WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment

Week Ended October 19, 2018

Our regular readers know our main worry these days is that rising inflation and higher interest rates could disrupt the financial markets. In fact, we think those forces are already weighing on actual activity in certain sectors. For example, the National Association of Realtors said this week that ***September existing home sales*** fell by a seasonally-adjusted 3.4%, marking their sixth straight monthly decline and leaving sales at an annualized rate of just 5.15 million units. The selling rate is now down 4.1% from a year earlier. In addition, the data showed price gains continue to moderate. The median price of a re-sale fell to $258,100 in September, up 4.2% on the year. Of course, the broader economy is still growing briskly at the moment, so we expect continued profit growth and a rebound in stock prices in the near term. We are therefore maintaining a significant exposure to equities for the time being (in our strategies that include them). However, we can't ignore the fact that the economy is now outrunning its resource base. Demand is rising faster than supply in a wide range of industries, putting upward pressure on prices and interest rates. We still think broad, long-standing factors such as population aging and new technologies will ultimately limit how bad inflation will get, but excess demand is creating a risk that the Federal Reserve may hike interest rates more aggressively than investors currently expect, or that rising costs will eventually short-circuit the economic 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. 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.

Rising interest rates also seem to be weighing on home construction. ***September housing starts*** dropped to a seasonally-adjusted, annualized rate of just 1.201 million units. Construction starts in September were down 5.3% from the previous month, erasing most of their revised 7.1% gain in August and leaving groundbreakings up a weak 1.6% from September 2017. Most of the recent slack in housing starts has been in the apartment sector, but single-family starts also fell in September, leaving them up just 2.9% year-over-year. Finally, in a bad sign for the future, ***September building permits*** declined 0.6%, after a revised fall of 4.1% in August. Overall permitting for new homes has now declined in five of the last six months, leaving them down 6.5% year-over-year. Single-family permits were down 2.9% year-over-year.

The week's data also showed a softening in consumption demand. ***September retail sales*** rose only weakly by a seasonally-adjusted 0.1%, just as they did in August. ***September retail sales excluding autos*** actually fell 0.1%, after rising by a revised 0.2% in the previous month. Fortunately, however, we think a lot of the recent weakness reflects temporary hurricane disruptions in the Southeast. Overall retail sales in September were still up a decent 3.1% year-over-year, and sales ex-autos were up 4.3%. Both those figures were higher than the 2.3% increase in the consumer price index over the last year, suggesting the actual volume of sales has continued to go up.

The tight labor market remains the key source of support for consumer demand. Companies are creating lots of new jobs, unemployment has fallen to very low levels, and wages are rising in response. In the most recent data on labor demand, ***initial jobless claims in the week ended October 13*** fell by a seasonally-adjusted 5,000 to just 210,000. The four-week moving average of claims rose slightly to 212,000, but that was still one of the lowest readings in decades. 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.

Reflecting the continued growth in overall demand, ***September industrial production*** expanded by a seasonally-adjusted 0.3%. That increase was a bit weaker than the 0.4% rise in August, and it slightly trailed the average monthly gain over the last year, but it still left overall output up a healthy 5.2% year-over-year. Mining production was up an astounding 13.1% on the year, and utility output was up 5.7%, while manufacturing production was up a more modest 3.6%. To better understand the implications for inflation and interest rates, the aspect of the report that we focused on showed ***September industrial capacity utilization*** came in at 78.1%. That figure was unchanged from the previous month, but it remained higher than the 20-year average rate of 77.3%, and it still shows signs of moving upward. That's important because firms producing closer to their maximum capacity are unlikely to be shy about raising prices.

Other data from the business sector also suggested firms may soon get more aggressive about raising prices. ***August business inventories*** rose 0.5%, slowing from their revised 0.7% increase in July. More important, inventories continued to grow in line with, or weaker than, the growth in business sales. As a result, the ***August business inventory-to-sales ratio*** was unchanged at just 1.34. The inventory ratio would still have to fall further to reach the readings of 1.30 or less that were common before the last recession, but the ratio has already fallen dramatically from its most recent high of 1.43 in late 2015 and early 2016. That's important because firms that aren't stuck with unwanted inventories have less reason to keep prices low.

In data specific to the energy sector, ***commercial crude oil inventories in the week ended October 13*** rose by 6.490 million barrels to a total of 416.441 million barrels. Crude stockpiles have now risen for four straight weeks, and inventories now stand at their highest level since late June. However, stockpiles are still 3.2% below their five-year moving average (an industry benchmark that suggests supply and demand are in balance). Just as important, it appears producers are now finding it harder to boost output than in the recent past. The data showed ***domestic crude oil production in the week ended October 13*** fell to 10.900 million barrels per day, staying in the range it has 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.

The last of the big reports this week was an index designed to show how the economy is likely to perform over the coming six months or so. The Conference Board said its ***September index of leading economic indicators*** rose by a seasonally-adjusted 0.5%, accelerating from its 0.4% rise in August and marking its 12th straight monthly gain. The rise in September came mostly from stronger readings in the subindexes on consumer expectations and new manufacturing orders. The key thing is that a string of increases like the index has shown over the last year is typically followed by continued economic expansion. That helps explain why we think the stock market can keep rising in the near term, in spite of the developing risks in the areas of inflation and interest rates.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
24-Oct	7:00	MBA Mortgage Applications Index	20-Oct	NA	-7.10%
24-Oct	9:00	FHFA Housing Price Index	Aug	0.30%	0.20%
24-Oct	10:00	New Home Sales	Sep	625K	629K
24-Oct	10:30	Crude Inventories	20-Oct	NA	+6.5M
24-Oct	14:00	Beige Book	Sep	NA	NA
25-Oct	8:30	Durable Orders	Sep	-1.80%	4.50%
25-Oct	8:30	Durable Goods –ex transportation	Sep	0.30%	0.10%
25-Oct	8:30	Initial Claims	20-Oct	211K	210K
25-Oct	8:30	Continuing Claims	13-Oct	NA	1640K
25-Oct	8:30	Adv. International Trade in Goods	Sep	-$74.4B	-$75.8B
25-Oct	8:30	Adv. Retail Inventories	Sep	NA	0.70%
25-Oct	8:30	Adv. Wholesale Inventories	Sep	NA	0.80%
25-Oct	10:00	Pending Home Sales	Sep	-0.20%	-1.80%
25-Oct	10:30	Natural Gas Inventories	20-Oct	NA	+81 bcf
26-Oct	8:30	GDP-Adv.	Q3	3.30%	4.20%
26-Oct	8:30	GDP Deflator	Q3	2.10%	3.00%
26-Oct	10:00	Michigan Sentiment - Final	Oct	99	99

Source: Briefing.com

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