Financial Market Weekly

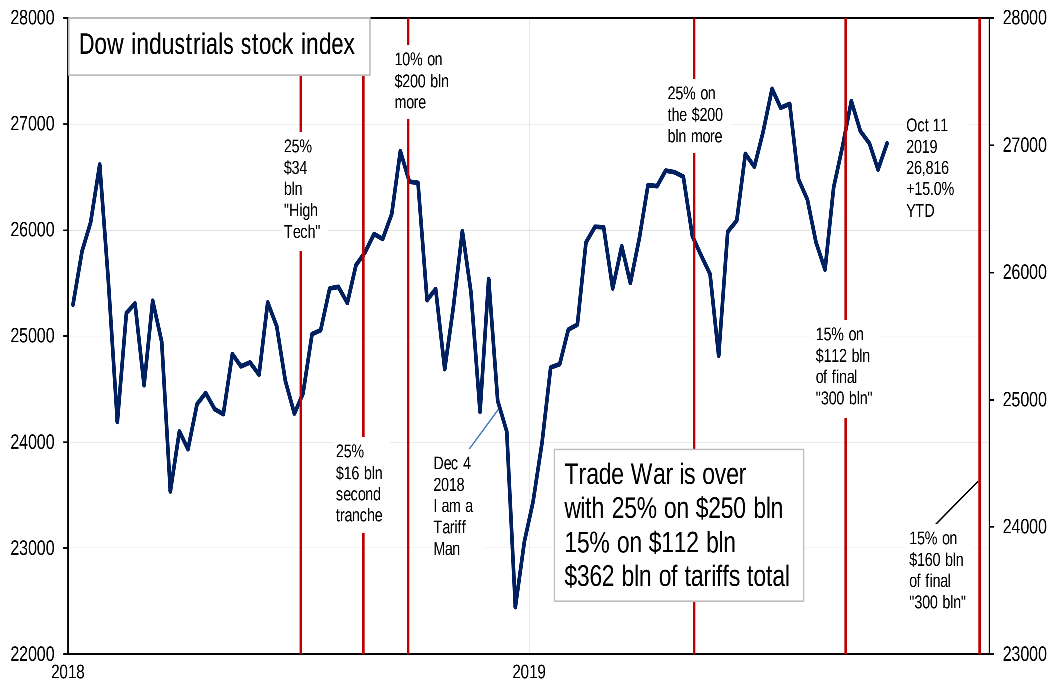
MUFG UNION BANK, N.A.
ECONOMIC RESEARCH (NEW YORK)
CHRISTOPHER S. RUPKEY, CFA
MANAGING DIRECTOR
CHIEF FINANCIAL ECONOMIST
(212) 782-5702
crupkey@us.mufg.jp

MUFG Bank, Ltd.
A member of MUFG, a global financial group

11 OCTOBER 2019

STOCKS CLIMB HIGHER ON THE CHINA-US TRADE TALKS

Stocks climbed higher on the hopes for progress on the U.S. China trade talks this week. Brexit hopes were also supportive of Friday's 319 point gain in the Dow industrials back to 26,816. Stocks had been even higher on Friday, up 517 points intraday, before hopes turned to buy-the-rumor, sell-the-fact reality, and more details emerged from the President's White House announcement where the press was able to ask questions. China is going to buy more agriculture products, there is a currency agreement, the tariff increase on October 15 is suspended, but everything still needs to get "papered" over the next 3 or 4 or 5 weeks in what was announced Friday afternoon as phase 1 of an agreement in principle with China. This is the big deal.



For the stock market, it is a we've been here before moment. It's good that the president announced a big deal with China to help the stock market at the end of this week even if looking back at the stock market's trend the last two years, the overall movement doesn't look like that big of a deal. Keep in mind here that the big gain was made late in 2017 in the run up to the signing of the Tax Cuts and

Jobs Act in December 2017. It really looks like the trade war news with China has done nothing but knock stocks down over the last two years. Then when it looks like the trade talks were back on track, the stock market rallies back. That's where we are today, stocks are back to where we were at the start of 2018 basically. Dow industrials closed Friday, October 11 up 15.0% year-to-date, which is better than a sharp stick poke in the eye, even as all everyone wants to know is the outlook for stocks in 2020 with 67% of CFOs saying we will be in a recession. (Doesn't that survey say that every year?)

A truce between China and the U.S. has been called for now. The final 15% tariffs on $160 billion of imports from China that go into effect on December 15 have not been suspended. These are the goods that Americans appear to want the most: cell phones, laptop computers, video game consoles, certain toys, computer monitors, and certain items of footwear and clothing. The trade war with China if it continues to escalate to the worst imaginable level, would knock nearly a percentage point off GDP growth in 2020 as US consumers and businesses would have to pay the tariff costs. GDP of 2.0% today in the second quarter would come down to about 1.0%. This is the dollars and cents effect if the tariffs on all $540 billion of 2018 imported goods from China rise to 30% across the board. A one percentage point hit to growth is not a recession, and the trade war has not maxed out yet. As we stand today, there are 25% tariffs on $250 billion of goods, and 15% tariffs on $112 billion of goods, or $362 billion in total.

US Trade War on Imports from China

	Tariff	Amount	Total
July 6, 2018	25%	34	34
Aug 23, 2018	25%	16	50
Sep 24, 2018	10%	200	250
May 10, 2019	25%	200	250
Sep 1, 2019	15%	112	362
Dec 15, 2019	15%	160	522
Suspended			
Oct 15, 2019	30%	$250	billion

The outlook for stocks as usual looks rather murky. It is interesting that the market continues to hold onto double-digit gains this year even with the trade war headwinds and CFO forecasts of recession in 2020 and the uncertainty of the 2020 presidential election. Maybe stocks remain buoyant as the Federal Reserve will not be taking away the punch bowl this cycle, if there is still an interest rate cycle. The stock market has forecast 9 of the last 5 recessions according to the first American winner of the Nobel Prize for Economics Paul Samuelson in 1970. The week ending Fridays drop in the Dow industrials at the turn of last year was 16.1%, which is the worst retreat since the 15.1% market rout in 2011 when S&P downgraded the U.S. rating from triple-A to AA+. There was no recession in 2011 after stocks collapsed and nothing yet in the ten months since stocks dropped 16.1% in December 2018.

Dow industrials market sell-offs

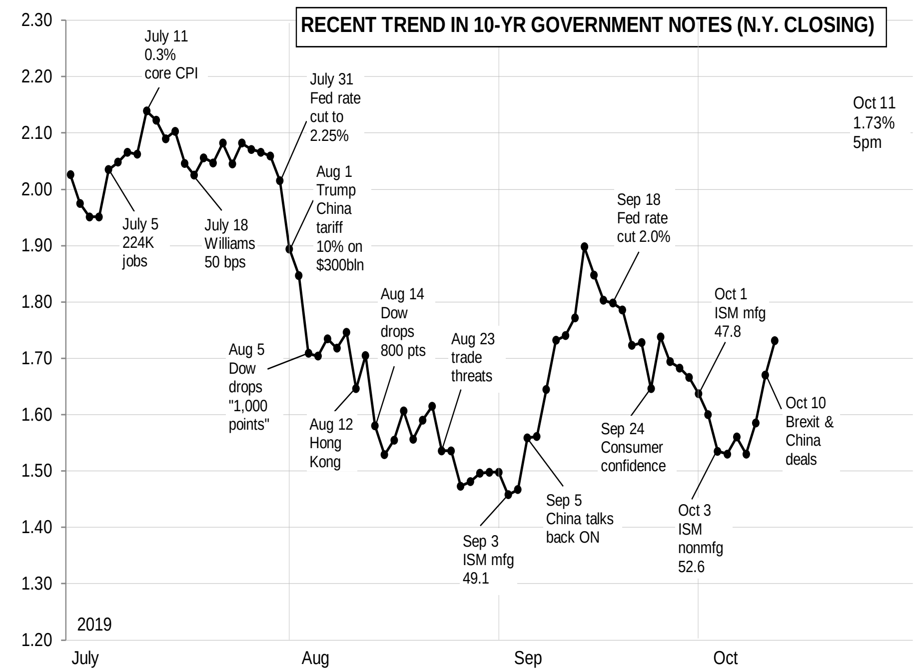
Week ending Fridays

Chg %	Points	High	Low	High	Low	Reason
-11.9	-2170.2	5-15-15	9-4-15	18,272.6	16,102.4	China, oil, 1,000 point flash crash Monday, Aug 24
-10.8	-1936.5	11-6-15	2-12-16	17,910.3	15,973.8	Fed liftoff, China, $20 oil, world growth, Japan negative rates
-5.3	-947.99	June 2016		18,011.1	17,063.1	Brexit: Two days June 23 close to Monday, June 27 low
-11.6	-3083.5	1-26-18	3-23-18	26,616.7	23,533.2	VIX-Linked Notes; China; Trade war(s)
-16.1	-4298.1	9-21-18	12-21-18	26,743.5	22,445.4	Fed hikes, 3.2% 10-yr, China war, Trump shutdown
-6.6	-1744.5	4-19-19	5-31-19	26,559.5	24,815.0	$200bln China tariffs from 10 to 25%, Trump tariffs Mexico
-6.2	-1703.1	7-12-19	8-23-19	27,332.0	25,628.9	Trump 10% tariff on $300bln, 2s10s yield curve inverts

MUFG

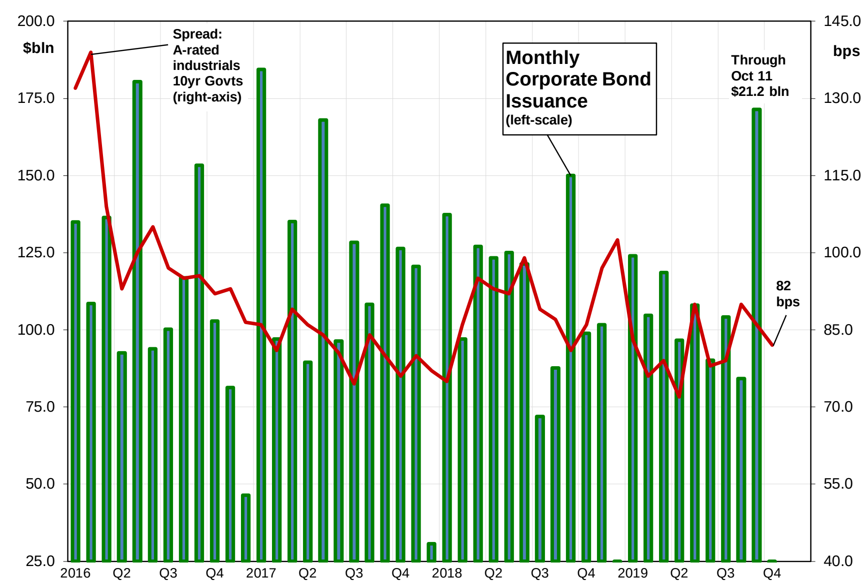
MARKETS OUTLOOK

	29-Mar 2019	28-Jun 2019	30-Sep 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
30-Yr Treasury	2.81	2.53	2.11	2.20	2.25	2.30	2.40	2.50	2.70
10-Yr Note	2.41	2.01	1.67	1.75	1.80	1.90	2.10	2.20	2.40
5-Yr Note	2.23	1.77	1.55	1.55	1.65	1.75	1.85	2.05	2.25
2-Yr Note	2.26	1.76	1.62	1.60	1.60	1.70	1.80	2.00	2.20
3-month Libor	2.60	2.32	2.09	2.10	2.10	2.10	2.10	2.20	2.20
Fed Funds Rate	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00
2s/10s spread	15	25	5	15	20	20	30	20	20



Treasury yields rose this week on hopes for a China deal and a Brexit deal. There were hopes for a partial China deal starting on Wednesday. A soft 0.1% core CPI reading on Thursday, marked the start of bond market selling with a Trump China tweet and Brexit news around 10am EDT. 10-yr Treasury yields were 1.58% before the CPI inflation data Thursday morning and closed the week 15 bps higher at 1.73%. Market-based odds of Fed action move with Treasury yields and now just one more rate cut to 1.75% is discounted by the end of the year. Fed funds futures say the odds of a rate cut at the first Fed decision date on October 30 are 62%. Eurodollar futures expiring in December next year are consistent with a 1.5% Fed funds rate.

CORPORATES: MANY BANKS, HONDA, TOYOTA, D.R. HORTON, PEPSICO



Corporate offerings were $13.1 billion in the October 11 week versus $7.7 billion in the October 4 week. On Tuesday, CubeSmart LP priced a $350 million 3.0% 10-yr (m-w +25bp) at 150 bps (Baa2/BBB). The self-storage facilities company will use the proceeds to repay its revolving credit facility and for working capital. Corporate bond yields (10-yr Industrials rated A2) were 82 bps above 10-yr Treasuries Friday versus 81 bps last Friday.

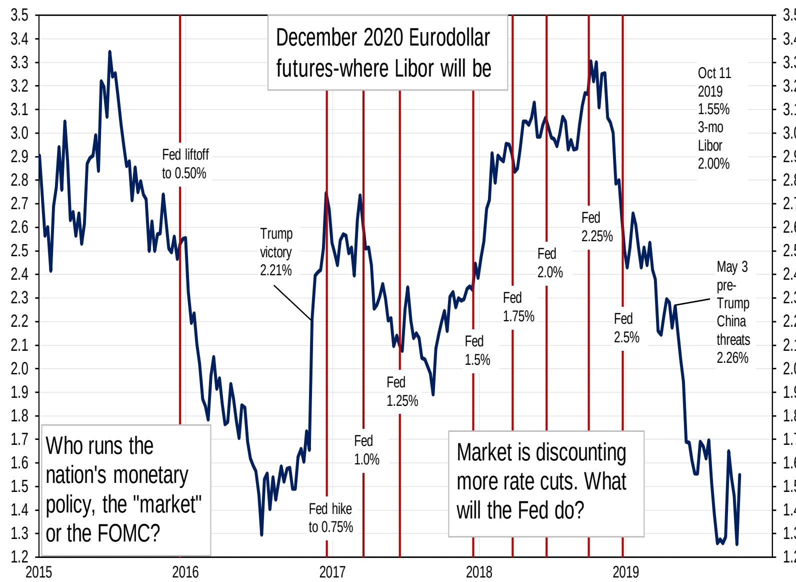
FEDERAL RESERVE POLICY

The Fed meets October 29-30 to consider its monetary policy. It's a good thing that the geopolitical and trade war risks diminished at the end of the week because some Fed officials think they might need to do more. A lot more. We don't want to forecast it, but it feels like Fed officials want to cut rates a third time this year to 1.75% at the October meeting. Three rate cuts were done during the 1990s which current Fed officials admire as smart policy "that worked," and are calling again for these limited easing insurance style, risk management rate cuts just in case something goes wrong, just a midcycle correction… even though none of them were "working" at the Fed in the 1990s. Doing more than three rate cuts would not be insurance; it would have to be because they thought the economy was headed over the cliff down in to a recession.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	9-Oct	2-Oct	25-Sep	18-Sep	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2121.485	2117.130	2107.683	2105.826	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1467.273	1467.260	1467.257	1484.434	0.000
Repurchase agreements	178.650	181.050	105.000	75.000	126.750
Primary credit (Discount Window)	0.001	0.031	0.004	0.004	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	0.039	0.973	0.042	0.039	62.000
Federal Reserve Assets	3998.2	3993.3	3906.0	3892.9	961.7
3-month Libor %	1.98	2.06	2.10	2.16	2.82
Factors draining reserves					
Currency in circulation	1769.136	1765.667	1762.927	1762.755	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	1.469	3.054	0.133	18.910	0.000
Reserve Balances (Net Liquidity)	1528.394	1486.710	1427.289	1385.426	24.964
Treasuries within 15 days	0.028	0.128	13.085	12.985	14.955
Treasuries 16 to 90 days	77.561	77.461	66.568	66.593	31.549
Treasuries 91 days to 1 year	267.176	267.176	269.442	269.514	69.272
Treasuries over 1-yr to 5 years	849.095	848.695	839.685	837.878	170.807
Treasuries over 5-yrs to 10 years	302.408	302.345	297.606	297.580	91.863
Treasuries over 10-years	625.217	621.326	621.296	621.275	101.337

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

Fed officials from both sides of the aisle sounded worried about a slowdown of the labor market. Uh-oh. Dum da dum dum. Dumb idea to cut rates more than three times this year. It will start them down the road to ruining the financial system, hurting fixed income returns for savers like retirees and their pension funds, sending Wall Street into a downward spiral. Minneapolis Fed President Kashkari and Cleveland Fed President Mester said in news headlines this week they are concerned about a slowing of the economy. Mester "will be particularly attentive to signs that the weakness in investment and manufacturing is broadening, and spilling over to reductions in hiring and household spending." Kashkari sees signs the labor market is softening, that wage growth is softening. Most Fed officials say they stand ready to do more than insurance rate cuts if the economy tanks. Not sure what the effect on the economy would be if they cut rates from say 1.75% down another 100 bps to 0.75% or so. Meanwhile the market discounts fewer rate cuts ahead after the big China deal. Fed funds futures are discounting a 62% chance of a rate cut at the October 29-30 meeting and one 25 bps rate cut in total is discounted by the December 10-11 meeting.



Odds of Rate Cuts	
Fed funds futures	
F10-11-2019	
	Fed meeting
15.5	October 30
27.0	December 11
Total bps of cuts discounted at future Fed meetings	

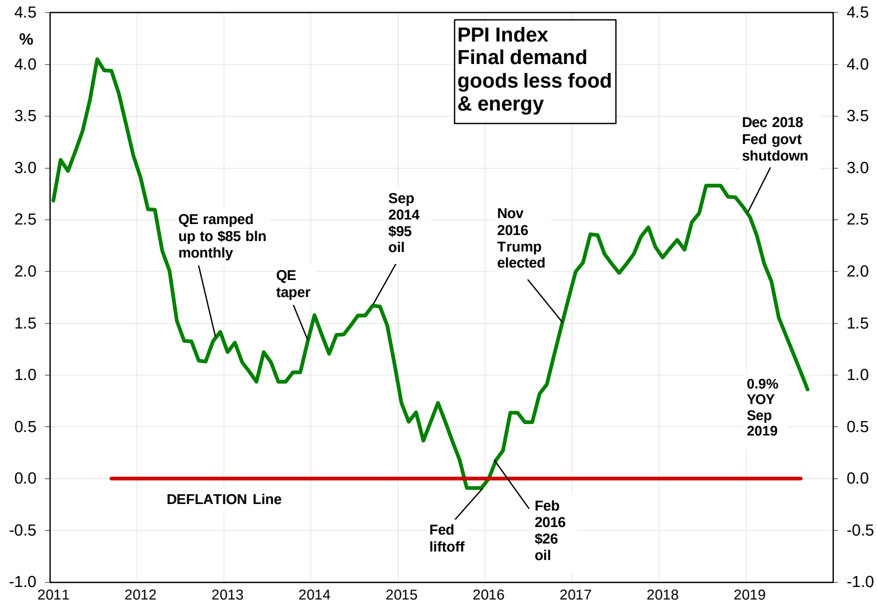
Year-ends for Interest Rates				
Percent %	2019	2020	2021	2022
Eurodollar futures	1.9	1.55	1.48	1.52
Fed's Sept forecast	2.0	2.0	2.25	2.5
Eurodollar futures price where 3-month Libor will be in the future. Friday, October 11, 2019 3-month Libor 2.00%				

OTHER ECONOMIC NEWS THIS WEEK

Producer prices are falling like there's deflation out there (Tuesday)

Breaking economy news. It's fall and there is deflation not inflation in the air. Winter is coming. Here we are ten years into an economic expansion and producer prices are falling instead of heating up with the long period of growth where the economy is running out of resources and inflation pressures start to build.

PPI total final demand prices fell 0.3% in September after a couple months of gains in July (0.2%) and August (0.1%). The deflation in goods prices is exactly what textbooks say we should see if the manufacturing sector is in recession.

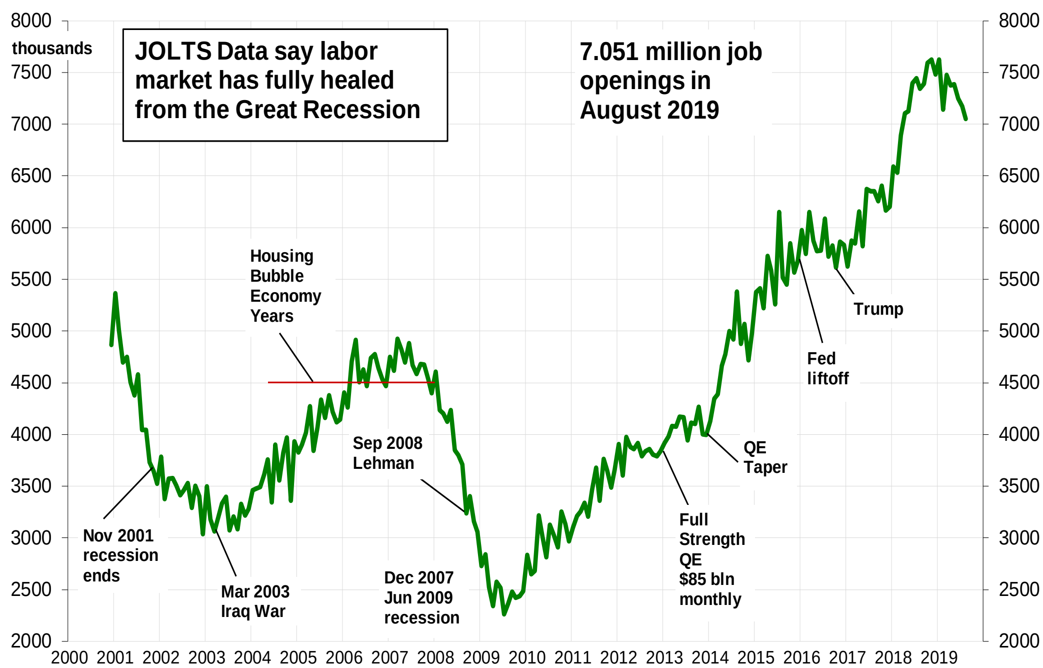


Net, net, it's deflation in the manufacturing sector that is the bigger worry for Fed officials as they meet in a couple of weeks if today's producer prices report is true. Most of the decline is in the category of Trade appropriately enough with the heated trade war and protectionist measures we've seen this year. The Trade category fell a whopping 1.0%. Half of the decline in PPI services prices were in the category of machinery and vehicle wholesaling which fell 2.7%.

The manufacturing sector is cooling and the deflation seen in producer goods and reduced margins received by wholesalers and retailers is helping to build the case for the Fed to take out some more insurance to guard against a broader downturn in the economy. The trade war is hurting margins and pricing power for manufacturers making it hard to see how America is winning this trade war with the world. Stay tuned. Story developing.

Jobs, jobs, jobs have peaked (Wednesday)

Breaking economy news. Job openings and labor turnover survey (Jolts). Millions of jobs out there in the country at 7.051 million in August. The peak was 7.626 million openings last November so the labor market may have passed its peak for hiring demand in this business cycle. Fed officials have backed off their rate hikes and actually cut interest rates, but this 180 degree policy shift may be too little too late. Companies don't have the same high demand for workers after the financial crisis and government shutdown at the end of the year which made a dent in business confidence. To be sure, today's Jolts data are not a sign the economy is going off the rails, it's just that the economy may have already had its best day for this cycle. It's not all gloom and doom for the jobs market. There is still a massive imbalance between the supply and demand for labor that may itself constitute another headwind for sustainable economic growth. There were 6.044 million unemployed versus the 7.051 million job openings in August.



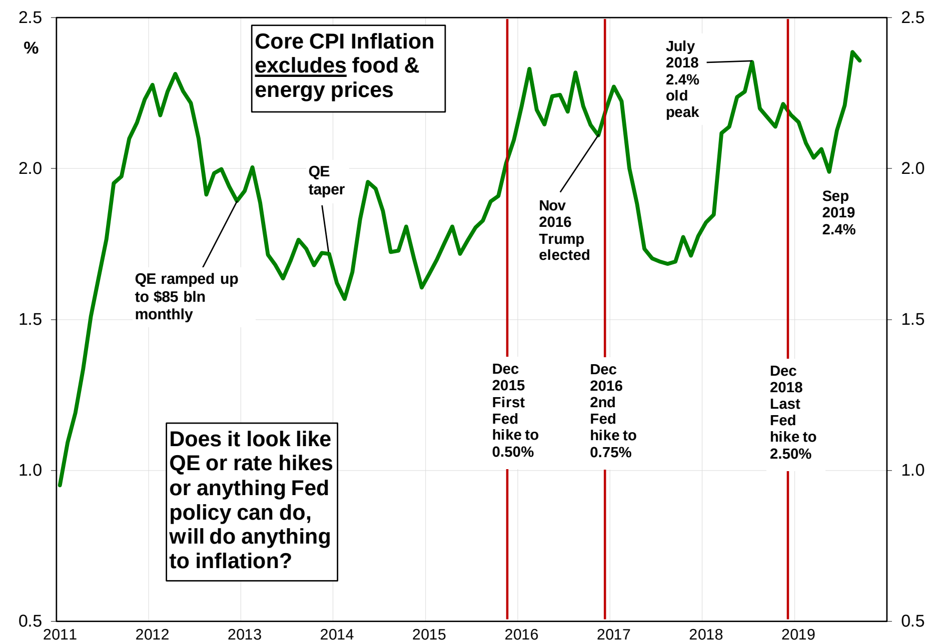
Net, net, American companies still want you to come to work for them so business remains open for now despite the headwinds of uncertainty and risks posed by the escalation of the trade war. The trade war was still coming though in August. There were still just tariffs on the first tranche of sanctioned China imports of $250 billion in August. The first installment of the second tranche of roughly $300 billion didn't occur until September 1 with 15 percent tariffs on $112 billion. Stay tuned. The labor market is slipping a little, but it's not flashing any recession signals yet. You can't have a recession with 7 million help wanted signs posted up in factory and store windows around the country. Bet on it.

Trade war not seen in CPI and jobless claims data (Thursday)

Breaking economy news. Jobless claims fell back 10K to 210K in the October 5 week as the labor market remains tight as a drum and the GM strike has not led to increased filings.

Meanwhile, CPI inflation cooled this month with core prices rising just 0.1% in September after three prior months of 0.3% gains. The year-on-year core CPI inflation rate remains stuck at 2.4% for a second month which is as high as it was in the housing bubble years when the Fed was busy raising interest rates as high as 5%.

No need for Fed officials to raise rates this time because core CPI inflation of 2.4% can run above the Fed's 2% inflation target to make up for the months where core CPI inflation was less than 2.0%. This is part of the Fed's makeup inflation strategy that they are floating which all sounds completely made up to us and not based on any serious fundamental economic theory we were ever taught.



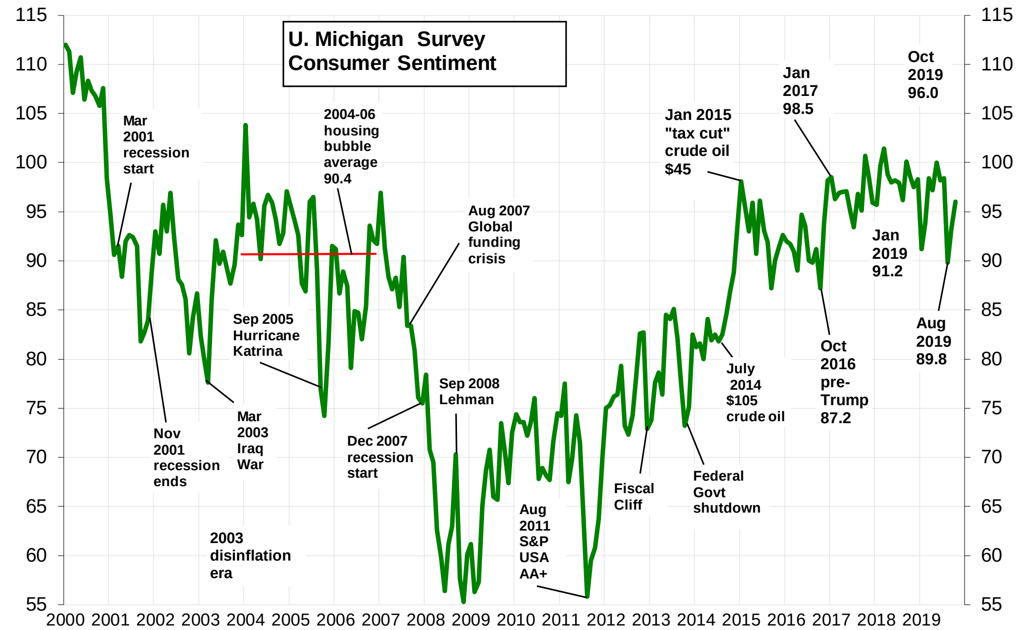
All this made up, makeup inflation strategy does is tell the public that the Fed won't raise interest rates for years and years and years once they push rates to zero in the next recession if it ever comes to that. That's good. Interest rates will be so low that they will no longer be an important cost for businesses to consider when planning for the future. Interest rates will be so low we won't need to hear from Fed officials on what they think about the economic outlook. The irony is this made up inflation proposal comes at a time when there's lots of inflation with core CPI running 2.4 percent for a second month in a row. Do you agree? Send us your thoughts. Let's discuss.

Net, net, the trade war headwinds of uncertainty that the economy is battling are nowhere to be seen where the tariffs are not boosting consumer inflation and companies have not scaled back their workforces in the face of weakening demand. There is no weakening of demand otherwise businesses would trim their headcounts.

The bottom line is inflation and jobs are holding up in this long trade war and there is not much that Fed officials need to or even can do. There is no negative effect yet to the economy from the U.S. economic war with China which may embolden US trade negotiators when they sit down at the table with their counterparts today as the steady economic outlook says Trump's advisers are free to tighten the sanctions and measures up a notch against China to get them to change business practices and buy more goods from the USA.

Consumers more confident even before Brexit and China trade risks fall (Friday)

Breaking economy news. The Michigan consumer sentiment index rebounded to 96.0 in October from 93.2 in September. The consumer isn't shouting the sky is the limit, but they are saying they see blue sky ahead for their own confidence and they don't believe there are any headwinds that might limit their spending at shops and malls that helps make the wheels of the economy go. If business confidence improves with a resolution of the trade war and Brexit headwinds, companies may invest more in the future which would go a long way to reducing the expectations for a recession next year.



Net, net, the economy is out of danger based on the rebound in consumer sentiment from the crisis of confidence this summer when the stock market collapsed over the escalation of the trade war between China and the US. Even brighter confidence readings are likely to lie ahead that will brighten the economic outlook in the months to come if the rumors the stock market is trading up on come true with a resolution of both the Brexit risks to the world economy and an agreement on trade between the US and China. Brexit and China risks are both major factors behind the slowing seen in the global economy. Consumer confidence rising today puts the economy in a good place especially if Fed officials take out more insurance and give the markets the third rate cut they want at the end of this month.

A Federal Reserve interest rate cut could still be coming even as the geopolitical risks from Brexit and the trade war diminish because the inflation outlook is still mixed as the latest import prices data remind us this morning. Import prices of nonfuel goods have either fallen or were lower every month this year since February. Nonfuel import prices fell 0.1% in September and were down 1.1% from last year. Fed officials can't import the inflation they want of that we can be certain. Stay tuned. Story developing.

Analyst Certification

The views expressed in this report accurately reflect the personal views of **Christopher S. Rupkey**, the primary analyst responsible for this report, about the subject securities or issuers referred to herein, and no part of such analyst's compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.

The information herein is provided for information purposes only, and is not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. Neither this nor any other communication prepared by MUFG Bank, Ltd. (collectively with its various offices and affiliates, "MUFG Bank") or should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective in light of your business objectives or operations. Before entering into any particular transaction, you are advised to obtain such independent financial, legal, accounting and other advice as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by MUFG Bank. MUFG Bank hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting or other issues or risks that may arise in connection with any particular transaction or business strategy. While MUFG Bank believes that any relevant factual statements herein and any assumptions on which information herein are based, are in each case accurate, MUFG Bank makes no representation or warranty regarding such accuracy and shall not be responsible for any inaccuracy in such statements or assumptions. Note that MUFG Bank may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information set forth herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the analysts who prepared them, and MUFG Bank is under no obligation to ensure that such other reports are brought to your attention.

Copyright 2019 MUFG All Rights Reserved

The articles and opinions in this publication are for general information only, are subject to change, and are not intended to provide specific investment, legal, tax or other advice or recommendations. The information contained herein reflects the thoughts and opinions of the noted authors only, and such information does not necessarily reflect the thoughts and opinions of MUFG or its management team. We are not offering or soliciting any transaction based on this information. We suggest that you consult your attorney, accountant or tax or financial advisor with regard to your situation. Although information has been obtained from sources we believe to be reliable, neither the authors nor MUFG vouch for its accuracy, and such information may be incomplete or condensed. Neither the authors nor MUFG shall be liable for any typographical errors or incorrect data obtained from reliable sources or factual information.

About Mitsubishi UFJ Financial Group, Inc.'s U.S. Operations including MUFG Americas Holdings Corporation

The U.S. operations of Mitsubishi UFJ Financial Group, Inc. (MUFG), one of the world's leading financial groups, has total assets of $326.5 billion at September 30, 2018. As part of that total, MUFG Americas Holdings Corporation (MUAH), a bank holding company and intermediate holding company, has total assets of $161.0 billion at September 30, 2018. MUAH's main subsidiaries are MUFG Union Bank, N.A. and MUFG Securities Americas Inc. MUFG Union Bank, N.A. provides a wide range of financial services to consumers, small businesses, middle-market companies, and major corporations. As of September 30, 2018, MUFG Union Bank, N.A. operated 354 branches, consisting primarily of retail banking branches in the West Coast states, along with commercial branches in Texas, Illinois, New York and Georgia, as well as 22 PurePoint® Financial Centers. MUFG Securities Americas Inc. is a registered securities broker-dealer which engages in capital markets origination transactions, private placements, collateralized financings, securities borrowing and lending transactions, and domestic and foreign debt and equities securities transactions. MUAH is owned by MUFG Bank, Ltd. and Mitsubishi UFJ Financial Group, Inc. MUFG Bank, Ltd., a wholly owned subsidiary of Mitsubishi UFJ Financial Group, Inc., has offices in Argentina, Brazil, Chile, Colombia, Peru and Canada as well as branches, agencies and representative offices in the U.S. Visit https://www.unionbank.com/ or https://www.mufgamericas.com/ for more information.

About MUFG

Mitsubishi UFJ Financial Group, Inc. (MUFG) is one of the world's leading financial groups. Headquartered in Tokyo and with over 360 years of history, MUFG has a global network with over 1,800 locations in more than 50 countries. The Group has over 150,000 employees and offers services including commercial banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing. The Group aims to "be the world's most trusted financial group" through close collaboration among our operating companies and flexibly respond to all of the financial needs of our customers, serving society, and fostering shared and sustainable growth for a better world. MUFG's shares trade on the Tokyo, Nagoya, and New York stock exchanges. For more information, visit https://www.mufg.jp/english.