Wealth Management International, Ltd.

Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment

Week Ended September 14, 2018

Since increased consumer spending is still the main driver for the current economic expansion, we pay close attention to any data on people's willingness or ability to keep shopping. Fortunately, the University of Michigan this week said its ***preliminary September consumer sentiment index*** rebounded to a historically high 100.8, after it pulled back to 96.2 in August and 97.9 in July. The index is now almost back to its cycle high of 101.4 in March (which was its highest level since 2004). We think such high levels of optimism will encourage further spending increases, keeping the economic expansion on track in the near term. The report was therefore consistent with our belief that the economy is growing briskly again and retains plenty of momentum. That should boost corporate profits and improve company finances in the near term, so we are maintaining a significant exposure to stocks for the time being (in our strategies that include them). The big issue is that the economy is expanding faster than its resource base. Demand is rising faster than supply in a wide range of industries, eating into available resources and encouraging producers to hike prices. We still think broad, long-standing factors such as population aging and new technologies will ultimately limit how bad inflation can get. For now, however, excess demand is creating a risk that the Federal Reserve may start hiking interest rates faster, or that rising costs will eventually short-circuit the expansion. There are also yellow flags in the government policy environment, such as risky posturing in national security and international trade disputes. Finally, stocks are trading at high valuations, making them vulnerable to selling. Because of those threats, we recently started to cut our exposure to stocks and other risky assets, especially in our strategies that aim to be more conservative. If the data keeps coming in like it has been, we expect to cut risk further in the coming months.

As we've noted before, the rise in consumer optimism and demand mostly reflects the strong labor market. Companies are creating lots of new jobs, unemployment has become very low, and wages are rising. In the latest data, ***initial jobless claims in the week ended September 8*** fell by a seasonally-adjusted 1,000 to just 204,000. The four-week moving average of claims, which erases some of the volatility in the series, fell to a nearly 49-year low of 208,000. With initial applications for unemployment benefits so minimal, it's clear that layoffs remain low, and/or jobs are so plentiful that those who do get laid off rarely bother to apply for benefits.

The news of continued strength in optimism and labor demand was especially important because it suggested a late-summer softening in retail sales and inflation will probably prove to be temporary. ***August retail sales*** increased only slightly by a seasonally-adjusted 0.1%, after a revised 0.7% rise in July. The weakness in August came in large part from a drop in the volatile auto sector. ***August retail sales excluding autos*** rose a more meaningful 0.3%, after a July gain of 0.9%. In any case, retail demand still looks solid from a longer perspective. Overall retail sales in August were up a robust 6.9% year-over-year, while sales ex-autos were up an even more impressive 7.6%. Since consumer prices have only increased 2.7% over the last year, it's clear that the actual volume of sales is rising very firmly.

Data from the business sector clearly show the positive impact of increased consumer spending (as well as improved corporate investment and rising exports). ***August industrial production*** rose by a seasonally-adjusted 0.4%, matching its good gain in the previous month. Output in August was up 4.9% from a year earlier, marking its best annual gain since 2010, during the initial recovery period after the Great Recession. August mining production was up a whopping 13.8% on the year, while utility production was up 4.7%. In the dominant manufacturing industry, output was up a more modest 3.2% on the year, but that was still one of its best performances of the decade. Still, as discussed above, rising output has started to use up spare capacity. ***August industrial capacity utilization*** increased to 78.1%, rising further above its 20-year average of 77.3% and providing more incentive for firms to boost prices.

Strong demand has prompted firms to invest more in inventories. ***July business inventories*** rose by a seasonally-adjusted 0.6%, accelerating from their rise of just 0.1% in June and handily beating the month's sales gain. The ***July business inventory-to-sales ratio*** therefore rose to 1.34 from 1.33 in June. More generally, however, inventory investment hasn't been keeping up with sales. Although the inventory ratio rebounded a bit in July, it remains far below its recent peak of 1.43 in late 2015 and early 2016. As the inventory ratio continues to trend downward toward its pre-recession nadir below

1.30, we think firms will be encouraged to keep boosting prices.

In data specific to the energy sector, ***commercial crude oil inventories in the week ended September 8*** plunged by 5.296 million barrels, marking their fourth straight weekly decline and leaving stockpiles at a more than 3-1/2 year low of 396.194 million barrels. Crude inventories stood a sharp 7.6% below their five-year moving average (an industry benchmark that suggests supply and demand are in balance). Although output remains near a record high, producers are no longer boosting production like they did over the last few years. The data showed ***domestic crude oil production in the week ended September 8*** fell slightly to 10.900 million barrels per day, remaining in the range it's been in since early summer. Against a backdrop of continued economic growth and rising usage around the world, we think stagnating U.S. production should help keep inventories in check and put additional upward pressure on prices. We are therefore maintaining our exposure to broad commodity funds in our more aggressive portfolios.

Finally, as mentioned above, data this week showed inflation slowed a bit during late summer, in spite of the decreasing availability of resources. For example, the ***August producer price index (PPI)*** edged down by a seasonally-adjusted 0.1%, after being flat in July and rising 0.3% in June. Excluding the volatile food and energy components, the ***August "core" PPI*** also fell 0.1%, after gaining 0.1% in July and 0.3% in each of the two months before that. After three straight months in which overall producer prices had been up more than 3.0% on the year, the August PPI was up "just" 2.8%. Similarly, the annual rise in the core PPI moderated a bit to 2.3%. Nevertheless, those were still some of the biggest annual increases in six years, and we believe producer prices will continue to be pushed higher by factors such as rising wage rates, increased capacity utilization, and reduced inventories.

In international trade, ***August import prices*** fell by a seasonally-adjusted 0.6%, after a revised 0.1% fall in July. ***August import prices ex-fuels*** fell just 0.1%, but that followed two straight months of 0.3% decreases. Because of big gains in earlier months, overall import prices in August were up a strong 3.7% year-over-year. Nonfuel import prices were up just 0.9%, at least in part reflecting the strong dollar, but that annual rise was still much stronger than was typical just a few years ago.

Sadly, the late-summer price slowdown for producers and importers wasn't fully reflected at the consumer level. The ***August consumer price index (CPI)*** rose by a seasonally-adjusted 0.2%, matching its rise in July. Excluding the volatile food and energy components, the ***August "core" CPI*** rose just 0.1%, but that wasn't too much less than the 0.2% increases in each of the previous three months. After year-over-year increases of 2.8% or more in each of the previous three months, the overall CPI in August was up a slightly weaker 2.7%. The annual gain in the core CPI also slowed a bit, to 2.2%. Nevertheless, the annual increases in August were still among the highest since the recession. Given the continued growth in demand and the unremitting strong cost increases for producers and importers, we still believe that consumer inflation will stay high enough to convince the Fed to keep raising interest rates.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
17-Sep	8:30	Empire Manufacturing	Sep	23	25.6
18-Sep	10:00	NAHB Housing Market Index	Sep	66	67
18-Sep	16:00	Net Long-Term TIC Flows	Jul	NA	-$36.5B
19-Sep	7:00	MBA Mortgage Applications Index	15-Sep	NA	-1.80%
19-Sep	8:30	Housing Starts	Aug	1229K	1168K
19-Sep	8:30	Building Permits	Aug	1310K	1311K
19-Sep	8:30	Current Account Balance	Q2	-$103.3B	-$124.1B
19-Sep	10:30	Crude Inventories	15-Sep	NA	-5.3M
20-Sep	8:30	Initial Claims	15-Sep	209K	204K
20-Sep	8:30	Continuing Claims	8-Sep	NA	1696K
20-Sep	8:30	Philadelphia Fed	Sep	15.3	11.9
20-Sep	10:00	Existing Home Sales	Aug	5.37M	5.34M
20-Sep	10:00	Leading Indicators	Aug	0.50%	0.60%
20-Sep	10:30	Natural Gas Inventories	15-Sep	NA	+69 bcf

Source: Briefing.com

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