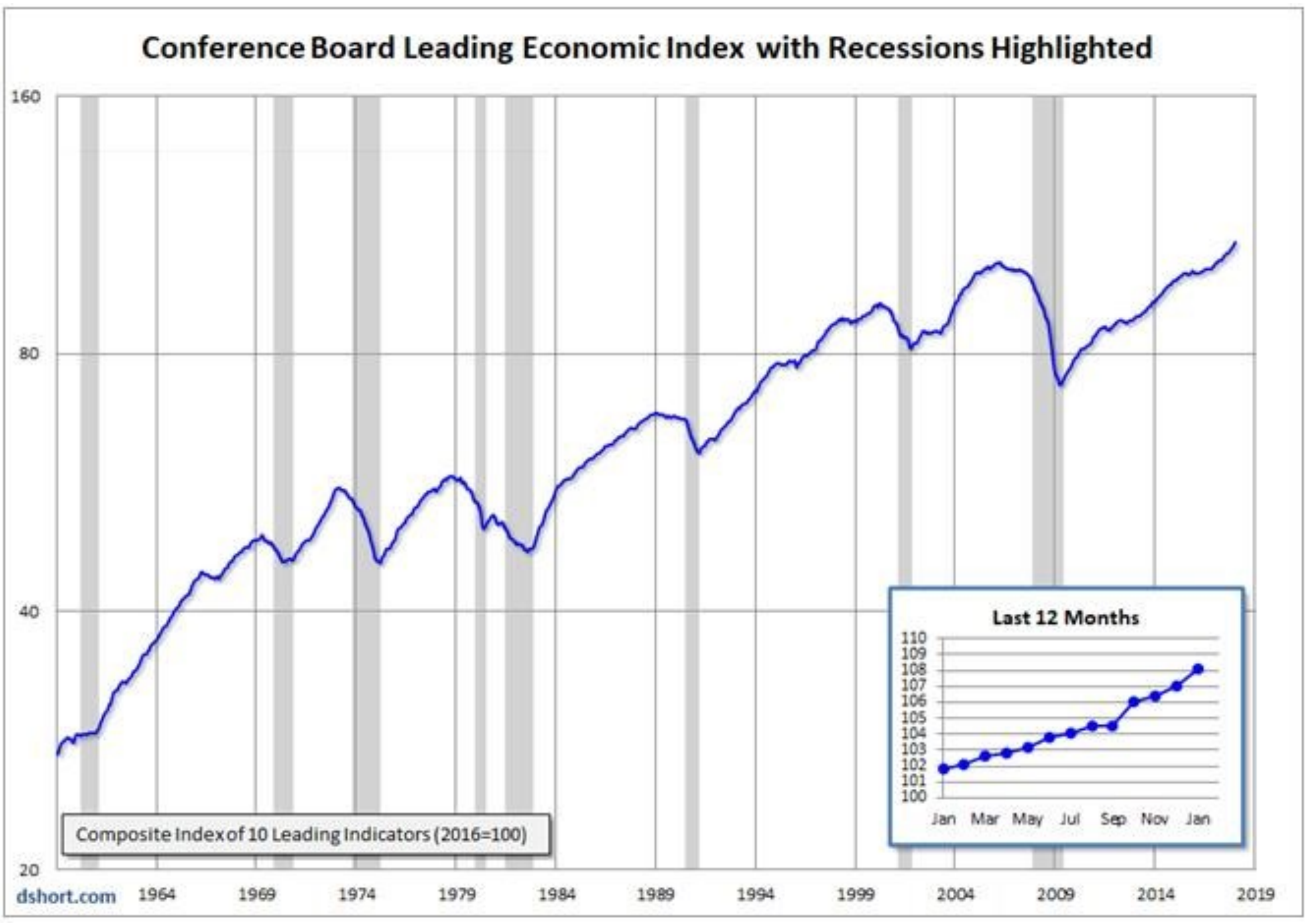
Chart of the Month

April 2018



The S&P 500 slipped 0.8% during the first three months of the year, breaking a streak of nine quarters with positive performance. After a 5.8% gain in January, the market fell 3.8% in February and 2.5% in March, the first back-to-back monthly declines in over two years.

Is this the beginning of the end to a bull market that is now nine years old or just an interim correction along the way? To answer that question, it is important to recognize that bear markets (defined as a drop of at least 20% from peak to trough) rarely occur without a recession. As such, we believe it makes sense to pay close attention to the underlying fundamentals that drive the economy.

One of the best indicators is The Leading Economic Index (LEI), which is published monthly by The Conference Board. It consists of ten components, including average weekly hours, initial claims for unemployment insurance, factory orders, building permits, consumer sentiment, and the S&P 500.

Despite the downturn in the stock market, the LEI increased to 108.7 in February from 108.0 in January, a 0.6% month-over-month advance. The index is up 4.0% over the past six months, equal to an annualized rate of 8.0% (which, historically, is consistent with GDP growth of 3.2%). According to The Conference Board, "The LEI points to robust economic growth throughout 2018. Its six-month growth rate has not been this high since the first quarter of 2011."

As shown in the graph above, recessions (marked by gray bars) only materialize *after* the LEI rolls over. With the index growing in 11 of the past 12 months (September fell slightly due to the hurricanes), there is no reason to believe that a recession is on the horizon.

Based on the previous three cycles, the next recession may not take place for another three to seven years (see below). Of note, the red lines represent "round trips" in the LEI — from the pre-recession cycle high through the trough and back to the prior high — while the green lines indicate the length of time between the completion of the round trip and the subsequent recession. Given that the LEI only took out its pre-recession high a year ago, the economy should be able to expand for several more years if the past is prologue.

In the meantime, we are mindful that a tightening in monetary policy is likely to offset some of the benefits from a loosening in fiscal policy. Nonetheless, we remain hopeful that the combination of a growing economy and lower corporate tax rates will lead to record profits and stock prices in the not too distant future (perhaps in response to the earnings season that gets underway in the next couple of weeks).

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