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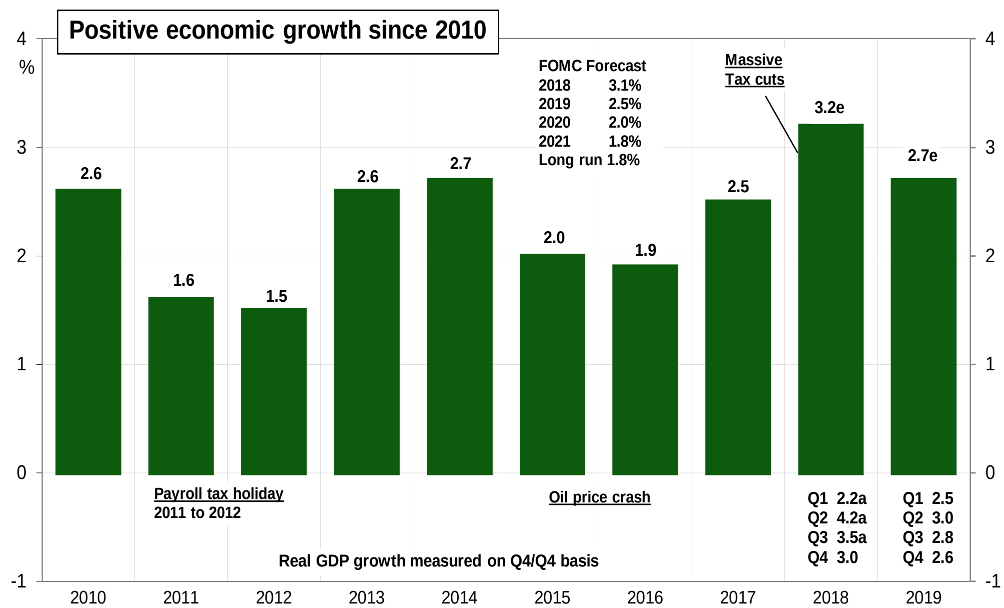
FIRST LOOK AT THIRD QUARTER GDP: RUNNING MID-3% ALL YEAR LONG

Real GDP was stronger than we thought in the third quarter at 3.5%. Consumers spent a lot, while companies invested in fewer structures and bought no equipment. Growth is running in the mid-3s this year, averaging the 2.2% in Q1 with 4.2% in Q2 to get 3.2% in the first half of 2018, and now 3.5% in the third quarter. If growth is 3.0% in the final quarter, then Q4/Q4 2018 growth will be 3.2% versus 2.5% in 2017, Trump's first year, and 2.7% in 2014, Obama's "last year" before the oil price crash slowed everything down.



	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18	Q3 18p
REAL GDP	1.8	3.0	2.8	2.3	2.2	4.2	3.5
REAL CONSUMPTION	1.8	2.9	2.2	3.9	0.5	3.8	4.0
CONSUMPTION	1.2	2.0	1.5	2.6	0.4	2.6	2.7
Durables	0.1	0.6	0.5	0.9	-0.2	0.6	0.5
Nondurables	0.3	0.6	0.3	0.6	0.0	0.6	0.7
Services	0.8	0.8	0.7	1.2	0.5	1.4	1.5
INVESTMENT	0.8	1.0	1.5	0.1	1.6	-0.1	2.0
Business Plant	0.4	0.1	-0.2	0.0	0.4	0.4	-0.3
& Equipment and	0.5	0.6	0.6	0.6	0.5	0.3	0.0
Intellectual Property	0.3	0.3	0.1	0.0	0.6	0.5	0.4
Homes	0.4	-0.2	0.0	0.4	-0.1	-0.1	-0.2
Inventories	-0.8	0.2	1.0	-0.9	0.3	-1.2	2.1
EXPORTS	0.6	0.4	0.4	0.8	0.4	1.1	-0.5
IMPORTS	-0.7	-0.4	-0.4	-1.7	-0.5	0.1	-1.3
GOVERNMENT	-0.1	0.0	-0.2	0.4	0.3	0.4	0.6
Federal defense	0.0	0.2	-0.1	0.1	0.1	0.2	0.2
Fed nondefense	0.0	-0.1	0.0	0.2	0.1	0.0	0.0
State and local	-0.1	-0.2	-1.0	0.2	0.1	0.2	0.4
Below line: Percentage point contributions to Q3 18 3.5% real GDP							
Second estimate for Q3 is Wednesday, November 28							

We left growth higher at 2.7% in 2019, same as it was during Obama's best year after the recession: 2.7% could reflect the current trend rate for growth for late in the cycle, ten years beyond the recession. We expect growth to slow to 2.3% in 2020 when many economists have sharpened their pencils and come up with recession or at least "growth recession" forecasts. A growth recession might be something like a 1.3% real GDP forecast in 2020, sharply slower economic growth.

Details in today's GDP report. We're winning. Strong results for a second straight quarter and you can thank the Republican Tax Cuts and Jobs Act for stuffing cash in consumers' pockets for giving the economy a lift. Who says the economy can't be bought just like votes? Real consumer spending shot the lights out again rising 4.0% after 3.8% in the second quarter. There will come a day of reckoning for the economy after the tax cuts monies are all gone, but for today Washington really has something to crow about.

Strong growth and still not too much inflation too. The core PCE price index increased 2.0% year-year in Q3, compared with increases of 1.9% in Q2 and 1.5% a year ago in Q3 2017. The economy isn't overheating so Fed policy doesn't need to go overboard with rate hikes and risk throwing the economy's engines into reverse. That should keep President Trump happy. He has been like an extra Fed governor at 20th and C Streets complaining loudly that the Fed's rate hikes undo what he is trying to do for the economy.

The only black lining in these shining 3.5% GDP numbers today is the notable absence of business investment spending which means productivity will not get the boost that Trump's economics team was banking on to put this economy into higher orbit with faster sustainable growth. The historic corporate tax money is going elsewhere with business spending on structures and equipment showing weakness in the third quarter with the trade war escalation causing uncertainty perhaps. Business spending on structures added 0.4 percentage points to growth last quarter and subtracted 0.3 percentage points this quarter. Business spending on equipment may be suffering from supply chain hiccups adding 0.3 percentage points last quarter and adding zero to 3.5 percent growth in the third quarter. At least companies bought a lot of computer software.

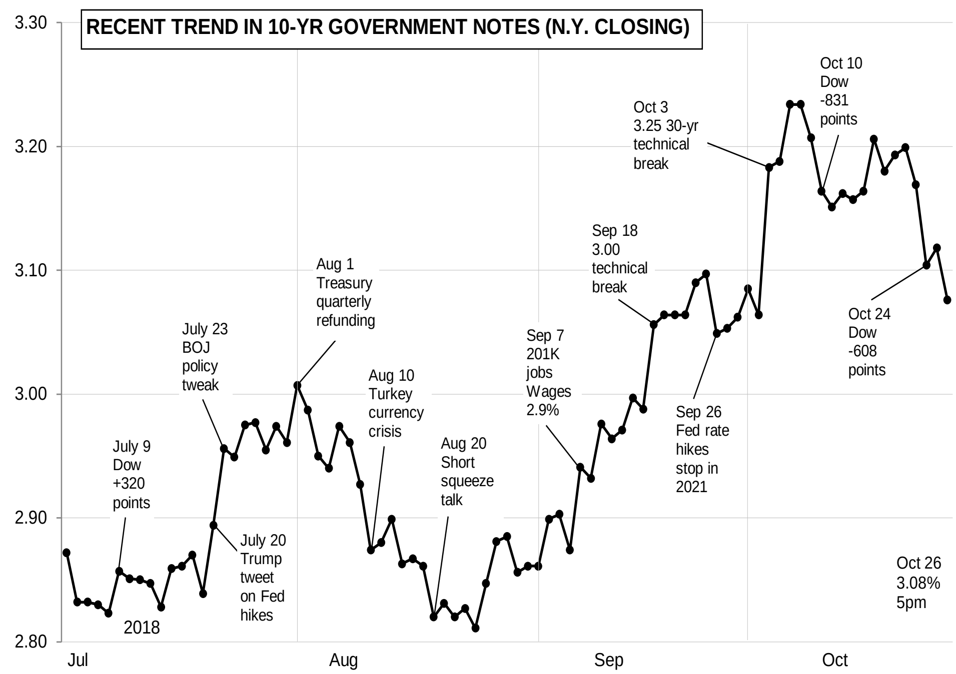
Stay tuned. Story developing. Consumer spending was surprisingly strong despite the hurricane weakness in dining out spending at restaurants and bars. Hope no one monkeyed with the data ahead of the midterm elections. The only mystery today is why the stock market isn't getting a lift with the good GDP report today. We can only think investors are already looking ahead to economic conditions next year when the fiscal stimulus boost starts to fade. For the stock market, the economy's as good as it gets and after buying the rumors they are selling the fact.

$BLN Nominal GDP expenditures	Q4 15	YOY%	Q1 16	Q2 16	Q3 16	Q4 16	YOY%	Q1 17	Q2 17	Q3 17	Q4 17	YOY%	Q1 18	Q2 18	Q3 18	Annual rate
Equipment & Intellectual Property	1891.3	2.2	1878.6	1895.9	1903.4	1908.0	0.9	1947.7	1988.3	2021.7	2052.0	7.5	2105.3	2147.4	2171.6	7.8%
EQUIPMENT	1113.7	0.9	1092.8	1091.4	1090.2	1089.3	-2.2	1112.3	1137.4	1162.8	1189.1	9.2	1212.6	1228.8	1233.6	5.0%
Information processing equipment	357.4	2.8	349.0	353.1	356.3	358.8	0.4	368.5	379.0	386.5	393.7	9.7	401.9	410.2	412.1	6.2%
Computers	99.8	-3.7	99.1	99.8	98.2	100.1	0.3	103.2	110.1	113.9	109.7	9.6	116.9	121.0	120.0	12.5%
Other processing equipment 1	257.5	5.4	249.9	253.2	258.2	258.6	0.4	265.4	268.8	272.6	284.0	9.8	285.0	289.1	292.1	3.8%
Industrial equipment	218.0	0.1	212.2	214.2	215.3	218.1	0.0	222.1	230.1	234.6	238.5	9.4	243.9	243.4	250.6	6.8%
Transportation equipment	303.3	8.3	298.8	295.2	287.5	280.5	-7.5	282.4	279.4	285.0	290.4	3.5	300.7	303.5	298.2	3.6%
Other equipment 2	235.0	-8.9	232.7	228.8	231.0	231.9	-1.3	239.2	249.0	256.8	266.4	14.9	266.1	271.7	272.7	3.2%
INTELLECTUAL PROPERTY	777.6	4.1	785.8	804.5	813.2	818.7	5.3	835.4	850.9	858.9	862.9	5.4	892.7	918.6	938.0	11.6%
Software	311.7	3.3	319.0	325.5	330.0	335.4	7.6	342.7	353.5	359.7	355.9	6.1	370.3	381.6	391.7	13.4%
Research & Development (R&D)	387.4	4.1	388.1	400.1	403.7	403.2	4.1	412.1	416.5	417.8	425.0	5.4	439.7	453.1	461.3	11.4%
Entertainment, literary, artistic	78.5	7.5	78.7	78.9	79.5	80.0	1.9	80.6	80.9	81.4	82.0	2.5	82.7	83.8	84.9	4.7%
1 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments																
2 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment																

P.S. Taking a look at nominal spending, actual dollars flowing into investment, three quarters into the year, spending on equipment and intellectual property is 7.8% on an annual basis about the same as Q4 2017's 7.5% increase. The Tax Cuts and Jobs Act signed in December 2017 seems to have boosted most this year: software, R&D, and computers.

MARKETS OUTLOOK

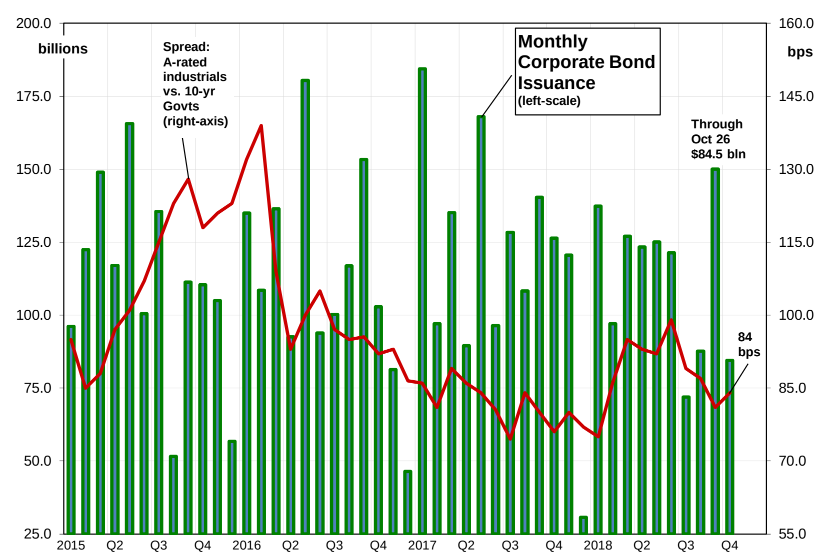
	28-Sep 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
30-Yr Treasury	3.21	3.25	3.40	3.45	3.65	3.60	3.80	3.85	3.85	3.95	3.95
10-Yr Note	3.06	3.10	3.20	3.30	3.50	3.50	3.70	3.80	3.80	3.95	3.95
5-Yr Note	2.95	3.00	3.10	3.20	3.40	3.45	3.65	3.75	3.80	3.95	3.95
2-Yr Note	2.82	2.90	3.00	3.15	3.40	3.40	3.60	3.75	3.80	4.00	4.00
3-month Libor	2.40	2.70	2.95	3.20	3.45	3.45	3.70	3.90	3.90	4.20	4.15
Fed Funds Rate	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00	4.00
2s/10s spread	24	20	20	15	10	10	10	5	0	(5)	(5)
Libor/funds spd	15	20	20	20	20	20	20	15	15	20	15



Bond yields dropped sharply to 3.08% on Friday versus 3.19% last Friday, the greatest weekly drop in yields since the last week of May. Drop in yields meaning bond price rally, but no one seems to be cheering. The stock market losses were the reason behind the decline in yields, especially on Wednesday with the new closing low for October, down 608 points on the day. Even Friday's strong GDP report of 3.5% in Q3 didn't push up yields. No one thinks the Fed is going to raise rates any faster on the stronger growth number, and not just because the FOMC has the President breathing down their necks. Higher bond yields helped bring the stock market down, but now yields are back down.

CORPORATES: UNITED RENTALS, OGLETHORPE POWER, KIMBERLY-CLARK

Corporate offerings were $6.0 billion in the October 26 week versus $24.1 billion in the October 19 week. On Monday, Constellation Brands sold $2.15 billion 7s/10s/30s/FRNs. It priced a $500 million 4.65% 10-yr (m-w +25bp) at 150 bps (Baa3/BBB). The alcoholic beverage company will use the proceeds to finance in part its investment in Canopy Growth (cannabis). Corporate bond yields (10-yr Industrials rated A2) were 84 bps above 10-yr Treasuries this week versus 83 bps last Friday.



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FEDERAL RESERVE POLICY

The Fed meets November 7-8 to consider its monetary policy. (That's right: Fed decision announced 2pm EST Thursday, November 8… not a Wednesday.) Twelve of sixteen Fed officials see a fourth rate hike this year to 2.5%. In December. Market odds for a December hike are 68% on Friday versus 84% a week ago.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	24-Oct	17-Oct	10-Oct	3-Oct	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2294.215	2294.245	2294.227	2294.210	479.782
Federal agency debt securities	2.409	2.409	2.409	2.409	0.000
Mortgage-backed securities	1676.956	1680.109	1681.778	1681.775	0.000
Primary credit (Discount Window)	0.048	0.010	0.013	0.064	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)	0.007	0.007	0.007	0.007	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	
Central bank liquidity swaps	0.080	0.089	0.090	0.151	62.000
Federal Reserve Assets	4220.8	4223.2	4224.6	4222.4	961.7
3-month Libor %	2.51	2.45	2.43	2.41	2.82
Factors draining reserves					
Currency in circulation	1690.508	1691.479	1692.975	1689.897	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	6.444	0.174	2.390	2.954	0.000
Reserve Balances (Net Liquidity)	1825.009	1831.618	1878.887	1837.587	24.964
Treasuries within 15 days	23.886	23.833	0.026	0.026	14.955
Treasuries 16 to 90 days	79.515	79.615	101.337	101.337	31.549
Treasuries 91 days to 1 year	308.510	308.510	310.595	310.595	69.272
Treasuries over 1-yr to 5 years	999.360	999.357	999.355	999.352	170.807
Treasuries over 5-yrs to 10 years	265.781	265.775	265.769	265.763	91.863
Treasuries over 10-years	617.162	617.154	617.146	617.137	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

Next year, 4 out of 16 Fed officials see three rate hikes to 3.25%, 7 see two or fewer rate hikes, and 5 see more than three hikes. The Committee seems less certain on the path of rates in 2019 as there are different opinions about where neutral rates for the economy are. President Trump sees no rate hikes next year.

It's always an interesting week for Fed policy when the stock market collapses and Fed officials (often with little experience) say this is normal or was to be expected. On Friday, the Dow industrials were down 9.3% from the 2018 highs and the S&P 500 index was down 10.6% from the highs of the year. For the tech-heavy S&P the sell-off almost rivaled the 11.8% sheer drop in early February, a move amplified by that unexplained 850 point drop in the Dow industrials over a ten minute period on Monday afternoon February 5. Yet for some Fed officials it was strictly business as usual this week, concentrating on doing their jobs. We aren't sure if they were serious or whether it was just a careful, measured response given the market turmoil. On Friday, Cleveland Fed President Mester and Dallas Fed President Kaplan, a hawk and a moderate, both said they need to keep moving the Fed funds rate up to 3% neutral. We will see. Three more rate hikes to go.

Year-ends for Interest Rates				
Percent %	2018	2019	2020	2021
Eurodollar futures	2.73	3.13	3.11	3.085
Fed's Sept forecast	2.5	3.25	3.5	3.5

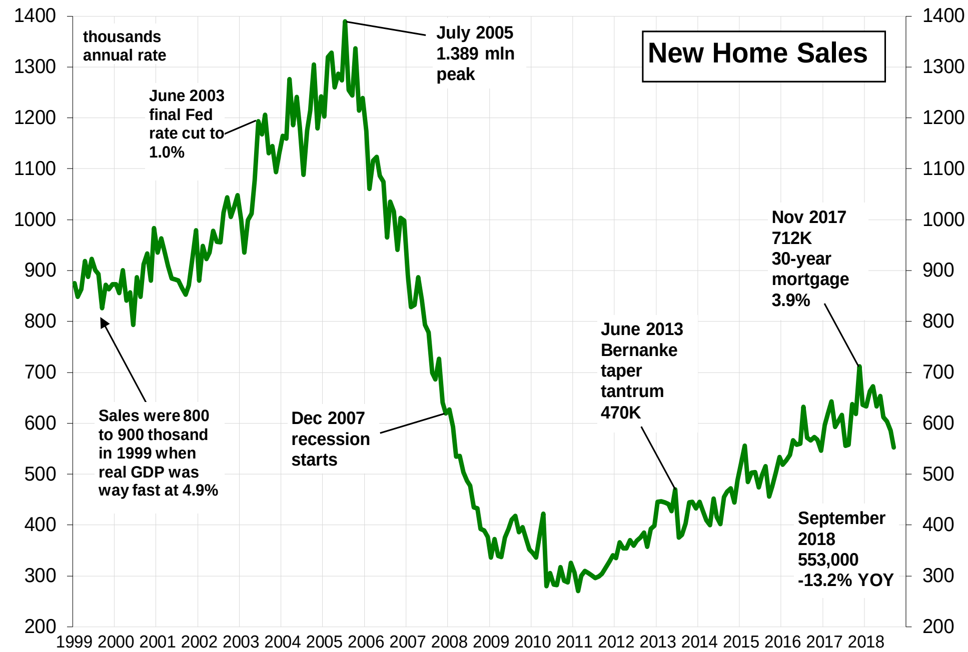
Eurodollar futures price where 3-month Libor will be in the future.
Friday, October 26, 2018 3-month Libor 2.52%

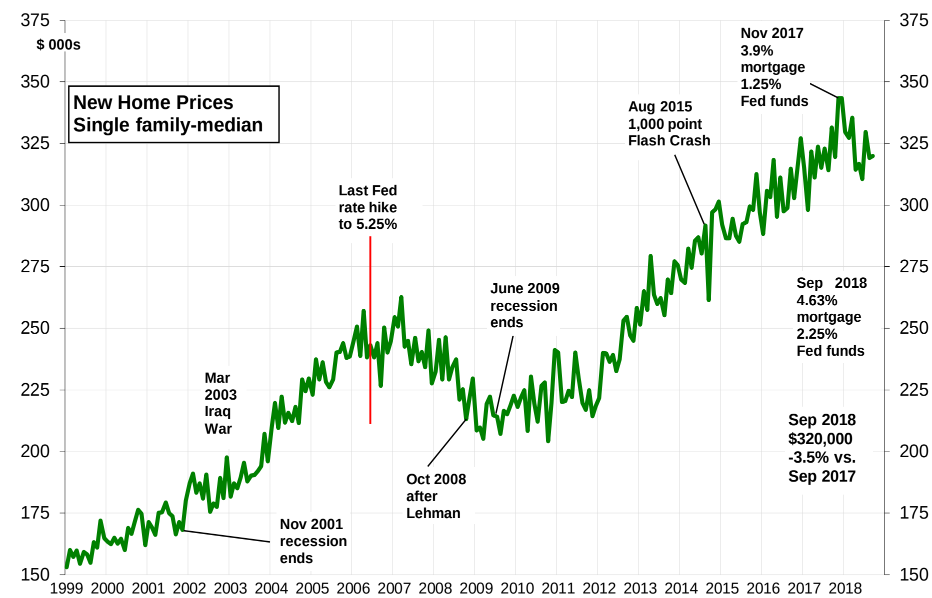
Fed Individual Forecasts					
Fed funds rate by year-end					Longer
Votes	2018 End	2019 End	2020 End	2021 End	run
1	2.125	2.125	2.125	2.125	2.500
2	2.125	2.375	2.625	2.625	2.500
3	2.125	2.625	2.875	2.875	2.500
4	2.125	2.875	3.125	2.875	2.750
5	2.375	2.875	3.125	2.875	2.750
6	2.375	2.875	3.125	3.000	2.750
7	2.375	2.875	3.125	3.125	2.750
8	2.375	3.125	3.375	3.375	3.000
9	2.375	3.125	3.375	3.375	3.000
10	2.375	3.125	3.625	3.375	3.000
11	2.375	3.125	3.625	3.375	3.000
12	2.375	3.375	3.625	3.500	3.000
13	2.375	3.375	3.625	3.625	3.000
14	2.375	3.375	3.625	3.625	3.250
15	2.375	3.375	3.625	3.875	3.500
16	2.375	3.625	3.875	4.125	
17					
Median	2.375	3.125	3.375	3.375	3.000
Meeting	Sep 2018	Sep 2018	Sep 2018	Sep 2018	Sep 2018

OTHER ECONOMIC NEWS THIS WEEK

Death knell for new home sales as in there aren't any (Wednesday)

Breaking economy news. New home sales were 553 thousand in September, down 5.5%, with sharp downward revisions to June, July, and especially August. September weakness was concentrated in the higher priced regions of the Northeast and the West so it looks like home buyers have sticker shock. The tax implications of the Tax Cuts and Jobs Act is also hurting the prospects for new home sales. One thing is for certain, the economy cannot grow at a sustainable 3% pace for long if new home sales continue to tumble. The Fed's rising interest rates may be more harmful for economic growth than they thought, chiefly because of its effect on long-term interest rates and mortgage rates.





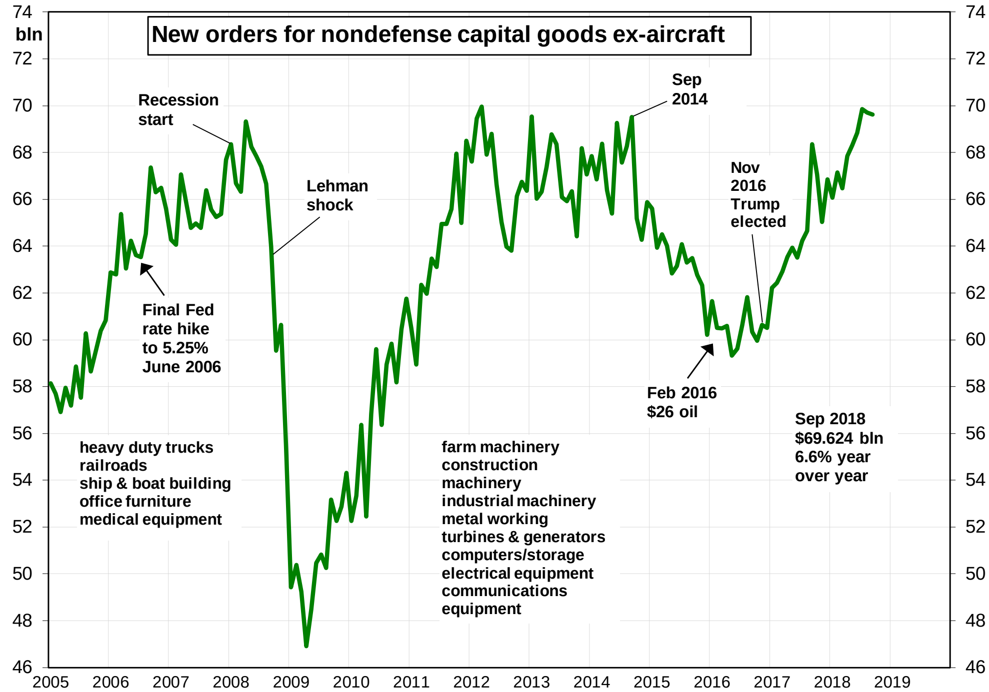
The President is sorry he ever put Powell in as head of the Fed and now home buyers are just as unhappy with the Fed's higher interest rates if the new home sales report for September is to be believed. Mortgage rates were 3.4% PT, pre-Trump, and now they are nearing 5% making it a lot more expensive to buy a new house.

Net, net, new home sales are shockingly lower than they were a month ago after revisions and the latest data. September home sales are 553 thousand where we thought they were 629 thousand. Single family housing starts were 871 thousand in September, so at some point home builders are going to stop new construction if sales activity doesn't pick up. New home sales are down and it is increasingly apparent that homes are getting too expensive to afford both on price and on financing costs. The stock market is crashing, new home sales are plummeting, and this means the Federal Reserve is unlikely to stick to its rate hike calendar which currently pencils in another 125 bps of monetary policy tightening. Stay tuned. Story developing. The Fed may be closer to hitting the pause button on their rate hikes than markets think. Bet on it.

Business capex looks toppy; Goods imports still coming despite trade war (Thursday)

Breaking economy news. Durable goods orders rose 0.8% in September, while the advance report on the trade deficit in goods was $76.0 billion in September, marginally higher than $75.5 billion in August.

Manufacturing which has been going full tilt is showing some early signs of slowing its advance as core capital goods orders have gone sideways the last two months having reached maxed out as good as it gets levels in July. The third quarter may prove to be the high water mark for US manufacturing in this long business expansion from the recession.



Net, net, the escalation of trade tensions appears to be expanding US trade with the world, not hurting it. If the trade war is going to slow economic growth it has to slow US exports and right now the exact opposite trend is being observed with exports of goods up 1.8% in September, and 8.3% higher than last year's level with capital goods and consumer goods exports leading the charge.

Business capital spending has cooled with orders on nondefense capital goods ex-aircraft looking like it has peaked in the third quarter. It looks like business has ordered up all the new equipment they need for now to meet the demand for their goods and services. The Tax Cuts and Jobs Act may have lined corporate coffers with cash, but companies have bought all the equipment they need for now.

ADVANCE TRADE STATISTICS FOR SEPTEMBER

	Monthly				Percent changes		
	September	August	July	September	Sep 18	Aug 18	Sep 18
Trade	2018	2018	2018	2017	Aug 18	July 18	Sep 17
Balance	-76,036	-75,456	-72,042	-64,921			
Exports	140,952	138,422	140,210	130,202	1.8	-1.3	8.3
Foods, Feeds, & Beverages	10,959	12,028	13,245	11,348	-8.9	-9.2	-3.4
Industrial Supplies (1)	46,745	44,126	46,537	39,162	5.9	-5.2	19.4
Capital Goods	47,443	46,417	46,316	44,921	2.2	0.2	5.6
Automotive Vehicles, etc.	12,907	12,780	13,060	13,094	1.0	-2.1	-1.4
Consumer Goods	17,758	17,615	15,973	16,336	0.8	10.3	8.7
Other Goods	5,139	5,455	5,079	5,341	-5.8	7.4	-3.8
Imports	216,988	213,878	212,252	195,124	1.5	0.8	11.2
Foods, Feeds, & Beverages	12,139	12,305	12,439	11,698	-1.3	-1.1	3.8
Industrial Supplies (1)	49,129	49,660	49,302	41,248	-1.1	0.7	19.1
Capital Goods	59,736	57,677	58,156	54,838	3.6	-0.8	8.9
Automotive Vehicles, etc.	31,096	31,711	30,709	29,722	-1.9	3.3	4.6
Consumer Goods	55,405	53,472	52,612	49,815	3.6	1.6	11.2
Other Goods	9,482	9,053	9,033	7,803	4.7	0.2	21.5

(1) Includes petroleum and petroleum products.

Don't tell that to importers as the flood of imports to American shores continues unabated as companies try to front run the tariffs that are still coming and haven't hit the economy with full force yet. Imported goods jumped 11.2% from last year, partly on the rebound of energy prices the last year. Crude oil WTI prices averaged $70.77

in September, up 41.9% from $49.88 in September 2017. But consumer goods imports are also up big with an 11.2% jump from last year trying to get those MAGA hats to America before they get even more costly. Those hats have cost America enough already. Capital goods imports are also up a strong 8.9% the last year. Auto imports up 4.6% the last year despite falling 1.9% in September. Stay tuned. Story developing. Nothing wrong with the economy yet even if it looks increasingly that activity cannot possibly get any better. Maybe another tax cut would help.

Analyst Certification

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