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V I E W P O I N T

THE ECONOMY

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1Q GDP GROWTH LOWERED SLIGHTLY TO 3.1%

The Commerce Department lowered its estimate of the 1Q19 GDP growth rate to 3.1% from 3.2%. The result, in line with expectations, portrays a U.S. economy that remains in excellent shape (the long-term growth forecast for GDP is 2.0%) but is slowing from an unsustainable growth rate above 4% earlier in 2018. The slowdown may accelerate, reflecting fall-out from trade and tariff issues.

As we typically do for the second estimate, let's take a closer look at the key contributing sectors to GDP.

* First, the consumer. During 1Q, personal consumption expenditures grew at a subdued 1.3% pace, below the rate of overall growth, and contributed 60.8% of core demand (which we define as personal consumption expenditures, information technology and intellectual property spending, housing, exports and government expenditures). This is in line with the 10-year average, as the consumer continues to drive the U.S. economy. We note the below-trend consumer line reflected a drop in spending on durable goods, which we expect to see reversed in later quarters of this year, unless consumer confidence, which is currently at all-time highs, falls sharply due to the impact of the trade war.

* Capital investments in intellectual property advanced at a solid clip (up 7.2%) while investments into equipment declined 1% after eight consecutive quarters of strong growth; once again, we expect to see a rebound later this year. Drilling deeper into investment into equipment, we note declines in spending on information processing and industrial equipment, which are likely trade-related. Looking ahead, we expect that low interest rates will support cap-ex spending. Indeed, overall, gross private domestic investment grew at a 4.3% pace in 1Q. That rate may come down a bit in the quarters ahead as ISM PMI readings have been declining toward the neutral 50-level in recent months.

* Housing has struggled in recent quarters. In 1Q, residential investment declined 3.5%. That's the seventh decline in the past eight quarters. The housing market has recovered from the collapse of 2008-2009 (somewhat slowly, at least compared to the auto market) and certainly does not appear to be in bubble territory. But the Federal Reserve's campaign to raise interest rates had a clear and negative impact on the sector in 2H18, and a stumble in consumer confidence could stunt any budding recovery.

* Exports rebounded in 4Q, as tariff talks hit a lull in 1Q before picking up in recent weeks. Export spending advanced 4.8%, including a 6.3% increase in export-goods. Meanwhile, spending on imports declined, which provides a boost to GDP growth. Looking ahead, we continue to anticipate bumpy trends in export growth in the next few quarters as politicians debate tariffs and trade. President Trump's latest plan to increase tariffs on Mexico could keep imports weak for a few quarters, providing support to GDP.

* Government spending remains weak on an historical basis but has strengthened somewhat over recent quarters. Typically, government spending accounts for 17.0% of total demand; but in 1Q19, the share was only 15.2%. We note, though, that the trend in government spending generally has been toward improvement over the past two years. We may soon see government spending as a key driver of GDP growth going forward.

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Our forecasts for GDP growth calls for economic expansion in the 1.5%-2.5% range through 2019. This is lower than the recent trend and reflects the impact of the trade wars, ISM and retail sales trends, as well as the strong dollar.

Risks of Recession

Since the current economic expansion began in the fourth quarter of 2009, the economy has grown for 38 quarters in a row. In the post-World War II era, the U.S. has experienced 10 periods of economic growth, which have averaged 20 quarters, or five years. The longest expansion was 39 months and the shortest was five.

Recently, expansions have been more durable. The six expansions since 1960 have averaged 27 quarters. But they all end at some point, and it is reasonable to believe the current expansion is closer to an end than it is to the beginning.

That said, we note that neither our current estimates nor the Fed's forecasts call for a recession in the U.S. through 2020. We believe that key forward-looking indicators (jobless claims, housing starts, new orders from Purchasing Managers) are positive enough to keep the economy on a growth track, despite the unpredictable impacts of swings in stock prices, the yield curve, global events, weather and other non-economic shocks.

Other risks to growth include volatile oil prices; a weaker-than-expected recovery in China; additional economic trouble in Europe related to Brexit or government finance problems; a dollar that continues to rise and limits export growth; a steep stumble in the housing market or in consumer confidence; or inflationary conditions, which cooled off a bit in the latest GDP report.

In summary, our growth forecasts into 2020 call for GDP expansion in the 1.5%-2.5% range, versus the current rate of growth in the 3% range. Investors should expect heightened market volatility as the economy cools off.

John Eade, President,
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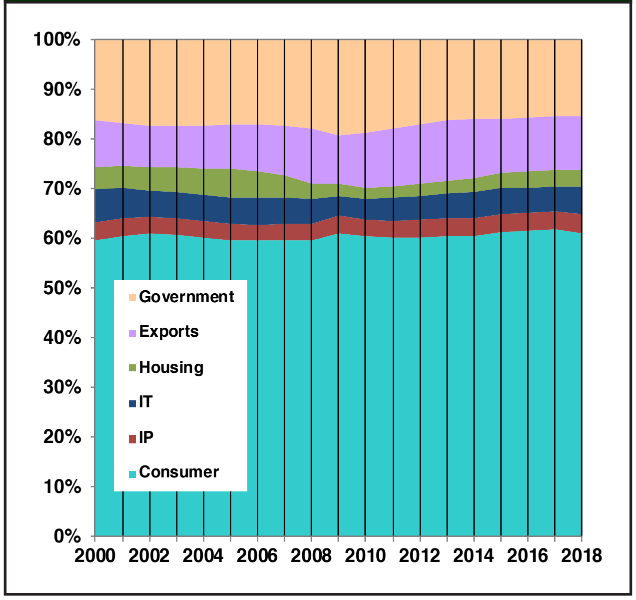
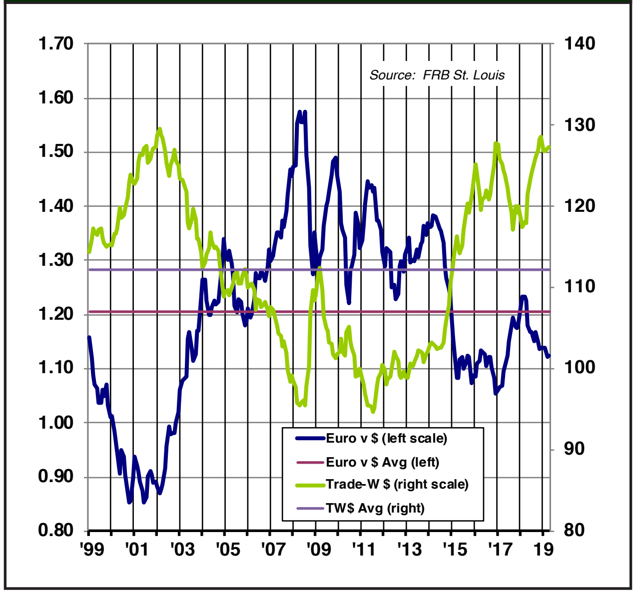
GDP CONTRIBUTORS



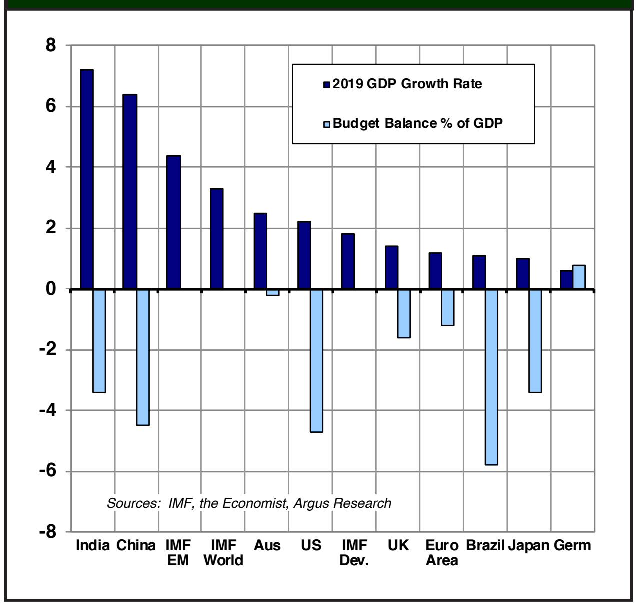
The growth rate for the all-important Personal Consumption Expenditure category declined from 2.5% in 4Q to 1.3% in 1Q, as spending on durable and nondurable goods stalled. Government spending picked up.

CURRENCY TRENDS



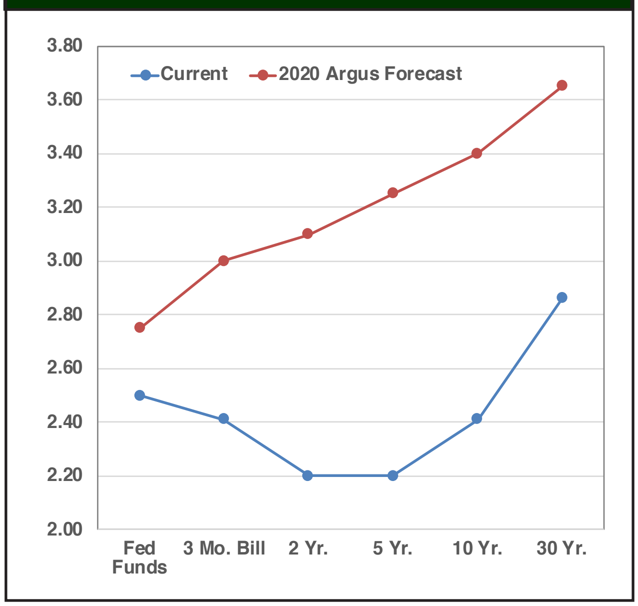
The dollar rose 7% in 2018 and is again near cycle highs set in late 2016. We anticipate a trading range around current levels this year, given the high dollar valuation and other factors (recoveries in Emerging Markets, potential improving trends in the euro once Brexit is resolved) that are likely to have an impact on low valuations of other currencies.

GLOBAL GDP FORECASTS (%)



GDP forecasts continue to moderate, though the IMF sees stronger global growth for 2019 (at 3.3%) compared to 2014-2016 (3.1%-3.2%). Emerging markets are expected to grow at a 4.4% rate, while developed markets grow at 1.8%. Foreign equity markets account for 60%-65% of world market cap, but we recommend a 25% weighting, given the risks of overseas investing.

TREASURY YIELD CURVE & OUTLOOK (%)



The yield curve has inverted, which is a worrisome development. Still, we think strong demand for U.S. Treasuries from overseas investors (who, in some cases, are facing negative interest rates in their own sovereign debt) are driving up demand and prices for long-term T-bonds. We look for the yield curve to resume its normal upward-sloping shape.