

Weekly Economic Commentary



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Beige Book: Window on Main Street

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Highlights

The latest Beige Book reflected a picture of the U.S. economy that has been largely unaffected by the increasing market concern over falling oil prices, the end of QE in the United States, and the rising U.S. dollar.

The report suggested that U.S. economic activity has “continued to expand,” and in general, optimism regarding the economic outlook far outweighed pessimism, as it has for the past 18 months or so.

For the first time in this business cycle, the latest Beige Book contained more than one mention of employers having difficulty finding low-skilled workers, and retaining and compensating key workers.

Over the past 3 Beige Books, the BBB has averaged +93, in-line with the highest readings over any 3 consecutive Beige Books since at least 2005, suggesting recent market concerns have not been a threat to the U.S. economic expansion as of late November 2014.

Beige Book Suggests That Recent Market Concerns Around Global Growth May Be Overdone

The Beige Book is a qualitative assessment of the U.S. economy and each of the 12 Federal Reserve (Fed) districts. We believe the Beige Book is best interpreted quantitatively by measuring how the descriptors change over time. The latest edition of the Fed Beige Book was released last Wednesday, December 3, 2014, ahead of the December 16–17, 2014, Federal Open Market Committee (FOMC) meeting. The qualitative inputs for the December 2014 Beige Book were collected through November 24, 2014, and thus captured a period of increasing financial market concern about the signal from the precipitous drop in oil prices, the end of quantitative easing (QE) in the United States, and the rising U.S. dollar.

In our view, the latest Beige Book reflected a picture of the U.S. economy that was largely unaffected by any of the concerns described above, noting that national economic activity “continued to expand in October and November,” and that “a number of districts also noted that contacts remained optimistic about the outlook for future economic activity.” In general, optimism regarding the economic outlook far outweighed pessimism, as it has for the past 18 months or so.

As it has over the past year or so, the December 3, 2014, Beige Book noted that in general, employers were having a difficult time finding qualified workers for certain skilled positions and that some reported upward wage pressures for particular industries and occupations. In the past, these characterizations of labor markets have been a precursor to more prevalent economy-wide wage increases. Indeed, for the first time in this business cycle, the latest Beige Book contained more than one mention of employers

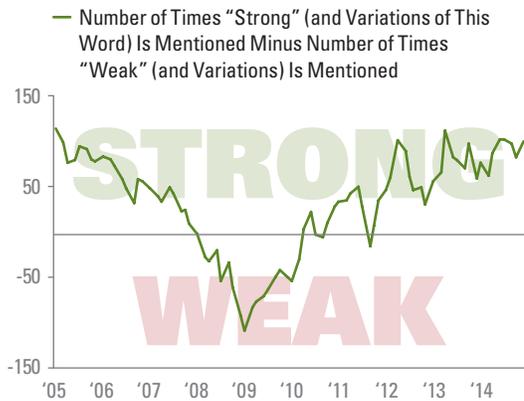
How the Barometer Works

The Beige Book Barometer is a diffusion index that measures the number of times the word “strong” or its variations appear in the Beige Book less the number of times the word “weak” or its variations appear. When the Beige Book Barometer is declining, it suggests that the economy is deteriorating. When the Beige Book Barometer is rising, it suggests that the economy is improving.

See page 3 for “Beige Book: How It Works.”



1 Beige Book Barometer Bounces Back in December to Near 10-Year High



Source: LPL Financial Research, Federal Reserve 12/03/14

having difficulty finding low-skilled workers, and retaining and compensating key workers. If this trend persists into 2015, history suggests that it won't be long until Fed policymakers begin to take note of a faster pace of wage inflation in their monetary policy deliberations.

Sentiment Snapshot

To provide a snapshot of the sentiment behind the entire Beige Book collage of data, we created our proprietary Beige Book Barometer (BBB) [Figure 1]. In December 2014, the barometer ticked up to +100, from the +82 readings in October 2014 and the +97 reading in September 2014. The +100 reading in December 2014 nearly matched the +102 readings seen in both June and July 2014. Over the past 3 Beige Books, the BBB has averaged +93, in-line with the highest readings over any 3 consecutive Beige Books since at least 2005. In short, the Beige Book did not support the financial markets' concern that falling oil prices, a rising U.S. dollar, and the end of QE were significant threats to the U.S. economic expansion.

The rebound in our Beige Book Barometer over the past several months is consistent with the Fed's view that the drop in economic activity in the first quarter of 2014—real gross domestic product (GDP) contracted at a 2.1% annualized rate for the quarter—was mostly weather related. The

2 Beige Book Word Clouds

December 2014



October 2014



December 2013



Source: LPL Financial Research, Federal Reserve Beige Book 12/03/14, 10/15/14, and 12/04/13



Beige Book: How It Works

The Beige Book compiles qualitative observations made by community bankers and business owners about economic (labor market, prices, wages, housing, nonresidential construction, tourism, manufacturing) and banking (loan demand, loan quality, lending conditions) conditions in each of the 12 Fed districts (Boston, New York, Philadelphia, Kansas City, etc.). This local color that makes up each Beige Book is compiled by 1 of the 12 regional Federal Reserve districts on a rotating basis—the report is much more “Main Street” than “Wall Street” focused. It provides an excellent window into economic activity around the nation using plain, everyday language. The report is prepared eight times per year, ahead of each of the eight Federal Open Market Committee (FOMC) meetings. The next FOMC meeting is December 16–17, 2014.

The word clouds or text clouds on page 2 are a visual format useful for quickly perceiving the most important words in a written document. They are culled from the Fed’s Beige Books published last week (December 3, 2014), the prior report (October 15, 2014), and the report from a year ago (December 4, 2013). In general, the more often a word appears in a speech, text, report, or other transcript, the larger that word appears in the word cloud. The word clouds show the top 50 words for each of the 3 Beige Books mentioned above. Similar words are grouped together and common words like “the,” “and,” “a,” and “is” are excluded, as are words that appear frequently in all Beige Books (federal, district, loan, level, activity, sales, conditions, firms, etc.).

+93 reading on the BBB over the past 3 Beige Books is also consistent with the above-trend pace of GDP growth seen in both the second and third quarters of 2014, when the U.S. economy grew, on average, by 4.2%, well above the long-term average of around 3.0%. In addition, we found the word “weak” or its variants appeared just 17 times in the latest Beige Book and just 18 times, on average, in the last 3 Beige Books (September, October, and December 2014), well under half of the long-term average of 50 mentions and the fewest since mid-2005. This suggests to us that the negative headwinds that have held the U.S. economy back over the past seven years may finally be abating; and as of late November 2014, the global growth concerns around the drop in oil prices, the end of QE, and the rising U.S. dollar are overdone.

Uncertainty Fading, Healthcare Still a Concern, and Optimism Way Up, but Few Signs of a Global Growth Scare

The uncertainty and lack of confidence around fiscal policy (fiscal cliff, debt ceiling, sequester, government shutdown) that dominated the Beige Book for most of 2013 is now clearly fading, and despite the hand-wringing in the financial markets and in the media, these words were used just 8 times in the December 2014 edition of the Beige Book [Figure 3]. In the 8 Beige Books released in 2014 (including the December edition), the words noted above were mentioned a total of 75 times, or around 10 mentions per Beige Book. In contrast, these words were mentioned 65 times, on average, in each of the 8 Beige Books released in 2013.

As we wrote in our *Outlook 2014: The Investor’s Almanac*, we expected that concerns over government policy would fade during the course of this year, and that has largely been the case. But as 2014 winds down and 2015 begins, this policy-related uncertainty could make a comeback, with the potential of a government shutdown looming this week (December 8–12, 2014) and

3 Uncertainty Has Faded As Restraint on Growth

	Shutdown/Fiscal/Sequester/Debt Ceiling/Uncertainty/Confidence	Affordable Care Act/Healthcare
12/2014	8	15
09/2014	13	3
07/2014	9	2
06/2014	12	6
04/2014	12	17
03/2014	18	22
2013 Avg.	520 (65 per Beige Book)	178 (22 per Beige Book)
	 Words surrounding government policy are still trending lower but may increase in coming months	 ACA/healthcare fading but may pick up later this year

Source: LPL Financial Research, Federal Reserve Beige Book 12/03/14



the next debt ceiling deadline (March 2015) on the horizon. Please see our *Outlook 2015: In Transit* and this week's *Weekly Market Commentary* for more details.

The Affordable Care Act (ACA), and healthcare in general, has remained a consistent source of concern among respondents to the Beige Book, although the impact has faded a bit recently. The start of the enrollment period for the second year of healthcare coverage under the ACA began on November 15, 2014, within the data collection period for the December 2014 Beige Book. Despite that, the ACA (and healthcare in general) received just 15 mentions in the latest Beige Book, up from 14 mentions in the October 2014 Beige Book and the fewer than 10 mentions in the Beige Books released in the late spring and summer of 2014. On average, the ACA/healthcare saw 22 mentions per Beige Book in 2013, and saw as many as 33 mentions in the October 2013 Beige Book, during the enrollment period that began on October 1, 2013, for coverage in calendar year 2014.

Optimism on Main Street remains high despite the recent barrage of news on the rising dollar, the end of QE, and the drop in oil prices—and its potential implications for global growth. In the December 2014 Beige Book, the word “optimism” (or its related words) appeared 36 times, whereas the word “pessimism” did not appear at all. However, this is not the start of a new trend; in the 8 Beige Books this year, the word “optimism” has appeared, on average, 30 times in each edition. In 2013, “optimism” appeared, on average, 25 times per Beige Book. Looking back to the worst of the 2007–09 financial crisis and Great Recession, the word “optimism” appeared, on average, just 9 times in the 8 Beige Books released in 2009, whereas the word “pessimism” appeared, on average, 5 times.

Concerns that the economic and market environment we are in today is similar to the period just prior to the onset of the Great Recession in late 2007 also appear to be well overdone, based on this metric. In the 8 Beige Books released in 2007, the word “optimism” appeared, on average, just 10 times per edition—a far cry from the 30 times per edition in the 8 Beige Books released in 2014 [Figure 4]. ■

4 Optimism on the Main Street Economy Is Running High in the Beige Book

All 8 Beige Books of:	Optimism	Pessimism
2007	10	1
2009	9	5
2013	25	1
2014	30	0

Source: LPL Financial Research, Federal Reserve Beige Book 12/03/14

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance reference is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

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The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of U.S. Treasury securities).

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