Capital
INVESTMENT SERVICES
of America, Inc.

Observations

January 2015

December 2014 ISM

Although December's Purchasing Manager's Index (PMI) slipped from November's level and was below general expectations, it is not likely a signal of a material weakening in the economy. The all-important New Orders sub-index moved down to be sure, but from a red-hot November reading to a still-strong level in December. Furthermore, while one can't be sure what, if any, impact the West Coast port work slowdown might be having, a number of PMI respondents said it was weighing on their businesses during the month.

Three other major areas registering declines are actually favorable developments in our estimation. Declines in prices triggered by falling commodity prices mathematically detract from the overall PMI reading, but are considered a good thing in our book. Falling inventories and the decline in production also weigh on the overall Index but suggest a tight and timely relationship between the new orders – production - and inventory sequence chain. The time to worry is when orders slow but current production does not, and an inventory overhang develops. In our view of business cycle theory where expansions become brittle and ripe for recession due to excessive accumulation of debt, and inventories, and inflation also rises, such unfavorable signals are generally absent. The expansion looks to be on solid ground as a result. The Institute of Supply Management that compiles the PMI offers somewhat similar commentary as well:

"*The past relationship between the PMI® and the overall economy indicates that the average PMI® for January through December (5.8 percent) corresponds to a 4.2 percent increase in real gross domestic product (GDP) on an annualized basis. In addition, if the PMI® for December (55.5 percent) is annualized, it corresponds to a 4.1 percent increase in real GDP annually."* (For context, real GDP has been running around 3% on a year-over-year basis). *"A PMI® in excess of 43.2 percent, over a period of time, generally indicates an expansion of the overall economy. Therefore, the December PMI® indicates growth for the 67th consecutive month in the overall economy."*

As the economy grows, the corporate profit up-cycle remains in place. Such an environment supports stock valuations, and suggests the bull market remains in place.

Report details are in the table that follows.

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MANUFACTURING AT A GLANCE DECEMBER 2014						
Index	Series Index Dec	Series Index Nov	Percentage Point Change	Direction	Rate of Change	Trend* (Months)
PMI®	55.5	58.7	-3.2	Growing	Slower	19
New Orders	57.3	66.0	-8.7	Growing	Slower	19
Production	58.8	64.4	-5.6	Growing	Slower	10
Employment	56.8	54.9	+1.9	Growing	Faster	18
Supplier Deliveries	59.3	56.8	+2.5	Slowing	Faster	19
Inventories	45.5	51.5	-6.0	Contracting	From Growing	1
Customers' Inventories	44.5	50.0	-5.5	Too Low	From About Right	1
Prices	38.5	44.5	-6.0	Decreasing	Faster	2
Backlog of Orders	52.5	55.0	-2.5	Growing	Slower	3
Exports	52.0	55.0	-3.0	Growing	Slower	25
Imports	55.0	56.0	-1.0	Growing	Slower	23
OVERALL ECONOMY				Growing	Slower	67
Manufacturing Sector				Growing	Slower	19

NOTE: All figures except backlog of orders, customer inventories, imports, exports, inventories & prices paid are seasonally adjusted. The diffusion index is calculated by adding the percent of positive responses plus one half of those responding the same.

*A PMI™ reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally declining. A PMI™ in excess of 42.2 percent, over a period of time, indicates that the overall economy, or gross domestic product (GDP), is generally expanding; below 42.2 percent, it is generally declining.

*Number of months moving in current direction