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Delta Insights
a weekly commentary on investing

Delta Investment Management is a registered investment advisory firm. Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new turnkey asset management solution.
Delta manages portfolios at TD Ameritrade and Schwab.
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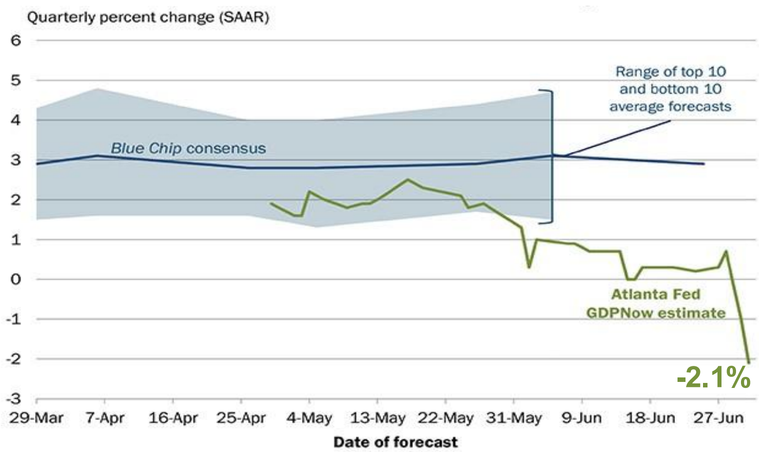
July 8, 2022

Recession Today

Crazy as it might seem with unemployment in the mid 3% range and the service and manufacturing sectors expanding, the U.S. may already be in a recession. The real gross domestic product (GDP) decreased at an annual rate of 1.6% in the first quarter of this year. The Atlanta Fed's model currently predicts the second quarter GDP will decline by 2.1%. If real GDP is negative in the second quarter, this will meet the common definition of recession.

Atlanta Fed GDPNow Real GDP Est. 2Q, 2022



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Real GDP is nominal GDP less inflation. Very high inflation can cause positive nominal GDP growth to turn negative when inflation adjusted. Additionally, personal consumption activity has slowed recently. The Atlanta Fed's "nowcast" of inflation picks up on the most recent slowdown in personal consumption activity.

If and when the US economy slips into recession matters from a stock investing standpoint. An unexpected transition into recession now or very soon could actually be a positive for stocks.

Before we discuss how an early recession may impact the stock market, let's review the indicators showing recession.

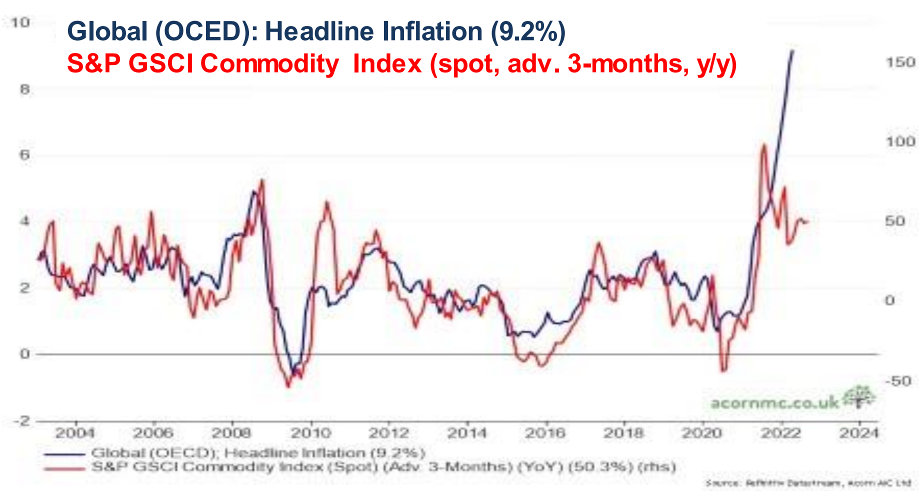
- The 2yr-10yr rates on the treasury yield curve have inverted again.
- Interest rates, especially long-duration rates, are declining showing less conviction in the growth outlook. The 2-yr note yield, which hit 3.44% on June 14, fell to 2.78% this week. The 10-yr note yield, which hit 3.50% on June 14, fell to 2.76% this week.
- The spread between non-investment grade debt interest rates and treasury rates (high-yield spread) is now almost 6%. Any reading above 5% has historically indicated lenders are becoming increasing concerned about credit risk, a close cousin of a declining macroeconomic environment.
- The Leading Economic Index (LEI) declined for the past three months through May. We expect the June report to also be negative. It is very likely that the six-month moving average of the LEI will turn negative on the June report which is a reliable recession indicator.
- Commodity prices are collapsing. For example, Copper prices are 30% off of their highs. This may be a surprise to some as electric vehicle sales which consume a significant amount of copper (EV ~183 lbs/copper/car vs ~30lbs in a gas-powered car) are climbing rapidly. A copper price decline may indicate demand declines from a recession overpower the secular growth coming from the move towards electric vehicles.

- The University of Michigan's gauge of consumer sentiment reached a final reading of 50 in June. This is the lowest reading on record going back to 1952. About 79% of consumers survey are pessimistic about future business conditions. This strongly suggests consumers are pulling back on their spending.

If we are in recession or if a recession is extremely likely this year, there may be several important positives that stem from this development.

- A recession in 2022 would be a significant surprise to many market participants, including the Federal Reserve. Currently, the Federal Reserve is projecting a Fed Funds rate of 3.4% by year-end and a 0.5% to 0.75% increase at the July 26-27 meeting. If we are in recession and the 10-year treasury remains below 3%, we would expect the Fed to back off its aggressive rate hike plan through the remainder of the year as their desire to slow demand will have been achieved.
- A recession now should cause inflation to slow materially near-term. Inflation rate and commodity prices are tightly correlated. In the graph below, commodities prices have broken lower as inflation has continued to climb. In a recession and with commodity prices remaining depressed, inflation is likely to rejoin commodities at a lower level.

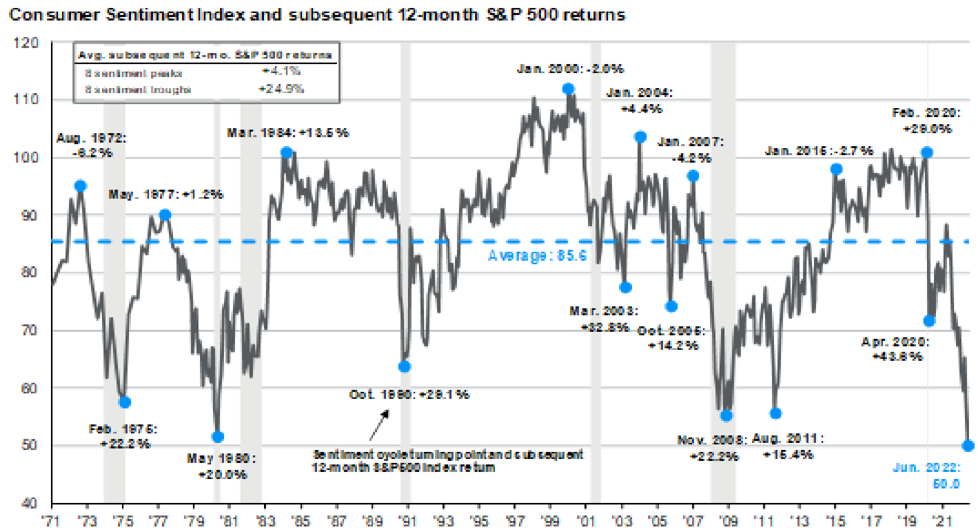
Inflation and S&P GSCI Commodity Index



- Lower interest rates and inflation will allow for multiple expansion, even if earnings are adjusted lower.

We mentioned above that consumer sentiment is at the lowest level ever recorded going back to 1952. Below is a chart showing the subsequent 12-month S&P 500 returns from consumer sentiment lows. The average return of the S&P 500 from the eight lows recorded since 1971 is 24.9% with no negative readings.

Consumer Sentiment at All-Time Low



Bear markets do not last forever. If the S&P 500 were to return to its January 2022 peak valuation in the next year, an investor would earn a 28% return. If it takes two years to get back to the old high, the average annual return is 14.3%. Even if it takes five years to return to the old high, the average annual return is above 6%. The average duration of a bear market dating back to 1926 is twenty months.

The first GDP report for the second quarter will not be released until July 28. The GDP report will then be revised two more times before it is final. Until the final GDP report has been released, we will not know definitively if the economy is in a recession. What we will see are company macroeconomic outlooks, additional inflation numbers and potentially more commentary out of the Fed updating their current rate hike expectations at the July meeting.

Let Us Help You Position Your Portfolio – Give Us a Call Today

We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.

"Mom-- the rule is, no tweeting in the sandbox!"

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BEARISH

THIS WEEK'S NUMBER IS

12.8

Our technical indicator decreased from 13.0 to 12.8 this week

INDICATOR STATISTICS

Consecutive Bearish Weeks:	10
Cycle Inception Date:	5/4/2022
Range:	5.2 – 40.8
Mean:	23.1
Bullish Weeks YTD:	8
Bearish Weeks YTD:	19
*S&P 500	-9.0%
*DJIA	-7.1%
*NASDAQ	-9.2%

* Percentage change during current cycle