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Economic Commentary

Economic Forecasting for 2019: Impacts on the Stock Market

This is the time of year when forecasts for the next year, 2019 in this case, are being made for political, social, environmental and economic outcomes. Of the four areas just mentioned, economics has the most reliable data for producing forecasts and possible effects on the stock market.

It is important to have an accurate forecast of economic growth over the next year because it forms the basis for producing a forecast for stock market returns in 2019. The sharp stock market correction that occurred during the fourth calendar quarter of 2018 requires careful analysis about the economy in 2019 and its impact on the stock market.

The current consensus of leading economists is that real Gross Domestic Product for 2019 will grow 2.5%-2.7% from 2018 levels. However, I believe the real GDP growth for 2019 will be 3.0% higher than 2018. A 3% growth rate would likely have the following effect on other areas of the economy: corporate profits could grow 7%-9%; unemployment could stay under 4%; wage growth could be in excess of 3%; and inflation could be close to 2%. The Federal Reserve could raise interest rates twice during the year, ending 2019 with the Federal Funds rate at 2.75% - 3.00%. The U.S. dollar could remain at or near its current elevated level relative to our major trading partners.

While these data point forecasts represent a slowdown from 2018 trends, the effect on stock market valuations of corporate earnings should generally be positive as current valuation levels are near the mid-point of historic averages.

This presents an interesting dichotomy between economic forecasts and stock market forecasts. Economic forecasts generally rely on comparing levels of economic activity when assessing economic trends. For example, if the trade deficit hits a new monthly high, economists then worry about its negative impact on GDP growth because of the way GDP statistics are compiled.

Stock market forecasts generally focus more on the rate of change from one month to the next in a trade deficit. If the new monthly high in the trade deficit is a 0.1% increase over the prior month, then most likely its impact would be ignored.

This difference between economic and stock market forecasts is not meant to imply that stock market forecasters are smarter than economic forecasters. It is meant to show that the same economic data can be viewed in different ways with different inferences drawn.

When I took the Chartered Financial Analyst Level I exam in 1975, I clearly remember the only question in which I had a choice between two options. The first option was to write an essay comparing and contrasting the Kuznets economic cycle with the Kondratiev economic cycle. Sidney Kuznets wrote in 1925 that over the intermediate term of 15-25 years, housing construction was primarily related to demographic population growth. Nikolai Kondratiev wrote in 1930 that he observed 40-60 year waves of rising and falling economic activity. The second choice was to solve a company finance problem that required setting up an algebraic

equation and solving for the unknowns. I chose the second option on the premise that I had to receive full credit for the correct answer to the math problem while I was certain I would not receive a perfect score for an economic essay.

In conclusion, it is fair to say that there are no economic or stock market forecasts that will be completely accurate, there is only the understanding that getting the direction of the forecast right is a worthy goal. I believe my economic and stock market forecasts for 2019 will prove to be correct.

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