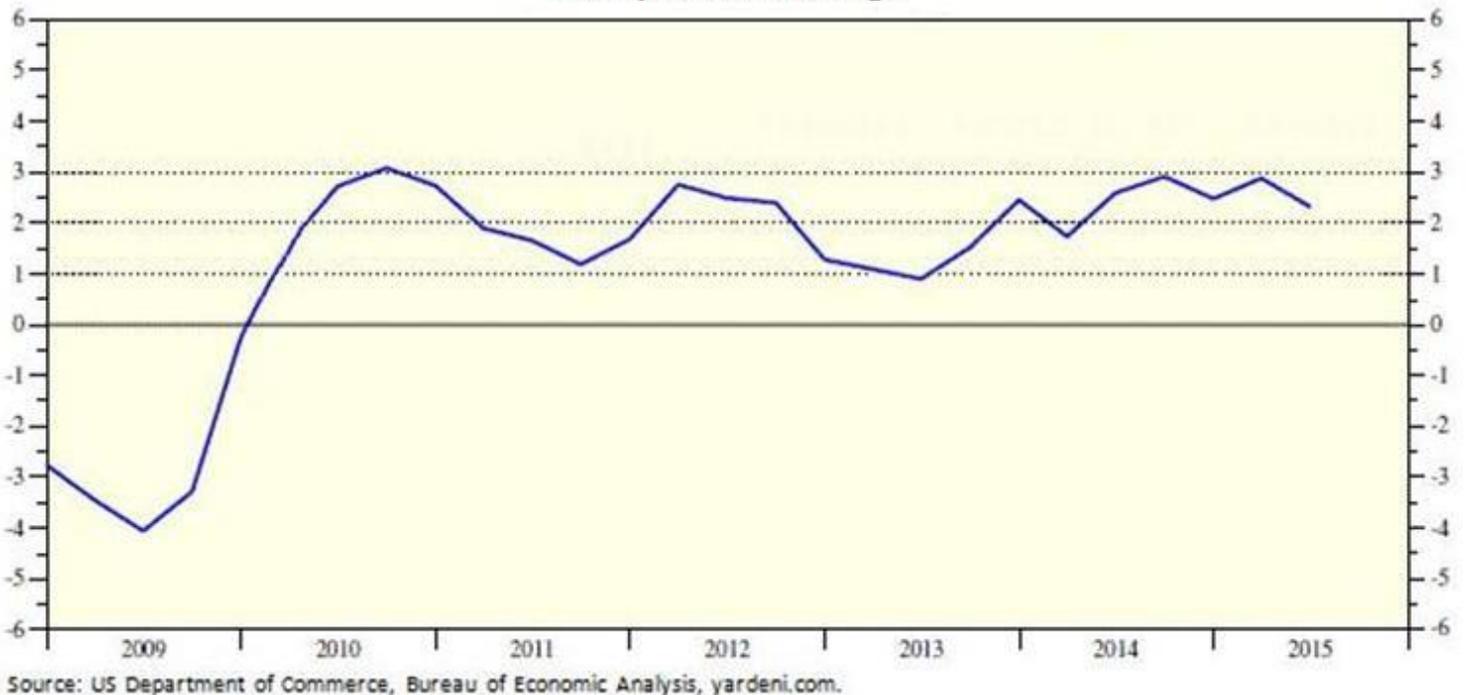


CHART OF THE MONTH

AUGUST 2015

REAL GDP GROWTH Yearly Percent Change



As shown in the chart above, real GDP growth has been meandering between 1% and 3% annually while averaging approximately 2% for the past five years. The year-over-year growth was 2.3% as of the end of the second quarter. The good news is that the economy is entering its seventh year of expansion. The bad news is that the recovery is the slowest on record.

The chart below compares the actual level of real GDP (blue) with its long-term trend of 3.1% per year. Owing to the Great Recession of 2008-09 and the sluggish rebound, the gap between real GDP and its long-term trend is about 15% or almost \$3 trillion in missing national income.

Nonetheless, we are not particularly surprised by the subpar growth. In our Chart of the Month titled [The Square Root Economy](#) four years ago this month, we projected a “gently upward-sloping trend line in the growth trajectory in the years to come.” We even warned that “the economy won’t grow in a straight line” but instead “will go through periods of decelerating and accelerating growth” as the blue overlay in our graph suggested. As it turns out, our forecast was on the money as the economy has produced below-average growth in an uneven manner.

Of note, we first discussed The Square Root Economy in July 2009. We envisioned a V-shaped downturn and recovery, followed by a period of muted growth in the post-credit-bubble world. The deleveraging of household balance sheets (which we applaud) and restrictive fiscal policies (which we frown upon) have combined to hamper economic output by roughly 1% annually for each of the past several years. As a result, the gap between actual and trend growth has widened rather than narrowed as it has in each of the previous cycles since World War II.

To repeat the conclusion from our August 2011 Chart of the Month, “we continue to believe that interest rates are likely to remain lower and for a longer time than the consensus view.” Accordingly, we maintain that the next recession and bear market are still years away. However, like the rolling pattern of the economy, we expect stock prices will ebb and flow with a bias to the upside over time.

REAL GDP Actual vs. Trend

