Financial Market Weekly

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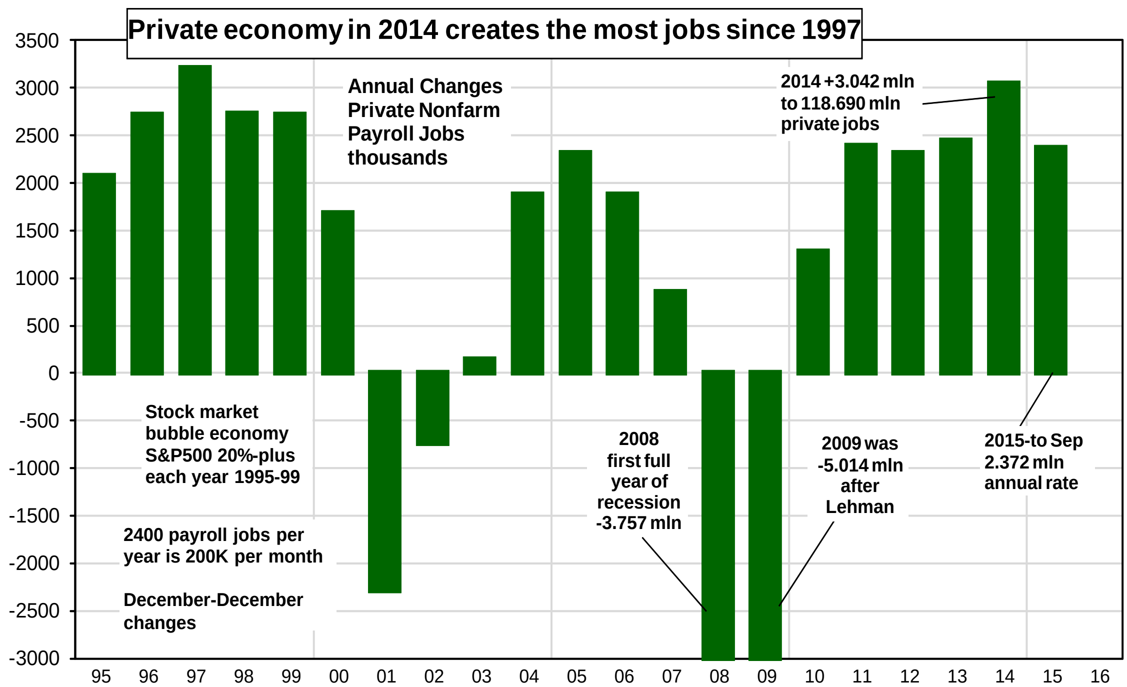
SEPTEMBER EMPLOYMENT REPORT--GOOD ENOUGH FOR DECEMBER 16 LIFTOFF



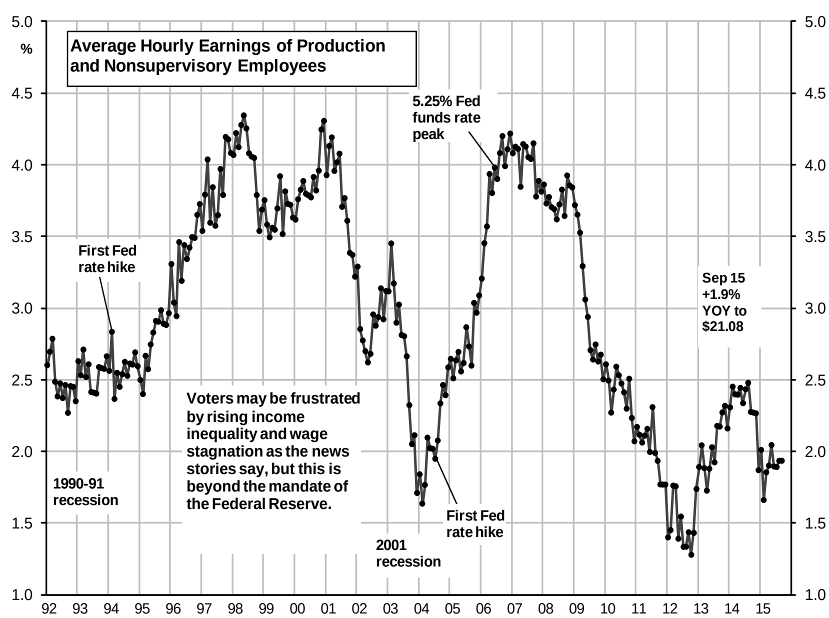
December 16 liftoff? Certainly didn't feel like a very live possibility on Friday morning after the headlined news for the employment numbers where one statistic after another seemed to fall short of the market's expectations. 10-yr Treasury yields were 2.05% before the number, 1.98% sixty seconds later, and 1.92% ten minutes after.

Full Labor Market Recovery Despite 2% GDP					
	2011	2012	2013	2014	2015
Payroll jobs mln	2.080	2.257	2.388	3.116	2.372
Private jobs mln	2.396	2.315	2.452	3.042	2.203
Unemployment %	8.5	7.9	6.7	5.6	5.1
Rate Change	-0.8	-0.6	-1.2	-1.1	-0.5
Real GDP %	1.7	1.3	2.5	2.5	2.3
Year-end changes (2015 through Q2)					Sep
Year-end changes (annualized 2015 jobs)					jobs

Let's take the four offending parts of the employment report in turn as the news headlines rolled across, sparking the bond buying binge on Friday. Actually they are not released in turn, the statistics are all displayed at once making it virtually impossible to tell what the market's collective intelligence found to be so bearish about the economic outlook in the report. The sixty second reaction is mostly stop losses getting hit or robot milliseconds trading. First thing wrong with the report was the 142K payroll jobs count for September which was less than expected along with 59K of downward revisions to August and July. These downward revisions to the prior two months are growing more frequent this year, which is leading us to think we are nearing full employment and jobs growth will naturally slow. However, private payroll jobs are very slow the last two months, 118K September 100K August, and are likely to pick back up later this year. The second thing wrong with the report is the 5.1% unemployment rate which was unchanged although the 3-decimal figure (5.051) was close to dropping a tenth closer to Yellen's 4.9% new goal line for full employment. The third thing wrong with Friday's report was that wages were unchanged. Average hourly earnings were 0.0% in September, although August was revised from +0.3% to +0.4%, and wages are running 2.2% year-on-year where it has been all third quarter long. The graph below is wages for working people and these show the same trend. The same story on wages: while they are likely to move up from this point forward with unemployment at full employment, it could take a year, and we think this series is being held down by inflation that is running 2% at best. Most employers benchmark annual wage increases across the firm to the prior year's inflation rate. If some on the FOMC want to wait for wages before liftoff, it is going to be a long wait. The final thing wrong was the drop in the participation rate from 62.6% to 62.4%. This is not cyclical, it is the baby boom retiring. It is true that 579K people dropped out of the labor force in September, but only 23K actually wanted to work.

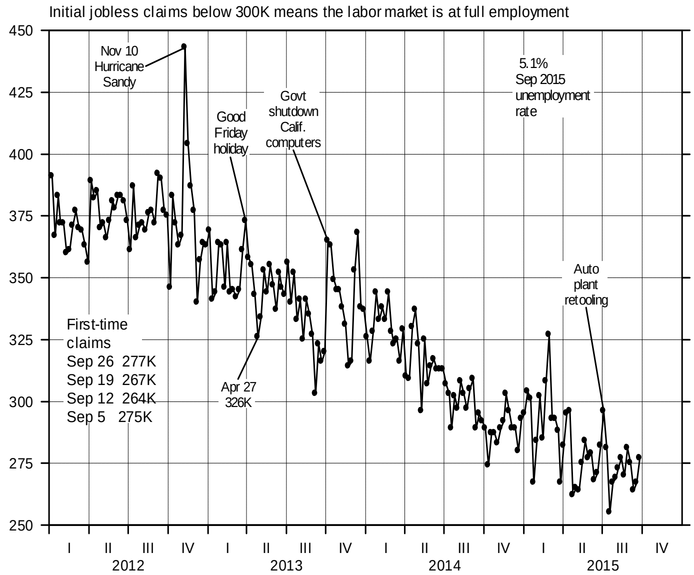
Payroll jobs in seventh year of expansion following recession

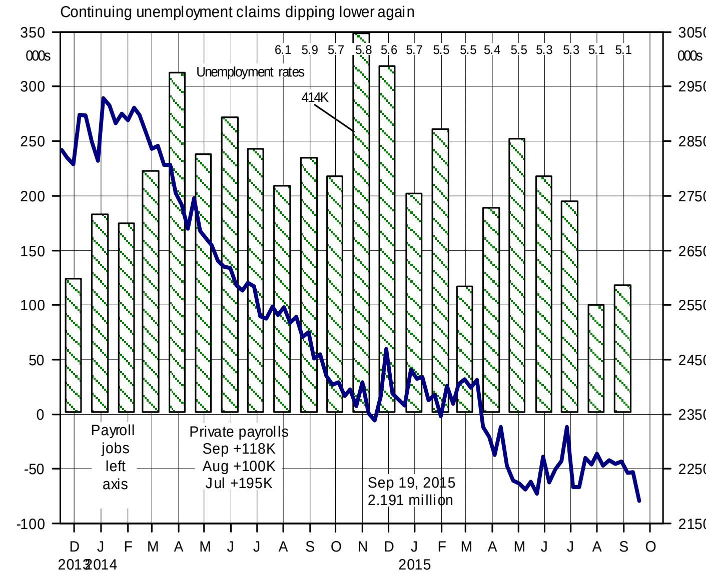
Dec. 2014 Totals millions		Sep 15	Aug 15	Jul 15	9 months Dec 14 to Sep 15	12 months Dec 13 to Dec 14
140.592	Nonfarm Payroll Employment	142	136	223	1779	3116
118.690	Total Private (ex-Govt)	118	100	195	1652	3042
19.489	Goods-producing	-13	-22	7	34	595
0.859	Mining	-10	-9	-9	-102	41
12.301	Manufacturing	-9	-18	11	17	215
0.902	Motor Vehicles & parts	2	7	2	32	50
6.275	Construction	8	5	5	121	338
99.201	Private Service-providing	131	122	188	1618	2447
26.669	**Trade, transportation, utilities**	23	17	47	334	510
15.497	Retail stores	24	4	29	227	224
3.138	General Merchandise	10	2	7	56	46
3.020	Food & Beverage stores	2	-1	1	24	53
4.738	Transportation/warehousing	4	6	14	59	166
1.441	Truck transport	-4	-1	2	11	47
0.616	Couriers/messengers	3	1	1	-17	45
0.557	Utilities	-1	1	2	7	7
2.767	**Information**	12	-5	4	34	43
8.049	**Financial**	0	12	15	105	135
2.506	Insurance	2	1	8	49	83
2.070	Real Estate	1	7	7	27	56
1.284	Commercial Banking	-2	-1	-2	-14	-20
0.888	Securities/investments	-1	3	1	17	17
19.439	**Professional/business**	31	27	40	408	704
2.863	Temp help services	5	7	-11	43	174
2.190	Management of companies	2	-1	13	39	55
1.403	Architectural/engineering	0	-4	6	23	48
1.814	Computer systems/services	7	8	12	77	79
1.120	Legal services	5	-1	1	5	-3
0.922	Accounting/bookkeeping	5	4	5	34	58
21.718	**Education and health**	29	47	42	435	488
4.815	Hospitals	16	17	22	124	42
3.439	Educational services	-8	0	2	11	65
14.948	**Leisure and hospitality**	35	32	32	273	482
1.896	Hotel/motels	2	-1	4	6	19
10.917	Eating & drinking places	21	24	26	223	401
21.902	Government	24	36	28	127	74
2.134	Federal ex-Post Office	-2	0	0	3	-12
5.079	State government	17	11	2	36	23
2.430	State Govt Education	14	12	-1	35	23
14.091	Local government	9	24	27	89	62
7.796	Local Govt Education	0	20	18	53	33



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

Unemployment claims rose 10K to 277K in the September 26 week. This is the timeliest, most sensitive indicator of current labor market conditions. If the economy was undergoing a serious slowdown, enough for companies to lay off workers, it would show up here first. Private payroll jobs have slowed the last two months certainly, but weekly jobless claims do not indicate anything serious is staking place. One implication from the low unemployment claims data is that monthly payroll jobs growth will slow to monthly gains of 180 to 190K within the next couple of years because the economy has reached 5.0% full employment. Maybe it is happening already.

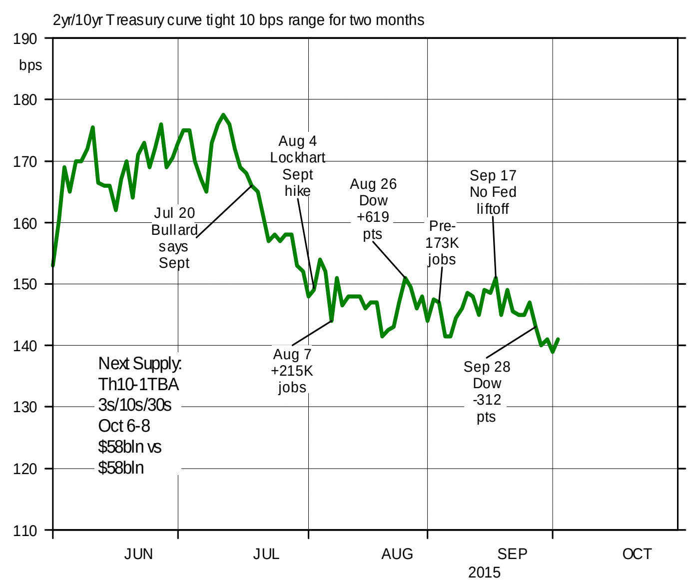


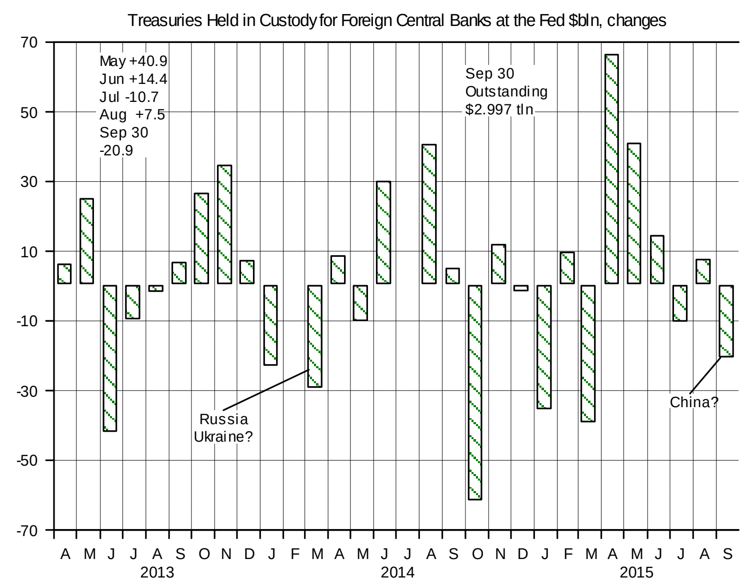


TREASURY CURVE STEADY AT 140 BPS-WAITING ON THE FED

	30-Sep 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
30-Yr Bond	2.85	3.40	3.60	3.60	3.70	3.70
10-Yr Note	2.04	2.70	3.00	3.10	3.20	3.30
5-Yr Note	1.36	2.10	2.50	2.60	2.80	2.90
2-Yr Note	0.63	1.30	1.70	1.90	2.10	2.40
3-month Libor	0.33	0.60	0.85	1.10	1.35	1.85
Federal Fund Rate	0.25	0.50	0.75	1.00	1.25	1.75
2s/10s spread	141	140	130	120	110	90

The yield curve between 2-yrs and 10-yrs was +141 bps on Friday versus +147 bps last week. The bond market was 2.05% before the employment data on Friday, moved down to 1.92% within 10 minutes of digesting the report. The bond rally was helped by the sharp sell-off in stocks. Dow futures were up 87 points at 830am; the index itself fell as much as 258 points from Thursday's close, shortly before 10am EDT. Bond yields came off the lows to close at 1.99% as the Dow reversed, closing up 200 points.





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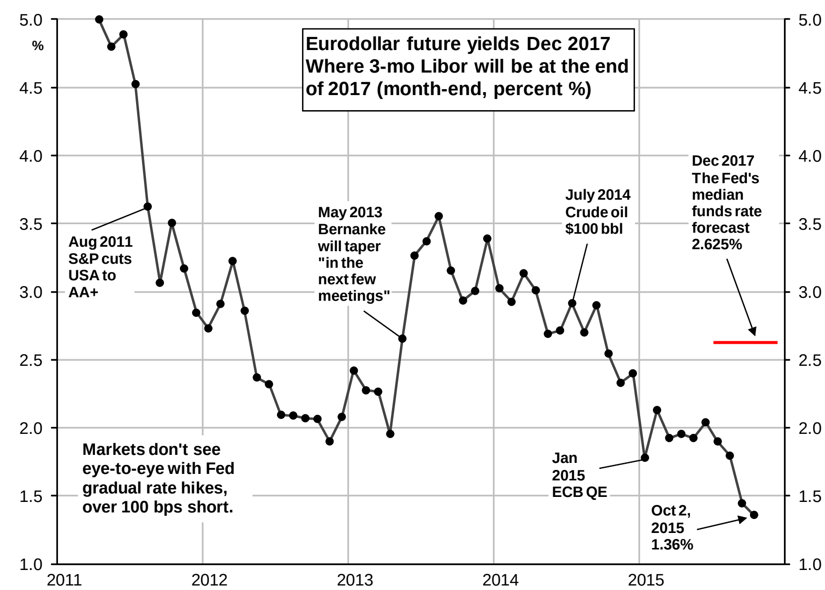
FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	30-Sep	23-Sep	16-Sep	9-Sep	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2461.948	2461.946	2461.944	2461.943	479.782
Federal agency debt securities	35.093	35.093	35.093	35.093	0.000
Mortgage-backed securities	1741.233	1752.619	1745.119	1736.706	0.000
Primary credit (Discount Window)	0.016	0.021	0.009	0.005	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)	1.703	1.702	1.702	1.703	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	0.681	0.683	0.145	0.136	62.000
Federal Reserve Assets	4528.8	4542.5	4532.6	4522.9	961.7
3-month Libor %	0.33	0.33	0.34	0.33	2.82
Factors draining reserves					
Currency in circulation	1387.415	1384.890	1384.773	1387.170	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	449.614	144.297	82.191	68.129	0.000
Reserve Balances (Net Liquidity)	2197.657	2602.196	2643.764	2734.650	24.964
Treasuries within 15 days	0.000	0.001	0.001	0.000	14.955
Treasuries 16 to 90 days	0.327	0.327	0.327	0.327	31.549
Treasuries 91 days to 1 year	166.961	166.961	166.961	166.961	69.272
Treasuries over 1-yr to 5 years	1142.559	1133.906	1133.906	1133.906	170.807
Treasuries over 5-yrs to 10 years	514.060	522.712	522.712	522.712	91.863
Treasuries over 10-years	638.041	638.040	638.038	638.037	101.337

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

The Fed meets October 27-28 to consider its monetary policy. At the June meeting they were waiting for further improvement. At the July meeting, they were waiting for "some" further improvement. The September meeting was a close call, and before you scoff, this was Fed Chair Yellen's characterization at the September 17 press conference. From the September meeting to the October meeting there is just one employment report to gauge additional "improvement." And on the face of it, Friday's report with 142K nonfarm payroll jobs and 59K of downward revisions was not enough. There are two additional employment reports before the December 16 decision date on Fridays November 6 and December 4. So things can always change. <u>We hope we are watching what the Fed is watching and understanding exactly what is the likely trigger.</u> The 142K jobs number does not sound so good to the bond world that thinks 200-plus numbers are all that matters. However, San Francisco Fed President Williams made some intriguing comments to the Wall Street Journal this week before the Friday jobs report: (1) "When you have a close decision like that (Sept 17), it doesn't take a lot of information to tip the balance." (2) "I would view October to be a completely live meeting." (3) "I'm just looking for steady, continuing improvement in the labor market, continuing improvement in the economy… Above 100K or 150K would be good to me." It sounds like he is saying if the economy is at full employment, why do 200K payroll jobs matter anymore? He was Yellen's research director and their thinking cannot be that far apart.

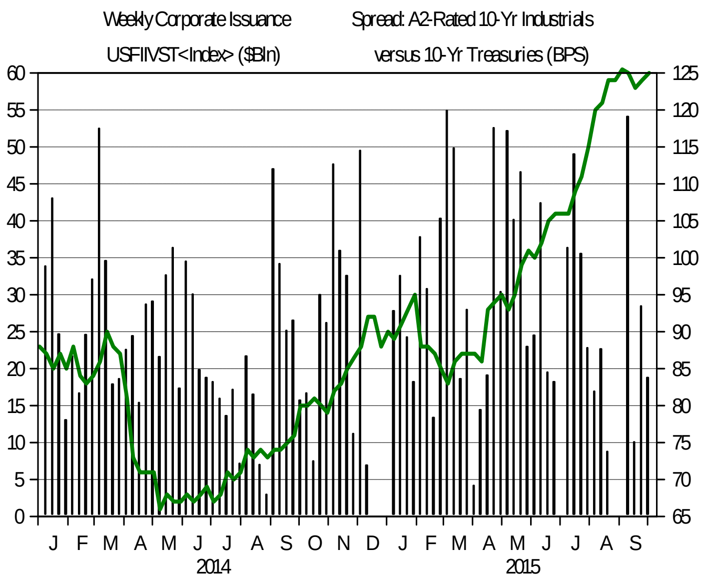


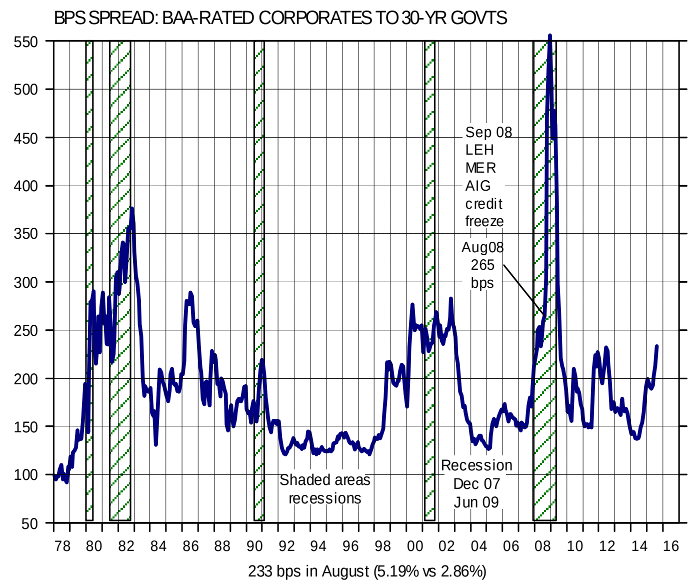
The 17 member committee participants were split in that close September meeting vote: 6 wanted to go with earlier, bigger moves than a simple December liftoff, 7 voted December (technically some of the 7 could favor October), and 4 voted 2016. A 6-7-4 split. The Friday jobs report probably rules out a October liftoff, but December cannot be ruled out as there are two more jobs market numbers to go before the data-dependent Fed "sits down to talk about it" on December 16.

The market does not believe our narrative here. Fed funds futures are not back to normal after years of zero rates, but if you insist, Fed funds futures do not fully discount a full 25 bps Fed rate hike until the June 2016 meeting. The December 2017 Eurodollar future (EDZ7) yield (where 3-mo Libor will trade at that time) is very low relative to the Fed forecasts as the financial system is flush with cash and traders will take the bet that the Fed is going to delay and go slow even when they liftoff. If money is free even the EDZ7 1.36% yield earns some carry interest for a while. Roll the dice, earn a return, for now. Stay tuned. Story is developing. The possibility of a 2015 rate hike still has a heartbeat-142K jobs, 0.0 wages and all.

CORPORATE BONDS: ENBRIDGE, PPL ELECTRIC UTILITIES, PECO ENGERY

Corporate bond offerings were $18.8 billion in the October 2 week versus $28.5 billion in the September 25 week. On Wednesday, Hewlett Packard Enterprise sold a $14.6 billion 9-part offering of FRNs/2s/3s/5s/7s/10s/20s/30s. It priced $2.5 billion 4.9% 10-yrs (m-w +45bp) at 290 bps (Baa2/BBB). The software and services company will use the proceeds to help fund its split into two different companies. Corporate bonds (10-yr Industrials rated A2) were 125 bps above 10-yr Treasuries on Friday versus 124 bps last Friday.





TREASURY MARKET OUTLOOK

EXPECTED 10-YR 2-3 WEEK TRADING RANGE 1.90% to 2.20%

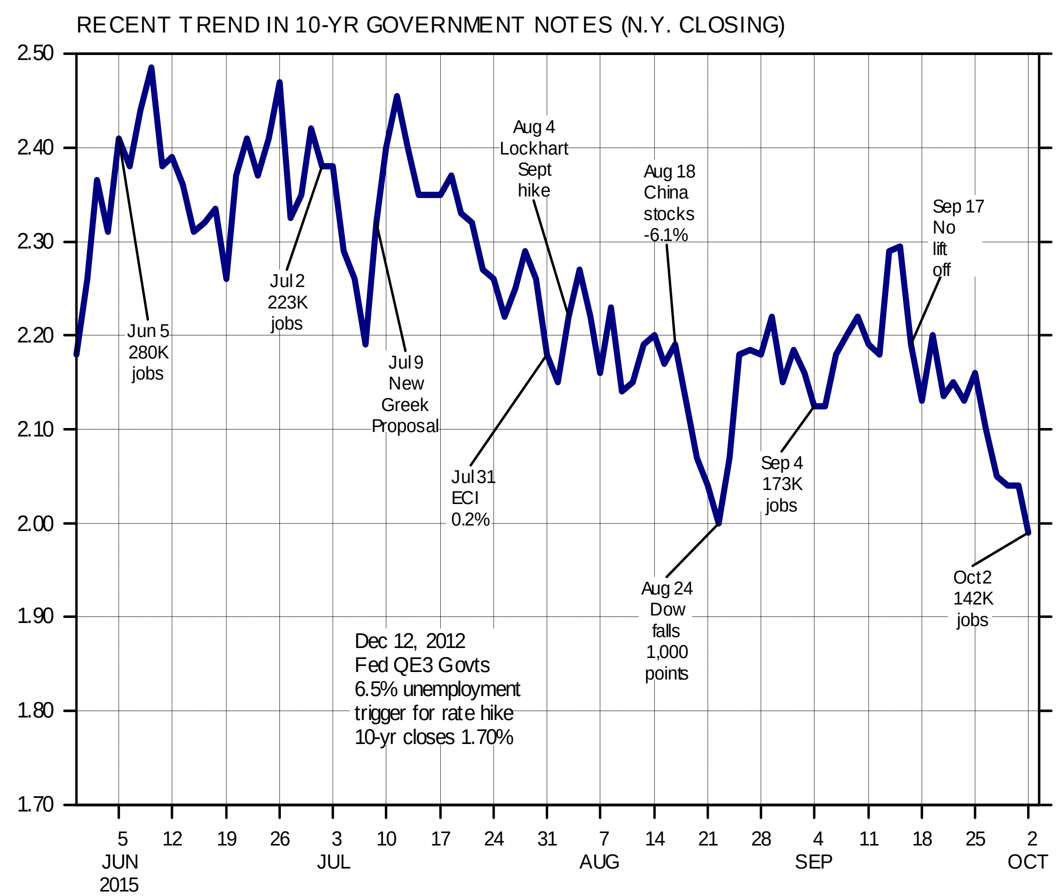
Week's 10-YR Range

HIGH 100-02 1.90%

Friday, October 2, rally on +142K payroll jobs, 0.0% average hourly earnings (wages)

LOW 98-16+ 2.17%

Monday, September 28, start of the week lows



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