

KEY TAKEAWAYS

At +55, the September 2016 Beige Book Barometer reading is now back in the middle of the range it has been in since early 2012, suggesting modest economic growth may continue.

All of the deterioration came in the nation's oil patch, despite a pickup in oil production in the past few months.

Despite the elevated level of uncertainty surrounding the U.S. presidential election and the outlook for the global economy, optimism still reigns in the Beige Book.

September 12, 2016

BEIGE BOOK: WINDOW ON MAIN STREET

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BEIGE BOOK SUGGESTS CONTINUED MODEST ECONOMIC GROWTH

The latest edition of the Federal Reserve's (Fed) Beige Book was released Wednesday, September 7, 2016, and based on our analysis, continues to deliver a positive view of the current state 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. The next FOMC meeting, the sixth of the year, is September 20–21, 2016. We believe the Beige Book is best interpreted by measuring how the descriptors change over time. The qualitative inputs for the June 2016 Beige Book were collected from mid-July through August 29, 2016. Thus, they captured Main Street's reaction to:

- A period of relative calm in U.S. and global financial markets
- Rising oil production and modestly higher oil prices
- A weaker dollar
- Economic and inflation data reflecting the economic and market reaction to the surprising Brexit vote on June 23, 2016

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 rising, it suggests that the economy is improving.

In September 2016, the barometer ticked down to +55 after the +61 reading in July 2016. At +55, the September 2016 reading is now back in the middle of the range it has been in since early 2012. All of the deterioration in the Beige Book versus July's came in the three Fed districts in the nation's oil patch (Minneapolis, Dallas, and Kansas City), despite a pickup in oil production in the past few months. Our Oil States Barometer (the barometer for the three Fed districts that include the top oil-producing states) moved from +21 in July to just +7 in September, matching the +7 reading seen, on average, in the 8 Beige Books ending in June 2016, which coincided with the worst of the declines in oil production and prices. The +7 reading

HOW THEY WORK

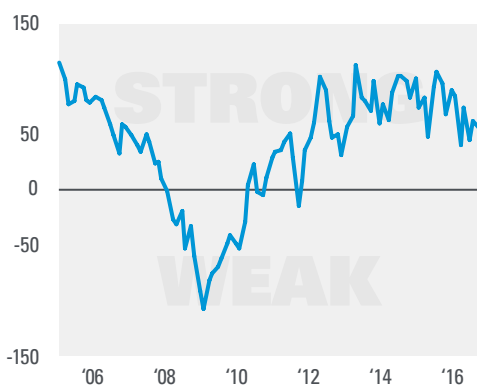
BEIGE BOOK AND BEIGE BOOK BAROMETER

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 September 20–21, 2016.

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.

1 BEIGE BOOK BAROMETER CONTINUES TO SUGGEST MODERATE 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 09/07/16

in September was even more disappointing given that the +21 reading in July put sentiment in these districts back to a level not seen since prior to the peak in oil prices in June 2014.

WATCHING WAGES & INFLATION

Now that the Fed has initiated its first rate hike cycle since 2006, FOMC members and market participants—who are trying to gauge what the Fed may do next—will be watching inflation closely. Each Beige Book provides an economy-wide assessment of wages and prices. The September 2016 Beige Book noted that “wage growth ranged from flat to strong across the Districts, but most reported that wage pressures remained fairly modest,” and “employment expanded at a moderate pace since the previous report.”

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 September 2016, these words appeared 103 times, down from the 117 in June and the 109 in July 2016, but above the 2016 low of 100 in January. These words appeared, on average, 109 times per Beige Book in 2015. In all of 2014—when deflation, not inflation, was a concern—those words appeared an average of just 98 times per Beige Book. So, after a brief drift back toward deflation worries in the January 2016 edition (100 mentions), the latest Beige Book shows a pickup in the number of inflation words. For reference, during 2011–13, also a period when heightened risk of deflation was evident, inflation words appeared 80 times per Beige Book on average.

OPTIMISM STILL RULES

One final thought on the Beige Book. Despite the elevated level of uncertainty surrounding the U.S. presidential election and the outlook for the global

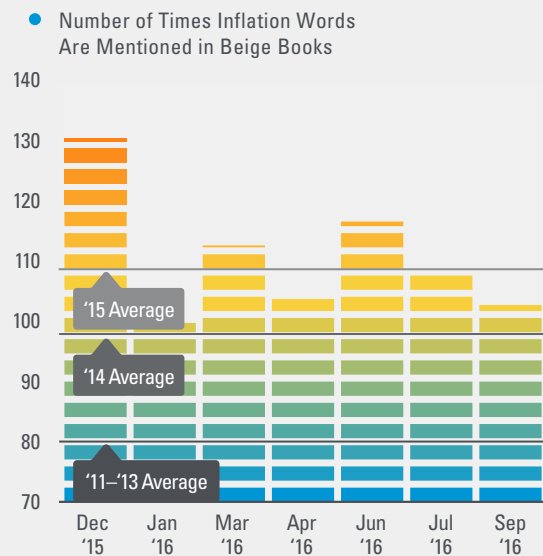
economy, optimism still reigns. In the September 2016 Beige Book, the word “optimism” (or its related words) appeared 15 times, whereas the word “pessimism” appeared just once [Figure 3]. In the 14 Beige Books released since early 2015, optimism appeared, on average, 18 times per Beige Book, while the word pessimism has appeared a total of just 18 times, with 12 of the 18 mentions coming in the Dallas and Kansas City districts, and were related to the outlook for the oil and gas sector.

As reassuring as it is to see that Main Street can remain optimistic despite the flow of bad news, the large number of optimistic comments in the Beige Book is not the start of a new trend: In the 8 Beige Books released in 2014, the word “optimism”

appeared, on average, 30 times. In 2013, “optimism” appeared, on average, 25 times per Beige Book. In the 8 Beige Books released in 2009, during some of the worst of the financial crisis and Great Recession, the word “optimism” appeared, on average, just 9 times.

Concerns that today’s economic and market environment is similar to the onset of the Great Recession and the stock market peak in late 2007 also appear to be misplaced. In the 8 Beige Books released in 2007, the word “optimism” appeared, on average, just 10 times per edition—a far cry from the 30 times per edition in the 8 Beige Books released in 2014, the 21 times per edition in 2015, and the 16 per Beige Book so far in 2016. ■

2 PRICE PRESSURES BEGINNING TO EMERGE IN THE BEIGE BOOK INFLATION BAROMETER



Source: LPL Research, Federal Reserve 09/07/16

3 OPTIMISM STILL RULES ON MAIN STREET

Mentions per Beige Book in:	Optimism	Pessimism
Sep '16	15	1
July '16	10	2
June '16	17	2
Apr '16	14	1
Mar '16	14	4
Jan '16	17	3
Dec '15	20	0
<hr/>		
'15	21	1
'14	30	0
'13	25	1
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'09	9	5
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'07	10	1

Source: LPL Research, Federal Reserve 09/07/16

IMPORTANT DISCLOSURES

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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.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

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