Morning Tack - “GDP?”

Yesterday, the 4Q GDP number was revised lower. As our economist Scott Brown Ph.D. writes:

As expected, the estimate of fourth quarter GDP growth was revised lower, with slight downward revisions to each of the major components. Inventory growth was a little less rapid than in the previous estimate (adding a little less to headline GDP growth), while the trade deficit was narrower (subtracting less than in the previous estimate). Nothing remarkable here. Weekly jobless claims are trending at a low level, consistent with further strength in the job market (March payrolls reported on April 5). The BEA will report on February personal income and January spending tomorrow.

As stated, that downside revision should come as no surprise given what the talking heads have been babbling about the economy slipping into a recession. As for me, I see no sign that a recession is on the horizon. Indeed, the “Present Situations Index,” which has predicted every recession since the 1960s, is at its highest level in decades. To be sure, said index has ALWAYS peaked, and turned down, months before the beginning of a recession, and that just is not happening.

As for the yield curve, while I continue to believe folks are looking at the wrong curve, I have to admit some of the close-dated yield curves have inverted. In the past ~60 years, the 3-month T‘bill to the 10-year T‘note have inverted ~11 times. The subsequent 12-month forward return for the S&P 500 has been positive six times out of the 11 occurrences.

The real question currently is if this cycle is totally different than past experiences given the $9 trillion of negative debt yields around the world that has caused a distortion in the flow of funds from international funds. As Bespoke writes:

The Fed’s dovishness and lowered economic expectations plus weak data in Europe set off a firestorm in the fixed income market late in the week. On Friday, we saw the famous yield curve that measures the difference between the 10-year and 3-month yield invert for the first time in 3,030 days. That’s the longest stretch on record without an inverted curve since 1962, and it’s not even close. For the stock market’s performance following those inversions see chart 1 [page 2].

So, how do inverted yield curves impact the various sectors? Again, as Bespoke writes:

In the initial period following an inversion of the curve, the Consumer Discretionary sector is among the worst performers, but then sees a rebound. After a median 4.1% decline in the month after inversion (worst of all sectors), the median return rebounds all the way up to a gain of 9.9% one year out (fourth best among sectors). Conversely, Financials typically are among the best performers three and six months after the curve inverts, but sees its median return sink to 0.4% one year later (worst of all sectors shown). While Transports may no longer be its own stand-alone sector, for most of the periods we looked at it was, and over both the one, three, six, and twelve month periods, it has a better median return than any other sector [chart 2, page 2].

As for the equity markets, well it appears that the longer-term positive “internal energy” overcame my shorter-term neutral models yesterday. Hopefully that trend continues for, as written yesterday:

Whether the "energy burst" arrives a bit late, or not, is not really all that important, because my work shows little downside risk right here, without a black swan news event, with the path of least resistance to the upside over the next four weeks. And then there was this, “The Global
Earnings Revision Ratio ticked up in March, hinting at the beginning of the end of the global earnings downturn."

The upcoming earnings season will tell if this is the case. Today is the end of 1Q. It was amusing but disgusting to see fin media "experts" grovel for fundamental excuses for the early U.S. stock market rally. "China trade talks have restarted". When did they stop? "Q2 GDP will be strong". It was Q1 performance gaming and window dressing. The S&P 500 Index had an Inside Day on Thursday. Traders will be sensitive to the high (2819.71) and low (2798.77). Obviously, a close below 2800 would not look good for stocks on a trading basis. PS - The UK Parliament will take its third vote on May’s Brexit deal. This morning, the preopening S&P 500 futures are flat.

Chart 1

Chart 2
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