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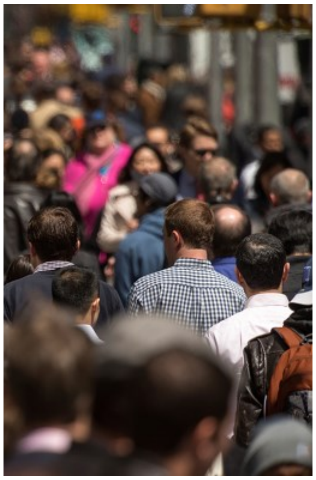
## Macroeconomic Review



### Make Your Move™

Global economies and domestic industries are not moving in sync in the current cycle. Focus on US, consumer-based opportunities for the next several quarters.

### Inside this issue:



Total US Industrial Production for the 12-month period ending in February increased 4.2% from the year before. Annual average Production is at a record-high level, and all signs point to further gains in the coming months. However, the rate of growth appears to have peaked in January, and we expect uneven growth going forward in 2015. Results are running slightly hotter than our expectations for now, but the timing of the shift in the trend is right in line with the long-term outlook. Input from the leading indicators continues to support a longer-term trajectory of ongoing growth, albeit at a decelerating pace in 2015. Our macroeconomic outlook remains unchanged.

A slower rate of growth in *Oil & Gas Extraction* is one of the contributors to slowing economic activity in terms of production. Low oil prices are not likely to derail extraction entirely, as those who can still produce profitably are trying to make up on volume what they have lost on margins, but it will not grow as rapidly throughout the year as it had over the past two to three years. The consumer in general stands to benefit from this.

Trends in the US economy are in stark contrast with economic trends elsewhere. While the US economy is on balance strong, as evidenced by growth in US Total Industrial Production and a very healthy consumer sector, the cyclical indications for China, Europe, Japan, and South America are in varying stages of decline. The global economy is not synchronized at this time, but the regions will likely fall closer in line with one another in 2015 with some deceleration in the US industrial trend. To be clear, the leading indicators included within this report are telling us that economic activity in the US will slow but most sectors will not contract and will not fall below year-ago levels. We are projecting that a more synchronous global economy will exist in 2016 as the above listed regions shift into business cycle rise. For now, North America, led by the US economy, is clearly outperforming most of the global economy.

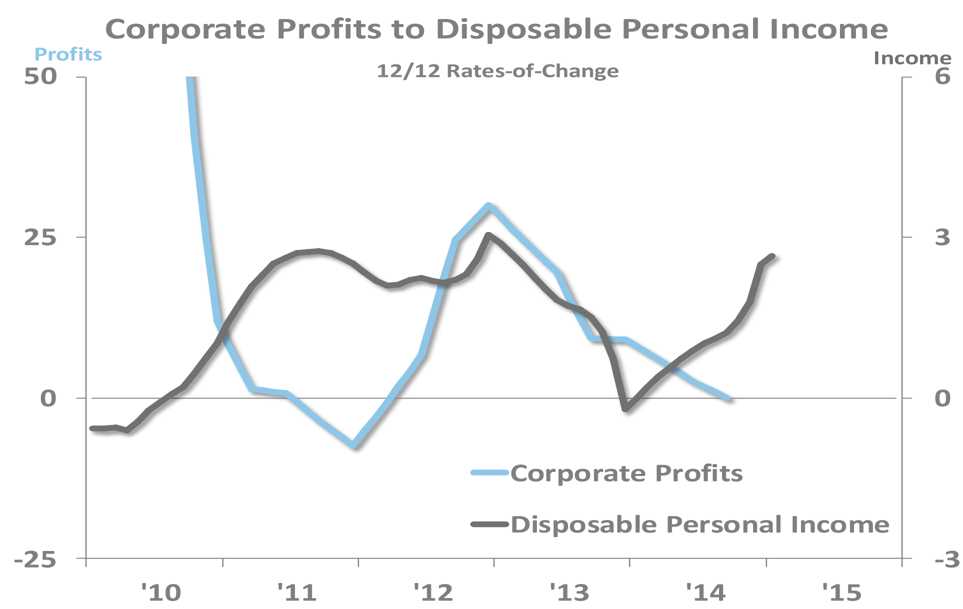
Across the Atlantic, the leading indicator trends are relatively ominous. The leading indicators portend cyclical decline in 2015 for most of Europe. As a sidebar, this is a bad time in the cycle for Greece to be going through its machinations. The potential disruption caused by Greece will not have an immediate, appreciable negative impact on the US, though potential fallout of greater weakness for the euro could translate into an even stronger US dollar, which is a trend that would largely be counter to the health and welfare of the US economy.

## The Great Rotation

As we move through the early portion of 2015, the tectonic plates of the US economy are stirring and the pillars that are supporting the world's largest, most resourceful, and vibrant economy are shifting. We are seeing the weight of economic growth fall from the shoulders of the industrial sector and shift onto the back of the US consumer. The good news is that the American consumer is well prepared to do the heavy lifting with a solid foundation of strengthening trends.

In 2014, businesses were doing the majority of the heavy lifting, spending the money to support accelerating economic growth. Throughout the year we saw *Nondefense Capital Goods New Orders* accelerate as companies invested in their business at a quickening pace. In 2014 *Retail Sales* (adjusted for inflation) increased only a mild 3.9% and decelerated through the majority of the year. In early 2015 we are seeing that spending trend shift. Consumers are starting to spend at a more rapid pace with Retail Sales in January coming in 7.7% ahead of January 2014, the fastest such increase in nearly 13 years. Improving *Employment*, increasing *Disposable Personal Income*, and lower prices at the gas pump leaving more money for discretionary spending, are all bolstering the consumer trend. At the same time, Nondefense Capital Goods New Orders are slowing in their rate of rise and *Corporate Profits* drastically slowed to a mere 0.4% annual growth rate in the third quarter of 2014 (most recent data available). Increasing upward pressure on wages, foreign competition weighing on prices, and higher employer contributions to healthcare have all dampened companies' bottom lines.

Another drag on US businesses is the strength of the US dollar. The US dollar has appreciated against all major currencies over the past few months. This has a more negative impact on US businesses than on consumers. For some businesses, a strong dollar means that their products are now more expensive on the foreign market relative to products priced in foreign currencies. This can weigh on both export and domestic demand for products, as consumers will tend to buy the cheaper foreign goods. However, this means stiffer price competition for US companies selling in the US economy. *(continued on the next page)*



## The Great Rotation

Consumers on the other hand, are benefitting from the stronger dollar. They now have more spending power to purchase some imported consumer goods for much cheaper, resulting in fatter wallets for other purchases. This also applies to domestically produced commodities that are traded and priced in global markets, such as crude oil and its derivatives.

All of these things combine to tell us that the trend of the US consumer is strengthening while businesses are becoming slightly more hesitant in 2015. Our forecasts for *Industrial Production* and *Gross Domestic Product* (GDP), which have been in place since July 2014, reflect this trend. We project that the growth rate for Industrial Production, which measures manufacturing, mining, and utilities production, will decelerate as we head through the final three quarters of 2015. Our forecast for GDP on the other hand, which adds in the measure of the construction industry, service sector, agriculture and retail sales, is expected to have a more robust rate of growth throughout the year and is not projected to see much deceleration.

What does all of this mean to your business? Are you a business-to-business (B2B) company? Are your clients primarily the end customer making you a B2C (business-to-consumer) company? This is the first question to answer. If you are a B2B business, the next step is to determine who your client base is. Are they B2B or B2C companies? Is it a mixture of both? Your answers to these questions should shape the way you handle the next three to four quarters.

The further into 2015 and 2016 we trudge, the stronger the consumer will feel and the less sensitive to prices they will become. If you are a B2C business, use this time to focus marketing strategies on building your brand. Identify your competitive advantages and communicate them to both current and potential new customers. Make sure they know why you are a premium product and why they should be willing to pay more for your good. With the consumer based side of the economy expected to be accelerating this year, it is key to ensure that you are ready and able to keep pace with the increased level of activity. Examine your capacity throughout the entire process from the sales team to the distribution channel. Did you feel strained in 2014 at any point along this production chain? If so, you will feel even more stressed in 2015 and 2016. Focus on workforce development through hiring, training, and retention to increase labor capacity. Do you need to invest in equipment or machinery to grow your production capabilities? Consider expanding distribution channels if you feel you may need additional capacity. All of these things will help ensure that the quality of your product and customer service keeps pace with increasing volume.

If you are a B2B company, look at the customers that your clients service. If it is a mixture of both businesses and consumers, then focus your marketing efforts toward the B2C client base. These are the businesses that will be growing the fastest and more likely to quickly open their wallets and invest further in the business this year. If you are a B2B business and all of your clientele are B2B businesses as well, there is no need to be pessimistic. There will still be opportunities for growth as we anticipate most sectors of the economy to be expanding; the industrial side will just do so at a decelerating rate. Use this period of slower growth in 2015 to prepare for the acceleration trend that will return in 2016 as the US and global economies get back into sync with one another, resulting in a prosperous year for all industries alike. Continue to improve, invest in, and expand your business and marketing strategies, but just beware of linear budgeting as growth will not likely develop at the same pace as in 2014. If capacity was tight in 2014 at all, lucky for you, you are a B2B business. 2015 will allow you to take the time to adequately prepare for the accelerating growth trend in 2016.

## RETAIL SALES

Retail Sales continued to show considerable strength in January, coming in 7.7% above January 2014, the strongest month-over-month gain since 2005. Annual Retail Sales are growing 4.4% year-over-year, at their fastest pace in over 10 years. We anticipate that Retail Sales will slow in the second half of the year when the overall economy has shifted into lower gear.

## MANUFACTURING

Overall, the US manufacturing sector is strong. There are tentative signs of slower growth ahead in the Purchasing Managers Index. New Orders for Metalworking Machinery, Industrial Machinery, Construction Machinery, and Electrical Equipment, as well as Heavy Duty Truck Production, are all slowing. The global economic slowdown, and strong US dollar, are weighing on Exports.

## MEDICAL

Annual *Medical Equipment Supplies & Production* is 6.9% above the year-ago level. The quarterly trend slowed in February. Annual Production will rise through late-2015 before remaining relatively flat until mid-2016. *Electromedical, Measuring, and Control Instruments New Orders* show an accelerating upward trend, up 10.2% from one year ago on an annual basis. However, this growth may slow in the next few months.

## WHOLESALE TRADE

Annual Wholesale Trade of Nondurable Goods finished 2014 4.5% ahead of the 2013, although weakness was evident in the fourth quarter, with Trade down 0.5% from the same time last year. Wholesale Trade of Durable Goods rose 5.8% in 2014. We anticipate that Wholesale Trade will grow through 2017, but the pace of rise will diminish beginning in 2015.

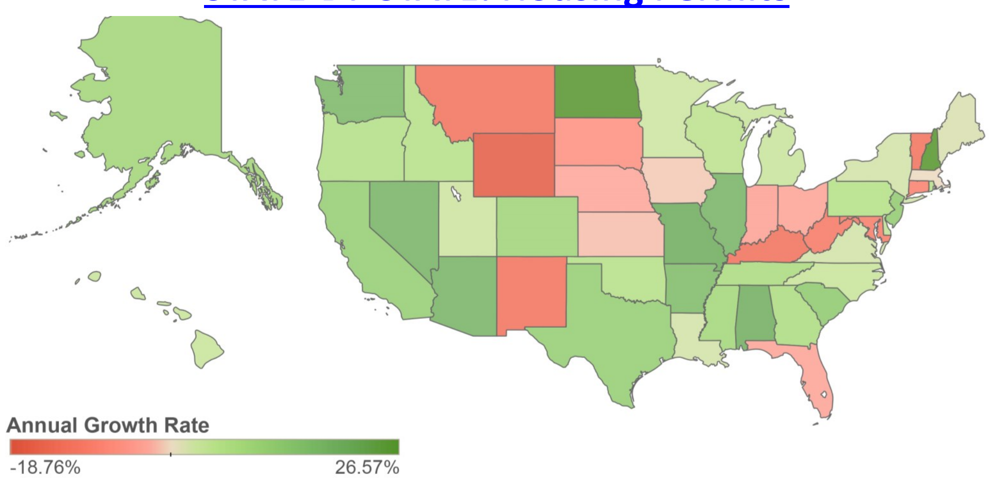
## INTEREST RATES

Treasury Bond Yields and Corporate Bond Yields both saw the fairly big drop in January essentially wiped out by nearly as big a rise in Yields in February. Despite the volatility, the net trend is still decline for now. In the long term, the era of ultra low benchmark rates is ending. Borrow this year.

## CAPITAL GOODS NEW ORDERS

Nondefense Capital Goods New Orders remains in a general downward cyclical trend. Expect New Orders to remain on the current trajectory through the first three quarters of this year. Growth will subsequently reaccelerate into mid-2017 before slowing once more in the latter half of the year.

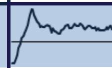
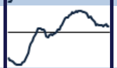
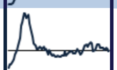
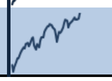
## STATE-BY-STATE: Housing Permits




The Housing Permits trend status is generally positive across the Southeast, Mid-Atlantic seaboard, and the West. Florida (-3.4%) and Maryland (-10.2%) are notable exceptions here. States in the lower Mid-West and upper Great Plains are still showing substantial decline in Permits.

Annual *Housing Starts* at the national level ticked slightly lower in February, totaling just over 1.0 million units, though this is a 9.6% increase from last year. The *Conventional 30-Year Mortgage Rate* leveled off in February, holding steady at 3.71%, maintaining the lowest Rate seen in almost two years. As the Federal Reserve's strategy for raising interest rates comes into clearer focus, buyers will likely by enticed to make the jump into home-ownership before Mortgage Rates begin to experience upward pressure.

## SNAP SHOT INDICATORS

| Indicator | Direction | | What it means for the US economy |
|---|---|---|---|
| **ITR Leading Indicator™** (Actual) |  | Decline | Decelerating economic growth through 2015 |
| **Housing Starts** (Most recent 12 months compared to same 12 months one year ago) |  | Rise | Slower growth in the overall economy this year |
| **Consumer Expectations Index** (Most recent 12 months compared to same 12 months one year ago) |  | Rise | Consumer-based economic expansion this year |
| **Chicago Fed National Activity Index** (Three-month average) |  | Horizontal | Mild rate of economic growth in 2015 |
| **US Leading Indicator** (Most recent month compared to same month one year ago) |  | Mild Decline | Deceleration in economic growth rate later this year |
| **Purchasing Managers Index** (Most recent month compared to same month one year ago) |  | Decline | Slower growth in US Industrial Production in 2015 |
| **S&P 500 Stock Prices** (Raw Data) |  | Generally Rising | Near-term indications for the economy are positive |
| **LONGER-TERM View:** | | | |
| **2015: Moderating Expansion** | **2016: Accelerating Growth** | | **2017: Robust Economic Activity** |

## READER'S QUESTION

*We are considering our options concerning expanding our facilities along with some other longer term thinking. 2015 through 2017 look good from the standpoint of US Total Industrial Production -we can make money in this market. However I recall concerns mentioned some time ago about 2018 / 2019. Can you comment on that or point me to a blog, etc? Someday the debt will catch up to us?*

**Jim Chappelow, an economist at ITR Economics, answered:** Thanks for your question. We expect 2016-2017 to really be the last, strong boom in the US economy for some time. By late 2018 and heading into 2019 we see downside risk of a recession, somewhere on the order of the 2001 negative cycle. In addition to the fiscal pressures of the debt that you mention, we expect that rising interest rates, real capacity constraints, and volatile pricing for commodities and industrial goods in the economy resulting from uneven expansion will all play a part in the recession and the years beyond. Our advice is that it will be critical to take maximum advantage of this next boom period while it lasts

## FED NOTES

At the conclusion of its March meeting, the Federal Open Market Committee (FOMC), the organization responsible for monetary policy in the United States, dropped its pledge to remain "patient" on interest rates. However, the Committee was also clear that this was not to be interpreted as an imminent hike in rates. Concern about low inflation and moderating economic activity has kept the expectations of committee members for rate hikes tempered, but 15 of the 17 still anticipate an increase sometime in 2015. It should also be noted that committee members expect, when rates start to rise, the increases will be more moderate than previously anticipated.