First Trust
Monday Morning OUTLOOK
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When Volatility is Just Volatility

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Stock market volatility scares people. But, volatility itself isn't necessarily bad. Only if there are fundamental economic problems, something that could cause a recession, would we think volatility itself is a warning sign.

So, we watch the Four Pillars. These Pillars – monetary policy, tax policy, spending & regulatory policy, and trade policy – are the real threats to prosperity. Right now, these Pillars suggest that economic fundamentals remain sound.

Monetary Policy: We're astounded some analysts interpreted last Wednesday's pronouncements from the Federal Reserve as dovish. The Fed upgraded its forecasts for economic growth, projected a lower unemployment rate through 2020 and also expects inflation to temporarily exceed its long-term inflation target of 2.0% in 2020.

As recently as December, only four of sixteen Fed policymakers projected four or more rate hikes this year; now, seven of fifteen are in the more aggressive camp. Some analysts dwell on the fact that the "median" policymaker still expects only three hikes in 2018, ignoring the trend toward a more aggressive Fed.

But all of this misses the real point. Monetary policy will still be loose at the end of 2018, whether the Fed raises rates three or four times this year. The federal funds rate is about 120 basis points below the yield on the 10-year Treasury (which will rise as the Fed hikes), and is also well below the trend in nominal GDP growth. Meanwhile, the banking system still holds about $2 trillion in excess reserves. Monetary policy is a tailwind for growth, not a headwind.

Taxes: The tax cut passed last year is the most pro-growth tax cut since the early 1980s, particularly on the corporate side. Some analysts argue that the money is just going to be used for share buybacks, but we find that hard to believe. A lower tax rate means companies have more of an incentive to pursue business ideas that they were on the fence about.

And there is a big difference between who cuts a check to the government and who truly bears the burden of a tax, what economists call the "incidence of a tax."

Cutting the tax rate on Corporate America will lift the demand for labor, meaning workers and managers share the benefits with shareholders. Yes, some of the tax cut will be used for share buybacks, but that's OK with us; it means shareholders get money to reinvest in other companies. Buybacks also move capital away from corporate managers who might otherwise squander the money on "empire building," pursuing acquisitions for the sake of growth, when returning it to shareholders is more efficient.

Spending & Regulation: This pillar is a little shaky. On regulation, Washington has moved aggressively to reduce red tape rather than expand it. That's good. But, Congress can't keep a lid on spending. That's bad.

Back in June, the Congressional Budget Office was projecting that discretionary spending in Fiscal Year 2018 would be $1.222 trillion. (Discretionary spending doesn't include entitlements like Social Security, Medicare, or Medicaid, or net interest on the federal debt.) Now, the CBO says that'll reach $1.309 trillion, a gain of 7.1% in just nine months.

Assuming the CBO got it right back in June on entitlements and interest, that would put this year's federal spending at 20.9% of GDP, a tick higher than last year at 20.8% - despite faster economic growth. This extra spending represents a shift in resources from the private sector to the government. The more the government spends, the slower the economy grows.

Trade: Trade wars are not good for growth. And the US move to put tariffs in place creates the potential for a trade war. We aren't dismissing this threat, but a "full blown" trade war remains a low probability event.

The bottom line: taxes, regulation and monetary policy are a plus for growth, spending and new tariffs are threats. Things aren't perfect, but, in no way do the fundamentals signal major economic problems ahead. The current volatility in markets is not a warning, it's just volatility.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-28 / 7:30 am	Q4 GDP Final Report	2.7%	**2.7%**		2.5%
7:30 am	Q4 GDP Chain Price Index	2.3%	**2.3%**		2.3%
3-29 / 7:30 am	Initial Claims - Mar 24	230K	**225K**		229K
7:30 am	Personal Income – Feb	+0.4%	**+0.5%**		+0.4%
7:30 am	Personal Spending – Feb	+0.2%	**+0.2%**		+0.2%
8:45 am	Chicago PMI – Mar	62.0	**63.3**		61.9
9:00 am	U. Mich Consumer Sentiment- Mar	102.0	**102.0**		102.0

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.