macro scan

<u>Wednesday, September 4th, 2019</u>

- ***ISM report confirms Mfg contraction that we have been expecting but there is more to this story…***
- ***Export/New Order decline indicates further weakness to come with employment losses now expected***
- ***Manufacturing (though smaller part of economy) always leads Services***
- ***States exposed to exports are now seeing positive jobless claims for the first time in a decade – watershed***
- ***Fixed Income supply could weigh on the longer end and steepen the curve – need Powell to end "mid-cycle" nonsense for any substantial steepening (updated technical charts)***

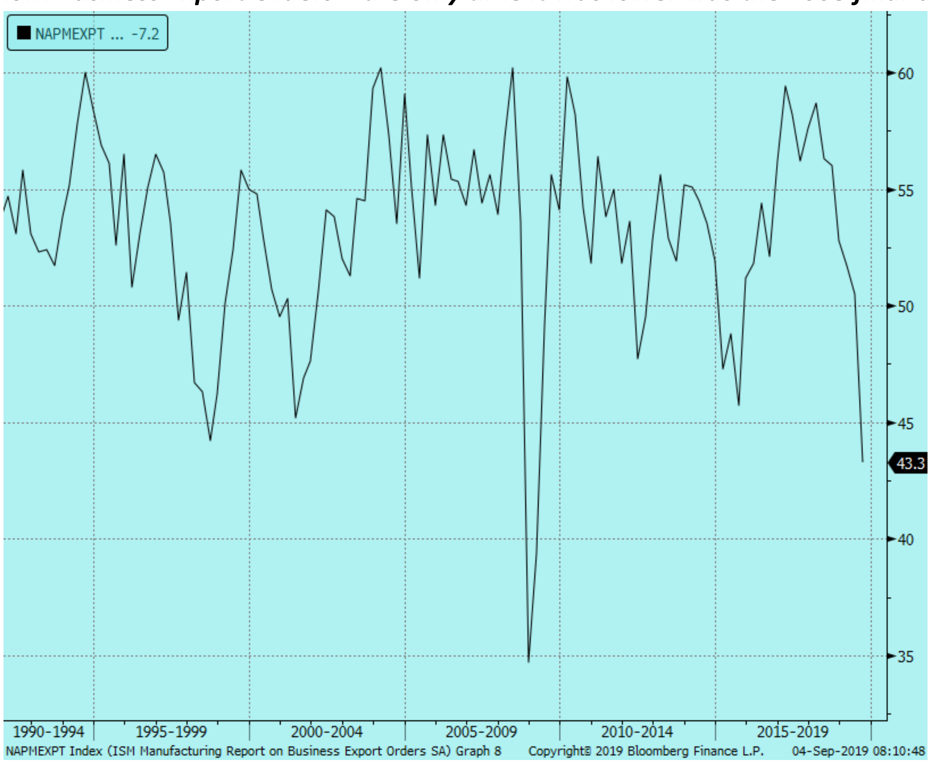
As we have discussed for a while, the regional Fed surveys, which have been THE best leading indicator of the US economy, had been signaling that the headline ISM Manufacturing PMI would slip into contraction for a couple of months now. So yesterday's first print below the 50 expansion/contraction line should be the least shocking thing.

Is it time to take a victory lap and call it a year? Heck no the story is not over. As we spoke about on Friday, the concern is now moving away from the declining Manufacturing surveys whose story is well known and towards the bleed into services which makes up the largest portion of the economy.

Thus, the more eye opening part of the ISM report yesterday was the large drop in the Employment component under 50 which means job <u>LOSSES</u> not just slowing hiring, and the shockingly large decline in New Orders which means the US data will stay soggy for a few more months (at least) due to sagging demand.

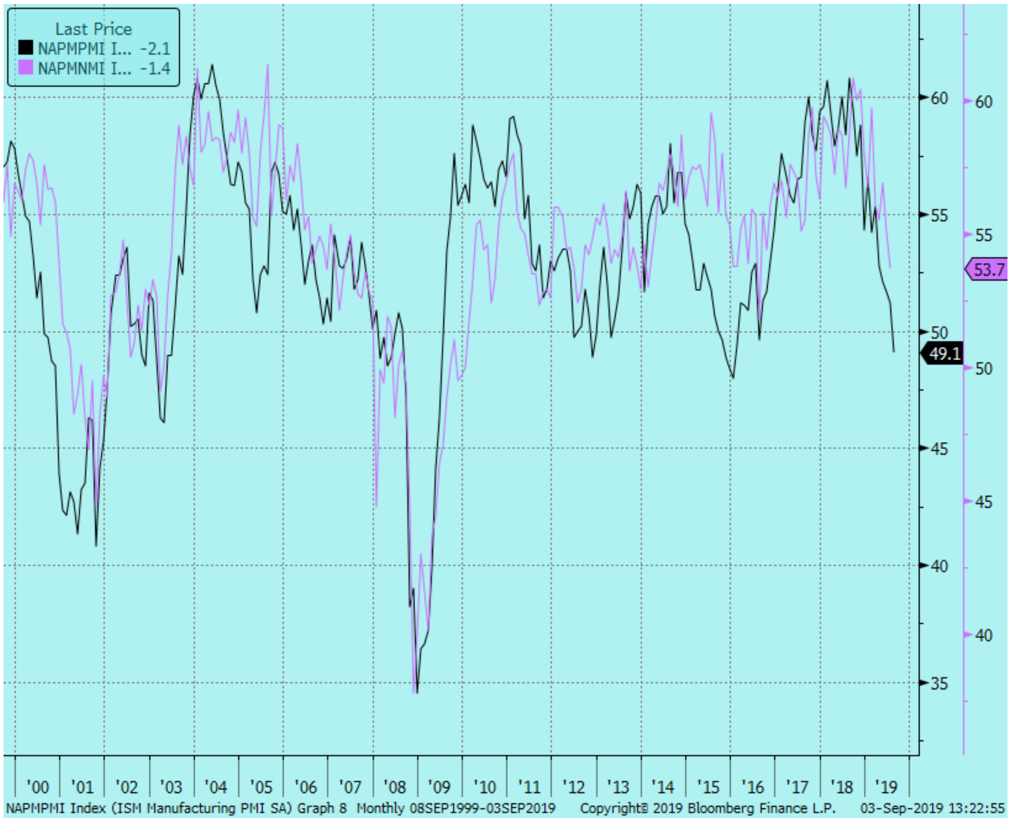
The idea that the US economy is an island that can withstand a global growth slowdown (to be conservative) is looking tenuous at best. US manufacturers haven't seen weaker export orders since the GFC.

ISM Business Export Orders – the only time it was lower was the 2008 financial crisis…

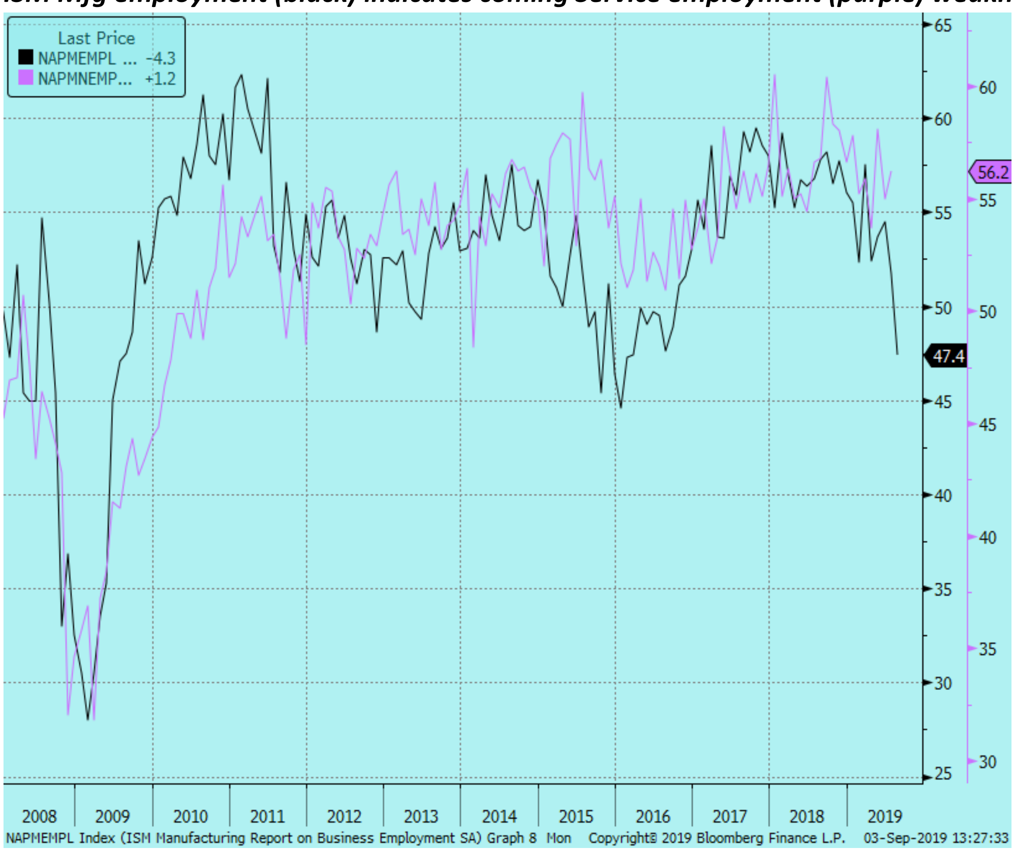


We have looked at this previously but it bears repeating. Manufacturing <u>always</u> leads Services. That means the Service PMI should continue its descent and more importantly, Service job losses will now begin to follow Manufacturing job losses.

Mfg PMI (black) vs. Non-Mfg PMI (purple) – Mfg always leads…



ISM Mfg employment (black) indicates coming Service employment (purple) weakness…



In a shout out to Danielle DiMartino Booth over at Quill Intelligence who does excellent micro analysis on jobless claims, the top export states in the US are seeing jobless claims go positive for the first time in a decade (ignoring one-off episodes due to hurricanes, etc.). That is watershed and another signal that at this point in the cycle, not only is the labor market seeing less hiring (NFP an example), but are now slowly seeing layoffs.

As I showed Friday, there are plenty of labor indicators that are confirming the layoffs risk. If layoffs accelerates, that can take down the consumer which is really the United States last leg to stand on. At that point, we can finally say "recession" to complete the "anatomy of a US slowdown" flow chart I created in Friday's note.

And folks it doesn't mean the world is ending or another repeat of the GFC; it is as far as I can tell your standard end of an economic cycle.

What does this all mean for duration and curves? For duration, my target has been 99.15 on EDH1.

As you can see here, the two "bull flag" formations noted in green and red both ironically target that ~99.15. The grey channel suggests two things: 1) you rather buy dips at the bottom of the range, and 2) if it stays in the channel, 99.15 will be hit by December given the rising trend support that originated in Nov 2018…

Now you may ask: why would fixed income back up to the bottom of the range if the job losses are coming? Couple reasons:

- Corporate Treasurers are taking advantage of lower yields by issuing the most debt so far this year – expectations are for $40B this week and $140B this month
- The mortgage refi wave we discussed on Friday will also bring a wave of issuance
- US Treasury market will have to digest 3y, 10y, and 30y auctions next week

Therefore, the flood of issuance could overwhelm the 5yr to 30yr part of the curve which would bleed somewhat into the front end (though its hard for ED's to sell off much at this point). Thus buy the dip is the playbook in Eurodollars.

Which brings us to curve shape. We have seen curves like 2s10s steepen out somewhat over the last week mostly due to the poor US data and the supply in the longer end.

There is only one thing that can stop the curve steepening at this point and that is if Powell continues his "mid-cycle adjustment" tomfoolery. We are talking manufacturing recession and job losses here, and he is still talking mid-cycle??? Nonsense.

Until we get Powell reconciling his rhetoric to the data, curves will have a hard time substantially steepening. So your signal for reentering steepeners will be Powell rhetoric shift towards recognizing this isn't mid-cycle, and seeing a curve like 2s10s break its 3-month downtrend (resistance currently around 5bps)…

Kind Regards,

Mark Orsley
Head of Macro Strategy, North America

prismFP

130 West 42nd, 23rd Floor Tel +1 646 205 6193
New York, NY 10019 Cell +1 914 456 9446
United States Email orsley@prismfp.com

#NC2

#substantive