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TFA Monthly Newsletter

September 2023

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Tribe building trade zone to make money, jobs
8/14/23 – ictnews.org

Wilton Rancheria's Sky River Casino Celebrates 1st Anniversary
8/15/23 – sacramentopress.com

Tesla discovers wildly creative loophole to sell cars in states where its showrooms were previously banned
8/15/23 – [msn.com](msn.com)

Casinos to clinics: a new economic frontier for Native American Tribes
8/16/23 – [nit.com](nit.com)

Two words that changed the Farm Bill
8/24/23 – ictnews.org

The Indigenous tribes reclaiming travel
8/28/23 – [bbc.com](bbc.com)

Pequot Woodlands Casino Opens at Foxwoods Resort
8/30/23 – casino.org

The Soft Landing: or How I Learned to Stop Worrying About the Inverted Yield Curve

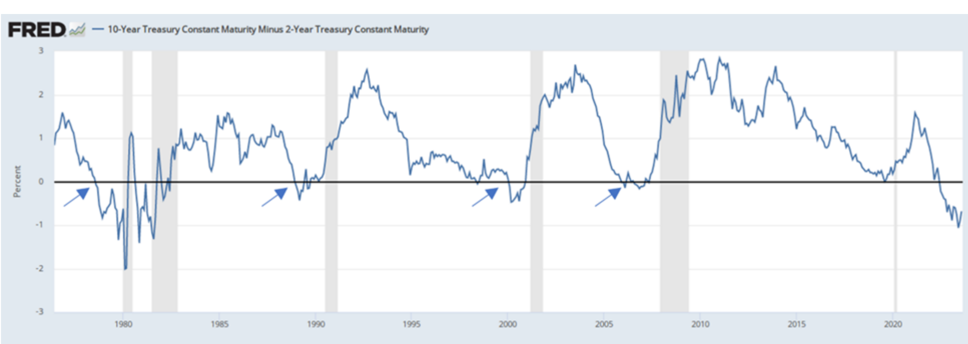
By Braxton Sato

Four years ago in our September 2019 newsletter – we discussed the concept of the Inverted Yield Curve as a predictor of domestic economic recession. In short, since 1970, all recessions have been preceded by a period where the 2-Year Treasury Yield (currently 4.97%) exceeds 10-Year Treasury Yield (currently 4.26%). Under normal economic and market conditions, the 10-Year should have a higher yield than the 2-Year to compensate the investor who is lending for a longer period (this is called the "term premium"). The chart below demonstrates this relationship between inversion (where the blue line dips below the X-Axis) and recession (the grey bars).

This latest inversion began in July 2022, and currently sits at a whopping 71 bps difference. As referenced in our previous newsletter, the average lag between first inversion and recession is 14 months. Also, as evident in the chart below, the magnitude of this latest inversion is the largest since 1980. So traditionally, according to this indicator, we should begin to see signs of recession soon. However, this indicator does not paint the entire picture and should be taken into consideration with other factors.

<u>Did COVID Disguise a Recession?</u>

Although not evident in the month-end numbers in the chart, during 2019 the yield curve was inverted for much of August and September and market participants and economists were both voicing concerns about recession. What we can say with certainty is



Source: https://fred.stlouisfed.org/graph/?g=183Q2

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that the Yield Curve did not predict the anomalous COVID-induced 2020 recession (a few conspiracy theorists may disagree). However, what remains to be asked is did the COVID shutdown disguise a more typical recession that was predicted by a short-lived inversion yield curve in 2019? Complicating this investigation of the yield curve as a good predictor of recession is the economic impact of the $5 trillion in stimulus funding during the pandemic. Fiscal policy may have bought us some time, but four years later, we are seeing the influence of that stimulus burning off.

Conditions Then (2019)

- **Weakening economic data**, but no signs of recession in other **leading indicators** (PMI Index, Consumer Confidence, WSJ Economist Survey).
- Looming Trade War with **China**.
- Negative treasury rates in **Europe and Japan** and the flight to US Treasuries as a "safe haven."
- **Strong credit markets**.

Conditions Now (2023)

- **Backward-Looking Economic Data Remains Strong**. 2Q23 GDP grew 6.3% year over year. The Federal Reserve Bank of Atlanta predicts 5.6% growth in the third quarter. The job market remains strong, and inflation continues to rise, primarily driven by shelter and transportation costs. July Personal Income and Consumer Spending both continued to rise.
- **However, leading economic indicators** are significantly worse than in 2019. The PMI Index has been below 50 since October 2022 and is continuing to worsen. Consumer Confidence is better year over year, but still significantly pessimistic. The WSJ Economist Survey put the probability of recession at 54% as compared to 40% in 2019.
- **China** is no longer a trade war threat – but an imminent recession there threatens to ripple through the global economy. As one of the largest holders of US Treasuries, economic troubles in China could put downward pressure on a variety of Treasury maturities. We do not know the exact composition of China's Treasury portfolio, nor do we know which maturities would be or have already been sold to generate liquidity for domestic stimulus. Escalating tension relative to Taiwan has increased instability and caused cautious investment in the region.
- **European and Japanese Treasury markets have recovered**, and no longer have negative yields.
- **Significantly worsening credit markets** – major banks have been downgraded, supply of credit is rapidly shrinking, many lenders to Indian Country are tightening underwriting standards, sticking to working with existing clients, and in some cases pulling back commitments.
- **Increase in the number Distressed Firms** since the Fed began increasing interest rates, with increasing risk of a cutback in private sector investment and hiring.

Recession or Soft Landing?

The possibility of a "soft landing" wasn't mentioned in the 2019 newsletter. This is the scenario where we have an economic slowdown, but don't officially go into a recession. The majority of economists and many bankers are predicting a soft landing instead of a recession. We are watching the Federal Reserve very closely, as they will play an outsized role in whether we end up in a soft landing or a recession. The Fed has a mechanism to boost GDP by increasing the supply of money, which results in lower interest rates, which results in more investment spending. However, they cannot cut rates too soon or risk stoking inflation further.

What Should Tribes Do?

Credit markets are no longer as strong as they were in 2019. Instead of leveraging significantly, we advise securing access to lines of credit and shoring up cash reserves, taking a more conservative approach to capital structure.

Our advice remains the same now as it did prior to COVID – **DON'T PANIC**. There will be a recession again one day, but we don't see many signs that one is imminent. Keep an eye on the market and other economic indicators, especially consumer and purchasing drivers. If working on 2024 budgets or evaluating economic development projects, management and tribal leadership should recognize recession risk, but don't use the downside as the "base case."

As always, we are happy to talk with you about how to best approach your Tribe's capital needs in this unique and uncertain economic environment.

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