SEVENS REPORT

Sevens Report Alpha Webinar – Is a Soft Landing Really Possible? (And What Would It Look Like?)

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What Is A Soft Landing?

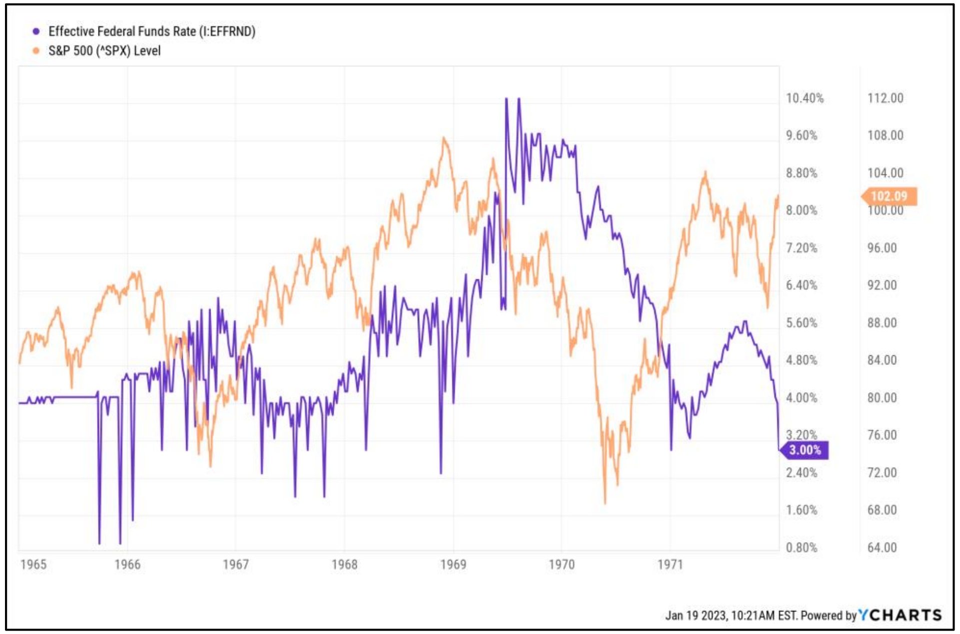
- Fed hikes rates to sufficiently reduce inflation, while economic growth slows but doesn’t decline meaningfully and unemployment remains low.
- Has this been done before? Yes, but not often.

Fed Tightening Cycles

- Not including the current cycle, since the mid 1960's there have been eight Fed hiking cycles.
- Three of them, '72-'74, '77-'81, and '04-'07 ended up in stagflation, recession, and the Global Financial Crisis, so clearly the Fed didn't achieve a "soft" landing.
- Of the remaining five, we investigated whether the Fed achieved a soft landing or not.

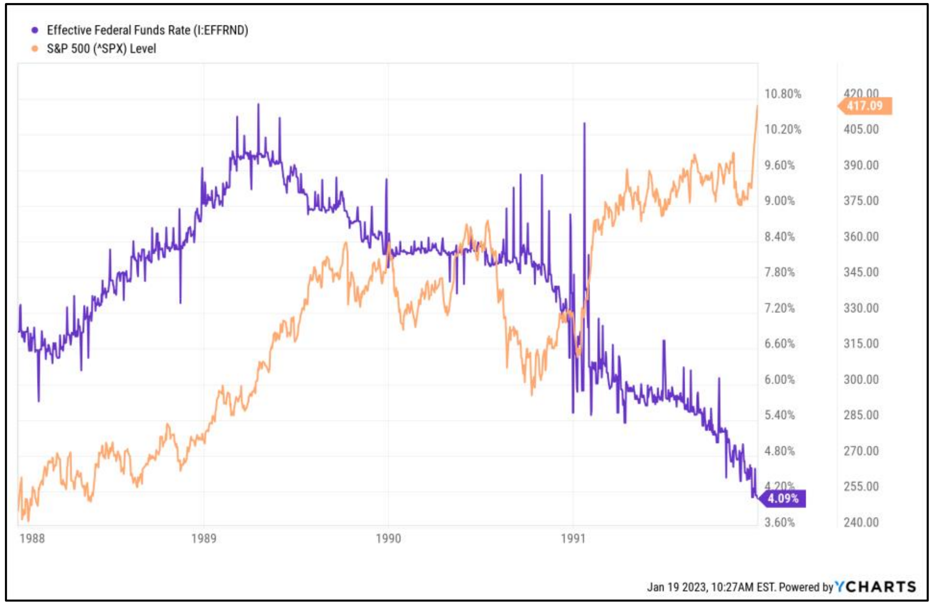
1965 - 1971

	Start		Extreme	
CPI	0.97%	Jan-65	6.20%	Dec-69
Unemployment Rate	4.90%	Jan-65	6.10%	Aug-71
Fed Funds Rate	4.00%	1/1/1965	10.50%	Aug-69
GDP	10.00%	Q1 1965	-4.20%	Q4 1970
S&P 500	84.23		69.24	May-70



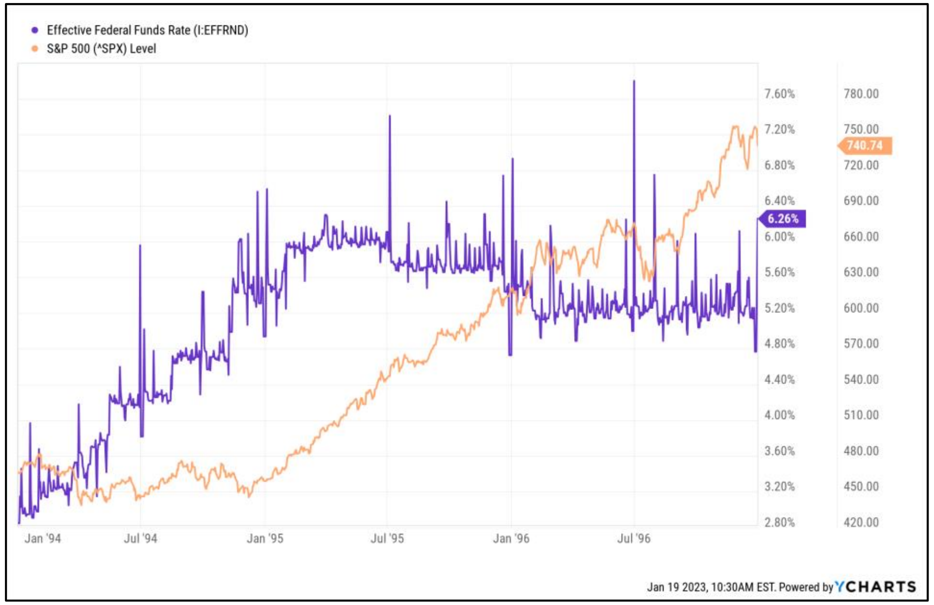
1988 - 1991

	Start		Extreme	
CPI	4.05%	Jan-88	6.29%	Oct-90
Unemployment Rate	5.70%	Jan-88	7.30%	Dec-91
Fed Funds Rate	6.89%	1/2/1988	9.71%	May-89
GDP	2.10%	Q1 1988	-3.60%	Q4 1990
S&P 500	247.08	Jan-88	300.03	Oct - 90



1994 - 1996

	Start		Extreme	
CPI	2.52%	Jan-94	3.32%	Dec-96
Unemployment Rate	6.60%	Jan-94	6.60%	Jan-94
Fed Funds Rate	2.85%	1/1/1994	6.30%	Mar - 95
GDP	3.90%	Q1 1994	1.20%	Q2 1995
S&P 500	467.55	Jan-94	438.92	Mar-94

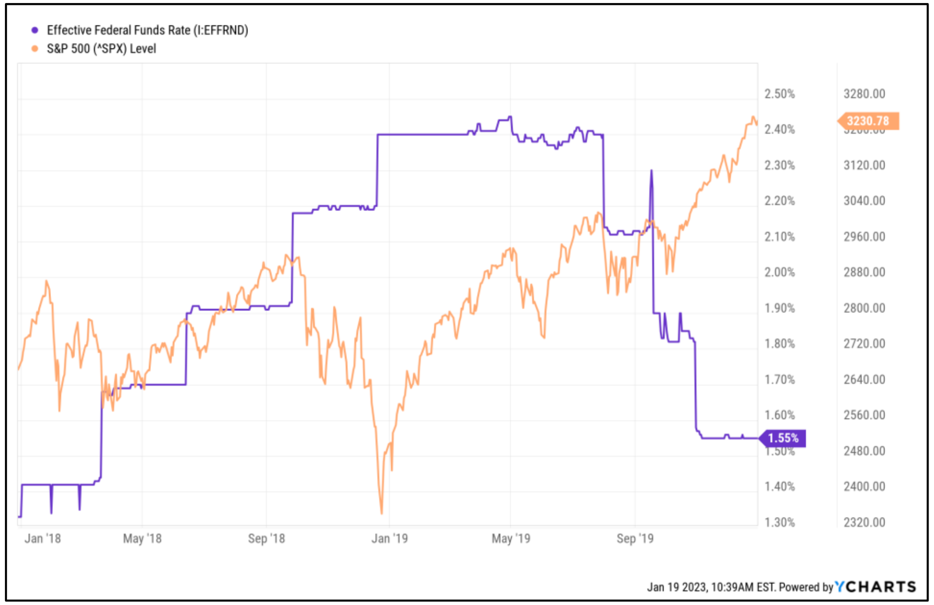


1999-2004

	Start		Extreme	
CPI	1.67%	Jan-99	3.76%	Mar-00
Unemployment Rate	4.30%	Jan-99	6.30%	Jun-03
Fed Funds Rate	4.60%	1/1/1999	6.50%	Aug-00
GDP	3.80%	Q1 1999	-1.70%	Q3 2001
S&P 500	1211	Jan-99	777	Oct-02

2018-2019

	Start		Extreme	
CPI	2.07%	Jan-18	2.95%	Jul-18
Unemployment Rate	4.10%	Jan-18	4.10%	Jan-18
Fed Funds Rate	1.33%	Jan-18	2.45%	Jan-19
GDP	2.80%	Q1 2018	0.70%	Q4 2018
S&P 500	2673	Jan-18	2351	Dec-18



Takeaways

- From an economic standpoint (“Did Fed Rate Hikes Cause an Economic Contraction?) then we can only say there has been one instance where the Fed pulled off a “soft landing” (in ’94-’95).
- However, the economy is not the market.
    - Of the five rate hike periods examined, in only one (’00-’04) did the S&P 500 fall more than 20% following the start of the rate hike cycle.
    - Point being, while the economy has consistently been hit by rate hike cycles, the S&P 500 largely weathered these rate hike periods well, with only modest declines.

So What Does That Mean for Us?

- This history of rate hike cycles appears clear:
  - If all the Fed is trying to do is prevent a rise in inflation and gradually hikes rates, it’s decently successful in achieving a soft landing (’94/95, ’18/19).
  - But, if the Fed is behind the curve on inflation, then a soft landing isn’t likely because the Fed doesn’t care – it’s just trying to get inflation lower (rate hikes of the late 60’s, mid 1970’s and early 1980’s).
  - Finally, if Fed rate hikes are combined with an extraneous event (Oil embargo of the early/mid 1970’s, Tech bubble burst of early 2000’s) then that combination can lead to years of asset market underperformance (mid 1970’s and ‘00-’04).

What Do We Have Now?

- Is the Fed preventing a further rise in inflation or chasing it? Chasing it (like 1970's/early 1980's).
- Has there been an extraneous event? Yes (Russia/Ukraine war).
- Is the Fed trying to engineer a soft landing or kill inflation? We don't know yet.
  - If trying to engineer a soft landing, then small chance they succeed.
  - If trying to kill inflation, virtually zero chance of a soft landing.

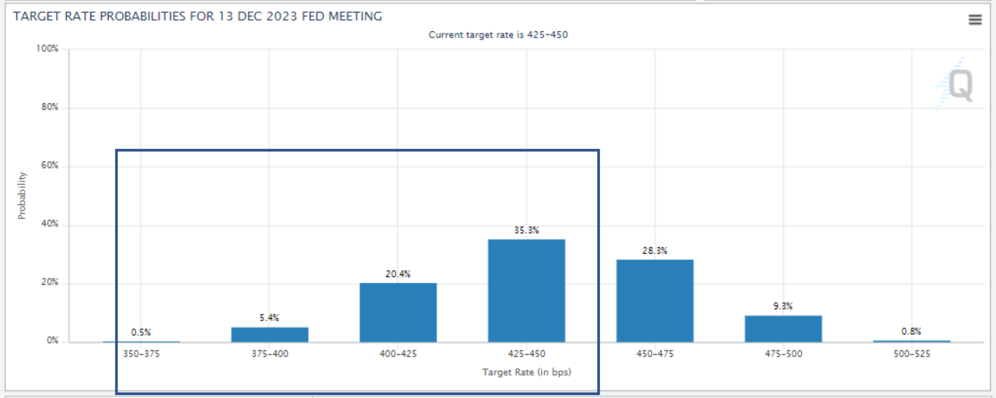
Key Metrics to Watch

FedWatch Tool

Target Rate: Current | Compare | Probabilities
Historical: Historical | Downloads | Prior Hikes
Dot Plot: Chart | Table

1 Feb23 | 22 Mar23 | 3 May23 | 14 Jun23 | 26 Jul23 | 20 Sep23 | 1 Nov23 | 13 Dec23

MEETING INFORMATION						PROBABILITIES		
MEETING DATE	CONTRACT	EXPIRES	MID PRICE	PRIOR VOLUME	PRIOR OI	EASE	NO CHANGE	HIKE
13 Dec 2023	ZQZ3	29 Dec 2023	95.5375	2,889	15,055	26.3 %	35.3 %	38.4 %



TARGET RATE (BPS)	PROBABILITY(%)			
	NOW*	1 DAY 18 JAN 2023	1 WEEK 12 JAN 2023	1 MONTH 19 DEC 2022
350-375	0.5%	0.9%	0.6%	0.8%
375-400	5.4%	7.6%	5.6%	6.1%
400-425	20.4%	24.0%	20.4%	19.3%
425-450 (Current)	35.3%	35.2%	34.1%	31.0%
450-475	28.3%	24.4%	27.7%	27.0%
475-500	9.3%	7.1%	10.1%	12.6%
500-525	0.8%	0.7%	1.4%	2.9%
525-550	0.0%	0.0%	0.1%	0.3%

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, December 2022

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2022	2023	2024	2025	Longer run	2022	2023	2024	2025	Longer run	2022	2023	2024	2025	Longer run
Change in real GDP	0.5	0.5	1.6	1.8	1.8	0.4–0.5	0.4–1.0	1.3–2.0	1.6–2.0	1.7–2.0	0.2–0.5	-0.5–1.0	0.5–2.4	1.4–2.3	1.6–2.5
September projection	0.2	1.2	1.7	1.8	1.8	0.1–0.3	0.5–1.5	1.4–2.0	1.6–2.0	1.7–2.0	0.0–0.5	-0.3–1.9	1.0–2.6	1.4–2.4	1.6–2.2
Unemployment rate	3.7	4.6	4.6	4.5	4.0	3.7	4.4–4.7	4.3–4.8	4.0–4.7	3.8–4.3	3.7–3.9	4.0–5.3	4.0–5.0	3.8–4.8	3.5–4.8
September projection	3.8	4.4	4.4	4.3	4.0	3.8–3.9	4.1–4.5	4.0–4.6	4.0–4.5	3.8–4.3	3.7–4.0	3.7–5.0	3.7–4.7	3.7–4.6	3.5–4.5
PCE inflation	5.6	3.1	2.5	2.1	2.0	5.6–5.8	2.9–3.5	2.3–2.7	2.0–2.2	2.0	5.5–5.9	2.6–4.1	2.2–3.5	2.0–3.0	2.0
September projection	5.4	2.8	2.3	2.0	2.0	5.3–5.7	2.6–3.5	2.1–2.6	2.0–2.2	2.0	5.0–6.2	2.4–4.1	2.0–3.0	2.0–2.5	2.0
Core PCE inflation[4]	4.8	3.5	2.5	2.1		4.7–4.8	3.2–3.7	2.3–2.7	2.0–2.2		4.6–5.0	3.0–3.8	2.2–3.0	2.0–3.0	
September projection	4.5	3.1	2.3	2.1		4.4–4.6	3.0–3.4	2.2–2.5	2.0–2.2		4.3–4.8	2.8–3.5	2.0–2.8	2.0–2.5	
Memo: Projected appropriate policy path															
Federal funds rate	4.4	5.1	4.1	3.1	2.5	4.4	5.1–5.4	3.9–4.9	2.6–3.9	2.3–2.5	4.4	4.9–5.6	3.1–5.6	2.4–5.6	2.3–3.3
September projection	4.4	4.6	3.9	2.9	2.5	4.1–4.4	4.4–4.9	3.4–4.4	2.4–3.4	2.3–2.5	3.9–4.6	3.9–4.9	2.6–4.6	2.4–4.6	2.3–3.0

NOTE: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The September projections were made in conjunction with the meeting of the Federal Open Market Committee on September 20–21, 2022. One participant did not submit longer-run projections for the change in real GDP, the unemployment rate, or the federal funds rate in conjunction with the September 20–21, 2022, meeting, and one participant did not submit such projections in conjunction with the December 13–14, 2022, meeting.

1. For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.
2. The central tendency excludes the three highest and three lowest projections for each variable in each year.
3. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
4. Longer-run projections for core PCE inflation are not collected.

Who Is Right? Market or Fed?

- If the market is right, then the Fed will soften language in the coming months (April or before).
  - In this case, the market way well chop for the next six months, but it will dramatically increase the chances the bottom is in.
- If the market is wrong, then the Fed will stay consistently talking about a 5% Fed Funds rate.
  - In this case, we not only have to brace for fresh lows, but potentially several years of volatility and sub-par returns (this is a similar scenario to mid 1970’s and early 2000’s).
- We should know within the next few months.

My View

- I am not in the “soft landing” camp for the following reasons:
  - First, it’s not clear to me the Fed is in the soft-landing camp, either.
  - Second, they are chasing inflation in a big way. That doesn’t usually end up with the Fed achieving a soft landing or end well for equity market returns.
  - Third, there has been an extraneous event that makes it even more difficult for the Fed.
  - Fourth, while a soft landing is not totally correlated with stock rallies, “hard” landings are – with stocks moving lower. As such, we remain cautious on stocks here.
  - Finally, as always, I could be wrong – and that’s why we’re watching Fed speak very closely over the next several weeks/months. If the Fed signals a pivot and market expectations for Fed Funds is correct, then a soft landing becomes much, much more likely.