The Chance Financial Quarterly

A year ago, I started this newsletter. Its objective was to help the average layperson, someone who, to their credit, doesn't claim to be an economist. (And if you are, it's nothing to brag about!) And if you are a professional investment manager, you have even less to brag about. If you're one of those professionals, this is not for you but feel free to read it, laugh, call me an idiot, and write your own stupid newsletter.

Each issue is usually a review of the quarter, but in January, I emphasize the entire year. My goal is to make sense of the economic and financial b*** s*** the media and people claiming to be experts hurl at you. You care about your money, not some confusing economic figures like Nonfarm Payroll Expenditures or the Standard Overnight Financing Rate, both widely-followed economic measures. I always try to keep this simple and focused on the most important things you need to know.

Making Sense of Markets and the Economy

After a lackluster third quarter, for some inexplicable reason the S&P 500 shot up in the fourth quarter 11.2%. This has given us an overall 2023 return of 26.1%, Yikes! That's way too high, given the performance of the economy. Keep in mind the long run average return is about 11%. What have we done to deserve this?

Most investments ("asset classes" if you want to use the technical term) did very well. After a crappy 2022, the US bond market rose 5.3%, with most of that being in short-term bonds. If you took my advice and grabbed those greater than 5% money market returns, you did well. Real estate investments (known as REITs) returned 11.6%, recovering a bit under half of last year's horrible performance. And as is often the case, commodities go opposite of stocks. Last year, they did well. This year, they sucked at -5.3%.

The global (non-US) market rose 15.4%, a nice return but well below the US pace, consistent with my personal belief that Dorothy was right: there's no place like home. In fact, in the last 38 years (the longest period for which I have a consistent measure), the US stock market has beaten the non-US stock market 22 times, with lower risk.

In case you stay up at night worrying about, or God forbid trading, crypto, well, you were lucky this past year. Crypto did well with Bitcoin up over 150%, proving once again that there are stupid people out there that will spend a ton of money for the sole purpose of hoping there is another fool that will follow them and spend even more.

Mortgage rates have come down a bit, closing the year at a little under 6%, down from their peak of a few months ago at over 7.

And now, for the economy. Inflation, which ran amok in 2022, was getting under control and then spiked up a bit in December. For the year, prices were up 4.1%. This is much better than last year (8%) or the year before (4.7%) but still much higher than it has been historically. On the good side, it seems to have convinced the Federal Reserve to stop pushing interest rates higher. They are not, however, pushing them lower.

Unemployment remains near its long-run average at a little under 4%. For various reasons, this number can virtually never fall much lower. I'll explain this in a future issue.

GDP rose a decent 2.93% in the third quarter. (We won't get the fourth quarter figure until February.) This is the highest number we have seen in a year. Just below, I will explain GDP and why it's overrated.

My overall take is that the economy is decent, save for a bit of inflation that's still here. With this an election year, you can bet that the Fed (and don't tell me the Fed wants Trump to win) and of course, the Biden administration will do its best to pump up the economy and make people feel better on November 5. It may suck afterwards, but I predict it will look good that day. That doesn't mean your money will do well. You cannot extract your piece of GDP to pay your bills. Pay more attention to the stock market because it looks ahead, while the economic indicators look to the past. I am expecting a below average year for stocks this year, say somewhere below +10%, but I will be happy if the number just has a plus sign in front of it.

A Teaching Moment: What's GDP?

No, that's not a *Jeopardy* response. Four times a year, the government gives us a number called GDP, which stands for Gross Domestic Product. It is supposed to be a measure of the economic activity of the country. The concept was developed in the 1930s and became a standard measure right after WWII. It was originally called GNP (Gross National Product), which included economic activity of US citizens and companies abroad, but in 1991, the domestic version was created, the idea being that we care about output here, not output of Americans elsewhere.

GDP is an ad hoc measure. There is no economic theory that says that it means anything. It's just the sum of four values called Consumption, Investment, Government Spending, and Net Exports. Consumption is what we spend for products and services. It is the largest component of GDP (about 70%). Investment is what companies spend on physical assets such as factories and equipment as well as inventories. Only expansion counts. Replacing old assets does not. Government spending is, well, what federal, state, and local governments spend with our money. Net exports is the difference between what we export and what we import. That number contributes negatively to the US economy, as we always import more than we export.

GDP is itself a dollar figure, but the reported number is usually the percentage change, and it's annualized. That means when we hear a number like 3.2% in a quarter it really means that it was 0.8%, which is equivalent to an annual number of 3.2%.

Although economists are fully committed to the concept of GDP, I have serious problems with it. For one, it was developed in a time of a mostly manufacturing economy that was largely domestic. In today's service-oriented, global economy, it does not capture our real productivity. For example, years ago two of the leading corporations were General Motors and US Steel. They contributed a great deal to the Investment figure in GDP. But today we look to companies like Google and Microsoft. They are not manufacturers and contribute virtually nothing to the Investment component of GDP, which does not measure the investment in brainpower that so dominates our economy. Google and Microsoft do not exactly have a lot of factories, and their inventories are in the cloud. And because we Americans generally find it cheaper to buy foreign-made goods, that hurts the overall GDP. While it counts in the Consumption component of

GDP, it is lower because the prices of foreign-made goods are lower. That all produces a negative result. But aren't we better off?

Unfortunately, everyone uses GDP, so we have to pay attention to it. But be aware that our economy grows at a much faster rate than they tell us. I pay far more attention to the stock market, because it means real money. You can spend your dividends and capital gains. You cannot spend your GDP.

In the next issue, I will carry this GDP concept forward by discussing what is a recession.

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Don Chance, PhD, CFA, holds the Norman V. Kinsey Distinguished Chair in Finance at Louisiana State University. Any views expressed herein are his own and may not represent those of his employer. He likes to think of himself as an all-around nice guy who believes that the more knowledge he shares with others, the better investors people will become and the more likely they can avoid being ripped off by the Wall Streeters, who know many ways to take your money and make you think you came out ahead. Visit his web site, donchance.com for lots of interesting and useless information.