THE AUSTIN ADVISOR

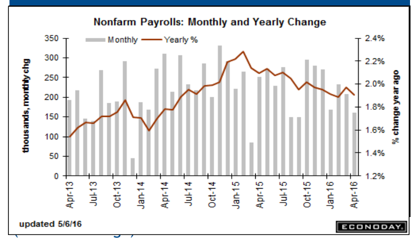
May 31, 2016

Markets	23-May	24-May	25-May	26-May	27-May	YTD%	31-Dec-15
DJIA	17,492.93	17,706.05	17,851.51	17,828.29	17,873.22	2.57%	17,425.03
S&P 500	2,048.04	2,076.06	2,090.54	2,090.10	2,099.06	2.70%	2,043.94
NASDAQ	4,765.78	4,861.06	4,894.89	4,901.77	4,933.51	-1.48%	5,007.41
SNL Bank Index	402.50	409.01	416.39	412.98	416.46	-3.48%	431.48
Fed Funds Rate	0.37%	0.37%	0.37%	0.37%	0.37%		0.35%
1 Month LIBOR	0.45%	0.44%	0.45%	0.45%	0.46%		0.43%
3 Month LIBOR	0.66%	0.67%	0.67%	0.67%	0.67%		0.61%
3 Month T-Bill	0.35%	0.35%	0.33%	0.31%	0.32%		0.16%
1 Year Treasury	0.69%	0.69%	0.67%	0.65%	0.68%		0.65%
2 Year Treasury	0.91%	0.92%	0.92%	0.87%	0.90%		1.06%
3 Year Treasury	1.05%	1.08%	1.08%	1.03%	1.06%		1.31%
5 Year Treasury	1.38%	1.41%	1.40%	1.35%	1.39%		1.76%
10 Year Treasury	1.84%	1.86%	1.87%	1.83%	1.85%		2.27%
30 Year Treasury	2.63%	2.65%	2.67%	2.64%	2.65%		3.01%

WEEKLY HIGHLIGHT

Strong data last week and expectations for the data this week keep the Fed on track for a rate hike

NONFARM PAYROLLS



Economy	Week of May 23, 2016	
New Home Sales	619,000	This highly volatile data series reported it's biggest month since before the recession of 2008-09
Durable Goods Orders	3.4%	A very strong report, driven by car sales up 2.4%, and a huge jump in aircraft orders
Real GDP-Revised	0.8%	First quarter growth revised upward from 0.5%, due to better residential investment and a lower trade deficit than first reported

MONDAY MUSING

I got an email yesterday offering a video which will allow me to test a dog's IQ. The video was only $12.95 plus shipping and handling. I figured the test was that if I bought the video, the dog was smarter than me.

Calendar	Release	Covering	Week of May 30, 2016
Memorial Day	Monday		All Markets Closed
Personal Income	Tuesday	April	Another solid month of 0.4% growth is expected, as incomes rise in a tight labor market
Personal Spending	Tuesday	April	A strong 0.7% is expected for the month, as consumption rebounds from a weak first quarter
PCE Core Price Index	Tuesday	April	Only a 0.2% rise is forecast, bringing the YOY rise to 1.6%, with no inflation risks evident
Consumer Confidence	Tuesday	May	A jump from 94.2 to 97.1 is the consensus forecast, indicating better consumption numbers going forward
Motor Vechicle Sales	Wednesday	May	Sales are expected to remain above the 17 million annual rate for the 9th consecutive month
ISM Index	Wednesday	May	Even as final demand has increased, manufacturing remains modest with no change from 50.8 reported last month
Unemployment Rate	Friday	May	The consensus does forecast a drop to 4.9%, due to a slowing in the growth of the workforce
Nonfarm Payrolls	Friday	May	Expectations call for a slowing in job growth, with 156,000 expected, following the 160,000 in April
Avg Hourly Earnings	Friday	May	Wages have increased at a faster rate in the last three months, but only 0.2% is expected for May
Trade Deficit	Friday	April	Exports have improved and allowed the deficit to drop with the consensus at -$41.2 billion

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Commentary

The question I get asked most often: Why should **the Fed** raise short-term interest rates and **normalize monetary policy** now? After all, the economy is growing at less than the long-term trend line. **Real GDP** for the first quarter was revised upward, but only to 0.8% following the 1.4% rate of growth in the fourth quarter. The **inflation** data remains well contained, even with oil and other commodity prices rebounding. The future indicators of inflation remain weak, with capacity utilization rates well below 80%, and **consumer final demand** only increasing at less than 2% this year. There appears to be little reason to raise rates in this environment.

The reason the Fed needs to raise rates is to reduce the risk incentive of very low **borrowing costs**. Keeping low rates will lead to speculative bubbles building in sectors of the economy. We have already experienced the pain when these bubbles burst. An example is found in the banking sector. Low borrowing costs usually lead to a surge in **loan demand,** but that has not happened yet. Companies and individuals are still reluctant to increase debt after the effects of the 2008-09 Great Recession. The result is that banks are extending terms to borrowers in order to get loan growth. We are hearing of more banks willing to quote seven and even ten year fixed rate loans in the low 4% rate area. The rebound in real estate market values are allowing these same banks to lend more on each commercial real estate loan. The larger banks have generated much faster loan growth than the community banks have been able to achieve because they have been more price competitive. This environment has led to an increase in risk in loan portfolios. It has not reached levels of pre-recession conditions, but any increase in economic growth will cause even more price competition to book loans as the only way to grow revenues.

Raising short term rates will drive funding costs higher and force lenders to increase loan rates. Low interest rates do alter the decision making process that leads to financial implications. We have had low rates for over ten years and have avoided the building of a speculative bubble and higher inflation. The question the Fed must answer in two weeks is whether they should wait to normalize rates until these risk conditions start to appear, or should they move in front of them. The Fed has said they would move in a controlled way before risks accelerate. We have learned to believe what they say. We continue to expect a 25 basis point upward move at the June 15 meeting.

Trusted Advisor to Financial Institutions
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