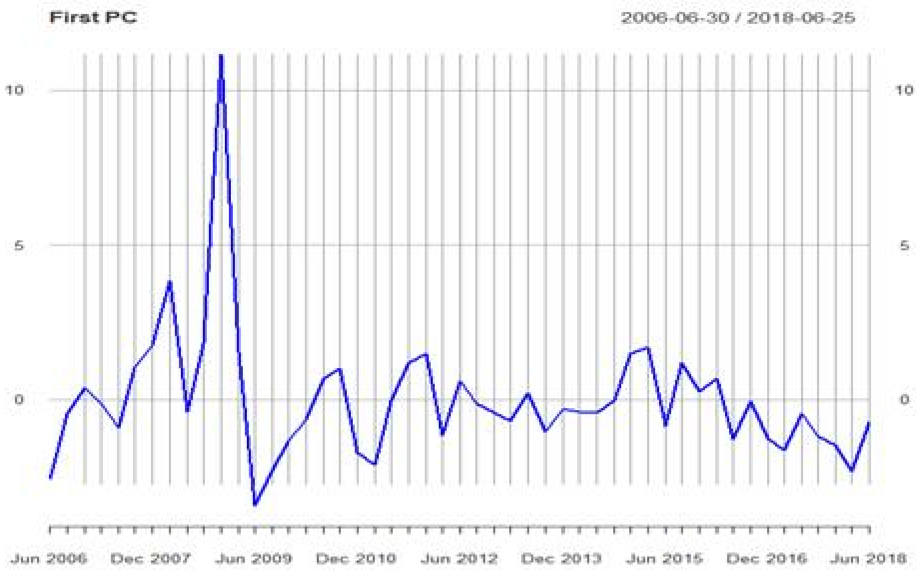
Moving to the 2018Q3 Year-Ahead Outlook

We’ve come to the end of the Q2 2018 forecast. This is a good time to review how the market outlook stands. Our forecast for year-over-year NGDP growth in 2019Q2 ended just hair over 4%, the forecast for the next quarter, which is currently only visible by mousing over the end of the plot, as there is only one day of data available for this current quarter, stands at 3.9%.

Please note that the current forecast available on Hypermind is for 2019Q1. Hypermind traders have that figure at 4.4% or 4.5%, whereas our system sees it at 4.3%, so we aren’t far from the market consensus. The Hypermind forecast unfortunately is becoming less interesting from an economic outlook standpoint. NGDP will probably come in over 4% YoY in 2019Q1, but 2019Q1 isn’t so far into the future anymore. We want to know what the year-ahead horizon holds; based on past co-movements of NGDP and market signals, it looks like things will cool off, a bit less than 4%. So much for Trump installing an ally at the Fed!

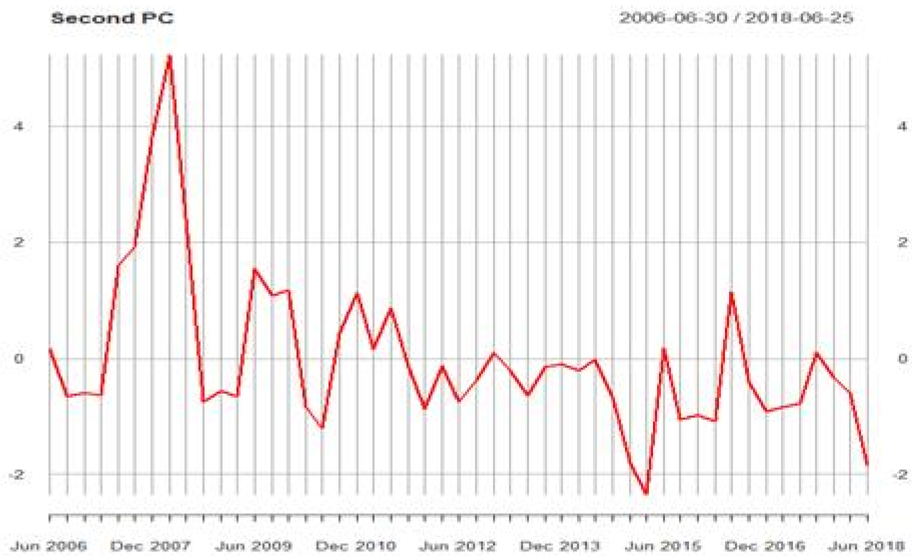
Our forecast models don’t look at all the market prices that go into our system, but instead at a sort of quasi-weighted-average of prices, the statistical concept is “principal components”.

The plot below shows the first PC or ‘signal’ from the market price basket, in quarterly average frequency of day-ending data. This signal goes “up” when times are bad. In the last few quarters the signal has gone “down”, coinciding with the “Trump Bounce” and then come back up, as the markets have cooled following Fed rate hikes.



The first signal is an overall proxy for markets. A strong dollar is ‘bad’ for this signal, higher TIPS spreads, copper, oil and S&P 500 are ‘good’, higher rates are ‘bad’, especially 5-year rates.

The next signal has a less obvious interpretation. In fact, while we have suspicions as to what it means, we can’t be sure. When this signal goes higher, it lifts the NGDP forecast. Interestingly, this component has zero weight on the S&P 500 index input, instead leaning relatively heavily on short term bond yields and oil.



Based on these components, it looks like markets see monetary policy as working to hold back the impetus of the economy. Again, this is intuitive; NGDP growth has been relatively strong, up 4.7% YoY as of the last 2018Q1 reading. Yet, all of our sub-models see NGDP growth well bellow this, ranging from 4.2% at the high end, to 3.3% at the low end. Interestingly, the sub model giving the 3.3%

is both the simplest, and the *most accurate* historically. For the forecast to move back to a more comfortable level, say around 4.5%, we will need to see a big lift in market sentiment, strong NGDP or more likely, some mix of the two.

Those who think NGDP is going to hit 4.5%+ in the next year might consider increasing generic long positions, because at present, based on what we know of the association between NGDP and market signals, things aren’t looking particularly encouraging. Trade at your own risk.