JULY 2019 CLIENT QUESTION

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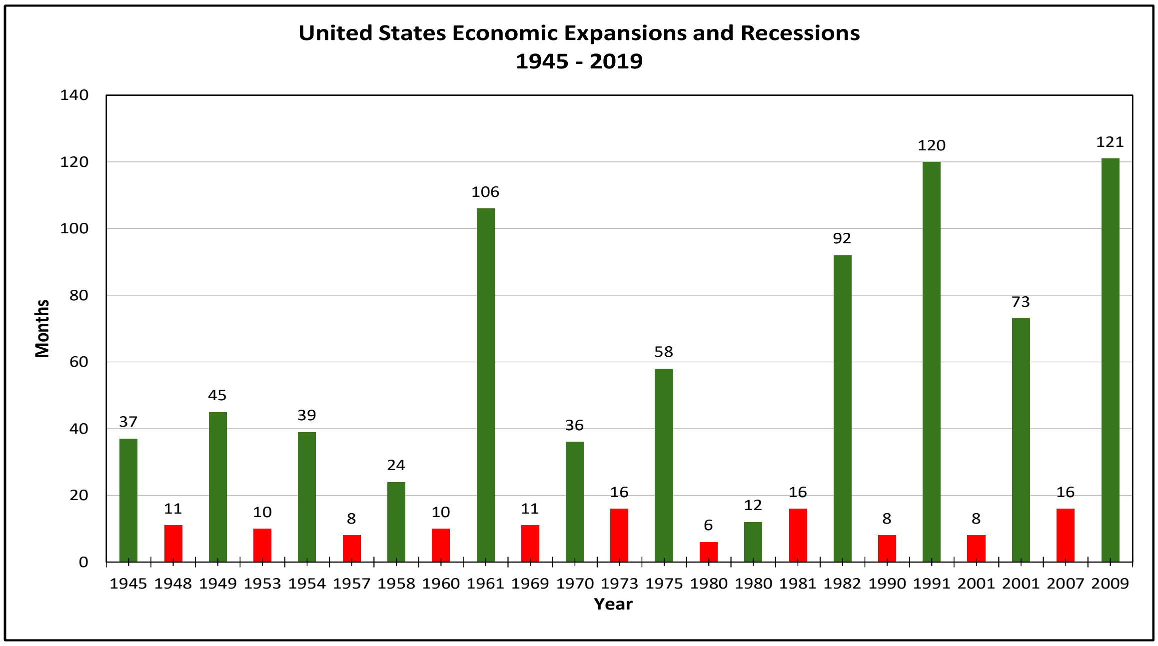
In July the current economic expansion in the United States officially became the longest on record dating back to 1854. The longest economic expansion is simply defined as the greatest time period without a recession. The expansion started after the end of the Global Financial Crisis in June 2009 and has lasted 121 months.

The National Bureau of Economic Research (NBER) Business Cycle Dating Committee is charged with maintaining official records of expansions and recessions. The NBER defines a recession as a significant decline in economic activity (this is slightly different than the traditional definition of a recession as two consecutive quarters of decline in real GDP). An expansion is defined as a period where economic activity rises substantially.

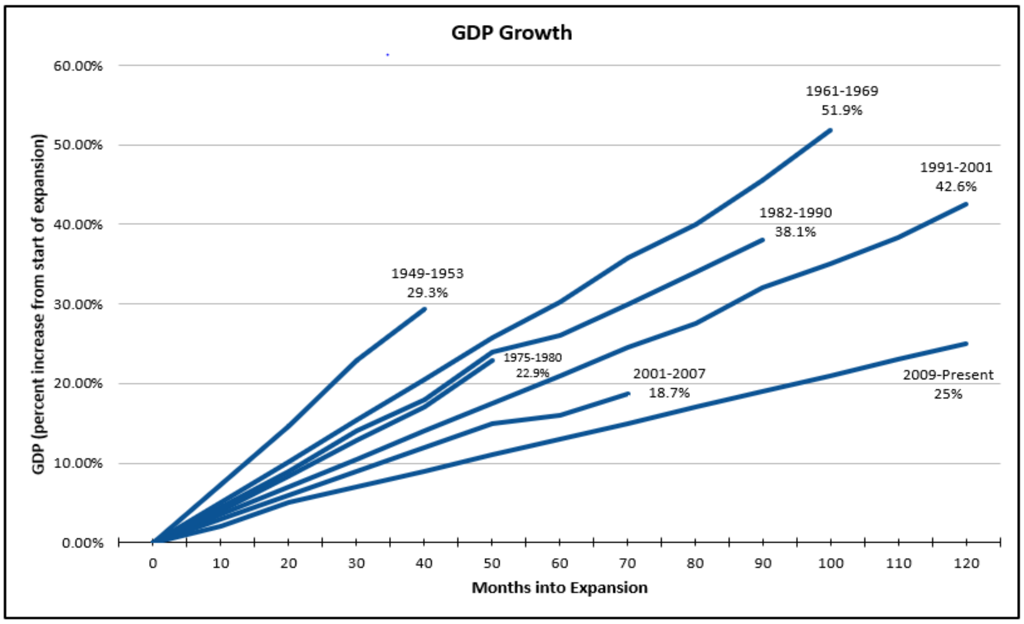
The chart below displays the list of United States economic expansions and recessions since 1945. According to the NBER, over this time period there have been 12 expansions and 11 recessions. The average expansion lasted 64 months while the average recession lasted 11 months. Note that the year on the chart indicates the start of an expansion or recession.



Source: National Bureau of Economic Research

While reaching the longest expansion in United States history is a nice milestone, we will point out that the overall growth rate has been sluggish. Total GDP growth has expanded by +25% during the current expansion, far less than previous periods. Annual GDP growth has averaged +2.3% Y/Y from 2010 to 2018, compared to +3.5% Y/Y in the sixty-year period from 1948 to 2007.

The chart below illustrates the shallow recovery since the Financial Crisis:



Source: National Bureau of Economic Research, St. Louis Federal Reserve

“Expansions don’t die of old age. I like to say they get murdered.”
- Ben Bernanke, Former Federal Reserve Chairman

Given that the current economic expansion is now the longest in history, does this mean that the United States is overdue for a recession? Not necessarily. Historically economic booms were followed by busts. An over-simplified business cycle typically followed a similar pattern: the economy expands rapidly- unemployment falls- inflation overheats- financial bubbles forms- the Fed responds by raising interest rates – credit tightens- good borrowers struggle to find loans – the economy stumbles- a recession occurs – the economy bottoms- repeat. The current environment is characterized by slow growth and the Fed just cut interest rates to fight low inflation and global uncertainty. At the latest FOMC meeting, Chairman Powell said “there is no reason the current expansion can’t continue. There is no sector that is booming and therefore might bust.”

At some point the economic expansion will end and the United States will have a recession. This is not a bold prediction, it is inevitable. Predicting that a recession will occur is easy, predicting WHEN is far more difficult. We believe it is important to understand the current economic environment and get a sense of the odds of a recession over the next year (the forecasting lens gets very fuzzy past twelve months as there are many different variables that can impact the economy).

We publish our thoughts on the economy each quarter as part of our market review and outlook (link). Right now, we believe the chance of a recession over the next year is still fairly low as the economy has several tailwinds:

- Accommodative Fed: The FOMC just cut interest rates by 25 Basis Points* and reiterated that they will “act as appropriate to sustain the expansion.” Chairman Powell described the cut as a “mid-cycle policy adjustment” and tried to maintain flexibility regarding future interest rate moves. Going forward, we expect the Fed to keep interest rates low.
- Strong consumer: The US consumer is in good shape as evidenced by the latest strong Retail Sales, quarterly GDP, and labor market data. Consumer spending accounts for close to 70% of GDP.
- Government Spending: The White House and Congressional leaders reached a deal that would raise discretionary spending by $50 billion to $1.37 trillion in 2020 and suspend the debt ceiling until July 2021. While the government debt and deficit must be addressed at some point, in the short run the increased spending will provide a boost to GDP. Without getting political, we expect the Trump Administration to do whatever they can to keep the economy strong before the 2020 election.

We believe the single biggest risk currently facing the United States economy is the trade war with China as manufacturing data has started to show cracks. On August 1st, President Trump threatened to place 10% tariffs on the remaining $300 billion worth of Chinese goods beginning on September 1st. As of now, the US has implemented 25% tariffs on $250B worth of Chinese goods and China has placed 5-25% tariffs on $110B worth of US goods. We acknowledge there are also other risks facing the economy and the markets (link), including, global growth deceleration, the inverted yield curve, Brexit, and the potential for new tariffs on other countries. Our role at Winthrop Wealth Management is to help our clients identify, manage, and navigate risk by providing a comprehensive financial plan combined with a structured, consistent, and repeatable investment process.

We implement a proactive approach to both comprehensive financial planning and investment management. Financial planning drives the investment strategy and provides a roadmap to each client’s unique goals and objectives. The comprehensive financial plan defines cash flow needs, optimizes account structures, considers tax minimization strategies, and continuously evaluates financial risks as circumstances and/or goals change. The investment management process is designed to provide well-diversified portfolios constructed with a methodology based on prudent risk management, asset allocation, and security selection. As always, please contact us if you have any updates to your personal or financial circumstances.

DISCLOSURES:

*Basis points (BPS) refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001, and is used to denote the percentage change in a financial instrument.