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PARTNERS

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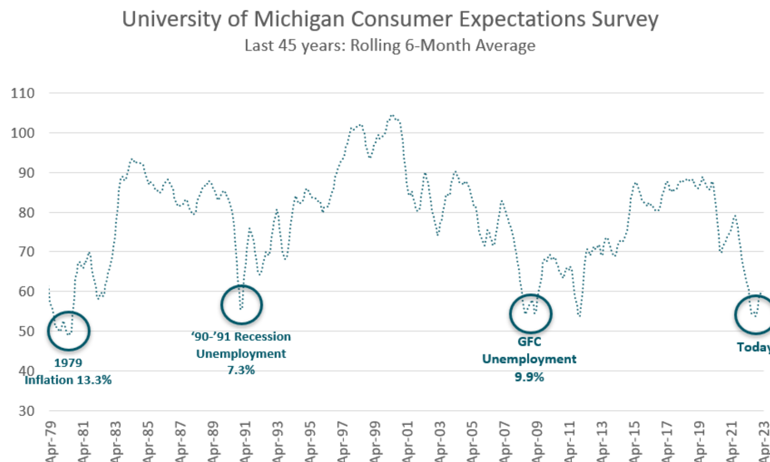
If headlines in the financial papers or websites you read are scaring you, they're supposed to. Keep scrolling.

Every financial news headline writer in America, whether they work for the CNBC website, *The New York Times,* or the *Financial Times*, knows that the best way to catch someone's attention is to scare them. Consciously or subconsciously, our brains are constantly on alert for what might go wrong, and any headline that taps into that reptilian instinct automatically gets prioritized.

I've been thinking about this concept recently, as the press is having a field day trying to scare people. It certainly is possible to find reasons. Janet Yellen speaks of the calamity that would ensue should the U.S. default on its debt. Financial media outlets are literally out-shouting each other on how horrific the fallout would be. Almost unimaginable. If you wanted to get scared by this market, the political brinksmanship playing out in Washington D.C. right now would certainly give you plenty of reasons.

If you wanted to worry about this market because of the damage that rising interest rates have done to U.S. consumers and businesses over the past year or so, you could certainly make a case. With selective focus, the latest data from the Fed tells us that bank loan charge-off rates (these are loans that are essentially "written off" as losses) are up a whopping 73% from last July. That headline, alone, could tie you up in knots.

If you wanted to get scared by this market because the *mood* of consumers is sitting at some of the lowest levels we've seen in years, in line with other dark periods of U.S. history - think double-digit inflation of 1979, the deep recession of 1990-91, or the Great Financial Crisis of 2008-09 - you'd have a



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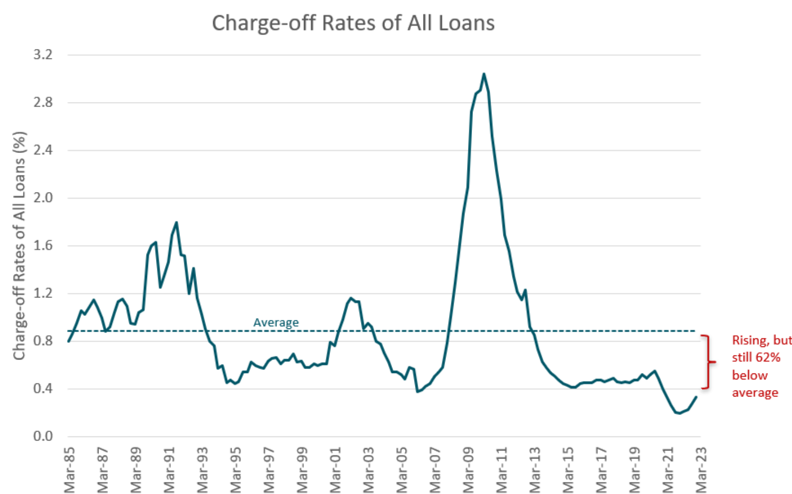
case to be made. See below the most recent reading from the University of Michigan consumer survey data. Given that the consumer drives over two-thirds of our country's GDP, this foul mood could certainly spell trouble.

But should long-horizon investors take a look at these headlines with a critical eye? We certainly think so. Yes, some bad things could get worse. While the inflation numbers are improving with almost every reading, the stickiness of certain key economic components - wages or home prices – could make the Fed's job a bit trickier. There's legitimate concern surrounding the continued fallout from the regional bank crisis from early March and its impact on credit availability. And the war in the Ukraine remains a constant worry. Make no mistake. We at Ballentine Partners are not naive about things that might still get off-track. But we must also acknowledge that much of the worry may be overblown. And that it is possible that the markets could shake off some of the doom and gloom that seems to pervade current thinking.

So while we absolutely recognize that a U.S. default would be catastrophically bad, we must also recognize that the odds of that actually happening are infinitesimally small. We wrote about this last week, and we re-iterate it here, as well. While both parties seem entrenched in their positions and hope for a win, the first few hours of a dramatic market sell-off would bring those same parties back to the negotiating table faster than you can say "2011".

And yes, it is true that rising interest rates have hurt both consumers and companies, a seemingly bad omen. But let's put today's environment into historical perspective. If we just step back a little, we see that the reality is much more benign. See below, which tracks national loan charge-off rates over the last four decades. The lower the number, the better. It is true: the number has ticked up from last summer, but it is nowhere near as catastrophic a reading as some fear-mongering headlines would have you believe. Write-offs are still near their 40-year lows, so even if things worsen, that does not make them bad in any absolute sense.

While worse than a year ago, bank loan stress still hovers at 40-year lows



Source: Federal Reserve

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U.S. household balance sheets are in very good shape today, as they largely took advantage of low rates over the past 13 years – refinancing their largest debt obligation, their mortgage, at bargain rates. Eighty-six percent of American households have a mortgage rate *under* 5%. Stimulus checks during the COVID era also helped shore up their finances. They are experiencing the lowest unemployment rate in 50 years, and their wages are rising in a stickier way, while the price of milk or eggs (wholesale egg prices are down -83% from six months ago) have turned notably downwards.

Finally, recent data from The Conference Board - a leading economic think tank - seems full of reasons to worry, as their Leading Economic Indicator is forecasting a 99% probability of a recession. On its face, that sounds like a scary number. But if you dig just a tiny bit deeper on their report, almost 90% of CEOs around the country believe that if a recession arrives, it will be of the "short and shallow" type. That does not make for scary headlines, so it gets buried. Those CEOs know something that the headline writer conveniently forgets to mention. Corporations also refinanced much of their debt during the last 13 years or so, locking in cheap money for many many years. This protects them from the recent rise in rates; yes those companies dependent upon short-term financing will feel the pinch, but for the vast majority of publicly-traded companies and their debt, they are shielded from the effects of rising rates. See the chart below.

Companies took advantage of low rates by extending debt maturity

Source: Oxford Economics, Ballentine Partners

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As we said, we're not blind to the risks that a recession might be approaching, so there are things we are doing and preparing for. We recently have brought down some credit risk in our fixed income portfolios, upping the quality of the whole, as current spreads are not really compensating us for the rising potentiality of a recession. We've also developed a number of steps for our clients to take before and in response to any volatility arising from the ongoing debt-ceiling saga. But overall, we're trying to keep our eyes on the longer horizon and the bigger picture. There will *always* be scary headlines. Our advice is to keep turning the page.

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Pete Chiappinelli, CFA, CAIA, Chief Investment Officer

Pete is Chief Investment Officer at the firm. He is focused primarily on Asset Allocation in setting strategic direction for client portfolios. Pete has 30 years of experience in research, investment strategy, and thought leadership regarding the management of multi-asset class portfolios, inclusive of equities, fixed income, and alternatives. His work has been featured in leading financial publications such as *The Wall Street Journal*, *The New York Times*, *Barron's*, and others in Canada, Europe, and Asia. His market commentaries have been featured at major industry conferences, in TV documentaries on capital markets history, and on social media outlets. Prior to joining Ballentine Partners in 2022, he was a Senior Portfolio Strategist on GMO's Asset Allocation team. Prior to that, he was an Institutional Portfolio Manager at a specialized unit within Fidelity Investments and was the Managing Director of Institutional Investment Strategy & Research at Putnam Investments. He is a graduate of Carleton College and holds his MBA from The Wharton School at the University of Pennsylvania. Pete holds the Chartered Financial Analyst (CFA) designation, is a member of the CFA Institute and CFA Society Boston, and he holds the CFA Institute Certificate in ESG Investing. He also holds the Chartered Alternative Investment Analyst (CAIA) designation and was the founding President of CAIA Boston. Pete lives in Hingham, MA with his wife, Cheryl, and enjoys travel, cooking (definitely not a "foodie" but a "foodie wannabe"), sourdough breadmaking, and conjuring up ways to embarrass his three children.

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