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BEIGE BOOK: WINDOW ON MAIN STREET

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KEY TAKEAWAYS

Based on our analysis, the Beige Book continues to deliver a positive view of the U.S. economy.

The Beige Book Barometer fell to +54, the lowest since March 2017, but still indicative of steady growth.

Words related to inflation and wage pressures fell since the last Beige Book, but remain above average.

BEIGE BOOK SUGGESTS CONTINUED MODERATE ECONOMIC GROWTH

The latest edition of the Federal Reserve’s (Fed) Beige Book, released Wednesday, September 6, 2017, continued to deliver a positive view of the U.S. economy. The Beige Book is a qualitative assessment of the domestic economy and each of the 12 Fed districts individually. The report is prepared eight times per year, ahead of each Federal Open Market Committee (FOMC) meeting. We believe the Beige Book is best interpreted by measuring how key words change over time. The qualitative inputs for the September 2017 Beige Book were collected in the weeks prior to August 28, 2017.

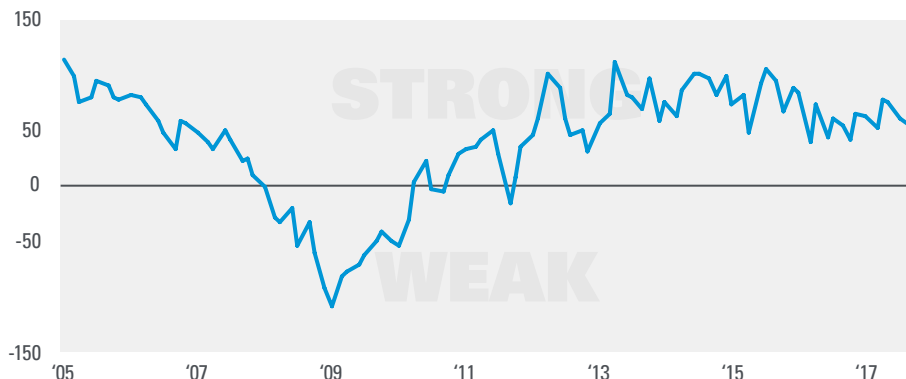
SENTIMENT SNAPSHOT

We created our proprietary Beige Book Barometer (BBB) [Figure 1] to evaluate the sentiment behind the entire Beige Book collage of data. The BBB is a diffusion index measuring the number of times the word “strong” or its variants appear in the Beige Book less the number of times the word “weak” or its variants appear. When the BBB is declining, it suggests that the economy is deteriorating; when it’s advancing, it suggests that the economy is improving.

In September 2017, the barometer declined for the third consecutive month, falling to +54. While near the lower end of the range the barometer has held since 2012, it is only slightly below the prior year’s average and almost exactly in line with the

1 BEIGE BOOK BAROMETER SUGGESTS MODERATE ECONOMIC GROWTH

● Number of Times “Strong” (and Variants) Is Mentioned Minus Number of Times “Weak” (and Variants) Is Mentioned



Source: LPL Research, Federal Reserve 09/11/17

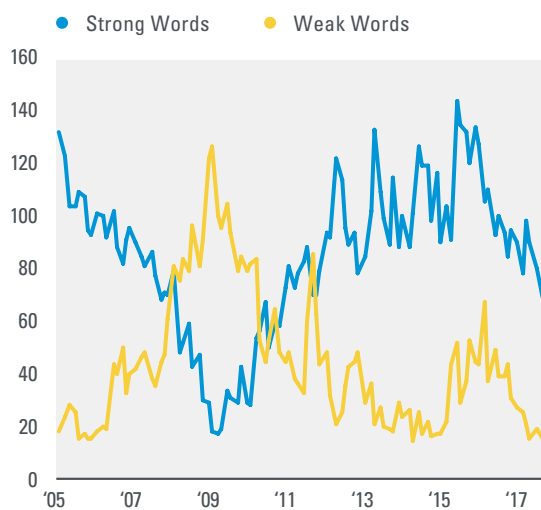
HOW THEY WORK

BEIGE BOOK AND BEIGE BOOK BAROMETER

The **Beige Book** compiles qualitative observations made by community bankers and business owners about economic (labor market, prices, wages, housing, nonresidential construction, tourism, manufacturing) and banking (loan demand, loan quality, lending conditions) conditions in each of the 12 Fed districts (Boston, New York, Philadelphia, Kansas City, etc.). This local color that makes up each Beige Book is compiled by 1 of the 12 regional Fed districts on a rotating basis — the report is much more “Main Street” than “Wall Street” focused. It provides an excellent window into economic activity around the nation using plain, everyday language. The report is prepared eight times per year, ahead of each of the eight Federal Open Market Committee (FOMC) meetings. The next FOMC meeting is September 19–20, 2017.

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2 WEAK WORDS REMAIN LOW DESPITE OVERALL DECLINE IN BAROMETER



Source: LPL Research, Federal Reserve 09/11/17

level from September 2016. Despite the decline, the number of weak words remains near an expansion low [Figure 2]; however, the number of strong words has also declined, falling to its lowest level since October 2010.

A decline in the number of times the word “optimism” and its variants appear presents a similar picture. In 2016, optimism appeared an average of 14 times. Following the U.S. elections, in the first three Beige Books of 2017, it jumped to an average of 27 mentions, but has since fallen back to 14 in the last two Beige Books. Main Street may believe there is less to worry about, thanks to a strengthening global economy and a more pro-business government backdrop. At the same time, policy uncertainty may be restraining positive sentiment, and although there has been some decline in barriers to growth, it may not be translating to a full willingness to take on the kind of economic risks required to create new opportunities.

ECONOMIC IMPACT OF HURRICANES HARVEY AND IRMA

The U.S. felt the impact of one devastating hurricane in late August, and continues to feel the impact of another in early September. This marks the first time two Category 4 or stronger magnitude hurricanes have hit the country in the same year. While regional survey responses predate these events, the September Beige Book does include a special note on Hurricane Harvey and its broad impact. We expect future Beige Books into early 2018 to reflect the destructive impact of the hurricanes, including the personal toll; extensive damage to homes, businesses, and infrastructure; and the slowdown in commerce—but also the subsequent economic pickup as the regions affected recover and rebuild. While the economic impact will be felt nationwide, it will be most prominent in the regional responses from the Dallas Fed, which covers Texas, northern Louisiana, and southern New Mexico; and the Atlanta Fed, which covers Florida, Georgia,

Alabama, Tennessee, southern Mississippi, and southern Louisiana.

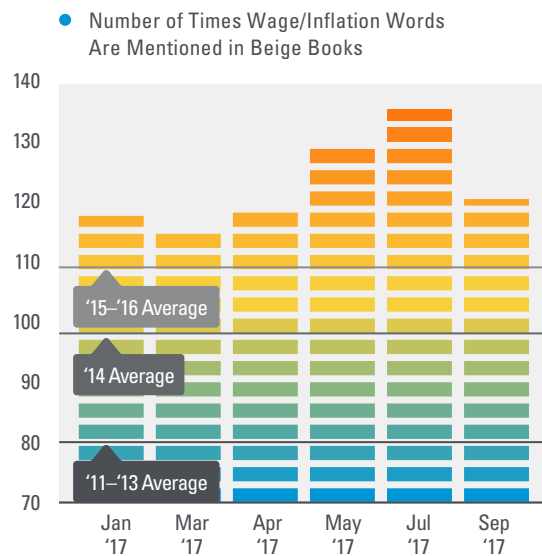
WATCHING WAGES & INFLATION

Market participants continue to monitor inflation and wages closely, as they gauge not just when, but how far and how fast the Fed might raise rates in the next year and beyond. Each Beige Book provides an economy-wide assessment of wages and prices. On wages, the September 2017 Beige Book observes, “Many Districts indicated that businesses were having difficulty filling openings at all skill levels. In spite of the tight labor market, the majority of

Districts reported limited wage pressures and modest to moderate wage growth”; and on price pressures, “Prices rose modestly across the country. Input and materials costs generally increased, most notably for freight, lumber, and steel.”

We monitor wage and price pressures via our Inflation Barometer, which is a simple count of the number of times wage/inflation words (“wage,” “skilled,” “shortage,” “widespread,” and “rising”) appear in the Beige Book. Despite the modest price pressures noted in the Beige Book’s overview, words related to inflation declined notably in the Beige Book after rising in May and July [Figure 3]. Between July and September 2017, the count of wage/inflation words fell from +136 to +121, the largest decline since January 2016. Even with the decrease, the level remains above the 2014–2016 average and higher than the reading in the first three Beige Books of the year, largely supporting the summary comment that some wage pressures are appearing but that the impact on price levels remains modest.

3 WAGE PRESSURE EVIDENT, BUT INFLATION REMAINS CONTAINED



CONCLUSION

The level of the September 2017 Beige Book Barometer has been historically associated with continued economic expansion. The count of weak words remains very low, but positive words have fallen as well. We may need positive sentiment to rise if we are to see acceleration beyond that level, but it’s likely healthy for Main Street’s positive view of the economy to remain tempered while we await greater clarity on policy. Nevertheless, there are clear signs that the economy continues to follow a steady course. ■

IMPORTANT DISCLOSURES

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