FRANKLIN TEMPLETON

ClearBridge Investments

Economic and Market Outlook

Second Quarter 2022

Anatomy of a Recession (AOR): US Recession Risk Indicators

ClearBridge Investments, one of Franklin Templeton's specialist investment managers, utilizes 12 different economic indicators to assess the risk of recession. Each individual indicator can signal expansion, caution or recession in the economy. The signals from each of the 12 indicators are combined into an overall dashboard signal. The indicators, signals and changes are based on ClearBridge's interpretation of the data. The dashboard is not a crystal ball but can serve as a tool to evaluate the risk of recession in the US economy.

The first quarter produced many events that may have caused concern for investors. On top of the humanitarian crisis in Ukraine, we've seen record inflation, rising rates, rising oil prices and concerns of stagflation. Despite these events, we believe the US economy has remained on solid footing. We did not experience any deterioration in the dashboard which is still sending a clear signal that we are in a period of economic expansion. As a result, we continue to anticipate a positive but choppy market environment ahead for the remainder of 2022.

		March 31, 2022	December 31, 2021	September 30, 2021
Consumer	Housing Permits	Expansion	Expansion	Expansion
	Job Sentiment	Expansion	Expansion	Expansion
	Jobless Claims	Expansion	Expansion	Expansion
	Retail Sales	Expansion	Expansion	Expansion
	Wage Growth	Recession	Recession	Expansion
Business Activity	Commodities	Expansion	Expansion	Expansion
	ISM New Orders	Expansion	Expansion	Expansion
	Profit Margins	Expansion	Expansion	Expansion
	Truck Shipments	Expansion	Expansion	Expansion
Financial	Credit Spreads	Expansion	Expansion	Expansion
	Money Supply	Caution	Caution	Expansion
	Yield Curve	Expansion	Expansion	Expansion
	Overall Signal	Expansion	Expansion	Expansion

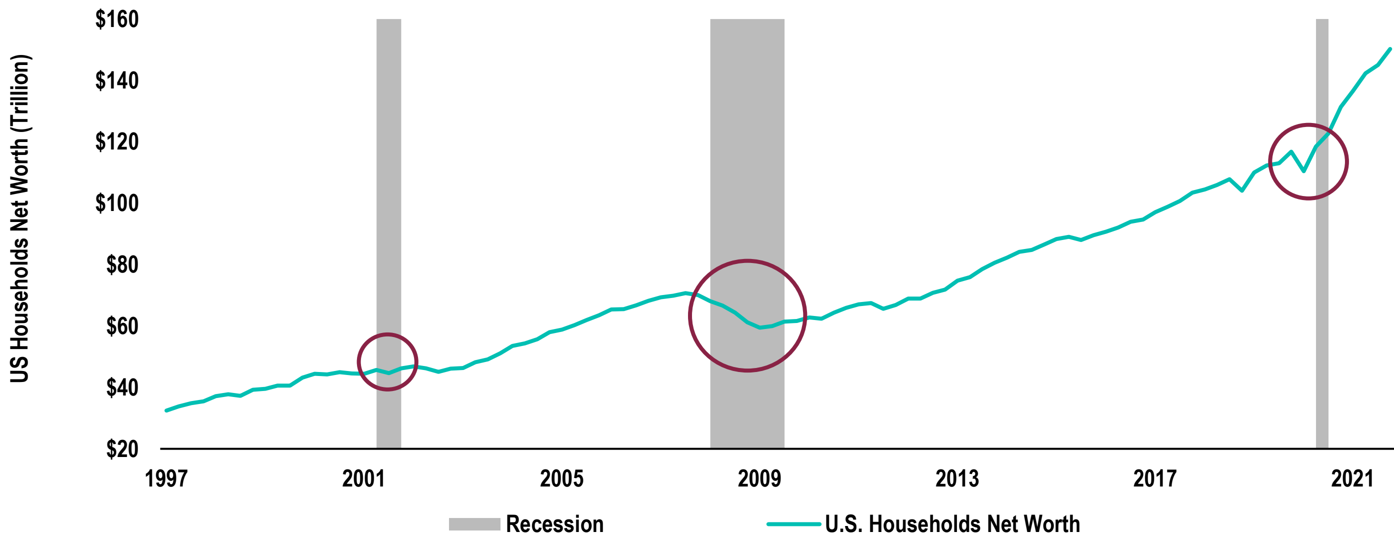
Legend: Expansion (green up arrow), Caution (yellow circle), Recession (red X)

Data as of March 31, 2022. Source: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

Not FDIC Insured | May Lose Value | No Bank Guarantee

Consumer strength leads the way

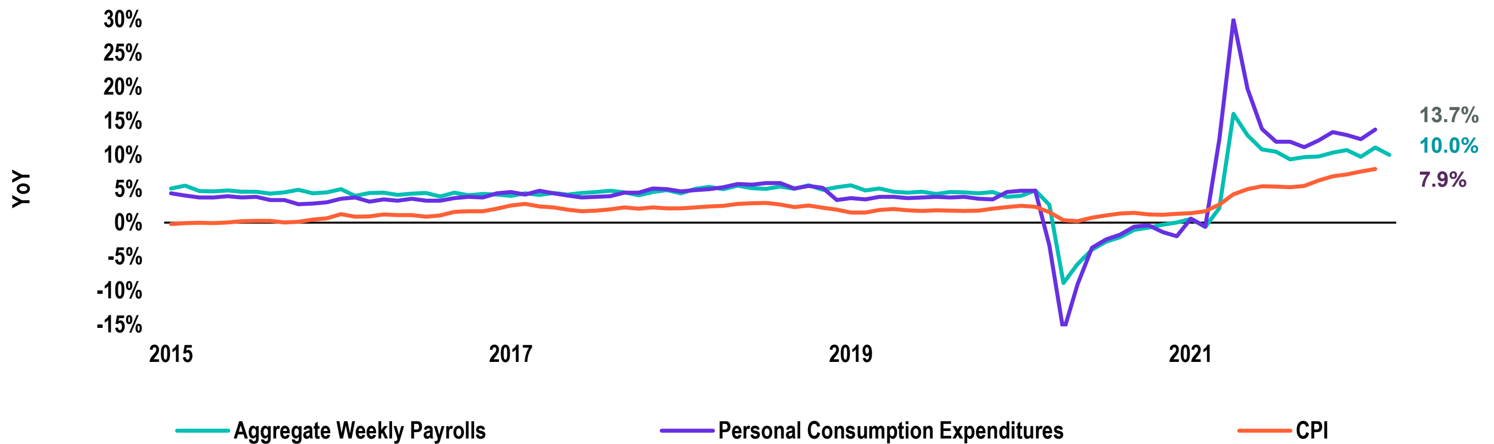
Aren’t recessions supposed to be painful?[1]



- Since the end of 2019 (pre-COVID), US household net worth has increased by $34 trillion.
- While personal savings rates jumped during the pandemic due to a combination of reduced in-person activity and government transfer payments, we are seeing savings rates come down as consumers are spending more, even in the face of higher prices. We view this increased willingness to spend as a positive for the economy.

Consumer outlook dependent on wages[2]

Compensation, consumption and CPI

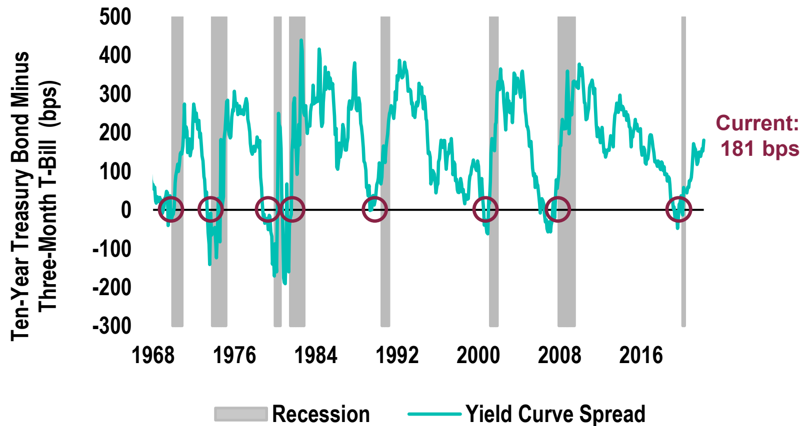


- Consumer strength is very dependent on not only wages but also inflation. Compensation is easily outpacing inflation, which bodes well for above-trend consumption continuing in 2022.
- Consumers will have the opportunity to borrow as banks are still willing to extend credit. Currently, credit card borrowing is well below pre-pandemic levels.
- Between record high US household net worth, compensation increases that are outpacing inflation and signs of more consumer spending, we believe consumption trends in 2022 will remain robust and drive further economic growth.

1. Data as of December 31, 2021, latest available as of March 31, 2022. Source: Federal Reserve Bank of St. Louis. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.
2. Data as of February 28, 2022, latest available as of March 31, 2022. Source: BLS, BEA, and Bloomberg. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

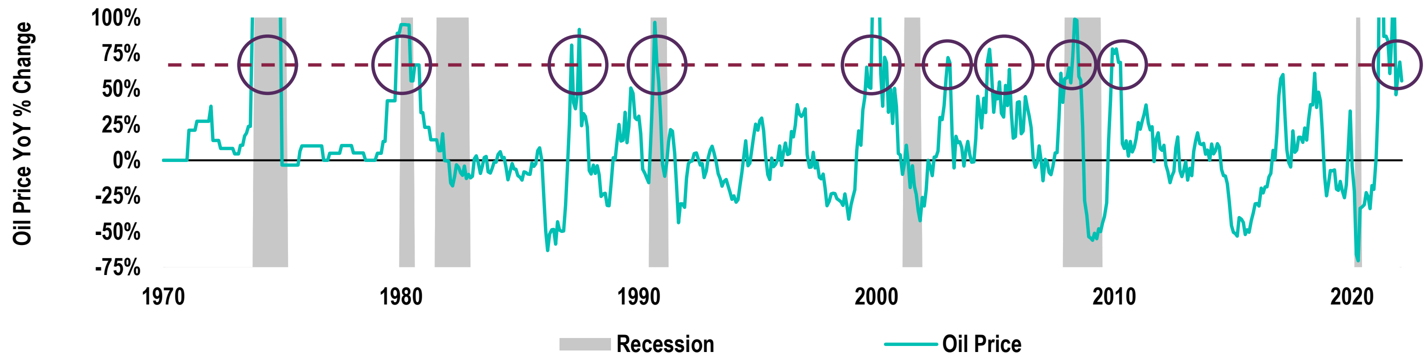
Headline risks: rates, oil and stagflation

Yield curve spread less than zero (inverted) occurs prior to recession[3]



- Partially due to the Fed beginning their process of raising interest rates, the 10-year Treasury to 2-year Treasury spread has inverted, which many are predicting as a signal of recession. While this is sometimes true, the more accurate measurement, and what we monitor in our Recession Risk Dashboard, is the 10-year Treasury to 3-Month T-Bill spread which has a longer history than 10-2s and has not had any of the false positives that have occurred with 10-2s.
- Our preferred measure is still far from inverting.

Oil price spikes alone don't forecast recession[4]



	1973	1979	1987	1990	1999	2004	2005	2007	2017	2018	Current
Overall Signal	⬆	✖	⬆	✖	⬆	⬆	⬆	✖	⬆	⬆	⬆
# of Yellow/Red Indicators	8	12	1	12	4	0	2	11	1	1	2
Recession	Yes	Yes	No	Yes	Yes	No	No	Yes	No	No	???
S&P 500 Ret +12M	-31.8%	32.4%	-11.3%	26.7%	14.9%	10.3%	6.8%	-37.5%	14.8%	8.2%	???

- Since 1973, oil price spikes have accurately predicted a recession only 50% of the time.
- Although oil prices are back at 2011-2014 levels, the impact should be blunted due to higher incomes and energy's long-term declining share of consumer's wallets (3.7% consumption average 2011-2014 vs. 2.5% YTD).
- Given the current strength of our US Recession Risk Dashboard, we believe the chances of an oil shock induced recession are low.

Stagflation fears overblown

- Stagflation is characterized by low or negative real GDP growth with high inflation and stubbornly high unemployment.
- Despite hearing this term used more often to describe where we are headed, the US is not currently close to experiencing this phenomenon as we have solid real GDP growth and extremely low unemployment.

3. Data as of March 31, 2022. Yield curve spread less than zero (inverted) has occurred prior to recessions. Source: FactSet. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.
4. Data as of February 1, 2022, latest available as of March 31, 2022. Oil price source: Bloomberg, Federal Reserve Bank of St. Louis, Economic Research Division. Recession Dashboard Source: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Market implication and summary

Stocks often rally following liftoff

Average performance for periods after rate hikes[5]

Asset class			After rate hike		
			+3 months	**+6 months**	**+12 months**
US equities	Cap size	US large-cap equities	-1.9%	4.7%	7.5%
		US mid-cap equities	-2.9%	4.2%	9.6%
		US small-cap equities	-2.9%	2.5%	7.4%
	Style	US growth	-1.5%	8.2%	14.2%
		US value	-2.5%	1.4%	2.0%
Fixed income		Investment grade bonds	0.0%	2.0%	4.2%
		High yield	0.4%	4.2%	2.6%
International equities		Emerging market equities	-1.9%	13.2%	11.8%
		International equities	0.9%	12.5%	10.7%

- Historically, both stocks and bonds have done well in the 12 months following an initial rate hike with growth stocks outperforming value. International and emerging market equities have also performed quite well.

In our opinion, recession risks are well below average, supported by strong consumer tailwinds. Markets will continue to experience volatility with the headwinds of tightening monetary policy, negative fiscal impulse, geopolitics and high inflation. It's our view that any selloff presents an opportunity to reposition for the middle innings of this market cycle.

5. Indices used include the following: US Large-Cap Equities: S&P 500; US Mid-Cap Equities: S&P Midcap 400; US Small-Cap Equities: S&P 600; US Growth: Russell 1000 Growth; US Value: Russell 1000 Value; Investment Grade Bonds: Bloomberg US Corporate Bond; High Yield: Bloomberg US High Yield (1-5Yr); Emerging Market Equities: MSCI Emerging Markets; International Equities: MSCI ACWI ex-US.
Averages included in the table use the last four rate hike occurrences with initial rate hikes on February 4, 1994, June 30, 1999, June 30, 2004 and December 14, 2016. Source: Bloomberg, FactSet. Data as of March 31, 2022. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

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