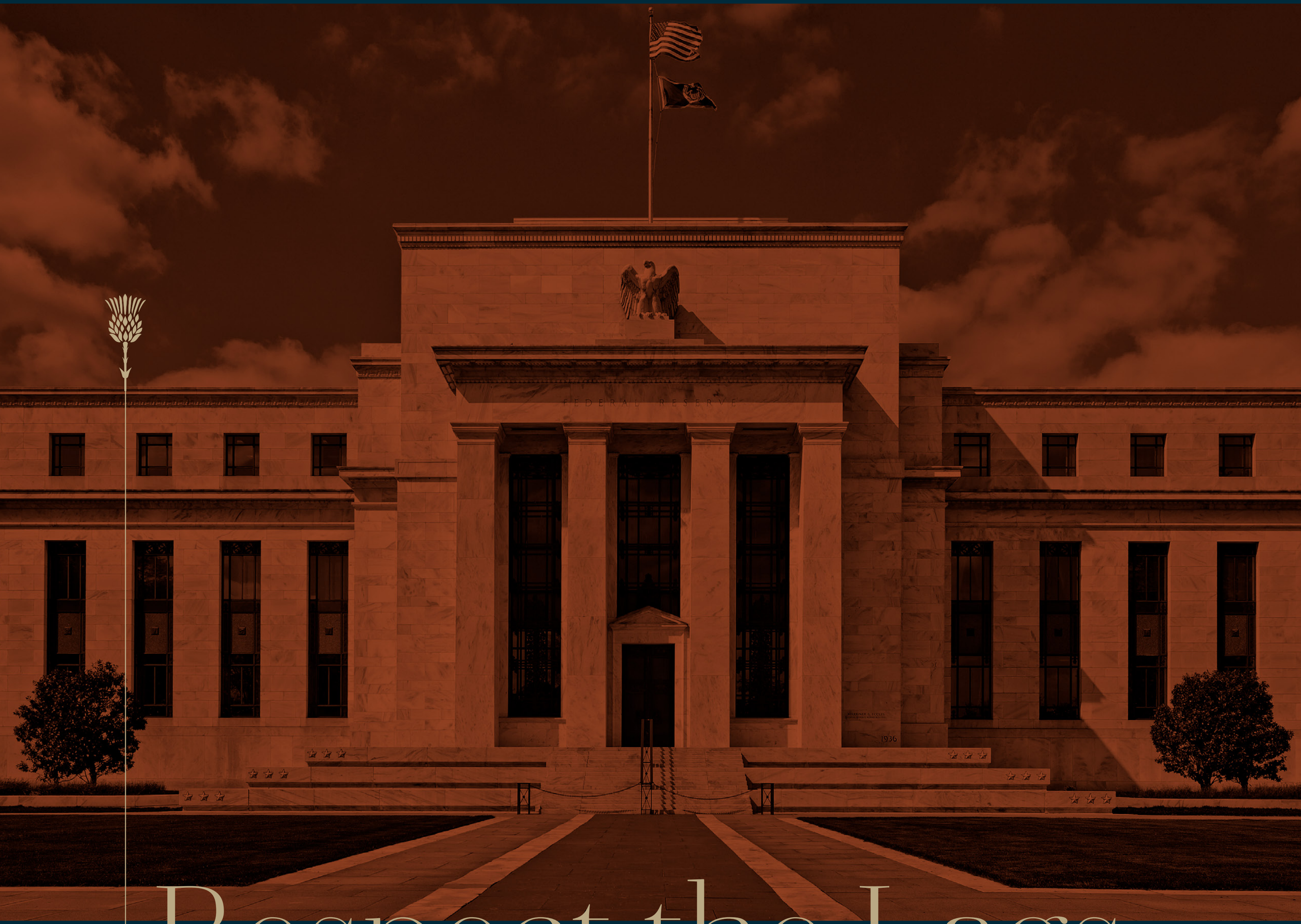
ROCKEFELLER
GLOBAL FAMILY OFFICE

CIO MONTHLY PERSPECTIVE

SEPTEMBER 2023



Respect the Lags

The business cycle has not short-circuited

estd 1882

Market Watch

Equity Market Indices[1]	7/31/23 Price	8/31/23 Price	MTD Change	YTD Change
MSCI All Country World	707	688	-2.7%	13.6%
S&P 500	4589	4519	-1.5%	17.7%
MSCI EAFE	2199	2117	-3.7%	8.9%
Russell 2000®2	2003	1903	-5.0%	8.1%
NASDAQ	14346	14035	-2.2%	34.1%
TOPIX	2323	2332	0.4%	23.3%
KOSPI	2633	2556	-2.9%	14.3%
Emerging Markets	1047	988	-5.6%	3.3%
Fixed Income				
2-Year U.S. Treasury Note	4.88%	4.86%	-2	-43
10-Year U.S. Treasury Note	3.96%	4.10%	13	22
BBG U.S. Agg Corp Spread	1.12%	1.18%	6	-12
BBG U.S. HY Corp Spread	3.67%	3.70%	3	-99
Currencies				
Chinese Renminbi (CNY/$)	7.14	7.26	1.6%	5.2%
Brazilian Real (Real)	4.73	4.95	4.8%	-6.2%
British Pound ($/GBP)	1.28	1.27	1.3%	-4.6%
Euro ($/Euro)	1.10	1.08	1.4%	-1.3%
Japanese Yen (Yen/$)	142.29	145.49	2.2%	11.0%
Korean Won (KRW/$)	1274.55	1322.65	3.8%	4.5%
U.S. Dollar Index (DXY)	101.86	103.60	1.7%	0.1%
Commodities				
Gold	1965	1940	-1.3%	6.4%
Oil	81.8	82.5	0.8%	2.8%
Natural Gas, Henry Hub	2.63	2.77	5.2%	-38.1%
Copper (cents/lb)	401	379	-5.6%	-0.7%
CRB Index	282	282	-0.1%	1.5%
Baltic Dry Index	1127	1094	-2.9%	-27.8%

Source: Bloomberg

INTRODUCTION

The world is becoming more bifurcated with each passing day. On the economic front, there is a growing divergence between the U.S. and the rest of the world. The Atlanta Fed's GDPNow model currently projects the U.S. economy to grow at a whopping 5.6% annualized pace in the third quarter. On the other side of the Atlantic Ocean, Europe appears to be slipping into stagflation as the region's manufacturing and services PMIs (Purchasing Manager Indices) both dropped below 50 while inflation remained elevated. China's economic prospects dimmed further with its troubled real estate sector triggering more defaults as well as deflation.

On the geopolitical front, the fifteenth BRICS (Brazil, Russia, India, China, and South Africa) Summit in South Africa was leveraged by several heads of state to vent their anti-Western grievances, but there were no new initiatives other than inviting six more nations to join the group in 2024. The much-anticipated common BRICS currency to rival the greenback was not introduced, and the Summit wound up being overshadowed by the death of Yevgeny Prigozhin, which some observers considered an unsurprising end for a man who had the audacity to mount a coup against Putin exactly two months earlier.

These events demonstrated that, as chaotic as things may appear in the U.S., America is still head and shoulders above other nations. However, Fitch Ratings poured cold water on U.S. economic supremacy by downgrading our long-term credit rating. It reminded investors that our economic resiliency has been artificially supported by Washington's rapidly rising budget deficit. Concerns over Uncle Sam's escalating borrowing needs briefly drove U.S. Treasury bond yields to new cycle highs, which in turn cooled off the equity rally from earlier this summer.

Fed Chair Powell capped the eventful August with a balanced speech at the Kansas City Fed's Jackson Hole Symposium. He reiterated the commitment to bring inflation down to 2%, left the door open for more rate hikes, but also acknowledged that the Fed's tightening may have significant further drag in the pipeline. In short, while the market consensus has embraced an immaculate disinflation and economic soft landing, the "further significant drag" noted by Chair Powell may wind up throwing investors yet another curveball.

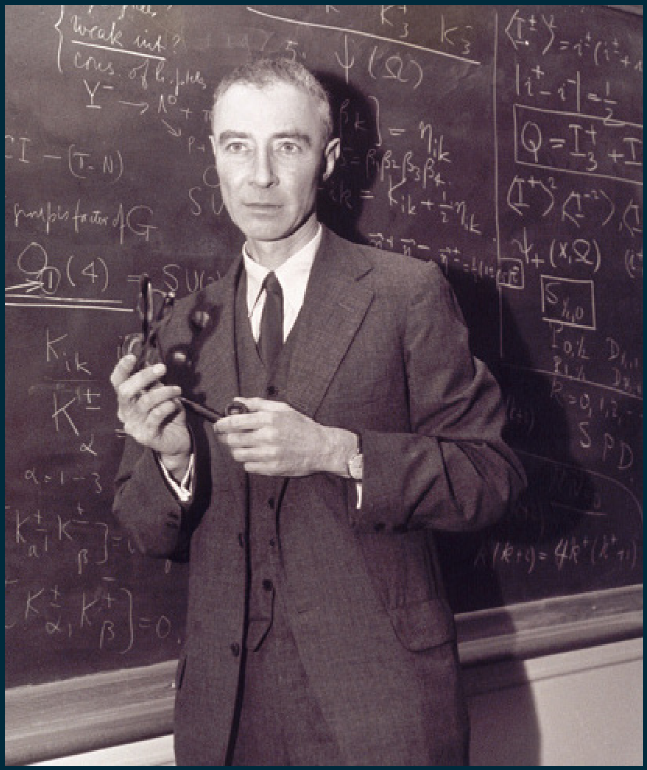
JIMMY C. CHANG, CFA
Chief Investment Officer
Rockefeller Global Family Office
jchang@rockco.com
212-549-5218

The Long Journeys

For a while, it looked like historian Martin Sherwin would take his ambitious biography on Robert Oppenheimer to the grave. He started working on the project in 1979, and had gathered 50,000 pages of interviews, letters, declassified documents, and diaries by 1985. However, he was unable to complete the book for 20 years. In 1999, Sherwin invited his friend and fellow writer Kai Bird to craft a more readable biographic outline. Bird did not disappoint his friend and created a draft that was later rewritten by Sherwin.

In 2005, 26 years after Sherwin started working on the book, *American Prometheus: The Triumph and Tragedy of J. Robert Oppenheimer* was finally published. The book won numerous awards, including the 2006 Pulitzer Prize for Biography or Autobiography. Hollywood also came knocking on his door, with British filmmaker Sam Mendes acquiring the movie option. However, it was yet another tortuous journey that dragged on for 15 years with the adaptation rights changing hands multiple times. Finally, in 2021, Christopher Nolan requested to meet with Sherwin and Bird to show them his screenplay for *Oppenheimer*. Sherwin, by then 84 years old, was unable to join the meeting as he was stricken with lung cancer. He bid the world farewell that October knowing that the book that consumed 25 years of his life was in good hands to be made into a blockbuster film.

While *Oppenheimer* the film has garnered rave reviews, some critics wondered if the film's cast would pass muster with the Oscar's new inclusion rules for award eligibility. Some suggested that the film could have given more spotlight to the Japanese bombing victims.



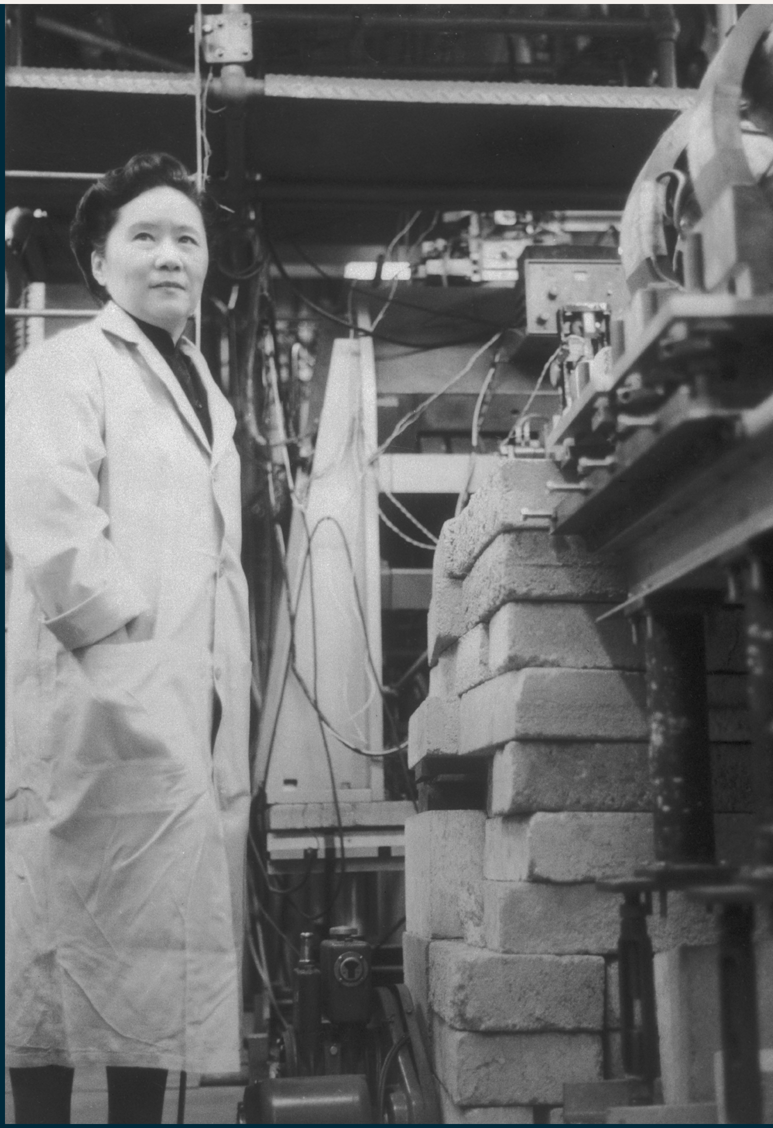
J. Robert Oppenheimer (January 1, 1945).

Among the Chinese diaspora, *Oppenheimer* has revived the memory of a petite woman whose portrayal could have provided the film with a bit of diversity – Dr. Chien-Shiung Wu, one of the most influential physicists of the 20th century and an important contributor to the Manhattan Project.

Wu was born in 1912, a year after the Xinhai Revolution that ended the imperial Qing Dynasty. Her father was an activist in the revolution and harbored ideals such as a republican form of government and women's equality. He was so liberal that he had no qualms giving his only daughter a masculine name – the literal translation of Chien-Shiung is "healthy and masculine."

Wu was a gifted student at the all-girls Ming De Middle School founded by her father. The father and daughter duo would sit under crape myrtle trees he had planted in the school's courtyard discussing Chinese classics, the latest scientific news, and politics. She shared her father's dislike of General Yuan Shikai, the second president of the Republic of China who died in ignominy shortly after crowning himself as the new emperor of China in 1916.

While attending a boarding school in her teens, Wu was inspired by Madame Curie and developed an interest in science. During her graduate-level studies in physics in 1934, she was encouraged by a female supervisor who had earned a PhD from the University of Michigan to study there. In 1936, at age 24, Wu bade her parents farewell in Shanghai and headed for the U.S., not knowing that she would never see them again.



Dr. Chien-Shiung Wu with Nuclear Physics Apparatus (March 21, 1963).

After disembarking in San Francisco, Wu toured the University of California in Berkeley and was shown around campus by physicist Luke Yuan. Yuan introduced Wu to Ernest Lawrence, the director of the Radiation Lab who would soon win the Nobel Prize. Wu was shocked to learn that sexism was so ingrained in America that women without male escorts were not allowed to use the front entrance of several buildings on the University of Michigan campus. She requested to study at the more liberal UC Berkeley and was accepted.

Her Berkeley years were an idyllic period, and she was affectionately nicknamed Gee Gee by her friends. One of Wu's professors, Italian physicist and future Nobel laureate, Emilio Segrè, compared her to Madame Curie. Another future Nobel laureate, Luis Alvarez, wrote in his autobiography that Gee Gee was the "most talented and most beautiful experimental physicist" he has ever met. Wu wound up falling in love with and marrying Luke Yuan – ironically the grandson of General Yuan Shikai.

In 1940, Wu presented her doctoral thesis in two parts – the first was related to beta decay, on which she would become an authority, and the second was on nuclear fission, which impressed Robert Oppenheimer, who was on the dissertation committee and knew Wu well enough that they were on a nickname basis.

THE LONG JOURNEYS

In 1944, Dr. Wu joined the Manhattan Project's Substitute Alloy Materials (SAM) lab at Columbia University. Her doctoral work on beta decay helped Enrico Fermi identify an unexpected problem in the first practical nuclear reactor ever built. Her work on separating uranium into U-235 and U-238 isotopes by gaseous diffusion was critical in producing uranium in sufficient quantities to make the bomb. However, like Oppenheimer, after witnessing the destructive power of the nuclear bomb, she distanced herself from subsequent weapons research.

After World War II, Dr. Wu became the first female faculty member of Columbia's physics department and remained there for the rest of her career. In the mid-1950s, Dr. Wu was approached by theoretical physicists Tsung-Dao Lee and Chen-Ning Yang to help prove their unorthodox theory that the hypothetical "law of conservation of parity" (deals with how a particle's wavefunction behaves when the particle undergoes spatial inversion) does not hold for weak nuclear force. She took on the challenge, and her experiment, henceforth known as the Wu Experiment, confirmed Lee and Yang's theory. This groundbreaking work helped Lee and Yang win the Nobel Prize for Physics in 1957. Many believed that Dr. Wu should have shared the prize, and she was subsequently nominated for the Nobel Prize at least seven times to no avail (lists of Nobel nominees after 1973 are not yet available since they are sealed for 50 years). However, she was honored with numerous other awards, and was called the Queen of Nuclear Research, the First Lady of Physics, and the Chinese Madame Curie.

In 1975, her colleague, physicist Robert Serber, became chair of the department and was shocked to learn that she earned much lower pay than her male colleagues for all those years at Columbia. In her later years, Dr. Wu became outspoken against gender discrimination and advocated for human rights as well as STEM education.

Dr. Wu's plan to visit her family in China was repeatedly disrupted by events beyond her control – the outbreak of the Pacific War in 1941, the Chinese civil war after WWII, and the Communist takeover that resulted in severe restrictions on U.S. citizens' travel to China. She could not even attend her parents' funerals in 1959 and 1962. Finally, a year after President Nixon's 1972 ice-breaking trip to China, she returned to her ancestral home for the first time in 37 years. It was a bittersweet visit as her next of kin had perished during the Cultural Revolution, and her parents' tombs were destroyed. However, the school that her father founded was still standing. Dr. Wu gave money to the school and set up a scholarship in her father's name. After Dr. Wu's death in 1997, Luke Yuan honored her wishes by burying her ashes under a crape myrtle tree planted by the elder Wu in the courtyard of the Ming De Middle School. The Chinese Madame Curie finally returned home for good.

The Dismal Science

Isaac Newton (1642 - 1727).

Since the 1800s, economists have been trying to make economics a science similar to Newtonian physics. However, whereas scientific models and experiments are deterministic and predictable – apart from quantum physics that can only predict the probabilities of measurement outcomes – economic laws and models lack the order and consistency of natural sciences. This is why economics is often derided as a dismal science, a discipline that is inherently stochastic and full of surprises.

THE DISMAL SCIENCE

The one thing that economics and natural sciences have in common is that they both crave equilibrium and stability. In nature, an atom with the same number of electrons and protons is stable, while an unstable atom will transmute and eject particles to become stable, a process known as radioactive decay. For example, uranium is an unstable element in a constant state of decay, a property harnessed by scientists on the Manhattan Project to create atomic bombs. In economics, markets will trend toward an equilibrium between supply and demand with price changes being an enabler.

The COVID-19 pandemic created a crisis out of the blue and brought about the most severe shocks to both supply and demand on multiple fronts. In the face of collapsing demand, disrupted supply, and unknown public health ramifications, governments were forced to make up policies on the fly to restore equilibria. In my March report, The Plot Thickens, I likened these policy responses to a play in four acts. Act I was about crisis management in 2020, when the government did an admirable job in restoring aggregate demand and averting deflation and depression. Act II featured overstimulation as both monetary and fiscal stimuli got carried away in 2021, which led to four-decade high inflation. Act III began in the spring of 2022, when the Fed belatedly started to tighten aggressively in order to restore price stability. In early March 2023, I surmised that the Fed was close to wrapping up interest rate hikes, which would set the stage for the final Act, the landing. I cautioned that the economic landing will likely unfold gradually with bumps along the way. I was concerned that falling leading indicators and a deeply inverted yield curve were signaling that recession was likely unavoidable.

Historical precedents show that the typical sequence of events leading a business cycle into recession are:

President Joe Biden talks with Jerome Powell, Federal Reserve Chair and Lael Brainard, nominee to be the Federal Reserve Vice Chair (November 22, 2021).

1. The Fed hiking interest rates to slow down economic growth.

2. Interest rate sensitive sectors such as housing and big-ticket consumer durables beginning to weaken.

3. Leading indicators and the yield curve flashing recession warnings.

4. Banks increasingly tightening lending standards.

5. Rising corporate layoff announcements and cost cutting efforts.

6. Equities teetering with defensive sectors outperforming cyclical sectors.

7. Waning inflationary pressure.

8. Rising interest rates and shrinking liquidity triggering one or more financial accidents.

9. The jobless rate going hockey stick.

10. The Fed pivoting to rate cuts in an attempt to arrest the economic downturn.

At the start of 2023, the first seven events had already taken place with the December 2022 readings of the ISM Manufacturing and Services Purchasing Manager Indices both showing contraction by falling below 50. Shortly after my March report was published, the eighth condition was met with the collapse of Silicon Valley Bank. To those who follow the traditional business cycle playbook, the banking crisis was like the last nail in the coffin as the ensuing credit contraction was expected to tip the economy into recession.

However, just when those in Team Recession were getting complacent, the proverbial rug was pulled out from under them. Equities started to take off in mid-March, and the U.S. economy remained resilient.

The strong equity rally since mid-March had a lot to do with idiosyncratic liquidity injections by policymakers – the Fed and the Federal Home Loan Bank lent aggressively to banks in need of liquidity, and the Treasury Department pumped roughly half a trillion dollars into the economy by draining the Treasury General Account during the debt ceiling negotiations that concluded in late May. Equities also benefited from artificial intelligence fervor being kicked into a higher gear after Nvidia's blowout earnings report in May.

Fundamentally, there were a few positive surprises belatedly recognized by Team Recession:

1. Excess savings from the pandemic era have continued to support household spending. A San Francisco Fed research paper published in May estimated that American consumers have been tapping into their excess savings, which peaked at $2.1 trillion in August 2021, to the tune of several hundreds of billion dollars each quarter. It estimated that there was still $500 billion of excess savings left as of March 2023.

2. Incentives from the 2021 Infrastructure Investment and Jobs Act and the 2022 Inflation Reduction Act have led to a surge in manufacturing construction spending – the annualized run rate has reached $201 billion in July, up 71% from a year earlier. There will be more federally funded infrastructure projects underway in 2024, which happens to be a presidential election year.

3. The federal government has continued to inject fiscal stimulus by running up budget deficits to surprisingly high levels. At the end of July, ten months into fiscal year 2023, the federal government's outlays were up 10% while its receipts were down 10%, which resulted in a budget deficit of $1.6 trillion – 122% higher than the $726 billion of deficit through the first ten months of fiscal 2022. The nearly $900 billion increase in the budget deficit is equivalent to more than 3% of GDP. For fiscal year 2023 ending in September, Uncle Sam will likely run up its deficit to $1.8 trillion or more, which is equivalent to 7% of GDP. It is unprecedented in U.S. history to run up a peace time budget deficit of this magnitude while the economy enjoys full employment with a 3.8% jobless rate in August.

Furthermore, I stand corrected with the assumption that the most aggressive Fed hiking cycle in four decades would slow down the economy at a faster pace. This assumption was probably one of the drivers leading to a relatively early yield curve inversion in the current tightening cycle – the 2s-10s yield curve inverted only three months after the first interest rate hike. It turned out that the opposite has happened – the net impact of aggressive rate hikes has been stimulative for many households and corporations.

THE DISMAL SCIENCE

These entities took advantage of the ultra-low interest rate environment of 2020-21 to lock in lower-cost financing – the former have refinanced their mortgages at 3.5% or lower, and the latter issued bonds to lock in low interest rates for years. As such, rapidly rising interest rates induced by the Fed's aggressive hiking cycle have unwittingly lowered their net interest expenses – their interest payments were fixed while their cash balances earned more interest income. Albert Edwards, a long-time investment strategist at Societe Generale, estimated that the reduction in non-financial corporations' net interest expenses has boosted their profits by 5%.

All told, these unusual developments have propped up the U.S. economy despite the Fed's aggressive tightening. The cherry on top is that headline inflation has come down rapidly during the first half of the year thanks to easy comparisons on the energy front. This combination of economic resiliency and falling inflation created a Goldilocks narrative and convinced most investors to join Team Soft Landing. The newfound optimism pushed the S&P 500 Index to a year-to-date high of 4,589 by the end of July, 19.5% above 2022's closing level, and merely 4.3% below the Index's all-time-high of 4,797 reached on January 3, 2022.

Fitch Ratings logo seen on the building in New York City (October 25, 2022).

Bad News Comes in Threes

Just when it looked like the market's momentum and optimism would catapult the S&P 500 Index to new all-time highs, Fitch Ratings unwittingly tipped over the market's proverbial punchbowl.

On August 1, citing a litany of challenges from the erosion of governance, rising deficits and debt, to an upcoming recession, downgraded the U.S. credit rating from AAA to AA+. The fury and criticism from Pennsylvania Avenue to Wall Street were palpable. Treasury Secretary Yellen called it an unwarranted and flawed assessment based on outdated data. Ironically, her department announced a day earlier that its borrowing needs for the rest of the year will be several hundred billion dollars more than what it had projected in May. The higher debt issuance was attributed to lower tax receipts and higher outlays, i.e., a greater deficit.

While investors don't make investment decisions on U.S. Treasury securities based on credit ratings, the downgrade was a reminder that there is a cost to Washington's extravagance. With interest rates having risen rapidly, the federal government's annual interest expense is fast approaching $1 trillion. Politicians are smart enough to know that the country's current fiscal trajectory is unsustainable, yet the desire to win the next election trumps their resolve to carry out unpopular fiscal measures. Some investors were starting to worry that there may not be sufficient demand for the deluge of Treasury issuance unless buyers are compensated with higher yields. There was also the belief that U.S. economic strength projected by the Atlanta Fed should drive long bond yields higher. These factors led to a rapid ascent in long bond yields to new cycle highs – the nominal and real 10-year Treasury yield surged to pre-Great Financial Crisis levels, and the 30-year fixed mortgage rate hit the highest level since 2000. Professional investors worth any salt ought to remember that higher interest rates often lead to lower valuations and vice versa.

Having missed the Silicon Valley Bank debacle and much of the subprime debt crisis in 2008, it appears that credit rating agencies are trying to be proactive this time around. On August 7, Moody's reminded investors that the stress in the banking system, which many investors have dismissed during the recent equity rally, was far from over. It cut credit ratings of ten small to mid-sized U.S. banks and put six larger banks on review for potential downgrades. Moody's downgrades were followed by warnings from Fitch Ratings that the U.S. banking industry has inched closer to another downgrade, which would force the rating agency to take negative actions on all U.S. banks, including the strongest ones. Not to be outdone by its rivals, S&P Global Ratings cut its ratings on five regional banks based on higher funding costs and troubles in the commercial real estate space.

BAD NEWS COMES IN THREES

People who believe that bad news come in threes received affirmation on August 16, with the San Francisco Fed publishing an updated report to its study on excess savings. The two co-authors updated their estimates and warned that the excess savings, which have been an important support for consumption, are likely to be depleted during the third quarter of 2023. While one can question the precision of the analysis as there is a wide range of estimates on the residual amount of excess savings and its impact on the economy, it is reflective of increasingly cautious consumer behaviors noted by various retailers in August.

Respect the Lags

The next big macro event will likely be the Federal Open Market Committee (FOMC) rate decision and the release of its quarterly Summary of Economic Projections (SEP) on September 20. While many investors believe that the Fed's last rate hike in July has concluded the hiking cycle (Act III), the Fed will likely keep its options open. As for the final Act, the landing phase, most investors have already assumed a happy ending with an immaculate disinflation and economic soft landing. However, I believe it is too early to pop the champagne as monetary tightening has long and variable lags. These lags are obviously nowhere close to the 26-years it took Martin Sherwin to finish his book on Oppenheimer or the 37-year wait for Dr. Wu's to return to China, but they could play out over a few years, which may feel like an eternity to investors who crave instant gratification.

For now, the combination of a still resilient U.S. economy, full employment, and elevated wage pressure from catalysts such as generous union contracts negotiated with UPS and American Airlines will keep the Fed funds rate higher for longer. While the sharp rise in the Fed funds rate has yet to hurt the economy's aggregate demand, its dampening impact will rise over time as existing debts mature and get refinanced at higher rates. To wit, S&P Global reported that year-to-date through July, bankruptcy filings were tallying up at the fastest pace since 2010, and auto-finance delinquencies have surpassed levels last seen during the Great Recession.

Higher interest rates will also exacerbate the headwinds against many banks by pushing up funding costs and losses in their bond portfolios. Many banks' loan portfolios, especially lending to commercial real estate, will likely experience greater delinquencies. Banks under duress have already started to tighten lending standards, which will reduce the supply of credit, the life blood of the modern economy, to many borrowers.

Investors may rationalize that this slow-motion credit squeeze will be offset by continued fiscal largess from Washington, which is not interest-rate sensitive in the near term. However, alarmed by the runaway deficit, members of the House Freedom Caucus are pushing to cut the fiscal 2024 budget, which has created an internecine feud between hardline and moderate Republican House members and could lead to a government shutdown in October or next January.

The U.S. economy will face a number of new headwinds in the coming months. Household consumption will likely be crimped by the resumption of student loan payments and dwindling excess savings. Business tax refunds, a surprise stimulus to the economy that ran up to nearly $30 billion a month recently, will likely be dialed down as the IRS puts the Employee Retention Tax Credit, a retroactive aid to businesses affected by the pandemic in 2020 and 2021, under greater scrutiny. Corporate layoffs have picked up after a recent lull in June and July. IBM even attempted to get a halo effect with investors by claiming that it will replace 8,000 existing jobs internally with artificial intelligence.

The potential rise in layoffs aligns with the 9th point in the aforementioned sequence of events leading to recession. Higher job losses will curtail consumer spending and set off a negative feedback loop to the economy.

RESPECT THE LAGS

Team Soft Landing may argue that the still tight labor market makes a material rise in joblessness improbable. However, the Fed is intentionally trying to weaken the job market. As Chair Powell indicated at Jackson Hole, he is still looking for further "labor market rebalancing," a euphemism for weakness, in order to prevent inflation from relapsing. Unfortunately, monetary policies are a blunt tool that cannot precisely engineer the desired equilibrium – things tend to overshoot. Past cycles have shown that once labor market weaknesses become a trend, the unemployment rate would shoot up by at least 2% from the trough.

The six U.S. economic downturns between 1970 and 2010 showed that, on average, recession begins roughly two years after the start of the Fed's tightening cycle, and the lag can be as long as 41 months. We are currently 18 months into the tightening cycle, and the two-year marker will be March 2024. In other words, just because recession hasn't taken place in the current cycle does not mean that it won't happen in 2024 or even 2025. With the consensus now firmly in the soft-landing camp, the stage is once again set for a phenomenon observed by legendary strategist Bob Farrell: "When all the experts and forecasts agree, something else is going to happen."

As for the depth of the next recession, if it occurs at all, the forecast always starts out with a mild one. It then depends on policy responses and whether a financial crisis gets triggered. For example, the Great Recession probably would not have been as traumatic had Lehman Brothers been bailed out to prevent more dominos from falling. As events were unfolding during that period, the National Bureau of Economic Research (NBER), an entity tasked with dating business cycles, did not even acknowledge that there was a recession until December 1, 2008, and it backdated the start of the recession to December 2007.

September Swoons

Rising long bond yields led to a 5% stock pullback during the first half of August. However, a string of weaker-than-expected economic data in the final week of the month triggered a "bad news is good news" rally in stocks and bonds. With the market's liquidity backdrop appearing to be deteriorating of late, equities may need either a positive external surprise – such as additional stimulus out of China – or strong earnings results and guidance to sustain upward momentum. With the earnings reporting season not starting until mid-October, September may turn out to be a rather volatile period as it has been historically. That said, many investors who have missed the early summer rally may seize further pullbacks as buying opportunities. Equities may wind up trading in a wide range until the landing phase of the cycle becomes clearer in 2024.

The recent back-up in long bond yields has brought out bond bears predicting higher yields. Hedge fund manager Bill Ackman tweeted that he has initiated a short position on the 30-year Treasury bond. Erstwhile Bond King Bill Gross and former NY Fed President Bill Dudley both said that the 10-year Treasury bond should yield around 4.5%. Larry Summers argued that the 10-year Treasury yield should average 4.75% this decade.

Assuming inflation winds up averaging 2.5% to 3% for the remainder of this decade, it is reasonable to expect the 10-year Treasury yield to average around 4.5%. However, with the economy and market having gotten used to subdued long bond yields – the 10-

year Treasury yield averaged 2.4% in the last decade and 2.1% nearly 4 years into this decade – I doubt the financial system can withstand a 4.5% 10-year yield for long. To wit, the banking system has already gotten into trouble in March, and the volume of mortgage applications has fallen to 28-year lows – a collapse in housing transactions is not a sign of economic resiliency.

I believe elevated interest rates will wind up choking off U.S. economic growth in the not-too-distant future and lead to a rapid reversal in bond yields as the weakness becomes apparent. As such, I view the back-up in Treasury bond yields as an opportunity to lock in higher interest income and to position for potential capital gains over the next couple of years.

Precious metals have been relatively resilient in the face of rising real and nominal bond yields. If my recession expectation turns out to be correct, the Fed will pivot to easing in 2024, which may be a catalyst to send gold and silver prices materially higher.

In the final analysis, with the lagged impact of rate hikes still working through the economy, and the Fed intending on keeping rates higher for longer, I still have a conservative investment bias and would remain patient, selective, and defensive. These three words might have appeared outdated during the market's blow-off rallies in June and July. However, given the potential risks at home, such as the credit squeeze and stretched consumers, and abroad with Europe's stagflation and China's structural economic challenges, I believe caution is still warranted. In short, respect the lags.

PRINCIPAL AUTHOR

Jimmy C. Chang, CFA

Chief Investment Officer
Rockefeller Global Family Office

EDITOR

Joan Park

Research & Strategy Specialist
Rockefeller Global Family Office

PHOTOGRAPHY

Getty Images, Wikimedia

Visit **rockco.com/market-perspectives** or scan the QR code to learn more.

ROCKEFELLER
GLOBAL FAMILY OFFICE

45 ROCKEFELLER PLAZA FLOOR 5
NEW YORK, NY 1011

1 Index pricing information does not reflect dividend income, withholding taxes, commissions, or fees that would be incurred by an investor pursuing the index return.
2 Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.
DIN #1428079438-3817