WEALTH MANAGEMENT INTERNATIONAL, LTD.
Proactive Investment Management & Financial Planning

# Weekly Economic Recap & Comment

## Week Ended February 1, 2019

This week's key release was the monthly employment report. ***January nonfarm payrolls*** grew very strongly by a seasonally-adjusted 304,000, handily beating their revised gain of 222,000 in December and their average monthly increase of 233,900 over the last year. The ***January unemployment rate*** rose to 4.0%, but that mostly reflected the temporary furlough of federal government workers. From a longer historical perspective, joblessness remains quite low. Finally, ***January average hourly earnings*** rose to $27.56, up a healthy 3.2% year-over-year. In sum, the data point to a strong and growing labor market, which we think will boost consumer spending further and keep powering the economy forward. That should keep corporate profits on the upswing, so we're maintaining a significant exposure to equities (in our strategies that include them). Until recently, strong demand growth was putting upward pressure on inflation and interest rates, but it now appears the Federal Reserve's rate hikes to date, the strong dollar, and broad, long-standing factors such as population aging and new technologies have brought inflation under control again. The Fed is now signaling it will slow the pace of its rate hikes going forward, which may give the economy room to keep running. The problem is that the Fed's move to take its foot off the brakes may not have been as perfectly timed as we all hope. We think there's a significant risk that the strong labor market and continued demand growth will boost inflation again and force the Fed to hike rates further. On the other hand, in an economy that is much less dynamic than in decades past, there's a chance the cost increases and rate hikes to date have already done their damage, and growth could now slow substantially. On top of that, foreign demand is still weakening a lot, which will hurt both exporters and U.S. firms that produce and sell abroad. There are also 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 still considering a near-term cut in our stock exposure once it seems that the current stock rebound is starting to peter out.

In other data on the labor market, ***initial jobless claims in the week ended January 26*** jumped by a seasonally-adjusted 53,000 to a level of 253,000, but the unusual surge may have come from problems with the seasonal adjustment process around the Martin Luther King holiday. The four-week moving average of claims only rose to 220,250, remaining close to its lowest level in decades. Even with the uptick in initial applications for unemployment benefits, it's clear that the demand for labor remains very high and layoffs are still quite limited.

Strong job growth, low unemployment, and limited layoffs continue to buoy spirits, but optimism may have been dented a bit by the stock market correction and federal government shutdown. The Conference Board said its ***January consumer confidence index*** fell to an 18-month low of 120.2, compared with 126.6 in December, 135.4 in November, and a cycle high of 137.9 in October. Meanwhile, the University of Michigan said its ***final January consumer sentiment index*** declined to a 28-month low of 91.2, compared with its final December reading of 98.3 and its cycle high of 101.4 last March. Both declines came mostly from weaker expectations for the future. Fortunately, history shows the subindexes on consumers' view of current conditions are the better indicator of near-term economic performance, and those subindexes have been relatively steady at high levels.

Not only are consumers becoming more wary about future prospects, but some are also struggling with current issues in the economy, such as the rise in home prices and mortgage interest rates over the last year. Data this week showed ***November new home sales*** jumped by a seasonally-adjusted 16.9% to an annualized selling rate of 657,000, but because of high prices and rising interest rates, the selling rate was still down 7.7% from one year earlier. The median price for a newly-built home fell to $302,400, down a sharp 11.9% on the year.

In the business sector, the Institute for Supply Management's ***January ISM manufacturing index*** rebounded to a seasonally-adjusted 56.6 from a revised 54.1 in December. The subindex on new orders, which we think is a key indicator for future economic growth, rebounded all the way to 58.2 from 51.3. The ISM indexes are designed so that readings over 50 point to expanding activity, so the figures suggest the factory sector continues to grow quite broadly.

For a read on activity in the building industry, ***November construction spending*** increased by a

seasonally-adjusted 0.8%, after a revised 0.1% gain in October. The acceleration came entirely from a rebound in expenditures on private residential projects. However, that wasn't nearly enough to offset the recent long period of weak homebuilding. Overall construction spending in November was up a modest 2.5% year-over-year, led by a 6.5% gain in public works and a 4.2% rise in commercial construction, but private residential spending was still down 1.1% on the year.

Finally, in data on the energy sector, ***commercial crude oil inventories in the week ended January 26*** edged up by 0.919 million barrels to a total of 445.944 million barrels, leaving inventories 2.3% 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 January 26*** remained at a 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), the figures suggest excess inventories and high U.S. production 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.

Finally, the week's data included a report showing that while the strong labor market is a positive for workers, it's also presenting cost challenges for businesses. The ***fourth-quarter employment cost index*** rose by a seasonally-adjusted 0.7%, in line with the robust increases of 0.8% in the third quarter and 0.6% in the second quarter. Overall employment costs in the final period of 2018 were up 2.9% year-over-year, marking their biggest annual increase since 2008. From a historical perspective, the annual rise in employment costs isn't all that high. All the same, we suspect the cost increases are painful in the context of only modest productivity gains and less dynamic demand growth than in decades past. That explains why we continue to worry about cost pressures and the possibility they could start to erode profit margins.

Patrick Fearon, CFA
Chief Investment Officer

## Upcoming U.S. Data

| Date | ET | Release | For | Consensus Forecast | Prior |
|---|---|---|---|---|---|
| 4-Feb | 10:00 | Factory Orders | Dec | NA | NA |
| 4-Feb | 14:00 | Auto Sales | Dec | NA | 4.00M |
| 4-Feb | 14:00 | Truck Sales | Dec | NA | 9.43M |
| 5-Feb | 10:00 | ISM Non-Manufacturing Index | Jan | NA | 57.6 |
| 6-Feb | 7:00 | MBA Mortgage Applications Index | 2-Feb | NA | -3.00% |
| 6-Feb | 8:30 | Trade Balance | Nov | NA | -$55.5B |
| 6-Feb | 8:30 | Productivity-Prel | Q4 | NA | 2.30% |
| 6-Feb | 8:30 | Unit Labor Costs - Prelim | Q4 | NA | 0.90% |
| 6-Feb | 10:30 | EIA Crude Oil Inventories | 2-Feb | NA | +0.9M |
| 7-Feb | 8:30 | Initial Claims | 2-Feb | NA | 253K |
| 7-Feb | 8:30 | Continuing Claims | 26-Jan | NA | 1782K |
| 7-Feb | 10:30 | EIA Natural Gas Inventories | 2-Feb | NA | -173 bcf |
| 7-Feb | 15:00 | Consumer Credit | Dec | NA | $22.1B |

*Source: Briefing.com*

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