WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment

Week Ended November 30, 2018

This week's key report was the second regular estimate of U.S. economic output in July through September. After stripping out seasonal variations and price changes, ***revised third-quarter gross domestic product (GDP)*** increased at an annualized rate of 3.5%, just as in the initial estimate. That marked a slowdown from the 4.2% growth rate in the second quarter, but it was still one of the best figures of the last several years. Taking a longer perspective, GDP in the third quarter was up a robust 3.0% from the same period one year earlier, handily beating the average annual increase 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 and government spending also contributed. Finally, in a broad measure of inflation, the ***revised third-quarter GDP deflator*** increased at a moderate rate of just 1.7%, after a big rise of 3.0% in the second period. In sum, the data showed the economy is still growing briskly, so we expect continued profit growth and a further 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 has been 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 recent data suggest inflation could already be cooling. All the same, excess demand has created a risk that the Federal Reserve might hike interest rates more aggressively than investors currently expect, or that rising costs could 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. We responded to those risks by modestly cutting our exposure to stocks and other volatile assets back in August, which helped protect our portfolios from the market correction in October and November. If the data keeps coming in like it has been, we expect to further cut risk once the current market rebound seems to have run its course.

Other data showed continued economic momentum early in the fourth quarter. ***October personal income*** rose by a seasonally-adjusted 0.5%, accelerating from its 0.2% gain in September and posting its best increase since January. ***October personal consumption expenditures (PCE)*** increased even more strongly, by 0.6%, after a revised 0.4% rise in the previous month. Personal income in October was up a healthy 4.3% from a year earlier, while PCE was up an even stronger 5.0%. The report also included the Fed's preferred measure of inflation. After stripping out the volatile food and energy components, the ***October "core" PCE deflator*** was up just 1.8% on the year, marking its smallest annual gain since February and falling back further from the Fed's target of 2.0%. This and other indicators suggest inflation has really slowed in recent months, but because of the continued strong growth in demand, we're not yet convinced that inflation has slowed for good.

The main source of consumers' increased income and spending is the strong labor market, which has boosted optimism. The Conference Board said this week that its ***November consumer confidence index*** pulled back a bit to 135.7, but that was only modestly lower than its 18-year high in October. The decline in November came entirely from a modest fall in the subindex on consumers' future expectations. The subindex on their view of current conditions continued to rise. In our view, high consumer optimism is likely to keep spending on the uptrend and create a continuing risk of excess inflation.

Other reports this week suggested the economy has already suffered some damage from cost increases, interest-rate hikes, and government policy changes. In fact, all three of those issues seem to be weighing on the market for newly built homes. A report this week showed ***October new home sales*** fell sharply by a seasonally-adjusted 8.9% to an annualized rate of 544,000, erasing their revised 1.0% rise in September and marking their fourth drop in the last five months. In October, sales of newly built homes were down a full 12.0% from the same month one year earlier. The median price of a new home declined to $309,700, down 3.1% from a year earlier.

Although the overall labor market remains strong, one indicator suggests the demand for labor could be starting to weaken. Continuing a recent trend, ***initial jobless claims in the week ended November 24*** rose by a seasonally-adjusted 10,000 to 234,000, and the four-week moving average of claims rose to a nearly five-

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month high of 223,000. Both figures remain historically quite low, but it now seems clear that new applications for unemployment benefits are on the uptrend again. Admittedly, some of the rise could reflect damage from the early autumn hurricanes. However, we worry the rise could also reflect layoffs stemming from factors such as reduced home sales or international trade disruptions from the administration's protectionist tariffs.

Finally, we're also seeing a yellow flag in the energy sector. In a report on the supply of energy, ***commercial crude oil inventories in the week ended November 24*** rose by 3.577 million barrels, marking their tenth straight weekly increase. Total stockpiles, at a one-year high of 450.485 million barrels, stood a full 4.2% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). One reason for the inventory surge was that ***domestic crude oil production in the week ended November 24*** remained at a record high of 11.700 million barrels per day. We still think continued economic growth, rising usage around the world, and reduced exports from big producers (such as Iran and Venezuela) could help keep inventories in check and support global prices, so we are maintaining our exposure to broad commodity funds in our more aggressive portfolios for now. However, we may well change tack if U.S. production and stockpiles continue to weigh on prices in the near term. We are also watching to see if excess supply and falling prices spark a pullback in energy employment and investment, which would exacerbate any damage from rising input costs, higher interest rates, and shifting trade policies.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
3-Dec	10:00	ISM Index	Nov	NA	57.7
3-Dec	10:00	Construction Spending	Oct	NA	0.00%
4-Dec	14:00	Auto Sales	Nov	NA	4.27M
4-Dec	14:00	Truck Sales	Nov	NA	9.31M
5-Dec	7:00	MBA Mortgage Applications Index	1-Dec	NA	5.50%
5-Dec	8:15	ADP Employment Change	Nov	NA	227K
5-Dec	8:30	Productivity-Rev.	Q3	NA	2.20%
5-Dec	8:30	Unit Labor Costs - Rev.	Q3	NA	1.20%
5-Dec	10:00	ISM Services	Nov	NA	60.3
5-Dec	10:30	Crude Inventories	1-Dec	NA	+3.6M
5-Dec	14:00	Beige Book	Nov	NA	NA
6-Dec	8:30	Trade Balance	Oct	NA	-$54.0B
6-Dec	8:30	Initial Claims	1-Dec	NA	234K
6-Dec	8:30	Continuing Claims	24-Nov	NA	1710K
6-Dec	10:00	Factory Orders	Oct	NA	0.70%
6-Dec	10:30	Natural Gas Inventories	1-Dec	NA	-59 bcf
7-Dec	8:30	Nonfarm Payrolls	Nov	NA	250K
7-Dec	8:30	Nonfarm Private Payrolls	Nov	NA	246K
7-Dec	8:30	Avg. Hourly Earnings	Nov	NA	0.20%
7-Dec	8:30	Unemployment Rate	Nov	NA	3.70%
7-Dec	8:30	Average Workweek	Nov	NA	34.5
7-Dec	10:00	Wholesale Inventories	Oct	NA	0.40%
7-Dec	15:00	Consumer Credit	Oct	NA	$11.0B

Source: Briefing.com

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