



MORNING BRIEFING

April 8, 2019

Topical Topics

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

(1) Reviving our *Topical Studies*. (2) More thoughts on the yield curve. (3) Yield-Curve Rules for the Fed's money-meisters. (4) The Fed pauses just as suggested by Rule #2. (5) More upside for stocks if Fed pause averts a (meaningful) yield-curve inversion. (6) Labor market is golden for Goldilocks. (7) Running out of workers? Not yet. (8) Wages still rising ahead of price inflation. (9) Rooting for a rebound in productivity. (10) Movie review: "The Highwaymen" (+).

Yield Curve I: YRI's Rules for Monetary Policymakers. From 1984-2010, I wrote 82 *Topical Studies* that explored various topics relevant to investors. An [archive](#) of them is available on our website. They were very popular, and I've often run into accounts who remember them fondly and ask why I stopped doing them. The answer is that I, along with my colleagues, have been putting lots of energy into our daily *Morning Briefings*, many of which are devoted to in-depth analyses of relevant topics.

Nevertheless, by popular demand, we are reviving our *Topical Studies*. We will be posting these occasional studies on the new [web page](#) devoted to them. Think of them as comprehensive analyses of our latest thinking on the key issues. [Topical Study #83](#), titled "The Flattening Yield Curve: It Might Be Different This Time," has been posted. Let us know what you think. (By the way, on the web page, there is also a link to the automatically updated charts for each study.)

Our latest thought piece led us to some additional thoughts about the yield curve. Here is the introduction to it:

"The yield curve is predicting, first and foremost, the outlook for Fed policy rather than for the next recession. Our research has confirmed this conclusion, as does a recent Fed study. While inverted yield curves don't cause recessions, they may provide a useful market signal that monetary policy is too tight and risks triggering a financial crisis, which can quickly turn into a credit crunch causing a recession. If so, then the Fed's recent decision to be patient and pause its rate-hiking may reduce the chances of a recession."

That insight and additional ones along the way in our latest study led us to the following three YRI Yield-Curve Rules for Monetary Policymakers:

"The shape of the yield curve may provide useful market signals for Fed officials to consider when they are deciding on the course of monetary policy:

"(1) A widening yield-curve spread suggests that the Fed can tighten monetary policy if necessary without risking a recession.

"(2) A flattening yield curve suggests that the pace of rate-hiking should be slowed, while a flat yield curve might be a good signal for the Fed to pause tightening for a while.

“(3) *An inverted yield curve* indicates that monetary conditions are too tight and that easing might be in order.

“For now, we still don’t see a significant risk of a recession on the horizon, especially since the FOMC recently switched from a gradual pace of rate hikes to a patient approach. The committee’s decision in March to pause hiking the federal funds rate, possibly over the rest of this year, reduces the risks of a credit crunch and a recession. That’s the current message from the yield curve.”

Yield Curve II: Fed Playing By Our Rules Now. Needless to say, our studies won’t be our last words on the topics at hand. In this spirit, let’s consider recent yield-curve action and its implications for the bull market in stocks:

(1) *Good rule for running current monetary policy.* It took some serious shouting by the financial markets late last year, but the Fed certainly got the yield curve’s message so far this year. As we observed in our latest *Topical Study*: “According to a July 2018 Fed note, the probability of a recession at that time was around 14% based on a yield-curve model. However, a February 2019 update study reported that the odds had risen to 50%. That recession warning might have contributed to the Fed’s remarkable pivot from a hawkish to a dovish stance on monetary policy since the start of this year.”

This pivot may have occurred just in the nick of time, and just as suggested by Rule #2 for monetary policy listed above, namely, a flat yield curve might be a good signal for the Fed to pause tightening for a while. The spread between the 10-year Treasury bond yield and the federal funds rate fell to just 2bps on March 28. It edged up to 13bps on Friday ([Fig. 1](#)).

The Fed’s pivot has reduced the odds of a recession, as confirmed by the yield on US high-yield corporate bonds from a recent peak of 8.05% on December 26 to 6.28% on Friday ([Fig. 2](#)).

(2) *Bond yield bounces off a flat yield curve.* It’s easy to track the monetary policy cycle with a chart identifying periods of rate-hiking with red shades and periods of rate-cutting with blue shades ([Fig. 3](#)). Since 1960, there have been 11 periods of distinct easing and 11 periods of tightening, with the latest one possibly ending December 19, 2018.

The yield curve inverted during the tail ends of eight of the tightening cycles ([Fig. 4](#)). Not surprisingly, the bond yield typically rises (falls) during periods of tightening (easing) ([Fig. 5](#)). But it rises less rapidly than the federal funds rate during the tail ends of tightening periods, which is why the yield curve inverts.

If the latest period of monetary tightening ended with the rate hike at the December 19, 2018 meeting of the FOMC, the bond yield anticipated that might be the case as it dropped from a recent peak of 3.24% on November 8, 2018 to 2.50% on Friday. It’s not unusual for the bond yield to anticipate the end of periods of monetary tightening. What is different this time is that the Fed halted its tightening before it triggered a financial crisis ([Fig. 6](#)). In the past, the peaks in the federal funds rate tended to coincide with calamities in the credit markets.

Interestingly, the bond yield rebounded from 2.39% on March 29 just as the yield curve completely flattened. If it’s none-and-done for the Fed in the foreseeable future, then the yield curve may remain relatively flat without inverting.

(3) *No inversion, no bear market for stocks.* The S&P 500 typically peaks near the end of monetary tightening cycles and just before the start of recessions ([Fig. 7](#)). The peaks in the S&P 500 tend to

coincide with the initial inversion in the yield curve, which hasn't really happened so far ([Fig. 8](#)). We expect that the S&P 500 will be setting new record highs over the rest of this year.

US Labor Market: Still Birthing Jobs. All told, March was a real Goldilocks month in the US labor market, as Debbie and I see it. Just enough jobs were created and just enough wage growth was sustained to support solid economic growth, but not so much as to cause the Federal Reserve to alter its patient policy stance. March's data also eased concerns about a shortage of labor potentially weighing on growth. More prime-aged workers on the sidelines rejoined the workforce. We think that these trends should continue to support the stock market. Consider the following:

(1) *Payroll employment climbed* by 196,000 jobs during March, and February's tepid gain was revised up a bit to 33,000 ([Fig. 9](#)). March's number confirms that the February figure was an anomaly, most likely due to bad weather and the government shutdown, as had been widely surmised. The unemployment rate remained at 3.8% during March, a touch above the 49-year low of 3.7% reached last fall. Over the past three months, jobs gains averaged 180,300 per month, somewhat weaker than last year's average of 223,250.

(2) *Lots more service jobs added.* In March, jobs growth was largest in the private-sector service-producing industries, which added 170,000 jobs, while the private-sector goods-producing industries added 12,000 jobs and the government sector added 14,000 jobs ([Fig. 10](#)). Getting a bit more granular, Debbie reports that employment continued to trend higher in the health care (49,000 m/m and 398,000 y/y), professional & tech services (34,000 and 311,000), and food services & drinking (27,000 and 309,000) industries. Meanwhile, manufacturers cut payrolls for the first time since July 2017.

(3) *Wage inflation is not price inflation.* While the inverse relationship between wage gains and unemployment appears to be making a comeback (finally), we aren't too concerned that this development is setting the stage for higher price inflation. Wage gains rose just above 3.0% y/y during October and remained there through March, continuing to outpace price inflation. Interestingly, the industries that experienced the highest wage gains—i.e., service-producing ones—generally tend not to be the most likely to pass costs on directly to customers via prices.

During March, average hourly earnings (AHE) for all workers in service-producing industries rose 3.4% y/y, while earnings for those in goods-producing industries increased 2.5% ([Fig. 11](#)).

(4) *Participation keeping up.* The prime-aged labor force participation rate (i.e., those in the labor force aged 25-54 as a percentage of the general population at that prime working age) has nearly returned to its pre-crisis rate ([Fig. 12](#)). That means that most of those would-be workers who had been discouraged about finding jobs and opted out of the labor force following the recession came back into the labor force and are now mostly gainfully employed.

Looking ahead, labor force participation may not have much more upside, since fewer available workers are on the sidelines and Baby Boomers continue to retire. On the bright side, employers' difficulty finding workers should lead them to boost their companies' productivity, which could keep a lid on price inflation.

Movie. "The Highwaymen" (+) ([link](#)) is a Netflix production based on the story of a pair of Texas Rangers who came out of retirement to hunt down the notorious Bonnie and Clyde and riddled the outlaws with bullets. Bonnie and Clyde were national celebrities during the early 1930s because they robbed banks, which were despised for foreclosing on homes during the Great Depression. But they also killed cops and innocent civilians at small stores and gasoline stations. The aged lawmen, played by Kevin Costner and Woody Harrelson, outsmart the FBI agents assigned to the case with all of their

latest technologies, including wiretaps and aerial surveillance. Their story may hold a lesson for us today: Don't underestimate common sense—it should continue to give human intelligence an edge over artificial intelligence.

CALENDARS

US. Mon: Factory Orders -0.5%. **Tues:** NFIB Small Business Optimism Index 102.0, Job Openings 7.566m. (DailyFX estimates)

Global. Mon: Eurozone Sentix Investor Confidence -2.0, Germany Trade Balance €16.5b, Japan Consumer Confidence 41.5, Kuroda. **Tues:** Japan Machine Orders 2.9%/m/m/-4.6%/y/y, Mexico Headline & Core CPI 4.0%/4.1% y/y. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): Last week saw the US MSCI index rise 2.0%, ranking 26th of the 49 global stock markets we follow in a week when 41/49 countries rose in US dollar terms. That compares to the prior week's 97/49 ranking, when the US MSCI gained 1.2% as 23 markets rose. The AC World ex-US index rose 2.1%; that performance compares to a 0.3% decline a week earlier. All of the regions rose last week, led by EM Latin America (3.2%), EMU (3.0), BRIC (2.5), and EM Asia (2.3). The regions underperforming last week: EMEA (1.8), EAFE (1.9), and EM Eastern Europe (2.0). Egypt was the best-performing country, rising 7.0%, followed by Turkey (6.9), South Africa (5.9), and Mexico (5.7). Of the 24 countries that underperformed the AC World ex-US MSCI last week, Jordan fared the worst, falling 7.3%, followed by Pakistan (-2.9), New Zealand (-2.2), and Argentina (-1.5). The US MSCI's ytd ranking dropped to 11/49 from 10/49 a week earlier, with its 15.7% ytd gain ahead of that of the AC World ex-US (11.8). All regions and 45/49 countries are in positive territory ytd. Among the regions, those outperforming the AC World ex-US ytd include: BRIC (16.6), EM Asia (13.4), and EMU (12.8). Regions underperforming the AC World ex-US: EMEA (7.2), EM Latin America (10.4), EM Eastern Europe (10.8), and EAFE (11.1). The best country performers ytd: Colombia (28.0), Egypt (22.7), China (21.3), Belgium (20.1), and Hong Kong (18.4). The worst-performing countries so far in 2019: Morocco (-5.1), Jordan (-4.1), Argentina (-3.5), and Malaysia (-0.8).

S&P 1500/500/400/600 Performance ([link](#)): All three of these indexes rose last week as SmallCap's 2.9% gain outpaced both MidCap (2.8%) and LargeCap (2.1) for a second week. LargeCap ended the week 1.3% below its record high on September 20, with MidCap and SmallCap 4.9% and 12.0% below their August 29 records, respectively. Among the 33 sectors, 28 moved higher last week compared to 31 rising a week earlier. The biggest gainers in the latest week: SmallCap Energy (5.6), MidCap Industrials (4.4), LargeCap Materials (4.3), and MidCap Financials (3.9). LargeCap Consumer Staples (-1.0) was the biggest decliner, followed by MidCap Consumer Staples (-0.4) and MidCap Utilities (-0.4). In terms of 2019's ytd performance, all three indexes are still off to a good start. MidCap leads with a 17.2% gain ytd, ahead of LargeCap (15.4) and SmallCap (14.3). All 33 sectors are positive ytd, with the SmallCap and MidCap cyclicals leading the top performers: SmallCap Energy (29.4), MidCap Tech (25.5), MidCap Energy (23.2), SmallCap Materials (22.4), and LargeCap Tech (22.4). LargeCap Health Care (6.4) is the biggest underperformer so far in 2019, followed by MidCap Consumer Staples (8.0), SmallCap Utilities (8.0), SmallCap Consumer Staples (8.1), and SmallCap Health Care (8.7).

S&P 500 Sectors and Industries Performance ([link](#)): Nine of the 11 S&P 500 sectors rose last week, and seven outperformed the S&P 500's 1.2% gain. That compares to nine rising a week earlier, when six outperformed the S&P 500's 1.2% gain. Materials was the best-performing sector, with a gain of 4.3%, ahead of Financials (3.3%), Consumer Discretionary (3.2), Communication Services (2.9), Industrials (2.7), Tech (2.5), and Energy (2.2). Last week's biggest underperformers: Consumer Staples

(-1.0), Utilities (-0.2), Health Care (0.3), and Real Estate (0.9). All 11 sectors are higher so far in 2019, compared to just two sectors rising during 2018, when the S&P 500 fell 6.3%. These six sectors have outperformed the S&P 500's 15.4% rise ytd: Information Technology (22.4), Industrials (19.7), Consumer Discretionary (19.0), Energy (18.0), Real Estate (17.7), and Communication Services (17.0). The ytd laggards, albeit with gains: Health Care (6.4), Utilities (9.7), Consumer Staples (10.0), Financials (11.5), and Materials (14.3).

Commodities Performance ([link](#)): Last week, the S&P GSCI index gained 3.0% as 17 of the 24 commodities moved higher. That compares to a flat performance a week earlier, when 10 commodities moved higher. The index is still in a correction with a drop of 11.0% from its high in early October after being down as much as 26.9% on December 24. Lean Hogs was the strongest performer for the week, as it rose 11.8%, ahead of Cocoa (5.8%), Crude Oil (4.9), and Unleaded Gasoline (4.4). Lead was the biggest decliner, with a drop of 1.7%, followed by Copper (-1.4) and Aluminum (-1.4). The S&P GSCI commodities index is up 19.5% ytd following a decline of 15.4% in 2018. The top-performing commodities so far in 2019: Lean Hogs (62.3), Unleaded Gasoline (50.9), Crude Oil (38.9), Brent Crude (30.6), and Nickel (22.4). The biggest laggards in 2019: Kansas Wheat (-11.5), Natural Gas (-9.1), Coffee (-8.0), and Wheat (-7.0).

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index rose 2.1% last week and improved relative to its short-term 50-day moving average (50-dma) and its long-term 200-day moving average (200-dma). The index's 50-dma relative to its 200-dma improved for an eighth straight week, and was in a Golden Cross for a second week after being in a Death Cross for 16 weeks. It had been in a Golden Cross for 137 weeks through late November, and its previous Death Cross lasted for 17 weeks through April 2016 (when its 50-dma bottomed at a then-four-year low of 4.5% below its 200-dma in March 2016). The current Golden Cross reading of 0.9% is up from 0.2% a week earlier and from -5.2% in early February, which had matched the lowest reading since November 2011. It's still down from a 55-month high of 7.2% in February 2018. The S&P 500's 50-dma rose for the ninth time in 10 weeks, after falling for 16 straight weeks in its worst downtrend since before the 2016 election. The index improved to 4.0% above its rising 50-dma from 2.8% a week earlier, but is down from 6.6% during mid-February, which was its highest since October 2011. That compares to a seven-year low of 12.0% below at the end of December. The 200-dma rose for a tenth week after falling in 11 of the prior 15 weeks in the first downtrend since May 2016, when it had been slowly declining for nine months. The S&P 500 improved to a 27-week high of 5.0% above its rising 200-dma from 3.0% a week earlier. That compares to 14.5% below its falling 200-dma on December 24, which was the lowest since April 2009. However, it remains well below the seven-year high of 13.5% above its rising 200-dma during January 2018.

S&P 500 Sectors Technical Indicators ([link](#)): All 11 S&P 500 sectors traded above their 50-dmas, up from 10 a week earlier, as Financials moved back above in the latest week. That's a dramatic improvement from early January when all 11 were below. The longer-term picture—i.e., relative to 200-dmas—shows 10 sectors trading above currently, up from nine a week earlier, as Financials traded above for just the second time in 28 weeks. That leaves Energy as the only sector still trading below its 200-dma, as it has done for the last 26 weeks. Eight sectors are now in the Golden Cross club (with 50-dmas higher than 200-dmas), the highest count since mid-November and unchanged from a week earlier. Among the three laggards, Materials has been out of Golden Cross territory for 49 straight weeks, Financials for 25 straight weeks and during 36 of the past 40 weeks, and Energy for 21 weeks. All 11 sectors had been in a Golden Cross in January 2018 (for the first time since a 26-week streak ended in October 2016). All 11 sectors now have rising 50-dmas, up from 10 a week earlier, as Financials turned up. Energy and Materials are the only sectors with falling 200-dmas. That's up from three a week earlier, as Financials turned flat in the latest week; which compares to just two sectors with a rising 200-dma in early January in what was then the lowest count since all 11 sectors had falling 200-dmas two years before.

US ECONOMIC INDICATORS

Employment ([link](#)): March payrolls rebounded after February saw the worst month for job creation since September 2017, as stormy weather and the government shutdown depressed February's job count. Payroll employment climbed 196,000 (19,000 above consensus expectations) last month, while revisions show both February (to 33,000 from 20,000) and January (312,000 from 311,000) gains were revised slightly higher, for a net gain of 14,000. Employment growth averaged 180,300 per month during Q1-2019, compared with 223,250 per month during all of 2018. Last month, private payrolls expanded 182,000—larger than the 129,000 increase reported by ADP; February's (28,000 from 25,000) gain was slightly higher than first reported, while, January's (297,000 from 308,000) was slightly lower, for a net loss of 8,000. Employment continued to trend higher for the health care (49,000m/m & 398,000y/y), professional & tech services (34,000 & 311,000), and food services & drinking (27,000 & 309,000) industries. Meanwhile, construction payrolls were back in the plus column, climbing 16,000 last month after falling 25,000 in February—which was the first decline since May 2016 and the steepest since December 2013. Manufacturers cut payrolls for the first time since July 2017, by 6,000, after only a 1,000 uptick in February; these payrolls averaged monthly gains of 25,000 during the final three months of 2018. The breadth of job creation (i.e., the percentage of private industries increasing payrolls) shows the three-month span slipped to 61.2% from 70.9% at the end of last year, while the one-month span edged up to 60.5% after slipping below 60.0% the first two months of the year.

Earned Income Proxy ([link](#)): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, continued to set new highs in March—not posting a decline since February 2016. Our EIP accelerated 0.6% in March, after slowing steadily from December's 0.9% advance (which was the best monthly performance since October 2015) to 0.1% in February; it was up a robust 5.2% y/y. Average hourly earnings (AHE), one of the components of our EIP, rose 0.1% last month, and 3.2% y/y, slowing from 3.4% in February—which was the highest since April 2009. Meanwhile, aggregate weekly hours—the other component of our EIP—rebounded 0.5%, more than reversing February's 0.3% decline; it was up 2.0% y/y, above February's 1.7%, but below January's 2.4%.

Unemployment ([link](#)): The unemployment rate in March remained at 3.8%, near the lowest level in almost 50 years, while the participation rate slipped to 63.0%, little changed from the 63.2% recorded the first two months of this year—which was the highest in more than five years. The volatile teenage rate sank to 12.8% in March after rising steadily from 12.0% (the lowest since December 1969) in November to 12.9% in January, while the college-grad rate fell back to its cyclical low of 2.0% last month after jumping to a 17-month high of 2.4% in January. Meanwhile, the adult unemployment rate held at 3.5%, back near its cyclical low of 3.4% recorded from September through November; it had increased to 3.7% at the start of the year. The number of workers working part-time for economic reasons (a.k.a. “involuntary part-time workers”) rose 189,000 to 4.5 million (2.8% of the civilian labor force) in March, after slumping 837,000 in February. The sum of the underemployment and jobless rates edged up to 6.6% last month after falling from 7.2% in January to 6.4% in February—which was the lowest reading since December 2000—while the U6 rate, which includes marginally attached workers, was unchanged at 7.3%, the lowest since March 2001.

Wages ([link](#)): March wages—as measured by average hourly earnings (AHE) for all workers on private nonfarm payrolls—climbed to another new record high. The wage rate slowed slightly to 3.2% y/y from 3.4% in February, which was the highest rate since April 2009; it was at a recent low of 2.3% during October 2017. The wage rate for service-providing industries (3.4% y/y) slowed slightly after matching its series high of 3.6% in February, while the goods-producing rate (2.5) continued to fluctuate in a flat trend between 2.0%-3.0%. Within goods-producing, the manufacturing rate (1.8) is holding around

2.0%, while construction's (3.3) is back above 3.0% after slipping below in February; the natural resources (2.1) rate continues to fluctuate around recent highs. Within service-providing, rates for both retail trade (4.9) and information services (6.1) held just below their series highs of 5.0% and 6.6%, respectively. Rates for wholesale trade (3.7) and leisure & hospitality (3.7) remain on accelerating trends—with the former jumping sharply in March—while rates for financial activities (3.3) and transportation & warehousing (1.5) are decelerating from recent highs, though the latter may be finding a bottom. Stalled around recent highs are rates for utilities (3.6) and professional & business services (3.3).

GLOBAL ECONOMIC INDICATORS

Germany Manufacturing Orders ([link](#)): German factory orders plunged the first two months of this year, posting the largest two-month drop in a decade. The Economy Ministry added further bad news, noting that manufacturing momentum will “continue to be subdued in coming months, particularly due to lack of external demand.” Orders contracted 4.2% in February and 6.2% during the two months ending February; billings were 8.4% below a year ago—the steepest yearly decline since October 2009. Foreign (-8.5% during two months through February) and domestic (-3.0) orders posted steep declines the first two months of the year, with losses in the former widespread—with demand falling from both outside (-11.2) and inside (-4.0) the Eurozone. Here's a look at orders' performances, for the main industry groupings on a two-month basis—for domestic orders and foreign orders—from both inside and outside the Eurozone, respectively: Capital goods (-5.1%, -2.2%, -15.2%), intermediate goods (-0.3, -5.5, -1.2), consumer durable goods (-3.1, -8.9, +8.6), and consumer nondurable goods (-1.5, -9.8, -8.2). Looking ahead, March's IHS Markit M-PMI (to 44.1 from 47.6) showed manufacturing activity contracted at its fastest pace since July 2012, “underpinned by a sharp and accelerated decrease in new orders, which was in turn partly driven by a further slump in export sales. Both total order books and new business from abroad fell at the fastest rate since April 2009,” according to the report.

Germany Industrial Production ([link](#)): “The industrial sector is expected to remain subdued given the weak development in orders and the gloomier business climate,” the Economy Ministry said in a statement. Germany's headline production—which includes construction—rose 0.7%, while January's 0.8% loss was revised up to show no change. February's gain was driven by a 6.8% weather-related surge in construction, which followed a 0.9% advance in January. Excluding construction, production contracted 0.4% in February and 0.2% in January. Meanwhile, manufacturing output declined 0.2% in February and 0.6% the first two months of the year; since its recent peak in May 2018, manufacturing output has tanked 4.0%. Over the first two months of 2019, intermediate and capital goods production contracted 1.0% and 0.9%, respectively, while consumer durable and nondurable goods output expanded 1.9% and 0.2%. IHS Markit March's manufacturing production data revealed the rate of decline accelerated from February—when production fell for the first time in almost six years—to its fastest in over 6.5 years.

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