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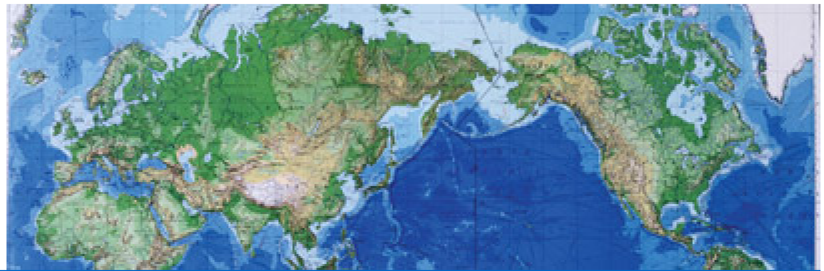

WEEKLY ECONOMIC COMMENTARY

This Week's Economic Review and Outlook

February 2018


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Weekly Economic Commentary | Week of February 19, 2018

DATA DELUGE SHOWS STEADY GROWTH

KEY TAKEAWAYS

- Many important economic reports were released last week and collectively they showed continued strength in the U.S. economy.
- Retail sales were the biggest disappointment, though stronger than expected consumer confidence may point toward a future rebound.
- Rising inflation could lead to a more aggressive Fed in 2018, though it isn't likely to hit levels that would significantly impact stocks.

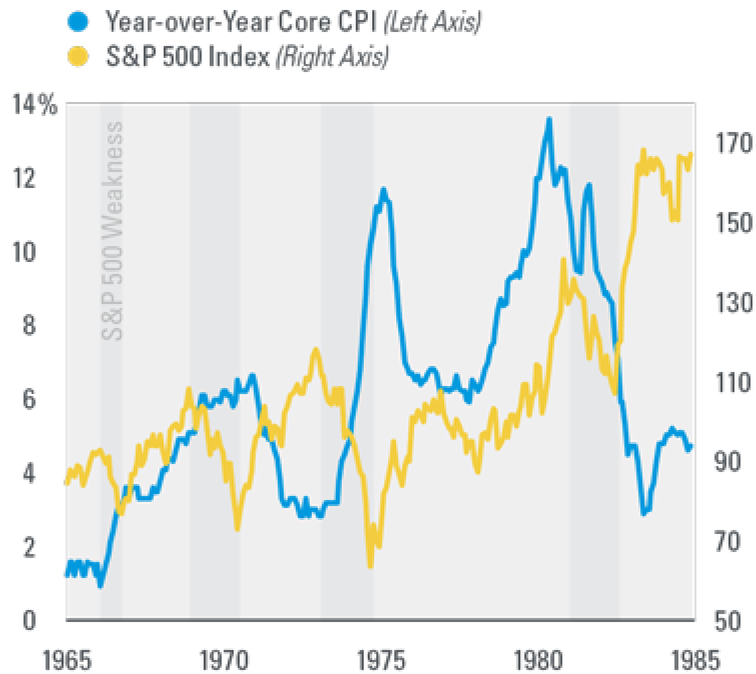
Inflation data stole the headlines, but reports on retail sales, manufacturing, and consumer sentiment were also released last week (February 12-16). Market participants may have been on edge about inflation, following faster than expected wage growth in the January jobs report that had pushed market interest rates higher and led to a brief, though volatile, correction in stocks during the previous week. However, even though both consumer and producer inflation came in above expectations, and interest rates moved higher, stocks saw gains every day last week. The S&P 500 closed the week 4.4% higher as investors renewed their focus on the positive fundamentals supporting growth in the economy and corporate profits.

INFLATION ACCELERATED, BUT MARKETS SHOULDN'T FEAR

When some hear the word inflation, it brings them back to the 1970s and 80s, when high inflation had a large impact on markets and everyday life. But we believe today's inflationary fears are quite different. Markets have largely become accustomed to an environment of low inflation and low interest rates since the financial crisis in 2008; however, the combination of wage pressures in the January employment report, followed by higher headline and core inflation (excluding volatile food and energy prices), which measured 2.1% and 1.8%, respectively, in the January Consumer Price Index (CPI) report, seemed to indicate that inflation may finally be starting to see some signs of life. The Producer Price Index also showed a larger increase than expected, showing core producer inflation of 2.2% year over year.

While these inflation numbers were notable, investors should remember that it is a trend of rising inflation, not a single month of slightly higher prices, which could lead to a more aggressive path of rate hikes from the Federal Reserve (Fed). Inflation has averaged 3.5% to 4.0% annually over the long term, and remains well below those levels today. Historically, inflation at, or even somewhat above, the Fed's current 2% target has not been an issue for markets. **Figure 1** shows how the S&P 500 Index reacted to rising inflation from the late 1960s through the mid-1980s. Markets sold off when inflation picked up appreciably in 1966, but at that time core inflation was nearing 4% after several years of sub-2% readings. Increasing inflation, along with corresponding recessions in 1969-70, and late 1973 through early 1975, led to significant weakness in equities, but core inflation readings during these weak periods for stocks were anywhere from 6-12%, a far cry from today's levels.

1 INFLATION TODAY IS FAR FROM 1970s LEVELS



Source: LPL Research, Bloomberg 02/19/18

The S&P 500 and Consumer Price Index (CPI) are unmanaged indexes that cannot be invested into directly. Past performance is no guarantee of future results.

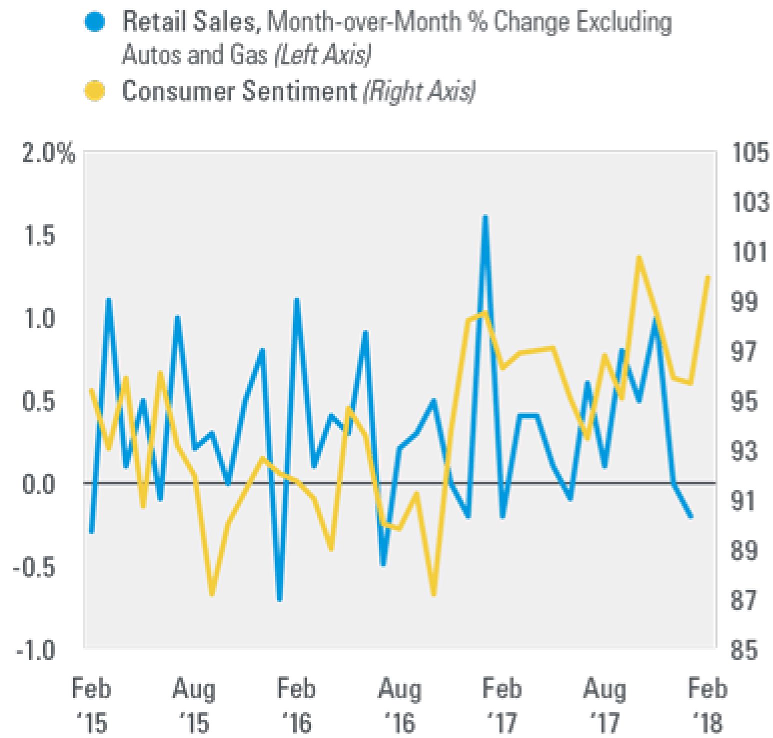
UNDERLYING STRENGTH IN MANUFACTURING

Industrial production missed expectations in January, though unseasonably cold weather likely kept the number lower than it otherwise would have been. The overall trend in manufacturing continues to be positive given that the Institute for Supply Management's (ISM) Manufacturing Purchasing Managers' Index (PMI) remains near a 14-year high. New orders, which tend to be a leading indicator of future manufacturing output, have remained strong as well, potentially indicating that that the positive trend may continue in the months ahead. The next ISM Manufacturing PMI release will come on March 1, and consensus estimates expect it to remain firmly in expansionary territory (above 50). Though manufacturing isn't as large of a part of the U.S. economy as it once was, it is still closely monitored by markets and is a significant driver of S&P 500 earnings.

RETAIL SALES AND CONSUMER SENTIMENT TELL DIFFERENT STORIES

Retail sales and consumer sentiment were also released last week. Retail sales fell in January by 0.3% month over month, though cold weather was likely a factor. Consumer sentiment, on the other hand, solidly beat expectations. Consumer sentiment has tended to lead retail sales in the past, so this beat may signify more strength for retail sales, which would make sense as consumers are now starting to feel the benefits of lower tax withholding in their paychecks.

2 CONSUMER SENTIMENT TENDS TO LEAD RETAIL SALES



Source: LPL Research, Bloomberg 02/19/18

Illustration is historical, and no guarantee of future results.

CONCLUSION

Markets were fixated on inflation heading into last week, but stocks were able to shake off a bigger than expected increase in CPI and head higher for the week. Additional economic data, including data on manufacturing, retail sales, and consumer confidence, though a mixed bag versus consensus expectations, continue to give us conviction that the U.S. economy can provide growth of up to 3% in 2018 (as outlined in our Outlook 2018), while avoiding inflation levels that would create serious headwinds for stocks. Given the positive fundamental backdrop, we maintain our view that though volatility may remain elevated, the S&P 500 may have the potential for continued upside in 2018.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

Any economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

Additional descriptions and disclosures are available in the Outlook 2018: Return of the Business Cycle publication.

INDEX DESCRIPTIONS

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services.

The Purchasing Managers' Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries, and the employment environment.

The Institute for Supply Management (ISM) Index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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