THE AUSTIN ADVISOR

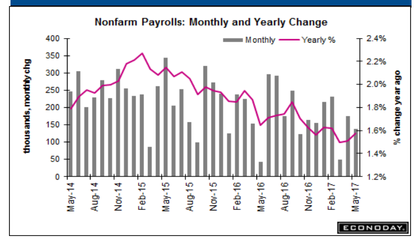
July 5, 2017

Markets	26-Jun	27-Jun	28-Jun	29-Jun	30-Jun	YTD%	30-Dec-16
DJIA	21,409.55	21,310.66	21,454.61	21,287.03	21,349.63	8.03%	19,762.60
S&P 500	2,439.07	2,419.38	2,440.69	2,419.70	2,423.41	8.24%	2,238.83
NASDAQ	6,247.15	6,146.62	6,234.41	6,144.35	6,140.42	14.07%	5,383.12
SNL Bank Index	530.65	534.69	544.67	553.29	552.35	3.70%	532.65
Fed Funds Rate	1.16%	1.16%	1.16%	1.16%	1.06%		0.55%
1 Month LIBOR	1.22%	1.22%	1.23%	1.23%	1.22%		0.77%
3 Month LIBOR	1.29%	1.30%	1.30%	1.30%	1.30%		1.00%
3 Month T-Bill	0.99%	1.00%	1.02%	1.04%	1.03%		0.51%
1 Year Treasury	1.20%	1.22%	1.21%	1.23%	1.24%		0.85%
2 Year Treasury	1.36%	1.38%	1.34%	1.38%	1.38%		1.20%
3 Year Treasury	1.48%	1.53%	1.51%	1.53%	1.55%		1.47%
5 Year Treasury	1.77%	1.83%	1.81%	1.85%	1.89%		1.93%
10 Year Treasury	2.14%	2.21%	2.22%	2.27%	2.31%		2.45%
30 Year Treasury	2.70%	2.75%	2.77%	2.82%	2.84%		3.06%

WEEKLY HIGHLIGHT

The yield curve has steepened slightly as the Fed is convinced inflation will increase

NONFARM PAYROLLS



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Economy	Week of June 26, 2017	
Durable Goods Orders	-1.1%	The large decline was all a function of the drop in aircraft orders, with orders excluding transportation up a modest 0.1%
Consumer confidence	118.9	A strong report with the index up from 117.6, but this is not being translated into higher spending or final demand
Real GDP-Final 1st Qtr	1.4%	The final first quarter growth was revised upward from 1.2%, with consumer spending revised to +1.1%
Personal Income	0.4%	Income growth continues at a solid pace, but it was transfer payments that fueled the increase, not wage rates
Personal Spending	0.1%	The rise in incomes was not used to increase spending and as a result the savings rate increased to 5.5%
Core PCE Price Index	0.1%	The modest growth in demand has kept inflation pressures low, with the YOY increase down to 1.4%, well below Fed's target of 2%

ON THIS DAY IN HISTORY

1865 - Secret Service begins operating under the Treasury Department

1891 - Hail kills 6 horses near Rapid City, SD

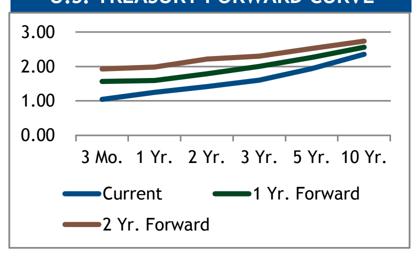
1946 - The bikini makes it's debut at a Paris fashion show

1971 - 26th amendment to the Constitution certified

1994 - Amazon.com founded

Calendar	Release	Covering	Week of July 3, 2017
Motor Vehicle Sales	Monday	June	Auto sales have plateaued at an under 17 million annual rate after a record year in 2016 at 17.4 million
ISM Index	Monday	June	The outlook for manufacturing activity going forward is much better with the 3 point increase to 57.8
Fourth of July Holiday	Tuesday		All Financial Markets Closed
Trade Deficit	Thursday	May	A narrowing of the deficit is expected at -$46.2 billion, from -$47.6 B in April, on higher export growth
Unemployment Rate	Friday	June	The rate at 4.3% is not expected to change with the June data and remains historically low, reflecting a tight labor market
Nonfarm Payrolls	Friday	June	Job growth slowed to 138,000 in May and is expected to bounce back to the monthly average of the last year at 175,000

U.S. TREASURY FORWARD CURVE



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Commentary

The economic data released over the last two weeks continues to paint a mixed picture of conditions. Incomes are growing, but **consumer final demand** remains only modest. **Personal income** rose 0.4% in May, while spending only grew by 0.1%. As a result, the savings rate rose to 5.5%. Consumers are saving a large portion of the rise in their incomes. **Auto sales** have backed down from the record levels reached in 2016 and are running below the 17 million annual rate. **Retail sales** growth is consistently below the level needed to grow the total economy at a 3% or better rate. All of this is in spite of the conditions that normally generate much faster final demand. **Consumer confidence** rebounded in May and the **unemployment rate** dropped to 4.3%. **Job growth** has slowed, but that is due to the lack of qualified workers to fill the open positions. The **ISM Index** jumped in June by almost 3 points, indicating a strong second half of 2017 for manufacturing activity. By historical standards this economic environment should produce a surge in both capital and consumer spending. That has not happened. Either the old relationships between economic data have broken down and no longer apply or this environment is temporary and we will soon revert back to the mean of the last 80 years. **The Fed** believes the latter will occur. They call the current environment "transitory" and are expecting much stronger economic growth in the second half of this year and into 2018. Therefore, they have not lowered their guidence of at least one more managed rate increase this year and at least three more in 2018. They also moved up the timing of the beginning the process of shrinking their balance sheet to September from December. They forecast the very low **inflation** data that has been reported in the last six months will reverse and prices will begin to rise at a rate at or above their target of 2%.

The bond market has not bought this forecast. Intermediate and long-term rates had moved down on the low inflation data, while short rates moved higher as the Fed removed some of the accommodative monetary policy. In the last two weeks some of the flattening of the **yield curve** has changed. The five-year treasury has risen in yield by 20 basis points and reached 1.93% while the ten-year has moved up to 2.35% from below 2.2% a week ago. Over the last month, the five-year is up 19 basis points while the two year is up 11 basis points. The spread between the two-year and the ten-year is still historically narrow at 93 basis points. The second quarter **Real GDP** data looks to be about 2.5% based on data released to date. That would be up from the 1.4% final growth for the first quarter, but well below the long-term growth for the U.S. economy. The dichotomy of a tight labor market, high levels of confidence, slow growth and low inflation either represents a permanent change in the behavior of consumers and business or the Fed will be correct and we will revert to the mean in the next six months. We are not changing our expectations and we are siding with the Fed.