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Market Analysis

The Recession Is Over

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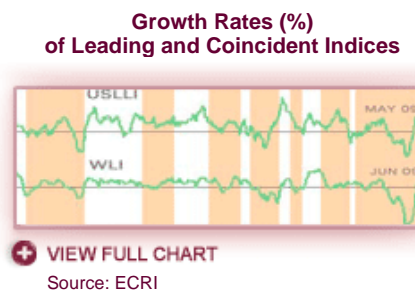
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Back in late April, amid rampant pessimism about the economy, the Economic Cycle Research Institute (ECRI) predicted that the recession would end this summer. The leading indices on which we based that call have since seen a synchronized surge.

In fact, the cyclical improvement in the economy is proceeding in a textbook sequence, from long leading indicators to short leading indicators to coincident indicators. In essence, there are now pronounced, pervasive and persistent upturns in a succession of leading indices of economic revival.

When approaching a cyclical turning point in U.S. economic growth, the growth rate of the U.S. Long Leading Index (USLLI) typically turns first, followed by the growth rate of the Weekly Leading Index (WLI), growth in the U.S. Short Leading Index (USSLI) and growth in the U.S. Coincident Index (USCI). Notably, the levels of the USLLI, WLI and USSLI are all rising. In fact, the chart below shows that by May, USLLI growth (top line) had already surged to a four-year high. Meanwhile, WLI growth (second line) has spurted to a two-year high, having crossed into positive territory. Following in their footsteps, USSLI growth (third line) has shot up to a one-year high, though it's still in negative territory.



Finally, the USCI is still slipping, indicating that as of June, the U.S. economic recovery had not yet begun. Yet USCI growth (bottom line), which represents the rate of growth of aggregate economic activity, has now risen for three months. While still in negative territory, it's now at a six-month high; almost certainly, the upturn in the growth rate cycle we predicted in April is now in progress.

But the sequential upswings in the leading indices aren't just about less negative growth -- we have pronounced, pervasive and persistent upswings in a succession of leading indices of economic revival, the most powerful possible predictor of a business cycle recovery. What's impressive here is the degree of unanimity within and across these leading indices, along with the classic sequence of advances in those indices. Such a combination of upturns doesn't happen unless an end to the recession is imminent.

If so, why is there such broad pessimism among analysts? The problem is a widespread inability to distinguish among leading, coincident and lagging indicators, along with the vast majority of economic indicators that don't fall neatly into any of those three categories. Thus, indicators are typically judged by their freshness, not their foresight. Because most market-moving numbers are coincident to short leading, while corporate guidance is often lagging, it's no surprise that analysts don't discern any convincing evidence of an economic upturn.

The arguments marshaled by standard-bearers of the pessimistic consensus hold little water. Usually, their "analysis" is based on gut feel, bolstered by any seemingly plausible argument that would support their case.

For instance, last month, with oil prices and interest rates staging something of an advance from their lows, skeptics opined that this would nip any potential recovery in the bud. But it's hardly unusual for such indicators to turn up in anticipation of economic revivals, which would never take place if higher oil prices or interest rates were able to head them off.

This month, the rise in the jobless rate to a 25-year high is being taken by some as an argument against recovery: Consumers supposedly won't spend when joblessness is mounting. Apparently, many analysts are unaware that even the 1929-33 recession ended when the jobless rate was over 25% -- and still rising!

The "second-derivative rally" in equities has provoked much derision, especially from those who missed it. Yet ECRI's leading indices now have positive second derivatives. More important, they've already had positive *first* derivatives for some months. It's worth reminding calculus-challenged analysts who doubt the significance of these cyclical upswings of the second-derivative test: When the first derivative of a univariate function rises to zero and its second derivative turns positive, it marks the low point of the function. That development is already in the rearview mirror for every one of ECRI's leading indices of economic activity.

In sum, the economy has a raft of problems that'll take a long time to resolve. But none of them can head off the imminent economic recovery that ECRI's objective leading indices are promising.

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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