Weekly Economic Commentary

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Revisiting the Recovery

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Highlights

Last week's data deluge did not change our view (or the markets') about the economy or the Fed. We still expect modest 2.0% real GDP growth in 2013.

We believe the labor market is still growing quickly enough to allow the Fed to begin to taper its bond-buying program known as quantitative easing sometime this fall.

The recent high-profile reports on the economy did little to change our long-held view that the U.S. economy is in the middle of an economic expansion that began just over four years ago in June 2009.

The tepid pace of the current expansion relative to prior expansions that lasted this long, supports the idea that we are closer to the middle of the expansion, rather than the end.

Please see the LPL Financial Research Weekly Calendar on page 3

Last week, financial markets absorbed a nearly unprecedented amount of information on the health of the economy and corporate America. It was just the eighth week in the past 708 (since January 2000) that the U.S. Department of Labor's monthly labor market report, the Institute for Supply Management's (ISM) monthly Report on Business, the Federal Reserve's (Fed) Federal Open Market Committee's (FOMC) statement and the first look at gross domestic product (GDP) for the prior quarter were all released in the same week. In general, the equity market took the data deluge in stride, with far less volatility than it had seen in the past when those four key economic events occurred in the same week.

On balance though, last week's data did not change our view (nor the markets') about the economy or the Fed. We still expect modest 2.0% real GDP growth in all of 2013—following the tepid 1.4% average growth rate in the first half of 2013. This implies real GDP growth in the 2.5–3.0% range, on average, in the final two quarters of 2013. The Fed is still forecasting an above-consensus 2.5% growth rate for the economy in 2013, which implies GDP growth between 3.5% and 4.0%, on average over the final two quarters of 2013. The FOMC will release a revised forecast for 2013 and 2014, at the conclusion of its next meeting in mid-September 2013.

Despite Disappointing Jobs Report, Continued "Real and Sustainable" Expansion

The July 2013 employment report disappointed, since the private sector economy created just 161,000 jobs in July, which was far fewer than the 195,000 expected by the consensus of economists as tallied by Bloomberg News. However, the labor market is likely still growing fast enough to allow the Fed to begin to taper its bond-buying program known as quantitative easing (QE) sometime this fall. The private sector has consistently (last three, six, and 12 months) added between 180,000 and 200,000 net new jobs per month, and that likely meets the standard set by the Fed of "real and sustainable" growth in the labor market. (Please see the *Weekly Economic Commentary: Real and Sustainable—An Update* from July 8, 2013 for details). The drop in the unemployment rate in July 2013 to 7.4% from 7.6% a month earlier also pushed the Fed closer to ending QE altogether. The Fed says that it will stop QE when the unemployment rate hits 6.5%, which under their current forecast, would occur in mid-2014.

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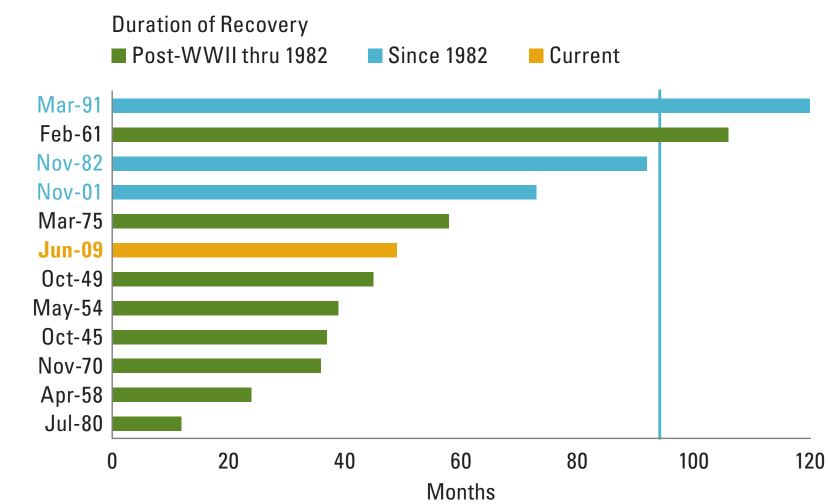
Midpoint of Economic Expansion

The recent high-profile reports on the economy did little to change our long-held view that the U.S. economy is in the middle of an economic expansion that began just over four years ago in June 2009. Based on indicators such as the Index of Leading Economic Indicators, the odds of a recession starting in the next two years is low, at around 10–15%. However, a spike in consumer energy prices, a spike in consumer interest rates, a policy mistake at home (by Congress, the Administration, or the Fed) or overseas, or a terrorist attack that would disrupt economic activity in large parts of the economy for a prolonged period would likely trigger a recession. (Please see the *Weekly Economic Commentary* from June 3, 2013, for more details).

The U.S. economy is now in the fifth year of the 12th economic recovery (or expansion) since the end of World War II (WWII). It is already the sixth longest of the 12 recoveries and would have to last another year to become the fourth longest. The nearby figure puts this expansion in context relative to the 11 other post-WWII recoveries.

95 months is the average length of the last three economic recoveries—which we think offers the most relevant comparison to the **current period**.

1 The Current Economic Expansion Is the Sixth Longest Post-WWII Recovery



Source: National Bureau of Economic Research 08/05/13

The average recovery since the end of WWII has lasted 58 months (or just over 19 quarters). On that basis, the current recovery (at 49 months, or just over 16 quarters) is almost over.

Looking back over the past 50 years (since the early 1960s), the average recovery has been 71 months (or just under 24 quarters). On that basis, the current recovery has another two years to go just to get to "average."

LPL Financial Research Weekly Calendar

2013	U.S. Data	Fed	Global Notables
5 Aug	▪ **Non-Manufacturing ISM (Jul)**	Fisher (hawk)	▪ Eurozone: PMI-Service Sector (Jul)
6 Aug	▪ Trade Balance (Jul) ▪ JOLTS (Jun)	Evans* (dove)	▪ Australia: Central Bank Meeting ▪ Italy: Industrial Production (Jun)
7 Aug	▪ Consumer Credit (Jun)	**Plosser** (hawk) Pianalto (dove)	▪ China: Imports and Exports (Jul) ▪ Germany: Industrial Production (Jun)
8 Aug	▪ **Initial Claims (8/3)**		▪ China: CPI (Jul) ▪ China: PPI (Jul) ▪ **Japan: Central Bank Meeting** ▪ South Korea: Central Bank Meeting
9 Aug	▪ Wholesale Inventories (Jun)		▪ **China: Retail Sales (Jul)** ▪ **China: Industrial Production (Jul)** ▪ China: Fixed Asset Investment (Jul) ▪ France: Industrial Production (Jun)

Hawks: Fed officials who favor the low inflation side of the Fed's dual mandate of low inflation and full employment

Doves: Fed officials who favor the full employment side of the Fed's dual mandate

* Voting members of the Federal Open Market Committee (FOMC)

What the Last Three U.S. Economic Recoveries Tell Us

The U.S. economy is now in the fifth year of the 12th economic recovery (or expansion) since the end of World War II.

The best comparison, however, may be to look at the duration of the three economic recoveries over the past 30 years since the end of the inflationary 1970s, and the period that has seen the transformation of the U.S. economy from a domestically focused manufacturing economy to a more export-heavy, service-based economy. In general, this economic structure is less prone to inventory swings that drove the shorter boom-bust cycles of the past. On average, the last three recoveries — the ones that began in 1982, 1991, and 2001 — lasted 95 months, or just under 32 quarters, or roughly eight years. Using those three recoveries as the standard, at 49 months (16 quarters) the current economic expansion is at its midpoint. The rather tepid pace of this expansion (the topic for a future edition of the *Weekly Economic Commentary*) relative to prior expansions that lasted this long, also supports the idea that we are closer to the middle of the expansion, rather than the end.

Most, but not all, recoveries end when imbalances within the economy build up over time. Examples of these imbalances can include: too much housing, overinvestment in technology, too much consumption, too much debt, among others. Currently, few, if any material imbalances have begun to emerge, as the economy continues to struggle to get back to "normal" after the Great Recession of 2007–2009, the worst economic downturn since the Great Depression of the 1930s.

Recent readings (for July 2013) on the U.S. and global economies do indeed suggest that the second half of 2013 began on a more solid footing domestically, and that the struggling economies in Europe and China may have finally stabilized. All of this supports our view that the U.S. economy

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can accelerate modestly in the second half—perhaps led by more robust export growth. With the economy still firmly in mid-cycle mode, markets need not worry about the type of overheating economy that typically triggers aggressive tightening moves by the Fed, which often marks the end of both economic expansion and equity bull markets. ■

The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasure securities).

Purchasing Managers' Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

The index of leading economic indicators (LEI) is an economic variable, such as private-sector wages, that tends to show the direction of future economic activity.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

Quantitative easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Consumer Price Inflations is the retail price increase as measured by a consumer price index (CPI).

The Institute for Supply Management (ISM) index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Job Openings and Labor Turnover Survey (JOLTS) is a survey done by the United States Bureau of Labor Statistics to help measure job vacancies. It collects data from employers including retailers, manufacturers and different offices each month. Respondents to the survey answer quantitative and qualitative questions about their businesses' employment, job openings, recruitment, hires and separations. The JOLTS data is published monthly and by region and industry.

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China CPI: In total there are about 600 "national items" used for calculating the all-China CPI. The list of items is revised annually for representativeness based on purchases reported in the household surveys. The number of items can change from year to year, but rarely by more than 10 in any given year.

China's producer price index PPI, measures inflation at the wholesale level.

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