Weekly Economic Recap & Comment

Week Ended September 28, 2018

This week's key report was the final regular estimate of U.S. economic output in April through June. After stripping out price changes and seasonal effects, ***final second-quarter gross domestic product (GDP)*** increased at an annualized rate of 4.2%, unchanged from the previous estimate but still significantly better than the growth rates of 2.2% in the first quarter and 2.3% in the fourth quarter of 2017. Because of the weaker growth in earlier periods, GDP in the second quarter was up a more modest 2.9% from the same period one year earlier, but that still beat the average annual rise of 2.2% over the last two decades. Most of the growth over the last year came from increased consumer spending, but higher corporate investment also made a significant contribution. Finally, in a broad measure of inflation, the ***final second-quarter GDP deflator*** increased strongly at an annualized rate of 3.0%, compared with a rate of just 2.0% in the first quarter. The figures were consistent with our belief that the economy is growing briskly again and retains plenty of momentum. Because of that, we think corporate profits will keep rising and company finances should keep improving for at least a while yet, so we are maintaining a significant exposure to stocks for the time being (in our strategies that include them). However, we can't ignore the fact that 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. All the same, excess demand is creating a risk that the Federal Reserve may start hiking interest rates even faster (in fact, the policymakers boosted their benchmark rate again this week), or that rising costs will eventually start to weigh on supply and demand. 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. Taking these risks into account, 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.

In a report providing more detail on the consumer sector, ***August personal income*** rose by a seasonally-adjusted 0.3%, matching its increase in July but falling a bit short of its typical monthly gain of 0.4% over the last year. ***August personal consumption expenditures (PCE)*** also posted a 0.3% gain, but that fell short of their 0.4% gain in July and their average monthly rise of 0.4% over the last year. The year-over-year increases for both gauges therefore moderated a bit, but they remained quite healthy. Personal income in August was up 4.7% from a year earlier, while PCE was up 5.3%. The report also included the Fed's preferred gauge of inflation. Excluding the volatile food and energy components, the ***August "core" PCE price index*** was up 2.0% from a year earlier, matching the Fed's target for the fourth straight month but still marking one of the most inflationary periods since the Great Recession.

As we've discussed before, the continued rise in personal income and spending stems mostly from the strong labor market. Companies are creating lots of new jobs, unemployment is extremely low, and wage rates are gradually rising. In the latest data, ***initial jobless claims in the week ended September 22*** rose by a seasonally-adjusted 12,000 to 214,000. However, the four-week moving average of claims was unchanged at a nearly 49-year low of 206,000. 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.

Naturally, the strong labor market has boosted consumer optimism. As evidence of that, the Conference Board this week said its ***September consumer confidence index*** jumped to an 18-year high of 138.4, after readings of 134.7 in August and 127.9 in July. Consistent with that, the University of Michigan this week announced that its ***final September consumer sentiment index*** jumped to 100.1 from 96.2 in August, leaving the index at its third-highest level in the last 14 years. Such swaggering self-assuredness is a key reason why we think consumer spending and overall economic activity will keep growing well in the near term.

In spite of the uptrend in overall consumer spending, housing demand has recently softened, at least in part because of rising interest rates. Although data this week showed ***August new home sales*** jumped by a seasonally-adjusted 3.5% to an annualized rate of 629,000 units, that still wasn't enough to offset the revised declines of 1.6% in July and 5.4% in June. Sales

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of newly built homes were up 12.7% year-over-year, but that was only because hurricane activity had pushed sales down so sharply late last summer. The report showed the median price of a new home came in at $320,200 in August, up just 1.9% on the year.

On the production side of the economy, data this week showed ***August durable goods orders*** jumped by a seasonally-adjusted 5.0%, easily erasing their revised 1.7% decrease in July. However, much of the rise in August came from the transportation category, where just a few airliner orders can have a big impact. ***August durable goods orders excluding transportation*** rose just 0.1% for the second straight month. The data showed similar weakness in a category that serves as a proxy for corporate capital spending. ***August nondefense capital goods orders excluding aircraft*** fell 0.6%, after a 1.6% rise in the previous month. Nevertheless, the trends continue to look positive from a longer perspective. Overall durable goods orders in August were up 13.1% year-over-year, while durable orders ex-transport were up 7.7% and nondefense capital goods orders ex-aircraft were up 8.0%.

Finally, in the energy sector, ***commercial crude oil inventories in the week ended September 22*** rose by 1.852 million barrels. However, that came after five straight weekly declines, and stockpiles remained near a 3-1/2 year low at just 395.989 million barrels. Crude inventories stood a full 7.8% below their five-year moving average (an industry benchmark that suggests supply and demand are in balance). Just as important, the data suggested producers are no longer able to boost production like they did over the last few years. The data showed ***domestic crude oil production in the week ended September 22*** did rise to a new record high of 11.100 million barrels per day, but that was only slightly above 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.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
1-Oct	10:00	ISM Manufacturing Index	Sep	60.4	61.3
1-Oct	10:00	Construction Spending	Aug	0.40%	0.10%
2-Oct	14:00	Auto Sales	Sep	NA	3.77M
2-Oct	14:00	Truck Sales	Sep	NA	9.37M
3-Oct	7:00	MBA Mortgage Applications Index	29-Sep	NA	2.90%
3-Oct	8:15	ADP Employment Change	Sep	184K	163K
3-Oct	10:00	ISM Services	Sep	58.2	58.5
3-Oct	10:30	Crude Inventories	29-Sep	NA	+1.85M
4-Oct	8:30	Initial Claims	29-Sep	210K	214K
4-Oct	8:30	Continuing Claims	22-Sep	NA	1661K
4-Oct	10:00	Factory Orders	Aug	1.80%	-0.80%
4-Oct	10:30	Natural Gas Inventories	29-Sep	NA	+46 bcf
5-Oct	8:30	Nonfarm Payrolls	Sep	184K	201K
5-Oct	8:30	Nonfarm Private Payrolls	Sep	180K	204K
5-Oct	8:30	Unemployment Rate	Sep	3.80%	3.90%
5-Oct	8:30	Avg. Hourly Earnings	Sep	0.30%	0.40%
5-Oct	8:30	Average Workweek	Sep	34.5	34.5
5-Oct	8:30	Trade Balance	Aug	-$52.6B	-$50.1B
5-Oct	15:00	Consumer Credit	Aug	NA	$16.6B

Source: Briefing.com

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