Weekly Economic Update
December 8, 2014

- **Several key economic reports came through last week, including better-than-expected ISM Manufacturing and Non-Manufacturing reports,**

- **Stock markets in the U.S. were generally higher on the week on better economic and employment situation report news, while bonds suffered under higher interest rates. Foreign equities and debt were mixed.**

U.S. stocks moved higher during the week, with help from higher energy prices (compared to the previous week) and the stronger economic data. Leading sectors on the week were financials and health care, while more defensive telecom and consumer staples lagged.

Foreign stocks were held back by a 1% increase in the value of the dollar during the week, which explains a portion of the negative returns. Leaders included China (policy support hopes as well as creation of a new and well-received deposit insurance program) and peripheral Europe, which each gained several percent on the week, while Latin America (due to Brazil raising interest rates 0.50% to ward off inflation, despite stagnant growth) and Russia (now in recession) sold off sharply.

Bonds lost ground on the week with higher interest rates from the better economic data—the 'belly' of the curve was most heavily affected, but rates were generally higher across the board. With duration effects, long bonds fared the worst, while floating rate and high yield held their ground a bit better, with lessened losses. International bonds were mixed, with the strong dollar being a headwind, but some European debt actually gained ground with continued hopes for Euro easing. Every time Mario Draghi speaks these days, the language is dovish and more dovish.

Real estate sold off a bit on the week, in keeping with higher interest rates. The U.S. fared better than abroad, with industrial/office and lodging/resorts actually registering gains (and correlated to better economic and job numbers), while

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apartments and mortgage REITs lagged from a sector perspective (the latter with bond-like tendencies).

Commodities were negative by just over a percent, about in line with the dollar's strength and energy prices. The crude oil segment of the GSCI index lost a half-percent, which was nothing compared to the week prior. On the positive side, precious metals (notably silver), nickel and wheat gained, while sugar and unleaded gasoline were the losers.

Some were especially interested in the gold market over the past few weeks, as Switzerland was considering a referendum (which failed) to increase and repatriate the nation's gold reserves. Gold reserves held within European national borders remains lower than one might expect, with stashes held in the U.S. and elsewhere, and the entire mix of who owns what is convoluted through the use of 'gold swaps,' or short-term borrowings of gold back-and-forth to satisfy ownership needs country-to-country. As the measure didn't pass, we'll leave it at that, but is another example of gold's odd and fickle place in the world's commodity and currency markets. As the current 'currency wars' continue, these types of political responses may crop up from time to time.

(+) The **ISM Manufacturing** report for November came in slightly better than expected at 58.7 (versus consensus estimates of 58.0), while still ticking down a few notches from 59.0 in October. The underlying changes were minor, with new orders rising, and production and employment falling slightly. Exports rose several points, while prices paid fell dramatically to their lowest level in over 2 years—in keeping with lower commodity prices.

(+) The **ISM Non-Manufacturing** version of the ISM report also came in strong, and better than expected, at 59.3, compared to a consensus estimate of 57.5 and 57.1 reading last month, and remained at a near-high for the recovery. In the underlying components of the index, business activity and new orders gained several points, while employment declined a few points. It's relevant to note, however, that on an overall basis, these measures continued to hover in the upper 50's to lower 60's, which is quite strong on a month-over-month basis. The prices paid index ticked upward a bit, but the services group is less commodity-sensitive than manufacturing.

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(0) **Nonfarm productivity** for the third quarter was revised higher from +2.0% to +2.3%, which just underwhelmed forecast by a tenth of a percent. The revision higher came via the nonfarm business sector output, which had stronger growth, and hours were also revised a bit higher. Over the past year, for better context, productivity rose +1.0%, which continues to be a slower pace than long-term historical trend (which is more like 2%). As an offshoot of this, **unit labor costs** in the third quarter fell -1.0%, which ended up as much larger than the expected -0.2% decline. These are calculated as total compensation divided by output, so the final number resulted from lower comp per hour but stronger productivity.

(+) **Construction spending** for October rose +1.1%, which was stronger than the expected gain of +0.6%, and a few positive revisions were logged for two prior months. In the details, residential construction rose +1.3%, split through gains in both single- and multi-family building. Non-residential building was also higher by a percent, due to equivalent gains in state/local spending, as the private non-residential side was flat.

(-) **Factory orders** for October fell -0.7%, relative to expectations for no change. The primary culprit was weaker non-durable goods orders, down -1.5%, with perhaps a connection to lower commodity prices.

(-) The **ADP employment report** for November came in at +208k, which lagged the median forecast of +222k. More tempered gains from the prior month were seen in professional and business services, as well as construction.

(0/-) **Initial jobless claims** for the Nov. 29 ending week fell by -17k to 297k, which was +2k higher than consensus—so relatively on track. **Continuing claims** for the Nov. 22 week rose to 2,362k, +39k higher than the prior week and +44k above expectations. No unusual factors were reported from the Labor Department.

(+) The big employment situation report for November was a strong one, and, from a headline basis, one of the best of the current recovery so far. In fact, it seems 2014 may be the best year for job growth since the late '90's, with about 2.7 mil. jobs created over the trailing year. The ratio of more desirable full-time to less desirable part-time jobs has also improved during that stretch.
Last month, **nonfarm payrolls** were +321k higher, outperforming expectations calling for +230k. Additionally, +44k jobs were added via revision for the prior two

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months. Job growth appeared to be relatively consistent across a multitude of industries, including large increases in business services as well as trade/transports/utilities, although seasonal employment and construction also rose. The **unemployment rate** was unchanged at 5.8%, on par with expectations, and the participation rate remained the same 62.8% as last month. Looking deeper, the rate of long-term unemployment fell a tenth to 1.8%, as did the U-6 'underemployment' figure to 11.4%. **Average hourly earnings** were +0.4% higher, which was at a rate twice that expected (bringing the 12-month gain to +2.1%), and the average workweek rose +0.1 hour to 34.6.

What do we take from all this? Pundits took this as a big win for the U.S. employment market, while continued strong results could raise the chances that the FOMC could take action raising rates sooner than expected from the current consensus baseline of mid-2015. In recent years, improved but lackluster job gains (with lower participation, partially due to demographic factors) have resulted in better unemployment rate improvement than would be required in prior cycles with a different labor supply dynamic. However, the closer the rate gets to the theoretical bound of 'full employment,' further improvements may be less dramatic. There are many more reports to go before that time, however, so data will be closely watched. The consensus view by many economists is that the emergency-state zero interest rate regime isn't appropriate at this point, but tightening has become a sensitive game of semantics and timing. Interestingly, New York Fed President Dudley made the comment, 'given the still high level of long-term unemployment, there could be a significant benefit to allowing the economy to run 'slightly hot' for a while in order to get these people employed again.' We think this sums up the Fed's opinion quite well.

(+/0) The **Fed beige book**, released full of periodic anecdotes about regional economies as reported by the various Fed banks, described an environment of 'continued expansion' (as opposed to the 'modest to moderate' expansion pace noted for the majority of recent releases). This language change may not mean much in the whole scheme of things, but progress nationwide continued to improve, from the tone of the underlying components. Consumer spending continued to move higher, including SUV/light truck sales due to lower gasoline prices, as well as other holiday shopping optimism. Manufacturing activity rose, particularly in autos/aerospace, as did chemicals (with lower petroleum input prices), and construction activity grew in the multi-family area particularly. Oil prices were mentioned—in Dallas, unsurprisingly—and sentiment

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had tempered somewhat but not extremely so, and oil services activity continued to grow. Employment was stronger across districts, although the type varied by region. Inflation, as measured by prices/wages, continued to show 'subdued' pressures overall with certain skilled jobs showing more pressure than others. Overall, this report didn't contain a lot of surprises and is on par with prior periods

The above information is believed to be reliable and accurate as of December 8, 2014. Several sources are used to compile the information, which include the Wall Street Journal, the Financial Times and Investor's Business Daily. Opinions expressed are solely those of Kenneth P. Butze, Jr. and Integrity First Planners, Inc. (a registered investment advisor). Questions and comments should be directed to Ken Butze, 216.751.4229. Triad Advisors, member FINRA /SIPC and Integrity First Planners, Inc. are not affiliated.

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Weekly Economic Notes

Question of the Week

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