Thackray Report
Peak Growth- Watch the Hook!

August 23, 2021 Written by Brooke Thackray

When a performer's performance is going south on the stage, there are a number of methods to get them off of the stage: increasing loud music, a loud gong, clapping and others. A metaphorical hook is often used to represent a last ditch attempt to remove a performer. Is the stock market about to hook lower?

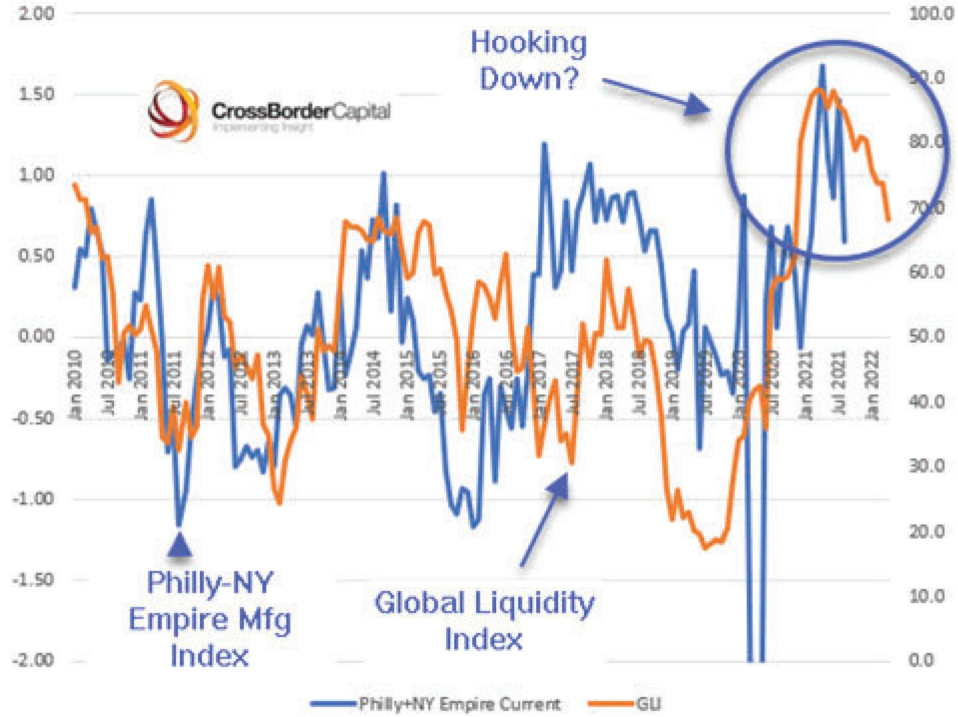
Right now, we have a lot of economic hooks trying to get the stock market off the stage as it continues to set all-time highs. Although the stock market can continue to move higher, at some point, the stock market could hook lower as an increasing number of economic indicators start to "hook lower."

US ISM Purchasing Managers Index (PMI)

The US ISM Purchasing Managers Index (PMI), which measures whether an economy is expanding or contracting, peaked in March and has hooked lower. A number above 50 indicates that the economy is expanding and a number below 50, the economy is contracting.

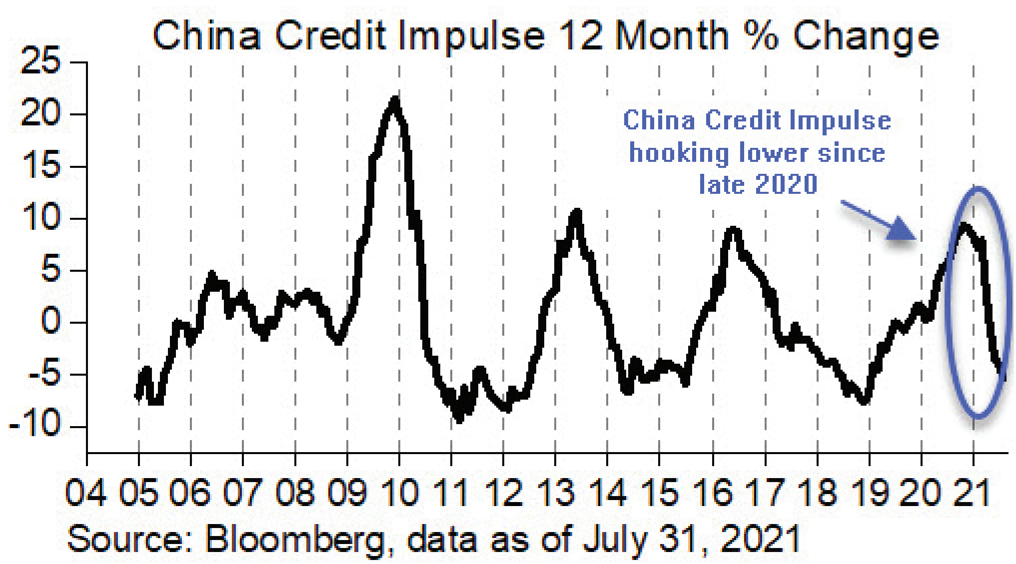
The current PMI number is still well above 50, but the move lower since March indicates that the economic rate of growth is slowing.

It is not just the PMI that has hooked lower, but also the Philadelphia Fed Manufacturing Index and the NY Empire Manufacturing Index. The graph below shows a composite of the two indexes shifting lower. It also shows the Growth Liquidity Index by Crossborder Capital shifting lower.



China Credit Impulse

The China Credit Impulse measures how much the Chinese government is letting credit expand in the Chinese economy. Unlike the US, China can dictate whether credit should expand or contract. In the pandemic, China has taken the total opposite tact compared to the US. China has been reducing stimulus as the COVID-19 pandemic has been maturing.

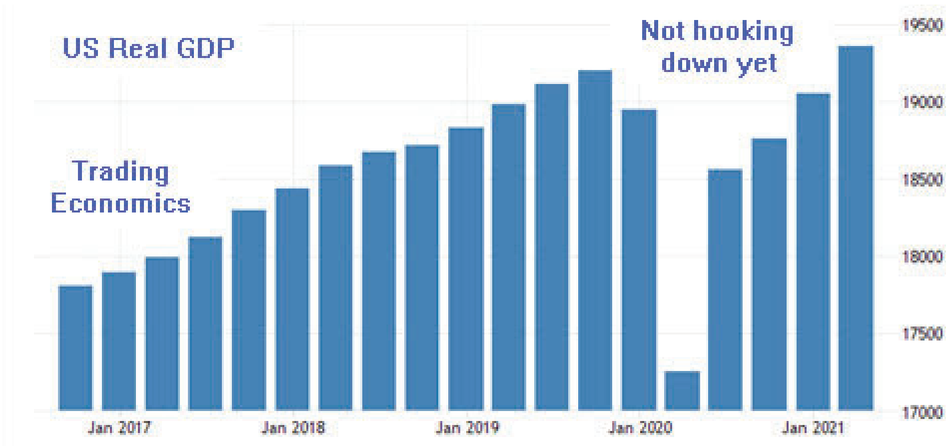


China has had the benefit of the US stimulus helping to boost Chinese exports, helping to support the Chinese economy. Nevertheless, it is difficult for a prolonged global expansion without China growing at a healthy rate. The chart above shows that China's Credit Impulse has been hooking lower since late 2020.

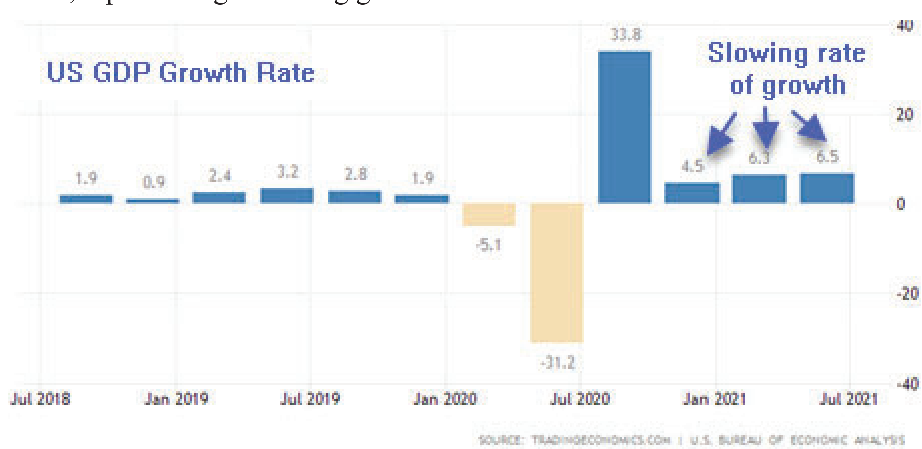
US Real GDP

There are different ways to measure the production of an economy. From a GDP perspective, a growth rate can be used or absolute values. Below is the graph of the total value of goods and services produced in the US. This graph is informative, as it shows the decline in 2020 from the pandemic and then the increase as the economy has recovered. The graph shows that the amount of goods and services produced in the US has increased above the pre-pandemic levels. It should be noted that artificial stimulus has created a situation of spending that cannot be maintained over long-term.

A recession is often classified as a decrease in GDP over two quarters. A decrease in GDP for even one quarter is not a common event. Expecting GDP to hook lower is an aggressive expectation. Investors should be looking for the gap between the bars to get smaller over time, to represent a decrease in the economic growth rate.



The graph below shows the US GDP growth rate. The graph shows that the GDP is still growing above average rates over the long-term. Long-term, GDP has grown at approximately 2-3% per year. The changing growth rate in the graph below is represented by the difference in the height of the bars in the above graph. The positive difference in bars is getting smaller, representing a slowing growth rate.



Investors should be looking for the growth rate in the graph above to start hooking downwards to represent a declining growth rate. If this were to happen this would be concerning for investors. If the growth rates were to "hook" lower to levels in the 2% range, this could be very concerning. If this were to happen, investors would start to speculate if the growth rate were going to go negative, which would be a big problem for the stock market.

Investors are constantly told that the economy is not the stock market. In other words, the stock market can move higher even while the economy is slowing. There is some truth in this, especially in the short-term. Nevertheless, common sense tells us that a strong economy is needed to generate corporate profits which ultimately helps to push the stock market higher. Currently, we are not in a recession, but a recession is not a prerequisite for poor stock market performance.

There are a number of economic reports that show a trend in results "hooking lower." It should be noted that although economic indicators are not good timing indicators, they should still be monitored. If economic growth is slowing, this increases the possibility that the stock market will struggle on a go forward basis.