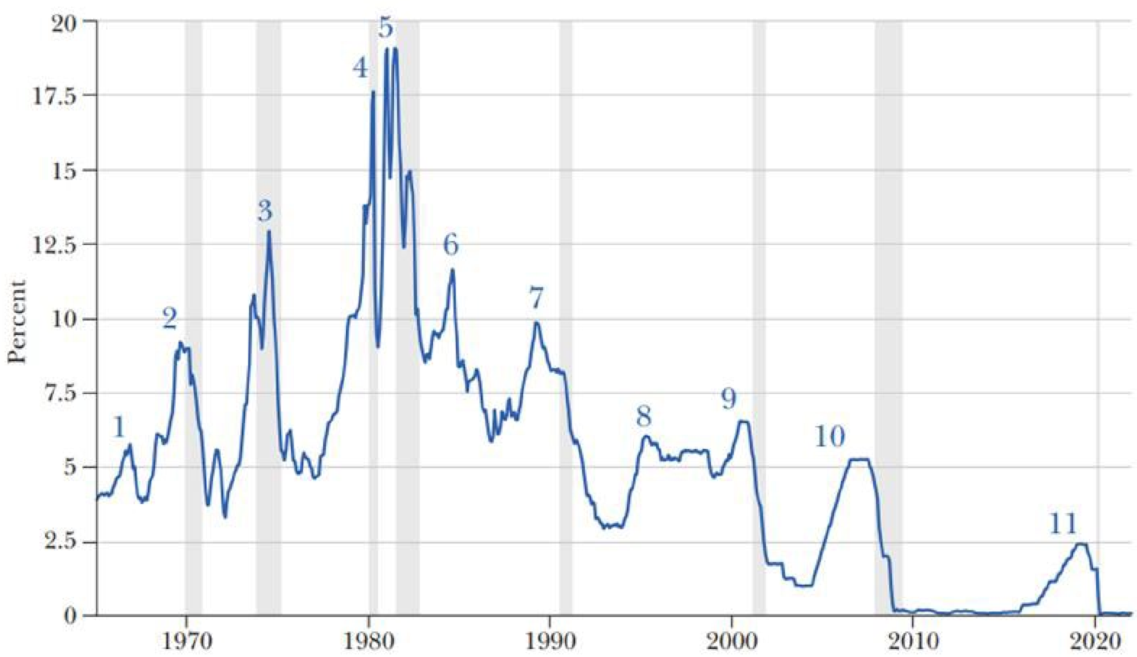
“LANDING THE LANDING”
September 2023

Perhaps the most anticipated recession in history, the 2023 recession has yet to officially arrive. It is possible that it will not arrive, and Chairman Powell will engineer the “softish” landing he has been calling for. It is also possible that the Fed has underestimated the damage from the rapid federal funds rate increases of 540 basis points, along with their higher for longer position on rates.

The media’s current favorite debate is “hard-landing" or a “soft-landing.” As this current leg of our investment journey includes a rate hiking cycle, fortunately, history offers examples of both types of landings to learn from:

The Magnificent Eleven: A History of Monetary Tightenings since 1965.

The Effective Federal Funds Rate, 1965–2021



Source: Board of Governors of the Federal Reserve System
Note: The effective federal funds rate is a volume-weighted median of actual overnight federal funds transactions. Shaded areas show recessions. The numbers show peaks of 11 monetary tightening cycles. Data are monthly.

1. **September 1965 – November 1966:** During this year-long episode, the U.S. faced inflation concerns amid low unemployment and the escalating Vietnam War. The Federal Reserve, led by William McChesney Martin, initiated a tightening period, although debates persist about whether it constitutes a "soft landing." This period involved a "credit crunch" and a "growth recession." Despite some disagreements, it underscores the intricate interplay of fiscal and monetary policies.

2. **July 1967 – August 1969:** The U.S. witnessed a significant rise in inflation, peaking at around 6 percent, leading to a two-year tightening cycle by the Federal Reserve. A total rate increase of 540 basis points occurred. Interestingly, fiscal policy was also employed, with President Johnson seeking a tax hike in early 1967, although its passage took time. The combined efforts resulted in slowing GDP growth and eventually a recession in 1970. This episode can be seen as a "softish" landing, which reduced core inflation to approximately 4.5 percent by 1971.

3. **February 1972 - July 1974:** In this episode, the U.S. faced a unique blend of challenges. President Nixon's wage-and-price controls in 1971 led to surging inflation. Additionally, substantial monetary stimulus in anticipation of the 1972 presidential election and supply shocks further complicated matters. The Federal Reserve responded with a massive rate hike, raising rates by roughly 960 basis points. However, stagflation, characterized by both inflation and recession, persisted. The Fed grappled with policy uncertainty and fluctuating interest rates, resulting in a prolonged and severe recession.

4. **January 1977 – April 1980:** Following a brief respite from inflation, the U.S. experienced rising food and oil prices in 1978 and 1979, partly due to global events like the Iranian Revolution and Iraq's invasion of Iran. Paul Volcker, leading the Federal Reserve, took decisive action by raising the federal funds rate significantly, ultimately increasing it by 1,300 basis points. This period involved two recessions, with the first in 1980, attributed more to President Carter's credit controls than monetary policy. While the landing was painful, it contributed to lower inflation rates in subsequent years.

5. **July 1980–January 1981:** Paul Volcker's Fed aggressively raised rates to combat inflation but briefly reversed course due to economic concerns. They then resumed tightening, raising rates by 1,005 basis points in six months. This triggered a severe 16-month recession with a 10.8 percent unemployment rate. The Fed's commitment to tackling inflation eventually succeeded, with inflation declining significantly. Paul Volcker prioritized inflation control over a soft landing.

6. **February 1983 – August 1984:** Spanning about a year and a half, this episode represented more of a policy recalibration than a tightening, considering the context of recovering from a deep recession and money supply targeting experimentation. Nonetheless, the Federal Reserve consistently raised the federal funds rate, accumulating a 313 basis point increase. During this period, GDP growth was robust, unemployment declined, and inflation remained moderate, around 3–4.5 percent. It marked the early years of the "Great Moderation."

7. **March 1988 – April 1989:** In early 1988, the U.S. economy appeared healthy, with low unemployment, robust GDP growth, and stable inflation. Under Alan Greenspan's leadership, the Federal Open Market Committee initiated a cautious tightening cycle, raising the federal funds rate by 326 basis points over 13 months. While this cycle had the potential for a soft landing, Saddam Hussein's invasion of Kuwait in 1990 led to a brief recession. Nonetheless, Alan Greenspan's monetary policy was not the primary cause of the less-than-soft landing.

8. **December 1993 - April 1995:** In 1994, Alan Greenspan led a tightening cycle that is renowned for achieving a perfect soft landing. Beginning in December 1993, the Federal Open Market Committee decided to raise the target federal funds rate seven times over a year. One of the significant hikes was a 75 basis point increase in November 1994. The results were remarkable: inflation remained around 3 percent, unemployment decreased, and real GDP growth stayed above 3 percent. This period marked a rare instance where a soft landing was successfully achieved without external disruptions.

9. **January 1999 – July 2000**: The late 1990s witnessed robust economic growth, falling unemployment, and low inflation. The Federal Reserve, led by Alan Greenspan, adopted a cautious approach. They maintained the target federal funds rate at 5.25 percent or 5.5 percent for approximately 2½ years and even lowered it to 4.75 percent during the 1998 financial crisis. This tightening cycle resulted in a mild recession known as the "recessionette." Inflation remained in check, fluctuating within the 1.9 to 2.6 percent range.

10. **May 2004 – July 2006:** The Global Financial Crisis of 2007–2009 stemmed primarily from the housing market bubble and reckless financial practices, rather than the Federal Reserve's monetary policy in 2003–2004. The Fed's rate hikes, totaling 425 basis points, closely aligned with the effective federal funds rate. Several factors, including the timing of the rate hikes and the severity of the financial system's near collapse in 2008, played more substantial roles in causing the Great Recession.

11. **November 2015 – January 2019:** The last Fed tightening period, spanning over three years, may not be classified as a traditional tightening cycle but rather a gradual normalization of interest rates following years of near-zero rates. Despite a 228 basis point rate increase, the Fed's actions did not cause the subsequent severe recession, which resulted from the COVID-19 pandemic and related factors.

Final Scoreboard

	Dates	*Total basis points (effective rate)*	*Inflation two years later*	*Landing hard or soft?*
1	Sept. 1965–Nov. 1966	174	Higher	Quite soft—but was it a landing?
2	July 1967–Aug. 1969	540	Lower	Softish
3	Feb. 1972–July 1974	962	Higher	Hard
4	Jan. 1977–Apr. 1980	1,300	Lower	Hard
5	July 1980–Jan. 1981	1,005	Lower	Hard
6	Feb. 1983–Aug. 1984	313	Lower	Very soft—but was it a landing?
7	Mar. 1988–Apr. 1989	326	Higher	Likely would have been a soft landing
8	Dec. 1993–Apr. 1995	309	Lower	Soft
9	Jan. 1999–July 2000	191	Same	Softish
10	May 2004–July 2006	424	Higher	Hard—but not due to Fed
11	Nov. 2015–Jan. 2019	228	Lower	Hard—but not due to Fed

*Source - Blinder, Alan S., 2023. "Landings, Soft and Hard: The Federal Reserve, 1965–2022".” Journal of Economic Perspectives 37 (1):119.

Today in 2023, what type of landing are we in for? As usual with economic activity, only time will tell.

When it comes to time, investors can spend a lot of it getting bogged down in the macro-economic climate. The market historically has “climbed a wall of worries” and lifted despite social, geopolitical, and economic headwinds. As investors, we cannot afford to ignore macro-economic conditions, however, we also cannot afford to hide out and wait for an all-clear. All clear signals usually do not arrive without the market moving considerably higher beforehand.

Instead of waiting for an all-clear, we keep scouring the universe for companies that can succeed in most economic conditions. One of the ways we look to navigate possible landings ahead is gravitating towards companies that are business to business companies (B2B) instead of directly consumer facing companies. We do this consciously for several reasons:

1. Not trendy. We don't have to navigate trends, fashion, or consumer tastes when we invest in B2B companies. Staying ahead of the latest trends is nearly impossible for an investor to do consistently. Instead of focusing on what's "cool," businesses are looking for providers of efficiency and growth.
2. Cost of switching. Most B2B companies have larger customers and switching products or services can be very costly and time consuming. Being offline is expensive, retraining employees is expensive, management reviewing new proposals and contracts is expensive. Switching can be expensive.
3. Mission critical. Many of the companies we invest in provide mission critical services to their corporate customers that are essential to operating their businesses. Although a company may reduce numbers of users and add-on services during an expense reduction campaign, there would be many other areas of cost cutting before a mission critical product is considered.
4. Less emotion. Consumers can get emotional, especially when it comes to financial decisions. They can be easily influenced by what their friends and family are buying (or not buying). The media and world events can also quickly play into purchasing decisions. Businesses, on the other hand, usually have management and boards to answer to when contemplating financial decisions which can lead to slower, more deliberate, and thought-out decisions.
5. Many operating levers to pull. Businesses can innovate through downturns and add new product offerings. We've seen companies leverage their physical footprint, expand to adjacent markets, or even vertically integrate their supply chain.
6. Many financial levers to pull. Corporations have many financial tools in their toolbelt to weather storms. They can cut expenses, issue debt, issue equity, spin off divisions or delay investment. Many businesses have teams constantly evaluating these options.

As a result of rising interest rates, a recession may be just around the corner, or we may see the "Goldilocks" scenario that slows inflation but does not impair growth in the economy. Rather than waiting on the sidelines, we prefer investing in B2B companies that can withstand either scenario. Constantly striving for efficiency, B2B companies free us from the burden of predicting trends, enjoy a high cost of switching, are usually central to the operations of their customers, are usually less emotional and have many levers to pull, both operating and financial. When business is the core customer, the B2B provider can usually expect more stability from their customers and thus, more predictability in the revenue stream. Predictable revenue streams provide the best possible safety belt for whatever landing may be ahead.

Thank you for your business and for "traveling" with us!

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