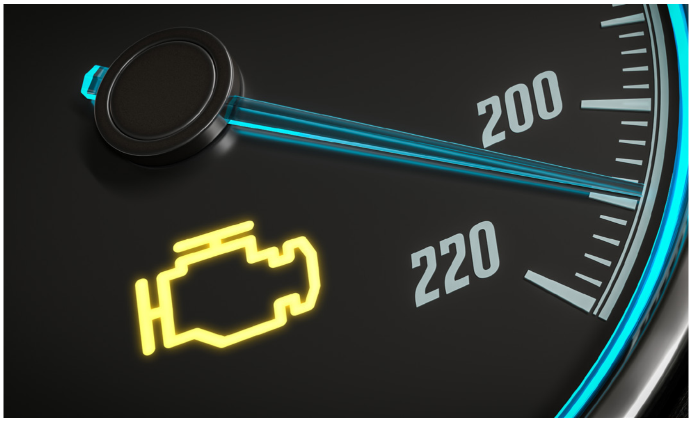
Cougar Global Viewpoints

A broken indicator?

NOVEMBER | 2023

Takeaways:

- Economic indicators that suggested recession in 2023 appear to be wrong, just as they were in the latter half of 2022.
- The Conference Board Leading Economic Index® (LEI) for the United States has been negative for 19 straight months, an unusually long period of time.
- Beneath the headline index, the underlying data has been stabilizing.
- Economic data trends post-COVID remain extraordinary.
- The LEI has a solid long-term track record, even if it missed 2023.



Top-down investors usually follow a host of indicators to assess the likely direction of future economic activity. Retail sales, various measures of manufacturing, labor market strength, bank lending, housing market activity: The list seems endless and continues to grow. **Each investor has a few favorites, and one historically successful indicator we monitor is the Conference Board Leading Economic Index (LEI) for the United States.** We like it because it has a long history of data going back to 1959 and fits with our investment approach of attempting to identify turning points in the U.S. business cycle. The LEI, according to the Conference Board, has anticipated these turning points by about seven months. It's also an aggregate of 10 important, widely recognized, and well-known individual data series.

However, **in a fitting sign of the times for macroeconomic models, the LEI looks broken as a recessionary indicator**, like the check engine light on a car that just keeps running. In October, the LEI for the U.S. fell by 0.8%, which followed September's decline of 0.7%. In fact, as of October, the LEI has declined for 19 months in a row (shown in the chart below). For context, the Conference Board suggests a recession is near based on rates of change over the past six months. The board noted the potential for a recession in September 2022 and the following month hardened its call for a recession by the end of 2022. There are other ways to interpret the LEI, but admittedly, they all generally suggest the same outcome: A recession is (was?) expected in the near term.

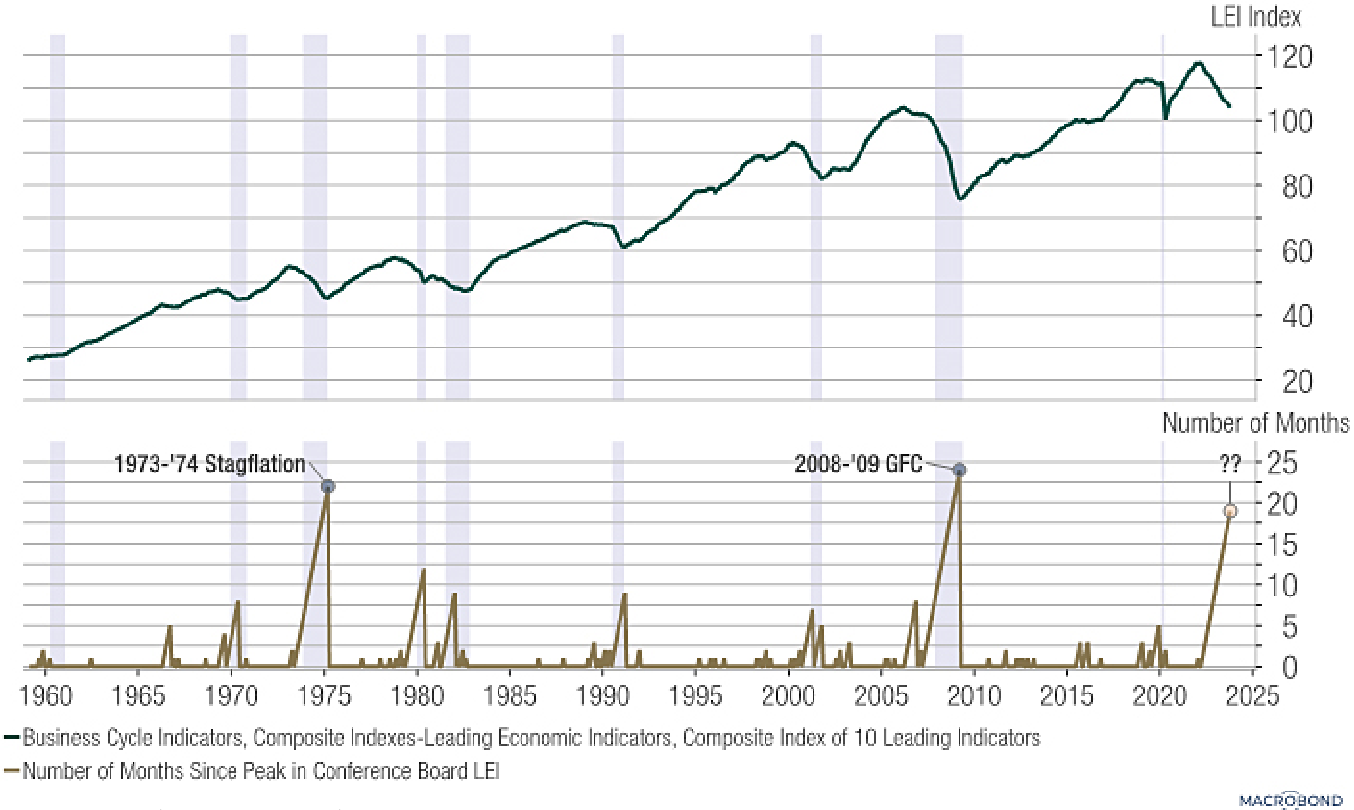
The bottom panel of our chart of the LEI calculates the number of consecutive months when the LEI declined for historical comparison. It's worth mentioning that after three to four months of declines, the LEI provides a fairly reliable recession warning. However, **at 19 consecutive months of declines, it's already the third-longest streak in history, next to the 1970s and the Global Financial Crisis (GFC) of 2008-09.**

Is this particular indicator broken? Perhaps, but we're not ready to give up on it yet. The continuing decline in the headline index is significant, but looking under the hood, the 10 underlying components are decidedly more mixed than they were in March and April of this year. Consumer expectations is a major drag for the LEI, and we already know that consumer sentiment has been terrible, a likely consequence of higher than normal inflation. An added factor dragging down the LEI is the inverted yield curve, another historical harbinger of recession. **We're following the direction of the LEI in aggregate, and the underlying data appears to be**

carving out a bottom. To be fair, the index remains in recessionary territory, and the recession call is getting long in the tooth. At the same time, we've noted, as have many others, the unusual nature of many post-COVID economic measures.

In total, as much as we would like to, it's hard to pinpoint a turn in the business cycle based on any single measure, or even a basket of measures. Besides, it appears that the recession calls for 2023 were misguided, and most of those calls were based on some favorite indicator. **If, looking back, the LEI provided a false positive signal in 2023, it still carries a reliable long-term track record.** So there's still room for the LEI to be accurate going forward. Perhaps the indicator is "delayed" rather than "broken" and we're in for a doozy of a recession ahead. No engine runs forever.

United States, Leading Indicators, Conference Board, SA, Index



Source: U.S. Conference Board, as of 12/1/23.

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DEFINITION

The Conference Board Leading Economic Index® for the United States is designed to signal peaks and troughs in the business cycle, to be highly correlated with real (adjusted for inflation) GDP, and to be a predictive variable that anticipates (or "leads") turning points in the business cycle by around seven months. It is comprised from 10 components: Average weekly hours in manufacturing; Average weekly initial claims for unemployment insurance; Manufacturers' new orders for consumer goods and materials; Institute for Supply Management® Index of New Orders; Manufacturers' new orders for nondefense capital goods excluding aircraft orders; Building permits for new private housing units; S&P 500 Index; Leading Credit Index™; Interest rate spread (10-year Treasury bonds less federal funds rate); Average consumer expectations for business conditions.

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To learn more about Cougar Global's strategies, philosophy and capabilities visit cougarglobal.com or call 1.800.521.1195.

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