



**MACRO Voices**  
with hedge fund manager Erik Townsend

## Lakshman Achuthan: Leading Indicators Say The Bear Market Has Not Ended

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**Erik:** Joining me now is Lakshman Achuthan, co founder of the [Economic Cycles Research Institute](#), Lak prepared a slide deck to accompany today's interview. Listeners, you'll find the download link in your research roundup email. If you don't have a research roundup email, just go to our homepage [macrovoices.com](#). Look for the red button above locks picture that says looking for the downloads. Lock, it's great to get you back on the show. Before we dive into the slide deck, I want to start with a super novice topic because it seems like we need to revisit it. Given a lot of politics lately. Let's start with the definition of what a recession is. I actually surprised myself recently, before President Biden changed the definition so to speak, I had said on the air that the neighbor definition the official National Bureau of Economic Research definition of a recession was two consecutive quarters of negative GDP growth. And I have more aggressive fact checkers than Donald Trump. So I was overwhelmed promptly, by listeners said, nope, you got it wrong. That's not it, you should get Lak back on the show, in order to teach you what in a recession really is. And that was before President Biden repeated my mistake. So let's start with recessions. But really as investors, what are the key things we need to understand about how recessions? What role they play in economic cycles and what they mean to us?

**Lakshman:** Thank you so much. And I'm really grateful to your listeners, and to you for asking the question and really wanting to understand what a recession is, I certainly find it fascinating. You know, they call it the Achilles heel of the free market oriented economy, which is not a knock on the free market. But it's just a feature of, kind of ebb and flow that we have, when we allow a free market to run, which is what we're generally trying to do. So a recession, first and foremost, one of the things is it's not a statistic, it's really a process. And I think that that trips people up. Certainly, it's easier if you could boil it down to a rule of thumb, like two negative quarters of GDP back to back. And that's a decent rule of thumb isn't a bad one. But it's not a necessary nor a sufficient condition for recession, defined as this process, that a free market goes through a business cycle. So we're literally talking about a contraction, a recession is a contraction when the level of economic activity falls on, so it's contracting. And when we say economic activity, we have to define that or we don't actually have to define it, we know we have to remember what it is. My mentor, Geoffrey Moore, his mentor was a man named Wesley Mitchell who defined what a recession is, and he helped set up the NBER. So it's a pronounced, pervasive and persistent decline in broad measures of output, employment, income, and sales. And so, we do have broad national accounts on those four different types of measurements of

broad economic activity. So you can think of GDP or industrial production for output. The jobs data, there's lots of different jobs data, nonfarm household, all kinds of different job activity, labor market activity data, there's broad income, and there's very broad sales much broader than retail sales, aggregate sales data for the economy. And in retrospect, because these are government data series, in retrospect, after the revisions are done and those can take many months or even a little longer, when those revisions are done, you can see with some clarity, when the peak and the trough and the level of activity occurred on a pronounced pervasive and persistent basis.

So in the current environment, the thing that I think needs to present itself which has not presented itself yet for a recession to kind of be underway, is clear evidence of falling labor market activity. We have some evidence of that, but not clear evidence of that. For example, household has fallen a little bit but nonfarm has not. And it won't be a recession unless there is a contraction in jobs, the level of jobs are falling. Same goes for income, sales and output. So that's broadly speaking what a recession is. That's the target the business cycle. Wesley Mitchell had named his book where he outlined this the business cycle, the problem, and its setting. And so that's the world, that's the pool we're swimming in. We're trying to figure out what's going on inside of that environment. And to do that we track the coincident data that helps define the cycle. And then more importantly, I think, for investors and speculators and decision makers, is what are the leading indicators doing, which we'll certainly get into the reason recessions can be important for investors or business managers, is because of what they do to demand growth, primarily, which can impact earnings growth. And the fact that it's pronounced, pervasive and persistent. Meaning it's not just one section of the country, or one sector of the country. It's pervasive, meaning it's hard to hide from it. There are some kind of non cyclical, less discretionary areas, but they probably get tagged a little bit, too, during recessions. And so let me stop there, just having set the table with it with the definition.

**Erik:** Let's move forward to where we stand in economic history right now. You predicted more than six months ago, last time I had you on the show, you predicted a recession was coming. I've predicted a recession was coming. Now, the White House has said this, whatever it is that we have, this is not a recession, right? Obviously there's some politics in this, but is there room to say because you just said a minute ago, we don't really have the confirmation we need in the in the employment data. Is there room to say this is not a recession? Or we're not going to have a recession? Is there room to say that or is that just political nonsense?

**Lakshman:** I'll agree with half of what you said and disagree with the other half. So, I will say there's room to say we're not in a recession. I think that, that seems clear to me that there is room to say that we are not in recession at this moment. The only hesitancy I have on that is that there have been some episodes where the decline in jobs began after the start of the recession. And this gets a little complicated in terms of recession dating, which is a little bit of an art more arcane thing. But technically speaking...see, none of these things, again, going to the beginning of my comment, recession is really a process. It's not a statistic. So it's unlikely that these four things output, employment income and sale or sales are all going to decline at the same moment, right? They all declined in June or July, right? It would be weird if that

happened, but they'll generally decline in the vicinity of one another. And we'll have to do some clustering work to figure out like, Okay, if one of them peaked four months ago, and one of them peaked two months ago, where's the peak, right? And you have to get into the innards of deciding where the actual peak is. But it's not impossible. And we have seen in particularly, interestingly enough, in the 70s, when it was kind of a more inflationary time, there were big swings and inflation, where jobs growth associated with some of those recessions continued into the recession, and then started to contract. So that's my only hesitancy on saying, yeah probably, it probably hasn't begun. But more importantly, I think, then that is what the leading indicators are doing. Because there's no ambiguity there. There's a pronounced pervasive and persistent decline in the indicators, and I included some of that in the deck that we'll go through that are just clearly recessionary.

**Erik:** Well, let's go ahead and dive into the slide deck then and take a look at some of the indicators that you follow and what they're telling us about where we stand in the cycle now.

**Lakshman:** Sure, so I'm sharing a deck. This is something I had shared privately a little bit ago, and happy to share it publicly now. So on page or slide, believe it is four, we're going to see a chart of our indexes for the overall economy. And then you'll see shaded areas on that chart, which will conform to growth rate cycle downturns when the growth of the economy is, is decelerating. And the bottom line is a coincident index, it contains all of those measures of output, employment, income and sales. And that marks off basically the shaded areas. When the blue lines decelerating, you have a growth rate cycle downturn when it's contracting, you're in recession. And when you're in the white areas, you're in an upturn and oversimplifying, but for decision makers risk on during the white areas and risk off during the shaded areas, okay? And then we can get into the nuances of that.

So you see, the blue line has not gone negative yet, it's being held up partly by employment, or mostly by employment. And so that's why I'm saying now we're probably not in recession at this moment. Now, look at the leading indexes, you've got the short leading, the weekly leading, and the long leading there. And when you're looking at those, you could see immediately how they move in sequence. And particularly, I'm drawn to the transition moments between the shaded and the white areas. And so, the long leading index peaks well inside the white area, and begins moving down. That's followed by the weekly leading index, which is followed by the short leading index, when the long leading index has turned. And by here, when I'm saying turned, meaning I'm using shorthand for internally, what we do internally at [ECRI](#), which is what we're looking at how pronounced, pervasive and persistent is the decline in that index itself. And we're getting inside of it, and comparing it to past cycles, and so on and so forth. It's so all very objective. If we're convinced that there's a so called three P's downturn in the long leading index, now we have a prior, we have a prior view, that we're receiving the incoming information on the shorter leading indicators with. And in a way, we can kind of jump on those turns a little quicker with the prior view, we build our conviction levels with the prior view. And it's pretty evident visually that we're in pronounced, pervasive and persistent declines, you can start to see that some of the declines in the indicators have not been seen outside of recession. There's this forward looking indicators, the long leading index right now.

For example, I'll call out something on the chart for you is the worst it's been since the great recession. And mind you, that part of the reason it was worse, during the Great Recession is, of course, because of Lehman, right? So, there was this big event that really kind of shot things even further to the downside. Lehman, of course, did not cause the recession. But it was a feature of that story. And it remains to be seen if there's any kind of event of some sort, some big thing that occurs in the current cycle. And the other thing I would call out here on this chart, and we can move on, is that they haven't turned up those forward looking indicators. So, a couple of weeks ago, you know, people may have been thinking like, hey, you know, the FOMO, right, the fear of missing out, am I missing something? Is the market onto something that I don't know about? Is there some soft landing out there, that I need to be worried about and these indicators were indicating? Of course, no, there is no upturn out there, at least not in as far as we can see, which is for a couple of quarters.

**Erik:** Let's talk about the timing of recession cycles versus market cycles, because the mistake that would be very easy to make is to look at one of these economic cycle charts and say, okay, recessions are the shaded areas, recessions are bad must mean that during the shaded areas, the stock market's going down, and during the clear areas, the stock market's going up. But it doesn't really work that way. Is there's a lead lag effect that comes into play? So when should we be most concerned? And if we're in a situation like we are now, where clearly these indicators have been selling off for quite a while now, does that mean we're bottoming or does that mean that the nastiness in the market is only just begun?

**Lakshman:** First off, I don't make market calls, it is not my expertise. I can weigh in from a cyclical risk point of view on the market. So these are all my caveats, and I'm thrown out ahead of talking, okay? There are times when the market, I want to call out two times specifically that the market blew through a recession was in 1945, when we were kind of reorganizing after World War II to peacetime, and the market just blew through the recession there. And the more interesting one, perhaps for consideration now is the late 1920s. And '26, '27, there was a recession. Of course, that's during the roaring 20s. And the market just blew through that recession. So this is a strong relationship between the business cycle growth rate cycles. And more importantly, I think, and the market, it's not like physics, there's not a hard and fast rule here.

If we flip back, if listeners can flip back to the chart on page three, we see some recent history of the S&P against growth rate cycle shading. This is, I think, a somewhat unique era, which we may still be in, we may not be in, of QE, following the Great Recession. So I'm just going to stipulate or assert that prior to the Great Recession, there's virtually a one to one correspondence between cyclical, pronounced, pervasive and persistent declines in the S&P and those shaded areas, the growth rate cycles, okay? Post GFC, in the QE era, what we see is that the persistence part of the decline in S&P is truncated. And so that's what visually I'm calling out, in this chart. You have growth rate cycle downturns, and then sharp corrections, major corrections associated with growth rates cycle downturns. But the persistence, you can see is instead of being a couple of quarters, it could be a few weeks. And it's over. So now,

ostensibly, and I honestly don't know, but ostensibly, we are headed into quantitative tightening, right? So you see the current growth rate cycle downturn, you see the correction, that's 24% correction? You know, I'm going to infer that most of that had to do with the rate hike cycle that started in March. And it was, it feels like it was a little less about earnings concerns. But I don't exactly know, I'm just kind of guessing that. And then we have that, that bounce that we had for the last couple of months. And now maybe we're slipping back down below 4000. I'm not I haven't seen the latest numbers today. But you can see that by our analysis, until we start forecasting a white shaded area, I would be careful. It's not that you're not engaged in the market. But you understand which way the wind is blowing, is what I would say. And if we are indeed, and this is an open question for discussion, if we are indeed moving into a QT environment, then the patterns could change from what I'm showing you here. Perhaps we get more to a more we move back to a more persistent decline around growth rate cycle turns. And let me just take a question if you have one there.

**Erik:** Okay, Lak, since you asked for the question, I'll hit you with what I think is the most challenging part of all this. The world has changed. We live in a world where the Fed and central banks in general play a much bigger role than they used to in markets. Does that invalidate any of the leading indicators that have been reliable in the past? Or not? And how should we adjust for the fact that, you know, it feels like what's going on here is, central banks are really much more in charge of the show than they ever were in the past. At least that's the way it feels to me. Does that change the way we interpret the old data from before it became that way?

**Lakshman:** Great question. Again, I love these questions. Because we get to step back a little bit and just be a little bit more thoughtful than the day to day stuff. And the answer, the big answer, the important thing there is, is the Fed and its actions messing with the framework with the cyclical indicators? And in particular, the leading indicators. And we're always asking that question, like, you know what could mess with the framework? Where does it break? And I'm relieved to tell you that no, it doesn't break. These indicators actually predate in many cases, the Fed and there were cycles. And there were markets. And these relationships, by and large held. What happens to the cycle as the structure of the economy has changed, including the advent of the Fed, is that the some of these relationships can change, like, I'm showing you how persistence of corrections got truncated in the QE era, the amplitude of the cycle can also change. By and large, I'm oversimplifying, but by and large, the size of some of the economic swings had largely gotten smaller. This is the so-called Great Moderation of the cycle. And maybe even the Greater Moderation. I think, Bernanke talked about that a little bit. Up until, of course, the Great Recession, when you had kind of a Minsky moment where complacency kind of evokes excess risk taking, which guarantees volatility.

So the free market has a way of kind of handling different types of manipulations, right? If you were in the current environment, QE could work as a policy. I mean, "work," I say that, in quotes, could work as a policy, when inflation is low. But when inflation is higher, it's not that all the central banks want to tighten. I don't know if it's in their DNA necessarily to be like, yeah, I really want to tighten around the world. But they have to, they're forced to. And what's particularly interesting in the current cycle is that they're forced to, even though the indicators or

the forward looking data is so recessionary. And that's a very toxic combination. So the advent, the interaction, the thumb on the scale of the governments and the central banks, in our experience, which is about now 100 years of research, right? I reached back to Wesley Mitchell, who taught Geoffrey Moore, who taught myself and others at [ECRI](#). And what we've learned is that if you're in a free market oriented dominated economy, so this can apply even for China, okay, then there's a cycle. I mean, it might be inconvenient, you might not want it, right. Whoever's in power at the moment certainly doesn't want these downturns, right? But that's the nature of the environment within which we are playing.

**Erik:** Let's spin this a slightly different way, Lak. Suppose that we were to look at the last 10 years and say, okay, so there's something significant that happened in history here, which is, we went from one central bank policy to this basically, quantitative easing era, where there were several years of quantitative easing. Now, we are supposedly about to begin a multi-year era of quantitative tightening. Now, without even getting into whether that's really, truly going to happen, because I think you and I are probably both pretty skeptical, it's really going to happen, but let's pretend that it's really, truly going to happen. Is it possible to look at the data and say, Okay, if the era of quantitative easing produced a certain set of results, then it should be possible to anticipate an opposite set of results from a period of quantitative tightening. Can we make those conclusions? Or is the data too complicated in order to draw conclusions like that?

**Lakshman:** I'm with you on the general thrust of it, right. I remember... I think it's President Reagan had a great quote. He was like, trust, but verify. And I love that. And so I hear something like what you said, and I kind of inherently trusted it, sounds like yeah, it makes sense. But I'd have to verify it. And that's where the cycle Indicators come in. We can have ideas like deflation, inflation eras, or QE versus QT eras, and what may happen as a result of that to grow through inflation. But then, at least for now, the near future looking out a few quarters, okay, we then switch over to our leading indicators as the kind of ruling radar screen that we're going to use to navigate. And so, for example, in the 70s, right? Yeah, we know that was a big inflationary decade, but it had huge inflation swings from like, 3% ish to like 12 percentage or something like that, right? So it was slamming up and down, up and down that volume. And therefore, even though structurally, we had this step up and inflation, you had to be able to kind of surf those cycles back and forth, where it would it would throttle back and then rev up again.

One of the slides that we presented in the deck does take a bit of a longer view, touching on the central bank policy and how it interacts with the economy. And that's on page 11. It's a different slide than I normally show you. And it, perhaps actually right before we get into that, because it's inflation related, which is related to the structural kind of fed questions anyway, maybe let's look at page nine real quick. So we just see the inflation gauge, because I'm then going to build on that inflation gauge for you. On the inflation gauge, the red line at the top, that's our US future inflation gauge. So that's conceptually, this is just a leading indicator, but it's not a leading indicator of growth, forget about growth, forget about growth rate cycles, business cycles, all that stuff. This is like a laser beam on inflation cycles, is its reason for being and in the fall of 2020. This took off in a three piece upturn, which is about halfway up that big rise that you see

on in the chart, and we made this inflation cycle upturn call in the fall of 2020, then it peaked out in the earlier part in the spring of 2021 around a 33 year high. And has a few quarters lead over inflation, and has been fairly gently off its peak since then. So cyclically speaking, regardless of all the money that's being poured out fiscally or from the banks, cyclically speaking, the peak and inflation is probably in. But the problem, of course, is that the magnitude of inflation is still going to remain high. And again, you can see that visually on this chart. And so the reason that I'm showing you this chart is because, as I said, in the spring of 2020, we had a pronounced, pervasive and persistent rise in that forward looking future inflation gauge. And that is critical information for understanding if you're going to get a soft landing or not, because now you can relate that information to the Fed.

So if you go to the next slide, I'm not sure if it's 10, or 11, but it's the one with all the dots on it, okay? And this basically tells you, if a soft landing is going to come to pass. I think there's a ton people talk about soft landings, and they're just kind of shooting from the hip. I think that it's very subjective, I think, as to if there's going to be a soft landing. So our research addresses the question in a much more systematic way, which I'm presenting here. And the conclusion is that the Fed must hike preemptively when underlying inflation pressures are rising. And so that's really the secret of a soft landing. So when inflation pressures are in a cyclical upturn, and I've pegged that, in the current cycle as the fall of 2020, the Fed has to nip it in the bud, then, okay, they need to do it right then. And so you see these vertical gray lines in this chart. And if the Fed starts to hike before, to the left of those vertical gray lines, you end up in with a good chance of engineering a soft landing. And so, you saw that in '83, '84. That's Volcker, helped generate a soft landing there. And you saw that in '94, '95, when Greenspan preemptively raised and then lowered rates. Now, if listeners can find the yellow dots on these charts, that's March of 2020. That's the current cycle. And that's really far away from that vertical gray line. Everything to the right of the gray line is a hard landing outcome on a rate hike cycle from the Fed. And so, we are squarely in hard landing territory. And they are just way behind the curve. And that's where you have whatever we had happened last week, where they're saying, look, we still are not fooling around, we still have to have to keep it tight.

**Erik:** Lak, you talk to clients all the time, who translate these economic outlooks into market outlooks. Let's talk a little bit about this environment. We're in the 3970s on the S&P as we're speaking right now, on Tuesday. A lot of people are looking at this chart saying, boy, the market was selling off hard into the middle of June, we saw a great big rally. And it's looking more and more like that has rolled over, we're at a point where it doesn't seem like it's set to continue any further. And maybe we're at the beginning of the next really big leg down. Is that the way to look at the stock market? Or is there room to say, you know, maybe the recovery has already begun,

**Lakshman:** I would lean towards the former, because the forward looking data is not even starting to really bottom out. And therefore, the prospect of going from like one of these shaded areas of downturns towards a shaded area, or wide area of upturns is extremely low. But it's just not on, it's not in sight yet. Now, the good news is we can only see a couple of quarters, two or three quarters ahead. So it doesn't mean this is indefinite, but it does say I would certainly be keeping some powder dry for now. Another way of thinking about this is that if we're right, and

then there's a recession in front of us. And we haven't even gotten to the global aspect of this but as a global recession, then you can ask yourself, the question is the market priced in declining earnings, like to what degree. And I know ex-energy, there has been some kind of come down in earnings expectations. But it doesn't seem to really reflect kind of the recessionary outlook as far as I can tell. And so that makes me lean towards staying, with the kind of risk off view in terms of these different assets. And so you can see that there's, there's a slide in there on junk, or whatever you call it high yield stuff and crypto stuff. And those will be great places to go. When we get some objective evidence of a cycle, bottoming and we just don't have that now. And that combination of the global indicators looking so weak, that's in one of the charts. And I just want to say this slowly, the largest proportion of central banks tightening around the world in history. That's a very difficult combination. And because remember, policy, the interest rate, the policy moves, work with long and variable lags. And when the economy, right, the market may try to react to it quicker. But in terms of all those loans, and all the resets and all the prospecting for business and deals, all of that stuff takes time to propagate through the economy. So these rate hikes still are going to be weighing on growth, even though the leading indicators are recessionary.

**Erik:** So Lak it sounds overall, like if I were to tell you that my interpretation of the S&P chart is we've probably seen the top of the bear market rally and just like happened in 2008, another summer when markets rallied pretty nicely, all until it really got ugly. It looks to me like the about to get ugly, could really be coming. Sounds like there's nothing that you have to say which counters that or says no, no, it's really looking great.

**Lakshman:** I'm with you. I'm smiling to myself, because I was on the one hand, I know Warren Buffett's in the news. It's his birthday and happy birthday to him. He, I think it was in '08 and maybe it's in the fall of '08. And he was like, you know, I love America and buying America and all this he was doing those stories. And there was another leg down. And now if you have the wherewithal to, to take a position and hold it for a year, yeah, we're gonna survive this recession and come out the other side and what doesn't kill you makes you stronger and all of that, you know, it is cathartic. But the leading indicators were not turning up in the fall of '08, right, they were still going down a bit. And we did get the recovery call. In March of '09, we had a growth rate cycle upturn call in April of '09 we had a business cycle upturn call. And, of course, the recession ended later that year. Mind you, when there is an upturn call, the markets are going to go risk on in a big way. And we're not market timing, but in risk management. The payoff for taking on risk in when there's a cyclical upturn, is much greater in the sense that the downside gets cut off. And so, since I'm not Buffett, that's how I'm approaching it.

**Erik:** Well Lak, I can't thank you enough for a terrific interview. But before I let you go, please tell our listeners a little bit more about what you do at [ECRI](#), what products are on offer there and how they can find out more about your work?

**Lakshman:** Yeah, sure. Well, thank you. And thanks for the time today. At [ECRI](#), we've done a lot of different things over the years. We're focused very much on partnering with clients to manage cycle risk, including, as I was just saying, when to embrace it again. And so we'll be



with investment managers, sovereign funds, pensions, hedge funds, and big companies, like a semiconductor company like Taiwan Semiconductor, or, or a consumer company had discretionary spend like Disney. And they use the information to do tactical stuff and their management. So you might have some mandate to be invested a certain way. But to the extent you have discretion, you can tilt with the cycle on managing risk. And certainly with businesses, if you see a downturn, you try to sell your product forward as best as you can, and then you and then you button up and ride out the storm. And if you do that better than your peers, then you can maybe buy them later on, and that's basically what we do and then rinse and repeat.

**Erik:** Patrick Ceresna and I will be back as MacroVoices continues right after this.