Financial Market Weekly

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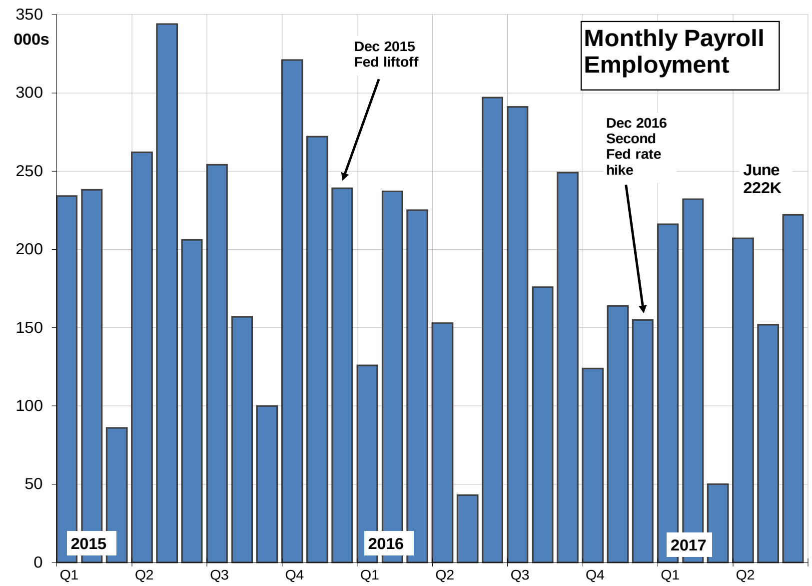
222K + 47K REVISIONS EQUALS 269K MORE JOBS, JOBS, JOBS

Breaking economy news. The monthly employment situation report. 222K + 47K revisions equals 269K more jobs, jobs, jobs, oh Fed, wherefore art thou now? What are they doing raising interest rates at such a gradual pace? The economy is at full employment and interest rates are too low. Fed policy is not required anymore to "improve financial conditions," why can't they stop and exit it all, now?



Soft patch three-month payroll jobs evident last month for March, April, May has disappeared. This should calm the nerves of some Fed officials who were concerned about what that meant for the economy. It was nothing. Temporary.

222K payroll jobs in June is it sustainable? Well, Government jobs added a big 35K so that will not continue at that rate. No other category looks particularly out of line. Retail jobs rose 8K, more people going to the mall instead of handheld, smartphone shopping from the couch. Bring back those factory jobs and make America great again? Manufacturing jobs rose just 1K in June after falling 2K in May, nothing to write home about or tweet about it either.

	Jun	May	Apr	Mar	Feb	Jan
Payroll jobs (000s)	222	152	207	50	232	216
Unemployment rate %	4.4	4.3	4.4	4.5	4.7	4.8
Unemployment (3 decimal)	4.357	4.294	4.404	4.496	4.703	4.780
Average hourly earnings	$26.25	$26.21	$26.18	$26.13	$26.10	$26.02
MTM % Chg	0.2	0.1	0.2	0.1	0.3	0.2
YOY % Chg	2.5	2.4	2.5	2.6	2.8	2.6
Production Worker earnings	$22.03	$21.99	$21.96	$21.90	$21.86	$21.83
MTM % Chg	0.2	0.1	0.3	0.2	0.1	0.1
YOY % Chg	2.3	2.4	2.3	2.3	2.5	2.4

Stagnant wages and income inequality anyone, anyone? The needle is still stuck at 2% wages, an increase of 2.5% over the last year. Wages won't be helping the Fed push inflation back to the 2% target. The unemployment rate rose a sliver to 4.4% in June (barely 4.357) from 4.3% in May. Those not in the labor force declined 170K to 94.813 million so you can stop pointing to drop outs as something that is wrong with America. Drop outs over time are completely normal. A certain amount of the 325 million U.S. population will not be in the labor force and the numbers will rise as the population increases each year. We aren't doomed. There are no drop outs wandering the streets in my town.

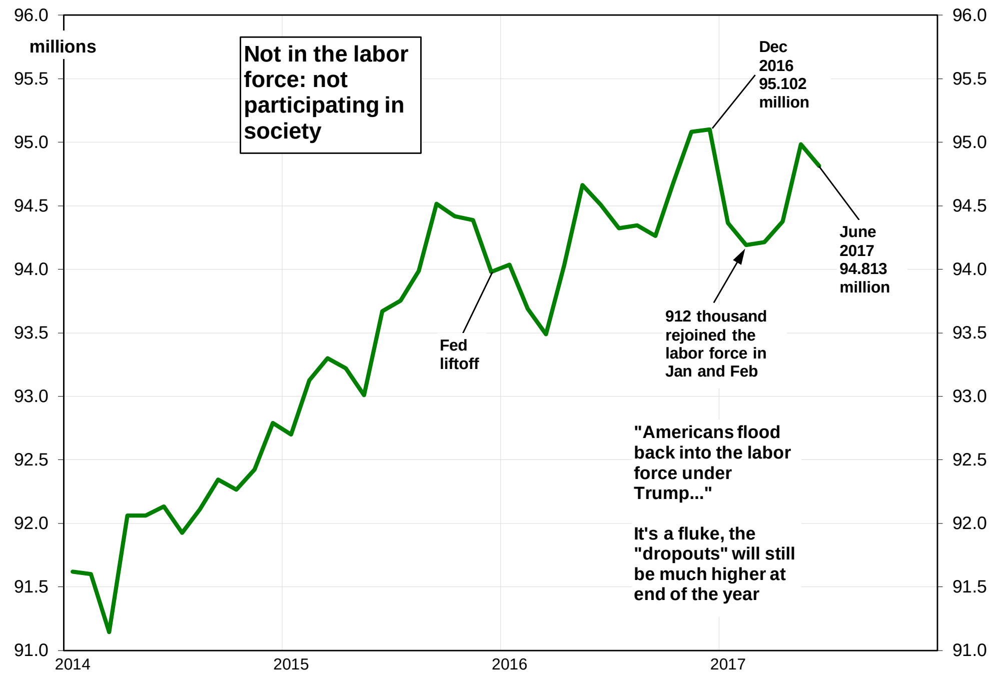
What about those part-timers who ardently desire full-time work? The numbers of these individuals have been used by first Bernanke and then Yellen to keep interest rates down low... forever. Part-timers for economic reasons as it is called increased 107K in June to 5.236 million, but this is still lower than the 5.820 million in this category in June 2016. The labor market is improving, or rather has fully recovered and hit the wall of full employment. Don't trot out these part-timers who want more as a statistic that indicates employment market weakness. Raise interest rates, most of these part-timers, who likely rely on savings in the bank more than the stock market, will thank you.

Payroll jobs in year eight following the recession

Dec. 2016 Totals millions		Jun 17	May 17	Apr 17	6 months Dec 16 to Jun 17	12 months Dec 15 to Dec 16
145.325	Nonfarm Payroll Employment	222	152	207	1079	2240
123.026	Total Private (ex-Govt)	187	159	194	1025	2039
19.794	Goods-producing	25	13	19	213	64
0.617	Mining	8	6	10	47	-75
12.343	Manufacturing	1	-2	9	53	-16
0.942	Motor Vehicles & parts	-1	-2	-1	-3	17
6.783	Construction	16	9	0	113	155
103.232	Private Service-providing	162	146	175	812	1975
27.374	**Trade, transportation, utilities**	22	5	10	15	331
15.881	Retail stores	8	-7	-4	-36	203
3.180	General Merchandise	12	-3	10	-44	37
3.097	Food & Beverage stores	3	-2	-4	-7	37
5.048	Transportation/warehousing	2	12	7	20	92
1.465	Truck transport	-1	-1	-2	7	10
0.668	Couriers/messengers	4	4	8	-2	31
0.943	Warehousing and storage	-1	2	2	6	63
0.557	Utilities	2	-2	0	-2	0
2.762	**Information**	-4	-6	-11	-43	0
8.364	**Financial**	17	13	16	85	176
2.605	Insurance	-2	3	7	18	46
2.169	Real Estate	10	4	2	31	59
1.311	Commercial Banking	1	2	-1	7	17
0.933	Securities/investments	5	2	4	15	18
20.416	**Professional/business**	35	56	46	289	534
2.962	Temp help services	13	17	2	70	32
2.259	Management of companies	6	6	3	24	35
1.427	Architectural/engineering	5	2	5	32	27
2.032	Computer systems/services	5	5	4	28	87
1.126	Legal services	2	3	3	5	5
1.000	Accounting/bookkeeping	0	-1	5	1	32
22.871	**Education and health**	45	35	45	226	553
5.077	Hospitals	12	3	3	34	119
3.604	Educational services	-14	5	-3	10	85
15.744	**Leisure and hospitality**	36	25	60	180	331
1.950	Hotel/motels	0	-4	7	5	11
11.549	Eating & drinking places	29	33	26	155	276
22.299	Government	35	-7	13	54	201
2.200	Federal ex-Post Office	3	2	-2	0	30
5.085	State government	-4	-7	-3	-5	-4
2.414	State Govt Education	-5	1	2	2	3
14.395	Local government	35	-8	23	60	160
7.945	Local Govt Education	14	-1	9	33	69

Net, net, payroll employment growth caught back up in a hurry this month in a move we would describe as the labor markets playing catch up to the earlier faster trend. Payroll employment rose 187K on average last year, a slowdown from 226K on average in 2015 as the economy has hit the wall of full employment. Before coming in today, payroll jobs had slowed to gains of just 50K in March, 174K in

April, and 138K in May, so today's jump in new jobs puts employment growth back to trend with the average over the first six months of 2017 running 180K about the same pace as in 2016.

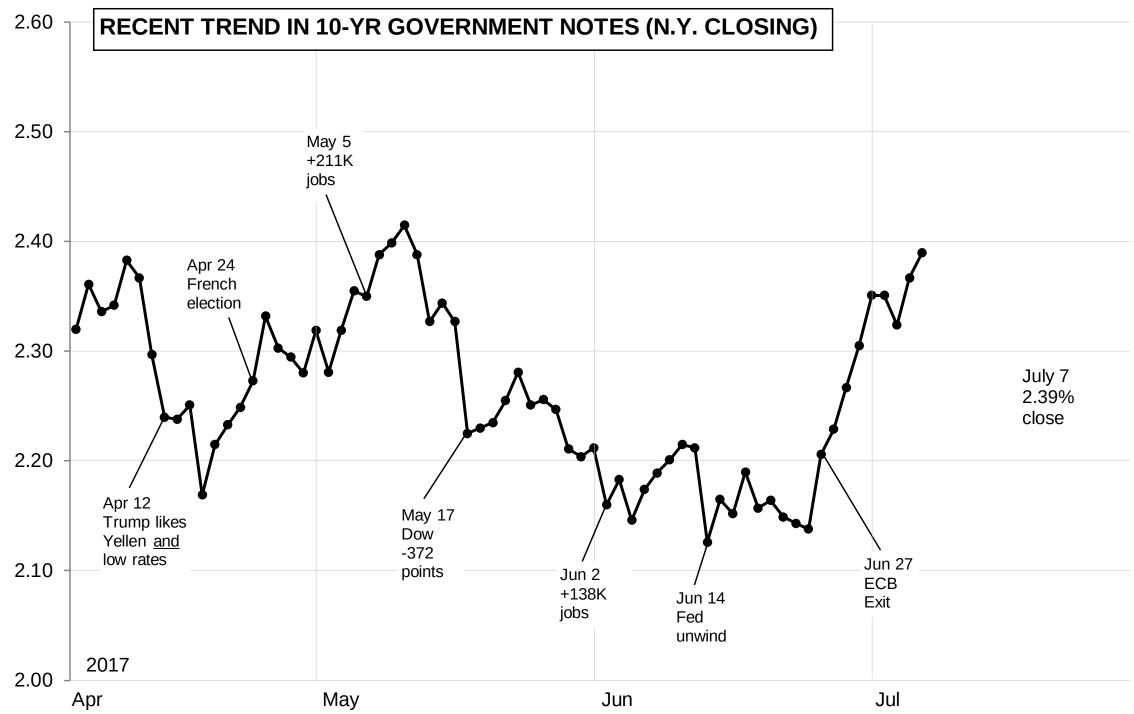


The labor market is back, not over the top growth, but back to trend so those Federal Reserve officials with questions regarding the durability of the economic expansion can throw caution to the wind. We're going to be okay. Actually the Fed Doves would never do that, it is in their DNA to worry constantly, they ought to be in risk management or on the FX trading desk where they can put their "what will go wrong next" attitudes to better use. The rest of the committee can start pumping up the volume on rates. Certainly, the balance sheet wind down announcement needs to be announced at the September meeting, and delay the last of the three rate hikes this year to December if you must, given the difficulty in doing two things at once, walking and chewing gum as it were. 222K payroll jobs today with 47K of upward revisions. The economy is stronger than you think. Bet on it.

MARKETS OUTLOOK

	30-Jun 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
30-Yr Treasury	2.83	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10
10-Yr Note	2.30	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90
5-Yr Note	1.89	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70
2-Yr Note	1.38	1.60	1.85	2.10	2.40	2.60	2.85	3.10	3.35	3.35	3.60
3-month Libor	1.30	1.65	1.90	2.20	2.45	2.70	2.95	3.20	3.45	3.35	3.70
Fed Funds Rate	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50
2s/10s spread	92	90	85	90	80	80	65	60	45	55	30
Libor/funds spd	5	15	15	20	20	20	20	20	20	10	20

Yields lifted in the July 4 holiday week, yet intraday trading feels sluggish. 10-yr Treasury yields were 2.38% before the stronger 222K jobs number on Friday (178K expected), moved about 1 basis point higher to call it 2.395% and did little for the rest of the trading session. Fed funds futures odds for a 25 bps rate hike at the September meeting remain low at roughly 20% despite the bounce back in payroll jobs this month. Most of the movement upward in yields has been caused by higher European yields, mostly Bunds. The ECB meeting minutes on Thursday has people thinking QE Exit. The next ECB meeting is Thursday, July 20.

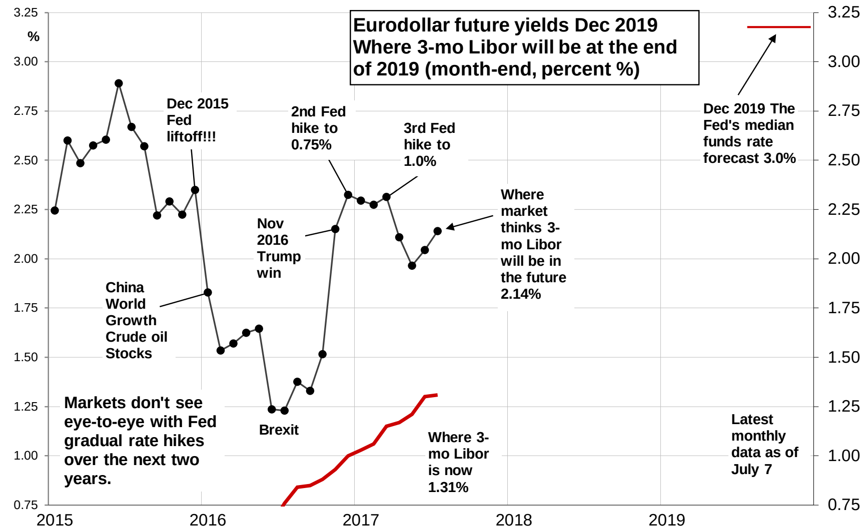


FEDERAL RESERVE POLICY

The Fed meets July 25-26 to consider its monetary policy. Actually, they aren't going to be considering much of anything at all. Why meet to talk things over? Maybe they should cut the annual meetings down to just four a year from eight meetings currently. They have moved rates just four times since 2015 including liftoff and all four rate hikes were announced at one of the four press conference meetings each year: March, June, September, December.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	5-Jul	28-Jun	21-Jun	14-Jun	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2465.096	2465.046	2464.958	2464.871	479.782
Federal agency debt securities	8.097	8.097	8.097	8.097	0.000
Mortgage-backed securities	1770.281	1770.280	1781.099	1782.601	0.000
Primary credit (Discount Window)	0.001	0.084	0.009	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)	1.709	1.709	1.709	1.709	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	3.070	0.035	0.042	0.036	62.000
Federal Reserve Assets	4513.8	4509.6	4520.9	4522.6	961.7
3-month Libor %	1.30	1.30	1.29	1.25	2.82
Factors draining reserves					
Currency in circulation	1565.957	1559.134	1555.694	1555.470	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	240.029	263.669	198.769	163.056	0.000
Reserve Balances (Net Liquidity)	2169.650	2118.108	2164.616	2291.433	24.964
Treasuries within 15 days	1.278	12.885	12.885	0.000	14.955
Treasuries 16 to 90 days	44.593	34.924	34.923	47.807	31.549
Treasuries 91 days to 1 year	275.577	256.069	256.067	256.065	69.272
Treasuries over 1-yr to 5 years	1152.801	1174.374	1174.361	1174.347	170.807
Treasuries over 5-yrs to 10 years	357.258	353.845	353.826	353.806	91.863
Treasuries over 10-years	633.589	632.949	632.897	632.846	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

There was some commotion about the Committee being split on the timing of the balance sheet unwind in the Fed meeting minutes (June 13-14 meeting, how quickly we forget) released at 2pm EDT on Wednesday this week. Without going into it, we expect the balance sheet unwind announcement at the September meeting, and for them to save the final rate hike for December this year. The June meeting discussed the balance sheet unwind in too much detail for an announcement not to be imminent: i.e. it must be extremely close. Maybe not as close as the FOMC meeting minutes stated, "Several preferred to announce a start to the process within a couple of months; in support of this approach, it was noted that the Committee's communications had helped prepare the public for such a step", but close. What is a couple months anyway, doesn't "couple" mean



"two" which indicates by August right? Sounds like "several" wanted a July meeting balance sheet unwind official announcement. That is a meeting after the detailed terms were announced which would be logical.

So there was mostly talk after the Fed meeting minutes release on Wednesday about how the Committee was split on the timing of the official announcement that the unwind process as outlined was commencing. But we were thinking the minutes talk on the path of the Fed funds rate was more important. The balance sheet unwind is supposed to run silently in the background with little effect on the markets.

Several officials were confident that one hike this year, three more in 2018 and three more in 2019 to 3.0% would be consistent with the Fed achieving its 2% inflation objective. That's good. Slow, but better than a poke in the eye with a sharp stick, we'll have to take it. [Yellen is almost sounding more like a hawk relative to some of these Dovish participants who worry about inflation.] Unfortunately, in this minutes excerpt here, they called moving the Fed funds rate up from 1.25% currently to 3.0% a "tightening of monetary policy." Tightening? You mean like slowing the economy down? Are you kidding? We learned back in Greenspan's day that tightening does not occur until the Fed funds rate starts moving up above 3% normal levels, so this tightening characterization shows how far the Committee has drifted in its core beliefs on how their policy affects the economy. Hopefully the incoming Fed Chairman will change the Committee's beliefs on this. Also unfortunate is the view of a "few" in the excerpt on the rates-path discussion, who are uncomfortable with even pushing the Fed funds rate up by four more 25 bps baby steps to 2.25% at the end of 2018. Four more rate hikes could stop the return of inflation to 2%... 2% inflation being a goal that just 6% of the American public are in favor of based on recent surveys that we read about on the internet, hopefully not in a "fake news" story. It is hard to tell.

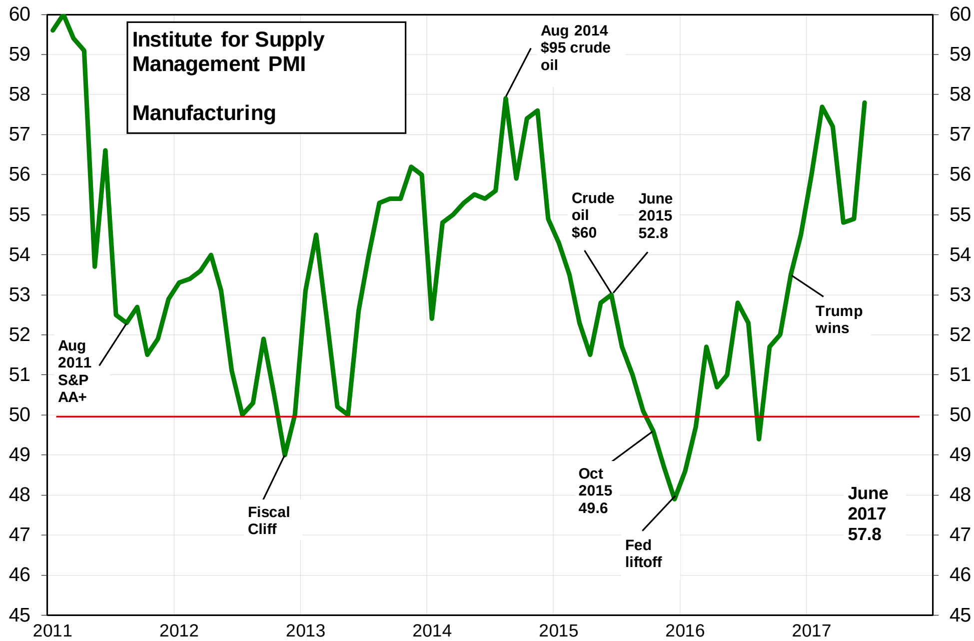
> Participants generally reiterated their support for continuing a gradual approach to raising the federal funds rate. Several participants expressed confidence that a series of further increases in the federal funds rate in coming years, along the lines implied by the medians of the projections for the federal funds rate in the June SEP, would contribute to a stabilization, over the medium term, of the inflation rate around the Committee's 2 percent objective, especially as this tightening of monetary policy would affect the economy only with a lag and would start from a point at which policy was still accommodative. However, a few participants who supported an increase in the target range at the present meeting indicated that they were less comfortable with the degree of additional policy tightening through the end of 2018 implied by the June SEP median federal funds rate projections. These participants expressed concern that such a path of increases in the policy rate, while gradual, might prove inconsistent with a sustained return of inflation to 2 percent.

The only reason we bring up the "few" not comfortable with a 2.25% Fed funds rate is that it reminds us of what New York Fed President Dudley said a while back about the Fed "perhaps" only needing to push the Fed funds rate to 2 to 2.5% anyway because of the very low "natural rate of interest" which cannot be seen with the naked eye and has to be guessed at. The bottom line is that it is hard to get 10-yr Treasury yields up to 3% unless investors think the Fed is going to push the Fed funds rate there. It's bad enough the median forecast the majority rallies around does not see a 3% Fed funds rate for two and a half more years, at the end of 2019. One wonders how long markets can wait for this glacial pace of normalization.

OTHER ECONOMIC NEWS THIS WEEK

Manufacturing shifts into a higher gear, with inflation a no show

Breaking economy news. ISM manufacturing survey shows sentiment reaching a new high this year, up nearly 3 percentage points to 57.8 in June.



Production and new orders bounced back strongly from a soft patch the last two or three months to go out with a bang at the end of the second quarter. Whatever misgivings you had about factory production, you can put your worries to the side with production leaping up 5.3 points to 62.4, and orders similarly showing no upward bound, rising strongly by 4.0 points to 63.5 in June. Orders and production are humming with new export orders back to the best levels of 2017. With the dollar weak and world economies strong, how could this manufacturing resurgence not last?

ISM manufacturing index

	Jun 17	May 17	Apr 17	Mar 17	Feb 17	Jan 17	Dec 16
PMI index	57.8	54.9	54.8	57.2	57.7	56.0	54.5
Prices	55.0	60.5	68.5	70.5	68.0	69.0	65.5
Production	62.4	57.1	58.6	57.6	62.9	61.4	59.4
New orders	63.5	59.5	57.5	64.5	65.1	60.4	60.3
Supplier deliveries	57.0	53.1	55.1	55.9	54.8	53.6	53.0
Employment	57.2	53.5	52.0	58.9	54.2	56.1	52.8

Prices meanwhile are a no show despite the humm of factory output with the robots and their masters toiling away. Prices paid fell to a new 2017 low of 55.0 which is hard down nearly 15 points from 70.5 in March. This puts the Fed's 2.0 percent inflation objective even further away as it looks like there will be no higher prices for consumer goods coming out of factories that will give American shoppers sticker shock. Low prices coming in, and low prices coming out.

Net, net, whatever ails manufacturing it sure isn't lacking in confidence in the June survey of company executives. This jump sure doesn't feel like a 2% economy, and it's not. Trump's economics team will be smiling ear to ear as a 57.8 reading on ISM manufacturing is better correlated historically with 3% GDP growth than it is a 2% sputtering growth rate.

If production were a rocket it would have already left the atmosphere with these stellar ISM manufacturing numbers on orders and production today. The economy is coming back strongly at the end of the second quarter. And these fireworks are likely to last. Bet on it. The economy is stronger than you think.

Growth without inflation is the recipe for a sustainable economic expansion. The economy is in its ninth year of growth and Trump's economics team remains on track to beat the ten-year expansion of the Clinton years in the 90s. Looking forward to the tweets on that when the record is broken.

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