Financial Market Weekly

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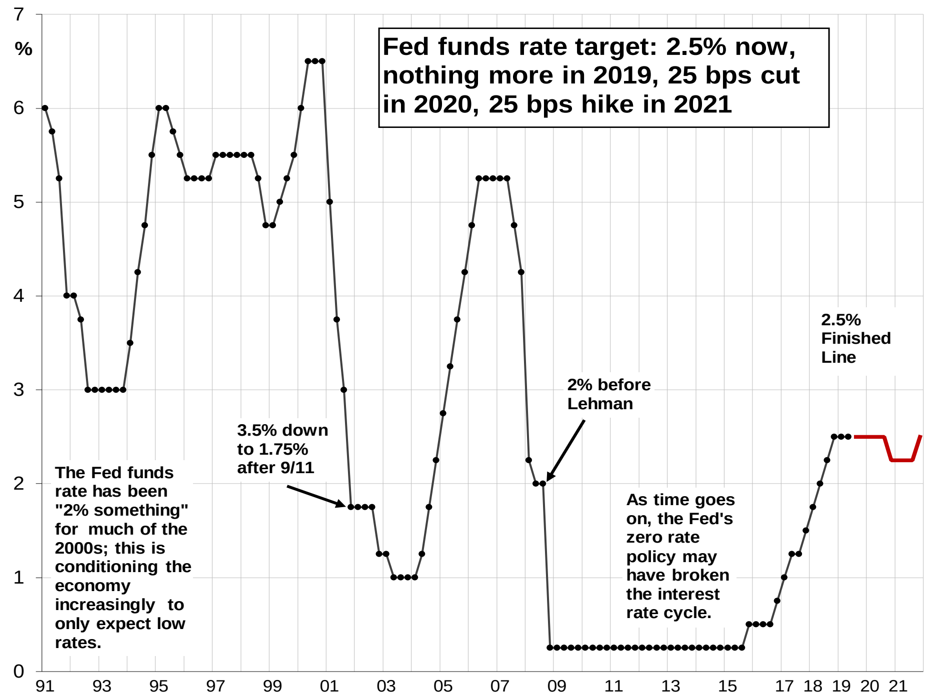
MANY FED VOTES SWING TO RATE CUTS, BUT MEDIAN STILL UNCH AT 2.5% THIS YEAR

We are starting to warm up to the Powell non-economist era at the Fed if it lasts, given the sound & fury tweets out of the White House. Press conferences with fewer words are growing on us. His explanation of how the dots forecasts of interest rates are nothing the Fed votes on as far as policy is rational as a lawyer-by-training can make them, but the market, irrational as it is, insists on trading on them. Maybe the market is right though as Powell said even those who wrote down flat-dots agreed the time for rate cuts was growing closer. Strengthening the case. Oh boy. Better duck, once they start swinging the axe every tree in the rates forest is coming down.



Here are our initial thoughts on this week's Fed meeting written after the release of the forecasts and press statement at 2pm New York time.

Powell opening statement
Though some participants wrote down policy cuts and others did not, our deliberations made clear that a number of those who wrote down a flat rate path agree that the case for additional accommodation has strengthened since our May meeting.

Fed Individual Forecasts				
Fed funds rate by year-end				Longer run
Votes	2019 End	2020 End	2021 End	
1	1.875	1.875	1.875	2.375
2	1.875	1.875	1.875	2.500
3	1.875	1.875	1.875	2.500
4	1.875	1.875	1.875	2.500
5	1.875	1.875	1.875	2.500
6	1.875	1.875	2.125	2.500
7	1.875	1.875	2.125	2.500
8	2.125	2.125	2.375	2.500
9	2.375	2.125	2.375	2.500
10	2.375	2.375	2.375	2.750
11	2.375	2.375	2.375	2.750
12	2.375	2.375	2.375	2.750
13	2.375	2.375	2.625	3.000
14	2.375	2.375	2.625	3.000
15	2.375	2.625	2.625	3.250
16	2.375	2.625	2.875	3.250
17	2.625	3.125	3.125	
Median	2.375	2.125	2.375	2.500
Meeting	June 19	June 19	June 19	June 19

The Fed isn't there yet on the rate cuts as the rising uncertainty hasn't harmed the economic outlook yet. Economic growth has not gone off the rails from the escalation in the China trade war with new tariffs in early May. This may be one of the longest wind-ups to a first-strike Fed rate cut in history. Powell's on the mound, but hasn't thrown one pitch yet. We'll see if the president doesn't yet take him out of the game for failing to remove one or two of those bridge too far rate hikes last year.

Taking the scissors out to the press release and getting rid of the word "patient" is big, just not as big as the market may have wanted. If you are no longer patient, you are getting ready to act, but "when" is the key word that could have been better defined. Coming into this meeting today, the market was looking for an unprecedented amount of easing, with two rate cuts discounted by the September meeting, and three rate cuts by December. Four rate cuts are discounted by the end of 2020 and we can't remember when any other Fed leadership allowed the market to go so far with their rate cut fever. Fed officials must like that they can have their cake and eat it too. They get the market discounting four rate cuts and mortgage rates tumbling 100 basis points which packs quite a punch of monetary stimulus without Fed officials needing to lift a finger and pull the trigger on cutting rates even once. The stock market seems to like it anyway with stock prices holding the highs of the rally in recent days.

Fed statement June 19 2019
The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes, but uncertainties about this outlook have increased. In light of these uncertainties and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent objective.

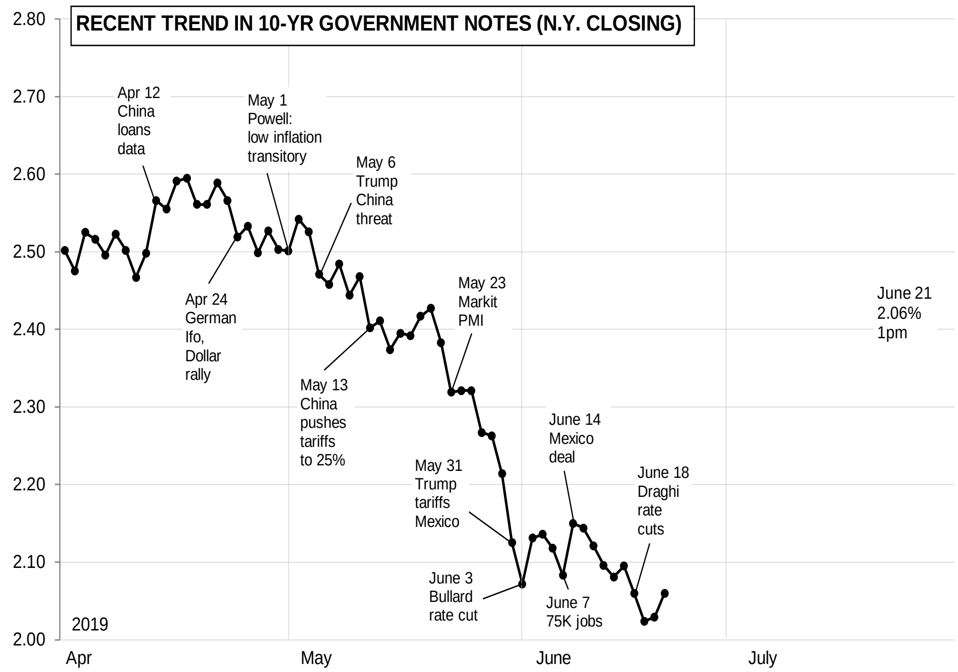
Fed statement May 1 2019
The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes. In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes.

The Fed's forecasts for interest rates have gone haywire. They had just one more rate hike in 2020 to 2.75%, and now they have penciled in one rate cut to 2.25% next year, and then get this, one rate hike in 2021. The real news is what happens this year where 11 votes were for unchanged rates this year and 6 wanted a rate hike at the March meeting. Now 7 see two rate cuts this year, 1 sees one rate cut, 8 see no change in rates and 1 sees a rate hike in 2019. It looks like the committee is a couple votes short on the need to cut rates today, but that could change by the time of the Fed's next decision date on July 31 depending on incoming data.

MARKETS OUTLOOK

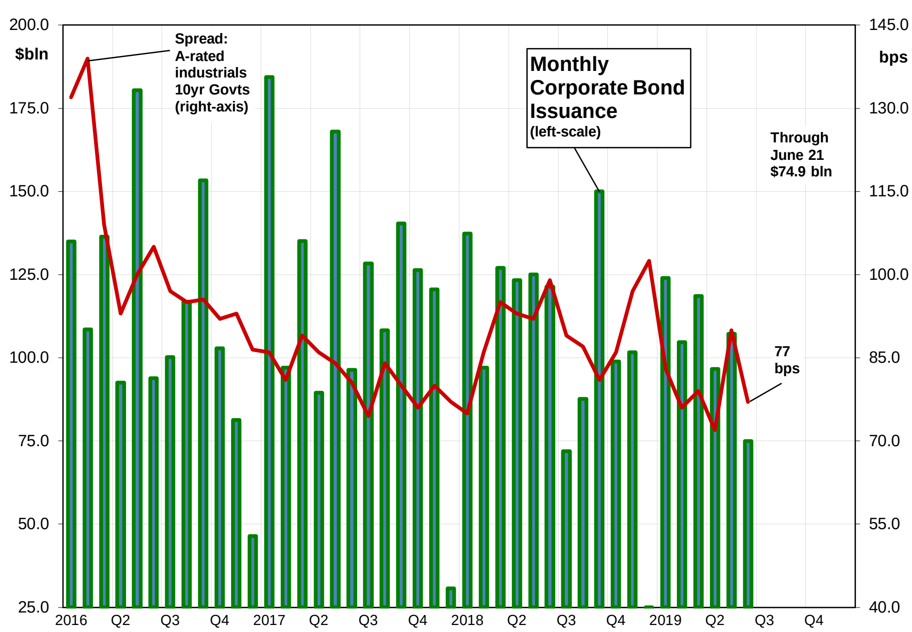
	29-Mar 2019	21-Jun 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.81	2.58	2.25	2.30	2.40	2.50	2.50	2.70
10-Yr Note	2.41	2.06	1.75	1.80	2.00	2.10	2.20	2.40
5-Yr Note	2.23	1.80	1.50	1.55	1.80	1.90	2.00	2.20
2-Yr Note	2.26	1.78	1.50	1.60	1.70	1.80	2.00	2.20
3-month Libor	2.60	2.35	2.00	2.00	2.00	2.00	2.00	2.00
Fed Funds Rate	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00
2s/10s spread	15	28	25	20	30	30	20	20

Well the 10-year Treasury yield is highly dependent on the Fed funds rate outlook in this day and age, when the bond market can no longer think for itself, and it isn't great that the Fed moved "normal" rates down to 2.5% in June from 2.75% in March. Powell has implied no rate hike without 2%-plus inflation, so 2.5% may be the limit for a Treasury bond sell-off for a while. If the Fed actually cuts rates this year like 8 of the 17 votes said this week, then 10-yr yields can trade 25-50 bps below that… waiting for more. The market always wants more. Europe and Japan here we come. We have suspended the next two rate hikes we had forecast for now and are eagerly awaiting the resolution of the Fed's uncertainties to the outlook to see if they spring into action on July 31. Boing.



CORPORATE BONDS: HYUNDAI CAPITAL, CABOT CORP, WISCONSIN P&L

Corporate offerings were $13.0 billion in the June 21 week versus $34.1 billion in the June 14 week. On Thursday, HCP Inc. sold $1.3 billion 7s/10s. It priced a $650 million 3.5% 10-yr (m-w +25bp) at 155 bps (Baa1/BBB+). The healthcare real estate investment trust (REIT) will use the proceeds to fund the repurchase of portions of its 4% 2022 notes and 4.25% 2023 notes. Corporate bond yields (10-yr Industrials rated A2) were 77 bps above 10-yr Treasuries Thursday versus 86 bps last Friday.



OTHER ECONOMIC NEWS THIS WEEK

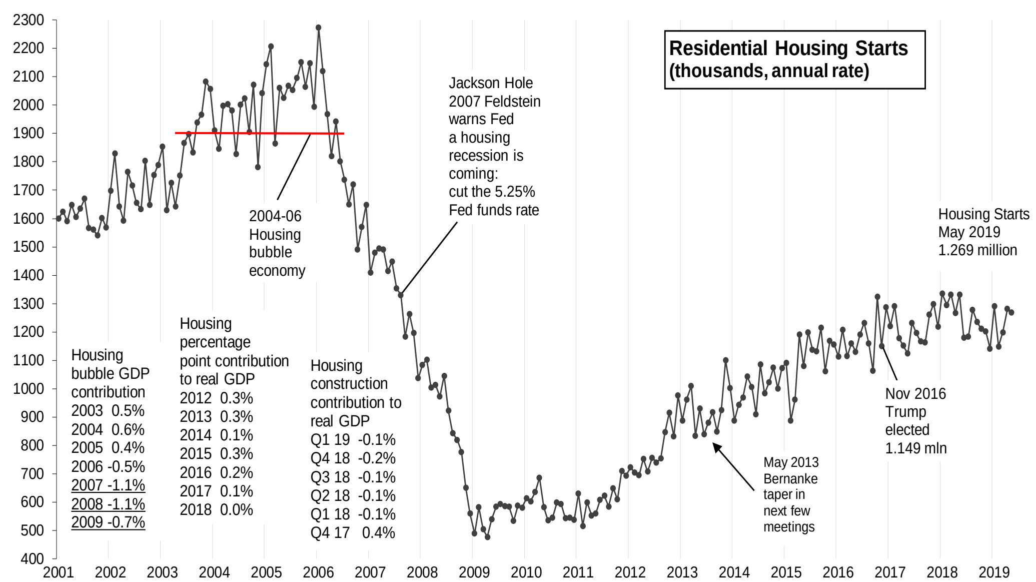
Extra, Extra, Read All About It. Housing starts are down in May (Tuesday)

We are glad to take some time out to write about housing starts this morning. The sky is falling with bond rates collapsing all over the world, Draghi is threatening rate cuts, Trump is threatening Draghi's monetary stimulus which weakens its currency and is thus unfair to the United States. You couldn't have ever imagined this morning's headlines just two or three years ago. French bond yields just went to zero this morning. How long can Wall Street just sit here and think their whole way of living is not about to change dramatically. You won't need as many sales and trading robots on the desks in Manhattan if Powell pushes rates here to zero.

Housing starts fell 0.9% in May to 1.269 million at an annual rate, but from a higher revised level of 1.281 million in April (was 1.235 million). Housing starts averaged 1.249 million in 2018, the best recovery level since the recession. Today's data of 1.269 million in May is off the lows at the turn of the year during the Federal government shutdown. Realistically, residential construction doesn't have far to fall in any Trump trade war recession because building never really got up to speed after ten years of economic growth.

Net, net, housing starts are not too hot and not too cold, and if you were waiting for more construction to deal with the nation's growing housing shortage, you are going to have a longer wait. Real construction activity will add little if anything to real GDP growth in the second quarter after subtracting 0.1 or 0.2 percentage points from growth in every quarter looking back as far as Q1 2018. Economists continue to puzzle why the 1 percentage point drop in mortgage yields since last November has not engendered more activity from homebuilders. Stay tuned. Story developing.

Housing starts have been one of those canary in a coal mine leading economic indicators of many recessions in years past, but it looks like it won't be this time around with construction never fully having recovered from the Great Recession. One thing is for certain, residential housing construction does not require rate cuts from the Federal Reserve to jumpstart the economy. Mortgage financing is cheap so no need for the Fed to step in to help this interest-sensitive sector of the economy.

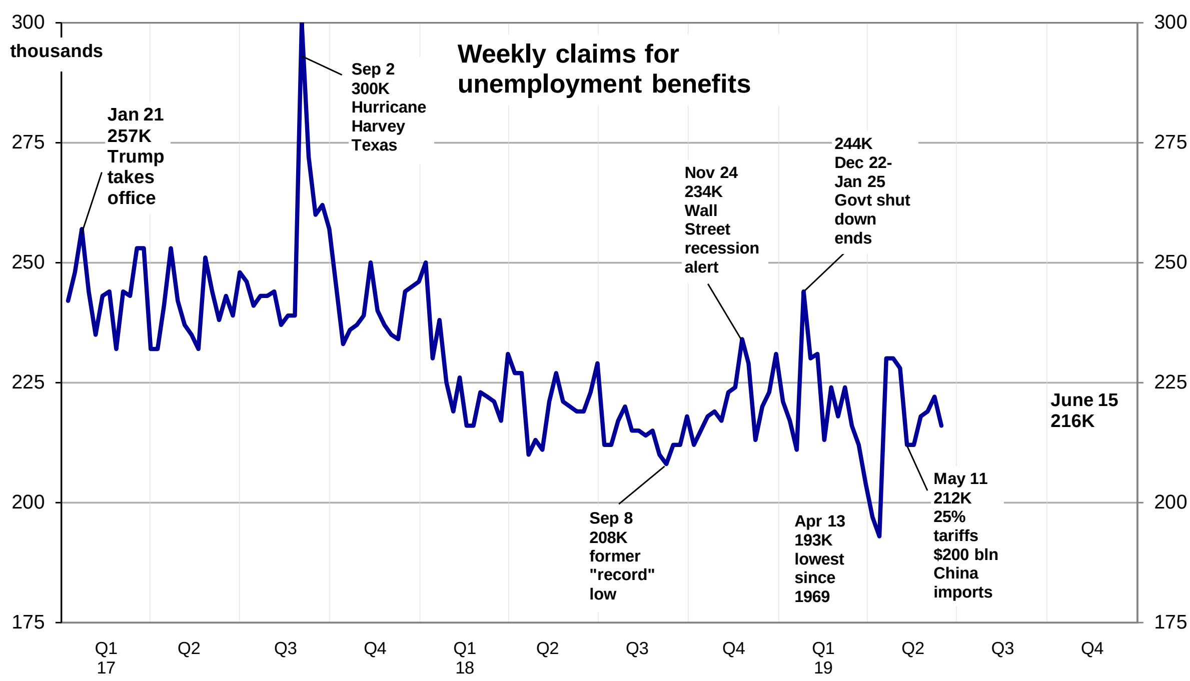


Jobless claims don't make the case for a Powell rate cut yet (Thursday)

Breaking economy news. Initial filings for unemployment benefits fell 6 thousand to 216 thousand in the June 15 week. No recession yet thank goodness. You didn't really want those Fed rate cuts that only come when the economy is on fire and in danger of burning to the ground, did you? Surely not. We are on a recession watch after the escalation in the trade war from the US side with tariffs on those $200 billion of China imports going from a manageable 10% to a catastrophic 25% on May 10, but nothing bad has happened yet with jobless claims still low at 216K this week.

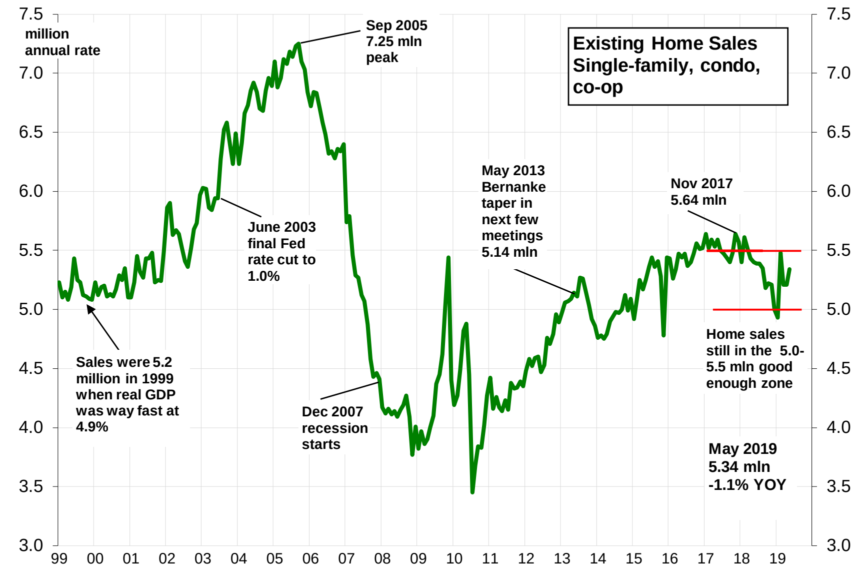
The case for additional monetary stimulus isn't strengthening the way Powell outlined it at Wednesday's meeting with today's report of jobless claims. No jobless, no recession, no rate cut, in our book. Makes one wonder if Powell is only threatening rate cuts to save his job and please his boss (highly recommended by the way, the latter!). The whole question of just what is monetary stimulus is in a new phase of course because the Fed never raised interest rates to normal. Oh, we forgot, yesterday's June meeting rates forecasts cut normal down to 2.5% from the 2.75% number they thought in March. The Fed finally brought rates up to normal by bringing down normal. Are you normal? Hard to judge probably.

Net, net, the economy still looks to be rolling along in full-on expansion mode in this tenth straight year of growth. Companies may have slowed their fixed investment in the economy as the Fed said in its statement yesterday, but companies continue have a demand for workers with job openings near all-time record highs. 12 o'clock and all is well at the moment for the economy. Bet on it.

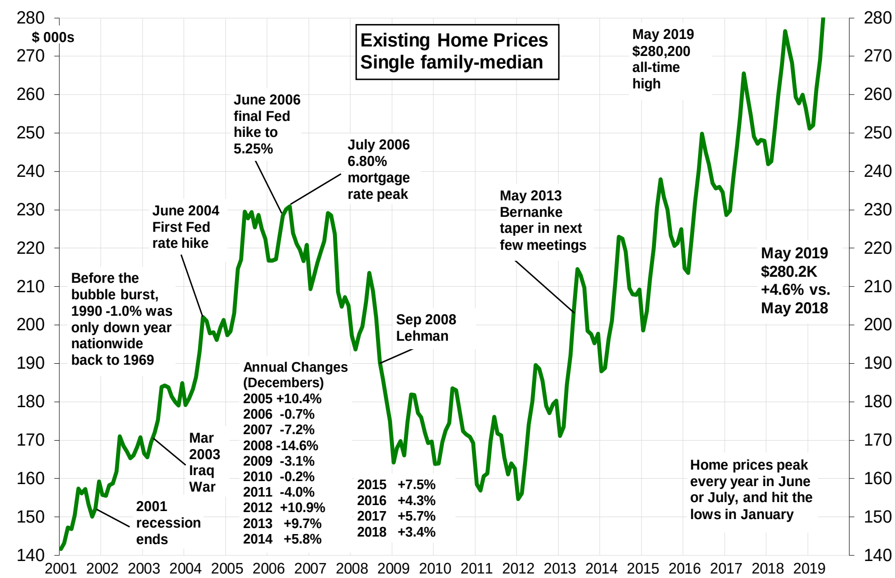


Existing home sales could use a 50 bps Fed rate cut. We all could. (Friday)

Breaking economy news. Existing home sales and Minneapolis Fed President Kashkari. Which do you want first? Kashkari said that he wanted a 50 bps rate cut at the meeting on Wednesday. Wait. Didn't Kashkari say a week ago that a rate cut wouldn't boost inflation? He also said no more rate hikes until core inflation hits 2.0%. Got it. (Core PCE inflation is 1.6% right now.) Also released on the newswires at 10am EDT was existing home sales which rose 2.5% to 5.34 million at an annual rate in May. Existing home sales of just single-family homes were up in every region with sales in the Northeast of 0.57 million, Midwest sales of 1.15 million, South sales of 2.04 million, and West sales of 0.99 million.



Net, net, existing home sales are strengthening as consumer confidence is near record highs and sharply lower mortgage rates are making it a bargain to buy and finance the purchase of a new home. Mortgage rates are 3.8% not 4.9% last November. Existing home sales tumbled during the uncertainty at year-end during the collapse in the stock market and the Federal government shutdown, but sales have bounced back. Fed officials are close to cutting interest rates due to rising uncertainty, but there is nothing uncertain about existing home sales. Home buyers are all-in and don't have any hesitation about making the biggest, big-ticket purchase of their lives. Bernanke once delayed tapering back in 2013 in part due to a modest decline in existing home sales, but there is no need for Fed officials to cut rates to improve home buyer confidence this time around.



Existing home sales are interest-rate sensitive and are also consumer confidence-sensitive and right now consumers have the wind at their backs when it comes to making one of the biggest financial decisions of their lives. Damn the torpedoes and full speed ahead the home buyers are saying. Interest rates are low and the trade headwinds the economy is experiencing are mostly weighing down the confidence at manufacturers and factories that rely on supply chain inputs from imports overseas. There is no need to cut interest rates to boost home purchases, that's for sure, consumers have already got their big break on cheaper financing costs through lower mortgage rates. Stay tuned. Story developing.

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