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## Mast Report

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**U.S. STOCKS TURN IN A GOOD WEEK**

As discussed at length in the August Investment Strategy Report that has been distributed, accelerating U.S. economic growth, rising corporate earnings, and solid growth in dividends provide support for stock prices at a time in which nearly all classes of financial assets are overvalued.

U.S. stock prices posted solid gains over the past week, indicating that the factors just cited cannot be overlooked in a world of significant and rising political and military risks and uncertainties. For the past week, the MCSI U.S. Index posted a return of 1.44%, compared to returns in the 0.5%-0.6% range for developed country stocks in the European and Pacific regions and in emerging country stocks. The U.S. dollar at least stemmed its decline, posting a very small increase for the week, based on the U.S. dollar index.

Among major U.S. stock indices, the S&P 500 Index gained 1.37%. The Nasdaq rose by a strong 2.62%, propelled by returns of 3.20% for the health care sector and 2.49% for the technology sector, both of which have heavier weightings in the Nasdaq. Growth stocks continued to outperform value stocks, with the Russell 3000 Growth Index returning 2.23%, compared to 0.94% for the Russell 3000 Value Index. Higher concentrations of health care and technology companies in growth indices were again a factor. Momentum remains clearly on the side of growth, and it has been dangerous to be a contrarian favoring value stocks.

Small cap stocks also rebounded. The Russell 2000 Index posted a return of 2.66%, compared to 1.49% for the large cap Russell 200 Index. Small cap growth was the best performing size/style segment for the week with a return of 3.53% (Russell 2000 Growth Index). The worst performer, in a relative sense, was large cap value with a return of 0.84% (Russell 200 Value).

Yields on U.S. Treasuries fell very slightly for maturities of 10 years and shorter and rose slightly for maturities 10 years and longer. Yield spreads on corporate bonds narrowed slightly, also benefiting from the improving economic and corporate earnings environment.

Worries on the political/military front continue to attract investors and traders to gold. Gold prices are notoriously driven by past price momentum, so recent gains attract more interest and attention. Gold closed the week a $1324.50, up 2.48% for the week, and up 9.59% from a recent low of $1208.60 on July 7th. Gold is at its highest level since September 27th of last year. The last major high in gold was $ 1364.90 on July 6th of last year. At the past week's close, gold was trading right at the top of its price channel.

Oil fell by 1.21% for the past week to $47.92. With about 20% of U.S. refining capacity off line due to hurricane Harvey's impact on the Houston area, gasoline prices surged and crude prices fell slightly. How much and how fast the affected refining capacity can come back online will be the major determinant of crude prices over the short run. Over the longer run, experts continue to call for oil prices at or very slightly above $50 by the end of next year, reflecting persisting concerns about excess supplies and production.

Broad commodity prices posted a strong 3.18% increase over the past week, based on the Dow Jones Commodity Index (spot prices). This index has risen a strong 9.49% since its last low on June 22nd of this year.

## TRACKING THE U.S. ECONOMY

**Employment continues to grow.** Total nonfarm payroll employment rose by 156,000, or by 0.11%, in August from July. This increase was below expectations and some of that was due to a 9,000 decline in employment in the government sector. Private sector employment rose by 165,000, or by 0.13%. Even with the more modest increase employment in August, total nonfarm employment posted an annualized 3-month increase of 1.53%, up from 1.28% on May of this year. The annualized 3-month rate of change in private sector employment was 1.83% in August, up from 1.49% in May. These numbers indicated some recent strengthening in employment growth.

Even with the recent pickup of rates of growth, employment growth over longer twelve- month periods continue to decelerate. The 12-month rate of change in total nonfarm employment has slowed from 2.11% in August 2015 to 1.59% in August. The 12-month rate of change in private sector employment has slowed from 2.39% to 1.75% over the same period. This should not be viewed at a negative, as much as it reflects the aging of the ongoing economic recovery/expansion that began in July 2009 and the accompanying modest rate of growth in the economic. The current recovery/expansion at an age of eight years is the second longest in U.S. history. It is normal for rates of growth in employment to slow as expansions age, which becomes more noticed in longer expansions. Also, the relatively modest of pace of economic growth since mid 2009 would be associated with more modest employment growth.

The unemployment rate rose slightly in August to 4.44% and is up from a recent low of 4.29% in May. This is not something to be worried about. The unemployment rate is computed from the Household Survey, and data on employment from that survey are not as reliable as data from the Establishment Survey, where nonfarm payroll employment numbers come from. The annualized 3-month rate of change in employment from the Household Survey was only 0.91% in August and was barely faster than the 0.85% annualized increase in the civilian labor force. The unemployment rate averaged 4.58% over the last twelve months through August and continues to fall. The 12-month average of 4.58% was the lowest level since November 2007.

A major concern on the employment front is the persisting tepid growth in the civilian labor force. The 12-month rate of change in the labor force was 0.99% in August, but the bigger concern is that the 12-month rate of change has decelerated from 1.31% in January of this year. This deceleration has occurred even as the pace of growth in the economy has accelerated. Part of the deceleration in the rate of growth in the labor force is the aging population and labor force. This explains a good deal of the growing shortage of workers in relation to demand. In a recent conversation I had, the person I was speaking with lamented that how jobs are being lost to technology. My response was that although this is true, it is not happening as fast the as the people with those jobs retire. The persisting slow growth in the labor force seems to support this. If so, one of the motivations to automate may be to replace a growing number of workers who voluntarily will no longer be working. Recent sizable increases in job openings and relative small increases in hirings reflect this.

A final observation and concern is the rate of growth in average hourly and weekly worker compensation. If the number of workers who are able and skilled to do jobs ranging from fruit and vegetable harvesters to tool and die makers are increasingly in short supply, then why are compensation levels not increasing much? The 12-month rate of change in average hourly compensation for production and non supervisory workers was 2.42% in August, but has actually slowed from 2.51% in November of last year. The 12-month rate of change in average weekly earnings was 2.37% in August and has not been accelerating in the past few months. There have not been many good explanations why rates of increase in labor compensation have not been accelerating, but increasing automation might be one.

**Unemployment insurance claims continue to improve.** Both initial and continued claims for unemployment benefits keep falling, a sign of further improvement and strength in labor market conditions. Over the last the 13-weeks, initial claims were down 1.57% (not annualized), and continued claims were down 1.59%. The 52-week rate of change in continued claims was -8.17%, and for continued claims,

-7.72%. Also encouraging, the number of workers dropping off of the unemployment rolls exceeded the number filing initial claims by 2.63% over the past four weeks. The percentage of workers covered by state unemployment insurance programs, approximately 140 million, who are receiving unemployment benefit payments continues at close to all time lows, only 1.40% averaged over the past thirteen weeks. However, the percentage has ceased to decline over the past month. This could possibly be a sign that there are simply fewer workers continuing to receive unemployment benefits, as many have found employment.

**Growth in second quarter real GDP was revised up.** After rising at a tepid 1.24% annualized rate in the first quarter of this year, real Gross Domestic Product was expected to grow at a faster pace in the second quarter. That did occur, and the annualized rate of growth in real GDP was revised up to a 3.03% annualized rate from an initial estimate of 2.57%. Real personal consumption expenditures and real nonresidential fixed investment in the private sector accounted for essentially all of the growth. Real personal consumption expenditures grew at a revised 3.32% annualized rate, compared to 1.92% in the first quarter. Real consumer spending on durable goods rose at a very strong 8.95% annualized rate. Real nonresidential fixed investment in the private sector rose at 6.90% annualized rate, nearly as fast as the first quarter's 7.14%. Even with a 6.51% annualized decline in real residential fixed investment, real domestic private final sales (the sum of real consumer spending and real private sector fixed investment) increased at a 3.45% annualized rate, which was even better than the first quarter's 3.07%. The heart of the U.S. economy, its private sector, continues to perform well and grow at solid rates.

Rates of growth in real GDP over longer periods have been accelerating. Based on the year-over-year rate of change in a 4-quarter average, real GDP growth has accelerated from a recent low 1.49% in the fourth quarter of 2016 to 1.89% in the second quarter. This measure of real domestic private final sales showed growth of 2.65% in the second quarter, again illustrating the strength of the economy's private sector.

**Relatively slower growth in real disposable incomes and declining personal savings will probably lead to slower growth in real consumer spending.** Strong second quarter growth in real GDP, and in real consumer spending, and real domestic private final sales will probably face some headwinds in upcoming months. The reason is that real disposable personal incomes have not grown nearly as fast as real consumer spending, which has also resulted in a drop in personal savings. For data through July, the 12-month rate of change in real personal savings was -31.29%, a huge decline. Also, the personal savings rate (personal savings/disposable personal income) was 3.88% in July, its lowest level since June 2008.

Real disposable personal income rose at a decent 2.85% annualized rate over the past three months, but the rate of change has slowed from a 4.46% annualized rate in May. The decelerating rate of growth in real disposable personal income and depleted personal savings are significant headwinds to growth in real consumer spending persisting at close to the 3.32% annualized rate in the second quarter. Real consumer spending in August, especially for durable goods, will provide important information to see if strong growth in consumer spending is persisting, or if it slows.

**U.S. manufacturing sector continues to strengthen.** Looking for some really good news on the U.S. economy, here is some. The Institute of Supply Management's August survey of the U.S. manufacturing sector indicated that the key Purchasing Managers' Index (PMI) was 58.8 in August, up from 56.3 in July and compared to a recent low of 49.9 a year ago. Readings can range from zero to 100, with a reading of 50 indicating that equal number of respondents say their businesses are expanding as those indicating contraction. To put this into perspective, only 17% of all monthly readings on the PMI since January 1948 have been higher than Augusts' 58.8. Monthly averages over the past 3, 6, and 12 months are all rising and in a range of about 55.5 to 57.5. The U.S. manufacturing sector is expanding at a solid, and at a pace that has significantly improved since about August of last year.

**Rates of increase in home prices have slowed slightly, but remain solid.** Based on data through June, the annualized 3-month rate of change in the Case-Shiller National Home Price Index (seasonally adjusted) slowed from 8.86% last November to 3.76% in June of this year. But the annualized rate of changed may have bottomed in May. The 12-month rate of change in this home price index was 5.43% in June and has steadily improved from 4.43% in September 2015.

While home prices have increased significantly in some major metropolitan areas, home prices nationally have rebounded much less rapidly. The seasonally adjusted Case-Shiller National Home Price Index peaked in February 2007, right at the time the U.S. economy entered the severe recession. This home price index then fell by 25.8% over the next five years, bottoming in February 2012. This low came about two and a half years after the recession had ended. This persisting decline in home prices was a main reason why many people understandably felt and thought the economy was still in a recession. From the February 2012 low, the National Home Price Index rose by 35.6% over the next four and three-quarters years (November 2016). But this only brought homes prices back to their previous peak levels in February 2007. Since November of last year, the home price index has increased by an additional 2.9%.

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