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

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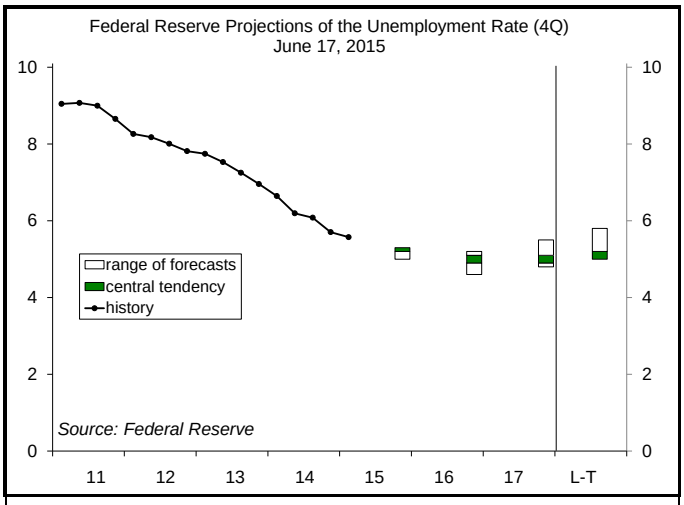
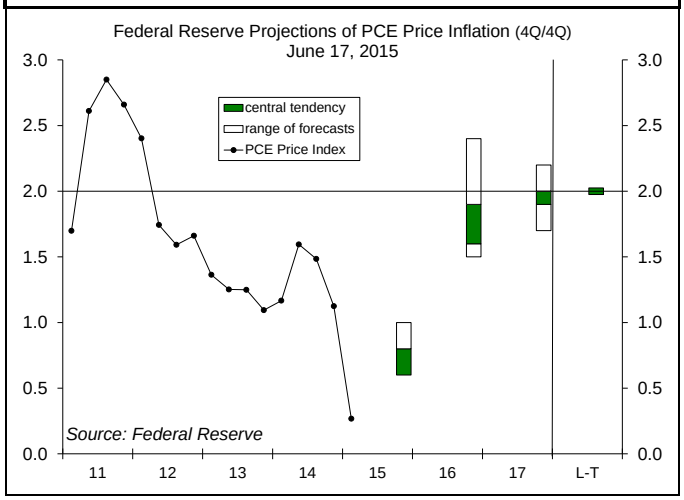
Weekly Market Monitor

Clarifying the Fed Policy Outlook

There was nothing unexpected in the Fed's monetary policy statement or in the revised economic projections of senior officials. Chair Yellen covered no new ground in her press conference. However, many investors appear to be unsure of the monetary policy outlook and the implications for the financial markets. So, to clear things up...

The Fed's decision to begin raising short-term interest rates and the pace of tightening beyond that first move will be data-dependent. The focus is on the job market and the inflation outlook. Job market conditions have improved significantly. Monthly growth in nonfarm payrolls has slowed somewhat (a 210,000 average over the last three months, vs. 280,000 in the second half of last year), but is still well above the pace consistent with trend labor force growth. Over the long term, this pace of job growth is unsustainable (as we'd eventually run out of people), but it is clearly welcome over the intermediate period, as excess slack generated from the recession is taken up.

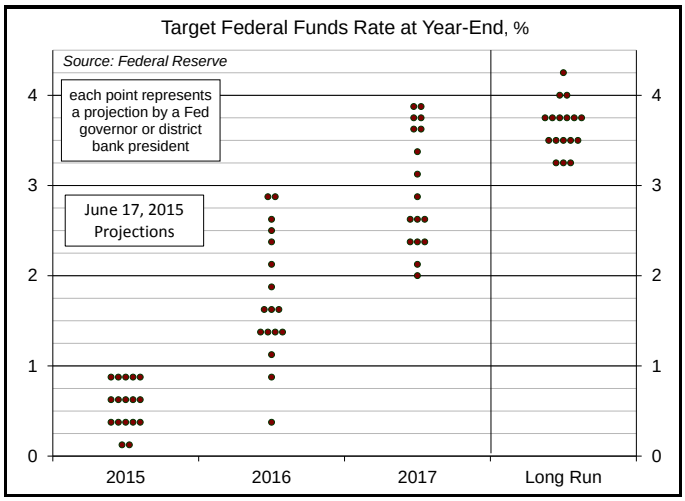




The Fed expects the unemployment rate to edge lower and then stabilize at around 5% over the next two years. Implicit in this forecast is an expectation of a long-awaited rebound in labor force participation. To gauge the amount of slack in the job market, the Fed will continue to examine a wide range of labor market indicators, including participation rates, part-timers wanting full-time employment, quit rates, and wages.

The Fed sees the recent modest trend in inflation as reflecting the transitory impact of low energy prices and a strong dollar. According to Yellen, *"inflation is likely to run at a low level for a substantial period of time."* However, oil prices and the dollar have stabilized in the last few months. As transitory impacts fade, inflation should move up. Continued economic growth should eventually put some upward pressure on inflation. Year-over-year growth in wages has ticked higher recently, but as Yellen noted, these signs are *"tentative"* and *"not yet definitive."*

As expected, the dots in the dot plot generally moved lower (relative to the mid-March projections). All but two of the 17 senior Fed officials expect an initial rate hike this year. The difference in the dots largely reflects the difference in economic expectations among the various Fed officials. Some are more optimistic than others. However, there is a lot of uncertainty around each dot and the policy views of each Fed official will evolve according to the incoming economic data.



In her press conference, Yellen emphasized that, for the financial markets, the timing of the initial Fed hike should be less important than the pace of tightening beyond that first move. That trajectory is expected to be very gradual, but it could move higher, if economic growth is stronger and inflation moves higher than expected, or lower and less steep, if conditions were to prove weaker. The Fed will not commit to a mechanical rule on the pace of tightening. However, Fed projections are consistent with about 25 basis points per quarter.

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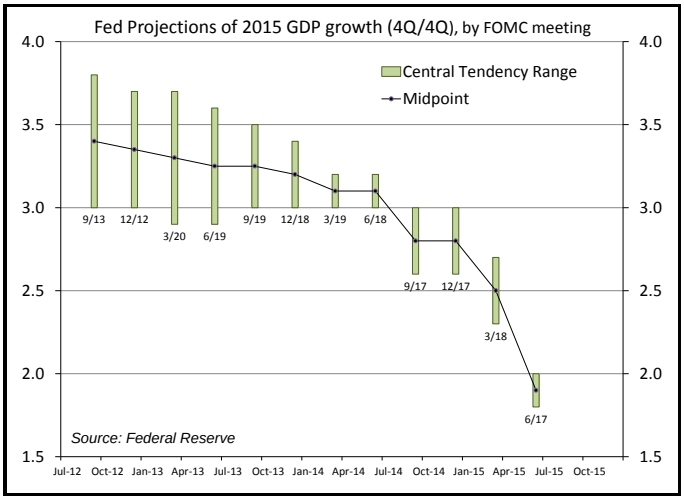
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
5/22/15	0.02	0.08	0.23	0.64	1.01	1.57	2.21	2.99	1.103	1.548	121.45	1.229	5089.36	2126.06	18232.02
6/12/15	0.02	0.10	0.28	0.74	1.12	1.75	2.39	3.10	1.128	1.559	123.23	1.231	5051.10	2094.11	17898.84
6/19/15	0.01	0.05	0.22	0.62	0.99	1.57	2.26	3.05	1.134	1.587	122.74	1.226	5117.00	2109.58	18013.55

Recent Economic Data and Outlook

There were no surprises in the Fed policy statement and Janet Yellen covered no new ground in her press conference, but financial market participants seemed relieved that the meeting was out of the way. However, Greece remained an ongoing concern, as debt negotiations with the IMF broke down.



In its monetary policy statement. the **Federal Open Market Committee** recognized that *"economic activity has been expanding moderately after having changed little during the first quarter."* Labor market slack has *"diminished somewhat."* Growth in consumer spending has been *"moderate,"* while the housing sector *"has shown some improvement."*

The Fed's revised **Summary of Economic Projections:**

	2015	2016	2017	long run
Real GDP (4Q/4Q)	**1.8-2.0%**	**2.4-2.7%**	**2.1-2.5%**	**2.0-2.3%**
Mar Projections	*2.3-2.7%*	*2.3-2.6%*	*2.0-2.4%*	*2.0-2.3%*
Unemp. Rate (4Q)	**5.0-5.3%**	**4.9-5.1%**	**4.9-5.1%**	**5.0-5.2%**
Mar Projections	*5.0-5.2%*	*4.9-5.1%*	*4.8-5.1%*	*5.0-5.2%*
PCE Price Inf.	**0.6-0.8%**	**1.6-1.9%**	**1.9-2.0%**	**2.0%**
Mar Projections	*0.6-0.8%*	*1.7-2.0%*	*1.9-2.0%*	*2.0%*
Core PCE Infl.	**1.3-1.4%**	**1.6-1.9%**	**1.9-2.0%**	
Mar Projections	*1.3-1.4%*	*1.5-1.9%*	*1.8-2.0%*	

In her post-FOMC press conference, **Fed Chair Yellen** repeated that policymakers believe that *"the first increase in the federal funds rate will be appropriate when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term."* However, she emphasized that *"the initial increase should not be overstated: The stance of monetary policy will likely remain highly accommodative for quite some time after the initial increase in the federal funds rate,"* adding that *"although policy will be data dependent, economic conditions are currently anticipated to evolve in a manner that will warrant only gradual increases in the target federal funds rate."*

The **Consumer Price Index** rose 0.4% in May (-0.0% y/y), partly reflecting a 10.4% jump in gasoline prices (-25.0% y/y). Food was flat (+1.6%), despite concerns about California's drought and bird flu (which sharply boosted the wholesale price of eggs). Ex-food & energy, the CPI rose 0.1% (+1.7% y/y, but a 2.3% annual rate over the first five months of 2015). Ex-food & energy, prices of consumer goods fell 0.1% in May (-0.3% y/y), while services rose 0.2% (+2.4% y/y).

Real Hourly Earnings fell 0.1% in May, down 0.2% since January (but up 2.2% from a year ago).

Industrial Production fell 0.2% in May (+1.4% y/y). Oil and gas drilling fell 7.9% (down 53.3% since September). Manufacturing output fell 0.2% (+2.1%). Auto production rose 1.7% (+7.6% y/y). Ex-autos, factory output fell 0.3% (+1.4% y/y, but -0.8% since December). Results were mixed across industries.

Building Permits jumped 11.8% in May, to 1.275 million seasonally adjusted annual rate (+25.4% y/y). Single-family permits rose 2.6% (+9.1%). Multi-family permits surged 24.9% (+51.4% y/y), as builders rushed to get ahead of an expiring tax break. **Housing Starts** plunged 11.1% to a 1.036 million pace +5.1% y/y), reflecting the usual statistical noise (the reported 11.1% decline was not statistically different from 0%).

Homebuilder Sentiment jumped to 59 in June, vs. 54 in May.

The Index of **Leading Economic Indicators** rose 0.7% in May, with half of the increase coming from the jump in building permits (which is likely to reverse in June).

Economic Outlook (2Q15): Around a 2.0% to 2.5% annual rate.

Employment: The pace of job growth appears to be relatively strong. Except for energy exploration, job losses are very limited. New hiring appears to have remained strong for small and medium-sized firms, but has slowed for larger firms.

Consumers: The drop in gasoline prices from last summer has boosted consumer purchasing power, but the pickup in spending has been moderate and less than anticipated.

Manufacturing: The strong dollar has been a constraint, but likely a transitory one (assuming the dollar stabilizes). A decline in corporate profits has contributed to a softening trend in capital spending. Domestic demand should be picking up.

Housing/Construction: Sales appeared mixed at the start of the spring selling season. Rising prices and relatively tight credit appear to be constraining the lower end of the market.

Prices: The PCE Price Index is about flat year-over-year – and the core inflation rate has moved lower in recent months. Pipeline pressures are mild. Wage pressures are limited. Inflation expectations remain well-anchored.

Interest Rates: Senior Fed officials believe that conditions are likely to warrant an initial increase in short-term rates this year, but the more important question is the pace of tightening after the initial hike (which is likely to be very gradual).

This Week:					*forecast*	last	last –1	comments
Monday	6/22	8:30	Chicago Fed Nat Act Index	May	***NF***	-0.15	-0.36	expected to turn positive
			three-month average		***NF***	-0.23	-0.27	recent growth below the long-term trend
		10:00	**Existing Home Sales, mln**	May	***5.16***	5.04	5.21	seen rebounding from dip in April
			% change		***+2.4***	-3.3	+6.5	still some supply constraints
Tuesday	6/23	8:30	**Durable Goods Orders**	May	***-0.5%***	-1.0%	+5.1%	lower aircraft orders
			ex-transportation		***+0.8%***	-0.2%	+0.6%	seen higher
			core capital goods		***+0.6%***	-0.3%	+1.6%	uneven in recent months, likely to pick up
		9:45	Markit US Manf PMI (flash)	Jun	***NF***	54.0	54.1	moderate
		10:00	**New Home Sales, th.**	May	***520***	517	484	likely to remain strong
			% change		***+0.6***	+6.8	-10.0	but these figures tend to be erratic
		1:00	Treasury Note Auction					$26 billion in 2-year notes
Wednesday	6/24	8:30	**Real GDP (3rd estimate)**	1Q15	***-0.1%***	+2.2%	+5.0	-0.7% in the advance estimate
		11:30	FRN Auction					$13 billion in re-opened 2-year FRNs
		1:00	Treasury Note Auction					$35 billion in 5-year notes
Thursday	6/25	8:30	Jobless Claims, th.	6/20	***278***	267	279	subject to some seasonal noise
		8:30	Personal Income	May	***+0.4%***	+0.4%	0.0%	healthy wage growth
			Personal Spending		***+0.5%***	0.0%	+0.5%	seen higher (with ↑ revisions to Mar/Apr)
			PCE Price Index ex-f&e		***+0.1%***	+0.1%	+0.1%	mild core inflation
		1:00	Treasury Note Auction					$29 billion in 7-year notes
Friday	6/26	10:00	UM Consumer Sentiment	Jun	***95.2***	90.7	95.9	94.6 at mid-month
Next Week:								
Monday	6/29	10:00	Pending Home Sales	May	***+1.4%***	+3.4%	+1.2%	trend is higher
Tuesday	6/30	9:00	Case-Shiller Home Price (20)	Apr	***+0.8%***	+1.0%	+1.2%	a stronger trend in recent months
			year-over-year		***+5.5%***	+5.0%	+5.0%	y/y increase picking up
		9:45	Chicago PM Index	Jun	***50.8***	46.2	52.3	unexpectedly weak in May
		10:00	**Consumer Confidence**	Jun	***98.2***	95.4	94.3	likely to improve
Wednesday	7/01	8:15	ADP Payroll Estimate, th.	Jun	***+195***	+201	+165	moderately strong (watch for revisions)
		9:45	Markit US Manf PMI (final)	Jun	***NF***	54.0	54.1	not market-moving
		10:00	**ISM Manf. Index**	Jun	***53.0***	52.8	51.5	moderate, mixed across industries
		10:00	Construction Spending	May	***-1.2%***	+2.2%	+0.5%	choppy components, watch for revisions
		tbd	**Motor Vehicle Sales, mln**	Jun	***17.1***	17.7	16.5	moderating (still strong)
			domestically built		***13.3***	13.9	12.9	trend may be slowing
Thursday	7/02	8:30	Jobless Claims, th.	6/27	***276***	***278***	267	a low trend
		8:30	**Nonfarm Payrolls, th.**	Jun	***+210***	+280	+221	still strong (but watch for revisions)
			private-sector		***+215***	+262	+206	a strong trend
			Unemployment Rate		***5.4%***	5.5%	5.4%	likely lower
			employment/population		***59.5%***	59.4%	59.3%	trending gradually higher
			Avg. Weekly Hours		***34.5***	34.5	34.5	seen steady
			Avg. Hourly Earnings		***+0.2%***	+0.3%	+0.1%	modest wage pressures
		10:00	Factory Orders		***NF***	-0.4%	+2.2%	mixed
Friday	7/03		Ind. Day Holiday (observed)					markets closed

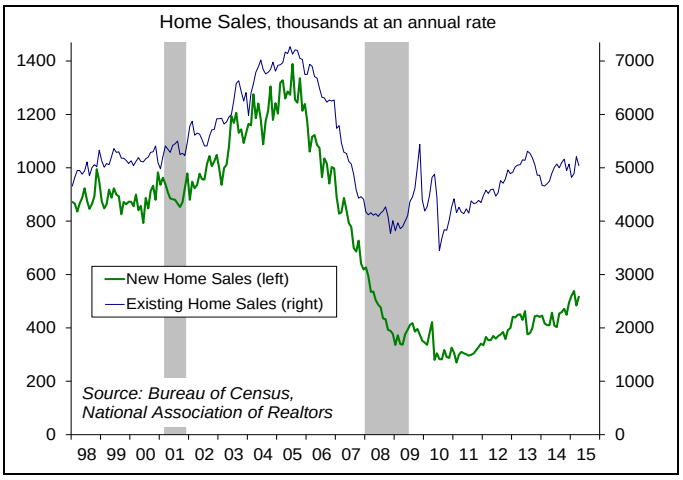
This Week…

The figures on new home sales and durable goods orders (Tuesday) are volatile and have some potential to surprise. The second revision to the estimate of first quarter GDP growth (Wednesday) is expected to show a smaller decline (in general, people put way too much weight on the headline GDP figure). Personal income and spending data (Wednesday) are usually ignored by the markets, but they should provide clearer picture of the consumer (and overall GDP) in 2Q15.

Monday

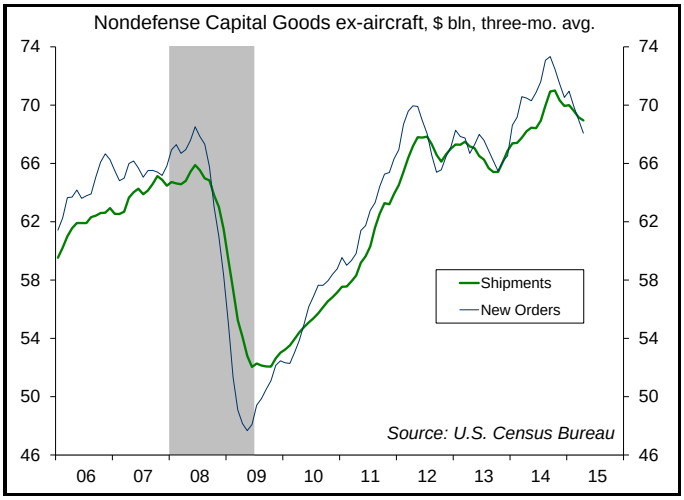
Chicago Fed National Activity Index (May) – The CFNAI is a composite of 85 economic indicators. Recent figures have been consistent with growth below the long-term trend. The index should turn positive in May, consistent with a pickup in growth.

Existing Home Sales (May) – The pace of sales has been limited somewhat in recent months due to a lack of supply and relatively tight credit at the lower end of the scale. However, we're likely to see some improvement in May.



Tuesday

Durable Goods Orders (May) – Orders of capital goods have declined over the last several months, likely reflecting the impact of a stronger dollar. With the dollar retreating more recently, orders are likely to be firming up, but results are likely to remain mixed across industries.



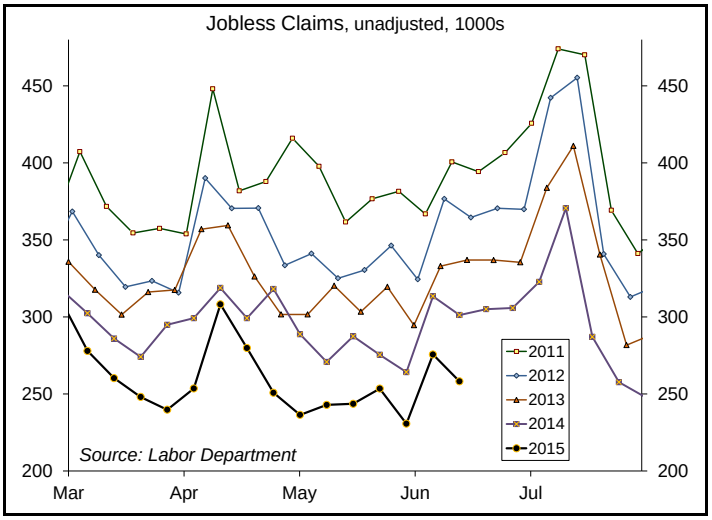
New Home Sales (May) – These figures are reported with a large amount of statistical uncertainty, but the underlying trend should be improving.

Wednesday

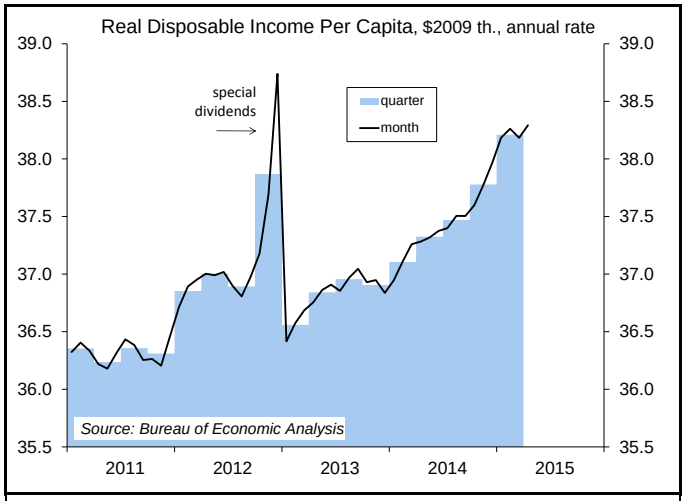
Real GDP (1Q15, 3rd estimate) – Recent data reports (retail sales, quarterly services) suggest that the estimate of first quarter growth will be revised to show a much smaller decline (or perhaps a slight increase). Market participants typically put far too much weight on the headline figure, which can be whipped around by odd factors (such as the first quarter's large drag from net exports). The more stable growth estimate (Gross Domestic Income, Domestic Final Sales) were positive.

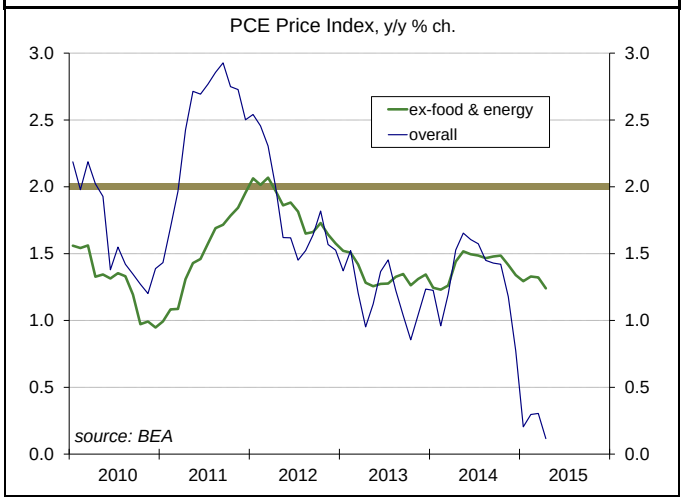
Thursday

Jobless Claims (week ending June 20) – The end of the school year normally leads to a pickup in unadjusted claims in June. However, figures are trending well below where they were a year ago (consistent with a strengthening job market).



Personal Income and Spending (May) – The jobs report showed good wage growth. Auto sales and retail sales improved. Core inflation is expected to remain low.





Friday

UM Consumer Sentiment (May) – The headline figure popped higher in the mid-month assessment. We may see some further improvement in the full-month reading.

Next Week …

Given the Fed's emphasis on the labor market, attention will turn to the June payroll figures, which arrive the day before the holiday (watch for possible revisions to April and May).

Coming Events and Data Releases

July 8	FOMC Minutes (June 16-17)
July 14	Retail Sales (June)
mid-July (tbd)	Yellen Monetary Policy Testimony
July 29	FOMC Policy Decision (no press conference)
July 30	Real GDP (2Q15 advance, benchmark revisions)
September 17	FOMC Policy Decision, Yellen press conference
October 28	FOMC Policy Decision (no press conference)
December 16	FOMC Policy Decision, Yellen press conference