Financial Market Weekly

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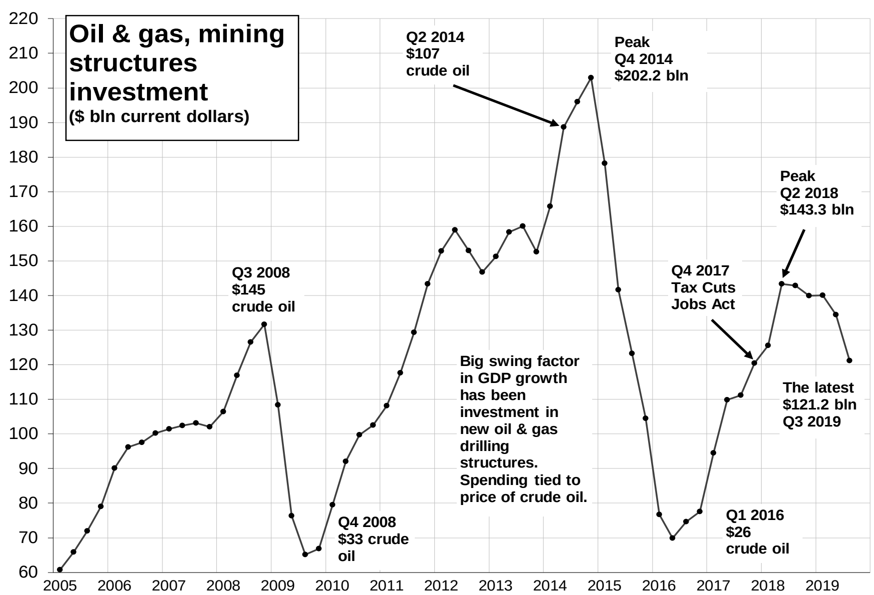
ECONOMY NEEDS MORE BUSINESS CONFIDENCE AND INVESTMENT

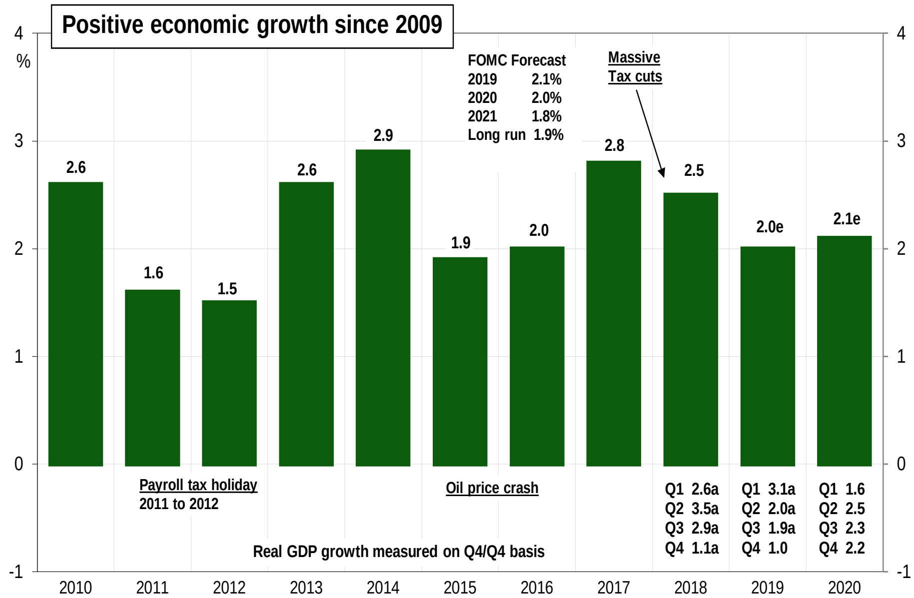


It is commonly thought that it is business investment that has slowed the economy from 3% growth down to 2%. Trade war uncertainty mostly with China is causing companies to hold back. The consumer is doing fine, pay no attention to the sharp drop in car & light truck sales to 16.5 million in October from 17.1 million in September to start fourth quarter out on a weak note. The latest Atlanta Fed GDPNow estimate for Q4 2019 is 1.0%. You see the trend, 3.1% real GDP in Q1, 2.0% in Q2 and 1.9% in Q3 this year, down and down and down. We will go along with 1.0% growth in Q4 2019, though it sounds too weak, where 1.0% in the final quarter of the year puts Q4/Q4 2019 growth at 2.0%: the weakest year since the final year of the Obama administration in 2016. Growth is on the softer side even without the full tariff war effect on $540 billion of China goods imports for 2018 taxed at 30% which would pull a 2.0% 2020 growth forecast down to 1.1 or 1.2 percent.

	Q1 17	Q2 17	Q3 17	Q4 17	YOY%	Q1 18	Q2 18	Q3 18	Q4 18	YOY%	Q1 19	Q2 19	Q3 19	SAAR
Structures ($billion)	580.2	589.0	583.7	594.4	5.0	615.9	640.0	641.7	635.2	6.9	648.5	633.2	609.7	-5.4
Commercial and health care	179.7	181.1	179.9	181.6	0.6	189.2	189.1	186.6	184.8	1.8	189.3	185.3	181.4	-2.5
Manufacturing	68.2	66.2	64.5	64.3	-11.7	63.9	62.2	65.9	66.8	3.9	70.2	68.5	68.9	4.2
Power and communication	122.5	116.3	112.7	109.8	-9.3	116.7	121.4	120.1	116.3	5.9	117.7	117.6	115.7	-0.7
Mining exploration, shafts, and wells	94.5	109.9	111.2	120.4	55.2	125.6	143.3	142.9	139.9	16.2	140.1	134.4	121.2	-17.8
Other structures *	115.3	115.5	115.4	118.3	3.8	120.5	123.9	126.1	127.4	7.7	128.6	127.4	122.5	-5.1

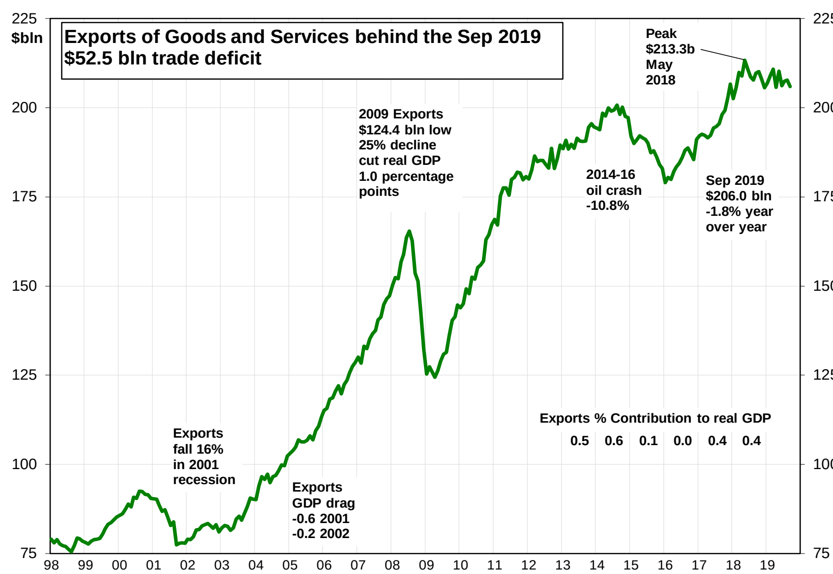
* Religious, educational, vocational, lodging, railroads, farm, and amusement and recreational structures, other

Fed Chair Powell at the press conference on October 30 after cutting rates a third time to 1.75% admitted business investment and exports were weak, but the Fed had done enough to address the risks to the broader economy for now. Business fixed investment is in structures, equipment, and intellectual property (software, R&D). Structures were a 0.5% negative contribution to 1.9% real GDP in the third quarter. Fracking oil & gas drilling expenditures are coming back down after adding to the economy. In 2017, oil & gas drilling structures spending was enormous on a Q4/Q4 basis, more than making up for the decline in spending on factories and power projects. In 2018, oil & gas drilling contributed roughly half of all business investment on structures, but the effect will be negative this year if the latest third quarter weakness persists.



How many new structures need to be built over ten years deep into an economic expansion is the overarching question? Fed officials see delay in projects from the trade war uncertainty, but some of the slowdown may simply be a natural one: they built it already. To conclude, business investment is still going on with more intellectual property spending despite the trade war uncertainty with software purchases and R&D expenditures leading the way, so the news on investment is not all gloomy… yet.

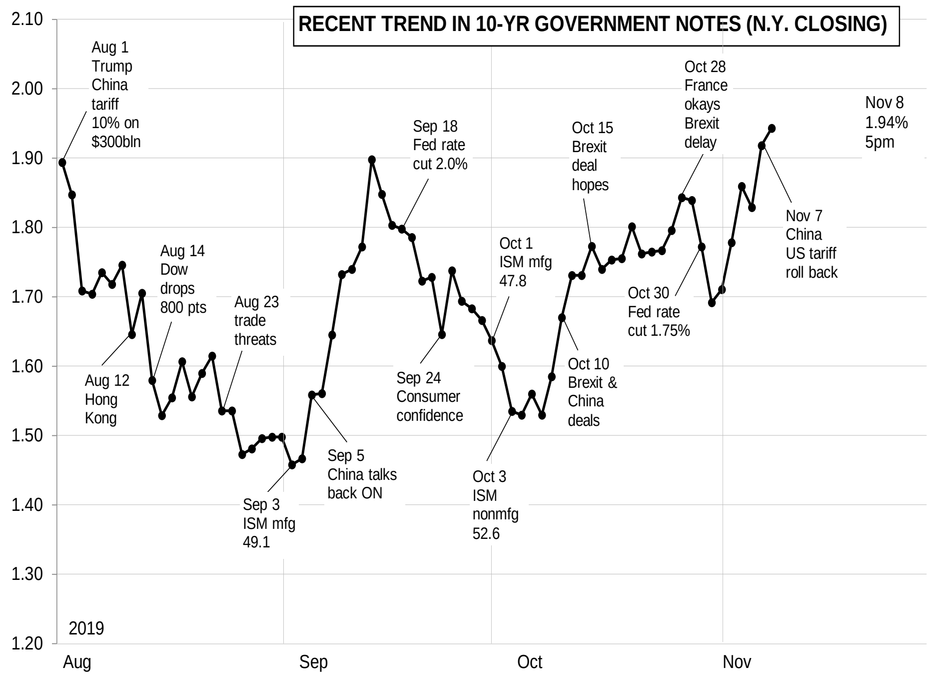
Powell said soft patch in business investment and exports not enough reason to keep cutting rates



Business Investment Spending in the nominal GDP accounts			$Bln
Q3 2019 $bln	Level	% YOY	YOY
Equipment	1237.9	0.8	10.0
Intellectual Property	1025.3	9.3	87.2
Construction			
Business structures	609.7	-5.0	-32.0
Mining, shafts, wells	121.2	-15.2	-21.7
Other	488.5	-2.1	-10.3
Total	2872.9	2.3	65.2

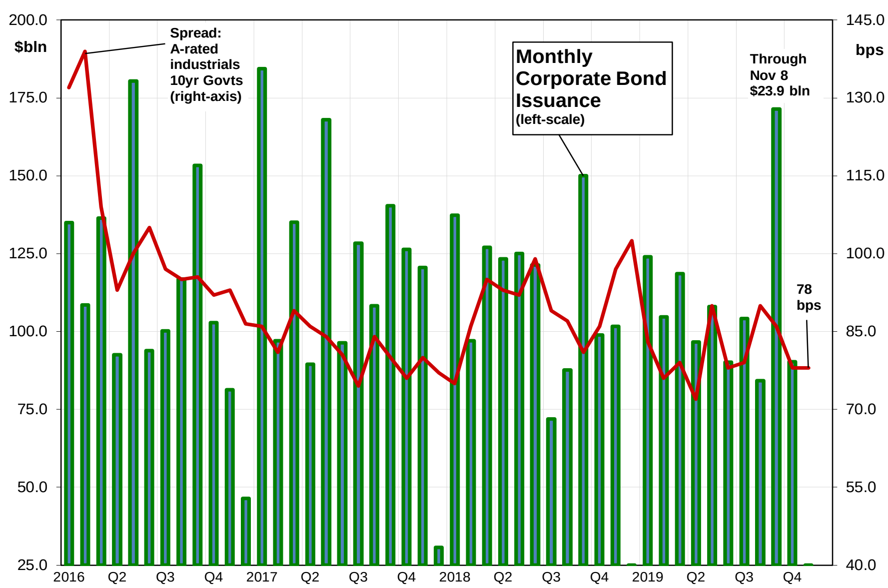
MARKETS OUTLOOK

	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	1.90	1.90	1.90	1.90	1.90	1.90
Fed Funds Rate	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75
2s/10s spread	15	25	5	15	20	20	30	20	20



Treasury yields jumped 23 bps this week to 1.94% on Friday from 1.71% last week. The big news came shortly after 2am Thursday morning, with 10-yr yields at 1.81%, a news headline that said a phase one US-China trade agreement would include a roll back of some of the tariffs. Even the president telling reporters at the White House Friday morning on his way to Georgia that he had not agreed to a tariff roll back didn't seem to turn the Treasury yield rally back much. Next week: Trump speaks at the Economic Club of New York on Tuesday; and Powell speaks Wednesday before the Joint Economic Committee, and Thursday at the House Budget Committee.

CORPORATE BONDS: ROYAL DUTCH SHELL, EQUINIX, BRITISH TELECOM



Corporate offerings were $23.8 billion in the November 8 week versus $36.3 billion in the November 1 week. On Monday, Baker Hughes priced a $525 million 3.138% 10-yr (m-w +25bp) at 135 bps (A3/A-). The oilfield products and services company will use the proceeds for general corporate purposes, basically for the redemption of its 3.2% 2021 senior notes. Corporate bond yields (10-yr Industrials rated A2) were 78 bps above 10-yr Treasuries Friday versus 77 bps last Friday.

FEDERAL RESERVE POLICY

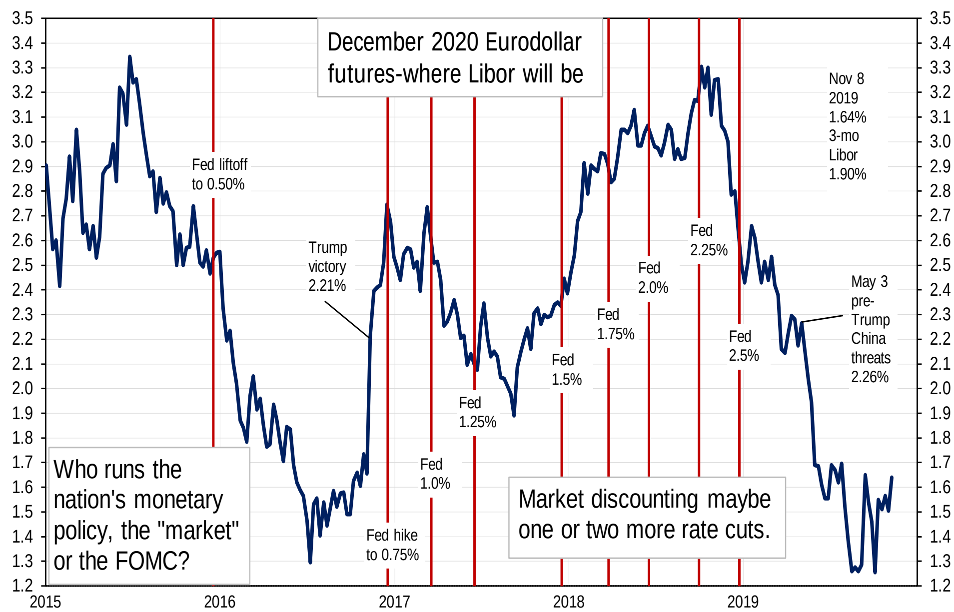
The Fed meets December 10-11 to consider its monetary policy. Not a lot to consider after Powell said monetary policy was in a good place at the press conference on October 30 after the FOMC cut rates a third time this year to 1.75%. He added later in the press conference in questioning that the "current stance is likely to remain appropriate" as long as the economy stays where it is with the Brexit and China trade war risks diminishing.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	6-Nov	30-Oct	23-Oct	16-Oct	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2194.318	2175.491	2149.188	2123.085	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1445.776	1445.762	1457.914	1463.137	0.000
Repurchase agreements	215.160	215.500	178.204	197.700	126.750
Primary credit (Discount Window)	0.002	0.028	0.005	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	0.046	0.041	0.043	0.043	62.000
Federal Reserve Assets	4087.6	4067.1	4016.9	4014.6	961.7
3-month Libor %	1.90	1.91	1.94	2.00	2.82
Factors draining reserves					
Currency in circulation	1784.936	1781.082	1773.219	1772.562	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	1.650	0.196	18.290	1.803	0.000
Reserve Balances (Net Liquidity)	1528.757	1484.718	1451.555	1469.871	24.964
Treasuries within 15 days	41.822	17.783	15.736	15.683	14.955
Treasuries 16 to 90 days	65.966	81.959	77.195	63.032	31.549
Treasuries 91 days to 1 year	285.932	292.006	276.315	267.651	69.272
Treasuries over 1-yr to 5 years	866.728	856.122	852.320	849.095	170.807
Treasuries over 5-yrs to 10 years	308.578	302.405	302.406	302.407	91.863
Treasuries over 10-years	625.292	625.215	625.216	625.217	101.337

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

Fed funds futures are not signaling much chance of a fourth rate cut this year, although the underlying conditions in the overnight funding markets is making it hard to draw a firm conclusion about what Fed funds futures are saying. We don't know where the Fed funds rate will trade each day right now, let alone where it will be in January. Longer-dated Eurodollar futures yields moved about 20 bps higher this week with half the move taking place on Thursday on hopes for a roll back in the tariffs put in place during the US-China trade war. December 2020 futures say one more Fed rate cut to 1.5% more or less but it's a long way out and nothing to bank on.

Powell 10-30-19
So, we think that the current stance of policy is likely to remain appropriate, likely to remain appropriate, as long as incoming information about the economy is broadly consistent with our outlook, which is a positive one of moderate economic growth, strong labor market, and inflation moving close to 2 percent. That's, so that's what we're saying about that. We also say, of course, if developments emerge that cause a material reassessment of that outlook, we would respond accordingly. So, that's really how we're thinking about it. I can't point to one data point or one thing that would change our minds.



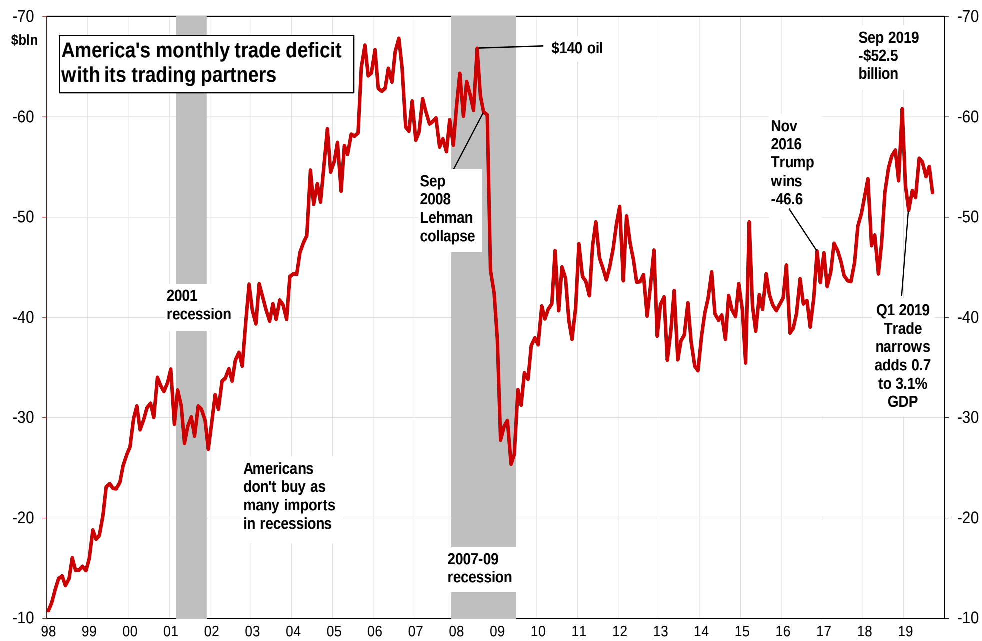
Year-ends for Interest Rates				
Percent %	2019	2020	2021	2022
Eurodollar futures	1.915	1.64	1.655	1.715
Fed's Sept forecast	2.0	2.0	2.25	2.5

Eurodollar futures price where 3-month Libor will be in the future.
Friday, November 8, 2019 3-month Libor 1.90%

OTHER ECONOMIC NEWS THIS WEEK

America has won the trade war (Tuesday)

Breaking economy news. The trade deficit in September narrowed to $52.5 billion from $55.0 billion in August. The trade war slings and arrows have stopped the rise in red ink trade deficits with China, but at what cost? Factory production in the US is going to continue to suffer with the slowdown in exports to America's trading partners. Slower exports are one reason this is a 2 percent growth economy not the 3 percent growth economy that the Trump economics team promised after the Tax Cuts and Jobs Act that was signed almost two years ago. Exports of goods fell $1.8 billion or 1.3% to $136.8 billion in September from August and are off 2.8% from a year earlier in part due to the fall in the price of crude oil.



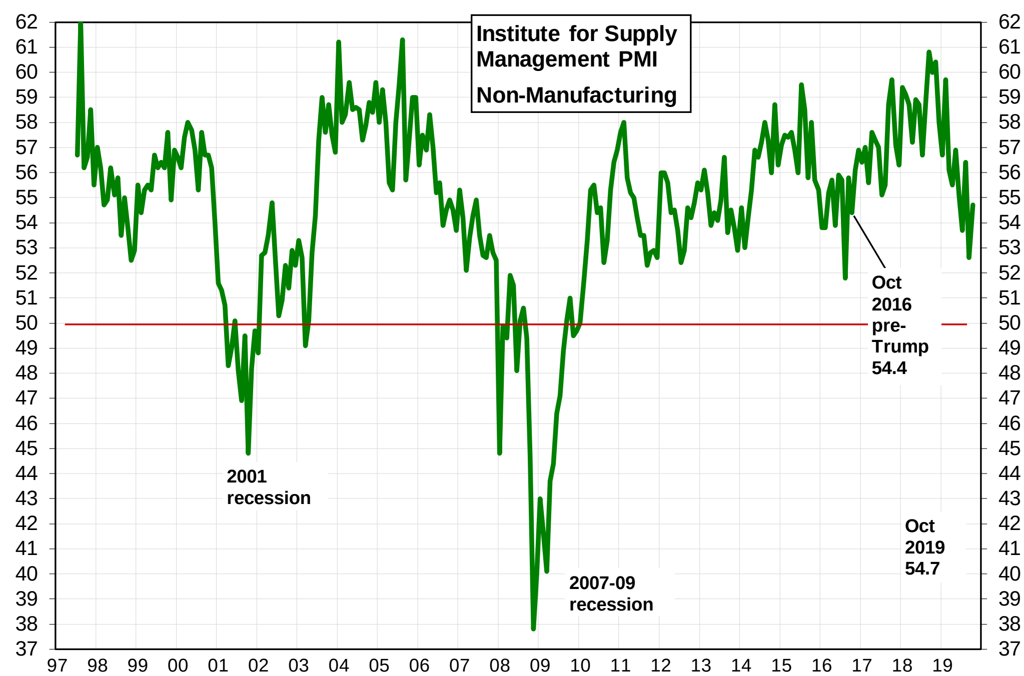
Net, net, the US trade war is delivering its intended results slowly and grudgingly with companies struggling to reroute their supply chains as tariffs on imported goods from China continue to make it more costly to rely on them. Imports from China are 13.4 percent lower in the first nine months of 2019 versus the same period in 2018. That high-water benchmark of $540 billion of US imported goods from China in 2018 will come down to $467 billion for the full year 2019 if the current trend continues. Not a lot of progress has been made with taming the trade deficit given the severity of the tariffs and sanctions that pushed the US and the world to the brink of recession. We can't count the number of times that stocks have tumbled on news headlines the trade war was escalating, and investors continue to scratch their heads on whether the trade war was worth it even if the stock market is up over 20 percent this year.

Whew, the economy is off life support purchasing managers say (Tuesday)

Breaking economy news. Job openings and the ISM purchasing managers survey for services. We will focus on the services industry data as the Jolts data looks unstable after a massive upward revision to August.

Purchasing managers certainly know a thing or two about the direction the economy is heading in.

A month ago, the economy was on death watch with recession banging at the market's door, when the ISM services index tumbled nearly four points to 52.6 in September from 56.4 in August. Bond yields were down at 1.5% on the news discounting the next Fed steps to combat an imminent recession. Today, the sun is out and shining for purchasing managers who buy pencils and paper and what, maybe staplers, for companies that provide services to consumers and other businesses. The ISM services index rebounded over two points to 54.7 in October from 52.6 in September. The Trump economics team must be breathing a great big sigh of relief as presidents don't tend to get reelected when the economy is in a downturn and millions of voters are joining the unemployment lines.



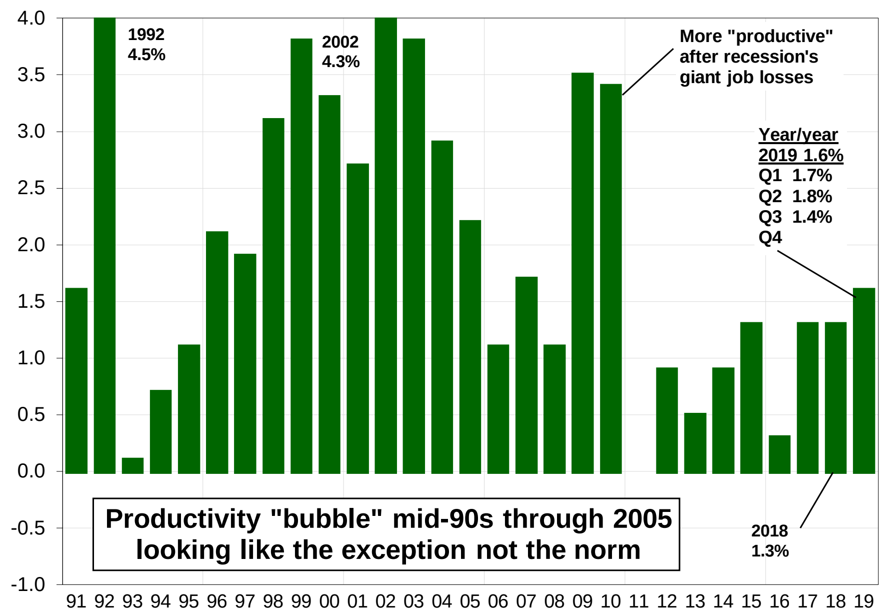
Net, net, a month ago it looked like the trade war weakness in manufacturing was spreading to the services sector where the bulk of the economy's workers toil away, but today, the outlook is sunnier for purchasing managers who aren't as doggone gloomy on the outlook. The stock market needed this report today as the rosy glow of optimism over the China US trade talks was starting to fade. If the discussions are over where the president of China is coming to sign a trade agreement, either in Alaska or Iowa, you know we are in trouble and that something doesn't add up. There has to be a major agreement to sign for one thing and phase one seems to be lacking on substance unless both sides add a clause for scaling back the existing tariffs. Stay tuned. Story developing. Stocks have turned back down again. And away we go.

Oops, someone stopped rowing the boat as productivity sinks (Wednesday)

Breaking economy news. Nonfarm business productivity for the third quarter. We aren't doing much this morning sitting at our desk reading the newspapers, and it looks like no one else is doing anything at work either because nonfarm productivity unexpectedly dropped 0.3% in the third quarter. Americans must work harder or the long-term prospects for growth will start to fade especially as the population starts to slow with the birth rate in decline and as the baby boom generation continues to retire.

Compensation of employees is up 4.5% the last year which has companies pulling their hair out as labor productivity rose just 1.4% the last year. Unit labor costs are up 3.1% the last year which is going to start to hit corporate profits hard as it often does this late in the business cycle.

Simply put, the more productive workers are, the more sustainable economic growth is in the long term. The fundamental underpinnings of economic growth are not as good as we thought. The year started out so well with productivity up 3.5% in the first quarter and 2.5% in the second quarter. Time will tell where the true trend lies. For the full year, productivity was 1.3% in 2017 and 1.3% in 2018, so hopefully the drop in productivity this quarter is a one off.

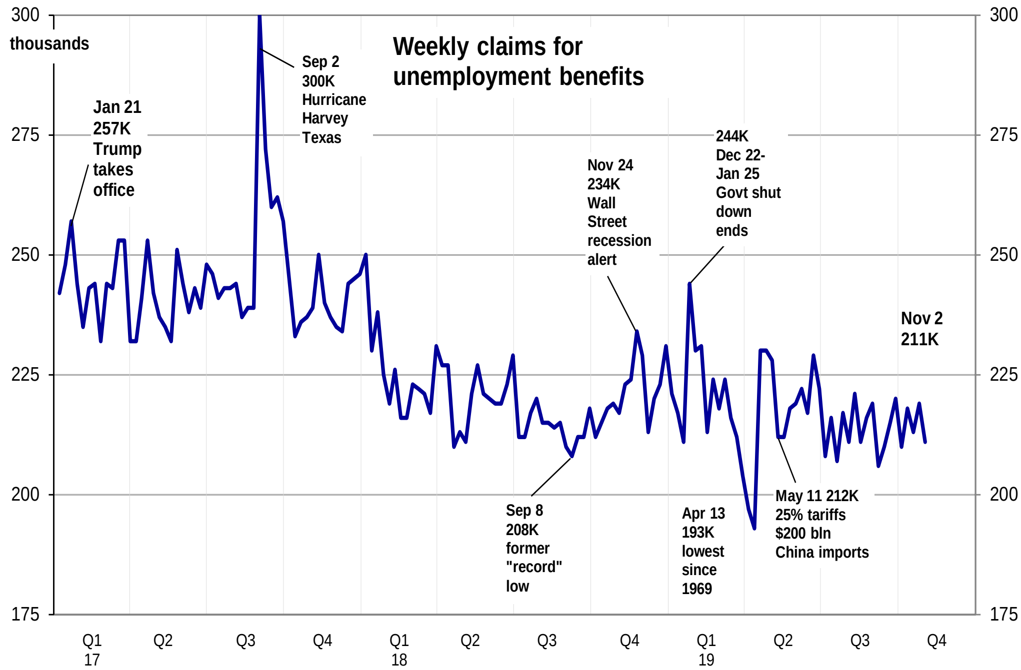


Net, net, the resurgence in productivity earlier this year under the Trump administration and its Tax Cuts and Jobs Act stimulus is looking more like a mirage. Growth for the long run cannot be assured and those dreams of 3% sustainable growth over the next decade are looking more and more like a fairy tale. Stay tuned. Story developing. The economy may be better than you think today, but whether there will be better times ahead in the future cannot be known. Workers in the country must row harder to make the dream of faster long-term growth a reality.

Breaking news on weekly jobless claims. Pick up a paper and read all about it. (Thursday)

Breaking economy news. No, not the headline a little after 2am NY time saying China and the U.S. agreed to lift tariffs in phases as the deal progresses. Sounds like a headline from earlier this year, or even in 2018.

No, not the news that the Bank of England is thinking rate cuts and Carney sees downside risks. Central bankers really need to stop talking about downside risks and scaring the markets and companies and themselves especially when they've got nothing. The U.K. base rate was brought down from 5.0% to 0.50% after the Lehman bankruptcy and sat there until the Brexit vote in June 2016 and the axe swung and brought rates down 25 bps to 0.25%. They raised rates with other central banks starting late in 2017 and it now sits at 0.75%, and now with downside risks maybe they are signaling more stimulus is needed and they will cut rates from 0.75%. The Bank of England doesn't realize that a decade of low rates has desensitized the public to interest rate changes. Rate cuts will not boost the economy.



No, the breaking news is jobless claims falling 8K to 211K in the November 2 week. No recession in the US as companies continue to hold onto their workers for dear life and are even paying them more than they are worth with wages growing faster than productivity. There's always someone worried about income inequality or protracted joblessness, something that's still not quite right this long into the economic expansion. The macro economy numbers are fine, the economy is doing as well as it can, despite some groups on the sidelines unable to get into the game. The total number of Americans receiving unemployment benefits is 1.689 million in the October 26 week. Sounds bad but it is really progress as 6.6 million were on the dole in the recession a decade ago. Wall Street always turns a blind eye to these income-inequality issues and is more interested in whether a recession is coming. No recession today, no job losses. We've been on a recession watch since Trump said China broke the deal back in May and slapped on more tariffs on U.S. companies bringing in goods to the US that they had had made for them in China. Jobless claims were 212K back in May when 25% tariffs were put on $200 billion of China imports and still remain low this week at 211K. Stay tuned. Story developing slowly.

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