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AN AGING CYCLE

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KEY TAKEAWAYS

The current economic expansion will become the longest ever in July.

Slow (but steady) growth and accommodative policy have made this expansion especially durable.

We still see many signals that this cycle could persevere at least through the end of 2019.

The tenth anniversary of the S&P 500 Index bull market is coming up on March 9. As the U.S. stock rally's double-digit birthday nears, we've reflected a lot on the durability of the current economic cycle. The U.S. economic expansion is entering its 118th month, on track to become the longest recovery on record in July.

Some things in life get better with age, but recession calls have grown louder recently amid heightened global uncertainty and market volatility. While it is important to be mindful of where we are in the cycle, we see a lot of evidence that this economic cycle has enough fuel left in its tank to persevere at least through the end of this year and could prove durable.

SLOW, BUT STEADY

In past economic cycles, slow but steady growth has won the race. Since 1970, cycles with annual gross domestic product (GDP) growth higher than 4% lasted about five years on average, while cycles with annual growth lower than 4% lasted about nine years on average [Figure 1]. While slow growth in this cycle has been frustrating at times, especially after a swift and painful downturn, it has helped extend the life of this cycle and keep excesses in check. Inflation-adjusted

1 SLOW BUT STEADY GDP GROWTH COMPARED TO PAST CYCLES

Economic Cycle Trough	Economic Cycle Peak	Length of Expansion (in Months)	Length of Recession (in Months)	Real GDP Change Over Expansion	Real GDP Change Per Year
February 1961	December 1969	106	11	52%	4.8%
November 1970	November 1973	36	16	16%	5.1%
March 1975	January 1980	58	6	23%	4.4%
July 1980	July 1981	12	16	4%	4.3%
November 1982	July 1990	92	8	38%	4.3%
March 1991	March 2001	120	8	43%	3.6%
November 2001	December 2007	73	18	19%	2.9%
June 2009	?	117	?	24%	2.3%
Average (Before Current Cycle)		71	12	28%	4.2%

Source: LPL Research, Bureau of Economic Analysis 02/28/19
Real GDP is the actual amount of gross domestic product adjusted for inflation.
GDP data for the current cycle is through Q4 2018.

GDP has expanded an average of 2.3% annually in this cycle, the slowest pace of growth among all expansions in recent memory, and a key contributor to the expansion's near-record age.

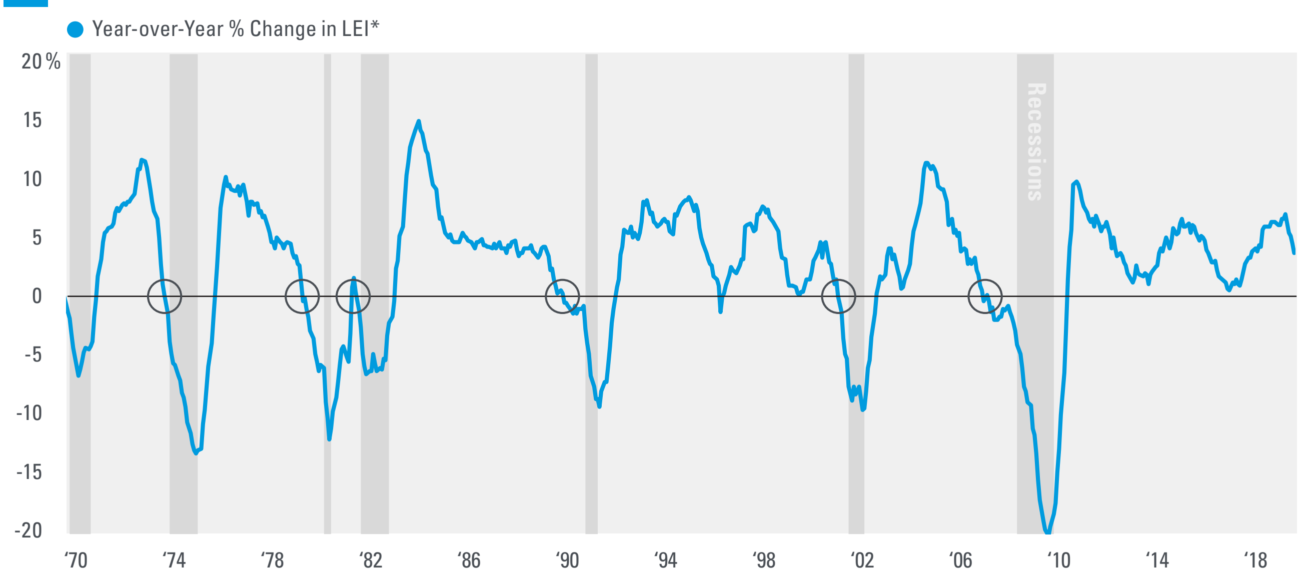
Steady economic growth has been helped in part by extraordinarily supportive monetary policy for much of the cycle and a cautious, gradual approach to tightening. The Federal Reserve's (Fed) supportive policy efforts have been in place for many years, but policymakers only started increasing rates in December 2015, more than six years into the expansion. Since then, the Fed has implemented nine 25-basis point (.25%) hikes, matching the slowest Fed hiking pace in tightening cycles since 1970. This tightening cycle is one of the longest on record, yet inflation-adjusted interest rates are barely above zero. Inflation (measured by core personal consumption expenditures) has been climbing since 2015, but it's still only hovering around the Fed's 2% target, and wage growth, while healthy, remains manageable. Muted inflation can be attributed to several structural factors like demographics and globalization, but the Fed has played a pivotal role in promoting stable pricing while restricting growth only minimally. We believe this pragmatic and gradual approach will continue to be effective, and we see minimal chances of a policy mistake en route to a soft landing from the current modest slowdown.

The lingering effects of fiscal stimulus may also provide an extra boost to the expansion, especially if companies ramp up capital expenditures once we see a United States-China trade resolution. Supply-side fiscal stimulus can have a positive impact on output for several years as consumers and businesses reap the benefits of tax cuts and fiscal incentives.

ENCOURAGING DATA

While we've noted recently that coincident economic reports have sent mixed messages about economic conditions, leading economic data hint to more runway in the expansion. The Conference Board's Leading Economic Index (LEI), composed of 10 leading economic indicators, rose 3.5% year over year in January, its 110th straight gain. Leading indicators typically show pronounced weakness as the economy approaches recession, and year-over-year growth in the gauge has turned negative an average of seven months before each recession going back to 1970 [Figure 2]. The current rate of change remains well off that mark.

2 LEADING INDICATORS TYPICALLY TURN NEGATIVE BEFORE RECESSIONS



Source: LPL Research, Conference Board 02/28/19

* The Conference Board Leading Economic Index

Other indicators we track in our [Recession Watch Dashboard] also show low odds of a recession over the next 12 months. U.S. companies' earnings growth has been solid, short-term yields have not fallen below long-term yields (known as yield curve inversion), manufacturing health is sound, market valuations are reasonable, and our sentiment indicator based on the Fed's Beige Book report shows Main Street remains relatively upbeat. Positive signs in leading indicators and a tight job market also infer that weakness in current reports is likely related to global headwinds that have slowed but have not derailed economic momentum.

GLOBAL LIQUIDITY

We've highlighted how the Fed's accommodation has supported economic growth over the past several years. However, the United States' current economic expansion has also benefitted from a wave of central bank accommodation across the globe, thanks to a staggered global economic recovery. Balance sheets for major central banks are still around the biggest they've been since the financial crisis amid tepid growth internationally, and interest rates are low worldwide, incentivizing borrowing and investment. This accommodative environment (and resulting global growth potential) will likely continue to support the domestic recovery, especially as the Fed pauses on rate hikes. The Fed has also communicated that it will be flexible on reducing the size of its own balance sheet and will likely maintain a larger balance sheet compared to before the 2008 financial crisis.

Ample accommodation this late in a cycle can potentially contribute to a build-up in economic excesses. However, we have yet to see any alarming signs of late-cycle excesses or "red flags" in the economy.

CONCLUSION

While it's important to be mindful of where we are in the economic cycle, later-cycle economies can continue to exhibit stable growth for years. We're maintaining our positive outlook for 2019, thanks to our conviction in sound fundamentals supporting moderate economic growth. At the same time, we remain on watch for any threatening signs of slowing or excess, and we'll continue to keep an eye on trusted economic and market signals. ■

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