

Market  
Commentary



## Bond Yields

- Recent lowest yields in history
- Yields don't make sense fundamentally
- Fed's QE took yields to those levels
- Yields might be higher absent the ECB's QE
- The wind-down of the ECB's QE will remove a weight on U.S. Treasury yields



## Fed policy

- Inflation has met Fed's target
- On a path of steady hikes to 3% fed funds rate
- The Fed manages the yield curve
- The Fed has created every recession since the 1950s
- The Great Unwinding: bond yields set to start rising
- The entire yield curve is shifting higher



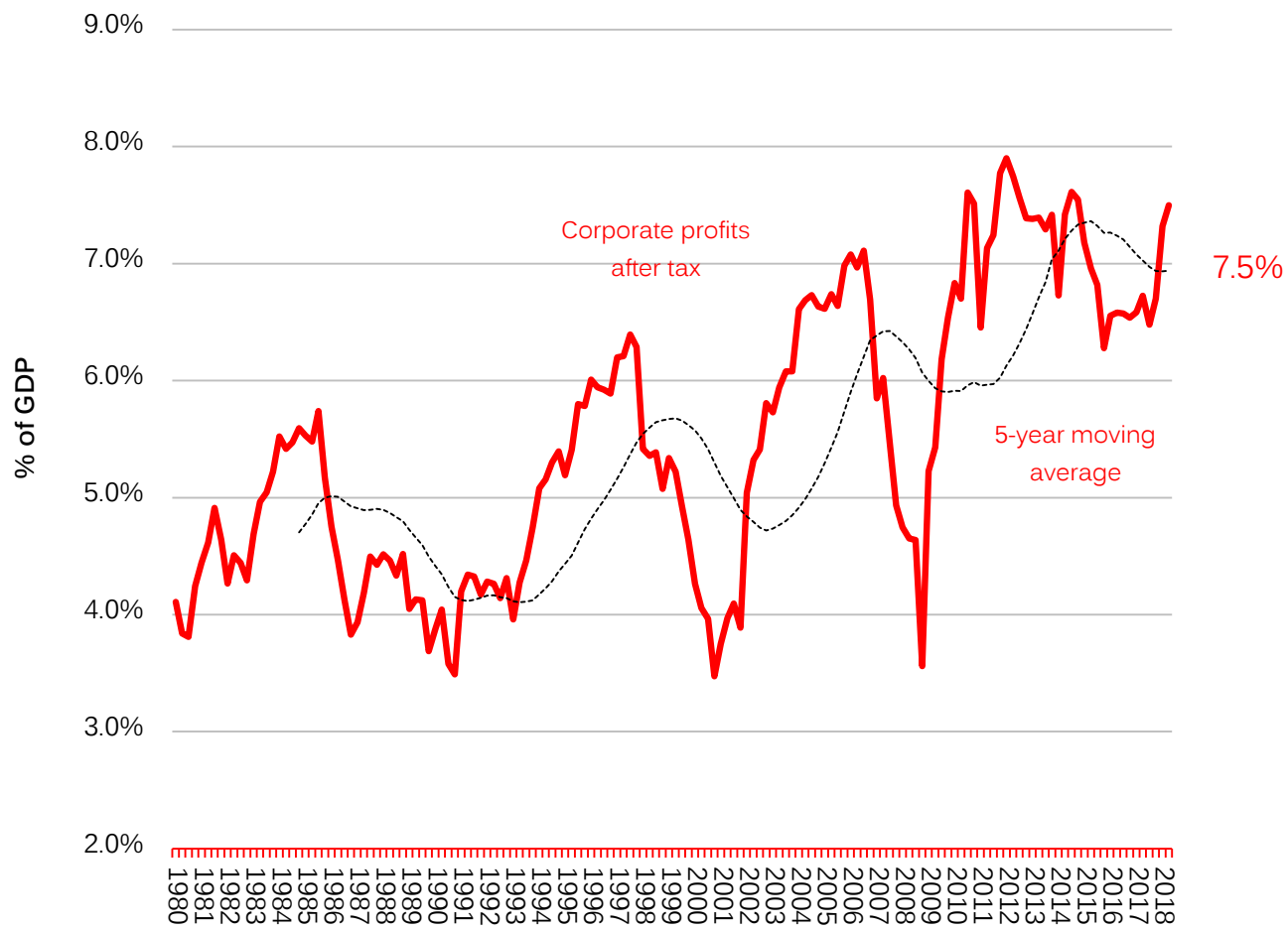
# Stock Market

- Near record highs
- Driven by global expansion and earnings surge
- Lower \$USD
- Stocks are not over-valued
- Margins are likely sustainable
- Fed is still accommodative
- Inflation is still tame
- Lack of irrational exuberance
- Are rising bond yields bad for stocks?



# Profit Margins

## Corporate Profit Margins Near Peak



Profit margins are near record highs even as labor's share of gross domestic income has increased to 53% from less than 52% in 2014.

See next slide.

The near-doubling in profit margins since 1980 may represent a substantially permanent shift. See footnote, next slide.

If profit margins have permanently upshifted, comparisons of stock market valuation tied to book value, replacement value (Tobin's Q), price-to-sales or GDP (Buffet indicator) are not helpful.

Source: BEA. Quarterly data through June 2018.



### Economy

Full-employment economy operating at full potential

+2.7% GDP growth forecast, compared to post-recession +2.2% average

Surge in LEI, small business optimism index, recovery in business investment healthy growth in personal income, real DPI, strong retail sales

Strong household balance sheets, savings rate, record FICO scores and low household financial obligations ratio record high PMIs, strong hiring, record high job openings, new low unemployment rate, record low weekly unemployment claims, flat vehicle sales, flat housing starts

Inflation expectations are rising

“Our economy is strong. Growth is running at a healthy clip.

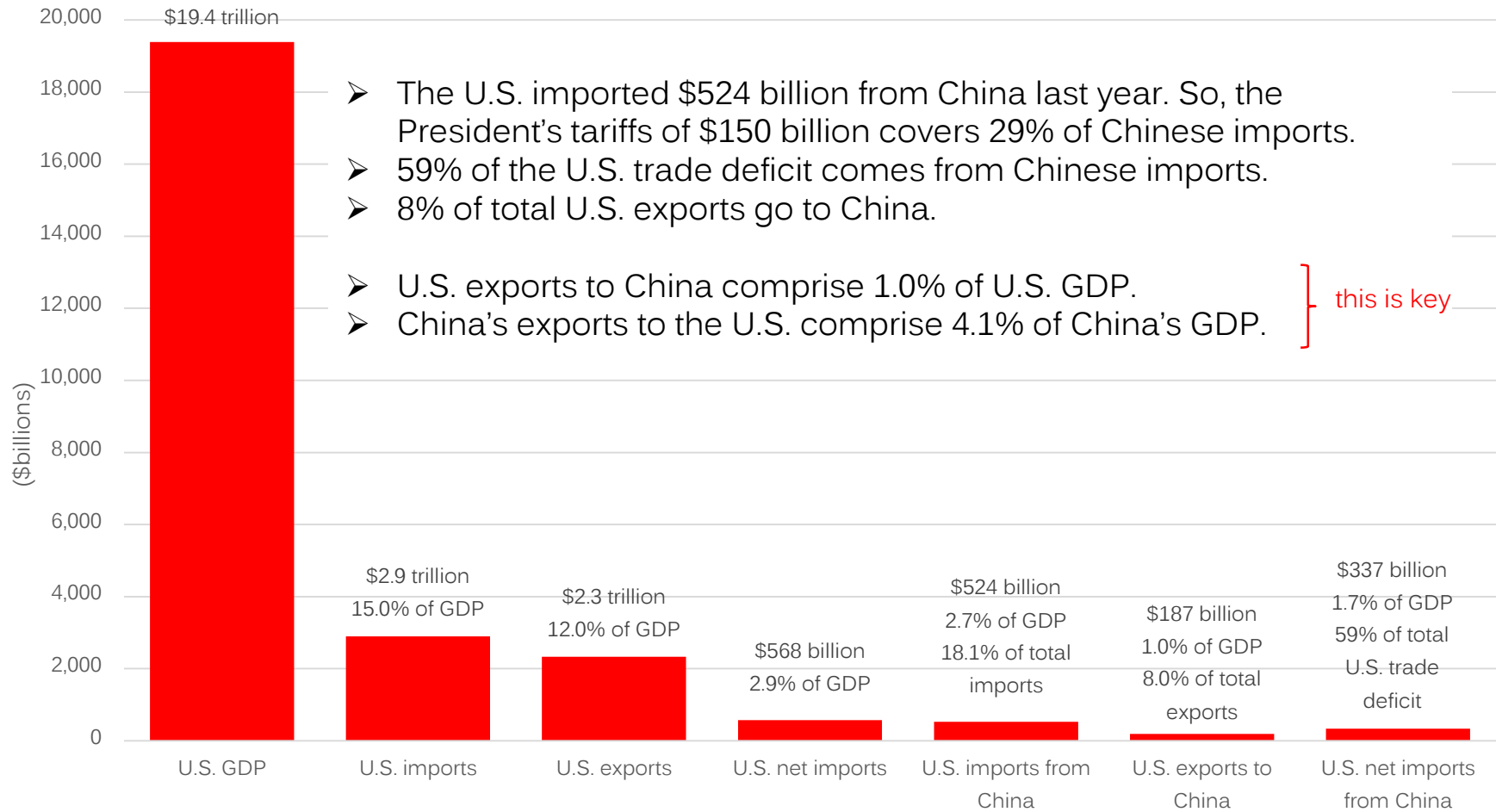
Unemployment is low, the number of people working is rising steadily, and wages are up. Inflation is low and stable.”

Jerome Powell  
Chairman of the Federal Reserve  
September 27, 2018



# Trade

## U.S. Imports and Exports % of GDP



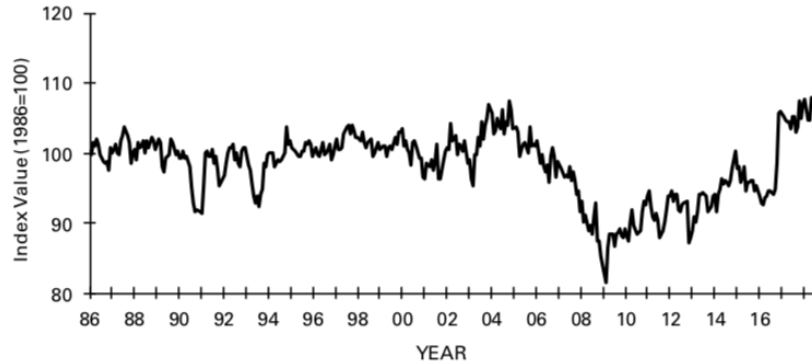
Source: U.S. Census Bureau. Includes goods and services. Data for 2017. China's 2017 GDP was \$12.86 trillion, reported by the South China Post 1/18/2018.



# Economic Data Small Business Optimism Index - Gangbusters

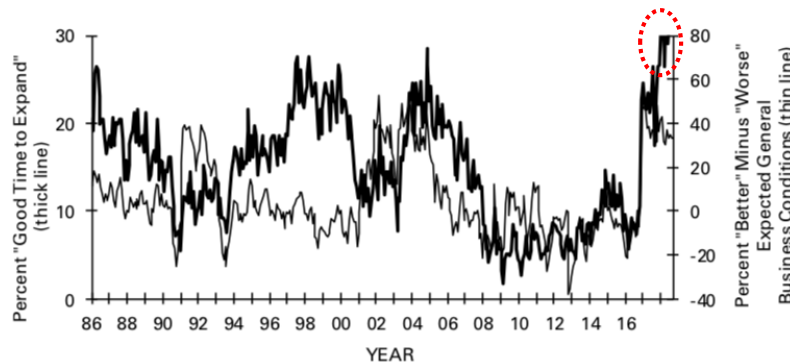
## OPTIMISM INDEX

Based on Ten Survey Indicators  
(Seasonally Adjusted 1986=100)



## OUTLOOK

Good Time to Expand and Expected General Business Conditions  
January 1986 to September 2018  
(Seasonally Adjusted)



“Small business owners continued to deliver a spectacular performance with September’s third highest Index reading in the survey’s 45 year history. The Index fell slightly from August’s survey record breaking high of 108.8 to 107.9. Six of the ten Index components declined, three advanced and one was unchanged, exactly reversing last month’s gain. Most of the decline came in the “hard” components of the Index (down 14 points) but still registered as the second highest reading since 1998, partially offset by some improvement in the expectations components (up 3 points).”

Expansion plans at record highs.

Source: NFIB. Data released October 9, 2018.





# Economic Data Small Businesses

## Small businesses play a major role in the American economy:

- Represents 99% of all employer firms
- Employ about half of private-sector employees
- Generated 60% to 80% of net new jobs annually over the last decade
- Create more than half of nonfarm private gross domestic product (GDP)

Table 2.

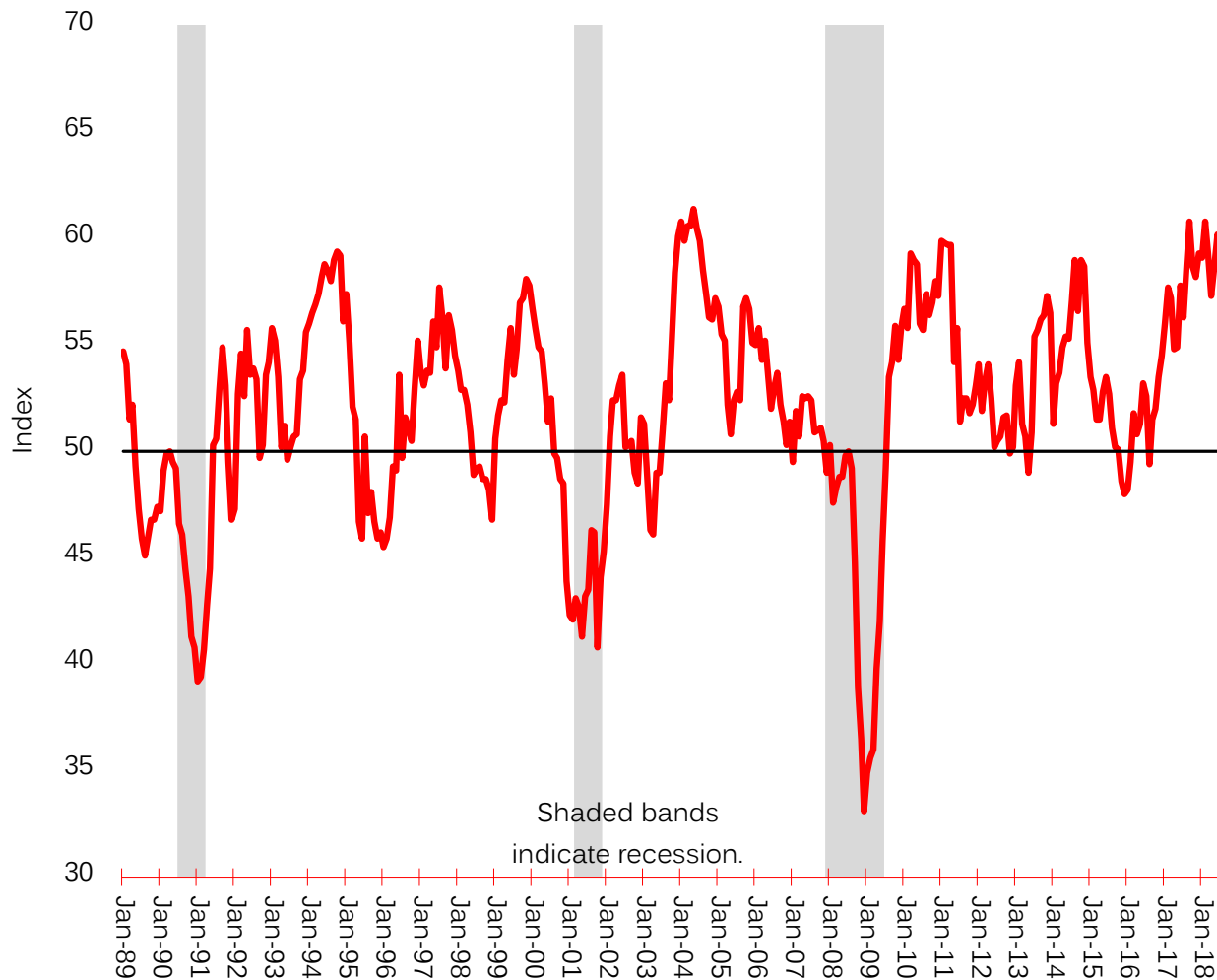
### Percentage of Total Employment by Enterprise Employment Size: 2003–2012

(For information on confidentiality protection, sampling error, nonsampling error, and definitions, see [www.census.gov/econ/susb/methodology.html](http://www.census.gov/econ/susb/methodology.html))

Enterprise employment size	Percentage of total employment									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Total</b> .....	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Enterprises with fewer than 500 employees . . . .	50.7	50.9	50.4	50.2	49.6	49.4	49.2	49.1	48.5	48.4
Very small enterprises .....	18.4	18.4	18.3	18.0	18.1	17.8	18.1	18.4	17.9	17.6
Small enterprises .....	17.8	17.9	17.6	17.6	17.3	17.1	16.9	16.6	16.6	16.7
Medium enterprises .....	14.5	14.6	14.5	14.6	14.2	14.5	14.1	14.2	14.0	14.0
Large enterprises .....	49.3	49.1	49.6	49.8	50.4	50.6	50.8	50.9	51.5	51.6

Source: U.S. Census Bureau, 2012 Statistics of U.S. Businesses.

Sources: National Federation of Independent Business website (top panel); U.S. Census Bureau, Statistics of U.S. Businesses Employment and Payroll Summary: 2012, released February 2015 (bottom panel).



September very strong at 59.8, down from August's 61.3.

New orders very strong at 61.8.

Note the historic volatility in the manufacturing PMI.

Note how this indicator has slumped well below 50 even during periods of strong economic expansion, eg. 1995, 1999, 2003, 2013.

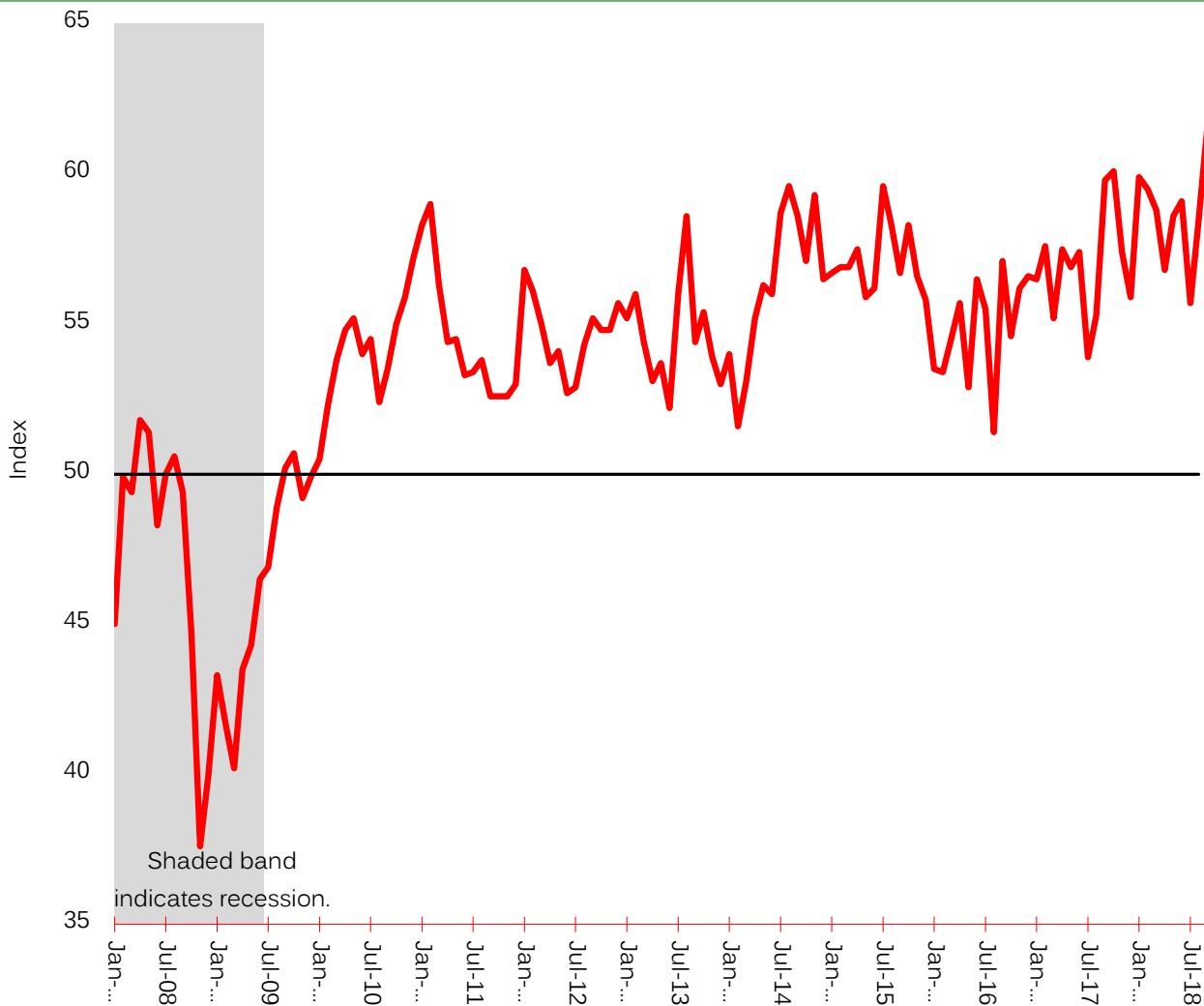
Source: Copyright 2018, Institute for Supply Management. Data through September 2018.

ISM: "A reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting. A PMI in excess of 43.1 percent, over a period of time, generally indicates an expansion of the overall economy."



# Economic Data

## ISM Manufacturing Purchasing Managers Index - Booming



September at 61.6 – a record.

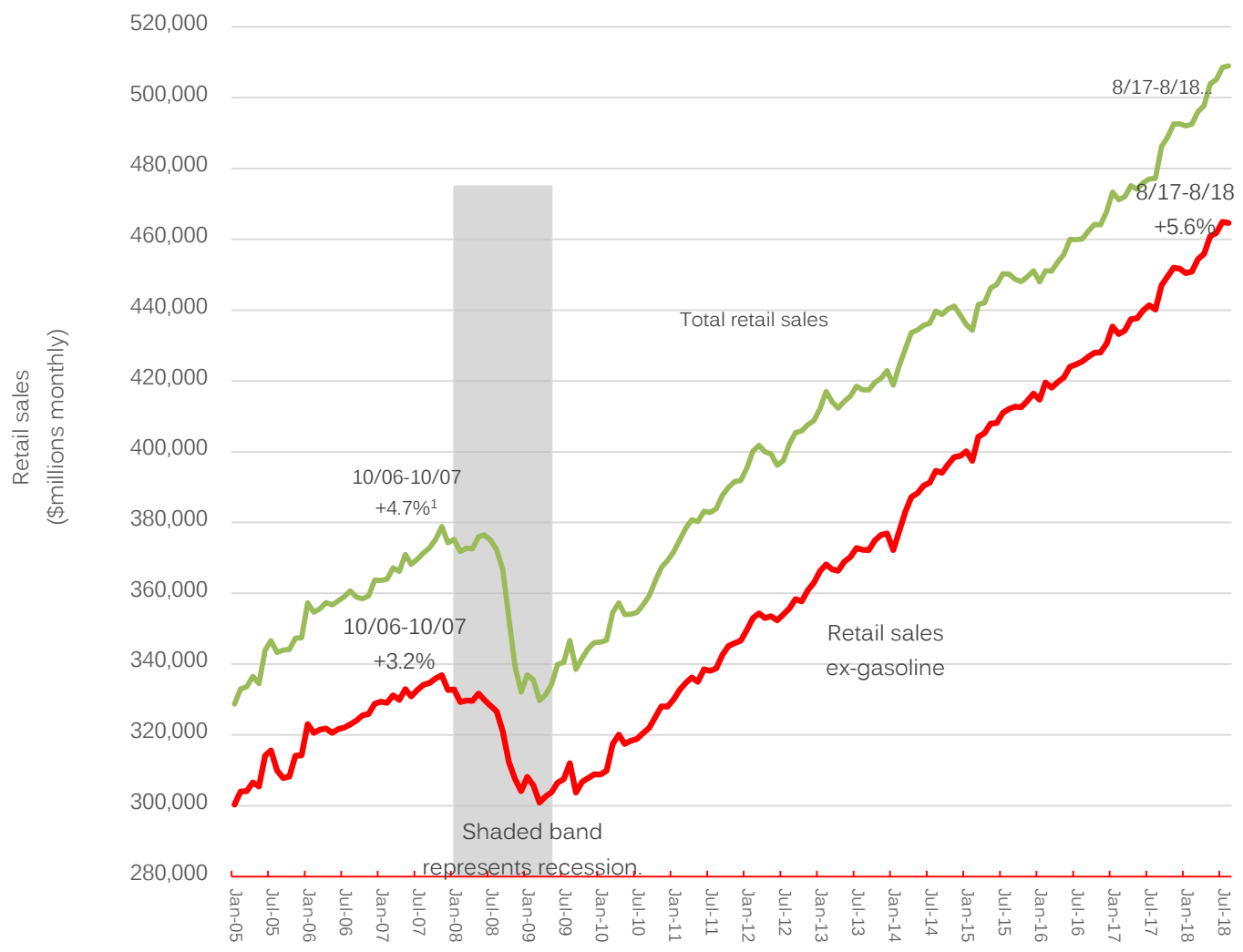
September new orders at 61.6, up from August's 58.5, and July's 55.7.

Non-manufacturing captures the vast majority of the U.S. economy.

Source: Copyright 2018, Institute for Supply Management; data through September 2018. This data series was created in 2008. ISM: "A reading above 50 percent indicates that the non-manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting."



# Economic Data Retail Sales



Retail sales are booming, growing faster than pre-recession.

August ex-gasoline +5.6% y/y.

Source: U.S. Census Bureau. Data through August 2018. <sup>1</sup>In the year 10-06-10/07 the price of crude oil surged +46% causing consumer expenditures on gasoline to surge as well.



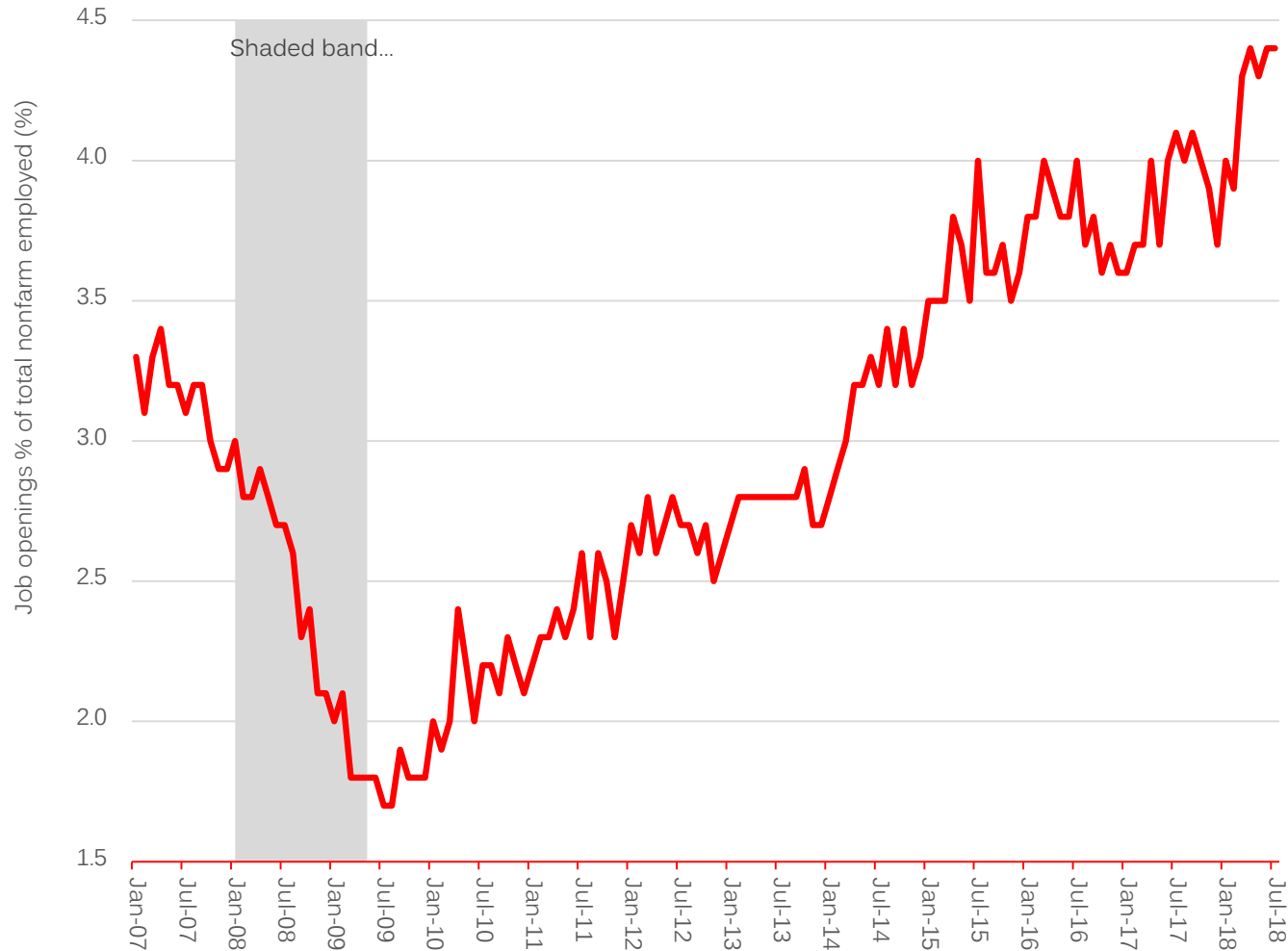
# Jobs

- Full-employment
- New jobs will soon be limited
- Good news in part-timers data
- Record job openings
- Declining participation rate due to ageing
- Still some slack?
- Strong relative U.S. job formation forecast long-term
- Strong real wage and income growth
- Mean and median incomes bottomed
- Myth: “... but we’re not creating good jobs”



# Economic Data – Jobs

## Job Openings Rate – Record High



Breakout to record highs.

Source: U.S. Department of Labor, NBER. Data through July 2018, released September 11, 2018. The job openings rate is computed by dividing the number of job openings by the sum of employment and job openings and multiplying that quotient by 100.



### Household balance sheets

- Fully repaired
- Financial obligations ratio at record low means that consumers are in record good shape to spend money
- Student debt growing fast but still just 10% of household debt



# BENCHMARK FINANCIAL

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