Financial Market Weekly

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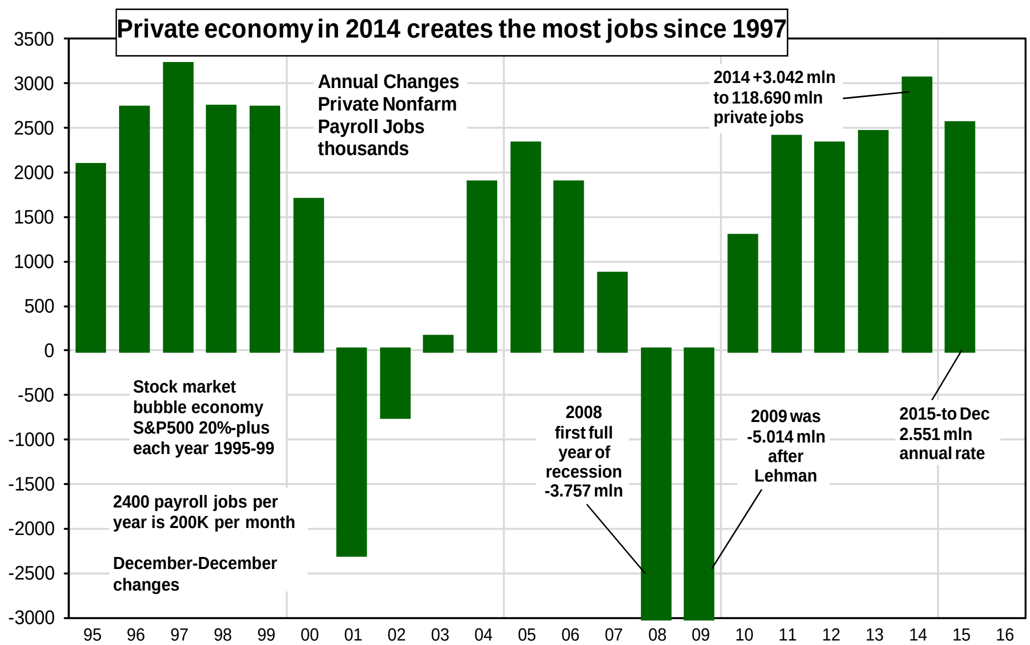
292K jobs: labor market in hyperdrive before Jan. financial markets storm



Holy cow, 292K jobs in December with 50K upward revisions to October/November. Only looking for 200K. The labor market is manufacturing jobs like there is no tomorrow. The economy at year end is in the perfect position to weather the financial market storms from China in the New Year. Data like these tell the Fed to keep raising rates and don't stop. Let's stop telling ourselves fairy tales about the pockets of weakness out there in the country. The economy was at full employment when the Fed pulled the trigger and lifted off in December and it is over full employment now.

Full Labor Market Recovery Despite 2% GDP					
	2011	2012	2013	2014	2015
Payroll jobs mln	2.080	2.257	2.388	3.116	2.891
Private jobs mln	2.396	2.315	2.452	3.042	2.783
Unemployment %	8.5	7.9	6.7	5.6	5.0
Rate Change	-0.8	-0.6	-1.2	-1.1	-0.5
Real GDP %	1.7	1.3	2.5	2.5	2.2
Year-end changes (2015 through Q3)					Dec
Year-end changes (annualized 2015 jobs)					jobs

Everything we write is the unvarnished truth always, but maybe not all the 292K is going to continue into 2016. Some of the strength is undoubtedly due to the warmest winter on record. Construction jobs added 45K of the 292K, larger than normal the last few months. We know the housing market is recovering, but construction jobs are unlikely to continue at this pace.

The report has lost some of its punch when it comes to driving the bond market up or down. The Fed is not expected to raise rates until March at the earliest so there are two more monthly jobs reports to go before that decision. Yellen has said the Fed has achieved the employment half of its dual mandate so all the drama on that question is gone. 10-yr Treasury yields barely changed from 2.17% before the news; gone are the days of bond yields soaring in anticipation of Fed "tightening."

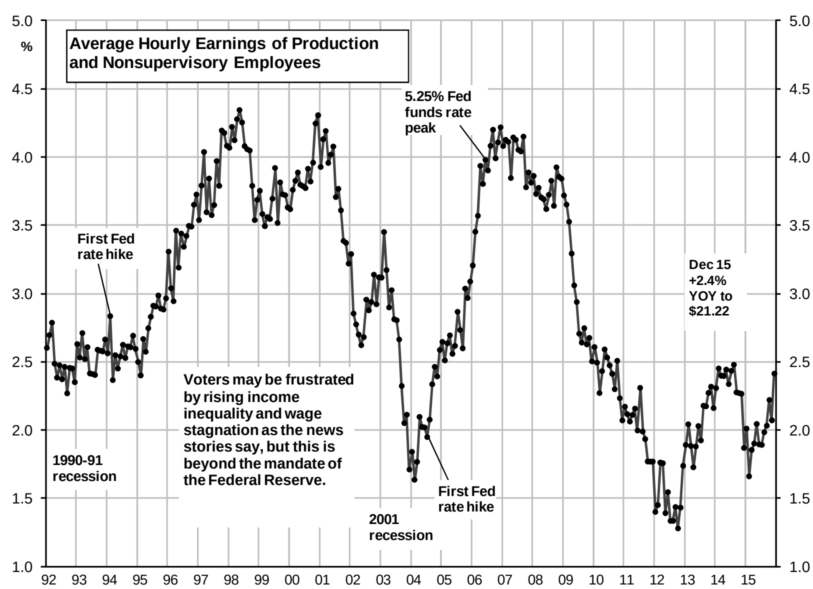
Yellen said it was time to lift off, but she said there was still slack out there in the labor market. If there's slack then that is reason enough for the Fed to raise rates a gradual four times per year total of 100 bps until they get it to normal levels of 3.5% in their view. And no faster. The participation rate is one slack stat she looks at and this went in the right direction today moving from 62.5% in November to 62.6% in December. Those working part-time but wishing for full-time employment held steady at 6 million in December. Many of these say they could only find part-time work which means this is how companies hire now, and so we doubt this is a sign of slack or "economic weakness." Fed officials should really stop talking the economy down all the time. It is affecting public confidence in the future.

Payroll jobs in seventh year of expansion following recession

Dec. 2014 Totals millions		Dec 15	Nov 15	Oct 15	12 months Dec 14 to Dec 15	12 months Dec 13 to Dec 14
140.592	Nonfarm Payroll Employment	292	252	307	2650	3116
118.690	Total Private (ex-Govt)	275	240	312	2551	3042
19.489	Goods-producing	45	39	34	162	595
0.859	Mining	-8	-11	-4	-129	41
12.301	Manufacturing	8	2	3	30	215
0.902	Motor Vehicles & parts	-2	-3	-1	27	50
6.275	Construction	45	48	35	263	338
99.201	Private Service-providing	230	201	278	2389	2447
26.669	**Trade, transportation, utilities**	31	63	37	445	510
15.497	Retail stores	4	32	25	274	224
3.138	General Merchandise	-5	6	5	63	46
3.020	Food & Beverage stores	0	-4	-8	12	53
4.738	Transportation/warehousing	23	20	2	94	166
1.441	Truck transport	5	4	-3	19	47
0.616	Couriers/messengers	15	11	10	9	45
0.557	Utilities	1	2	0	11	7
2.767	**Information**	16	-9	5	50	43
8.049	**Financial**	11	15	11	147	135
2.506	Insurance	6	6	6	72	83
2.070	Real Estate	2	5	1	33	56
1.284	Commercial Banking	0	0	-3	-16	-20
0.888	Securities/investments	2	3	4	29	17
19.439	**Professional/business**	73	21	94	605	704
2.863	Temp help services	34	-12	35	95	174
2.190	Management of companies	3	4	6	54	55
1.403	Architectural/engineering	5	-3	8	35	48
1.814	Computer systems/services	4	4	9	91	79
1.120	Legal services	1	0	1	8	-3
0.922	Accounting/bookkeeping	-5	12	5	47	58
21.718	**Education and health**	59	50	73	655	488
4.815	Hospitals	12	15	17	172	42
3.439	Educational services	7	11	11	64	65
14.948	**Leisure and hospitality**	29	47	48	419	482
1.896	Hotel/motels	-5	4	-1	5	19
10.917	Eating & drinking places	37	31	46	357	401
21.902	Government	17	12	-5	99	74
2.134	Federal ex-Post Office	0	2	-1	11	-12
5.079	State government	6	3	3	34	23
2.430	State Govt Education	5	4	3	34	23
14.091	Local government	7	4	-8	48	62
7.796	Local Govt Education	0	-1	-13	-7	33

There is some "inflation" data in the report in looking at wages, so-called average hourly earnings. These were unchanged for the month, but it is better to focus on the year-to-year change which is 2.5%, and so starting to move up a little. Inflation is in the driver's seat when it comes to Fed policy, so better wages and sky-high jobs numbers should make Fed officials more confident that inflation will indeed get to the 2.0% target in the next couple of years.

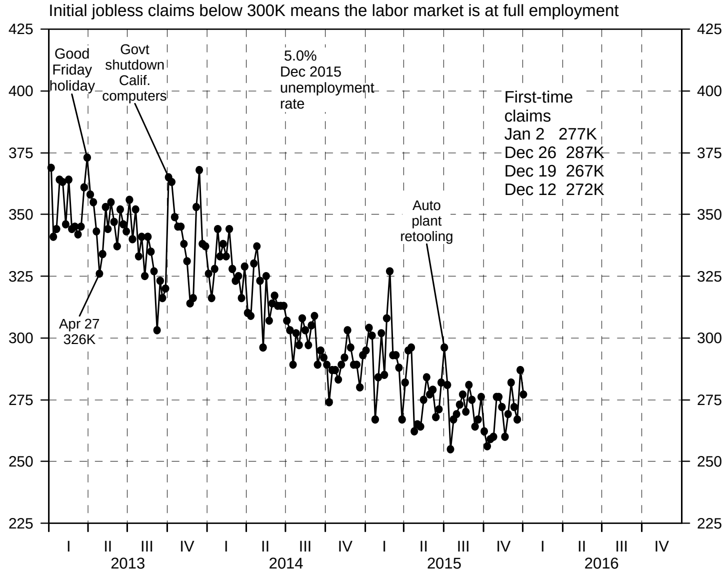
To conclude, the labor market was extremely strong in the final months of the year and this provides credible evidence that the economy and the Fed's policy are moving in the right direction. We look for another measured rate hike of 25 bps at the March 2016 meeting to 0.75%. Don't be fooled by these forecasts that real GDP is growing less than 1% in the fourth quarter. The more reliable number of how good conditions are out there is jobs, jobs, jobs, and 307K October, 252K November, and 292K in December means Q4 was a blow-out quarter. The economy is stronger than you think. The risks from China are overblown. Four rate hikes are coming this year, bet on it.



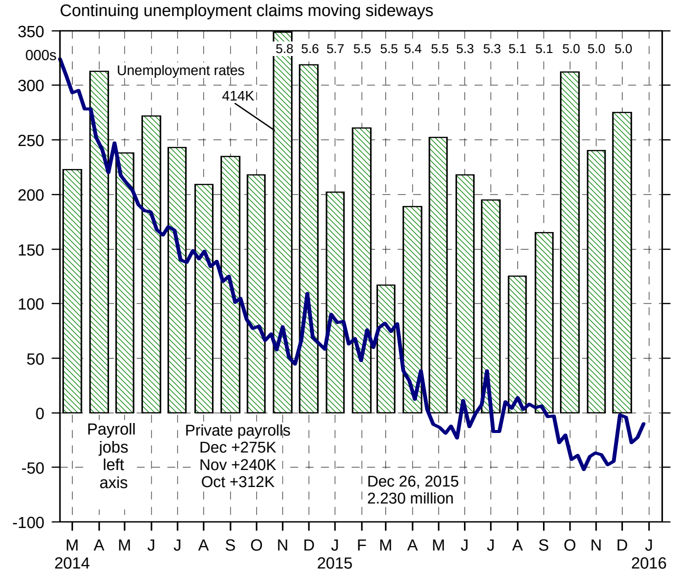
JOBLESS CLAIMS, BETTER, LOWER THAN ANY TIME IN RECORDED HISTORY

Unemployment claims fell 10K to 277K in the January 2 week. The big hiring boost in private nonfarm payroll jobs does not match up 100% with the sideways movement of first-time jobless claims. Of course the labor market as defined by unemployment benefits is in uncharted waters due to the extremely low readings on jobless claims. The current cycle low of initial claims was 255K in July 2015 and before that you have to go back to the 1970s to find a lower (better) reading. In the late 90s stock market bubble, claims were as low as 259K and the Fed pushed rates to 6.5% to slow the economy down. There is no slack in the labor market. The economy is fully employed.

Initial jobless claims below 300K means the labor market is at full employment



Continuing unemployment claims moving sideways

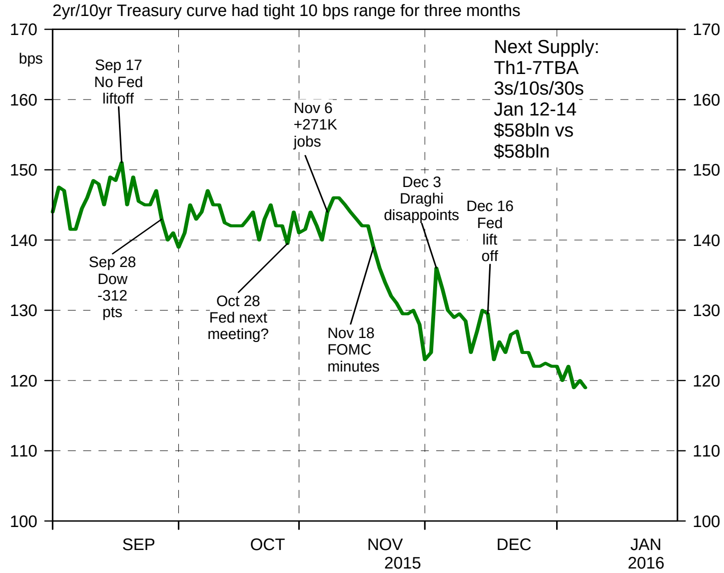


TREASURY CURVE NARROWS SLIGHTLY FROM 130 BPS AFTER FED LIFTOFF

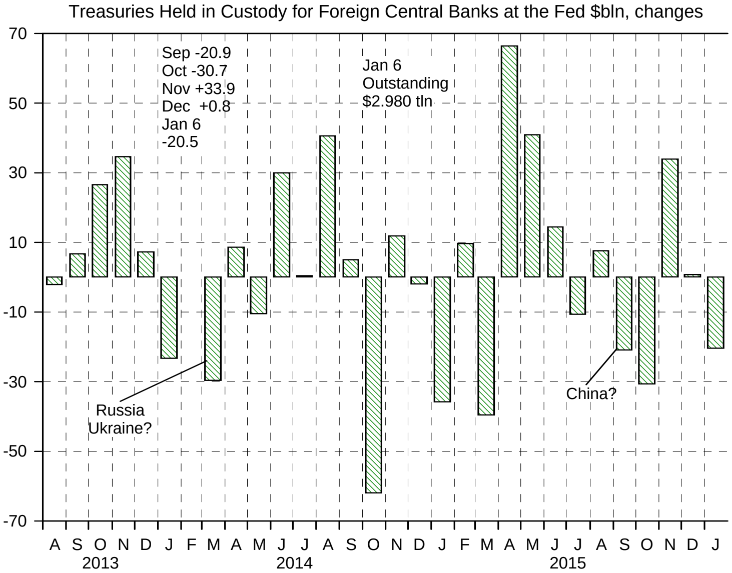
	31-Dec 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017
30-Yr Bond	3.02	3.40	3.60	3.60	3.70	3.70	3.90
10-Yr Note	2.27	2.70	3.00	3.10	3.20	3.30	3.50
5-Yr Note	1.76	2.10	2.50	2.60	2.80	2.90	3.10
2-Yr Note	1.05	1.40	1.70	1.80	2.10	2.30	2.60
3-month Libor	0.61	0.85	1.10	1.35	1.60	1.85	2.35
Fed Funds Rate	0.50	0.75	1.00	1.25	1.50	1.75	2.25
2s/10s spread	122	130	130	130	110	100	90

The yield curve between 2-yrs and 10-yrs was +119 bps on Friday versus +122 bps last week. The stock market got the bond market's attention this week with China market circuit breaker early closings on Monday and Thursday: Dow industrials fell 1,078 points or 6.2% this week. The 10-yr Treasury was 2.17% before the jobs report and repriced instantly 4 bps higher to 2.21%, but retraced the violent "move" 15 minutes later. Two more monthly jobs reports to go before the Fed's next "live" March 16 decision date.

2yr/10yr Treasury curve had tight 10 bps range for three months



Treasuries Held in Custody for Foreign Central Banks at the Fed $bln, changes



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FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	6-Jan	30-Dec	23-Dec	16-Dec	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2461.505	2461.554	2461.566	2461.578	479.782
Federal agency debt securities	32.944	32.944	32.944	32.944	0.000
Mortgage-backed securities	1747.467	1747.467	1757.757	1753.157	0.000
Primary credit (Discount Window)	0.133	0.553	0.002	0.010	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)	1.717	1.717	1.715	1.716	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	0.000
Central bank liquidity swaps	0.997	0.997	0.926	0.138	62.000
Federal Reserve Assets	4532.0	4532.0	4541.7	4534.8	961.7
3-month Libor %	0.62	0.61	0.60	0.53	2.82
Factors draining reserves					
Currency in circulation	1421.914	1426.176	1421.758	1414.321	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	126.584	277.447	178.332	102.004	0.000
Reserve Balances (Net Liquidity)	2353.501	2208.681	2371.078	2460.053	24.964
Treasuries within 15 days	0.000	0.000	0.000	0.000	14.955
Treasuries 16 to 90 days	62.206	38.619	38.619	38.619	31.549
Treasuries 91 days to 1 year	153.907	165.794	165.795	165.795	69.272
Treasuries over 1-yr to 5 years	1118.342	1124.291	1124.293	1124.295	170.807
Treasuries over 5-yrs to 10 years	489.219	494.987	494.988	494.990	91.863
Treasuries over 10-years	637.831	637.863	637.871	637.878	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

The Fed meets January 26-27 to consider its monetary policy. The jobs report on Friday was over-the-top strong at 292K in December, but we are fairly certain the Fed will not be moving up rates in January a second step to 0.75%. The March 16 decision date with its Yellen press conference seems a long time to wait for a rates adjustment given the strength of Friday's payroll jobs report. Forgetting that the optics are not right with China's stock market spreading financial losses around the globe this week. Eventually, it may dawn on the U.S. consumer that the prospects for their investments in U.S. stocks is not what it was, the Dow industrials down 2.2% in 2015, and down Friday 6.2% year-to-date. A negative wealth effect could curb consumer spending later this year although it is not showing up in the confidence surveys yet.

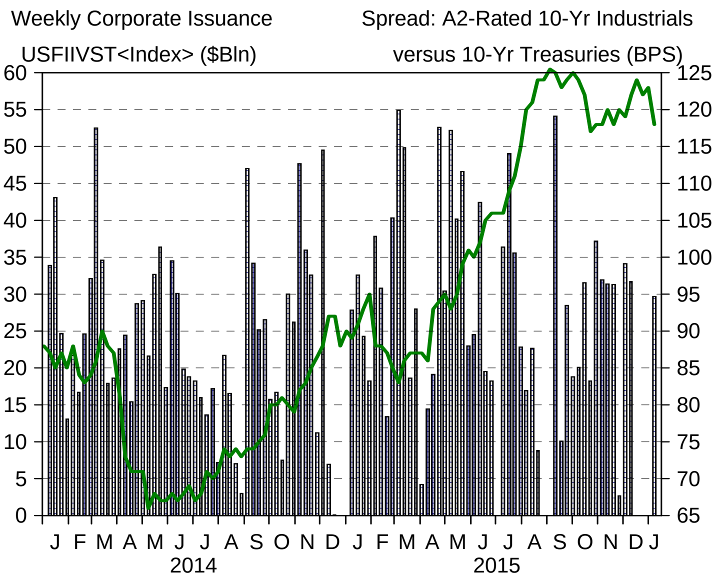
The problem is the Fed has laid out a path for rates that has taken uncertainty out of the market. It is almost like we are living in an economy managed by Government officials in the central planning office. The Dots forecasts began in 2012 when the Fed wanted to get the message out that interest rates would stay lower for longer. They wanted to stimulate the economy through lower bond yields because the short-term interest rate had already been pushed to zero back in December 2008. But now the Dots forecasts are holding back natural market forces, and it is an attempt to oversteer the economy and its financial market conditions. Credit demand has been overly strong in this expansion because of the continued zero-rates, free-money policy stance. The policy of gradualism (100 bps per year) telegraphs that the economy is not quite right, and this affects the public's confidence. The reality is the economy as of December 2015 was more than all right; it is looking over ripe with rates too low at 0.50%. The economy is at full employment where short-term interest rates should be at least 3.5% if not slightly higher leaning against the wind. It is inappropriate to say they are still missing on the inflation half of their dual mandate. Core CPI inflation is 2.0% YOY in November 2015, and their "preferred measure" core PCE inflation is 1.3% YOY in November 2015. Core PCE inflation is lower based on the index weighting differences of various component prices like health care and home prices; it is not appropriate for Fed officials to point to core PCE inflation as if the economy is not fully healed. There is no deflation risk from deficient demand.

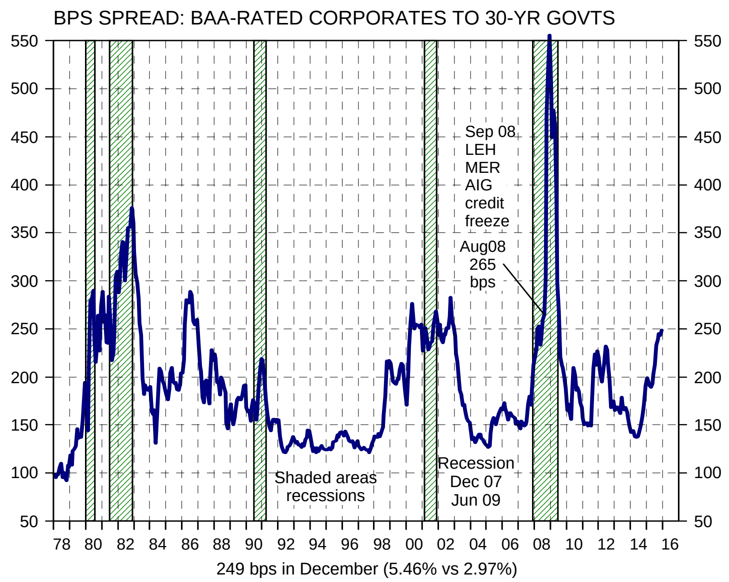
Fed Forecasts versus the Market					
	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16
3-mo Libor	0.52	0.62 on Friday, Jan 8			
Eurodollar futures	0.52	0.70	0.815	0.93	1.06
Jan 8, 2016	EDZ15	EDH16	EDM16	EDU16	EDZ16
Fed forecasts	0.50	0.75	1.00	1.25	1.50

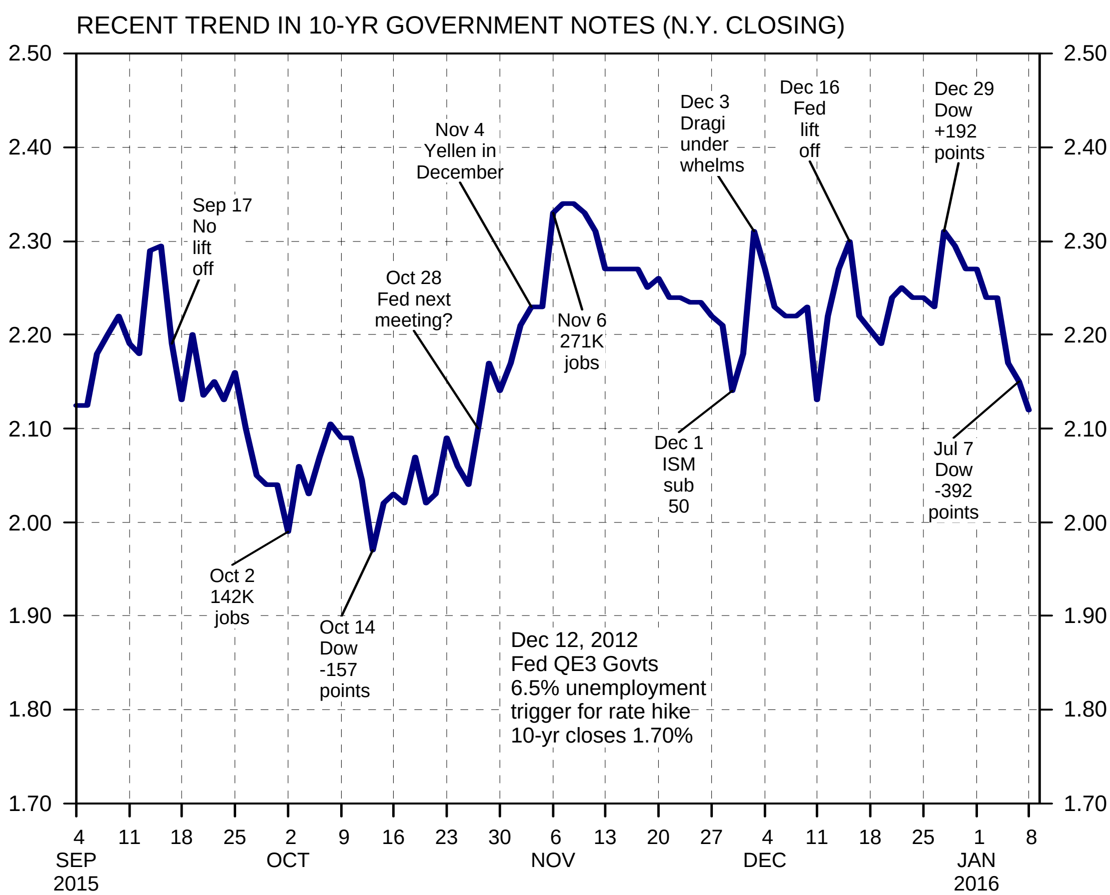
In conclusion, the biggest policy mistake they are making in their communications is that a 25 bps rate hike from 0.50%, that such a move has a restrictive effect on the economy. This is what the public thinks when they raise rates, it is restrictive; the average consumer and business owner questions whether the economy is strong enough to handle a rate hike. At this stage, it would be better for Fed policy to shift into "the measured moves" Greenspan stance, saying they will take away the accommodative low rates policy at a measured pace or 100 bps per year, half the 200 bps speed of the Greenspan Fed following the 2001 recession. This will they or won't they go, data-dependent, guessing game this year at the four "live" Fed meetings tells the markets that they think the economy might be too fragile to move rates higher and so they need to skip a meeting. Every other Fed in modern economic history since the 70s had the Fed funds rate at 3.5% neutral when the unemployment rate had fallen back to full employment levels. The Yellen Fed has delayed normalization and we hope it isn't too late to get rates back up there because they do not have a reliable means to steer the economy right now. Without a 3.5% Fed funds rate, there is no rudder to steer the economy.

CORPORATES: BLACK HILLS, KROGER, AMERICAN TOWER, JOHN DEERE

Corporate bond offerings were $29.7 billion in the January 8 week versus $0.0 billion in the January 1 week. On Tuesday, the Walt Disney Co. sold $3.0 billion 3s/5s/10s/30s/FRNs. It priced $1.0 billion 3% 10-yrs (m-w +15bp) at 80 bps (A2/A). The global media and entertainment company will use the proceeds for general corporate purposes, possibly including share buybacks and M&A. Corporate bonds (10-yr Industrials rated A2) were 118 bps above 10-yr Treasuries on Friday versus 123 bps last Friday.







TREASURY MARKET OUTLOOK

EXPECTED 10-YR 2-3 WEEK TRADING RANGE 2.00% to 2.50%

Week's 10-YR Range

HIGH 101-07+ 2.11%

Friday, January 8, stock and oil market rally on 292K jobs faded; maybe 0.0% wages?

LOW 99-20+ 2.29%

Monday, January 4, start of the week lows in a rally week

Analyst Certification

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