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Just the Facts

Monthly Perspectives
March 2024

15 minutes

Wealth Investment Office

Vibecession: Managing Portfolios in a Post-Fact Era

Brad Simpson, Chief Wealth Strategist | TD Wealth

There was a new term that joined our lexicon last year: "vibecession." A vibecession, for those unfamiliar, is this idea that the facts around the economy don't really matter. What matters is how people *feel* about the economy. In other words, it's about the importance of perception versus reality — a topic that's always top-of-mind here at the Wealth Investment Office, where I've spilled a lot of ink writing about the differences between economic theory, where markets move in a smooth equilibrium, and economic reality, where they tend to react to whatever happens to be the predominant narrative.

Views on the current state of the economy, particularly south of the border, are increasingly being perceived in the eye of the beholders, who are allowing their political views to cloud the objectively quantified financial ones. While I find these extremes concerning for the state of the union, this monthly publication is committed to providing financial market views, not political ones. The case I am making in this issue: that the polarization between voters in the world's largest economy is having unintended, and undesirable, consequences for global wealth investors.

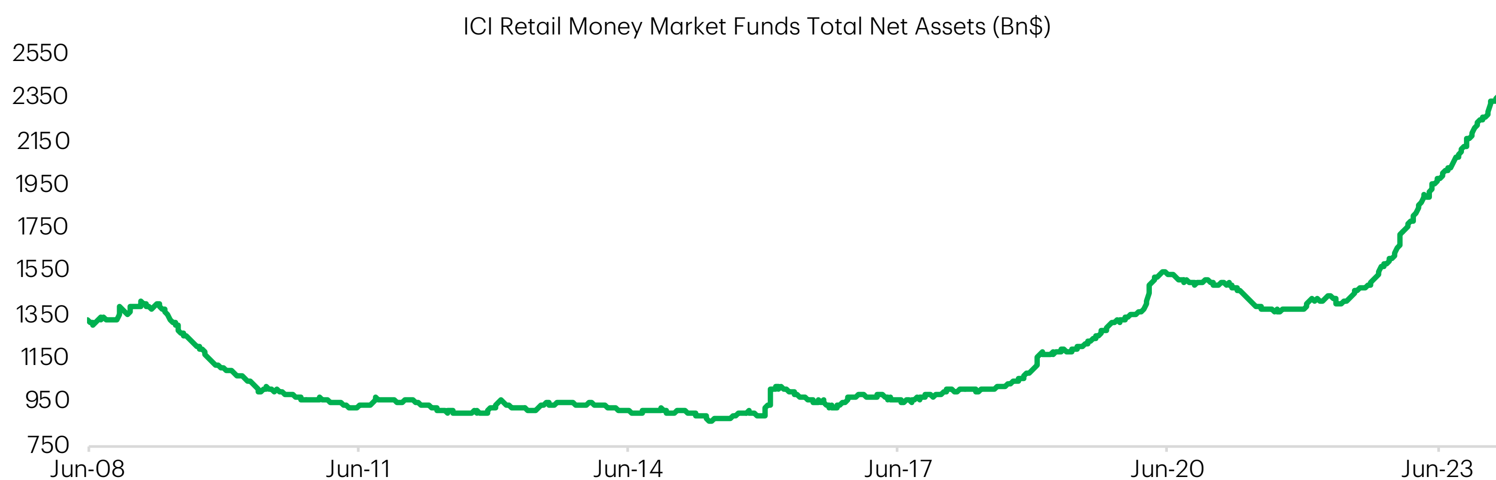
The cold fact is, the economy in the United States is, all in all, good — and compared to most of the rest of the world, it's pretty great. Toxic politics in the world's superpower is being perpetuated by social media, compounded by algorithms, and it's having a negative impact on wealth investors globally. The solution for this malaise, where faulty ideas like vibecession are born, is a clearly defined, empirical decision-making process. Further, it is incredibly important to remain mindful that our emotions are being challenged in a way that they have never been before.

Let's consider some basic facts right up front:

- U.S. inflation has declined meaningfully and is currently at 3.2% on a year-over-year basis, down from a high of 9.1% in July 2022 (6% a year ago).
- U.S. Q4 GDP was much better than expected at 3.2%, and domestic demand remains very strong at 3.1%.
- The labour market remains incredibly tight, even after some recent softness. The unemployment rate, at 3.9%, is close to its historical low. And non-farm employment data continues to increase at much higher-than-expected levels (275,000 jobs created in February), even with downward revisions to December and January figures. Hiring over the December-to-February period averaged 265,000 jobs per month, which compares to the historical average of around 125,000.
- The consumer remains strong, supported by a robust jobs market. Growth in retail spending in February was 0.6%

This may be news to some investors, who are sitting on cash "till things get better," caught up in the vibe created by the machine in the palm of their hands. If the current $2.4 trillion sitting in money-market funds is any indication, they are doing it in droves (Figure 1). Unfortunately, these investors have been, and are, missing a financial market out here in the real world where the U.S. economic facts have been supporting positive returns across diversified portfolios that are rather good.

Figure 1: Waiting until things get better



Source: Investment Company Institute, Wealth Investment Office as of March 12, 2024

The "news"

Let's begin by considering the narrative that seems to have taken hold in the U.S. right now — that accommodative monetary policy and Covid-era fiscal policies have brought about structural inflation that has left the U.S. economy in a state of intensive care. There are a number of deficiencies around this narrative. One is the tendency for investors, professionals and lay people alike, to find an anchor from the past to inform our current and future state.

In the current environment, this approach may be deeply flawed. Never in the past has so much biased information been so readily available, targeted and tailored to investors in bulk. Figure 2 highlights the relatively new phenomenon — which became entrenched during the Covid era, when we were isolated in our homes all day living through monitors and screens — that almost 60% of Americans use social media to get their information, a number that unsurprisingly skews higher the younger you are. We live in an age where you can do a Google search based on your worst fears, and an algorithm is sure to feed you something to reinforce those fears, via comments and "news."

Let's consider how this is having an impact. Back in September 2023, *The Economist* did a deep dive on this phenomenon of vibecession and it's impact on consumer sentiment, as measured by the University of Michigan Consumer Index. Historically, changes in consumer sentiment have been a useful economic benchmark, and the University of Michigan survey is the longest running measure of this. Comparing the period between 1980 and 2019 to the post-pandemic period, they found that the relationship between consumer sentiment and the 13 traditional data points that make up the survey — like inflation, unemployment and oil prices — had been broken.

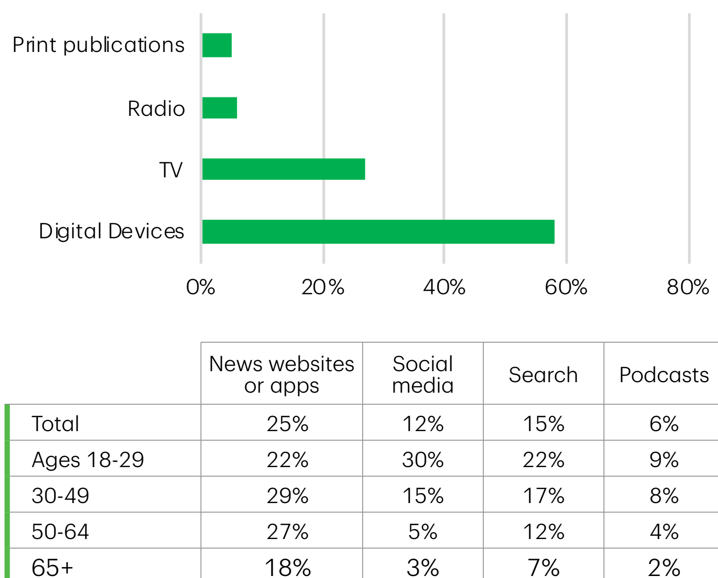
Prior to the pandemic, the relationship between these indicators and consumer sentiment were relatively stable. These 13 economic inputs could be used to explain approximately 86% of the variation in the index, but since 2019, that is no longer the case. If these correlations had remained stable, the index in September 2023 would have come in at an extremely high 98, some 30 points above the number that was actually published.

The hard data show that Americans are doing a lot better financially than they think, and what's worse, *The Economist* suggests that these bad vibes may be the new normal. Sad to say, but based on the data, I think they may be right. It seems that the good news that many investors see when they peruse their banking and investment apps is quickly forgotten in the seconds it takes them to be distracted by a negative post on X, Facebook or Instagram.

I don't think it's a stretch to suggest that a lot of this gloom is a byproduct of today's heated politics, which dominates so much of the discourse on social media. Think about how often the word "Trump" is used as an ice-breaker socially. This is true in red and blue States, as well as Canada and even outside of North America. In the U.S., however, this sort of discourse is not just providing idle chitchat — it's eroding trust in government.

Increasingly, that trust is based on nothing more than which party happens to be in power. During the Trump presidency, for example, Republican trust in the political system was quite high. Then, as soon as Biden came in to office, Republicans' trust in government dropped, while that of Democrats jumped. In one survey in July 2023, respondents were asked whether the current administration could result in the downfall of the nation — I repeat, *the downfall of the nation*. Almost 60% of Republicans felt this way, compared to about 20% of Democrats (Figure 3).

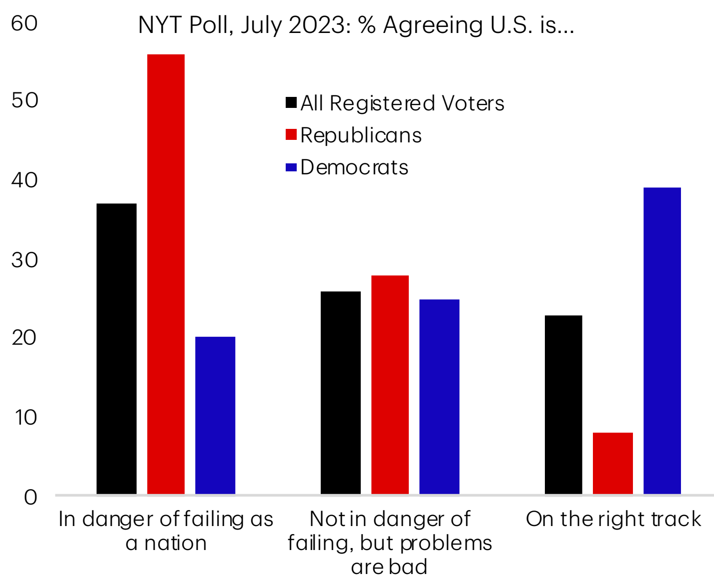
Figure 2: Where do Americans get their "news?"



	News websites or apps	Social media	Search	Podcasts
Total	25%	12%	15%	6%
Ages 18-29	22%	30%	22%	9%
30-49	29%	15%	17%	8%
50-64	27%	5%	12%	4%
65+	18%	3%	7%	2%

Source PEW Research Centre, survey of U.S. adults conducted from September 25 to October 1, 2023

Figure 3: Polarization reaching intense levels



Source: Pew Research Center, New York Times

You see it everywhere. Views on the economy are now being perceived through a political lens. And that's important because it has an impact on how clients allocate capital. More and more, they're making decisions based not on facts, but on emotions influenced by a political worldview. But as the old saying goes, the facts don't matter, until they do. In this case, you can actually measure the consequences in real dollars earned or lost.

Very few political views about the economy are based on the underlying reality; rather, they speak to the dangers that can happen when political views become so extremely polarized. Adherence to any political view — whether you believe in protecting jobs at home or fighting tyranny abroad — requires adherence to a bunch of underlying premises. That's normal. But once the adherence to a political view requires ignoring or misstating the facts, you have two options: (1) reject the facts in favour of the belief; or (2) review the facts and reconsider those views.

I would suggest the latter. The human condition is all about harnessing reason to overcome our base instincts, which reduce every consideration down to tribalism. For us in the industry, it's our job to help dispel the false narratives all around us, and to present the facts because, while it's true that narratives may dominate over the short term, real economic facts — and ultimately earnings growth on the corporate side — are still what drive returns over the long term. It's our job to help clients move away from portfolio management based on emotion (how I *feel* about things) and back towards a process based on facts and reason (how I *think* about things). And the fact is, when we look at the environment we're moving into, it's actually pretty darn good.

So, with that said, let's run through some facts.

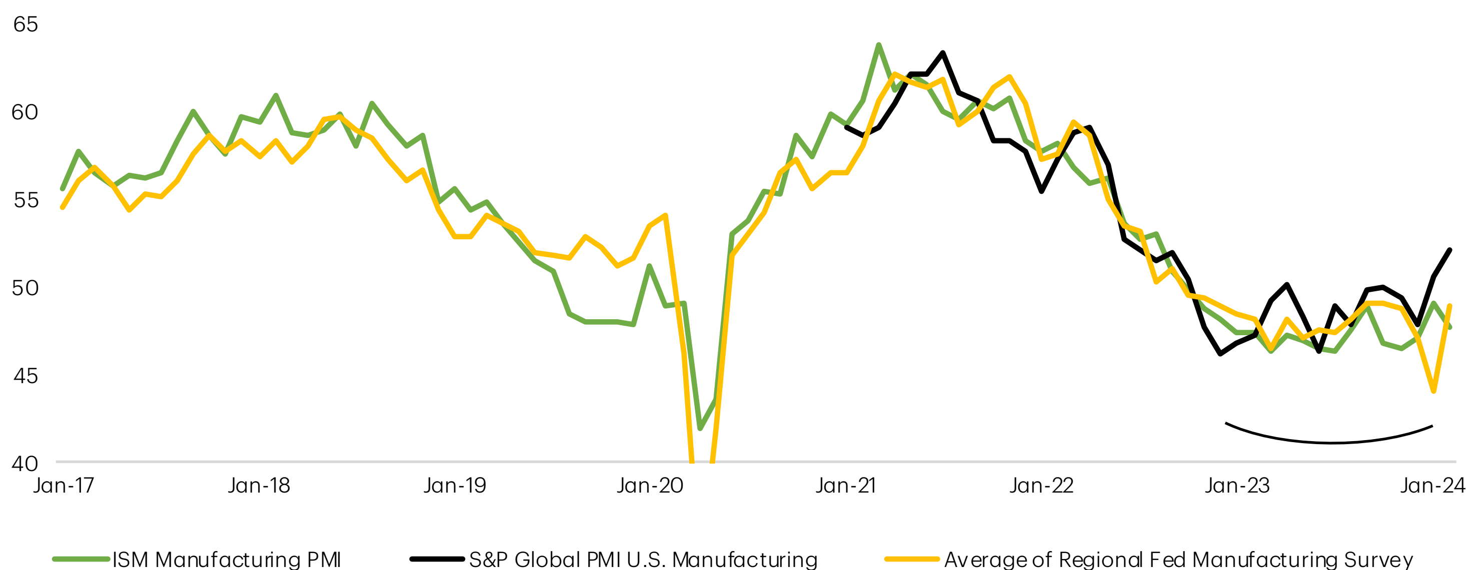
Fact: Business confidence is on the rise

The clearest indication of rising business confidence can be seen in the purchasing managers indices (PMIs). These are based on surveys that ask managers whether business orders are rising or falling, and as such provide an excellent indication of whether the economy is contracting or expanding and what the trend looks like. While the larger, services-related economy in the U.S. has remained expansionary (above 50) throughout the post-pandemic period, manufacturing PMIs fell into contraction in late 2022 as services reopened and people began to spend once again on things like restaurants, recreation and travel.

Recent data suggests the manufacturing PMIs have now bottomed (Figure 4). The S&P Global PMIs are rebounding above 50, and while the version from the Institute of Supply Management (ISM) is still slightly below 50, it's also rising. Eight of 18 industries in the ISM PMI reported growth in February, up from four in January.

These are all strong signs of a soft landing, which is a reversal from last year, when most investors (professional and individuals alike) believed that the spate of rate hikes would lead the U.S. into recession. However, that has not happened, and today the U.S. economy seems to be skirting that economic downturn. If the U.S. does avoid a recession, which is looking more and more likely, cyclical stocks and those that have lagged over the past two years — energy, materials, transportation — should begin to outperform, as well as private equity.

Figure 4: Manufacturing PMIs appear to have bottomed



Source: FactSet, Wealth Investment Office as of February 29, 2024

Fact: Inflation is approaching target

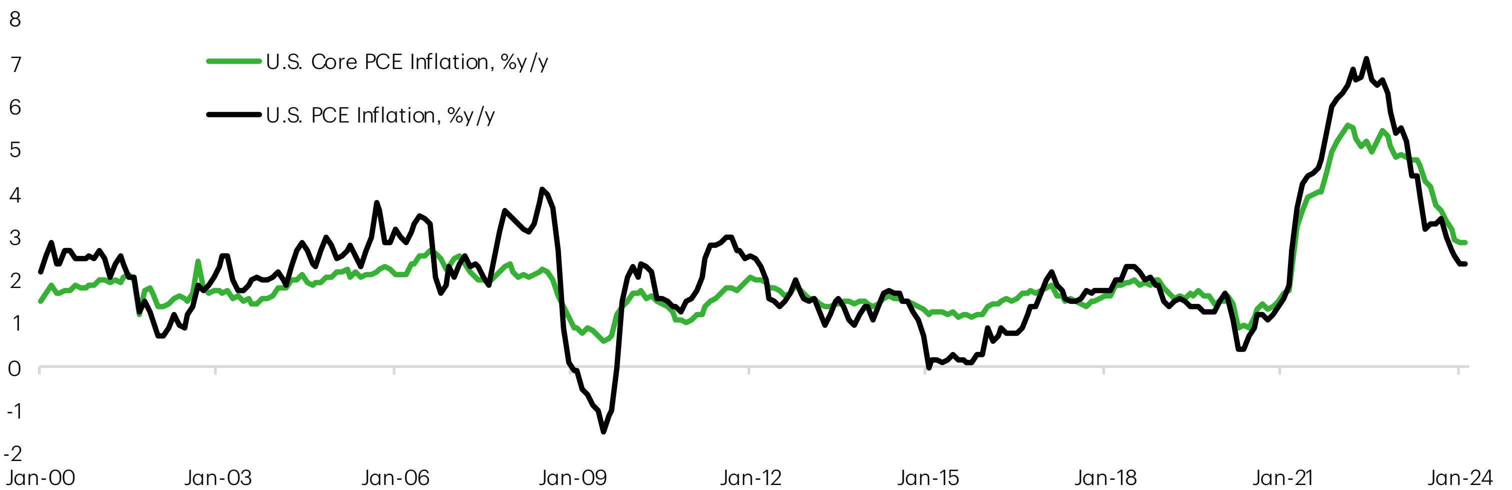
For another indication that the U.S. is headed for a soft landing, take a look at the inflation numbers (Figure 5). Pricing pressures continue to trend down, with the latest core PCE inflation data — the preferred measure of the Fed — falling from 2.9% in January to 2.8% in February. That's in line with expectations and already within the Fed's 1% to 3% range, although still a bit higher than what the central bank will need to see before it begins cutting rates.

In January, the market may have gotten ahead of itself with expectations of a March rate cut, but the Fed has recently signalled that it expects to begin cutting rates at some point this year. Absent any significant rebound in the inflation numbers, that first cut in the U.S. could come as early as June.

Fact: The labour market remains very strong, but it is cooling

Instead of pulling out one data point — which can be misleading depending on the indicator you choose — we decided to look at the U.S. employment situation in a more comprehensive way (Figure 6). And what we find is that while the data is pointing to an easing in the labour market, it still remains very strong and tighter than what it would be in an average cycle. Let's look at the trends that are pointing to a softening. The ISM employment index signalled a deeper contraction last month, from 47.1 in January to 45.9 in February, and has now fallen for five months in a row. Another example can be found in the U.S. non-farm payrolls. While they remain much higher than historical levels and continue to come in above expectations, the data has been softening over the past few months.

Figure 5: Inflation almost back to normal



Source: FactSet, Wealth Investment Office as of February 29, 2024

Figure 6: Labour stats starting to look more normal

		Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24
Hard Data	Initial jobless claims %y/y	97%	96%	95%	94%	94%	94%	95%	91%	51%	66%	77%	35%	31%	42%	16%	16%	25%	19%	24%	23%	30%	42%	18%	28%
	Continuing jobless claims, %y/y	95%	96%	96%	95%	94%	94%	94%	93%	87%	46%	40%	29%	23%	18%	17%	16%	18%	16%	15%	16%	20%	23%	23%	24%
	Unemployment Rate, 12-m chg	97%	96%	95%	96%	95%	94%	91%	84%	57%	52%	70%	41%	36%	47%	30%	33%	33%	29%	26%	29%	30%	28%	24%	26%
	Household Survey Employment Change, 3-m chg	98%	97%	62%	44%	62%	85%	75%	25%	11%	49%	95%	94%	86%	61%	80%	60%	74%	63%	51%	37%	48%	19%	8%	5%
	Non-farm Payroll, 3-m chg	94%	95%	92%	90%	93%	93%	93%	83%	85%	75%	84%	87%	88%	70%	72%	79%	72%	60%	61%	57%	52%	60%	67%	77%
	Temporary Help Services, 3-m chg	89%	61%	28%	12%	21%	24%	25%	25%	20%	11%	12%	14%	21%	17%	23%	19%	15%	11%	14%	15%	16%	16%	23%	22%
	Job Opening Rate	100%	99%	97%	96%	97%	93%	95%	93%	94%	95%	93%	92%	91%	92%	90%	89%	88%	90%	90%	88%	89%	88%	88%	88%
	Job Quit Rate	2%	1%	4%	6%	8%	6%	8%	8%	6%	6%	9%	8%	9%	24%	8%	12%	24%	24%	24%	24%	35%	35%	49%	49%
Soft Data	ISM Manufacturing Employment	56%	28%	32%	21%	25%	25%	37%	25%	29%	27%	29%	59%	35%	36%	25%	51%	33%	64%	48%	29%	31%	6%	30%	19%
	ISM Services Employment	85%	38%	32%	31%	41%	72%	30%	37%	32%	37%	36%	29%	26%	33%	38%	30%	12%	27%	43%	21%	16%	24%	21%	16%
	NFIB Business Hiring Plan	86%	86%	97%	82%	86%	90%	94%	86%	77%	72%	82%	72%	60%	72%	82%	60%	72%	72%	77%	72%	77%	66%	57%	45%
Wages	Average Hourly Earnings, %y/y	99%	99%	98%	95%	97%	95%	92%	91%	92%	89%	84%	86%	84%	86%	84%	86%	86%	82%	82%	80%	80%	80%	82%	80%
	Employment Cost Index, %y/y	94%	94%	94%	98%	98%	98%	97%	97%	97%	98%	98%	98%	96%	96%	96%	94%	94%	94%	93%	93%	93%	91%	91%	91%
	Atlanta Fed Wage Growth Tracker	95%	95%	96%	99%	99%	99%	98%	98%	98%	96%	96%	96%	98%	96%	95%	94%	94%	92%	89%	89%	89%	89%	87%	87%

Source: FactSet, Wealth Investment Office as of February 29, 2024

This all might sound like bad news for the economy, but remember, we're going through a period of *normalization*. A looser labour market will help bring inflation down closer to the 2% target. To be clear, however, we're nowhere near the point where unemployment becomes a problem. In fact, the current unemployment rate of 3.9% remains close to the historical record low. Rather, what we're seeing is in perfect sync with that soft-landing narrative — a gradual easing that continues to support workers while bringing down inflation.

Fact: Consumer spending is also starting to cool

Household spending is another area where weakening data would normally be considered bad news, especially for the consumer-driven U.S. economy. But in this over-inflationary environment, the goal of the central bank is to return spending levels to normal — and we're starting to see that in some of the ancillary data (Figure 7).

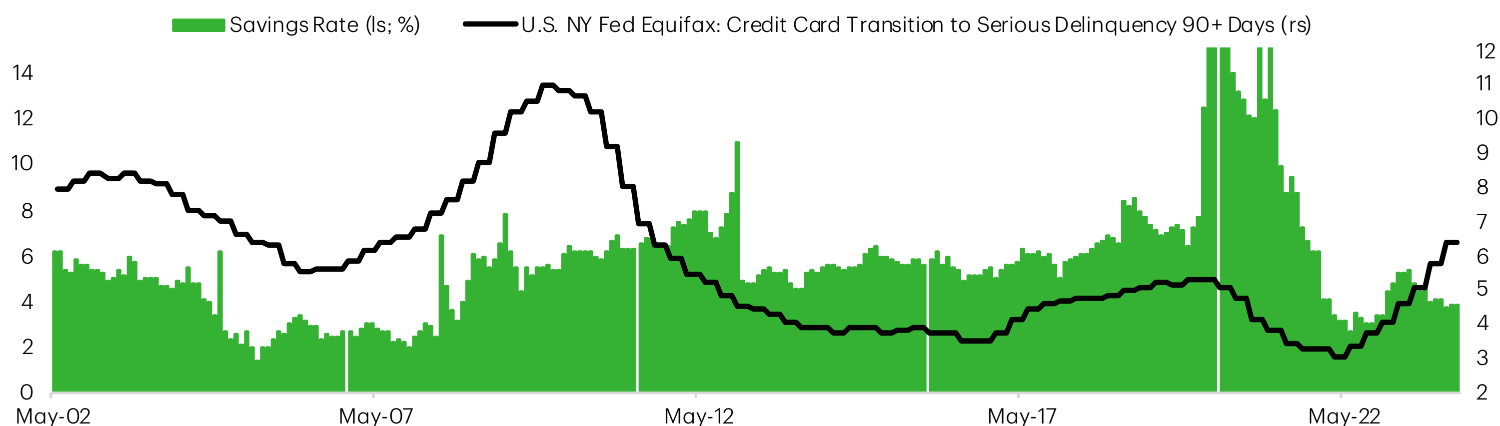
Households credit delinquencies, for example, are rising above pre-pandemic levels, which will eventually force consumers to tighten their belts. We're also starting to see the savings rate come down, which is also expected to lead to slower spending trends. Consumer spending has been one of the most stubborn data points, due mainly to high wage growth in the tight labour market. Finally, however, it appears that consumers are beginning to slow their spending.

Fact: The U.S. economy has defied the narrative time and again

We should also be careful with any narratives that include overconfident forecasts around rate cuts. The reality is that the U.S. economy has been defying the narratives here for well over a year, proving economists, analysts and investors wrong time and time again.

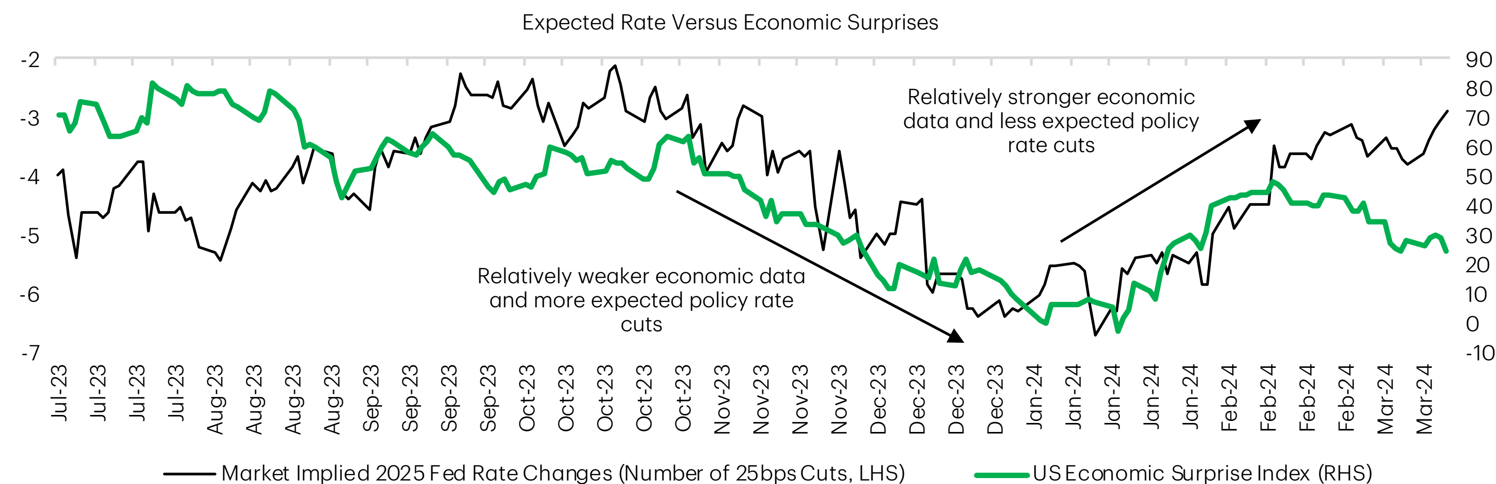
In the accompanying chart, we track the U.S. Economic Surprise Index against market expectations for rate cuts in 2024 (Figure 8). Note, first off, that U.S. economic surprises remained in positive territory from June 2023 to February 2024. Note also how the range of expected rate cuts swings wildly — diverging about 400 basis points — on these economic surprises and the short-term narratives they inspire. In late 2023, the market clearly had no idea what was going to happen.

Figure 7: Consumers begin to tighten their belts



Source: FactSet, Wealth Investment Office as of February 29, 2024

Figure 8: Rate cut forecasts have swung wildly on data releases

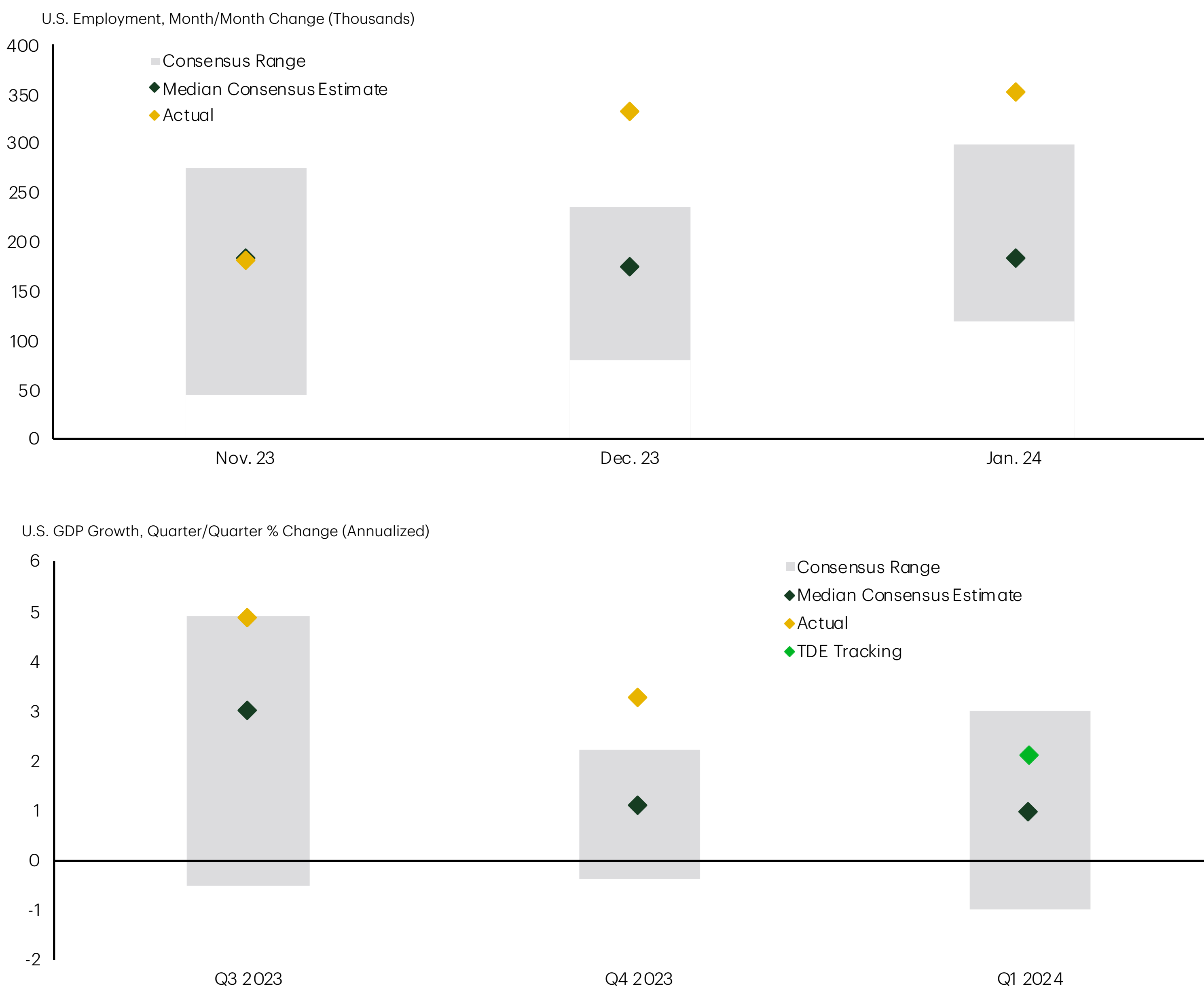


Source: FactSet as of March 4, 2024

Neither, it appears, did the consensus analyst opinion or the Fed itself. In a recent article by TD's chief economist, Beata Caranci, she characterizes these forecast misses as "embarrassingly large," particularly given this late stage of the economic cycle, which tends to be more predictable. The accompanying bar chart (Figure 9) underscore the range of analyst views for jobs and GDP. The actual data overshot even the upper end of people's views.

Which is all to say that investors need to be very careful of policy-rate projections as we move through this year. There's going to continue to be a lot of noise in this area.

Figure 9: Misses have been 'embarrassingly large'



Source: FactSet as of March 4, 2024

Fact: This is not the tech bubble of 2000

Finally, let's take some time to examine the elephant in the room — or perhaps the "Magnificent Seven" elephants in the room. There's a growing fear out there that the tech consolidation we've seen in the past two years is beginning to look a lot like the dot-com bubble that burst in late 2000, the so-called Tech Wreck. This concern has come up in client meetings and conference calls, but the argument for an imminent tech crash is highly debatable.

Sure, some of these stocks are expensive, but they are strong businesses that offer exposure to solid financial metrics and attractive growth prospects. If you look at Q4 results for the Mag 7 mega-caps, these companies grew their sales 15% year over year and lifted their margins by over six percentage points, leading to earnings growth of over 60%.

In contrast, the other 493 stocks on the S&P 500 grew their sales by 3% and saw their margins contract by 0.6 percentage points. So, you've got this scenario where, for the Mag 7, earnings are growing 60%, and for everyone else they're falling 2%. Given that disparity, you can argue that there's some justification for the elevated prices we're seeing.

To put this into even greater context, consider what Big Tech looked like in 2000. Back then, the emerging brands were mere start-ups, with little more than an idea and an enthusiastic sales pitch. In fact, the crash of 2000 can be credited, to some extent, for separating the wheat from the chaff. The enterprises that survived and thrived look nothing like their long-defeated competitors. Many of today's tech leaders have the biggest and best balance sheets in the world. They generate huge cash flow and return a lot of that to their shareholders. Recently, Apple, Alphabet and Meta all announced share buybacks. The Mag 7, moreover, are reinvesting 60% of their cash flow into capex and R&D — about three times what the other 493 companies on the S&P are investing in the future.

We're not saying that these seven companies are appropriately priced, or even that they represent the best opportunities in the market. Far from it — there are plenty of attractive opportunities outside the Mag 7, particularly in cyclicals and in the health care and industrial sectors. But by the same token, we have to admit that the current environment looks nothing like the dot-com bubble.

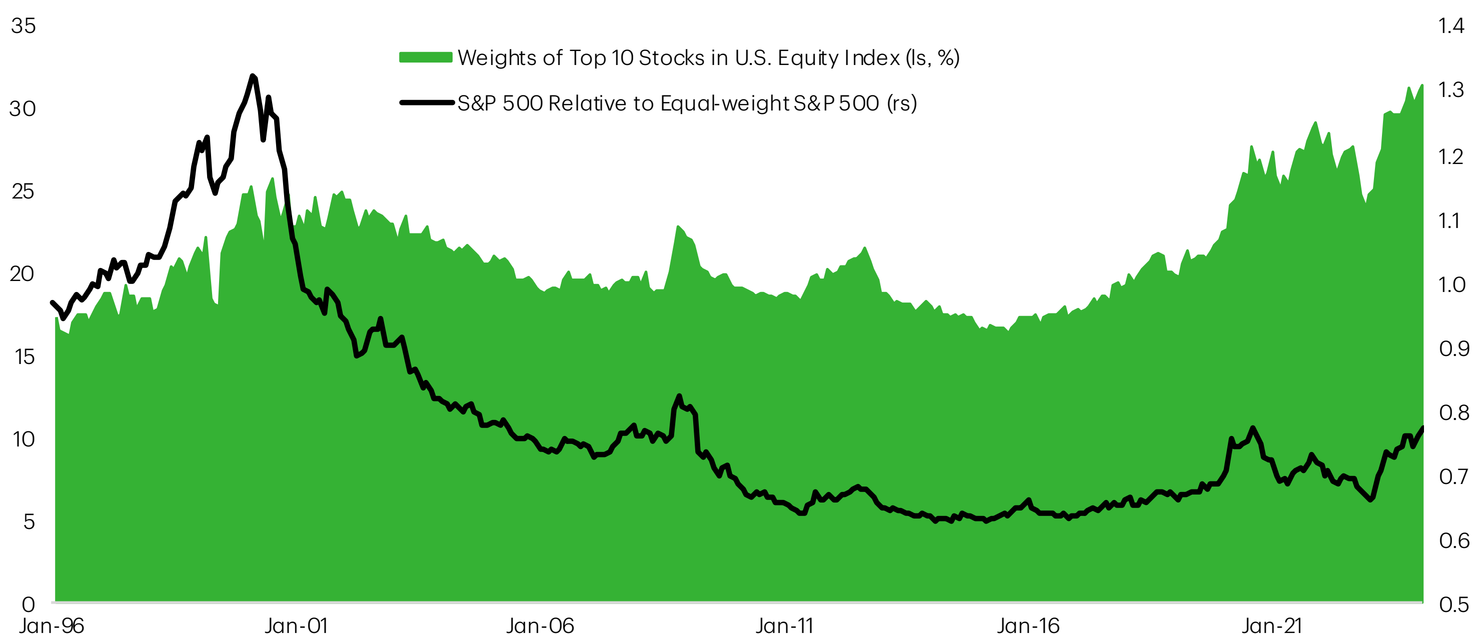
Vibecession and Facts

We all have biases. As a lover of math, science, psychology and history, many of my biases are derived from empirical thinking. I also understand this has its shortcomings; a lot of great research has been done to suggest that how one feels is incredibly important to how we think. A better blend of both can lead to better, and smarter, decisions. But making investment decisions based on how you feel about the economy at the expense of the facts about the economy can have a considerable long-term impact on your financial goals.

More often than not, the noise on your phone only matters over the short term. Over the long term, what's really important is not always having the correct facts, but having the correct process. That process starts with a lot of self-reflection — an examination of one's personality and financial priorities. It also requires professional investment management, ideally from an institution that can provide the best information in real time, along with an investment philosophy that can stand the test of time.

I think that, amid all the political noise this year, investors run the risk of allowing their emotions to cloud their better judgment. It's incumbent on professionals to step in, present the unbiased facts, and also to provide some reassurance that, while the forecasts are never perfect, the process and strategy remain correct. Ultimately, investment decisions need to be based on the foundation of empiricism, not on political fears reinforced by algorithms.

Figure 10: Apples and oranges (2000 vs. 2024)



Source: FactSet, Wealth Investment Office as of February 29, 2024

Market Performance

Canadian Indices ($CA) Return	Index	(%) 1 Month	(%) 3 Months	(%) YTD	(%) 1 Year	(%) 3 Years	(%) 5 Years	(%) 10 Years	(%) 20 Years
S&P/TSX Composite (TR)	86,039	1.82	6.39	2.38	9.19	9.01	9.29	7.37	7.55
S&P/TSX Composite (PR)	21,364	1.63	5.57	1.93	5.65	5.76	5.95	4.16	4.54
S&P/TSX 60 (TR)	4,241	1.95	6.65	2.49	9.79	9.78	9.75	8.06	7.96
S&P/TSX SmallCap (TR)	1,272	0.77	4.18	0.40	0.25	1.44	6.04	3.23	3.44
S&P/TSX Preferred Share(TR)	1,791	0.13	6.81	5.94	5.61	0.87	3.48	1.87	2.32
U.S. Indices ($US) Return									
S&P 500 (TR)	11,062	5.34	11.98	7.11	30.45	11.91	14.76	12.70	9.90
S&P 500 (PR)	5,096	5.17	11.57	6.84	28.36	10.17	12.85	10.61	7.75
Dow Jones Industrial (PR)	38,996	2.22	8.47	3.47	19.41	8.03	8.52	9.10	6.74
NASDAQ Composite (PR)	18,044	5.29	13.14	7.24	49.84	11.81	20.52	17.18	13.36
Russell 2000 (TR)	9,803	8.12	17.19	4.66	14.18	-4.59	6.50	7.33	8.25
U.S. Indices ($CA) Return									
S&P 500 (TR)	15,012	6.70	11.88	9.90	30.08	14.45	15.46	15.01	9.96
S&P 500 (PR)	6,916	6.53	11.48	9.63	28.00	12.67	13.53	12.88	7.82
Dow Jones Industrial (PR)	52,920	3.54	8.38	6.16	19.07	10.48	9.17	11.34	6.80
NASDAQ Composite (PR)	24,486	6.65	13.05	10.03	49.41	14.35	21.24	19.59	13.43
Russell 2000 (TR)	13,303	9.52	17.09	7.38	13.86	-2.42	7.14	9.53	8.32
MSCI Indices ($US) Total Return									
World	10,428	4.24	10.67	5.49	24.96	8.64	11.66	9.06	7.90
EAFE (Europe, Australasia, Far East)	7,972	1.83	7.86	2.42	14.41	4.45	6.77	4.39	5.52
EM (Emerging Markets)	8,867	-0.15	3.04	-4.93	23.14	12.33	3.38	2.82	7.90
MSCI Indices ($CA) Total Return									
World	14,151	5.58	10.58	8.24	24.60	11.11	12.33	11.30	7.97
EAFE (Europe, Australasia, Far East)	10,818	3.14	7.77	5.08	14.09	6.82	7.41	6.53	5.58
EM (Emerging Markets)	12,032	1.13	2.95	-2.46	22.78	14.88	4.01	4.93	7.97

Currency									
Canadian Dollar ($US/$CA)	73.69	-1.27	0.08	-2.54	0.29	-2.22	-0.60	-2.01	-0.06
Regional Indices (Native Currency, PR)									
London FTSE 100 (UK)	6,972	4.23	8.65	5.17	11.32	5.43	5.70	3.16	4.50
Hang Seng (Hong Kong)	3,015	8.13	-0.48	1.35	-8.06	-4.93	0.50	3.90	2.98
Nikkei 225 (Japan)	16,511	6.63	-3.12	-3.14	-16.55	-17.10	-10.43	-3.19	0.86

Benchmark Bond Yields	3 Months	5 Yrs	10 Yrs	30 Yrs
Government of Canada Yields	4.97	3.57	3.49	3.36
US Treasury Yields	5.39	4.25	4.25	4.38

Bond Indices ($CA Hedged) Total Return	Index	1 Mo (%)	3 Mo (%)	YTD (%)	1 Yr (%)	3 Yrs (%)	5 Yrs (%)	10 Yrs (%)
FTSE TMX Canada 91-day Treasury Bill Index	454	0.41	1.26	0.87	4.89	2.51	1.95	1.38
FTSE TMX Canada Universe Bond Index	1,102	-0.34	1.66	-1.71	3.79	-2.17	0.65	1.94
FTSE TMX Canada All Government Bond Index	1,036	-0.53	1.29	-2.12	2.94	-2.73	0.17	1.65
FTSE TMX Canada All Corporate Bond Index	1,340	0.21	2.78	-0.47	6.34	-0.55	2.01	2.76
U.S. Corporate High Yield Bond Index	283	0.25	3.79	0.19	10.11	1.29	3.39	3.80
Global Aggregate Bond Index	250	-0.74	2.05	-0.98	4.69	-2.11	0.57	1.90
JPM EMBI Global Core Bond Index	501	0.96	4.44	-0.35	8.61	-3.30	-0.36	2.26
S&P/TSX Preferred Total Return Index	1,791	0.13	6.81	5.94	5.61	0.87	3.48	1.87

Credit Suise ($US) Total Return	Index	1 Month	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Credit Suisse Equity Market Neutral USD	320	0.91	2.27	1.75	8.20	4.97	3.57	1.77
Credit Suisse Event Driven USD	848	2.01	5.08	2.49	10.00	4.07	5.55	2.83
Credit Suisse Global Macro USD	1,360	1.28	4.12	2.71	-0.41	6.91	7.55	4.77
Credit Suisse Hedge Fund USD	804	2.06	4.23	3.50	8.57	5.48	6.25	4.08
Credit Suisse Long/Short Equity TR USD	1,023	3.02	6.38	5.50	14.30	5.55	6.60	4.85
Credit Suisse Managed Futures USD	421	5.03	5.79	6.32	4.25	9.35	8.43	4.80

Source: TD Securities Inc., Morningstar®, TR: total return, PR: price return, as of February 29, 2024.

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