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Economic Outlook Remains Weak, Stocks Continue to Move Sideways

As I had expected, U.S. stocks, in general, continued to move sideways last week, with all of the United States' major market indices closing on Friday essentially unchanged from the prior week's closes.

Stocks in most other regions of the world also moved mostly sideways last week, with the exception of Japanese stocks, which pulled back a bit.

With the readings on numerous economic indicators continuing to suggest that economies around the globe will continue to grow at a sluggish pace over the next couple of months, I expect stocks to continue to trade in a narrow sideways pattern during the weeks ahead.

On a positive note, two infrastructure stocks that I mentioned over the past few months – **Cliffs Natural Resources (CLF)** and **Granite Construction (GVA)** – pulled back and held above some key price-support levels over the past two weeks. **Shake Shack (SHAK)**, which I also mentioned in past editions of our ***Free Weekly Investment Commentary***, also pulled back after the company announced its second quarter financial operating results on August 10.

Yet, our research and analysis suggests that financial market participants are still overvaluing CLF, GVA and SHAK, and that each of those stocks will pull back further over the next several weeks. Therefore, I'm still not ready to recommend any of those stocks for purchase.

And, even though crude oil prices rallied considerably over the past two weeks, **JPMorgan Alerian MLP Index ETN (AMJ)** and **E-TRACS Alerian MLP Infrastructure ETN (MLPI)** have moved essentially sideways since oil began its advance on August 3.

With our research indicating that oil prices will decline a bit before continuing to move higher, I'm waiting for such a pullback to develop before recommending for our clients and subscribers to establish any new positions in either of those exchange-traded funds.

Economic Developments and Stock Market Trading Action

In regard to the latest economic developments, the U.S. Department of Commerce reported on August 16 that initial work on the construction of new homes – new housing starts – rose for the second consecutive month during July, albeit at a slow pace. However, the number of building permits issued for the construction of new homes declined during July, and mortgage applications declined during three of the four weeks ended August 14, the latest week for which data are available. Hence, there's a good chance that new housing starts, which are a reliable leading economic indicator, have declined during August. The fact that the recent interests expressed by potential homebuyers to purchase a home declined over the past four weeks seems to support that likelihood.

On a positive note, industrial production at U.S. factories, mines and utilities rose during each of the past two months after trending lower from December 2015 to May of this year. However, recent reports on U.S. manufacturing activity suggest that industrial production declined over the past couple of weeks.

In regard to economic developments that have more of a direct impact on stock prices, the productivity of persons employed by U.S. companies – the number of goods and services produced per hour by those persons – declined while the costs per hour to employ those persons – unit labor costs – rose during the quarter ended June 30, 2016.

Specifically, the U.S. Department of Labor reported on August 9 that the productivity at U.S. businesses declined by 0.1% while unit labor costs rose by 0.5% during the quarter ended June 30, 2016, as compared to the prior quarter. That's the third consecutive quarter that productivity has declined and the seventh consecutive quarter that unit labor costs have risen. On a year-over-year basis, productivity declined by 0.4% while unit labor costs rose by 2.1% for the quarter ended June 30, 2016.

Considering the fact that any given company's profits are determined by deducting the company's expenses from its sales revenues, and that labor costs account for a substantial portion of most companies' expenses, the continuing increases in unit labor costs and last quarter's decline in productivity suggest that the profit margins realized by U.S. companies, in the aggregate, are being squeezed.

And, because stock prices are determined ultimately by the level and direction of corporate profits, last quarter's big negative divergence between unit labor costs and productivity suggests that U.S. stock prices, in general, are due for a substantial pullback.

In regard to economic developments abroad, the most-recent readings on key economic indicators for the Eurozone suggest that the regions' output of goods and services will continue to increase over the next few months.

Meanwhile, economic indicators for Japan, China and Brazil suggest that economic activity in those countries' economies is in the process of bottoming.

Yet, the recent trading action in the world's major stock markets suggests that stock prices, in general, will continue to move in a narrow sideways pattern over the next few weeks. With the readings on valuation metrics indicating that financial market participants, in the aggregate, are currently overvaluing U.S. stocks, I'm therefore continuing to advise my firm's clients and persons who subscribe to our ***Free Weekly Investment Commentary*** to allocate the majority of their financial market assets to cash-like investments (i.e. money-market securities) and to a few relatively-safe, yet high-paying dividend securities, including **Gabelli Equity Trust Inc. Series H Cumulative Preferred Stock (GAB-PH)**, **Welltower Inc. (HCN)**, and **Nuveen S&P 500 Buy-Write Income Fund (BXMX)**.

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