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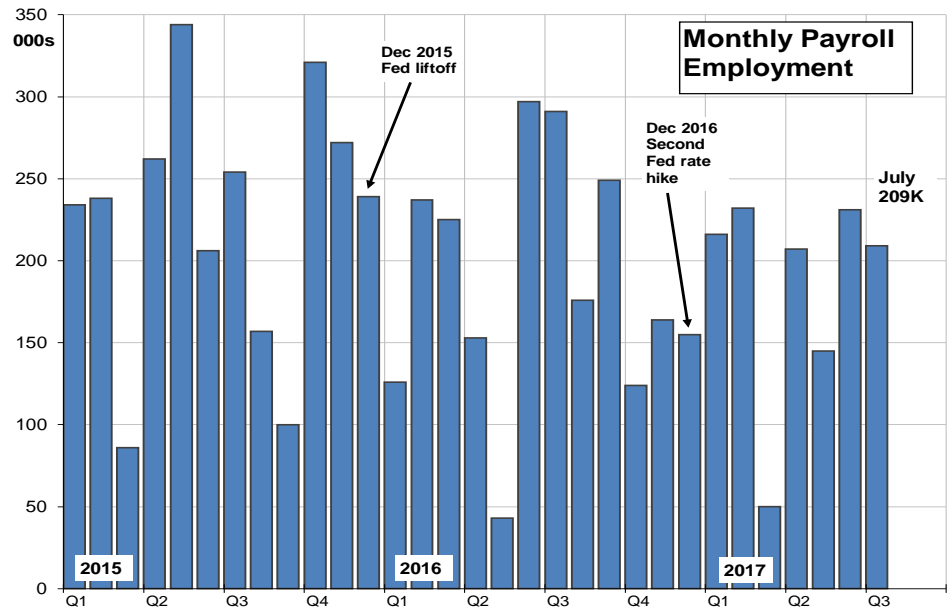
## TWO IN A ROW, GO JOBS, GO; GAME ON FOR THE FED: ANOTHER RATE HIKE THIS YEAR?

Breaking economy news. Who would have thought it: none of the other indicators really suggested another 200K payroll jobs today, besides consumers saying jobs are plentiful, but it's here and it's real and not fake news. We will probably hear the spectacular employment report news today tweeted shortly.

Didn't get this out fast enough, before 20 minutes passed,

Trump tweeted: Excellent Jobs Numbers just released - and I have only just begun. Many job stifling regulations continue to fall. Movement back to USA! ("I have just begun..." Sounds like a song from the 70s. Make Music Great Again.) The market is impressed with 10-yr Treasuries rising 2 bps in yield higher from 2.23% at post time to 2.25% five minutes later. Dow Jones industrials were up 46 points and moved to up some 60 points on the day.

Three out of the last four months have now printed 200K jobs numbers. So much for Fed forecasts that jobs growth was going to slow because the economy hits the wall of full employment. There



|                            | Jul     | Jun     | May     | Apr     | Mar     | Feb     |
|----------------------------|---------|---------|---------|---------|---------|---------|
| Payroll jobs (000s)        | 209     | 231     | 145     | 207     | 50      | 232     |
| Unemployment rate %        | 4.3     | 4.4     | 4.3     | 4.4     | 4.5     | 4.7     |
| Unemployment (3 decimal)   | 4.350   | 4.357   | 4.294   | 4.404   | 4.496   | 4.703   |
| Participation rate %       | 62.9    | 62.8    | 62.7    | 62.9    | 63.0    | 63.0    |
| Average hourly earnings    | \$26.36 | \$26.27 | \$26.22 | \$26.18 | \$26.13 | \$26.10 |
| MTM % Chg                  | 0.3     | 0.2     | 0.2     | 0.2     | 0.1     | 0.3     |
| YOY % Chg                  | 2.5     | 2.5     | 2.5     | 2.5     | 2.6     | 2.8     |
| Production Worker earnings | \$22.10 | \$22.04 | \$21.99 | \$21.96 | \$21.90 | \$21.86 |
| MTM % Chg                  | 0.3     | 0.2     | 0.1     | 0.3     | 0.2     | 0.1     |
| YOY % Chg                  | 2.4     | 2.4     | 2.4     | 2.3     | 2.3     | 2.5     |

is a shortage of skilled labor, but someone is getting hired. 2.2 million more payroll jobs over the last year, half Obama's and half Trumps. July 209K, June 231K, May 145K, Apr 207K.

And those manufacturing jobs are coming back from overseas, somehow or other, 12K more in June and 16K more in July. Fabricated metal products, Machinery, Transportation equipment. Maybe the dollar weakness trend is making U.S. exports once again more competitive in world markets.

The key shift in the jobs mix is that last month's 231K made it over the finish line with 37K Government jobs, a new hire pace which of course could not continue, but now this month Government added just 4K to 209K jobs count, with bigger, more long-lived trend gains for Business services (49K), Education and health (54K) and Leisure, hospitality (62K).

What else? The unemployment rate fell a tenth to 4.3% this month, which is okay, but we wouldn't tweet it from the roof tops as the 3-decimal change was not terribly significant, not a marked improvement 4.357% in June to 4.350% in July.

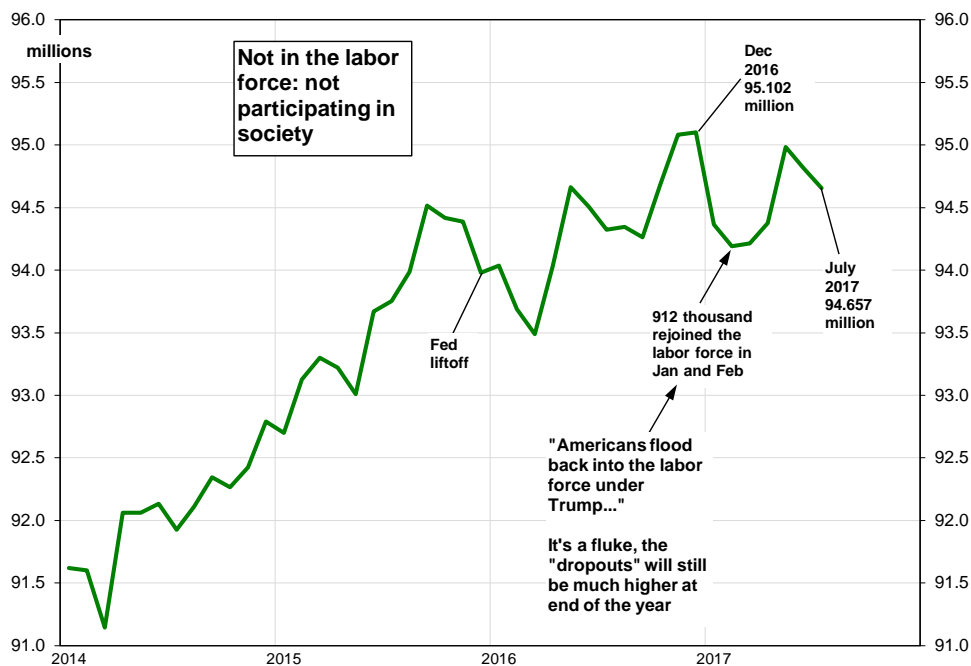
Wages? Not sure why the market thinks this is an important data point in the report as Yellen downplayed the number a while back: in other words, they are still on the gradual pace of interest rates path to 3% in 2019 even if

wages continue to run just 2%-something. Anyway in today's report, Average hourly earnings rose 0.3% and the year-on-year change is 2.5%. Wages have been 2.5% for four straight months now. What else? Oh yeah, the participation rate where even members of Congress are giving rallying speeches calling for steps to be taken that brings people back into the workforce. Sounds good for stump thumping, banging the lectern stuff, but there are no dropouts to bring back into society. 94.657 million are still out of the labor force in July, mostly due to demographics, where just 5.420 million of them actually want a job. Waah. Those not in the labor force are not a sign of economic weakness or

| <b>Payroll jobs in year nine following the recession</b> |   |        |        |        |                                 |                                  |
|--|---|--------|--------|--------|---------------------------------|----------------------------------|
| Dec. 2016  |   | Jul 17 | Jun 17 | May 17 | 7 months<br>Dec 16 to<br>Jul 17 | 12 months<br>Dec 15 to<br>Dec 16 |
| Totals   | millions                                |        |        |        |                                 |                                  |
| 145.325  | <b>Nonfarm Payroll Employment</b>       | 209    | 231    | 145    | 1290                            | 2240                             |
| 123.026  | <b>Total Private (ex-Govt)</b>          | 205    | 194    | 153    | 1231                            | 2039                             |
| 19.794   | <b>Goods-producing</b>                  | 22     | 32     | 13     | 242                             | 64                               |
| 0.617  | Mining                                  | 1      | 6      | 6      | 46                              | -75                              |
| 12.343   | Manufacturing                           | 16     | 12     | 0      | 82                              | -16                              |
| 0.942  | Motor Vehicles & parts                  | 2      | 0      | 1      | 2                               | 17                               |
| 6.783  | Construction                            | 6      | 15     | 7      | 116                             | 155                              |
| 103.232  | <b>Private Service-providing</b>        | 183    | 162    | 140    | 989                             | 1975                             |
| 27.374   | <b>Trade, transportation, utilities</b> | 7      | 19     | 0      | 14                              | 331                              |
| 15.881   | Retail stores                           | 1      | 2      | -10    | -45                             | 203                              |
| 3.180  | General Merchandise                     | 5      | 9      | -5     | -45                             | 37                               |
| 3.097  | Food & Beverage stores                  | -2     | -1     | -6     | -17                             | 37                               |
| 5.048  | Transportation/warehousing              | 1      | 6      | 14     | 26                              | 92                               |
| 1.465  | Truck transport                         | 0      | -2     | -2     | 6                               | 10                               |
| 0.668  | Couriers/messengers                     | 3      | 4      | 4      | 1                               | 31                               |
| 0.943  | Warehousing and storage                 | -2     | 2      | 2      | 7                               | 63                               |
| 0.557  | Utilities                               | -1     | 1      | -2     | -4                              | 0                                |
| 2.762  | <b>Information</b>                      | 4      | 2      | -5     | -32                             | 0                                |
| 8.364  | <b>Financial</b>                        | 6      | 13     | 10     | 84                              | 176                              |
| 2.605  | Insurance                               | 4      | -1     | 2      | 22                              | 46                               |
| 2.169  | Real Estate                             | -2     | 7      | 3      | 25                              | 59                               |
| 1.311  | Commercial Banking                      | 0      | 1      | 1      | 7                               | 17                               |
| 0.933  | Securities/investments                  | 3      | 4      | 1      | 15                              | 18                               |
| 20.416   | <b>Professional/business</b>            | 49     | 32     | 50     | 329                             | 534                              |
| 2.962  | Temp help services                      | 15     | 3      | 15     | 72                              | 32                               |
| 2.259  | Management of companies                 | 1      | 6      | 3      | 23                              | 35                               |
| 1.427  | Architectural/engineering               | 4      | 5      | 1      | 34                              | 27                               |
| 2.032  | Computer systems/services               | 5      | 4      | 0      | 27                              | 87                               |
| 1.126  | Legal services                          | -4     | 3      | 2      | 0                               | 5                                |
| 1.000  | Accounting/bookkeeping                  | 2      | 1      | 0      | 5                               | 32                               |
| 22.871   | <b>Education and health</b>             | 54     | 43     | 37     | 280                             | 553                              |
| 5.077  | Hospitals                               | 7      | 13     | 3      | 42                              | 119                              |
| 3.604  | Educational services                    | 10     | -12    | 7      | 23                              | 85                               |
| 15.744   | <b>Leisure and hospitality</b>          | 62     | 40     | 33     | 254                             | 331                              |
| 1.950  | Hotel/motels                            | 0      | 4      | -2     | 12                              | 11                               |
| 11.549   | Eating & drinking places                | 53     | 27     | 37     | 210                             | 276                              |
| 22.299   | <b>Government</b>                       | 4      | 37     | -8     | 59                              | 201                              |
| 2.200  | Federal ex-Post Office                  | -2     | -1     | -2     | -11                             | 30                               |
| 5.085  | State government                        | -3     | 7      | 0      | 10                              | -4                               |
| 2.414  | State Govt Education                    | -1     | 5      | 8      | 18                              | 3                                |
| 14.395   | Local government                        | 7      | 31     | -13    | 58                              | 160                              |
| 7.945  | Local Govt Education                    | 1      | 12     | -4     | 29                              | 69                               |

distress and our elected officials should stop winding the public up about it.

Net, net, the labor market stars are all in perfect alignment for Fed officials this month on jobs, the unemployment rate, more wages, a rising participation rate bringing opportunity back for all Americans, in short an absolutely perfect employment report, where the Federal Reserve can continue with their gradual steps to take away the excess money and negative "free money" real interest rates they provided to the economy during the recession. There is no longer a role for monetary policy to play in this economy. Fed officials can stop talking down the economy. We are okay. The markets don't believe we are okay, but traders are losing their jobs so their pessimistic opinions are biased. A rate hike



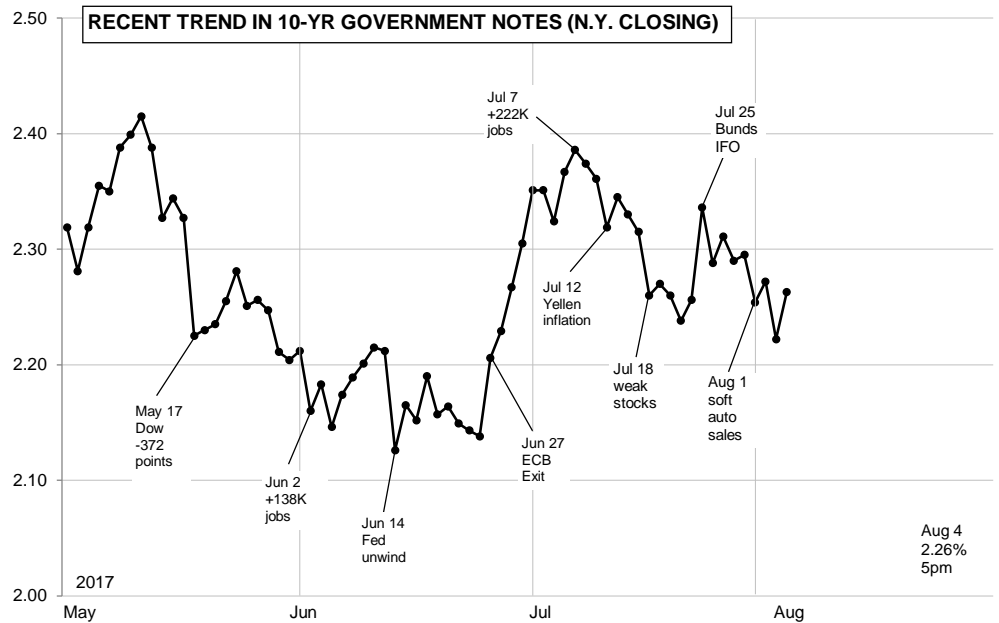
isn't on the table for the rest of this year, i.e. no rate hike is discounted by the markets with a rate hike from 1.25 to 1.50 percent at year-end less than a 50-50 proposition. Why? Some muddled thinking out there by the market's thought leaders saying something like inflation has to reach 2% before the Fed moves rates up again.

The economy is absolutely perfect today for one brief shining moment. The key moment in every economic recovery is when does the labor market start putting people back to work. This economy is still pumping out jobs nine years into the recovery from the recession, a fact we find remarkable, and suggests this economy steered first by President Obama and now taken over by President Trump at the helm is destined to be the longest expansion in modern economic history. The economy is better 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      |

The bond rally from 2.4% on last month's 222K jobs report continued this week with a new closing yield low of 2.22% on Thursday before the 209K jobs report. Weak auto sales on Tuesday had something to do with the rally even though the annual rate of 16.7 million in July is no lower than where it has been this year. The market frequently mistakes the meaning of the year-to-year automaker sales results. The Treasury



announced the terms of the August quarterly refunding: selling \$24 billion 3-years Tuesday, August 8, \$23 billion 10-years on Wednesday, August 9, and \$15 billion 30-years on Thursday, August 10, all to raise \$14.7 billion of new cash. Supply could become an issue pushing up yields at some point down the road if the Federal budget deficits don't remain under control, and the Fed's balance sheet wind down will add another \$360 billion to the Treasury's new cash need a year after the Fed's unwinding program is officially announced. The Treasury needs \$96 billion in the third quarter and \$501 billion in the October – December 2017 quarter which sounds like a lot.

## FEDERAL RESERVE POLICY

The Fed meets September 19-20 to consider its monetary policy. The jobs report today gives them the green light to officially announce the great balance sheet wind down at 2pm EDT September 20. Unfortunately, we get another jobs report before the September meeting when Fed officials have to make a decision, and they've been known to cut and run before. What if the August employment report on Friday, September 1 isn't as strong as today's 209K payroll jobs count?

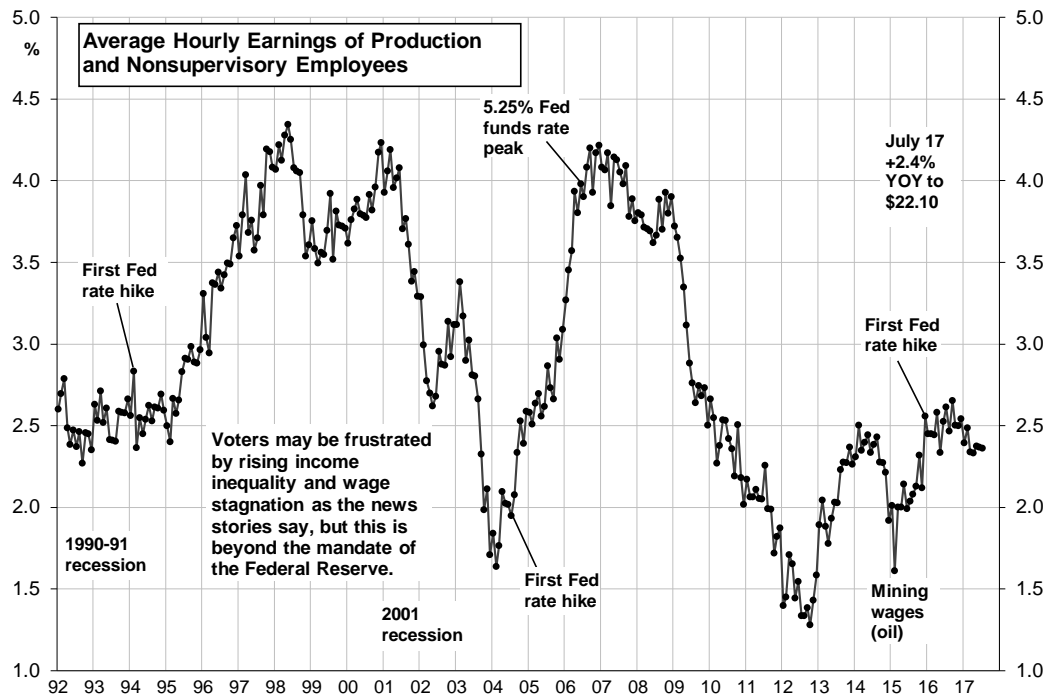
The Fed has had a problem before with its meet me in September decision promises, leaving the markets, and many Fed officials around the table as well, heart-broken. But you said... Maybe taking a summer holiday in August clouds the senses and alters your mind-set. We will see what Yellen has to say in a curtain raiser perhaps when she makes the traditional Fed Chair Jackson Hole speech on Friday, August 25, while the rest of us are hard at work at our cubicle desks in New York.

| Selected Fed assets and liabilities     |                 |                 |                 |                 | Sep 10        |
|---|-----------------|-----------------|-----------------|-----------------|---------------|
| Fed H.4.1 statistical release           | 2-Aug           | 26-Jul          | 19-Jul          | 12-Jul          | 2008**        |
| billions, Wednesday data                |                 |                 |                 |                 | pre-LEH       |
| <b>Factors adding reserves</b>          |                 |                 |                 |                 |               |
| U.S. Treasury securities                | 2465.195        | 2465.170        | 2465.145        | 2465.121        | 479.782       |
| Federal agency debt securities          | 8.097           | 8.097           | 8.097           | 8.097           | 0.000         |
| Mortgage-backed securities              | 1769.026        | 1768.999        | 1779.394        | 1770.281        | 0.000         |
| Primary credit (Discount Window)        | 0.003           | 0.013           | 0.051           | 0.001           | 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)                      | 1.710           | 1.710           | 1.710           | 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            | 0.035           | 0.085           | 0.041           | 0.055           | 62.000        |
| Federal Reserve Assets                  | 4513.4          | 4512.0          | 4523.6          | 4513.4          | 961.7         |
| 3-month Libor %                         | 1.31            | 1.31            | 1.31            | 1.30            | 2.82          |
| <b>Factors draining reserves</b>        |                 |                 |                 |                 |               |
| Currency in circulation                 | 1565.431        | 1561.976        | 1561.884        | 1564.816        | 834.477       |
| Term Deposit Facility                   | 0.000           | 0.000           | 0.000           | 0.000           | 0.000         |
| Reverse repurchases w/others            | 119.334         | 103.311         | 144.731         | 179.172         | 0.000         |
| <b>Reserve Balances (Net Liquidity)</b> | <b>2291.576</b> | <b>2293.616</b> | <b>2250.646</b> | <b>2238.951</b> | <b>24.964</b> |
| Treasuries within 15 days               | 18.655          | 11.794          | 11.794          | 1.278           | 14.955        |
| Treasuries 16 to 90 days                | 22.845          | 32.799          | 32.799          | 44.593          | 31.549        |
| Treasuries 91 days to 1 year            | 298.286         | 276.684         | 276.684         | 275.578         | 69.272        |
| Treasuries over 1-yr to 5 years         | 1129.960        | 1152.633        | 1152.629        | 1152.805        | 170.807       |
| Treasuries over 5-yrs to 10 years       | 361.528         | 357.353         | 357.347         | 357.263         | 91.863        |
| Treasuries over 10-years                | 633.921         | 633.907         | 633.892         | 633.604         | 101.337       |

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

What is it about the Fed and September meeting policy decisions? September Fed meetings have been prone to disappointment. Bernanke did not taper as promised in September 2013. After promising for years to raise rates the first time famously sometime in the middle of 2015, the Fed signaled a September liftoff at the July 2015 meeting by saying a rate hike would occur after it had “seen some further improvement in the labor market” and yet, and yet, they still didn’t hike rates at the September 2015 meeting despite the July heads-up nod-nod, wink-wink signal.

How is it again that we are supposed to worry about too-low inflation when wages are 2%?



Okay, a China currency reval, and 1,000-point Dow industrials flash crash may have changed a few minds between the July and September meetings in 2015, but the Fed under Bernanke/Yellen still reacts too cautiously to every bump in the road for our liking. Humpty Dumpty fell off a great wall in 2008 and they still have not put the pieces back together again by returning interest rates to normal levels.

And finally, last year ahead of the September 2016 meeting, even Yellen’s old research director John Williams, now President at the San Francisco Fed, wanted to raise rates, even put it front and center on the front page of his bank’s website, and yet nothing happened. The Committee worried about China and global market volatility at the start of the year finally signaled at the July 2016 meeting that “near-term risks to the economic outlook have diminished.” But they didn’t hike rates in September, incredibly going so far as to say that although the case for a rate hike had strengthened (just like Yellen said at Jackson Hole in August 2016, “strengthened,” they still somehow decided to wait for further improvement. Nine out of the 12 regional Federal Reserve Presidents voted to hike rates in September last year (as we found after the fact) and yet it just didn’t happen.

To conclude, we cannot imagine they would disappoint us again this September and not at least announce the start of the balance sheet wind down. They already announced the specific details of how the balance sheet reduction would be conducted at the June meeting. They’ve waited long enough. They need to keep normalizing policy. The recession ended a long time ago and the economy faces no significant headwinds.

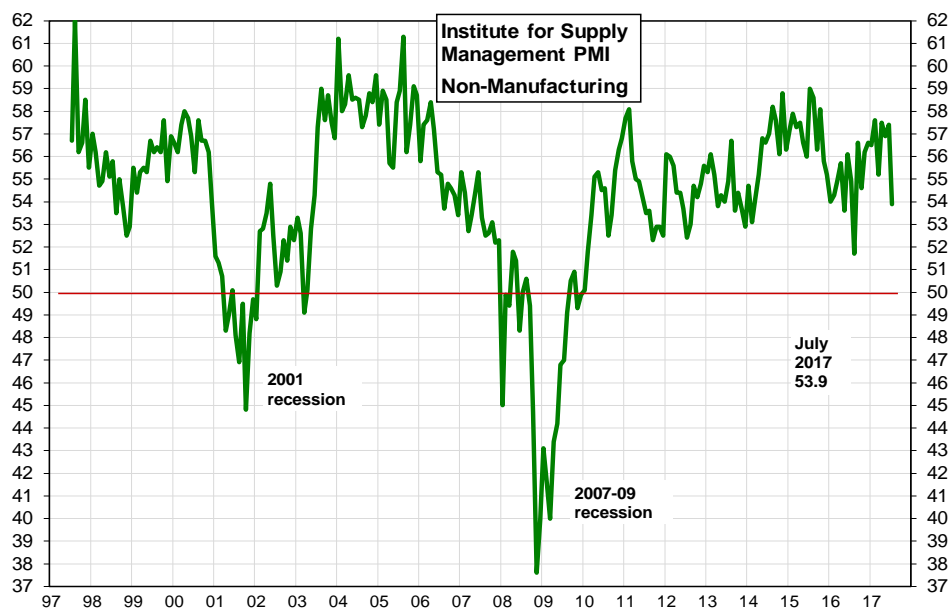


## OTHER ECONOMIC NEWS THIS WEEK

### Great. Now ISM says the services economy may be stalling

Breaking economy news. The ISM non-manufacturing index, services to you, fell in July just hours ahead of the formerly all-important monthly jobs report. Not quite fair perhaps, formerly all-important. Jobs reports and the outlook for growth are still important in setting monetary policy around the world. Just look at the U.K. The economic outlook is important for the Bank of England which seems to think growth is not quite as "on track" with only two members wanting to hike rates.

We cannot call it a dip in services activity as the index dropped a sharp 3.5 points back to 53.9 in July the weakest reading on the services sector since Trump was elected President. New Orders way down from 60.5 in June to 55.1 in July. Employment back down the last couple of months and less supportive of another 200K payroll jobs number tomorrow: 57.8 in May, 55.8 in June and 53.6 in July. The bond market actually moved on the weakening ISM services trend, yields declining call it, oh maybe 1 basis point, though the major reason yields are lower today is the BOE statement at 7am EDT earlier about not so many thinking a U.K. rate hike is needed.



Net, net, the services economy is cooling which makes the Fed's goal of 2% inflation a little harder to achieve certainly even if this news is unlikely to alter the Fed's policy of gradually removing some of its stimulus later this year. Pay no attention to the rise in the ISM services prices paid index from 52.1 in June to 55.7 in July; inflation will take some time to heat up.

We know an above 50 index reading means the services sector is expanding, only more slowly this month, but the sharp reversal of fortunes for services companies, this index, does not look like a very positive development for the economic outlook when you graph it out on a chart. Fifteen services industries are still moving higher, and just two are in decline, Management of companies and support services are down as is Agriculture and forestry.... Timber! Stay tuned. Story developing. We have some questions about the strength of the expansion going forward with today's data, but we don't want to make a change yet to the forecast.

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