

April 11, 2017

*“Winning is easy, young man, governing’s harder.”*

President George Washington to  
Treasury Secretary Alexander Hamilton  
In the musical “Hamilton”

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Note to Presidents: Economic success has a lot to do with where we are in our business cycle. And where you end up has a lot to do with where you begin.

Based on the statistics below, when would you rather start your Presidency?

1 <sup>st</sup> Quarter 2009	1 <sup>st</sup> Quarter 2017
In March 2009, the stock market, as measured by the S&P 500 stock market index, collapsed to the lowest level since 1996.	In March 2017, the stock market, as measured by the S&P 500, rallied to an all-time high. This followed the initial rally to a new high after the election of President Trump.
In February 2009, the consumer confidence index, as calculated from the Conference Board’s consumer sentiment survey, fell to the lowest level in more than 40 years of data.	In March 2017, the consumer confidence index spiked to the highest level since December 2000.
In March 2009, margin debt, the amount of money borrowed against stocks held in brokerage accounts (i.e., leverage), reached the lowest level since 1995.	In March 2017, margin debt reached an all-time high.
In the 1 <sup>st</sup> quarter of 2009, an estimated 1,912,000 jobs were eliminated from our economy.	In the 1 <sup>st</sup> quarter of 2017, an estimated 533,000 jobs were added to our economy.

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**Business cycle:** *The continuous expansion and contraction of economic growth in fairly regular intervals. That is, a business cycle involves GDP growth (the growth in the value of all goods and services produced in the U.S.) and the creation of wealth for a period of time, followed by overheating and a recession. When the recession reaches its bottom the business cycle starts again. Some economists believe that the length and strength of business cycles are easily predictable, while others dispute this. A business cycle is seen as an inevitable part of the capitalist system. It is informally called a boom-and-bust cycle. (Definition from the Farlex Financial Dictionary.)*

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According to the National Bureau of Economic Research, the current business cycle began in July 2009 (that marks the trough of the last recession as June 2009). At the end of March 2017, we were 93 months into the current business cycle, the 3<sup>rd</sup> longest economic expansion since the data set began in 1854. The longest economic expansion ever recorded ended after 120 months in March 2001.

Statistically, the current business cycle that began in 2009 has yet to roll over into a recession because the Gross Domestic Product (GDP) of the U.S. has not shrunk for 2 consecutive quarters. However, as I have reported in past letters, the earnings of the combined businesses in the S&P 500 stock market index declined

for almost 1¾ years, from the middle of the 3rd quarter of 2014 into the 2nd quarter of 2016. Led by a collapse in oil and commodity related businesses, we did enter an “earnings recession.” Right now, as I look at the data beneath the surface, I see some economic indicators that signal we are approaching the end of the current business cycle that began in 2009 and some economic indicators that signal we are in the beginning of a new surge of economic growth within the 2009 cycle (or what I would call a new “smaller cycle” within the larger business cycle).

Regarding indicators that signal we are approaching the end of the current business cycle: when I see record levels of auto debt (and rising default rates) and record levels of margin debt, I wonder where the future purchasing power to extend this cycle is going to come from. When I see the Atlanta Federal Reserve Bank’s GDPNow estimate for U.S. economic growth in the 1st quarter of 2017 drop to 0.6%, well below the 2.1% growth rate of the 4th quarter of 2016, I wonder if all the consumer enthusiasm reflected in various surveys is a contrary signal marking the top of the cycle before the bust.

Regarding indicators that signal we are in the beginning of a new surge of economic growth, or a new smaller cycle within the larger business cycle: I can point to the return of revenue and earnings growth in the S&P 500 businesses in the 3rd and 4th quarters of 2016 and the strong earnings estimates for the 1st quarter of 2017. I can point to the expansion in U.S. manufacturing over the last 6 months. And I can point to a more confident emerging market outlook, including in China, along with positive manufacturing statistics in Europe, as potential catalysts for a synchronized global expansion.

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I have purposely excluded potential policy changes in Washington, D.C. in my assessment of the business cycle, including tax reform, infrastructure spending, trade policy, regulatory changes, immigration policy, et al. In my mind they are a wild card. I am not sure what will get done and whether it will be a net positive or a net negative for our economy and our markets. Despite what candidates say on the campaign trail, governing is hard. I do believe that positive expectations for policy changes have been built into the stock market and consumer expectations. I have certainly seen the stock prices of many companies jump since the election in what I perceive to be investor anticipation of a material drop in corporate tax rates and/or a material acceleration in infrastructure spending. It would also not surprise me if policy confusion, or a “waiting to see if anything changes” mindset, could be holding up some business investments. In part, the ability to change policy is affected by where we are in our business cycle. The strengths and weaknesses in our economy help dictate policy priorities and options. The changes in status and alignment of constituents and vested interests through the cycle impact how politicians are pushed and pulled. The bank bailout in 2008 was a classic example of how economic conditions can move politicians to take actions, some of which they may have never contemplated before. At least from an economic perspective, I do not currently see the kind of urgency that would motivate material policy changes by our federal government. Politically, we will see what the politicians are able to do.

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We appreciate your business and we continue to work hard to earn the trust you have placed in us. Please let us know if you have a friend or family member that could use our assistance.

John McCorvie, CFA