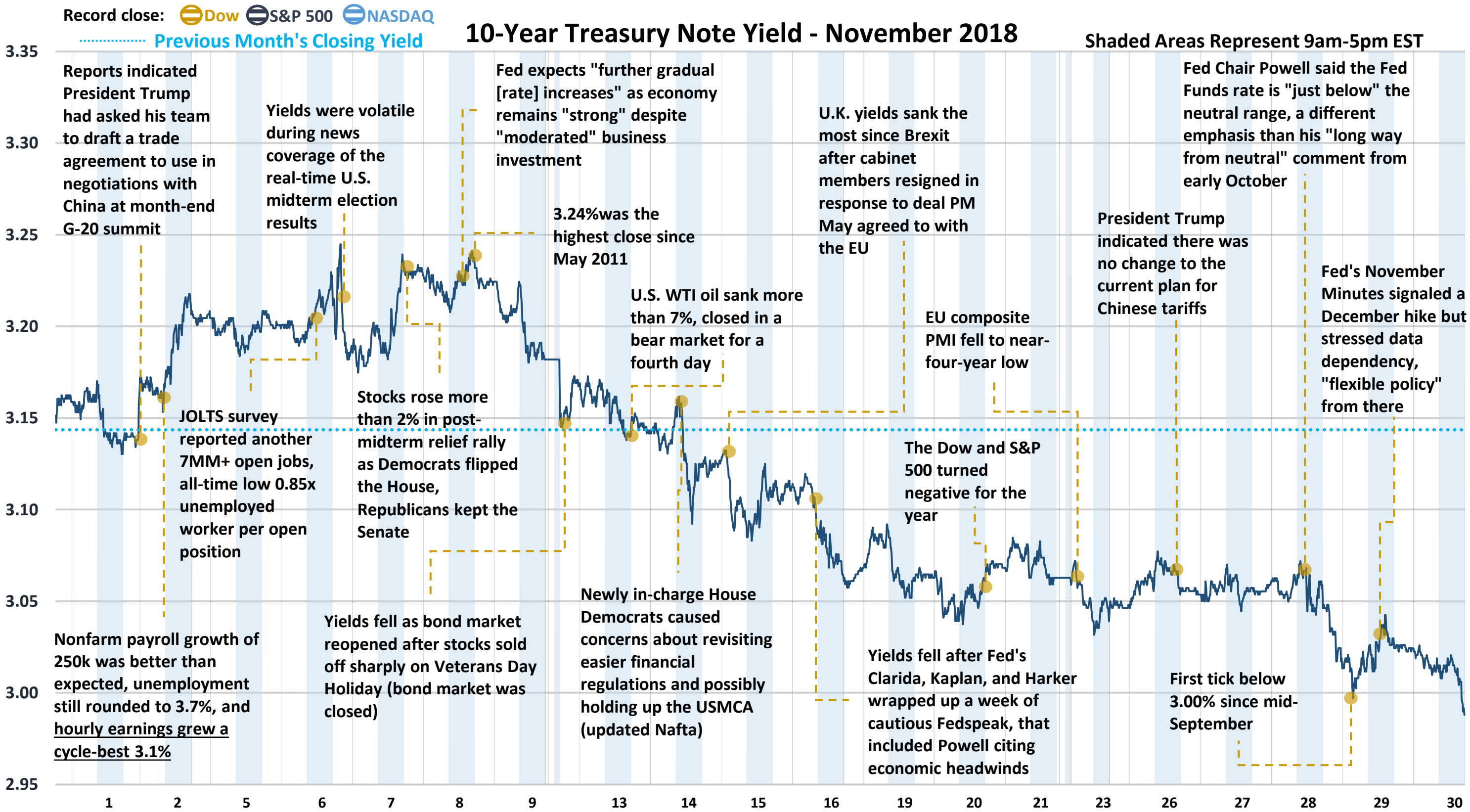
Monthly Review

VINING SPARKS

November 2018

Uncertainty Pushed Yields Lower in November and Led the Fed to Stress "Flexible Policy" Heading into 2019



Cycle-High Wage Growth Pushed Yields Higher Before Geopolitical Uncertainty, an Oil Collapse, Trade Concerns, and a Possible Fed Pause Pulled Them Back Lower

Markets: Market uncertainty continued in November, with the S&P 500 briefly turning negative for 2018, the 10-year Treasury yield closing below 3% for the first time since mid-September, and the 2s10s spread ending below 20 bps, the lowest since August. Wage growth hit a cycle-high 3.1%, sending the 10-year yield to 3.24%, its highest close since May 2011. However, uncertainty quickly overtook optimism and yields drifted lower for the remainder of the month. Equities sold off after newly-in-charge House Democrats threatened the new North American trade deal and any further regulatory relief. Weakness in tech stocks was compounded by global growth concerns and a bear market in oil. Economic data from China and the EU remained weaker-than-expected. U.S. WTI crude posted a 22% decline on concerns of oversupply, its worst month since the recession. Although PM May agreed to a Brexit deal with the EU, passage through a fractured parliament looked suspect. And Italy's planned budget deficit led to more bickering between the country's government and the EU. Combined, these factors also likely played a part in the Fed calling for "flexible policy" beginning in 2019. A possible Fed pause next year lifted stocks back into positive territory for the month but left yields near their lowest levels since September.

Consumer: Consumer spending was revised lower in 3Q GDP's first revision to a still-solid 3.6%, creating a lower bar for comparison (positive) for 4Q activity. Both retail sales and personal spending data were solid in October signaling a strong start for the final quarter of 2018. Firmer incomes and elevated confidence remain supportive of spending. Nonfarm payrolls grew a better-than-expected 250K in October, the unemployment rate held near a 50-year low, but the 3.1% YoY increase in average hourly earnings made the most headlines. The Conference Board's consumer sentiment index pulled back slightly, but held at its second strongest level of the cycle. However, a recent softening trend in jobless claims, which are still at healthy levels, is worth keeping an eye on.

Private Investment: The initial disappointment for fixed business investment in 3Q was pared back thanks to positive revisions to GDP. However, October's capital goods orders, a predictor of future business equipment purchases, were weaker-than-expected (unchanged) following a 0.5% decline the month before. The recent moderation in business investment was noted by the Fed in its Official Statement released after their November meeting. The outlook for housing is no brighter after the reports released in November showed the second biggest drop in homebuilder confidence since 2001 (lowest since 2016), the fewest new home sales since 2016, the second worst month for existing sales since 2016, the lowest number of pending sales since 2014, and the slowest YoY pace of price increases since November 2016.

External Trade: After dragging nearly 2%-points from 3Q growth, the goods trade deficit continued to widen in October and trade disputes remained in the headlines. Presidents Trump and Xi met at the G-20 summit starting the final day of the month and ultimately agreed to a temporary truce on December 1.

Inflation: Softer inflation continued in November, adding to uncertainty about how much further the Fed will be able to raise. Despite wage growth above 3%, core PCE slipped to 1.78%, the lowest since February, and market-based expectations dropped to 2018 lows (5-Yr expectations ended at 1.77%, 10-Yr at 1.97%.)

Monetary Policy: Fed Chair Powell shifted emphasis when describing where Fed Funds is relative to the neutral estimate. In October, Powell said policy was "a long way from neutral," a likely reference to the median 3% estimate. In November, Powell instead noted Fed Funds was "just below" the broad range of estimates. Both are true but the shift was seen as intentional, stirring speculation of a Fed pause in 2019. That tone was reinforced by Fed Minutes which signaled a December hike but stressed data-dependent, "flexible policy" in 2019.

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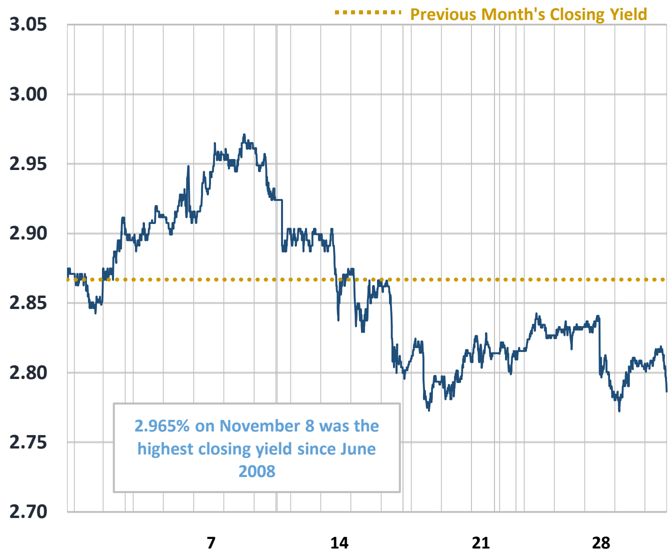
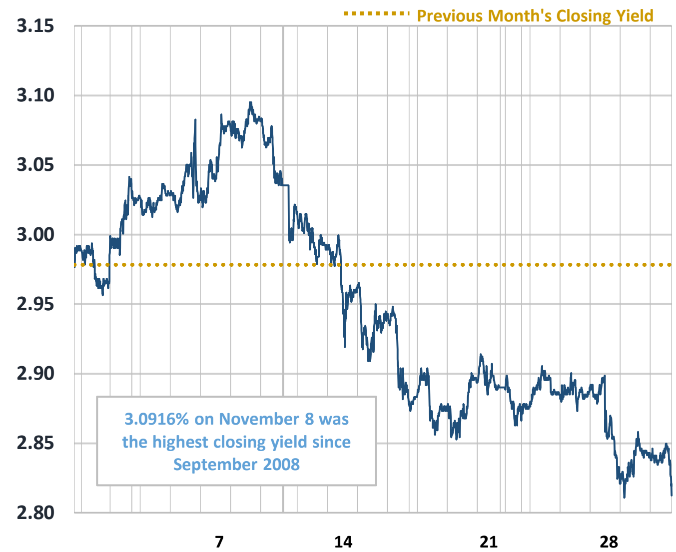
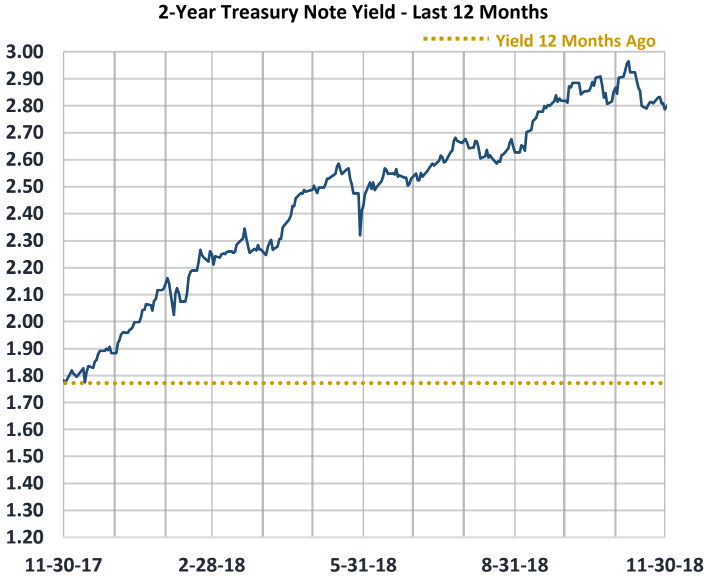
2-Year Treasury Note Yield - November 2018



5-Year Treasury Note Yield - November 2018

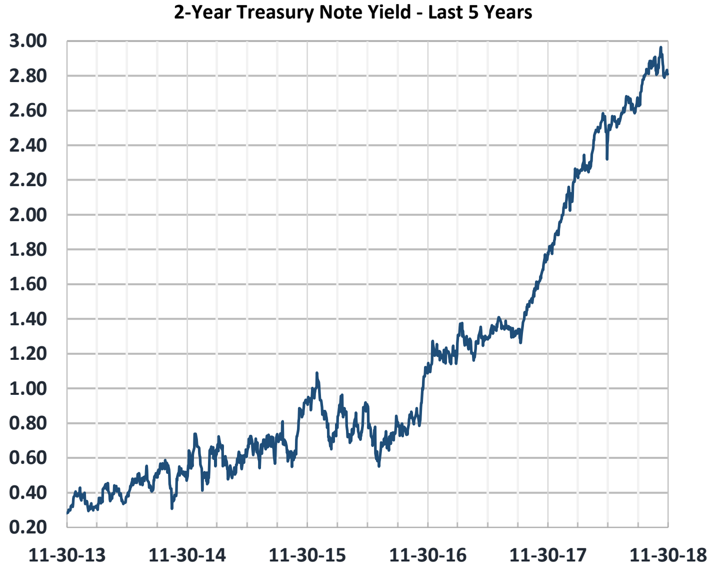


2-Year Treasury Note Yield - Last 12 Months

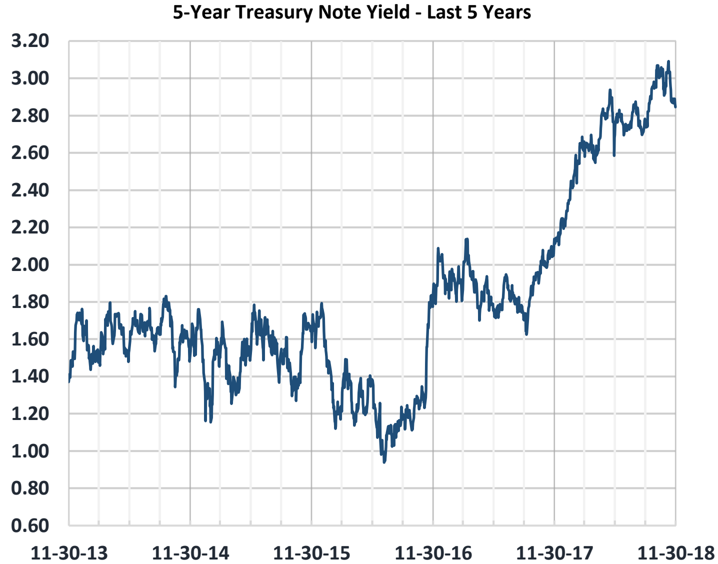


5-Year Treasury Note Yield - Last 12 Months

2-Year Treasury Note Yield - Last 5 Years



5-Year Treasury Note Yield - Last 5 Years



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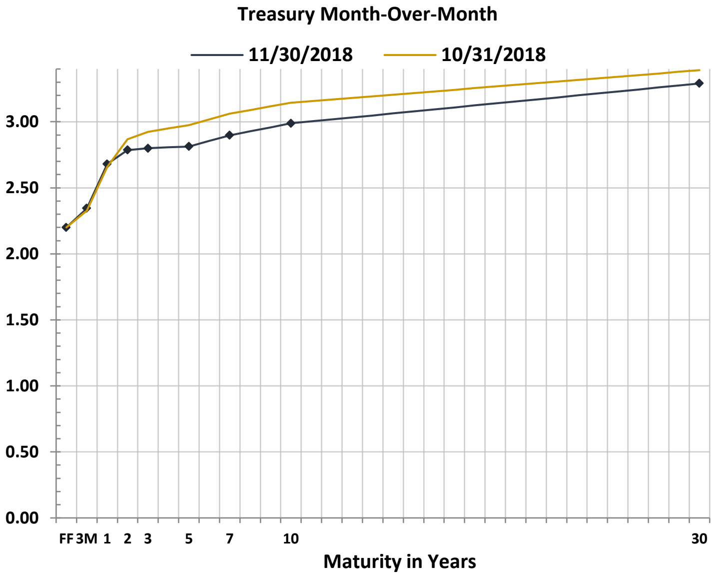
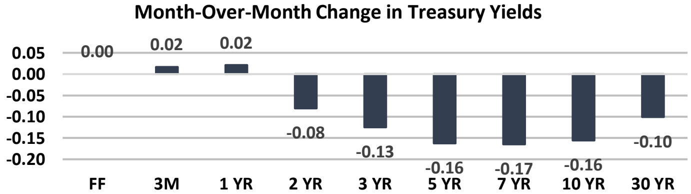




Global Stock Performance

	Value	MTD Change	QTD Change	YTD Change
Dow Jones	25,538	1.68% ↑	-3.48% ↓	3.31% ↑
S&P 500	2,760	1.79% ↑	-5.28% ↓	3.24% ↑
Nasdaq	7,331	0.34% ↑	-8.90% ↓	6.19% ↑
Stoxx Europe 600	357	-1.14% ↓	-6.70% ↓	-8.14% ↓
China CSI 300	3,173	0.60% ↑	-7.74% ↓	-21.29% ↓
Nikkei 225	22,351	1.96% ↑	-7.33% ↓	-1.82% ↓

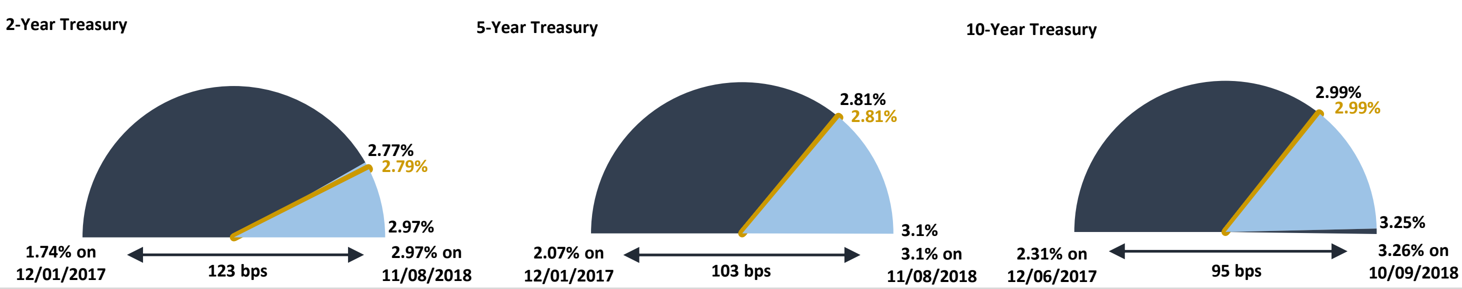
Global Sovereign Debt Performance

	Yield	MTD Change (in bps)	QTD Change (in bps)	YTD Change (in bps)
U.S. 2-year	2.79%	-8.0 ↓	-3.2 ↓	90.4 ↑
U.S. 5-year	2.81%	-16.2 ↓	-14.0 ↓	60.6 ↑
U.S. 10-year	2.99%	-15.6 ↓	-7.3 ↓	58.3 ↑
German 10-year	0.31%	-7.2 ↓	-15.7 ↓	-11.4 ↓
U.K. 10-year	1.36%	-7.3 ↓	-20.9 ↓	17.4 ↑
French 10-year	0.68%	-6.7 ↓	-12.0 ↓	-10.1 ↓
Italian 10-year	3.21%	-21.4 ↓	6.6 ↑	119.7 ↑
Japanese 10-year	0.09%	-3.5 ↓	-3.8 ↓	4.4 ↑

Commodity Performance

	Value	MTD Change	QTD Change	YTD Change
WTI Crude	$ 50.93	-22.02% ↓	-30.47% ↓	-15.71% ↓
U.S. Dollar	97.27	0.15% ↑	2.25% ↑	5.59% ↑
Gold Spot	1,223	0.64% ↑	2.52% ↑	-6.18% ↓
Commodity Index	82.56	-0.76% ↓	-3.10% ↓	-6.36% ↓

Treasury Notes Intraday Ranges: 52-Week Yield Range / Monthly Yield Range / Last Traded Yield



Nonfarm Payrolls
October
250k

Unemployment Rate
October
3.7%
Unchanged

The biggest focus of the nonfarm payroll report was wage growth, which hit a cycle-high 3.1%

Existing Home Sales MoM
October
1.4%

New Home Sales MoM
October
-8.9%

Existing home sales rose for the first time in seven months (2nd weakest since 2016); New home sales were the weakest since 2016

Core Retail Sales
October
0.3%

Consumer Confidence
November
135.7
Down 2.2 pts
Second best of the cycle

ISM Non-Manufacturing
October
60.3
-1.3 pts

ISM Manufacturing
October
57.7
-2.1 pts

Non-manufacturing, 2nd best since 2005, edged off 21-year high; Manufacturing fell to a six-month low

Manufacturing Production
October
0.3%

Core Capital Goods Orders
October
0.0%

Weaker than expected, adding to disappointing trend

Trade Balance
September
-54B
-0.7B

Core PCE YoY
October
1.8%
Down 0.16%
Weakest since February