



Byron Wien: Recession Fears Are Overblown

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by Robert Huebscher

When the yield curve inverted earlier this year, Blackstone's economic model predicted a recession in the next 20 months. But Byron Wien cautioned against relying on that forecast.

Wien is the vice chairman for private wealth solutions at Blackstone. He spoke to investors yesterday via webcast, along with Joe Zidle, who is Blackstone's chief investment strategist. The slides from their presentation are available [here](#). The two spoke in a debate-style format, with Zidle presenting arguments aligned with the conventional wisdom and Wien taking a contrarian position.

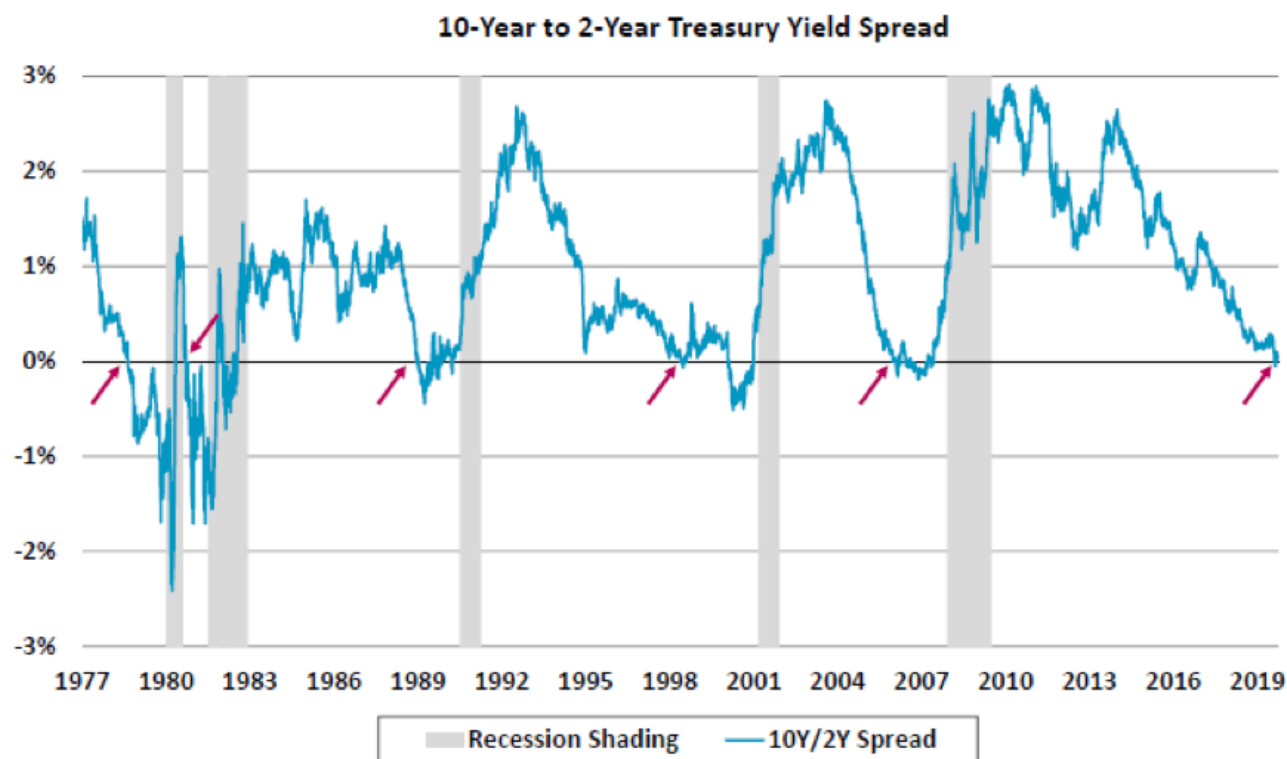
They noted that the predictive value of the yield curve is that it inverts ahead of a recession. At those inversion points, generally economic conditions have been good, as they are now, or even improving.

The following chart, from their presentation, shows the inversion points (with red arrows) approximately 20 months ahead of recessions (with grey bars):



Most Reliable Recession Signal Is Flashing

10Y/2Y spread inverted before each of the past five recessions



Source: Federal Reserve, as of 9/30/19.

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Wien said that the yield curve, using Blackstone's preferred measure of the two-year to 10-year spread, has only "flirted" with inversion. Usually an inversion is caused by the Fed raising short-term rates. But this time it has been because long rates dropped below short rates, which Wien attributed to "too much liquidity" in the bond market.

"That argues that maybe we are not going to have a recession as soon as you think," Wien said.

Wien and Zidle reviewed a series of what they called "primary" and "secondary" recession indicators, and compared their readings to prior to the bursting of the tech and housing bubbles. The yield curve is the most predictive, according to Zidle. But he noted that average hourly earnings, another primary indicator, typically crosses above 4%, which normally leads to the Fed hiking and a recession. It is currently at 3.5% and growing "slowly," Zidle said.

The leading economic indicators (LEIs), the third primary indicator, are signaling that the "countdown has begun," Zidle said. The LEIs have "rolled over," meaning that growth has slowed. But they have not turned negative, which has been a pre-condition of all prior post-war recessions.

They discussed how the Fed and presidential politics would affect the recession outlook.

In 1990, 2000 and 2008, the real Fed funds rate was strongly positive, Wien said, with values of 900, 400-500 and 250 basis points, respectively. There were events – the bursting of bubbles in Japan, technology and housing – that triggered recessions. With the real Fed funds rate barely positive and no bubble about to burst, conditions today are very different.

In 2007, oil prices surged and inflation moved above 4%, Wien said. “Those conditions not in place now that makes me think a recession will be later than we expect.”

Moreover, 2020 is an election year and “Trump does not want to run during a recession,” Wien said.

Without a recession the chances of Trump’s reelection are “perfect,” Wien said. “Trump will do everything in his power to make sure the economy stays at full employment and avoids a recession.”

Monetary policy, developments abroad and predictions for stocks and bonds

Wien expects one more 25 basis point cut, after which the Fed will stop cutting rates. “Rates are low enough,” he said. “If you want money, you can borrow effectively.” Low rates just move the stock market and don’t help the real economy, according to Wien.

Looking outside the U.S., Wien said that Brexit has knocked several points off U.K. growth. The October 31 deadline will be postponed, he predicted, and Britain cannot leave the EU without a deal. The U.K. equity market may be attractive, according to Zidle, to long-term allocators because it will be much better in two or three years than people expect. This is similar to the fears over Y2K, when investors were projecting the worst possible outcomes.

“The British pound is very attractive,” Wien said, and the probabilities of it rising are favorable.

China will pass the U.S. in real GDP in the 2030s, Wien said, and trade with it is very important. “Trump needs a deal politically and China needs one economically,” he said. “China will not give on intellectual property, and Trump won’t compromise either.” As a result, he predicted that China won’t do a major trade deal until after the 2020 election.

Get ready for lower returns in the decade of the 2020s, Wien said. Don’t expect the double-digit returns of the last couple decades, he said, and called for mid or low single-digit returns for stocks, which he said would still be “better than bonds.”

With U.S. equities at a P/E of 18, based on historical data, the next decade will have lower returns, according to Wien. But he said the S&P 500 should be well above 3,000 based on earnings and interest rates; it closed at 2,938 on the day he spoke. “At 18 times earnings it is not as excessively priced as it was in 2000,” Wien said.

Turning to the bond market, Wien said that in 2000, the national debt was \$6 trillion with a servicing

cost of 6%, and debt service cost \$360 billion. Today the debt is \$22 trillion with a servicing cost of a little more than 2%, so debt servicing costs \$450 trillion.

“You can never have debt get to this size without interest rates reflected in some way,” Wien said. “It is an economic blessing that we can’t expect to continue.”

The low in the 10-year yield has been reached and rates are heading higher, Wien said.

Everyone wants to buy our paper, Wien said, so we can “endure for a period of time.” The big buyers of our debt, aside from Social Security, are China and Japan. They are put off by our trade policies and will buy fewer bonds, he said.

The national debt will be burden, according to Wien, but not for a few years.

Zidle asked if the U.S. could already be living in a modern monetary theory (MMT) world, given the increases in the deficit coupled with low rates. “I am not a believer in MMT,” Wien said. “At some point, the growth in debt will have a negative impact on interest rates.”

“I own no Treasury bonds in my asset allocation,” Wien said.