Frank DeMaio Presents:

# QUARTERLY ECONOMIC UPDATE

A review of Q1 2018

QUOTE OF THE QUARTER

"Time is the coin of your life. It is the only coin you have, and only you can determine how it will be spent. Be careful lest you let other people spend it for you."
- *Carl Sandberg*

QUARTERLY TIP

Heads of household need to prioritize retirement saving over saving for "big ticket" items like a car, a down payment on a home, a college education, or a trip.

## THE QUARTER IN BRIEF

Stocks rallied in January, corrected in February, and slumped in March as volatility and economic policy changes took some of the enthusiasm out of the market. The Trump administration announced tariffs on foreign steel, aluminum, and assorted products from China; China soon said that it would reciprocate with excise taxes of its own. The Federal Reserve adjusted the federal funds rate upward and welcomed a new chair; the White House appointed a new chief economic advisor. An orderly process was outlined for the Brexit. The Nasdaq Composite advanced for the first quarter, but the Dow 30 and S&P 500 did not; most major Asian and European benchmarks also retreated. Among commodities, bitcoin declined notably, while oil and gold improved. The placid market climate of 2017 vanished, giving way to trading sessions marked by significant ups and downs.[1]

## DOMESTIC ECONOMIC HEALTH

A protectionist trade strategy emerged from the nation's capital in March. The Trump administration declared that a 25% tariff would be instituted on imported steel and a 10% tariff on imported aluminum. Some countries were given short-term exemptions from these excise taxes: Argentina, Australia, Brazil, Canada, Mexico, South Korea, and members of the European Union. Additionally, up to $60 billion in Chinese imports would soon face excise taxes. China retaliated at the end of the quarter, imposing import charges of either 15% or 25% on 128 U.S. products, including pork and fruits.[2]

Elsewhere in Washington, the Janet Yellen era gave way to the Jerome Powell era at the Federal Reserve. Weeks after Powell took over as Fed chair, the central bank made its first interest rate adjustment of the year, a 0.25% hike that set the target range for the federal funds rate at 1.50%-1.75%. The Fed's updated dot-plot forecast, reflecting the consensus opinion of its policymakers, projected two more hikes this year: three in 2019 and two in 2020. All that would leave the benchmark interest rate around 3.4%, according to the dot-plot. The Trump administration hired former Reagan administration official and CNBC commentator Larry Kudlow as its new chief economic advisor, following the resignation of Gary Cohn.[3,4]

Business growth looked good in the first quarter; correspondingly, so did hiring. The Institute for Supply Management's factory PMI went from 59.1 to 60.8 to 59.3 across three months; ISM's service sector gauge was also very high at readings of 59.9 in January and 59.5 in February. January saw a net job gain of 239,000 hires by the Department of Labor's estimation, and February brought an even more impressive net gain of 313,000. The headline jobless rate stayed at 4.1% in January and February, and the U-6 rate, counting the underemployed, remained at 8.2% in both those months.[5]

Inflation became a worry during the quarter, but fears that it was running away subsided. There was a half-percent spike in the headline Consumer Price Index in January, plus a 0.3% gain for the core CPI. A month later, both the headline and core CPI moved but 0.2%. By February, annualized consumer inflation was running at 2.2%, core inflation at 1.8%. Wholesale inflation pressure was greater: the year-over-year advance in the Producer Price Index through February was 2.8%. Speaking of production, industrial output was up 4.4% in the 12 months ending in February; durable goods orders rose 3.1% in February after a 3.5% January decline.[5]

Consumer incomes rose 0.4% in both January and February, paralleled by consecutive 0.2% gains in consumer spending. Another indicator from the Department of Commerce seemed to show consumers were saving rather than buying: overall retail sales fell 0.1% in February following a 0.1% January increase. The Bureau of Economic Analysis showed real consumer spending at 4.0% in the fourth quarter, a major factor in the 2.9% expansion of the economy. (That number was an upgrade from the BEA's second estimate of Q4 GDP, which was 2.5%.)[5]

Consumer confidence indices posted very high readings. The successive marks for the University of Michigan's monthly index in the quarter: 95.7; 99.7; 101.4. The Conference Board's index hit an 18-year peak of 130.0 in February before dipping slightly to 127.7 a month later.[6,7]

## GLOBAL ECONOMIC HEALTH

Things looked better for China's economy as the quarter ended. The nation's official manufacturing PMI rose 1.2 points to 51.5, marking the twentieth straight month of expansion for the P.R.C.'s factory sector. That reading was a point higher than the consensus in a Reuters survey. Economists polled by Reuters forecast China's growth rate to decline slightly to 6.6% in the quarter; the Chinese government projected GDP of 6.8%. Vietnam looked like the star of Asian economies in the quarter; its GDP reached 7.4%, and its exports were up 22% year-over-year.[8,9]

The European Central Bank shifted policy slightly in the quarter. In its March policy statement, it removed references to the possibility of increasing its €30 billion-per-month bond purchase program if the global economic outlook worsened. It forecast euro area growth of 2.4% in 2018, 1.9% in 2019, and 1.7% in 2020. In January, the Markit manufacturing PMI for the eurozone reached a 12-year peak of 58.8. Economists worried about Italy's sharp swing toward nationalism, as voters embraced two radical-right parties, the Five-Star Movement and the League, in its latest national election. The fear was that renewed populist sentiment might build and lead Italy to vote to abandon the euro and head back to the lira.[10,11]

## WORLD MARKETS

Next to the Nasdaq Composite, Hong Kong's Hang Seng had the best Q1 of any notable stock benchmark: it rose 0.58% in the first three months of 2018.[12]

The FTSE 100 took the hardest fall: the United Kingdom's marquee index plunged 8.21%. Germany's DAX tumbled 6.64%, and the Nikkei 225 had a quarter almost as poor, dropping 5.76%. Canada's TSX Composite lost 5.19% in Q1, and Australia's All Ordinaries retreated 4.84%. In China, the Shanghai Composite finished the quarter 4.18% lower. France's CAC 40 lost 3.43%, and India's BSE Sensex slumped 3.20%. MSCI's two closely watched benchmarks rode through the turbulence without much damage: the MSCI World index fell 1.80%, and the MSCI Emerging Markets index, 0.93%.[12,13]

## COMMODITIES MARKETS

Bitcoin was the worst-performing major commodity of the quarter. CME bitcoin futures lost 39.69% in three months, with the price settling at $7,903.94 on March's last market day. S&P 500 VIX futures led the commodities pack in the quarter, rising 41.26%.[14,15]

Other notable commodity and currency gains and losses in Q1: cocoa, +35.02%; soybean meal, +19.96%; lumber, +18.82%, the Mexican peso, +10.17%; corn, +8.01%; WTI crude, +7.83%; soybeans, +7.37%; cotton, +3.17%; wheat, +2.44%; orange juice, +2.39%; the U.S. Dollar Index, -2.01%; silver, -5.12%; coffee, -8.09%; palladium, -9.64%; #11 sugar, -17.78%. Gold gained 0.81% for the quarter; unleaded gasoline, 1.33%. Platinum retreated 1.17%. On March 29, WTI crude settled at $64.94 per barrel on the NYMEX; gold and silver respectively closed at $1,327.30 and $16.27 on the COMEX.[14,16]

## REAL ESTATE

In the first quarter, home loans certainly became more expensive. On March 29, Freddie Mac's Primary Mortgage Market Survey showed the interest rate on a conventional mortgage at 4.44%, up from 3.99% on December 28. Rates also climbed for 15-year FRMs and 5/1-year ARMs. Average interest on the 15-year fixed rose from 3.44% to 3.90% in the same time frame, and from 3.47% to 3.66% for the 5-year adjustable-rate home loan.[17,18]

After falling for two straight months, existing home sales improved 3.0% in February – even as some serious headwinds threatened to hold sales back. The median house price had risen 5.9% in a year (to $241,700); mortgage interest rates were climbing, and there was a distinct shortage of affordable properties for buyers – but demand overruled all of that. Economists surveyed by Reuters had forecast that the National Association of Realtors would announce a February sales gain, but just one of 0.5%; NAR said that resales were up 1.1% year-over-year through February. New home buying, according to the Census Bureau, declined for a third consecutive month in February. The 0.6% dip occurred even with new home supply at a 9-year high, and the median price, down 0.9% from a peak reached in November. Through February, new home sales had strengthened 0.5% in 12 months.[19,20]

The NAR's pending home sales index partly reversed its 5.0% January retreat with a 3.1% February advance. Building permits improved 5.9% in January, then slumped 5.7% a month later; housing starts were up 10.1% in January, then fell 7.0% in February. The 20-city S&P CoreLogic Case-Shiller Home Price NSA Index rose 0.3% in its January edition, taking its yearly gain to 6.4%.[5]

## LOOKING BACK…LOOKING FORWARD

At the end of Q1, the Nasdaq Composite had managed a decent YTD advance, unlike the Dow Jones Industrial Average, S&P 500, or Russell 2000. (The Russell also had a negative quarter, losing 0.40%.) The PHLX Oil Service index brought up the rear among U.S. equity indices during Q1, retreating 9.27%. Volatility sent the CBOE VIX jumping: the "fear gauge" of the stock market climbed 80.89% for the quarter. On March 29, the Dow settled at 24,103.11; the S&P, at 2,640.87; the Nasdaq, at 7,063.44; the Russell, at 1,529.43; the VIX, at 19.97.[1]

| % CHANGE | Q1 CHG | 2017 | 1-YR CHG | 10-YR AVG |
|---|---|---|---|---|
| DJIA | -2.49 | +25.08 | +16.67 | +9.73 |
| NASDAQ | +2.32 | +28.24 | +19.77 | +21.24 |
| S&P 500 | -1.22 | +19.42 | +11.85 | +10.08 |
| REAL YIELD | 3/29 RATE | 1 YR AGO | 5 YRS AGO | 10 YRS AGO |
| 10 YR TIPS | 0.69% | 0.41% | -0.64% | 1.13% |

Sources: wsj.com, bigcharts.com, treasury.gov – 3/29/18[1,21,22,23,24]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

As a tough quarter for stocks becomes history, signs of a trade war have surfaced. What could the second quarter hold? All three major indices (and oil futures) sold off significantly as Q2 began. Investors hope that the March jobs report and the start of a new earnings season will restore some optimism to the market. Housing and retail sales aside, fundamental economic indicators have looked good for the most part. The anticipation (and results) of this coming earnings season could take investors' minds off recent headwinds, but a continuation of the marked volatility we witnessed in the first quarter would not be a surprise. If earnings can distract Wall Street away from concerns about trade, the slump in tech shares, and the Fed's plans for tightening; then, the tone might be set for a better month and quarter than some investors expect. For now, the feeling that a promising year for equities might turn into a poor one persists.[25]

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