**MORNING BRIEFING**
**November 6, 2017**

## TGI . . . TCJA?

*See the collection of the individual charts linked below.*

(1) Radical overhaul. (2) Now the hard part. (3) The losers are mostly wealthy individuals with big bills for SALT including property taxes. (4) A stealth 46% tax rate. (5) Mass migration from SALT to SALT-free states. (6) A boon for SmallCaps. (7) Budget resolution and the Byrd Rule. (8) Trump's tax reform mostly bullish for business and stocks. (9) Reagan's tax reform mostly benefited individuals. (10) Movie review: "The Florida Project" (+ +).

**Tax Reform I: Sausage Factory.** House Republicans released their massive tax reform bill last Thursday. It is 429 pages long. The new bill, known as the "Tax Cuts and Jobs Act" (TCJA), proposes a radical overhaul of the tax system. Now comes the hard part. Getting it passed through both houses of Congress will be challenging, especially in the Senate. To get it passed, Republicans may have to alter it in significant ways, which makes it hard to predict what the ultimate bill will look like. Of course, it might not pass. Consider the following:

(1) *Losers*. As currently proposed, the TCJA hits wealthy individuals in states with high income and property taxes the hardest. That's because the plan eliminates the itemized deduction for state and local income or sales taxes (SALT) for individuals and caps the real property tax deduction at $10,000. (Currently, there is no cap on the SALT deduction.) It also caps the amount of deductible mortgage interest expense on new loans that are no larger than $500,000. (The current limit is for loans up to $1 million.) That may be too much simplification for wealthy people to bear without putting up a political fight, given that their top marginal tax rate won't be cut and might actually go up.

The top rate stays at 39.6% for both joint and single filers. However, it would apply to fewer people—joint filers with annual incomes of $1 million or more rather than $470,701 as now and single filers with annual incomes of $500,001 or more rather than $418,401 or more. For joint filers, incomes between $260,001 and up to $1 million would have a marginal tax rate of 35%, combining the 33% and 35% rates that previously applied to income in this bracket. For single filers, the 35% applies to incomes between $200,001 and up to $500,000. (For more, see *Business Insider's* helpful chart found in an 11/2 article.)

In an 11/2 article, Politico discussed a hidden 46% tax bracket in the November bill. It noted: "[A] little-noticed provision effectively creates a new band in which income is taxed at over 45 percent. Thanks to a quirky proposed surcharge, Americans who earn more than $1 million in taxable income would trigger an extra 6 percent tax on the next $200,000 they earn—a complicated change that effectively creates a new, unannounced tax bracket of 45.6 percent." That means that "the top marginal tax rate would rise above 40 percent for the first time since 1986."

The new code could be bad news for real estate values, especially for large homes since the mortgage interest deduction has been cut in half. It's bad news for states with high income taxes like California, Connecticut, Illinois, New Jersey, and New York. They've been seeing net population outflows to states with no income taxes like Florida, Tennessee, and Texas. The new tax plan will only exacerbate these outflows from SALT to SALT-free states. That would depress real estate prices in the SALT states too, and force them to raise property taxes and/or cut spending.

Now that there is a detailed bill with specific measures, the special interest groups are marshalling their resources and lobbyists to fight the measures they don't like. The housing-related special interest groups are already up in arms. Republican senators from the high-tax states are threatening not to support the bill.

(2) *Winners.* The big winners are corporations. They are projected to get a tax cut of $1.5 trillion over the next 10 years from lower corporate rates alone (which is somewhat offset by other reforms). The corporate statutory tax falls from up to 35% to a flat 20% rate starting next year. (A different rate applies to personal service corporations.)

Interestingly, the effective tax rate during Q2-2017 for all corporations was down to 21.3%, according to National Income & Product Accounts data (*Fig. 1*). For the S&P 500 (LargeCaps), the effective tax rate was 26.4% during 2016 (*Fig. 2*). Part of the reason that those rates are lower than the 35% top statutory rate is because of offsetting deductions. Additionally, corporate tax rates are currently based on a rate schedule, so some smaller corporations do not incur the 35% statutory rate; accordingly, lowering the statutory rate to 20% may not matter that much to them.

Since Election Day (November 8, 2016), S&P 500/400/600 are up 21.0%, 21.3%, and 24.1% partly on expectations of lower corporate tax rates (*Fig. 3*).

**Tax Reform II: The Byrd Rule.** Any changes that are made to TCJA risk violating the Byrd Rule. Passed in 1985, it requires any bill going through the budget reconciliation process not to contain any "extraneous matter" or something "merely incidental" to the federal budget. The budget-reconciliation maneuver through which the GOP hopes to move the TCJA allows a bill that adjusts the federal budget to pass through the Senate with a simple 50-vote majority to avoid a filibuster. Any other legislation needs 60 votes to avoid a filibuster.

One of the provisions of the Byrd Rule is that any bill going through the reconciliation process can't add to the federal deficit outside of 10 years, which is the length of a budget resolution. According to an 11/3 Business Insider analysis: "The most likely way leaders could cut down on the deficit increase in the second decade would be to make its planned corporate tax cut temporary."

The key will be whether dynamic scoring, i.e., factoring in faster economic growth from tax reform, will boost revenues enough to satisfy another provision of the fast-track reconciliation process: "Procedurally, the economic impact is important—because under the reconciliation rules, it can only add $1.5 trillion to deficit over 10 years. If the economic growth projection slips, however, this could change, putting it outside of that $1.5 trillion window."

The bottom line is that the bill might change a lot to achieve enactment, or it might die.

**Tax Reform III: Favoring Business.** The TCJA is weighted more toward benefiting corporations and small businesses than individuals. To demonstrate this, it is helpful to step away from the minutia of the specific tax changes. Here are the major bottom lines based on the Joint Committee on Taxation's (JCT) table of the estimated revenue effects of the tax bill:

(1) *On balance, revenue effects seem equally split between individuals and businesses.* JCT estimates that the net effects of the proposed tax changes will result in a $1.5 trillion overall tax cut from 2018 through 2027. According to the JCT breakdown, that is composed of cuts of $929.2 billion for individuals and $846.5 billion for businesses. To arrive at the balance, there are offsetting increases for

tax changes for foreign income and foreign persons of $285.4 billion and $3.2 billion for exempt organizations. So on the surface, according to the JCT, it appears that the cuts are more or less balanced for individuals and businesses.

(2) *Pass-through businesses are businesses.* Notice, however, that the JCT version includes the treatment of pass-through business income in the total of the section for "individuals." Many pass-through businesses will enjoy a reduced tax rate under the bill, which is estimated to result in tax cuts of $448 billion. If we simply shift that to the business side of the ledger from the individual side, it's obvious that the bill favors businesses.

We aren't the only ones who think this classification makes sense. When the Tax Policy Center (TPC) analyzed the Trump administration's September preliminary tax framework that preceded the November bill, the analysts included the treatment of pass-through business income as a provision for businesses (see Table 1 on page 7 of the TPC's preliminary analysis of the framework). Further, the policy highlights for the November bill from the House Ways & Means committee don't discuss pass-through provisions under "individuals and families" but under "job creators of all sizes."

(3) *The bottom lines.* Even without pass-throughs, corporate cuts are bigger than individual cuts. The rate reductions for individuals are expected to result in cuts of $1.1 trillion, offset by other adjustments that will increase tax revenues by $608 billion, for a net effect of $481 billion in cuts. Lower corporate tax rates are estimated to result in tax cuts of $1.5 trillion offset by increases from other reforms of $616 billion, for a net effect of $846 billion in cuts. (For more details on the bill, see the House Ways & Means committee's section-by-section summary of the "Tax Cuts and Job Act.")

**Tax Reform IV: Good for Stocks.** Politically speaking, the Trump administration never would blatantly admit that the goal of tax reform is to benefit the stock market. However, Steve Mnuchin did recently indicate as much. In a mid-October interview with Politico, Mnuchin said: "To the extent we get the tax deal done, the stock market will go up higher. But there's no question in my mind that if we don't get it done you're going to see a reversal of a significant amount."

So far, the market has reacted positively to the release of the detailed tax bill on 11/2. The S&P 500 has risen 0.3% since 11/1 and 3.2% since the White House released an outline of the plan on 9/27. So it held the gains since late September despite the news that the tax bill would result in a lower dollar amount of tax cuts than preliminary estimates suggested. Based on the September framework, the TPC estimated the net effect of the tax cuts would be $2.4 trillion versus the JCT's recent $1.5 trillion estimate. Nevertheless, the market's upbeat reaction could simply demonstrate that the investors are starting to believe more in the tax cuts now than they did before, even though the effects might not be as great.

**Tax Reform V: Reagan's Cuts Favored the Wealthy.** Unlike TCJA, President Ronald Reagan's tax cuts significantly favored reducing taxes for individuals over those for corporations. Corporate rates were consolidated and reduced, but corporate deductions were reduced too, as discussed in a 1986 *NYT* article "The Tax Bill of 1986: Lower Corporate Rate, But Fewer Deductions; Numerous Changes Would Raise Burden on Business."

The *1990 Budget of the United States Government* includes a table on page 4-4 that shows the net effect on tax receipts of major enacted legislation during the 1980s. At the bottom of the table, an addendum breaks the effects down by source. For all periods shown, the largest reduction in tax receipts by far is for individuals.

For example, the net effect of tax receipts expected for the farthest year out shown, 1992, is a reduction of $258.3 billion. Included in that figure, individual tax reductions totaled a whopping $326.9 billion, while corporate income taxes and social insurance taxes and contributions were among the offsetting increases totaling $43.7 billion and $27.8 billion. (Increases to excise taxes and reductions to estate and gift taxes as well as miscellaneous receipts made up the difference to arrive at the overall net tax cut.)

Pre-Reagan, the top tax rate was 70%, which was slashed to 28% by the time Reagan was done, according to a record of tax facts found in a 2006 US Department of Treasury analysis. The current top tax rate stands at 39.5% and could rise to 45.6% for some high-income taxpayers, as noted above.

**Tax Reform VI: Raising Taxes to Cut Taxes.** The GOP tax reform plan is likely to reduce the percentage of Americans paying income taxes, placing a greater burden on wealthy individuals. Nothing in it is likely to broaden the tax base, in our opinion, other than the faith-based notion that the plan will boost growth enough to create more wealthy people, who will pay more taxes.

The key concept of the plan seems to be to raise taxes on the wealthy to pay for some tax cuts for the middle class and a big cut for business owners, with a key assumption being that they will pay their workers more and spend on capital to boost productivity.

Just for the record, IRS data available for 2014 show that 35.0% of income tax return filers paid no taxes (*Fig. 4*). The IRS reports that during 2014, there were around 400,000 millionaires. Collectively, they accounted for 17.2% of total taxable income and paid 27.6% of all income taxes (*Fig. 5*).

The media has actually hyped the opposite: that wealthy taxpayers stand to get a windfall from the tax cuts. That's because the owners of pass-through entities, which are essentially small businesses that file through individual tax returns, mostly fall into the higher income tax brackets. However, the catch is that it all depends on how that income is earned, i.e., either actively or passively.

There are strict guidelines via a formula that's intended to prevent the new lower rates on pass-throughs from being applied to personal labor income. So, for example, accountants, lawyers, and doctors who do their work through their own practices might not get much of a benefit. The rule is intended as a "give" for small business owners who are creating lots of jobs, rather than those who are practicing their trade solo through pass-through entities. While many might not like it, it's an important rule because it should help to prevent taxpayers from fraudulently shifting personal income to pass-through income. Such fraud was a key concern that came out of the previous framework, which had assumed more aggressive rate cuts for pass-throughs than the latest bill.

**Movie.** "The Florida Project" (+ +) (*link*) is a movie that all rich people should see, especially if they are depressed by what the GOP is planning to do to them under TCJA. The film is about Moonee, a precocious and mischievous six-year-old girl growing up with a single mom in a welfare motel, which is next to Disney World. She certainly makes the best of tough living conditions. Perhaps the rich would feel better about paying more in taxes if they actually benefited kids like Moonee.

## CALENDARS

**US. Mon:** Dudley. **Tues:** NFIB Small Optimism Index 105.0, Job Openings 6.082m, Consumer Credit $17.4b. (*Wall Street Journal* estimates)

**Global. Mon:** Eurozone, Germany, France, and Italy Composite PMIs 55.9/56.9/57.5/54.3, Eurozone, Germany, France, and Italy NM-PMIs 54.9/55.2/57.4/53.0, Germany Factory Orders -1.1%m/m/7.1%y/y, Japan Composite & NM-PMI, Kuroda. **Tues:** Eurozone Retail Sales

0.6%m/m/2.8%y/y, Germany Industrial Production -0.8%m/m/4.4%y/y, RBA Cash Rate Target 1.50%, Draghi, Poloz. (DailyFX estimates)

## STRATEGY INDICATORS

**Global Stock Markets Performance** (*link*): The US MSCI index rose 0.3% last week, and ranked 32nd out of the 49 markets as 35 countries rose in US dollar terms. That compares to ninth a week earlier, when it rose 0.2% as 12 countries moved higher. The AC World ex-US index, with a 1.1% gain, outperformed the US MSCI for just the fourth time in 10 weeks; that result compares to a 0.6% decline a week earlier. Most regions rose w/w, but EM Asia performed best as it gained 2.3%, followed by EMU (1.3). EM Latin America was the worst-performing region as it fell 2.8% w/w, followed by EM Eastern Europe (-0.4), EMEA (0.2), BRIC (0.9), and EAFE (0.9). Korea was the best-performing country, with a gain of 4.9%, followed by Greece (3.9), Indonesia (3.1), Egypt (2.7), and Philippines (2.4). Colombia was the worst performer for a second week as it fell 4.2%, followed by Israel (-3.8), Brazil (-3.7), and Argentina (-3.4). In October, the US MSCI rose 2.2%, ranking 14/44 and ahead of the 1.8% gain for the AC World ex-US index as most regions rose. That compares to a 1.9% gain in September, when it ranked 20/44 and was ahead of the 1.6% gain for the AC World ex-US in a month when most regions rose. The best regions in October: EM Asia (5.3) and BRIC (3.0). October's worst-performing regions: EM Latin America (-3.7), EM Eastern Europe (-0.3), EMEA (-0.3), EMU (0.9), and EAFE (1.5). The US MSCI is up 15.7% ytd, with its ranking steady w/w at 31st of the 49 markets, but continues to trail the AC World ex-US (21.2) on a ytd basis. Forty-four of the 49 markets are positive ytd, led by Argentina (66.1), Austria (48.7), China (47.6), Poland (46.2), Korea (46.0), Chile (34.9), and Hungary (33.7). The worst country performers ytd: Pakistan (-25.1), Israel (-11.1), Russia (-5.4), Jordan (-1.8), and New Zealand (-1.5). EM Asia is the best-performing regions ytd with a gain of 37.9%, ahead of BRIC (35.2) and EMU (25.7). The worst-performing regions, albeit with gains: EMEA (6.9), EM Eastern Europe (7.2), EM Latin America (18.5), and EAFE (19.3).

**S&P 1500/500/400/600 Performance** (*link*): Last week, the LargeCap indexes rose for an eighth straight week and the 10th time in 11 weeks, but MidCap fell for the first time in eight weeks and SmallCap dropped for the second week in four weeks. LargeCap's 0.3% gain edged out MidCap's 0.2% drop, but SmallCap's 1.7% fall was its biggest in 11 weeks. LargeCap ended the week at a record high, but MidCap was down 0.2% from its October 27 record and SmallCap was 1.9% below its October 3 record. Ten of the 33 sectors rose w/w, compared to 19 a week earlier. Energy dominated last week's biggest gainers: MidCap Energy (6.8%), SmallCap Energy (5.5), LargeCap Tech (1.8), LargeCap Energy (1.7), MidCap Health Care (1.7), and LargeCap Real Estate (1.6). Telecom dominated last week's worst performers: MidCap Telecom (-11.5), SmallCap Telecom (-8.9), SmallCap Tech (-4.0), MidCap Consumer Staples (-3.1), and LargeCap Telecom (-2.6). All three market-cap indexes moved higher in October as LargeCap's 2.2% squeaked ahead of MidCap (2.2) and easily beat SmallCap (0.9). LargeCap's gain was its best in eight months. Twenty-two of the 33 sectors advanced in October, down from 25 rising in September. October's best performers: LargeCap Tech (7.7), MidCap Tech (5.8), MidCap Utilities (4.5), SmallCap Telecom (4.1), and MidCap Telecom (4.0). October's laggards: LargeCap Telecom (-8.7), MidCap Energy (-3.6), and SmallCap Energy (-3.6). Twenty-five of the 33 sectors are positive ytd, down from 25 a week earlier, as LargeCap (15.6) continues to outperform both MidCap (10.6) and SmallCap (7.5). Tech and Health Care dominate the biggest sector gainers ytd: LargeCap Tech (37.1), SmallCap Health Care (23.9), MidCap Tech (23.5), MidCap Health Care (22.3), SmallCap Utilities (18.5), and LargeCap Health Care (18.4). Telecom and Energy dominate the worst performers ytd: MidCap Telecom (-46.1), SmallCap Energy (-31.1), MidCap Energy (-23.8), LargeCap Telecom (-17.4), and LargeCap Energy (-8.4).

**S&P 500 Sectors and Industries Performance** (*link*): Four of the 11 sectors rose last week, and four outperformed the S&P 500's 0.3% gain. This compares to five sectors rising a week earlier, when five outperformed the S&P 500's 0.3% rise. Tech was the best-performing sector as its 1.8% gain beat these outperforming sectors: Energy (1.7%), Real Estate (1.6), and Utilities (0.3). Telecom (-2.6) was the worst performer, and was followed by these underperformers: Consumer Discretionary (-0.8), Industrials (-0.8), Health Care (-0.7), Materials (-0.5), Financials (-0.1), and Consumer Staples (0.0). The S&P 500 rose 2.2% in October as seven sectors moved higher and four beat the index; that compares to eight sectors rising and five beating the S&P 500's 1.9% rise in September. The leading sectors in October: Tech (7.7), Utilities (3.9), Materials (3.8), and Financials (2.8). Telecom was the biggest laggard by far in October as it fell 8.7%, followed by Consumer Staples (-1.6), Health Care (-0.8), Energy (-0.7), Industrials (0.2), Real Estate (0.7), and Consumer Discretionary (2.0). So far in 2017, nine of the 11 sectors are higher, but only three have outperformed the S&P 500's 15.6% gain. The best performers in 2017 to date: Tech (37.1), Health Care (18.4), and Materials (18.1). The seven sectors underperforming the S&P 500 ytd: Telecom (-17.4), Energy (-8.4), Consumer Staples (2.9), Real Estate (6.2), Consumer Discretionary (12.6), Industrials (12.9), Utilities (13.4), and Financials (14.9).

**Commodities Performance** (*link*): Seventeen of the 24 commodities we follow rose last week as the S&P GSCI commodities index rose 2.1%. That compares to 15 commodities advancing a week earlier, when the GSCI index rose 2.4% for its best gain in 13 weeks. The week's strongest performers: Nickel (9.8%), Live Cattle (5.4), and Unleaded Gasoline (4.4). Last week's biggest laggards: Cocoa (-2.6), Coffee (-2.1), and Sugar (-1.7). October saw 15 of the commodities climb, up from 12 rising in September and led by Nickel (17.4), Lean Hogs (13.4), Live Cattle (9.0), and Unleaded Gasoline (8.9). October's laggards: Wheat (-6.6), Kansas Wheat (-5.9), Natural Gas (-3.7), Lead (-3.3), and Corn (-2.7). Industrial metals-related commodities dominate the best performers in 2017 so far: Feeder Cattle (29.1), Aluminum (28.7), Nickel (27.1), Zinc (25.9), Copper (24.4), and Lead (22.6). This year's laggards: Sugar (-26.3), Natural Gas (-19.9), Coffee (-9.6), Cocoa (-3.1), and Cotton (-2.7).

**Assets Sorted by Spread w/ 200-dmas** (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 18/24 commodities, 6/9 global stock indexes, and 7/33 US stock indexes compared to 15/24, 5/9, and 18/33 rising a week earlier, respectively. Commodities' average spread surged w/w to 4.9% from 3.5%. Fifteen commodities trade above their 200-dmas, unchanged from a week earlier. Nickel now leads all commodities and all assets at 24.1% above its 200-dma, and rose 10.3ppts w/w for the best performance of all commodities and all assets. It is followed by Brent Crude (17.1%) and Heating Oil (17.1). Sugar (-7.9) and Lean Hogs (also -7.9) trade the lowest of all commodities relative to their 200-dmas, followed by Coffee (-7.8). Cocoa (3.9) fell 2.6ppts last week for the worst performance of all commodities. The global indexes trade at an average of 8.6% above their 200-dmas, up from 8.4% in the prior week. All nine of the global indexes trade above their 200-dmas, also unchanged from a week earlier. Japan (13.8) now leads the global indexes as its 2.2ppt gain w/w was the best performance among its peers. Brazil (9.5) fell 3.4ppts for the worst performance among the global indexes. The UK (2.4) trades the lowest among its country peers, followed closely by Canada (3.7). The US indexes trade at an average of 2.9% above their 200-dmas, with 25 of the 33 sectors above, down from an average of 3.9% a week earlier, when 26 sectors were above. LargeCap Tech leads all US stock indexes at 15.6% above its 200-dma, but MidCap Energy (-0.4) gained 7.1ppts w/w for the best performance of the US stock indexes. MidCap Telecom trades 27.2% below its 200-dma, the lowest among the US stock indexes and all assets, followed by LargeCap Telecom (-8.8). SmallCap Telecom (-3.8) dropped 9.4ppts for the worst performance among the US indexes and all assets last week.

**S&P 500 Technical Indicators** (*link*): The S&P 500 index remained in a Golden Cross last week for an 80th week (after 17 weeks in a Death Cross), but both the short-term and long-term technicals weakened w/w. The index's 50-day moving average (50-dma) relative to its 200-dma rose to a 10-week high of 3.9% from 3.8% a week earlier. That compares to a 34-month high of 5.4% in early April, a 39-

week low of 3.4% in early October, and a 52-month low of -4.5% in March 2016. The S&P 500's 50-dma and 200-dma both rose together for an 11th straight week, after failing to rise together in mid-August for the first time in 36 weeks. The index closed above its 50-dma for a tenth week after three weeks below, which was its worst streak since it closed below its 50-dma for 10 straight weeks from September 2016 until the November election. The S&P 500 fell to 2.6% above its rising 50-dma from 2.9% a week earlier, which compares to a 33-week high of 3.1% three weeks ago and a four-month low of 1.0% below its falling 50-dma in mid-August. These 50-dma readings compare to a 38-week high of 4.8% on December 13 and a 52-month high of 6.2% in March 2016. The S&P 500 edged down to 6.5% above its rising 200-dma from 6.6% a week earlier, which compares to a 13-week high of 6.7% three weeks ago and a post-election low of 3.0% above its rising 200-dma in mid-August. That's down from a 38-month high of 9.4% on March 1, but up from an eight-month low of -0.1% immediately before the election.

**S&P 500 Sectors Technical Indicators** (*link*): Among the 11 sectors, five improved w/w relative to their 50-dmas and four relative to their 200-dmas. These four had improvements in both moving averages: Consumer Staples, Energy, Real Estate, and Tech. Eight of the 11 sectors trade above their 50-dmas, unchanged from a week earlier as Real Estate moved above and Health Care moved below. Telecom was below for a third straight week and Consumer Staples for a sixth week. Still, that's a turnaround from mid-August when just three sectors traded above their 50-dmas (matching mid-April's reading, which was the lowest since the election). All 11 sectors had been above their 50-dmas during mid-January, and all 11 were below the week before the election, for the first time since December 11, 2015. The longer-term picture is similarly strong: Nine of the 11 sectors were above their 200-dmas last week, unchanged from a week earlier. Energy traded above its 200-dma for a sixth week after 29 weeks below; Consumer Staples was below its 200-dma for a seventh week after 32 straight weeks above; and Telecom ended the week below its 200-dma for a 32nd straight week. Eight sectors are in a Golden Cross, with 50-dmas higher than their 200-dmas, unchanged from a week earlier. Consumer Staples was out of the Golden Cross club for a third week and for the first time since early March; Telecom was out for a 34th week; and Energy for a 30th week. All 11 sectors had been in a Golden Cross during a 21-week streak that ended in late October of 2016, the longest such stretch since October 2014. Nine of the 11 sectors have rising 50-dmas, unchanged from a week earlier. Consumer Staples' 50-dma has been falling for seven weeks, and Telecom's for five weeks. Nine sectors have rising 200-dmas, unchanged from a week earlier. Energy's 200-dma fell for a 27th straight week, and Telecom's dropped for a tenth week.

## US ECONOMIC INDICATORS

**Employment** (*link*): Employment posted its largest gain in 15 months in October, and there were sizable upward revisions to September and August. US companies added 261,000 to payrolls last month—the most since July 2016—while September's (to 18,000 from -33,000) hurricane-related decrease was revised to an increase, and August's (208,000 from 169,000) advance was considerably higher than first reported. This resulted in a net gain of 90,000 over the two-month period. Meanwhile, private payrolls climbed 252,000, following increases of 15,000 (vs. -40,000) and 184,000 (164,000) for a two-month net gain of 75,000. The breadth of job creation (percent of private industries increasing payrolls) for the one-month span fell for the fourth month from 64.9% in May to 59.6% in October, while the three-month span rebounded to 65.5%, heading back toward August's 69.2%, which was the highest reading since the end of 2014.

**Earned Income Proxy** (*link*): Our Earned Income Proxy (EIP) in October continued to set new record highs. It has increased in ten of the last 12 months, advancing 0.2% m/m. Average hourly earnings, one of the components of our EIP, was unchanged last month after shooting up 0.5% in September, which matched its high for the year, while aggregate weekly hours, the other component, rose 0.2% after showing no growth in September. On a y/y basis, our EIP rose 4.1% y/y, easing from 4.4% and 4.7% the prior two months. The AHE rate slowed to 2.4% y/y after matching its high for this year of 2.8% in September; aggregate hours climbed 1.7%—up slightly from September's 1.5%, but down from August's 2.0%. Our proxy tracks income and spending closely and continues to predict solid gains in both.

**Employment by Industry** (*link*): October payrolls were boosted by a rebound in restaurant jobs after September's hurricane-related decline, while professional & business services, manufacturing, and health care also showed solid gains. Employment in restaurants jumped 88,500, nearly reversing September's record monthly decline of 98,000. Meanwhile, job growth for professional & business services (50,000) was in line with its average monthly gain over the past 12 months, with payrolls up 536,000 y/y. Factories continued to boost payrolls, adding 24,000 jobs last month and 156,000 since the recent low in November 2016. Health care jobs still trending higher, expanding 21,500 in October and 300,600 the past 12 months. Employment in other major industries—including mining, construction, wholesale trade, retail trade, transportation & warehousing, information services, financial activities, and government—showed little change last month.

**Unemployment** (*link*): October's unemployment rate sank to a 17-year low of 4.1% on a sharp drop in the civilian labor force. The labor force plummeted 765,000 after a four-month surge of 1.36 million; those not in the labor force jumped 968,000 after falling three of the prior four months by 566,000. The participation rate retreated to 62.7% after reaching 63.1% in September—which was the highest since March 2014; it still has showed little movement on net over the past year. The adult (3.7%) and college grad (2.0) rates fell to new cyclical lows last month, while the teenage rate climbed to 13.7% after dropping to 12.9% in September, which was the lowest rate since October 2000. Those working part-time for economic reasons (a.k.a. "involuntary part-time workers") fell for the fourth month, by 369,000 m/m and 573,000 over the period to 4.75 million (3.0% of the civilian labor force), the lowest since December 2007. Both the sum of the underemployment and jobless rates (7.1) and the U6 rate (7.9)—which includes marginally attached workers—fell to new cyclical lows.

**Wages** (*link*): Wage inflation—as measured by the average hourly earnings rate for all workers on private nonfarm payrolls (AHE)—slowed to 2.4% y/y last month after matching its high for this year of 2.8% in September. The wage rate for goods-producing industries (1.9% y/y) was the lowest since July 2015, while service-providing's (2.6) eased from September's 2.9%, which was the highest since April 2009. Within goods-producing, the manufacturing rate (1.6) fell to a 27-month low, while construction's (2.3) eased from September's eight-month high of 3.0%; the natural resources rate (0.8) slipped back below 1.0%. Within service-providing, the rate for information services slowed for the third month from a recent high of 5.2% in July to 3.4% in October, while the education & health services rate (1.9) continued to ease from August's multi-year high; wholesale trade's (0.7) sank below 1.0%. Rates for professional & business services (3.1) and transportation & warehousing (2.7) remained stalled at recent highs, while financial activities (3.3) accelerated to its fastest pace since August 2013. The utilities' rate (1.2) may have found a bottom, while retail trade's (1.8) is up from recent lows.

**Productivity & Labor Costs** (*link*): Productivity expanded at its fastest pace in three years last quarter, keeping unit labor costs at a near standstill. Nonfarm productivity accelerated for the second quarter, up 3.0% (saar)—the best pace since Q3-2014—following gains of 1.5% and 0.1% the prior two quarters. Output advanced 3.8% (saar), in line with Q2's gain, while hours worked slowed to a one-year low of 0.8%. (While other government data show that the hurricanes reduced the number of hours worked, the Labor Department didn't report any specific effects.) Unit labor costs (0.5%, saar) remained near zero for the second straight quarter, despite an acceleration in hourly comp (3.5%) from Q2's 1.8%. Over the past year, productivity expanded at a nine-quarter high of 1.5% y/y, while unit labor costs (-0.1% y/y) were just below zero for the second quarter.

Contact us by email or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor & Webmaster, 570-775-6823