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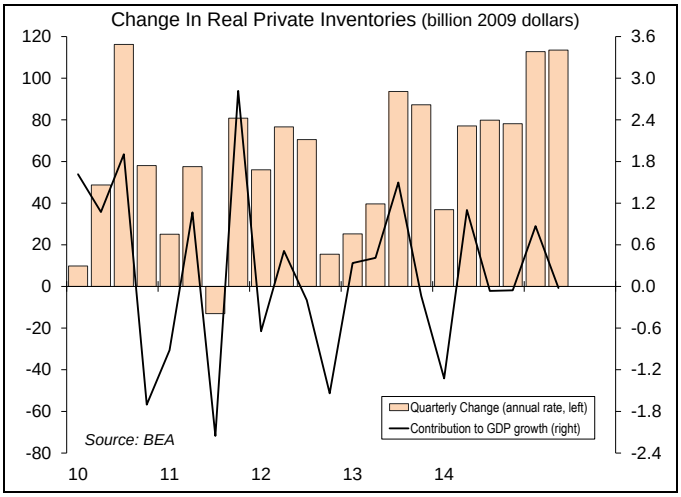
Weekly Market Monitor **Revised**

Gross Domestic Product

The Bureau of Economic Analysis will report its initial estimate of third quarter growth on Thursday. There's always plenty of uncertainty in the advance estimate. The BEA does not have a complete picture and will have to make some assumptions about foreign trade and inventories in September. These figures will be revised, perhaps a lot, which is why it is more important to focus on the story behind the numbers.

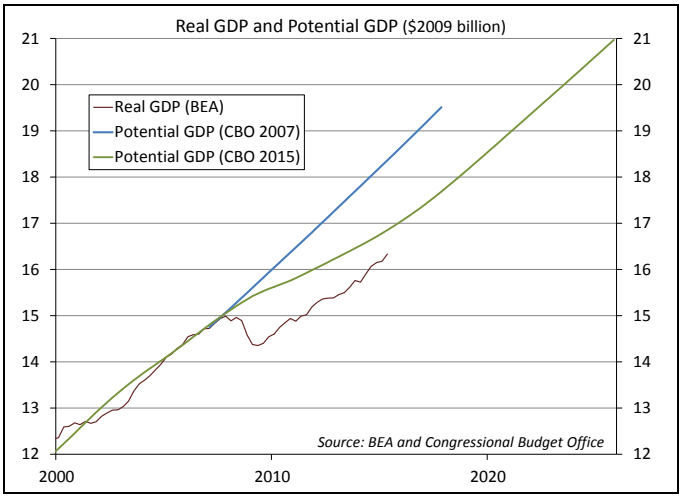
Real GDP, according to the BEA, is "the value of the goods and services produced by the nation's economy less the value of the goods and services used up in production, adjusted for price changes." Consumer spending accounts for 68% of GDP. Business fixed investment makes up about 13%; government consumption and investment about 18%. Exports account for 13%, but you have to subtract imports, which are about 15%. Inventories are perhaps the most confusing component. GDP is a flow ($/time), while inventories are a stock ($). The *change* in inventories ($/time) contributes to the *level* of GDP. The *change in the change* in inventories contributes to GDP *growth*. In other words, faster inventory growth adds to GDP growth, while slower inventory growth subtracts. This can get quite noisy from quarter to quarter, so one should focus on Final Sales (GDP less the change in inventories) or better yet, Final Sales to Private Domestic Purchasers (GDP less the change in inventories, net exports, and government).



Consumer spending growth appears to have been strong in 3Q15. The contraction in energy exploration should be less of a drag on business fixed investment. Inventory growth was very strong in the first two quarters of the year, but is widely expected to slow in 3Q15 (and perhaps a bit more in 4Q15). It's hard to say by how much. We don't have a complete picture for the quarter and figures have to be adjusted for price changes. Hence, there is a lot of uncertainty in the headline GDP figure.

While GDP is a quarterly figure, there is a GDP estimate near the end of every month. First comes the advance estimate (based on incomplete information), then the 2nd estimate (formerly called the "preliminary" estimate), then the 3rd (formerly called the "final" estimate) – each revision representing a more complete picture. Once a year, in late July, the figures undergo annual benchmark revisions, based on revised source data (and sometimes include methodology changes, such as when intellectual property products were added to business fixed investment in 2013). One should not get too wedded to any particular GDP estimate. The numbers will change. The story behind the numbers, the strengths and weaknesses of individual sectors typically doesn't change a lot (but we've seen some large revisions in recent quarters).

We like to say that this was not your father's recession we went through in 2008-2009. Rather, it was your grandfather's depression. In the Great Depression, policymakers – especially the Federal Reserve – made all the wrong moves. This time, they got things mostly right. The one clear mistake was a premature move to austerity, which slowed the recovery. That's not to say that austerity is never justified. Rather, to raise taxes or cut spending in a struggling economic recovery, when interest rates are low and the central bank has little leeway to offset contractionary fiscal policy, is the definition of "foolish."



GDP is now a lot closer to its potential, but that's largely because the path of potential GDP has fallen (reflecting a lower pace of capital investment). We're still 11% below the pre-recession trajectory, with no expectation that we will get back to that previous path. Moreover, slower population growth and a slowdown in productivity growth may keep us on a much slower growth path in the years ahead – adding to fears of secular stagnation. The Fed can attempt to prevent this by keeping the pedal to the metal for a longer period.

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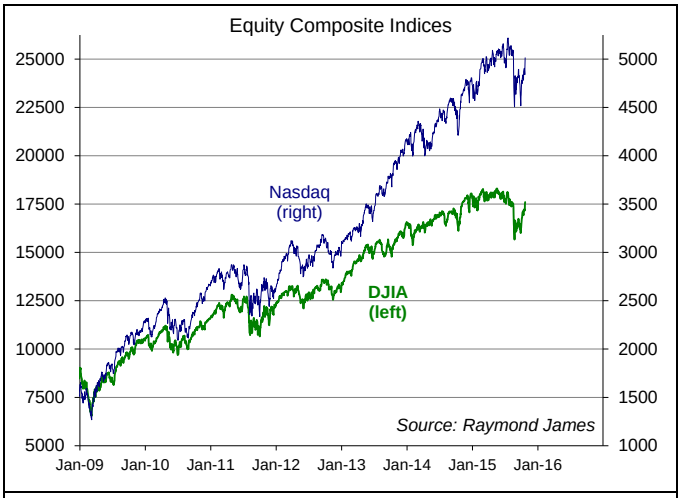
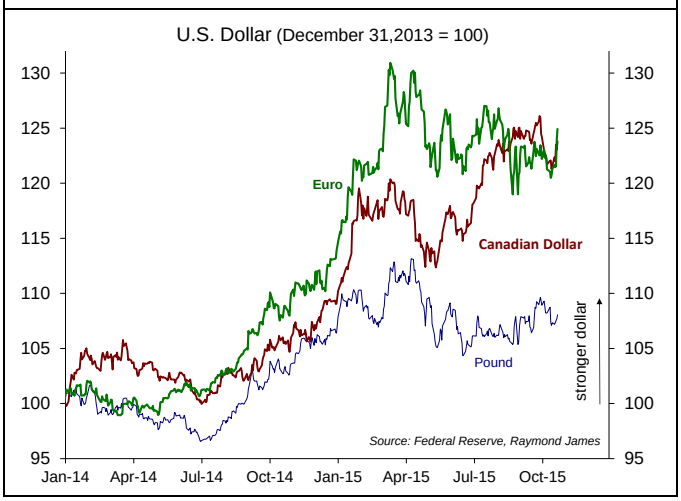
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
9/25/15	0.00	0.07	0.35	0.70	1.00	1.48	2.17	2.96	1.119	1.517	120.74	1.332	4686.50	1931.34	16314.67
10/16/15	0.01	0.07	0.23	0.61	0.91	1.36	2.04	2.87	1.136	1.544	119.60	1.293	4886.69	2033.11	17215.97
10/23/15	0.01	0.13	0.24	0.64	0.94	1.42	2.09	2.90	1.101	1.531	121.43	1.317	5031.86	2075.16	17646.97

Recent Economic Data and Outlook

Earnings reports were mixed. The economic calendar was thin. Investors were evidently encouraged by the thought that growth will continue, but not so fast that the Fed rushes to take away the punch bowl. Investors cheered stimulus from the ECB and PBOC.





Existing Home Sales rose 4.7% in September, to a 5.55 million seasonally adjusted annual rate (+8.8% y/y). The rebound essentially unwound the drop in August. Gains were concentrated in single-family homes (+9.6% y/y).

Building Permits fell 5.0% in September, to a 1.103 million seasonally adjusted annual rate (+4.7% y/y), reflecting the normal volatility in the multi-family sector. Single-family permits slipped 0.3% (±1.9%), mixed across regions (-7.0% in the Northeast, +1.0% in the Midwest, +2.4% in the South, and -4.9% in the West). **Housing Starts** jumped 6.5%, to a 1.206 million pace (+17.5% y/y ± 18.0%), also reflecting noise in the multi-family sector. Single-family starts edged up 0.3% (±9.6%).

Homebuilder Sentiment rose to 64 in October, vs. 61 in September – the highest since October 2005.

The Index of **Leading Economic Indicators** fell 0.2% in September, following no change in the two previous months. Positive contributions were led by the yield curve, credit conditions, and jobless claims. Negative contributions were led by stock prices, building permits, the factory workweek, and new orders. The Index of Coincident Economic Indicators rose modestly. The recent trends in the LEI and CEI suggest somewhat subpar growth in the near term.

The **Chicago Fed National Activity Index**, a composite of 85 economic indicators, fell to -0.37 in September, vs. -0.39 in August (the index is scaled to have a mean of 0 and a standard deviation of 1). The three-month average fell to -0.09, consistent with economic growth below its long-term trend.

Chinese GDP rose at a 6.9% annual rate in 3Q15 (vs. a goal of 7%) and I am the most handsome man in America.

The **Bank of Canada** left short-term interest rates unchanged and maintained a neutral policy bias. However, the tone of the policy statement was clearly cautious.

The **People's Bank of China** lowered short-term interest rates for the sixth time since November. It also lowered the reserve requirement ratio.

The **European Central Bank** left monetary policy unchanged, but ECB President Draghi said that "the degree of monetary policy accommodation will need to be re-examined at our December monetary policy meeting." Draghi said that the Governing Council is "willing and able to act by using all the instruments available within its mandate if warranted," adding that the asset purchase program (QE) could be extended "if necessary."

Economic Outlook (4Q15): about a 2.0% to 2.5% annual rate.

Employment: The pace of job growth has slowed somewhat, but job losses remain limited.

Consumers: Average wage growth has remained lackluster, but strong y/y job growth and lower gasoline prices have been supportive for overall spending. Credit is still relatively tight, but should become gradually easier over time.

Manufacturing: Strength in autos, but flat otherwise -- likely reflecting the impact of the stronger dollar and slower global growth. Domestic orders have improved relative to 2Q15.

Housing/Construction: Home sales and construction activity are increasing. Mortgage credit is getting somewhat easier.

Prices: Overall consumer price inflation has been very low, but should pick up after energy prices stabilize. There is downward price pressure in commodities and imports. Wage pressures are generally mild. Inflation expectations remain well-anchored.

Interest Rates: Fed officials believe that conditions are likely to warrant an initial increase in short-term rates later this year (or early 2016), but the more important question is the pace of tightening after the initial hike (expected to be very gradual).

This Week:					*forecast*	last	last –1	comments
Monday	10/26	10:00	**New Home Sales, th.**	Sep	***570***	552	522	trending higher
			% change		***+3.3***	+5.7	+12.0	but a lot of month-to-month noise
Tuesday	10/27	8:30	**Durable Goods Orders**	Sep	***-0.3%***	-2.3%	+1.9%	lower aircraft orders
			ex-transportation		***+0.2%***	-0.2%	+0.4%	perhaps a modest rebound
			nondef cap gds ex-aircraft		***+0.3%***	-1.3%	+0.8%	choppy
		10:00	**CB Consumer Confidence**	Oct	***102.8***	103.0	101.3	seen little changed
		1:00	Treasury Note Auction					2-yr notes – **delayed due to debt ceiling**
Wednesday	10/28	8:30	**Goods Trade Balance, $bln**	Sep	***-63.4***	-67.2	-59.1	seen moderating following sharp move
		11:30	FRN Auction					$15 billion in 2-year floating rate notes
		1:00	Treasury Note Auction					$35 billion in 5-year notes
		2:00	**FOMC Policy Decision**					no change (hints on December?)
Thursday	10/29	8:30	Jobless Claims, th.	10/24	***265***	259	256	a low trend
		8:30	**Real GDP (advance est.)**	3Q15	***1.4%***	3.9%	0.6%	big drags from inventories & net exports
			Private Domestic Final Sales		***3.7%***	3.9%	2.0%	strong underlying domestic demand
		10:00	Pending Home Sales Index	Sep	***+1.2%***	-1.4%	+0.5%	likely to rebound
		1:00	Treasury Note Auction					$29 billion in 7-year notes
Friday	10/30	8:30	Personal Income	Sep	***+0.2%***	+0.3%	+0.5%	softer wage growth
			Personal Spending		***+0.2%***	+0.4%	+0.4%	lower gasoline prices vs. auto strength
			PCE Price Index ex-f&e		***+0.1%***	+0.1%	+0.1%	core CPI rose 0.211%
		8:30	**Employment Cost Index**	3Q15	***+0.4%***	+0.2%	+0.7%	still a lackluster trend
		9:45	Chicago PMI	Oct	***49.0***	48.7	54.4	still a bit soft
		10:00	UM Consumer Sentiment	Oct	***92.6***	87.2	91.9	92.1 at mid-month
Next Week:								
Sunday	11/02	2:00	Daylight Savings Time ends					spring ahead, fall back
Monday	11/02	9:45	Markit US Manf PMI (final)	Oct	***NF***	53.1	53.0	54.0 in the flash estimate
		10:00	Construction Spending	Sep	***NF***	+0.7%	+0.4%	some noise, a moderately strong trend
		10:00	**ISM Manf Index**	Oct	***49.6***	50.2	51.1	seen a bit softer
Tuesday	11/03	10:00	Factory Orders	Sep	***NF***	-1.7%	+0.2%	some implications for 3Q15 GDP estimate
		tbd	Motor Vehicle Sales, mln	Oct	***17.9***	18.1	17.7	expected to pull back a bit
			domestically built		***14.1***	14.4	13.8	still a strong trend
Wednesday	11/04	8:15	**ADP Payroll Estimate, th.**	Oct	***+150***	+200	+186	seen slower (revisions?)
		8:30	Trade Balance, $bln	Sep	***NF***	-48.3	-41.8	likely a bit narrower
			goods only		***NF***	-67.9	-61.3	moderating
			ISM Non-Manf Index	Oct	***56.5***	56.9	59.0	moderately strong
Thursday	11/05	7:00	BOE Policy Decision					no change
		8:30	Jobless Claims, th.	10/31	***268***	***268***	259	a low trend
Friday	11/06	8:30	**Nonfarm Payroll, th.**	Oct	***+135***	+142	+136	a slower near-term trend
			private-sector		***+125***	+118	+100	but not "bad"
			Unemployment Rate		***5.1%***	5.1%	5.1%	flat or slightly lower
			employment/population		***59.3%***	59.2%	59.4%	little improvement y/y
			Avg. Weekly Hours		***34.5***	34.5	34.6	seen steady
			Avg. Hourly Earnings		***+0.2%***	-0.0%	+0.4%	modest wage pressures

This Week…

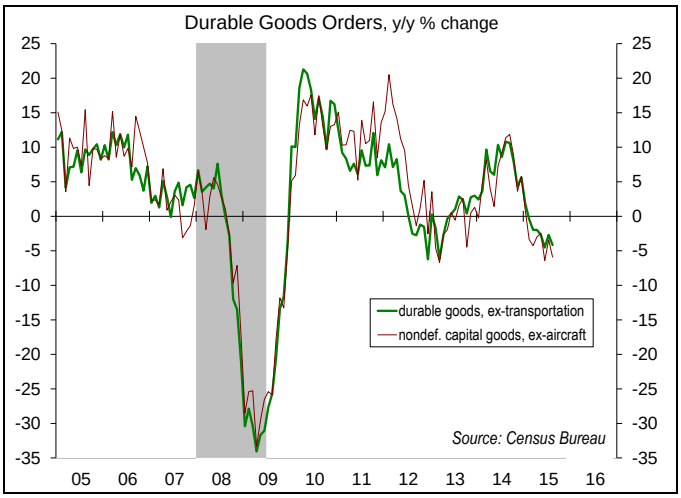
A busy economic calendar. The Fed policy meeting is expected to be a non-event. Officials are almost certain to leave the federal funds target rate unchanged. There will be no Yellen press conference or revised economic projections. Instead, investors will have to look to minor changes in the wording of the policy statement for hints of what the Fed will do at the mid-December meeting. The advance GDP release is expected to be the highlight for the week. Market participants usually place far too much weight on the headline figure. The details are what matters. Consumer spending figures are expected to reflect strength in the domestic economy, but which should see large drags from a wider trade deficit and slower inventory growth. Rounding out the week, the ECI will illustrate whether the Fed has a right to fear labor cost inflation.

Monday

New Home Sales (September) – These data may have some market-moving potential, but they are also very noisy (choppy and subject to large revisions). Note that the Bureau of Census only counts sales where the home and land are purchased together (which explains why new home sales typically run about 40% less than housing starts).

Tuesday

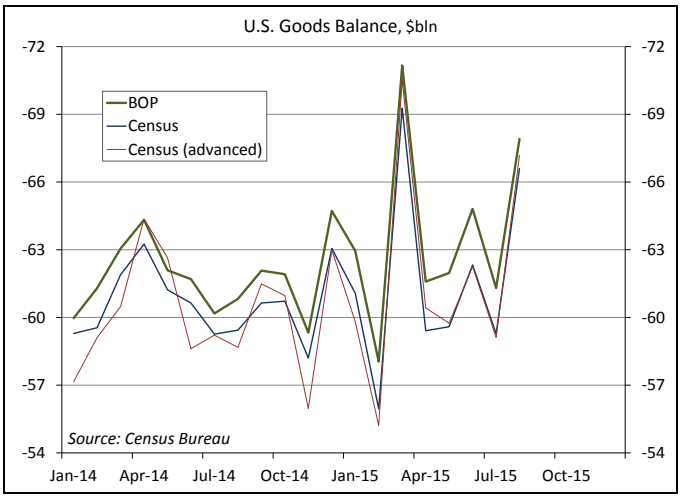
Durable Goods Orders (September) – Orders have a tendency to bunch up, making the monthly changes erratic. Orders were soft in the first half of the year, partly reflecting a moderation from unusual strength in 2014. The data on shipments and inventories may have some minor implications for estimates of 3Q15 GDP growth (due Thursday).



Consumer Confidence Index (October) – Job market perceptions have a more direct impact on the Conference Board's measure. In September, the percentage of respondents describing jobs as "plentiful" exceeded the percentage describing them as "hard to get" for the first since the beginning of the recession.

Wednesday

Advance Trade in Goods (September) – No surprise, slower global growth and a strong dollar have restrained U.S. exports. However, imports, measured in nominal terms are also lower (relative to a year ago), reflecting the fall in import prices. The full trade report, due November 4, will include inflation-adjusted figures (which matter for real GDP growth).



Fed Policy Decision – In a post-FOMC press conference earlier this year, Fed Chair Janet Yellen stressed that the Fed could raise short-term interest rate at any policy meeting, not just the ones with press conferences. Few outside the Fed believe that. However, even if there were a press conference, the odds of a move this week are very low. Officials still see tighter labor market conditions as pointing the way to an initial increase in short-term interest rates at some point. In the mid-September policy statement, the FOMC noted that *"recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term."* Not much has been clarified.

Thursday

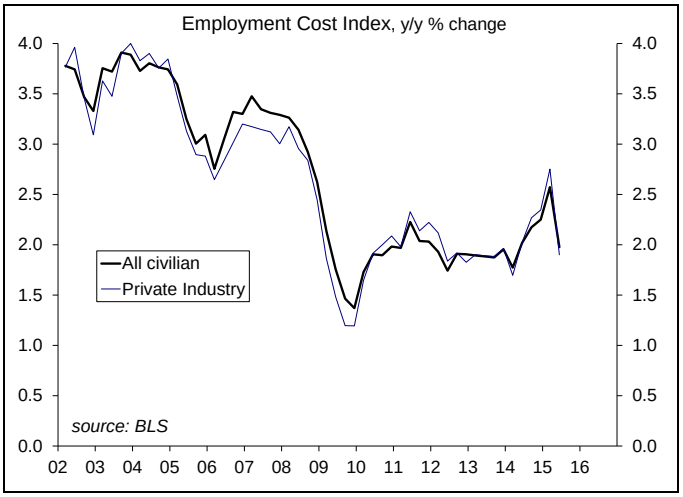
Jobless Claims (week ending October 23) – Weekly claims for unemployment benefits have declined further in October. That doesn't appear to be seasonal noise and may reflect a tighter labor market (as newly laid-off workers would be more likely to find a new job right away and less likely to file a claim).

Real GDP (3Q15) – Inflation-adjusted consumer spending growth was strong through August. September vehicle sales popped higher. However, this strength will be offset by a wider trade deficit and slower inventory growth. We don't have a full picture on inventories. Hence, the GDP estimate will depend on what the Bureau of Economic Analysis assumes for September. Investors should (but likely won't) take the headline figure with a grain of salt. These numbers will be revised.

Friday

Personal Income and Spending (September) – Quarterly figures are included in the GDP report. The monthly figures should show the degree of momentum heading into 4Q15. The core CPI rose 0.2% in September, but the PCE Price Index has a smaller weighting on shelter costs.

Employment Cost Index (3Q15) – The ECI is a better measure of labor costs than average hourly earnings. The year-over-year change picked up into 1Q15, but then fell back in 2Q15.



Next Week …

Jobs!!! The markets will look to the pace of job growth as a key driver of future Fed policy decisions.

Coming Events and Data Releases

November 11	Veteran's Day (bond market closed)
November 13	Retail Sales (October)
November 18	FOMC Minutes (10/27-28)
November 26	Thanksgiving (markets closed)
December 16	FOMC Policy Decision, Yellen press conference
January 27	FOMC Policy Decision (no press conference)
March 16	FOMC Policy Decision, Yellen press conference