ECONOMIC INSIGHTS

Volatility: Why This Is Not the "End of Days"

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Recession-wary investors eager to sell in the current climate appear to be disregarding strong U.S. economic fundamentals.

In a recent Lord Abbett **video roundtable on the 2019 investment outlook**, I made a light-hearted reference to investor sentiment during the market volatility of October and November. To wit: Worries that a flattening yield curve was signaling an imminent slowdown or recession for the U.S. economy "had investors wandering around as if it were the end of days."

Well, the eschatological mood has only deepened over the past week, with major U.S. equity indexes suffering large losses on December 4 and 6 after starting the shortened trading week with a modest rally on December 3. Various factors have been cited for the weakness: Trade fears, the flattening yield curve, prospects for softening growth in China. But as I noted in the video, the typical stresses that develop during long periods of economic growth—accelerating inflation, rapid increases in labor costs, credit bubbles or other widespread market dislocations—are not apparent at the current time. When might these stresses become evident? There is no clear indication.

At this point, we believe it's important to focus on what we *do* know. As we have emphasized in the past few months, U.S. economic fundamentals remain solid. That has been reinforced by a raft of reports we received in recent days:

- The **Atlanta U.S. Federal Reserve Bank's GDPNow** estimate for the fourth quarter of 2018 was raised to 2.8% from 2.6% in the latest revision. The report, released December 6, showed that upward revisions to estimates for consumer spending and private fixed investment were the drivers of the improvement.

- Per a Mortgage Bankers Association report released December 5, **weekly for-purchase mortgage production** has improved sharply and the short-term trend has turned upwards. Thus, notwithstanding falling risk asset prices, homebuyers may be emerging cautiously from their foxholes.

- A December 6 report showed that **consumer comfort**, as measured by a proprietary Bloomberg index,[1] remains very high, notwithstanding a bump higher in jobless claims in recent weeks (claims, it should be noted, remain near historic lows). With the most intense portions of the holiday shopping season approaching, this is encouraging.

- **Light vehicle sales**, as reported by U.S. auto manufacturers in the first week of December, reached a seasonally adjusted annual rate of 17.4 million or better in each of the past three months. This should feed into rising consumer and business equipment spending in the fourth quarter of 2018.

- **U.S. household leverage** continued to decline in the third quarter of 2018, although more gradually, according to U.S. Federal Reserve (Fed) data released December 6. Net financial assets, liquid and otherwise, at all-time highs relative to income in the third quarter.
- The U.S. housing crisis is now firmly in the rear view mirror. The December 6 Fed report also showed that **home prices** have climbed back above replacement values—that is, the household sector now has positive net collateral to offer in the most widely distributed form of wealth.

Summing Up

As I said in the roundtable, based on recent market action, it appears that investors have started to price in the end of the current economic cycle, even though the things that create the downturn are really not evident yet. The widespread selling of equities during the current bout of market volatility—amid an otherwise strong economic environment—may offer opportunities for long-term investors as the fundamentals eventually reassert themselves.

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[1]The Bloomberg Consumer Comfort Index.

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The **Bloomberg Consumer Comfort Index** measures Americans' perceptions on three important variables: the state of the economy, personal finances and whether it's a good time to buy needed goods or services. A new index reading is generated every week.

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