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Economic and Market Outlook

March 31, 2018

"A Taste of Things to Come"

Sampling Observations

> If the economy is, in fact, slowing and that is what sidelined the Federal Reserve, then what we are witnessing at the moment is a bear market rally.
>
> History is replete with examples of major recoveries following big sell-offs, many of which turn out to be head-fakes otherwise known as bear-market rallies.
>
> —Danielle DiMartino Booth, *Bloomberg* blog (Feb. 25, 2019)

> In the history of Market Corrections and Bear Markets since 1926, a decline that reaches 15% has odds of 4-in-5 (i.e., 80.8%) of becoming a Bear Market, whose average loss has been a decline of 38%, and whose average length has been 1.4 years. The 15% decline level was reached in December.
>
> —Clutinger, Williams & Verhoye, *Economic and Market Outlook* letter (Dec. 31, 2018)

> History shows that if the unemployment rate increased by 0.3% or more, the economy has always ended-up in a full-blown Recession.
>
> —William Dudley, former Federal Reserve Bank of New York President (2016 speech to IMF)

At the end of January 2019, the unemployment rate had increased by +0.3%. In February, however, the rate fell back to a +0.1% gain from its low. This indicator bears a close watch. If it again returns to a rise of +0.3% from the low, and at the same time, the 40-week moving average of the S&P 500 turns negative, then there is a 96.74% probability of a Recession nearby. The data was developed by the website *Philosophical Economics.com* and presented on Feb. 21, 2016, in a report entitled, "In Search of the Perfect Recession Indicator." The study goes back to 1948. The indicator leads a Recession by an average of 3.45 months.

Melanie Kramer, in an article entitled, "2019 Dow Recovery Nothing More than a Bear Market Rally," published Feb. 02, 2019, on the financial blog called *Shutterstock*, said:

> Crescat Capital reports:
>
> > "Our analysis shows that when the Fed halts and/or reverses its monetary tightening late in a business cycle… it is not a bullish signal at all. Instead, it is a reliable sign that we are in the early stages of a macro downturn that can often very quickly lead to recession."
>
> The US Federal Reserve's promise to be "patient" in regard to future interest rate hikes was indeed the catalyst to the current stock market recovery. Combined with trade-talk optimism, Crescat Capital says:
>
> > "We are highly confident that what we have seen year to date in 2019 is nothing more than a bear market rally."

Section I. A Bear Market Rally?

As we present in this report, the Fed's pause in rate hikes is likely related to a slowing U.S. and Global economy rather than simply exercising "patience."

We note that while the seven leading and coincidental indicators we use to determine the health of the economy remain positive, all are developing weakness.

We continue to expect that a Recession will begin in late 2019 or early 2020.

Since Bear Markets lead Recessions by an average of six months, we must be aware that the sharp market decline in the October-December quarter, followed by the sharp rebound in the first quarter of 2019, may be the first leg down followed by a rally in a Bear Market already underway. Such large changes in both directions are historically connected to Bear Markets.

We would like to stress an important point we have made in some of our past reports on *Aspects of Investing* (4-part series): "The biggest stock-market rallies come in Bear Markets!"

The rapid movement of stocks in both directions is not characteristic of the type of behavior we see in Bull Markets, but it is the behavior we see in Bear Markets!

In an article entitled, "Bear Market Rallies in Context" (Jan. 18, 2019), Melotte Financial Advisors cite the following: "The average Bear Market rally since 1973 has been about 15% and has lasted 1.5 months on average.

A Bear Market rally is simply a temporary uptrend in stock prices during a longer-term downtrend (i.e., Bear Market).

They offer the following exhibits showing rallies in Bear Markets:

1. 1973-74 (see Exhibit 1—S&P Level Jan. 11, 1973, to Oct. 3, 1974)

   First leg down: -16.4%
   First 10%-plus Rally: +10.8%

Next leg down:	-44.1%
Total loss:	-48% over 20 months

2. 1980-82 (see Exhibit-2—S&P Level Nov. 28, 1980, to Aug. 12, 1982)

First leg down:	-19.7%
First 10%-plus Rally:	+12.0%
Next leg down:	-15.0%
Next 10%-plus Rally:	+11.3%
Next leg down:	-14.3%
Total loss:	-27% over 20 months

3. 1987 (see Exhibit-3—S&P Level Aug. 25, 1987, to Dec. 4, 1987)

First leg down:	-33.2%
First 10%-plus Rally:	+14.9%
Next leg down:	-13.3%
Total loss:	-33% over 3 months

4. 2000-02 (see Exhibit-4—S&P Level Mar. 23, 2000, to Oct. 9, 2002)

First leg down:	-11.2%
First 10%-plus Rally:	+12.1%
Next leg down:	-27.5%
Next 10%-plus Rally:	+19.0%
Next leg down:	-26.4%
Next 10%-plus Rally:	+21.4%
Next leg down:	-32.0%
Next 10%-plus Rally:	+20.7%
Next leg down:	-19.3%
Total loss:	-50% over 30 months

5. 2007-09 (see Exhibit-5—S&P Level Oct. 9, 2007, to Mar. 9, 2009)

First leg down:	-18.6%
First 10%-plus Rally:	+12.0%
Next leg down:	-37.0%
Next 10%-plus Rally:	+11.6%
Next leg down:	-15.45
Next 10%-plus Rally:	+11.6%
Next leg down:	-25.2%
Next 10%-plus Rally:	+24.2%
Next leg down:	-27.6%
Total loss:	-56% over 17 months

In the same article, Melotte Financial Advisors point out, “It’s also interesting that in 4 out of the last 5 bear markets, the first 10%+ rally occurred BEFORE the S&P 500 was in a confirmed bear market (defined as at least a 20% decline).”

In a second article entitled, “Bear Market Phases” (Feb. 6, 2019), a spokesman for Fox Capital said: “In the 26 Bear Markets since June 1901, the median loss has been -33.9%, with a duration of 17.6 months. (Median refers to the mid-point of the data sample.)”

The article adds that the median of the first leg down was a drop of -11.2%, with a range of -7.2% to -27.4%, spread over 50 trading days.

Furthermore, the first rally had a median advance of +8.4%, with a range of +3.9% to +37.3%, spread over 29 trading days.

In a final illustration of the pattern of Bear Markets vs. Bull Markets, Yardini Research (on Feb. 13, 2019) issued a special report entitled, *The S&P 500’s Bear Market Rallies*. The report stated, “Outsized upward movements in stock prices occur most frequently in Bear Markets [our emphasis].”

What is an outsized amount for the stock market to go up in a single day? They answered, using data from 17,364 daily observations covering 69 years (Jan. 3, 1950, to Jan. 4, 2019): an outsized gain was set at +2.92%, or 3 standard deviations, from the average daily gain during the 17,364 trading days of the study.

The major finding of the study was that outsized days were not evenly distributed throughout the 69 years of data. Out of 115 outsized days of +2.92% or more, 100 were connected to Bear Markets (87) and Corrections (13). The remaining 15 outsized days were spread across the 69 years randomly.

This is important since we have already seen 2 outsized days between Dec. 26, 2018, and Jan. 4, 2019.

Exhibits-6 through -10 challenge the current general opinion that “all is well” with the stock market.

First, examine Exhibit-6 (Record IG [Investment Grade] Corporate Bond Outflows Past 6 Weeks). Note the record outflow of investment funds from Corporate bonds. Also, Exhibit-7 (Record Government Bond Inflows Past 6 Weeks) shows where a good part of Corporate bond outflows went as 2018 came to a close.

Second, examine Exhibit-8 (Cumulative Bond Flows since Jan. 2017 [by Maturity]) and Exhibit-9 (Cumulative Bond Flows since Jan. 2017 [by Type of Bond]). Both Exhibits show the move towards lower risk investments (i.e., known as risk-off flows). Through the increased flow to intermediate and short maturities seen in Exhibit-8 and away from high yield (also known as “junk bonds”) seen in Exhibit-9, we find

reinforcement to the risk-off (i.e., lowering risk) trend in the flow of funds between Corporate and Government bonds.

Finally, we see in Exhibit-10 (Cumulative Equity Flows since Jan. 2017) that investors are following the same risk-off flow from equities.

The persistent longer-term risk-off fund flows since 2017 from high yield ("junk bonds") and equities (i.e., stocks) in the direction of short and intermediate bonds raises a clear concern that the stock market's upward move from the December lows is likely nothing more than a rally in a Bear Market.

Section II. Ignoring the Risk of Recession

Part-A. Early Stages of a Macro Downturn

As Lance Roberts, of *Investing.com*, said (Feb. 14, 2019):

> It is often said that one should never discuss religion or politics, as you are going to wind up offending someone. In the financial world, it is mentioning the "R" word. The reason, of course, is that it is the onset of recession that typically ends the "bull market" party.
>
> Since recessions are painful, as investors we would rather not think about the "good times" coming to an end.

Roberts concludes by referring to Chart-1 (So You're Saying There's a Chance), which points out that the risk of Recession is much higher than currently appreciated. In the Chart, a score above 30 declares the start of Recessions.

This indicator is the fourth "NowCasting" Recession-probability tool. This one is provided by the Federal Reserve Bank of New York, and joins those of Atlanta, Philadelphia, and Chicago as the Fed's "NowCasting" tools.

The New York Federal Reserve's Recession Indicator is at the highest level since 2008.

Additionally, Goldman Sachs reports that their Bull/Bear Market Risk Indicator is waving a Red Flag (see Chart-2—Our GS Bull/Bear Market Risk Indicator Is at Its Highest Level in 10 Years).

Why is the Goldman Sachs Chart so significant? If the risk depicted is right, the lead time to Recession is just over six months. Chart-3 (The U.S. Equity Market Usually Peaks Before the Recession Hits) and Chart-4 (Why Is the Business Cycle Important?) both show the close tie between the performance of the stock market and the economy.

Chart-5 (U.S. Unemployment Momentum) is perhaps the single most important indicator of a directional change to the growth rate of the Gross Domestic Product (GDP). It turns out there is a very high correlation between the current Unemployment Rate's crossing its 12-month moving average and the beginning of Recessions.

This is one of our seven forecasting tools. As Chart-5 shows, the Unemployment Rate turned negative (i.e., crossed above its 12-month moving average) in January, but

it crossed back in February (not shown on the Chart). We will need another month, or perhaps two months, to determine if January's negative call returns.

If the negative call does return, the forecast of Recession still needs a simultaneous negative call from the current price of the S&P 500's falling below its 40-week moving average.

If both turn negative, a Recession call will be made.

Table-1 (Recession Start) shows that the average lead time to Recession from the Unemployment Rate's turning negative (i.e., turning up on the Table) is 3.45 months for the eleven Recessions since 1948.

Intuitively, one would think that low Unemployment means a strong economy and, thus, a strong stock market. However, the opposite is true. In fact, according to Ned Davis Research, since 1948, the U.S. Unemployment Rate has been below 4.3% for 20.5% of the time. They add:

> In those years, the S&P 500 gained an annualized 1.7%. While 1.7% is meager, it is still positive. It could be worse! But why is the S&P 500's performance not stronger with low Unemployment? The answer is because Unemployment is lowest when the economy is in a mature growth cycle, and stock returns are in the process of flattening and rolling over. Sadly, that is where we seem to be right now. Unemployment is presently in the "low" range which, in the past, often preceded a Recession [our emphasis].

The low rate so far was 3.7% back in November of 2018. The February 2019 level was 3.87%, up 0.17 from the low. Note that if the current level exceeds 0.3 up from the previous low of 3.7% (i.e., reaching 4% or more), or if the current month crosses above the 12-month moving average (as mentioned above), either action triggers the warning of a Recession.

Chart-6-A (Worst December Ever) shows that the decline in the stock market this past December exceeded the decline of 1931. The magnitude of December 2018's decline, together with the sharp Jan./Feb. rise of the S&P 500 back to its 40-week moving average, raises the probability that a Bear Market is underway.

The two outsized days during the rally from December's low also increase the probability that a Bear Market exists. In effect, we have both the outsized moves and the speed of both the decline and recovery as evidence, but not yet proof, of an existing Bear Market.

If the rally falters and falls back to December's low, and then goes on to penetrate the prior low of November, we have the Bear Market pattern seen in Exhibits-1 through -5.

If, instead, the prior late-September 2018 peak of the S&P 500 is penetrated to the upside, then the Bull Market will continue until clear evidence of a Recession is present according to our forecasting tools.

Chart-6-B (Triple Top) would be the most likely pattern. Top 3 in the Chart can be somewhat higher or lower than Tops 1 and 2. The key is that they form a broad top. Chart-6-C (S&P 500 Weekly) shows a pattern similar to the composite pattern shown in Chart-6-B.

The stock market is at a crossroad. The economy and corporate earnings are both weakening; the political environment in the U.S., Europe, and Asia (China) is contentious.

The Atlanta Fed's forecast for GDP growth in the first quarter is but 0.4%, not 3-to-4%, but 0.4%.

While most commentators, analysts, investors, politicians, etc., will concede that the Global economy is slowing, they steadfastly hold the view: "We see no signs of a Recession."

But history shows us that such pronouncements are almost always the case. Take a look at Table-2 (Inflation-Adjusted Growth Rates Just Before Recessions). Each of the dates listed shows the GDP growth rate as it existed prior to the onset of a Recession. It is pretty clear that, in 1957, 1973, 1981, 2001, and 2007, there was no sign of a Recession, and yet the next month a recession started.

Who can forget that Federal Reserve Chairman Bernanke stated in January of 2008, "The Federal Reserve is not currently forecasting a Recession." In hindsight, it was ultimately determined by the National Bureau of Economic Research (NBER) that the Recession had begun in December of 2007.

In Chart-7 (NBER Recession Dating Vs. Market Realization), we see the market peaking before Recessions. In eight of nine instances since 1957, the S&P 500 peaked and turned lower prior to the recognition of a Recession by the NBER.

There are plenty of risks to be aware of.

Doug Kass, President of Seabreeze Partners Management, warns, "Bull market complacency is back." Blogging at *Real Investment Advice* (Feb. 7, 2019), Kass said, "Investors are ignoring a diminished outlook for economic and profit growth in 2019-2020." He continued, "We've got a stock market that has detached itself from reality." Kass listed some of the risks concerning him:

1. Domestic economic growth weakens. Chinese growth fails to stabilize and Europe enters a recession
2. U.S./China fail to agree on a trade deal
3. Trump institutes an attack on European Union trade by raising auto tariffs
4. U.S. Treasury yields fail to ratify an improvement in economic growth
5. The market leadership of FANG [Facebook, Amazon, Netflix, Google] and Apple (NASDAQ:AAPL) subsides
6. Earnings decline in 2019 and valuations fail to expand

7. The Mueller Report jeopardizes the President
8. A hard and disruptive Brexit
9. Crude oil supplies spike and oil prices collapse, taking down the high-yield market
10. Draghi is replaced by a hawk

In a blog written for *MarketWatch* entitled, "Opinion: The evidence is in: Stocks are in a bull trap," Steven Henrich, frequent contributor to *MarketWatch,* sarcastically says: "What slowing global growth? What reduced earnings expectations? What trade wars?" He continues:

> Who cares? It'll all sort itself out. All that matters was the Federal Reserve's caving in spectacularly and laying the foundation for the big bull case. The "Central Bank Two-Step" is back: Dovish + dovish = nothing but higher prices. The lows are in; what else can I buy?

Henrich continues:

> This pretty much sums up the current sentiment.
>
> And so goes the familiar script during emerging bear markets: a general relief that the lows are in, and a return of optimism and greed after an aggressive counter rally following an initial scary drop [our emphasis].

Jeffrey Gundlach, Chief Executive of DoubleLine Capital, who oversees $123 billion in capital, said in a phone interview with *Reuters* (January 30, 2019):

> It is possible that the U.S. economy could slow to near recession-level growth later this year. The most recessionary signal at present is consumer future expectations relative to current conditions. It's among the worst reading ever.

He continued:

> Consumer expectations data are flat-out bright red bells ringing [our emphasis].

In Chart-8 (Consumer Confidence: Present Conditions vs Expectations), we see Gundlach's concern. While the confidence shown in the Present Conditions Index remains strong, the Expectations Index has not only tumbled two of the last three months, but the 82.3-point gap between the Present Situation Index (169.6) and the Expectations Index (87.3) represents one of the widest gap readings on record.

Research done by the Conference Board indicates that Recessions were not far behind when the gap has exceeded 50 points.

Moreover, Chart-9 (NFIB Small Business Optimism Index) has also fallen sharply, as has the ECRI Weekly Leading Index, seen in Chart-10. The ECRI is the Economic Cycle Research Institute's Index of Economic Health. The Weekly Index raises concerns, but ECRI has not called a Recession to be underway yet.

Chart-11 (Evolution of Atlanta Fed GDPNow Real GDP Estimate for 2019: Q1) calls for growth of 0.4%, as mentioned earlier. Note that Atlanta Fed's 2019 Q1 forecast is dramatically lower than the consensus of "*Blue Chip*" economists.

Nothing presented above declares that a Recession is underway. The data simply point out that the economy is not nearly as healthy as most investors believe.

Chart-12 (Aruoba-Diebold-Scotti Business Conditions Index) and Chart-13 (Chicago Fed National Activity Index) both clearly show the economy remains in expansion. Both indicators are "NowCasts" that we use to determine final exit and entry points to the stock market based on economic Recession and Expansion calls.

Part-B. Economic Interdependence

World economies have grown steadily more interdependent in recent decades.

We will not argue or present the case for greater or less interdependence, but simply point out that economic growth has become increasingly dependent on supply chains and distribution systems that require increasing cooperation between nations.

The inescapable fact is that the current political unrest among trading nations now risks a truly Global Recession.

Simply put, if our trading partners suffer economic contractions, the likelihood is that the growth rate of the U.S. economy will suffer as well.

The challenge for U.S. stock investors is becoming more difficult than anticipated.

If we ask the question, "How Global is the S&P 500?" we find certain facts:

First, the S&P 500 Index captures approximately 82% of the total U.S. equity market value.

Second, according to S&P Dow Jones Services, the percentage of U.S. products and services sold outside the U.S. amounts to 43.2% (2017 data). It was as high as 46% in 2013.

Third, *Forbes*, as far back as 2011, pointed out that approximately 50% of all U.S. production, sales, and profits come from overseas business.

Moreover, industries within Information Technology indicate that approximately 56% of their sales come from outside the U.S. In fact, the nine leading Information Technology companies had foreign sales in excess of 85% of their total.

Significantly, Chart-14 (Global Leading Manufacturing Index and Global Industrial Production Index) shows weakness approaching outright contraction. The weakness suggested by Chart-14 can clearly be seen in Chart-15 (Net Exports of Goods and Services). The trend of net exports (exports less imports) has been negative since the early 1970s, but note the improvement that took place after the 2007-2009 Recession. The improvement, though, was temporary. In fact, despite President Trump's trade policies, or perhaps because of them, our net exports have again reversed in a negative direction. In our judgment, any widening of the trade war will produce still lower numbers and even, perhaps, a new low.

It is important to remember that falling net exports is a drag on GDP growth.

Chart-16 (Synchronized Slowdown) presents the increasing Global risk. The World's economies are slowing! In fact, the Chart indicates the World's economies are the weakest since 2008-2009.

Chart-17 (Global Recession Probability Model) is from Ned Davis Research, one of the best-known and most widely respected investment research firms, serving more than 1,000 investment firms in 20 countries. The Chart is a composite model of leading economic indicators across 35 countries. Such things as the money supply, yield curve, building permits, consumer and business sentiment, share prices, retail sales, and manufacturing production are part of the probability model shown. When this index is above 70.0, as it is now, over 90% of the time we've come to know a Recession was underway.

With the Global economy (ex-U.S.) near or in a Recession, the spillover effects to the U.S. are coming.

Chart-18 (Industry Is Likely to Have Gone into a Recession in H-2 2018) shows German GDP and Industrial Production estimated to have entered Recession. Since this Chart, the rest of the EU appears to be at the same door or actually in Recession. The German economy is the powerhouse of the EU. Germany's Manufacturing PMI plunged in March to 44.7. Below 50 is contraction!

In 2017 and the first half of 2018, Europe and the U.S. were both expanding. The trade-war, touted "so easy to win," has disrupted world economic growth. Business confidence is rapidly eroding in Europe, Asia, and the U.S.

Section III. Promise of Accelerated Growth—What Has Gone Wrong?

> The 2017 tax cut has received pretty bad press, and rightly so. Its proponents made big promises about soaring investment and wages, and also assured everyone that it would pay for itself. None of that happened.
>
> —So says Paul Krugman, Nobel Prize Winner and Op-Ed columnist for *The New York Times*

Paul Krugman continues: "If you want to know whether investable funds are really being transferred to the U.S., you need to look at the overall balance on financial account."

Chart-19 (-100*Balance on Current Account, NIPA's Gross Domestic Product) presents what Krugman refers to. By way of explanation, the balance of current accounts is the broadest measure of income flows between the U.S. and the rest of the world—specifically, it is the net trade in goods and services, it is the net earnings or cross-border investments, and it is the net transfers.

Krugman is saying that the current account balances in the National Income and Product Accounts (NIPA) related to the Gross Domestic Product show that literally little has happened. The massive fund-flow home has been, in fact, a minor event.

"Beyond minor accounting maneuvers," Krugman says, "there was one overwhelming result—the tax cut is a big break for corporations: Federal Tax receipts on corporate income have plunged." See Chart-20 (Federal Government Current Tax Receipts: Taxes on Corporate Income).

As government revenues have dropped, the deficit to be financed has risen. As Krugman says, "So much for the cut in taxes paying for itself!"

Chart-21 (US Federal Deficit/Surplus) clearly shows that the deficit has grown worse since the Corporate tax cut. The deficit is likely to pass the levels created by the Great Recession (2007-2009) in the next fiscal year beginning in October of this year.

In Table-3 (Summary of Goldman Sachs S&P 500 Cash Spending Forecasts), note that, while expenditures did rise in 2018, and are expected to rise again in 2019 by 9%, share buybacks are again expected to be the winner by increasing some 22%.

We, however, take issue with the 9% growth expected for capital expenditures.

Chart-22 (Manufacturers' New Orders: Nondefense Capital Goods Excluding Aircraft) strongly suggests that overall capital spending is likely to be closer to zero than to a gain of 9%.

The National Association of Business Economics (NABE) released their quarterly survey on business condition (Jan. 29, 2019). It shows weakness across the board from sales to pricing and to profit margins. Importantly, 84% of respondents confirm the cyclical trends in growth are pointing lower relative to previous years, and that dominates short-run spending decisions.

The NABE also reports that materials' import costs are rising. The majority of respondents (53%) report shortage of materials needed as well as of skilled labor to draw upon.

The respondents additionally say that the Tax Cuts and Jobs Act did not stimulate new investment. The increased cash primarily went to fund stock buybacks, increased dividends, and increased mergers and acquisitions. (See again Table-3.)

The comparative lack of increased investments primarily resulted from a lack of confidence, resulting in an inability to plan in an increasingly chaotic business environment. (See again Chart-9.)

The U.S. trade deficit widened in 2018 to a ten-year high of $621 billion (see again Chart-15). The trade deficit even widened with China, which has been the principal target of Trump's trade war. Record deficits also took place with Mexico and the EU.

So much for the Administration's trade war to date.

We summarize this **Section** of the review by returning to Chart-11. Growth expectations are in the process of rolling over. The GDPNow forecast from the Atlanta Fed has fallen dramatically. Since the NowCast leads the consensus forecast, the

drumbeat of slowdown will increase, along with greater expectations that Recession is nearer than expected.

Section IV. Summary Observations and Economic Indicators

The expressed opinion of this report is that a Recession is likely to be underway by year-end or during the first quarter of 2020.

Could our forecast be wrong? Sure! But, as we see it, the risks to investors are no longer those connected to successfully recognizing an economy emerging from the Great Recession, or recognizing recovery has turned into a growing economy across a wide front.

This is now an economy in its late stages that received a sugar high from tax cuts and spending increases that were injected into an economy already near full employment and maximum capacity to produce. That sugar high is gone—the economy is slowing!

The risks of a Bear Market are here and may actually already be underway. In acting to reduce risks from the likely downturn this year, investors may miss some part of the final market gains during the economic deceleration before the contraction that brings with it a Bear Market. Of course, the importance of any such miss is personal.

By referring to investment risks as personal, we mean they should be weighed relative to each investor's ability to bear risk both financially and emotionally. It is natural that our goals and our stages of life change, and so must we change as investors. Just as the economy passes through cycles, so do we.

We note that many of our clients have moved from accumulation, to growth, to approaching or achieving their goals. In effect, asset protection has asserted itself to the point where protection of principal at least competes with return on principal.

For most investors in the accumulation and growth-building phase of moderate risk-taking, we have always argued that they should wait for the majority of our Economic Indicators (i.e., at least four of the seven) to turn negative. At that time, in our opinion, long-term investors will be well served by missing the major part of Recessions through reducing stock in favor of money-market and bond investments. Waiting to reduce stock holdings until the majority of our Economic Indicators dictate such action reduces emotional errors, thus adding to long-term success.

The Summary Table, listing our seven current Economic Indicators (Charts-23 to -29), follows:

Summary Table of Charts 23-29

Indicator No.	Chart	Indicator Name	Status
(1)	Chart-23	Civilian Unemployment Rate (Current vs. 12 Months Moving Average)	Positive/ Weakening
(2)	Chart-24	Advance Real Retail and Food Service Sales (Percentage Change from Year Ago)	Positive/ Weakening
(3)	Chart-25	Industrial Production Index (Percentage Change from Year Ago)	Positive/ Off Peak
(4)	Chart-26	All Employees: Total Nonfarm Payments/Civilian Labor Force (Percentage Change from Year Ago)	Positive/ Weakening
(5)	Chart-27	10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity (Percent)	Positive at .16/ Weakening
(6)	Chart-28	Aruoba-Diebold-Scotti Business Conditions Index— 91-Day Moving Average	Positive/ Weakening
(7)	Chart-29	Chicago Fed National Activity Index	Positive/ Weakening

All seven Charts remain positive, but all except Chart-25 (Industrial Production Index) show important weakening. Industrial Production has just come off a peak.

Concerning the Indicators listed, it is important that decisions to reduce the allocation to stocks due to an expected Recession depends on sell signals from a majority of the seven Indicators and, at the same time, the market direction be negative (i.e., the 40-week moving average of the S&P 500 Index must be greater than the current week).

The above rule remains our policy for our long-term investors. But, as discussed, as goals become related to nearing retirement, including the preparation for new standard-of-living objectives, the requirement of principal protection grows in relationship to that of return on principal.

Thus, the more conservative the investor becomes through time (i.e., risk averse), the earlier the attention that we, as investment managers, must give towards responding to the increasing business and market risks connected to a maturing economic cycle (i.e., the decelerating phase).

For investors who desire or require greater protection of principal, success lies with earlier stock reductions as the risk of Recession rises. Simply put, the potential of added return by waiting until four of our seven economic forecasting tools turn negative

is potentially offset by an asset-price decline that can occur over a longer-than-average market decline before Recession begins. Yes, that missed return could be significant, but it is the well-paid price for greater protection of principal.

The present weakness in six of our seven Indicators suggests greater caution than normal. The weakness seen is not some slowdown to an early or mid-economic phase, but to a late-cycle deceleration yet to find its Recession.

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