



**The Anatomy of a Recession:
What to Look for
and Where We're Headed**

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Probabilities vs. Possibilities

There's a long list of risks

China hard landing

Trump's policy agenda

Fed tightens

Dollar strengthens

Breakup of Eurozone

Japan's problems intensify

S&P earnings continue to decline

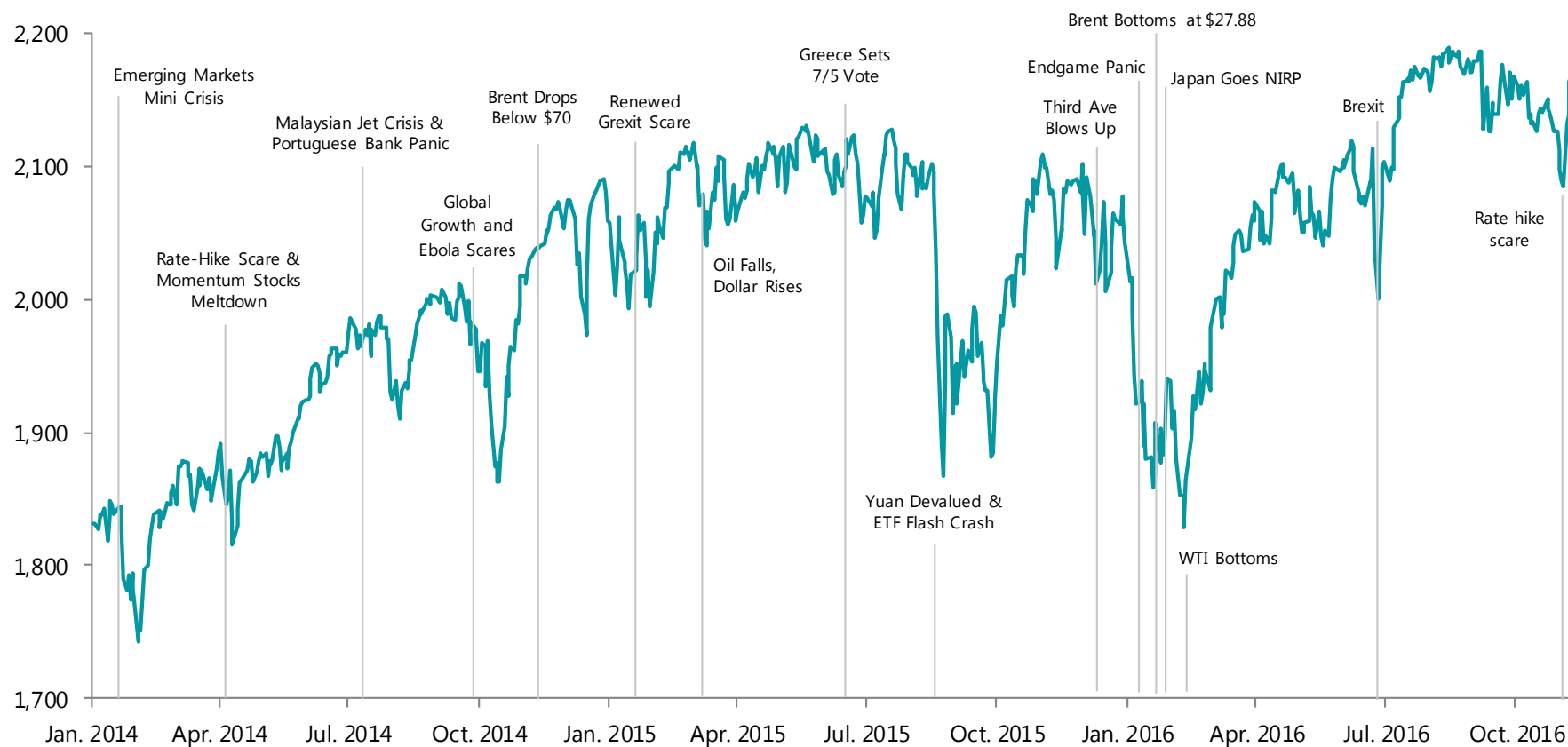
EM problems intensify

U.S. economy slows

Central bankers out of bullets

Unwinding QEs

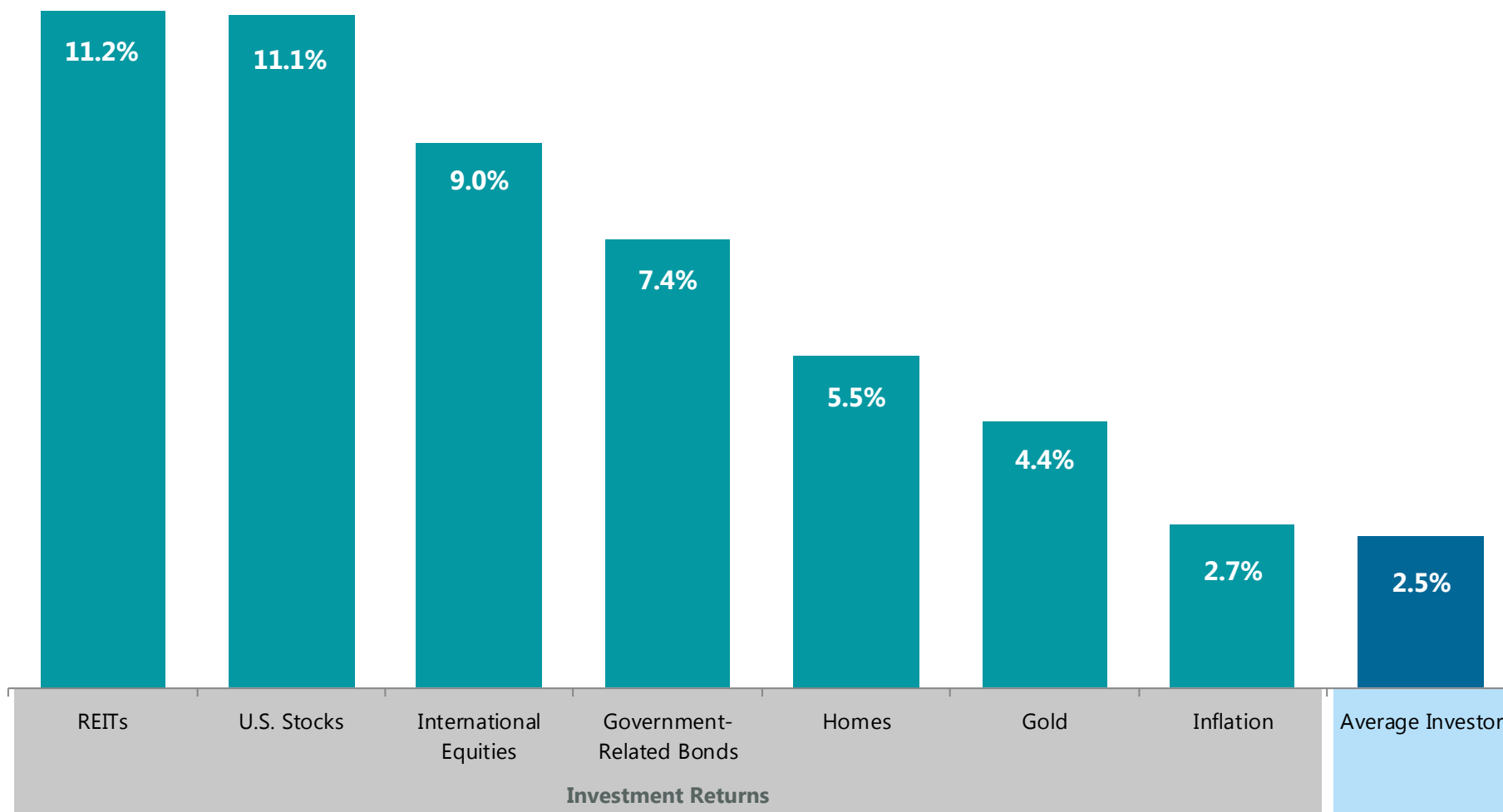
S&P 500 & Panic Attacks



"The definition of insanity is doing the same thing over and over again and expecting a different result."
- Attributed to Albert Einstein

Effects of Panic Attacks on Average Investors

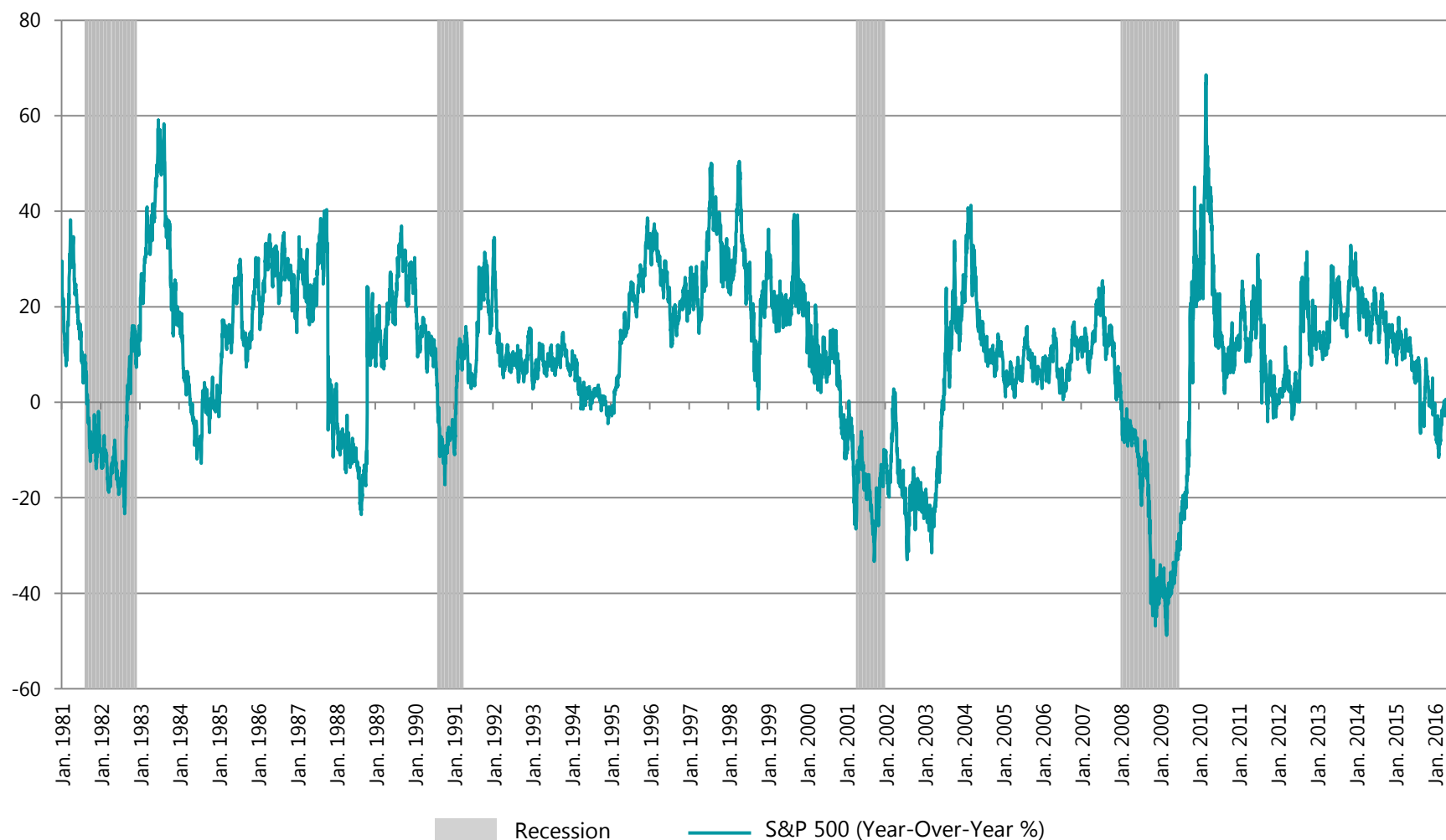
30-Year Annualized Returns % (1985-2014)



Source: Bloomberg. Dec. 31, 2014. Average asset allocation investor return is based on an analysis by DALBAR, Inc. which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Indices shown are as follows: REITs are represented by the FTSE NAREIT Equity REIT Index. U.S. Stocks are represented by the S&P 500 Index, International Equities are represented by the MSCI EAFE Index, Government-Related Bonds are represented by the Barclays U.S. Aggregate Bond Index, Homes are represented by U.S. existing home sales median price. Gold is represented by the U.S. dollar spot of one troy ounce. Inflation is represented by the Consumer Price Index. Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict the performance of any investment. **Past performance does not guarantee future results.**

Noise vs. Signal

- A market crash is a drop of 20% or more that lasts longer than 12 months
- Market crashes are typically the largest and longest market drawdowns
- Over the past 35 years, only one market crash hasn't been accompanied by a recession



1929 vs. 1987

The Great Depression: 1929



Black Monday: Truly an Outlier?

"All the News That's Fit to Print"

The New York Times

NEW YORK, TUESDAY, OCTOBER 26, 1987

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STOCKS PLUNGE 508 POINTS, A DROP OF 22.6%; 604 MILLION VOLUME NEARLY DOUBLES RECORD

U.S. Ships Shell Iran Installation In Gulf Reprisal
Offshore Target Topped a Base for Gunboats

By STEVEN V. ROBERTS
Special to The New York Times

WASHINGTON, Oct. 25 — United States naval forces struck back in Iran today for attacks on American-registered vessels and other Persian Gulf shipping by shelling two connected offshore platforms that American officials said were a base for Iranian gunboats.

A few hours later, a naval command detachment boarded a third platform five miles away and destroyed radar and communications equipment, Pentagon officials said.

No American casualties were reported in the action, which occurred 120 miles east of Bahrain at about 2 P.M. (7 A.M. Eastern daylight time).

A 30-Minute Warning

American officials said the striking force took pains to avoid killing Iraq ships, giving the crews on the Iraq vessels a 30-minute warning before their destruction, according to three aides away, began the shelling.

At the United Nations, an Iranian delegate said "several innocent persons" had been killed in the attack, but the American could not be convinced.

With the bombardment, the American trainees intended to send a message to Iran. The Times today had shown an

Does 1987 Equal 1929?

By ERIC GELMAN
Special to The New York Times

As stock prices soared this year, a Moore, director of the Center for International Business Cycle Research at Columbia University.

News

Analysts

Individuals and the nation.

The quick answer, many economists say, is no. The huge boom on Wall Street continues a traditional flow in the economy at large. But there are many judgments on "Black Monday."

Is he sure, there are some unsettling similarities between the current era and the post-Depression years. Like the roaring Twenties, the 1980's have seen an escalating boom. Wall Street, now as then, individual and corporate debt are high, and some sectors of the economy are extremely weak. Trade imbalances are strained, with government borrowing growing.

But today's economy is better equipped to handle financial shocks. "I don't see this decline in the stock mar-

A Huge Blow to the Five-Year Bull Market

The Dow Jones Industrial average, which has been surging since August 1982, began a dramatic fall today that continued through yesterday when it ended at 1,729.74. (Shown: Weekly close of the Dow.)

Worldwide Impact

Frenzied Trading Raises Fears of Recession — Tape 2 Hours Late

By LAWRENCE J. DE MARA
Special to The New York Times

Stock market prices plunged in a tumultuous wave of selling yesterday, giving Wall Street its worst day in history and raising fears of a recession.

The Dow Jones Industrial average, considered a benchmark of the nation's health, plummeted a record 508 points, to 1,729.74, based on preliminary calculations. That 22.6 percent decline was the worst since World War I and far greater than the 12.8 percent drop on Oct. 26, 1929, then along with the next day's 11.2 percent decline recorded the Great Depression.

Since hitting a record 3,211 in August 1929, the Dow has fallen almost 1,600 points, or 49 percent, putting the blue-chip indicator 137.3 points below the level at which it started the year. With Friday's plunge of 508.55 points, the Dow has fallen more than 20 percent in the last two sessions.

Unprecedented Trading

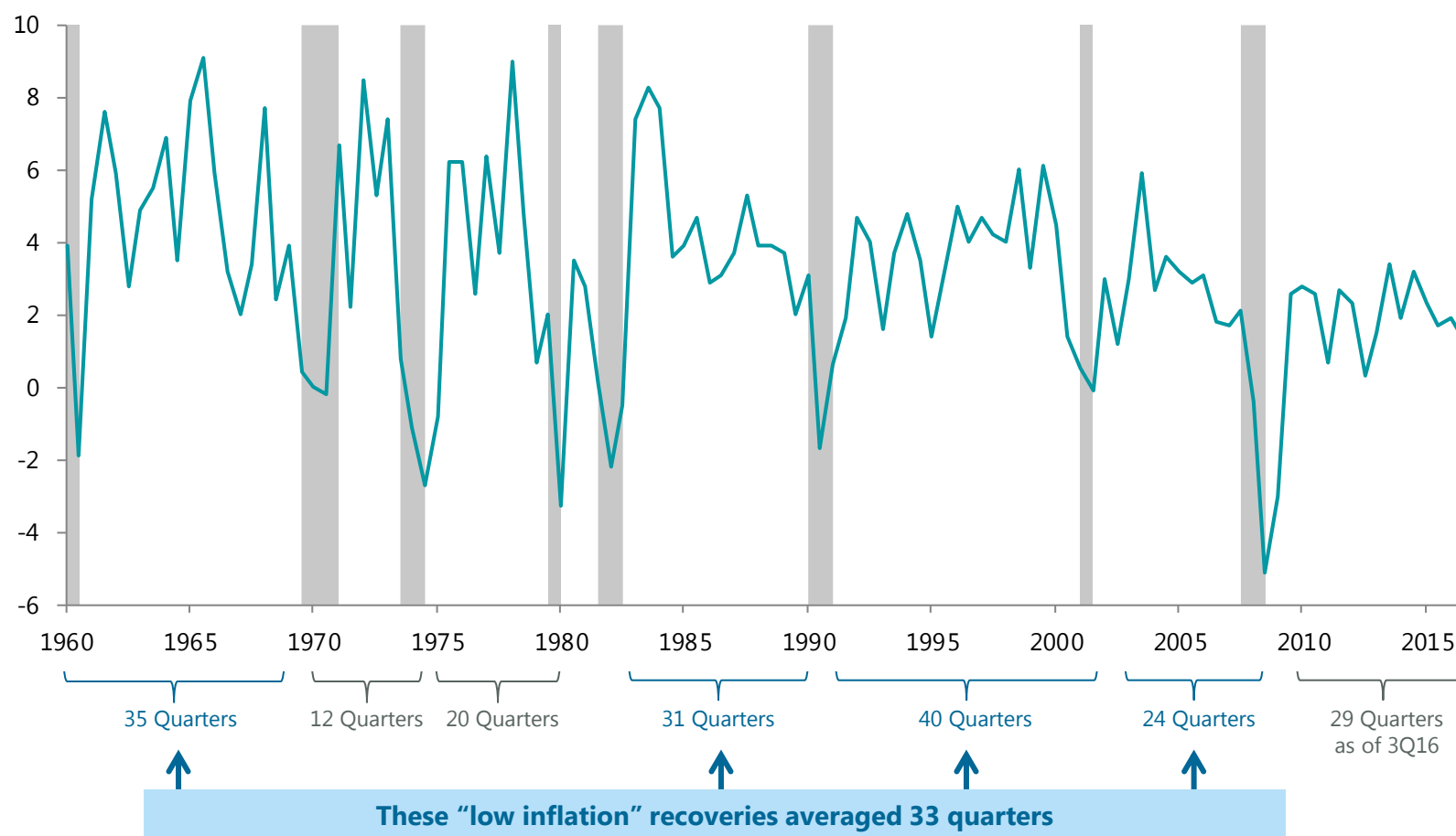
Yesterday's frenzied trading on the nation's stock exchanges lifted volume to unheard-of levels. On the New York Stock Exchange, an estimated 604.3 million shares changed hands, almost double the previous record of 328.3 million shares set just last Friday.

With the tremendous volume of "longer" trading on the New York

Recovery/Expansion

U.S. Real GDP

- Recoveries (1960-2007) averaged 27 quarters
- Low-inflation expansions tend to be longer than high-inflation expansions
- Currently recovery is still shorter than average low-inflation expansion



All About Context

PAIR:

Two corresponding persons or items, similar in form or function and matched or associated

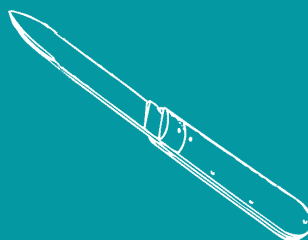
Example:
A pair of shoes



PARE:

To remove the outer covering or skin with a knife or similar instrument

Example:
Pare an apple



PEAR:

A fruit with a spherical base and a tapered top, as well as the tree that bears this fruit

Example:
Eat pears



U.S. Recession Risk Indicators

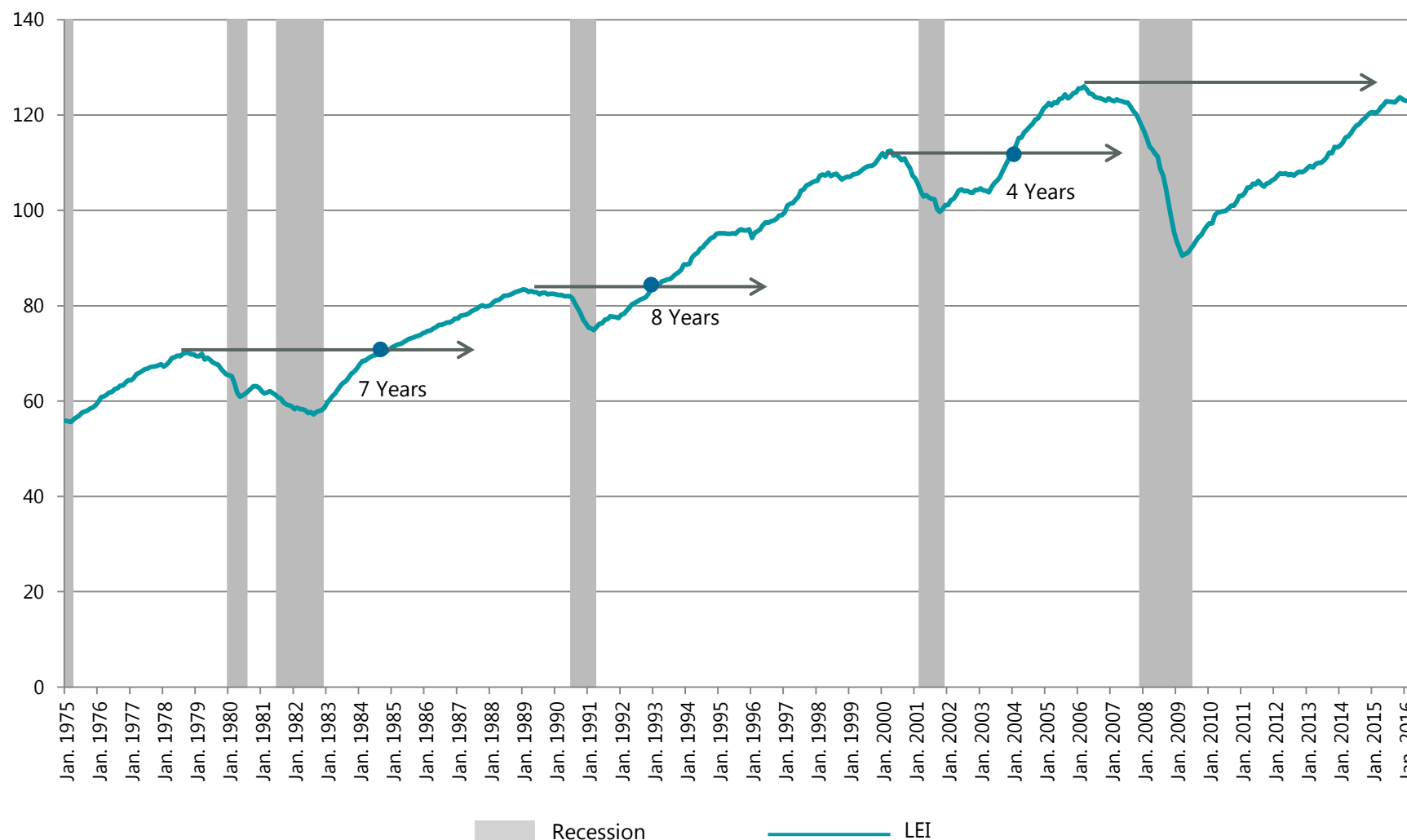
- 11 indicators have historically foreshadowed a looming recession
- Only corporate profits signal risk right now

	Recession Signal
Average Hourly Earnings (3 Mo. Avg. Y/Y%)	No
PCE Deflator (12 Mo. Avg. Y/Y%)	No
CPI Energy (12 Mo. Avg. Y/Y%)	No
10-Year Treasury and 3-Month T-Bill Spread (3 Mo. Avg.)	No
Consumer Non-Mtge. Delinquency Rate (ABA)	No
Corp Profits Fin and Nonfin % GDP (2 Yr. Avg.)	Yes
High Yield Spread	No
Housing Permits	No
Dollar Strength	No
Temporary Worker Trend	No
Four-Week Average of Initial Claims	No

LEI Suggests U.S. Recession Years Out

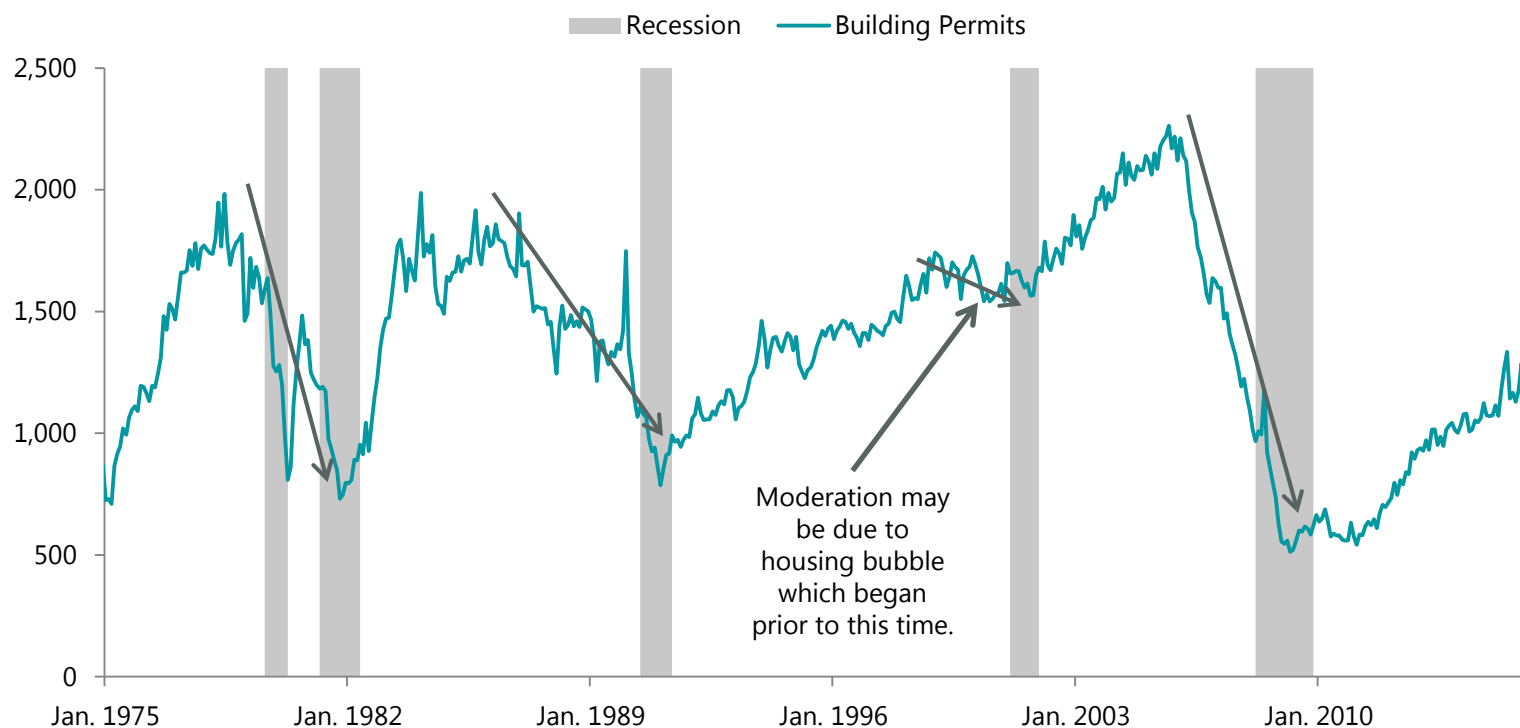
U.S. Leading Economic Indicators

Average of 6.33 years to the next recession



Building Permits for New Private Housing Units

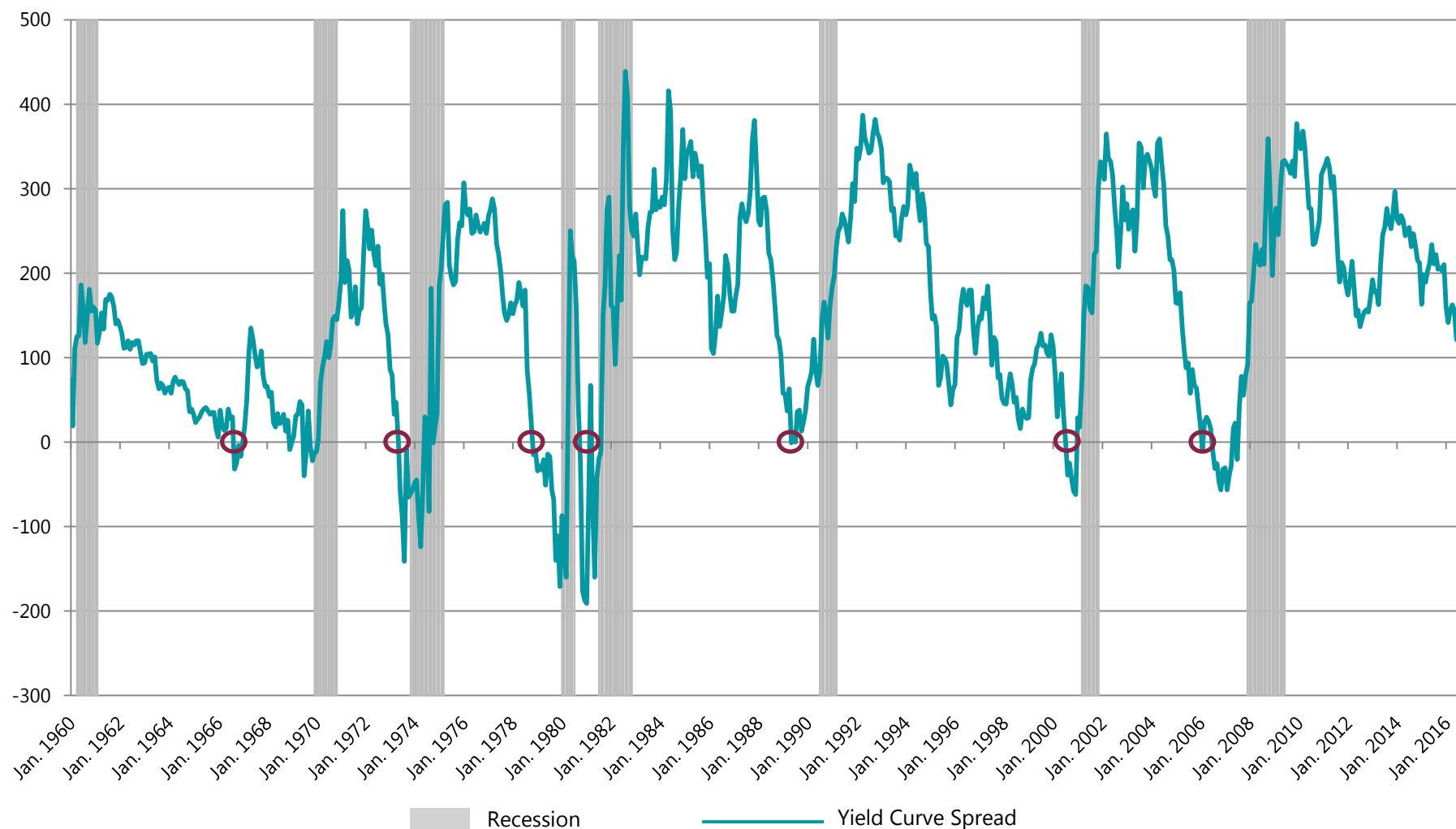
Thousands of Units



Yield Curve Spread

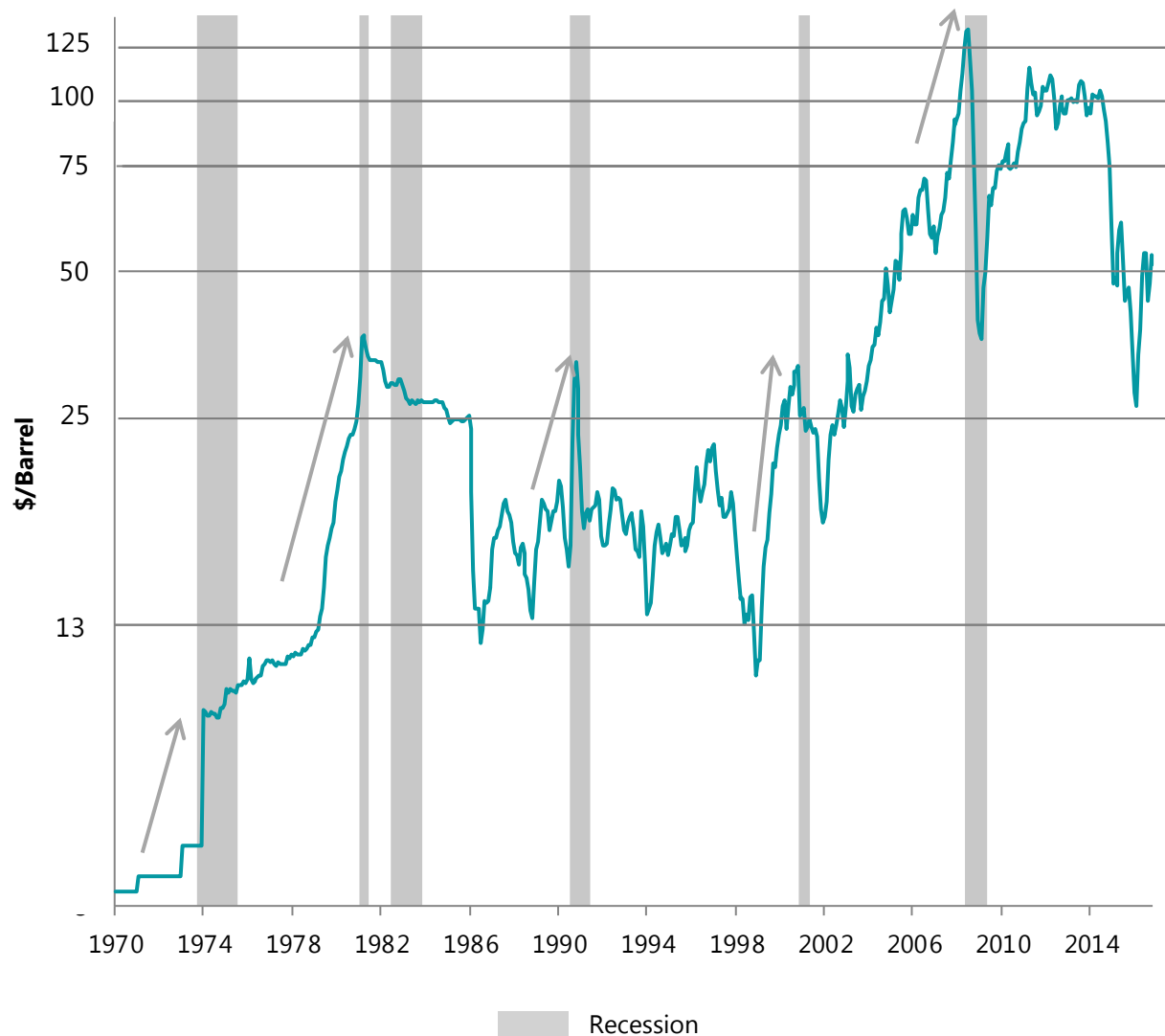
10-Year Treasury Bonds Minus 3-Month T Bills

**Yield curve spread less than zero (inverted)
occurs prior to recessions.**

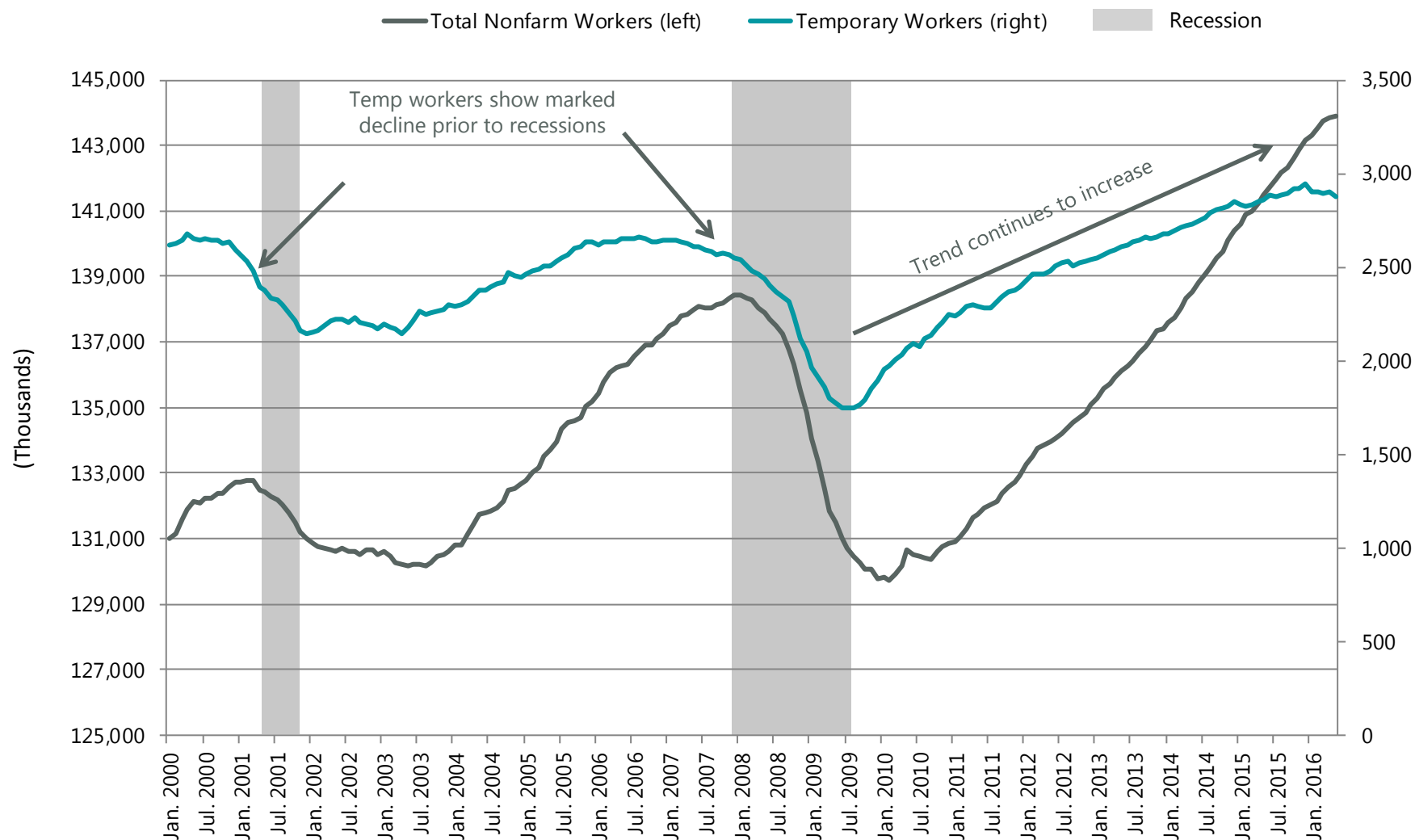


No Oil Price Spike

West Texas Intermediate Crude Oil



Temporary Workers Employment Trend



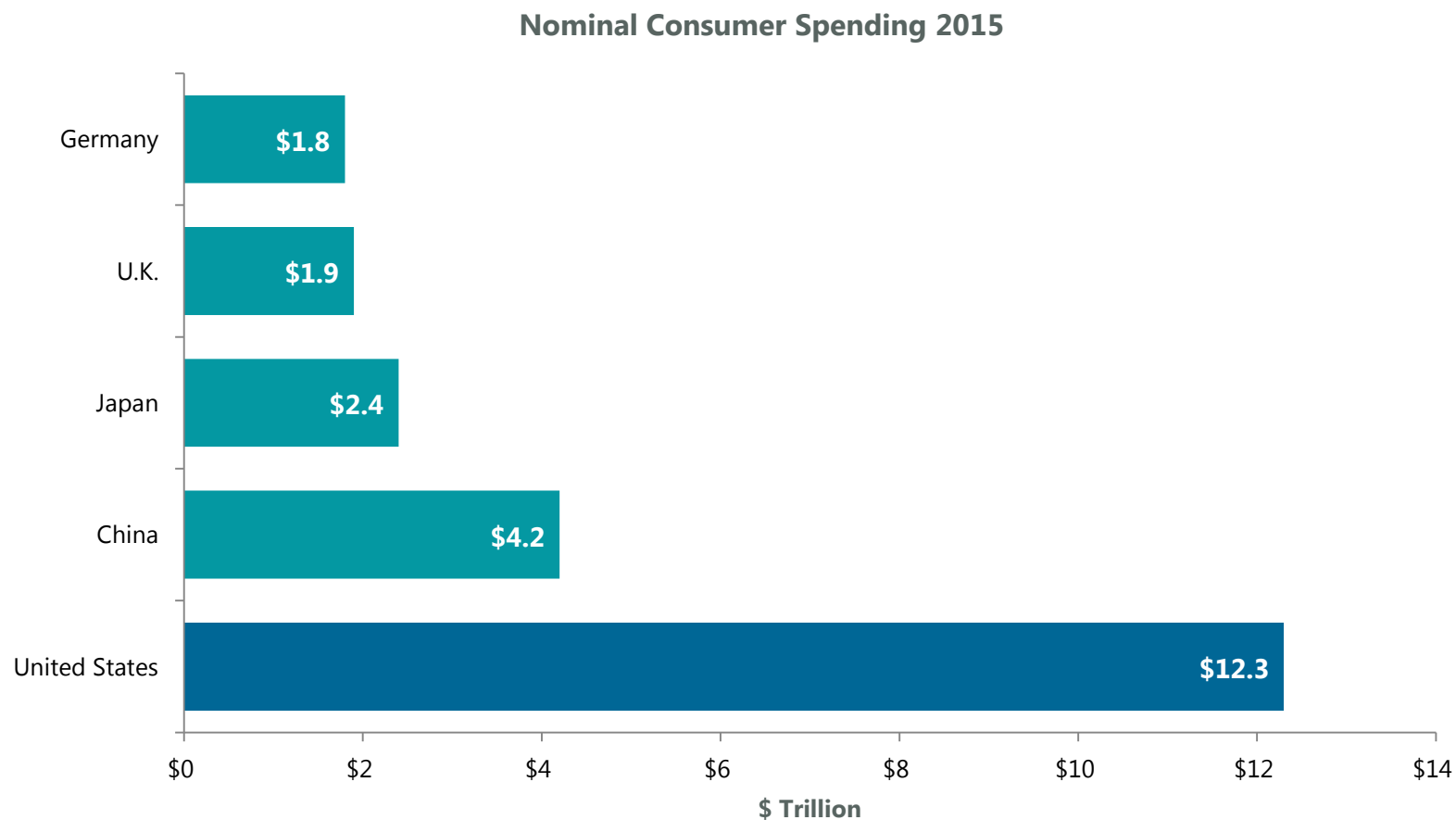
The Consumer is King in the U.S.



The Consumer is King in the U.S.

U.S. Consumer Spending Is Largest in the World

- U.S. consumer spending is larger than the next 4 largest countries (China, Japan, U.K., Germany) combined



One Year Outlook

Themes That Will Drive the Market Over the Next 12 Months



**Trump's
Presidential Agenda**



China



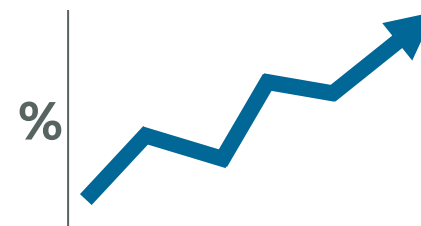
Europe



U.S Dollar



Corporate QE



Interest Rates

Market Perspective

Post-Election Sector Winners and Losers

Industrials

- Increased infrastructure spending to spur demand for construction and engineering firms
- Greater defense spending is a short-term positive for defense contractors
- Commitment to American shale revolution should spark renewed business for suppliers to energy industry

Health Care

- Worst-case drug pricing legislation off the table, eliminating major risk for biopharmaceuticals
- Repeal/reform of Affordable Care Act should expand opportunities for managed care
- Changes at DoJ could pave way for proposed managed care mergers to be completed
- Coverage rollbacks would hurt hospitals and Medicaid managed care

Financials

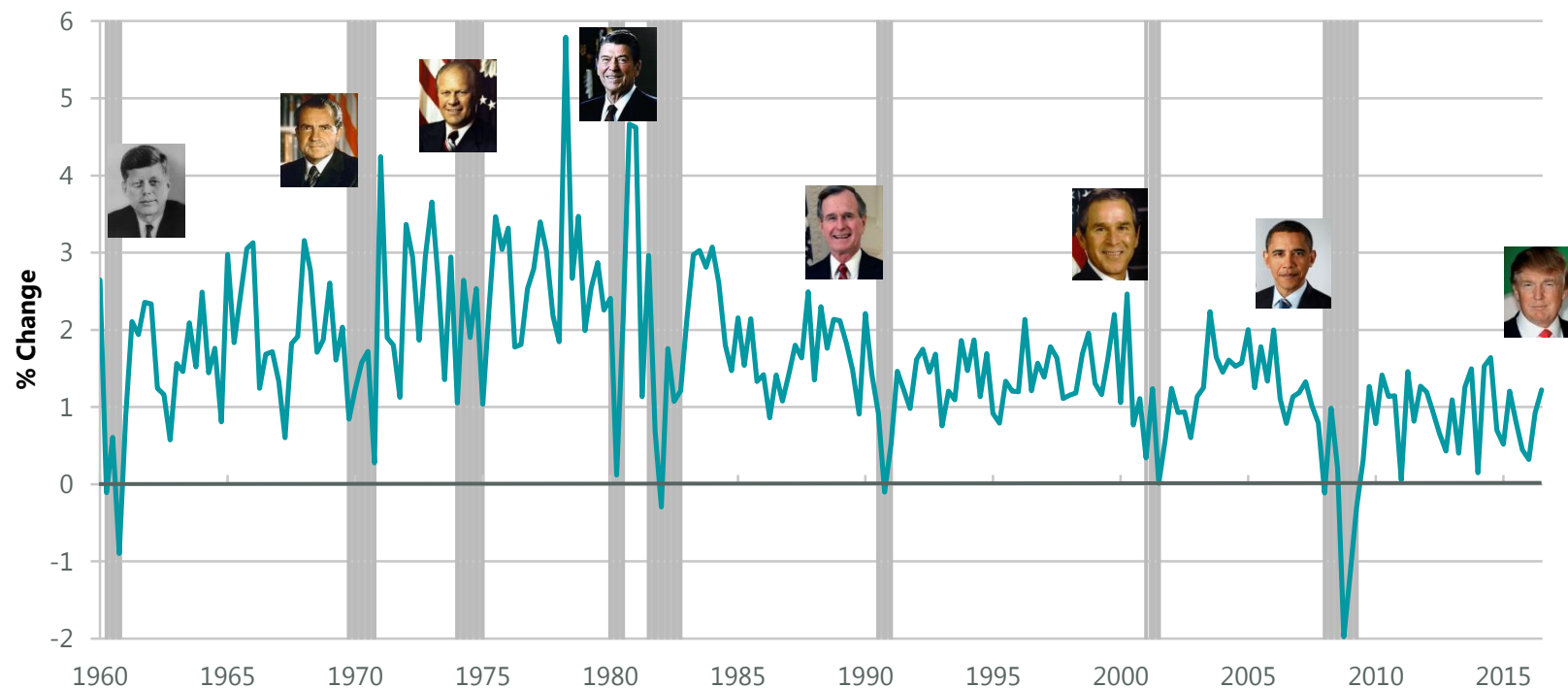
- Simplified regulation should lower costs, boost loan growth for all banks
- Regional banks would benefit most from lower regulatory burden
- Higher interest rates due to better growth would benefit insurers, spread-oriented lenders

Negatives

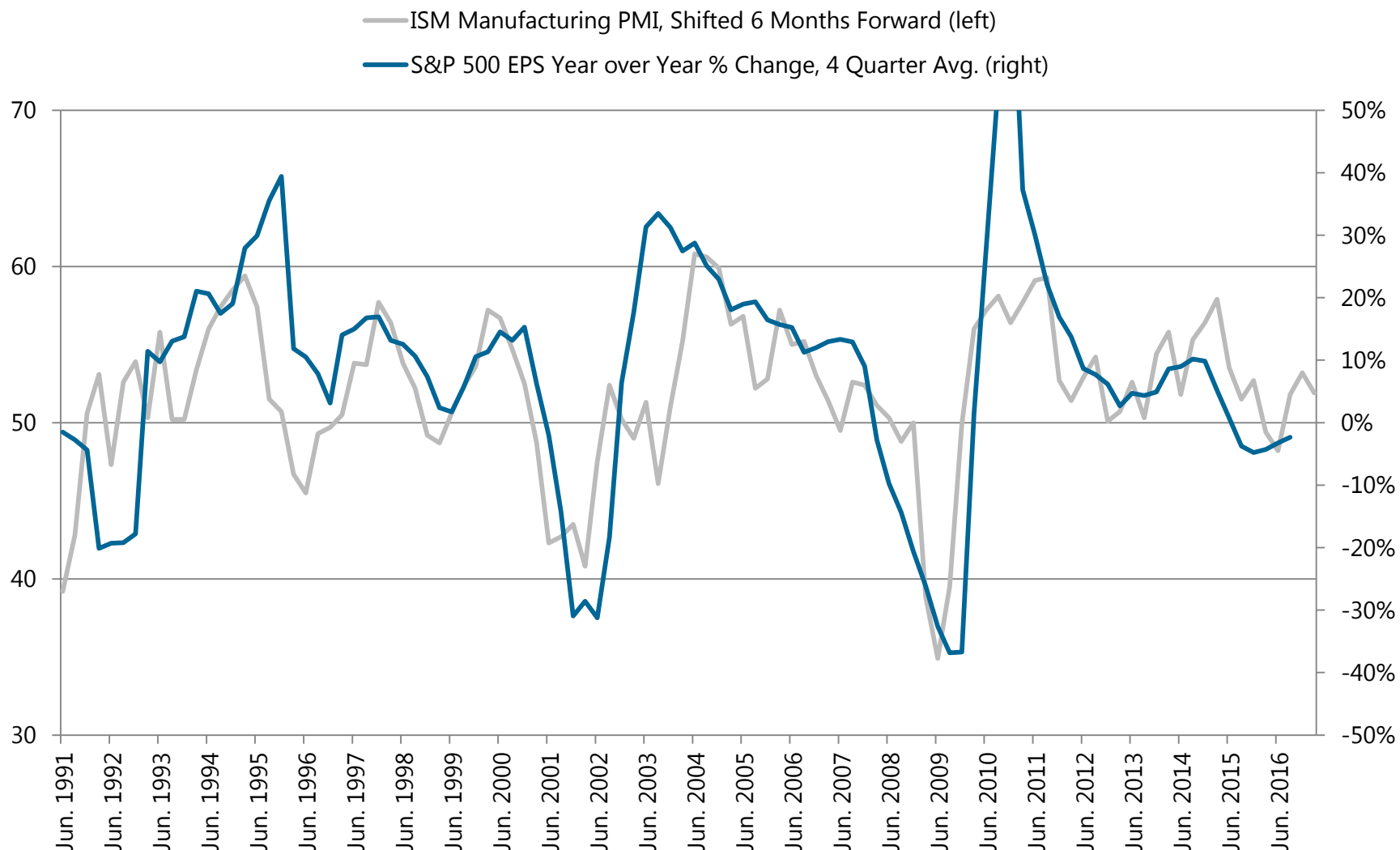
- Trump's advocacy of fossil fuels a headwind for utilities and renewable energy producers
- Protectionist agenda impacting trade and immigration could hurt sales for multinationals in the technology and consumer sectors; IT hiring

Fresh Faces in White House Met by Recession in First Year

Gross Domestic Product

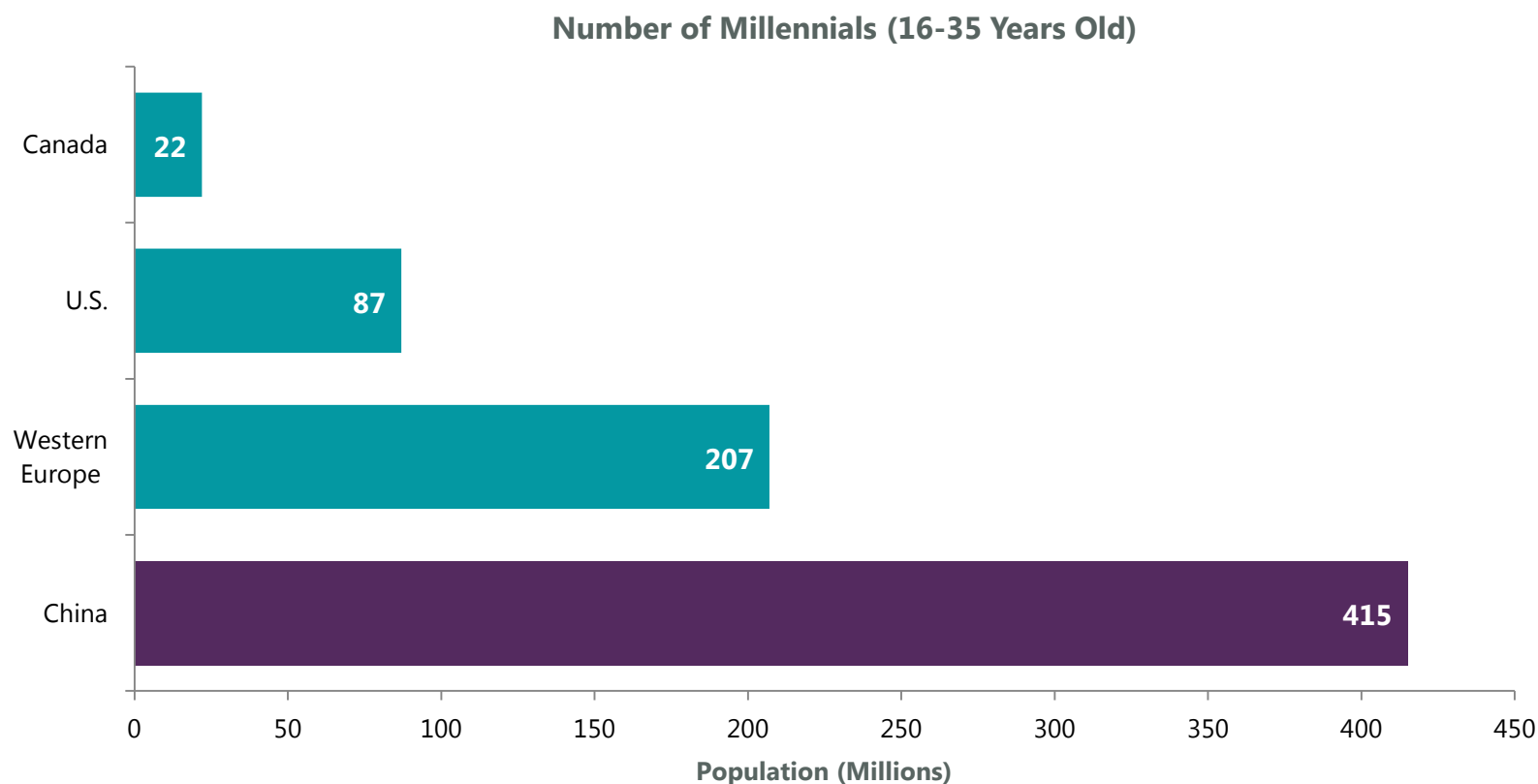


Manufacturing PMI and S&P 500 EPS

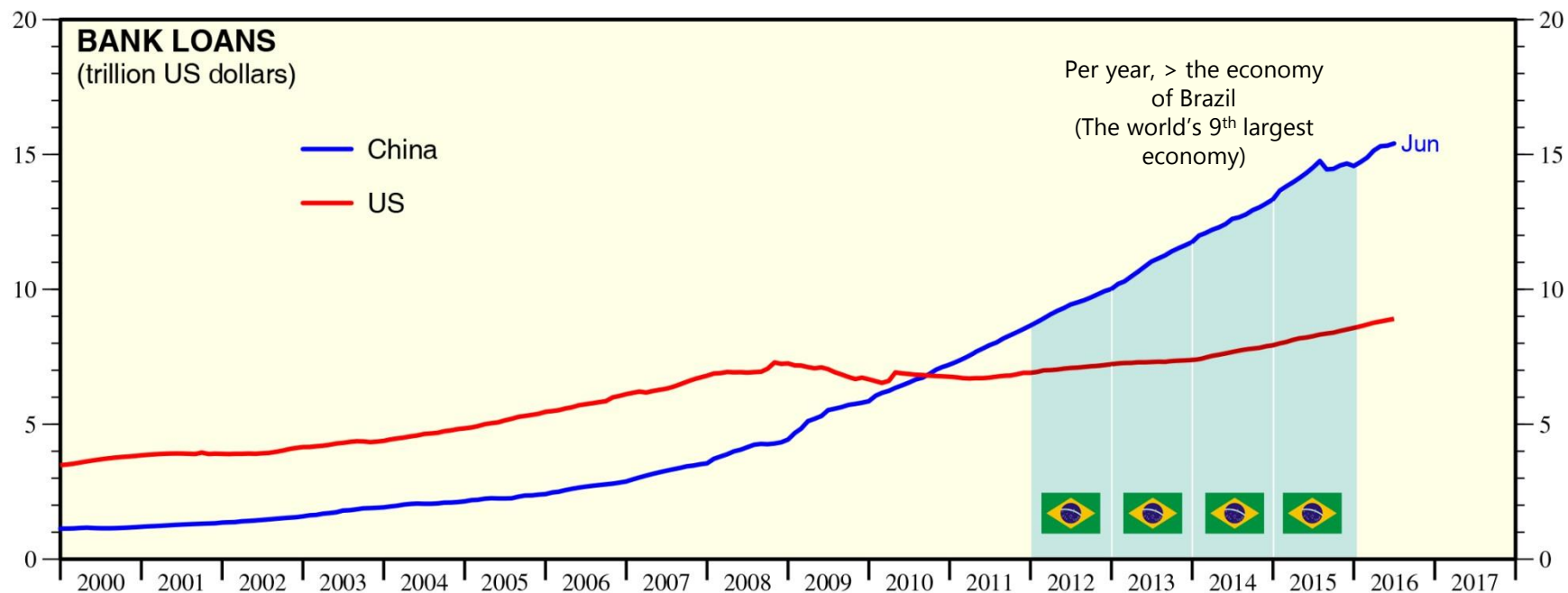


Long-Term Growth Prospects for China

- Number of millennials in China is larger than the working populations of U.S., Canada and Western Europe combined
- More than one-quarter of China's millennials are college graduates
- As 400 million new Chinese people enter the spending class, implications are huge



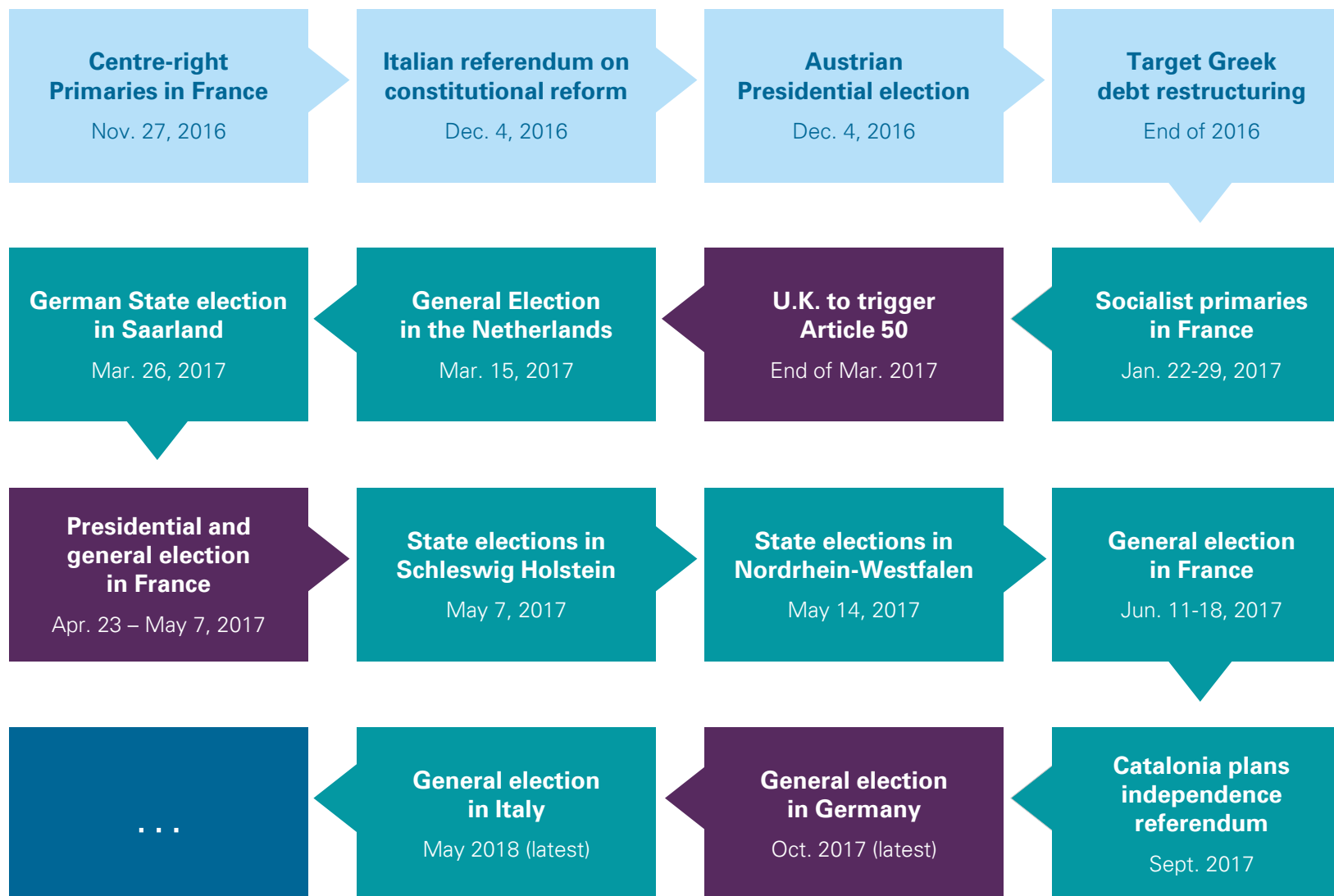
Bank Loans: China & U.S.



European Union



Next Domino to Fall?

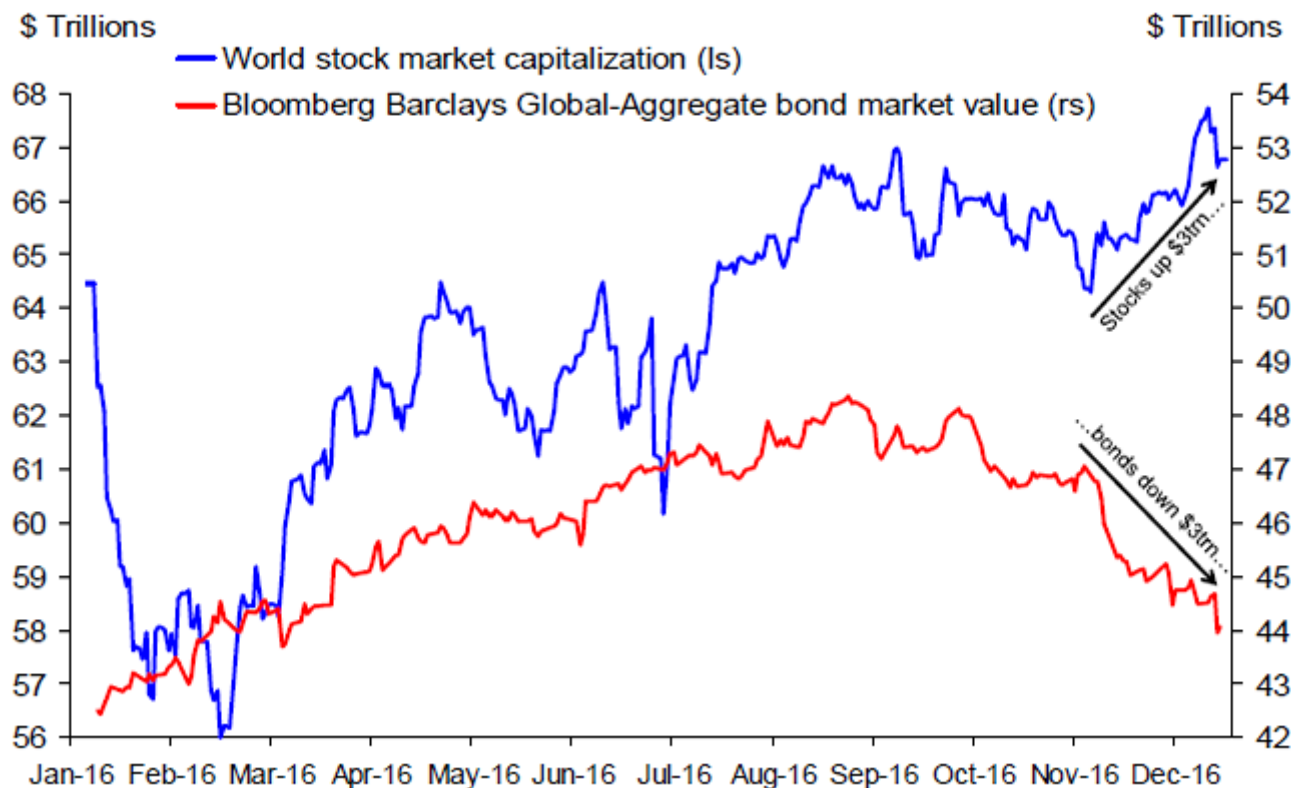


U.S. 10-Year Treasury Bond



Bond Markets to Stock Markets

- Since the U.S. election in November, roughly \$3 trillion have moved from bond markets to stock markets



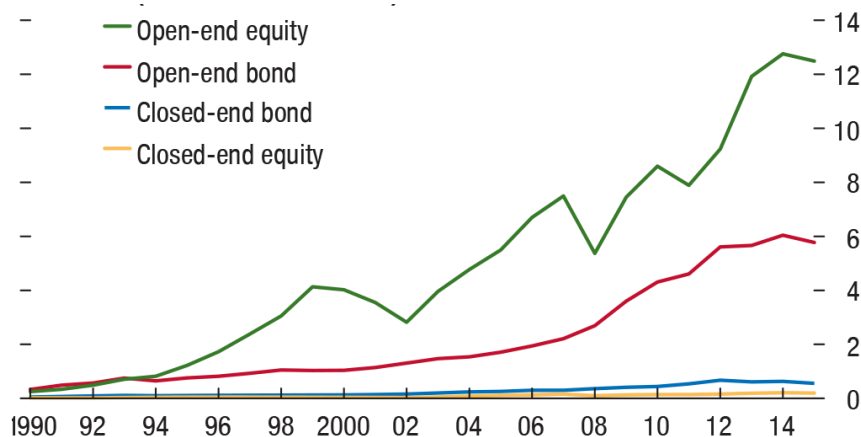
Short-Term Risk for Bonds

Net Flows into Mutual Funds + ETFs (\$ Billions)

Years	Domestic Equity		Bond
	Mutual Fund	ETF	
2009	-27.6	30.9	417.2
2010	-81.1	46.7	262.0
2011	-133.3	47.3	163.7
2012	-159.1	80.9	358.5
2013	18.1	104.0	-59.0
2014	-60.2	143.0	94.5
2015	-170.8	63.1	29.5
2016 YTD	-181.3	91.5	207.4
Total	-795.2	607.4	1473.8

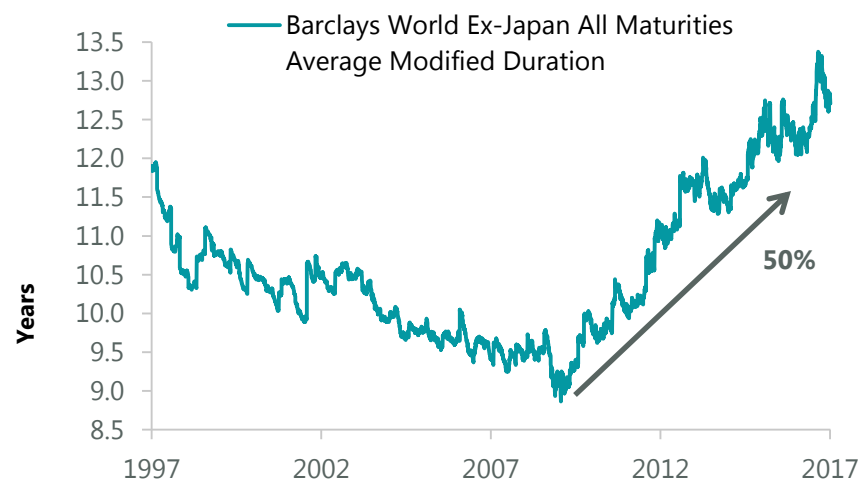
Global Bond Duration

**Assets Under Management
by Mutual Funds, (\$ Billions)**



As of Jan. 1, 1990 – Dec. 31, 2015.
Source: IMF Financial Stability Report.

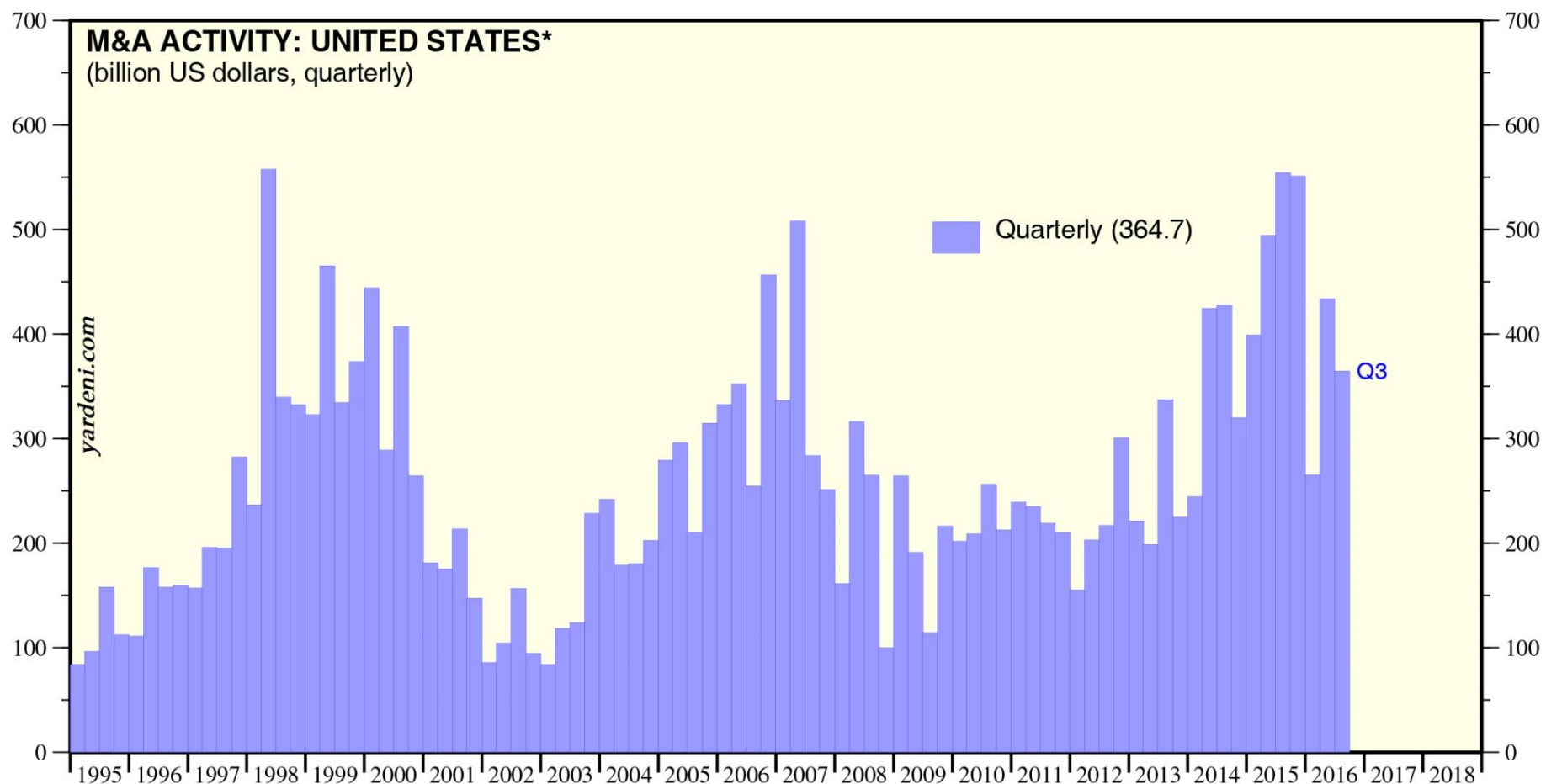
**World Bond Indices Have Been
a Surge in Duration**



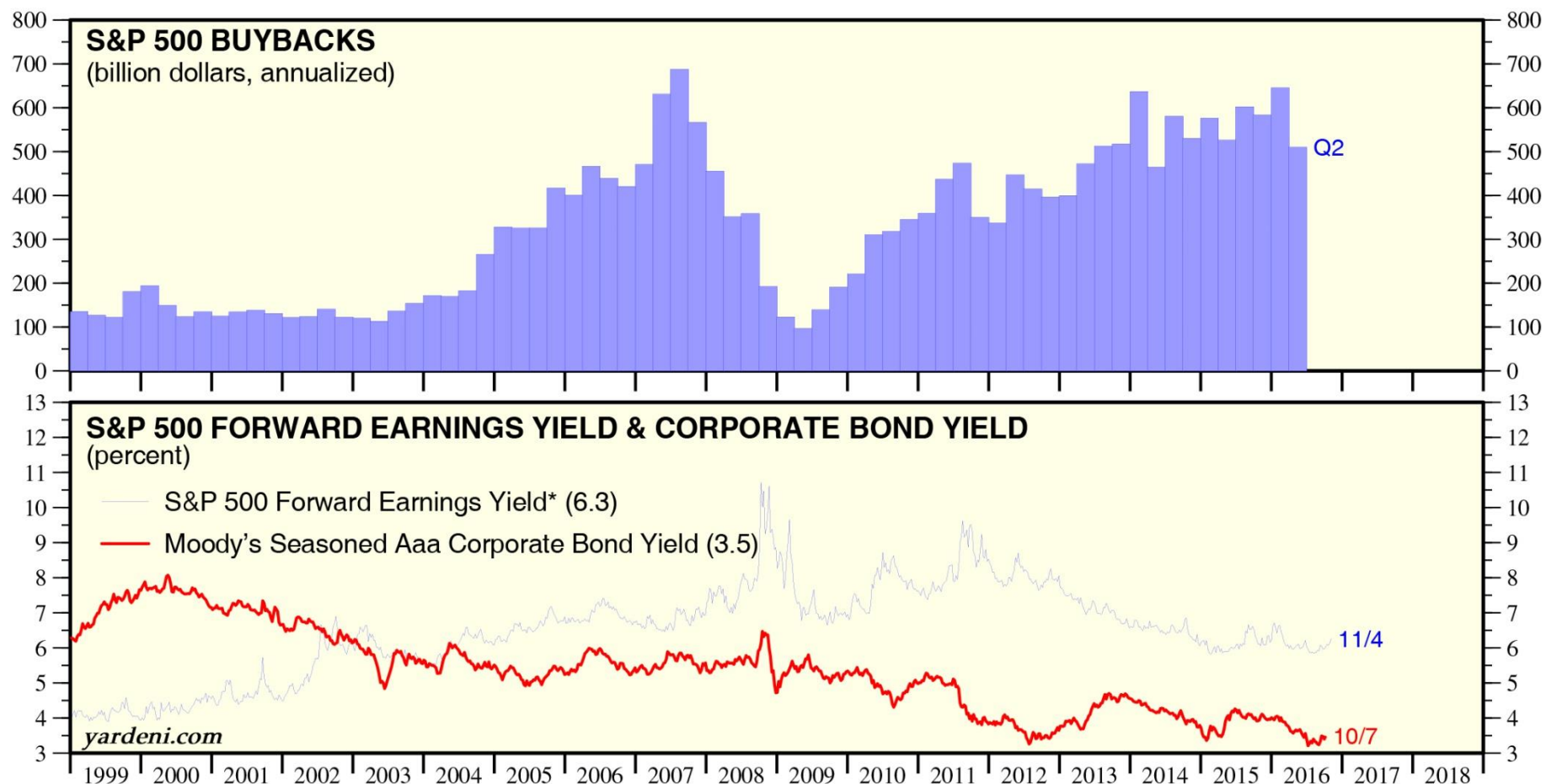
As of Jan. 1, 1997 – Jan. 3, 2017.
Source: Bloomberg, SG Cross Asset Research/Rates.

Corporate QE - M&A Activity

United States

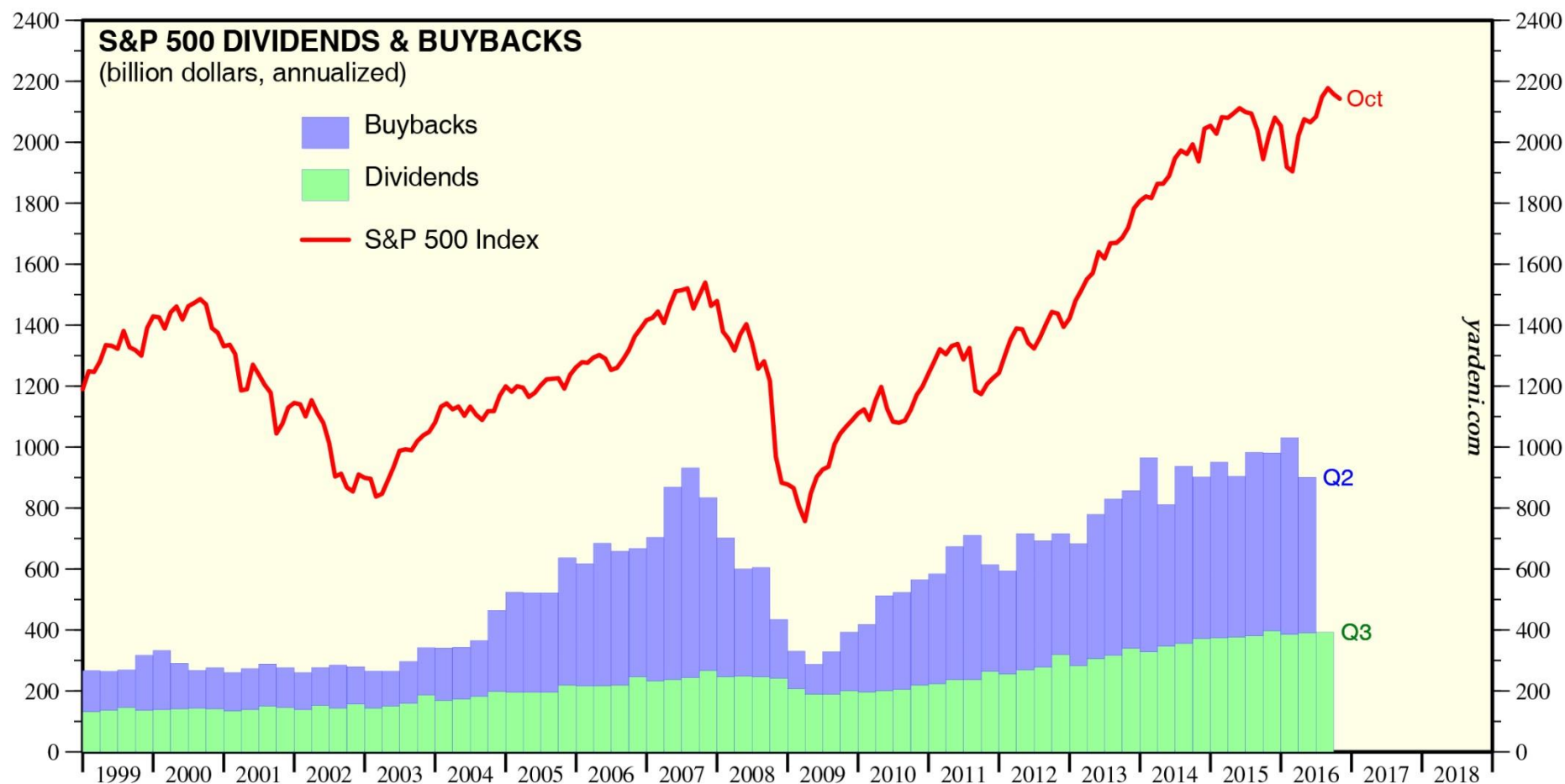


S&P 500 Forward Earnings Yield & Corporate Bond Yield and S&P 500 Buybacks



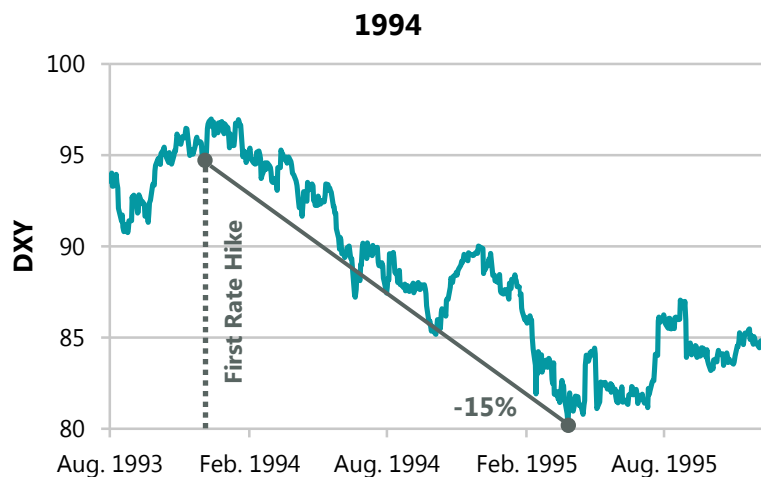
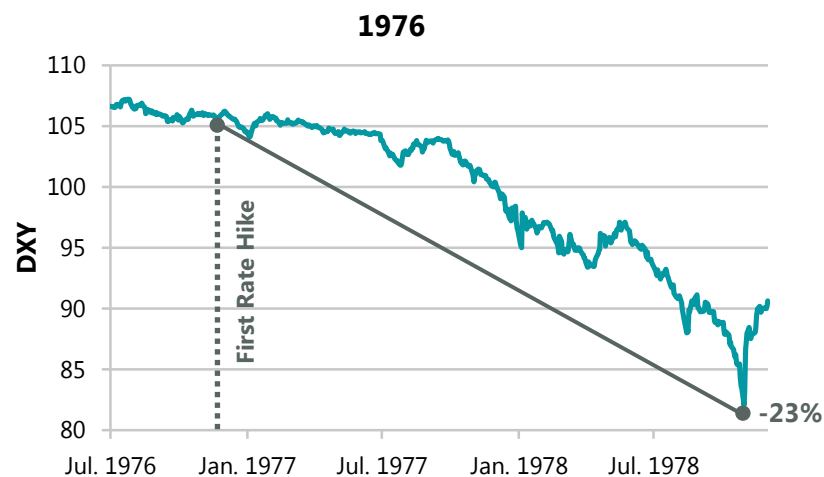
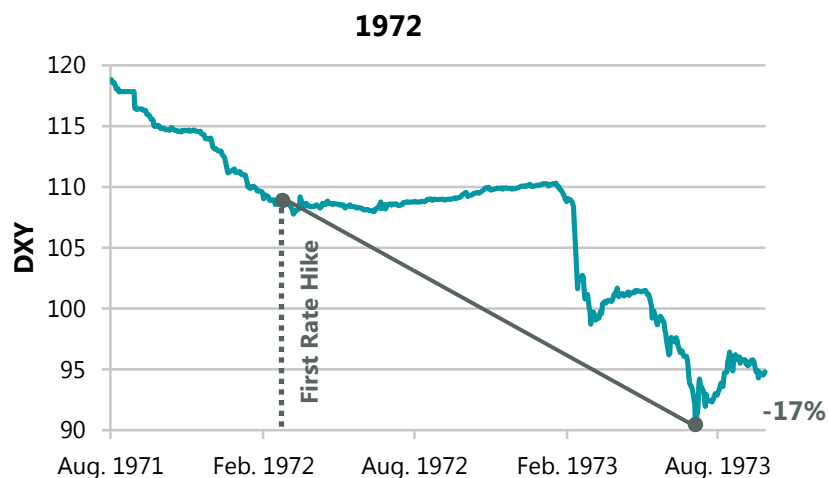
* Forward earnings (time-weighted average of consensus operating earnings estimates for current and next year) divided by S&P 500 stock price index.
Source: Thomson Reuters I/B/E/S and Board of Governors of the Federal Reserve System and Standard & Poor's Corporation.

Buybacks & Dividends



Dollar Might Not Rise

- The easy assumption that the dollar will rise with Fed tightening is not validated by history, as in only one of the last seven tightening cycles did the dollar clearly rise (1983). Here are four examples where the dollar declined in a tightening cycle.



Additional Important Information

Past performance is no guarantee of future results.

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