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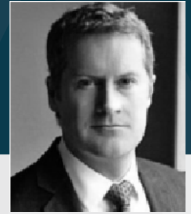
Perspective



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Recessions Risks Remain Contained and Equity Markets to Rise if Trump Impeached

RECESSION RISKS CONTAINED

A recession is technically defined as two consecutive quarters of contracting GDP. While the National Bureau of Economic Research (NBER) is the official arbiter of the timing of U.S. recessions, determinations are only possible in hindsight.

There have been nine recessions since the middle of the last century. That means recessions occur on average every eight years or so. According to the NBER, the current recovery started in June 2009 and is now the longest in the post-war economic expansion. As I've discussed in prior editions of the Perspective, this cycle's duration along with weak headline data created some worry about the sustainability of the current expansion. With stocks declining 33% on average around post-war recessions, investors have good reason to continue to review economic indicators and the probability of a contraction.

Putting aside any formal definition, a recession is an economic convulsion which wreaks havoc on virtually every aspect of economic life from housing and industrial activity, to corporate profits, interest rates and loan defaults. Most importantly, these downturns result in widespread layoffs and falling asset values.

CREDIT SUISSE RECESSION MODEL

Economic indicators wax and wane throughout the business cycle, punctuating expansions, contractions, and turning points. The Recession Dashboard below, from Credit Suisse, organizes economic indicators into logical categories to help signal potential turning points. Credit Suisse concludes the data does not yet point to a recession.

The Credit Suisse dashboard shows that only one out of six indicators points to a recession. Historically, a minimum of four indicators has been evident before a recession materialized.

Recession Dashboard

Start of Recession	Yield Curve	Mfg.	Inflation	Jobs	Housing Activity	Credit Perform	Earnings
Nov-73	⇩	⇩	⇩	⇩	⇩	--	⇩
Jan-80	⇩	⇩	⇩	⇩	⇩	--	⇩
Jul-81	⇩	⇩	⇧	⇧	⇩	--	⇩
Jul-90	⇩	⇩	⇩	⇩	⇩	⇩	⇩
Mar-01	⇩	⇩	⇩	⇩	⇔	⇩	⇩
Dec-07	⇩	⇩	⇩	⇔	⇩	⇩	⇩
Present	⇩	⇔	⇧	⇧	⇔	⇧	⇔

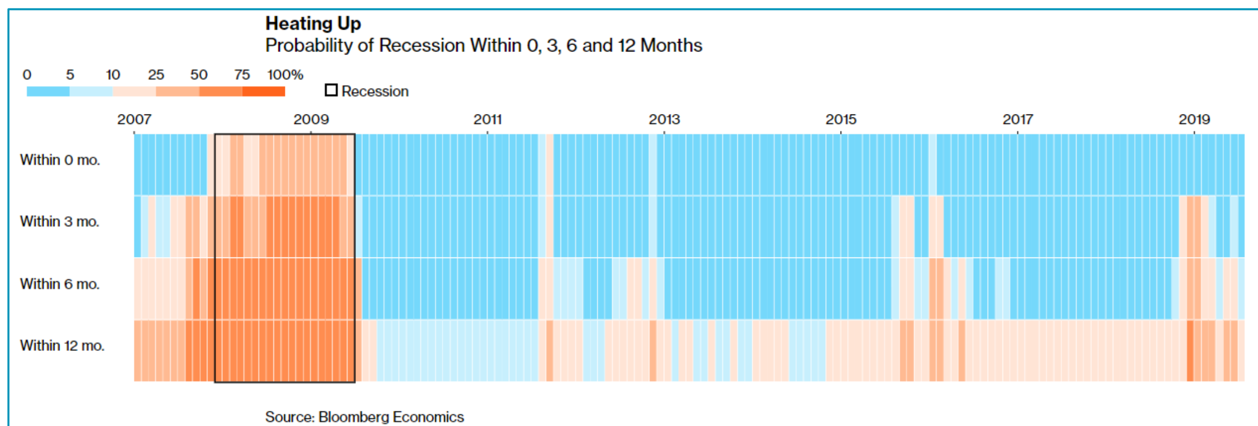
Key: ⇩ Recessionary ⇧ Expansionary ⇔ Neutral

Source: Standard & Poor's, Federal Reserve, BLS, NBER, ISM, Census Bureau, Haver Analytics®, Credit Suisse

BLOOMBERG RECESSION MODEL

Bloomberg's Economics proprietary recession risk assessment is similarly optimistic. Bloomberg points out that recession fears have grown in recent months amid a persistent trade war with China, pullbacks in corporate hiring and investments in the manufacturing sector that has already slipped into contraction. However, as shown in the chart at the bottom of this page, their conclusion is a 73% probability the U.S. economy will not enter a recession in the next 12 months.

Bloomberg's recession modelling incorporates economic and financial data across economic cycles, designed to



gauge underlying stress and to estimate the probability of a downturn. Bloomberg's model focusses on traditional recession indicators such as weekly filings for unemployment benefits, real wage gains, the yield curve, and corporate profit margins.

As I discussed in prior editions of the Perspective, the yield curve inverted earlier this year, raising fears of a recession. However, negative yields in other regions are a structural impediment to curve normalization. Despite this, the U.S. curve reverted recently, giving some relief that the economy will continue to expand.

Last December, the model assessed the recession probability at 50%. Since then the risk is fallen to a more reassuring 27%.

TRUMP IMPEACHMENT GOOD FOR STOCKS

President Trump isn't shy about touting his "great and unmatched wisdom," making him God's gift to the stock market. In September's oddly deranged defense, Trump boldly predicted that "markets would crash," if the House of Representatives impeach him. Despite Trump's bluster, we have a different take, matched by the stock market's muted reaction to the impeachment investigation.

Despite this worsening political predicament and growing odds that the House will impeach him, markets have not indicated any particular concern. If Trump were forced out of office, either by resigning or being driven from office, relief from his erratic agenda and twitter distractions is more likely the push stock markets higher than lower.

However, Trump has the resilience (and vocabulary) of a punch-drunk fighter – the punches keep coming, but he won't go down. He'll likely scrap it out until there is nowhere to run. It's unclear if impeachment proceedings will harm political prospects. As he professed during the election, "I could stand in the middle of Fifth Avenue and shoot somebody, and I wouldn't lose any voters." It turns out he may be partially right as his base remains undeterred. Indeed, in 1998 Bill Clinton's popularity rose as voters regarded him a victim of impeachment by overreach by a vindictive Republican party. Despite the facts, Trump could be viewed a victim of Democratic overreach.

Trump's predicament is more challenging than Clinton's, who lied under oath about an extramarital affair, a moral failing. Trump's crimes appear direr, as he may have subordinated national security matters in favour of personal political interests. Critical aid money, appropriated by Congress, was withheld from Ukraine to compel a new investigation into unsubstantiated allegations about a likely and credible domestic political challenger, Joe Biden. To make matters worse, there appears to have been a coordinated White House cover-up. If true, Trump abused his Presidential power by subjugating foreign policy and national security, core presidential responsibilities, to his personal and political interests.

Trump could survive an impeachment. If the House of Representatives impeaches the President, he remains in office until a trial is held by the Senate, controlled by Republicans, which requires a two-thirds vote for conviction. If not convicted, Trump would remain in office, as Clinton did for the remainder of his second term. However, Republican loyalty to Trump in the Senate might dim after an actual impeachment. If convicted, Trump would be replaced by Vice President Mike Pence.

To understand the outcome of impeachment, we must ask how the stock market would react to President Pence. Before becoming one of Trump's yes-man, Vice-President Pence aligned with traditional Republican values of free trade and limited government. He certainly wouldn't abandon everything Trump espouses; however, he'd likely shed the worst of it.

Tax cuts and deregulation would surely remain in place. However, tariffs, protectionism, xenophobia and political interference with free markets would dissipate. Investors would cheer the restoration of White House discipline.

OUTLOOK REMAINS POSITIVE

Although there is conflicting data, absent increased U.S.-China trade tensions, we expect global economic data to stabilize and gradually improve in 2020. Progress towards a trade war and/or Brexit resolution will reignite the economic engine. If Trump is removed from office and replaced by Pence, stock market will respond positively, creating a positive economic feedback loop.

With the balance of risks shifting to the upside ahead of the seasonally strong November to January period, portfolios remain skewed towards stocks.

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