



August 26 2019

LPL'S U.S. REAL GDP FORECAST CHANGE

John Lynch, *Chief Investment Strategist, LPL Financial*

Jeffrey Buchbinder, CFA, *Equity Strategist, LPL Financial*

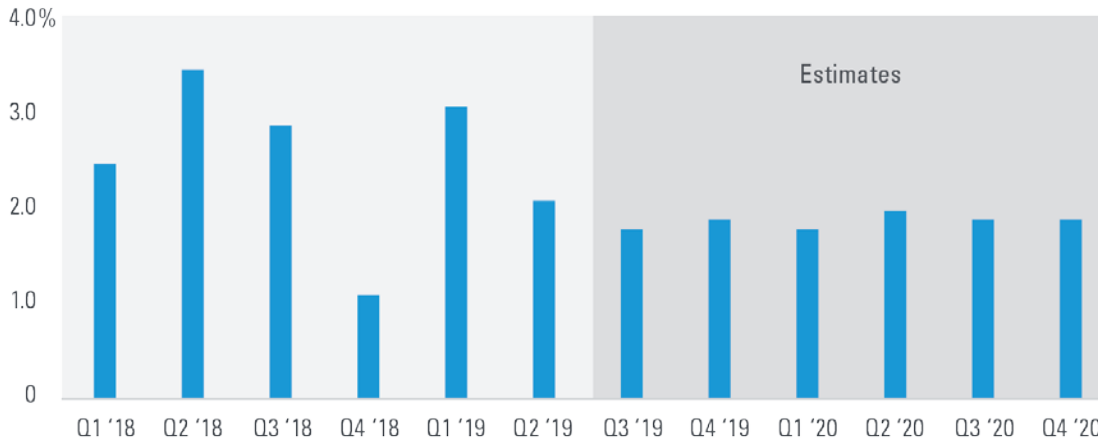
We have lowered our projections for U.S. gross domestic product (GDP), the 10-year U.S. Treasury yield, and operating earnings for the S&P 500 Index in 2019, as we noted in the August 19 [Weekly Market Commentary: Tweaking Forecasts](#), and introduced our preliminary 2020 forecasts. Over the next three weeks, we will highlight our reasoning behind these changes. Delayed prospects for a trade agreement between the United States and China remain central to our projections for economic growth and financial market performance in the coming months and quarters.

Tariffs and threats of escalation weigh on business investment. As we emphasized in our [Midyear Outlook 2019](#), business investment remains a critical component in determining the extent to which this record economic expansion can persist. As businesses invest in their futures, productivity growth often results, leading to increased efficiencies and improved output per hour worked. This can help elongate the expansion, as higher productivity limits inflation growth, and the absence of threatening wage gains helps sustain profit margins, supporting equity prices.

Unfortunately, the delayed trade negotiations and increased tariff threats between the United States and China have led businesses to hold back on their capital expenditures. After growing by approximately 7% in the first half of 2018, business investment has grown by only an average of 3.8% over the past year. This is troubling because after a decade of monetary policy support, the *2017 Tax Cuts and Jobs Act* provided businesses with a package of fiscal policy incentives to increase investment. The combination of tax rates, repatriation of internationally sourced profits, and immediate expensing provisions were all tailwinds for capital expenditures. Yet it appears these tailwinds have been no match for the headwind of trade uncertainty. Consequently, we reduced our forecast for U.S. real GDP from a range of 2.25%–2.50% to 2% in 2019. Though the U.S. economy may be slowing from last year's pace, it is still growing [\[Figure 1\]](#).

1 GDP GROWTH EXPECTED TO SLOW IN UPCOMING QUARTERS

● Actual Change in Real Gross Domestic Product (GDP)



Source: LPL Research, Bloomberg 08/21/19

GDP = Gross Domestic Product. GDP projections are median Bloomberg consensus forecasts.

GDP forecasts may not develop as predicted.

GDP=C+I+G+X

While some of you may cringe remembering this formula from Economics 101, we believe it still serves as a powerful reminder for the context and components of U.S. economic activity. Consumption (C), investment (I), government spending (G), and net exports (X), or trade, all factor into the calculation for economic output (GDP). While trade has gained all the headlines recently, it's important to note that net exports account for only approximately 12% of U.S. GDP. The derivative, or add-on effects, of drops in business investment and trade can affect manufacturing, however, which has maintained growth but at a slower rate. Manufacturing may comprise only less than one-fifth of the overall economy, but we would argue that it is responsible for the majority of economic volatility.

Fortunately, the bulwark of the domestic and global economies has been the U.S. consumer. The combination of low unemployment and moderate wage growth has led to strong trends in personal spending, an area that comprises approximately 70% of the economy. Indeed, in the second quarter, personal consumption grew 4.3%, contributing 2.9 percentage points to the overall GDP increase of 2.1%.

Upcoming Challenges, But No Immediate Recession

The consumer can pull only so much weight, however. Even after the recent tariff reprieve, 25% levies remain in place on roughly \$290 billion of Chinese goods, and 10% tariffs on an additional \$110 billion in goods begin in September. Businesses are absorbing some of these costs while facing uncertainty about future trade actions, including currency. Slower international growth and geopolitical concerns also add to near-term pressure on U.S. output, potentially offsetting renewed monetary policy accommodation. We suspect these trends may persist in the coming quarters, factoring into our preliminary real GDP estimate of 1.75% for 2020.

CONCLUSION

We believe the U.S. economy is in much better shape than the rest of the developed world. After a record expansion, demand may be moderating, but we do not see the fundamental justification for recession anytime soon. Solid consumption, high employment, low interest rates, and inflation all factor into our thought process. We view the flattening/inversion of the U.S. Treasury yield curve as more of a reflection of valuation relative to global sovereign bond rates than an indicator of immediate domestic risk. Yet we have to have recession—someday—and we suspect the likeliest cause may prove to be a confluence of global events, including a rancorous U.S. elections campaign season. Indeed, at the end of 2020 and the beginning of 2021, businesses and consumers may simply decide to “sit this one out” and wait to see what happens with the winning administration.

NEW WEEKLY MARKET PERFORMANCE REPORT

We are pleased to share our new *Weekly Market Performance* report with insights on major asset classes.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The economic forecasts set forth in this material may not develop as predicted.

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

All information is believed to be from reliable sources; however LPL Financial makes no representation as to its completeness or accuracy.

DEFINITIONS

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

This research material has been prepared by LPL Financial LLC.

Securities and advisory services offered through LPL Financial (LPL), a registered investment advisor and broker-dealer (member FINRA/SIPC). Insurance products are offered through LPL or its licensed affiliates. To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL is not an affiliate of and makes no representation with respect to such entity.

If your advisor is located at a bank or credit union, please note that the bank/credit union is not registered as a broker-dealer or investment advisor. Registered representatives of LPL may also be employees of the bank/credit union. These products and services are being offered through LPL or its affiliates, which are separate entities from, and not affiliates of, the bank/credit union. Securities and insurance offered through LPL or its affiliates are:

Not Insured by FDIC/NCUA or Any Other Government Agency | Not Bank/Credit Union Guaranteed | Not Bank/Credit Union Deposits or Obligations | May Lose Value

RES-68200-0819 | For Public Use | Tracking #1-886003 (Exp. 08/20)