Op-ed: A history of economic cycles going back to the 1850s suggests a recession is near

A history of economic cycles going back to the 1850s signals a bull market in the final innings

- At the end of this week, the current economic expansion will complete its eighth year and become 96 months old.
- The typical completed economic cycle has averaged about 58 months since 1945.
- Investors need to be prepared for a very rocky period for equity markets over the coming three to five years.

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An employee inspects a component for hybrid electric vehicle motors at the Toshiba International manufacturing facility in Houston, Texas.

America is about to celebrate a birthday, and not just a political one.

On June 30, the current economic expansion cycle will complete its eighth year and become 96 months old. According to the National Bureau of Economic Research (NBER), the official arbiter of U.S. business cycles, since 1854 the U.S. economy has experienced 34 cycles in all, and since the modern era of macroeconomics began post World War II, it has experienced 12 cycles in total (including the present one in both instances).

The typical completed economic cycle averaged 38.7 months and since 1945 it has averaged 58.4 months. Only two other cycles: the ones from 1961-1969 (which lasted 106 months) and 1991-2001 (which lasted 120 months) managed to last longer than the one we are presently experiencing.

Statistically speaking, when the economy has been in expansion mode, we have only experienced a cycle this old only 2.5 percent of the time since 1854, and only slightly more than 4 percent of the time since 1945. This a tail condition no doubt.

The historical unconditional probability of having a recession in any given year is roughly 15 percent. Making it conditional on the historical length of the cycle would place it at 50 percent for the coming 12 months and 100 percent in the coming 24 months.

By any measure, the cycle is old. And while Fed Chair Janet Yellen is technically correct when she argues that business cycles don't die of old age, I would argue that no living being technically does die of old age. We all eventually die of symptoms that impact us far more severely when we are older than when we are younger.

The economy is no different. When the economy is running at full speed as it is today, with little slack in the labor markets and with confidence levels at or near all-time highs and valuations stretched across equity sectors, shocks that may have had little impact on the economy during the early years can derail the whole thing now.

Speaking of valuations, the history of the prior two tails are mixed in the short run and abysmal for the longer run.

When the 1960s expansion reached its ninth year (December 1968 to be exact), the S&P 500 had already peaked the prior month and proceeded to drop 36 percent into the spring of 1970. The three-year and five-year total price returns of the S&P 500 were a negative 1.7 percent and a negative 6.1 percent, respectively.

When the 1990s expansion reached its ninth year (March 1999 to be exact), the S&P 500 proceeded to rally a further 17.5 percent before peaking 12 months later, impressive by any measure. However, the three-year and five-year returns were even weaker than the 1960s, at negative 10.8 percent and negative 12.45 percent respectively.

So, while the short-term performance is mixed and one can argue with a continuation of recent performance given the strong technicals, the longer-term outlook is quite abysmal.

We sincerely wish our business cycle a very happy ninth birthday, however, given the rarity of how often we reach such heights, we need to be very wary of continued strength and be prepared for potentially a very rocky period for equity markets over the coming three to five years.

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