Weekly Economic Recap & Comment
Week Ended May 31, 2019

The key economic report this week was the second estimate of U.S. output in January through March. After stripping out seasonal impacts and price changes, ***revised first-quarter gross domestic product (GDP)*** grew at an annualized rate of 3.1%, compared with 2.2% in the fourth quarter of 2018 and 3.4% in the third quarter. GDP in the first period was up 3.2% year-over-year, easily beating the average annual increase of 2.1% over the last two decades. The main source of growth over the last year was consumer spending, followed by inventory investment. In a broad measure of inflation, the ***revised first-quarter GDP deflator*** rose at a mild rate of just 0.8%, down from 1.7% in the fourth quarter. In sum, the data was consistent with our view that while the economy is still growing, some sectors are facing headwinds, and inflation pressures are weakening. Continued 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 threats, last week we implemented another modest reduction in our exposure to stocks and other riskier assets, just as we did in February and last August. Those earlier adjustments helped cushion our portfolios from the recent market turbulence, and we expect our latest moves to help even more. Our portfolios are now substantially "risk off," although we think our remaining exposure to stocks is still significant enough to take reasonable advantage of any rebound in the market. At some point in the coming months, we anticipate that we may need to cut risk again in more dramatic fashion, but we don't think we're at that point quite yet.

The week also included several reports on the key consumer sector in the second quarter. For example, ***April personal income*** rose by a seasonally-adjusted 0.5%, accelerating from a mere 0.1% gain in March. ***April personal consumption expenditures (PCE)*** rose a bit less strongly, by 0.3%, but that was probably to be expected after they jumped by a revised 1.1% in the previous month. Taking a longer perspective, personal income in April was up 3.9% year-over-year, while PCE was up a slightly stronger 4.3%, which we think reflects continued confidence among consumers. The report also included the Fed's preferred inflation gauge. After stripping out the volatile food and energy categories, the ***April "core" PCE deflator*** was up 1.6% from April 2018, as it continued to undershoot the Fed's target of 2.0%.

In data touching on the consumer sector in mid-quarter, ***initial jobless claims in the week ended May 25*** rose by a seasonally-adjusted 3,000 to a level of 215,000. However, the four-week moving average of claims, which helps strip out some of the volatility in the data, declined to an extraordinarily low 216,750. Initial applications for unemployment benefits remain near their lowest levels in decades, suggesting layoffs are still minimal.

With continued job creation, low unemployment, rising wages, and only limited layoffs, consumer optimism remains elevated. The Conference Board said this week that its ***May consumer confidence index*** increased to a six-month high of 134.1, compared with readings of 129.2 in April and 124.2 in March. The index is still a bit below its cycle high, but it remains historically quite high. Similarly, the University of Michigan announced that its ***final May consumer sentiment index*** came in at 100.0, posting a good increase from the final April reading of 97.2 and reaching its highest level since last September. The high optimism reflected in these reports suggests consumers will likely keep boosting their spending in the near term. The problem is that the reports also showed continued underperformance in the subindexes on how consumers feel about current economic conditions (as opposed to the indexes on their future expectations). That's a yellow flag because the current conditions subindexes have historically weakened ahead of a recession and bear market in stocks.

Finally, in data on the nation's energy industry, ***commercial crude oil inventories in the week ended May 25*** fell by 0.282 million barrels to a total of

476.493 million barrels. Nevertheless, stockpiles remained bloated at 7.6% above their five-year moving average (an industry benchmark that suggests supply and demand are in balance). Even worse, the report said ***domestic crude oil production in the week ended May 25*** rose once again to its record high of 12.3 million barrels per day. Because of continued demand growth and reduced exports from some big producers (such as Iran and Venezuela), global oil prices had been trending upward until recently, but it now appears that investors have come around to our thinking that historically high inventories and strong U.S. output could eventually lead to excess supplies. Oil prices therefore fell sharply again this week, and we are concerned that they could now keep falling. We therefore continue to avoid commodity funds in most of our strategies at present.

Patrick Fearon, CFA
Lead Portfolio Manager

Upcoming U.S. Data

Date	ET	Release	For	Consensus Forecast	Prior
3-Jun	10:00	ISM Manufacturing Index	May	NA	52.8
3-Jun	10:00	Construction Spending	Apr	NA	-0.90%
4-Jun	10:00	Factory Orders	Apr	NA	1.90%
5-Jun	7:00	MBA Mortgage Index	1-Jun	NA	-3.30%
5-Jun	8:15	ADP Employment Change	May	NA	275K
5-Jun	10:00	ISM Non-Manufacturing Index	May	NA	55.5
5-Jun	10:30	EIA Crude Oil Inventories	1-Jun	NA	-0.3M
5-Jun	14:00	Fed's Beige Book	Jun	NA	NA
6-Jun	8:30	Initial Claims	1-Jun	NA	215K
6-Jun	8:30	Continuing Claims	24-May	NA	1657K
6-Jun	8:30	Trade Balance	Apr	NA	-$50.0B
6-Jun	8:30	Productivity-Rev.	Q1	NA	3.60%
6-Jun	8:30	Unit Labor Costs - Rev.	Q1	NA	-0.90%
6-Jun	10:30	EIA Natural Gas Inventories	1-Jun	NA	+114 bcf
7-Jun	8:30	Nonfarm Payrolls	May	NA	263K
7-Jun	8:30	Nonfarm Private Payrolls	May	NA	236K
7-Jun	8:30	Avg. Hourly Earnings	May	NA	0.20%
7-Jun	8:30	Unemployment Rate	May	NA	3.60%
7-Jun	8:30	Average Workweek	May	NA	34.4
7-Jun	10:00	Wholesale Inventories	Apr	NA	-0.10%
7-Jun	15:00	Consumer Credit	Apr	NA	$10.3B

Source: Briefing.com