INTRINSIC VALUE WEALTH REPORT™

ECONOMIC OUTLOOK

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OVERVIEW

Our view of the outlook for the U.S. economy is based on our analysis of the economy using the *Simple and Effective Economic Forecasting Model* developed by our firm. Accordingly, the analysis looks at the four components of the expenditure approach to the measurement of gross domestic product (GDP): (1) Consumption; (2) Business Investment; (3) Government Expenditures; and (4) Net Exports. Our analysis is also based on forecasts that are derived from a proprietary model that weights and adjusts forecasts made by professional economists in various periodic surveys including the *Survey of Professional Forecasters*, published by the Federal Reserve Bank of Philadelphia (www.philadelphiafed.org).

CONSUMPTION

The persistent exit of people from the job market is an ongoing concern for the long-term prospects of the U.S. economy. As reported by Reuters (March 27, 2014), "A growing number of Americans quitting the labor force are likely gone for good…this suggests the current drop in the labor force is more structural in nature." The Wall Street Journal (February 16, 2014, p. A1) reported that, "More than one in six men ages 25 to 54, prime working years, don't have jobs – a total of 10.4 million…[furthermore] more than two-thirds said they weren't looking for work…" The effects of these trends are that many households are cutting back on purchases and spending. Overall, the jobless rate is 6.7 percent, the highest jobless rate on record at this stage of recent economic expansions (Wall Street Journal, April 21, 2014, P.A1). With roughly two-thirds of U.S. Gross Domestic Product (GDP) dependent on consumption, the consumer is the key to economic growth. Consumer cutbacks are a very negative long-term trend for the economy. As we have discussed in past reports, until consumers are fully employed and confident, economic growth will be slow at best.

Consumer confidence declined somewhat in April. The Conference Board's index of consumer attitudes declined to 82.3 for mid-April from 83.9 in March. Consumers continue to spend only moderately due to worries about jobs and the economy, although the recent consumer confidence readings indicate increasing near-term confidence in the job market and potential for household income.

In the housing sector, recent data suggest a slow start for the spring selling season. Pending home sales were down 7.9 percent in March of this year from March of 2013 (Reuters, April 28, 2014). New home sales declined 14.5 percent in March from February of this year. March new home sales were down 13.3 percent from March 2013 (Wall Street Journal, April 24, 2014). Homeownership is at its lowest level since 1995. Most housing statistics remain weak, according to David Blitzer, chairman of the index committee at S&P Dow Jones Indices (Reuters, April 29, 2014).

As shown in our *Forecasts* table, unemployment is seen decreasing slowly from a 7.4 percent rate in 2013 to 5.5 percent in 2017 (which is the so-called normal rate of unemployment of around 5.5 percent). But that is still a few of years out.

BUSINESS INVESTMENT

There are signs of improvement in the business sector. Durable goods orders rose 2.6 percent in March, following a 2.1 percent increase in February. Core capital goods, which are non-defense capital goods excluding aircraft, rose 2.2 percent in March after falling 1.1 percent in February. Orders for transportation equipment increased 4.0 percent in March. The capital goods orders increases were seen in many categories, including machinery, electrical equipment, appliances, fabricated metal products, computers, and electronic products.

U.S. industrial production rose 0.7 percent in March, following a 1.2 percent gain in February. Manufacturing output rose 0.5 percent, the output from mines rose 1.5 percent, and the output from utilities rose 1.0 percent.

On a negative note, same store sales growth for the fourth quarter of 2013 declined to 1.1 percent, finishing at less than one-half the rate of the third quarter of 2013, which was 2.3 percent. By comparison, same store sales growth was 1.5 percent for the full year of 2013; 2.6 percent for 2012; and 2.9 percent for 2011.

In another sign of improvement in the business sector, banks have been increasing their lending to businesses. This has been a result of both banks' willingness to lend more by loosened lending standards, and companies' willingness to borrow more, perhaps reflecting increased confidence in the economy.

Corporate earnings finished 2013 on a strong note. Earnings were up 6 percent in 2013 from the year earlier. Companies have so far managed to maintain high profit margins due to aggressive cost cutting, automation, and lower commodity prices. Unfortunately for the economy and households, firms have restricted their hiring. Companies have record amounts of cash they are not willing to invest in this uncertain business climate.

GOVERNMENT

At the conclusion of its policy meeting on April 30th, the Fed said it would reduce monthly bond purchases to $45 billion from the current $55 billion. This puts the bond buying program, known as quantitative easing (QE), on track to end in October of this year. The government reported on the same day that first quarter GDP grew at only a 0.1 percent annual rate. Defending its move to reduce bond purchases further in light of the weak first quarter report, the Fed cited its belief in other evidence showing that the economy is on a positive trajectory. But the Fed also said that it will keep the overnight target rate between 0 and 0.25 percent for a considerable time after the bond buying program ends, citing the need to keep rates low for continued improvement in the economy. It is widely expected that the Fed won't move the target interest rate up before the second half of 2015.

NET EXPORTS

The world economy is projected to grow at a 3.4 percent overall rate this year, up from a 2.9 percent rate last year, according to a Reuters poll (Reuters, April 16, 2014). But many important U.S. trading partners will be lagging – including Japan and the euro zone.

A lot depends on China, the second-largest economy in the world, for its role in furthering global economic growth. In the first quarter, China's economy weakened to its slowest pace in 18 months.

In the euro zone, low inflation and high rates of unemployment in many areas pose a risk for the region. The European Central Bank earlier this month announced that it is has considered negative interest rates and bond purchases to prevent low inflation from undermining growth in the region. Euro zone GDP grew at only a 1.1 percent annual rate in the fourth quarter of 2013.

Latin America is also expected to be in a major economic slowdown. Argentina and Venezuela are projected to be in a recession. Brazil's growth has been forecast at less than 2 percent.

U.S. exports dropped 7.6 percent in the first quarter of 2014. This was the largest quarterly decline in five years. By comparison, exports grew by 9.5 percent in the fourth quarter of 2013.

THE BOTTOM LINE ON GDP GROWTH

As we have noted in previous reports, the U.S. economy has actually been in a slow recovery mode since the latter part of 2009 (see our Forecast table), though it doesn't feel like a recovery to most consumers. In fact, with the economy having been in recovery mode for a little over 58 months, this recovery is getting close to exceeding the post-World War II average length for recoveries, according to the Wall Street Journal (April 21, 2014, p. A1). The recovery has also been one of the most lackluster recoveries in U.S. economic history, with gross domestic product (GDP) having grown at only 1.8 percent per year on average since the recession – which is half the rate of growth in the previous three recoveries (Wall Street Journal, April 21, 2014, p. A1). This jobless recovery has not been helping households, and actually has been a significant factor in dampening the economy's growth.

Going forward, the economy is seen growing at 2.8 percent in 2014, 3.2 percent in 2015, 3.1 percent in 2016, and 2.4 percent in 2017. At the same time, inflation (as measured by the CPI) is expected to remain subdued, closing out the year at 1.8 percent and rising to only 2.1 percent by 2016.

In a recent survey of economists by the Federal Reserve Bank of Philadelphia, the economists see an 11.2 percent chance of negative growth in the current quarter, with the chance of negative growth in the following four quarters being in the 9.3 percent to 11.7 percent range.

We have determined a score of 61.92 percent from our Simple and Effective Economic Forecasting Model, which indicates a likely period of slow economic growth. This is the same score as we assigned in our March 2012 forecast, and that we maintained through the Third Quarter 2013 report, as the conditions indicating slow growth have not changed.

Please see the accompanying tables and graphs listed on the Economic Outlook page that detail our expectations and outlook for the economy.