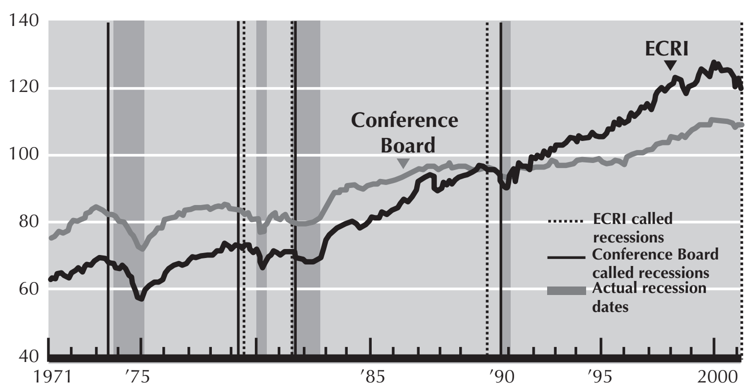
In order to distill the message of the indicators, we combine them into a single summary measure. One difficulty in doing this is that it essentially involves combining apples and oranges. For example, how do you add up or balance out overtime hours and corporate bond yields? To get the most out of the indicators, it is necessary, in a sense, to make fruit juice.

In the late 1950s, Geoffrey Moore and his colleagues developed just such a breakthrough approach—a statistical tool known as a composite index.[1] The idea behind the composite index is that the common denominator of various cyclical indicators could be based on their sensitivity to the business cycle. Some indicators are extremely sensitive and move up and down a great deal before recessions and recoveries, such as stock prices. Others, like the average workweek, are less sensitive, but even the small movements they exhibit are significant. Looking at indicators in terms of their relative sensitivity to the cycle provides a common dimension on which they can be combined. This was the approach he used to develop the Index of Leading Economic Indicators (LEI).

Forty years later, the creation of the LEI remains a landmark accomplishment. But in terms of our ability to predict turning points, the state of the art has advanced considerably. The innovations reflected a more sophisticated understanding of the cyclical nature of the economy. From that expanded body of knowledge, we have developed forecasting tools that leave the LEI far behind.

It is not without nostalgia that we look back on Moore's pioneering work. But the demand for better forecasting compelled

How the Leading Indicators Compare



Note: Conference Board calls were not made at the time, but rather they would have called a recession based on a standard they've created since the last recession; ECRI did not make recession calls prior to 1979.

Sources: Economic Cycle Research Institute; The Conference Board

This chart ran in the Wall Street Journal *on April 19, 2001, comparing ECRI's Weekly Leading Index with the Index of Leading Economic Indicators (LEI, maintained by the Conference Board). ECRI forecast that a recession was unavoidable, while the LEI indicated that the expansion would continue.*

us to move forward. The Model T Ford represented cutting-edge technology in 1908, and remains highly valued by car aficionados. Still, nobody would rely on one today to make an important trip. Similarly, depending on the LEI to predict turning points has proved dangerous. In fact, the LEI failed to predict the last two U.S. recessions in real time, while ECRI's Weekly Leading Index (WLI), which we will soon discuss in detail, was right on target.[2]

Since the original LEI was put together, we have made substantial progress in composite index construction and in cyclical forecasting in general. Those advances are rooted in a broad observation of cycles wherever they exist, often in places no one looked before. To understand the foundation for these improvements, we must step back from a U.S.-centric view and examine business cycles around the world.