



## ***Ahead of the Curve: A Common Sense Guide to Forecasting Business and Market Cycles***

By Joseph H. Ellis  
Harvard Business School Press

Economic and stock market cycles affect companies in every industry. Unfortunately, a confusing array of anecdotal and conflicting indicators often renders it impossible for managers and investors to see where the economy is heading in time to take corrective action. Now, a 35-year Wall Street veteran unveils a new forecasting method that will help managers and investors understand and predict the economic cycles that control their businesses and financial fates. In *Ahead of the Curve*, Joseph H. Ellis argues that the problem with current forecasting models lies not in the data, but rather in the lack of a clear framework for putting the data in context and reading it correctly. The book explains critical economic indicators in non-technical language, identifies and documents the recurring cause-and-effect relationships that consistently predict turning points in the economy, and provides the tools managers and investors need to position themselves ahead of cyclical upturns and downturns. Economic events are not as random and unpredictable as they seem. This book will help readers recognize and react to signs of change that their rivals don't see and win a sizeable competitive advantage. Joseph H. Ellis was a partner of Goldman Sachs and was ranked for 18 consecutive years by Institutional Investor magazine as Wall Street's #1 retail-industry analyst.

Ellis shares with his reader what he learned when he set out "to investigate how I might develop an improved method for forecasting consumer spending and, with it, the rest of the economy. Ellis commented, "Furthermore, I wanted to document the basis for my forecasts with such clarity that my [Goldman Sachs] clients would understand not only the forecast but also the rationale supporting it."

As Ellis explained, his book has two broad purposes: "To help us understand and then overcome major flaws in the way most economic information is reported and digested by the business, investment, and economist communities" and "To put this new framework to work in forecasting." The material is carefully organized and presented in the following four parts:

1. "Seeing" the Economy: Creating Order from Chaos
2. Consumer Spending: The Cornerstone of the Economy and the Stock Market
3. Forecasting Consumer Spending: Understanding the Key Indicator Relationships
4. From Theory to Practice: Applying the Charting Discipline to Your Own Forecasting

Ellis then provides four appendices. It would be a disservice to him, as well as to those who have not yet read his book, to comment in detail on each of the most important insights concerning the "major flaws" to which Ellis refers earlier.

Ellis explains how and why consumer spending drives the demand chain in the economy, in terms of the correlations between and among consumer spending, corporate profits, and the marketplace. When commenting on industrial production and the inventory effect Ellis stated, "The key point here is that because inventories in the retail, distributor, and factory pipelines grow during periods of strengthening consumer spending and shrink when consumer spending slows, the changes in the industrial production that supplies this system are far more volatile than the changes in consumer spending at the front end of the system." (Page 75)

Ellis' analysis of the separate but interdependent factors that can (indeed should) guide and inform forecasting consumer spending—specifically, real income; employment and unemployment, interest rates, inflation, and the economic cycle; interest rates and the stock market, and the link between federal deficits and interest rates. When commenting on the key determinant of growth in unit consumer spending, Ellis suggests that it is "the unit purchasing power, or real wages, of the 93% to 96% of the workforce that is employed (given an unemployment rate of 4% to 7%), rather than marginal changes in the number of unemployed (or the unemployment rate)." Then later in Chapter 10, Ellis explains how the real average hourly earnings series published by the Bureau of Labor Statistics "provides the measurement we need of the purchasing power of those employed."

Moreover, it “serves as the single most reliable leading indicator of consumer spending and consequently also is one of the better predictors of the general direction of the economy and the stock market.” (Pages 117-118)

Finally, Ellis explains how to calculate the macroeconomic effect of advancing or declining consumer borrowing on year-over-year consumer spending growth. Ellis stated, “In general, although borrowing clearly is affected by interest rates, it increases most when employment growth in the economy is at its strongest and consumers have the economic confidence to take on additional debt; borrowing has its most impact when job-based economic confidence is low.” (Page 214)

Even those who have little interest in forecasting business and market cycles will receive a wealth of valuable advice about prudent management of money. As a value-added service, Ellis provides monthly updated versions of the nineteen most important charts in his book (provided in table D-1 on page 256) at [www.aheadofthecurve-thebook.com](http://www.aheadofthecurve-thebook.com). 