Financial Market Weekly

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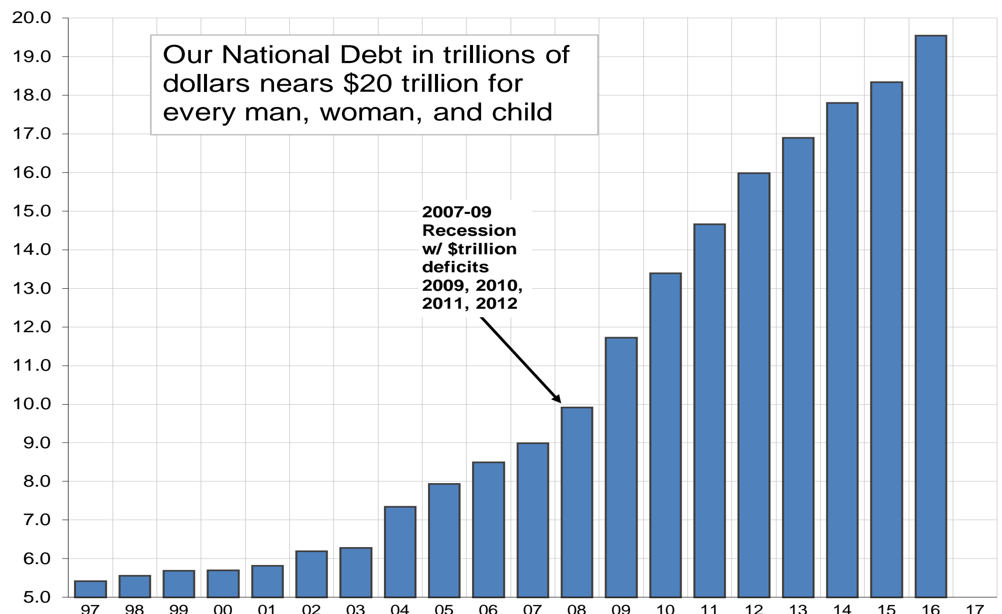
BABY BOOMERS DON'T THINK SOCIAL SECURITY IS AN ENTITLEMENT

The good news is you are getting a tax cut. The bad news is you are not entitled to anything else after you retire because the Federal government is bankrupt and does not have the financial means to pay you your Social Security or Medicare benefits. Especially after the $1.5 trillion tax cut. Okay. An exaggeration. But the first of a twenty-year wave of baby boomers turned 65 years old in 2011 if you didn't know. The national debt is $20 trillion and crunch time for those looming, massive Federal budget deficits, that people have warned about since the 70s/80s, is coming "twenty years from now," in the year 2035, when the baby boom generation will be 70 to 90 years of age and drawing down the maximum amount of their entitled benefits before they eventually pass on. And thank goodness when they are all gone, we won't have to keep hearing about the dangers and risks that that generation poses to the economy and markets. One thing is certain. The country will be quite rich when the baby boomers are all gone.



There was a time that Washington thought social security should be privatized. It was probably not realistic however. Money could be withheld for workers, but where would it be invested? The amounts of monies saved by workers would be enormous. These private money retirement savings coming into the stock market would push share prices too high relative to the fundamentals of earnings and economic growth. Talk about Dow at 36,000. Who was it who wrote that book about the Dow industrials stock index at 36,000 back in 2000 anyway? One of the authors was economist Kevin Hassett, Trump's Chairman of the Council of Economic Advisers.

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The monies collected by the social security taxes paid by workers need to remain outside of the private economy. But it is intriguing to think about what if you had saved all the social security contributions you made for yourself. Would you be better off today?

45 YEARS OF SOCIAL SECURITY CONTRIBUTIONS						
WHAT IF YOU INVESTED IT YOURSELF?						
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Years On the Job	Year	SS Earnings Base $	OASI Tax Rate %	Max Contri-bution	Future Value at 5%	Future Value at 10%
1	1972	9,000	4.05	365	6550	53137
2	1973	10,800	4.3	464	7948	61546
3	1974	13,200	4.375	578	9413	69577
4	1975	14,100	4.375	617	9576	67565
5	1976	15,300	4.375	669	9896	66650
6	1977	16,500	4.375	722	10164	65343
7	1978	17,700	4.275	757	10147	62266
8	1979	22,900	4.33	992	12663	74178
9	1980	25,900	4.52	1171	14239	79615
10	1981	29,700	4.7	1396	16170	86302
11	1982	32,400	4.575	1482	16353	83312
12	1983	35,700	4.575	1633	17160	83453
13	1984	37,800	5.2	1966	19669	91303
14	1985	39,600	5.2	2059	19624	86955
15	1986	42,000	5.2	2184	19822	83841
16	1987	43,800	5.2	2278	19687	79486
17	1988	45,000	5.53	2489	20486	78951
18	1989	48,000	5.53	2654	20811	76558
19	1990	51,300	5.6	2873	21451	75325
20	1991	53,400	5.6	2990	21266	71280
21	1992	55,500	5.6	3108	21050	67349
22	1993	57,600	5.6	3226	20806	63543
23	1994	60,600	5.26	3188	19581	57085
24	1995	61,200	5.26	3219	18834	52409
25	1996	62,700	5.26	3298	18376	48812
26	1997	65,400	5.35	3499	18567	47078
27	1998	68,400	5.35	3659	18494	44761
28	1999	72,600	5.35	3884	18695	43191
29	2000	76,200	5.3	4039	18513	40826
30	2001	80,400	5.3	4261	18603	39160
31	2002	84,900	5.3	4500	18709	37593
32	2003	87,000	5.3	4611	18259	35021
33	2004	87,900	5.3	4659	17569	32166
34	2005	90,000	5.3	4770	17132	29941
35	2006	94,200	5.3	4993	17078	28489
36	2007	97,500	5.3	5168	16835	26806
37	2008	102,000	5.3	5406	16773	25494
38	2009	106,800	5.3	5660	16726	24267
39	2010	106,800	5.3	5660	15930	22061
40	2011	106,800	5.3	5660	15171	20055
41	2012	110,100	5.3	5835	14895	18796
42	2013	113,700	5.3	6026	14650	17646
43	2014	117,000	5.3	6201	14357	16507
44	2015	118,500	5.3	6281	13849	15199
45	2016	118,500	5.3	$6,281	$13,189	$13,817
46	2017	127,200	Total	$147,428	$735,734	$2,364,713

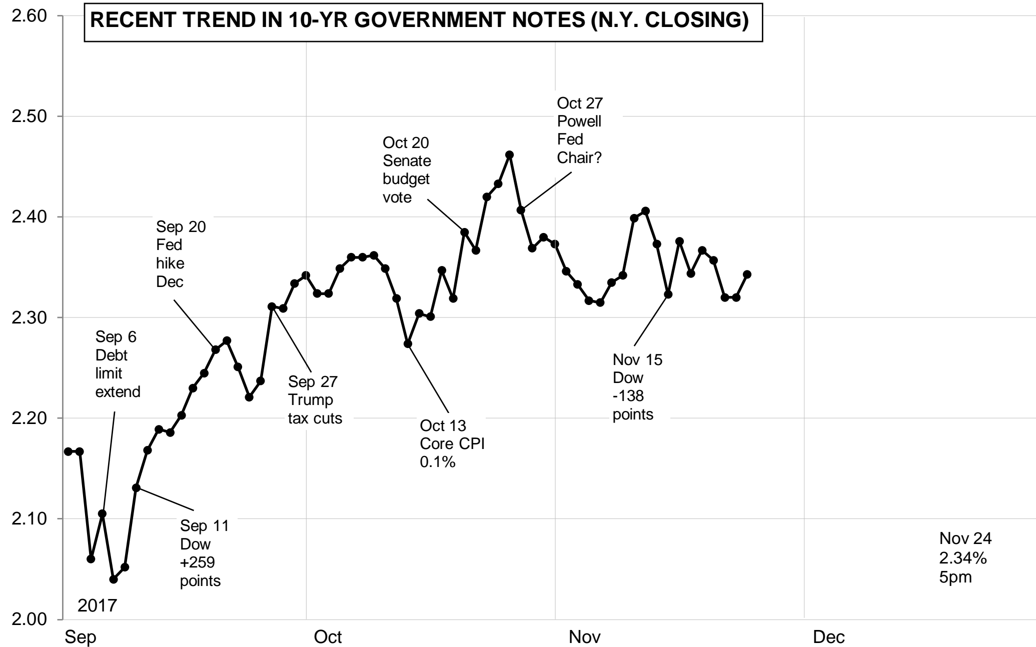
Assuming you made the maximum social security earnings base each year along the way, your first contribution of 4.05% on earnings of $9,000 in 1972 was $365. Your last contribution 45 years later in 2016 was 5.3% OASI tax on $118,500 of taxable earnings or $6,281 saved for your retirement. Add up all 45 years and you accumulated $147,428. Double that amount if you had convinced your employer kick in 5.3% like they do under the current social security plan.

Whether it is $147,428 or double that, $294,856, it isn't enough to match what social security will pay you at retirement in 2017 which is $2,687 per month… for life.

Social security would pay you $32,244 per year and if you had to pay that out of your own savings here, you would have exhausted that retirement money after 10 years. If you had been able to invest the money you contributed yourself, the table above shows a big difference between investment returns averaging 5% per year or 10% per year. With a 5% return in the table above (assumes 5.3% contributed by you and 5.3% from your employer), you would have $735,734 45 years later, and $2,364,713 if you had investment returns of 10%. It is intriguing to think if social security could be privatized, but doing so would distort private markets.

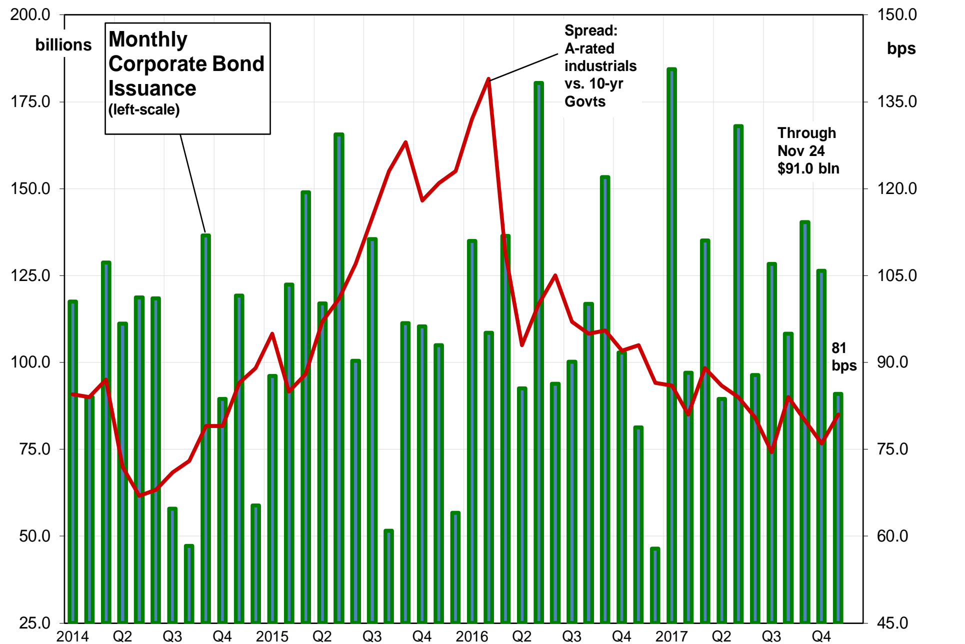
MARKETS OUTLOOK

	29-Sep 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
30-Yr Treasury	2.86	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10	4.20
10-Yr Note	2.33	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90	4.00
5-Yr Note	1.94	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70	3.90
2-Yr Note	1.48	1.60	1.85	2.10	2.40	2.60	2.85	3.10	3.35	3.35	3.60	3.85
3-month Libor	1.33	1.65	1.90	2.20	2.45	2.70	2.95	3.20	3.45	3.35	3.70	3.95
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	3.75
2s/10s spread	85	90	85	90	80	80	65	60	45	55	30	15



10-year Treasury yields close 2.34% this week and 2.34% last week. The strong German IFO index was a factor behind higher yields at 4am Friday morning. There was a big move down Wednesday on a quiet day from 2.37% to 2.32% during the NY session on durable goods orders down, the FOMC meeting minutes with inflation concerns, and general short-covering before the Thanksgiving holiday on Thursday. PCE inflation is Thursday, November 30.

CORPORATE BONDS: EXPRESS SCRIPTS, STARBUCKS, ROYAL CARIBBEAN



Corporate offerings were $7.1 billion in the November 24 week versus $46.2 billion in the November 17 week. On Monday, Express Scripts sold $1.4 billion 3s/5s/FRNs. It priced $500 million 3.05% 5-yrs (m-w +15bp) at 100 bps (Baa2/BBB+). The pharmacy benefits, managed care company will use the proceeds to repay a $400 million Term Loan, to partly fund its eviCore acquisition, and possibly for share repurchases. Corporate bonds (10-yr Industrials rated A2) were 81 bps above 10-yr Treasuries this week versus 82 bps last Friday.

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FEDERAL RESERVE POLICY

The Fed meets December 12-13 to consider its monetary policy. Fed funds rate futures odds of a rate hike to 1.5% are 92%; so the Fed is going.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	22-Nov	15-Nov	8-Nov	1-Nov	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2456.822	2456.641	2459.985	2459.827	479.782
Federal agency debt securities	4.391	6.757	6.757	6.757	0.000
Mortgage-backed securities	1778.683	1775.854	1770.630	1770.630	0.000
Primary credit (Discount Window)	0.010	0.003	0.004	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	
Maiden Lane (Bear)	1.710	1.710	1.712	1.712	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	0.035	0.037	0.040	62.000
Federal Reserve Assets	4497.5	4495.3	4505.4	4502.8	961.7
3-month Libor %	1.46	1.42	1.41	1.38	2.82
Factors draining reserves					
Currency in circulation	1598.883	1593.044	1591.737	1589.253	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	51.634	35.038	74.546	87.165	0.000
Reserve Balances (Net Liquidity)	2329.834	2357.806	2317.610	2281.472	24.964
Treasuries within 15 days	7.869	7.869	11.043	11.043	14.955
Treasuries 16 to 90 days	65.010	48.442	56.307	28.456	31.549
Treasuries 91 days to 1 year	335.542	352.103	317.797	345.643	69.272
Treasuries over 1-yr to 5 years	1117.078	1117.050	1111.537	1111.513	170.807
Treasuries over 5-yrs to 10 years	308.286	292.840	329.680	329.644	91.863
Treasuries over 10-years	623.038	638.336	633.622	633.529	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

Don't blink or you'll miss it: the great balance sheet unwind has begun. The Fed's Treasury security holdings dropped $8.9 billion from $2.465 trillion on October 25, 2017.

There have been some comments from members that, given the turnover at the top, the Yellen handoff to Powell, that now is an ideal time for the Fed to reexamine its core principles. Where did this come from? Yellen's away the mice will play? The Fed in Washington, the only place that counts, isn't even fully staffed yet even. Four more Fed governor appointees yet to come from Treasury Secretary Mnuchin, we mean President Trump's economics team. The committee votes for these principles in January each year. Bernanke made them vote on the statement of principles the first time in January 2012 when he launched his 2% inflation target.

When it comes to principles, we hope they don't mean they are thinking of raising the inflation target higher than 2% or something stupid like that. It was hard enough listening to Yellen say this week that by keeping rates lower than they should be right now (not that much lower, don't get your hopes up), that this setting on rates should allow inflation to move up to 2%. We don't view policy that way. If the Fed funds rate was over 3% there might be some greater risk of slowing the economy, but the current 1.25% Fed funds rate isn't helping inflation itself to move any higher, grow any faster. They over estimate their powers over inflation by simply moving around the Fed funds rate within this tiny range.

They made a policy mistake in cutting rates massively at the start of the recession. No one was going to borrow more to invest in the future and help spur economic growth when the sky was falling. They used up all their ammo by knocking down the Fed funds rate too quickly: down 300 bps from the peak to 2.25% after Bear Stearns in March 2008. The recession did not end for 15 months later, in June 2009, and they had nothing left. Not that it mattered, the economy recovered without them. They make another mistake by not having put the Fed funds rate back up in neutral already with the economy at full employment, and we don't mean their neutral of 2.75%. Inflation moves too slowly as an economic variable to guide monetary policy. Stick with the employment markets, and maybe economic growth, real GDP, if you think you must.

The debate currently is over the three rate hikes penciled in as Fed forecasts for 2018. Will they, or won't they? We saw a news headline that looked like "forget about it" when Yellen had a "conversation" led by former Bank of England head Mervyn King Tuesday night at NYU. Something about how it was

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"dangerous" to allow inflation to drift lower the headline read. Risks of inflation are two-sided, but obviously the current concern is too low inflation as the October 31-November 1 Fed meeting minutes released on Wednesday at 2pm relayed. (We were in at our desk, were you?)

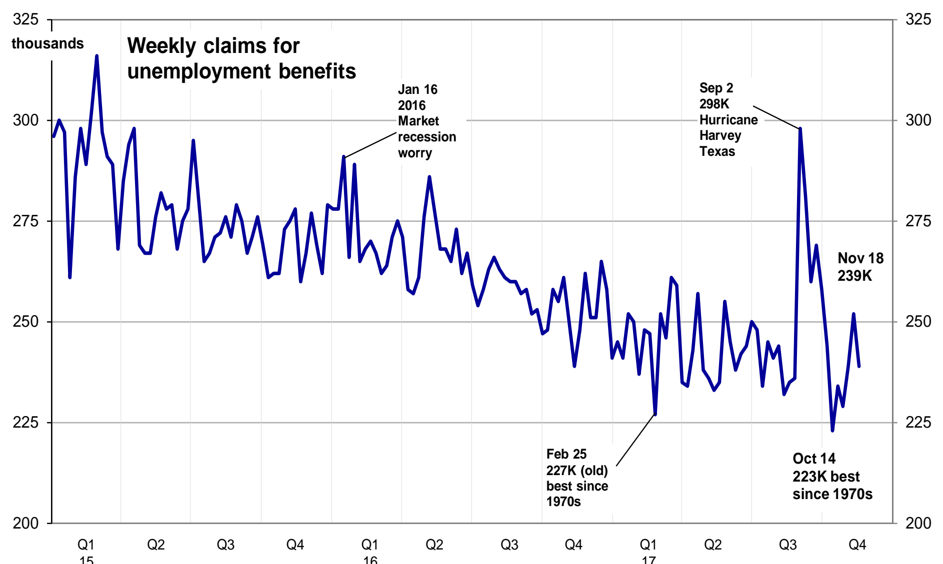
What's wrong with 1.5% inflation and not 2% she said? Well this is when she said it can be quite dangerous. One danger reason is because inflation expectations might drift down. That would be undesirable, the lower inflation is, then the lower interest rates are. And if they can't get interest rates back up then they won't have the tools to fight the next recession. So that's it. Nothing about middle America savers thrown under the bus. Low inflation means low rates means there is no Fed policy tool that works.

We don't find the "danger" argument over low inflation here very convincing. We don't find the 2.75% neutral Fed funds rate estimate credible either. Too low. We are not sure how a noneconomist Fed Chairman is going to make the case more convincing to the American people next February either. Stay tuned. Story developing. We recommend listening to the Yellen NYU meeting. It is hard to think of rates going above 2.75% listening to Yellen's new normal comment on rates early in the conversation. The mere idea of a 2.75% Fed funds rate maximum target yield is going to further cut bond market volatility next year. And it puts our happy economy 3% bond yield forecast at risk. While we wait for more inflation, we can always hope for some trillion-dollar budget deficits we guess, more supply higher yields maybe. Let's see what Congress does next week.

OTHER ECONOMIC NEWS THIS WEEK

Business capex orders and jobless claims falling down, falling down

Breaking economy news. Durable goods orders, our monthly proxy for business investment trends, and jobless claims. Jobless claims fell 13K back to 239K in the November 18 week after last week's Veterans' Day holiday boost on uncertain seasonals. The economy remains at full employment.



Durable goods orders fell 1.2% in October after rising 2.1% in August and 2.2% in September. Orders overall are getting pushed around by massive civilian aircraft orders which mirror the trend: 33.5% August, 33.9% in September, and now -18.6% today for October.

Nondefense capital goods orders ex-aircraft fell back 0.5% in October although from a higher revised level. These critical business capex orders fueling investment and growth rose 1.4% in August, 2.1%

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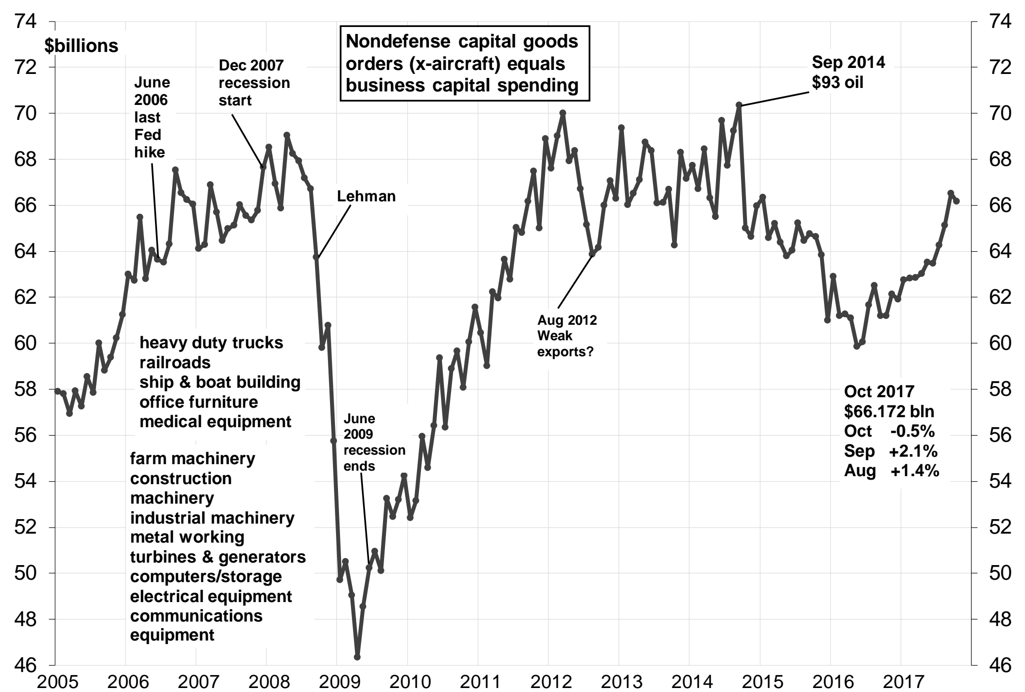
in September and now falling today 0.5% in October. Orders are down not out and companies just took a rest this month after orders rose steadily this year. The only down months for orders this entire year were in June, and now the drop today reported for October. It's nothing. A mere blip on the highway of investment bliss or something like that. The reality is that corporations have stepped up their purchases steadily this year doing their part to help make America great again.

Net, net, companies took their foot off the gas this month after ramping up their new orders for capital equipment the last several months. Trump administration officials are trying to light a torch under corporate executives by cutting their taxes in order to get companies to invest more in the economy and fuel the extra growth needed to pay for those tax cuts in coming years. It almost sounds like a Ponzi scheme cutting taxes today to bring in more taxes in the future.

Capex orders fell in October maybe signaling that companies are waiting for the final shoe to drop on if and when and under what terms they can fully write-off the purchase of new equipment. Maybe orders came off the recent pace as corporate executives wait for the final tax reform package to emerge from the labyrinth of committees and votes which is the U.S. Congress. It's coming, I'm telling you.

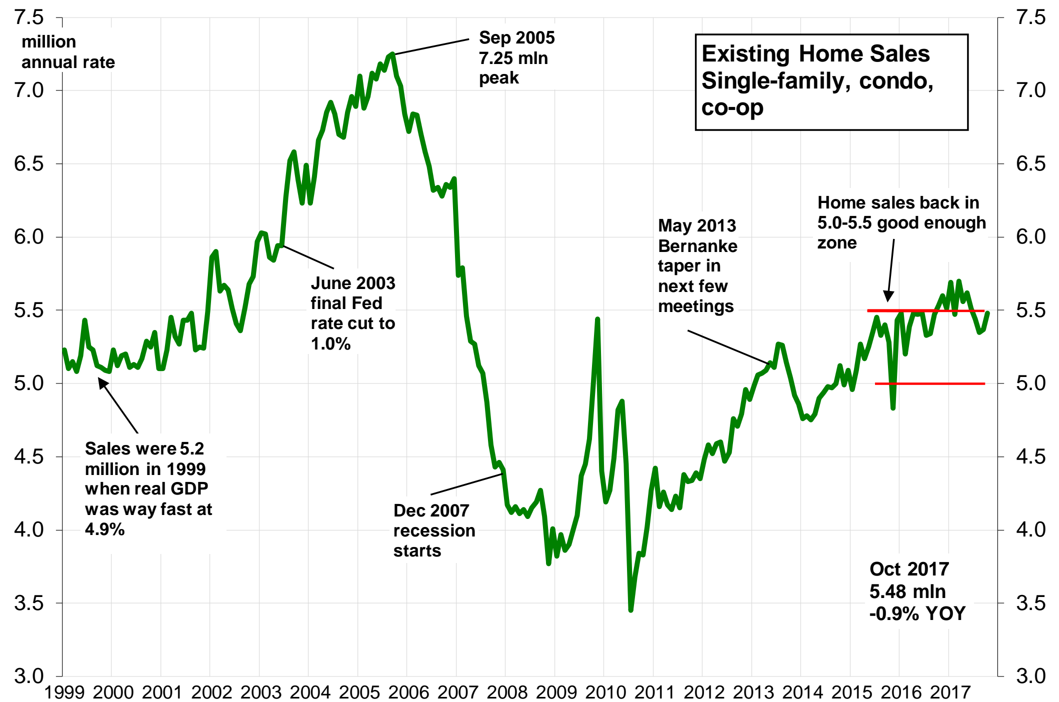


Fed policymakers will likely be impressed with the positive overall trend of business investment in equipment this year. Interest rates do not need to be left at such low levels if the goal is to further business investment. Business orders for key capital goods are up 4.4% the last year and remain a key driver of economic growth. The economy would not have made it to 3% GDP growth the last two quarters without business equipment investment adding 0.5 percentage points in each quarter turning a 2% ho-hum economy to a humming 3% strong growth economy that remains one of the key goals of the Trump administration.

We expect the Fed to continue to look past this small decline in business orders today and continue with its gradual and cautious pace of rate hikes with a 25 bps move to 1.5% expected at the final December meeting this year. The economy remains stronger than you think. Bet on it.

Existing home sales up 2% to 5.48 million-best since June

Breaking economy news. Existing home sales rebound from the hurricane storm-related slowdown in August and September. That's a 5.48 million annual rate of turnover in October which is 2.4% higher than the 5.35 million in August at the weakest point. Not that much of a slowdown really. Truth be told sales activity in the South hasn't recovered yet. It is sales in the West, the left coast, that is experiencing faster sales that is pulling up the national average. Maybe homebuyers out West are rushing to get ahead of the looming changes in the tax code which may limit the mortgage deduction and property tax deductions from taxable income. The new gold rush. Home prices out West are the highest in the nation at $375,100 versus $272,800 in the Northeast, $194,700 in the Midwest, and $214,900 in the South.



Net, net, the home resales market continues to churn at normal levels of activity close to 5.5 million at an annual rate in October. Americans are not trading homes like hotcakes like during the housing bubble a decade ago where sales turnover reached 7 million in late 2005 before the fall. Existing home sales are not too hot but they are just right enough to keep the economic expansion on track as these big-ticket purchases will light a fire under retail sales as home buyers spend more on furniture, appliances, big-screen TVs, lawn services and even helps Detroit move inventory off the lots as well with a shiny new car in the driveway. The Fed can continue to move rates up at a cautious and gradual pace confident that they won't slow the housing recovery.

The economy is moving along nicely right now, we just hope the tax cut plans are not too radical and end up scaring the consumer and make the purchase of a new home even less affordable after-taxes. Stay tuned. Story developing. Our accountants can't tell us what we will owe in taxes yet, and until they can figure it out, the outlook for housing is not completely one of clear skies and calms seas. Congressional changes to the tax code could yet throw a monkey wrench into the residential housing economy and really gum up the works when it comes to future growth.

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