GOVERNMENT PORTFOLIO ADVISORS

Weekly Economic Update

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GOVERNMENT PORTFOLIO ADVISORS

November 2, 2018

Financial Indicators

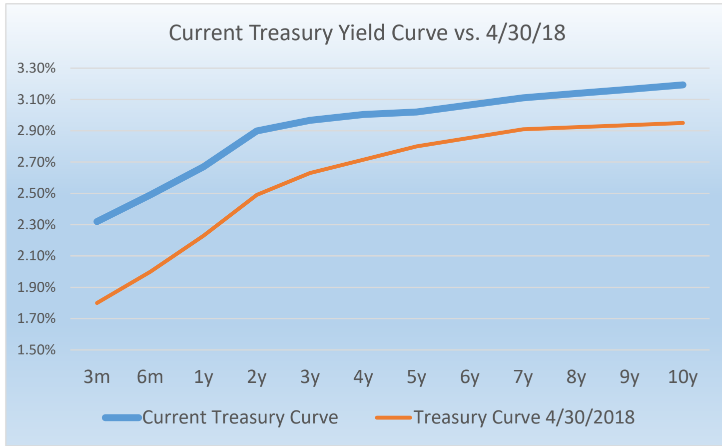
Interest Rates	Latest	Previous Month	Previous Year
Fed Funds - Upper Boundary	2.250	2.250	1.250
3-Month Tbill	2.270	2.211	1.162
6-Month Tbill	2.430	2.400	1.290
3-Month Libor	2.592	2.408	1.158
2-Year T Note	2.901	2.813	1.614
5-Year T Note	3.020	2.952	2.019
10-Year T Note	3.194	3.064	2.373
30-Year T Note	3.429	3.218	2.858
1-5 Year AAA-AA Corporate Benchmark	3.400	3.230	2.070
1-5 Year Agency Bullet Benchmark	2.970	2.850	1.730
Spread=	0.430	0.380	0.340
Tax-Exempt Revenue Bonds(AAA)			
5- Year	2.362	2.228	1.470
10-Year	2.803	2.618	2.034
30-Year	3.488	3.265	2.885
Mortgages			
30-Year Fixed Mortgage Rate	4.790	4.690	3.840
15-Year Fixed Mortgage Rate	4.110	3.930	3.130
5/1-Year ARM	4.390	4.330	3.390
Stock Market			
Dow Jones Industrials	25,408.07	26,773.94	23,435.01
S&P 500	2,730.39	2,923.43	2,579.36
NASDAQ Composite	7,301.77	7,999.55	6,716.53
Commodities			
Gold($ per troy ounce)	1,230.84	1,203.32	1,274.66
Oil($ per barrel) - Crude Futures(WTI)	63.74	75.23	54.30
USD Currency Index	96.38	95.51	94.82

Economic Indicators

	Latest	Previous Month	Previous Year
Real GDP (qoq %)	3.50	2.00	3.20
Real GDP (yoy %)	3.00	2.80	2.30
Nominal GDP (yoy %)	5.50	4.70	4.10
Gov't Spending (qoq %)	3.30	1.30	0.70
Core Price Deflator (qoq %)	1.60	2.30	1.30
CPI (yoy %)	2.30	2.90	2.00
CPI (mom %)	0.10	0.20	0.10
CPI x-Food/Energy (yoy %)	2.20	2.40	1.80
CPI x-Food/Energy (mom %)	0.10	0.20	0.20
Unemployment Rate	3.70	3.90	4.10
U6 Underemployment Rate	7.40	7.40	8.00
NonFarm Payrolls (mom chng, '000)	250.00	286.00	271.00
Average Hourly Earnings (yoy %)	3.20	2.90	2.20
Average Hourly Earnings (mom %)	0.30	0.40	-0.10
Industrial Production (yoy %)	5.14	3.80	2.65
Industrial Production (mom %)	0.25	0.62	1.54
Capacity Utilization	78.11	77.99	76.76
Durable Goods Orders (yoy %)	6.40	10.30	2.90
Durable Goods Orders (mom %)	0.70	-0.40	-4.10
ISM Manufacturing Index	57.70	61.30	58.50
Composite PMI	54.90	54.70	55.20
Conference Board Leading Ind.	111.80	109.50	105.90
Housing Starts	1201.00	1350.00	1265.00
Retail Sales (mom %)	0.10	0.50	0.60
Retail Sales (yoy %)	4.70	6.60	5.30
Consumer Confidence	137.90	134.70	126.20
Personal Income (yoy %)	4.40	4.00	4.60
Personal Income (mom %)	0.20	0.40	0.40
Trade Balance (USD bn)	-54.02	0.40	-0.10
Total Debt Outstanding(USD bn)	21516058	21458849.7	20442474

Other Sources: Bloomberg, L.P.

Selected Charts



Selected Chart:

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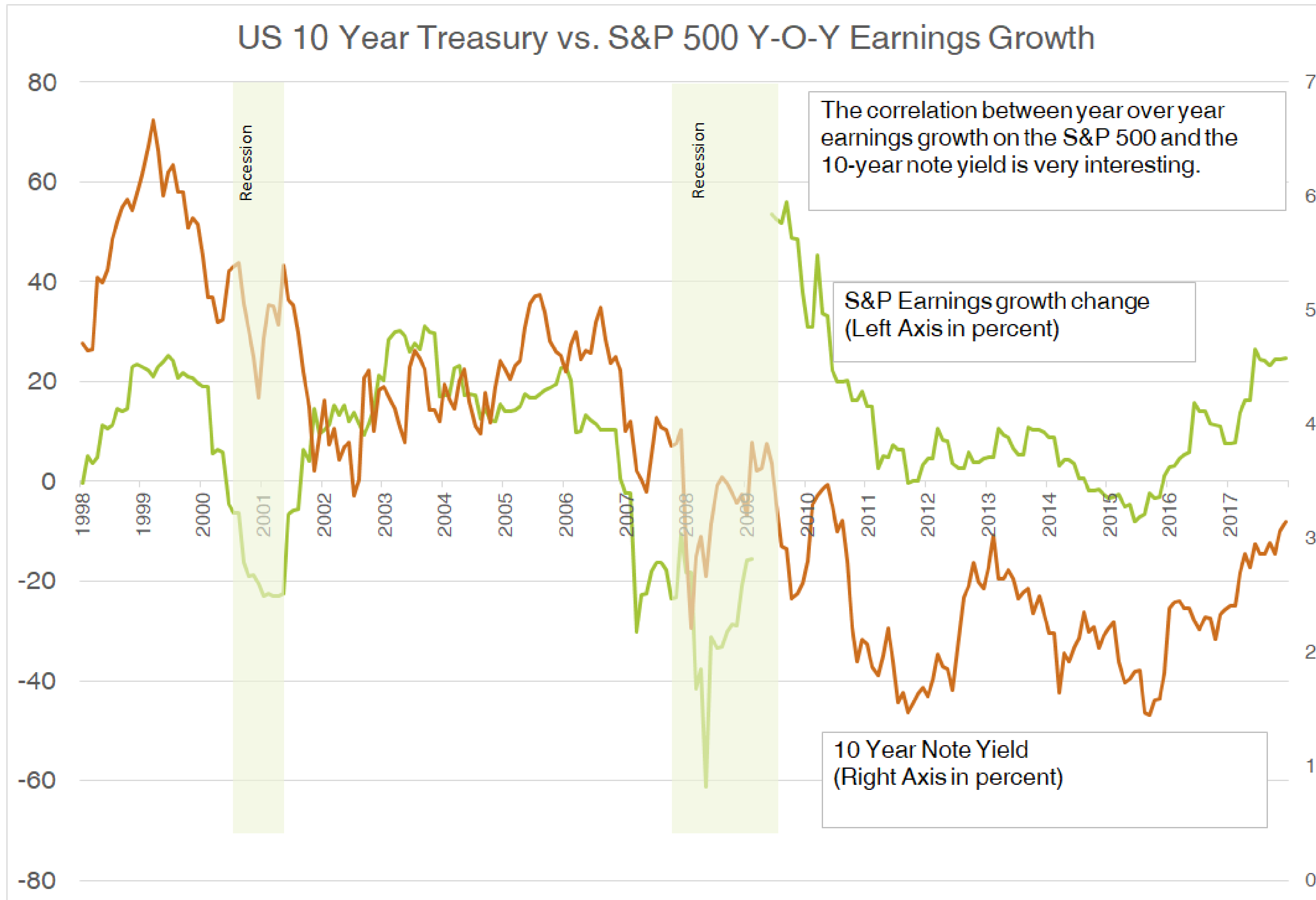
Source: Bloomberg L.P.

Other Sources: Bloomberg, L.P.



Source: Bloomberg L.P.

WEEKLY ECONOMIC COMMENTARY – WEEK OF November 2, 2018

After suffering through a dispiriting month, investors looked to November with hopeful eyes. So far, things look mildly promising, as a powerful three-day rally more than overshadowed a modest setback in stock prices on Friday. Thanks to the modest rebound for the week as a whole, concerns about the wealth effect on the economy (more than $2 trillion in U.S. equity value was wiped out last month) or a possible Fed response to a potential market correction have subsided. As usual, pundits with 20-20 hindsight are offering a litany of explanations for the turnaround in stock prices, including favorable earnings reports for the third quarter and lessened fears of a trade war after President Trump on Thursday stated he had a positive conversation with President Xi of China. Unfortunately, that upbeat news of a possible deal was rescinded by the administration on Friday, which contributed to the market sell-off at the end the week.

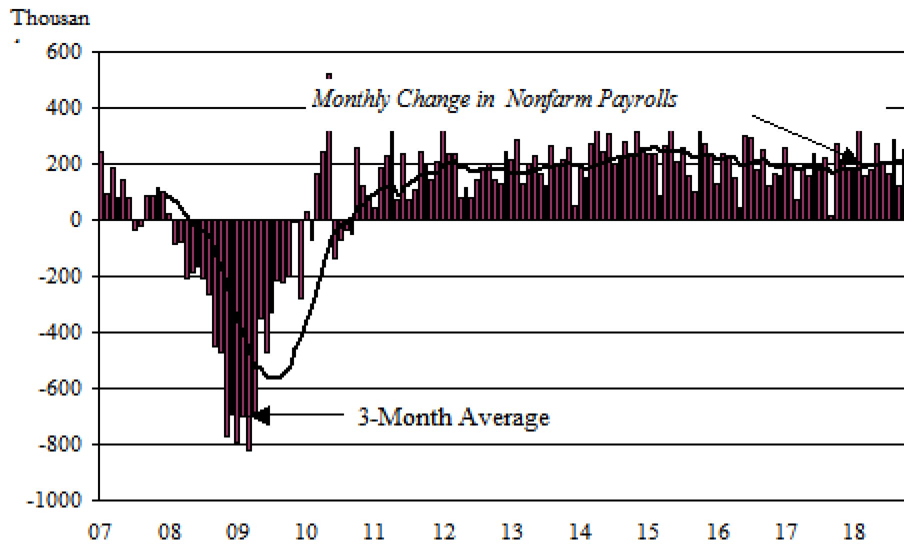
While views on the direction of the market vary widely, most agree on one thing: the complacency that nurtured the bull market in recent years has fallen by the wayside. What's more the volatility that has returned with a vengeance this year is poised to intensify, reflecting the economic crosscurrents that typically arise during the late stage of a business cycle, uncertainty over how the Federal Reserve navigates these crosscurrents and the economic impact of emerging geopolitical shocks. More immediately, the upcoming midterm elections stands out as a potentially disruptive event, given their ramifications for fiscal policy, trade, immigration and deregulation, all of which can have palpable effects on the economic outlook.

For example, if the Republicans sweep both the House and Senate, Congress is likely to approve another dose of fiscal stimulus in response to Trump's latest proposal to cut income taxes again and boost infrastructure spending. Conversely, a split verdict, with the Democrats winning the House – the most likely outcome according to the latest polls – would provide a check on these impulses. But should the Democrats gain the majority in the House, that will likely usher in a protracted period of investigations into the Trump administration, stifling policy decisions and stoking more uncertainty among investors. Importantly, should some form of fiscal stimulus come to pass next year, it would add fuel to a growth engine that is already running at full speed. Barring an unexpected meltdown in the fourth quarter, the economy is on track to possibly break the 3.0 percent growth barrier this year for the first time in a decade, which is well above its 2.0 percent noninflationary speed limit. Clearly, if this pace were sustained heading into next year it would likely prod the Federal Reserve into a more aggressive rate-hiking trajectory.

As it is, the economy still has considerable momentum at the start of the fourth quarter after posting robust growth rates in the second and third quarters. Consumers are spending freely and are highly confident about job and income prospects, according to the latest Conference Board survey. If they maintain anything close to the torrid spending pace seen in the third quarter, it would more than offset weakness in housing activity and the inexplicable soft reading on business capital spending. So far, there is little sign that households are set to retrench anytime soon. Auto sales exceeded expectations in October and retailers are ramping up for a robust holiday season, taking on a record number of seasonal workers and building up inventories. Real imports of consumer goods,

excluding autos, increased by sizeable 10.5 percent in September from a year-earlier, a sign that merchants are stock piling goods in anticipation of strong holiday sales.

At this juncture, the markets are fully pricing in another quarter point rate increase at the Fed's policy meeting on December 15-16. The only event that might derail that prospect would be a downshifting of job growth in October, thus confirming the weak payroll gain registered in September. But Friday's jobs report did nothing of the sort. Instead, the Labor Department reported that job growth blasted through expectations, revealing a 250 thousand surge in nonfarm payrolls during the month. The consensus on Wall Street was for an increase of about 190 thousand. And while September's disappointing 134 thousand increase was revised down by 16 thousand, the tally for August was revised up by an equal amount, resulting in a wash for the two months of revisions.

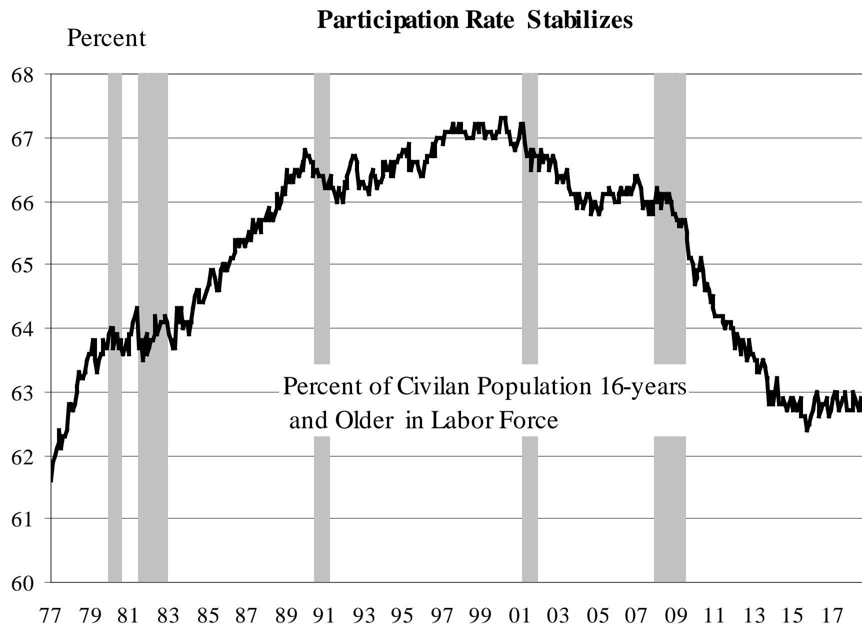


Source: Stone & McCarthy

The agency noted that the recent hurricanes had no discernible effect on the latest payroll figures, but the 42 thousand spike in payrolls at leisure and hospitality firms – twice the average over the prior three months – suggests that hiring in this sector rebounded from the depressed pace in September caused by Hurricane Florence. A similar, but less amplified, pattern took place in the retail

sector. To get a better insight into the underlying trend, it is better to smooth out extraneous events by looking at averages over three and six month periods. However the numbers are sliced and diced, the trend is decidedly strong. Job gains averaged 218 thousand over the past three months, 216 thousand over the last six months and 218 thousand over the past year. Not only was job creation strong last month, it was broadly based, with 65.7 percent of private industries expanding payrolls.

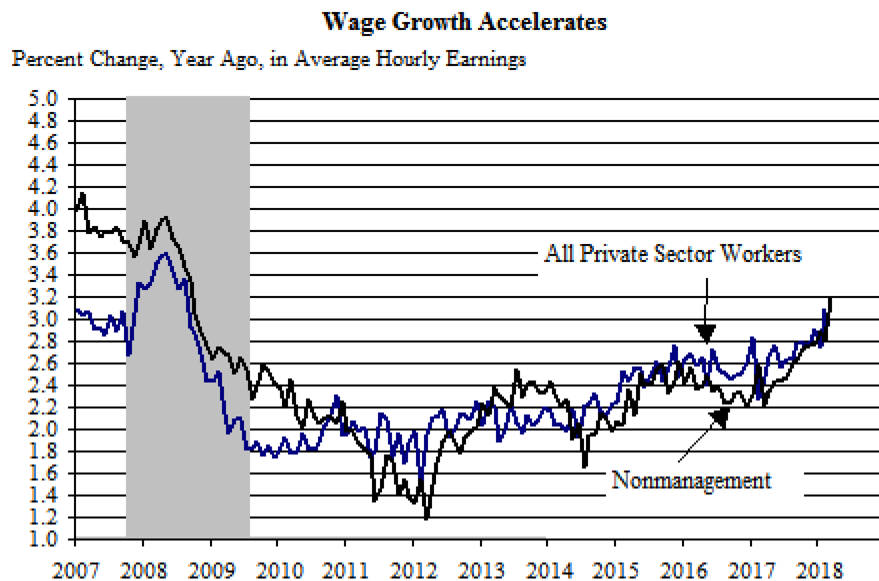
Anything north of 200 thousand a month against a trend growth in the labor force of about 100 thousand a month should be putting downward pressure on the unemployment rate. But the jobless rate remained at 3.7 percent in October, holding at September's 48-year low. The reason: the persistent strength in job creation is drawing workers off the sidelines. The labor force expanded by a whopping 711 thousand in October, more than accommodating the 600 thousand increase in households that took jobs during the month. Put another way, more working-age adults are entering or reentering the labor force. In October, the labor force participation rate increased 0.2 percent to 62.9 percent. To be sure, that's still well below the 66.0 percent prerecession share, but it is bucking a powerful downward trend associated with an aging population that is generating a wave of retiring baby boomers every month.



Source: Stone & McCarthy

The fact that the overall participation rate has stabilized over the past three years instead of remaining on a downward track tends to support the notion by Fed Chairman Powell and others that there is more slack in labor force than is widely perceived. According to this argument, the job market has not fully healed from the Great Recession and by allowing strong job growth to continue, more people can be drawn into the labor force. No doubt, there is a pool of available workers on the sidelines that still can be lured in, but there is no question that most of the slack in the labor force has been used up. Indeed, within the prime working-age population – those aged 25-54 – fully 80 percent are gainfully employed, the highest share since November 2007, a month before the onset of the recession.

Perhaps the most tangible evidence that the job market is tightening is the strengthening bargaining power of workers. In October, average hourly earnings increased 3.1 percent from a year earlier, the steepest gain of the expansion. The latest increase comes with a caveat, as earnings fell by 0.2 percent last October, which depresses the base period against which the current month is measured. That said, the trend is pointing up and, in time-honored fashion, workers on the middle and lower-income scale are deriving the greatest benefits when slack in the job market becomes scarce. Hence, non-management workers saw their earnings increase by 3.2 percent over the past year and by an annual rate of 3.9 percent over the past three months.



Source: Stone & McCarthy

But the dark side of stronger wage gains, which we expect will continue, is that it heightens inflation expectations and raises the likelihood of a harsher Fed response. Indeed, the bond vigilantes came out in force following the October jobs report on Friday, driving the 10-year Treasury yield up above 3.20 percent, close to the four-year high reached early last month. Interestingly, this comes against the backdrop of recent data that actually depict a slowing inflation trend. The latest consumer price index and the personal consumption deflator, which the Fed closely monitors, eased off the peak increases seen in recent months. What's more, the recent slump in oil prices and strength in the dollar are powerful disinflationary influences.

We suspect that the latest jobs report will give more ammunition to the inflation hawks on the Fed but will not prompt a change in current policy intentions. Another rate hike seems baked in for December and we expect three more increases next year, similar to the Fed's projections. That said, the robust jobs report heightens the risk of more frequent rate hikes, particularly if payrolls continue to grow near its current pace and wage growth accelerates markedly over the balance of the year. If the prospect of more fiscal stimulus gains traction, the Fed's response could well become more aggressive – and provoke some harsh criticism from the president. That adds another element of drama to the midterm elections.

Source: Stone & McCarthy

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