THE VISION COUNCIL

ITR ECONOMICS

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## SNAP SHOT INDICATORS

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| | |
|---|---|
| ↘ | Retail Sales |
| ↘ | Manufacturing |
| ↗ | Medical |
| ↘ | Auto Production |
| → | Wholesale Trade |
| ↘ | Interest Rates |
| ↘ | Capital Goods |
| ↗ | Electronics |
| ↗ | ITR Leading Indicator |
| ↘ | Housing Starts |
| ↘ | Consumer Expectations |
| ↗ | Total Industry Capacity Utilization Rate |
| ↗ | US Leading Indicator |
| ↗ | Purchasing Managers Index |
| ↗ | S&P 500 Stock Prices |

↑ Steep Rise
↗ Mild Rise
↓ Steep Decline
→ Flat
↘ Mild Decline

## MACROECONOMIC OUTLOOK

US Industrial Production is on track to transition into the recovery phase of the business cycle this quarter. Internal trends are rising and ITR Checking Points indicate that recovery is imminent. Production has been pulled down by sharp contractions in the US Mining Production and the Utilities Production components (roughly 27.8% of Total Production) during the last year. However, the Utilities and Mining components of US Industrial Production are showing signs of recovery. Quarterly Mining Production is in recovery and Utilities Production during the last three months is up 2.4% from the same time last year. This is contributing to the upward momentum in overall Production while the Manufacturing component stagnates. A slowdown in the US auto sector is contributing to this stagnation in Manufacturing. US Light Vehicle Retail Sales in the most recent three months are virtually flat compared to one year ago as consumer spending on discretionary items, such as dining and big-ticket items like automobiles, cools in recent months.

Total Retail Sales (deflated) for the 12 months through August are growing at a slowing pace, up 1.8% from the year-ago level, and growth will slow into mid-2017. The malaise in US Single Unit Housing Starts in August 2016, up a modest 0.5% from the August 2015 level, will likely be temporary as US New Homes Sold are up 32.6% during the same time. The consumer is spending but the pace of growth is slowing. However, consumer fundamentals point to a more confident consumer for 2017 as wages rise and both unemployment and interest rates remain low.

Consumer trends over the last year held up the economy while the industrial side of the economy faltered. US Nondefense Capital Goods New Orders for the 12 months through July totaled $765.8 billion, down 4.1% from the year-ago level and fell back into Phase D, Recession. The US Census Bureau's New Orders data release in July generally showed negative trends, but a few segments showed positive momentum. US Electromedical, Measuring, and Control Instruments (up 4.8%) and US Other Electrical Components New Orders (up 18.5%) were bright spots for New Orders in July.

It is likely that the strong US dollar, uncertainty due to the upcoming election, and faltering US corporate profitability are dampening the New Orders transition to recovery in the near term. However, the leading indicators support that the cyclical decline in Nondefense Capital Goods New Orders will abate in late 2016 and New Orders will then rise in 2017. The Total Industry Capacity Utilization Rate, a six-month leading indicator to New Orders, is generally rising from a December 2015 low and is good news for Nondefense Capital Goods New Orders as it suggests rising business activity through at least early 2017. The Purchasing Managers Index (PMI) took a step back with August's data but overall rise in the PMI 1/12 is indicative of improving conditions for Manufacturers for 2017. As a 12-month leading Indicator to Nondefense Capital Goods New Orders, the rise in the PMI 1/12 supports a fourth quarter 2016 business cycle low in New Orders and rise into at least late 2017. Rise in commodity prices as well as leading indicator output keeps us optimistic for New Orders for 2017.

There is much to be optimistic about moving into 2017 within the fundamentals and leading indicators of the economy. Utilize this slower period to train your labor force and make necessary investments in order to maximize productivity in the coming period of rise.

## MAKE YOUR MOVE™

Ensure your pricing is competitive to retain market share as business-to-business activity declines into late 2016. Do not fall victim to pessimism, and if you are coincident with New Orders activity, ensure you are planning for growth in 2017.

# INDUSTRY ANALYSIS

## Retail Sales

US Total Retail Sales (deflated) during the 12 months through August rose 1.8% from the year-ago level. Retail Sales will decelerate through early 2017, but accelerating growth will then take hold into mid-2018. General upward movement in Money Supply (deflated) since late 2014 will provide support to Retail Sales into at least late 2017.

## Manufacturing

Annual US Total Manufacturing Production ticked down to 0.3% in August. Imminent upward movement in the US Machinery New Orders annual trend and rise in the US Corporate Profits for Domestic Manufacturing Industries quarterly trend signal that despite the recent tick down, Manufacturing Production will reach a cyclical low in the second half of 2016.

## Medical

US Medical Equipment and Supplies Production is up 3.9% year-over-year. A cyclical peak in the quarterly trend in May 2016 supports the expectation of an annual trend high in the final quarter of 2016. Personal Consumption Expenditures for Medical Care Services, a nine-month leading indicator, supports rise in Production through early 2017, in line with our expectations.

## US Industrial Machinery New Orders

Annual US Industrial Machinery New Orders through July is up 2.3% from the prior year. Slower growth is imminent and will persist through the end of the year before accelerating growth takes hold from early 2017 into early 2018. Upward movement in the food industry will provide support to New Orders in 2017.

## Wholesale Trade

US Total Wholesale Trade for the month of July was down 6.6% from the July 2015 level. Both Durable Goods and Nondurable Goods Wholesale Trade had negative year-over-year months compared to July 2015. Rising Wholesale Trade of Metals and Minerals and Wholesale Trade of Petroleum signal that a recovery for Wholesale Trade as a whole is imminent.

## Interest Rates

US Short-Term Interest Rates ticked up to 0.72% in August, a 17.6 percentage-point increase from July. Interest Rates are expected to mildly rise on a quarterly basis through at least mid-2017. Sporadic employment results over the last few months will likely keep the benchmark federal funds rate low as a rise may be a shock to the market at this time.

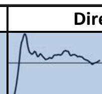
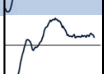
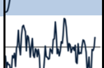
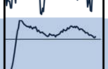
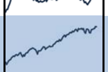
## Capital Goods New Orders

US Nondefense Capital Goods New Orders (excluding aircraft) for the 12 months through July were down 4.1% from the prior. The New Orders forecast was downward revised due to lower-than-expected results over the last few months. Recovery will take hold in late 2016 but year-over-year growth will not return until the second half of 2017.

## North American Light Vehicle Production

North American Light Vehicle Production for the 12 months ending in July totaled 17.6 million units, up 2.2% from the year-ago level. A recent slowdown in the rate of growth was more distinct than expected and necessitated a downward revision to the outlook. Expansion will still occur, just at a slower pace. Anticipate acceleration in 2017.

# SNAPSHOT INDICATORS

| Indicator | Direction | | What it means for the US economy |
|---|---|---|---|
| **ITR Leading Indicator™** (Actual) |  | Rise | The rising trend suggests that US Industrial Production is likely to reach a cyclical low this quarter, followed by rise through at least mid-2017. |
| **Housing Starts** (Most recent 12 months compared to same 12 months one year ago) |  | Flat | General rise in Starts will be supported by a strong consumer, one benefiting from increased wages and low interest rates, moving into 2017. |
| **Consumer Expectations Index** (Most recent 12 months compared to same 12 months one year ago) |  | Decline | A third month below the year-ago level signals slower retail sales activity may occur into the first half of 2017. |
| **US Total Industry Capacity Utilization Rate** (Most recent month compared to same month one year ago) |  | Rise | The August Utilzation Rate monthly rate-of-change is generally rising from a December 2015 low, suggesting cyclical rise in the US economy into 2017. |
| **US Leading Indicator** (Most recent month compared to same month one year ago) |  | Mild Rise | The Indicator ticked up in July and if the tentative trend reversal holds, it would suggest support for economic growth into at least early 2017. |
| **Purchasing Managers Index** (Most recent month compared to same month one year ago) |  | Flat | The trend declined in August but remains above its November 2015 low, indicating a stronger economy into 2017. |
| **S&P 500 Stock Prices** (Raw Data) |  | Rise | Stock Prices rose in August and signal general growth in the US economy by late 2016. |

## LONG-TERM VIEW

**2016:**
Recovery in Second Half

**2017:**
Accelerating Growth

**2018:**
Slower Growth

## RISK FACTORS FOR MANUFACTURERS

By: Serine Yamout

The end of the year is fast approaching and manufacturers are concerned about how the weakness in the US industrial sector, the political environment, and the recovering commodity prices will impact their businesses going into 2017. ITR is optimistic about consumer strength and rising Oil Prices driving growth in 2017. General rise in the US Manufacturing Purchasing Managers Index (PMI) monthly trend, which leads Total US Industrial Production by 12 months, signals that the industrial sector will be stronger in the second half of 2016 and into at least late 2017. The monthly figure, 49.4, ticked down just below the 50-point benchmark for the first time since February, but do not overreact to one month of decline. Volatility in the PMI monthly trend is normal and it is important to look at the PMI subcategory series to determine certain risk factors that your business will face, even if the overall PMI indicator is improving.

The BDO Manufacturing Riskfactor Report represents information from the most recent 10-K filings of the largest 100 publicly-traded US manufacturers. The report states the top issue that manufacturers fear is vendor and distribution disruptions. Constantly updating inventory using OEM systems, proactively issuing repairs on your machines, and ensuring materials are on hand are important to prevent your business from unexpectedly going offline. The PMI Deliveries Component number for August is 50.9 percent (a reading above 50.0 signals longer delivery times). Longer delivery times will hinder manufacturers in need of punctual deliveries and input materials. Expedited shipping services are expensive and sometimes impossible if supplies are unavailable.

The BDO reported that the second risk factor for manufacturers was government regulations. Separate from the political environment, we do expect interest rates to rise, which would indicate that the Federal Reserve Board is confident in the strength of the consumer and the stability of the economy. The PMI Prices Component was 53.0 percent in August, confirming the increase in raw materials prices. It is a good time to consider budgeting the impact of rising commodity prices, another reported risk factor, and rising interest rates on business input costs in 2017.

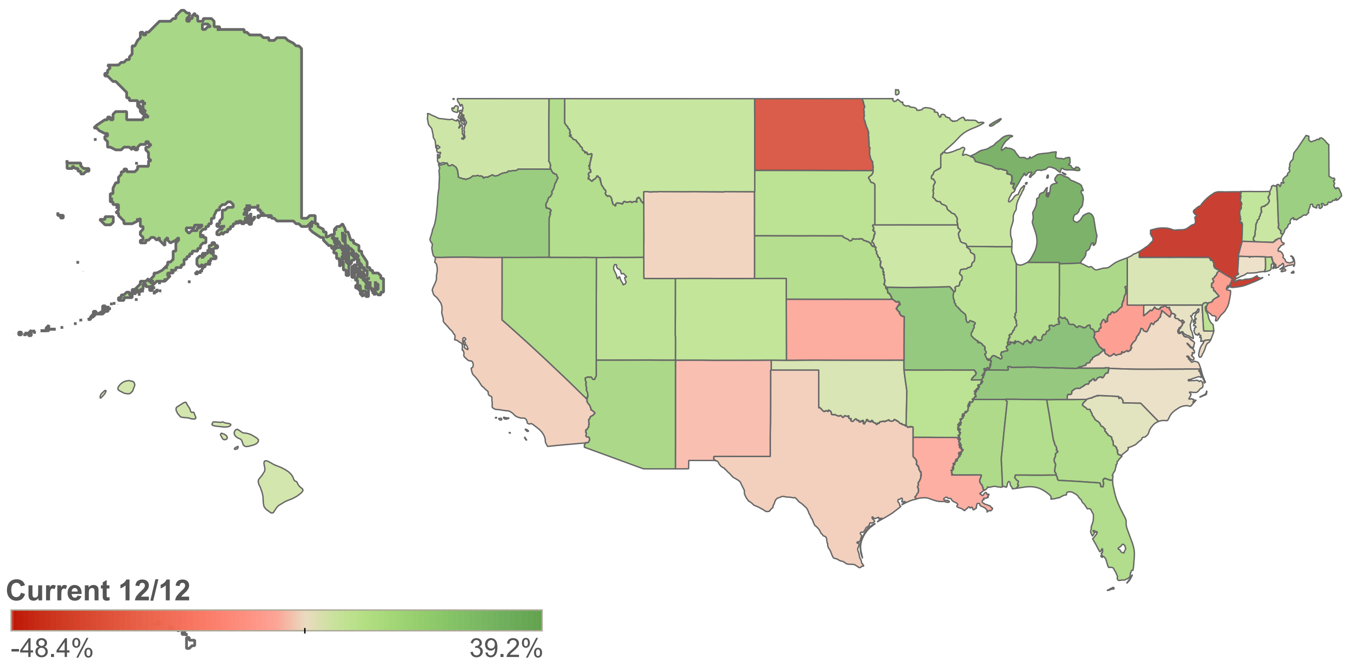
Labor concerns was cited as a risk factor by 97% of the companies examined by the BDO. Look for ways to create efficiencies and capacity without increasing the number of people, as skilled labor becomes harder to find and labor costs increase. There has been general rise in the PMI Employment Component since a low in January. Keep searching to hire top people and offering short, intensive training programs in order to increase bodies and efficiences in production lines. Consider investing in co-robots as an effective way of lowering the pain point which drains efficiencies.

Which brings us to the last of the top ranking risk factors: competition and consolidation in manufacturing. Communicating competitive advantages is key for a business. This is done through investing in market research to determine what your potential, and existing, clients value most. Then, spend money on focused market efforts. Your competitive advantages are there, now tell your market about your value preparation. This is a proven way to improve margins.

Concerns over breaches of technology security, privacy, theft, and computer crime have jumped the most in the past four years. This was identified as a risk factor by 92% of companies surveyed by the BDO this year. Growth in 2017 should provide your firm with the funds necessary to adress this issue.

## STATE-BY-STATE: Average US Housing Permits




Average US Housing Permits over the last 12 months increased 3.0% compared to the prior-year level, but are in Phase C, Slower Growth, of the business cycle. Rising Permit levels in the Great Lakes Region (up 22.9%), Central Region (up 6.9%), the West (up 6.8%), and the Southeast (up 10.6%) are offsetting decline in the South (-1.3%), Northeast (-27.8%), and the mid-Atlantic (-14.2%). The 15 states, which make up 37.4% of Permit volume, saw Permits fall below their year-ago level. The most noticeable cluster of these states on the map are in the Mid-Atlantic (New York excludes NYC) and the South Region. Other noticeable declines are in North Dakota, West Virginia, Wyoming, and California. Review your asset allocation to focus on growth regions and ensure your pricing is competitive to retain market share within the regions that are experiencing cyclical decline.

## READER'S FORUM

I saw you give a tremendous presentation about four years ago and you shared that you advised your daughter to "stretch and buy the best house she could". In hindsight that was excellent advice! What would be your advice to her if it were today?

***Brian Beaulieu, CEO at ITR Economics™, answers:***

Buy and buy big! Fixed rate mortgages are still so incredibly low. The loan will turn into an "economic asset" as interest rates rise in the future. Buy based on three economic "locations": 1) urban, 2) with a view, 3) near water. Stretch yourself to make extra payments during the course of the years ahead so that you can be relatively debt free come 2030.

**Please send questions to questions@itreconomics.com**