

# MARKET STRATEGY VIEWPOINT

## Hard To Ignore

May 28, 2019

**Most U.S. data points to an economy that remains relatively strong. However, some PMI numbers are beginning to show definitive weakness.**

**What are the drivers of the recent PMI data? What does it mean? And how could policymakers react?**

**Composite PMI data offers an aggregate look at both the manufacturing and services sectors of the U.S. economy.**

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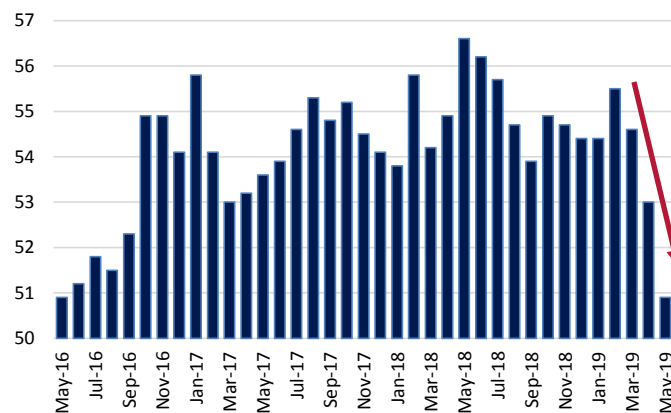
### Headline U.S. Economic Data Decidedly Positive...However

By most measures, there is little to complain about when it comes to the U.S. economy. Unemployment is at the lowest level since 1969, consumer confidence is near all-time highs, and the first quarter GDP was recently reported at +3.2%. Things seem pretty good. A deeper look at some business-centric data, however, does leave something to be desired. Business confidence (Philly Fed Index) has been on a slide since 2017, and Purchasing Managers' Index (PMI) survey data is now precariously close to the growth/contraction line of demarcation. So while oft-reported U.S. economic headlines may look rather glowing, some underlying developments have indeed been hard to ignore.

Why is business-centric data weakening? Our view is that slowing economies outside the U.S. and what looks like a long-standing trade dispute with China are causing some caution among business decision-makers. While the charts and data we cite in this report are something to watch, we do not expect that further data weakness, should it develop, will go unanswered by policymakers. We believe the Federal Reserve is on guard against allowing the economy to slip into a recession, and market participants are likely aware of this prospect. Thus, additional weakness in the high-frequency data we highlight could elicit a more accommodative monetary policy response. This is perhaps one reason the PMI data has so far failed to resonate in the minds of equity market participants.

**Figure 1: Markit U.S. Composite PMI**

Source: IHS Markit



**The Basics**

Purchasing Managers’ Index (PMI) data are closely followed economic series published by two primary entities. The Institute for Supply Management posts a series of information which includes input from over 400 companies in 19 industries, and IHS Markit publishes a similar series of data for the U.S. and over 40 other countries. Both data publishers rely on survey responses from purchasing managers in those multiple different industries. It is thought that purchasing managers are uniquely positioned to deliver an early look into how trading or business conditions may be changing for their respective company and/or industry. The managers are queried for factual information only (not opinion), and questions are asked that relate to employment, prices, new orders, backlog, delivery times, inventories, and output. Respondents are asked whether such conditions may have improved, deteriorated, or stayed the same. Each specific series of information is compiled and then rolled up into “Manufacturing” or “Non-Manufacturing” (Services), depending on the industry. “Composite” readings aggregate both Manufacturing and Non-Manufacturing data.

*A PMI data series above 50 indicates expansion and numbers below 50 indicate contraction.*

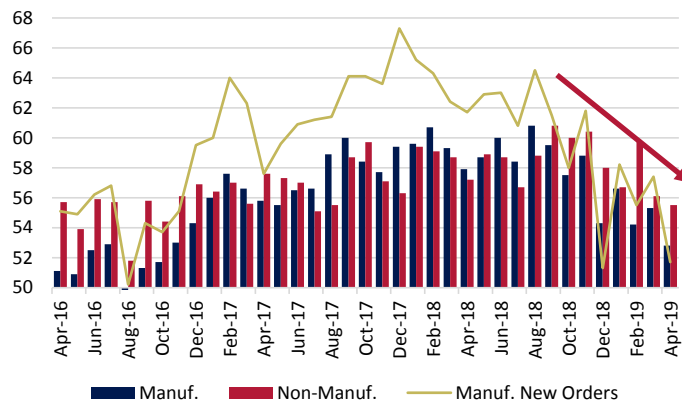
Purchasing manager’s indices are calculated via a “diffusion index” such that the percentage of respondents is tabulated to indicate improvement, no change, or deterioration in business conditions. For example, if 80% of respondents cited improvement the index reading would be 80. If 80% of respondents cited deterioration the index reading would be 20 (100 minus 80). Thus, an index reading of 50 indicates there is an equal amount of respondents citing improvement and deterioration. Consequently, economists and market participants note when the 50-line is crossed, either up or down, which signals a directional change in economic conditions. In addition, readings above or below 50 can pinpoint degrees of improvement or deterioration.

*The PMI New Orders component is a data series that many forecasters look to as a forward indicator of business conditions.*

*It is thought that a fall in new orders could mean a decline in business activity and/or revenue in the out months.*

**Figure 2: ISM Manufacturing, Services, & New Orders**

Source: Institute for Supply Management



### **Something to Watch**

The broad, business-centric perspective of the PMI data is a reason why the series are closely followed by market practitioners. The current trajectory of the data series points to emerging weakness across the U.S. business sector, and indications are now falling near the 2016 lows; a time of more-pointed economic anxiety. We believe this deterioration in business conditions should be concerning for both market participants and policymakers. Should the indices break below 50, we imagine more participants would take note and markets could react more negatively. At the same time, such an occurrence could help elicit a monetary policy response. Today, we believe the data offers a modest warning signal that there may be more to the story than U.S. GDP data and Unemployment figures are telling, and investors may want to keep these numbers in mind when setting their financial asset allocations.

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