

“Market Cycles Revisited”

By Tommy Williams, CFP®

We all know the age-old fairytale, “*Goldilocks and the Three Bears*”, but did you know Goldilocks is real? Well, metaphorically. According to a recent *CNN Money* report, “*It turns out that Goldilocks is real: The labor market is not too hot and not too cold,*’ says Douglas Holtz-Eakin, president of the American Action Forum.”



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The U.S. unemployment rate ticked higher early this month. The September jobs report showed the United States added 156,000 new jobs in September. That was 16,000 fewer than

economists were expecting and 11,000 fewer than were added in August, according to *Barron’s*.

That doesn’t sound like good news, does it? On the other hand, the report showed more people are working and looking for jobs. Also, wages increased so people are earning more. *The Wall Street Journal* wrote:

“The report – marked by a slight uptick in the unemployment rate to 5 percent – largely fit the narrative Fed Chairwoman Janet Yellen laid out for the labor market after the central bank’s September policy meeting. People are rejoining the labor force in search of work. Many of them are finding jobs, but not all...Ms. Yellen sees the return of workers to the job search process as a healthy sign.”

That sounds like good news, right? The jobs report seemed to support the conclusion of *The New York Times* that there are two economic realities in the United States, “...*healthy hiring and falling unemployment on the one hand, millions of economically sidelined Americans on the other...*”

Nils Bohr, Nobel laureate in Physics, famously once said, “*Prediction is very difficult, especially if it’s about the future.*” Well, when it comes to the economy, future growth may not be predictable, but it does tend to follow a pattern. An economic cycle consists of periods of recession (when the economy contracts) which are followed by periods of growth (when the economy expands).

Some companies and market sectors tend to perform better during economic expansions. They’re

known as cyclical companies, and they make goods or deliver services – entertainment, automobiles, vacations, and so on – that people want to buy when they’re feeling prosperous. Generally, people feel prosperous during periods of economic expansion. Other companies are called ‘defensive.’ They offer goods or services – food, beverages, personal products, and so on – that people need regardless of their wealth or economic conditions.

In recent months, we’ve seen what may be a rotation from defensive market sectors into cyclical ones. *Financial Times* explained the shift in U.S. markets:

“The shift signals investors are worrying about high prices for the defensive, dividend-paying stocks that were in heavy demand in the first half as worries over the outlook for the global economy dominated... Indicatio

ns of a potential rate increase this year and hopes that economic growth was improving were making unloved, cyclical parts of the market look more attractive.”

If you look at returns for the first three quarters of the year, cyclical stocks and defensive stocks delivered almost the same performance. Through September 30, 2016, the MSCI ACWI Cyclical Sectors Index was up 4.8 percent and the MSCI ACWI Defensive Sectors Index was up 4.7 percent. The trend appears when you look at the numbers during the third quarter. During July, August, and September, cyclical sectors were up 8.2 percent and defensive sectors were down 0.7 percent!

I don’t think it takes winning a Nobel Prize to see that we’re in a cyclical rotation!

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