Weekly Economic Recap & Comment
Week Ended October 26, 2018

This week's most important report was the initial estimate of U.S. economic output in July through September. After stripping out price changes and seasonal variations, ***advance third-quarter gross domestic product (GDP)*** expanded at an annualized rate of 3.5%, only modestly slower than the robust 4.2% rate in the second quarter. Compared with the same period one year earlier, GDP in the third quarter was up 3.0%, beating the average annual increase of 2.2% over the last couple of decades. Continuing recent trends, most of the growth over the last year came from increased consumer spending, but corporate investment and government spending also made significant contributions. Finally, in a broad measure of inflation, the ***advance third-quarter GDP deflator*** rose at a rate of just 1.7%, compared with a rapid 3.0% rate in the previous quarter. In our view, the figures confirm that the overall economy is still growing briskly, 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). The problem is that 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, and the weak deflator in the GDP report makes us even more comfortable with that expectation. All the same, 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 hurt corporate profits and 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. This week's big drop in the stock market shows many investors are only now responding to these risks, but we started to cut our exposure to stocks and other risky assets ahead of the pack – back in August – 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.

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, ***initial jobless claims in the week ended October 20*** rose by a seasonally-adjusted 5,000 to 215,000, but the increase apparently stemmed in part from hurricane disruptions in the Southeast. The four-week moving average of claims, which helps remove some of the volatility in the series, was unchanged at an extremely low 212,000. 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.

With workers in high demand and layoffs low, consumers have become extraordinarily optimistic. Nevertheless, the University of Michigan announced this week that its ***final October consumer sentiment index*** fell back to 98.6 from 100.1 in September. The index remains historically quite high, which we think portends further good growth in consumer spending in the coming months, but we are closely watching a slight softening in the subindex on consumers' view of current conditions. That subindex has recently seemed to hit a plateau, although it is still far above the level that would indicate a recession is imminent.

In spite of the continued growth in the overall economy and the positive impact of the strong labor market, this week's economic data showed more slowing in certain sectors – especially those that are sensitive to rising interest rates. Consistent with last week's data showing continued softness in home re-sales, this week's data showed ***September new home sales*** dropped by a seasonally-adjusted 5.5%, after revised declines of 3.0% in August and 1.5% in July. Sales of newly built homes have now fallen in five of the last six months, and the annualized selling rate of 553,000 units in September was the lowest since late 2016. Even though the median price of a new home rose slightly to $320,000 in September, that was still 3.5% lower than the median price one year earlier.

Other data this week suggested the impact of the recent tax cuts may already be starting to peter out. ***September durable goods orders*** rose only moderately by a seasonally-adjusted 0.8%, after a revised surge of 4.6% in August. Some of the slowdown could be attributed to the volatile transportation sector, where just a few airliner orders can skew the results, but

September durable goods orders excluding transportation slowed to an increase of just 0.1% from their 0.3% rise in August. Most important of all, the report showed more weakness in a category that serves as a proxy for corporate capital investment. ***September nondefense capital goods orders excluding aircraft*** fell 0.1%, after falling 0.2% in the previous month. Overall durable goods orders in September were up 6.5% year-over-year, and durable orders ex-transport were up 3.9%, but nondefense capital goods orders ex-aircraft were up a weak 0.9%.

Finally, in data touching on supply and demand in the energy sector, ***commercial crude oil inventories in the week ended October 20*** rose by 6.346 million barrels to a total of 422.787 million barrels. That means stockpiles have now risen for five straight weeks, leaving inventories at their highest level since early June. However, stockpiles are still 1.8% below their five-year moving average (an industry benchmark that suggests supply and demand are in balance). Also, the data showed ***domestic crude oil production in the week ended October 20*** was flat at 10.900 million barrels per day, staying within 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.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
29-Oct	8:30	PCE Prices	Sep	0.10%	0.10%
29-Oct	8:30	PCE Prices - Core	Sep	0.10%	0.00%
29-Oct	8:30	Personal Income	Sep	0.40%	0.30%
29-Oct	8:30	Personal Spending	Sep	0.40%	0.30%
30-Oct	9:00	Case-Shiller 20-city Index	Aug	5.90%	5.90%
30-Oct	10:00	Consumer Confidence	Oct	135.8	138.4
31-Oct	7:00	MBA Mortgage Applications Index	27-Oct	NA	4.90%
31-Oct	8:15	ADP Employment Change	Oct	180K	230K
31-Oct	8:30	Employment Cost Index	Q3	0.70%	0.60%
31-Oct	10:30	EIA Crude Inventories	27-Oct	NA	+6.3M
1-Nov	8:30	Productivity-Prel	Q3	2.10%	2.90%
1-Nov	8:30	Unit Labor Costs - Prelim	Q3	1.10%	-1.00%
1-Nov	8:30	Initial Claims	27-Oct	213K	215K
1-Nov	8:30	Continuing Claims	20-Oct	NA	1636K
1-Nov	10:00	Construction Spending	Sep	0.20%	0.10%
1-Nov	10:00	ISM Manufacturing Index	Oct	59	59.8
1-Nov	10:30	EIA Natural Gas Inventories	27-Oct	NA	+58 bcf
1-Nov	14:00	Auto Sales	Oct	NA	3.92M
1-Nov	14:00	Truck Sales	Oct	NA	9.40M
2-Nov	8:30	Nonfarm Payrolls	Oct	190K	134K
2-Nov	8:30	Nonfarm Private Payrolls	Oct	185K	121K
2-Nov	8:30	Avg. Hourly Earnings	Oct	0.20%	0.30%
2-Nov	8:30	Unemployment Rate	Oct	3.70%	3.70%
2-Nov	8:30	Average Workweek	Oct	34.5	34.5
2-Nov	8:30	Trade Balance	Sep	-$53.4B	-$53.2B
2-Nov	10:00	Factory Orders	Sep	0.40%	2.30%

Source: Briefing.com

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