2nd Quarter GDP (Final)

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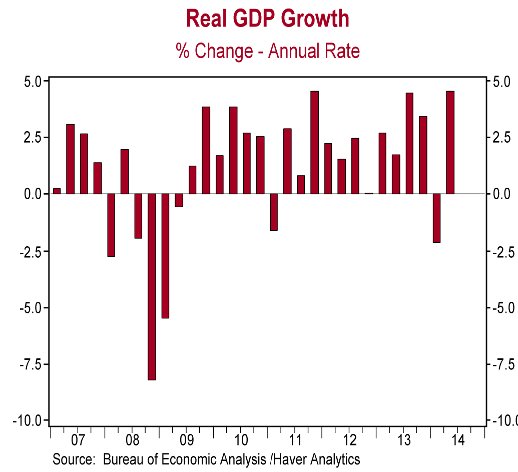
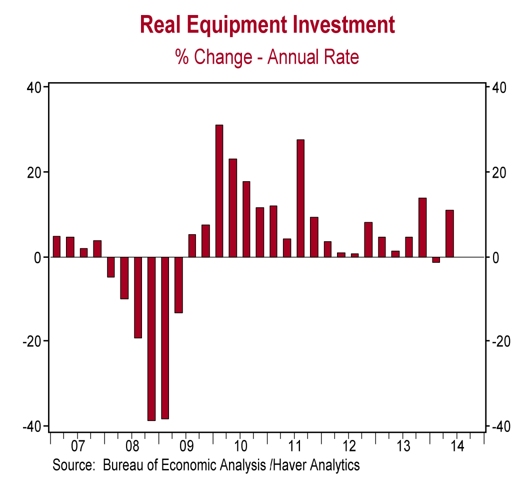
- Real GDP growth in Q2 was revised to a 4.6% annual rate from a prior estimate of 4.2%, exactly matching consensus expectations.
- The upward revision was due to small upward revisions for all major categories of GDP, led by commercial construction and net exports.
- The largest positive contribution to the real GDP growth rate in Q2 came from consumer spending and inventories. The weakest component of real GDP was net exports.
- The GDP price index was unchanged at a 2.1% annualized rate of change. Nominal GDP growth – real GDP plus inflation – was revised up to a 6.8% annual rate versus a prior estimate of 6.4%. Nominal GDP is up 4.3% versus a year ago.

Implications: Forget about GDP for a moment. The most important news this morning was that economy-wide corporate profits were revised up for the second quarter, rebounding 8.4%. In particular, profits in the domestic non-financial sector rose 11.9% to a new record high. All of these profit numbers are calculated by government statisticians and include "capital consumption and inventory valuation adjustments." (Sorry for the jargon, but that's what they call it.) These adjustments don't affect cash flow. However, combined with the weather in Q1, they have made the profits data extremely volatile. Excluding the adjustments, overall corporate cash flow is at a record high and the highest share of GDP since the early 1950s. These figures support the case for optimism for equities in general as well as business investment. In terms of real GDP, the consensus got it exactly right, with an upward revision to a 4.6% annual growth rate in Q2. The upward revision from the prior estimate of 4.2% was unusually broad, with every major category of real GDP revised slightly higher. As a result, after declining in Q1, nominal GDP (real growth plus inflation) snapped back at a 6.8% rate in Q2, the fastest pace for any quarter since 2006. Nominal GDP is now up 4.3% from a year ago and up at a 3.8% annual rate in the past two years. These figures continue to signal that a federal funds rate of essentially zero makes monetary policy too loose. Regardless, the Federal Reserve won't start raising rates until next year. Plugging today's data into our models suggests real GDP is growing at about a 3% annual rate in Q3, still in the Plow Horse range.





2nd Quarter GDP *Seasonally Adjusted Annual Rates*	Q2-14	Q1-14	Q4-13	Q3-13	4-Quarter Change
Real GDP	**4.6%**	-2.1%	3.5%	4.5%	2.6%
GDP Price Index	**2.1%**	1.3%	1.5%	1.7%	1.7%
Nominal GDP	**6.8%**	-0.8%	5.0%	6.2%	4.3%
PCE	**2.5%**	1.2%	3.7%	2.0%	2.4%
Business Investment	**9.7%**	1.6%	10.4%	5.5%	6.8%
Structures	**12.6%**	2.9%	12.8%	11.1%	9.8%
Equipment	**11.2%**	-1.0%	14.1%	4.7%	7.1%
Intellectual Property	**5.5%**	4.7%	3.6%	2.8%	4.1%
Contributions to GDP Growth (p.pts.)	**Q2-14**	**Q1-14**	**Q4-13**	**Q3-13**	**4Q Avg.**
PCE	**1.8**	0.8	2.5	1.4	1.6
Business Investment	**1.2**	0.2	1.2	0.7	0.8
Residential Investment	**0.3**	-0.2	-0.3	0.3	0.0
Inventories	**1.4**	-1.2	-0.3	1.5	0.4
Government	**0.3**	-0.2	-0.7	0.0	-0.1
Net Exports	**-0.3**	-1.7	1.1	0.6	-0.1