Financial Market Weekly

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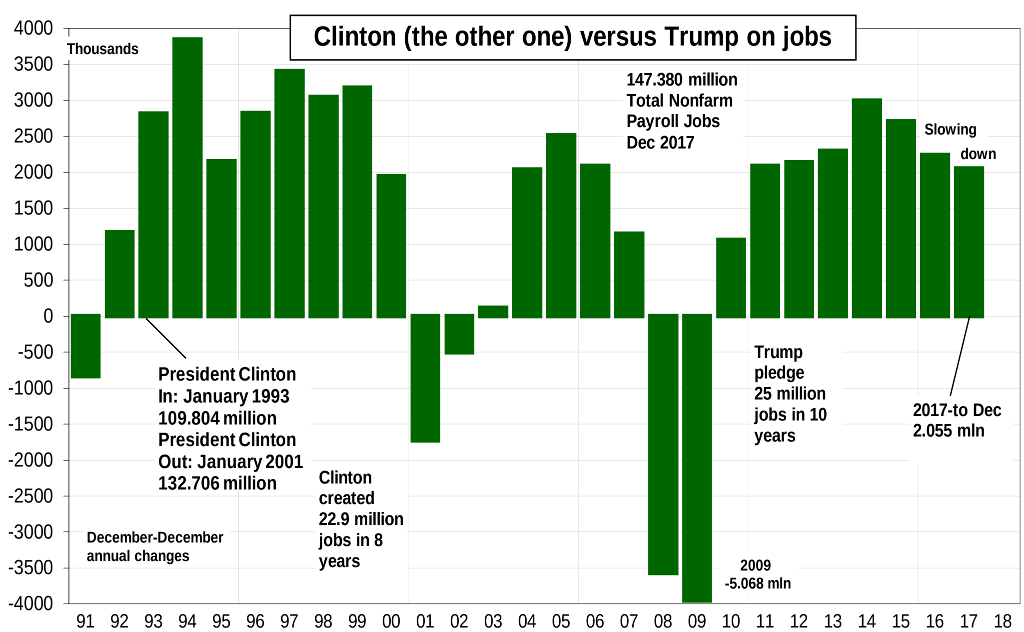
PAYROLL JOBS JUST 148K THIS MONTH, TAX CUTS AND JOBS ACT IN NAME ONLY

Breaking economy news on Friday. The monthly employment situation report, trade deficit too if anyone cares. The biggest trade deficit since 2012 will make it hard for GDP growth to hit 3% again this quarter Q4 2017. Not sure many cared about the employment report either as bond trading stalled after 1030am. Even with the Dow Jones industrials soaring 220 points to a new record Friday.

Only 148 thousand new payroll jobs in December. Better get used to it. Philly Fed President Harker volunteered the view on Friday that payroll jobs might slow permanently to just 100K monthly increases by the end of 2019. Payroll jobs are fated to slow eventually we guess as the economy hits the wall of full employment. Companies don't need to increase headcounts materially in the ninth year of an economic expansion as they have hired enough people already to run their operations and meet the demand from customers for their goods and services for some time. Besides with a rock bottom low 4.1% unemployment rate, there aren't very many potential workers left to bring aboard anyway.

COHN: DON'T THINK WE NEED TO GET USED TO JOBS NUMBERS BELOW 200K



So that's 148K in December and the average in 2017 is now 171K. You can see the hiring slowdown pattern quite clearly. 250K in 2014, 226K in 2015, and 187K in 2016. Fewer jobs, jobs, jobs as the long years of expansion have already put most Americans back to work following the worst economic downturn since the Great Depression.

No amount of tax cuts is going to increase hiring by corporations at this stage of the business cycle, so how about increasing the wages of the existing staff? Average hourly earnings rising the same, 2.5% the last year. At least this number hit the Street's expectations. Want more wages? In the science of economics it is not just a tight labor market that leads to wage pressures, there also must be inflation too. Many companies benchmark firmwide salary increases each year based on the rate of inflation and CPI inflation is just 2.2% right now. Why oh why would management increase wages more than 2.2% inflation? They'd rather do share buybacks and keep their shareholders happy would be our thought.

Payroll jobs in year nine following the recession

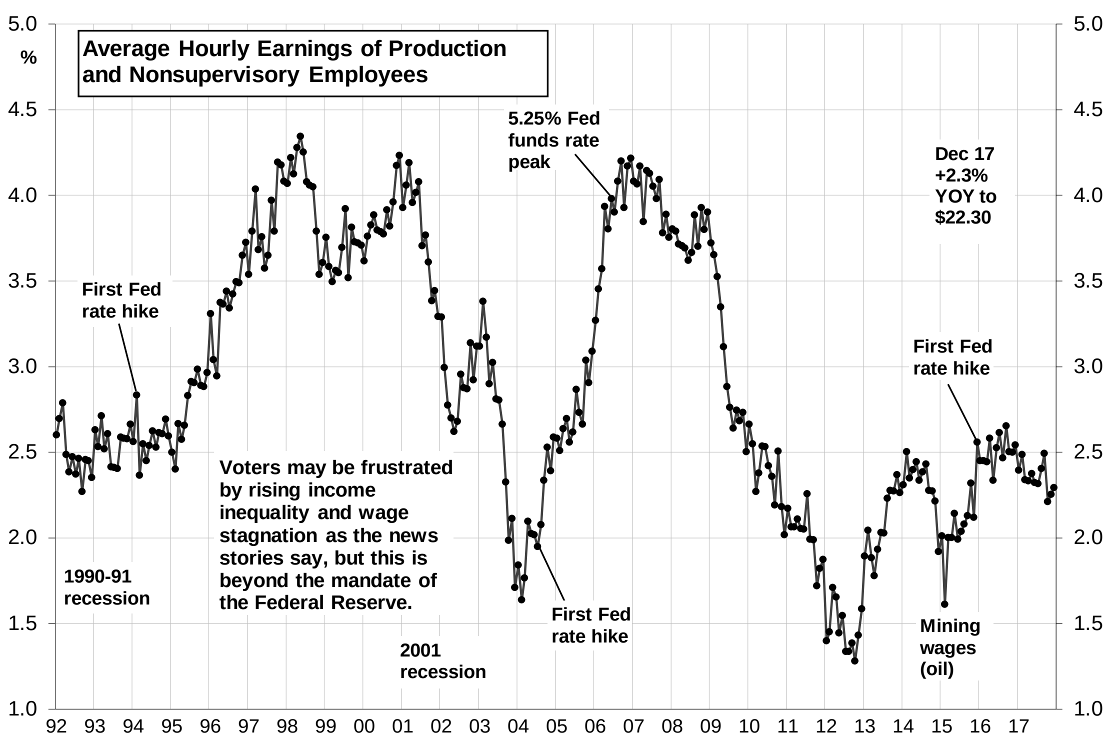
Dec. 2016 Totals millions		Dec 17	Nov 17	Oct 17	12 months Dec 16 to Dec 17	12 months Dec 15 to Dec 16
145.325	Nonfarm Payroll Employment	148	252	211	2055	2240
123.026	Total Private (ex-Govt)	146	239	222	2013	2039
19.794	Goods-producing	55	63	38	465	64
0.617	Mining	-2	4	1	59	-75
12.343	Manufacturing	25	31	23	196	-16
0.942	Motor Vehicles & parts	1	2	-1	-1	17
6.783	Construction	30	27	15	210	155
103.232	Private Service-providing	91	176	184	1548	1975
27.374	**Trade, transportation, utilities**	-10	43	-9	74	331
15.881	Retail stores	-20	26	-20	-67	203
3.180	General Merchandise	-27	4	-21	-90	37
3.097	Food & Beverage stores	7	11	5	1	37
5.048	Transportation/warehousing	2	11	4	74	92
1.465	Truck transport	-1	1	0	10	10
0.668	Couriers/messengers	2	2	1	10	31
0.943	Warehousing and storage	-5	8	3	24	63
0.557	Utilities	-1	0	0	-4	0
2.762	**Information**	7	1	-1	-40	0
8.364	**Financial**	6	7	8	134	176
2.605	Insurance	2	-2	-5	30	46
2.169	Real Estate	2	7	10	57	59
1.311	Commercial Banking	-1	0	1	3	17
0.933	Securities/investments	1	2	0	20	18
20.416	**Professional/business**	19	49	47	527	534
2.962	Temp help services	7	17	14	136	32
2.259	Management of companies	4	3	5	35	35
1.427	Architectural/engineering	2	3	4	48	27
2.032	Computer systems/services	3	4	5	47	87
1.126	Legal services	1	0	0	2	5
1.000	Accounting/bookkeeping	-15	4	-3	-6	32
22.871	**Education and health**	28	50	17	438	553
5.077	Hospitals	12	1	11	76	119
3.604	Educational services	0	10	-14	65	85
15.744	**Leisure and hospitality**	29	17	104	306	331
1.950	Hotel/motels	0	3	3	16	11
11.549	Eating & drinking places	25	16	78	249	276
22.299	Government	2	13	-11	42	201
2.200	Federal ex-Post Office	0	-2	0	-10	30
5.085	State government	-4	8	-8	-19	-4
2.414	State Govt Education	-3	8	-6	-6	3
14.395	Local government	5	20	-2	77	160
7.945	Local Govt Education	3	3	-5	45	69

148K is not enough in many people's minds, were there any special industries seeing a reduction in hiring or was it across the board the jobs slowdown? Well manufacturing and construction hiring was very strong at 25K and 30K, respectively. Retail jobs fell 20K in December after adding 26K in November, but retail fell 20K in October as well when the total jobs count was 211K. Nevertheless, retail jobs remain one of the key elements behind the low 148K jobs number this month as do business services where new jobs slowed to 19K from 49K in November and 47K in October.

To conclude, if it looks too good to be true, it usually is. Payroll jobs were just 38K in September due to the hurricanes, and bounced back rising 211K in October and another 252K in November, but now it is mean reversion time. Job gains have not averaged more than 200K since the year 2015. Those trying to stimulate the economy with a massive tax cut in order to create jobs, jobs, jobs, have a lot of explaining to do. Either that or they could form another presidential commission to look at the underreported jobs that must be out there, but just cannot be found and improperly counted.

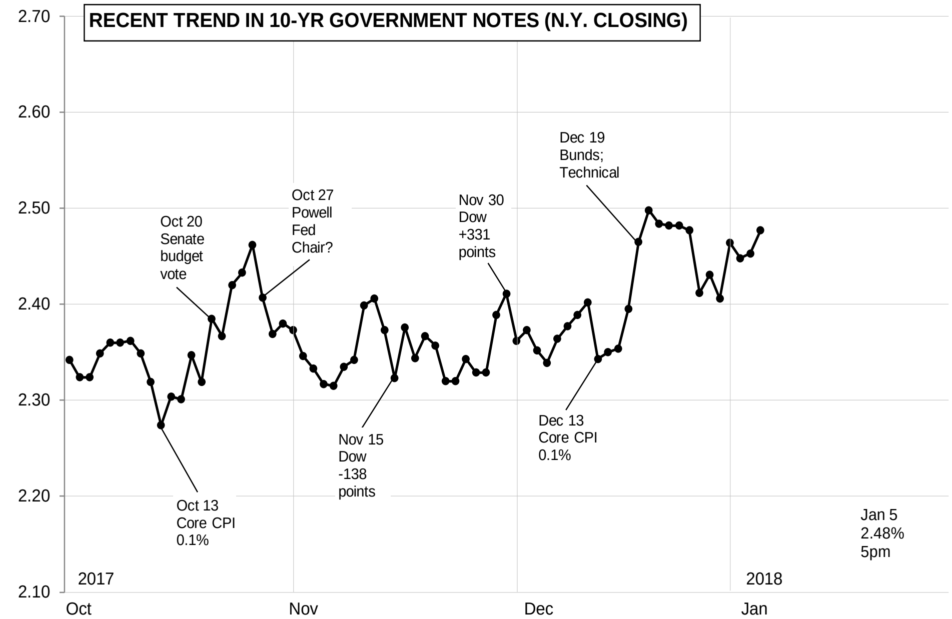
Jobs growth is slowing and so too is the economy's momentum and this will make Fed officials even more cautious on the outlook for inflation. Without strong economic growth, it is hard to be confident that inflation will make it back to the Fed's 2% objective. The slow 148K jobs number is just the ammunition the Fed doves need to scuttle one or two of the rate hikes the committee forecasts in 2018-19. The path of higher rates this year is no longer assured. The market based odds of a March 21, 2018 rate hike have not changed after today's employment data, but one wonders for how long. The odds of a rate hike are staying high at 76% in this morning's post-jobs report trading. The bottom line is that the market isn't panicking, but we haven't heard yet what Fed officials think about today's report. 148K is no reason to speed up the path of rate hikes in 2018, that's for sure.

	Dec	Nov	Oct	Sep	Aug	Jul
Payroll jobs (000s)	148	252	211	38	208	138
Unemployment rate %	4.1	4.1	4.1	4.2	4.4	4.3
Unemployment (3 decimal)	4.095	4.121	4.068	4.196	4.438	4.335
Participation rate %	62.7	62.7	62.7	63.0	62.9	62.9
Average hourly earnings	$26.63	$26.54	$26.51	$26.53	$26.42	$26.39
MTM % Chg	0.3	0.1	-0.1	0.4	0.1	0.5
YOY % Chg	2.5	2.4	2.4	2.8	2.6	2.6
Production Worker earnings	$22.30	$22.23	$22.20	$22.22	$22.14	$22.09
MTM % Chg	0.3	0.1	-0.1	0.4	0.2	0.3
YOY % Chg	2.3	2.3	2.2	2.5	2.4	2.3



MARKETS OUTLOOK

	29-Dec 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
30-Yr Treasury	2.74	2.90	3.00	3.10	3.30	3.40	3.50	3.60	3.70	3.80	3.80
10-Yr Note	2.41	2.50	2.70	2.80	3.00	3.20	3.30	3.40	3.50	3.70	3.70
5-Yr Note	2.21	2.20	2.40	2.60	2.80	3.00	3.15	3.30	3.40	3.60	3.60
2-Yr Note	1.89	1.95	2.20	2.45	2.65	2.85	3.10	3.30	3.40	3.60	3.80
3-month Libor	1.69	1.90	2.10	2.40	2.60	2.90	3.10	3.40	3.40	3.60	3.90
Fed Funds Rate	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	52	55	50	35	35	35	20	10	10	10	(10)



Yields moved back up this week on the first day of the year. Payroll jobs were weaker at 148K on Friday, but 10-yr yields only dropped briefly from 2.46% to 2.43% on the news before closing the week at 2.48%. It is surprising the market is not adjusting its Fed rate hike expectations downward. Philly Fed President Harker gave a speech Friday after the employment data saying he looked for two rate hikes in 2018 which is one short of the FOMC 3 hike median forecast. The problem with the market's "analysis" is that quite a few, 6 out of 16 members of the FOMC, want just two rate hikes in 2018. Even before today's 148K jobs #.

FEDERAL RESERVE POLICY

The Fed meets January 30-31 to consider its monetary policy. Yellen's last one. No press conference, no expectation of policy changes. The March 21, 2018 meeting odds of a rate hike remain high at 76%. If some Fed officials aren't comfortable with this they better start talking the market down because 148K payroll jobs didn't change the market's Fed outlook.

Selected Fed assets and liabilities

Fed H.4.1 statistical release billions, Wednesday data	3-Jan	27-Dec	20-Dec	13-Dec	Sep 10 2008** pre-LEH
Factors adding reserves					
U.S. Treasury securities	2448.208	2454.219	2454.237	2454.256	479.782
Federal agency debt securities	4.391	4.391	4.391	4.391	0.000
Mortgage-backed securities	1764.929	1764.926	1775.451	1780.237	0.000
Primary credit (Discount Window)	0.038	0.108	0.077	0.004	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)	1.713	1.712	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	12.067	12.008	0.057	0.042	62.000
Federal Reserve Assets	4490.9	4495.7	4494.7	4499.8	961.7
3-month Libor %	1.70	1.69	1.66	1.59	2.82
Factors draining reserves					
Currency in circulation	1618.531	1616.323	1607.915	1604.008	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	131.622	147.749	127.582	143.392	0.000
Reserve Balances (Net Liquidity)	2194.651	2176.452	2237.141	2322.762	24.964
Treasuries within 15 days	3.098	17.504	17.504	0.000	14.955
Treasuries 16 to 90 days	107.658	79.555	79.556	97.060	31.549
Treasuries 91 days to 1 year	315.420	328.412	328.412	328.412	69.272
Treasuries over 1-yr to 5 years	1085.113	1095.446	1095.449	1095.451	170.807
Treasuries over 5-yrs to 10 years	314.035	310.412	310.416	310.420	91.863
Treasuries over 10-years	622.884	622.890	622.901	622.912	101.337

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

The FOMC meeting transcripts from 2012 were released. Powell's first meeting was June 2012. A lot of water under the bridge since then, views change and get updated, but it is interesting to look at some of his comments about policy and the economy. His specialty seems to be industrial companies so he relays to the committee what his contacts have been telling him about the outlook. We were more impressed with his comments about policy and the economy than we thought we would be, and this was five years ago, so he has gained more experience. Maybe he will be more interesting in speeches and testimonies than we had expected over the next four years. On the other hand, all we really want to see done is for the committee to move rates up at a measured pace to more neutral interest rate levels of 3.5 to 4 percent.

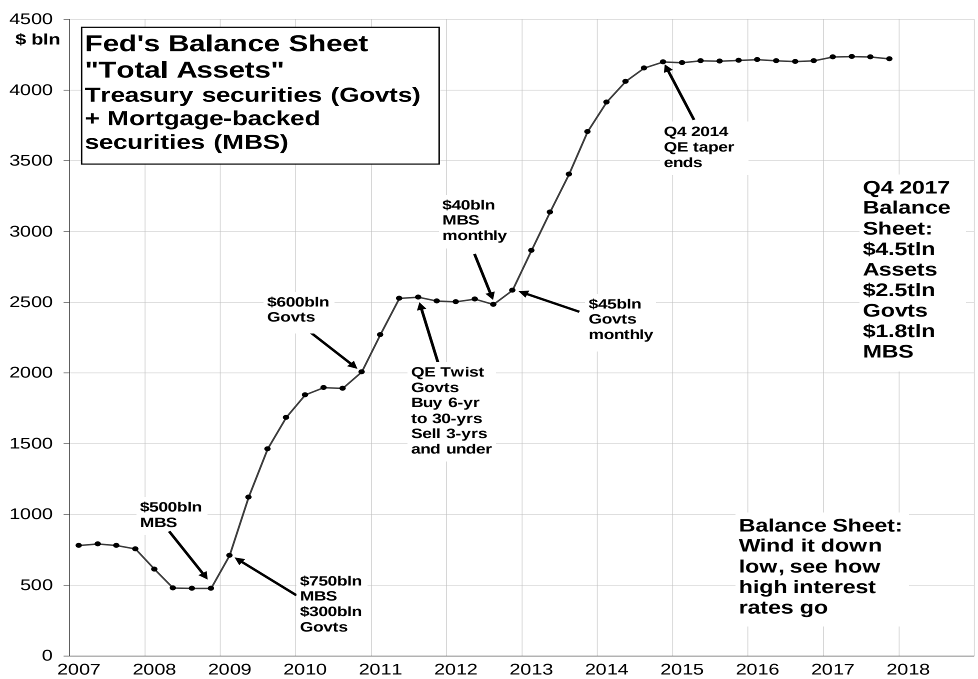
July 31-August 1, 2012 I continue to see US inflation at 1.8% as low and under control. I see us as running just below 2%, but I wouldn't characterize that as missing the mandate. [Core PCE inflation was 1.8%, and headline PCE inflation with food/energy was 1.5% when he spoke then, and today core PCE is a little lower at 1.5% and headline PCE inflation is 1.8%. Energy adding more to inflation now than back then.] He probably still believes they are not missing on the inflation mandate so much, at least not enough to alter the median rates forecast path with three rate hikes in 2018 and two more rate hikes in 2019.]

Powell didn't seem to be in favor of more QE at the July/August meeting. The sticking point seems to be not in whether to provide more stimulus, but how. Taking more securities onto the Fed's balance sheet could lead to negative net worth for the Federal Reserve System on a mark-to-market basis if interest rates eventually move higher down the road.

September 12-13, 2012 The Fed voted for open-ended QE purchases of MBS at a $40 billion monthly rate. It was an interesting period where the GDP growth central tendency forecasts were 3.0 to 3.8 percent in 2014 and then again in 2015. That sure changed.

"If this guy prints more money between now and the election, I don't know what y'all would do to him in Iowa, but we would treat him pretty ugly down in Texas."
Governor Rick Perry in August 2011

In the first go-round at Fed meetings, usually about the economy and business conditions Powell talked a good while about private equity firms and how they thought this was a valuable time to invest given their natural 3 to 5 year investment horizon. In the policy discussion, he thought QE could have positive effects on the economy even if the effect was likely to be quite modest. We think that's what he said, but went on to say, "I'm supporting [QE] with a certain lack of enthusiasm, and am somewhat uncomfortable with the road that we are on." QE in a recession or monetary crisis was okay, but "we're now using [QE] as a straightforward jobs program."



October 23-24, 2012 At the next meeting, despite initial reservations, Powell was impressed by the market reaction to the Fed's $40 billion MBS announcement in September. Later on there was this: "While I see some improvement at the margin, it still feels to me like a world with 2 percent inflation and 2 percent economic growth, which is obviously not strong enough to reduce unemployment." [Many of the Fed's policies sought to boost growth to bring down unemployment, but the slow-growth economy put people back to work anyway.] He told the committee what he heard from investors. "Well, your policy is working," these investors told him but what they really meant to say was, "Well, you want people to take some risk, and they are." He added, "Investors are clamoring for leveraged loans and high-yield bonds, anything with a decent yield." This was all due to the Fed's September announcement of $40 billion monthly MBS purchases which caused a major change in risk sentiment he said. Later in the meeting he did not sound in favor of additional QE. "If we have another good run of data, I think there would be a persuasive case to defer action."

December 11-12, 2012 The committee voted for the open-ended $45 billion monthly purchases of 4-year to 30-yr Government securities. Powell said he expected growth to pick up and bring the economy closer to full employment, but was increasingly doubtful this would occur in 2013. This was the period before the fiscal cliff. "My industrial contacts report nothing but weakness and significant layoffs in the coming months," he said. As far as the QE itself, he supported QE in principle in 2013, but seemed to have problems with the open-ended nature of the program and would not be supportive of a plan that was close to the market's expectations of $1.2 trillion in total purchases.

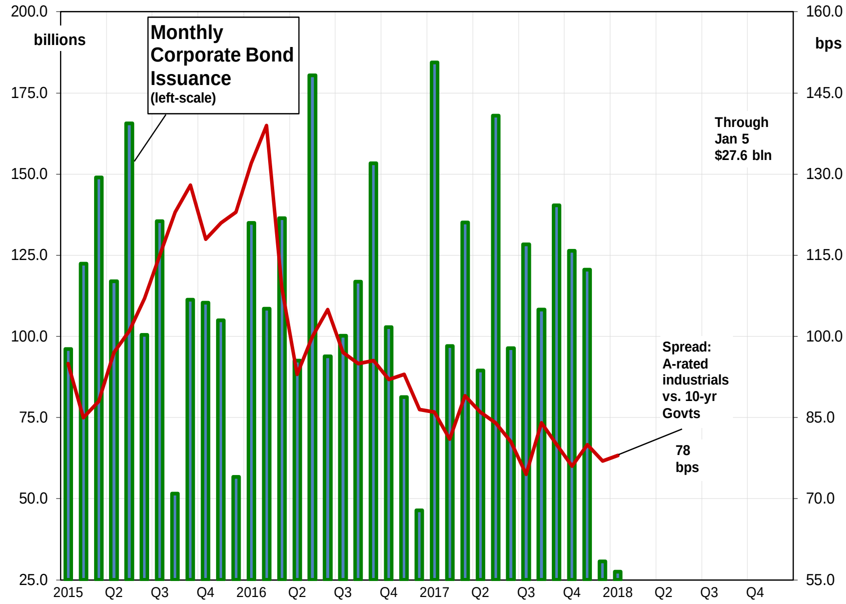
To conclude this brief look through the 2012 transcripts released on Friday, Powell's comments on the economy and inflation seem okay and informed, reassuring to us, given that he has no formal training as an economist. This is five years ago and he has paid the price and sat through a lot of FOMC meetings since then where he has acquired even more experience. He does seem to have had an issue with the size of the Fed's balance sheet, particularly on how to unwind it. We don't know if this means he would not use the QE stimulus tool again, if for instance, the economy was to turn down and enter a new recession during his reign as Fed Chair.

Fed Individual Forecasts					
Fed funds rate by year-end					Longer
Votes	2017 End	2018 End	2019 End	2020 End	run
1	1.125	1.125	1.375	1.375	2.250
2	1.125	1.375	1.625	2.375	2.500
3	1.375	1.625	2.375	2.625	2.500
4	1.375	1.875	2.375	2.625	2.750
5	1.375	1.875	2.625	2.875	2.750
6	1.375	1.875	2.625	3.000	2.750
7	1.375	2.125	2.625	3.000	2.750
8	1.375	2.125	2.625	3.000	2.750
9	1.375	2.125	2.750	3.125	2.750
10	1.375	2.125	2.875	3.125	3.000
11	1.375	2.125	2.875	3.125	3.000
12	1.375	2.125	2.875	3.125	3.000
13	1.375	2.375	3.125	3.125	3.000
14	1.375	2.375	3.375	3.500	3.000
15	1.375	2.375	3.375	4.125	3.000
16	1.375	2.625	3.625	4.125	
17					
Median	1.375	2.125	2.688	3.063	2.750
Meeting	Dec 2017	Dec 2017	Dec 2017	Dec 2017	Dec 2017

We also don't know much from these transcripts what Powell thinks about interest rates back then. But in more recent speeches, thinking early in 2017, he said most committee members thought the natural rate of interest might be 1%, not the 2% constant in the Taylor Rule. Adding 1.8% headline PCE inflation in November 2017 to a 1% real "natural" rate and you get a normal Fed funds rate level of 2.75 to 3.0 percent. This is a normal level for the economy which is not high enough to slow economic growth, and should not be viewed as a terminal rate or the final move for interest rates in the business cycle. Anyway, current Fed forecasts don't see any hurry to get to 3%: more of a late 2019 story… wait for it. We will be here.

CORPORATE BONDS: BERKSHIRE HATHAWAY, GM, ENBRIDGE, METLIFE

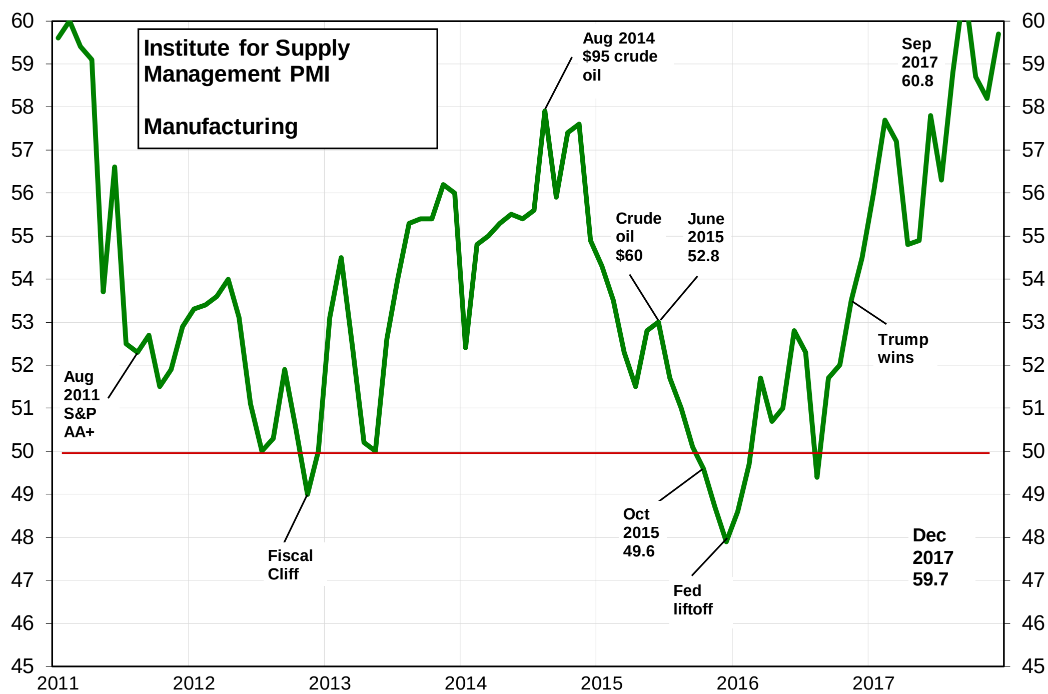
Corporate offerings were $27.6 billion in the January 5 week versus zero in the December 29 week. On Wednesday, Deere sold $1.75 billion 3s/5s/10s/FRNs. It priced $400 million 3.05% 10-yrs at 62 bps (A2/A). The manufacturer of agriculture and construction equipment will use the proceeds for general corporate purposes. Corporate bonds (10-yr Industrials rated A2) were 78 bps above 10-yr Treasuries this week versus 77 bps last Friday.



OTHER ECONOMIC NEWS THIS WEEK

Manufacturing finishes the year with a bang, some inflation seen too

Breaking economy news. The ISM manufacturing survey for December. Purchasing managers say that overall conditions in manufacturing jumped at year-end to a survey reading of 59.7, up 1.5 points from November, the second highest level of the year. Greater price pressures are also being reported with the price index moving up 3.5 points to 69.0 in December. Where there's smoke there's fire, and where there is growth there is greater risk of increasing inflation is the message in this report from purchasing managers today that policymakers ignore at their peril. The 69.0 price survey is well above the index readings down in the 30s during the oil price crash in late 2014 through 2015. Inflation reports are back, at least reports of higher inflation.



Net, net manufacturing activity is up all over the world with U.S. factories leading the way. Manufacturing is still the heart of any economy even if factories employ fewer workers than they used to due to technology advances leading to rapid productivity gains over the years. Manufacturing executives wouldn't be this confident if there wasn't strong export demand from America's trading partners. Today's reading bodes well for the outlook not just in the U.S. but globally as well. 2018 will be the one year where there just aren't that many risks to point to unless you want to count the risk that the expansion will simply grow tired after running strong for nearly a decade.

Stay tuned. Story developing. Corporations got a massive break on their taxes and time will tell what they do with the huge cost savings that Uncle Sam has given them. Whatever they choose, spend more on their employees, make additional capital expenditures that invest in future growth, or buy back stock, this money from Washington will boost economic growth and profits and keep the Trump stock market rally alive for another year. Dow 30,000 anyone? Tax reform means greater profits and means stocks could rise to record levels sooner than you think. Bet on it.

ISM manufacturing index

	Dec 17	Nov 17	Oct 17	Sep 17	Aug 17	Jul 17	Jun17
PMI index	59.7	58.2	58.7	60.8	58.8	56.3	57.8
Prices	69.0	65.5	68.5	71.5	62.0	62.0	55.0
Production	65.8	63.9	61.0	62.2	61.0	60.6	62.4
New orders	69.4	64.0	63.4	64.6	60.3	60.4	63.5
Supplier deliveries	57.9	56.5	61.4	64.4	57.1	55.4	57.0
Employment	57.0	59.7	59.8	60.3	59.9	55.2	57.2

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