Financial Market Weekly

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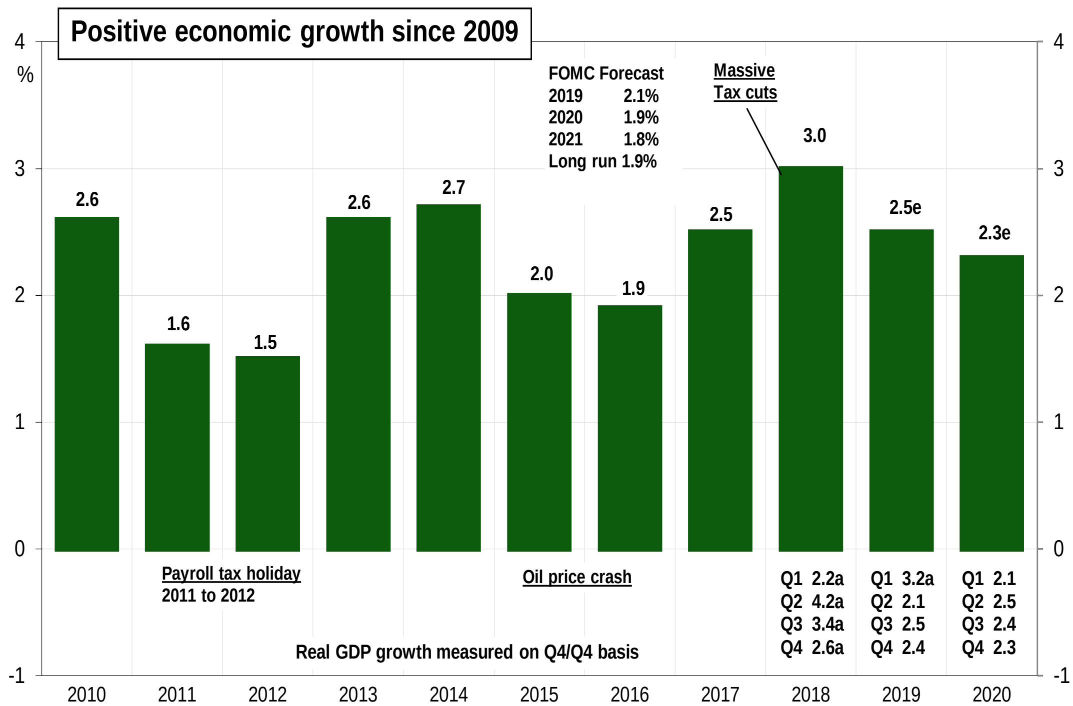
3.2% REAL GDP TO START THE YEAR OUT RIGHT. SOUNDS GOOD. IS IT REAL?



Real GDP growth hits 3.2% in the first quarter, so you can stop peddling those gloom and doom recession stories to the markets for now. The stock market never believed it anyway with the S&P 500 up 16.7% this year at last night's close. State & local government spending, the narrowing trade deficit, and greater inventories contributed about two-thirds of the growth today. However ephemeral or long-lasting you think today's figures for growth in the first quarter might be, keep in mind the first quarter growth forecasts were written-off as zero for a time, after retail sales and stock markets plummeted in December and the Federal government shutdown stretched into late January. Anyway, warts and all, 3.2% GDP growth is a long way from the zero-dividing line between an expanding and contracting economy. Embarrassingly so.

> Donald J. Trump 4-26-19 10:25AM EDT
> @realDonaldTrump
> Just out: Real GDP for First Quarter grew 3.2% at an annual rate. This is far above expectations or projections. Importantly, inflation VERY LOW. MAKE AMERICA GREAT AGAIN!

The economic expansion will set new records for longevity in July and it looks like there is no stopping this economy. Consumer spending was off the mark in the first quarter and the inventory pileup added 0.7 percentage points to growth, but next quarter the sides will reverse with consumer spending strengthening at the end of last quarter and inventories coming back down. Fed officials have mud in their eye for forecasting economic growth of just 1.9% in the years to come. The Trump administration is shooting too high with 3% sustainable economic growth as there's not enough labor to row the boat any faster with unemployment so low no matter how much red-tape regulations you take down. But Fed officials are underplaying just how fast growth can be. 1% growth is too slow as a forecast of what lies ahead for the economy, the Trump boast of 3% is too high, and a more realistic forecast is something with the number 2 in front of it. Even with two recessions in the decades of the 2000s, real economic growth still averaged 2.0%. Don't sell the economy short. Fed officials please stop scaring the public with your policy statements warning of "downside risks." There are no downside economic risks in today's GDP report, and this good news will be heard by markets around the world.

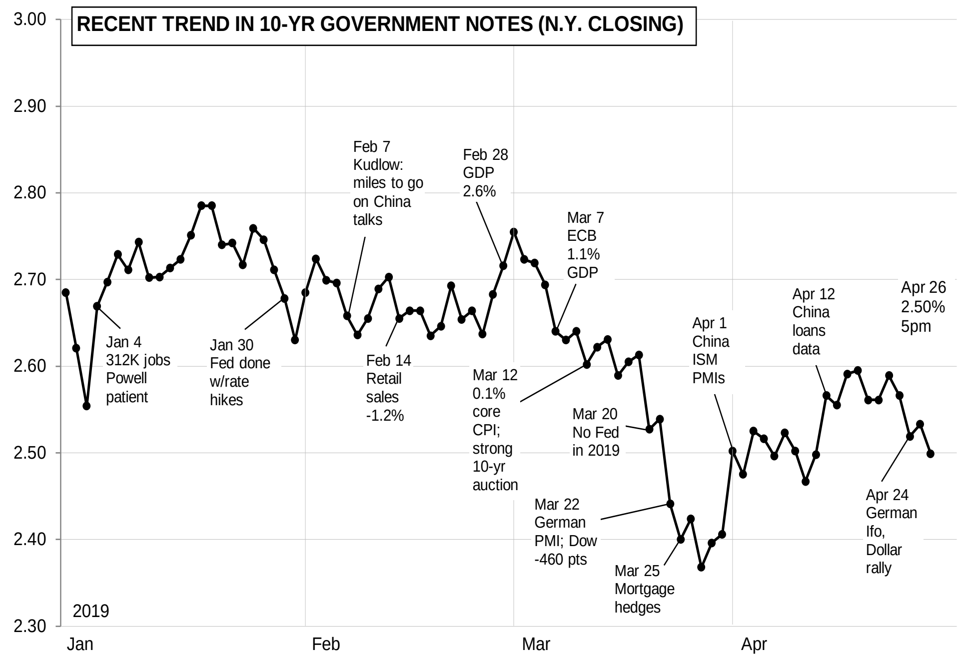
	Q3 17	Q4 17	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19p
REAL GDP	2.8	2.3	2.2	4.2	3.4	2.2	3.2
REAL CONSUMPTION	2.2	3.9	0.5	3.8	3.5	2.5	1.2
CONSUMPTION	1.5	2.6	0.4	2.6	2.4	1.7	0.8
Durables	0.5	0.9	-0.2	0.6	0.3	0.3	-0.4
Nondurables	0.3	0.6	0.0	0.6	0.6	0.3	0.2
Services	0.7	1.2	0.5	1.4	1.5	1.1	1.0
INVESTMENT	1.5	0.1	1.6	-0.1	2.5	0.7	0.9
Business Plant	-0.2	0.0	0.4	0.4	-0.1	-0.1	0.0
& Equipment and	0.6	0.6	0.5	0.3	0.2	0.4	0.0
Intellectual Property	0.1	0.0	0.6	0.5	0.3	0.5	0.4
Homes	0.0	0.4	-0.1	-0.1	-0.1	-0.2	-0.1
Inventories	1.0	-0.9	0.3	-1.2	2.3	0.1	0.7
EXPORTS	0.4	0.8	0.4	1.1	-0.6	0.2	0.5
IMPORTS	-0.4	-1.7	-0.5	0.1	-1.4	-0.3	0.6
GOVERNMENT	-0.2	0.4	0.3	0.4	0.4	-0.1	0.4
Federal defense	-0.1	0.1	0.1	0.2	0.2	0.2	0.2
Fed nondefense	0.0	0.2	0.1	0.0	0.0	-0.2	-0.2
State and local	-1.0	0.2	0.1	0.2	0.2	-0.1	0.4
Below line: Percentage point contributions to Q2 2019 3.2% real GDP							
Second estimate for Q1 is Thursday, May 30							

Net, net, the economy is flying miles above the recession level with output expanding 3.2% in the first quarter. We had all but given up on the first quarter with the Federal government shutdown ending January 25, frigid winter weather conditions shutting down manufacturing production, and the fears of a world growth slowdown. So far, the fears are unfounded with exported goods to America's trading partners adding 0.4 percentage points to the GDP growth's 3.2% bottom line this quarter. The economy's is better than you think. Bet on it. Oh, finally, 3.2% growth is it real, will it repeat beyond the first quarter? We forecast growth will slow to 2.5% this year after 3.0% in 2018, so the Trump administration economists will have to work harder for new growth initiatives and job creation policies from Washington.

$BLN Nominal GDP expenditures	Q4 15	YOY%	Q4 16	YOY%	Q4 17	YOY%	Q1 18	Q2 18	Q3 18	Q4 18	YOY%	Q1 19	SAAR
Equipment & Intellectual Property	1891.3	2.2	1908.0	0.9	2052.0	7.5	2105.3	2147.4	2176.4	2218.8	8.1	2244.9	4.8
EQUIPMENT	1113.7	0.9	1089.3	-2.2	1189.1	9.2	1212.6	1228.8	1243.0	1260.7	6.0	1263.2	0.8
Information processing equipment	357.4	2.8	358.8	0.4	393.7	9.7	401.9	410.2	415.8	409.8	4.1	407.1	-2.6
Computers	99.8	-3.7	100.1	0.3	109.7	9.6	116.9	121.0	120.3	115.0	4.8	115.2	0.7
Other processing equipment 1	257.5	5.4	258.6	0.4	284.0	9.8	285.0	289.1	295.5	294.8	3.8	291.9	-3.9
Industrial equipment	218.0	0.1	218.1	0.0	238.5	9.4	243.9	243.4	250.2	254.5	6.7	256.5	3.2
Transportation equipment	303.3	8.3	280.5	-7.5	290.4	3.5	300.7	303.5	302.9	312.6	7.6	319.6	9.3
Other equipment 2	235.0	-8.9	231.9	-1.3	266.4	14.9	266.1	271.7	274.1	283.9	6.6	280.0	-5.4
INTELLECTUAL PROPERTY	777.6	4.1	818.7	5.3	862.9	5.4	892.7	918.6	933.4	958.1	11.0	981.7	10.2
Software	311.7	3.3	335.4	7.6	355.9	6.1	370.3	381.6	389.0	395.6	11.2	407.4	12.5
Research & Development (R&D)	387.4	4.1	403.2	4.1	425.0	5.4	439.7	453.1	459.7	476.9	12.2	486.8	8.6
Entertainment, literary, artistic	78.5	7.5	80.0	1.9	82.0	2.5	82.7	83.8	84.8	85.6	4.4	87.5	9.2
1 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments													
2 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment													

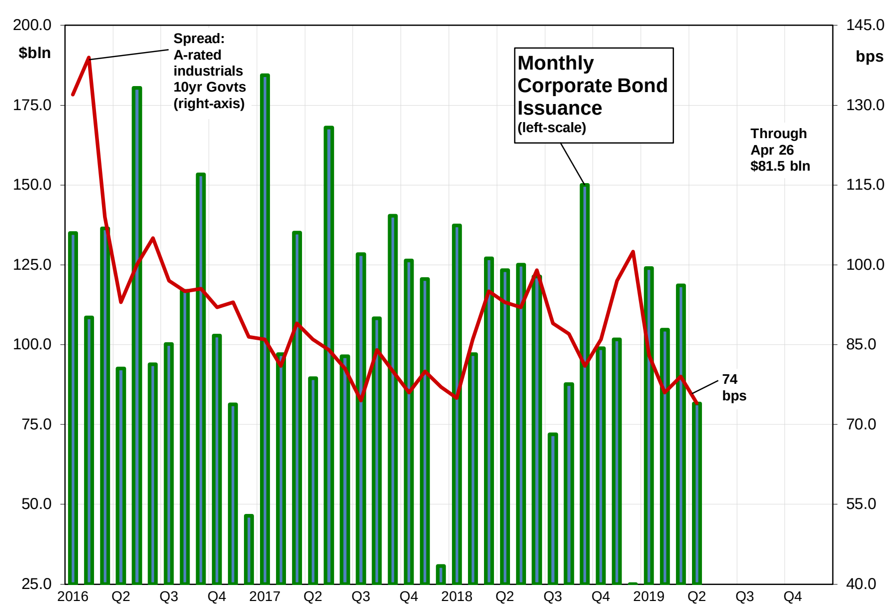
MARKETS OUTLOOK

	29-Mar 2018	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.81	3.00	3.00	3.10	3.10	3.25	3.20	3.20
10-Yr Note	2.41	2.60	2.70	2.90	2.90	3.10	3.10	3.10
5-Yr Note	2.23	2.45	2.60	2.80	2.80	3.05	3.05	3.05
2-Yr Note	2.26	2.45	2.50	2.70	2.70	2.90	2.95	3.00
3-month Libor	2.60	2.60	2.60	2.90	2.90	3.10	3.10	3.10
Fed Funds Rate	2.50	2.50	2.50	2.75	2.75	3.00	3.00	3.00
2s/10s spread	15	15	20	20	20	20	15	10



Bond market yields fell in two stages this week. The German Ifo business climate survey at 4am EDT Wednesday brought Bunds and Treasury yields down along with the dollar rally. Friday's GDP report saw yields rise from 2.52% to 2.54%, before traders or robots saw the 3.2% growth was boosted 1.7% percentage points by a narrowing trade deficit and higher inventories. The bond market stopped thinking at all by 9am EDT and just sat there at 2.50% for the remaining eight hours of trading on Friday. It was unclear what Wall Street fixed income traders discussed for the rest of the day. Next focus is Wednesday's Fed press conference. Will Powell give Trump his rate cuts? Stay tuned.

CORPORATES: ROGERS COMMUNICATIONS, BROOKFIELD PROPERTY, PENSKE

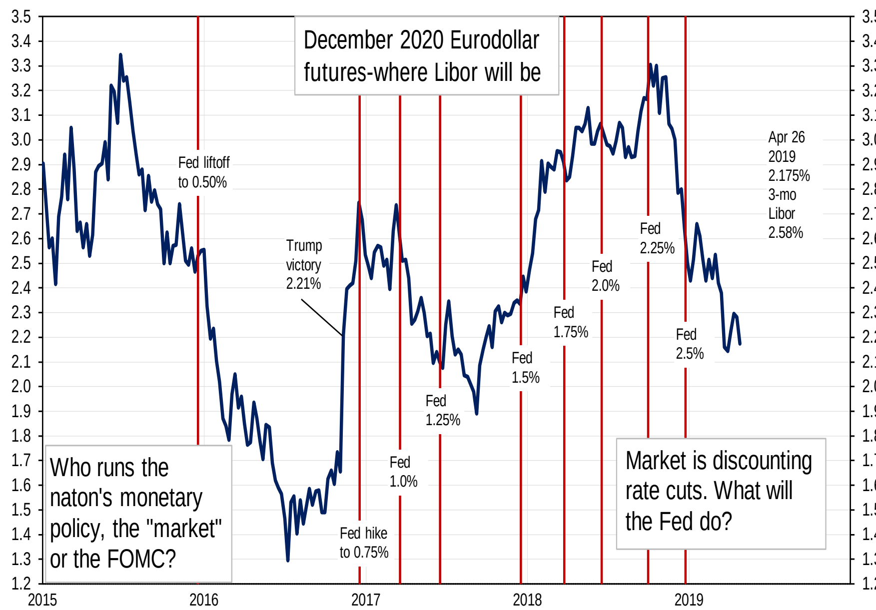


Corporate offerings were $10.3 billion in the April 26 week versus $21.9 billion in the April 19 week. On Tuesday, Kimberly-Clark priced a $700 million 3.2% 10-yr (m-w +10bp) at 65 bps (A2/A). The global health and hygiene company (Kleenex) will use the proceeds for general corporate purposes, including partial repayment of its commercial paper ($1.231 billion outstanding on March 31). Corporate bond yields (10-yr Industrials rated A2) were 74 bps above 10-yr Treasuries this week versus 76 bps last Friday.

FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	24-Apr	17-Apr	10-Apr	3-Apr	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2153.544	2153.409	2153.443	2153.308	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1583.393	1587.938	1592.912	1592.723	0.000
Primary credit (Discount Window)	0.014	0.005	0.010	0.003	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)	0.000	0.000	0.000	0.000	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	0.055	0.055	0.055	1.365	62.000
Federal Reserve Assets	3976.3	3979.7	3984.7	3983.2	961.7
3-month Libor %	2.59	2.59	2.60	2.60	2.82
Factors draining reserves					
Currency in circulation	1728.622	1728.061	1728.355	1727.490	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	9.515	0.015	56.676	0.016	0.000
Reserve Balances (Net Liquidity)	1472.812	1524.297	1646.560	1630.987	24.964
Treasuries within 15 days	31.746	31.746	0.180	0.180	14.955
Treasuries 16 to 90 days	82.182	82.182	111.741	111.741	31.549
Treasuries 91 days to 1 year	263.735	263.734	265.651	265.650	69.272
Treasuries over 1-yr to 5 years	908.702	908.683	908.927	908.908	170.807
Treasuries over 5-yrs to 10 years	262.007	249.260	249.207	249.157	91.863
Treasuries over 10-years	605.171	617.804	617.738	617.673	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

The Fed meets April 30 - May 1 to consider its monetary policy. The stock market (S&P 500) closed at all-time records not once, but twice, this week, ending Friday at a record level that is up 17.3% year to date. Yet we still have the fixed income market clamoring for a rate cut. Where did they get such a stupid idea? National Economic Council (NEC) head Kudlow said on Friday that even after a strong 3.2% real GDP report, he still thought the Fed should cut rates. He's talking for his boss of course, and then Kudlow went on to spin the need for rate cuts on the Fed's own metrics. They are missing on their inflation target so Kudlow said a rate cut could be coming at some point as he said because PCE inflation had fallen from 2.4% last July to 1.4% in January. Not sure how a Fed rate cut to 2.25 or 2.0 percent could lift inflation, but there you go. Not even sure why lifting inflation is so important, especially since it has declined with crude oil prices falling from $76 to $42 last year. Oil goes back up, inflation goes up. Bernanke originally said that inflation under the 2% target was a worry because it brought with it an increased risk of deflation, but that argument seems like a stretch. Fed officials shouldn't be warning about deflation, like we mean 1920s Great Depression deflation. Chicken Little stuff.



Anyway, if inflation is the key to policy, we get not one but two reports of monthly PCE inflation on Monday bright and early at 830am. February and March data combined. Cat's out of the bag though because Friday's Q1 GDP report includes PCE inflation for the first quarter which we can all agree includes the months January, February and March. PCE inflation still looks a little down low. Headline PCE inflation is 1.4% and the first quarter data are also 1.4%. Core PCE inflation in January is 1.8% and the first quarter data are 1.7%. Stay tuned. Story developing. Inflation is under target, how will Powell characterize inflation, how worried is he. We will find out at the Fed meeting press conference starting 230pm EDT Wednesday, May 1.

Odds of Rate Cuts Fed funds futures	
F4-26-2019	
28%	2.25% June
68%	2.25% September
104%	2.25% December
Odds at June, September, December Fed meetings	

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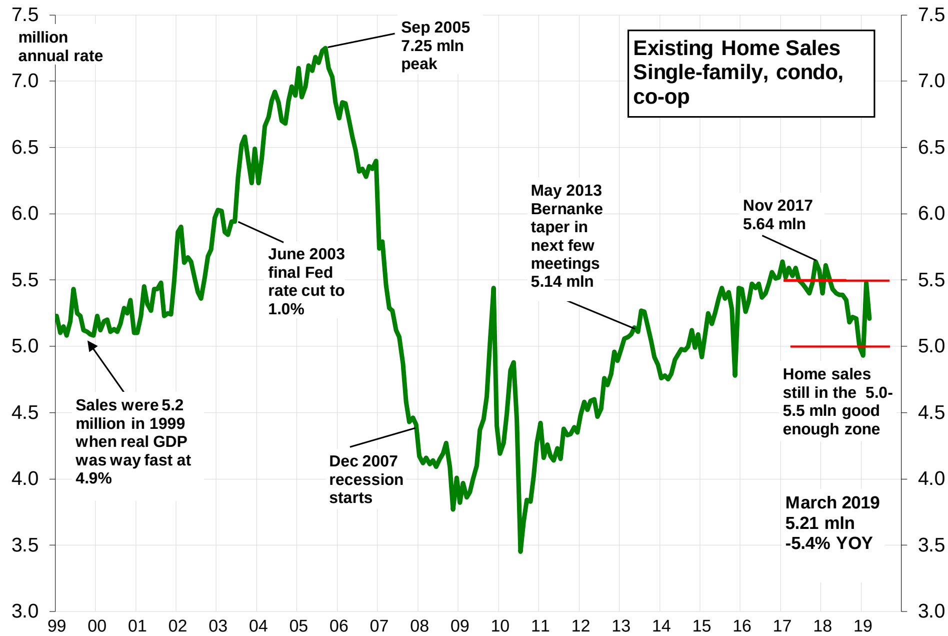
OTHER ECONOMIC NEWS THIS WEEK

Existing home sales show extreme volatility; January lows are holding (Monday)

Breaking economy news. Existing home sales. Up last month, down this month. Hard to discern the trend here, although sales activity is lower since the start of 2018 as the Fed's rate hikes started moving higher, pushing mortgage rates to 4.94% right before Thanksgiving. Mortgage yields have come back down sharply making it easier to finance the purchase of a home, but existing home sales activity remains somewhat depressed.



Existing home sales fell 4.9% in March to 5.21 million at an annual rate after jumping 11.2% to 5.48 million in February. Northeast sales are moving sideways, and sales in the Midwest and West completely reversed their big gain made in February. The biggest market in the South is 2.28 million or 43.8% of total sales nationwide of 5.21 million. Sales in the South fell to 2.28 million in March from 2.36 million in February, holding well above the lows made in January down at 2.08 million.

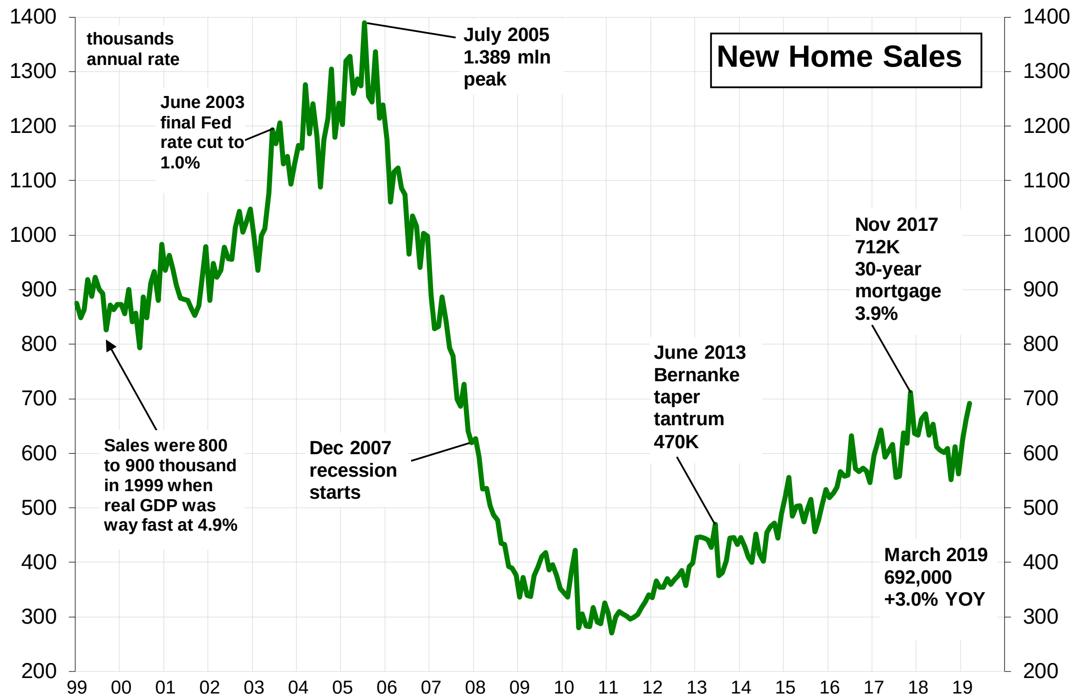
Net, net, consumer sentiment has improved this year, but consumers are not confident yet to rush out and buy more homes like they did at the start of 2018. But hang on, better days for sales are coming. Mortgage rates have swung lower to 4.17% last week, but it is early yet to see the effect of lower financing costs on home sales. Existing home sales data are based on when the sales contract has closed, which means the actual consumer purchase of a new home in March may have occurred in January or February. Our guess is that existing home sales are still being held down by the harsh winter weather conditions in much of the country at the start of the year.

Stay tuned. Story developing. The Fed has retreated to the sidelines and blown the whistle telling home buyers it’s safe to get back in the water with no more rate hikes later this year, but it could be a couple more months before we see home sales activity pick back up again. Our best guess remains that existing home sales hit rock-bottom at 4.93 million in January and should trend higher to 5.5 million normal levels of turnover in the months to come.

One thing is for certain and that is existing single-family home prices have nowhere to go but up with the peak of the summer selling season just a few months away in June. Prices are $261.1 thousand in March, and likely to go above last June's record level of $276.5 thousand in the next few months. Fed officials may think interest rates are high enough to slow the economy, but rates are certainly not high enough to stop the rise in increasingly unaffordable home prices. The housing bubble in prices just keeps expanding, and will continue to unless mortgage rates start moving higher.

New home sales respond to Fed engineered better financial conditions (Tuesday)

Breaking economic news. New home sales jump 4.5% in March to 692 thousand at an annual rate. This is the second best monthly sales level since the recession ended almost a decade ago and it shows homebuyers are back on their feet after retreating from the market late last year during the financial market turbulence and rising mortgage rates. Home buyers are highly certain it is time to buy a new home which says a lot about the economic outlook. Let the markets fool themselves about the chance of a recession, new home buyers simply don't see it. There are no downside economic risks if you look at a graph of new home sales. It is much easier to finance the purchase of a new home today with mortgage rates of 4.17% last week down sharply from the 4.94% peak in the November 15 week. Let the good times roll is what home buyers are saying. New home sales are responding well to the Fed policy seeking to bolster financial conditions.

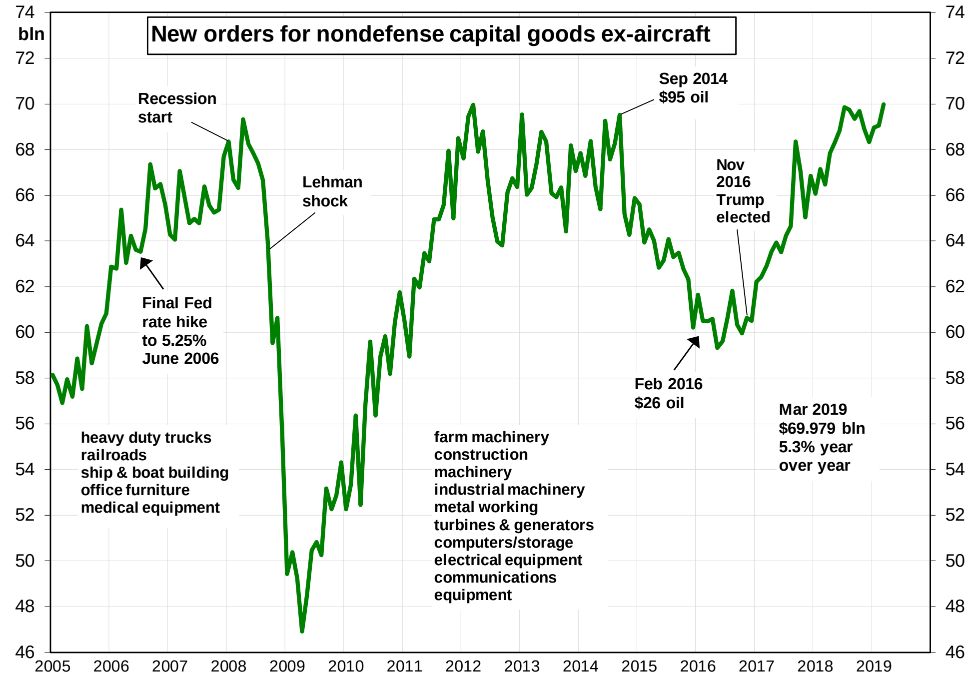


Sales fell in the Northeast but were up everywhere else. In March, the South had sales of 401 thousand, the West had 176 thousand in sales, the Midwest saw sales of 87 thousand, and the Northeast had sales of just 28 thousand, all at annual rates.

Net, net, it didn't take long for home buyers to return to the market after the Fed's signals that it was backing off its tighter policy earlier this year. Mortgage yields have plummeted and this along with the strong labor market with more jobs with better wages have led to a resurgence in consumer big-ticket purchases of a new home. Consumer spending was in a soft patch rut in the first quarter, but with new home sales soaring, we expect consumers to start buying more goods and services that need to be made with the purchase of a new home, including appliances, carpeting, furniture and possibly even a brand new car to put in the driveway.

First quarter GDP growth is likely to prove to be the low-water mark for economic growth this year, as the new home sales leading indicator is telling us that more growth is on the way. The Trump economics team forecast of 3% sustainable growth is probably too hot, and the Fed officials' forecast of 1.9% long term growth is probably too low. Why don't we just pencil in some meet me in the middle forecasts of 2.5% growth this year. The economy is looking up. No recession. The stock market looks cheap. Bet on it.

Business orders hit records, job layoffs technical in Good Friday week (Thursday)



Breaking economy news. Weekly jobless claims and durable goods orders. Business orders for nondefense capital goods ex-aircraft are surging at the end of the first quarter, rising 1.3% in March to record highs. $70.0 billion more long-lived equipment was ordered up in March, the fastest one-month rise in history. Companies don't invest in the future if they think the economy is close to falling over a cliff. Fed officials are worried about world economic growth, and trade frictions, but company executives see nothing to hold them back. Uncertainty kills business investment, and right now, companies don't see the uncertainty that Fed officials do. The stock market is at record highs and so too is business investment which tells you just how positive the economic outlook is this year. The fears and concerns from the stock market turbulence and Federal government shutdown late last year have faded.

Orders for communications equipment leaped 9.0% in March, and motor vehicles and parts jumped 2.1%, although this latter category is not included in the nondefense capital goods tally of orders. There is not a lot of detail in the durable goods report for capital goods. More detail must wait for the factory orders economic report which is released on May 2. The only fly in the ointment in today's economic reports is the 37K jump in jobless claims to 230K in the April 20 week. Because the seasonal factors have found it hard to adjust for the Good Friday holiday some years, we expect this rise is just technical for now.

Net, net, there is more wind in the economy's sails than Federal Reserve officials thought with business investment in new equipment jumping in March. It was a strong finish to the first quarter with companies investing more in long-lived capital equipment and showing just how durable they think this economic expansion is. The economy will break a record for growth this summer if the optimistic outlook of companies is to be believed. Business does not invest in the future if they think the skies are darkening with the threat of recession.

Business investment in capital goods equipment just hit all-time record highs which doesn't exactly look like the downbeat outlook that Fed officials are afraid of. The storm clouds of recession remain off shore for now with companies' orders surging to levels never seen before. Company CEOs may have feared recession in surveys taken at the start of the year, but those concerns have faded as businesses bring on new equipment to meet the demand for their goods and services they provide their customers. Today's what me worry, positive economic report on business investment puts the market's worries of recession to rest for now. Things are better than you think. Bet on it. No recession. No rate cuts. Federal Reserve, are you listening? For gosh sakes. Follow your conscience, not the President's tweets. Rate cuts aren't needed to spur business investment in the economy that's for sure.

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