

Economic/Markets Update

October 2019

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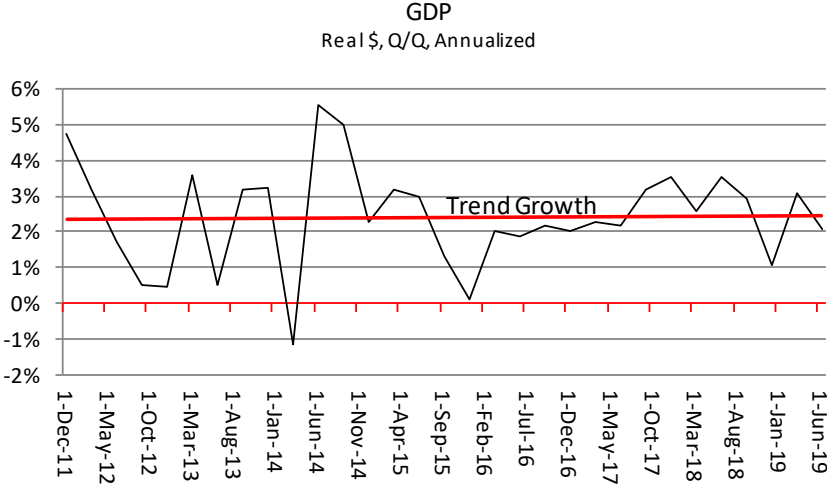


For Institutional Use Only

Risks & Opportunities

- **GDP** – Global growth and trade uncertainty weigh on business fixed investment and manufacturing. PCE is solid, but housing and autos are stagnant.
- **Inflation** – Cyclical components firm, while acyclical (e.g. technology) are minimally responsive to policy actions.
- **Employment** – Business confidence churns, consumers remain confident, hiring decelerates.
- **Financial Stability** – Leverage and valuations pose risk to the system.

GDP Trend Growth Has Been Stable Around 2.25%



Source: Bureau of Economic Analysis, Bloomberg Finance L.P., Stifel

	FRB ATL*	FRB NYC*	Stifel
2019Q03	1.78%	2.06%	1.50%

Source: Federal Reserve, Stifel

Note: Federal Reserve data represents “Nowcasts”, or contemporaneous modeling of factors that aggregate to GDP. 10/01/19

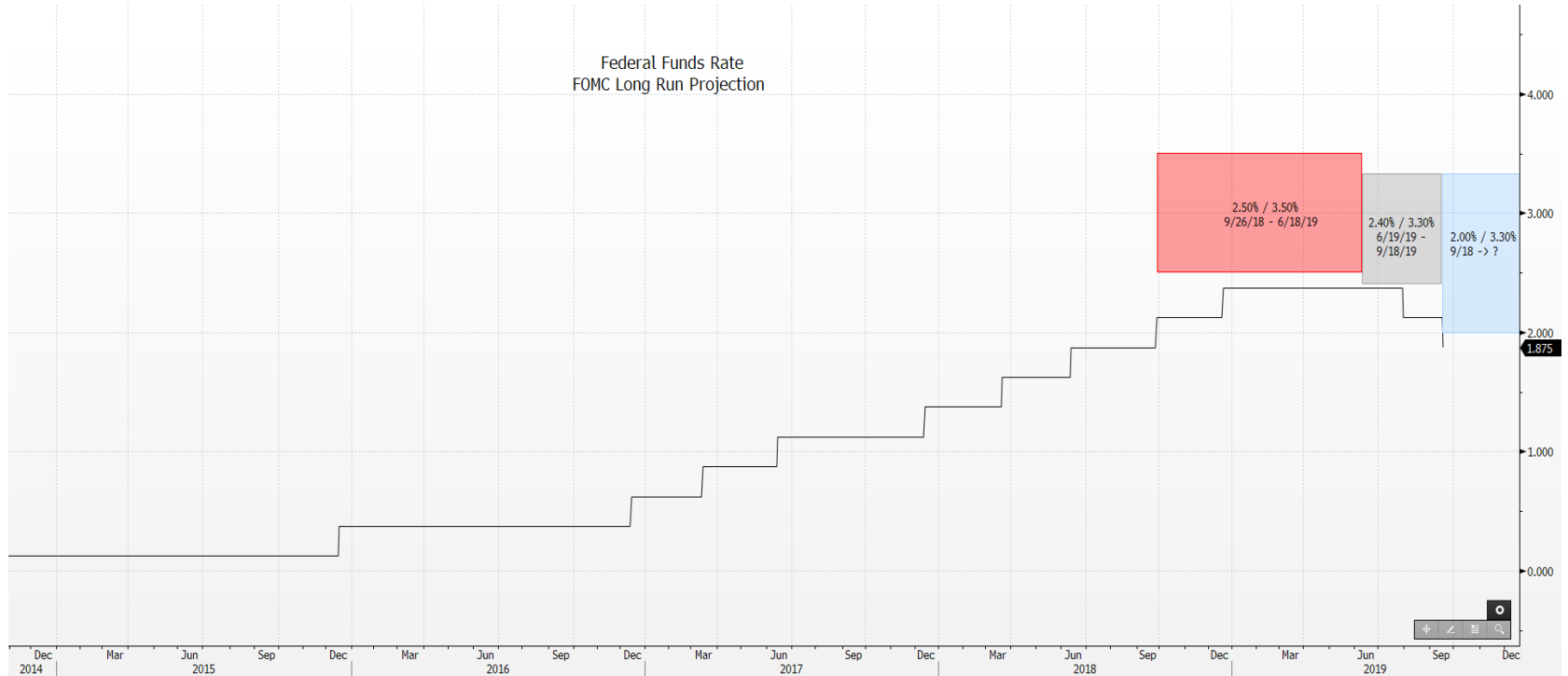
Median GDP	2019	2020	2021
Fed Projection	1.90%	1.90%	2.10%

Source: Federal Reserve, Stifel

Note: FOMC forecasts are as of September 18, 2019; Summary of Economic Projections



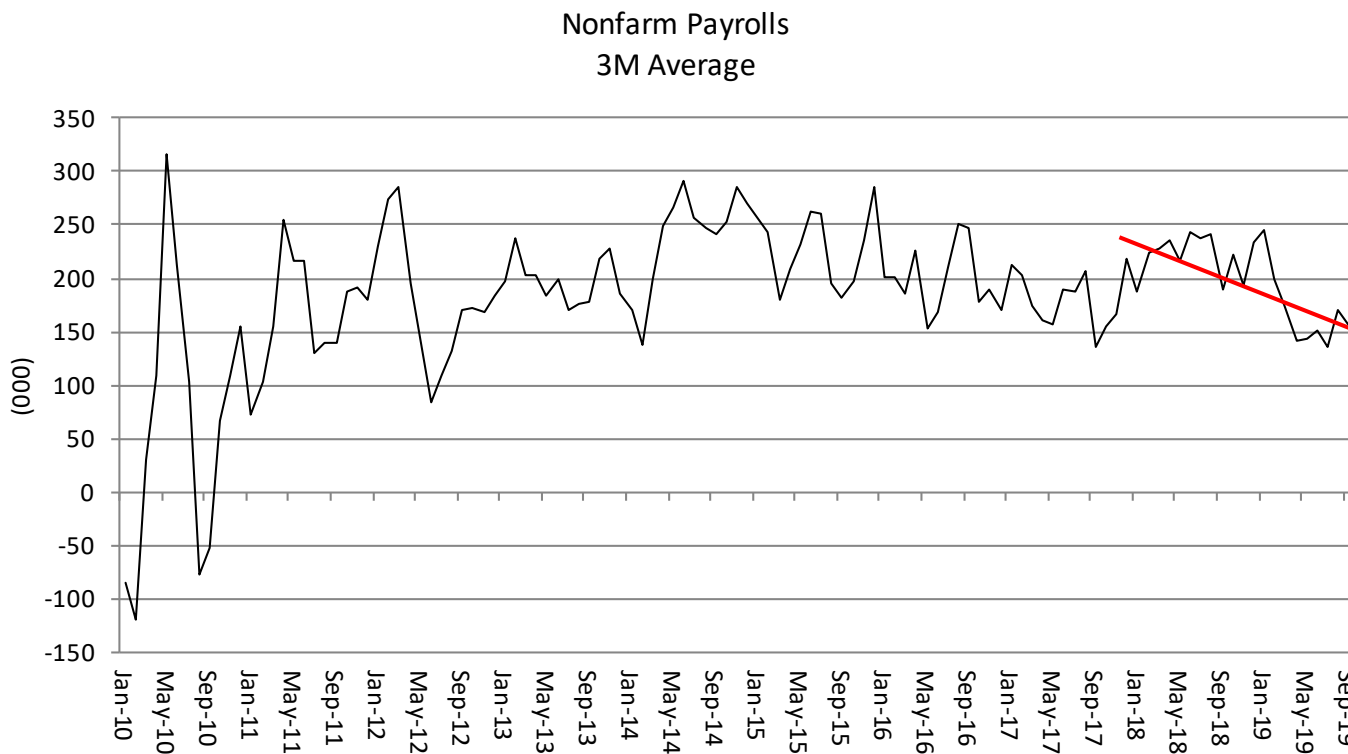
Fed Lowers the Neutral Rate and Retreats



Source: Federal Reserve, Bloomberg Finance L.P., Stifel



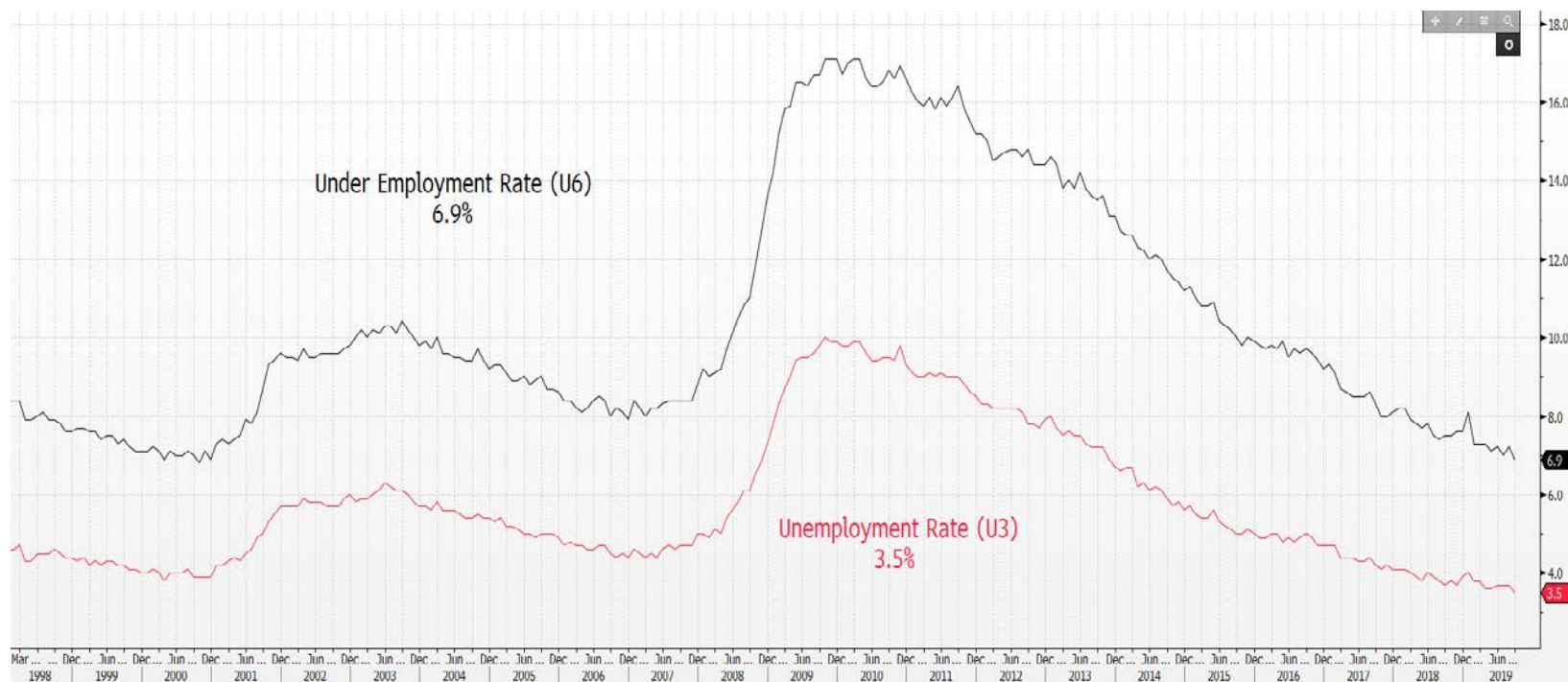
Slow Deceleration in Payroll Growth



Source: Bureau of Labor Statistics, Bloomberg Finance L.P., Stifel



Unemployment Rate(s) Hold Near Secular Lows



Source: BLS, Bloomberg Finance L.P., Stifel



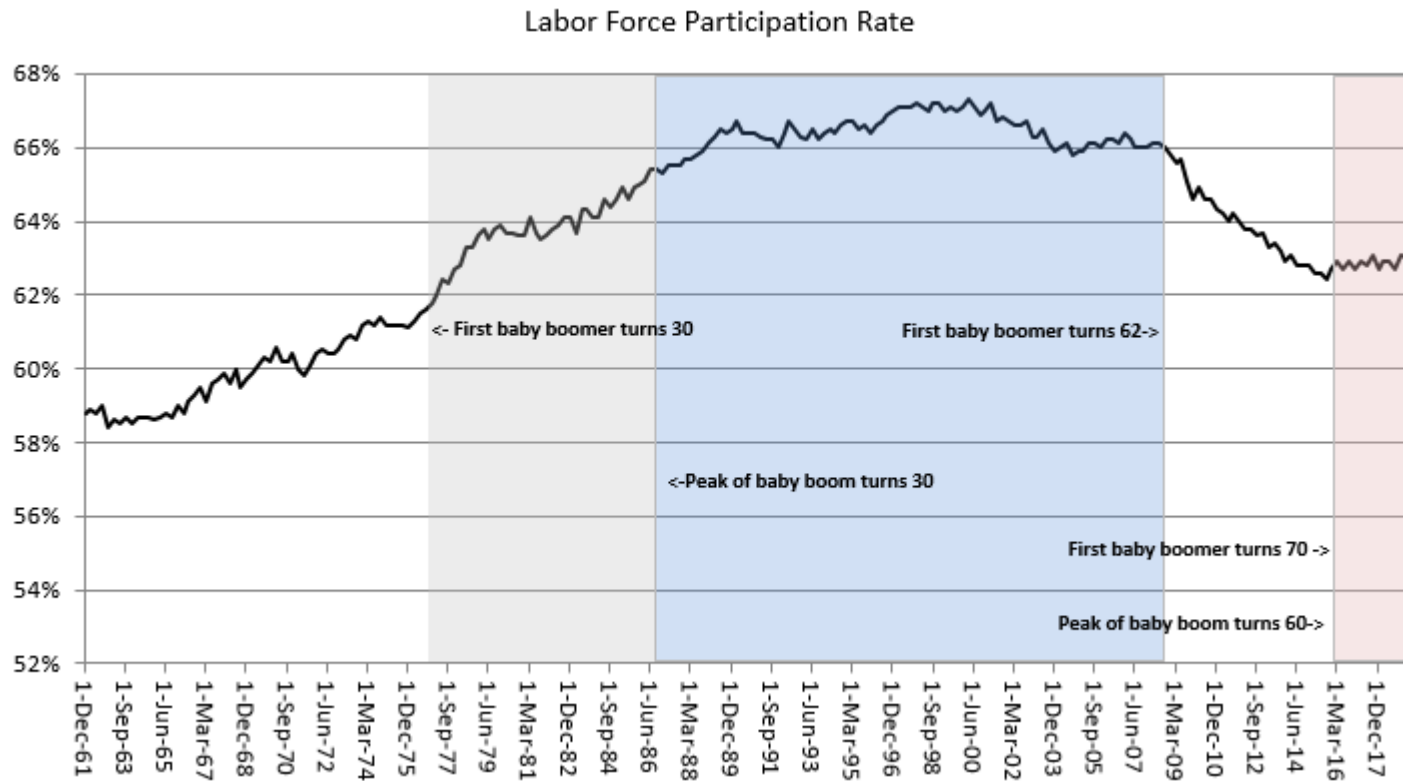
Hiring Metrics Could Be Characterized as “Firm” (but may have peaked)



Source: BLS, NFIB, Bloomberg Finance L.P., Stifel



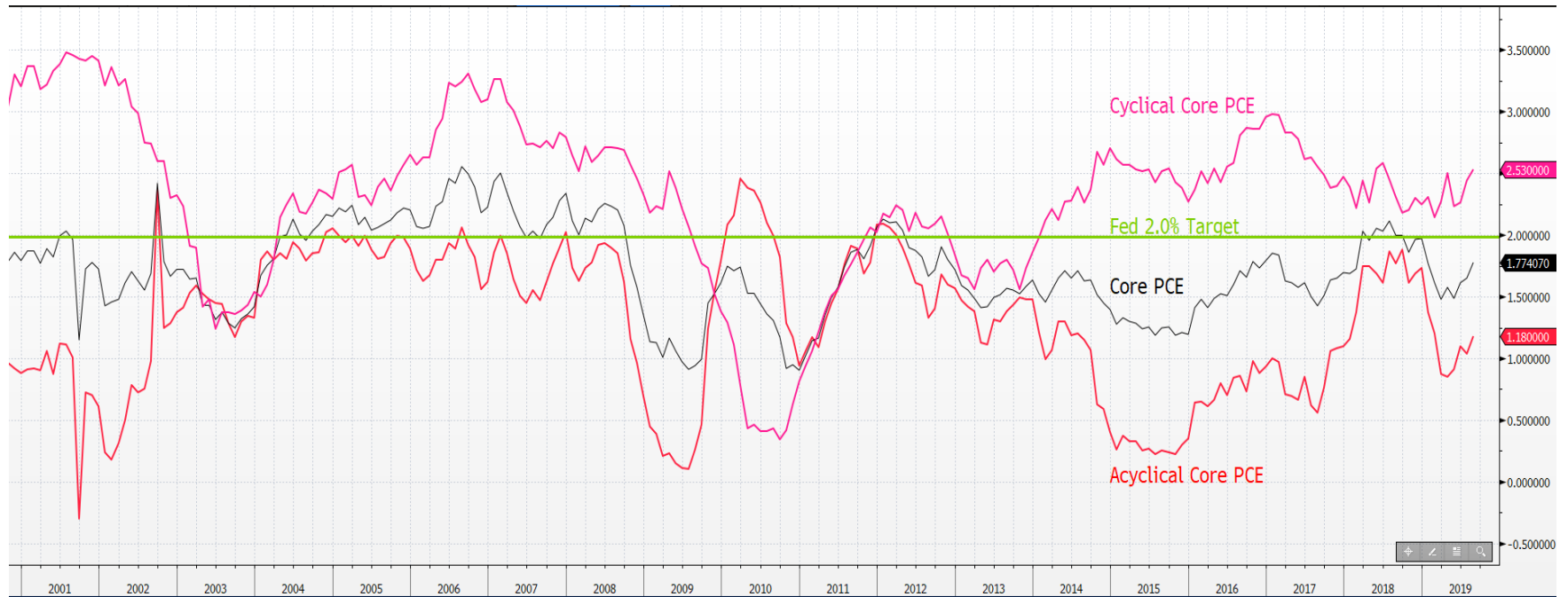
U.S. Demographic Profile is Part of the Poor Participation Rate Narrative



Source: Federal Reserve, Bloomberg Finance L.P., Stifel

Core PCE Fails to Sustainably Attain Fed's 2.0% Target

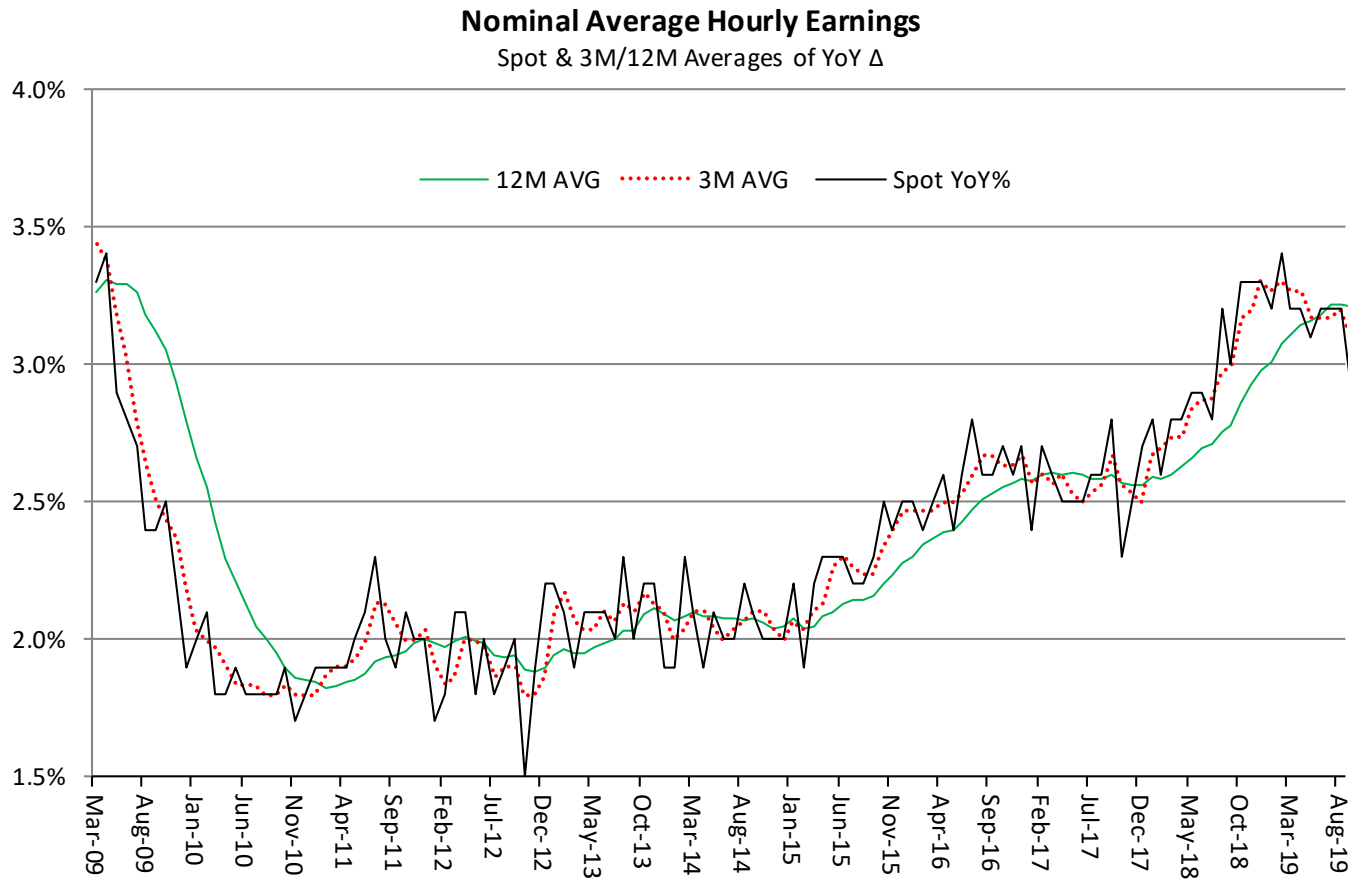
Below Target More Often Than Above Target



Source: Federal Reserve, BEA, Bloomberg Finance L.P., Stifel



Average Hourly Earnings: Starting to Roll Over?



Source: BLS, Bloomberg Finance L.P., Stifel



Market Measures of Inflation Declined in Q2

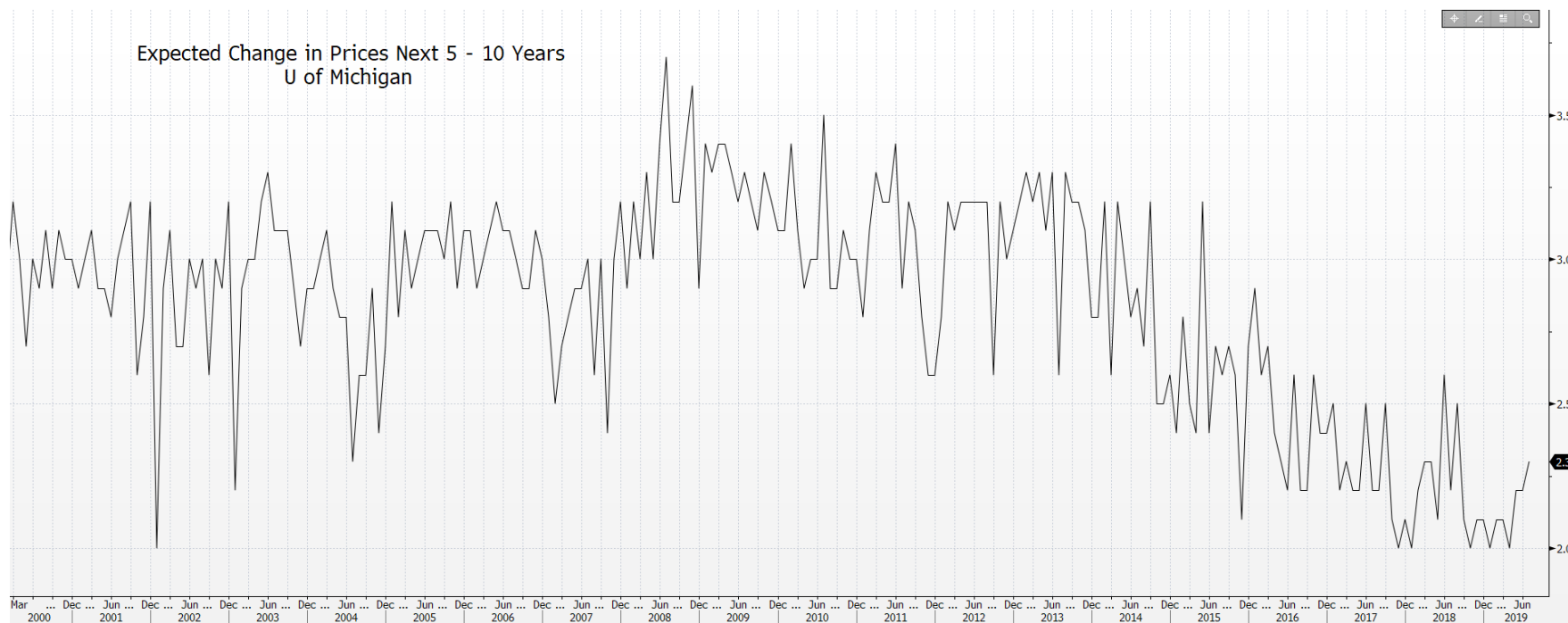
Market Derived Measure



Source: Bloomberg Finance L.P., Stifel



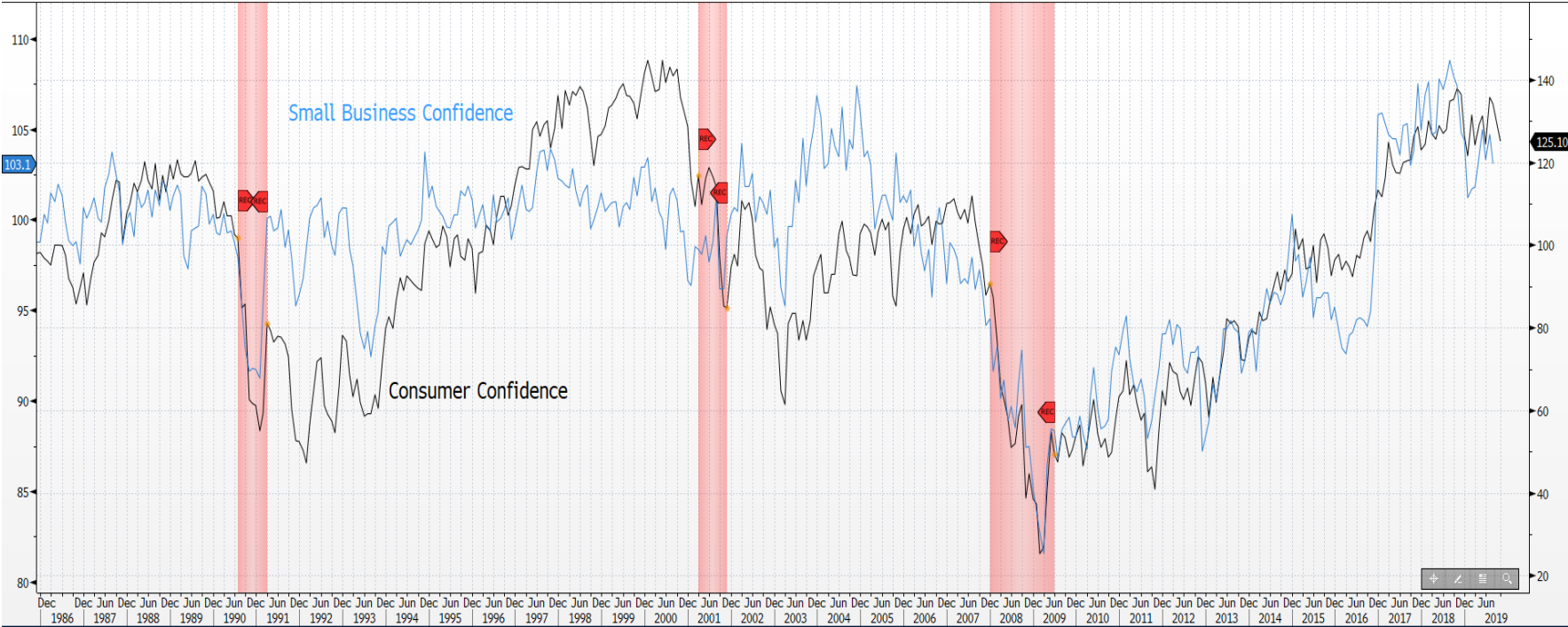
Consumer Expectations for Inflation Remain Subdued



Source: University of Michigan, Bloomberg Finance L.P., Stifel



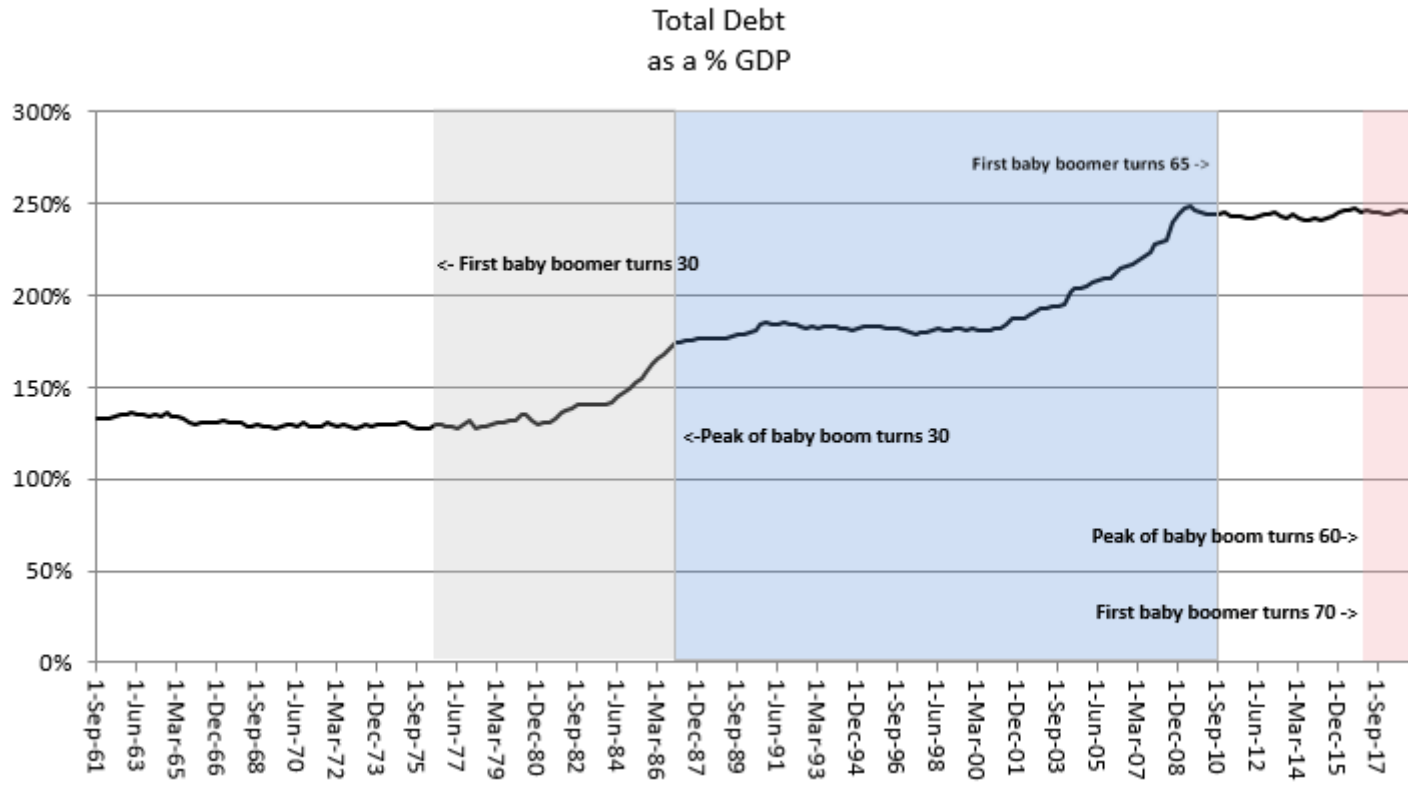
Confidence is a Leading Indicator



Source: Conference Board, Bloomberg Finance, L.P, Stifel

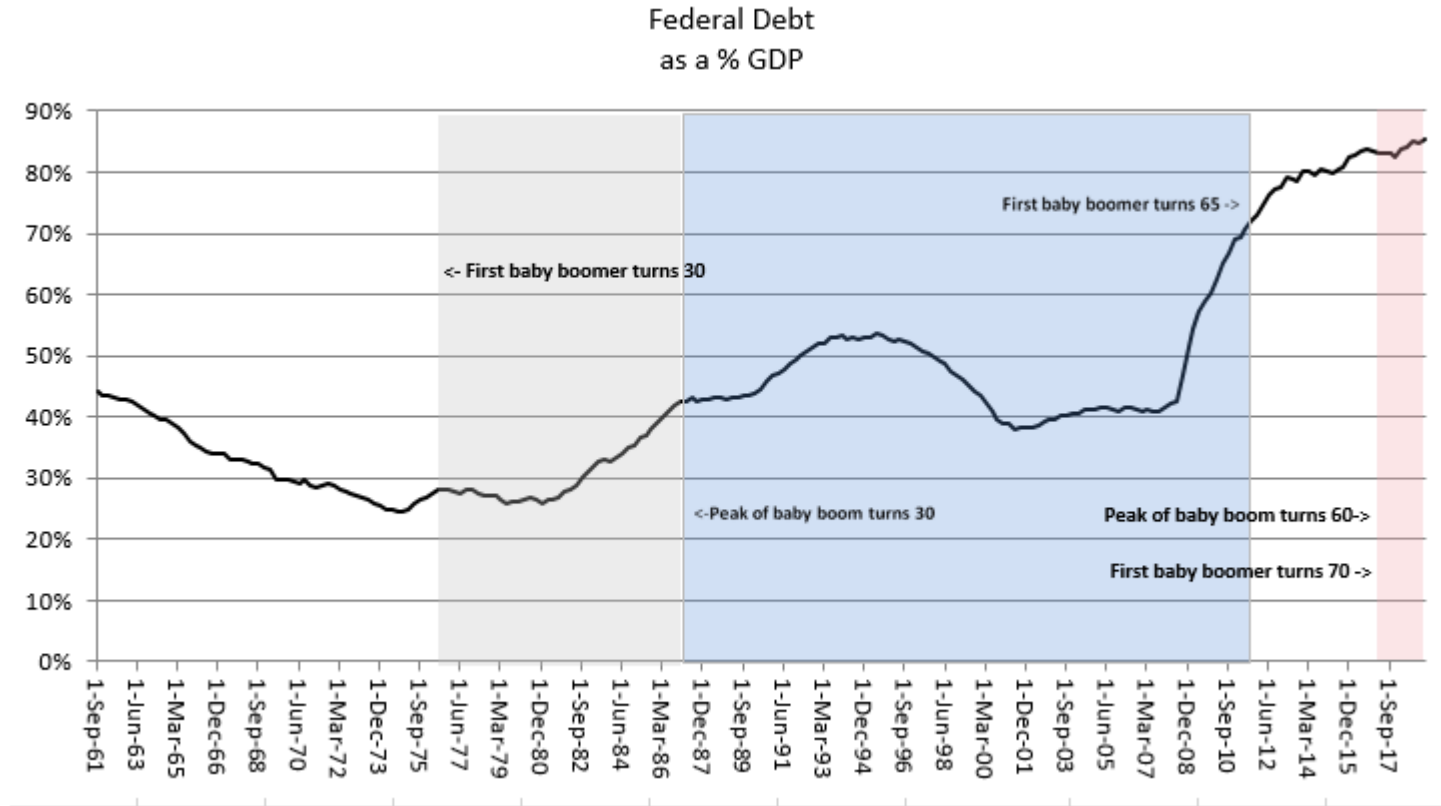


High Debt Levels in an Ageing Society



Source: Federal Reserve, Bloomberg Finance L.P., Stifel

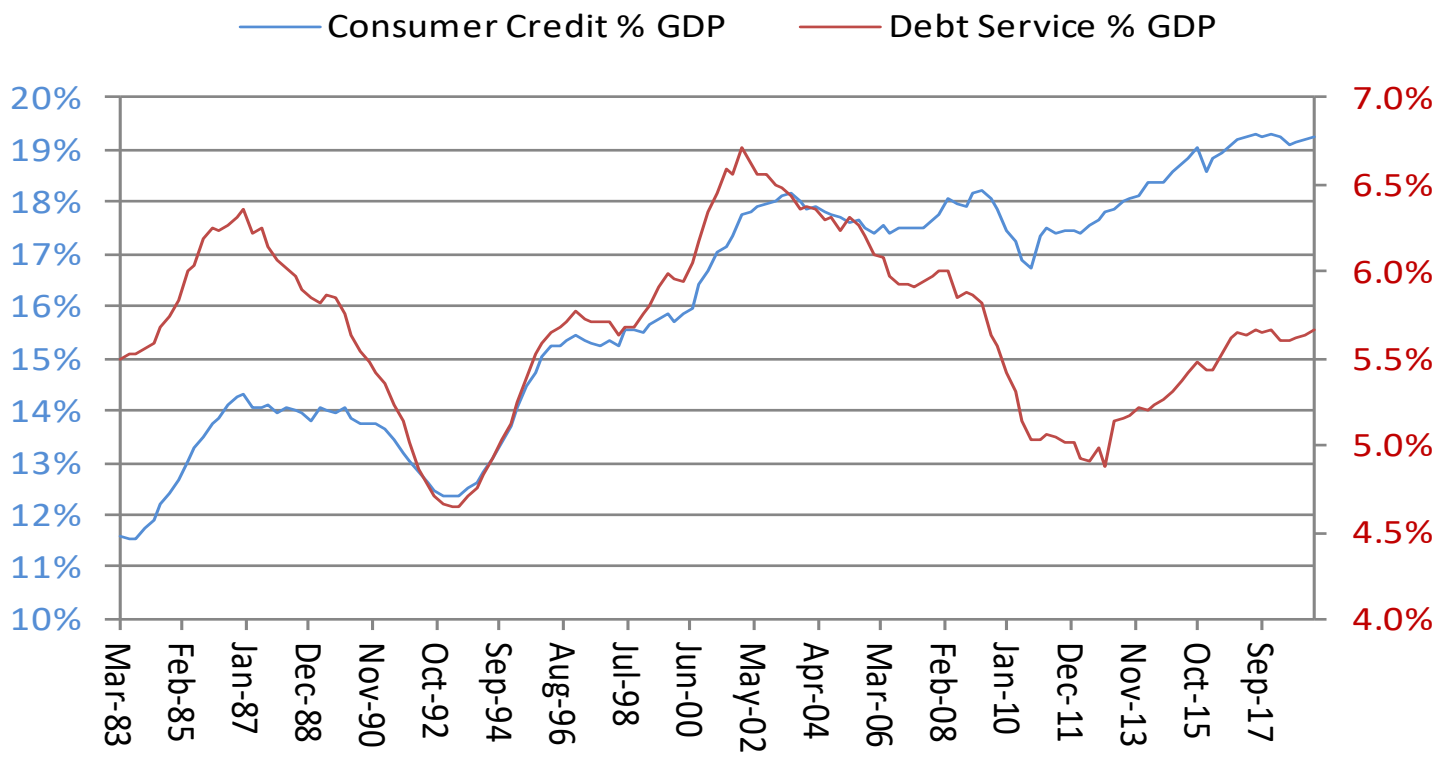
Federal Debt Levels are Set to Explode Due to Demographics



Source: Federal Reserve, Bloomberg Finance L.P., Stifel



Consumer Debt at Record Levels Relative to GDP; Servicing Costs are Moving Higher

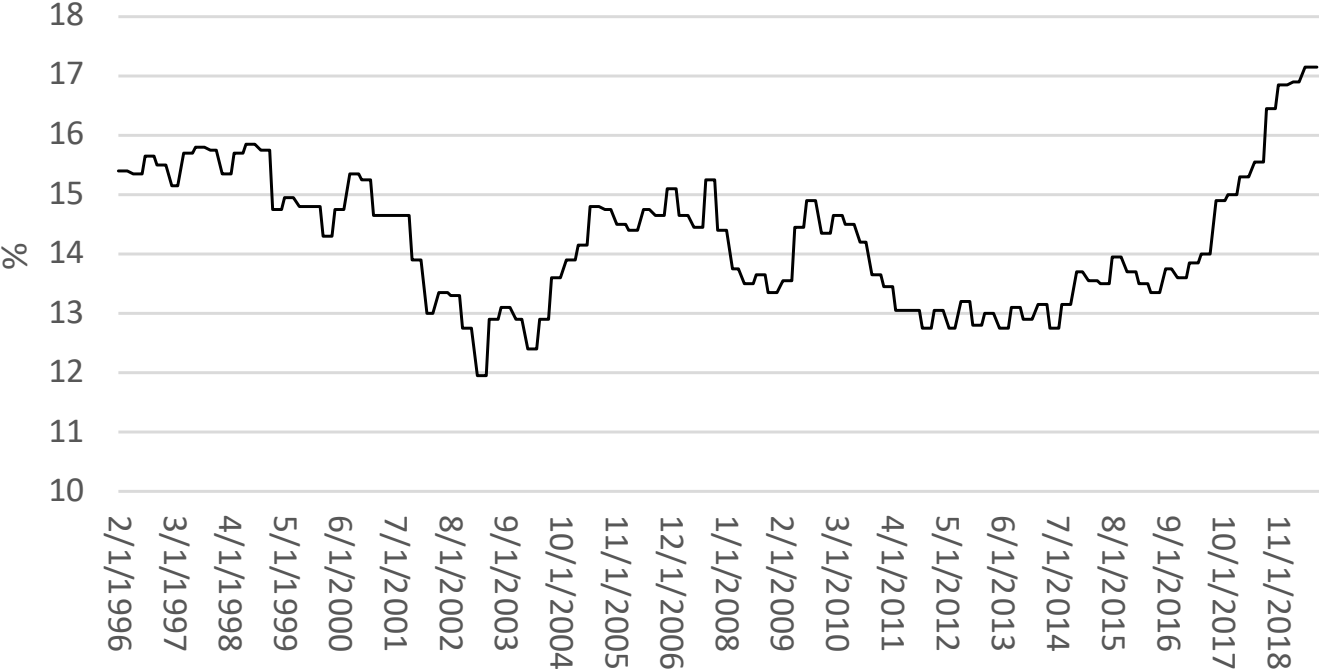


Source: Federal Reserve, BEA, Bloomberg Finance L.P., Stifel



Consumer Cost of Carry is Going Up

Credit Card Assessed Interest Commercial Bank



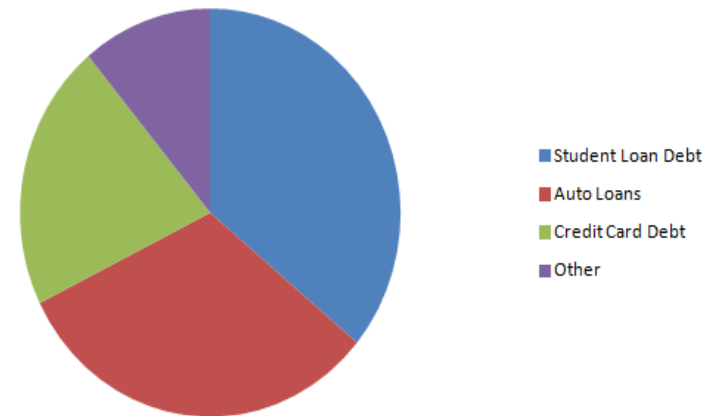
Source: Federal Reserve, Bloomberg Finance, L.P., Stifel



Consumer Debt Breakdown Ex-Mortgages

College, Cars, and Cards

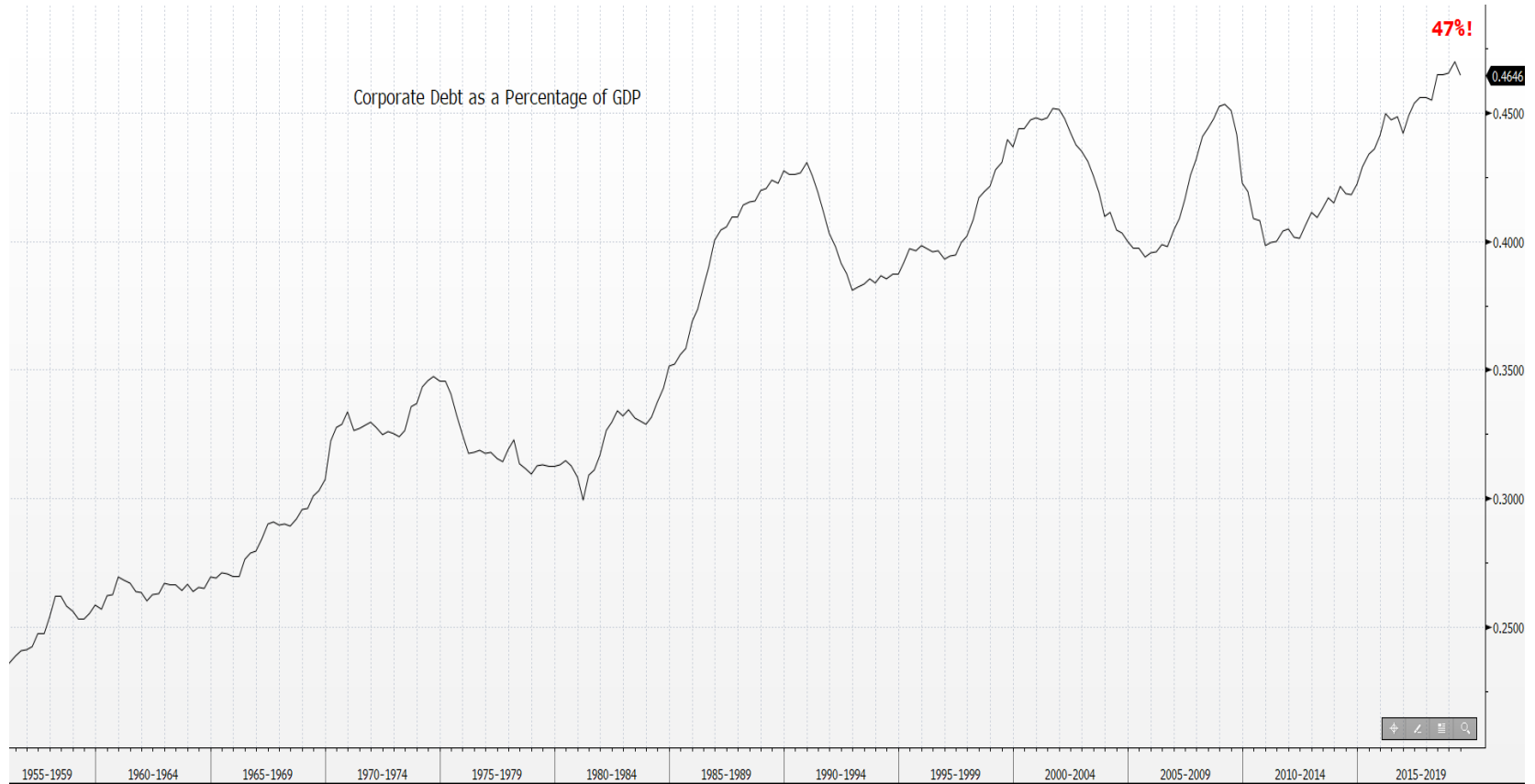
Type	\$ Billions	%
Student Loan Debt	\$ 1,478	36%
Auto Loans	\$ 1,297	32%
Credit Card Debt	\$ 868	21%
Other	\$ 412	10%
Total:	\$ 4,055	29%



Source: Federal Reserve, Bloomberg Finance L.P., Stifel

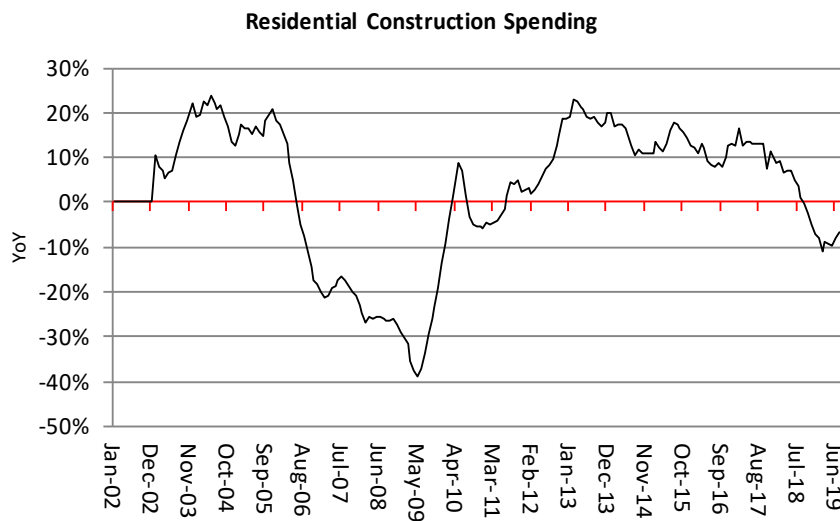
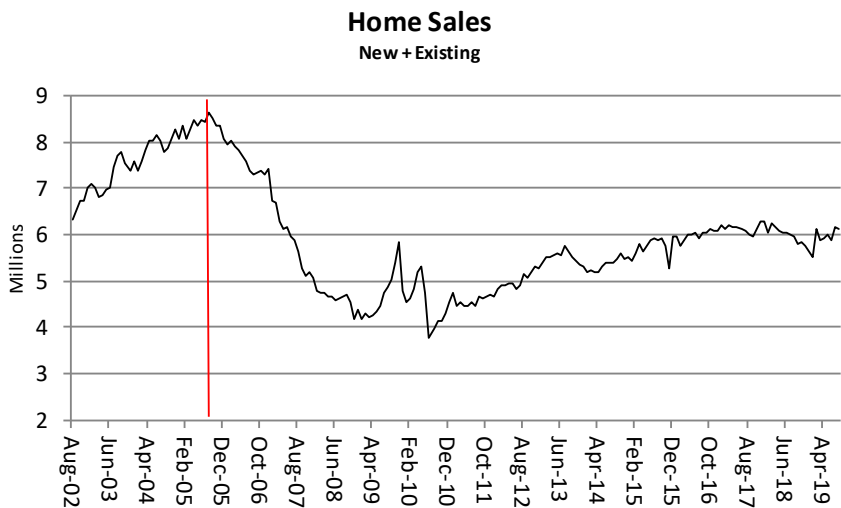


Corporate CFOs Leverage the Balance Sheet



Source: Federal Reserve, Bloomberg Finance, L.P., Stifel

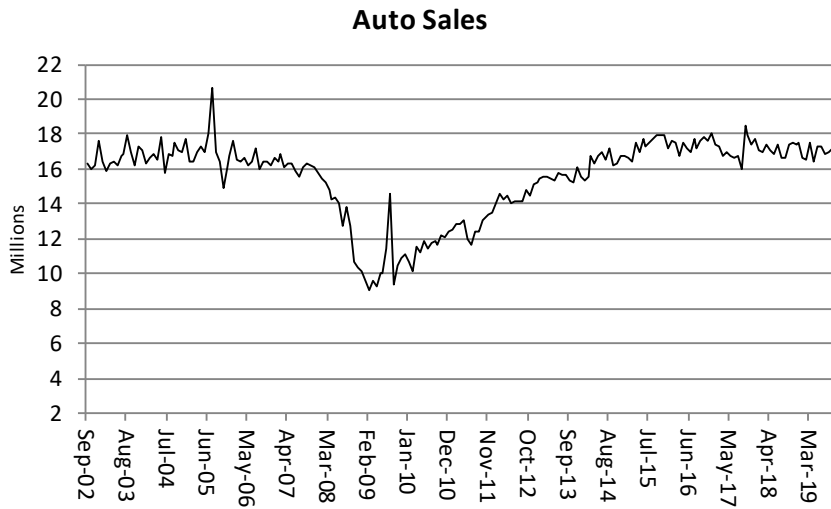
Housing Sales Churn – Residential Construction Spending Collapses



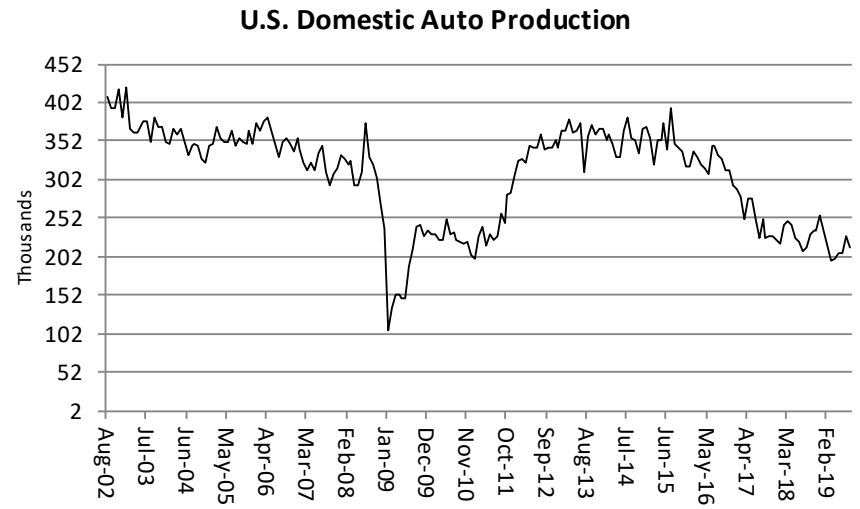
Source: National Association of Realtors, Census Bureau, Bloomberg Finance L.P, Stifel

Source: Census Bureau, Bloomberg Finance L.P, Stifel

Auto Sales Flat Line and Manufacturers Rein in Production



Source: WARD's Automotive Group, Bloomberg Finance L.P, Stifel

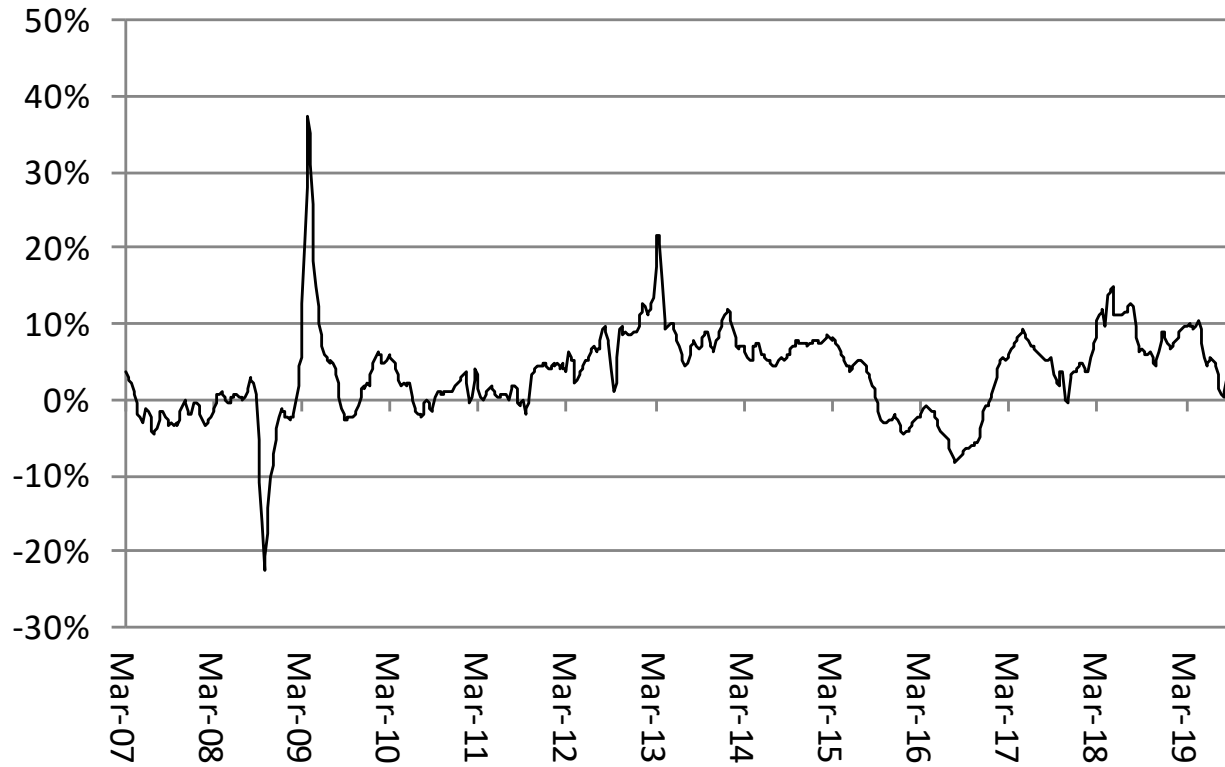


Source: Bureau of Economic Analysis, Bloomberg Finance L.P, Stifel



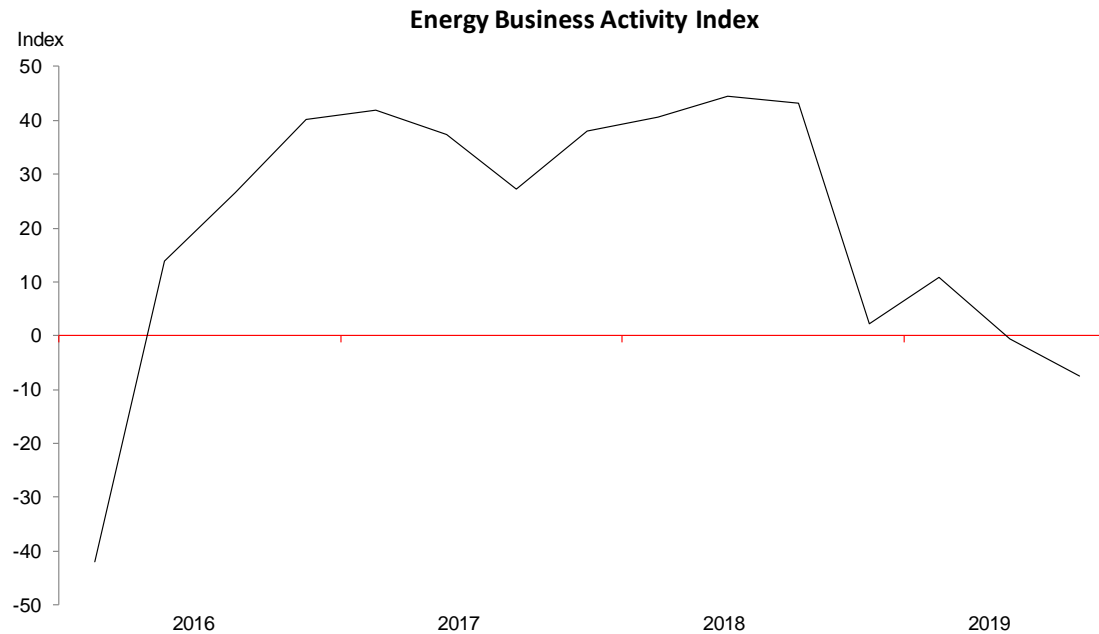
Oil Production – Responding to Diminished Demand?

US CRUDE OIL PRODUCTION
4 Week Average % Δ v 6M Prior



Source: Department of Energy, Bloomberg Finance L.P., Stifel

Energy Sector is on Its Back Foot



“Overall sentiment is very negative due to low natural gas prices and lack of available funding for oil and gas exploration. Investors have been hard hit by catastrophic declines in the price of oil and gas securities. Additionally, many oil shale projects are failing to meet production projections. Oil service companies have no pricing power [and are] delivering services at rock bottom levels. Further cost declines will not be forthcoming. It seems no one has any money for oil and gas projects. Lack of Wall Street participation in oil is very apparent.”

Source: Federal Reserve Bank of Dallas

Trade is Only One Component of the Broader Battle

Intractable Trade Issues:

- Unauthorized or forced transfer of technology
- Rampant violation of intellectual property protections
- Over reliance on state sponsorship of industry

Broader Battle:

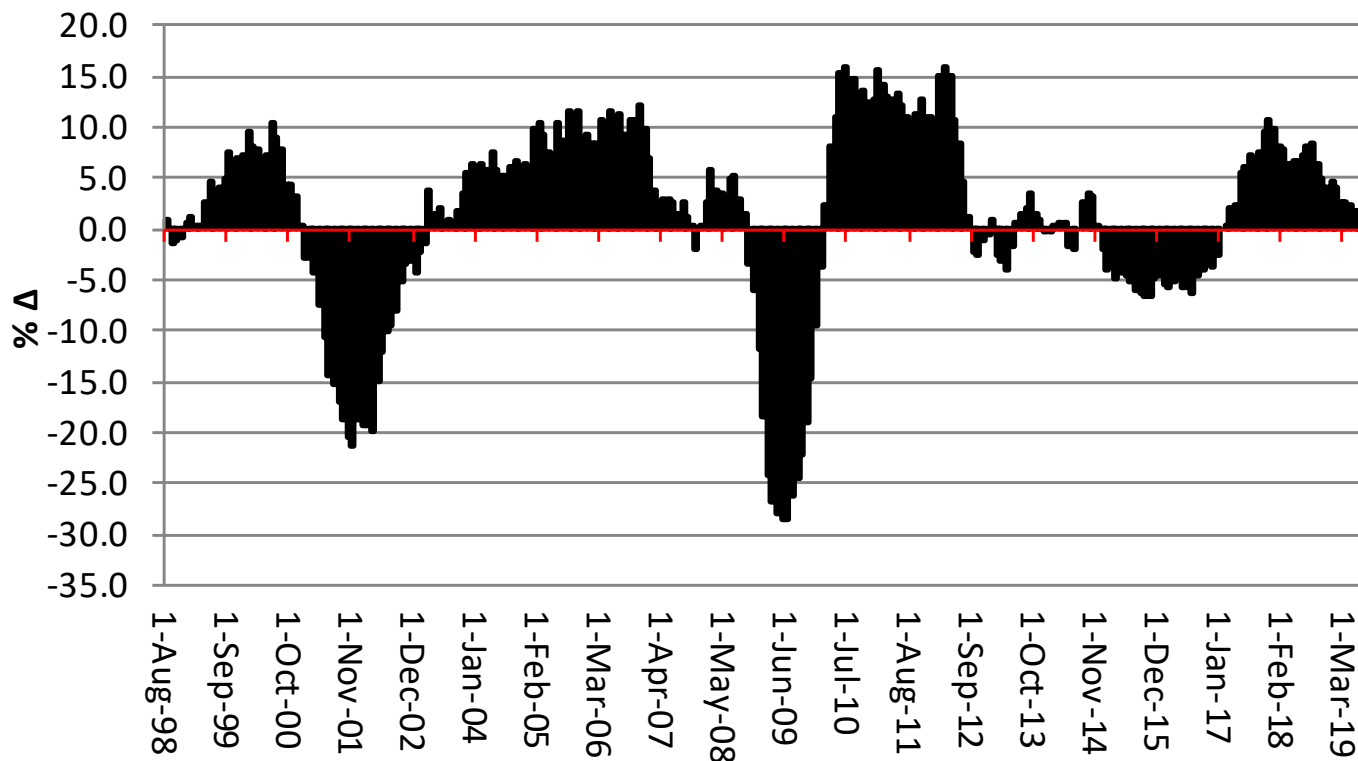
- Competition for geopolitical dominance in the Indo-Pacific region.
- U.S. has been unchallenged in the post-World War II era.
- In 2013, China announced the launch of the **Belt and Road Initiative**, a massive infrastructure project (estimated cost in excess of \$1.2 trillion) designed to “break the bottleneck in Asian connectivity,” according to President Xi. The project involves over 60 countries and creates a web of financial, economic, military, and social ties intended to cement China’s dominance in the region.



Durable Goods Order Flows are Slowing!

Non-Defense Capital Goods Orders Ex-Aircraft & Parts

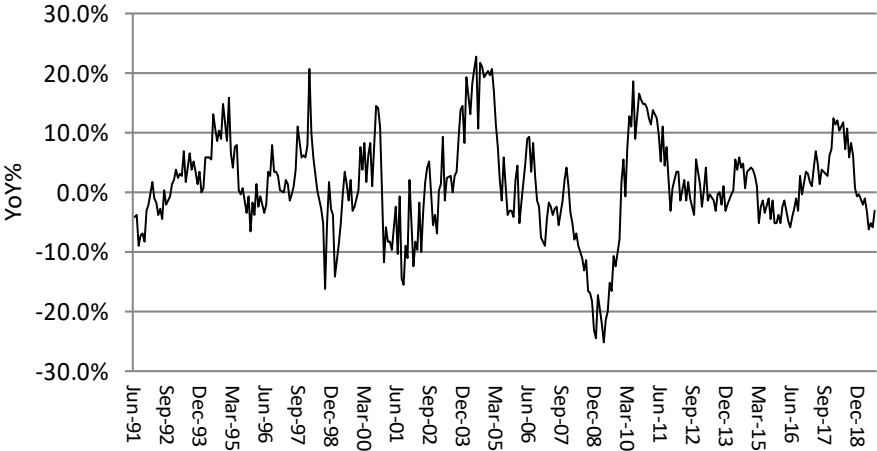
NSA 3M Avg of YoY % Δ



Source: Census Bureau, Bloomberg Finance L.P., Stifel

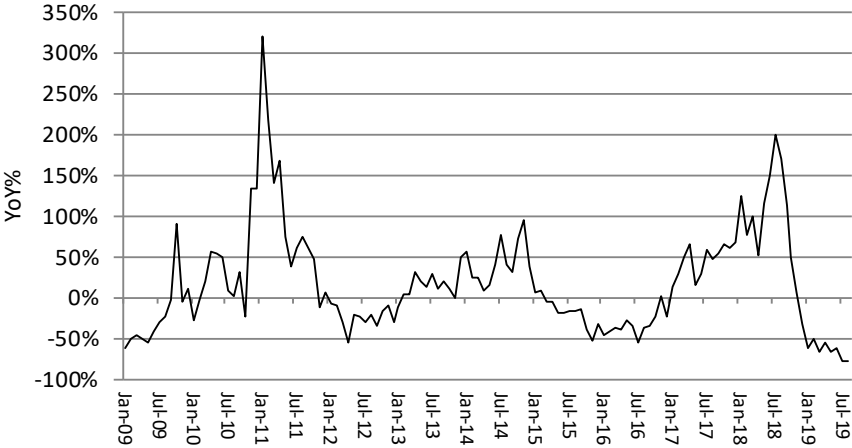
Freight and Trucking Data Shows Signs of Softening

Cass Freight Index Shipments

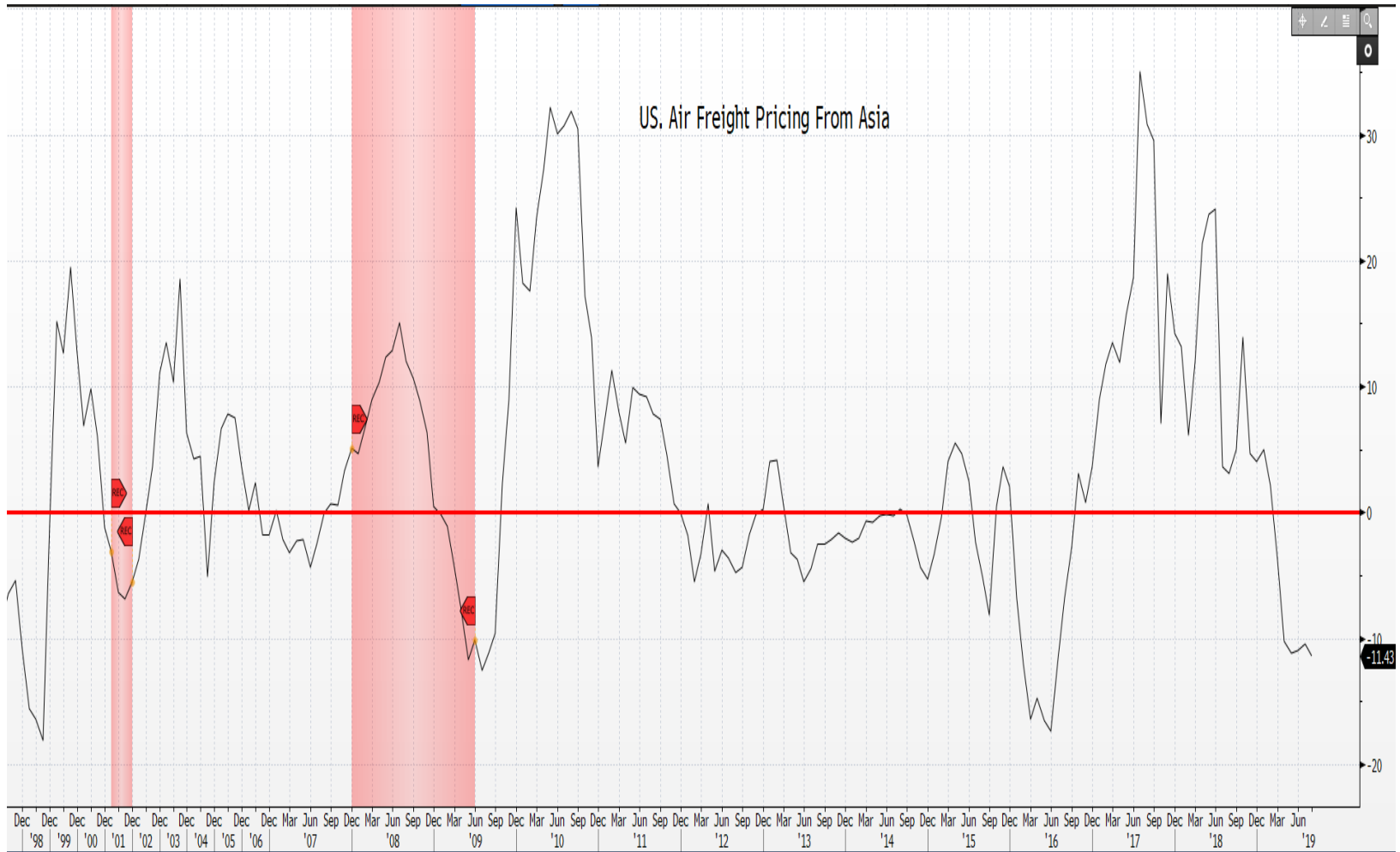


Source: Cass Information Systems, Bloomberg Finance L.P., Stifel

Class 8 Truck New Orders



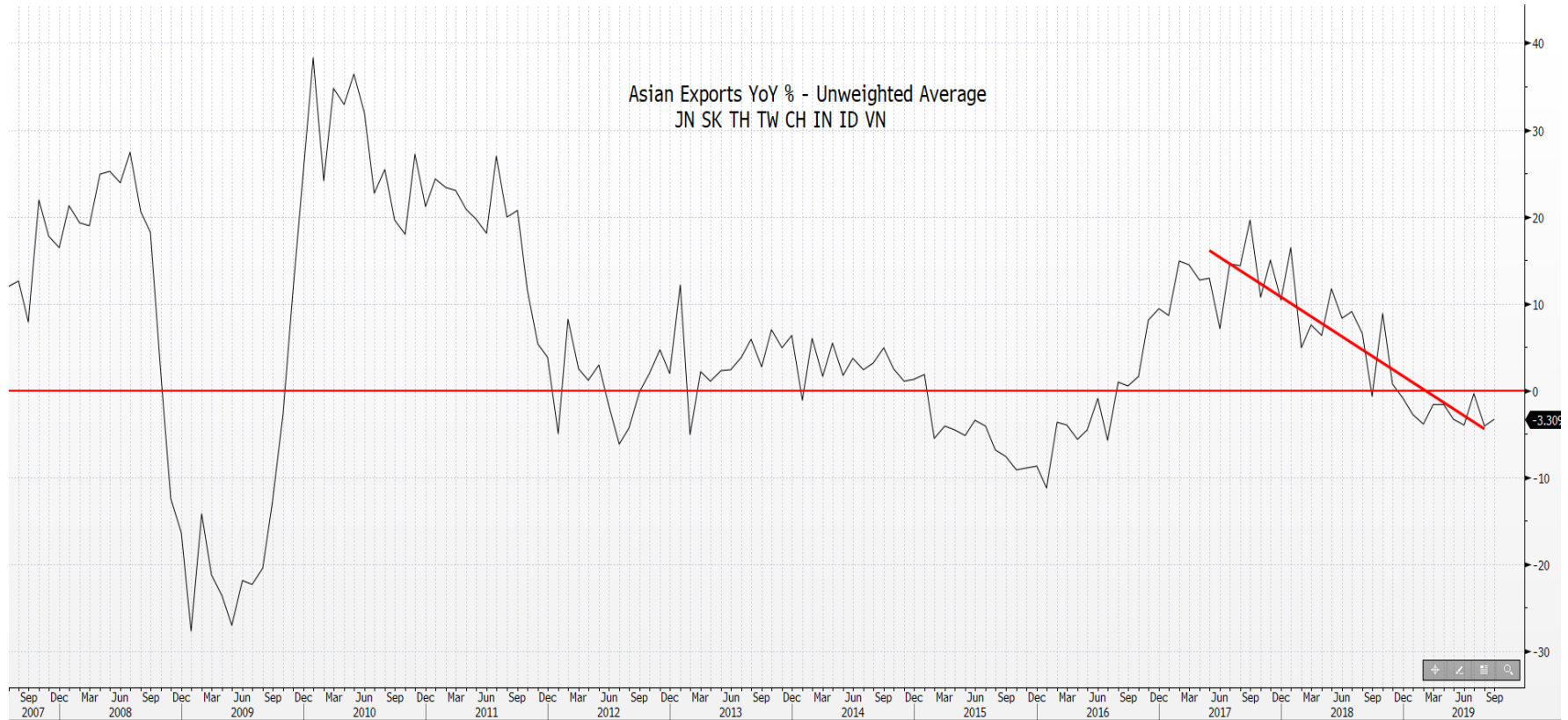
Source: FTR Associates, Bloomberg Finance L.P., Stifel



Source: Bureau of Labor Statistics, Bloomberg Finance L.P., Stifel

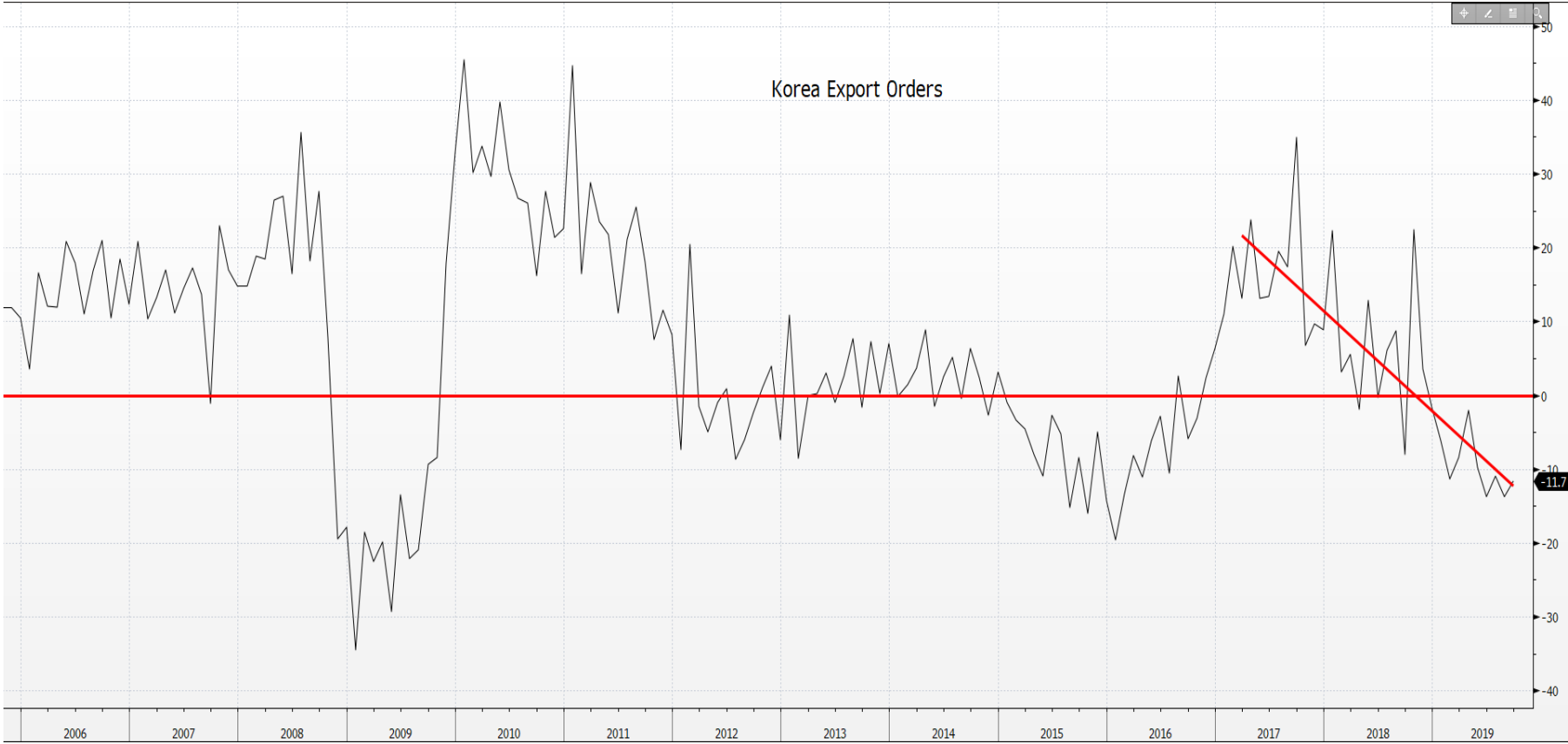


Export Flows in Asia are Contracting YoY



Source: National Statistics Offices, Bloomberg Finance, L.P., Stifel

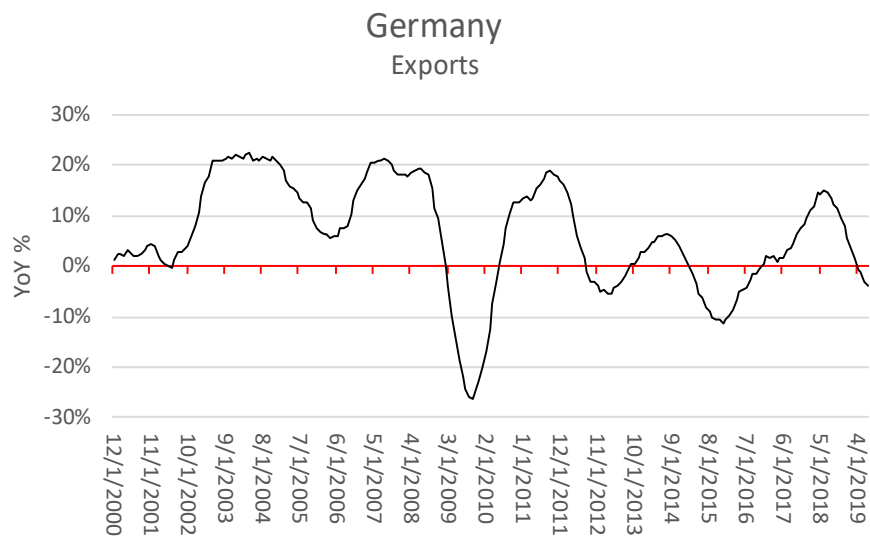
South Korea: World's 5th Largest Exporter, Diversified Export Markets, and High Value Added Products



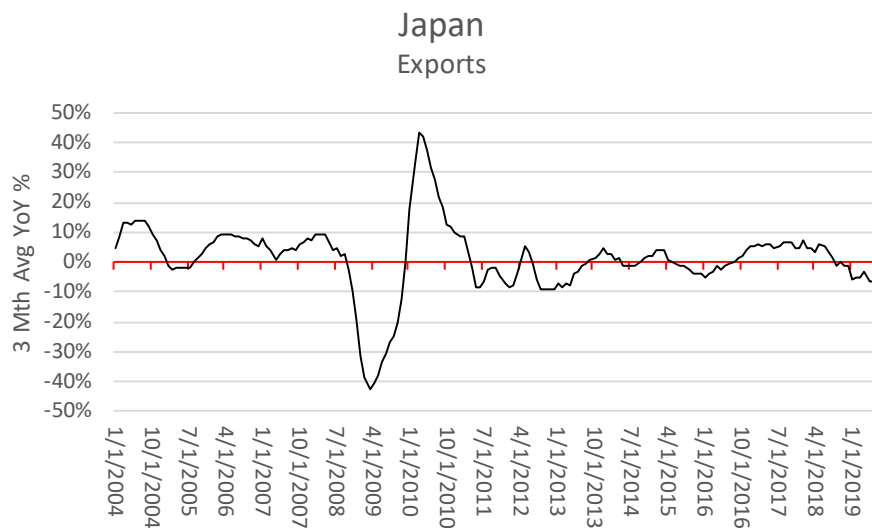
Source: South Korea Ministry of Trade, Bloomberg Finance L.P., Stifel



Germany (#3 Exporter) and Japan (#4 Exporter) – High Value Added Exports Slowing



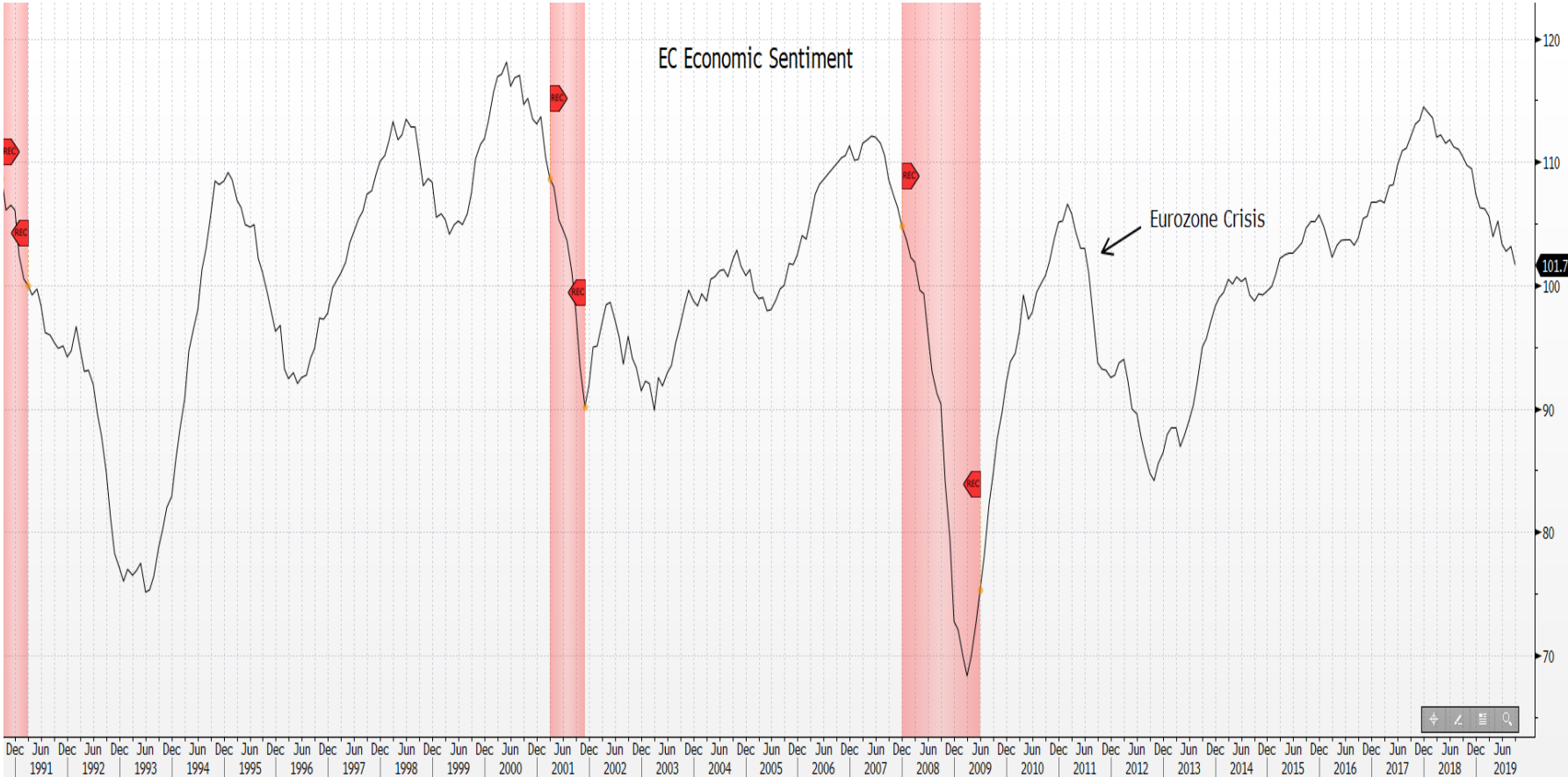
Source: Deutsche Bundesbank, Bloomberg Finance L.P., Stifel



Source: Ministry of Finance, Bloomberg Finance L.P., Stifel



Sentiment is a Precursor to Recession



Source: European Commission, Bloomberg Finance L.P., Stifel

Narrative Economics: “By narrative economics I mean the study and spread of popular narratives, the stories, particularly those of human interest and emotion, how these change through time, to understand economic fluctuations.” ~ Robert Shiller

Sources of Narratives:

- Wall Street Economists
- Wall Street Strategists/Analysts
- Professional Money Managers
- The Federal Reserve
- The Administration
- Academia
- Media Outlets

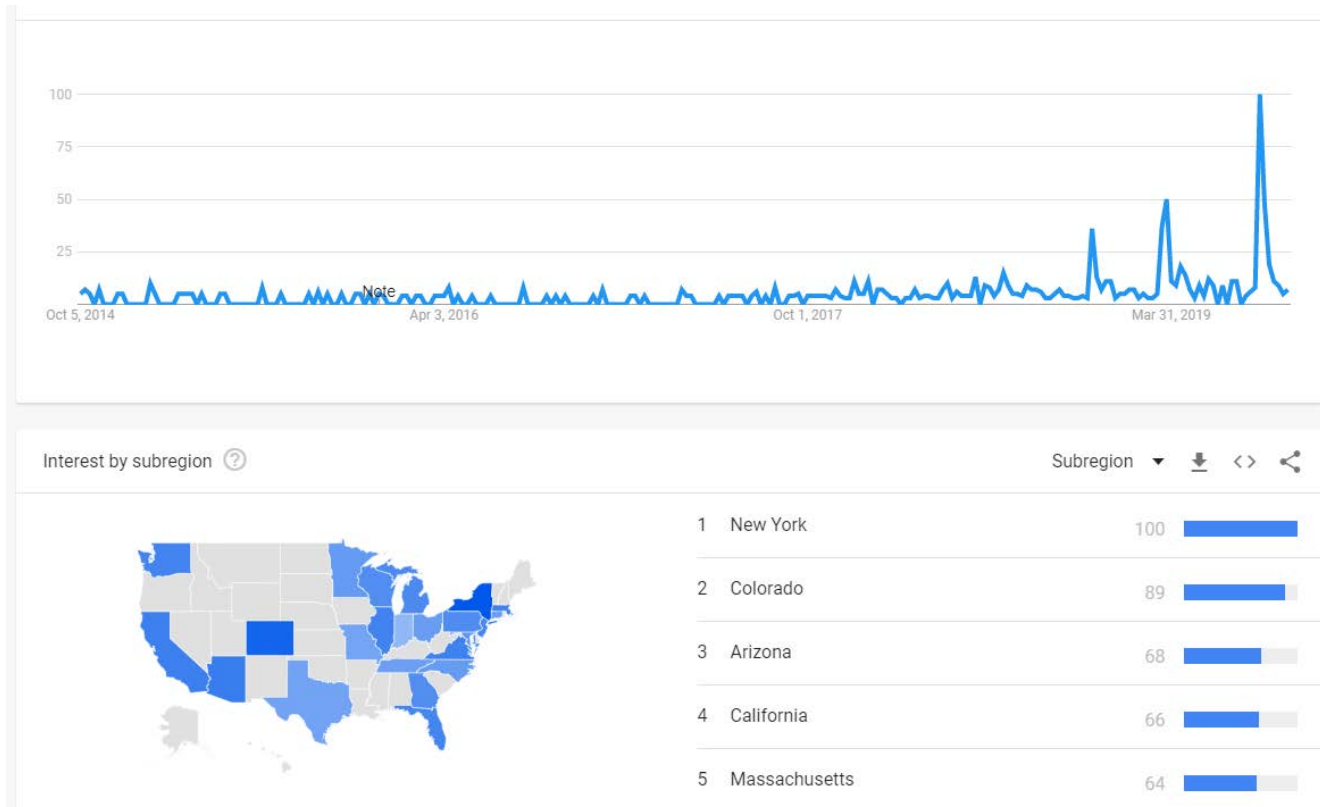
Conduits for Narratives:

- Research reports
- Public Presentations
- Traditional Media
- Social Media

Narrative Examples

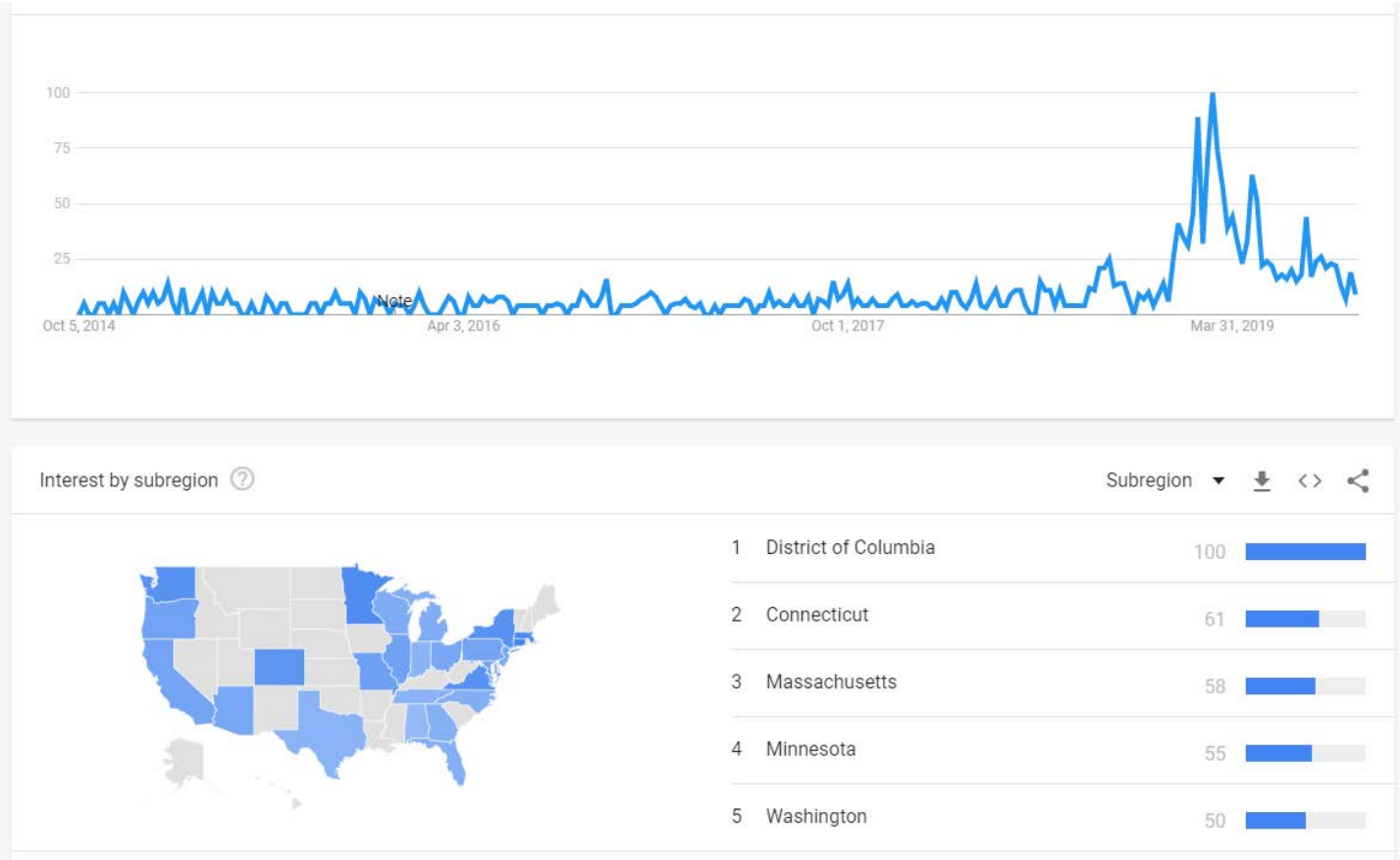
- **Street Strategists:** An inverted yield curve precedes a recession.
- **The Fed:** QE will force money out of high quality assets, down the credit curve, and into the hands of risk takers who will stimulate economic growth.
- **Academia:** Modern Monetary Theory provides a free pass for a ramp in fiscal spending that will provide a catalyst to economic growth.
- **The Administration:** Trade wars are good and easy to win.

An Inverted Yield Curve Precedes a Recession



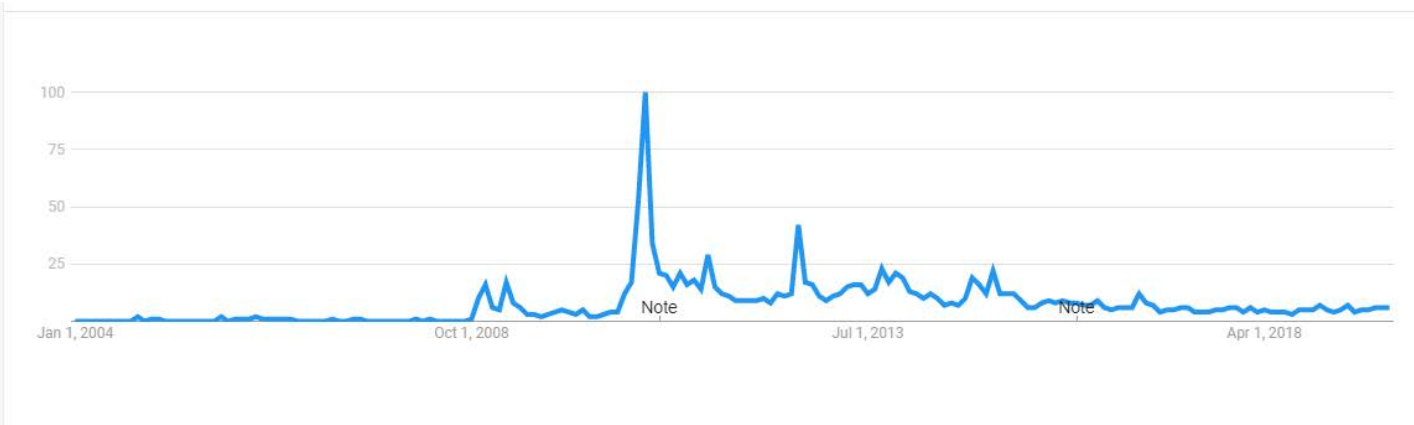
Source: Google Trends

Modern Monetary Theory Facilitates Fiscal Expansion



Source: Google Trends

Quantitative Easing



Interest by subregion ?

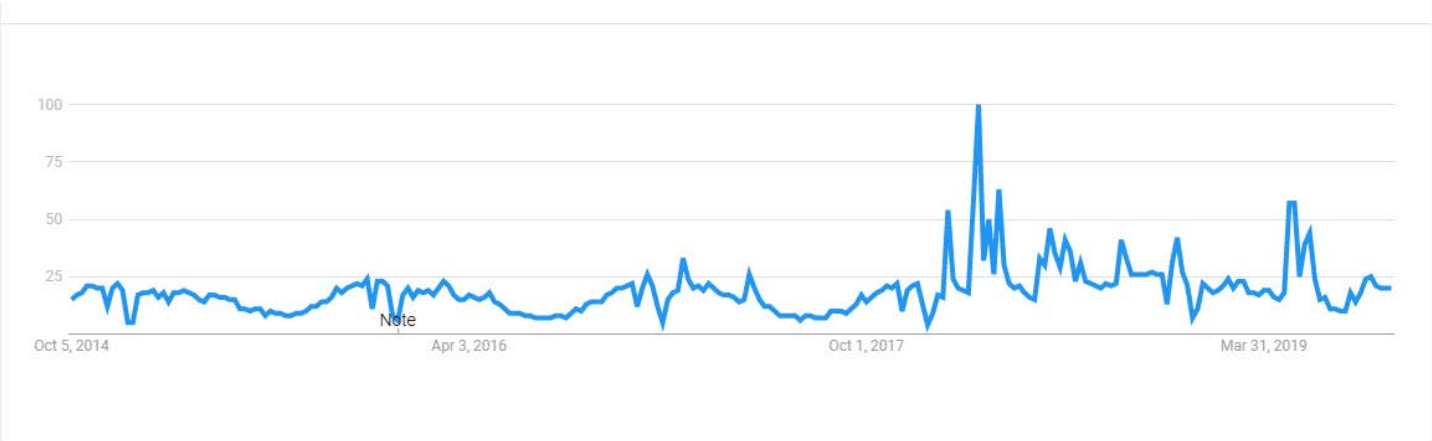
Subregion ▼ ⬇ ⏪ ⏩ 🔗



1	District of Columbia	100	<div style="width: 100%;"></div>
2	New York	70	<div style="width: 70%;"></div>
3	Massachusetts	66	<div style="width: 66%;"></div>
4	Rhode Island	62	<div style="width: 62%;"></div>
5	Connecticut	56	<div style="width: 56%;"></div>

Source: Google Trends

Tariffs



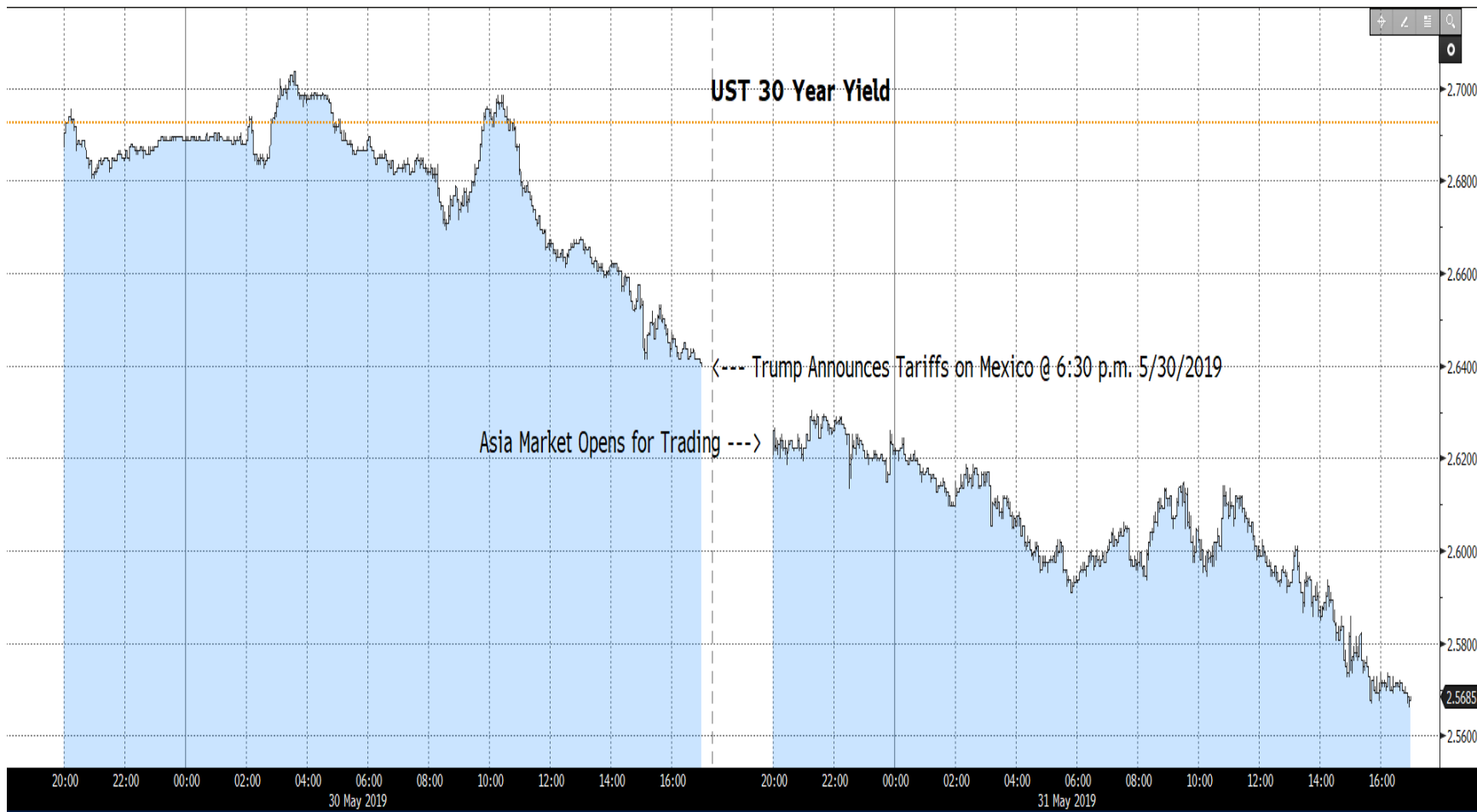
Source: Google Trends

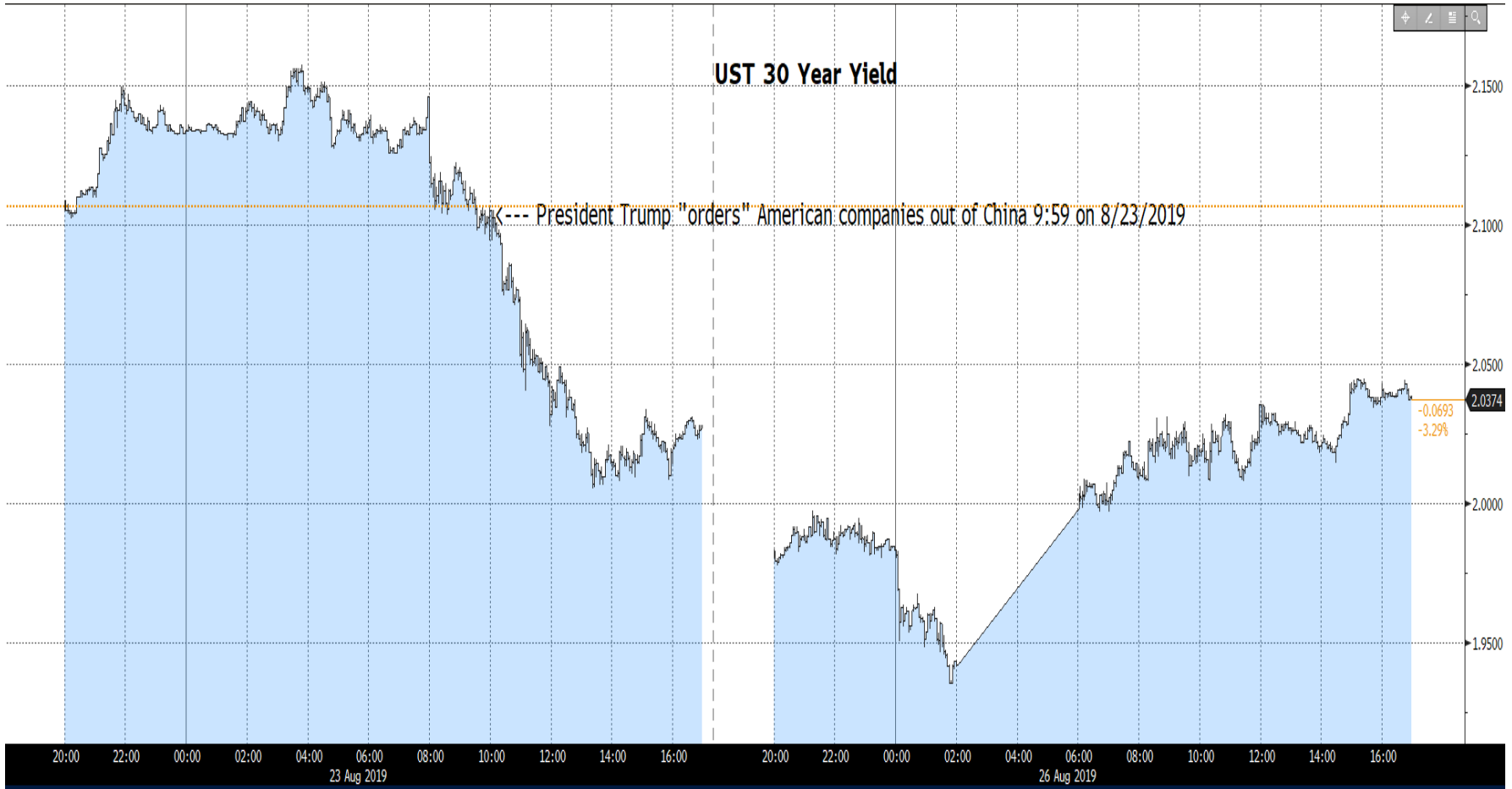
High Frequency Promotion of Narratives Increases Volatility

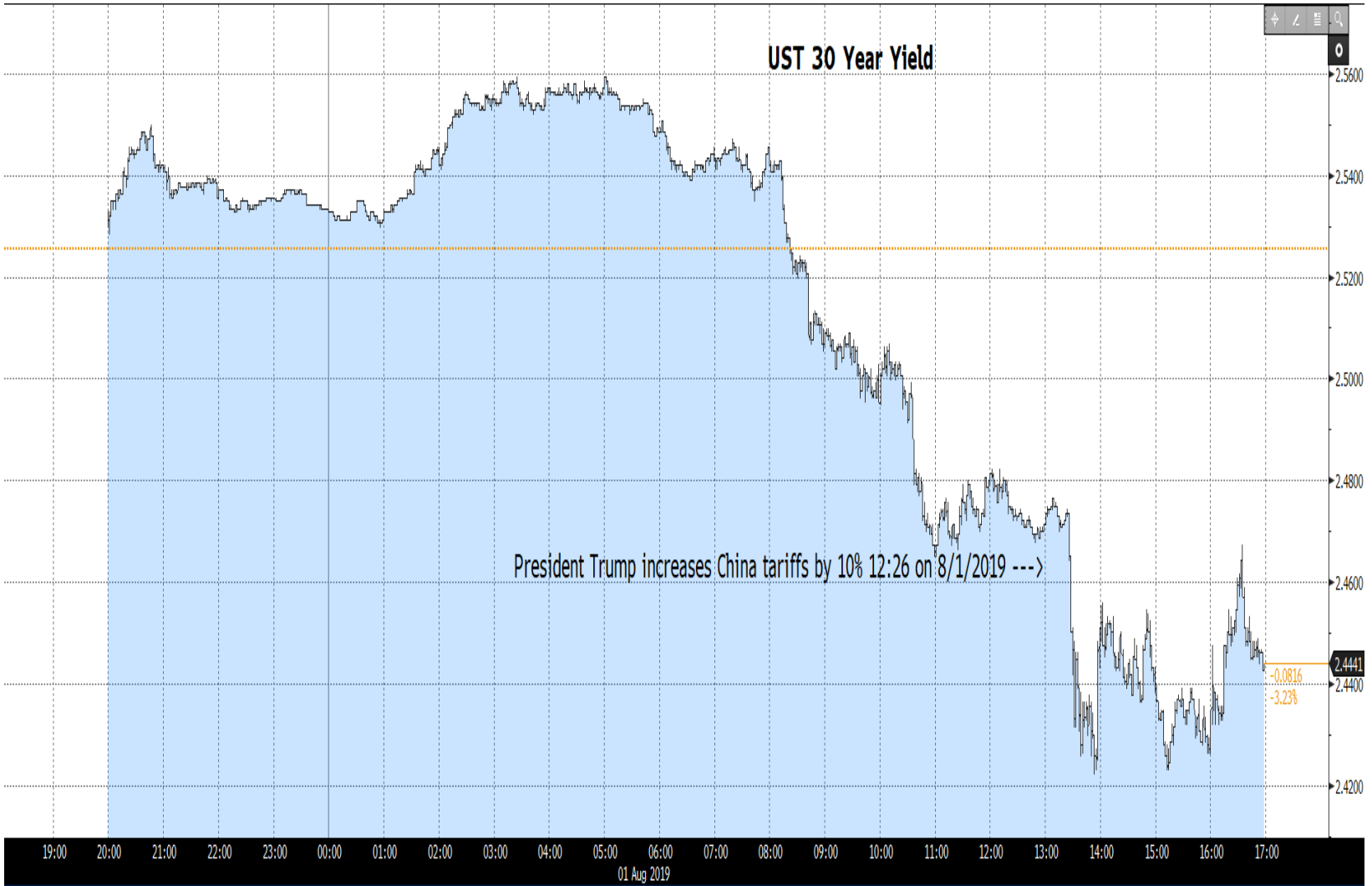
Trump Tweets as a Price Catalyst:

- 17,000+ Tweets¹ since President Trump announced his candidacy
- “Embargoed for Release” is a thing of the past
- Tweets occur on a 24-hour cycle
- Major economic pronouncements are made at random periods of time
- Tweets are the main mechanism by which the president advocates for his agenda

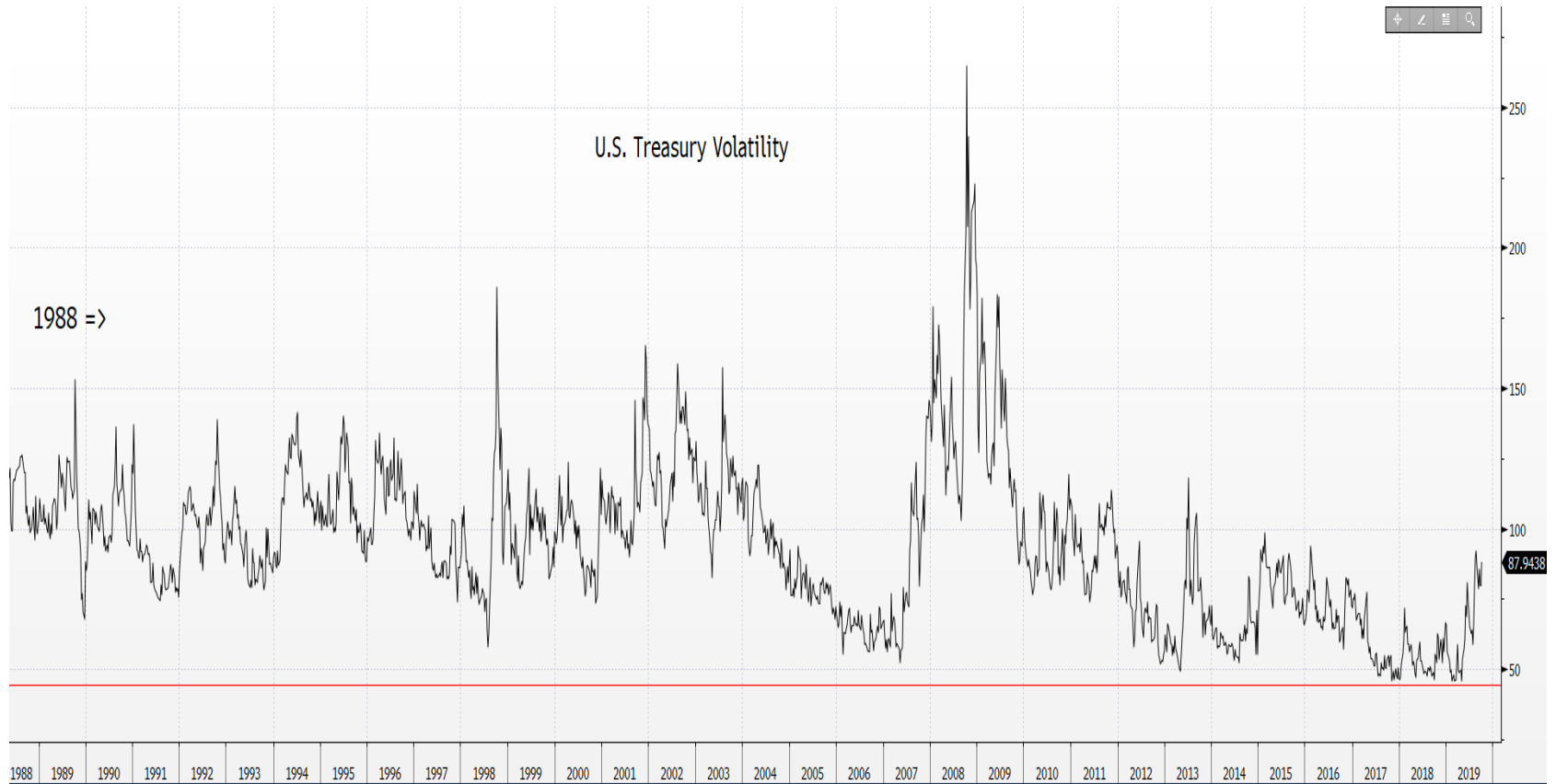
¹trumptwitterarchive.com







Volatility is Rising, but Still Remains Moderate in Historic Context



Source: BAML, Bloomberg Finance L.P., Stifel

Key Takeaways

- Be cognizant of the agenda behind the narrative
- Focus on the signal (hard data) not the noise (opinions/pronouncements)
- Develop thematic ideas which are durable and allow the data and the price action to challenge your thought process
- The price action response in the market will often reveal the underlying bias in positions

**Questions?
Contact Us!**

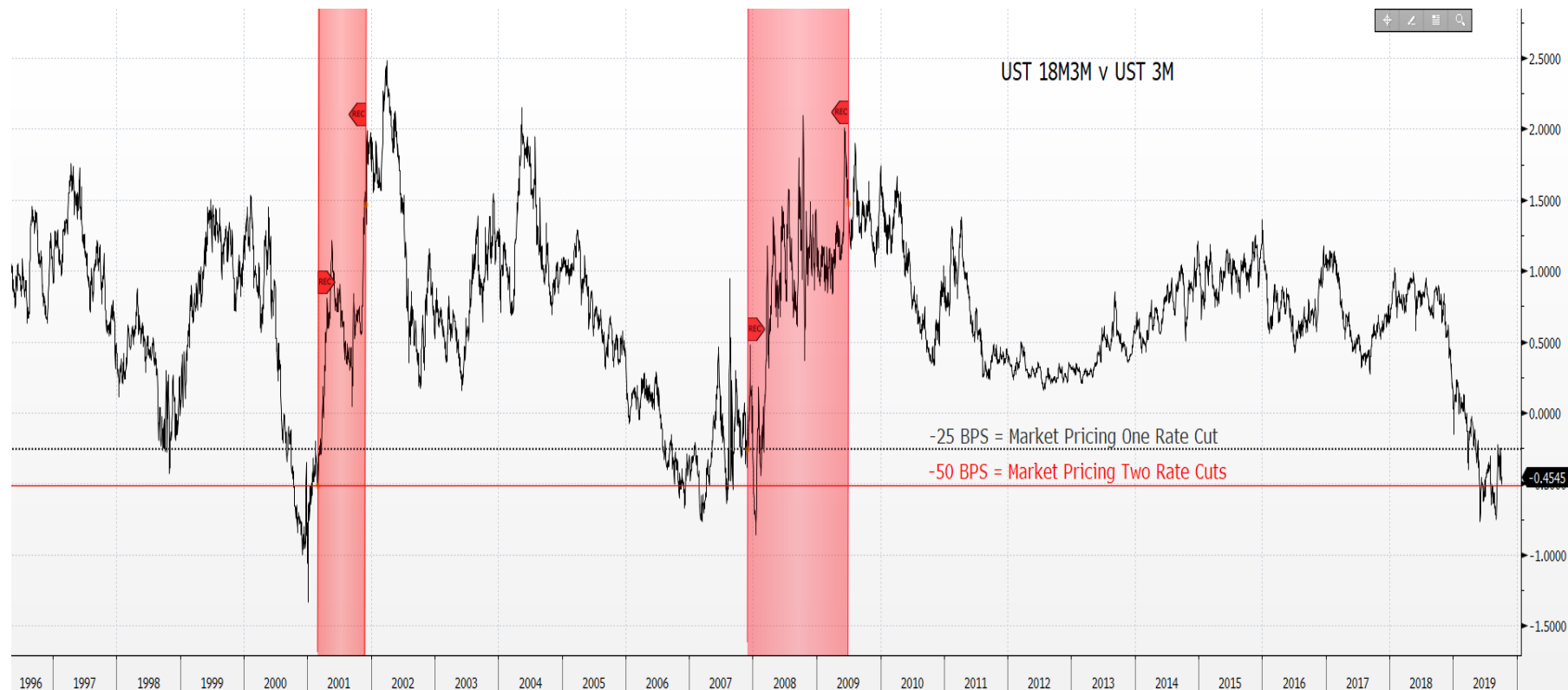
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Addendum



Yield Curve is Pricing One Rate Cut



Source: Bloomberg Finance L.P., Stifel



UST 2-Year Yields at a Major Technical Level



Source: Bloomberg Finance, L.P., Stifel

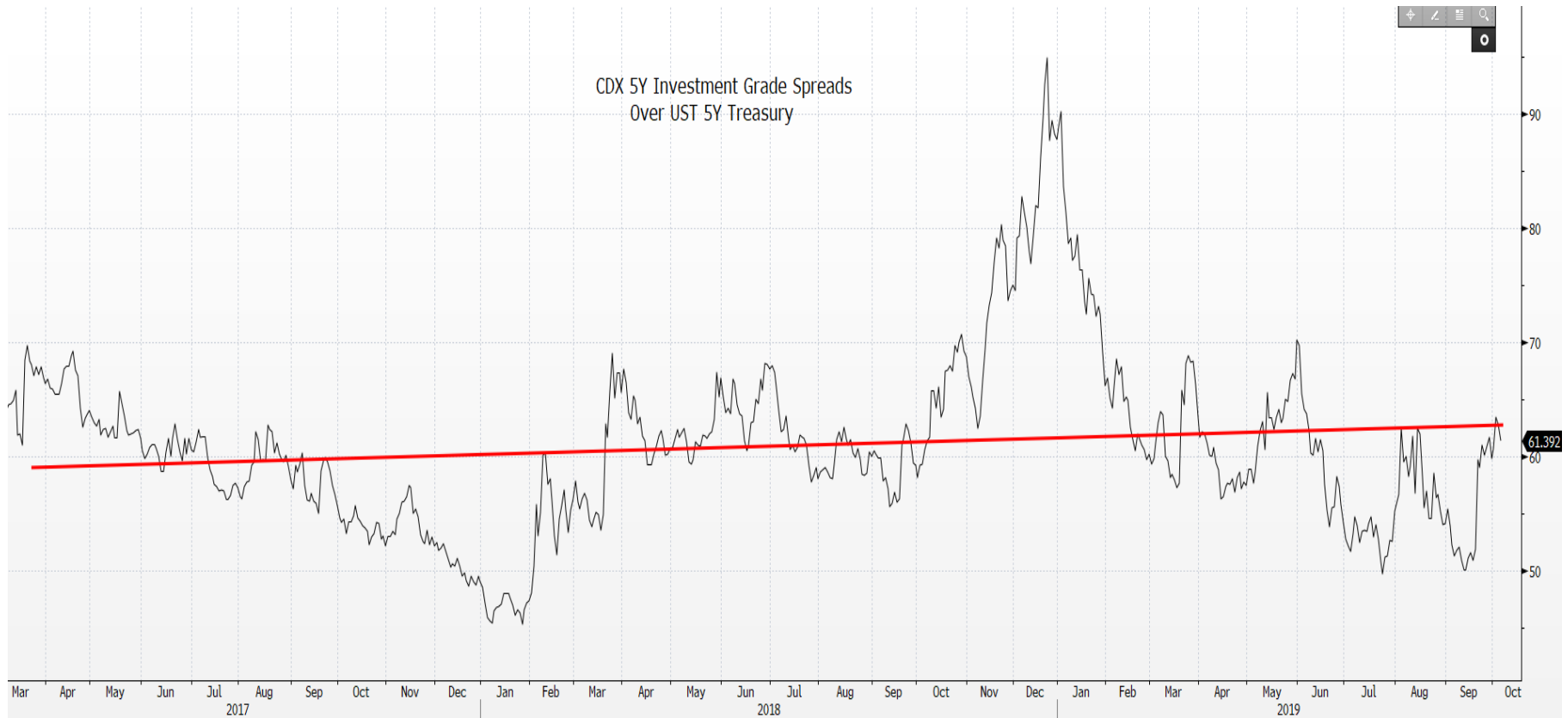


UST 10-Year Yields: Solid Bull Trend



Source: Bloomberg Finance, L.P., Stifel

Credit Spreads Narrowed Into September Supply; Widening Now on Economic Concerns



Source: Markit, Bloomberg Finance, L.P., Stifel



Capital Structure Starting to Respond to Fear of Slowing Economy



Source: Markit, Bloomberg Finance, L.P., Stifel

Investment strategies for when rates are falling:

Extend the duration of the portfolio (go longer term, emphasize structure, go into higher quality credits, buy larger issue sizes, buy more fixed-rate investments, and reduce near-term cashflow).

- 1) Buy longer term non-callable “bullet” investments – US Treasuries, Agency Notes, Certificates of Deposit, Bank Notes, Corporate Bonds, and Municipal Bonds.
 - If you do buy callable bonds, avoid near-term call dates (generally, minimum 1 year or longer to the next call date, but preferably even longer), deep discount prices preferred.
- 2) Buy 15-, 20- and/or 30-year mortgage-backed securities (MBS).
 - Look for high coupon, very seasoned MBS (factor of .20 or lower) to take advantage of “prepayment burn-out” (statistically, 20% of homeowners are unlikely to refinance, regardless of the interest rate environment).

Investment strategies for when rates are falling: (cont.)

- 4) Buy DUS balloon MBSs (DUS balloons have a prepayment penalty that reduces the risk of prepayments).
- 5) Buy Agency Collateralized Mortgage Obligations (CMOs) with “lock-out” (CMOs that pay interest only for several years, then pay principal and interest in the later cashflow years).
- 6) If you are buying variable-rate investments (floaters or ARMs) look for “hybrids” with a 7/1, 5/1, 3/1 type of structure. Always check to ensure “evenly distributed” or “laddered” re-set dates in the variable-rate portfolio.
- 7) If SBA pools generally fixed-rate securities preferred.

Discount paper is preferred. If rates fall, margin gets squeezed, bonds get called/prepaid so the discount will be amortized over a shorter duration, producing a higher yield

Investment strategies for when rates are rising:

Generally speaking, you want to shorten the duration of the investment portfolio (go shorter term, buy more variable-rate investments, and increase near-term cash flow).

- 1) Sell out of longer-term investments, especially non-callable “bullet” investments.
- 2) Build a solid ladder of short-term bullets & callable bonds.
 - If you are buying callable bonds, near-term call dates preferred, premium price (“cushion bonds”) are preferred.
 - Buy step-up securities, preferably with near-term step dates.
- 3) Buy “seasoned” 10 & 15 year mortgage-backed securities (MBS), (premium price is preferred) to add up-front cash flow.

Investment strategies for when rates are rising: (cont.)

- 4) Buy current principal pay Agency Collateralized Mortgage Obligations (CMOs).
 - Also in the an “up interest rate shock” scenario, you want CMOs that have limited extension risk. The more stable and predictable the cashflows the better.)
- 5) If you are buying variable-rate investments (floaters or ARMs) look for investments that reset in one-year or less (monthly, quarterly, semi-annual or annual”. Always check to ensure “evenly distributed” or “laddered” re-set dates in the variable-rate portfolio.
- 6) If SBA pools generally variable-rate securities preferred.

Generally speaking, premium paper is preferred. If rates rise, bonds are not called/prepaid as quickly so premiums will be amortized over a longer duration producing a higher yield.

End of Quarter Figures

	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	2018	2019	2020
<i>Growth indicators</i>											
GDP, QoQ %	3.1%	2.0%	1.5%	1.1%	-0.2%	0.8%	1.9%	1.6%	2.7%	1.9%	1.0%
Consumer Spending, %	1.1%	4.7%	2.1%	1.5%	1.0%	2.5%	2.0%	1.9%	2.3%	2.4%	1.9%
Fixed Investment, %	3.2%	-1.1%	2.6%	1.3%	-2.5%	0.8%	2.5%	2.0%	4.6%	1.5%	0.7%
Housing Starts, k	1,199	1,253	1,120	1,110	1,080	1,075	1,065	1,060	1,221	1,171	1,070
Unemployment Rate, %	3.9%	3.6%	3.7%	3.6%	3.6%	3.7%	3.7%	3.7%	3.9%	3.7%	3.7%
Nonfarm Payrolls, k	153	178	150	130	110	140	165	170	195	153	146
<i>Inflation indicators, YoY%</i>											
PPI	2.2%	1.7%	2.4%	2.5%	2.4%	2.3%	2.3%	1.9%	2.9%	2.2%	2.2%
PCE	1.4%	1.4%	1.4%	1.6%	1.6%	1.5%	1.5%	1.3%	2.1%	1.5%	1.5%
Core PCE	1.5%	1.6%	1.7%	1.8%	1.7%	1.6%	1.4%	1.4%	2.0%	1.7%	1.5%
<i>Interest rate, %</i>											
FF	2.50	2.50	2.00	1.50	1.00	0.75	0.75	0.75	2.13	2.13	0.81
3month UST bills	2.39	2.09	1.80	1.45	0.95	0.80	0.85	0.85	2.05	1.93	0.86
2yr UST notes	2.26	1.76	1.55	1.35	1.20	1.12	1.15	1.15	2.53	1.73	1.16
5yr UST notes	2.23	1.77	1.40	1.20	1.10	1.10	1.18	1.20	2.69	1.65	1.15
10yr UST notes	2.41	2.01	1.45	1.28	1.15	1.15	1.20	1.25	2.84	1.79	1.19
30yr UST bonds	2.82	2.53	2.08	1.86	1.55	1.50	1.70	1.85	3.05	2.32	1.65
2s to 10s Spread bps	14	25	-10	-7	-5	3	5	10	31	6	3

Lindsey Piegza, Ph.D. - Chief Economist

Source: Bloomberg, Stifel

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