Business Cycle Update

Late-cycle pressures rise and the global economic expansion becomes more complicated

United States

- The U.S. expansion continues to mature amid an increasing flavor of late-cycle dynamics.
- The expansion remains underpinned by a healthy consumer sector bolstered by solid household balance sheets and nominal income growth.
- Inflationary late-cycle pressures represent a challenge, as tight labor markets push up wages, supply constraints disrupt production, and rising commodity prices raise costs for both businesses and consumers.
- While bank lending and overall credit conditions remain relatively benign, rate hikes by the Federal Reserve have begun to tighten financial conditions.
- Recent trends suggest a higher probability that the U.S. may move through the cycle faster than during prior mid-cycle phases, but near-term recession risks remain low.

Global

- The global expansion continues, but the ongoing conflict in Ukraine has injected a more stagflationary element into the outlook.
- Europe is particularly exposed to fallout from the war, including higher natural gas prices, and is facing rising recession risk.
- Commodity exporters such as Canada, Australia, and Brazil benefit from improved terms of trade, but consumers in many developing economies—including India—face significant headwinds from higher food and energy prices.
- China is still struggling to emerge from its growth recession. COVID-related lockdowns have hamstrung the industrial-cycle recovery, but policy easing is picking up steam.
- Generally tighter global monetary policies and financial conditions may sap some momentum from the global expansion, and a broad set of crosswinds is creating greater differentiation among countries.

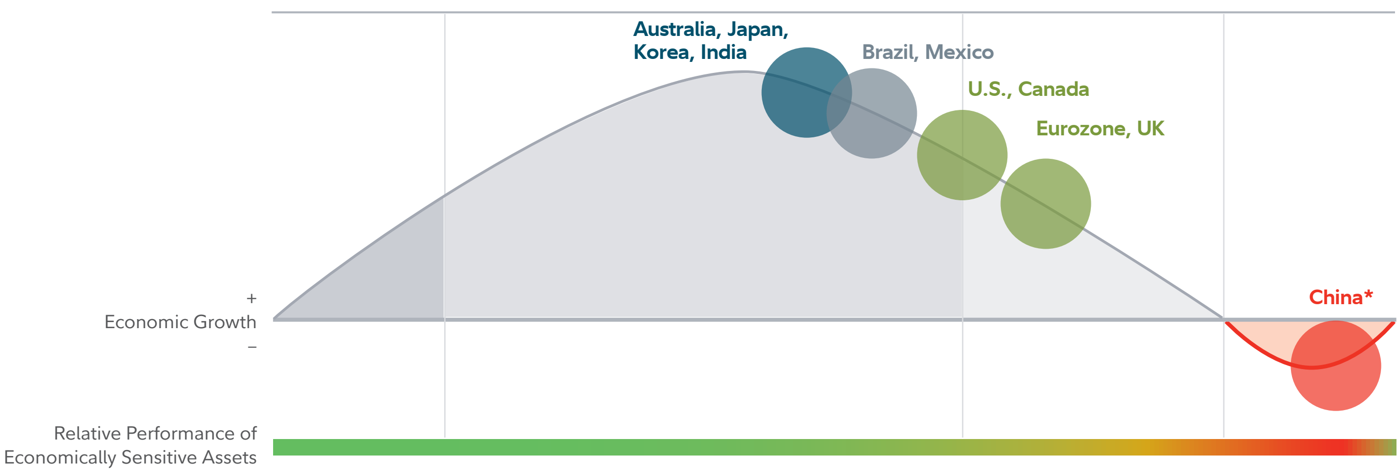
Asset Allocation Outlook

- The Federal Reserve faces a difficult balance of tightening monetary policy to confront decades-high inflation without engendering a downturn, and slower liquidity growth represents a headwind for financial markets.
- The broad-based decline in asset prices through the first third of 2022 implies the market is already reflecting some of the multiple challenges confronting the U.S. and global business cycles.
- The high degree of uncertainty surrounding the outlook for inflation, monetary policy, and the conflict in Ukraine imply that elevated volatility levels may persist for some time.
- The cyclical outlook remains generally constructive amid low near-term U.S. recession risk, but portfolio diversification is as important as ever.

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, the pattern of cyclical fluctuations in an economy over a few years that can influence asset returns over an intermediate-term horizon. 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 (AART), as of 4/30/22.

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