EFFICIENT GROUP

ECONOMIC COMMENTARY
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YOUR WEEKLY ECONOMIC UPDATE

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HOW PAINFUL CAN THINGS GET?

Last week, the United States (US) Federal Reserve (Fed) increased interest rates by 0.75% for the third consecutive time this year. Interest rates in the US now range between 3% and 3.25%, and many expect that rates will, most likely, increase to 4.40% by the end of the year. Fed Chairman, Jerome Powell, made it clear that they are willing to do whatever it takes to ensure that inflation is brought under control. He also made it clear that this includes allowing the economy to have a hard landing, that is, entering a painful and potentially deep recession. But how painful can things get, and what does this mean for long-term investment decisions?

What we can learn from history is that markets in the US usually bottom out three to six months before the economy does. The reason for this is because markets anticipate and then price in future events. The question thus arises: When will the US economy bottom out? For this, we can, once again, look to the past. Of course, history does not repeat itself exactly, therefore, we should be aware of the shortcomings when interpreting today's developments through the lens of historic data. That being said, even though history might not repeat itself, it does often rhyme, and, for many reasons, it seems as though history will, once again, rhyme in the US.

Usually, recessions in the US last between 18 and 24 months, and, based on data, we know that the US is already in a technical recession. The US has been recessionary since January 2022 and entered a technical recession in July, after data confirmed that the country experienced two consecutive quarters of negative growth. Fast-forward 18 to 24 months and this means that the US will probably emerge from their recession sometime between the third quarter of 2023 and the first quarter of 2024. In this scenario, US markets should bottom out in the first half of 2023. Consequently, we continue to urge our clients to ready themselves and to take advantage of this investment opportunity of a lifetime.

But what does 'ready yourself' mean? Readying yourself does not mean waiting until the markets collapse, because the markets have a funny way of not always doing what we expect. Readying yourself does mean doing the necessary admin to ensure that you will be ready to invest. It means considering where the markets are, where the rand is trading at, and what your base-case scenario is. From here, prudent investors dollar-cost average (DCA) into their positions over a certain period. If it is retirement money that you are already dollar-cost averaging into your investment each month, please do not stop. If it is discretionary money that you want to invest now, it is good to DCA over a three- to six-month period, as the abovementioned is considered: The current market, the rand, and your base case.

It is worthwhile to mention that we do not believe that the US will enter a depression, where the economy remains recessionary for a protracted period. Usually, in a depression, a combination of consumer, business, and investor sentiment is almost wiped out and economic momentum is lost. We are, however, concerned that the European Union (EU) might enter a depressive period because, unlike the US, they are unwilling to force their economy into a recession that can re-allocate scarce capital to more productive uses; a process that is commonly referred to as 'creative destruction'. What the EU is doing is likened to what Japan did that led to their zombie-like economy: They are trying to keep everything afloat, trying not to allow economic pain. Unfortunately, everything that is good, is growing, and everything that is growing will experience growth pains. If the EU does enter a depression, it will, most likely, lead to even greater support for the US dollar, equities, and bonds. Make sure that you do not miss out on this unique, long-term investment opportunity!

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