THE FRONT VIEW

Volume 1 / Issue 3 – Oct 2016

GAUGES

- GDP – 2.3 ↑
- Interest Rates – .25%
- Unemployment – 5.0 ↑
- ISM – 53.2 ↑
- Inflation – 1.1 ↑
- Consumer Sentiment – 91.6 ↑

HIGHLIGHTS

- Business investments continues to be low
- Corporate profits have stabilized
- Consumers are still driving the economic growth

SUMMARY OF THE ECONOMY

The economic outlook remains positive going into 2017. Jobs growth remains steady, retail sales are up, and automobile sales are up, interest rates remains steady, the unknown of the Presidential election is behind us now. With President-elect Trump vowing for infrastructure spending and more government debt, should reflect in a robust economy in a few years.

Housing remains on a positive trajectory which bodes well for the economy. Consumer sentiment is up, people are feeling good about the outlook of the economy.

With more government spending, will inflation raise its ugly head, which will cause interest rates to rise? Rising rates have historically made borrowing money expensive and slows down economic growth.

China's PMI is showing signs of expansion even though the exports are down. Japan's PMI is improving and showing signs of manufacturing expansion.

GLOBAL ECONOMY

China's growth continues to be on target in 2016 of 6-7% GDP. China's GDP growth rate accelerated last quarter to 1.9%, strongest expansion in a year.

The latest Manufacturing PMI from China for Oct 2016 is reported at 51.2, a 4th consecutive month of growth. [2]

China's exports are down 7.3% from a year earlier indicating a lower global demand for goods.[3] Not sure if this rise in manufacturing is due to seasonal, Christmas holidays, or a filling backlog of inventory.

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The Euro zone area continues to show enemic growth. Unemployment is 10% (vs 4.9% US), Consumer condidence is -6.1, yes negative (vs 91.6 US). Manufacturing PMI is 53.5 (vs 53.4 US). Retail Sales Year over Year are 1.15 (vs 4.3% US).

Brazil is not growing their economy, GDP is -0.6%, inflation is 7.8%, unemployment is 11.8%. Brazil's manufacturing PMI is 46.3 in October, basically flat for the past four months, and well below the 50 considered to be expansion.

USA ECONOMY

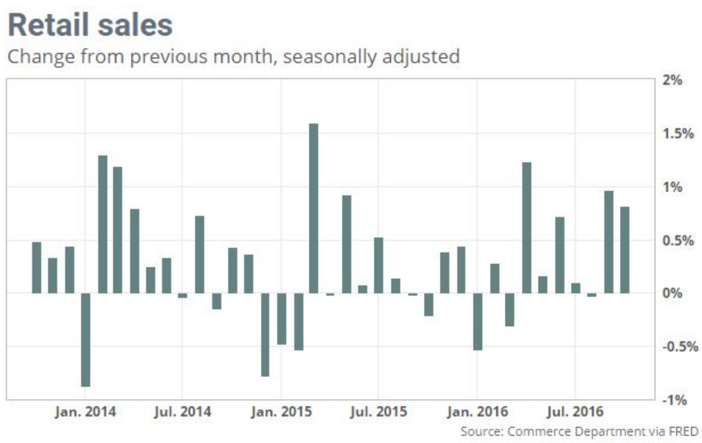
The US economy is continuing to expand, but at a slow pace. Employment outlook is robust, jobless claims are down, the housing market continues to be positive with interest rates holding steady. Here is a summary of some key economic data:

Economic Data	Latest Date	Current	Prior Period	Year Ago	Trend: Yr -Yr% Chg	Note
GDP	3Q16	2.9	1.4	2.0	45.0 ↓	
Capacity Utilization (%)	Oct	75.3	75.4	76.3	-1.3 ↓	1972-2015 average is 80.0
New Home Sales (1000's units)	Sept	593	575	457	29.7 ↑	Up
New Housing Starts (k)	Oct	1,323	1,054	1,063	24.4 ↑	Up
Inventory to Sales Ratio Motor Vehicles	Oct	1.76	1.81	1.78	-1.12 ↓	Working off Inventory
PMI	Oct	51.9	51.5	50.1	3.5 ↑	> 50 manufacturing expanding. 3 months in a row over 50.
Consumer Price Index (CPI)	Oct	241.8	241.0	238.3	1.4 ↑	
Rate of Inflation (%)	Oct	1.6	1.5	0.2	-	Government target less than 2.0%
Consumer Sentiment	Oct	91.6	87.2	90.0	1.7 ↑	
Unemployment Rate	Sept	4.9	4.9	5.1	-1.96 ↓	

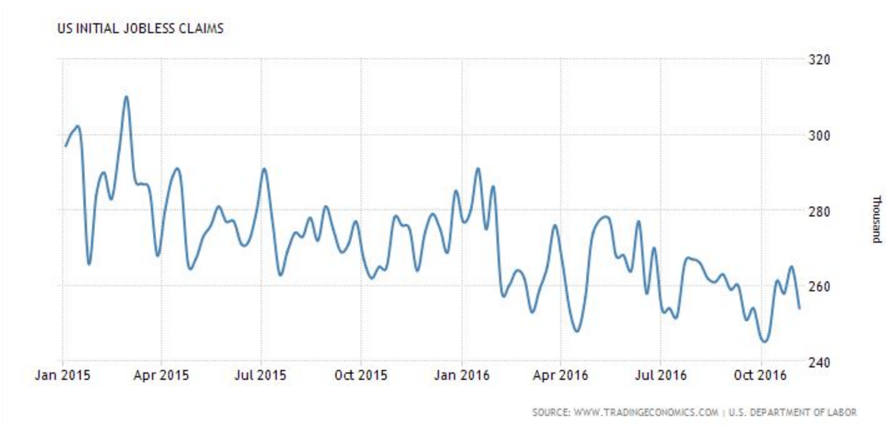
The jobs market continues with all good news, unemployment is holding steady, jobless claims continues on a downward trend.

Manufacturing PMI shows an increase to 51.9 in Oct. [4] In summary, it shows new orders, production growing, employment and inventories growing.[5]

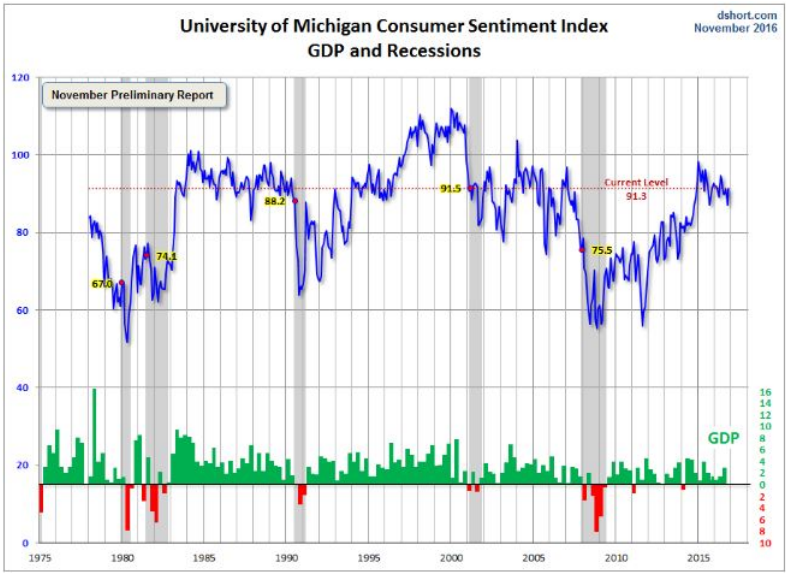
Solid jobs market is driving retail sales for the second consecutive month. [6] On a positive note, auto sales are up, driven by discounts. The cautionary side going forward is that auto inventory has been building up for months and GM has just announced layoffs for 2017.



Initial jobless claims continues to stay under the 300,000 per week and is trending lower since Jan 2015.[7] This continues to be a sign of economic strength, as people have jobs and spending increases.



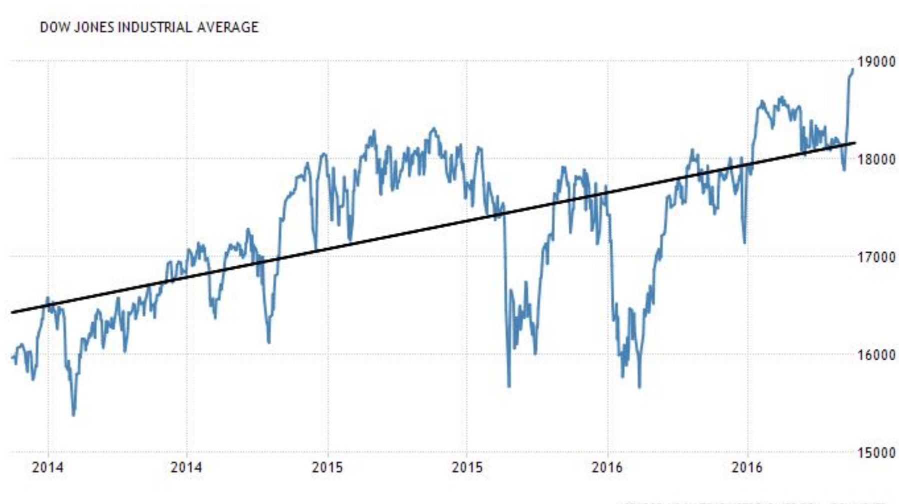
The Michigan Consumer Sentiment is a widely watched indicator of the overall health of the economy from consumers. Oct reading came in at 91.6, up from Aug 87.2. [9]



Per my last writing, I didn’t expect a rate hike until after the elections. Now that the elections are behind us, I would not be surprised to see a rate hike in the range of 0.5 to 1.0% for 2017. This means we could be seeing 2 to 4 rate hikes next year.

MARKETS

The stock market headed higher after the elections on the news that President-Elect Trump will be spending money on infrastructure, reducing corporate taxes, and improving trade.



Looks like the promise of spending is driving the markets higher. But, corporate profits are down about 1.9% from the prior quarter. [11] The markets tend to be driven by future expectations of increased sales and profits.

This is all positive, but to put things in perspective, we are in the 7th year of a bull market, and the historical average bull market is a few months over 4 years. The low interest rate environment along with low inflation makes fixed income investments less attractive than stocks. This explains the longivity of the bull market.

The US Government 10 year bond is at 2.22% as of Nov 15th, from a low in July of 1.36%. The yield has been trending lower since Jan 2016, but looks like it broke a short term downtrend. Is this in anticipation of inflation to come and driving up bond rates?

REAL ESTATE

Housing starts climbed in Oct to 1323k units, up 24.4% from the previous month. The S&P/Case Shilling index on home prices shows home values up 5.1% year to year in Aug 2016.[12]

The 30 year mortgage rates have been trending upward since late Sept. possibly anticipating a rate hike coming soon. The forecast is projected to trend toward 6.5% in 2020. [14]

COMMODITIES

Oil has been trending downward since late 2014, and currently is holding steady around $45/barrel. With average gas prices at $2.20/gal, lower than 2015, this puts more money in the consumer's pockets.

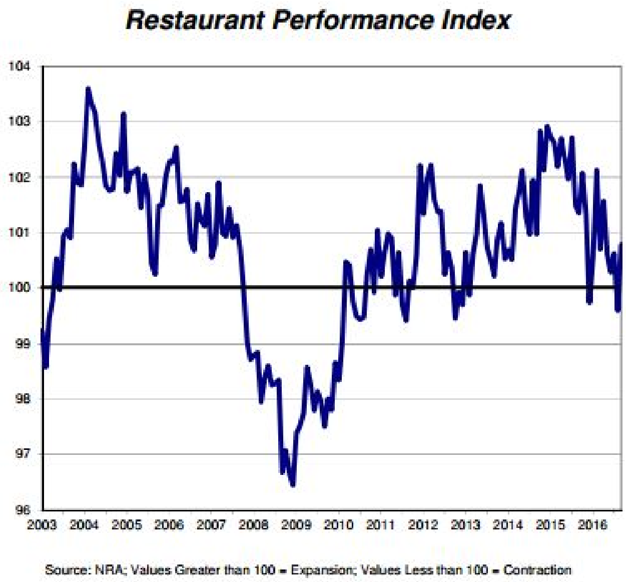
Gold is holding steady, currently around $1,200. Gold prices tend to go down when interest rates rise, as rising rates creates income.

The US Dollar Index has increased post election to a 13 year high, based on a promise to increase spending, stoke inflation, and increase government debt. A strong dollar makes US exports more expensive abroad.

SOME THOUGHTS FOR YOUR THOUGHTS – CANARY(S) IN THE COALMINE

So where is the economy going in 2017? In the world we live in, there is economic data and statistics that are used to predict what is going on in the future. Some are lagging indicators, being indicators that show what has happened after the fact. Some are leading indicators that can be used to determine a direction. Here are some leading indicators I look at to gauge the direction of the economy.

Restaurant Traffic and Sales – More of discretionary spending by consumers, and a gauge of consumer belt tightening. The Restaurant Performance Index for Sept 2016 showed an improvement over August 2016, 100.8 vs 99.6. Driven by improvements in same store sales and customer traffic. But owners are cautious about the uncertain environment going forward. Restaurant performance has been trending lower for 2016. I have noticed a slow trend toward higher prices. Maybe this is due to the minimum wage increasing and being passed onto consumers. There was an article a few weeks ago talking about higher restaurant prices forcing consumers to the supermarkets and cooking at home.



Retail Sales – Gauge of consumer belt tightening. A particular group in retail sales, durable goods such as furniture, appliances and equipment, shows a decline in July 2016 of -5.8% year over year. This group is sensitive to the economy, these goods are not urgent necessities and purchases can be deferred in tough economic times.

Jobless Claims – With layoffs comes getting unemployment benefits. During the last recession, new jobless claims peaked up over 600k per week. Now we are under 300k per week, with the unemployment rate around 5%.

Layoffs – I found this a good indicator of bad things to come prior to the last recession in 2008. Layoff announcements that come in groups across industries is a telling sign. Consumers getting laid off causes spending to be cut and has a ripple effect through the economy.

Auto Discounts – this one is subjective as discounts can apply to the competitive nature of the different manufacturer models. It looks like the Auto Inventory to Sales Ratio has been creeping up in 2016. With inventory building, more discounts occurring and GM announcing layoffs, it this an indication of a softening economy?

Consumer Sentiment – a gauge of consumer confidence in the economy and their financial well being and willingness to spend.

Housing – Has been strong the past few years. When I talked to a Realtor a few weeks ago, there are indications that fewer bids are being placed on homes for sale. Not sure if this is due to the elections or reflecting a slowdown coming.

Stock Market – Yes, we are in the 7^{th}+ year of a supposed bull market. We live in a world where things go in cycles. We are supposedly near the end of a bull market cycle. So is 2017 the year?

As you can sense all of these indicators are intertwined and have a relationship. One cannot rely on one indicator to project the future. Also world events that creates an outlier in the data, does not make a trend over time. Such as Brexit, the Presidential elections, terrorist attacks, etc. It all boils down to people having jobs, feeling wealthier and confident about the future to want to spend. Spending has a multiplier effect throughout the economy.

Yes there are times indicators conflict with each other and it is hard to judge which way things are going. So I would tend to follow the laws of physics – momentum continues in the same direction until acted upon to change it's direction.

No, I don't have an answer to the question posed. But the data and time will tell where we go in 2017.

ABOUT THE AUTHOR

David Lau is Allied's Chief Technology Officer, "Rocket Scientist," Chef, Martial Arts extraordinaire, and In-House economist. David Lau joined Allied in April 2007 as Chief Technology Officer. He is responsible for all aspects of information technology, workflow processes and facilities management, including identifying technology solutions. He is always on the lookout for innovative and cutting edge strategies that will deliver Allied's services more efficiently. He is our resident "go to guy" for anything and everything technology related. David has a strong background in systems engineering, customer interfacing and product life cycle management with both small and large corporate process exposure. He has start-up, corporate and international experience, as well as expertise in the financial, defense, telecommunications and computer industries.

Prior to joining Allied, David was the Co-Founder and President of Dallas-based System Solutions Group, Inc., where he managed a staff placement, consulting and custom development company for the Internet and telecom industry. He built a start-up business that generated $1 million revenue in the first 18 months, securing a major contract with Verizon. This company was successfully acquired by another telecom business he co-founded where he developed sales of over $2 million and generated proposals of over $60 million in new business opportunities. Prior to that, he worked as a Senior

Systems Engineer for Texas Instruments for over 18 years, where he also worked on drones. David has a Bachelor of Science degree in Electrical Engineering from Virginia Polytechnic Institute and graduate work in Computer Science at Southern Methodist University. He also holds various patents. David enjoys cycling, traveling, photography, reading, cooking, and trying out new restaurants and cuisines. David also teaches martial arts and is a car enthusiast.

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