

# THE SMITHFIELD Forecast

*A Quarterly Survey of Trends • Ninety-First Edition • April 2023*

## A NOTE FROM THE CHAIRMAN EMERITUS

*For Customers & Friends of*  
SMITHFIELD TRUST COMPANY

It is with great pleasure that I tell you about three recent hires at Smithfield Trust Company, all of whom have materially strengthened our capabilities, especially in our already proficient areas of tax and estate administration. These three are Timothy A. Dopp, Suzy Gavin and Amy R. Palmer, and each combines skills and valuable experience with a “can do” attitude and pleasant personality.

Coming to us from Bank of New York Mellon, Tim Dopp has gained experience in many areas of tax over the past 25 years, including tax compliance with exempt organization rules, preparation of personal and fiduciary income tax returns and the oversight of many other facets of tax. Tim has an undergraduate degree from Robert Morris University, plus a Masters in Tax from that institution. His strong work ethic as Tax Manager has served Smithfield well during the current tax season.

As our newest Trust and Estate Paralegal, Suzy Gavin has extensive paralegal experience, working mostly during the past 15 years in the trust and estates field. She is a graduate of the University of Arizona. With a wealth of knowledge in probate matters, fiduciary income tax issues and preparation of death tax returns, Suzy has generated a high level of confidence from all the Smithfield customers she has worked with.

Our newest Trust Officer, Amy Palmer, has spent over a decade immersed in estate and trust administration at the Pittsburgh law firms of Leech Tishman and Clark Hill. A graduate of Duquesne and Kent State Universities, Amy has already demonstrated to us her ability to handle trust and estate matters with competence, diligence and an abiding measure of common sense. She has fit into the culture of Smithfield beautifully.

For those of my dear readers who may also be customers, please welcome Tim, Suzy and Amy to our team in the event that you have interactions with any of them.

– Bob Kopf

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## **SMITHFIELD SECOND QUARTER 2023**

It is always hard to write a quarterly newsletter in a time of great uncertainty when reality may shift in a moment. We feel the best strategy is to reaffirm the fundamentals one felt were in place before the fog began to descend, and to think about what guideposts you should be looking for to determine if you remain on the true path – or not. We have believed for some time that the US economy would slow in 2023 – but that profits were sound enough that it would not fall into recession. We have also believed that given a relatively fixed money supply (it is actually falling in recent months) that inflation would cool faster than expected by the consensus. Unlike the consensus, we have not tied the slowdown in inflation to a recession. Rather, we have argued that competition for liquidity from the asset markets and from positive real growth would crowd out inflation – leaving the economy on a kind of gold standard. In recent months we have seen the asset markets grind sideways, while real growth was stronger than expected – and inflation has surprised to the downside, though it remains well above the Federal Reserve’s 2% target.

At the heart of our “no recession” call is our view that demographics and immigration policy have strengthened the hand of US lower income labor. In traditional downturns, it is significant layoffs of these least skilled workers – who lose substantial income despite the unemployment safety net – that starts the downward spiral. In the current environment, firms are far more reticent to let these workers go, given the difficulty they had in attracting them in the first place. Instead, firms are adjusting to revenue shortfalls by trimming the growth in payments to higher skilled workers. This started during COVID, when the surge in goods demand made low skilled work more costly, and firms limited raises for white collar positions, often as a trade-off for work from home. More recently, there have been rounds of layoffs at technology firms, whose output was often designed to replace rising labor costs. Firms have also increased imports (partly due to stronger goods demand) to find cheaper labor, as the strength of the dollar has sharply reduced the cost of foreign compensation after currency translation.

Bottom line, the money drops that were the proximate cause of surging inflation also provided both businesses and consumers with hefty savings, which can help absorb economic adjustments. Since, the bulk of the savings drifted to the top of the food chain, larger firms (often in the S&P500) and higher income households have the biggest cushions. Meanwhile, some smaller firms find themselves caught between their larger competitors and rising input costs for both labor and capital.

Critically, it was this surge in savings that exploded deposits at US banks in 2020-2021 – at the same time that few businesses or consumers needed or wanted a loan. Part of these liabilities ended up parked at the Federal Reserve earning interest on excess reserves, but some institutions bought securities or made loans at very low rates – which has created a capital loss as interest rates have risen.



## SMITHFIELD TRUST COMPANY BOOK REVIEWS

### AN IMMENSE WORLD

*By: Ed Yong*

A customer of ours, knowing that this book is not my typical reading fare, gave me it with an overwhelming endorsement. Somewhat to my surprise, given my lack of scientific acumen, I found Pulitzer-prize winning Ed Yong's book to be, in a word, fascinating.

All animal species live in, navigate through and utilize their own unique "Umwelt," a German word for environment. Every animal handles its Umwelt by using its special senses, and while most, if not all, animals have multiple senses, usually one sense is dominant. For example, human beings have a superb sense of sight, an average sense of smell and no sense of electromagnetic fields. Yong describes the Umwelt of species ranging from ants to elephants. (Believe it or not, the lowly ant is incredibly interesting, and deserving of our respect.) Writing with flair, clarity and excellent humor, Yong captures the astounding variety of sensory attributes in the animal kingdom.

This book was published in June of 2022. I was thunderstruck when I saw Yong's prediction that the Atlantic Ocean wind turbines, seriously disrupting the sonar senses of whales and dolphins relying on sonar to navigate through their Umwelt, would begin to kill these beautiful species. Shortly after this written prediction, deaths commenced.

I recommend this book with unreserved enthusiasm.

– Bob Kopf

### ON THE HOUSE

*By: John Boehner*

This is a memoir by John Boehner who was speaker of the House of Representatives from 2011 to 2015, written early last year. This is a most amusing and interesting book which, I think, should appeal to anyone regardless of their political persuasion. He tells briefly of his childhood growing up in the Cincinnati area and his business career after graduation from Xavier University before joining the House in 1991. He made his name for himself in those early years as a firebrand earning friends and enemies on both sides of the aisle. The book, which backs no punches, tells of his encounters with many presidents and other leading lights in Washington. As might be expected, he had closer relationships with Republican presidents, particularly George W. Bush. As speaker, he tried to work with Democrats as much as he could and it would appear that his biggest problems came not from them but rather from some members of his own party that he refers to "the crazies" and, in particular, with Ted Cruz (this part is highly entertaining). The latter part of the book talks about his time as a lobbyist after leaving Congress and of his global travels as a congressman. He also includes his love of red wine, his addiction to cigarettes and his love of the game of golf; you come away with the distinct impression that he's a fun guy to spend time with. On that note, since he plays so many rounds a year, he is to be forgiven that he does not make mention of his round a few years ago at Allegheny.

– Charlie Gross

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## **HOW THE ALLIES WON WORLD WAR II: FROM IMPROBABLE TO INEVITABLE**

*By: David Sculley*

I confess to twinges of envy regarding my friend David Sculley's writing of a new book about World War II. I wish I had written it, although David's effort surely surpasses anything I would have done.

Perhaps to the surprise of no one, neither David nor I is a Marxist with what I regard as a crabbed political and economic view of the world. Devout Marxists believe that progress is inevitable as we march inexorably toward "progress," and that no man or woman can alter the Hegelian march significantly, if at all. Conversely, for David Sculley great human personages can change the course of history.

The underlying thesis of David's book is that the Allies had better and greater leaders than the Axis powers, and the Allies' forces prevailed, despite overwhelming odds against success at the beginning of the war, because of the superiority of the leadership of the Allies. David remains true to this thesis throughout the book and does not try to write a more generalized and overly nuanced history of the World War II campaigns.

Put simply, Franklin D. Roosevelt and Winston S. Churchill were the two most important men in the war, and their leadership qualities were vastly superior to those of Adolf Hitler and Hideki Tojo. While David certainly extols the virtues of Roosevelt and Churchill, he lauds the other members of the Allies' leadership like Dwight D. Eisenhower, George Marshall and many others on our side. He contrasts them negatively with the Axis reliance on flawed individuals like Herman Goring, Heinrich Himmler, Joseph Goebbels and Emperor Hirohito. It is refreshing to engage an author like David who has a hero/villain view of the world. Given this, David has an interesting take on Joseph Stalin.

I recommend the book highly. The voluminous and powerful photographs are an added bonus for the reader.

– Bob Kopf



Not all capital losses have to be recognized, and banks can classify loans as either held to maturity or available for sale (which must be marked to market). The run on Silicon Valley Bank forced them to sell loans from their held to maturity portfolio, exposing their capital losses – and the rest is history. Signature Bank and First Republic also has significant dependence on wholesale (uninsured) deposits, which caused investor flight.

As we write, Signature Bank and SVB have been sold (with some deposits and assets still at the FDIC) and discussions are underway to provide First Republic further aid. No new name has popped up in the US, and the demise of Credit Suisse has shifted the focus to European banks – particularly Deutschemark. We believe the Federal Reserve, FDIC and Treasury will do everything in their power to protect the US depositor – though not bank investors, including bondholders. However, the ultimate power to revise rules lies with Congress – and there is a significant political element to the banking system’s current woes.

The greatest distinction between Democrats and Republicans is the population density of where they live. Small to medium sized banks, which control just over half of all deposits, are naturally concentrated outside major cities. Thus, any resolution to the banking crisis via Congress is likely to be caught up in the upcoming political battles over the debt ceiling, restart of student loans, and the hashing out of the size and details of the US federal budget. Until a commitment to ensure all depositors is enshrined, depositors may drift and lenders will likely raise their standards, slowing the economy. The very fat margins on new mortgages and tightening standards for auto and credit card loans are early signals of this process.

Bottom line, weekly readings on the size of bank deposits and where they reside (from the Federal Reserve’s H8) is likely to be as important to markets as the weekly initial claims report, which tells us about labor market slack (or the lack of it). High frequency data and anecdotal information are sure to be of more value than monthly data telling us what the world looked like before March 15th.

The Federal Reserve just raised rates by 25 basis points on March 22nd to signal they are still fighting inflation – and Chair Powell indicated that rates may move higher and the FOMC expected no easing this year. In the Summary of Economic Projections which accompanied this hike, the Fed forecast just 0.4% growth in 2023 and 1.2% in 2024. This seems extremely low given the Atlanta Fed’s GDPNow is forecasting 3.2% growth (0.8% before annualization) in Q1 – which implies a -0.4% decline in real GDP by year end. Thus, the Fed sees less growth over the next seven quarters than in any one of the previous three. Despite this forecast of a mild recession with virtually no recovery, they still have inflation above target until 2025 – and thus overnight rates falling far more slowly than expected by the market consensus. That seems like very sticky inflation indeed, given that goods prices are already falling due to the dollar and rents are likely to decline by year end based on private market indicators, like Zillow and Redfin.

There is an old saying that the Federal Reserve decides when to raise rates and the market tells them when to stop – usually after something breaks. In the aftermath of SVB, oil had fallen below \$70 a barrel and remains below the mid-December through mid-March average.

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Two year notes have fallen by more than 100 basis points, relieving some stress for borrowers – while ten year notes have declined to 3.5% reducing capital loss for bank portfolios. The widespread expectation of tighter bank credit is likely to hit demand harder than supply, given that demand had been ahead – thus, reducing inflationary bottlenecks. Constraints on shipping and warehousing have already all but disappeared. Any increase in supply should spur competition, and reduce inflation, particularly in those sectors where scarcity spiked prices earlier.

Bottom line, we remain skeptical on the potential for a recession in 2023. It seems to us that businesses have far more room to sustain revenue growth by offering a heavily employed workforce lower prices than by resorting to layoffs. An erosion in profits for the weakest performers may lead to trouble down the road – but we suspect that would not occur until 2024. We do expect slower growth – after all we have averaged nearly 3.0% at an annualized rate for three quarters (while rates were rising). And the political dynamics heading into an election year could raise tensions. Given the Fed is still raising interest rates after the banking system signaled they should stop, how much economic uncertainty and investor angst might Congress endure before they settle the many thorny issues coming in the next several months? While the consensus is betting that a 2023 recession cuts interest rates, we still feel that inflation falling faster than expected will provide a shock absorber that limits economic weakness – for now.

– Michael Drury

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