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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) eked out another small rise for the week ending March 1. It rose a whopping 0.39% to close at 2803.69 after breaking through the 2800 level two earlier times and finally bouncing up and down on Friday to end near its high point for the week. The market continues to struggle with cross-currents of bad news and good news and appears uncertain as to what to expect next. What happened this week was not as impressive as what has happened since the beginning of the year as the SPX has risen nearly 12% in two months. Still, it is only up 4.18% from a year ago and remains down over 4.3% from last year's highs.

The ten-year U.S. Treasury note displayed a bit of that same guarded optimism with its yield rising 8.6 basis points (hundredths of a percent) to 2.757% but remains down from this time last year by about a 10th of a percent. That pesky dip in the yield curve between two and five years continues to suggest the bond market thinks things may slow in a year or so. West Texas Crude declined 2.3% to close at $55.75 but is up a whopping 20% so far this year as OPEC sent signals it was going to cut production. The dollar crept higher, up 0.22% but far more significantly, up well over 7% from a year ago. The relatively high dollar makes imports cheaper and exports more expensive and has largely offset the 10% tariffs on many Chinese imports.

The Economy

There was big news that caused economists to scratch their heads this week as the Commerce Department finally released its first estimate of the 4th quarter and full 2018 GDP. Economists and even the Atlanta Fed were estimating that the 4thquarter annualized rate of growth would be around 1.5% to 1.7% but when the news release came out it was a whopping 1% higher at 2.6%. That officially put the first estimate of 2018 GDP at 2.9%. One would assume that with that sudden shot of admittedly two-month-old good news that the markets would shoot up as would interest rates but almost nothing happened.

The problem was that much if not most of that additional growth appears to have come from inventory buildup. What happened was that businesses across the country were stockpiling raw materials and finished products in anticipation of the threatened tariff increases due this month. They had seen the roughly 40% increase in steel prices from the steel tariff and had seen a similar rise in price in washing machines following that tariff, so they moved to buy before the rise. In a seeming oddity, the U.S. Trade Negotiator announced that the 25% tariffs scheduled for March were off the table but again the market was unmoved. We suspect that the history of dramatically different scripts between the trade office and the President's tweets may have discredited the announcement.

The problem with rises in stockpiles and associated economic activity is that stockpiling detracts from future growth as the businesses must sell through their stockpiles before they buy again. That suggests that a bust of some degree will follow the boom we have just witnessed. The net result comes to about zero, thus explaining why stock prices and interest rates were generally unmoved.

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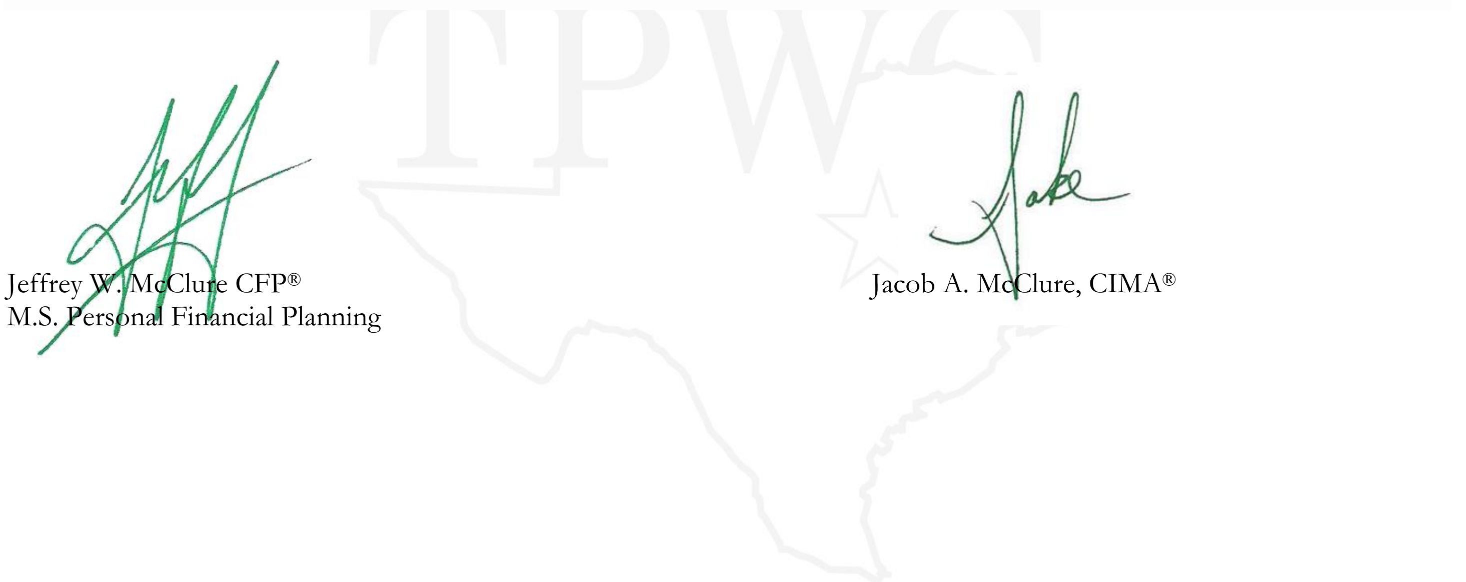
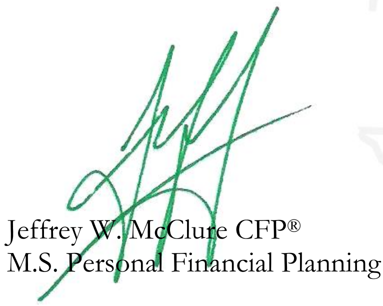
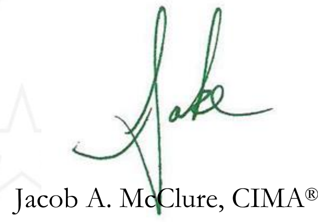
Meanwhile, the Chicago Fed National Activity Index continued its downward slope to end January at a negative 0.43, indicating, like the Index of Leading Economic Indicators, that the economy shrunk a bit in January. That -0.43 is more impressive when compared with the +0.56 reading in August. The culprit appears again to be uncertainty about tariffs combined with a labor shortage.

Other announcements this week supported the thesis that the U.S. economic growth rate is slowing. Consumer spending dropped 0.6% in December, the largest decline since 2009. Nominal personal income declined by 0.2% in January. Manufacturing output appears to still be growing, but each report we get suggests it is growing at a slower rate.

There is nothing catastrophic in view, but it would be reasonable at this point to expect a bit of a low-side shock for the first quarter GDP growth this year.

Until next week, we remain vigilant in our quest to make sense of the morass of contradictory information we receive every day and refuse to quit until we find it!

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