Recession Indicators: Strong…to Quite Strong

June 1, 2021

Key Takeaways

- With three indicators improving in May, all 12 underlying signals on the ClearBridge Recession Risk Dashboard are flashing green, consistent with a robust economic backdrop.
- While a burgeoning economy should support strong earnings growth, some of this may already be priced into forward-looking equity markets. Historically, the strongest years for economic growth have seen more modest, but still above-average, market performance.
- Equity markets typically experience bouts of volatility during the hand-off from early- to mid-cycle. We believe any corrections should present attractive entry points for long-term investors given minimal near-term recession risk.

Economic Growth Forecasts Keep Climbing

Fans of *Meet the Parents* will recognise the title of this blog as a reference to a scene from the 2000 film. "Strong … to quite strong" has also become something of a running joke between the authors; whenever economic data comes out that surprises substantially to the upside, one of us will often send a message to the other describing it as a "strong … to quite strong" release. It is also an apt description for the state of the U.S. economy today, with full-year real GDP expectations currently at 6.5%, up from 3.9% at the start of the year and 5.7% at the end of last quarter. The second quarter is likely to be one of the strongest periods in modern history for economic growth, with the Atlanta Fed's GDPNow tracker on pace for a 9.3% print currently. This strength is also reflected in the ClearBridge Recession Risk Dashboard, which had three upgrades this month meaning all 12 indicators are currently flashing green and the overall signal remains quite strong (and green).

Exhibit 1: ClearBridge Recession Risk Dashboard

		May 31, 2021	April 30, 2021	March 31, 2021
Consumer	Housing Permits	Expansion	Expansion	Expansion
	Job Sentiment	Expansion	Caution	Recession
	Jobless Claims	Expansion	Expansion	Caution
	Retail Sales	Expansion	Expansion	Expansion
	Wage Growth	Expansion	Caution	Recession
Business Activity	Commodities	Expansion	Expansion	Expansion
	ISM New Orders	Expansion	Expansion	Expansion
	Profit Margins	Expansion	Expansion	Expansion
	Truck Shipments	Expansion	Caution	Caution
Financial	Credit Spreads	Expansion	Expansion	Expansion
	Money Supply	Expansion	Expansion	Expansion
	Yield Curve	Expansion	Expansion	Expansion
	Overall Signal	Expansion	Expansion	Expansion

Expansion Caution Recession

Source: ClearBridge Investments.

The first of these is Job Sentiment, which has improved from yellow to green. Last month saw the largest monthly jump in "Jobs Plentiful" responses to the Conference Board's Consumer Confidence Survey in history. This month upped the ante in true showmanship fashion with a new largest increase in "Jobs Plentiful" responses to the survey, which now stands at 46.8% of the total. This is approaching the pre-pandemic peak of 50.3% from August 2019, and equally important just 12.2% of respondents are reporting "Jobs Hard to Get." This dataset suggests the labor market continues to find firmer footing, which bodes well for economic growth into the second half of 2021 and beyond.

The second indicator improvement is Wage Growth. Wages represent the greatest component of income for Americans and a key support for consumption. However, rising wages can also pressure corporate margins if productivity doesn't keep pace. Wage gains are starting to moderate as distortions from the pandemic ebb, but measures that are less impacted by these issues, such as the Atlanta Fed's median Wage Growth Tracker, have remained relatively steady and even cooled modestly to 3.2% in the latest reading. At the same time, productivity appears to be picking up and was +5.4% in the first quarter. While some industries such as leisure and hospitality are feeling wage pressure, on a broader basis (and given the productivity gains) wage gains do not appear to pose a threat to corporate profitability and should not bring Fed rate hikes back into the equation anytime soon.

The final indicator to advance from yellow to green is Truck Shipments. 11.8 billion tons of freight, representing 72.5% of the national total, is moved via truck each year. Even goods shipped via rail, plane, or ship are typically moved to/from the yard/port via truck. At the moment, total tonnage is still below pre-pandemic levels, but recent readings are consistent with an improving economy and budding recovery. As with most industries during the reopening, one of the challenges holding back volumes noted by the American Trucking Association comes from supply (finding qualified drivers), not demand. With wages on the rise, this should help draw in more drivers and ease the bottleneck, leading to further upside in the coming months.

In aggregate, the current readings from the dashboard are among the best in modern history, consistent with the current state of the U.S. economy. The stock market, however, is not the economy. While a robust economic backdrop should support strong earnings growth, some of this positive news may already be priced in because of the forward-looking nature of equity markets. Consequently, the best years for economic growth have gone hand-in-hand with more mixed but above-average stock market performance. Further, it isn't unusual to see a correction of over 10% in periods of economic strength, as investors try and handicap just how much growth will slow in the following year.

Exhibit 2: The Stock Market is Not the Economy

Best 10 Years U.S. Real GDP Growth Since 1950

Year	Real GDP YoY	S&P 500 Return	Max Drawdown
1950	8.7%	31.5%	-14.0%
1951	8.1%	24.0%	-9.0%
1955	7.1%	12.0%	-9.0%
1959	6.9%	-8.7%	-26.8%
1962	6.1%	-10.0%	-22.2%
1964	5.8%	-14.7%	-23.4%
1965	6.5%	12.5%	9.9%
1966	6.6%	16.4%	-3.2%
1973	5.6%	6.2%	-12.6%
1984	7.3%	31.4%	-10.6%
Average:		**10.1%**	**-12.1%**

Source: Bloomberg, FactSet.

This pattern is consistent with our unchanged outlook for healthy stock market gains in 2021, albeit with increased volatility and more muted performance compared with last year. As the economy approaches the one-year mark since the end of the recession (in our view – the NBER has not yet announced anything) – the ClearBridge Recovery Risk Dashboard turned yellow one year ago, at the end of May 2020, and green the following month – many investors are contemplating the transition from early- to mid-cycle. However, it may be a bit premature to declare the end of the early-cycle phase of the current recovery just yet. We believe that the hand-off will occur later this year, which will have implications for equity market leadership and volatility. Ultimately, any pullbacks during this shift represent a buying opportunity for long-term investors given the underlying health of the economy and minimal near-term recession risk.

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