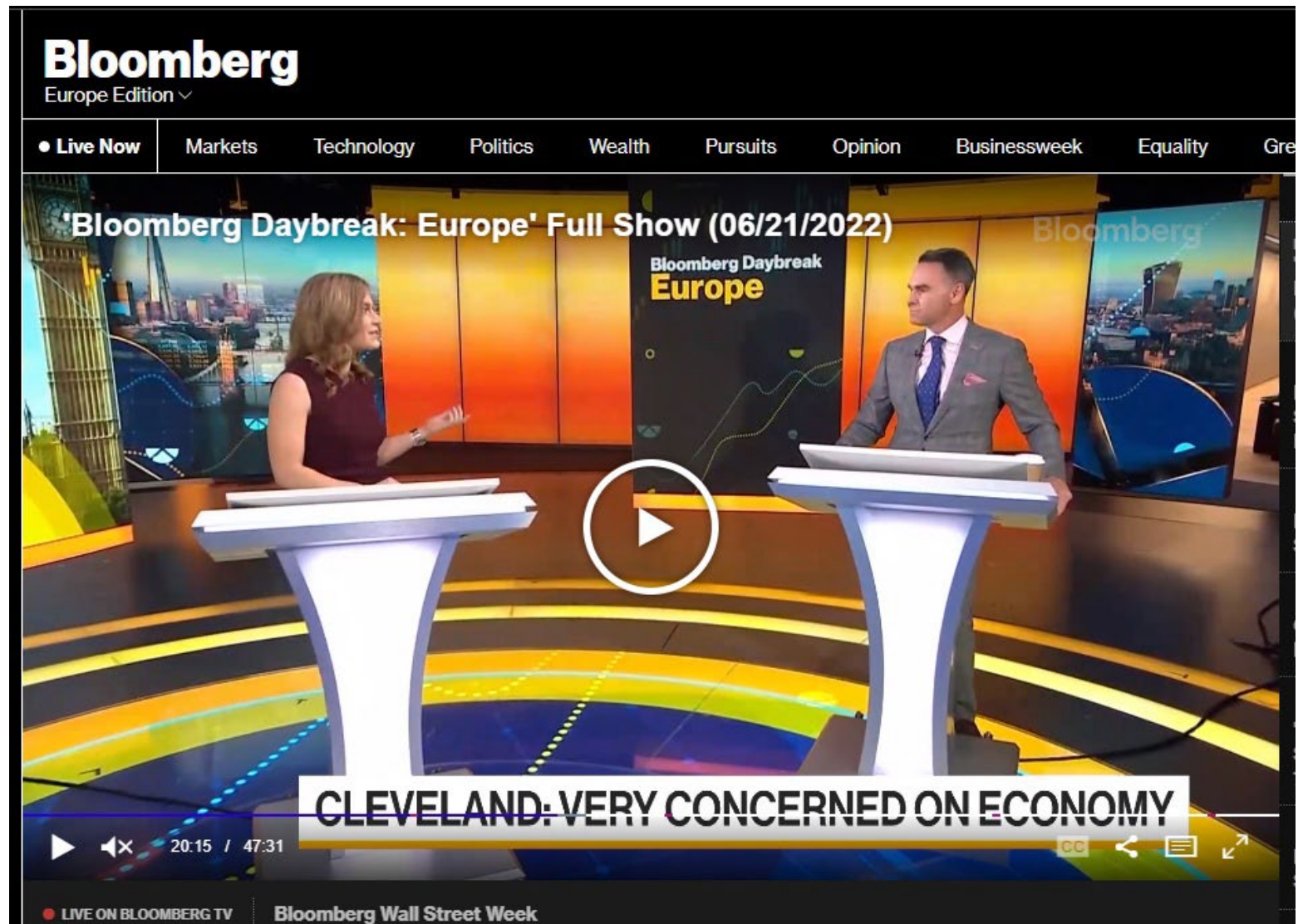
## *What I Think We Do...*



## *What the Trading Floor Thinks We Do...*



## As Usual, My Mother Is (Mostly) Right



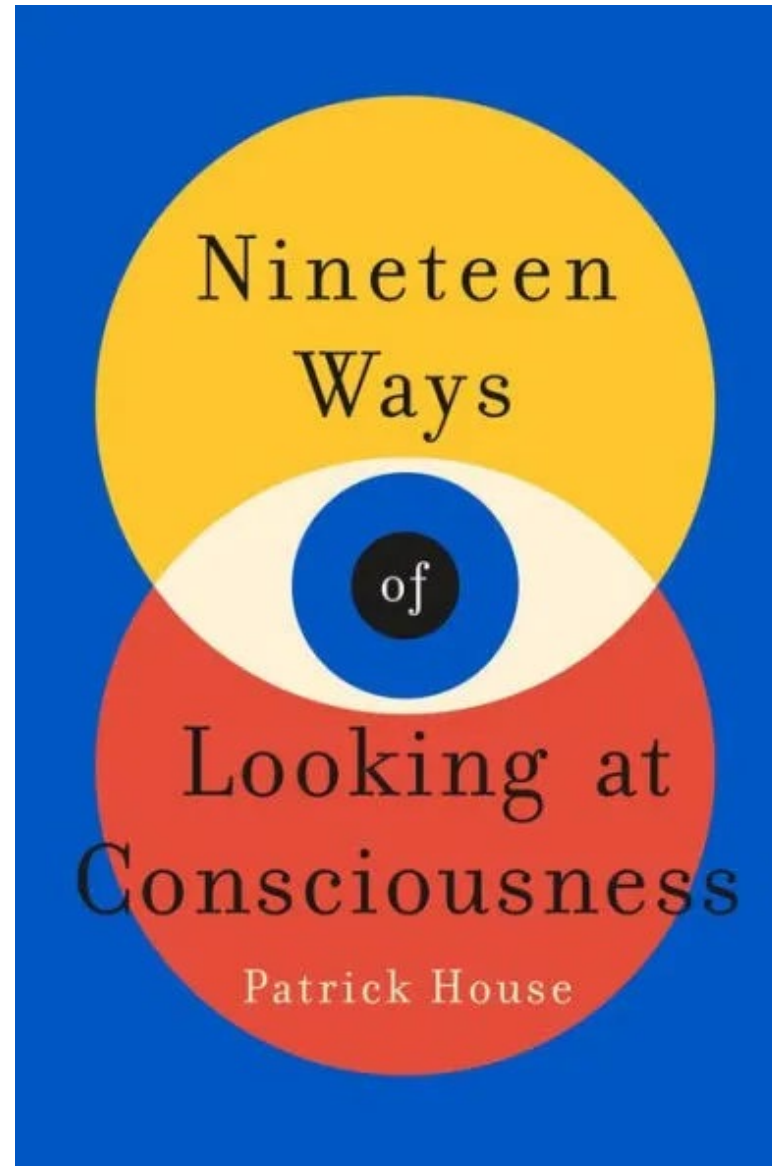


**“Narratives set current prices.  
*Changes* in narratives move markets.”**  
— Rob Arnott



**“Markets make opinions.”**  
— Richard Russell

**“Markets make minds.”**  
— Payden Economics





**“Markets make opinions.”**

— Richard Russell

**“Markets make minds.”**

— Payden Economics

**“Minds make-up memes.”**

— Payden Economics





## Key Macro Memes At The Moment

1

“A recession is *inevitable* this year.”

2

“Inflation will slow quickly this year.”

3

“Interest rates have peaked.”

4

“The worst is behind us for financial markets.”

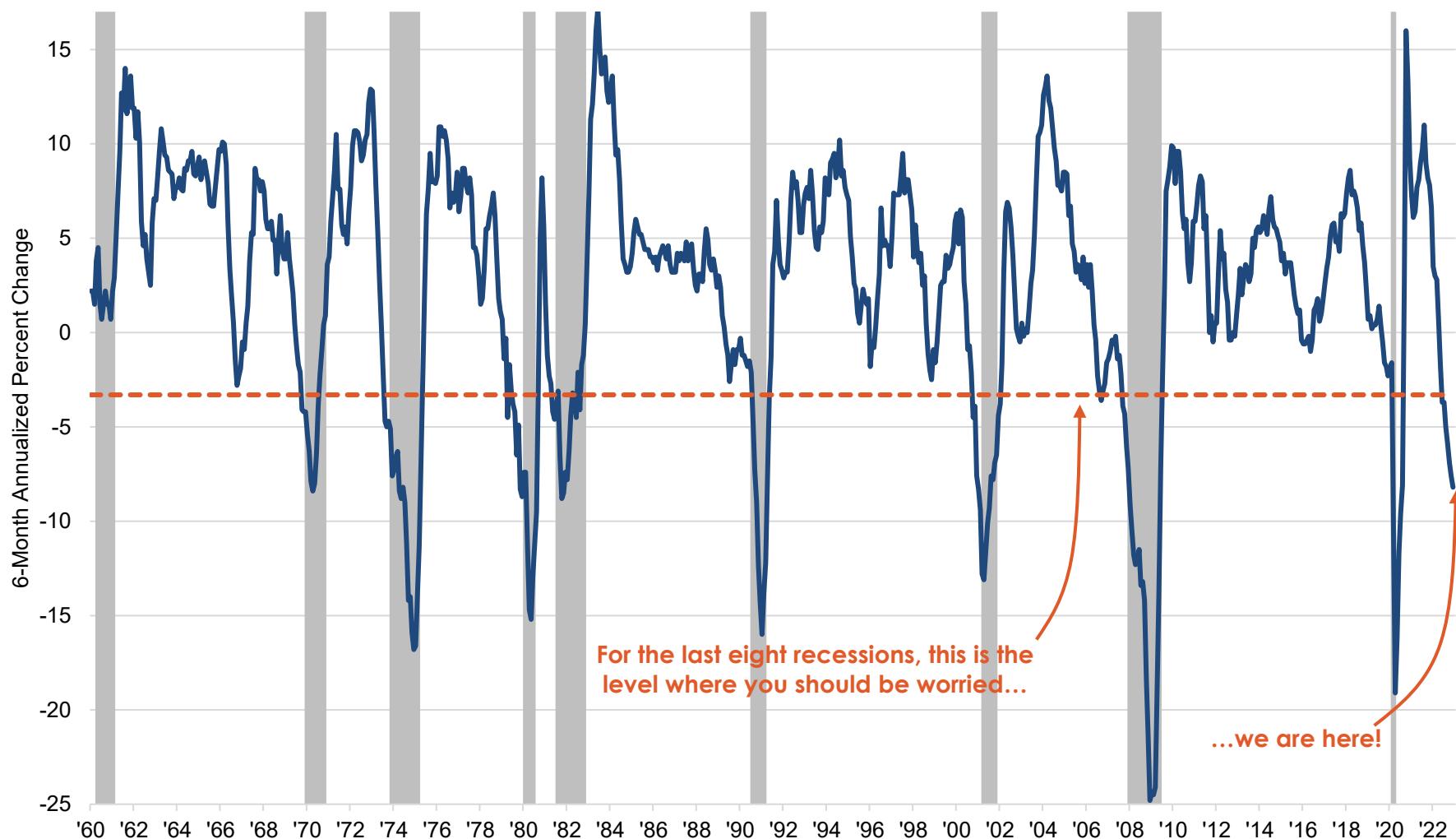


**1** “A recession is inevitable this year.”



# Leading Indicators of Economic Activity Point To A Downturn Ahead

## Conference Board's Leading Economic Index\*



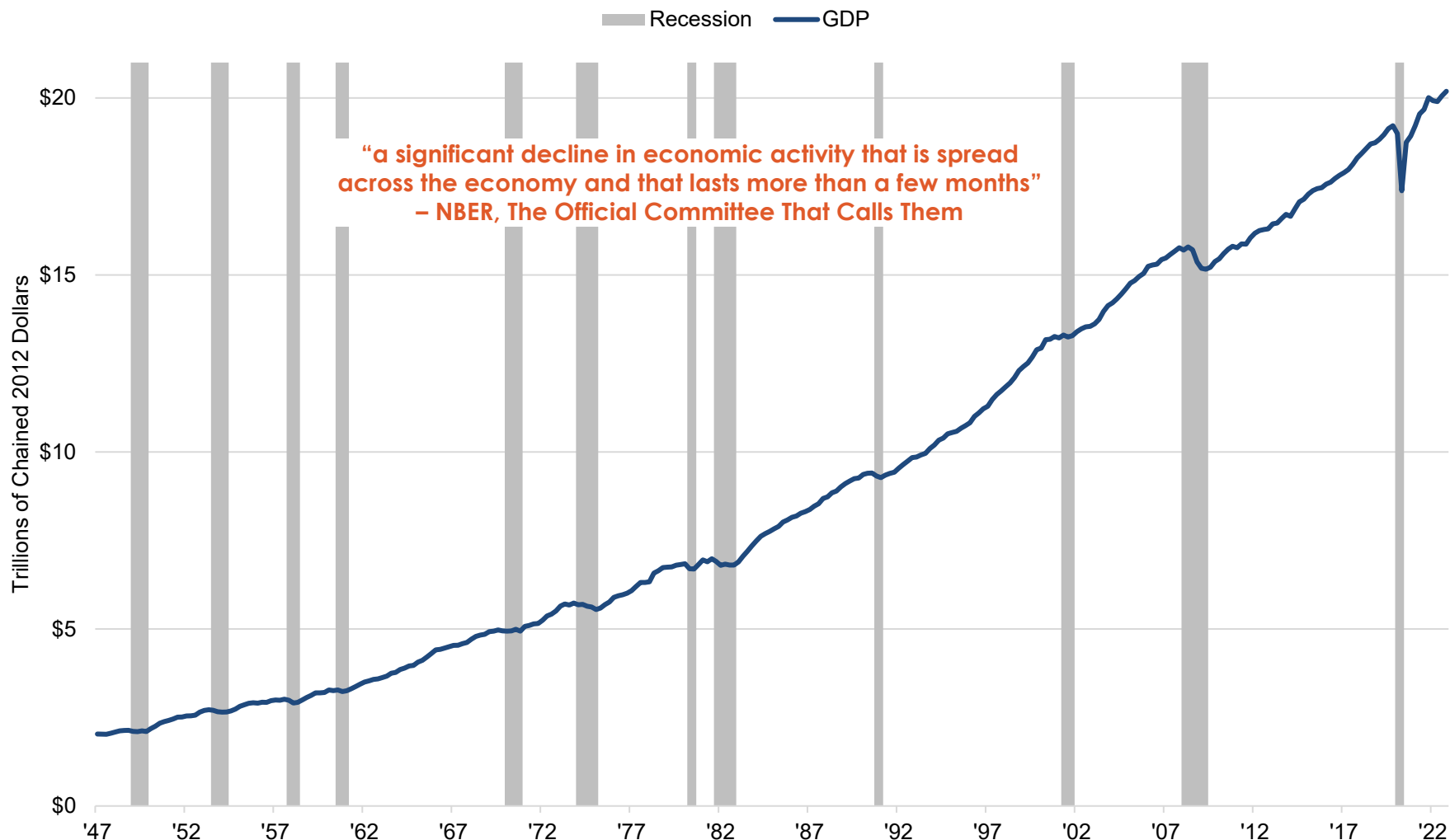
Source: Conference Board

\*includes ten variables that track the economy's health and "anticipate turning points in the business cycle by around seven months."



## First, What Is A Recession? Spending Shrinks

### Real Gross Domestic Output Since 1947



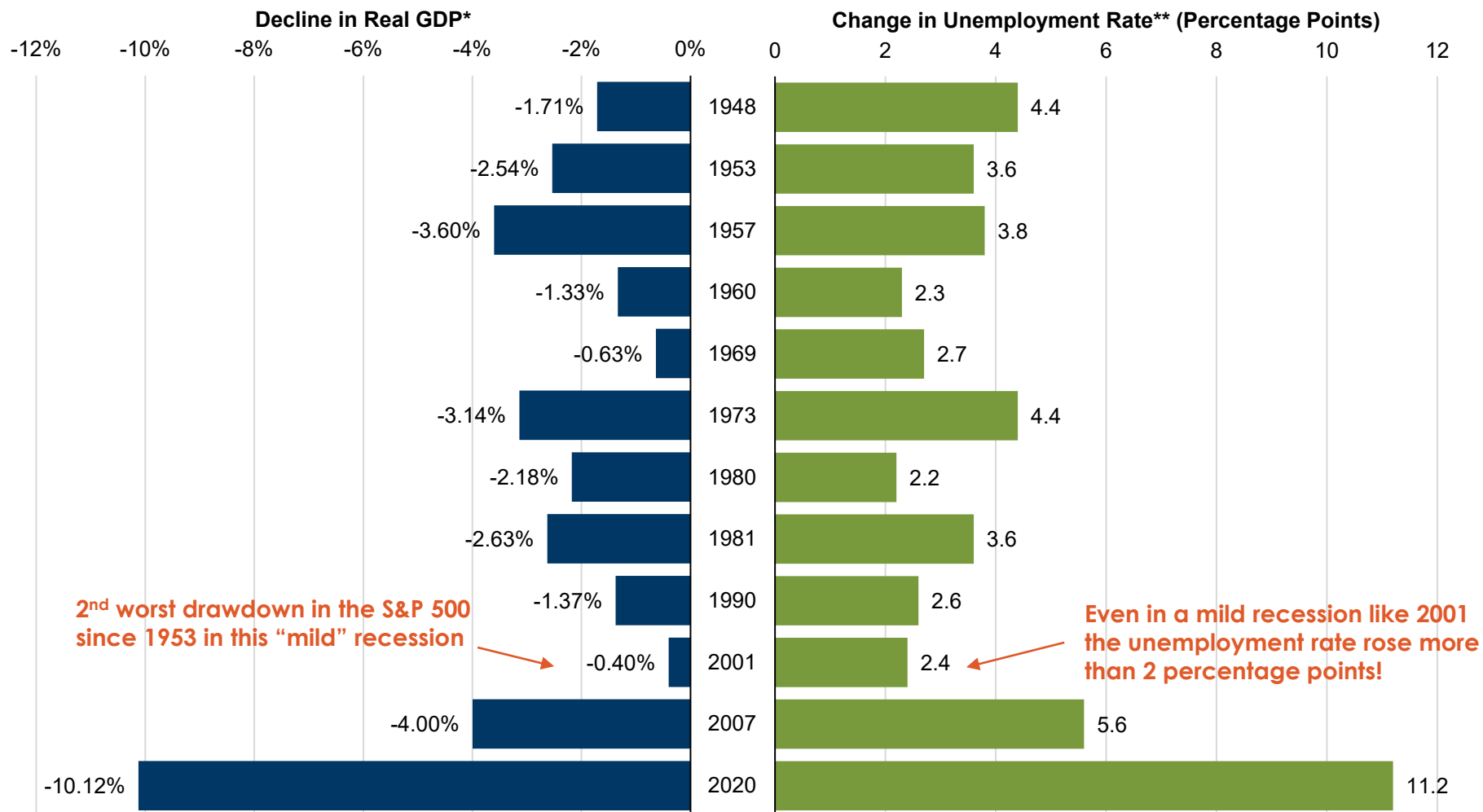
Source: Conference Board





# Even In A Shallow Or Mild Recession The Unemployment Rate Moves Up

## Change in Real GDP and Unemployment During Recessions



Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics

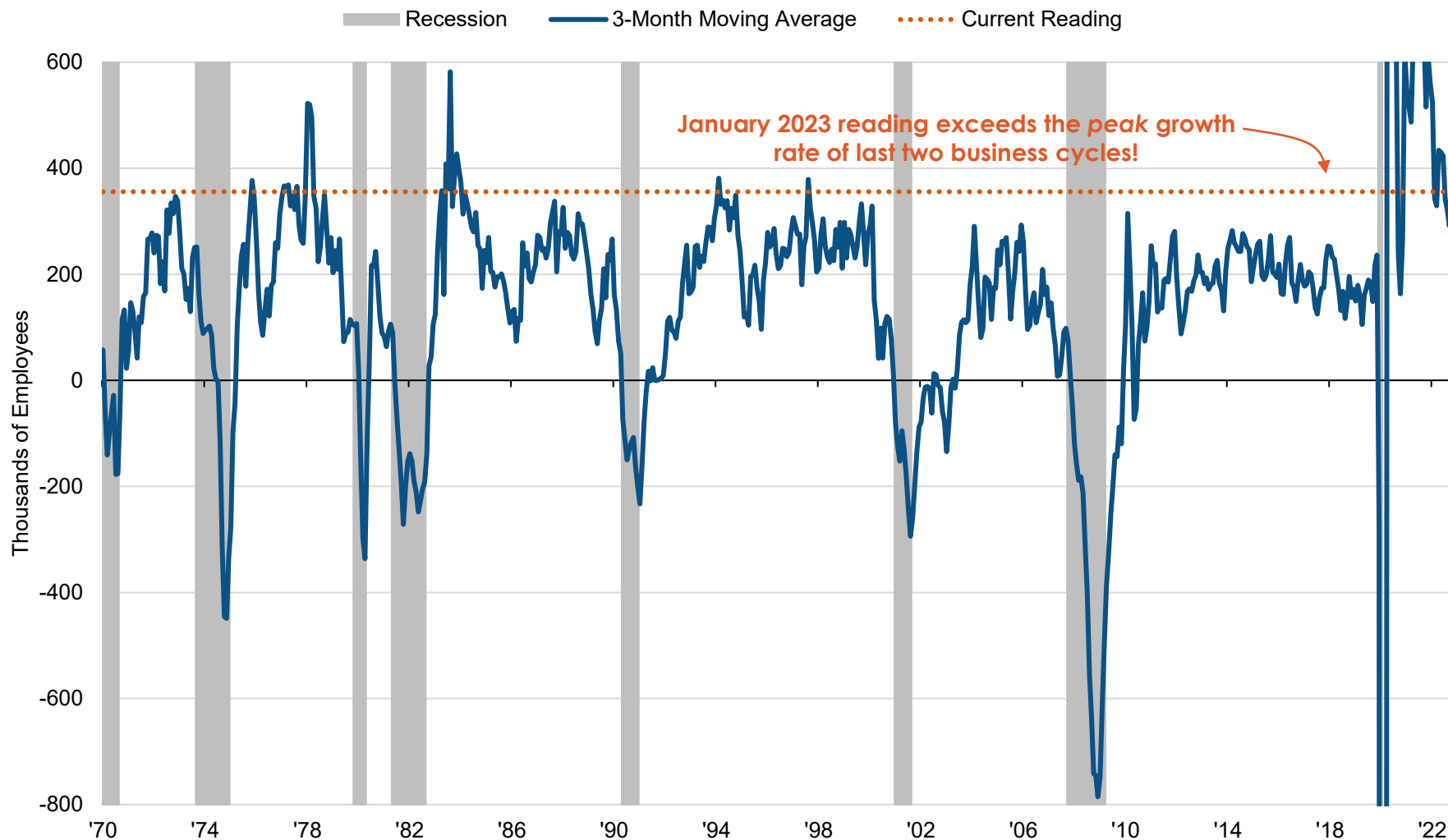
\*From peak to trough

\*\*From trough to peak



# Labor Market Says: “Sorry, What Recession?”

## 3-Month Average of Job Growth Since 1970

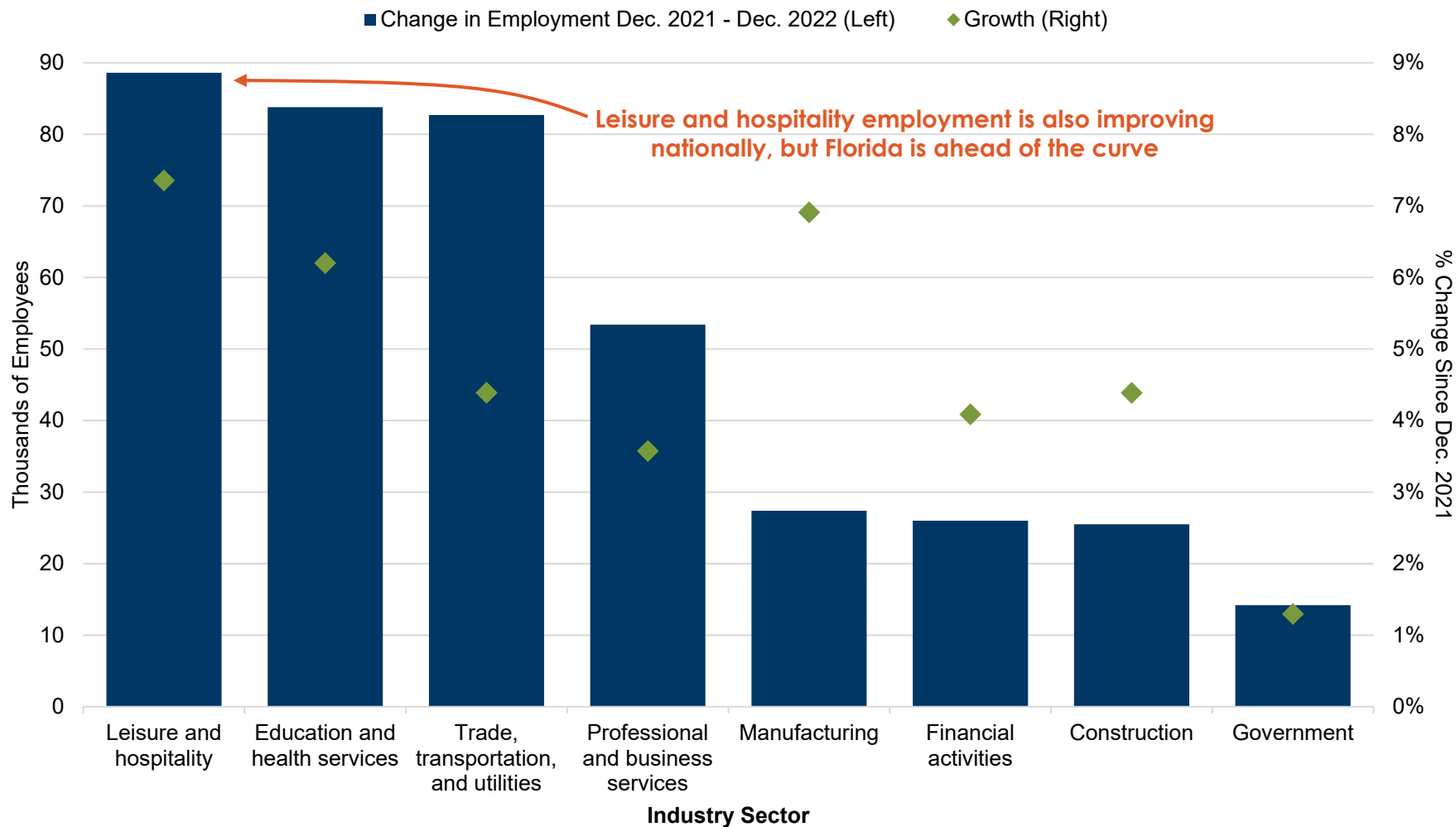


Source: Bureau of Labor Statistics



# What's Driving Employment Growth In Florida?

## Change in Employment Level Between Dec. 2021 and Dec. 2022 By Industry Sector

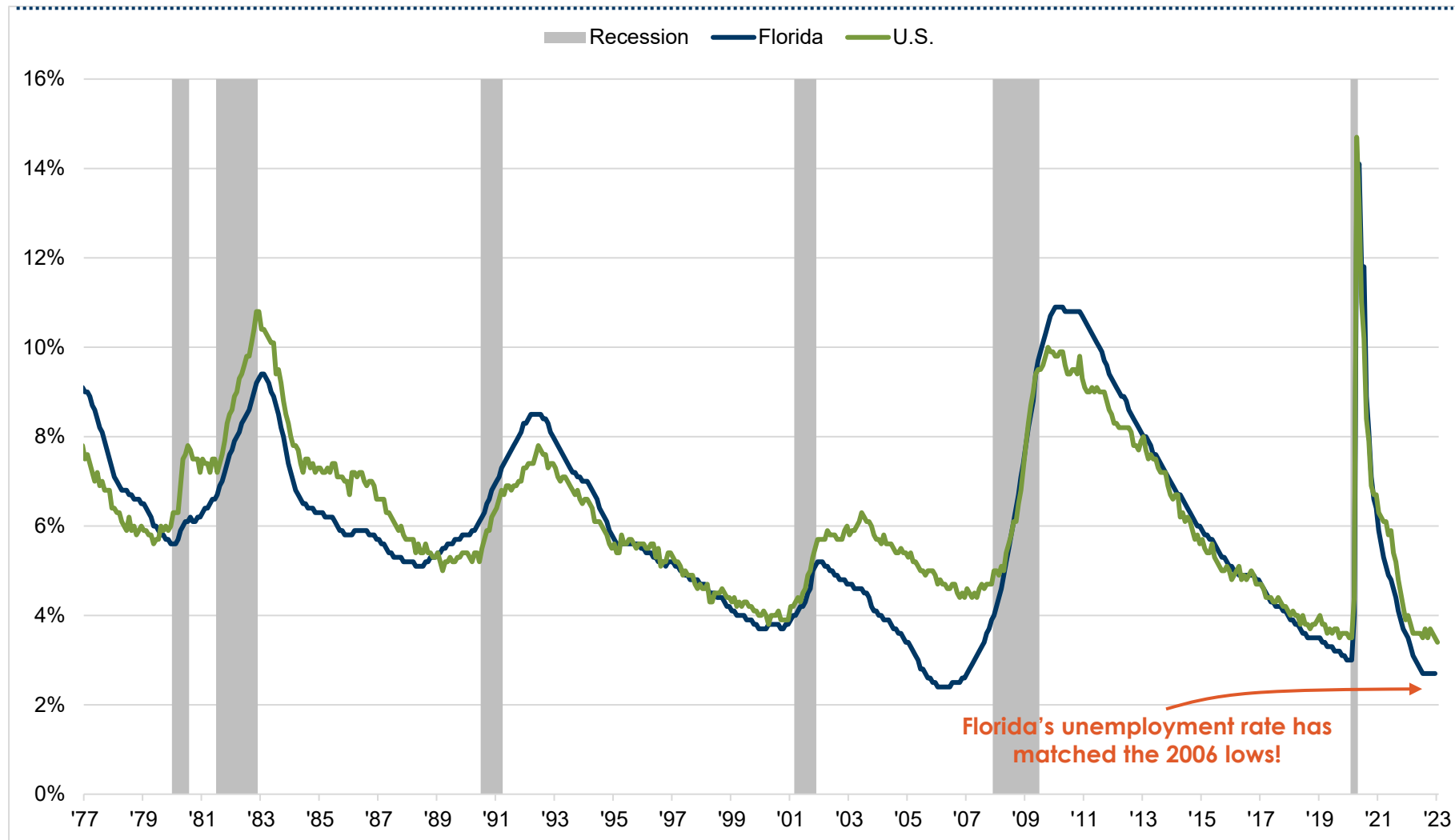


Source: U.S. Bureau of Labor Statistics, Payden Calculations



# Florida's Unemployment Rate Is An Entire Percentage Point Below The U.S.

## Unemployment Rate In Florida Versus Nationally



Source: U.S. Bureau of Labor Statistics





Leading  
economic  
indicators



The  
labor market

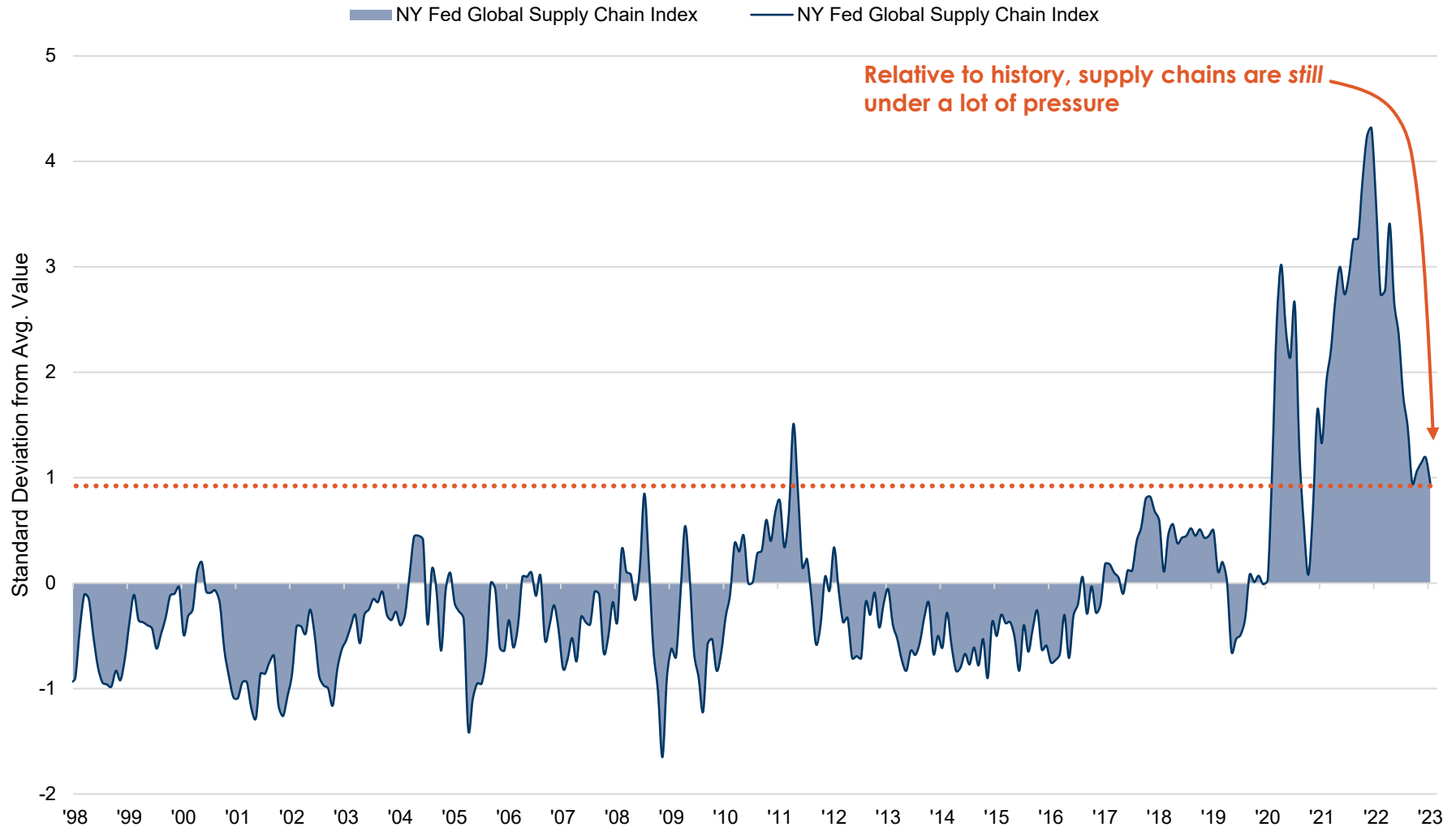


**2** “Inflation will slow quickly this year.”



# Supply Chains Still Under Stress (But Is The Worst Behind Us?)

## NY Fed Global Supply Chain Index

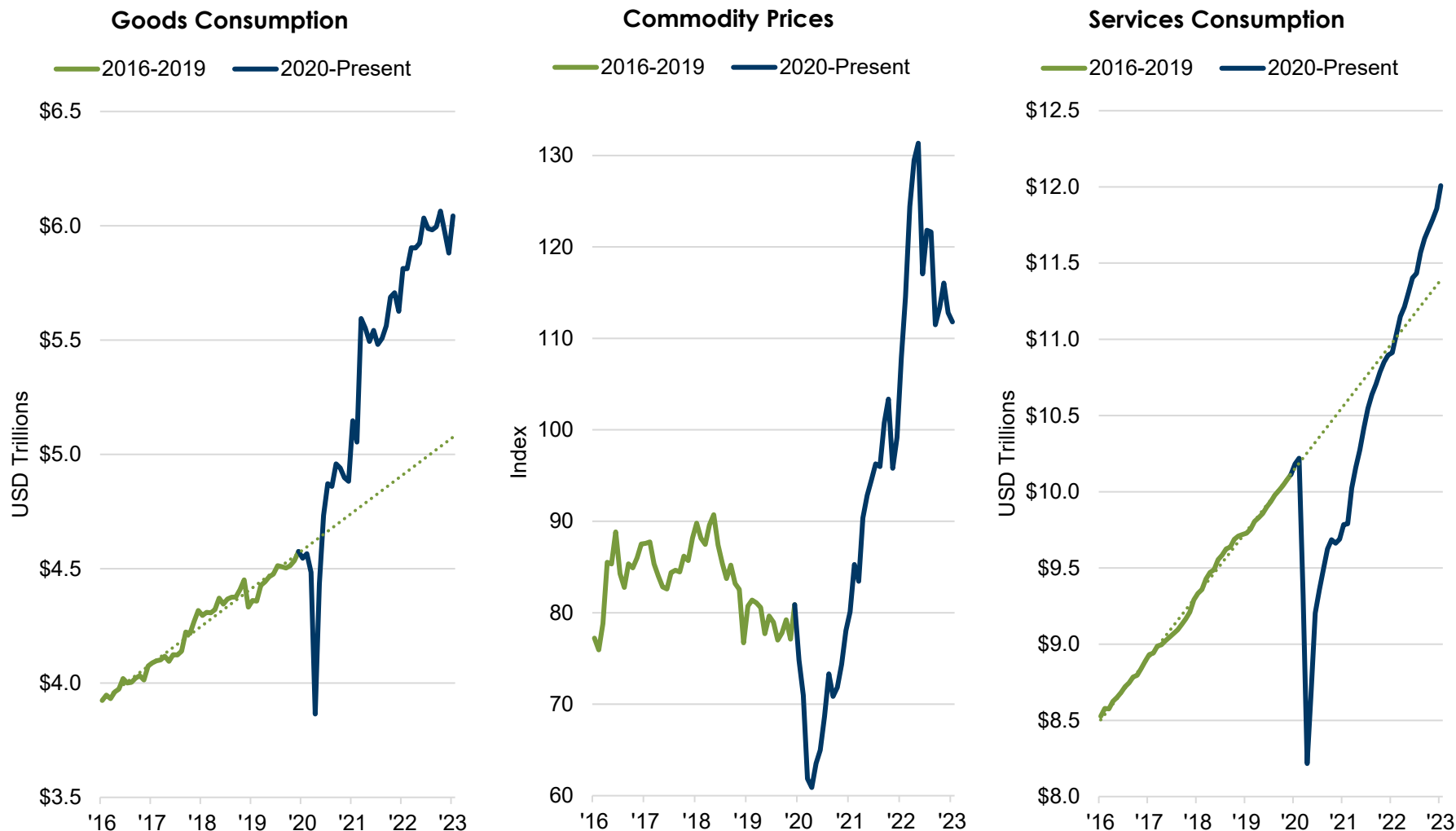


Source: New York Federal Reserve



# Three Inflation Waves: Goods, Energy, And Now Services

## Personal Consumption Expenditures (Nominal) on Goods, Services and the Bloomberg Commodity Index



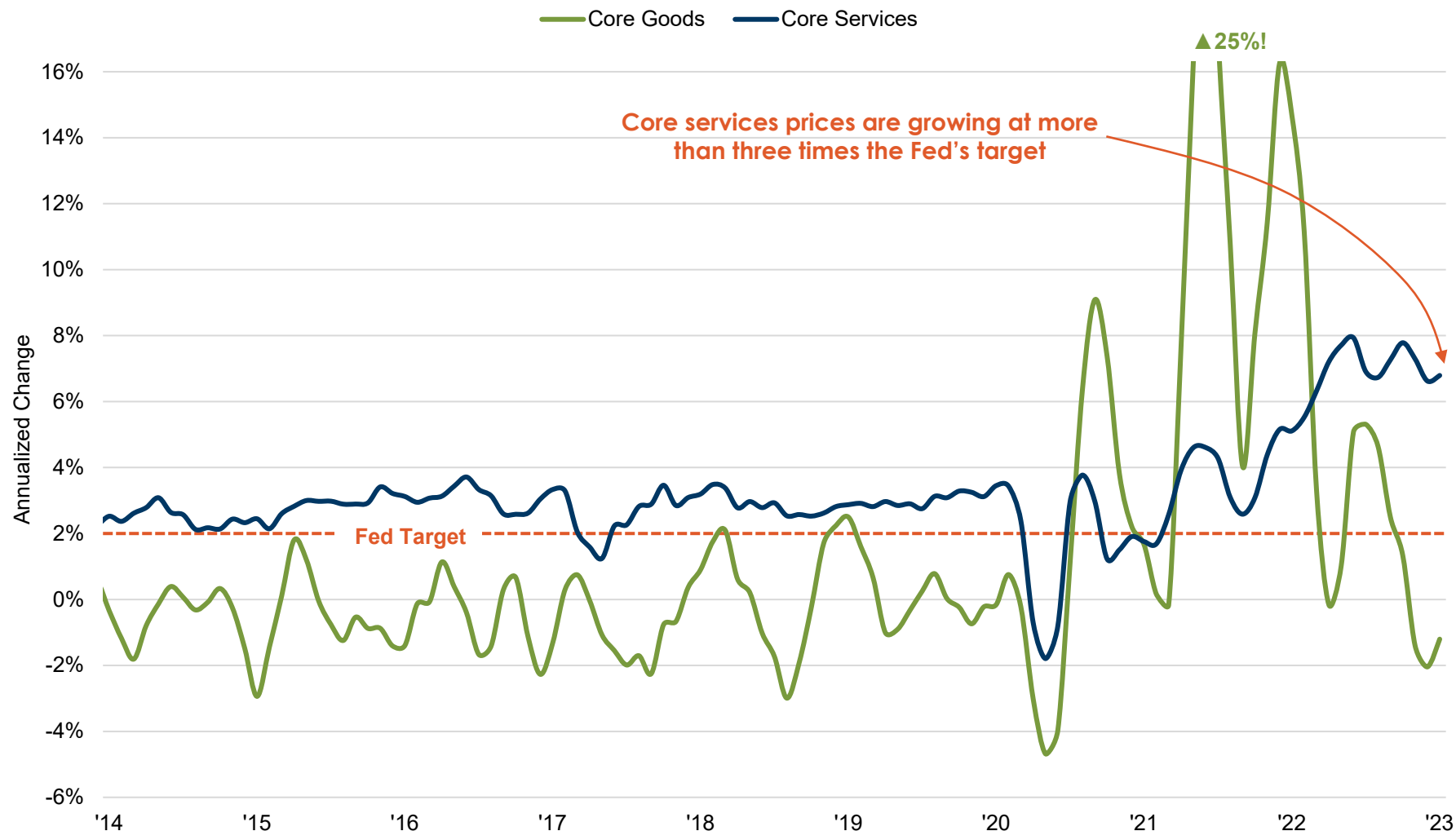
Source: U.S. Bureau of Economic Analysis, Bloomberg, Payden Calculations





# Inflation Was A Goods Problem But Has Spread To Services Prices

## 3-Month Annualized Change in Consumer Price Index for Core (Ex. Food & Energy) Goods & Services

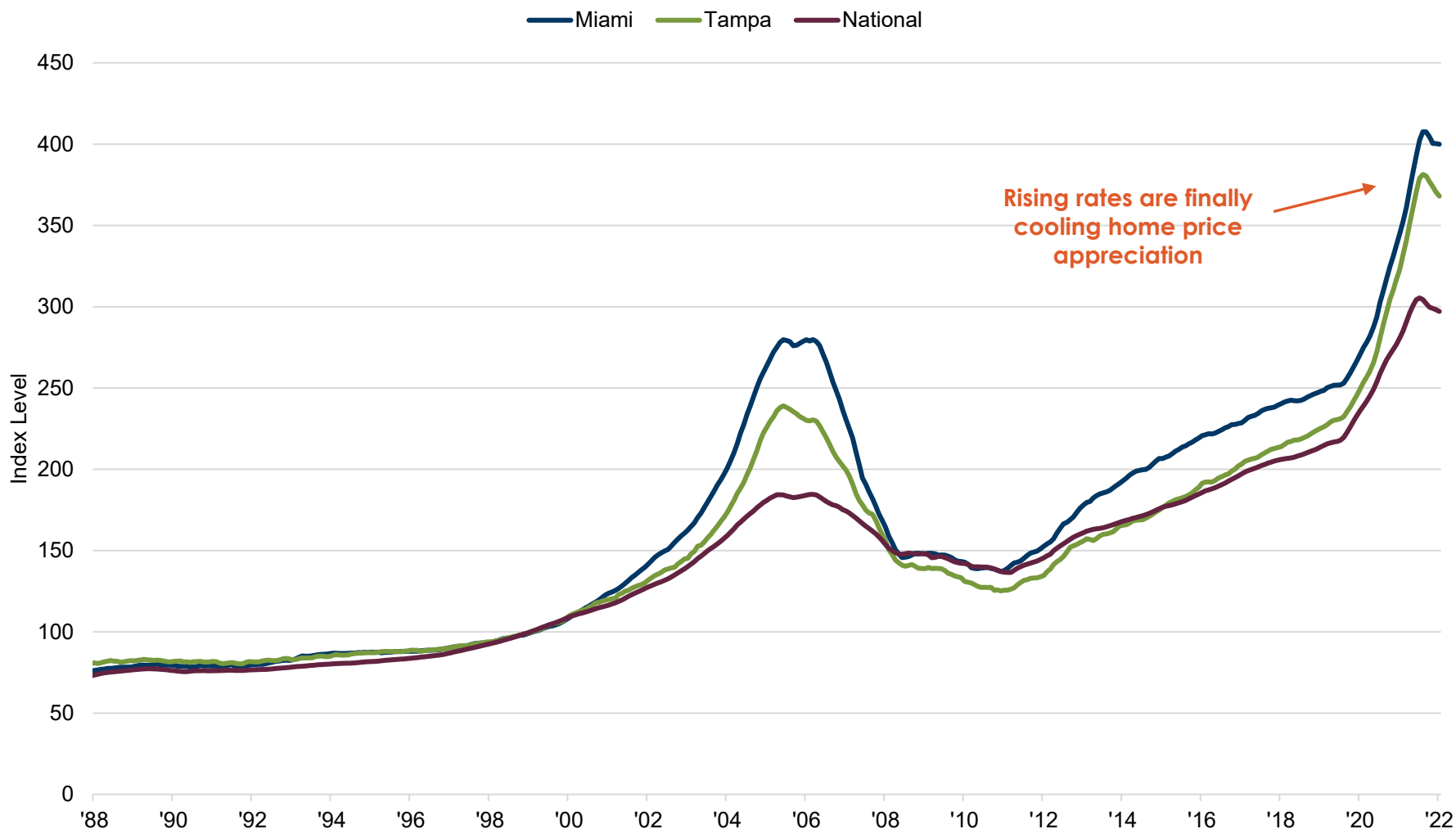


Source: Bureau of Labor Statistics, Payden Calculations



# Home Prices In Florida Have Grown Faster Than The National Average

## Case-Shiller Home Price Index

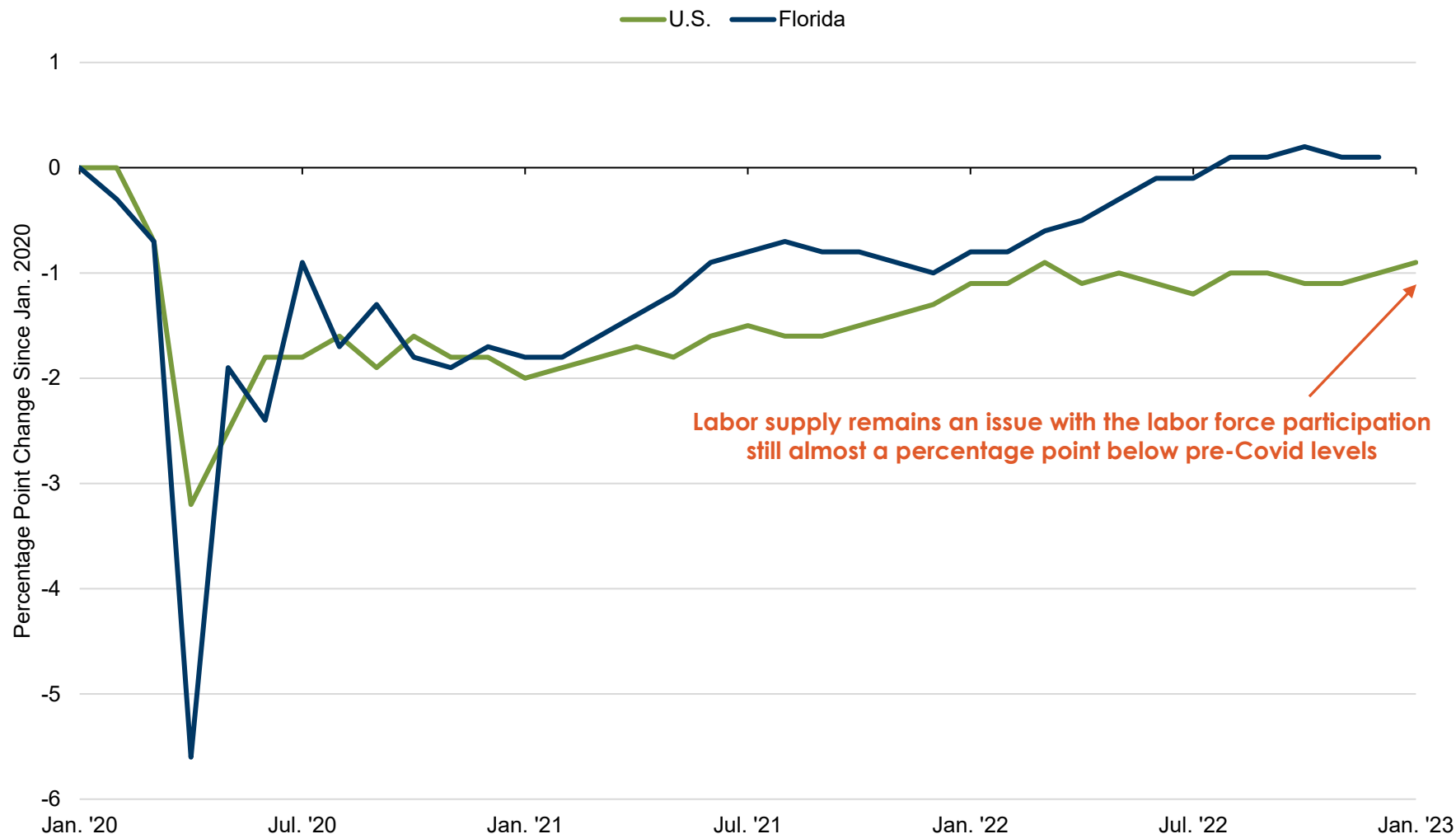


Source: U.S. Federal Housing Finance Agency



# Florida's Labor Force Participation Has Recovered To Pre-Covid Levels

## Change in Labor Force Participation Since January 2020

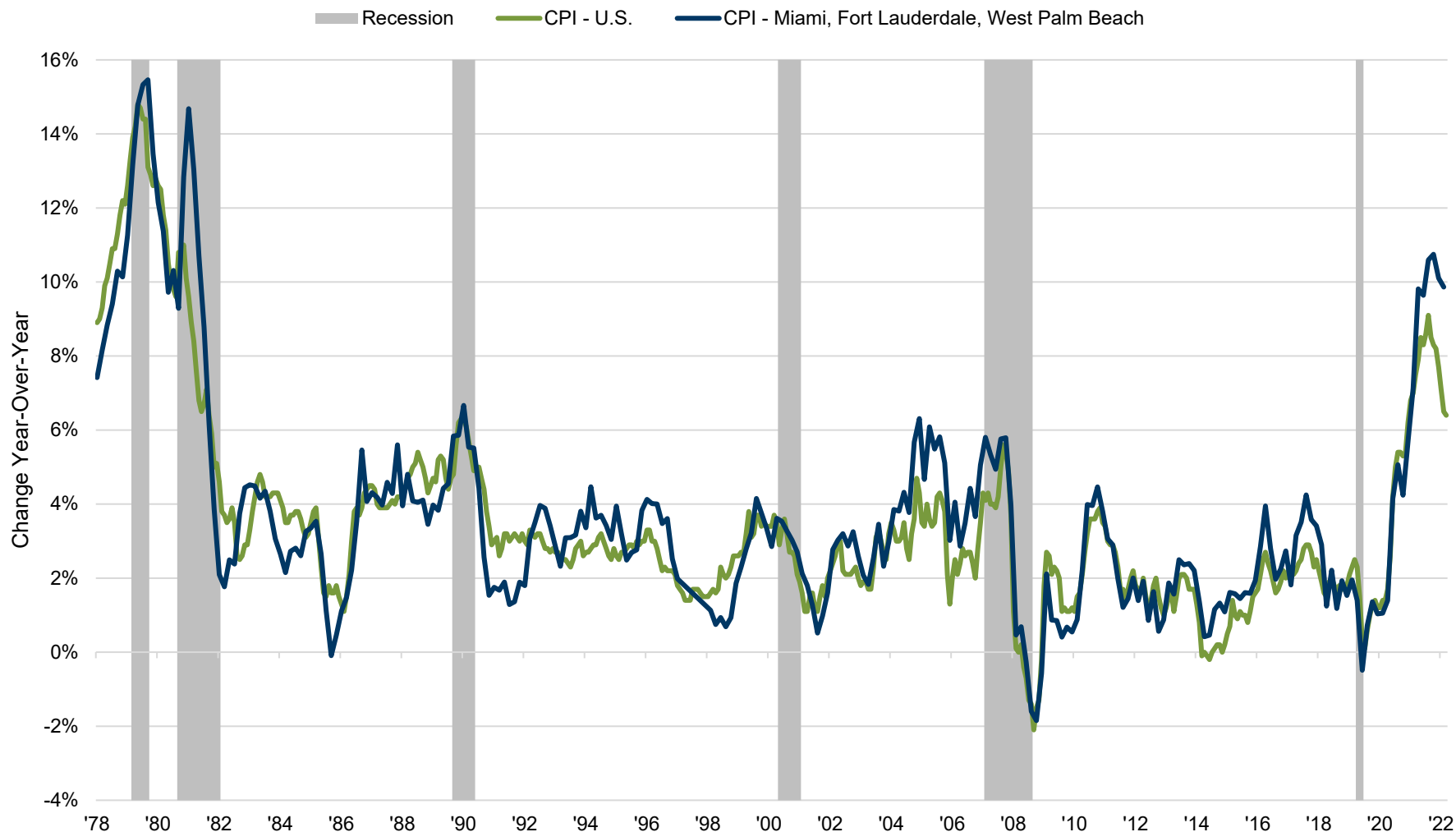


Source: U.S. Bureau of Labor Statistics



# While Off Recent Peaks, Inflation Is The Highest It Has Been In Four Decades

## U.S. Versus Local Consumer Price Index



Source: Bureau of Labor Statistics





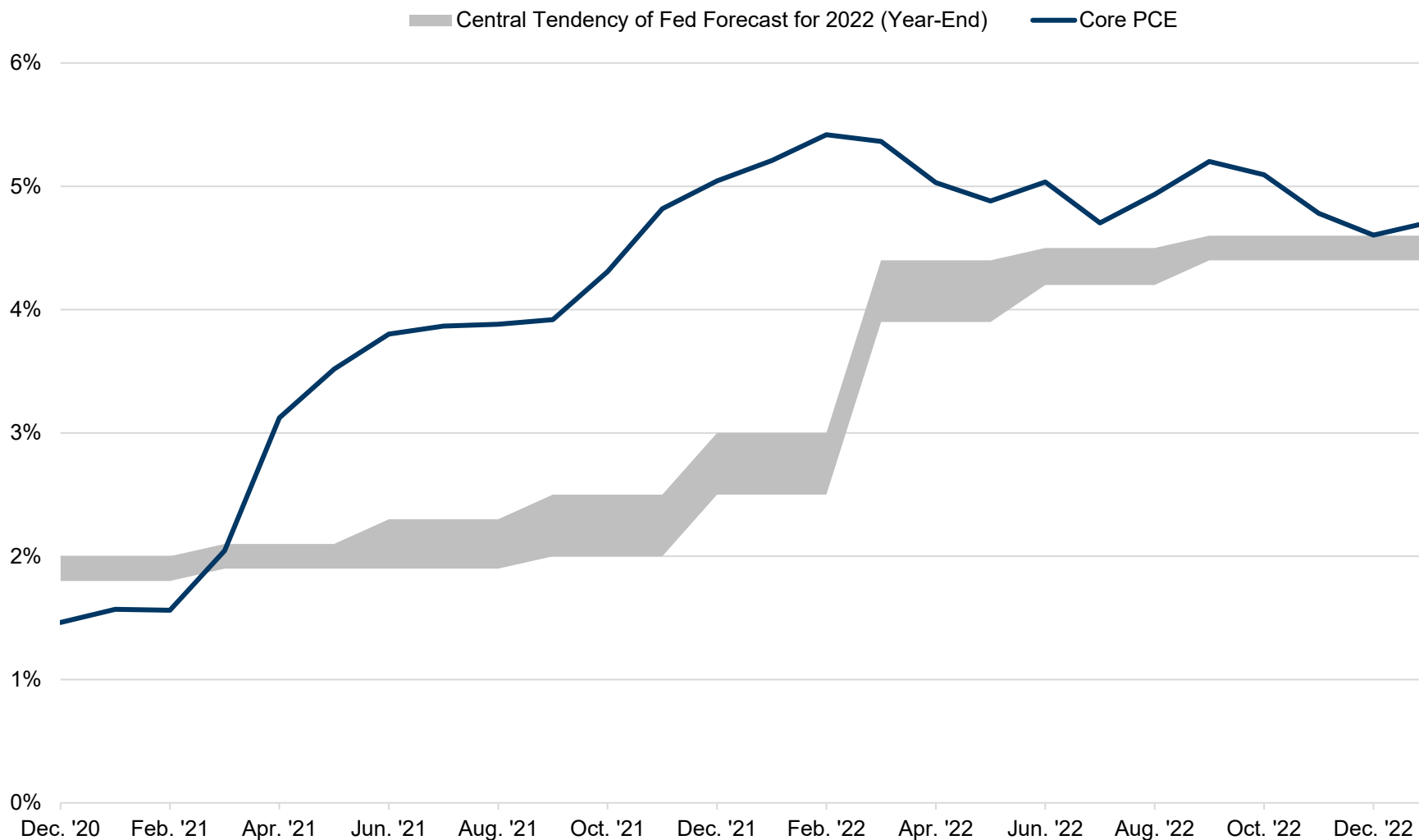


### 3 “Interest rates have peaked.”



## Inflation Surprised Policymakers For Two Years!

### Core PCE Versus The Fed's Year-End Forecast

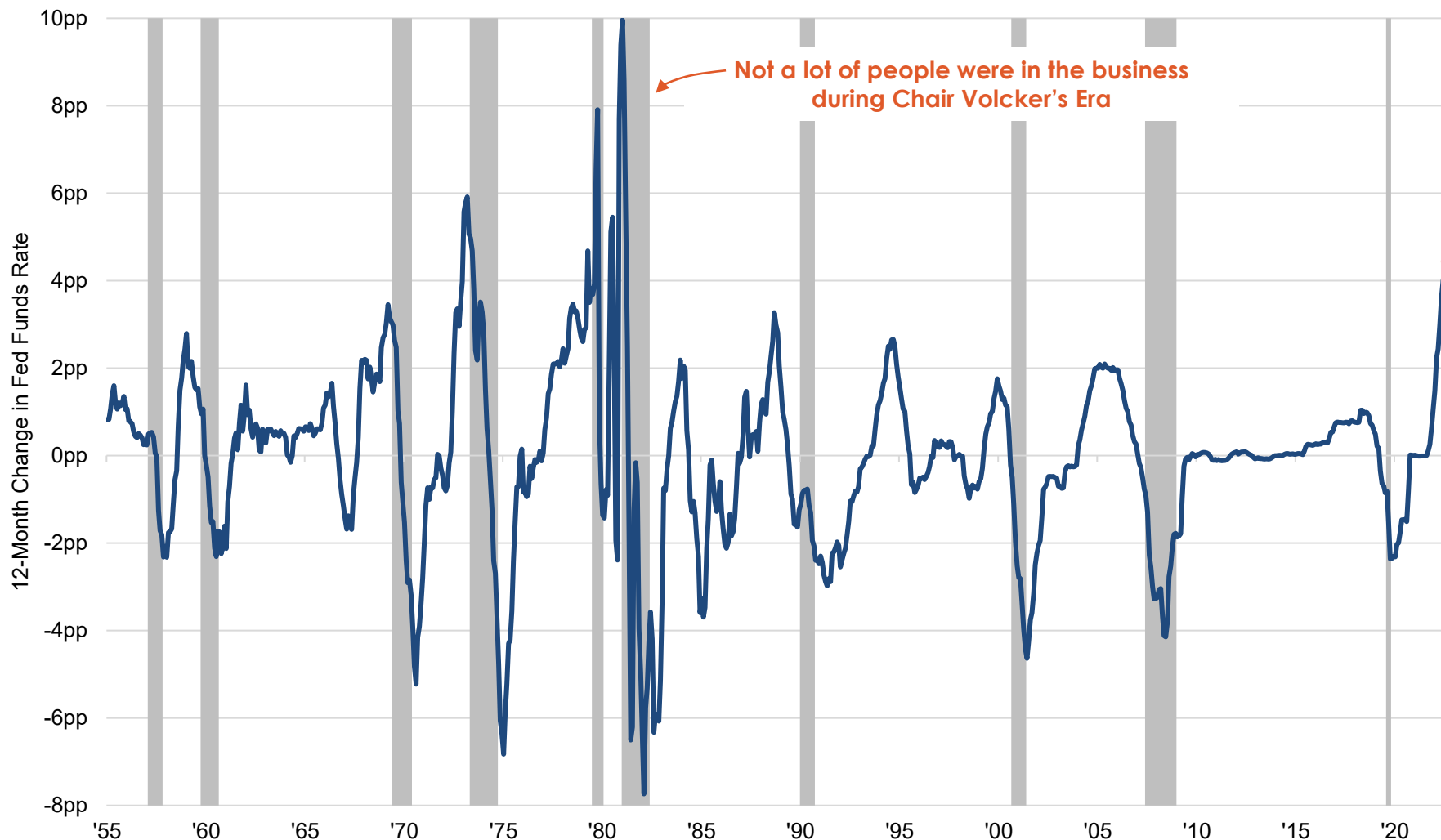


Source: U.S. Bureau of Economic Analysis, Federal Reserve, Cleveland Fed



## With Inflation Elevated, The Fed Raised Rates *Rapidly*

### 12-Month Change In The Fed Funds Rate Since 1955



Source: Federal Reserve, Payden Calculations

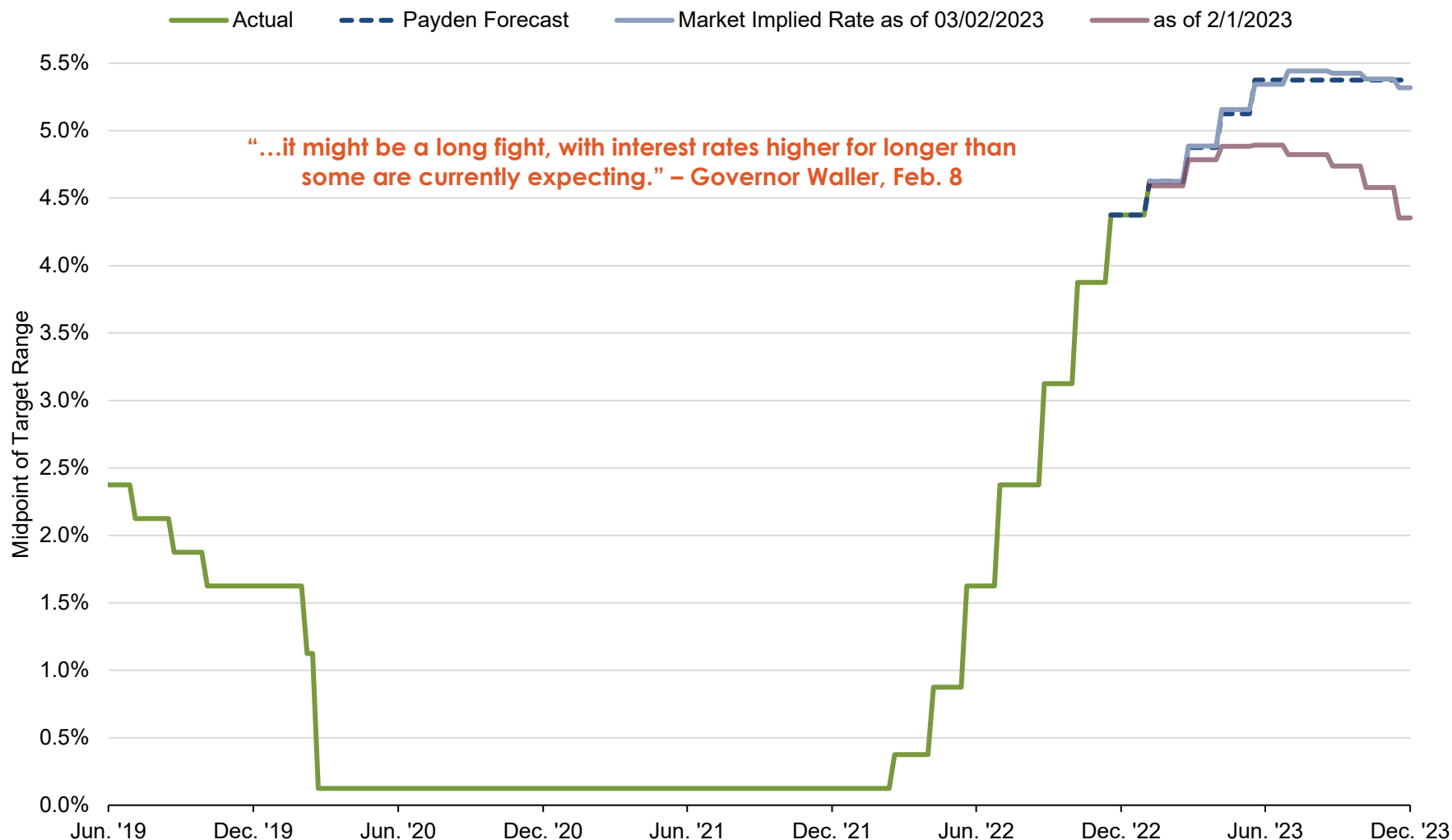
## The Fed Chair Is “Keeping At It”





# The Fed Will Hike Into “Restrictive Territory” And Stay For “Some Time”

## Market Implied Path\* Versus Payden Forecast for the Fed Funds Rate (FFR)



Source: Federal Reserve, Bloomberg, Payden Calculations

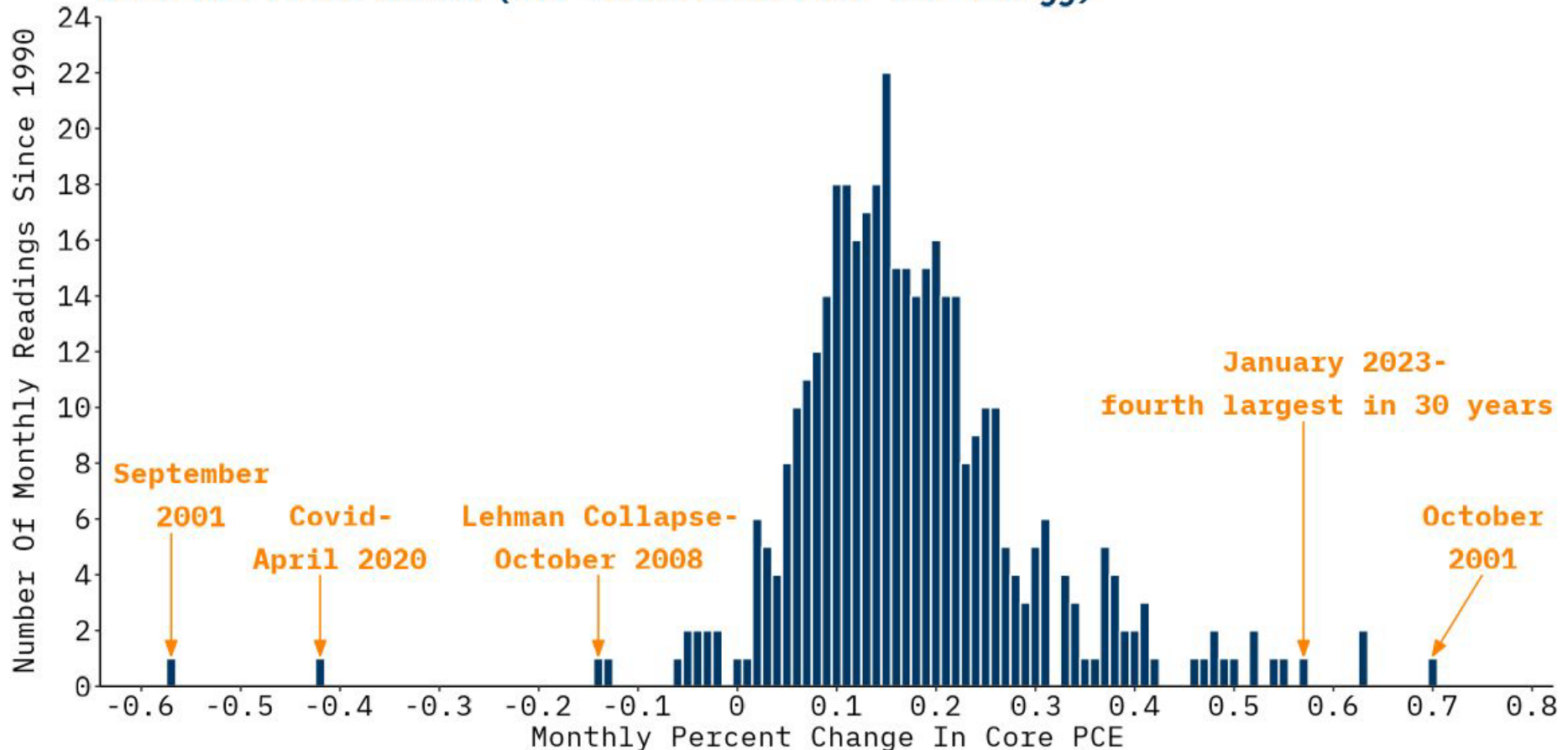
\*can imply fraction of rate hikes and is the effective rate, not the upper bound





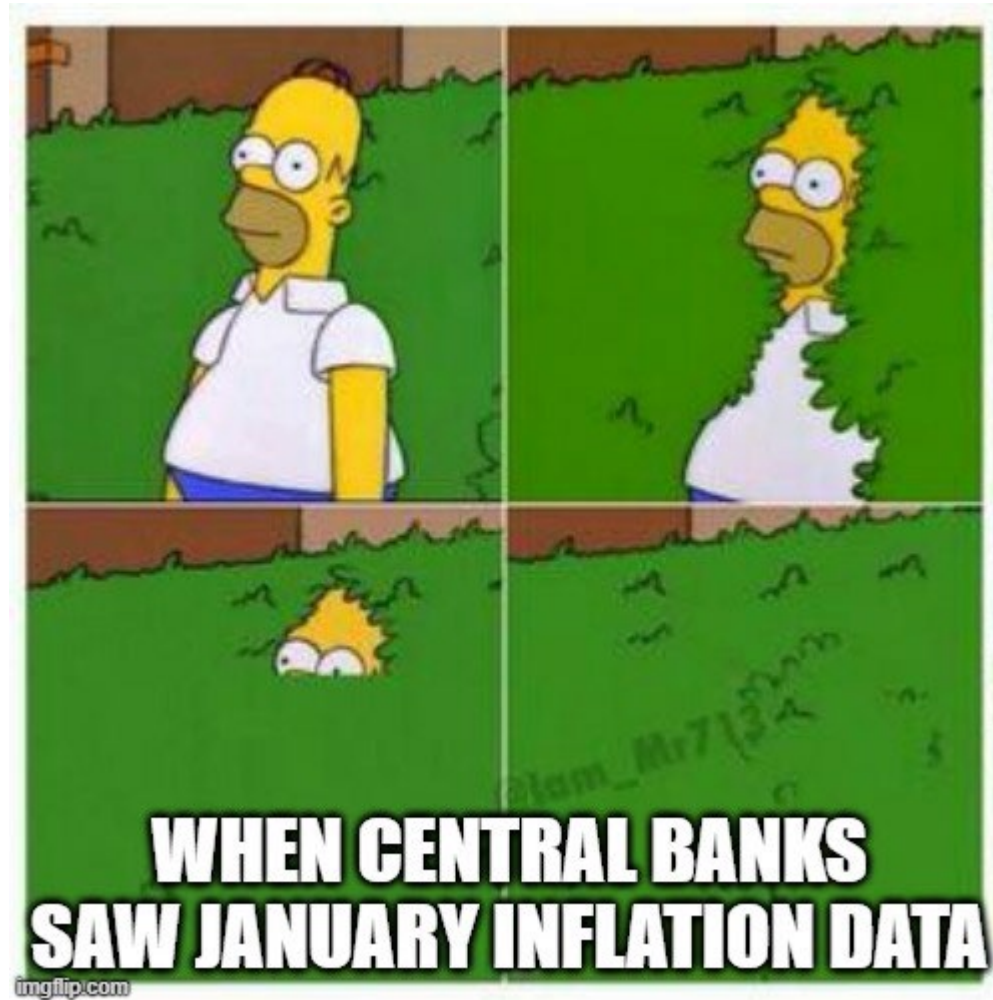
## Historic Inflation

### Outlier Or Out-Of-Control? Inflation Still Way Too Hot In January *Core PCE Price Index (All Items Less Food and Energy)*



Source: U.S. Bureau of Economic Analysis







**4**

**“The worst is behind us for financial markets.”**





# So, What Does This Mean For Assets?

## As The Fed Reaches Its Terminal Rate, A Sequence Of Events Unfolds

Months Before (-) Or After (+) Terminal Fed Funds Rate Is Reached For Select Market Indicators\*

Terminal Fed Funds	Last Hike	Peak 2-Year Tsy Yield	Peak 10-Year Tsy Yield	3mo/10y Curve Trough	Recession Start	HY OAS Peak	S&P 500 Trough
20.0%	Mar. '80	-1	-1	-3	-2	N/A	-10
20.0%	May. '81	3	4	-4	2	N/A	14
9.8%	May. '89	-2	-3	0	14	N/A	17
6.0%	Feb. '95	-2	-3	9	N/A	10	-9
6.5%	May. '00	-1	-4	7	10	16	16
5.3%	Jun. '06	0	0	5	18	21	21
2.5%	Dec. '18	-2	-2	8	14	0	0
Rates "peak" as Fed nears its "terminal" rate		Median: -1	-2	5	12	13	14

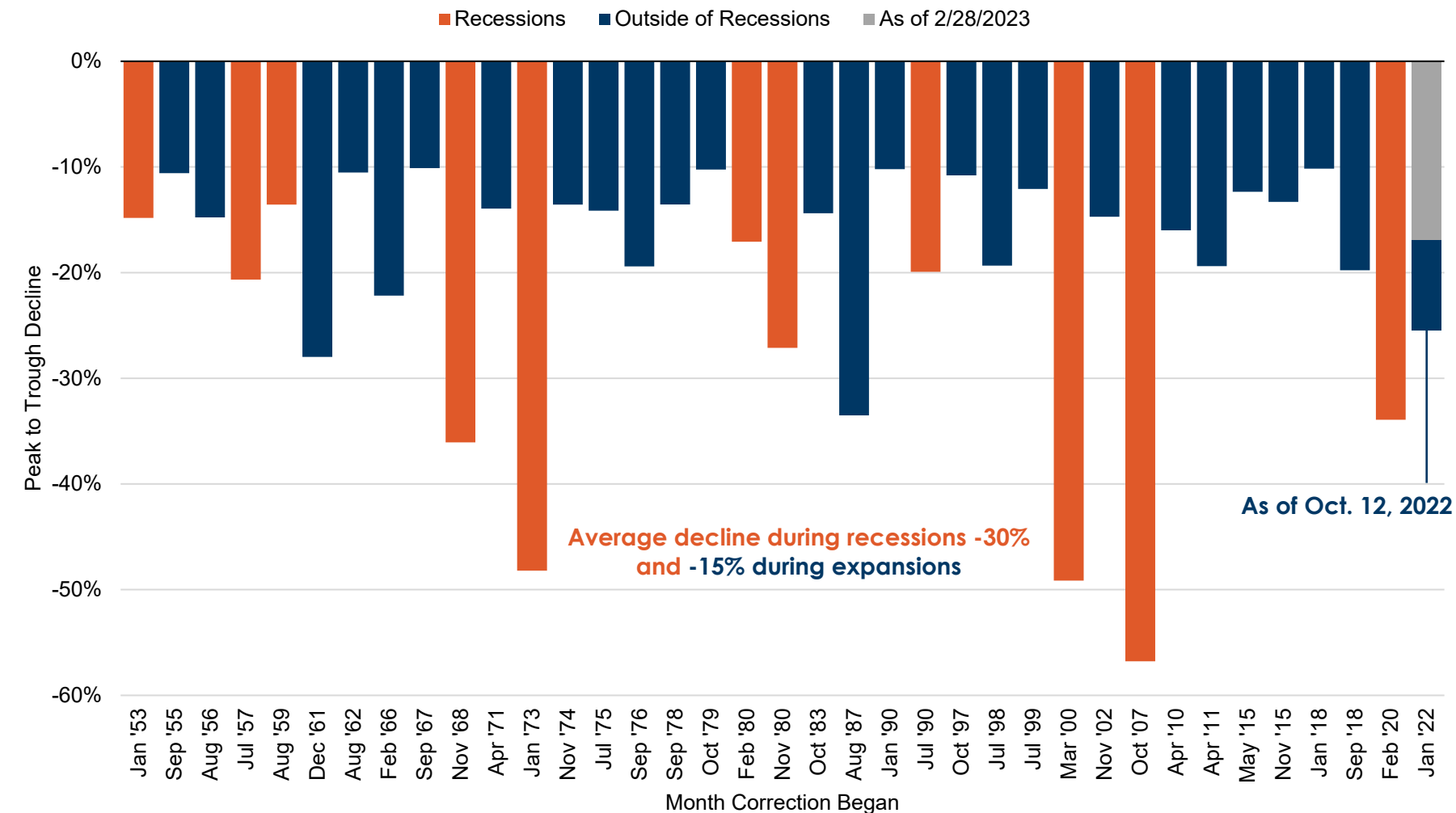
Equities bottomed long after Fed hikes ended

The lesson of history is that investors should anticipate a sequence of events to unfold as the business cycle wanes. First, the Fed reaches its terminal rate. Second, Treasury yields peak 1-2 months before terminal is reached as markets anticipate the end of Fed tightening. Next, the yield curve "troughs" and begins to "bull steepen" as the bond market anticipates rate cuts. The recession usually begins about a year after the Fed is done hiking. Often, the S&P500 finds its bottom long after the Fed stops tightening (median: 14 months) and the recession is well underway, with a similar story for high yield corporate spreads.



# “A Recession Is Already Priced In.” Maybe, But Let’s Wait Until We Hit Peak Rates Before Drawing Grand Conclusions

## Greater Than 10% Declines in the S&P 500 Index Since 1953

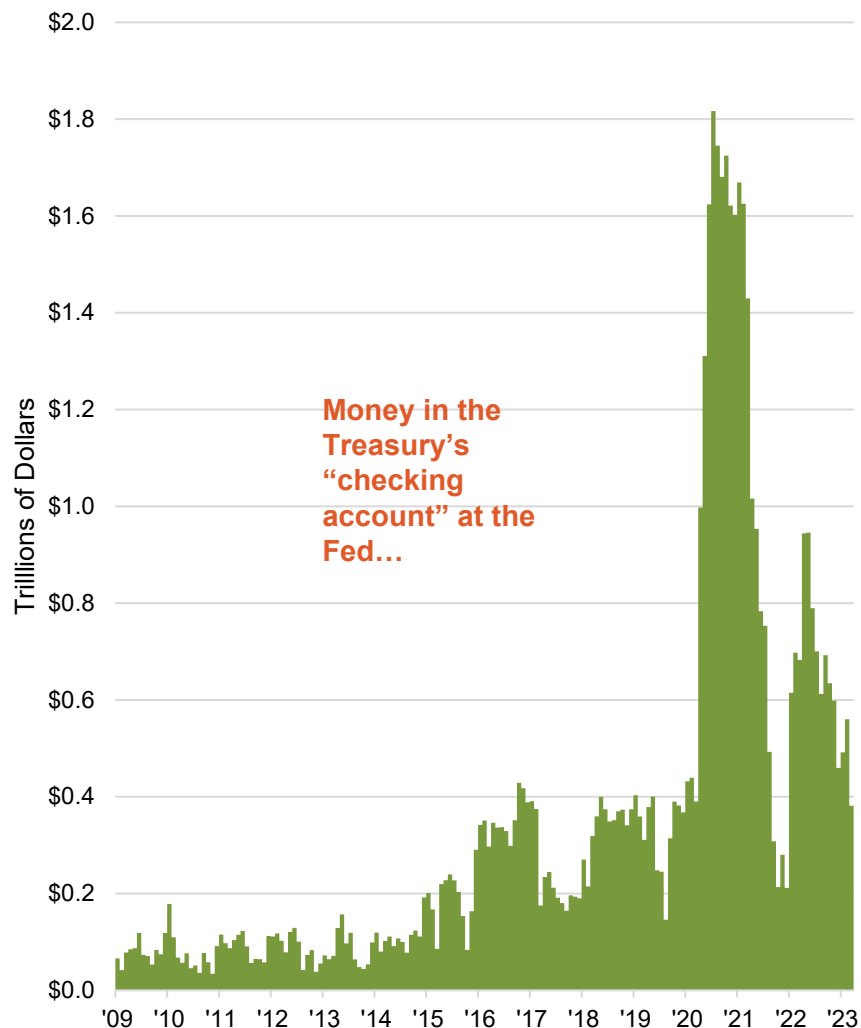


Source: Yardeni Research, Payden Calculations

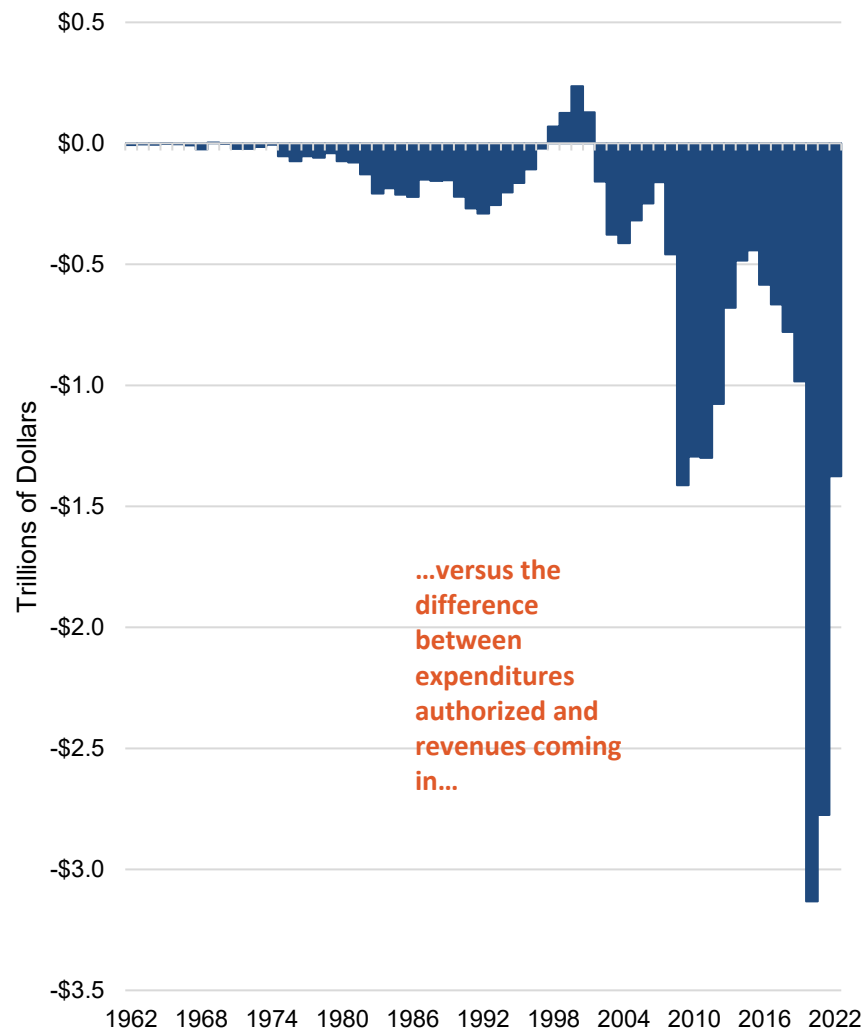


# Another Federal Debt Ceiling Debacle Looms

## Treasury General Account



## Annual Federal Government Deficit\*



Source: U.S. Treasury, CBO

\*Total revenues minus spending



## Executive Summary: Right Or Wrong, Memes Make Markets

1

**“A recession is inevitable this year.”**

- Nothing is inevitable, but the leading economic indicators do suggest a downturn in the next year is likely.
- Labor market conditions remain very strong and continue to give the economy momentum in the near-term.

2

**“Inflation will slow quickly this year.”**

- Inflation remains persistently elevated and is unlikely to return to the Fed's target (2.5%) in 2023.
- Beyond 2023, if goods prices fall, rents decelerate, and the labor market weakens (dampening services prices), inflation should moderate. The risk is that it takes longer than markets expect.

3

**“Interest rates have peaked.”**

- Interest rates peak near the time the Federal Reserve reaches its “terminal rate.”
- Given the uncertainty around Memes 1 and 2, we think it's premature to conclude we've witnessed the peak in rates for this cycle.

4

**“The worst is behind us for financial markets.”**

- While equity markets did sell off in response to the sharp pivot in rates last year, historically equities bottom after the Fed has reached the “terminal” fed funds rate.
- In recessions, market declines from peak to trough can be worse than what is currently priced in.





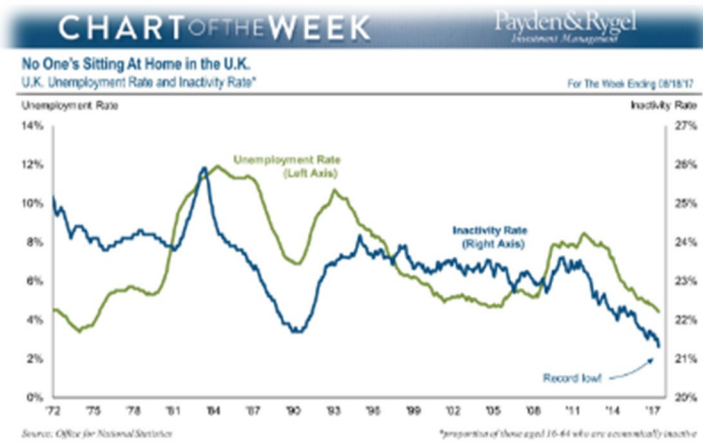
## Our Macro Philosophy In One Sentence

**“Rather than trying to be right, assume you are wrong and try to be less wrong.”**  
– James Clear

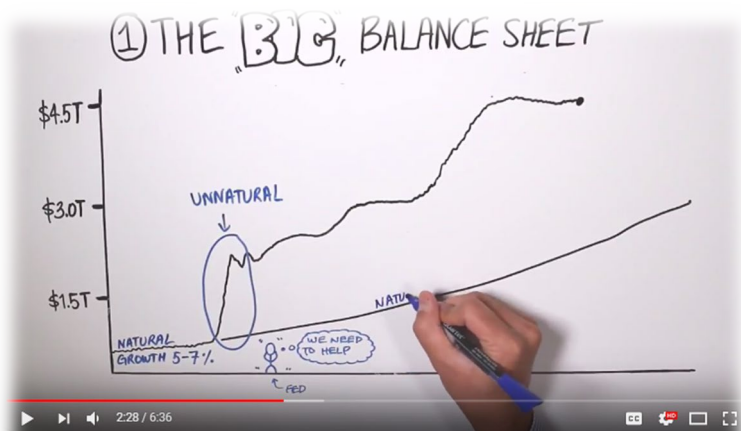


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## The Point of View

**Payden & Rygel**  
**POINT of VIEW**  
SUMMER 2017  
Our Perspective on Issues Affecting Global Financial Markets

**India Undergoing Modifications:**  
putting "Demonetization" in perspective

Once seen in context, demonetization is a step in India's economic journey.

Demonetization is merely the halfway point on the path to the real change investors should be focused on: digitization. The Modi government envisioned the process of digitization as having four steps: identification, banking infrastructure, digital records, and, ultimately, cashless commerce. We will examine each in turn. The journey begins with the Aadhaar Act of 2010 and, we think, ends with the implementation of the Aadhaar Act of 2010 and, we think, ends with the implementation of the Aadhaar Act of 2010 and, we think, ends with the implementation of the Aadhaar Act of 2010.

**"ON THIS COLD NIGHT, NARENDRA MODI, PRIME MINISTER OF INDIA, TAKES OVER THE AIRWAYS TO MAKE A SUDDEN AND STUNNING ANNOUNCEMENT."**

The value long-term impact of demonetization will take decades to determine. In this interim, investors must look behind the scenes to see the major transformation that the Indian economy is undergoing.

**VALUE AND VOLUME OF ALL BANKNOTES IN INDIA BY DENOMINATION**

**INDIA BEFORE 2009: FINDING AN IDENTITY**

Most citizens in the developed world contemplate their identity in sleep and dreamless nights.

In India, before 2009, nearly 50% of the population lacked an official identity. Millions of Indians were born every year without a birth certificate, which precluded their inclusion from basic services such as driving licenses, bank accounts and mobile phones.

To remedy this problem, India launched a project called Aadhaar, a nationwide biometric database based on a random-digit digital identity, fingerprint and retina scans. Eight years later, Aadhaar is the largest

system with just their Aadhaar identification number. The proliferation of new bank accounts as a result of the initiative began to be realized. Over 270 million new bank accounts were opened in the span of three years.

One of the primary incentives used to convince the previously unbanked to open an account was the linkage to social welfare programs. The rural population finally had an efficient and non-bureaucratic method of receiving social welfare programs provided by the state and government with less leakage. Once people could instantly register a mobile phone number with their Aadhaar number, mobile phone penetration rapidly increased as well. In March 2017, the government made Aadhaar verification mandatory for all mobile phone numbers.

**THE WAR ON CASH**

This brings us to another cornerstone: once bank accounts and welfare became digital and linked to biometrics, cash is no longer needed.

In his initial speech (the one quoted at the beginning of this article), Modi gave the country until the end of 2016 to deposit their money in a bank account. The idea is to curb the circulation of money in the shadow economy, the so-called "black" or "grey" economy, thereby making counterfeit notes used by nefarious elements in society worthless. However, in an economy where cash transactions make up 70% of all consumer transactions (putting off of 40% of the country's GDP), circulation was disruption, to say the least (see Figure 2).

Working people across India skipped work for days or weeks at a time to make sure their cash was properly deposited into banks. These same citizens spent additional days or weeks waiting in line up at ATMs to withdraw new notes, a virtually insurmountable barrier to order to run daily business. The subsequent cash shortage affected millions. Without cash, the economy temporarily froze.

**"MOST CITIZENS IN THE DEVELOPED WORLD CONTEMPLATE THEIR IDENTITY IN SELFIES AND SLEEPLESS NIGHTS. IN INDIA, BEFORE 2009, NEARLY 50% OF THE POPULATION LACKED AN OFFICIAL IDENTITY."**

**ERECTING A DIGITAL BANKING INFRASTRUCTURE**

The next phase of India's digital infrastructure overhaul was the banking and mobile phone industries. Building on the identification infrastructure, digital banking now allows Indian customers to open an

**BLOOMBERG CONSENSUS FORECAST FOR 2017 REAL GDP GROWTH IN INDIA**

Announcement of Demonetization

Email [economics@payden.com](mailto:economics@payden.com) to be added to our mailing list.

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