Business Cycle Index

JANUARY 2021

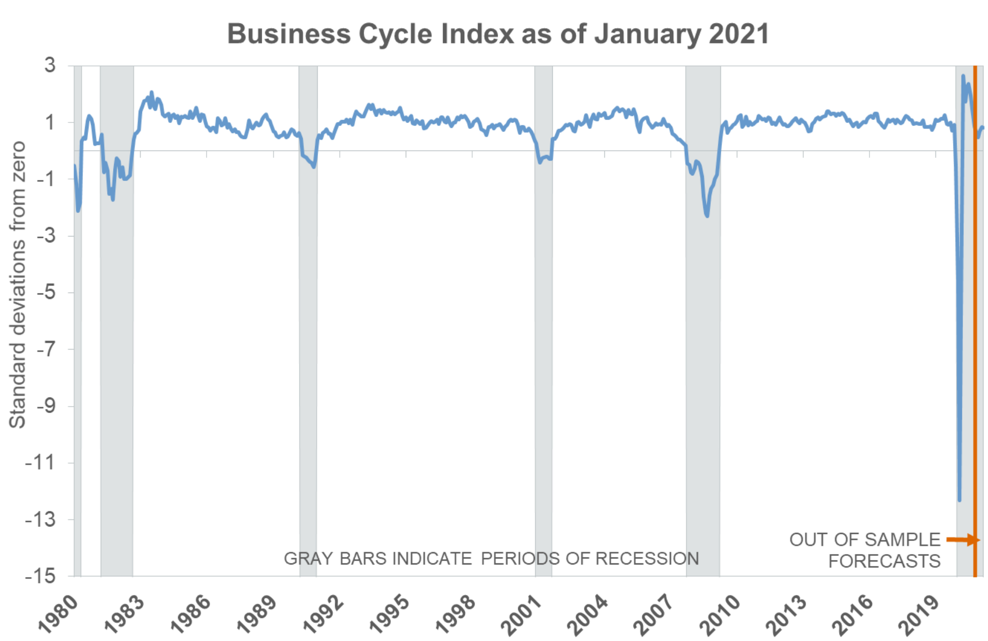
January employment report: minimal gains

Nonfarm payrolls increased in the first month of the new year by 49 thousand jobs, missing consensus estimates of 105 thousand. Additionally, the December report was revised down by 87 thousand jobs to negative 227 thousand jobs. Unemployment fell to 6.3% however some of this is due to changes in labor participation rate. The economy has added back around 12 million jobs since April but remains well under level seen before the onset of the pandemic. Vaccine news and additional stimulus has brought optimism to the markets, however challenges around vaccine distribution and reopening economies remain.

Implications for Federal Reserve (Fed): The slowing job recovery supports our view that the Fed and federal government will remain accommodative to support the economy regain stable footing. We do not see the Fed taking any action to increase rates in the near term.

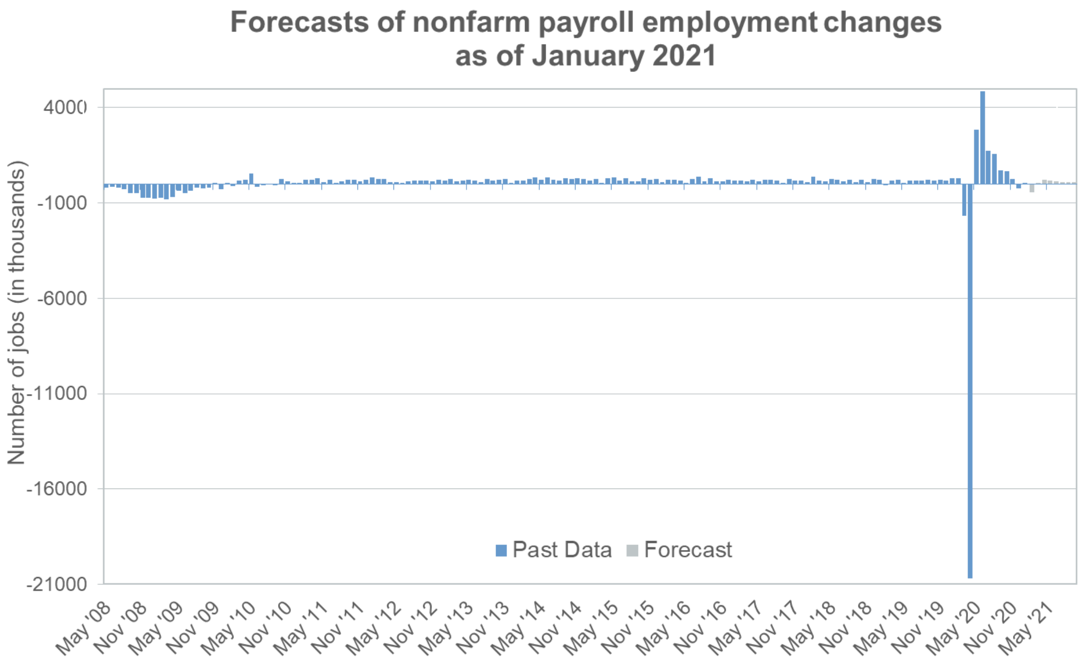
Implications for growth: The BCI model estimates a 22% probability of still being in a recession in 12 months (little changed from 22% in November and December, though much lower than the peak of 67% in May). A key driver of the BCI model is the consumer. The labor market recovery was temporarily interrupted by renewed localized lockdowns within the U.S. because of increased Covid-19 infections. Fiscal stimulus continues to be an important backstop until vaccines have been widely deployed.

EXHIBIT 1: BUSINESS CYCLE INDEX (BCI)



Source: Recession dates from National Bureau of Economic Research. Out of sample forecasts were calculated by simulating the time-series model into the future. The value shown is the median of the simulated value for the month

EXHIBIT 2: EMPLOYMENT DATA



Source: Actual employment data from St. Louis FRED database. Out of sample forecasts were calculated by simulating the time-series model into the future. The value shown is the median of the simulated value for the month.

FREQUENTLY ASKED QUESTIONS

What is the Business Cycle Index?

- **The Business Cycle Index (BCI) seeks to forecast the strength of economic expansion or recession in the coming months, along with forecasts for other prominent economic measures.**
- The two outputs featured here are the Business Cycle Index and the Employment Forecast.
- Inputs to the model include non-farm payroll, core inflation (without food and energy), the slope of the yield curve, and the yield spreads between Aaa and Baa corporate bonds and between commercial paper and Treasury bills. A different choice of financial and macroeconomic data would affect the resulting business cycle index and forecasts.
- "Dynamic forecasts of qualitative variables: A Qual VAR model of U.S. recessions", published in the Journal of Business and Economic Statistics in January 2005, provides background on the statistical model behind the BCI.

Why is it important?

- **The BCI seeks to forecasts the future direction of the business cycle.**
- Historically, the stock market responds to investor perceptions of the future direction of the business cycle.

Can I use the BCI as a market-timing tool?

- **No. The BCI is not meant to serve as a direct prediction regarding the future performance of any financial market.** It is not intended to predict or guarantee future investment performance of any sort.

How do we interpret it?

- An increase in the BCI typically indicates that the business cycle conditions are improving — either moving closer to exiting a recession or to stronger expansion.
- A decrease in the BCI typically indicates that business cycle conditions are worsening — either moving closer to entering a recession or to a deeper recession.

How often is it updated?

- The Business Cycle Index is updated monthly after payroll employment numbers are released and will be published around the 15th calendar day of the month.

These macroeconomic forecasts do not constitute a projection of the stock market or of any specific investment.

Historical employment data displayed in the Business Cycle Index are reflective of current data as provided by the data sources including any revisions to previous data. These revisions may change historic data points and historic ranges for some or all indicators. These changes are usually due to seasonal adjustments to previously supplied data.

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No investment strategy can guarantee a profit or protect against a loss in a declining market.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

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