SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Definitions

Words can have different definitions, e.g., lead the metal versus lead the action. For clarity, some financial market terms have arbitrary but generally accepted definitions, e.g., a bear market for stocks is a decline in value of -20% or more. An economic recession generally is understood to be a period of significant decline in real economic activity that extends across the economy and lasts more than a few months. Over time, the measure of recession generally has been accepted as two consecutive quarters of decline even though the official measure is more sophisticated. Some key relationships with official recessions can provide perspective for investing ahead.

PERSPECTIVE

The Bureau of Economic Analysis ("BEA") measures all aspects of U.S. economic activity including overall real growth. The National Bureau of Economic Research ("NBER") identifies phases of the U.S. economic cycle including recessions. In the 75-year, post World War II period, growth has been the normal condition of the economy. This relatively smooth upward growth trend is shown in Chart I. Also shown are the 12 official periods of recession identified by NBER. In 10 of the 12 recessions, real economic activity did decline for at least two consecutive quarters, giving credence to this short-hand measure. In the other two recessions, at least two quarters of decline occurred although not consecutively. In addition, only once was a two-consecutive-quarter decline not identified as a recession.

Corporate profits are a closely followed subset of U.S. economic activity. Chart II shows the long, generally upward trend of profits over time. Also visible is the more irregular trend of profits versus overall economic activity. Corporate profits have tended to decline during recessions, but timing and magnitude have varied widely. Using the NBER recession time periods, profits declined in 8 of 12 recessions with an average decline of -12.4%. For the four recessions in which profits rose, the average increase was a meaningful +10.2%. Recessions are important markers but the peaks and troughs of the profits cycle have additional influences to be monitored and assessed.

The Conference Board maintains an economic leading indicator intended to forecast future economic activity. The indicator has turned downward before a recession. Among the variables in the indicator is a measure of the stock market performance. Chart III shows the trend of the U.S. stock market relative to recessions. Stock market returns during recessions are quite mixed. In 7 of 12 recessions, the stock market posted average gains of +16.8%. The stock market had declined in price earlier, giving support to its leading indicator status. However, during the other five recessions, the stock market declined -14.8% on average. Losses were recorded in each of the last three recessions.

INVESTMENT IMPLICATIONS

Labeling economic and financial market conditions with generally accepted definitions helps bring clarity to assessment and discussion. No matter how defined, however, the economy, profits and stock markets each have moved in cycles over time. The cycles are closely related but exact timing of relative peaks and troughs have varied widely. It is important to be aware of these variabilities and to understand the limitations of any definitions for investment decision-making.

CHART I

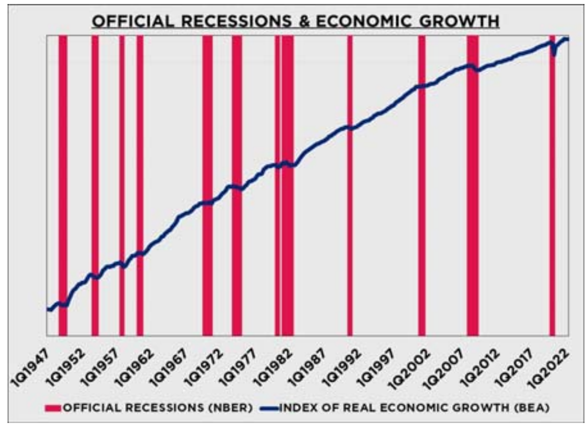

CHART II

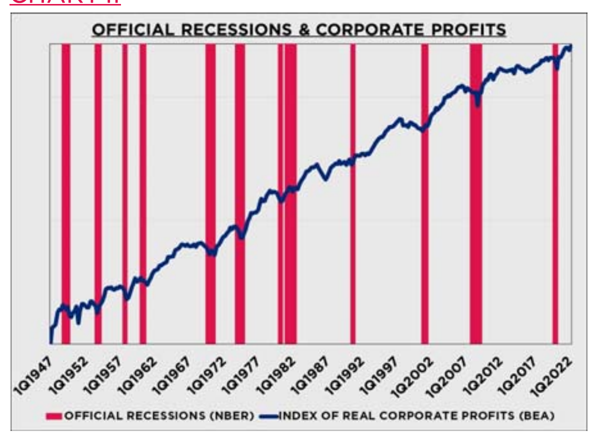

CHART III