Bull Market Monitor

US comfortably in late cycle

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- Equity bull markets rarely end in the absence of a recession occurring. We track key attributes of the business cycle to gauge how the expansion is evolving and risks of a recession.
- We think that the US business cycle has transitioned to the late stage. The good news is that the economy can be late cycle for a long time.
- US-China trade talks failed to produce an agreement and additional tariffs have been imposed by both sides. Consumer spending has been somewhat disappointing and PMIs have surprised to the downside. Recent inflation data has been soft.
- While now late cycle, we view the current growth, inflation, and monetary policy environment as still supportive of risk assets.

Cycle status

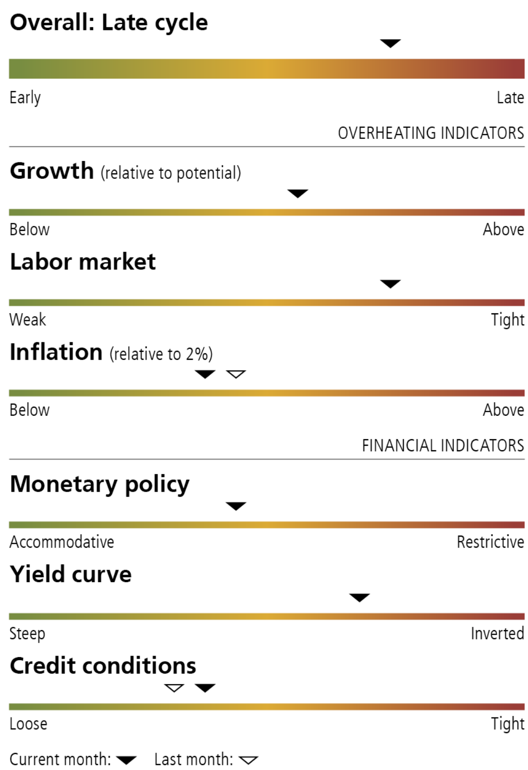
We think that the US business cycle has transitioned to the late stage. Growth decelerating from its peak toward long-term potential and Fed monetary policy being roughly neutral are the two characteristics typical of a late-cycle economy. The good news is that the economy can be late cycle for a long time. At one point last year the economy had been trending toward overheating, but the more recent data shows that growth is slowing to a more sustainable pace as fiscal and monetary stimulus fades. Subdued inflation has allowed the Fed to send more dovish signals, and risks that excessive monetary policy tightening will cause the cycle to end appear very low.

What's new?

US-China trade talks failed to produce an agreement and additional tariffs have been imposed by both sides. A decision on auto tariffs has been delayed for six months to allow time for negotiations with the EU and Japan. Recent economic data has been mixed. Job growth and consumer sentiment have been strong, and wages are rising, yet consumer spending has been somewhat disappointing. PMIs have surprised to the downside, with particular weakness in the manufacturing sector. After 3.2% growth in 1Q19 GDP, 2Q19 tracking estimates have slipped below 2%. For the moment we leave our growth indicator just above neutral. Core PCE inflation has fallen further below the Fed's 2% target. Credit spreads on corporate bonds have drifted higher over the past month. Bond yields have hit new lows and the market is fully pricing in a Fed rate cut by the end of 2019.

Key cycle indicators for US

The cycle indicators gauge whether the economy is overheating and if financial conditions are restricting growth. These determine our assessment of where we are in the cycle.



Each indicator is evaluated relative to a neutral level that is sustainable over time in order to determine whether the economy is at risk of overheating or if financial conditions will start to restrict growth.

What are we watching?

In addition to the latest round of tariffs, the US has started the process to impose tariffs on nearly all remaining Chinese imports. In our view, this would take around one percentage point off of growth and increase recession risks. President Trump and China President Xi are expected to meet at the 28–29 June G–20 summit in Osaka for what could be the last chance to avoid further escalation. The drama over Brexit continues, although regardless of the outcome, the impact on the US economy should be limited.

What are the investment implications?

While now late cycle, we view the current growth, inflation, and monetary policy environment as still supportive of risk assets.

Appendix

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