## ***Monthly Outlook for March, 2019: "Tupelo Honey…"***

*"You can take all the tea in China, Put it in a big brown bag for me, Sail right around all the seven oceans, Drop it straight into the deep blue sea. She's as sweet as Tupelo honey, She's an angel of the first degree, She's as sweet as Tupelo honey, Just like honey from the bee…"*
***(Van Morrison, Northern Irish Singer-Songwriter, October 1971).***

The above song from Van Morrison, whose plaintive singing in his early years, neatly links China, the seven seas and the economic angel we call growth as the theme of our outllook this month. Indeed, while Chinese GDP and other figures continue to disappoint all does not appear to be lost – we still think the globe is ***growing at a reasonable pace*** and as inflation remains quiescent and interest rates remain low, it is time to continue to ***"make hay while the sun shines".***

Economic data released for the month of February can be summed up in two words: ***strange and discombobulating***. The labor market added a ***paltry 20k jobs*** for the month, a huge miss, relative to the consensus estimates of around +180k. Granted, weather conditions were likely a driving factor – given the Polar Vortex that seemed to beseige much of the North American Continent during the month. Services jobs increased a net 52k while goods producing jobs lost a net -32k for the month. The ***unemployment rate*** decreased two-tenths to ***3.8%*** (from 4.0% in January).

***Among the sectors***, professional and business services (+42k) and education and health services (+4k) notched the biggest jump from the prior month, while construction (-31k) and mining and logging (-5k) were the laggards. The household survey remained fairly strong, with the labor force participation rate holding steady at 63.2%. The average weeks unemployed (21.7 weeks vs. 20.5 in January) as well as the median weeks unemployed (9.3 weeks vs. 8.9 weeks in January) retraced back to December levels after coming down slightly in January. In conjunction with a lower unemployement rate, the ***U-6 measure of underemployment*** decreased by an outsized eight-tenths of a percent to 7.3% in February (from January's reading of 8.1%).

***Average hours worked*** ticked down slightly to around 34.4 (from 34.5 the prior month) hours per week for all employees in the establishment survey, while average weekly earnings rose to $951.50 (from $950.48 the month prior). Further, ***average hourly earnings*** also rose slightly to $27.66 (from $27.55 in January). Currenlty, average hourly earnings are rising at ***3.4% (y/y)*** while average weekly earnings have increased 3.1% (also y/y) over that same time period.

Survey data including those released by the Institute of Supply Management on the manufacturing sector (with February's reading of 54.2 compared to January's 56.6) as well as the non-manufacturing or services sector (where the February reading was 59.7 compared to January's 56.7 enumeration) showed an economy that appears to be growing at a reasonable pace. The Federal Reserve's ***Beige Book*** contained language to suggest that prices in the economy were rising in most districts at a "modest-to-moderate" rate.

We believe that rising wages should be ***watched closely*** as it will likely be a significant factor in determining the path of future rate hikes by the Federal Reserve. A strong labor market will undoubtedly result in worries about inflation (although we suspect that currently there is much complacency about inflation) which may, in turn, force the Federal Open Market Committee (FOMC) of the Federal Reserve to further increase interest rates even though the market may be naively believing that the FOMC is "on hold" for all intents and purposes.

The EuroDollar Futures curve is pricing in a ***"mild easing"*** by the FOMC into next Spring (2020) – with rates staying at current levels until then. If there is one thing we know about the consensus on the EuroDollar Futures curve, it is this: While the curve currently represents what is built into prices at this juncture, the future does not always evolve like current expectations and more times than not, the conensus is often wrong.

The other problem with a "stand pat" FOMC assumption is that it does not take into account the possibility that the US economy might well ***accelrate*** into the Fall of this year – especially if 1Q GDP growth comes in at a ***below***

***consensus*** level (weather related though the disappointment might be). The Atlanta Federal Reseve's GDPNow forecast shows a GDP growth for 1Q2019 at a mere 0.4% (q/q, Seasonally Adjust Annual Rate).

Farther afield, ***the Brexit Saga continues***: The Conservative Government of Prime Minister Theresa May lost another landmark vote in Parliament last week by a sizable margin (bringing its tally to 0-2 for those of us keeping score at home) – where the MPs voted down her second "negotiated" arrangement for Brexit. While the ***complications attendant*** such a move as Brexit have always been ***nightmarish,*** given the issues involved (including not wanting a hard border between Ireland and Northern Ireland and the EU backdooring its way into British citizens' lives), it is still hard to fathom the level of incompetence that has been on display.

A ruling earlier today (Monday, March 18$^{th}$) by Speaker of the House of Commons John Bercow, prohibits Prime Minister Theresa May seeking another vote in Parliament for essentially the same "deal" as before. In other words, unless a new resolution on Brexit is subtantially different than the previous one, Parliament is unlikely to vote on it (this rule goes back to the early 17$^{th}$ century).

Here we are, mere days and weeks away from the ***March 29$^{th}$ deadline for Article 50***, and we are still not at all sure if Brexit will even happen – or not! The Pound Sterling for its part has been quite volatile – not sure how to react to the ebbs and flows of the ***Brexit saga.*** Rgeardless, the best that one can say about this whole situation is that the powers that be will likely find a way to ***"kick the can down the road"***. As one analyst blithely put it "we might still be talking about the timing of Brexit five years from now". Ouch!

Chinese data has been disappointing as well: The Chinese Government lowered its ***"growth target"*** for the next five years to ***6.0%*** (from the previous 6.5%) at its just concluded National People's Congress. While data released so far continues to paint a picture of an economy that is growing around 6.5%, the ***ground realities*** suggest something entirely different. An analysis of such data like railroad car loadings, cement production or electricity produced and consumed (which are all available with a substantial lag) implies a growth rate that is ***closer to 4.0%.***

Reports that the US and China have an "almost agreed to" ***trade deal*** (either from Tweets by President Trump or from other media reports) have also been viewed positively in the Middle Kingdom. Indeed, both the Shanghai and the Shenzen stock exchanges have moved up smartly, easily outpacing the broad US market on a year-to-date basis. Regardless, we continue to believe that the "devil will be in the details" of the deal, despite the leaders of both countries desperately wanting to ***conclude "a deal***".

We have often marveled at how the Chinese economic Mandarins (how is that for a metaphor?) are able to produce ***GDP data*** for their economy well before any other nation. Perhaps it is as a result of "cooking the books" or it is as a result of not wanting to stray too far from their published "targets". In essence, however, it is an economy that is currently being stimulated with lots of ***"priming the pump",*** with plenty more left in the tank for the Government to do if they felt the need to do so.

US interest rates are clearly not believing the ***low continued GDP growth story*** – as Treasury rates have posted declines in the past month or so. With the front end of the Treasury yield curve still inverted (as yields on the two-year Treasury are ***above*** those of the five-year Treasury – thus causing an ***"inversion"***) and the back end still quite flat (the difference between the yields on the ten-year and two-year Treasury are a mere 14bp), we worry that the yield curve might indeed be signaling something very different from the equity market.

Speaking of the equity market, we are happy to see it continue to grind higher as it appears to have recently taken out key resistance around 2814 on the S&P500. We do not see the equity market ***spiking higher*** (for lack of an immediate catalyst), but expect it to grind higher. As we have often said before "the direction that the market causes most pain is likely up in price, not down in price going forward".

Ask Van "the man" Morrison, as he sings about "all the tea in China" and "sailing the Seven seas".

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