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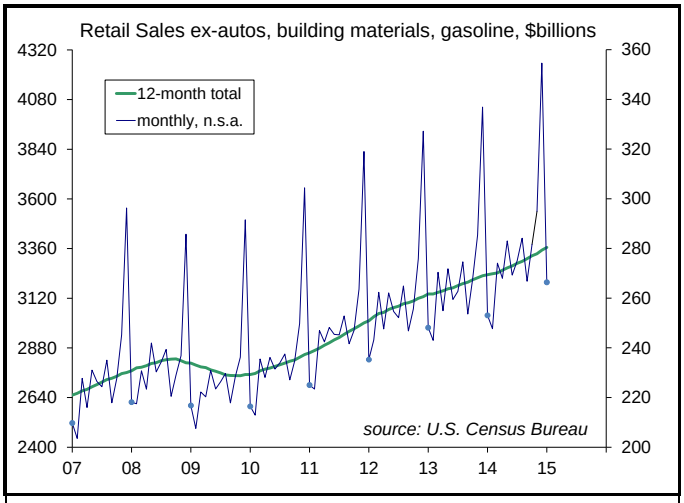
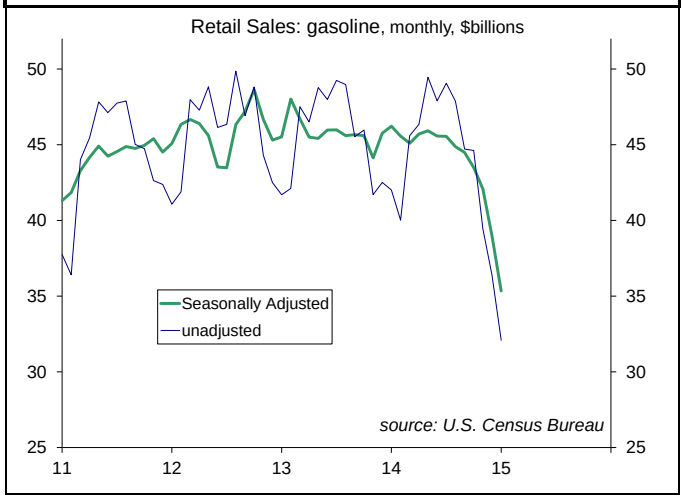
Weekly Market Monitor

Winter of Discontent or Winding the Spring?

Retail sales figures disappointed in December and January. The Bloomberg/University of Michigan Consumer Sentiment Index fell back in mid-February. This news has cast some doubt about whether the drop in gasoline prices will propel consumer spending growth in the near term. However, economic data are notoriously unreliable in the winter months. The spring economic data reports should provide a better picture of the underlying strength in jobs, consumer spending, and housing.

Seasonal adjustment is often difficult, but is especially challenging in the winter months. Prior to seasonal adjustment, core retail sales (which exclude autos, building materials, and gasoline) rose 20.2% in December and fell 24.9% in January. The total for the last three months was up 4.6% y/y.

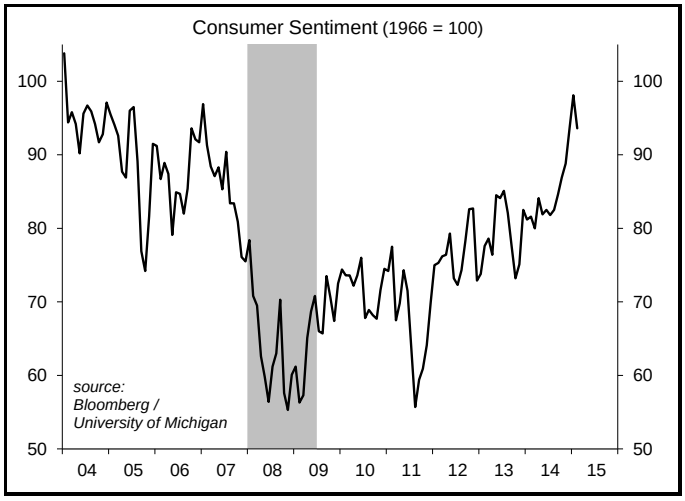




The impact of lower gasoline prices shows up with a lag. Prices fell more sharply in January, but have now risen off their lows. That's not a surprise. Gasoline prices normally rise from December to May and then trend lower in the rest of the year.

The drop in gasoline prices has freed up about $10 billion per month to spend on other things. Note that the household sector typically pays down debt in January and February, making up for its holiday season generosity. The drop in gasoline prices should speed that adjustment and consumers will be better able to spend in March (the early Easter ought to boost spending).

Consumer sentiment spiked higher in January, but fell back somewhat in the reading for mid-February. That's not an indication of weakness. Rather, there is a fair amount of noise in the data from month to month. The overall trend is still significantly higher. More detailed surveys have long shown a wide difference in ratings of the economy by income. Those at the top have maintained a rosy outlook for much of the economic recovery, while those at the bottom of the income scale still see conditions as troubled. Those in the middle have grown more optimistic, the most since before the recession.



Spring is the most important time of the year for the economy. It's when most firms expand their hiring. Last year, for example, we added 4.4 million jobs between January and June (prior to seasonal adjustment) – that works out to an average of 880,000 jobs per month. Spring usually marks the seasonal peak in new home sales and construction activity. Housing has disappointed in this recovery, but anecdotal evidence points to a solid pickup in the near term. There is scope for substantial further improvement as housing activity works back toward normal conditions over the next few years.

Most investors should be aware of the noise that seasonal adjustment can generate in the economic data reports. Most of these figures are based on statistical samples, which also generates some uncertainty from month to month.

In setting monetary policy, Federal Reserve officials look at a wide range of economic data and also put a lot of emphasis on anecdotal information. That means looking beyond the noise as they attempt to judge the underlying strength.

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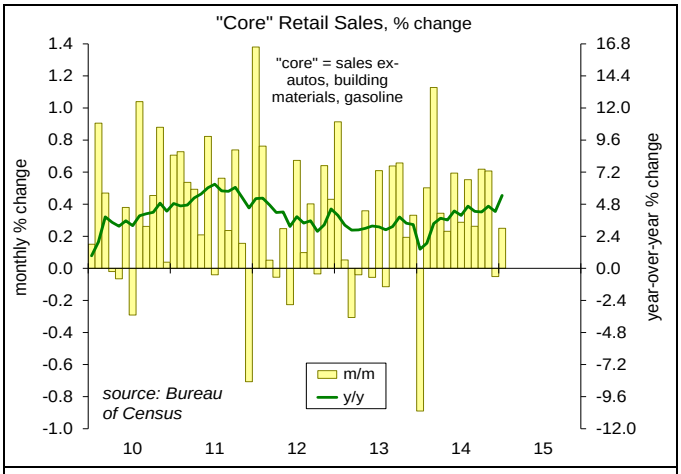
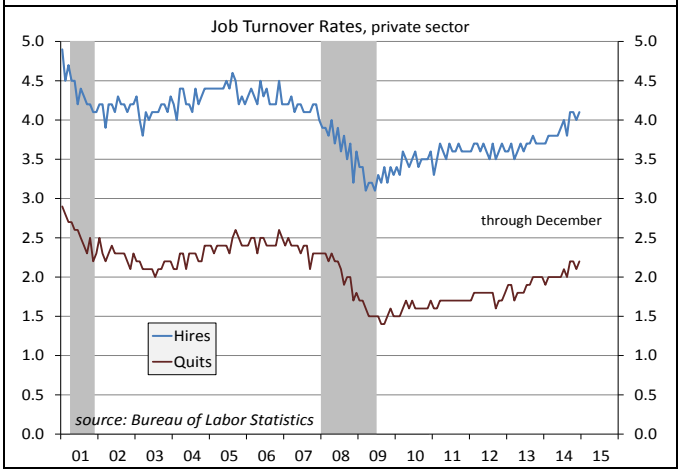
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
1/16/15	0.03	0.07	0.17	0.49	0.80	1.29	1.83	2.44	1.152	1.513	117.45	1.199	4634.38	2019.42	17511.57
2/06/15	0.02	0.07	0.26	0.65	1.03	1.48	1.95	2.51	1.133	1.525	119.16	1.252	4744.40	2055.47	17884.88
2/13/15	0.01	0.07	0.23	0.64	1.04	1.53	2.03	2.63	1.140	1.540	118.78	1.246	4893.84	2096.93	18019.23

Recent Economic Data and Outlook

As expected, U.S. financial market participants kept a close eye on developments in Europe. A fragile ceasefire agreement was reached in Ukraine (but we've seen that before). Negotiations to reduce austerity in Greece and restructure the country's debt broke down, but the two sides agreed to try again this week. Retails sales were softer than expected in January and consumer sentiment fell unexpectedly in the mid-February assessment, leading to some concerns about the strength of consumer spending, but also fueling expectations that the Fed may delay its initial increase in short-term interest rates.





Retail Sales fell 0.8% in January (median forecast: -0.5%), following -0.9% (unrevised) in December. Ex-autos, sales fell 0.9%, following 0.9% in December (revised from -1.0%). The January drop reflected a 9.3% decline in gasoline sales (-11.8% before seasonal adjustment and -27.4% y/y). Ex-autos and gasoline, sales rose 0.3%. Note that seasonal adjustment is very challenging at the start of the year. Unadjusted core sales fell by 24.9% m/m, vs. -24.9% in January 2014. Clothing store sales slipped 0.8% (-52.1% before seasonal adjustment). Department store sales fell 0.7% (-55.3% before seasonal adjustment).

Business Inventories rose 0.1% in December. Manufacturing and wholesale inventories (released earlier) rose less than assumed in the advance GDP report. Retail inventories (the only new information in the report) rose by 0.9%, more than assumed in the GDP report. The data suggest that (all else equal) the change in inventories will make a smaller contribution to the estimate of fourth quarter growth.

The **Job Opening and Labor Turnover Survey** data for December suggested a continued gradual trend of improvement in overall labor market conditions, but with a significant amount of slack remaining. The job openings rate rose to 3.5%, vs. 3.3% in November and 2.8% in December 2013. The private-sector hiring rate rose to 4.1%, little changed over the last three months, but up from 3.7% a year ago. The quit rate edged up to 2.2% (trending roughly flat in recent months) and up from 2.0% in December 2013 (in a strong labor market, workers are more likely to quit their jobs and pursue employment elsewhere).

Import Prices fell 2.8% in January (-8.0% y/y), reflecting a 17.7% decline in petroleum prices (-40.1% y/y). Ex-food & fuels, import prices fell 0.6% (-1.1% y/y). Disinflationary pressures picked up in raw materials and finished goods.

The Index of **Small Business Optimism** fell to 97.9 in January, vs. 100.4 in December and 98.1 in November. The earnings trend remained weak, but respondents were roughly neutral about the general business outlook and sales expectations remained positive. Hiring plans remained moderate.

Euro Area Real GDP rose 0.3% q/q (+0.9% y/y) in the flash estimate for 4Q14, led by a 0.7% gain for Germany (+1.5% y/y). France edged up 0.1% (+0.2% y/y). Italy was flat (-0.3% y/y).

Economic Outlook (1Q15): Real GDP growth of 2.5-3.0%.

Employment: Job growth is strong. Small firms are hiring.

Consumers: Strong job growth and lower gasoline prices should support spending growth in 1H15. Confidence is trending higher, but we'll eventually need to see a pickup in wages.

Manufacturing: Mixed. A stronger dollar and weakness in the global economy are expected to restrain exports, but domestic demand should strengthen in the months ahead.

Housing/Construction: Supply constraints have eased and affordability has improved. Look for a better balance in 2015 (less speculative buying, better consumer fundamentals).

Prices: The PCE Price Index remains well below the Fed's 2% goal – and the core rate is moving in the wrong direction. Pipeline pressures are mild. Wage pressures are limited. Inflation expectations remain well-anchored, but may decline.

Interest Rates: With low inflation and a still-high elevated level of slack in the economy, the Fed can be patient in deciding when to begin raising short-term interest rates. Global financial conditions are also a consideration (along with the outlooks for inflation and the job market). The hard part for the Fed will be managing financial market expectations.

This Week:					*forecast*	last	last –1	comments
Monday	2/16		Presidents Day Holiday					markets closed
Tuesday	2/17		Mardi Gras					*laissez les bons temps rouler*
		8:30	Empire St. Manf. Index	Feb	***4.5***	10.0	-1.2	weather impact?
		10:00	Homebuilder Sentiment	Feb	***60***	57	58	should trend higher
Wednesday	2/18	8:30	**Producer Price Index**	Jan	***-0.4%***	-0.2%	-0.2%	lower gasoline
			ex-food & energy		***+0.0%***	+0.3%	+0.1%	a low trend
			ex-f, e, & trade services		***+0.1%***	+0.1%	+0.1%	mild "new" core reading
		8:30	**Building Permits, th.**	Jan	***1075***	1058	1052	likely higher
			% change		***+1.6***	+0.6	-3.7	but spring figures will be more important
			Housing Starts		***1070***	1089	1043	choppy, but expecting a higher trend
			% change		***-1.7***	+4.4	-4.5	watch for revisions
		9:15	**Industrial Production**	Jan	***+0.6%***	-0.1%	+1.4%	colder temps
			Manufacturing Output		***+0.4%***	+0.3%	+1.3%	aggregate hours reported at +0.2%
			Capacity Utilization		***80.1%***	79.7%	80.0%	still relatively low
			Manufacturing		***79.5%***	79.3%	79.2%	no threat of higher inflation
		2:00	**FOMC Minutes**	1/28				insight into what the Fed worries about
Thursday	2/19	8:30	Jobless Claims, th.	2/14	***292***	304	279	choppy, but a low trend
		10:00	Philly Fed Index	Jan	***9.5***	6.3	24.3	choppy, but likely moderate
		10:00	Leading Econ Indicators	Jan	***+0.1%***	+0.5%	+0.4%	components more mixed in January
Friday	2/20	9:45	Markit US Manf PMI (flash)	Feb	***NF***	53.9	53.9	moderate
Next Week:								
Monday	2/23	10:00	**Existing Home Sales, mln**	Jan	***5.12***	5.04	4.92	likely to improve
			% change		***+1.6***	+2.4	-6.3	but spring activity will be more important
Tuesday	2/24	9:00	C-S Home Prices (national)	Dec	***+0.6%***	+0.8%	+0.7%	trending higher
			year-over-year		***+4.6%***	+4.7%	+4.6%	roughly steady
		10:00	CB Consumer Confidence	Feb	***103.2***	102.9	93.1	follows strong gain in January (revisions?)
		10:00	**Yellen Mon Pol Testimony**	Feb				Senate, tentatively scheduled
		1:00	Treasury Note Auction					2-year notes
Wednesday	2/25	10:00	**New Home Sales, th.**	Jan	***490***	481	431	anecdotal reports of solid strength…
			% change		***+1.9***	+11.6	-6.7	but these figures are erratic
		10:00	**Yellen Mon Pol Testimony**	Feb				House, tentatively scheduled
		11:30	FRN auction					re-opened 2-year Floating Rate Notes
		1:00	Treasury Note Auction					5-year notes
Thursday	2/26	8:30	Jobless Claims, th.	2/21	***290***	***292***	304	should settle down
		8:30	**Consumer Price Index**	Jan	***-0.5%***	-0.4%	-0.3%	lower gasoline prices
			year-over-year		***+0.2%***	+0.8%	+1.3%	near-flat vs. a year ago
			ex-food & energy		***+0.1%***	+0.0%	+0.1%	low core inflation
			year-over-year		***+1.5%***	+1.6%	+1.7%	edging lower
		8:30	Real Weekly Earnings	Jan	***+1.0%***	+0.2%	+0.8%	nominal earnings rose 0.5%
		8:30	**Durable Goods Orders**	Jan	***-0.2%***	-3.3%	-2.2%	seasonal adjustment may complicate
			ex-transportation		***-0.4%***	-0.8%	-1.2%	mixed across sectors, but a poor trend
			nondef cap gds ex-aircraft		***-0.6%***	-0.1%	-0.5%	weakness in energy and exports
		1:00	Treasury Note Auction					7-year notes
Friday	2/27	8:30	**Real GDP (2nd estimate)**	4Q14	***+2.6%***	+5.0%	+4.6%	+2.6% in adv. est., mixed revisions
		9:45	Chicago PMI	Feb	***59.0***	59.4	58.8	moderately strong
		9:55	UM Consumer Sentiment		***94.8***	98.1	93.6	93.6 at mid-month
		10:00	Pending Home Sales Index	Jan	***+1.6%***	-3.7%	+0.6%	likely to rebound

This Week…

The economic data reports pile up on Wednesday. January residential construction figures should not be important (what happens in the spring is key), but seasonal adjustment could exaggerate. Industrial production is likely to be mixed across sectors, but up moderately overall. The Fed policy meeting minutes have potential to move the markets, especially if the news wires take quotes out of context.

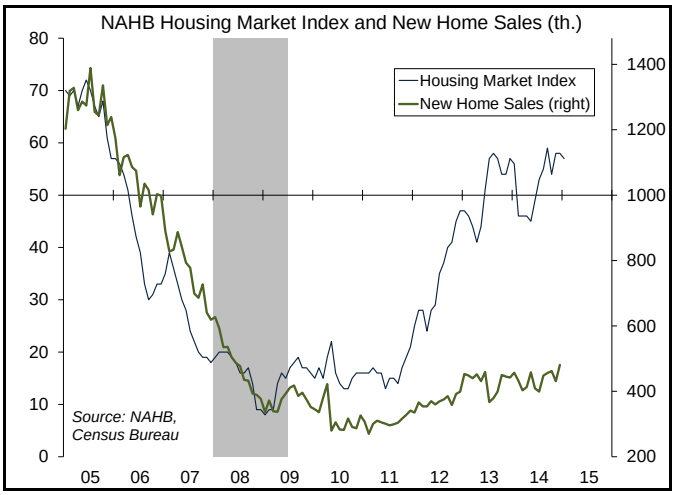
Monday

Presidents Day Holiday – Markets closed

Tuesday

Empire State Manufacturing Index (February) – The New York Fed's factory sector survey results are often volatile. We may see some impact from the weather.

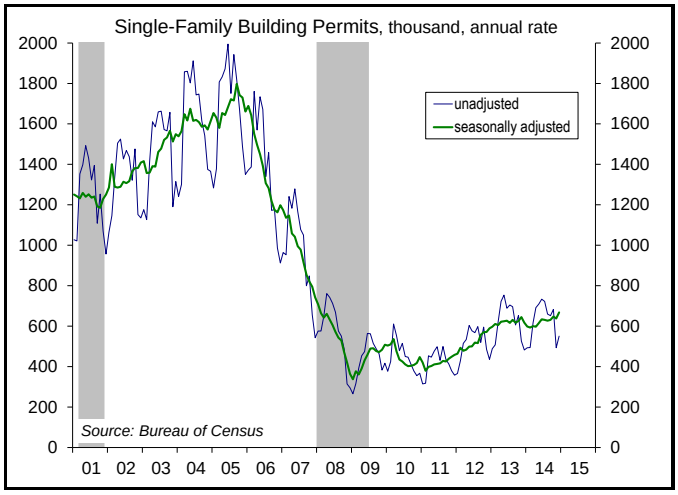
Homebuilder Sentiment (February) – Anecdotal reports suggest a brighter outlook for the housing sector as we move toward the critical spring season. Job growth, a key factor for housing demand, has been strong. Credit is still relatively tight, but affordability has improved relative to a year ago and home builders are seeing a lot fewer supply constraints.



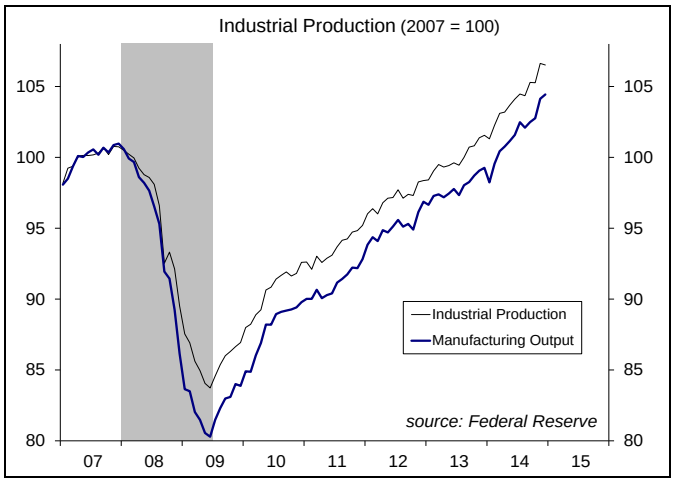
Wednesday

Producer Price Index (January) – The lower wholesale price of gasoline should push the headline figure lower. The new "core" inflation figure (ex-food, energy, and trade services) should remain mild. Pipeline pressures should continue to recede.

Building Permits, Housing Starts (January) – Seasonal adjustment can exaggerate. We should get a clearer picture in the spring.



Industrial Production (January) – Results are likely to be mixed across industries (reflecting some softness in exports), but the overall trend should remain moderate.



FOMC Minutes (January 27-28) – The Federal Open Market Committee believes that it can be patient in deciding when to begin raising short-term interest rates. However, as we are likely to see in the minutes of the January policy meeting, some Fed officials are more patient than others. Everyone agrees that policy decisions will be data-dependent, but officials differ in their views on the amount of slack remaining in the job market and whether inflation pressures may build. The drop in gasoline prices is seen a transitory, but we haven't seen very many signs of upward pressures. The trend in wage growth is lackluster. Firms don't seem to have much pricing power. There's always a chance that some particular quote will be taken out of context, which could generate some reaction in the financial markets. However, one should reserve judgment, as Fed Chair Yellen will provide a more comprehensive picture next week.

Thursday

Jobless Claims (week ending February 24) – Unadjusted claims are likely to settle into a relatively low level as we enter the important spring hiring season (note that unadjusted payrolls rose by about 4.4 million from January to June last year).

Philadelphia Fed Index (February) – Likely to be moderate.

Leading Economic Indicators (January) – The ten components were mixed last month, but most made positive contributions.

Friday

Markit U.S. Manufacturing Purchasing Managers Index (February, "flash" estimate) – This gauge is still not getting much respect from U.S. financial market participants.

Next Week …

There are some important economic data reports, but the focus is expected to be on Janet Yellen's monetary policy testimony. The Fed chair will likely present an optimistic outlook for the economy, rehashing the issues seen in the FOMC minutes (expect a lot of "on the one hand this, on the other hand that"). She should also come out swinging against the horribly misguided "Fed audit" bill (which would allow Congress to influence monetary policy – a truly bad idea).

Coming Events and Data Releases

March 2	ISM Manufacturing Index (February)
March 4	Fed Beige Book
March 5	ECB Policy Meeting
March 6	Employment Report (February)
March 12	Retail Sales (February)
March 18	FOMC Policy Decision, Yellen press conference
March 6	Employment Report (February)
April 29	FOMC Policy Decision (no press conference)
June 17	FOMC Policy Decision, Yellen press conference