RJO Previews and Perspectives for Friday, Nov 23

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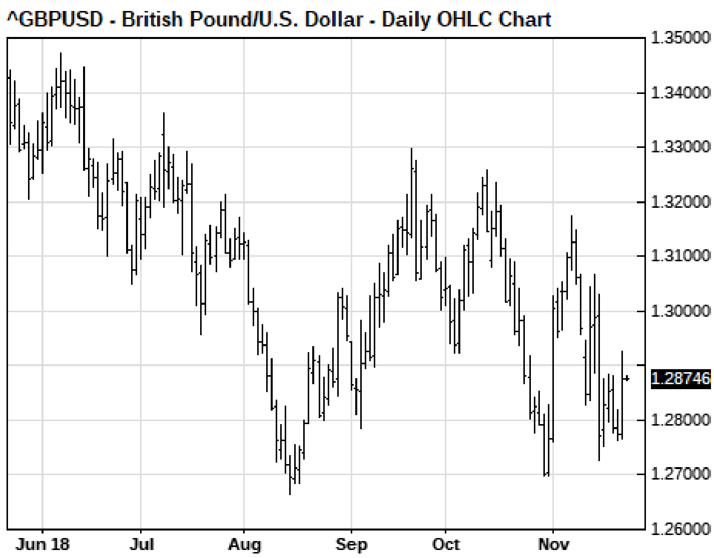
Stocks weaken during Thursday's U.S. holiday -- The S&P 500 E-mini during Thursday's Thanksgiving holiday traded lower and was down -0.61% late Thursday afternoon. The tone remained bearish, despite some Brexit progress, as the markets worry about Sunday's EU emergency summit on Brexit, the upcoming Trump-Xi meeting, and tech stocks. The Euro Stoxx 50 index on Thursday closed down -0.86% and the Shanghai Composite index closed down -0.23%, but the Nikkei index bucked the negative tone and close the day up +0.65%. Jan WTI crude oil prices were down -1.43% at $53.85 late Thursday afternoon and consolidated just mildly above Tuesday's 1-year low of $52.77.

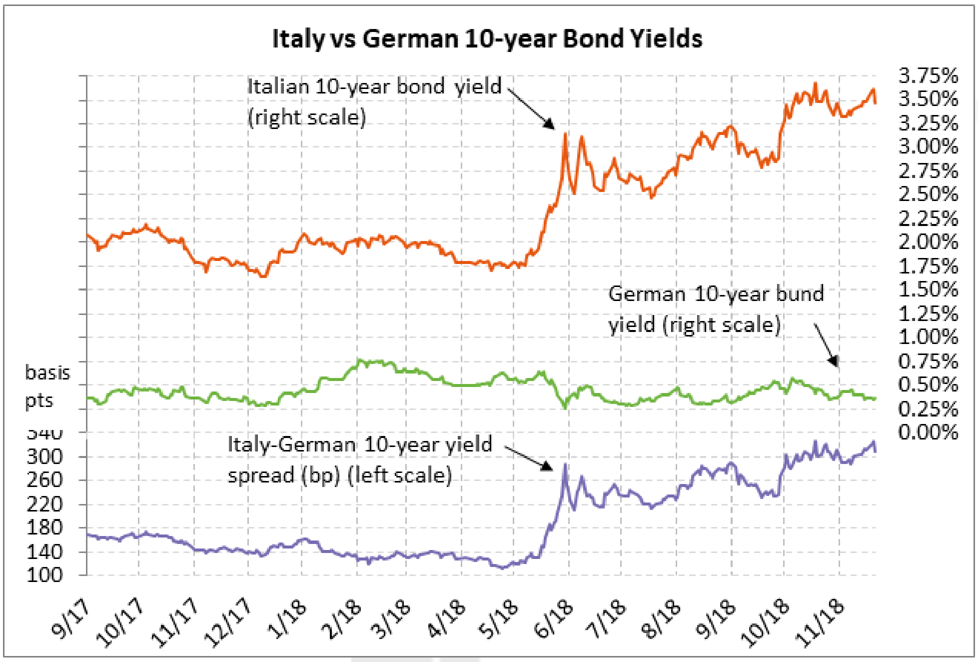
Brexit progress sparks some optimism -- GBP/USD on Thursday rallied by +0.77% to $1.2877/GBP after Prime Minister May announced that the UK and EU agreed on the general idea of an eventual EU/UK free trade area and that they will seek to solve the Irish border problem with technology. Ms. May is hoping that the promise of a good trade deal for the UK, to be negotiated later, will help her get her Brexit separation agreement over the finish line. Ms. May still faces a steep uphill battle getting the Brexit separation agreement approved by Parliament in December. More immediately, the markets are waiting to see if EU leaders at their emergency summit on Sunday approve the Brexit deal.



Italian bond yield declines on hopes for compromise -- The Italian 10-year government bond yield fell on Wednesday and Thursday on hopes that the Italian government might be willing to compromise. The newspaper La Stampa on Wednesday reported that League leader Salvini may be willing to reduce the proposed budget deficit by reducing spending on the proposed citizen's income and on reducing the retirement age.

The Italian bond market was able to shake off the fact that the European Commission on Wednesday declared that Italy's budget is in "particularly serious non-compliance" of EU limits and took its first step towards beginning the "excessive deficit" procedure. The Commission over the next two weeks will solicit input from the other EU countries and then decide whether to formally begin the excessive deficit procedure. Even if that procedure is started, there are many opportunities for input from other EU countries and for Italy to compromise.

The Italian 10-year bond yield on Wednesday and Thursday fell by a total of -17 bp to 3.45%, down from Tuesday's 3-week high of 3.61% and 23 bp below Oct's 4-3/4 year high of 3.68%. The Italian-German 10-year yield spread on Wednesday and Thursday fell by a total of -18 bp to 308 bp, leaving the spread well below Oct's 5-3/4 year high of 327 bp.



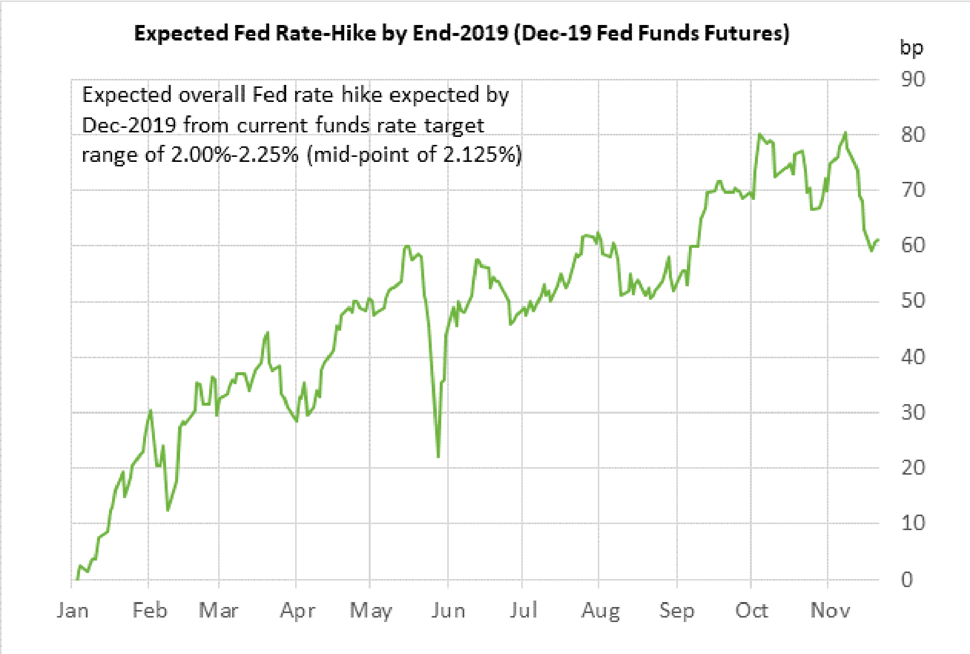
Outcome highly uncertain for next week's Trump-Xi meeting -- The markets are looking forward to the all-important Trump-Xi meeting in Buenos Aires on Saturday, Dec 1 following the G-20 meeting. China has offered some concessions but it remains to be seen whether President Trump will be willing to declare a ceasefire similar to his current deals with Japan and Europe where he refrains from new tariffs while formal negotiations are ongoing. If next week's Trump-Xi meeting goes badly, then President Trump has said he would go ahead in early December with slapping tariffs on the remaining $267 billion of Chinese goods and would go through with the current plan of raising the tariff to 25% from 10% on $200 billion of Chinese goods.

On the negative side for an agreement, Vice President Pence last week in Asia issued some harsh language on China and USTR Lighthizer earlier this week released a report claiming that China has not changed its behavior and is still involved in corporate technology hacking and the forced transfer of America technology. On the more positive side, the Trump administration announced earlier this week that White House trade advisor Navarro, the most virulent Chinese critic in the Trump administration, will be excluded from the Trump-Xi meeting in Buenos Aires.

Powell's appearance next week may indicate whether the Fed is curbing its hawkish bent -- Fed policy will be in the spotlight next week as Fed Chair Powell speaks on Wednesday at the Economic Club of New York. The following week, Mr. Powell will testify before the Joint Economic Committee of Congress on the U.S. outlook.

Fed Chair Powell last week made some comments that were interpreted as dovish by the markets. Mr. Powell said that the U.S. economy is currently strong but he acknowledged that the U.S. economy faces headwinds from slower growth overseas, fading fiscal stimulus, and the lagged effects of the Fed's rate hikes to-date. Mr. Powell sounded dovish by saying, "We have to be thinking about how much further to raise rates, and the pace at which we will raise rates." He also suggested that the Fed might slow its rate-hike regime when he mentioned the analogy that in a dark room it is time to slow down to avoid running into the furniture.

Still, the Fed is likely to go ahead with its December rate hike since the Fed would not want to be seen as kowtowing to the stock market or providing it with the infamous put protection. The U.S. economy and labor market are strong and inflation is at the Fed's +2.0% target, meaning that the Fed needs to keep moving its funds rate up to the perceived neutral level of 3.00%. But while a Fed rate hike at its meeting in three weeks (Dec 18-19) is likely a done deal, the Fed might delay the next rate hike in early 2019 if the outlook continues to worsen.



Expected Fed Rate-Hike by End-2019 (Dec-19 Fed Funds Futures)
bp
Expected overall Fed rate hike expected by Dec-2019 from current funds rate target range of 2.00%-2.25% (mid-point of 2.125%)
90
80
70
60
50
40
30
20
10
0
Jan
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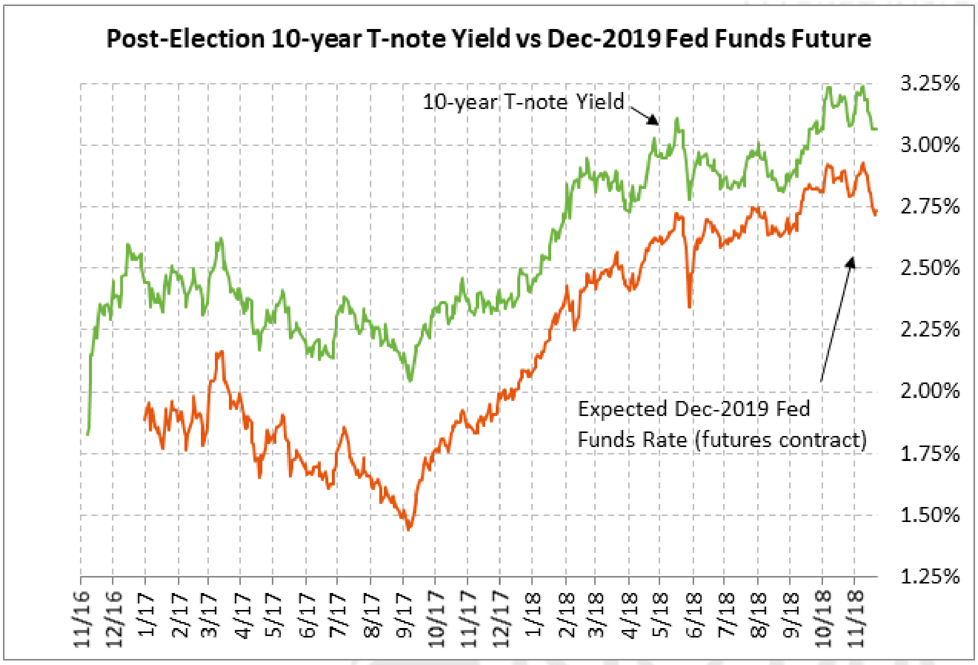
Nov



Post-Election 10-year T-note Yield vs Dec-2019 Fed Funds Future
10-year T-note Yield
Expected Dec-2019 Fed Funds Rate (futures contract)
3.25%
3.00%
2.75%
2.50%
2.25%
2.00%
1.75%
1.50%
1.25%
11/16
12/16
1/17
2/17
3/17
4/17
5/17
6/17
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