PRAETORIAN℠ GUARD

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Praetorian Perspectives

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The Use of A Key Economic Indicator in Gauging the Health of the Economy

Gross Domestic Product

RAW STATISTICS , INFORMATION & ANALYZED ECONOMIC DATA

President Harry Truman famously quipped that he wanted a one-armed economist because every time he asked one a question, the answer would be phrased as "On the one hand…..On the other hand."

The challenge of understanding, interpreting and actually using the incredible quantity of data we receive has only become greater with specialized cable financial shows and the internet.

The purpose of this issue of Praetorian Perspectives is to highlight the construction, timeliness and usefulness of one of the main economic statistics routinely discussed in the financial media.

GROSS DOMESTIC PRODUCT (GDP)

GDP is one of the most talked about and least understood of all routine economic statistics. The challenge in measuring economic activity, accurately and quickly, in an economy larger than $13 trillion is staggering.

Quarterly GDP is estimated and revised three times in the months immediately following the end of a quarter. These are referred to as the advance, preliminary and final estimates and they can vary widely as shown in the table below for the most recent quarter as more accurate and complete data is incorporated.

Real GDP Growth Rate	Advance Estimate	Preliminary Estimate	Final Estimate
Release Date	Jan 27, 2007	Feb 28, 2007	Mar 29, 2007
4th Qtr 2006	3.5%	2.2%	2.5%

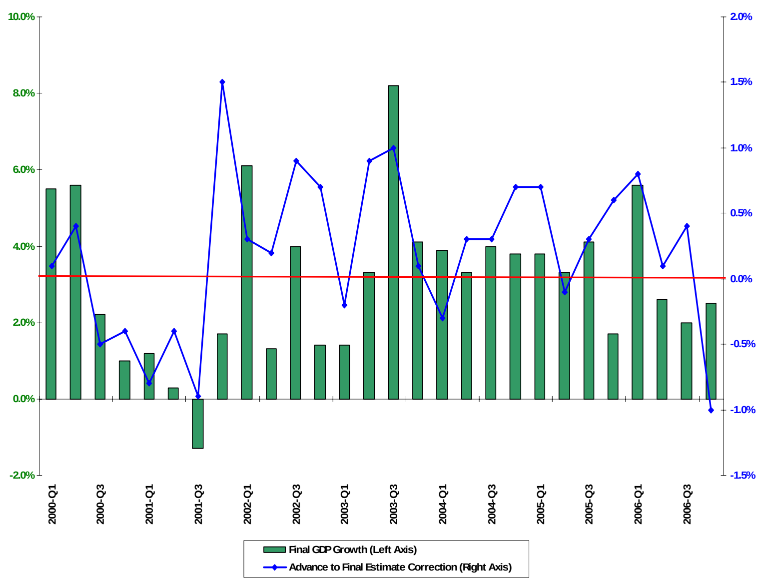
Growth expressed at an annualized rate

So what is the significance of the data where a difference of 1.3% equates to more than $174 billion on an annual basis? We believe GDP estimates are best suited to help us gauge the following:

First, the broad trend of economic activity: is our economy growing and if so, is it at a rate that will concern policy makers like the Fed and positively or negatively impact the near term future? This helps provide a sense of the possible direction of interest rate changes in the next 6-9 months as the Fed commonly announces that decisions are "data dependent"

Secondly, Wall Street reacts (and oftentimes over-reacts) to each of these data releases and some perspective helps maintain focus on the economic accuracy and significance when the talking heads are breathlessly filling the airwaves with "instant analysis."

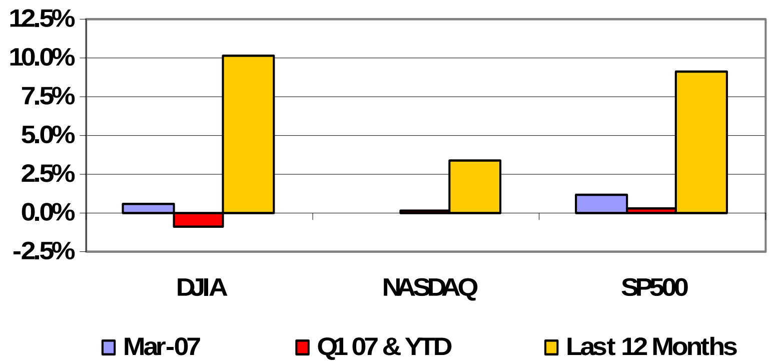
Finally, it provides some insight into turning points in economic growth. The graph below helps to illustrate its usefulness in this role. As the economy's trend changes from expansion to contraction and back (the green bars), the trend in GDP estimates generally has been a fair barometer for the trend in GDP growth. If we observe several quarters where the corrections from the advance estimate to the final estimate are negative (for example 2000 Q3 to 2001 Q3) it likely indicates a turn towards very slow growth or even contraction. Changes that bounce around 0% are most likely just data "noise."



As with any single economic statistic, GDP growth rates are only useful in the broader context of all the data (unemployment, corporate profits, personal income growth, inflation, etc) and should be viewed as one indicator and <u>not</u> as an answer unto itself.

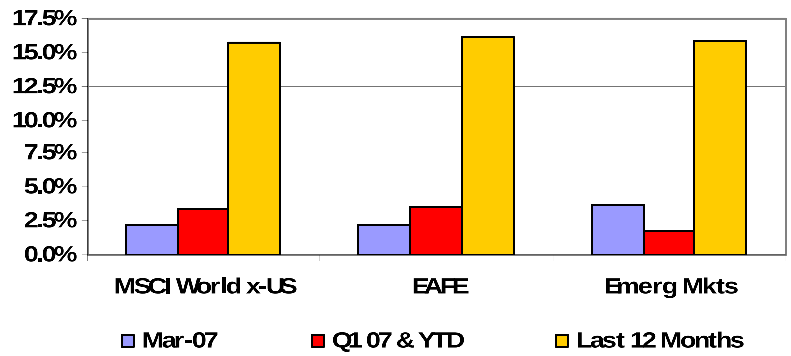
Source: US Bureau of Economic Analysis www.bea.gov

There has been a great deal of market volatility during the first quarter of 2007 as the bull run continued in January and most of February. We received a reminder that markets move down as well as up in late February with the Dow Industrials declining more than 400 points in one trading session, followed by a period of increased daily volatility.



Source: Bloomberg

Despite that the quarter ended up almost flat, with small gains for the NASDAQ and the SP500 and a less than 1 % decline for the Dow. Internationally, the three indices below were all positive for the month of March as well as for the 1st quarter of the year.



Source: MSCI Barra