Business Cycle Update

Mature but less synchronized global cycle

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 yield curve.
- The U.S. consumer and housing sector remain solid amid cycle-low unemployment and low interest rates.
- Leading indicators for employment, consumption, and manufacturing have stopped improving—a typical pattern during late cycle.
- The inflation outlook remains firm but range bound, allowing the Federal Reserve to remain accommodative.

Global

- Entering 2020, the global cycle reflected signs of a bottoming in trade and industrial activity, incremental improvement in corporate sentiment in part due to de-escalation of the U.S.–China trade confrontation, and hints of improvement in some countries such as Germany.
- However, the coronavirus outbreak in China adds a significant near-term headwind to global growth.
- China is likely to step up its monetary and fiscal policy easing in order to smooth disruptions to its underlying growth trend.
- Most major economies are in the late-cycle phase, and the near-term global outlook has become less certain.

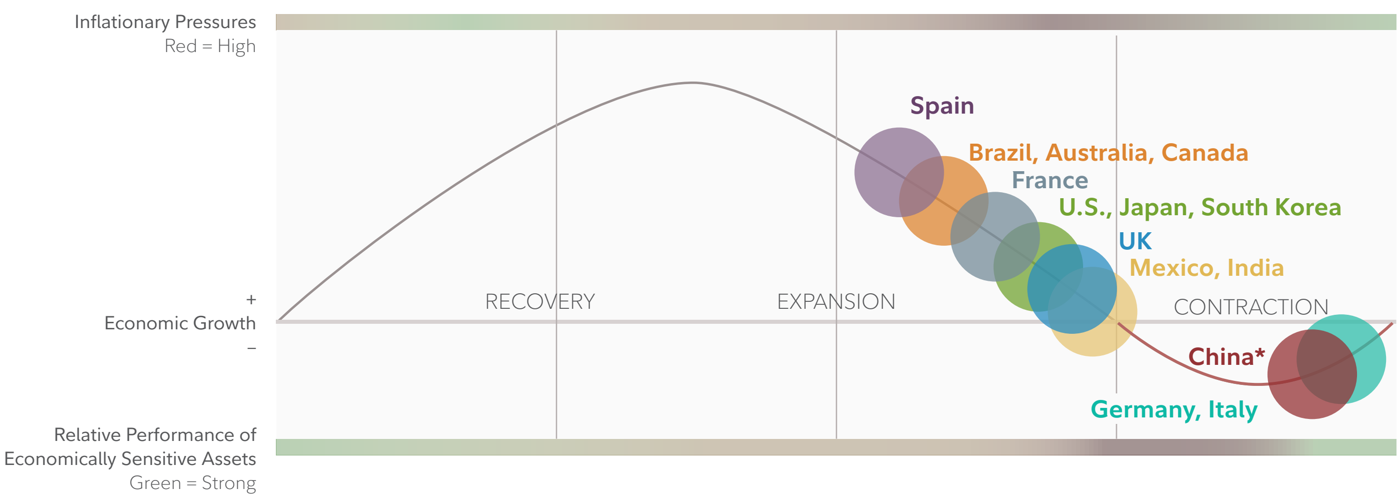
Asset Allocation Outlook

- Consistent with a maturing business cycle, asset-class patterns may become less reliable, warranting smaller cyclical tilts and prioritization of portfolio diversification.
- The favorable liquidity environment provided by dovish central banks may provide support for financial conditions in the near term, but late cycle conditions may blunt the ability of monetary easing to stimulate growth.
- Non-U.S. equities and inflation-sensitive assets are attractive from both a valuation and diversification perspective.
- 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 Jan. 31, 2020.

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