# The Dreaded "R" Word

In early July, Michael Lebowitz appeared on Real Vision?s, ?Investment Ideas? (LINK), with Edward Harrison. In the interview, Michael stated that the window for a recession was open but that a recession was not necessarily imminent. He based this opinion on the premise that the benefits of increased government spending and recent tax reform are waning and economic headwinds such as China-U.S. trade discussions, slowing European growth, Iran, and a disorderly BREXIT are all serving to slow the growth of the economy. Importantly, he warned that historically the catalyst for recession is often something that is not easy to forecast or predict.

Over the last month, we have noted the ?R? word increasingly bandied about by the media. This potential recession catalyst is in everyone?s face, literally, but few recognize it.

## Consumers Drive the Bus

Almost 70% of U.S. GDP results from personal consumption. Since 1993, retail sales and GDP have a correlation of 78%, meaning that over three-quarters of the quarterly change in GDP is attributable to the change in retail sales.

The table below shows the dominant role consumption plays in the GDP calculation. In this hypothetical example, 2.5% consumption growth more than offsets a 4% decline in every other GDP category (an increase in net exports negatively affects GDP). If in the same example consumption was 1% weaker at +1.5%, GDP would go from positive .12% to negative .58%.

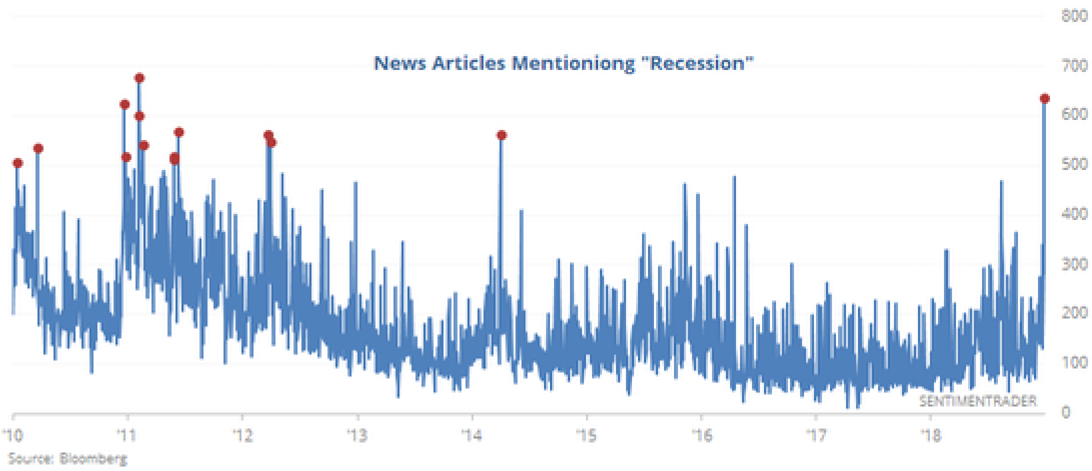
| GDP Category | Q2 2019 ($billions) | Hypothetical Change | Result | $ Change |
|---|---|---|---|---|
| Consumption | 13,253 | 2.5% | 13,584.74 | 331.33 |
| Investment | 3,427 | -4.0% | 3,289.92 | (137.08) |
| Net Exports | (983) | 4.0% | (1,021.80) | (39.30) |
| Government | 3,294 | -4.0% | 3,162.05 | (131.75) |
| **Total** | **18,991.70** | | **19,014.90** | **23.20** |
| | | | | **0.12%** |

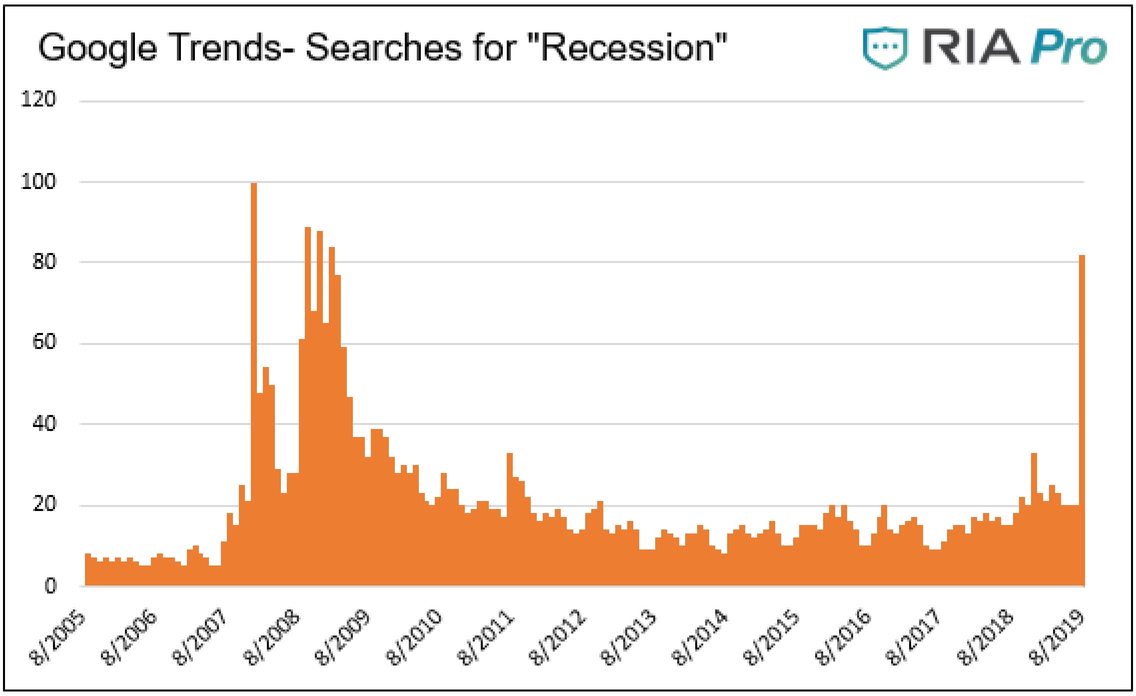
Spending decisions, whether for low dollar items such as coffee or dinner or bigger ticket items like a new TV, vacation, or housing, are influenced by our economic outlooks. If we are confident in our job, financial situation, and the economy, we are likely to maintain the pace of consumption or even spend more. If we fear an economic slowdown with financial repercussions, we are likely to tighten our purse strings. Whether we skimp on a cup of Starbucks once a week or postpone the purchase of a car or house, these one-off decisions, when replicated by the masses, sway the economic barometer.

Our economic outlooks and spending habits are primarily based on gut analysis, essentially what we see and hear. Accordingly, print, television, and social media play a large role in molding our economic view.

## Recession Fear Mongering

Increasingly, the media has been playing up the possibility of a recession. For example, on August 15, 2019, the day after the yield curve inverted for the first time in over a decade, the lead article on the Washington Post?s front page was entitled *Markets Sink on Recession Signal*. The signal, per the Washington Post, is the inverted curve. The New York Times followed a few days later with an article entitled *How the Recession of 2020 Could Happen*. Since mid-August, the number of articles mentioning recession has skyrocketed, as shown below. Furthermore, the number of Google searches for the ?R? word has risen to levels not seen since the last recession.




*Data Courtesy Google Trends*

We have little doubt that the media airing recession warnings are partially politically motivated, but regardless of their motivation, these articles present a growing threat to the consumer psyche and economic growth.

The more the media mentions ?recession,? the higher the likelihood that consumers will retrench in response. Small decisions like not going out to dinner once a week may seem inconsequential, but when similar actions occur throughout a population of hundreds of millions of people, the result can be impactful.  To wit, in *The Dog Whistle Heard Around the World*, we personalized how our decisions play an important role in measuring economic activity:

*Picture your favorite restaurant, one that is always packed and with a long waiting list. One Saturday night you arrive expecting to wait for a table, but to your delight, the hostess says you can sit immediately. The restaurant is crowded, but uncharacteristically there are a couple of empty tables. Those empty tables, while seemingly insignificant, may mean the restaurant?s sales that night will be down a few percent from the norm.*

A few percent may not seem like a lot, but consider that the average annual recessionary GDP trough was only -1.88% for the last five recessions.

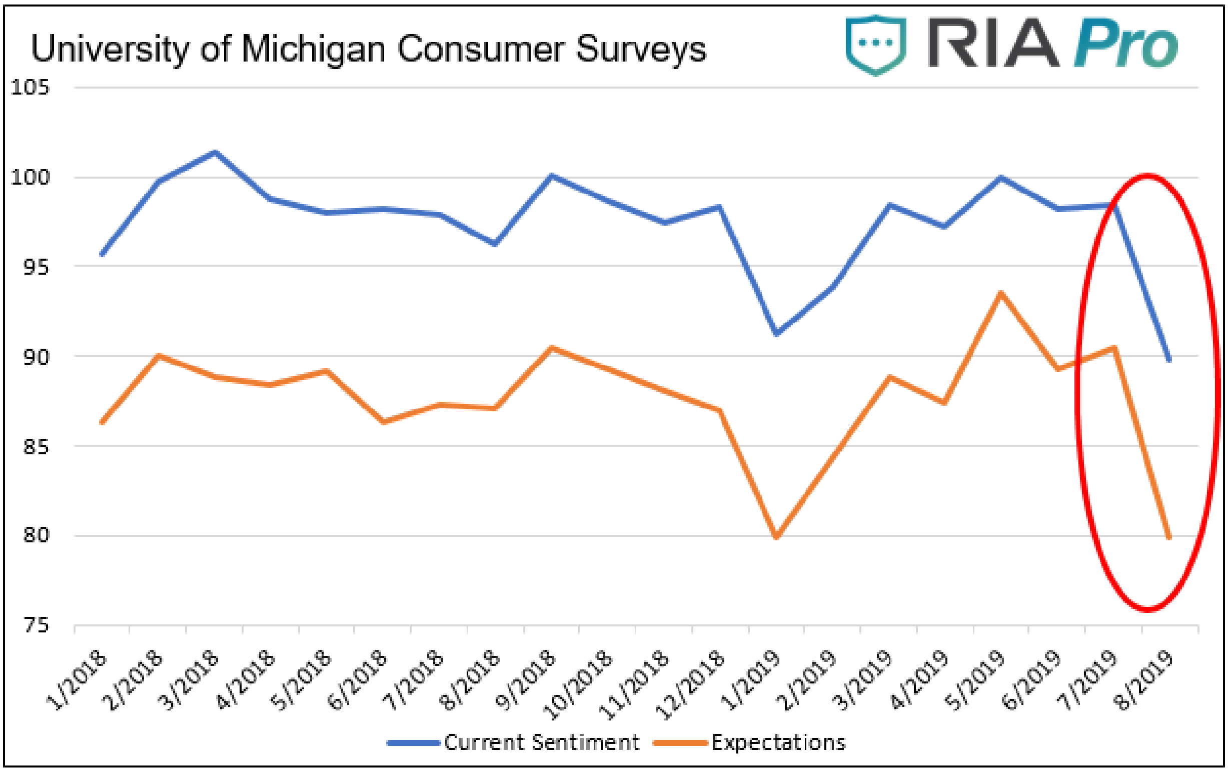
If economic growth is starting from a relatively weak point, as it is today, then it requires even smaller reductions in consumption habits than in the past to take the economy from expansion to contraction. GDP growth before the last three recessions peaked at 4.47%, 5.29%, and 4.32% respectively. The recent peak in GDP growth was 3.13%, leaving at least 25% less of a cushion than prior peaks.

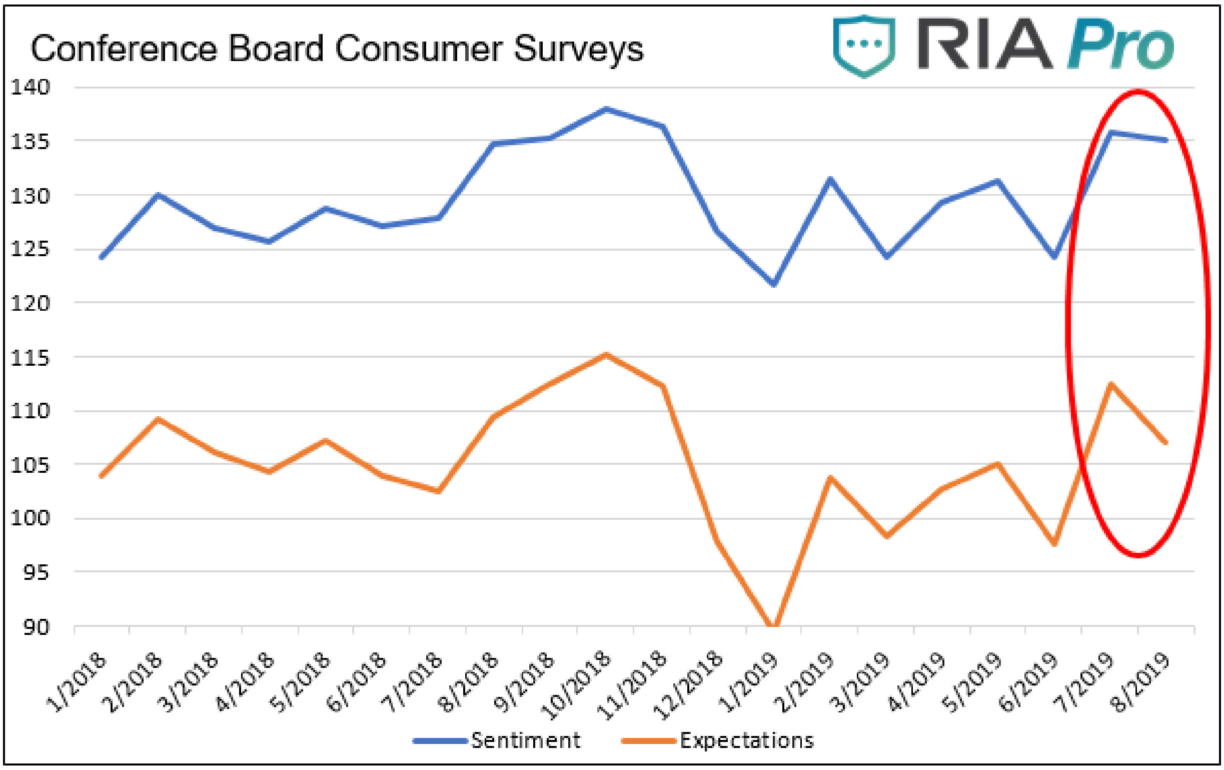
## Summary

Recessions are difficult to predict because they are usually borne out of slight changes in consumer behavior. Needless to say, changes in short term behavioral patterns are difficult to predict at best for a large population and likely impossible.

Whether or not a recession is imminent is an open question, but the window for a recession is open, allowing a strong negative catalyst to push the economy into contraction. What if that catalyst is as simple as the media repeatedly using the dreaded ?R? word?

Over the coming months, we will pay close attention to consumer confidence and expectations surveys for signs that consumer spending is slowing. We leave you with the most recent consumer sentiment and expectations surveys from the University of Michigan and the Conference Board. At this point, neither set of surveys are overly concerning, but we caution they can change quickly.




*Data Courtesy Bloomberg*