WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment

Week Ended December 21, 2018

This week's key news came from the Federal Reserve. The ***Federal Open Market Committee (FOMC)*** raised its benchmark "fed funds" interest-rate target by 0.25% to a range of 2.25% to 2.50%, as expected. The move still left the benchmark rate historically quite low, but it didn't sit well with those investors who have gotten themselves into a tizzy about moderating economic growth. On top of that, in his post-decision press conference, Chairman Powell seemed to emphasize the current strength in the economy and the policymakers' expectation that they will keep hiking rates, albeit a bit less than previously thought. We think the Fed's action was entirely consistent with our view that the economy continues to grow quite well at present. That should create more profit growth and an eventual rebound in stock prices, so we are 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. Recent data suggest inflation could already be cooling. All the same, excess demand has created a risk that the Federal Reserve might eventually hike interest rates too far, or that rising costs could cut into corporate profits and short-circuit the economic expansion, compounding the slowdown in growth overseas. There are also yellow flags in the government policy environment, such as risky posturing in national security and international trade disputes, and we think political risks are increasing as investigators make more progress in their examination of high-level scandals. We responded to those future risks by modestly cutting our exposure to stocks and other volatile assets across all our strategies in August, and we have continued to cut risk selectively in our more conservative portfolios. That has helped protect our portfolios in the recent market correction. If the data keeps coming in like it has been, we expect to continue cutting risk in the coming months.

Importantly, recent data confirm that current economic performance remains strong. After stripping out seasonal impacts and price changes, ***final third-quarter gross domestic product (GDP)*** grew robustly at an annualized rate of 3.4%. That was slower than the extraordinary growth rate of 4.2% in the second quarter, and it was slightly slower than the previous estimate, but it still marked one of the best growth rates of the last decade. GDP in the third quarter was up 3.0% from the same period one year earlier, easily beating the average annual gain of 2.2% over the last 20 years. Increased personal consumption spending was the main driver of growth over the last year, but rising corporate investment and government spending also made significant contributions. Finally, in a broad measure of inflation, the ***final third-quarter GDP deflator*** rose at a moderate rate of 1.8%, down from the worrisome 3.0% rate in the previous period and falling below the Fed's target of 2.0%.

The key to the rise in consumer spending that's powering the economy forward is the strong labor market. In the latest report on the demand for labor, ***initial jobless claims in the week ended December 15*** rose by a seasonally-adjusted 8,000 to a level of 214,000, but the four-week moving average of claims fell to 222,000. With initial applications for unemployment benefits that low, it's clear that layoffs remain minimal.

Coupled with strong job growth and low unemployment, the low level of layoffs is boosting consumer spirits. As evidence of that, the University of Michigan this week said its ***final December consumer sentiment index*** rose to 98.3 from 97.5 in November. The index is still a bit lower than the 14-year high of 101.4 in March, but it remains historically quite elevated, which we think will encourage consumers to keep boosting their spending.

In fact, the latest data on consumer income and spending remained good. ***November personal income*** rose only modestly by a seasonally-adjusted 0.2%, after a 0.5% jump in October, but that still helped encourage shopping. ***November personal consumption expenditures (PCE)*** rose 0.4%, after increasing a revised 0.8% in October. Personal income in November was up a healthy 4.2% from one year earlier, but PCE was up an even stronger 4.7%. The report also included the Fed's preferred measure of inflation. After stripping out the volatile food and energy components, the ***November "core" PCE deflator*** was up just 1.9% from a year earlier.

In spite of the overall strength in the consumer sector, rising interest rates and high prices have been weighing on housing. ***November existing home sales*** did rise by a seasonally-adjusted 1.9% to a seasonally-adjusted rate of 5.32 million units, marking an acceleration from their revised 1.4% gain in October. However, sales have declined in most months this year, so sales were still down a steep 7.0% from November 2017. The median price of an existing home in November came to $257,700, up 4.2% year-over-year.

Data on the homebuilding industry showed similar trends. ***November housing starts*** rose by a seasonally-adjusted 3.2%, erasing their revised 1.6% decline in October, but the increase came solely from a jump in the volatile apartment segment. Overall residential starts in November were down a modest 2.0% year-over-year, but single-family groundbreaking was down 12.7%. ***November building permits*** rose 5.0%, after a revised 0.4% fall in October, but that also reflected gains in the multi-family segment. Total November permits were up 2.9% on the year, but single-family permits were down 1.8%. We think that's a big reason why some investors are panicking about economic growth going forward.

In the week's key report on the business sector, ***November durable goods orders*** rose by a seasonally-adjusted 0.8%, erasing part of their revised 4.3% drop in October. However, the rebound came mostly from the volatile transportation sector, where just a few airliner orders can have a big impact. ***November durable goods orders excluding transportation*** were down 0.3%, after rising 0.4% in the previous month. A category that serves as a proxy for corporate investment was even weaker. ***November nondefense capital goods orders excluding aircraft*** fell 0.6%, wiping out their revised 0.5% rise in October and marking their third decline in the last four months. Overall durable goods orders in November were still up 4.9% year-over-year, and durable orders ex-transport were up 4.5% and nondefense capital goods orders ex-aircraft were up 6.6%. However, those annual gains were all much weaker than earlier in the year, which suggests the boost from this year's tax cuts is waning.

One big headwind for investment is low oil prices, which often discourage new drilling. In the latest data, ***commercial crude oil inventories in the week ended December 15*** fell by 1.497 million barrels, for a third straight weekly decline. However, total stockpiles, at 441.457 million barrels, still stood 1.9% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). The report said ***domestic crude oil production in the week ended December 15*** was unchanged at 11.600 million barrels per day, but that was still close to a record high. In spite of continued U.S. economic growth, rising usage around the world, and reduced exports from big producers (such as Iran and Venezuela), it's now clear that high production and excess inventories could keep weighing on oil prices, so we are now looking for opportunities to exit the broad commodity funds that we have in some of our more aggressive strategies.

Finally, the Conference Board issued its index designed to show how the economy should perform over the next few months. The ***November index of leading economic indicators*** rose 0.2%, erasing its revised 0.3% fall in October and marking its 13th gain in the last 14 months. In our view, that suggests the U.S. economy will keep growing well in the very near term, which would imply the current stock correction is coming too early.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
26-Dec	9:00	S&P Case-Shiller Home Price Index	Oct	5.00%	5.10%
27-Dec	7:00	MBA Mortgage Applications Index	22-Dec	NA	-5.80%
27-Dec	8:30	Initial Claims	22-Dec	225K	214K
27-Dec	8:30	Continuing Claims	15-Dec	NA	1688K
27-Dec	9:00	FHFA Housing Price Index	Oct	NA	0.20%
27-Dec	10:00	New Home Sales	Nov	560K	544K
27-Dec	10:00	Consumer Confidence	Dec	133.7	135.7
27-Dec	10:30	Natural Gas Inventories	22-Dec	NA	-141 bcf
27-Dec	11:00	Crude Inventories	22-Dec	NA	-0.5M
28-Dec	8:30	Adv. International Trade in Goods	Nov	NA	-$77.2B
28-Dec	8:30	Adv. Wholesale Inventories	Nov	NA	0.70%
28-Dec	8:30	Adv. Retail Inventories	Nov	NA	0.90%
28-Dec	10:00	Pending Home Sales	Nov	0.50%	-2.60%

Source: Briefing.com