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.

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.
BUSINESS CYCLE UPDATE: GLOBAL ACTIVITY PAST ITS PEAK

Unless otherwise disclosed to you, any investment or management recommendation in this document is not meant to be impartial investment advice or advice in a fiduciary capacity, is intended to be educational, and is not tailored to the investment needs of any specific individual. Fidelity and its representatives have a financial interest in any investment alternatives or transactions described in this document. Fidelity receives compensation from Fidelity funds and products, certain third-party funds and products, and certain investment services. The compensation that is received, either directly or indirectly, by Fidelity may vary based on such funds, products, and services, which can create a conflict of interest for Fidelity and its representatives. Fiduciaries are solely responsible for exercising independent judgment in evaluating any transaction(s) and are assumed to be capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies.

Information presented herein is for discussion and illustrative purposes only, and is not a recommendation or an offer or solicitation to buy or sell any securities. Views expressed are as of the date indicated, based on the information available at that time, and may change based on market or other conditions. Unless otherwise noted, the opinions provided are those of the authors and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

Investment decisions should be based on an individual’s own goals, time horizon, and tolerance for risk. Nothing in this content should be considered to be legal or tax advice, and you are encouraged to consult your own lawyer, accountant, or other advisor before making any financial decision.

Fixed income securities carry inflation, credit, and default risks for both issuers and counterparties. Although bonds generally present less short-term risk and volatility than stocks, bonds do contain interest rate risk (as interest rates rise, bond prices usually fall, and vice versa) and the risk of default, or the risk that an issuer will be unable to make income or principal payments. Additionally, bonds and short-term investments entail greater inflation risk—or the risk that the return of an investment will not keep up with increases in the prices of goods and services—than stocks. Increases in real interest rates can cause the price of inflation-protected debt securities to decrease.

Stock markets, especially non-U.S. markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks, all of which are magnified in emerging markets.

Investing involves risk, including risk of loss.

Past performance is no guarantee of future results.

Diversification and asset allocation do not ensure a profit or guarantee against loss.

All indices are unmanaged. You cannot invest directly in an index.

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 for those with substantial foreign interest in any investment alternatives or transactions described in this document. Fidelity receives compensation from Fidelity funds and products, certain third-party funds and products, and certain investment services. The compensation that is received, either directly or indirectly, by Fidelity may vary based on such funds, products, and services, which can create a conflict of interest for Fidelity and its representatives. Fiduciaries are solely responsible for exercising independent judgment in evaluating any transaction(s) and are assumed to be capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies.

Information presented herein is for discussion and illustrative purposes only, and is not a recommendation or an offer or solicitation to buy or sell any securities. Views expressed are as of the date indicated, based on the information available at that time, and may change based on market or other conditions. Unless otherwise noted, the opinions provided are those of the authors and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

Investment decisions should be based on an individual’s own goals, time horizon, and tolerance for risk. Nothing in this content should be considered to be legal or tax advice, and you are encouraged to consult your own lawyer, accountant, or other advisor before making any financial decision.

Fixed income securities carry inflation, credit, and default risks for both issuers and counterparties. Although bonds generally present less short-term risk and volatility than stocks, bonds do contain interest rate risk (as interest rates rise, bond prices usually fall, and vice versa) and the risk of default, or the risk that an issuer will be unable to make income or principal payments. Additionally, bonds and short-term investments entail greater inflation risk—or the risk that the return of an investment will not keep up with increases in the prices of goods and services—than stocks. Increases in real interest rates can cause the price of inflation-protected debt securities to decrease.

Stock markets, especially non-U.S. markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks, all of which are magnified in emerging markets.

Investing involves risk, including risk of loss.

Past performance is no guarantee of future results.

Diversification and asset allocation do not ensure a profit or guarantee against loss.

All indices are unmanaged. You cannot invest directly in an index.

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 for those with substantial

Third-party marks are the property of their respective owners; all other marks are the property of FMR LLC.

If receiving this piece through your relationship with Fidelity Institutional Asset Management® (FIAM), this publication may be provided by Fidelity Investments Institutional Services Company, Inc., Fidelity Institutional Asset Management Trust Company, or FIAM LLC, depending on your relationship.

If receiving this piece through your relationship with Fidelity Personal & Workplace Investing (PWI) or Fidelity Family Office Services (FFOS) this publication is provided through Fidelity Brokerage Services LLC, Member NYSE, SIPC.

If receiving this piece through your relationship with Fidelity Clearing and Custody Solutions® or Fidelity Capital Markets, this publication is for institutional investor or investment professional use only. Clearing, custody or other brokerage services are provided through National Financial Services LLC or Fidelity Brokerage Services LLC, Members NYSE, SIPC.

© 2018 FMR LLC. All rights reserved.

848628.1.0
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.