Uncharted Territory: Understanding This Economic Cycle

Services
Investment Management

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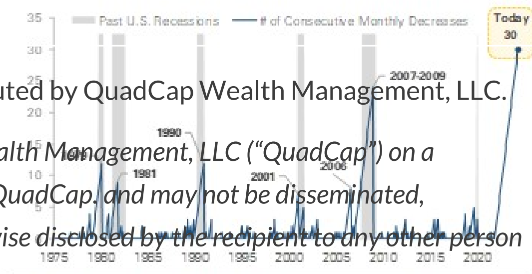
FIGURE 1 – Leading Economic Index (2000 to Present)

Source: U.S. Conference, NBER. Data from 1/1/2000 to 8/31/2024.

FIGURE 2 – Number of Consecutive Monthly Decreases of the LEI



Source: U.S. Conference Board, NBER. Data from 1/1/1975 to 8/31/2024.

The economy is in uncharted territory. Figure 1 graphs the Leading Economic Index (LEI), which tracks ten data points that tend to change before the overall economy does. Economists monitor the LEI because it includes data that can provide insight into future economic activity, such as unemployment claims, building permits, and manufacturing hours worked. A rising LEI signals improving economic conditions, while a declining LEI suggests worsening conditions. In early 2020, the LEI declined as the pandemic led to economic shutdowns. Following a brief recession, the index rebounded later in 2020 and into 2021, driven by government stimulus, the reopening of the economy, and low interest rates. The LEI peaked in November 2021, but it has declined steadily over the past few years and is now the lowest since 2016.

Figure 2 graphs the number of consecutive monthly decreases in the LEI, with gray shading marking past U.S. recessions. Historically, when the LEI declines for several consecutive months, the economy is often entering or is already in a recession. For example, in 1979, the LEI declined for eight consecutive months leading up to the recession. The number of consecutive monthly declines ranged from three months ahead of the 1981 recession to four in 1990 and six in 2001. The longest streak of declines before a recession started was ten months in 2007. The latest data shows the LEI has declined for 30 consecutive months, which surpasses all prior levels.

The steady decline of the LEI suggests that economic growth should be slowing more than it is, highlighting that today's economic cycle is unlike anything we've seen before. The disconnect may be explained by several demographic and fiscal changes brought on by the pandemic. Domestic migration has surged. The Federal Reserve cut interest rates to near zero, enabling businesses and individuals to lock in low-cost debt. The government issued stimulus checks and passed multiple spending bills to invest in infrastructure and incentivize domestic manufacturing. The pandemic exposed weaknesses in global supply chains, prompting companies to reinvest in U.S.-based production. The LEI's recent trend doesn't necessarily mean the economy is broken, just that it's different. It's unclear how long these shifts will last, but the two charts below remind us how this post-pandemic economic cycle continues to unfold in an unusual manner.

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The S&P 500 Index or Standard & Poor's 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S.

The Russell 2000 index measures the performance of approximately 2,000 small-cap US equities.

The MSCI EAFE Index is a stock market index that measures the performance of large- and mid-cap companies across 21 developed markets countries around the world. Canada and the USA are not included.

The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries.

The Nasdaq 100 Index is a stock index of the 100 largest companies by modified market capitalization trading on Nasdaq exchanges.

The Russell 1000 Growth index is an index that tracks large cap, growth stocks. This benchmark is important for investors that might tilt their investments towards large cap growth. Growth stocks, in comparison to value stocks, are considered companies with a more growth potential, and a higher risk profile.

The Russell 1000 Value index is an index that tracks large cap, value stocks. This benchmark is important for investors that might tilt their investments towards large cap value. Value stocks, in comparison to growth stocks, are considered companies with a stable cash flow, and more mature business model.

The CBOE VIX Index is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPX℠) call and put options.

The Magnificent 7 is a group of major tech companies with stock growth that, on average, far outpaced the high-performing S&P 500® in recent years.

Coined in 2023, the group consists of Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla.

The Dow Jones Industrial Average, or simply the Dow, is a stock market index that indicates the value of 30 large, publicly owned companies based in the United States, and how they have traded in the stock market during various periods of time. These 30 companies are also included in the S&P 500 Index. The value of the Dow is not a weighted arithmetic mean and does not represent its component companies' market capitalization, but rather the sum of the price of one share of stock for each component company. The sum is corrected by a factor which changes whenever one of the component stocks has a stock split or stock dividend, so as to generate a consistent value for the *index.*

The Bloomberg US Aggregate Bond Index is used as a benchmark for investment grade bonds within the United States. This index is important as a benchmark for someone wanting to track their fixed income asset allocation.

The Bloomberg US Corporate Index covers performance for United States corporate bonds. This index serves as an important benchmark for portfolios that include exposure to investment grade corporate bonds.

The Bloomberg US Corporate High Yield Index covers performance for United States high yield corporate bonds. This index serves as an important benchmark for portfolios that include exposure to riskier corporate bonds that might not necessarily be investment grade.

Treasuries, also known as Treasury securities, are debt obligations issued by the United States government. They are used to raise cash needed to fund government operations and help finance the federal deficit. Treasuries are backed by the full faith and credit of the US government, making them one of the safest investments. They are an important instrument in monetary policy, allowing central banks to control the money supply.

The Prime Rate is the interest rate that commercial banks charge their most creditworthy corporate customers. The prime rate is derived from the federal funds rate, usually using fed funds + 3 as the formula.