ANCHOR

A LITTLE INSIGHT INTO GLOBAL MARKETS

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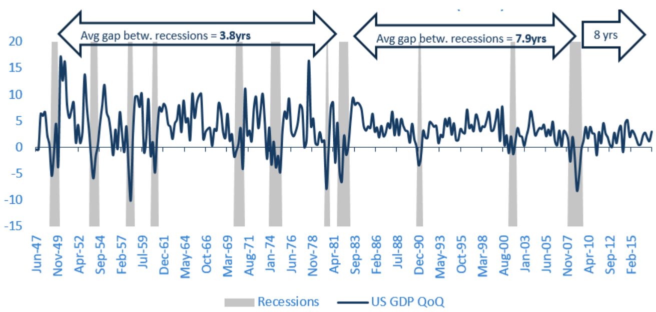
vol 23

Business cycles and asset-class returns

It's been just over 8 years since the US National Bureau of Economics decided that **the last US recession had ended** (in June 2009) and there's plenty of debate about when the next one might come around. The consensus is that, **while another recession is not imminent, we're probably closer to the next one than the last one**

US Economic Growth (GDP)



Source: Anchor Capital, Bloomberg, NBER

A lot has happened since the last recession - we've had about $8trn of quantitative easing (QE) globally (enough cash to buy 2 new iPhone X's for everyone in the US), and here's a few more changes since the end of the last US recession:

Changes since the last recession:

	Chinese Govt Debt	Brent Crude Oil	Facebook	Walmart	Macy's	Amazon
Change	234%	-28%	456%	21%	-16%	513%
Units	CNY, trillion	$ / Barrel	Users, million	Annual Sales, $ Billion	Square Foot of Retail Space	Annual Sales (net), $ Billion
2009	12.0	77.95	360	404.4	154,300	24.5
NOW	40.1	56.29	2,000	490.0	130,200	150.1

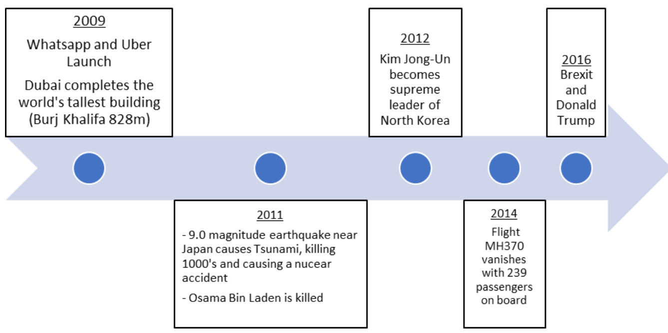
Source: Anchor Capital, Bloomberg

More changes since the last recession:

	US President	Naspers	Priceline (online travel agent)	Bitcoin	British Pound/US Dollar	Cell Phone Users
Change	????	892%	571%	4,826,566%	-16%	73%
Units		Share Price, Rand	Share Price, US$	Price, US$	Exchange Rate	User, billion
2009	Obama	299.8	218	0.08	1.62	2.56
NOW	Trump	2,972.4	1,466	3,861.33	1.35	4.43

Source: Anchor Capital, Bloomberg

What else happened since the last recession?



About ***20% of the current US workforce will have entered the labour market after the last recession*** – anyone under 24 and most of those under 30 with tertiary education. In the financial services industry there's a higher proportion of graduates, so probably about 15% of US financial-sector employees have never experienced a recession during their careers. So, the pain of a major correction in asset prices is a largely theoretical concept for this "TINA" generation (**T**here **I**s **N**o **A**lternative to buying stocks if you want to grow your wealth - fast).

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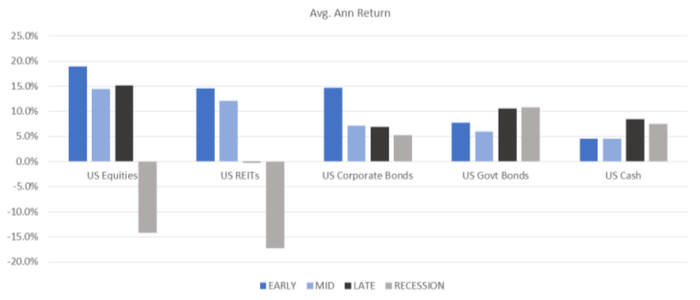
Why should we care about recessions and business cycles?

Business cycles tend to be important for asset allocation, since asset classes are inclined to perform differently at various stages of the business cycle.

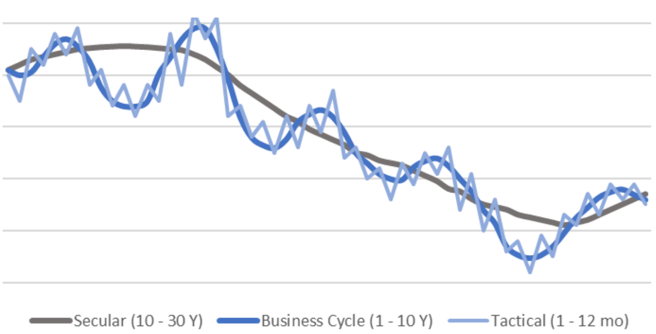
"Sometimes I put all the eggs in the same basket just to feel alive."

US Asset Class Performance Across Business Cycle Phases (1974 – 2016)



There are mainly 3 different types of cycles that affect the rate of economic growth:

Economic Cycles (Hypothetical)



Source: Anchor Capital

Secular trends: these are longer-term trends that influence the economy over extended periods **(~10 – 30 years)**. Secular trends that impact economic growth are usually a result of:

- ***demographics*** e.g. a growing working-age population usually leads to greater output (and greater consumption from an increasing population in the prime spending years of their lives).
- ***productivity***: Innovations which allow each worker to be more productive (producing more and, typically, also earning and consuming more).
- Secular trends can have both a positive or a negative impact on the economy (e.g. baby boomers boosted US growth for the last few decades, while an ageing Japanese population curtailed economic growth in that country).
- **Tactical trends**: These are shorter-term changes in economic activity, usually as a result of ***changes in sentiment*** (e.g. the election of Donald Trump led people to believe they were going to pay less tax and get better jobs, increasing their confidence to go out and spend some of those perceived future gains, dipping into their savings to do so – if these changes don't materialise, confidence will likely drop along with declines in consumption in order to replenish savings).
- **Business cycle:** This cycle typically happens over 1 – 10 years and is characterised by four phases:
- ***Early*** (normally 1 – 2yrs.): Economic activity rebounds (GDP, industrial production, employment etc.), credit begins to grow, sales improve while inventory is still low and profits grow rapidly. Central Bank policy is usually stimulative.
- ***Mid*** (usually the longest phase, typically 1 – 7 yrs.): Sales grow along with inventories and profit growth peaks, central bank policy becomes neutral and credit growth is strong. Growth in industrial production, employment and GDP peak.
- ***Late*** (ordinarily 1 – 2yrs.): Growth in economic activity moderates, inventories grow while sales growth falls and company earnings experience pressure. Credit starts to tighten along with central bank policy.
- ***Recession*** (characteristically 1 – 2yrs.): Inventories and sales fall and profits decline along with GDP growth, industrial production, employment and incomes. Credit dries up and central bank policy eases.

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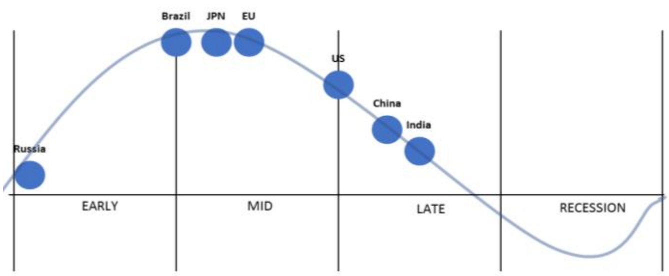
So where are we in the business cycle?

If we knew which stage of the business cycle we were in, and how long this cycle would last, we'd know exactly when to switch from stocks to bonds.

The reality is that **each business cycle is unique** and nuanced and the impact of tactical and structural cycles also muddies the water. Having said that, we have **plenty of indicators that give us a rough idea of where we are**. Since this analysis is typically more art than science, there's a healthy amount of debate about this, but here's a rough idea of where we think the major global economies are in the business cycle.

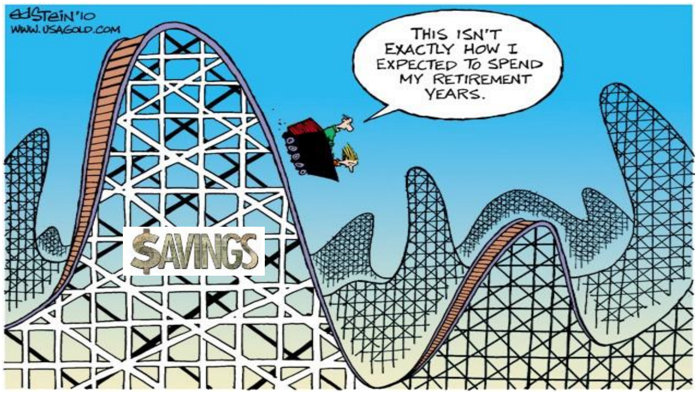


Source: Anchor Capital

These 7 economies account for c. 70% of global economic activity (GDP). **China's position in the business cycle is probably the most challenging to estimate**. The economy and the data supplied by the Chinese government are notoriously opaque and the government has a heavy hand in guiding the economy. Also, **many of these economies are closely linked so, for example, a recession in China would likely cut the business cycles short of commodity exporting economies like Brazil and Russia.**

Conclusion

We can't tell with certainty when the next recession in major global economies will happen, but we are reasonably confident that when it does come around it will probably cause major capital losses for growth assets like stocks and listed real estate. The central banks will also likely be forced to intervene and that should drive bond prices higher.



For investors with a long enough investment horizon they can likely sit tight and those growth assets will probably end up worth more than they are today at some point down the line. **For investors with a slightly shorter time horizon for some or all of their savings, it probably makes sense to consider some asset-class diversification.**