MORNING BRIEFING
November 5, 2018

Relief Rally #62?

See the collection of the individual charts linked below.

(1) Center-stage worries. (2) Still bullish but curbing our enthusiasm. (3) Whether Fed is turning from neutral to restrictive remains a worry. (4) Lots of confusion about Trump's China policy should clear up after mid-terms. (5) Santa vs the two Grinches. (6) Goldilocks was a moocher with bad taste. (7) When wage "inflation" isn't really inflation. (8) Productivity may finally be heating up, which is heating up economic growth while cooling price inflation. (9) No pickup in unit labor cost inflation. (10) Lowest short-term unemployment rate on record! (11) Bonds are not having fun. (12) Movie review: "Bohemian Rhapsody" (+ + +).

Strategy: Betting on Santa. Stock investors had lots of background worries come to center stage during October. As a result, the S&P 500 dropped 9.9% from 2930.75 on September 20 to 2641.25 through October 29 (*Fig. 1*). That was just shy of a 10% correction. However, it still counts as Panic Attack #62 as Joe and I have been tracking these events since the start of the bull market. (See our *S&P 500 Panic Attacks Since 2009*.)

The index is up 3.1% since October's low through Friday's close. Is this the beginning of Relief Rally #62, which will take the S&P 500 to new record highs as previous relief rallies have done? We think so. However, we did curb our enthusiasm in last Tuesday's *Morning Briefing* titled "Lowering Our Targets." We reduced our year-end target for the S&P 500 from 3100 to 2900—a rebound to the 9/20 record high. Next year could be a more challenging one for the S&P 500 if revenues growth slows and the profit margin stops rising, as we expect. So we are using 3100 as our target for next year. But our confidence in the staying power of the economic expansion is reflected in our 3500 target for 2020. That would be a 28.5% increase from Friday's close.

With the benefit of hindsight, there were two major triggers of October's selloff:

(1) *The Fed.* On October 3, Fed Chairman Jerome Powell said in an interview: "So interest rates are still accommodative but we're gradually moving to a place where they will be neutral, not that they'll be a restraint on the economy. We may go past neutral but we're a long way from neutral at this point, probably." That meant that while Trump's fiscal policy (i.e., deregulation and tax cuts) was akin to stepping on the economy's accelerator, Powell's monetary policy was moving toward tapping on the brakes more forcefully than had been anticipated by the financial markets. That seemed to trigger the October stock market drop (*Fig. 2*).

(2) *China.* In the Monday 10/1 *Morning Briefing* titled "China's Syndromes," I wrote: "The Trump administration's overarching policy goal vis-à-vis China, therefore, may be first and foremost to use America's economic power to slow, or even halt, the ascent of China into a superpower, which will challenge America's interests around the world. If so, then any concessions that the Chinese make on trade and technology are likely to be rejected by the Trump administration. In other words, they have nothing to offer that would satisfy Trump other than an unconditional retreat from their geopolitical expansion plans, which they will never do voluntarily."

Only three days later (and one day after the Powell interview), in a blistering 10/4 speech, Vice President Mike Pence berated China for using "an arsenal of policies inconsistent with free and fair trade, including tariffs, quotas, currency manipulation, forced technology transfer, intellectual property theft, and industrial subsidies that are handed out like candy to foreign investment." He included an attack on China's hostile policies abroad and human rights abuses at home.

Pence's speech raised the risks of a protracted US trade war with China aimed at forcing manufacturers to move out of China. The potential disruptive impact on supply chains and the possible loss of sales in China were mentioned by some company managements during their Q3 conference calls last month.

(3) *Santa.* These two issues aren't going away anytime soon. After Friday's remarkably strong employment report, Fed officials are likely to continue raising the federal funds rate toward 3.00%—the level they deem to be "neutral" in terms of economic impact—through next year. More of them might talk about possibly moving higher to "restrictive" levels, with the R-word mentioned twice in the September 25-26 FOMC meeting minutes. Stock prices zig-zagged on Friday, moving higher on scuttlebutt (originating from President Trump) that a trade deal with China was in the works, only to fall on denials from unnamed White House sources.

So what might fuel last week's relief rally through year-end? Getting the mid-terms over with might be a plus, removing that source of uncertainty. To quote Randy Forsyth in his *Barron's* column this week: "According to data compiled by Yardeni Research, the S&P 500 has been up in the 12 months following every midterm election since the middle of the last century, with gains from 1.1% in the post-1986 vote stretch (which included the October 19, 1987, crash) to 33.2% in the year after the 1954 election" (*Fig. 3*).

More fundamentally, the most recent batch of economic indicators shows that the near-term economic outlook remains strong. Improving wage gains and record-high employment should result in one of the best holiday seasons on record for retailers.

Furthermore, while corporate earnings have been boosted this year, mostly by the tax cut at the end of last year, corporate revenues growth has also been remarkably strong. The growth rate of S&P 500 revenues per share on a y/y basis was 11.2% during Q2, the highest pace since Q2-2011 (*Fig. 4*). This series is highly correlated with the US M-PMI, which during October remained near the cyclical highs of the past year or so. This explains why S&P 500 forward revenues continued to climb into record-high territory through the 10/25 week, rising 9.9% y/y (*Fig. 5*). That gave forward earnings, which rose 22.5% y/y, an additional lift besides the tax cuts, which accounted for most, if not all, of the remaining 12.6% boost (*Fig. 6*).

This year, let's hope that the Grinches in the White House and the Fed don't trip up Santa and ruin the holidays for investors. We are betting on Santa. If we are right to do so, that would be a big relief.

US Economy: Better than Goldilocks. The latest batch of economic news well exceeded even Goldilocks' exacting standards. She likes her porridge not too hot and not too cold. Of course, most of us like a hot meal followed by a cold dessert.

The labor market is hot, with wages rising at a faster pace. However, productivity gains are hot too, and cooling the inflationary consequences of this development while at the same time boosting GDP growth. Supply-siders should be rightly pleased, even proud, since they can take some credit for this happy combination of hot growth with cool inflationary pressures. Consider the following cornucopia of good news as we approach the holiday season:

(1) *Better than GDP.* The quarterly productivity and labor costs for nonfarm business (NFB) report was released last Thursday. It was a beauty! The growth rates of real NFB output and real GDP are highly correlated on a y/y basis (*Fig. 7*). The former rose 3.7% during Q3, outpacing the 3.0% gain of the latter. The increase in real NFB output was led by a solid 2.4% increase in hours worked and a relatively weak gain of 1.3% in productivity. However, the q/q growth rates in productivity are promising, with solid gains of 3.0% (saar) during Q2 and 2.2% during Q3 (*Fig. 8*).

(2) *Unit labor cost pressures remain moderate.* Also encouraging is that the y/y growth rate of NFB unit labor costs has been moderating over the past four quarters, from 2.5% to 1.5% (*Fig. 9*).

Granted, wage "inflation" has picked up lately. However, wage gains offset by productivity gains are not inflationary. Debbie and I believe that some of the upward pressure on wages resulting from the tight labor market is forcing companies to increase productivity. That's allowing wages to rise faster than prices, resulting in real pay increases, which boost economic growth without heating up inflation. That's better than a Goldilocks scenario.

Here is a quick roundup of the major compensation measures on a y/y basis: Average hourly earnings all workers (3.1% through October), Average Hourly Earnings Production & Nonsupervisory Workers (3.2%, also through October), Employment Cost Index (ECI) (2.9% through Q3), and NFB hourly compensation including benefits (2.8% though Q3). The first data series doesn't start until 2006, and the last one tends to be too noisy, so we focus on the second and third measures (*Fig. 10*).

Both are showing signs that the Phillips curve is finally starting to work. So the labor market has finally tightened enough to boost wage inflation, which should then boost price inflation.

Hold on: We beg to differ with this conventional wisdom. A good measure of unit labor costs is the ratio of private-sector ECI (including wages, salaries, and benefits) to NFB productivity. The y/y growth rate of this series was just 1.6% during Q3 (*Fig. 11*). It's actually been hovering around this rate since 2011, and even since the mid-1990s excluding the volatile moves around the Great Recession.

In other words, this measure of unit labor costs is showing that productivity gains have been and continue to offset (and to justify) a significant portion of compensation gains. That certainly helps to explain why the core PCED inflation rate has stayed within a low range between 0.9% and 2.5% since 1995!

The result has been that average hourly earnings divided by the headline PCED rose to a record high during September. This series has been on an upward trend since the start of 1995—rising 30% over this period (*Fig. 12*). The widespread notion that real wages have been stagnating for the past couple of decades is just dead wrong!

(3) *No shortage of workers.* Another widespread and erroneous notion is that we are running out of workers because the unemployment rate is so low. The labor force jumped 711,000 during October, and 2.04 million ytd. It may be harder to fill jobs right away, yet 250,000 positions were filled on balance during October and 2.13 million ytd. That's based on the payroll employment survey. The household survey showed a gain of 600,000 during October, and 2.54 million ytd.

By the way, payroll employment in the trucking industry rose during October to a record high with a m/m gain of 2,400 and a y/y gain of 36,600. So even the industry that purportedly has the worst trouble finding labor is finding truck drivers after all.

(4) *Full employment at record high.* Full-time employment rose to yet another record high during October. Not widely reported is that the 3.7% unemployment rate can be disaggregated into the short-term rate at 2.9% and the long-term rate at 0.8% (*Fig. 13*). The former reflects unemployment for less than 27 weeks. It is the lowest since the early 1950s!

Credit: Bad News for Bonds. Bond yields rose sharply after Friday's employment report. When the stock market dropped during October, the 10-year Treasury bond yield dipped from a high of 3.23% on October 5 to a low of 3.08% on October 29 (*Fig. 14*). It was back up to 3.22% on Friday on expectations that the Fed remains on course for another rate hike at the December 18-19 FOMC meeting, with three to four additional hikes next year.

Interestingly, the recent backup in the 10-year yield was led by the TIPS yield, while the expected inflation component declined (*Fig. 15*). We aren't sure how to read that odd combination. But it is unsettling to see that the bond yield can go up as a result of its TIPS component reacting badly to good news on the economy even as actual and expected inflation rates remain subdued.

While we still believe that the US bond yield is being held down to a certain extent by near-zero yields for comparable bonds in Germany and Japan, more chattering by Fed officials suggesting that the FOMC needs to consider going beyond neutral to restrictive monetary policy could push the bond yield as high as 4.00%. In this scenario, the TIPS yield would normalize to 2.00%, which is where it was during the four years prior to the 2007-2008 financial crisis, and the expected inflation component would remain around 2.00%.

The question is: Will Fed officials chill out about strong growth if price inflation remains subdued? We don't have a good answer, but we still expect that the 10-year yield should remain in a range of 3.00%-3.50% through the middle of next year. That's mostly because we believe that price inflation will remain subdued as productivity gains offset wage gains.

Movie. "Bohemian Rhapsody" (+ + +) (*link*) is an extremely interesting and entertaining biopic about the rock band Queen and its lead singer Freddie Mercury, brilliantly played by Rami Malek. Freddie was a musical genius, and Queen is renowned for such great classic rock hits of the 1970s and 1980s as "We Will Rock You," "Another One Bites the Dust," and "We Are the Champions." The movie has been criticized for not doing full justice to Freddie's amazing story and legacy because the musical rights were owned by two of the surviving band members, who made sure they were properly depicted. Freddie tragically died of AIDS at the age of only 45. He certainly lives on in the incredible music he helped to create.

CALENDARS

US. Mon: ISM & IHS Markit NM-PMIs 59.4/54.7, Williams. **Tues:** Job Openings 7.1m, Midterm Elections. (Econoday estimates)

Global. Mon: UK C-PMI & NM-PMI, China C-PMI & NM-PMI, Japan Household Spending, Kuroda. **Tues:** Eurozone C-PMIs & NM-PMIs, Germany Factory Orders, Japan C-PMI & NM-PMI, RBA Cash Target Rate 1.50%. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index rose 2.5% last week, ranking 35th out of the 49 markets in a week when 44 countries rose in US dollar terms. That compares to the prior week's 28/49 ranking when the US MSCI fell 3.9% and six markets rose. The AC World ex-US index rose 3.9% for the week; that compares to a 3.7% drop a week earlier, which was its worst in eight months. EM Asia was the best performer for the week with a gain of 6.9%, ahead of BRIC (6.8%) and EM Eastern Europe (4.1) as all regions rose w/w. EM Latin America (1.4) rose the least, followed by EMU (3.2), EAFE (3.3), and EMEA (3.7). Argentina was the best-performing country as it soared 12.8%, followed by South Africa (10.1), Turkey (8.3), and China (8.1). Of the 25 countries that underperformed the AC World ex-US MSCI last week, Greece fared the worst, falling 4.5%, followed by Mexico (-2.9), and Morocco (-1.4). In October, the US MSCI tumbled 7.0% for its worst decline since September 2011, ranking 19/44 and ahead of the 8.2% decline for the AC World ex-US index in a month when nearly all regions fell. That compares to the US MSCI's 0.3% rise in September, when it also ranked 19/44 and was just ahead of the 0.2% gain for the AC World ex-US in a month when regional performances were mixed. The best-performing regions in October: EM Latin America (3.4), EMEA (-3.9), EM Eastern Europe (-6.3), BRIC (-6.6), and EAFE (-8.0). October's worst-performing regions: EM Asia (-11.0) and EMU (-8.8). The US MSCI still ranks an astounding 4/49 ytd with its 1.9% gain far ahead of the AC World ex-US (-11.4). Nearly all countries—44/49—and all regions are in negative territory ytd. Falling less on a ytd basis than the AC World ex-US are: EM Latin America (-3.7), EM Eastern Europe (-5.9), EMEA (-9.8), and EAFE (-10.4). EM Asia (-14.7) is the biggest laggard relative to the AC World ex-US's performance, followed by EMU (-12.4) and BRIC (-12.3). The best country performers ytd: Israel (7.2), Peru (4.4), Brazil (2.4), the US (1.9), and Finland (1.0). The worst-performing countries ytd: Argentina (-47.8), Turkey (-43.1), Greece (-35.3), South Africa (-26.1), and Pakistan (-24.3).

S&P 1500/500/400/600 Performance (*link*): All three of these indexes rose last week for the first time in seven weeks. SmallCap surged 4.4% for the week, ahead of the gains for MidCap (3.7%) and LargeCap (2.4). SmallCap remains in a correction at 11.4% below its August 29 record high, and MidCap exited its correction but remains 9.2% below its August 29 record. LargeCap barely avoided slipping into a correction during the recent selloff and ended the week 7.1% below its record high on September 20. Twenty-nine of the 33 sectors moved higher in the latest week, compared to just one rising a week earlier. The best performers in the latest week: MidCap Communications (7.5), SmallCap Materials (6.6), SmallCap Tech (6.2), and MidCap Materials (6.2). MidCap Utilities was the biggest decliner last week, falling 1.0%, followed by MidCap Energy (-0.6), LargeCap Utilities (-0.6), and SmallCap Energy (-0.4). All three of these market-cap indexes moved lower in October compared to just LargeCap rising in September. SmallCap tumbled 10.5% in October for its worst decline since February 2009, and underperformed both MidCap (-9.6, worst since September 2011) and LargeCap (-6.9, worst since September 2011). Just two of the 33 sectors advanced in October, down from 13 rising in September and the lowest count since one rose in February. October's best performers: LargeCap Consumer Staples (2.1), LargeCap Utilities (1.9), MidCap Consumer Staples (-0.1), and LargeCap Real Estate (-1.7). October's biggest laggards: SmallCap Energy (-18.8), MidCap Energy (-16.7), SmallCap Materials (-14.7), SmallCap Industrials (-13.3), and MidCap Industrials (-13.2). LargeCap is now up 1.8% ytd and trailing SmallCap (4.0) again, but both are ahead of MidCap (-2.0). Seventeen sectors are now positive to date in 2018, up from 12 a week earlier and compared to just three in early February. The best-performing sectors ytd: SmallCap Health Care (30.6), MidCap Health Care (20.6), SmallCap Communication Services (17.3), LargeCap Tech (9.1), LargeCap Consumer Discretionary (8.7), and LargeCap Health Care (8.0). The worst performers ytd: SmallCap Energy (-14.0), LargeCap Materials (-10.9), MidCap Materials (-10.6), LargeCap Communication Services (-9.8), and SmallCap Real Estate (-9.6).

S&P 500 Sectors and Industries Performance (*link*): Ten of the 11 sectors rose last week and four outperformed the S&P 500's 2.4% gain. That compares to all 11 falling a week earlier, when five outperformed the S&P 500's 3.9% decline. Materials was the best-performing sector with a gain of 6.1%, ahead of Financials (4.4), Consumer Discretionary (4.0), and Industrials (2.6). Utilities (-0.6) was the sole decliner, followed by the also-underperforming Tech (1.0), Real Estate (1.4), Energy (1.7), Health Care (2.1), Communication Services (2.3), and Consumer Staples (2.4). The S&P 500 tumbled 6.9% in October as 2/11 sectors moved higher and six beat the index. That compares to 6/11 rising and six beating the S&P 500's 0.4% gain in September. The leading sectors in October: Consumer Staples (2.1), Utilities (1.9), Real Estate (-1.7), Financials (-4.9), Communication Services (-6.0), and Health Care (-6.8). The biggest laggards in October: Energy (-11.3), Consumer Discretionary (-11.3), Industrials (-10.9), Materials (-9.5), and Tech (-8.0). 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 three sectors are outperforming the S&P 500's 1.8% ytd gain: Tech (9.1), Consumer Discretionary (8.7), and Health Care (8.0). The eight ytd underperformers: Materials (-10.9), Communication Services (-9.8), Industrials (-6.6), Energy (-6.1), Financials (-5.6), Consumer Staples (-3.3), Real Estate (-3.2), and Utilities (0.8).

Commodities Performance (*link*): Last week, the S&P GSCI index tumbled 3.7% for its worst decline since early February as 13 of the 24 commodities that we follow move higher. That compares to a 1.4% decline a week earlier when 11/24 commodities rose. Last week's strongest performers: Soybeans (3.5%), Copper (1.9), Natural gas (1.8), and Corn (1.0). Energy-related commodities dominated last week's biggest decliners: Crude Oil (-6.6), Brent Crude (-6.2), Unleaded Gasoline (-5.7), and Heating Oil (-5.7). October saw nine of the 24 commodities climb as the S&P GSCI Commodities index tumbled 6.2%, compared to 15 rising in September when the index rose 3.8%. October's best performers were led by Sugar (17.8), Coffee (10.0), Cocoa (8.6), and Natural Gas (8.4). October's laggards: Unleaded Gasoline (-16.0), Crude Oil (-10.8), Brent Crude (-9.3), and Nickel (-8.7). The S&P GSCI commodities index is up 1.8% ytd, but is in a correction now with its current level down 10.3% 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 Cocoa (19.8), followed by Wheat (19.1), Kansas Wheat (18.0), Natural Gas (11.2), and GasOil (11.0). The biggest laggards of 2018 to date: Zinc (-22.8), Lead (-20.0), Lean Hogs (-19.0), Silver (-13.9), and Copper (-13.0).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 11/24 commodities, 7/9 global stock indexes, and 24/33 US stock indexes, compared to 10/24 commodities, 2/9 global stock indexes, and 1/33 US stock indexes rising a week earlier. Commodities' average spread fell w/w to -3.4% from -2.4%, and eight commodities trade above their 200-dmas, down from 10 a week earlier. Natural Gas now leads all commodities and all assets at 12.7% above its 200-dma, but Wheat (0.7%) rose 3.7ppts w/w relative to its 200-dma for the best performance among commodities. Unleaded Gasoline (-14.9) trades the lowest relative to its 200-dma among commodities, but Sugar (9.2) fell 6.5ppts w/w for the worst performance among commodities and all assets. The global indexes trade at an average of 5.1% below their 200-dmas, up from -6.6% in the prior week. Just one of the nine global indexes trades above their 200-dmas, unchanged from a week earlier. Brazil (9.5) leads the global indexes as it rose 5.2ppts w/w for the best performance among global assets. South Korea (-14.3) trades at the lowest point relative to its 200-dma among global assets, dropping 1.2ppts last week for the worst performance among global assets. The US stock indexes trade at an average of 1.9% below their 200-dmas, with 13 of the 33 sectors above, up from -3.6% a week earlier, when nine sectors were above. SmallCap Communication Services (9.5) still leads the US stock indexes, but LargeCap Materials (-7.5) rose 5.5ppts last week for the best gain among US stock indexes and all assets. SmallCap Energy (-15.9) now trades the lowest among all US stock indexes and all assets relative to 200-dmas, but LargeCap Utilities (4.0) and MidCap Utilities (3.0) each dropped 2.0ppts w/w for the worst performance among US stock indexes last week.

S&P 500 Technical Indicators (*link*): The S&P 500 price index rose 2.4% last week, but remained solidly below its short-term 50-day moving average (50-dma) and long-term 200-dma. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 132nd 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 fourth straight week. The current Golden Cross reading of 2.9% is at an 11-week low and down from 3.2% 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 improved to 4.2% below its falling 50-dma from a 33-month low of 7.0% below its falling 50-dma a week earlier. That 33-month low had surpassed 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 third 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 1.4% below its falling 200-dma, up from a 32-month low of 3.9% below its falling 200-dma a week earlier and down from a six-month high of 6.4% above its rising 200-dma during the week ending September 21. Last week's reading remains well below the seven-year high of 13.5% above its rising 200-dma on January 29.

S&P 500 Sectors Technical Indicators (*link*): Ten of the 11 S&P 500 sectors improved last week relative to their 50-dmas and 200-dmas. Ten are also trading below their 50-dmas, compared to all 11 below a week earlier for the first time since the end of March and only the second time since February 2016. Consumer Staples moved above its 50-dma in the latest week and is the only sector in that club. 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 four sectors trading above currently, up from three a week earlier in the lowest count since all 11 were below in January 2016. That's a relatively swift reversal from the September 26 alignment, when all 11 sectors were above their 200-dmas. The long-term leaders left the building in recent weeks. Tech fell below its 200-dma several weeks ago for the first time in 121 weeks. That follows Consumer Discretionary's exit in mid-October, when it fell below for the first time in 102 weeks. Real Estate moved above its 200-dma in the latest week and joined these three sectors: Health Care (23 straight weeks), Utilities (19), and Consumer Staples (3). 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 are in a Golden Cross (with 50-dmas higher than 200-dmas), unchanged from a week earlier. Financials has been out for three weeks and in 15 of the past 19 weeks, while Materials has been out for 27 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). Ten sectors have a falling 50-dma now, up from all 111 below a week earlier, as Consumer Staples turned higher w/w. 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 two sectors (Tech and Utilities) still have rising 200-dmas, down from three a week earlier, as Real Estate turned lower in the latest week. That's the lowest count since January 2016 when all 11 sectors had falling 200-dmas.

US ECONOMIC INDICATORS

Employment (*link*): Employment growth in October was much stronger than expected after September's hurricane-related slowdown. Last month, 250,000 were added to payrolls (vs a 190,000 consensus estimate), while September's (to 118,000 from 134,000) gain was 16,000 lower and August's (286,000 from 270,000) 16,000 higher than initially reported, for no change on a two-month basis. Private payrolls added 246,000 jobs last month—19,000 above ADP's count of 227,000—following no change to September's (121,000) advance and an upward revision to August's (267,000 from 254,000), for a net gain of 13,000. Every sector added jobs last month. Here's a tally of the industries leading October's gain, along with their year-over-year performances: Leisure & hospitality (42,000 m/m & 254,000 y/y), health care (35,600 & 322,500), professional & business services (35,000 & 516,000), manufacturing (32,000 & 296,000), construction (30,000 & 330,000), and transportation & warehousing (24,800 & 183,700). Meanwhile, the breadth of job creation (i.e., the percentage of private industries increasing payrolls) remained impressive last month, with percentages in both the one-month (to 65.7% from 60.7%) and three-month (69.2 from 65.1) spans moving higher. The household survey showed employment rose 600,000 last month after a 420,000 gain in September—this measure tends to be more volatile month-to-month than the payroll measure. Over the past 12 months, the measures for payroll and household employment climbed 2.516 million and 2.716 million y/y, respectively.

Earned Income Proxy (*link*): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, continued to climb to new record highs in October, not posting a decline in 20 months. Our EIP rose 0.7% in October—double the average monthly gain posted the prior six months—and 5.5% y/y. Average hourly earnings (AHE), one of the components of our EIP, rose 0.2% m/m, slightly below the 0.3% six-month average, though the y/y rate accelerated 3.1% y/y—the first reading above 3.0% and the highest since April 2009. Over the past three months through October, wages accelerated 3.4% (saar), holding around September's recent high of 3.9%. Meanwhile, aggregate weekly hours—the other component of our EIP—rose 0.6% in October, matching its best pace this year; it was up 2.4% y/y.

Unemployment (*link*): October's unemployment rate remained at its lowest reading since the end of 1969. The headline rate was unchanged at September's 3.7%, down from 3.9% the previous two months; it peaked at 10.0% in October 2009. Meanwhile, the participation rate edged up from 62.7% to 62.9%—fluctuating within a narrow band between 62.5% and 63.0% the past three years. The volatile teenage rate sank to 11.9%—the lowest since December 1969—while the adult unemployment rate ticked up to 3.4% last month, after dropping to a new cyclical low of 3.3% in September; the college-grad rate remained at its cyclical low of 2.0% posted in September, May, and last October. Those working part-time for economic reasons (a.k.a. "involuntary part-time workers") decreased for the seventh time in eight months, by 539,000 to 4.6 million (2.8% of the civilian labor force). The sum of the underemployment and jobless rates (6.5%) was the lowest reading since February 2001, while the U6 rate (7.4)—which includes marginally attached workers—was back down at August's rate, which was its lowest reading since spring 2001.

Wages (*link*): October wage inflation—as measured by the average hourly earnings (AHE) rate for all workers on private nonfarm payrolls—moved above 3.0% for the first time in nearly a decade, while the unemployment rate held near a 50-year low. The wage rate accelerated 3.1% y/y, its best pace since April 2009; it was at a recent low of 2.3% a year ago. The wage rate for service-providing industries (3.3% y/y) remains on a volatile uptrend, posting its best reading since January 2009, while the goods-producing rate (2.5) continues to move sideways. Within goods-producing, the manufacturing rate (1.5) is volatile around recent lows, while the construction rate (3.9) was the highest since June 2009; the natural resources rate (2.2) remains on a modest uptrend. Within service-providing, rates for information services (5.2), retail trade (3.9), and wholesale trade (2.8) were the highest since June 2017, December 2015, and February 2017, respectively. The rate for professional & business services (3.1) was above 3.0% for only the second time since March 2017, while education & health series (2.7) remained in a volatile flat trend near the top of its range. Rates for both financial activities (4.1) and utilities (3.5) have slowed from recent highs, while rates for leisure & hospitality (3.4) and transportation & warehousing (2.0) remain around recent lows, though the former may have found a bottom.

Productivity & Labor Costs (*link*): Nonfarm productivity growth slowed last quarter, though was among the strongest of the past three years, while unit labor costs accelerated but remained subdued. Productivity advanced 2.2% (saar) last quarter, after an upwardly revised 3.0% (from 2.9%) advance during Q2—which was the fastest pace since Q1-2015. During Q3, output (4.1%, saar) rose at more than double the pace of hours worked (1.8), as was the case during Q2—with output up 5.0%, and hours worked 2.0% higher. Meanwhile, unit labor costs accelerated 1.2% (saar) during Q3, after falling -1.0% during Q2, as hourly comp (3.5) exceeded productivity gains last quarter. Productivity expanded 1.3% y/y for the second quarter during Q3, on track to match 2015's five-year high; growth fell to zero during 2016. Output rose 3.7% y/y during Q3—the best yearly growth since Q2-2015, while hours worked was up 2.4% y/y—fluctuating between 2.0% and 2.5% the past four quarters. Meanwhile, unit labor costs rose 1.5% y/y, slowing steadily from the 2.5% pace posted a year ago, as hourly comp slowed from 3.9% to 2.8% y/y over the period.

GLOBAL ECONOMIC INDICATORS

Global Manufacturing PMIs (*link*): Global manufacturing activity expanded at its slowest pace in nearly two years in October. JP Morgan's M-PMI fell for the ninth time this year in October, from a seven-year high of 54.5 at the end of last year to 52.1 last month. Developed nations (to 53.2 from 53.6) continued to record stronger growth than emerging ones (50.5 from 50.3), though both have slowed since late last year—to the weakest readings since November 2016 for the former, while the latter barely budged from September's 25-month low. Among the larger industrial nations, M-PMIs show that growth in the US (to 55.7 from 55.6) accelerated slightly, to a five-month high, while Japan's (52.9 from 52.5) reached a four-month high—both saw above global-average growth. The Eurozone (52.0 from 53.2) as a whole expanded at the slowest pace since August 2016. While growth in the Netherlands (57.1, 21-month low), Ireland (54.9, 7-month low), Austria (53.8, 25-month low), Greece (53.1, 6-month low), and Germany (52.2, 29-month low) all eased, they exceeded the Eurozone's overall reading of 52.0. M-PMIs for Spain (51.8, 2-month high) and France (51.2, 25-month low) recorded growth below the overall Eurozone's, while Italy's (49.2, 46-month low) contracted for the first time in 26 months. Meanwhile, the UK's manufacturing (51.1 from 53.6) sector expanded at its slowest pace since July 2016. Among the larger emerging nations, only India (53.1 from 52.2) registered a M-PMI reading above the world average—posting its best reading in four months—while Brazil's (51.1 from 50.9) was the highest in two months. China's M-PMI (50.1 from 50.0) remained close to the stagnation point, while Russia's (51.3 from 50.0) expanded for the first time since April.

US Manufacturing PMIs (*link*): Manufacturing activity in October held near 14-year highs, according to the ISM measure, while IHS Markit's gauge accelerated to a five-month high. The ISM M-PMI edged down for the second month, to 57.7 last month, after rising four of the prior five months from 57.3 to 61.3—which was the best pace since May 2004. Both the new orders (to 57.4 from 61.8) and production (59.9 from 63.9) indexes eased below 60.0, though remained at a very robust pace. Meanwhile, the new export orders sub-index (52.2 from 56.0) showed export growth slowed to a 23-month low after reaching a seven-year high of 62.8 in February. The employment (56.8 from 58.8) measure eased slightly from September's seven-month high after accelerating the previous three months, while the supplier deliveries (63.8 from 61.1) gauge was above 60.0 for the ninth straight month, peaking at a 14-year high of 68.2 in June; inventories (50.7 from 53.3) continued to accumulate, though at a slower pace. The price index climbed to 71.6 last month after easing the prior four months from a seven-year high of 79.5 in May to a 10-month low of 66.9 in September. IHS Markit's M-PMI rose for the second month in October, to 55.7, after falling the previous four months from 56.5 in April to its low for this year of 54.7 in August. According to the survey, "The headline PMI was driven by a stronger expansion in new business received by goods producers in October. The upturn in new orders accelerated to a five-month high and was widely attributed to greater client demand across the domestic market. Conversely, new export orders grew only fractionally and at the weakest pace in the current three-month sequence of growth. Production levels expanded strongly."

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