Financial Market Weekly

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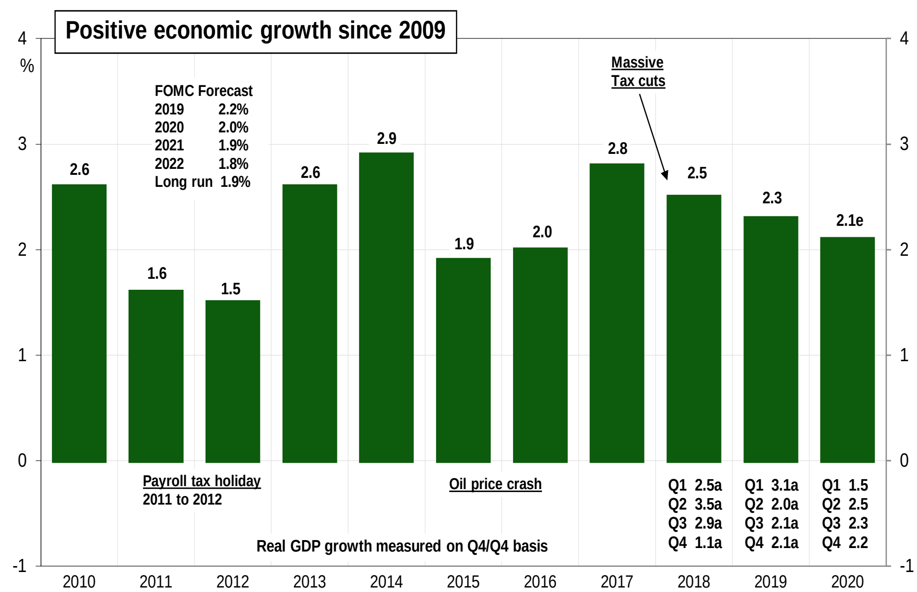
THAT'S A WRAP. ECONOMIC GROWTH SLOWS TO 2.3% IN 2019



The market was more concerned with the threat to world growth from the coronavirus. Dow industrials closed down 603 points on Friday at 28,256.03 which is off 3.8% from the high for the year. The coronavirus fear in the markets is spreading as the disease spreads even if on Friday just 257 people had died from the virus in a country of nearly 1.4 billion.

Real GDP for the fourth quarter was released Thursday and the 2.1% final quarter of the year means full year 2019 Q4/Q4 growth is 2.3%. That's final, except for two more revisions in February and in March. We hesitate to repeat the story of economic growth the last decade with its four subpar years of 2.0% or less. Hesitate because despite the concern of markets and those down in Washington, somehow "slow" growth was good enough, strong enough to put everyone back to work after the recession with the unemployment rate falling from 9.9% in 1999 to 3.5% today. The story of growth this decade starts with 2.6% in 2010 over half of which was inventory rebuilding after the recession and "doesn't count." The payroll tax cut holiday in 2011 and 2012 couldn't move growth up from 1.5 to 1.6 percent in those same years. After 2012, growth picked up finally after the recession due to the Fed's QE (haha, joking, QE boosts the stock market not economic growth), growth picked up to the fastest of the decade which is 2.9% in 2014 under President Obama. Growth slowed back to 2.0% in 2015-16 during the fallout from the oil price crash. GDP rebounded to 2.8% under President Trump in 2017, crude oil prices recovered, and maybe some animal spirits were unleashed at the start of the new administration and ahead of the Tax Cuts and Jobs Act signed in December 2017. And that was it so far for growth under the Trump administration as the economy has slowed steadily since 2017 despite the biggest corporate tax cut in history.

That's the story of the past. That's our story we're sticking to it. What can the fourth quarter GDP data tell us about growth in 2020? Fed officials have been concerned about the "uncertainty" that continues to hobble business investment. Can't all be uncertainty holding companies back if software sales, so-called intellectual property, continue to be strong. Anyway, after two strong quarters in the middle of the year, consumers, who were thought to be keeping the economy running, slowed their spending to just 1.8% in the fourth quarter which added 1.2 percentage points to 2.1% real GDP. Without the consumer and business investment what is left to grow the economy in 2020? There's Net exports, Inventories, Government spending. Imports added to GDP, a big 1.3 percentage points, because American's bought fewer imported goods, partly due to the higher tariffs perhaps. This could reverse and be a drag on first quarter 2020 growth. That would be bad except for the decline in Inventories which subtracted 1.1 percentage points from Q4's 2.1% growth, and that could reverse and add to growth in the first quarter possibly offsetting much of the drag when American's resume buying imports. Government spending will need to continue to add 0.5 percentage points to GDP in Q1 2020 if growth is going to have any chance of making it to 2% again.

	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19p
REAL GDP	2.9	1.1	3.1	2.0	2.1	2.1
REAL CONSUMPTION	3.5	1.4	1.1	4.6	3.2	1.8
CONSUMPTION	2.3	1.0	0.8	3.0	2.1	1.2
Durables	0.3	0.1	0.0	0.9	0.6	0.2
Nondurables	0.5	0.2	0.3	0.9	0.5	0.1
Services	1.6	0.7	0.5	1.3	1.0	0.9
INVESTMENT	2.3	0.5	1.1	-1.2	-0.2	-1.1
Business Plant	-0.1	-0.3	0.1	-0.4	-0.3	-0.3
& Equipment and	0.2	0.4	0.0	0.1	-0.2	-0.2
Intellectual Property	0.2	0.5	0.5	0.2	0.2	0.3
Homes	-0.2	-0.2	0.0	-0.1	0.2	0.2
Inventories	2.1	0.1	0.5	-0.9	0.0	-1.1
EXPORTS	-0.8	0.2	0.5	-0.7	0.1	0.2
IMPORTS	-1.3	-0.5	0.2	0.0	-0.3	1.3
GOVERNMENT	0.4	-0.1	0.5	0.8	0.3	0.5
Federal defense	0.1	0.2	0.3	0.1	0.1	0.2
Fed nondefense	0.1	-0.1	-0.2	0.4	0.1	0.0
State and local	0.2	-0.1	0.4	0.3	0.1	0.2

Below line: Percentage point contributions to Q4 2019 2.1% real GDP

Second estimate for Q4 is Thursday, February 27

Most forecasters are thinking GDP will be just 1.5% in the first quarter, with growth held back by fewer orders from Boeing. Airplane orders are in Transporation equipment in the real business investment table here and these orders were surprisingly up 8.7% at a seasonally adjusted annual rate (SAAR) in Q4 19.

Real Business Investment (% change SAAR)

$bln 2019		2017	2018	2019	Q1 19	Q2 19	Q3 19	Q4 19
516.8	STRUCTURES	4.7	4.1	-4.4	4.0	-11.1	-9.9	-10.1
154.1	Commercial and health care	3.2	-0.1	-5.3	7.0	-13.8	-4.6	-6.7
56.4	Manufacturing	-15.2	-6.1	1.3	17.8	-17.4	7.3	-9.5
103.3	Power and communication	-0.9	-0.7	-3.7	1.9	-2.2	1.5	-2.8
109.2	Mining exploration, shafts, wells	40.9	24.2	-7.9	-0.7	-15.6	-29.5	-18.3
97.3	Other structures 1	1.7	2.6	-3.2	-0.1	-6.3	-13.5	-14.0
1,272.4	EQUIPMENT	4.7	6.8	1.4	-0.1	0.8	-3.8	-2.9
517.0	Information processing equipment	9.8	9.2	3.7	9.2	6.9	-6.4	-2.0
129.2	Computers	8.8	9.9	4.6	9.2	34.7	-29.2	28.5
390.1	Other processing equipment 2	10.3	9.0	3.3	9.2	-2.9	4.9	-12.2
241.0	Industrial equipment	6.3	4.5	1.0	-3.4	1.6	6.7	-13.1
278.8	Transportation equipment	-4.9	6.4	-0.5	-4.1	-9.3	-11.3	8.7
251.5	Other equipment 3	7.9	5.6	0.3	-5.7	3.1	-0.4	-6.1
971.1	INTELLECTUAL PROPERTY	3.7	7.4	7.7	10.8	3.6	4.7	5.9
456.3	Software	8.0	10.6	10.3	14.7	5.8	9.9	11.6
435.5	Research & Development (R&D)	0.4	5.3	6.4	9.7	2.7	0.6	1.7
86.0	Entertainment, literary, artistic	2.6	4.6	3.2	0.8	-0.3	4.1	4.1

1 Religious, educational, vocational, lodging, railroads, farm, amusement/recreational, other

2 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments

3 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment

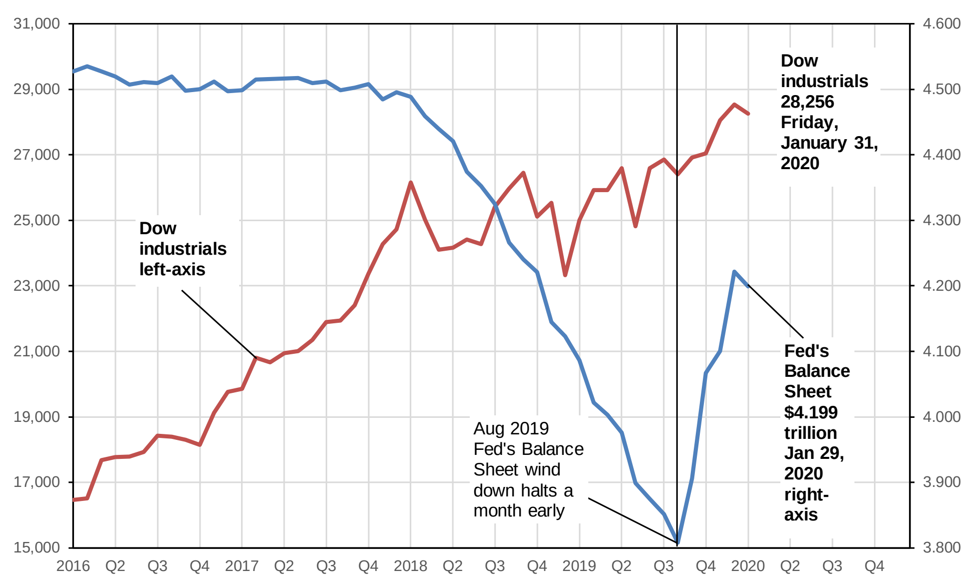
Two percent economic growth isn't impossible in 2020 generally and the first quarter in particular. Business equipment hasn't been that weak, and intellectual property investment has held up well, rising 7.7% in 2019. It has really been spending on structures that was the investment drag . Still, consumers are going to have to get back in the game to keep growth near 2% in 2020. Another quarter at 1.8% won't be enough.

FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	29-Jan	22-Jan	15-Jan	8-Jan	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2409.108	2381.020	2362.635	2347.714	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1387.288	1398.642	1404.318	1408.677	0.000
Repurchase agreements	175.125	186.076	229.468	210.587	126.750
Primary credit (Discount Window)	0.034	0.000	0.009	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)	0.000	0.000	0.000	0.000	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	
Central bank liquidity swaps	0.051	0.054	0.059	3.728	62.000
Federal Reserve Assets	4199.3	4194.1	4224.1	4197.8	961.7
3-month Libor %	1.78	1.80	1.84	1.83	2.82
Factors draining reserves					
Currency in circulation	1792.779	1794.751	1795.725	1802.383	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	0.300	15.604	0.068	0.876	0.000
Reserve Balances (Net Liquidity)	1612.223	1609.594	1673.362	1656.629	24.964
Treasuries within 15 days	28.266	23.659	14.867	18.271	14.955
Treasuries 16 to 90 days	135.202	126.629	131.504	125.491	31.549
Treasuries 91 days to 1 year	378.533	369.212	349.598	344.202	69.272
Treasuries over 1-yr to 5 years	908.219	902.619	907.750	894.850	170.807
Treasuries over 5-yrs to 10 years	315.598	315.605	315.612	324.301	91.863
Treasuries over 10-years	643.290	643.297	643.304	640.599	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

The Fed met January 28-29, 2020 to consider its monetary policy. We almost forgot. They did nothing on interest rates, but at Friday's close because bond market yields have fallen so sharply, Fed funds futures yields have plummeted as well with the market now talking about Fed rate cuts in 2020 as the spread of the coronavirus will slow world economic growth, and, and and. Not much chance of a Fed rate cut at the upcoming March 17-18, 2020 meeting, but the June meeting odds of a 25 bps rate cut to 1.5% are 88 percent, and the December Fed meeting odds are completely discounting, by a sure-thing 100 percent, two 25 bps rate cuts with the Fed funds rate ending the year at 1.25%. Three rate cuts in 2019 and now two more rate cuts in 2020. The bond market can't wait. It will be the last bond market rally there will ever be.

Powell's press conference was widely followed Wednesday afternoon at 230pm EST, or at least the stock market seemed to fall during it. We liked the question on whether the stock market was overvalued. Powell out-greenspaned Greenspan, by saying: "We do see asset valuations as being somewhat elevated—I do—somewhat elevated, if you look at risk spreads, they're narrow, if you look at PEs, they're high." Great. Thanks a lot. Stick with something you know all about like monetary policy and the economy and the participation rate is our advice. Talking down the stock market rally will not endear you with the President.



Finally, the Fed's balance sheet. So much else going on that everyone ignored the news that the FED'S BALANCE SHEET IS NOT GOING TO GO ANY HIGHER. All the Treasury bill purchases were done to address technical conditions in the funding markets that led to the flare-up in overnight rates last September. It's not QE, never was, and anyway, it's ending. Our reading of the Powell press conference Q&A is that the level of the balance sheet has peaked and that while Treasury bill purchases will continue into the second quarter, they will only be done to plug the hole from declining assets as the Fed stops adding liquidity through its repo operations ($175.125 billion in the table above this week.). Wow thanks. Fed Chair Powell bashing the stock market twice this week, (1) no more QE that was never QE in the first place and (2) the stock market is overvalued. We don't know what more to say. Over and out. Check your 401Ks. If you dare.

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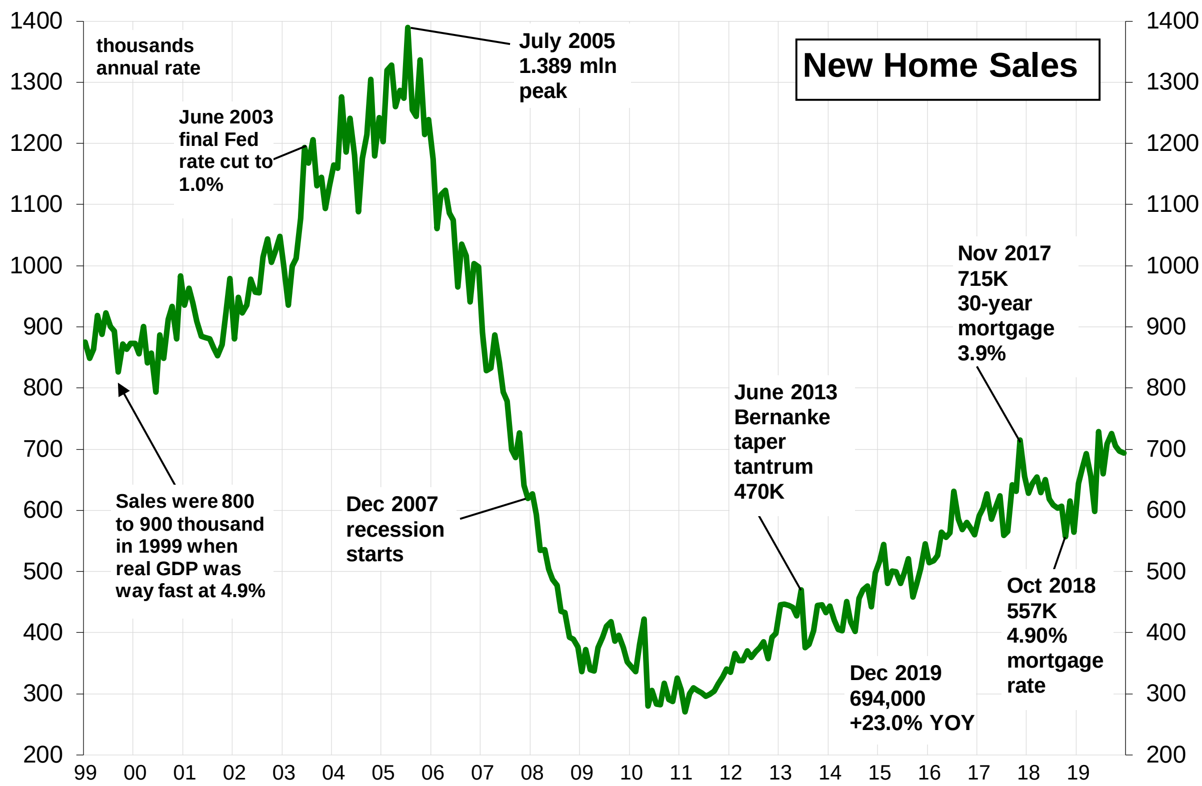
OTHER ECONOMIC NEWS THIS WEEK

New home sales stall (Monday)

Breaking economy news. It's a good thing for the housing markets that consumers are buying over 5.5 million existing homes in December because new home buyers have stepped back from the plate. The data are notoriously volatile and true to form the November new home sales were revised to 697 thousand at an annual rate from the initial estimate of 719 thousand. Today's report says new home sales fell slightly by 0.4% to 694 thousand in December.

Regionally, sales were very mixed with sales surging in the South on what were warmer than average winter temperatures, but sales tumbled in the West.

Net, net, it looks like the Fed's good medicine of rate cuts that lowered the boom on mortgage rates last year has boosted new home sales as much as it can for now which adds another cloud to the 2020 economic outlook. There's a lesson in here somewhere that Fed policy has just a limited effect of short-term duration on even interest rate sensitive sectors of the economy. At some point the negative effect of pushing interest rates to zero which damages the financial system outweighs the good that trying to push mortgage rates down can do to boost home sales and construction and the broader economy.

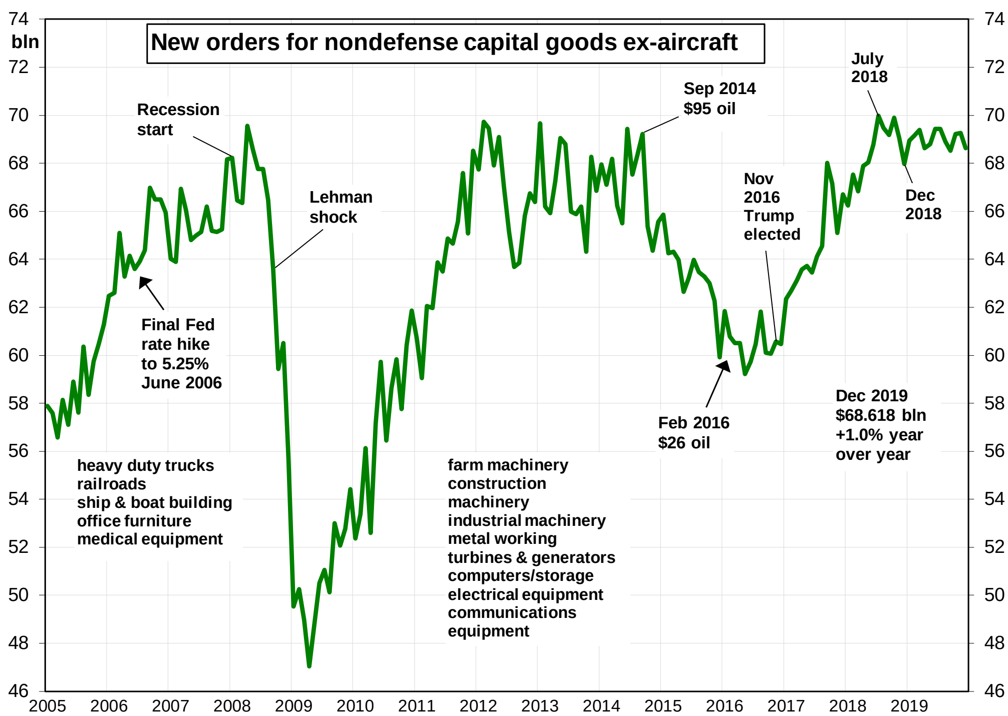


Early warning recession signs as manufacturing orders slide at year-end (Tuesday)

Breaking economy news. Not the number of new coronavirus cases in the U.S., closer to home in Canada, in China or the world. Hopefully, so-called investors will stop wrecking the stock market on the latest handful of coronavirus cases here in the USA, USA, USA. The news we want to focus on is that of December durable goods orders and shipments. We can't see much effect from the GM strike the last three months, with motor vehicles and parts down 1.8% in October, up 1.6% in November, and down 0.9% in December. Aircraft, as in Boeing 737 Max, orders have collapsed. Nondefense aircraft and parts orders down 28.4% in November and 74.7% (checking that, 747) in December.

Our monthly proxy for business investment in equipment is nondefense capital goods orders ex-aircraft which fell 0.9% in December. Some categories of durable goods orders were quite weak, backing up the talk that manufacturing is in a recession. Computers fell 9.7% in December after sharp gains the prior two months. One of the largest sectors is machinery and these orders fell 1.0% in November and 1.1% in December. The sun is always shining somewhere in the world though and communications equipment rose 6.1% in December after November's 2.9% increase.

Net, net, business investment orders for new equipment cooled in the final month of 2019 as companies grow more cautious about the outlook. Business demand for long-lived capital goods that last and last had held up surprisingly strong even with purchasing managers at manufacturing firms warning for months that manufacturing was in recession. But now nondefense capital goods orders ex-aircraft fell 0.9% in December after rising 0.1% in November and 1.0% in October. It's not lights out for manufacturing let alone the broader economy, nevertheless, markets and investors should take today's slide in capital goods orders as an early warning. No recession yet, but the sector is clearly losing momentum as many of the most extreme tariffs on supply-chain inputs factories need to produce their final goods remain in place despite the U.S. and China signing off on a phase one agreement.

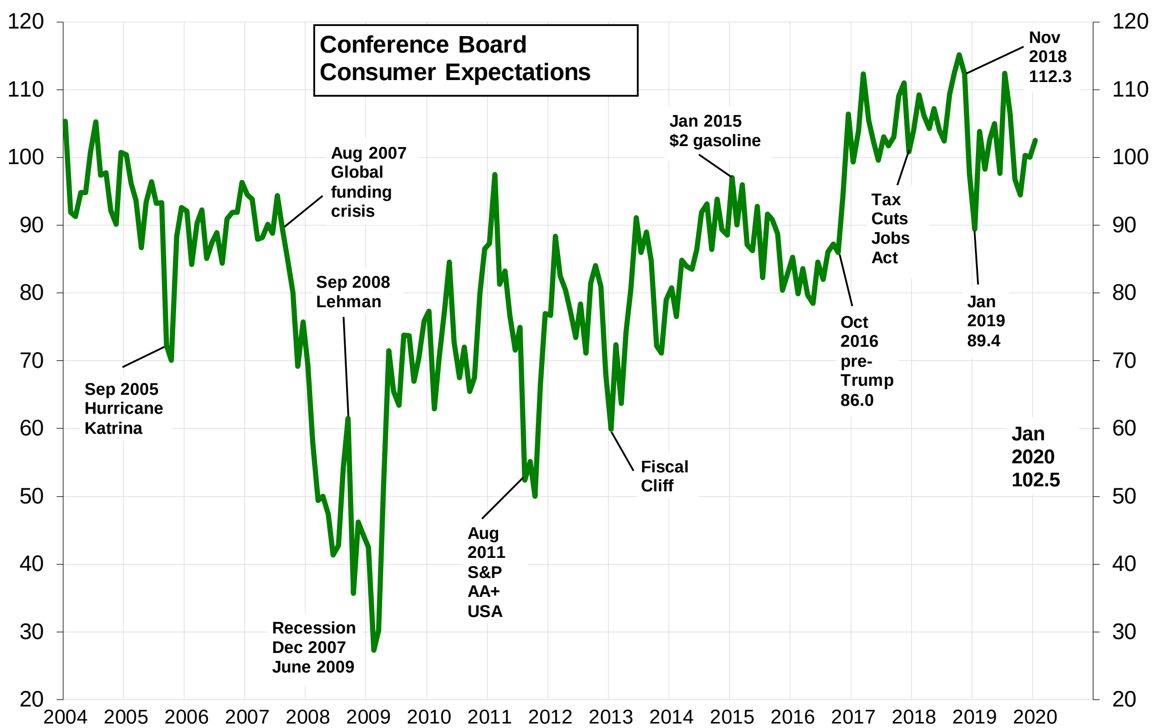


Somehow consumers are more confident at the start of the year (Tuesday)

Breaking economy news. The consumer is saying they are more confident with the survey index rising to 131.6 in January. Last month's confidence was revised up to 128.2 from the initial December index reading of 126.5.

The reason for the consumer's joy is apparently the strength of the labor market where jobs haven't been this easy to get since August 2019. We guess the consumer still thinks there are enough job openings out there even if the Bureau of Labor Statistics' Jolts data says there are somewhat fewer opportunities on job boards to be had. The latest optimism in the consumer confidence data is likely to convince Fed officials meeting today to keep a steady hand on the tiller when it comes to steering the economy with no reason to turn the rudder toward higher or lower interest rates for now.

Net, net, the consumer is more upbeat at the start of 2020 and that's good news for the outlook this year as the Trump administration is counting on consumer spending to offset the caution on the part of businesses which aren't expected to buy as much equipment as they did in 2019. When it comes to forecasting the economy in 2020, it's the consumer stupid. It could well be the key to the outcome of this year's elections as well.



America's trade deficit with the world is getting worse not better (Wednesday)

Breaking economy news. The trade deficit in goods widened in December to $68.3 billion from $63.0 billion in November. The improving trend in the trade balance, where the Trump administration is seeking to stop the world from ripping us off, had a setback this month. The trade war between China and the U.S. is over for now, but the trade deficit red ink remains which makes markets scratch their heads and wonder what that was all about. The relentless, decades-long, forces of globalization are back.

Okay, calm down, one month does not a trend make. The $5.3 billion widening in the December goods deficit occurred as imports of industrial supplies rose $3.8 billion to $44.6 billion in December, a figure that includes petroleum and petroleum products, and petro-imports may sink back with the price of crude oil in the coming months.

Net, net, America's trade balance with the world wasn't narrowing as much as we thought as the goods deficit rose sharply in December as companies and consumers bought more from overseas. It's still a toss-up after this preliminary trade report whether fourth quarter real GDP will come in a little above or somewhat below the 2% line in the sand where growth better be if the Trump economics team is going to claim bragging rights at all. Stay tuned. We'll see if it's still the economy stupid tomorrow after the first look at fourth quarter real GDP.

ADVANCE TRADE STATISTICS FOR DECEMBER

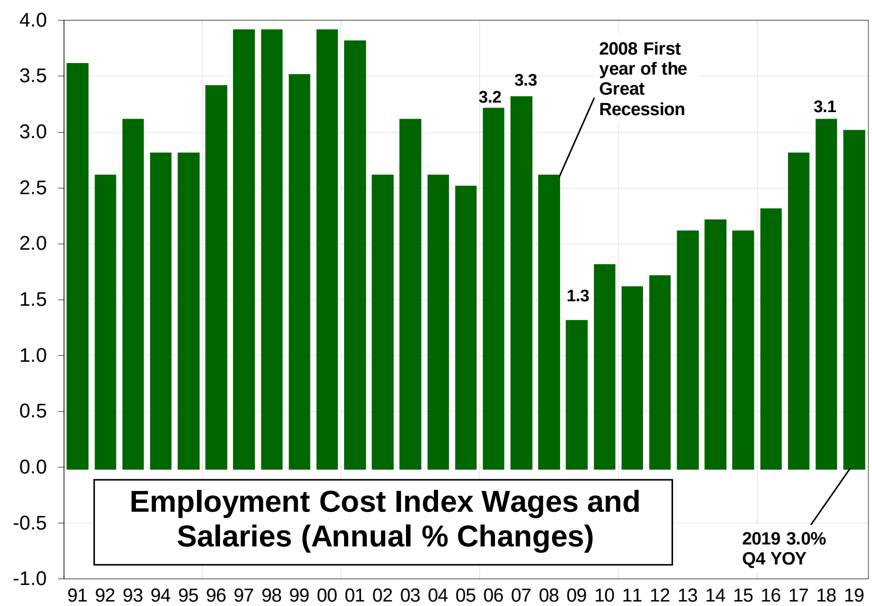
	Monthly				Percent changes		
	Dec	Nov	Oct	Dec	Dec 19	Nov 19	Dec 19
Trade	2019	2019	2019	2018	Nov 19	Oct 19	Dec 18
Balance	-68,332	-62,988	-66,693	-79,790			
Exports	136,983	136,571	135,552	136,001	0.3	0.8	0.7
Foods, Feeds, & Beverages	10,706	10,705	10,512	9,929	0.0	1.8	7.8
Industrial Supplies (1)	45,624	44,381	44,570	44,019	2.8	-0.4	3.6
Capital Goods	45,500	45,325	44,715	46,853	0.4	1.4	-2.9
Automotive Vehicles, etc.	12,293	13,399	12,966	12,479	-8.3	3.3	-1.5
Consumer Goods	16,493	17,105	16,621	17,137	-3.6	2.9	-3.8
Other Goods	6,367	5,656	6,167	5,582	12.6	-8.3	14.1
Imports	205,315	199,559	202,246	215,791	2.9	-1.3	-4.9
Foods, Feeds, & Beverages	12,284	12,238	12,402	12,569	0.4	-1.3	-2.3
Industrial Supplies (1)	44,634	40,773	41,391	46,666	9.5	-1.5	-4.4
Capital Goods	55,738	55,406	56,562	59,595	0.6	-2.0	-6.5
Automotive Vehicles, etc.	29,811	30,114	29,049	31,969	-1.0	3.7	-6.8
Consumer Goods	51,937	51,309	52,311	55,790	1.2	-1.9	-6.9
Other Goods	10,911	9,719	10,530	9,201	12.3	-7.7	18.6

(1) Includes petroleum and petroleum products.

Consumer says don't count on me in 2020 (Friday)

Breaking economy news. The December personal income report. Not yours. The economy's. In this report, we are really interested in just two things: consumer spending and the Fed's preferred measure of inflation that never rises, and never will, above 2%-- the personal consumption expenditures deflator which we just call PCE inflation. Real consumer spending rose just 0.1% in December and consumers had to raid their piggy banks to keep on spending it as personal saving as a percentage of disposable income fell to 7.6% in December from 7.8% in November. We knew already coming in today that consumers bought fewer cars and light trucks, 16.7 million in December down from 17.1 million in November, both months at annual rates.

Inflation is a little better today, haha, emphasis on little. Headline PCE inflation is 1.6% year-to-year in December and core PCE inflation is 1.6% year-to-year. With inflation short of target, Fed officials will never really be comfortable with their current setting on monetary policy which looks for no change in interest rates this year.



Consumers seem to have enough wages if they would only spend it. The latest Q4 2019 Employment Cost Index (ECI) was also released at 830am EST this morning. Private industry wages and salaries are running 3.0% in Q4 2019 versus the prior year, even if compensation is just 2.7% because benefits doled out by stingy, cost-cutting corporations are only 1.9%. The wage data continue to be favorable overall for the economic outlook if consumers would only open their wallets and purses to help make the economy grow this year. Spending it all would make consumer spending grow 3.0% instead of the tepid 1.8% consumer spending we got yesterday in the Q4 2019 GDP data.

Net, net, based on their recent spending, consumers are not as positive as they were in the middle of 2019 and are sitting on their wallets as the year came to a close which draws a great big question mark over the 2020 economic outlook. Business investment spending on equipment and structures is declining which doesn't suggest companies think consumer spending will be all that red hot in 2020 and this is before the coronavirus has spread to over 10,000 cases globally generating uncertainty that could keep the consumer at home instead of taking those trips to the mall that the economy sorely needs to keep growing. The Trump administration economists are already puzzling over how to get the economy up to 3 percent growth, now it looks like they are going to have to work harder to keep the economy growing 2 percent. The first quarter of 2020 is looking like a disaster for growth with Boeing shutting down production of the 737 Max and the coronavirus starting to unnerve the consumer. We will start Q1 2020 off with a 1.5% GDP forecast, but there is a lot of wishful thinking here with much of the growth coming from a reversal of the Q4 1.1 percentage point drag from falling inventories. Stay tuned tuned. Story developing badly. The consumer says don't count on me in 2020 and their support will be critical for growth this year. Bet on it.

Analyst Certification

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