

Market Perspective

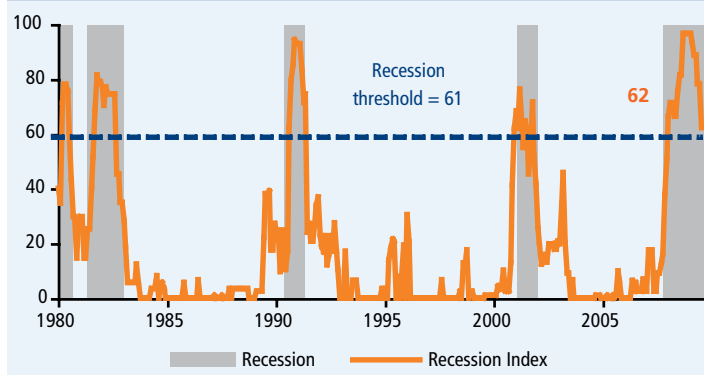
ING Recession Index Says Recession Ended in July 2009

Recent market action, with the S&P 500 Index reaching an intraday high of 1017 on August 7 and up 50% off its March lows, left many market participants wondering if the market has gotten ahead of itself in pricing in a nascent recovery. The market has appeared to be overbought for several weeks, according to different measures, but the broadly anticipated correction has not happened yet.

If the recession is really over, we should continue to see more positive than negative surprises in economic data, and the recovery in stock prices is therefore largely justified. Any correction might be slight – a technical market consolidation – or might not happen at all. On the other hand, if the economy is still approaching a cyclical trough, stocks may be vulnerable to negative economic news. So, is the recession in the United States over?

Our proprietary model answers this question unambiguously. According to the ING Recession Index, the 19-month recession ended in July 2009. (Figure 1.)

Figure 1: Recession is Over



Source: ING Investment Management Model.

Past performance is no guarantee of future results. The performance quoted represents past performance.

Our model, designed to capture widespread economic weakness consistent with recession,¹ is based on 14 macroeconomic, financial and market indicators that reflect different aspects of the economy. The modeling technique is based on a signal extraction methodology used to determine a level at which each indicator signals a recession. This design allows the model to correctly predict or identify the beginning and end of recessions. The model was successful in correctly identifying January 2008 as the starting month of the current recession, 11 months prior to the official announcement by the National Bureau of Economic Research (NBER). The model is described in more detail in the previous month's publication (See *Is the Recession Over?* by Nora Omarova, ING Market Perspective, July 17, 2009).

The ING Recession Index is a weighted average of signals extracted from 14 indicators and can potentially take on values from 0 to 100. The current reading of the Index is 62. The recession threshold is 61. From a technical standpoint, the reading is close enough to a threshold and constitutes a legitimate signal of the recession's end. The Index has declined from 97 at the height of the recession in January 2009, to 62 in July. The indicators contributing to the recovery signal are those that have already breached their respective thresholds and are currently in recovery territory: the Institute of Supply Management (ISM) manufacturing index; the OECD leading economic indicators index (OECD LEI); ISM net new orders; real, same-store sales; annual change in oil price; and the yield curve spread (10-year Treasury yields minus the Fed funds rate).

Some indicators in the model have data lags – thus, for example, the U.S. leading economic indicators (U.S. LEI) index for July has not been reported yet. It could potentially bring the July Recession Index level even further down to 44 points if the July year-over-year decline in the U.S. LEI is less than 0.5%. Several other indicators are also approaching their thresholds: the initial jobless claims indicator is 150,000 away from its threshold of 410,000. The high-yield spread to Treasuries is only 110 basis points away from its threshold: its current reading is 809 basis points. The positive dynamic continues in all other indicators and reinforces the ING Recession Index's signal that the economic contraction ended in July 2009.

From a stock market perspective, the end of recession means that there is a higher probability of positive economic surprises going forward as recovery takes hold. That, in turn, implies that even with some short-term technical correction in sight, the equity market still has potential to go higher from its current elevated levels.

¹ According to the National Bureau of Economic Research (NBER) – the institution officially mandated with the task of dating business cycle – a recession is widespread significant decline in economic activity, lasting more than few months, and visible in real income, employment, industrial production and wholesale-retail sales.




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