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8/11/2022

AN UPDATE FROM PAUL DIETRICH

FOCUS ON THE ECONOMY – NOT THE STOCK MARKET

The great hockey player Wayne Gretzky always said, "*I skate to where the puck is going to be, not where it is.*" That is also good investment advice.

Suppose you want to know in advance where the stock market is heading. In that case, investors should not focus on the stock market but only on the leading economic indicators, usually known as the early warning signals for a recession. They are pointing to where the puck is going to be.

There Are Only Two Cycles In The Stock Market

In college, I had a wise old economics professor. He used to say that we make understanding the stock market far more complex than it really is.

Like in the 24-hour cycle of each day, there is day and night. He believed that there were only two cycles in investing.

The first is a bull market. They usually last six to ten years. During that time, the economy is growing and expanding, sales are up, revenues are up, and earnings are up. And most importantly, the stock market is almost always up too.

The second cycle is a bear market/recession. They usually last 9 to 18 months. During that time, the economy is declining and contracting. Revenues are down, earnings are down, and the stock market is declining.

Anyone who has taken Economics 101 knows that over the long-term—not the short-term, but over the long-term—the stock market always mirrors the long-term directional trend of the underlying economy.

My old economics professor believed that investors simply needed to act appropriately depending on whether we are in a bull or bear market cycle. Just as most people work during the day and sleep at night, one has to act appropriately to whether you are in a bull or bear market.

He believed that if we are in a bull market where the economy is expanding, and everything is going up, an investor should be fully invested in the stock market.

He also believed that if the economy is contracting and everything is going down, one should move to a defensive investment strategy and preserve one's capital.

It's Like Coaching Football

In football, you are either playing offense or defense. There is no in-between.

Every coach has different strategies, plays, and team members, depending on whether he is playing offense or defense.

It would be a foolish coach who tried to play his offensive team all the time when the team was on defense. He would most likely lose every single game.

My experience as an investment manager has been that understanding long-term economic and stock market cycles is the secret to successful investing.

Since 1945, the U.S. has had a bull market on average for six to ten years, followed by a bear market that lasted an average of 9 to 18 months. These two investment cycles are repeated roughly every 12 years.

Leading Economic Indicators—Recession's Early Warning Signals

Watch the leading economic indicators to know when the next bear market recession is coming. They are the "early warning systems" of recessions.

These are the economic indicators that turn down before other government statistics decline.

For example, companies are buying less when trucks, trains, and ocean freight shipments start to decline year-over-year. When manufacturers start going from three factory shifts to two shifts, orders are usually starting to slow. When companies begin lowering inventories, they typically expect sales to decline.

These indicators start declining before investors see official sales, earnings, unemployment and manufacturing declines. That is why they are called leading US economic indicators.

When analyzing leading economic indicators, there is more credibility when several of them are flashing red declining signals at once.

Why Has The Stock Market Gone Up Over The Past Month?

The press, business TV pundits, and many analysts have focused on lagging and intermediate (coincident) economic indicators like earnings that came in "not as bad as expected." Earnings are a lagging economic indicator.

Inflation is another lagging economic indicator, and unemployment is an intermediate economic indicator.

The other reason is that Bear Market rallies are common during all Bear Market recessions. That is why it is so essential to understand the long-term directional trends in the economy.

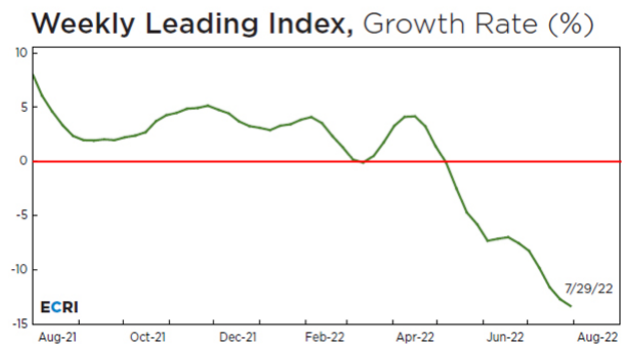
Bear Market rallies are like a "head fake" during a recession. Investors can lose a lot of money trying to get back into the stock market before the leading economic indicators signal that the economy is turning up again.

During the 2008-2009 Great Recession, the stock market declined -57% from October 2008 to March 2009. There were five Bear Market rallies, and three of these upward trending rallies lasted several months before falling again.

Only Focus On The Leading Economic Indicators!

The most recent release of the ECRI Weekly Leading Economic Indicators published by the Economic Cycle Research Institute shows this composite of major leading economic indicators has been declining for over 112 weeks.

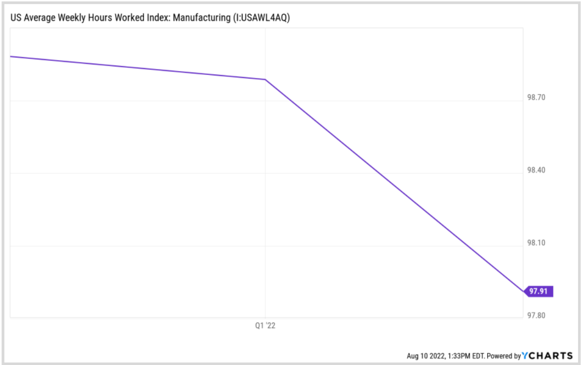
Historically, this composite usually signals a bear market recession six to nine months before a recession. It signaled a recession three months ago when the composite dropped below zero.



Following are charts and explanations of the major leading economic indicators:

Average Weekly Hours In Manufacturing (Long-Term Economic Directional Trend: DECLINING)

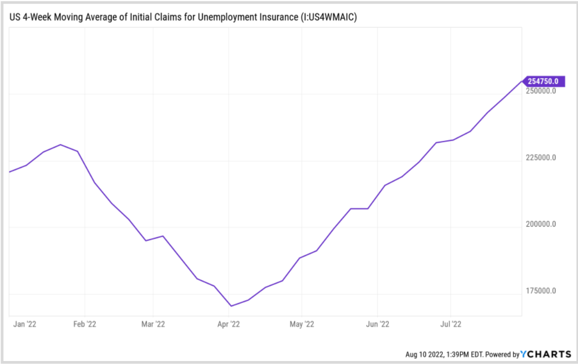
US Average Weekly Hours Worked Index: Manufacturing is at a current level of 97.91, down from 98.79 last quarter and down from 98.64 one year ago. **This is a change of -0.88% from last quarter and -0.74% from one year ago.**



US 4-Week Moving Average of Initial Claims for Unemployment Insurance

(Long-Term Economic Directional Trend: DECLINING)

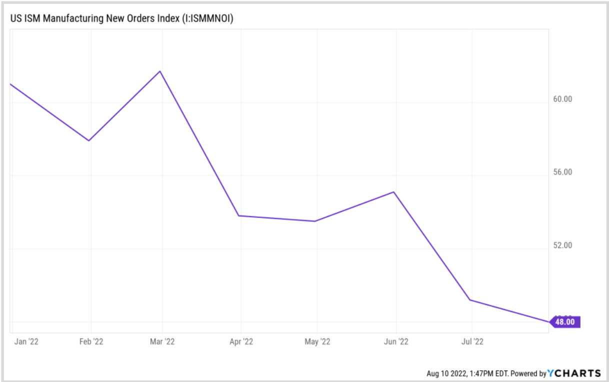
US 4-Week Moving Average of Initial Claims for Unemployment Insurance is at a current level of 254,750, up from 248,750 last week and down from 407,250 one year ago. This is a change of 2.41% from last week and -37.45% from one year ago. (*Note: On this chart, an upward movement is negative.*)



US ISM Manufacturing New Orders Index

(Long-Term Economic Directional Trend: DECLINING)

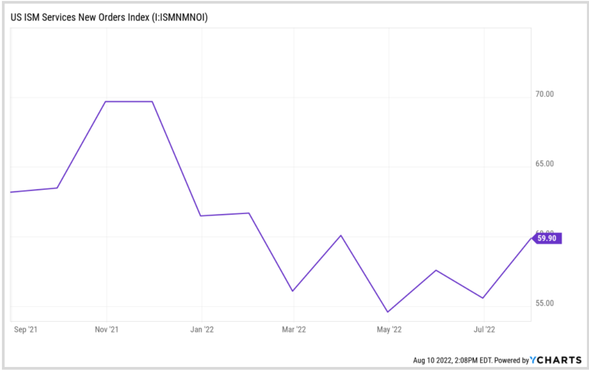
US ISM Manufacturing New Orders Index is at a current level of 48.00, down from 49.20 last month and down from 64.90 one year ago. This is a change of -2.44% from last month and -26.04% from one year ago.



US ISM Services New Orders Index

(Long-Term Economic Directional Trend: DECLINING)

US ISM Services New Orders Index is at a current level of 59.90, up from 55.60 last month and down from 63.70 one year ago. This is a change of 7.73% from last month and -5.97% from one year ago.



US Nondefense Capital Goods Excluding Aircraft New Orders

(Long-Term Economic Directional Trend: DECLINING)

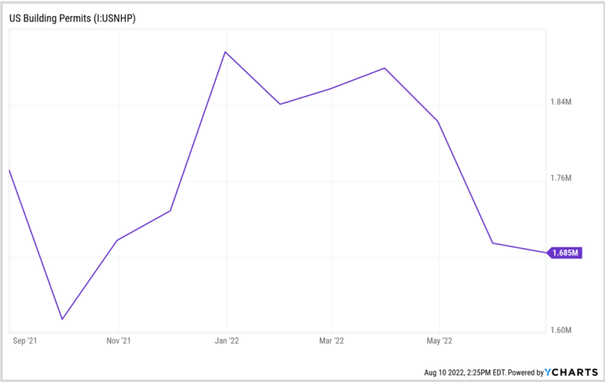
US Nondefense Capital Goods Excluding Aircraft New Orders is at 0.73%, compared to 0.50% last month and 1.91% last year.

US Building Permits

(Long-Term Economic Directional Trend: DECLINING)

US Building Permits, as defined by the Census Bureau, is the approval or authorization by the government to legally work on construction projects in permit-issuing places, in this case, specifically for new privately owned housing units. An increase in building permits is a leading indicator of the health of the US Housing sector and the US economy. US Building Permits declined between 2006 and 2009, reaching a trough in March 2009 of 513,000 building permits as sentiment in the US housing market fell drastically during the housing bubble.

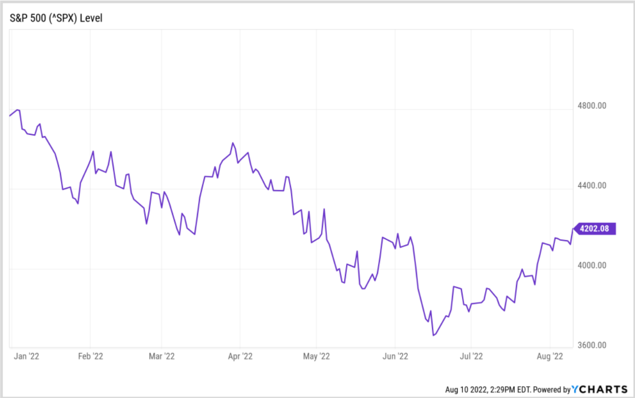
US Building Permits is at a current level of 1.685M, down from 1.695M last month and up from 1.661M one year ago. This is a change of -0.59% from last month and 1.44% from one year ago.



S&P 500 Index

(Long-Term Economic Directional Trend: DECLINING)

The S&P 500 index covers the 500 largest companies in the United States. These companies operate in various economic sectors. The S&P 500 is one of the most important indices in the world as it widely tracks how the United States stock market is performing. The S&P 500 has had several significant drawdowns greater than 40% during recessionary periods, including in 1974, 2002, and 2009. As of the market close on August 9, 2022, the Index was down year-to-date -13.5%.



10-2 Year Inverted Treasury Yield Curve

(Long-Term Economic Directional Trend: DECLINING)

The 10-2 Treasury Yield Spread is the difference between the ten-year and two-year treasury rates. A 10-2 treasury spread approaching 0 signifies a "flattening" yield curve. A negative 10-2 yield spread has historically been a precursor to a recessionary period.

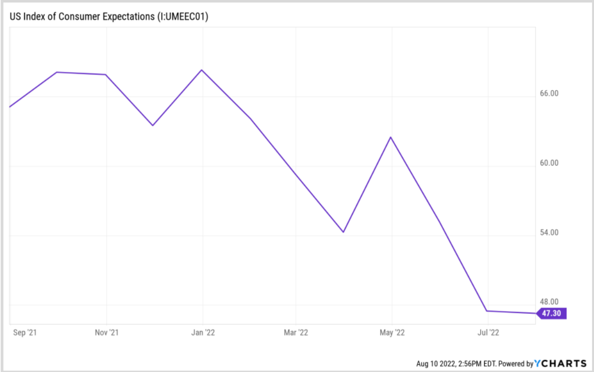
A negative 10-2 spread has predicted every recession from 1955 to 2018, but has occurred 6-24 months before the recession occurred, and is thus seen as a far-leading indicator. The 10-2 spread reached a high of 2.91% in 2011 and went as low as -2.41% in 1980.

The 10-2 Year Treasury Yield Spread is at -0.48%, compared to -0.44% the previous market day and 1.10% last year. This is lower than the long-term average of 0.92%.

US Index of Consumer Expectations

(Long-Term Economic Directional Trend: DECLINING)

US Index of Consumer Expectations is at a current level of 47.30, down from 47.50 last month and down from 79.00 one year ago. This is a change of -0.42% from last month and -40.13% from one year ago.



US Weekly Economic Index

(Long-Term Economic Directional Trend: DECLINING)

US Weekly Economic Index is at a current level of 2.95, down from 3.30 two weeks ago and down from 8.97 one year ago. This is a change of -10.61% from two weeks ago and -67.11% from one year ago.

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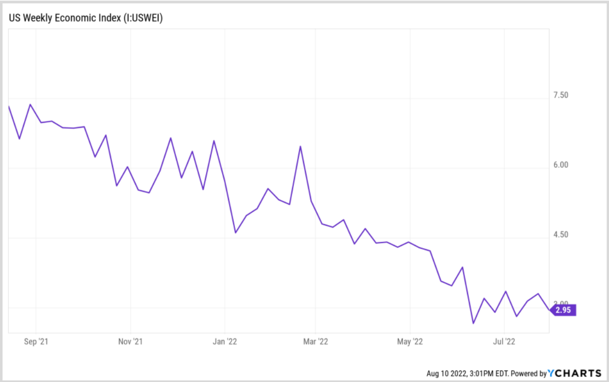
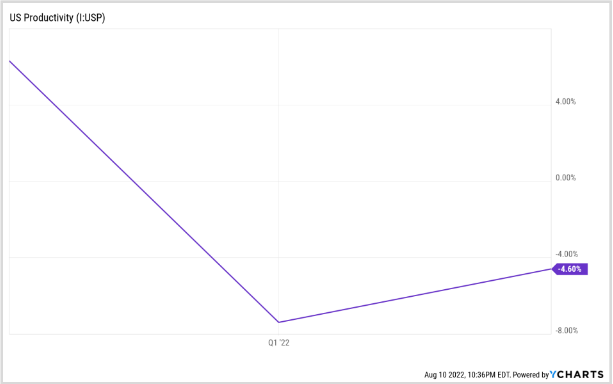


US Productivity
(Long-Term Economic Directional Trend: DECLINING)

US Productivity measures the quarter-over-quarter percent change of labor productivity, measured as output per hour worked of non-farm business employees. As productivity per hour worked grew in the long run, the results reflect positively on the overall economy. Through the 2000s, the increased usage of technology in the workplace led to more productive hours worked.

US Productivity slumped for the second-straight quarter. It is at -4.60%, compared to -7.40% last quarter and 3.20% last year. This is lower than the long-term average of 2.14%. This marks the weakest back-to-back readings in data going back to 1947. On a year-over-year basis, output per hour fell by the most ever on record.



The United States Is Headed For A Bear Market Recession

Every one of the major leading economic indicators above has declined over the past 12 months. That confirms the recession signal from the ECRI Weekly Leading Economic Indicators composite three months ago.

Now is not a time to take risks with your investments. Now is a time to manage risk, play defense, and preserve your investment capital.

Paul Dietrich, *Chief Investment Strategist,* B. Riley Wealth Management

Paul Dietrich is focused on managing investments for private investors, retirement funds and private institutions throughout the United States. He also serves as a frequent on-air commentator and regularly contributes market analysis to business and financial media including *CNBC, Fox Business, Bloomberg TV, CNN, The Wall Street Journal, Yahoo! Finance, Reuters* and *The Washington Post.*