Commerce Trust Company
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2019 Investment Summit
Colbert Transcript

Scott Colbert: I think we're here to tell you maybe three things because that's about all you can take away from any of this stuff.

Number one, the economy is better than you know. All right? There's a lot going on of course. There's a lot of volatility late in the year with the stocks going down and having recovered, but we're going to make forward progress in this country and we're going to have the longest economic expansion we've ever had. It's going to go for a considerable while, a lot longer than the average economist is projecting, which is somewhere around 2020.

By the way, it's always about a year away when you predict the next recession. We think it goes on a lot longer.

Number two, we're not backing away from risk assets. You're going to hear Joe Williams talk about why we're still fully invested in the stock market. Largely because in a year like we've just had, where you actually had corporate earnings explode while at the same time, prices came down, you're looking at very good returns the following year. Don't get too bashful about sticking with the market.

And then number three, within those stock markets, it's not a generic market. Don MacArthur's going to talk about why we're overweight growth on a relative basis, why we're underweight international, and talk about what we're going to be looking for as the year progresses.

Let's set this all up by talking a little bit about the economy. As we mentioned, things are a little slower.

We came off the best year that we've had in this recovery. Now, we've been recovering since June of 2009. This recovery is about to be 10-years-old, and it will be the longest economic recovery we've ever had in this country between two recessions. Don't think of 10 years as just some finite amount of time because there are other countries that have grown a lot longer. For instance, Australia has grown 26 consecutive years without a recession, so 10 years is not some fine defined line.

But what you see here is the global economy is beginning to roll over after we've just had peak growth, but just because you're rolling over, doesn't mean you're heading towards a recession.

This is also picked up when you look at the global PMIs. These are the surveys where you call up a purchasing manager at a corporation and say, "Hey, what are the new orders like? Are you hiring anybody? What is the outlook?" But as long as the PMIs are above 50, we are still making forward progress and note just because they roll over and decline like they did back in 2016 when we had the energy bust. They can bottom, make forward progress, and move forward.

While this is a clear cooling and a sign of cooling, it's not necessarily a sign of any recession.

One of the reasons this is likely to be the longest economic recovery is because it's also been, what? The most anemic economic recovery we've ever experienced. This is the line along the bottom of the chart there that shows basically we've only made about half the forward progress that we typically do. But what is it that ends a recovery?

Well, generally, you use up all of your plant, your capital equipment, and your people. Now, maybe we've used up most of the people. I was just talking to some reporters back there in the room and one of the largest complaints in Columbia is the unemployment rate. Theresa, is what?

Theresa: Under 2%.

Scott Colbert: Under 2%. It's 1.8%. I'm glad you knew that. Thank god you didn't say 7%! Right? She's still running the bank, aren't you? Behind the scenes, are you still hiding in the vault? Okay.

But any rate, the one thing we are running out of, even though this has been the most shallow economic recovery we've ever had, are people. We still have excess plant, capital equipment, and you know that what has inflation been? It's only about 2%. It's not growing rapidly enough that the Federal Reserve has to come along and do what? Choke the economy until it rolls over. They're in the process today of coming out of their meeting by the time we leave this room and they're about to tell you that we are no longer going to try and choke this economy because we don't need to because inflation has been so modest.

Just because it's been the shallowest, I can still see that this can go for quite a while before we get up to the point where basically the federal reserve is going to have to push back on rates enough to push us into recession.

Secondly I might add, it's not just the Federal Reserve that has to be pushing rates up to push us into a recession. We need some time of exogenous financial shock of some kind to accompany that. Think about all the shocks that we've had in the past and they're always different. In 1974, what created the recession? I bet you were around '74. I was.

Audience: The oil.

Scott Colbert: The oil! Exactly. It was the oil embargo. In '79, it was the wage price spiral and Paul Volcker raising rates to 21%. In 1990, it was the first Iraq war. In 2000, it was the internet bubble. In 2007, it was, we all remember this, the housing crisis.

Who wants to tell me what the next recession is going to be? I don't know. Those were quite a ... There's a host of things. I have some ideas, but nonetheless, we still think we're quite a ways away from a recession.

Now, that doesn't mean that we're going to start to grow at this 3 plus percent rate. This country grew at 3.1% pace of GDP, this is adjusted for inflation, so real growth of 3%, per year from 1951 to essentially 2007. Now, the recovery that we've been having has only been about a 2% recovery.

The reason for that is three-fold. We're stuck with these three things that create headwinds for us, essentially for the rest of most of our lives. By most of us, I'm talking about the baby boomers in this room. I'm at the tail end of the baby boom generation. I'm 57-years-old. I was born in 1961. Basically, we're confronted with getting these baby boomers off the planet so we can get back to those growth rates. What do I mean by off the planet? Die. Right.

I used to work at a steel company and we used to root for our employees to die. We couldn't afford the pension plan. You wake up every year and hope that they're dying. This is what we've got is this situation where the boomers are sucking so much life out of the economy as they're aging that we really need to move them along or we need to open up immigration or create more babies down at the bottom to build a better base.

But you can see that we've built up a huge amount of debt and that debt won't go down until basically we begin to save more and spend less and that's what the boomers are doing. As they move towards retirement, they begin to save more and spend less. You see this reduction in debt, but if you're going to reduce debt, you're not pulling growth forward. That acts as a headwind and we're stuck with this for a number of years.

Secondly, we know demographics, of course, are moving against us. The average age of the average worker continues to grow and grow and grow. We've been doing these things for, it feels like, what? I don't know. How many of these annually have we had? Theresa, what do you think?

Theresa: Well, we've had our trust for 10 years. Probably eight years.

Scott Colbert: Eight years in a row. We all know that largely, we keep coming back and we're all getting about a year older each year. The aging in the country, the demographics are pushing back.

And of course, what I didn't put up there, the other D. It's debt, demographics, and our deficit, which we're going to continue to wrestle with as entitlement spending becomes more and more prevalent.

We always talk about the bad things though that keep growth slow. What about the good things?

Well, we're as wealthy as we've ever been. I suppose that's one reason why Commerce Trust is the 19th largest trust company in the country is because our wealth has grown and grown and we've saved and saved and saved. By the way, we're the largest trust company, as long as we get to define the geographic region. Let's be clear about that. We're the largest trust company here.

Cumulative wealth in this country is five times GDP. It's an all-time record and we're 50% wealthier today as a country than we were prior to the last recession. Our liabilities, as big as they seem, all the debts that we talk about are small relative to the size of our worth.

Now, there's no doubt that the economic cycle peaked and we're rolling over. There's no doubt that we're on the other side of the roller coaster. We've already gone up and we're coming down the hill. The only question is when do you get to the bottom? You can see this in car sales. I always love to ask is there a car dealer in the room? Do we have a car dealer?

Audience: Yes, sir.

Scott Colbert: All right. When did car sales peak? When did they peak?

Audience: Last year, I'd say.

Scott Colbert: Last year, maybe even the year before. We've satiated quite a bit of the demand. Of course, interest rates are a little bit higher, and credit standards are getting a little tougher at the banks, and of course, delinquencies are actually picking up a little bit in the car lending space. Basically, this is rolling over. Housing starts, we know, are coming in not nearly a robust a pace as they used to because rates have come up, and the price of housing has come up, so the affordability has come down. You can see that housing isn't going to drive us any further.

Fortunately, we don't have a huge supply of inventory. One of the nicest things we've got going on here is a slight rebound in capital spending. You never get this. Once capital spending peaks and rolls over, we have a recession. Peaks, rolls over, recession. Peaks, roll over. Ah! Look at this. No recession. The tax package we put in place that have cut corporate taxes and accelerated depreciation is bringing people back into the market. It just makes sense that companies are reinvesting now back in capital equipment and software and things like that because what? They can't find any people to throw at the problem so they've gotta throw machinery and equipment and software at the problem.

This little rebound is exceptional positive because it helps extend the recovery on a non-inflationary basis.

Now, you never have a recession ... And by the way, if you're worried about stocks in this recession, the stock market peaks on average five months before you have a recession. If you really think the stock market peaked in October, on October 3rd, five months later, we'd be having a recession. If this was the stock market's leading indicator that we're about to have a recession, the recession needs to start March 3rd or a month from now. You don't get a recession until unemployment begins to roll over and we hire fewer and fewer and fewer people. This took a year to happen, all right?

This took several years for unemployment to roll over, roll over. Until unemployment actually goes negative, and here's where we are today, until this begins to roll over and goes negative, we don't have a recession. As long as you promise we will hire just one person cumulatively next year, the country never goes backwards. It goes backwards when we start losing jobs, but we're still creating jobs. My gosh. We're going to have a job print on Friday.

If you tell me, "Colbert, it's negative" on Friday, I gotta start to change my whole speech. I gotta change everything up and I'm going to tell you. First, I'm going to explain to you it was the government shutdown and the statistics are all warped. I will hide behind that for at least one more month. But if you give me two months of a negative job report, then you can tell me, "All right, we're totally wrong. The stock market did peak on October 3rd and we're going to have this recession that people worried about," but we don't see that because we don't have any other indicator that would suggest that we're in a recession.

Now, how much further do we have to go before we have this recession? Why do I even ask? Why do you even care? What do you think? Why do you care? Why do you care if there's a recession? Do you really care? You're probably retired. You care?

No, you don't care. You care because your portfolio went down 55% in the last recession and it went down 50% in the prior recession. You lost half your stock market value. You turned your 401(k) or what was left of it to the 201(k). That's why you're worried about the recession.

But these are our leading economic indicators and first off, the leading economic indicators always peak about 12 to 18 months prior to recession. They peak and they roll over. Our leading economic indicators have not peaked and they continue to make forward progress. That'd be point one.

Number two, after they fall, they have to recover. Once they recover, on average, we grow for another six years. First off, because our recession was so deep, it was 60% deeper than any other recession we'd ever had. It was so deep and because the recovery is so shallow, it took forever just to get back to where we were. We didn't really get back to where we were until March of 2017.

But then on average, you get another six years of growth, which takes you out to essentially 71 months, takes you out to February of 2023, which is about three years longer or at least two-and-a-half years longer than the average economic expansion forecasted right now. This is an out of consensus thought that we can continue to grow for four more years. I'm running for Governor. Four more years.

If you didn't like that chart, this one's better and it's more positively and the coefficient of the correlation is much stronger. The number of years that you have a steep yield curve, in other words, the short-term rates are lower than long-term rates, is very proportionate to the recovery. In fact, for every year that you have short rates lower than longer term rates, you get 1.2 years of recovery. We've had about 140 months of positive yield curve. 140 months times 1.2 takes you out to exactly, and mind you I've tortured these statistics to come up with this, which I think is pretty incredible, February 2023.

I get the exact same answer out of either chart, either way. Most people aren't thinking about it that way. I just want you to think about the physicality of it just simply this way.

The Federal Reserve, we talked about, has to raise rates high enough to slow the economy and economic growth fast enough to push us into a recession. The last three times they've done this, they had to take rates 3.25% above trailing inflation. Where's inflation today? What do you think? 2%. Sure, you knew that. You're going to tell her that, right Perry? Perry gets these charts and graphs monthly whether he wants them or not. 2%.

Where are short-term rates? About 2.25, 2.5%. The Federal Reserve has barely pushed rates into what we would consider to be restrictive territory. On average, 3.25% is what it takes to create a recession. The lowest it's ever been is 2.5%. If inflation's 2%, that tells you the Federal Reserve has to get short-term rates to 4.5%. They are so far away from 4.5% and pushing us into a recession that I really do think we do have the opportunity to really grow.

Now, one thing that's helping us expand here too is that rates overseas are so low. The next six largest borrowers on the planet are only borrowing money at 1% per year. That's helping keep our rates low, which also helps continue the expansion. Of course, the Fed isn't fighting inflation right now. With inflation just now finally back to their target 2% and energy prices low, and actually, we're slowing, we're not accelerating, it's pretty easy to see why the Federal Reserve is going to come out and say, "We are on perma-pause until things improve" because they don't have to fight back against inflation.

Perhaps the best thing for our outlook and the outlook for financial assets is the dollar has peaked. As the dollar strengthens, it puts tremendous pressure on the emerging markets. It slows China and it hurts all the peripheral credits. As the dollar now is peaking, and why is the dollar peaking? Because the Federal Reserve is stopping their rate hike. When our rates are higher, money flows towards the US dollar, but now that it's not going to keep getting much higher and higher, now monies can flow overseas and this is very positive for financial assets overseas.

Basically, we see an economy that's going to continue to expand. We see a slow down, but we don't see a recession. Globally, it's about the same thing. The Fed is going to be accommodative. We think the stock market has peaked and is setting us up for an exceptionally good year.

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