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TPWC Market and Economic Update

The Markets

Despite the hoopla about daily record closes, the S&P 500 Stock Index (SPX) ended the week only 0.58% higher than last week at 3240.02, another record high close. The index is up 3.15% for the last month and 9.39% for the trailing three months. The stock market continues its series of record-high closes in hopes of better profits in 2020 despite lower earnings at this point than a year ago. The SPX price-to-earnings ratio (P/E), a measure of just how high the market really is, rose to 24.27, certainly well above the index's long term mean of 15.77, but not wildly out of bounds. Still, when the P/E ratio gets around 25, historically it has marked a countdown to a market correction that will take it back to much nearer the long-term mean (average). The P/E ratio is the current price divided by the last year's earnings.

Another measure of the "real" level of the stock market is to measure the dividend yield. When the SPX dividend yield is above that of the ten-year Treasury note, the market is considered by that measure to be "underpriced." On the other hand, when the ten-year Treasury is paying a high-interest rate than the market is in dividends, the SPX is "overpriced." The SPX current yield is 1.44% while the ten-year T-note is yielding 1.878%, suggesting the market is a bit rich.

Indeed, the 10-Year U.S. Treasury note closed out the week yielding 1.878%, down about 2.1% from its close last week. For reference, the yield is still almost a full percent lower than it was a year ago. West Texas Intermediate crude oil rose about 0.7% for the week to close at $61.72.

The Economy

Economists have been puzzled as the unemployment rate in the U.S. fell to record levels while wages paid to rank and file workers has barely outpaced inflation over the past several years. 2019 may mark the turning point for that anomaly. According to the Federal Reserve Bank of Atlanta, pay for the bottom 25% of hourly wage earners rose 4.5% in November from last year at this time. Across the board, non-supervisory wages have risen 3.7% from last year.

The Christmas shopping season has turned out to be even better than expected for on-line stores if less than exciting for the traditional brick and mortar variety of businesses. Total U.S. retail sales for November through Christmas Eve rose 3.4% from a year earlier, according to Mastercard Spending Pulse. What was notable was that the same source reported that online shopping rose 19% in the same period. In-store sales rose only 1.2% despite extensive discounting. Not too surprisingly, major department stores like Macy's and Nordstrom saw total sales fall by 1.8%.

As usual, the retail good news was somewhat offset by manufacturing weakness. Orders for long-lasting factory goods made in the U.S. fell a seasonally adjusted 2% in November versus October. New orders for non-defense capital goods, excluding aircraft, gave a glimmer of hope as they rose 0.1%. The sector remains weak as the year over year gains in that sector were only up 0.7% but at least they rose.

Despite the tariff assist to U.S. Steel manufacturers United States Steel Corporation announced it was idling most of a mill near Detroit as company losses are increasing. The same tariffs that raised the price of imported steel appear to have put the crunch on domestic manufacturers who use steel, dropping demand and with it, lowering steel prices. A large part of the problem seems to have come from domestic steel plants expanding on expectations of a permanent rise in prices and in doing so created a surplus in supply. The result is that more modern, more automated plants can turn out steel at a lower price with fewer workers. Tariffs have indeed made the industry more competitive, but ironically, resulted in net job losses for steelworkers. Those workers may not have much difficulty finding new employment, but often that employment is with a significant wage reduction.

After sagging for most of the year, U.S. car and light truck sales surged upward 1.9% in November. The reason appears to be record sales of commercial vans to package delivery companies in anticipation of the online sales boom that hit during the Christmas season. Year-over-year, passenger car sales fell 9.8% while sales of light-trucks, including delivery vans, rose 3.4%. Overall the auto industry sales declined 0.8% for the trailing twelve months.

The bottom line remains the same. Retail sales are growing but the underlying part of our economy that produces things to sell continues to shrink. The market is pushing its upper limits and the beginnings of the market euphoria that historically ends a bull market may be showing its head. In many ways, it looks a lot like the end of 1999 but only time will tell.

Until next week, we remain at our posts, vigilantly watching the tea leaves of the economic data for signs of the future.

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