The ITR Advisor

JUNE 2019

Insider

ITR Economics

Industry Snapshots

Arrow denotes 12-month moving total/average direction.

RETAIL SALES	↗
WHOLESALE TRADE	↗
AUTO PRODUCTION	↘
MANUFACTURING	→
ROTARY RIG	↘
CAPITAL GOODS	↗
NONRESIDENTIAL CONSTRUCTION	↗
RESIDENTIAL CONSTRUCTION	↘

↑ Steep Rise ↗ Mild Rise → Flat ↘ Mild Decline ↓ Steep Decline

Macroeconomic Outlook

US Total Industrial Production during the 12 months through April was up 3.4% from the year-ago level. The three major segments of the industrial economy are rising at slowing rates. The largest segment, US Total Manufacturing Production, was up 2.2% from the year-ago level. US Mining Production was up 12.7%, and US Electric and Gas Utilities Production was up 1.7%. US Industrial Production activity will peak in the next few months before it enters a declining trend.

Slowing growth in the consumer sector is contributing to slowing industrial activity. US Total Retail Sales will rise at a slowing rate through the remainder of this year and the first half of next year. Retail Sales will likely avoid a recession during this business cycle, which will limit the severity of the decline expected in US Industrial Production during this time. However, firms should not expect the consumer sector to present the same growth potential in the next few quarters that it presented in recent quarters.

> *"Communicate the competitive advantages of your products to increase brand loyalty and dissuade your buyers from seeking alternatives."*

US Exports are rising at a slowing pace. A strengthening dollar will likely exacerbate this trend. Waning demand from abroad will further hinder US Production. Consider marketing your products with a lower cost basis to better compete with less-expensive foreign goods. Communicate the competitive advantages of your products to increase brand loyalty and dissuade your buyers from seeking alternatives.

After it declines into next year, Production will recover and rise through much of 2020 and 2021. How your business endures the slowdown in the economy will impact your ability to invest for the next cyclical rising trend. Focus on maintaining a cash flow while limiting expenditures in the near term.

Make Your Move

Market your products with a lower cost basis to appeal to increasingly price-conscious consumers as the business cycle moves downward this year and in early 2020.

Investor Update

The stock market is showing positive signs despite cyclical decline in the industrial economy. However, it is too early to determine whether stock market conditions will improve further during this cycle.

ITR Economics Long-Term View

2019
WEAKER SECOND HALF

2020
MILD GROWTH

2021
GROWTH

Industry Analysis

RETAIL SALES

- Retail Sales during the 12 months through April were up 4.1% on a year-over-year basis
- Retail Sales will rise at a slowing pace into mid-2020
- The retail sector will likely avoid a recession during this business cycle

WHOLESALE TRADE

- Wholesale Trade was up 5.5% from the year-ago level
- Wholesale Trade of Durable Goods, up 5.5%, and Wholesale Trade of Nondurable Goods, up 5.4%, are both rising at slowing rates
- The Nondurable Goods segment will likely enter a mild recession this cycle

AUTO PRODUCTION

- North America Light Vehicle Production was down 1.4% from one year ago
- Production will generally decline through the remainder of this year and into next year
- Activity in the Light Truck segment was up 1.7% year over year, while activity in the Passenger Car segment fell 8.3%

MANUFACTURING

- Total Manufacturing Production was up 2.1% on a year-over-year basis
- Activity will likely peak around the middle of this year before then declining into next year
- Medical Equipment and Supplies Production and Civilian Aircraft and Parts Production, both growing at accelerating rates, are areas of opportunity

ROTARY RIG

- The Rotary Rig Count was up 9.4% from the year-ago level
- However, the May Rig Count declined mildly from the April level
- The Oil Rig Count is declining while the Natural Gas Rig Count, up 6.4%, is increasing

CAPITAL GOODS NEW ORDERS

- Nondefense Capital Goods New Orders were up 4.7% from a year ago
- New Orders will peak imminently before declining into early 2020
- Defense Capital Goods New Orders were up 20.6%
- Spending on Defense Capital Goods will likely plateau through the remainder of 2019

TOTAL NONRESIDENTIAL CONSTRUCTION

- Nonresidential Construction was up 5.8% from the year-ago level
- Construction is rising at an accelerating rate
- The Hospital segment and the Public Water and Sewer Facilities segment will likely be areas of weakness in 2019, with spending expected to fall below 2018 levels

TOTAL RESIDENTIAL CONSTRUCTION

- Residential Construction was down 1.8% from one year ago
- Single-Unit Housing Starts, which were down 2.9%, will likely recover later this year
- Multi-Unit Housing Starts, down 1.9%, will likely decline throughout 2019 and into 2020

Leading Indicator Snapshot

	2Q2019	3Q2019	4Q2019
ITR Leading Indicator™	🔴	🔴	🔴
ITR Retail Sales Leading Indicator™	🔴	🔴	🔴
US Leading Indicator	🟢	🔴	🔴
US ISM PMI (Purchasing Managers Index)	🔴	🔴	🔴
US Total Capacity Utilization Rate	🔴	🔴	⚪

🟢 *Denotes that the indicator signals cyclical rise for the economy in the given quarter.*

🔴 *Denotes that the indicator signals cyclical decline for the economy in the given quarter.*

⚪ *N/A*

KEY TAKEAWAYS

- Our collection of leading indicators is signaling that US Industrial Production is likely to trend along the back side of the business cycle through at least the end of this year
- The ITR Leading Indicator ticked up in recent months, but it is too early to determine if it has entered a prolonged rising trend
- The US ISM PMI resumed decline after some recent rise and is now no longer signaling the next rising trend for Industrial Production

A Closer Look: US Manufacturing

MADE IN AMERICA

BY: ALAN BEAULIEU

What you need to know: Manufacturing is an important, vibrant part of the American economy. However, manufacturing in America is slowing down in its rate of growth.

It seems to me that most people in the US do not understand how strong manufacturing is in this country. The reality is that manufacturing is an important, vibrant part of the American economy. US Manufacturing Employment has risen to 12.782 million people (12MMA), the highest level in 9.9 years, and accounts for 10.01% of total Private Sector Employment.

Yes, the percentage used to be a lot higher, but today's manufacturing utilizes less human labor. The efficiencies (technologies of the last 30 years) responsible for this change have created our globally competitive manufacturing sector. Having the goal that manufacturing account for a certain percentage of total employment is unrealistic and harmful, as it would require increasing manufacturing's labor component, a move akin to choosing a typewriter over a computer.

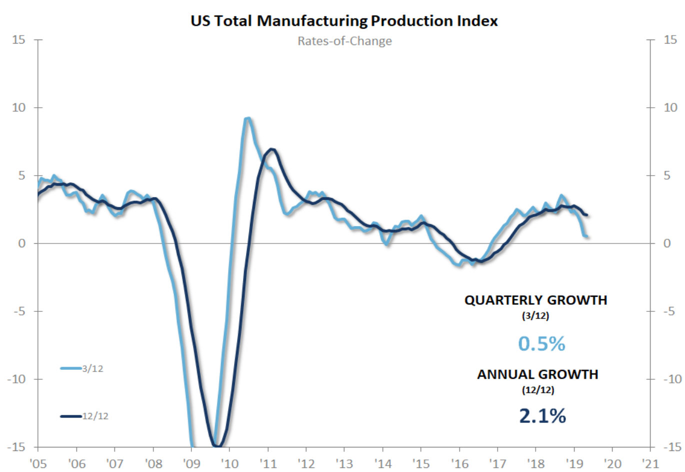
Some may be tempted to say that we could increase the labor component and thereby increase our output to match the good old days. That argument does not hold water, either. Manufacturing output through May 2019, on a 12MMA basis, is a thin 1.2% below the February 2008 *record high*. Things are slowing down in manufacturing now, but they will rebound in 2020, and it won't be long before America is producing more than ever for domestic consumption and to export to our trading partners.

Beyond our being very good at capital intensive manufacturing, the lack of qualified, trained labor is an inhibitor to increased employment in the manufacturing sector. The monthly trend in US Manufacturing Job Openings is descending off a November 2018 record high, but it is still impressive at 476,000, 11.7% above the May 2018 level. The lack of labor is not for a lack of compensation; manufacturing wages are a record-high $27.53/hour (3MMA basis).

Making things in America requires capital, of which there is plenty, and labor, of which there is a functional scarcity. If manufacturers are going to fill their ranks, they must work aggressively to improve the image of manufacturing in America. There must be an emphasis on clean, modern, stable, high-paying jobs with professional growth potential. Pride in manufacturing employment needs to be restored; position a manufacturing job as a great career choice.

SLOWING DOWN

Manufacturing in America is slowing down in its rate of growth. The chart below clearly shows that the annual growth rate (12/12) has slipped to 2.1%, and the quarterly year-over-year growth rate (3/12) is at 0.5%. The ITR Checking Points™ system is indicating further downside business cycle pressure on manufacturing through the rest of the year. The 3MMA seasonal rise since February is the mildest since 2009. The diminishing rates of rise in US Nondefense Capital Goods and in our exports of goods to the rest of the world are significant contributors to this slowdown.



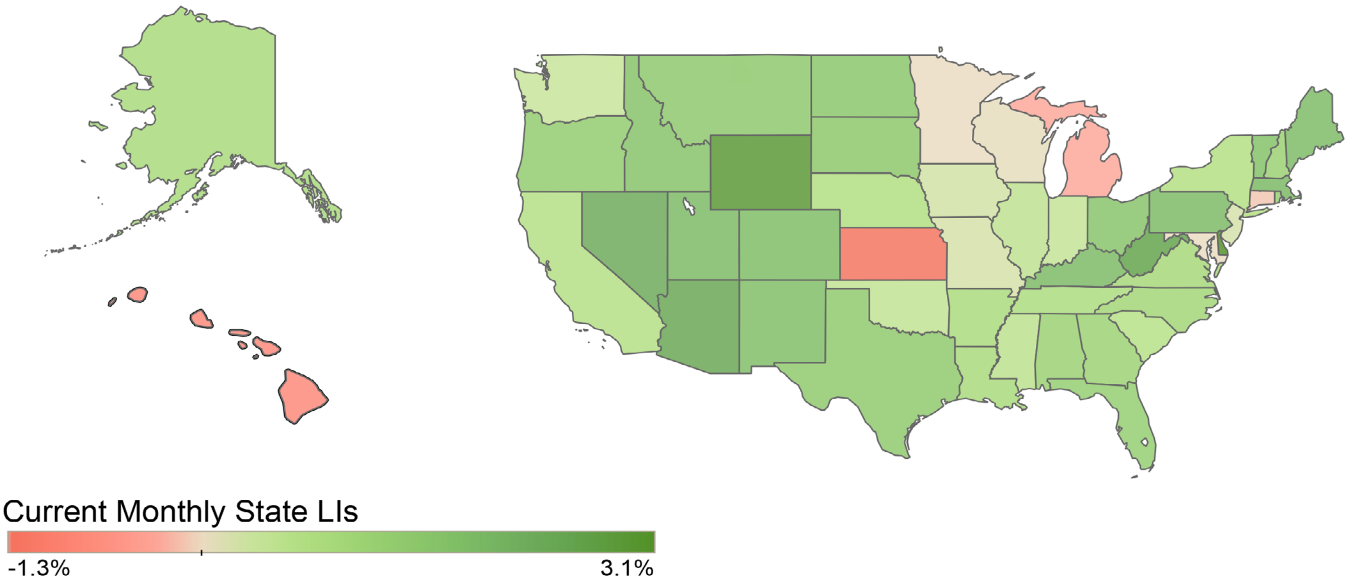
Automobile Production in the US is also a key contributor to the decelerating rise in manufacturing. Automobile Production's 12/12 stands at -0.6% with a 3/12 of -5.1%. The 12MMT is down 1.4% from the January 2019 high. Expect further decline in the second half of 2019. However, even without automobile production, manufacturing is still in Phase C, Slowing Growth, with a 12/12 of 1.7% and a 3/12 of 0.4%.

In the table below, 3 of the 10 production series listed are in Phase B, Accelerating Growth. Participants in those segments can expect increased demand on production capacity through at least the near term. It would be worth the effort to grab any low-hanging fruit to increase efficiency as you work to keep output from bogging down. Manufacturers in Phase C or D might consider focusing more on reducing costs and waste, even if at the expense of the speed of output. All manufacturers should anticipate a healthy level of demand in 2021 as they consider their longer-term capital projects.

Description	NAICS	12/12	3/12	Notes
Machinery Production	333	4.1% C	1.4% C	Decelerating rate of rise
Farm Equipment Production	333111	8.5% B	2.8% C	3/12 is signaling some deceleration ahead
Construction Equipment Production	33312	18.3% B	20.8% C	More rise ahead
Mining Equipment Production	33313	11.1% C	8.6% C	Tentative March 2019 3MMA peak
Industrial Machinery Production	3332	-4.6% D	-7.2% D	Ongoing decline
Refrigeration and HVAC Equipment Production	3334	0.6% C	-2.9% D	March 2019 12MMA high
Metalworking Machinery Production	3335	1.1% C	-1.4% D	March 2019 12MMA high
Engines and Turbines Production	333612-8	13.4% C	4.2% C	Tentative April 2019 12MMA high
Motor Vehicle Parts Production	3363	2.1% C	-2.5% D	Flat to mildly negative 12MMA off a January record high
Aerospace Products and Parts Production	3364	2.8% B	4.4% C	More rise ahead

Slowing growth or decline characterizes most of these production series. This is a great time to assess inventory needs, sales expectations, and anticipated cash flow through the rest of 2019 and into 2020. Compute your rates-of-change, utilize ITR's Checking Points system, find a system of reliable leading indicators, and use them to prepare for the next business cycle shift in your company for maximum profitability and asset utilization.

State-by-State: Leading Indexes



- The US Leading Index is signaling cyclical decline in the US economy
- The majority of state leading indexes are suggesting growth in the US economy. However, they are transitioning to the back side of the business cycle, signaling that opportunity may be waning
- The Hawaii, Kansas, Michigan, and Connecticut Leading Indexes are declining. With a mild macroeconomic recession expected for the second half of 2019 and into the first half of 2020, it is unlikely that these states will see growth opportunities return before 2020

Reader's Forum

With economic activity expected to decline later this year, how should I adjust my pricing strategies to remain profitable?

James Giles, Economist at ITR Economics™, answers:

While we are not expecting a particularly severe recession during this cycle, demand will no longer support the inflation rates of recent quarters. During this time, it will be increasingly important to keep an eye on your competitors' prices to ensure that you are not raising your own too rapidly, at the risk of losing market share. Producer Prices are rising at a slowing rate, up just 1.0% from May 2018, with costs for certain inputs such as oil and steel even falling in recent months. These trends will make it a little easier to keep your own prices down. If your industry is headed for a recession during this cycle, consider keeping your prices competitive enough to attract new business, and build a backlog to keep cash flowing into your company as economic activity declines later this year.

Please send questions to: questions@itreconomics.com