Zacks
INVESTMENT
MANAGEMENT

Mitch on the Markets

Time to Check the U.S. Economy's Pulse

By Mitch Zacks
Portfolio Manager

Expectations for the U.S. economy are seemingly running high. With tax cuts, a rising stock market, historically low unemployment, and solid corporate earnings, it makes sense that investors and consumers alike are optimistic about what lies ahead. At Zacks Investment Management (ZIM), we're optimistic too, but more so because of what we see when we grind into the economic data.

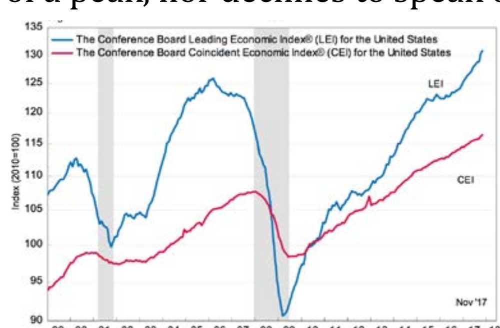
This week I'll take a look at a broad cross-section of economic data to paint a picture of how the U.S. economy is doing. The short answer: *just fine.*

Economic Indicators and Data Worth Eyeing

If an investor were to only look at one economic indicator (though we recommend looking at several), I would suggest checking-in each month on the Conference Board Leading Economic Index, also known as the LEI. The LEI is made up of ten key and influential data points, including, but not limited to Manufacturers' new orders, nondefense capital goods excluding aircraft orders, building permits, new private housing units, stock prices, consumer expectations for business conditions, and interest rate spreads. In other words, important and forward-looking data.

But there is another, important reason to focus on the LEI: *since the LEI came into existence in 1959, no U.S. recession has occurred when the LEI was rising*. Indeed, throughout its history, the LEI has been the "canary in the coal mine" when it peaks and then declines for months (sometimes several months). When that trend reversal happens, a recession has followed every time. (According to USA Today)

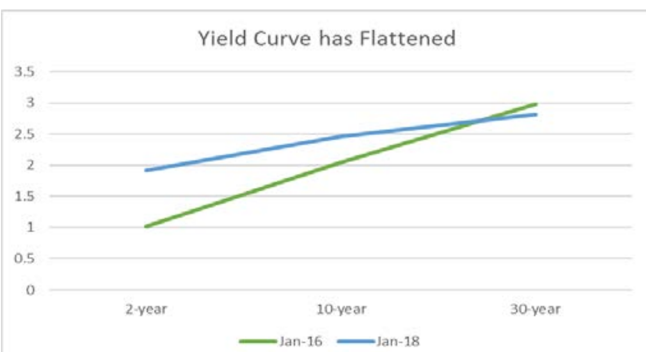
The chart below should illustrate a couple of things. First is evidence of the LEI peaking and declining prior to U.S. recessions (indicated by gray bars). Second is that currently, the LEI is high and rising. We do not need to see any sign of a peak, nor declines to speak of.



Source: Conference Board

An interest rate spread (10-year U.S. Treasury minus fed funds) is included in the LEI's data, but another leading indicator we believe is worth eyeing is the yield curve, particularly if it is inverted or close to inverting. On average, the yield curve inverts 16 months prior to an economic recession and 13 months before major stock-market corrections (According to Silverlight Invest). As it stands today, the yield curve has been flattening but is not yet inverted, indicating in our view that the risk of recession is still some time off.

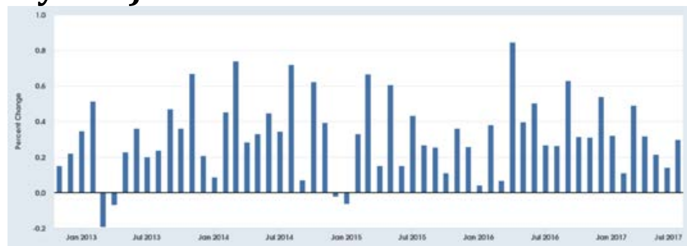
Here is the yield curve at the beginning of 2016 (green, steep) compared with the yield curve at the beginning of 2018 (blue, flatter). It is clear to see the flattening trend, and worth watching closely to see when and if it inverts:



Source: US Department of the Treasury

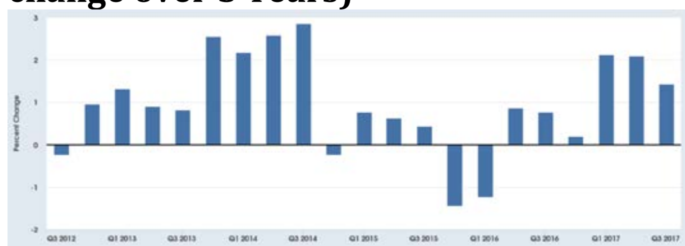
Here are some other key economic data points we believe are also worth watching, in charts:

Personal Consumption Expenditures (Consumer Spending, % change over 5 years)



Source: Federal Reserve Bank of St. Louis

Private Nonresidential Fixed Investment (Business Investment, % change over 5 Years)



Source: Federal Reserve Bank of St. Louis

Manufacturing Sector: Real Output (% change over 5-Years)

Source: Federal Reserve Bank of St. Louis

If we added nonfarm payroll growth (jobs) to this series, it would also show steady growth over the last five years, as would the broader measure of GDP and to a lesser extent, personal disposable income.

Bottom Line for Investors

Economic data has been firm in the U.S., and we expect the growth trend to continue in 2018. We further believe that stock prices should follow.

That being said, the U.S. economy is running at close to full capacity, with very little slack for further output. That could potentially have an effect on costs, wages, prices, and ultimately inflation and interest rates. As you watch the above economic indicators progress over the course of the year, remember to keep one eye on inflation and monetary tightening from the Federal Reserve.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.