Financial Market Weekly

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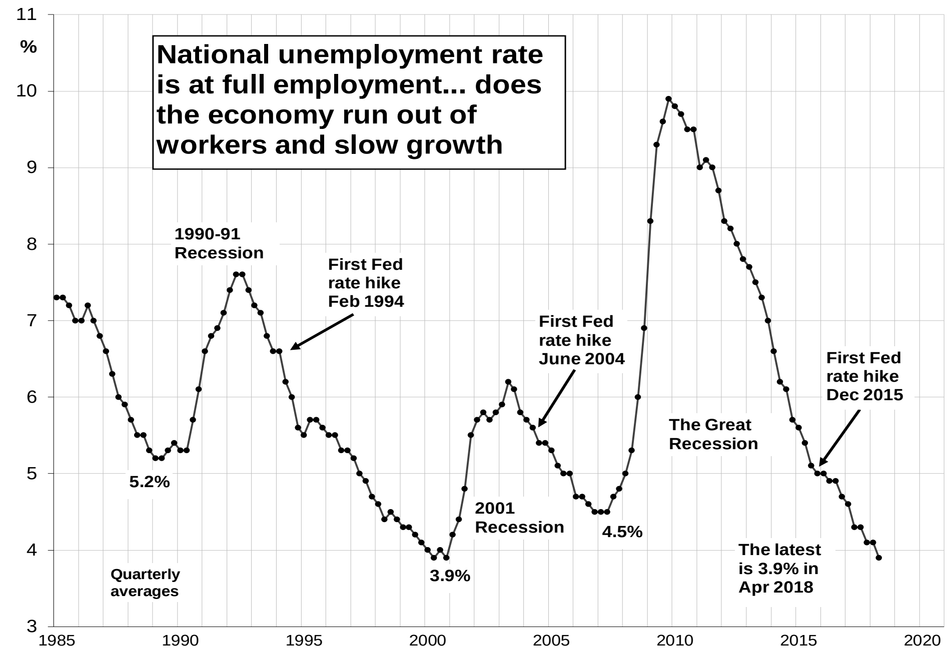
JOBS SLOW WITH LOW, LOW UNEMPLOYMENT, NO WAGES YET TO BE SEEN

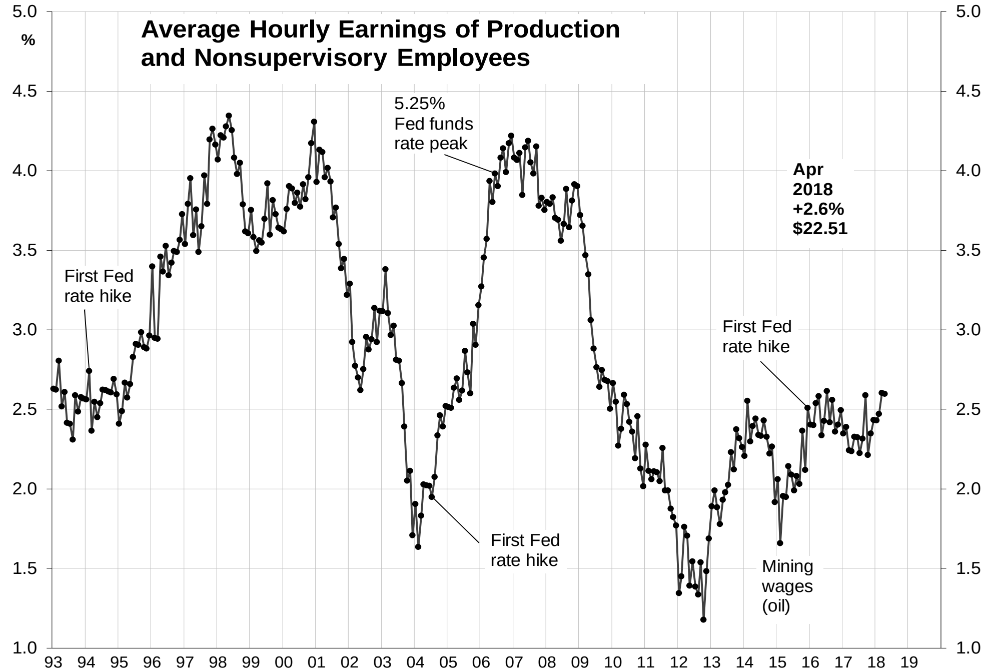


	Apr	Mar	Feb	Jan	Dec	Nov
Payroll jobs (000s)	164	135	324	176	175	216
Unemployment rate %	3.9	4.1	4.1	4.1	4.1	4.1
Unemployment (3 decimal)	3.929	4.071	4.142	4.149	4.095	4.121
Participation rate %	62.8	62.9	63.0	62.7	62.7	62.7
Average hourly earnings	$26.84	$26.80	$26.74	$26.71	$26.64	$26.54
MTM % Chg	0.1	0.2	0.1	0.3	0.4	0.3
YOY % Chg	2.6	2.6	2.6	2.8	2.7	2.5
Production Worker earnings	$22.51	$22.46	$22.39	$22.34	$22.31	$22.23
MTM % Chg	0.2	0.3	0.2	0.1	0.4	0.2
YOY % Chg	2.6	2.6	2.5	2.4	2.4	2.3

We didn't get much news from Trump's economics team in China overnight to trade on, maybe a good thing for the stock market, so let's look at the BLS monthly employment situation report for April. The market always trades on that. The unemployment rate dropped two-tenths to 3.9%, which may explain why payroll jobs are slowing down, 164K in April after 135K in March. Payroll jobs are slowing down because there is no one left to hire in America with the unemployment rate at rock bottom lows: there is no labor pool for employers to draw upon for help. We aren't going to see the 3% sustained GDP growth the Trump administration is banking on, if employment and paychecks and consumer spending are not rising. Who says an economic expansion cannot die of old age? We are going to test that economic theory in the months to come. Certainly by the end of 2019.

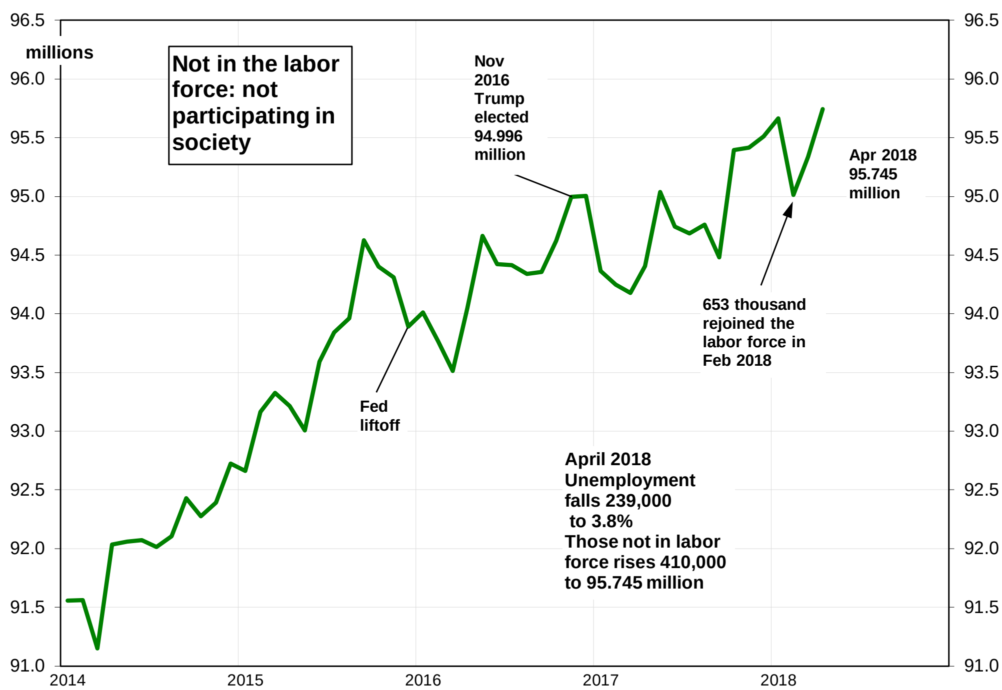
Speaking of wages, it is a tale of two cities here, and who do you believe? Average hourly earnings are not going up. Average hourly earnings rose 0.1% to $26.84 in April which is an increase of 2.6% over the last year (just missed being 2.5%). Meanwhile, the employment cost index last week for the first quarter said wages and salaries were rising 2.9%. Not so much different than 2.6% for today's average hourly earnings measure. The difference in the two comes in knowing average hourly earnings were rising over 4% per year the last two times that the economy was at full employment in the late 90s and mid-2000s, so it looks like 2.6% is not indicating we are at full employment. Miles to go.

Worker wages look better this month; may move higher.



However, the employment cost index measure of wages never got that high and indicates wages are as good as they are going to get. 2.9 today and maybe 3.2-3.3 percent max.

The President cheered 3.9% unemployment; has forgotten his claim about labor force dropouts “the 90 million people that aren’t working…so our real unemployment rate is 42%.”



So don't go overboard with the idea there are no wages given today's average hourly earnings data. Anyway, we still think inflation drives wages not tight labor market conditions. Not so much inflation, and no inflation expectations, is keeping wages low... average hourly earnings.

The bond market in its wisdom seems to think this is not a strong economy report, one that might make the Fed hurry-up with rate hikes 4 times this year not three times. Average hourly earnings were weak at 2.6%. It was 2.9% that set off an inflation scare a few months ago in the bond market. 10-yr yields were 2.93% before the economic news at 830 New York time and rallied 2 bps to 2.91% fifteen minutes later.

Net, net, the economy continues to power ahead driving unemployment to the lowest level in almost two decades. The unemployment rate fell as low as 3.8% in April 2000 during the stock market bubble years with strong 5% real GDP growth.

The labor market is heating up with workers in short supply, but companies are still not paying up to bring in help despite one of the tightest labor markets in a generation. Fed officials can rest easy that there is not any wage-based inflation on the horizon and keep the economy on course with their projections for three rate hikes in 2018. There is no need to speed up the path of interest rates because at this point inflation is barely even on the radar.

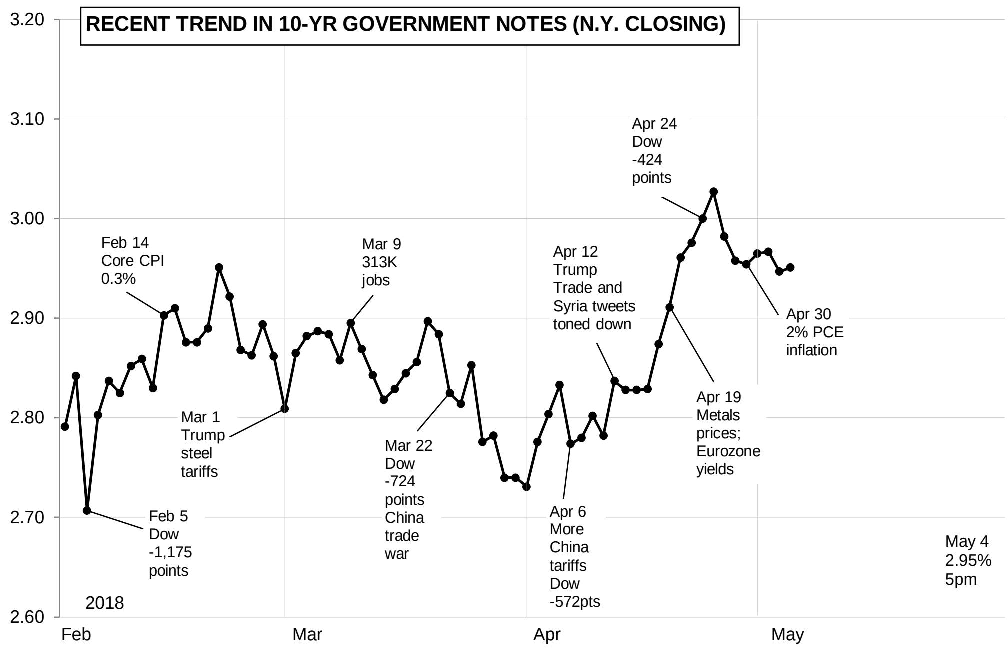
Payroll jobs in year nine following the recession

Dec. 2017 Totals millions		Apr 18	Mar 18	Feb 18	4 months Dec 17 to Apr 18	12 months Dec 16 to Dec 17
147.625	Nonfarm Payroll Employment	164	135	324	799	2188
125.294	Total Private (ex-Govt)	168	135	321	812	2163
20.328	Goods-producing	49	20	107	231	509
0.648	Mining	8	8	9	31	53
12.558	Manufacturing	24	22	31	97	207
0.956	Motor Vehicles & parts	-1	1	4	4	4
7.072	Construction	17	-10	67	102	250
104.966	Private Service-providing	119	115	214	581	1654
27.593	**Trade, transportation, utilities**	-7	32	68	127	169
15.861	Retail stores	2	6	46	66	-29
3.122	General Merchandise	8	-8	15	13	-51
3.100	Food & Beverage stores	2	-3	3	-2	3
5.236	Transportation/warehousing	0	16	18	49	135
1.460	Truck transport	-6	7	3	11	9
0.708	Couriers/messengers	6	6	2	22	39
1.011	Warehousing and storage	6	3	3	14	43
0.554	Utilities	1	0	1	1	-3
2.776	**Information**	7	6	-1	-4	-36
8.511	**Financial**	2	4	29	38	142
2.664	Insurance	-4	-1	7	1	38
2.220	Real Estate	2	6	8	19	60
1.323	Commercial Banking	2	1	3	3	5
0.951	Securities/investments	2	2	6	14	20
20.677	**Professional/business**	54	39	61	192	458
2.998	Temp help services	10	-2	22	29	96
2.308	Management of companies	0	4	2	7	38
1.456	Architectural/engineering	5	-4	7	11	45
2.065	Computer systems/services	7	6	7	27	47
1.137	Legal services	1	0	-1	-1	5
0.982	Accounting/bookkeeping	3	10	1	7	-3
23.380	**Education and health**	31	24	32	137	458
5.124	Hospitals	8	7	11	36	70
3.696	Educational services	1	-8	-12	1	77
16.207	**Leisure and hospitality**	18	8	18	65	354
2.014	Hotel/motels	4	5	3	14	31
11.844	Eating & drinking places	15	4	18	57	261
22.331	Government	-4	0	3	-13	25
2.182	Federal ex-Post Office	2	0	1	5	-12
5.129	State government	-7	-1	-7	-25	-16
2.462	State Govt Education	-5	0	-7	-19	-1
14.407	Local government	2	0	15	13	56
7.938	Local Govt Education	3	-3	12	-1	28

Our biggest concern is that America is running out of workers for companies to employ and that this will have negative consequences for the economic outlook soon. The economy starts its tenth year of recovery from the recession in July and the risk is that growth may slow dramatically later in 2019 and into 2020 as the economy hits the wall of full employment. Stay tuned. Story developing.

MARKETS OUTLOOK

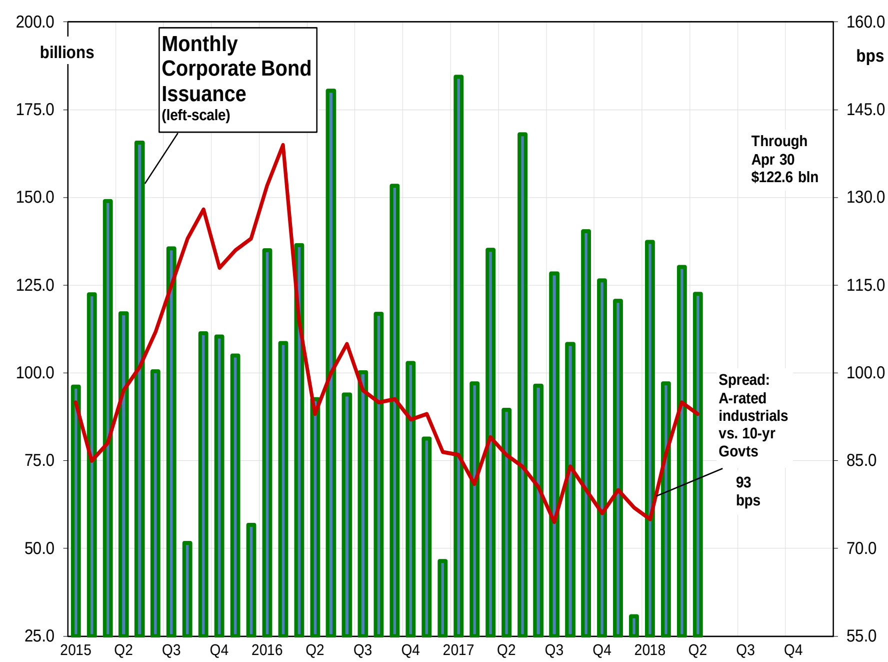
	29-Mar 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.97	3.10	3.10	3.20	3.35	3.45	3.60	3.55	3.75	3.75	3.90	4.00
10-Yr Note	2.74	2.80	2.90	3.00	3.20	3.30	3.50	3.50	3.70	3.70	3.90	4.00
5-Yr Note	2.56	2.60	2.70	2.80	3.05	3.15	3.40	3.45	3.65	3.65	3.90	4.00
2-Yr Note	2.27	2.40	2.55	2.80	3.00	3.15	3.40	3.40	3.60	3.80	4.00	4.20
3-month Libor	2.31	2.30	2.55	2.80	3.05	3.30	3.55	3.55	3.70	3.95	3.95	4.20
Fed Funds Rate	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00
2s/10s spread	47	40	35	20	20	15	10	10	10	(10)	(10)	(20)



10-yr Treasury yields closed 2.95% on Monday and 2.95% on Friday despite lots of news like inflation hitting the Fed's 2% target, a FOMC meeting, Trump's economics team goes to China, the monthly employment report. Supply is the most interesting market factor now, as it looks like growth and inflation won't alter the Fed's set-in-stone rates path. The Treasury auctions $31 billion 3-yrs on Tuesday May 8, $25 billion 10-yrs on Wednesday, May 9, and $17 billion 30-yrs on Thursday, May 10. Auction sizes are going up $1 billion for 10s/30s this quarterly refunding (3-yrs up $5 billion), and foreign purchases may be going down, let's see what happens to bond yields.

CORPORATES: TRANSCANADA, FORD, TEXAS INSTRUMENTS, HERSHEY

Corporate offerings were $23.8 billion in the May 4 week versus $27.4 billion in the April 27 week. On Thursday, Mondelez International sold $2.5 billion 2s/5s/10s/30s. It priced a $700 million 4.125% 10-yr (m-w +20bp) at 130 bps (Baa1/BBB). The global snacks company will use the proceeds to repay a 364-day revolving credit facility, and outstanding commercial paper. Corporate bonds (10-yr Industrials rated A2) were 93 bps above 10-yr Treasuries this week versus 92 bps last Friday.



FEDERAL RESERVE POLICY

The Fed met Wednesday and issued a statement at 2 o'clock. Glad we were at our desk. Not a lot had happened in the markets before they issued their communique. Not much happened after either. 10-yr yields were 2.97% when the minutes were released. Yields were 2.97% a half hour later in "trading" after the Fed's news. The Fed has stopped moving the markets having laid out a gradual path for interest rates that is hard to find fault with. Don't feel bad Fed officials. Not seeing the love. No one caring what you do or say. The U.S. Treasury announced it was increasing its debt sales this morning and the bond market didn't move on that news either. All news is fake news for the bond market.

Lots of word play in this meeting's press statement. They took the scissors out and cut the sentence on "The economic outlook has strengthened in recent months." Does that mean they think it has already strengthened, that is, it is now strong? Or is their reading of the data not consistent with an economic outlook that is still strengthening? Tough talk on trade hurting the outlook? Answer: the economy has already strengthened, it has not strengthened even further from the March meeting. Drop the old-news sentence.

May 2, 2018 Fed Statement	March 21, 2018 Fed Statement
Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with further gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace in the medium term and labor market conditions will remain strong. Inflation on a 12-month basis is expected to run near the Committee's symmetric 2 percent objective over the medium term. Risks to the economic outlook appear roughly balanced.	Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The economic outlook has strengthened in recent months. The Committee expects that, with further gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace in the medium term and labor market conditions will remain strong. Inflation on a 12-month basis is expected to move up in coming months and to stabilize around the Committee's 2 percent objective over the medium term. Near-term risks to the economic outlook appear roughly balanced, but the Committee is monitoring inflation developments closely.

The old balance of risks statement is completely evened up now roughly speaking. Risks are balanced for a longer time into the future as well as they no longer refer to these as near-term risks. Near-term drops out of the statement. And they no longer say they are monitoring inflation developments closely, which signals to us that they do not foresee the need to take any rate hikes off the table and can continue, almost automatically regardless of the incoming data, with the plan to hike rates three times this year and three times again in 2019. They are no longer hedging their bets, they are going to raise rates three times this year with the risks balanced. The fact that they added the word symmetric to the inflation 2% objective is not as meaningful. They have had a symmetric inflation target for some time, where inflation can run above 2%, and the word symmetric is also in the last paragraph of the Fed statement. It does not mean they aren’t going to raise interest rates to 3.5% in 2020 if inflation moves a little above 2%.

Net, net, if the risks are balancing up for the economic outlook, with low-inflation no longer a concern, then the Federal Reserve can continue to mop up the liquidity left over from the recession and financial crisis, and move interest rates up gradually to more normal levels.

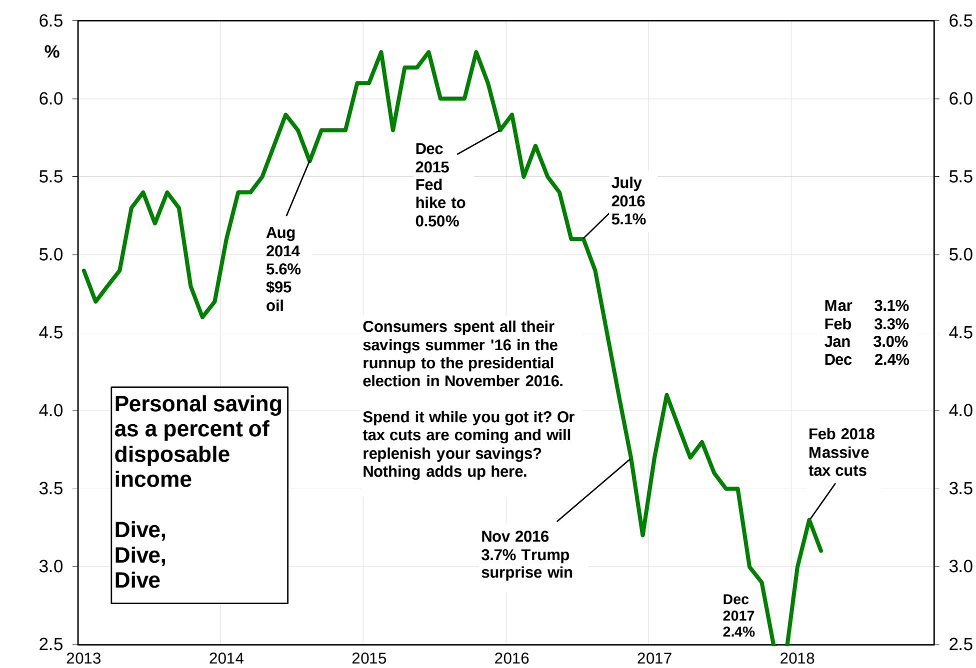
Unfortunately, one piece of the monetary policy jigsaw puzzle was not to be found in Wednesday's press statement. The Fed's forecasts, like the economic outlook, are roughly balanced between two more, and three more rate hikes this year. There was no information in Wednesday's statement shedding light on whether the Fed funds rate would end the year at 2.25 or 2.5 percent. The committee forecasts were split in March with 8 Fed officials saying the Fed funds rate would be 2.25% or lower in 2018, and 7 Fed officials saying the Fed funds rate would be higher than 2.25%. Our advice to investors is to flip a coin if you want to know where the Fed funds rate will be at the end of the year, the Fed is. Bet on it.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	2-May	25-Apr	18-Apr	11-Apr	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2395.460	2413.218	2413.079	2413.060	479.782
Federal agency debt securities	4.391	4.391	4.391	4.391	0.000
Mortgage-backed securities	1744.972	1744.967	1756.290	1754.369	0.000
Primary credit (Discount Window)	0.160	0.034	0.000	0.000	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.714	1.714	1.710	1.709	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	0.000
Central bank liquidity swaps	0.117	0.082	0.082	0.079	62.000
Federal Reserve Assets	4403.6	4420.5	4433.3	4431.2	961.7
3-month Libor %	2.36	2.37	2.36	2.34	2.82
Factors draining reserves					
Currency in circulation	1646.124	1643.335	1642.295	1640.817	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	6.520	3.570	14.021	2.361	0.000
Reserve Balances (Net Liquidity)	1991.823	2010.948	2067.159	2128.844	24.964
Treasuries within 15 days	26.228	34.346	34.346	0.229	14.955
Treasuries 16 to 90 days	90.359	86.284	86.282	119.506	31.549
Treasuries 91 days to 1 year	290.878	289.432	289.430	290.370	69.272
Treasuries over 1-yr to 5 years	1068.418	1079.938	1079.919	1080.029	170.807
Treasuries over 5-yrs to 10 years	304.579	308.277	308.229	296.322	91.863
Treasuries over 10-years	614.998	614.941	614.872	626.605	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

OTHER ECONOMIC NEWS THIS WEEK

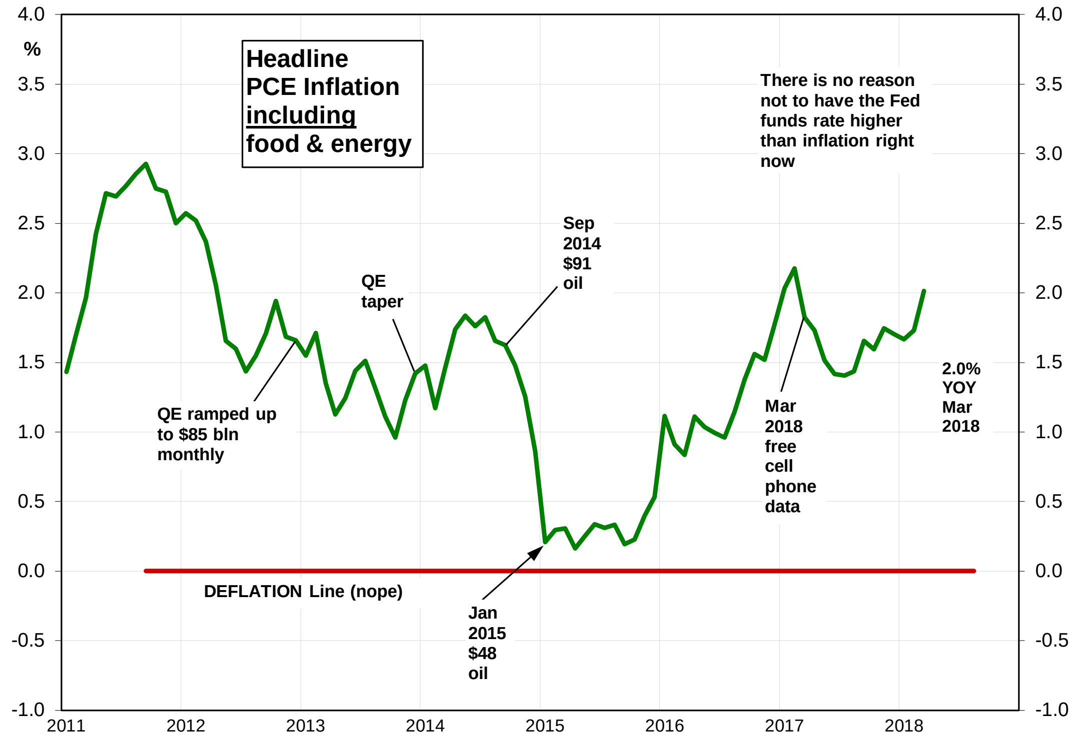
Consumer emerges from winter hibernation, inflation reaches Fed's goal (Monday)

Breaking economy news. The March personal income report is out with consumer spending and the Fed's preferred PCE inflation measure.



Consumers emerged from a long winter hibernation with real expenditures jumping 0.4% in March after dropping in January and February. This rebound in spending looks like consumers finally went out and spent their tax cuts. There is image and reality always when it comes to reading the economic data however. Consumers have been juggling their finances in recent months between spending and saving. Consumer spending was red hot in the fourth quarter as consumers raided their piggy banks, but then the savings rate returned to more normal levels in early 2018, making it look like consumers were saving their tax cuts. But instead, it looks like they spent the money early late last year even before the change in tax withholding rates put more cash in consumers' pockets. The saving-spending trend is hard to read, but the early story is that consumer spending will not boost economic growth as fast as many economists are expecting this year from those historic tax cuts. Consumer spending certainly did not jump after the payroll tax holiday stimulus back in 2011 and 2012.

With the rebound in March, there is a lot of spending momentum going into the second quarter with real consumer expenditures up 0.9% already even if the consumer doesn't spend a dime in April, May, or June. Spending of 4.0% in Q4 was too hot, and spending of 1.1% in Q1 was too cold, but spending in the second quarter is on its way to somewhere in the middle which is just right.



Meanwhile, inflation is back to target which puts the ball in the Fed's court when it comes to the decision on where to set interest rates. Normal rates are 3% based on their own calculation, so how fast should they raise the 1.75% Fed funds rate to normal is the overriding question. They are behind the curve after this morning's report with headline PCE inflation at the 2.0% objective and the labor markets have been at full employment for many months now.

The inflation-busting cell phone data plan effect from last year washes out of the year on year data, so March headline inflation rose from 1.7% to 2.0%, and more sustainable inflation, core inflation, got a bump to 1.9% from 1.6%. The bond market knew this already of course coming in this morning so yields are not trying to discount the Federal Reserve moving quicker or higher certainly. 10-yr yields were 2.96% at the data release time of 830am on the East Coast, and thirty minutes later are 1 basis point lower at 2.95%.

Net, net, spring is here, and consumers have reengaged with the economy, spending their tax cuts and creating more demand that is lighting the fuse that will heat up inflation. Federal Reserve officials are right to continue with the gradual pace of rate hikes this year as the economic slowdown in the first quarter was just a temporary soft patch on the road to prosperity. Real consumption expenditures fell in January and February, but the surge in March expenditures will strengthen the economy and certainly push growth faster than 2.3% in the second quarter.

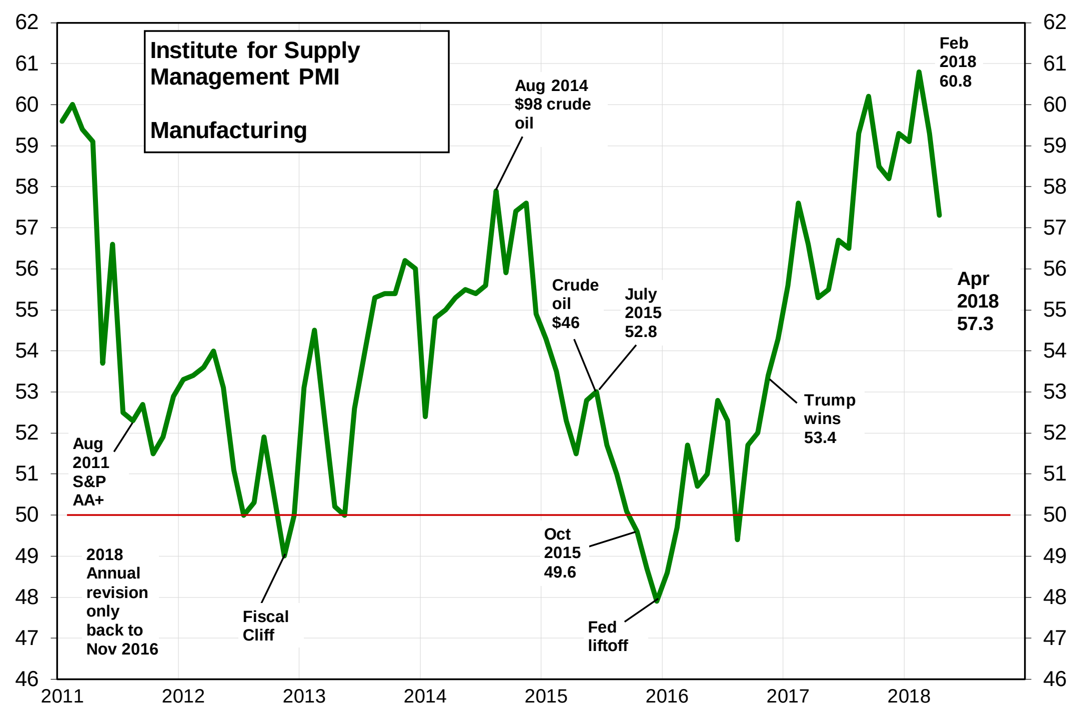
For now, all is well for the economy as consumers are back spending money that helps make the economy grow. The 2018 outlook is a little brighter today as the talk of trade wars has not led to a loss of confidence on the part of consumers. The consumer has emerged from the winter's hibernation, and inflation is heating up to the Fed's goal, so interest rates are headed higher. Bet on it. The economy is normal with the risks slightly skewed to the overheating side and interest rates need to be higher to make sure economic demand does not push inflation too high and derail the long economic expansion.

Manufacturers cite increasing shortages, investment in construction is flat (Tuesday)

Breaking economy news. The ISM manufacturing survey fell 2 points to 57.3 in April while employment fell a few points to 54.2 and prices moved up from 78.1 in March to 79.3 in April.

Private nonresidential construction spending fell slightly in March and has moved sideways since Trump's election in November 2016. Companies have invested enough for now in offices, factories, shopping malls, warehouses, and even the biggest corporate tax cut in history is not leading to more business investment in structures.

Net, net, companies were less optimistic than they have been, although they remain confident in the outlook overall. There is just the nagging question of whether they have enough supply of materials on hand or have all the workers they need to keep the economic growth juggernaut going another year into the record books.



As many of the inputs that go into manufacturing comes from goods imported from overseas, business planning for the longer run has pretty much come to a standstill until there is clarity on the looming question of tariffs and quotas. There is strong demand overall and order books and backorders remain strong, but there is a cloud out there on the horizon from the imports issue.

Companies supply chains have depended on imports for decades now, and if the flow of materials stops, then manufacturing is going to suffer the consequences. We hope that the Trump administration focus on America first is not the straw that breaks the camel's back and brings the long economic expansion to a screeching halt.

To tell the truth we have forgotten what the reason was for reopening negotiations on trade. If the reason is to create more jobs in the US, the administration is living in the past because the economy has reached full employment and there is no one to staff those factory floors as it is, let alone find the workers to place in new factories. Stay tuned. Story developing. Better get that Mercedes and BMW in the driveway while you still can. The price is only likely to go higher. Bet on it.

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