SILVERCREST
ASSET MANAGEMENT GROUP

U.S. ECONOMIC AND MARKET REVIEW—SEPTEMBER 2016

Most global equity markets, including the U.S., seemed to be holding their breath in August, waiting for a sign from the economic data that never materialized, telling them which way to jump. The data that did arrive was pretty decent, for the most part, but peppered with enough warning indicators to temper anyone's enthusiasm.

The Atlanta Fed is currently projecting a strong +3.3% rebound in Q3 GDP growth following a lackluster Q1 and Q2. The New York Fed projects +2.8%. Both are above consensus expectations. Yet the ISM gauges for both manufacturing and the larger non-manufacturing sectors showed economic momentum abruptly cooling in August, driven by a steep deceleration in new orders. Whether this is a one-month blip, or a more serious concern, remains to be seen.

Before August, services were going strong, and manufacturing looked to be on the mend. Factory orders, down −3.5% from the year before, got a +1.9% boost in July, their strongest since last October. That included a +1.5% monthly rise in orders for core capital goods, down −4.9% from last year. Industrial production rebounded +0.7% in July, increasing capacity utilization over a full point to 75.9%. All of these promised a possible end to an otherwise serious industrial slump.

Inventory-to-sales ratios, which rose to worrying heights over the past two years, have fallen back a bit in recent months. That pullback shaved well over a point off GDP growth in Q2, but should put future output on a sounder footing. A somewhat weaker dollar (down −6% from its peak in January), along with cheaper but relatively stable oil (in the $40-50 range) should also be supportive of growth.

Cheaper oil has kept the inflation rate under 1%, even as hourly wages have risen +2.4% from a year ago. That puts the Fed under less immediate pressure to raise interest rates, despite a tightening labor market, and gives workers room to enjoy real wage gains, despite the much-lamented slump in labor productivity growth.

That productivity slump is due, in part, to the fact that job growth has continued even as parts of the economy—notably capital investment—have faltered. The average pace of job creation so far this year (182,000 per month) has slowed from last year (229,000) but along with rising wages, has been sufficient to drive growth in personal income (up +3.3% in July from a year ago) and consumption spending (up +3.8%). Retail sales growth was flat from June to July, and auto sales cooled in August to a still-respectable annual rate of 17.0 million, but consumer confidence remains close to its highest level of the current cycle. The housing market has waxed and waned in recent months, but new home sales, in particular, have seen real improvement this year, up +31.3% in July over a year ago.

The S&P 500 has retained most of the gains from its recent rally, ending August up +6.2% on the year (for a total return of +7.8%). Contrary to some misleading headlines, operating earnings per share have improved, growing +4% in Q1 and +8% in Q2 after being pulled down -22% over the preceding five quarters almost entirely by energy and materials. Still, the recent rally, and the preceding decline, have pushed the 12-month trailing P/E ratio to 22x operating and 25x reported earnings. Those are rich valuations, but they are supported, for the time being, by negative bond yields abroad, pushing capital to the U.S. and keeping U.S. Treasury "risk free" rates near their lowest levels in history. With the equity risk premium above 6%, long-term investors are still being well compensated, on a relative basis, for taking on the risk of enduring any short-lived downturn in the stock market.

September 13, 2016

Patrick Chovanec
Managing Director, Chief Strategist

This communication contains the personal opinions, as of the date set forth herein, about the securities, investments and/or economic subjects discussed by Mr. Chovanec. No part of Mr. Chovanec's compensation was, is or will be related to any specific views contained in these materials. This communication is intended for information purposes only and does not recommend or solicit the purchase or sale of specific securities or investment services. Readers should not infer or assume that any securities, sectors or markets described were or will be profitable or are appropriate to meet the objectives, situation or needs of a particular individual or family, as the implementation of any financial strategy should only be made after consultation with your attorney, tax advisor and investment advisor. All material presented is compiled from sources believed to be reliable, but accuracy or completeness cannot be guaranteed. © Silvercrest Asset Management Group LLC