THE AUSTIN ADVISOR

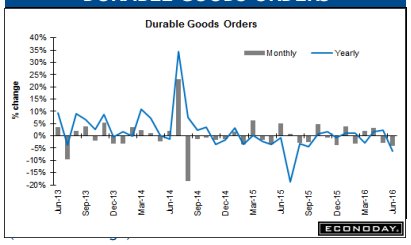
August 22, 2016

Markets	15-Aug	16-Aug	17-Aug	18-Aug	19-Aug	YTD%	31-Dec-15
DJIA	18,636.05	18,552.02	18,573.94	18,597.70	18,552.57	6.47%	17,425.03
S&P 500	2,190.15	2,178.15	2,182.22	2,187.02	2,183.87	6.85%	2,043.94
NASDAQ	5,262.02	5,227.11	5,228.66	5,240.15	5,238.38	4.61%	5,007.41
SNL Bank Index	411.91	412.39	413.23	413.67	414.17	-4.01%	431.48
Fed Funds Rate	0.40%	0.40%	0.40%	0.40%	0.40%		0.35%
1 Month LIBOR	0.51%	0.51%	0.51%	0.51%	0.52%		0.43%
3 Month LIBOR	0.80%	0.80%	0.81%	0.81%	0.82%		0.61%
3 Month T-Bill	0.31%	0.27%	0.30%	0.30%	0.30%		0.16%
1 Year Treasury	0.56%	0.57%	0.58%	0.58%	0.59%		0.65%
2 Year Treasury	0.72%	0.76%	0.74%	0.71%	0.76%		1.06%
3 Year Treasury	0.85%	0.87%	0.86%	0.81%	0.88%		1.31%
5 Year Treasury	1.14%	1.16%	1.15%	1.12%	1.17%		1.76%
10 Year Treasury	1.55%	1.57%	1.56%	1.53%	1.58%		2.27%
30 Year Treasury	2.27%	2.29%	2.27%	2.26%	2.29%		3.01%

WEEKLY HIGHLIGHT

An important speech this week by Fed Chair Yellen should give us some insight into their thinking

DURABLE GOODS ORDERS



Economy	Week of August 15, 2016	
Consumer Price Index	0.0	The core rate was up a modest 0.1%, which brings the YOY increase down to 2.2% from 2.3%
Housing Starts	1.211 Million	The 2.1% monthly increase was much better than expected, but building permits were little changed
Industrial Production	0.7%	Second consecutive month of strong growth, providing some evidence manufacturing may be recovering
Capacity Utilization	75.9%	The jump from 75.4% reflects the strong data from production growth, but remains well below inflationary levels
Leading Indicators	0.4%	The last three months of solid data for this index does point to a better economic environment in the second half of the year

MONDAY MUSING

School has started here in Ohio. Three of my grandchildren go to Catholic school and parents and grandparents get to eat lunch with them on the first day. In line at the cafeteria someone had placed a sign in front of the pile of apples that read, "Please take only one each. God is watching." At the end of the line one of the kids had put a sign that read, "Take all you want. God is watching the apples". This kid is going to grow up to be a consultant.

Calendar	Release	Covering	Week of August 22, 2016
New Home Sales	Tuesday	July	After reaching a post recession high in June, sales are expected to hold steady at 590,000 for July
Existing Home Sales	Wednesday	July	Again, the housing sector remains strong with sales at an annual rate of 5.525 million, down slightly from 5.570 M in June
Durable Goods Orders	Thursday	July	After soft data in May and June, a strong 4% increase in July is expected
Real GDP-Revised	Friday	2nd Qtr	A downward revision of the weak 1.2% growth reported in the advance data, to 1.0%, is expected
Fed Chair Yellen Speaks	Friday		Fed Chairwoman Yellen speaks at the Jackson Hole meeting providing insight into the direction of monetary policy (11 am)

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Commentary

As good as the data has been in the last two months, it will not be data that moves markets this week. **Fed Chairwoman Yellen** speaks at the annual Jackson Hole economic meeting this Friday. The purpose each year is to review current economic conditions and to highlight the issues **the Fed** believes are most important in setting **monetary policy**. The Fed has said they are data dependent, but in the last year they have been event dependent. The data has not caused them to move monetary policy, but rather events such as foreign economic conditions and Brexit votes have been the issues. From the minutes of the last **FOMC** meeting in July, it is clear the Fed will not move managed rates unless **inflation** data is higher. The comments the Chairwoman makes this week will provide insight into the Fed's outlook for inflation. We do not expect the Fed to move rates up until December of this year. They have not sent a signal that they believe inflation is sufficient to cause them to move. They are willing to be behind inflation because they remain concerned events in foreign markets could cause deflation pressures in those markets and it could spread to the U.S. They would rather be late than early in **normalizing monetary policy**.

The U.S. domestic economic data continues to reflect accelerating rates of growth. The **durable goods orders** due out this week is expected to reflect a rebound in **capex**. The rebound in manufacturing activity as reported with the growth in **industrial production** and the jump in **capacity utilization** reported last week should lead to higher capex in the third quarter than the weak second quarter data. The **housing sector** remains strong, as does **consumer final demand**. The **labor market** is tight and wages are beginning to accelerate. Job growth has been very strong in the last two months, putting even more pressure on wage rates. **Consumer confidence** is solid.

All of these factors point to a solid growth rate in the second half of the year. The Fed needs a more stable environment in foreign markets while inflation reaches their target of 2%. The risk is the Fed gets behind **the curve** with inflation moving up faster or sooner than currently expected. In that environment, the Fed would need to move rates up more and faster than the gradual increase they would like to achieve. Banks need higher rates and a steeper curve in order to grow top line revenues. The benefit of low rates in the form of cost of funding is now behind us, and the yields on earning assets is still coming down. Unless rates move higher and intermediate and long rates move up more than short rates, net interest income growth will be very difficult to achieve.

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