The Advisor Weekly™

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Striving to provide the best tools that can be used to authoritatively communicate unfolding financial and economic events.

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What to keep an eye on . . .

Report	Previous	Forecast	Day
NFIB Small Business Optimism Index	97.9	99.0	Tuesday
JOLTS, job openings and labor turnover	5.028 mln	5.075 mln	
Wholesale inventories	0.1%	0.1%	Wednesday
Weekly jobless claims	320k	309k	Thursday
Retail sales**	-0.8%	0.3%	
Ex-autos	-0.9%	0.5%	
Ex-autos, gas stations	0.2%	0.5%	
Import prices	-2.8%	0.2%	
Business inventories	0.1%	0.1%	
Producer Price Index	-0.8%	0.3%	Friday
Core PPI	-0.1%	0.1%	
Preliminary consumer sentiment	95.4	96.0	

Source: Bloomberg, Barron's – forecasts subject to change; Releases in red merit extra attention
**more likely to impact markets

It's a week that's mostly devoid of big releases, with the exception of **retail sales**.

> We're looking for signs that savings at the gas pump are being spent in the broader economy. Spending at restaurants and bars has surged, but that's about it so far.

JOLTs (job openings, labor turnover) – it's on Yellen's dashboard so this release gets some press

Deflation in **import prices** is probably playing a role in holding down core inflation

> Thank the surging dollar and lackluster global growth, which translates into extra capacity and lack of pricing power

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Mar 2

(MarketWatch) – **China cuts rates**

- In a surprise move, the People's Bank of China on Saturday cut the one-year loan to 5.35% and the one-year deposit rate to 2.5%, both by a quarter of a percentage point.
- The central bank signaled in a statement that a looming threat of deflation was a trigger for the rate cut.

(NY Times) – **Vice Fed Chair Stanley Fischer suggests Fed will give less guidance**

- "It seems to me that you unnecessarily constrain yourself."

(Reuters) – **Stanley - Fed will not follow robotic rate-hike path, Fischer says**

- "I know of no plans to behave by following one of those deterministic paths for the next three years," referencing the steady stair-step march of the last decade
- No need to telegraph every Fed action, not for hiking at every meeting, Fed getting closer to hiking rates on data

Mar 3

(Reuters) – **U.S. running out of room to store oil; price collapse next?**

(WSJ) – **India cuts rates for 2nd time this year**

- Reduces its main repurchase rate by 0.25 percentage point to 7.5%, citing weakness in parts of the economy as well as favorable inflation figures

(Reuters) – **Dollar index 11-year high at 95.730**

(Reuters) – **Fitch: Failure by Greece to reach durable agreement with EZ would lead to downgrade**

Mar 4

(WSJ) – **Exxon to reduce capital spending by $4.5 billion or 12% in 2015**

- Exxon joins more than 4 dozen U.S. energy producers that have announced plans to curb capital spending in 2015 by more than $50 billion compared with last year's budgets

Wow!

(Bloomberg) – **India surprise, cuts key rate from 7.75% to 7.50%**

- 2nd move in less than 2 months as inflation slows

(Fed) – **Fed Beige notes slight moderation in growth, flat to slight price increases, some troubles in the energy sector**

Mar 5

(Reuters) – **China announces growth target of 7%**

- Beijing plans to lift government spending to 17.15 trillion yuan ($2.74 trillion) in 2015, an increase of 10.6% on 2014
- Last year's 7.4% growth was slowest in 24 years

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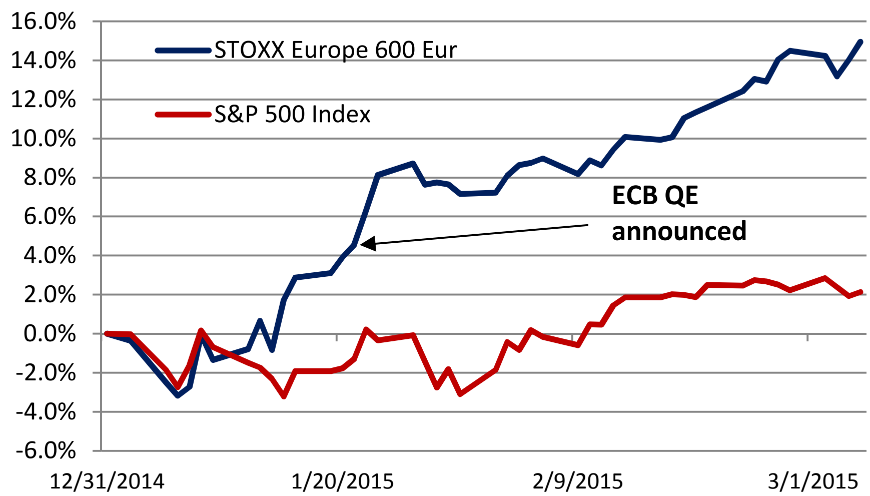
(WSJ) – **ECB raises economic forecasts for euro zone ahead of QE**

- It now expects 1.5% growth this year, 1.9% in 2016 and 2.1% in 2017. It previously had predicted growth of 1% in 2015 and 1.5% in 2016

A winner this year—The Stoxx Europe 600 Index of equities (priced in euros) across the eurozone, which had risen 15% year-to-date on stimulus hopes, added almost 1% after Thursday's meeting

QEuphoria

European vs U.S. stocks



Data Source: STOXX, St. Louis Federal Reserve

Greek worries!? What worries?

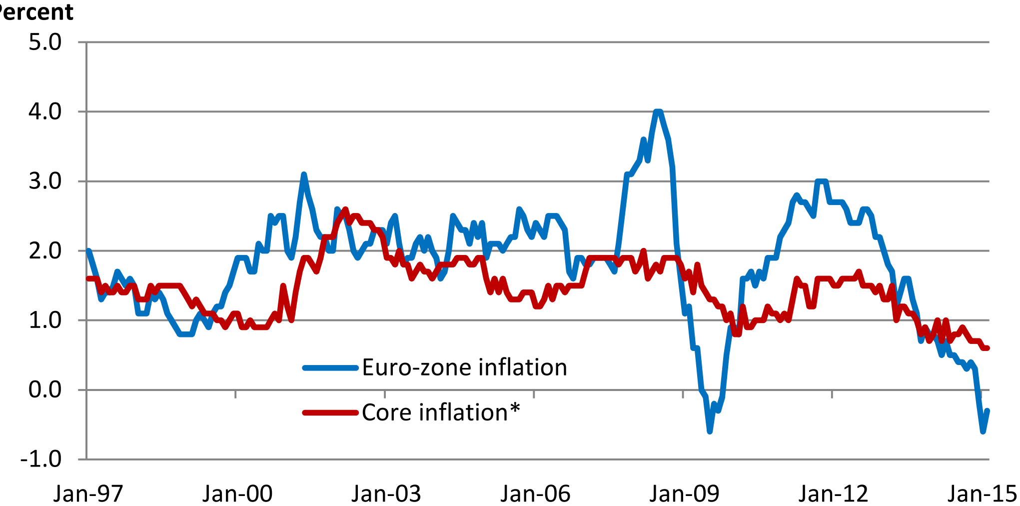
Bond buys—

> The ECB will buy €60 billion a month in mostly government bonds between March and Sept. 2016. Draghi added the bank would buy government bonds even if they carry a negative yield—but only to the level of the ECB's deposit rate—meaning it won't purchase bonds with a negative yield in excess of -0.20%

He's not concerned there will be a lack of bonds to buy

Euro-zone CPI

Percent



Data Source: Eurostat *core excludes excludes food, energy, alcohol, tobacco

Core held steady at 0.6% in March;

Headline rose from -0.6% to -0.3%

(Reuters) – **SF Fed Williams – Fed shouldn't be too patient on hiking rates**

- Early-gradual hikes preferred over sharp hikes later, waiting too long risks overshooting inflation, sharp hikes risks destabilizing markets, damaging recovery, eyes maximum employment by year-end, inflation "normal" in 2 years

Mar 6

(Fed) – **31 large banks pass Fed stress test**

- The most severe hypothetical scenario projects that loan losses at the 31 participating bank holding companies would total $340 billion during the 9 quarters tested.
- The "severely adverse" scenario features a deep recession with the unemployment rate peaking at 10%, a decline in home prices of 25%, a stock market drop of nearly 60%, and a notable rise in market volatility.
- The aggregate tier 1 common capital ratio, which compares high-quality capital to risk-weighted assets, would fall from an actual 11.9% in the third quarter of 2014 to a minimum level of 8.2% in the hypothetical stress scenario.
- This hypothetical post-stress minimum is significantly higher than the 31 firms' aggregate tier 1 common capital ratio of 5.5 percent measured in the beginning of 2009.
- No green light yet, but it sets the stage for return of capital for most banks
- Zions, Morgan Stanley and Goldman Sachs came in at the bottom

(Reuters) – **Greek central bank chief: Greek banks are fully recapitalized, no problem with deposits**

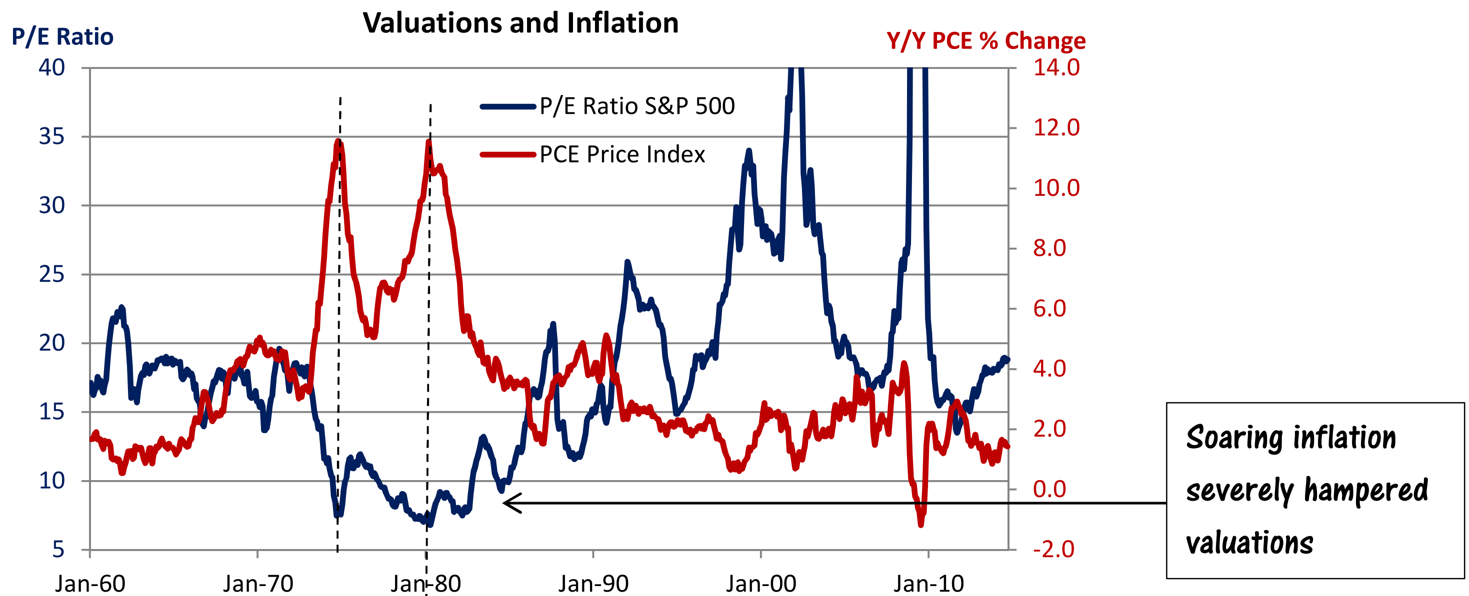
- Hmmmm, we'll see

(WSJ) – **Apple to replace AT&T in the Dow Jones Industrials**

- Apple will join the Dow at the close of trading March 18

(Reuters) – **Dollar Index makes new 11-year high 96.727**

Stocks, PEs, and low inflation



Data Source: Yale Econ Online Shiller, St. Louis Federal Reserve

Date as of Sept 2014

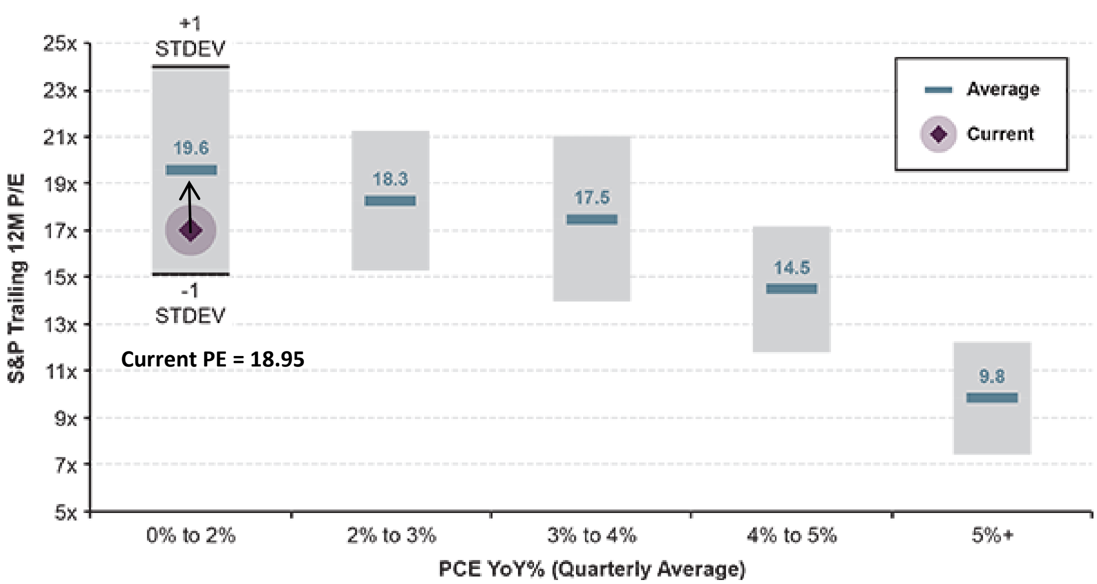
Feb 27 Trailing P/E Ratio = 18.95 per WSJ

Monthly correlation = -0.51

Low inflation is a support for valuations—

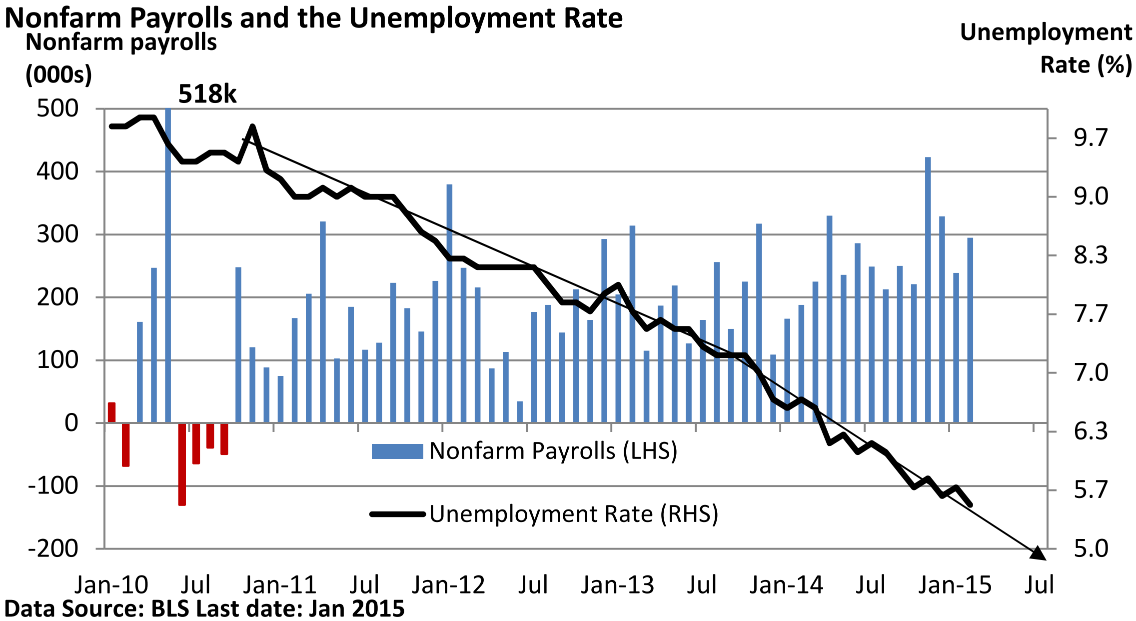
- It increases the quality of earnings, as earnings growth is not simply a general increase in prices
- Low inflation encourages a more accommodative Fed policy

HISTORICAL P/E RATIO IN DIFFERENT INFLATION ENVIRONMENTS



Source: Bloomberg, Guggenheim Investments. Data as of 2/25/2014

Full employment? Yep, according to the Fed



The Fed considers 5.2-5.5% as full employment

We're at the top of the range!!

Nonfarm payrolls rose a healthy 295k in Feb – weather? port slowdown? it's not showing up in the aggregate data

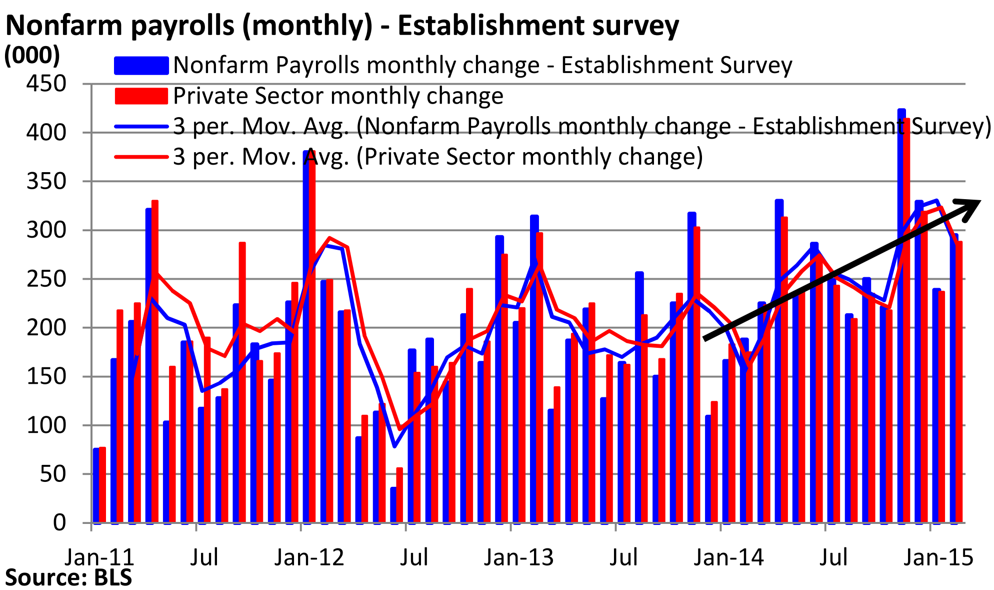
The **Unemployment Rate** fell from 5.7% in Jan to 5.5% in Feb

- Much was due to a drop in the labor force; a 0.1% drop in the labor force participation rate to 62.8%
- Employment rose by 9k in the Household Survey, labor force fell by 178k; Last month's 1.05 million growth in labor force was distorted by annual change in population control

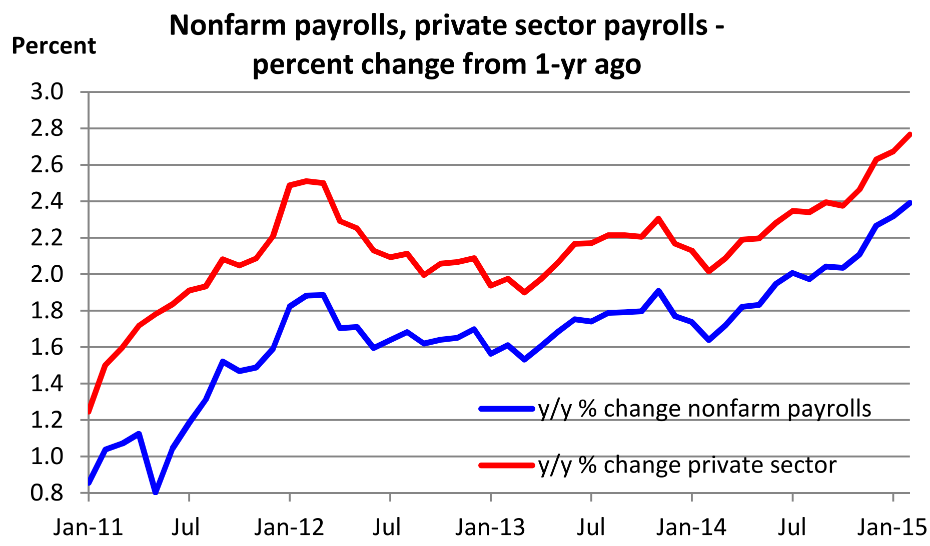
This super simple model for 'forecasting' the unemployment rate has worked well over the last year

If we continue on the same path, we could see a jobless rate of 5.0% or less by July

A zero fed funds rate and 5% jobless rate!!??



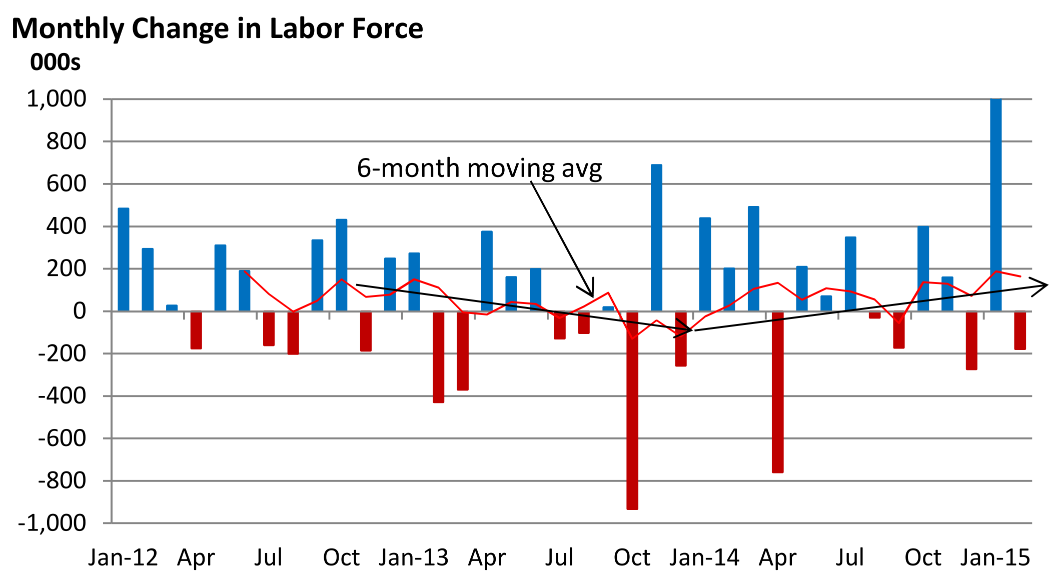
Job growth is nearly all in the private sector – and it has been accelerating



Data Source: BLS

Easy comparisons from Dec/Jan of last year due to weather, but we're seeing a real acceleration in job growth

While job growth is strong, it's not all blue skies – labor force growth fell



Data Source: BLS

Note the heavy volatility in monthly changes in the civilian labor force.

Jan's surge was affected by the annual change in population controls.

Feb saw some give back. Six-month moving avg wiggles in a narrow range

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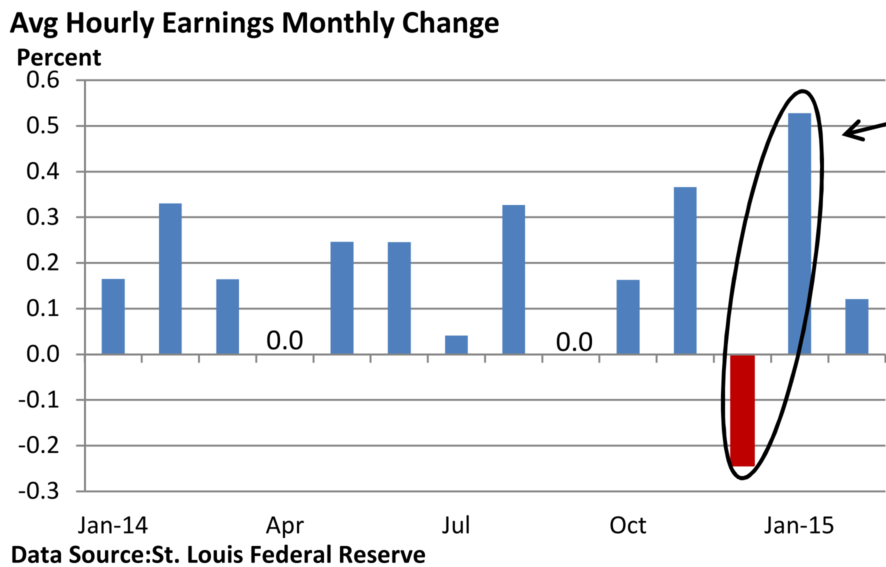
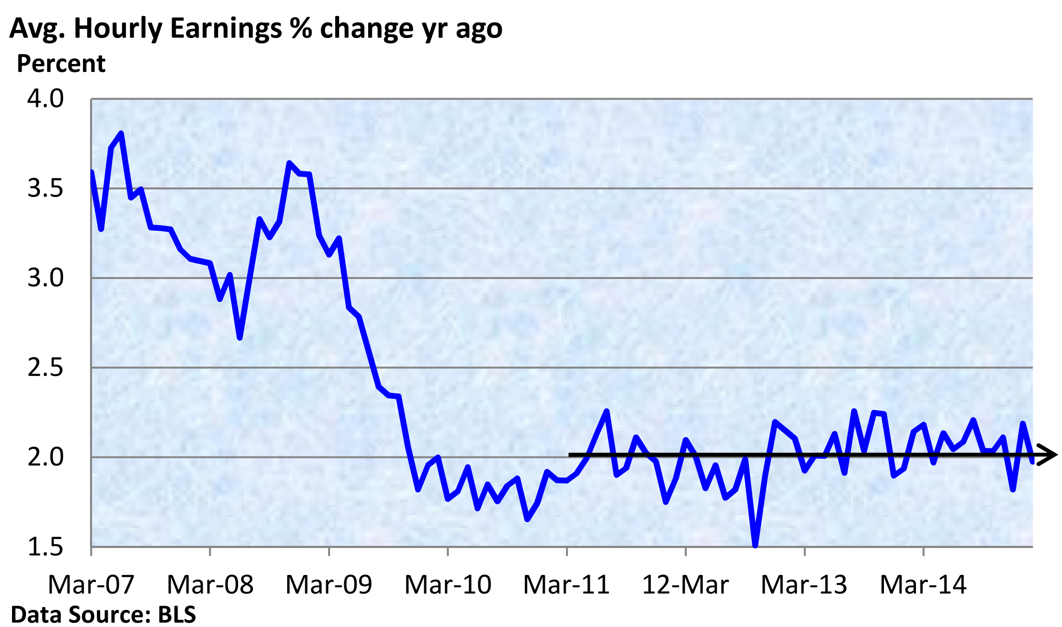
…And we're still waiting on wage growth



Throw out Dec and Jan. Statistical quirks created by calendar distortions

We're still not seeing wage growth



Steady but slow wage growth

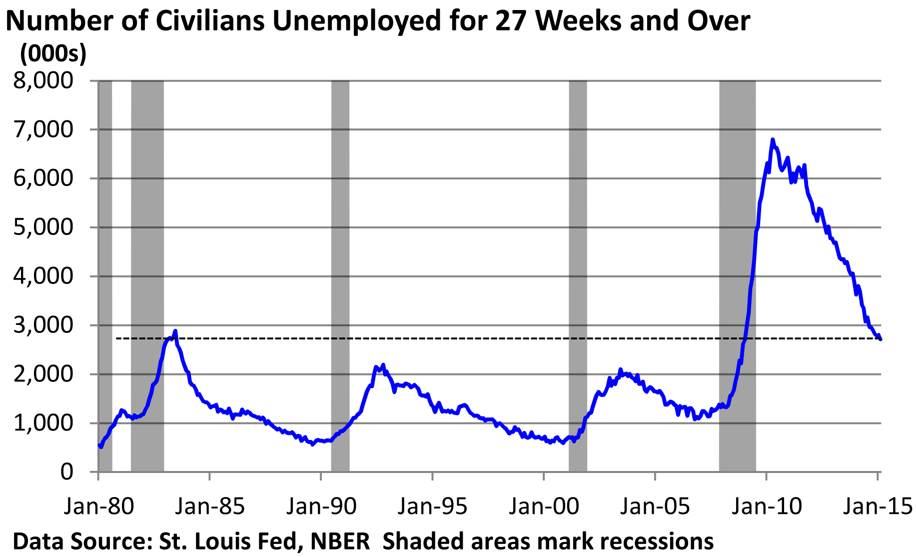
Year-over-year slowed to 2.0% from 2.2%

Disconnect – Wage growth is weak and the unemployment rate is falling

Is there more slack in the labor market than the unemployment rate suggests or are there distortions in avg hourly wages, i.e., boomers retire from higher wages and millennials taking jobs at lower wages?

Key measures (BELOW) are moving in the right direction but more progress is needed

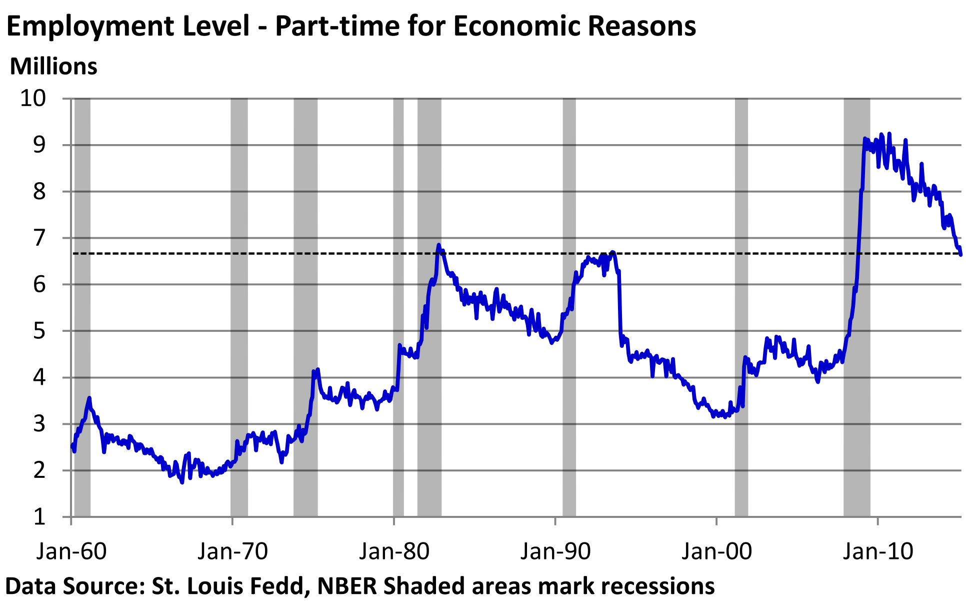
What's holding up wage growth? Possibly an oversupply of labor in the labor market



Tremendous progress has been made, but the long-term unemployed soared in the recession;

More progress is needed

The long-term unemployed fell by 91k to 2.71 million in Feb; it's a cyclical low but remains elevated



We remain near the tops of the 1990 and 1982 recessions

Part-timers who want full time work but can't find full-time work fell 175k to 6.64 million

Like the long-term unemployed, there has been strong progress but more is needed

Bottom line—

Both groups represent an available supply of labor – it's supply and demand; an ample pool of labor keeps pressure on wages

Job growth and a Fed rate hike – the Fed is losing patience

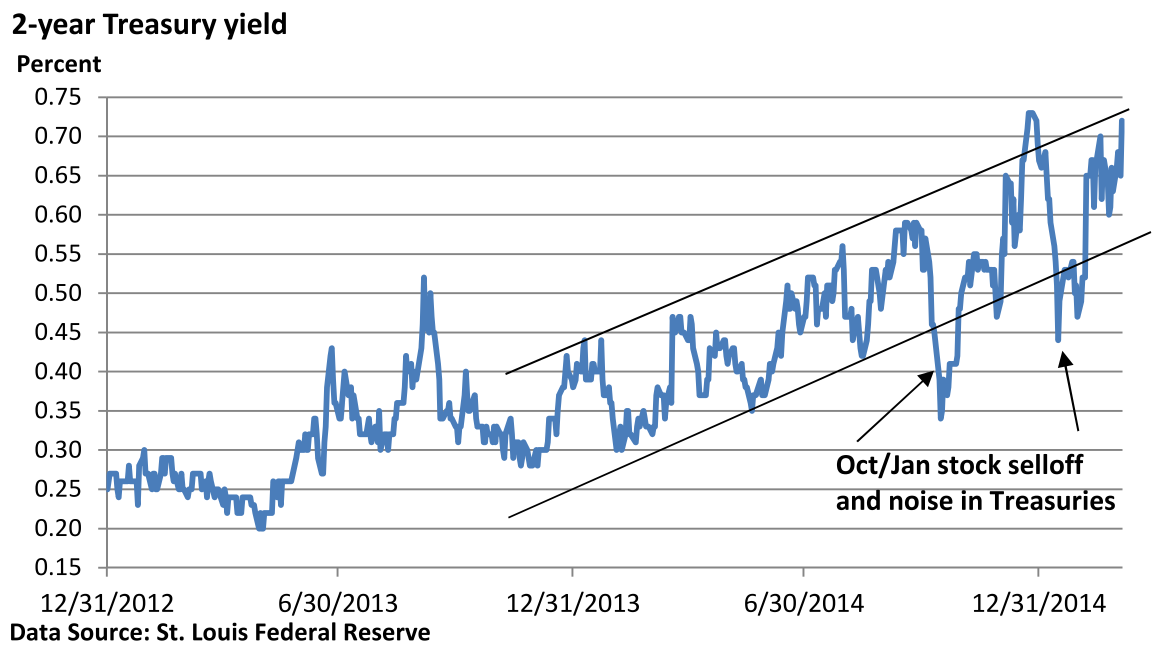
Strong job growth but weak wage growth

Fed fund futures priced in a nearer term hike following the report

Its seems likely that the Fed will remove its "patient" verbiage regarding rate hike at the March 17-18 meeting, which would give it flexibility to move at the June meeting

Yellen hinted at this in last month's testimony but emphasized that removing "patience" does not foreordain a June rate hike. It just gives the Fed the flexibility to move if it feels the data warrant such a move.

We're likely to soon get past liftoff talk and into a discussion as to how gradual or how quickly the Fed will raise rates – Yellen's #2, Stanley Fischer, said recently he doesn't want the predictable pattern of 25b bp hikes as we saw last decade



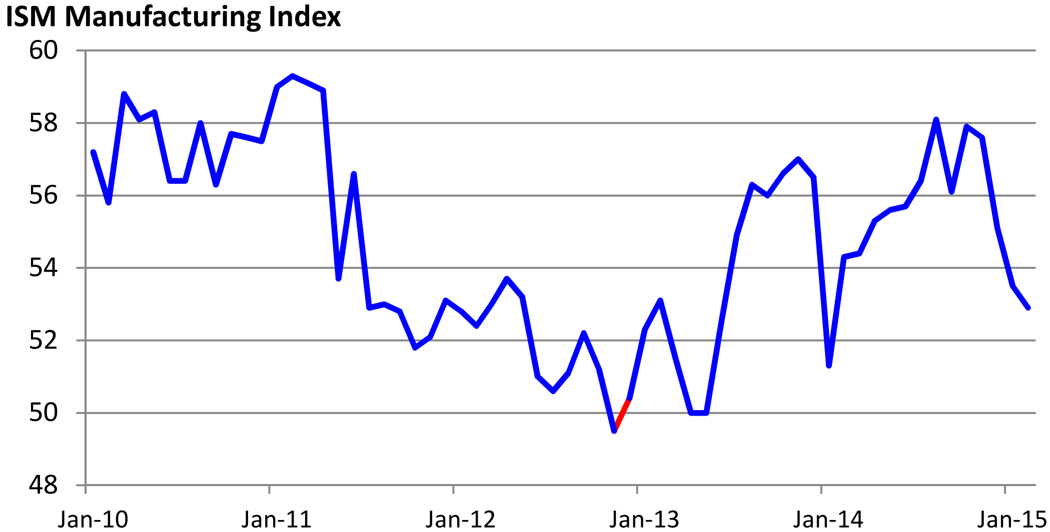
It's very volatile but the 2-year yield is a good proxy for the fed funds rate.

The trend is upward as investors are pricing in more of a mid-year hike than a fall hike in rates

Fed funds futures are pricing in a 25bp fed funds rate in July and a 50 bp fed funds rate in Nov

There is a 20% chance of a fed rate hike in June, up from 15% on Thursday. Despite weak wage gains, sentiment shifted following the strong gain in jobs (CME Group)

Manufacturing Moderating



Data Source: ISM

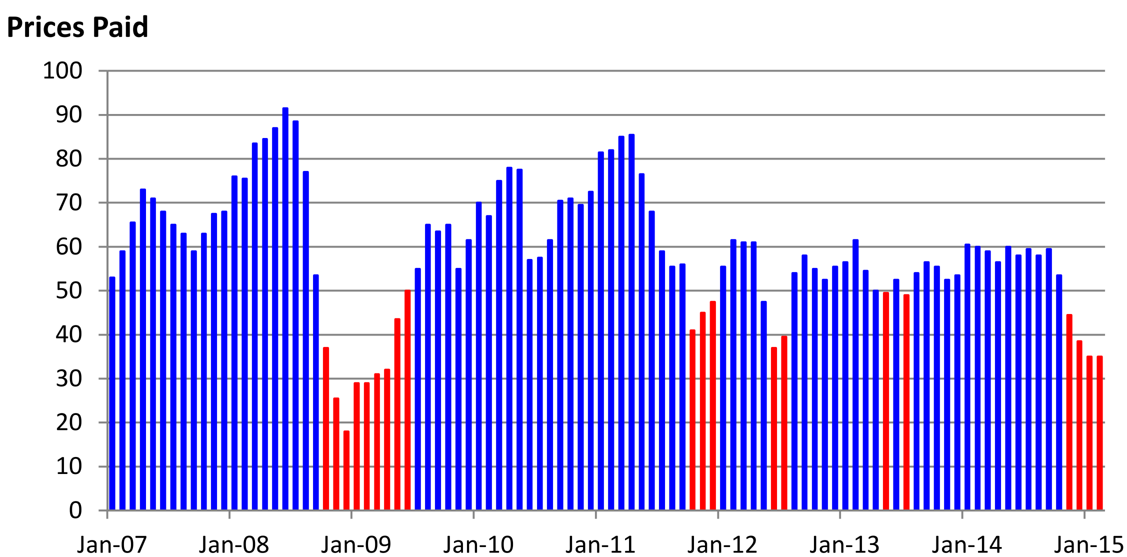
A reading of 50 suggests manufacturing is neither expanding nor contracting

The **ISM Manufacturing Index** fell from 53.6 in Jan to 52.9 in Feb, the lowest reading since last Jan, when a cold winter slowed activity

- 4-straight slowdowns point to moderation in manufacturing

Plenty of comments of the West Coast port slowdown (a couple below); the union has recently come to an agreement. And there is the collapse in oil prices and the impact on capex – this will be a longer-term problem

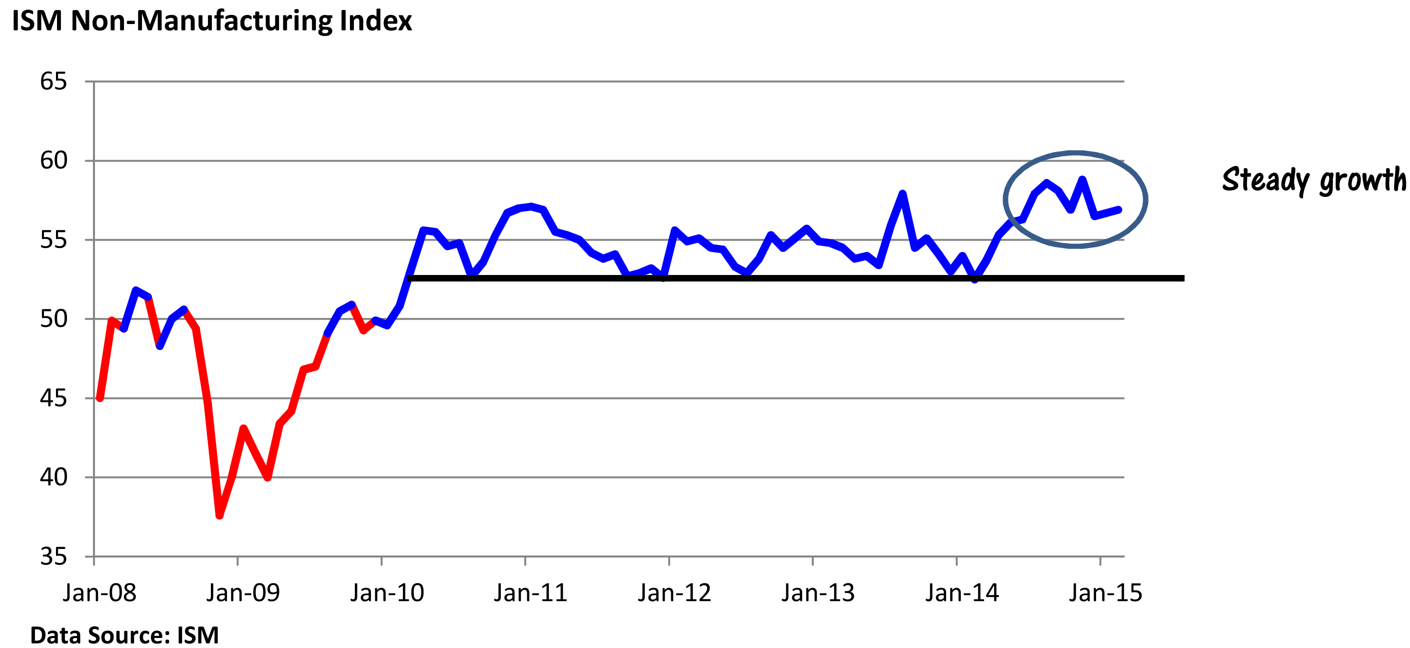
> *"West Coast port issue has been a problem for exporting." (Food, Beverage & Tobacco Products)*
> *"The dock delay on the West Coast is seriously impacting the supply chain logistics." (Computer & Electronic Products)*
> *"Lower oil and natural gas prices continue to put pressure on our revenues. We continue to pursue capital budget cuts and rate reduction efforts with our suppliers." (Petroleum & Coal Products)*



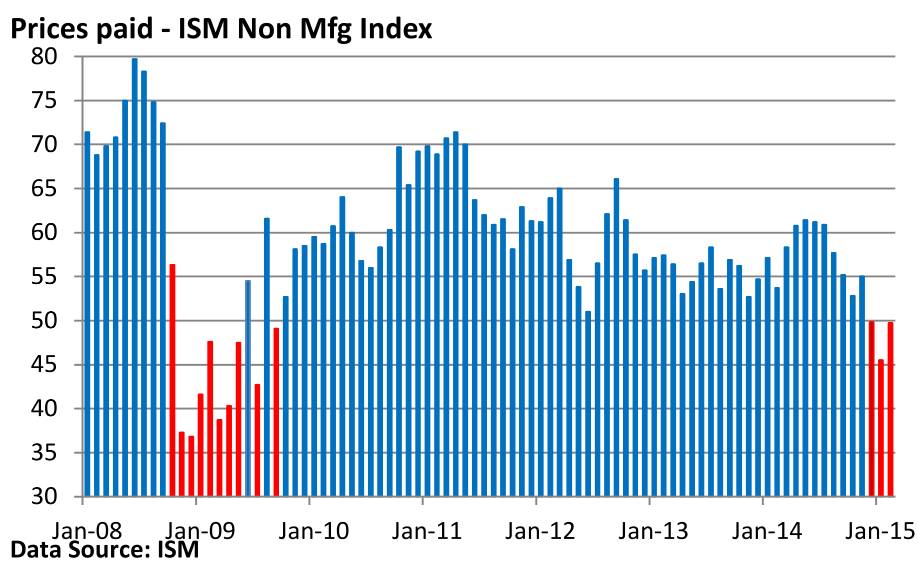
Data Source: ISM

Prices paid holds at 35

4-straight months below 50, as the drop oil prices influences input costs



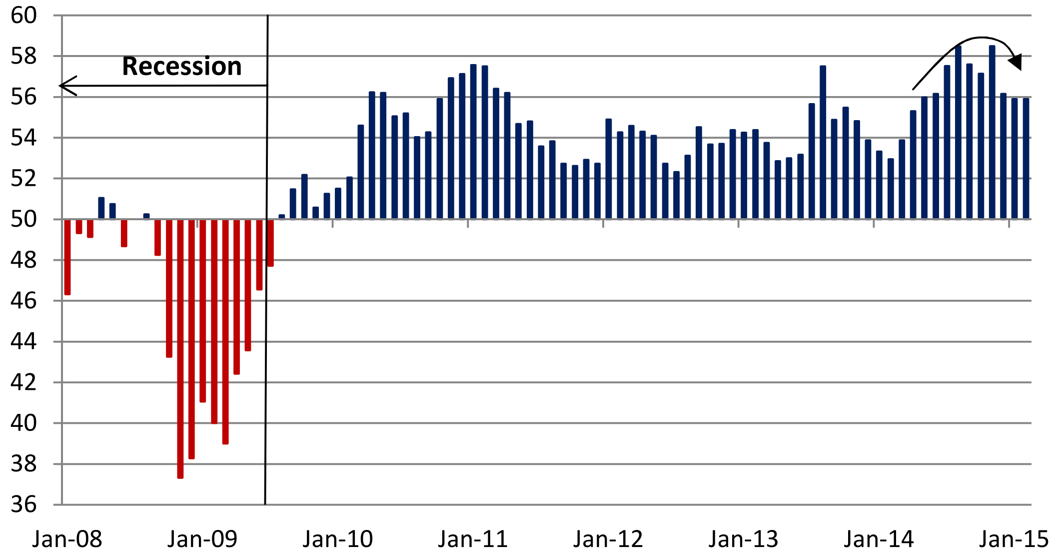
The measure of the service economy rose by 0.2 to 56.9 in Feb – steady growth



Prices tick up from 45.5 to 49.7,

We'd expect services to hold up better than manufacturing amid the slide in oil prices, but at below 50, there are no pricing pressures at the early stages of production based on the survey

ISM Manufacturing/ISM Services



Data Source: ISM, NBER

A composite of 25% of ISM Mfg + 75% of ISM Non-Mfg

Moderation – 55.9 suggests healthy/moderate growth

But ISM composite points to a moderation in growth from last fall

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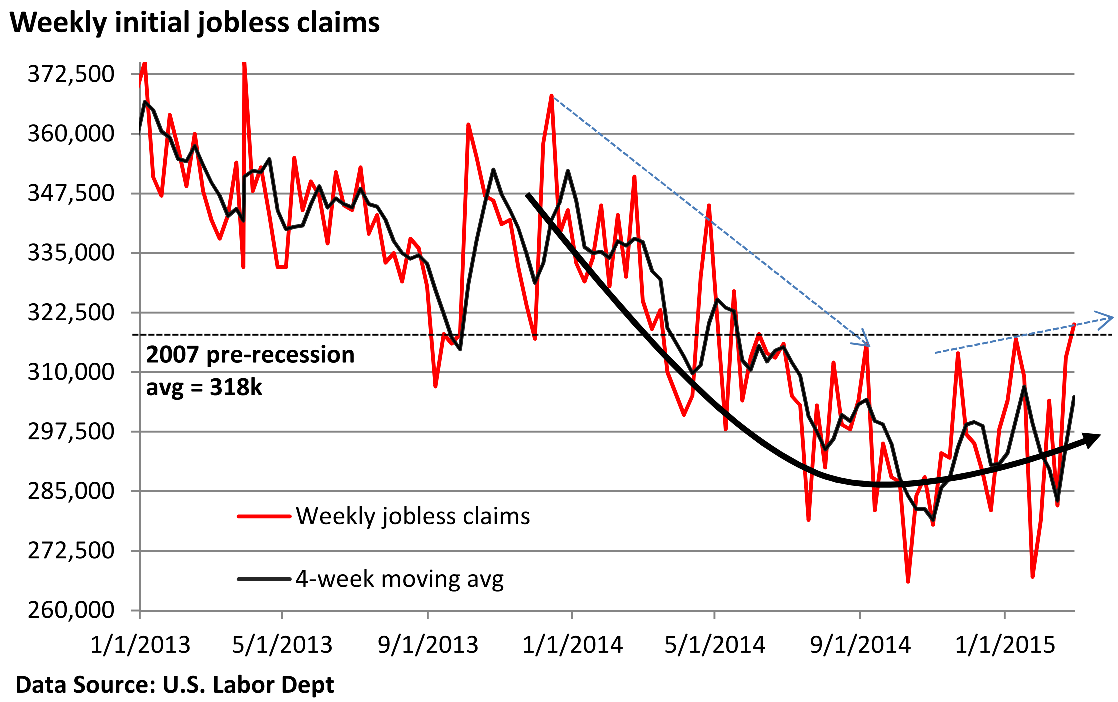
Creeping higher



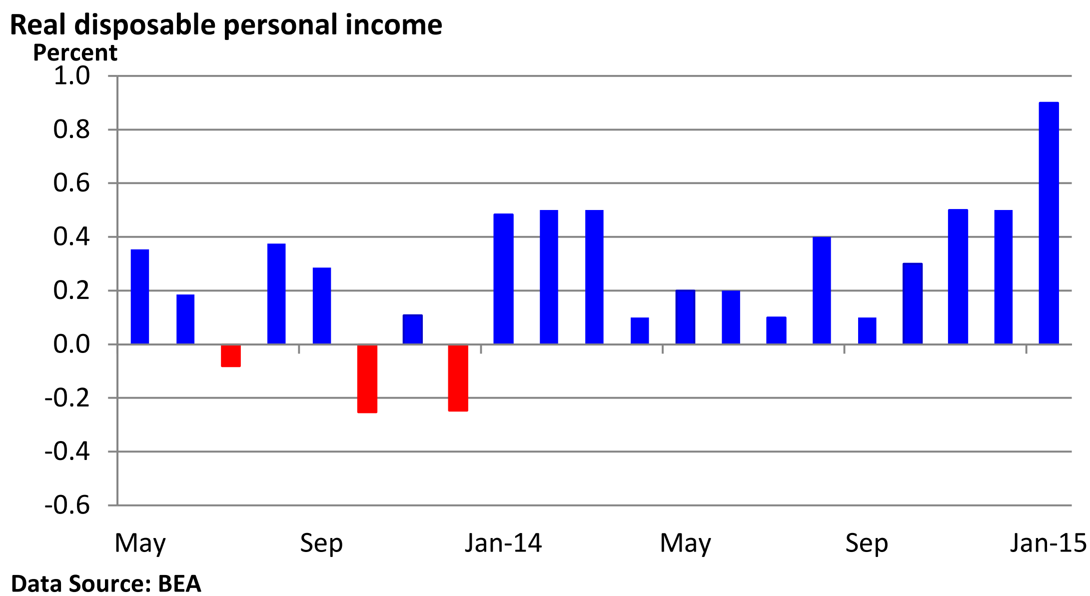
Initial weekly jobless claims edged up 7k to 320k in the latest week, the highest reading since May 2014

- 6 of the last 9 weeks have been above 300k

Jobless claims are sometimes subject to weekly noise and quirks in the seasonal adjustment process, but it's a good leading indicator of activity as companies in the aggregate won't let workers go unless demand is slackening; the opposite holds true, too.

- The recent rise, which has been modest, suggests a moderation in growth – similar to ISM Indexes
- Cutbacks in oil/oil related industries without the corresponding rise in consumer activity?

Rising aggregate income



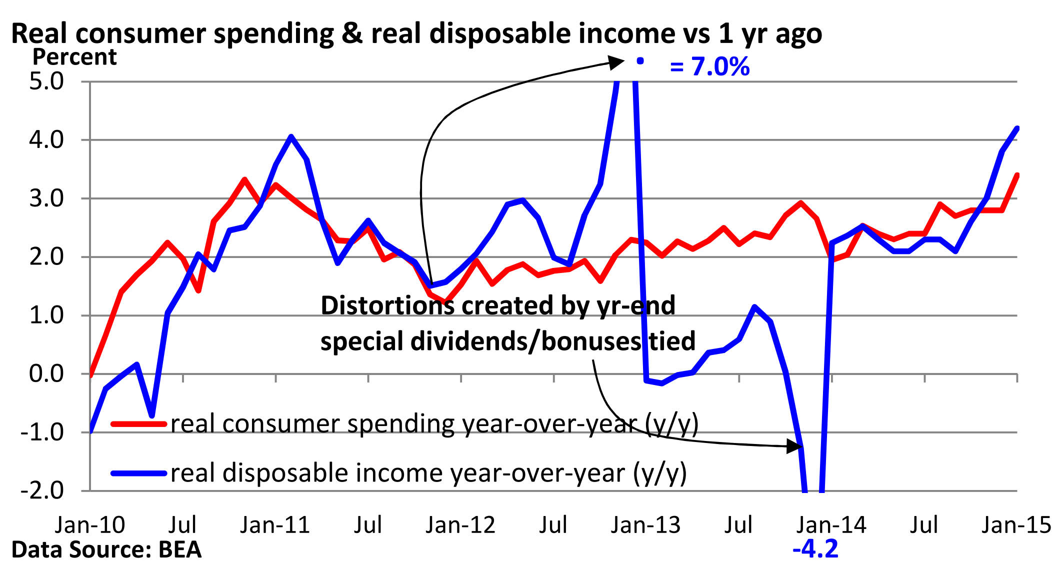
Real disposable income rose 0.9% in Jan; unadjusted for the drop in the PCE Price Index, disposable income increased 0.4%

Real consumer spending increased at a modest 0.3% in Jan following a 0.1% drop in Dec

Rising income is a definite plus for the economy – employment is up and higher wages accounted for much of the gain but so are govt transfer payments

"Government transfers to persons are up 5.9%, largely driven by Obamacare; Medicaid spending is up 11.8% versus a year ago. Outside Medicaid, government transfers are up a more tepid 4.5% in the past year and unemployment compensation is at the lowest level since 2007." –First Trust

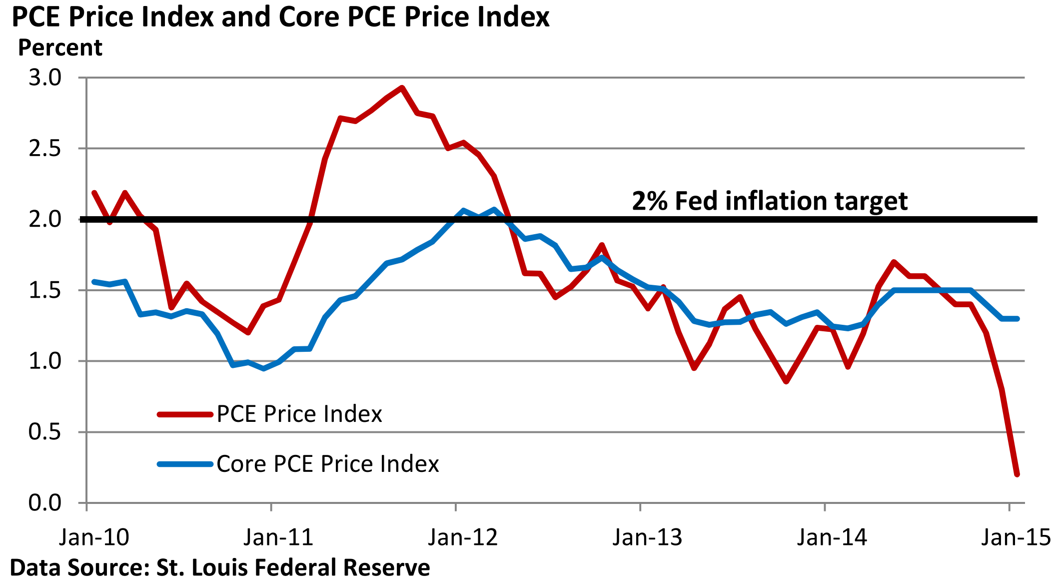
- Though it's a tailwind for spending, rising govt transfer payments tend to redistribute to less productive sources within the economy



Though the rise in spending is encouraging, much of the upturn in Jan occurred amid easy y/y comparisons

Spending was hampered last year due to the harsh winter

Slowing inflation

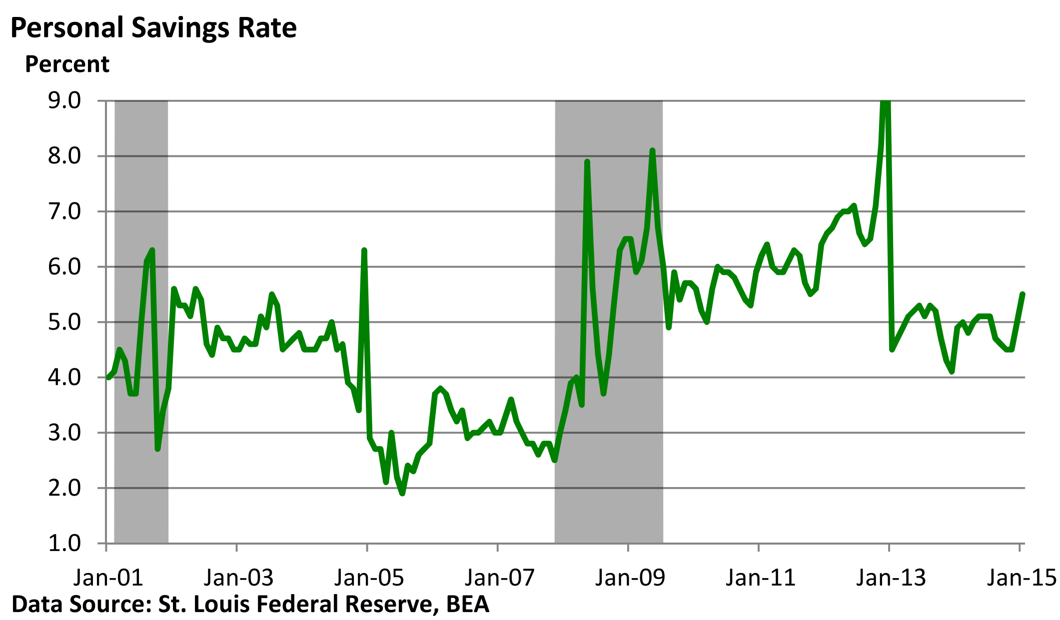


The Fed-favored **PCE Price Index** slowed from 0.8% y/y in Dec to 0.2% y/y – it's all about oil

So the focus is on core inflation, which minuses out food and energy

The core PCE Price Index held steady at 1.3% y/y but it is down from last year's peak of 1.5% y/y

- Most of the modest slowing is probably related to falling import prices, which are in deflationary territory – weak global growth and the strong dollar are keeping import prices under a tight lid
- The Fed wants to see evidence that prices are moving back toward their target of 2% before it hikes rates



Savings is up from 4.5% in Nov to 5.5% in Jan

Cash goes from the gas tank to savings accounts

The **savings rate** rose from 5.0% to 5.5%

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