Financial Market Weekly

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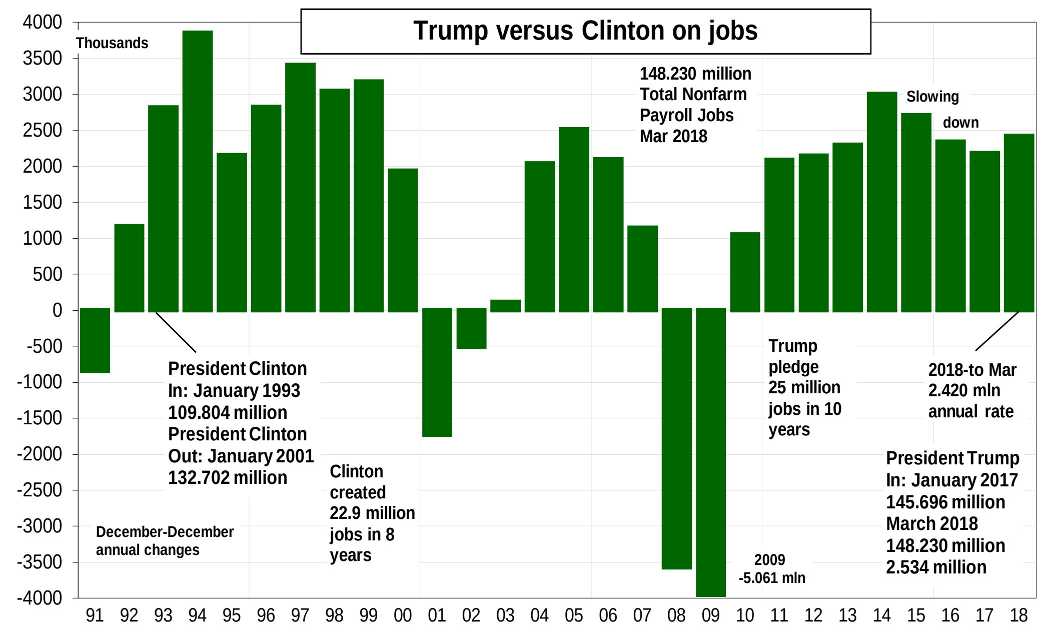
3 RATE HIKES TO STAY; JOBS GAINS REVERTING TO NORM, WAGES UP A TICK



No need to back up the truck on those "how many 2018 rate hike bets" this year because the monthly employment report is nothing to crow about. There is no need for Fed officials to overreact. Trump's economics policies only created 103 thousand jobs in March and there were 50 thousand fewer jobs created in January and February. There are 22 thousand more manufacturing jobs, a stat the President can pack and take on the road with him, but wages moved up just a tenth to 2.7%, and fewer people are participating. 95.3K Americans were not in the labor force in March and if only the Federal government stopped subsidizing them, then maybe some of these would return to working.

Why the jobs slowdown from 326K in February to 103K in March? Construction was part of it, rising 65K in February and falling 15K in March. Nothing else really stands out. Manufacturing jobs rose 22 thousand in March, but fabricated metals products was the standout adding 9 thousand jobs, although one might wonder for how long if those steel and aluminum tariffs ever get fully implemented in the trade war of words and manage to muck up the global supply chain of production inputs that many American companies rely on. Payroll jobs are up 605 thousand in 2018 through March versus 2.188 million in 2017, and 2.344 million in 2016 which was Obama's final year in office, but who's counting.

The economy stumbled at the end of the first quarter creating fewer new job positions than economists expected, which makes us wonder if companies are not hiring as many employees with one of the biggest tax cuts in American history than we had thought. Jobs creation ran hot and cold, mostly cold with the weather this quarter perhaps, with new jobs of 176K in January, 326K in February, and the 103K clunker in March. Companies are not giving the tax cuts money away to their workers either with average hourly earnings up 8 cents to $26.82 in March which is an increase of 2.7% from last year. Only construction workers earned less in March versus February and the standout is workers in utilities--we still can't understand what they do, must be highly productive with hourly earnings of $39.97.

Payroll jobs in year nine following the recession

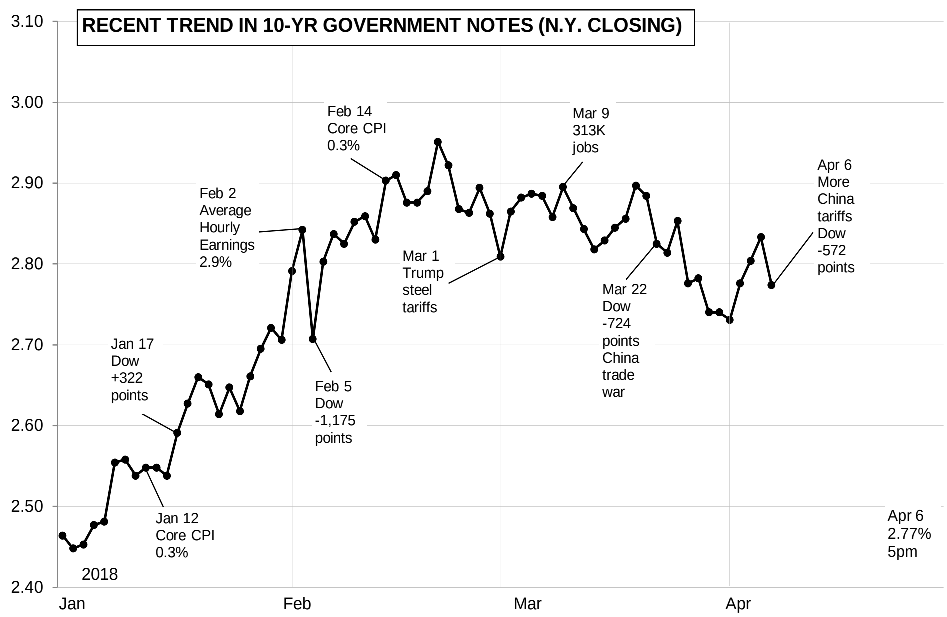
Dec. 2017 Totals millions		Mar 18	Feb 18	Jan 18	3 months Dec 17 to Mar 18	12 months Dec 16 to Dec 17
147.625	Nonfarm Payroll Employment	103	326	176	605	2188
125.294	Total Private (ex-Govt)	102	320	188	610	2163
20.328	Goods-producing	15	106	55	176	509
0.648	Mining	9	9	6	24	53
12.558	Manufacturing	22	32	20	74	207
0.956	Motor Vehicles & parts	3	5	0	9	4
7.072	Construction	-15	65	28	78	250
104.966	Private Service-providing	87	214	133	434	1654
27.593	**Trade, transportation, utilities**	21	74	34	129	169
15.861	Retail stores	-4	47	12	55	-29
3.122	General Merchandise	-13	13	-2	-1	-51
3.100	Food & Beverage stores	-3	3	-5	-6	3
5.236	Transportation/warehousing	10	18	15	43	135
1.460	Truck transport	7	6	6	19	9
0.708	Couriers/messengers	6	2	7	15	39
1.011	Warehousing and storage	3	0	3	5	43
0.554	Utilities	4	2	-1	5	-3
2.776	**Information**	2	-2	-16	-16	-36
8.511	**Financial**	2	30	3	35	142
2.664	Insurance	3	8	-2	9	38
2.220	Real Estate	4	9	3	16	60
1.323	Commercial Banking	-1	2	-3	-3	5
0.951	Securities/investments	2	5	4	10	20
20.677	**Professional/business**	33	55	38	126	458
2.998	Temp help services	-1	21	-2	19	96
2.308	Management of companies	2	3	2	7	38
1.456	Architectural/engineering	-3	6	3	6	45
2.065	Computer systems/services	5	5	7	17	47
1.137	Legal services	0	0	-1	-1	5
0.982	Accounting/bookkeeping	10	1	-8	3	-3
23.380	**Education and health**	25	28	50	103	458
5.124	Hospitals	10	10	10	30	70
3.696	Educational services	-9	-13	20	-2	77
16.207	**Leisure and hospitality**	5	23	21	49	354
2.014	Hotel/motels	4	2	2	8	31
11.844	Eating & drinking places	0	20	20	40	261
22.331	Government	1	6	-12	-5	25
2.182	Federal ex-Post Office	-1	-1	1	0	-12
5.129	State government	-1	-5	-10	-16	-16
2.462	State Govt Education	1	-4	-7	-10	-1
14.407	Local government	3	18	-4	17	56
7.938	Local Govt Education	0	14	-12	2	28

Policymakers can rest easy because there is no sign of an overheating economy in this long-lived expansion from anything in today's report, and they can stick with 2018's playbook and raise interest rates two more times this year to 2.25%. There will be questions whether 103 thousand jobs will become the new normal in this economy which starts its tenth year of growth in July this year on course still to break the record of modern economic times of ten years under President Clinton. Trump's economics team can try to pump up the volume on growth by gutting regulations and slapping tariffs on goods produced overseas, but this does not look like a winning strategy with the country at full employment and likely to experience even worse labor shortages down the road. This will be the first economic expansion to face the loss of labor, plenty of capital out there with the corporate tax cuts and money is cheap with interest rates low, this will be the first economy in modern economic times to test the idea of whether growth can continue at any speed without workers to help make it run.

MARKETS OUTLOOK

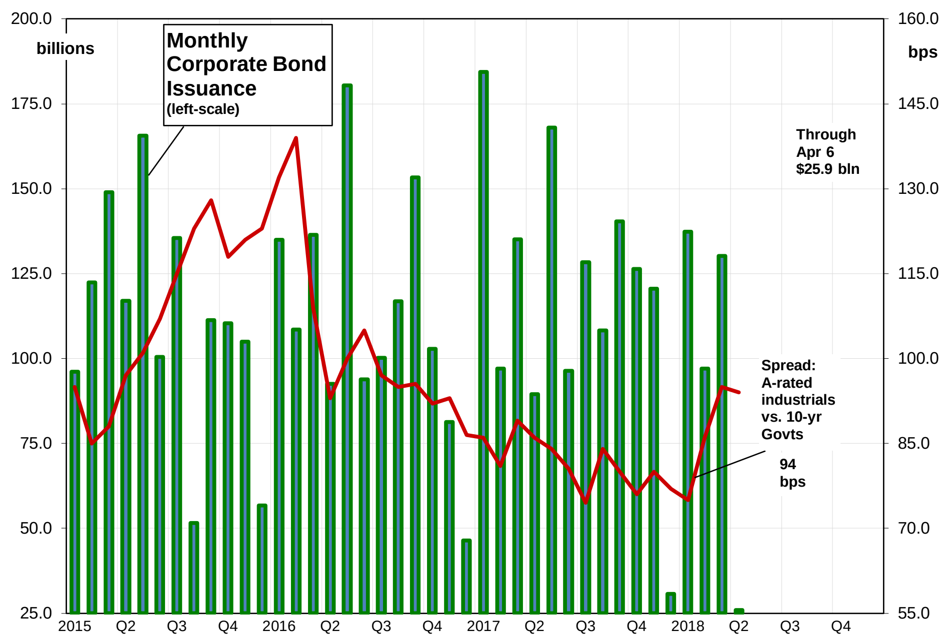
	29-Mar 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.97	3.10	3.10	3.20	3.35	3.45	3.60	3.55	3.75	3.75	3.90	4.00
10-Yr Note	2.74	2.80	2.90	3.00	3.20	3.30	3.50	3.50	3.70	3.70	3.90	4.00
5-Yr Note	2.56	2.60	2.70	2.80	3.05	3.15	3.40	3.45	3.65	3.65	3.90	4.00
2-Yr Note	2.27	2.40	2.55	2.80	3.00	3.15	3.40	3.40	3.60	3.80	4.00	4.20
3-month Libor	2.31	2.30	2.55	2.80	3.05	3.30	3.55	3.55	3.70	3.95	3.95	4.20
Fed Funds Rate	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00
2s/10s spread	47	40	35	20	20	15	10	10	10	(10)	(10)	(20)

The bond market is stuck between a rock and a hard place, or maybe it's just in a hard place. More supply of bonds is coming October 1 to finance a "$1.2 trillion budget deficit," but how high can yields go if the Fed is only slowly pushing up rates to 3% by the end of 2019, a forecast reiterated by incoming NY/SF Fed President Williams. And bond yields cannot go much lower unless the economic data weakens or the stock market tumbles lower… enough for Fed officials to question their current path of rates that looks for three hikes in 2018 and three more rate hikes in 2019.



CORPORATES: GM, DOLLAR TREE, CHARTER COMMUNICATIONS, ENBRIDGE

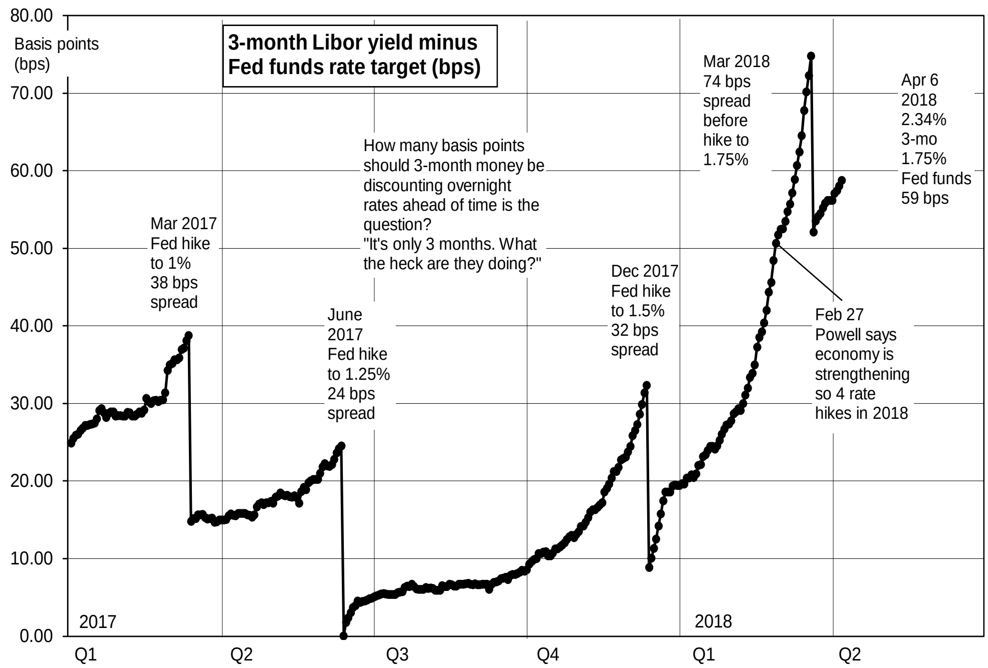
Corporate offerings were $25.9 billion in the April 6 week versus $12.4 billion in the March 30 week. On Tuesday, General Mills sold $6.05 billion 3s/5s/7s/10s/20s/30s/FRNs. It priced a $1.4 billion 4.2% 10-yr (m-w +25bp) at 145 bps (Baa2/BBB). The global consumer foods company will use the proceeds to help finance its acquisition of Blue Buffalo Pet products. Corporate bonds (10-yr Industrials rated A2) were 94 bps above 10-yr Treasuries this week versus 95 bps last Friday.



FEDERAL RESERVE POLICY

The Fed meets May 1-2 to consider its monetary policy. There is no press conference and no chance of anything happening. Two more rate hikes this year according to the median Fed forecast (7 of 15 say 3 more hikes this year), which meetings will they choose, June, September, or December? For the June 12-13 meeting, the rate hike odds are 70%. Three-month Libor is 2.34%, 59 bps above the 1.75% Fed funds rate, and already discounting a 25 bps Fed rate hike on June 13.

Here is our comment on Fed Chair Powell's maiden speech on the economic outlook in Chicago on Friday.



For a noneconomist, the speech looks pretty much like the one Fed Chair Yellen would have given if she had been reappointed instead of the Trump administration putting in their own man, making their own mark, with the appointment of Obama's Fed governor Powell.

What was the song? Here comes the new boss, same as the old boss. Powell stuck to his knitting and did not speak to the financial market volatility or the Trump administration's growing trade war with China and the rest of the world. Financial conditions have clearly deteriorated with the stock market down about 10% for the year, and 3-month Libor short-term interest rate borrowing costs soaring. Monetary policy is there to improve financial market conditions as Bernanke famously said, but with the Fed funds rate at 1.75%, the setting of interest rates cannot do much for the economy. We don't think the Fed will be able to control the economy at all going forward steering with just the

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	4-Apr	28-Mar	21-Mar	14-Mar	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2413.031	2424.883	2424.723	2424.562	479.782
Federal agency debt securities	4.391	4.391	4.391	4.391	0.000
Mortgage-backed securities	1754.368	1754.368	1763.171	1768.588	0.000
Primary credit (Discount Window)	0.002	0.002	0.000	0.004	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)	1.709	1.709	1.708	1.708	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	5.011	0.079	0.077	0.064	62.000
Federal Reserve Assets	4433.4	4439.3	4448.7	4454.6	961.7
3-month Libor %	2.32	2.30	2.27	2.15	2.82
Factors draining reserves					
Currency in circulation	1640.597	1636.934	1634.754	1634.992	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	4.570	17.898	20.586	4.970	0.000
Reserve Balances (Net Liquidity)	2098.731	2119.605	2135.068	2190.143	24.964
Treasuries within 15 days	0.229	31.201	31.201	0.000	14.955
Treasuries 16 to 90 days	119.506	89.281	89.280	120.481	31.549
Treasuries 91 days to 1 year	290.367	298.438	298.434	298.430	69.272
Treasuries over 1-yr to 5 years	1080.010	1081.513	1081.492	1081.470	170.807
Treasuries over 5-yrs to 10 years	296.395	298.012	297.970	297.929	91.863
Treasuries over 10-years	626.525	626.439	626.346	626.253	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

Fed funds rate. It probably won't matter much. The economy can come back from recessions on its own, or at least we may test that economic theory somewhere down the line.

Not much in the speech. Again, he referred to a couple of indicators saying the economy was not at full employment, citing prime age employment, there have been more drop outs, mostly of men who are aged 25-54 years of age. That's the prime age of life by the way, and if you are outside the band maybe get your affairs in order. The economy is also not at full employment he said otherwise wages would be going up at a quicker pace. We don't know why he wades into this debate among economists as it means little for policy, or perhaps he is just trying to illustrate how hard it is for he and his colleagues to thread the needle and get policy right. If we are not at full employment it also means the Fed needs to raise rates just gradually and no faster.

As far as policy, there was no curtain raiser on the June 13 Fed meeting decision date. The market does not believe the May 1-2 meeting has any chance of action. Because they are only going three times a year max, there is no reason to meet so frequently, once a quarter would be adequate and they could save on meeting costs, pencils, paper, flying in officials from around the country… to do nothing but talk.

Fed focus back on Dropouts?

BREAKDOWN OF THOSE NOT IN THE LABOR FORCE

Thousands, NSA	.Mar 17	Mar 18	Change
Total not in labor force	94,502	95,549	1,047
Don't want job now	88,994	90,757	1,763
Want a job	5,507	4,793	-714
Did not search for work in a year	3,308	2,817	-491
Searched in last year, not in the	2,200	1,976	-224
past 4 weeks			0
Not available to work now	604	522	-82
Marginally attached, can work now	1,595	1,454	-141
Discouraged	460	450	-10
Reasons other than discouraged	1,135	1,004	-131
Family obligantions	201	113	-88
In school or training	230	200	-30
Poor health or disability	129	172	43
Other	576	142	-434

The final bit of his speech was on monetary policy, he does pick up the two hands of the two-handed economist in this section. It's like the three bears, one bowl of porridge is too hot, one is too cold and one is just right.

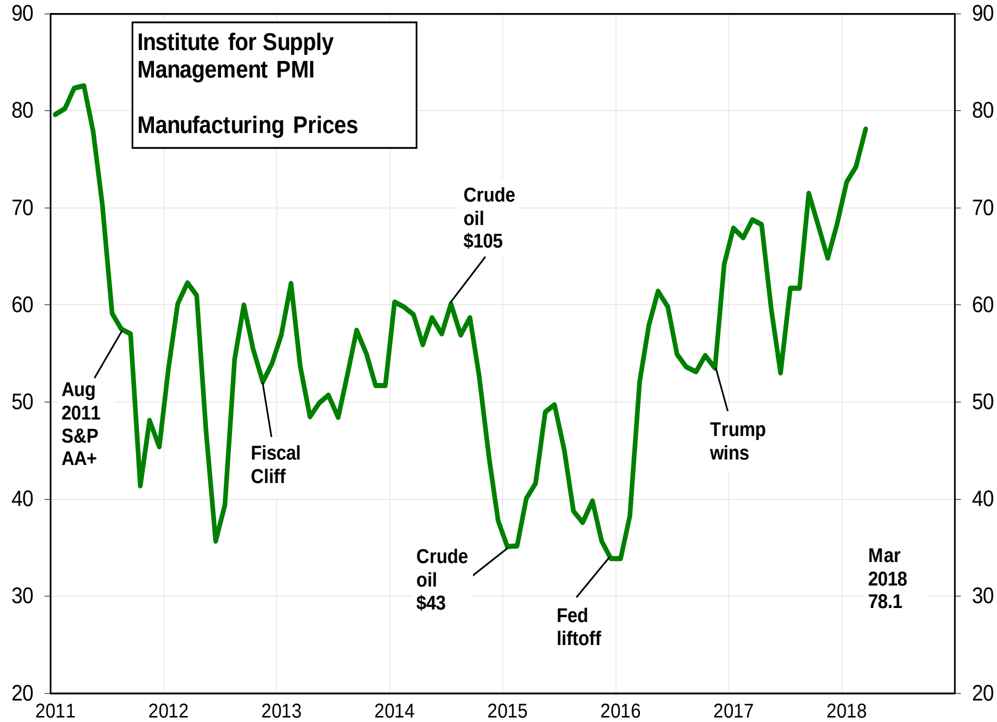
On the one hand, raising rates too slowly could force them to raise rates too quickly suddenly, a catch-up move, and possibly send the economy into a downturn. On the other hand, raising rates too quickly would increase the risk that inflation will not make it up to their 2 percent target. We guess he means higher rates too quickly would take the punch bowl away and keep inflation from reaching target. Come on. Dry your eyes. Core PCE inflation is 1.6 percent and close enough to the 2 percent objective. Not clear what all the fuss is about.

Net, net, slow and steady wins the race according to Powell, and it's good to know we have a steady captain at the helm of the economy because financial markets are turbulent and it may get worse before it gets better. What did Trump say about there may be some short-term pain? So many headlines we missed it. But it doesn't sound like he is backing off his heated trade rhetoric, never will, and he hasn't gotten to all those automobiles coming in from Europe yet. Stay tuned. Story developing. The economy was better than you think. Except for you prime age men who dropped out of the labor force. You know who you are.

OTHER ECONOMIC NEWS THIS WEEK

Inflation is heating up based on survey of manufacturers (Monday)

Breaking economy news. ISM manufacturing fell back to 59.3 in March from 60.8 in February. Employment fell back a little further to 57.3 in March from 59.7 in February. Manufacturing hiring in the monthly jobs report has been on a tear since October with steady monthly gains running from 20 to almost 40 thousand new jobs per month, and today's reading may indicate hiring is slowing somewhat perhaps due to the confusing picture on trade as many manufacturing jobs are dependent on exports to the rest of the world. Manufacturing executives are also pointing with alarm to growing inflation.

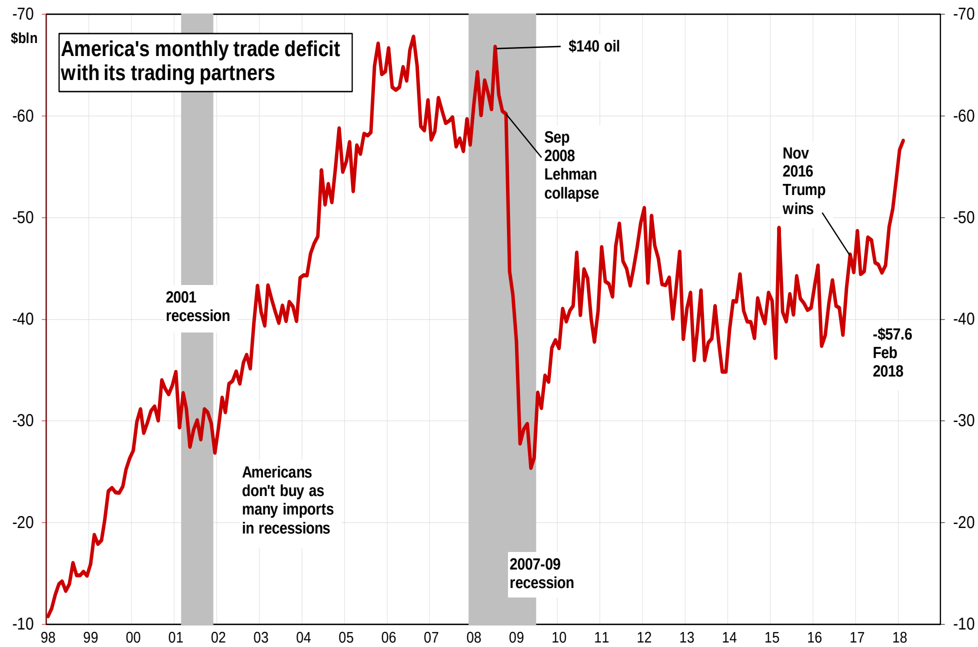


Meanwhile, construction spending rose just 0.1% in February in a report out today versus an unchanged reading in January. Construction spending isn't going to make America great again this year unless there is some. Perhaps builders are waiting on clarification from Washington on the plans for infrastructure spending, building new projects now instead of waiting till the bridges fall down. Nonresidential construction on commercial projects that counts as investment spending in GDP has gone sideways since Trump was elected in November 2016.

Net, net, the economy is generating enough heat to allow the inflation genie to escape his bottle according to purchasing manager executives who say inflation pressures have not been this great since 2011. Federal Reserve officials will be tested more than we thought this year threading the needle on monetary policy between the extremes of policy that is too tight and slows one of the longest expansions in modern economic history versus policy that is too easy and allows inflation pressures to build. Powell has said one of the risks in the past is that the Fed has had to raise rates too quickly to too high of a level in order to keep a lid on inflation. Too high of a Fed funds rate can risk sending the economy into a downturn that no one wants to see. We haven't had much of a recession risk in our forecasts, but now maybe we should be raising those risks a little. Stay tuned. Story developing.

Trade threats to USA (Thursday)

Breaking economy news. Exports up $3.5 billion and imports up $4.4 billion in February which will not be good news for Trump administration officials who are trying to get a better deal, make America first and stop the three decade trend of job losses to factories overseas.



Trade threats. Only one side started off making them. Actually, we could not identify any threats to the United States looking at the current pattern of trade between US companies and the rest of the world. Keep in mind it is companies doing this. Companies are winning by doing this and other companies are losing. It's called creative destruction. Sounds bad but the net effect of globalization and greater trade with rest of the world is a plus for the United States. We are winning. And in any case even if we weren't winning we can't go back and change what has already happened. Production moved overseas years and years ago, and it doesn't mean America isn't great again right now. If you try to snap your fingers and bring back factories overnight it would be impossible to find any workers to employ to operate the machinery on the shop floors because everyone has a job in this economic cycle. At this point the economic expansion has gone on for so long that factories would have to move overseas in search of workers.

Net, net, we're becoming more sanguine that these tariffs being thrown around from various countries, mainly just two of them, are not going to be an impediment to U.S. economic growth going forward this year. Increasingly it really looks like these 25% tariffs are only being done to try and bring about a better advantage for us in the terms of trade and to get a better deal. A bluff. A bluff that caused the stock markets around the world to collapse, but a bluff nevertheless. There's the art of the deal of course, and there's a lot of handwaving and still leaving the table without getting much more. You can't always get a better deal when you sit down at the table and sometimes you have to settle for just cents on the dollar of your original position. A whole lot of hot air for nothing. This isn't negotiating a better deal on an apartment lease in Queens. Take a look at what happened with South Korea. The US really came away with very little, just a slight limitation on the amount of steel exports coming into the country, while cars galore continue to come in to this country and patriotic Americans buy them all. Stay tuned. Story developing. We hope the stock market settles down because there's a lot more deals to be made.

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