Market Analysis

Using the Conference Board Leading Economic Index®

Most gains in life require some form of trade-off or compromise. For financial advisors in the broker dealer world, that has most often translated into choosing between investment resources and individual attention, between high tech and high touch. But a new model is emerging that may very well make it possible for advisors to "have it all."

As part of a network of independent broker dealers and other financial service firms owned by one nimble parent company - Ladenburg Thalmann, SSN is able to provide our representatives with the same personal service they have always known while bringing additional specialized resources to the table from our sister companies.

This whitepaper, written by Phil Blancato, President and CEO of Ladenburg Thalmann Asset Management, provides in-depth analysis on the use of leading economic indicators in portfolio management. SSN advisors benefit from the expertise that LTAM has developed over the past several decades of money management amid various market conditions. Some of our representatives use the information in consultation with LTAM to tweak their own model portfolios; others use these strategies to better evaluate third party managers, like LTAM, while focusing advisor time on financial planning and relationship building.

We hope that the information is valuable to you, as well. If you are looking for a broker dealer partner who can sustain your business model with just the right amount of personal attention and powerful technology and support, check out our website (joinssn.com) or give us a call at 866-218-2865 and ask to speak to Landon Moore.

Market Analysis Using the Conference Board Leading Economic Index®

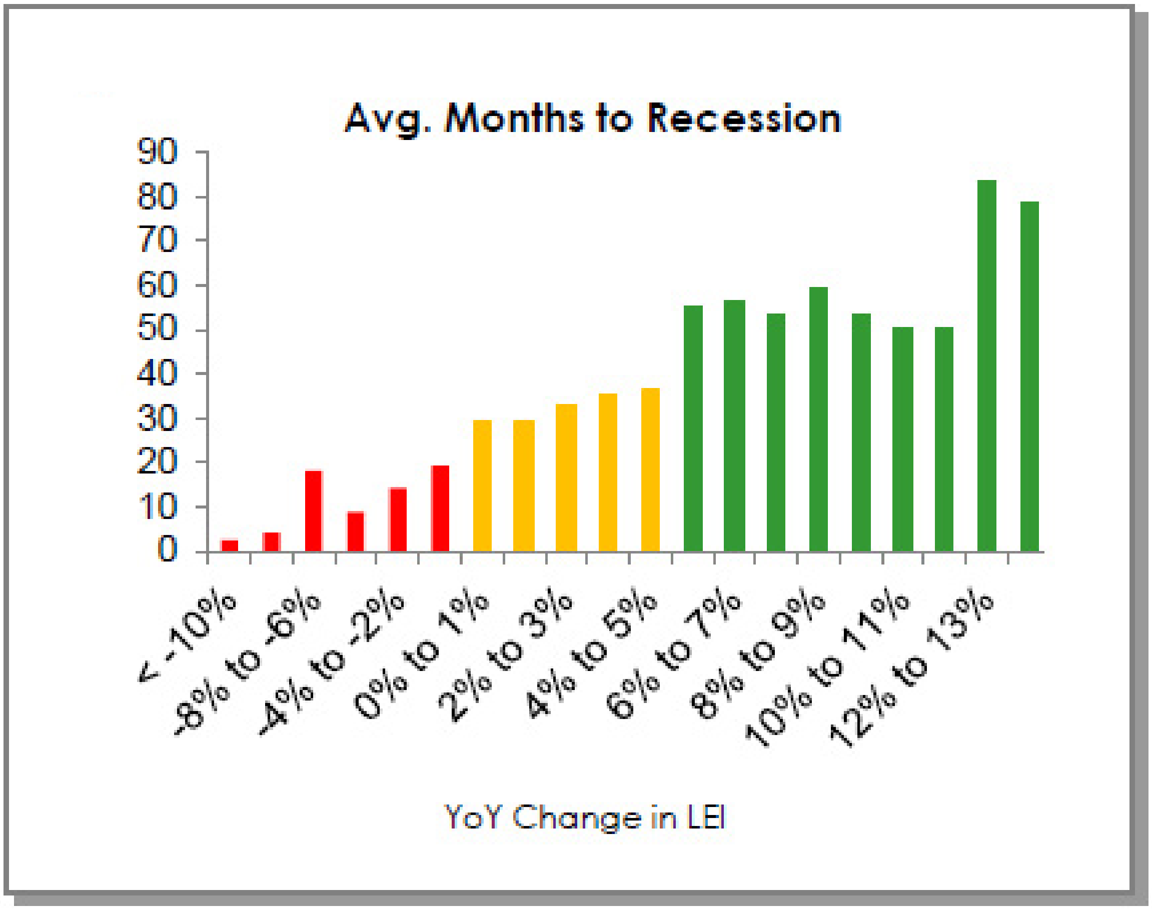
By Philip S. Blancato
President and CEO
Ladenburg Thalmann Asset Management

Bear markets are dangerous for investors, not just because of how difficult it is to recover from the loss but because humans tend to overreact and miss substantial upside following big declines. As asset managers, our goal is to avoid these losses as much as possible, but how can we tell when a bear market is around the corner? The good news is that real bear markets (which are stock declines of 20% or more) almost exclusively happen when the economy is falling apart and/or the Fed is tightening by raising rates. It is easy to know when the second situation is happening but predicting recessions is more challenging.

As part of the Ladenburg Thalmann Asset Management (LTAM) research process, our Investment policy Committee reviews economic data points, indexes and research from several sources to develop a market outlook that serves as the fundamental catalyst for making tactical shifts in our portfolios. One of our key sources of U.S. economic data comes from the Conference Board, an independent business membership and research association, which publishes various indexes aimed at helping economists anticipate changing conditions in global markets. Specifically, LTAM closely monitors the Conference Board's Leading Economic Index® (LEI) for the U.S., which is designed to signal peaks and troughs in the business cycle, and can be a good indicator of how likely it is that we have a recession and potentially a bear market, lurking around the corner. The LEI is a composite average of ten individual leading indicators, constructed to show common patterns in economic data, which results in what can be viewed as a projection of where the economic cycle is headed over the next 3-6 months. What we like about this measure is that the included indicators (listed at right) cover a wide range of the economy and when monitored over time, the index can provide a signal through every day.[1]

We looked at the LEI going back to its first release in 1959 and compared the year over year change to the average amount of time until the next recession began, and not surprisingly, when the change was negative, we were uncomfortably close to a recession. This is the "red zone" in our study. The next zone is the "yellow zone", when the change in LWI was positive but still 5% or less. In this zone, we were usually about 20-30 months away from a recession on average. Safer, but not out of the bear filled woods just yet. Above 5%, the length of time until a recession jumps up considerably and stays above 50 months on average. While this does not mean that a recession is impossible while LEI is in the "green zone", based on historical evidence, the odds are substantially lower and so we are more comfortable being more aggressive with our equity allocations.

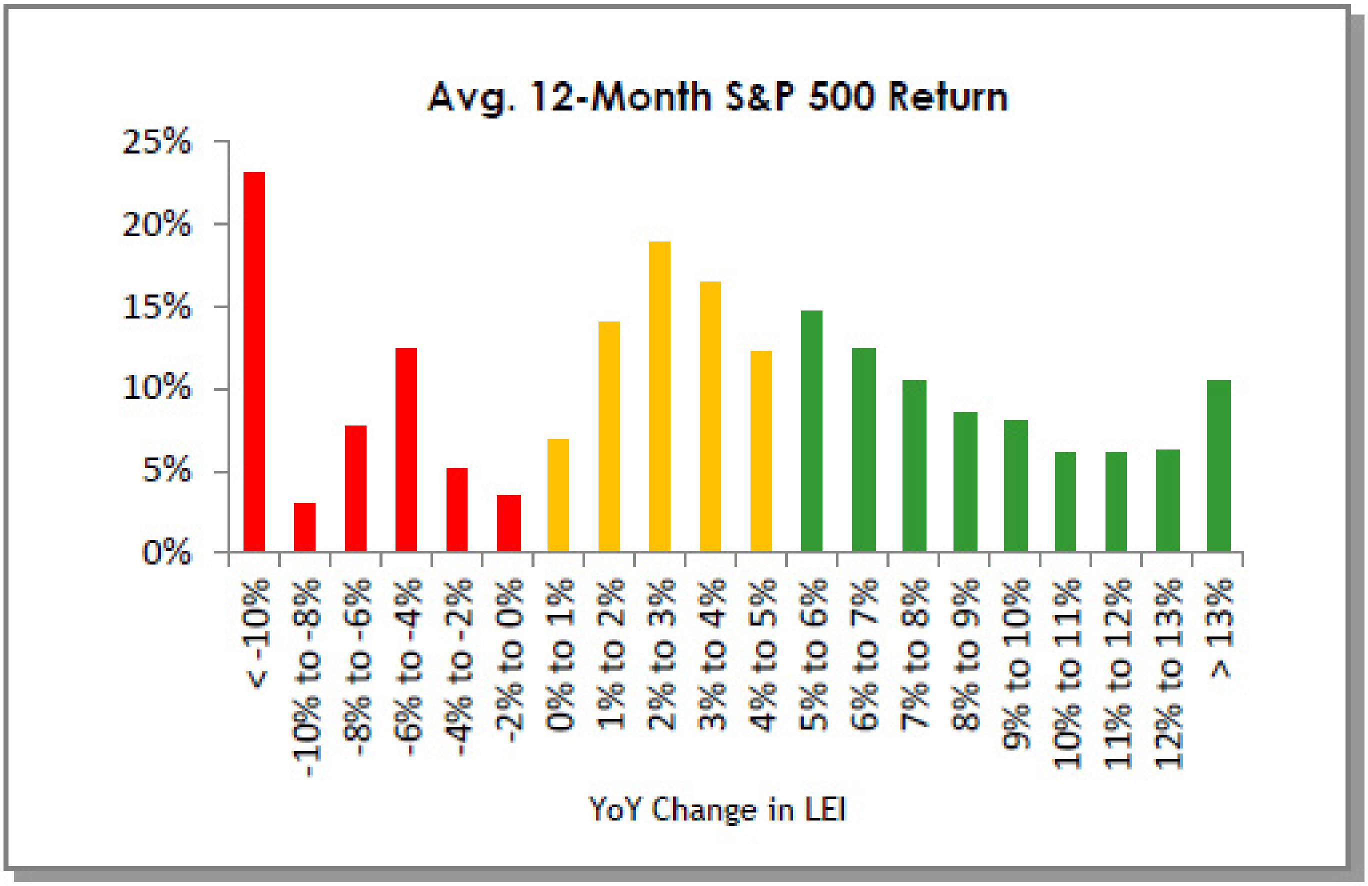
Figure 1.



Where are we now?

After spending most of the last few years in the yellow zone, LEI accelerated to the green zone in early 2014 and was most recently up 5.7% year over year. We're now in the range where, on average, we should be nearly 5 years away from the next recession and in the green zone of our LEI study. Aside from protecting against downside losses, we also strategically allocate our portfolios between equity and fixed income and tactically rotate within those asset classes over shorter timeframes. While the length of time until a recession is helpful in managing the risk of catastrophic losses, it is not always the case that markets and the economy recover at the same speed. Frequently, stocks will outperform while the economy is still in the early stage of a recovery.

Figure 2.



We can use the LEI to look at how the S&P 500 performs at different stages in the cycle.

In Figure 2, we can see that historically, S&P 500 returns have been higher during economic recoveries, or when the year-over-year change in the LEI is between +1% and +8%. S&P 500 returns have, in general, been lower when the change in the LEI is in the "red zone" and are also lower when LEI is showing double digit improvement, which occurs in the early recovery stages. The best performance for the S&P 500 follows a negative change in the LEI of over 10%. This makes sense given what we know about bear markets and why they are so dangerous for investors. During recessions, markets tend to overshoot loosses and investors who sell at the bottom run the risk of missing a significant portion of the upside when markets begin to rally again.

We also use LEI in our tactical decisions to diversify within equity and fixed income.

To use LEI as an indicator in our tactical equity decisions on size and style, we looked at the performance of the Russell Indexed in the month following the date of release. We further broke LEI into two types: if the LEI was above its 12 month moving average, the pace of economic growth was accelerating and if it was below the moving average, the pace was slowing. While an accelerating LEI might indicate an expansion, the reverse could indicate a recession is approaching. We wanted to find the historically best returns in each of these different environments.

Figure 3.

LEI Minimum	LEI Maximum	Russell 1000 Growth	Russell 1000 Value	Russell Midcap Growth	Russell Midcap Value	Russell 2000 Growth	Russell 2000 Value
-25.0%	-10.0%	-1.00%	-1.12%	-0.86%	-0.69%	-0.90%	-0.64%
-10.0%	-5.0%	0.17%	-0.01%	0.37%	0.58%	1.10%	1.31%
-5.0%	-2.5%	-9.16%	-3.77%	-9.13%	-2.46%	-8.33%	-2.20%
-2.5%	0.0%	0.91%	0.16%	1.03%	0.03%	1.34%	-0.11%
0.0%	1.0%	1.89%	2.12%	2.92%	2.48%	3.96%	3.37%
1.0%	2.0%	1.06%	2.17%	1.47%	2.50%	1.21%	1.98%
2.0%	3.0%	1.13%	1.18%	1.66%	1.07%	1.67%	1.36%
3.0%	4.0%	2.84%	2.68%	3.36%	1.62%	1.18%	1.07%
4.0%	5.0%	-0.75%	-0.47%	-3.68%	-1.38%	-0.69%	0.19%
5.0%	6.0%	-0.16%	-1.06%	-1.59%	-1.07%	-1.61%	-1.45%
6.0%	7.0%	1.59%	1.25%	2.19%	1.64%	2.91%	2.03%
7.0%	8.0%	-0.49%	0.72%	0.59%	-0.70%	-0.94%	-1.95%
8.0%	10.0%	-0.27%	1.09%	0.82%	1.61%	-0.20%	0.69%

Growth has been accelerating since May 2013 but has recently moderated. The most recent LEI figure of 5.7% was below its recent average. This reading predicts flat to negative returns over a shorter time frame (looking out a month). Short term weakness combined with longer term positive returns fits with our view that the bull market has not run its course but we should expect more volatility in coming months.

LEI alone can't predict the future but it's an important piece of the portfolio management puzzle, providing both a red flag warning of danger to come and some insight into which asset classes are likely to outperform at different points in the business cycle.

[1]The Conference Board Global Business Cycle Indicators. May 22, 2014. https://www.conference-board.org/data/bcicountry.cfm?cid=1 (accessed July 21, 2014).

Although this report has been prepared from public and private sources and data that LTAM believes to be reliable, LTAM makes no representation as to its accuracy or completeness. Source: LEI data is obtained from Bloomberg. And indices and other financial benchmarks shown are provided for illustrative purposes only and reflect reinvestment of income, dividends, and other earnings. They do not reflect the deduction of advisory fees. Indexed are unmanaged and investors cannot invest directly in an index. The Program's actual performance may be higher or lower from the performance of an index mentioned. Investors should bear in mind that past performance is no guarantee of future results and there can be no assurance that the Program will achieve comparable results. The information and views expressed are given as at the date of the writing and are subject to change. This information is not to be used or considered as an offer of solicitation. Ladenburg Thalmann Asset Management Inc. is a registered investment advisor and subsidiary of Ladenburg Thalmann Financial Services Inc., which is traded on the NYSE_MKT: LTS.

Philip Blancato is the CEO and Preident of Ladenburg Thalmann Asset Management (LTAM) and Chairman of the Ladenburg Investment Policy Committee. He also serves as President of Ladenburg Thalmann capital Agency, and Member of the Boards of Directors for affiliated companies: Ladenburg Thalmann & Co., Inc., Investacorp, Inc., Triad Advisors, Inc., Premier Trust, Securities America, Inc., and Securities Service Network, Inc.

Phil is a twenty-five year veteran of the financial services industry with a specialized knowledge of portfolio and risk management, asset allocation, and macro-economic theory, as well as construction and implementation of seamlessly integrated platforms for fee-based solutions. Prior to joining Ladenburg Thalmann, he worked as the Managing Director of Advisory Services for Powell Johnson where he directed the creation and implementation of a suite of fee-based platforms.

Phil started his career with Prudential Securities in 1990 and held various positions within the firm. In 1996, he assumed the role of First Vice President and Director of Portfolio Management Programs where his primary role was to develop and improve upon the positioning and functionality of discretionary fee-based programs. During his tenure, the Portfolio Management division became one of the most successful divisions within Prudential Securities with assets in excess of $16 billion.

Blancato has been quoted in the Wall Street Journal, appears often on CNBC, and frequently speaks at industry conferences on topics surrounding investment management, portfolio risks and diversification and alternative investments.

About Ladenburg Thalmann Asset Management

LTAM is an SEC Registered Investment Advisory firm, established in 1982, and has over $2 billion in assts under management. LTAM was formed to create a high net worth asset management division based on the individual talents and areas of expertise of its members to support our clients' diverse financial needs. Investments are managed based on a long-term time horizon while being mindful of the historical context of the markets. The goal of this active portfolio management approach has been quality returns that are in excess of the current market with a lower level of volatility.

About Securities Service Network, Inc.

Securities Service Network, founded in 1983, is a locally owned and operated independent broker dealer, headquartered in Knoxville, Tennessee. SSN currently has nearly 500 affiliated financial professionals nationwide.

SSN is ranked one of the nation's leading independent broker dealers as recognized in Investment News and Investment Advisor and a member of the INC 500 magazine's Hall of Fame.

Through its subsidiaries, SSN offers investment management, advice, financial planning and insurance services. For more information on SSN please visit www.joinssn.com.

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