Weekly Economic Recap & Comment
Week Ended May 17, 2019

We thought this week's most important economic release was the latest report on the nation's industrial sector. ***April industrial production*** fell by a seasonally-adjusted 0.5%, reversing its revised 0.2% gain in March and marking its third decrease in the last four months. Consistent with recent trends, the decline in April stemmed mostly from falling output in the dominant manufacturing sector. Overall industrial output in April was up 0.7% from the same month one year earlier, but manufacturing output was actually down 0.4%. The report said ***April industrial capacity utilization*** fell to a 14-month low of 77.9%, while capacity usage in manufacturing declined to a 15-month low of 75.7%. In our view, overall economic activity still seems to be recovering from its soft patch in mid-winter, but the industrial report served as a reminder that some sectors are still facing headwinds and inflation pressures continue to dissipate. Continued overall growth should help keep domestic corporate profits on an uptrend for now, so we are maintaining a significant exposure to equities for the time being (in our strategies that include them). The problem is that the Federal Reserve's recent pause on interest-rate hikes may have come too late. With the economy much less dynamic than in decades past, there's a chance that the inflation and rate hikes through 2018 may have already done their damage, and growth could now slow further. Besides, a continued weakening in foreign demand could 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 the administration's risky posturing in national security and international trade disputes. Because of those risks, we may keep trimming our exposure to stocks and other riskier assets across our various strategies over time, although we think we've kept enough exposure at present to take reasonable advantage of any further gains in the stock market.

The softness in manufacturing reflects multiple issues, including the strong dollar, weak foreign demand, slowing domestic investment, and the vestigial impact of last year's inflation and interest-rate hikes. We also think many firms are trying to reduce their excess inventories by holding the line on new orders to their suppliers. As evidence of that, ***March business inventories*** were unchanged on a seasonally-adjusted basis, compared with their increases of 0.3% in February and 0.9% in January. For the first time since last summer, inventories grew much slower than sales last month. Therefore, the ***March business inventory-to-sales*** ratio fell to 1.37 from an elevated 1.39 in each of the three prior months. The inventory ratio would have to fall even further to reach the recent levels below 1.35 and the pre-recession levels below 1.30. We therefore think manufacturing orders and factory activity will probably continue to face headwinds in the near term. The question is whether the softness in manufacturing will get bad enough to drag down the rest of the economy.

Falling capacity use and excess inventories also tend to discourage price increases, but this week's only inflation data was probably more affected by the strength of the dollar and weaker demand overseas. The data showed ***April import prices*** rose mildly by a seasonally-adjusted 0.2%, after a 0.6% increase in March and a 1.0% jump in February. Excluding the impact of rising oil prices, ***April nonfuel import prices*** were actually down 0.1%, after falling 0.2% in the previous month. Overall import prices in April were down 0.1% year-over-year, while nonfuel import prices were down 0.9%. Coupled with the impact of weaker domestic demand, falling capacity use, and excess inventories, the softness in import prices suggests overall inflation may well remain low for some time to come – perhaps low enough to prevent the Fed from hiking interest rates any further, and maybe even low enough to eventually prompt a cut in rates.

In data touching on supplies and pricing in the energy industry, ***commercial crude oil inventories in the week ended May 11*** rose by 5.431 million barrels to a total of 472.035 million barrels. As a result, stockpiles remained bloated at 6.8% 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 May 11*** fell to 12.1 million barrels per day, but that was only slightly below the record high reached two weeks ago. Because of continually rising demand and reduced exports from some big producers (such as Iran and Venezuela), global oil prices have recently been trending upward. Still, we think historically high inventories and strong U.S. output could eventually lead to excess supplies and falling prices. We therefore continue to avoid commodity funds in most of our strategies at present.

Fortunately, two reports this week pointed to continued strength in consumer demand. ***April retail sales*** edged down by a seasonally-adjusted 0.2%, but that came after a revised jump of 1.7% in March. Moreover, the April decline came entirely from the volatility in auto sales. ***April retail sales excluding autos*** rose 0.1%, after a March jump of 1.3%. Overall retail sales in April were up a healthy 5.0% year-over-year, and sales ex-autos were up an even stronger 5.2%.

In data touching on the housing market, a new report said ***April housing starts*** rose by a seasonally-adjusted 5.7% to an annualized rate of 1.296 million units. That came after groundbreakings rose a revised 1.7% in March. ***April building permits*** increased a more muted 0.6%, but that was still a welcome relief after three straight months of declines. Overall housing starts in April were still down 2.9% on the year, led by a drop of 4.6% in the single-family category. Permits in April were down 0.5% year-over-year, with single-family permitting down 4.8%. All the same, those annual declines were significantly smaller than in recent months.

The week did include some cautionary data related to consumer spending. In a report touching on the demand for labor, ***initial jobless claims in the week ended May 11*** fell by a seasonally-adjusted 16,000 to a level of 212,000, but the four-week moving average of claims rose to a nearly three-month high of 225,000. Initial applications for unemployment benefits remain historically low, which suggests layoffs are still not a significant problem. All the same, it looks like layoffs are on an uptrend again, and if that continues, some consumers might rein in their spending as they prepare for a potential job loss.

In fact, that potential risk may have shown up in one of the main gauges of optimism. The University of Michigan said its ***preliminary May consumer sentiment index*** jumped to a 15-year high of 102.4, after a final April reading of just 97.2, but virtually all of the increase came from the subindex on consumers' future expectations. Our analysis shows the subindex tracking how consumers feel about current conditions is actually the better predictor of a near-term recession or bear market in stocks, and that subindex was virtually flat in early May. The subindex on current conditions has consistently underperformed since the beginning of 2018, which suggests consumers may be getting more concerned about increasing layoffs and reduced economic momentum.

Finally, the week included a Conference Board index designed to show how the economy should perform over the coming six months or so. On a positive note, the ***April index of leading economic indicators*** rose by a seasonally-adjusted 0.2%, following its revised increases of 0.3% in March and 0.2% in February. That marked the first time the index has risen for three straight months since last summer. The problem was that the magnitude of the increases was quite modest in comparison with the gains last year. In addition, the rise in April came almost entirely from the subindexes on stock prices and credit availability, rather than being broad based. Even though the overall index is pointing toward continued economic growth in the near term, the details in the report suggest the growth may well be more muted and fragile than in 2018.

Patrick Fearon, CFA
Lead Portfolio Manager

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
21-May	10:00	Existing Home Sales	Apr	NA	5.21M
22-May	7:00	MBA Mortgage Applications Index	18-May	NA	-0.60%
22-May	10:30	EIA Crude Oil Inventories	18-May	NA	+5.4M
22-May	14:00	FOMC Minutes	May	NA	NA
23-May	8:30	Initial Claims	18-May	NA	212K
23-May	8:30	Continuing Claims	11-May	NA	1660K
23-May	10:00	New Home Sales	Apr	NA	692K
23-May	10:30	EIA Natural Gas Inventories	18-May	NA	+106 bcf
24-May	8:30	Durable Orders	Apr	NA	2.60%
24-May	8:30	Durable Goods –ex transportation	Apr	NA	0.40%

Source: Briefing.com