You can Throw Consensus out the Window

Key takeaways

- Economic uncertainty is creating consensus estimates for upcoming data that comes from a very wide range of “guesstimates”.
- As a result, the accuracy and reliability of consensus estimates will be suspect as last Friday’s employment report illustrated.

Remember the good old days when economists would be arguing over whether or not the economy would grow 2% in a given quarter or 2.4%? Or how about equity analysts butting heads over whether company XYZ was going to earn $1 or $1.10 per share in a particular quarter? Well the good old days were in place through the final quarter of last year, but the whole process took a dramatic turn as the COVID-19 pandemic led to wide swaths of the economy being shut down almost overnight. If you are seeking specific recent proof of this turn, look no further than last Friday’s employment report covering the month of May.

Coming into this report, dire predictions showed nearly 20% of the U.S. working population as being out of work in May according to the consensus “Street” estimate. For this particular report, consensus is the average of more than 30 predictions made by economists from a number research departments. Most of the consensus projections for major U.S. economic reports are based on a minimum of 30 economist estimates.

Looking at last Friday’s report, the average consensus estimate called for a 1.9% unemployment rate and a loss of 7.5 million jobs in the month of May. The reality? The unemployment rate came in at 13.3% (still, clearly, very bad) while slightly more than 2.5 million jobs were added (a record one-month gain). In technical economic parlance, this report absolutely crushed consensus estimates. Granted, if we include furloughed workers (which the report did not) the unemployment rate would be closer to 20%. What happened? How did a group of highly trained economists get it so wrong? The answer may surprise some, but in this highly uncertain economic environment, the simple answer is there was a lot of “educated” guessing involved.

And, in our opinion, it would be wise to expect more of the same in coming months. It has been difficult to get a handle on the economic effects of the virus-related shutdown. Researchers need reliable data to analyze the landscape and come up with high-conviction projections. That is unlikely to happen any time soon. The economy fell apart quickly with millions of people losing their jobs in a very short period of time.

The upcoming gross domestic product (GDP) report for the second quarter, due to be released in late July, will likely be another example of much-anticipated economic data that will likely come in far different than the consensus estimate. The range of estimates we have seen on the Street calls for anywhere from a 20% annualized contraction to a 45% decline. But when the financial media report the consensus estimate, it will be an average of this wide range of numbers and likely won’t be accurate.

Over the coming few months, whether it is economic data or company earnings, you can throw consensus estimates out the window. Accuracy will not likely be high.
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