

How Deep Are the Potholes?

Key economic indicators and capital market events for March 2014 by Joe Terranova, Chief Market Strategist



In a recent CNBC interview, Jan Hatzius, Goldman Sachs' chief economist, described January's disappointing U.S. labor report as a "pothole"—an excellent term for a variety of recent U.S. economic data that may have severe winter weather to blame. I would argue that even though U.S. stock indexes have managed to rise to new highs and many European stock indexes remain strong, further market appreciation has been impeded by economic potholes caused by weather distortion. For March, the calendar focus is on U.S. economic data as we seek clarity on how deep the potholes are and how extensive the damage to future growth may be.

March 2014

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
						1
2	3 Reaction to China PMI (February) 10:00 AM: U.S. ISM Mfg.	4	5 8:15 AM: U.S. ADP Employment Report 10:00 AM: U.S. ISM Non-Mfg. 2:00 PM: Fed Beige Book	6 ECB & BOE Meetings	7 8:30 AM: U.S. Labor Report	8
9	10	11 7:30 AM: U.S. NFIB Small Business Optimism Index	12	13 8:30 AM: U.S. Retail Sales	14	15
16	17 8:30 AM: U.S. Empire State Mfg.	18 8:30 AM: U.S. Housing Starts	19 2:00 PM: FOMC Meeting 2:30 PM: Fed Chair Press Conference	20 10:00 AM: U.S. Philly Fed	21	22
23	24	25 9:00 AM: U.S. S&P Case-Shiller HPI 10:00 AM: U.S. New Home Sales 11:00 AM: Richmond Fed Mfg. Index	26	27 10:00 AM: U.S. Pending Home Sales	28	29
30	31 9:45 AM: U.S. Chicago PMI China PMI (March)					

Times shown are Eastern Time.

March indicators / events of note:

China PMI

China PMI (purchasing managers' index) provides a monthly gauge of China's manufacturing sector which, when combined with the monthly U.S. ISM Manufacturing Index value, gives a clear picture of global manufacturing health. A PMI value above 50 indicates growth, below 50 contraction.

ISM Manufacturing Index

The ISM Manufacturing Index, which is issued by the Institute of Supply Management, provides an influential monthly measure of the health of U.S. manufacturing based on an in-depth survey of 300 manufacturing firms. An index value of 50 is the dividing line between an expanding or slowing economy. Data released is for the previous month.

ADP Employment Report

The ADP employment report is based on U.S. private payroll data (excluding government). It is released monthly, two days ahead of the U.S. Labor Department's Employment Situation report, and is used for the advance read it gives on the labor market.

ISM Non-Manufacturing Index

The ISM Non-Manufacturing Index is based on surveys of nearly 400 firms from 60 sectors across the U.S., including agriculture, mining, construction, transportation, communications, wholesale trade, and retail trade. The index provides the economic backdrop for the various markets, and consists of data on business activity, new orders, employment, and supplier deliveries.

Fed Beige Book

The Beige Book provides FOMC commentary on the current economic conditions in each of the Federal Reserve's 12 districts and is released two weeks prior to the next FOMC meeting.

You should be watching:

The month of March begins with a reaction to the weekend China PMI reading for February. Last month, China PMI slipped from 51.0 to 50.5, the lowest reading in the last six months. We would need to see a major contraction in the China PMI (sub-49 print) for the market to react in any meaningful way.

ISM manufacturing will be one of the most relevant reports in March. Last month, ISM manufacturing contracted significantly to 51.3, from 56.5 the previous month, and was the weakest reading since last May's 50.0. Within the Q1 2014 playbook, I stated my belief that there was a goods-over-services transformation occurring, and I continue to stand by that. Last month's report was weak in every measure – new orders, production, and employment; and several participants cited poor weather as the reason for the weakness. I believe the contraction was largely weather distorted, and I expect to see a recovery in that figure.

The Bureau of Labor Statistics' revisions to the national ADP employment figures should be very interesting this month. To date, the monthly ADP report has suggested slightly better employment conditions than the actual nonfarm payroll report has shown. A normal ADP report in advance of the U.S. labor report isn't all that important, but this month's report may hint at seasonal weather factors affecting the jobs market. This report is not the ultimate arbiter of what will occur in the U.S. labor report released on the following Friday but we should monitor it closely.

Ironically enough, last month's ISM non-manufacturing index, which measures the services side of the economy, rose from 53.0 to 54.0. That was a very bizarre result, and I would expect a similar reading this month. I've included this indicator on the calendar as evidence that the impact of weather on the economy is transitory. Otherwise why would the ISM manufacturing contract so significantly while the services sector did not?

This month's Beige Book will serve as the template for the March 19 FOMC meeting. Investors should pay attention to it because it will give very precise and up-to-date assessments of the economic conditions of the regional Federal Reserve bank districts that the FOMC will consider at its meeting.

March indicators / events of note:

ECB & BOE Meetings

The European Central Bank (ECB) and the Bank of England (BOE) release their respective monetary policy announcements on Thursday, March 6, following their monthly meetings.

U.S. Labor Report

Private payroll data is part of the Labor Department's monthly U.S. Employment Situation report. This data gives the true employment story, is the best gauge of the economy's direction, and has the power to move markets.

NFIB Small Business Optimism Index

This index offers insight on the health of the small business sector and is based on a survey conducted by the National Federation of Independent Business (NFIB) of its members. Results are for the previous month.

U.S. Retail Sales

Retail sales data are released monthly by the U.S. Department of Commerce, providing total sales receipts for durable and nondurable goods. Consumer spending accounts for two-thirds of GDP and is therefore a key element in economic growth. Each report is based on the previous month's data.

You should be watching:

Investors shouldn't expect much change in policy from either the ECB or BOE. Europe is completely investable once again. The currency markets are absent the volatility seen over the last few years. The euro currency is trading in a very comfortable, non-volatile capacity. The German DAX remains one of the leading developed market equity indexes for the year.

The March labor report will be a big report as a follow-up to two consecutive months of disappointing reports. Investors should be looking for signs of further deterioration. The FOMC wants to continue with its tapering plans, and I suspect that only a significant disappointment in the labor data would deter them from that plan. The unemployment rate, which has fallen significantly over the last few months, is currently 6.6%, and I don't expect it to fall much further. Last month, private payrolls added 142,000 new jobs; and this month's estimates call for at least 160,000 added new jobs. Last month, the headline figure added 113,000 jobs, and current estimates are for about 150,000 additions.

There is no better measure of economic confidence than small businesses, and I like utilizing this report to gauge what's really going on within the sector. At CNBC, a lot of guests talk in generalities about the lack of confidence among small business owners and their concerns about economic conditions. Yet, last month the NFIB Small Business Optimism Index rose to 94.1, the highest reading since May 2013. Over the last few years, the index average has gradually been rising, from 91.4 in 2011, to 92.2 in 2012, to 92.4 in 2013. In 2009, the average reading was 86.7. Small business optimism is out there; you can't argue with these numbers. Many small businesses respond to favorable asset pricing, and this index has a history of rising concurrently with the stock market.

Last month, retail sales contracted 0.4% due largely to the cold weather, and I expect further struggles from the retail sector this month. I believe the Street will respond to this month's report because it falls in a week void of any significant economic data (following the week of the U.S. labor report) and will have greater relevance than usual for market participants.

March indicators / events of note:

U.S. Federal Reserve Bank Regional Manufacturing Surveys

- > **Empire State Manufacturing Survey** – This monthly indicator provides useful intelligence on regional manufacturing conditions within the New York Federal Reserve district and is a useful indicator of national manufacturing trends.
- > **Philly Fed Survey** – This monthly survey provides useful intelligence on manufacturing conditions within the Philadelphia Federal Reserve district and is useful as an indicator of broad manufacturing sector trends.
- > **Richmond Fed Manufacturing Index** – The Federal Reserve Bank of Richmond release a monthly report of manufacturing activity in the mid-Atlantic and Southeast, which includes Virginia, Maryland, the Carolinas, the District of Columbia, and parts of West Virginia.

U.S. Housing Indicators

- > **U.S. Housing Starts** – The most closely followed report on the housing sector discloses the number of new residential buildings under construction in the U.S. in the prior month.
- > **S&P Case-Shiller Home Price Index (HPI)** – This index, released on a two-month lag, tracks changes in the value of residential real estate in 20 metropolitan regions across the U.S.
- > **New Home Sales** – Issued monthly by the U.S. Census Bureau, U.S. Commerce, and U.S. Housing Departments, this report reveals the number of newly constructed homes with a committed sale.
- > **Pending Home Sales** – This monthly report issued by the National Association of Realtors is a leading indicator of existing home sales, not new home sales. It gives a gauge on the demand for housing as well as economic momentum.

You should be watching:

We need to pay particular attention to these regional manufacturing reports in March, especially if we get a weak national ISM manufacturing report at the beginning of the month. Last month, the Empire State manufacturing index fell to 4.48 from a very strong 12.51 in the prior month. The Philly Fed was also disappointing last month, coming in at -6.3, the first negative reading since May 2013. Finally, the Richmond Fed manufacturing index fell to -6 last month from 12 the previous month.

Housing data has been impacted by poor weather this winter, and will be important to watch this month. I don't believe there's a slowdown in the housing recovery. The sand states of Nevada, California, and Florida are experiencing sustained housing recoveries and less weather distortion than in the Midwest and Northeast. Existing home inventories are at levels not seen since 2001. The first-time home buyer is much wealthier. I don't see any evidence for concern about rising rates impeding the housing recovery. Overall, I am confident that the housing recovery will continue, and investors should look to a very strong spring season.

In terms of the data:

- > Housing starts were weak last month, down 16% month on month, to 880,000. It was the first month where starts were below 1 million since October. While 16% is a sharp decline, keep in mind that has much to do with the extremely cold weather that has delayed home builders.
- > S&P Case-Shiller home prices in December saw a marginal lift of 0.8% month on month. On a year-on-year basis, home prices rose 13.4%, the fastest calendar year growth since 2005.
- > New home sales surged 9.6% in January, to 468,000 units—the highest reading since July 2008, before the credit crisis.
- > Pending home sales rose 0.1% in January from December. While smaller than expected, it was the first gain since May of last year.

March indicators / events of note:

FOMC Meeting and Fed Chair Press Conference

Following its March 18-19 monetary policy meeting, the Federal Open Market Committee (FOMC) releases its statement, and Chairperson Yellen gives her first press briefing of the year.

Chicago PMI

This monthly index, compiled by the Institute of Supply Management – Chicago, provides insight into business conditions at manufacturing and non-manufacturing firms in the Chicago area, and is considered a proxy for the overall U.S. economy. A reading above 50 indicates an expanding business sector, below 50 contraction. Data released is for the previous month.

You should be watching:

This will be Janet Yellen's first quarterly FOMC press conference. It will be interesting and, I would argue, rather dramatic, if the Fed decides not to taper at the March meeting. There is no reason to expect the Fed not to taper unless there is significant economic deterioration. The debt ceiling suspension has been very favorable, and fiscal policy concerns can't be cited anymore as an obstacle. I expect tapering consistent with the last two rounds, with another \$10 billion reduction in the monthly pace, which is currently at \$65 billion (\$35 billion in Treasuries and \$30 billion in mortgage-backed securities). Look for each of those asset purchases to be slashed \$5 billion. The next FOMC meeting will be held on April 30.

The Chicago PMI reading on the last day of March will provide useful insight as to what we might expect from the March ISM manufacturing survey that will be released in the first week of April.



JOSEPH M. TERRANOVA, *Chief Market Strategist, Virtus Investment Partners*

Joe Terranova is chief market strategist for Virtus Investment Partners, a position he was elevated to in 2009, after having started with the company as chief alternatives strategist. In his current role, Mr. Terranova works with Virtus' regional sales teams and the financial advisors who sell the company's investment products, providing insight into the domestic and global investing landscape and has represented Virtus as a keynote speaker for several financial institutions. He is a member of the Virtus Investment Oversight Committee.

Prior to joining Virtus in 2008, Mr. Terranova spent 18 years at MBF Clearing Corp., rising to the position of director of trading for the company and its subsidiaries. In this capacity, he managed more than 300 traders and support staff for MBF, one of the New York Mercantile Exchange's largest firms. His work was highlighted as the feature story in the June 2004 issue of *Futures* magazine.

Mr. Terranova is perhaps best known for his risk management skills, honed while overseeing MBF's proprietary trading operations during some of the most calamitous times for the U.S. markets, including the first Gulf War, the 1998 Asian Crisis, 9/11, and the collapse of Amaranth Advisors. In 2003, he was one of the first Wall Street professionals to make an early call for higher energy, natural resources, and commodity prices. In June 2008, he cautioned investors to move to the sidelines in commodities and, in March 2009, he encouraged investors to ignore the global "embrace of pessimism" and overweight equities. Before joining MBF, Mr. Terranova held positions at both Swiss Banking Corp. and JP Morgan Securities.

Mr. Terranova has been an ensemble member of the CNBC *Fast Money* franchise since 2008. He also frequently contributes exclusively to CNBC's other business programs. He is the author of *"Buy High, Sell Higher"* (Business Plus, 2012), a book about the "new rules" of investing based on his years as a professional trader.

Mr. Terranova is strongly committed to charitable causes benefiting children. He founded and funds the 501(c) South Nassau Rock organization, which provides specialized athletic experiences for children, and works with Nassau County to sponsor the improvement of baseball and outdoor ice rink facilities. In 2007, he established "Bossy's Bunch," a program that rewards academic excellence among elementary school students, with New York Islanders Hall of Fame hockey player Mike Bossy. In 2013, he expanded his charity work with the Islanders, creating and sponsoring the "Courier of Courage" program, which acknowledges children who have overcome hardships, disabilities, or illness.

Mr. Terranova earned a bachelor's degree in finance from the Peter J. Tobin College of Business at St. John's University in New York.

For more information, visit Virtus.com

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