MORNING BRIEFING
October 8, 2018

Bonds' Tether Tantrum

See the collection of the individual charts linked below.

(1) Bonds: Six reasons to fold them and one reason to hold them. (2) US bonds' tether to bunds and JGBs may be fraying. (3) Bond Vigilantes model is most bearish of them all. (4) Latest wage inflation data remain subdued. (5) Industries with highest wage inflation are among most competitive. (6) Phillips curve on life support. (7) Powell says Fed remains on course. (8) Fed is adding an annualized $360 billion to Treasury supply. (9) Fed data show big buyers of Treasuries so far this year have been households, foreigners, and pension funds. (10) US PMIs outpacing the rest of the world's PMIs. (11) Will bond yield top out at 3.50% or 4.00%? (12) Movie review: "A Star Is Born" (+ +).

Bonds: Rerating the Fed. In the 9/24 *Morning Briefing*, I noted that there are "[s]ix good reasons to dump bonds and one really good reason to hold onto them."

I added: "Perhaps this will all end badly when the 10-year US Treasury bond yield soars from 3.00% to 4.00% or higher. There is absolutely no reason to like bonds when the 10-year Treasury yield is hovering around 3.00%. Actually, there is one good reason."

The one good reason is that "the US 10-year government bond yield has been tethered to the comparable yields in Japan and Germany, which are around 0.00%" (*Fig. 1*). The latter two yields remain near zero because the ECB and BOJ continue to peg their official interest rates slightly below zero (*Fig. 2*).

The tether seems to be fraying, as the 10-year US Treasury yield rose to 3.23% at the end of last week to the highest level since May 10, 2011. Altogether, the six bearish factors suggest that the 10-year Treasury bond yield could rise to 4.00%. I'm not giving up on the tether, and I am expecting that it will keep the yield from rising above 3.50%. Furthermore, the bond yield has long been tied to the inflation rate, which is likely to remain subdued around 2.0%, in my opinion. Let's review and update the six bearish factors:

(1) *Bond Vigilantes Model*. There has been a good (not great) correlation between the y/y growth rate in nominal GDP and the 10-year US Treasury bond yield (*Fig. 3* and *Fig. 4*). I've used this simple model since the early 1980s to explain why the two often have diverged rather than converged, as they eventually tend to do—though "eventually" can be a long time. In any event, nominal GDP rose 5.4% y/y during Q2. With GDP growth so high, this seems like one of those times when the bond yield may start to move toward the GDP growth rate. (To keep track of this relationship for the US, UK, Germany, France, and Japan, see our *Bond Vigilantes Model*.)

(2) *Inflation*. Interestingly, expected inflation over the next 10 years has remained remarkably subdued and stable so far this year around 2.1% (*Fig. 5*). This variable is simply the spread between the nominal 10-year Treasury yield and its comparable TIPS yield (*Fig. 6*). So the backup in the nominal yield in recent weeks—to 3.23%, the highest reading since May 10, 2011—is mostly attributable to the rise in

the TIPS yield, to 1.07%, the highest level since March 3, 2011. The last time that the TIPS yield was this high, on March 3, 2011 (at 1.09%), the nominal yield was 3.58% with expected inflation at 2.49%. During the early 2000s, the TIPS yield hovered around 2.00%. If it goes there again and expected inflation remains around 2.0%, then the nominal yield would rise to 4.00%.

What about expected inflation? The latest inflation news should help to keep a lid on inflationary expectations. Despite tight labor market conditions, wage inflation remains remarkably subdued. The unemployment rate fell to 3.7% during September, the lowest since December 1969. Yet average hourly earnings rose only 2.8% (*Fig. 7*). The Phillips curve may not be dead, but it remains on life support.

Here is the latest performance derby for wage inflation for all workers in the following industries: Information Services (4.7% y/y), Financial Activities (4.6), Utilities (4.2), Retail Trade (3.5), Construction (3.1), Service-Producing (2.9), Leisure & Hospitality (2.9), All Workers (2.8), Natural Resources (2.8), Professional & Business Services (2,7), Wholesale Trade (2.2), Goods-Producing (2.1), Education & Health Services (2.1), Transportation & Warehousing (1.9), and Manufacturing (1.3).

It's interesting to note that the industries with above-average wage gains tend to be very competitive, making it hard to pass costs through to prices. Also of note is that wage inflation is very low in Transportation & Warehousing and Manufacturing, where there has been lots of anecdotal evidence of severe labor shortages! Wages for truck drivers rose just 2.4% y/y during August (*Fig. 8*).

By the way, among the five Fed districts that produce monthly surveys of business conditions, only the Richmond Fed tracks wage trends. During September, the wage index for manufacturing rose to a record high, while the one for services remained at the record highs recorded since late 2016 (*Fig. 9*). Yet none of those trends showed up in the national data for wages.

Of course, President Donald Trump's policies on tariffs and sanctions also have inflationary potential consequences—especially if he slaps a 25% tariff on all goods imported from China. However, that might not be as inflationary as his sanctions on Iran, which are driving the price of a barrel of Brent crude oil higher (*Fig. 10*). Of course, higher oil prices may also depress economic growth, as they seem to be doing already among emerging economies.

(3) *The Fed*. As Fed Chairman Jerome Powell noted during his 9/26 press conference, there's plenty of anecdotal evidence of tight labor markets, but it isn't showing up in the macro data on wages so far. Powell followed up with a 10/2 speech in which he discussed whether the Phillips curve might be dead. He concluded (as we have) that it's probably still alive, but flat on its back.

Again, Powell mentioned "widespread anecdotes" about the tightness of the labor market, noting "the words 'shortage' and 'bottleneck' are increasingly appearing in the Beige Book, the Federal Reserve's report summarizing discussions with our business contacts around the country." Nevertheless, he conceded that it's possible that the natural rate of unemployment might be lower than current estimates suggest. "[T]hat would imply less upward pressure on inflation," said the Fed chairman, and all the more reason to raise rates gradually.

He concluded: "This historically rare pairing of steady, low inflation and very low unemployment is testament to the fact that we remain in extraordinary times. Our ongoing policy of gradual interest rate normalization reflects our efforts to balance the inevitable risks that come with extraordinary times, so as to extend the current expansion, while maintaining maximum employment and low and stable inflation."

While Powell reiterated that the Fed's policy remains on course for gradually raising interest rates, the fixed-income markets concluded last week that rates may be going up sooner and higher. The two-year US Treasury note yield, which tends to signal where the federal funds rate will be in a year, rose 17bps over the last four weeks to 2.88% (*Fig. 11*). Some of that increase occurred last Wednesday on news that ADP payrolls rose by 230,000 during September and that the ISM nonmanufacturing PMI leapt to the highest reading since August 1997 (*Fig. 12*). Both the nominal and TIPS 10-year yields popped on the news.

Friday's lower-than-expected payroll increase of 134,000 didn't stop yields from rising further. That's because 299,000 workers said that bad weather (likely hurricane related) hindered them from going to work, according to the household survey of employment. That compares to an average of 85,000 for a normal September. Meanwhile, the household measure of employment still rose 420,000, and the payroll measure of employment was revised higher by 87,000 during July and August. The labor market is hot, but not overheating—so far.

(4) *Federal deficit.* In addition to gradually raising interest rates, the Fed started tapering its balance sheet during October 2017. Since the start of that month through September, the Fed's holdings of Treasuries and mortgage-backed securities are down $152 billion and $86 billion, respectively (*Fig. 13*). The pace of tapering was upped this month for Treasuries from $25 billion per month to $30 billion. (See our *Winding & Unwinding QE*.)

In effect, the Fed is adding $360 billion at an annual rate to the federal budget deficit. In the past, I've found that a supply/demand analysis of bond yields isn't very useful. However, given that the Congressional Budget Office is projecting federal deficits averaging roughly $1.0 trillion per year, deficits may be starting to weigh on the bond market.

(5) *Pension funds.* In the "Bear Traps for Bonds" story of my 9/24 *Morning Briefing* commentary, I noted that an 8/21 CNBC article observed: "But now that it's getting into September, many pension funds, after diving in big time, may be ready to get out of the pool temporarily—or at least slow fixed income investments as summer moves into fall. That's because when the tax law changed last year, many companies were given until mid-September to deduct their pension contributions at last year's tax rate instead of the new 21 percent rate." That seemed to be a good call: The bond yield is up 26bps since mid-September.

There's one problem with the narrative that pension fund activity is driving the bond yield up: It's not really supported by the data. The Fed's *Financial Accounts of the United States* is available through Q2-2018. Table F.210 shows net purchases of US Treasuries by various investors. During the H1-2018, US private pension funds purchased Treasuries at an annual rate of just $69.7 billion (*Fig. 14*)! That's a big pace of purchases for pensions, but relatively small compared to the federal deficit. It's possible that pensions scrambled to buy much more during Q3, though I doubt it. We will see when the Fed's accounts are updated with Q3 data during December.

(6) *Foreign and other buyers.* The data also don't confirm that China and other foreign investors responded to Trump's trade war by dumping their US Treasuries. *Au contraire, mon frère*: The Fed's accounts show that the "rest of the world" snapped up US Treasuries at an annual rate of $267.5 billion during H1-2018 (*Fig. 15*). By the way, the biggest buyer of US Treasuries was the US household sector, which purchased these securities at an annual rate $922.8 billion during the same period (*Fig. 16*).

(7) *Bottom line.* The data do confirm that foreign investors have tethered the US bond yield to comparable yields in Germany and Japan. So does the strength of the dollar (*Fig. 17*). The dollar's

strength is attributable to the outperformance of the US economy—thanks in no small part to Trump's regulatory, tax, and trade policies.

This is clearly visible when comparing September's M-PMI and NM-PMI in the US (59.8, 61.6) to the Eurozone (53.2, 54.7), UK (53.8, 53.9), and Japan (52.5, 50.2) (*Fig. 18* and *Fig. 19*). The US indexes have been getting stronger this year, while the others have mostly been getting weaker, including the comparable composites for emerging economies (*Fig. 20*).

The bottom line for the stock market remains bullish. The US has the world's largest economy with one of the lowest corporate tax rates on the planet after Congress cut it to 21% in the US at the end of last year. I'm betting that supply-side forces will jump-start productivity growth, keep a lid on price inflation, boost real wages, pump up government revenues, and keep the dollar strong.

I'm betting that Trump soon will win his trade skirmishes with all of America's trade partners except China, which is likely to experience a big exodus of manufacturing to the US and/or all the other countries that have struck bilateral trade deals with the US. These countries would benefit significantly from this scenario.

Nevertheless, I'm still recommending a Stay Home posture on stocks, i.e., overweighting the US in a global stock portfolio. My S&P 500 targets remain 3100 by the end of this year and 3500 by the end of next.

I'm betting that the bond yield won't rise any higher than 3.50%. I recognize that Powell and his colleagues are aiming to raise the federal funds rate to 3.40% by 2020. They would like to have 340bps between the federal funds rate and zero when the next recession occurs. However, the latest rate hikes may already be enough to slow housing activity and auto sales.

In any event, America always has been great, and remains great!

Movie. "A Star Is Born" (+ +) (*link*) is a remake of the 1954 classic with Judy Garland and the 1976 remake with Barbara Streisand. It stars Lady Gaga and Bradley Cooper, who also directed the film. The movie is a bit slow at times, but Lady Gaga really is an amazing singer, and also a very good actress in her first movie role. Cooper is convincing as a self-destructive rock star heading toward oblivion. Coincidentally, FRBNY President John Williams recently suggested that the star quality of the neutral rate of interest, or r-star, is fading: "[A]t times r-star has actually gotten too much attention in commentary about Fed policy. Back when interest rates were well below neutral, r-star appropriately acted as a pole star for navigation. But, as we have gotten closer to the range of estimates of neutral, what appeared to be a bright point of light is really a fuzzy blur, reflecting the inherent uncertainty in measuring r-star." Williams had been one of the biggest promoters of the star; now, he's saying it's a has-been!

CALENDARS

US. Mon: None. **Tues:** NFIB Small Business Optimism Index 108.0, Williams, Evans. (Econoday estimates)

Global. Mon: Eurozone Sentix Investor Confidence 11.6, Germany Industrial Production 0.3%m/m/-0.1%y/y, Japan Merchandise Trade Balance ¥208.0b. **Tues:** Germany Trade Balance €16.2b, Japan Machine Orders -3.7%m/m/1.6%/y/y, Canada Housing Starts 208.4k, Australia Business & Consumer Confidence, Mexico CPI 5.01% y/y, IMF World Economic Outlook Report. (DailyFXestimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index fell 1.1% last week following a 0.5% decline a week earlier, but has risen in 14 of the past 20 weeks. The index ranked ninth out of the 49 markets in a week when just three countries rose in US dollar terms, the lowest count since zero countries in early February; that compares to the prior week's 22/49 ranking when 14 markets rose. The AC World ex-US index fell 2.8% compared to a 0.9% decline a week earlier. EM Latin America performed the best among markets abroad and was the sole gainer with an increase of 2.2%, followed by EAFE (-2.4%), EMU (-2.6), and EMEA (-2.6). Regions underperforming the AC World ex-US last week: EM Asia (-5.4), BRIC (-4.1), and EM Eastern Europe (-2.8). Brazil was the best-performing country, soaring 6.7%, followed by Sri Lanka (0.6) and Austria (0.3). Of the 23 countries that underperformed the AC World ex-US MSCI last week, South Africa fared the worst, falling 7.9%, followed by India (-7.8), Indonesia (-7.2), and Turkey (-7.0). With a gain of 7.9% ytd, the US MSCI ranks an astounding 2/49; it's up by exactly as much as the AC World ex-US (-7.9) is down. Most countries—42/49—and all other regions are in negative territory ytd. Falling less on a ytd basis than the AC World ex-US are: EM Eastern Europe (-3.5), EAFE (-6.0), EM Latin America (-6.9), and EMU (-7.7). BRIC (-14.1) is the biggest laggard relative to the AC World ex-US's performance, followed by EM Asia (-13.5) and EMEA (-9.5). The best country performers ytd: Israel (9.4), the US (7.9), Finland (5.8), Norway (5.2), Colombia (4.0), Russia (1.8), and Peru (1.7). The worst-performing countries ytd: Argentina (-52.9), Turkey (-49.8), Greece (-30.1), South Africa (-29.4), Indonesia (-24.7), and the Philippines (-24.1).

S&P 1500/500/400/600 Performance (*link*): All three of these three market-cap indexes moved lower last week. LargeCap fell for a second week as MidCap and SmallCap dropped for a third week. SmallCap (-3.9%) and MidCap (-2.6) were the worst performers as both registered their biggest declines in 28 weeks. LargeCap (-1.0) ended the week 1.5% below its record high on September 20, ahead of MidCap (-4.0, August 29) and SmallCap (-7.1, August 31). Just eight of the 33 sectors rose in the latest week, down from 11 rising a week earlier and matching the low counts recorded at the end of June and in early April. The best performers in the latest week: LargeCap Energy (1.9), LargeCap Utilities (1.9), LargeCap Financials (1.5), and MidCap Energy (1.2). SmallCap Consumer Discretionary was the biggest decliner last week, falling 5.6%, and followed by SmallCap Tech (-5.3), SmallCap Health Care (-5.2), MidCap Consumer Discretionary (-4.8), and MidCap Tech (-4.7). LargeCap is now up 7.9% ytd; it has beaten MidCap (3.5)—in recent weeks pulling away from MidCap on a ytd basis after trailing it for much of the year—but both are significantly trailing SmallCap's (recently shrinking) gain of 9.0%. Twenty-four sectors are now positive to date in 2018, up from 23 a week earlier and compared to just three in early February. The best-performing sectors ytd: SmallCap Health Care (35.3), MidCap Health Care (27.2), SmallCap Communication Services (23.9), MidCap Energy (21.7), LargeCap Tech (16.8), LargeCap Consumer Discretionary (14.2), and LargeCap Health Care (14.2). The worst performers ytd: SmallCap Real Estate (-8.3), LargeCap Consumer Staples (-6.4), MidCap Consumer Discretionary (-5.6), and LargeCap Communication Services (-5.5).

S&P 500 Sectors and Industries Performance (*link*): Four sectors rose last week, and seven outperformed the S&P 500's 1.0% decline. That compares to five rising a week earlier, when five outperformed the S&P 500's 0.5% decline. Energy and Utilities were the best-performing sectors with gains of 1.9%, ahead of Financials (1.5%), Industrials (0.8), Materials (-0.5), Health Care (-0.8), and Consumer Staples (-0.9). Consumer Discretionary was the biggest underperformer, with a drop of 4.4%, followed by Real Estate (-2.7), Communication Services (-2.2), and Tech (-2.2). Despite last week's decline for the S&P 500, seven sectors are now in the plus column so far in 2018, up from five a week earlier. That compares to nine in mid-September, which had matched the best ytd count also achieved in early March. However, just three sectors have outperformed the S&P 500's 7.9% ytd gain: Tech (16.8), Consumer Discretionary (14.2), and Health Care (13.2). The eight ytd underperformers:

Consumer Staples (-6.4), Communication Services (-5.5), Materials (-4.7), Real Estate (-3.7), Financials (0.2), Utilities (1.8), Industrials (4.1), and Energy (7.1).

Commodities Performance (*link*): Last week, the S&P GSCI index rose 1.7% w/w for only its fourth straight weekly gain as 12 of the 24 commodities that we follow moved higher. That's its best winning streak in 54 weeks when it rose for five straight weeks, and compares to the prior week's 2.6% gain when 12/24 commodities rose. Last week's strongest performers: Sugar (12.8%), Coffee (6.3), Natural gas (4.8), Aluminum (3.5), and Corn (3.4). Last week's biggest decliners: Lead (-2.0), Cocoa (-1.6), Copper (-1.4), Lean Hogs (-0.6), and Live Cattle (-0.6). The S&P GSCI commodities index is up 11.7% ytd and near its highest level since December 2014, but remains at half of its record high in July 2008 just before the financial crisis and is down 3.8% from its four-year high on Wednesday. The top performer so far in 2018 is Brent Crude (25.7), followed by GasOil (23.2), Crude Oil (23.0), Kansas Wheat (22.7), and Wheat (22.0). The biggest laggards of 2018 to date: Zinc (-19.8), Lean Hogs (-19.8), Lead (-19.8), Sugar (-16.7), Copper (-14.7), and Silver (-14.6).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 15/24 commodities, 3/9 global stock indexes, and 8/33 US stock indexes, compared to 13/24 commodities, 6/9 global stock indexes, and 10/33 US stock indexes rising a week earlier. Commodities' average spread rose w/w to -0.7% from -2.3%, and 11 commodities trade above their 200-dmas, up from 10 a week earlier. GasOil and Brent Crude lead all commodities—both 15.4% above their 200-dmas—but Sugar (4.0%) surged 12.3ppts w/w for the best performance among all assets. Lean Hogs (-15.5) trades the lowest of all commodities and all assets, but Cocoa (-13.6) fell 1.6ppts w/w for the worst performance among commodities. The global indexes trade at an average of 2.2% below their 200-dmas, down from -1.4% in the prior week. Just two of the nine global indexes trade above their 200-dmas, down from three a week earlier. Japan (5.7) leads the global indexes, but Brazil (2.6) improved 3.5ppts w/w for the best performance among global assets. China (-8.2) continues to trade at the lowest point relative to its 200-dma among global assets, but Indonesia (-6.3) performed the worst among global assets last week, falling 3.8ppts. The US stock indexes trade at an average of 3.0% above their 200-dmas, with 23 of the 33 sectors above, down from 5.2% a week earlier, when 28 sectors were above. SmallCap Communication Services (15.6) leads the US stock indexes and all assets, but LargeCap Utilities (5.1) gained 1.9ppts last week for the best performance among US stock indexes. MidCap Consumer Discretionary (-5.2) now trades the lowest among all US stock indexes relative to 200-dmas, but SmallCap Health Care (8.6) tumbled 6.8ppts w/w for the worst performance among US stock indexes and indeed all assets last week.

S&P 500 Technical Indicators (*link*): The S&P 500 price index fell 1.0% last week to barely above its short-term 50-day moving average (50-dma) trend line as it weakened relative to both 50-dma and its long-term 200-dma for a second week and only the fifth time in 14 weeks. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 128th straight week (after 17 weeks in a Death Cross) as the S&P 500's 50-dma relative to its 200-dma rose for the 17th time in 18 weeks following 17 straight weekly declines. The current Golden Cross reading of 4.1% is at a 27-week high and up from 4.0% a week earlier, but well below its 55-month high of 7.2% in early February; these compare to its 25-month low of 1.0% at the end of May and four-year low of -4.5% in March 2016. The S&P 500's 50-dma rose for a 19th week after mostly declining from late March to late May—including four straight weeks of decline through mid-April that constituted its worst performance since before the 2016 election. The index successfully tested its 50-dma at the end of June, but fell to a 14-week low of 0.2% above its rising 50-dma from 1.5% a week earlier. That compares to a 25-month low of 5.6% below its falling 50-dma near the end of March and a two-year high of 6.2% above its rising 50-dma on January 29. The 200-dma continued to rise last week, as it has done since May 2016, but at a pace near its slowest since October 2011. The S&P 500 successfully tested its 200-dma in early April. It ended the week at an 11-week low of 4.4% above its rising 200-dma, down from 5.6% a week earlier and a 27-

week high of 6.4% the week before that. That compares to 0.6% below the index's rising 200-dma on April 3 (the lowest reading since June 2016) and a seven-year high of 13.5% above its 200-dma on January 29.

S&P 500 Sectors Technical Indicators (*link*): Among the 11 S&P 500 sectors, just four improved last week relative to their 50-dmas and 200-dmas: Energy, Financials, Industrials, and Utilities. Five of the 11 sectors are trading above their 50-dmas now, down from seven a week ago. Utilities turned positive w/w (joining Energy, Health Care, Industrials, and Telecom), but these three sectors turned negative: Consumer Discretionary, Consumer Staples, and Tech. In late July, all 11 sectors had traded above their 50-dmas, the most since early December. Just a few months prior, the picture was the opposite: All 11 sectors were trading below their 50-dmas at the end of March (a first since February 2016). The longer-term picture—i.e., relative to 200-dmas—shows eight sectors trading above currently, down from nine a week earlier as Real Estate fell below. That compares to 11 above their 200-dmas the week before that, which was up from just four sectors in early May (which matched the lowest count since January 2016). Sectors trading above their 200-dmas for the longest timespans: Tech (118 straight weeks), Consumer Discretionary (100), and Health Care (19). All 11 sectors had been above both their 50-dmas and 200-dmas briefly in mid-December (for the first time since July 2016). Ten sectors now are in a Golden Cross (with 50-dmas higher than 200-dmas), unchanged from a week earlier. Materials is the sole laggard, out of the Golden Cross club for a 23rd week, but its 50-dma is just 0.4% below its 200-dma. All 11 sectors had been in a Golden Cross back in mid-January (for the first time since a 26-week streak ended in October 2016). Eight sectors have rising 50-dmas now, down from 10 a week earlier, as Financials and Real Estate turned down w/w and joined Materials. That compares to all 11 sectors with falling 50-dmas during early April (the worst count since before the election in November 2016). Seven sectors now have rising 200-dmas, unchanged from a week earlier and compared to six in mid-July (which was tied with a count in February for the lowest since May 2017). Financials' 200-dma zigged back up again last week, but Utilities zigged back down and joined Consumer Staples, Materials, and Communication Services as the four members of the declining 200-dma club.

US ECONOMIC INDICATORS

Employment (*link*): Employment growth in September was weaker than expected, with the reason likely hurricane related; losses in the retail trade (-20,000) and leisure & hospitality (-17,000) industries were likely attributable to Hurricane Florence. Last month, 134,000 were added to payrolls (vs a 180,000 consensus estimate)—the weakest in a year—while gains for both August (to 270,000 from 201,000) and July (165,000 from 147,000) payrolls were revised higher, for a net gain of 87,000. Private payrolls added 121,000 jobs last month—109,000 below ADP's count of 230,000—following an upward revision to August (254,000 from 204,000) and a downward revision to July (137,000 from 153,000) payrolls, for a net gain of 34,000. The industries boosting September payrolls once again were a combination of service-providing and goods-producing companies. Professional & business services (54,000) and health care & social assistance (29,800) once again finished one-two, boosting payrolls by 560,000 and 405,600, respectively, the past 12 months; transportation & warehousing (23,800) companies added the most monthly jobs since last September, up 173,800 y/y. Construction (23,000) and manufacturing (18,000) employment continued to trend up last month, adding 315,000 and 278,000 jobs, respectively, the past 12 months, with four-fifths of the gain in the latter in the durable goods component. Meanwhile, the breadth of job creation (i.e., the percentage of private industries increasing payrolls) remained elevated last month, with the three-month span (66.5%) remaining above 60.0%, though easing from June's 72.1%, and the one-month span (60.9) holding just above 60.0%.

Earned Income Proxy (*link*): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, continued to climb to new record highs in September. Our EIP rose 0.4% in

September—in line with the average monthly gain the past six months—and 5.4% y/y. Average hourly earnings (AHE), one of the components of our EIP, rose 0.3% m/m, matching gains posted the prior two months, while the y/y rate ticked down to 2.8% from 2.9% in August—which was the highest since June 2009. Over the past three months through September, wages accelerated 3.7% (saar), the best pace since last September. Meanwhile, aggregate weekly hours—the other component—rose 0.1% in September, slowing from August's 0.3%; it was up 2.6% y/y.

Unemployment (*link*): September's unemployment rate sank to its lowest reading since the end of 1969. The headline rate fell to 3.7% from 3.9% the previous two months; it peaked at 10.0% in October 2009. Meanwhile, the participation rate held at 62.7% last month—fluctuating within a narrow band between 62.5% and 63.0% the past three years. The adult unemployment rate dropped to a new cyclical low of 3.3%, while the college-grad rate was back down at its cyclical low of 2.0% posted in May and October. Meanwhile, the volatile teenage rate was unchanged at 12.8% after rising from 12.6% to 13.1% in July, holding near its cyclical low of 12.6% recorded in June. Those working part-time for economic reasons (a.k.a. "involuntary part-time workers") increased for the first time in seven months, by 263,000 to 4.6 million (2.9% of the civilian labor force), after sliding 781,000 the prior six months—likely reflecting the shortage of full-time jobs. The sum of the underemployment and jobless rates (6.6%) was unchanged at its lowest reading since spring 2001, while the U6 rate (7.5)—which includes marginally attached workers—was little changed from August's 7.4%, which was its lowest reading since spring 2001.

Wages (*link*): September wage inflation—as measured by the average hourly earnings (AHE) rate for all workers on private nonfarm payrolls—remained below 3.0%, while the unemployment rate is near a 50-year low. The wage rate was at 2.8% y/y, slowing from August's 2.9%, which was the best rate since June 2009; it was at a recent low of 2.3% in October. The wage rate for service-providing industries (2.9% y/y) remains on a volatile uptrend, while the goods-producing rate (2.1) continues to move sideways. Within goods-producing, the manufacturing rate (1.3) is volatile around recent lows, while the construction rate (3.1) is volatile around recent highs; the natural resources rate (2.8) accelerated to a 27-month high. Within service-providing, rates for retail trade (3.5, the highest since December 2015), wholesale trade (2.2), and utilities (4.2) are on accelerating trends, while rates for financial activities (4.6) and education & health services (2.1) are down from recent highs. Meanwhile, rates for information services (4.7) and professional & business services (2.7) have bounced off recent lows, while rates for transportation & warehousing (1.9) and leisure & hospitality (2.9) remain around recent lows.

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