

LATE-CYCLE IS NOT END OF CYCLE

Ask **the** PORTFOLIO
MANAGER

What are the risks of the next recession?

Transcript of a video recorded on May 30, 2018.

In time, of course, the U.S. expansion looks relatively old at almost 10 years, but if you look beneath the surface, it looks much more mid-cycle. For example, 80% of U.S. households, which account for about 60% of consumer spending in the U.S., only really began to recover in late 2016, early 2017.

The reason is that for much of this expansion, the U.S. banking system wasn't working. The bottom 80% of households couldn't get a loan to buy a house and so forth. That classic credit cycle, which has driven historic cyclicity for the economy, looks much more like the fourth or fifth year of the expansion, not the tenth year of the expansion.

That's certainly one positive. Another positive is partly because of that, the economy today is much less sensitive to higher interest rates than it has been in the past.

The consumer here is probably in the best shape they've been in in 30 years. Although the corporate sector has relevered—that's absolutely true, there's much more debt today than there was five years ago across the corporate sector—you cannot judge that without taking consideration of the boost in profitability that we've seen in the last six months.

This late-cycle boost in corporate profitability has no recent precedent. It probably adds a few years to the expansion itself. It's why I think although there are debt risks in the corporate sector, they can be delayed for a time. Our judgment is that although it looks late cycle, we're still at the point of indeterminate length.

If you look at the cash flows across the consumer today, across the corporate sector, they're remarkably healthy, much more healthy than they've ever been if we were about to roll over into recession. We need to see something that undermines those cash flows.

That could be higher interest rates eventually. It could be a capital spending cycle. It could be higher wage inflation that impacts profit margins. But we're not quite there yet. That's why we think the critical question is: How late is late? It's why we say late-cycle is not end of cycle, at least not yet.



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Video recorded 5/30/18.

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