Wealth Management International, Ltd.
Proactive Investment Management & Financial Planning

Weekly Economic Recap & Comment

Week Ended February 8, 2019

Since the service sector accounts for the vast majority of U.S. economic activity, we focused this week on a gauge of the sector from the Institute for Supply Management. The ***January ISM nonmanufacturing index*** fell to a seasonally-adjusted 56.7, down from a revised 58.0 in December, 60.7 in November, and a cycle maximum of 61.6 in September. However, the ISM indexes are designed so that readings over 50 point to expanding activity. In spite of the recent declines, the figures still suggest the service sector is growing broadly. We think that will support further growth in the overall economy and help keep domestic corporate profits on the upswing, so we are maintaining a significant exposure to equities (in our strategies that include them). The key risks revolve around inflation and interest rates. Until recently, strong demand growth was putting upward pressure on prices, and the Federal Reserve was responding with a continual series of small interest-rate hikes. Now, it appears that the 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, so the Fed is signaling it will slow the pace of its rate hikes going forward. That could help keep the economy on its current growth path. 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. Besides, foreign demand is still weakening a lot, which will hurt both exporters and those 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 modestly trimmed our exposure to stocks and other riskier assets this week, though we think we've kept enough exposure to enjoy the benefits of any further recovery in stocks.

A key reason we think the Fed may have already hiked rates too far is that we continue to see moderation or even weakness in various data series, including those that mostly reflect the domestic economy. In the latest data on the labor market, ***initial jobless claims in the week ended February 2*** fell by a seasonally-adjusted 19,000 to a level of 234,000. However, that came after a big surge in claims during the previous week, so the four-week moving average of claims increased to 224,750. Initial applications for unemployment benefits remain historically low, so it appears layoffs are not a big problem yet. It's also important to remember that the recent volatility in the figures could merely reflect problems with the seasonal adjustment process around the Martin Luther King holiday, or the private-sector impact of the partial shutdown of the federal government in December and January. All the same, we sense that underlying claims have been starting to tick upwards over the last few months, which may mean the demand for labor is softening a bit.

The week's data from the industrial sector also came in on the soft side. ***November factory orders*** fell by a seasonally-adjusted 0.6%, marking a second straight decline after orders fell 2.1% in October. Total factory orders in November were up just 3.7% from the same month one year earlier, compared with annual gains of 10.2% or more last summer. November orders for durable goods were up 4.8% on the year, and orders for nondurables were up 2.5%. However, each of those increases was only about one-third as large as the annual gains seen last July and August.

In the energy sector, ***commercial crude oil inventories in the week ended February 2*** rose by 1.263 million barrels, reaching a total of 447.207 million barrels. That means inventories now stand a significant 2.5% 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 February 2*** 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 energy prices. We have therefore recently eliminated our exposure to broad commodity funds in many of our strategies. More broadly, weak energy prices could also discourage new drilling and oil field development, which would likely weigh on businesses ranging from pipe manufacturers to homebuilders active near the oil fields. That would likely compound the headwinds we're already seeing in the economy, such the slowdown in foreign economic growth and the way that cost increases and higher interest rates to date have already become a drag on domestic sectors like housing.

As mentioned above, slowing economic growth overseas would likely hurt both exporters and those firms that produce and sell abroad. In data touching on the exporters, the ***November trade balance*** improved to a seasonally-adjusted deficit of $49.3 billion, after a deficit of $55.7 billion in October. The smaller deficit came mostly from a sharp decline in U.S. imports. However, in a reflection of the slowing demand overseas and the negative impact of the strong dollar, exports also fell in November. In fact, exports have now fallen in five of the last six months. November exports were up just 3.7% year-over-year, while imports were up 3.2%. Both those annual growth rates were less than half as strong as the figures posted late last spring.

Patrick Fearon, CFA
Chief Investment Officer

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
12-Feb	6:00	NFIB Small Business Optimism Index	Jan	NA	104.4
12-Feb	10:00	JOLTS - Job Openings	Dec	NA	6.888M
13-Feb	7:00	MBA Mortgage Applications Index	9-Feb	NA	-2.50%
13-Feb	8:30	CPI	Jan	NA	-0.10%
13-Feb	8:30	Core CPI	Jan	NA	0.20%
13-Feb	10:30	EIA Crude Oil Inventories	9-Feb	NA	+1.3M
13-Feb	14:00	Treasury Budget	Dec	NA	-$23.2B
14-Feb	8:30	Retail Sales	Dec	NA	0.20%
14-Feb	8:30	Retail Sales ex-auto	Dec	NA	0.20%
14-Feb	8:30	PPI	Jan	NA	-0.20%
14-Feb	8:30	Core PPI	Jan	NA	-0.10%
14-Feb	8:30	Initial Claims	9-Feb	NA	234K
14-Feb	8:30	Continuing Claims	2-Feb	NA	1736K
14-Feb	10:00	Business Inventories	Nov	NA	0.60%
14-Feb	10:30	EIA Natural Gas Inventories	9-Feb	NA	-237 bcf
15-Feb	8:30	Export Prices ex-ag.	Jan	NA	-1.10%
15-Feb	8:30	Import Prices ex-oil	Jan	NA	0.00%
15-Feb	8:30	Empire State Manufacturing Survey	Feb	NA	3.9
15-Feb	9:15	Industrial Production	Jan	NA	0.30%
15-Feb	9:15	Capacity Utilization	Jan	NA	78.70%
15-Feb	10:00	U of Mich. Consumer Sentiment - Prelim	Feb	NA	NA
15-Feb	16:00	Net Long-Term TIC Flows	Dec	NA	NA

Source: Briefing.com