FORTRESS PARTNERS

eMemo

TO: INVESTOR/MEMBERS, BANKERS AND FRIENDS
FROM: Jon Bruss
DATE: February-March 2023
SUBJECT: Where are the US Economy and Bank Stocks *Really* Going(*Redux*)?

In our August-September iteration of the **FORTRESS PARTNERS eMemo**, we said we'd "been told by the expert economists at the National Bureau of Economic Research (NBER) that should Gross Domestic Product (GDP) decline in value for two consecutive calendar quarters, the US Economy is in recession" *and* that we were setting out to "dispute that notion".

Much of what we discussed was based on our own (classical) economics education and a piece in the Wall Street Journal (WSJ) by Jon Hilsenrath on August 29 last entitled "A Different Take on the US Economy: Maybe It Isn't Really Shrinking". In Hilsenrath's article he pointed out that an alternative to GDP, GDI or Gross Domestic Income, was really pointing to a "stall in the economy". Hilsenrath further showed that the average of GDP and GDI for Q1 and Q2-2022 grew by a modest 0.2% annual rate. That was the first half of 2022. Unfortunately Q4-2022 GDI has not yet been published as of February 17, 2023 but GDP has. **Since Q4-2021, GDP** has grown by **+7.32%** according to our calculations. Moreover, the **average of GDP and GDI for Q3** showed a **+2% growth from Q2!**

While we are unable to plug in GDI for Q4-2022 (to be released 03/30/2023), we can report that the economy added **+1.1 million jobs in Q4-2022** according to Sarah Chaney Cambon (WSJ Economics Reporter) and Ray A. Smith in their WSJ article on February 9, 2023 entitled "Mass Layoffs or Hiring Boom? What's Actually Happening in the Jobs Market". We've been bombarded recently by the bad news of layoffs. . .in the tech heavy information sector. These have not been modest numbers—10,000 here 12,000 there, 18,000 from Amazon and the percentage of employment at tech companies seems to hover in the 5%-10% range. . .and on and on. Furthermore, we've gotten January CPI number and the Producer Price Index (PPI) number, neither of which showed any material reduction from the past month. In fact year over year the CPI rose 6.4% and the PPI, 6.0%! The Fed hawks are circling and looking for a 50 basis point increase in the Fed Funds rate. That does not bode well for our no recession outlook!

But wait! We added 1.1 million jobs in Q4 and reported a **January 2023 unemployment rate of 3.4%**, the **lowest in** more than **53 years!** But we were being led to believe that the world was coming to an end because it seemed the tech sector would be imploding with the loss of tens of thousands of jobs! Well, guess what? According to the WSJ article on February 9, "Layoffs, outside of a few sectors, remain historically low."

Its seems that we were being led to believe that the proverbial tail was wagging the dog! The *tail* is the *tech sector* which employs ***2%*** of all private-sector jobs which shed jobs for two straight months, but the *dog* is the *service industry sector* which represents ***36%*** of all private-sector payrolls! Ms. Cambon further points out that these service industries "added 1.19 million jobs over the past six months, accounting for **+63%** of all private-sector job gains during that time, up from **+47%** in the preceding year and a half."

What's going on with these job gains? Well, it appears that the the effects of the pandemic are diminishing and therefore the managers of service businesses are finding it easier to hire, in part because of higher hourly wage rates.

According to Charles White, economist for Stifel in his weekly commentary of February 12, 2023, it looks like the consumer, notwithstanding what we hear, is still in pretty good financial shape. Consumer credit is still in line with the prior trend and credit card debt is also inline and consistent with pre-pandemic trends. These stats are from the St. Louis Fed. He also highlights a "sea change" in that "slowly most of the Wall Street Economic community is abandoning the 'recession is imminent' outlook. . .forcing a lot of things to be recalibrated in the coming weeks." And, according to the Fed chairman, Jerome Powell, "disinflation has started in the goods sector."

This week we've gotten January CPI number and the Producer Price Index (PPI) number, neither of which showed any material reduction from the past month. In fact year over year the CPI rose 6.4% and the PPI, 6.0%! The Fed hawks are circling and looking for a 50 basis point increase in the Fed Funds rate. That does not bode well for our no recession outlook!

Putting on my classical economists hat, I conclude that a recession is less likely and, possibly unlikely, but we'll need to have inflation die off naturally (without draconian rate hikes) to the 2% level the Fed seems to be comfortable with. A smooth and soft landing!

And that should be good for banks as many of them have bolstered their loan loss reserves through Q4-2022 with increased provisions for losses. Should our "no recession" forecast be correct then we could expect some release of reserves toward YE 2023 boosting bank earnings results.

In any case, we have said before that the banking industry is healthy with strong capital ratios, little loan delinquency, accelerating growth in commercial lending and favorable lending rates. We see that in the banks we own and you see that in the banks you own and/or manage.

As we look at our portfolio results for 2022 we can report that most of our holdings beat expectations of research analysts and/or Fortress Partners Capital Management, Ltd., the manager of FFP BankManagers Fund.

We continue to believe that the performance of community banks and banks in general has not been recognized by the market which seems to be influenced by the talking heads on CNBC and Fox Business News. Stock prices of banks still have plenty of room to grow as measured by average P/E ratios and P/TBV ratios.

Moreover, we think that the current prices of banks reflect a view that the economy is still heading for a recession, modest though it may be. Until the wet blanket of recession no longer hangs over the economy, bank stocks as a group will not outperform. That means buying opportunities will prevail!

Copyright 2023 Fortress Partners Capital Management, Ltd

* * *

FORTRESS
PARTNERS
CAPITAL MANAGEMENT, LTD.
N61 W29865 Stoney Hill Court, Suite 200
Hartland, WI 53029
262-719-3719 (Jon Bruss)
www.fortresspartners.com

THIS COMMUNICATION IS NOT AN OFFER OF INTERESTS IN FFP BANKMANAGERS FUND, LLC. PERFORMANCE INFORMATION IS HISTORICAL AND IS NOT INDICATIVE OF, NOR DOES IT GUARANTEE FUTURE RESULTS.