Good News or Bad News?

July joined January as the only two down months for the U.S. investment markets, and the month's last week (down 3%) provided yet another exciting lurch of the roller coaster. But if you put it all in perspective, July's overall 1.5% decline is relatively small and has since been mitigated somewhat by rising stock prices in August.

One reason investors seem to be optimistic despite the market downturn is the report by the Bureau of Economic Analysis showing that the U.S. gross domestic product grew by a robust 4% rate in the second quarter this year. This would represent a pretty large reversal from the 2.1% decline in the first quarter.

Any time the economy grows at a 4% rate, it's an indication that we're living in a terrific business climate. But there is reason to wonder about that number and whether it reflects what many people seem to think it does. For one thing, the final GDP figure will be revised at least twice between now and September. These revisions can be significant. The first quarter estimates initially came in at 0.1% growth, then were revised to a 1% drop, then a much larger 2.9% drop before the BEA revised it back to -2.1%.

For another, the second quarter may have picked up some of the growth that was suppressed in the first quarter by the well-publicized weather anomalies. Indeed, a big part of the final GDP number came in the form of replenishing inventories and stockpiles, not real spending, which grew by just 2.3% for the quarter. (Of course, that, too, is subject to heavy revision.)

Job growth has been rising but the housing recovery, so robust last year, has stalled. People are saving more and spending less. Gas prices remain about where they were before the ISIS advance through Syria and Iraq. Add it all up, and we are likely looking at another year of below-historical-average growth, rather than the long-anticipated economic takeoff which was originally projected for 2015 or, perhaps, later. If the stock markets were buoyed by the comforting feeling that good times are here again, they may experience disappointment when the final numbers come in.

But, ironically, that may actually be good news for the markets in the longer term. Fed Chairperson Janet Yellen is watching the economy closely for signs of overheating--for, in other words, signs of 4% or greater economic growth. If the second quarter number is revised downward, and the rest of the year shows steady moderate growth, the Fed is likely to keep interest rates low, stimulating both the economy and the stock market, for the foreseeable future.

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