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MARKETS

Here's how to invest with 5 of 6 key economic indicators signaling that a recession is on the horizon, according to the multi-asset solutions head at $700 billion Federated Hermes

James Faris

- **A recession is a strong possibility in 2024, according to asset management firm Federated Hermes.**
- **Investors should brace for slower economic growth caused by higher interest rates.**
- **Here are four types of investments that should hold up well in a weaker economy.**

The US economy could contract as soon as next June, according to Federated Hermes.

Five of the six indicators on the $704 billion asset management firm's recession dashboard are either within or exceeding ranges typically seen during downturns.

Despite material improvements in recent months, historical precedent suggests that both inflation and manufacturing data are in red-alert territory.

Price growth, as measured by the core personal consumption expenditures (PCE) index, has tumbled back to the 3% range but remains far above levels seen in the last seven recessions. Additionally, manufacturing activity is still in a contraction, according to the latest ISM Index.

Other areas of concern are falling housing starts — which Goldman Sachs sees continuing next year — and the inverted yield curve of the 10-year US Treasury and the federal funds rate. And while jobless claims remain relatively muted, they're well above the cycle low, which strategists at Federated Hermes see as a clear sign of a slowing labor market.

FEDERATED HERMES

Steve Chiavarone – head of multi-asset solutions.

A soft landing is still possible — if not probable

However, investors shouldn't necessarily bank on a recession and become bearish.

Steve Chiavarone, who's Federated Hermes' head of multi-asset solutions, told Insider in a recent interview that he's calling for a "70s-style blah" in 2024 instead of an outright downturn.

In the strategist's base case, the economy will grind to a

near-halt instead of crashing. Growth will wilt under the pressure of perpetually high interest rates, Chiavarone said, though he added that rolling recessions across industries are more likely than a sudden, 2008-style downturn.

"While we do feel like these lags will hit, and we do feel like these lags will slow things down, it's not clear whether or not that's in a classic recession or a slow, '70s-style meander through malaise that never quite becomes a full-on recession," Chiavarone said.

Although almost all of the indicators in his firm's recession dashboard suggest that caution is warranted, Chiavarone said there won't be a downturn unless, or until, the unemployment rate spikes. Jobless claims may be above historic lows, but that's not enough to cause a contraction.

"I don't think a recession is imminent at this point because the labor market — to this point — is still so strong," Chiavarone said.

Higher-for-longer interest rates are the biggest threat to the US economy, Chiavarone said. The Federal Reserve scrambled to tackle inflation by raising rates, and while it may be pausing hikes now, soaring bond yields have kept borrowing costs high for businesses and individuals.

"After the Fed basically stopped tightening policy in July, the bond market said, 'Hold my beer — I got it from here,'" Chiavarone said. "And it's now tightening policy significantly since."

Monetary policy works with a long lag, Chiavarone noted. He pointed out that throughout history, inflation doesn't fall until after the Fed's rate-hiking cycle ends. Ironically, the US central bank is often cutting rates once inflation finally comes down since its hikes tend to lead to recessions.

Eighteen months of tightening financial conditions will have a profound impact on the economy, Chiavarone said. The multi-asset solutions head is watching how corporations respond next year when they're forced to refinance debt at much higher rates. Abnormally high borrowing rates are also squeezing both small businesses and consumers, Chiavarone added.

Other under-the-radar concerns are the US government's rising interest expenses and soaring deposit outflows from banks, Chiavarone said. More money put toward servicing the national debt is less money put toward other programs or more tax money out of Americans' pockets — or both. And if banks have fewer deposits, they'll have less money to lend to business and consumers, which could cause the economy to spiral.

GOLDMAN SACHS

Financial conditions have gotten much tighter since early 2022, according to Goldman Sachs.

4 top ways to invest in 2024

While Chiavarone thinks the US can dodge a downturn, he said the odds of a soft landing over a recession are more like 60-40 or 70-30 than a 90-10 proposition.

Stocks should log solid single-digit returns if the economy continues to slowly expand, the strategist and senior portfolio manager said. Active managers will outperform in this environment since high earnings multiples will keep a cap on indexes, Chiavarone added.

Investors should focus on **high-quality, dividend-paying stocks**, Chiavarone said. These firms generate sizable cash flows that translate to healthy balance sheets, he said. Since they have plenty of cash on hand, these companies aren't reliant on external financing and can avoid exposure to lofty interest rates. So instead of repaying lenders, they can reward shareholders.

Those concerned about the economy should also get defensive by buying stocks in a trio of defensive sectors, Chiavarone said: **consumer staples, healthcare**, and **utilities**.

Companies in these parts of the market can usually thrive regardless of the economic backdrop since demand for household products, life-saving or -improving goods and services, and electricity doesn't fade during recessions.

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Stocks are subject to risks and fluctuate in value. There are no guarantees that dividend paying stocks will continue to pay dividends. In addition, dividend paying stocks may not experience the same capital appreciation potential as non-dividend paying stocks.

Core personal consumption expenditures (PCE) index: Measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

Institute of Supply Management (ISM) Manufacturing Index: A composite, forward-looking index derived from a monthly survey of U.S. businesses.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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