Business Cycle Update: Global Economy Continues to Mature

United States

- The U.S. is firmly in the late-cycle phase but with low near-term risk of recession.
- Consistent with typical late-cycle trends, we are currently seeing: tight labor markets, challenged corporate profit margins, rising inventories, less accommodative monetary policy, a flat/inverted yield curve, and tighter credit conditions.
- The U.S. consumer backdrop remains strong amid low unemployment, but wage growth may have peaked.
- Corporate earnings growth has decelerated due largely to higher worker compensation, weak global growth, and a fading boost from the 2018 tax changes.
- The Federal Reserve (Fed) appears willing to ease policy if conditions deteriorate, although historically rate cuts have been less effective late in the economic cycle.

Global

- Global growth remains positive but has become more uneven, and many major economies have progressed toward more advanced stages of the business cycle.
- Rising trade tensions and higher tariffs, particularly between the U.S. and China, are a significant threat to global growth.
- China's fiscal and monetary stimulus measures have helped stabilize the country's growth trajectory, though the magnitude of stimulus is less than during previous cycles.
- Overall, global activity appears to have passed its peak, and it remains to be seen whether China's stabilization will prove sufficient to incite a sustained domestic and global reacceleration.

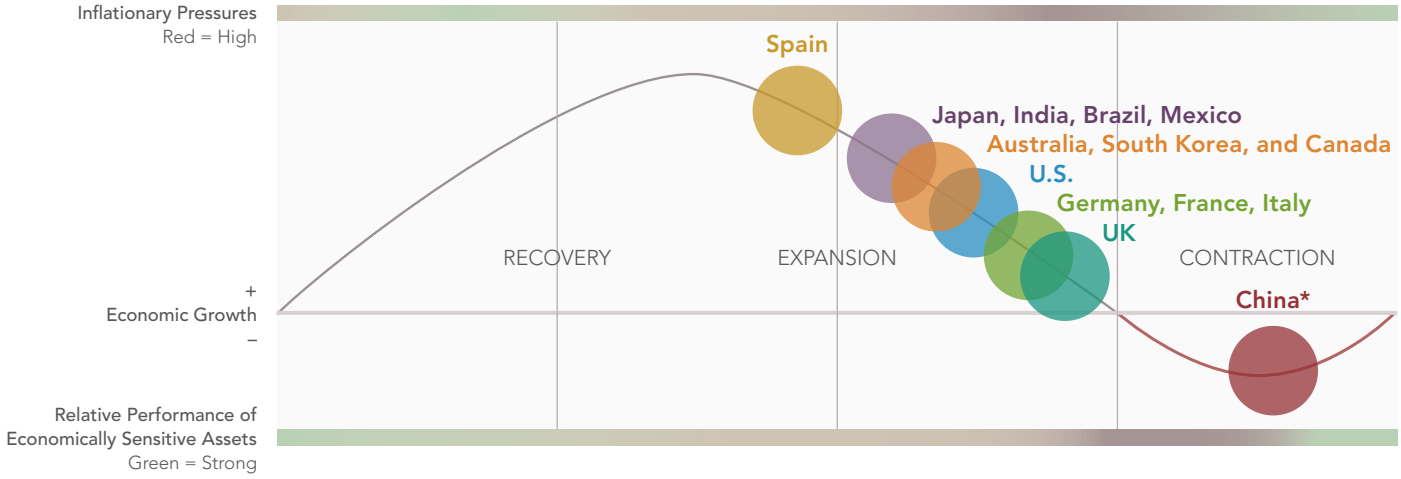
Asset allocation outlook

- Consistent with a maturing business cycle, asset-class patterns may become less reliable, warranting smaller cyclical tilts and prioritization of portfolio diversification.
- Meanwhile, low U.S. recession risk implies it's too early to have high conviction in the likelihood of extremely bearish scenarios.
- The less hawkish posture of the U.S. Fed since the beginning of 2019 has provided some relief for financial conditions, but monetary policy and the global liquidity backdrop remain much tighter than they were two years ago.
- Overall, we expect the late-cycle environment to provide more volatility and a less favorable risk-return profile for asset markets than during recent years.

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) • Credit begins to grow • Profits grow rapidly • Policy still stimulative • Inventories low; sales improve	• Growth peaking • Credit growth strong • Profit growth peaks • Policy neutral • Inventories, sales grow; equilibrium reached	• Growth moderating • Credit tightens • Earnings under pressure • Policy contractionary • Inventories grow; sales growth falls	• Falling activity • Credit dries up • Profits decline • Policy eases • Inventories, sales fall



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. *A growth recession is a significant decline in activity relative to a country's long-term economic potential. We use the "growth cycle" definition for most developing economies, such as China, because they tend to exhibit strong trend performance driven by rapid factor accumulation and increases in productivity, and the deviation from the trend tends to matter most for asset returns. We use the classic definition of recession, involving an outright contraction in economic activity, for developed economies. Source: Fidelity Investments (AART), as of May 31, 2019.

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