



MELFA WEALTH MANAGEMENT

Melfa Wealth Management Presents:

MONTHLY ECONOMIC UPDATE

March 2018

MONTHLY QUOTE

“We cannot fail to win unless we fail to try.”

- Tom Clancy

MONTHLY TIP

Some employers offer flexible spending accounts for child care. Married joint filers and heads of household can defer up to \$5,000 per year (or the amount of the lower-earning spouse’s income, whichever is lesser) in pre-tax dollars into these FSAs to save for child care costs. Most such FSAs are “use it or lose it,” meaning that the funds must be spent before (or shortly after) the end of a year.

MONTHLY RIDDLE

Neil claims you can make the number 9 using only three toothpicks. Is this claim true?

Last month’s riddle:

Sometimes it is good, sometimes it is bad,

THE MONTH IN BRIEF

Investors certainly received a wake-up call in February. A correction hit Wall Street for the first time in nearly two years, and benchmarks overseas were also challenged. Two weeks later, though, the S&P 500 had gained back more than half of what it had lost in the dive. Prices of important commodities sank early in the month, but recoveries followed. While the latest readings on fundamental indicators were largely upbeat, reports on retail sales and home sales disappointed. As the Jerome Powell era began at the Federal Reserve, investors wondered if four rate hikes would occur this year rather than the three the central bank had envisioned, given inflation pressure. ¹

DOMESTIC ECONOMIC HEALTH

While the rollercoaster ride taken by equities dominated the news stream last month, inflation was also a hot topic. According to the Department of Labor, the Consumer Price Index advanced 0.5% in January, leaving annualized inflation at 2.1%. The monthly number was the concern: the half-percent gain represented the largest single-month inflation jump in a year. The core CPI rose 0.3% in a month, which it had not done in nearly 13 years. Producer prices climbed 0.4% in January, with their year-over-year increase at 2.2%. Did the January numbers amount to an aberration, or was inflation pressure now stronger than it had been in some time? February’s data, due in mid-March, may shed further light on the matter. ^{2,3}

The Conference Board’s monthly barometer climbed another 6.5 points to a remarkable reading of 130.8. Also rising, the University of Michigan’s consumer sentiment index posted a mark of 99.9 during February; it had been at 95.7 when January ended. Consumer spending advanced 0.2%, and consumer income, 0.4%, in the opening month of 2018; retail sales, on the other hand, weakened 0.3%. The federal government’s final estimate of Q4 growth also came in at the end of the month: 2.5%. ³

The pace of service sector growth picked up in January, according to the Institute for Supply Management; its purchasing manager index for non-manufacturing industries improved to a fine 59.9, rising 3.9 points. ISM’s other key PMI showed manufacturing sector expansion moderating just a bit in January; that PMI declined 0.6 points to 59.1. Then, it rose to an especially strong 60.8 in February. ³

sometimes you wait for it, other times you fear it. At times you may make it or even spread it. What is it?

Last month's answer:
The news.

In its January jobs report, the Department of Labor reported 200,000 net new hires in the year's first month, with the jobless rate holding at 4.1%. (The U-6 rate, counting the underemployed, rose 0.1% to 8.2%.) The detail that jumped out, though, was the 2.9% annualized increase in hourly wages, a strong indication that employers were boosting pay as a response to the rising cost of living. ⁴

Janet Yellen more or less continued the monetary policy established by the Federal Reserve under Ben Bernanke, and Jerome Powell is expected to follow suit. Testifying for the first time before Congress on February 27, the new Fed chair said that he saw little near-term risk of a recession. "The next couple of years look quite strong," he commented. "I would expect the next two years to be good years for the economy." Maintaining a Goldilocks view, Powell noted that the central bank "will continue to strike a balance between avoiding an overheated economy and bringing PCE price inflation to 2 percent on a sustained basis." Strategists have noted, based on Powell's comments, that the Fed could opt to make four rate increases in 2018 rather than the projected three. ^{5,6}

GLOBAL ECONOMIC HEALTH

In the Asia-Pacific region, some of the latest signals were less than reassuring. By one barometer, China's powerful economy cooled off notably last month. The P.R.C.'s official factory purchasing manager index fell a full point to 50.3 in February; economists polled by Reuters projected it would come in 51.2. The Nikkei manufacturing PMI for India showed a seventh straight month of industry expansion in February, but it also declined 0.3 points to 52.1. Also notable was the 6.6% drop in January for Japanese industrial output. ^{6,7}

To the west, Eurostat published statistics showing the jobless rate at 7.3% at the end of 2017 in the 28-nation eurozone. Through January, the eurozone's annualized inflation rate was 1.6%. In the middle of February, the latest Markit PMIs for the eurozone displayed some impressive numbers: a manufacturing PMI reading of 58.5, a service sector reading of 56.7, and a composite mark of 57.5. All these indicators came in a half-point to a point below forecasts, but nevertheless, they indicated a thriving economic engine. ^{8,9}

WORLD MARKETS

Away from Wall Street, other equities benchmarks were deep in the red in February. The Shanghai Composite dropped 8.39% month-over-month; the Hang Seng, 6.97%; the Nikkei 225, 6.62%. India's major indices, the Nifty 50 and BSE Sensex, respectively fell 5.21% and 5.18%. South Korea's Kospi lost 5.72%; Taiwan's TSE 50, just 3.21%. The MSCI Emerging Markets index stumbled 4.73%; the MSCI World index, 4.30%. ^{10,11}

Losses could certainly be found elsewhere. Mexico's Bolsa dove 7.22%; Canada's TSX Composite, 4.91%. France's CAC 40 suffered only a 3.77% February loss, but the DAX gave back 6.78% in Germany, while the IBEX 35 tumbled 7.13% in Spain. The FTSE 100 benchmark in the United Kingdom retreated 5.66%; the pan-European FTSE Eurofirst 300, 5.51%. The exceptions to all this: Russia's Micex added 0.07% last month, and Brazil's Bovespa gained 1.64%. ¹⁰

COMMODITIES MARKETS

A mixed month for commodity futures brought significant losses, yet also a few major gains. Nearly all the winners were crops: cocoa improved 12.78%; wheat, 6.92%; cotton, 6.43%; soybeans, 4.87%; corn, 3.46%; gasoline, 0.92%. Aside from those advances, there were plenty of retreats. Platinum slipped 1.65%; sugar, 1.66%; coffee, 1.68%; gold, 1.86%; copper, 2.83%; oil, 5.05%; silver, 5.14%; heating oil, 7.93%; natural gas, 9.57%. Oil ended February at \$61.52 on the NYMEX. Gold and silver closed out the month with respective settlements of \$1,319.00 and \$16.32 on the COMEX. ¹²

Bitcoin had finished January at \$9,995.87; as the trading day wrapped up on February 28, the price stood at \$10,645.19, representing a monthly gain of 6.50%. The U.S. Dollar Index rose 1.38% for the month to 90.36. ^{13,14}

REAL ESTATE

High prices and higher mortgage rates were taking a toll on the housing market, and January's 3.2% decline in existing home sales was merely the tail end of a trend, as the National Association of Realtors said that resales had also fallen 4.8% year-over-year. In the opening month of 2018, the median price for an existing home was \$240,500, a 5.8% rise from 12 months earlier. New home buying weakened 7.8% in January. More new homes were on the market in January than at any time in the past nine years, but the median new home price increased 2.5% to \$323,000 in one month. ^{15,16}

Climbing home loan interest rates also held back sales. Freddie Mac said that the mean interest rate on the 30-year, fixed rate loan was at 4.40% on February 22. Roughly a month earlier (January 25), it was at 4.15%. Between January 25 and February 22, the average interest rate on the refiner's favorite, the 15-year FRM, rose from 3.62% to 3.85%; the mean rate on the 5/1-year ARM increased to 3.65% from 3.52%. ^{16,17}

Indicators from the Census Bureau offered some encouragement. Construction activity had increased in January: there was a 9.7% gain in groundbreaking, according to the Census Bureau, and a 7.4% advance for building permits. On the other hand, the NAR's pending home sales index sank 4.7% in the first month of the year. ³

LOOKING BACK...LOOKING FORWARD

The major indices did recover impressively from their early February drop, but all three retreated for the month. The Nasdaq Composite was the least damaged, losing just 1.87% on the way to a February 28 close of 7,273.01. A 3.89% February loss left the S&P 500 at 2,713.83 as Wall Street closed for business on the eve of March. The Dow Jones Industrial Average slumped 4.28% for the month to 25,029.20. As for the small caps, the Russell 2000 gave back 3.97% across the month, falling to 1,512.45. The CBOE VIX settled at 19.85 on February 28, completing a 46.60% surge. ¹⁸

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	+1.25	+20.26	+15.62	+9.89
NASDAQ	+5.35	+24.84	+26.03	+21.19
S&P 500	+1.50	+14.82	+15.83	+9.84
REAL YIELD	2/28 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.75%	0.34%	0.64%	1.26%

Sources: wsj.com, bigcharts.com, treasury.gov - 2/28/18 ^{18,19,20,21}

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

February's correction took some of the zeal out of the market and provided a reality check for investors who watched equities start the year on a record-shattering pace. Did technicals mostly spur the February selloff, or did fundamentals play a larger role than some investors dare to admit? You can make both arguments. Still, the collapse of the short-volatility trade may have driven the correction more than anything else; when real turbulence broke the calm on Wall Street, that trade imploded and equities were hit hard. What are the chances of another serious downdraft this year? Possibly slim, as investor perceptions about the economic outlook have not dramatically shifted. Earnings have been strong, some key indicators have been impressive, and the Fed has been upbeat in its assessment of economic conditions. So, if this long bull market has in fact entered

its final phase (as some analysts believe), it appears to have considerable running room left.

UPCOMING ECONOMIC RELEASES: The roll call of key news items for the balance of March is as follows: the February ISM service sector PMI (3/5), January factory orders (3/6), ADP's February employment change report (3/7), a new Challenger job-cut report (3/8), the Department of Labor's February jobs report (3/9), February consumer inflation (3/13), February wholesale inflation and retail sales (3/14), the Census Bureau's latest snapshot of housing starts and building permits (3/16), a Federal Reserve interest rate decision and February existing home sales (3/21), the Conference Board's February index of leading indicators (3/22), February new home sales and durable goods orders and the University of Michigan's final March consumer sentiment index (3/23), the March consumer confidence index from the Conference Board (3/27), February housing contract activity and the third estimate of Q4 growth (3/28), and finally, February's PCE price index and personal spending report (3/30).

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All economic and performance data is historical and not indicative of future results. The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. The NASDAQ Composite Index is a market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. The Standard & Poor's 500 (S&P 500) is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The CBOE Volatility Index (VIX) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. NYSE Group, Inc. (NYSE:NYX) operates two securities exchanges: the New York Stock Exchange (the "NYSE") and NYSE Arca (formerly known as the Archipelago Exchange, or ArcaEx), and the Pacific Exchange). NYSE Group is a leading provider of securities listing, trading and market data products and services. The New York Mercantile Exchange, Inc. (NYMEX) is the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals, with trading conducted through two divisions - the NYMEX Division, home to the energy, platinum, and palladium markets, and the COMEX Division, on which all other metals trade. The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The Hang Seng Index is a free float-adjusted market capitalization-weighted stock market index that is the main indicator of the overall market performance in Hong Kong. Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. The Nifty 50 (NIFTY 50) is a well-diversified 50-stock index accounting for 13 sectors of the Indian economy. It is used for a variety of purposes such as benchmarking fund portfolios, index-based derivatives and index funds. The BSE SENSEX (Bombay Stock Exchange Sensitive Index), also-called the BSE 30 (BOMBAY STOCK EXCHANGE) or simply the SENSEX, is a free-float market capitalization-weighted stock market index of 30 well-established and financially sound companies listed on the Bombay Stock Exchange (BSE). The Korea Composite Stock Price Index or KOSPI is the major stock market index of South Korea, representing all common stocks traded on the Korea Exchange. The FTSE TWSE Taiwan 50 Index consists of the largest 50 companies by full market value, and is also the first narrow-based index published in Taiwan. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. The MSCI World Index is a free-float weighted equity index that includes developed world markets, and does not include emerging markets. The Mexican Stock Exchange, commonly known as Mexican Bolsa, Mexbol, or BMV, is the only stock exchange in Mexico. The S&P/TSX Composite Index is an index of the stock (equity) prices of the largest companies on the Toronto Stock Exchange (TSX) as measured by market capitalization. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The DAX 30 is a Blue-Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The IBEX 35 is the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange. The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The FTSEurofirst 300 Index comprises the 300 largest companies ranked by market capitalisation in the FTSE Developed Europe Index. The US Dollar Index measures the performance of the U.S. dollar against a basket of six currencies. The MICEX 10 Index is an unweighted price index that tracks the ten most liquid Russian stocks listed on MICEX-RTS in Moscow. The Bovespa Index is a gross total return index weighted by traded volume & is comprised of the most liquid stocks traded on the Sao Paulo Stock Exchange. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards. This material represents an assessment of the market environment at a specific point in time and is

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