Weekly Economic Recap & Comment

Week Ended January 4, 2019

As usual, the monthly employment report was the week's key economic release. ***December nonfarm payrolls*** surged by a seasonally-adjusted 312,000, handily beating the average increase of 219,800 over the last year and accelerating from the revised November gain of 176,000. The ***December unemployment rate*** rose to 3.9%, but only because more people were enticed into the labor market than actually found jobs. Even with the rise, the unemployment rate stayed historically quite low. Perhaps most important, ***December average hourly earnings*** jumped to $27.48. The average wage was up 4.0% from one year earlier, marking its best annual gain since early 2009. In spite of the developing softness in some economic sectors and the steep stock-market correction over the last few months, the report suggests consumer spending can continue to buoy the economy in the near term. That should keep corporate profits growing, 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 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. Finally, we think political risks are increasing as investigators make more progress in their examination of high-level scandals. We began to respond to these future risks by modestly cutting our exposure to stocks and other volatile assets across all our strategies in August, well ahead of the market turmoil that began when other investors finally started to focus on the risks and then overreacted. Even though the stock sell-off seemed too early and excessively deep, those future risks are still a reality for down the road, so we plan to use any near-term recovery in stocks to cut risk further.

In another report on the demand for labor, ***initial jobless claims in the week ended December 29*** jumped by a seasonally-adjusted 10,000 to a level of 231,000. However, because of some big declines earlier in December, the four-week moving average of claims fell to 218,750. The four-week average is once again near its lowest level in decades. With initial applications for unemployment benefits that low, it's clear that layoffs remain minimal.

As mentioned above, we do see signs of a slowdown in certain sectors of the economy, in spite of the strength in the labor market. For example, we've noted a clear downtrend in home sales and residential construction, while auto sales have stagnated, albeit at a high level. Those trends seem to stem in large part from rising interest rates. Now, in addition to those problems, the Institute for Supply Management this week released data suggesting the factory sector is starting to soften. The ***December ISM manufacturing index*** unexpectedly plunged to a seasonally-adjusted 54.1, compared with 59.3 in November and a cycle high of 61.3 in August. The ISM indexes are designed so that readings over 50 point to expanding activity, so the figures still suggest the factory sector is growing relatively broadly. However, the December reading was the weakest in more than two years. Even more worrying, the December subindex on new orders fell to just 51.1. It's still not clear exactly why manufacturing has cooled so much. The cooling seems out of sync with the strong labor market and increased consumption spending. Since the subindex on new export orders is holding up better than the subindex on overall new orders, it's also hard to pin much of the blame on weaker foreign demand. We suspect the biggest issues are the slowdown in housing, a recent drop in energy prices (which has discouraged new oilfield investment), and the overall rise in input costs. On top of those issues, we wonder if corporate managers may be getting more cautious in the face of the administration's protectionist trade policies, which could upend the highly efficient, global supply chains that firms have developed over the last several decades.

Finally, the week included some key data that helps explain why energy prices have been so weak. According to the report, ***commercial crude oil inventories in the week ended December 29*** increased only slightly by 0.007 million barrels, after four straight weekly declines. However, because of an extended surge in inventories during the autumn, total stockpiles remained relatively high at 441.418 million barrels. Inventories still stood 1.7% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). The report also said ***domestic crude oil production in the week ended December 29*** remained at its record high of 11.700 million barrels per day. 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. We have therefore started to exit the broad commodity funds that we have been holding in some of our more aggressive strategies.

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Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
7-Jan	10:00	ISM Non-Manufacturing Index	Dec	58.8	60.7
8-Jan	6:00	NFIB Small Business Optimism	Dec	NA	104.8
8-Jan	10:00	JOLTS - Job Openings	Nov	NA	7.079M
8-Jan	15:00	Consumer Credit	Nov	$18.0B	$25.4B
9-Jan	7:00	MBA Mortgage Applications Index	5-Jan	NA	-8.50%
9-Jan	10:30	EIA Crude Oil Inventories	5-Jan	NA	UNCH
9-Jan	14:00	FOMC Minutes	Dec	NA	NA
10-Jan	8:30	Continuing Claims	29-Dec	NA	1740K
10-Jan	8:30	Initial Claims	5-Jan	225K	231K
10-Jan	10:30	EIA Natural Gas Inventories	5-Jan	NA	-20 bcf
11-Jan	8:30	Core CPI	Dec	0.20%	0.20%
11-Jan	8:30	CPI	Dec	-0.10%	0.00%
11-Jan	14:00	Treasury Budget	Dec	NA	-$23.2B

Source: Briefing.com

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