Financial Market Weekly

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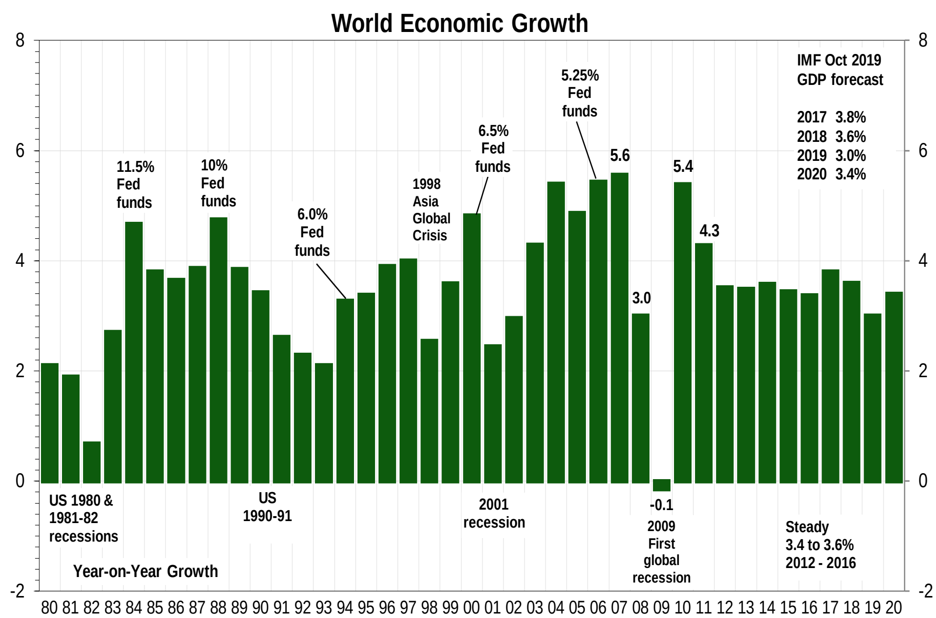
WORLD ECONOMIC SLOWDOWN GETS WORSE

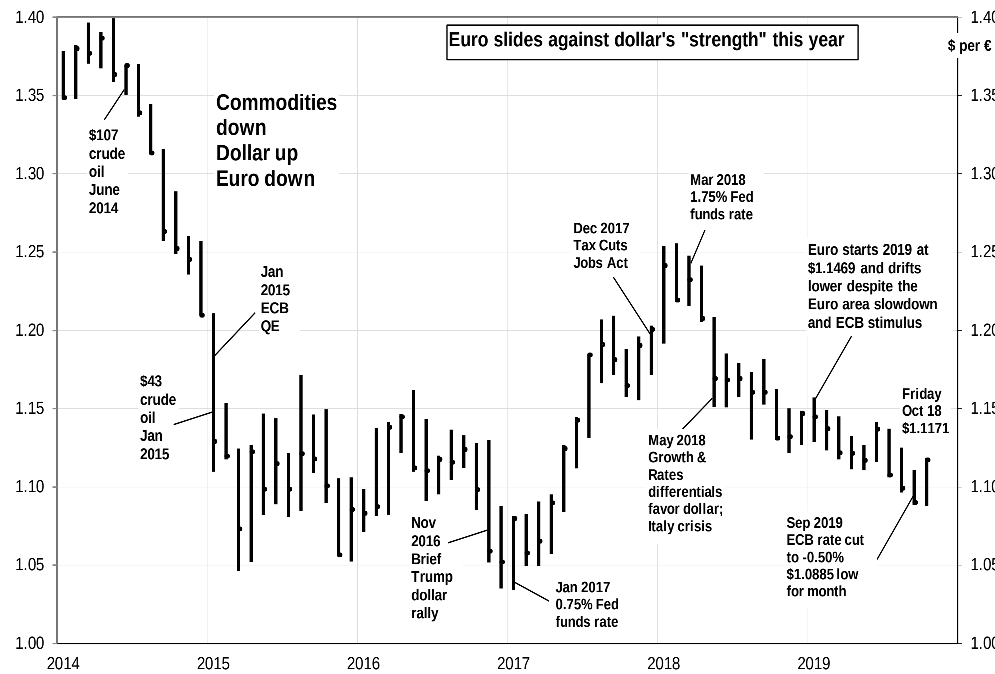


The world economy slowed further this year according to IMF forecasts released at 9am EDT Tuesday morning. Some news headlines said the IMF had slashed its forecast and it was the slowest growth for the global economy in ten years. At least the market didn't trade (down) on the news. There are a lot of fears for world growth with the ongoing China-U.S. trade war, but growth has been remarkably steady since 2009 when it fell 0.1% in the first worldwide recession in modern economic history. In 2019, the IMF says world growth will be 3.0%. Not so bad. At the start of the year they said growth would be 3.5% this year, revising that down to 3.3% in their April forecast, and even lower to 3.2% in their July outlook. They do say growth will rebound to 3.4% in 2020 so it's not all gloom and doom for the world despite the risks.

> Donald J. Trump 9-12-19 8:13AM EDT
> @realDonaldTrump
> European Central Bank, acting quickly, Cuts Rates 10 Basis Points. They are trying, and succeeding, in depreciating the Euro against the VERY strong Dollar, hurting U.S. exports…. And the Fed sits, and sits, and sits. They get paid to borrow money, while we are paying interest!

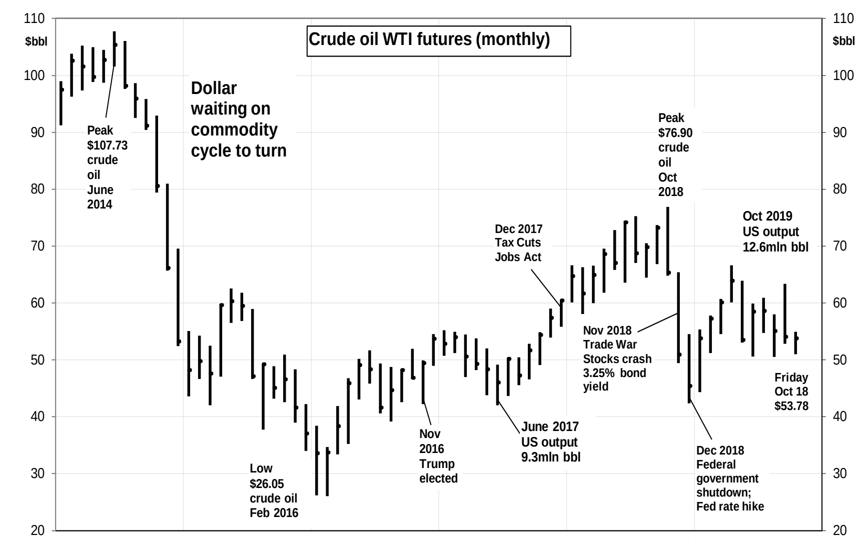
Looking through all the country forecasts, we are reminded of President Trump's tweets this year about ECB stimulus that depreciates the Euro and hurts U.S. exports. In foreign exchange markets, it seems at times the markets think that it is a battle between which economy goes into recession first.

Perhaps some of the dollar's strength is related to fears of a recession in Europe. The IMF forecasts still favor U.S. growth over Europe. In the U.S., growth is forecast at 2.4% in 2019 and 2.1% in 2020. In the Euro Area, growth is forecast at 1.2% in 2019 and 1.4% in 2020. Growth differentials have favored the dollar for some time, yet the dollar didn't strengthen all that much this year.



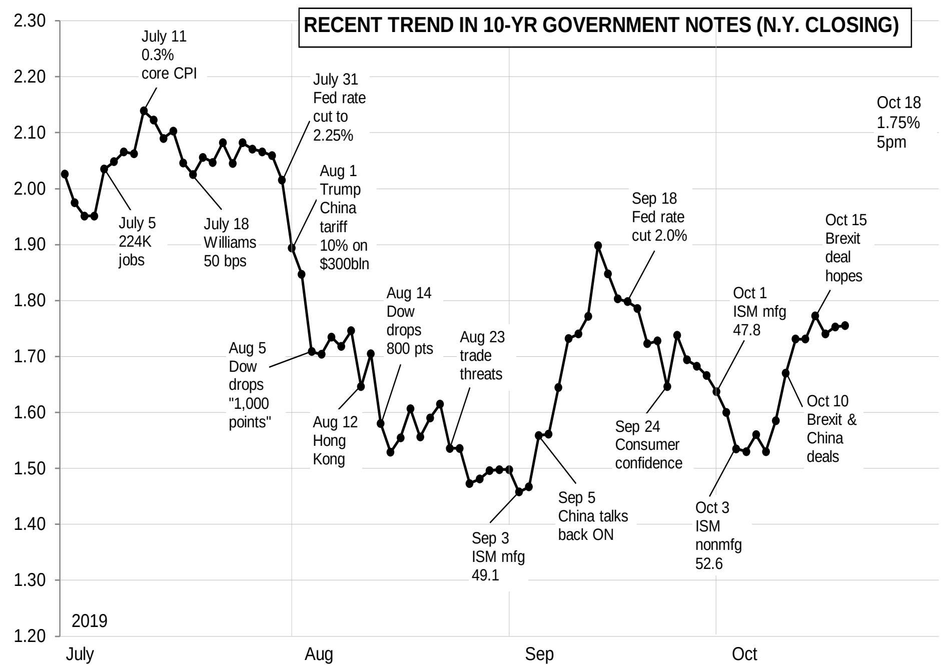
The dollar had a big rally in 2014 when commodity prices crashed. This was a concern of exporters and multinationals and it played a role in dampening the confidence of American manufacturers in the ISM survey in 2015. 2015 was our last "manufacturing recession" that didn't spread to the rest of the economy. The dollar flat-lined for a while and there was a brief Trump dollar rally. The year 2017 saw the Euro appreciate 20 cents from $1.05 to $1.25. In 2018 the dollar may have gotten a boost from a stronger economy with the Tax Cuts and Jobs Act passage in December 2017, and the Fed boosting rates from "zero" to 1.75% in March 2018 may have helped turn the trend. The dollar's relative strength since the start of 2018 really got rolling in May 2018, growth and interest rate differentials moved in dollar's favor, and there was a political crisis in Italy that threatened the Euro.

To conclude, we would expect the world economy to stay on its feet with growth of 3.0% in 2019, which is not all that weak looking back to the downturn in 2009, before rebounding in 2020. The dollar has appreciated somewhat against the Euro this year before the Euro bounced in October on the hopes for a Brexit deal. If world growth stays on track the demand for commodities should rally prices, keep your eye on crude oil despite the fracking U.S. supply, and commodities up always means the dollar down and the Euro up eventually. The ECB is done cutting interest rates and the Federal Reserve is just beginning which may weaken the dollar as well.



MARKETS OUTLOOK

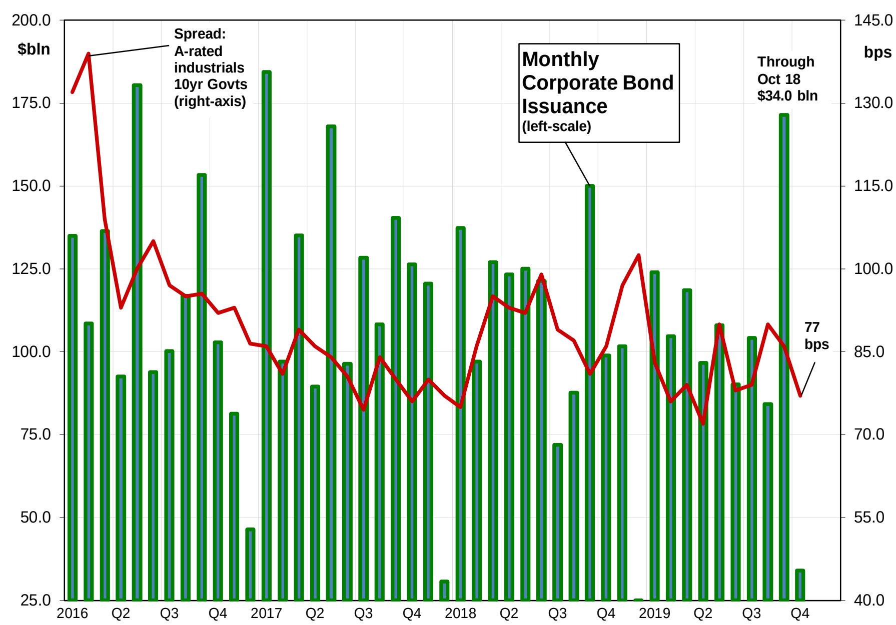
	29-Mar 2019	28-Jun 2019	30-Sep 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
30-Yr Treasury	2.81	2.53	2.11	2.20	2.25	2.30	2.40	2.50	2.70
10-Yr Note	2.41	2.01	1.67	1.75	1.80	1.90	2.10	2.20	2.40
5-Yr Note	2.23	1.77	1.55	1.55	1.65	1.75	1.85	2.05	2.25
2-Yr Note	2.26	1.76	1.62	1.60	1.60	1.70	1.80	2.00	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 traded mostly on the Brexit deal news this week. It was the decline in retail sales reported Thursday though that edged up the odds of a Fed rate hike on October 30 by another 15% or so. Bonds closed the week at 1.75% and no one would be surprised if the Fed cuts rates to 1.75% at the end of this month, so bonds are priced appropriately. We don't think Powell will hint at the press conference on October 30 that they are going to cut a fourth time this year. The insurance style rate cuts that Fed officials have fond memories of in the 1990s were only 75 bps. More than three rate cuts would require recession economic data or an end of the China-U.S. ceasefire.

CORPORATE BONDS: ANOTHER WEEK OF FINANCIALS

Corporate offerings were $12.7 billion in the October 18 week versus $13.1 billion in the October 11 week. On Tuesday, Charter Communications priced a $1.5 billion 4.8% 30-yr (m-w +40bp) at 260 bps (Ba1/BBB-). The cable telecommunications company will use the proceeds to fund potential stock buybacks and repay certain indebtedness. Corporate bond yields (10-yr Industrials rated A2) were 77 bps above 10-yr Treasuries Friday versus 82 bps last Friday.



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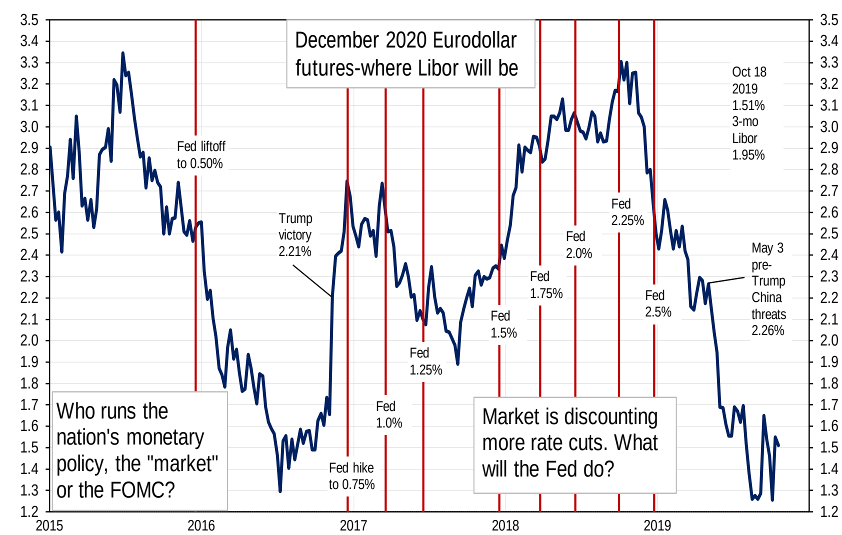
FEDERAL RESERVE POLICY

The Fed meets October 29-30 to consider its monetary policy. Market odds of a 25 bps rate cut to 1.75% are over 90%. Fed officials sound as split as they were going into the September meeting where the 25 bps rate cut to 2.0% was controversial and their rate forecasts showed five Fed officials didn't want to cut rates further in 2019. Those same forecasts also showed just seven Fed officials wanted to cut rates a third time this year to 1.75%. Fed officials say they will make the decision on a meeting by meeting basis, so they could be swayed by the high market-based odds of action.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	16-Oct	9-Oct	2-Oct	25-Sep	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2123.085	2121.485	2117.130	2107.683	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1463.137	1467.273	1467.260	1467.257	0.000
Repurchase agreements	197.700	178.650	181.050	105.000	126.750
Primary credit (Discount Window)	0.000	0.001	0.031	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	0.043	0.039	0.973	0.042	62.000
Federal Reserve Assets	4014.6	3998.2	3993.3	3906.0	961.7
3-month Libor %	2.00	1.98	2.06	2.10	2.82
Factors draining reserves					
Currency in circulation	1772.562	1769.136	1765.667	1762.927	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	1.803	1.469	3.054	0.133	0.000
Reserve Balances (Net Liquidity)	1469.871	1528.394	1486.710	1427.289	24.964
Treasuries within 15 days	15.683	0.028	0.128	13.085	14.955
Treasuries 16 to 90 days	63.032	77.561	77.461	66.568	31.549
Treasuries 91 days to 1 year	267.651	267.176	267.176	269.442	69.272
Treasuries over 1-yr to 5 years	849.095	849.095	848.695	839.685	170.807
Treasuries over 5-yrs to 10 years	302.407	302.408	302.345	297.606	91.863
Treasuries over 10-years	625.217	625.217	621.326	621.296	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

We hope this is the last rate cut we see from them this year. We aren't sure we would vote for more rate cuts even if the labor market melts down with a string of job losses that means the economy is entering a recession. Rate cuts starting from such a low level this time are certainly not going to encourage more borrowing for investment. Rate cuts could help "improve financial conditions," but you should probably wait for the markets to want you to improve their conditions. Stock markets aren't clamoring for a rate cut with Dow industrials closing up 14.8% year-to-date on Friday. The change in Fed policy from rate hikes to rate cuts has already brought down bond yields, or maybe it's the other way around, but the point is 50 bps of rate cuts has got mortgage rates down to 3.5% which is over 100 bps lower than the peak at 4.94% last November. Rate cuts have improved financial conditions enough and more cuts are not needed. We forgot to mention that rate cuts will help speed inflation's return to the 2.0% target, but our memory lapse is due to our belief that rate cuts will do nothing to inflation. Our view remains the same: the Fed funds rate tool is broken at this low of a level and shouldn't be used because it won't work. The economy will have to get along without the Fed's encouragement this time.



Odds of Rate Cuts	
Fed funds futures	
F10-18-2019	
	Fed meeting
23.0	October 30
34.5	December 11
Total bps of cuts discounted at future Fed meetings	

Year-ends for Interest Rates				
Percent %	2019	2020	2021	2022
Eurodollar futures	1.87	1.51	1.475	1.525
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 18, 2019 3-month Libor 1.95%				

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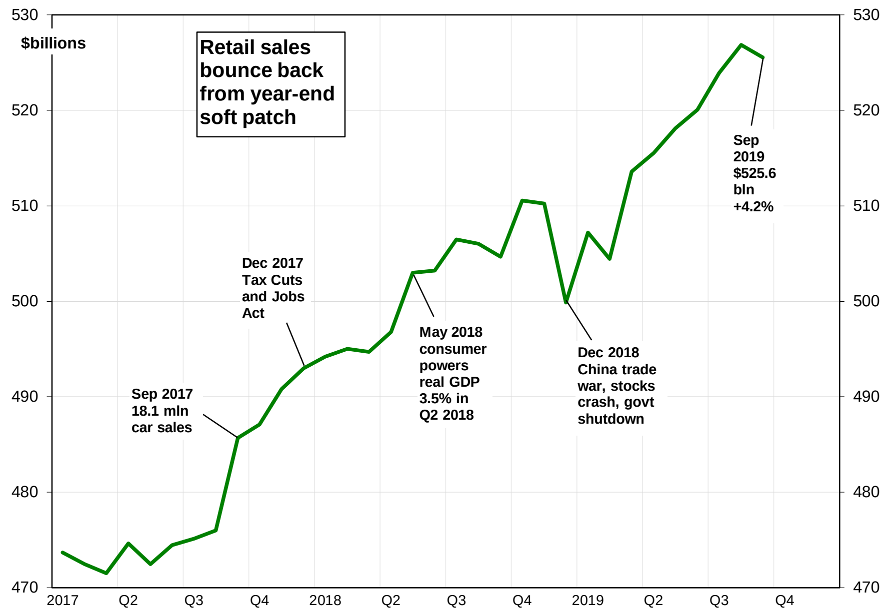
OTHER ECONOMIC NEWS THIS WEEK

Trade war claims another victim as consumers start to chicken out (Wednesday)

Breaking economy news. Now the trade war is spreading to the consumer sector of the economy as retail sales fell 0.3% in September. It looks like the trade war has claimed yet another victim, in addition to diminished business confidence and reduced investment spending, as consumers are starting to chicken out. The news wasn't all bad looking back where sales were 7.7% in the second quarter and 6.0% in the third quarter despite the September decline.

The data are volatile month to month and in particular the 0.9% decline in auto sales doesn't match the already reported 17.2 million number of cars sold in September up 1.2% from 17.0 million in August (annual rates). It was also a surprise that retail sales bought on your phone over the Internet fell 0.3% after a strong showing in recent months where so-called non-store retail sales are up a phenomenal 15.6% in September from prior year levels.



Net, net, consumers stayed home in September and didn't spend a dime at the shops and malls across the country as it looks like the China-US trade war has claimed another victim. The million dollar question is whether this is just a temporary pullback or whether something darker is occurring where the consumer is starting to chicken out.

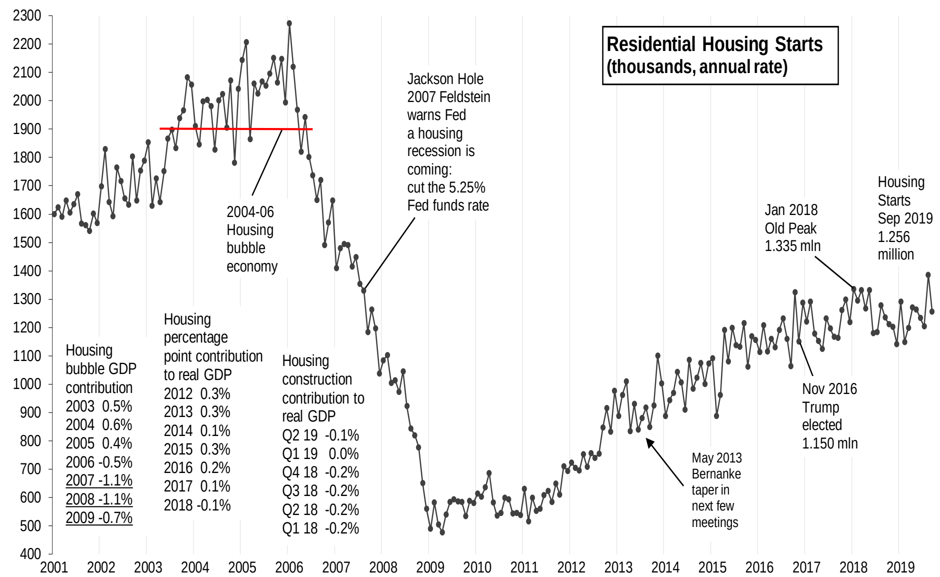
Fed officials arguing for another insurance rate cut in a couple of weeks have more evidence in their favor today as consumer spending is starting out in the hole in the fourth quarter with September retail sales falling. The market-based odds of a rate cut to 1.75% at the end of October continue to climb after today's soft patch report for retail spending.

One of the leading indicators of recession is three consecutive months of declining retail sales, so today was strike one for the economy which is in the extra innings of its tenth year of a record expansion. Let's hope the Trump economics team gets the so-called phase one trade agreement with China signed in a hurry because the consumer's confidence and willingness to spend appears to be hurt by this long trade war designed to bring factories and production and jobs back to the US. Consumers don't feel like America is winning the trade war and it is their vote and spending power that counts when it comes to keeping the economy afloat. To be sure, the news isn't all bad as retail sales were very strong the last two quarters, it is just that the latest month's decline is a disappointment and time will tell if this is just the tip of the iceberg when it comes to forecasting consumer spending ahead where there could be more weakness in the future.

Housing starts fall back to earth (Thursday)

Breaking economy news. Housing starts tumble 9.4 percent to 1.256 million in September which offsets much of August's 15.1 percent gain. Housing starts fell back to earth in September as economists' hopes for more investment to help sustain the long expansion were dashed. The reversal of fortune for housing construction has important repercussions for Fed officials meeting in less than two weeks as it inches them forward to taking out a little more insurance to help support the economy that continues to face the headwinds of reduced world trade from tariffs and sanctions.

Net, net, the good news of the recovery in residential housing construction looks like fake news as housing starts tumbled in September reversing the August gains. The news needs to be taken with a grain of salt however as the weakness was all in multifamily construction. Away from apartment building construction, single family homes managed a small gain thanks to a surge in construction in the biggest market down in the South that offset declines in every other region of the country.



Housing Starts Total, Single-Family, Multi-Family

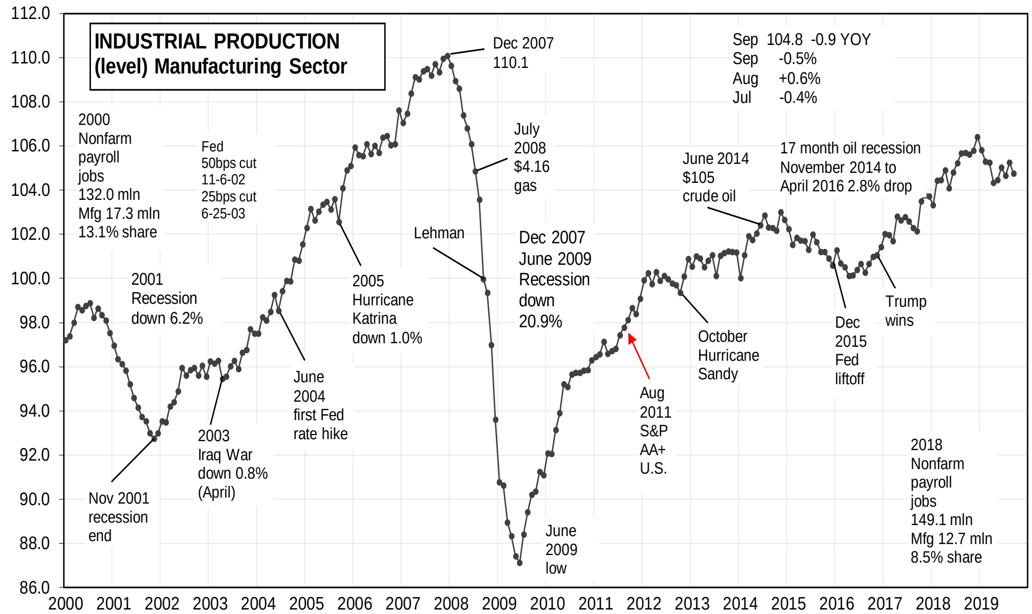
	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Sep 19	1256	918	327	109	61	167	122	676	525	304	210
Aug 19	1386	915	456	166	62	206	133	704	490	310	230
Sep 18	1236	880	347	140	59	171	129	570	447	355	245
% Chgs											
Sep/Aug	-9.4	0.3	…	-34.3	-1.6	-18.9	-8.3	-4.0	7.1	-1.9	-8.7
Sep/Sep	1.6	4.3	…	-22.1	3.4	-2.3	-5.4	18.6	17.4	-14.4	-14.3

Factory lights dim on GM strike (Thursday)

Breaking economy news. Industrial production fell 0.4 percent in September after August's 0.8 percent gain. It is important for headline focused markets to realize that production is off the lows made earlier this year so the manufacturing recession if that's what it was may actually be closer to being over.

Manufacturing industrial production fell 0.5 percent in September, but the decline would have been just 0.2 percent if not for the GM strike. The downturn in manufacturing from the trade war with China is actually more modest than is commonly thought.

Net, net, manufacturing is on the front lines of America's trade war with China and Europe, but this month the wound was self-inflicted as the GM strike hit factory output hard. While the strike is likely to have negative repercussions for the jobs data as well with nearly 50 thousand auto workers sitting at home, it is important to realize for the economic outlook that this too will pass. The factory lights were dimmed by the GM strike this month but this doesn't mean the recession clouds are moving closer to shore. The economy is better than you think. Bet on it.



Percent changes			Industrial Production September 2019		
Jul	Aug	Sep	YOY		Weight
-0.2	0.8	-0.4	-0.1	Total Index	100.0
-0.4	0.6	-0.5	-0.9	Manufacturing	75.1
-2.4	2.4	-1.3	2.6	Mining	14.6
4.2	0.2	1.4	1.2	Utilities	10.4
			Manufacturing payroll jobs 12.9 million +117K YOY 10.0% of Private Payroll Jobs		

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