Weekly Market Insights

April 29, 2019

An Interesting Market, Interesting Economic Reports, and the Opening of Primary Season

The equity markets ended the week mixed with no great movement in either direction. The DJIA was -0.06%, the S&P 500 +1.20% and the NASDAQ was +1.85%.

Earnings reports dominated investor thinking throughout the week and this will, of course, be true until the end of earnings season. But, important economic statistics are being released which should command investors' attention. This past week first quarter GDP was released. It was a surprise on the up side. GDP is an important number, but concerned citizens should know what it really means and be aware of its forecasting limitations. GDP has been called the most powerful number on earth and it is hard to argue against that. As Charles Steindel writes, GDP is a number that is not an absolute such as temperature, fresh water freezes at 32 degrees Fahrenheit and that is perfectly clear. But to say that GDP grew at 3.2% in the first quarter of 2019 cannot be interpreted without considerable context. The U.S. GDP did grow at 3.2% for the first quarter of 2019. At first glance, one might expect that number to inspire investors to enter the market, but no. Investors held back, first, because earnings reports failed to inspire and second, investors appear to have put the GDP number in context. There is no question that growth of 3.2% is good news; the question is how good? The first point to consider is the release is an "advance" release. The advance releases are notorious for future revisions. This should always temper investor response to first releases. Next, GDP is made up of many factors[1] and each component is highly complex and difficult to measure. Looking at the makeup of the components this quarter gives us and many others a degree of concern. The last term in the GDP identity, net exports, was much better than in the past, and, confusingly, a smaller negative than normal. Imports fell the last few years, making net exports a smaller detractor than in previous quarters. This may reverse itself next quarter and the way it happened, less imports is not necessarily a gain in U.S. production, just a deduction of imports. Another cause for concern is the growth of business inventories. There may be many reasons for this: a buildup of inventories in anticipation of higher tariffs, a slowdown in sales, or business optimism in future sales. If it is the first reason, then inventories will fall over time with no harm done. The second may lead to a slowdown in the U.S. economy, and the third is what we all hope for. Market participants appear to have taken these points into consideration and treated the release as good news, but have taken a wait and see attitude. We entirely agree. This is just a cautionary thought, not a bearish one.

Former Vice President Joe Biden has formally entered the contest for the Democratic candidacy for president. This now sets the stage for the 2020 election cycle. It promises to be one of exceptional rancor and harshness seldom seen in the past. No one, of course, can tell how it will turn out, but we all can be assured that many proposals will be put forward. We can also be assured that all these proposals, whether brilliant or foolish, will go through teams of spin doctors, campaign workers, and others trying to make these proposals clever and fit into sound bites. Not only do they try to make them into memorable sound bites, but they diligently work to obscure any part of the proposal that may have a downside. We will be treated to *impartial* experts opining, pro and con. A word of caution, there are very few completely impartial experts, particularly those hired to write or opine for a particular candidate or proposal. The cautionary tale is to read and listen very carefully no matter how wonderful the proposal may be.

As we enter the silly season I'd like to recommend a book: Advice and Dissent: Why America Suffers When Economics and Politics Collide, by Alan S. Blinder, Ph.D., Basic Books, 2018.

Professor Blinder is the Gordon S. Rentschler Professor of Economics and Public Affairs at Princeton. He is a former member of the Clinton Council of Economic Advisers and a former Vice Chairman of the Federal Reserve.

It is informative, particularly for this season, and written with great humor. A caution, Professor Blinder is clearly a Democrat and some of his examples show this, but the reader should not be discouraged or upset; he is fair and his points, often humorous, are important and very helpful.

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[1] GDP = C + I + G + (Ex-Im)
C= CONSUMERS, I=INVESTMENT, G=GOVERNMENT, (EX-IM)=NET EXPORTS