Financial Market Weekly

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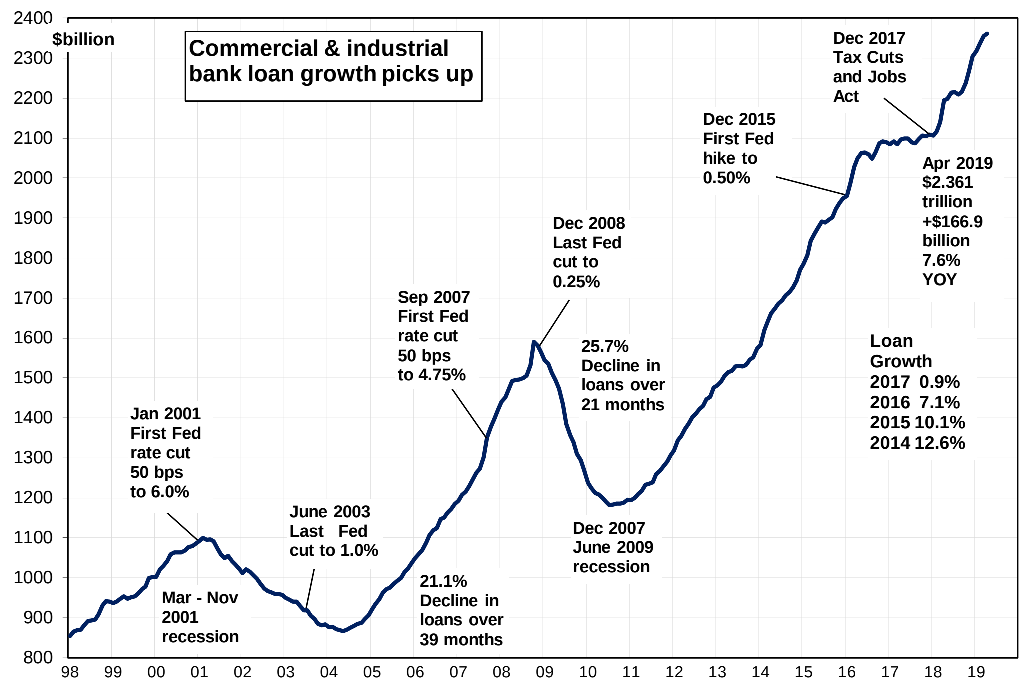
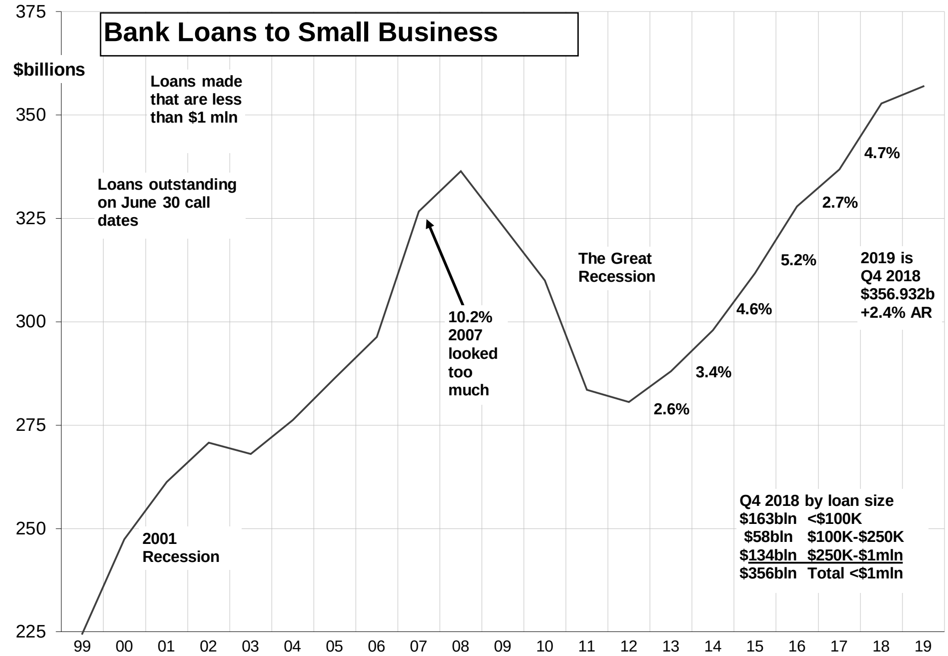
PLENTY OF CREDIT FOR THE ECONOMY IN ADDITION TO THE TAX CUTS AND JOBS ACT GIVEAWAY



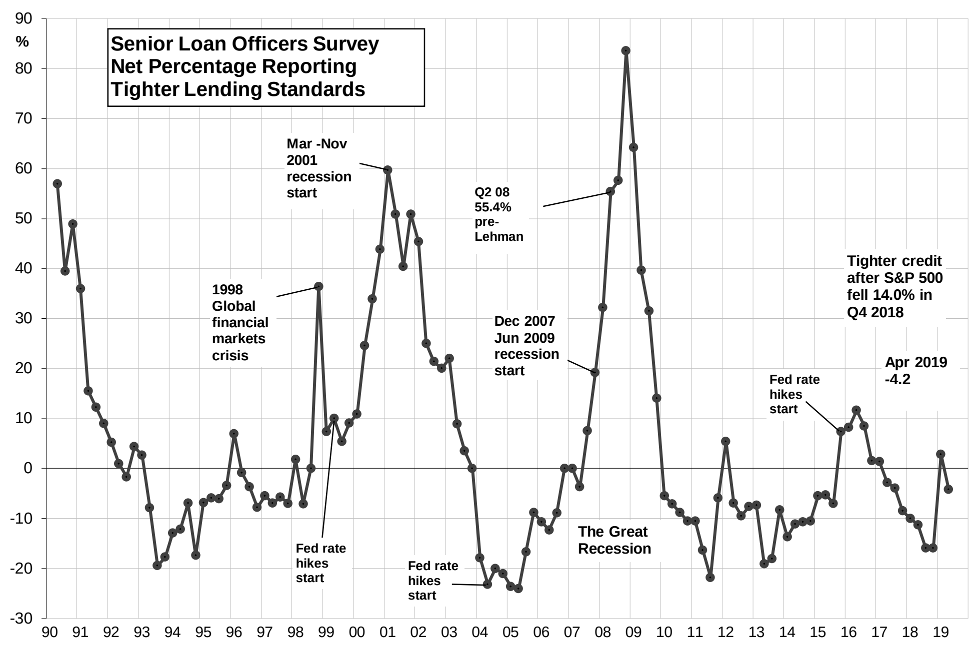
Seems like there is plenty of money out there sloshing around in the economy. If credit is the life blood of the economy, then banks seem to be providing enough of it. Commercial & Industrial bank (C&I) loans are rising 7.6% the last year to $2.361 trillion in April 2019. In reviewing the past, the last two times the Fed cut interest rates, banks were still increasing their loans to businesses. You would think Fed officials might wait to cut interest rates till the time when companies had stopped demanding credit, in order to make stock buybacks, we mean in order to make the capital expenditure investments in the economy that generates growth. The Fed cut interest rates when no one cared is what it looks like in hindsight. Companies were not going to borrow any more from banks than they were already doing when the Fed slashed interest rates the last two cycles in 2001 and then 2007. Btw- There will be an interest rate cycle going forward,

FDIC Banks and S&Ls	2018	2008	1998
Number	5,406	8,451	10,713
Employees	2.067	2.203	1.842
Deposits	13.866	8.572	4.209
5,406 banks in Dec 2018, 2.067 million employees, $13.866 trillion in deposits			

won't there? Anyway, in addition to the Tax Cuts and Jobs Act money given out in December 2017, bank loans outstanding here are up $253.4 billion or 12.0%. When will the money stop.



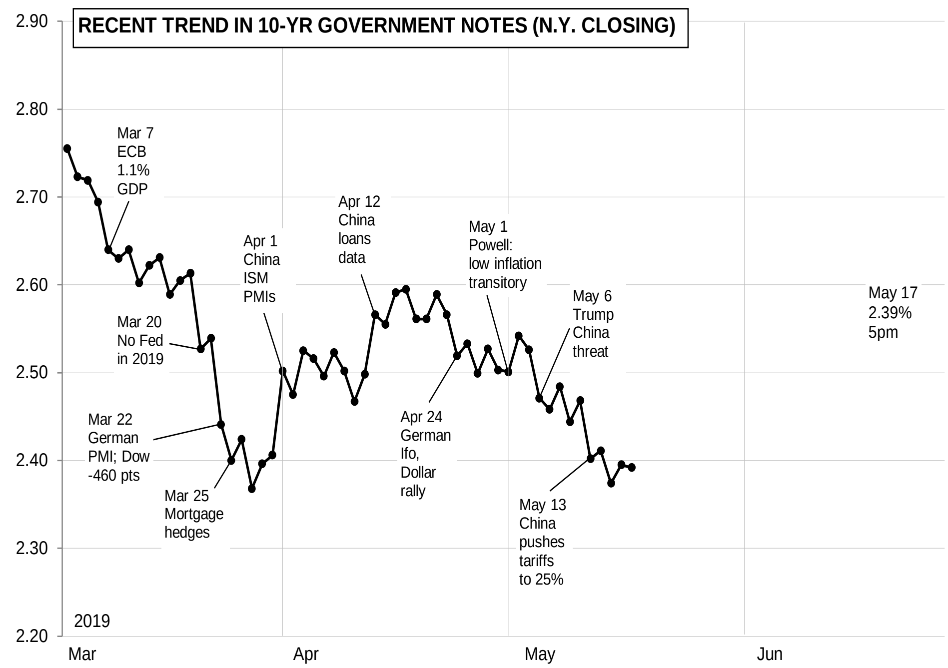
And small business owners are also on the receiving end. Halfway through the June 30, 2019 year, small business loans less than $1 million are up 2.4% at an annual rate to $356.9 billion Since the Tax Cuts and Jobs Act in Q4 2017, small business loans less than $100 thousand are up from $156.6 billion to $163.8 billion in Q4 2018; loans $100K to $250K are up from $55.3 billion to $58.2 billion; and loans $250K to $1 million have increased from $130.6 billion to $134.9 billion.



The quarterly Senior Loan Officer Survey on Bank Lending practices this month covered 73 large domestic banks and 21 U.S. branches and agencies of foreign banks. The April 2019 survey was released on May 6 and finds credit standards were little changed, and C&I loans terms were easier. Loan terms were eased for large and middle-market companies. The graph here on the net percentage reporting tighter lending standards at large and medium firms has been moving around recently. Standards were tightening in late 2015 when the oil crash hurt many firms in manufacturing and of course energy production. The net percentage eased to -15.3 in the second half of 2018 before the volatility in stocks, China trade war and growth concerns, and Federal government shutdown sent the net percentage to +2.8, and now it is stabilizing with a reading of -4.2 in April 2019. There was a special question on C&I loans to companies with exposure to developments in Asia and Europe, and a number of large banks (13/28) said their loans to such firms were over 10 percent of their loan book. Only 3 out of 25 large banks expected the loan quality on these to "deteriorate somewhat," the rest looked for little change in Europe/Asia loans quality.

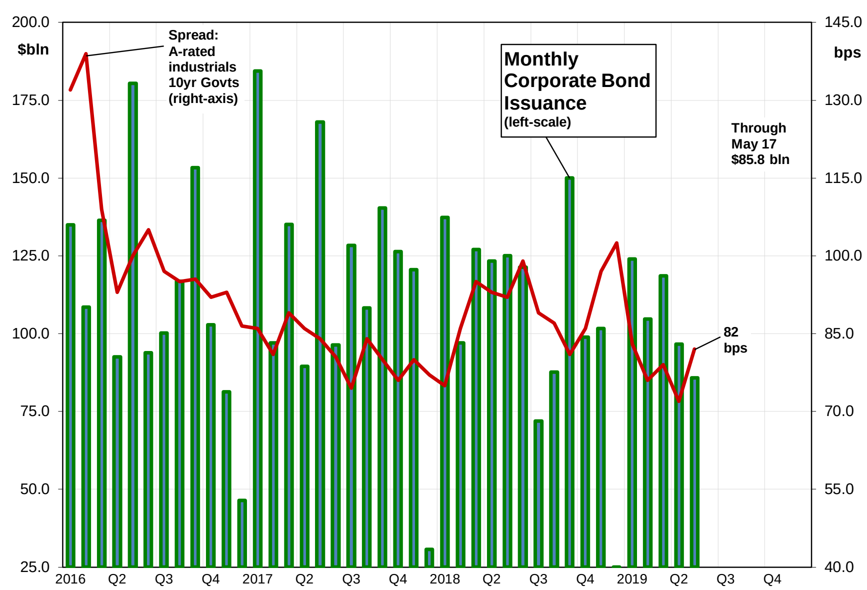
MARKETS OUTLOOK

	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



10-yr yields closed 8 bps lower this week at 2.39%. The technical charts-based rally continues. Bond yields have fallen the last two Mondays on US-China trade news and stock market rout to start the week and tended to stay at the new low yield for the rest of the week. Last Monday it was Trump tariffs on China going to 25% and this Monday it was China retaliating by raising tariffs on US goods to 25%. Stocks rallied back from Monday's 617 point loss erasing it completely at one point on both Thursday and then again Friday, but bond yields did not recover much and were unable to close above 2.40%. The old yield low as a target for the uptrend is 2.34% on March 28.

CORPORATES: WASTE MANAGEMENT, AMEX, DOW, CATERPILLAR, RYDER



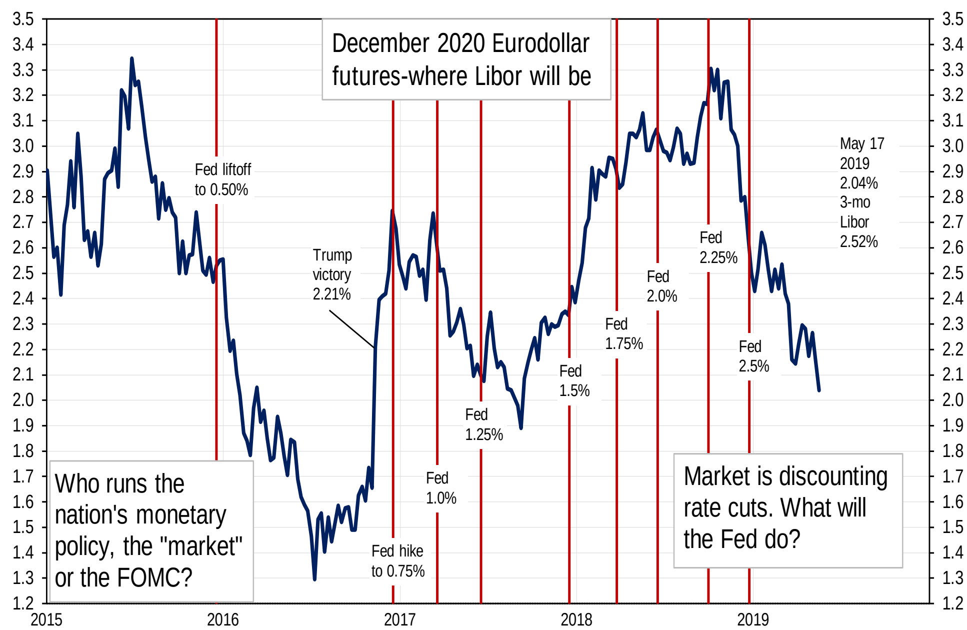
Corporate offerings were $30.2 billion in the May 17 week versus $47.5 billion in the May 10 week. On Thursday, Discovery Communications sold $1.5 billion 10s/30s. It priced a $750 million 4.125% 10-yr (m-w +30bp) at 175 bps (Baa3/BBB-). The company operates educational TV channels and will use the proceeds to redeem 2.75% notes due November 2019 and 5.05% notes due June 2020. Corporate bond yields (10-yr Industrials rated A2) were 82 bps above 10-yr Treasuries this week versus 79 bps last Friday.

FEDERAL RESERVE POLICY

The Fed meets June 18-19 to consider its monetary policy. Not a lot going on. Market still waiting for the president to kick the Fed into making some rate cuts. Cuts from the lofty heights of 2.5% which doesn't sound very restrictive. Market odds of one 25 bps rate cut to 2.25% by the December Fed meeting are 118% versus 92% last week. The economy seems fine. The stock market doesn't think the trade war sanctions and tariffs and quotas are going to lead to a recession. Dow industrials are down 3.5% from April 2019's record high. The US and China aren't talking which doesn't seem to matter and the hearing on putting 25% tariffs on the rest of the incoming China imports isn't until June 17.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	15-May	8-May	1-May	24-Apr	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2114.444	2124.129	2123.954	2153.544	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1569.584	1575.433	1575.433	1583.393	0.000
Primary credit (Discount Window)	0.022	0.030	0.000	0.014	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	0.050	0.055	0.055	0.055	62.000
Federal Reserve Assets	3912.7	3940.2	3937.4	3976.3	961.7
3-month Libor %	2.53	2.55	2.58	2.59	2.82
Factors draining reserves					
Currency in circulation	1732.314	1733.109	1730.760	1728.622	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	0.562	0.021	0.027	9.515	0.000
Reserve Balances (Net Liquidity)	1516.418	1490.680	1460.010	1472.812	24.964
Treasuries within 15 days	0.000	38.475	38.475	31.746	14.955
Treasuries 16 to 90 days	63.117	63.116	43.808	82.182	31.549
Treasuries 91 days to 1 year	255.980	255.978	275.285	263.735	69.272
Treasuries over 1-yr to 5 years	917.215	902.527	902.502	908.702	170.807
Treasuries over 5-yrs to 10 years	257.102	258.739	258.659	262.007	91.863
Treasuries over 10-years	621.030	605.292	605.225	605.171	101.337

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



There were more stops on the "Fed Listens" tour around the country hosted at regional Federal Reserve offices. We don't like what we are hearing as it doesn't look like much change in interest rates is coming. Even the mere talk of allowing inflation to run above 2% seems to put a lid on tighter Fed policy which seeks to slow the economy. The median for neutral rates is only a baby-step higher at 2.75%, even if the main cluster of neutral votes is 6 for 2.5%, 4 for 2.75% and 4 for 3.0%. Dallas Fed President Kaplan said rates were at neutral now and the Fed should move to the sidelines. Fed Vice Chair Clarida said low interest rates could be with us for years. New York Fed President Williams says the fact of lower neutral rates requires new policy approaches. He has been saying for a long time now that low interest rates are a "global phenomenon driven by demographic trends and what economists call the global savings glut or heightened demand for safe assets." The direction on rates? On the one hand, you have a hawk like Kanas City Fed President George saying she doesn't see the argument for a rate cut now, but we aren't sure she would favor a rate hike above "2.75% neutral" if as she says it is acceptable for inflation to have 50 bps deviations around the 2.0% inflation goal. On the other hand, you have a dove like Minneapolis Fed President Kashkari saying there is a cost to shifting their policy positions around and he is not in favor of an insurance-style, "just in case" rate cut and is not sure a rate cut would do much to bolster inflation expectations. It's going to be a long hot summer while we wait to see the effect on the economy from full-strength 25% tariffs on $500 billion China imports that would act as a $125 billion tax hike. Stay tuned. Story developing slowly.

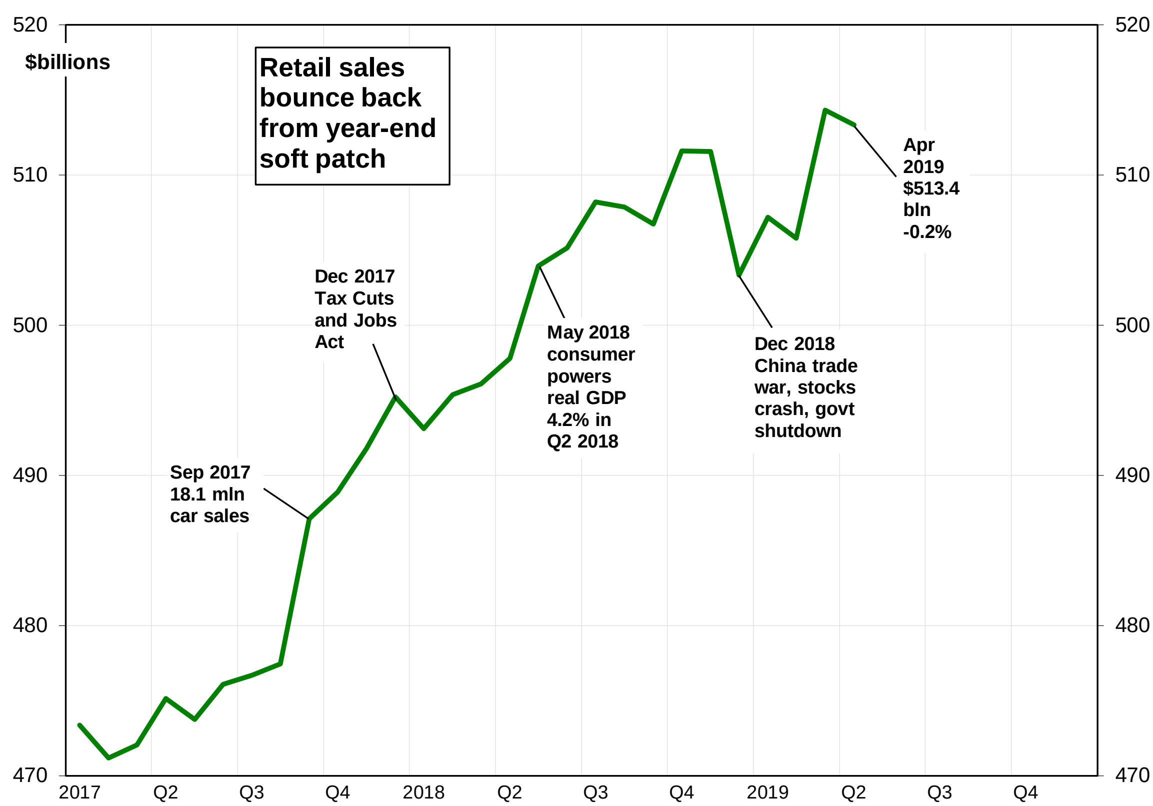
OTHER ECONOMIC NEWS THIS WEEK

Consumers on strike, spend nothing to start the second quarter (Wednesday)

Breaking economy news. Retail sales turn down 0.2% in April following that huge gain of 1.7% in February after the Federal government shutdown ended. The stock market doesn't like the news apparently as Dow stock futures were down 111 points at the 830am news release time and are now down 180 points 15 minutes later. Lots of news headlines going on however with the US saying China badly wants a deal and China saying it is foolish to try to change the nation's state-owned enterprises business model. The 3-month T-bill to bonds yield spread has inverted again forecasting a recession as well with bond yields falling at the start of the European trading session.

Net, net, consumers need to pick up the pace or the economic outlook is going to start to dim later on this year. We expect consumers are just taking a break in April after that huge rebound in retail sales in March. Unfortunately, the trade war escalation and tumbling stocks in May do not suggest that retail sales will be over the top and the weather was cooler than seasonal as well which will postpone those summer-time sales in next month's report.

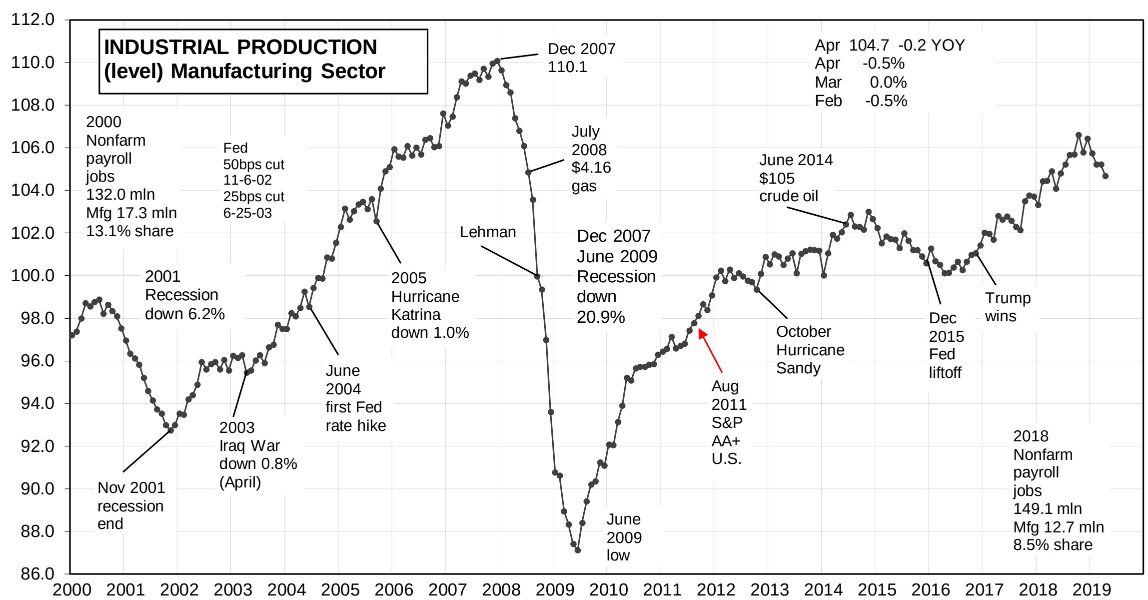
It's a good thing that retail spending has good momentum coming into the second quarter. Retail sales are up 3.4% so far in the second quarter after a tepid gain of 0.2% in the first quarter. Consumers are two-thirds of the economy so if they aren't happy then no one is happy. The economy is still likely to set new records for growth this July, but it is going to limp over the finish line if consumers don't restart their engines and return to the shops and malls. Stay tuned. Story developing.



Wrong time to pick a trade war, now production is falling in April (Wednesday)

Breaking economy news. Industrial production fell sharply in April and has declined in three of the last four months. It looks like factory production is singing the trade war uncertainty blues this month as a lot of the goods built in American factories are sent overseas. Factories are dimming the lights and their exports may be suffering the consequences of America's trade war with the world. The tariff fight swings both ways and right now the US cannot claim to be a winner with industrial production sputtering. The economic data are unexpectedly weak in April which is starting to make us nervous about the economic outlook later on this year. It looks like the trade war chickens are coming home to roost where bad economic policy has a blowback on actual economic growth and output.

Net, net, this looks to be the wrong time for the Trump administration to pick a trade fight because the underlying strength of the economy looks to be fading at the start of the second quarter. With factory output down sharply in April and the consumer staying at home, there is no way the economy this quarter can match the 3.2% GDP growth at the start of the year. The Trump administration may be touting the best economy in history, but that premise needs to be sharply questioned after today's one-two punch of weaker retail spending and factory production reports. Stay tuned. Story developing badly for the economy. The tea leaves are not as rosy in April and with cool weather and a trade war and stock market sell-off in May, the second quarter is going to slow sharply. The White House is going to up the pressure on the Federal Reserve to cut interest rates to help keep this economy afloat. Bet on it.



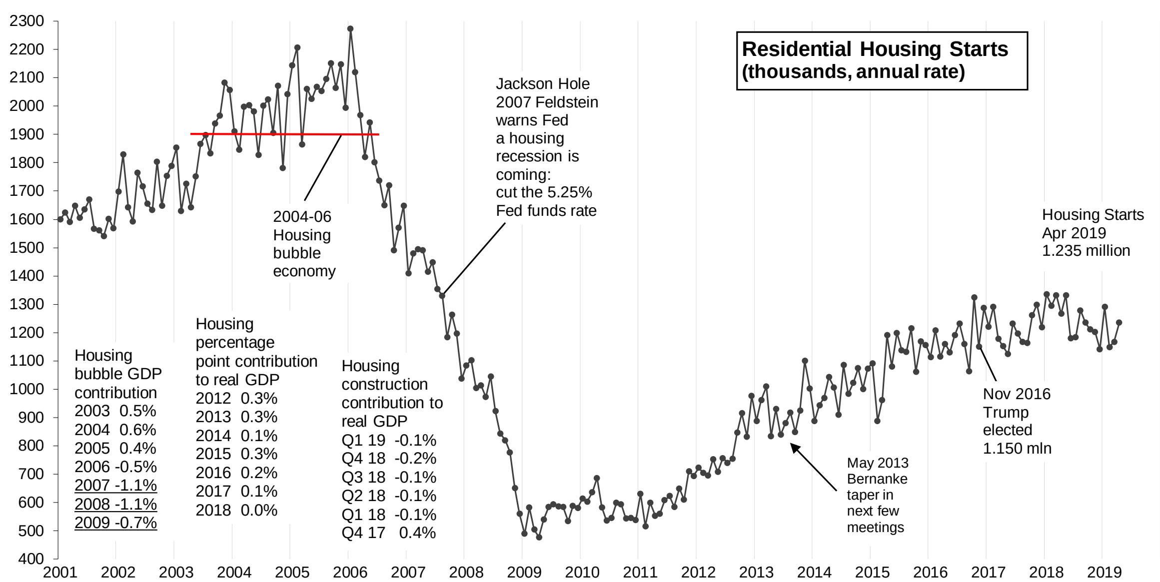
America's building homes and everyone has a job... for now (Thursday)

Breaking economy news. Housing starts and weekly jobless claims. Weekly jobless claims fell back to 212K in the May 11 week so the escalation in the US-China trade war is not leading companies to trim their headcounts. Meanwhile, residential housing construction is better than expected at 1.235 million housing starts in April which is 8.4% higher than 1.139 million in March after accounting for revisions as well.

Single family home construction rose 6.2% to 854 thousand in April with the only weak spot being the 5.6% decline in the biggest region down South to 440 thousand. Single family homes rose 29.6% to 70 thousand in the Northeast, 37.9% to 120 thousand in the Midwest, and 13.7% to 224 thousand in the West.

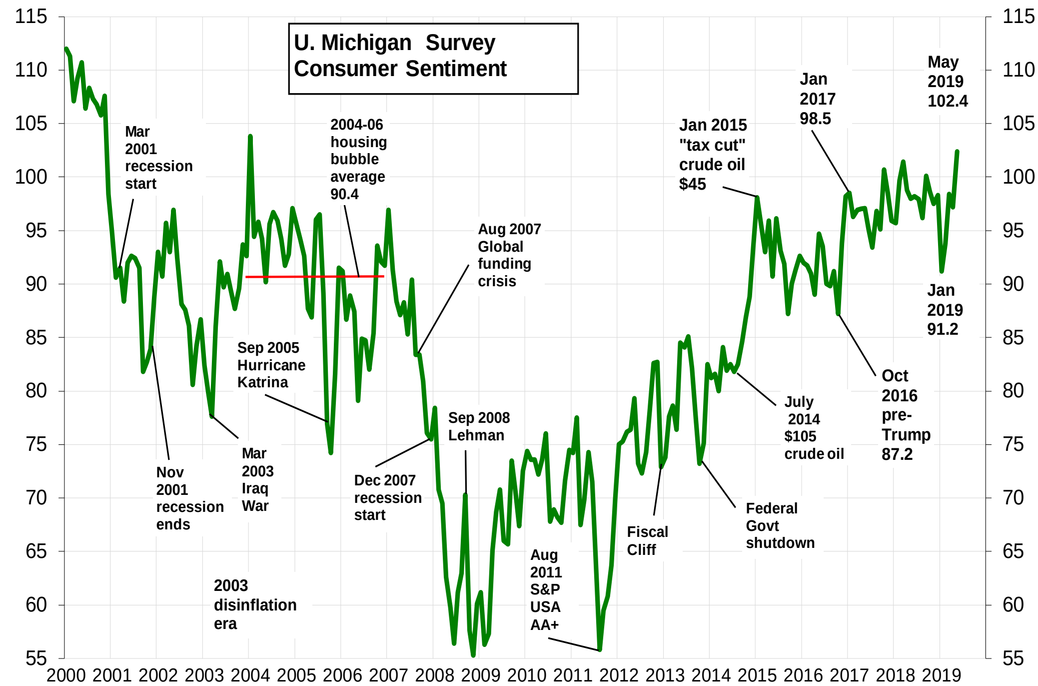
Net, net, today's data provide a ray of sunshine for the economy giving the markets hope that this long economic expansion from the recession can still make it to the ten-year finish line next month. Workers have jobs and home builders are constructing more places for them to live. Both jobless claims and residential housing construction are leading indicators so the favorable reading today bodes well for the 2019 economic outlook. The escalation in the trade war between the US and China has not thrown the economy off course yet.

The market sees an increasing risk of recession this year and has discounted a couple of interest rate cuts, but so far, the economic picture is not darkening enough to get the Federal Reserve to jump in from the sidelines. Jobless claims and housing starts both say the economy is in a good place right now and there is no need for policy officials to spring into action. Mortgage rates have already tumbled since last year and are helping to improve the outlook for the housing sector. Housing construction remains depressed still from the housing bubble highs in the mid-2000s, and has not contributed to economic growth the last five quarters, but at least home construction rose in April and home building may add to economic growth in the second half of 2019.



Consumer has lost it: thinks the outlook is the greatest in history (Friday)

Breaking economy news. Trade war, what trade war is what the consumer is saying. The Michigan survey of consumer sentiment is the highest yet in this ten-year economic expansion from the recession of 2007-09. In January during the Federal government shutdown (yeah, remember that?) consumer sentiment tumbled 7.1 points to the 91.2 low for 2019. Today consumer sentiment jumped 5.2 points to 102.4 which is the highest since the president was elected. Sentiment was 87.2 back in October 2016 before the presidential election (yeah, remember that?). If it's the economy stupid for the 2020 elections, the Trump economics team must be jumping for joy. Those on the team who are still young enough to jump in the air. The consumer may not be smart enough to know they got a tax cut, but they sure are happy. Even the Fed is going to be happy as the public's 5 to 10 year inflation expectations are moving up with the tariffs we would guess, moving up to 2.6% in May from 2.3% in April. Who says inflation is dead?



Consumers certainly weren't worried by the trade war, we mean the winner-take-all, all out economic war for domination with China that sent Dow industrials down 5.5% from the April 2019 record high. Half of consumers don't own stock anyway, and plenty of the other half who own stock hold their company's stock or have the money stashed out of sight in a 401K and barely know how much is in there. Let stocks fall 5.5%, we don't care consumers are telling us.

We can't keep getting positive economic readings like this and think the economy is doomed with recession around the corner and the Federal Reserve needing to cut interest rates a few times. There are no storm clouds of recession out there on the horizon. The outlook is sunny not gray is what the consumer is saying.

The fact that retail sales down 0.2% in April, as reported this week, appears to be a great big head fake on the economy's direction because consumers are bursting with confidence and it looks like their spending at the shops and malls is going to take the economy over the finish line in July making this the longest expansion of the economy in history. Consumers aren't depressed and staying at home and not spending. The government's figures are just plain wrong, just look at Walmart's out of the ball park sales in the quarter ending in April. The economy is better than you think. Bet on it.

Analyst Certification

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