



2023 Economic and Investment Update

Are We Heading Toward a Recession?

Cleveland, OH

October 12, 2023





Agenda

welcome

Shawn Hufstedler – President, Ohio GFOA
9:00 am

economic and
investment update

Tim McDonough – KeyBank
9:05 am

questions

All
9:50 am



Agenda

- I. Current State of the US Economy
- II. Federal Reserve Monetary Policy
- III. Recessions: What Should We Be Watching?
- IV. Municipal Bond Market Update



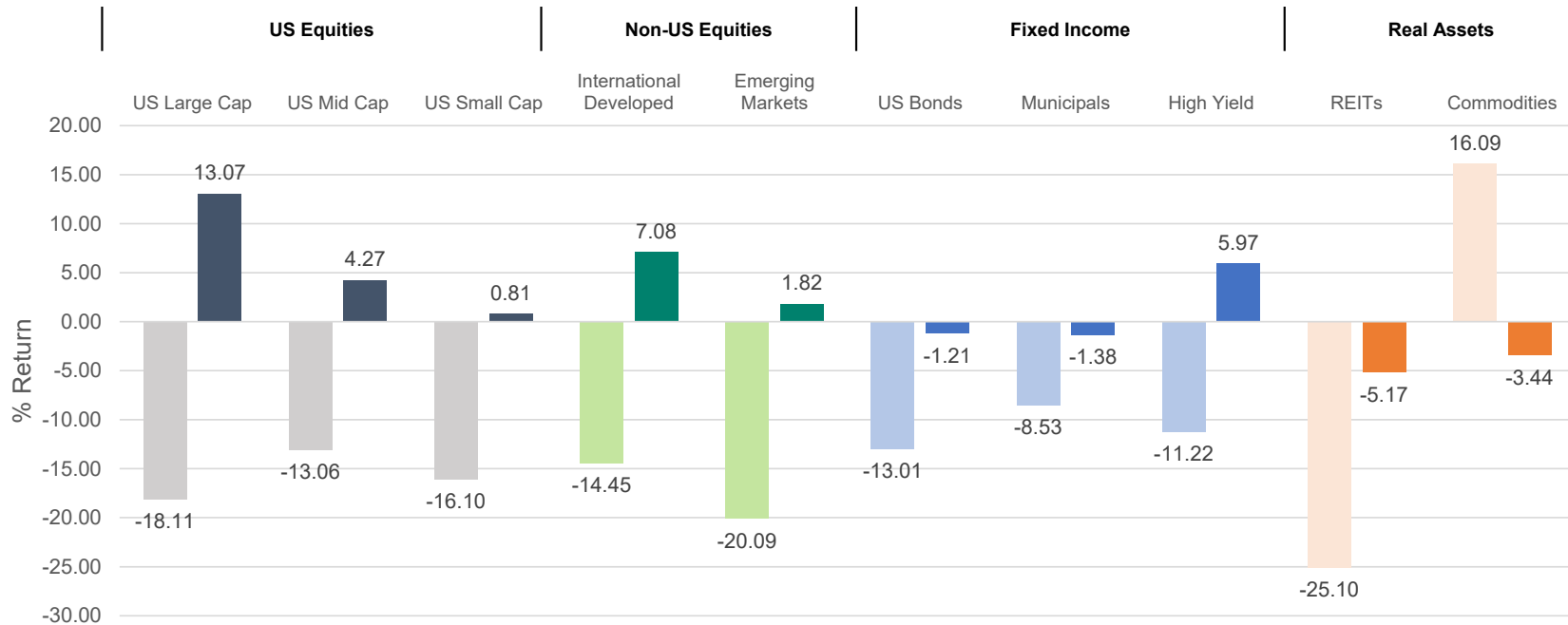
Current State of the US Economy

How did we get here?



Financial markets are rebounding this year...

YTD through September 30, 2023



Light Color: 2022 Dark Color: YTD 2023

Indices used for:

Past performance is no guarantee for future results

US Equities: US Large Cap - S&P 500 TR USD; US Mid Cap - S&P MidCap 400 TR USD; US Small Cap - S&P SmallCap 600 TR USD

Non-US Equities: International Developed - MSCI EAFE NR USD; Emerging Markets - MSCI EM NR USD

Fixed Income: US Bonds - Bloomberg US Agg Bond TR USD; Municipals - Bloomberg Municipal TR USD; High Yield - ICE BofA US High Yield TR USD

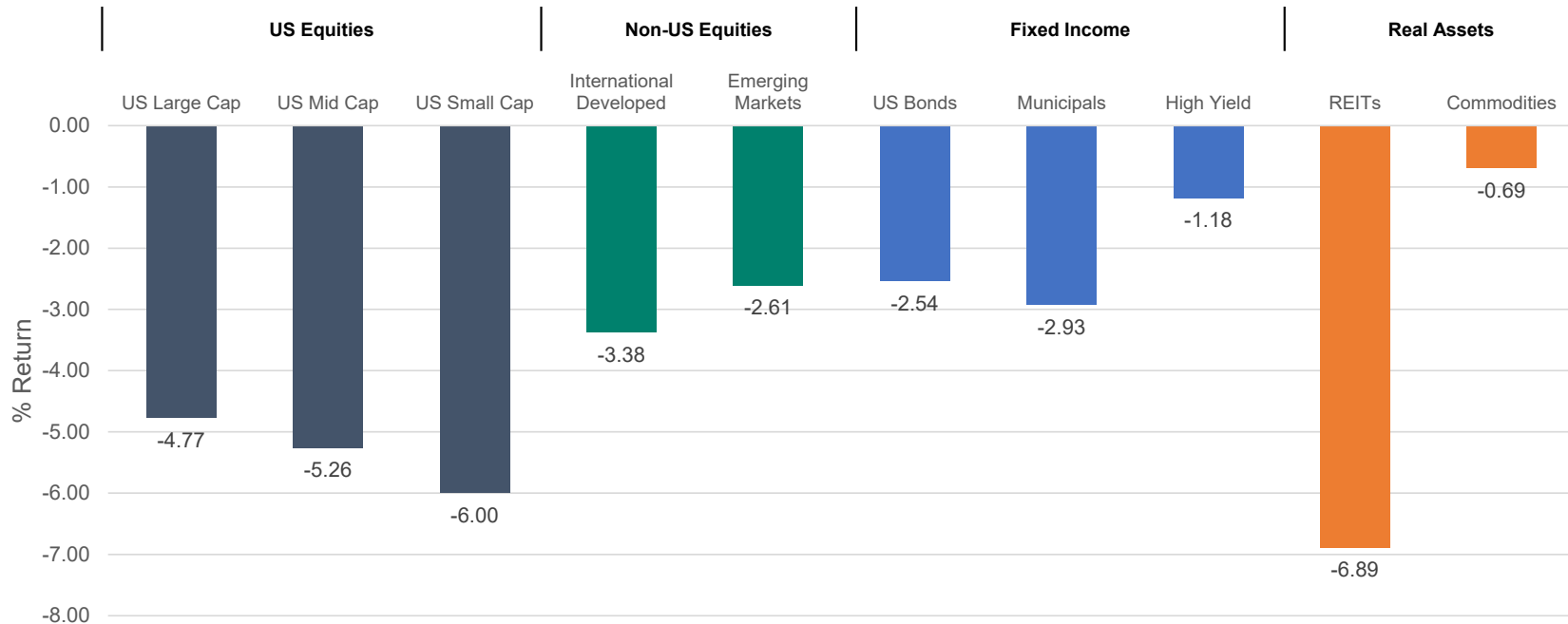
Real Assets: REITs - FTSE Nareit All REITs TR USD; Commodities - Bloomberg Commodity TR USD

Source(s): Key Wealth Management, Morningstar Direct



...after a tough September

MTD through September 30, 2023



Dark Color: MTD 2023

Indices used for:

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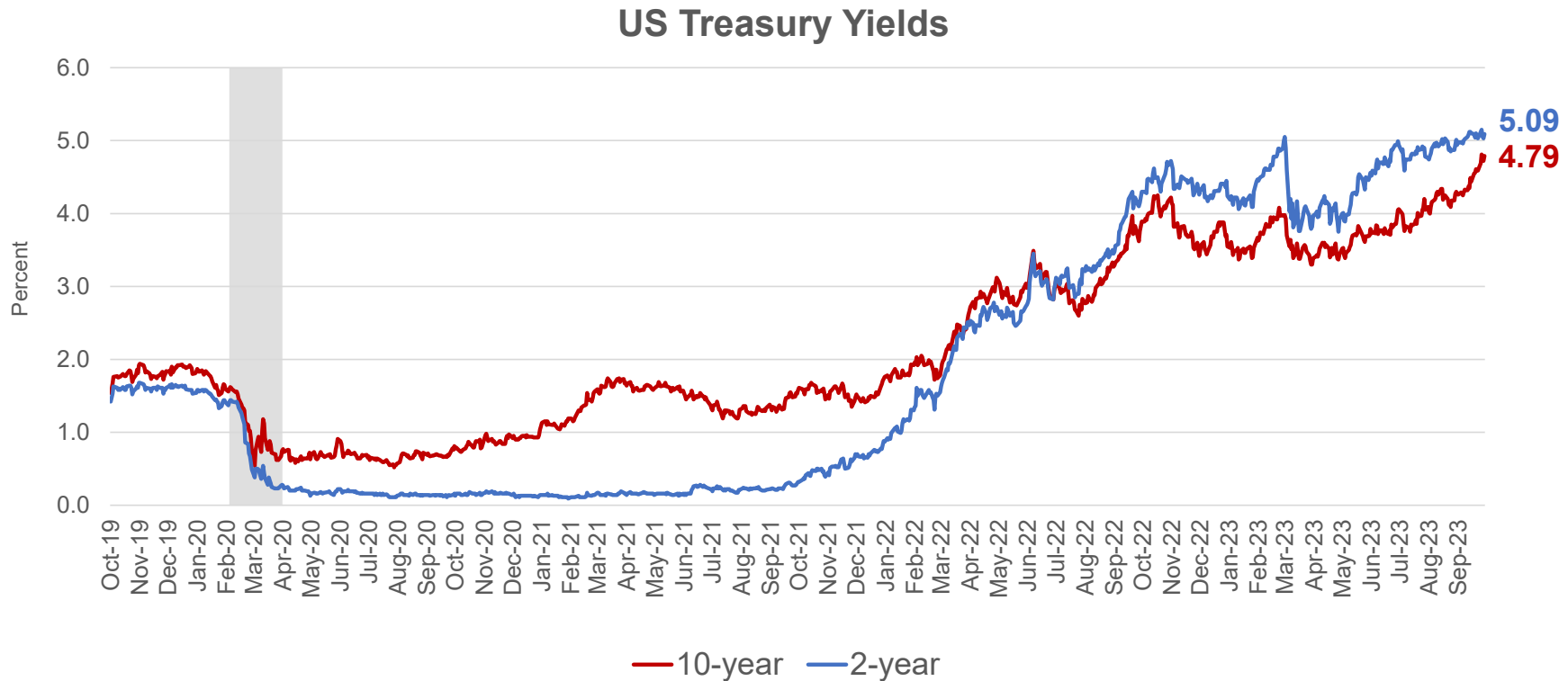
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Real Assets: REITs - FTSE Nareit All REITs TR USD; Commodities - Bloomberg Commodity TR USD

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Interest rates have surged higher



Market Yield on U.S. Treasury Securities at Constant Maturity, Quoted on an Investment Basis, Daily as of October 6, 2023. Shaded areas indicate U.S. recessions.



Source(s): Board of Governors of the Federal Reserve, Federal Reserve Bank of St. Louis, Key Wealth Management

Interest rates have surged higher

30-Year Fixed Rate Mortgage Average in US

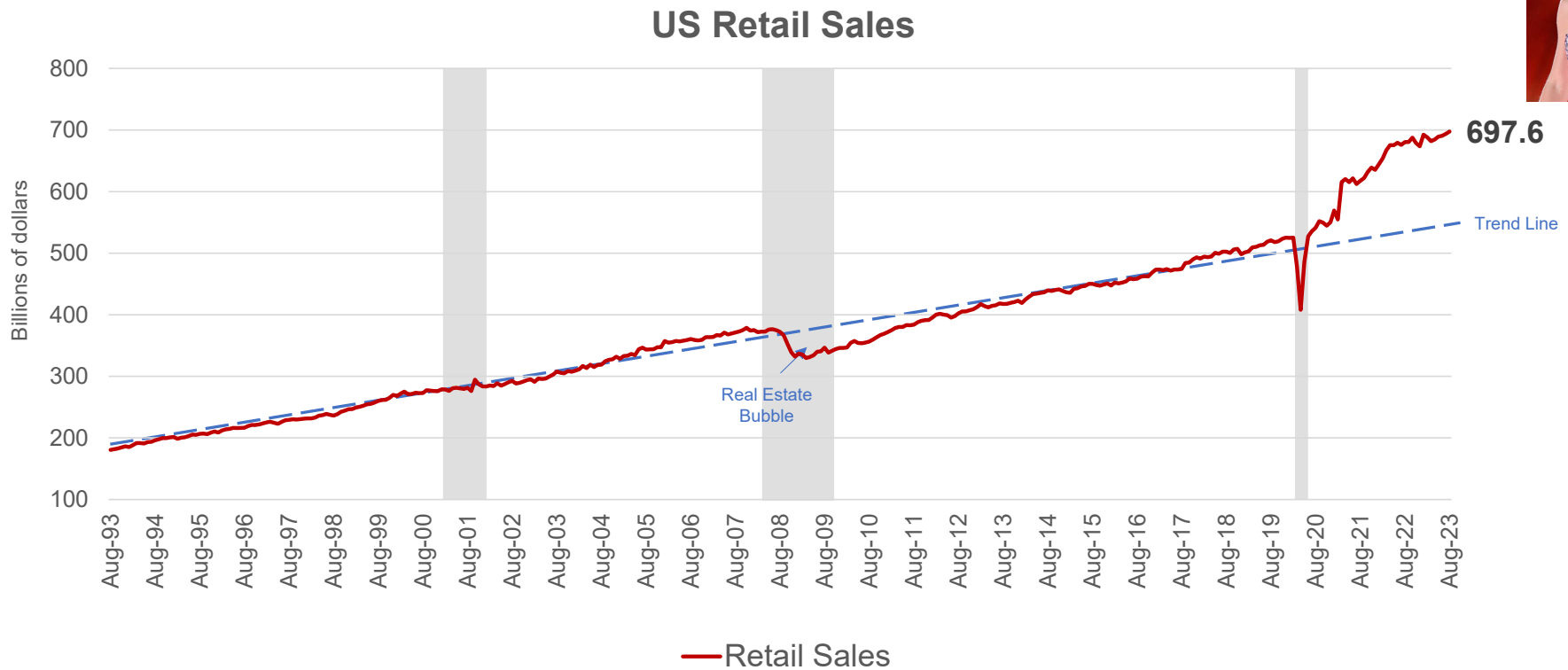


Freddie Mac, 30-Year Fixed Rate Mortgage Average in the United States Weekly, Ending Thursday as of October 5, 2023.



Source(s): Board of Governors of the Federal Reserve, Federal Reserve Bank of St. Louis, Key Wealth Management

How did we get here? A post-pandemic demand boom

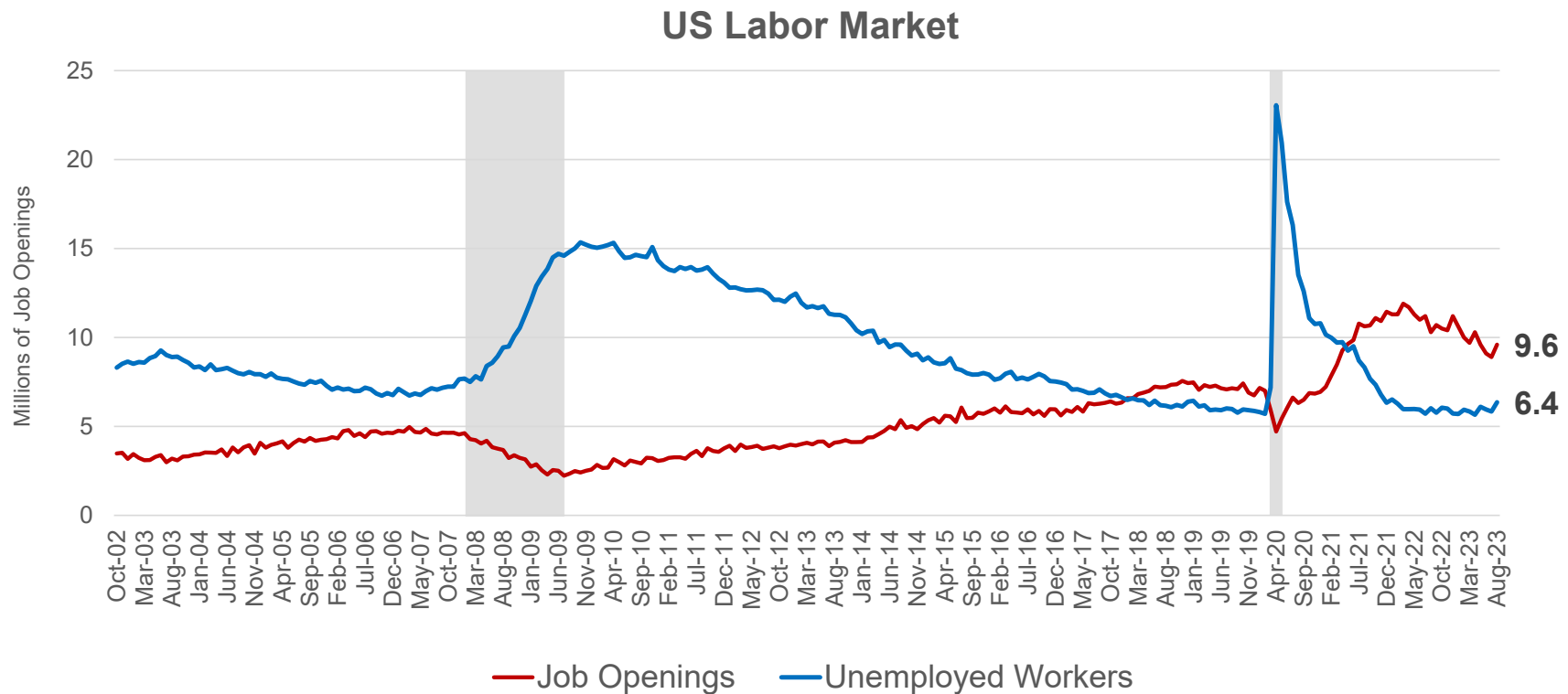


Advance Retail Sales (nominal) – Retail Trade and Food Services; seasonally-adjusted. As of August 2023. Shaded areas indicate U.S. recessions.



Source(s): U.S. Census Bureau, Federal Reserve Bank of St. Louis, Key Wealth Management

How did we get here? A robust labor market



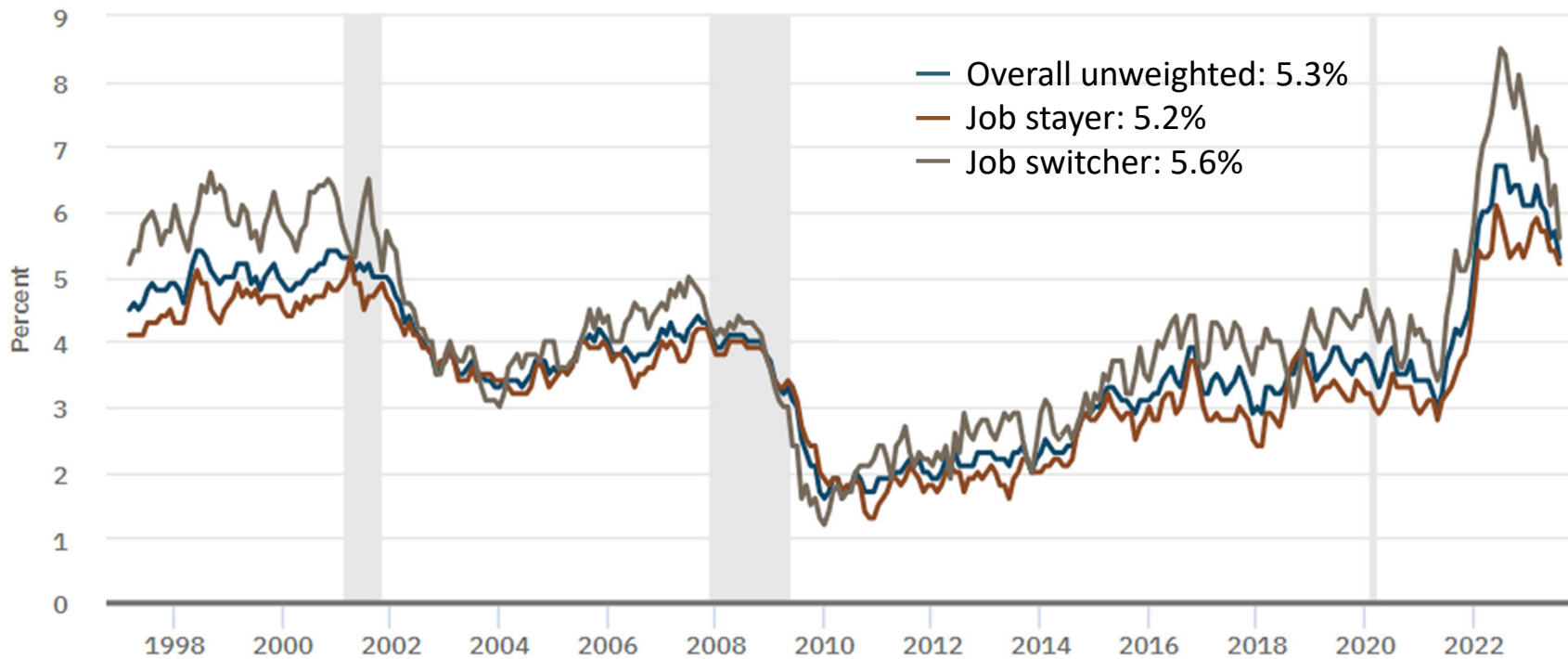
Job Openings: Total Nonfarm, Monthly, Seasonally Adjusted. As of August 2023. Shaded areas indicate U.S. recessions.



Source(s): U.S. Census Bureau, Federal Reserve Bank of St. Louis, Key Wealth Management

Wage growth – still high but decelerating

Wage Growth Tracker – August 2023

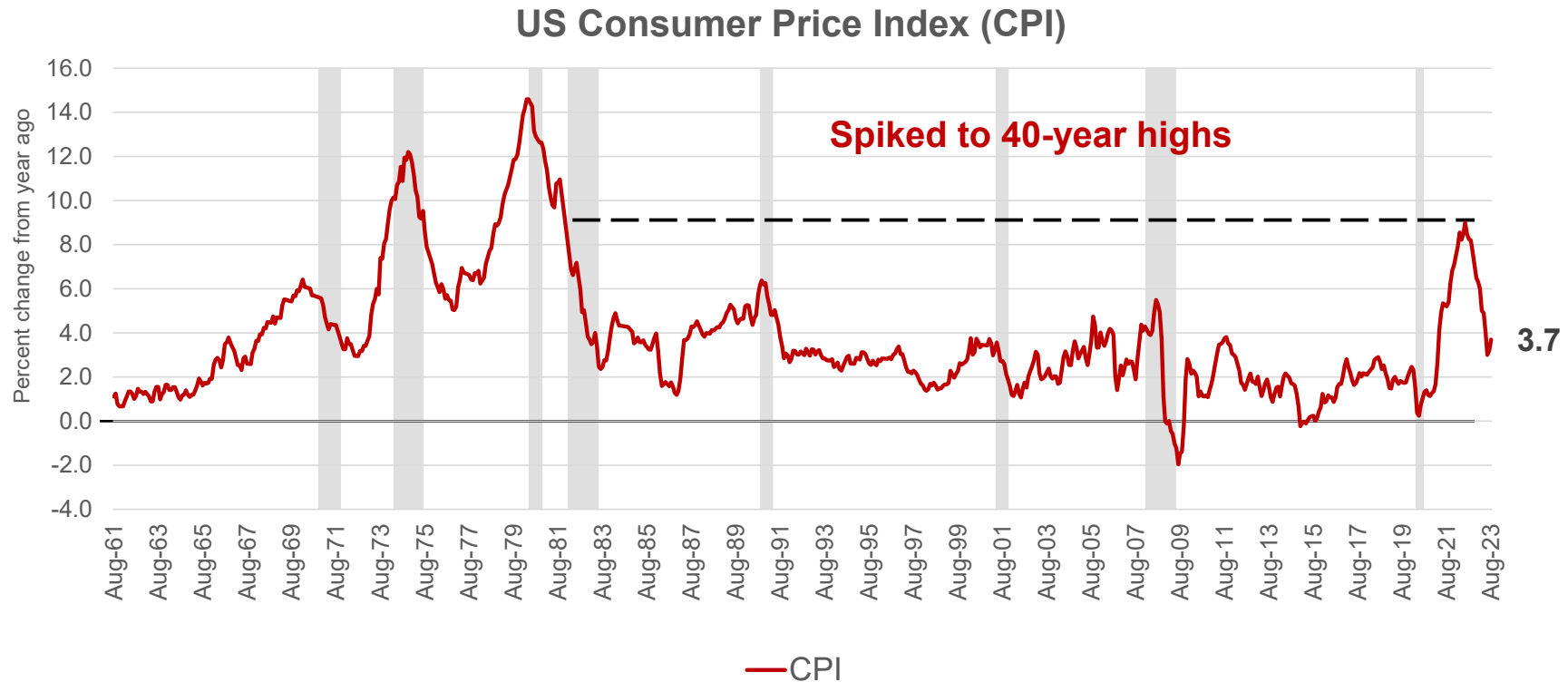


Three-month moving average of median wage growth, hourly data. As of August 2023. Shaded areas indicate U.S. recessions.

Source(s): Federal Reserve Bank of Atlanta, Current Population Survey, Bureau of Labor Statistics, Author's Calculations



Put these together and what do you get? Inflation



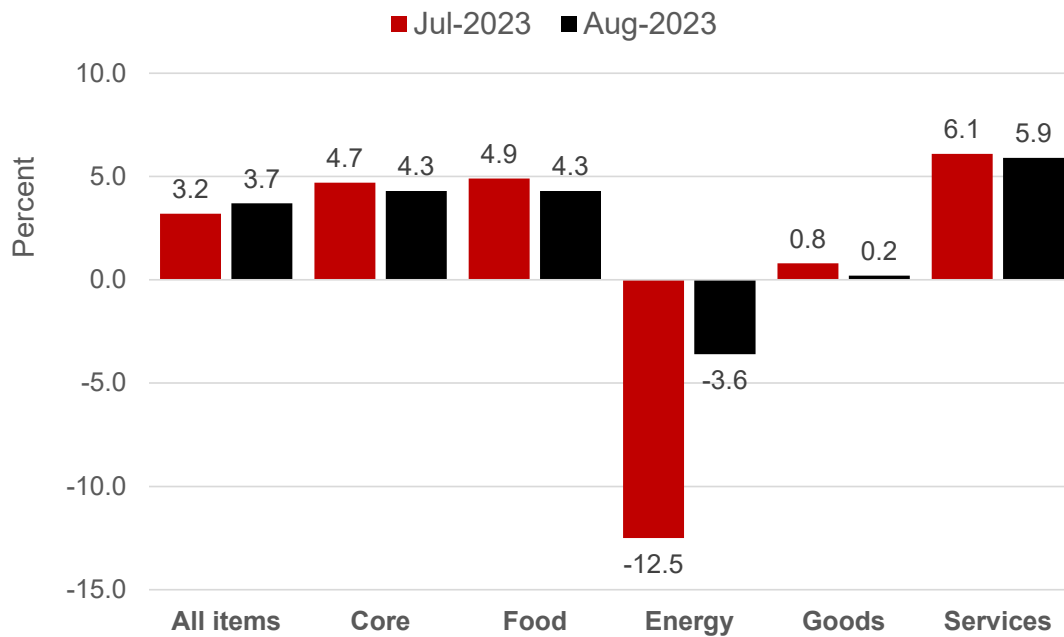
Consumer Price Index for All Urban Consumers, unadjusted all items in U.S. City Average. As of August 2023. Shaded areas indicate U.S. recessions.



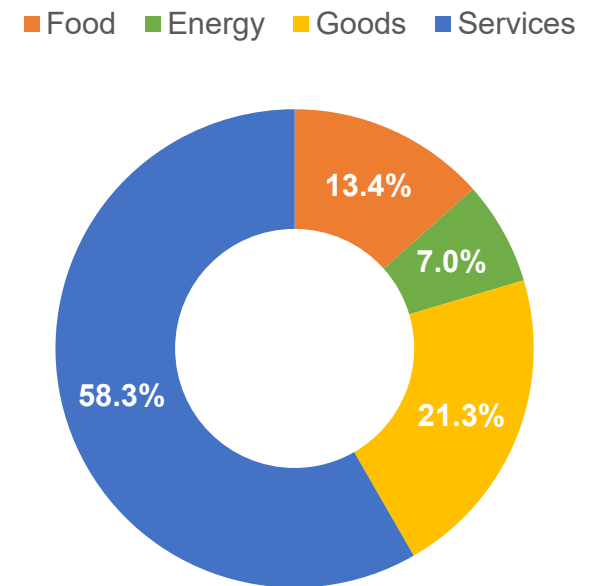
Source(s): Bureau of Labor Statistics, Federal Reserve Bank of St. Louis, Key Wealth Management

Inflation is moderating, but remains elevated

CPI Year-over-Year Percentage Change – July / August



CPI Components % Weighting



12-month percent change in Consumer Price Index (CPI) for All Urban Consumers (CPI-U), not seasonally adjusted.
Core, Goods and Services components exclude Food & Energy

Source(s): Federal Reserve Bank of St. Louis, Bureau of Labor Statistics, Key Wealth Management



The Federal Reserve

When will they finish raising interest rates?

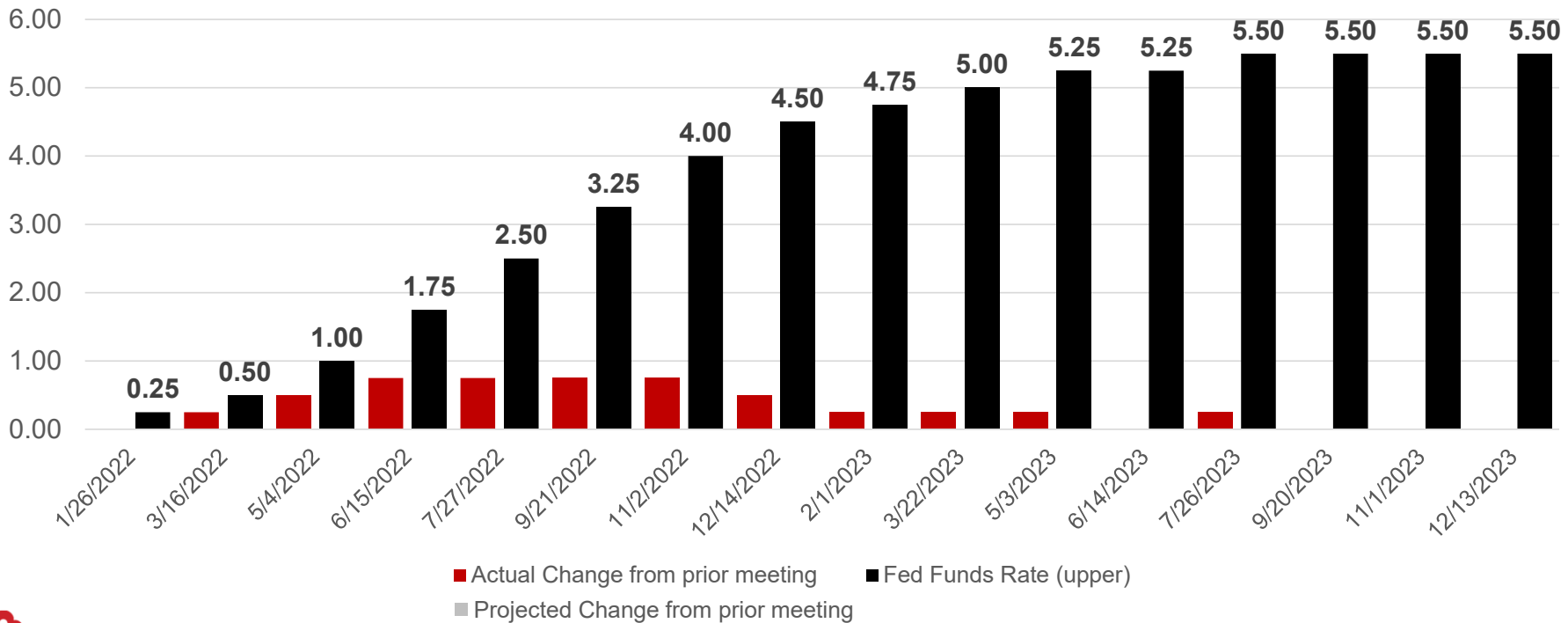


FOMC Rate Hikes: Pace and Magnitude

2022-2023: A total of 11 rate hikes (21 increments of 25 bps) in 17 months – an increase of 525 bps

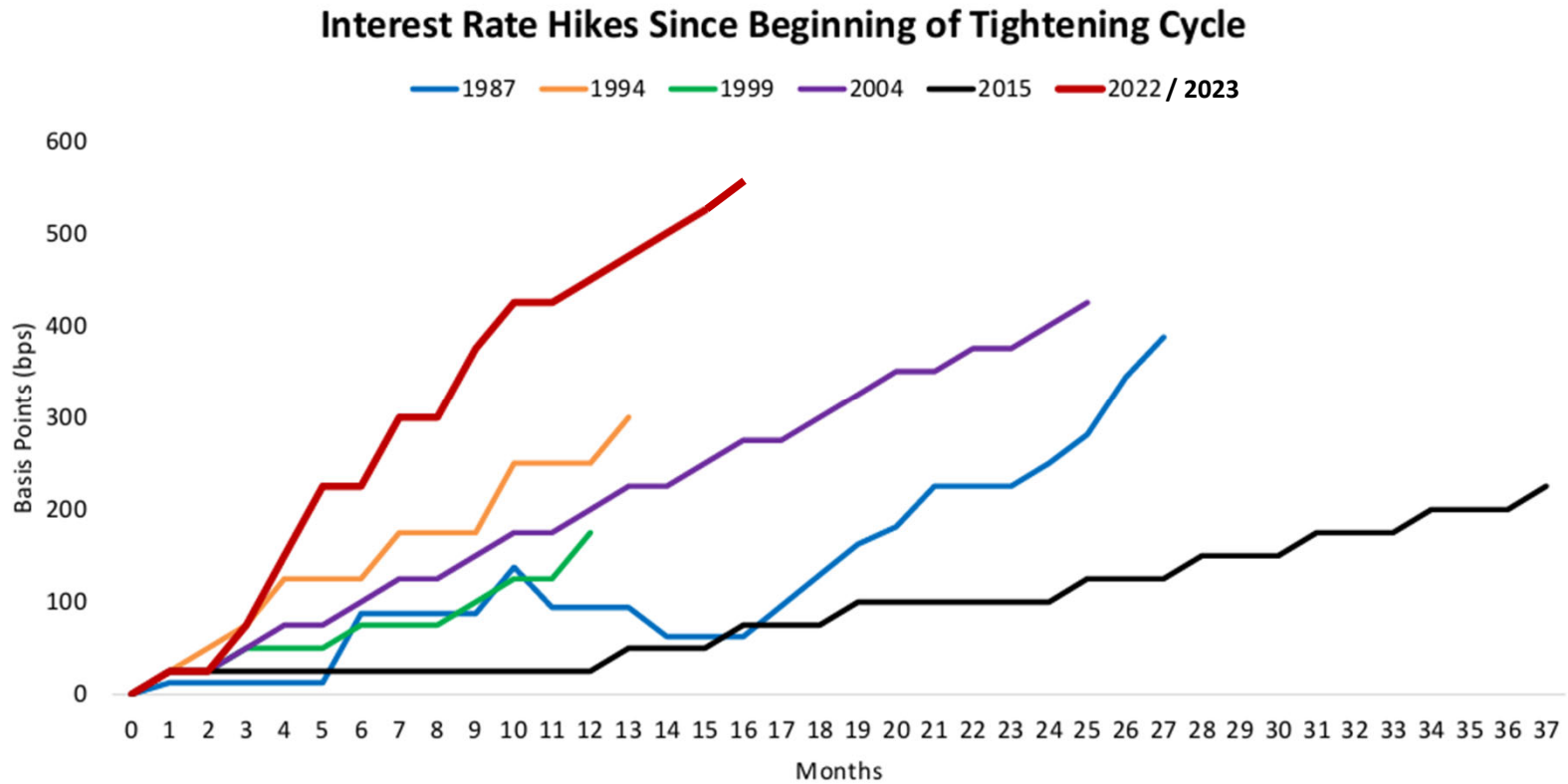


“The Committee is strongly committed to returning inflation to its 2 percent objective. In assessing the appropriate stance of monetary policy, the Committee **will continue to monitor the implications of incoming information** for the economic outlook.” – Jay Powell (September 20, 2023)



Source(s): Key Wealth Management, Board of Governors of the Federal Reserve System; Data through September 20, 2023

The Fed usually tightens until something breaks



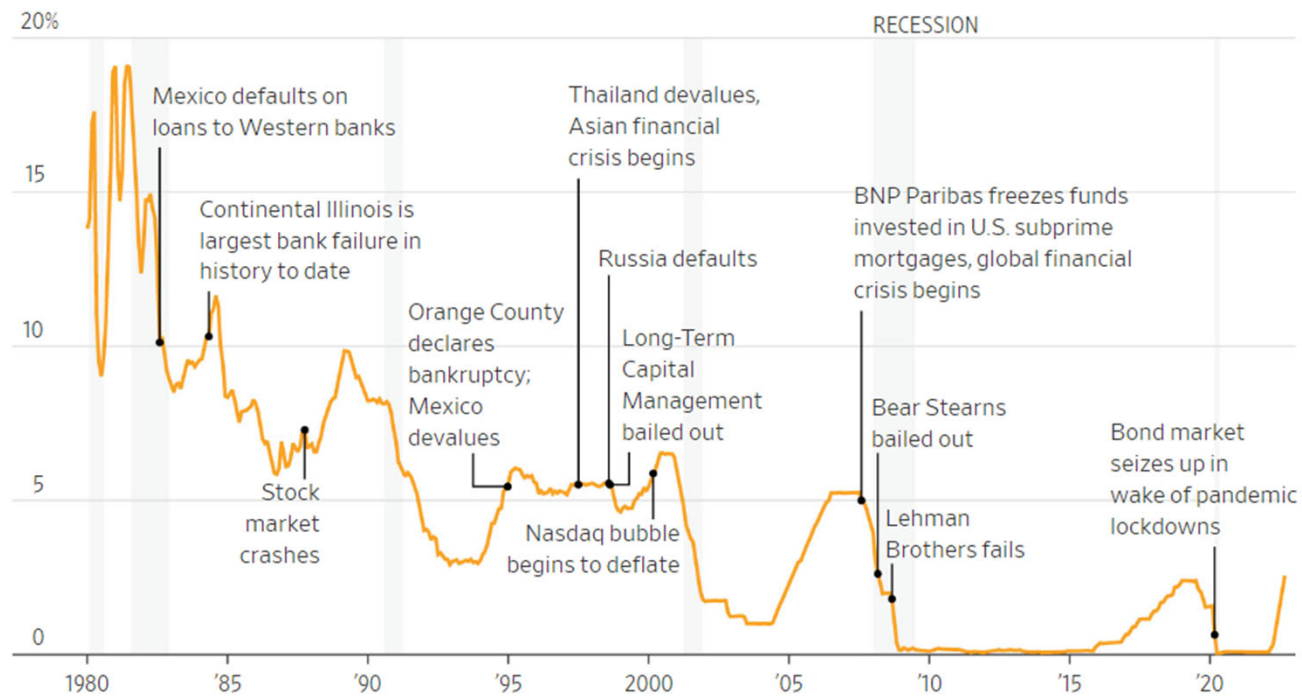
Through the September 20, 2023, FOMC Meeting.

Source(s): Federal Reserve, Key Wealth Management



The Fed usually tightens until something breaks

Federal-funds effective rate



Source: Board of Governors of the Federal Reserve System via St. Louis Fed



Source(s): Board of Governors of the Federal Reserve System

When will The Fed stop? History may be a guide...

The Fed has never stopped raising rates before the Federal Funds Rates was above the Consumer Price Index (CPI). Will this time be different?

Tightening Cycle	Fed Funds Peak	Date of Peak	CPI	Real Fed Funds
1973	11.00%	8/30/1973	7.40%	3.60%
1976-1980	20.00%	3/3/1980	14.80%	5.20%
1980	20.00%	12/5/1980	12.50%	7.50%
1983-1984	11.75%	8/24/1984	4.30%	7.45%
1986-1989	9.75%	2/24/1989	4.80%	4.95%
1994-1995	6.00%	2/1/1995	2.90%	3.10%
1999-2000	6.50%	5/16/2000	3.20%	3.30%
2004-2006	5.25%	6/29/2006	4.30%	0.95%
2015-2018	2.50%	12/19/2018	1.90%	0.60%
2022-2023	5.50%	???	3.70%	1.80%

2022-2023 – Fed Funds Rate as of the 9/20/23 FOMC meeting, CPI as of August 2023 (12-month)



Unemployment Rate Remains low, for now



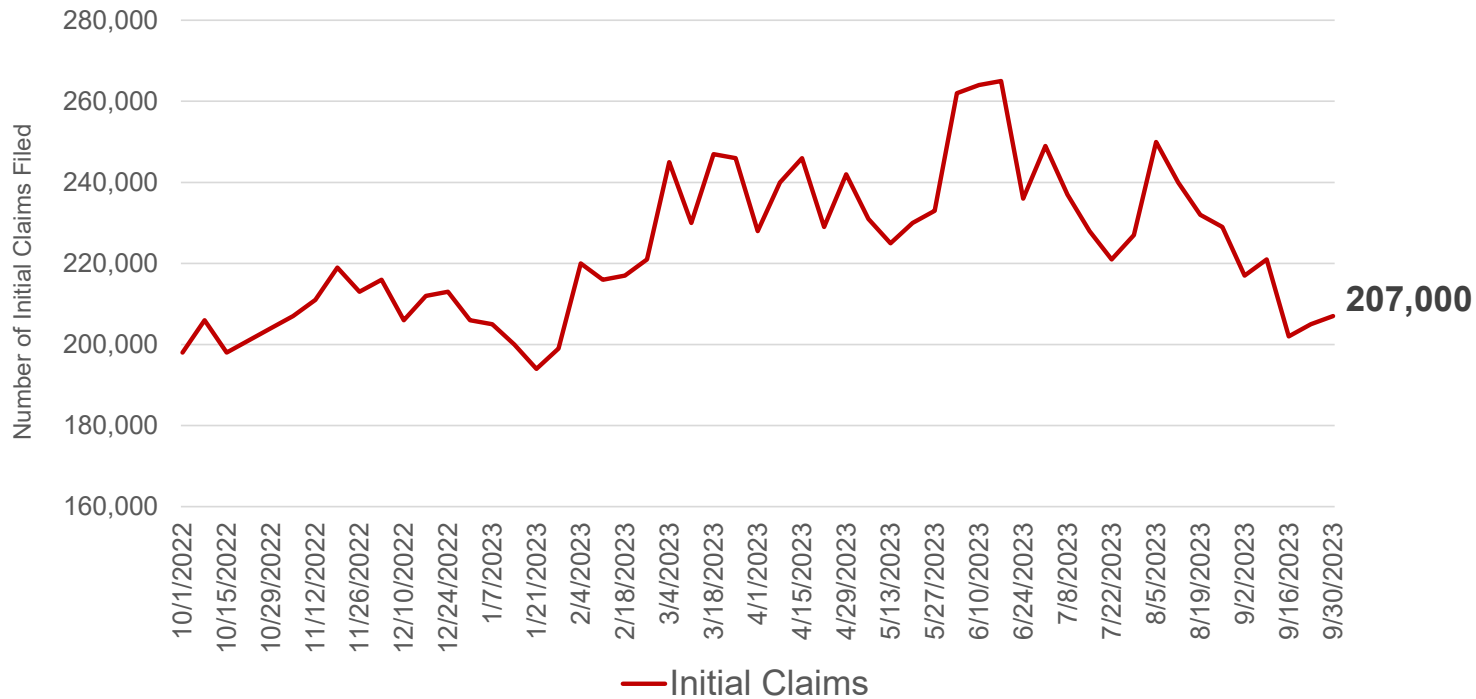
Unemployment Rate: Monthly, Seasonally Adjusted. As of September 2023. Shaded areas indicate U.S. recessions.

Source(s): Federal Reserve Bank of St. Louis, Bureau of Labor Statistics



Initial Claims remain steady for now

US Weekly Initial Unemployment Claims



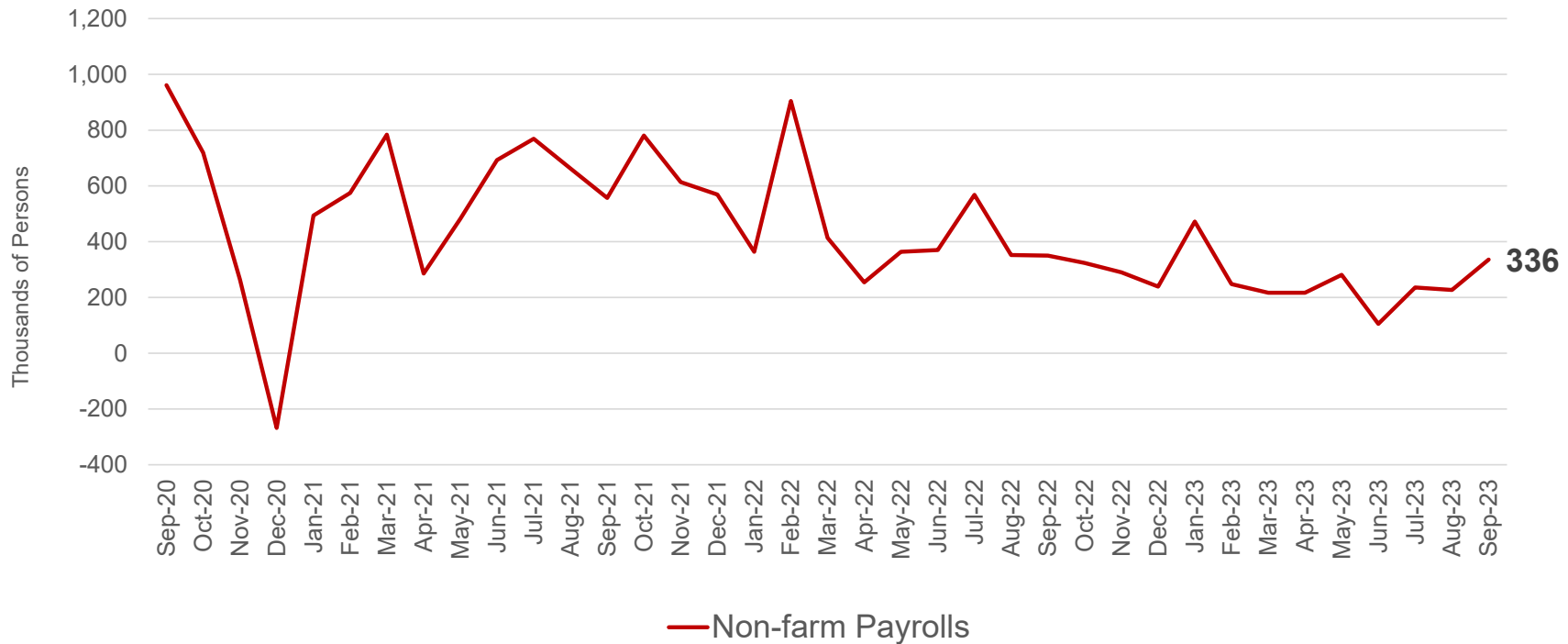
Initial Claims, Weekly, Seasonally Adjusted. Week ending September 30, 2023.

Recession Date	Peak in Claims
May 1970	343,750
Feb 1975	560,750
Jun 1980	629,000
Oct 1982	674,250
Mar 1991	501,250
Oct 2001	489,250
Mar 2009	659,250



New Non-farm payrolls surprised in September

US Total Non-farm Payrolls – Monthly Change

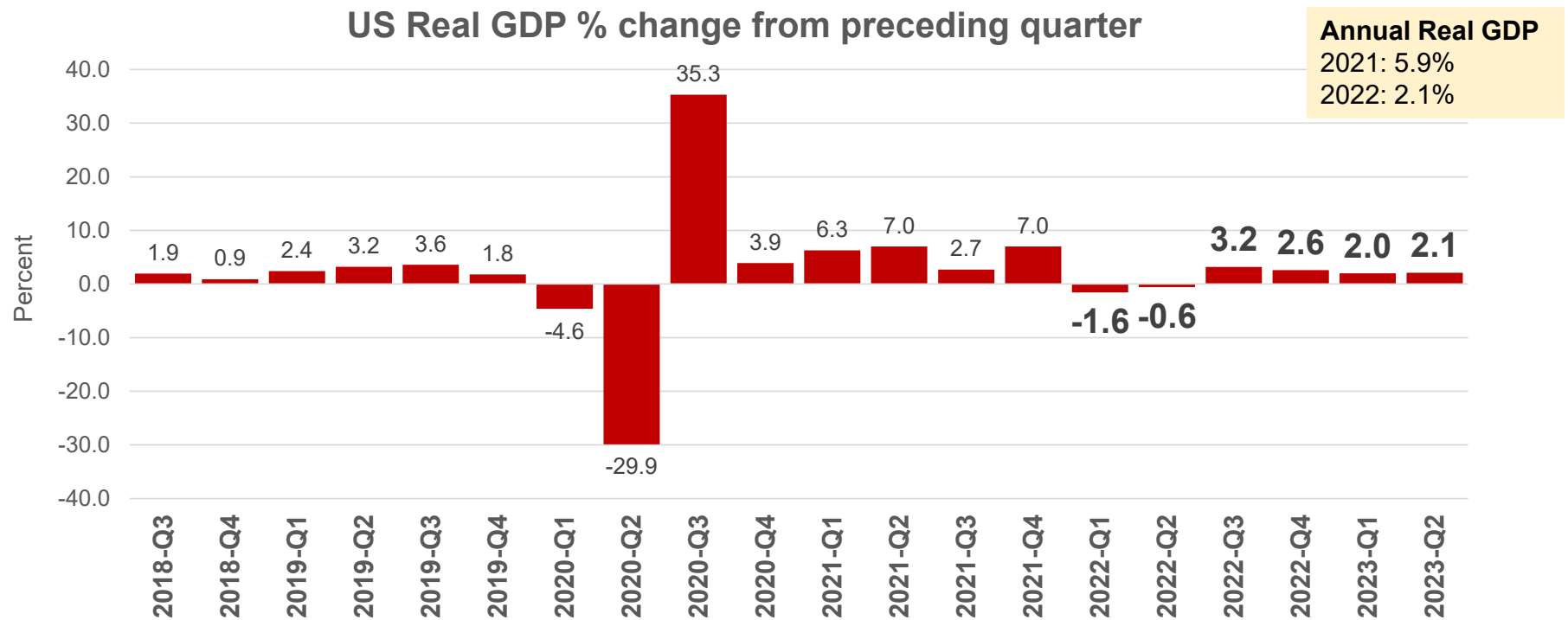


All Employees, Total Nonfarm, Monthly Change, Seasonally Adjusted. As of September 2023.

Source(s): Federal Reserve Bank of St. Louis, Bureau of Labor Statistics



Economic Growth is Positive, but slowing

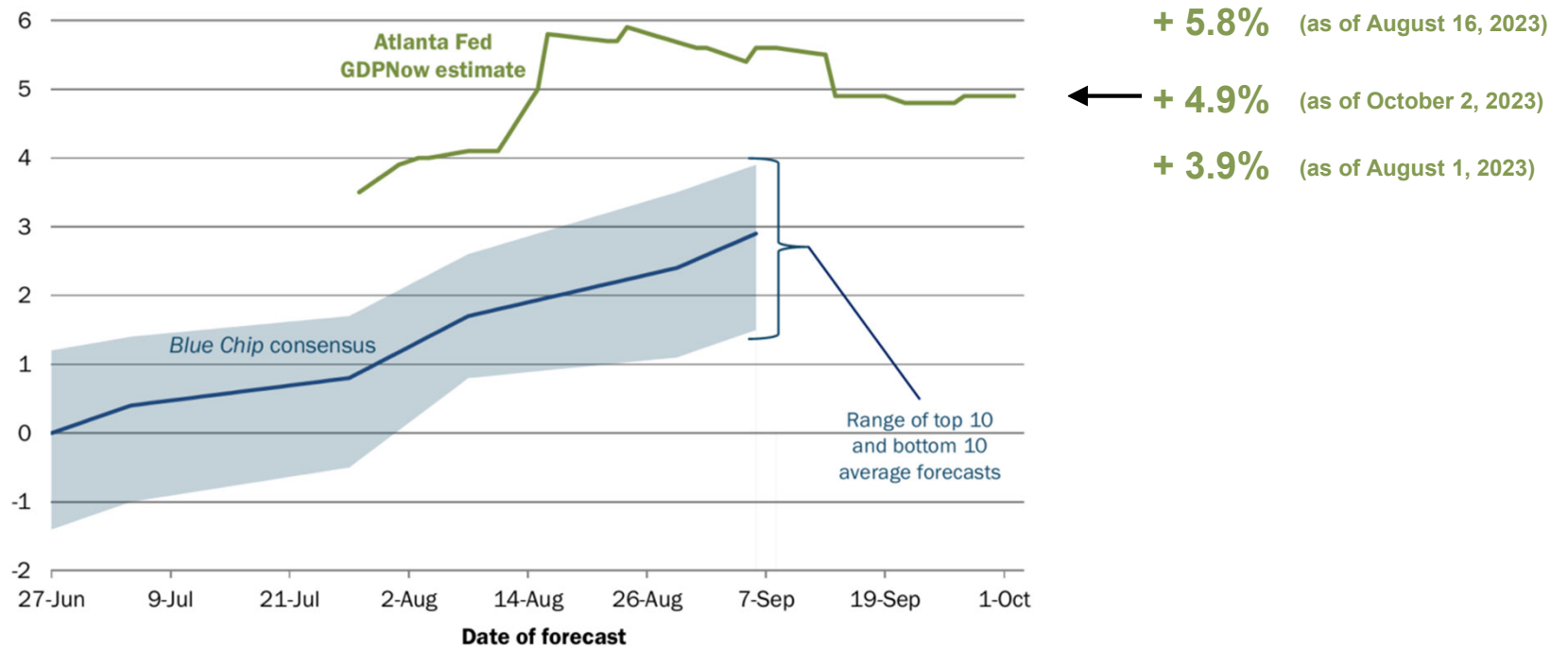


Real Gross Domestic Product (GDP), Compounded Annual Rate of Change, Quarterly, Seasonally Adjusted Annual Rate. Q2-2023 Final estimate.



Bigger questions for growth in Q3:2023 and FY:2023

Evolution of Atlanta Fed GDPNow real GDP Estimate for 2023:Q3



Quarterly percent change (SAAR)
 Sources: *BlueChip Economic Indicators* and *BlueChip Financial Forecasts*
 Note: the top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *BlueChip* survey.



Fed/FOMC Meeting (9/20/23)

“Good” News

- The Fed paused for the second time in 3 meetings
- Left Fed Funds rate at 5.50%
- Believes monetary policy is working, but with a lag
- Revised forecast for real GDP growth higher
- Revised forecast for unemployment rate lower

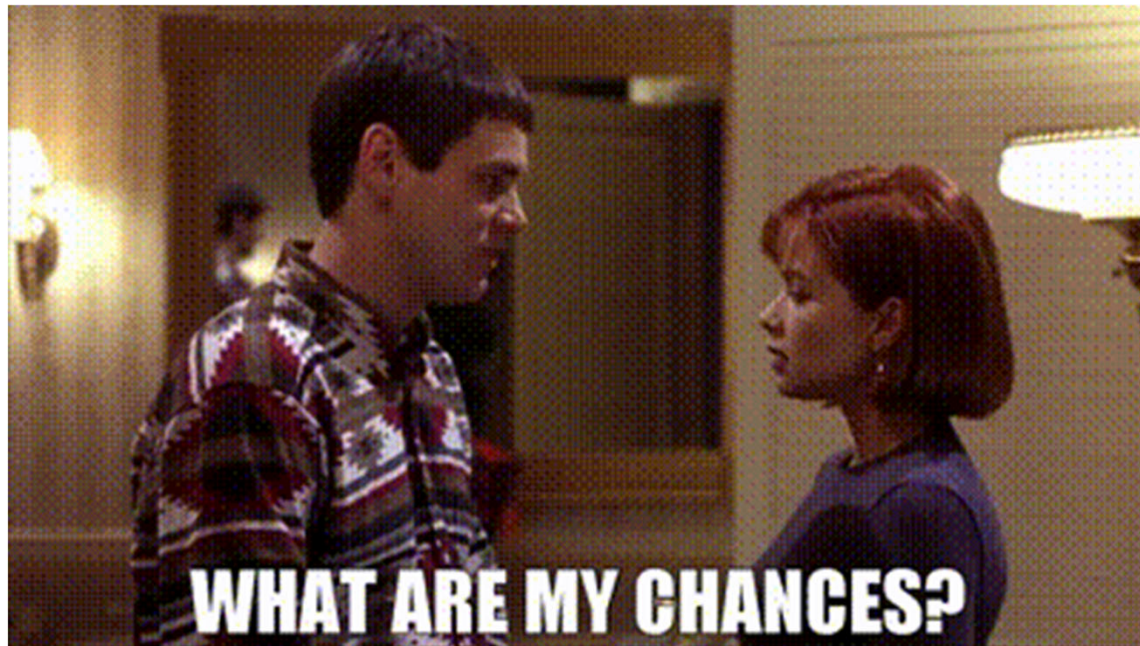
“Bad” News

- Left room for one more rate increase in 2023
- SEP forecasts raised Fed Funds rate in 2024 and 2025
- “Higher for longer”

Resilient economy + higher inflation = higher rates = “higher for longer”



Does the Fed have a chance of engineering a soft landing?



Source(s): Dumb and Dumber (1994)

Does the Fed have a chance of engineering a soft landing?



Does the Fed have a chance of engineering a soft landing?



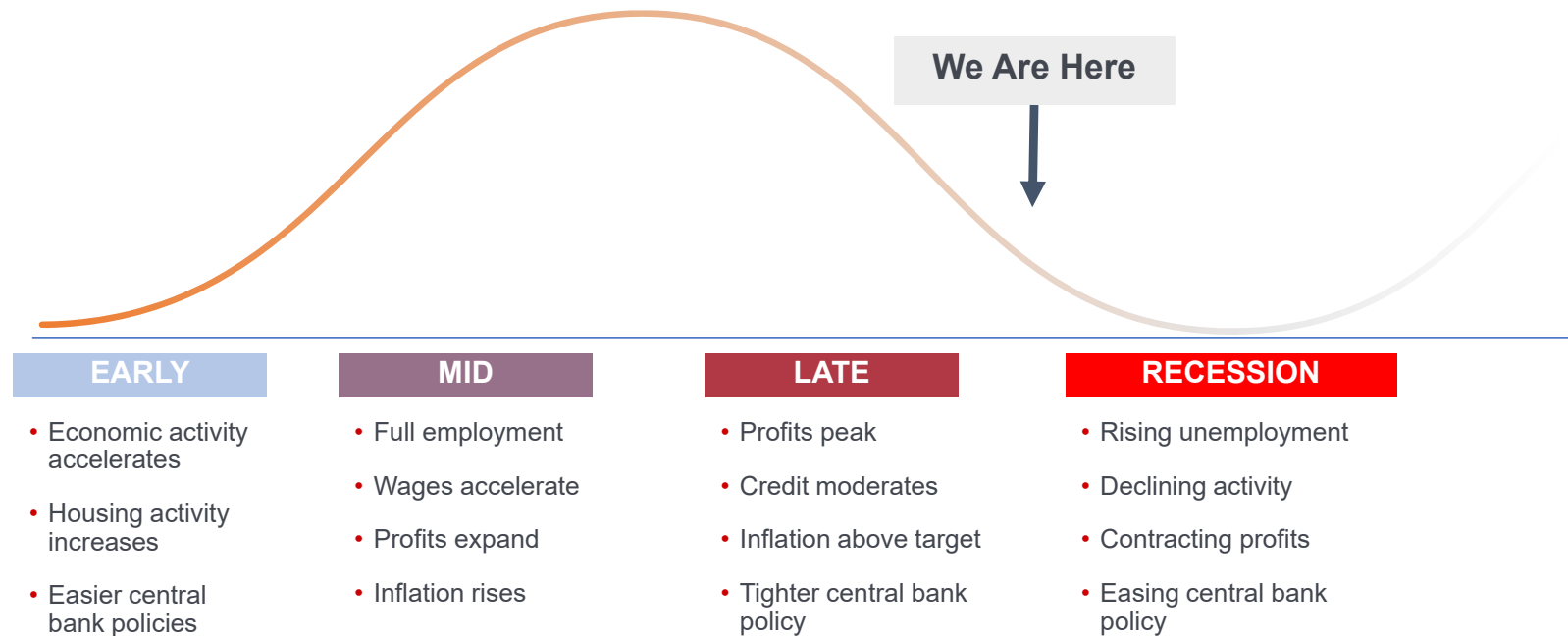
Source(s): Dumb and Dumber (1994)

Recession Indicators

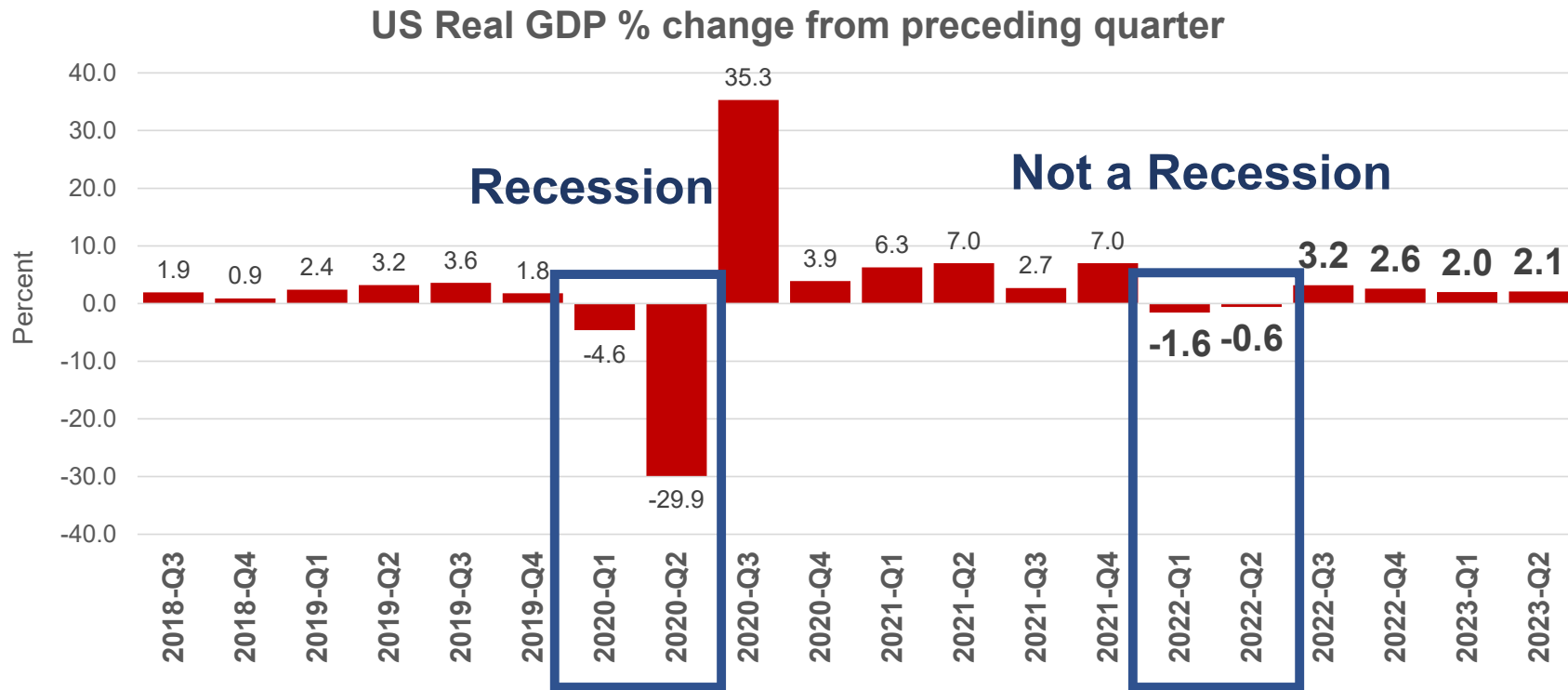
Are we headed for one and if so, what do we do about it?



What is a recession? Normal business cycle.



What is a recession?



Real Gross Domestic Product (GDP), Compounded Annual Rate of Change, Quarterly, Seasonally Adjusted Annual Rate. Q2-2023 Final estimate.



What is a recession? Who determines we are in one?



– The NBER's traditional definition of a recession is that it is “**a significant decline in economic activity that is spread across the economy and that lasts more than a few months.**” The determination is based on a range of monthly measures of aggregate real economic activity published by the federal statistical agencies:

Actual or close proxy *	Change from prior month					
	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23
NBER Economic Activity (measure)						
Real personal income (disposable) *	0.3%	0.2%	0.4%	0.0%	-0.2%	-0.2%
Nonfarm payroll employment (000s)	217	217	281	105	236	227
Real personal consumption expenditures	0.0%	0.1%	0.1%	0.3%	0.6%	0.1%
Nominal Retail Sales *	-0.7%	0.4%	0.5%	0.3%	0.5%	0.6%
[Un] Employment (household survey)	3.5%	3.4%	3.7%	3.6%	3.5%	3.8%
Industrial production	0.1%	0.5%	-0.3%	-0.4%	0.7%	0.4%

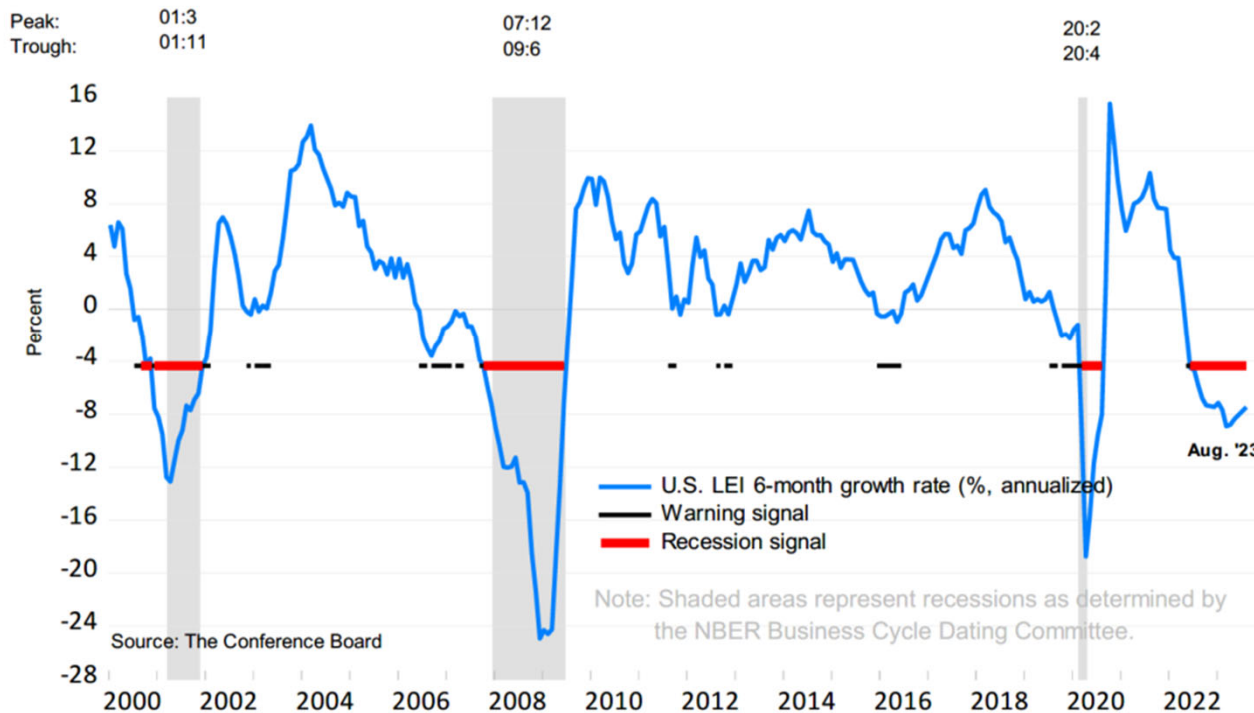
Note: data is from original sources and not official NBER calculations/measures



What is a recession? What else do we watch?

US LEI continued to decline, signaling a contraction in economic activity may be imminent

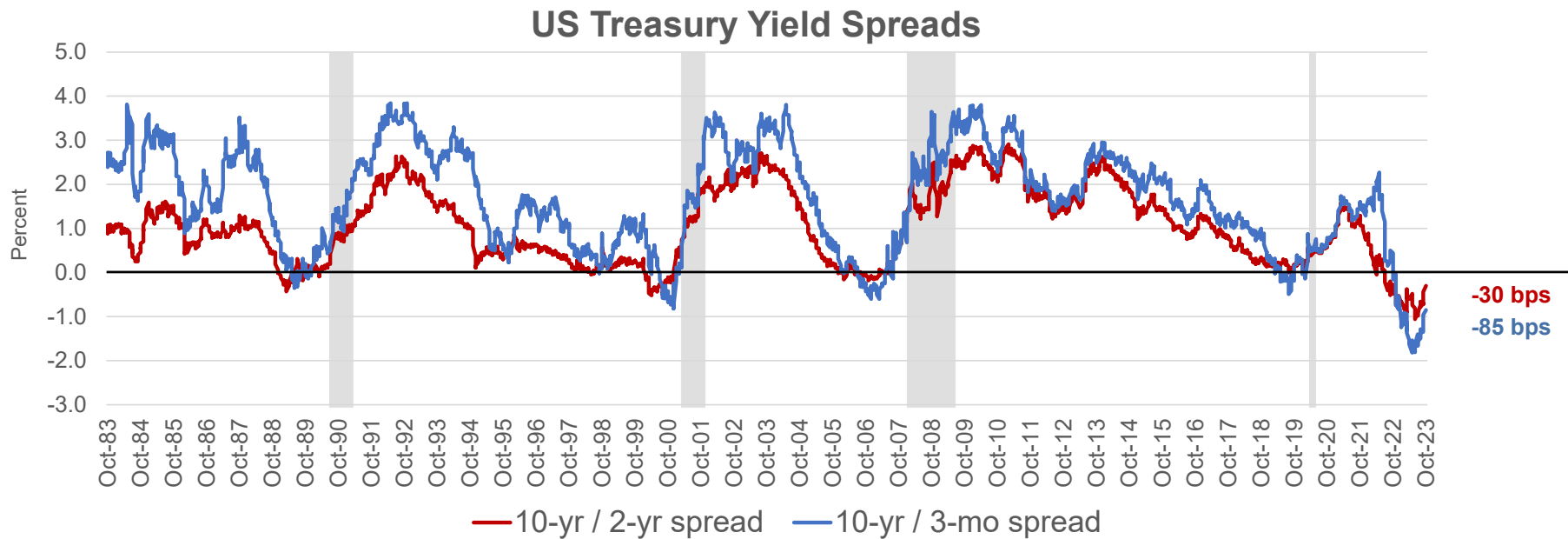
The US LEI continues to signal a recession ahead



Source(s): The Conference Board



Inverted yield curve suggests risk of a recession



Market Yield Spread on U.S. Treasury Securities at Constant Maturity; weekly ending Fridays end of period; as of October 6, 2023. Shaded areas indicate U.S. recessions.

The **10-yr/2yr yield curve** has been inverted, suggesting a recession may be looming ~12-18 months from now.

The **10-yr/3month yield curve** is also deeply inverted, suggesting a recession may be more imminent.



Recession- Not If, But When?

How Long Until the Recession?			
When the 3-month to 10-year yield curve inverts for 10 consecutive trading days			
Date of Inversion	Consecutive Trading Days Inverted	Date of Next Recession	Calendar Days to Next Recession
1/10/1969	24	Dec-69	325
6/14/1973	177	Nov-73	140
12/8/1978	91	Jan-80	389
11/7/1980	102	Jul-81	236
6/6/1989	30	Jul-90	390
7/31/2000	135	Mar-01	213
8/1/2006	217	Dec-07	487
6/6/2019	41	Feb-20	268
11/22/2022	299	????	????
Average	111		311

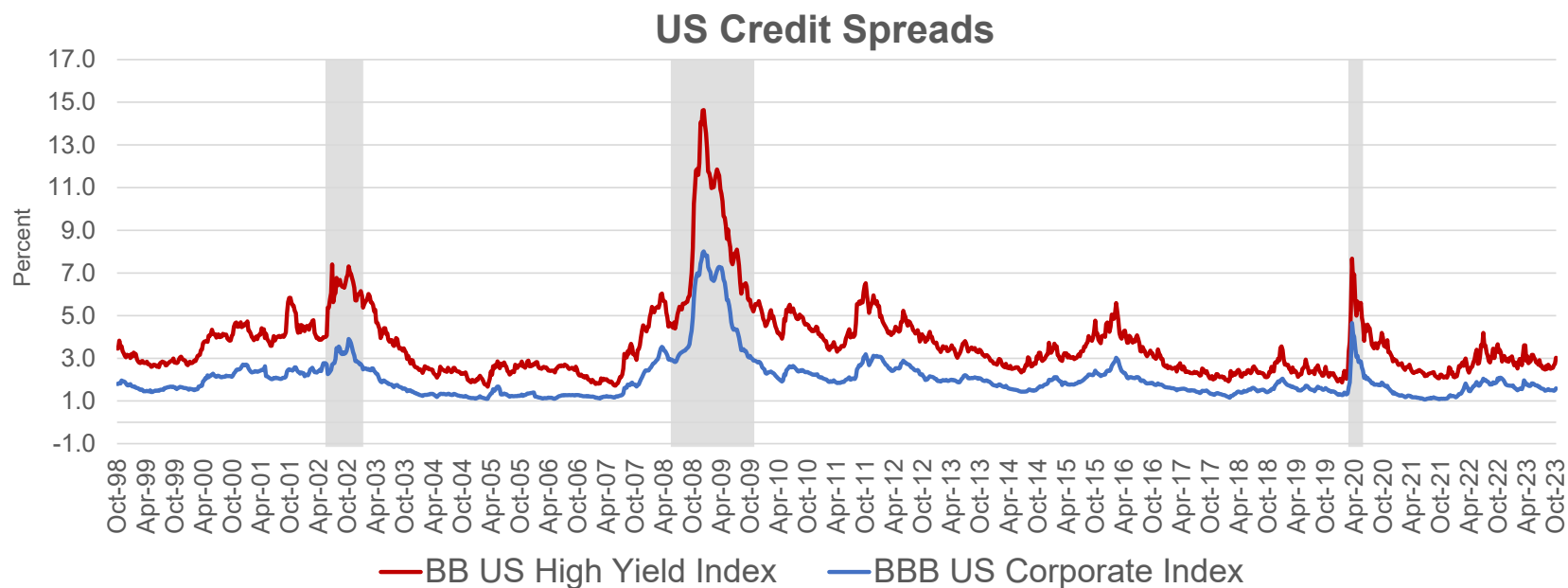
1/10/1969 = Inverted for 24 calendar days, went positive for 33 days, then inverted again for 53 days

6/6/1989 = Inverted for 30 calendar days, went positive for 9 days, inverted again for 26 days

6/6/2019 = Inverted 41 consecutive trading days, went positive for 1 day, then inverted again for 67 days (through October 10)



Credit markets are concerned, but not panicked



Option-Adjusted Spread, percent, weekly ending Friday, not seasonally-adjusted; as of October 6, 2023. Shaded areas indicate U.S. recessions.

Rising credit spreads (the difference in yield between corporate debt and government debt) usually signals signs of distress. While spreads have approached 2018 levels and thus deserve attention, spreads are below recessionary levels and reflect a “growth scare” vs. an economic contraction.



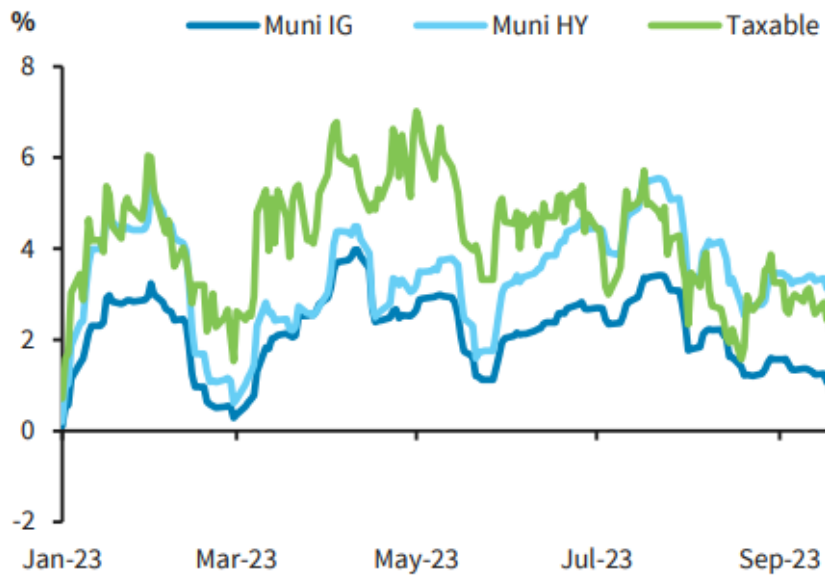
Municipal Bond Market Update

Staying the Course



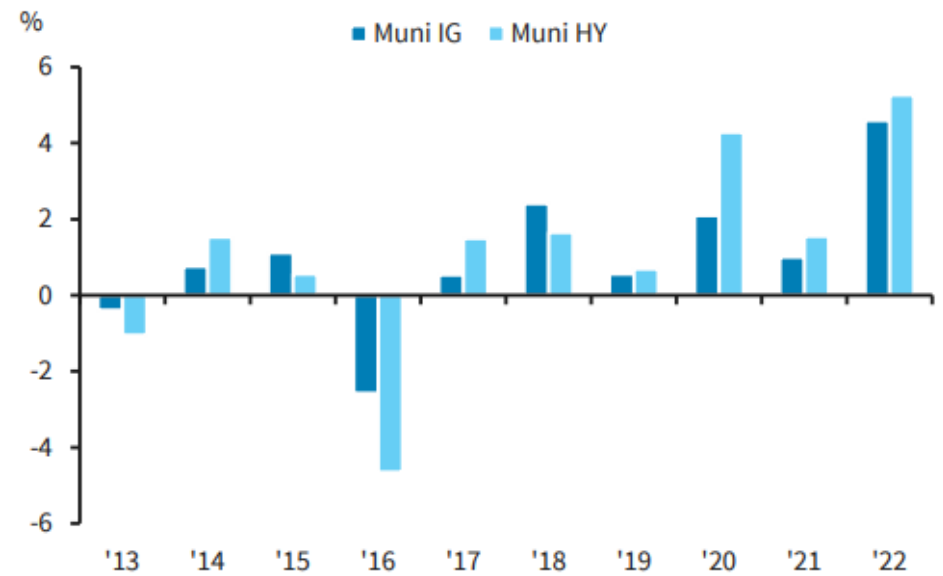
Municipal Bond Market Performance

FIGURE 1. Giving Back All YTD Gains



Source: Bloomberg Fixed Income Indices

FIGURE 2. Muni Performance in November-December

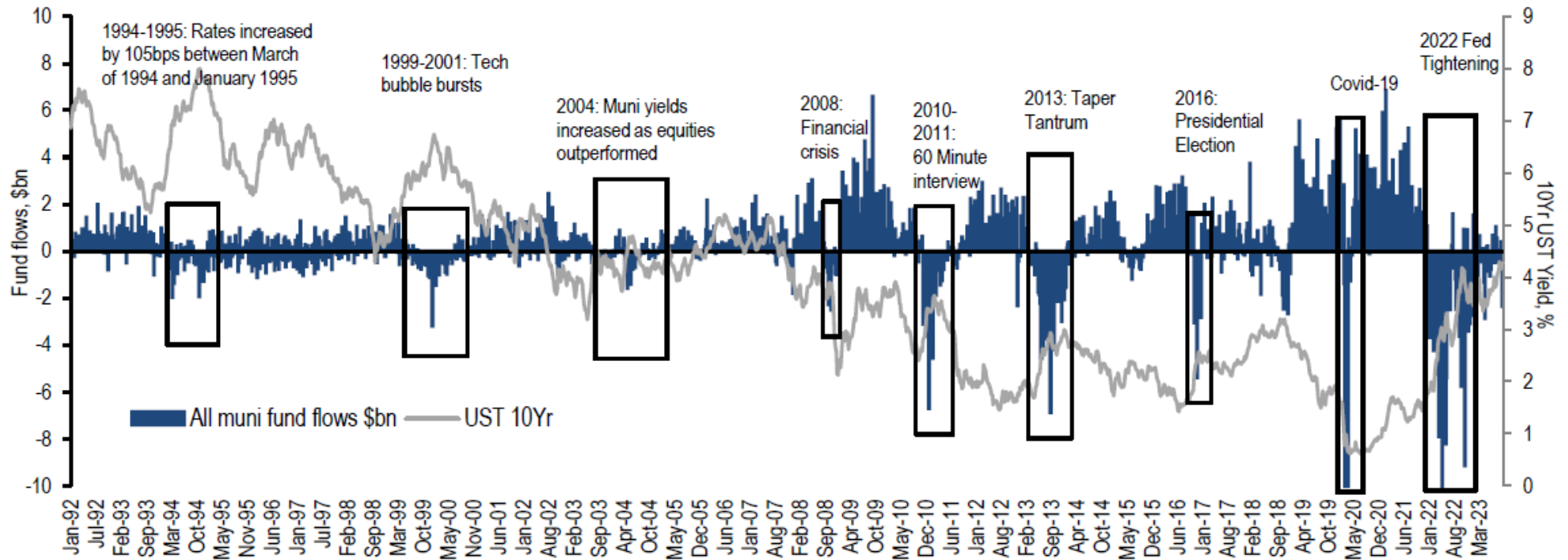


Source: Bloomberg Fixed Income Indices



Municipal Bond Fund Flows

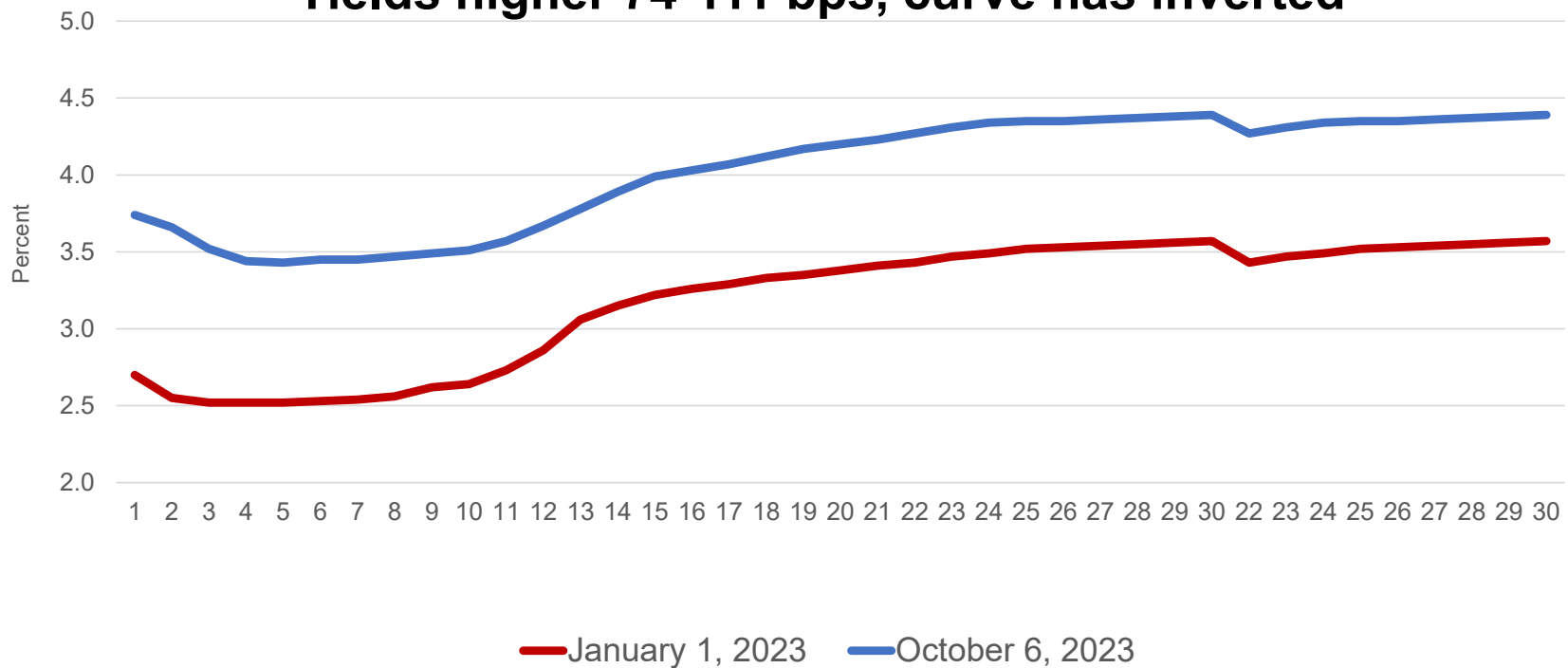
-13 billion YTD, volatile around UST rallies and sell-offs



Source(s): Lipper US fund flow, J.P. Morgan

Municipal AAA Yield Curve

Yields higher 74-111 bps, curve has inverted



Market Yield on AAA Municipal Bonds

Source(s): Bloomberg, Refinitiv TM3, Key Wealth Management



Municipal / Treasury Ratios

Munis cheapening but not cheap

Years	January 1, 2023			Historical Average	October 6, 2023		
	AAA Muni	US Treasury	Ratio		AAA Muni	US Treasury	Ratio
1	2.70	4.65	58%	78%	3.74	5.42	69%
2	2.55	4.35	59%	82%	3.66	5.08	72%
3	2.52	4.10	61%	82%	3.52	4.89	72%
5	2.52	3.84	66%	84%	3.43	4.76	72%
7	2.54	3.77	67%	90%	3.45	4.81	72%
10	2.64	3.68	72%	88%	3.51	4.80	73%
20	3.38	3.96	85%	92%	4.20	5.17	81%
30	3.57	3.80	94%	96%	4.39	4.97	88%



Sector and Credit Quality Performance

High yield outperforming investment grade

	MTD	Last 3M	YTD	ANNUALIZED (%)		
				1 Year	3 Years	5 Years
GO Revenue	-3.01	-4.10	-2.01	-3.54	0.54	1.37
	-3.00	-4.04	-1.16	-3.61	0.64	1.52
AAA	-3.19	-4.34	-2.35	-3.86	0.20	0.99
AA	-2.83	-3.89	-1.58	-3.47	0.49	1.27
A	-2.86	-3.69	-0.58	-3.22	0.93	1.77
Baa	-3.57	-4.49	-0.24	-3.55	1.14	2.38
High Yield	-3.40	-4.24	0.00	-3.19	1.66	3.18



Source(s): Bloomberg, Refinitiv TM3

Municipal Investment Grade Spreads

FIGURE 8. BAA Municipal Index Yields Minus AAA Municipal Index Yields



Source: Bloomberg Fixed Income Indices



Source(s): Barclays Research

Municipal High Yield Spreads

FIGURE 9. High Yield Municipal Index Yields Minus Investment Grade Municipal Index Yields



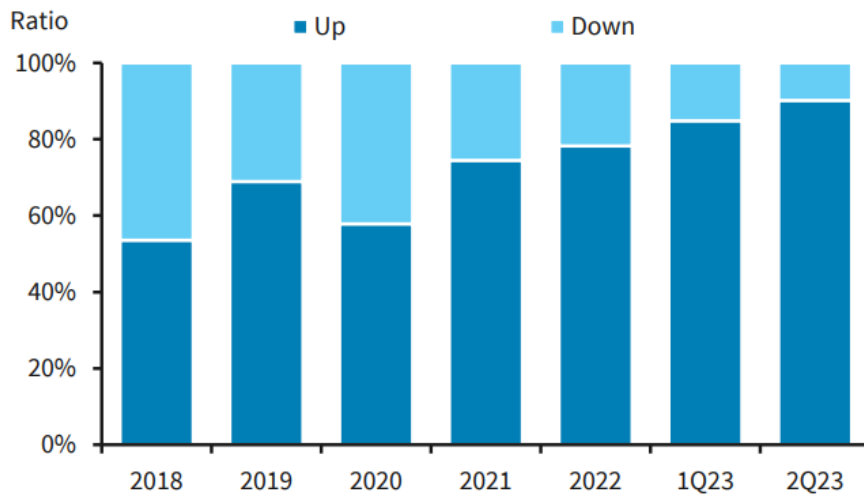
Source: Bloomberg Fixed Income Indices



Source(s): Barclays Research

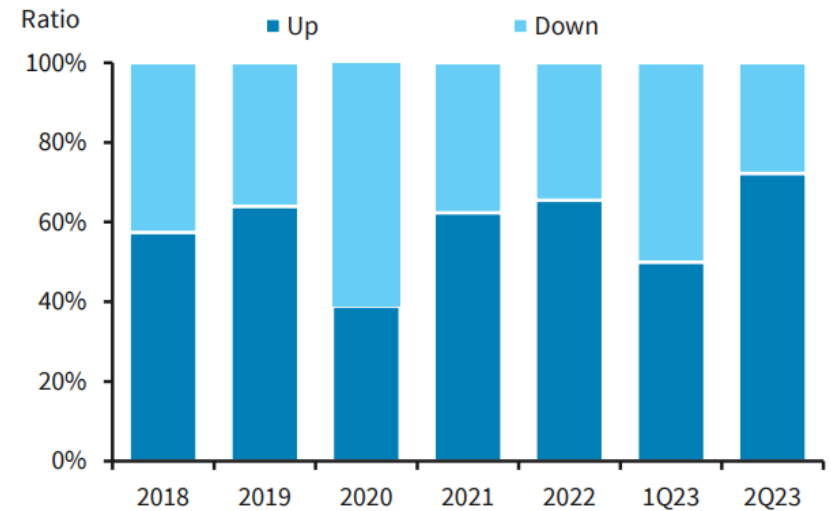
Municipal Bond Rating Trends

FIGURE 9. Tax-Backed Issuers' Ratings Trend



Source: Moody's

FIGURE 10. Revenue Issuers' Ratings Trend



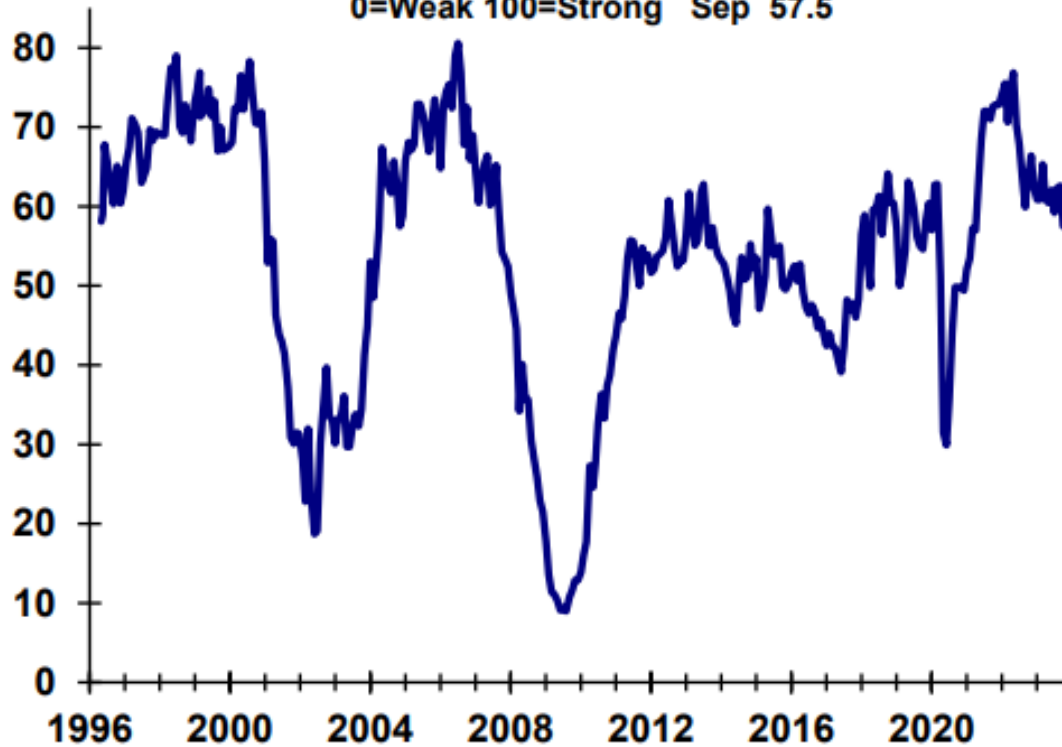
Source: Moody's



Source(s): Barclays Research

State Tax Receipts Stabilizing

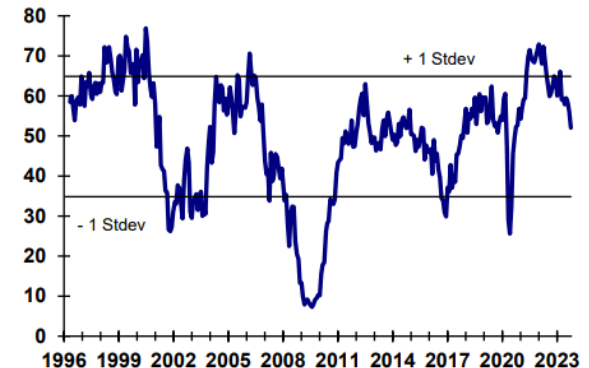
Evercore ISI State Tax Receipts Survey
Overall Receipts
0=Weak 100=Strong Sep 57.5



Evercore ISI State Tax Receipts Survey
Personal Income Receipts
0=Weak 100=Strong Sep 53.0



Evercore ISI State Tax Receipt Survey
Sales Receipts
0=Weak 100=Strong Sep 52.0



Source(s): Evercore ISI Research



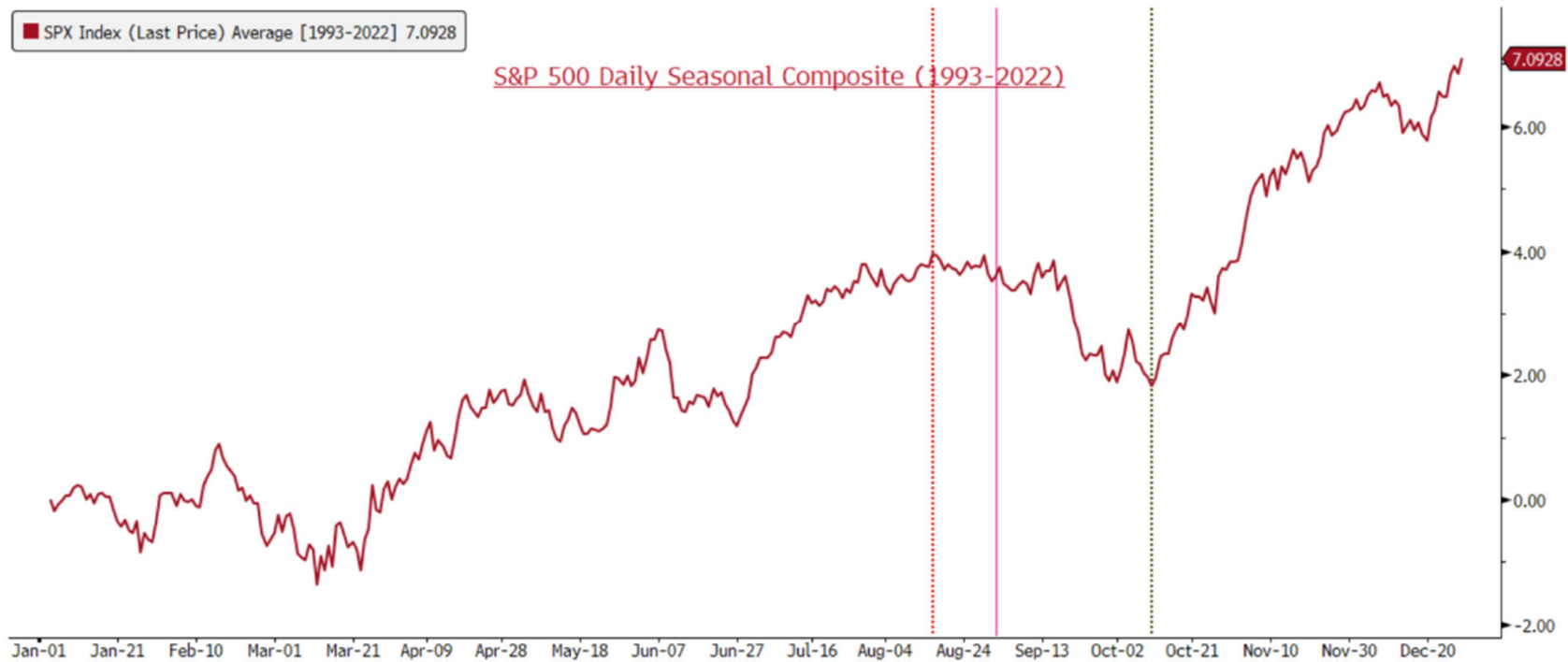
Final Thoughts

What should we consider?



Seasonality: Navigating the weakest part of the year

S&P 500: Seasonals are not the most important factor, but they often provide a headwind or a tailwind for prevailing market conditions. Will the traditional seasonal headwind from mid-August to mid-October matter this year?



Past performance is no guarantee for future results
Source(s): Bloomberg, Key Wealth Management



Seasonality: A September to remember? Maybe. Maybe not.

S&P 500 returns in years with positive year-to-date returns and negative August returns

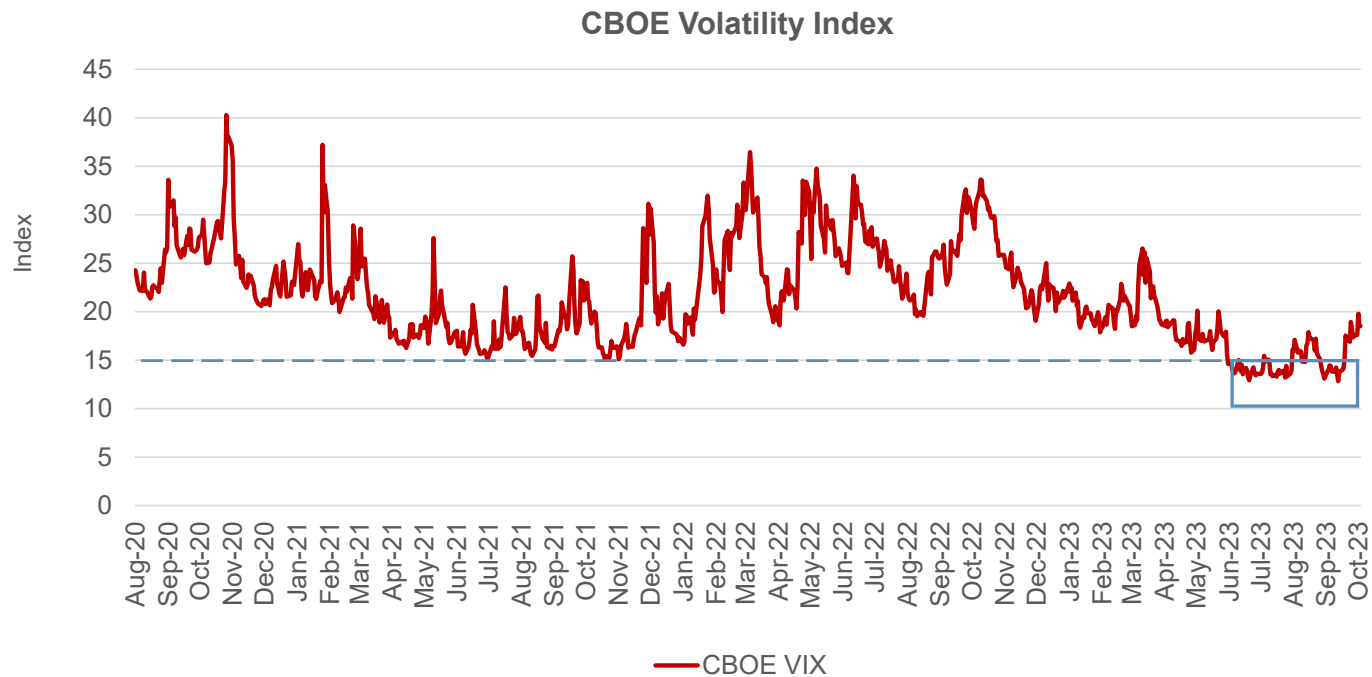
Year	YTD returns through August	August return	September return	Sept – Dec return
1954	20.2%	-3.4%	8.3%	20.6%
1955	20.0%	1.1%	7.2%	5.4%
1967	16.6%	-1.2%	3.3%	3.0%
1975	26.7%	-2.1%	-3.5%	3.8%
1976	14.1%	-0.5%	2.3%	4.4%
1985	12.8%	-1.2%	-3.5%	12.0%
1995	22.3%	0.0%	4.0%	9.6%
1997	21.4%	-5.7%	5.3%	7.9%
2013	14.5%	-3.1%	3.0%	13.2%
2019	16.7%	-1.8%	1.7%	10.4%
2023	17.4%	-1.8%	-4.8%	???
Average			2.1%	9.0%
% of time positive			72%	100%

Past performance is no guarantee for future results
 Source(s): Bloomberg; JPMWM; Key Wealth Management



Volatility: Complacency creeping in...and then not

With volatility collapsing toward multi-year lows (blue dotted line) on the recent market rebound, and with the weakest seasonal period somewhat behind us, the market's complacency (blue box) might be over due to recent events.



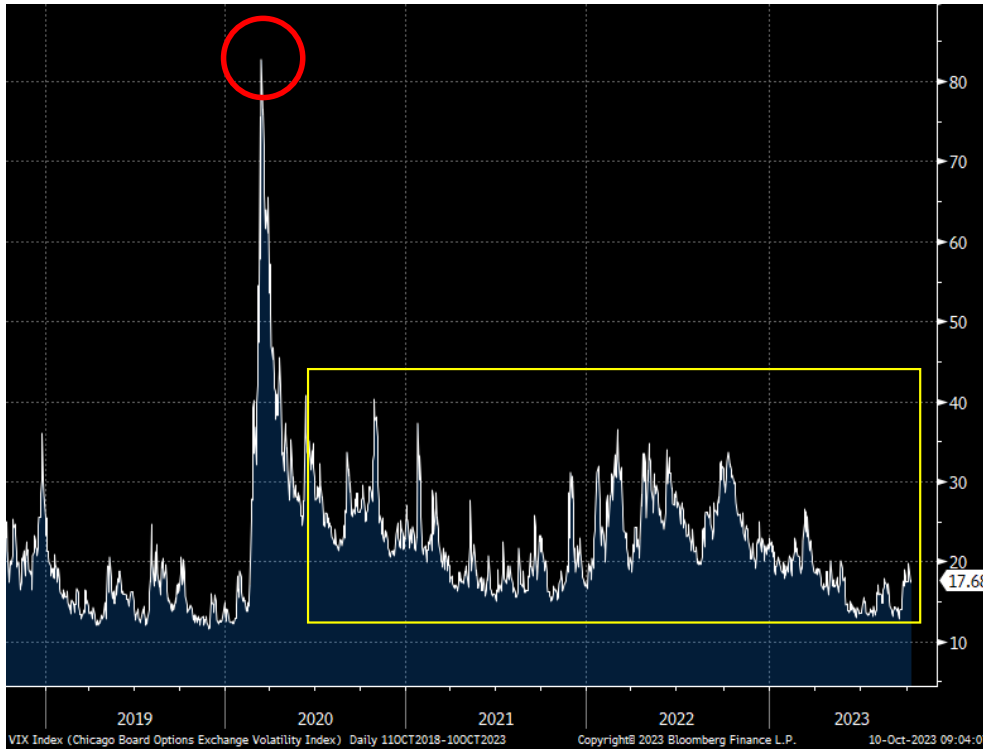
CBOE VIX, last price. As of October 5, 2023.

Source(s): Chicago Board Options Exchange, Bloomberg, Key Wealth Management



Bond Market Volatility Persists in 2023

VIX Index (S&P 500)



MOVE Index (US Treasuries)



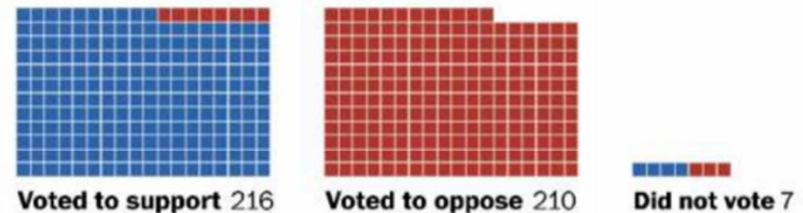
Source(s): Bloomberg

Political disorder: likely to remain the order of the day

Enjoy the theatre! Don't alter your investment plans.



House members voted to oust McCarthy as speaker



Three Big Questions for 2023 (and our answers)

Question	Our Thoughts
1. Will inflation persist?	<ul style="list-style-type: none">• Inflation will slow but remain above the Fed's target rate
2. How will the Fed respond and how will the economy perform?	<ul style="list-style-type: none">• The Fed will keep interest rates higher for longer and the economy will slow
3. Will we have a recession?	<ul style="list-style-type: none">• Most likely, but we don't expect it will be a historic one



Source(s): Dumb and Dumber (1994)



Key Wealth Institute – where to learn more

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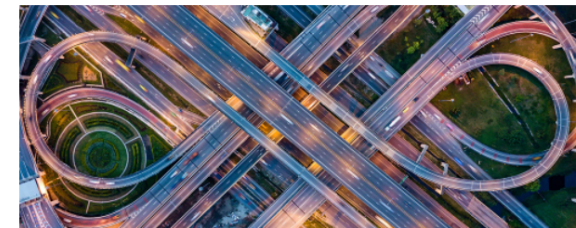


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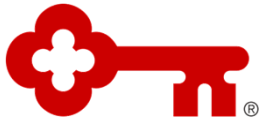
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