

Santa Barbara County Employees' Retirement System

U.S. Economic Update

December 2023



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Tom Porcelli is Chief U.S. Economist at PGIM Fixed Income. Mr. Porcelli is responsible for leading the formulation of PGIM Fixed Income's views on the U.S. economy, contributing to the internal investment process, and engaging with clients and key stakeholders on timely macroeconomic developments. Prior to joining the Firm, he was Chief U.S. Economist at RBC Capital Markets for 14 years. In that role, he focused on forecasting and creating narratives around the U.S. economic backdrop as part of the global economic effort. Mr. Porcelli worked closely with the various functional units within RBC Capital Markets and traveled globally to meet with RBC clients to share his insights on the U.S. economy and markets. Before RBC he worked as an economist at Merrill Lynch where he was a member of the team responsible for economic forecasting and Fed watching. Mr. Porcelli began his career at the Federal Reserve Bank of New York working on the Open Market Desk. In this capacity, he was closely involved with the execution of and analysis around monetary policy. In addition, he was responsible for disseminating pertinent economic and market analysis to policy makers in an effort to provide them with critical information used in the policy making process. Mr. Porcelli appears regularly on Bloomberg and CNBC and is quoted widely in the global press. He holds a Master's degree from Columbia University.

Peter Taggart is a Principal, Client Advisory for PGIM Fixed Income. Mr. Taggart works with our largest institutional investors in developing fixed income solutions to meet their needs. Mr. Taggart has more than 20 years of experience in the investment management business, structuring and managing portfolios for U.S. and international institutions. Prior to joining the Firm in 2002, Mr. Taggart was Executive Director of Marketing with WestAM. Previously, Mr. Taggart was Managing Director with Forstmann-Leff, where he was responsible for marketing equity, fixed income and private equity investment services to institutions. Prior to Forstmann-Leff, Mr. Taggart was with Salomon Brothers Asset Management for nine years, in both bond portfolio management and client relations positions and at First Boston Asset Management, where he was a bond Portfolio Manager. Mr. Taggart received a BA in Computer Science from Colgate University.

Robert Ventura, CFA is a Manager in Client Management for PGIM Fixed Income. Mr. Ventura is responsible for providing comprehensive support for PGIM Fixed Income's institutional clients including development of customized client communication plans, responding to daily client inquiries, and coordination of activity with our client's service providers. He joined the Firm in 2011. Prior to joining Client Management, Mr. Ventura was a Senior Specialist in PGIM's Hedge Fund Administration group where he was responsible for various reporting, accounting, and regulatory requirements for a variety of PGIM's alternative products including Hedge Fund, UCITs and Qualified Investor Accounts. Mr. Ventura received a BS in Finance from The College of New Jersey and holds the Chartered Financial Analyst (CFA) designation.



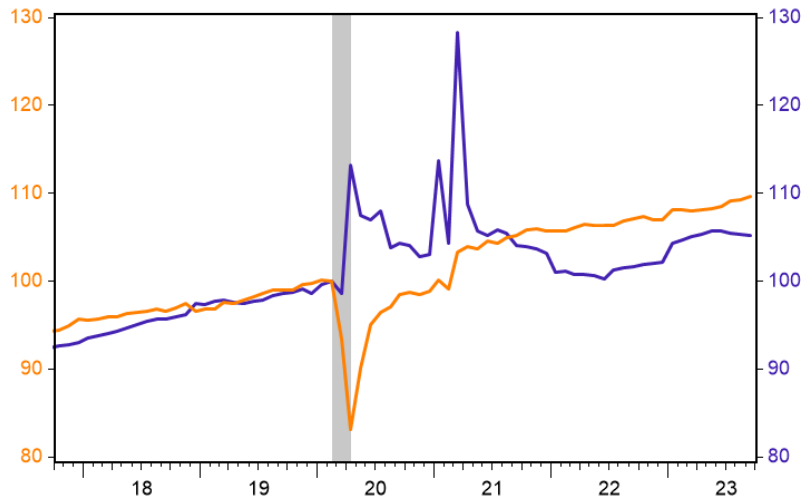
U.S. Economic Outlook 12 Months Out—Potential Scenarios

Scenario	Description	Probability (%)
Weakflation	<ul style="list-style-type: none"> Tight monetary, fiscal, and credit conditions slow cyclical momentum to a below-trend pace of real GDP growth of between 1.0-1.5%. Inflation descends to 2.5-3% - somewhat higher than the 2% target – due to sticky services inflation and structural forces. Still, the downward movement of inflation – plus below-trend growth – allows the Fed to “fine-tune” policy rates with a 50 basis points easing next year. Risk assets perform reasonably well, though elevated inflation keep yields elevated. 	35%
Recession	<ul style="list-style-type: none"> The labor market runs out of steam, denting income and spending just when the combined weight of tight monetary and credit conditions begins to mount. Unemployment rises and inflation falls rapidly, leading to a substantial Fed easing cycle starting in Q4 23. U.S. rates rally and risky assets correct lower. 	25%
Soft Landing	<ul style="list-style-type: none"> Growth remains solid in the 1.5-2.2% range, while inflation converges toward the 2% PCE target. Labor supply outpaces demand but consumption remains robust enough to power growth. Fed cuts rates to 3%, creating a favorable environment for interest rates and risk assets. 	15%
Nominal GDP Boom	<ul style="list-style-type: none"> Growth is moderately above trend while inflation reaccelerates due to energy market volatility and structural labor imbalance in the services sector. Solid labor market supports consumer demand, while above-target inflation means the Fed raises rates by another ~100bps. Front-end repricing further inverts curve with widespread losses across fixed income. 	15%
Roaring 2020s	<ul style="list-style-type: none"> U.S. growth accelerates significantly above trend, supported by productivity growth due to public investments and the diffusion of technology. Inflation drops rapidly due to positive supply shocks and the labor market eases due to sustained immigration. The Fed cuts rates to mid-3%. Risk assets and rates rally. 	10%

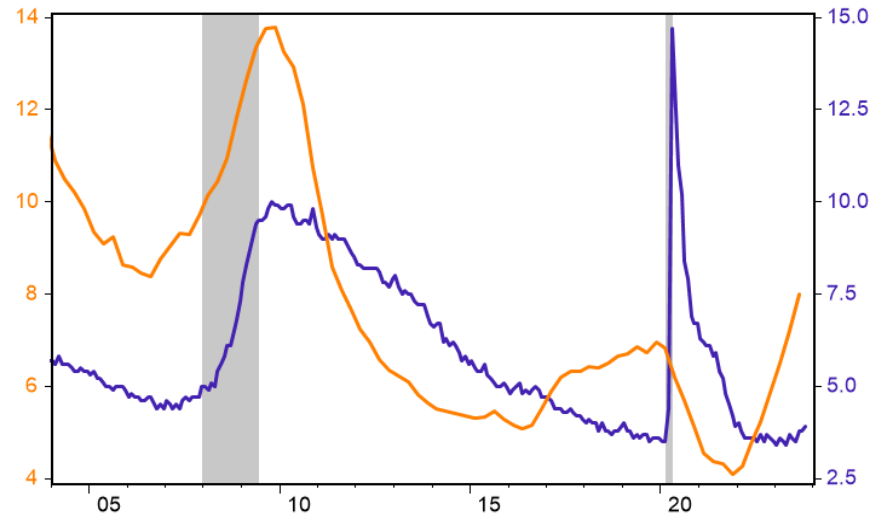
As of September 2023. Source: PGIM Fixed Income and Bloomberg. **Past performance is not a guarantee or a reliable indicator of future results.** Please see Notice for important disclosures. The forecasts presented herein are for informational purposes. There can be no assurance that these forecasts will be achieved. Survey forecast for global growth based on average forecast from several broker dealers and PGIM Fixed Income calculations.



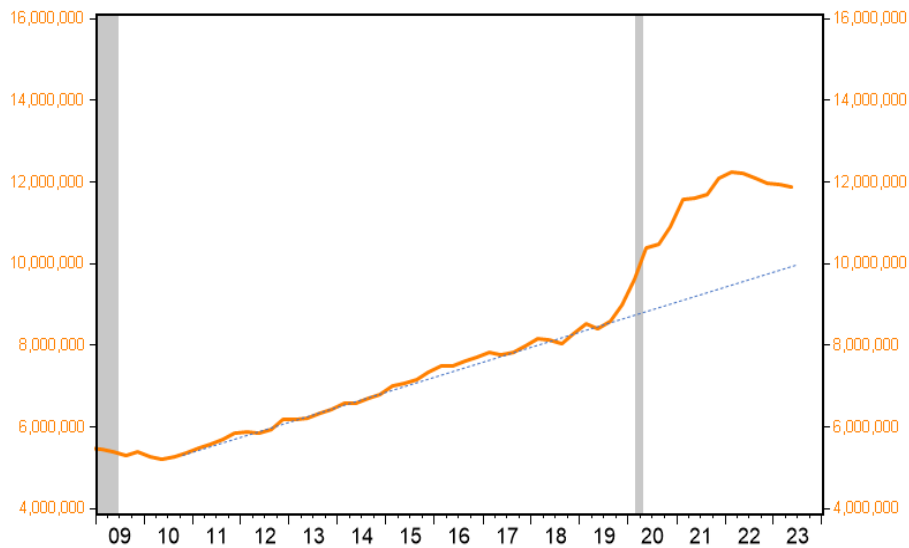
Real Personal Consumption Expenditures
202002=100
Real Disposable Personal Income
202002=100



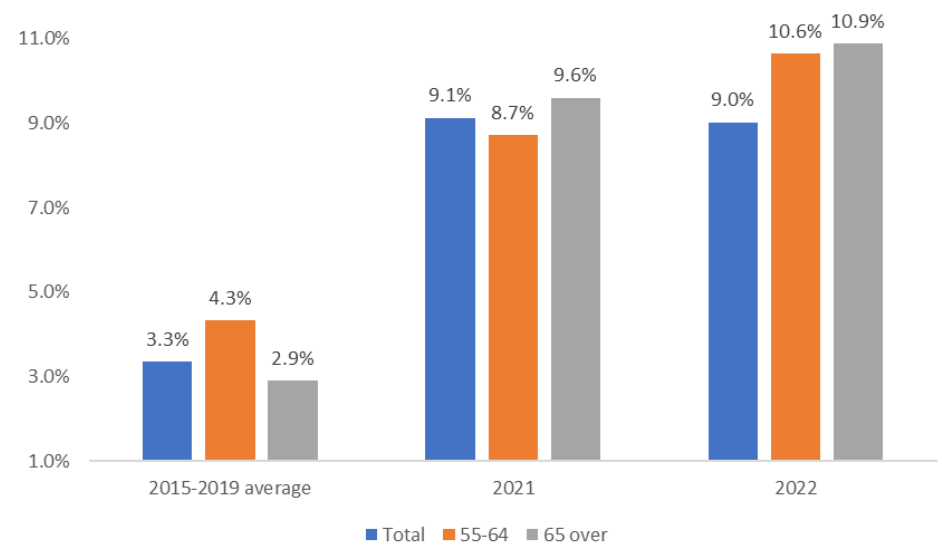
NY Fed Credit Panel: New Delinquent Credit Card Balances
% of Current Balance
Civilian Unemployment Rate: 16 yr +
SA, %



Cash and equivalents for 55 and over
(millions)



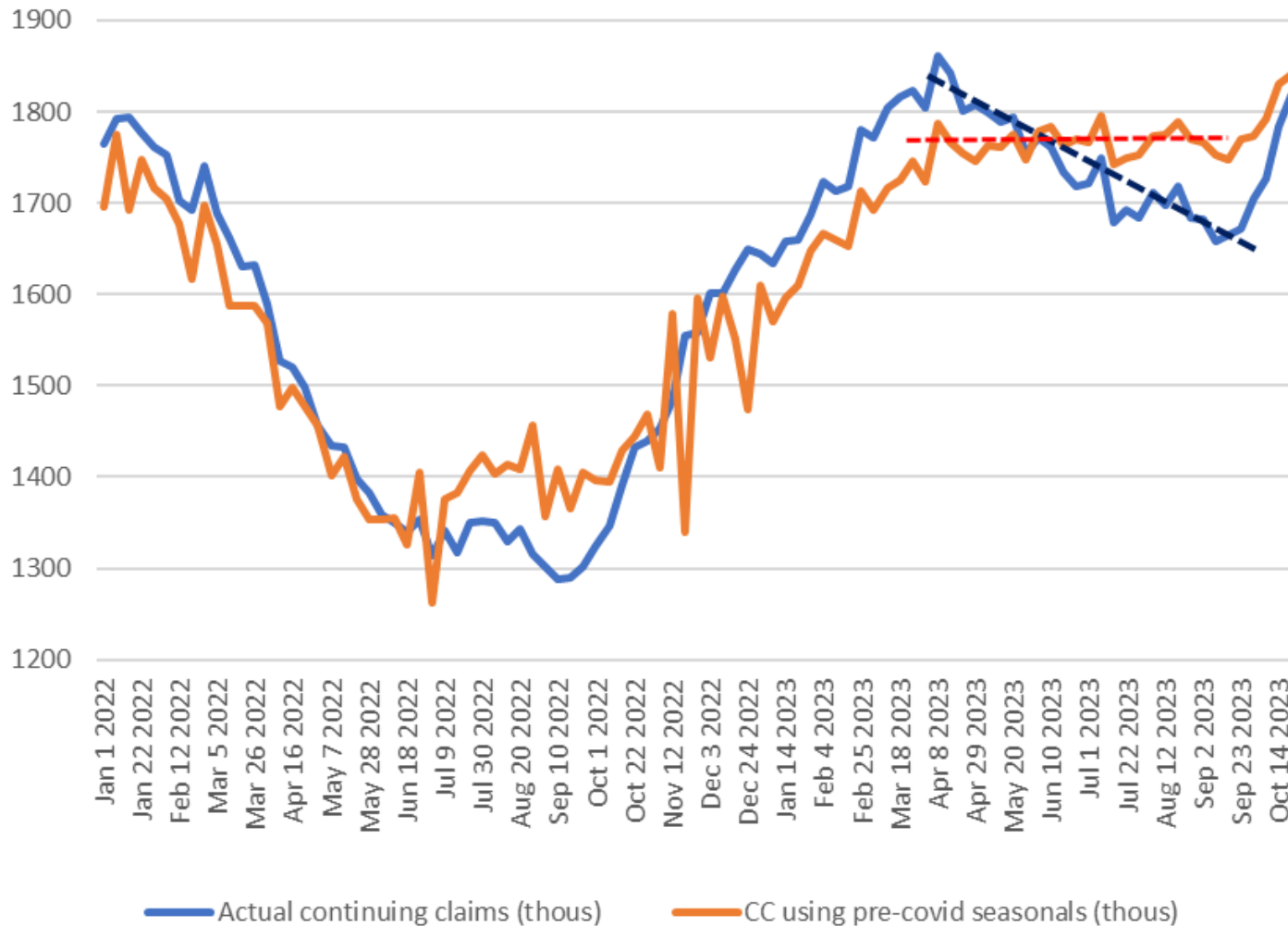
Growth in average annual expenditures by age cohort



Source: Haver Analytics. Last updated: November 2023.

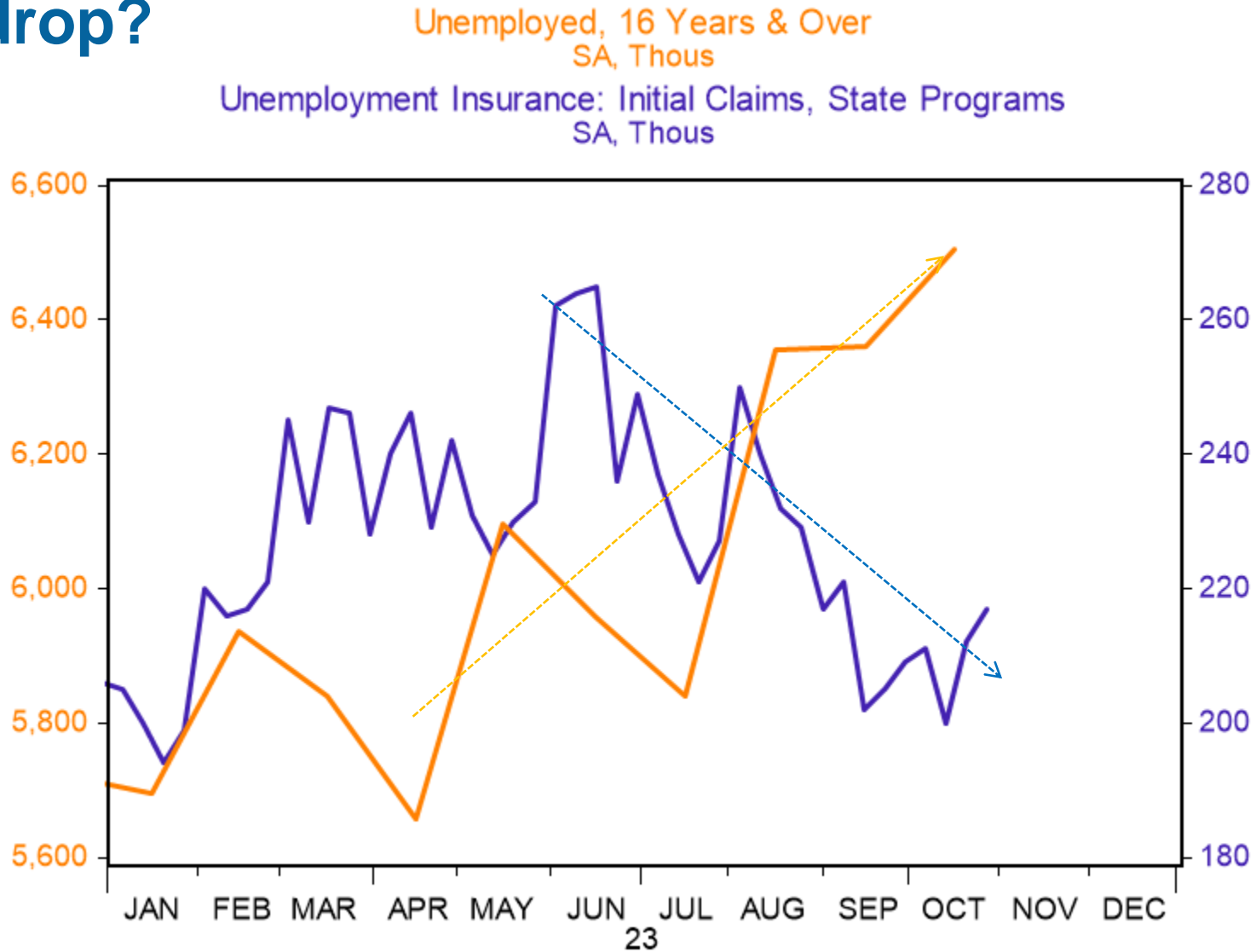


A simple adjustment to claims yields very different results





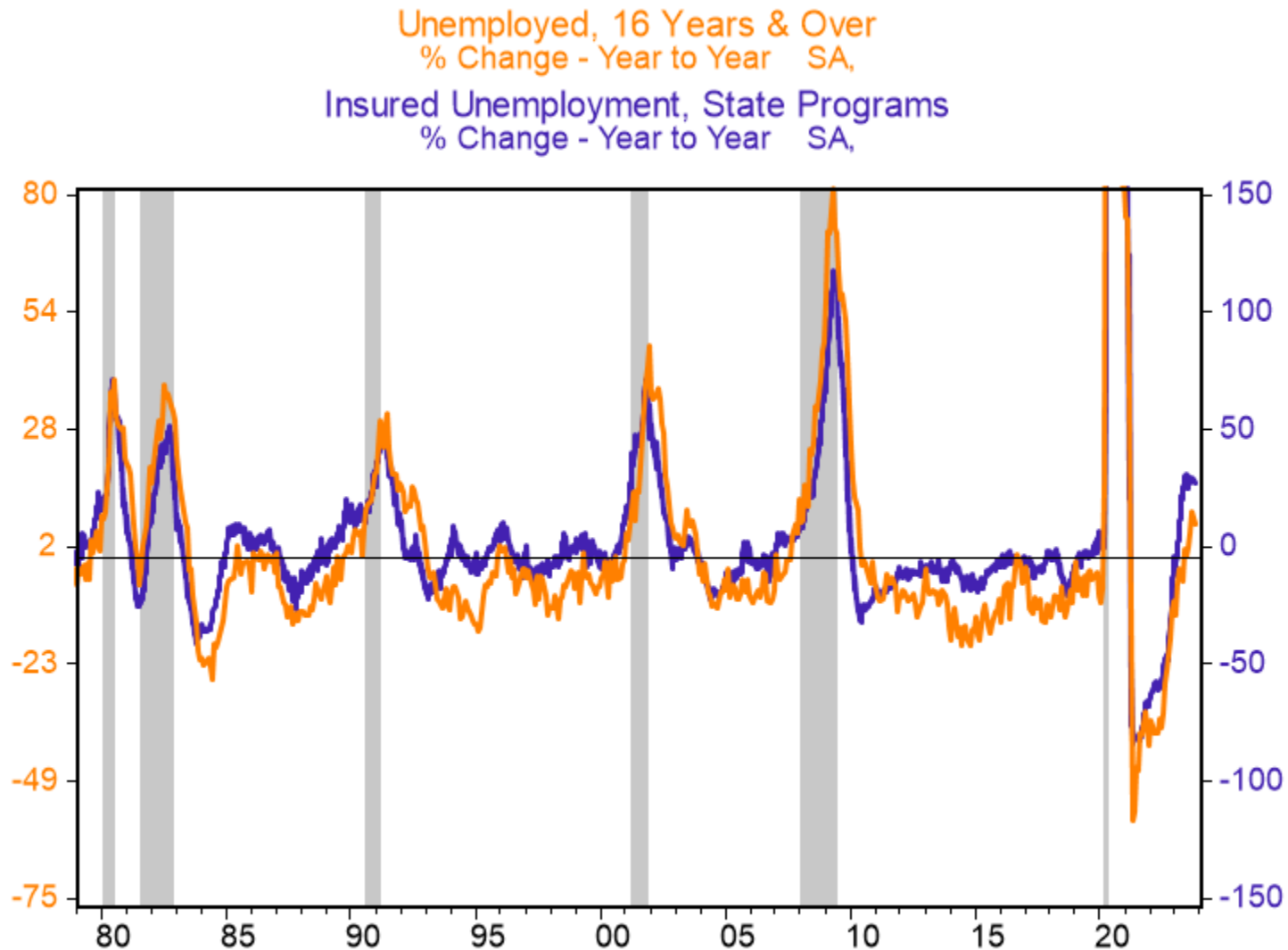
Have initial claims been a poor signal of labor backdrop?



Sources: Bureau of Labor Statistics, Department of Labor/Haver Analytics



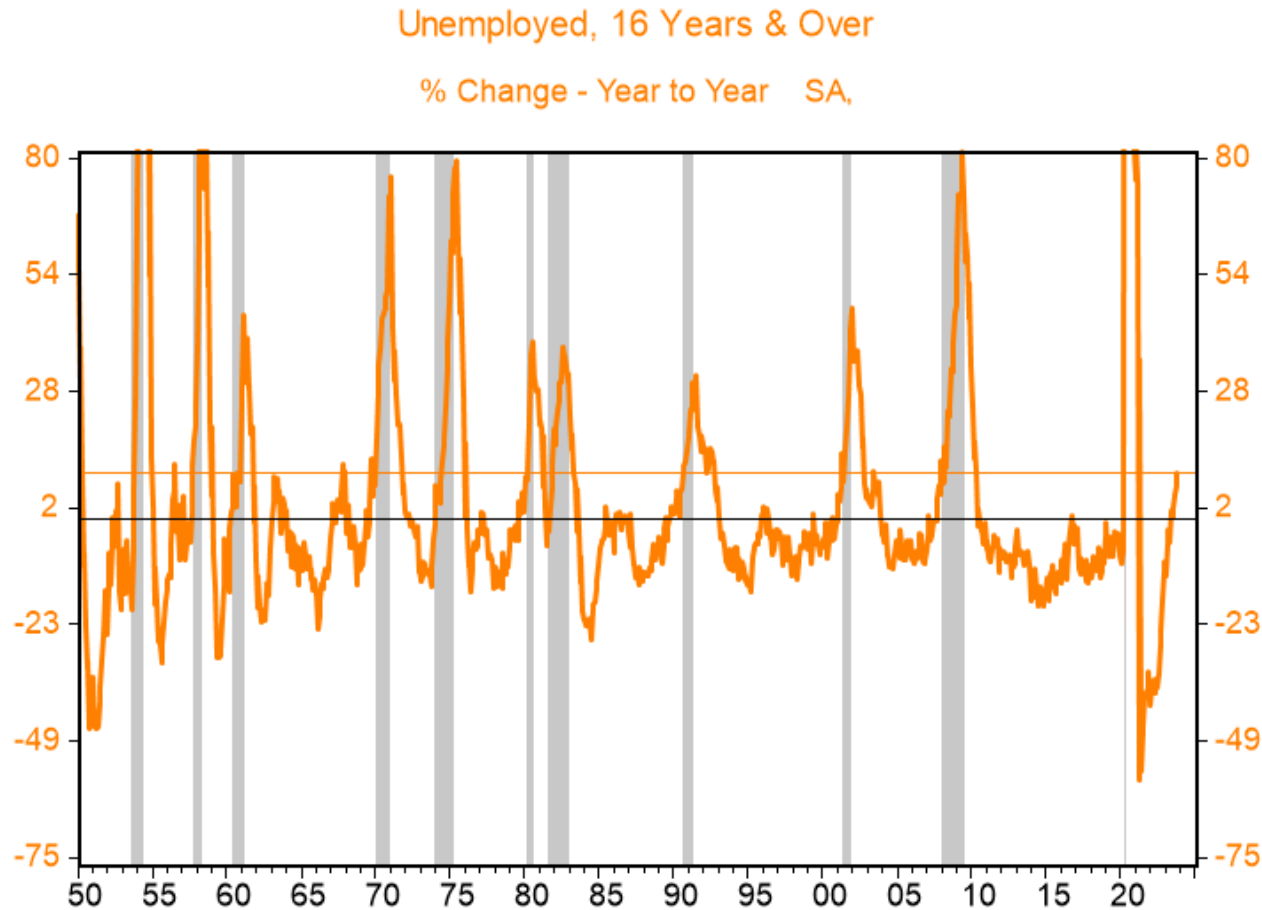
Continuing claims seem to be a better signal



Sources: Bureau of Labor Statistics, Department of Labor/Haver Analytics



An important signal of underlying labor market weakness...

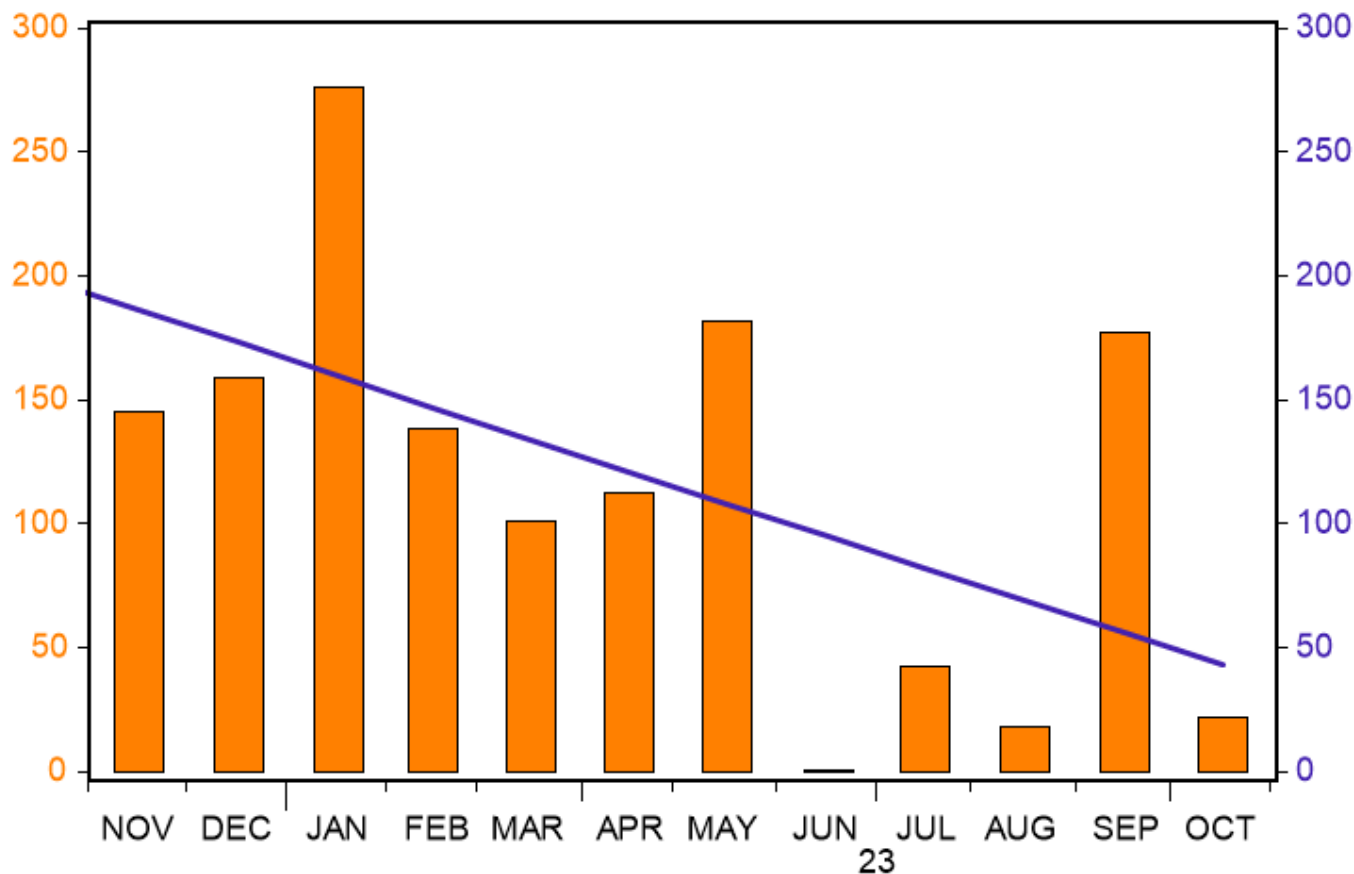


Source: Bureau of Labor Statistics/Haver Analytics



Cyclical employment is slowing

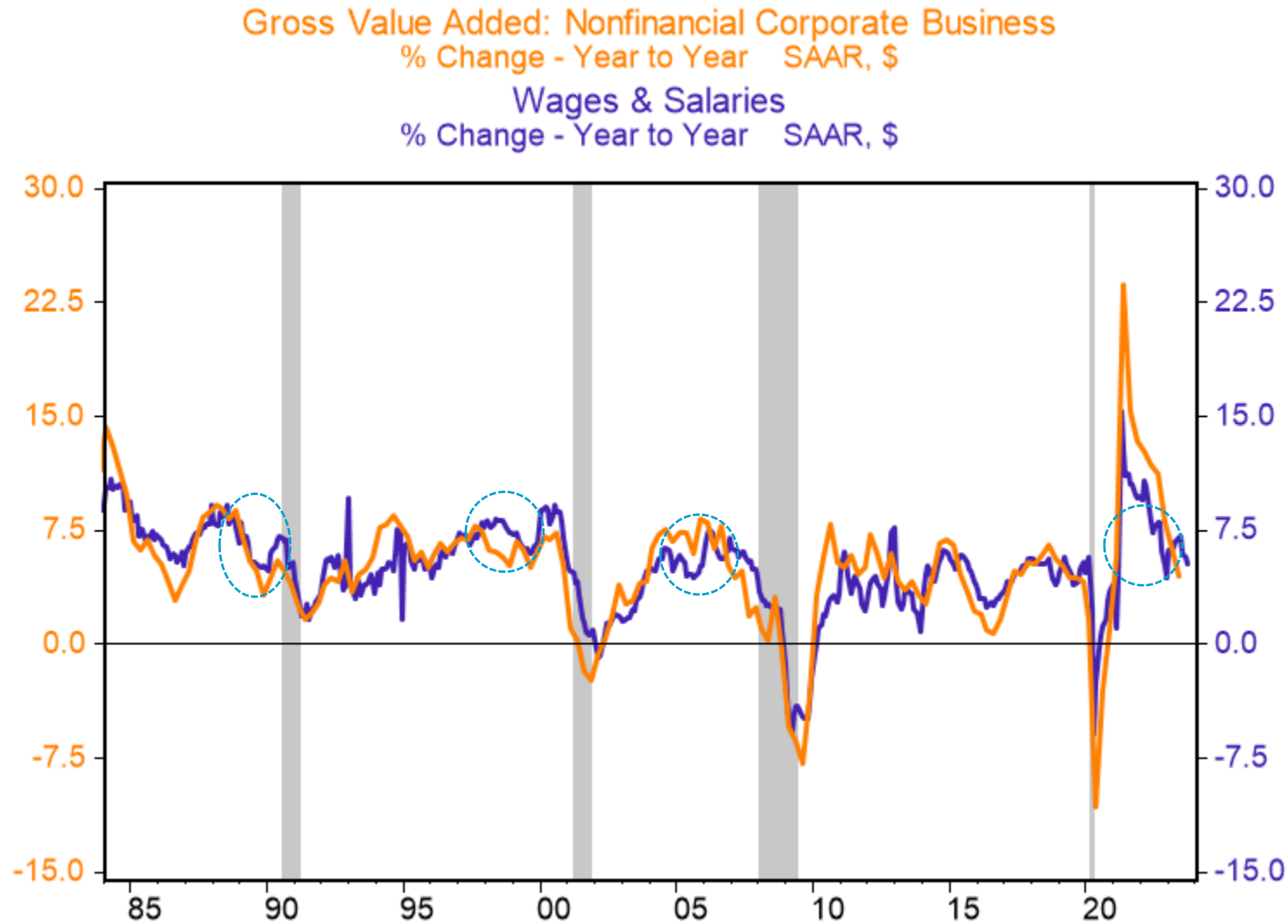
Private payrolls less healthcare
 Change - Period to Period (Thousands)
 (trend)



Source: Bureau of Labor Statistics/Haver Analytics



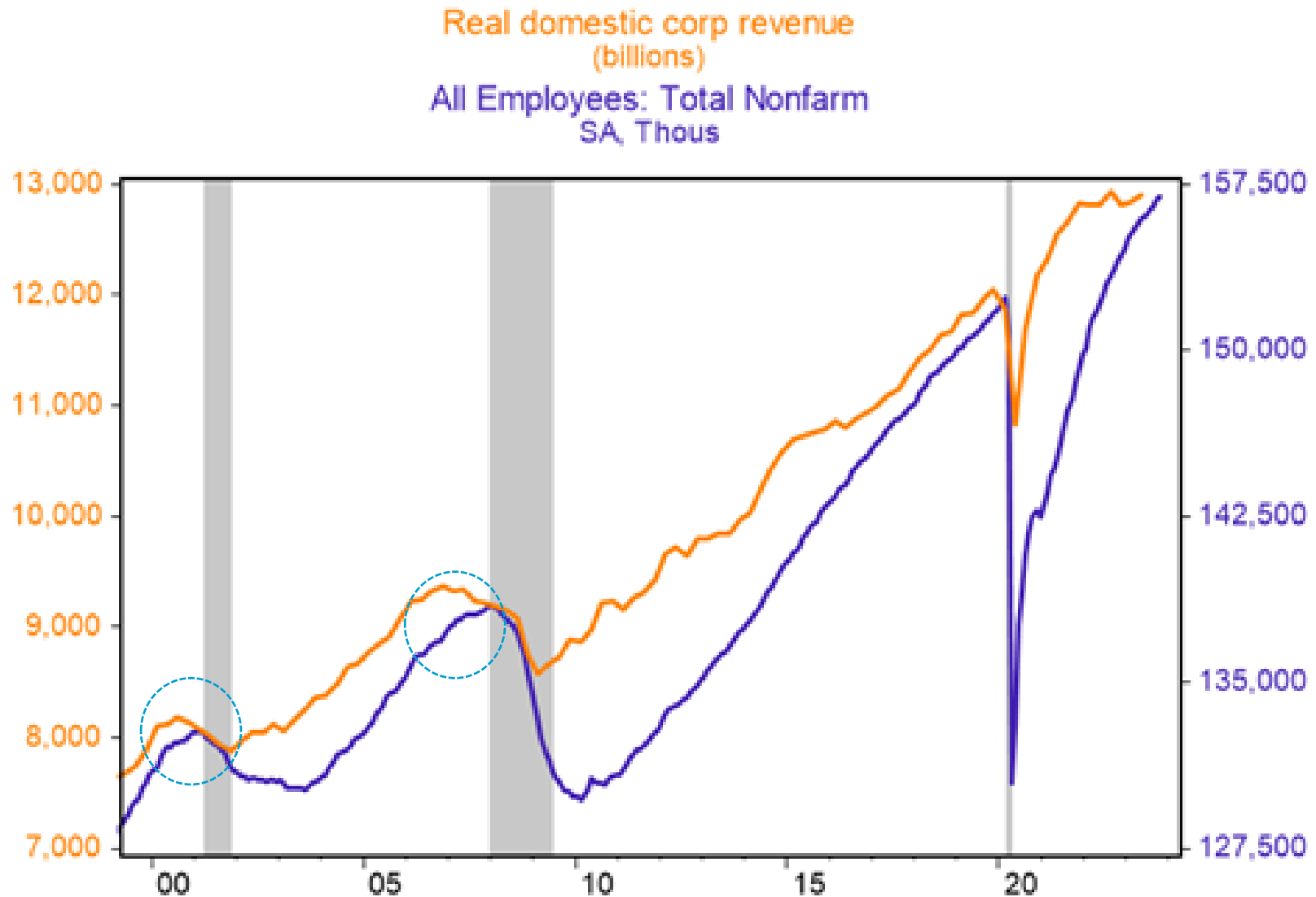
Revenue running north of wages is not sustainable



Source: Bureau of Economic Analysis/Haver Analytics



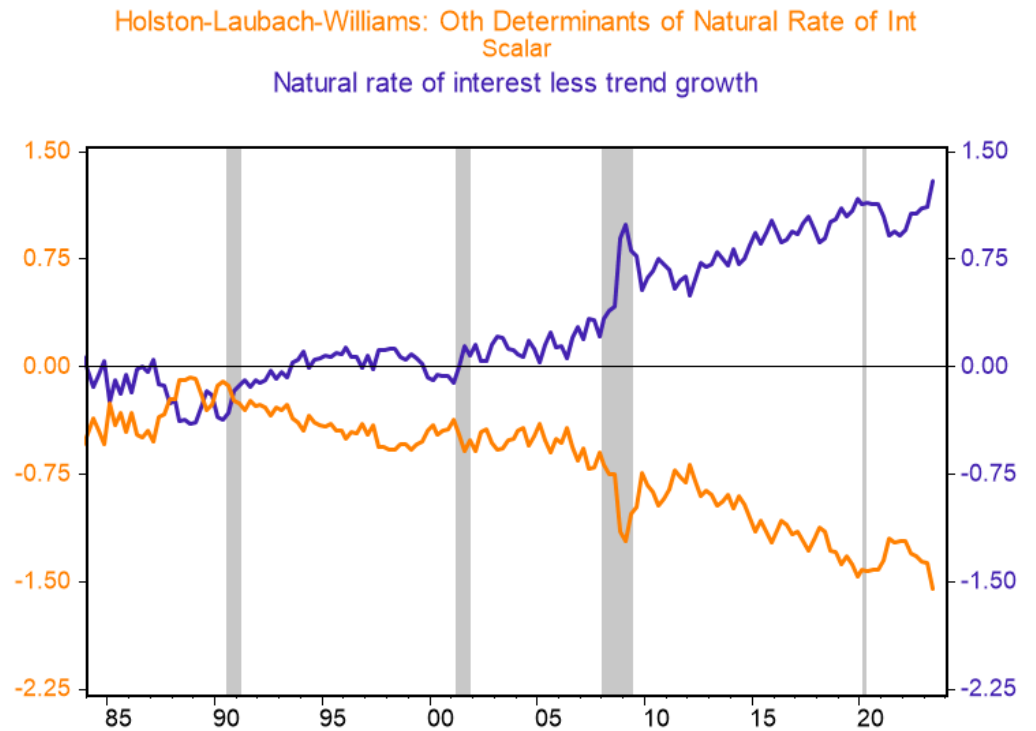
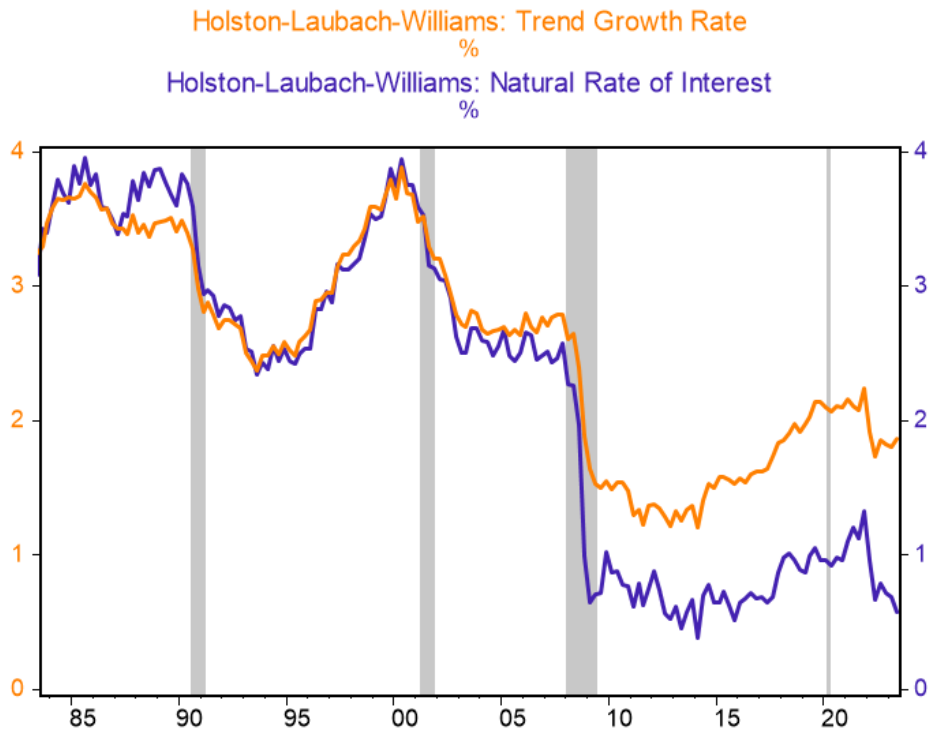
Real revenue tends to roll first, employment follows

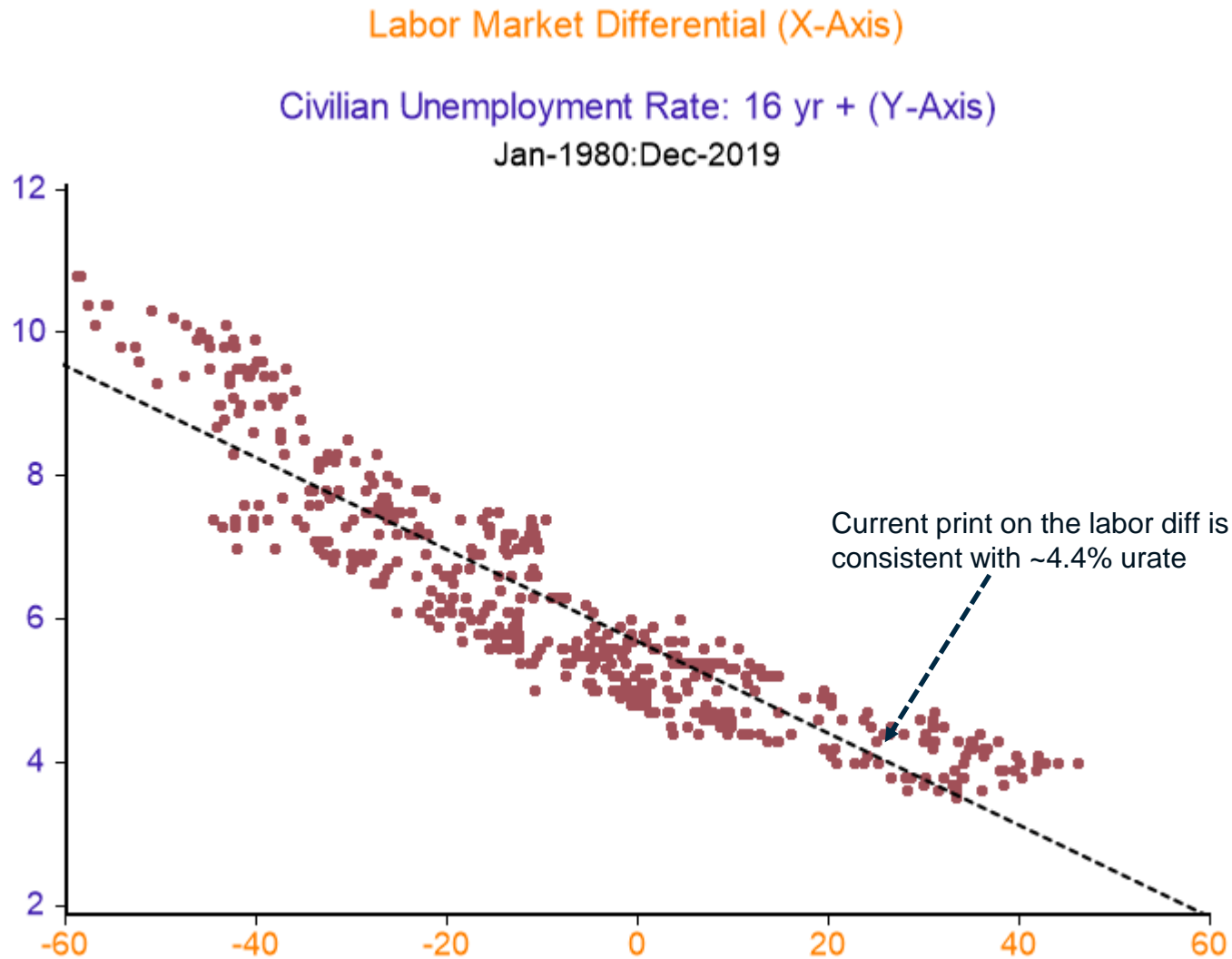


Source: Bureau of Labor Statistics/Haver Analytics



Something to note on the Fed



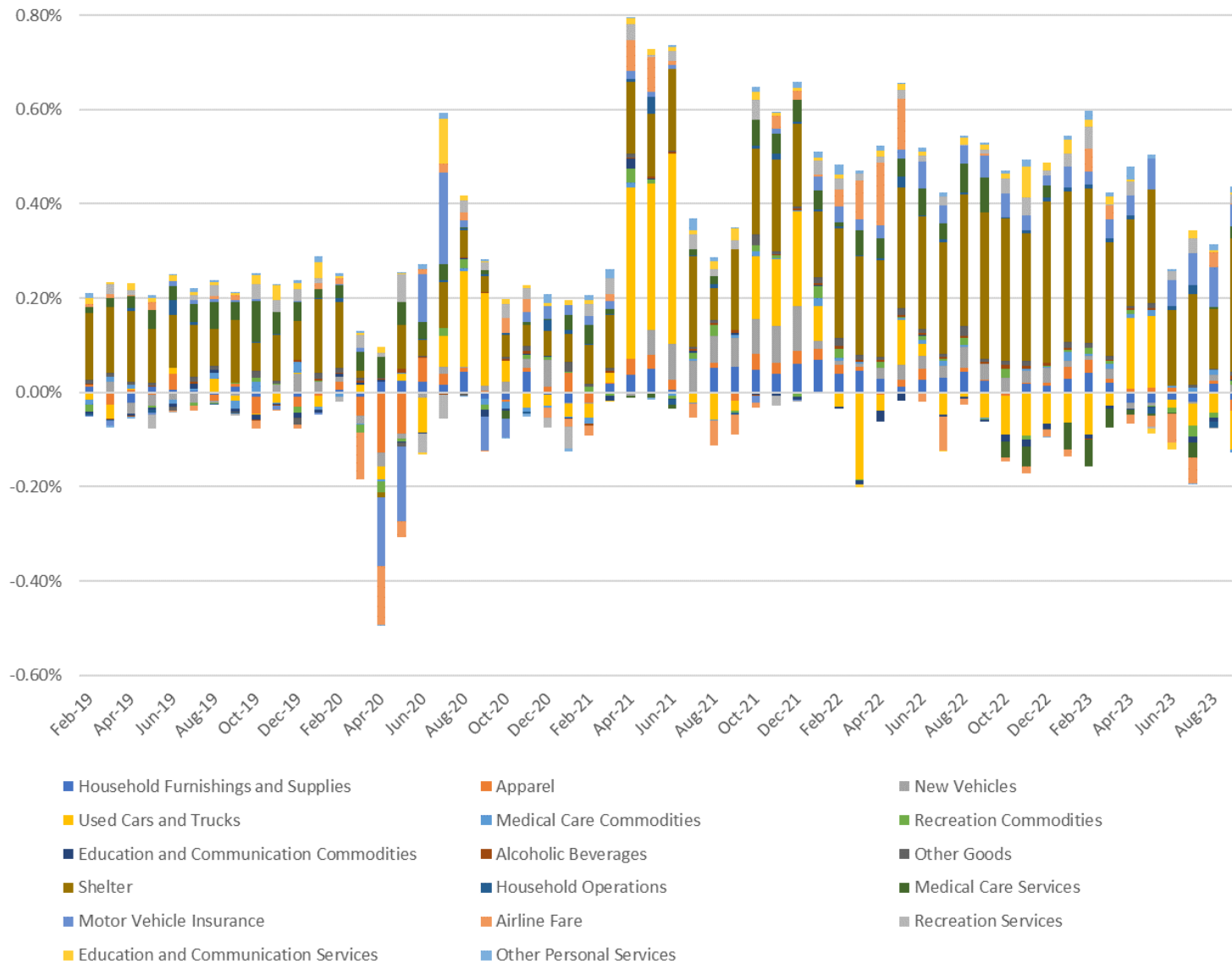


Sources: The Conference Board, Bureau of Labor Statistics/Haver Analytics



Shelter prices: ever additive...

Contributions to Core CPI



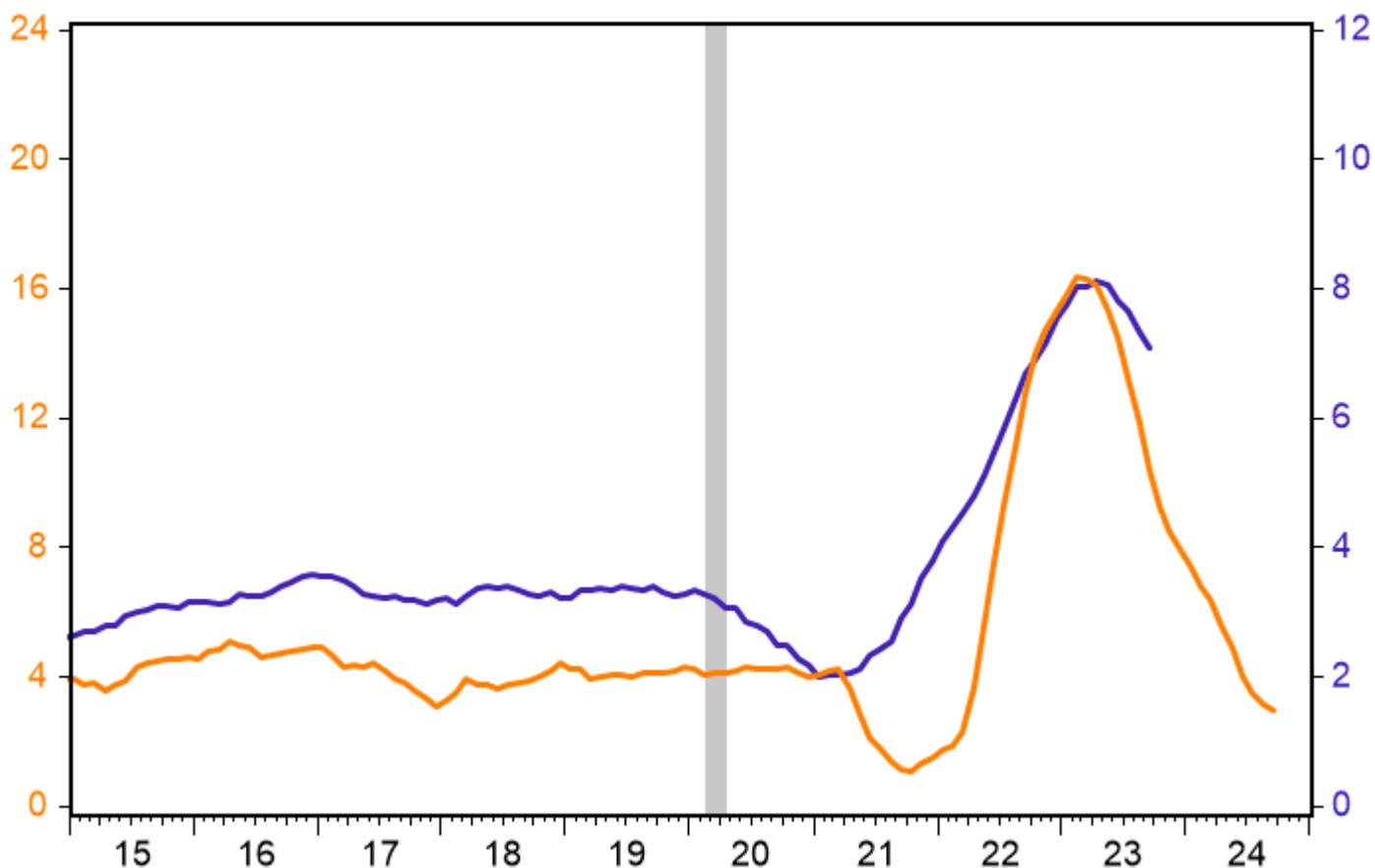
Source: Haver Analytics. Last updated: November 2023.



...but even the Fed realizes how broken this measure is...

United States: Zillow Observed Rent Index [-12]
 % Change - Year to Year SA, \$

CPI-U: Owners' Equivalent Rent of Residences
 % Change - Year to Year SA, Dec-82=100

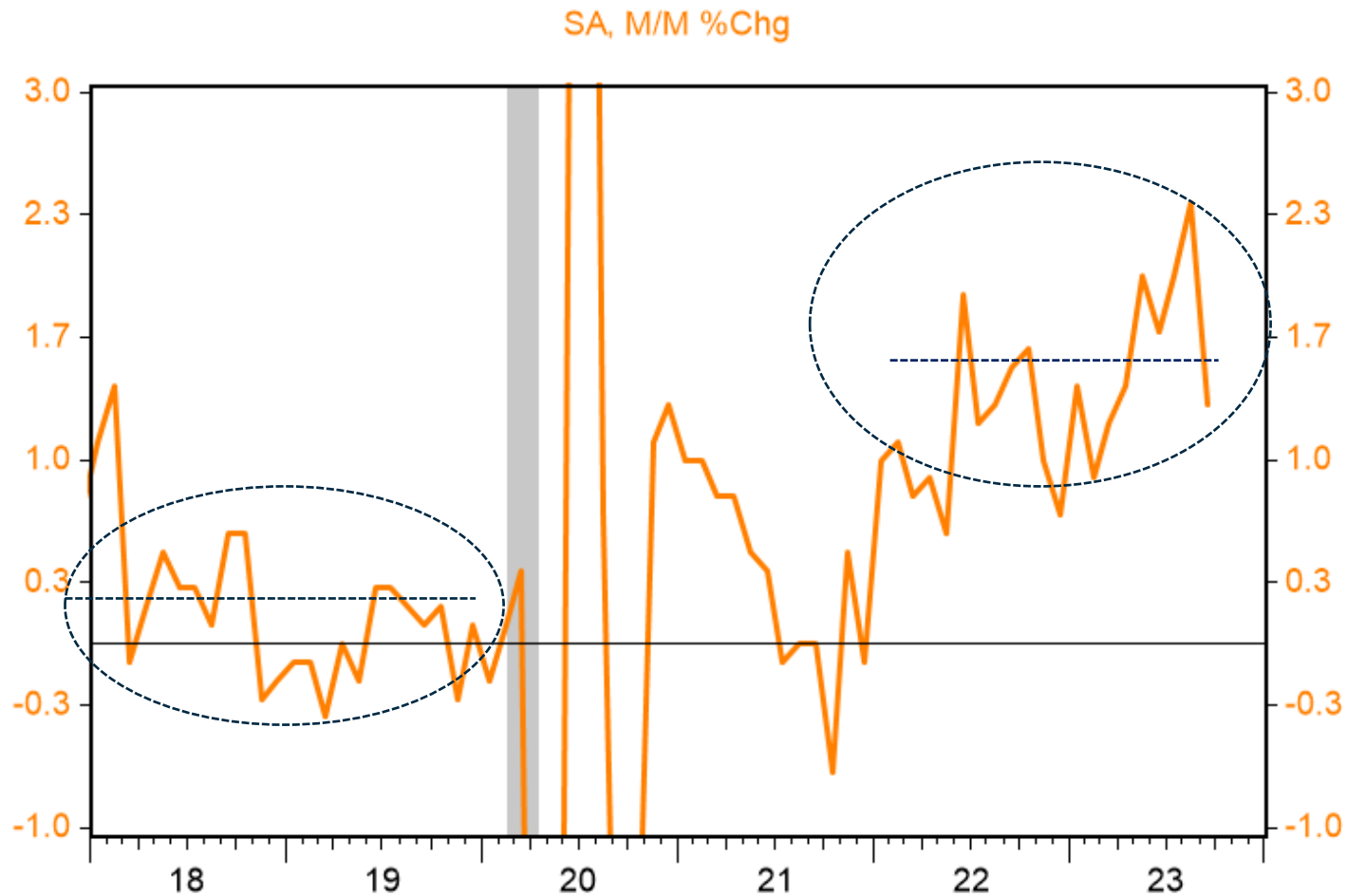


Sources: Zillow, Bureau of Labor Statistics/Haver Analytics



...one category in particular has been acting as a floor beneath CPI

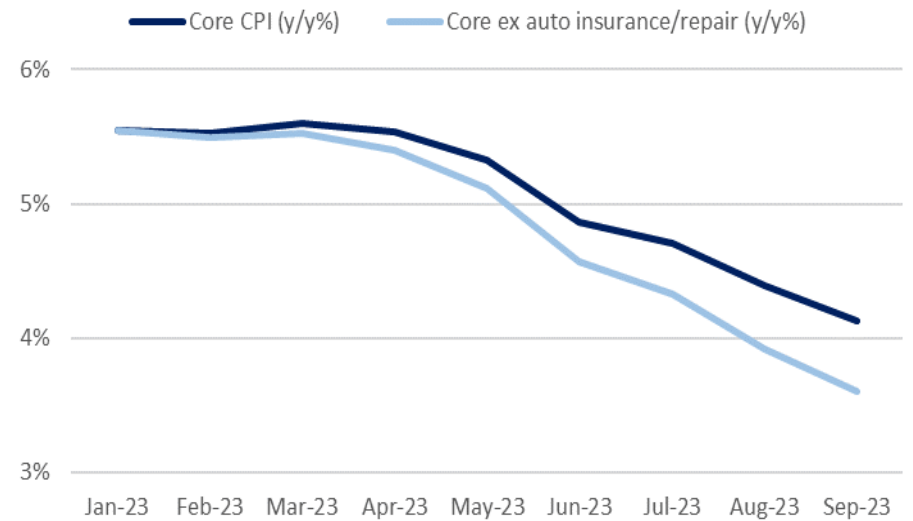
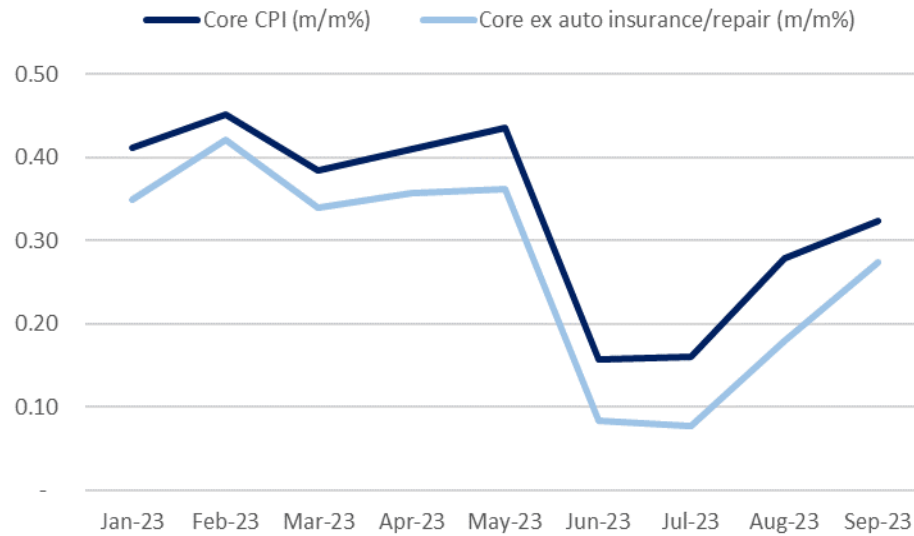
CPI-U: Motor Vehicle Insurance: 1982-84=100



Source: Bureau of Labor Statistics/Haver Analytics



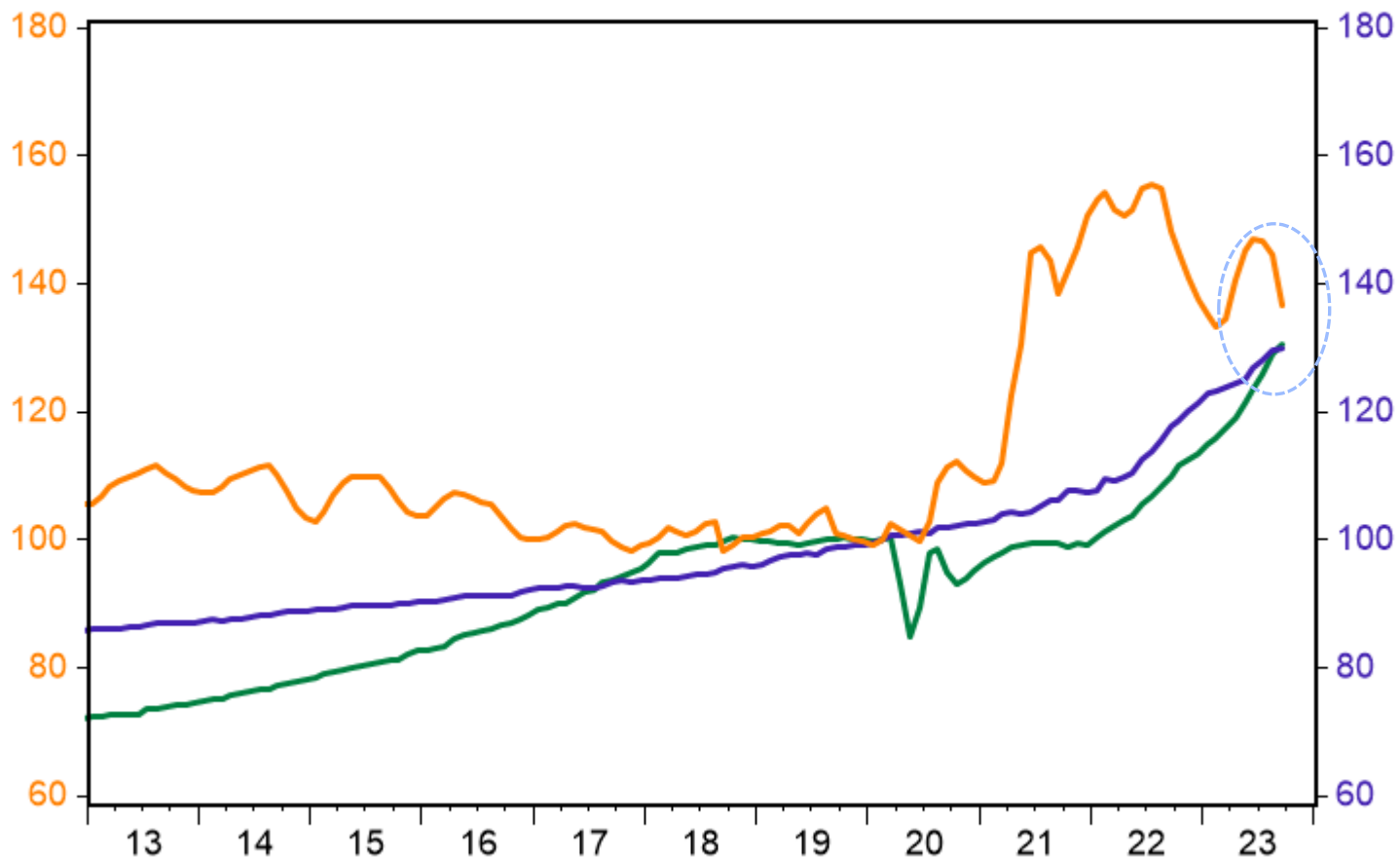
The combined impact of auto insurance and auto repair has been notable...





...thankfully it looks like the worst is behind us...

CPI Used Cars and Trucks (202002=100)
 CPI Motor Vehicle Maintenance & Repair (202002=100)
 CPI Motor Vehicle Insurance (202002=100)



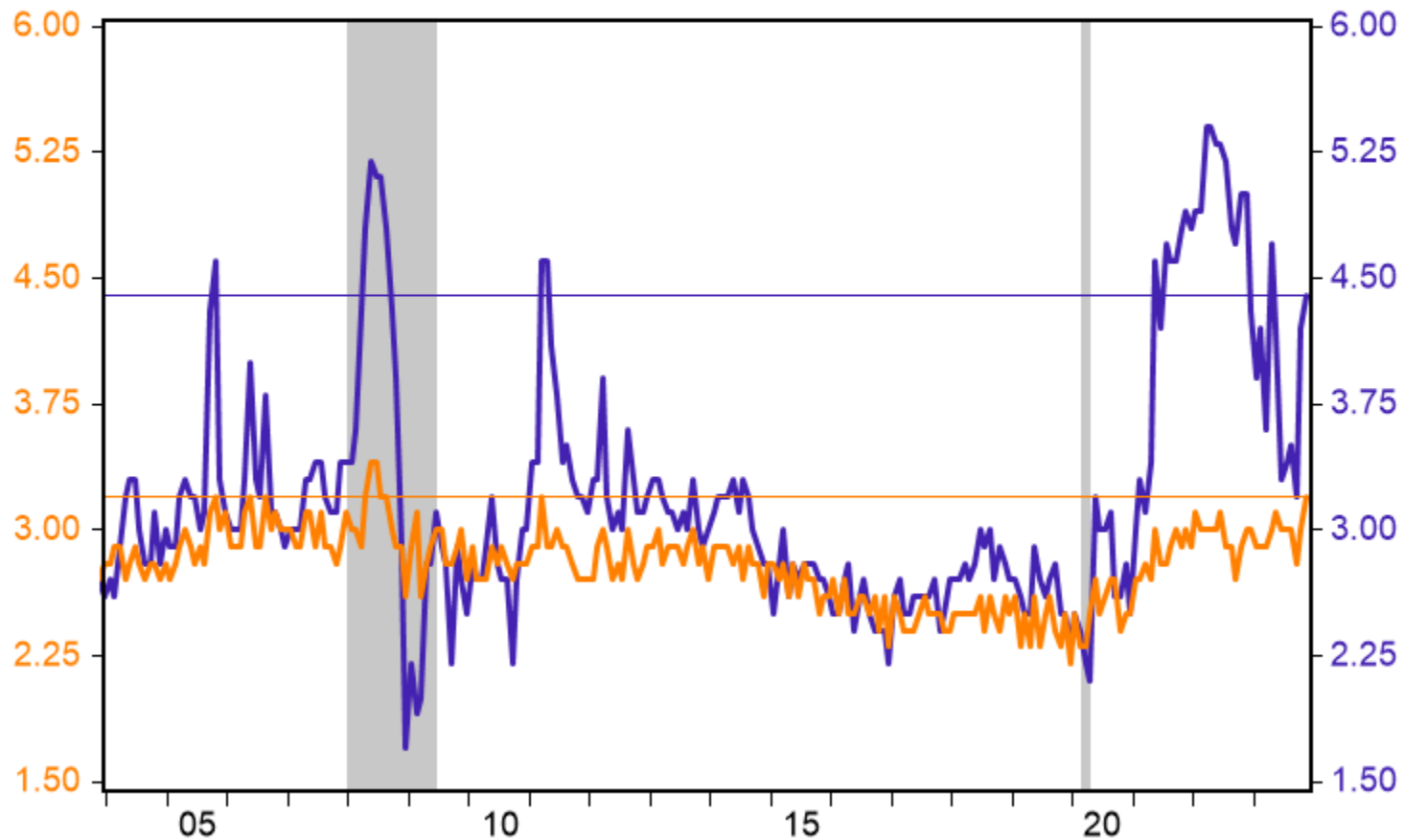
Source: Bureau of Labor Statistics/Haver Analytics



Something we are watching with interest...

University of Michigan: Expected Inflation Rate, Next 5 Years
%

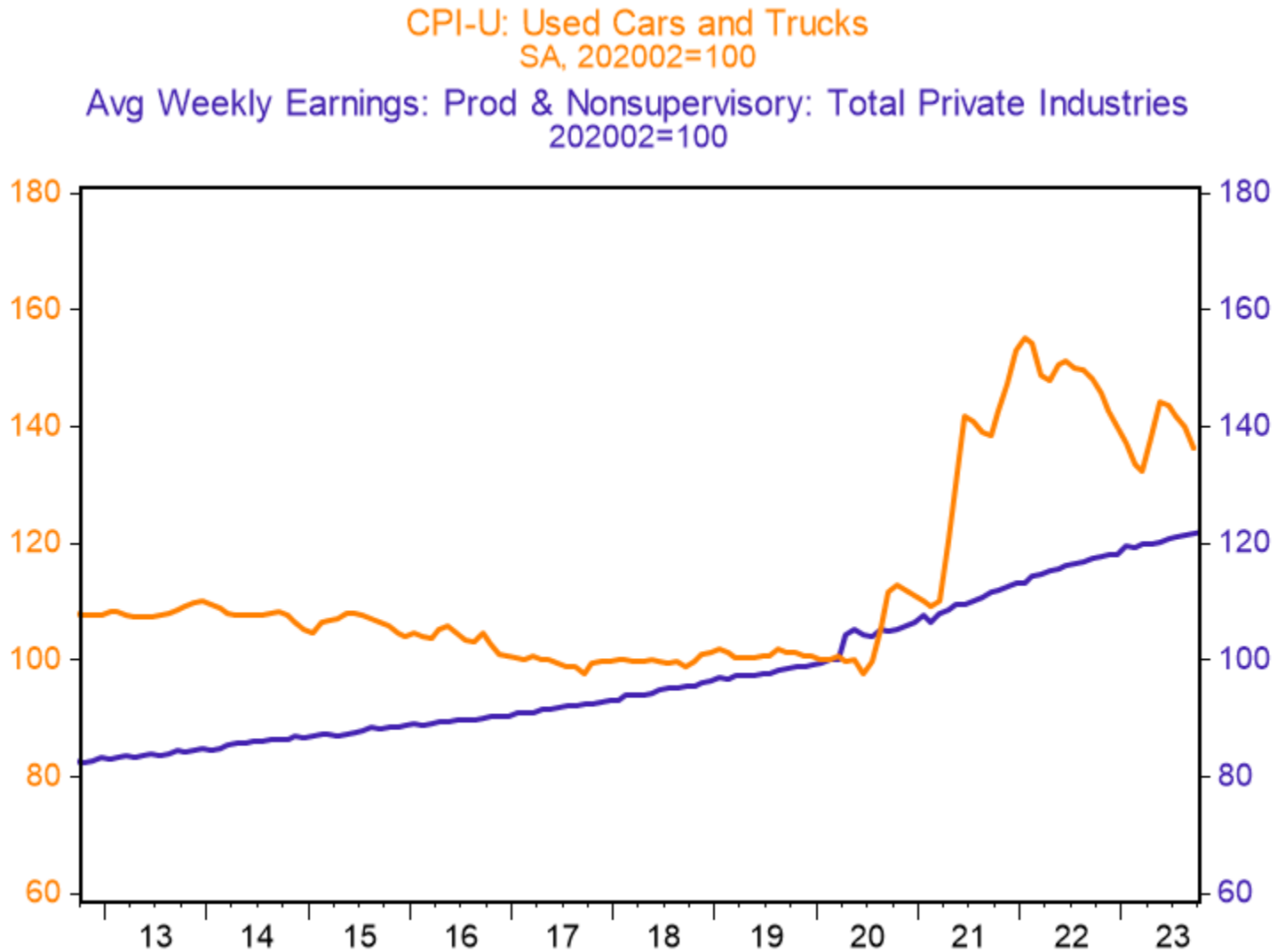
University of Michigan: Expected Inflation Rate, Next Year
%



Source: University of Michigan/Haver Analytics



Is this the problem?

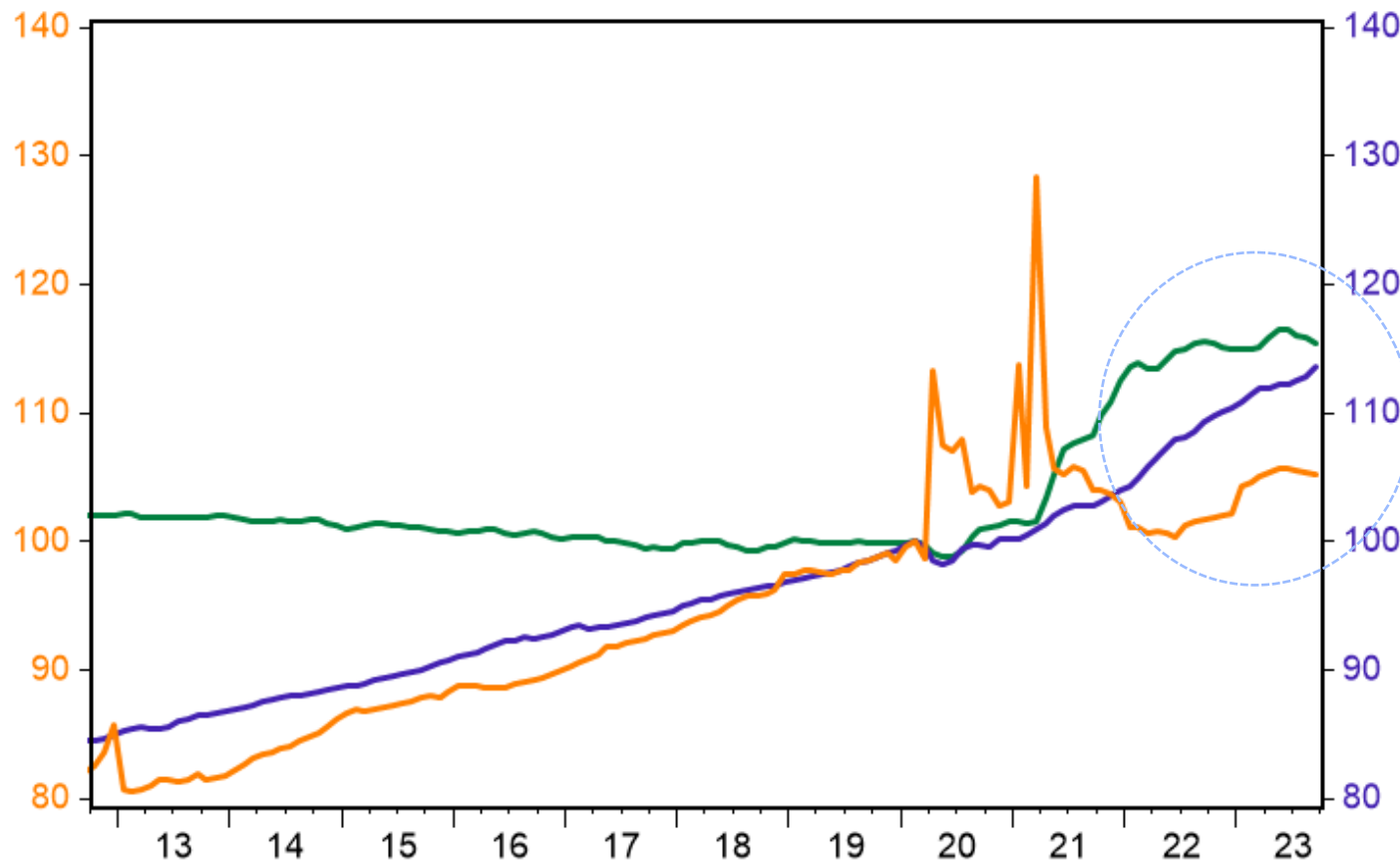


Source: Bureau of Labor Statistics/Haver Analytics



Are consumers responding to continued elevated PRICES?

Real Disposable Personal Income (202002=100)
 CPI: Services less Energy, Rent of Primary Residence & OER (202002=100...
 CPI: Commodities Less Food & Energy Commodities (202002=100)



Sources: BEA, BLS/H, BLS/Haver

Reference



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