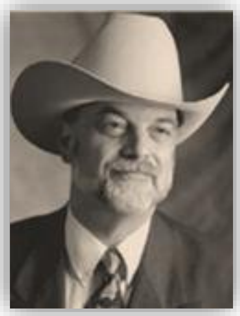

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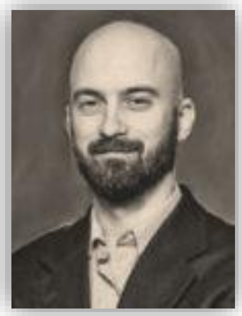

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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) turned in a very respectable rise of 2.54% for the week ending February 15, closing at 2775.60. The index has risen 10.67% this year but remains down about 5.3% from last year's September high. There was plenty of economic reason for the market to fall for the week and it did take a bit of a dip on Thursday, but with every rumor or tweet suggesting the threatened 25% tariff on Chinese imports was less likely, the market jumped upward in a knee-jerk reaction. The evidence continues to suggest that the threat of a major trade-war was the cause of the recent market correction and is the greatest fear in the market for the moment.

The 10-year U.S. Treasury note yield, the benchmark for the bond market, rose nicely topping out mid-day Thursday above 2.7% only to drop to 2.67% by the end of the week on the retail sales news. That puts the bond market at odds with the stock market. Bond buyers are pessimistic, and it shows in the yield curve with a sag in the curve suggesting they still anticipate an economic slowdown between two and five years in the future. U.S. oil prices effected a slow climb for the week, closing up 5.77% at $55.75. It is hard to tell whether the rise is an indication of global economic optimism or an ongoing reaction to embargos and sanctions. Gold was up half a percent at $1,324.40 but is still down about 4.5% from a year ago.

The Economy

The economic headline this week was when the Commerce Department released a report on consumer spending, delayed by the recent shutdown. Sales at stores, restaurants, and online fell a seasonally adjusted 1.2% in December from November's figures. That monthly decline was the biggest drop since September 2009 and the comparison sent chills down economists' spines. The average retail sales increase over the past decade has been 0.4% per month, making the drop seem even more pronounced. Another element in the report was the drop in online sales, down 3.9% from November.

This one-time decline in the largest portion of the U.S. economy, consumer spending, could be an anomaly caused by political noise or a shift in Christmas spending to earlier in the calendar year. If so, then it will be a non-event. On the other hand, there is more than a little concern that the relatively sudden decline in spending might be related to the consumer confidence decline reported in other surveys and thereby be something more significant. Adding to the concern was the report from the New York Fed that over seven million borrowers are now 90 days or more behind on their auto loans. The last time we saw the percentage of seriously overdue auto loans reach this level (2.4%) was in 2007 as the economy shifted from expansion into recession. More less-than-optimal news followed as U.S. industrial production was revised down to a 0.1% gain for December and the January number fell to a 0.6% decline.

It is important to take this one-month set of negatives with a grain of salt. Remember that all the negative data came as the government was shut down. That record-length shutdown combined with the threat of tariffs and some harsh winter weather could easily have caused manufacturers and retail shoppers to hit the "pause" button. Political events historically have little effect on the economy, but the drama and uncertainty we have seen in the past few months is unprecedented and may have had an effect.

In a good-news/bad-news event, Germany avoided entering a recession by the narrowest of margins. It had a negative 0.2% GDP in the third quarter and the official reading for the 4th quarter was a flat 0% growth, but at least not negative. The European Union turned in a GDP growth for the quarter of just 0.2%. Meanwhile, the retail sales figures for the U.S. economy have caused the Atlanta Fed to estimate our 4th quarter GDP annualized growth to be about 1.5%, a substantial decline from a year ago when hopes for 3% to 4% figures were pinned on the tax cuts and spending increases.

The bottom line here is we are the late stages of an economic expansion and teetering on the edge. Good news on the tariffs could give this expansion a new lease on life while bad news could easily push us into recession. Stay tuned.

Until next week, we remain as always, alert and watchful for the winds of change.

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