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GOING INTO OVERTIME

QUICK POINTS

Economic and market data in late 2015 have imparted mixed signals to investors.

Historically, recessions haven't happened without some shock or excess as a reason.

US consumer and corporate spending may be able to push this business cycle forward.

Conflicting news reports, contradictory economic data, the Dow plunging 150 points one day and rallying 250 points the next. Investors these days face mixed signals everywhere and a market that churns with no real direction.

It reminds me of a football game late in the fourth quarter. One team advances into field goal range then fumbles the ball, which the other team recovers and scores. After that, an onside kick allows the first team to catch up, and the game goes into overtime.

Two steps forward, one step back

Late in 2015, a closely contested economic and market match is playing out before an audience of confused investors. Pessimists latch onto every bit of disappointing data as a sign of impending recession. Optimists focus on more positive releases and claim that the numbers are getting better.

In the past month alone, we've watched retail sales falter in the United States, only to see that piece of news followed by the announcement that total personal consumption (PCE) has actually accelerated. Similarly in China, we read more and more bad news about manufacturing and production. Within days, however, retail sales are reported to be rising at a 10% annual rate, and the service side of the Chinese economy appears to be doing fine. In Europe, though manufacturing remains in decline, we learn that the weaker currency has helped exports, and German and Italian consumers have ramped up their spending.

In interest rate space, we're beset by worries that the Federal Reserve's impending hike will slow the US economy and hinder global growth, and yet the markets continue to project that rates will be lower for longer.

Who is right and who is wrong? Are things getting better or worse?

Start making sense

Here's how I suggest investors can make sense of this.

Above all, the risk of recession should be the biggest concern. The end of a business cycle means trouble for portfolios that aren't totally bulletproof and risk-free. Recessions are episodes of sharply curtailed spending and deeply depressed profits. But recessions don't happen without a reason. A shock has to occur that ends the expansion and takes the spending and profits away.

Since World War II, those shocks have been rate increases, oil price and currency displacements, or other excesses that need to be corrected. In most cases, we've suffered a combination of shocks — usually rising rates end up curing excesses or bubbles that have developed in the economy.

Right now we see no major excesses — not in the labor markets, not in the financial markets, not in the inflation numbers. Fed policymakers tell us that interest rates may go up but the adjustment will be gradual. Past recessions have involved oil shocks, though only price increases, never decreases. Oil is currently more than 50% below its peak.

If there are no major excesses that need to be corrected, then what can provide the energy needed to keep the economy going?

Drivers of momentum

Here's what I think can push the US and global economy forward.

The US consumer matters to the world as the number-one source of final demand. The main drivers of momentum for US consumer spending are wages, hours worked and the number of workers. All three measures have been improving consistently, month over month, showing no signs of being dragged down. Corporations are mostly quite profitable, flush with cash and ready to spend again — albeit cautiously — on big-ticket items. That tends to raise the number of workers. Rising vehicle sales are further evidence of positive consumer sentiment, although home sales have been the big laggard of this cycle.

My conclusion is that the ebb and flow of good and bad economic news is netting out on the side of more of the same modest expansion that has been the hallmark of this business cycle since 2009. The moderate pace of the past six years may not be as invigorating for investors as the heady days of 3%, 4% and 5% annual real growth in the 1980s and 1990s. But a more measured rate of growth, without the uninhibited use of credit, just may get us a longer reprieve, buying us more time before the onslaught of the next recession. Which means this cycle may well go into overtime, and I don't think we'll mind that one bit.

Past performance is no guarantee of future results.

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