Business cycle update: global economy in a mature expansion

United States

- The U.S. is firmly in the late-cycle phase but with low near-term risk of recession.
- The late cycle typically is characterized by tight labor markets, challenged corporate profit margins, less accommodative monetary policy, a flattening yield curve, and tighter credit conditions.
- Consistent with late-cycle dynamics, the U.S. consumer backdrop remains strong amid a low unemployment rate, accelerating wage growth, and manageable financial obligations.
- Corporate earnings growth has decelerated due largely to wage pressure, weak global demand, and a fading boost from the 2018 tax changes.
- The policy backdrop is highly uncertain, with the direction of monetary and trade policies unclear.

Global

- Global growth remains positive but has become more uneven, and many major economies have progressed toward more advanced stages of the business cycle.
- China's entrance into a growth recession in 2018 continues to weigh on industrial sectors in Europe and other export-oriented economies.
- China's policymakers have stepped up the pace of fiscal and monetary stimulus measures, which appears to have begun stabilizing the country's growth trajectory.
- Overall, global activity appears to have passed its peak, and it remains to be seen whether China's policy actions will prove sufficient to incite a sustained domestic and global reacceleration.

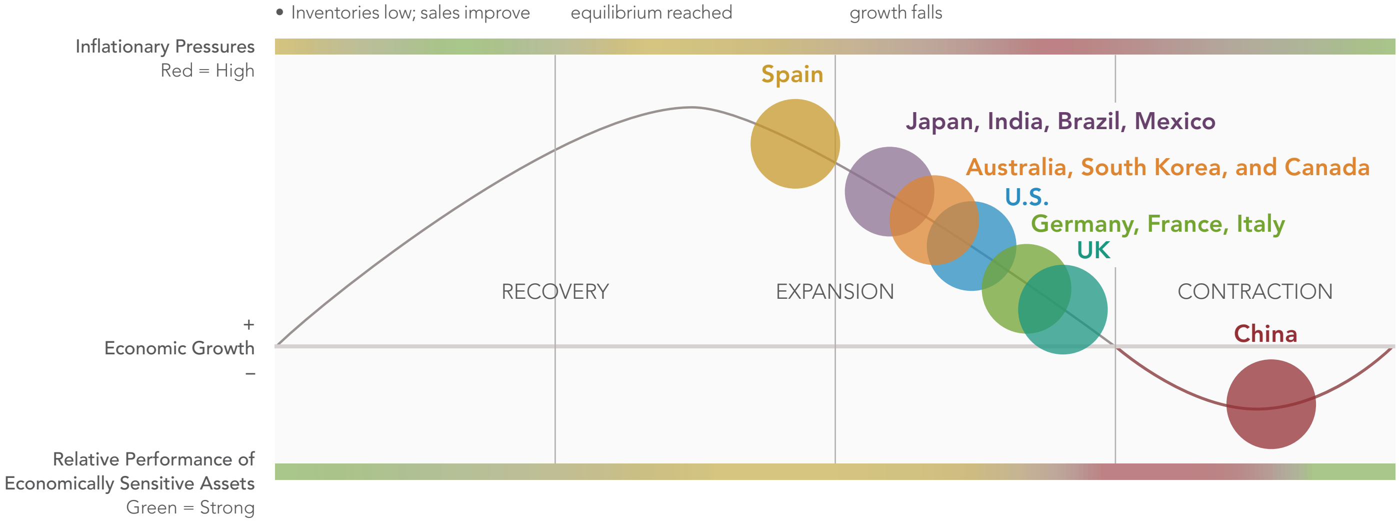
Asset allocation outlook

- Consistent with a maturing business cycle, asset-class patterns may become less reliable, warranting smaller cyclical tilts and prioritizing 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. Federal Reserve 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



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 Feb. 28, 2019.

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