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2nd Quarter GDP (Preliminary)

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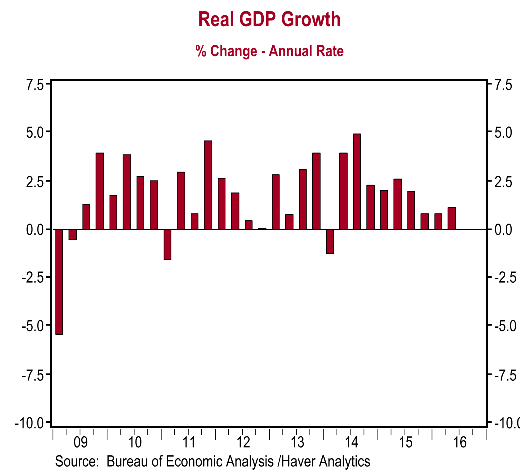
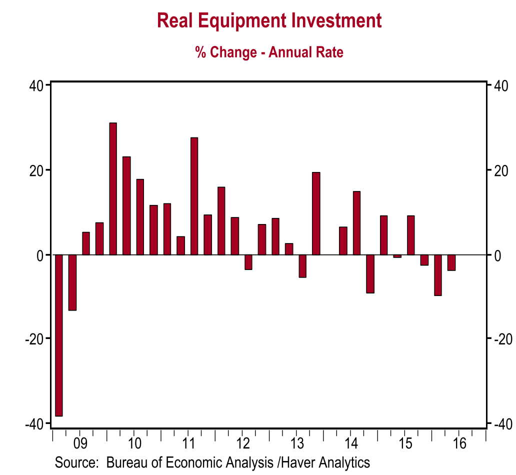
- Real GDP was revised to a 1.1% annual growth rate in Q2 from a prior estimate of 1.2%, matching consensus expectations.
- The largest downward revisions were for net exports, government purchases, and inventories, which offset upward revisions for business R&D and consumer spending.
- The largest positive contribution to the real GDP growth rate in Q2 was personal consumption. The only other positive contributions were for R&D and net exports; the other categories of GDP were down.
- The GDP price index was revised up to a 2.3% annual rate of change from a prior estimate of 2.2%. Nominal GDP growth – real GDP plus inflation – was revised slightly lower to a 3.4% annual rate from a prior estimate of 3.5%.





Implications: Real GDP was revised slightly lower for the second quarter but the "mix" of growth was better and implies faster economic growth ahead. Today's second reading of GDP Q2 showed real economic growth at a 1.1% annual rate, matching consensus expectations, versus the 1.2% reading a month ago. However, the downward revision was mainly due to net exports, government purchases, and inventories, none of which can be relied on for long-term economic growth. Consumer spending and business investment in R&D were revised higher. In fact, consumer spending grew at the fastest pace since late 2014, a sign consumers are growing more confident about the future. As a result, "core" GDP, a measure we like to follow that strips out these transitory factors, was revised to a 3.0% annual rate in Q2 versus a prior report of 2.7%. Core GDP is up at a 2.9% annual rate in the past two years. Nominal GDP growth (real growth plus inflation) was revised to 3.4% annual rate in Q2 from a prior estimate of 3.5%. Nominal GDP is up 2.4% in the past year and up at a 3.3% annual rate in the past two years. All of these figures suggest the economy can sustain higher short-term interest rates and the Fed is already behind the curve. Look for the Fed to raise rates at least once this year, with the odds of two rate hikes greater than the odds of none at all. Also in today's GDP report was our first glimpse at economy-wide corporate profits in the second quarter. Profits declined 1.2% in Q2 and are down 4.9% versus a year ago, putting them at essentially the same level as early 2012. Although some investors will see this as a reason to sell equities, we do not. Profits are artificially low right now given weakness in the energy sector. But energy prices appear to have bottomed out already, so profits will soon rebound as well. In addition, our capitalized profits models suggest that even at higher interest rates (such as a 10-year Treasury yield of 3.5% - 4%), stocks are relatively cheap. The last several years have seen a non-stop battle between entrepreneurs and innovators trying to boost growth while a bigger government suppresses it. That's why we have a Plow Horse economy instead of a Race Horse economy like in the mid-1980s and late-1990s. Look for more Plow Horse growth ahead, and a continuation of the bull market in stocks.

2nd Quarter GDP Seasonally Adjusted Annual Rates	Q2-16	Q1-16	Q4-15	Q3-15	4-Quarter Change
Real GDP	**1.1%**	0.8%	0.9%	2.0%	1.2%
GDP Price Index	**2.3%**	0.5%	0.8%	1.3%	1.2%
Nominal GDP	**3.4%**	1.3%	1.8%	3.2%	2.4%
PCE	**4.4%**	1.6%	2.3%	2.7%	2.7%
Business Investment	**-0.9%**	-3.4%	-3.3%	3.9%	-1.0%
Structures	**-8.4%**	0.1%	-15.2%	-4.3%	-7.1%
Equipment	**-3.7%**	-9.5%	-2.6%	9.1%	-1.9%
Intellectual Property	**8.6%**	3.8%	4.5%	2.1%	4.7%
Contributions to GDP Growth (p.pts.)	**Q2-16**	**Q1-16**	**Q4-15**	**Q3-15**	**4Q Avg.**
PCE	**2.9**	1.1	1.5	1.8	1.8
Business Investment	**-0.1**	-0.4	-0.4	0.5	-0.1
Residential Investment	**-0.3**	0.3	0.4	0.4	0.2
Inventories	**-1.3**	-0.4	-0.4	-0.6	-0.7
Government	**-0.3**	0.3	0.2	0.3	0.1
Net Exports	**0.1**	0.0	-0.5	-0.5	-0.2