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Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com

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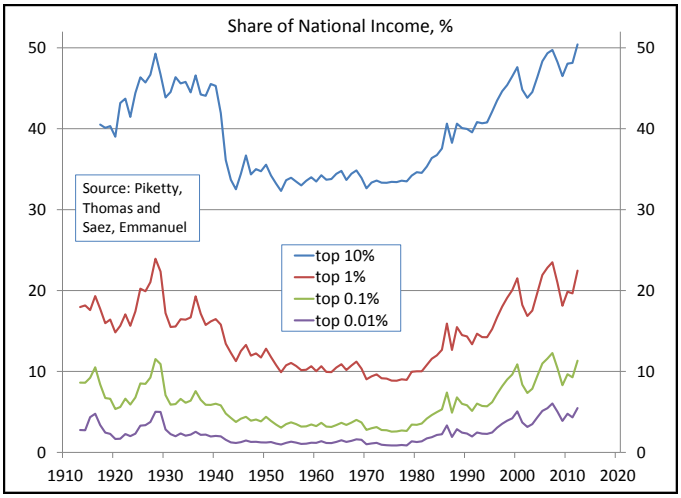
Weekly Market Monitor

An Uncomfortable Discussion

Income inequality is a touchy subject. It's hard to have a polite conversation, but like it or not, we *are* going to have a discussion this year. I will not take a position here (this is largely a political question). Rather, I will try to illustrate what the data say and to present the different points of view.

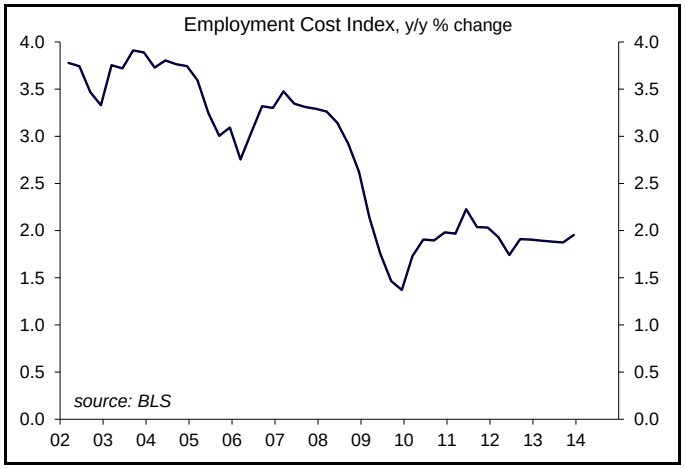
In the fall of 2013, Thomas Piketty, a French economist, published a book titled "Capital in the 20th Century." The English translation arrived in March. It's been suggested by those on the left that the book may be the most important economic book of the year, if not the decade (just as Marx's "Das Kapital" was in the 19th century). Piketty is not some lunatic radical. He is a well-respected scholar and has spent a considerable amount of time assembling an historical database of the distribution of income for several countries. The key point of the data is that there has been a sharp rise in income inequality over the last three decades and the distribution is increasingly more skewed the higher you go up the income scale. In the U.S., the top 10% of income earners account for 50% of national income. The top 1% account for 45% of the top 10%, the top 0.1% account for about half of the 1%, and the top 0.01% account for half of the 0.1%. Income inequality has risen in most advanced economies and is currently at or near record highs.



One of the key ideas in Piketty's book is that if the rate of return on capital, r, is greater than the growth rate of the economy, g, then capital ownership will become increasingly more concentrated. He suggests that this has been the case throughout history, with the exception of the last 100 years. Piketty notes that this is not a market failure – it is the fundamental nature of capitalism. This turns one long-standing view in economics on its head. Starting from the 1950s and 1960s, it had generally been believed that economic prosperity benefits everyone across the income scale.

The question is whether rising income inequality is bad for economic growth overall, and if so, what can be done about it. Research by the IMF suggests that countries with higher income inequality tend to have slower economic growth. Piketty proposes that rising income inequality can be addressed through higher tax rates, not just in the U.S., but worldwide (otherwise investors would simply move to countries with lower taxes). This is where conservatives are going to draw the line. The right has long argued that low taxes encourage business investment. Raising taxes would reduce incentives. The left argues that tax rates have been a lot higher than they are now and the economy prospered just fine. Regardless, given the current composition of Congress, it would be extremely difficult to raise taxes and it would be virtually impossible to do so on a coordinated basis across countries.

It's worth noting that the recession has added to income inequality. As Fed Chair Yellen has indicated, the lower trend in labor compensation suggests that there is a large amount of slack in the labor market. A tighter labor market would lead to faster growth in wages, which would help support faster growth in spending, and stronger growth would then lead to more jobs, etc. However, we still seem to be far from that point.



In the U.S., there is currently an active debate about whether to raise the federal minimum wage. While a higher minimum wage will have an impact on labor-intensive firms (restaurants, for example), it's unlikely to have a significant effect on overall employment. Many states have minimum wages that are higher than the federal and studies show that there is relatively little impact on employment when the minimum wage rises. On the other hand, those on the left who argue that raising the minimum wage will reduce poverty will be disappointed – the research suggests that a higher minimum wage has little impact.

This week, Thomas Piketty will be in Washington and the income inequality discussion is expected to pick up.

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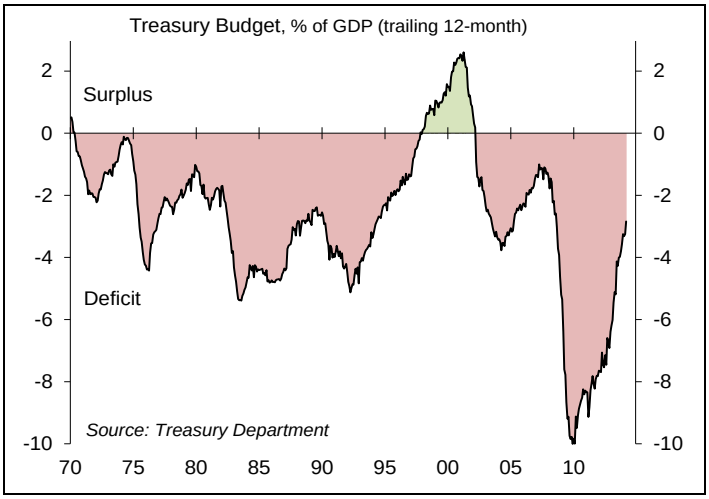
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
3/14/14	0.05	0.08	0.12	0.36	0.74	1.55	2.65	3.59	1.392	1.663	101.46	1.109	4245.40	1841.13	16065.67
4/04/14	0.03	0.05	0.11	0.43	0.89	1.71	2.74	3.59	1.370	1.659	103.39	1.098	4127.73	1865.09	16412.71
4/11/14	0.04	0.05	0.09	0.36	0.80	1.57	2.62	3.48	1.388	1.674	101.62	1.098	3999.73	1815.69	16026.75

Recent Economic Data and Outlook

The stock market rallied on expectations of an accommodative Fed, but technology shares led a broad-based decline later in the week. Bond yields fell as share prices tumbled.



The **FOMC Minutes** from the March 18-19 policy meeting noted that "while there was general agreement that slack remains in the labor market, participants expressed a range of views regarding the amount of slack and how well the unemployment rate performs as a summary indicator of labor market conditions." In the commentary on the Fed's projections, it was noted that "most participants expected that highly accommodative monetary policy would remain warranted over the next few years to foster progress toward the Federal Reserve's longer-run objectives" (Yellen expressed a similar sentiment in her March 19 press conference).

In an update to its **World Economic Outlook**, the IMF slightly reduced its forecasts for global economic growth this year and next (+3.6% in 2014 and +3.9% in 2015). Growth forecasts for the advanced economies were little changed from January projections, but the outlook for emerging economies was less robust (especially for Russia and Brazil). The IMF expects 2.7% GDP growth for the U.S. in 2014 and 3.0% growth in 2015. The report noted that *"although downside risks have diminished overall, lower-than-expected inflation poses risks for advanced economies, there is increased financial volatility in emerging market economies, and increases in the cost of capital will likely dampen investment and weigh on growth."*

The **Producer Price Index** rose 0.5% in March (+1.4% y/y), reflecting a 0.7% rise in services (vs. -0.5% in February, up 1.6% from a year earlier). The price index for goods was unchanged (+1.1% y/y), up 0.1% ex-food & energy (+1.2% y/y). The price indices for the earlier stages of production continued to reflect an absence of significant pipeline pressures.

Import Prices rose 0.6% in March, following a 0.9% raise in February (-0.6% y/y). Ex-food & fuels, import prices rose 0.2%, following a 0.1% decline in February (-1.2% y/y).

Treasury reported a $36.9 billion **Budget Deficit** in March, vs. $203.5 billion in March 2013 (March 1 fell on a weekend this year, shifting some spending into February). For the first six months of the fiscal year, revenues were up 10.4% y/y (partly reflecting higher payroll taxes), while outlays fell 3.5%. Over the last 12 months, the deficit has totaled about 2.9% of GDP.

The **Job Opening and Labor Turnover Survey** continued to suggest that labor market conditions are far from normal. The hiring rate held steady at 3.3% (it was 3.4% in February 2013). The quit rate was unchanged at 1.7% (same as a year earlier).

The **Index of Small Business Optimism** rose to 93.4 in March, vs. 91.4 in January, still relatively low by historical standards. Details were mixed. The earnings trend weakened, but sales expectations picked up. The general business outlook remained pessimistic. Hiring plans moderated. Capital spending plans remained moderate (relative to historical norms).

Economic Outlook (2Q14): 2.5%-3.0% GDP growth, following 1.0%-1.5% in 1Q14.

Employment: The pace of job growth has remained moderately strong despite an impact from adverse weather. Job destruction remains relatively limited. New hiring should pick up in the spring and early summer.

Consumers: Spending growth appears to have been dampened by poor weather. Wealth has increased, supporting spending. Average wage gains are barely keeping up with inflation.

Manufacturing: Recent data on new orders, production, and employment, while uneven, suggest moderate improvement in the factory sector. However, an inventory correction and global growth will be important concerns in the near term.

Housing/Construction: Higher mortgage rates and rising home prices have reduced housing affordability. Poor weather hasn't helped. Homebuilding activity is expected to improve, but supply constraints are likely to remain an issue.

Prices: The PCE Price Index, the Fed's chief inflation gauge, is trending well below the 2% goal, which will be a problem if that continues. Pipeline pressures have been modest. Wage gains are mild. Inflation expectations remain well-anchored.

Interest Rates: The tapering of asset purchases is "not on a preset course," but Fed officials anticipate further reductions "at a measured pace" (-$10 billion per FOMC meeting) – and it would take a significant change in the economic outlook for the Fed to deviate from the path. If the economy evolves as the Fed anticipates, short-term interest rates are likely to be raised by the middle of 2015. Long-term interest rates should trend gradually higher, with some volatility along the way.

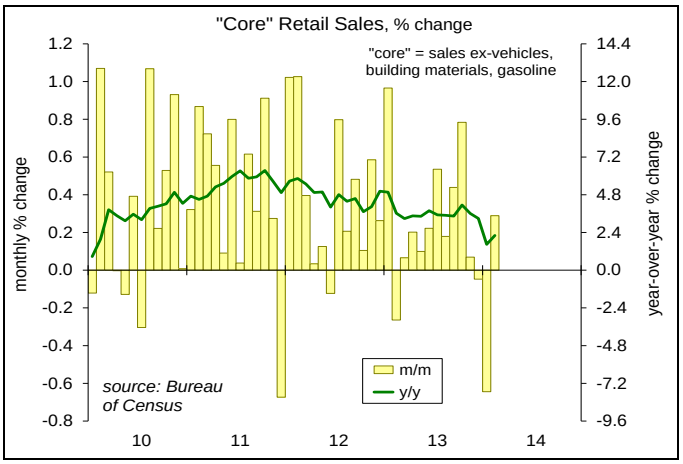
This Week:					*forecast*	last	last –1	comments
Monday	4/14	8:30	**Retail Sales**	Mar	***+1.0%***	+0.3%	-0.6%	unit auto sales jumped
			ex-autos		***+0.5%***	+0.3%	-0.3%	some rebound from weather effects
			ex-autos, bld mat, gasoline		***+0.6%***	+0.3%	-0.6%	better, but a lackluster quarter
		10:00	Business Inventories	Feb	***+0.6%***	+0.4%	+0.5%	trending lower than in 4Q13
Tuesday	4/15	8:30	**Consumer Price Index**	Mar	***+0.1%***	+0.1%	+0.1%	seasonal factors to trim gasoline
			year-over-year		***+1.4%***	+1.1%	+1.6%	a low trend
			ex-food & energy		***+0.1%***	+0.1%	+0.1%	mild core inflation
			year-over-year		***+1.6%***	+1.6%	+1.6%	still low
		8:30	Real Weekly Earnings	Mar	***+0.4%***	0.0%	+0.1%	nominal earnings rose 0.5%
		8:30	Empire St. Manf. Index	Apr	***8.2***	5.6	4.5	moderately strong
		8:45	Yellen Speaks					opening remarks at Atlanta Fed conf.
		10:00	Homebuilder Sentiment	Apr	***50***	47	46	likely to pick up
Wednesday	4/16	8:30	**Building Permits**, th.	Mar	***995***	1014	945	volatility in multi-family
			% change		***-1.9***	+7.3	-4.6	a rebound from weather otherwise
			Housing Starts		***955***	907	909	a bounce back from poor weather
			% change		***+5.3***	-0.2	-11.2	but watch for revisions
		9:15	**Industrial Production**	Mar	***+0.5%***	+0.6%	-0.2%	not as unseasonably cold
			Manufacturing Output		***+0.8%***	+0.8%	-0.8%	aggregate manufacturing hours rose 0.7%
			Capacity Utilization		***79.1%***	78.8%	78.5%	still no threat to the inflation outlook
		10:00	BOC Policy Decision					no change
		12:25	**Yellen Speaks**					*"Monetary Policy and the Econ. Recovery"*
		2:00	**Fed Beige Book**					should see improvement
Thursday	4/17	8:30	Jobless Claims, th.	4/12	***320***	300	322	watch for revisions
		10:00	Philadelphia Fed Index	Apr	***8.5***	9.0	-6.3	moderate
		1:00	TIPS Auction					5-year TIPS
		2:00	Early Bond Mkt Close					recommended by SIFMA
Friday	4/18		**Good Friday Holiday**					markets closed
Next Week:								
Monday	4/21	10:00	Leading Econ Indicators	Mar	***+0.8***	+0.5	+0.1	most components were positive
Tuesday	4/22	10:00	**Existing Home Sales, mln**	Mar	***4.70***	4.60	4.62	should pick up
			ex-food & energy		***+2.2***	-0.4	-5.1	but may reflect February weather
		1:00	Treasury Note Auction					2-year notes
Wednesday	4/23	9:45	Markit US Manf PMI (flash)	Apr				
		10:00	**New Home Sales, th.**	Mar	***455***	440	455	likely to rebound
			% change		***+3.4***	-3.3	+3.2	but watch for revisions
		1:00	Treasury Note Auction					5-year notes
Thursday	4/24	8:30	Jobless Claims, th.	4/19	***320***	***320***	300	a low trend
		8:30	**Durable Goods Orders**	Mar	***+1.8***	+2.2	-1.4	Boeing reported higher aircraft orders
			ex-transportation		***+0.3***	+0.1	+0.9	mixed, but moderate otherwise
			nondef cap gds ex-aircraft		***+0.8***	-1.4	+0.8	choppy
		1:00	Treasury Note Auction					7-year notes
Friday	4/25	9:55	Consumer Sentiment	Apr	**83.0**	80.0	81.3	82.6 at mid-month

This Week…

The mid-month economic data arrive. The focus for the markets may be the retail sales report, which should reflect a rebound from bad weather (but may not help us to gauge underlying strength). Fed Chair Yellen speaks twice. Her speech on Wednesday has some potential to move the markets, especially as there is a tendency to take something out of context. The Fed's Beige Book is usually ignored by the markets, but it could shed some light on the underlying strength of the economy (beyond weather effects). Friday is a holiday.

Monday

Retail Sales (March) – Unit auto sales snapped back sharply last month from adverse weather in January and February. Ex-autos, we should see a general pickup in sales. Note that figures are adjusted for the late Easter, but it's hard to get it right.



Business Inventories (February) – A slower pace than in 4Q13 (which is a subtraction from GDP growth).

Tuesday

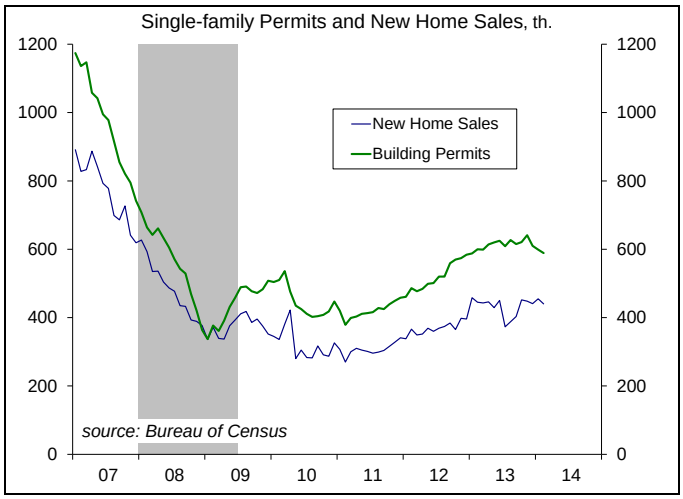
Consumer Price Index (March) – Gasoline prices rose last month, but not as much as they usually do in March (hence, a decline in the seasonally adjusted data). Core inflation is expected to remain mild. The low trend in inflation is a concern for a number of Fed officials and (if it continues) could push out the expected timing of the first increase in short-term interest rates.

Real Weekly Earnings (March) – Nominal weekly earnings rose 0.5% in March (+2.1% y/y), reflecting a rebound in hours (average hourly earnings were flat in March, but up 2.1% y/y).

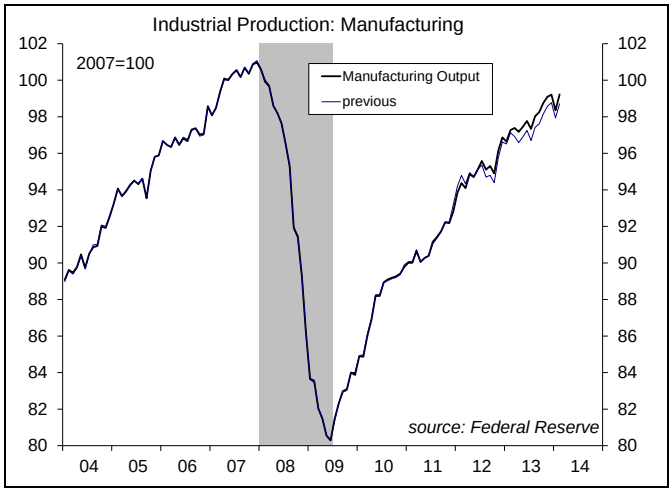
Homebuilder Sentiment (April) – Weather had a clear negative impact on builder sentiment in the first quarter. We should see a rebound as the weather improves in April. However, there are still concerns about affordability and supply constraints.

Wednesday

Building Permits, Housing Starts (March) – We should see a rebound from adverse weather. Note that, even with the weather effect, the headline figures have been dominated by the usual volatility in the multi-family sector.



Industrial Production (March) – The Fed released benchmark revisions in late March, but the picture changed little. In March, we should see a drop in the output of utilities (which was boosted by cold temperatures in January and February). Manufacturing output should rebound from adverse weather.

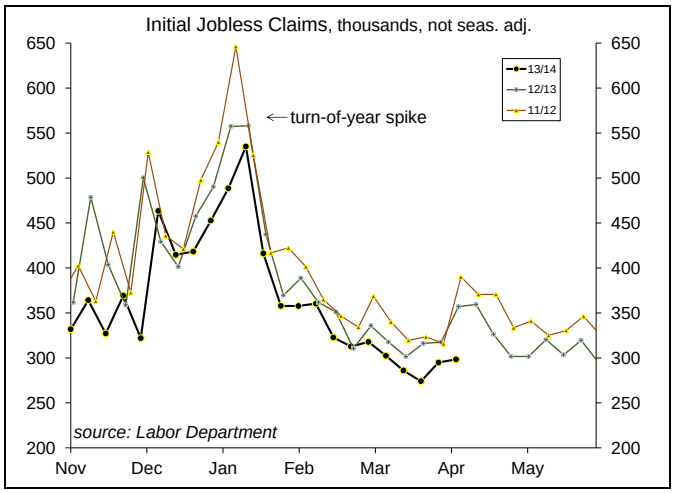


Janet Yellen Speech (*"Monetary Policy and the Economic Recovery"*) – Speaking before the Economic Club of New York, the Fed chair is expected to repeat recent themes (there's still a very large amount of slack in the labor market, the Fed's not going to be in any hurry to raise short-term interest rates and will raise rates only gradually once it starts).

Fed Beige Book – Weather has distorted most of the hard economic data reports. The anecdotal information in the Beige Book may help us to gauge the economy's underlying strength.

Thursday

Jobless Claims (week ending April 12) – Unadjusted claims did not exhibit the usual start-of-the-quarter spike. That's a bit unusual. We may see a revision or the late Easter could be having some impact. The claims data are adjusted for floating holidays, but it's hard to get it right. Still, the underlying trend has remained consistent with other data reports (such as corporate layoff announcements) showing a limited pace of job destruction.



Philadelphia Fed Index (April) – The headline index should hold at a moderate level, but note that these figures are choppy even when weather isn't a factor.

Friday

Good Friday Holiday – Markets closed.

Next Week …

Home sales and durable goods orders.

Coming Events and Data Releases

April 29	Consumer Confidence (April)
April 30	Real GDP (1Q14, advance estimate) FOMC Policy Decision (no press conference)
May 1	ISM Manufacturing Index (April)
May 2	Employment Report (April)
June 7	Employment Report (May)
June 18	FOMC Policy Decision, Yellen press conference
July 30	FOMC Policy Decision (no press conference)
September 17	FOMC Policy Decision, Yellen press conference