LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

KEY TAKEAWAYS

The latest reading on the Conference Board's monthly LEI helps to provide some timely guidance regarding recent market volatility.

The LEI says the risk of recession in the next 12 months is very low (4%), but not zero.

Based on the level of the LEI relative to its prior peak, the current economic expansion may last at least another four years.

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FORECAST FOR CLEAR SKIES

LEI STILL SHOWS LOW ODDS OF RECESSION

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Last week, global equity markets, including in the U.S., were driven lower by a variety of fears, most notably the weakness in China's economy and financial markets, as well as the Chinese government's response (or lack thereof). As a new trading week (August 24–28, 2015) begins, the S&P 500 is in the midst of its first 10% pullback since late 2011, triggering talk of recession signals. The latest reading on the Conference Board's monthly Leading Economic Index (LEI)—released last week for July 2015—helps to provide some timely guidance in this area.

The LEI is one of our "Five Forecasters" (see our *Midyear Outlook 2015: Some Assembly Required* for further discussion) and provides a valuable guidepost each month as to where we are in the economic expansion. As noted in our *Outlook 2015: In Transit*, when the economy has not been in recession, the S&P 500 has been positive 82% of the time and provided low double-digit returns. When the economy has been in recession, the S&P 500 has been positive just 50% of the time, with average returns in the low single digits.

The latest reading on the LEI, based on data from July 2015, revealed that the LEI had climbed 4.1% since July 2014. The LEI is designed to predict the probable path of the economy 6–12 months in the future. Since 1960, a span of 667 months (or 55 years and 7 months), the LEI's year-over-year increase has been at least 4.1% in 333 months. Not surprisingly, the U.S. economy was not in recession in any of those 333 months. Thus, it is highly unlikely that the economy was in recession in July 2015, despite the impact of the weakening Chinese economy, the stronger dollar, and lower oil prices.

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But the LEI is designed to forecast the potential direction of the U.S. economy and tell market participants what may happen, not what has already happened. Three months after each of the 333 months that the LEI was up 4.1% or more, the economy was in a recession just once. Six months after the LEI was up by 4.1% or more on a year-over-year basis, the U.S. economy has been in recession in just four months, or 1% of the time. Looking out 12 months after the LEI was up 4.1% or more, the economy was in recession in just 14 of the 333 months, or 4% of the time. Based on this relationship, the odds of a recession within the next 18 months and 2 years are 9% and 11%, respectively [Figure 1].

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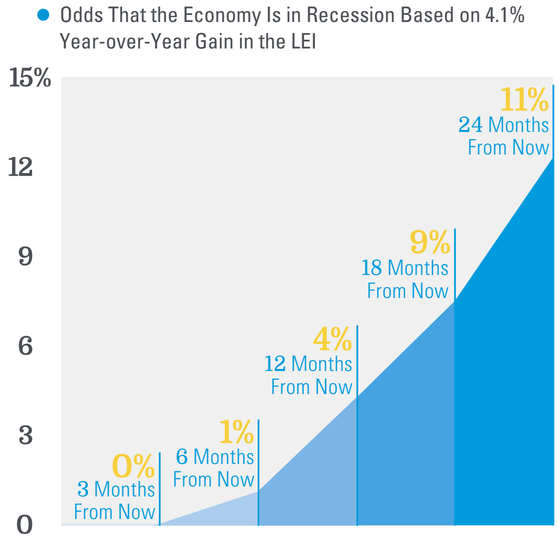
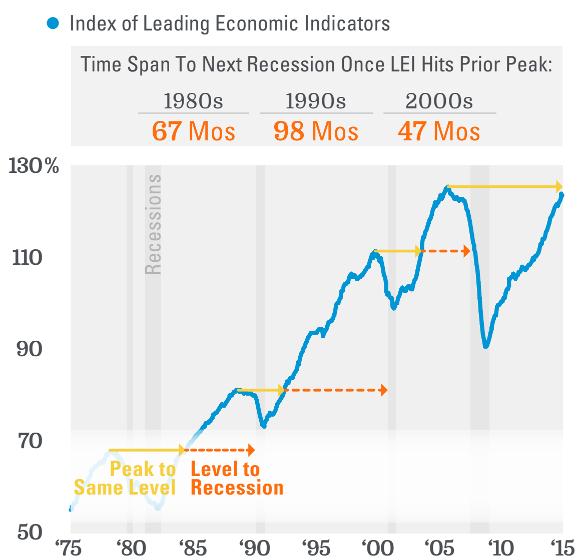
1 **LEI CONTINUES TO SUGGEST VERY LOW ODDS OF A RECESSION IN NEXT TWO YEARS**



Source: LPL Research, Conference Board, Bureau of Economic Analysis 08/20/15

Past economic performance is not a guarantee of future results.

2 **NEW HIGH FOR LEI HAS LEFT EXPANSIONS PLENTY OF ROOM TO RUN**



Source: LPL Research, Bloomberg 08/20/15

Another way to look at the LEI is its level relative to its prior peak [Figure 2]. Sometime in the next several months, the level of the LEI will reach its prior peak (125.1), hit in March 2006. This may raise concern that the economic cycle is nearing an end. But in fact during the last three economic recoveries (commencing in 1982, 1991 and 2001) the recovery continued, on average, for another 6 years after the LEI hit its prior peak. During the 1982–1990 recovery, the LEI finally hit its prior peak in November 1984, and the economic expansion continued for another 67 months (nearly 7 years) before entering a recession in July 1990. During the 1991–2001 recovery, the LEI hit its prior peak in December 1992, and the economic expansion continued for another 98 months (more than 8 years) before entering a recession in February 2001. During the recovery that began in 2001, the LEI passed its prior peak in January 2004, almost four years before the Great Recession began in December 2007.

On balance, the LEI says the risk of recession in the next 12 months is very low (4%), but not zero, and that based on the level of the LEI relative to its prior peak, the current economic expansion may last at least another four years. While the odds of a recession increase when looking out 18 months (9%) and 2 years (11%), they remain low—but again, not zero. We would agree, and note that economic recoveries do not generally die of old age, but end due to excesses building up in one or more sectors of the economy. In the past, overbuilding in housing or commercial real estate, borrowing too much to pay for overbuilding and overspending, or even overconfidence by businesses and consumers have all led to overheating and recession. The current recovery has been relatively lackluster by historical standards, and the excesses that have triggered recessions in the past are not present. Still, a dramatic deterioration of the financial or economic situation in China, a fiscal or monetary policy mistake here in the United States or abroad, or an exogenous event (a major terror attack, natural disaster, etc.), among other events, may cause us to change our view. ■

IMPORTANT DISCLOSURES

All performance referenced is historical and is no guarantee of future results.

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for your clients. Any economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

All indexes are unmanaged and cannot be invested into directly.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Leading Economic Indicators (LEI) Index is a measure of economic variables, such as private-sector wages, that tends to show the direction of future economic activity.

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