THE "VOICE" OF THE ECONOMY—AND WHAT IT'S REALLY SAYING

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JUNE 2018

BY ROB STEIN

CEO, Astor Investment Management

The buzz around the internet these days has been a computer-generated voice and whether it's saying [Yanni or Laurel](). As it turned out, the computer was saying both, and the difference in auditory perception was due to the frequency of the playback and how well people's ears perceive different frequencies.

This struck me as a curious analogy to a much more relevant debate taking place. As I review the current economic data, especially the data used to create our proprietary [Astor Economic Index®]() (AEI), I hear a similar "debate" based on differing perceptions about the state of the U.S. economy and the stock market. Is the economy strong and stable, or is fragile and vulnerable? Is the stock market overvalued and headed for a correction, or will the trend of the past few years continue?

Unlike the Yanni/Laurel scenario, this time the answer is not "both." Based on our macroeconomic analysis, the economy is speaking clearly with one voice. Here's what we're hearing:

The AEI, which aggregates macroeconomic data into one value that is compared to long-term historical averages, shows the U.S. economy growing above trend.

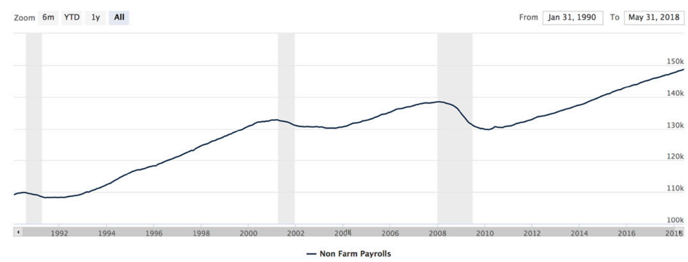
Astor Economic Index® 2000 to May 31, 2018

Source: Astor calculations

Shaded regions represent recessions as determined by NBER.

Digging into underlying data included in the AEI—such as employment trends, measured by jobless claims and non-farm payroll, and output data such as GDP and ISM—the clear indication in our view is that the economy is not ready to throw in the towel on the current expansion.

Non-Farm Payrolls

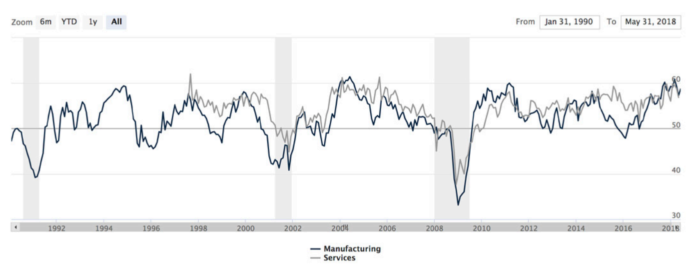


Source: Bureau of Labor Statistics

US Real GDP, year over year

Source: Bureau of Economic Analysis

ISM Purchasing Manger Indexes



Man: Manufacturing PMI, Svc: Services PMI

50 represents activity which is neither increasing nor decreasing

Source: Institute of Supply Management

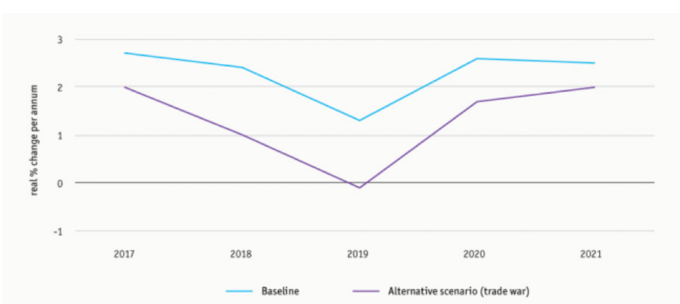
Even the much-watched [yield curve](), although flattening, has yet to give a true signal on the economy.

While we're confident about our current take (our "now-casting") of the U.S. economy, our analysis and view can change. There are certainly things to be watchful of. Top of the list is the Federal Reserve's action on interest rates. The very long period of monetary easing has ended, and the hiking cycle is underway. As of the March 2018 increase, six rate hikes have occurred since December 2015. The Fed watchers are weighing in with their own debate: Will the Fed get it right or will the central bank act too aggressively and create a tight money environment that could lead to a recession? Or, will the Fed tighten too slowly and allow inflation to erode asset values and income values?

Currently, the Fed is expected to raise rates three more times before the end of the year, with the next move in June widely anticipated. If this occurs, that will bring the Fed funds rate close to 2.5%. The two-year Treasury note is trading at about 2.3%, and the GDP reading for Q1 2018 (advance reading) was 2.3%. The current inflation rate is about 2%. I believe there is a relationship among these numbers; if they stay within the current range, then a little bit of pickup in growth, inflation, and yields should not create a headwind for the economy or the stock market. If that changes, however, it could in our view become a concern about continued economic growth and stock market performance.

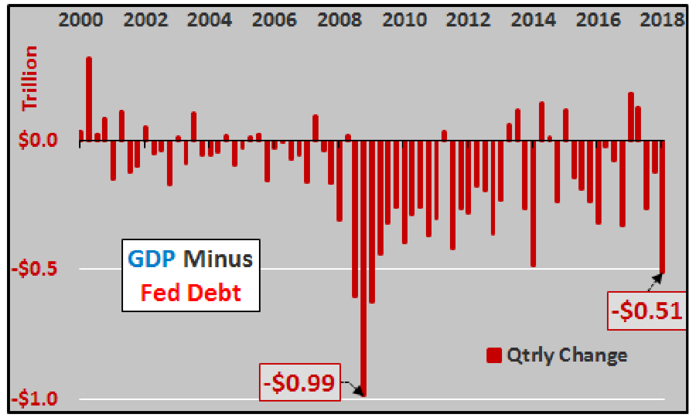
There are other concerns as well: Will a trade war erupt over proposed tariffs and countervailing tariffs? Will threats and worries be enough to increase market volatility? The market does not like uncertainty. However, until we see the trade policies, it's hard to measure their impact. That said, in my view, a trade war with China would likely cause domestic prices to rise, without an offsetting impact from tariffs. Consumption, which accounts for about 70% of GDP, would likely be negatively impacted by a trade war with China, as the chart below shows.

US Private Consumption Growth 2017–2021



Source: Growth Crossings, The Economist Intelligence Unit

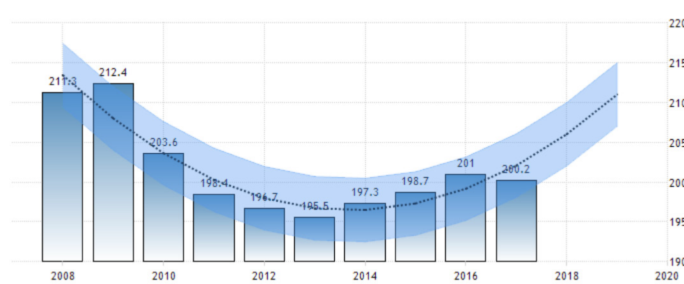
Another economic question being pondered these days is whether corporate debt levels will become too heavy when combined with the increase in the federal deficit in Q1. While I avoid citing debt levels and the deficit as catalysts for economic weakness, it's worth noting that recent increases in the deficit are the largest we've seen since 2008. The chart below shows that GDP minus federal debt is approaching $0.5 trillion, and recent increases in the deficit are approaching the recent increase in GDP.



Source: Seeking Alpha

We cannot compare U.S. government debt and federal deficit to that of major corporations as there are too many variables in government that don't exist in corporate America. Nonetheless, corporate America is also increasing its debt at a pace not seen since 2008. Debt should not be viewed as an indicator of trouble ahead, as not all debt is created equal; debt that spurs growth and investment is generally a good thing. However, as interest rates and [market???] volatility rise after being low for many years, increased debt could potentially create an unstable situation in the future.

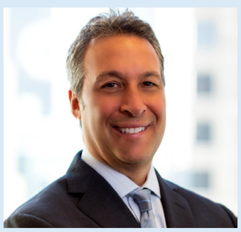
US Private Debt to GDP



Source: tradingeconomics.com | OECD

This brings us back to our original premise: What is the economy saying now? Unlike the Yanni vs. Laurel debate, the economy and the stock market are not saying two things at the same time. If you are listening now, as we are with the AEI and our analysis, the economy is saying there is still more room to grow in this expansion.

ABOUT ROB STEIN



Mr. Robert Stein began his career as a project analyst for the Federal Reserve under former Chairman Paul Volcker and later went on to hold senior trading or portfolio management positions with large money-center Wall Street banks.

Returning to Chicago in 1994, he formed Astor Financial, Inc., the parent company of Astor Asset Management LLC ("AAM") a registered investment adviser and the predecessor firm to Astor Investment Management, LLC. Knight Capital Group (NYSE: KCG) acquired AAM in 2010 and Mr. Stein was appointed to the Executive Committee reporting to the Board of Directors and directly to the Chairman. In a management restructuring, Mr. Stein re-organized AAM as an independent firm (Astor Investment Management LLC). Mr. Stein is the co-creator of the Astor Economic Index (AEI), the firm's proprietary method used to create what we believe is a smoother, more accurate "live read" on the economy.

He is also the author of several books, including Inside Greenspan's Briefcase (McGraw-Hill) and Finding the Bull inside the Bear (John Wiley & Sons). Mr. Stein is the founder of the i-CARE Foundation, an organization that provides an annual grant to Northwestern Hospital to enhance patient experience and is Vice Chairman of the Board of Advisors to GlenKirk, an organization that supports people with special needs. Mr. Stein holds a Bachelor of Science from the University of Michigan.

FOR MORE INFORMATION

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the Astor Investment Committee, visit www.astorim.com

Astor Investment Management LLC

111 S. Wacker Drive, Suite 3950
Chicago, Illinois 60606

800.899.8230

www.astorim.com