Chart of the Month

February 2015

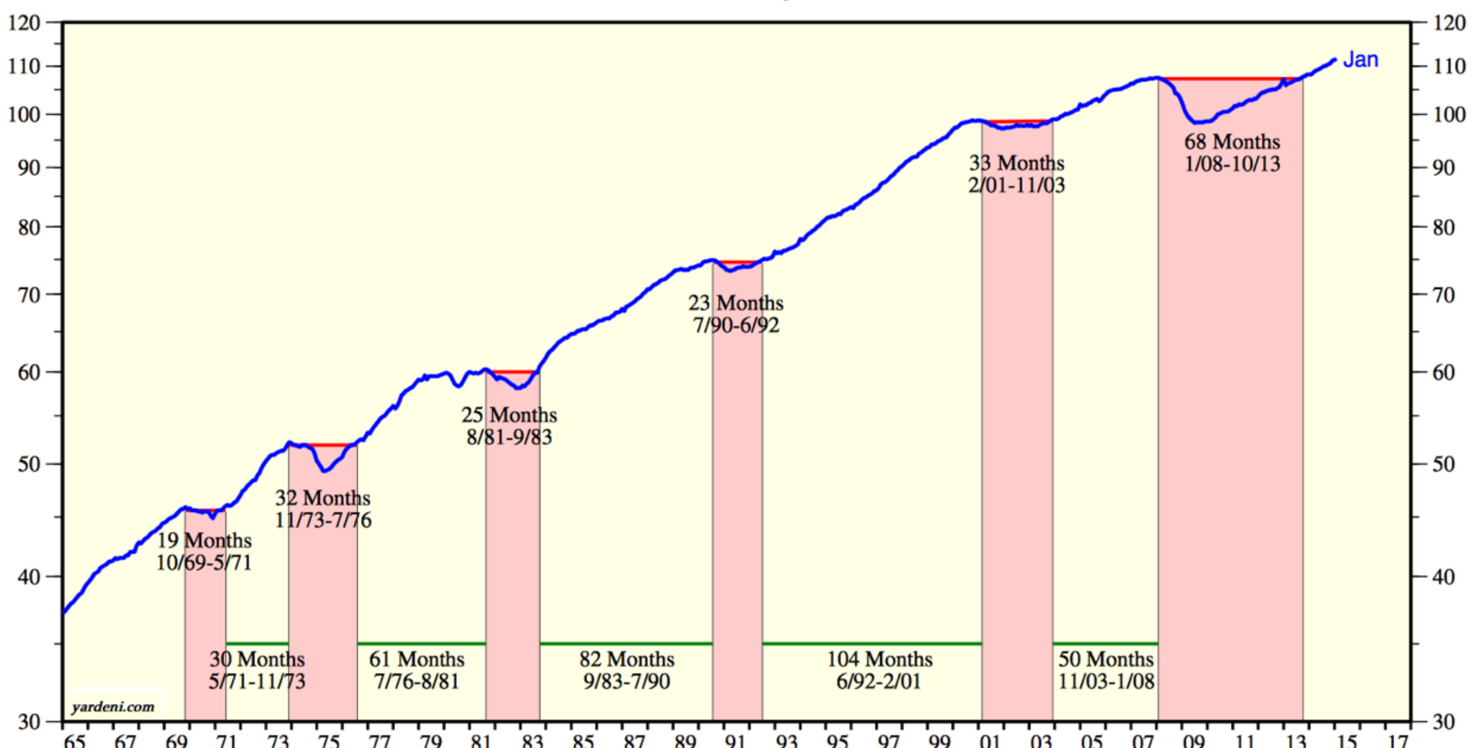
Despite the ongoing skepticism by many about the strength of the economic recovery and expansion, it has been our belief for years that we are in the midst of a long-term period of slow and sustainable growth that is likely to exceed the duration of the typical upturn. Our view has been shaped by the Fed's accommodative monetary policy, historically low inflation and interest rates, improving corporate and household balance sheets, and the wealth effect resulting from rising stock prices and real estate values.

To gain an appreciation of where the economy stands, let's take a look at the chart of the Coincident Economic Indicators (CEI) below. The index tracks payrolls, incomes, production, and sales. It is one of the best gauges of current economic activity because the indicators change at approximately the same time and pace as the overall economy.

The graph is basically a map of the business cycle. The index, as measured by the blue line, increased 0.2% in January to 111.6 (2010=100), following a 0.2% gain in December. The level of the CEI is less important than the direction and cyclical turning points. The index last peaked in January 2008 and bottomed in June 2009.

As noted within the pink bar, the index didn't return to its previous height until October 2013. At 68 months, the cyclical downturn and recovery was the longest in the past 50 years. The economy, in fact, only entered the expansion phase 16 months ago. Of note, as shown by the green horizontal lines, the expansion periods have lasted a minimum of 30 months and as long as 104 months. If the past is prologue, the economy should continue to grow through at least April 2016 and perhaps out to 2022. An average expansion (65.4 months) would suggest that the next downturn is more than four years away.

In the absence of a recession or excessive valuation — neither of which appear to be an issue for the foreseeable future — we believe a portfolio of carefully chosen stocks will continue to reward investors who can endure the inevitable corrections along the way. Since the bull market began in March 2009, the S&P 500 has experienced eight reversals in excess of 5% (ranging from 5.8% to 19.4%) for an average of one to two such declines per year. Trying to time these corrections, however, is virtually impossible. Therefore, we remain focused on the fundamentals of the economy and the companies that we own in our Growth and Equity Income strategies.



Red horizontal lines span cyclical peaks through subsequent cyclical recoveries. Green horizontal lines are expansion periods following recoveries.
Source: Conference Board, Haver Analytics, and YRI calculations.

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