Of Rates and Recessions (Last of a Series)

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We conclude our unpacking of the rich content delivered by our three top economists in last month's exclusive webinar [link] by looking at global policies.

The Fed is way ahead of the other central banks in its quantitative tightening and rate hike program. The ECB is "dithering" and the BOE not well organized. Japan continues to maintain a very easy rate policy. The Brazil's Banco Central has hiked rates by over 1000 bps, and markets have rewarded them, helped by energy exports to China.

China over the last twenty-five years has been the engine of global growth. No longer. It suffers from deep-seated problems, economic weakness has been persistent, and real estate is showing symptoms of over-investment. Which is problematic because over 80% of households invested in real estate.

China is also seeing declining export orders. That's having a significant negative impact on its trading partners. Official data on 3Q GDP was not available last week but has now been reported at a fairly healthy 3.9%. That level was down from the 5.5% target, but topped estimates. Looking to non-standard data collection such as used car parking lots, trucks at cement plants and retail stores revealed consumers have not been buying as much.

Looking ahead to 2023, China growth should be more stable. If nothing else, there's a benefit from the economy being "open" for a full year compared to the Covid-induced shutdown this year.

"The resting heartbeat of the US economy is greater than 2%." As our Chart of the Week shows, higher rates and a still-percolating economy have given rise to a strong greenback. Yes, that tends to be destabilizing for the global economy. But there are other reasons for the strong dollar. Companies are showing better revenues and earnings. And our economy appears to contain less recession risk.By contrast UK rates are rising and the pound sterling is falling. That's not a good combination. Keep in mind that oil is priced in dollars. Hedging is tough when moves are so fast. The US dollar was actually headed down modestly when Russia invaded Ukraine.

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Twenty-five years of globalization gave the US a canopy of durable goods deflation and low volatility. "Inflation skipped a generation" or two, allowing the Fed an almost effortless rate and inflation balance. But that's unwinding fast.

Daily mark-to-market has not been investors' friend. Good "financial hygiene" means building in more stability to valuations with alternative assets such as private real estate, private equity and private credit. More floating rate, more real assets, and more active management. The key to optimizing performance is to rebuild portfolios to manage through the next cycle.