The stock market has been rallying on the surge in global economic growth *(recently monikered global synchronized growth)* over the past year. The hope, as always, is that growth is finally here to stay. The surge in growth has also given cover to the Federal Reserve, and Central Banks globally, to start reducing the flood of liquidity that has been propping up markets globally since the *"financial crisis."* That optimism has bled over in recent months as improving confidence has pushed leverage back to record levels, investors carry the highest levels of risk assets since the turn of the century, and yield spreads remain near record lows. It certainly seems as *"things are as good as they can get."* But it is when things are *"as good as they can get"* that we find the rest of the story. A recent report from the Brookings Institute highlights one of the biggest risks to investors currently - global growth.

> *"The world economy?s growth momentum remains strong but is leveling off as the winds of a trade war, geopolitical risks, domestic political fractures, and debt-related risks loom, with financial markets already reflecting mounting vulnerabilities. The latest update of the Brookings-Financial Times TIGER index provides grounds for optimism*

about the current state of the world economy ***matched by some pessimism about the sustainability of the growth momentum."***

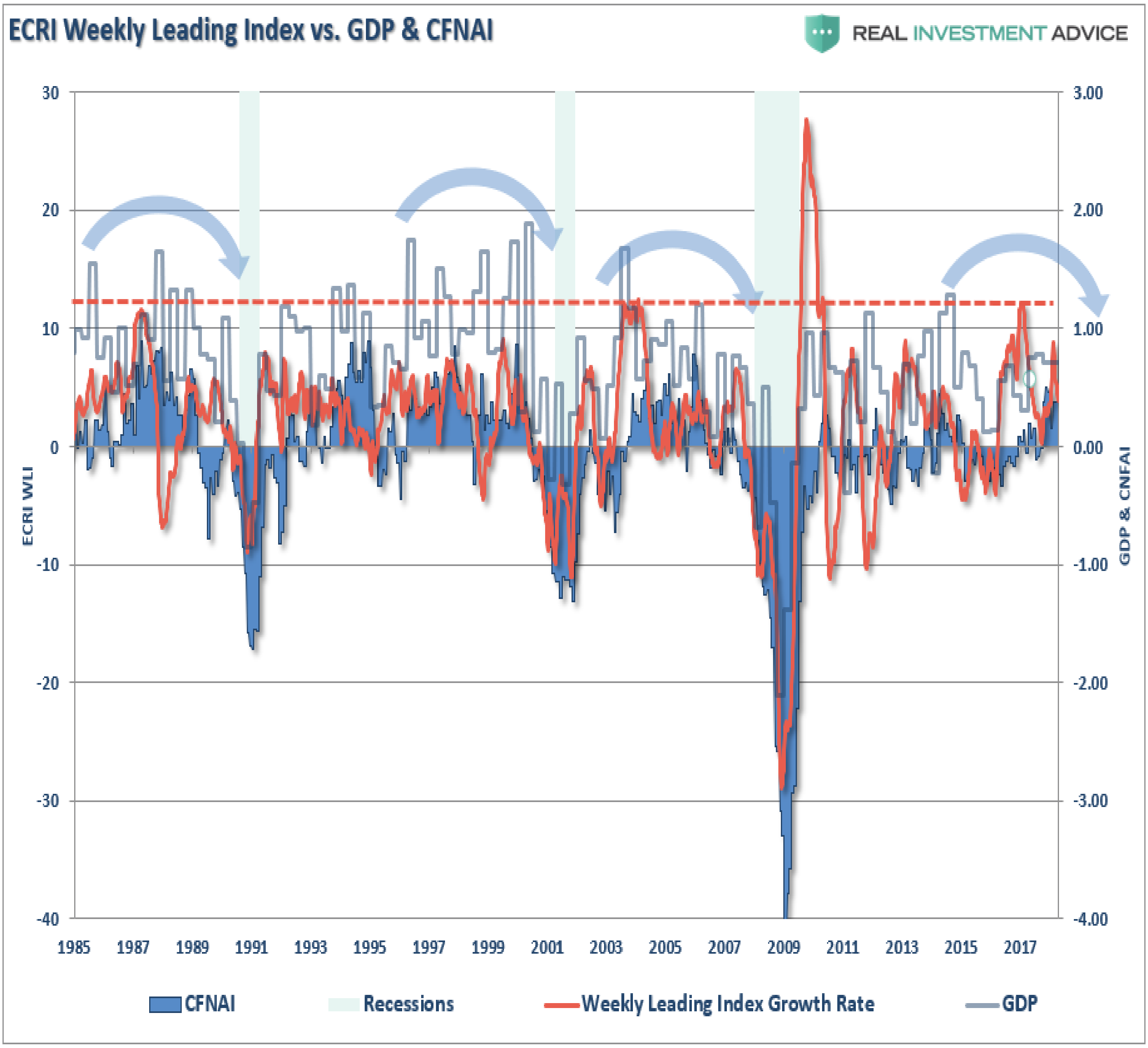
This has been a key concern of mine of the last several months. The recent uptick in the U.S. economy has been undeniably the strongest we have seen in the last few years. As Brookings notes:

> *The U.S. economy remains in robust shape, with growth in GDP, industrial production, and investment holding up well.* ***In tandem with strong consumer confidence and employment growth, wage and inflationary pressures have picked up slightly, although less than would be typical at this stage of the cycle.***

The issue, however, is that much of that uptick was attributable to a series of natural disasters in 2017. To wit:

> *"The Trump Administration has taken a LOT of credit for the recent bumps in economic growth. We have warned this was not only dangerous, credibility-wise, but also an anomaly due to three massive hurricanes and two major wildfires that had the•'broken window'•fallacy working overtime."*

As shown in the chart below, the ECRI's index and the Chicago Fed National Activity Index suggests that bump in growth may be waning. Historically, spikes in activity have historically noted peaks in the economic cycle. Such should not be surprising as growth breeds optimism which drives activity. Just remember, everything cycles.



While current optimism is high, it is also fragile. For investors, when things are *"as good as they can get,"* that is the point where something has historically gone wrong. It is always an unexpected, unanticipated event that causes a revulsion of risk assets across markets. Currently, there are a host of competing forces at play within the markets and the economy. These competing forces weave a delicate balance that can be easily disrupted creating a reversion in behaviors. As Brookings notes:

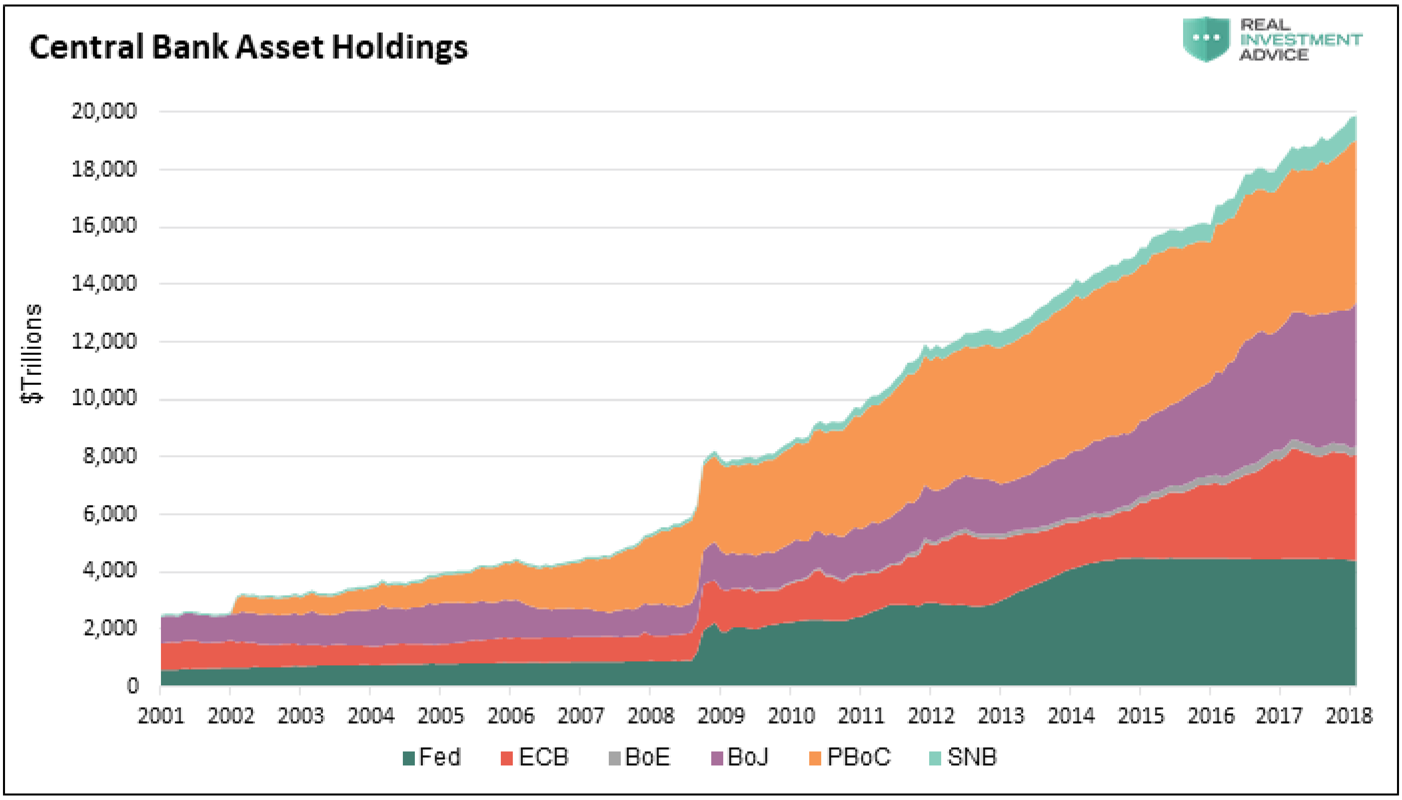
> *The U.S. is engaged in a perilous macroeconomic experiment,* ***with the injection of a significant fiscal stimulus even as the economy appears to be operating at or above its potential.*** *The Fed is likely to lean hard against potential inflationary pressures as this stimulus plays out. Export growth has been buoyed by a weak dollar and strong external demand,* ***but the U.S. trade deficit has still risen over the past year.*** *The large bilateral trade deficit with China remains a flashpoint, setting in motion trade tensions that could have implications for China, the U.S., and the entire world economy."*

But this isn't just in the U.S. It is also on a global scale.

> *"In 2017, the Euro-zone turned in its fastest pace of growth over the last decade. Growth in overall GDP as well as in the manufacturing and services sectors remains solid but has cooled off slightly this year.* ***Centrifugal political forces in many countries, rising global trade frictions, and the withdrawal of monetary stimulus could lay bare some of the unresolved structural problems and tensions in the zone."***

The last point was recently noted by Michael Lebowitz:

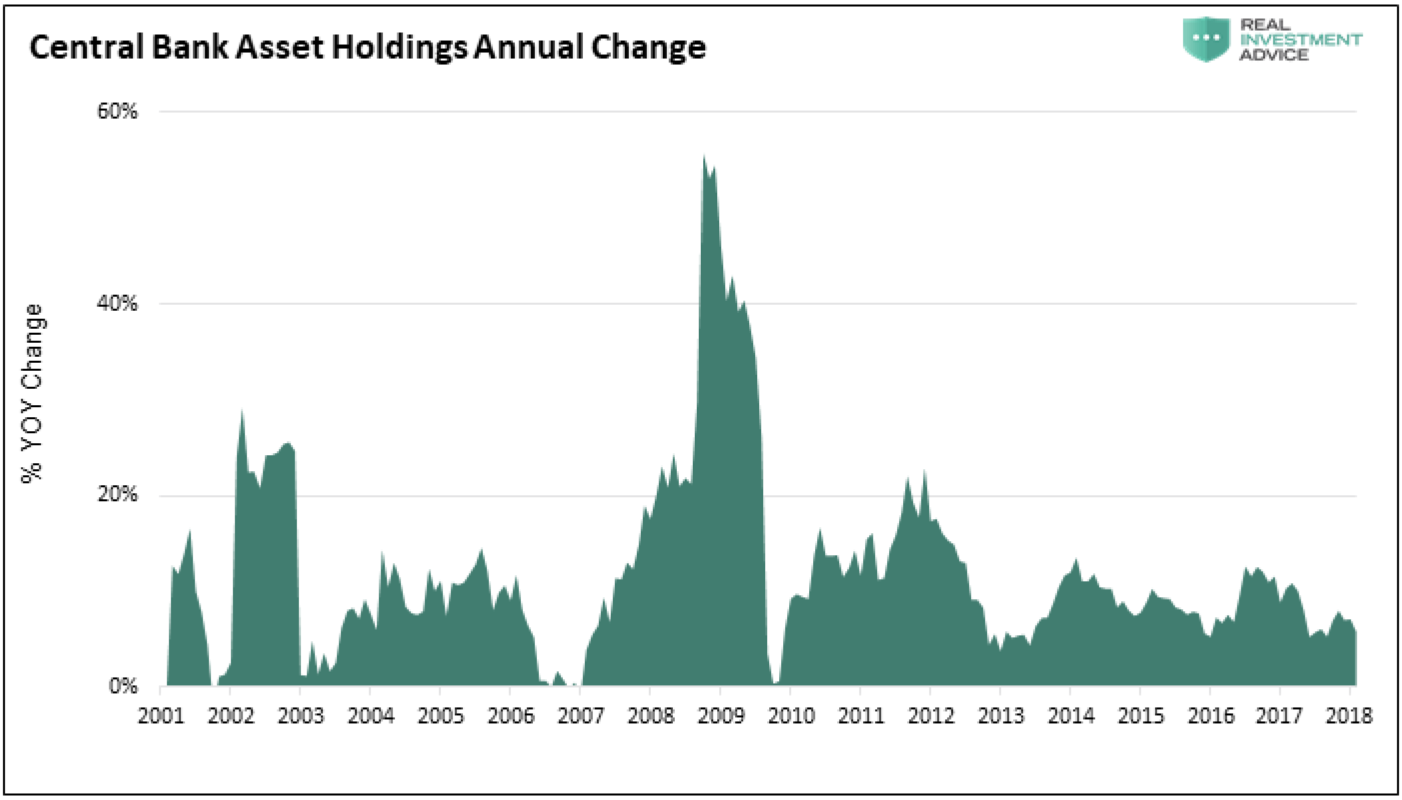
> *"Global central banks? post-financial crisis monetary policies have collectively been more aggressive than anything witnessed in modern financial history. Over the last ten years, the six largest central banks have printed unprecedented amounts of money to purchase approximately $14 trillion of financial assets as shown below. Before the financial crisis of 2008, the only central bank printing money of any consequence was the Peoples Bank of China (PBoC)."*



The central banks? goals, in general, were threefold:

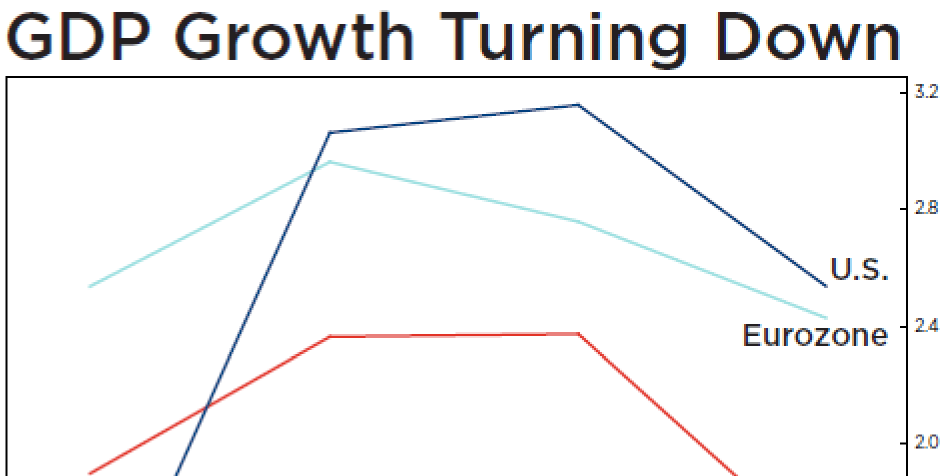
- *Expand the money supply allowing for the further proliferation of debt, which has sadly become the lifeline of most developed economies.*
- *Drive financial asset prices higher to create a wealth effect. This myth is premised on the belief that higher financial asset prices result in greater economic growth as wealth is spread to the masses.*
  - ***?And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion.??*** *Ben Bernanke Editorial Washington Post 11/4/2010.*
- *Lastly, generate inflation, to help lessen the burden of debt.*

QE has forced interest rates downward and lowered interest expenses for all debtors. Simultaneously, it boosted the amount of outstanding debt. The net effect is that the global debt burden has grown on a nominal basis and as a percentage of economic growth since 2008. The debt burden has become even more burdensome. However, that liquidity support is now being removed.



That extraction of liquidity is potentially already showing up in slower rates of global economic growth. As recently noted by the •ECRI:

> *?Our prediction last year of a global growth downturn was based on our 20-Country Long Leading Index, which, in 2016, foresaw the synchronized global growth upturn that*
> *17. With the*
> *wnturn is no longer a*



pinpoint the problem facing investors currently which is a *"willful blindness"* to changes in the economic fabric.

> *?Still, the groupthink on the synchronized global growth upturn is so pervasive that nobody seemed to notice that South Korea?s GDP contracted in the fourth quarter of 2017, partly due to the biggest drop in its exports in 33 years. And that news came as the country was in the spotlight as host of the winter Olympics. Because it?s so export-dependent, South Korea is often a canary in the coal mine of global growth. So, when the Asian nation experiences slower growth ? let alone negative growth ? it?s a yellow flag for the global economy. The international slowdown is becoming increasingly obvious from the widely followed economic indicators. The most popular U.S. measures seem to present more of a mixed bag. Yet, as we pointed out late last year, the bond market, following the U.S. Short Leading Index, started sniffing out the U.S. slowdown months ago.?*

While at the headline, things may seem to *"firing on all cylinders,"* there are many indicators showing rising?*economic stress?*•such as:

- *Rising delinquency rates*
- *Rising levels of charge-offs*
- *Weakening rates of consumption*
- *Collapsing yield spreads*
- *Surging consumer and government debt levels*
- *Declining wage growth for the bottom 80% of workers*

The shift caused by the financial crisis, aging demographics, massive monetary interventions and the structural change in employment has skewed many of behaviors of politicians, central bankers, and investors. We are currently sailing in very unchartered waters where a single unexpected wave could easily capsize the ship. Not just domestically, but on a global scale.
As Brookings concludes:

> ***"The era of growth fueled by macroeconomic stimulus, with no apparent adverse side effects such as high inflation, appears to be drawing to an end.*** *In the absence of deep-rooted reforms to improve productivity, it will be difficult to ratchet up or even sustain high growth in the major economies."*
>
> ***Mounting public debt in the U.S. and other advanced economies, compounded by unfavorable demographics, and rising external debt levels of some emerging market economies are risk factors that also reduce policy space for responding to shocks****."*

There are a multitude of risks on the horizon, from geopolitical, to fiscal to economic which could easily derail growth if policymakers continue to•count on the current momentum continuing indefinitely. The dependency on liquidity, interventions, and debt has displaced fiscal policy that could support longer-term economic resilience. We are at war with ourselves, not China, and the games being played out by Washington to maintain the status quo is slowly creating•the next crisis•that won?t be fixed with another monetary bailout.