CORBETT ROAD
WEALTH MANAGEMENT

MACRO MUSINGS

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Assessing the Odds of a Soft Landing for the Economy

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SUMMARY

- The **macro**cast™ score suggests the probability of a recessionary bear market remains elevated, while the positioning of **micro**cast™ reflects the improvement in technical indicators seen during the last market rally. A closer look at both risk models reveals the current dichotomy in market data—a conflict between weakening fundamental economic indicators and the constructive price action exhibited by major equity indices.
- So far, in 2023, the contradicting signals of **macro**cast™ and **micro**cast™ is the defining market theme—in essence, it is a clash between a recession and a soft landing.
- A tight labor market and improving market returns are key factors supporting the soft landing narrative, but it's important to remember that hope for a soft landing always precedes a recession.
- The stock market has had a strong start to the calendar year. Historically, that has been bullish for the rest of the year; however, the market was down more than 10% in 2022, and years following double-digit market declines have been worse than average.

WHAT EXACTLY ENTAILS **A SOFT LANDING?**

The term "soft landing" refers to situations where economic growth slows without contracting significantly. In our view recent soft landings occurred in 2011, 2016, and 2018. In all three cases, economic growth slowed and there were worries about a possible recession. The stock market suffered brief, double-digit declines before quickly recovering as the cycle reversed and growth rebounded.

As of now, we believe a recession in 2023 is still likely but not inevitable. As we noted in our December Macro Musings ("Our 2023 Outlook"), the Conference Board Index of Leading Economic Indicators has never fallen to current levels without a recession following.

The latest Senior Loan Officer survey confirms the view of an economy on the edge of recession. As shown in the chart below, lending standards have tightened significantly over the past year. Historically, they have never tightened this much without a subsequent recession:

At Corbett Road, we strive to separate the data from the news and let the data drive our process and view. It is not uncommon to see an uptick in calls for a soft landing prior to a recession. A recent Forbes article highlights several instances from the past 50 years where market prognosticators have predicted a soft landing, only to see the economy eventually fall into a recession each time. This is a good reminder that there is always hope of avoiding a recession, regardless of what happens.

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ONE FACTOR IN FAVOR OF THE SOFT LANDING NARRATIVE: **A TIGHT LABOR MARKET**

Nevertheless, there are factors at play that suggest this time might be different—the most compelling argument being that the rapid nature and historic response to the pandemic is affecting traditional economic indicators. The economic boost from fiscal stimulus and loose monetary policy in 2020/2021 is likely to cause distortions in the data as those policies are unwound, similar to a wartime economy transitioning to peacetime.

Labor market tightness is a key factor. Recessions are unlikely to occur without significant job losses, and job openings remain well above historical levels. Despite the fact that some of these openings may be duplicates (thanks to remote work options), it is evident that the labor market remains tight. According to Bureau of Labor Statistics, the ratio of job openings to unemployed persons remains high, with two job openings available for every one unemployed worker.

THE STOCK MARKET IS NOT ACTING LIKE **A RECESSION IS INEVITABLE**

Another factor driving hope for a soft landing is the recent behavior of the stock market. While bear market rallies are common, improving price action and the strong momentum of the latest rally has been encouraging.

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The table below highlights a combination of historically bullish price action. In the past, when stocks have rallied after Christmas, early in the new year, and for the entire month of January, returns going forward were robust and always higher when the market was flat or negative in the year prior (from Carson Group):

If Stocks Are Down the Previous Year, This Trifecta is Very Bullish

Trifecta Of The Santa Claus Rally, First 5 Days of the Year, and January All Green (1950 - Current)

S&P 500 Index Returns					
Year	Santa Claus Rally	First 5 Days	January Return	Previous Year Returns	Full Year Return
1954	0.5%	1.7%	5.1%	-6.6%	45.0%
1958	2.5%	3.5%	4.3%	-14.3%	38.1%
1961	1.2%	1.7%	6.3%	-3.0%	23.1%
1963	2.6%	1.7%	4.9%	-11.8%	18.9%
1971	0.0%	1.9%	4.2%	-0.1%	10.8%
1975	2.2%	7.2%	12.3%	-29.7%	31.5%
1995	0.3%	0.2%	2.4%	-1.5%	34.1%
2012	1.8%	1.9%	4.4%	0.0%	13.4%
2019	2.7%	1.3%	7.9%	-6.2%	28.9%
2023	1.4%	0.8%	6.2%	-19.4%	?
		Average			27.1%
		Median			28.9%
		% Higher			100.0%

Source: Carson Investment Research, FactSet 01/31/2022
The Santa Claus Rally is the final 5 trading days of a calendar year and the first two of the following year.
@ryandetrick

CARSON

A recent study of market momentum looks at previous instances when the market was up 5% or more in 3 out of 4 months. Again, results were bullish and did not occur during bear markets (table from LPL Financial):

What Happens When the S&P 500 Is Up More Than 5% in 3 Out of 4 Months?

	S&P 500 Performance		
S&P 500 Up More Than 5% Three out of Four Months	Next 3 Months	Next 6 Months	Next 12 Month
May 1986	3.1%	2.5%	21.2%
July 1997	-3.8%	3.6%	19.3%
November 1998	6.8%	12.6%	20.9%
December 1998	5.0%	12.4%	21.0%
January 1999	4.7%	4.5%	10.3%
May 2009	11.7%	20.5%	21.0%
June 2009	15.6%	22.6%	14.4%
July 2009	5.5%	9.9%	13.8%
January 2023	?	?	?
Average	6.1%	11.1%	17.7%
Median	5.2%	11.1%	20.1%
% Positive	88%	100%	100%

Source: LPL Research, FactSet 2/1/2023
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

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The results of these studies are encouraging, but we offer two cautionary notes. First, the sample size is small, and second, it is unclear if the economic conditions driving the historical returns are present—or even relevant—today.

When we look at a broader study of market performance after a down year, results are more muted.

According to a study from DataTrek Research:

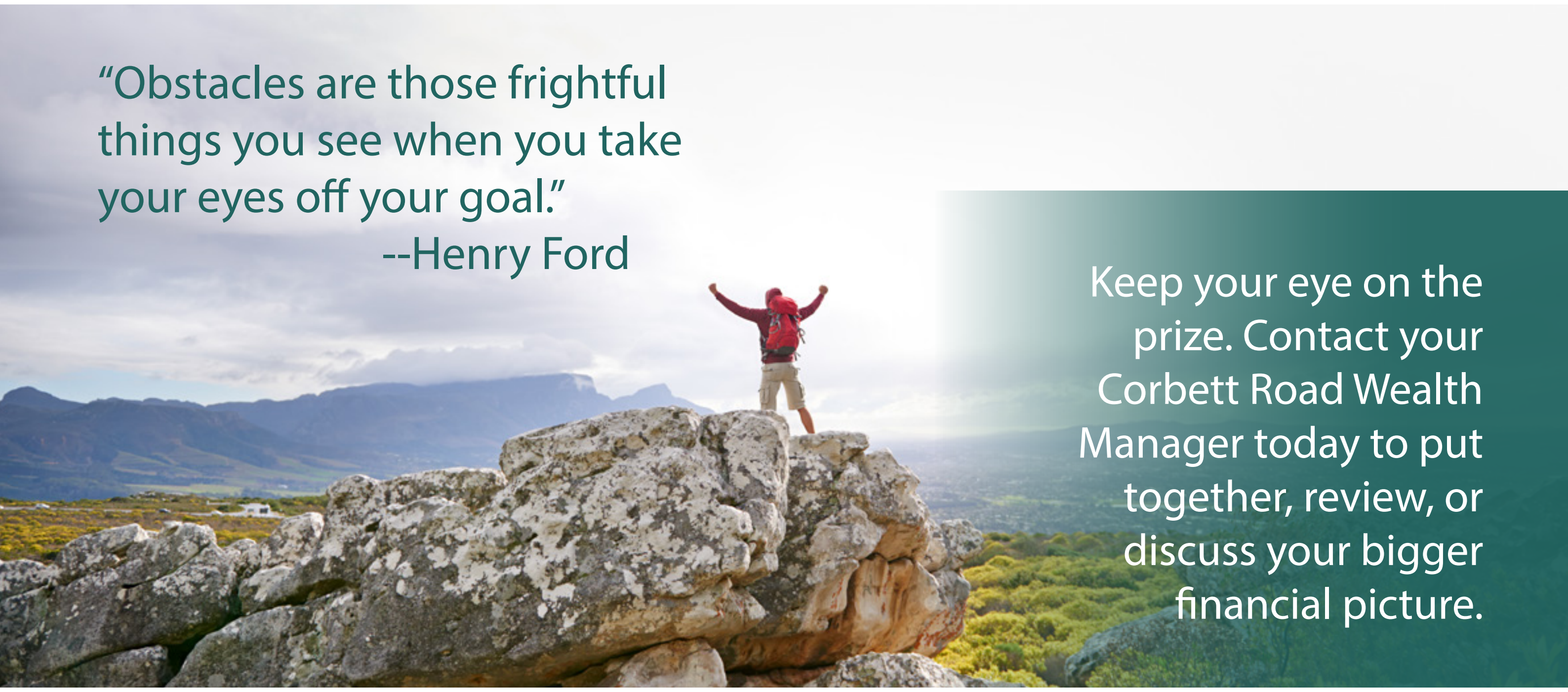
- *In the 25 down years since 1928 (save 2022), the S&P has posted a negative return of less than 10 pct just over half the time (56 pct, or 14 years). During these years, the average return was -6.0 pct and the next year the index was positive most of the time (79 pct, or 11 out of 14 years). The average return in the subsequent year was +17.5 pct.*
- *The S&P was down 10 percent or more in 11 out of the 25 negative years (44 pct of the time), losing an average of 22.6 pct. The next year the index's return was positive just over half the time (55 pct, 6 out of 11 years) and up by an average of 6.4 pct.*
- ***The S&P 500 has a much better win rate (79 vs 55 pct) and average performance (+17.5 vs +6.4 pct) in the 12 months following a down calendar year of less than 10 percent than one that does worse than that like in 2022 (-18.0 pct).***

Overall, our analysis this month shows that we find ourselves in a challenging environment in early 2023. **macro**cast™ and **micro**cast™ are sending conflicting signals. Many leading indicators remain at recessionary levels, but the labor market is tight, and without a significant rise in unemployment, it is hard to see how we end in recession.

Recent strength in market action supports the soft landing narrative, as stocks tend to do better when the economy is growing and have a higher-than-average return in periods following a year of negative returns. However, as noted by DataTrek, the magnitude of the decline in the down year is an important distinction. When the market is down more than 10% in a year (as in 2022), the following year's returns tend to be weaker, with a lower win rate and lower average returns.

Lastly, it seems every previous recession had at least a few experts calling for a soft landing, only to see the economy eventually roll over. This is one reason why we cannot simply ignore the negative data and assume the stock market has all the answers.

We expect to have a clearer picture on the state of the economy and market conditions as we progress through the year and more data rolls through. If **macro**cast™ improves in the coming months, it is a good sign that recessionary bear market risks have receded. In the meantime, **micro**cast™ reflects the improving market technical conditions, but that can quickly change if the recent rally fails and stocks head lower from here. As always, we will keep you updated on these developments as well as any events of note, such as the debt ceiling standoff that could be a market moving issue later in the Spring.



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Use of Indicators
Corbett Road's quantitative models utilize a variety of factors to analyze trends in economic conditions and the stock market to determine asset and sector allocations that help us gauge market movements in the short- and intermediate term. There is no guarantee that these models or any of the factors used by these models will result in favorable performance returns.

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