It is a fact of human nature that people tend to see what they want to see and hear what they want to hear. On that basis, analysts espousing both bullish and bearish scenarios are each finding support for their respective points of view in the most recent spate of quarterly economic reports.

Specifically, optimists are crowing that first quarter economic growth was much stronger than feared, while skeptics are cautioning that it was much less than meets the eye. Our view is that both conclusions are correct, and both are supportive of continuing strength in the equity market which is discounting an economy that is neither too hot nor too cold.

"Glass-half-full" proponents point out that GDP grew at a much stronger-than-expected annualized pace of 3.2% in the first quarter, and would have been even stronger were it not for a 35-day federal government shutdown that shaved 0.3% from that number. The reported growth rate exceeded consensus estimates of 1.5% and last year's fourth quarter growth of 2.2%. In addition to the drag exerted by the government shutdown, the economy also had to overcome brutal winter weather and the negative wealth effect of the fourth quarter's 20% stock market collapse which adversely affected Q1 retail sales. Personal Consumption Expenditures (PCE), which account for 70% of GDP, remained weak for the first two months of the quarter before rebounding strongly in March.

While the Q1 report undeniably exceeded expectations, the "glass-half-empty" crowd will tell you that the headline figure was lifted by inventories, trade, and government spending.

Inventory accumulation added 0.65% to the reported growth rate, and will exert more of a drag going forward if personal consumption doesn't continue to improve. Total government spending, driven primarily by state and local infrastructure needs, rose at the strongest pace since 2017. Final sales to *private* domestic purchasers, on the other hand, have decelerated sharply from the pace of last year, and are back down to post-2008 recovery averages. Additionally, residential real estate investment contracted for the fifth consecutive quarter in Q1, and non-residential investment has not responded favorably to lower tax rates. These, and other indicators of "softness" in the reported numbers should be enough to keep the Fed on pause.

A note on trade: sharp improvement in net trade during the quarter added a significant 1.03% to growth. Exports rose by 3.7% in the first quarter, more than double the 1.8% rate of the prior quarter, fueling expectations that the ongoing U.S./China trade talks would lead to a favorable resolution by mid-year. However, as this is being written, the markets are being shaken by a presidential tweet threatening that the next round of tariffs on China could be implemented starting this Friday, May 10th. We are thus reminded that trade remains very much a wild card in the current economic and market environment.

Elsewhere, the markets received another “goldilocks” employment report, with the economy adding a better than expected 263,000 non-farm jobs in April, well above the 200,000 average of the last 6 months. The unemployment rate dropped to a 50-year low of 3.6%, yet wage growth remained modest with average hourly earnings up just 0.2% month-to-month and 3.2% above year ago levels. That yearly number is significant, as wage growth of 3.2% is slightly below the sum of the Fed’s long term inflation target of 2%, and the 10-year average productivity growth rate of 1.3%. Thus, there are no signs of overheating in the labor market.

These economic reports suggest that the Fed could remain on hold for some time. April’s Consumer Price Index (CPI) won’t be released until May 10th, but the personal consumption data released in the first quarter GDP report suggests that core inflation is likely to remain well below the Fed’s target.

Finally, we are now more than 75% of the way through the first quarter earnings season, for which consensus expectations had been for a year-over-year decline of 3%-5%. So far, corporate America is following the economy’s lead, with almost 80% of the earnings reports coming in above estimates. Stocks of financial companies are often a good indicator of continuing market strength, and financials are showing earnings gains of more than 6% over last year’s first quarter results, the best performance of all of the eleven S&P sectors. Overall, despite the 17% rise in the market this year, the S&P 500 is still trading at less than 17 times forward 12 months estimated earnings, in line with the average multiple over the last five years.

So we have an economy that is at full employment, no inflation, low interest rates, an accommodative Fed, strong corporate earnings, reasonable valuations - and spring has finally arrived. Enjoy.

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