Economic Sign Language

You needn't be an economist to draw a bead on the economy's current health. Just learn to recognize a few simple indicators, which you can find in the financial section of your newspaper or in specialized publications like *The Wall Street Journal* or *Barrons*.

Q. What factors indicate a strong economy?

A. Ideally, you'd like to see an economy that is growing quickly enough to generate more jobs and higher corporate profits. Economists like to track the growth in employment, which generally comes out on the first Friday of every month. The Bureau of Economic Analysis, part of the U.S. Commerce Department, tracks corporate profits. When employment and corporate profits grow strongly, it's generally a sign that the economy is thriving.

Q. Is it possible for the economy to grow too quickly?

A. Absolutely. When that occurs, the demand for goods and services outstrips the supply and prices and wages may rise sharply. Wage inflation may make it more expensive for companies to hire workers, and price inflation makes it harder for customers to buy. This can have a negative impact on economic growth. Excessive economic growth also leads to increased competition for loans, causing banks and other lenders to raise interest rates. That makes it more difficult for individuals and companies to spend, which can slow the economy further. That's why economists generally like to see modest growth in the Gross Domestic Product (GDP), accompanied by low and stable inflation and interest rates.

Q. What are the signs of an unhealthy economy?

A. That depends on the overall financial context. For example, a sharp increase in job growth might be a cautionary sign if the economy is growing too fast. On the other hand, such an increase is good news when the economy has been slumping. Rising inflation or interest rates are generally signs that the economy is straining to maintain its growth—and that's not good.

Q. How should investors respond to these signals?

A. There's usually not much point to altering your investment strategy in response to changing economic news, because the rates of inflation and interest and GDP growth are always changing. While past performance is no guarantee of future results, history shows that our economy generally expands over the long term, leading to growth for corporate America—and for most investors, that's what matters.