WEALTH MANAGEMENT INTERNATIONAL, LTD.

Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment

Week Ended January 18, 2019

Despite the partial shutdown of the federal government, several key inflation reports came out this week. Most important, the ***December producer price index (PPI)*** fell by a seasonally-adjusted 0.2%, wiping out its November rise of 0.1% and marking the first decline in business-to-business prices since early 2017. The decline came partly from a drop in the volatile energy category, but that wasn't the whole story. Even excluding food and energy, the ***December "core" PPI*** edged down 0.1%, after rising 0.3% in November and 0.5% in October. The overall PPI in December was up 2.5% from the same month one year earlier, while the core PPI was up 2.7%. The figures help confirm that U.S. inflation has at least topped out and may even be cooling. Strong demand growth has continued to drive up input costs, so producer prices are still rising relatively fast. The bigger story is that consumer prices have slowed so much, perhaps because of the broad, long-standing factors we've been talking about (new shopping technologies, population aging, post-recession frugality, etc.). With underlying demand continuing to grow, we still think price hikes could accelerate again and the Federal Reserve might hike interest rates too far. Indeed, the Fed may already have done so. Nevertheless, we think moderating inflation pressure will reduce the number of potential new rate hikes in the near future and help keep the economy growing well. That should keep corporate profits on the upswing, so we're maintaining a significant exposure to equities for the time being (in our strategies that include them). The problem now is that foreign demand is still weakening a lot, which will hurt not only exporters but also U.S. firms that produce and sell abroad. With input costs rising faster than consumer prices, many firms will also see downward pressure on profit margins. There are yellow flags in the government policy environment, such as risky posturing in national security and international trade disputes, and political risks are increasing as investigators make more progress in their examination of high-level scandals. Because of those risks, we are not yet ready to increase our exposure to stocks again, even though the market is recovering nicely from its correction in the fourth quarter. Because of the rising future risks, we still expect to gradually cut our stock exposure further over time.

In other data that should help convince the Fed to slow or stop its rate hikes, ***December import prices*** fell 1.0%, after a revised 1.9% decline in November. As with U.S. producer prices, some of the recent declines in import prices have come from lower prices for crude oil and other energy products, but that wasn't the only factor. ***December nonfuel import prices*** were flat, after a 0.3% fall in November. Total import prices in December were down 0.6% on the year, marking a big slowdown from the annual increases of 3.4% or more as recently as October. Nonfuel import prices in December were up just 0.5% year-over-year, compared with annual gains of more than 1.0% as recently as July.

Another report suggested energy prices could remain under control and help keep inflation from rebounding in the future. The data showed ***commercial crude oil inventories in the week ended January 12*** fell by 2.683 million barrels, marking their sixth decline in the last seven weeks. At 437.055 million barrels, total inventories stood just 0.5% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). However, the report also showed a continuing rise in inventories of refined product, which could eventually undercut refiners' demand for crude. The report also said ***domestic crude oil production in the week ended January 12*** rose to a new record high of 11.900 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 the market. Oil prices have recently been recovering after they fell in tandem with stocks during the fourth quarter, but we wonder if there may be limits to the rebound. We have therefore started to exit the broad commodity funds that we have been holding in some of our more aggressive strategies.

In its past battles with inflation, the Fed has often kept hiking interest rates until they snuffed out economic growth and pushed the country into recession. What's encouraging now is that the big slowdown in inflation and the prospect for stabilized monetary policy have come while the economy still seems to have the momentum needed to keep growing. That's mostly because of the strong labor market: Companies are creating lots of new jobs, unemployment has fallen to extremely low levels, and wage rates are rising nicely. In the latest data, ***initial jobless claims in the week ended January 12*** fell by a seasonally-adjusted 3,000 to a very low level of

© Wealth Management International, Ltd.
23131 North Lake Pleasant Parkway | Peoria, AZ 85383 | 623-875-5204 |1-888-91-ASSET
To find out how we use our research in an effort to build better investment strategies, see our website at www.wealthadv4u.com.
Advisory services offered through Wealth Management International, Ltd. (WMI), or AdvisorNet Wealth Management (AWM), SEC registered investment advisors. WMI and AWM are not affiliated.

213,000. The four-week moving average of claims fell to 220,750, once again approaching its lowest level in decades. With initial applications for unemployment benefits that low, it's clear that the demand for labor remains very high and layoffs are still quite limited.

Nevertheless, the week included some data that helped remind investors that the risks mentioned above remain in place. For example, the University of Michigan said its ***preliminary January consumer sentiment index*** fell sharply to just 90.7, far below the final December figure of 98.3 and the cycle high of 101.4 last March. In fact, the reading for early January was the lowest since October 2016. The subindex on consumers' view of current conditions only fell moderately, so it doesn't yet indicate an imminent recession or bear market. In contrast, the subindex on consumers' future expectations fell quite sharply, marking its fifth decline in the last six months. The slide in expectations could reflect everything from the rise in interest rates so far to the big drop in the stock market through late December. The slide in expectations for the future could also reflect the continuing trade spat with China or the government shutdown. Whatever the slide is indicating, it suggests to us that the future risks we discussed above are not to be ignored, even if the near-term prospects look good for the economy, corporate profits, and the nascent recovery in the stock market.

Finally, in a report supporting the idea that there is still some risk of inflation and further interest-rate hikes, ***December industrial production*** increased by a seasonally-adjusted 0.3%, in line with the revised increases of 0.4% in November and 0.2% in October. The recent increases have come in part from a dramatic jump in mining output (especially crude oil production), but gains in manufacturing were also strong last month. Overall industrial production in December was up a healthy 3.6% year-over-year, with mining production up 13.5% and manufacturing output up 3.0%, while unseasonably warm weather and reduced heating demand left utility output down 5.2%. The data also showed ***December industrial capacity utilization*** rose to a three-year high of 78.7%. Capacity usage is still only a bit higher than its 20-year average of 77.3%, but if it continues to march upward, we think cost pressures will keep increasing and there will continue to be some risk of unexpected Fed rate hikes.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
22-Jan	10:00	Existing Home Sales	Dec	NA	5.32M
23-Jan	7:00	MBA Mortgage Applications Index	19-Jan	NA	NA
23-Jan	9:00	FHFA Housing Price Index	Nov	NA	5.70%
23-Jan	10:30	EIA Crude Oil Inventories	19-Jan	NA	-2.7M
24-Jan	8:30	Initial Claims	19-Jan	NA	213K
24-Jan	8:30	Continuing Claims	19-Jan	NA	1737K
24-Jan	10:00	Leading Indicators	Dec	NA	0.20%
24-Jan	10:30	EIA Natural Gas Inventories	19-Jan	NA	-81 bcf
25-Jan	8:30	Durable Goods –ex transportation	Dec	NA	-0.30%
25-Jan	8:30	Durable Orders	Dec	NA	0.80%
25-Jan	10:00	New Home Sales	Dec	NA	NA

Source: Briefing.com

© Wealth Management International, Ltd.
23131 North Lake Pleasant Parkway | Peoria, AZ 85383 | 623-875-5204 |1-888-91-ASSET
To find out how we use our research in an effort to build better investment strategies, see our website at www.wealthadv4u.com.
Advisory services offered through Wealth Management International, Ltd. (WMI), or AdvisorNet Wealth Management (AWM), SEC registered investment advisors. WMI and AWM are not affiliated.