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Strategic International Securities Inc.

A Registered Investment Advisory

Analyzing the Numbers*

Morning Note

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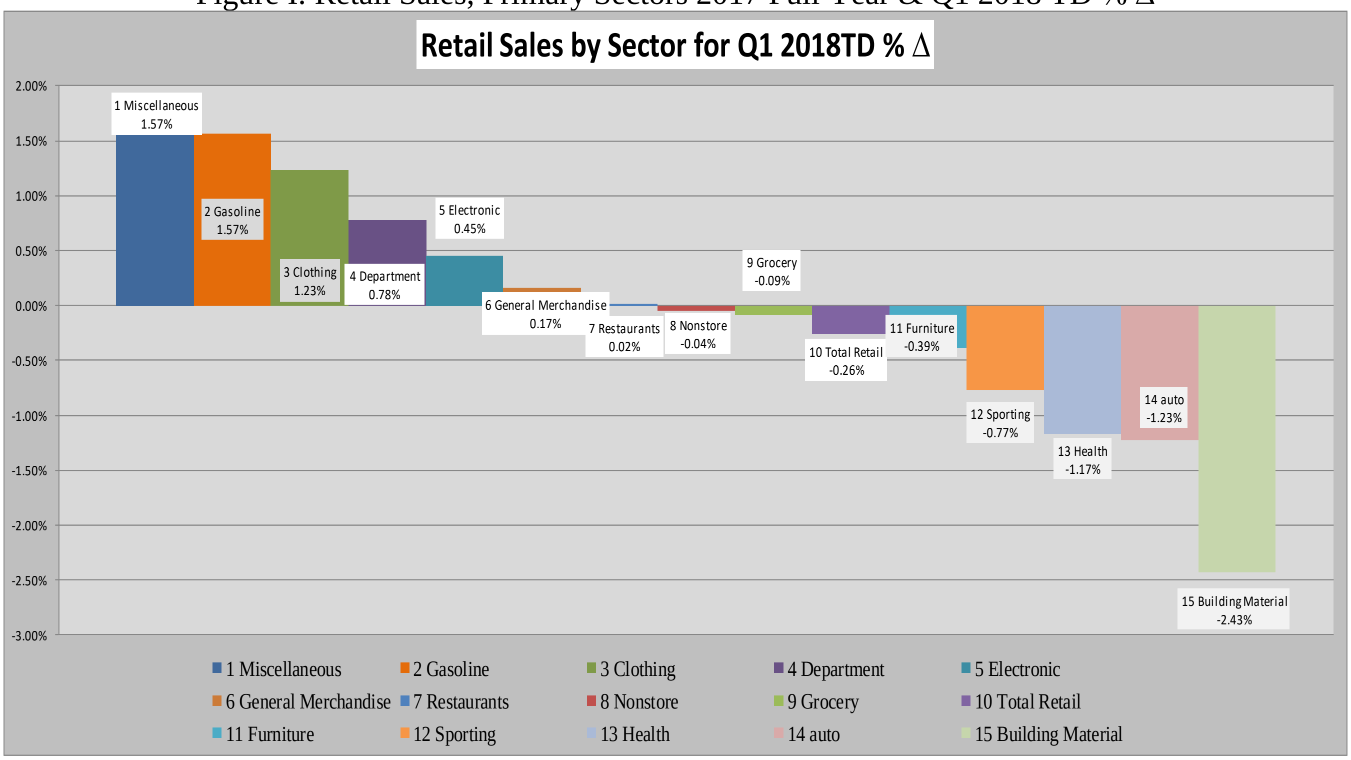
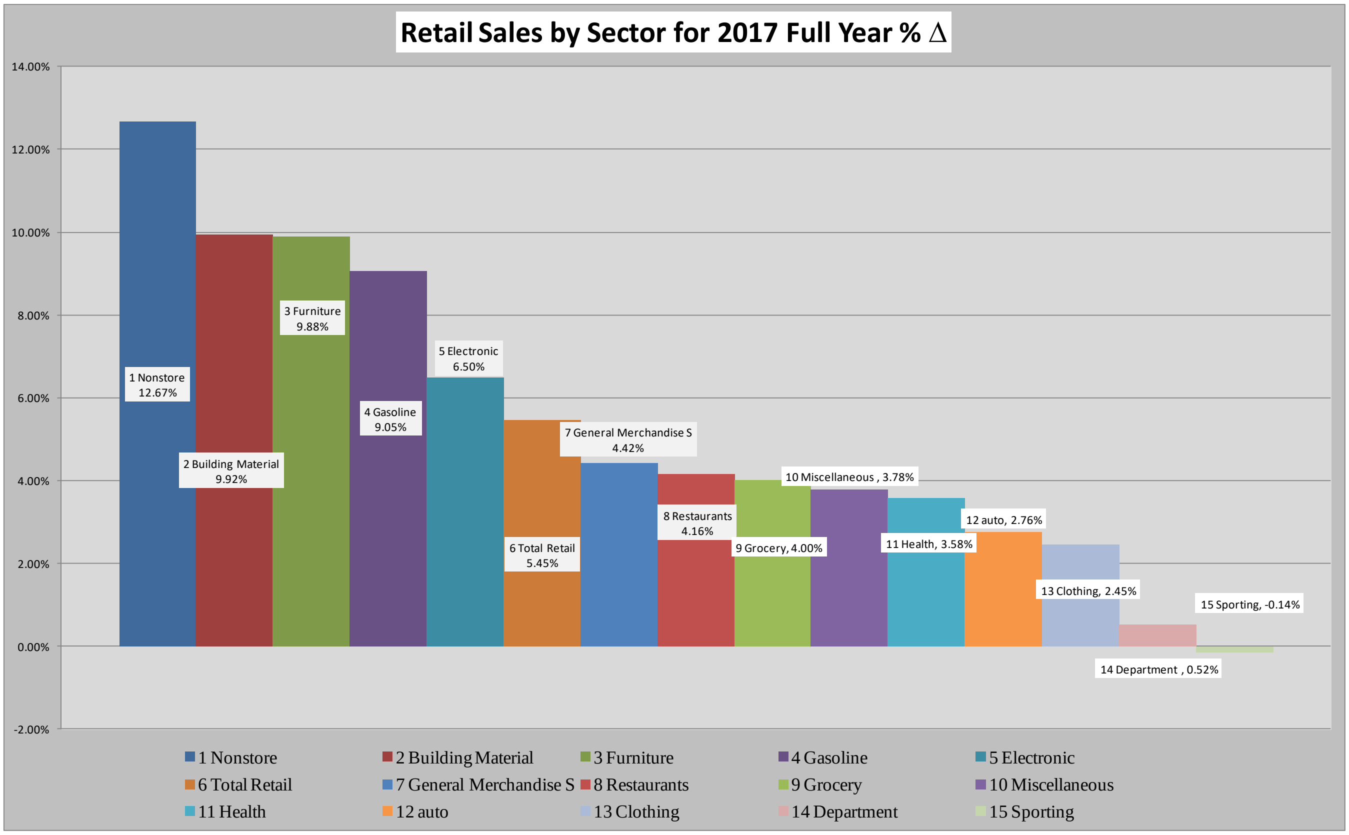
Retail sales down 0.3% m/m x gasoline down 0.43% - Auto sales down -1.23% returning closer to normal post Hurricane at 17.16M -Building materials also soft at down -2.43%

Figure I: Retail Sales, Primary Sectors 2017 Full Year & Q1 2018 TD % Δ





Source: DOC, SISR

Figure II: 2017 YTD & Q4 QTD 2017 % ∆ by Sectors

Retail Commerce Report 2017 Full Year Ranking

	Sector	2017 YTD
1	Nonstore	12.67%
2	Building Material	9.92%
3	Furniture	9.88%
4	Gasoline	9.05%
5	Electronic	6.50%
6	Total Retail	5.45%
7	General Merchandise S	4.42%
8	Restaurants	4.16%
9	Grocery	4.00%
10	Miscellaneous	3.78%
11	Health	3.58%
12	auto	2.76%
13	Clothing	2.45%
14	Department	0.52%
15	Sporting	-0.14%

Source: DOC, SISR

Retail Commerce Report Q1TD Ranking

	Sector	2018 Q1
1	Miscellaneous	1.57%
2	Gasoline	1.57%
3	Clothing	1.23%
4	Department	0.78%
5	Electronic	0.45%
6	General Merchandise	0.17%
7	Restaurants	0.02%
8	Nonstore	-0.04%
9	Grocery	-0.09%
10	Total Retail	-0.26%
11	Furniture	-0.39%
12	Sporting	-0.77%
13	Health	-1.17%
14	auto	-1.23%
15	Building Material	-2.43%

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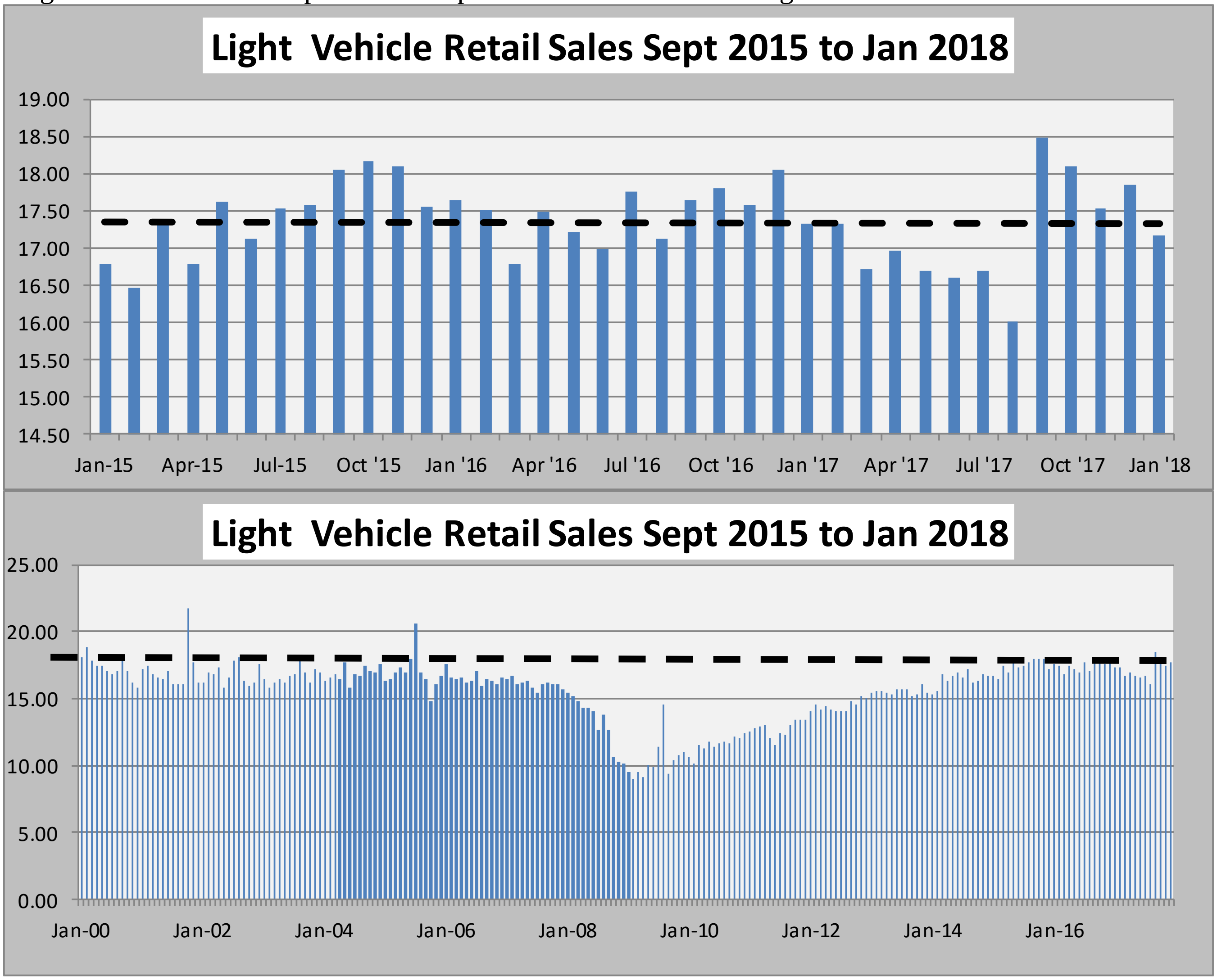
Figure III: Auto Sales Sept 2015 to Sept 2017- From Motor Intelligence & Jan 2000 to Jan 2018- BEA



Source: Motor Intelligence, BEA, SISR

Introduction

Total Retail sales were released this morning and the numbers were concerning down 0.3% m/m and down 0.43% x gasoline. The two sectors expected to be impacted by higher interest rates were very weak:

1. **Auto sales** were weak coming in at 17.1 million units annualized. On the retail report auto sales were also weak at down (-1.23%) m/m and was the second weakest sector in the retail report only ahead of the weakest sector Building Materials. Auto sales were up last month in December after a drop the prior month November as auto sales were coming down to earth from the post hurricane replacement surge. It will be important to watch auto sales to see if they fall back to the 16M annual rate from the low pre-hurricane average.
2. **Building materials** were the weakest sector at down 2.43% m/m.

What is concerning is that these two sectors have been the strongest in the low interest rate environment, and now that interest rates are slightly higher, these two-interest rate sensitive and important sectors for the entire economy may possibly be struggling, which is problematic.

Major Sector movements:

1. **Auto sales** were very strong for three months following the hurricanes on auto replacements but have fallen back over the past two months. Auto sales in January, however, were still above the concerning low pre-hurricane levels of 16.5M units in mid 2017. The post hurricane replacement sales for destroyed autos are now mostly replaced and had the effect of a temporarily boost in sales. This month auto sales have returned to earth at 17.1M units and from the three-month low of 17.8M from last month. However, the 17.1M rate is close to the top of the range when there were concern with auto sales prior to the hurricane boost. From the retail report auto sales in January were the second worst sector down (-1.23%) and ranked #14 out of the 15 sectors.

2. **Building materials** were the worst sector in this January report and down (-2.43%) and ranked #15 in this retail sales report (Figure IIB). Last year building materials were the second strongest sector at up 9.92% and ranked #2 (Figure IIA). It is quite possible that this was weather related in that the East coast and the Midwest had been very cold in January. The housing data will be coming out later this week and next week, but it may take another month or two to see if the higher interest rates are putting a damper on this sector.

3. **Nonstore retailers** have been the most consistent place for excellent growth and were ranked #1 up 12.7% for the full year 2017 and #1 up 5.6% in Q4 2017. This January, however, this sector was down slightly down (-0.04%) and ranked #8 this month. This sector of course cannot be excused for the bad weather, so one must give some credence to the view that retail sales have stumbled this past month.

4. **Furniture** was the real surprise sector last quarter and last year but this past month it was in line with the rest of the weak retail report down (-0.39%) and ranked #11 out of the 15 sectors. Given the strong results from last year but recognizing that there may be issues in the housing sector one needs to be careful with this sector. Last month it was ranked #3 for both Q4 2017 and for the full year 2017 at up 3.25% and up 9.9% respectively.

5. **Gasoline station sales** were up 1.57% on higher oil and gasoline prices, making this report even worse than the top line would appear to be at down (-0.26%). When gasoline stations are taken out this report is down a more significant (-0.43%).

Summary

Today's retail sales report was relatively weak down (-0.26%) and x gasoline down (-0.43%). What may be most troubling is that the two worst sectors autos and building materials were both the strongest in the low interest rate environment, but as rates have been going up they turned from best to worst. Even the strong nonstore retailers were impacted in this weak report and were actually down on a m/m basis (-0.04%) which is unusual. Worse still what had helped this report were the very strong higher gasoline station sales.

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