Financial Market Weekly

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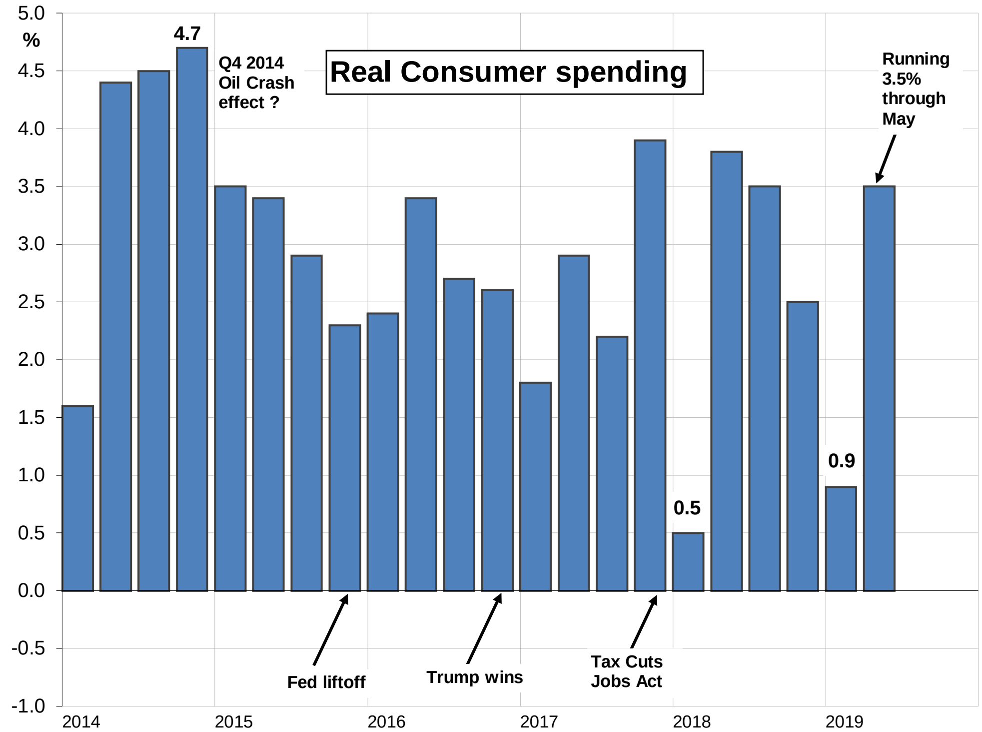
CONSUMER WAS STILL SPENDING IT ALL IN MAY BEFORE CONFIDENCE FELL IN JUNE



It was just the week before that Powell said the case for additional accommodation had strengthened since the May FOMC meeting, but more monetary stimulus isn't needed to boost consumer spending based on Friday's personal income report for May. [Consumer confidence was weaker in June as reported on Monday this week, see OTHER ECONOMIC NEWS.] Real consumer spending is rising 3.5% in the second quarter with June data left to go. 3.5% is about all one can expect from the consumer which famously contributes two-thirds to economic growth (GDP). The Tax Cuts and Jobs Act signed in December 2017 put more money in the consumer's pocket, but real consumer expenditures have been just modestly better since that time after accounting for the 0.5% weakness in Q1 2018 (cold weather effect and tumbling stocks) and the 0.9% spending weakness in Q1 2019 (Federal government shutdown, cold weather effect, and tumbling stocks.) It is unclear what else Fed rate cuts would do for consumer spending given that mortgage rates are already lower at 3.73% this week from almost 5% in November 2018. But then the June 19 Fed press statement characterized the economy as mixed with the consumer okay and business investment less okay.

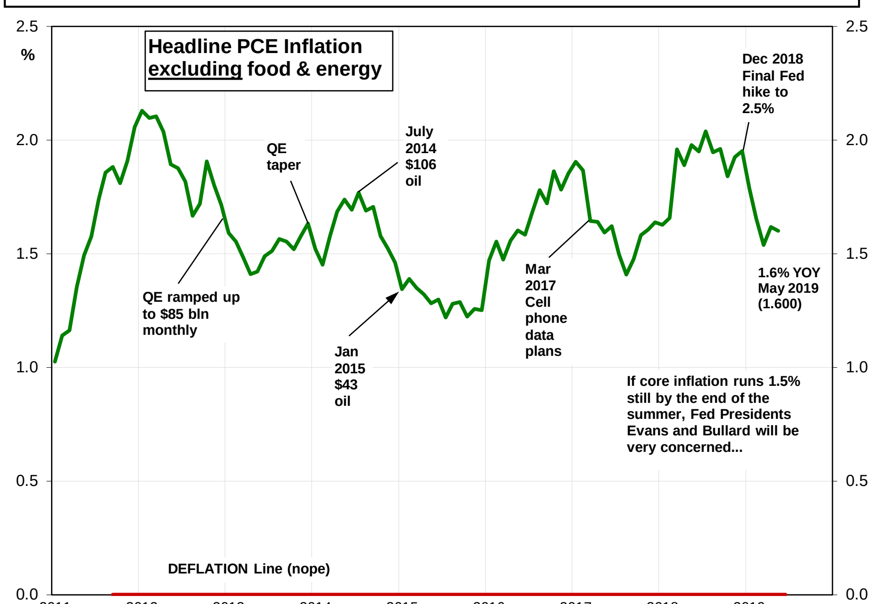
The June 19 press statement read, "Although growth of household spending appears to have picked up from earlier in the year, indicators of business fixed investment have been soft." We will have more to say about investment spending in the OTHER ECONOMIC NEWS section ahead in this report.

It is easy at times to think that economic growth is subpar or that the economy is not doing that well. The Fed's own GDP median forecast at the June meeting has real GDP growth slowing from the 3.1% Q1 2019 figure the Trump economics team always points to, down to 2.0% in 2020 and 1.8% in 2021. But focusing on the actual dollars the consumer is spending and sending through the cash registers at the stores across the country shows "growth" is really much faster. On a year over year basis, Q1 2019 versus Q1 2018, personal consumption expenditures rose 4.1%. 4.1% sounds like good growth to us. The only thing that is down is 1.3% fewer Motor vehicles as the consumer has put all the cars they want in their driveways for now, and 5.9% less Gasoline due to the price effect. In conclusion, the consumer was still spending in May and we will see if the escalation in the trade war with China boosting tariffs on $200 billion to 25% announced in a pair of presidential tweets on Sunday, May 5, we will see if this sends the consumer into hibernation. We don't think this will happen, you never know. In fact, the warmer weather may actually boost consumer spending in upcoming reports.

Nominal Consumer Expenditures & GDP	Q1 2019	Q4 2018	Q3 2018	Level $bln Q1 2019	% Change Year/Year
Gross domestic product (GDP)	3.8	4.1	4.9	21,060.1	5.1
Personal consumption expenditures	1.4	4.0	5.1	14,238.6	4.1
Goods	-1.0	1.4	3.9	4,375.9	2.5
Durable goods	-2.6	2.1	2.7	1,466.2	2.2
Motor vehicles and parts	-18.0	9.0	1.3	492.2	-1.3
Furnishings and durable household equipment	4.5	-2.6	3.5	335.7	3.6
Recreational goods and vehicles	10.7	-0.3	5.9	408.2	5.1
Other durable goods	1.9	-1.6	-0.7	230.0	3.0
Nondurable goods	-0.1	1.1	4.5	2,909.7	2.7
Food and beverages for off-premises consumption	-0.4	1.0	3.8	1,008.9	2.1
Clothing and footwear	-1.5	0.5	3.3	397.0	3.0
Gasoline and other energy goods	-28.0	-4.4	5.9	320.6	-5.9
Other nondurable goods	10.5	3.1	5.2	1,183.3	5.8
Services	2.5	5.2	5.7	9,862.7	4.8
Household consumption expenditures (for services)	3.7	4.3	5.4	9,415.2	4.7
Housing and utilities	4.1	5.2	3.6	2,630.5	4.6
Health care	6.7	1.9	6.0	2,443.4	4.8
Transportation services	-0.1	9.9	3.5	463.7	3.0
Recreation services	-0.1	3.6	1.5	562.6	2.5
Food services and accommodations	3.3	-1.5	8.6	964.6	5.5
Financial services and insurance	-1.0	6.7	5.3	1,144.4	3.8
Other services	5.1	7.8	8.5	1,206.1	6.7

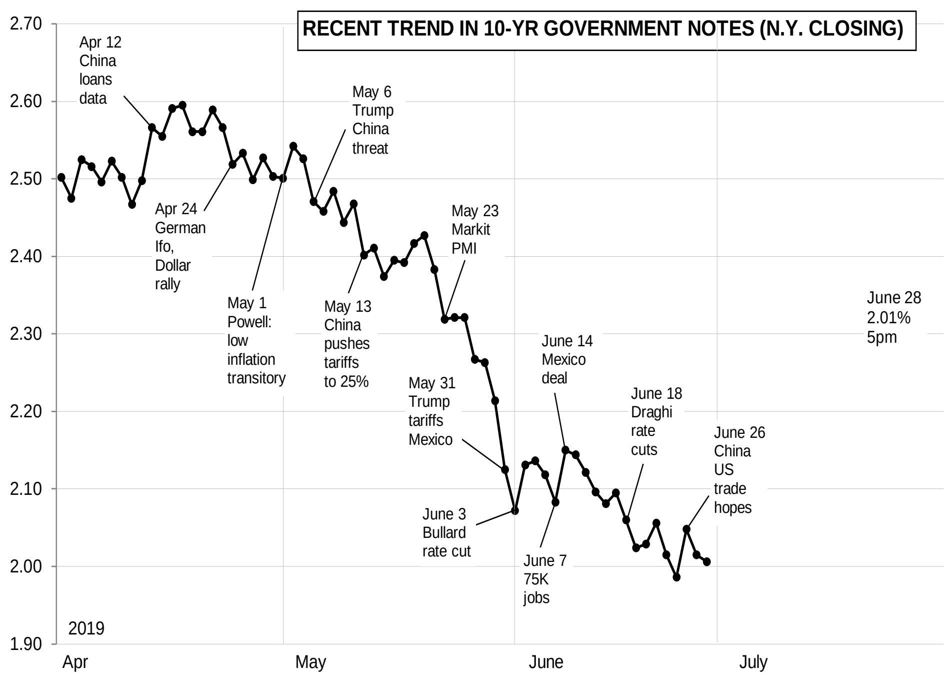
One final note on the Fed's preferred PCE inflation data for May in the personal income report released on Friday. Core PCE inflation is 1.6% year-on-year. Powell has said he wouldn't want to hike rates again unless "inflation" was 2%. Core PCE inflation was 2.5% in December when the Fed did its last rate hike to 2.5%. Despite all the talk and worry, core PCE inflation has been sideways since 2012, a period where unemployment tumbled.

Lowflation: talk about making a mountain out of a molehill



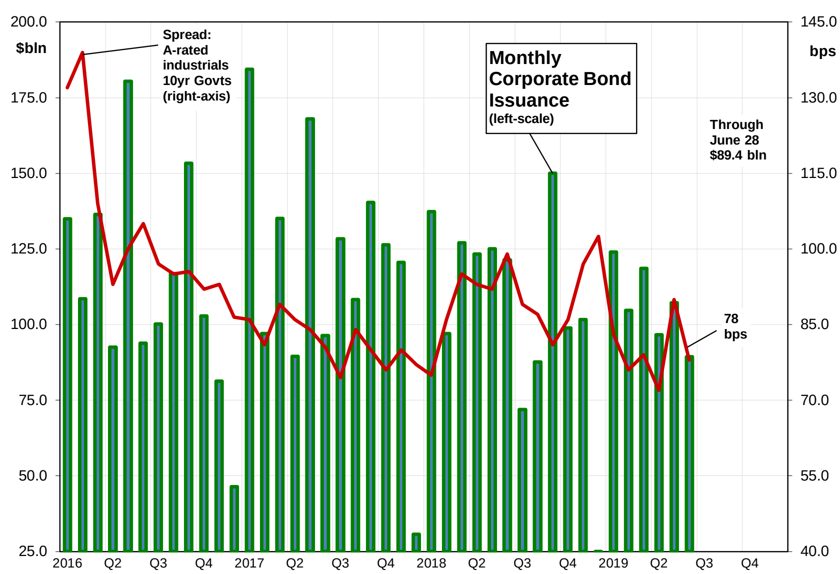
MARKETS OUTLOOK

	29-Mar 2019	28-Jun 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.81	2.53	2.25	2.30	2.40	2.50	2.50	2.70
10-Yr Note	2.41	2.01	1.75	1.80	2.00	2.10	2.20	2.40
5-Yr Note	2.23	1.77	1.50	1.55	1.80	1.90	2.00	2.20
2-Yr Note	2.26	1.76	1.50	1.60	1.70	1.80	2.00	2.20
3-month Libor	2.60	2.32	2.00	2.00	2.00	2.00	2.00	2.00
Fed Funds Rate	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00
2s/10s spread	15	25	25	20	30	30	20	20



10-year Treasury yields stayed close to 2.0% this week and are discounting a lot of action from the Fed at 50 bps under the 2.5% Fed funds rate. The consensus is for 25 bps rate cuts at each of the upcoming July 31 and September 18 Fed decision dates. The consensus forecast on 10-yr Treasury yields has flat-lined from 2.1% this quarter, steadily increasing out to 2.3% at the end of 2020. Powell is waiting on inflation before thinking of rate hikes ever again, and core PCE inflation released Friday for May is 1.6% and at least it is looking more like 1.6% instead of closer to 1.5% after some slight upward revisions. Welcome to the start of a zero rates world minus volatility.

CORPORATE BONDS: CHARTER COMMUNICATIONS, DOMINION ENERGY



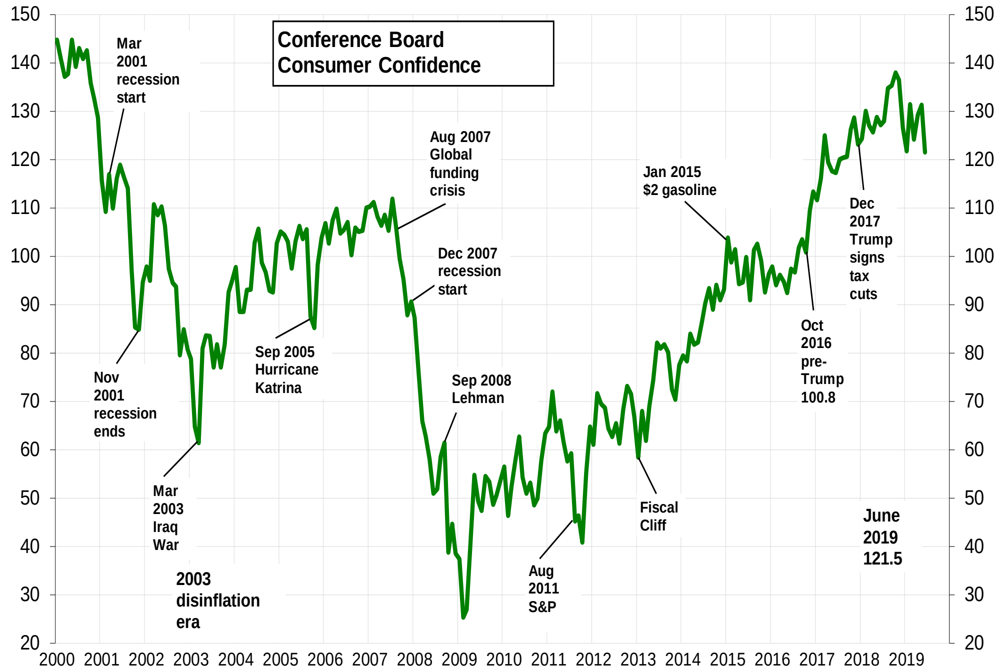
Corporate offerings were $15.5 billion in the June 28 week versus $13.0 billion in the June 21 week. On Monday, Enterprise Products Operating sold $2.5 billion 10s/30s. It priced a $1.25 billion 3.125% 10-yr (m-w +20bp) at 110 bps (Baa1/BBB+). The company provides processing and transportation services to producers/consumers of natural gas liquids and will use the proceeds for debt repayment, including commercial paper and $1.25 billion notes due July 2019. Corporate bond yields (10-yr Industrials rated A2) were 78 bps above 10-yr Treasuries Thursday versus 77 bps last Friday.

OTHER ECONOMIC NEWS THIS WEEK

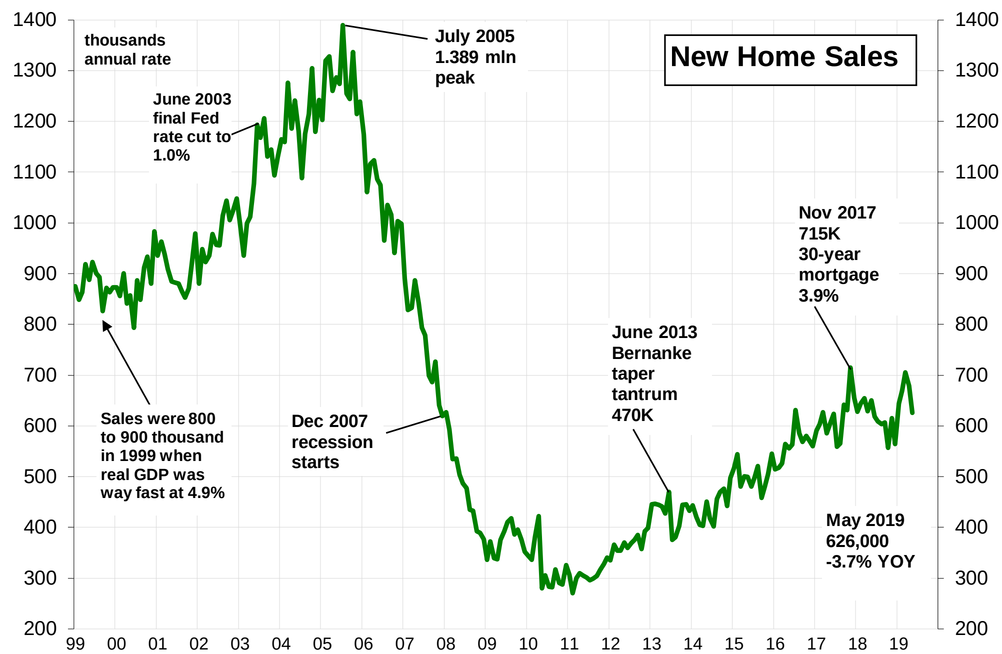
Consumer loses confidence and interest sensitive new home sales plummet (Monday)

Breaking economy news. New home sales rebounded from the stock market meltdown and Federal government shutdown at the turn of the year, but now home sales are in headlong retreat with a big drop of 7.8% in May to 626 thousand at an annual rate.

Those survey readings of higher consumer confidence were just a lot of hot air as it turns out. The confidence bubble has burst today with the Conference Board survey falling to 121.5 in June from 131.3 in May. If the Fed had had this almost ten point drop in the confidence number last week it may well have tipped the scale and led them to cut interest rates.

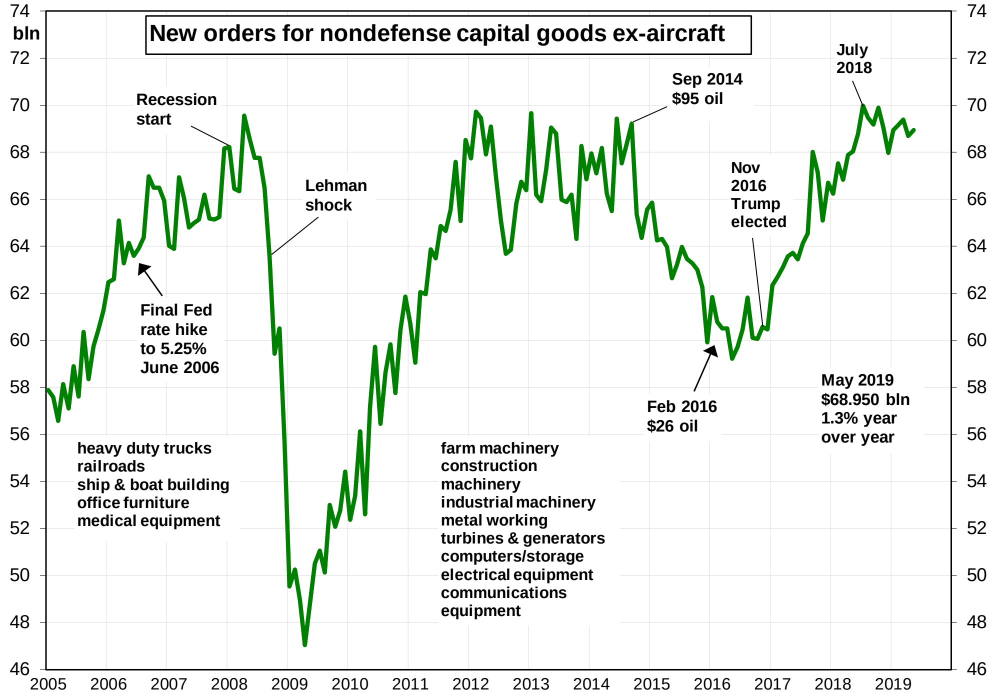


It's not the economy stupid, it's the labor market stupid for politicians running for the highest office in the land, and right now there are sharply higher numbers of consumers saying jobs are harder to get and sharply lower numbers of people saying jobs are plentiful. Every economic cycle has a tipping point where the downside risks emerge with full force and take the economy over the cliff into a recession. We hope it isn't true that the inflection point was in May or June this year, but the headwinds from the ongoing trade war the economy faces are definitely growing stronger, and it will be a miracle if Fed officials can pull a rabbit out of their hats and keep the economy moving forward.



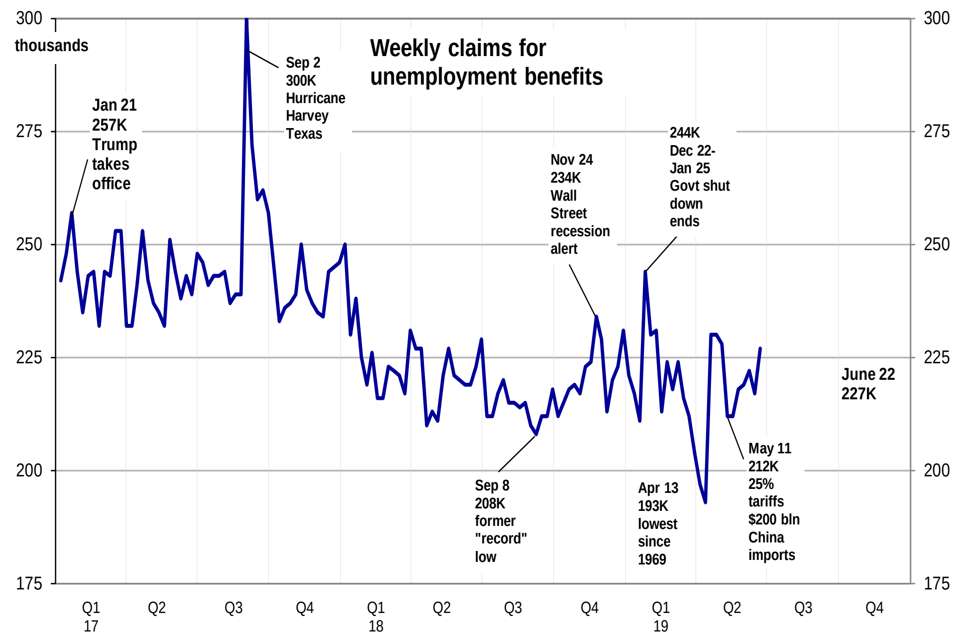
Durable goods orders, business investment, are at a high level (Wednesday)

Breaking economy news. The durable goods report for May. Our monthly proxy for business investment spending is nondefense capital goods orders ex-aircraft which rose 0.4% in May after a 1.0% decline in April. These orders are still up 1.3% to $68.950 billion from year ago levels. This is the dollar amount of capital equipment ordered in just the month of May. The order flow continues at a high level for this late in the economic expansion of nearly ten years. The Fed may be concerned about a slowdown in the growth of new orders, but capital equipment orders were unlikely to keep going up any higher. Orders have maxed out for now near the prior peaks in 2008 and 2014. Stop the hand-wringing already.



Unemployment claims rose… no recession worry yet (Thursday)

Breaking economy news. Weekly jobless claims moved up 10K to 227K in the June 22 week. The clock is ticking after the Twin Trump Tweets Sunday, May 5 that escalated the trade war with China to a new level. Shocks to the economy are hard to gauge always, but certainly it doesn't hurt to be on the alert for potential job losses that might signal the economy is dangerously close to recession. For this particular week however, June 22, there may be some seasonal adjustment problems with public schools closing for the summer in states like New Jersey (Yay! That's where we live.) and Connecticut and Massachusetts. June 29 week claims will be released Wednesday July 3 ahead of the national holiday.



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