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# The Conference Board<sup>®</sup> U.S. Business Cycle Indicators<sup>SM</sup> **U.S. LEADING ECONOMIC INDICATORS** **AND RELATED COMPOSITE INDEXES FOR JUNE 2005**

### Revisions in U.S. Leading Indicators

The July 2005 release incorporates two major revisions to the composite index of leading economic indicators (LEI): 1) a new method for calculating the contribution of the yield spread (BCI series 129) in the LEI and 2) a trend adjustment to the LEI. The new measure of the yield spread improves the performance of the LEI by better reflecting the way the yield spread anticipates cyclical economic turning points. The trend adjustment facilitates interpretation and use of the LEI.

A minor procedural change is also made to the *Vendor Performance* (BCI series 32) and *Index of Consumer Expectations* (BCI series 83) components. The monthly contributions of both series will now be calculated using simple difference instead of percent change. These changes have a small effect on the new set of standardization factors, but they have little effect on the cyclical performance of the composite leading index.

These changes are the result of research at The Conference Board (TCB) and regular consultations with its Business Cycle Indicators Advisory Panel and other experts. The Conference Board continuously monitors the behavior and performance of the composite indexes and their components and makes changes from time to time (See BCI Handbook, 2001, for a description of the previous comprehensive revision that The Conference Board undertook in 1996.) This revision is consistent with long-standing TCB policy to make changes to the indexes when research indicates substantial improvements are possible.

The Conference Board also undertakes maintenance benchmark revisions yearly, normally in January, when the histories of the composite indexes are recomputed to reflect data revisions. This month's release also incorporates benchmark revisions to the composite indexes which bring them up-to-date with revisions in the source data and update the standardization factors used in their calculation. This maintenance procedure, last performed in January 2005, is repeated in this release in order to maintain data consistency. These maintenance revisions do not change the cyclical properties of the indexes and their effects are very small, as expected.

Detailed descriptions and discussion of the changes are posted on The Conference Board web site at [www.conference-board.org/economics/bci](http://www.conference-board.org/economics/bci).

The Conference Board announced today that the U.S. leading index increased 0.9 percent, the coincident index increased 0.2 percent and the lagging index increased 0.3 percent in June.

- Based on the benchmarked figures announced today, the leading index increased sharply in June following no change in May. The revised leading index has increased at a 1.2 percent annual rate over the last six months, but this is down from a peak of about 10.0 percent at the end of 2003. The strengths and weaknesses among the components of the leading index have been roughly balanced in recent months.
- The coincident index, a measure of current economic activity, increased again in June. The coincident index has been increasing at a relatively steady 2.5 percent annual rate since April 2003, and the strength continues to be widespread. At the same time, the growth rate of real GDP has been fluctuating around a 4.0 percent annual rate over the last two years.
- The leading index increased rapidly through the first quarter of 2004 but this has been followed by a steady slowing of growth through the first half of 2005. The sharp pick up in June keeps the leading index on a slightly rising trend, and this behavior is consistent with the economy continuing to expand moderately in the near term, but at a slower pace than in recent quarters.

LEADING INDICATORS. Seven of the ten indicators that make up the leading index increased in June. The positive contributors – beginning with the largest positive contributor – were index of consumer expectations, vendor performance, real money supply\*, average weekly initial claims for unemployment insurance (inverted), interest rate spread, stock prices, and building permits. The negative contributor was manufacturers’ new orders for nondefense capital goods\*. The average weekly manufacturing hours and manufacturers’ new orders for consumer goods and materials\* held steady in June.

The leading index now stands at 137.7 (1996=100). Based on revised data, this index remained unchanged in May and increased 0.2 percent in April. During the six-month span through June, the leading index increased 0.6 percent, with five out of ten components advancing (diffusion index, six-month span equals fifty-five percent).

COINCIDENT INDICATORS. All four indicators that make up the coincident index increased in June. The positive contributors to the index – beginning with the largest positive contributor – were industrial production, employees on nonagricultural payrolls, personal income less transfer payments\*, and manufacturing and trade sales\*.

The coincident index now stands at 120.5 (1996=100). This index increased 0.1 percent in May and increased 0.3 percent in April. During the six-month period through June, the coincident index increased 0.2 percent.

Lagging Indicators. The lagging index stands at 119.7 (1996=100) in June, with four of the seven components advancing. The positive contributors to the index – beginning with the largest positive contributor – were average duration of unemployment (inverted), ratio of manufacturing and trade inventories to sales\*, average prime rate charged by banks, and change in labor cost per unit of output\*. The negative contributors – beginning with the largest negative contributor – were commercial and industrial loans outstanding\* and change in CPI for services. The ratio of consumer installment credit to personal income\* held steady in June. Based on revised data, the lagging index increased 0.4 percent in May and increased 0.3 percent in April.

## **Details on the Major Revisions in U.S. Leading Indicators**

The new measure of the yield spread, one of the current components of the LEI, uses the same interest rate spread (10-year Treasury note minus federal funds rate) in the calculations. The revision involves a shift from using the yield spread in the LEI to using the cumulative sum of the yield spread. The primary effect of this revision is to change the way the contribution of the yield spread is calculated.

The LEI has ten components and the monthly contribution calculation is based on monthly changes in each component. With the revision, the contribution of the yield spread will be calculated from the value of the yield spread in a given month instead of its change over the previous month. Currently, the yield spread contributes negatively – i.e., reduces the growth rate of the index – to the LEI whenever the spread is declining and this happens before recessions, but at many other times as well. The new measure will contribute negatively to the LEI only when the spread inverts; that is, when the long rate is less than the short rate. The cumulative measure of the yield spread provides a less “noisy” leading indicator, one that better reflects the effect of the yield spread on future economic activity.

The July 2005 revision also reinstates an old and well-known trend adjustment procedure to the leading and lagging indexes. This procedure offers two advantages:

- The long-term trend in the LEI will be “fixed” as the procedure equates the trend in the LEI to the trend that is measured by the average growth rate in the coincident index (CEI). This means that the trend of the LEI will not vary with changes in the composition of the index or set of indicators used to calculate it. This facilitates the interpretation of the indexes as cyclical measures and provides a more consistent framework for their use.
- The trend adjustment makes the growth of the leading and lagging composite indexes more similar to that of the coincident index. In turn, the levels of these indexes are more meaningful since the coincident index is a measure of current economic activity. While the composite indexes are mainly used to indicate directional changes in aggregate economic activity, many users also regard them as measures of the level of economic activity. The trend adjustment facilitates this use.

Further detailed descriptions and discussion of the changes are posted on The Conference Board web site at [www.conference-board.org/economics/bci](http://www.conference-board.org/economics/bci).

DATA AVAILABILITY AND NOTES.

The data series used by The Conference Board to compute the three composite indexes and reported in the tables in this release are those available “as of” 12 Noon on July 20, 2005. Some series are estimated as noted below.

\* Series in the leading index that are based on The Conference Board estimates are manufacturers’ new orders for consumer goods and materials, manufacturers’ new orders for nondefense capital goods, and the personal consumption expenditure used to deflate the money supply. Series in the coincident index that are based on The Conference Board estimates are personal income less transfer payments and manufacturing and trade sales. Series in the lagging index that are based on The Conference Board estimates are inventories to sales ratio, consumer installment credit to income ratio, change in labor cost per unit of output, the consumer price index, and the personal consumption expenditure used to deflate commercial and industrial loans outstanding.

The procedure used to estimate the current month’s personal consumption expenditure deflator (used in the calculation of real money supply and commercial and industrial loans outstanding) now incorporates the current month’s consumer price index when it is available before the release of the U.S. Leading Economic Indicators.

Effective with the September 18, 2003 release, the method for calculating manufacturers’ new orders for consumer goods and materials (A0M008) and manufacturers’ new orders for nondefense capital goods (A0M027) has been revised. Both series are now constructed by deflating nominal aggregate new orders data instead of aggregating deflated industry level new orders data. Both the new and the old methods utilize appropriate producer price indices. This simplification remedies several issues raised by the recent conversion of industry data to the North American Classification System (NAICS), as well as several other issues, e.g. the treatment of semiconductor orders. While this simplification caused a slight shift in the levels of both new orders series, the growth rates were essentially the same. As a result, this simplification had no significant effect on the leading index.

Effective with the January 22, 2004 release a programming error in the calculation of the leading index -- in place since January 2002 -- has been corrected. The cyclical behavior of the leading index was not affected by either the calculation error or its correction, but the level of the index in the 1959-1996 period is slightly higher.

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THE CYCLICAL INDICATOR APPROACH. The composite indexes are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging indexes are essentially composite averages of between four and ten individual leading, coincident, or lagging indicators. (See page 3 for details.) They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component—primarily because they smooth out some of the volatility of individual components.

Historically, the cyclical turning points in the leading index have occurred before those in aggregate economic activity, while the cyclical turning points in the coincident index have occurred at about the same time as those in aggregate economic activity. The cyclical turning points in the lagging index generally have occurred after those in aggregate economic activity.

U.S. Composite Indexes: Components and Standardization Factors

<u>Leading Index</u>	<u>Factor</u>
1 Average weekly hours, manufacturing	0.2533
2 Average weekly initial claims for unemployment insurance	0.0328
3 Manufacturers' new orders, consumer goods and materials	0.0755
4 Vendor performance, slower deliveries diffusion index	0.0702
5 Manufacturers' new orders, nondefense capital goods	0.0191
6 Building permits, new private housing units	0.0263
7 Stock prices, 500 common stocks	0.0375
8 Money supply, M2	0.3521
9 Interest rate spread, 10-year Treasury bonds less federal funds	0.1034
10 Index of consumer expectations	0.0298

Coincident Index

1 Employees on nonagricultural payrolls	0.5236
2 Personal income less transfer payments	0.2149
3 Industrial production	0.1459
4 Manufacturing and trade sales	0.1156

Lagging Index

1 Average duration of unemployment	0.0372
2 Inventories to sales ratio, manufacturing and trade	0.1218
3 Labor cost per unit of output, manufacturing	0.0623
4 Average prime rate	0.2751
5 Commercial and industrial loans	0.1144
6 Consumer installment credit to personal income ratio	0.1972
7 Consumer price index for services	0.1920

Notes:

The component factors are inversely related to the standard deviation of the month-to-month changes in each component. They are used to equalize the volatility of the contribution from each component and are “normalized” to sum to 1. When one or more components are missing, the other factors are adjusted proportionately to ensure that the total continues to sum to 1.

These factors were revised effective on the release in July 2005, and all historical values for the three composite indexes were revised at this time to reflect the changes. (Under normal circumstances, updates to the leading, coincident, and lagging indexes only incorporate revisions to data over the past six months.) The factors for the leading index were calculated using 1984-2003 as the sample period for measuring volatility. A separate set of factors for the 1959-1983 period is available upon request. The primary sample period for the coincident and lagging indexes was 1959-2003. For additional information on the standardization factors and the index methodology see: “Benchmark Revisions in the Composite Indexes,” *Business Cycle Indicators* December 1997 and “Technical Appendix: Calculating the Composite Indexes” *Business Cycle Indicators* December 1996, or the Web site: [www.conference-board.org/economics/bci](http://www.conference-board.org/economics/bci).

The trend adjustment factor for the leading index is -0.0139, and the trend adjustment factor for the lagging index is 0.1706.

To address the problem of lags in available data, those leading, coincident and lagging indicators that are not available at the time of publication are estimated using statistical imputation. An autoregressive model is used to estimate each unavailable component. The resulting indexes are therefore constructed using real and estimated data, and will be revised as the unavailable data during the time of publication become available. Such revisions are part of the monthly data revisions, now a regular part of the U.S. Business Cycle Indicators program. The main advantage of this procedure is to utilize in the leading index data such as stock prices, interest rate spread, and manufacturing hours that are available sooner than other data on real aspects of the economy such as manufacturers’ new orders. Empirical research by The Conference Board suggests that there are real gains in adopting this procedure to make all the indicator series as up-to-date as possible.

**U.S. Leading Economic Indicators news release schedule for 2005:**

August 18, Thursday.....for July 2005 data  
September 22, Thursday.....for August 2005 data  
October 20, Thursday.....for September 2005 data  
November 21, Monday.....for October 2005 data  
December 22, Thursday.....for November 2005 data

All releases are at 10:00 AM ET.

ABOUT THE CONFERENCE BOARD. The Conference Board is the premier business membership and research network founded in 1916. It has become a global leader in helping executives build strong professional relationships, expand their business knowledge and find solutions to a wide range of business challenges. Its Economics Program, under the direction of Chief Economist Gail Fosler, is a recognized source of forecasts, analysis and objective indicators such as Leading Economic Indicators and Consumer Confidence.

This role is part of a long tradition of research and education that stretches back to the compilation of the first continuous measure of the cost of living in the United States in 1919. In 1995, The Conference Board assumed responsibility for computing the composite indexes from the U.S. Department of Commerce. The Conference Board now produces business cycle indexes for the U.S., Australia, France, Germany, Korea, Japan, Mexico, Spain and the U.K. To subscribe to any of these indexes, please visit [www.conference-board.org/economics/bci](http://www.conference-board.org/economics/bci) or contact the customer service department at 212-339-0345 or email [indicators@conference-board.org](mailto:indicators@conference-board.org).

AVAILABLE FROM THE CONFERENCE BOARD

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**Table 1.--Summary of Composites Indexes**

	2004			2005			
	Dec	Jan	Feb	Mar	Apr	May	Jun
Leading index	136.9 r	136.8 r	137.2 r	136.2 r	136.5 r	136.5 r	137.7 p
Percent change	.7 r	-.1 r	.3 r	-.7 r	.2 r	.0 r	.9 p
Diffusion index	65.0	55.0	50.0	10.0	60.0	45.0	80.0
Coincident index	120.3 r	119.5 r	119.7 r	119.8 r	120.1 r	120.2 p	120.5 p
Percent change	1.3	-.7	.2	.1 r	.3 r	.1 p	.2 p
Diffusion index	100.0	50.0	75.0	62.5	75.0	100.0	100.0
Lagging index	116.4 r	118.0 r	118.6 r	118.6 r	118.9 p	119.4 p	119.7 p
Percent change	-.8 r	1.4 r	.5 r	.0 r	.3 p	.4 p	.3 p
Diffusion index	35.7	64.3	71.4	42.9	57.1	71.4	57.1
Coincident-lagging ratio	103.4 r	101.3 r	100.9 r	101.0 r	101.0 r	100.7 p	100.7 p
	Jun to	Jul to	Aug to	Sep to	Oct to	Nov to	Dec to
	Dec	Jan	Feb	Mar	Apr	May	Jun
Leading index							
Percent change	1.8	1.3	1.6	.7	1.0	.4	.6
Diffusion index	80.0	50.0	60.0	40.0	70.0	40.0	55.0
Coincident index							
Percent change	2.6	1.5	1.5	1.6	1.4	1.2	.2
Diffusion index	100.0	100.0	100.0	100.0	100.0	100.0	75.0
Lagging index							
Percent change	.6	1.2	1.5	1.2	1.3	1.8	2.8
Diffusion index	57.1	42.9	57.1	71.4	57.1	57.1	85.7

p Preliminary. r Revised (noted only for index levels and one-month percent changes).

CALCULATION NOTE: The diffusion indexes measure the proportion of the components that are rising. Components that rise more than 0.05 percent are given a value of 1.0, components that change less than 0.05 percent are given a value of 0.5, and components that fall more than 0.05 percent are given a value of 0.0.

The full history of composite and diffusion indexes is available by subscription on our web site at [www.conference-board.org/economics/bci](http://www.conference-board.org/economics/bci)

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**Table 2.--Data and Net Contributions for Components of the Leading Index**

Component	2004		2005				
	Dec	Jan	Feb	Mar	Apr	May	Jun
Leading index component data							
Average work week, production workers, mfg. (hours).....	40.5	40.7	40.6	40.4	40.5	40.4	40.4 p
Average weekly initial claims, state unemployment insurance (thousands)*.	330.0	330.1	307.4	337.8	321.9	334.7	320.7 p
Manufacturers' new orders, consumer goods and materials (mil. 1982 dol.).....	148,228	146,349 r	145,057	143,953	145,693 r	146,276 r	146,275 **
Vendor performance--slower deliveries diffusion index (percent).....	56.1	53.7	53.9	52.5	51.5	50.5	53.1
Manufacturers' new orders, nondefense capital goods (mil. 1982 dol.).....	48,526	48,878 r	48,698	47,005	48,787 r	55,748 r	52,845 **
Building permits (thous.).....	2,081	2,136	2,093	2,021	2,148	2,062 r	2,111
Stock prices, 500 common stocks (c) (index: 1941-43=10).....	1,199.21	1,181.41	1,199.63	1,194.90	1,164.62	1,178.28	1,202.26
Money supply, M2 (bil. chn. 2000 dol.)....	5,903.9 r	5,907.4 r	5,910.4 r	5,903.3 r	5,876.1 r	5,874.6 r	5,901.0 **
Interest rate spread, 10-year Treasury bonds less federal funds.....	2.07	1.94	1.67	1.87	1.55	1.14	0.96
Index of consumer expectations (c) (1966:1=100).....	90.9	85.7	84.4	82.8	77.0	75.3	85.0
LEADING INDEX (1996=100).....	136.9 r	136.8 r	137.2 r	136.2 r	136.5 r	136.5 r	137.7 p
Percent change from preceding month..	0.7 r	-0.1 r	0.3 r	-0.7 r	0.2 r	0.0 r	0.9 p
Leading index net contributions							
Average work week, production workers, mfg.....	....	.12	-.06	-.13	.06	-.06	.00
Average weekly initial claims, state unemployment insurance.....	....	.00	.23	-.31	.16	-.13	.14
Manufacturers' new orders, consumer goods and materials.....	....	-.10	-.07	-.06	.09	.03	.00 **
Vendor performance--slower deliveries diffusion index.....	....	-.17	.01	-.10	-.07	-.07	.18
Manufacturers' new orders, nondefense capital goods.....	....	.01	-.01	-.07	.07	.25	-.10 **
Building permits.....	....	.07	-.05	-.09	.16	-.11	.06
Stock prices, 500 common stocks (c)	....	-.06	.06	-.01	-.10	.04	.08
Money supply, M2.....	....	.02	.02	-.04	-.16	-.01	.16 **
Interest rate spread, 10-year Treasury bonds less federal funds.....	....	.20	.17	.19	.16	.12	.10
Index of consumer expectations (c)	....	-.15	-.04	-.05	-.17	-.05	.29

p Preliminary. r Revised. c Corrected.

\* Inverted series; a negative change in this component makes a positive contribution to the index.

\*\* Statistical Imputation (See page 3 for more details)

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CALCULATION NOTE--The percent change in the index does not always equal the sum of the net contributions of the individual components (because of rounding effects and base value differences).



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**Table 3.--Data and Net Contributions for Components of the Coincident and Lagging Indexes**

Component	2004		2005				
	Dec	Jan	Feb	Mar	Apr	May	Jun
Coincident index component data							
Employees on nonagricultural payrolls (thousands).....	132,449	132,573	132,873	132,995	133,287 r	133,391 r	133,537
Personal income less transfer payments (ann. rate, bil. chn. 2000 dol.).....	8,157.1	7,891.6 r	7,912.8 r	7,913.7 r	7,926.9 r	7,938.2 r	7,956.7 **
Industrial production (index: 1997=100).....	117.908	117.753	118.303	118.595 r	118.228 r	118.631 r	119.657
Manufacturing and trade sales (mil. chn. 2000 dol.).....	947,333	950,749 r	941,916 r	941,099 r	949,471 r	950,477 **	953,037 **
COINCIDENT INDEX (1996=100).....	120.3 r	119.5 r	119.7 r	119.8 r	120.1 r	120.2 p	120.5 p
Percent change from preceding month....	1.3	-0.7	0.2	0.1 r	0.3 r	0.1 p	0.2 p
Coincident index net contributions							
Employees on nonagricultural payrolls.....	....	.05	.12	.05	.11	.04	.06
Personal income less transfer payments...	....	-.71	.06	.00	.04	.03	.05 **
Industrial production.....	....	-.02	.07	.04	-.05	.05	.13
Manufacturing and trade sales.....	....	.04	-.11	-.01	.10	.01 **	.03 **
Lagging index component data							
Average duration of unemployment (w eeks)*.....	19.3	19.3	19.1	19.5	19.6	18.8	17.1
Ratio, manufacturing and trade inventories to sales (chain 2000 dol.).....	1.270	1.277 r	1.291 r	1.294 r	1.284 r	1.286 **	1.287 **
Change in index of labor cost per unit of output, mfg. (6-month percent, ann. rate)	2.9	2.6	1.5	.20	.3 **	.4 **	.5 **
Average prime rate charged by banks (percent).....	5.14	5.25	5.49	5.58	5.75	5.98	6.01
Commercial and industrial loans outstanding (mil. chn. 2000 dol.).....	536,188 r	560,010 r	567,968 r	561,625 r	573,110 r	580,781 r	567,408 **
Ratio, consumer installment credit out- standing to personal income (percent).....	20.41 r	21.05	21.00 r	20.97 r	20.85	20.77 r	20.77 **
Change in CPI for services (6-month percent, ann. rate).....	2.7	2.6	3.0	3.3	3.7	3.2	3.1
LAGGING INDEX (1996=100).....	116.4 r	118.0 r	118.6 r	118.6 r	118.9 p	119.4 p	119.7 p
Percent change from preceding month....	-.8 r	1.4 r	.5 r	.0 r	.3 p	.4 p	.3 p
Lagging index net contributions							
Average duration of unemployment.....	....	.00	.04	-.08	-.02	.16	.35
Ratio, manufacturing and trade inventories to sales.....	....	.07	.13	.03	-.09 **	.02 **	.01 **
Change in index of labor cost per unit of output, mfg.....	....	-.02	-.07	-.08	.01	.01 **	.01 **
Average prime rate charged by banks.....	....	.03	.07	.02	.05	.06	.01
Commercial and industrial loans outstanding.....	....	.50	.16	-.13	.23	.15	-.27 **
Ratio, consumer installment credit out- standing to personal income.....	....	.61	-.05	-.03	-.11	-.08	.00 **
Change in CPI for services.....	....	-.02	.08	.06	.08	-.10	-.02

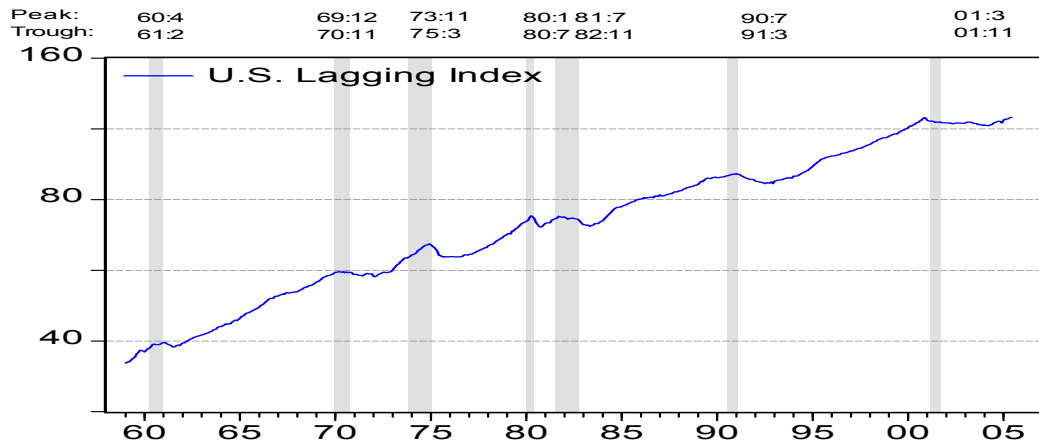
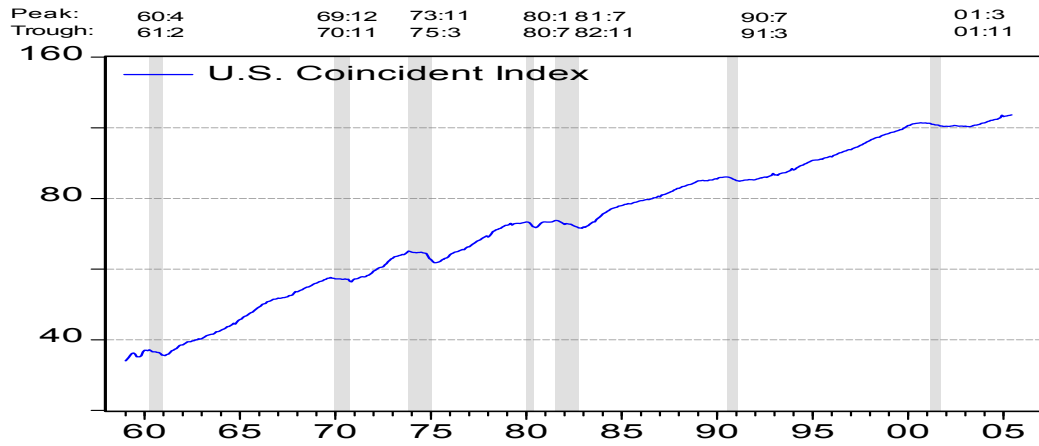
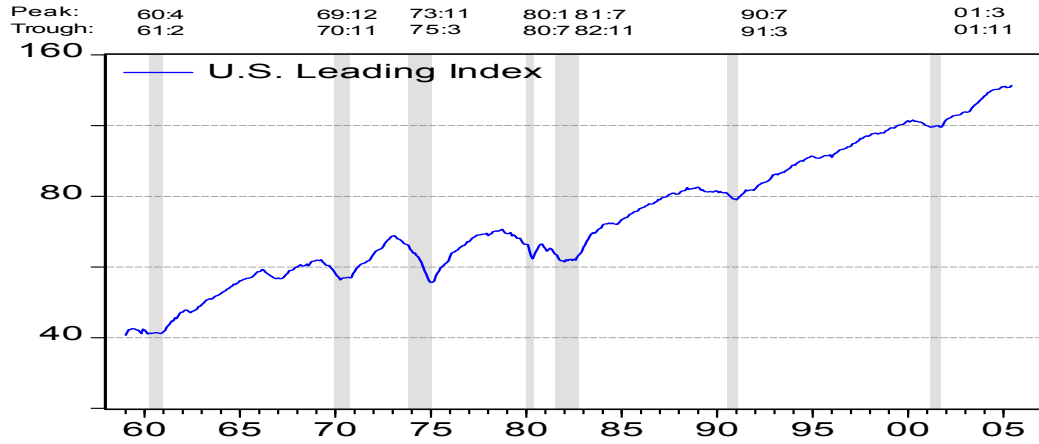
CPI Consumer Price Index. For additional notes see table 2.

\* Inverted series; a negative change in this component makes a positive contribution to the index.

\*\* Statistical Imputation (See page 3 for more details)

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### U.S. Composite Indexes (1996=100)



Shaded areas represent recessions.

Source: The Conference Board