

THE 'END OF CYCLE GAME' UPDATE

By Francis P. Rybinski, CFA, Chief Macro Strategist &
D. Harris Kere, CFA, Investment Strategist

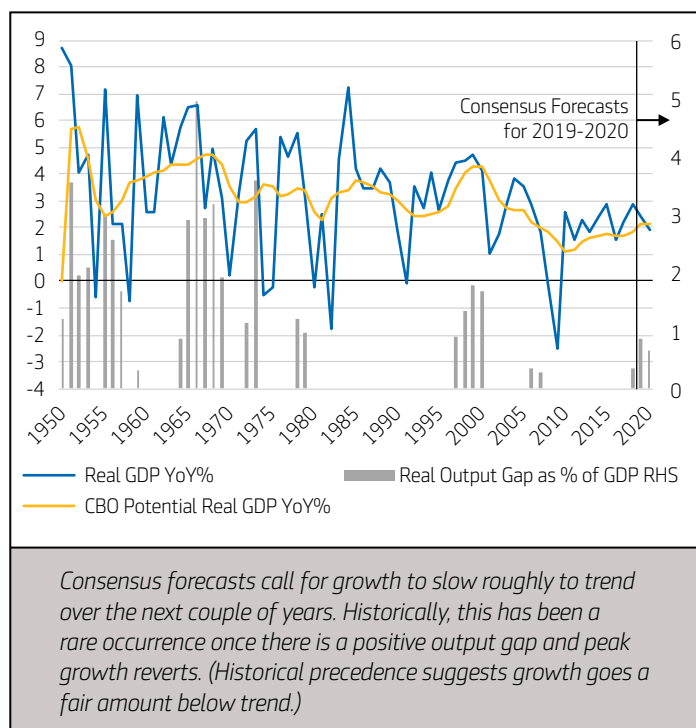
The following provides an update on the note we issued in March 2019, "[Still Playing the 'End of the Cycle' Theme.](#)"

Will history rhyme?

While each economic cycle has its own idiosyncrasies, there are often threads of commonality in overarching elements. Two cases in point for the post-World War II era:

1. When the output gap has peaked, the above-trend level of growth has not reverted just to trend, it has generally gone below it (Exhibit 1). We highlight this because after years of above-trend growth, the output gap is now positive and consensus forecasts are calling for growth to slow to roughly trend over the next couple of years.

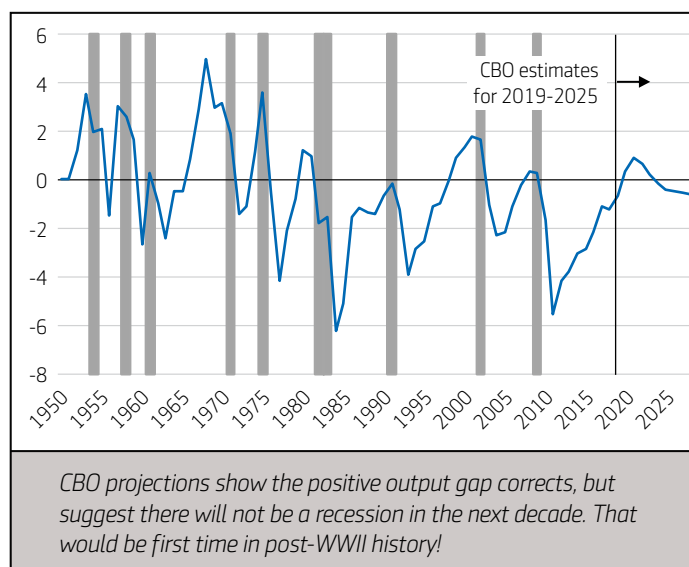
Exhibit 1: Historically, growth has slowed below trend once the output game peaks



Sources: Aegon AM US, BEA, CBO, Bloomberg

2. As a positive output gap corrected, it has not stopped at equilibrium; rather, it has always gone below equilibrium and eventually leads to a recession (Exhibit 2).

Exhibit 2: Real US output gap as a percent of real potential GDP (with forward estimates)



Sources: CBO, Haver Analytics. Data as of December 31, 2018.

What does this highlight? First, that the consensus growth scenario for the next few years is quite unlikely given historical precedence, and that it suggests downside risk. Second, that the typical late-cycle unwind process historically has led to a recession.

We are updating macro forecasts to reflect a more dovish Federal Reserve. Back in December the Fed did an about face and took a much more dovish tone. While we think monetary policy is currently in a tight zone, the fewer rate hikes now implied by the Fed dot plots decrease the risk of a severely restrictive policy stance, as illustrated in the recent drop in the St. Louis Fed Bank Stress Index. As such, we have modestly increased our growth forecast for 2021 from 1.0% to 1.3%. It is important to note that we still see growth heading to below trend. The new forecasts are just dampening the negative velocity and exhibiting a more balanced risk profile.

Rates update. In light of the modest tweak higher to our 2021 forecast, we are slightly raising our 10-year forecast by 10 basis points to 2.15% (Exhibit 3). However, we are leaving our call for FOMC rate cuts unchanged. This is primarily due to the directional component of growth remaining consistent with our previous forecast, the magnitude of change to our GDP forecast itself being relatively modest, and the lack of change to our forecasted level of inflation.

Catalysts for slowdown. While there is more uncertainty the further forecasts go out, especially as the timeframe in question incorporates the 2020 US presidential election cycle, we continue to think that, in addition to tight monetary policy, the other leading suspects of the slowdown will stem from the manifestation of our 'Small(er) World After All' theme. That is to say, the secular trends driving global growth lower have broad economic and political implications, with demographics, global fracturization, and a rise in protectionism and populist movements, key among them.

Exhibit 3: Aegon AM US economic forecasts

	2016	2017	2018	2019	2020	2021
GDP (Real %, YoY)	1.60	2.30	2.90	2.25	1.80	1.30
Unemployment (%)	4.90	4.40	3.90	3.60	3.90	4.40
Core PCE	1.70	1.60	1.90	2.00	1.90	1.70
Fed Funds (%)	0.75	1.50	2.50	2.50	1.75	1.25
TSY10 (%)	2.45	2.41	2.72	2.60	2.35	2.15

Sources: Aegon AM US as of May 1, 2019. Includes historical data sources from Bureau of Economic Analysis, Congressional Budget Office, Haver Analytics.

Disclosure

Past performance is not indicative of future results. This material is to be used for institutional investors and not for any other purpose. This communication is being provided for informational purposes in connection with the marketing and advertising of products and services. This material contains current opinions of the manager and such opinions are subject to change without notice. Aegon AM US is under no obligation, expressed or implied, to update the material contained herein. This material contains general information only on investment matters; it should not be considered a comprehensive statement on any matter and should not be relied upon as such. If there is any conflict between the enclosed information and Aegon AM US' ADV, the Form ADV controls. The information contained does not take into account any investor's investment objectives, particular needs, or financial situation. Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to you. The value of any investment may fluctuate. Investors should consult their investment professional prior to making an investment decision. Aegon AM US is not undertaking to provide impartial investment advice or give advice in a fiduciary capacity for purposes of any applicable federal or state law or regulation. By receiving this communication, you agree with the intended purpose described above.

The information presented is for illustrative purposes only.

Specific sectors mentioned do not represent all sectors in which Aegon AM US seeks investments. It should not be assumed that investments of securities in these sectors were or will be profitable.

Results for certain charts and graphs are included for illustrative purposes only and should not be relied upon to assist or inform the making of any investment decisions.

Aegon AM US may trade for its own proprietary accounts or other client accounts in a manner inconsistent with this report, depending upon the short term trading strategy and/or guidelines for a particular client as well as other variables.

This document contains "forward-looking statements" which are based on to the firm's beliefs, as well as on a number of assumptions concerning future events based on information currently available. These statements involve certain risks, uncertainties and assumptions which are difficult to predict. Consequently, such statements cannot be guarantees of future performance and actual outcomes and returns may differ materially from statements set forth herein. In addition, this material contains information regarding market outlook, rates of return, market indicators and other statistical information that is not intended and should not be considered an indication of the results of any Aegon AM US-managed portfolio.

Aegon Asset Management US is a US-based SEC registered investment adviser and is also registered as a Commodity Trading Advisor (CTA) with the Commodity Futures Trading Commission (CFTC) and is a member of the National Futures Association (NFA). Aegon Asset Management US is part of Aegon Asset Management, the global investment management brand of the Aegon Group.

Recipient shall not distribute, publish, sell, license or otherwise create derivative works using any of the content of this report without the prior written consent of Aegon USA Investment Management, LLC, 6300 C Street SW, Cedar Rapids, IA 52499.

©2019 Aegon Asset Management US