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Recessions and economic downturns

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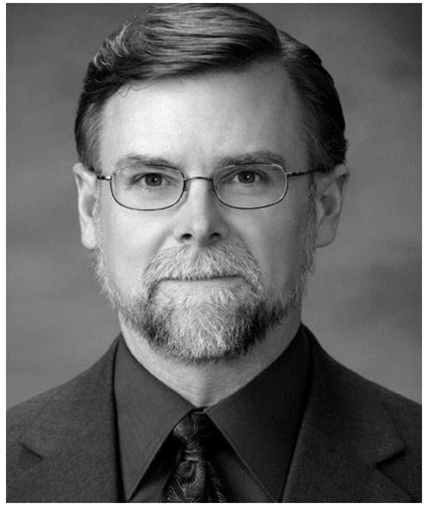

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Definition of a recession

Headline news . . . . versus the NBER (National Bureau of Economic Research)

Definition of a recession

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- The popular press
- Just weirdness . . . at the individual level . . . but no less valid
- Actual definition . . . NBER . . . and why

Definition of a recession

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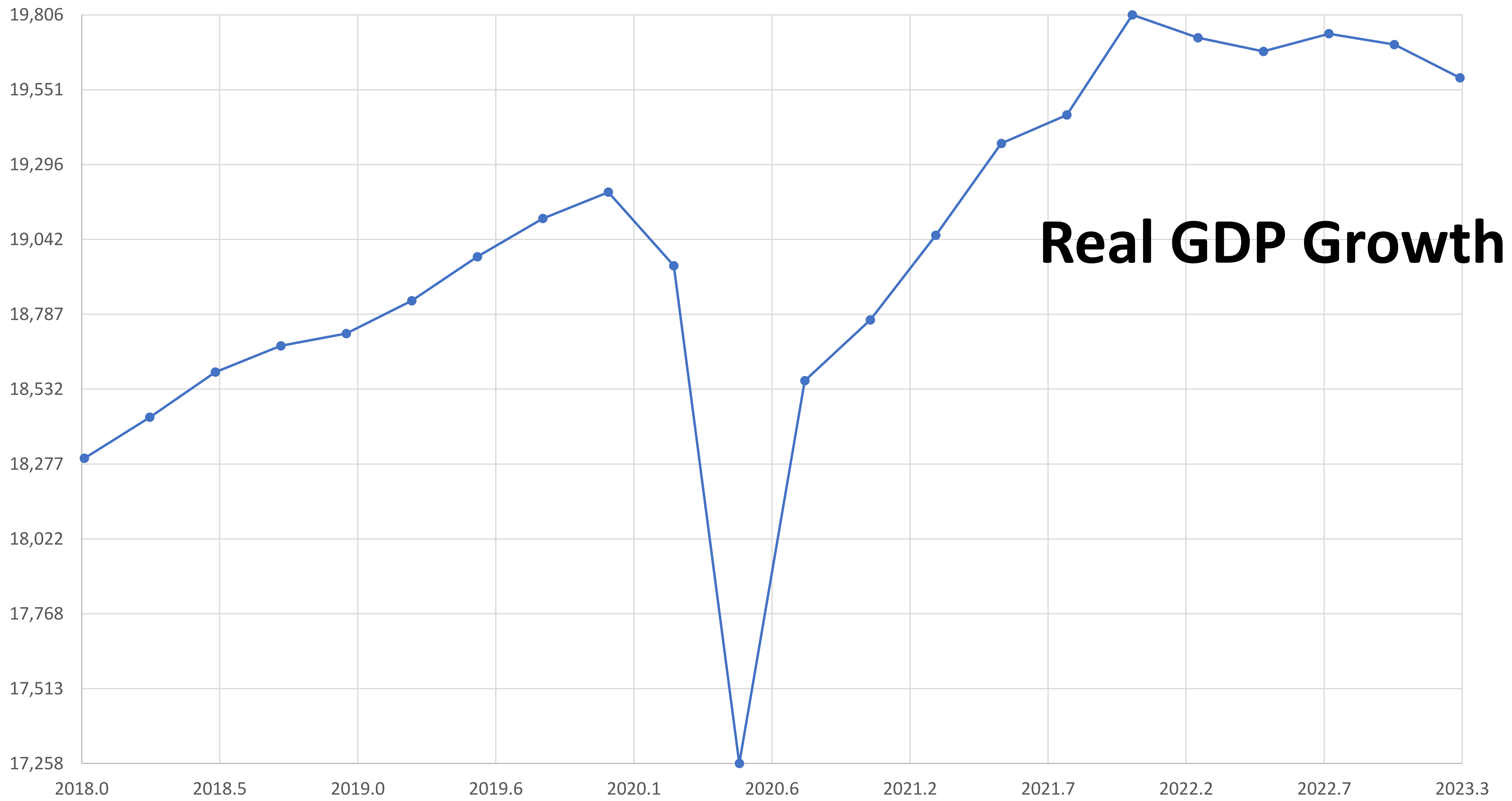
- It is not . . . "two consecutive quarters of negative GDP growth"

- It is . . . . determined by a committee of the NBER (National Bureau of Economic Research)
  - The NBER's definition emphasizes that a recession involves a significant decline in economic activity that is spread across the economy and lasts more than a few months. In our interpretation of this definition, we treat the three criteria - depth, diffusion, and duration - as somewhat interchangeable. That is, while each criterion needs to be met individually to some degree, extreme conditions revealed by one criterion may partially offset weaker indications from another.

Recession . . . . versus downturn

A recent example

Recession versus downturn



Recession versus downturn

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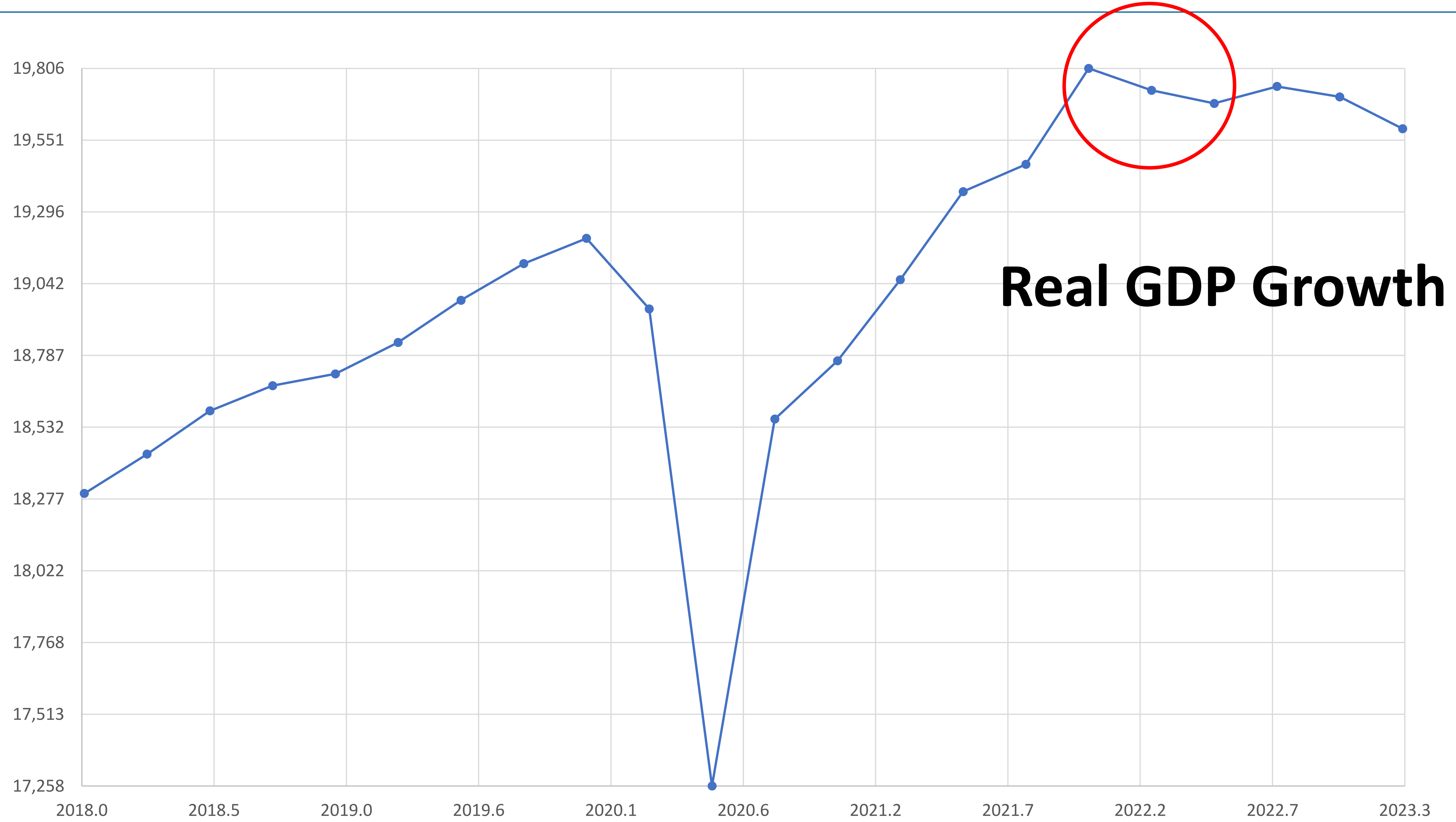
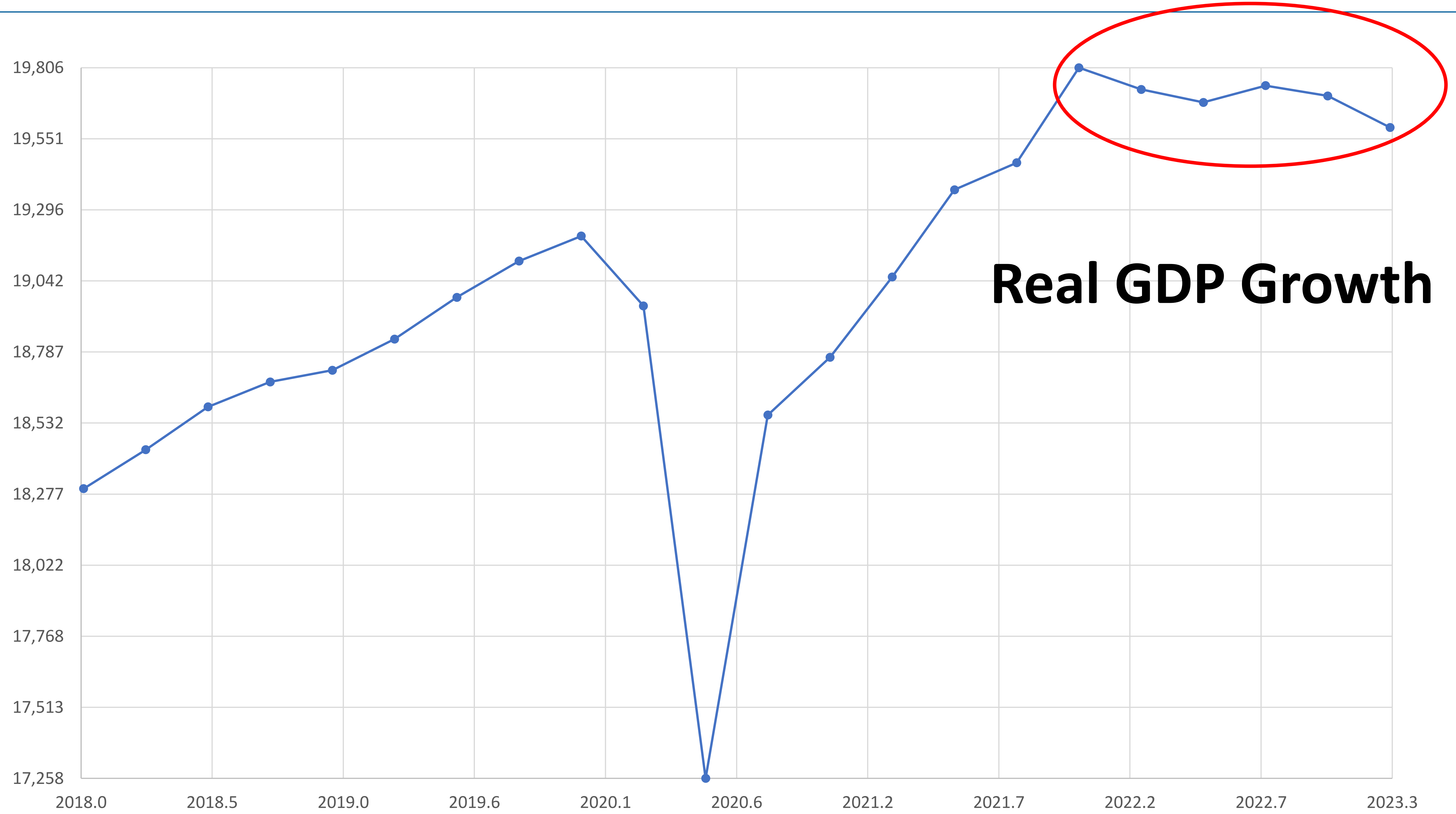


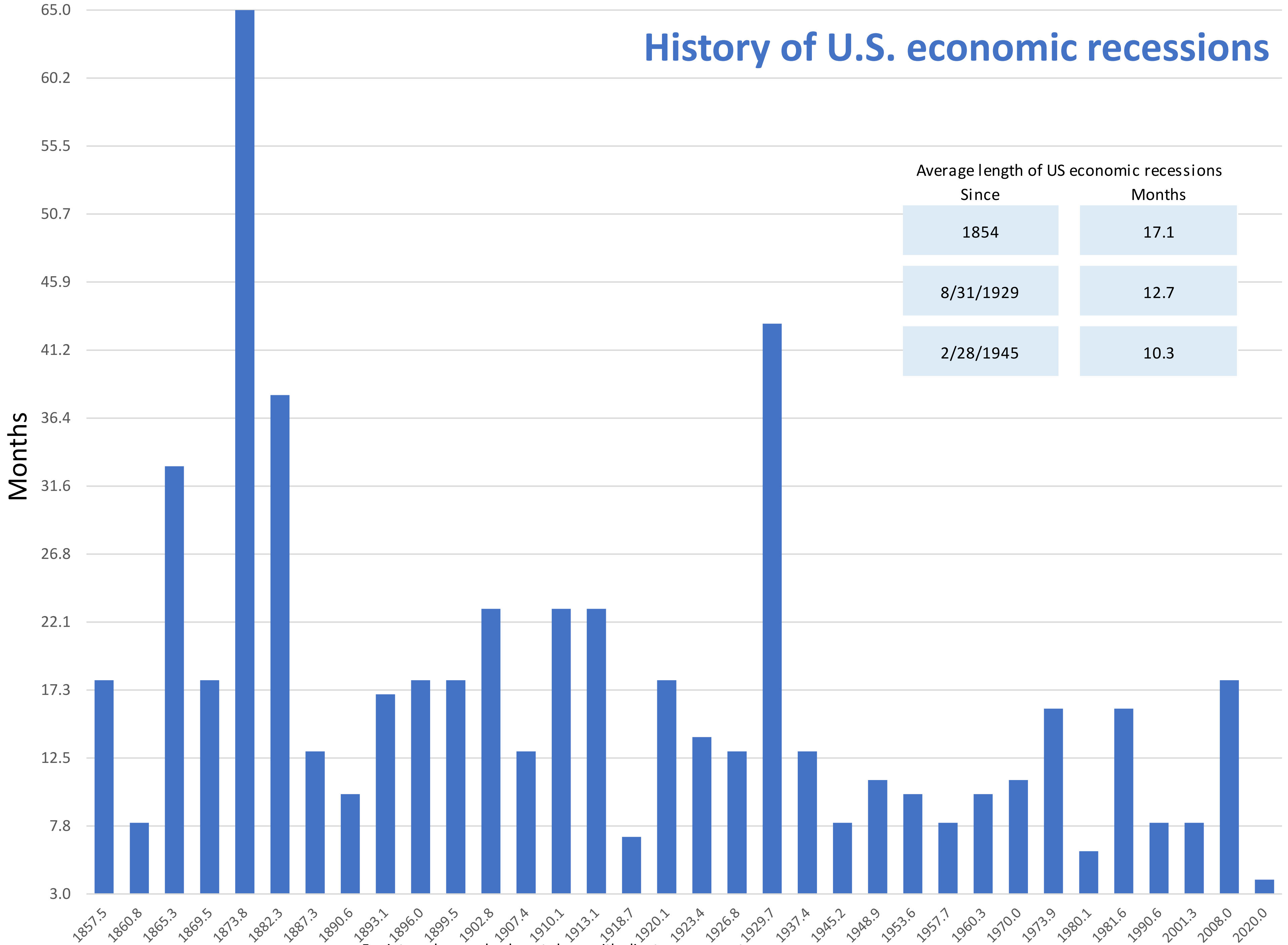
Recession versus downturn



History of U.S. recessions

What can we learn from this history

History of recessions



Average length of US economic recessions

Since	Months
1854	17.1
8/31/1929	12.7
2/28/1945	10.3

History of recessions

Average length of US economic recessions

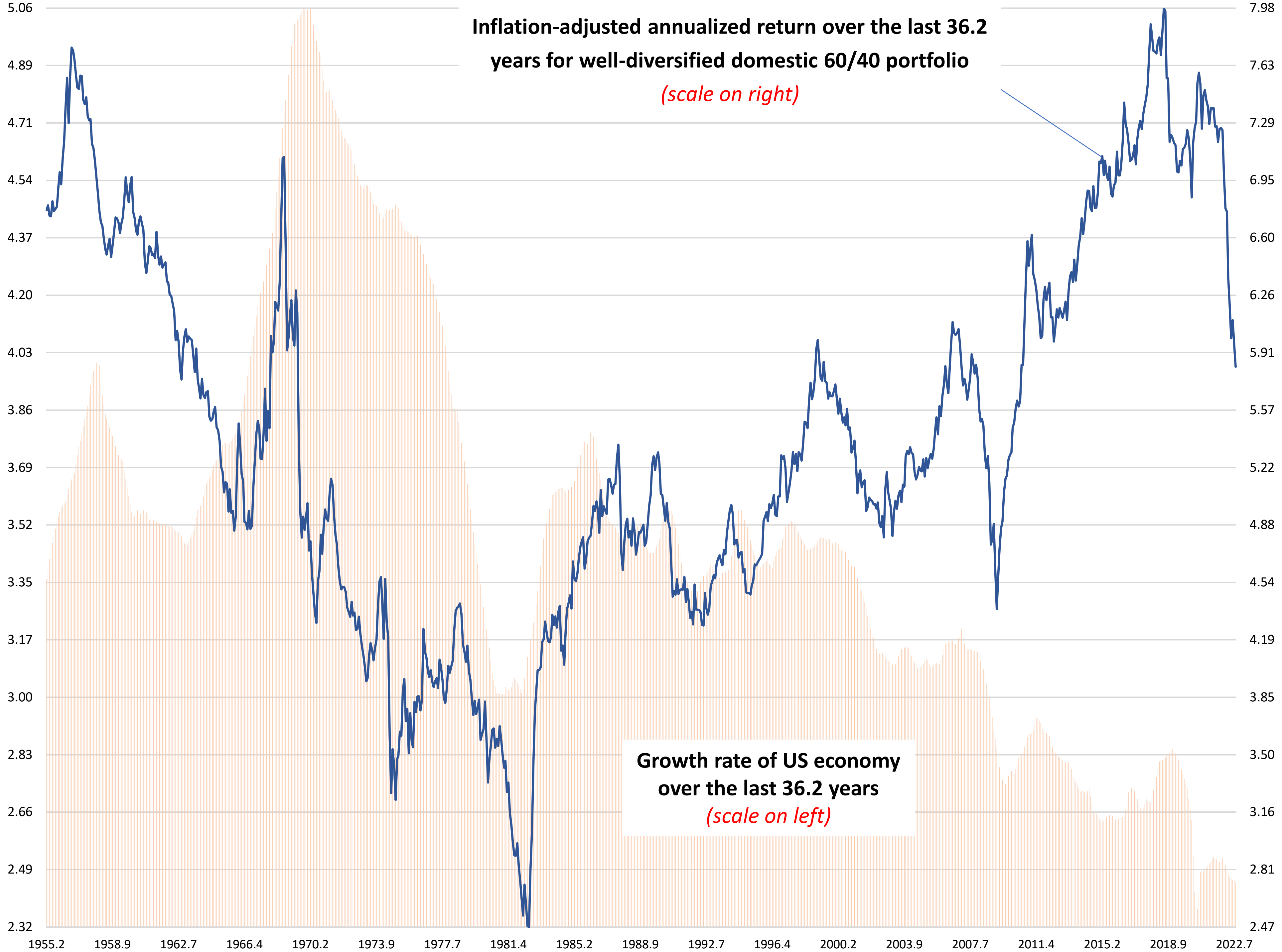
Since	Months
1854	17.1
8/31/1929	12.7
2/28/1945	10.3

History of economic expansions

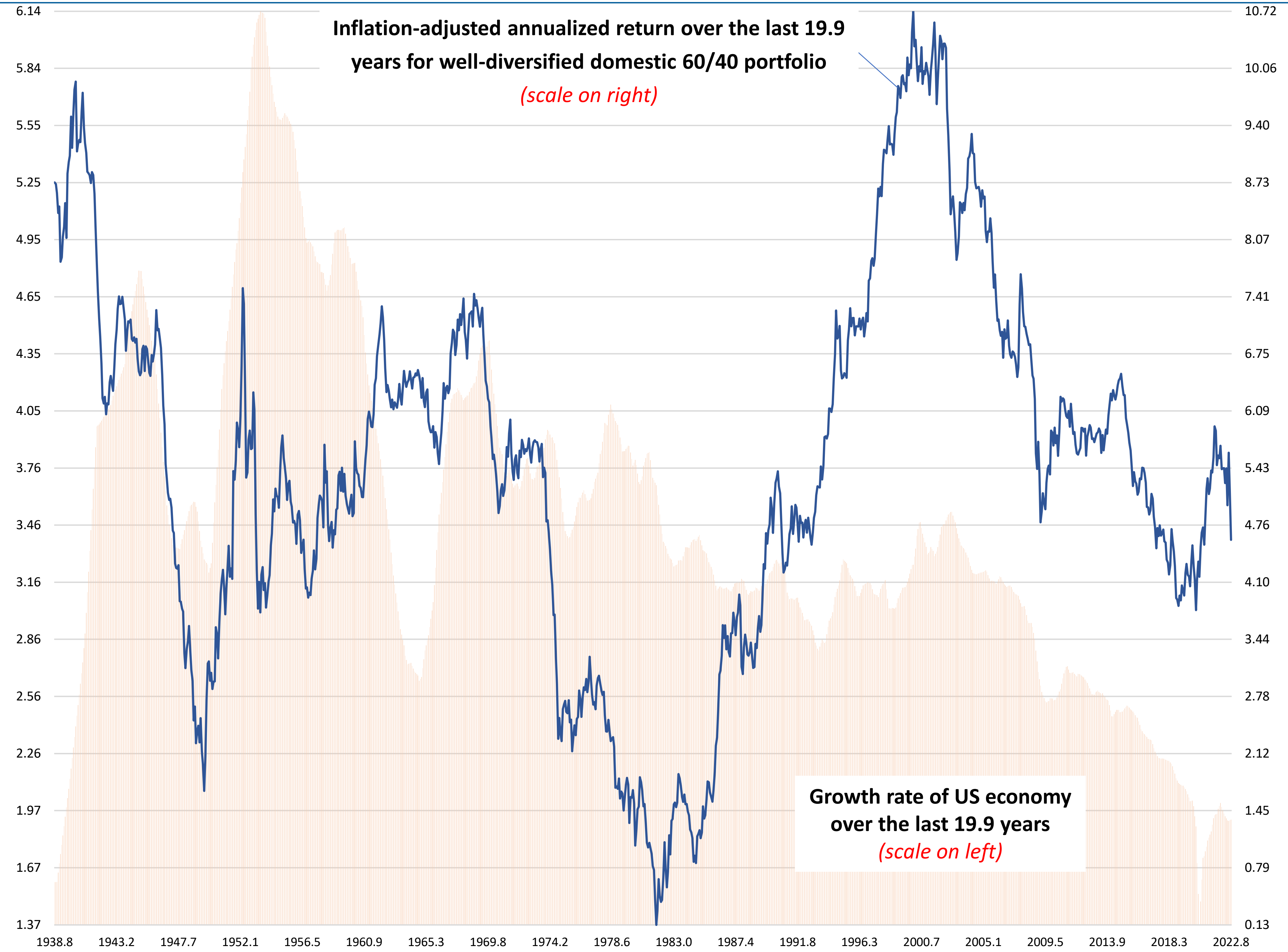
Average length of US economic expansions

Since	Years
1854	3.44
8/31/1929	5.35
2/28/1945	5.33

Economic growth rates . . . versus investment returns (and pricing)



Economic growth rates . . . versus investment returns (and pricing)



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U.S. economy grows more slowly with the passage of time, as it matures and its flexibility and demographics decline

Annualized growth rate (in %) of	Fifteen years ending on March 31st of									
	1888	1903	1918	1933	1948	1963	1978	1993	2008	2023
Real GDP	5.13	4.61	3.14	0.53	6.27	3.75	3.78	2.99	3.15	1.49
Population	2.32	1.95	1.76	1.29	0.98	1.92	1.00	0.97	1.05	0.70
Real GDP per capita	2.75	2.61	1.36	-0.75	5.24	1.80	2.75	2.00	2.08	0.78

Fifteen years ending 3/31/1918 included three recessions (in their entirety) and part of an additional recessions (but only partially)

Fifteen years ending 3/31/1933 included the 1920/1921 Depression and most but not all of The Great Depression which started in 1929

Estimates for 2022 and 2023 provided by Financial Forecast Center, LLC at www.forecasts.org

Irrational fear of the next recession

What's causing this irrational fear

The developing recession will be worse than average . . . . NOPE *!!*

- Over last 20 years we had 2 recessions
- Both were existential events . . . "*end of the world*" type events
- You will draw the wrong conclusion if you view the coming recession through the lens of the last 20 years
- It will be average . . . or more likely . . . milder than average
- And there will be strength, growth, prosperity on the other side
  - Five new industries . . . big industries
  - Consumer and business balance sheets . . . strongest in over 40 years
  - No inherent imbalances . . . other than outsized central bank balance sheets

Letting go of irrational fears

How humans develop views of the future

As humans, we craft our views of the future on the basis of our recent experiences. We're all products of our respective past journeys.

Let's apply this observation to the coming recession. Just how should we feel about, view . . . anticipate the burgeoning recession? Our human nature tells us to view it through the lens of past recessions. Over the last 20 years, we've had two: (1) 2007-2009 The Great Recession and (2) 2019-2020 The COVID-19 Recession. Both of these recessions were existential events . . . in the sense that they quite literally delivered the possibility for an "end-of-the-world" type outcome.

Wow! Let me explain.

2007-2009 The Great Recession - During the 4th quarter of 2008, both the domestic and the global financial systems were going into lockup, breakdown, and disassembly. We were careening towards a global financial meltdown. It was only as a result of heroic and unprecedented stimulus by central banks (Federal Reserves) and treasuries (national governments) from around the world, operating in full coordination, that we just barely avoided a depression every bit as bad (or worse than) the last one. Nevertheless, we still experienced great damage . . . the worst recession since The Great Depression of the 1930s.

2019-2020 The COVID-19 Recession - COVID-19 first hit in December of 2019. A global pandemic ensued. We didn’t know what was going to happen, how many people would die, how fast, and whether any medical remedies could be developed (much less over what timeframe). But we did have solid history from which to draw perspective. During the last great pandemic, The Black Death (of the 14th century), quite literally between 40% and 50% of the entire human race died from the Yersinia pestis pathogen. In response to COVID, governments around the world reacted by turning off their respective economies and sending workers home . . . what came to be known as “social distancing.” Once again, we avoided disaster . . . both as a result of dumb luck (the COVID-19 pathogen proved to be far less deadly than what could have been . . . and incredibly efficacious vaccines were developed and distributed in record time).

Why am I drilling down on the last two recessions?

Because they were incredibly rare and exceptional events. Because such severe downturns almost never occur. Because the normal person will never experience such challenges over their entire financial lives (or at most once).

If we make the mistake . . . of viewing the coming recession through the lens of the last 20 years (the last two rare and exceptional recessions), then we'll draw the wrong conclusions - thinking that the developing recession will be far worse than is plausible or reasonable.

Look . . . the last two recessions were not normal or typical. Instead, they were incredibly rare and exceptional in terms of the threats that they presented. Set them aside, and don't let them flavor or influence how you view the burgeoning recession.

Instead, consider the next recession through the lens of what is normal, typical, and common place. Quite frankly, the average, vanilla, garden variety recession is pretty much irrelevant for any investor focused on a successful rewarding lifelong financial journey.

But . . . the story gets even better, we have two additional advantages.

Several additional advantages

Most Telegraphed

The developing recession is probably the single most telegraphed recession in all of history. If true, that's a really big deal. It means that markets, businesses, and consumers are better reflecting the coming recession and far fewer surprises are likely to develop.

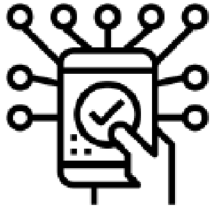
Five New Industries

Recessions are only irrelevant (or at least easily overcome) because there's something to look forward to on the other side of the downturn. Today, we're likely to see (expected to benefit from) the robust development of five incredibly powerful and innovative new industries. Collectively, these new industries will deliver jobs, growth, and higher standards of living. They'll drive out-sized growth as we come out of the developing recession. The five new industries are:

Transportation - This is about transitioning from fossil fuels to "renewables." But it is even more importantly about who "owns" the vehicle and about autonomy (who or what is "driving" the vehicle). It's equally important to appreciate that this trend involves far more than just "cars," instead it includes vehicles of all types.

Energy - Yes, the world has begun the conversion from fossil fuels to renewables. I am neither agreeing nor disagreeing with this trend. But I am validating its reality and permanence. Nevertheless, far more important (and game changing) than which renewable source or sources will be adopted . . . is the development of energy storage. Energy storage is the seriously big story, and the opportunity.

Biotechnology - It's far more than vaccine development (despite the miraculous development of the incredibly efficacious mRNA COVID-19 vaccines in record time). The big story is another game changer . . . and is about how the world ramps up food production, reducing inputs while increasing output. The new agricultural revolution will displace conventional agriculture. It will embrace genetically altered organisms, large-scale controlled environment farms, and factory cultivation.



Digitization - The first and the biggest application will be in the area of digital finance. No, this is not about Crypto (that was just an unfortunate and temporary malady). Digital finance is a natural outgrowth of seven brilliant new technologies . . . all harmonizing together: (1) Artificial intelligence, (2) Social networks, (3) Machine learning, (4) Mobile applications, (5) Distributed ledger technology (blockchain), (6) Cloud computing, and (7) Big data analytics. In brief, this is about a new more beneficial way of conducting banking and all financial transactions.

Artificial Intelligence - This is perhaps a less "well-rounded" development. But it remains unhelpful to deny its presence and development. A new industry is finally coming into its own, that of artificial intelligence weaponry. This is a big deal, and the forces at play will drive it both deep and far. Think Skynet.

Finally, a last word of hope and encouragement . . . we're going into this recession with the strongest balance sheets (for both consumers and businesses) that we've seen in over 40 years. This will help to shorten the coming downturn and make it less severe.

Why we absolutely need recessions

Without recessions, our economy would quickly fail

I will be hurt by the stock bear, bond bear, and recession . . . NOPE !!

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- If drawing down evening (straight-line) over the next 20 to 50 years . . . then their arrival is a benefit
- Three forest fires and windstorms
  - Recession
  - Stock bear market
  - Bond bear market
- Clean out the dead and dying
- Reallocate resources to higher and better use
- Eliminate the speculation, excess, emotion, and crazy ideas
- Return balance and harmony between risk and return
- A faster growing economy
- Return of opportunity to investment markets

Counterintuitive - Several quite positive developments

Recession and bear markets

At some point, right around here . . . we'll have an economic recession, stock bear market, and bond bear market. The trifecta. That doesn't sound so good. One, two, or all three of these have already begun. These types of corrections aren't much fun. They breed worry, doubt, concern, and even outright fear. Investors may question whether their future is diminished or worse yet, broken. Such concerns may be well-placed if one must withdraw and spend a clear majority of their net worth over the next zero to five years.

However . . . if you’re evenly and smoothly spreading out your expenditures over the next 20, 30, or 40 years, then having bear markets and an economic recession are remarkably positive developments. Disruptions that will inevitably lead to a brighter, more bountiful, and dependable life-long financial journey.

Wow! How can this be? But it is . . . let me put a bit of flesh on the bone, attempting to explain.

Our economy and investment markets are living breathing “animals.” As such, they follow highly dynamic paths over time, evolving and responding to stimulus. They benefit from and even require challenges in order to overcome internal deficiencies and to grow stronger.

Let me use an analogy . . . to build out our understanding. Consider the history of forest management.

Necessity of fires and windstorms

Long ago (ok, so maybe not all that long ago), it was falsely believed that the best way to manage a forest was to prevent forest fires and windstorms. Eventually, we learned just how incredibly naïve and destructive such a simplistic static view really was. Today, we understand that a healthy, thriving, and growing forest requires regular periodic fires and windstorms.

These "destructive" forces serve several invaluable purposes . . . they serve to (1) reallocate forest resources from less productive to more productive, (2) eliminate the slow growing and stagnant, and (3) remove the diseased and pest-ridden. Without these beneficial perils, the forest eventually becomes sickly, stops growing, and declines.

The economy is no different. A healthy thriving macro economy requires recessions, growing unemployment, and corporate bankruptcies. These are the economy's fires and windstorms. These perils serve to (1) reallocate labor and capital from less productive to more productive, (2) eliminate the slow growing and the stagnant, (3) retire outdated and backward-looking industries, and (4) drive innovative training and education for new types of jobs. Without these painful corrective forces, the economy eventually becomes sickly, stops growing, and declines.

Investment markets operate in a similar fashion. Healthy thriving investment markets require bear markets, individual investors “losing their shirts,” and the failure of individual investment firms. These hurtful forces serve a necessary and vital purpose.

They help us by: (1) reallocating investment capital from less productive to more productive, (2) starve the slow growing and the stagnant, (3) purge the disruptive speculators from the marketplace, and (4) correct the all-important tradeoff between forward-looking risk and return. Without these investment market “fires” and “windstorms,” investment markets become sickly, stop growing, and decline.

Bottom line . . . we want and need bear markets and economic recessions. Their regular and periodic occurrence results in a healthy, growing, and prosperous economy and rewarding efficient investment markets. As a result, the long-term life-long investor benefits.

Eventually, now or in the future, we'll be passing through a recession, bond bear market, and stock bear market. If you're spending down your accumulated wealth over the next 20 to 40 years . . . then this unsettling but quite temporary episode will be a remarkably positive development. The forthcoming cleansing forces will serve to create a more productive and rapidly growing economy . . . and a more attractive investment marketplace offering greater opportunities.

The coming recession

Mild, average, or severe

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NBCUniversal

US likely to go into recession in 6 to 9 months, says Jamie Dimon

Tue, October 11, 2022 at 4:42 AM

Jamie Dimon, the chief executive of JP Morgan, is warning that the United States may go into a recession next year. Dimon pointed to inflation, high interest rates, the war in Ukraine and Europe's current recession as key indicators of the country's future financial instability.

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US ECONOMY

Steve Hanke says the chance of a U.S. recession just shot up to 80%

PUBLISHED FRI, SEP 23 2022•3:15 AM EDT | UPDATED FRI, SEP 23 2022•3:27 AM EDT

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KEY POINTS

- According to CNBC's September Fed survey of economists, fund managers and strategists, those surveyed said there's a 52% chance that U.S. could enter into recession over the next 12 months.
- "The probability of recession, I think it's much higher than 50% — I think it's about 80%. Maybe even higher than 80%," Hanke told CNBC's Street Signs Asia.

Economy | Inflation

Is the US economy in a recession and taking the world with it?

The US is facing rising recession fears as the Federal Reserve remains bullish in fighting high inflation.

By Radmilla Suleymanova
10 Oct 2022

The United States is facing rising recession fears as the Federal Reserve, the country's central bank, remains bullish in fighting high inflation and officials increasingly talk about the need to impose some economic pain to get price pressures under control, several economists told Al Jazeera.

"There's still a good amount of strength in the labour market and that's going to allow the Fed to remain aggressive in fighting inflation," Edward Moya, a senior market analyst at OANDA, a New York-based foreign exchange firm, told Al Jazeera.

SUNDAY TALK SHOWS

Chief economist says US headed to recession that was ‘totally avoidable’

BY JULIA MUELLER - 10/09/22 2:32 PM ET

Mohamed El-Erian, Allianz’s chief economic adviser, said on Sunday that the U.S. is heading toward a recession that was “totally avoidable” amid ongoing concerns about inflation and economic stability.

“I fear that we risk a very high probability of a damaging recession that was totally avoidable,” El-Erian told CBS’ “Face the Nation,” arguing that the Federal Reserve has made mistakes that will “go down in the history books.”

“One is mischaracterizing inflation as transitory. By that, they meant it is temporary, it’s reversible, don’t worry about it. That was mistake number one. And then mistake number two, when they finally recognized that inflation was persistent and high. They didn’t act. They didn’t act in a meaningful way,” El-Erian said.

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Update on small cap versus large cap

Friday

October 21st

11:00 a.m. EASTERN

Important Disclosures

All data and statistics were provided by Global Financial Data, Inc. and NDR, Inc. (unless otherwise indicated in the exhibit)

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