MV CAPITAL MANAGEMENT

Weekly Market Flash

The Hard, the Soft and the Ugly

April 28, 2017

Another Friday, another "hard" piece of data that comes in shy of expectations. The Bureau of Economic Analysis released the first estimate of Q1 2017 real GDP growth, and the 0.7 percent quarter-on-quarter growth rate was a bit below economists' consensus estimate of one percent. As a standalone data point this does not tell us very much. There will be two further revisions that could increase (or reduce) this first estimate. Q1 is notoriously subject to seasonal factors; for example, a warmer than average winter resulted in lower utility consumption by households, which in turn had a slowing effect on personal consumption expenditures. The first quarter of 2016 also produced sub-one percent growth, but that perked up to more robust levels as the year played out. As always, one data point doth not a trend make.

Sentimental Journey

That being said, today's release will do little to shed light on the mysterious "hard versus soft" debate that has been a staple on the menu of financial gabfests this year. The GDP number comes on the heels of two other underwhelming "hard" macro releases of recent Fridays past: headline inflation below the Fed's two percent target, and March payroll gains falling short of 100,000. By contrast, a number of "soft" numbers reflecting sentiment among consumers and small business owners have being going gangbusters; by some estimates consumer confidence is higher than it has been any time since the tech bubble peak in 2000. The upbeat sentiment has served for many in the commentariat as an easy go-to explanation for the stock market's bubbly performance in the year to date (our own take on the market is a more mundane assessment of momentum feeding on itself, more or less impervious to outside catalysts).

Hard, Hard Road

The sentimental bullishness may yet converge into the subdued hard numbers, but it's not a given. Take retail sales, which posted a modest gain in February and then fell in March. Now, with consumer sentiment being so jazzed up, shouldn't some of that effervescence be showing up in the actual spending numbers? You can't blame the weather for this one: those balmy February days should have been mall and DIY store magnets. In fact, the poor showing of retail sales throughout the first quarter was as good a sign as any that GDP might come up short. Seventy percent of growth in output is driven by consumer spending. If consumers aren't walking the walk, then all the happy talk in the world isn't going to move the growth needle.

And Now for the Ugly

Behind all these month-to-month metrics we use to measure the economy's health is the grim reality that long-term growth remains challenged by three major headwinds: declining population growth, a smaller percentage of the population at work in the labor force, and anemic levels of total factor productivity. Of those three headwinds, the only one that can plausibly deliver growth as we know it is productivity. It was the unique convergence of productivity advances with baby boom demographics that delivered the amazing, historically unprecedented growth rates of the 1950s and 1960s. The demographics are no longer in our favor, so to have any growth at all we will need to see some material evidence that all the technology innovations of the last 10 to 15 years can deliver a new, sustained dose of productivity gains. Until that happens, we should not expect to see the kind of go-go growth being promised by some who should know better (ahem, Treasury Department tax plan crafters). At some point, sooner rather than later, this reality will likely make itself known in the soft data as much as the hard.

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