THE VISION COUNCIL

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Make Your Move™
Identify and communicate your unique competitive advantage to customers in order to maintain sales growth as the macroeconomy slows.

Inside this issue:

Macroeconomic Review

The monthly US Industrial Production Index for May came in 1.6% above May 2014. This marked the slowest year-over-year rise in five years and further confirms our outlook that US Industrial Production will slow noticeably through the latter half of the year. On an annual average basis, Industrial Production is still up 3.7% from one year ago, but the rate of rise is clearly diminishing.

Along with slowing economic growth comes negative emotional reactions and downbeat media headlines. Recent news articles are harping on the softness in the industrial side of the economy. As an ITR reader you should not be getting caught up in the hype. If you have heeded our warnings, your business is well-positioned for a decelerating US economy in 2015; avoiding linear sales and budget projections this year, but also eschewing harsh cutbacks. No need to be overly worried about the slowdown. It will persist into about the first quarter of 2016. Accelerating rise will characterize the US economy once more in 2016. It is important to focus on preparing your business for the acceleration in 2016.

Within the components of U.S. Industrial Production, low commodity prices are having a substantial impact on Total Mining Production . Mining activity in April was only 1.0% ahead of last year, the mildest such gain in over five years. Our analysis of commodity prices and leading indicators tells us that the mining industry is going to slow further during the coming months. In addition, the Manufacturing component of Industrial Production is also easing, although it is up 3.9% over the past year. Expect further deceleration through the latter half of this year, particularly in the high end capital goods sectors.

One development that you need to be aware of this month (especially if you incorporate our leading indicator programs into your strategic planning) is the recent, dramatic revisions undertaken by the US Census to the estimates of New Orders for a broad range of goods. The revisions impact the period from 2011 to present, and involve substantial downward adjustments to the capital goods new orders series that are key to many of our subscribers. In turn, the revisions have necessarily spurred ITR to adjust our forecasts accordingly. In particular, Nondefense Capital Goods New Orders (excluding. Aircraft) , Industrial Machinery New Orders, and Defense Capital Goods New Orders are all being driven into recession this year in light of the newly released data. Construction Machinery New Orders, Metal Working Machinery New Orders, Electrical Equipment New Orders, and Computer and Electronics Products New Orders are all fairing relatively better under the revised data, still on track for soft landings this year. If you are currently participating in our leading indicator programs, you should already have been contacted regarding the implications of these revisions for your planning by your personal ITR program economists. If your Trendcast or EVP analysis is due for an update or if you've taken the initiative to track these leading indicators on your own, then now is the perfect time to contact us for a consultation.

Competitive Advantage in a Slowing Economy

The US economy undoubtedly is in the slowing phase of the business cycle. As growth slows (and some markets see outright decline) the need to retain your edge in the face of increasingly motivated competition is greater than ever. A key objective that we have been emphasizing lately during periods like this is to leverage your competitive advantages to maintain or grow profitability even as your markets slow. What does this mean?

The two fundamental sources of competitive advantage are product/service differentiation and cost advantage. In simple terms, do it better or do it cheaper. On the downstream side these means capturing a larger slice of a static market, or perhaps even a shrinking market, by offering your customers a superior product at a better value than your rivals. As our friend Jaynie Smith at SmartAdvantage teaches, it is imperative that what makes the product or service superior be quantified in terms the customer care about. On the production side, competitive advantage means maximizing technological, input cost, or recruitment advantages you have over competing producers.

Identifying and marketing your existing competitive advantage or creating a new competitive advantage at the right time can help you buck the trend of slower sales growth and a sluggish economy this year.

Product Differentiation

As market activity slows on the backside of the business cycle, the need to differentiate yourself from your competitors becomes acute. Buyers facing increased pressure will look to cut costs for nonessential outlays so you need to make yourself essential. Above all, do not become a commodity that cash strapped customers will try to economize on when the macroeconomic situation deteriorates.

Not only do you need to identify your differentiators, but as Jaynie Smith emphasizes, you need to communicate them so that they appeal from you customers' point of view. The value and uniqueness of your product or service needs to really shine through to your customers now more than ever when we are experiencing slowing rates of growth. Clear communication of a quantifiable benefit that you offer and others don't is key.

Cost Advantage

Current business cycle conditions present another avenue for competitive advantage. We know that the normal cycles of input prices, output, prices, wages, and financing expenses occur. Timing these cycles in order to lock in long term supply agreements, labor contracts, and leases under current conditions of mild pricing and low inflation expectations can provide you with a significant cost advantage over rivals, boosting your margins as you head into the more lucrative times on the upside of your business cycle.

Conversely, avoid dropping your prices as the low point of the cycle approaches. Cheapening your product can lead you into the trap of commoditizing yourself, negating any product differentiation advantage you have spent the time and effort to build up. It can also make raising prices later more difficult if it alters customer perceptions of the value of your product. If you must, consider introducing a separate, economy brand to avoid tarnishing the luster of you prime offerings.

Timing

With any of these approaches to competitive advantage, a reliable outlook on current and oncoming macroeconomic conditions is critical. Track and understand your own business cycle, leading indicators of your input and output markets, and of potential new markets. You need the insight to know when to make your move to achieve successful, sustainable competitive advantages for your company .

RETAIL SALES

Over the past 12 months, Retail Sales increased 4.9% the fastest annual rate of growth in nearly 11 years. The US consumer is strong. However, tentative signs are developing that suggest the rate of growth will slow during the coming months. The quarterly growth rate has trended lower over the past two months. This suggests that annual growth may begin to slow as we move into the latter half of the year.

MANUFACTURING

The Manufacturing component of Industrial Production is easing, although it is up 3.8% over the past year. Expect further deceleration into the latter half of this year. The monthly Manufacturing Capacity Utilization Rate is slipping, now at 77.8%, down from a post-recession November 2014 peak of 79.0%.

MEDICAL

Medical Equipment Supplies & Production through May is up 5.2% from the 12 months prior, but growth is slowing. The current decelerating trend will persist through the remainder of the year. Electromedical and Electrotherapeutic Apparatus Production are up 7.6% from last year. However, annual growth is at a tentative peak, with quarterly trends slowing. Expect slower growth in this market.

WHOLESALE TRADE

Wholesale Trade of Durable Goods is at a record high and 5.9%above one year ago. Growth will continue through 2017, but at a milder pace over the next five quarters. Wholesale Trade of Nondurable Goods during the same period is a weaker 0.8% below the year prior, with a 7.4% decline in the quarterly data.

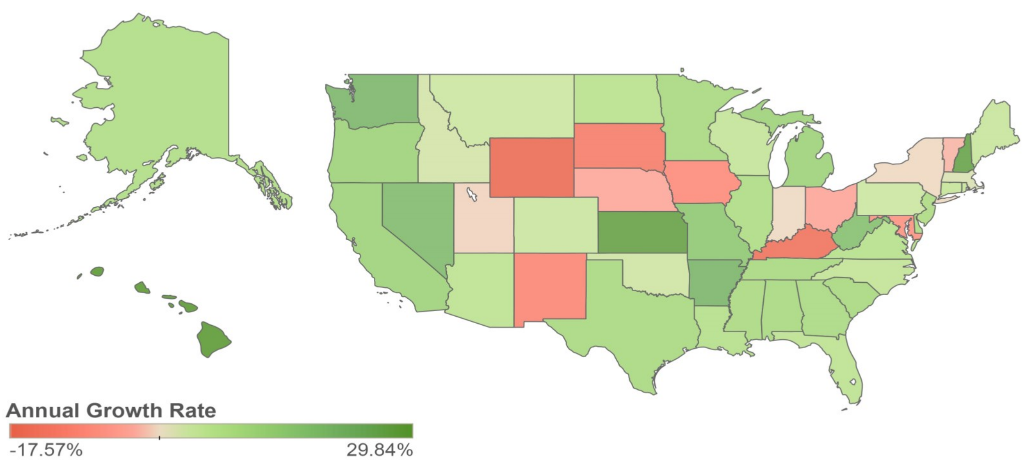
INTEREST RATES

Long term rates are all moving upward in parallel. Long Term Treasury Bond Yields inched up in May, closing the month at 2.12%. Municipal Bonds show a similar movement, with a rising trend in the three-month moving average firmly in place in the second quarter. A comparable trend is evident in 30-year Conventional Mortgage Rates.

CAPITAL GOODS NEW ORDERS

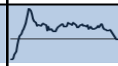
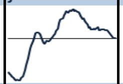
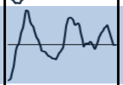
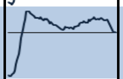
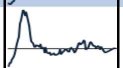
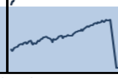
The trend for Nondefense Capital Goods New Orders was revised lower by the US Census Bureau. We are still projecting business cycle decline into late 2015, but the outlook is more negative. A significant, but brief, recession will occur in Capital Goods in the second half of this year.

STATE-BY-STATE: US Permits



Housing Permits for the US overall are positive, but growth is slowing in regions that were key to the recovery from the great recession and a few clusters of negative activity have developed. The annual rate of Permit growth in the big oil states Texas and North Dakota has dropped into single digit rates, 9.5% and 6.2% respectively. Oil drilling activity has plunged on low crude prices, with the North America Rotary Rig Count down 51.9% from one year ago. Negative activity in Permits is clustered in several Great Plains states and in the Ohio River basin. By this metric, the Pacific Coast states still offer the best opportunities as a region.

SNAP SHOT INDICATORS

Indicator	Direction	What it means for the US economy
ITR Leading Indicator™ (Actual)	 Decline	Slower growth in the economy at large
Housing Starts (Most recent 12 months compared to same 12 months one year ago)	 Flat	Steady at current levels
Consumer Expectations Index (Most recent 12 months compared to same 12 months one year ago)	 Rise	Consumers are confident in the economy
Chicago Fed National Activity Index (Three-month average)	 Horizontal	Continued deceleration next 2-3 quarters
US Leading Indicator (Most recent month compared to same month one year ago)	 Mild Decline	General deceleration in US economy
Purchasing Managers Index (Most recent month compared to same month one year ago)	 Decline	Slowing growth into early 2016
S&P 500 Stock Prices (Raw Data)	 Generally Rising	Input is still cautionary
	LONGER-TERM View:	
2015: Moderating Expansion	**2016: Robust Economic Activity**	**2017: Ongoing Strength**

READER'S QUESTION

I'd be interested to hear your view on the idea that the global slump in oil and industrial commodity prices signals that there has been no real economic recovery since the Great Recession, just an artificial run-up in financial asset prices.

Jim Chappelow, an economist at ITR Economics, answered: There has indeed been a measurable recovery in real economic activity in the US beyond just the on-paper recovery in financial asset markets. This is clearly evident in the industrial production and construction data. It cannot simply be chalked up to some kind of illusion.

That said, we are also very sympathetic to the view that the recovery in financial asset markets has been largely driven by artificially low interest rates and quantitative easing by the Fed. This has also spilled over into the recovery in the real economy as well, especially export oriented manufacturers who benefited from the relatively weak dollar (up until last summer) and oil producers who were able to finance marginal opportunities by floating high yield (junk) bonds.

The bottom line is that there is some real underlying strength to the recovery in the US, but to some extent (and especially in finance) it has also been built on the artificial crutch of monetary policy. With the end of quantitative easing last fall and the impending interest rate hikes we will see just to what extent which trend will dominate. Our expectation is for a soft landing for 2015 that will involve sloughing off some of the excess malinvestment that has accumulated over the past several years of overly easy money.

FED NOTES

The Federal Reserve Board announced at its June meeting that it will not begin raising interest rates for the time being. The Fed will look for ongoing gains in employment and inflation moving back toward the target 2% rate before moving to raise rates. We have recently downward revised our forecast for the Consumer Price Index. Inflation will remain subdued this year, approaching the 2% target in the first half of 2016.