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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 rose to +77, the highest level since April 2017, suggesting the possibility of some recent acceleration.

Three Fed districts saw hurricane-related disruptions, but recovery efforts were progressing steadily.

BEIGE BOOK SUGGESTS CONTINUED MODERATE ECONOMIC GROWTH

The latest edition of the Federal Reserve’s (Fed) Beige Book, released Wednesday, October 18, 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—the next of which is set to take place from October 31 to November 1, 2017. We believe that the Beige Book is best interpreted by measuring how key words change over time. The qualitative inputs for the October 2017 Beige Book were collected in the weeks prior to October 6, 2017.

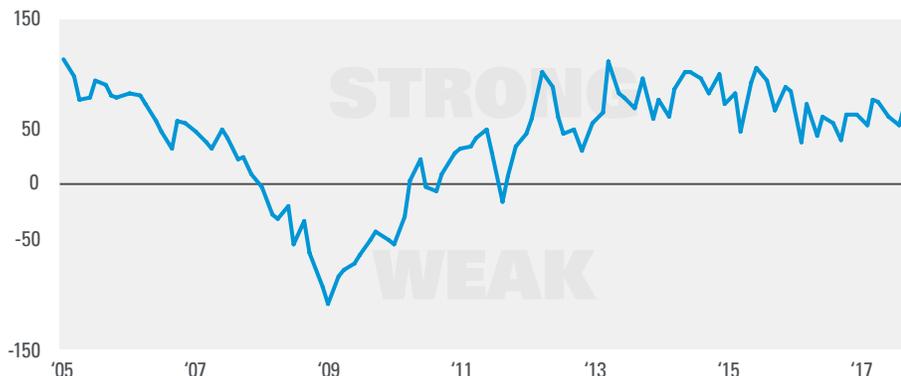
SENTIMENT SNAPSHOT

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 October 2017, the barometer increased to +77, tying the year-to-date high last seen in April 2017. This movement brings the barometer back to the middle of the

1 BEIGE BOOK BAROMETER CONTINUES TO SUGGEST MODERATE GROWTH

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



Source: LPL Research, Federal Reserve 10/18/17

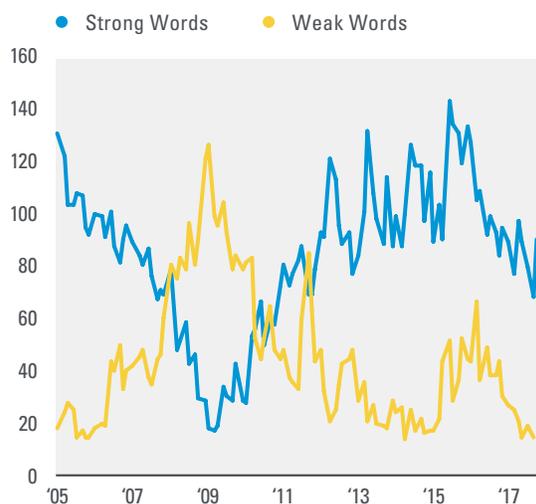
HOW THEY WORK

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 October 31—November 1, 2017.

The **Beige Book Barometer** is a diffusion index that measures the number of times the word “strong” or its variations appear in the Beige Book less the number of times the word “weak” or its variations appear. When the Beige Book Barometer is declining, it suggests that the economy is deteriorating; when the Beige Book Barometer is rising, it suggests that the economy is improving.

2 STRONG WORDS INCREASED AND WEAK WORDS DECREASED IN OCTOBER BEIGE BOOK



Source: LPL Research, Federal Reserve 10/18/17

range it has held since 2012 and above its prior year average of +65. Weak words moved lower to tie April 2014 for the lowest level of the current expansion [Figure 2], though the word “disrupt” and its variants were used 11 times in relation to the impact of Hurricanes Harvey and Irma. The number of strong words increased significantly, hitting its highest level since April 2017.

ECONOMIC IMPACT OF HURRICANES HARVEY AND IRMA

The U.S. felt the devastating impact of Hurricane Harvey in late August, and Hurricane Irma in early September, marking the first time two Category 4 or stronger magnitude hurricanes hit the country in the same year. The September Beige Book did include a special note on Hurricane Harvey and its broad impact, though the October version was the first to collect survey data after the storms. As expected, the October Beige Book did reflect the destructive impact of the hurricanes, especially in the Dallas, Atlanta, and Richmond districts. Though the hurricanes were disruptive, many responses seemed to indicate that recovery was already well underway in all but the hardest hit areas. It will take some time to determine the impact to agriculture, but the energy industry seemed to sustain minimal damage and producers and refiners were able to resume operations in a relatively short amount of time.

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 October 2017 Beige Book observes:

Labor markets were widely described as tight. Many districts noted that employers were having difficulty finding qualified workers, particularly in construction, transportation, skilled manufacturing,

and some healthcare and service positions. These shortages were also restraining business growth.

Regarding price pressures the Beige Book stated:

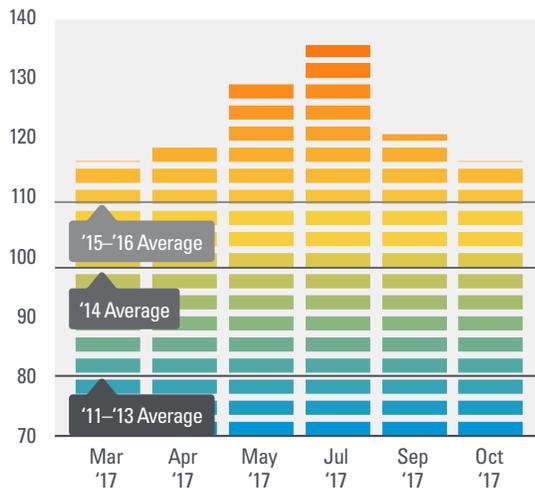
Several districts noted increased manufacturing input costs, but in most cases these weren't passed through to selling prices. Retail prices generally increased slightly. Transportation, energy,

and construction materials prices increased more rapidly, with some districts citing effects from hurricanes.

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 continued to decline in October’s Beige Book after peaking in July [Figure 3]. Between September and October 2017, the count of wage/inflation words fell from +121 to +116, following a multi-year high of +136 in July. Even with the decrease, the level remains above the 2015–2016 average, 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

- Number of Times Wage/Inflation Words Are Mentioned in Beige Books



Source: LPL Research, Federal Reserve 10/18/17

CONCLUSION

The level of the October 2017 Beige Book Barometer has been historically associated with continued economic expansion. The count of weak words came in at expansion lows, while positive words saw a significant increase. Hurricane disruptions were noted, though few long-term impacts are expected, and recovery efforts seemed to be moving along well. We may need positive sentiment to rise if we are to see acceleration beyond the barometer’s current level, but it may be a healthy sign that Main Street’s positive view of the economy remains 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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