LPL RESEARCH

WEEKLY ECONOMIC COMMENTARY

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WHAT DO CLAIMS CLAIM?

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KEY TAKEAWAYS

We have raised the odds of recession to 30% today, from around 10–15% at the start of the year.

The initial jobless claims indicator, one of many that we monitor, suggests little cause for immediate recession concerns.

Recession fears in the financial markets are mounting, and we have raised the odds of recession from around 10–15% at the start of the year to approximately 30% today. The economic data—notably the Conference Board's Leading Economic Index (LEI)—put the odds of a recession at only 10–15%, but the rocky start to the year in financial markets has raised the likelihood of a policy mistake (monetary, fiscal, and/or currency), pushing recession odds higher (discussed in today's *Weekly Market Commentary* "What a Non-Recessionary Bear Might Look Like"). With their year-to-date performance, many financial markets have already priced in a recession. While no serious market participant uses only one indicator to make a recession call during times of uncertainty (we look at a broad range of indicators: economic, market, and sentiment based, to gauge the likelihood of a recession occurring), many investors want to focus on the most timely indicators, which are market based. But while market data (equity, fixed income, and commodities) can provide minute-by-minute updates on recession odds, markets often overreact, making it difficult sometimes to separate out the signal from the noise.

> During times of uncertainty, many investors want to focus on the most timely indicators, which are market based.

NUTS AND BOLTS OF CLAIMS

Taking a slightly longer-term view (weekly) helps to reduce—but not entirely eliminate—the signal-to-noise problem. The weekly report on initial claims for unemployment insurance is one such gauge. While most data on the labor market are lagging indicators of economic activity, initial claims are a leading indicator, and as such, the Conference Board includes initial claims in its Leading Economic Index. Initial claims are released by the U.S. Department of Labor every Thursday morning at 8:30 AM ET, tracking claims for the week ending the previous Saturday. For example, the initial claims data released this Thursday, February 11, 2016, will include initial claims for unemployment insurance filed in the week ending Saturday, February 6, 2016. The weekly claims data are subject to revision, and oddly, claims in prior weeks are almost always revised higher, even during economic expansions. Most other economic data series tracked by financial markets see both upward and downward revisions to prior periods. In addition to the revisions, the weekly initial

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claims data are subject to a great deal of week-to-week volatility due to weather and the timing of holidays that don't always fall on the same date every year (Thanksgiving and Easter, for example) or fall on a different day of the week each year (Christmas, New Year's Day, Fourth of July, etc.). Claims are adjusted for seasonality. For example, the data take into account that retail workers laid off after Christmas file for unemployment insurance in large numbers in January. Because of all the potential distortions noted above, we often look at a four-week average of initial claims to help smooth out the series, helping to further reduce the noise and increase the signal from claims. One final quirk to claims is that while they are reported by a federal agency—the U.S. Department of Labor—each state has its own rules and regulations for administering their own unemployment insurance programs and for reporting the data to the Federal government each week.

WHAT CLAIMS ARE SAYING ABOUT THE ECONOMY NOW

The weekly data on initial claims are available back to the 1960s, providing a robust history to gauge the efficacy of claims as a recession indicator [Figure 1]. The Figure 1 table details the behavior of claims back to the late 1960s, through six of the seven business cycles over that time frame. Not included is the signal sent by claims in between the back-to-back recessions that began in January 1980. The recession "signal" we choose for claims is one we hear and see often today, which is that claims have "bottomed out" and are now headed higher. This is factually correct, as the four-week average on claims bottomed out at around 260,000 in October 2015 and in the latest week (January 30, 2016) stood at 285,000.

Figure 1 shows that the "bottoming out of claims" signal has made six correct recession calls, with an average lead time of 16 months:

- May 1969
- February 1973
- April 1978
- December 1988
- April 2000
- February 2006

For example, claims troughed in May 1969 at near 180,000, eight months prior to the start of the recession in January 1970. However, the "bottoming out in claims" signal has also sent five false recession signals: one in the 1970s (1976), two during the long economic expansion in the 1980s (1984 and 1987), and one each in the 1990s (1994) and 2000s (2002). Many of these false signals (1976, 1984, 1987, and 1994) were associated with tightening by the Federal Reserve (Fed); a few were associated with a financial crisis—a major bank failure in 1984, the stock market crash 1987, the Mexican peso crisis in 1994, and Argentina in 2002; and others were associated with a strong dollar (1976, 1984, and 1987). Is the recent trough in claims related to the first Fed rate hike in nine years, a reaction to the precipitous drop in oil prices, the slowdown in the Chinese economy, or the stronger dollar? Or is it something else?

While we will respect the "bottom in claims" indicator, another way to gauge claims suggests little cause for concern yet. In the past, a rise in claims of between 75,000 and 100,000 over a 26-week period has been associated with recession. Over the past 26 weeks (July 2015 through January 2016), initial claims have increased by 16,000—well below the 75,000 to 100,000 increase needed to

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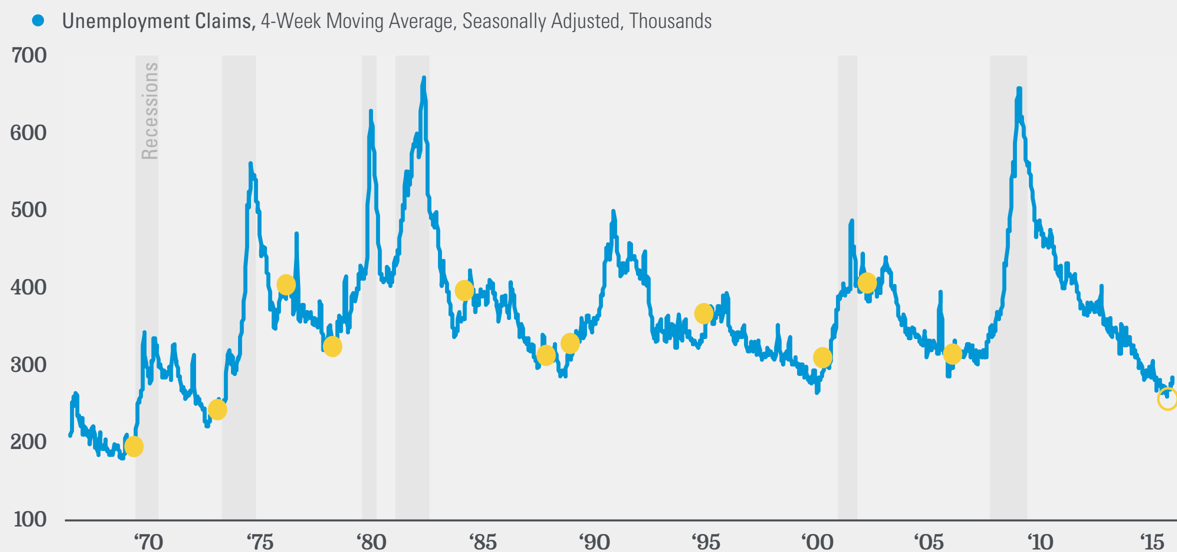
signal a recession. The Fed just began raising rates, oil prices have collapsed, the dollar has surged, and a potential financial crisis is brewing in several oil exporting nations due to the drop in oil prices, and all of these types of events have been associated with a false recession signal from claims in the past. With the odds of a recession on the rise, we will continue to monitor initial claims, and all the other economic, financial market, and sentiment indicators, looking for signs of a recession.

1 INITIAL CLAIMS ARE A LEADING INDICATOR OF THE ECONOMY



Low in Claims	Recession Signal	Start of Recession	Lead Time
May 1969	Yes	January 1970	8 Months
February 1973	Yes	December 1973	10 Months
March 1976	No	False Signal	N/A
April 1978	Yes	February 1980	22 Months
March 1984	No	False Signal	N/A
November 1987	No	False Signal	N/A
December 1988	Yes	August 1990	20 Months
December 1994	No	False Signal	N/A
April 2000	Yes	April 2001	12 Months
June 2002	No	False Signal	N/A
February 2006	Yes	January 2008	23 Months
October 2015	??	??	??
All Cycles	6 Correct Signals	5 False Signals	16 Month Lead Time
Last 3 Cycles	3 Correct Signals	4 False Signals	18 Month Lead Time

Source: LPL Research, U.S. Department of Labor 02/05/16

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INDEX DESCRIPTIONS

The Leading Economic Index is a monthly publication from the Conference Board that attempts to predict future movements in the economy based on a composite of 10 economic indicators whose changes tend to precede changes in the overall economy.

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