
ON PRODUCTIVITY, THE FED AND TAXES

Jeremy Schwartz – Global Chief Investment Officer
11/07/2017

Last week was one of the most important weeks from an economic standpoint in some time, with announcements on the new [Federal Reserve \(Fed\)](#) chair, more details on the Republican tax legislation that is pending and a slew of economic releases. We were privileged to speak with chief economists Constance Hunter of KPM, and Brian Wesbury of First Trust Advisors on our “Behind the Markets” podcast. These are the takeaways:

Constance Hunter on Productivity

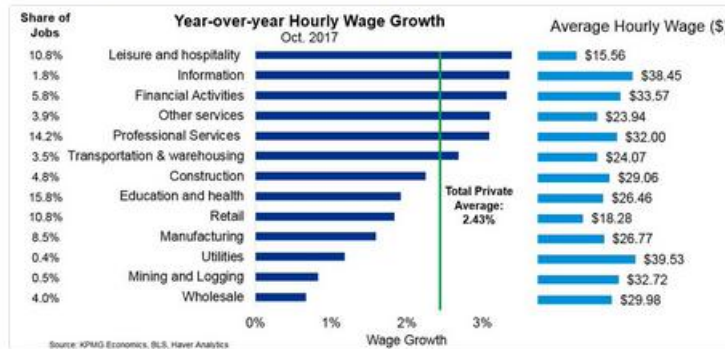
- The productivity print came in higher than expected due to [gross domestic product \(GDP\)](#) data coming out higher than expected. Hunter’s role at KPMG entails consulting with clients, and every CEO, CFO and CTO she meets with is focused on enhancing productivity throughout their organizations. With that focus, you would think productivity would come. Why were we in a productivity funk? Hunter believes that’s partly due to our economy’s transition to a service-based economy where things that used to count as investments in GDP are now counted as service purchases (cloud computing is an example). This is a big element of where Hunter sees spending. If this is not counted as investment in GDP accounting, this will depress productivity statistics as well.
- The trends in productivity from peak to trough, while averaging 1.8% over the last 50 years, often are driven by trends in labor scarcity. Constance plots this data using surveys from the National Federation of Independent Business. Intuitively, this makes sense. When labor is hard to find or expensive to find, necessity becomes the mother of invention.
- Why are wages being suppressed? Perhaps it is a compositional effect of the labor force—higher-paid baby boomers are retiring and that may be depressing aggregate wage figures. We’ve had 85 consecutive months of job gains—which is the largest stretch in post-world war II data by over 50%. Hunter released a chart on Twitter showing how the type of jobs and level of wages in jobs correlate with wage gains. Big job categories like professional services and health care have above-average incomes but not big gains in wages, while leisure and hospitality are seeing bigger gains but from a low base. <https://twitter.com/ConstanceHunter/status/926494405309222912>



Constance L Hunter @ConstanceHunter · 18h

Replying to @BizRadio111 @wesbury

Excited to be on @BizRadio111 today! On the subject of #JobsReport, despite reports of labor shortages, wage growth remains subdued



- Hunter’s background prior to joining KPMG is a unique one—she went from an asset management and portfolio management role to serving KPMG clients and the firm generally on the big directional trends in the economy and how clients should incorporate those views into planning. She’s getting to focus on the real economy, and approaches clients from having been an investor in either their stocks or bonds.
- In the closing part of our conversation we spoke about her former life in asset management and how she thinks investors should apply economics to their investment decisions.
 - GDP growth is part of a [beta](#) factor in returns; one reason why investors look to emerging markets is their faster GDP growth.
 - For [G7](#) economies, this may be different. Hunter looks at final sales to domestic purchasers to get a more local pulse.
 - She also likes to look at residential construction and investment, and recently we’ve seen two quarters of declining numbers here—something Hunter will focus on more closely.
 - We have labor shortages in construction, something Hunter sees as a red flag to watch for the next [recession](#). Labor shortages and increases in wages are factors that Hunter is paying the most attention to right now.

With Brian Wesbury

- Wesbury’s still bullish. Going into 2017, Wesbury was one of the more optimistic forecasters and had targets of Dow 23,700 and S&P 500 2,700. He has been largely spot-on with markets hitting those targets, which is a return of close to 20%. Wesbury’s forecasts included a belief the market was undervalued and earnings were going to grow 10%.
- Wesbury uses a capitalized profits model that divides trends in overall economy-wide profits and divides it by a nominal 10-Year bond rate. His forecast includes using a 3.5% 10-Year bond rate, which is 1% higher than current rates due to forces (the Fed) he sees as artificially constraining rates lower than they ought to be. Wesbury sees 10% earnings growth next year again and still sees the market at 15% undervalued, so while he hasn’t made official forecasts for 2018, he said using a base of 15% growth in the market would be reasonable.

- Wesbury sees 95% of recessions being caused by the Fed getting too tight. He sees this recessionary scenario as two years off given the pace of Fed hikes that would need to invert the yield curve and get short-term rates high enough to harm growth.
- This sets up another strong year in the markets pending the rollback in regulation and positive global growth trends. Wesbury uses a modified version of the “[Taylor Rule](#)” (moving averages of real GDP growth and inflation) to get a sense of when [monetary policy](#) is too tight. This suggests a rate of at least 3% in this cycle and maybe even 4% to invert the curve and become too tight—so we still have a way to go before we are close to those levels.
- Wesbury points to one of the factors supporting the markets as the drop in regulation—he has found 800 regulations have been rolled back, and we had the largest one-year drop ever in the number of pages in the Federal Register, which is where all U.S. federal regulations must be published. Every page in that journal is something Wesbury feels hinders entrepreneurs, and this drop is bullish for the economy and markets.
- Wesbury points out that when Reagan won the presidency, 140 other countries cut corporate tax rates. We might be experiencing pressure now to cut corporate taxes, and this corporate tax rate cutting war will be good for markets. Wesbury continues to like Europe as cheaper than the U.S. He’s also a big fan of India and Modi, and thinks this will be a market for the next decade in which to be over-weight—and my team absolutely agrees.

In a big week for the economy, it was again great to speak with these two distinguished economists. You can listen to the full conversation [here](#).

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only. You cannot invest directly in an index.

DEFINITIONS

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Beta: A measure of the volatility of a security or a portfolio in comparison to a benchmark. In general, a beta less than 1 indicates that the investment is less volatile than the benchmark, while a beta more than 1 indicates that the investment is more volatile than the benchmark.

G7: The Group of 7 is a group consisting of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

Recession: two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

“Taylor Rule”: approach to determining an appropriate level of the Federal Funds rate based on economic inputs developed by Professor John B. Taylor of Stanford University.

Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.