# Business Cycle Update: Global Activity Past Its Peak

## United States

- Broad-based U.S. growth implies a low probability of recession, and the U.S. remains in a prolonged shift between the mid- and late-cycle phases of expansion.
- The trends for profit growth and credit have yet to show the signs of significant deterioration that typically occur during the late-cycle phase.
- However, the tightening U.S. labor market is supporting wage pressures, which act as a restraint on profit margins and have prompted the Federal Reserve to continue to tighten monetary policy.

## Global

- The global expansion is becoming less synchronized, with the pace of overall activity likely past its peak.
- China's economy remains in an expansionary phase, but the industrial sector has slowed materially and the risks of a growth recession continue to rise. Policymakers may have begun to ease monetary conditions, but overall activity is in a decelerating trend.
- Countries most impacted by slowing China industrial activity—including Germany, Japan, and South Korea—have experienced deceleration in recent months.
- Overall, the global expansion continues, but maturing cycles among many larger economies imply that the risks of a growth slowdown may be higher than generally appreciated.

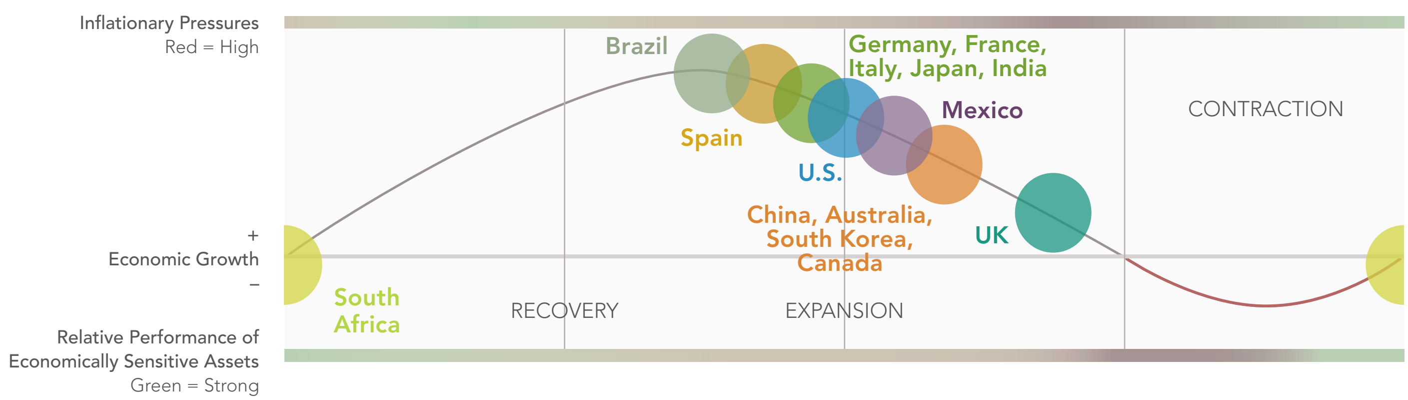
## Asset allocation outlook

- We believe the world is in the midst of a slow transition toward a less accommodative monetary policy stance, global activity has peaked, the U.S. business cycle continues to mature, asset valuations are not generally attractive, and policy and geopolitical risks are elevated.
- The shift toward global monetary policy tightening is beginning to slow liquidity growth and result in higher volatility in the financial markets.
- Therefore, smaller cyclical tilts are warranted at this point in the cycle, 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.

| Cycle Phases | EARLY | MID | LATE | RECESSION |
|---|---|---|---|---|
| | • Activity rebounds (GDP, IP, employment, incomes)<br>• Credit begins to grow<br>• Profits grow rapidly<br>• Policy still stimulative<br>• Inventories low; sales improve | • Growth peaking<br>• Credit growth strong<br>• Profit growth peaks<br>• Policy neutral<br>• Inventories, sales grow; equilibrium reached | • Growth moderating<br>• Credit tightens<br>• Earnings under pressure<br>• Policy contractionary<br>• Inventories grow; sales growth falls | • Falling activity<br>• Credit dries up<br>• Profits decline<br>• Policy eases<br>• Inventories, sales fall |




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 June 6, 2018.

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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Title: Global Activity Past its Peak (June 2018 Business Cycle Update)

Description: Dirk Hofschire, CFA, senior vice president, asset allocation research, and Lisa Emsbo-Mattingly, director of asset allocation research, assess key factors influencing the outlook for both the U.S. and the global economy as of June 2018.