Financial Market Weekly

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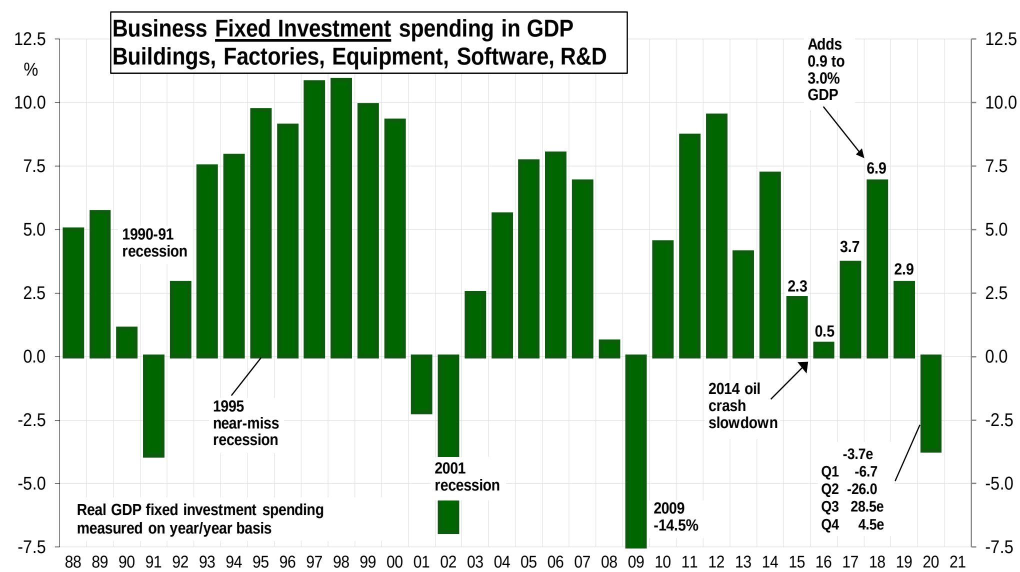
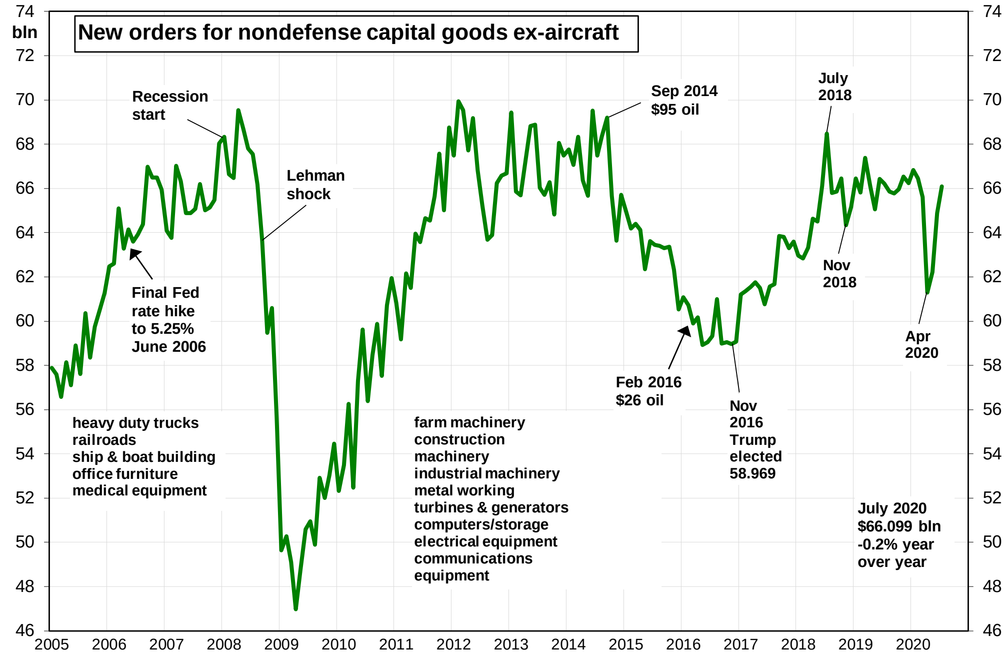
BUSINESS INVESTMENT DROPS SHARPLY IN RECESSIONS



Business investment in GDP is only 14.7% of total real spending, yet it is the swings from the highs to the lows in capex expenditures of companies on structures, like offices and warehouses and factories, on equipment, like computers, trucks, construction equipment, and so-called intellectual property, like software and R&D, that makes a recession a recession. Business investment declines a lot in percentage terms as orders get canceled. Consumer spending, which is a larger two-thirds share of GDP expenditures, doesn't fall much in many recessions, even if it certainly did in this one with the public locked down. Business investment tumbles in recessions. During the last recession, it fell 14.5% in 2009. That's why right now it is surprising that business investment in long-lived nondefense capital goods ex-aircraft has come roaring back to the best economy in 50 years at the start of the year. We would have thought businesses would have been more cautious with many

	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20p	Q2 20r
REAL GDP	2.9	1.5	2.6	2.4	-5.0	-32.9	-31.7
REAL CONSUMPTION	1.8	3.7	2.7	1.6	-6.9	-34.6	-34.1
CONSUMPTION	1.3	2.5	1.8	1.1	-4.8	-25.1	-24.8
Durables	0.1	0.9	0.4	0.2	-0.9	0.0	0.0
Nondurables	0.5	0.7	0.4	-0.1	1.0	-2.2	-2.0
Services	0.7	0.9	1.0	1.0	-4.8	-22.9	-22.8
INVESTMENT	0.7	-1.0	0.3	-0.6	-1.6	-9.4	-8.7
Business Plant	0.2	0.1	0.1	-0.2	-0.1	-1.2	-1.1
& Equipment and	0.1	-0.2	-0.1	-0.1	-0.9	-2.1	-2.0
Intellectual Property	0.2	0.2	0.2	0.2	0.1	-0.3	-0.4
Homes	-0.1	-0.1	0.2	0.2	0.7	-1.8	-1.7
Inventories	0.2	-1.0	-0.1	-0.8	-1.3	-4.0	-3.5
EXPORTS	0.2	-0.5	0.1	0.4	-1.1	-9.4	-9.2
IMPORTS	0.3	-0.3	-0.1	1.1	2.3	10.1	10.1
GOVERNMENT	0.4	0.9	0.4	0.4	0.2	0.8	0.8
Federal defense	0.2	0.2	0.2	0.3	0.0	0.2	0.2
Fed nondefense	-0.1	0.4	0.1	0.0	0.1	1.0	1.0
State and local	0.3	0.3	0.1	0.2	0.1	-0.4	-0.4
Below line: Percentage point contributions to Q2 2020 -31.7% real GDP							
Third estimate for Q2 is Wednesday, Sep 30							

companies' balance sheets in tatters after losing sales and revenues for three or four months. This "durables" data has always been quirky. Durable goods orders were still rising 6 or 7 months into the Great Recession which is one of the reasons why Bernanke shouted fire in the crowded theatre, we mean he warned the Fed might raise interest rates in June 2008 during a recession because inflation was still an issue and many areas of the economy were not that bad… even if millions had already lost their jobs at the time.

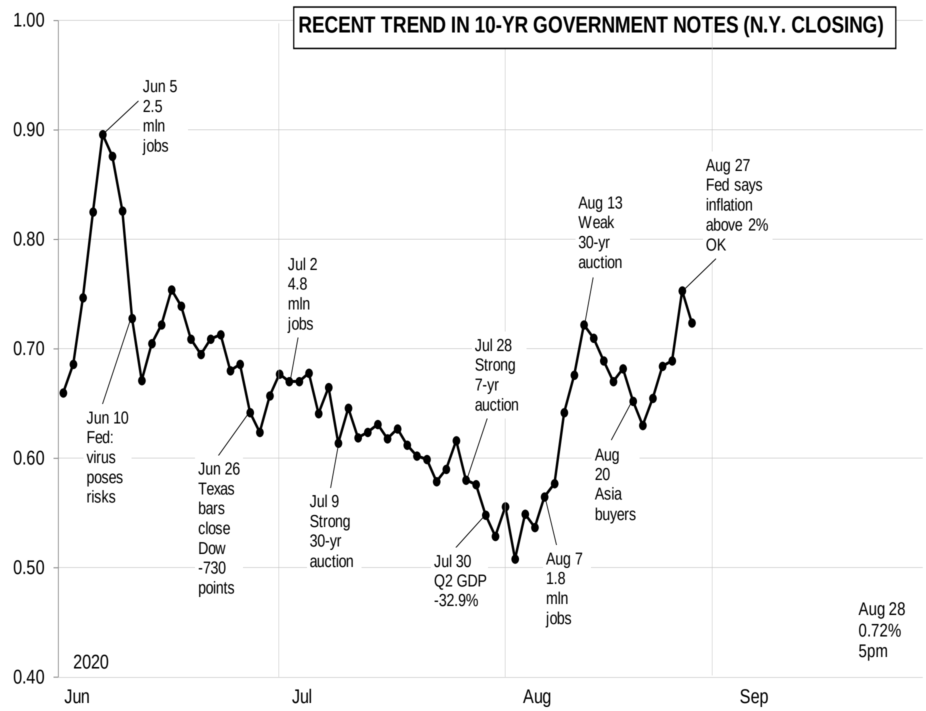


In any case, based on the July durable goods report this week, it looks like business investment in the graph on the first page will rebound 28.5% in Q3 2020, after collapsing 26.0% in Q2 2020. If it rises 4.5% in the fourth quarter this year, then business investment would be down 3.7% for 2020 which is less than the investment pullback seen in the 1990-91 and 2001 recessions. If business investment is unchanged from Q4 2020's level of all of 2021, then investment would rise 2.1% in 2021. Monthly durable goods orders, nondefense capital goods ex-aircraft, is not always the most accurate of proxies for business investment in equipment in the quarterly GDP accounts, but the two measures still tend to move together. GDP real fixed investment in equipment includes aircraft for one thing, and the trucks category includes light trucks, unlike durable goods, which has accounted for a lot of equipment purchases by businesses in recent years. There's uncertainty, but investment is hanging in there.

2019 Billions	How much business investment in equipment?	Percent 2019	2018	2017	2016
1267.7	**Real Fixed Investment in Equipment**	2.0	7.9	3.1	-1.7
	Percentage Point Contributions				
493.9	Information processing equipment	0.97	2.79	2.35	1.37
130.7	Computers, peripheral equipment	0.52	1.14	0.69	-0.06
203.6	Communications equipment	0.27	0.27	1.24	1.22
118.4	Medical equipment, instruments	0.28	1.04	0.62	0.18
36.7	Nonmedical instruments	-0.07	0.36	-0.17	0.00
8.5	Photocopy, related equipment	-0.01	-0.01	0.02	0.09
3.1	Office and accounting equipment	-0.01	0.00	-0.04	-0.05
249.1	Industrial equipment	0.44	1.66	1.07	-0.26
21.9	Fabricated metal products	0.02	0.16	0.03	-0.13
15.9	Engines and turbines	-0.05	0.12	0.11	-0.08
36.7	Metalworking machinery	-0.13	0.19	0.29	-0.17
44.7	Special industry machinery	0.53	0.20	0.04	0.03
86.9	General equip. (materials handling)	0.04	0.55	0.43	-0.04
43.0	Electrical transmission/distribution	0.03	0.44	0.16	0.13
285.7	Transportation equipment	-0.11	1.48	-0.42	-1.60
203.2	Trucks, buses, truck trailers	1.32	2.45	-0.24	0.39
22.3	Autos	-0.17	-1.21	-1.41	-0.92
40.1	Aircraft	-1.39	0.42	1.24	-0.42
7.4	Ships and boats	0.02	-0.06	0.10	-0.17
10.9	Railroad equipment	0.11	-0.12	-0.10	-0.47
264.4	Other equipment	0.79	2.15	0.14	-1.31
47.4	Furniture and fixtures	0.09	0.16	0.15	0.12
42.5	Agricultural machinery	0.26	1.07	-0.15	-0.69
46.6	Construction machinery	0.15	0.41	0.20	-0.10
23.5	Mining, oilfield machinery	-0.09	0.28	0.27	-0.62
35.9	Service industry machinery	0.08	0.15	-0.09	0.09
7.5	Electrical equipment	0.00	0.03	-0.01	-0.01
60.9	Other	0.30	0.05	-0.23	-0.10

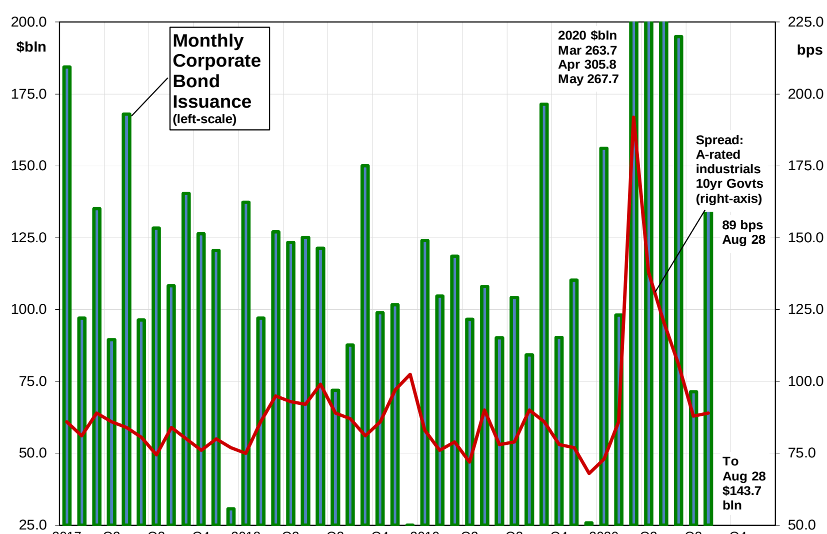
MARKETS OUTLOOK

	28-Jun 2019	30-Sep 2019	31-Dec 2019	31-Mar 2020	30-Jun 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
30-Yr Treasury	2.53	2.11	2.39	1.32	1.41	1.40	1.40	1.50	1.60	1.70
10-Yr Note	2.01	1.67	1.92	0.67	0.66	0.70	0.70	0.80	0.90	1.00
5-Yr Note	1.77	1.55	1.69	0.38	0.29	0.30	0.30	0.40	0.50	0.60
2-Yr Note	1.76	1.62	1.57	0.25	0.15	0.20	0.20	0.20	0.30	0.30
3-month Libor	2.32	2.09	1.90	1.45	0.30	0.30	0.30	0.20	0.20	0.20
Fed Funds Rate	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25
2s/10s spread	25	5	35	42	51	50	50	60	60	70



A new high for 10-year Treasury yields this week which keeps the uptrend in place for another week at least: 10-yr year yields ended at 0.72% versus 0.63% last week. Powell said policymakers would never raise rates until inflation runs moderately above 2% for some time. He said this at the Virtual Jackson Hole conference at 910am ET Thursday morning. 10-yr yields first fell from 0.68% to 0.65% on the news suggesting no Fed rate hikes for a longer period of time, but then yields rose, expecting more inflation down the road (wait for that), and 10-yr yields closed Thursday at 0.75%. This new policy messaging from Fed officials is fine, but the last time the Fed pushed rates to zero in December 2008 they left them down in the gutter for 7 years, so that seems like as good a forecast as any for the future.

CORPORATES: ROYALTY PHARMA, GLENCORE, TENCENT, ENTERGY



Corporate bond offerings were $18.0 billion in the August 28 week versus $33.9 billion in the August 21 week. On Monday, Alabama Power priced a $600 million 1.45% 10-yr (m-w +15bp) at 85 bps (A1/A). The regulated utility owned by the Southern Company will use the proceeds for general corporate purposes, including its continuous construction program and expected procurement of additional generating capacity. Corporate bond yields (10-yr Industrials rated A2) were 89 bps above 10-yr Treasuries Friday versus 88 bps last week.

FEDERAL RESERVE POLICY

The Fed meets September 15-16, 2020 to consider its monetary policy. The news of the week for policy came out of the famous Jackson Hole Economic Policy Symposium with this year's theme of "Navigating the Decade Ahead: Implications for Monetary Policy." The Symposium (look it up) was done virtually this year which meant everyone could attend. Ever been to a Fed conference before? You can now, and careful what you wish for, and good luck with the academic papers presented. Brush up maybe on your maths skills from university. The current Fed Chair Powell gave his remarks on the "Monetary Policy Framework Review" at 910am ET on Thursday, August 27 and the news headlines rocked the bond world when Powell as Fed leader essentially said that inflation could go as high as it wants, we don't care, or something like that. The bond market inflation vigilantes rode high again at least for one last ride in the saddle. Every bond trader worth his or her salt is or has been or should be retired since inflation was a huge bond market issue back in the 1990s. Bond yields actually fell on the Powell headlines on Thursday a little before the 910am ET scheduled release time. Yields fell before the bond traders remembered it is time for one last "reflation trade" where this time the Fed is actually seeking more inflation. Lots of it. So bond yields went back up.

Selected Fed assets and liabilities

Fed H.4.1 statistical release billions, Wednesday data	26-Aug	19-Aug	12-Aug	5-Aug	Sep 10 2008** pre-LEH
Factors adding reserves					
U.S. Treasury securities	4358.559	4345.544	4320.093	4305.651	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1949.228	1977.897	1933.548	1933.466	0.000
Repurchase agreements	0.000	0.000	0.000	0.000	126.750
Primary credit (Discount Window)	2.704	2.818	2.690	2.809	23.455
MMLF	9.961	10.839	11.484	12.253	
PDCF	0.243	0.693	0.693	1.163	
Commerical Paper Funding Facility	8.588	8.588	8.603	8.646	
Paycheck Protection Facility	68.158	67.800	68.177	67.820	
Corporate Credit Facility (CCF)	44.604	44.480	44.413	44.351	
Municipal Liquidity Facility	16.541	16.089	16.088	16.087	
Main Street Lending Program	38.371	37.983	37.734	37.601	
Term Asset-Backed Facility (TALF II)	10.771	10.771	10.124	10.123	
Central bank liquidity swaps	92.140	95.780	99.782	105.663	62.000
Federal Reserve Assets	7039.0	7059.3	7005.9	6993.9	961.7
3-month Libor %	0.26	0.25	0.26	0.24	2.82
Factors draining reserves					
Currency in circulation	2013.961	2009.715	2006.288	2000.875	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Treasury credit facilities contribution	114.000	114.000	114.000	114.000	
Reverse repurchases w/others	0.009	0.112	0.103	0.000	0.000
Reserve Balances (Net Liquidity)	2875.399	2821.849	2828.170	2753.531	24.964
Treasuries within 15 days	64.117	62.806	116.715	119.829	14.955
Treasuries 16 to 90 days	237.185	237.795	222.451	208.908	31.549
Treasuries 91 days to 1 year	663.816	664.486	632.529	642.929	69.272
Treasuries over 1-yr to 5 years	1648.650	1647.558	1642.529	1639.244	170.807
Treasuries over 5-yrs to 10 years	771.901	762.621	754.625	745.463	91.863
Treasuries over 10-years	972.889	970.278	951.244	949.280	101.337

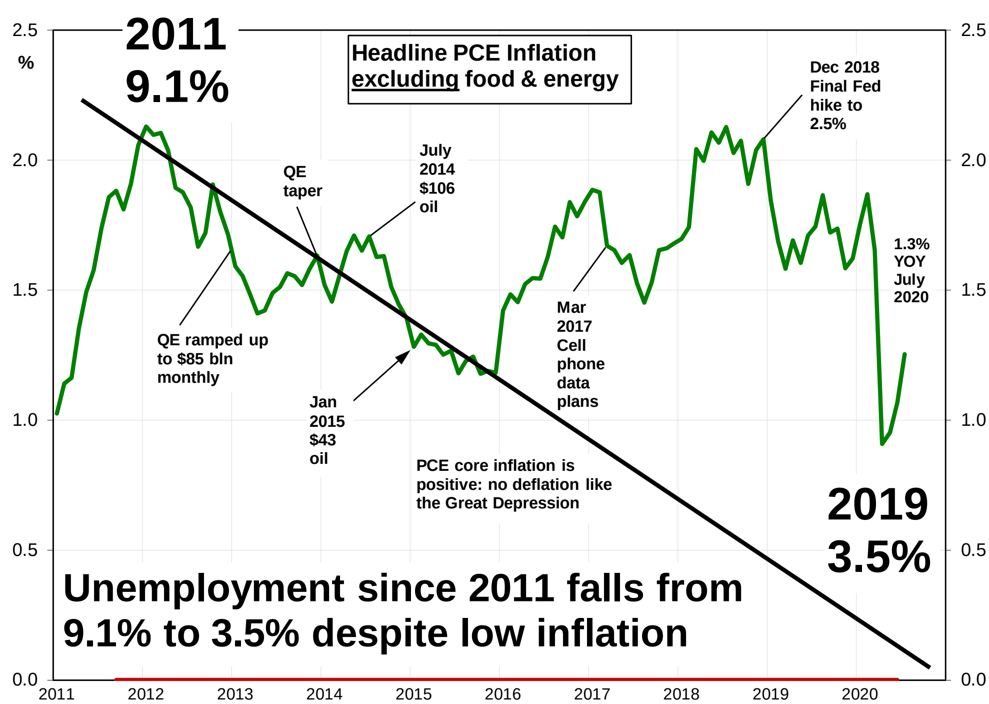
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds

PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days

CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)

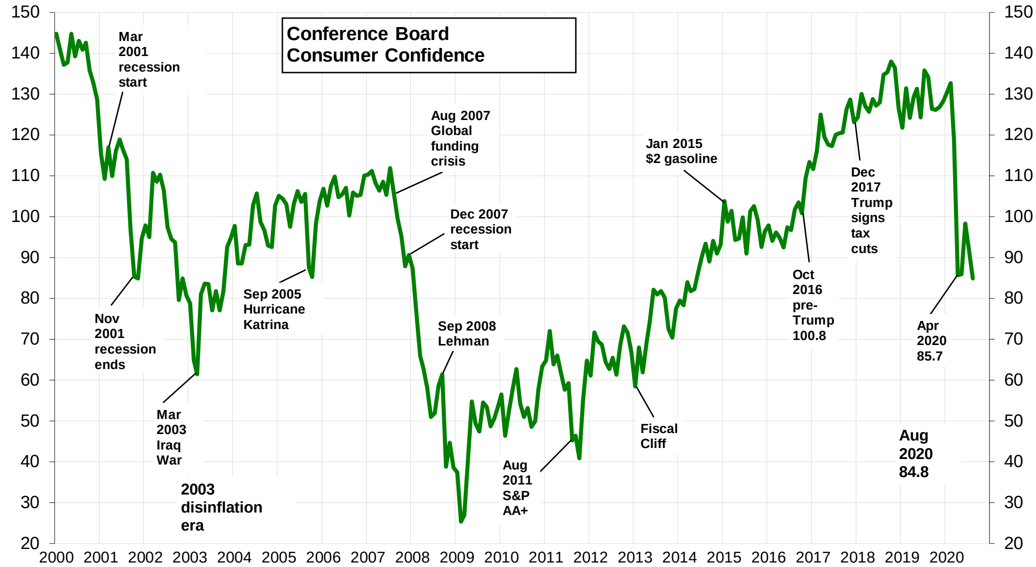
Does it look like low inflation stopped the economy from creating jobs the last decade? Answer: No. Does the Fed really need zero interest rates now when 10,000 baby boomers are reaching the retirement age of 65 years old each day and need to be able to live on the safe and stable, fixed income investment returns generated from bonds in their golden years? Maybe the Fed is right. Rates will be low for the next decade so retirees should throw their hats in the ring, give up, and convert their cash savings into equity shares in the best companies in America: Microsoft, Alphabet, Apple, Amazon, and Facebook.



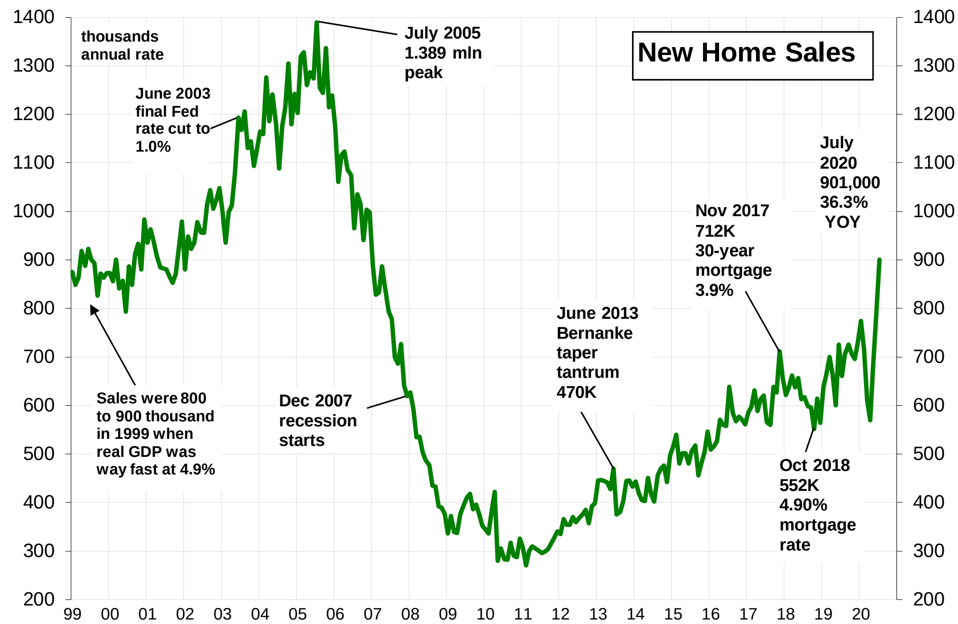
OTHER ECONOMIC NEWS THIS WEEK

Consumers aren't happy then economy won't be (Tuesday)

Breaking economy news. The consumer confidence index dropped to a new low for this recession of 84.8 in the month of August from a revised 91.7 reading in July. Confidence in July had been at a level of 92.6. America is not winning this war with recession yet and Washington may be hurting the recovery more than helping the economy after stopping the $600 weekly unemployment checks prematurely at the end of July.



Meanwhile, new home sales soared to a new record since the housing bubble burst over a decade ago. Sales rose 13.9% to 901 thousand in July. Northeast sales cooled to 40 thousand from 52 thousand last month and sales in the West at 221 thousand were still short of the best levels seen earlier at the turn of the year before the pandemic hit, but everywhere else is strong. Midwest sales were 127 thousand versus 80 thousand last month and sales in the South jumped to 513 thousand in July from 454 thousand in June. There's still millions and millions of jobless workers out there which holds the economy back and darkens the economic outlook later this year.

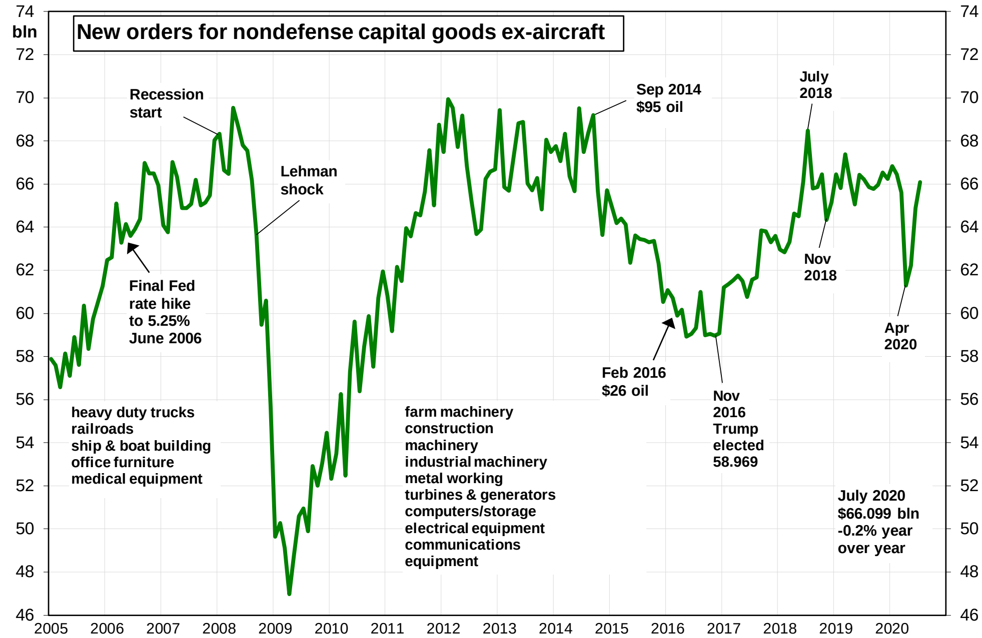


Net, net, the consumer is losing confidence in August and this changes the green light of the recovery from the pandemic recession to a slower yellow caution signal as the lack of additional fiscal stimulus and the coronavirus spread through new communities is taking a toll. Today's confidence and home sales data are telling us that while some lucky workers are able to buy new homes, millions of others are unable to afford life's necessities and pay the rent especially after the Federal government canceled those $600 checks. We estimate the reduction in unemployment benefits in August will cut $50 billion from retail sales this month which is nearly ten percent of sales at shops and malls across America. Stay tuned. The consumer is the most worried they have been all year which pours cold water on the idea that the economic recovery is sustainable.

You can't throw a party for the recession if business equipment orders are up (Wednesday)

Breaking economy news. Durable goods orders jumped 11.2% in July as the worst of the pandemic downturn seems to be slip-sliding away into the history books. It's over for now with our proxy for business investment spending in today's report showing a third consecutive month of gains. Nondefense capital goods orders ex-aircraft rose 1.9% in July to $66.099 billion and are now little changed from February before the country was shut down to fight the spread of the deadly virus. Machinery orders were up 2.0%, computers rose 9.1%, motor vehicles and parts orders jumped 21.9% showing America's businesses are humming. The recession is over America's companies are saying unless there is a second wave somewhere out there on the horizon if for instance downbeat consumers start to slow their purchases and unemployed workers run out of cash to buy basic goods and services.

Net, net, companies are back ordering new equipment as the worst of the pandemic recession is behind us and there are new opportunities to do business with this stay-at-home economy where orders for computers, communications equipment, electrical equipment, appliance and components are seeing a demand-surge. Long-lived capital goods orders have returned to where they were at the start of the year in January and February before the coronavirus sent the economy into lock down.

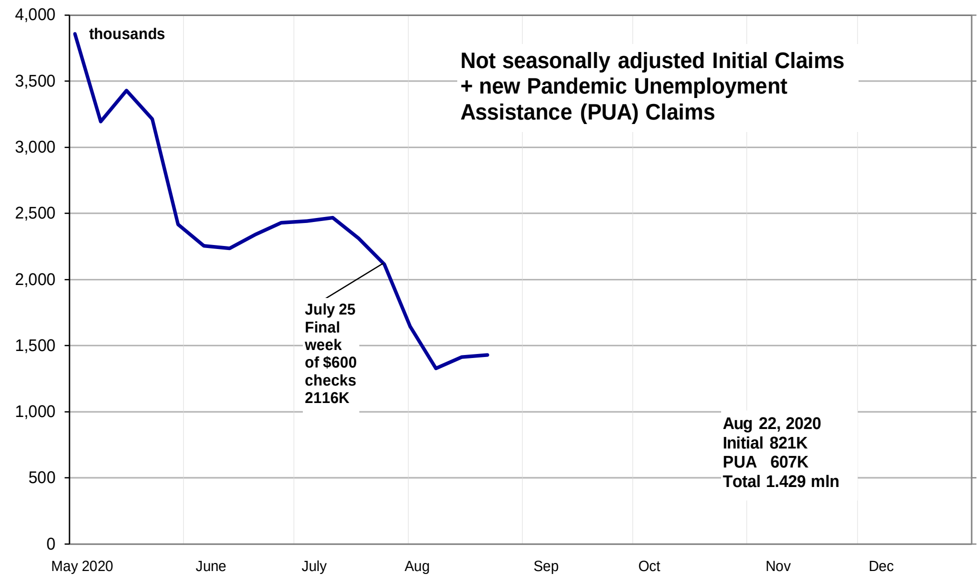


The country cannot be in a recession if businesses are ordering up a storm of long-lived capital goods as this indicates companies have a positive economic outlook not just for the next handful of months but for the next few years. The economy is steady as a rock is what these solid new equipment orders are telling us today. Consumer confidence has suffered lately leading to questions about whether the V-shaped recovery in retail sales will continue, but companies have no such worries at all and see the economic picture brightening as we head into the final months of the year.

Good news. Only a million workers sacked this week, GDP falls just 31.7% (Thursday)

Breaking economy news. Second look at second quarter real GDP shows a revised decline of just 31.7 percent where the estimate a month ago was a larger 32.9 percent drop. Meanwhile, even with the tea leaves saying real GDP could rise back 30 percent in the third quarter, the job losses continue at levels worse than any week seen in the Great Recession over a decade ago. 1.006 million people applied for the regular state unemployment benefit programs in the August 22 week, which is almost a month after the Federal government stopped sending out those $600 weekly checks for unemployment benefits. The new Federal program to send out $300 checks, as long as the FEMA disaster relief funds have any cash left in them, is slow to get off the ground with just a trickle of benefits being sent to the unemployed the last two weeks.

The unemployed are getting more desperate by the day and this points to darkening skies for the economy in August. In the August 22 week, initial claims in the state programs had 821 thousand new applicants for benefits on a not seasonally adjusted basis, and you can add to this the 607 thousand new applicants for the Pandemic Unemployment Assistance program for the self-employed. This economy is not out of the woods yet if there are close to 1.5 million made redundant at their place of employment in just the last week.



Net, net, the recession wasn't quite as deep with real GDP revised slightly better in the second quarter, but the hurricane force winds of the worst downturn since the Great Depression are still hitting America's workers very hard. Without Federal government assistance it will take years for the services-based economy to generate employment opportunities for the workers unable to return to thousands of closed and bankrupt restaurants and bars and retail shops and malls across America. This is the worst recession for income inequality in decades as millions of low-wage workers find themselves without paychecks while millions of professional class, white-collar workers are able to work from home and seem to be getting richer by the day with their retirement funds parked in the stock market.

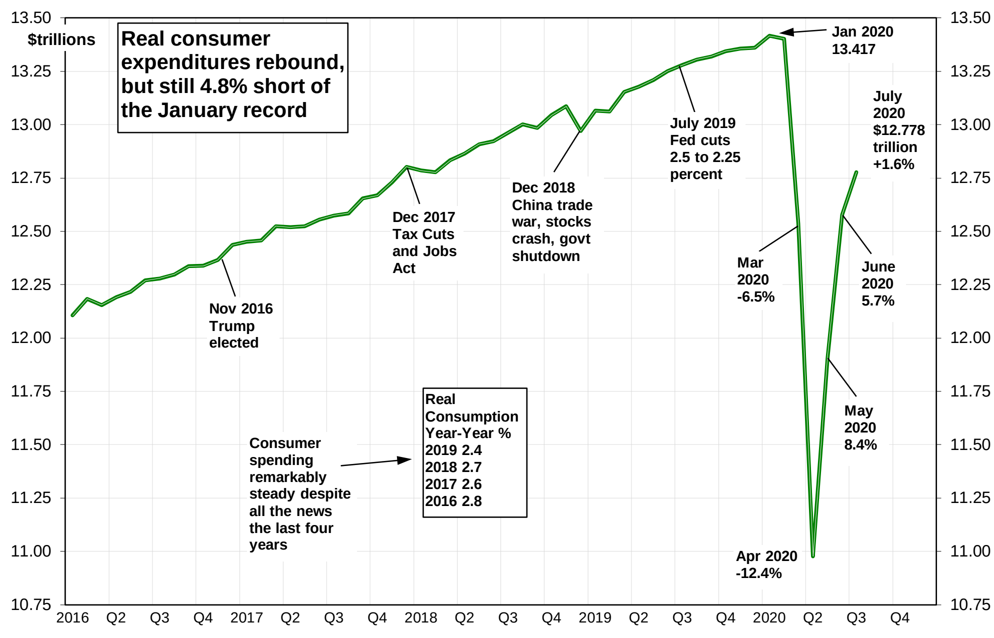
The loss of those $600 weekly unemployment checks is going to hit the economy hard in August with perhaps $50 billion being subtracted from retail sales. This recession isn't over yet. Bet on it.

Big quarter for the consumer, but spending still 5% short of February record (Friday)

Breaking economy news. The Personal Income report for July if you have any money left after remodeling your home, paying up for in-home shopping, and purchasing equipment and accessories for your new work-from-home office. Personal income continues to paint a confusing picture of how much money consumers have given the massive pandemic assistance from the Federal government this year. Personal income rose a solid 0.4 percent in July to $20.042 trillion, but $1.364 trillion is from unemployment insurance which is set to collapse in August when the $600 weekly checks go away. Back in February before the pandemic really got going, unemployment insurance payments were less than $30 billion.

Real consumer spending slowed to a gain of 1.6% in July from 5.7% in June. Spending is still about 5 percent short of the February pre-pandemic all-time record. Nevertheless, real GDP could rise 30 percent in the third quarter if the stars are all in alignment. Real consumer spending fell 34.1 percent in the second quarter but it is rising 36.6 percent in the third quarter with August and September data still to come. It will be choppy for consumer spending as the $600 weekly unemployment benefits go away starting in August, but then the payroll tax cut is coming in September, or at least the U.S. Treasury says they won't collect it, if that's possible, which is worth about $100 billion although for all income levels. The president's plan is to defer collection of the 6.2% tax withheld for social security for workers with incomes less than $105,000. Social security taxes are assessed on incomes up to $137,700 currently.

There's inflation too in today's report, but after Powell said yesterday that he would give inflation a free-pass to grow as much as it wants, eroding the real purchasing power of workers' savings, the inflation data don't need to be monitored as closely. PCE inflation rose 0.3% in July to a 1.0 percent year-to-year rate, and core PCE inflation rose 0.3% in July to a 1.3 percent year-to-year rate.



Net, net, the consumer is back spending at the shops and malls in July, but many of their purchases reflected pent-up demand following the pandemic lockdown, and the expenditures needed to fuel the economy's recovery in August are a big question mark given the hit to personal income nationwide with the loss of those $600 weekly unemployment benefit checks. Unemployment assistance paid out $1.364 trillion in July which is 6.8% of personal income of roughly $20 trillion and these payments could easily drop to $750 billion on the loss of the $600 government checks. Stay tuned. Story developing. Beware of August as no money coming in means no money going out.

Analyst Certification

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