Capital Markets Group

Points to Ponder

July 19, 2019

The First Tee...

Keep on Truckin'…the current U.S. economic business cycle has marked its place in history as the longest expansion since record keeping began in 1854 (eclipsing the 1991 to 2001 cycle):

- Beyond its longevity, the expansion has been rather unexceptional…logging a low rate of growth:
  - GDP has increased 22% in the 39 quarters since June 2009, this compares to the 43% GDP growth seen during the first 39 quarter of the 1991 to 2001 cycle (this expansion has been characterized by underperformance):
    - At the economy's current growth rate, it would need to expand 6 more years to match the total output of the 1991-2001 expansion…and 9 additional years to meet the aggregate growth of the 1961-1969 cycle that saw GDP grow 54%:
      - The lethargic pace of the current growth cycle has been more beneficial to capital and wealth than labor…workers' share of national income has declined from 68.9% to 66.4% during the past ten years (a widening between the haves and have nots).
- The decline in unemployment has been the hallmark event of this economic upturn:
  - Declining to a 3.6% rate, unemployment is the lowest in 50 years after hitting 10% in October 2009:
    - The demand for workers has aided individuals who traditionally have had difficulty finding employment:
      - These worker groups include minorities, handicapped, less educated and older individuals.
    - The pace of job growth and the Labor Participation Rate have not performed as well as in other long expansions:
      - Job growth has increased by 12% during the current expansion, this compares to a 17% increase during the 1991 expansion:
        - The pace of job gains seen during the economic expansions that began in 1961 and 1982 saw increases of 19.7% and 20% respectively.
      - The Labor Participation Rate has averaged 63.4% during the current expansion, this compares to the 66.7% rate seen during the 1991-2001 cycle and below the participation rate of 64.5% seen during the past 50 years (hit a 38 year low in 2015 at 62.4%):
        - **Only 3.1% of men age 25 to 54 were officially unemployed in April, but an additional 10.8% were entirely out of the labor force.**
    - The under-the-radar reserve of potential workers available in the labor force has kept a cap on wage growth:
      - The pace of wage gains for the past 10-years remains the slowest for any economic expansion since World War II:
        - Average hourly earnings have increased by 2.3% annually since 2009 but have accelerated to a 3.2% annual increase the past year.
- Current expansion has characteristics of secular stagnation (also seen in past cycles of 1930's, 50's and early 2000's):
  - Secular stagnation is a phenomenon where desired economic growth can only be achieved by extreme fiscal and monetary stimulus…exemplified by 0% and negative interest rates, quantitative easing and record government debt:
    - A large part of Europe, as well as Japan, are currently in the same secular stagnation economic environment.
  - The U.S. economy received a fiscal boost from the 2017 tax-cuts, although, a majority of the tax bill favored businesses and the wealthy…the rich do not typically spend windfalls and companies have not accelerated investment
    - A poll of members of the National Association of Business Economics showed 84% of respondents stated their companies have not increased outlays or hiring in response to the tax cuts *(there have been a lot of share buy-backs though)*.
- Despite recent hurdles, the economic expansion appears poised to expand even further:
  - Expansions typically end when the Fed excessively tightens monetary policy to off-set inflation growth or there is a major economic/financial crisis…such as the housing market collapse that led to the last recession:
    - Inflation has not been an issue as both the CPI and PCE price indexes have spent a majority of the past decade below the Feds 2% target…monetary policy has been ultra-accommodative in an effort to re-inflate the economy.
    - The slowing international economic activity and trade dispute with China remain hurdles, but the impact to U.S. growth should be marginalized by strong consumer activity…consumers have been bolstered by solid employment and rising wages.
  - Fed to the rescue…the Central Bank is expected to cut its interest rate target the next few months:
    - Either influenced by political pressure or perceived threats to the economy, the FOMC lowering interest rates will reduce borrowing costs to consumers/businesses as well as place downward pressure on the value of the dollar:
      - The bond market has already done some heavy lifting for the Fed, the yield on the 10-year U.S. Treasury note has declined 120 basis points from its high last November…the yield on the benchmark issue is the standard fixed-rate loan levels are priced from:
        - At 2.05%, the current yield on the 10-year T-Note is already 141 basis points below its average rate during the Great Recession.
- History has shown recessions are inevitable…**when the next cycle arrives we can only hope for the elusive soft landing:**
  - Beyond recession rumor mill, GDP is still forecast to grow at a 2.2% rate this year (the average pace seen the past ten years).

At the turn...

The Back Nine...

Littler House on the Prairie...despite talk of a slowing economy, home prices remain high:

- The decade old hangover from the housing crash is still influencing pricing variables:
  - A tight supply of homes for sale, lack of construction ready lots, reduced speculative building, higher lending standards for builders, and restrictive regulations have contributed to higher prices:
    - Home prices crashed late in the last decade due to unsustainable speculation by builders, buyers and lenders:
      - The pace of building single-family homes remains below levels seen in the 1960's...when the population was 60% smaller.
  - High prices have placed homeownership out of reach for many buyers (renting reality):
    - During the past five years, home prices have increased 5.5% annually while wages have increased at a 2.6% rate:
      - The 14.5% differential between income and housing cost growth rates could be a boon for the tiny home market!

Bond Bombshell...yields dive while stocks spike, first half of year a financial paradox:

- Data format: July 1, 2018 / January 1, 2019 / April 1, 2019 / July 1, 2019:

Equities
- **Dow:** 24271 / 23327 / 25928 / 26,599
- **S&P 500:** 2718 / 2506 / 2834 / 2941
- **NASDAQ:** 7510 / 6635 / 7729 / 8006
- **Russell 2000:** 1643 / 1348 / 1539 / 1566

Commodities
- **CRB:** 200 / 169 / 183 / 181
- **Oil:** $74.15 / $45.41 / $60.14 / $58.47
- **Gold:** $1253 / $1282 / $1292 / $1409
- **Copper:** $296 / $263 / $293 / $271
- **Natural Gas:** $2.92 / $2.94 / $2.66 / $2.30

Borrowing Benchmarks
- **Libor:**
  - **1mo:** 2.090% / 2.502% / 2.494% / 2.398%
  - **3mo:** 2.335% / 2.807% / 2.599% / 2.319%
- **SOFR: (U.S Secured Overnight Financing Rate)**
  - **1day:** 2.04% / 3.00% / 2.65% / 2.42%

Treasuries Issues
- **3mo:** 1.88% / 2.31% / 2.40% / 2.12%
- **6mo:** 2.06% / 2.41% / 2.44% / 2.09%
- **1yr:** 2.24% / 2.52% / 2.40% / 1.92%
- **2yr:** 2.52% / 2.49% / 2.27% / 1.78%
- **3yr:** 2.63% / 2.46% / 2.21% / 1.71%
- **5yr:** 2.73% / 2.50% / 2.23% / 1.76%
- **7yr:** 2.82% / 2.58% / 2.31% / 1.87%
- **10yr:** 2.86% / 2.68% / 2.41% / 2.00%
- **30yr:** 2.99% / 3.01% / 2.81% / 2.52%

Currencies
- **Euro:** 1.168 / 1.146 / 1.121 / 1.137
- **Yen:** 110.76 / 109.69 / 110.86 / 107.85
- **Peso:** 19.91 / 19.65 / 19.42 / 19.22
- **Canadian $:** 1.313 / 1.363 / 1.334 / 1.309
- **Yuan:** 6.621 / 6.878 / 6.712 / 6.866

Grain Futures
- **Corn:** $3.71 / $3.75 / $3.56 / $4.31
- **Soybeans:** $8.80 / $8.95 / $8.84 / $9.23
- **Wheat:** $5.01 / $5.03 / $4.57 / $5.27

Job / Inflation Indicators
- **Unemployment:** 4.0% / 3.9% / 3.8% /
- **Consumer Price Index:** 2.9% / 1.9% / 1.9% / 1.6%
- **Core PCE Index:** 1.9% / 1.9% / 1.5% / 1.5%

Federal Funds Open: 1.90% / 2.40% / 2.40% / 2.37%

Prime Rate: 5.00% / 5.50% / 5.50% / 5.50%

19th Hole...

Economics is extremely useful as a form of employment for economists.

John Kenneth Galbreth

Ross Elford, First Vice President

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