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GREEN SHOOTS ON MAIN STREET

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KEY TAKEAWAYS

Our Beige Book Barometer climbed from a seven-year low.

Strong words increased, but weak words remained elevated as businesses dealt with lower demand.

Oil districts' weakness had a notable impact on the sentiment gauge.

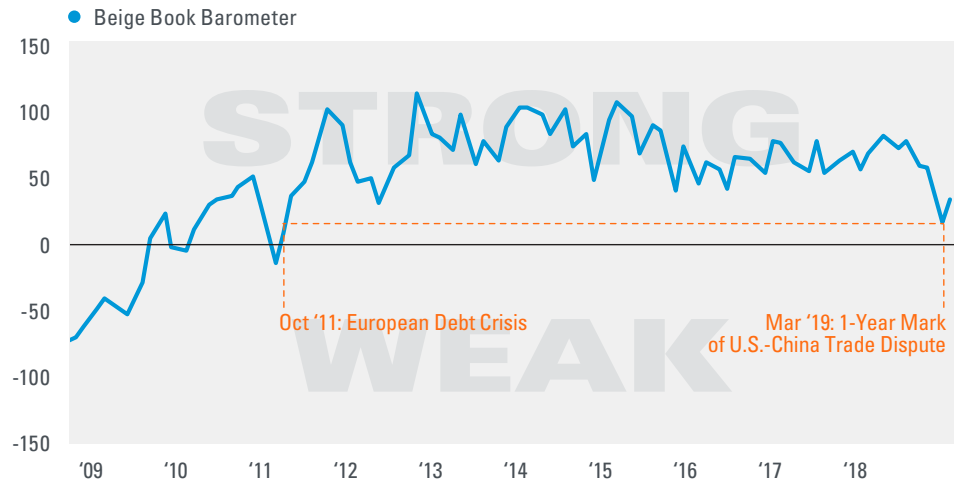
We've talked a lot about green shoots in the U.S. economy recently. A slew of recent data has pointed to a rebound in growth from a disappointing first quarter hampered by global headwinds. Last week, we gathered more clues on a potential recovery from an uptick in business sentiment in the Federal Reserve's (Fed) Beige Book [\[Figure 1\]](#).

WINDOW ON MAIN STREET

Economic reports are important for clues on economic health and macro trends, but the Beige Book, which the Fed produces eight times a year, provides a window into Main Street's perspective, offering valuable color on how larger trends are affecting U.S. businesses. In the Beige Book, the Fed presents qualitative observations made by community bankers and business owners about economic (housing, labor market, manufacturing, nonresidential construction, prices, tourism, wages) and banking (lending conditions, loan demand, loan quality) conditions. The latest Beige Book was compiled in the weeks before April 8 and published April 17.

At LPL Research, we maintain an indicator called the Beige Book Barometer (BBB), which helps us gauge Main Street's sentiment by looking at how frequently key words and phrases appear in the Beige Book. The BBB measures the difference between the number of times the word "strong" or its variants appears in each

1 BEIGE BOOK BAROMETER REBOUNDS FROM SEVEN-YEAR LOW



Source: LPL Research, Federal Reserve 04/17/19

Beige Book, and the number of times the word “weak” or its variants appears. When the BBB is declining, it suggests the economy may be deteriorating; when it’s advancing, it suggests the economy is likely improving.

The BBB climbed to 33 in April, its biggest gain since October 2017. This month’s jump was entirely due to a resurgence in strong words, as weak words were unchanged from the previous edition. In the March edition, the BBB fell to its lowest level since October 2011 (the peak of the European debt crisis), a drop we attributed to businesses struggling with uncertainty more than definitive signs of sustained weakness.

LOWER GLOBAL DEMAND

Mentions of weakness in the latest Beige Book centered on a drop in global demand, a trend that we think should improve as the United States and China reach a resolution on trade. Respondents mostly cited weak conditions in agriculture, manufacturing, and consumer spending—three areas of the economy that were in decline in the first quarter as trade tensions intensified. Gauges of U.S. manufacturing health have sputtered around multiyear lows, retail sales have slowed considerably, and agriculture prices have dropped about 20% since the first tariffs were implemented.

Raw material costs have also risen amid global trade disruption, and companies are struggling to raise prices to account for higher expenses. This has become an increasing drag on U.S. profit margins and a difficult dynamic for the Fed to manage as it tries to promote stable but healthy inflation. Input costs increased “in the modest to moderate range,” according to the latest Beige Book, while prices have risen modestly. Respondents also reported a “mixed” ability to pass on these higher costs to consumers. Healthy wage and heightened wholesale price growth shows that pricing pressures could be building, but we believe global

demand will need to recover before consumer inflation can pick up to levels seen just a few months ago.

Trade-related repercussions are clearly disrupting Main Street’s operations, but we expect these impacts to subside as the United States and China near a trade resolution. Global data have improved recently, encouraging us that economic activity in other economies has picked up enough to boost demand. China data have rebounded across the board, global manufacturing activity gauges have stabilized, and global leading indicators have perked up. Global economic progress could be stop-and-go, like it has been for most of this expansion, but even a slight recovery could provide crucial support for consumer and business sentiment worldwide. Mentions of uncertainty in the Beige Book declined slightly, a sign to us that business spending and planning could pick up soon as a result of more clarity on the economic outlook.

OIL’S IMPACT

Oil’s impact is also notable. Even though oil prices have bounced back, weakness among energy companies has significantly weighed on Main Street’s sentiment. Excluding oil districts (Minneapolis, Kansas City, Dallas), the BBB climbed to 36, the biggest rise for this subset of the gauge since November 2016. Nearly half of all weak mentions were from oil districts. While the ongoing repercussions of the 2018 oil sell-off have been difficult for energy sector firms, the concentration of weak words in those firms’ responses shows us that negative Main Street sentiment isn’t as broad-based. Sentiment improved in seven of the 13 districts surveyed from the previous edition, with the Boston, New York, and Richmond (Washington, D.C. area) Fed districts leading gains. As energy companies slowly recover, we expect improvement in oil districts to help buoy higher BBB readings.

CONCLUSION

U.S. businesses are still struggling with a complicated economic environment. The clouds are breaking, though, as evidenced by the uptick in the BBB and improving data. We still think lower Beige Book sentiment is a temporary consequence of heightened uncertainty. U.S. companies have contended with significant trade and political headwinds, but we're seeing more signs of these headwinds dying down. As the global economy improves, we expect Main Street's sentiment to brighten, which will help the U.S. economy climb out of this latest soft patch. ■

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