WELLS FARGO
INVESTMENT INSTITUTE

Global Perspectives

WEEKLY GUIDANCE ON ECONOMIC AND GEOPOLITICAL EVENTS

December 4, 2018

# Resilient U.S. Economy Continues Its Solid Growth

**Craig Holke**
*Investment Strategy Analyst*

### Key takeaways

- *The U.S. economy continues to grow at a solid, above-trend rate. Greater business investment would alleviate pressure for the consumer to be the primary driver of economic growth.*
- *Ongoing economic growth and strong corporate profits should be supportive of further gains in business investment in the fourth quarter and into next year.*

### What it may mean for investors

- *Continued strong U.S. economic growth should help to fuel equity markets. We remain favorable on U.S. large- and mid-cap equities. With the Federal Reserve (Fed) likely continuing its trajectory of higher interest rates, we prefer short-term taxable fixed income today.*

The U.S. economy continues to grow at a solid pace. The second look at third-quarter gross domestic product (GDP) matched the advance look, showing that the U.S. economy grew at a 3.5% annualized quarterly rate. Consumer spending has been responsible for most of the growth during the recovery and current expansion. Expectations were for business investment[1] to accelerate as a result of tax reform, yet it has improved only moderately. However, the latest GDP report reflects slightly lower personal spending and higher business investment. This greater diversification makes for a more resilient economy that we expect to continue to grow in 2019.

## Diversifying growth is beneficial

Consumer spending was revised downward in the third-quarter GDP report, from 4.0% to 3.6%. This remains a very solid level of personal consumption. Offsetting this decline was an increase in business investment and inventories. Yet, trade continues to be a net drag on the U.S. economy. Increases in tariffs and the threat of further trade actions contributed to net exports subtracting the most from economic growth since 1985.

While trade is expected to remain a drag on growth into 2019, we expect consumer spending and business investment to post solid growth. The consumer remains supported by the strongest labor market in decades and additional take-home pay from tax cuts. The unemployment rate is at the lowest level since 1970, and payroll gains continue at solid levels. While personal income growth has slowed recently, it had

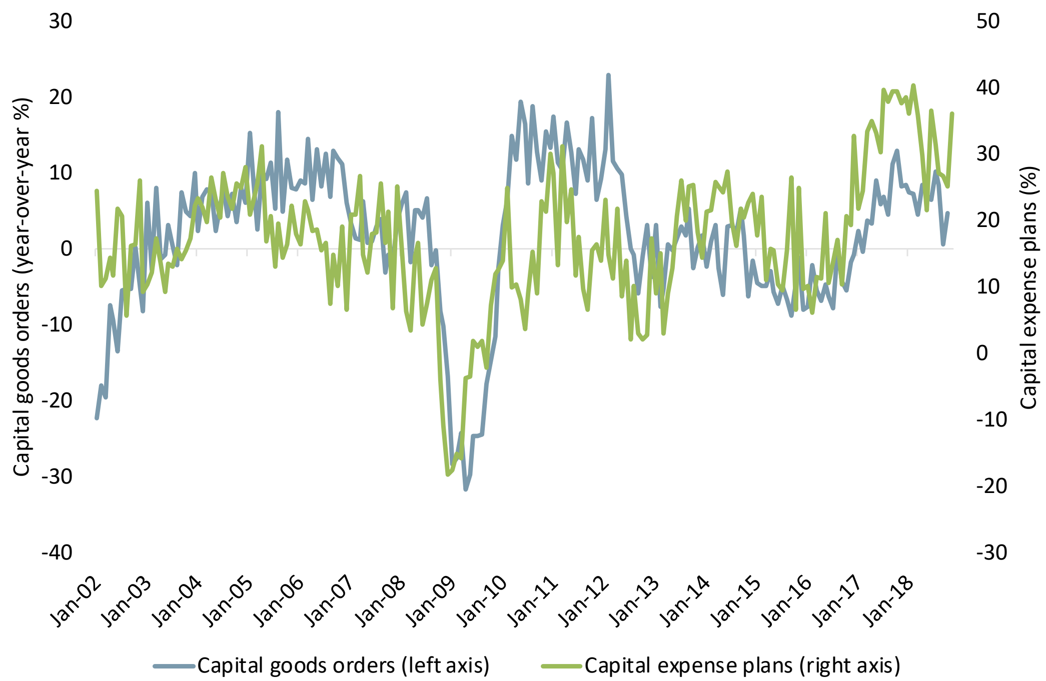


[1] Defined as real nonresidential, private fixed investment.

risen by 4.4% year-over-year (YoY) as of September. This gives consumers more disposable income with which to drive further economic growth.

The uptick in business investment reduces concerns over a significant U.S. economic slowdown. While the growth in business investment has been less than expected following the capital expensing incentives in tax reform, it has risen by 6.8% YoY. Spending on equipment and structures (e.g., plants, buildings, and oil rigs) was revised higher in the second reading for the third quarter. Fundamentals are supportive for this growth to continue in the fourth quarter and into 2019. Corporate profits grew by 10.3% YoY in the third quarter, the highest growth since 2012. This increased cash flow offers the opportunity for businesses to evaluate and invest in projects which increase productivity and competitiveness—rather than purely returning cash to shareholders. As a result, businesses have increased their plans for investment. Chart 1 depicts YoY growth in business investment compared with plans for investment over the next six months. Plans remain at elevated levels and have even ticked higher in the fourth quarter.

**Chart 1. Plans for U.S. business investment are rising**




Sources: U.S. Census Bureau, Federal Reserve Bank of Philadelphia, Wells Fargo Investment Institute; November 28, 2018. Capital goods orders are for new, nondefense, ex-aircraft orders. Capital expense plans are drawn from a survey conducted to determine increases in planning for new capital investment over the next six months. Data is from January 2002 through November 2018.

## Investment implications

Although expectations are for U.S. and global growth to slow, the U.S. economy remains solid, and we expect it to continue posting above-trend growth in the fourth quarter and into 2019. The U.S. likely will see less in the way of fiscal stimulus as the benefits of tax reform and increased government spending diminish on a YoY basis. We continue to believe that there is more room left for the U.S. economy and markets in this cycle. As such, we maintain our positive cyclical outlook for equities—favoring large-cap and

and mid-cap stocks. This growth environment should continue to benefit the Consumer Discretionary and Industrials sectors. We also have a favorable view on Health Care and Information Technology, while we hold a most favorable view on Financials. Above-trend growth and moderate inflation, which we believe will continue, should allow the Fed to continue raising interest rates. Thus, our outlook remains favorable on U.S. short-term taxable fixed income—as we believe that yields will rise over time as the Fed continues to increase rates into 2019.

Risks do remain to this favorable outlook on the U.S. economy. Primary concerns include whether the Fed will raise rates too high and/or too quickly; whether trade risks will diminish with positive negotiations—or increase and further undermine growth; or whether there will be an unexpected deceleration in global growth. While none of these are in our base-case scenario, we remain diligent in our efforts to identify events that may negatively impact our view for above-trend U.S. growth into next year.

## Economic Calendar

| Date | Country | Report | Estimate | Previous |
|---|---|---|---|---|
| 12/4/2018 | EC | PPI YoY | -- | 4.50% |
| 12/5/2018 | IN | RBI Repurchase Rate | -- | 6.50% |
| 12/5/2018 | EC | Retail Sales YoY | -- | 0.80% |
| 12/5/2018 | US | MBA Mortgage Applications | -- | -- |
| 12/5/2018 | US | ADP Employment Change | -- | 227k |
| 12/5/2018 | US | ISM Non-Manufacturing Index | -- | 60.3 |
| 12/5/2018 | US | Nonfarm Productivity | -- | 2.20% |
| 12/5/2018 | US | U.S. Federal Reserve Releases Beige Book | | |
| 12/5/2018 | AU | Retail Sales MoM | -- | 0.20% |
| 12/6/2018 | GE | Factory Orders MoM | -- | 0.30% |
| 12/6/2018 | US | Initial Jobless Claims | -- | -- |
| 12/6/2018 | US | Durable Goods Orders | -- | -- |
| 12/6/2018 | US | Factory Orders | -- | 0.70% |
| 12/6/2018 | US | Trade Balance | -- | -$54.0b |
| 12/6/2018 | US | Continuing Claims | -- | -- |
| 12/6/2018 | US | Cap Goods Orders Nondef Ex Air | -- | -- |
| 12/7/2018 | EC | GDP SA QoQ | -- | 0.20% |
| 12/7/2018 | MX | CPI MoM | -- | 0.52% |
| 12/7/2018 | US | Change in Nonfarm Payrolls | 220k | 250k |
| 12/7/2018 | US | U. of Mich. Sentiment | -- | -- |
| 12/7/2018 | US | Unemployment Rate | 3.70% | 3.70% |
| 12/7/2018 | US | Wholesale Inventories MoM | -- | -- |
| 12/7/2018 | US | Change in Manufact. Payrolls | -- | 32k |
| 12/7/2018 | US | Consumer Credit | -- | $10.923b |
| 12/7/2018 | US | Average Hourly Earnings YoY | -- | 3.10% |
| 12/9/2018 | JN | GDP SA QoQ | -- | -0.30% |
| 12/10/2018 | IT | Industrial Production MoM | -- | -0.20% |
| 12/10/2018 | JN | Money Stock M2 YoY | -- | 2.70% |
| 12/10/2018 | US | JOLTS Job Openings | -- | 7009 |
| 12/11/2018 | GE | ZEW Survey Expectations | -- | -24.1 |
| 12/11/2018 | JN | Core Machine Orders MoM | -- | -18.30% |
| 12/11/2018 | US | PPI Final Demand YoY | -- | 2.90% |
| 12/11/2018 | US | PPI Ex Food and Energy YoY | -- | 2.60% |
| 12/11/2018 | US | NFIB Small Business Optimism | -- | 107.4 |
| 12/11/2018 | US | PPI Ex Food, Energy, Trade YoY | -- | 2.80% |

Source: Bloomberg as of November 30, 2018.

## Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. Investing in **Financial** services companies will subject a investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks smaller, less-seasoned companies, tend to be more volatile than the overall market.

## General Disclosures

Global Investment Strategy (GIS) is a division of Wells Fargo Investment Institute, Inc. (WFII). WFII is a registered investment adviser and wholly owned subsidiary of Wells Fargo Bank, N.A., a bank affiliate of Wells Fargo & Company.

The information in this report was prepared by Global Investment Strategy. Opinions represent GIS' opinion as of the date of this report and are for general information purposes only and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally. GIS does not undertake to advise you of any change in its opinions or the information contained in this report. Wells Fargo & Company affiliates may issue reports or have opinions that are inconsistent with, and reach different conclusions from, this report.

The information contained herein constitutes general information and is not directed to, designed for, or individually tailored to, any particular investor or potential investor. This report is not intended to be a client-specific suitability analysis or recommendation, an offer to participate in any investment, or a recommendation to buy, hold or sell securities. Do not use this report as the sole basis for investment decisions. Do not select an asset class or investment product based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon.

Wells Fargo Advisors is registered with the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority, but is not licensed or registered with any financial services regulatory authority outside of the U.S. Non-U.S. residents who maintain U.S.-based financial services account(s) with Wells Fargo Advisors may not be afforded certain protections conferred by legislation and regulations in their country of residence in respect of any investments, investment transactions or communications made with Wells Fargo Advisors.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company. CAR 1218-00065