

Third Quarter 2018
Economic Report

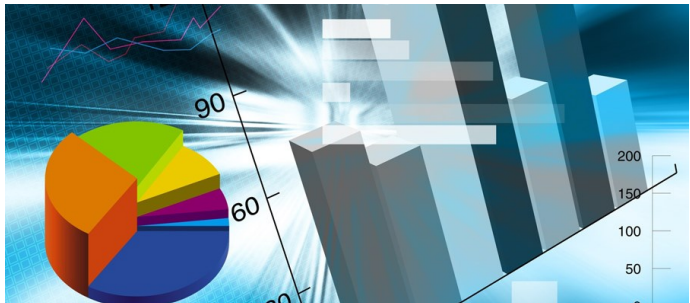


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overview

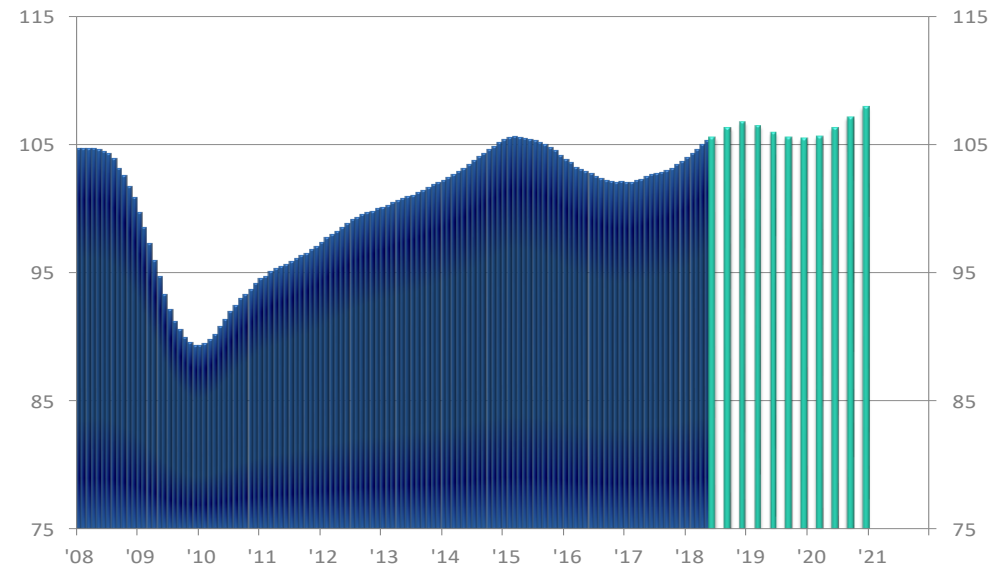
US Industrial Production during the 12 months through May was up 2.8% from the same period one year ago. Each component is growing at an accelerating pace.

We revised our forecast for US Industrial Production for 2018. The 2018 annual average is projected to be 0.2% higher than the prior forecast. The year-over-year percent change is a larger shift, to 2.9% for the year, in part because of revised historical data by the Federal Reserve Board. Our forecast for 2019 is essentially unchanged on a year-over-year basis.

The timing of the US Total Industrial Production high is delayed until the third quarter of 2018; we previously expected a first-quarter-2018 business cycle peak. The US Purchasing Manager Index, JP Morgan Global PMI, OECD Leading Indicator for the US, US Corporate Profits, and the rates-of-change for the S&P 500 are in agreement regarding business cycle decline in 2019. Look for business cycle rise to characterize 2020. This is unchanged from our prior forecast.

An annual data revision by the Bureau of Labor Statistics led us to revise our forecasts for US Hotel and Motel Employment and US Manufacturing, Utilities, and Oil & Gas Extraction Employment. The US Public Safety Employment forecast and the US Transportation and Material Moving Employment forecast were revised to account for recent divergence from their respective forecast ranges and to account for recent leading indicator evidence. The forecast revisions were mild, with the largest change being 3.5%.

US Industrial Production Trend



US Casino Employment is expected to decline through 2020 and may offer limited opportunities during that time. US Manufacturing, Utilities, and Oil & Gas Extraction Employment is expected to rise in the near term and then plateau from mid-2019 to mid-2020. Employment in the remaining markets included in this report is expected to generally rise through at least 2020. NAUMD members should focus their efforts strategically in order to maximize growth potential. US Transportation and Material Moving Employment may offer the strongest near-term opportunities, as Employment in this sector is growing at a faster pace relative to the other markets in this report.

US Producer Prices are rising at an accelerating pace. Tariffs could skew costs upward as global trade shifts toward domestic sources. NAUMD members should carefully monitor production costs and consider adjusting pricing to protect profit margins.

Business Cycle

<u>Industry</u>	<u>Current 12/12</u>	<u>Phase</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
US Hotel and Motel Employment	1.5%	C	1.3%	1.0%	0.7%
US Casino Employment	-3.2%	D	-2.3%	-3.6%	-2.3%
US Transportation & Material Moving Employment	2.8%	B	4.1%	0.6%	1.2%
US Restaurant Employment	2.2%	C	2.0%	2.3%	2.3%
US Health Care Employment	2.0%	B	1.9%	2.2%	1.9%
US Selected Retail Trade Employment	0.8%	B	1.4%	0.9%	0.6%
US Manufacturing, Utilities, and Oil & Gas Extraction Employment	1.2%	B	1.8%	0.2%	0.5%
US Public Safety Employment	0.2%	C	0.1%	0.8%	0.2%



RECOVERY

ITR Economics™



ACCELERATING GROWTH



SLOWING GROWTH



RECESSION

Third Quarter 2018

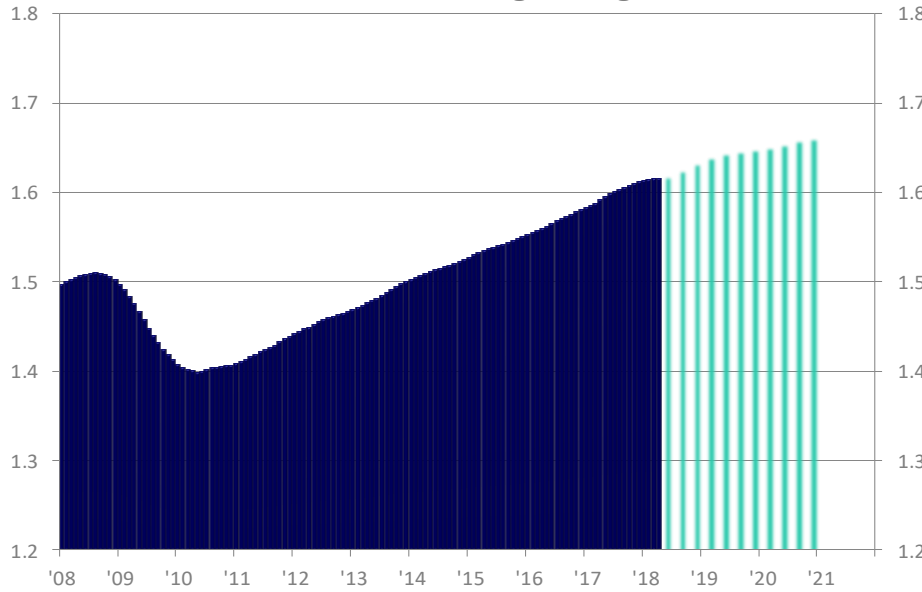
US Hotel and Motel Employment

Annual Trend: 1.615 million

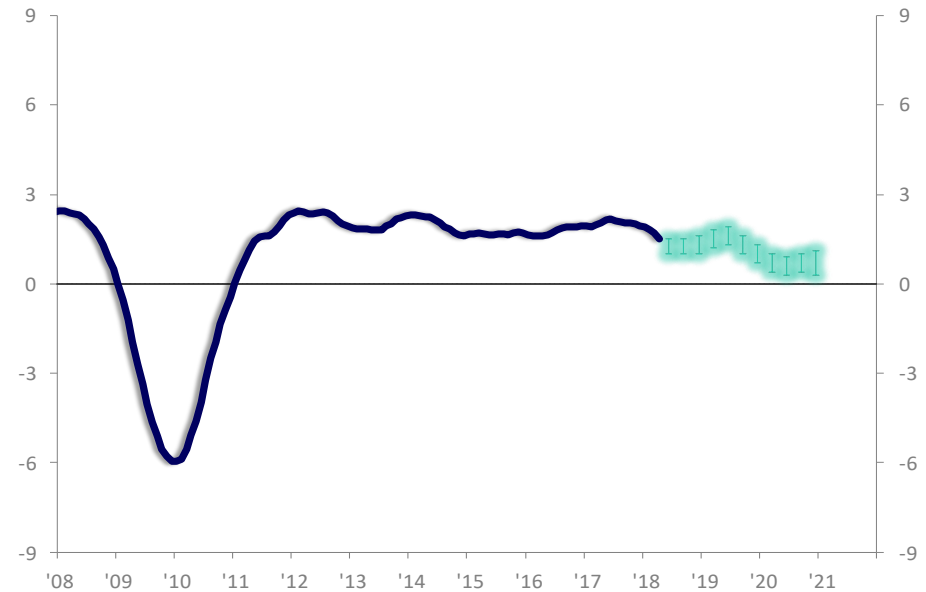
Phase: C

Year-over-Year: 1.5%

12-Month Moving Average



Year-over-Year Growth Rate



Industry Outlook

2018: 1.632

2019: 1.648

2020: 1.660

(millions)

US Hotel and Motel Employment data from early 2016 onward was revised upward by the Bureau of Labor Statistics. The deviation from the pre-revision data was increasing over time, reaching 2.2% (annual average basis) by late 2017. The revision also affected the annual growth rates, changing the trend from Phase B, Accelerating Growth, to Phase C, Slowing Growth. Consequently, we revised our annual Employment forecast upward by 2.8% for 2018, 3.5% for 2019, and 2.9% for 2020 to account for the revision. Our

expectation of expansion in Employment through at least 2020 is unchanged from the prior forecast.

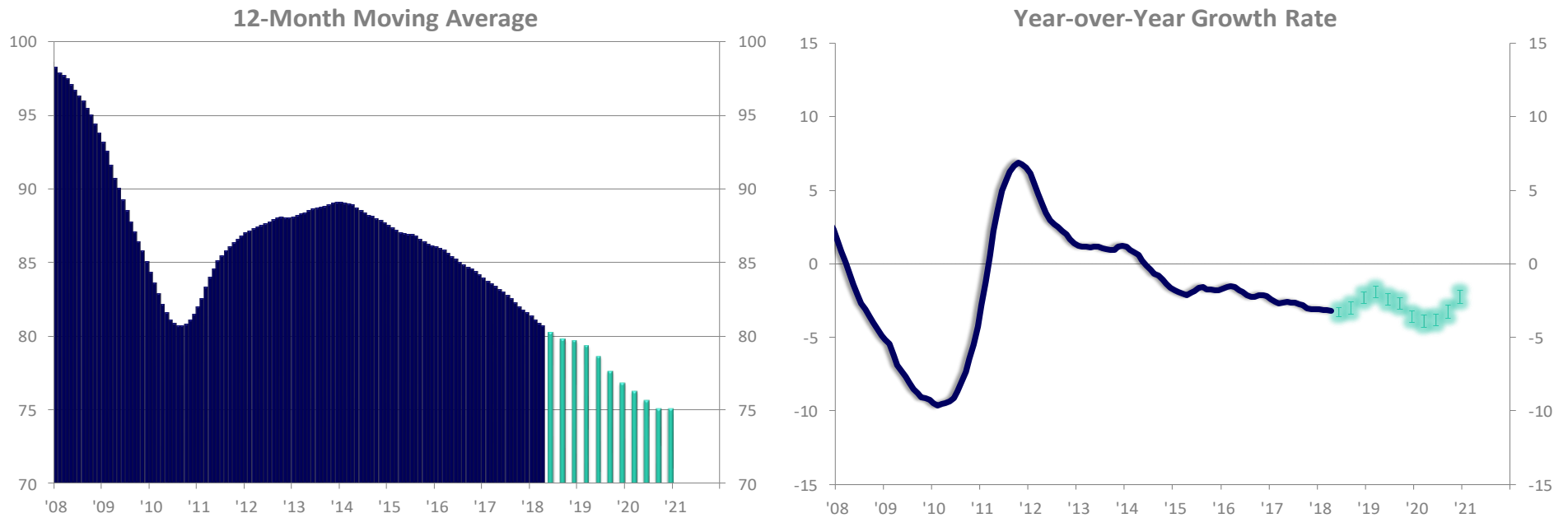
US Personal Consumption Expenditures for Hotels and Motels and Gross Domestic Product for Direct Tourism are in accelerating growth trends, supporting near-term rise in Employment. However, declining savings rates, along with rising inflation and interest rates, are putting pressure on the consumer. These factors will result in a milder pace of growth in Employment next year.

US Casino Employment

Annual Trend: 80.650 thousand

Phase: D

Year-over-Year: -3.2%



Industry Outlook



2018: 79.658
2019: 76.790
2020: 75.063
(thousands)

The Bureau of Labor Statistics revised US Casino Employment data downward from early 2016 to late 2017 by an average of 0.6%, with the deviation increasing to 1.3% in recent months. We adjusted our outlook for 2018, 2019, and 2020 downward by 1.1% to account for the data revision. Our rate-of-change forecast is unchanged.

Average US Casino Employment during the 12 months through April was down 3.2% from the prior year. Casino Employment is expected to decline through at least 2020

due to trends toward automation and online gambling.

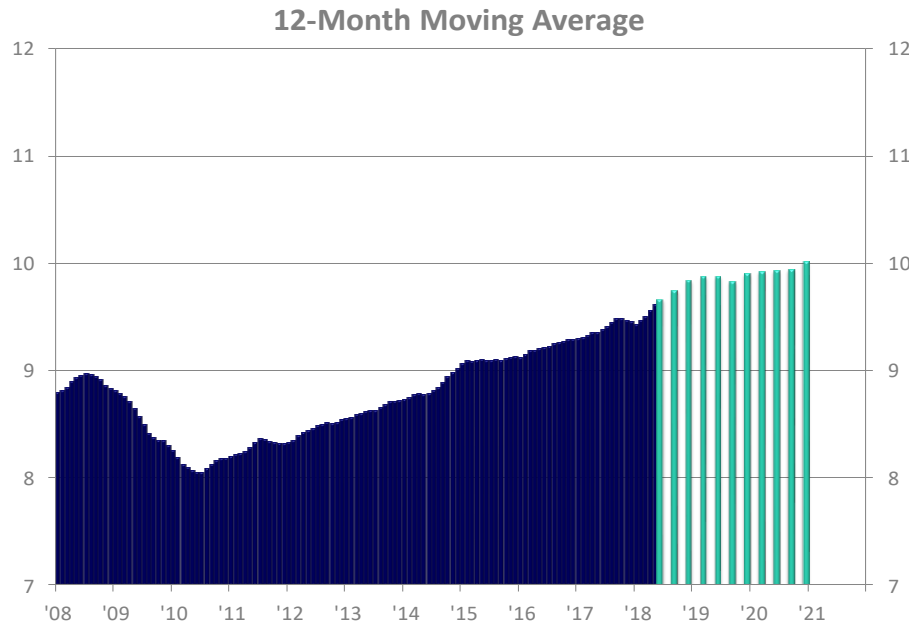
The US Supreme Court’s decision to overturn the Professional and Amateur Sports Protection Act of 1992 (which restricted sports betting to specific states) could reinvigorate the casino industry. This poses a potential upside risk to our forecast. Look for sales opportunities in states that are developing sports betting. However, do not commit significant resources to an industry that has a declining employment trend.

US Transportation & Material Moving Employment

Annual Trend: 9.608 million

Phase: B

Year-over-Year: 2.8%



Industry Outlook

2018: 9.833
2019: 9.892
2020: 10.010
 (millions)

Employment during the 12 months through March tracked along the upper end of the forecast range due to the best December-to-March percentage change on record. Additionally, May data and leading indicator evidence indicated that Employment was likely to outperform our previous forecast. The forecast was revised upward by 3.3% for 2018, 2.4% for 2019, and 3.1% for 2020. Expect Employment to generally rise though at least 2020.

Rising business-to-business activity and US Surface Trade

with Canada and Mexico will contribute to accelerating rise in the US Transportation Services Freight Index for at least the near term. This suggests rising demand for workers in this industry and supports our forecast expectation. However, uncertainty concerning NAFTA poses a potential downside risk to growth in US Surface Trade with Canada and Mexico, and consequently, to our Employment expectations.

Take advantage of accelerating growth in Employment this year, as growth will not be as robust in 2019.

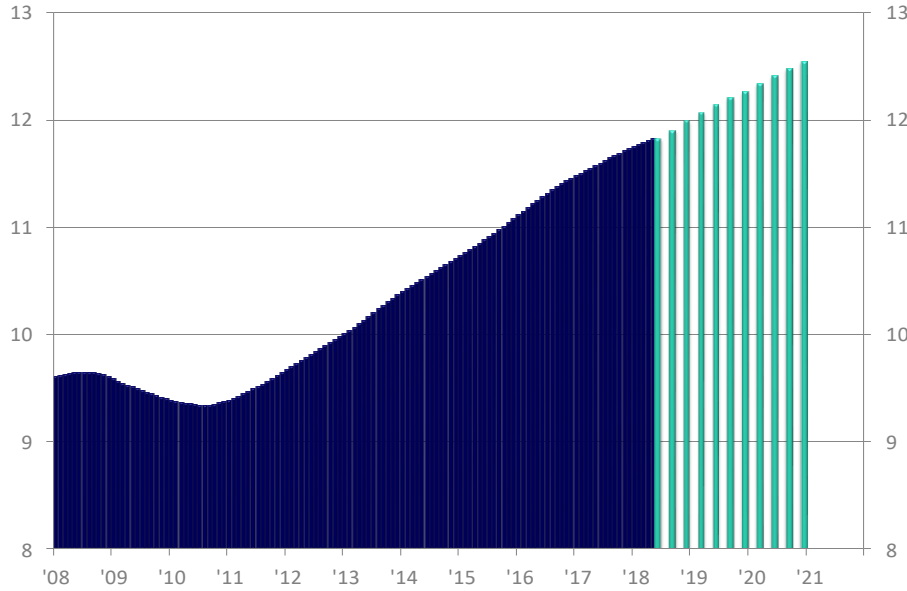
US Restaurant Employment

Annual Trend: 11.819 million

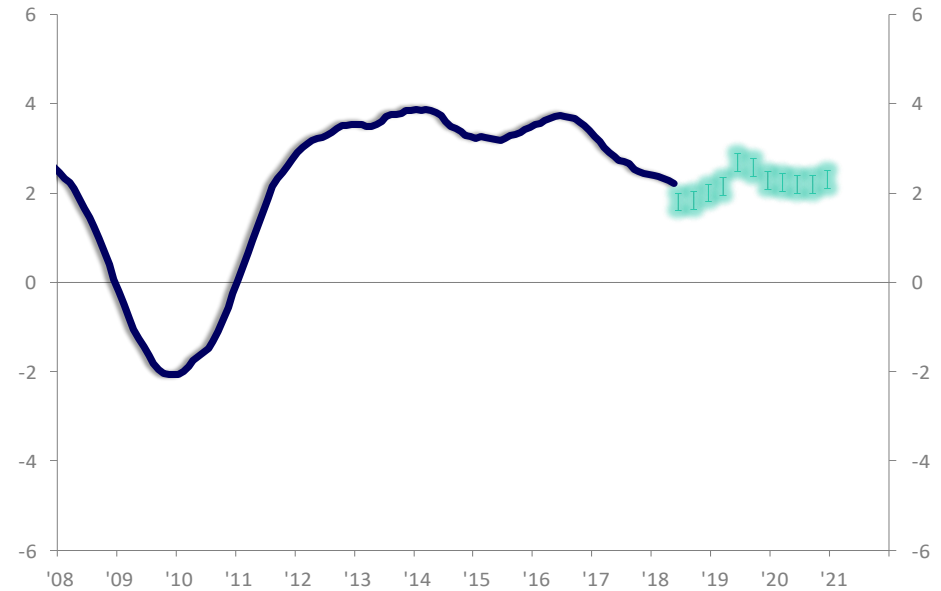
Phase: C

Year-over-Year: 2.2%

12-Month Moving Average



Year-over-Year Growth Rate



Industry Outlook

2018: 11.983
2019: 12.257
2020: 12.539
 (millions)

Annual US Restaurant Employment in May was up 2.2% from the year-ago level. We adjusted the annual rate-of-change forecast to account for a minor revision to historical data by the Bureau of Labor Statistics. The forecasted annual averages are unchanged.

Annual average Employment will rise at a steady pace through at least 2020. Anticipated rise in Retail Sales for Food Services and Drinking Places through at least 2020 supports our expectation of rise in Restaurant Employment.

Retail Sales for Full Service Restaurants (up 4.0% on an annual basis) are outpacing Retail Sales for Fast Food Establishments (up 1.9%), and have already transitioned to Phase B, Accelerating Growth. Employment in the fast food industry is at a greater risk due to the ability to substitute labor for automation. This poses a potential downside risk to opportunities for NAUMD members in this market. Focus sales and marketing efforts on the full service restaurant industry to take advantage of higher growth rates.

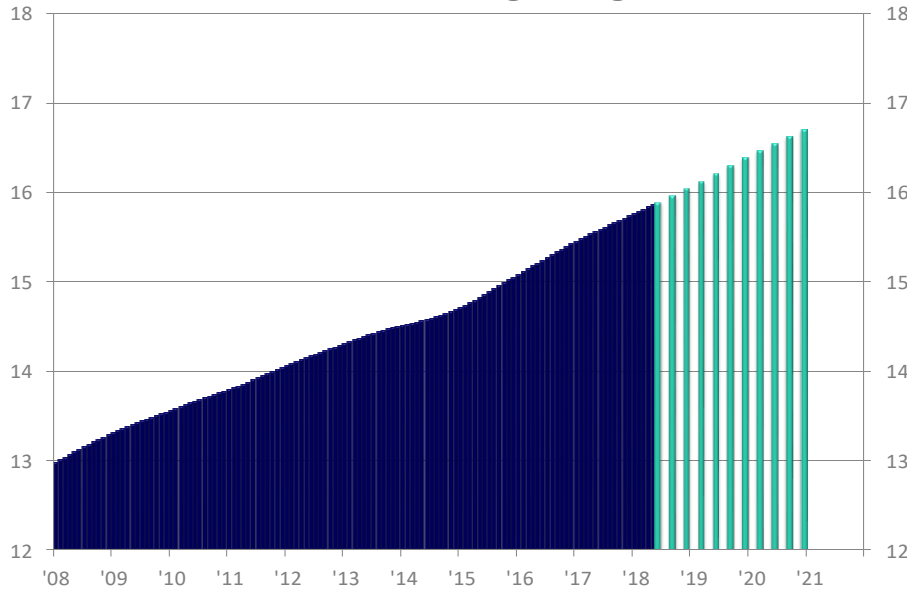
US Health Care Employment

Annual Trend: 15.855 million

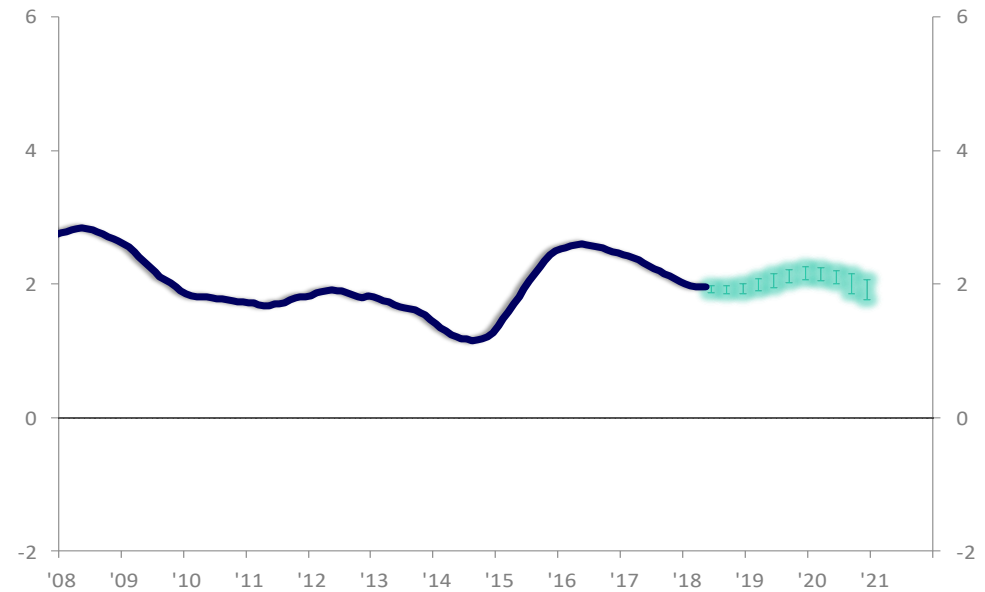
Phase: B

Year-over-Year: 2.0%

12-Month Moving Average



Year-over-Year Growth Rate



Industry Outlook

2018: 16.031

2019: 16.378

2020: 16.690

(millions)

US Healthcare Employment tentatively transitioned to Phase B, Accelerating Growth. We expect this trend to persist into early 2020. However, US Personal Consumption Expenditures for Medical Care and US Hospitals Service Revenue remain in Phase C, Slowing Growth, suggesting further decline in the Employment growth rate is possible. This is a downside risk to the forecast for the next three quarters.

Positive trends in other leading indicators outweigh this

near-term downside risk. Average annual Earnings of Healthcare Workers are accelerating, and US Medical Equipment and Supplies Production is expected to expand by the end of the year.

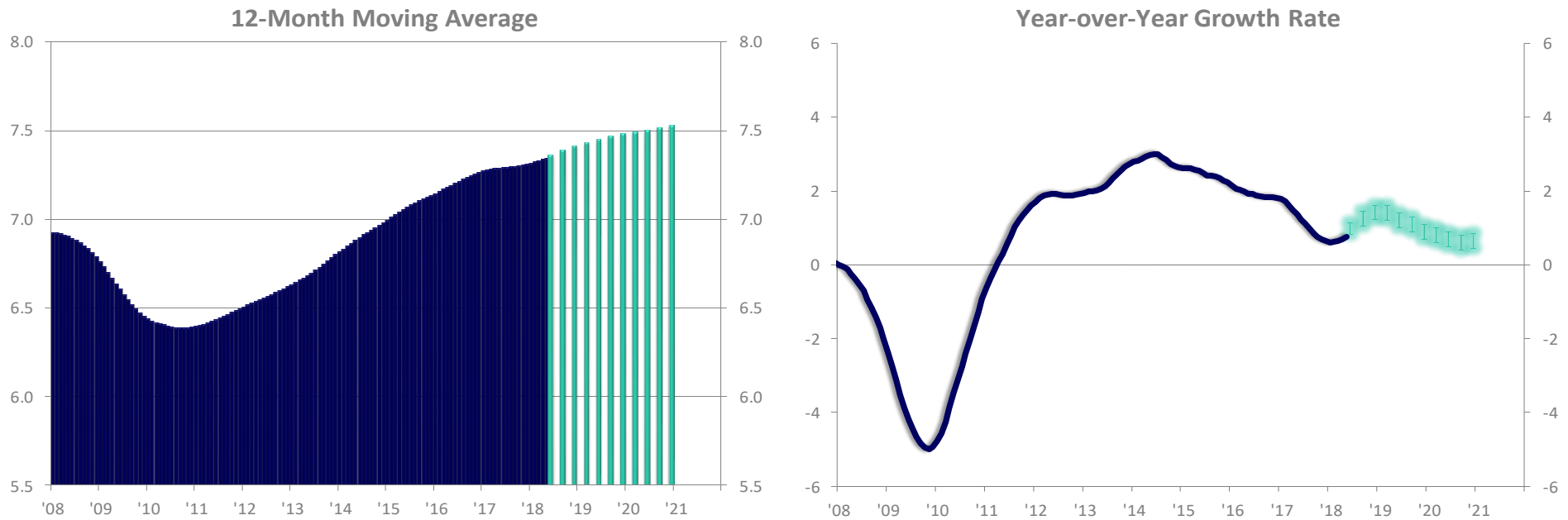
Steady annual growth in Health Care Employment through at least 2020 is a positive sign for NAUMD members. Consider targeting the home health care market, as expenditures in this market are growing at a faster pace than overall medical care.

US Selected Retail Trade Employment

Annual Trend: 7.341 million

Phase: B

Year-over-Year: 0.8%



Industry Outlook

2018: 7.411

2019: 7.477

2020: 7.526
(millions)

US Selected Retail Trade Employment during the 12 months through May averaged 0.8% higher than the year -ago level. Employment transitioned to Phase B, Accelerating Growth, in line with the forecast. The data was mildly revised downward by the US Bureau of Labor Statistic since the least report. We adjusted the forecast rates-of-change to account for the data revision. Our annual average forecast is unchanged. Expect Selected Retail Trade Employment to rise through at least 2020. Building Material and Garden Supply Stores will likely

provide the best near-term growth opportunities within the selected retail trade industry. Employment is up 2.2% year over year, and further acceleration is likely for at least the next two quarters.

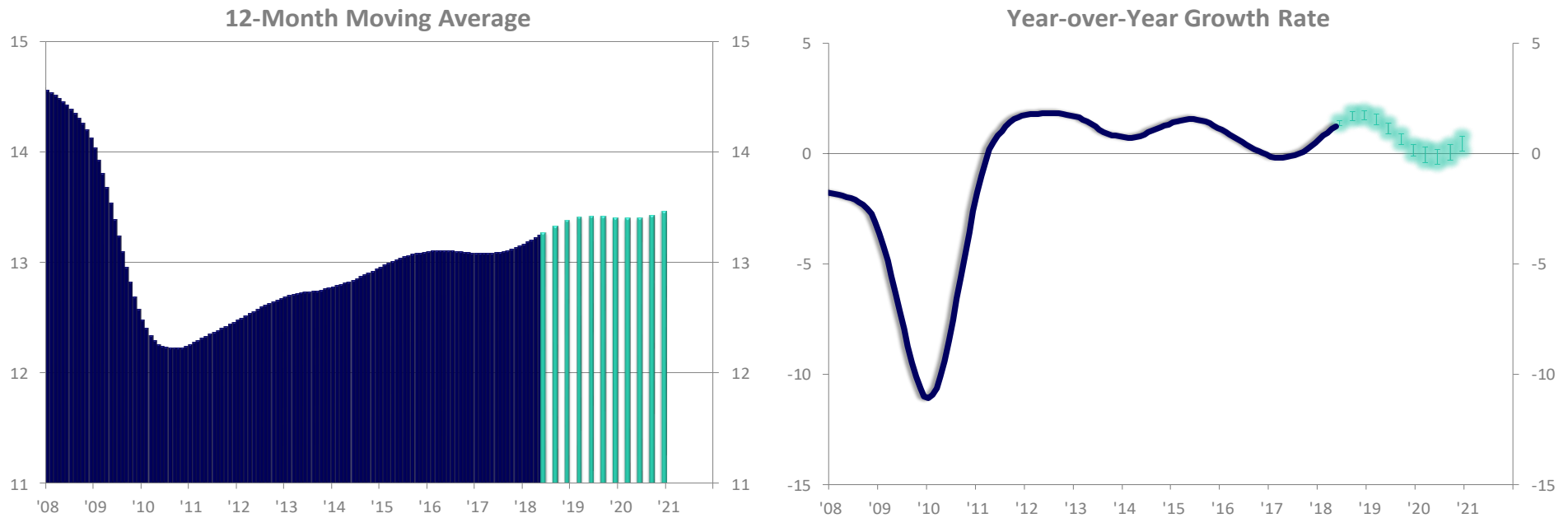
Employment at Motor Vehicle and Parts Dealers and Gas Stations, up 1.2% and 0.9%, respectively, is growing at a slowing pace. Food and Beverage Store Employment is nearly flat compared to the year-ago level but is expected to rise imminently. Growth rates are not static; avoid straight-line planning.

US Manufacturing, Utilities, and Oil & Gas Extraction Employment

Annual Trend: 13.243 million

Phase: B

Year-over-Year: 1.2%



Industry Outlook

2018: 13.375
2019: 13.395
2020: 13.455
(millions)

We revised our forecast for US Manufacturing, Utilities, and Oil & Gas Extraction Employment since the last report to account for a mild data revision by the Bureau of Labor Statistics and recent leading indicator evidence. Our expectations for annual Employment were raised by 1.7% for 2018 and 2.0% for 2019 and 2020.

Employment will rise into mid-2019 before plateauing into mid-2020. Rise will resume in the second half of 2020. Accelerating rise in US Industrial Production, US

Electric and Gas Utilities Production, and US Oil and Gas Extraction support our expectation for further rise in Employment.

Manufacturing Employment is growing faster than the other components, up 1.4% year over year. Oil and Gas Extraction Employment, the most volatile component, is 5.3% below the prior year, but the data is now rising and will likely provide growth opportunities in the near term. Utilities Employment is nearly flat with the year-ago level.

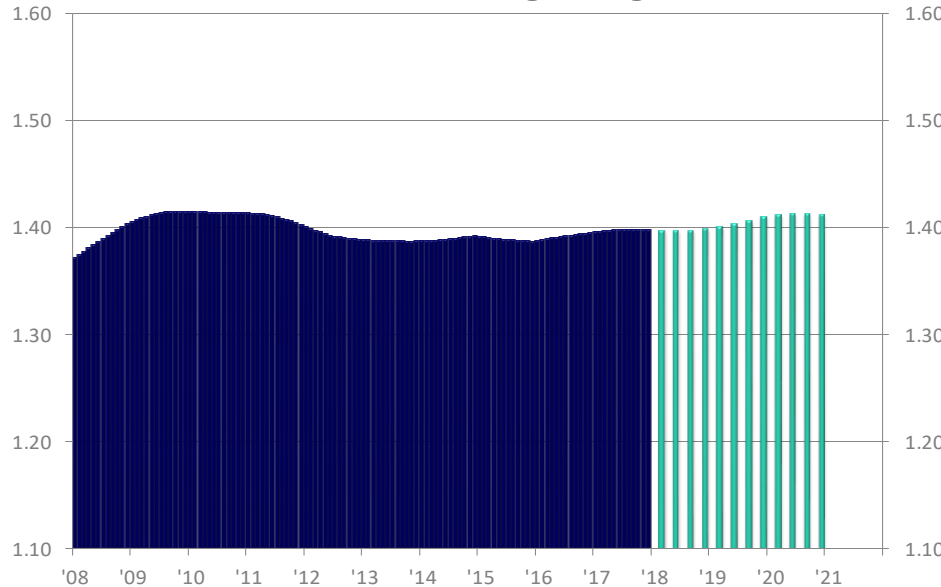
US Public Safety Employment

Annual Trend: 1.397 million

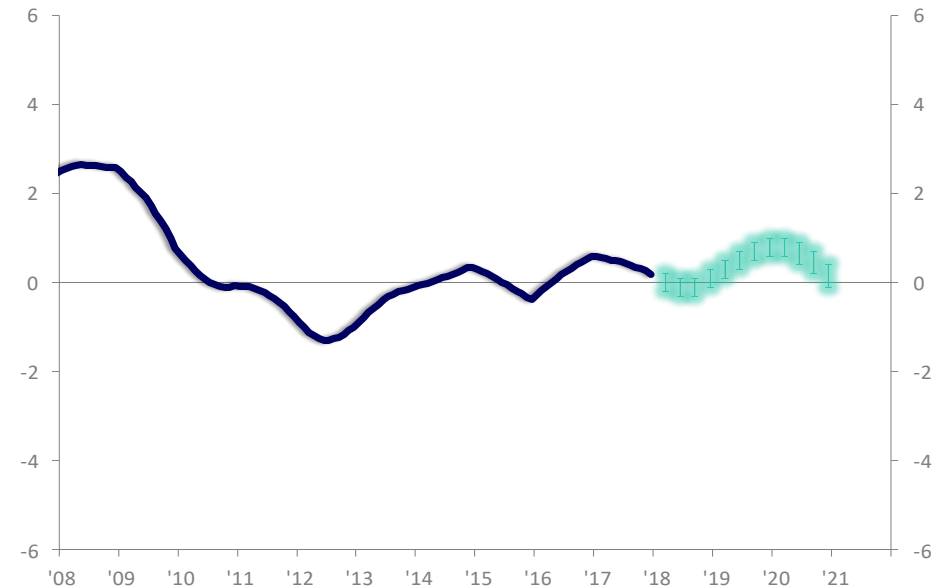
Phase: C

Year-over-Year: 0.2%

12-Month Moving Average



Year-over-Year Growth Rate



Industry Outlook

2018: 1.398

2019: 1.409

2020: 1.411

(millions)















US Public Safety Employment transitioned to Phase C, Slowing Growth, earlier than our forecast anticipated. The forecast was revised down 0.6% for 2018, up 0.2% for 2019, and down 0.4% for 2020. Expect annual average Employment to decline into mid-2018, before ending the year nearly flat with 2017. Employment will then rise from late 2018 into late 2020. Employment is expected to tick down in the fourth quarter of 2020.

US Total State and Local Government Construction, a

leading indicator for US Public Safety Employment, declined from mid-2016 into late 2017, suggesting upward momentum in Employment may be limited in the near term. Accelerating growth in US Gross Domestic Product since mid-2016 is boosting tax revenue. These funds could be used to finance public safety employment. However, given the time that it takes for tax revenue to be allocated, we don't expect upward trends in Employment until late 2018.

INDICATORS

US Leading Indicators

Indicator	Direction			What it means for the US economy
	2Q18	3Q18	4Q18	
ITR Leading Indicator™				<ul style="list-style-type: none"> • Decline in the ITR Leading Indicator and the US Purchasing Managers Index suggests that US Industrial Production will transition to a slowing pace of rise by the fourth quarter of this year. • The US Leading Indicator signals accelerating growth for US Industrial Production through the fourth quarter of 2018. • The ITR Consumer Activity Leading Indicator suggests that the consumer side of the economy may transition to a slowing pace of rise imminently.
ITR Consumer Activity Leading Indicator™				
US Leading Indicator				
US Purchasing Managers Index				
US Total Capacity Utilization Rate			N/A	
<p>Green denotes that the indicator signals cyclical rise for the economy in the given quarter. Red denotes the opposite.</p>				

Both business-to-business and consumer activity are rising at an accelerating rate. However, leading indicators suggest that upward momentum is waning. Expect growth in these markets to begin decelerating by the end of this year.

Appendix — Market Definitions

US Hotel and Motel Employment — Total employment of hotel and motel workers (excluding casino hotels) in the US, measured in millions of people, not seasonally adjusted (NSA).

US Casino Employment — Total employment of casino workers (excluding casino hotels) in the US, measured in thousands of people, NSA.

US Transportation & Material Moving Employment — Total employment of transportation and material moving workers in the US, measured in millions of people, NSA.

US Restaurant Employment — Total employment of workers in food services and drinking places in the US, measured in millions of people, NSA.

US Health Care Employment — Total number of employees employed in the health care industry in the US, measured in millions of people, NSA.

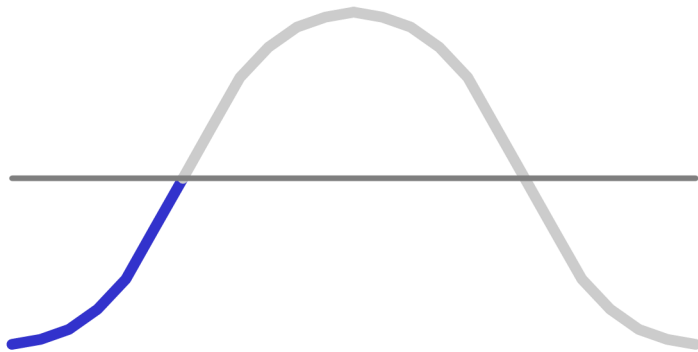
US Selected Retail Trade Employment — Total number of employees employed in the retail trade sector in the US, measured in millions of people, NSA.

US Manufacturing, Utilities, and Oil & Gas Extraction Employment — Total employment of workers in manufacturing, utilities, and oil and gas extraction in the US, measured in millions of people, NSA.

US Public Safety Employment — Total employment of public safety workers in the US, measured in millions of people, NSA. Includes police officers, fire fighters, correctional officers, and parole and probation officers employed by federal, state, and local governments.

Management Objectives™

Phase



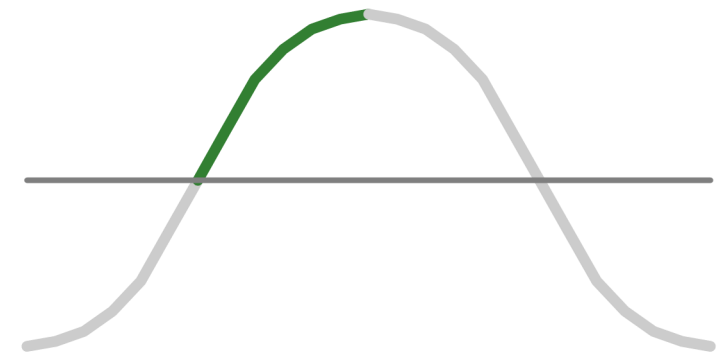
A

- 1 Model positive leadership (culture turns to behavior)
- 2 Establish tactical goals that lead to strategic achievement
- 3 Develop a system for measurement and accountability re: objective 2
- 4 Align compensation plans with objectives 2 and 3
- 5 Be keenly aware of the BE (Break Even) point and check it regularly
- 6 Judiciously expand credit
- 7 Check distributions systems for readiness to accommodate increased activity
- 8 Review and uncover competitive advantages
- 9 Invest in customer market research (know what they value)
- 10 Improve efficiencies with investment in technology and software
- 11 Start to phase out marginal opportunities
- 12 Add sales staff
- 13 Build inventories (consider lead time and turn rate)
- 14 Introduce new product lines
- 15 Determine capital equipment needs and place orders
- 16 Begin advertising and sales promotions
- 17 Hire "top" people
- 18 Implement plans for facilities expansion
- 19 Implement training programs

Management Objectives™

- 1 Accelerate training
- 2 Check the process flow for possible future bottlenecks
- 3 Continue to build inventory
- 4 Increase prices
- 5 Consider outside manufacturing sources if internal pressures are becoming tight
- 6 Find the answer to “What is next?”
- 7 Open distribution centers
- 8 Use improved cash flow to improve corporate governance
- 9 Use cash to create new competitive advantages
- 10 Watch your debt-to-equity ratio and ROI
- 11 Maintain/pursue quality; don’t let complacency set in
- 12 Stay in stock on A items, and be careful with C items
- 13 Consider selling the business in a climate of maximum “goodwill”
- 14 Penetrate new selected accounts
- 15 Develop plan for lower activity in traditional, mature markets
- 16 Freeze all expansion plans (unless related to “What is next?”)
- 17 Spin off undesirable operations
- 18 Consider taking on subcontract work if the backside of the cycle looks recessionary
- 19 Stay realistic – beware of linear budgets
- 20 Begin missionary efforts into new markets
- 21 Communicate competitive advantages to maintain margins

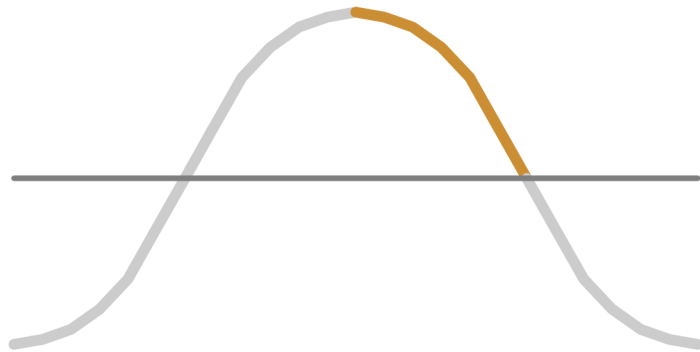
Phase



B

Management Objectives™

Phase



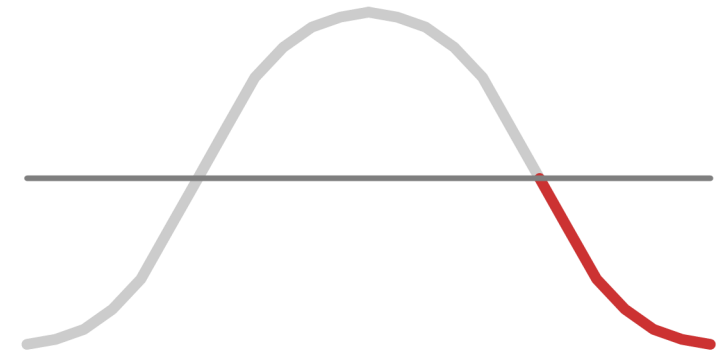
C

- 1 Begin workforce reductions
- 2 Set budget reduction goals by department
- 3 Avoid long-term purchase commitments late in the price cycle
- 4 Concentrate on cash and balance sheet
- 5 Reduce advertising and inventories
- 6 De-emphasize commodity/services in anticipation of diminishing margins
- 7 Weed out inferior products (lose the losers)
- 8 Encourage distributors to decrease inventory
- 9 Identify and overcome any competitive disadvantages
- 10 Make sure you and the management team are not in denial
- 11 Cross train key people
- 12 Watch accounts receivable aging
- 13 Increase the requirements for justifying capital expenditures
- 14 Evaluate vendors for strength (don't get caught honoring their warranties with no one to accept returned goods)
- 15 Manage the backlog through pricing and delivery; try to fill the funnel

Management Objectives™

- 1 Continue force reduction
- 2 Reduce advertising – be very selective
- 3 Continue to avoid long-term purchase commitments
- 4 Review all lease agreements
- 5 Increase the requirements for justifying capital equipment
- 6 Eliminate all overtime
- 7 Reduce overhead labor
- 8 Combine departments with like capabilities and reduce management
- 9 Select targets of opportunity where price will get the business
- 10 Tighten credit policies – increase scrutiny
- 11 Look for opportunistic purchases
- 12 Grab market share as your competitor dies
- 13 Prepare training programs
- 14 Negotiate union contracts, if possible
- 15 Develop advertising and marketing programs
- 16 Enter or renegotiate long-term leases
- 17 Look for additional vendors
- 18 Consider capital expenditures and acquisitions in light of market-by-market potential
- 19 Make acquisitions – use pessimism to your advantage
- 20 Lead with optimism and “can do” attitude to mitigate employee anxiety

Phase



D