Morgan Stanley
Private Wealth Management

The Novelli Group
At Morgan Stanley
Private Wealth Management

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Cycles and Surprises

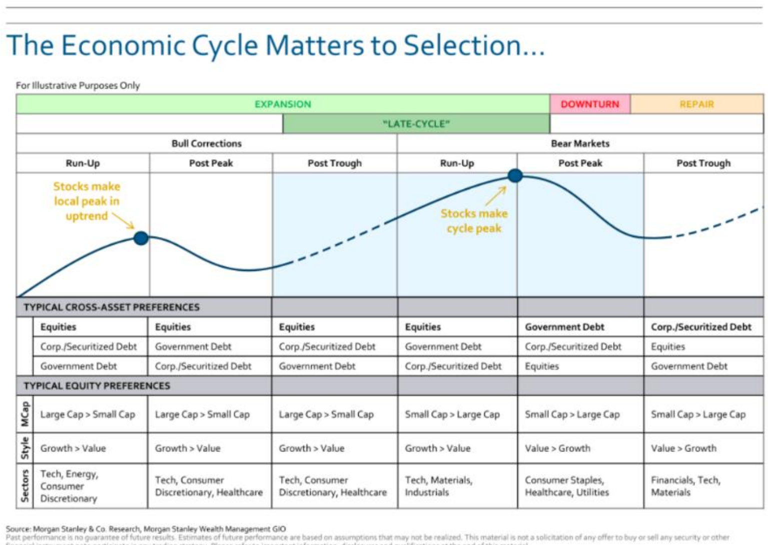
In 2020 the US suffered one of its deepest recessions brought on by the exceptional and wholly unexpected onset of a global pandemic which was likely last rivaled by the Spanish Flu in 1918. In 2008, we entered what is now referred to as the Great Financial Crisis by historians, recorded as the most severe economic crisis since the Great Depression.

Surprises like these can be catalysts for recessions and often emerge with little warning discernable only to the most fortunate or scrutinous set of eyes. These are often named as Black Swan Events, defined as unpredictable events that have severe consequences and are difficult to predict in normal circumstances, because of their rarity. Indeed, the very method and ideology we apply to managing investment portfolios and helping guide clients through life events are designed to mitigate the impact of these unexpected exogenous events.

But there is another truism within free market economies which is relatively more predictable, if only so much so. Back at the University of Texas, almost 40 years ago, I learned in several classes that economies have a common pattern which can help us make informed investment and business decisions.

Typical Cycles

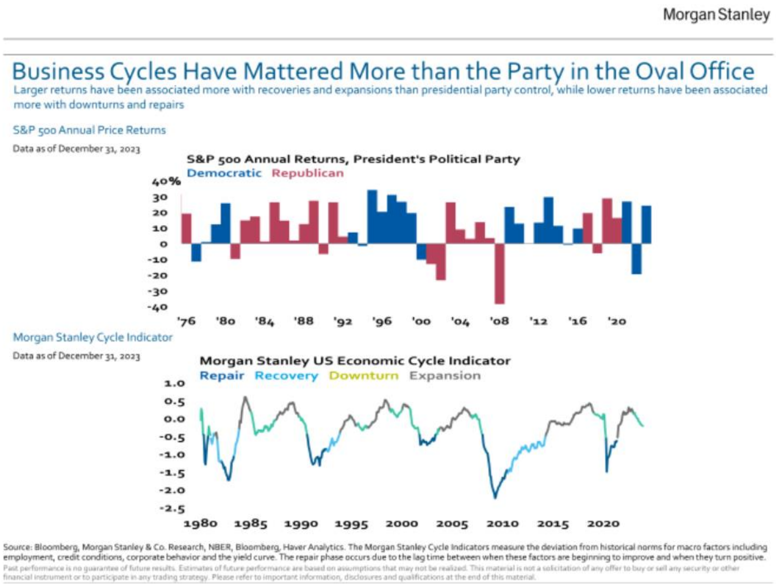
Healthy economies are supported by fluid liquidity, favorable policies and rising productivity. Since World War II, we enjoyed multiple generations of innovations which have largely supported innovations that lead to rising productivity. We believe this will continue as advances in understanding and knowledge lead to improvements in virtually every industry which support free market economies. Perhaps this is why we all celebrate living in the United States and not totalitarian countries like North Korea.



Outside of black swan surprises, economies expand often until either poor policies, excesses, tighter liquidity or other factors cause demand to decline. In the most simple terms cycles can be broken into four phases of ***expansion*** followed by ***downturn*** (contractions) leading to ***repair*** and finally ***recovery*** setting up the next economic expansion.

The Current Cycle

This cycle will be one for the record books and student case studies for generations to come. A recession brought on by a pandemic, followed by unprecedented fiscal stimulus which led to massive inflation as consumers and businesses were flush with funds and liquidity leading to record levels of inflation all make this cycle unique in many ways. Now that inflation has been coming closer to the Federal Reserve's long-term target of 2 – 3%, the FED has telegraphed rate cuts starting as early as September. Rate cuts will likely give this expansion one last shot in the arm as lower mortgage rates and consumer borrowing rates will help some pursue new homes and larger discretionary consumers purchases like autos and appliances.



With a close national election and two *non-incumbent* candidates, it stands to reason that both new administrations will seek to advance new policies and programs. While business cycles are more important than the party in the oval office, we ask ourselves, is it possible a new Presidential Administration will be willing to use the early part of their term when they have the most electoral mandate possible to push forward things that could be disruptive or temporarily austere for the economy so that they might enjoy a growing expanding economy leading into the 2028 national election to ensure reelection and continuity of policy will continue.

Crystal Balls are Cloudy

I've yet to find a crystal ball I could depend on, but four decades at a craft leads one to learn a few things about reading the tea leaves. We indeed believe this expansion has at least one more good kick from lower rates but being concerned about the impact of both Presidential Candidates policies initiatives, we are thinking that late 2025 could bring the next recession, five years after the last expansion began following the deep downturn from Covid. As always, we'll be keeping our eye on the ball and share with clients and followers our best thinking as more information emerges.