



Business Cycle Update: U.S. cycle maturing as synchronized global expansion continues

United States

- Steady, broad-based U.S. growth implies a low probability of recession, although the tightening U.S. labor market is a sign of U.S. business-cycle maturity.
- In part because wage and broader inflation pressures have been relatively muted thus far, the trends for profits and credit have yet to show signs of significant deterioration that typically occur during the late-cycle phase.
- The U.S. thus remains a mix of mid- and late-cycle dynamics, and the slow pace of inflation and a solid global backdrop imply that the full transition to late cycle continues to be prolonged.

Global

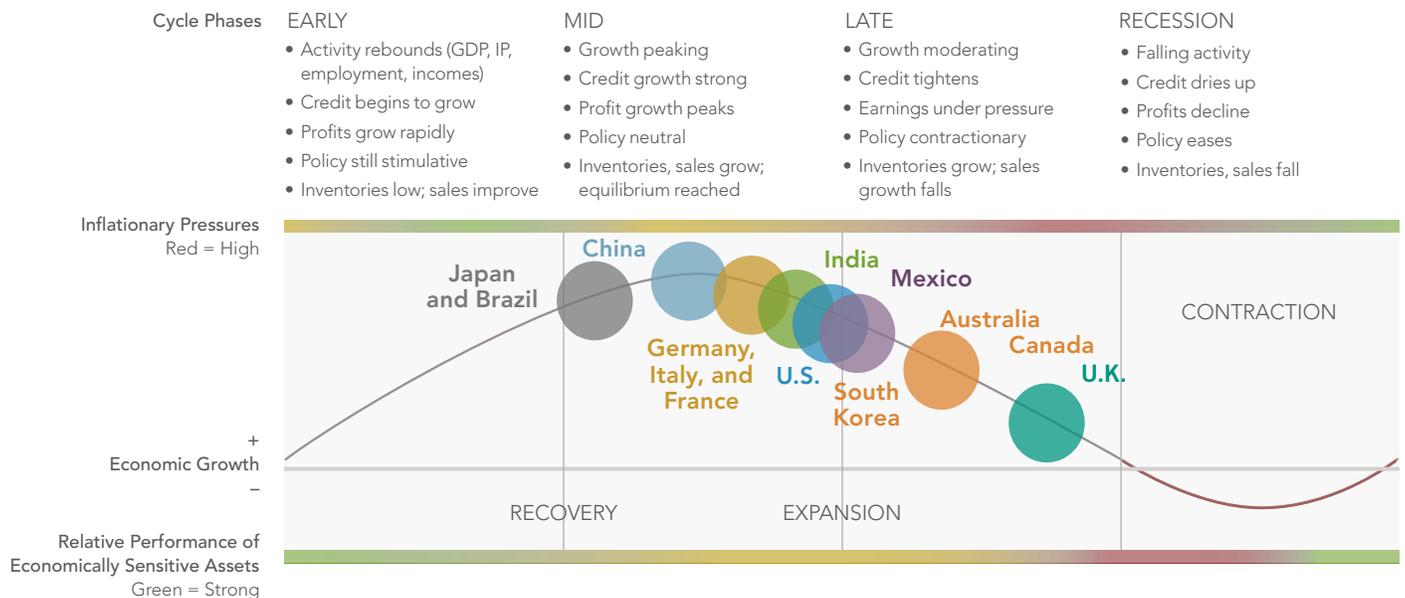
- The global expansion remains relatively steady and synchronized across major economies.
- Broadly speaking, most developed economies have low recession risk and are in more mature (mid-to-late) stages of the business cycle.
- The Eurozone is not as far along as the U.S. in the cycle, and it continues to benefit from improving sentiment and credit conditions.
- China’s activity has rebounded to multiyear highs, but policy tightening and slowing momentum in industrial activity and housing suggest that most of the upside has already occurred.
- Overall, the global expansion is on firm ground, but peak activity levels have probably already been reached.

Asset allocation outlook

- The global financial markets have remained in a sweet spot amid steady growth, low inflation, and heavily accommodative monetary policies, and we continue to favor global equities.
- However, we believe the world is in the midst of a slow transition toward a less accommodative monetary policy stance, global activity is likely peaking, the U.S. business cycle continues to mature, asset valuations are generally elevated, and geopolitical risks are rising.
- Smaller cyclical tilts are therefore warranted, in addition to thorough portfolio diversification that includes international equities and inflation-resistant assets.

Business Cycle Framework

The business cycle, which is the pattern of cyclical fluctuations in an economy over a few years, can influence asset returns over an intermediate-term horizon. Cyclical allocation tilts are only one investment tool, and any adjustments should be considered within the context of long-term portfolio construction principles and strategic asset allocation positioning.



Note: The diagram above is a hypothetical illustration of the business cycle. There is not always a chronological, linear progression among the phases of the business cycle, and there have been cycles when the economy has skipped a phase or retraced an earlier one. Source: Fidelity Investments (AART), as of Sep. 15, 2017. [See related reports from Fidelity’s Asset Allocation Research Team (AART), including “The Business Cycle Approach to Asset Allocation” (Jan. 2017) and “Will Dwindling Unemployment Finally Spark Inflation?” (Aug. 2017).]



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The Business Cycle Framework depicts the general pattern of economic cycles throughout history, though each cycle is different; specific commentary on the current stage is provided in the main body of the text. In general, the typical business cycle demonstrates the following:

During the typical **early-cycle phase**, the economy bottoms out and picks up steam until it exits recession, then begins the recovery as activity accelerates. Inflationary pressures are typically low, monetary policy is accommodative, and the yield curve is steep. Economically sensitive asset classes such as stocks tend to experience their best performance of the cycle. • During the typical **mid-cycle phase**, the economy exits recovery and enters into expansion, characterized by broader and more self-sustaining economic momentum but a more moderate pace of growth. Inflationary pressures typically begin to rise, monetary policy becomes tighter, and the yield curve experiences some flattening. Economically sensitive asset classes tend to continue benefiting from a growing economy, but their relative advantage narrows. • During the typical **late-cycle phase**, the economic expansion matures, inflationary pressures continue to rise, and the yield curve may eventually become flat or inverted. Eventually, the economy contracts and enters recession, with monetary policy shifting from tightening to easing. Less economically sensitive asset categories tend to hold up better, particularly right before and upon entering recession.

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