Zacks
INVESTMENT MANAGEMENT

Mitch on the Markets

Economic data suggests slowing growth, possible recession

By Mitch Zacks
Portfolio Manager

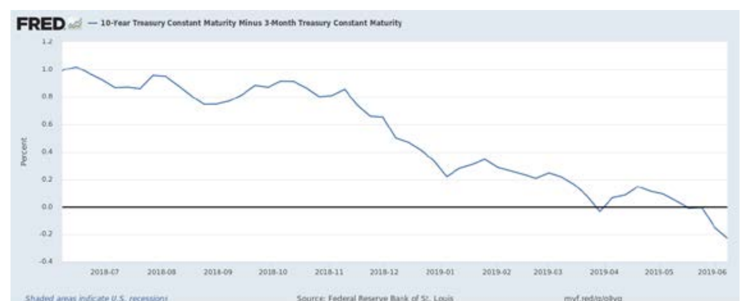
According to the National Bureau of Economic Research (NBER), the U.S. economy has been growing for over ten years – putting it on the level with the longest expansion period in U.S. history, from March 1991 to March 2001. By the NBER's measure, just one more month of growth would make this the longest expansion cycle in our country's history.[1]

Expansions don't die of old age, so this historical milestone does not by itself imply that the U.S. is headed for a recession soon. But there's some recent economic data that seems to be implying a real growth deceleration, with cracks forming in the economy that have some Fed officials voicing concern.

Below is a detailed look at recession indicators you should keep an eye on:

1) The Yield Curve: Let's start with the yield curve, which has historically been a reliable indicator of expansions and recessions. Vice Chair of the Federal Reserve Board, Richard Clarida, made the point clear when he stated that "I think historically a flat yield curve doesn't convey a lot of information. If the yield curve inverts as it has…and if it persists for some time, that's obviously something I [Clarida] would definitely take seriously."

When looking at the difference between the 10-year U.S. Treasury and the 3-month T-bill, the yield curve is officially inverted:[2]



Source: Federal Reserve Bank of St. Louis

We'll be watching to see if the yield curve stays inverted moving forward. But it's worth noting that interest rates have been subject to a $4 trillion balance sheet expansion by the Fed as well as extraordinary monetary policies that have kept interest rates artificially

low for some time. For these reasons, it's debatable whether the yield curve indicator may be as reliable in forecasting a recession as in times past (see chart below). Regardless, we'll need to see if the yield curve remains consistently inverted for some time, and reassess in a few months.

Source: Federal Reserve Bank of St. Louis[3]

2) The Labor Market: Another indicator to watch closely is the labor market, which some could argue has already reached a peak in its ability to create new job growth. The U.S. Department of Labor's May employment report showed far weaker job growth than expected, with 75,000 new nonfarm jobs added versus the 175K–180K expected.[4] Keen observers would also note that with downward revisions to March and April readings, the net change for May was essentially flat. The economy's ability to create new jobs or fill existing openings is a key tenet for growth.

3) Transportation: Transportation is another area where signs of weakness are starting to show in the data. The movement of goods across the country by freight or rail is often a good measure of economic activity at-large, and by some measures that activity has turned negative in recent months. One such measure, the Cass Freight Index, measures volume and velocity of goods moving across the United States, and its April report showed *negative* year-over-year activity over the last five months.[5]

On balance, we have an economic expansion that is near becoming the longest in U.S. history, and we have economic data showing that the expansion may be losing its legs - not to mention an ongoing trade war between the U.S. and the world's second largest economy, China. Even if one cannot make the case for a recession in 2019 or soon, it's at least apparent that the road to accelerating economic growth is uphill (and fairly steep).

Bottom Line for Investors

The Fed's actions later this month and in July will almost certainly matter to markets, and investors should continue to monitor economic data carefully.

But at the end of the day, investors should also remember that the stock market is arguably the most reliable leading indicator for recessions, often peaking well before the U.S. economy does. By a similar token, the stock market will often begin its recovery a few months before the U.S. economy starts growing again.

Trying to time these peaks and troughs is extraordinarily difficult, as the windows for getting it right are small relative to most investor's time

horizons. Over the last 65 years, the U.S. has been in a recession in less than 15% of all months, and in some of those cases equity returns were positive even over the full length of the contraction (again, since stock market recoveries often start before economic recoveries do). Trying to time the recession perfectly is certainly an option, it just might not be a wise one.

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.

[1] Forbes, June 9, 2019. https://www.forbes.com/sites/chuckjones/2019/06/09/reliable-recession-indicator-blinking-yellow/#4fb3ccb633c3
[2]Federal Reserve Bank of St. Louis, June 10, 2019. https://fred.stlouisfed.org/series/T10Y3M
[3]Federal Reserve Bank of St. Louis, June 10, 2019. https://fred.stlouisfed.org/series/T10Y3M
[5] Forbes, June 7, 2019. https://www.forbes.com/sites/chuckjones/2019/06/07/trumps-job-growth-is-the-lowest-since-he-took-office/#103c37f81c09
[5] Forbes, May 27, 2019. https://www.forbes.com/sites/chuckjones/2019/05/27/3-charts-show-trumps-economy-is-weaker-than-people-think/#60abc46a6294

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