Late cycle investing: Long and slow

This is the first of a multi-part special series during a challenging time for investors.

At a glance:

- Investors may miss out on asset rallies if they anticipate a recession too early
- Pessimism is overpriced into the markets with escalating warning signs
- Our main assessment shows that we are likely at least 9 to 12 months away from a recession

With the global economy at a late stage cycle, the premise of a recession has increasingly been highlighted. The danger associated with pricing in a recession too early, that is turning pessimistic at this time, can mean missing out on asset rallies in both the equity and fixed income markets.

Recessions are marked by decelerating economic growth, peaks in corporate margins and equity multiples such as the scenario we face now. The fear is that any negative events from below can tip the balance of the economy into a recessionary mode.

- Inverted US Treasury yield curve
- A mature expansion which has extended for over a long time of 10 years
- Global growth slowdown
- Reigniting trade tensions between the US and China
- Geopolitical tussles (South Korea with Japan, Hong Kong, Brexit, Iran, etc.)

While investors are confronted with the above warning signs, this does not mean a recession is imminent and fears are premature. Even as more caution is warranted, we are still many months away from a recessionary onset.

When will the next recession start?

Our estimates of the timing of the next recessions come broadly from two parts

1) Average time after yield curve inverts

While the recent US Treasury yield curve inversion in August 2019 has strengthened the predictive case of a recession, it has inverted on average 17 months before the prior five recessions. In the history of US recessions, the shortest timeframe reported was 11 months between the inversion date (in August 1980) and the actual downturn.

2) Leading indicators. These are variables we look during this stage of heightened uncertainty.

Good news	Bad news
• Evidence indicates the economic cycle still has room for expansion. The estimates for 2019 global GDP growth are at 3.2% despite downward revisions. (Source: International Monetary Fund) • Trends for some US leading indicators have been stabilising overall • Growth in China and the Eurozone has moderated • Japan gross domestic product growth levels have improved	• Industrial production figures worldwide are either negative (Japan and the Eurozone) or falling (US and China) • Retail sales in China, Japan and Eurozone remain sluggish • Global manufacturing numbers are trending downward and production has fallen to the lowest levels since 2012

Conclusion: Cycle is not yet over

Based on previous recessions, overall leading indicators spent a year in decline before hitting negative levels. Our main assessment with leading indicators, in addition to the inverted yield curve shows that we are likely at least 9 to 12 months away from a recession which makes it still too early to start positioning for a downturn.

The best case scenario appears to be a slow grind towards lower growth as positive drivers are sorely lacking. Regardless of a slow grind or hard landing, policymakers appear ready and responsive to manage frictions in the global economy.

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