

July 24, 2017

Data Calm before the Earnings Storm

While most of the nation slips into summer doldrums in uninterrupted fashion, Wall Street has an odd hitch in the process. Just when sultry July days are causing eyes to slip to half-mast at mid-afternoon, calendar 2Q earnings seasons arrives like a swarm of bees at a summer picnic.

Earnings, economic data, and (this year at least) Washington goings-on have been the key market drivers in 2017. Earnings will soon hog the spotlight. After a tumultuous first six months, turmoil in Washington appears to have died down, or at least shifted into “new normal” status that is no longer driving ups and downs in the stock market. The latest twist in the healthcare reform saga – John’s McCain’s pending surgery, which has prompted Mitch McConnell to postpone a Senate vote – is likely quietly welcome on Wall Street, as it will remove a potential distraction at least for a few weeks.

Quietly, economic data is confirming the steady if slow pace of economic growth. Most data will be subsumed in the earnings tsunami. Before that happens, it is worth reviewing a handful of reports for what they say about the economy partway into summer.

INDUSTRIAL, CONSUMER ECONOMY RISING

A logical jumping point for our economic data review is the June nonfarm payrolls report – because that was also the jumping off point for this latest rally leg that has brought stocks to new all-time highs. As reported on 7/7/17, June nonfarm payrolls totaled 222,000, well above the 12-month trend of 180,000 and besting expectations for a gain of 179,000. As a sweetener on the report, April and May payrolls were revised higher by a net 47,000 jobs.

Growth was led by professional and business services, healthcare and food services, all in the service economy.

The hoped-for renaissance in manufacturing is not yet visible, but neither is the nation hemorrhaging factory jobs. Also on the industrial front, mining ticked higher. The U3 unemployment report ticked higher, to 4.4%, reflecting job seekers returning to the workforce.

The most notable data point in the June jobs report was 2.5% annual growth in wages. Investors seeking to determine the pace of Fed rate hikes too often focus on the pace of economic activity while stinting the trend in pricing pressures. Chair Yellen and the other FOMC members and Fed governors are likely to hone in on that number, which is above the desired 2% pace of inflation consistent with a well-functioning economy.

The June producer price index nudged up 0.1% month-over-month while rising 2.0% on a year-over-year basis. The June annual pace did represent a step-down from the 2.4% annual rate reported for May, while still signaling that price appreciation has become steady, rather than erratic. Consumer prices have been more subdued, rising 1.6% for the all-items index and 1.7% for the core index (less food and fuel) over the past 12 months.

The Fed released its Beige Book in mid-July, confirming its concerns regarding wage pressures for both low- and high-skilled jobs. Economic activity expanded across all 12 Federal Reserve districts in June, as the U.S. grew at a “slight to moderate” pace reflecting some regional variation. Household spending held up, despite weaker auto unit sales and worsening challenges for traditional mall-based retail.

One of the key inflection changes during July has been the recent recovery in energy prices, as crude rose 5% in the mid-month week. The positive trend began after the Energy

(continued on next page)

ECONOMIC & MARKET COMMENTARY (CONT.)

Information Agency on 7/8/17 reported a decline in oil inventories; that data also confirmed a like report from the American Petroleum Institute.

Second-quarter pressure on energy prices partly reflects increased supply coming on line from the global swing producers, which are mainly U.S. energy companies primarily operating in the major shale basins. That increased activity is being reflected in industrial production, which rose a solid 0.4% in June. Capacity utilization nudged down a tick, but at 76.6% remains above the 75% level at which this index was mired for years.

The Commerce Department reported a 0.2% drop in retail sales, representing a second consecutive decline after May's 0.1% drop. The data reflects the transformation whereby consumers are shifting away from the mall and more fully toward online commerce. Other areas that are only moderately impacted by the internet, such as casual dining, have also backed down. We have pointed out that year-over-year trends in core and control retail sales look better than the Commerce Department numbers, but the consumer does appear to be suffering wallet fatigue.

Another down note was sounded by the Mortgage Bankers Association (MBA), which reported a 7% decline in mortgage applications for the 7/7/17 week even after adjusting for the July 4 holiday. However, the MBA also reported that mortgage applications for new home purchases increased 10% in

June 2017 compared with June 2016.

We expect June housing data, to be reported later in the month, to generally show continued momentum in areas including permits, starts, new home sale and existing home sales. Housing data points, mainly released in the July 23 week, will likely be overshadowed as the earnings flow moves to firehose strength. July will wrap up on the data front with the advance report on 2Q17 GDP, to be released on the penultimate trading day in the month.

CONCLUSION

In a few weeks, with earnings reported and digested, Wall Street will begin its real summer season, which runs from mid-August to Labor Day (or maybe a week past). For now, investors are pleasantly abuzz in anticipation of what should be a good earnings season.

After summer vacations wind down, the market will resume its focus on key economic data releases. These include payrolls, industrial production, the pricing indexes, and consumer-economy indicators that measure housing and autos as well as sentiment.

In a sense, the upcoming strong earnings season and solid economic growth go hand in hand. We would expect positive feedback from both to keep the stock market moving forward as fall gets underway, even if stocks indulge in their usual summer siesta.

Jim Kelleher,
Director of Research

Argus Research Co. (ARC) is an independent investment research provider whose parent company, Argus Investors' Counsel, Inc. (AIC), is registered with the U.S. Securities and Exchange Commission. Argus Investors' Counsel is a subsidiary of The Argus Research Group, Inc. Neither The Argus Research Group nor any affiliate is a member of the FINRA or the SIPC. Argus Research is not a registered broker dealer and does not have investment banking operations. The Argus trademark, service mark and logo are the intellectual property of The Argus Research Group, Inc. The information contained in this research report is produced and copyrighted by Argus Research Co., and any unauthorized use, duplication, redistribution or disclosure is prohibited by law and can result in prosecution. The content of this report may be derived from Argus research reports, notes, or analyses. The opinions and information contained herein have been obtained or derived from sources believed to be reliable, but Argus makes no representation as to their timeliness, accuracy or completeness or for their fitness for any particular purpose. This report is not an offer to sell or a solicitation of an offer to buy any security. The information and material presented in this report are for general information only and do not specifically address individual investment objectives, financial situations or the particular needs of any specific person who may receive this report. Investing in any security or investment strategies discussed may not be suitable for you and it is recommended that you consult an independent investment advisor. Nothing in this report constitutes individual investment, legal or tax advice. Argus may issue or may have issued other reports that are inconsistent with or may reach different conclusions than those represented in this report, and all opinions are reflective of judgments made on the original date of publication. Argus is under no obligation to ensure that other reports are brought to the attention of any recipient of this report. Argus shall accept no liability for any loss arising from the use of this report, nor shall Argus treat all recipients of this report as customers simply by virtue of their receipt of this material. Investments involve risk and an investor may incur either profits or losses. Past performance should not be taken as an indication or guarantee of future performance. Argus has provided independent research since 1934. Argus officers, employees, agents and/or affiliates may have positions in stocks discussed in this report. No Argus officers, employees, agents and/or affiliates may serve as officers or directors of covered companies, or may own more than one percent of a covered company's stock. Argus Investors' Counsel (AIC), a portfolio management business based in Stamford, Connecticut, is a customer of Argus Research Co. (ARC), based in New York. Argus Investors' Counsel pays Argus Research Co. for research used in the management of the AIC core equity strategy and model portfolio and UIT products, and has the same access to Argus Research Co. reports as other customers. However, clients and prospective clients should note that Argus Investors' Counsel and Argus Research Co., as units of The Argus Research Group, have certain employees in common, including those with both research and portfolio management responsibilities, and that Argus Research Co. employees participate in the management and marketing of the AIC core equity strategy and UIT and model portfolio products.

