

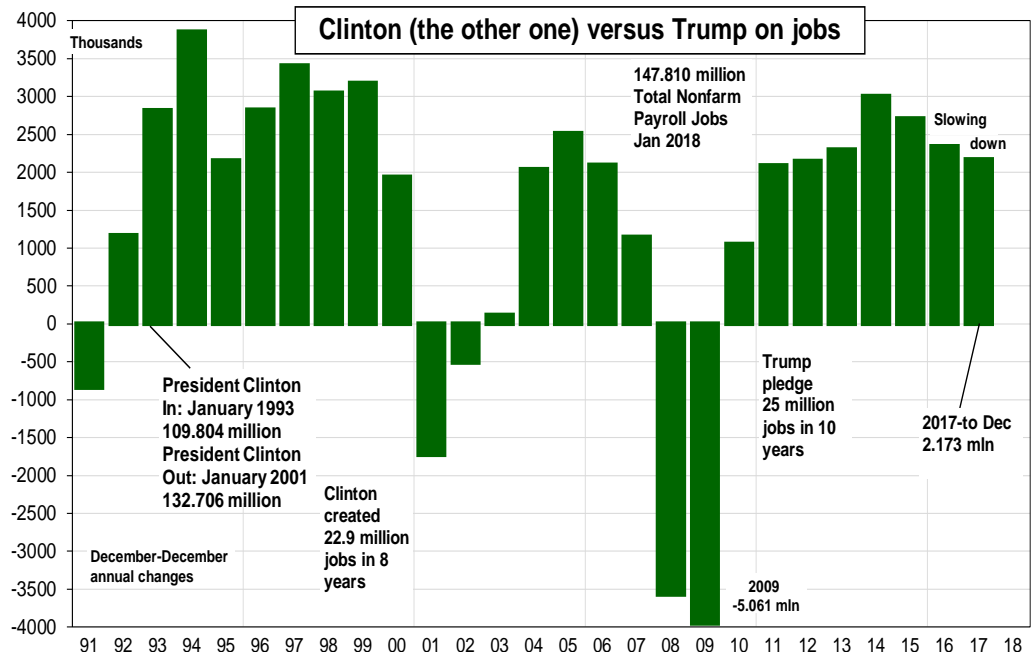
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## JOBS SOLID AT 200 THOUSAND, AND WAGES HEATING UP (FOR SOME)

Breaking economy news. The monthly employment situation report from the Bureau of Labor Statistics with payroll jobs, unemployment rate, and wages. You might have heard the news already, perhaps you even got your Republican tax cut in your paychecks (open the envelope to check); we will get to the big wages news in a minute. Jobs count surprisingly normal despite winter cold and Federal government shutdown.



The jobs count was solid with 200K new jobs to start the year in January. Employment trends are positive for home builders, hospitals, manufacturing, eating & drinking places, jobs galore out there despite the ninth

	Jan	Dec	Nov	Oct	Sep	Aug
Payroll jobs (000s)	200	160	216	271	14	221
Unemployment rate %	4.1	4.1	4.1	4.1	4.2	4.4
Unemployment (3 decimal)	4.149	4.095	4.121	4.068	4.196	4.438
Participation rate %	62.7	62.7	62.7	62.7	63.0	62.9
Average hourly earnings	\$26.74	\$26.65	\$26.54	\$26.47	\$26.51	\$26.39
MTM % Chg	0.3	0.4	0.3	-0.2	0.5	0.2
YOY % Chg	2.9	2.7	2.5	2.3	2.8	2.6
Production Worker earnings	\$22.34	\$22.31	\$22.23	\$22.18	\$22.20	\$22.11
MTM % Chg	0.1	0.4	0.2	-0.1	0.4	0.2
YOY % Chg	2.4	2.4	2.3	2.2	2.6	2.3

year of economic expansion with its decades low unemployment rate of 4.1%. Not sure where companies and firms are finding the workers out there to hire in their factories, shops, restaurants and malls.

The market has found a new dynamic where stocks fizzle while the bond market collapses. Normally, bond markets rally when the stock market drops as they expect the Fed to stop raising interest rates. It is hard to escape from the belief that higher bond yields have somehow sparked some trepidation among stock market investors. Higher bond yields represent less punch in the punch bowl which will lead to slower economic growth somewhere down the road. Higher interest rates aren't going to make America great again is what stock market investors fear.

The bond market is selling off on the surprise of average hourly earnings now rising 2.9% the last year. At least one economic number is closing in on the Trump economics team's goal of 3.0%. Maybe workers can thank those massive Washington tax

cuts for more moolah in their paychecks. There was an annual benchmark revision finding more wages out there as well. Last month we thought the wages data as represented by average hourly earnings was up 2.5% the last year, and now low and behold, wage inflation is faster at 2.9%. The economic laws have not been repealed after all, a tight labor market leads to upward pressure on wages and eventually more inflation.

To conclude, the Fed seems to be a little further behind the curve with interest rates still low at 1.5% after today's solid jobs report where wage inflation is heating up. Maybe the economy with 4.1% unemployment really is at the cross roads of full employment, with no slack left in the labor market, the point where inflation starts to gain a foothold in the economy. We think Fed officials are going to view this report today with greater alarm and telegraph to the world at the March meeting that they need to up their game and plan on raising interest rates four times this year not just three times.

Payroll jobs in year nine following the recession				Annual benchmark	
				12 months Dec 16 to Dec 17	12 months Dec 15 to Dec 16
Dec. 2016					
Totals					
millions		Jan 18	Dec 17	Nov 17	Dec 17
145.437	<b>Nonfarm Payroll Employment</b>	200	160	216	2173
123.131	<b>Total Private (ex-Govt)</b>	196	166	217	2155
19.819	<b>Goods-producing</b>	57	55	78	482
0.595	Mining	5	1	4	53
12.351	Manufacturing	15	21	30	189
0.953	Motor Vehicles & parts	0	2	3	3
6.822	Construction	36	33	42	241
103.312	<b>Private Service-providing</b>	139	111	139	1673
27.424	<b>Trade, transportation, utilities</b>	34	-3	49	175
15.890	Retail stores	15	-26	27	-29
3.173	General Merchandise	-2	-18	5	-42
3.097	Food & Beverage stores	0	3	18	3
5.102	Transportation/warehousing	11	12	12	138
1.451	Truck transport	2	1	1	7
0.669	Couriers/messengers	5	8	1	45
0.968	Warehousing and storage	5	-2	10	43
0.557	Utilities	-1	0	0	-3
2.812	<b>Information</b>	-6	-1	-4	-33
8.369	<b>Financial</b>	9	6	9	140
2.627	Insurance	-2	1	-3	37
2.160	Real Estate	7	3	10	60
1.318	Commercial Banking	-3	-1	-1	4
0.931	Securities/investments	4	2	3	19
20.219	<b>Professional/business</b>	23	25	16	452
2.902	Temp help services	2	-2	7	96
2.270	Management of companies	0	3	2	38
1.412	Architectural/engineering	4	4	4	44
2.017	Computer systems/services	5	4	2	47
1.132	Legal services	-1	1	-1	5
0.985	Accounting/bookkeeping	-10	-6	-11	-3
22.922	<b>Education and health</b>	38	39	38	467
5.054	Hospitals	13	16	1	72
3.619	Educational services	12	3	10	81
15.853	<b>Leisure and hospitality</b>	35	37	20	360
1.983	Hotel/motels	1	1	3	31
11.583	Eating & drinking places	31	27	21	263
22.306	<b>Government</b>	4	-6	-1	18
2.195	Federal ex-Post Office	3	-4	-4	-12
5.145	State government	-11	-4	-6	-20
2.463	State Govt Education	0	-2	-1	-3
14.351	Local government	10	4	9	51
7.910	Local Govt Education	0	-1	-3	23

No more pussyfooting around for these rookie Fed officials that have never been tried and tested. The Fed funds rate should be at 2.5% today, not at the end of this year, if inflation pressures are starting to emerge in an economy that is running out of resources.

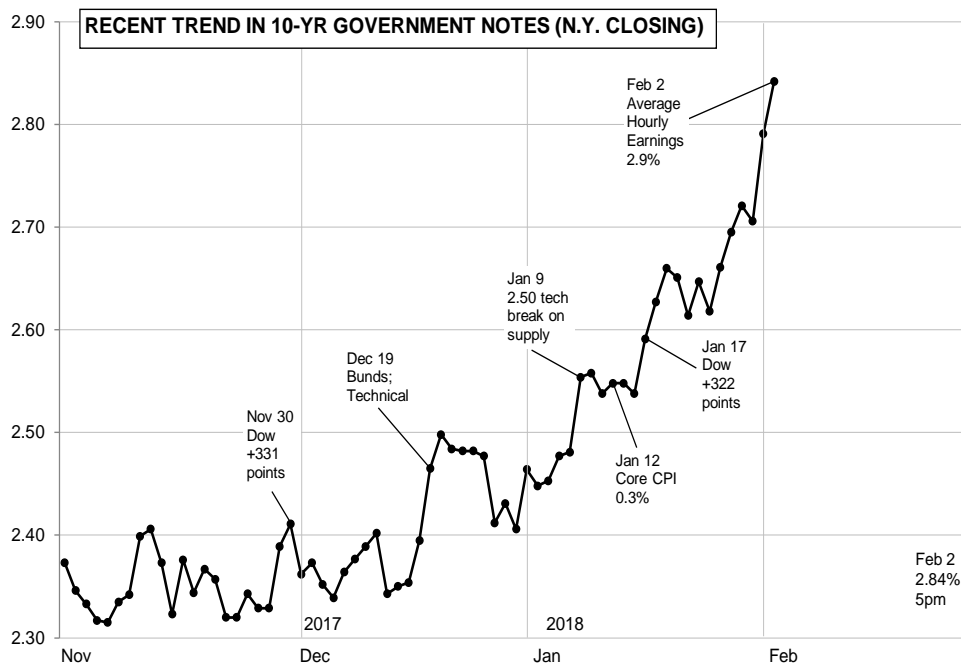
Today's report sounds the death knell for the argument that there is still slack in the labor market. Where there's smoke, there's fire and today's smoking hot wages are going to spread the fire of inflation that could lead to the economic expansion's end if Fed officials don't cool the economy's momentum with additional rate hikes.

At the moment, the Fed still has their foot on the gas with interest rates that are simply too low for where the country is in the business cycle. If the Trump administration and Congress are putting another log on the fire for the economy with additional fiscal stimulus, the last thing Fed officials need to do is pour gasoline on the fire. That's the bond market's fear. Fed policy is behind the curve. It's too bad that we are losing so many tenured Fed officials at this important juncture of the economy because the incoming Fed leaders are short on experience and even the formal academic training that would allow them to successfully steer the economy through the challenges and storms out there starting to appear on the market's radar screens. Stay tuned. Story developing.

## MARKETS OUTLOOK

	29-Dec 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
30-Yr Treasury	2.74	2.90	3.00	3.10	3.30	3.40	3.50	3.60	3.70	3.80	3.80
10-Yr Note	2.41	2.50	2.70	2.80	3.00	3.20	3.30	3.40	3.50	3.70	3.70
5-Yr Note	2.21	2.20	2.40	2.60	2.80	3.00	3.15	3.30	3.40	3.60	3.60
2-Yr Note	1.89	1.95	2.20	2.45	2.65	2.85	3.10	3.30	3.40	3.60	3.80
3-month Libor	1.69	1.90	2.10	2.40	2.60	2.90	3.10	3.40	3.40	3.60	3.90
Fed Funds Rate	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75
2s/10s spread	52	55	50	35	35	35	20	10	10	10	(10)

Yields moved up 18 bps to 2.84% this week. Yields were already at 2.79% before the 2.9% wages in Friday's employment report. We are happy to see higher bond yields, unless they are going to topple the stock market rally. Dow industrials stocks are now down 4.2% from the January 26 highs. Stocks have not fallen this far since the 5.3% Brexit loss in June 2016. There is market talk of the Fed raising rates 4 times in 2018 after the better wage data Friday, but the stock market would have to stabilize or they will skip a meeting.



## FEDERAL RESERVE POLICY

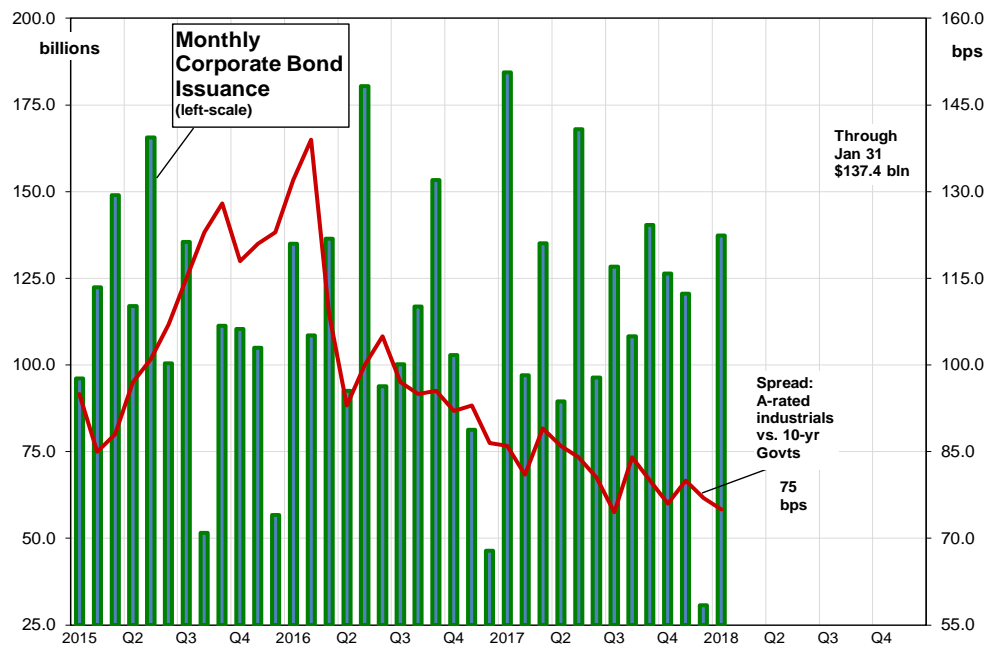
The Fed met January 30-31 to consider its monetary policy. Yellen's last one. Thank you for your service. They added a word to a sentence in the final paragraph of the press statement. "The committee expects that economic conditions will evolve in a manner that will warrant **further** gradual increases in the federal funds rate..." Not sure what the word "further" adds; are they going four times in 2018, more than the three times they forecast at their December meeting? Does "further" signal they are going to hike rates at the next meeting in March? Powell has pledged transparency. We guess this is it. Are we clear? Crystal. The March 21, 2018 meeting odds of a rate hike were steady at 88 percent this week.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data					pre-LEH
<b>Factors adding reserves</b>					
U.S. Treasury securities	2436.211	2447.009	2447.009	2448.209	479.782
Federal agency debt securities	4.391	4.391	4.391	4.391	0.000
Mortgage-backed securities	1760.743	1771.054	1770.349	1764.930	0.000
Primary credit (Discount Window)	0.046	0.048	0.096	0.107	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	0.000
Maiden Lane (Bear)	1.715	1.714	1.715	1.715	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
<u>Central bank liquidity swaps</u>	0.673	0.072	0.118	12.067	62.000
Federal Reserve Assets	4465.6	4488.5	4486.4	4493.2	961.7
3-month Labor %	1.78	1.75	1.74	1.71	2.82
<b>Factors draining reserves</b>					
Currency in circulation	1607.532	1606.672	1610.257	1612.650	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	65.797	36.371	20.548	57.954	0.000
<b>Reserve Balances (Net Liquidity)</b>	<b>2323.217</b>	<b>2182.220</b>	<b>2234.452</b>	<b>2257.894</b>	<b>24.964</b>
Treasuries within 15 days	16.563	27.847	27.847	3.098	14.955
Treasuries 16 to 90 days	97.821	80.038	80.038	107.658	31.549
Treasuries 91 days to 1 year	297.078	317.233	317.233	315.420	69.272
Treasuries over 1-yr to 5 years	1081.309	1083.901	1083.901	1085.113	170.807
Treasuries over 5-yr to 10 years	322.166	316.716	316.716	314.035	91.863
Treasuries over 10-years	621.274	621.273	621.273	622.884	101.337

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

## CORPORATE BONDS: IBM CREDIT, CRANE CO., HUBBELL INC., FEDEX

Corporate offerings were \$30.7 billion in the February 2 week versus \$11.3 billion in the January 26 week. On Thursday, Comcast sold \$3.2 billion 10s/20s/30s. It priced a \$1.0 billion 3.55% 10-yr (m-w +15bp) at 80 bps (A3/A-). The cable television, internet services company will use the proceeds to repay maturing debt including a portion of its commercial paper. Corporate bonds (10-yr Industrials rated A2) were 71 bps above 10-yr Treasuries this week versus 76 bps last Friday.

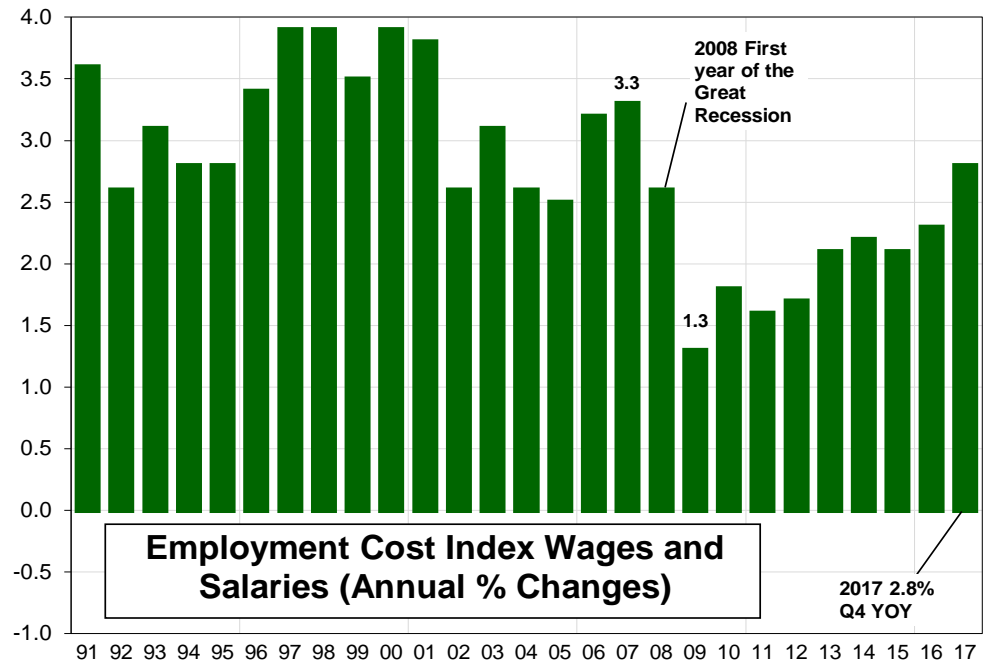


## OTHER ECONOMIC NEWS THIS WEEK

### ECI report, another lost year for wages, woe is me (Wednesday)

Breaking economy news. The Employment Cost Index for the fourth quarter. One of the three main economic indicators of what is in employee paychecks each month.

The tax cuts and jobs act is supposed to do four things. Pick the one that is most likely to occur. Tax reform is gonna boost growth, jobs, wages, and finally if nothing else, return the money to the hardworking American people. And they better be working otherwise under the means tested Trump administration they will never get another dime from the Federal government. But we digress.



The employment cost index is out for the fourth quarter and you can lift your sorry head and smile again because wages are going straight up this year. Drop the word "stagnant" in front of the word "wages." This is the best increase in wages and salaries seen since the Great Recession. And now that Yellen is gone we can drop the word "Great" in front of the word "Recession." It wasn't great and the downturn in the economy was over a long time ago. Thank you for your service by the way Chair Yellen, not an easy job, but you wanted the corner office, as did noneconomist Fed Chairman Powell for some reason, now installed as the new Nation's Chief Economist only without the academic degree.

Net, net, wages and salaries within the Employment Cost Index, don't worry about benefits as companies are gutting those to save on costs, wages and salaries rose 2.8% in 2017. Looking back over the last 16 years, only three, in only three years have workers seen more in their paychecks. It's 2.8% this year and only 2003 3.1%, 2006 3.2% and 2007 3.3% are greater. If you don't like 2.8% wages, then we don't know if you will be that happy with 3.3% either frankly. Some people are never satisfied.

It's a myth that wages are not going up so the Fed doves can stop thinking there is slack in the labor market because if conditions were tight, then wages would be going up. Ditto this to incoming Fed Chairman Powell who thinks wages are soft as well. Stay tuned. Story developing. Wages are better than you think even before the withholding tables change from the new tax reform law and put even more dollars in workers wallets and purses. Today's news on wages is bullish for short-term yields as we now expect the Fed can lift rates four times this year and not the three rate hikes they penciled in in December. Rates are going up. To normal. Nine years into the economic expansion from recession. Bet on it.

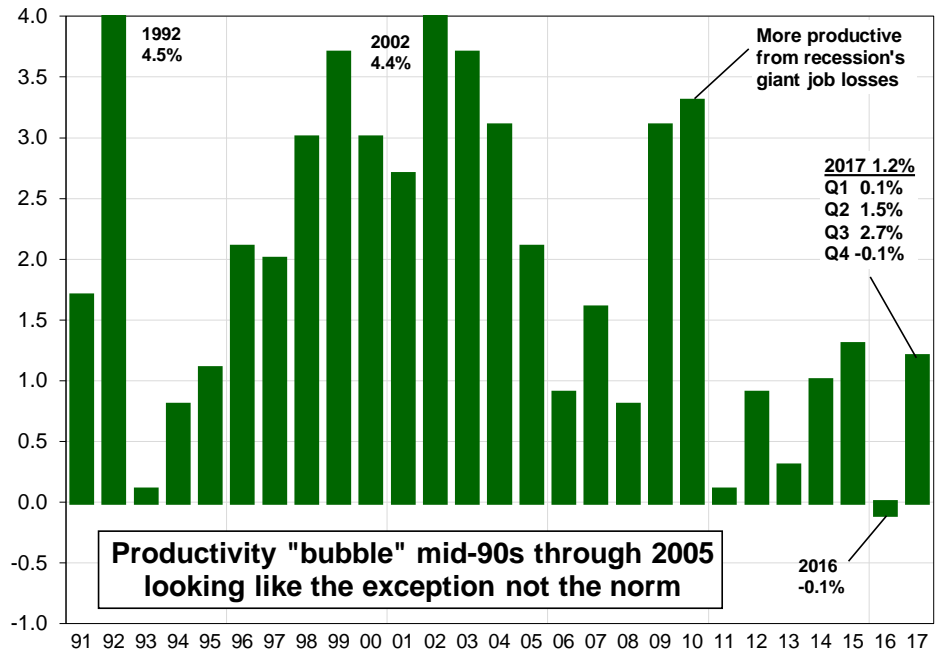


## Productivity does not support Trump out-of-this-world growth (Thursday)

Breaking economy news. Productivity sputtered at the end of last year making it even harder for Trump's economics team to push sustainable growth up to 3% any time soon. Anytime soon is not until 2020 on Trump's calendar forecast from the Treasury Department so they still have some time to stoke the economy's engines and get growth all fired up. Who knows? Workers might like what they see in their paychecks after the historic tax reform legislation and come out this year ready to play and work harder to make the 3% growth goal a reality.

But back to reality, real GDP growth was 2.6% in the fourth quarter last year, but productivity actually fell 0.1% as workers didn't put in as much effort and leaned back on their oars a little. The economic news today wasn't all bad keeping in mind that the economy's quarterly productivity

reading jumps around a lot. For the full year 2017 productivity rose 1.2% which is an improvement from 2016's -0.1% setback. Historically the productivity trend has slowed dramatically since the 90s and with the economy facing demographic headwinds as baby boomers retire, long-term sustainable growth of 2% will be a challenge for the economy let alone 3%.



Net, net, the economy is simply less productive today than it was two decades ago which leaves economic growth stuck in a rut when it comes to the dreams many Americans have for a better future. Weak productivity and slowing population growth is not a recipe for success when it comes to the story of sustainable economic growth of 3% in coming years. It is looking more and more that the productivity trend will make it impossible for those \$1.5 trillion of tax cuts to be paid for by faster economic growth that improves incomes and leads to greater tax revenues.

The Federal Reserve is forecasting fiscal stimulus will lead to stronger growth of 2.5% in 2018 before looking for the economy to slow back down to trend. The productivity trend of 1.2% in 2017 is not going to make Fed officials want to change their longer run forecast of just 1.8% real GDP growth.

The weaker productivity trend will keep the Fed on track to raise interest rates gradually to normal levels of about 2-3/4 percent, but interest rates will not be going too much higher than that if growth doesn't warm up more and heat up inflation. Productivity is where the Trump administration and Federal Reserve official forecasts collide with the Trump's economics team saying 3% growth in 2020 and Fed official forecasts saying just 2.0%. There can only be one winner. We are not sure who is more credible at this point. Stay tuned. Story developing.

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