

*In this month's recap: equity and commodity markets experience major losses, the Fed sends a hawkish message, home sales improve, and the economy maintains its momentum.*



# Monthly Economic Update

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*January 2019*

## THE MONTH IN BRIEF

December 2018 will be remembered for its volatility and its challenges. The S&P 500 flirted with bear market territory, dropping 10.16% for the month. Appetite for risk declined here and abroad in the face of tariffs, concerns about the Federal Reserve raising interest rates too quickly, a federal government shutdown, and questions about the Brexit. It was also a difficult month for commodities. In contrast, Main Street seemed in good shape: low unemployment, high consumer confidence, and strong consumer spending were all evident.<sup>1</sup>

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## DOMESTIC ECONOMIC HEALTH

While the Federal Reserve certainly pays attention to Wall Street's mood, it adjusts its monetary policy in respect to the economy, not the preferences of market participants. In December, the central bank did not exactly tell investors what they wanted to hear. Following the announcement of another quarter-point rate hike (the target range is now 2.25-2.5%), Fed chair Jerome Powell stated that monetary policy "does not need to be accommodative," and affirmed that the Fed would continue to remove up to \$50 billion per month of Treasury and mortgage-backed securities from its balance sheet. According to the latest Fed dot-plot, there would be no pause in tightening: two rate hikes were still envisioned for 2019. Major indices fell sharply after Powell's remarks.<sup>2</sup>

To justify its stance, the Fed could point to a number of economic indicators. The manufacturing and service sectors were seeing considerable expansion, by the look of the

Institute for Supply Management's November purchasing manager indices. ISM's non-manufacturing PMI rose 0.4 points to 60.7, and its factory PMI climbed 1.6 points to 59.3; these were great readings. (Additionally, the Federal Reserve said that industrial production rose 0.6% in November.) Department of Commerce data showed personal spending up 0.4% in October and retail sales advancing a decent 0.2%. Consumer confidence remained high. The University of Michigan's index finished December at 98.3, higher than its final November mark of 97.5. The Conference Board's monthly gauge came in at 128.1 – notably below its (revised) November reading of 136.4, but still at an impressive level.<sup>3,4</sup>

The Consumer Price Index was flat in November. The main reason? Cheaper fuel. Gasoline prices dropped 4.2%. Annualized inflation weakened to 2.2%, the smallest advance seen since February. Wholesale inflation, as measured by the Producer Price Index, ticked north 0.1%; in October, the gain was 0.6%.<sup>4,5</sup>

Job creation did fall short of expectations in the eleventh month of the year. Employers added 155,000 net new workers to their payrolls in November, the Department of Labor stated, and the October increase was revised down to 237,000. A Bloomberg survey of analysts projected a November jobs gain of 198,000. Headline unemployment stayed remarkably low, just 3.7%; the U-6 rate, which also counts the underemployed, rose 0.2% to 7.6%. Annualized wage growth remained at 3.1%. Average net monthly payroll growth for the September-November period was 170,000.<sup>4,6</sup>

By December, the ongoing U.S.-China trade dispute had cooled a bit, with negotiations continuing. December 1 marked the start of a 90-day “ceasefire,” with both nations agreeing not to impose additional import taxes until late in the first quarter of 2019. China actually scaled back some tariffs as the year ended; the U.S. was set to boost tariffs on as much as \$200 billion of Chinese goods effective this month.<sup>7</sup>

Lastly, the end of 2018 was very good for retailers. Mastercard Pulse measured a 5.1% year-over-year increase in retail purchases between November 1 and December 24, resulting more than \$850 billion in purchases – the best holiday retail sales season in six years.<sup>8</sup>

## GLOBAL ECONOMIC HEALTH

In December, the United Kingdom witnessed a parliamentary deadlock over the Brexit, with Prime Minister Theresa May withdrawing a scheduled vote over her deal with the European Union in the face of probable legislative defeat. In fact, as Christmas approached, there was no clear majority in Parliament favoring any of the Brexit options: May's deal, the no-deal Brexit (an outcome that would dismay corporations), a “managed” no-deal, or another national vote on the matter. The U.K.'s March 29 deadline to leave the E.U. remains. In other euro area

news, yearly inflation fell sharply in the region to 1.9% in November, descending from 2.2% in October.<sup>9,10</sup>

While China's statistics bureau said recently that the country was on track to reach its 6.5% economic growth target for 2018, signs of a slowdown emerged. In December, the country's factory output contracted for the first time in nearly three years, with its official manufacturing PMI falling to 49.4. The November Markit manufacturing PMIs for other key Asian economies indicated either minor month-over-month factory sector expansion (slightly above 50) or contraction (below 50). Japan's Markit PMI came in at 51.8 (though it recovered to 52.4 in December); Taiwan's, at 48.4; South Korea's, at 48.6.<sup>11,12</sup>

## WORLD MARKETS

Yes, December brought substantial losses for other major equity benchmarks – though generally speaking, the losses were smaller than the ones seen in the U.S. While the Nikkei 225 slid 10.10% last month, the common December loss was single-digit: 5.76% for the TSX Composite, 1.53% for the Bovespa, only 0.22% for the Bolsa, 6.55% for the DAX, 5.46% for the CAC-40, 3.61% for the FTSE 100, 5.92% for the IBEX 35, 2.49% for the Hang Seng, 4.14% for the Shanghai Composite, and just a respective 0.35% and 0.13% for the Sensex and the Nifty 50.<sup>13</sup>

How about some of the regional and multinational indices? Well, the MSCI World slipped 7.71%, while the MSCI Emerging Markets declined 2.92%. The FTSE Eurofirst 300 took a 5.44% loss. On a positive note, two emerging market benchmarks saw double-digit gains in 2018: Russia's Micex advanced 12.16%; Brazil's Bovespa, 15.03%.<sup>13,14</sup>

## COMMODITIES MARKETS

Dollar strength put pressure on this sector in 2018; the U.S. Dollar Index gained 4.64% for the year, a performance better than that of many commodities. Gold and silver moved up in December. The yellow metal gained 5.11% to reach \$1,284.50 on the COMEX on New Year's Eve. Silver rose 9.90% for the month to \$15.54 on the COMEX. Across 2018, gold lost 2.42%; silver, 9.14%. Copper retreated 5.17% last month, and platinum settled 1.29% lower.<sup>15,16</sup>

Oil prices kept falling. In December, WTI crude declined 9.64% to finish out the year at \$45.83 on the NYMEX. For all of 2018, crude retreated 24.05%. Unleaded gasoline suffered a 7.45% December setback. Heating oil fell 7.83%. All of that paled next to natural gas, which plunged 36.01%. Most key crops also went negative on the month: soybeans lost 1.26%; wheat, 2.42%; coffee, 2.88%; sugar, 3.50%; cotton, 8.52%. Cocoa and corn were notable exceptions, the former advancing 11.85%, and the latter, 2.46%.<sup>16</sup>

## REAL ESTATE

More homes sold in November – more existing homes, that is. The National Association of Realtors said that resales improved 1.9% in the penultimate month of the year, and that followed the 1.4% gain seen in October. The trend might not continue, though, as NAR’s pending home sales index retreated 0.7% in November. (Due to the federal government shutdown, the Census Bureau’s November new home sales report was still pending at this writing.) Housing starts and building permits were both up for November: groundbreaking increased 3.2%, and the pace of permits issued improved 5.0%.<sup>4</sup>

Home loans grew cheaper in December. Back on November 29, Freddie Mac’s Primary Mortgage Market Survey listed the mean interest rates on the following loans: 30-year FRM, 4.81%; 15-year FRM, 4.25%; 5/1-year ARM, 4.12%. By the December 27 Freddie Mac survey, everything was cheaper: 30-year FRM, 4.55%; 15-year FRM, 4.01%; 5/1-year ARM, 4.00%.<sup>17</sup>

The NAR reported a median existing home sale price of \$257,700 in November, up 4.2% from November 2017. Another key measure of annualized gains, the 20-city composite S&P CoreLogic Case-Shiller home price index, had risen 5.0% year-over-year through October.<sup>18,19</sup>

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### TIP OF THE MONTH



*If you have a high-interest credit card, you may want to search to see if you can refinance the balance to a lower-interest card. A lower-interest card means a greater percentage of your payments will be applied to principal rather than interest.*

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### LOOKING BACK, LOOKING FORWARD

During one of the most volatile months in recent Wall Street history, the S&P 500 had nine intraday moves of at least 1% (as opposed to eight such instances during all of 2017), and the Dow Jones Industrial Average gained 1,000 points in a day for the first time. The ups and downs tested the patience of investors large and small. When the month ended, the most esteemed Wall Street indices were considerably lower. The S&P 500 ended the year at 2,506.85; the Dow, at 23,327.46; the Nasdaq Composite, at 6,635.28. The small-cap Russell 2000 wrapped up 2018

at 1,348.56, taking a 12.94% December fall and losing 12.18% for the year. The CBOE VIX soared 54.62% for the month and 130.25% for 2018, settling at 25.42 on December 31.<sup>1,20</sup>

MARKET INDEX	Y-T-D CHANGE	1-MO CHANGE	2017
DJIA	-5.63	-9.68	25.08
NASDAQ	-3.88	-10.83	28.24
S&P 500	-6.24	-10.16	19.42
YIELD	12/31 RATE	1 MO AGO	1 YR AGO
10 YR TIPS	2.69	3.01	2.40

Sources: wsj.com, bigcharts.com, treasury.gov - 12/31/18<sup>1,21,22</sup>

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

10-year TIPS real yield = projected return at maturity given expected inflation.

At this moment, investors old and young are looking at their portfolios and wondering what moves might be appropriate. How about no moves at all? At its core, a saving and investment strategy for a pre-retiree is developed based on risk tolerance, time horizon, and goals, and that big-picture approach takes episodes of market instability (and market downturns) into account. A deviation from that strategy may be ill-advised. If you are wondering about the outlook for Wall Street for 2019, many prognostications are bullish, some to remarkable degree. *USA TODAY* recently polled a range of Wall Street investment strategists, and they thought the S&P 500 would gain about 25% this year, on average. Is this just wishful thinking, drenched in blue sky? Anything is possible, but to encourage returns like that, it might help to have a pause in tightening by the Fed, an end to the trade war between China and the U.S., a comeback for oil, and earnings calls that contradict worries about corporations becoming slightly less profitable. January will likely see more of the volatility witnessed in December, hopefully less pronounced. This month and this year, investors will appreciate the core principle of diversification, for little is certain about the next few months on Wall Street.<sup>23</sup>

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#### QUOTE OF THE MONTH



*“Make your life a mission – not an intermission.”*

ARNOLD GLASOW

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## UPCOMING RELEASES

January's roll call of major economic news items includes the December employment report from the Department of Labor (1/4), ISM's December non-manufacturing PMI (1/7), a new Consumer Price Index (1/10), the latest Producer Price Index (1/15), December retail sales and a new Federal Reserve Beige Book (1/16), December housing starts and building permits (1/17), December industrial output and the preliminary January University of Michigan consumer sentiment index (1/18), the latest existing home sales report from the National Association of Realtors (1/22), a fresh Conference Board leading indicators index (1/24), December new home sales and durable goods orders (1/25), the latest Conference Board consumer confidence index and the November S&P CoreLogic Case-Shiller home price index (1/29), a Federal Reserve policy decision, ADP's January payrolls data, and NAR's index of housing contract activity for December (1/30), and finally, the December PCE price index and consumer spending report (1/31).

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### THE MONTHLY RIDDLE



*You can see right through me. Different lights make me strange,  
and for each one, my size may change. What am I?*

*LAST MONTH'S RIDDLE: It is often surrounded by water and at risk from waves, and it has a fin rather than a sail or motor, but without water and waves, there would be no real use for it. What is it?*

*ANSWER: A surfboard.*

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