

April 24 2017

BEIGE BOOK: WINDOW ON MAIN STREET

Matthew E. Peterson *Chief Wealth Strategist, LPL Financial*
Barry Gilbert, Ph.D, CFA *Senior Economic Analyst, LPL Financial*

KEY TAKEAWAYS

Based on our analysis, the Beige Book continues to deliver a positive view of the U.S. economy.

The Beige Book Barometer (strong words minus weak words) rose to +77 in April, indicating continued steady economic growth in early 2017, with some signs of potential acceleration.

Words related to wage pressure have held steady over the last six months at levels above the 2015–2016 average, indicating the appearance of modest but still manageable wage pressure.

BEIGE BOOK SUGGESTS CONTINUED MODEST ECONOMIC GROWTH

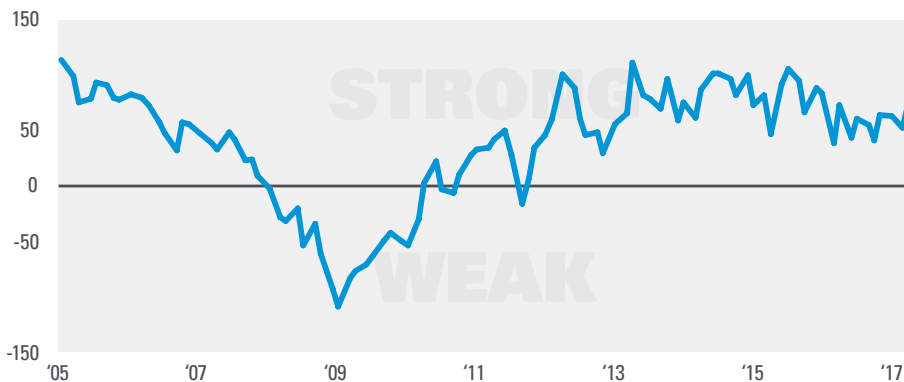
The latest edition of the Federal Reserve’s Beige Book, released Wednesday, April 19, 2017, continued to deliver a positive view of the U.S. economy. The Beige Book is a qualitative assessment of the U.S. economy and each of the 12 Fed districts individually. The report is prepared eight times per year, ahead of each of the eight Federal Open Market Committee (FOMC) meetings. We believe the Beige Book is best interpreted by measuring how the key words change over time. The qualitative inputs for the April 2017 Beige Book were collected in early March 2017 through April 10, 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 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 advancing, it suggests that the economy is improving.

1 BEIGE BOOK BAROMETER CONTINUES TO SUGGEST POSITIVE ECONOMIC GROWTH IN THE U.S.

- Number of Times “Strong” (and Variations of This Word) Is Mentioned Minus Number of Times “Weak” (and Variations) Is Mentioned



Source: LPL Research, Federal Reserve 04/24/17

In April 2017, the barometer moved down to +77, after a +53 reading in March 2017, and a +63 reading in January 2017. At +77, April's Beige Book Barometer reading was the strongest since January 2016. Improvement in the April 2017 Beige Book versus March 2017 was broad based, with similar improvement in the three Fed districts in the nation's oil patch (Minneapolis, Dallas, and Kansas City) compared with other districts.

Our Oil States Barometer (the barometer for the three Fed districts that include the top oil-producing states) moved from +9 in March 2017 to +14 in April 2017, the largest positive change since July of 2016 and only the second time in the last 10 Beige Books, dating back to March 2016, the reading has been

above +10. Not to be outdone, the +63 reading on the barometer excluding the oil states is the highest value in a year.

WATCHING WAGES & INFLATION

As noted in our *Outlook 2017: Gauging Market Milestones* publication, our view is that the Fed will raise rates one to two more times in 2017. Expectations for a rate hike at the May meeting are low, given we are just one meeting out from the March 2017 hike, which was already the second in approximately three months.

Still, market participants continue to monitor inflation and wages closely, as they gauge not just when, but how far and how fast, the Fed may raise rates this year and beyond. Each Beige Book provides an economy-wide assessment of wages and prices. On wages, the April 2017 Beige Book observed, "Modest wage increases broadened, and reports noted bigger increases for workers with skills that are in short supply." In discussing price pressures, the April 2017 Beige Book highlighted: "On balance, prices rose modestly since the previous report. Input prices generally increased at a modest rate and outpaced gains in selling prices, which rose only slightly...Businesses mostly expected mild to moderate price growth to persist in the next several months."

We monitor wage pressures via the data in [Figure 2](#), which show the recent trend in the number of wage/inflation words in the Beige Book. We counted the number of times the words "wage," "skilled," "shortage," "widespread," and "rising" appeared in recent editions of the Beige Book. In April 2017, these words appeared 119 times, higher than any Beige Book since December 2015, but still similar to the average of 116 mentions in the prior four Beige Books.

By comparison, in the first half of 2016, these wage/inflation words appeared, on average, just 108 times per Beige Book. These words appeared, on average, 109 times per Beige Book in 2015. In all of 2014—when deflation, not inflation, was a

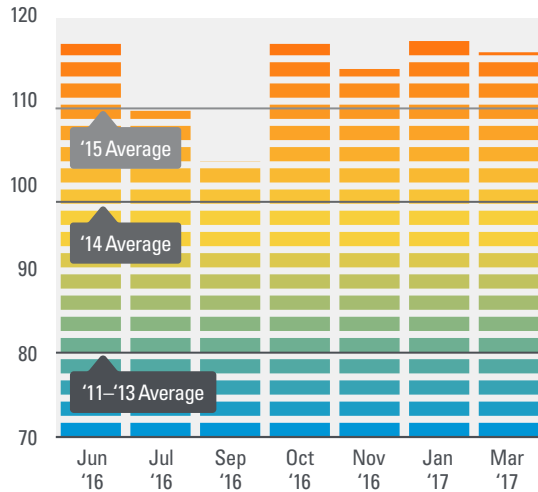
HOW THEY WORK BEIGE BOOK AND BEIGE BOOK BAROMETER

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 May 2–3, 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 RISE IN WAGE AND PRICE PRESSURES EVIDENT IN OUR INFLATION BAROMETER

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



Source: LPL Research, Federal Reserve 01/06/17

concern—those words appeared an average of just 98 times per Beige Book. The increase in the number of inflation words signals that some pick-up in wage pressure has started to become a modest but manageable concern.

CONCLUSION

After dipping somewhat in March, the April Beige Book Barometer resumed acceleration off of the more suppressed levels seen in mid-2016. While the hard economic data has yet to show a strong pickup in economic growth, there are clear signs that the economy has steadied, and it may be healthy for a generally optimistic view of the economy from Main Street to remain tempered as we await greater clarity on potentially pro-growth policy developments. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

Any economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

This research material has been prepared by LPL Financial LLC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial LLC is not an affiliate of and makes no representation with respect to such entity.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by Any Government Agency | Not a Bank/Credit Union Deposit

RES 5862 0417 | Tracking #1-602243 (Exp. 04/18)