PBS Ep132 What Happened to the Recession?

Patti Brennan: Hi, everybody. Welcome to the "Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Those of you who have been listening and tuning in over the years know that at the beginning of the year, we usually do an economic outlook. That's usually done with Brad Everett and I. At the end of the year, we kind of hold ourselves accountable and say, "OK, this is what we thought was going to happen, what actually did happen?"

Today, I thought it might be fun to do a mid-year outlook, a mid-year accountability check. For that, I've invited Sam Baez. Let me frame this for you. We refer to Eric Fuhrman as the professor. When he takes on a subject, he goes deep and detailed.

He's Mr. Historian as well. Brad, on the other hand, he's a brainiac. He is brilliant and has a way of taking something really complicated and summarizing it in maybe a sentence or two, and then he nails it.

Sam is the best of both worlds. He goes deep. For example, for today's podcast, this young father has prepared 14 pages in the form of a white paper, taking time away from his family over the last couple of weeks to prepare for this podcast today.

For the inside scoop, we refer to Sam as Mr. Relatable because everybody loves Sam. He's got a Hollywood smile that you're about to see, he's so smart, he cares so much, and he brings that personal element of love to everything that he does. An unusual introduction, but there you have it.

Sam. Thank you for everything that you did to prepare for today. Welcome to the show.

Sam Baez: Thank you, Patti. Thank you so much for having me. Thank you for your incredibly kind words. I'm humbled by it. Thank you.

Patti: You betcha. Here is the question. The topic of our podcast this mid-year review is what happened to the recession? Everybody was predicting a recession. It's interesting because I was just reminded that I wasn't so sure we were going to have one this year, but we'll put that aside.

The experts were talking about this looming recession. Why don't we just get to the basics? First, for the people who are listening and watching, what is a recession?

Sam: Sure. A recession is traditionally defined as two consecutive quarters of negative GDP. What does that mean? That means the economy is slowing down. People aren't buying as much. Companies aren't producing as much. People aren't hiring, if anything. Oftentimes, they're laying off to try and cut costs.

It's a slowing down of the overall economy. If that happens two quarters consecutively, traditionally, we're in a recession.

Patti: Got it. Again, keeping it with the basics. Because we are 70 percent consumer-based economy, one person's expense is another person's income. It's the velocity of money. It's the exchange of dollars that makes this thing work so well.

One of the things that we've talked about many times before, as we think about real financial planning, real wealth management, can we avoid the recession? Can we position things so that people aren't hurt if the economy does go through a couple of negative periods?

Sam: Sure. It's a great question. I think it's such a personal question because a recession is going to be different for everybody. Like I said, earlier, layoffs often come with recessions, but not everybody gets laid off during a recession, so preparations are what need to be done for somebody who was laid off is different to somebody who was able to maintain employment.

As far as where portfolios are concerned, I think the disconnect more often than not is market performance and portfolio performance, very seldom moves in line with where the economy is moving. The market is what's referred to as more of a leading indicator. The market tends to go down or up before the economy booms or bust.

It's kind of telling us, "Hey, this is where the economy is headed," so market prices head in that direction to let us know what may be coming down the pike.

Patti: Isn't it fair to say that the market isn't always right?

Sam: The market is not always right.

Patti: How about it?

Sam: The market is not always right.

Patti: The market was down last year. A lot of people, including some of the other components of the leading economic indicators, suggested that, "Oh, yeah. We're going to have a recession in 2023. No doubt about it."

By the way, I'm just going to say it now. I may say it again, and again, and again. The goal for everybody listening and everybody watching...Our goal is not to avoid a recession. It is to endure it. We're going to give you some tips. Stay tuned to the end of this podcast.

Sam and I have some ideas on how you can prepare and endure whatever might be around the corner.

You talked about leading economic indicators. Can you explain to everybody what they are and what that really means?

Sam: Sure. The leading economic indicators, the economic conference board has three indexes that they look at. There's leading, current, or coincident -- I say current because it's easier to remember -- and lagging.

Leading are all those indicators that point to where the economy is going. It's made up of 10 components. Right now, a lot of those leading indicators are, especially for the past month and the past six months. are trending downward. The only one that's pointing up has been the market. The market has performed well year to date.

Some of these components are new orders. New orders, whether companies are ordering inventory...If we're getting more inventory...If companies are not ordering large amounts of inventory, they're not expecting large sales. That's a leading indicator that these companies, for the next quarter or two quarters, are expecting things to slow down.

In addition to that, new housing permits. New builds. A lot of construction companies, and I'm sure we're going to go into this in a little bit, but a lot of the pain we felt last year had so much to do with the cost of capital going up. We have been spoiled for a decade plus of really cheap money.

You can do a lot of really cool things with cheap money. Who doesn't want cheap money?

Patti: Exactly.

Sam: As soon as that cost starts to really go up, suddenly you get handcuffed. Your monthly payments go up. Your ability to borrow goes down. Now, your liquidity starts to leave the household and things get tight.

When you look at the leading indicators and you see that credit card balances and credit lines are going up but people are extending less credit...That means that credit card balances are going to get maxed out and they can't get more money.

If we think back to the...I don't want to get too much into the weeds, but if we look back to the financial crisis, that was a liquidity issue. That was systemic with the banks. The banks are the lifeblood of our economy and if we can't get cash, we can't do anything.

Again, like you said, 70 percent consumer-based economy. We love to spend money. Companies love to make things for us to purchase, so when we see those indicators going in the opposite direction, not in a boom cycle, those leading...those are the indicators telling us the economy is likely going to follow what these companies are preparing for.

Patti: What's interesting is that...We talked about leading. Coincident indicators. What's currently happening in the economy? It's probably easier to articulate, to figure it out. We've got tons of data, etc.

Then, there's the lagging indicators. The lagging indicators are corporate profitability and the unemployment rate, because at the end of the day, if companies are looking at what they have to tell Wall Street and their profits are down, what are they going to do? They're going to lay people off because that's usually their biggest expense.

That tends to be the last shoe to drop, but by then most of the damage from a recession has already occurred. Leading indicators are important. They have been signalling a recession for 2023.

What's actually been happening?

Sam: Great, great question. I think this is the big puzzle, which is currently, even though the leading indicators are suggesting that things are slowing down, they're not really slowing down that much. We ask ourselves why.

It goes right back to that 70 percent consumer-based economy. That 70 percent of our economy is being bolstered by low unemployment. By the way, payments have gone up. We're making more money.

If inflation's going up but we're also getting raises...Social Security got a cost-of-living adjustment in the rage of eight percent last year. Even individuals who aren't working necessarily and getting raises, they got their raises as well through the government programs.

The expectation that the higher cost of capital was going to really slow down the economy, I do believe that's still going to happen. It's just been pushed out. We're going to go into this in a little bit. However, some of the industries that are hiring the most are the ones that felt the most pain back in 2020.

Patti: That reminds me of what Liz Ann Sonders from Charles Schwab has been talking about. I remember way back to last year. She talked about the looming recession, and these are my words, not hers because it hasn't been that dramatic. She talked about this and has coined the term, to my knowledge, this rolling recession.

In other words, some sectors of the economy got hit right away, 2020, pandemic, then 2021, etc. It's been hitting different sectors of the economy at different times instead of all at once. I thought that was a fascinating analysis. It does feel right to me. That's why it doesn't feel as dramatic and, frankly, even scary.

The market was looking at all those leading indicators last year and said, "Oh, yeah. We're going to get hit big time." Yet, we were not. We have not been because unemployment is still very low. A lot remains to be seen. To your point, the factory orders are a little worrisome because the next thing that will happen is they'll start having massive layoffs.

We have seen layoffs in the different sectors, but it hasn't been massive across the economy. People are still employed. Because of that, they're feeling flush. They've got income. They're paying their bills. They're going out to Starbucks and Costco etc. The credit card balances are increasing though, and the bank balances are decreasing. There are a few headwinds, aren't there?

Sam: Absolutely.

Patti: Sam, let's talk more about this idea of rolling recessions, and what we mean by that. I loved it when Liz Ann Sonders talked about it. Capital Group did a deep dive and got really specific of which sector got hit first, what got hit next, and then next, and then next. Let's talk about that more. What have we learned?

Sam: Gladly. I have to say this is probably some of the most fun I've had doing the research.

Patti: Oh, you are a real nerd.

Sam: It is. It's amazing when you actually look at the data because you can get read the headlines, get all kinds of information, but facts are in the data. It makes perfect sense that the more you mentioned Capital Group looked into it, more and more investment managers are subscribing to this rolling recession theory.

The more we looked into it, the more we realized it makes practical sense. I went back to 2020. Starting there, because that's when we officially had the last recession. It was very short, but we did have one.

Patti: By the way, can I say something about that?

Sam: Yeah.

Patti: Stay on that thought. Hang tight. To me, and I don't know about you, remember, go back to 2020. We were in a recession. The Federal Reserve came out with their bazooka, the federal government came out with the second bazooka.

I believe, don't have anything to give, but I believe when the textbooks come out about the pandemic and the recession and what happened, because again, as we've talked about so many times before, every crisis that we've gone through in America, our leaders have learned.

Whether we agree or not. This is not about Democrats or Republicans. We learn, and we take a deep breath. They do their debriefing.

When they do that this time, they're going to look back and say, "When we look at lowering interest rates and quantitative easing and the stimulus that was put into this economy irrespective of income and need, I believe that the textbooks are going to say that it was the stimulus that really saved this economy because it was so much more powerful than any other nation in the world."

Guess what? Look at our economy. As we compare ourselves to every other nation in the world, we came out of that fantastically, very short recession, not a huge amount of damage, a lot of wealth creation since. Look at every other country around the world. Not so. That's my theory. I don't know.

Again, I'll leave it to the experts in these areas. What did they call? Oh, don't know for sure. The think tanks will tell us in 5 or 10 years, and we'll be reading about it, but that's my theory. Let's go back to this concept of this rolling recession and which industry got hit first, and how that has occurred.

Sam: Going back to 2020, at one point in 2020, we all remember, the market lost more than 30 percent, but it's snapped back very quick, Patti, as you mentioned, because of the large amounts of stimulus throughout the year. The S&P ended the year up over at 18 percent. The NASDAQ, just shy of 45 percent. The Dow Jones, just shy of 10, 9.72.

The market did well despite falling 30 percent in the first quarter. Now, everybody didn't participate in that. We all remember the phenomenon of negative oil prices. They were trying to pay us to take oil. That's what negative oil was. Exon Mobil was down 36 percent in that same year.

We weren't driving anywhere. Nobody was flying. There was no need for oil. Oil had their recession in 2020. The airlines, travel and leisure, restaurants, hotels, nobody was going out. We hear about all this revenge spending now and that's why the prices are going up, but back in 2020, it was non-existent.

Maybe closer to the end of the year. You look at a company like American Airlines, down close to 45 percent for the year.

Patti: That is really interesting. I remember the cruise lines also getting hammered. I don't know about you, Sam. The last thing that I was going to do is get on some boat and get stranded.

Sam: None of us were.

Patti: That's fascinating.

Sam: In that environment, again where we have the global financial crisis, the tech bubble, everything's falling all at once. In that same environment where American Airlines gets cut in half, Zoom video increases by close to 400 percent In the same year. Peloton, I don't

know how many people have Peloton bikes, I have one that is now a coat rack, was up 434 percent.

Patti: What's happened to Peloton since, though?

Sam: I can't wait to get to that.

Patti: Good deal.

Sam: I'll give you this stat. From 2020 till now, as of yesterday's close, the Peloton stock is down 73 percent...

Patti: Wow. That is quite the drawdown.

Sam: ...over a three-year period. Those were...And banks as well. Banks didn't do as well in 2020 because there was this fear if all these businesses are shut down, they're not going to pay back the loans that they owe the banks, individuals if they're not working, unemployment, was close to 15 percent.

There was stimulus, as you mentioned. That helped get us through this. If we didn't have that stimulus, there were going to be a lot more defaults on loans, mortgages, all that. There were industries that did not boom in 2020, even after all the stimulus.

Patti: Despite the overall 18 percent increase in the Standard and Poor's Index.

Sam: That's right. If you're just looking at Standard and Poor's, you would think there was no recession. There was a recession, and for some industries, it was horrible.

Patti: It's back to the Gardner Theory, right? You know you want something blooming all the time. That's the benefit of diversification.

Sam: Absolutely.

Patti: One thing is dead or dying, another one is going to bloom. That's the key to successful portfolio management.

Sam: Absolutely. Fast-forward, go the next year. This is a rolling recession. Now, we're past COVID and there's this talk of interest rates are at zero or they're very low, we're going to need to start bringing these back up. Suddenly, the companies that would be a little more interest-sensitive or will be affected by that started to experience their own recession.

Companies that did well last year, like PayPal, allowed a lot of online payment systems. PayPal was down about 20 percent. Let me start with the S&P. The S&P in 2021 did 28.71 percent, the NASDAQ, 22.18 percent, Dow Jones, 20.95 percent. Again, you look at those indexes, no recession.

Look at certain sectors. I'm sure a lot of folks, and if you were in the market to purchase the house, even now or even back in 2020 and 2021, you probably weren't having fun dealing with all the bidding wars, 50,000 over asking wave inspection. It was a wild time.

Fast forward to 2021 when we knew rates were going up. Zillow, which they even got into the business of giving individuals cash offers, right online. Talk about really trying to take advantage of a situation. They were down 50 percent in 2021. Zoom, the close to 400 performer in 2020, was down 46 percent.

Patti: What I think is interesting about Zoom, Sam, is I don't know about everybody watching and listening to this show, but Zoom has a great business model.

Sam: It does.

Patti: That seems to have overtaken Microsoft Teams and some of the WebX and some of the other video programs. As a business, Zoom seems to be very popular. And yet, the stock is way, way down. Again, another kind of takeaway. Never confuse a business with its stock.

Sam: Absolutely. I love that you said that because if you compare those two, Peloton versus Zoom, Peloton's business model, I would say, isn't as good as Zoom's is. From 2020 til now, what we saw was more of a stabilization, a normalization of the price.

From then until now, it's only down less than three percent. It's come back to Earth.

Patti: That's Peloton?

Sam: No, that's Zoom.

Patti: Zoom, OK.

Sam: Peloton is still down 74 percent. They've got to work on that business model.

Patti: Zoom has recovered a lot of what it lost by focusing on its business model. Peloton still has some struggles. By the way, yours may be gathering dust. I'm still using mine every day. It's the only way I can keep sane. I just love Allie Love and Robin. They are the best, but I digress.

Sam: It's great, but I think, like a lot of individuals, I couldn't wait to get out. I don't like working out in my house. I need to leave my house to go somewhere else.

Patti: You know what's interesting about that, Sam? I need convenience. I need convenient friends. My best friends are in my neighborhood. I need convenient everything. I've got the Peloton at the house. I do 20 minutes, bang it out, then I'm off to work.

Sam: Wait a second, Patti. I don't live in your neighborhood.

Patti: This is true, Sam. This is true. You'll always be my best friend. All right?

Sam: Excellent.

Patti: There was a lot of volatility, wasn't there?

Sam: Yeah, a lot of volatility.

Patti: What's happening now? If we think about current, who's suffering? What sectors seem to be suffering now?

Sam: Ironically, it seems that a lot of the rolling recession, a lot of those sector real downdrafts were 2020, 2021, and 2022. 2022, that was tech. It was the darling tech...

Patti: That's right.

Sam: ...that was the winner for the past 10 to 12 years. I give you those numbers. Apple, down over 26. Microsoft, down over 28. Google, down over 38. Amazon, down close to 50, 49.62. NVIDIA, down 50 percent. Facebook, down 64 percent. Tesla, down 65 percent.

I just went down a list of companies that we are exposed to every day. I don't know what everybody else did last year. I did not cancel my Prime Delivery, I didn't stop using spreadsheets, and I still Google search everything. They're still getting activity. It's not like those businesses ceased to exist.

It was more of a valuation thing and preparing for, again, an economic slowdown as interest rates went up and the cost of capital started going up. You could argue that the normalization for the tech side happened last year. The travel and leisure, more oil, all that, that was 2020.

We even had, with the semiconductors, that's part of tech, we had the supply chain issues. It was such a wild scenario to see brand-new cars selling for less than cars that were two to three years old, because at least, they had their chips. Some of the brand-new cars didn't have the chips. That's not normal. The stock prices reflected that.

Patti: Then, we fast-forward to 2023 and artificial intelligence is all the rage. A company that maybe three years ago, people never heard of, called NVIDIA, what is NVIDIA? Guess what? They are the company that is best positioned to take advantage of artificial intelligence.

It is fascinating some of the political decisions that have been made, in terms of the semiconductors, and chips, and the dependence that we've had overseas allowing factories to be built here right on the US. Soil. That's interesting to me.

I'm not saying that it's an investment theme or any of that. I just think it's interesting. Sure enough, that particular area or sector is doing great.

Sam: NVIDIA is up 200 percent year-to-date.

Patti: Fascinating. We can talk about that further, but let's talk about people. Let's talk about the consumer, because, as we've said, so much is dependent on the consumer.

You and I going out and saying, "Interest rates are seven percent. I'm still going to buy that refrigerator. I'm still going to renovate my home. I'm still going to buy a home."

Is that happening? Probably, on the latter, definitely not. Some of the other things are still happening. It's safe to say that pressure is beginning to build. I thought your statistic and your research, in terms of who benefited most from the stimulus was off the charts. Why don't you share that with everybody today?

Sam: Sure. Back to the theme is, where is this recession? Some of these points that we're going to go through point to the fact that we're not out of the woods yet, because we haven't felt the pressure, as you said, yet. A lot of that pressure is going to be on liquidity. Where was the liquidity from 2020 on?

Studies show that a lot of it was with recent grads, because they don't have high expenses, they don't have high mortgages. In a lot of cases, they don't have children yet. All that stimulus was great for them to just spend. They could just spend it. They could use it.

They didn't have to pay their student loans. I hope they were paying their student loans, but they didn't have to. That's extra.

Patti: That blows me away. I never would have thought about that, Sam, until you brought it to my attention, and it's so true. Again, they are bodies, they are really. They are buyers. They are spenders. They spent the stimulus money, those $1,400 checks, they got them, they spent them.

Sam: They spent them, and they're the ones who they're able to travel, they're able to go around. They don't have a lot of the, I want say restrictions, but for lack of a better term, the limitations that somebody who has a family, has a home may have. They're able to go out there and take advantage of that.

Patti: I don't know about you and Sasha. I don't know that you were taking lots of trips and going overseas. I know Michael and Caylee, my son and daughter-in-law, certainly weren't. Their big trip might have been into Philadelphia to see a show. That was it. By the way, guess who babysat?

Sam: [laughs]

Patti: There you have it. It is a really interesting analysis after the fact, in terms of who benefited and how that helped our economy overall. That's about to change, isn't it?

Sam: That's about to change, and it's about to change on so many different levels, because it's not just the student loans coming back into the picture. That's in October they're going to have to start making these payments.

On average, studies say that on average, an individual has a $500 monthly student loan payment. That's not change.

Patti: That is interesting. That's a lot of money to a recent graduate.

Sam: That's a lot.

Patti: Granted, there might be some who are earning six figures, but these kids are making $60,000 to, on the high side, maybe $80,000 a year. You add that payment to rent, car payments, thirsty Thursdays, all the stuff that they like to do, that's going to put a crimp in their style.

Sam: 100 percent. To add on top of that, the cost of capital has gone up. What are these recent grads, more often than not, going to be doing in the next couple of years, maybe in the next couple of months? Buying a house. The cost of buying a house has gone up significantly.

Whatever your situation was in 2020, as far as your ability to purchase a house, that same house, even with your same income, even if your income has gone up, costs you significantly more today.

Patti: Let's go through an example that you prepared in the white paper. I thought that was fascinating. Good news, bad news, incomes have gone up, but guess what? Housing has pretty much remained the same, hasn't it?

Sam: It has.

Patti: Housing has not gone down, which is surprising to a lot of people, myself included. Now, you couldn't get a house. Now, even if you could get a house, which is not necessarily

the case either, we still have a real inventory issue. Let's say that you could find a house. Let's use an average in America, average cost of 400-plus.

Sam: The median home price in the United States is $436,000.

Patti: Which I don't know, for those of you who are listening and watching, I would be hard-pressed in our area to find a home for that cost that doesn't need a ton of work. You might as well just tear the thing down. I digress. Let's just look at median over American. $436,000.

Sam: $436,000. We're going to assume a 20 percent down payment. That would be $87,200. You mortgage the rest at three percent. At three percent, that was back in 2020, you could get a three percent mortgage. You can get a lower mortgage back when rates were at zero.

Your monthly payment would be $1,471. That's a 30-year mortgage at three percent, $1,471 a month. That's just principal and interest. That same house, let's say in 2020, that's the house you wanted. That's what you could afford. Let's say the price of the house did not go up. The only thing that went up was interest rates.

Your income is the same, your credit score is the same, nothing has changed at all. At seven percent, because that's where rates are right now. I have heard higher, but we'll keep it at seven. 30 years at seven percent, your monthly payment goes from about $1,400 to $2,321. That's an $850 difference.

You add that to the $500 a month student loan payment that's starting back, that's a big headwind. We're talking over $1,300 of a headwind.

Patti: That's all after-tax dollars, right?

Sam: That's all after-tax dollars.

Patti: The new tax law in 2017, most people are not itemizing, so you don't get the benefit of mortgage interest deductions. That's $2,000 of your monthly paycheck that's going to these two items that you didn't have before.

It's an important consideration, and I appreciate you bringing that to all of our attention, in terms of a potential headwind going forward. Let me put it in perspective. Let's think about demographics of America. How many people are we talking about?

One of the things that we're going to talk more about is recessions tend to be very personal. Not everybody feels it the same way. I would offer that if there was such an impact with the pandemic, there may be a reverse impact as we move forward with these new headwinds. Fair to say?

Sam: Yeah, that's fair to say.

Patti: Many people listening remember the days of 14 percent mortgage rates. You might be thinking, "That's nothing compared to what I had." Truly, I remember refinancing to seven percent and feeling like we hit the lottery. Again, everything is relative, but at the same point, we've got this recency bias.

It's human nature. We remember three percent mortgages. Just be aware that that could have an impact not only personally, but on the economy as a whole.

Sam: Absolutely. I would even go further to say maybe the thought would be or the preparation for this environment is maybe it doesn't stay at seven or eight, but the chances of it going back to two or three anytime in the near term is very slim.

Patti: That's the other thing everybody's been predicting, haven't they, Sam? They've been saying, "Rates will probably peak. The federal funds rate peak between 5.25 and 5.35, and then it'll crawl back down again." I don't think so.

I think that what we have today is about what we're going to have. Yeah, they might float down a little bit if we get some recessionary pressures. I wouldn't count on it as it relates to your plans and your quality of life and the decisions that you've got to make.

Sam: 100 percent.

Patti: The other thing that you brought out in your white paper, Sam, is the impact of Fitch and Moody's on the bank ratings and what that could do to interest rates.

Sam: That's big.

Patti: Let's talk about that, because that is not being discussed, and I think that's important for everybody who's listening today who may be looking at making major decisions, like, "Should I buy a home? Should I buy a second home?" Etc. Let's talk about that. This is all brand-new, right off the press.

Sam: This is beginning in August, and it reminds me back of 2011, where we avoided or kicked the can down on the road where the debt ceiling was concerned, but we got downgraded anyway.

Patti: Correct.

Sam: Same thing happened here. We avoided the issue, but we still got downgraded. That was the US, which, OK, we were expecting that.

Patti: We lost our AAA rating. Mm-hmm.

Sam: We lost our AAA rating.

Patti: That was a bummer.

Sam: It was a big bummer. We went from AAA to AA+, but we're still an A student.

Patti: There you go. Love it.

Sam: What happened a week later was Fitch came back and started downgrading banks. What happens when these rating agencies give you a rating, it's like us getting a credit score. The better our credit score, the better our rates on car loans, credit cards, mortgages, all that.

However, if our credit score is horrible, it doesn't mean we can't get that stuff. It's just going to cost us a lot more. Back to that liquidity crunch, that's more money that's being squeezed out of our pockets or corporations' profits.

With their ratings going down, now, banks are...It's a warning to them. It's saying, "Hey, no risky loans. We're watching you." Banks take a step back. They're not going to lend as much.

Patti: Don't you think that the banking crisis that turned out not to be such a bad crisis earlier in the year, may have made the rating agencies a little bit more, "Let's really look at these people."? Because they don't want to get blamed, right?

They don't want to get blamed and say, "Oh, you missed this. Look at SVP. Look at these banks. They went under. They had to be purchased by stronger entities." They are, again, nobody wants to get blamed.

They are taking a much more cautious outlook, aren't they? They are already hitting many banks with downgrades.

Sam: Hitting them with downgrades and putting others on what they call review. Which means they may be downgraded in the future, and that's including J. P. Morgan.

Patti: Which is the largest banking entity in the country. 27 banks are on watch or they've already been downgraded. If I'm on the board of directors of this bank, I'm going to say, "Hey guys, we have to increase our liquidity, we have to really be conservative with our lending practices. Forget the interest rates. We understand that rates are higher."

Typically, you think about banks as being more profitable as interest rates go up. Now they're getting hit with these downgrades, and it may not be the case. What's going to happen? They're going to pull money out of the economy, and those people who want to borrow anyway and can borrow, and are being offered these loans, you're going to pay more.

That's corporations, as well as individuals. Corporations now their cost of capital, as you refer to it, their ability to get cash is going to cost them more money. What does that affect? That affects their bottom line, so their profitability is going to be affected. Their ability to pay their dividends is going to be affected. Even their ratings are affected.

Sam, I love the one statistic you brought out. I couldn't believe it. Yesterday, Sam and I were preparing for this podcast. Sam said to me, "Patti, if you were to guess...There are only two companies that have a AAA rating that are left..."

It used to be everyone wanted to be AAA. That's what you wanted to be. You got the best loans, the lowest rates. It was almost free money. There are only two companies left. Guess which ones they are? Of course, I lost. I didn't guess either one of them.

Sam: You got close, Patti. You said IBM.

Patti: I got close. That's true. I said IBM. I'm an IBM baby, so...It was Microsoft and...

Sam: ...and Johnson and Johnson.

Patti: I should have known J&J. J&J is very conservatively well managed, well run.

Sam: That's it.

Patti: They're the only ones left that are AAA rated. How about that one?

Sam: That's it. What really surprised me about that information was the number of companies that are considered junk bonds, that are considered high risk. Close to one-third of US corporations, 29 percent, are considered high risk debt. These companies issue bonds. Banks issue bonds to raise money.

Patti: Again, let's just drill down. What's a bond? A company basically says, "We could either go to a bank, JP Morgan...We don't want to do that. They're going to charge us eight percent. Or, we could issue a bond. We could float a bond for $10 million, $100 million, and people will scoop it up.

We'll guarantee that 6.5 percent interest for the next 30 years. People will say, "Hey, you're AA rated. I'm going to buy your bond because I think you're still going to be paying me in year 29." Now, it gets downgraded. It's a BB or a junk bond. Sorry, you're going to have to pay.

Sam: You have to pay more. More risk.

Patti: 8.5, because I don't know that you're going to be here in year 29 so pay me more. Risk/return.

Sam: That is exactly how these downgrades trickle down into creating additional liquidity issues, because if banks are lending less, businesses can borrow less. Individuals can borrow less, whether to buy a home or start a business. That slows down the economy. We're not starting businesses.

Patti: Here we are back to this rolling recession.

Sam: Yep.

Patti: The other thing that you brought out was inflation. We haven't had inflation for decades. Now, that's another headwind that we have. Now, it's much, much better. Again, this is not a statement as it relates to political whatever. You've got to give credit where credit is due.

It peaked at 9.1 percent. It's now back down to three. It's not at two percent, but, you know, as painful as it has been, inflation is getting under control. Fair to say?

Sam: It is absolutely fair to say. I don't know how many individuals are in this camp. I know some individuals love Jay Powell. Other individuals do not like him one bit or the Fed for what they're doing with interest rates.

I do admire and respect the fact that they're hyper-focused on keeping inflation down because, as painful as high interest rates are, high inflation is a far uglier beast.

Patti: It is a cancer in an economy. We've got to get rid of it. He's given us some chemotherapy. We're losing our hair and we might be throwing up, but it's the only thing that we know, they know, right now that can cure it.

Let's fast forward. What are the two things that we should take a look at as we face what may be a recession, may not be a recession. Forget about it. What should we be thinking about? What are you telling our clients?

Sam: That's a great question. Oftentimes, we'll get a call. We'll talk to clients. Investors want to know two things about a recession. When is it going to start? When is going to end? If I know when it starts, I can get out before it starts. If I know when it ends, I can get in at the bottom. Nobody can do that.

Patti: Ain't going to happen, guys.

Sam: Not going to happen.

Patti: Don't even try.

Sam: Not going to happen. Those are the two questions that are often asked. I would argue that the two questions that should be asked are, how well am I prepared for this recession? How is my liquidity? How secure am I in my job?

Patti: Those are the two areas. You've got it.

Sam: That's it. A recession is not an issue unless you have a liquidity issue. If you are gainfully employed, if you're working through the recession. You're not laid off. You're able to pay your bills, recessions are temporary. You can just endure it.

Patti: You may not like it, but you can live through it. That is the most important thing. It's not to avoid it. It is to endure it. With enough liquidity and an emergency fund, look at worst case scenario. Run your own numbers. What if you did get laid off? Would you be OK?

In recessions, unemployment tends to increase towards the end of it. If you lose your job, chances are it might be harder to find another job because companies, generally speaking, are laying people off.

Look at worst case scenario and understand where you stand. If you're really secure, great. I love this one line that you said, when it's all said and done, liquidity is only an issue if you have no income and no reserves.

I also think it's important that...because one of the things that people talk with us a lot about is inflation. If we have a recession, what's going to happen with prices and that sort? I think it's safe to say, and I'm going to steal your punchline.

Inflation tends not to go up when we're in a recession. It tends to be, honestly, the cause of a recession because interest rates go up. The damage from inflation has probably been done, whether you're looking at prices at the food store, or clothing, or what have you.

In fact, I would say that inflation tends to go down in the midst of a recession because everybody's pulling back. People aren't buying. Supply and demand. Federal Reserve is lowering interest rates to get us out of it, etc. I would say, at this point, I wouldn't worry about inflation quite as much as we may have been. Fair?

Sam: Correct. Absolutely.

Patti: Now let's talk a little bit about the impact of recessions, and let's talk about how recessions are more personal. Sam, if you don't mind, I think that your story says it all, so let's talk a little bit about that.

Sam: As I was putting this together, I was saying, rather than asking when is a recession going to start, when is it going to end, we should ask ourselves, "What does a recession mean for me?" I was looking back, and the two recent recessions that we had, 2020 and 2008, I was looking at those recessions and what they meant for me.

In 2020, I was gainfully employed here, happily, it was fantastic. I know it was a horrible year where COVID was a concern, so a lot of bad things happened, but recession-wise, it didn't affect my life necessarily. If I go back to 2008, I was just about to graduate college.

Finance major, so you would think that, "Wow, that's horrible. You graduated as a finance major during a financial crisis." In hindsight, it was the best thing that could have ever happened to me.

Patti: Really?

Sam: It was the best, because it was a great learning experience. I'm sitting in the safety of a classroom, learning about recessions, and I happen to live through it. Not to mention, a lot of firms were very eager to hire new brokers at very cheap prices during a recession, so I was able to find a job pretty quickly.

That 2008 recession didn't feel like a recession to me. The more I thought about it, I thought, "I have had a recession, but it had nothing to do with the market." It had more to do with my preparation in life and financially in liquidity, back in 2014. Today, my wife's name is Sasha. We have two kids, Xander and Zoe, and we couldn't be happier.

Back in 2014, it was a bit of a different story. To begin the year, speaking of markets, peaks and troughs, we had our peak. Our son, Xander, was born on March 24th, 2014.

Patti: I have chills, Sam. I remember that.

Sam: Remember that?

Patti: I do remember.

Sam: The birth of any child, it's a beautiful, very exciting time, and also very stressful. We had a high-deductible health plan, so we had some medical bills that racked up, but we didn't even think about them. I'd say, "You know what? We'll pay it off over time. Look at how beautiful he is. I shouldn't be worried about medical bills."

Fast-forward nine months later. We're now close to Thanksgiving, and my wife wakes up with a very stiff neck. She checks, and she has a large bump on her neck, so she gets it checked out. Several tests, she's hearing different things. After about a month, we finally learned that she was diagnosed with Hodgkin's lymphoma.

That was our trough. The market that year went up 14 percent. I didn't care. I had money in my 401(k), that didn't make a difference for us. What we needed at that time was support, and we didn't get that from the market. We got that from the individuals that we worked with here. A lot of you listening to this right now helped us get through that.

You still ask about Sasha, and I can't thank you enough. You guys helped me get through my recession, and it had nothing to do with the market. We learned very quickly that we have to prepare, so we buckled down. We moved into my parents' basement with our newborn, and we just reassessed.

We got through it with the support of loved ones, with the support of Key Financial, and the support of all you out there.

Patti: I have to pull myself together, because I remember that so acutely. When you think about your personal recession, that time, how awful it was, I remember one day saying to you, "Sam, work is optional. You do what you need to do for Sasha. I don't care if you never come in. We got your back."

You started to cry, and I cried, it was just such a difficult period of time. As you think back to that period of time, Sam, what would you say to people listening? What is the biggest take away from it?

Sam: The biggest takeaway is, what's important is the support that we have around us, who help us get through and endure these tough situations. We can only control what we can control. We can't control the markets. We can't control illnesses. Ultimately, it was having the support of those around us that got us through that. It was not monetary or market-related at that point.

Patti: From a practical perspective, what do you think would have made it a little bit easier? I'm going to give you a hint. How about a big, fat bank account? That emergency fund that we all talk about.

Sam: I did a podcast, you and I did, Patti, about children and finances. I remember going back to how we would pay bills with the family.

That's what we got back to, because we were living in my parents' basement, and I saw my mom at the table, doing the bills. To your point, I was like, "We wouldn't be in this situation if we were prepared for this."

Patti: As we've talked about many times before, what we talk about every day, hope for the best, plan for the worst, and run the numbers. It's different for everybody, so this thing about the economy, the thing about recessions, markets, it is what it is. You're not going to avoid these things. The worst thing that you can do is to try, because there's significant cost in doing so.

The key is to endure it, get through it, whether it be a personal recession or an economic one. Sam, I've pulled myself together. Thank you so much for sharing your story. It's life, and that's what we do. If I may speak for you, Sam, I think your experience makes you a better advisor.

I know the experiences that I've had over my life, whether it's dealing with my parents and what they went through, whether it's dealing with raising four children...There must be something about this basement theme, because...

Sam: [laughs]

Patti: Sam, you worked in my basement for many years, right?

Sam: I did.

Patti: Whatever it might be, the struggles, the adversity, you'll get through it as long as you're surrounded with people who believe in you, someone who can give you that perspective and, most importantly, give you the guidance to tell you, "OK, here's the next right thing."

Sam: I couldn't agree more.

Patti: Sam, thank you so much for joining me. Thank you so much for sharing that very personal story and taking us back to that time. Do you agree or not? Is he Mr. Relatable or what? Thanks to all of you, by the way, for listening and for watching. Thank you for going to our website and giving us these ideas.

Please feel free to continue to do so. We're here for you. Many people come in, they hear a podcast, and they want to brainstorm with us about it. It's a great opportunity to have an extra set of unbiased eyes to say, "Here's how we believe you might be affected by a potential recession."

Don't know if it's going to happen. If it does, here's what you want to think about. A, B, C, you walk out. It's wonderful. I love giving people action items. It's a real feel good and those people feel fantastic. Thanks again for joining us. Go to our website at keyfinancialinc.com. In the meantime, thanks so much for joining us. Take care. Bye-bye.