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SIGNS OF SPRING

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KEY TAKEAWAYS

The U.S. economy has suffered from seasonal first-quarter weakness recently.

Seasons change, and growth typically rebounds as the year progresses.

Leading indicators in jobs, manufacturing, and markets suggest economic acceleration.

A chilly winter is finally behind us, and flowers are starting to bloom. The U.S. economy kicked off the year with a disappointing first quarter as consumers and businesses weathered symptoms of a global slowdown. Thankfully, seasons change, and we're seeing signs of thaw in leading economic data.

SEASONAL WEAKNESS

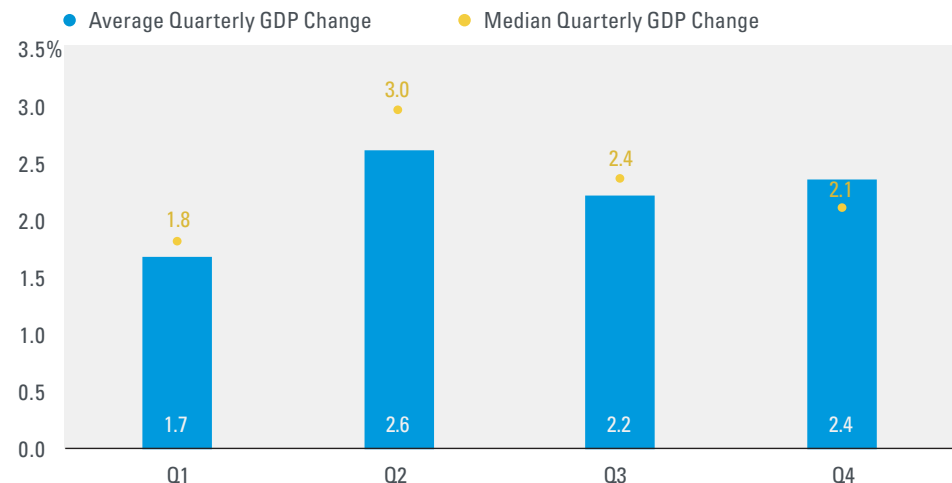
The U.S. economy likely hit a soft patch last quarter, with forecasters predicting it could have been the slowest quarter for gross domestic product (GDP) growth in three years. Even though last quarter felt especially rough, it's important to consider that there are seasonal tendencies in the data that have been hard to remove.

Chilled growth in the winter has been typical in this expansion [\[Figure 1\]](#). Since the cycle began in 2009, the first quarter has grown an average of 1.7%, the weakest quarter for output growth. Winter could be to blame for seasonal weakness, as inclement weather can inhibit consumer activity.

This year, consumers also had to contend with a record government shutdown and an influx of negative global headlines. Consumer spending, which accounts for about 70% of output, likely added 0.4% to first-quarter GDP, according to the Federal Reserve (Fed) Bank of Atlanta's model. That would be well below consumer spending's 1.7% contribution to output over the past three years. We see lower

1 U.S. ECONOMY HEADING INTO ITS STRONGEST QUARTER

Average and Median Gross Domestic Product (GDP) Changes by Quarter This Cycle



Source: LPL Research, Bureau of Economic Analysis 04/05/19

consumer spending as the primary weight on first-quarter GDP, and one that can be removed over the next several months if global headwinds subside and demand picks up.

Fortunately, the economy tends to rebound with the advent of spring. Second-quarter GDP growth in this cycle has averaged 2.6%, the strongest pace of all quarters, and seasonality in GDP has been more evident in recent years. Output has grown the most in the second quarter in each of the past five years, as the economy bounces back from first-quarter weakness.

GREEN SHOOTS IN DATA

Hard data, which capture actual economic activity, have slumped lately. However, leading indicators, which forecast the near-term economic trajectory, suggest an impending uptick in growth. The Conference Board's Leading Economic Index (LEI), a composite of 10 economic indicators, rose 3% year over year in February [Figure 2]. Even though LEI growth has slowed recently, its year-over-year change remains squarely in positive territory.

Leading data that have shown signs of strength recently include:

Jobs

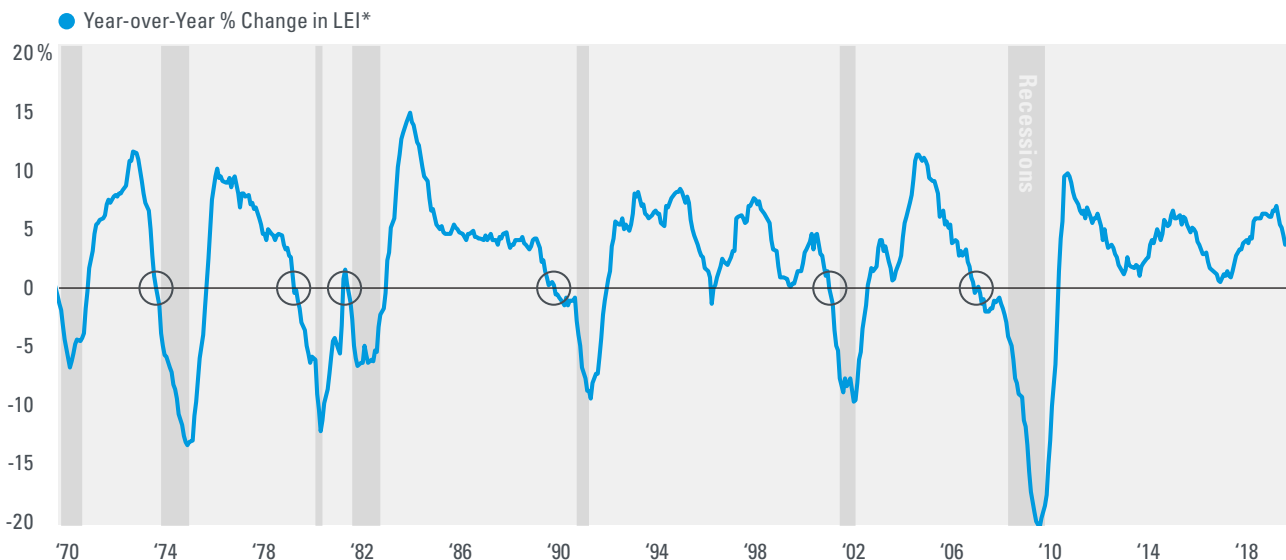
Global uncertainty hasn't been strong enough to derail U.S. companies' hiring plans. Payroll growth has averaged 211K over the past 12 months, above the 164K average growth for the rest of the cycle. Even though payrolls are considered a lagging indicator for economic health, job creation has slowed in the months before past downturns, and we haven't seen that yet.

Initial jobless claims, which are viewed as a classic labor market leading indicator, continue to grind lower. Claims for unemployment benefits have averaged 217K over the past four weeks, close to the cycle low of 210K claims reached in September 2018. Historically, that average has increased about 60K in the 12 months before the economy has peaked.

Manufacturing

Trade risk has been an increasingly heavy weight on global growth, but the outlook is starting to clear as the United States and China move closer to a deal. Manufacturing was the first sector to slide as trade tensions heated up, and it could be the first showing signs of progress during negotiations.

2 LEADING INDICATORS TYPICALLY TURN NEGATIVE BEFORE RECESSIONS



Source: LPL Research, Conference Board 04/05/19

* The Conference Board Leading Economic Index

Markit's Global Purchasing Managers' Index (PMI) stabilized in March, breaking a 10-month slide that began April 2018, or one month after the United States implemented its initial tariffs on goods from China. The Institute for Supply Management's (ISM) U.S. manufacturing PMI is well below a cycle high reached in August 2018, but the sector is still in expansionary territory and should improve as global and domestic demand pick up.

Financial Markets

Financial markets play a powerful role in supporting economic health. Rising stock prices lead to more confident consumers and businesses and increased spending from both groups. Falling stock prices lead to a decreased sense of financial well-being, which can chill economic activity.

Stocks also tend to be forward-looking and have a reasonable record forecasting future economic activity, if looked at in the context of other indicators. The S&P 500 Index just capped its best quarter since September 2009, climbing 13.1% over the three months. The benchmark index previously has posted returns that high in only 15 quarters since 1970. In the quarters following those high marks, GDP growth has accelerated by an average of 0.5% over the prior quarter.

Investors in other markets are positioning for an economic rebound. The yield curve has steepened slightly after last month's inversion

scare, which we covered in last week's [Weekly Economic Commentary](#). While a flat yield curve is still concerning, we've been encouraged by the recovery in long-term yields as global data have improved. Recent market action backs up our theory that much of the decline in yields has been from higher international demand in a low-rate environment, not a rush to safety.

Copper prices, which we view as a barometer for global health, have rallied 15% since dropping to a 20-month low in January. Semiconductor stocks, which are loosely correlated with China's economic activity and demand for technology products, have jumped nearly 40% to all-time highs.

CONCLUSION

The first quarter's mixed signals were understandably difficult to digest. Pockets of the economy unexpectedly weakened, uncertainty grew amid global setbacks, and trade and political headlines were an added distraction.

As the calendar turns, we're seeing some signs of growth break through as global headwinds subside. We still see compelling evidence of sound fundamentals, and we expect consumer and business activity to rebound as trade and political headwinds subside. ■

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