Weekly Commentary **July 30, 2010**

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GDP Data Confirm GDP Bounce back; Stocks in Critical Technical Area

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The big news today are the GDP data. In my opinion the markets over-reacted on the negative side to the numbers. Certainly the 2nd quarter growth came in marginally lower than expected (2.4% vs. 2.6%), but there was a big upward revision of the first quarter, now recorded up 3.7% versus 2.7%.

The benchmark GDP revisions all the way back to the first quarter of 2007 showed that the recession was deeper than expected and, over the past 3 years, GDP did not grow as fast as expected. This downward revision was fully expected, since the GDP data derived from the income side of the ledger has been consistently below that compiled on the spending side. The new GDP numbers also fit the other economic data and confirm the NBER call that the recession began in December 2007. GDP did fall in the first quarter of 2008, but originally there was a rebound in the second quarter that put GDP above the fourth quarter of 2007. In the new data, the rebound in the second quarter was not sufficient to raise GDP to a new high. Furthermore, the worst quarter for the recession was the "Lehman Crisis" 4th quarter of 2008, where GDP fell by 6.8% (annualized rate), not the first quarter of 2009, as was originally reported. However, the new data (including the first quarter of 2010) shows that the GDP increase from the recession bottom are as strong as earlier forecast. It has been reported that the NBER was reluctant to call an end to the recession, fearing the new data would show a much slower recovery. That is not the case and there is now absolutely no question that the recession ended in the summer of 2009.

On the details of the report, the surge in imports was the major reason for the lackluster growth. Indeed, gross domestic spending on goods and services (wherever the origin) increased at a whopping 5.1%, but the lion's share of the increase was spending on imports. Indeed, the trade deficit subtracted 2.8 percentage points from. growth, and imports alone subtracted 4 percentage points. The US is once again an engine of world growth and has contributed to the world-wide rebound in GDP, particularly in the emerging economies.

Stocks are now in a critical technical area. The S&P 500 Index rallied near the June 21 closing high of 1113, but then fell back. Until the closing price can be exceeded, the pattern of lower lows and lower highs is still intact. The 1113 level is also where the 200 day moving average now stands. All this means that if stocks could rally above 1113, it would be a huge buying signal to the technicians and could carry the market much higher. On the other hand, a failure to penetrate this level would be construed as a negative indicator.
