# THE AUSTIN ADVISOR

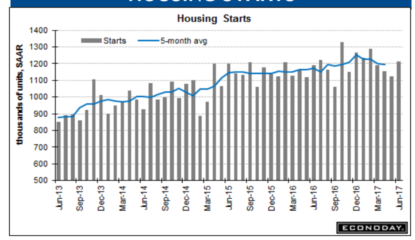
August 14, 2017

| Markets | 7-Aug | 8-Aug | 9-Aug | 10-Aug | 11-Aug | YTD% | 30-Dec-16 |
|---|---|---|---|---|---|---|---|
| DJIA | 22,118.42 | 22,085.34 | 22,048.70 | 21,844.01 | 21,858.32 | 10.60% | 19,762.60 |
| S&P 500 | 2,480.91 | 2,474.92 | 2,474.02 | 2,438.21 | 2,441.32 | 9.04% | 2,238.83 |
| NASDAQ | 6,383.77 | 6,370.46 | 6,352.33 | 6,216.87 | 6,256.56 | 16.23% | 5,383.12 |
| SNL Bank Index | 556.60 | 556.85 | 553.91 | 542.53 | 538.87 | 1.17% | 532.65 |
| Fed Funds Rate | 1.16% | 1.16% | 1.16% | 1.16% | 1.16% | | 0.55% |
| 1 Month LIBOR | 1.23% | 1.23% | 1.23% | 1.23% | 1.23% | | 0.77% |
| 3 Month LIBOR | 1.31% | 1.31% | 1.31% | 1.31% | 1.32% | | 1.00% |
| 3 Month T-Bill | 1.02% | 1.06% | 1.06% | 1.05% | 1.03% | | 0.51% |
| 1 Year Treasury | 1.22% | 1.24% | 1.21% | 1.22% | 1.21% | | 0.85% |
| 2 Year Treasury | 1.36% | 1.36% | 1.33% | 1.33% | 1.30% | | 1.20% |
| 3 Year Treasury | 1.52% | 1.53% | 1.50% | 1.49% | 1.43% | | 1.47% |
| 5 Year Treasury | 1.81% | 1.84% | 1.81% | 1.78% | 1.74% | | 1.93% |
| 10 Year Treasury | 2.26% | 2.29% | 2.24% | 2.20% | 2.19% | | 2.45% |
| 30 Year Treasury | 2.84% | 2.86% | 2.82% | 2.79% | 2.79% | | 3.06% |

## WEEKLY HIGHLIGHT

The data released last week did not reflect any change in the "no inflation" economic environment

## HOUSING STARTS




(click to enlarge)

| Economy | Week of August 7, 2017 | |
|---|---|---|
| Consumer Credit | $12.4 Billion | The lower than expected result was a function of lower auto and student loans, with credit card debt rising by $4.1 Billion |
| JOLTS | 6.163 Million | The huge jump in unfilled job openings and limited job growth reflects the difficulty employers have in finding workers |
| Producer Prices | -0.1% | The core rate was also down 0.1% again, raising the risk of disinflation as opposed to rising inflation as the Fed expects |
| Consumer Price Index | 0.1% | Still no inflation indications with the core rate also up only 0.1%, making further rate increases less likely |

## ON THIS DAY IN HISTORY

1873 - 'Field & Stream' first published

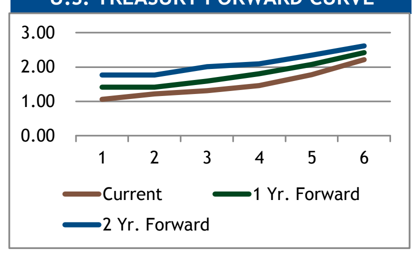
1893 - France introduces motor vehicle registration & driving test

1925 - Mount Rushmore first proposed

1945 - V-J Day as Japan surrenders unconditionally to end WWII

| Calendar | Release | Covering | Week of August 14, 2017 |
|---|---|---|---|
| Retail Sales | Tuesday | July | The consensus forecast calls for a strong rebound in July at +0.3%, after the drop of 0.2% in June |
| Housing Starts | Wednesday | July | Construction surged in June following two very weak months and expectations call for another increase at 1.225 million |
| Industrial Production | Thursday | July | Mining output drove the data higher in June, with manufacturing still soft and expectations are for the same at +0.3% |
| Capacity Utilization | Thursday | July | Little change in the operating rate at 76.6% is expected, which is well below inflationary levels |
| Leading Indicators | Thursday | July | Driven by a strong building permits number, the index jumped 0.6% in June and is expected to be up by 0.3% for July |

## U.S. TREASURY FORWARD CURVE



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## Commentary

Another week of data reflecting the same economic environment of the first six months of the year. The **inflation** data was very weak, providing no indication it is about to rise as **the Fed** expects. There simply is no inflation pressure. Wage growth remains well contained in spite of the tight **labor market**. This condition was again the case with the **JOLTS index** rising to a near record high above 6 million. It is clear companies are having difficulty finding qualified workers to fill open positions. Normally, companies would raise wages to fill their needs but that is not happening in this cycle. The surge in business fixed investment reported for the second quarter is being driven by companies finding alternatives to hiring employees at higher wage costs. Companies are lowering the labor content by becoming more efficient. This response can only go so far in a service economy. At some point, wages will begin to increase as companies compete for the limited number of qualified workers. This has been the primary risk cited by the Fed as they remain concerned about rising inflation risk going forward. None of these risks have materialized yet.

The **CPI** and **PPI** released last week for July were both very low. The CPI has now increased by 1.7% over the last twelve months and the core rate is at the same level. This trailing twelve month growth was at 2.5% for all of 2016. This decline below the Fed's target of 2% is causing the forecast for future Fed efforts to **normalize monetary policy** by raising short-term interest rates to be pushed back into 2018. The next Fed move is still expected to be an increase in rates but there is less than a 50% probability of it happening in December.

The bond market is not pricing any inflation risk. The yield on the ten-year treasury is at 2.20% and the spread between the two-year and the ten-year is 90 basis points. This spread would be above 200 bp if investors were pricing rising inflation going forward. The current rate environment is going to make growing net interest income in the second half of the year more difficult. Competitive loan pricing has returned and the cost of funds is rising. Most of the increase in funding costs has occurred in the markets sensitive to national market rates. Public fund deposits, corporate balances and large retail depositors are demanding higher rates. Fixed rate loans of longer durations are being priced below 4.5%. Margins, which increased in the first half of the year, will erode should this rate environment continue in the second half of the year. **The curve** must steepen and that will only happen if inflation begins to increase. So far, there is no indication that is about to happen.