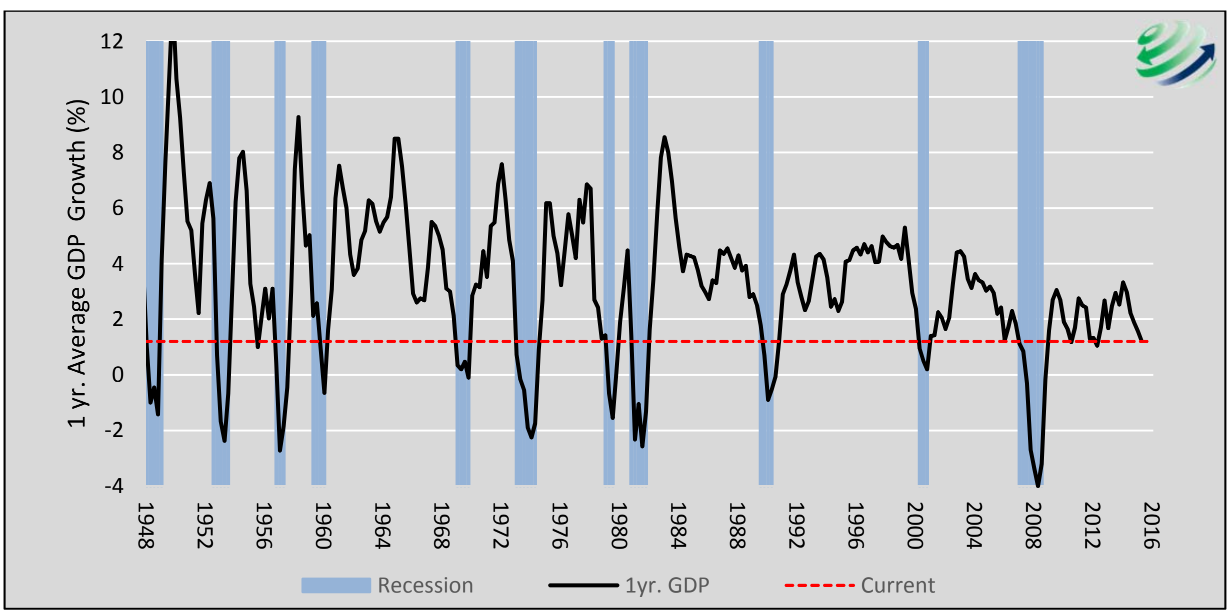
Another Warning in the GDP Data

On Friday July 29th, 2016, the Bureau of Economic Analysis (BEA) released the second-quarter GDP figures and revisions for prior quarters. At a disappointing annualized growth rate of only 1.20%, second quarter GDP widely missed consensus expectations of 2.50% growth. Coincidently the current 1-year average growth rate has risen at the same 1.20% and that annualized growth rate has declined for five quarters in a row.

For the most part, the recent bout of stagnant GDP data has not caught the attention of the media or the markets. As consultants to those who manage wealth we believe this data is vitally important, regardless of what others may think. Accordingly, we provide some context around this data to help you better grasp its magnitude.

The graph below plots average 1-year GDP growth on a quarterly basis going back to 1948. The blue shaded areas represent periods deemed recessionary by the National Bureau of Economic Research (NBER), and the red dotted line facilitates the comparison of the current 1.20% reading versus those of the past.

1-Year Average GDP Growth



Data Courtesy: St. Louis Federal Reserve (FRED)

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Here are four important takeaways:

- All recessions since 1948 started with an average growth rate greater than the current 1.20% rate.
- There are only three instances where the 1-year growth rate was below the current level and recession did not occur. In the two most recent instances (2011/2012), weak growth was met with renewed rounds of extraordinary stimulus in the form of quantitative easing (QE).
- Only 18% of all observations going back to 1948 are below the current 1.20% level.
- Of that 18%, 94% occurred during or within a quarter of a recession.

Based on recent history, one might elect to maintain an aggressive stance towards equities and other risky assets in anticipation of another round of stimulus from the Federal Reserve. One should be reminded however, the primary difference between where we are today versus those two recent periods is that the Fed's posture was not leaning toward interest rate hikes as they are now.

Though difficult in a world of poor returns, equity investors should remain defensive and highly concerned by the recent economic data. As a reminder, re-consider the following table and excerpt from "Dear Prudence" published in April 2016.

> The possibility of a recession while equity valuations are extreme is deeply troubling. Since 1929, there have been 14 recessions. All but one, in 1945, coincided with a period of negative returns for stocks. Included in this data, as shown in the table below, are periods when stock valuations ranged from greatly undervalued to extremely overvalued. *-Data and Table Courtesy Doug Short*

Equity Valuations, Recessions and Market Declines				
Recessions	Number of Months	Average Valuation, Month Prior to the Recession, Deviation from Mean	Market Price, Peak to Trough*	Change in GDP
Mar 2001 to Nov 2001	8	106%	-49.1%	-0.3%
=> We are here		76%		
Aug 1929 to Mar 1933	43	74%	-86.1%	-26.7%
Dec 2007 to June 2009	18	64%	-56.8%	-4.3%
May 1937 to June 1938	13	32%	-54.5%	-18.2%
Dec 1969 to Nov 1970	11	22%	-36.1%	-0.6%
Apr 1960 to Feb 1961	10	9%	-13.6%	-1.6%
Nov 1973 to Mar 1975	16	7%	-48.2%	-3.2%
Aug 1957 to April 1958	8	2%	-20.7%	-3.7%
July 1990 to Mar 1991	8	1%	-19.9%	-1.4%
Feb 1945 to Oct 1945	8	-32%	Gain	-12.7%
July 1953 to May 1954	10	-37%	-14.8%	-2.6%
July 1981 to Nov 1982	16	-40%	-27.1%	-2.7%
Jan 1980 to July 1980	6	-43%	-17.1%	-2.2%
Nov 1948 to Oct 1949	11	-43%	-20.6%	-1.7%

* *The S&P Composite pre-recession market peak to the post-recession market trough*

720 Global is not calling for an immediate equity market sell-off. In fact, the market may appreciate further, irrespective of weak economic data, declining earnings and historical precedent. That said, periods like today, characterized by extreme valuations and weak economic activity, have ultimately proved disastrous for investors. Those managing wealth for others should be cognizant of the implications present in today's stagnating economy.

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