We are barely two months removed from the worst year for stocks since the financial crisis and the worst December since the Great Depression, and all seems right in the world again. The S&P 500 Index has risen nearly 20% from its Christmas Eve low, and is currently within 3% of its all-time high reached in August 2018. At one point during the market's recovery, the Dow Jones Industrial Average was up in nine consecutive weeks for only the 15th time in its 123-year history. Equally significant, the CBOE Volatility Index, a popular measure of the market's expected volatility and commonly referred to as the fear index, has fallen 55% over the last 10 weeks, the largest such decline since this measure came into existence in 1986.

The economy's performance has surprised on the upside, as well. Fourth quarter GDP grew at an annualized rate of 2.6%, below the paces of the prior two quarters but well ahead of expectations. Based on the stock market's 4th quarter collapse, December's weak retail sales and the federal government shutdown, the Bloomberg consensus was for 2.2% growth, and the Atlanta Fed's estimate was even lower at 1.8%.

Despite the unexpectedly strong economic and market performance, 10% of economists surveyed still think the U.S. will enter a recession this year, and more than half expect one by the end of 2020. It is clear that many economists remain susceptible to "late cycle" thinking, even though the economy and the markets are behaving as if we were still in the middle innings, not the late innings.

Since World War II, the U.S. has experienced a recession every 5.5 years, roughly. The current expansion will mark its 10th anniversary in June, and become the longest on record. But there is no time limit on an economic cycle, and this one has behaved unconventionally in a number of ways.

First and foremost, even though unemployment has been at or below 4% for almost a year, wage growth and inflation have remained muted, contrary to what traditionally happens late in a cycle. Further, the Federal Reserve has signaled a "pause" in its tightening, which is also atypical of the later part of a cycle.

Additionally, even though the jobless rate may be low, there is still a lot of slack in the labor market. The labor force participation rate (the share of working age people actually in the labor force) has never recovered from the financial crisis. This measure hit a 41-year low in 2015 and hasn't moved up significantly since. In other words, the actual labor force against which joblessness is measured is not fully representative of the much larger *potential* labor force.

Finally, technology is changing the demand for labor. Companies are increasingly turning to software and robots, either because they can't find workers with the requisite skills, or because machines that don't require benefits and can work 24/7 help them compete in a

global marketplace. This is the primary reason why labor's share of domestic income has fallen while business's share has been rising.
The point is that we cannot look simply to labor statistics – or the calendar – to alert us that the end of the cycle is near. The more reliable indicators are jobless claims, housing starts, core inflation, the yield curve, credit spreads, and ISM manufacturing data. And although housing starts remain weak and the yield curve has narrowed, none of these measures are anywhere close to indicating a recession, or that we are late in the economic cycle.

Near term, though, we are concerned that the market has risen "too far too fast" from the December lows. As mentioned earlier, the S&P 500 has soared nearly 20% in just ten weeks, and 90% of the stocks in the Index are trading above their respective 50-day moving averages – the highest percentage since March 2016.

It is also somewhat concerning that the market's rise coincides with further downward revisions in expectations for corporate earnings, making valuations less compelling. First quarter estimates are now 6.5% below where they were at the beginning of the year, and comparisons to last year's results will likely remain difficult as the year goes on. But such concerns are probably already priced into the market, based on the market's more muted reaction to disappointment than in prior quarters. So, near term concerns aside, we are increasingly comfortable that stocks can continue to rise, even if the pace were to slow dramatically from here.

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