Ropes Wealth Reviews GDP Growth & the Technology Rout

After shrinking the first half of the year, the U.S. economy rebounded from July through September, posting annualized growth of 2.6%, despite inflation that has hovered near a 40-year high and sharply rising interest rates. But the performance likely marked a reprieve ahead of next year's projected recession rather than a sign of a brighter outlook.

The solid showing was fueled by a more favorable trade balance and modest rise in both consumer and business spending. These offset another plunge in housing construction and weaker business stockpiling. The 2.6% annualized GDP growth advance followed declines of 1.6% and 0.6% in the first and second quarters that were largely due to changes in business stockpiling and trade – two volatile categories that typically don't reflect the health of the economy.

Companies heavily padded their inventories in response to supply chain bottlenecks and product shortages. Many retailers now have too much product and are expected to offer shoppers big discounts to unload the goods and will be more cautious in the future. Meanwhile, U.S. dollar strength is hurting U.S. exports by making them more expensive for foreign buyers. And consumer spending, which makes up 70% of economic activity, is slowing, showing only 1.4% growth after adjusting for inflation following a 2% rise in the second quarter.

While it was nice to see a positive number for growth amid all the negative numbers of 2022, don't let the headline fool you into believing recession risks are behind us. This print will add fuel to the Fed's fire to raise interest rates again next week, by another supersized amount of seventy-five basis points, bringing the policy rate to 3.75%-4% as part of what has been the sharpest set of rate increases in 40 years.

Notably, U.S. Senate Banking Committee Chair Sherrod Brown penned a letter to the Fed urging Federal Reserve Chair Jerome Powell to be careful about tightening monetary policy so much that millions of Americans already suffering from high inflation also lose their jobs.

"It is your job to combat inflation, but at the same time, you must not lose sight of your responsibility to ensure that we have full employment," Brown said. "We must avoid having our short-term advances and strong labor market overwhelmed by the consequences of aggressive monetary actions to decrease inflation, especially when the Fed's actions do not address its main drivers." Brown's missive underscores the political backdrop against which the Fed operates, much as policymakers try to stay out of politics and say their very effectiveness depends on political independence.

As the mid-term election cycle heats up, inflation and the economy appear to be the top polling issues for voters, perhaps surpassing other priorities like access to abortion, voting rights, and climate change. With that, Republicans are looking increasingly likely to take back the House of Representatives after the November 8 elections and House Republican leader Kevin McCarthy has already signaled that he would push for spending cuts.

I would be remiss not to address the absolute rout in technology stocks occurring over the course of this week and year. If dismal earnings reports and outlooks from bellwethers like Microsoft, Alphabet, Meta, and Amazon didn't make you feel queasy, seeing Elon Musk march through the halls of Twitter carrying a sink as he completed the

company's takeover might have. Many clients have asked our team if this is the end of the tech investment explosion (or the end of the world if Elon Musk is our protector of freedom of speech, but I digress). The answer is no, but it is true that the market for technology is changing, innovation is broadening, and new areas of leadership are emerging.

Over the last two decades, innovation was driven by the proliferation of broadband and mobility. Since the iPhone launched in 2007, billions of people around the world embraced newfound abilities to surf, shop and play via their mobile devices. This drove massive growth in companies that powered mobile ecosystems, including network providers, chipmakers and phone manufacturers. Now global smartphone penetration has exceeded 100% and unit shipments are slowing. The rapid growth in social media may also be peaking. To be sure, companies at the heart of the last digital decade are still likely to deliver growth. Perhaps though they will become more like utilities —companies that deliver essential services that may have reached peak profitability.

Market historians will recall how legends and leaders are constantly being replaced. From the nifty fifties of the 1970s to the four horsemen of the 1990s (Microsoft, Dell, Cisco and Intel) to the FAANGs (Facebook, Amazon, Apple, Netflix, and Google), there is a normal process of renewal of leadership, particularly in the technology sector. We may be at a crossroads of one today. And yet, while the favored FAANGs might be a little beat up right now, take caution in counting them and technology investments more generally down and out forever. The leadership of these companies, and many new emerging ones, are focused on the future, especially the transformation of technology-enabled infrastructure, which has become a necessity because of changes in consumer behavior. The next decade may be more a story of power of robotics, artificial intelligence, cloud infrastructure to ensure faster and reliable processing and response, cybersecurity, and energy generation, storage, and management, to name a few likely themes. For this reason, as with markets more generally, we urge clients to avoid abandoning market segments just because sentiment has soured, and trust that we are considering how to rotate and position for some of these shifts in the individual companies and funds we select on your behalf. The best opportunities often present themselves in moments of market disarray.

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