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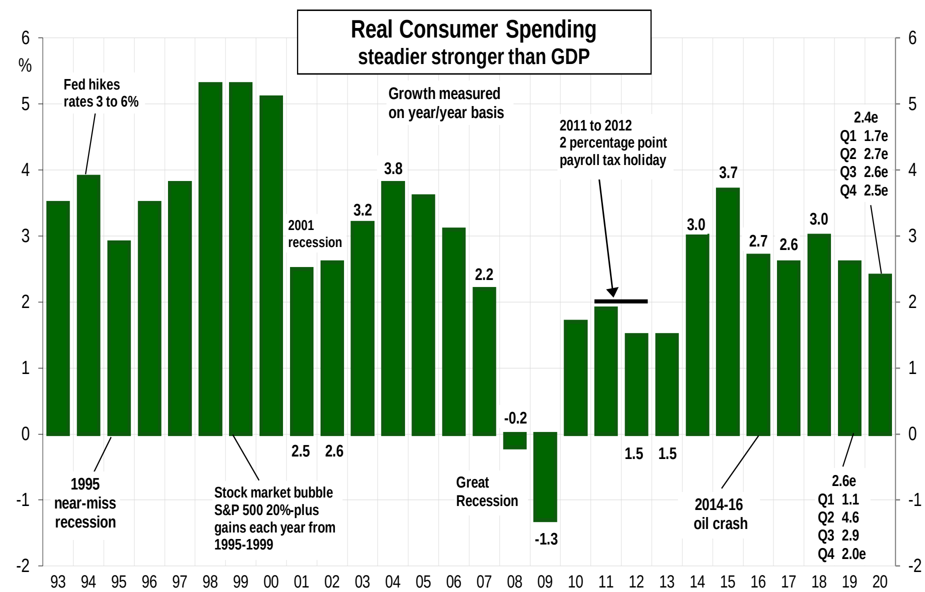
2020 OUTLOOK DEPENDS ON THE CONSUMER



We gave a sigh of relief when the Atlanta Fed GDPNow forecast sounded the all-clear siren for fourth quarter growth and revised it higher to 1.7% on Wednesday after the 830am and 10am EST economic data reports. (Okay, most of the revision upward was due to the narrowing of the preliminary trade deficit in goods data on Tuesday.) The Q4 GDPNow forecast had been way down low at 0.3% on Friday, November 15. Whew. Out of danger. No recession. But the outlook for 2020 still depends importantly on the consumer that is two-thirds of the economy always.

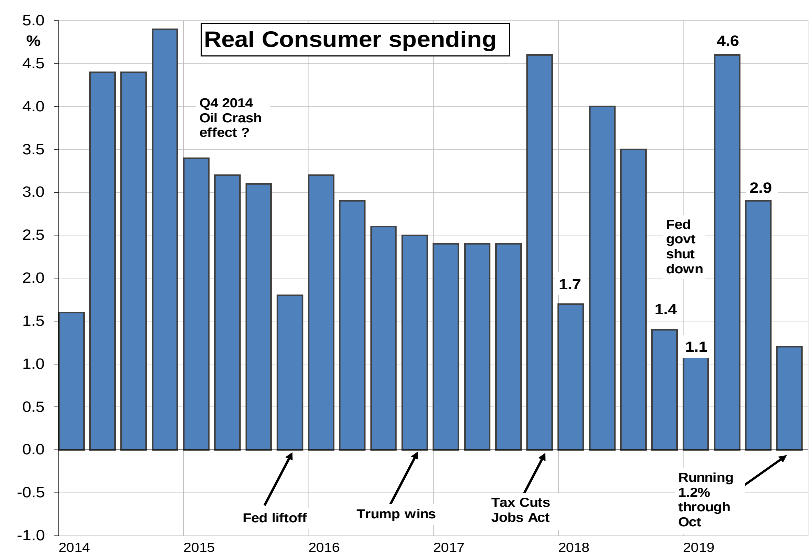
Q3 2019 real GDP was revised up to 2.1% on Wednesday from 1.9% in the initial estimate, and real consumption expenditures was left unchanged at 2.9%. 2.9 is 2.9. What is not commonly realized by investors is that consumer spending is often quite stable in recessions. Level-headed consumers still need to buy boxes of tissues, and eat at home at least, even if not dining out on the town, and get haircuts, repair the leaks in their homes, eventually buy new clothes (even if for job interviews), and yes, even manage to take vacations in recessions. Poconos, Caribbean, Europe, Mammoth Lakes, Yosemite, Lake Tahoe, it's all good.

In fact, real consumer spending never even declined in the 2001 recession. It did not drop in the 1995 near-recession miss either, 1995 the last time the Fed cut rates three times to support the economy.

Of course, the reasoning for the 2019 rate cuts is more muddled at least in the fact that the economy was never in danger of outright decline like it was in 1995. Real consumer spending did decline in the Great Recession and was slow coming out of the recession. This was true even with the 2 percentage point cut in payroll taxes in 2011 and 2012 which should be a cautionary tale for those advocating fiscal stimulus. Giving consumers money temporarily doesn't always lead them to spend it, we think someone got a Nobel Prize for discovering this decades ago. If you think the Tax Cuts and Jobs Act did something for the consumer, spending did rise from 2.6% in 2017 to 3.0% in 2018, but that was it. For 2019, we look for real consumer spending of 2.6%, and forecast the consumer buys 2.4% more in 2020. No recession… for the consumer anyway. Assuming a 15% tariff on video game consoles imported from China doesn't go into effect on December 15. Perish the thought.

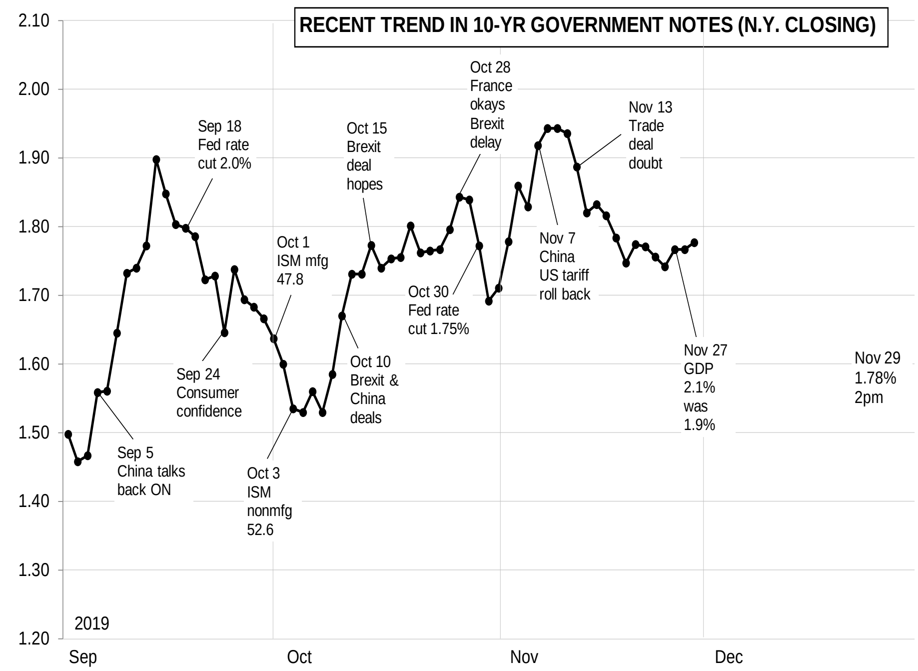
Nominal Consumer Expenditures & GDP	Q3 2019	Q2 2019	Q1 2019	Level $bln Q3 2019	% Change Year/Year
Gross domestic product (GDP)	3.8	4.7	3.9	21,542.1	3.8
Personal consumption expenditures (PCE)	4.4	7.0	1.5	14,669.6	3.9
Goods	4.8	10.3	-0.2	4,560.5	3.7
Durable goods	6.9	11.0	-0.1	1,550.4	4.4
Motor vehicles and parts	3.2	16.1	-10.8	537.3	2.5
Furnishings and durable household equipment	7.1	7.6	5.5	359.0	4.2
Recreational goods and vehicles	11.8	9.1	9.7	426.5	7.3
Other durable goods	7.0	8.3	1.3	227.6	3.8
Nondurable goods	3.8	10.0	-0.2	3,010.1	3.3
Food and beverages for off-premises consumption	5.5	5.9	1.3	1,044.1	3.6
Clothing and footwear	3.3	6.0	-1.3	402.6	1.9
Gasoline and other energy goods	-11.4	38.8	-27.0	338.9	-5.3
Other nondurable goods	7.1	7.7	8.2	1,224.4	6.3
Services	4.3	5.6	2.3	10,109.1	4.0
Household consumption expenditures (for services)	4.2	5.7	3.6	9,656.8	4.2
Housing and utilities	4.6	4.4	3.2	2,685.9	4.1
Health care	3.7	5.5	7.8	2,481.2	4.2
Transportation services	5.3	11.0	-2.0	483.2	4.5
Recreation services	0.6	8.0	0.8	587.0	3.6
Food services and accommodations	5.8	8.8	3.2	1,030.6	4.2
Financial services and insurance	3.3	7.2	-0.8	1,158.4	3.6
Other services	5.0	2.1	4.7	1,230.4	4.7
PCE excluding food and energy	4.8	6.6	2.7	13,043.8	4.3

Nominal dollars going through cash registers is better than real spending always. Nominal might be more real, actually. Consumer spending was 4.4% in the third quarter. The biggest decline was 11.4% for gasoline, and the biggest increase was 11.8% for recreational vehicles. We just report the facts, as odd as they seem. It's hard to measure an economy with 330 million Americans, what can we say. We would note that this list of consumer goods and services is what is right and what is mostly wrong with the Fed's reliance on the PCE price index as an inflation indicator. Core consumer purchases were $13.043 trillion in Q3 2019 at an annual rate, and Health Care was $2.481 trillion. Core PCE inflation slipped back to 1.6% this week, but the short-of-target inflation reading is dependent on slow Health Care "inflation" that is 19% (2.481/13.043) of total core consumer purchases. Sounds like the Fed's inflation is flawed as it overweights Health Care in the typical consumer's budget. To conclude, real consumption is slower in the fourth quarter, running just 1.2% with data only through October. Holiday sales are picking up however, especially over the internet, and spending this holiday season will certainly be stronger than last year.



MARKETS OUTLOOK

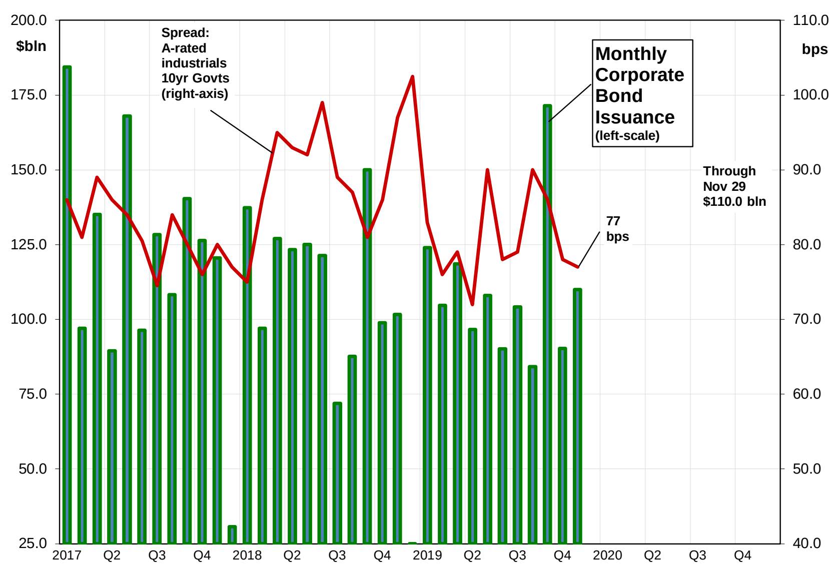
	29-Mar 2019	28-Jun 2019	30-Sep 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
30-Yr Treasury	2.81	2.53	2.11	2.20	2.25	2.30	2.40	2.50	2.70
10-Yr Note	2.41	2.01	1.67	1.75	1.80	1.90	2.10	2.20	2.40
5-Yr Note	2.23	1.77	1.55	1.55	1.65	1.75	1.85	2.05	2.25
2-Yr Note	2.26	1.76	1.62	1.60	1.60	1.70	1.80	2.00	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



We think the Treasury market was open this week. Doesn't look like much happened on a closing basis. Yields were at 1.79% early Monday, came down to 1.73% Tuesday, and jumped with the better economic news at 830am EST Wednesday: durable goods orders bounced, unemployment claims fell, GDP was revised from 1.9 to 2.1 percent in the third quarter, all of which served to quiet the market's recession fears. The day after Thursday's Thanksgiving Day holiday is the biggest single shopping day of the year due to the discount sales, with online sales expected to break records, and bond yields hit the week's high. 10-year Treasury yields are still in a technical uptrend with the 1.7% low from November 21 holding.

CORPORATE BONDS: QUIET THANKSGIVING DAY WEEK; HALF WAS DNB BANK

Corporate offerings were $4.4 billion in the November 29 week versus $30.6 billion in the November 22 week. On Wednesday, Mastercard Inc. priced a $750 million 2.0% 5-yr (m-w +10bp) at 43 bps (A1/A+). The financial transactions processing services company will use the proceeds for general corporate purposes, including working capital, investments, shareholder returns. Corporate bond yields (10-yr Industrials rated A2) were 77 bps above 10-yr Treasuries Friday versus 79 bps last Friday.



FEDERAL RESERVE POLICY

<u>Powell says the economy's cup is not overflowing but it's at least half full</u>

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	27-Nov	20-Nov	13-Nov	6-Nov	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2248.498	2220.361	2201.529	2194.318	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1423.724	1437.197	1450.089	1445.776	0.000
Repurchase agreements	207.243	199.159	209.609	215.160	126.750
Primary credit (Discount Window)	0.020	0.007	0.016	0.002	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	0.047	0.048	0.041	0.046	62.000
Federal Reserve Assets	4100.5	4078.6	4096.1	4087.6	961.7
3-month Libor %	1.91	1.90	1.91	1.90	2.82
Factors draining reserves					
Currency in circulation	1792.322	1785.928	1787.932	1784.936	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	0.506	26.097	1.762	1.650	0.000
Reserve Balances (Net Liquidity)	1559.719	1530.158	1542.664	1528.757	24.964
Treasuries within 15 days	10.203	10.034	41.805	41.822	14.955
Treasuries 16 to 90 days	97.984	96.881	66.967	65.966	31.549
Treasuries 91 days to 1 year	303.961	282.729	287.950	285.932	69.272
Treasuries over 1-yr to 5 years	882.505	876.899	867.266	866.728	170.807
Treasuries over 5-yrs to 10 years	317.323	317.309	310.038	308.578	91.863
Treasuries over 10-years	636.521	636.510	627.503	625.292	101.337

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

Fed Chairman (is it Chair or Chairman?) spoke Monday at 7 o'clock New York time. Just in case you've had your fill of China and U.S. trade deal are-they, aren't-they news today, last week, the whole last two years. Your whole darn life. Close the deal already! This is worse than buying an apartment in New York City, or maybe on second thought, this is exactly what it's like. Dragging it out until you are fed up or you pay up.

He spoke in New York, Powell, no in Washington DC, no... it is at the Annual Meeting of the Greater Providence Chamber of Commerce, Providence, Rhode Island. He said the Fed has heard two messages loud and clear on its magical mystery tour around the country seeking input from people who don't know what money supply is or what interest rates are instead of Wall Street economists and companies who borrow and might know what Federal Reserve policy is currently and what that policy might be able to do. One: economic conditions are good in this 11th year of expansion. Two, the benefits of the expansion are only now reaching many communities.

The outlook for further progress in the economy is good Powell said, and that policy was in a good place. Pay no attention to that man behind the curtain saying we are boneheads. Powell cited the Survey of Professional Forecasters, whoo-hoo, we are one of the forecasters, as saying 2019 started with a favorable outlook and that outlook has changed only modestly over the course of the year.

Near the end of his remarks, Powell wrapped up with “two areas where we have an opportunity to build on our gains.” (1) A sustained return of inflation to 2 percent, and (2) Spreading the benefits of employment. Surprise he found the general public doesn't care about inflation they care about rising medical care costs. Secondly, on the benefits of employment, the Fed keeps going off course talking about the employment prospects of those in their prime years, 25-54 years of age. These people are still enjoying life so what's the problem? The older people, none of you certainly, are 55 years and older and grumpy and, well, finished with much of life, so who cares, you should have bought that wave runner or dune buggy already, and now all you have to look forward to is a frigid cruise off Alaska with the grandkids.

Okay, let's get to the glass half full and half empty reference. Seriously, it looks like Powell is writing his own stuff without edits. In conclusion he said, “Monetary policy is now well positioned to support a strong labor market and return inflation decisively to our symmetric 2 percent objective. If the outlook changes materially, policy will change as well. At this point in the long expansion, I see the glass as much more than half full. With the right policies, we can fill it further, building on the gains so far and spreading the benefits more broadly to all Americans.”

Geez, nothing in here that's market moving. The Fed will change their policy if the outlook changes materially, so that means more rate cuts are possible if the economy weakens. Powell sees the glass as much more than half full. Okay, we guess that counts as optimism. Stay tuned. Story developing. We see nothing in Powell's remarks that allays our fears that interest rates are either going to stay here at 1.75% or come crashing down to zero if the economy flips over on its back and falls into a recession.

OTHER ECONOMIC NEWS THIS WEEK

The trade deficit narrows as the consumer backs away. Fewer autos too. (Tuesday)

Breaking economy news. The early peek at the October trade balance for goods. A big $4 billion drop in the trade deficit in October to $66.5 billion from $70.5 billion in September which will boost some of those weak half of a percent GDP growth forecasts this quarter that the regional Federal Reserves do so that Wall Street economists don't have to.

There is a lot of talk about business postponing equipment purchases due to the trade talks uncertainty, but the sharp adjustment in the trade deficit in October hits the consumer right between the eyes. Imports of consumer goods fell from $54.7 billion in September to $52.1 billion in October. Autos fell from $30.9 billion in September to $29.0 billion in October. Meanwhile, capital goods imports were relatively unchanged. If America was winning the trade war it was all due to the consumer which now appears to have less appetite for exotic imported goods this month and over the last year with consumer goods imports down 7.8% since October 2018.

Net, net, more evidence today that America is winning the war on reining in trade deficit red-ink spending on imports relative to what we export. Winning the war comes at a cost however because business investment has nosedived on the uncertainty thrown up by the long war since the first tariffs were put on China imports back in July 2018. You can't plan for the future and make investments if you don't know the future. Stay tuned. Story developing.

ADVANCE TRADE STATISTICS FOR OCTOBER

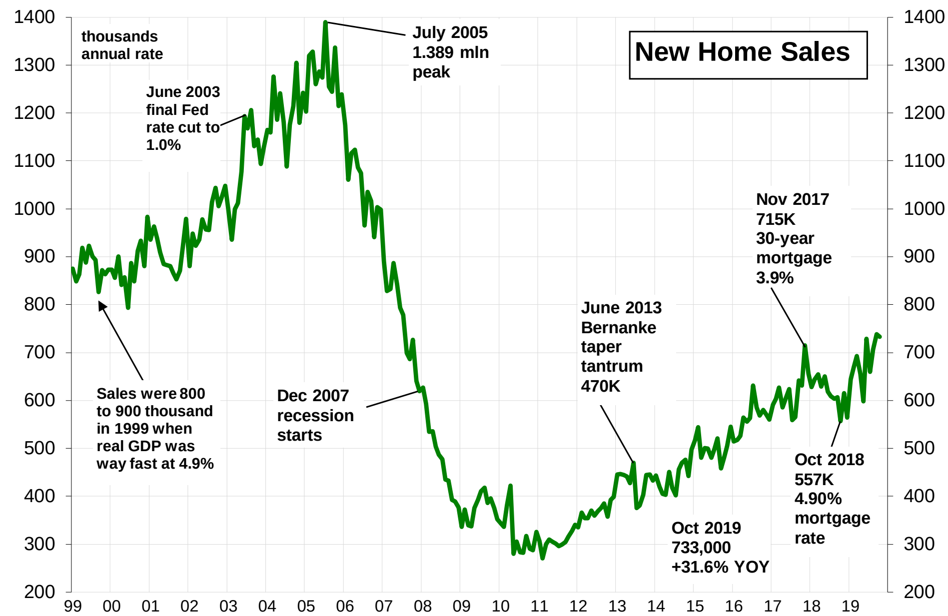
	Monthly				Percent changes		
Trade	Oct 2019	Sep 2019	Aug 2019	Oct 2018	Oct 19 Sep 19	Sep 19 Aug 19	Oct 19 Oct 18
Balance	-66,528	-70,547	-73,023	-76,148			
Exports	135,317	136,266	138,126	140,562	-0.7	-1.3	-3.7
Foods, Feeds, & Beverages	10,437	10,756	12,262	10,001	-3.0	-12.3	4.4
Industrial Supplies (1)	44,529	44,070	44,340	47,255	1.0	-0.6	-5.8
Capital Goods	44,758	45,104	44,256	47,210	-0.8	1.9	-5.2
Automotive Vehicles, etc.	12,963	13,279	14,280	12,796	-2.4	-7.0	1.3
Consumer Goods	16,670	17,366	16,877	17,781	-4.0	2.9	-6.2
Other Goods	5,960	5,691	6,111	5,519	4.7	-6.9	8.0
Imports	201,845	206,813	211,148	216,710	-2.4	-2.1	-6.9
Foods, Feeds, & Beverages	12,401	12,772	12,613	12,319	-2.9	1.3	0.7
Industrial Supplies (1)	41,142	41,923	42,543	49,119	-1.9	-1.5	-16.2
Capital Goods	56,416	56,162	57,267	57,062	0.5	-1.9	-1.1
Automotive Vehicles, etc.	29,046	30,851	31,950	31,792	-5.9	-3.4	-8.6
Consumer Goods	52,092	54,716	57,227	56,485	-4.8	-4.4	-7.8
Other Goods	10,748	10,389	9,549	9,934	3.5	8.8	8.2

(1) Includes petroleum and petroleum products.

Consumer is confident enough just to purchase a brand new house, nothing else (Tuesday)

Breaking economy news. Consumer confidence and new home sales. Confidence dropped from 126.1 in October to 125.5 in November. Not sure what is bugging the consumer. Jobs are not as plentiful and harder to get, but let's get real, 44.8% still say jobs are plentiful and just 12.7% say jobs are hard to get. Meanwhile, new home sales got revised up from 701K in September to 738K today which is the best sales level looking back twelve years. The sales pace came down marginally to 733K in October but who cares after the giant upward revision.

Net, net, you would think consumer confidence surveys would be much more optimistic given new home sales are the strongest in 12 years after last month's stunning upward revision to 738 thousand. It takes a lot of confidence to buy the biggest, big-ticket item that consumers will ever make in their lives, therefore it is curious that the consumer is relatively cautious on the economic outlook.



The confidence survey high this year was 135.8 in July and the low was 121.7 in January during the January Federal government shutdown and November's confidence reading of 125.5 is closer to the blah level than the happy and you know it level this summer. Heading into the holiday season the consumer isn't especially thankful this year which could pose a problem for the economic outlook if they don't find something to improve their spirits. The Trump economics team is counting on the consumer to carry the economy forward as business investment still is being held back by an uncertain outlook for the trade talks. One thing is true and that is times cannot be all that bad if the stock market is closing up 25% year-to-date last night. If the economy has hit a bump in the road, stock market investors are sticking in their seats and enjoying the ride with the best returns since 2013. Stay tuned. Story developing.

How's the labor market doing?
Conference Board asks the consumer.

Indexes	Nov 19	Oct 19	Sep 19	Aug 19	Jul 19	Jun 19	May 19
Confidence	125.5	126.1	126.3	134.2	135.8	124.3	131.3
Expectations	97.9	94.5	96.8	106.4	112.4	97.6	105.0
Jobs are:	Nov 19	Oct 19	Sep 19	Aug 19	Jul 19	Jun 19	May 19
Plentiful	44.8	47.7	44.5	50.3	45.6	44.0	45.3
Not so	42.5	40.7	44.5	37.7	41.9	40.2	42.9
Hard to get	12.7	11.6	11.0	12.0	12.5	15.8	11.8

The economy is back today, better than it was yesterday or the day before (Wednesday)

Breaking economy news. Second look at third quarter GDP. October durable goods orders for equipment. Jobless claims for the November 23 week of 213K down from 228K the week before. Real GDP was 2.1% in the third quarter up from the initial estimate of 1.9% as there was more inventory accumulation with inventories a 0.1 percentage point drag before and now adding 0.2 percentage point in today's report or a positive swing of 0.3 percentage points.

Business spending on nondefense capital goods ex-aircraft popped today with orders up 1.2 percent in October which should improve the trend of business investment in the fourth and final quarter of the year.

	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19p	Q3 19r
REAL GDP	3.5	2.9	1.1	3.1	2.0	1.9	2.1
REAL CONSUMPTION	4.0	3.5	1.4	1.1	4.6	2.9	2.9
CONSUMPTION	2.7	2.3	1.0	0.8	3.0	1.9	2.0
Durables	0.6	0.3	0.1	0.0	0.9	0.5	0.6
Nondurables	0.6	0.5	0.2	0.3	0.9	0.6	0.6
Services	1.6	1.6	0.7	0.5	1.3	0.8	0.8
INVESTMENT	-0.3	2.3	0.5	1.1	-1.2	-0.3	0.0
Business Plant	0.3	-0.1	-0.3	0.1	-0.4	-0.5	-0.4
& Equipment and	0.2	0.2	0.4	0.0	0.1	-0.2	-0.2
Intellectual Property	0.5	0.2	0.5	0.5	0.2	0.3	0.2
Homes	-0.2	-0.2	-0.2	0.0	-0.1	0.2	0.2
Inventories	-1.2	2.1	0.1	0.5	-0.9	-0.1	0.2
EXPORTS	0.7	-0.8	0.2	0.5	-0.7	0.1	0.1
IMPORTS	0.0	-1.3	-0.5	0.2	0.0	-0.2	-0.2
GOVERNMENT	0.4	0.4	-0.1	0.5	0.8	0.4	0.3
Federal defense	0.3	0.1	0.2	0.3	0.1	0.1	0.1
Fed nondefense	0.0	0.1	-0.1	-0.2	0.4	0.1	0.1
State and local	0.2	0.2	-0.1	0.4	0.3	0.1	0.1
Below line: Percentage point contributions to Q3 2019 2.1% real GDP							
Third estimate for Q3 is Friday, December 20							

We can be thankful that the economy is still in a good place with economic growth a little better, a rebound in business durable equipment expenditures, and a sharp decline in joblessness which together tell the story that recession is nowhere to be seen and should not be on anyone's radar in 2020. Political uncertainty, impeachment, trade war with China and the world, none of these headlines as yet show an economy that is about to go down. Real economic growth in the fourth quarter is likely to come up further from those near-zero estimates and the economy should grow at least 1.5%.

Net, net, the economy's forward momentum has been dented this year by the escalation of the trade war which has created a cloud of uncertainty for companies, disrupting their global supply chains of parts needed for domestic production that were decades in the making. Putting America first has reduced trade between nations and is in danger of braking the world economy.

3.1 percent US GDP growth to start the year, 2.0 percent in the second quarter and 2.1 percent in the second look at the third quarter today. The consumer is still in the driver's seat when it comes to steering the economy forward as capital investment spending has cooled due to the uncertain business outlook. The news is not all bad as gains in software purchases, and R&D expenditures partially offset the decline in equipment spending and less investment in offices, warehouses, factories and especially, oil & gas drilling.

The halo from the Tax Cuts & Jobs Act signed in December 2017 is fading and there is unlikely to be additional fiscal stimulus as that tax cut was controversial only passing by a narrow 51 to 49 vote in the Senate. There isn't a lot of oomph here in the GDP report details to power the economy forward at anywhere near the Trump economics team's prediction of 3 percent. There are some green shoots however that bodes well for the economy in the months ahead. The stock market remains hopeful otherwise investors would never have pushed stocks to these dizzying heights up over 20 percent this year.

Analyst Certification

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