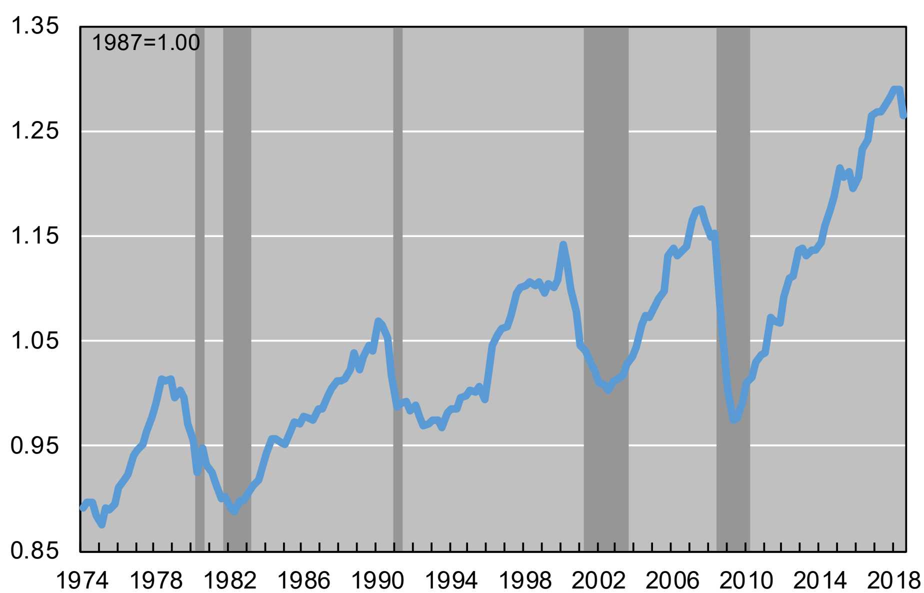
Leading Index

The leading index turned down noticeably this quarter, with six of the seven components dropping. Only the Boeing backlog ratio improved. This downturn certainly has our attention, but our biggest worry is that we may read too much into the drop. We've had the index drop several times during this expansion, only to turn positive again the next quarter, so a reversal is certainly possible. GDP is slowing, but not stalling. Inflation is stable. And trade disputes could be resolved, reducing uncertainty and encouraging investment. Yet pessimism is building. Janet Yellen recently voiced concerns about corporate debt in the U.S., while Brexit and weakness in Italy are challenging Europe. China's economy seems to be slowing and it is anyone's guess how trade talks between the Trump administration and China will play out. Additional tariffs, originally planned for March 1, would be problematic for many businesses. (We've heard that the first round of tariffs were manageable, but the next round is larger.) So is the news making us worry about the index's fall? Or is the change alone enough to be worrisome? The answer is yes. The news is increasing our worry about a change in the index in one quarter. But a decline of 1.9 percent from the previous quarter is notable, as is the fact that most of the individual components declined together. Other drops in the index we have seen over the last several years have been small, with not more than half of the components dropping.

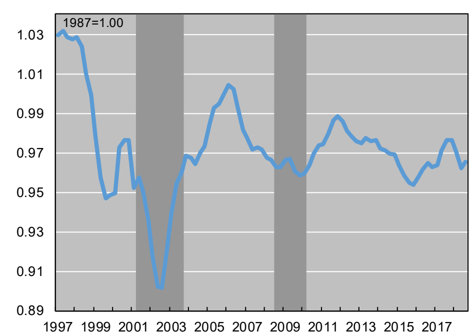
One of the components in the index is the spread between the yield on 10-year and 2-year U.S. Treasuries. The spread is still positive (no yield curve inversion), but it fell again this quarter. Moreover, the spread between 5-year and 2-year Treasuries was negative in early December. Like our leading index, the yield curve is suggesting we pay attention. Cue the economist jokes. (Economists have predicted nine out of the last five recessions. If you laid all the economists in the world end to end, you would not reach a conclusion. Etc.) Of course, the future is unknowable. We try to understand what is most likely, but low probability events happen. And when they do, most forecasts can be off. But the real value of a forecast is in the questions it makes you ask, not in its specific accuracy. In the end, our leading indicator is demanding that we ask questions about what we might be overlooking when there are positive macroeconomic movements and relatively normal corporate earnings (lower after the tax cuts, but positive).

Puget Sound Index of Leading Economic Indicators

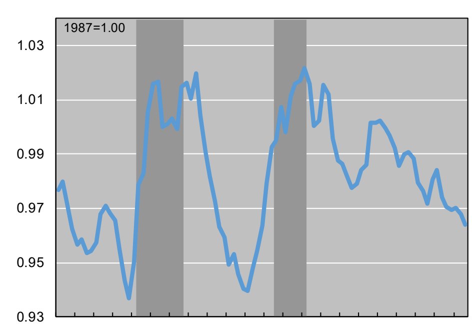


Shaded areas show recessions.

Boeing Backlog-Delivery Ratio



Interest Rate Spread



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