

# Mr. Fiscal Fire and Mr. Monetary Freeze Conspire

## **Beginning with the Bottom Line:**

*The escalation in trade tensions and the resistance of the Fed to commit to a rate reduction cycle means fiscal and monetary policy tightened even further on the week. In response, markets and yields plumbed new lows. The data received this week depicts weakness in the manufacturing sector and yet strength in the consumer sector. While we appreciate the media's promotion of the consumer as our economic savior, the data reveals that consumers succumb to recessions...they don't create them. As such, we place more weight on the negative signal from manufacturing than the positive signals from retail. Until we see a meaningful lift in the leading economic indicators, our cautious approach to these markets will remain.*

### **The Full Story:**

On Friday, a thunderclap of Trump tweets and frigid Fed speak from Jerome Powell left investors despondent and the Dow down after another volatile week. More tariff talk from Trump amounts to more fiscal constraint while less rate cut talk from Powell amounts to more monetary constraint. Our belief that these forces have conspired to punish the economy and investors only gained further validation this week as the fundamental data arrived, albeit somewhat controversially. US manufacturing activity crossed the contraction threshold for the first time since 2009, but consumer spending and retail earnings reports lifted spirits in refute. How can the manufacturing sector shrink while the consumer sector expands? Timing!

### **Follow the Leader**

We intuitively find the strength of the manufacturing sector as a leading indicator and the strength of the consumer sector as a lagging indicator. In the event business leaders grow cautious, they will first reduce purchases (new orders), they will then reduce labor allocations (hours worked), they will then reduce employee count (unemployment claims) and ultimately stop hiring altogether (unemployment levels). Once compensation levels drop and

jobless levels rise, Americans begin spending less (retail sales). Let's examine where we are in this progression:

### **ISM New Manufacturing Orders**



ISM New Manufacturing Orders tracks whether manufacturers have received more or less customer orders month over month. A number above 50 means more orders this month than last month. A number below 50 means less orders this month than last month. This indicator registered 50.8 in July, signaling virtually no growth in new orders.

### **Manufacturing Hours Worked**



According to the Bureau of US Labor statistics, employees across the US manufacturing sector clocked 42.4 hours a week back in mid-2018. As of July 2019, their weekly hours have fallen to 41.5, indicating a little more than 2% reduction in compensable hours.

### **Initial Unemployment Claims**



While work hours have begun to decline, initial claims for unemployment insurance have yet to begin rising. However, they have recently halted their descent. As displayed, the current level of claims sits well below the nadir reached in previous expansions and when claims do rise, they tend to do so in a hurry.

### **Unemployment Levels**



The US unemployment rate at 3.7% today resides at levels unseen since the 1960's. While we did receive a 3.6% number in April and May, a .1% uptick does not establish a trend. Unemployment rates are low and steady according to the data.

## **Retail Sales**



Consumer spending levels have accelerated this year after slowing a bit from lofty levels last year. This indicator highlights the strength and resilience of the US consumer. In fact, consumer spending levels accelerated right up to the day the last recession began in 2007. Furthermore, retail sales didn't even turn negative until nine months into the last recession. Atlas indeed!

Based upon this analysis, new orders for manufactured goods have flatlined, employers have trimmed work hours but they haven't yet trimmed payrolls, providing enough consumer confidence to underwrite robust consumer spending. While "don't bet against the US consumer" provides confident headlines, the underlying data reveals deterioration and weakening retail sales to come.

*Have a great Sunday!*

**Sources: FRED, Bloomberg, WSJ, Yardeni**