First Trust
Monday Morning OUTLOOK
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Fooled By Extrapolation

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – Dep. Chief *Economist*
Strider Elass – *Economist*

Pundits have a bottomless reservoir of pessimism and also a magnified ability to extrapolate the most recent trends. So, when Q1-2014 real GDP fell at an annual rate of 2.1%, fear turned rampant.

We had forecast a 0.5% annualized increase, not a drop, so we were surprised by the impact of unusually harsh winter weather. But, since we watch the fundamentals (underlying pillars of growth) we thought the drop was temporary. Many thought we were nuts. They dismissed the weather, extrapolated the trend, and thought the US economy was in real trouble.

But real GDP rebounded strongly, growing at annual rates of 4.6% in Q2, and then 5.0% in Q3. The conventional wisdom went from pessimistic to positive and started talking about stronger, durable growth, more like the expansions of prior decades.

We weren't surprised by the rebound, but kept forecasting a growth trend of 2.5 – 3%. Remember, we believe in a Plow Horse economy. As a result, it's not a huge surprise that real GDP grew at just 2.6% annualized in Q4.

So, while many forecasters turned bullish in the fall and are now sounding dour, we haven't really changed at all. The fundamentals are still the same. The Fed is running an expansionary monetary policy (even if it raises rates this year). And, in spite of tapering, commercial and industrial loans for the week of January 14th were up 14.2% from a year ago, the strongest growth since 2008, a sign that money multipliers are on the mend.

At the same time, tax rates are stable, the US is working on two major free trade agreements and other fiscal policy is frozen by a divided government. In other words, there are no major changes to underlying economic fundamentals.

As a result, in spite of the first back-to-back monthly declines in the S&P 500 since 2012, we remain bullish.

Those who extrapolate are starting to become more bearish, but they do this every time the market turns down. Yes, earnings misses were covered like the non-snowstorm in NYC last week, but this hides the underlying trend.

Earnings data for the fourth quarter show that 70.9% of companies have exceeded estimates. So, while negative news is reported with more vigor because the market is down, the positive news underneath still exists. It's true the economy could be doing better with a better set of fiscal policies, but it is not true that fundamentals have changed.

Don't be fooled by extrapolation. The underlying drivers of growth remain intact and so does our Plow Horse forecast for overall growth and our expectation for a fourth annual double-digit gain for the S&P 500.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-2 / 7:30 am	Personal Income – Dec	+0.2%	**+0.3%**	+0.3%	+0.4%
7:30 am	Personal Spending – Dec	-0.2%	**-0.3%**	-0.3%	+0.6%
9:00 am	ISM Index – Jan	54.5	**55.0**	53.5	55.1
9:00 am	Construction Spending – Dec	+0.7%	**+0.9%**	+0.4%	-0.3%
2-3 / 9:00 am	Factory Orders – Dec	-2.4%	**-3.5%**		-0.7%
afternoon	Total Car/Truck Sales – Jan	16.6 Mil	**16.6 Mil**		16.8 Mil
2-4 / 9:00 am	ISM Non Mfg Index – Jan	56.5	**56.5**		56.2
2-5 / 7:30 am	Initial Claims – Jan 31	290K	**288K**		265K
7:30 am	Q4 Non-Farm Productivity	+0.2%	**-1.5%**		+2.3%
7:30 am	Q4 Unit Labor Costs	+1.2%	**+2.3%**		-1.0%
7:30 am	Int'l Trade Balance – Dec	-$38.0 Bil	**-$37.7 Bil**		-$39.0 Bil
2-6 / 7:30 am	Non-Farm Payrolls - Jan	232K	**245K**		252K
7:30 am	Private Payrolls – Jan	230K	**236K**		240K
7:30 am	Manufacturing Payrolls – Jan	12K	**24K**		17K
7:30 am	Unemployment Rate – Jan	5.6%	**5.5%**		5.6%
7:30 am	Average Hourly Earnings – Jan	+0.3%	**+0.3%**		-0.2%
7:30 am	Average Weekly Hours - Jan	34.6	**34.6**		34.6