ClearBridge Investments

AOR Update: The Dominoes Are Falling

1 May 2023

Key Takeaways

- The ClearBridge Recession Risk Dashboard saw three negative signal changes this month in Truck Shipments, Jobless Claims and Job Sentiment, pushing it deeper into red or recessionary territory and suggesting a significant downshift in the economy.
- As leading indicators of labor market health, a worsening of Job Sentiment and Jobless Claims suggests net job losses and a rising unemployment rate may emerge later in 2023. This, in turn, is likely to crimp consumption which is the backbone of U.S. economic growth.
- A sharp decline in truck freight volumes provides further evidence of an economic slowdown on top of supply chain normalisation, which appears to have largely played out.

Stock Market Downplaying Macro Weakness, For Now

A better than feared start to earnings season coupled with lingering recession fears is causing a tug of war between the bulls and the bears. Consequently, U.S. equities were remarkably steady last month, with the S&P 500 Index trading in a narrow 2.5% range the entire month and closing up just 1.6%. Despite the rangebound market, April economic data was consistently weak, as evidenced by the US Citi Economic Surprise Index which declined from 57 to 22 during the month. Given this deterioration, it is unsurprising that the ClearBridge Recession Risk Dashboard saw three negative signal changes this month, with Truck Shipments and Jobless Claims worsening from green to yellow, and Job Sentiment worsening from yellow to red.

Exhibit 1: ClearBridge Recession Risk Dashboard

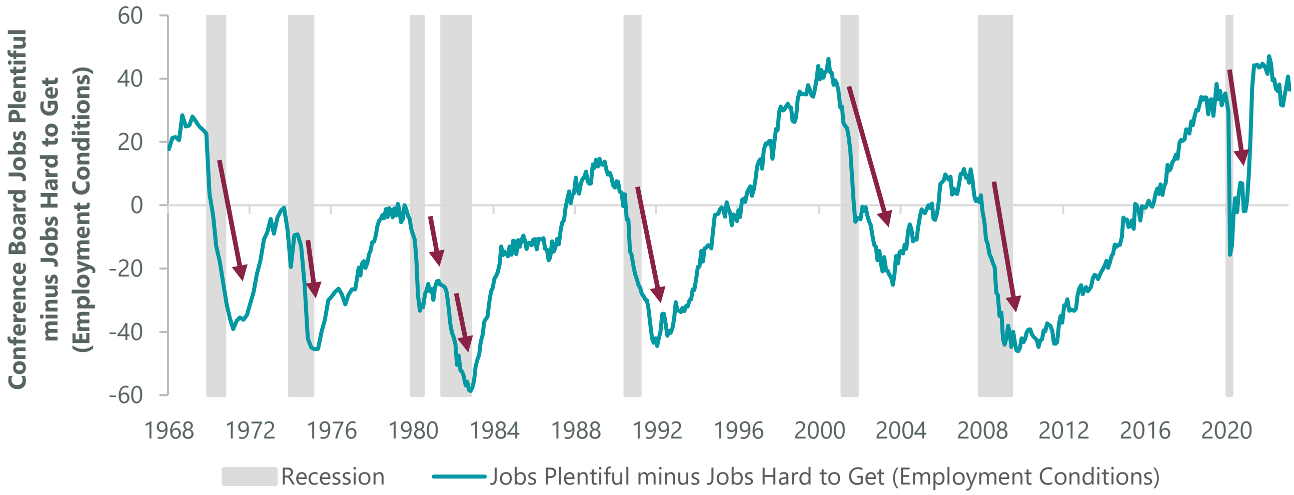
		Current	Deepening Red Signal		
		Apr. 30, 2023	Mar. 31, 2023	Dec. 31, 2022	Sept. 30, 2022
Consumer	Housing Permits	✖	✖	●	●
	Job Sentiment	✖	●	●	⬆
	Jobless Claims	●	⬆	⬆	⬆
	Retail Sales	✖	✖	✖	✖
	Wage Growth	✖	✖	✖	✖
Business Activity	Commodities	✖	✖	✖	✖
	ISM New Orders	✖	✖	✖	✖
	Profit Margins	✖	✖	✖	●
	Truck Shipments	●	⬆	⬆	⬆
Financial	Credit Spreads	✖	✖	✖	✖
	Money Supply	✖	✖	✖	✖
	Yield Curve	✖	✖	✖	●
	Overall Signal	✖	✖	✖	✖

⬆ Expansion ● Caution ✖ Recession

Source: ClearBridge Investments.

Two of these indicators – Job Sentiment and Jobless Claims – are leading indicators for the health of the labor market which has remained remarkably resilient. If history is a guide, net job losses and a rising unemployment rate should emerge later in 2023. Focusing first on Job Sentiment, individuals are reporting a more challenging environment for finding work. The share of individuals responding that jobs are plentiful in the Conference Board Consumer Confidence Index® has fallen from 56.7% just over a year ago to 48.4% currently, while those responding that jobs are hard to get has risen but remains low. The difference between the two tends to presage slowdowns in consumption – individuals hold off on marginal purchases given less confidence in their ability to find work if needed – and has rolled over in recent months.

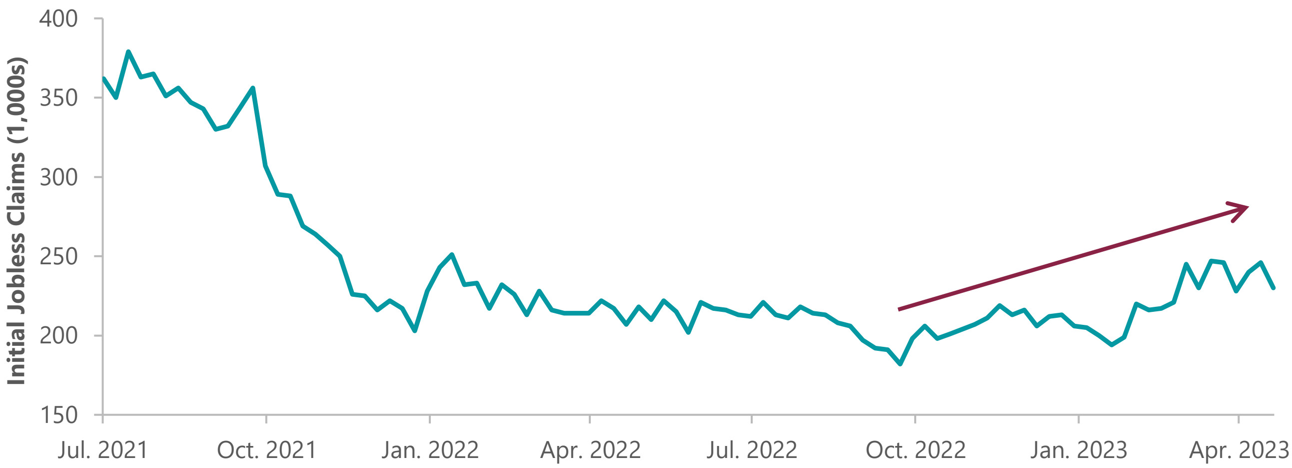
Exhibit 2: Job Sentiment Showing Fatigue



Data as of 31 March 2023, latest available as of 30 April 2023. Source: FactSet, Conference Board, National Bureau of Economic Research.

The second weakening labor market indicator is Jobless Claims, which has been drifting higher in 2023. In early April, the Bureau of Labor Statistics released updated seasonal adjustment factors for jobless claims that impacted the last several years. One impact of these changes was that jobless claims were stronger (lower) during the summer of 2022, but weaker (higher) in early 2023 than previously believed. Jobless claims have been choppy over the past two months – as is their nature and why we (and many) focus on their 4-week moving average – but have clearly risen into a higher range relative to what was seen in the second half of 2022. This step-up in claims is unsurprising as companies face margin pressure from reduced pricing power, coupled with stickier cost structures.

Exhibit 3: Jobless Claims a Canary in the Coalmine

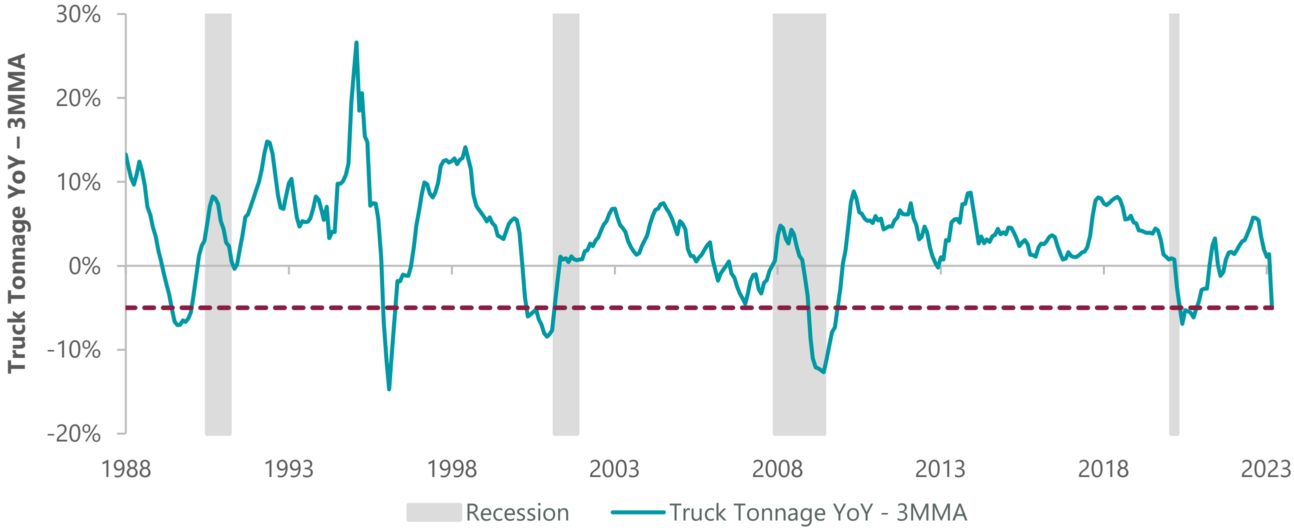


Data as of 21 April 2023. Source: Bloomberg, BLS.

The increase in the number of individuals filing for first-time unemployment benefits bodes poorly for future consumption, particularly given that high earners make up a disproportionately large share of the rise in those filing for benefits today, which is uncommon. This suggests that generous severance packages granted at termination may be running out. It similarly bodes poorly for future economic growth if these workers are unable to find new employment, a prospect that appears more challenging given deteriorating Job Sentiment.

The labor market is not the only area of the economy showing strain. Seventy-two percent of total freight moved each year goes on trucks, and the American Trucking Association's Truck Tonnage Index saw one of its worst monthly declines on record in April going back to the early 1970s. Supply chain pressures appear to have normalised at this point with the New York Fed's Global Supply Chain Pressure Index dropping to -1 standard deviation from +3 just over a year ago. This, in turn, is contributing to the decline in freight volumes as bottlenecks have eased, inventories have been restocked and less "stuff" is moving through the economy overall, portending a further slowdown in activity.

Exhibit 4: Truck Tonnage Hits the Brakes



Data as of 31 March 2023. Source: ATA, NBER, and Bloomberg.

Taken together, these three dashboard signal changes support the notion that the U.S. economy experienced a substantial downshift in economic activity in March and April. The dashboard now has 10 red and two yellow underlying signals, along with an overall deep red or recessionary reading. Our base-case view for the last 10 months has been that a recession was the most likely outcome, although the timeframe was always uncertain and never imminent. While we still do not believe a recession has yet started, we are less confident than we were just two months ago given the dominoes falling (dashboard signal changes) and think the onset of a recession is likely within the next few quarters. Given this assessment, we continue to believe tilts toward defensive and high-quality equities will be rewarded in the coming months.

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