An economic soft-landing? Yes, no, maybe...

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Keith: Welcome to The Empowered Investor. My name is Keith Matthews and I'm joined by my co-host, Marcelo Taboada. Marcelo, how are you today?

Marcelo: I'm doing great. I'm excited about the show. By the way, great job on the dividend investing podcast. That was a great episode.

Keith: Oh, thank you. Lawrence did an amazing job. Jackson did research, the team put it together and I think it went very well. We got good feedback from our listeners. So today we're going to talk about soft landing. We're going to describe what it is. There's a lot of information in the media now that the United States might actually be close to a soft landing, or it might occur. So, we figured we would have a show, an episode just on what that means exactly. Often in the past, we've done these shows that are timeless. This is obviously a very specific in-the-moment discussion.

Marcelo: Yeah. There's a lot of buzz around it right now, for sure. The markets agree too.

Keith: In particular, it's a soft landing, perhaps in the US economy. So, let's start the conversation here, Marcelo. What exactly is a soft landing?

Marcelo: So essentially, the word "soft landing" is an analogy from a plane, obviously. So, if we're thinking about the economy, you have an overheated economy. Maybe you have high inflation, just like we have now. Things are working out well. Unemployment is at a low level, so things are well, but you have high inflation. So, the central bank comes and says, "Look, we need to control inflation" because at the end of the day, they have an inflation mandate. So, it's the idea that they could raise rates to the point where inflation starts coming down and the unemployment levels stay stable. And you don't rock the boat, so to speak, on economic growth. So, you're essentially landing the plane softly, right? Instead of crashing it to the ground, which would be a bad thing. So, it's the idea that the Fed or the Bank of Canada can come in, raise rates, slow down the growth without killing the geese, so to speak.

Keith: This is an analogy that you're trying to get in there. I get it. That makes total sense. And why particularly are we doing this podcast right now? What's been going on in the United States that has us thinking about this?

Marcelo: You look at the markets in the last two years, I think the zeitgeist has been: how can the Fed, the Bank of Canada control the high inflation that we got after the COVID supply problem and then the war in Ukraine? So, I think what you've seen in the markets in the last two years is all the markets care about is inflation. Can the central bank control it? And that's reflected by how the market reacts to every announcement the Fed and the Bank of Canada make, and every minute they release on the conversation. So, they're not only focusing on the actual actions of the government, but this idea of moral suasion happening where they're also closely looking at what they're saying and the signals they're sending in the market. I think that's what has captured the imagination of the market. You saw the numbers in the U.S. came down significantly on the inflation level, GDP growth is still very high in the U.S., and unemployment hasn't really gone up a lot. So, the idea that they've achieved a soft landing is being bought by the market right now. And you've seen the numbers just in the first 22 days of November. It's capturing the imagination of the market.

Keith: Yeah. So here we are the third week of November in this recording. And Marcelo, you're alluding to the fact that in the United States, three weeks ago, CPI came in lower, and unemployment was still very reasonable, and the economy is moving forward. And people are saying, "Oh my goodness, maybe this soft landing might actually occur." Correct. What were people talking about a year ago?

Marcelo: We talk about experts, right? I think a lot of the predictions or the forecasts for the economy were that 100 percent we were going to have a recession and the recession never arrived.

Keith: So here we are having this conversation on economics and cycles and business cycles. The impact, of course, is people say, "How should we be managing portfolios?" And we've been fairly steady at this, which is essentially, we're not looking at these moments to find ways to bend and move portfolios to try to predict. We go through these cycles with very steady portfolios and rebalance throughout, but it is telling that we're doing the show and we're talking about these. I think part of it is it's good just to understand what is happening because it does have an impact in terms of returns that are popping up in people's portfolios. So in the last month, stock markets are up about seven or eight percent in the last three weeks because people are saying maybe this soft landing thing is going to happen.

Marcelo: And people ask, right? When they hear economists like Larry Summers and the big banks, like the Goldman Sachs of the world, the Merrill Lynch's of the world, saying that there's going to be a hundred percent chance of a recession in the next 12 months, I think people's first reaction, investors at large, first reaction is, "Should I do something? Should we move stuff in the portfolio?" And the answer is always no.

Keith: If you go back to, we'll fast forward into some of the data we had at the end of this show. But if you go back to September of last year, to September of 2022, the stock market had gone down during the months prior to that because they were pricing in a recession.

Marcelo: Yeah. It was anticipating it. Yeah.

Keith: It was feeling like it's coming for sure. And so general stock markets were down about what?

Marcelo: They were down like 16%.

Keith: So that's our global portfolio where we've got a third in Canada, third in the United States and a third in international and some emerging. So down 16%.

And imagine if you had sold, if you're an investor and you said, oh my God, a recession is coming. Sometimes recessions take stocks down 30%. So, I'm going to get out of stocks now in anticipation that it's going to go down even further. Where would that person be today? What's happened since then?

Marcelo: You'll be up 19 percent since then. So, if you look at from September 30th of 2022 till now, it's 19 percent up. So, you would have given up that return. And yeah, you could say, I could move to a cash product that pays four or 5 percent if you're lucky, right? But it's not 19 percent.

Keith: So that's what the markets have done in the last year and a bit. That's a very dramatic change. And that fits into our thesis all the time, which essentially is do not be moving portfolios around to try to anticipate any of these cycles because they're very difficult to predict.

Marcelo: Yeah. Look, I would love the fact that if we get a soft landing in Canada and the U.S., Canada seems to be far from that right now at the moment. You look at GDP numbers, they're not as positive as they are in the United States. But we may still get it. We don't know. Technically, we're not in a recession, right? But it's hard to predict. I remember going through my economics degree in university and all the models that the Fed follows, the Bank of Canada follows, they're based on the idea or the assumption that people are rational. And we know now from behavioral finance, behavioral economics, that people are not rational. Predicting the economy is hard. You have billions of people interacting every day. Now, there's herding mentality, there's a lot of things that could work when you have ideas that capture people's imaginations, but it is hard to predict because at the end of the day, the markets work because people have different opinions and just an economy is hard to predict.

Keith: 100 percent, 100 percent. So, listen, we've done a nice job defining what a soft landing is. What's a hard landing?

Marcelo: So, the hard landing is the opposite of that. You have high inflation, you have low unemployment, low economic growth.

Keith: I think it's high inflation, low unemployment, and high growth. Yes, which spurs on price appreciation.

Marcelo: Correct.

Keith: And then what?

Marcelo: The central bank says we're raising rates because we need to bring the inflation to the target, which is anywhere between one and 3 percent, 2 percent usually. And the economy crashes, you have high unemployment, negative growth, and people start losing jobs and it gets ugly, right? That's the hard landing.

Keith: Okay. So, we've got these two very different types of landings, if you will. Okay. So, Marcelo, you mentioned there's a slight difference between the United States and Canada right now. Can you articulate a little bit more about that?

Marcelo: Yeah. So, on the inflation front, we're similar numbers. So Canada, the latest numbers were 3.1 percent, then the U.S. was 3.2. So on the main inflation number, we're very similar.

Keith: And then of course, the Federal Reserve and the Bank of Canada's target is to get to two, two and a half percent.

Marcelo: Actually, the Bank of Canada has a hard inflation mandate. The U.S. has a dual mandate between inflation and the stability of financial markets. They don't say it, but I think the target, everybody knows the target is one to 3 percent. So we're getting there. The GDP growth in Canada, completely different picture. The U.S. is growing at 4.9 percent as of the third quarter. Canada came in flat, essentially, at 0 percent.

Keith: And Canada the quarter before was also zero.

Marcelo: 0.6, but yes.

Keith: Okay, so we almost have, in Canada, two quarters of flat GDP growth.

Marcelo: Correct.

Keith: Which isn't good for the economy, and it feels sluggish in Canada relative to the U.S.

Marcelo: And then unemployment, Canada is at 5.9, a bit higher, and the U.S. at 3.9. You look at the U.S., very different picture, right? You're growing nicely, you have low unemployment, and you're taming down inflation.

Keith: All right, Marcelo, can you give us a couple of examples of whether we've had soft landings in the past or not?

Marcelo: Yeah. So, I think we have to make a distinction, Keith, because we've had scenarios where the economy is hot, but we haven't had inflation. And that's a situation where the government may want to slow down growth, so we don't end up in a worse situation later on, where we have an overheated economy that causes problems. There are instances where we have just like now, high inflation and high economic growth where the government like fiscal policy, monetary policy has to come in and try to tame it down. So, I think we have to make the distinction. So when you look at the high inflation scenario, there has never been a case of a soft landing. So if we achieve it now, it would be a huge deal because we've never done that in history.

Keith: So that's a huge distinction that you're bringing up. And I guess you're referring to back in the seventies and eighties, the last time there was high inflation and there were high interest rates to cut the inflation, we had hard landings.

Marcelo: Yeah. So, people remember Paul Volcker. He raised interest rates to 19 percent and that caused a 16-month recession. I wouldn't call that a soft landing. I would call that a crash.

Keith: So, this is the part that's potentially different right now. If this can actually occur, that would be, I guess, the markets would celebrate and there'd be a lot of positive feelings around that concept.

Marcelo: Now, if you look at the other thing that I discussed, which is high economic growth, but not necessarily high inflation, there's been 11 Fed rate hiking cycles from 1965 to 2019. And for five instances, they've achieved a soft landing, which means being able to tame the growth without getting into a recession.

Keith: And there may not have been inflation. They were just taming the growth. And I recall the most famous one in my lifetime was Alan Greenspan curbing high growth in the mid-nineties. And it was a soft landing and boy, was he celebrated. He was like a rock star and he was a central banker and all because they felt that his judgment around when to increase rates and then decrease rates were such that you got a soft landing. So soft landings are celebrated.

Marcelo: It's speculative when I'm about to ask you, but do you think that had something to do with the dot-com crash? Had he been hard on rate hikes, and had we had a hard landing, could we have avoided it?

Keith: Yeah, it's an interesting point because he was celebrated in the late nineties. And then by 2004, 2005, 2006, people look back in time and say maybe he wasn't such a superstar.

Marcelo: I think going back, a lot of people blame him for leading up to the 2008 crisis, where rates were very low at that time. It pushed speculative products like mortgage-backed securities and all these things. I think you'll find that in the literature that a lot of people view him as one of the culprits.

Keith: Yeah, it's interesting you mention that because 2008-2009 was a period where you can have different countries experiencing different things. So, the Canadian recession was nowhere near as hard as the U.S. recession.

Marcelo: In your experience, when was the last real recession that Canada had?

Keith: 2008 would be one of them. That was a global crisis, for sure. Prior to that, you'd be going to 1991. 1991, unemployment, 11%, 11.8%, very tough. But that would be the last time I really recall. And I was graduating with my post-grad and there were no jobs. 11.8 percent unemployment, no jobs.

Marcelo: No one in my generation has ever experienced more than 10 percent unemployment.

Keith: No, no one in your generation's experienced more than seven or 8 percent unemployment. And that might've been just around the 2008 credit crisis. But where I was going with the comment was that for the United States, it was a very difficult time. Fast forward to 2023, it looks like the United States economy is doing reasonably well. And the Canadian economy is actually having a hard time. So, it goes to show you how it doesn't all work in sync, which is one of the reasons we continue to talk about having globally diversified portfolios and making sure that your portfolio has exposure to all these different regions. So, Marcelo, today's show was not a long show. It was a quick show to get in and talk about something that's very topical. Thank you so much for your input and checking out history and making sure that our listeners get up to speed on soft landing, hard landing. What's your takeaway?

Marcelo: Diversification, we always talk about that, but it's investment philosophy. This is what's going to carry you through. Same like COVID where we had big drawdowns and people wanted to cash out and they were panicking, not necessarily our clients, but people at large. The investment philosophy carries you through because that's what sets up the rules. It sets up your North Star, that's where you want to be. These things will come and go, ups and downs, they will come and go. But at the end of the day, if you have a plan that gives you stability and the reassurance that you're well taken care of, and you're going somewhere for the long term.

Keith: That's a fabulous point. The only thing I would add to that is it is almost impossible to predict. So here we've gone through a show where we're talking about predictions where people were a year ago, predicting doom and gloom, here we are, maybe the market's feeling a little different. The reality of it is do not be trying to predict markets and then adding that into your portfolio adjustments. It's just impossible to do. So, choose your asset allocation. Go through it, rebalance accordingly. So, if stocks go down, sell your bonds, buy more stocks during those dips, and it's all part of the course. So, thank you so much, Marcelo, for a great show on soft landing and to all the listeners, have a great weekend. We'll see you next week.

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