



MORNING BRIEFING

October 29, 2018

Trump's Regrettables

See the [pdf](#) and the [collection](#) of the individual charts linked below.

(1) Kashkari's plea. (2) What's the rush to raise interest rates? (3) Slower GDP growth ahead in response to recent rate hikes. (4) Regional surveys mostly show inflation topping. (5) Trump probably regrets not reappointing Yellen. (6) Did Powell really say that? (7) New Fed vice chairman is yet another fan of r-star who admits it's unobservable. Says rates still accommodative. (8) What is normal? What is neutral? What is the meaning of life? (9) Yield curve has flattened, so why does FOMC still estimate NAIRU at 4.5%? Why not 3.7%? (10) Fed's Beige Book still has plenty of green. (11) Movie review: "Beautiful Boy" (+).

The Fed I: Let's Pause. The 10/26 *WSJ* included an [op-ed](#) by FRB Minneapolis President Neel Kashkari titled "Pause Interest-Rate Hikes to Help the Labor Force Grow." He observed:

"The Fed has raised the federal-funds rate eight times in the past three years, and inflation now stands right at the 2% goal. A hard inflation ceiling would justify pre-emptive rate increases to ensure inflation doesn't climb any higher. But the symmetric objective gives the Federal Open Market Committee the flexibility to see how the economy evolves before determining if further rate increases are necessary."

His basic message is: What's the rush to raise interest rates? Why not pause the rate hikes and assess how the economy is responding to them so far? I agree. In my opinion, the plunge in stock prices, especially the ones of cyclical companies, suggests that the economy may not be as strong as the Fed perceives and that inflationary risks remain low.

I was on CNBC on Friday. My [message](#) was: "We need the Fed to pause here and just take a breather. Let's see how the economy plays out, and that will help the stock market a lot." I concluded: "Fed officials have been talking like mission accomplished—that it's the best economy that we've ever had. If it's the best economy that we ever had, why raise interest rates? Why not leave it be if it's growing with low inflation?"

A close look at the latest data suggests that the fast pace of economic growth during Q2 and Q3 may also be about to take a pause, which should increase the chances of a pause by the Fed. Consider the following:

(1) *GDP*. Real GDP rose 3.5% (saar) during Q3 following a gain of 4.2% during Q2. The latest quarter was boosted by inventory building, probably in advance of tariffs. The prior quarter was boosted by soybean exports for the same reason. On a y/y basis, real GDP rose 3.0% during Q3. That's at the top end of the range since the start of the current expansion ([Fig. 1](#)). Now might be a good time for the Fed to pause to see if GDP is on a fundamentally faster track.

(2) *Housing*. Private residential investment in real GDP has flattened out over the past six quarters ([Fig. 2](#)). Rising mortgage rates are weighing on both new and existing home sales ([Fig. 3](#)). Let's pause so that would-be home buyers can reassess their house-buying budgets.

(3) *Durable goods orders*. Private nonresidential investment in real GDP rose just 0.8% (saar) during Q3. Industrial equipment rose to a record high, but transportation and other equipment stalled ([Fig. 4](#)). Nondefense capital goods orders excluding aircraft remain in record-high territory, but edged down in September ([Fig. 5](#)). Let's pause to see if higher interest rates, a stronger dollar, and tariffs might be weighing on capital spending.

(4) *Inflation*. The personal consumption expenditures deflator in GDP is exactly where the Fed wants it to be. During Q3, it was up 2.2% y/y ([Fig. 6](#)). The core rate was 2.0%.

Five of the Fed's regional districts conduct monthly surveys of business conditions that include prices-paid and prices-received indexes ([Fig. 7](#)). The latest data through October show that three of them (Kansas City, New York, and Philadelphia) continue to look topky, as they have in recent months. September data for Dallas show the same pattern. Richmond, for some reason, shows big spikes in its two price indexes. Let's pause to see whether inflationary pressures might actually be abating.

So Kashkari and I are singing the same song: "All we are saying is give growth a chance." President Trump and his economic adviser Larry Kudlow are singing it too, as is CNBC's Jim Cramer ... and everybody who is long stocks!

The Fed II: We Miss You, Janet! President Donald Trump must regret that he didn't renew Janet Yellen's contract to head the Fed for another four years. She probably would have been more accommodating to his supply-side policies. They both are populist do-gooders at heart. They want as many people to get jobs as possible.

Instead, Trump appointed Jerome Powell to be the new Fed chairman at the start of this year. Powell had been the vice chairman under Yellen. Trump appointed Richard H. Clarida to fill Powell's vacant position after he was promoted. Both of them are all for continuing to raise interest rates. Both see strong economic growth and a tight labor market as potentially inflationary. So they want to raise interest rates to avert this scenario, by slowing the economy down.

No wonder that the 10/23 [WSJ](#) reported that President Donald Trump directly accused Powell of endangering the US economy by raising interest rates: "I'm just saying this: I'm very unhappy with the Fed because Obama had zero interest rates." He also complained that "[e]very time we do something great, [Powell] raises the interest rates."

Melissa and I are increasingly convinced that this month's stock market rout started on October 3, when Fed Chairman Jerome Powell said in an [interview](#) with Judy Woodruff of PBS: "The really extremely accommodative low interest rates that we needed when the economy was quite weak, we don't need those anymore. They're not appropriate anymore." CNBC also [reported](#) that Powell said: "Interest rates are still accommodative, but we're gradually moving to a place where they will be neutral. We may go past neutral, but we're a long way from neutral at this point, probably."

We couldn't find this widely reported quote in either the video or transcript of the interview! So we sent the Fed a request to confirm Powell had actually said that. Whether he said it or not, the CNBC article cited above was alarmingly headlined as follows: "Powell says we're 'a long way' from neutral on interest rates, indicating more hikes are coming." We will let you know the Fed's response to our request.

The S&P 500 dropped 9.1% from the close on October 2 through Friday's close as Fed officials continued to hammer home Powell's narrative ([Fig. 8](#)).

For example, in his first public [speech](#) as vice chairman last Thursday, Clarida explained why he thinks higher interest rates are in order. Sadly, it's the same old party line that Fed officials have been spouting for a while to explain their gradual normalization of monetary policy. Here it is in brief:

(1) *Star struck and star stuck.* Clarida along with other Fed officials are all star struck. They are stuck on the fanciful notion that actual interest rates should be set relative to "the longer-run neutral real rate," often referred to as "r-star," or "r*." Clarida acknowledges that it is an "unobservable and time varying" variable. However, fear not: It is "computed from the projections submitted by Board members and the Reserve Bank presidents."

It gets even worse: Clarida admits that r^* "must be inferred as a signal extracted from noisy macro and financial data. That said, and notwithstanding the imprecision with which r^* is estimated, it remains to me a relevant consideration as I assess the current stance and best path forward for policy."

He then goes on to quote a reputable authority on matters of economic astronomy (astrology, actually): "The reason for this is because, as Milton Friedman argued in his classic American Economic Association presidential address, a central bank that seeks to consistently keep real interest rates below r^* will eventually face rising inflation and inflation expectations, while a central bank that seeks to keep real interest rates above r^* will eventually face falling inflation and inflation expectations." (Friedman, of course, was the father of monetarism, which has been mostly relegated to the dustbin of economic history.)

By the way, unobservable stars tend to be black holes!

All this suggests that the best measure of whether the federal funds rate is too low or too high relative to the phantom r^* is the actual inflation rate. So by Clarida's own logic, if inflation remains subdued, why should the Fed raise interest rates at all?

(2) *The new abnormal.* That's a good question. The Fed's house view is that monetary policy has been set on a course of "normalization," with the aim of raising the federal funds rate to a more normal and neutral level of 3.00%, after interest rates were near zero from 2009 through 2015. The problem is that no one really knows if that's the right level after so many years of abnormally easy monetary policy. What if the neutral federal funds rate is 2.00% rather than 3.00%? In that case, further rate hikes will be restrictive even though inflation remains subdued. (See our tables on the [FOMC September 2018 Summary of Economic Projections, September 2018-2021 & Beyond](#).)

That's why the stock market plunged in October. Instead of setting the course of normalization on autopilot with 25bps hikes following the March, June, September, and December meetings of the FOMC, why not try a more gradual pace of increases with longer pauses to assess whether the course of normalization needs to be recalibrated?

(3) *Accommodative or not?* Recall that the latest, 9/26 FOMC [statement](#) deleted the following language that had appeared in previous statements: "The stance of monetary policy remains accommodative." This sentence had been in every FOMC statement since December 16, 2015, when the Fed started its latest rate-hiking program. In his press conference that same day, Powell minimized the import of this development, saying that the language simply had outlived its "useful life."

How does that square with Clarida saying that the federal funds rate needs to be raised some more because it is still below r^* ? There certainly is a big inconsistency between the change in the 9/26 statement and Clarida stating, "However, even after our September decision, I believe U.S. monetary

policy remains accommodative.” (By the way, Powell said the same in his 10/3 interview, according to the CNBC report cited above.)

The 9/26 meeting was Clarida’s first one on the FOMC. Maybe he made a rookie mistake. However, the September dot plot shows that the federal funds rate remains well below the median “longer-run federal funds rate” forecast of 3.00%, and is expected to be hiked closer to this consensus guesstimate of the value of r^* .

(4) *Phillips’ disciples*. Now that the unemployment rate is down to 3.7%, the lowest since December 1969, Fed officials seem most concerned that the tight labor market will boost inflation. They’ve mostly admitted that the Phillips curve trade-off between unemployment and inflation has flattened out. Yet they still fear that it will make a big comeback unless they continue to raise interest rates.

They figure that by raising the federal funds rate to a neutral rate of 3.00%, they will keep price inflation around their cherished 2.0%. However, their latest dot plot shows that the FOMC’s median estimate of the longer-run unemployment rate—a.k.a. “NAIRU,” the nonaccelerating inflation rate of unemployment—is 4.5%.

In other words, they are saying that to keep a lid on inflation, they have to raise the federal funds rate—up to a restrictive 3.40%, they currently reckon according to the latest dot plot—until the jobless rate rises back from 3.7% to 4.5%! That would imply a sharp economic slowdown indeed. So they figure that they could then lower the federal funds back down to their cherished 3.00% r -star.

Yet Clarida admits that NAIRU might be lower than 4.5%. So far, it certainly seems to be lower given that a 3.7% jobless rate isn’t boosting inflation much at all ([Fig. 9](#)). In his speech, Clarida said that NAIRU “may be somewhat lower than I would have thought several years ago.” He added: “With unemployment falling and wage gains thus far in line with productivity and expected inflation, the traditional indicators of cost-push price pressure are not flashing red right now.” You think?

(5) *Raising rates to lower them*. Melissa and I believe that Powell is more of a pragmatist than Yellen. His unspoken game plan may simply be to raise the federal funds rate to 3.00% or even 3.50% so that when the next recession occurs, the Fed will have 300-350bps of leeway between the federal funds rate and zero.

(6) *Trump’s regrets*. It’s no wonder that in the 10/23 *WSJ* interview linked above, Trump said: “To me the Fed is the biggest risk, because I think interest rates are being raised too quickly.” As for why he thought Powell was raising rates, Trump said: “He was supposed to be a low-interest-rate guy. It’s turned out that he’s not.” Does Trump regret nominating Powell? It’s “too early to say, but maybe,” the President said.

By the way, the *WSJ* article cited above notes: “The law isn’t clear about whether Mr. Trump could dismiss Mr. Powell even if he wanted to do so. The Federal Reserve Act, as amended in 1935, says Fed governors can be removed by the president ‘for cause.’ The stipulation applies to the board’s governors, who serve 14-year terms, and not to the Fed chairman, who serves a four-year term concurrent with a 14-year term as governor.”

The Fed III: Green Light in Beige Book. Since this tricky month began, we’ve been covering all the reasons for the market’s recent downturn and volatility. To add to that, Melissa and I noticed that the Federal Reserve’s October [Beige Book](#) was released at 2:00 pm on Wednesday, October 24. That was just minutes before the S&P 500 took an especially ugly turn downwards, starting around 2:35 pm.

Perhaps computer trading algorithms were triggered to sell based on a quick artificially intelligent scan of the inflationary pressures noted throughout the Fed's report. Maybe the algos were programmed to do so in expectation of further Fed rate increases. That day, the S&P 500 dropped 1.5%, with the DJIA down 2.4%, or 508 points. By Friday's close, the S&P 500 was down 9.3% from its September 20 record high, just shy of the 10.0% need for an outright correction.

We were less alarmed by the report's contents than were the algos. The picture of the US economy painted by the Fed District contacts surveyed for the report seemed to us to be unchanged from that of the previous, 9/12 [report](#). Economic growth continued to pick up at a modest to robust pace for most industries and regions. Price pressures mounted, but there was no indication of any sharp rise in prices.

The labor market remains tight, with labor shortages continuing to be a problem. Some employers have started to moderately raise wages, but others are exploring alternatives. The outcome of the US trade dispute with China continues to be uncertain, raising concerns about supply chains. The tariffs already implemented are causing some price pressures. Some firms are passing on rising input and labor costs. Some are absorbing them, and have plenty of room in profit margins to do so.

For more details, have a look at our [tables](#) of excerpts from the latest *Beige Book*, organized into the following categories: economic activity, tariffs, employment and wages, and prices. Here are some of the highlights:

(1) *Economic activity*. "Moderate" is the word that best summarizes Fed District commentary in the latest report. Specifically, the report said: "Economic activity expanded across the United States, with the majority of Federal Reserve Districts reporting modest to moderate growth." Eight of the 12 District banks used the words "moderate" or "modest" in summarizing activity in their regions. Of the four that did not, contacts in Dallas were the most upbeat, reporting that economic activity "expanded at a solid pace"; those in Boston reported "continued expansion"; New York and St Louis contacts both saw their economies grow "slightly."

(2) *Employment and wages*. As in the previous report, nationwide labor shortages were "broadly noted and were linked to wage increases and/or constrained growth." Employers continued to report "difficulties finding qualified workers, including highly skilled engineers, finance and sales professionals, construction and manufacturing workers, IT professionals, and truck drivers."

We noticed a bit more evidence of employers raising wages to attract and retain employees than in September's report. But the wage increases mentioned were generally no more than 3.0%-4.0%. Employers are continuing to find ways around increasing wages, such as using technology to keep headcount down. Some firms are offering incremental non-wage benefits to employees and lowering job standards for prospective employees rather than offering higher wages.

(3) *Prices*. Inflationary pressures seemed slightly more pervasive than depicted in September. Price increases were noted across the Fed Districts for input prices, selling prices, and the cost of labor. October's report noted: "Prices continued to rise, growing at a modest to moderate pace in all Districts. Manufacturers reported raising prices of finished goods out of necessity as costs of raw materials such as metals rose, which they attributed to tariffs. Construction contract prices increased to cover rising costs of labor and materials. Retailers and wholesalers in some Districts raised selling prices as they continued to see increased costs in transportation and also worried about impending cost increases resulting from tariffs. Districts reported rising oil and fuel prices."

(4) *Tariffs*. Previously, we reported that the tariff commentary seemed a bit more alarming in the

September book than the July one (see our 9/18 [Morning Briefing](#)). But the latest tone seemed to slide back in the other direction. Contacts continued to express concerns about the tariffs in the October report, especially higher input prices. But they didn't seem quite as worried about tariffs as they did last month.

Firms seem to be adjusting to the tariffs that already have been implemented, passing some of the cost on to customers. For example, Boston firms "expected to pass on (or had already passed on) to consumers at least some of the tariff burdens." In Chicago, "[r]etail contacts across numerous sectors indicated that they expected consumers to see the impact of US tariffs on imports by early 2019."

Concern about the tariff-related uncertainties that lie ahead was expressed by several Fed Districts. Some contacts expect an impending orders dip because some customers have accelerated orders ahead of expected tariff implementation.

Movie. "Beautiful Boy" (+) ([link](#)) is a disturbing film about the terrible consequences of drug addiction, not only for the addict but also for the addict's family. The movie is based on the actual experience of a teenager who had a very bright future that turned very dark very quickly as he experimented with drugs until his addiction to crystal meth almost killed him. In this case, the "beautiful boy" had a very supportive father played very convincingly by Steve Carell. Sadly, many families can't cope with such stress, and the addicted become homeless people, often with mental illnesses. Just as sad is that our communities haven't done enough to help the desperate people who are living under [blue tarps on the streets of Los Angeles](#) and other metropolitan centers.

CALENDARS

US. Mon: Personal Income & Consumption 0.4%/0.4%, Headline & Core PCED 2.0%/1.9% y/y, Dallas Fed General Activity Index 28.0, Evans. **Tues:** Consumer Confidence 136.0, S&P Corelogic Case-Shiller HPI 0.2%/m/m/6.0%/y/y. (Econoday estimates)

Global. Mon: Japan Jobless Rate. **Tues:** Eurozone GDP, Eurozone Business Climate Index, Germany Unemployment Change & Unemployment Claims Rate, Germany CPI, France GDP, Italy GDP, Japan Industrial Production, Mexico GDP. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): The US MSCI index was down 3.9% last week; that follows a flat performance a week ago and a 4.1% drubbing the week before that, which was its worst decline since late March. The index ranked 28th out of the 49 markets in a week when six countries rose in US dollar terms; that compares to the prior week's 16/49 ranking when 13 markets rose. The AC World ex-US index fell 3.7% for the week for its worst decline in eight months; that compares to a 0.3% drop a week earlier and a 3.5% fall the week before that. EM Latin America was the best performer for the week, albeit with a decline of 0.5%, easily outpacing BRIC (-1.8%), EMEA (-2.8), and EMU (-3.6). EAFE (-3.9) was the biggest underperformer last week as EM Asia (-3.7) and EM Eastern Europe (-3.7) matched the AC World ex-US index. Pakistan was the best-performing country as it soared 6.7%, followed by Sri Lanka (4.7), Greece (2.8), Argentina (2.2), and Brazil (2.0). Of the 23 countries that underperformed the AC World ex-US MSCI last week, Colombia fared the worst, falling 7.5%, followed by Belgium (-7.3), Poland (-6.6), Korea (-6.6), and Austria (-6.5). The US MSCI still ranks an astounding 3/49 ytd with its 0.6% decline far ahead of the AC World ex-US (-14.7). Nearly all countries—48/49—and all regions are in negative territory ytd. Falling less on a ytd basis than the AC World ex-US are: EM Latin America (-5.0), EM Eastern Europe (-9.6), EMEA (-13.0), and EAFE (-13.3). EM Asia (-20.2) is the biggest laggard relative to the AC World ex-US's performance, followed by BRIC

(-17.9) and EMU (-15.1). The best country performers ytd: Israel (1.4), Brazil (-0.6), the US (-0.6), Finland (-1.5), and Peru (-1.6). The worst-performing countries ytd: Argentina (-53.7), Turkey (-47.5), South Africa (-32.9), Greece (-32.3), and Pakistan (-27.7).

S&P 1500/500/400/600 Performance ([link](#)): All three of these indexes tumbled last week, but less so than the drop several weeks earlier. SmallCap fell 3.1% for the week, ahead of the declines for LargeCap (-3.9) and MidCap (-4.1). LargeCap ended the week 9.3% below its record high on September 20, ahead of MidCap (-12.4, August 29) and SmallCap (-15.1, August 31). Just one of the 33 sectors moved higher in the latest week, compared to 18 rising a week earlier and none the week before that. The best performers in the latest week: SmallCap Consumer Discretionary (0.6%), SmallCap Real Estate (-0.8), LargeCap Real Estate (-1.0), LargeCap Consumer Staples (-1.4), and SmallCap Consumer Staples (-1.5). MidCap Energy was the biggest decliner last week, falling 10.4%, followed by SmallCap Energy (-10.1), LargeCap Energy (-7.1), and MidCap Communication Services (-6.2). LargeCap is now down 0.6% ytd and trailing SmallCap (-0.4) again, but both are well ahead of MidCap (-5.5). Twelve sectors are now positive to date in 2018, down from 16 a week earlier and compared to just three in early February. The best-performing sectors ytd: SmallCap Health Care (23.1), MidCap Health Care (17.6), SmallCap Communication Services (14.4), LargeCap Tech (8.1), LargeCap Health Care (5.8), and SmallCap Consumer Staples (4.7). The worst performers ytd: LargeCap Materials (-16.1), MidCap Materials (-15.8), SmallCap Energy (-13.7), MidCap Financials (-12.3), MidCap Consumer Discretionary (-12.0), and SmallCap Materials (-12.0).

S&P 500 Sectors and Industries Performance ([link](#)): All 11 sectors fell last week and five outperformed the S&P 500's 3.9% decline. That compares to six rising a week earlier, when the same six outperformed the S&P 500's flat performance. Real Estate was the best-performing sector, albeit with a decline of 1.0%, ahead of Consumer Staples (-1.4%), Utilities (-2.1), Tech (-2.7), and Consumer Discretionary (-3.2). Energy (-7.1) was the biggest underperformer, followed by Industrials (-5.6), Financials (-5.2), Materials (-4.5), Health Care (-4.5), and Communication Services (-4.3). Just four sectors are still in the plus column so far in 2018, unchanged from a week earlier and down from nine in mid-September, which had matched the best ytd count also achieved in early March. These same four sectors are outperforming the S&P 500's 0.6% ytd decline. The ytd leaders: Tech (8.1), Health Care (5.8), Consumer Discretionary (4.6), and Utilities (1.4). The seven ytd underperformers: Materials (-16.1), Communication Services (-11.8), Financials (-9.6), Industrials (-8.9), Energy (-7.7), Consumer Staples (-5.6), and Real Estate (-4.5).

Commodities Performance ([link](#)): Last week, the S&P GSCI index fell 1.4% as 11 of the 24 commodities that we follow move higher. That compares to a 1.2% decline a week earlier when 7/24 commodities rose. Last week's strongest performers: Lean Hogs (12.3%), Cocoa (4.1), Live Cattle (1.4), and Zinc (1.0). Last week's biggest decliners: Unleaded Gasoline (-5.1), Nickel (-4.5), Kansas Wheat (-3.1), Natural Gas (-2.5), and Crude Oil (-2.4). The S&P GSCI commodities index is up 5.8% ytd. Its current level is down 6.9% from its four-year high on October 3, which was just half of its record high in July 2008 before the financial crisis. The top performer so far in 2018 is now Cocoa (19.0), followed by Wheat (18.3), Kansas Wheat (17.1), GasOil (17.0), Brent Crude (16.1), and Crude Oil (11.9). The biggest laggards of 2018 to date: Zinc (-19.6), Lead (-19.6), Lean Hogs (-19.3), Copper (-14.7), and Silver (-14.3).

Assets Sorted by Spread w/ 200-dmas ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 10/24 commodities, 2/9 global stock indexes, and 1/33 US stock indexes, compared to 7/24 commodities, 6/9 global stock indexes, and 17/33 US stock indexes rising a week earlier. Commodities' average spread fell w/w to -1.9% from -1.5%, and 10 commodities trade above their 200-dmas, down from 11 a week earlier. Sugar now leads all commodities and all assets at 14.6% above its 200-dma. Lean Hogs (-13.2%) still trades the lowest of all commodities, but soared

10.0ppts w/w relative to its 200-dma for the best performance among all assets. Unleaded Gasoline (-10.2) fell 4.8ppts w/w for the worst performance among commodities. The global indexes trade at an average of 7.0% below their 200-dmas, down from -5.1% in the prior week. Just one of the nine global indexes trade above their 200-dmas, down from two a week earlier. Brazil (4.3) leads the global indexes, but China (-13.6) rose 1.7ppts w/w for the best performance among global assets. South Korea (-14.6) now trades at the lowest point relative to its 200-dma among global assets, but Japan (-5.5) dropped 5.8ppts for the worst performance among global assets last week. The US stock indexes trade at an average of 5.0% below their 200-dmas, with nine of the 33 sectors above, down from -1.1% a week earlier, when 16 sectors were above. SmallCap Communication Services (5.5) still leads the US stock indexes, but SmallCap Consumer Discretionary (-5.3) rose 0.6ppts last week for the sole gain among US stock indexes. SmallCap Energy (-16.5) now trades the lowest among all US stock indexes and all assets relative to 200-dmas, but MidCap Energy (-5.5) fell 10.9ppts w/w for the worst performance among US stock indexes and all assets last week.

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index fell 3.6% last week and remained solidly below its short-term 50-day moving average (50-dma) trend line. It also dropped well below its long-term 200-dma after being just a hair below it a week earlier. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 131st straight week (after 17 weeks in a Death Cross) as the S&P 500's 50-dma relative to its 200-dma fell for a third straight week. The current Golden Cross reading of 3.3% is at a seven-week low and down from 3.7% a week earlier and a 27-week high of 4.1% in early October. That's 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 fell for a third week following 19 straight weekly gains, which compares to declines during eight of the 10 weeks from mid-March to late May in what was then the worst performance since before the 2016 election. The index tumbled to a 33-month low of 7.0% below its falling 50-dma from 3.6% below its falling 50-dma a week earlier. That surpasses the then-25-month low of 5.6% below its falling 50-dma near the end of March, and is down from a two-year high of 6.2% above its rising 50-dma on January 29. The 200-dma fell for a second straight week and is now falling for the first time since May 2016, when it had been slowly declining for nine months. The S&P 500 had successfully tested its 200-dma in early April, but ended the week at a 32-month low of 3.9% below its falling 200-dma, down from a six-month high of 6.4% above its rising 200-dma during the week ending September 21. Last week's reading crashed through the prior low on April 3 and is well below the seven-year high of 13.5% above its rising 200-dma on January 29.

S&P 500 Sectors Technical Indicators ([link](#)): All 11 S&P 500 sectors deteriorated last week relative to their 50-dmas and 200-dmas. All are also trading below their 50-dmas now again for the first time since the end of March and only the second time since February 2016. These two sectors fell below their 50-dma in the latest week: Consumer Staples and Utilities. In late July, all 11 sectors had traded above their 50-dmas, the most since early December. The longer-term picture—i.e., relative to 200-dmas—shows three sectors trading above currently, the lowest since January 2016 when all 11 were below. That's a relatively swift reversal from September 26 when all 11 sectors were above their 200-dmas. The long-term leaders appear to have left the building. Tech fell below its 200-dma in the latest week for the first time in 121 weeks. That follows Consumer Discretionary's exit a week earlier, when it fell below for the first time in 102 weeks. The three sectors still trading above their 200-dmas: Health Care (22 straight weeks), Utilities (18), and Consumer Staples (2). All 11 sectors had been above both their 50-dmas and 200-dmas briefly in mid-December 2017 (for the first time since July 2016). However, nine sectors are still in a Golden Cross (with 50-dmas higher than 200-dmas), unchanged from a week earlier. Financials has been out for two weeks and in 14 of the past 18 weeks, while Materials has been out for 26 straight weeks. 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). All 11 sectors have a falling 50-dma now, as it turned lower w/w for four sectors: Communication Services, Consumer Staples, Health Care, and

Utilities. That's down from eight sectors with rising 50-dmas in early October and compares to all 11 sectors with falling 50-dmas during early April (the worst count since before the election in November 2016). Just three sectors (Real Estate, Tech, and Utilities) still have rising 200-dmas, down from five a week earlier as Consumer Discretionary and Health Care turned lower in the latest week. That's the lowest count since February 2016.

US ECONOMIC INDICATORS

GDP ([link](#)): Real GDP expanded a healthy 3.5% (saar) last quarter, slowing from Q2's 4.2%—which was the fastest growth since Q3-2014. Driving economic growth last quarter were consumer spending, inventory investment, government spending, and business investment; these increases were partially offset by decreases in exports and residential investment. Real consumer spending (4.0%, saar) accelerated at its fastest pace since the end of 2014, with services consumption (3.2) the fastest since Q4-2014 and goods spending (5.8) the strongest this year. Within goods consumption, nondurable goods growth accelerated for the second quarter from 0.1% during Q1 to 5.2% (saar) last quarter—the best performance since Q1-2013—while durable goods slowed to a still robust 6.9% (saar) from 8.6% during Q2. Real inventory investment rebounded to \$76.3 billion (saar) last quarter, after contracting - \$36.8 billion during Q2, led by wholesale and manufacturing inventories. Growth in real government spending (3.3) was the fastest since Q1-2016—more than double the pace at the start of the year—with both federal (3.3) and state & local (3.2) government spending accelerating. Real capital spending (0.8) barely grew last quarter, slowing steadily from Q1's double-digit pace of 11.5%. Spending on intellectual property products (7.9) remained healthy, though slowed from advances of 10.5% and 14.1% the prior two quarters, while spending on equipment (0.4) was the weakest in two years and structures (-7.9) contracted after two quarters of double-digit growth. The real net exports deficit widened to -\$939 billion (saar)—its biggest gap in the history of the data going back to 1947—as real exports (-3.5) contracted for the first time in seven quarters and real imports (9.1) expanded at its fastest pace this year. Real residential investment (-4.0) contracted for the third time this year.

Contributions to GDP Growth ([link](#)): Real consumer spending once again was the number-one contributor to real GDP growth last quarter, while trade was the major drag after being a major positive contributor during Q2. (1) Real consumer spending accounted for 2.69ppts of real GDP growth, with both services (1.49ppt) and goods (1.20) consumption adding significantly to Q3 growth—the latter by strong contributions from both nondurable (0.72) and durable (0.48) goods. (2) Inventory investment (2.07) was another big contributor to growth last quarter, after subtracting -1.17ppt last quarter, entirely nonfarm (2.09) related. (3) Real government spending added 0.56ppt to growth last quarter, with both state & local (0.35) and federal (0.21) government spending contributing. (4) Nonresidential fixed investment was fairly neutral, accounting for only 0.12ppt of Q3 GDP, with intellectual property products (0.35) driving whatever growth there was last quarter; structures (-0.26) subtracted from growth, while equipment (0.03) barely contributed. (5) Residential investment (-0.16) was a slight negative contributor during Q3; it has contributed positively only once in the past six quarters. (6) Trade (-1.78) was a major drag on economic growth, as both real imports (-1.34) and real exports (-0.45) subtracted from growth.

Durable Goods Orders & Shipments ([link](#)): Both core capital goods orders and shipments stalled for the second month after soaring the prior four months to new cyclical highs—with each just shy of new record highs. Nondefense capital goods orders ex aircraft (a proxy for future business investment) slipped -0.3% during the two months through September after soaring 5.1% during the four months through July. The comparable shipments measure (used in calculating GDP) was flat for the second month, after averaging monthly gains of 0.8% the previous four months. Core capital goods orders expanded 8.2% (saar) during Q3, not far from Q2's 10.6% and considerably above Q1's 1.5%. The comparable shipments measure accelerated 7.4% (saar) last quarter, improving steadily from the prior quarters' gains of 4.2% and 1.9%. Total durable goods orders rose 0.8% in September after a 4.7%

surge during August; orders had dropped -1.7% during the three months through July. Excluding transportation, orders rose for the eighth straight month, by a total of 4.8% to a new cyclical high, though September's 0.1% uptick was the weakest of those months' readings.

New Home Sales ([link](#)): New home sales—tabulated when contracts are signed—fell for the fourth month in September (by a total of -15.3%) to its lowest reading in nearly two years, as housing affordability remains a challenge due to ongoing interest-rate and price increases. Sales slumped -5.5% in September to 553,000 units (saar)—the lowest since December 2016—while August's 3.5% rise was revised down to a -3.0% fall; July and June sales were also revised lower. Regional sales over the four-month period fell in the Northeast, South, Midwest, and West by -42.4%, -18.0%, -7.2%, and -6.7%, respectively. In September, there were 327,000 new homes on the market, the most since January 2009 and up 16.8% y/y; the months' supply jumped to 7.1—the highest since March 2011. Meanwhile, the National Association of Home Builders/Wells Fargo Housing Market Index (HMI) for October ticked up to 68. Of the index's three components, buyer traffic (to 53 from 48) saw the largest gain—crossing the line into positive territory—while current sales conditions (74 from 73) and sales expectations in the next six months (75 from 74) each rose a point. According to NAHB Chairman Randy Noel, “Builders are motivated by solid housing demand, fueled by a growing economy and a generational low for unemployment. Builders are also relieved that lumber prices have declined for three straight months from elevated levels earlier this summer, but they need to manage supply-side costs to keep home prices affordable.”

Pending Home Sales ([link](#)): The Pending Home Sales Index (PHSI)—measuring sales contracts for existing-home purchases—rose for the first time in five months. September's PHSI edged up 0.5% in September, but the level fell short of year-ago levels for the ninth straight month, contracting -1.0% y/y. Lawrence Yun, NAR chief economist, noted that even though we are still seeing year-over-year declines, the latest monthly increase is a good, stabilizing trend. “This shows that buyers are out there on the sidelines, waiting to jump in once more inventory becomes available and the price is right,” he said. Last month, sales were mixed, with contract signings up in the West (4.5%) and Midwest (1.2) and down in the Northeast (-0.4) and South (-1.4). The South had the biggest monthly decline last month, though was the only region with a yearly gain, up 3.3% y/y, while the West had the biggest monthly gain but the steepest y/y decline at -7.4%. Yearly declines in the Northeast and Midwest were more modest, at -2.7% and -1.1%, respectively. Yun continues to point to the lack of inventory of moderately priced homes and affordability as factors restraining the housing market, but when viewed through the lens of the last few decades, the current affordability climate is still favorable. “When compared to the year 2000, when the housing market was considered very healthy and home sales figures were roughly equivalent, the affordability conditions were much lower compared to now. So even though affordability has been falling recently, the demand for housing should remain steady.”

Consumer Sentiment ([link](#)): “The Consumer Sentiment Index has been higher thus far in 2018 (98.5) than in any prior year since 2000, which was the last year of the longest expansion since the mid-1800s,” Richard Curtin, chief economist for The University of Michigan's survey, said in a statement. “Importantly, stock price declines, rising inflation and interest rates, and the negative mid-term election campaigns, have not acted to undermine consumer confidence.” The Consumer Sentiment Index (CSI) ticked down to 98.6 this month from 100.1 last month—which was only the third time in the past 14 years it exceeded 100.0; it's within 2.8 points of January's 14-year high of 101.4. Both the present situation (to 113.1 from 115.2) and expectations (89.3 from 90.5) components slipped a bit this month, though the former remained near its record high of 121.2 in January, while the latter was little changed from its recent high of 90.5 posted this September and last October.

GLOBAL ECONOMIC INDICATORS

Germany Ifo Business Climate Index ([link](#)): Sentiment among German firms weakened further this month as growing global uncertainty increasingly takes its toll on the German economy. Of the four sectors, business climate indexes for the manufacturing, services, and trade sectors all deteriorated this month, while construction's continued to hit new record highs. Overall business confidence fell for the second straight month, from a six-month high of 103.9 in August to 102.8 this month; October's decline was the seventh this year. Both the present situation (to 105.9 from 106.7) and expectations (99.8 from 101.0) measures fell over the two-month period, though remain at elevated levels. Ifo's expectations component correlates closely with German factory orders and production, while the overall index tracks exports more closely. Recent Ifo data suggest modest growth. Meanwhile, Germany's IHS Markit Flash M-PMI sank to a 29-month of 52.3 in October, from 53.7 in September.

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, 570-775-6823

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