ARGUS®

WEEKLY ECONOMIC COMMENTARY

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Economic Data & Earnings Season Overshadowed by Geopolitical Events

The new president, still within his first 100 days in office, has executed an about-face on foreign policy that has caused as many heads to spin as any of his domestic swivels. During campaign season and the general election, President Trump espoused an "America First" policy. The then-candidate said the U.S. would no longer act as the world's policeman. He declared NATO "obsolete" and further distanced himself from NATO member states by cozying up to Russia.

In just the past few weeks, however, the president has launched a strike on a Syrian airfield; dropped the "mother" of all non-nuclear bombs on an ISIS tunnel complex in Afghanistan; and sent VP Mike Pence to the Korean DMZ to declare that the era of strategic patience with North Korea had ended. He called NATO no longer obsolete. And he has rotated toward China while swinging away from Russia. The President has increased the number of U.S. troops supporting anti-ISIS efforts in Iraq and Syria, while keeping them out of front-line combat roles.

President Trump claims there is no change in his governing style and says that giving his military field commanders more operational leeway is consistent with his tendency to delegate authority. There is a risk that military responses will come to crowd out diplomatic approaches. For now, and despite the headline strikes, the U.S. has made no new major military commitments.

While some investors see a correlation between the stalled stock-market advance and rising U.S. geopolitical involvement, others attribute the stock stall to the need to consolidate gains after a nearly 14% market run-up from early November '16 through early March '17. Investors are always inclined to take money off the table following strong gains in a short period, and any one of the flashpoints – particularly Syria or North Korea – would have been sufficient to trigger some profit taking.

What is notable is that the stock market has retraced just a small portion of the post-election gains. We believe this signals investors' confidence in the overall health of the economy and in the likelihood of a strong earnings season ahead.

RECENT DATA INCONCLUSIVE

Data from early and mid-April has generally been supportive of ongoing economic expansion. At the same time, some economists point to a slowing in economic momentum that might result in another sub-1% GDP reading for the first quarter of 2017.

Although nonfarm payrolls growth for March disappointed with just 98,000 jobs created, the JOLTS job-openings data suggests room for long-term job gains. The JOLTS reading for February came in at 5.74 million openings, ahead of consensus and above the upwardly revised 5.63 million reading from the prior month. The nearly six million job openings is a positive for the long-term employment outlook. The near-term problem, however, is the disconnect between out-of-work former factory workers in the nation's interior, and digital-age jobs clustered in coastal cities.

The president's more hawkish tone in geopolitical matters has prompted a rush into safe-haven investments, from defensive sectors (Utilities, Consumer Staples) to U.S. Treasury bonds. One silver lining to the rapid drop in Treasury rates has been renewed mortgage activity. The MBA Mortgage Applications index for the week ended 4/8/17 increased 1.5%, rebounding from a 1.6% decline in April's first week.

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In their meetings with homebuilding company managements, Argus analysts have reported that some buyers are evidently rushing to set mortgage terms and purchase homes before interest rates move sharply higher.

We continue to regard the housing economy as one of the stronger manifestations of consumer confidence. The consumer sentiment survey from the University of Michigan rose to 98.0 in April from 96.9 in March. The current conditions gauge, which measures consumers' perceptions of their personal finances, reached 115.2 in April, the highest reading in this series since November 2000.

On the same day as the positive consumer sentiment report, economists were surprised by a reported drop in March producer prices. The all-items PPI declined 0.1% (seasonally adjusted) in March, continuing the deceleration from February (+0.3%) and January (+0.6%). The 12-month change in all-items PPI, however, was a stout 2.3%, the largest 12-month gain since the period ended March 2012. Adjusted PPI (less food, fuel, and trade services) edged up 0.1% in March and was up 1.7% on a trailing 12-months basis. On the consumer side of pricing, All-items and core CPI were both negative for March.

While consumers can talk a good game in confidence and sentiment surveys, they do not always follow up with actual activity. U.S. retail sales unexpectedly dropped 0.2% in March, against expectations for a flattish to slightly down reading. Of equal concern, February retail sales were revised to a decline of 0.3%, from an initial reported 0.1% gain.

The March retail sales number was thus doubly disappointing, as it was measured against the February drop that was the most severe in a year. So-called "core" sales, which exclude automobiles, gasoline, building materials, and food services, were up 0.5% in March; that was off a downwardly revised 0.2% decline in February.

While the core number for March was encouraging, consumer spending appears to have moderated in the first quarter of 2017 after growing at a solid 3.5% rate in 4Q16. Several factors are contributing to the slowdown. Automotive unit sales likely peaked at some point in mid- to late-2016. Income tax refunds were delayed this year as the IRS sought to fight worsening fraud in the age of eFiling. The unexpected and massive March snowstorm in the Northeast may have knocked a few days out of the retail sales season.

The consumer accounts for 70% of the contribution to gross domestic product, so any downsizing in retail sales has real implications for overall growth. Two Federal Reserve banks, in Atlanta and New York City, have lowered their forecasts for first-quarter 2017 GDP growth. The New York Fed cuts its outlook to 2.09%, from 2.58% a week earlier. The Atlanta Fed, which was gloomier to begin with, cut its outlook from a 0.6% growth forecast to 0.5%.

CONCLUSION

It is too early to draw even preliminary conclusions about the 1Q17 earnings season. The Street is universally expecting high-single to low-double EPS growth. The numerous global hot spots continue to represent the greatest possible distraction from a positive EPS season.

Worth remembering is that trouble spots can remain on the boil for a long time without quite boiling over. We believe investors should keep an eye on the headlines but without losing sight of long-term investment objectives.

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