



## Economic Contraction.

### US GDP slows in first quarter 2014, but we're smarter for it.

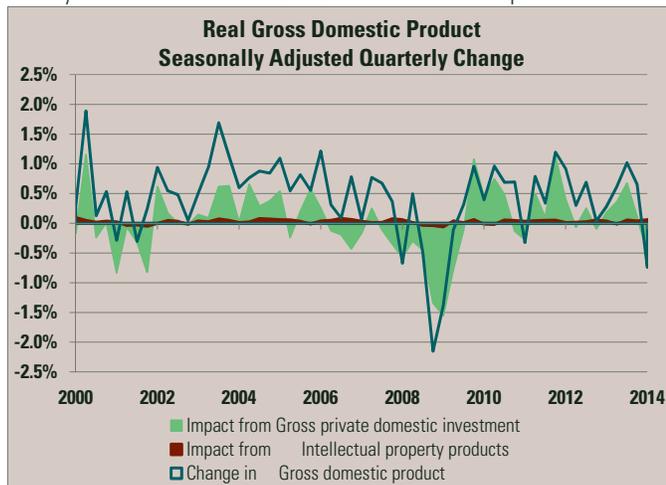
On June 25, the US Bureau of Economic Analysis (BEA) reported that Gross Domestic Product (GDP)—the standard measure of economic strength—shrank at an annual rate of 2.9% during the first quarter in real terms.<sup>1</sup> The US economy appears unable to find an elixir from a hangover that has lingered since the dot-com bubble burst in 2000.

#### Private Investment.

To interpret economic numbers, it helps to understand the underlying components. GDP has four main components:

1. Personal consumption,
2. Private investment,
3. Government expenditures, and
4. Exports net of imports.

**Investment drives the economy.** Personal consumption usually comprises about two-thirds of GDP, and lately government has been larger than private investment. Yet, private investment tends to more significantly impact economic fluctuations. Even more relevant from a financial market perspective, private investment correlates more closely with financial markets than do the other components.



SOURCE: US Bureau of Economic Analysis.

<sup>1</sup>"Gross Domestic Product: First Quarter 2014 (Third Estimate)." (June 25, 2014)

<sup>2</sup>"Preview of the 2013 Comprehensive Revision of the National Income and Product Accounts," *Survey of Current Business* 93 (March 2013)

Private investment excludes government and most consumer investments. Private investment covers residential (i.e., consumers) and nonresidential (i.e., businesses) investments in structures, equipment, inventories, and intellectual property products. Nonresidential investment makes about 80% of private investment or 13% of GDP.

**Investment falling.** During the first quarter, intellectual property products was the sole segment of private investment to rise...more on intellectual property later. From last quarter, private investment fell more than 3% which knocked real GDP down 2% at an annual rate. Incidentally, falling investment has accompanied each real GDP contraction since 2000. See the inset graphic for further illustration.

**Volatile inventories.** The segment of private investment attributable to changes in inventory average a little over 1% of total GDP. However, inventory levels vary widely across periods. In the first quarter period, inventories rose \$45.9 billion or 60% below recent quarters that averaged about \$115 billion. This is largely consistent with conclusions from an evaluation of company financial reports.

#### Measuring Intellect.

Hawk100 is intrigued that BEA found intellectual property products to have been the only segment of private investment to grow during the first quarter. They found that Americans produced \$642.9 billion new intellectual property products in the first quarter—even more than the prior quarter. Apparently, the BEA gnomes are bigger fans of Katy Perry than Miley Cyrus. (Ms. Perry's "Dark Horse" topped pop music charts in March while Ms. Cyrus's aptly named "Wrecking Ball" held the top spot in December. For the record, Hawk100 likes Onerepublic "Counting Stars" among contemporary pop hits.)

Hawk100 remains skeptical of BEA ability to reliably guess value of intellectual property products when it decided to add them to GDP.<sup>2</sup> We find the inherent judgment in making those estimates a tempting tool to smooth otherwise rough quarters like that just reported.

By Richard Clemens, CFA CPA, *President*

HawkTalon © 2004–2013 by Hawk Investment Management, LLC. All Rights Reserved.

Information herein is based on sources believed to be reliable but the accuracy of which is not guaranteed. Conclusions and views expressed reflect the author's opinions and are subject to change without notice. HawkTalon neither offers nor solicits the purchase or sale of securities.

Contact Hawk100 to discuss how this information may affect alignment of your wealth with your life.

Your wealth.  
Your life.  
Aligned.