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Economy

Indicators See the End of the Recession

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The end of this recession -- the most severe downturn since World War II -- is finally in sight. This is the clear message from Economic Cycle Research Institute's array of leading indices of the U.S. economy.

What are these indicators? One is the ECRI's U.S. Long Leading Index (USLLI), which has the longest average lead times of any U.S. leading index. Another is the Weekly Leading Index (WLI), which has a shorter lead over the business cycle but is very promptly available.

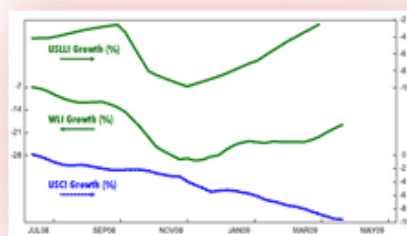
The growth rate of the USLLI turned up in November 2008 and has now advanced for four straight months. The growth rate of the WLI turned up soon after that, in early December 2008, and as of mid-April 2009 it had been rising for more than four months (see the top two lines in the chart below). A rigorous examination of the data affirms that both USLLI growth and WLI growth have been in cyclical upturns for at least four months.

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Therefore, the economy is on the cusp of a growth rate cycle upturn - i.e., a cyclical acceleration in economic growth. In other words, U.S. economic growth, which, according to ECRI's U.S. Coincident Index growth rate, is still plunging deeper into negative territory (bottom line in chart), will start becoming less negative in short order.

Signs of Recovery Ahead



LARGER IMAGE

Not Just Green Shoots

But so what? Isn't this tantamount to the growing conventional wisdom about the slowing descent in economic activity? Indeed it is, but those who dismiss this development don't understand its implications for a business cycle recovery.

In fact, over the last 75 years, growth rate cycle upturns during every recession were followed *zero to four months later* by the end of the recession itself. No exceptions.

Actually, there's been only one solitary exception in the data we have examined, which go back well over a century. This was the growth rate cycle upturn of 1930-31, which gave way to a renewed downturn. But when this growth rate cycle upturn was beginning at the end of 1930, USLLI growth was turning back down, warning that the firming in growth would soon be reversed, effectively opening the door to depression. That's not the case today.

We know this because the USLLI data go back to 1919, covering not only the Great Depression but also the 1920-21

depression. Another ECRI leading index has a 105-year history, covering not only those depressions but also the panic of 1907 and the associated 1907-08 depression. All of those leading indices, which correctly anticipated recessions and recoveries over long periods of history, are now pointing the same way.

While ECRI has known about the growth rate cycle upturn for a while, what's new this month, beyond the implications of a growth rate cycle upturn, is that the *level* of the USLLI has been rising for three straight months in a way that signals the end of the recession. The *level* of the WLI has been rising for six weeks - this wouldn't yet be significant, except that this comes in the wake of the upturn in the USLLI. Along with the rest of ECRI's leading indices, these developments are pointing to a business cycle recovery this year, probably by the end of the summer.

How Reliable Are These Indices?

In order to take this forecast seriously, it's important to look at the track record of ECRI's leading indices. Some may recall that these indices helped us [predict](#) the 2001 recession. These same leading indices correctly anticipated the current recession, turning down before the recession began. Specifically, the Weekly Leading Index (WLI) turned down in early June 2007. By December 2007, its growth rate had plunged to its worst reading since the 2001 recession.

In January 2008, we [recognized](#) that "a self-reinforcing downturn has already begun. If allowed to continue, it will amount to the vicious cycle known as a business cycle recession." At the time, we explained why "prompt stimulus to boost consumer spending can avert a recession. But time is truly of the essence -- the stimulus is needed in a matter of weeks, not months."

When our warning went unheeded, I [wrote](#) in March 2008 that we had entered a recession that "didn't have to happen." Even as stock prices rallied by 12% that spring and upbeat analysts decided that the economy had dodged the recession, we stuck to our guns, knowing that the recession would be recognized belatedly, as usual.

In the months that followed our warning, the **S&P 500** lost half its value -- even today, after a sharp run-up, it's still a third below its value at the time. But the leading indicators that warned us of recession are now pointing clearly to a business cycle recovery.

The Giant Error of Pessimism

But isn't this recession without precedent? Sure, if you consider only the run-of-the-mill postwar recessions to which most economists have fitted their models. But the ECRI's indicator systems cover not just garden-variety recessions but also jungle-variety depressions, panics and crises spanning well over a century. After all, we're the only research group in the world that studies business-cycle recessions and recoveries for a living. And we find that this recession shares family resemblances to earlier, prewar downturns that few have systematically examined.

Still, most will be skeptical about our forecast of a business cycle upturn. This is precisely what we'd expect. Why is that?

Wesley C. Mitchell was a mentor to ECRI's late founder, Geoffrey H. Moore, whom *The Wall Street Journal* called "the father of leading indicators." More than 80 years ago, Mitchell described how the error of optimism at the heart of every boom "grows in scope and magnitude. ... But since the prosperity has been built largely upon error, a day of reckoning must come. ... Then the past miscalculation becomes patent - patent to creditors as well as to debtors, and the creditors apply pressure for repayment. Thus prosperity ends in a crisis."

Then, as Mitchell quotes A.C. Pigou writing in 1920, "The error of optimism dies in the crisis but in dying it 'gives birth to an error of pessimism. This new error is born, not an infant, but a giant; for [the] boom has necessarily been a period of strong emotional excitement, and an excited man passes from one form of excitement to another more rapidly than he passes to quiescence."

The "giant error of pessimism" is now rampant. This is why many will be blind to the light at the end of the tunnel that marks the exit from this recession. But to ECRI's array of objective leading indices, designed specifically to spot recessions and recoveries, the end of the recession is now in clear sight.

Know What You Own: In Wednesday's trading, the most active stocks included the **SPDR International Dividend** (DWX), **Bank of America** (BAC), **Citigroup** (C), **S&P Depository Receipts** (SPY), the **Financial Bull 3X** (FAS), the **Financial Bear 3X** (FAZ) and the **iShares MCSI Taiwan** (EWT).

Anirvan Banerji is the director of research for the Economic Cycle Research Institute, which was founded by Dr. Geoffrey H. Moore, creator of the original index of leading economic indicators (LEI) for the U.S. Department of Commerce. Banerji serves on the economic advisory panel for New York City, is the co-author of [Beating the Business Cycle: How to Predict and Profit From Turning Points in the Economy](#) and is the president of the Forecasters Club of New York. Under no circumstances does the information in this column represent a recommendation to buy or sell stocks. While Banerji cannot provide investment advice or recommendations, he appreciates your feedback; [click here](#) to send him an email.

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