WEALTH MANAGEMENT INTERNATIONAL, LTD.
Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment

Week Ended November 9, 2018

The service sector accounts for most U.S. economic activity, so we pay close attention to any data related to it. This week, the Institute for Supply Management said its ***October ISM nonmanufacturing index*** fell to a seasonally-adjusted 60.3, but we think that was a natural give-back after the index surged to a record high of 61.6 in September. Even with the October pullback, the index remains historically very high. Since the ISM indexes are designed so that readings over 50 point to expanding activity, the October figure suggests the service sector is still growing quite broadly. In a particularly good sign for the future, the October subindex on new orders fell only slightly to 61.5 from 61.6 in the previous month. In sum, the figures were consistent with our view that the 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. 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. The recent drop in the stock market came as many investors belatedly responded to these risks, but we started to cut our exposure to stocks and other volatile assets 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.

As we've noted many times before, the strong labor market remains the biggest driver for the economy in general, and for the services sector in particular. Companies continue to create lots of new jobs, unemployment has fallen to extremely low levels, and wages are gradually rising. In the latest data on the demand for labor, ***initial jobless claims in the week ended November 3*** fell by a seasonally-adjusted 1,000 to a very low 214,000. The four-week moving average of claims held steady at that same level. Admittedly, initial applications for unemployment benefits have risen a bit from their nearly 50-year low in September, but some of that probably reflects the impact of the late-season hurricanes. Initial claims are still historically low, so it's clear that layoffs remain quite limited.

With companies much more interested in hiring than firing, consumer optimism remains elevated. This week, the University of Michigan announced that its ***preliminary November consumer sentiment index*** came in at 98.3, down slightly from its final October reading of 98.6 but still historically high. The decline in early November came entirely from a modest pullback in the subindex on future expectations. For purposes of gauging near-term economic and financial prospects, we focus more heavily on the subindex that tracks consumers' assessment of current economic conditions. That subindex actually edged up a bit in November, and it remains far above the level that would signal an impending problem.

While the strong labor market is a boon for workers, it's a challenge for employers. Higher wage rates are exacerbating the fast-rising cost of other inputs, such as raw materials and transport services. Reflecting that, the ***October producer price index (PPI)*** surged by a seasonally-adjusted 0.6%. The increase, which was the biggest in more than six years, followed a mild 0.2% gain in September and a 0.1% decline in August. Some of the rise in October reflected higher energy prices, but that wasn't the whole story. Excluding the volatile food and energy components, the ***October "core" PPI*** was up a robust 0.5%, after its 0.2% increase in September and 0.1% decline in August. The overall PPI in October was up 3.6% from the same month one year earlier, and the core PPI was up 2.4%. Both those increases were more modest than the annual gains registered in early summer, but they remained substantial enough to suggest consumer prices will also keep rising fast and the Fed will keep hiking interest rates.

This week's only good news on inflation came in the energy sector. In a report on energy supplies, ***commercial crude oil inventories in the week ended November 3*** rose by 5.783 million barrels, marking their seventh straight weekly increase and lifting total stockpiles to a nearly five-month high of 431.787

million barrels. Inventories are once again slightly above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). Just as important, ***domestic crude oil production in the week ended November 3*** jumped to a new record high of 11.600 million barrels per day, after being basically stagnant for months. We still think continued economic growth, rising usage around the world, and reduced exports from big producers (such as Iran and Venezuela) should help keep inventories in check and support global prices. We are therefore maintaining our exposure to broad commodity funds in our more aggressive portfolios. However, the new rebound in U.S. production and stockpiles could weigh on prices and overall inflation in the near term.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
13-Nov	6:00	NFIB Small Business Optimism Index	Oct	NA	107.9
13-Nov	14:00	Treasury Budget	Oct	NA	$119.1B
14-Nov	7:00	MBA Mortgage Applications Index	10-Nov	NA	-4.00%
14-Nov	8:30	CPI	Oct	NA	0.10%
14-Nov	8:30	Core CPI	Oct	NA	0.10%
14-Nov	10:30	Crude Inventories	10-Nov	NA	+5.8M
15-Nov	8:30	Retail Sales	Oct	NA	0.10%
15-Nov	8:30	Retail Sales ex-auto	Oct	NA	-0.10%
15-Nov	8:30	Initial Claims	10-Nov	NA	214K
15-Nov	8:30	Continuing Claims	3-Nov	NA	1623K
15-Nov	8:30	Empire Manufacturing	Nov	NA	21.1
15-Nov	8:30	Import Prices ex-oil	Oct	NA	0.00%
15-Nov	8:30	Export Prices ex-ag.	Oct	NA	0.20%
15-Nov	8:30	Philadelphia Fed	Nov	NA	22.2
15-Nov	10:00	Business Inventories	Sep	NA	0.50%
15-Nov	10:30	Natural Gas Inventories	10-Nov	NA	+65 bcf
16-Nov	9:15	Industrial Production	Oct	NA	0.30%
16-Nov	9:15	Capacity Utilization	Oct	NA	78.10%
16-Nov	16:00	Net Long-Term TIC Flows	Aug	NA	$131.8B

Source: Briefing.com