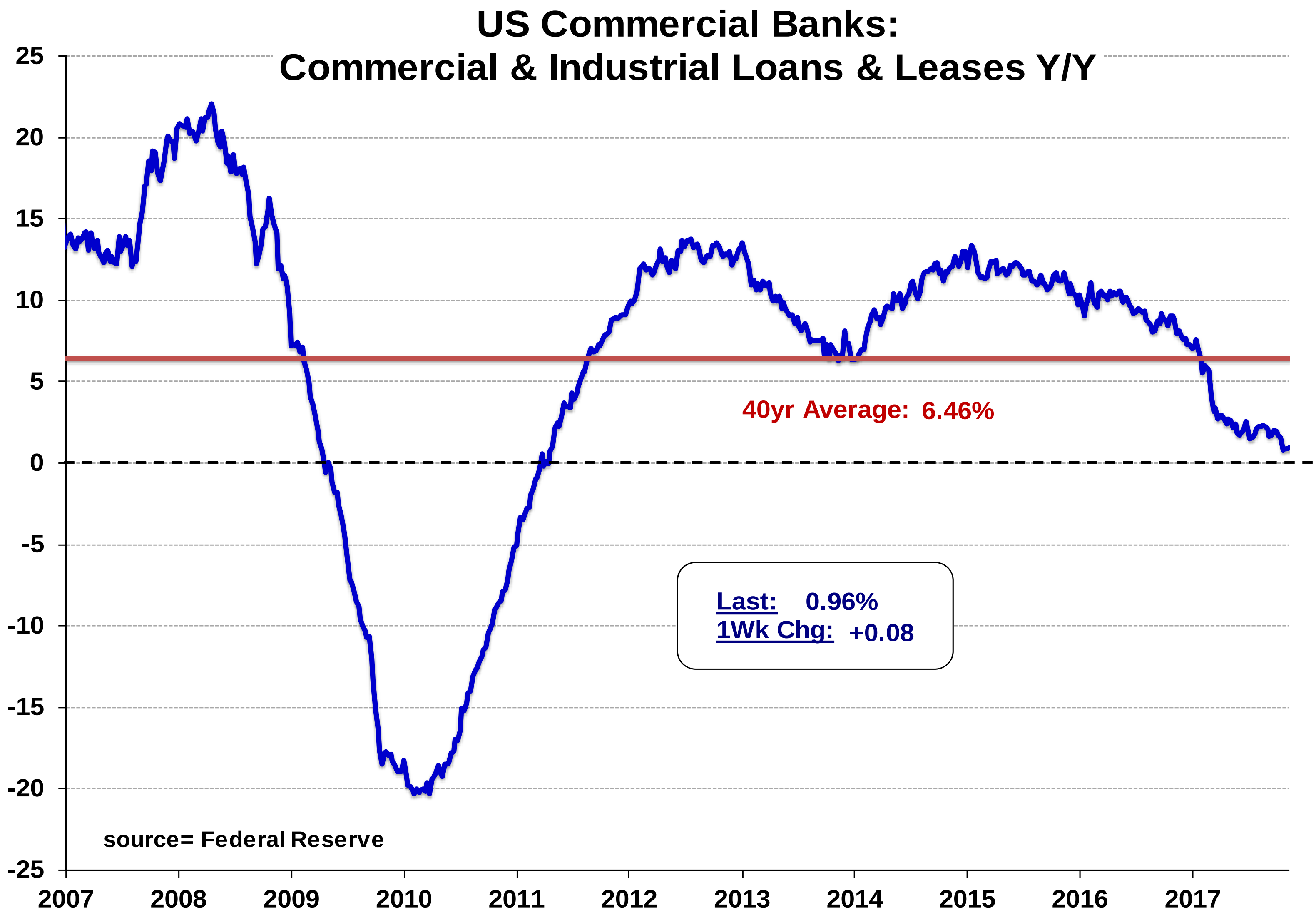
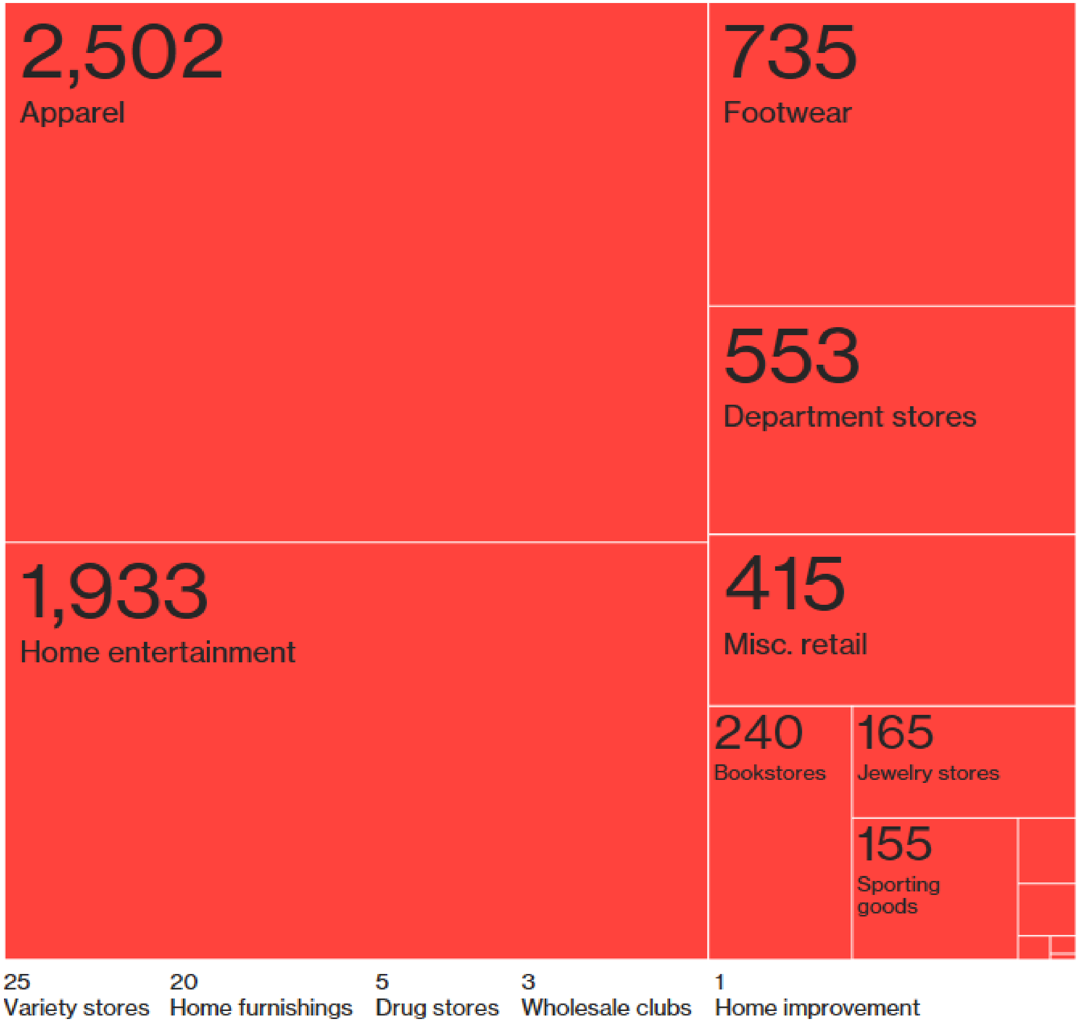
While confidence in the reflation trade remains high, 10yr yield remains within long-term downtrend as yield curve flattens (2s10s now at 62bps…lowest since Nov. 2007)

Latest weekly Commercial Bank C&I Loan data includes revisions going back to July…lower revisions…pushing y/y growth under 1%. First sub-1% reading since April 20th, 2011 (further back, lowest since April 8th, 2009).



Clothing stores and entertainment chains lead store closing surge
Q1–Q3 2017 data

6,752 announced store closings



Source: ICSC Research Team and PNC Real Estate Research

According to a recent Bloomberg report (citing ICSC data), retail store closings reached 6,752 through the third quarter…just 150 stores shy of surpassing the all-time high seen in 2008.

Not exactly reflective of a strong consumer. The blame of course is placed on Amazon as online shopping gains market share. *Yet, no mention of real employee earnings which have been in steady decline the past 2 years…matching the decline in S&P Department Stores Index*. The reason consumers are shopping online more is because it's the cheaper option, plain and simple. Again, not reflective of a strong consumer and rising wages.

So, while investors have jumped back into the retail stocks as of late (perhaps optimistic the carnage is overdone and retail is set for a strong holiday season), we fear retail woes are not over yet…especially as health expenditures are set to soar again in 2018.

HOW MUCH WOULD PEOPLE SAVE?

People across income brackets would see savings from the Senate plan in 2018. But for many in the middle class, the savings would be relatively small. The table below shows the average savings, by income, for those who would receive a tax cut.

- Under $30,000: **$180**
- $30,000-$50,000: **$600**
- $50,000-$75,000: **$976**
- $75,000-$100,000: **$1,277**
- $100,000-$200,000: **$2,113**
- $200,000-$500,000: **$4,121**
- More than $500,000: **$28,313**

Tax cuts: will they boost growth? Not likely. According to analysis of the Senate's plan, persons earning median income of $50-$75k/yr will see about $1000 in tax relief (House Speaker Paul Ryan, in a recent town hall discussion, said persons earning $60k/yr would see about $1200 in relief). While tax cuts are always welcome, and may boost spending and growth at the margin, the big elephant in the room… as ever…is rising health care costs. For those persons who do not qualify for a subsidy under the ACA, their premiums are set to rise by 38% in 2018 (national average estimate). Considering premiums, on average, have doubled since 2013 (more than doubled in some cases; see HHS press release next page), a 38% increase is a 'consumer spending killer'. Individuals who, on average, paid $5.7k in 2017 ACA premiums would be paying nearly $2.2k more in 2018, wiping out their $1200 tax cut…and then some. In addition, as noted in a recent report of ours, an increasing number of small businesses (the bulk of job creators) are either not offering health benefits, or are pushing off a larger portion of rising costs to employees. Unless or until soaring health care costs are addressed, the odds of a consumer comeback remain decidedly low.

To put these costs in perspective: A $2.2k increase in annual health premium outlays is the equivalent of buying an additional 800 gallons of gas each year at current prices. Speaking of gas prices, consumers had better hope fuel costs don't rise! Should average pump prices rise 25% in 2018 to $3.40/gal, and at an average of 12k miles driven per year, that would equate to an additional outlay of ~$350 per year (given latest avg. auto fuel efficiency data of ~24mpg).

Press release from HHS in May

FOR IMMEDIATE RELEASE
May 23, 2017

Contact: HHS Press Office
202-690-6343
media@hhs.gov

HHS REPORT: Average Health Insurance Premiums Doubled Since 2013

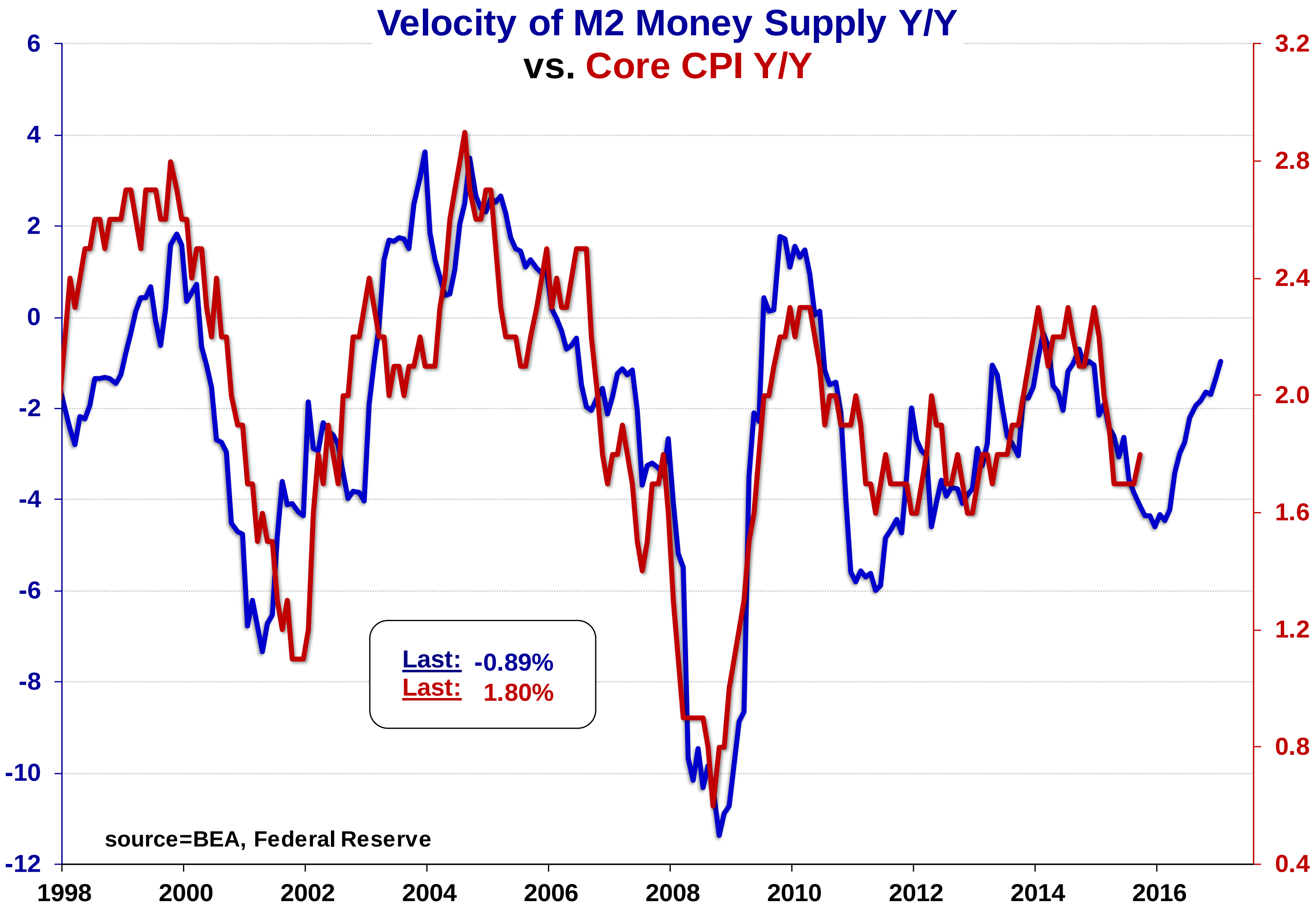
Washington, D.C. – The Department of Health and Human Services (HHS) released a new analysis today that shows premiums have doubled for individual health insurance plans since 2013, the year before many of Obamacare's regulations and mandates took effect. The analysis is based on data compiled by the previous Administration, and the report was produced by the Office of The Assistant Secretary for Planning and Evaluation (ASPE).

"With data that shows average premiums doubling nationwide and Americans paying nearly $3,000 more for health insurance per year, this report is a sobering reminder of why reforming our healthcare system remains a top priority of the Trump Administration. The status quo is unsustainable." – HHS National Spokesperson, Alleigh Marré

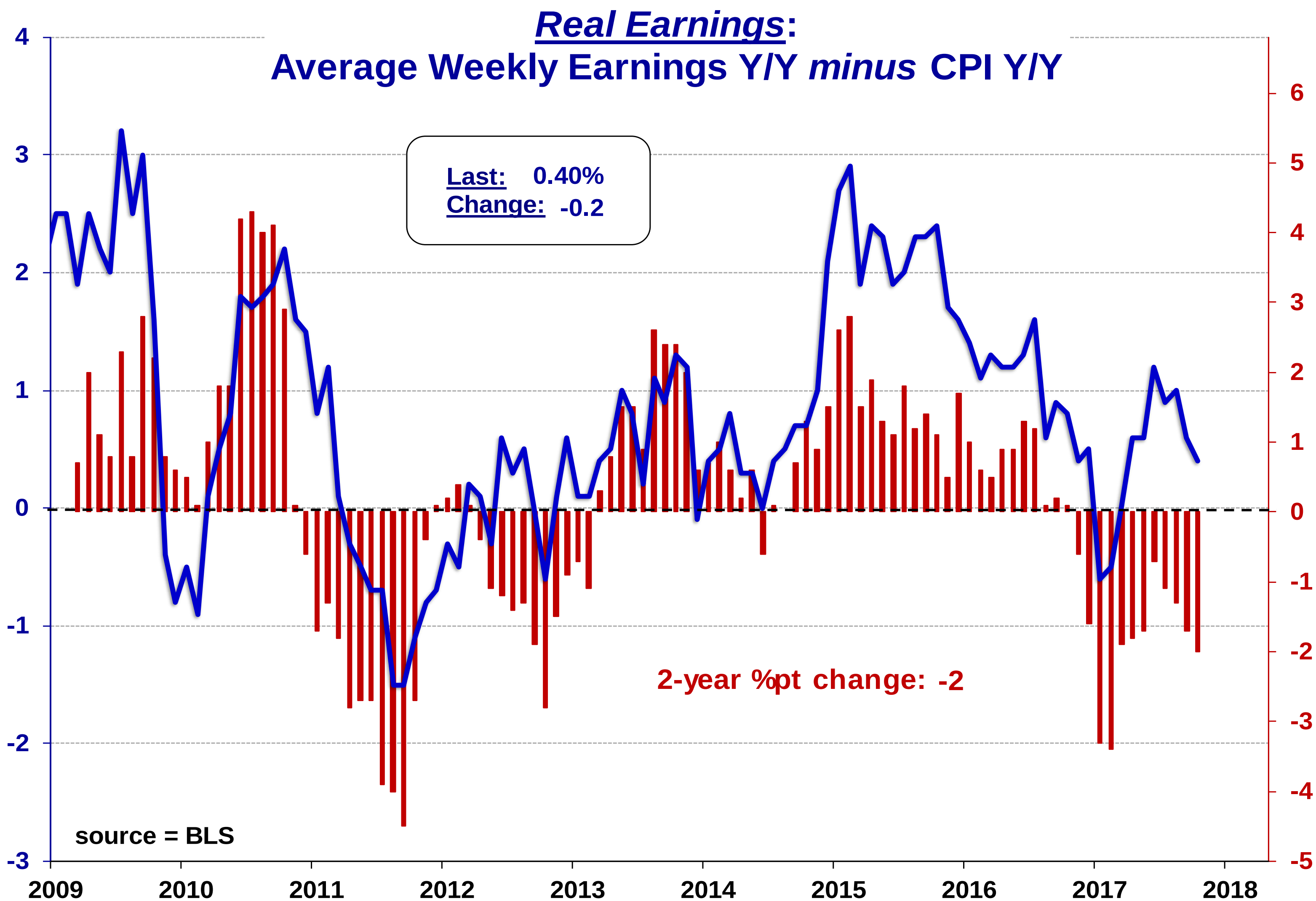
According to the report:

- Average individual market premiums more than doubled from $2,784 per year in 2013 to $5,712 on Healthcare.gov in 2017 – an increase of $2,928 or 105%.
- All 39 states using Healthcare.gov experienced an increase in individual market premiums from 2013 – 2017.
- 62% of states using Healthcare.gov had 2017 premiums double what was measured in 2013.
- Three states – Alaska, Alabama, and Oklahoma – saw premiums triple from 2013-2017.

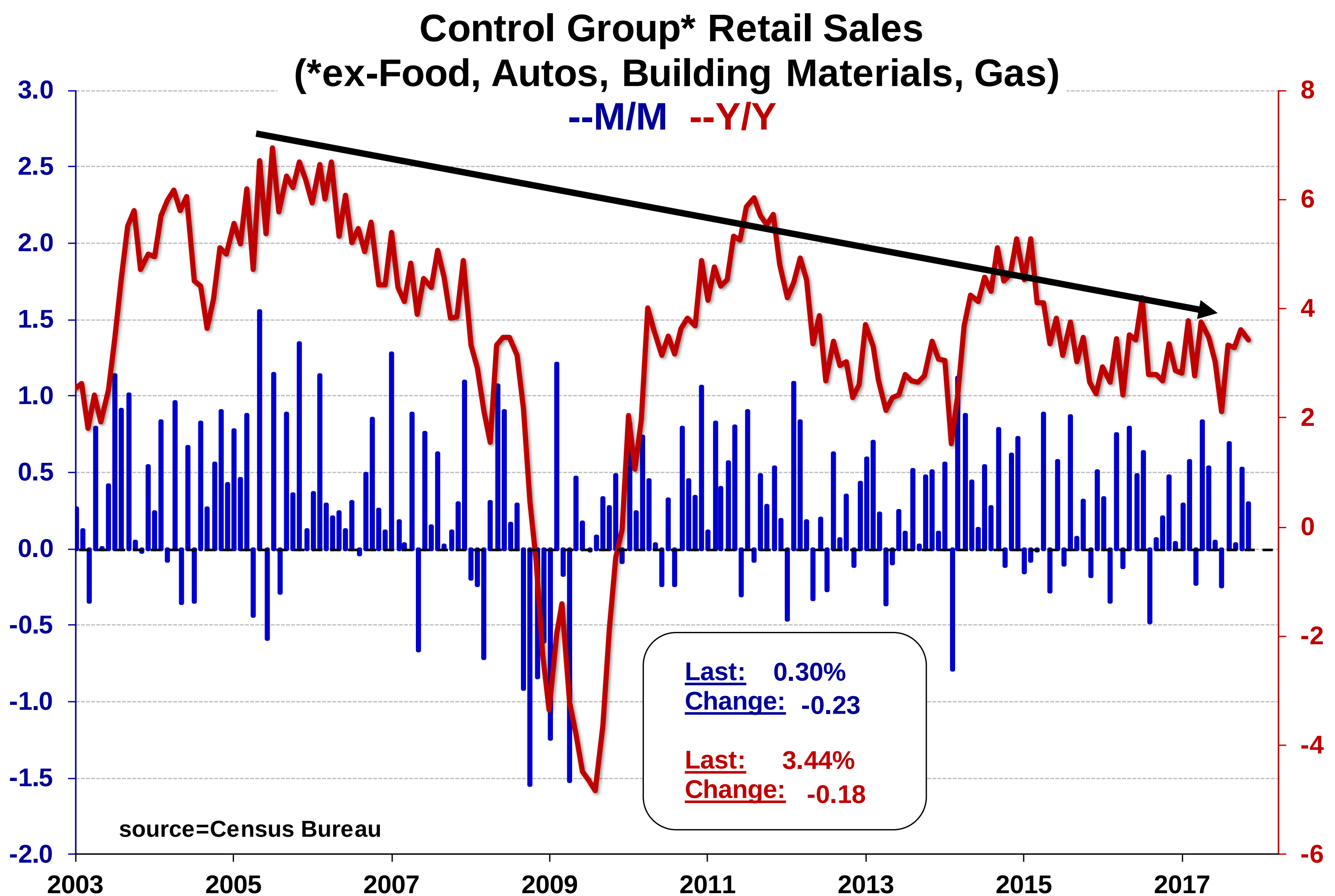
According to latest inflation data, CPI may be turning the corner…yet Velocity of Money suggests weak readings may persist in the short term. However, should CPI have now turned, there is a problem…



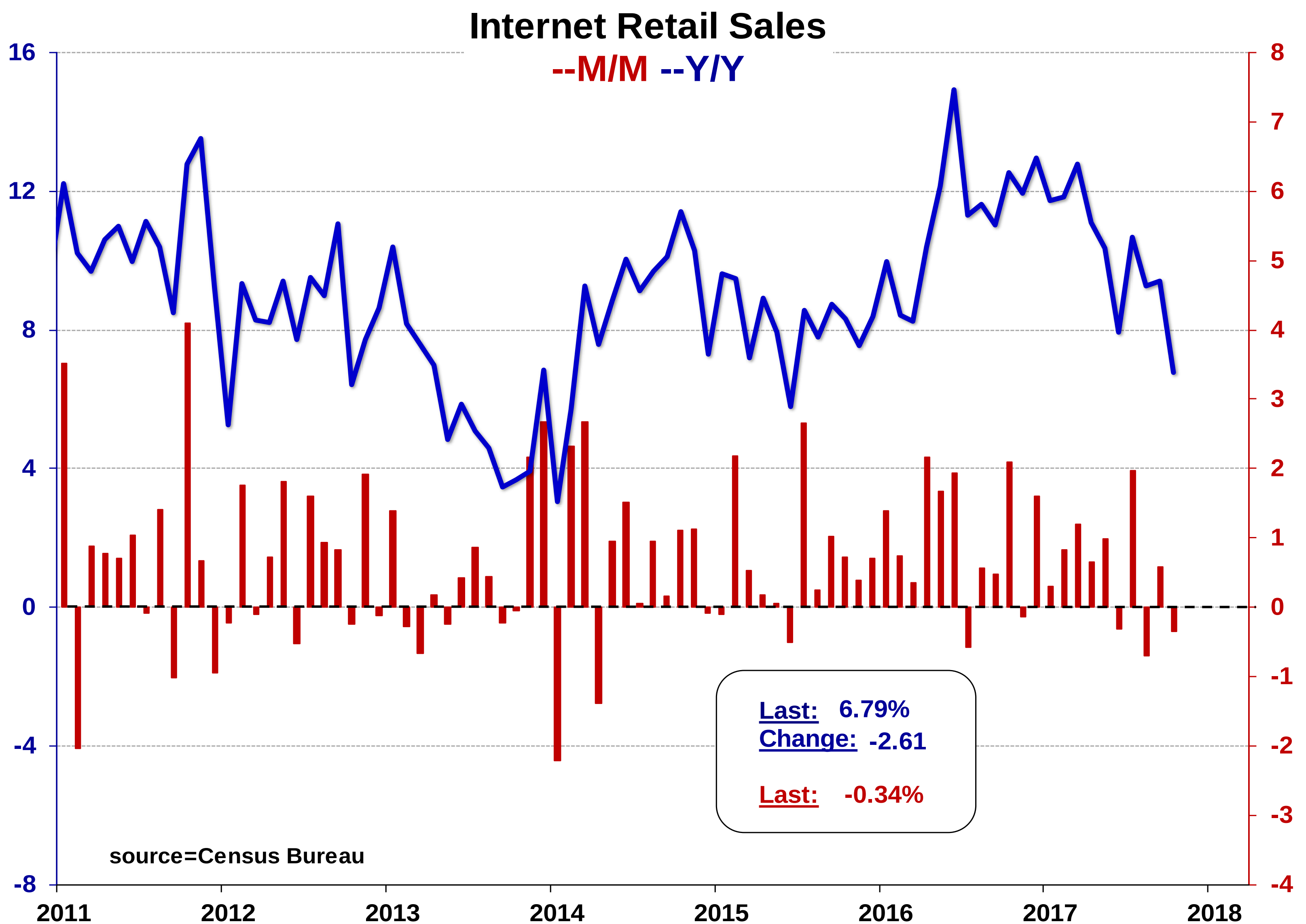
…which is the effect on real earnings, which dropped -0.2pts to 0.4% y/y at last reading. 2-year change in Real Earnings y/y has declined for the last 12 months straight, the longest stretch since 2011. Short of employee earnings posting a meaningful turnaround in coming months, headwinds for the consumer will continue as CPI rises…and we may well see negative real earnings again soon.



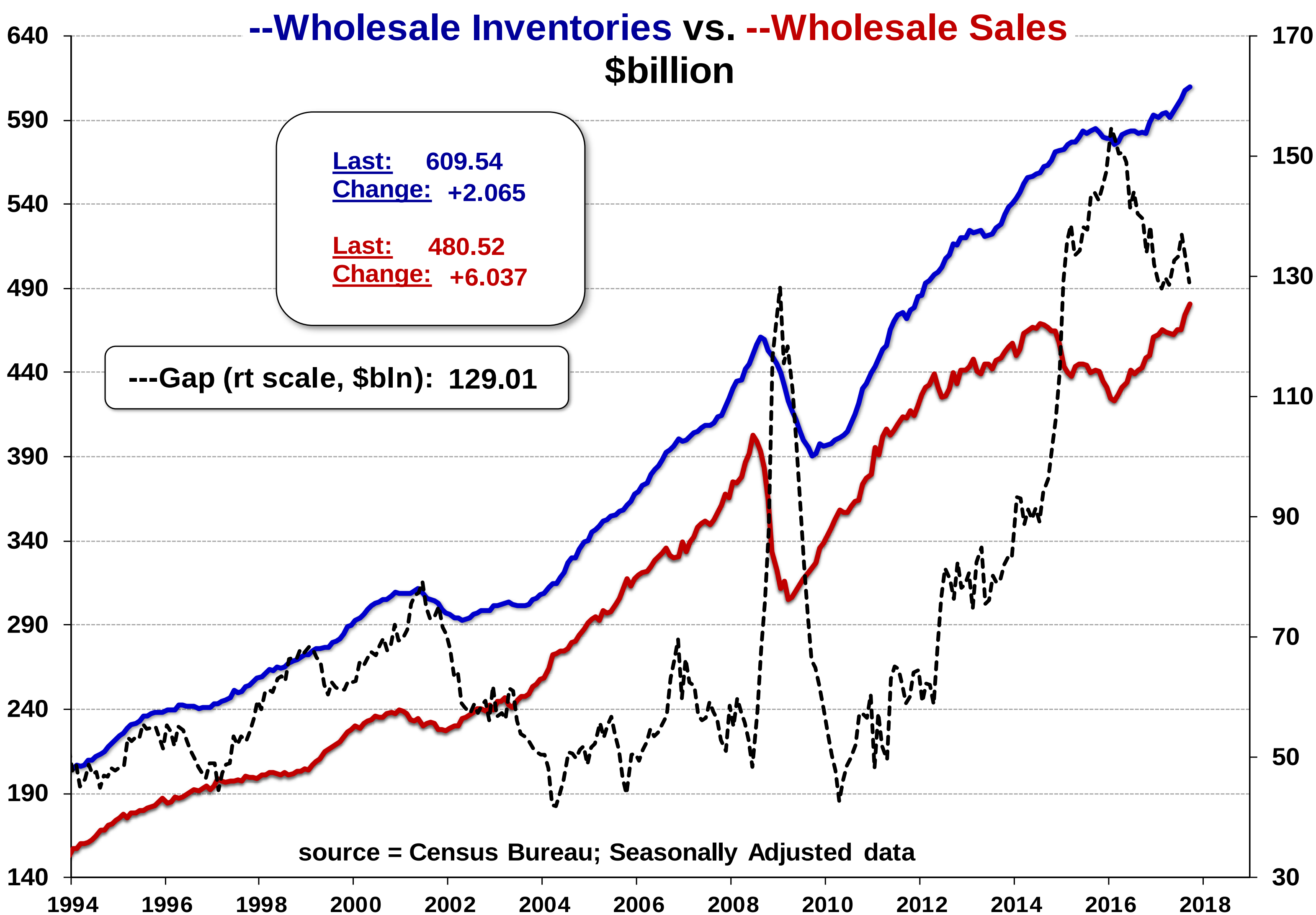
Retail Sales rise +0.2% m/m vs. expectations of 0.0%; Control Group Sales also come in as expected at 0.3%. Long-term y/y trend remains lower (current growth rate less than half pre-recession level).



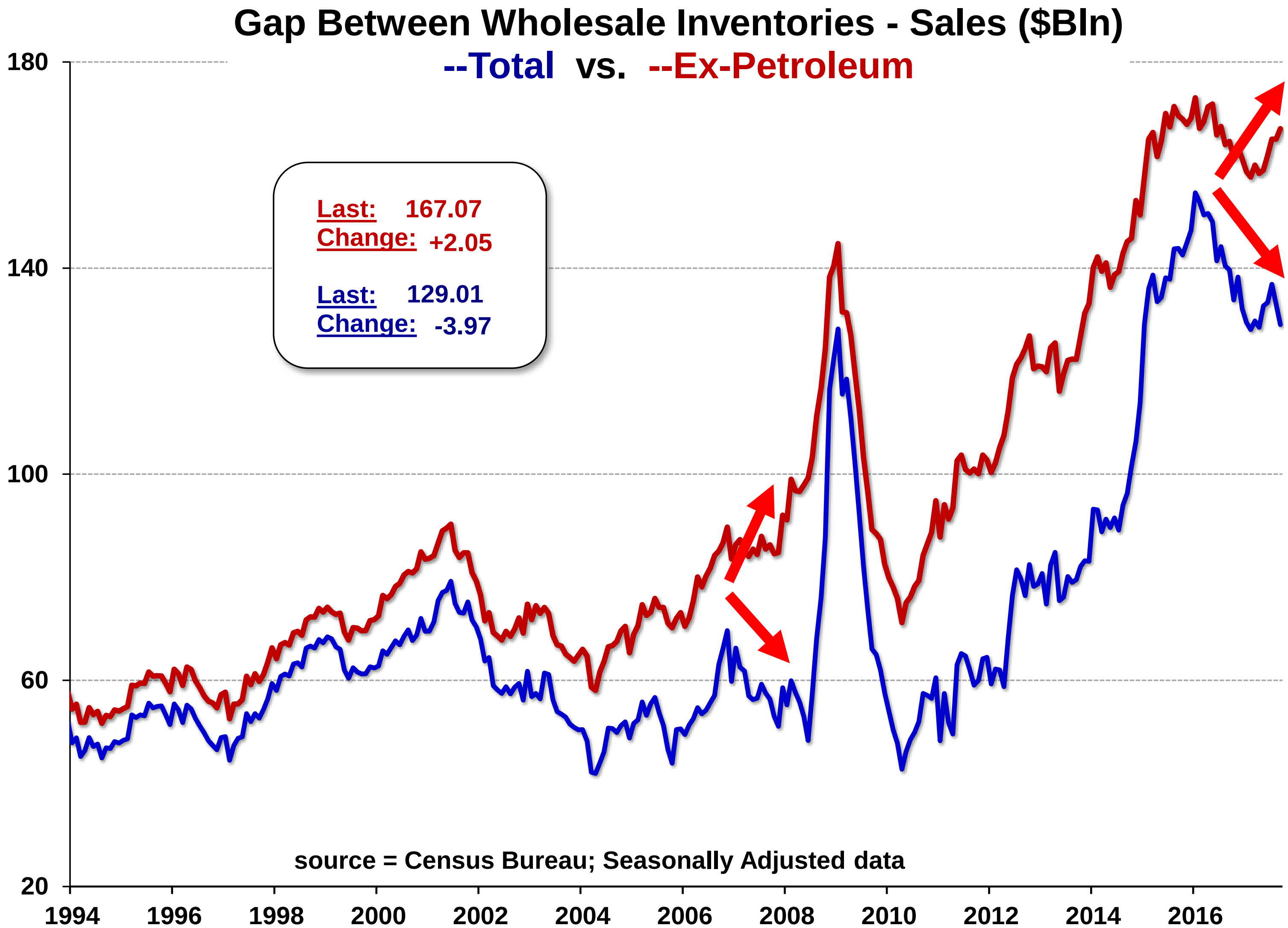
Internet sales growing at a respectable 6.8% y/y rate, yet down from 14.9% y/y seen in June 2016



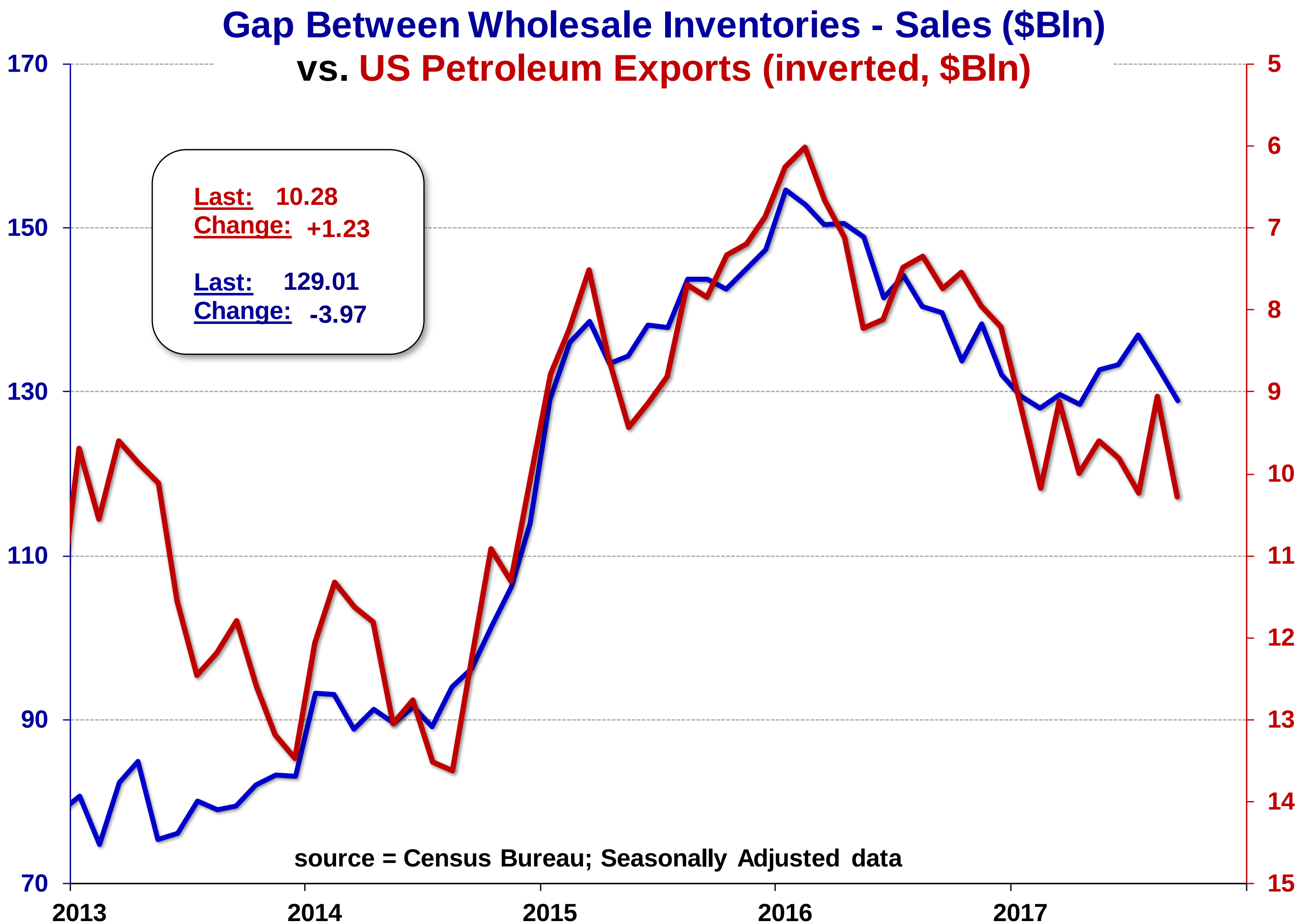
Gap between Wholesale Inventories & Sales drops -$4bln to $129bln (still elevated, above peak recession level, but a noticeable pullback from Jan. 2016 record high of $155bln) …pushing Inventory/Sales Ratio down to lowest since Dec. 2014. This looks promising as inventory growth slows and sales rise, however there's a catch…



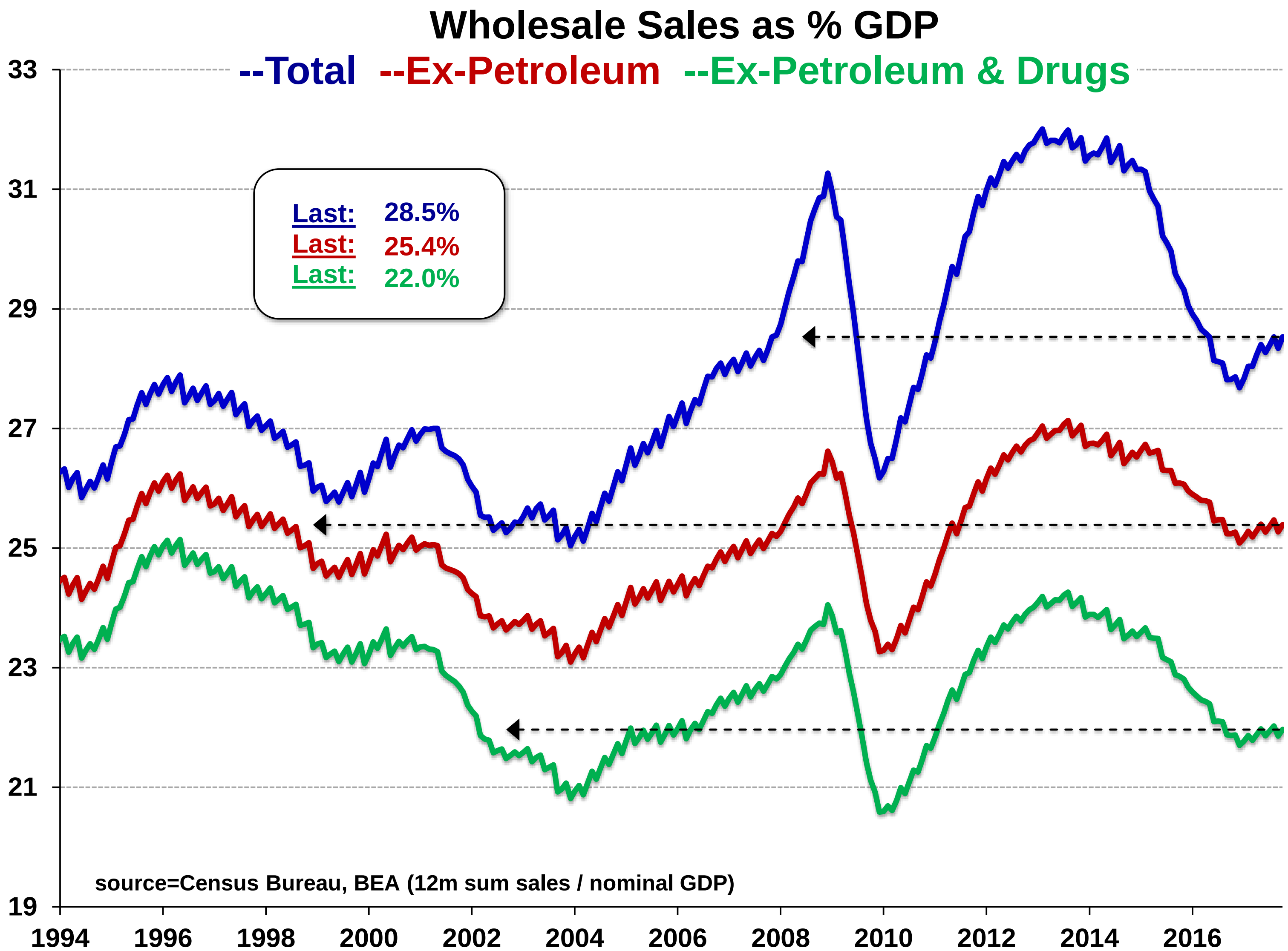
…excluding petroleum, gap between Inventories and Sales **rose +2bln to $167bln**. If economic activity is picking up as we are led to believe and the consumer is 'back in the game', then ***why is ex-petroleum inventories-sales gap just $6bln shy of a record high***? We should also point out a similar divergence emerged just prior to onset of last recession.



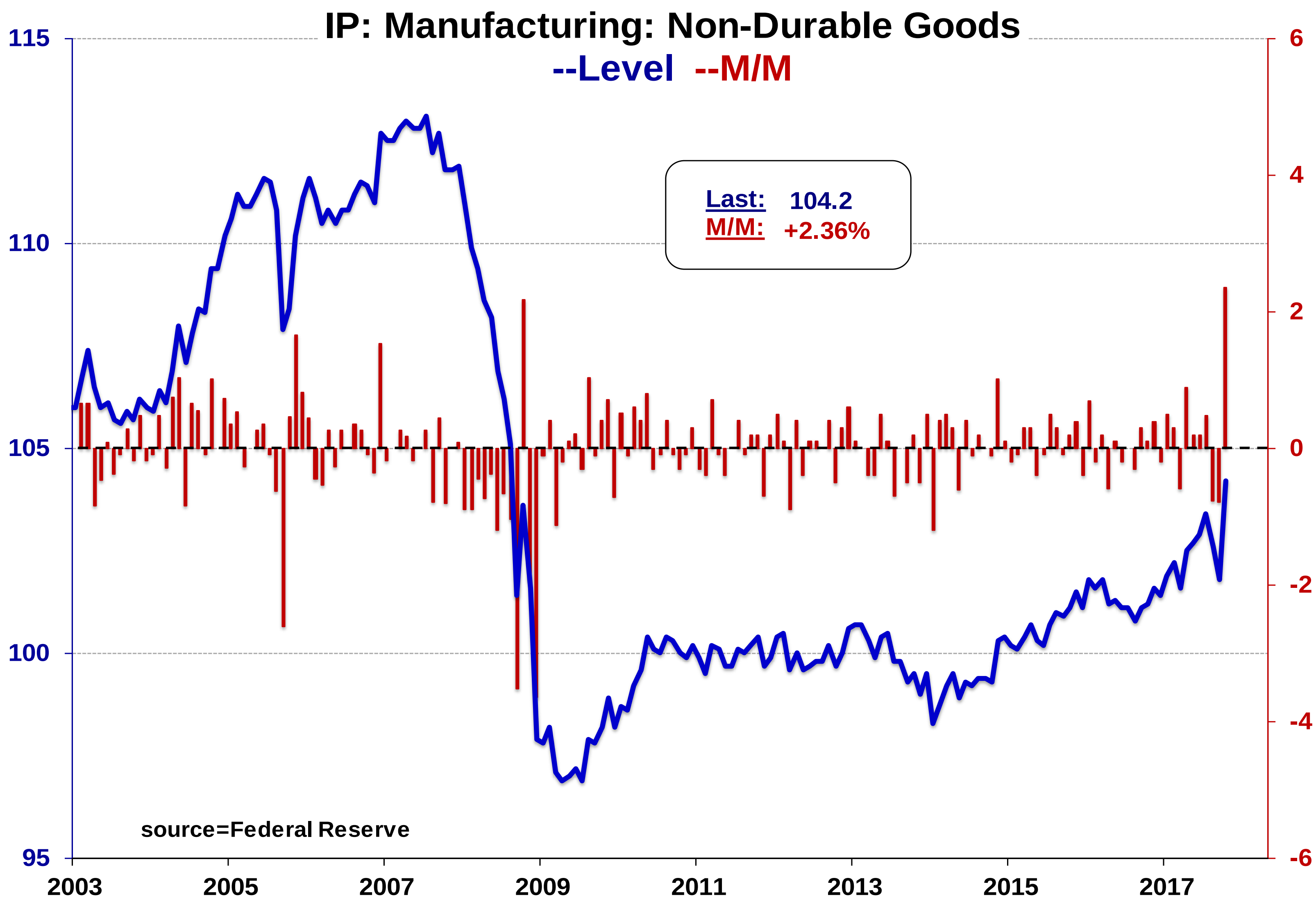
Further, we find Petroleum sales account for 48.5% of net rise in total Wholesale Sales since February 2016, with exports driving the decline in gap between overall Inventories & Sales. IE- not a reflection of domestic demand.



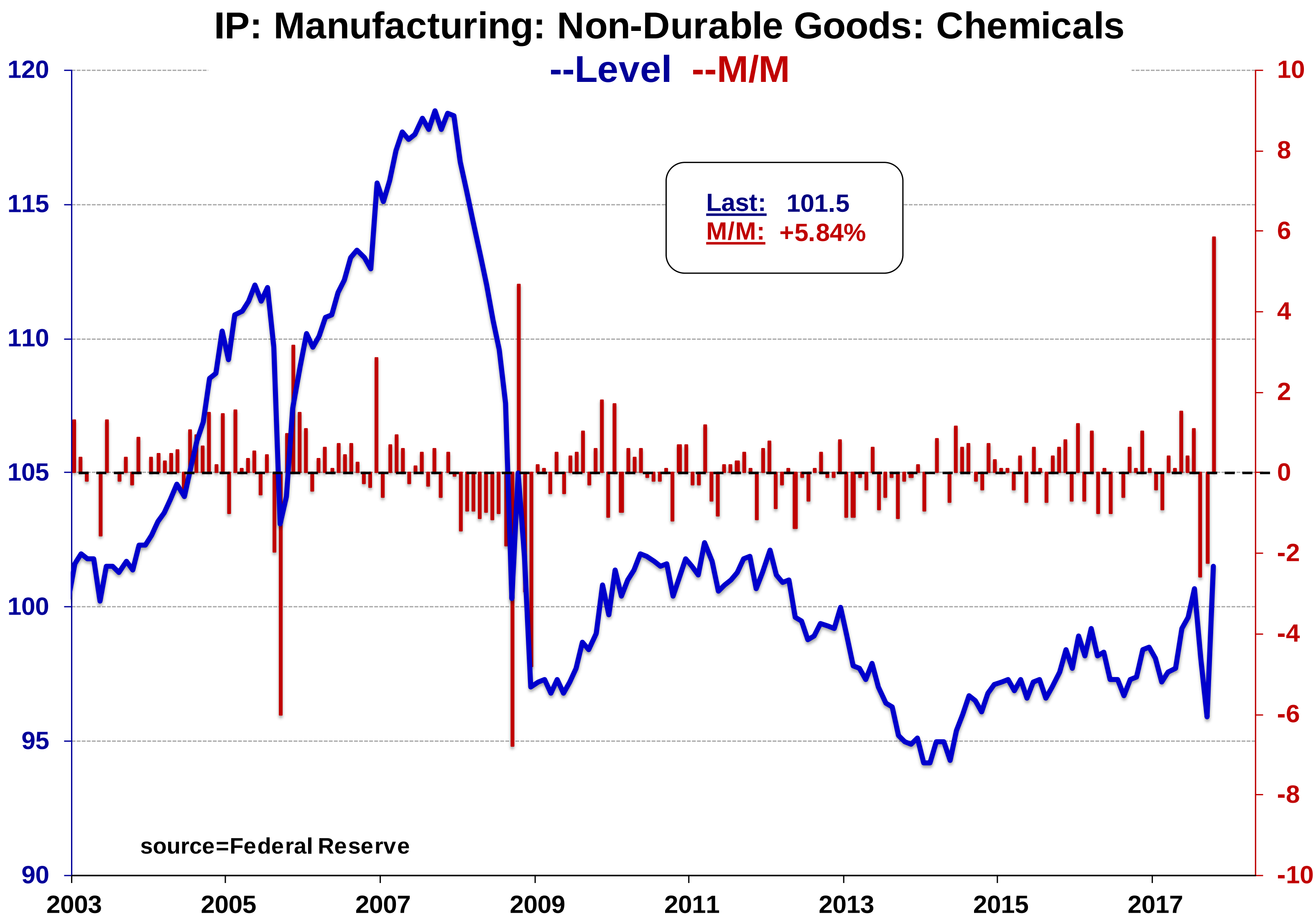
Meanwhile, Sales Ex-Petroleum & Drugs as % GDP are at lowest level since 2002 (drugs hit a record high 12.4% of overall wholesale sales in Nov. 2016; see: soaring costs).



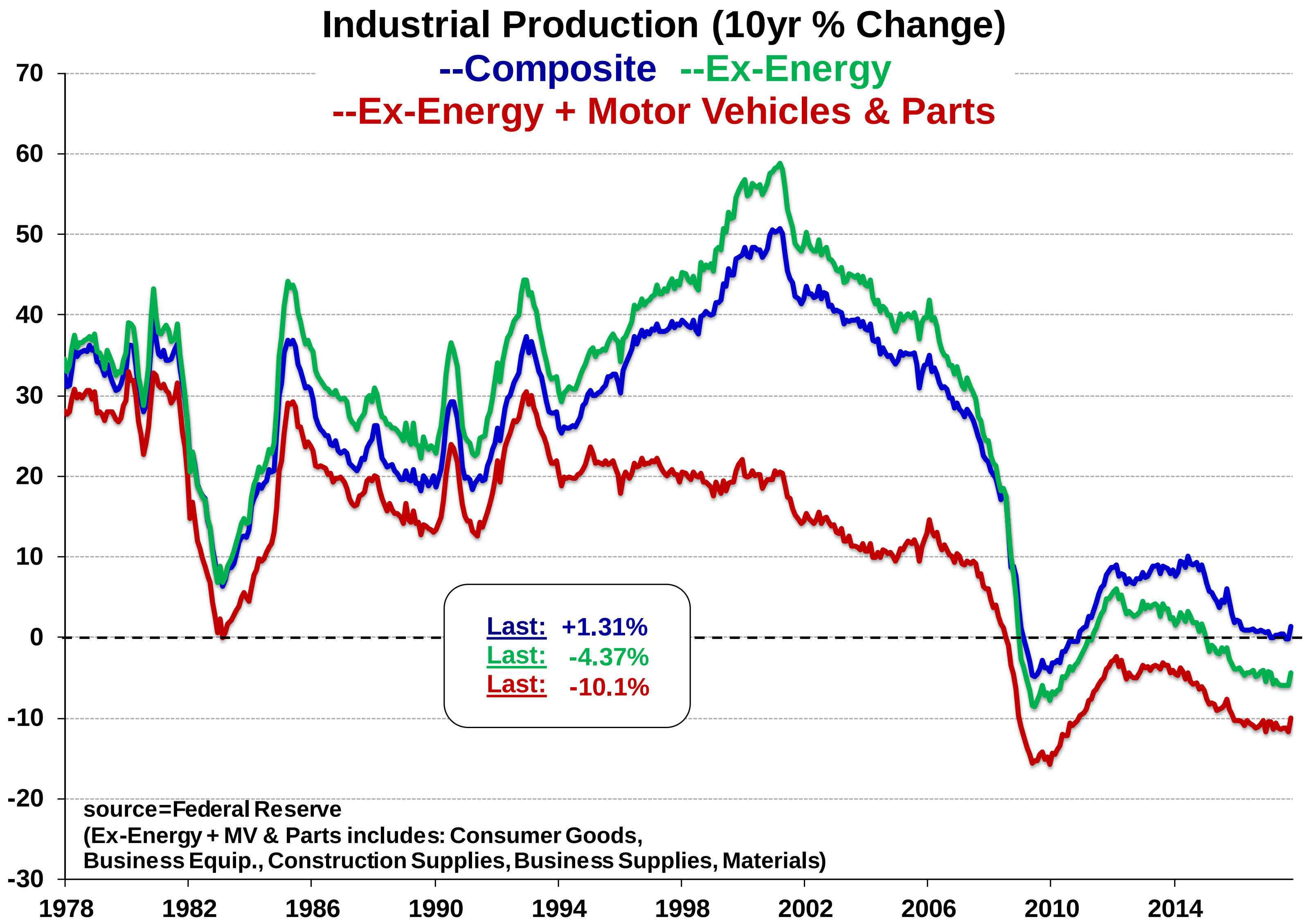
Industrial Production data came in nearly double expectations: +0.9% m/m vs. +0.5% expected; up +2.9% y/y, highest since Jan. 2015. The bulk of October's IP surge came from Non-Durable Goods which saw biggest monthly jump since June 1975 (+2.36% m/m).



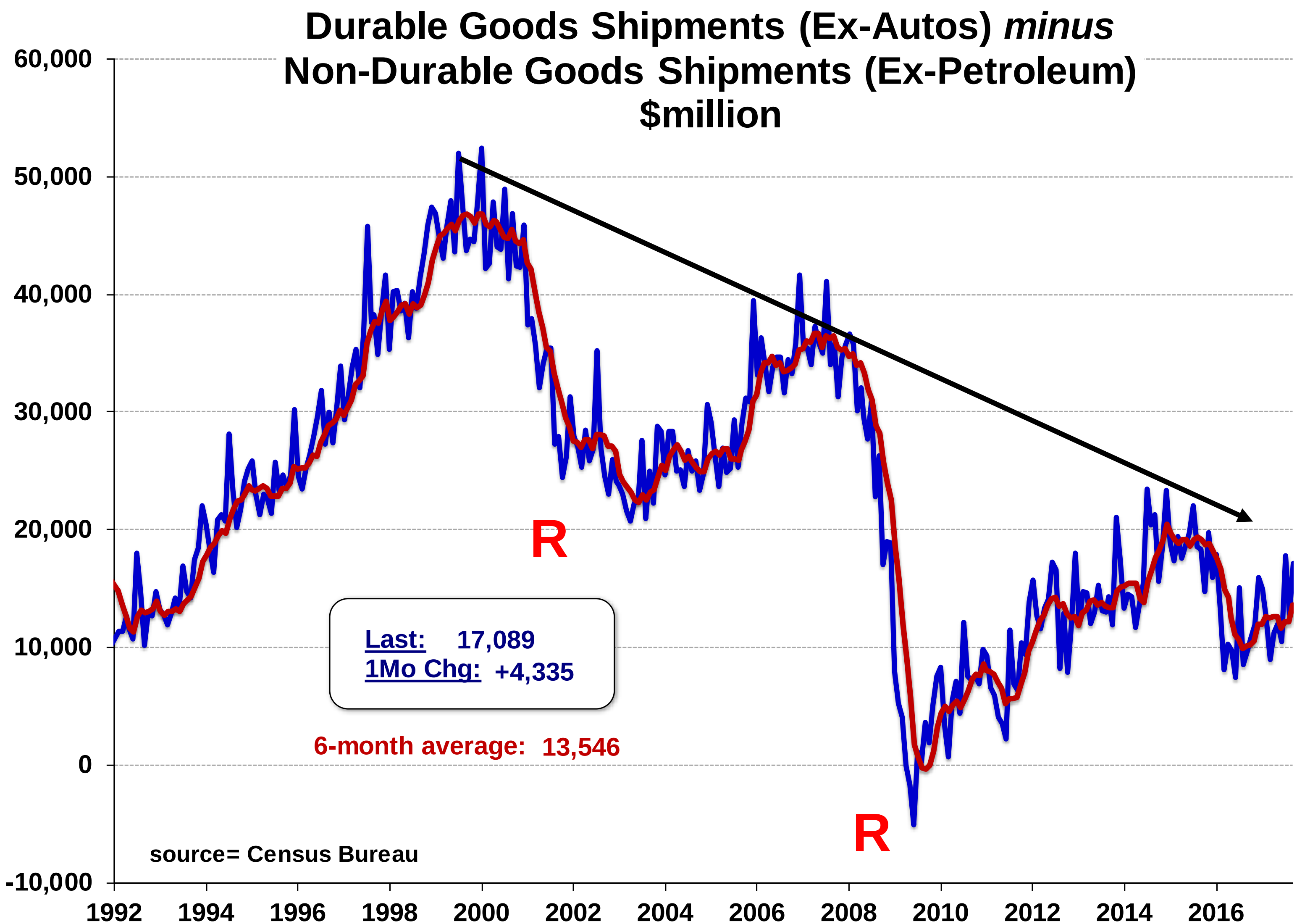
Digging into the Non-Durable data we find Chemicals is where all of the strength was. As refiners and chemical producers in Houston area came back online post-Harvey, production soared. The +5.8% m/m reading is biggest jump on record (data back to 1947).



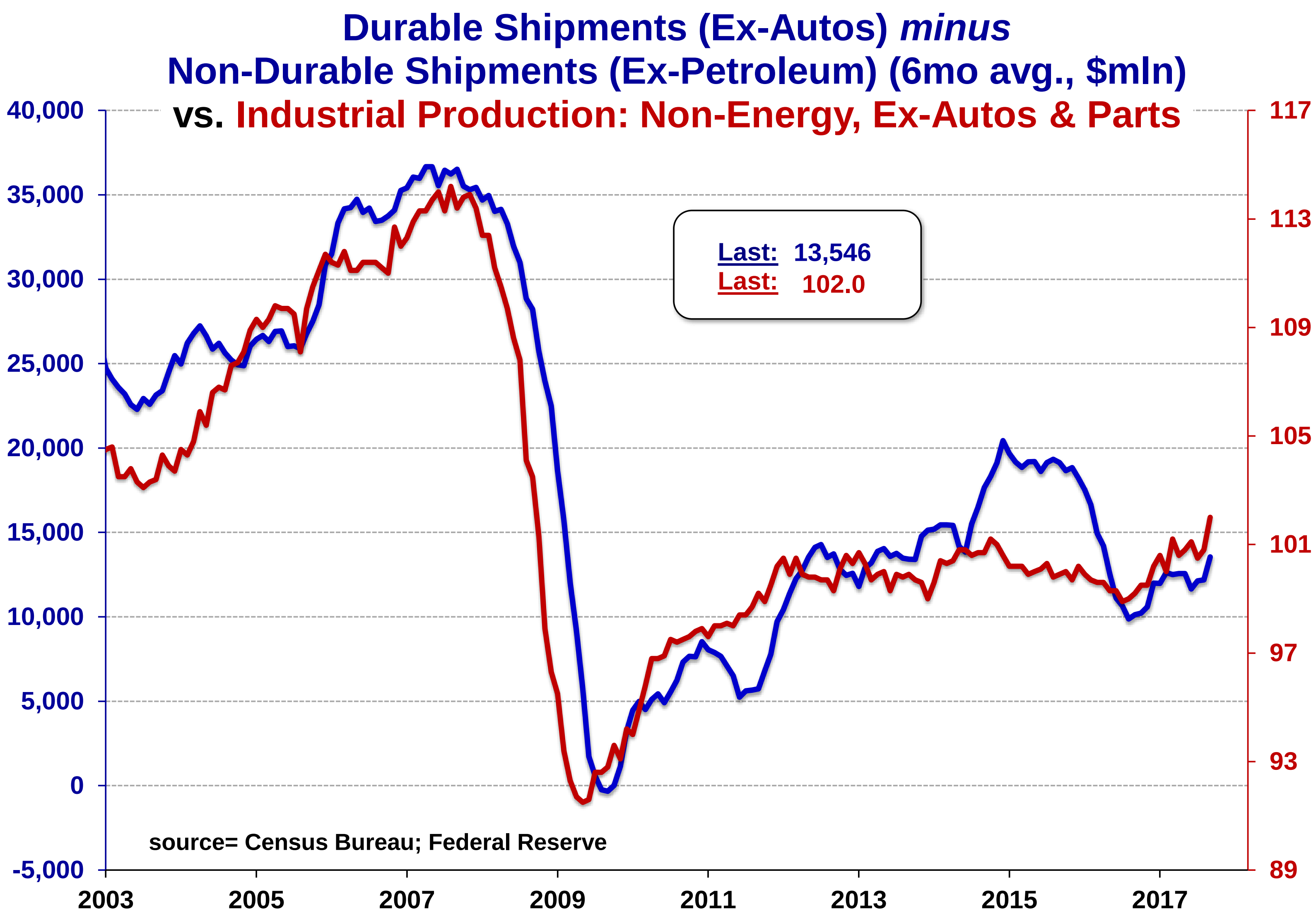
The big picture: Industrial production Ex-Energy, and Ex-Energy & Autos indices remain below pre-recession levels… down -4.4% and -10.1% respectively. We'll let this chart speak for itself.



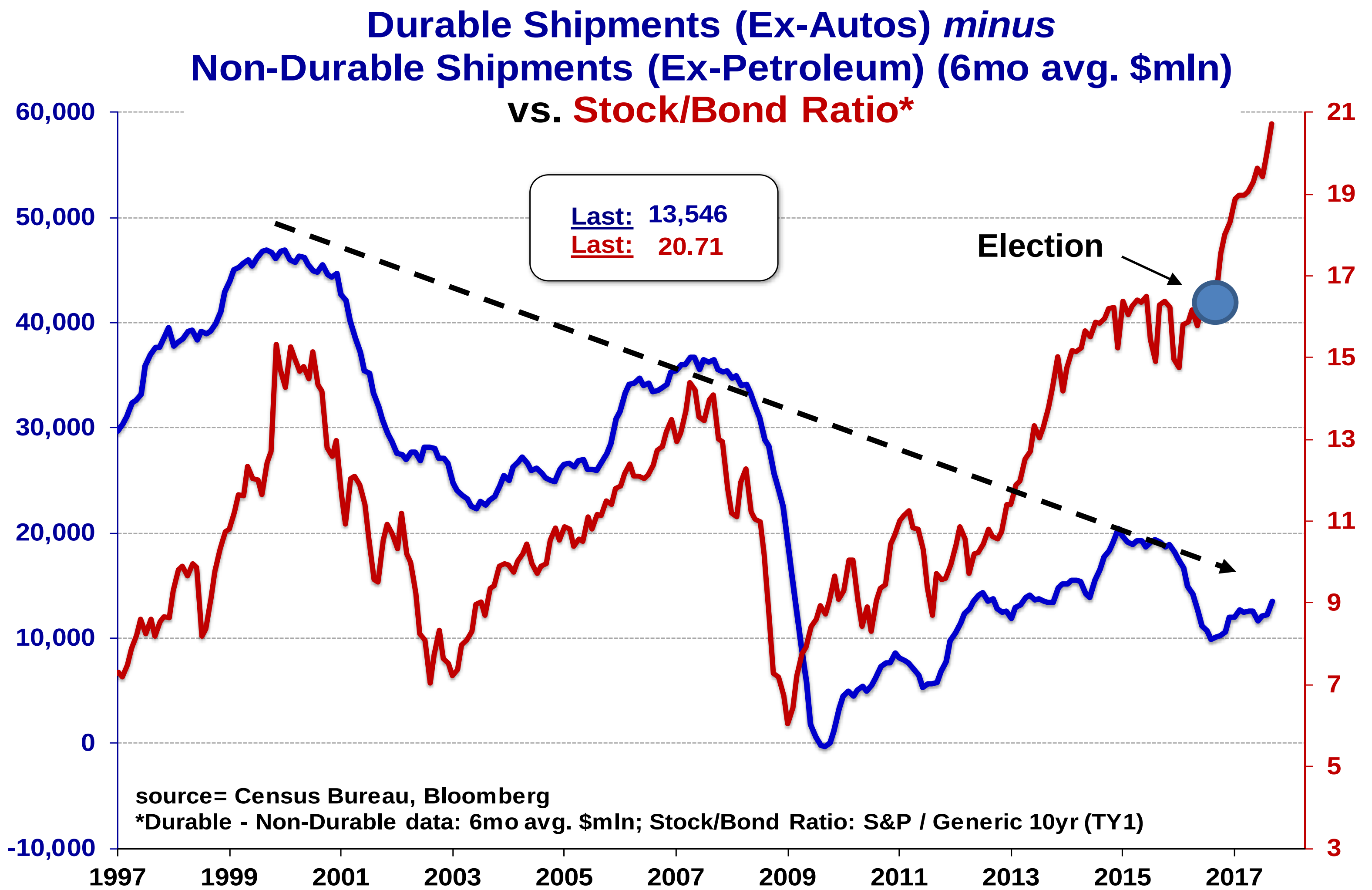
When looking at 'core' Durable Goods & Factory Order data, we find weakness persists. Strong economic activity would show Durable shipments far outpacing Non-Durable shipments. Clearly this is not the case at present, and long-term trend points lower.



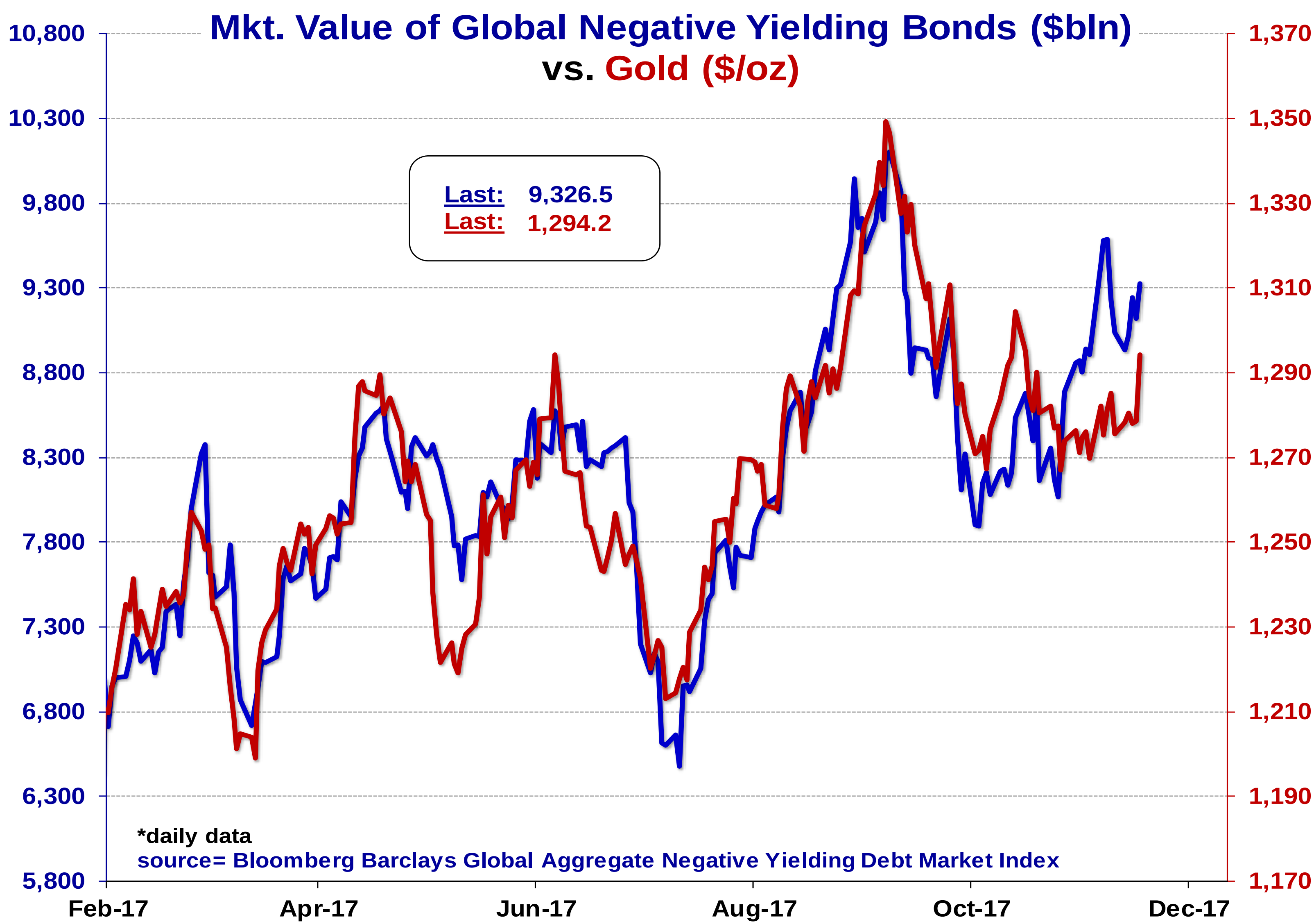
The chart of 10yr % change in Industrial Production certainly puts the Durable Goods data into perspective.



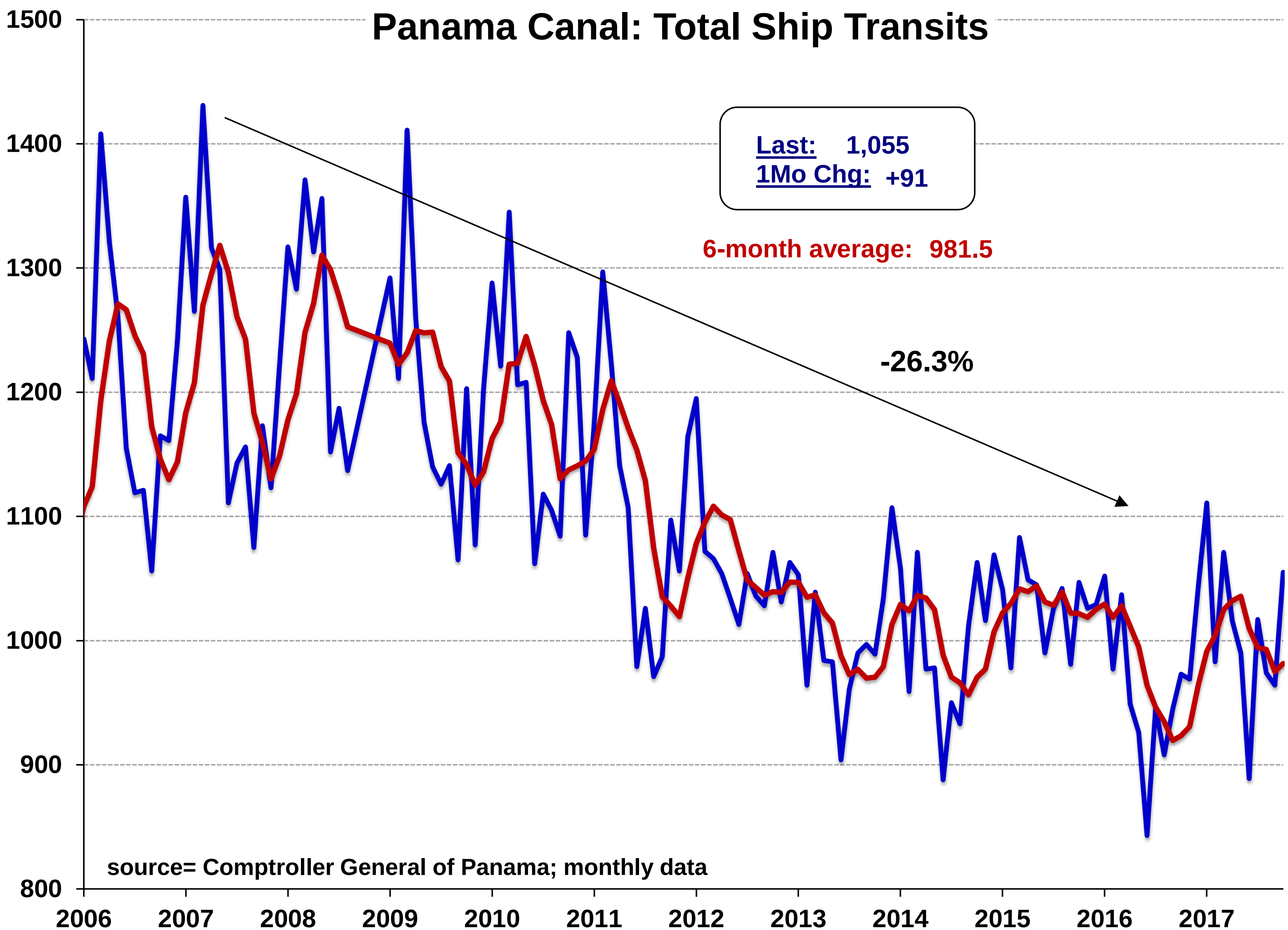
As such, If you thought stocks were well out over their skis prior to the election, they've moved into white hot territory since. The question now really isn't whether there's a bubble or how big it is, but how much further it can go before reality finally sets in. And with a Fed determined to raise rates, we suspect the reversion is coming sooner than later. Should the Fed reverse course, their credibility will go from near zero…to zero, and the dollar will tumble. Recent action suggests the dollar, yields, and gold are beginning to sniff out such a scenario.



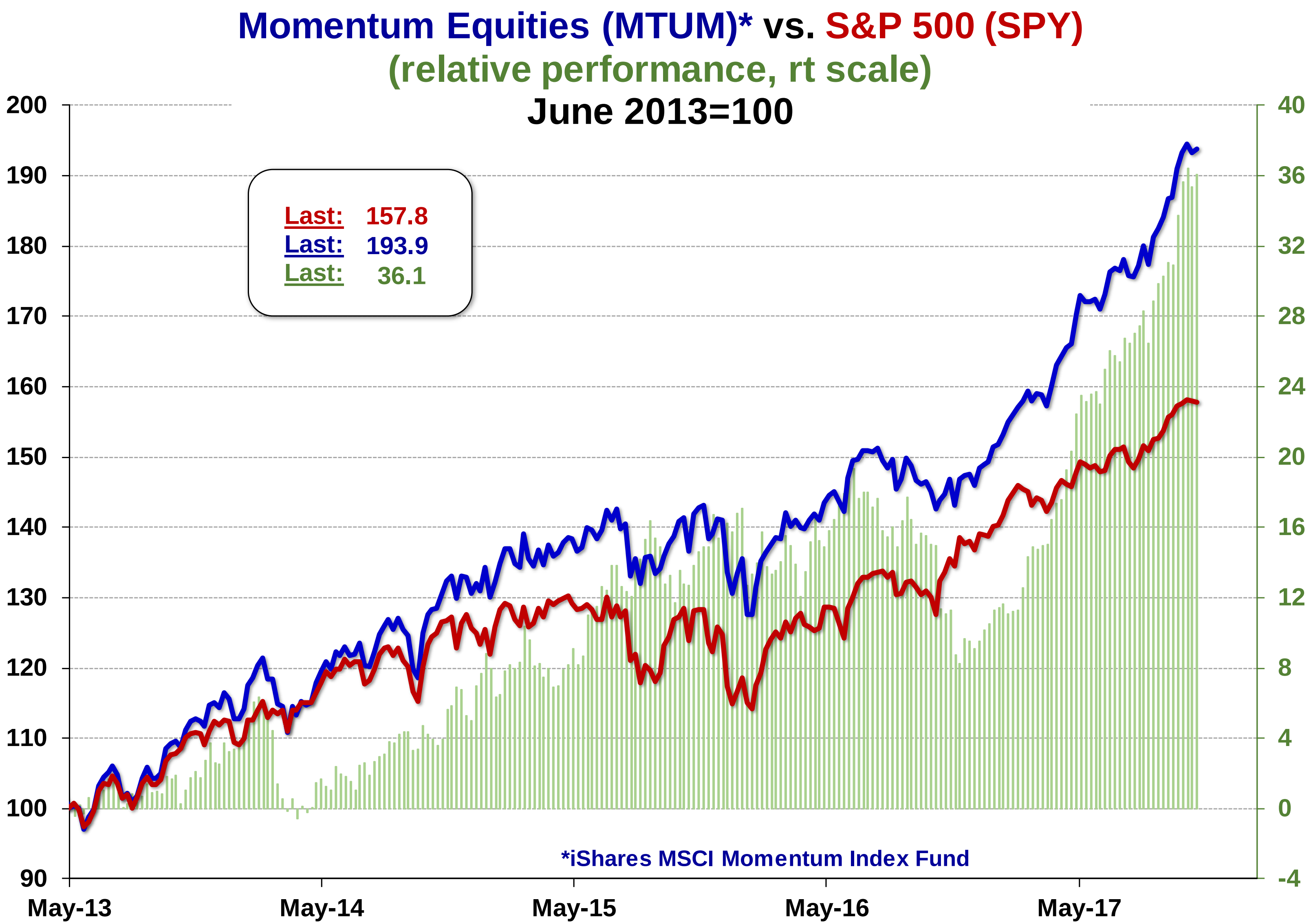
Value of Negative Yielding Bonds presses higher as global yields turn lower; Gold follows



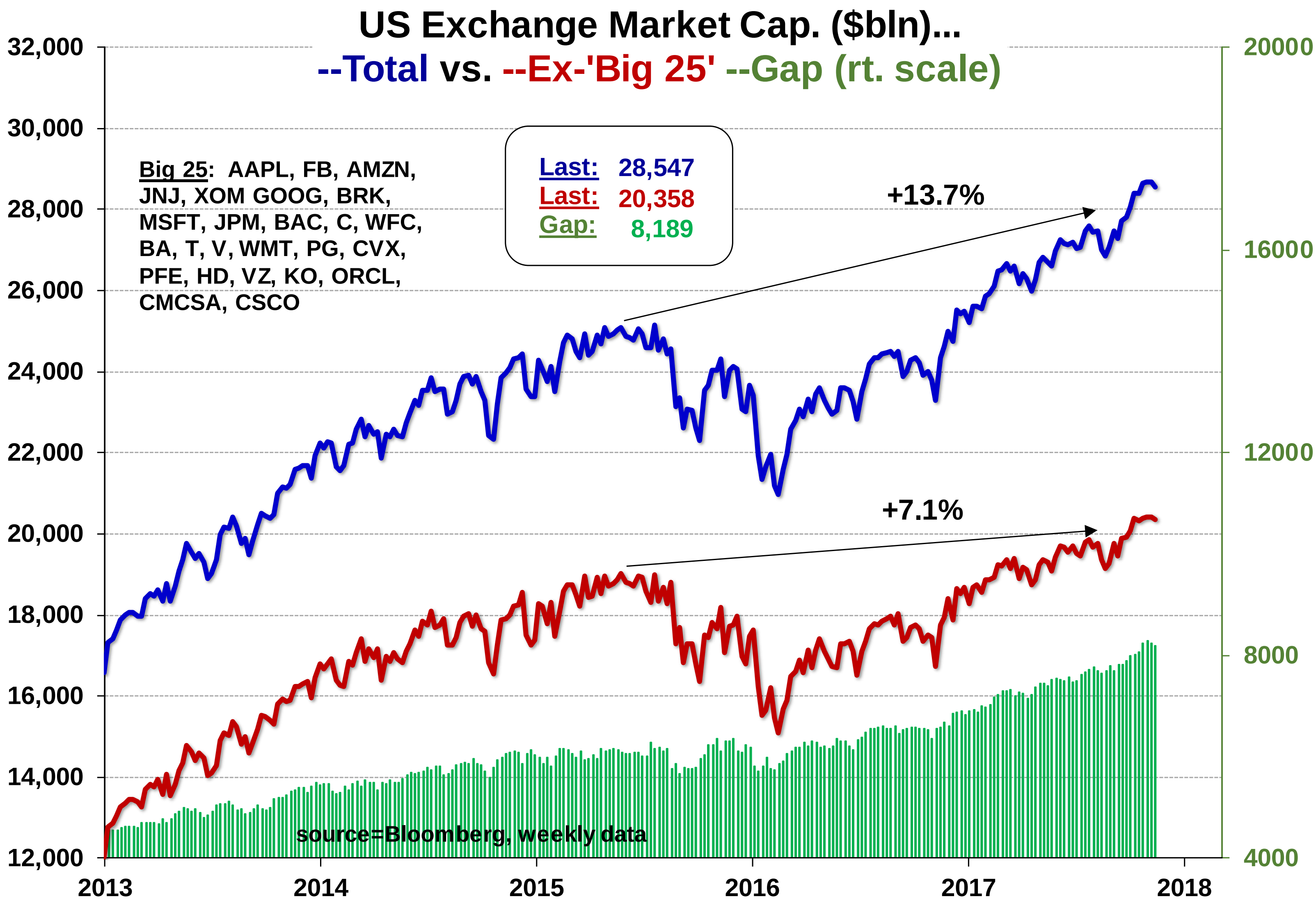
Global synchronized growth? Panama Canal ship transits down -26% from 2007 high.



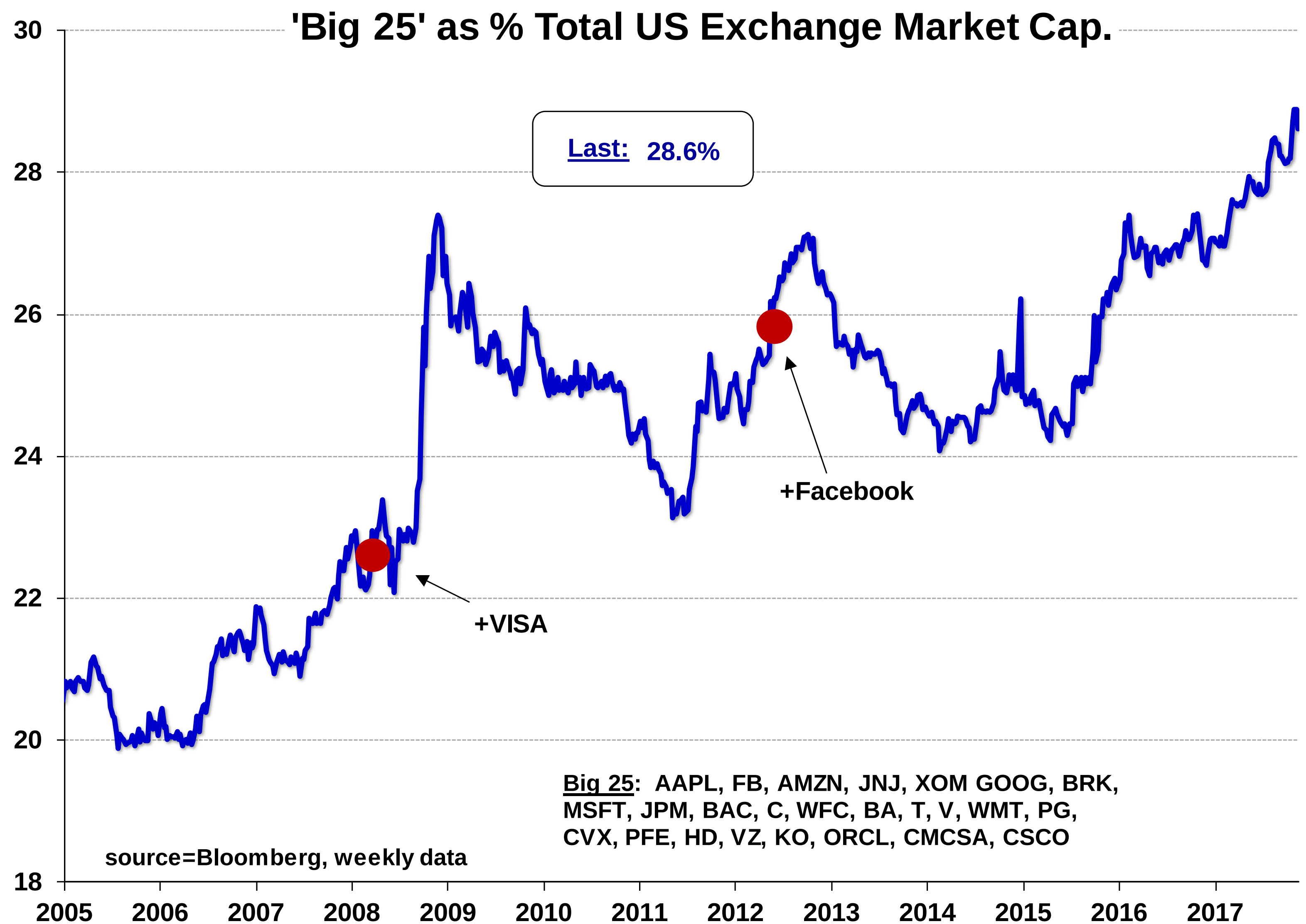
The ‘chasing momentum’ trade is alive and well: iShares MSCI Momentum ETF continues to outshine S&P.



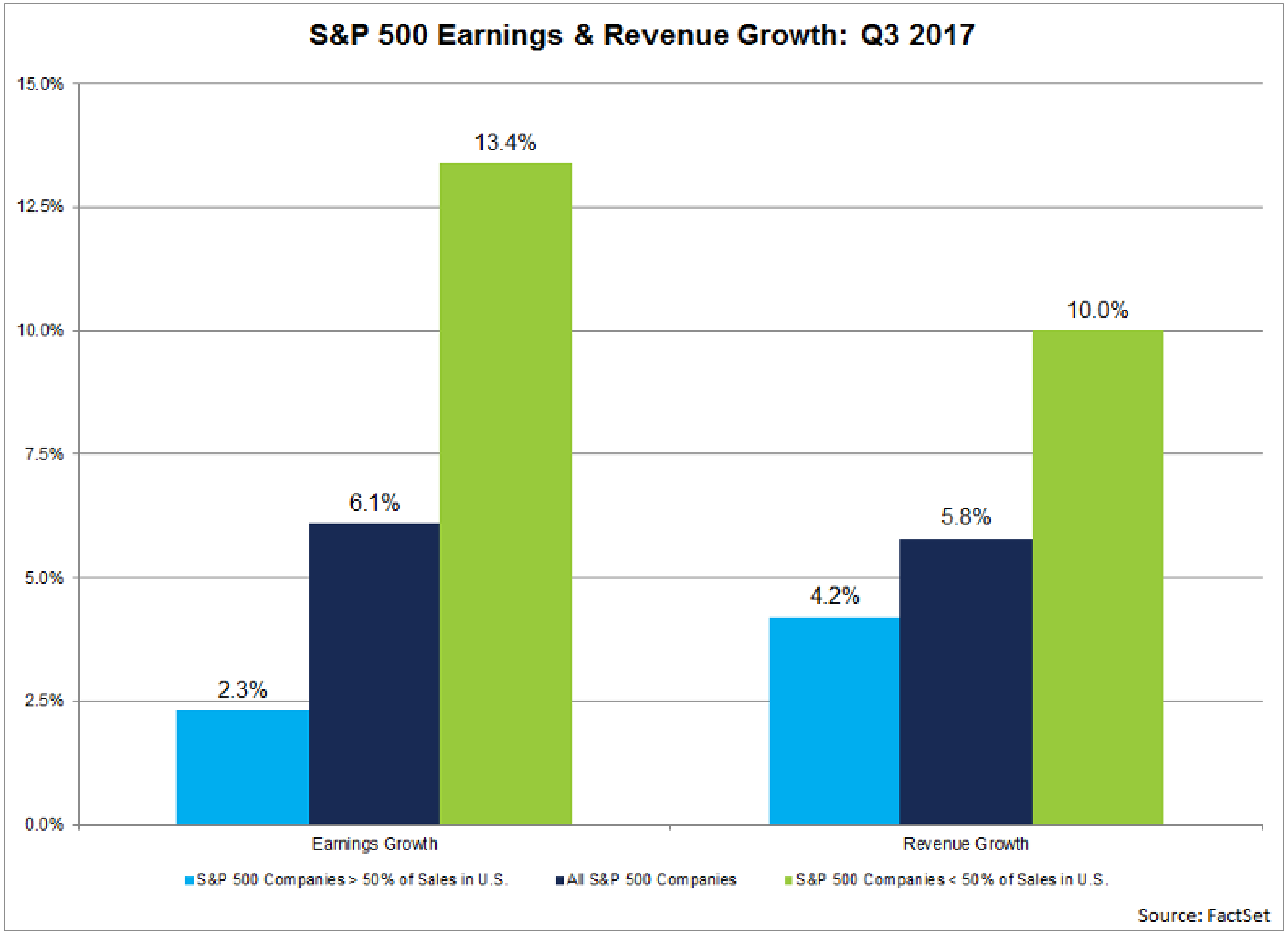
Excluding the top 25 stocks, remainder of the market has underperformed by nearly half since 2015 highs.



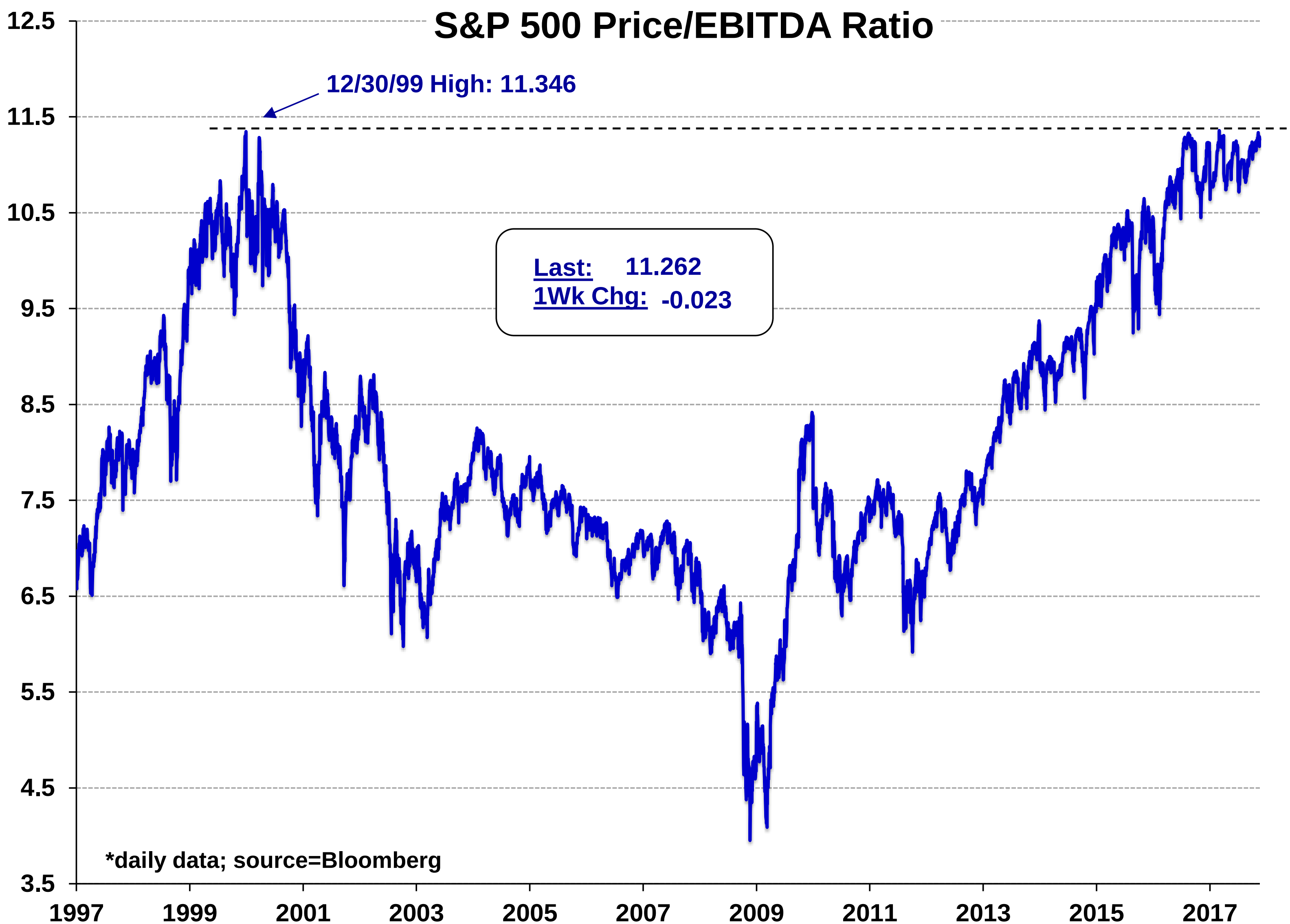
…and Top 25 stocks account for nearly 30% of total US Exchange Market Cap., a record high.
(IPOs: VISA added in 2008, Facebook added in 2012)



Top 25 stocks by market cap are almost entirely multinationals, and considering relatively weak US growth it comes as little surprise these companies are faring better than those with greater US exposure. From FactSet report on Q3 S&P Earnings & Revenue: *For companies that generate more than 50% of sales inside the U.S. (less global exposure), the earnings growth rate is* ***2.3%****. For companies that generate less than 50% of sales inside the U.S. (more global exposure), the earnings growth rate is* ***13.4%****.*



Meanwhile, S&P Price/EBITDA Ratio is just a hair shy of record high



Top 10 stocks account for 18% of total Market Capitalization