2019 3RD Quarter Economic Update
Is the Economy Booming Part I (August Update),
or Is a Recession on the Horizon (September Update) Part II?

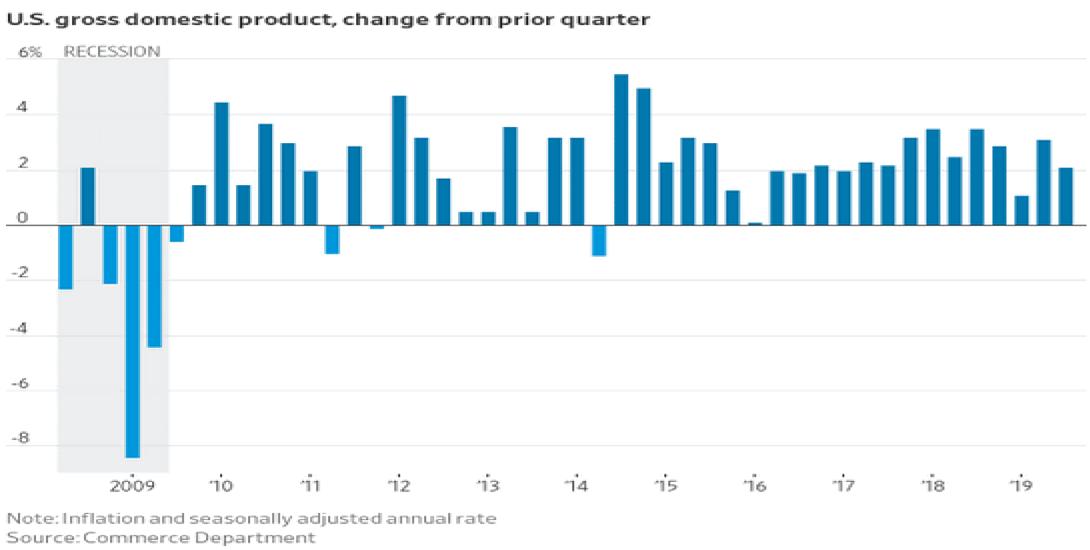
I'm on the board of the local chamber of commerce and most chamber members believe the economy is booming. This sentiment is also echoed by cable news channels and politicians on both sides. Lately, there is talk not only in the financial media, but in all media of the potential for a recession.

In this Update Part I, I will try and answer the question – is the economy booming? In Part II (to be issued next month) I try to answer the question - are we headed for a recession? Answering the question of a booming economy is easier to answer because I look at current economic data points.

The U.S. trade wars are slowing the global economy, and the slowing economy is impacting certain parts of our economy. Can the U.S. economy escape the global slowdown?

Is GDP/the Economy Booming

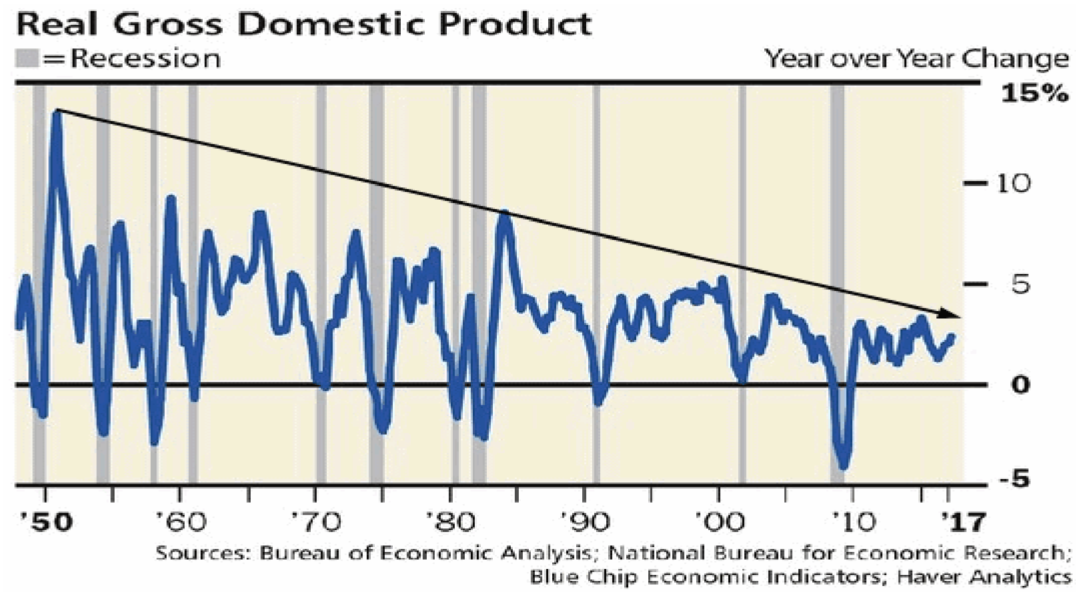
Below is chart for our GDP for this cycle:



Source WSJ, Daily Shot

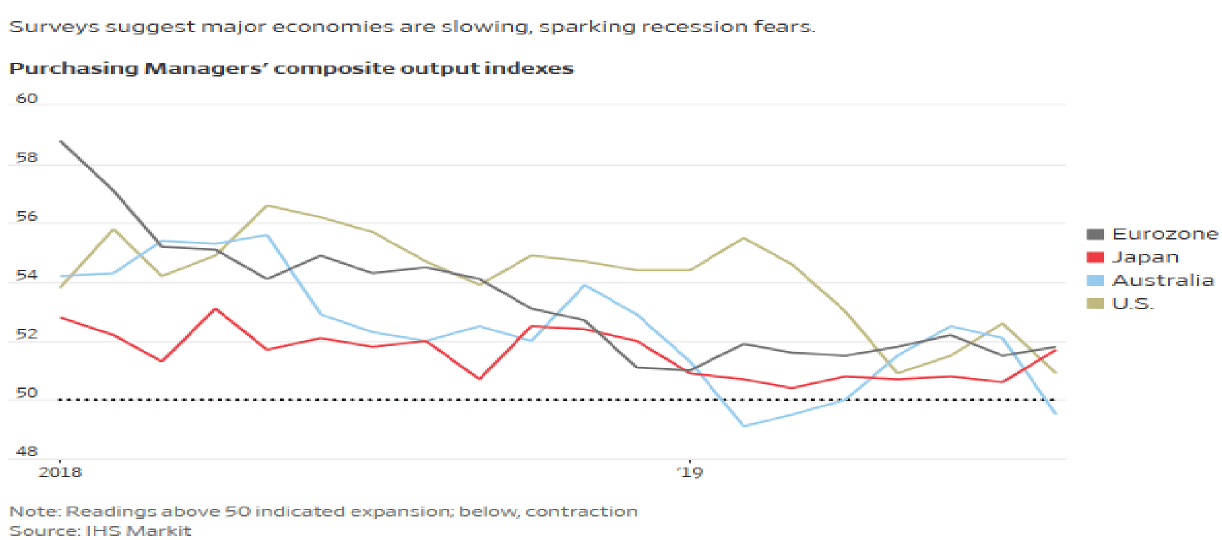
The economy did get a boost in late 2017 and early 2018 thanks to the anticipation of a new business friendly administration with tax cuts and the lowering of regulations and increased military spending. From the GDP chart above, So far this year, the economy is growing about 2.5%, not a booming economy. Earlier in the economic cycle, there were a few quarters where the economy was stronger than current growth but it was not sustainable.

Below is a chart of our economy since 1950 that shows periods when the economy was booming:



The chart shows how the law of large numbers works, as the economy grows from around $2 trillion in the 1950s to over $20 trillion today, economic growth slows as the economy gets much bigger. The 1980s boomed thanks to the large baby boomer population including women and minorities who were all joining the work force, establishing families, buying homes and cars. The 1990s boomed and had several years of close to 5% growth thanks to the digital revolution including the internet, and major advances in software and hardware. The current cycle does not have a major catalyst driving an economic boom like the 1980s (baby boomers) and 1990s (technology boom).

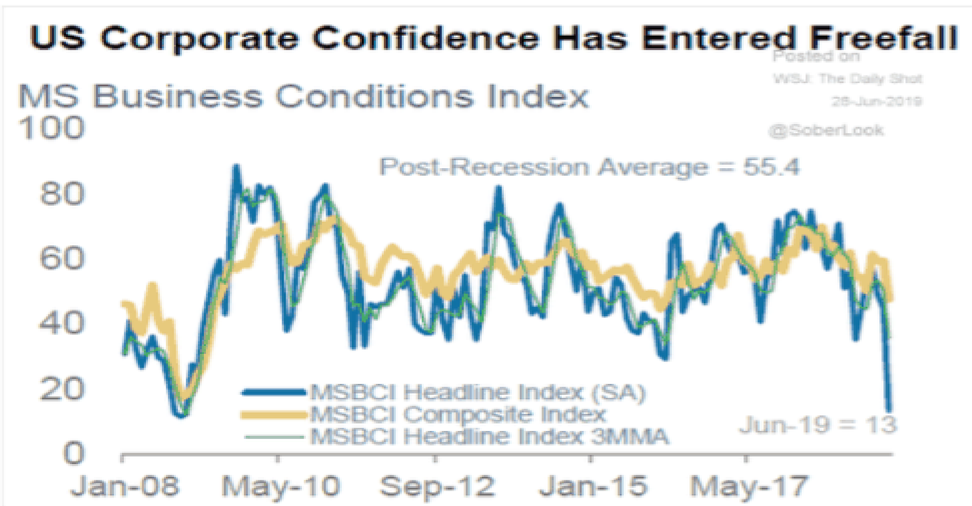
The trade war is causing the global economy to slow as measured by PMI (purchasing manager index).



A reading below 50 indicates the economy is contracting. All economies listed above have fallen and are close to a contracting economy. The U.S. PMI has fallen from around 57 to around 51.

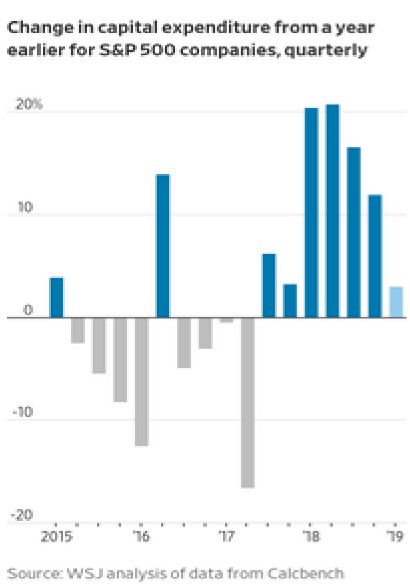
According to the Wall Street Journal "But central bankers made clear they see Mr. Trump's mercurial trade policy as the biggest threat." Global central bankers, investors, U.S. and international businesses are all concerned about U.S.'s trade wars.

Because of the trade wars especially with China, is causing some prices to increase but also the uncertainty is impacting U.S. business confidence as the chart below evinces:



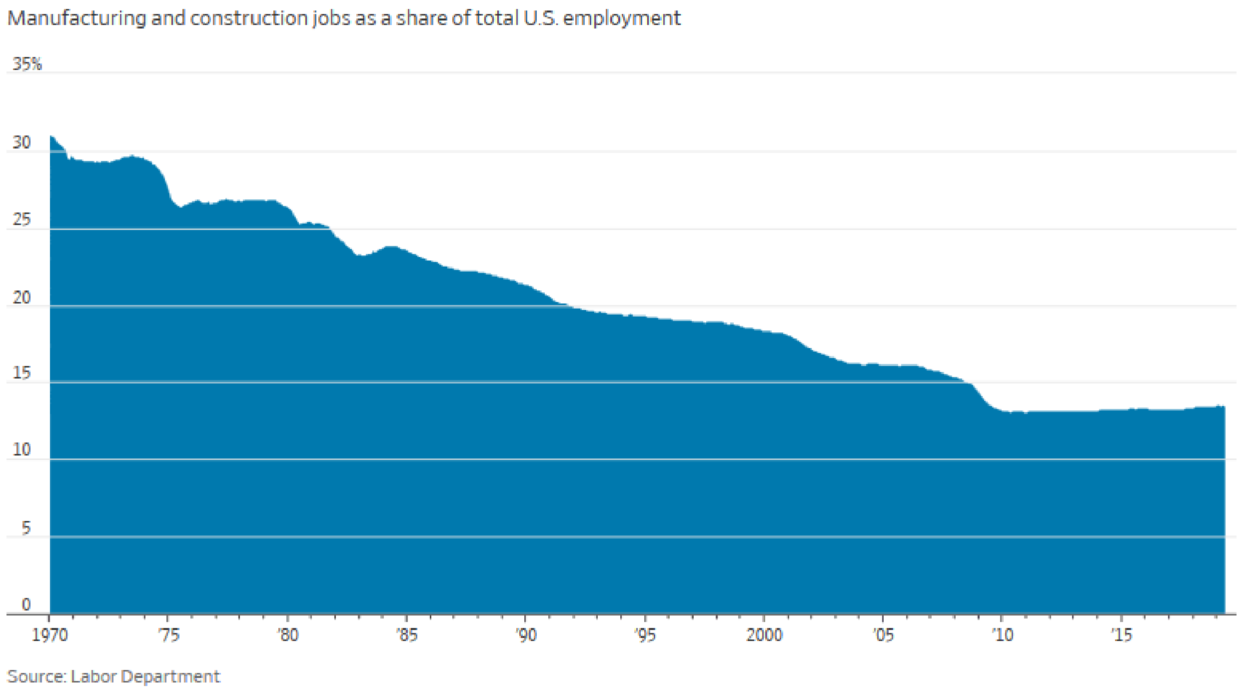
Source: Morgan Stanley, @jsblokland

Capital spending picked up dramatically after the elections, but lower business confidence and uncertainty has caused a dramatic fall in capital spending:



Capital spending is important because it impacts corporate profitability, job growth and normally productivity growth.

The U.S. is the most diverse economy in the world and each industry in our economy also has some of the best managed. Our President has focused on a few industries, manufacturing, energy, coal, steel with regulations and trying to bring back jobs from these industries from overseas. The results of his efforts haven't helped much. Let's look at manufacturing jobs:



In 1970, manufacturing jobs used to be about 30% of U.S. jobs. They have declined to less than 15%. There is a slight pickup the last few years. Jobs were outsourced, but now automation is replacing workers here in the U.S. and around the globe.

The President initiated tariffs on steel to help the steel industry and its workers, a noble effort. The tariffs and tax cuts have not helped most companies in the steel industry:

Source: wwwerlangerchartroom.com

U.S. Steel (ticker X) is down about 75% from its peak at the end of 2017 when tax reform was passed. It looks like X is still making new lows.

Another sign that trade wars are causing a slowdown in the economy are many commodity prices are falling:

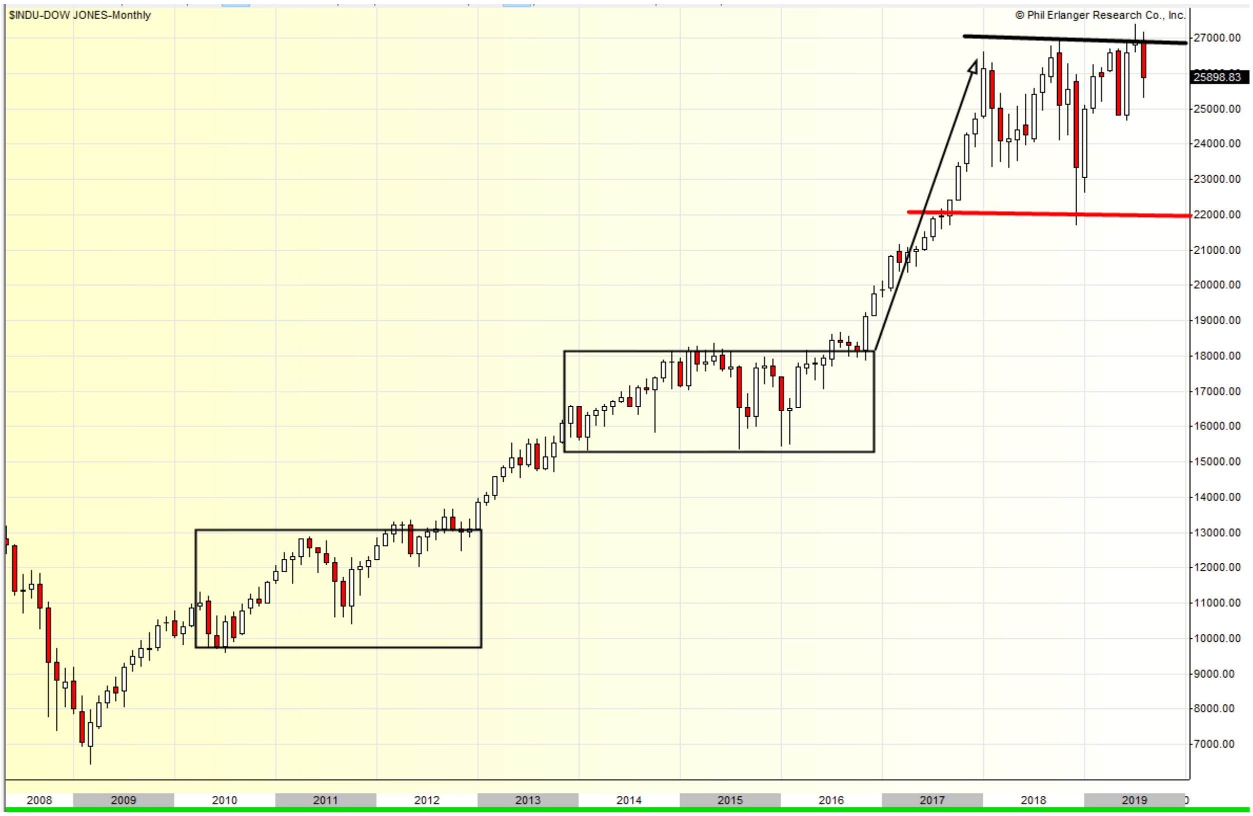
Falling oil and copper prices are a sign of a slowing global economy and less demand.

The President also tried to help our energy industry, especially by opening up ANWR Alaskan land for drilling and approving several energy pipelines but energy industry equities are in bear markets. Below is a chart of the energy exploration and production ETF (XOP):

Source: wwwerlangerchartroom.com

The XOP is down over 50%. Investors forget how much money you can lose in a bear market. I've studied and experienced many bear markets (I've been an investment professional for over 35 years) and I've learned it's investing in bear markets where investors can make the most money (buy low/undervalued and sell high/overvalued). I will write much more about recessions and bear markets over the next few months.

One of the best indicators we have for the economy are the markets. I will go more into what the markets are saying in Part II, but the markets do **not** portray a booming economy. Below is a chart of this market cycle:



Source: wwwerlangerchartroom.com

Let’s review this important chart:

- The bottom of the bear market occurred in March of 2009 at around 7,000. This bull market is the longest on record and is the second best performing.

- Currently, the market has essentially been going sideways for about two years and is forming a major topping reversal pattern, specifically a rounding top. It is a sign that the market is in the mature phase of this market cycle. The next phase is the decline phase. Most major reversal topping patterns last about 14 months.

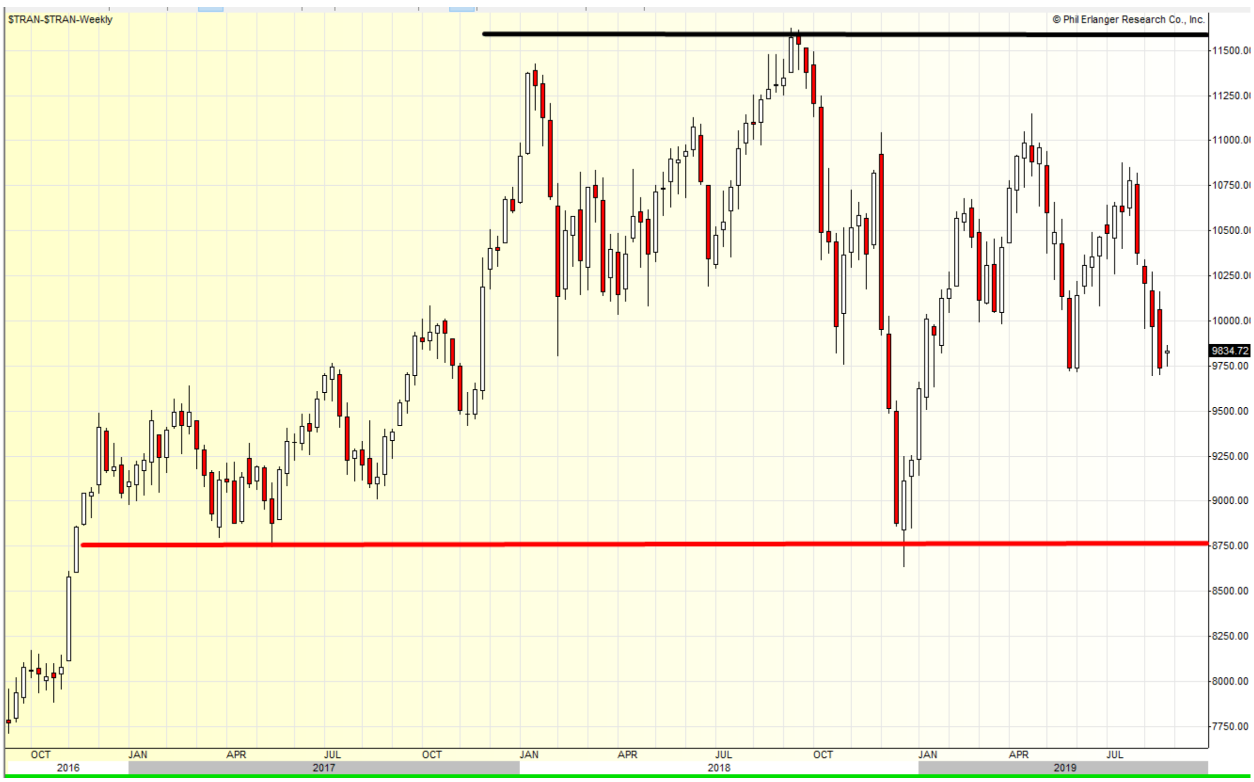
- Notice the rectangle areas where the markets paused. Both pauses were caused by international events.

The first pause was caused by: Grexit and the frailty of the European Union; the Japanese tsunami, earthquake and nuclear plant crisis; the Arab Spring with citizen uprising across Northern Africa and the Middle East (disruption to oil supplies were a concern).

The second pause was caused by the Chinese changing their economic model from an export, manufacturing driven economy to a technology and consumer driven economy. At the start of the transition, many countries and companies that supplied China suffered economically including China and the U.S. This focus on the Chinese consumer will make negotiations with the Chinese more difficult as they are trying to meet their own consumer’s needs internally.

U.S. investors focus too much on the U.S. economy and not on international trends. Most of the risks for our economy are outside our borders but the U.S. is a major contributor to these risks (sanctions against Iran, Venezuela, North Korea and trade wars with Europe, Mexico, Canada, Japan, South Korea, and of course China). Many economies including China, Europe, South Korea and Japan were showing signs of weakness before the. U.S. trade wars started.

Dow Theory has a tenet that the transportation index should confirm the trend of the markets. The main indexes: S & P 500, NASDAQ 100 (QQQ), and the Dow 30 are in major reversal topping patterns. The Transportation Index has also been going sideways for over two years confirming the major reversal topping pattern, but it is weaker:



Source: wwwerlangerchartroom.com

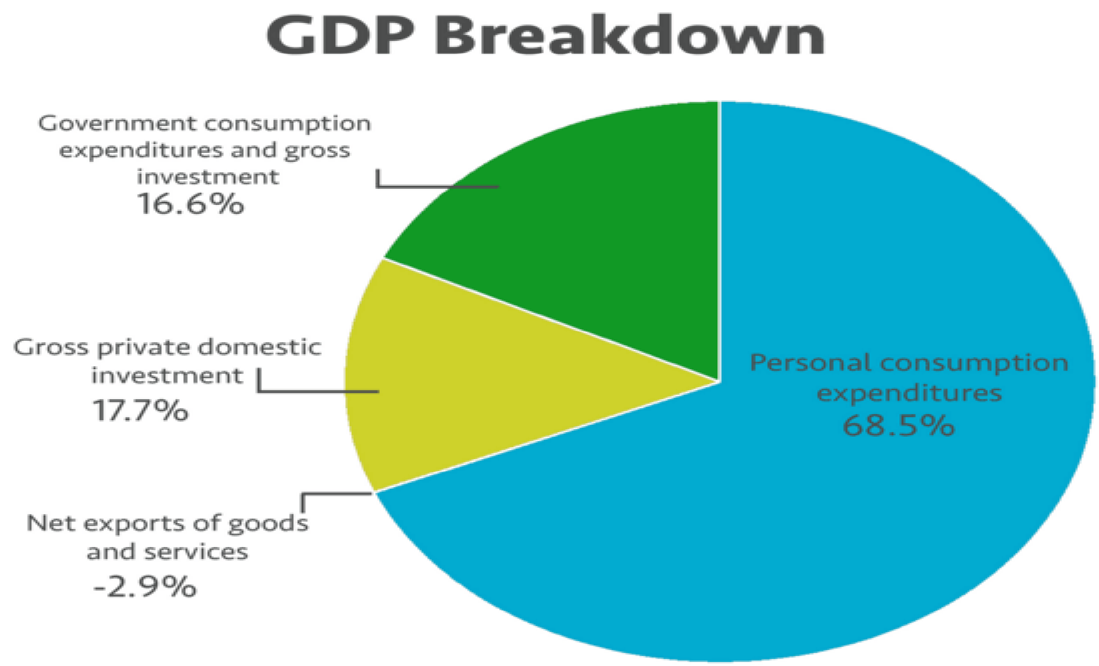
There are more stocks and indexes that look like the Transportation Index and not the major indexes.

The indicators and charts above **do no**t suggest an economic boom. The President needs a good trade deal with China to reverse the uncertainty, tariffs/rising prices and global weakness, but the longer it takes the more damage to the global economy.

There is a major bright spot in the economy - the consumer.

The Consumer

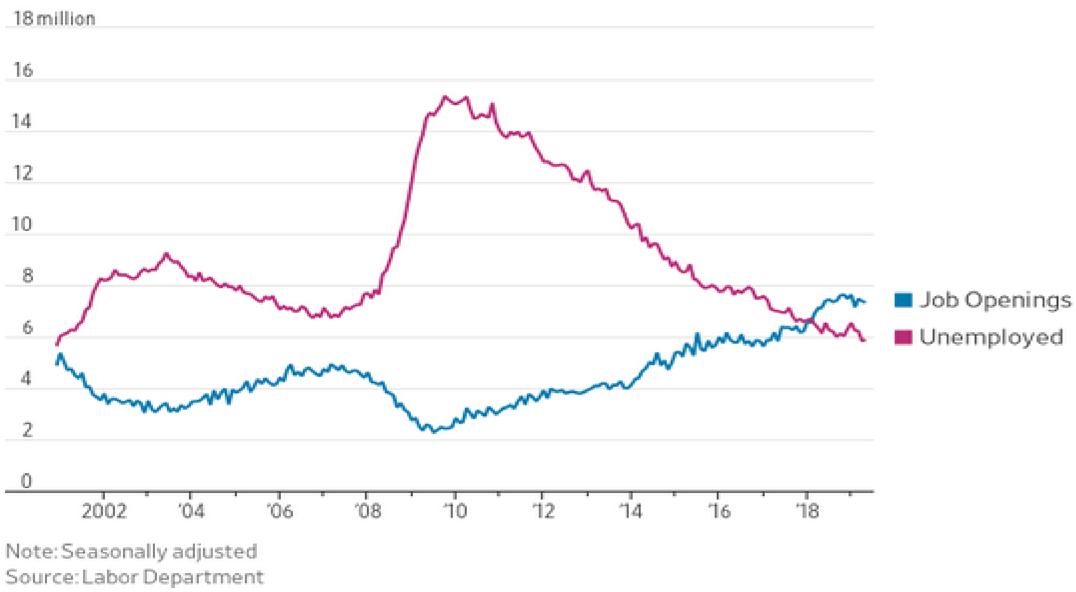
Below is a pie chart that shows the components of our economy:



Source: WSJ

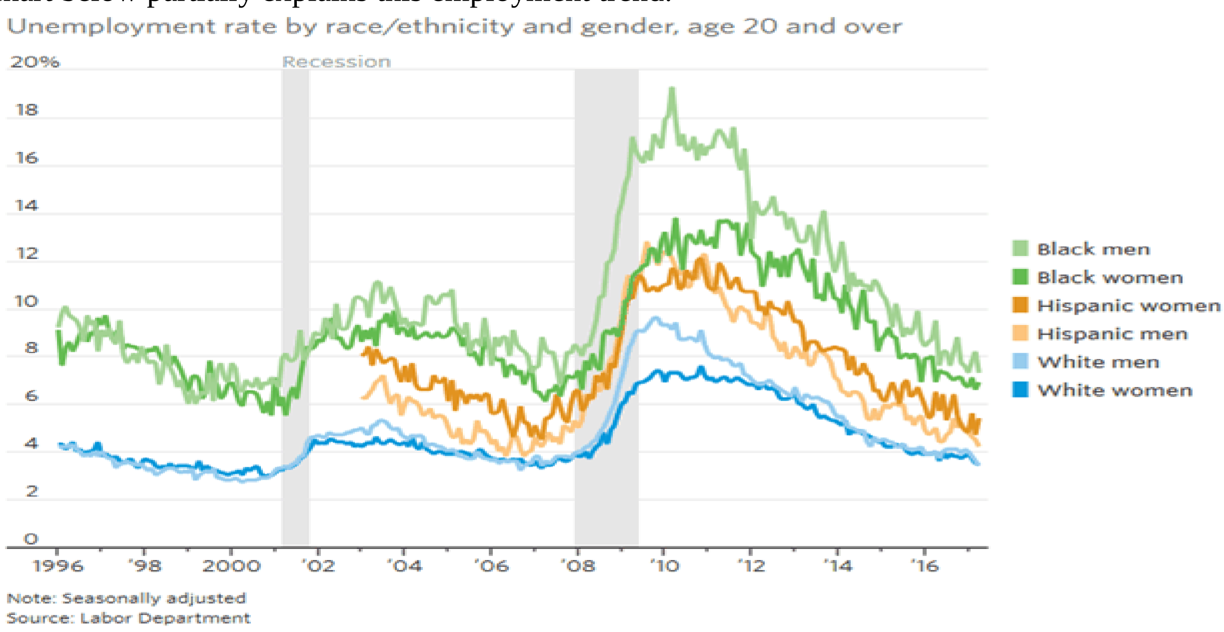
As the chart shows, the consumer is close to 70% of our economy. Fortunately the consumer is the healthiest part of our economy – for now.

There are many indicators to help determine the trends of the consumer. An important indicator is employment trends:



At the nadir of the recession unemployment was about 16 million, but it has come down dramatically to about 6 million. During the same period, job openings increased from around 2 million to almost 8 million. There are now more job openings than the unemployed. Some employers complain they can't find the right workers with the right skills. The U.S. does have a job skills gap. The administration understands this and is considering several proposals to reduce the job skills gap.

The President often touts that Black and Hispanic employment is at historic lows. The chart below partially explains this employment trend:

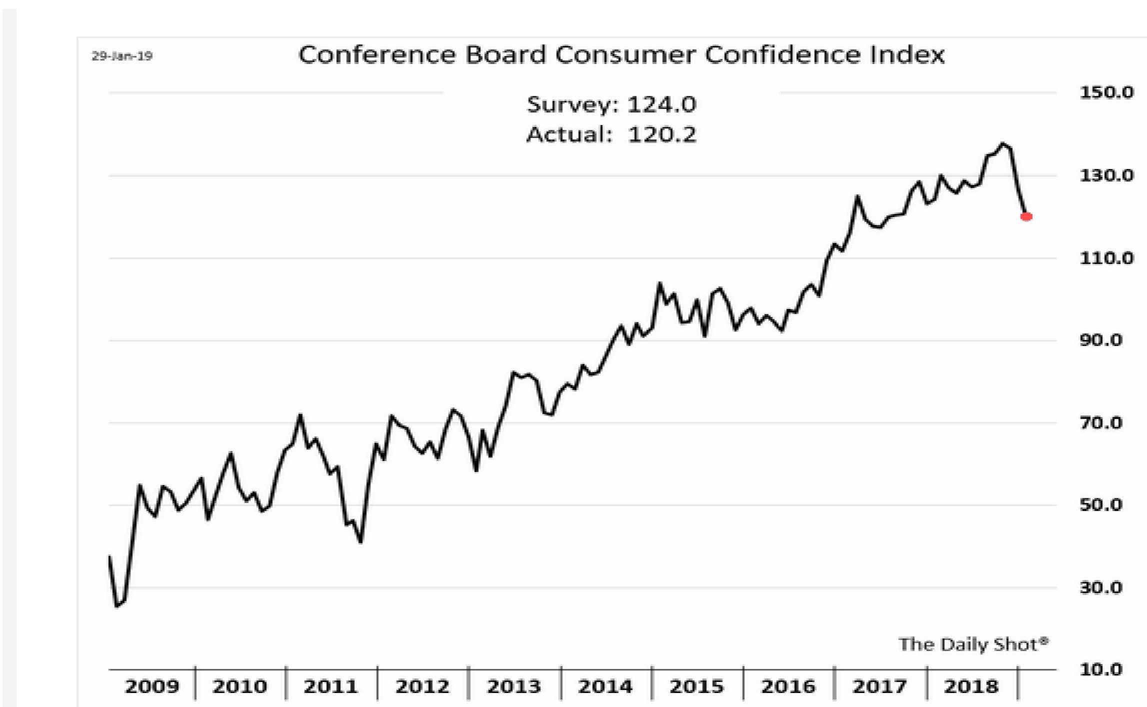


Blacks and Hispanics had much higher levels of unemployment during the Great Recession, so there are more from this population to hire.

Wages have been stagnant for years, but wages are finally growing:

Source: WSJ/Daily Shot

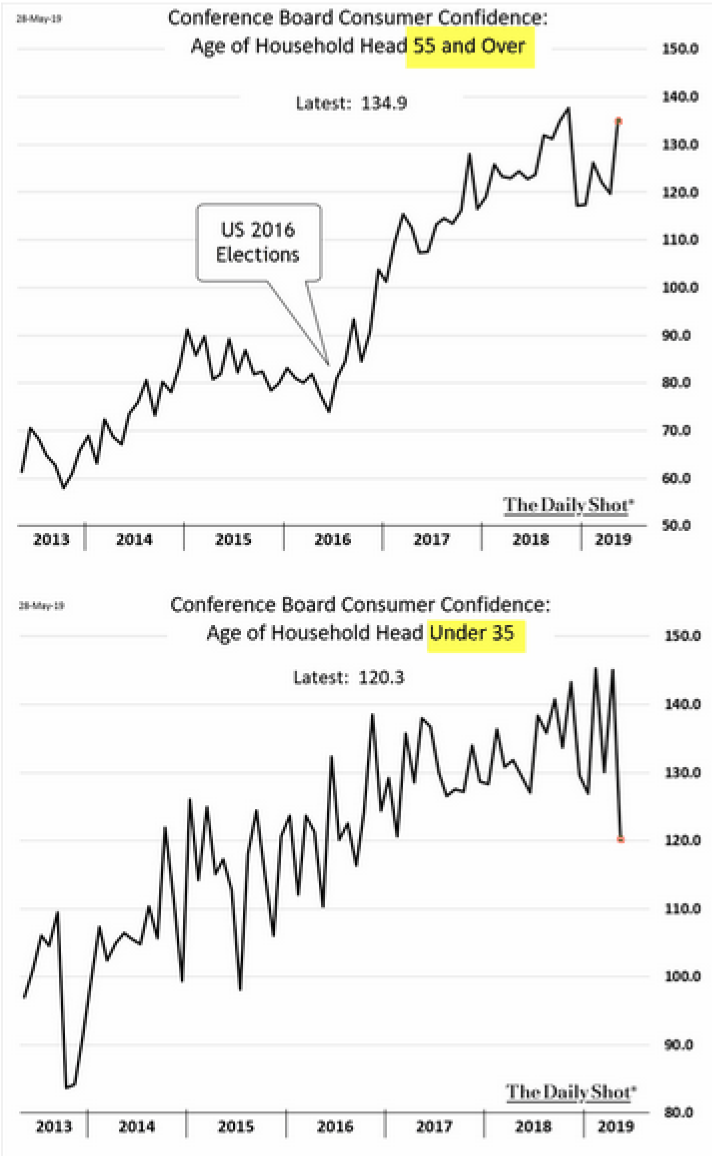
Normally higher employment and higher wages means more people working with money in their pockets that leads to increased consumer confidence that leads to spending and the potential for an expanding economy. Below is a chart that shows the trend for consumer confidence:



Source: WSJ/Daily Shot, Conference Board

Consumer confidence did spike after the election, but it is declining. It did take a hit after the government shutdown in the first quarter.

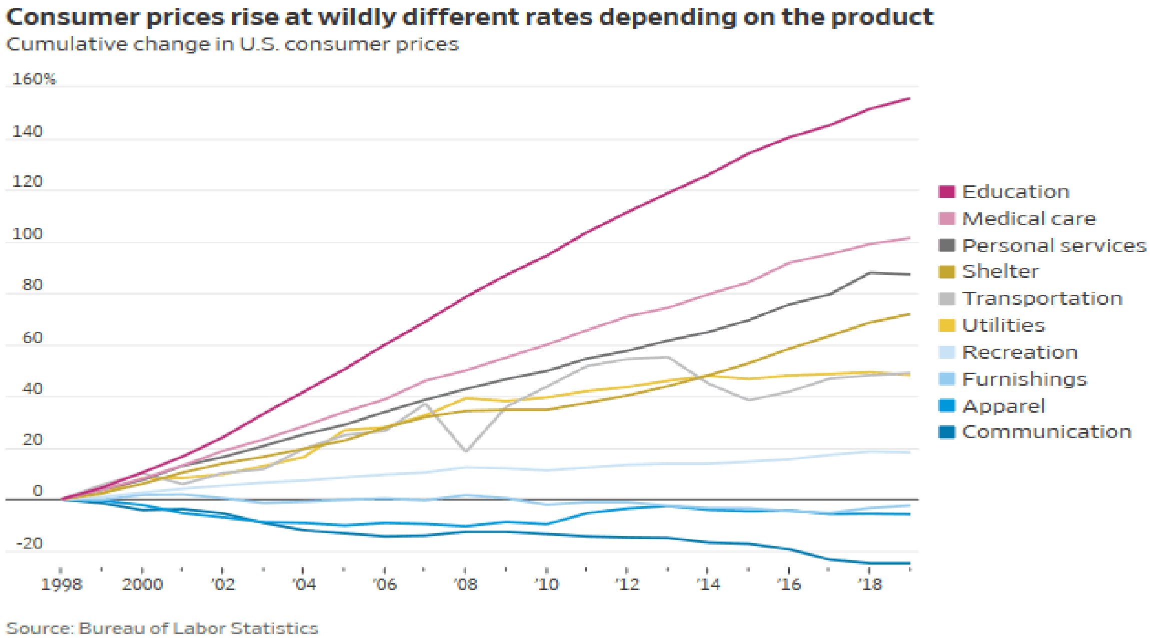
If we peel the onion on consumer confidence we see a more helpful picture for the consumer trends:



Source: WSJ/Daily Shot, Conference Board

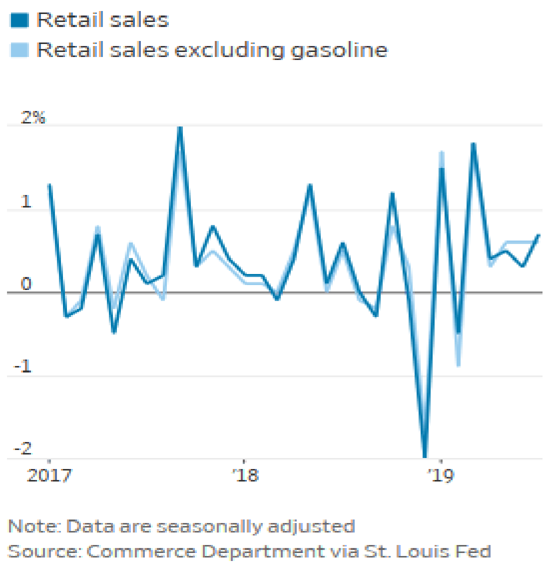
The first chart shows that older consumers have higher confidence than younger consumers as reflected in the bottom chart.

Younger consumers face more headwinds including large school loans and a much higher cost of living than previous generations. Here is a chart of inflation trends for certain services and products:



The cost of education, medical care and not shown child care have increased dramatically more than the average rate of inflation.. This partially explains why younger voters are embracing Bernie Sanders and Elizabeth Warren as both have plans to help younger voters with school loans and health care.

Higher employment, wages and consumer confidence has led to good retail sales:



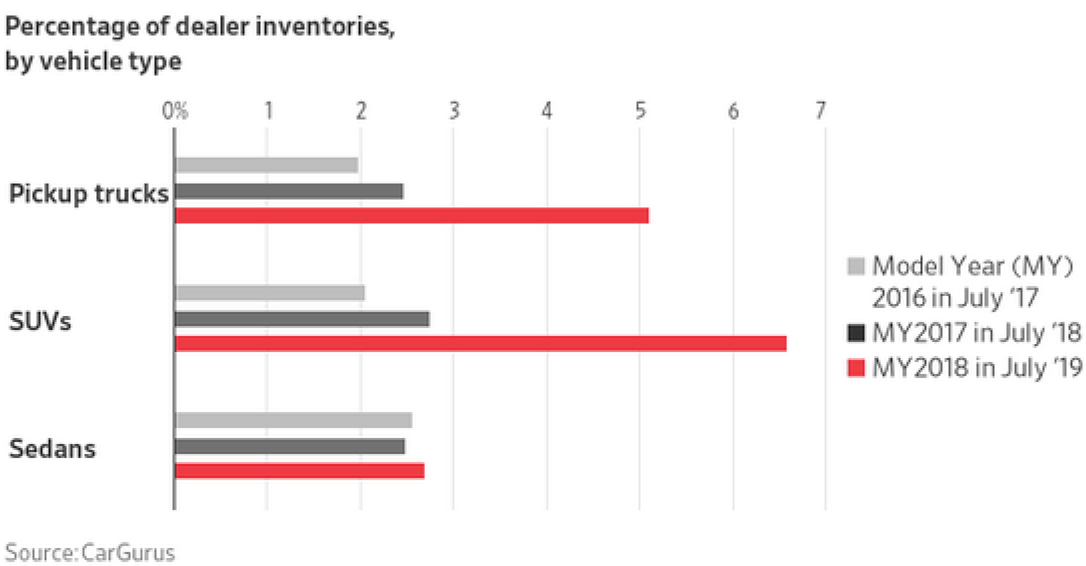
Retail sales are seasonal (Christmas, back to school) and if we smooth the numbers, the average retail sales increase is positive.

The two most important consumer segments are housing and autos and both have been weak. Below is a chart of the trend for housing sales:

Source: National Association of Realtors

Housing sales had been negative for months. Falling mortgage rates have helped July's numbers turn barely positive.

SUV and truck inventories are growing:



Growing inventories are a sign of slowing sales and could lead to layoffs at auto plants and suppliers to the auto industry.

Summary and Conclusion

- U.S. trade wars, especially with China, are causing a slowing global economy including U.S. manufacturing, and capital spending. China, Europe and Japan all had slow growth before our trade wars started.

- The consumer, employment trends, and retail sales are bright spots in our economy.

- Poor home, SUV and truck sales are a concern.

- We **do not** have a booming economy.

- The President needs to compromise and make a deal to reverse the uncertainty and the slowing U.S. and global economy.

Are we headed for a recession? I try to answer this question in Part II. In the next few weeks I will do an Update for the markets, and by the end of September I should issue Part II.

If you would like a second opinion on your portfolio in terms of prospects for the future, risk, costs - at no charge, please email danhassey@yahoo.com.