



WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment Week Ended January 11, 2019

With the federal government partially shut down because of a budget dispute, only a few economic releases came out this week. The most important was some data on inflation. The **December consumer price index (CPI)** fell by a seasonally-adjusted 0.1%, after a flat reading in November and a 0.3% rise in October. However, the decline in December came entirely from a pullback in the volatile energy category. Excluding food and energy, the **December "core" CPI** rose 0.2%, matching its typical gain in recent months. The overall CPI in December was up 1.9% from the same month one year earlier, while the core CPI was up 2.2%. Both versions confirm that inflation remains very close to the Federal Reserve's target of 2.0%. That's comforting in light of the fact that overall economic growth remains so strong. Continued growth should keep corporate profits on the upswing, 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, so we think there is still some upward pressure on prices and interest rates. We suspect that broad, long-standing factors such as population aging and new technologies will ultimately limit how bad inflation will get. All the same, excess demand has created a risk that the Fed 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 remain a reality for down the road, so we still plan to gradually cut risk further as the nascent recovery in stocks progresses.

We think a lot of the remaining inflation pressure comes from the fact that strong output growth has used up a lot of spare physical resources. For example, industrial production has grown so much that capacity utilization is now relatively high, while inventories have gotten much

leaner. Another factor is that the demand for labor is quite high. Companies are creating lots of new jobs, and the ranks of the unemployed have fallen so low that it's increasingly difficult to hire new workers. Companies have therefore become desperate to hold onto their current employees. In the latest data, **initial jobless claims in the week ended January 5** fell by a seasonally-adjusted 17,000 to an extremely low level of 216,000. Because of a rise in claims early in December, the four-week moving average of claims rose slightly to 221,750, but that was still one of the lowest levels in decades. With initial applications for unemployment benefits that low, it's clear that layoffs remain quite limited indeed. Wage growth has also accelerated, and even though wage rates aren't rising as fast as they did in previous decades, they may be putting pressure on those firms that are still finding it hard to raise prices.

In fact, in spite of the continued growth in the overall economy and the good rise in consumer spending, we do see evidence of stress in the business sector. The Institute for Supply Management this week said its **December ISM nonmanufacturing index** fell to a seasonally-adjusted 57.6, compared with 60.7 in November, 60.3 in October, and a cycle high of 61.6 in September. The ISM indexes are designed so that readings over 50 point to expanding activity, so the December figure still suggests the service sector is growing broadly. However, since the indexes for manufacturing and services are both at their lowest level in many months, it seems activity is softening at least a bit. We suspect the main culprits are rising input costs, higher interest rates, and faltering demand in the domestic housing and energy sectors, along with weaker demand overseas. Concern about the administration's trade policy is probably also paralyzing at least some firms.

Finally, the week included some key data related to the weakness in the energy sector. According to the report, **commercial crude oil inventories in the week ended January 5** fell by 1.680 million barrels, erasing their slight gain in the previous week and marking their fifth decline in the last six weeks. However, because of an extended surge in inventories during the autumn, total stockpiles remained relatively high at 439.738 million barrels. Inventories still stood 1.2% above their five-year moving average (an industry benchmark that suggests

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supply and demand are in balance). The report also said **domestic crude oil production in the week ended January 5** 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. Since excess inventories and low prices discourage new drilling and development, we are also looking for any sign that lower energy-sector investment may be holding back the broader economy.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
15-Jan	8:30	PPI	Dec	NA	0.10%
15-Jan	8:30	Core PPI	Dec	NA	0.30%
15-Jan	8:30	Empire State Manufacturing Survey	Jan	NA	10.9
16-Jan	7:00	MBA Mortgage Applications Index	12-Jan	NA	23.50%
16-Jan	8:30	Retail Sales	Dec	NA	0.20%
16-Jan	8:30	Retail Sales ex-auto	Dec	NA	0.20%
16-Jan	8:30	Import Prices ex-oil	Dec	NA	-0.30%
16-Jan	8:30	Export Prices ex-ag.	Dec	NA	-1.00%
16-Jan	10:00	Business Inventories	Nov	NA	0.60%
16-Jan	10:00	NAHB Housing Market Index	Jan	NA	56
16-Jan	10:30	EIA Crude Oil Inventories	12-Jan	NA	-1.7M
16-Jan	14:00	Fed's Beige Book	Jan	NA	NA
16-Jan	16:00	Net Long-Term TIC Flows	Nov	NA	\$31.3B
17-Jan	8:30	Housing Starts	Dec	NA	1256K
17-Jan	8:30	Building Permits	Dec	NA	1328K
17-Jan	8:30	Initial Claims	12-Jan	NA	216K
17-Jan	8:30	Continuing Claims	5-Jan	NA	1722K
17-Jan	8:30	Philadelphia Fed Index	Jan	NA	9.4
17-Jan	10:30	EIA Natural Gas Inventories	12-Jan	NA	-91 bcf
18-Jan	9:15	Capacity Utilization	Dec	NA	78.50%
18-Jan	9:15	Industrial Production	Dec	NA	0.60%
18-Jan	10:00	Univ. of Michigan Consumer Sentiment - Prelim	Jan	NA	98.3

Source: Briefing.com