Business cycle update: mature U.S. and global business cycles

United States

- The U.S. is firmly in the late-cycle phase as evidenced by tight labor markets, challenged corporate profit margins, and a flat/inverted yield curve.
- The U.S. consumer remains solid amid low unemployment—a typical pattern during late cycle.
- Corporate earnings growth has decelerated due largely to higher wages and a weak global backdrop.
- The Federal Reserve (Fed) has started to ease monetary policy, although historically rate cuts have been less effective late in the economic cycle.

Global

- The global business cycle continues to mature, with most major economies in the late-cycle phase and several appearing to be in an industrial production recession.
- China's economy has stabilized as a result of the past year's stimulus measures, but growth remains subdued and a reacceleration from its growth recession has remained elusive.
- Rising trade tensions and higher tariffs, particularly between the U.S. and China, have damaged corporate confidence and added to global-growth headwinds.
- Overall, weaker global manufacturing and trade activity have shown few signs of abating, and it remains to be seen whether policy easing measures will prove sufficient to incite a sustained global reacceleration.

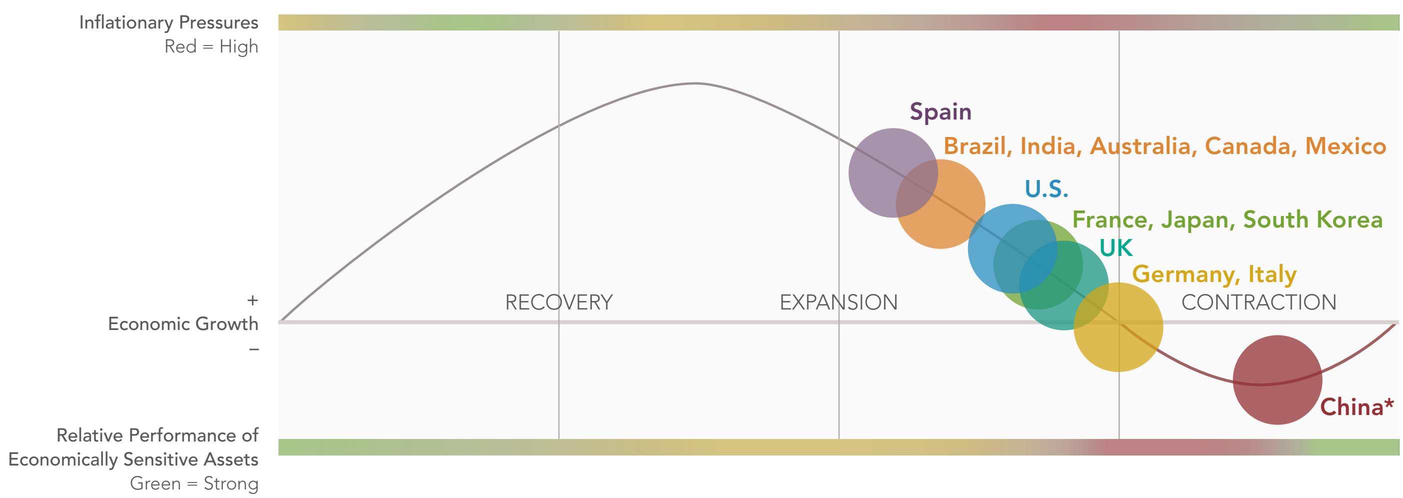
Asset allocation outlook

- Consistent with a maturing business cycle, asset-class patterns may become less reliable, warranting smaller cyclical tilts and prioritization of portfolio diversification.
- The move to a global monetary easing cycle may boost asset valuations and provide support for financial conditions in the near term, but heightened trade policy risks and a multitude of economic headwinds may blunt the ability of monetary easing to stimulate global growth.
- 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



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. * A growth recession is a significant decline in activity relative to a country's long-term economic potential. We use the "growth cycle" definition for most developing economies, such as China, because they tend to exhibit strong trend performance driven by rapid factor accumulation and increases in productivity, and the deviation from the trend tends to matter most for asset returns. We use the classic definition of recession, involving an outright contraction in economic activity, for developed economies. Source: Fidelity Investments (Asset Allocation Research Team), as of Aug. 31, 2019.

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