

Financial Market Weekly

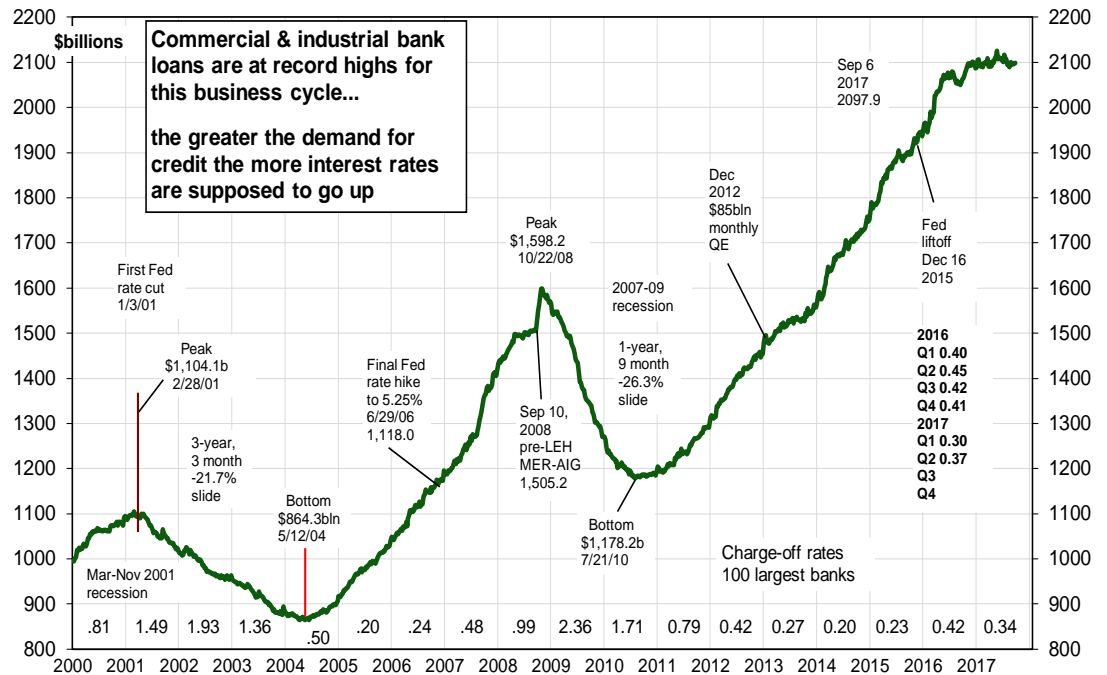
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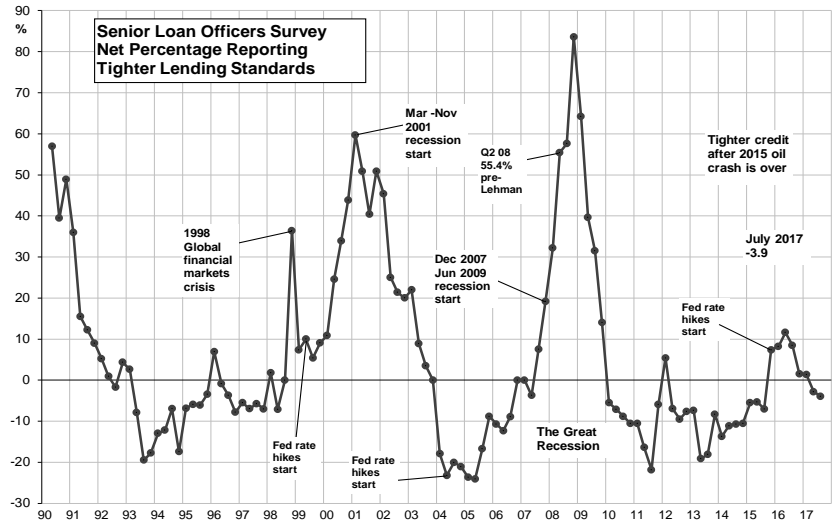
COMPANIES HAVE STOPPED BORROWING THIS YEAR UNDER PRESIDENT TRUMP

Commercial & industrial bank loans (C&I loans) have stopped their vigorous rising trend this year as it looks like companies have borrowed enough already for this long economic expansion. Business loans are down 0.4% this year through September 6 after rising 7.1% in 2016, the final year of Obama's second term

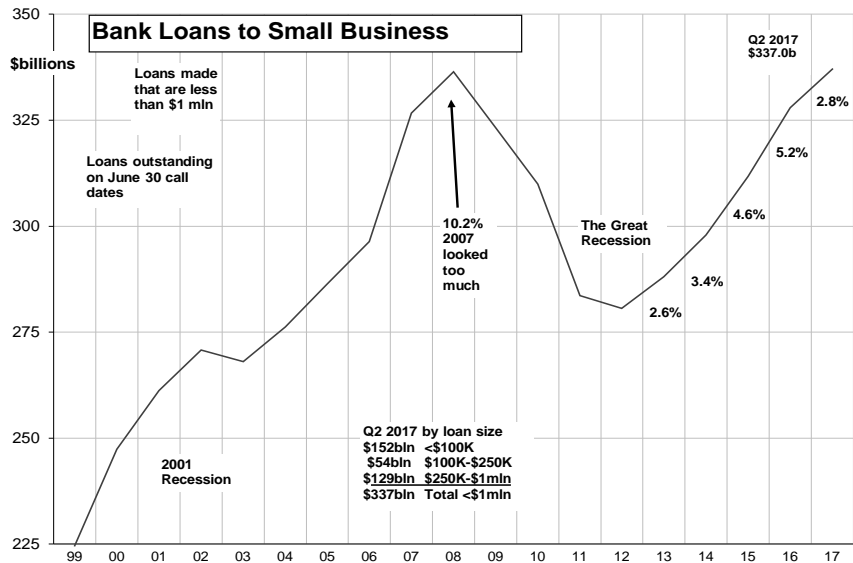


in office. C&I loans rose 10.6% in 2015, 12.3% in 2014, and 6.2% in 2013. The Fed cut rates to zero in December 2008 and C&I loans eventually turned back up a year and a half later in July 2010. Now you can either think the Fed's second rate hike this cycle in December 2016, and two more in 2017, have increased borrowing costs and dissuaded additional borrowing. Or more likely the long expansion has led companies to borrow enough for now, in which case tax reform is unlikely to lead to new borrowing and new investment. Sounds like Washington is going to try to increase the budget deficit with tax cuts which has never been attempted before in modern economic history... given where we are in the business cycle. Fiscal stimulus is ordinarily taken up by lawmakers when the sky is falling and the economy is in recession. Not when the economy has reached the nirvana of full employment where everyone has a job.

Bank loans to small business has also slowed in the June 2017 call report rising 2.8% from the prior year. Maybe small business has all the free money they need as well although the prime rate is 4.25%. Of the 2017 \$5.8 billion increase in small business loans to \$337.0 billion, most of the increase was in loans made that were less than \$100,000. Bank lending isn't a leading indicator of the broader economy, but the slowing trend should be monitored.



Trump February 3, 2017
 “Frankly, I have so many people, friends of mine that have nice businesses that can’t borrow money, they just can’t get any money because the banks just won’t let them borrow because of the rules and regulations in Dodd-Frank.”



Fed to market: damn the low inflation, full speed ahead

It's official. Fed officials waved the green flag Wednesday to start the \$4.5 trillion balance sheet wind down. This news had no immediate effect on the markets as the exact details were spilled, down to the last dollar of just how they would do it, back three months ago at the June Fed meeting. All it means for bonds is that 10-yr Treasury yields might go 40 bps higher over the next few years. It's all about supply. If a maximum wind down of \$360 billion of Treasuries come off the Fed balance sheet over a year's time, then the Treasury has to auction \$360 billion more Treasuries back to the market. 10-yr Treasury yields have started their climb we guess as yields were about 4 bps higher at 2.28% immediately after the Fed's announcement.

The biggest news at this week's meeting was the Fed's interest rate forecasts. It may be a slippery slope these so-called dots forecasts on rates in the years ahead, things can change, but it is the latest thinking of Fed officials none the less. It matters. All's we can say is whew! We were worried the low inflation advocates at the Fed would pick up enough votes from colleagues to scuttle the third rate hike seen later this year. We are talking about one more rate hike is all to 1.5%, and some officials around the table seem to be of the belief that rate hikes slow growth. From this low level. Oy-vey.

Anyway, the year-end 2017 median forecast for the Fed funds rate remains 1.4% (call it 1.5% among friends), the same call as the committee had in June. Nothing has changed. Low inflation didn't take a rate hike off the table (this year anyway). The market was all ears. January Fed funds futures said a rate hike in December was a 46% possibility and after the Fed news at 2 o'clock Wednesday the odds moved up to 64%. We will see. Three months more to go before a decision needs to be made on December 13 and a lot can change. We may even know if Yellen will be reappointed with her term finishing up shortly on February 3, 2018.

Net, net, the Fed is keeping with the game plan and neither hurricanes nor low inflation can keep them from raising interest rates a third time this year. Hurricanes Harvey, Irma, and Maria devastated many communities the press statement said and had inflicted severe damage and hardship. But the Committee thought based on past experience that storms do not normally alter the path of the economy over the longer term. The Greenspan Fed didn't skip a rate hike following Hurricane Katrina in 2005. This Fed under Yellen is not going to skip a beat either. The economy remains better than many out there think. Rate hikes are coming. Bet on it.

DOTS FORECASTS SEPTEMBER VS. JUNE MEETINGS

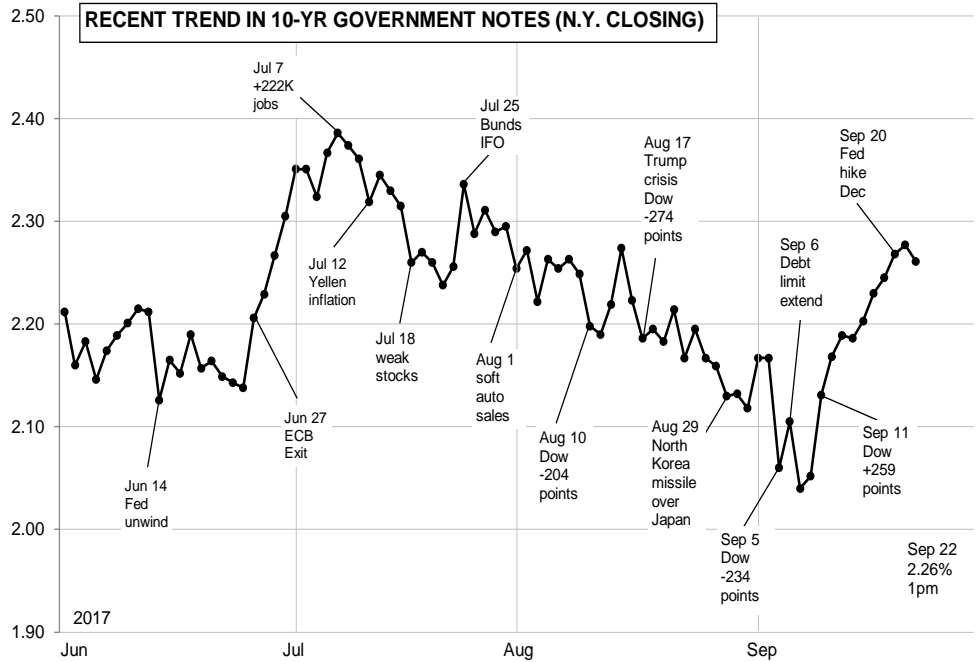
Fed Individual Forecasts						Fed Individual Forecasts					
Fed funds rate by year-end					Longer	Fed funds rate by year-end					Longer
Votes	2017 End	2018 End	2019 End	2020 End	run	Votes	2017 End	2018 End	2019 End	run	
1	1.125	1.125	1.125	1.125	2.250	1	1.125	1.125	1.125	2.500	
2	1.125	1.125	1.625	2.375	2.500	2	1.125	1.625	2.375	2.750	
3	1.125	1.625	2.125	2.375	2.500	3	1.125	1.875	2.375	2.750	
4	1.125	1.875	2.375	2.500	2.500	4	1.125	1.875	2.625	2.750	
5	1.375	1.875	2.375	2.625	2.500	5	1.375	2.125	2.625	2.750	
6	1.375	2.125	2.500	2.625	2.750	6	1.375	2.125	2.625	2.750	
7	1.375	2.125	2.625	2.750	2.750	7	1.375	2.125	2.875	3.000	
8	1.375	2.125	2.625	2.875	2.750	8	1.375	2.125	2.875	3.000	
9	1.375	2.125	2.750	2.875	2.750	9	1.375	2.125	3.000	3.000	
10	1.375	2.125	2.875	2.875	3.000	10	1.375	2.375	3.000	3.000	
11	1.375	2.125	2.875	3.000	3.000	11	1.375	2.375	3.125	3.000	
12	1.375	2.375	3.125	3.125	3.000	12	1.375	2.625	3.125	3.000	
13	1.375	2.375	3.125	3.500	3.000	13	1.625	2.625	3.125	3.000	
14	1.375	2.375	3.250	3.500	3.000	14	1.625	2.625	3.250	3.000	
15	1.375	2.500	3.375	3.625	3.500	15	1.625	2.750	3.375	3.500	
16	1.625	2.625	3.375	3.875		16	1.625	3.125	4.125		
17						17					
Median	1.375	2.125	2.688	2.875	2.750	Median	1.375	2.125	2.938	3.000	
Meeting	Sep 2017	Sep 2017	Sep 2017	Sep 2017	Sep 2017	Meeting	Jun 2017	Jun 2017	Jun 2017	Jun 2017	

They kept with the call for a final rate hike this year. Okay. But one problem for those like us that want to see higher interest rates is their idea of the long run Fed funds rate came down 25 bps from 3% in June to now 2.75%. This unfortunately tends to make investors think 10-yr yields are not going up above 3%. The Fed was before today looking for 7 rate hikes through 2019 (they added a 2020 forecast today), and now they are looking for, call it 6-1/2 rate hikes. Out in 2019 you have 7 saying the Fed funds rate ends the year at 3%, one member is in the middle, and 8 say just two hikes in 2019 ending the year at 2.75%. There is some uncertainty because these forecasts can either be the midpoint of a 25 bps range or the top of the target, e.g. 2.875 is the middle of the 2.75-3.00 Fed funds rate range, or a Fed official could just call this 3%. Anyway, it is a long way out there. The dots forecasts are a little less relevant as there is likely to be a new Fed Chairman in there this time next year and we assume they will be more hawkish and bring rates up more quickly than Yellen. But at least Yellen is more hawkish and sticking to her guns on a final rate hike this year. More hawkish than those handwringers concerned that inflation is too low. Thank you.

MARKETS OUTLOOK

	22-Sep 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020
30-Yr Treasury	2.80	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10
10-Yr Note	2.26	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90
5-Yr Note	1.87	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70
2-Yr Note	1.44	1.60	1.85	2.10	2.40	2.60	2.85	3.10	3.35	3.35	3.60
3-month Libor	1.33	1.65	1.90	2.20	2.45	2.70	2.95	3.20	3.45	3.35	3.70
Fed Funds Rate	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50
2s/10s spread	82	90	85	90	80	80	65	60	45	55	30

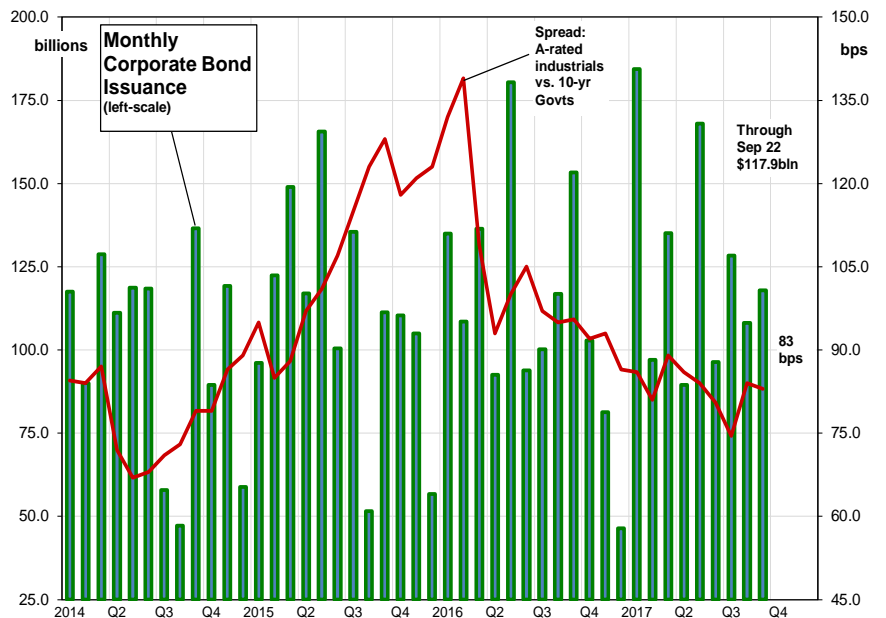
The Fed came and met, no action on rates, so we moved the quarterly interest rate forecast out... well, one quarter. We don't want to change the higher 3%-plus bond yields story now with more Fed rate hikes in the pipeline, the market exaggerating the low inflation threat to the economy, foreign investors have stopped buying Treasuries, and the balance sheet unwind will add \$360 billion to the Treasury auction schedule by October 2018 at the same time Washington is talking



about boosting the Federal budget deficit by an additional \$150 billion per year. Fortunately, Yellen has more experience than many on the FOMC and is in favor of keeping with the higher path of rates.

CORPORATE BONDS: 3M, EXPEDIA, BUNGE, ALLEGION, NEXTERA, AEP

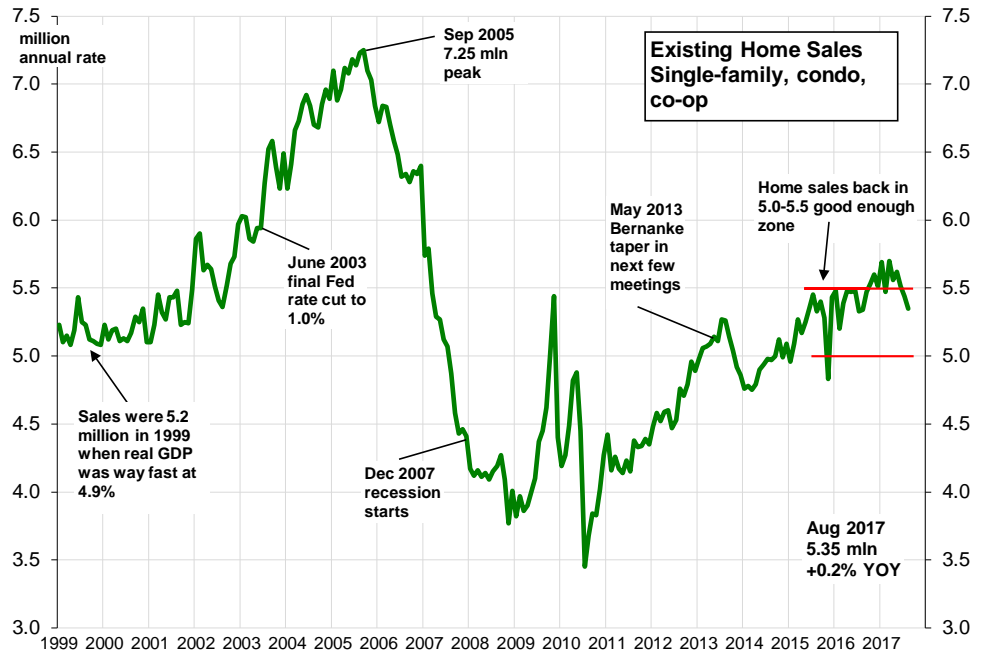
Corporate offerings were \$18.7 billion in the September 22 week versus \$49.5 billion in the September 15 week. On Thursday, 3M Co. sold \$2.0 billion 5.5s/10s/30s. It priced \$850 million 2-7/8% 10-yrs (m-w +12.5bp) at 67 bps (A1/AA-). The global diversified manufacturer will use the proceeds to purchase outstanding debt and for its Scott Safety acquisition. Corporate bonds (10-yr Industrials rated A2) were 83 bps above 10-yr Treasuries this week versus 85 bps last Friday.



OTHER ECONOMIC NEWS THIS WEEK

Existing home sales slow as baby boomers delay their retirement plans and instead shelter in place

Breaking economy news. Existing home sales fell 1.7% from 5.44 million in July to 5.35 million in August (annual rates). Okay, not a lot, and some of the decline was in the South from Hurricane Harvey according to the National Association of Realtors that produces the report. Part of the slower turnover may also reflect sticker shock for home buyers as prices continue to rise faster than wages.

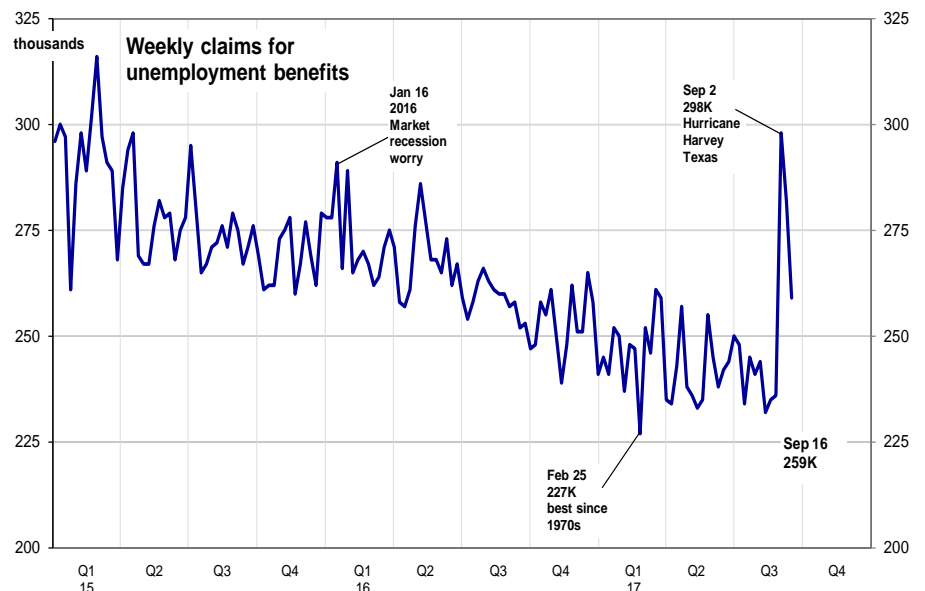


Kind of a double whammy here for home sales turnover. There's not enough homes to select from as retirement plans get shelved and at the same time prices of what is on the market are increasingly moving out of reach. A decade ago there was a housing bubble in prices now there's a housing shortage crisis where there is not enough affordable housing.

One of the risks out there for the broader economy is that this house of cards comes tumbling down. The housing sector is the one area of the economy that just never reached a full recovery from the recession. The Fed cut rates to zero and did billions of QE yet nothing worked. Their tool box is empty when it comes to trying to boost the housing economy.

Jobless claims fall as companies weather the storm(s)

Breaking economy news. Don't turn out the lights yet on this increasingly long-lived economic expansion is the message of hope in this week's drop in unemployment claims. The weekly count of newly unemployed workers applying for jobless benefits fell for a second week in a row by 23K to 259K in the September 16 week. Before the first storm, Hurricane Harvey, hit Texas, jobless claims



were normal at 236K in the August 26 week. The storm count lifted layoffs by 62K to 298K in the September 2 week and then claims started to come back down. The joblessness or those unable to work was much worse in Hurricane Harvey in Texas than it was when Hurricane Irma struck Florida a week later.

Net, net, jobless claims continue to normalize after getting walloped by the hurricane storms a couple of weeks back when many workers were unable to work in the disaster related counties of Texas. Jobless claims are a sensitive indicator of current economic conditions but the rise in claims was largely technical, putting economists on a storm watch not a recession watch. Higher stormy-weather jobless claims were spinning in a vortex offshore of the real economy. There is no fundamental economic weakness story behind these elevated layoff readings. The economy is better than we think. The Fed is right to stick with the plan to normalize its policy as the economy is expected to weather these latest storms in the medium term. We expect a rate hike by Fed officials at the end of the year. Bet on it. The economy is normal and interest rates need to be too.

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