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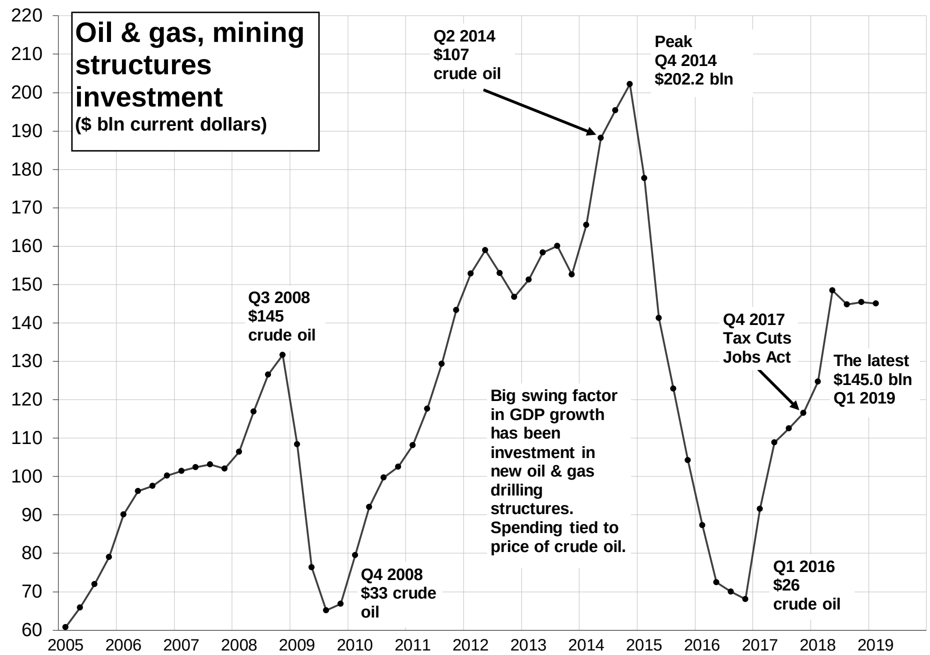
THERE'S NOT ENOUGH FRACKING INVESTMENT IN THE COUNTRY

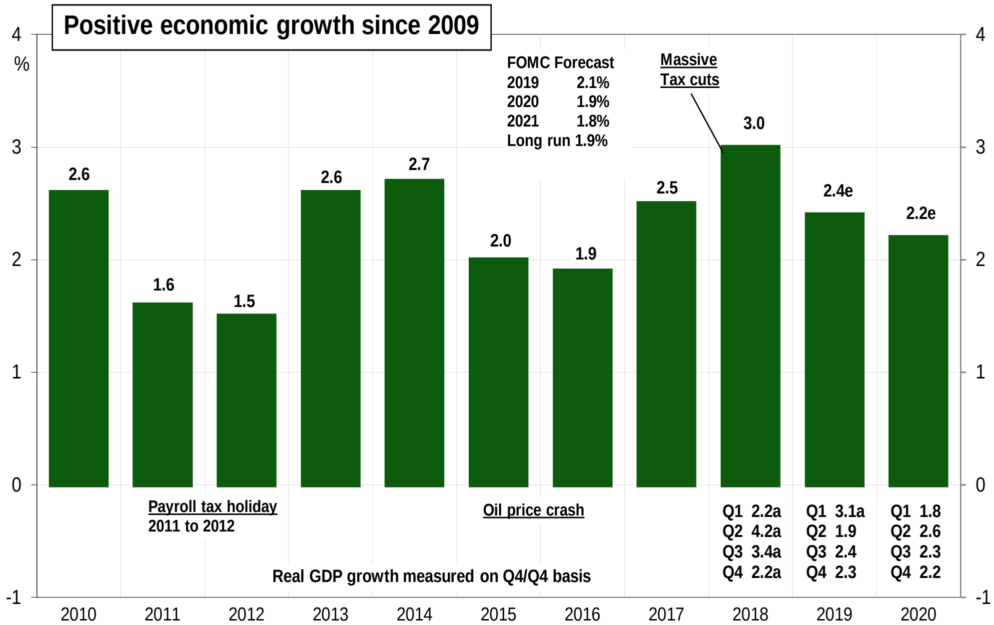


GDP was out Thursday. Q1 growth is now 3.1% where it was 3.2%. Q2 data isn't out until July 26, but it is not looking good as the latest Atlanta Fed [GDPNow estimate] is 1.2%. The country needs more investment, is often the cry, to stoke the fires of economic growth. One of the drivers of investment growth and in GDP has been oil & gas drilling. In 2018 nominal GDP rose 5.2% (real GDP 2.9%); business investment rose 8.2%, where $51.7 billion of spending on structures was 24.5% of the $211.2 billion increase in business investment (ex-inventories and housing starts). Almost two-thirds (64.8) of the investment in structures in 2018 was oil & gas drilling which looks to have topped out for now, maybe in part because crude oil is 50 dollars not the 75 dollar level last year before the crash in markets.

	Q1 17	Q2 17	Q3 17	Q4 17	YOY%	Q1 18	Q2 18	Q3 18	Q4 18	YOY%	Q1 19	SAAR
Structures ($billion)	577.5	588.3	585.3	590.6	6.1	614.9	644.1	643.3	646.0	9.4	653.2	4.5
Commercial and health care	179.7	181.1	179.9	181.6	0.6	189.2	189.4	188.0	187.8	3.4	192.3	9.6
Manufacturing	68.3	66.2	64.5	64.2	-11.9	63.7	61.1	63.8	65.9	2.6	67.1	7.3
Power and communication	122.4	116.3	112.7	109.8	-9.3	116.6	121.3	120.4	117.0	6.6	117.8	2.7
Mining exploration, shafts, and wells	91.6	108.9	112.5	116.5	71.3	124.7	148.5	144.8	145.4	24.8	145.0	-1.1
Other structures *	115.6	115.8	115.7	118.5	3.7	120.7	123.7	126.3	129.8	9.5	130.9	3.4

* Religious, educational, vocational, lodging, railroads, farm, and amusement and recreational structures, other

Investment spending on structures was 4.5% in the first quarter at a seasonally adjusted annual rate (SAAR), with commercial and health care up 9.6% and manufacturing construction increasing 7.3%.

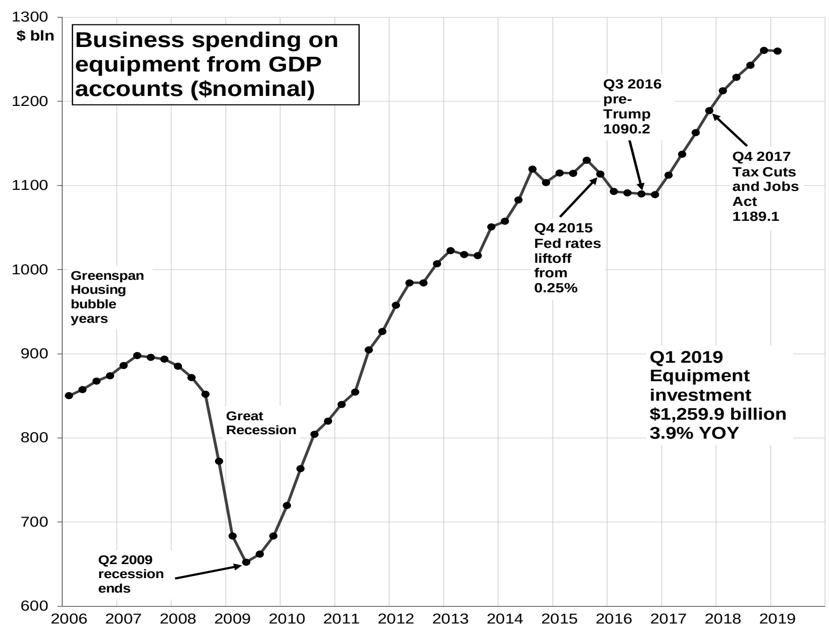


Investment spending on equipment was down a little in the first quarter, but the overall trend is a strong one despite the trade war which is still escalating of course. Equipment purchases slowed in 2015-16 with the crash in oil prices and perhaps the recent oil sell-off from $75 is slowing new orders again. At this point, there is no sign of recession-type uncertainty leading to a postponement of new equipment orders as it did ten years ago in the Great Recession.

We haven't changed our GDP forecast that much yet from the trade wars. We don't know if the 25% tariffs on the rest of the 2018 $539.5 billion of imported goods from China will happen. Same thing with the $346.5 billion of imports from Mexico in 2018. If the trade deficit narrows further as tariffs reduce imports more than exports, GDP could see a boost. Fed officials look for 1.9% GDP growth in 2020, not exactly recession, and we expect 2.2%. For this year, we expect GDP to slow to 1.9% in the second quarter before rebounding somewhat, making for full year 2019 Q4/Q4 growth of 2.4%.

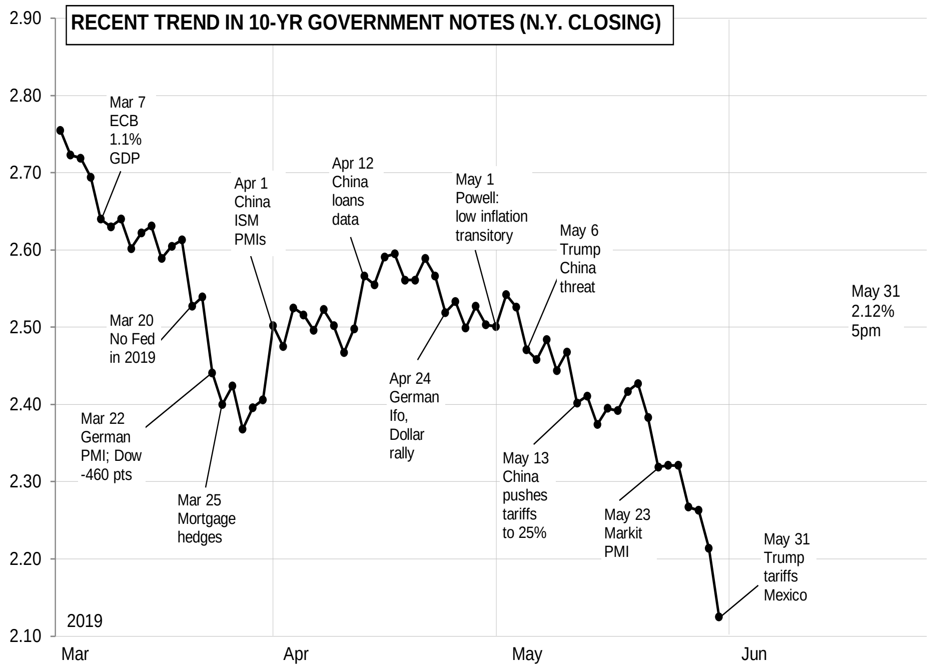
Business equipment spending needs no encouraging rate cuts from the Federal Reserve

Business Investment Spending in the nominal GDP accounts			$Bln
Q1 2019 $bln	Level	% YOY	YOY
Equipment	1259.9	3.9	47.3
Intellectual Property	978.5	9.6	85.8
Construction			
Business structures	653.2	6.2	38.3
Mining, shafts, wells	145.0	16.3	20.3
Other	508.2	3.7	18.0
Total	2891.5	6.3	171.2



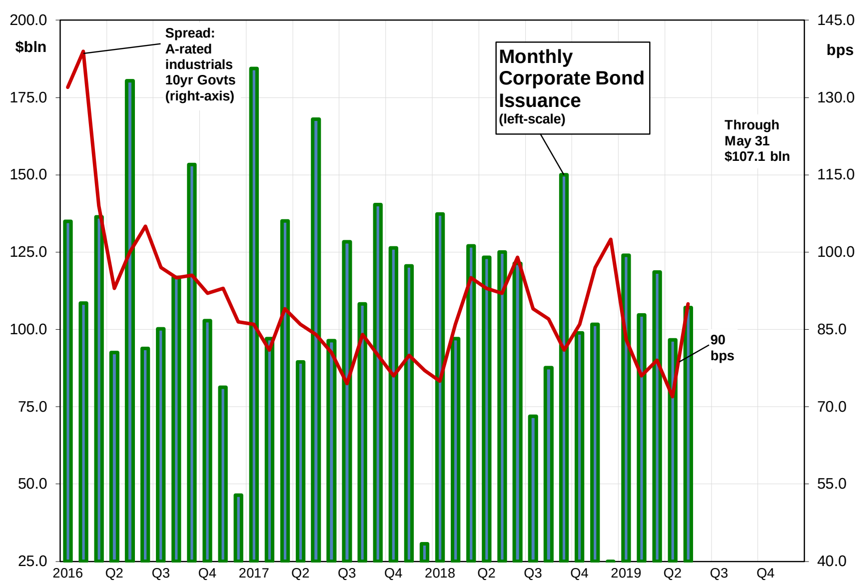
MARKETS OUTLOOK

	29-Mar 2018	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.81	3.00	3.00	3.10	3.10	3.25	3.20	3.20
10-Yr Note	2.41	2.60	2.70	2.90	2.90	3.10	3.10	3.10
5-Yr Note	2.23	2.45	2.60	2.80	2.80	3.05	3.05	3.05
2-Yr Note	2.26	2.45	2.50	2.70	2.70	2.90	2.95	3.00
3-month Libor	2.60	2.60	2.60	2.90	2.90	3.10	3.10	3.10
Fed Funds Rate	2.50	2.50	2.50	2.75	2.75	3.00	3.00	3.00
2s/10s spread	15	15	20	20	20	20	15	10



A new low this year for 10-yr yields keeps the bond rally alive. That's what we wrote last week and maybe better leave it in there for next week. The rally rolls on. We can't think of what will roll it back. The Fed has its big confab on its We're Listening tour at the Chicago Fed June 4-5. We don't like the early talk that they could let PCE inflation move in a 1.5 to 2.5 percent range without doing anything. This means rate hikes above "2.75%" neutral are nearly impossible without the energy from oil prices going up. The big drop in yields occurred Friday after Trump's tweets about putting 25% tariffs on Mexico. 10-yr yields were 2.21% Thursday and fell as low as 2.12% on Friday.

CORPORATES: FLEX LTD, SOUTHERN CAL GAS, SAN DIEGO G&E



Corporate offerings were $6.1 billion in the May 31 week versus $15.2 billion in the May 24 week. On Tuesday, Mastercard sold $2.0 billion 10s/30s. It priced a $1.0 billion 2.95% 10-yr (m-w +10bp) at 70 bps (A1/A+). The credit card company will use the proceeds for general corporate purposes: working capital, investment in inorganic/organic growth, shareholder returns. Corporate bond yields (10-yr Industrials rated A2) were 90 bps above 10-yr Treasuries this week versus 86 bps last Friday.

FEDERAL RESERVE POLICY

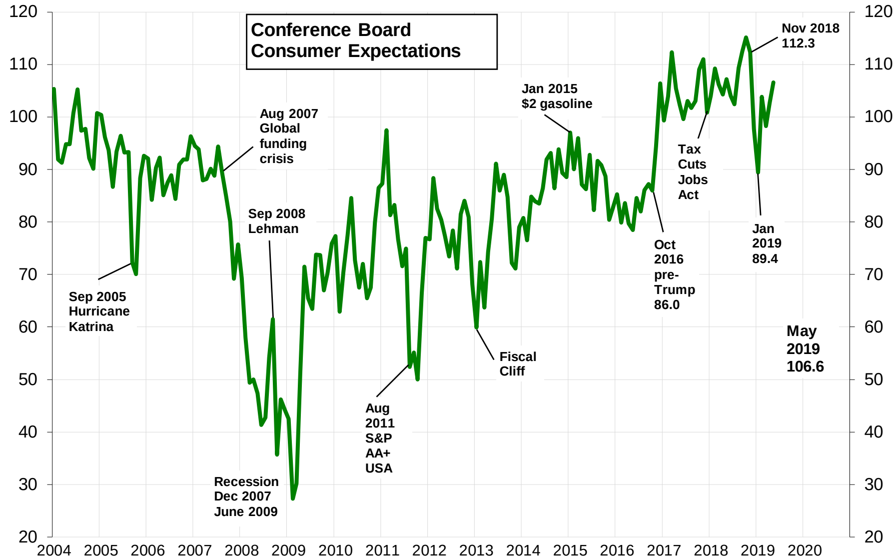
The Fed meets June 18-19 to consider its monetary policy. Interest rates collapsed this week, they had been falling, but looking back at this rally from roughly 2.50% for 10-yr yields, the driver has all been negative trade war news and its effect on the US economy, primarily the manufacturing sector. The Trump tweets pushing up the tariffs on $200 billion of China imports from 10 to 25 percent was Monday, May 6. China raised tariffs in retaliation a week later on Monday, May 13. The May 23 drop in Markit purchasing manager survey data for manufacturing brought yields lower to 2.32%. Friday's rally in Treasuries as low as 2.12% was on Trump raising tariffs on Mexico. You now have a situation where rates have fallen so far that two rate cuts are expected by the December meeting (Fed funds futures) and nearly four rate cuts to 1.5%, just like the president wanted are discounted by December 2020 Eurodollar futures by the end of next year. Not sure what the Fed should do with this advice from the market. They did cut rates well before job losses in the 20017-09 recession, the trigger being the Global funding crisis in August 2007. Rates were higher at 5.25% back then. Fed Vice Chair Clarida spoke conversation-style after a speech Thursday at the Economic Club of New York and responded to a question about what changed policymakers from their gradual pace of rate hikes path this year. Two things he said. Core PCE inflation was lower at 1.6% even if it is "transitory" it is lower, and the second thing was the global slowing of economies. If we had a vote, we would stay put for the moment, unless it looks like the US economy is going downhill with job losses. The Fed moved too quickly the last two cycles cutting rates when nobody, no company, was going to borrow more money and increase investment anyway. Rate cuts can also help bring down mortgage rates and stimulate housing and increase mortgage refinancing. But mortgage rates have already fallen to 3.99% this week from the 4.94% peak last year in November and don't need the Fed to cut rates from 2.5%. Rate cuts could help "improve financial conditions," but this isn't necessary as the stock market sell-off is not as bad as it was last year yet. Cutting rates at this stage from such a low level will not boost confidence or inflation, but it will hurt the returns to savers maybe permanently just at the time when 10,000 baby boomers are retiring every day. Hanging it up and living on the interest income that your savings throw off won't be a pork and beans retirement, it will just be beans, a great big hill of beans for the baby boom generation.

Odds of Rate Cuts Fed funds futures	
F5-31-2019	
20%	2.25% June
114%	2.25% September
218%	2.25% December
Odds at June, September, December Fed meetings	

OTHER ECONOMIC NEWS THIS WEEK

Consumer says best current conditions since the year 2000 (Tuesday)

Breaking economy news. Consumer is clearly off his rocker here. Current conditions in a survey from the Conference Board are the best since the year 2000. The consumer confidence index itself not quite at nearly two decade highs. The consumer confidence index rose 4.9 points to 134.1 in May. Back in October last year, confidence reach 137.9 before sentiment took a big hit in December during the Federal government shutdown and trade war tweets and tumbling stocks. But the bad times are over with that 121.7 low on confidence in January. Since January, the economy looks pretty darn good is what the consumer is saying and this bodes well for the economic outlook later this year.



It's all about jobs, jobs, jobs, where just 10.9 percent think jobs are hard to get. You have to go way back to September 2000 to find fewer people saying that the labor market was this darn good. If jobs are this hard to get, it means the labor market is tight as a drum and the Trump economics team better be careful with trying to get American businesses to bring their factories back from China because right now there is no skilled labor to work on the shop floors, and there is increasingly fewer job candidates that companies can even train to do the work.

Net, net, there are trade wars and tumbling stocks, but nothing is shaking the outlook of consumers who say that this is the best economy in nineteen years. You have to go back not one, but two recessions and go back more than two presidents to find the consumer this bulled up about the current outlook. Things have never been this good since the year 2000 during the stock market, Internet-bubble years. Wow. That is saying a lot.

Federal Reserve officials must be floored in thinking how wrong they got this. The economy is soaring to unforeseen levels based on the assessment of consumers with current conditions far beyond normal. A normal economy requires a normal interest rate. Pay no attention to the view of the man behind the curtain, the current occupant of the White House. Rates aren't choking off growth. Far from it.

There are some concerns about business investment and fears that economic growth is slowing down to maybe just 1 percent in the second quarter, but don't tell that to the consumer as they think current economic conditions are the best since the year 2000 when economic growth was 4.8%. We believe the sky-high confidence of consumers is likely to pave the way to a better tomorrow with economic growth rebounding to over 2% in the second half of this year. Better times ahead. Bet on it, the consumer says.

Last call for 3% GDP growth as trade wars set to sink economy's ship (Thursday)

Breaking economy news. It's the last call for 3% growth for the Trump administration as the trade wars with China and Europe are set to sink the economy's ship in the months to come. The best for the Trump presidency is likely to be the 3.0% economic growth in 2018 which is not all the much better and faster and stronger than 2.7% in 2014, the best year in the Obama presidency. The biggest tax cut in history boosted growth three-tenths faster to 3.0% last year, but blink and it's gone. Poof.

GDP in the first quarter was revised down to 3.1% from last month's 3.2% estimate. The big show is in a couple of months with the first look at second quarter data due out on July 26 where the financial world wants to know just how low can growth go. 3.1% growth to start the year was not built to last as 0.6 percentage point was from a temporary inventory build, and another 1.0 percentage point was added by a narrowing trade deficit. It's not America First yet for the US economy as our reliance on imported goods is likely to swing the trade deficit wider and renew the drag on domestic economic growth. That 3.1% growth at the start of the year could easily drop back to 1.5% (3.1 -0.6 -1.0) next quarter unless the consumer gets back in the game.

	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19p	Q1 19r
REAL GDP	2.2	4.2	3.4	2.2	3.2	3.1
REAL CONSUMPTION	0.5	3.8	3.5	2.5	1.2	1.3
CONSUMPTION	0.4	2.6	2.4	1.7	0.8	0.9
Durables	-0.2	0.6	0.3	0.3	-0.4	-0.3
Nondurables	0.0	0.6	0.6	0.3	0.2	0.3
Services	0.5	1.4	1.5	1.1	1.0	1.0
INVESTMENT	1.6	-0.1	2.5	0.7	0.9	0.8
Business Plant	0.4	0.4	-0.1	-0.1	0.0	0.1
& Equipment and	0.5	0.3	0.2	0.4	0.0	-0.1
Intellectual Property	0.6	0.5	0.3	0.5	0.4	0.3
Homes	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1
Inventories	0.3	-1.2	2.3	0.1	0.7	0.6
EXPORTS	0.4	1.1	-0.6	0.2	0.5	0.6
IMPORTS	-0.5	0.1	-1.4	-0.3	0.6	0.4
GOVERNMENT	0.3	0.4	0.4	-0.1	0.4	0.4
Federal defense	0.1	0.2	0.2	0.2	0.2	0.2
Fed nondefense	0.1	0.0	0.0	-0.2	-0.2	-0.2
State and local	0.1	0.2	0.2	-0.1	0.4	0.4

Below line: Percentage point contributions to Q1 2019 3.1% real GDP

Third estimate for Q1 is Thursday, June 27

In other news, weekly jobless claims remain at full employment levels and show no signs of stress given the recent stock market turmoil and escalation of the trade war starting in early May. Jobless claims of newly laid off workers were just 215 thousand in the May 25 week showing companies are holding on tight to their workers for now.

Net, net, growth is solid today, but today may just be the calm before the trade storm with economic growth set to slow after the recent escalation in the economic war between the US and China. Maybe trade wars can be won, but economic wars go on and on and on. Tariffs are a tax on the US economy, no doubt about that as US consumers mostly will have to pay as will US manufacturers that source many critical supply inputs for their finished products from China's factories.

If the Trump administration goes whole-hog and tariffs all $500 billion of the US imports from China at an assessed 25% rate then this is an effective tax on the US economy of $125 billion. $125 billion is about 0.7 percentage point of real GDP which means if you were forecasting 2.0% GDP growth in 2020 then growth would slow to just 1.3%. The math isn't certain of course, but tariffs will not be good for the American economy. The irony is that the America First thinking on the part of the president was advocated in order to create more jobs. But that thinking from an old campaign pledge is so yesterday because today everyone in America has a job and it would be impossible for companies to assemble a workforce even if they did bring their factories back home from China. Stay tuned. Story developing.

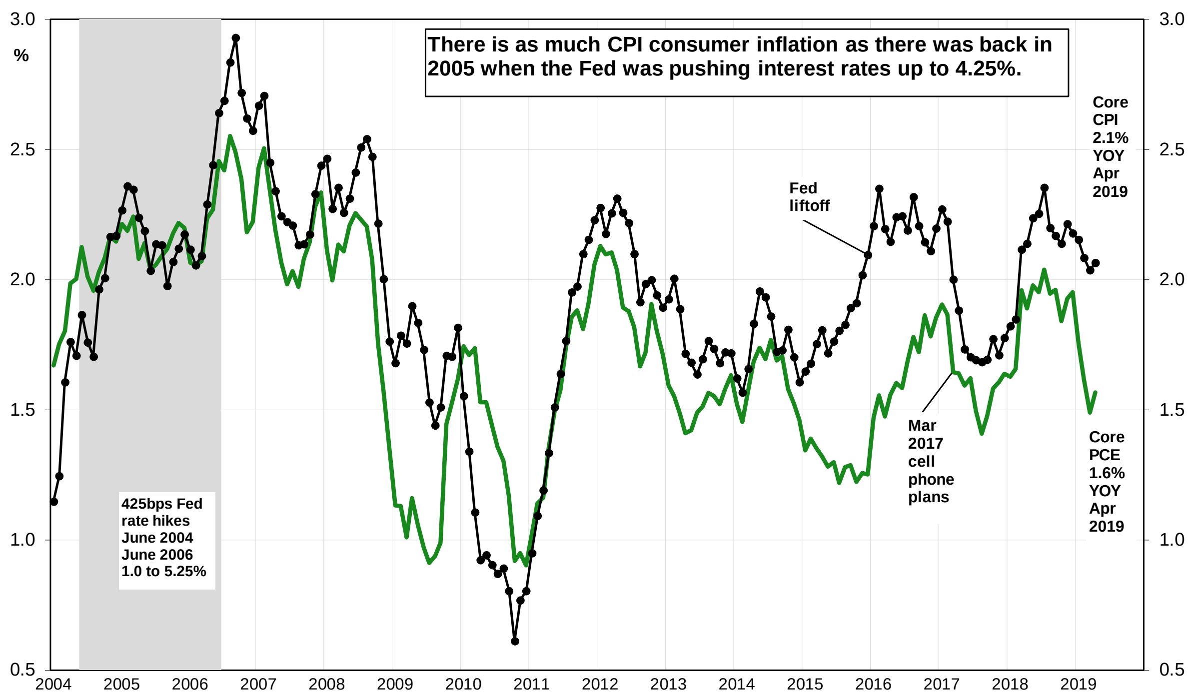
Consumer spending unchanged in April, while inflation remains low (Friday)

Inflation still transitory after all these years

Breaking economy news. The Fed's preferred measure of PCE inflation remains stuck in a rut at 1.5 percent for headline and 1.6 percent for the core.

If unemployment was still stuck at an acceptably high level you could point a critical finger at low inflation and say that's a problem. It's not, but Fed officials are nevertheless worried.

Net, net, the consumer has more income this month, but they are sitting on their hands and doing no real spending at the shops and malls. If this trend of an absent consumer keeps up, that 3 percent growth in the first quarter will simply melt away. With trade sanctions and tariffs flying every which way it will be a miracle if the economy can maintain a 2 percent pace of growth. The downside risks are clearly mounting for Fed officials and will test the patience for some who are concerned low inflation is not transitory. The Fed is in a good place when it comes to its current policy, but it won't be for long if the market's forecasts for rate cuts are to be believed. The market and the President want rate cuts and they might just get them if this slowdown persists and the Fed caves to the mob of public opinion. Just do the right thing. Tell the truth. Indeed.



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