

GDP Growth and Equity Returns

May 2016

Many investors look to gross domestic product (GDP) as an indicator of future equity returns. According to the advance GDP estimate released by the Bureau of Economic Analysis (BEA) on April 28, annualized real US GDP growth was 0.5% in the first quarter of 2016—below the historical average of 3.2%.¹ This might prompt some investors to ask whether below-average quarterly GDP growth has implications for their portfolios.

Market participants continually update their expectations about the future, including expectations about the future state of the economy. The current prices of the stocks and bonds held by investors therefore contain up-to-date information about expected GDP growth and a multitude of other considerations that inform aggregate market expectations. Accordingly, only new information that is not already incorporated in market prices should impact stock and bond returns.

Quarterly GDP estimates are released with a one-month lag and are frequently revised at a later point in time. Initial quarterly GDP estimates were revised for 54 of the

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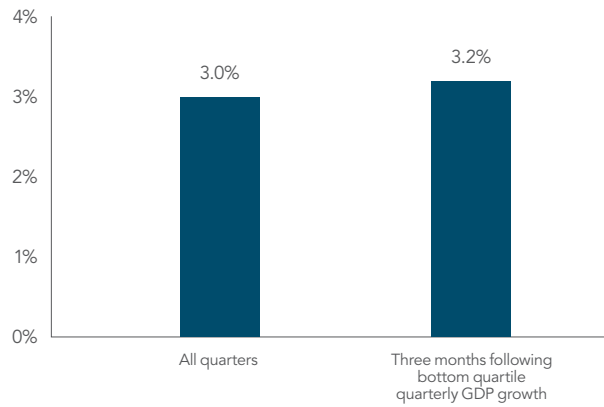
56 quarters from 2002 to 2015.² Thus, the final estimate for last quarter may end up being higher or lower than 0.5%.

Prices already reflect expected GDP growth prior to the official release of quarterly GDP estimates. The unexpected component (positive or negative) of a GDP growth estimate is quickly incorporated into prices when a new estimate is released. A relevant question for investors is whether a period of low quarterly GDP growth has information about short-term stock returns going forward.

1. Source: Bureau of Economic Analysis.

2. 2002 to 2015 is the longest time period for which BEA provides data comparing initial to final estimates. The average difference between an initial and final estimate was 1% in absolute magnitude over this time period.

Exhibit 1: Quarterly S&P 500 Index Returns, 1948–2016



Sources: S&P Dow Jones Indices, Bureau of Economic Analysis.

Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

Exhibit 1 shows that, from 1948 to 2016, the average quarterly return for the S&P 500 Index was 3%. When quarterly GDP growth was in the lowest quartile of historical observations, the average S&P 500 return in the subsequent quarter was 3.2%, which is similar to the historical average for all quarters. This data suggests there is little evidence that low quarterly GDP growth is associated with short-term stock returns above or below returns in other periods.

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