THE WALL STREET JOURNAL.
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Investors Brace for ECB's Unwind

By Jon Sindreu
574 words
8 July 2017
The Wall Street Journal
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English

Investors are dumping government bonds, certain that the European Central Bank will soon start dialing back the massive stimulus that has buoyed markets.

They are less sure what that tapering will look like -- a key question as the ECB becomes the main focus for spooked investors around the world.

Many market participants are betting that officials will reduce bond purchases from 60 billion euros ($69 billion) to 40 billion euros during the first half of next year and then cut them to 20 billion euros in the second half. But there are other options investors are considering, from tapering less to following the Federal Reserve's model of reducing the buying on a monthly basis.

Whatever the ECB does, investors expect **volatility** along the way. In the wake of the financial crisis, central banks cut interest rates to record lows and bought billions of dollars of assets, pushing up **bond prices** and sending investors chasing returns into equity and emerging markets. Because such monetary policy was so experimental in implementation, there is little precedent in what to expect in the retreat.

"When we are in the territory of unconventional monetary policy, expectations of what the central bank will do in the future have no anchor," said Willem Verhagen, a senior economist at NN Investment Partners.

ECB President Mario Draghi kicked off the bond selloff last week with **bullish** comments about the eurozone economy that investors saw as heralding tighter monetary policy.

Yields on 10-year German bonds, which move opposite to prices, closed at 0.568% on Friday, the highest in 18 months, compared with 0.247% the day before Mr. Draghi's speech. Treasury 10-year yields traded at 2.388% from 2.143%. The euro has gained more than 2% over this period.

Yet markets were broadly unchanged by Fed minutes on Wednesday, which showed no clear consensus on how the central bank should unwind a portfolio of bonds that has been unchanged since 2014.

Most investors expect the ECB to announce the future of its bond buying as soon as September.

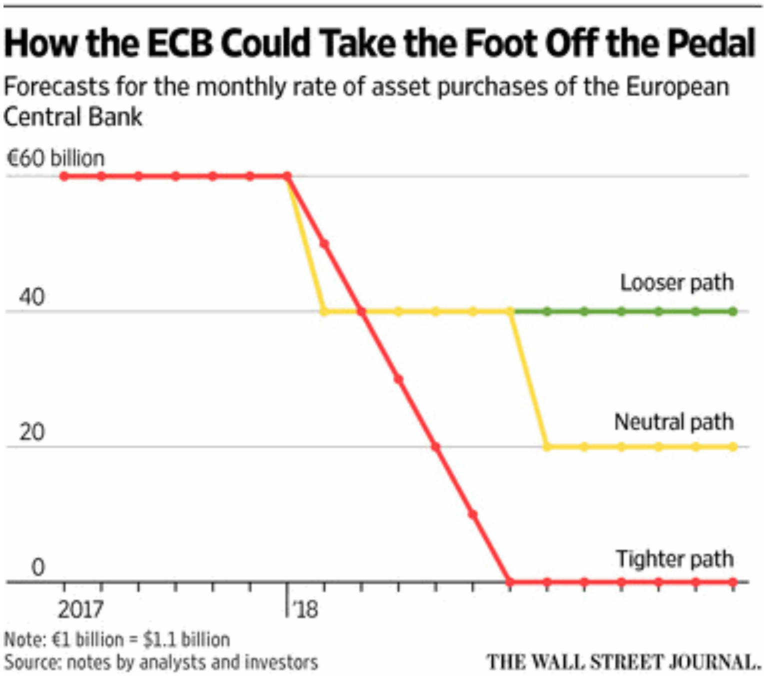
Aside from recent selling, another clue to what investors expect lies in derivatives markets that currently predict the ECB's first interest-rate rise will be in December next year. The ECB has said it would only raise rates, currently at minus 0.4%, once it has stopped buying bonds, suggesting that investors believe that time will be before next December.

Buying less than 40 billion euros of bonds a month would be seen as a tightening of policy, said Thomas Page-Lecuyer, a strategist at CPR Asset Management, leading to a larger selloff in eurozone bonds and a further rally in the euro.

There are other alternatives. The ECB could also follow in the Fed's footsteps and announce that purchases will be smaller each successive month, reaching zero at the end of the year. That would likely boost bonds and depress the currency, investors say.

Many investors think this is unlikely, however, because ECB officials will want flexibility. They see the Fed as a cautionary tale, after it triggered abig bond selloff when announcing in 2013 that it would taper asset purchases.

"The experience in the U.S. was very painful, and that's what the ECB wants to avoid," said Franck Dixmier, global head of fixed income at Allianz Global Investor.



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U.S. News: On Similar Job Market, Different Rhetoric

By Eric Morath
456 words
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New president. Similar job market. Different analysis.

U.S. employers added a seasonally adjusted 1.1 million jobs during the first six months of 2017, the Labor Department said Friday. That almost exactly matched the first-half job gain in 2016, and is consistent with the yearslong trend of steady job creation pushing down the unemployment rate.

Though the trends haven't changed much, the president and his advisers are describing them differently.

White House press secretary Sean Spicer tweeted Friday, "Great news for US workers - 222000 jobs added in June."

Labor Secretary Alexander Acosta noted Friday that the unemployment rate has declined by 0.4 percentage point since the president took office in January. "Robust job creation and moderate wage growth has direct impact on American families," he said.

President Donald Trump has embraced the figures. On July 2, he tweeted, "**Stock Market** at all-time high, unemployment at lowest level in years."

Less than a year ago, as a candidate, he took a starkly different view of jobs numbers.

"One in five American households do not have a single member in the labor force," Mr. Trump said in a August 2016 speech. "These are the real unemployment numbers -- the 5% figure is one of the biggest hoaxes in modern politics."

Labor-force participation now is virtually unchanged from a year ago, and the unemployment rate has edged down further to 4.4% in June, near the lowest level since 2001.

When asked about the president's different tone toward job numbers since he was a candidate, a White House spokesman Friday referred to a comment Mr. Spicer made at a March press briefing. "I talked to the president prior to this, and he said to quote him very clearly -- 'They may have been phony in the past, but it's very real now,' Mr. Spicer said with a smile.

To be sure, it is common for presidents to point to improving employment figures to show their policies are effective. President Barack Obama held a news conference in February 2016 to tout the unemployment rate's fall below 5% for the first time since the recession ended. And many economists say the control any president has over hiring and the economy is typically overstated, and to the degree policies influence the data, it takes years, not months.

The Bureau of Labor Statistics, a largely independent arm of the Labor Department, compiles the jobs figures. Mr. Trump hasn't yet nominated a new statistics commissioner, the only political appointee in the agency. Mr. Acosta has said maintaining the integrity of economic data is a high priority.

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The New York Times

Business/Financial Desk; SECTB
Strong June Jobs Report Pushes Markets Higher

By THE ASSOCIATED PRESS
692 words
8 July 2017
The New York Times
NYTF
Late Edition - Final
2
English

Stocks climbed on Friday after the government said hiring grew at a stronger pace in June. Technology and consumer-focused companies led the way as investors welcomed a positive sign for the economy.

The Labor Department said American employers added 222,000 jobs last month. That was more than analysts had expected, and it came a day after a survey that showed weaker job creation by private companies. Stocks regained much of the ground they lost on Thursday. Technology companies jumped, and retailers like Amazon and McDonald's traded higher. Bond yields climbed and the dollar got stronger. Gold fell.

''The data itself shows a pretty strong labor market,'' said Sean Lynch, co-head of global equity strategy for the Wells Fargo Investment Institute, adding that it laid to rest some worries that the economy was taking a step back.

The **Standard & Poor's 500**-**stockindex** picked up 15.43 points, or 0.6 percent, to 2,425.18. The **Dow Jonesindustrial average** gained 94.30 points, or 0.4 percent, to 21,414.34. It fell 158 points a day earlier. The **Nasdaq composite** rose 63.61 points, or 1 percent, to 6,153.08.

The government said more people looked for work in June, which pushed the unemployment rate slightly higher. The government also raised its estimates of job gains in April and May. Average wage growth remained modest. Companies that would benefit from better economic growth, like banks and industrial companies, made strong gains.

Facebook added $2.62, or 1.8 percent, to $151.44, and Microsoft rose 89 cents, or 1.3 percent, to $69.46, as technology companies made the biggest gains Friday. They have done better than any other industrial group within the **S**.**&P**. **500** this year.

Despite the gains on Friday, technology stocks have had a bad month. The **Nasdaq composite** closed at a record high on June 8, and the **S**.**&P**. **500** technology index closed at a 17-year-high. Since then, the tech index has dropped 4 percent, its worst one-month stretch since Britain voted to leave the European Union last June.

McDonald's rose $3.18, or 2.1 percent, to $156.27. Amazon picked up $13.62, or 1.4 percent, to $978.76, and Netflix advanced $3.93, or 2.7 percent, to $150.18. The homebuilder D. R. Horton added $1.30, or 3.8 percent, to $35.79.

Benchmark United States crude oil lost $1.29, or 2.8 percent, to $44.23 a barrel in New York. Brent crude, used to price international oils, fell $1.40, or 2.9 percent, to $46.71 a barrel in London. Analysts said investors were focused on the strong increase in United States production in Thursday's energy supply report. Hess fell $1.05, or 2.4 percent, to $41.79, and Devon Energy gave up 64 cents, or 2.1 percent, to $29.54.

Bond prices fell. The yield on the **10**-**year Treasury** note rose to 2.39 percent from 2.37 percent. Big-dividend stocks like phone companies, household goods makers and utilities mostly lagged the market as investors who sought yield were lured elsewhere.

Shares of Advisory Board, a consulting company, jumped after Bloomberg said the health insurer UnitedHealth Group and the private equity firm Vista Equity planned to buy it and break it up. Advisory Board shares climbed $2.90, or 5.4 percent, to $57.10. Investors value the company at about $2.3 billion. UnitedHealth gained 97 cents to $187.96.

The dollar rose to 113.87 yen from 113.2 yen. The euro fell to $1.1404 from $1.1418.

Gold sank $13.60, or 1.1 percent, to a four-month low of $1,208.60 an ounce. Silver dropped 56 cents, or 3.5 percent, to $15.43 an ounce. Copper lost 1 cent to $2.65 a pound.

CHART: The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Friday. (Source: Reuters)

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The New York Times

Washington; SECT
Federal Reserve Sees U.S. Economic Growth as Steady but Slow

By BINYAMIN APPELBAUM
661 words
8 July 2017
The New York Times
NYTF
The New York Times on the Web
English

WASHINGTON -- The Federal Reserve's view of the American economy, which it updated Friday in a semiannual report to Congress is out: steady growth still impeded by a range of problems.

The report gives the reasons for confidence, describing the steady growth of consumer spending on the foundation of a solid economic expansion. However, it also highlighted a number of reasons that growth has remained relatively slow by historical standards.

The Fed raised its benchmark interest rate in June for the third consecutive quarter, a sign of confidence in the strength of the economy. It also announced that it planned to start reducing its securities holdings by the end of the year.

The Fed pointed to evidence that lenders are seeking opportunities to take larger risks. It noted, for example, that companies with poor credit ratings are able to borrow at interest rates that are unusually close to the rates for companies with good credit ratings. The differences "now stand near the bottom of their historical ranges," the Fed said.

Yet demand for loans remains weak. "Apparent high risk appetite in asset markets has not led to increased borrowing in the nonfinancial sector," the report said.

In a similar vein, the Fed said banks reported a broad decline in loan demand during the first quarter of 2017, "even as lending standards on such loans were reported to be basically unchanged."

The Fed publishes the assessment, called the Monetary Policy Report, twice a year, in the winter and the summer. Janet L. Yellen, the Fed's chairwoman, will appear before House and Senate committees on Wednesday and Thursday to present the report.

Stanley Fischer, the Fed's vice chairman, said Thursday that uncertainty about federal fiscal policy may be weighing on the economy once again. Businesses reported a burst of optimism after President Trump's election, in part because of hope that the new administration would enact fiscal policies like tax cuts. But that optimism is flagging.

"This cautious approach to investment may in part reflect uncertainty about the policy environment," Mr. Fischer told an audience in Vineyard Haven, Mass. "Providing more clarity on the future direction of government policy is highly desirable."

The report noted, however, that business investment "rose robustly" in the first quarter, thanks to increased spending on drilling and mining equipment, which could indicate a shift.

The low level of investment may be one reason for the slow pace of productivity growth, an average annual pace of just 1 percent, about half the pace during the period from 1990 to 2004.

Productivity growth in the United States remains a little bit faster than in other developed countries.

The slow pace of productivity growth is an important reason that employee compensation is rising slowly. A measure of hourly compensation that includes wages, salaries and benefits rose at an annual pace of 2.25 percent over the last four quarters, the Fed said. Measures of wage growth, excluding benefits, are in the same ballpark.

There is some evidence of a modest upward trend as the labor market has tightened, but the growth remains very weak by historical standards.

The eagerness of investors is driving up a wide range of asset prices, a trend the Fed said had continued since its last report in mid-February. It noted that "valuation pressures have increased further" for Treasury securities, equities, corporate bonds and commercial real estate.

But the Fed is not sounding alarms. "Vulnerabilities in the U.S. financial system remain moderate on balance," it said.

It also dismissed persistent concerns about the liquidity of **financial markets**, particularly the market for corporate securities.

"Available evidence suggests that **financial markets** have performed well in recent years, with minimal impairment in liquidity, either in the market for corporate bonds or in the market for other assets."

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Markets & Finance: BOJ Props Up Domestic Bonds

By Suryatapa Bhattacharya
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B8
English

TOKYO -- Japan's central bank stepped in to tame a rise in government-bond yields on Friday, signaling its determination to stick to its current policy mix, even as the recent selloff in global bond markets intensifies.

The Bank of Japan's increased intervention in the markets came after the yield on the country's benchmark 10-year government bond rose earlier in the day to 0.105%, its highest since Feb. 3. The central bank's target is 0%. Bond yields rise as their prices fall.

The yield on the 10-year government bond later slipped back to 0.085%, after the BOJ said it would buy an unlimited amount of government bonds maturing in five to 10 years at a yield equivalent to 0.110% and raised the amount of bonds it said it would buy at a regularly scheduled auction.

The Japanese central bank's display of determination to prop up domestic **bond prices** came after the yield on benchmark German government bonds, known as bunds, rose overnight to its highest level in 18 months, 0.57%, and U.S. Treasury yields continued their recent climb. The bond selloff spilled into Asia Pacific on Friday, with yields on benchmark 10-year government bonds rising in Korea, Australia and Indonesia.

The trigger for government-bond market declines has been talk among leading central bankers suggesting that years of easy monetary policy designed to stimulate struggling economies may be coming to an end. The Federal Reserve is considering further interest-rate increases this year and the European Central Bank has been signaling that it is getting ready to wind down its stimulus efforts after years of huge bond buying.

The situation in Japan is different. If the Bank of Japan keeps to its inflation target, the market "cannot expect it to exit its stimulus program anytime soon," said Shuichi Ohsaki, rates strategist at Bank of America Merrill Lynch in Tokyo.

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The New York Times

Fair Game
Business Day
Warren Buffett Invests in Canada, but Should You?

By GRETCHEN MORGENSON
1,396 words
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NYTFEED
English

When Warren Buffett acts, investors notice. And after he took a roughly $300 million position last month in Home Capital Group, a troubled Canadian mortgage underwriter, some investors saw it as a vote of confidence not only in that company, but also in Canadian stocks over all.

Al Rosen takes a different view. A veteran forensic accountant and independent equity analyst who predicted the collapse of Nortel Networks, the Canadian telecom company, two years before its 2009 demise, Mr. Rosen has a message for people investing in Canadian stocks: be wary.

It is a mystery to Mr. Rosen why Mr. Buffett bought into Home Capital Group, a company that has been the subject of a titanic battle between the investors who believe in the company and other investors — short sellers — who do not. Certainly, Mr. Buffett expects to make money on his deal. But in an interview, Mr. Rosen said he thought there was more to the story than the markets yet know.

Mr. Rosen is certain of this: International accounting rules followed by Canadian companies since 2011 are putting investors in Canadian stocks — not just Home Capital Group's — at peril. Canada's rules, which are substantially different from the generally accepted accounting principles (G.A.A.P.) governing American companies, give much more leeway to corporate managers when it comes to valuing assets and recording cash flows.

In addition, a 1997 decision by the Supreme Court of Canada has severely limited investors in suing company auditors for malpractice. Combined, these two factors generally make Canadian stocks a danger zone, Mr. Rosen said.

American investors often fail to recognize this, though, because they assume Canadian companies are abiding by American accounting standards. "I've been trying to alert investors in the U.S. to this," Mr. Rosen said in an interview. "But there's just that belief that Canada is following U.S. standards when it's not."

Mr. Rosen provides forensic accounting services and also works with his son Mark Rosen at the Accountability Research Corporation in Toronto. The two men recently published a book called "Easy Prey Investors: Why Broken Safety Nets Threaten Your Wealth."

In Mr. Rosen's view, the international accounting standards followed by Canadian companies allow managers to apply overly rosy assumptions to the financial figures they report to investors. For a while, these assumptions can propel stock prices — and executive bonuses — well beyond where they would be otherwise, he said.

Canadian accounting rules can also mask problems at a company. How else, Mr. Rosen asked, to explain the events leading up to the June 22 bankruptcy filing by Sears Canada? The company's shares trade on both the Toronto Stock Exchange and the **Nasdaq** market in the United States.

Like many retailers, Sears Canada's fiscal year ends in January. It compiled its 2016 annual financial statement in accordance with International Financial Reporting Standards, set by the International Accounting Standards Board, a group of experts from an array of countries.

Sears Canada's numbers weren't good. Both revenues and same-store sales had fallen, but it reported shareholders' equity of 222 million Canadian dollars (about $171 million) and 1.24 billion Canadian dollars ($956 million) in total assets.

In the report, company management characterized Sears Canada as a going concern. In accounting parlance, that meant the business was expected to operate without the threat of liquidation for the next 12 months.

The auditor for Sears Canada did not challenge this view and assigned the company an unqualified — or "clean" — opinion on April 26. The report fairly represented Sears Canada's financial position, the opinion said. And that opinion may well have been justified under Canadian rules.

Less than two months later, Sears Canada was bankrupt.

"What are the auditing and accounting rules in Canada that allow you to give this totally clean opinion on a company and you can't even look beyond six weeks?" Mr. Rosen asked. "That's the scary situation with Sears, and we're just seeing it more and more on other cases coming forward."

Canada is not alone in following the International Financial Reporting Standards, or I.F.R.S. Some 150 jurisdictions in Europe, Africa, Asia and elsewhere also use these rules. Many are underdeveloped nations whose previous accounting rules were none too stringent.

The international standards came about in 2002, when the European Unionrequired adherence to them for all its listed companies beginning in 2005. The rules are designed to "bring transparency, accountability and efficiency to **financial markets**," the I.F.R.S. Foundation says in a mission statement on its website.

But that's not the outcome, Mr. Rosen said. In practice, the rules allow company executives to inflate their revenues and hide excessive acquisition costs. They also let managers overstate assets and understate liabilities, he said.

Not all managers will do so, of course. But Mr. Rosen's forensic accounting work has taught him that "for every honest manager, there's a cheat waiting to pounce."

A spokeswoman for the I.F.R.S. Foundation, Kirstina Reitan, said its members disagree with Mr. Rosen's take. "The success of accounting standards depends on companies applying them properly and exercising sound judgment," she said in an emailed statement. "Both U.S. G.A.A.P. and I.F.R.S. are high-quality standards, and one is not more prone to abuse than the other."

Still, the differences between the two standards can be significant. Consider, for example, the approach taken to recognizing revenue under the international standards.

Under these rules, companies can record revenues based on only a 50.001 percent probability of eventually collecting the money — something Mr. Rosen calls the "more-likely-than-not rule." By contrast, under American guidelines, managers must have a reasonable assurance that they will generate the revenues before they can record them; companies generally interpret this as 70 percent to 80 percent certainty, he said.

Valuing assets is another problem with international standards, Mr. Rosen said. Under the generally accepted accounting principles used in Canada before 2011, a company would have to complete the sale of a property or building before recording the results of the transaction for financial reporting purposes.

Because the international standards instead focus on current value accounting, executives have much more freedom to assign value to assets that may or may not be real.

Mr. Rosen presents a hypothetical example in his book. Say a company owns a building that may sell for $10 million. But based on medium-term contracts, the company's managers assess the building's current value at $18 million. In Canada, the managers can use the higher figure in the company's financial statements.

What can these differences mean to a particular company? In "Easy Prey Investors," Mr. Rosen presents a side-by-side example of one public company's 2011 financial results based on the previously applicable generally accepted accounting principles and the new international standards. The company, which owned rental properties, showed a $4 million loss under G.A.A.P. and an $82 million profit under the international standards.

"Many Canadian-traded stocks are trying to appear more financially adequate by utilizing the massive holes in I.F.R.S.," Mr. Rosen wrote in his book. He calls financial reporting in Canada right now "the calm before the storm."

The Toronto Stock Exchange index is up 6 percent over the past 52 weeks. Although that pales next to the Standard & Poor's 500 return, it is nonetheless respectable.

Seems as good a time as any to heed a warning from an experienced investigator like Mr. Rosen.

Twitter: @gmorgenson

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* The Trump Effect on C.E.O. Pay

The forensic accountant Al Rosen, who founded the Accountability Research Corporation with his son Mark, wants people to be wary of investing in Canadian stocks. | Cole Burston for The New York Times | On April 26, an International Financial Reporting Standards auditor assigned Sears Canada an unqualified — or “clean” — opinion after evaluating its annual financial statement. On June 22, the company filed for bankruptcy. | Frank Gunn/Canadian Press, via Associated Press

Document NYTFEED020170707ed77007eq

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U.S. News: Export Gains Shrink Trade Deficit

By Ben Leubsdorf
525 words
7 July 2017
The Wall Street Journal
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A2
English

WASHINGTON -- The U.S. trade deficit narrowed in May as exports rose to their highest level in more than two years.

The foreign-trade gap in goods and services narrowed 2.3% from April to a seasonally adjusted $46.51 billion in May, the Commerce Department said Thursday.

Imports fell 0.1% in May to $238.54 billion, and exports rose 0.4% from April. Total exports were $192.03 billion in May, the strongest month for overseas sales since April 2015.

"The survey evidence suggests that annual export growth will accelerate from here, reflecting the strength of the global economy and the slight depreciation of the U.S. dollar since the beginning of the year," said Michael Pearce, U.S. economist at Capital Economics, in a note to clients.

Data on international trade can be **volatile** from month to month, and the figures weren't adjusted for inflation.

The deficit had jumped in April and even after narrowing in May it was larger than at any point last year.

Both imports and exports have risen this year, reflecting a stronger world economy driving an upswing in global trade flows.

The dollar has strengthened against other currencies since 2014 but weakened since late last year; a strong dollar makes U.S. products more expensive for foreign customers.

"Exports have shown greater strength this year, in part reflecting a pickup in global growth," Federal Reserve Chairwoman Janet Yellen said last month.

In the first five months of 2017, the value of U.S. imports rose 7.3% while U.S. exports increased 6.0% compared with the year-earlier period.

The overall trade deficit was up 13.1% compared with the first five months of 2016.

Export demand could strengthen further headed into the second half of the year. The Institute for Supply Management said Monday that its index tracking new export orders at U.S. factories rose in June.

The U.S. imports more goods than it exports, though it runs a trade surplus for services.

The overall trade deficit totaled $504.79 billion in 2016, or roughly 2.7% of economic output as measured by nominal gross domestic product.

President Donald Trump campaigned for the White House on skepticism about current U.S. trade agreements.

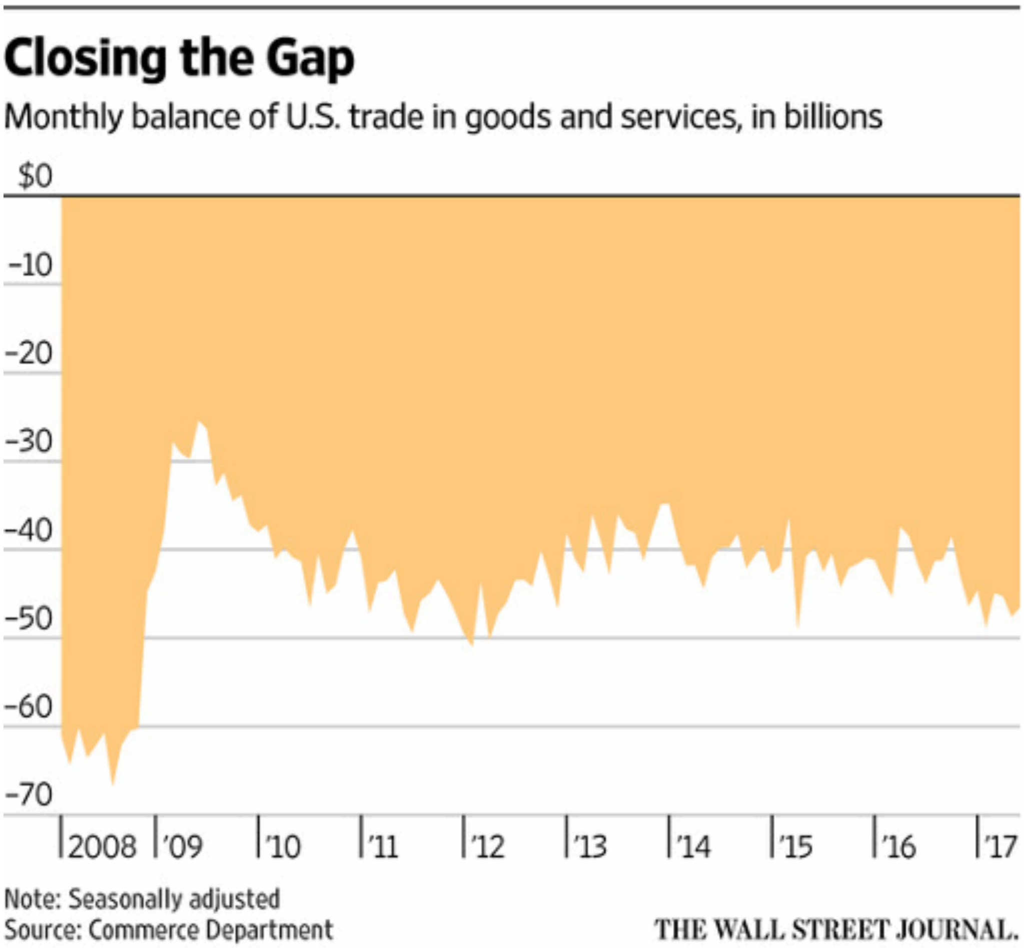
"The fact is that the United States has trade deficits with many, many countries, and we cannot allow that to continue," Mr. Trump said last week at a meeting with South Korean President Moon Jae-in.

Looking only at trade in goods, U.S. deficits with China and the European Union narrowed in May from April but remained sizable.

The U.S. ran trade surpluses during the month with the U.K. and Latin America.

The U.S. economy has run overall trade deficits for decades, during both economic expansions and recessions, which economists say reflects the fact that Americans consume more than they produce relative to the rest of the world.

To shrink or eliminate the gap, the U.S. would either have to produce more or consume less.



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THE WALL STREET JOURNAL.
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Rocky Trading Expected in Tech

By Chris Dieterich
415 words
7 July 2017
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B11
English

While traders continue to expect placid trading for the broader U.S. **equity market**, they are also seeing big moves in tech stocks.

A rare disconnect has emerged between the expected **volatility** of the **Nasdaq** 100 Index and the **S&P 500**. It is one more sign of investor uncertainty that 2017's biggest winners can continue to gallop higher.

Technology and internet stocks that propelled U.S. **stock market** gains for the first five months of this year but abruptly reversed course on June 9 and have lost ground since.

While **S&P 500** technology companies, including Apple Inc., Facebook Inc. and Google parent Alphabet Inc. climbed on Wednesday, the group has fallen 5.2% from last month's closing high.

Tech's U-turn was met with continued calm in the broader market. That is due in part to a rebound in shares of financial and health-care stocks, which have picked up the slack from tech.

The sector rotation is evident in the divergence between the subdued CBOE**Volatility** Index, or VIX, and a measure tracking the expected **volatility** of the tech-heavy **Nasdaq** 100.

The VIX is based on prices of **S&P 500** options and gauges expectations for swings in the index over the next 30 days.

The CBOE**NASDAQ**-100 **Volatility** Index does the same for the **Nasdaq** 100, an index of the largest nonfinancial stocks listed on that exchange.

The **Nasdaq** 100 **volatility** index darted as high as 18.9 this week from under 13 early last month, while the VIX ended Thursday at 12.5.

The current ratio of the two, at 1.4, is well above average and this week hit 1.7, near its highest level in a decade.

Traders often watch for unusual departures in trading relationships with the assumption that in time, the levels will revert to back to historical patterns.

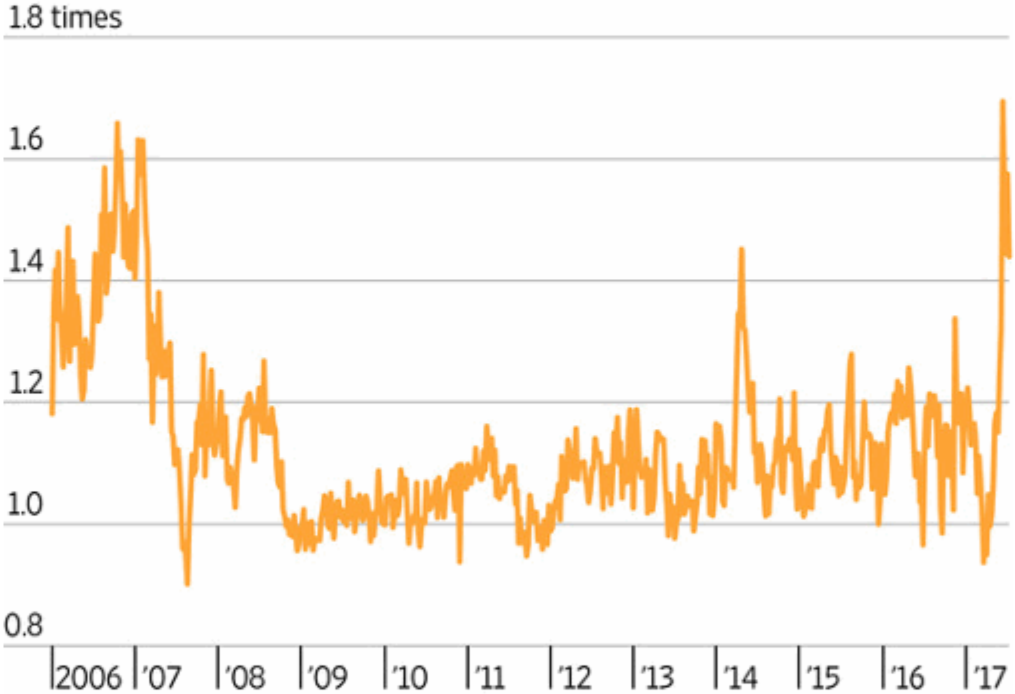
Expected **volatility** of the **Nasdaq** 100 tends to be higher than the **S&P 500** because its stocks are generally more **volatile**.

Still, the two have tended to move up and down in tandem. That indicates that either the VIX is due to play catch-up and rise or that worries about tech stocks will recede, pulling down the **Nasdaq**-100 **volatility** measure.

The degree of difference between the two gauges currently "is typically not sustainable," said Peter Tchir at Brean Capital LLC in New York.

Divergence

The ratio of the VXN, a measure of expected volatility in the Nasdaq 100 Index, to the VIX is near the highest in a decade.



Source: Chicago Board Options Exchange

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The New York Times

OP-ED CONTRIBUTOR
OpEd; SECT

A new deal for a volatile 21st century

By YANIS VAROUFAKIS
1,841 words
7 July 2017
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NYTF
The International New York Times
English

ATHENS -- The recent elections in France and Britain have confirmed the political establishment's simultaneous vulnerability and vigor in the face of a nationalist insurgency. This contradiction is the motif of the moment -- personified by the new French president, Emmanuel Macron, whose résumé made him a darling of the elites but who rode a wave of anti-establishment enthusiasm to power.

A similar paradox is visible in Britain in the surprising electoral success of the Labour Party leader, Jeremy Corbyn, in depriving Theresa May's Conservatives of an outright governing majority -- not least because the resulting hung Parliament seemingly gives the establishment some hope of a change in approach from Mrs. May's initial recalcitrant stance toward the European Union on the Brexit negotiations that have just begun.

Outsiders are having a field day almost everywhere in the West -- not necessarily in a manner that weakens the insiders, but neither also in a way that helps consolidate the insiders' position. The result is a situation in which the political establishment's once unassailable authority has died, but before any credible replacement has been born. The cloud of uncertainty and **volatility** that envelops us today is the product of this gap.

For too long, the political establishment in the West saw no threat on the horizon to its political monopoly. Just as with asset markets, in which price stability begets instability by encouraging excessive risk-taking, so, too, in Western politics the insiders took absurd risks, convinced that outsiders were never a real threat.

One example of the establishment's recklessness was releasing the financial sector from the restrictions that the New Deal and the postwar Bretton Woods agreement had imposed upon financiers to prevent them from repeating the damage seen with the crash of 1929 and the Great Depression. Another was building a system of world trade and credit that depended on the booming United States trade deficit to stabilize global aggregate demand. It is a measure of the sheer hubris of the Western establishment that it portrayed these steps as "riskless."

When the ensuing financialization of Western economies led to the great financial crisis of 2007-8, leaders on both sides of the Atlantic showed no compunction about practicing welfare socialism for bankers. Meanwhile, more vulnerable citizens were abandoned to the mercy of unfettered markets, which saw them as too expensive to hire at a decent wage and too indebted to court otherwise.

When the insiders' rescue schemes -- including quantitative easing, the buying up of toxic assets, the eurozone's bailouts and temporary nationalizations of banks -- succeeded in refloating banks and asset prices, they also left whole regions in the United States, and whole countries on Europe's periphery, stagnant. It was not rising inequality that provoked undying anger among these discarded people. It was the loss of dignity, of the dream of social mobility, as well as the experience of living in communities that were leveled down, so that a majority of people were increasingly equal but equally miserable.

As more and more voters became mad as hell, governing parties lost elections between 2008 and 2012 in the United States, Britain, France, Italy, Spain, Portugal, Ireland, Greece and elsewhere. The problem was that the incoming administrations were as much part of the establishment as the outgoing ones. And so they made bipartisan the very approach that had caused the wave of anger that carried them into office.

That approach was doomed, not least because economic forces were already working against the new governments. After the 2008 crash, the monetary easing by central bank institutions like the Federal Reserve, the

Bank of Japan and the Bank of England fended off a global repeat of the Great Depression. China's unleashing of a huge credit-fueled construction boom, which saw investment rise to 48 percent of national income in 2010, from 42 percent in 2007, and total credit climb to 220 percent of national income by 2014, from 130 percent in 2007, also softened the **financial market** failures of the West.

Unsurprisingly, though, these central bank money-creation schemes and the Chinese credit bubble proved unable to prevent severe regional depressions, which struck from Detroit to Athens. Nor could they prevent sharp global deflation from 2012 to 2015.

By 2014, voters had begun to give up on the new administrations they had voted for after 2008 in the false hope that the establishment's loyal opposition could provide new solutions. Thus, 2015 saw the first challenges to the insiders' authority start to surface.

In Greece -- a small country, yet one that has proved to be a bellwether thanks to its gargantuan and systemically significant debt -- protests against the debt bondage imposed on the population evolved into a progressive, internationalist coalition led by the Syriza party that came from nowhere to win government. In Spain, a similar movement, Podemos, began to rise in the polls, threatening to do the same.

In Britain, a left-wing internationalist tendency that had been marginal in the Labour Party coalesced around the leadership campaign of Jeremy Corbyn -- and surprised itself by winning. Soon after, the independent socialist senator from Vermont, Bernie Sanders, carried the same spirit into the Democratic Party primaries.

Everywhere, the political establishment treated these left-of-center, progressive internationalists with a mixture of contempt, ridicule, character assassination and brute force -- the worst case, of course, being the treatment of the Greek government in which I served during the first half of 2015. Historians may mark that year as when the establishment turned truly illiberal.

By 2016, the establishment's arrogance met its first, frightful nemesis: Brexit. The shock waves from the insiders' unheralded defeat in that referendum rippled across the West. They brought new energy to Donald Trump's outsider campaign in the American presidential election, and they invigorated Marine Le Pen's National Front in France.

From the West to the East, a new Nationalist International -- an allied front of right-wing chauvinist parties and movements -- arose.

The clash between the Nationalist International and the establishment was both real and illusory. The venom between Hillary Clinton and Donald Trump was genuine, as was the loathing in Britain between the Remain camp and the Leavers. But these combatants are accomplices, as much as foes, creating a feedback loop of mutual reinforcement that defines them and mobilizes their supporters.

The trick is to get outside the closed system of that loop. The progressive internationalism of Mr. Corbyn's Labour Party, Mr. Sanders's supporters and the Greek anti-austerity movement came to offer an alternative to the deceptive binaries of establishment insiders and nationalist outsiders. An interesting dynamic ensued: As the insiders defeated or sidelined the progressive internationalist outsiders, it was the nationalist outsiders who benefited. But once Mr. Trump, the Brexiteers and Ms. Le Pen were strengthened, a remarkable new alignment took place, with a series of unstable mergers between outsider forces and the establishment.

In Britain, we saw the Conservative Party, a standard-bearer of the establishment, adopt the pro-Brexit program of the tiny, extreme nationalist U.K. Independence Party. In the United States, the outsider in chief, Mr. Trump, formed an administration made up of Wall Street executives, oil company oligarchs and Washington lobbyists. As for France, the anti-establishment new president, Mr. Macron, is about to embark on an austerity agenda straight out of the insiders' manual. This will, most probably, end by fueling the current of isolationist nationalism in France.

Where does this prey-predator game between the globalist establishment and the isolationist blood-and-soil nationalists leave us?

The recent elections in Britain and France confirm that both strands are alive and kicking, reinforcing each other, as they tussle, to the detriment of a vast majority of their populations. Both Mrs. May's and the European Union's negotiating teams in Brussels are investing their efforts in an inevitable impasse, which each believes will bolster their political authority, even though it will disadvantage the populations on both sides of the English Channel that must live with the consequences.

In the United States, Mr. Trump is pursuing an economic policy that, if it has any effect, will set off a run on Treasury bonds at a time when the Fed is tightening monetary policy. A result will be a panicked administration whose reflex will be to impose austerity measures before the midterm elections. Those policies will further disadvantage precisely the regions and social groups that carried Mr. Trump into the White House.

So, what will it take to end this destructive dynamic of mutual reinforcement by the largely liberal establishment insiders and the regressive nationalist outsiders?

The answer lies in ditching both globalism and isolationism in favor of an authentic internationalism. It lies neither in more deregulation nor in greater Keynesian stimulus, but in finding ways to put to useful purpose the global glut of savings.

This would amount to an International New Deal, borrowing from Franklin D. Roosevelt's plan the basic idea of mobilizing idle private money for public purposes. But rather than through tax-and-spend programs at the level of national economies, this new New Deal should be administered by a partnership of central banks (like the Fed, the European Central Bank and others) and public investment banks (like the World Bank, Germany's KfW Development Bank, the Asian Infrastructure Investment Bank and so on). Under the auspices and direction of the Group of 20, the investment banks could issue bonds in a coordinated fashion, which these central banks would be ready to purchase, if necessary.

By this means, the available pool of global savings would provide the funds for major investments in the jobs, the regions, the health and education projects and the green technologies that humanity needs. A further step would be to generate more, better-balanced trade by establishing a new international clearing union, to be run by the International Monetary Fund. The new clearing union would help to rebalance trade and create an International Wealth Fund to fund programs to alleviate poverty, develop human capital and support marginalized communities in the United States, Europe and beyond.

Today's false feud between globalization and nationalism is undermining the future of humanity, and spreading dread and loathing. It must end. A new internationalist spirit that would build institutions to serve the interests of the many is as pertinent today across the world as Roosevelt's New Deal was for America in the 1930s.

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Yanis Varoufakis, a former finance minister of Greece, is a professor of economics at the University of Athens and a founder of DiEM25, a European umbrella group of progressive democratic organizations.

Results of an exit poll predicting Labour Party victories in the British general election last month, projected onto the BBC Broadcasting House at Portland Place in London. PAUL ELLIS/AGENCE FRANCE-PRESSE -- GETTY IMAGES

Document NYTF000020170707ed770006q

The New York Times

Business/Financial Desk; SECTB
Forecasts Dim Hopes for a 'Trump Bump'

By NELSON D. SCHWARTZ
1,335 words
7 July 2017
The New York Times
NYTF
Late Edition - Final
1
English

The promise of faster economic growth has become a study in the triumph of hope over experience.

While the June jobs report, coming on Friday, is expected to show that hiring continued at a healthy pace last month, other recent indicators in areas like consumer spending, construction and auto sales have been decidedly less robust.

As a result, Wall Street forecasters have been busy lowering their growth estimates for the second quarter, which ended last Friday, much as they were forced to do over the first three months of the year. Economic expansion for the full year now appears unlikely to be much greater than 2 percent -- about the average for the current recovery, which celebrates its eighth year this month.

While hardly terrible, it is not the burst of growth -- a ''Trump bump'' -- that many expected to result from an upturn in consumer and business sentiment after President Trump's election.

Mr. Trump himself declared upon taking office that his policies would produce 4 percent annual growth, and just this week said on Twitter to affirm that ''things are starting to kick in now.''

Really great numbers on jobs & the economy! Things are starting to kick in now, and we have just begun! Don't like steel & aluminum dumping! -- Donald J. Trump (@realDonaldTrump) July 3, 2017

But the Federal Reserve Bank of Atlanta's widely followed GDP Now expects the second-quarter growth figure to come in at 2.7 percent, more than a full percentage point below where it was in May, and a decline even since the beginning of the week. The New York Fed's Nowcast is even more **bearish**, with an estimate of 1.9 percent for the quarter just ended and 1.6 percent for the current quarter.

''We never seem to have the rebound that people anticipate,'' said Stephanie Pomboy, an independent economist in New York who has been skeptical about initially rosy forecasts favored by many of her colleagues in recent quarters.

The fading expectations for the current quarter are only the latest example of how faster economic growth seems perpetually out of reach.

Far from living up to expectations of a lift after Mr. Trump's election, the growth rate in the first quarter turned out to be an anemic 1.4 percent. Some of the weakness stemmed from seasonal factors and calendar quirks that have repeatedly produced soft annual starts during the current recovery.

The indicators that Mr. Trump highlighted in recent messages on Twitter are indeed pointing in the right direction -- strong job creation, a record high for the **Dow Jonesindustrial average** and low gasoline prices. But so far, the economy's basic trajectory remains the same as it did under President Barack Obama.

The diminishing expectations are reflected in the dollar's recent slump. That is not necessarily a bad thing -- a weaker dollar makes exports more competitive in foreign markets. It is, however, a sign of the world's take on the American economy, as well as an indication of improving prospects abroad, especially in Europe.

Experts say that without a meaningful change in government policies -- greater infrastructure investment, an overhaul of the corporate tax code, a new commitment to improve the skills of American workers -- there is no reason to expect the domestic outlook to change.

And with deep party divisions in Washington -- and the inability of Republicans so far to capitalize on control of Congress and the White House -- the odds of passing a major infrastructure bill or sweeping tax legislation are growing longer by the day.

''I don't see any reason we will veer from a 2 percent growth rate,'' said Scott Anderson, chief economist at Bank of the West in San Francisco. ''The safe bet is to expect more of the same. Unless we do things to boost productivity, this is the economy we are going to see.''

Growth of 2 percent is not horrible, especially given that the recovery is now the third longest on record and that the unemployment rate is at 4.3 percent, the lowest in 16 years.

Still, it is a far cry from the annual gains of 3 percent or more achieved a decade ago, or the 4 percent rate in the late 1990s. Nor is it strong enough to deliver big increases in household income, which has been stagnant for decades for all but the wealthiest slice of the population.

Mr. Anderson said much of the deceleration could be linked to forces beyond the control of politicians and policy makers: an aging population in the United States and a work force that is growing much more slowly than in past decades.

''Washington seems tone deaf to this reality,'' he said. ''Economists have been talking about these things for years, but getting the political will together to address them has been difficult with the gridlock in Washington.''

''We had an opportunity to do some real heavy lifting on the infrastructure issue when interest rates were very low,'' Mr. Anderson added. That window has now almost certainly closed, with the Fed normalizing monetary policy and gradually raising interest rates.

With higher borrowing costs practically inevitable in the future, Mr. Anderson said, ''the real tragedy is that the price tag for any future infrastructure spending will be a lot higher.''

Ms. Pomboy pointed out that changing consumer habits in the wake of the financial crisis and the recession -- notably an increased wariness about spending and taking on debt -- also explain what is looking more and more like a long-term downshift.

''The post-crisis consumer is fundamentally different from the consumer we knew and loved before the crisis,'' she said. The household savings rate, which bottomed out at 2.2 percent amid the housing bubble in 2005, now stands at 5.5 percent.

In addition to being more cautious about spending in general and about borrowing against their homes in particular, Ms. Pomboy said, consumers are holding back on discretionary purchases because of the rising health insurance premiums and medical costs as well as onerous student debt payments.

Another warning sign: After rising steadily from 2011 to 2015, federal tax payments from individuals are down slightly this year compared with the previous 12 months, suggesting that personal income is faltering.

''Despite lip service about the 'new normal,' economists continue to forecast growth of 3 to 3.5 percent,'' Ms. Pomboy said. ''We're eight years into the recovery -- that's not when things accelerate. It's when they die.''

To be sure, most mainstream economists do not foresee an imminent recession.

Nariman Behravesh, chief economist at IHS Markit, goes so far as to say, ''we're chugging along here,'' citing healthy income growth and hiring, as well as a strong housing market.

Nor is everyone prepared to give up on growth.

Macroeconomic Advisers, a St. Louis research firm whose crystal ball is highly regarded among forecasters, began the second quarter by calling for 3.6 percent growth but now estimates the rate will be more like 2.5 percent. But Ben Herzon, a senior economist there, said the rebound is delayed, not dead, especially as businesses restock warehouses and shelves after drawing on inventories in the first half of the year.

''Godot has to show up at same point,'' he joked. ''The models are showing that.''

Workers at a Marriott Renaissance hotel in Plano, Tex., in March. Job growth is expected to stay healthy, but other indicators are not so rosy. (PHOTOGRAPH BY BRANDON THIBODEAUX FOR THE NEW YORK TIMES) (B1); A construction site in Manhattan. The unemployment rate is at a 16-year low, but experts are lowering their growth predictions for the American economy this year. (PHOTOGRAPH BY DREW ANGERER/GETTY IMAGES) (B2) MAP: Fading Expectations: In both the first and second quarters of 2017, initial hopes for a burst of growth faded, as Goldman Sachs's evolving estimates show. (Source: Goldman Sachs) (B2)

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U.S. News: Illinois House Overrides Veto To Pass Budget, Ending Standoff

By Quint Forgey
354 words
7 July 2017
The Wall Street Journal
J
A3
English

Illinois has a budget for the first time in more than two years, ending a standoff that threatened to downgrade the state's debt to junk status and was wreaking havoc with cities, colleges and school districts across the state.

The state's House of Representatives, led by Democratic Speaker Michael Madigan, voted Thursday to override Republican Gov. Bruce Rauner's vetoes of revenue and spending measures the chamber passed Sunday.

The House's repudiation of the governor marked the final hurdle in enacting a budget for Illinois -- the first state in the union to have gone without a budget for more than a year since the Great Depression. Illinois entered its third fiscal year without a budget on July 1.

"The people in this chamber did not do what was easy today, but they did do what was right for the future of our state," Mr. Madigan said on the House floor following the votes.

"Today was another step in Illinois' never-ending tragic trail of tax hikes," Mr. Rauner said in a statement after the vote. "It proves how desperately we need real property tax relief and term limits."

The new budget funds a more than $36 billion spending proposal with a roughly $5 billion income-tax increase. The state brings in roughly $32 billion a year.

The plan also includes a provision that would allow Illinois to borrow billions of dollars through the sale of bonds. Those funds would go toward paying down the $14.6 billion in unpaid bills the state has accrued since 2015.

Illinois **bond prices** have climbed this week as lawmakers made progress toward a budget. A 2014 Illinois general obligation bond maturing in 2030 traded at 99.5 cents on the dollar Thursday, up from 99 cents Wednesday.

Ahead of the House action Thursday, the Capitol was put on lockdown while a Hazmat crew investigated reports of a woman throwing an unidentified white powder into the offices of the governor and other areas.

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Heard on the Street
Overheard

154 words
7 July 2017
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

What do a Connecticut bank, a furniture maker and a gold miner have in common? They are the **S&P 500** stocks most heavily owned by index funds, according to Bank of America Merrill Lynch.

People's United Financial, Leggett & Platt and Newmont Mining are all more than 20% owned by index funds.

Why does that matter? Because the more shares are owned by passive funds, the fewer shares are available for regular trading. That can make stocks more **volatile**, according to Merrill.

The share of assets run by index funds has doubled since 2009 and the impact of the change has been debated endlessly.

Merrill argues that stocks with the highest passive ownership have become more **volatile** and suffer bigger drops than comparable stocks.

Investors who buy index funds thinking they are safer should get ready for a wild ride.

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The New York Times

Business Day
Tesla Loses No. 1 Spot in Market Value Among U.S. Automakers

By NEAL E. BOUDETTE
1,022 words
6 July 2017
09:51 AM
NYTimes.com Feed
NYTFEED
English

For almost three months, Tesla reigned as the most valuable automaker in the nation, ahead of both General Motors and Ford Motor, thanks to a remarkable run-up in its stock this year. It seemed its chief executive, Elon Musk, could do no wrong.

But a spate of negative news this week has brought the electric-car maker's many challenges into focus, especially its ambitious plans to ramp up production of its first mass-market offering, the Model 3, which begins rolling off the assembly line on Friday.

With investors shying away, Tesla has seen its shares fall by almost 17 percent since Monday's intraday high, to $308.89, including a 5.6 percent drop on Thursday. That reduced the company's market capitalization to $50.7 billion, according to Bloomberg, and put G.M. ahead once again, at $52.6 billion.

Most critical to Tesla's troubles was a new, slower timetable for the Model 3 introduction, and a separate acknowledgment of problems manufacturing battery packs, a critical component of its cars, in the second quarter, said David Whiston, an analyst at Morningstar.

"The market is punishing them harshly for that," Mr. Whiston said.

It may be harder for Tesla to pass G.M. a second time. Auto sales in the United States are slowing over all, and Tesla is not yet a significant player in China, the world's largest auto market. In the second quarter, Tesla produced more cars than it delivered to customers, causing some analysts to question whether demand for current models — the Model S sedan and the Model X, a sport-utility vehicle — is reaching a plateau.

While Tesla is by far the most successful producer of battery-powered electric cars, analysts believe traditional automakers will catch up fairly soon. This week, Volvo, the Swedish company, stole some of Tesla's thunder by saying that all its models would be hybrid or fully electric vehicles by 2019.

With established manufacturers expanding their electric options, "Tesla will face intense competition by the next decade," Brian Johnson, a financial analyst at Barclays, wrote in a note to clients.

But by far the biggest concerns are related to the Model 3.

Until now, the company has produced the Model S and Model X, which can sell for $70,000 and up, in relatively small numbers. In 2016, Tesla made about 85,000 vehicles. But the Model 3 will be priced at roughly $35,000 and is aimed at a wider range of buyers. With the Model 3 in the lineup, Tesla expects to sell about 500,000 cars a year by 2018.

Last year, Mr. Musk predicted that Tesla would sell about 100,000 Model 3s this year. But late on Sunday, outlining a production plan on Twitter, he said the company expected to make 30 this month, 100 in August, and 1,500 in September. He expected production to climb to about 20,000 cars in December. That would leave it well short of 100,000.

Concern over Model 3 production was compounded when the company said its giant battery plant in Nevada had struggled to produce enough battery packs.

“Up to now, Tesla has had little experience with volume production,” Axel Schmidt, managing director of the automotive practice at Accenture, a large consulting firm, said in an email. Ramping up Model 3 production “remains a huge challenge,” he said.

The slump in Tesla’s share price halts a remarkable surge for the company, in which its stock rose from a little over $180 in November to more than twice that recently.

A year ago, Tesla stock was shaken by news that an owner of a Model S was killed when his car, operating in the company’s self-driving mode known as Autopilot, failed to see a tractor-trailer crossing a highway in Florida.

The crash raised questions about the reliability of the technology and about whether Tesla had overstated its capability in its marketing, and even in using the name Autopilot. Federal agencies opened investigations, including one to determine if there was a safety defect in Autopilot.

The **stock price** languished even after Mr. Musk laid out an updated “master plan” for the company, with a pledge to expand beyond electric cars into battery-powered pickups, semi-trailer trucks and buses, and to equip them with advanced self-driving systems.

But this year, investors began focusing on the introduction of the Model 3 and Mr. Musk’s confident prediction that Tesla would be able to increase sales fivefold next year.

Tesla raised $1 billion in stock and debt offerings to bolster its coffers in advance of the Model 3 introduction. The National Highway Traffic Safety Administration concluded its investigation of the fatal crash and found no defects in Autopilot.

April brought more good news: a strong jump in vehicle production in the first quarter, and a new surge in the **stock price** that pushed Tesla’s market value to $48 billion, surpassing the market capitalization of Ford Motor. The run continued, and on April 10, the stock surged to $312.39.

That made Tesla more valuable than General Motors, a company that last year produced more than nine million vehicles and earned $9.4 billion. Tesla, by comparison, produced about 85,000 cars last year and reported losses in most of the last several quarters. In the first quarter of this year, it lost $397 million, compared with a loss of $282 million in the same period a year earlier. The company’s revenue more than doubled, however, to $2.7 billion.

* Tesla’s First Mass-Market Car, the Model 3, Hits Production This Week

* Tesla in Talks to Set Up Electric Car Factory in Shanghai

* G.M. and Tesla Shareholders Rebuff Dissidents’ Proposals

* Tesla’s Market Surge Has Even Fans Looking for Feet of Clay

The Tesla Model 3 at the automaker’s battery factory in Sparks, Nev. Tesla said problems in battery manufacturing had hindered output of its luxury cars. | James Glover/Reuters

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U.S. News -- Capital Account: Economic Conditions Signal Recession Risk

By Greg Ip
851 words
6 July 2017
The Wall Street Journal
J
A2
English

If you drew up a list of preconditions for recession, it would include the following: a labor market at full strength, frothy asset prices, tightening central banks, and a pervasive sense of calm.

In other words, it would look a lot like the present.

Those of us who have lived through economic mayhem before feel our muscle memory twitch at times like this. Consider the worrisome absence of worry. "Implied **volatility**" measures the cost of hedging against big market moves via options. When fear is pervasive, options are expensive so implied **volatility** is high. At present, implied **volatility** in bonds, stocks, currencies and gold sits near its lowest since mid-2007, the eve of the financial crisis, according to a composite measure maintained by Variant Perception, a London-based investment advisory.

The economic expansion is now entering its ninth year and in two years will be the longest on record. The unemployment rate sits at 4.3%, the lowest in 16 years, suggesting the economy has reached, or nearly reached, full capacity.

Expansions don't die of old age, economists like to say. On the other hand, should we really assume this one will be a record breaker? From a level this low, unemployment has more room to go up than down. Another ominous sign: Central banks are tightening monetary policy, which has preceded every recession. The Fed has raised rates three times since December and last week central banks in Britain, the eurozone and Canada all hinted that years of easy money were coming to an end.

Still, the presence of recession preconditions isn't enough to say one is imminent. To understand implied **volatility**, think of hurricane insurance. Right after a storm, homeowners are more anxious to have coverage, even as insurers withdraw, which of course means premiums spike. As years go by without another hurricane, homeowners let their coverage lapse, insurers return and premiums drop. Similarly, implied **volatility** is low today because years without a financial calamity have sapped demand for hedging while enticing sellers with the prospect of steady income in exchange for potentially huge losses. But just as hurricane premiums don't predict the next hurricane, low implied **volatility** tells us nothing about whether or when a downdraft will actually come.

Similarly, when unemployment got nearly this low in 1989 and again in 2006, a recession was about a year away; but in 1998, it was three years away, and in 1965, four years. A narrowing spread between short-term interest rates and long-term rates comparable to the present has happened 12 times since 1962, and only five times did recession follow within two years.

But if today's conditions don't dictate a recession or a market meltdown, they expose vulnerabilities that make either more likely in the face of some catalyzing event.

When growth is steady and interest rates are low for years, investors and businesses behave as if those conditions will last forever. That's why even with muted economic growth, stocks are trading at a historically high 22 times the past year's earnings. It's also why home prices have returned to their pre-crisis peaks in major American cities.

Companies meanwhile have responded to slow, stable growth and low rates by borrowing heavily, often to buy back stock or pay dividends. Corporate debt as a share of economic output is at levels last seen just before the past two recessions.

When everyone acts as if steady growth and low **volatility** will last forever, it guarantees they won't. Once asset prices fall, the flow of credit that sustained them dries up, aggravating the correction.

Of course, some things are different this time. The postcrisis regulatory crackdown means if asset prices fall, they probably won't take banks down with them. Last week Janet Yellen, the Fed chairwoman, said she thought there wouldn't be another financial crisis "in our lifetimes." Fair enough: crises as catastrophic as the last happen twice a century. But small crises are inevitable as risk migrates to financial players who haven't drawn the attention of regulators. "Elevated asset valuation pressures today may be indicative of rising vulnerabilities tomorrow," Fed vice chairman Stanley Fischer warned last week.

Inflation is uncomfortably low rather than too high as in previous cycles, which makes it less likely central banks will have to raise interest rates sharply or rapidly. But in a world with permanently lower inflation and growth, businesses will struggle to earn their way out of debt, and interest rates will bite at lower levels than before. This confronts the Fed with a dilemma. If bond yields remain around 2% to 2.5%, the Fed may be playing with fire by pushing rates to 3%, as planned. If it backs off those plans, it could egg on excesses that make any reversal more violent.

Ms. Yellen and Mr. Fischer, both veterans of past mayhem, need to be on guard for a repeat. So should everyone else.

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Heard on the Street
The Fed's Words Appear to Spell Worry

By Justin Lahart
286 words
6 July 2017
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

Is the drop in inflation starting to rattle Federal Reserve policy makers? Their words suggest as much.

At their meeting last month, Fed officials debated when to start shrinking the central bank's balance sheet, according to meeting minutes released Wednesday. The main sticking point: uncertainty over whether the recent drop in inflation is temporary or a real problem.

Indeed, inflation was much on the policy makers' minds, according to a textual analysis of the minutes conducted by University of Notre Dame economist Bill McDonald. The word showed up 97 times in the minutes. That was the most since the minutes of the January 2016 meeting, when worries about emerging-market stresses, falling commodity prices and slower U.S. growth were buckling **financial markets**.

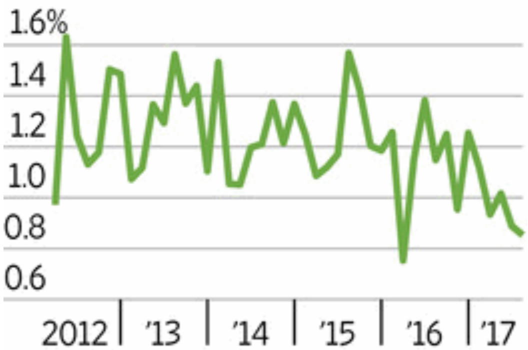
The low level of inflation is a worry for the Fed because it calls into question whether the central bank will be able to keep raising rates to what it considers normal levels without damaging the economy.

The tone of the minutes was also less upbeat. The share of words in the minutes that were positive ("optimistic," "progress," etc.), fell to the lowest level since January 2016, according to Mr. McDonald. Such shifts in tone can be revelatory. As carefully worded as the Fed's communications tend to be, they can reveal shifts in sentiment.

Consider what happened after the Fed's January 2016 meeting: Even though some Fed officials had recently professed otherwise, they soon dialed back plans to raise rates four times over the course of the year. In the end, they ended up tightening only once.

Mood Swing

Positive words as share of total words in Federal Reserve minutes



Source: Bill McDonald

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Hotels, Cruise Lines, Casinos Flourish --- Stocks are among top U.S. performers as demand for travel and leisure stays strong

By Amrith Ramkumar
732 words
6 July 2017
The Wall Street Journal
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B11
English

Hotels, cruise lines and casinos are some of the best-performing stocks in the U.S. so far this year, reflecting solid demand for travel and leisure despite industry concerns that President Donald Trump's policies could hurt foreign tourism.

Wynn Resorts Ltd. was one of the top five best-performing stocks in the **S&P 500** so far this year, rising 53% through Wednesday. Royal Caribbean Cruises Ltd. and Wyndham Worldwide Corp., a hospitality-service company, were among the index's 35 best performers. A group of 11 hotel, restaurant and leisure stocks in the **S&P 500** has risen 19% so far this year, outperforming the **S&P 500** and its broad consumer-discretionary sector.

Some travel organizations, including the World Travel & Tourism Council and travel consultant ForwardKeys, have said that they expected some of Mr. Trump's policies to damp appetite for tourism to the U.S.

The administration started to implement its temporary travel ban that affects visitors from six Muslim-majority nations last week and has pushed to restrict some visas and issued new security measures for airlines flying to the U.S.

"We are watching it like a hawk," said Marriott International Inc. Chief Executive Arne Sorensen, when asked at an analyst meeting in March about travel challenges relating to the travel ban, currency difficulties and nationalist sentiment in the U.S. and abroad. "To state the obvious, the language around these issues and the sentiment around these issues is not a positive thing."

Mr. Sorensen is one of several executives who have publicly voiced concerns that Mr. Trump's policies could hurt the travel industry.

So far, some analysts say that anxiety hasn't hurt their shares. Travel and leisure shares are benefiting from improved consumer confidence and tourism-related spending, making them attractive investment alternatives compared with other stocks in the consumer-discretionary sector, they say. The **S&P 500** grouping also includes traditional retailers, many of which have been hammered by lower foot traffic and internet competition from e-commerce giants like Amazon.com Inc.

"Consumer-discretionary money needs to be invested somewhere, and the gaming and lodging spaces have benefited from some of the Amazon-driven disruption in some of the other subsectors," Deutsche Bank analyst Carlo Santarelli said.

The U.S. Travel Association said Wednesday that international travel to the U.S. grew in May compared with the same month a year earlier, after also posting a year-to-year increase in April. Domestic travel also rose in May, the association said.

As of May, spending on hotels, leisure and travel has increased every month except for two since the start of 2015 compared with a year earlier, according to First Data Corp. Sales data from a database that includes four million merchant locations across the U.S. show monthly travel expenditures increased almost 6% on average year to year, hotel expenditures rose 4.4% and leisure spending increased 2.8% over that period.

Aside from leisure-linked shares in the consumer-discretionary sector, "you're looking at retail or restaurants, where every day, same-store sales are down," and store closures and fears of competitive encroachment weigh on investors, said Rachael Rothman, a Susquehanna Financial Group analyst who covers hotels, casinos and cruise companies.

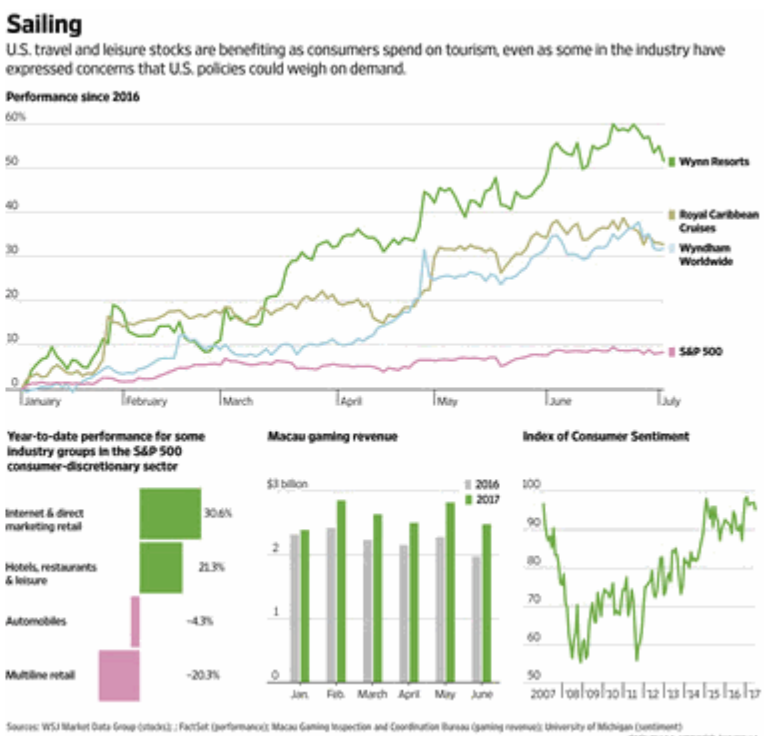
Meanwhile, casinos are benefiting from strength in Macau, Las Vegas and regional gambling, Telsey Advisory Group senior equity analyst David Katz said.

Macau monthly gambling revenue has increased every month from a year earlier since August 2016, according to the Macau Gaming Inspection and Coordination Bureau. That follows 26 months of declines as Chinese President Xi Jinping's administration cracked down on corruption.

Steve Wynn, chairman and CEO of Wynn Resorts, said on Wynn's most recent earnings call in late April that the crackdown hurt the company briefly, but that expected patterns of spending were resuming.

"People are settling back into routines that they're comfortable with, and that includes going to Macau and buying a new car or shopping at Louis Vuitton," Mr. Wynn said.

Wall Street analysts expect Wynn's earnings per share to grow by more than 40% from the end of 2016 to the end of 2017, according to FactSet.



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The New York Times

Foreign Desk; SECTA
Going Electric, Volvo Declares Gas Is the Past

By JACK EWING; Bill Vlasic contributed reporting.
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English

Volvo Cars on Wednesday became the first mainstream automaker to sound the death knell of the internal combustion engine, saying that all the models it introduces starting in 2019 will be either hybrids or powered solely by batteries.

The decision is the boldest commitment by any major car company to technologies that currently represent a small share of the total vehicle market but are increasingly viewed as essential to combating climate change and urban pollution.

While most major automakers offer hybrids and battery-powered options, none of them have been willing to forsake cars powered solely by gasoline or diesel fuel. On the contrary, United States automakers have continued to churn out S.U.V.s and pickup trucks, whose sales have surged because of relatively low fuel prices.

Yet Volvo's move may be the latest sign that the era of the gas guzzler is slowly coming to an end. Tesla, which makes only limited numbers of electric cars, surpassed Ford and General Motors this year in terms of **stock market** value, despite making significantly fewer cars than those automotive giants -- a clear indication of where investors think the industry is headed.

''Our customers are asking more and more about electric cars,'' Hakan Samuelsson, the chief executive of Volvo, said in a telephone interview on Wednesday. While Volvo's strategy has risks, Mr. Samuelsson acknowledged, ''a much bigger risk would be to stick with internal combustion engines.''

Though based in Sweden, Volvo is owned by Geely Automobile Holdings of China, which already produces battery-powered cars for the Chinese market. The decision by Volvo to focus on electric vehicles could ultimately give it and Geely a head start if, as many analysts expect, sales of battery powered cars begin to take off. China is already the largest market for electric vehicles.

Volvo's battery-powered vehicles will be produced initially in China, but eventually also in Europe and at a new factory the company is building near Charleston, S.C.

Hybrids, which combine battery power with gasoline or diesel engines, accounted for about 2 percent of passenger car sales in the United States last year, a number that has been declining because gasoline prices have fallen.

And cars that run solely on battery power are still rare in most countries because of high purchase prices, lengthy charging times and limited ranges.

Still, most carmakers expect the share of electric cars to grow quickly as the technology improves, prices fall and public charging stations become more commonplace. Rapid advances in self-driving cars will also encourage a shift to battery power: It is simpler to link self-driving software to an electric motor than to a conventional engine.

We are committed to electrification, so from 2019 all new Volvo car models will include an electric motor. #VolvoCarsEVs pic.twitter.com/FWGVKyAdgo -- Volvo Cars (@volvocarsglobal) July 5, 2017

Although no other traditional carmakers have declared their intention to bury the internal combustion engine, virtually all of them are investing in hybrid and battery technology.

Daimler, the maker of Mercedes-Benz cars and trucks, said on Wednesday that it would invest 5 billion renminbi, or $735 million, in a new battery factory it will build in Beijing with its Chinese partner, BAIC Motor.

The major American automakers are moving forward with their own electrification strategies, albeit on a much smaller scale than Tesla and now Volvo.

General Motors, for example, this year introduced the Chevrolet Bolt -- a battery-powered model that sells for about $35,000 before government incentives are applied. The Bolt can travel 238 miles on a single charge and will be the basis for other electric models that G.M. expects to add to its lineup.

Ford has sold electric versions of a few mainstream models, but it has not yet developed an all-electric vehicle from the ground up. That is changing, however. The company has said it will introduce a battery-powered S.U.V. by 2020 and will add other electric models thereafter.

The third big domestic automaker, Fiat Chrysler, has lagged. It sells an electric version of its Fiat 500 subcompact car and a hybrid gas-electric variation of its Chrysler Pacifica minivan. But the company has yet to announce any plans to build a new vehicle that is available only as an electric model.

Even though consumer demand for electric cars is so far small, carmakers view it as a way for them to meet stricter fuel economy and pollution standards. The pressure is particularly acute in Europe, where an emissions cheating scandal at Volkswagen has set off a sharp decline in the sales of diesel cars, which account for about half the auto market in the region.

Carmakers including Volvo have depended on diesel to provide better fuel efficiency and lower carbon dioxide emissions. But the Volkswagen scandal has raised awareness of the health effects of diesel exhaust.

Diesel engines burn fuel more efficiently than gasoline motors, but they produce far more nitrogen oxides, which cause asthma and are considered a carcinogen. The cost of the equipment needed to neutralize diesel fumes is becoming prohibitive.

"The diesel engine is getting more expensive," Mr. Samuelsson said during a news conference in Stockholm on Wednesday. "We would prefer to talk about the alternatives."

The changing political landscape in the United States has somewhat muddied the outlook for electric cars on the other side of the Atlantic. The Obama administration was highly supportive of electrified vehicles, which could help companies meet tougher federal fuel-economy standards.

But, so far, President Trump has not pursued policies that encourage the development of electric vehicles.

Moreover, the persistence of low gasoline prices continues to push American buyers toward bigger vehicles -- trucks and S.U.V.s -- and has made the fuel economy of electric or hybrid vehicles less potent as a selling point.

Volvo's transition will be gradual. It plans to still produce existing models with conventional engines after 2019, but it will no longer introduce new models with the older technology. Depending on demand, Volvo will completely phase out cars powered solely by gasoline or diesel by around 2024.

But by focusing on electrification, Volvo can concentrate its limited research and development resources on new technologies rather than continuing to invest in fuel-powered motors that may become obsolete. With sales of 534,000 cars last year, Volvo is dwarfed by companies like Toyota, Volkswagen and General Motors, each of which sold about 10 million vehicles in 2016.

Volvo will be able to draw on technology developed by its parent company, Geely. The companies can also save money by purchasing components such as batteries together.

Analysts said Volvo's decision to pursue a lineup dedicated to electric and hybrid vehicles is motivated, in part, by the Chinese government's efforts to reduce harmful emissions from internal combustion engines.

"Chinese ownership of Swedish-based Volvo likely played a role in the automaker's announcement today," said Michelle Krebs, an analyst with the auto-research site Autotrader.com. "China's air pollution problems have prompted a more serious push toward cleaner automobiles."

Volvo said on Wednesday that it would introduce five models from 2019 to 2021 that would run solely on electric power. That includes two models sold under Volvo's Polestar brand, which the company is marketing as a maker of high-performance electrified cars.

Other models will include plug-in hybrids, which can be charged from power outlets and run for short distances solely on batteries, and so-called mild hybrids, which charge their batteries from the car's conventional engine or by recovering energy from braking. Hybrids still require gasoline or diesel fuel, but they are typically more efficient because the batteries share the load.

Mr. Samuelsson said the company also wanted to encourage suppliers to invest in battery technology and charging stations.

''It's important to make a clear statement,'' he said.

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The New York Times

Business/Financial Desk; SECTB
Oil Prices Tumble, Dragging Energy Companies Down

By THE ASSOCIATED PRESS
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English

Stock indexes were mixed on Wednesday as energy companies skidded along with **oil prices**, but technology stocks rose and reversed part of their recent losses.

After O'Reilly Automotive reported weak sales growth in the second quarter, the three biggest losers on the **Standard & Poor's 500**-**stockindex** were all auto parts companies. Carmakers, too, slumped.

An eight-day rally in United States crude **oil prices** ended with a thud, and energy companies took sharp losses. Retailers and small, domestically focused companies also struggled.

Technology companies bucked the trend and finished higher. Those companies have hit a wall in the last month. Banks and industrial and health care companies also rose on another quiet day of trading after the Independence Day holiday.

The Federal Reserve is trying to decide when it will start letting its $4.5 trillion bond portfolio shrink. Some Fed officials want to announce the start of that process within a few months, according to minutes from the central bank's June meeting, while others want to wait longer.

''The Fed seems to be a little bit divided over what it's going to do,'' said Doug Burtnick, deputy head of North American equities for Aberdeen Asset Management. That division, he said, makes investors put more emphasis on economic reports and other data.

The **S**.**&P**. **500** added 3.53 points, or 0.2 percent, to 2,432.54. The **Dow Jonesindustrial average** slid 1.10 points to 21,478.17. The **Nasdaq composite** rose 40.80 points, or 0.7 percent, to 6,150.86.

Benchmark United States crude dropped $1.94, or 4.1 percent, to $45.13 a barrel in New York. Brent crude, used to price international oils, sank $1.82, or 3.7 percent, to $47.79 a barrel in London.

Hess fell $2.06, or 4.5 percent, to $43.36, and Exxon Mobil shed $1.25, or 1.5 percent, to $80.85.

O'Reilly Automotive said sales had been sluggish at its older locations over the past three months because of weak demand and the effects of a mild winter. Its stock lost $41.64, or 18.9 percent, to $178.77. Advance Auto Parts gave up $13.20, or 11.1 percent, to $105.21, and AutoZone slid $54.88, or 9.6 percent, to $516.83.

Those three companies have each plunged more than 30 percent this year as investors worry about the effects of slowing car sales.

Tesla took its biggest loss in a year after as investors were disappointed with the company's second-quarter production and delivery totals. The electric-car maker's stock dropped $25.53, or 7.2 percent, to $327.09.

Ford declined 26 cents, or 2.2 percent, to $11.30, and General Motors sagged 56 cents, or 1.6 percent, to $35.01.

The payment processor Vantiv will buy Worldpay, a British rival, for about $10 billion. Worldpay, which allows businesses to accept credit cards and online payments, released a statement on Wednesday saying the companies had agreed on the key terms of an acquisition. Vantiv stock retreated $1.49, or 2.4 percent, to $61.02, but two other payment technology companies, Square and PayPal, both climbed.

Technology companies did relatively well, although they have taken sharp losses over the last month. The Chinese e-commerce company Baidu rose $3.86, or 2.1 percent, to $183.83, and the chip maker Nvidia gained $3.72, or 2.7 percent, to $143.05. The companies said they would work together on a group of projects intended to bring artificial-intelligence technology to cloud competing, autonomous cars and home assistants.

Bond prices edged higher. The yield on the **10**-**year Treasury** note dipped to 2.33 percent from 2.35 percent late Monday.

Gold rose $2.50 to $1,221.70 an ounce. Silver fell 20 cents to $15.90 an ounce. Copper lost 3 cents to $2.66 a pound.

The dollar declined to 113.22 yen from 113.44 yen. The euro fell to $1.1342 from $1.1363.

CHART: The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Wednesday. (Source: Reuters)

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National Desk; SECTA

U.S. Oil Exports, Once Banned, Are Now a Boon

By CLIFFORD KRAUSS
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CORPUS CHRISTI, Tex. -- In a twist that would have been unthinkable only two years ago, the oil tanker that arrives in China today may be carrying crude that left the South Texas port of Corpus Christi instead of Saudi Arabia.

Chinese drivers most certainly don't care where their fuel comes from, but the export of American crude oil to dozens of countries over the last year is the latest chapter in a remarkable turnaround for the American oil and gas industry, about the only good news in three years of plummeting commodity prices, bankruptcies and layoffs.

For 40 years it was virtually impossible to sell American oil to any country except Canada because of an export ban that was a bedrock of United States energy policy. The Obama administration slowly loosened the ban and Congress finally ended it in late 2015 in a compromise that also extended tax credits for renewable energy.

Oil exports grew slowly through most of 2016, but this year there has been a surge reaching 1.3 million barrels a day -- roughly 15 percent of domestic production -- which even at today's depressed prices is worth more than $1.5 billion a month.

That may be only the beginning. In a test a few weeks ago, the French-flagged supertanker Anne, empty but capable of holding more than two million barrels of oil, docked safely at Occidental Petroleum's year-old export terminal here. The docking of the 1,093-foot vessel, larger than any tanker to come into port previously in the Gulf of Mexico, is seen as the herald of an export boom, lifting the spirits of American oil executives despondent over the crumbling price of crude and sending ripples across global energy markets.

''This is our chance, this is our turn to prosper,'' said Khalid A. Muslih, executive vice president of Buckeye Partners, a pipeline and terminal operator in the midst of a major export expansion. ''We're working our way toward energy independence. We're grabbing market share, and we're doing our part to rectify our imbalance of trade.''

Suddenly buyers from all over the world are purchasing the new American supplies, from South Korea to India -- even oil-rich Venezuela, which uses the light sweet crude that comes out of American shale to blend with its gooey heavy crude. The light crude is highly prized even while global oil markets are saturated. Canadian oil sands, which also tend to be heavy, are being increasingly produced and need to be mixed with lighter crudes.

European countries are looking to American exports to reduce their dependence on oil from Russia and African countries that produce light crudes, particularly Libya and Nigeria, which are politically unstable and unreliable suppliers. And China, with slumping oil production and rising demand, wants a more reliable source than the Persian Gulf, which it now depends on.

As the Organization of the Petroleum Exporting Countries cuts production to prop up **oil prices**, American exports are beginning to elbow out Saudi crude in some markets, a development that would have been inconceivable four decades ago when OPEC oil embargoes threatened to cripple the American economy.

And the world's energy leaders are noticing.

''U.S. oil exports are a game changer and are going to be a larger and larger changer in the markets,'' said René Ortiz, a former Ecuadorean energy minister and former OPEC secretary general.

The United States still imports far more oil than it exports, and probably will continue to do so for many years. But since many American refineries were designed for heavy crudes from Mexico, Venezuela and Canada, the light shale oil from Texas is an awkward mismatch. Meanwhile, that oil is coming out of the fields in a record gush, and despite persistently low **oil prices**, the Energy Department projects that domestic production next year will top 10 million barrels a day, an all-time high.

That output, an increase of half a million barrels a day from current production levels, will need to find a market somewhere. With domestic demand flattening because of increased fuel efficiency in cars, oil executives say that somewhere is likely to be overseas.

The expansion of energy exports fits neatly with President Trump's promise last week to usher in an age of ''American energy dominance.'' But oil executives say the driving force for future production and exports will be the economics of global supply and demand, rather than Washington policy.

Oil and dock workers here say the new exports are all the chatter among their buddies at the kitchen table and during their fishing trips and deer hunts.

''There's definitely a vibe, there's a buzz -- people are excited about it,'' said Kevin Craft, a terminal operator who got his job at NuStar Energy in April thanks to the company's export expansion. After losing a job with a contractor in 2015 when **oil prices** plummeted, Mr. Craft has rebounded and is making more money than ever. At 37, he said, he can now start saving for his retirement and put money away for his son's college education. ''A lot of people are going back to work,'' he added.

Much of Texas has been in an economic slump in recent years, having lost about 100,000 oil jobs since late 2014, when the price of oil fell from over $100 a barrel to less than $50. But because of the exports, the job losses have been stemmed and there is the promise of new jobs to come. Oil executives said that if weren't for exports, so much oil would be stockpiled in already flush domestic inventories that the American benchmark price would be $10 to $20 below the current $45 a barrel, making most new drilling uneconomical.

Even with prices lagging, lower oil field costs and new technologies have enabled producers in the dominant Permian Basin shale fields of West Texas and New Mexico to deploy 250 rigs over the last year or so, which has led to the hiring or retention of as many as 25,000 workers, according to Scott Sheffield, executive chairman of the Pioneer Natural Resources, a leading Texas producer.

And here in Corpus Christi, a hub of refineries and pipelines between some of the country's richest oil fields and the Gulf of Mexico, the port is just beginning a $1 billion capital investment program that includes deepening and widening the shipping channel for bigger tankers to dock and load. Some of the program is dependent on final approval of funding from Congress.

Occidental, NuStar and other companies have made major investments in additional dock and tankage facilities and are planning additional ones, while several pipelines between the Permian Basin and the port are in the planning stage.

Crude exports from Corpus Christi have already increased from an average of 68,000 barrels a day during the first half of 2016 to 384,000 barrels a day this April, according to a recent report by RBN Energy, an analysis firm.

Buckeye Partners alone has invested $1.2 billion since 2015 in docks and other export facilities here, putting to work 1,500 construction workers and 130 full-time employees. It has plans to put more than $1 billion into additional investments, including a pipeline system called South Texas Gateway that would connect West Texas with Corpus Christi and global markets. The system is expected to be finished in 2019, with the potential to move 400,000 barrels a day. In the meantime, it plans to add a sixth and seventh deepwater dock in the port capable of loading big tankers for export.

The expansion has been nothing but good news for Rudy Dominguez, a pipeline technician who was laid off in early 2016 after working for the same pipeline company for 26 years. With two children to support, he was out of work for 15 months and living off his severance pay, savings and odd jobs. Friends brought him fish from boating trips to put on the table, and he learned more hamburger recipes then he cares to remember. Learning of Buckeye's expansion, he applied for several jobs and was finally hired a few weeks ago.

''God closes doors and then opens them right up,'' Mr. Dominguez said. ''I just hope oil, gas, energy exports go on forever.''

Many more jobs may be on the way. Ray Perryman, a leading Texas economist and president of the Perryman Group, a consulting firm, estimated that expanded crude exports will add more than 30,000 jobs in Corpus Christi over the next couple of decades. For the nation, 484,000 jobs could be added, nearly 60 percent of which will be in Texas, even if **oil prices** remain moderate to low, he estimated.

But oil executives still voiced concerns about the future, and many say that not all the pipelines planned to take crude to Corpus Christi will be built unless market conditions improve. Persistently low **oil prices** could squeeze the marginal price advantage -- currently around $2.50 -- that West Texas intermediate, the American benchmark, has over the international benchmark, Brent crude. The cheaper the American crude is relative to Brent, the more the price difference offsets the shipping costs to replace Saudi or Russian crude on global markets.

And if the shale boom spreads internationally, there could be a further glut. Domestic refineries could invest more money to refine more light crude, leaving less to export. And if electric cars catch on, demand for gasoline could shrink.

''The thing I worry about is price,'' said Danny Oliver, senior vice president for marketing and business development for NuStar Energy. Nevertheless Mr. Oliver expressed optimism. ''The potential is huge,'' he said. ''The ability to export means we can continue to drill for new oil.''

The industrial view at a beach in Corpus Christi, Tex., where crude exports are spurring a boom. (A1); The industrial view at a beach in Corpus Christi, Tex., where crude exports are spurring a boom. (PHOTOGRAPHS BY BRANDON THIBODEAUX FOR THE NEW YORK TIMES) (A12)

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THE WALL STREET JOURNAL.
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Fed Readies Timing of Portfolio Tapering

By Nick Timiraos
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6 July 2017
The Wall Street Journal
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WASHINGTON -- Federal Reserve officials in June readied plans to start slowly shrinking the central bank's large portfolio of bonds and other assets in the next few months, and the debate since then over when to launch the plan has increasingly pointed to September.

Several officials said the Fed had sufficiently prepared markets to initiate the tapering "within a couple of months," according to the minutes of the central bank's June meeting released on Wednesday. Some others said waiting longer could give them more time to figure out why inflation has slowed and that moving sooner might wrongly signal they were moving more aggressively to raise interest rates.

Taken together, the minutes of the June meeting and subsequent comments from Fed officials show a growing likelihood that the Fed will initiate its balance sheet runoff plan in September. That sequence would give officials more time to see if the inflation slowdown is temporary before raising rates, and it would allow officials to proceed well before any transition to a new Fed leader if Chairwoman Janet Yellen isn't reappointed before her term ends Feb. 3.

The Fed's internal debate over the policy path has been complicated by two puzzles. Inflation has weakened, justifying some officials' call for a slower pace of rate increases.

But financial conditions have eased despite recent rate increases -- with stock markets running to new highs, long-term yields declining and the dollar weakening. This has strengthened the resolve of those who want to stick with the Fed's current rate path, which projects another quarter-percentage move this year and four more next year.

At the June meeting, officials discussed reasons why financial conditions haven't tightened, including strong corporate-earnings growth and growing risk tolerance among investors. Some officials raised concerns that stock prices looked high and that subdued market **volatility** could lead to "a buildup of risks to financial stability," the minutes said.

"The policy implication says, 'Look we've been raising rates. We haven't overly tightened financial conditions, so we can afford to continue here,'" said Roberto Perli, an analyst at research firm Cornerstone Macro LP. "It is a green light to continue, more than anything."

Officials raised rates to a range between 1% and 1.25% at the June meeting, their third quarter-point rate increase in as many quarters, and they penciled in one more increase this year. They also reached consensus on how they will gradually reduce the Fed's $4.5 trillion asset portfolio, also known as its balance sheet, which could lead long-term rates to rise.

Because the Fed is prepared to gradually shrink those holdings in a slow, predictable manner, by allowing some assets to mature without reinvestment, officials last month said they expected launching the runoff would have a limited impact on markets, according to the account published Wednesday.

From a market standpoint, the Fed has "done everything to make the end of reinvestment as palatable as humanly possible," said Jim Vogel, market strategist at FTN **Financial.**

Markets showed little reaction to the minutes Wednesday. The **Dow Jones Industrial Average** ended down 1.1 points, or 0.01%, to close at 21478. Yields on the benchmark **10**-**year Treasury** note moved up after the release of the minutes but ended the day at 2.334%, according to Tradeweb, below Monday's 2.352% closing yield.

The next Fed policy meeting is July 25-26. Ms. Yellen will have an opportunity to elaborate publicly on her outlook when she delivers semiannual testimony before Congress next Wednesday and Thursday.

The minutes showed officials also face divisions over how the portfolio runoff plans could alter the path of interest rates going forward. At the June meeting, officials' median forecasts showed four more quarter-point rate increases in 2018.

The central bank's discussion around the balance sheet picked up this year because Fed officials have grown more comfortable with the economic outlook. Officials stopped adding to the balance sheet in 2014, but they have been reinvesting the proceeds of maturing assets to keep the Fed's holdings steady.

Under the plans announced last month, the Fed will allow its holdings to decline gradually by allowing a predetermined amount of bonds to mature every month without using the proceeds to buy more bonds.

It would start by allowing up to $6 billion in Treasury securities and $4 billion in mortgage bonds to roll off without reinvestment, and let those amounts rise each quarter. The plan's pace would ultimately rise to a maximum of $30 billion a month for Treasurys and $20 billion a month for mortgages.

Fed officials have said they want the balance-sheet wind-down to run quietly in the background, meaning they are unlikely to adjust it from one meeting to the next, barring a shock to the economy.

Officials raised rates last month despite some concern over declines in inflation gauges, which Ms. Yellen and others have largely attributed to one-off factors such as big discounts on wireless phone plans. The Fed's preferred inflation gauge briefly surpassed the central bank's 2% target in February but posted greater-than-expected drops since then, rising just 1.4% on the year ended in May.

Officials will receive two more monthly inflation readings before their September meeting and are likely to study those reports closely to confirm their latest forecasts. They could face greater doubt or division on their policy path if current trends continue -- inflation remains soft, the unemployment rate falls further and asset prices continue their rise.

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Streetwise: Spike in VIX Fear Gauge Should Set Off Alarms

By James Mackintosh
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Some dates deserve a place in market history. Black Monday 1987 and Black Thursday 1929 occurred before the VIX fear gauge was created, but the volatility index's three biggest intraday rises also resonate: August 2015's China fears. May 2010's flash crash. February 2007's subprime concerns mixed with another China panic.

Last Thursday shouldn't merit being on the list. Central bankers kind of maybe indicated that just possibly they might do what they previously said they would do, and tighten monetary policy if the economy improves. Yet the VIX, a measure of the volatility expected over the next 30 days, had its fourth-biggest-ever rise of 55% from open to peak, before recording its eighth-biggest fall from peak to close. By its low on Friday it was back in the lowest 1% of VIX readings ever. The VIX was created in 1993.

The outsize reaction to so little news tells us three things, all worrying.

First, investors are very concerned about any signs that central banks might pull back from super-easy monetary policies. Second, when volatility starts to go up it can go up a lot faster than anyone thought. And third, complacency still rules, with "buy the dip" firmly embedded in investor psychology after an eight-year bull market.

The second of these is the biggest danger to the growing group of investors who have been betting on low volatility. They are convinced it is safe because in the past the markets have given plenty of warning before a spike. When low-volatility regimes have ended in the past, they have typically trended higher before turning really nasty, giving investors time to get out. If volatility is no longer predictable, the "short-vol" strategies used by hedge funds, pension funds and institutional investors -- and available through exchange-traded products, too -- are riskier than their advocates suggest.

Just how risky was evident last week. The VelocityShares Daily Inverse VIX exchange-traded note, known by its ticker XIV, tumbled 15% intraday on Thursday. Investors must decide if this is advance warning of danger ahead or merely a move to be expected after gains of 263% in the previous 12 months.

In some ways, this is the same assessment investors always have to make. Is the market signaling complacency, or is volatility low -- and stock and bond prices high -- for a good reason: Because profits are strong, inflation low and the economic outlook sunny? Christian Mueller-Glissmann, a strategist at Goldman Sachs, says in past periods of low-inflationary growth such as the 1960s and 1990s, volatility stayed low.

But in another way the decision is specific to volatility. It is one thing to put money on volatility staying low as a high-risk, high-reward bet that nothing upsets the calm in the next 30 days. It is quite another to do it on the basis that when markets start to become more volatile there will be a shift to a higher volatility regime before a major VIX spike.

The losses to the strategy when the VIX does jump can be torture.

The August 2015 panic meant those who had continued selling volatility -- despite a warning from a smaller VIX rise earlier that summer -- lost more than half their money. The XIV exchange-traded note took until January 2017 to recover all its losses.

There are two causal stories to tell behind these concerns. One is that explicit bets against volatility are crowded, so when volatility starts rising, the rush for the exit drives it up further. Anecdotally this feels right, and open interest in VIX futures is close to record levels. Against that, Goldman analysts point out that across all VIX-related exchange-traded products, overall bets are still on higher volatility -- so still more could go in before short vol positions are as extended as in 2015.

The second story is that implicit bets against **volatility** such as equities or emerging-market debt are crowded. Investors who have been persuaded by calm markets to move out of their comfort zone to buy riskier assets are very sensitive to any sign that the market or economic cycles might be ending.

Accept either of these stories, and you will want to avoid bets against **volatility** and have a more balanced portfolio. Unless, that is, you buy into a radical explanation for low **volatility**: Perhaps the market is finally approaching efficiency.

The efficient-market hypothesis has been roundly ridiculed since the Lehman crash, and for good reason.

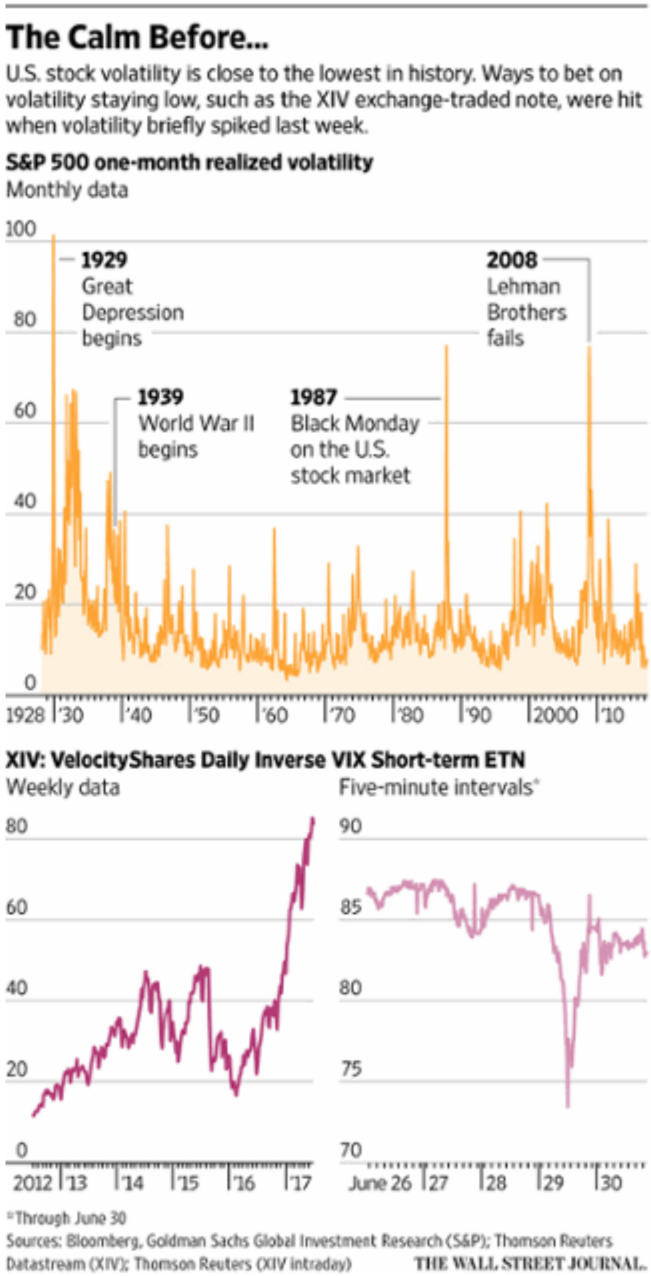
But one of the academic arguments against is that if markets were truly efficient, they would be much less **volatile** than they actually are, as Robert Shiller, now at Yale, set out in a 1981 paper. Investors should trade less and shares move around much less. Active management would probably be less popular, too, as a more efficient market is harder to beat.

Well, **volatility** has collapsed, money has flooded into passive funds and trading is increasingly done by dispassionate algorithms.

Prof. Shiller even accepts that the market is in some ways more efficient than it used to be.

But has the market actually become efficient? No.

"It has to do with mass psychology," Prof. Shiller told me. "Maybe in the next 200 years it will happen."



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THE WALL STREET JOURNAL.
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Banking & Finance: Banks Face Hurdles After Stress Tests --- The Fed's approvals fuel a rally, but tough conditions on lending, rates are still an issue

By Telis Demos
750 words
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The Wall Street Journal
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B12
English

Bank stocks soared after lenders handily passed the Federal Reserve's stress tests, but the upbeat finish to the second quarter belies a tough spell amid challenging lending and interest-rate conditions.

Those trends threaten to drag on banks' performance in coming months, a potential counterweight to the higher dividends and share buybacks many banks announced last week. In the second quarter, growth in business lending fell to its slowest pace since spring 2011. Long-term interest rates remain close to historically low levels, despite an uptick in the last week of June. And market **volatility** remains subdued, resulting in muted trading activity.

"As we head into the second half of the year, the question is how long can banks fight the fundamentals," said James Chappell, an analyst at banking group Berenberg. "Earnings expectations may be too high."

Worries about banks' underlying performance have weighed on their stocks this year, even though first-quarter results were strong. Financial stocks in the **S&P 500** have led all sectors since November's U.S. election, but the bulk of the gains came in late 2016. In the first half of 2017, financial stocks trailed the broader market.

In the second quarter, the KBW **Nasdaq** Bank index, which tracks 24 of the U.S.'s biggest banks, lagged behind the **S&P 500** until the stress-test results were announced June 28. The end-of-quarter surge happened as banks announced shareholder payouts -- through dividends and share buybacks -- that are just shy of their highest level relative to earnings in nearly two decades, according to analysts at Barclays.

Regional banks didn't get the same bump. The KBW Regional Banking index was nearly unchanged in the second quarter, trailing the broader market. In the first half, it was down more than 4%.

Besides the immediate prospect of more cash in hand for shareholders, the stress tests also bolstered investor hopes that the Trump administration would usher in a period of less-stringent bank regulation. That approach could help bolster returns on equity, which have remained tepid.

Donald Trump's election spurred hopes for even broader changes from Washington, namely a tax-code overhaul and policies, such as major infrastructure spending, that would promote stronger economic growth. But these have yet to bear fruit.

That has led to a decline in confidence that growth will accelerate. As a result, long-term interest rates slid in the second quarter.

At the same time, short-term rates have marched higher thanks to continued increases in the Fed's rates.

The result: The difference in yields between 10-year and two-year Treasurys, which is a proxy for the profits banks can make from borrowing and lending money, fell below 1 percentage point in mid-May. It has stayed there since and closed the quarter at 0.90 percentage point. In the wake of the election, the spread topped out at 1.35 percentage points in late December.

Bank of America Corp. Chief Executive Brian Moynihan told investors in May that the bank's potential net-interest income growth in the second quarter could be lower by tens of millions of dollars compared with the first quarter. "We always follow the [yield] curve, and it's been lower," Mr. Moynihan said at an investor conference.

The other point of concern, slowing lending activity, is a bit of a mystery. Bank executives have been at a loss to explain the decline, especially given the surge of optimism among business owners following the election.

Loans and leases in bank credit, which are counted on a weekly basis, were up 3.8% in late June compared with the same period in 2016, according to Fed data released on Friday. That was the slowest rate of growth in more than three years. The week before the presidential election, banks registered a 7.3% rate.

Meanwhile, trading activity has been held back as hopes for an uptick in inflation, which would lead long-term interest rates higher, have faded. Also, **volatility** levels during the quarter plumbed historic lows, which also suppressed trading.

Executives at J.P. Morgan Chase & Co. and Citigroup Inc. warned during the second quarter that trading revenues may be down by double-digit percentage points from those of the year-earlier period.

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The New York Times

Business Day; DealBook
Tech Stocks Boom, but Some Stock Pickers Are Wary

By LANDON THOMAS Jr.
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NYTFEED
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Technology stocks had another scorching weeklong run last month, capped off by Amazon's startling decision to buy Whole Foods for $13.4 billion.

And like many stock pickers these days, the portfolio managers at Parnassus Investments, a mutual fund company that invests mostly in large American companies, were at their wits' end as they gathered for the firm's weekly investment committee meeting.

"These stocks are hitting highs — again," said Todd C. Ahlsten, who oversees the firm's $15.6 billion core equity fund, pointing out that even low-risk exchange-traded funds were piling into the likes of Facebook, Apple, Google, Netflix and, yes, Amazon.

The explosion in low-cost, index-tracking E.T.F.s and soaring technology stocks is generating existential angst among portfolio managers working in traditional mutual fund companies.

Products of a culture where fame and fortune have accrued to those with the skills to pick **stock market** winners — foremost among them Warren E. Buffett and Peter Lynch at Fidelity — these brainy stock experts are now finding it harder than ever to fulfill their core function: investing in stocks that beat the broader market indexes.

That is largely because a torrent of money has been pouring into machine-driven tracking funds, which allocate money to stocks like Facebook, Apple, Amazon, Netflix and Google's parent — the so-called Fang stocks — on the basis of how big they have become and where they rank in an index.

For stock pickers, who pride themselves on their ability to zig where others zag by uncovering undervalued gems, such follow-the-crowd investing is anathema — and it is showing up in the numbers.

According to S.&P. Dow Jones Indices, 88 percent of mutual funds that invest in large capitalization stocks trailed their benchmark over a five-year period ending last year.

This period of underperformance has been most acute in the last 12 months, a period when the Fang stocks have outpaced the market by a large measure.

Value-oriented investors who screen out companies that don't meet strict social standards, Mr. Ahlsten and his team have, over the last year, generated a respectable 14 percent return in their core equity fund where they have large stakes in Apple and Google.

But the positions are not nearly enough to keep pace with the 18 percent return of the **Standard & Poor**'**s 500**-**stockindex**, within which six of the 10 top components are now technology stocks.

Making matters even more stressful, Amazon, which they do not own, just agreed to buy Whole Foods — a deal that sent its stock even higher and could threaten a number of companies in the Parnassus portfolio.

"This is giving me a flashback to L.T.C.M. with all this correlation," said Benjamin E. Allen, Mr. Ahlsten's partner on the fund, recalling the lemminglike behavior of investors that led to the collapse of Long Term Capital Management in 1998. "It is just mindless buying of these technology names."

Over the past year through May, $263 billion has exited actively managed mutual funds that invest in United States stocks while $308 billion has poured into E.T.F.s and index funds. Vanguard and BlackRock have vacuumed up just about all of this cash, according to Morningstar.

This wave of money, combined with the slack performance of its old-style equity funds, prompted Laurence D. Fink, the chief executive of BlackRock, to shake up his stock-picking ranks this spring.

Funds were revamped, managers were let go and, in so doing, Mr. Fink questioned whether, in light of technological advances and the spread of information, stock experts could actually add value when it came to assessing widely followed companies in the **S**.**&P**. **500 index**.

More than $5 trillion remains invested in active-oriented funds according to FactSet, a data provider. It is still early to determine if Mr. Fink is describing a trend that will eventually reach its limits or whether a more fundamental, longer-term reordering of the stock-picking process will take place.

The Parnassus portfolio managers are not alone in their fears. Of late, the argument has been made that the rise of machines and passive investing is distorting the broader market.

And this week, Bank of America in a report called it the "E.T.F.-ization" of the S&P, warning that passive mutual fund assets in the United States have doubled to 37 percent today since 2009.

For the moment, though, be it hedge funds that refuse to chase Amazon because it disdains showing profits, or value investors who blanch at the thought of buying Netflix at a price-to-earnings multiple of 360, the frustration is beginning to boil over.

Compared with many of its peers, Parnassus has held up fairly well in terms of outflows.

The company was founded in 1984 by Jerome L. Dodson on the notion that buying companies that respect the environment, cultivate harmony in the workplace and have sound governance policies would generate decent investment returns in addition to making investors feel virtuous.

It has been a well-timed strategy, one that kicked into high gear after the financial crisis as investors embraced both the fund's philosophy and its performance.

Assets under management shot up to $25 billion today from $1.8 billion at the end of 2008.

Still, as technology stocks have skyrocketed, the returns of Parnassus' bellwether fund have lagged. Some 80 percent of the fund's peer group has done better over the past year.

Over the longer term, however, the Parnassus results are better. For 10 years, the core equity fund handily beats its benchmark — 9 percent compared with 7 percent, a record that outpaces 98 percent of the competition.

But at a time when investors are transferring cash from pricey mutual funds to lower-cost — and to date — better-performing exchange-traded funds, falling back on 10-year performance figures has become a less reliable defense.

Through the first five months of the year, according to Morningstar data, the core equity fund has experienced outflows. They are small — $150 million out of a $15 billion fund — and they come after five consecutive years of inflows.

Nevertheless, they have been enough to concentrate minds at Parnassus.

"It's stressful — we are competitive people," Mr. Allen said. "I don't like calling my clients up every quarter and saying 'Sorry.'"

Embracing a deep-value style of investing, Parnassus is no momentum investor. And Mr. Allen, who was appointed president earlier this year and is expected to succeed Mr. Dodson in running the firm, has made it clear to fund holders that his ultimate aim is to outperform when stocks are tanking — as core equity did in 2008 — as opposed to running ahead of a **bull market**.

So instead of chasing Amazon and Facebook, Mr. Allen and team have been betting big on health care stocks like Gilead Sciences.

“There is a herd mentality out there,” he said. “People are buying stocks irrespective of valuations — if we can’t do the math, we are just not going to own it.”

Parnassus has a quirky culture. Turnover is very low and just about all investment professionals start as summer interns, an approach that exposes potential hires to a three-month period of scrutiny.

As per the orders of Mr. Dodson, men must wear ties — in the office and on the road — a sartorial demand that stands out in San Francisco’s ultracasual workplace culture.

To foster togetherness, at the end of each investment committee meeting, participants are asked to offer up a personal tidbit about how they spent their weekends.

Deep-value stock pickers often exhibit idiosyncratic qualities, and that is true here.

Mr. Allen, for example, keeps his desk virtually clutter-free, to encourage lean, disciplined thinking.

And Mr. Ahlsten, to keep his own mind clear, limits himself to one hour of screen time (phone, computer or any other device) per day.

Lately, it has been Amazon filling up their brains, and following the investment committee meeting, the two portfolio managers huddled in Mr. Ahlsten’s office.

At its current valuation, they agreed the stock was too expensive to buy.

But the Whole Foods transaction poses a potential threat to at least five companies that Parnassus owns — from Sysco, the food distributor, to CVS, the pharmacy chain.

All five have trailed the index over the past year, and the worry is that the Amazon deal could put further pressure on them.

“The threat to these companies has increased,” Mr. Allen told his colleague. “It reveals what Jeff Bezos’ ambitions are, which are to disrupt and be part of everything. But the reality is that Amazon is not going to take over the entire world.”

At least they hope not.

Benjamin E. Allen, left, and Todd C. Ahlsten at Parnassus Investments in San Francisco last week. | Jason Henry for The New York Times | Mr. Allen and Mr. Ahlsten leading a meeting at Parnassus Investments. They are skeptical of the recent bull run of the so-called Fang stocks. “It is just mindless buying of these technology names,” Mr. Allen said. | Jason Henry for The New York Times

Document NYTFEED020170705ed75007bx

THE WALL STREET JOURNAL.
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Heard on the Street
Dismal Math Of Investing In Bonds

By Richard Barley
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5 July 2017
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J
B14
English

[Financial Analysis and Commentary]

Tiny hints from central banks about policy normalization shook markets up last week. They were also a reminder of the highly abnormal situation bond markets find themselves in, with little or no cushion for investors against rising yields.

Returns on bonds come from two sources: the interest income that accrues to holders and changes in **bond prices**. Years of zero-interest-rate policy have drastically reduced the former, making the latter far more important. That shift has changed the way normally reliable bonds behave.

Take Germany, which was at the center of last week's repricing: The country's benchmark 10-year bond pays a coupon of 0.25%, and at the start of last week was priced nearly close to par, with a yield of 0.25%. By the end of the week, it yielded 0.47%, but the bond's price had dropped by around 2%, data from Tradeweb show.

It gets worse: Yields on all German government bonds that mature out to the start of 2024 are still negative. So far this year, the German bond market as a whole has returned minus 1.9%, according to Bank of America Merrill Lynch index data.

The U.S. is faring a bit better, and higher bond yields give a little more room for maneuver. But last week's swing still reduced year-to-date returns to 1.9% from 2.7% a week earlier on BAML's index.

Even if yields don't surge from here -- with forces like demographics, regulation and still-soft inflation weighing on the fixed-income market -- the outlook for returns is hardly inspiring. Bond investors face thin times.

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Economic Trends
The Upshot
Confidence Boomed After the Election. The Economy Hasn't.

By NEIL IRWIN
1,400 words
4 July 2017
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NYTFEED
English

After Donald J. Trump won the presidential election, Americans' optimism about the economic future soared. But midway through the year, that optimism has not translated into concrete economic gains.

This seeming contradiction exposes a reality about the role of psychology in economics — or more specifically, how psychology is connected only loosely to actual growth. It will take more than feelings to fix the sluggishness that has been evident in the United States and other major economies for years. Confidence isn't some magic elixir for the economy: Businesses will hire and invest only when they see concrete evidence of demand for their products, and consumers intensify their spending only when their incomes justify it.

The sharp rise in economic optimism after the election came through no matter how the question was asked or who answered, whether the survey was intended to capture consumer confidence or consumer comfort or consumer sentiment. It was true in surveys of small-business owners and of C.E.O.s of some of the biggest companies in the world. And the rise during the winter months in these surveys has mostly been sustained in the months since.

But the economy is plodding along at the same modest rate it has for the last eight years nonetheless — at least when you look at "hard" data around economic activity instead of "soft" data like surveys, as analysts put it.

President Trump said on Twitter on Sunday that the **stock market** was at an "all-time high" and that unemployment was at its lowest level in years, both of which are true (he added that wages would start going up, which is certainly possible).

But in overall measures of economic activity, the expansion looks much as it has for years, with steady growth of around 2 percent. The Trump economy so far looks an awful lot like the Obama economy.

For all of business executives' apparent enthusiasm, the nation is adding jobs more slowly in 2017 than it did in 2016, and investment spending by businesses is growing modestly; new orders for capital goods are up only 0.7 percent so far in 2017.

Consumers' spending was 2.7 percent higher in the first four months this year than in the same period of 2016, adjusted for inflation — which is slower than the 3.2 percent year-over-year gain at the end of 2016.

And while the **stock market** has been surging and the Federal Reserve has raised short-term interest rates, long-term Treasury bond yields remain very low, suggesting that traders do not buy the idea that growth is poised to accelerate. A falling dollar suggests currency markets see improving prospects in Europe and elsewhere.

There is no sign a recession is brewing, but neither is there evidence for the kind of boom you might expect if you believe that confidence is a crucial driver of economic growth.

This is less surprising when you look at the historical record of confidence surveys.

When financial commentators talk about the economy, they often use the elusive concept of confidence as part of their narrative. It's hard to describe what is happening in the global economy, with billions of people producing trillions of dollars of goods and services. Using a vague psychological concept is a tidy way of describing why things happen when the underlying drivers are uncertain.

To say that “the economy is slowing down because people are less confident” sounds a lot better than “the economy is slowing down for a whole bunch of complex reasons that I’m not really sure about.” Confidence has a kind of mystical explanatory power thanks to its vagueness.

But “confidence” isn’t really some psychological pixie dust that determines the economic future. Rather, it often reflects underlying fundamentals — whether consumers see job opportunities readily available, for example, and whether businesses are seeing strong advance orders.

“Confidence generally goes up when we see strong income growth or big gains in household wealth,” said Karen Dynan, a senior fellow at the Peterson Institute for International Economics whose former work for the Treasury Department and Federal Reserve included forecasting consumer spending. “You’ll typically see higher consumption spending after that happens. But it’s caused by the rise in income and wealth, not the rise in confidence.”

Sometimes these surveys can pick up on shifts in those fundamentals before they are evident in more concrete data points. But that doesn’t mean that they do a fantastic job on their own of predicting the economic future.

Since 1999, there has been a fairly strong correlation between the Conference Board’s consumer confidence index and the growth in personal consumption expenditures over the ensuing six months, just as you might expect. (And if the past relationship holds, spending levels will accelerate.)

But that chart looks about the same if you instead look at the relationship between growth over the preceding six months and the next six months. In fact, that correlation was stronger than confidence. In other words, if you had just predicted that the immediate future would be similar to the recent past, you would have done a better job projecting consumer spending during the last couple of decades than if you had relied only on a confidence survey.

Confidence surveys can make economic forecasts more accurate, according to some analysis — but only in certain circumstances, and if used correctly.

For example, Michelle L. Barnes and Giovanni P. Olivei of the Federal Reserve Bank of Bostonfound that forecasts are more accurate when they build in data from the Reuters/University of Michigan survey that is also used to calculate consumer sentiment. And Stéphane Dées and Pedro Soares Brinca of the European Central Bank found that confidence surveys can provide information about the future that economic fundamentals do not at economic turning points, and may be a factor in how crises spread between countries.

Those results suggest that why confidence shifts matters a great deal. At certain moments, ordinary consumers and businesses may instantly pick up on shifting economic fundamentals that would take time to show up in the official economic data.

For example, from July through November of 2007, consumer sentiment and confidence numbers plummeted, even as measures of consumer spending and employment were relatively steady. Credit was tightening and the housing crisis was worsening, but consumers seemed to pick up that the economy was on the verge of a recession (which began in December 2007) before it was at all clear from official data.

For every example like that, though, you can also find the reverse. Those same measures of confidence fell precipitously in September 2005, in the aftermath of Hurricane Katrina. That disaster ultimately had no major impact on the overall economy.

When confidence rises or falls suddenly, the move will predict a shift in economic performance only if something happens to the fundamentals to justify it. The early warning that confidence surveys offered on the 2008 recession was useful, but the downturn happened not because consumer confidence fell, but because the underlying forces around housing and credit that it reflected were so damaging. The post-Katrina drop wasn’t matched by any major deterioration in economic fundamentals, so it was a mere historical blip.

One clue as to which precedent applies here is in the partisan breakdown in sentiment surveys. Instead of an across-the-board improvement in confidence, it appears that Republicans became sharply more confident while Democrats became somewhat less so. That implies that the postelection confidence surge was about conservatives feeling more giddy about their side winning than about the broad mass of Americans picking up on improving economic fundamentals not yet evident in the data.

The Trump administration’s promises of major tax cuts, infrastructure spending and pro-growth regulatory policy have been slow in coming, but could conceivably change that over time.

But history shows that confidence alone won’t cut it.

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* The Big Question for the U.S. Economy: How Much Room Is There to Grow?

* The Economy May Be Stuck in a Near-Zero World

* The Amazon-Walmart Showdown That Explains the Modern Economy

* Trump Is Offering Populism, Minus the Free Candy

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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Bank Shares Rise Further, Following Interest Rates

By THE ASSOCIATED PRESS
725 words
4 July 2017
The New York Times
NYTF
Late Edition - Final
2
English

Stocks rose on Monday as bank shares continued to climb with interest rates, and energy companies rallied again with **oil prices**. Better-than-expected auto sales and a strong report on American factories also bolstered stocks.

Energy companies made large gains in Monday's abbreviated trading session as **oil prices** rose for the eighth consecutive day. Banks rose as bond yields and interest rates continued to go up. Companies likely to benefit from faster economic growth, like industry and basic materials makers, climbed after the Institute for Supply Management said that manufacturing activity in the United States climbed in June to its highest level in almost three years.

''The market clearly liked that number,'' said Scott Wren, senior global equity strategist for Wells Fargo Investment Institute. He said that economic reports over the last few months had been a bit disappointing, but ''it's still in line with expectations for modest G.D.P. growth.''

The **Standard & Poor's 500**-**stockindex** added 5.60 points, or 0.23 percent, to 2,429.01. The **Dow Jonesindustrial average** rose 129.64 points, or 0.6 percent, to 21,479.27.

The **Nasdaq composite** index lost 30.36 points, or 0.5 percent, to 6,110.06. That was a six-week low, as technology companies, which make up a major part of the index, have slumped for almost a month.

Banks continued recent gains as bond yields and interest rates increased further. Higher interest rates made lending more profitable, and that helped financial companies rally last week. Major banks also raised dividends and said they would buy back more stock. JPMorgan Chase added $1.85, or 2 percent, to $92.75, Citigroup rose $1.38, or 2.1 percent, to $68.26, and Morgan Stanley climbed $1.05, or 2.4 percent, to $45.61.

Bond prices fell. The yield on the **10**-**year Treasury** note rose to 2.34 percent from 2.30 percent.

Factories did more work in June, the Institute for Supply Management reported. Its survey of manufacturing reached the highest level since August 2014. That suggests that the economy could be growing stronger and that manufacturing continues to recover after a slump in late 2015 and early 2016.

General Electric rose 44 cents, or 1.6 percent, to $27.45, and the chemical maker DuPont added $1.42, or 1.8 percent, to $82.13.

Benchmark United States crude gained 73 cents, or 1.6 percent, to $46.77 a barrel in New York, its eighth consecutive gain. Brent crude, used to price international oils, rose 62 cents, or 1.3 percent, to $49.39 a barrel in London. Before their recent winning streak, crude prices had reached their lowest levels of the year. On Monday, Exxon Mobil stock rose $1.37, or 1.7 percent, to $82.10, and ConocoPhillips added $1.70, or 3.9 percent, to $45.66.

Automakers reported monthly sales on Monday. Overall sales continued to slip, but the stocks traded mostly higher as investors deemed the results reasonably strong. Ford Motor and General Motors each said sales fell about 5 percent, but Ford shares gained 37 cents, or 3.3 percent, to $11.56, and G.M. rose 64 cents, or 1.8 percent, to $35.57. Fiat Chrysler advanced 44 cents, or 4.1 percent, to $11.07, despite a 7 percent decline in its sales. Shares of most auto parts companies rose as well.

Bankrate, a consumer financial services company, climbed $1.10, or 8.6 percent, to $13.95 after it agreed to be bought by Red Ventures, a marketing company, for $14 a share, or $1.25 billion.

Precious metal prices dropped. Gold fell $23.10, or 1.9 percent, to $1,219.20 an ounce, and silver lost 54 cents, or 3.2 percent, to $16.09 an ounce. Copper slipped 2 cents to $2.69 a pound.

The dollar jumped to 113.37 yen from 112.54 yen on Friday. The euro fell to $1.1368 from $1.1422.

CHARTS: 3-Month Treasury Bills: High rate at weekly auction. (Source: The Bond Buyer); The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Monday. (Source: Reuters)

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ISIS Setback Lifts Iraq Leader --- Prime minister, who generated few expectations, stitched military alliance, damped sectarianism

By Ben Kesling
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3 July 2017
The Wall Street Journal
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A1
English

MOSUL, Iraq -- Three years ago, Abu Bakr al-Baghdadi proclaimed the existence of an Islamic State caliphate and proceeded to sweep his forces through northern Iraq and toward Baghdad, threatening the viability of the fragile country.

Today, the leader declaring an end to the caliphate is someone few would have imagined in the position, Iraqi Prime Minister Haider al-Abadi. A man seen as the favorite of none but acceptable to all, the 65-year-old former electrical engineer has managed to turn that tepid sentiment into a defining strength.

Over nearly three years in office, Mr. Abadi has narrowed gaps between Iraq's warring Shiite and Sunni politicians. He balanced competing interests among geopolitical rivals Iran and the U.S., and spearheaded an overhaul of Iraqi security forces, who had fled advancing Islamic State fighters. Iraq is close to retaking Mosul, Islamic State's psychologically important stronghold.

"Abadi has magnificently shifted between leading and balancing," said Jon Alterman , director of the Middle East program at the Center for Strategic and International Studies in Washington. "If he led too much then there'd be too many alienated people, and if he balanced too much there would be no forward progress."

Today, Iraq's security forces are on the verge of defeating Islamic State, the key requirement if the nation wants to enjoy a stable and cohesive future, despite daunting challenges that remain. Sectarian anger still simmers, and the country's economy and infrastructure have been devastated by years of fighting.

"Abadi is riding high," said one U.S. official in Washington. "But the government needs to show that it can act to make people's lives better, and probably the window for that is pretty limited. If it doesn't, all that goodwill Abadi built up will diminish."

There wasn't always such a sense of possibility in Iraq. Before Islamic State swept to power in 2014, the country was at its most-fractious since the fall of Saddam Hussein. Mr. Abadi's predecessor, Nouri al-Maliki, was a polarizing figure, accused of fueling sectarian conflict and packing ministries with loyalists.

Transparency International ranked the country near the bottom at 171 of 177 countries world-wide for corruption, with such pervasive problems that the country has only moved up a few positions after years of attempted overhauls. Mr. Maliki didn't respond to a request for comment, but Sunday released a public statement praising the military and militias.

When the festering Syrian civil war next door bled across the border, Iraq's military crumbled. In June of 2014, militants exploited Iraq's problems to blitz into Mosul -- grabbing nearby land, stores of weapons and oil fields. In Islamic State's advance, millions of civilians came to live under the Sunni extremist group's rule.

Some Sunnis initially welcomed the militants as an alternative to the predominantly Shiite government of Mr. Maliki. The implementation of Shariah law followed, where people could be jailed for smoking or executed for unauthorized use of a cellphone.

Amid the turmoil, the conciliatory Mr. Abadi was tapped to become prime minister, an antidote to Mr. Maliki's divisive rule. He faced growing alarm among Iraq's allies.

Iran, the world's biggest Shiite-majority country, couldn't countenance its neighbor falling to a Sunni extremist group. In 2014 Grand Ayatollah Ali al-Sistani, the pre-eminent Shiite cleric in Iraq, called on fellow countrymen to rise up to help protect the country; Shiite militias formed that Mr. Abadi has both empowered and theoretically kept under central government control. Iran's Islamic Revolutionary Guard Corps's elite Quds Force decided to fund and train many of them.

Ayatollah Sistani, who typically makes public statements via a representative at Friday prayers, didn't respond to a request for comment.

For Iran, forging such a partnership offered a way to cultivate a new proxy in Iraq and also to nurture others. Iran could revive overland supply routes through Iraq and its other ally, Syria, to Lebanon, where the Shiite political and militant group Hezbollah is based.

For Mr. Abadi, the relationship provided a backstop to a buckling Iraqi military. It also offered a skilled battlefield partner in Qasem Soleimani, the commander of the Revolutionary Guards. Iran's heavy involvement in Iraq also exposed Mr. Abadi to accusations that he was turning his country into an Iranian pawn.

An official in the office of Iran's United Nations representative didn't return a request for comment on Iran's relationship with Mr. Abadi.

U.S. State Department officials mostly sidestep the thorny issue of Iran's involvement in Iraq's war against Islamic State, saying Baghdad was ultimately in charge of the powerful Shiite militias. As part of this balancing act, Mr. Abadi courted the U.S. military for assistance, too, just years after the Americans pulled troops out of the country.

In 2014, the U.S. military started a gradual increase of troops with the launch of Operation Inherent Resolve. By the end of Barack Obama's presidency, more than 5,000 Americans were deployed to Iraq with hundreds close to the front lines of combat. Support has increased under President Donald Trump .

Iraq has benefited from a more than billion-dollar investment by the U.S. to train and equip forces, and fund U.S. troops in the country. Mr. Abadi also fired generals from the Maliki era and demanded that top officers eschew sectarianism. Those steps brought increased assistance from the U.S., including advanced weapons and air support.

As the war with Islamic State heated up, Iraq became a tinderbox of crisscrossing rivalries and sectarian tensions.Christian and Sunni minorities in Iraq grew wary of Iran's growing influence, with those groups forming some of their own militias.

Some Iran-friendly Shiite forces, meanwhile, became openly hostile to U.S. troops. In late 2015, multiple militias pledged to fight U.S. troops if they deployed to Iraq and established bases in the country, harking back to their efforts against Americans during the Iraq war.

Mr. Abadi sought to keep everyone on the same side, largely by lauding the benefits of a unified Iraq, adding Kurdish and Sunni elements to his cabinet and reaching out to Sunni leaders for dialogue.

From the beginning of his tenure, the Iraqi prime minister reached out to Sunni Arab countries in the region while maintaining his ties with Iran.In 2015, the Saudi government reopened its embassy in Baghdad, which had been shuttered decades before in response to Saddam Hussein's invasion of Kuwait.

Inside Iraq, Mr. Abadi begin to win over the country's minority Sunnis.

"This government led by Abadi has not met desired levels of ambitions, but if you compare it with the previous government, you will find a big difference," said Ahmed al-Masari, head of the Sunni political bloc in federal parliament. "Now there are reforms and progress, while during the previous government several provinces fell to terrorism."

Renad Mansour, a fellow at Chatham House , a London-based internationally focused think tank, said Sunni leaders came to realize a flexible Shiite leader may be their least bad option, especially if they hoped to exercise some power as a minority group in a democratic Iraq. "The Sunnis are past their denial of reality," he said. "They realize that they're going to be a minority."

Mr. Abadi didn't neglect the country's Shiite majority either. By 2015, Ayatollah Sistani, arguably the most revered figure in the country, voiced strong support for Mr. Abadi and worked to ensure the militias remained by law ultimately under Iraqi government control. Mr. Abadi in turn has praised the cleric, even this week saying his call to form militias was a crucial move to save the country from Islamic State dominance.

In marshaling foreign and domestic support, Mr. Abadi's government began racking up wins. In mid-2015 Iraqi forces took back Tikrit from Islamic State, their first major territorial victory. In November 2015, Kurdish Peshmerga forces pushed into the northern town of Sinjar, and the Iraqi military soon declared the Anbar hub of Ramadi free from militant control. The city of Fallujah fell months later.

In Mosul, where an offensive began last fall, Islamic State didn't retreat but dug in deeper. Even as Iraqi forces surrounded the city and advanced, the militants used hundreds of thousands of civilians as human shields while stockpiling munitions and setting up snipers' nests in the warrens of the old city.

Today, Iraqi forces are fighting scattered pockets of Islamic State fighters.

In east Mosul, shops selling mobile phones or fashionable jeans have reopened next to restaurants slicing up kebabs. Patrons smoked openly, even during the holy month of Ramadan -- a display unthinkable under Islamic State control.

Still, seeds of new conflicts are just below the surface.

Iraqi soldiers are accused of beating and summarily executing unarmed men and boys fleeing fighting in the heart of Mosul. The most recent allegations come from a Human Rights Watch report released Friday. Because the military is seen as a Shiite institution and Mosul is predominantly Sunni, such abuses, real or even rumored, threaten to fan sectarian tensions.

The Iraqi government will investigate any credible cases of abuse, according to Saad al-Hadithi, a spokesman for Mr. Abadi, but he said those allegations must be based on evidence and not hearsay.Mr. Abadi has said he wouldn't tolerate any human-rights abuses by troops.

In Anbar Province, tribal officials have exiled families of Islamic State members. In the city of Mosul, the city council recently passed a resolution declaring the same. Mr. Abadi has signaled he will use his federal authority to prevent the local government from taking such actions.

Mosul mobile-phone salesman Forat Latif said the environment is ripe for another antigovernment group to lure Sunnis into more fighting.

"We will go back to the same environment that created Daesh," he said. "It's the same cloud that brought all this rain."

Iraqi officials recently released a 10-year $100 billion reconstruction plan. The government doesn't have the money, and the World Bank and the International Monetary Fund haven't come forward with funds. Last year, the IMF provided a $5.3 billion dollar emergency loan to help stabilize the country -- a sizable contribution at the time but a fraction of what is needed now. Large sections of major cities like Ramadi and Mosul have been destroyed, with buildings, bridges and water mains turned to rubble.

During his tenure, Prime Minister Abadi has overseen an increase in oil production, which helped boost the country's GDP last year by 11%, according to the IMF . Yet low **oil prices** have complicated Iraq's efforts to pay government workers, who have sporadically taken to the streets to protest, and the non-oil sector of the economy is still reeling.

One of the biggest challenges for Mr. Abadi is the pressure from different Iraqi minorities for more autonomy. The Kurdish north, led by President Masoud Barzani, has been angling for independence for years, and last month announced it will hold a referendum on the issue in September.

Federal elections are scheduled for April, and Mr. Abadi may face rivals for his position. He has managed to remain on good terms with both Iran and the U.S. -- with U.S. Secretary of State Rex Tillerson praising the prime minister publicly in March.

But as the relationship between the U.S. and Iran deteriorates, there is a risk that Iran will back a challenger to the prime minister more clearly in Tehran's camp. Mr. Maliki has remained a constant presence in the political realm.

Mr. Abadi may face his biggest test when Iraq and its foreign allies no longer share a common foe.

On Thursday, as he declared the end of the caliphate, Mr. Abadi stayed focused on defeating Islamic State. "We will continue to fight Daesh until every last one of them is killed or brought to justice."

On the same day, though, brownouts in Baghdad left millions without power, showing the government's limited capacity to provide public services to its people. Four improvised bombs, meanwhile, detonated in different areas of Baghdad, killing a handful of people.Such attacks are a reminder that the war against Islamic State is moving beyond the battlefield and into the daily lives of Iraqis, something they had hoped a prime minister would prevent.

Ghassan Adnan in Baghdad, Asa Fitch and Ali A. Nabhan in Erbil, Iraq, and Dion Nissenbaum in Washington contributed to this article.

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THE WALL STREET JOURNAL.
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Markets Review & Outlook: Second Quarter: Yield Seekers Flood Into Municipal Debt

By Heather Gillers
553 words
3 July 2017
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English

For evidence of investors' appetite for municipal debt, look no further than New Jersey.

That is where delays have plagued the planned megamall American Dream for more than a decade. Nevertheless, investors last month flooded into unrated public authority bonds designed to revive the project.

The $1.1 billion offering, which promised returns of as much as 6.86%, is a sign of how hungry investors are for new municipal debt despite mounting fiscal problems in some cities and states around the country.

Buyers have snapped up nearly $88 billion in new public bonds this year through Friday, up 8%from the same period last year, according to Thomson Reuters. That happened as annual borrowing by local governments rose to a seven-year high.

It also comes as ratings firms have downgraded Illinois and Hartford, Conn., to the brink of junk status, and the troubled U.S. territory of Puerto Rico was placed under court protection as a way of sorting through its mountain of liabilities.

"The market is able to take these individual events in stride," said John Miller, co-head of global fixed income at Nuveen Asset Management.

The demand for new bonds is driving down costs for government borrowers and making existing debt more expensive for investors. The S&P Municipal Bond Index gained 3.25% year to date through Friday.

One high performer was a bond issued by the Harris County Sports Authority to refinance Houston's NRG Stadium. It returned 20.7% during the second quarter through Thursday, according to bondholder Nuveen Asset Management.

The same authority struggled during the latest recession with soured debt deals, a cash crunch and ratings downgrades. But it has now been able to set aside enough money to repay the bonds, making them more valuable.

Many investors still view public debt as a relatively safe way to make money because municipal defaults are rare and states aren't allowed to seek bankruptcy protection. But some observers say they see greater potential for losses as public expenses rise.

The performance of the municipal-debt market in 2017 is a surprise to many observers, who expected a pullback following the election of President Donald Trump. The S&P Municipal Bond Index fell 3.46% last November largely because of expectations that tax cuts and higher inflation would reduce the value of tax-exempt debt, analysts said.

About $27 billion flowed out of municipal-bond mutual funds and exchange-traded funds during the last two months of 2016, according to the Investment Company Institute.

But those outflows reversed at the start of 2017 as tax cuts and higher inflation looked less likely in the near term. Inflows have totaled $15 billion so far in this year. Lower inflation expectations typically give investors confidence that the debt will retain its value.

A drop in municipal-bond refinancing combined with an increase in debt coming due during 2017 also have driven up **bond prices** as investors look for ways to use their cash, analysts said.

"Despite the Illinois and Connecticut headlines, munis have performed just fine," said J.R. Rieger, managing director of fixed income index product management at S&P Dow Jones Indices LLC.

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THE WALL STREET JOURNAL.
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Funds Don't Buy Europe Recovery Story --- Big investors are wary as concerns linger over political and financial instability

By Christopher Whittall and Georgi Kantchev
858 words
3 July 2017
The Wall Street Journal
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B11
English

LONDON -- How long Europe's stock and bond rally lasts may depend on U.S. investors like Eric Stein.

International funds, such as Mr. Stein's Eaton Vance, had withdrawn billions of dollars from the eurozone for large parts of the past decade, amid a sovereign-debt crisis and weak growth.

But even as the region's economy and markets rebound and political risks appear to clear, Mr. Stein -- like many big foreign-based investors -- are still cautious amid lingering concerns over political and financial instability.

An analysis of the holdings of the 29 largest active equity mutual funds with global mandates -- which control close to $500 billion in assets and are predominantly U.S.-based -- shows that major active investors outside of Europe, as a group, haven't added eurozone shares this year, according to J.P. Morgan Chase & Co.

While local funds can help the upward momentum, and some U.S. hedge funds are wagering on Europe, the large pool of capital from big foreign investors is key to how high those markets can go. International flows helped push European equities higher amid signs of firming economic growth last year.

But as valuations rise, many of the largest foreign-based investors aren't buying into the rally until they have greater certainty that Europe's problems are behind it.

"We can see some cyclical momentum with good growth numbers and signs of political cohesion. . .but the question is, how long will that last?" Mr. Stein said. "Some of the most urgent European issues haven't magically gone away."

After years of underperformance, eurozone equities are on a tear, with the Euro Stoxx index up around 6.5% this year compared with a roughly 8% gain for the **S&P 500**. In dollar terms, the Euro Stoxx has comfortably outperformed the S&P, given that the brighter economic outlook has pushed up the euro 8.6% against the greenback this year.

Eurozone junk-rated bonds have notched a return of 4.2% this year compared with 4.9% for the U.S. market, according to Bloomberg Barclays bond indexes.

The eurozone economy grew by 2.3% in the first quarter over the same period in 2016, its fastest rate since 2015, compared with 1.4% in the U.S.

In politics, the threat to the eurozone from antiestablishment lawmakers who want to take their countries out of the EU has faded. Such parties lost in recent French and Dutch elections, and polls show their popularity slipping in Germany, Italy and elsewhere.

Meanwhile, Italian authorities last month bailed out two troubled lenders in a move that analysts said was a step toward stabilizing the country's weak banking sector.

"By and large we're in an environment where the investment backdrop in Europe is benign," said Mark Dowding, co-head of investment-grade debt at London-based BlueBay Asset Management. Mr. Dowding believes, for instance, that Italian government bonds look attractive at current levels.

The yield premium of 10-year Italian bonds over ultrasafe German bunds is currently around 1.7 percentage points, down from a two-year high of around 2.1 percentage points in April before the French elections, according to Tradeweb.

But many funds are more cautious after being burned several times before. That was particularly so during the sovereign-debt crisis of 2010 to 2012, when yields on bonds such as Italy's soared amid concern about a eurozone breakup.

Mr. Stein, who is Eaton Vance's co-director of global income, said that while the short-term outlook for Europe has improved, there are plenty of unresolved problems.

They include uncertainty around Britain's Brexit negotiations, the impact of the European Central Bank tapering its massive bond-buying program and longer term questions over further EU integration and the region's poor demographic prospects.

"We just seem to have a major European crisis once a year," he said.

The fact that markets have rallied makes some investors all the more cautious.

Pacific Investment Management Co. scooped up Italian bonds in the years following the sovereign-debt crisis. Now that those yields have fallen, the bonds don't look so attractive given the prospect of the ECB tapering and remaining political risks, said Nicola Mai, global sovereign credit analyst at Pimco.

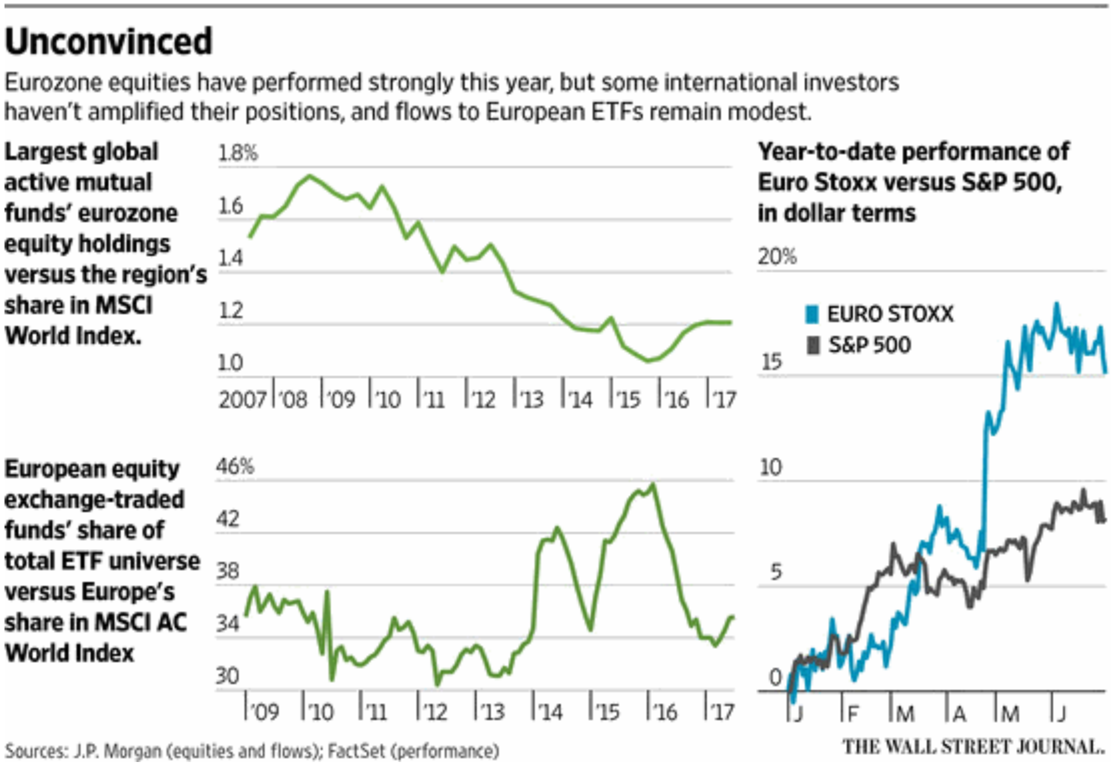
"A eurozone breakup is still very possible over the medium to long term," said Mr. Mai.

Investors sold Italian bonds after ECB President Mario Draghi hinted on Tuesday at scaling back the bank's asset purchases.

Still, on some metrics Europe remains cheap compared with the U.S.

Analysts estimate earnings per share growth of 16.9% this year for the Euro Stoxx, according to FactSet, compared with 10.3% for the **S&P 500**.

The price-to-book value, which compares a company's share price with the value of its assets, for the Euro Stoxx index is 1.7, compared with 3.1 for the **S&P 500**.



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THE WALL STREET JOURNAL.
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Heard on the Street
Overheard

145 words
3 July 2017
The Wall Street Journal
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B12
English

[Financial Analysis and Commentary]

The last week of June seems to be lucky for bond traders.

After the Brexit referendum on June 23 last year, global currency and bond markets gyrated wildly.

The sudden **volatility** unnerved many, but was quite pleasant for people who make a living trading fixed income and currencies at major banks.

Those same bankers got another summer surprise last week, as comments by central bankers in the U.K. and Europe triggered a sudden surge in interest rates and currencies.

While smaller than last year, the bump still makes for a refreshing reprise at the end of a weak quarter for trading.

As U.S. traders head off for the Independence Day holiday, they may be tempted to toast their old colonial masters for delivering yet another last-minute second-quarter boost.

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THE WALL STREET JOURNAL.
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Heard on the Street
A Bumpy Second Half Takes Shape

By Richard Barley
265 words
3 July 2017
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

The calm has been broken. The first half of 2017 has ended with big moves in global bond yields and exchange rates, sparked by a belated realization that central banks are increasingly edging toward reining in extraordinary policy measures. The stage is set for a scrappier second half.

Comments last week from central bankers have challenged the conditions that have lifted bonds and stocks together this year and kept **volatility** low.

Falling unemployment and closing output gaps mean emergency policy looks inappropriate: There is no emergency. The withdrawal will likely be gradual, but the direction of travel is clear.

Bonds got a rude awakening with yields jumping. Stocks and currencies got caught up in the turmoil too.

Inflation remains weak in Europe and the U.S., but central bankers clearly want to engender confidence in reflation. And they may be more willing to look through swings in headline measures as long as they think they are driven by supply, not demand.

The second is investment. A pickup in investment spending would reassure central banks that growth isn't overly dependent on consumption.

If central bankers are right and growth is solid while inflation is held back by temporary factors, then bond buyers should lose out. Stocks should do better, but to the extent valuations have been inflated by low interest rates, then there is a headwind. After a long stretch in which both bonds and stocks have done well, a new landscape is forming.

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THE WALL STREET JOURNAL.
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For Whom the Bell Tolls, Sell

By Andy Kessler
920 words
3 July 2017
The Wall Street Journal
J
A13
English

You think this market's crazy? One day in early 1987, with Wall Street humming, a meeting after trading closed involved several cases of champagne. The **Dow Jones Industrial Average** had breached 2000 that day, a cause for celebration. A week and a half later, more champagne was ordered when the average passed 2100. Then again a few weeks later for 2200. Eventually my boss stopped buying bubbly when breaking records became the norm. Japanese insurance companies would show up at the brokerage firm where I was a securities analyst and ask for a list of our five favorite stocks, then hand it to their salesman and say "buy 50,000 of each."

On Friday, Oct. 16, 1987, the average dropped 108 points. Rumors swirled that we'd celebrate with cases of Bud Light. No matter: I was with some traders and a client in a stretch limo, headed to watch Mike Tyson fight Tyrell Biggs for the heavyweight championship -- an event staged by Donald Trump in Atlantic City, N.J. Man, I miss the 1980s.

The market truly crashed the next Monday, dropping 508 points, or 22.6%. In retrospect, there had been signs all over the place. How did everyone miss them? Well, as the old Wall Street adage goes, no one rings a bell at the top (or bottom) of the market.

So here we are in 2017. The **stock market** is supposed to be the great humbler, but the records are coming fast and easy. The **Dow Jones Industrial Average** is up 8% for the year and flirts with a record practically every day. Some of this is structural: Bonds are no fun, since the yield curve is flattening and three-month Treasurys are 1%. So money flows to stocks -- and other weird things.

A friend of mine used to run a large-growth mutual fund. In the dot-com mania of 1999, he told me that tens of millions of new capital would flow in every single day. Trying to figure out where to put it, he would consider the new batch of initial public offerings -- and then inevitably he just would buy more Yahoo or America Online or Cisco or, what the heck, Yahoo again.

Today, money is flowing into exchange-traded funds. But because ETFs are weighted by market cap, that money flows into the biggest names: Facebook, Amazon, Apple, Microsoft, Google. Classic momos, or momentum stocks. The church of what's working now. What could possibly go wrong?

Sure, the economy is picking up, earnings are growing, and the business is being transformed by mobile, cloud and artificial intelligence. But who doesn't already know that? On the flip side, we're at the start of a 30-year cycle of interest-rate raising, nonhousing debt is higher than in 2008, and deciphering China's direction is as hard as Chinese arithmetic.

Remember, bull markets end when the perception of earnings growth disappears, maybe because of a recession or even simply pending inflation. Manias, on the other hand, end when the market runs out of buyers.

In 1987, Treasury Secretary James Baker refused to support the dollar, and Japanese buyers left town. In late 1999, Federal Reserve Chairman Alan Greenspan flooded the economy with money to head off a potential panic over the Y2K computer glitch. Then in early 2000 he pulled the money back in, ending the stock-buying frenzy. In 2007, the subprime mortgage-backed security market rolled over as foreign buyers left, though because of thinly traded markets it took another year to show up in prices.

Another ding-dong: In less than a year at least 50 companies, including one named Mysterium, have raised hundreds of millions of dollars via something called Initial Coin Offerings, selling a percentage of a new cryptocurrency service in exchange for other digital coins. That's a modern version of a blank-check company, which usually ends in tears.

So are we facing a raging **bull market** or a mania? Sadly, you'll only know in retrospect. I'm not saying it's a top today, though if it is, I'm happy to take credit. It could go on for a while. Pundits pore over charts of **volatility** and put-call ratios. Forget that. Real investors survey the landscape and look for signs of a market gone loco. In one week in late 1999, the hedge fund I used to run had two groups from the Middle East each insist on wiring us $500 million. Practically "The Gong Show." We politely declined and then started returning money to our existing investors.

Are there any bells ringing now? How about a few months back when someone looked me in the eye and insisted -- without cracking a smile -- that Uber was a bargain at a $68 billion valuation? Or when, with shades of AOL and Time Warner, Amazon bought Whole Foods for $13 billion -- and then its stock went up by more than that amount? Or when Tesla missed its numbers again and the stock rose anyway? Or when the price of a bitcoin, backed by nothing but the faith of devotees, hit $3,000, tripling over a year? Or when Hertz stock rose 14% on news of a deal with Apple for a self-driving car that is still vaporware?

Listen for whom the bell tolls.

Mr. Kessler writes on technology and markets for the Journal.

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The New York Times

Business Day
Ex-Executives of Barclays Are in Court, and U.S. Jobs Report Is Due

By THE NEW YORK TIMES
835 words
2 July 2017
09:00 PM
NYTimes.com Feed
NYTFEED
English

Here’s a look at what’s coming up this week.

BANKING

A financial crisis-era case is a first in Britain.

A group of former Barclays executives will make their first court appearance in London on Monday after they were charged, along with the bank, last month with misrepresenting arrangements with Qatar when the bank raised money as the financial crisis worsened in 2008. The bank raised a total of $15 billion with two capital infusions from Qatar and other investors in June and October 2008, allowing it to avoid a government bailout, unlike several of its British banking rivals.

The criminal charges against Barclays are the first to have been brought in Britain against a bank for actions taken during the financial crisis. The four former executives — including a onetime chief executive, John S. Varley — are among the most senior bank managers to be charged anywhere in a crisis-era case. Chad Bray

AUTO INDUSTRY

A decline in auto sales is expected to continue.

Automakers on Monday report how many new vehicles they sold in June, and analysts expect some gloomy results. Kelley Blue Book is forecasting a decline of 3.6 percent, to 1.46 million new cars and light trucks. More important, if that outlook holds, June would be the sixth month in a row with declining sales. Most forecasters now expect auto sales to fall this year, to around 17.1 million light vehicles, down from the record 17.5 million sold in 2016. Neal E. Boudette

ECONOMY

A modest increase is seen in construction spending.

On Monday, at 10 a.m., the Commerce Department will release data on construction spending in May. After a strong increase of 1.4 percent in April, economists are looking for a more modest 0.3 percent rise in May. The residential portion of the report could be softer. That, in turn, could hurt the level of overall economic growth for the second quarter. Nelson D. Schwartz

MARKETS

U.S. markets will take a July Fourth breather.

On Tuesday, **financial markets** and government offices in the United States will be closed for Independence Day, giving Americans the chance to fire up their grills and, later, to watch the fireworks. Other global markets and governments will be open as usual. Zach Wichter

REGULATION

Uber’s legal fight in Europe continues.

On Tuesday, Uber’s battle with the European authorities will reach a new stage. The advocate general of the European Court of Justice is expected to publish an opinion on the ride-hailing service’s operations in France. In May, the advocate general designated Uber as a transportation company, rather than a digital service, that would thus have to comply with regional rules. Prashant Rao

ECONOMY

Minutes will offer insight on the Fed’s thinking.

The Federal Reserve delivered on schedule during the first half of the year, raising its benchmark interest rate in March and again in June. It was the first time since the financial crisis that its plans were not spoiled by economic wobbles. The minutes of the June meeting, which the Fed will publish on Wednesday, may provide some fresh information for those trying to gauge whether the Fed will stay on course during the second half of the year. Inflation remains more sluggish than the Fed would like, but Janet L. Yellen, the Fed’s chairwoman, has pointed to the strength of job growth as a reason to believe that inflation will rebound. Investors are close to evenly divided on the chances of a December rate increase. Binyamin Appelbaum

The pace of hiring in June will offer clues on the job market.

On Friday, at 8:30 a.m., the Labor Department will release figures for hiring and unemployment in June. Wall Street economists estimate the economy added 180,000 jobs, with the unemployment rate remaining 4.3 percent. While economic reports have been mixed lately, experts will closely watch the pace of hiring in June to see if the strong job market so far this year remains on track. One wild card: Calendar quirks and the end of the school year could produce a drag on education jobs, reducing the total payroll figure. Nelson D. Schwartz

‘Very difficult’ trade talks are expected when the G-20 meets.

Trade will be high on the agenda when Group of 20 leaders begin two days of meetings in Hamburg, Germany, on Friday. Chancellor Angela Merkel of Germany has already predicted that the talks will be “very difficult.” German-American relations are at a low after a series of reciprocal snubs, including one last week when organizers of an economic conference in Berlin cut short a speech that Wilbur Ross, the secretary of commerce, was delivering by video link. But Mr. Ross also called for the resumption of talks on a trans-Atlantic trade pact, a project dear to the Europeans. Jack Ewing

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The New York Times

STRATEGIES
Money and Business/Financial Desk; SECTBU
Clouds Are Forming Over the Bond Market

By JEFF SOMMER
1,286 words
2 July 2017
The New York Times
NYTF
Late Edition - Final
6
English

The bond market is flashing warning signals that bad times may be ahead for the **stock market** and the economy.

That is probably not what most people want to hear -- stock investors especially. In the first half of the year, after all, stocks have performed spectacularly. The **Standard & Poor's 500-stockindex** returned 9 percent through June, churning out gains so regularly that it may seem churlish to note that clouds are appearing on the horizon.

Yet like a long-range forecast about a possible storm, an old and trusted financial indicator is telling us that trouble may be looming.

Simply put, while the Federal Reserve has been raising short-term interest rates since December, the bond market hasn't gotten the memo. The longer-term rates that are set through bond market trading have, for the most part, been declining, though there was a brief reversal in the last few days. But the disconnect over the last few months is a sign that bond investors believe economic growth and inflation are still weak and the Fed's actions are premature.

In the past, when disputes between the Fed and the bond market have persisted and grown, they have sometimes predicted big problems ahead -- like a plunging **stock market** and, eventually, a recession.

''I think people should be paying close attention to all of this right now,'' said David Rosenberg, chief economist and strategist at Gluskin-Sheff in Toronto. ''When do you want to make sure you've got an umbrella? When rain is in the forecast or after it's already started pouring?''

Rain is coming, Mr. Rosenberg said, recommending that investors prepare by keeping enough cash on hand and setting up their portfolios to weather a storm. Regions like the eurozone are in an earlier stage of the economic cycle, he said, and may be better bets now. He urges caution in the United States. ''I can't tell you when it is going to happen,'' he said, ''but the economic cycle has not been abolished, and the chances of a recession are rising.''

Though there is widespread concern about the behavior of the fixed-income markets, some analysts aren't as convinced that the forecast is quite so gloomy.

''There are grounds for concern, certainly,'' said Edward Yardeni, an independent economist and strategist, who has been studying the bond markets for decades. ''But we're in a very strange world now, and it's hard to know how this will all play out.''

''The economy is growing very slowly,'' he added, ''at a pace of less than 2 percent per year, a rate that we used to call 'stall speed,' in the belief that when the economy is that feeble, it will fall into a recession. But that hasn't happened. The economy keeps growing, the **stock market** keeps going up, yet inflation remains very low. Where are we heading? There are many possibilities here. This isn't the economy we used to know.''

Understanding the situation more deeply requires a little technical knowledge, so bear with me.

The Federal Reserve, along with other central banks, lowered short-term rates to near-zero levels during the financial crisis. With the economy on the mend, and asset prices like stocks and real estate soaring, Fed officials have begun raising short-term rates and say they intend to continue to do so.

What is unusual is that while the short-term rates that are controlled and heavily influenced by the Fed have been rising, the longer-term rates that the bond market sets have generally been dropping. That is why 30-year fixed mortgage rates are still below 4 percent, not all that much higher than they were a year ago.

The benchmark **10**-**year Treasury** note, for example, declined from more than 2.6 percent in March to about 2.1 percent earlier in June. (It rose to 2.3 percent on Friday.) The rate on the 10-year note has been hovering at only about 1 percentage point above the Fed funds rate and 0.6 or 0.7 of a percentage point above the three-year Treasury note.

In bond market jargon, "the yield curve has been flattening" -- meaning short- and long-term interest rates have been moving closer to parity. In itself, such a development is unusual. But if the trend continues, with shorter-term rates rising above longer-term rates, the message from the bond market would amount to a flashing red light.

In such a case, bond mavens would say, "The yield curve has inverted," implying a reversal of the natural order of things, because most of the time, investors demand a yield premium for tying their money up for longer periods. An inversion would express deep skepticism about Fed policy and about the health of the economy. In the past, inversions have often predicted economic recessions and sharp declines in the **stock market**.

In fact, the last yield-curve inversion occurred in 2006 and 2007, according to data maintained by the Federal Reserve Bank of New York. Recession probabilities climbed, a model maintained by the New York Fed showed, and for good reason. The economy plunged into recession in December 2007, and, by some measures, it is still recovering. That's why the yield curve's messages are worth taking seriously.

That said, we don't have an inversion at this point, and we may not go there at all.

"Just because the yield curve is flattening doesn't mean that it will become an inversion," said Jeffrey Kleintop, chief global investment strategist at Charles Schwab. At the moment, he said, the British economy has been battered by "Brexit" and other worries and is quite vulnerable to a downturn. But he believes that the probability of a recession in the United States in the next 12 months is low. "I think we've probably got a year or more of growth ahead here," he said.

Mr. Yardeni remains **bullish** on United States stocks and is cautiously positive about the economy, saying low bond yields probably reflect persistently low inflation, which could be benign. Factors like demography (the aging of the baby boom generation), technology (the efficiency of smartphones and cloud computing) and globalization have changed the economy and reduced the inflation rate, he said.

Low inflation, along with low global interest rates, are at least partly responsible for the low bond yields in the United States. Those low yields have been a boon to people who own bonds because yield and price move in opposite directions: The benchmark Bloomberg Barclays Aggregate index returned more than 2.4 percent through June, despite predictions early in the year of bad times for bond investors.

The danger signals from the bond market could easily change to another pattern. The Fed may pause in raising short-term rates, though that could unleash irrational exuberance and drive already stretched stock prices higher. On the other hand, the bond market could blink, raising bond yields and relieving the tension. But that would be far more likely if, counter to current expectations, inflation or economic growth began to surge.

For now, the rally in risky assets like stocks continues unabated, while the conflict between the Fed and the bond market continues. Fed officials indicate that they are determined to keep raising short-term rates and to begin reducing the Fed's bond holdings -- perhaps preparing the central bank for action whenever the next recession comes.

At a bare minimum, the policy choices ahead are difficult. And for investors, there is ample reason for caution.

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DRAWING

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The New York Times

RETIRING
Money and Business/Financial Desk; SECTBU
Investing Along Religious Guidelines

By TOM VERDE
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2 July 2017
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English

When faced with a loss in the market versus a lapse in his faith, Nabeel Hamoui, 37, a radiologist in Chicago, will invariably opt for the loss. This is because Dr. Hamoui manages his retirement portfolio in accordance with halal, or religiously sanctioned, Islamic guidelines.

''I chose halal investing based on my religious beliefs, and try to remain in compliance with those beliefs,'' Dr. Hamoui said. A return on his investment, he said, is beside the point.

For Dr. Hamoui and many other Muslims, both in the United States and abroad, saving for retirement means steering clear of investments in companies and funds that trade in a host of forbidden goods and services, which are known as haram. The lengthy list includes alcohol, tobacco, pork products and media or entertainment considered immoral, such as pornography.

The rules can be tricky to navigate. Investments are banned in companies with too much debt as a percentage of their assets. Interest on loans (known as riba) is also haram, which rules out investing in conventional banking and insurance sectors. Investing in companies earning a minimal amount of interest, typically 5 percent or less, may be allowed, so long as the dividend income derived from that interest is donated to charity.

Equally problematic are many customary market gambits such as annuities and short-selling, which can be viewed as gambling, and thus are prohibited under Islamic law, or Shariah.

''The Islamic principles look to what you are doing with your capital, what types of businesses, assets and operations are you furthering,'' said Umar Moghul, a New York-based lawyer specializing in Islamic finance.

Other important criteria, he said, are the terms and conditions of someone's holdings, ''since Shariah also speaks to procedure as well as to the substance of investment.''

In spite of these challenges, the global Islamic financial sector is healthy and growing.

While the bulk of the Islamic financial sector's assets lie in Malaysia, the United Arab Emirates and Bahrain, financial services managers in the United States are addressing the retirement savings needs -- and dollars -- of a steadily growing number of observant Muslim-Americans, now about 1 percent of the United States population. Their economic profiles show them to be slightly more likely than non-Muslim workers to be engaged in professional careers, according to a 2009 Gallup Poll, and as likely as other Americans to earn annual incomes in excess of $100,000, according to a 2011 Pew Research Center study.

Islamic finance in the United States is ''a nascent industry, but people are very optimistic about where it is going,'' said Bashar Qasem, the chief executive of Azzad Asset Management, a money management firm in Falls Church, Va., that he founded in 1997.

The philosophy behind Islamic saving and investing can be traced to the Quran and other early Islamic texts. The story of the prophet Yusuf (Joseph, the same one as in the Bible) conserving grain from rich harvests in Egypt, related in Sura (chapter) 12 of the Quran, is often cited as an admonition to save against hard times. Other verses advise against squandering wealth, while the Prophet Muhammad warned in a hadith (a collection of his sayings) that one ''who is prudent in spending will not be dependent on others'' later in life.

Both the Quran and hadith inform Shariah, which guides Muslims through practical life decisions, including how they should make and save money while remaining true to their religious principles.

"Because Islam tends not to distinguish between the temporal and the religious, there is a perennial desire among Muslims to live all aspects of their lives, including the financial, in a manner consistent with their faith," observed Usman Hayat and Adeel Malik, the authors of a 2014 study of Islamic finance by the CFA Institute.

The Accounting and Auditing Organization for Islamic Financial Institutions, Malaysia's Islamic Financial Services Board and Bahrain's International Islamic **Financial Market** are among the major independent organizations that help Muslims achieve these goals. Advised by boards of Islamic financial experts and religious scholars, these organizations continually and systematically review companies, bonds and mutual funds to ensure they are Shariah-compliant. The vetted products are listed on various Islamic indexes that have concurrently emerged.

"As Islamic funds were being developed, there was a need for benchmarks, and so we were responding to the needs of the assets management industry," said Michael Orzano, the head of equity indices at S&P's Dow Jones Indices. The original Dow Jones Islamic Market Index was introduced in 1999 as the world's first Shariah-compliant index. Today, the company's portfolio of more than 15,000 indexes is among many offered by major financial firms.

Like Shariah itself, which varies in interpretation (known as ijtihad), the indexes differ on what is compliant and what is not. Most regard the trade and manufacture of weapons as noncompliant, for example, yet S&P's board of Islamic scholars takes a nuanced approach. The use of weapons can be permissible (self-defense) or nonpermissible (unprovoked violence), but the weapons themselves are neutral, so investing in their manufacture is sanctioned, as Mr. Orzano noted in a 2013 report.

A vast range of customized, equally nuanced Islamic financial products structured like standard investments but operating within Shariah has likewise gained traction in the market.

Sukuks are among the most prevalent. These are essentially Shariah-compliant bonds. Yet whereas standard bonds pay investors a set rate of interest over a period of time, sukuks offer a fixed rate of profit instead, thus avoiding forbidden riba.

Another important distinction is that sukuks must be backed by some tangible asset, such as properties or a Shariah-compliant business. Ownership is transferred to the investors who then lease the asset to the issuer for a set period, essentially charging rent for its use, an arrangement known in Islamic finance as ijarah.

"So with a sukuk, the investor owns a piece of the asset," said M. Yaqub Mirza, chief executive officer of Sterling Management Group in Herndon, Va. "With a bond, it is a debt, and you earn interest on it, which is noncompliant with Shariah." In 1986, Dr. Mirza introduced the Amana Income Fund, the first Shariah-compliant mutual fund in the United States.

Shariah-compliant exchange traded funds (E.T.F.s) are another attractive product for Muslim investors. Whereas a standard E.T.F. is a security that tracks an index, commodity, bonds or an index fund, an Islamic E.T.F. exclusively tracks a benchmark index composed of Shariah-compliant companies. They are also usually overseen by a Shariah committee to ensure compliance.

Saving for retirement the Muslim way involves "very intentional investing that is consistent with values," said Josh Zinner, the chief executive of the Interfaith Center on Corporate Responsibility, in a telephone interview from his office in New York.

Yet whether driven by conscience or a keen sense of the market, Muslim and non-Muslim investors alike have historically done well by parking retirement savings in the Islamic financial sector, particularly during **volatile** times. Both WorldCom and Enron were removed from the Dow Jones Islamic Market Index when their debt levels hit 33 percent, the Shariah cutoff. Shares of both companies later lost their value after they collapsed in 2001-2. More recently, halal investors similarly weathered the financial crisis of 2008 in relative safety, Mr. Orzano observed.

"During that specific time frame, when the financial sector was devastated, being in a Shariah-compliant investment was beneficial," he said.

The bottom line for Khalique Zahir, a plastic surgeon from McLean, Va., is that whether it be high finance or in the interest of a higher cause, building a Shariah-compliant nest egg simply makes sense.

''Basically it's just safe, intelligent investing,'' said Dr. Zahir, who is 51. He began saving for retirement in conventional markets soon after graduating from medical school but was drawn to halal investing around 2001, after watching the rise and fall of the dot-com bubble.

''With halal investing, you're investing in a company that has at least 50 percent of its value in hard cash,'' Dr. Zahir said. ''It's not in some hypothetical dot-com kind of thought processes. It doesn't matter if you're Muslim or non-Muslim -- you just don't like to lose your capital.''

Nabeel Hamoui, a radiologist in Chicago, manages his retirement portfolio in accordance with halal, or religiously sanctioned, Islamic guidelines. (PHOTOGRAPH BY WHITTEN SABBATINI FOR THE NEW YORK TIMES)

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Weekend Profile: Berkowitz's Comeback Bet --- The fund manager stakes his return to glory on Sears

By Sarah Krouse
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English

Bruce Berkowitz was named mutual-fund manager of the decade in 2010. Today, his fund has lost 89% of its assets from a 2011 peak and he is staking a comeback partly on one of America's most beaten-down companies: Sears Holdings Corp.

Mr. Berkowitz's flagship Fairholme Fund has lost 12.5% so far this year, while the **S&P 500** is up about 9%. Over five years, his Fairholme Fund returned 6.9% compared with 14.6% for the S&P. At $2.2 billion in assets, the fund is just a fraction of the $20 billion in assets it held in 2011.

Performance has hit assets in the fund, but so have redemptions. Many investors who once relished Mr. Berkowitz's concentrated bets have taken their cash elsewhere. The fund manager is now the firm's largest customer after several years of customer withdrawals.

Mr. Berkowitz is unapologetic for the poor returns, noting he always has promised his investors ultraconcentrated, often contrarian bets and high **volatility** was a likely result.

"The people who had the smoothest ride were those in Bernie Madoff. Life is not smooth," he said.

Since the Fairholme Fund was started in 1999, it has delivered an annualized total return of about 10% versus about 5% for the S&P, according to Morningstar Inc.

Mr. Berkowitz is an anomaly in the investing world. He still does what a shrinking number of his peers do: mining regulatory filings himself, gauging his faith in company leaders, conferring with analysts and at times playing the role of activist.

That type of examination is behind his growing bet on Sears, the formerly quintessential American retailer that has reported seven years of losses.

Last month, Sears raised concerns about its ability to continue operating as a "going concern."

Most days, he works from his Coral Gables, Fla., home, calling his staff located at a nearby white-and-glass office building. His day-to-day appearance is more country club than Wall Street -- he often wears boat shoes and jeans or khakis.

Mr. Berkowitz says one part of his comeback -- big bets on government-backed mortgage financing giants -- could pay off in the next six months.

Treasury officials have said they want to reform Fannie Mae and Freddie Mac, which could include moving them out of government control. Such a move could put an end to litigation over their future and deliver a windfall to investors. For now, however, the future of the two entities and what that will mean for investors is unclear. Preferred shares in the two represented 38% of the Fairholme Fund at the end of February, according to a regulatory filing, the most recent holdings information available.

Mr. Berkowitz started building a position in Sears stock in late 2005 and now owns both debt and equity in a number of Sears entities. He also owns shares in its spinoff real-estate investment trust Seritage Growth Properties. He has continued to add to some of those holdings in recent years.

As of the end of February, more than 10% of the fund was invested in Seritage shares, Sears and appliance seller Sears Hometown and Outlet Stores Inc. stock and various Sears entities' corporate debt, according to the filing. The fund's holdings also include warrants to purchase Sears common stock.

Mr. Berkowitz has been adding to his Sears exposure in recent years as its **stock price** has declined. This year through Wednesday, Sears shares had fallen 14%.

"The deaths of today's malls and other enclosed spaces is greatly exaggerated," Mr. Berkowitz said in a recent interview.

He believes restaurants are returning to malls, but in the form of outdoor eateries. Mr. Berkowitz said traditional clothing chains may die, but their space will be replaced by movie theaters and auto showrooms. As online retailers reshape shopping, he says the parking lots and properties traditional retailers occupied will be redeveloped and used for new services or homes.

When that happens, he says anchor properties will have heightened value given their footprint and location. And, Sears often inhabits the largest corner of malls.

Still, many landlords have lost large anchor tenants in recent years, and some analysts and property owners have questioned whether a resurgence of such malls is possible.

"No one thinks about the parking lots. Those already have infrastructure, highways, secondary roads, sewers, water systems," he said.

Together with the Fannie and Freddie stakes, real estate and retail-related holdings account for 70% of the Fairholme Fund. Other real-estate holdings include Florida-based developer St. Joe Co., which represents about 14% of the fund.

Some investors have opted to sit out the real-estate bets.

Steve Bachman, a retired chemical engineer in Orange County, Calif., who owned the fund for 10 years sold his stake in 2015 concerned about the prospects of its positions in Sears and the Florida development firm, where Mr. Berkowitz is chairman.

"They bought Sears because the land was valuable, but it would probably be forever before they'd get a return on it, and meanwhile I was watching Sears stock go down," he said.

A Warren Buffett devotee, Mr. Berkowitz, 59, seeks unloved, undervalued companies.

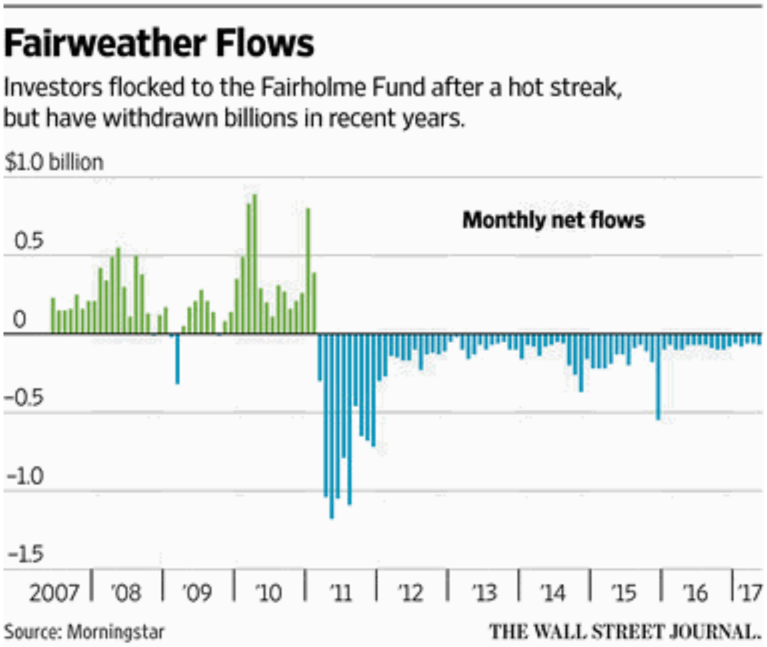
He made lucrative bets on insurance companies including American International Group Inc. and Bank of America Corp. in the wake of the financial crisis that paid off in recent years as they recovered.

He dodged the technology bubble and bust and before the financial crisis made successful bets on energy and defense that contributed to his fame.

In 2010, fund-research firm Morningstar named Mr. Berkowitz U.S. stock fund manager of the decade.

More recently, he has invested more in debt than stocks, drawn to the income and protection from price swings that bonds offer.

"Spending 30 years analyzing equities is a really great way to understand credit," Mr. Berkowitz said.



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Global Stocks Cap Strong First Half --- After a blockbuster run for equities in the U.S. and abroad, investors ask if gains will last

By Steven Russolillo
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The Wall Street Journal
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Global stock markets collectively had their best opening half-year in years, but turbulence this week could be a harbinger of greater **volatility**.

All but four of 30 major indexes representing the world's biggest stock markets by value have risen this year, a first-half performance unmatched since 2009, according to an analysis by The Wall Street Journal. In the past 20 years, only four first-half rallies have been as widespread or better than the current global surge. Two of them preceded sharp market crashes, and two others came at the start of long bull markets.

In the U.S., the tech-heavy **Nasdaq Composite** surged 14%, its best first half since 2009. The **Dow Jones Industrial Average** and **S&P 500** each rose about 8% -- the best start to a year since 2013. Stock benchmarks from South Korea to India to Spain put up double-digit percentage gains for the first six months.

Investors attribute the rally's breadth to strengthening corporate earnings, improving economies and continued support from central banks. A sentiment reading of Eurozone businesses and consumers released this week jumped to its highest level since before the financial crisis. In the U.S., earnings growth has been a crucial to the market's performance. And a resilient tech sector, led by U.S. and Chinese giants, is an increasing influence on domestic and Asian markets.

Despite challenges to President Donald Trump's agenda, and political jolts in countries from Brazil to the U.K., stock markets have been unusually steady. Measures of **volatility** in the year's first half were at or near multiyear lows in the U.S., Europe and Asia.

Investors are now asking whether the strong first half heralds a choppier second half, or continued strength.

Data on global rallies offer a mixed record: A surge in the first half of 1999 preceded the tech bubble's burst. The rally to start 2007 came before the global financial crisis. But broad, world-wide gains in 2003 and 2009, similar to this year's, were early stages of yearslong market rallies.

High stock valuations and tranquil trading this year have led to concerns about complacency. The **S&P 500** trades at about 18 times projected earnings over the next 12 months, around its highest level in 13 years. Still, this forward multiple was above 26 times at the dot-com bubble's peak in 2000, according to FactSet.

Valuations are more modest elsewhere. Germany's DAX trades at less than half its 2000 peak. The Nikkei 225 fetches 17 times forward earnings, around its five-year average.

This week, investors tasted greater uncertainty that could lie ahead, when top European Central Bank officials offered mixed messages on the future of its bond-buying program. Heads of central banks in the U.K. and Canada also indicated they were pondering when to raise interest rates.

Stocks and currencies gyrated on the notion of less central-bank accommodation. "Central banks have created huge distortions in the markets, which are going to be difficult to unwind," said Colin Graham, chief investment officer of multiasset solutions at BNP Paribas Asset Management. "But we think they are going to talk hawkish and walk dovish," he said, implying that central banks won't do anything too drastic.

In the ninth year of a **bull market** in the U.S., the Dow, **S&P 500** and **Nasdaq Composite** have set numerous records. Globally, nearly half of the top 30 stock indexes are at or near all-time highs. "We're really seeing a synchronized global recovery take shape this year," said Graeme Bencke, global portfolio manager at Pinebridge Investments in London. "Everything is looking better."

The tech sector's rising clout has been key. The five largest U.S. companies are tech- and consumer-related companies, led by Apple Inc. They propelled the **Nasdaq** this year. China's tech behemoths fared even better.

In January, investors hoped Donald Trump's election victory would trigger lower taxes, less regulation and more infrastructure spending. France's presidential election loomed over Europe's prospects. So far, though, Mr. Trump hasn't enacted major changes to fiscal policy or taken significant protectionist measures. And pro-Europe Emmanuel Macron romped to victory in France, allaying fears about anti-European Union sentiment.

Through it all, the market's focus has remained on central bankers, the pattern since the financial crisis. While the U.S. has raised short-term interest rates four times since the end of 2015, the ECB and Bank of Japan have mostly remained accommodative, helping juice asset prices.

Investors point to a pickup in earnings growth as the vital driver of global gains this year. In the U.S., first-quarter earnings from **S&P 500** companies increased 14%, the best growth since 2011. First-quarter earnings in Asia-Pacific, excluding Japan, and in Europe, also grew at a double-digit rate.

"We've never been in a period like this," Mr. Bencke of PineBridge Investments said. "It's like central banks are slowly pulling the rug from under your feet. My hope is they'll move slowly, and the world will err on the side of caution."

Demi Guo contributed to this article.

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The New York Times

Business/Financial Desk; SECTB
Wall St. Ends Last Day of Quarter With Slight Gains

By THE ASSOCIATED PRESS
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2
English

Wall Street closed out the final day of the second quarter with slight gains after a broad rally faded in the last few minutes of trading on Friday.

The **Dow Jonesindustrial average** and the **Standard & Poor's 500**-**stockindex** eked out tiny increases, while the **Nasdaq composite** closed essentially flat.

Industrial stocks and consumer-focused companies led the markets. Energy stocks also rose as crude **oil prices** closed higher for the seventh straight day. Utilities, technology and health care companies were among the biggest decliners.

Trading was mostly subdued ahead of the Independence Day holiday next week, though many investors seized on the final trading day of the quarter and the market slide on Thursday to buy more shares or close out positions and book profits.

"Over all, we're ending this quarter with a strong market. Even though technology has taken a hit, other sectors have moved up," said Quincy Krosby, chief market strategist at Prudential Financial.

The **S**.**&P**. **500** rose 3.71 points, or 0.2 percent, to 2,423.41. The Dow gained 62.60 points, or 0.3 percent, to 21,349.63. The **Nasdaq** lost 3.93 points, or 0.1 percent, to 6,140.42.

Bond prices fell. The **10**-**year Treasury** yield rose to 2.30 percent from 2.27 percent late Thursday.

The major stock indexes got off to a shaky start early Friday, but soon veered higher and held course for much of the day. A last-minute flurry of selling nudged the **Nasdaq** slightly into the red.

The Dow, **S**.**&P**. **500** and **Nasdaq** ended the week in negative territory. This was also the worst week of the year for the **Nasdaq** and the third loss in the last four weeks for the tech-heavy index.

The market's snapshot at the halfway mark for 2017 is more encouraging, however.

The **S**.**&P**. **500**, the broadest measure of the **stock market**, is up 8.2 percent this year, while the Dow is up 8 percent. The **Nasdaq** has amassed a gain of 14.1 percent.

Remarks from central bank officials in Europe this week helped set the tone for the market, spurring speculation among investors that global interest rates could move higher. That sent **bond yield** sharply higher and helped lift shares in banks.

On Friday, investors sized up the latest company earnings and deal news.

The Commerce Department said consumer spending grew just 0.1 percent in May, less than the last couple of months. Personal income grew by a healthy 0.4 percent, but spending only rose 0.1 percent.

Nike had its best day in almost two years on Friday. Its shares jumped 11 percent after a strong quarterly report. Nike also said it was testing a program to sell sneakers directly through Amazon.com. Nike shares were the biggest gainer in the **S**.**&P**. **500**, adding $5.83 to $59.

The specialty contractor Quanta Services was the biggest winner in the industrials sector, rising $1.04, or 3.3 percent, to $32.92.

Parkway, a commercial real estate investment trust, vaulted 12.3 percent after the Canada Pension Plan Investment Board agreed to buy it for about $1.13 billion. Parkway rose $2.51 to $22.89.

Crude **oil prices** closed higher for the seventh straight day. Benchmark United States crude gained $1.11, or 2.5 percent, to settle at $46.04 a barrel in New York. Brent, the international standard, rose $1.14, or 2.4 percent, to close at $48.77 a barrel in London.

Gold fell $3.50 to settle at $1,240.70 an ounce. Silver slipped 3 cents to $16.63 an ounce. Copper gained 2 cents to $2.71 a pound.

The dollar rose to 112.45 yen from 112.04 yen late Thursday. The euro weakened to $1.1417 from $1.1438. The pound rose to $1.3024 from $1.2996.

CHART: The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Friday. (Source: Reuters)

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U.S. News: Weak Inflation Poses Fresh Test for the Fed

By Jeffrey Sparshott
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English

WASHINGTON -- Inflation eased for the third consecutive month and consumer spending was tepid in May, potential complications for the Federal Reserve as it charts a course for interest rates.

The Fed's preferred measure of inflation, the price index for personal-consumption expenditures, rose 1.4% in May from a year earlier, the lowest level in six months, the Commerce Department said Friday. Excluding the often-**volatile** categories of food and energy, so-called core prices were also up 1.4%, the lowest level since December 2015.

The Fed, tasked with promoting full employment and stable prices, targets a 2% annual inflation rate. The price index poked above that threshold in February for the first time in nearly five years but has settled lower each month since.

"Although the real economy is doing well, Fed officials are concerned that isn't translating into stronger inflationary pressures," Paul Ashworth, chief U.S. economist at Capital Economics, said in a note to clients.

Despite soft readings, the Fed's policy-making committee earlier this month decided to raise its benchmark interest rate by a quarter percentage point and penciled in one more increase for later this year.

Fed Chairwoman Janet Yellen said the weak inflation numbers largely reflect temporary factors, such as falling prices on cellphone plans, and smaller-than-normal rises for drug prices.

"With employment near its maximum sustainable level and the labor market continuing to strengthen, the committee still expects inflation to move up and stabilize around 2% over the next couple of years," Ms. Yellen said.

Outside of inflation, the economy appears to be advancing at a steady if unspectacular pace.

Personal-consumption expenditures, a measure of household spending on everything from new cars to medical care, increased a seasonally adjusted 0.1% in May from the prior month, the Commerce report said. The measure had risen 0.4% the prior two months.

Instead of splashing out, Americans saved more, boosting the personal-saving rate to 5.5%, its highest level in eight months.

"Americans are in good shape to increase consumption -- the question is when?" Eugenio Aleman, senior economist at Wells Fargo, said in a note to clients.

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Heard on the Street
To Markets: Just Relax, From China

By Nathaniel Taplin
274 words
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The Wall Street Journal
J
B10
English

[Financial Analysis and Commentary]

Investors have become accustomed to rude shocks from China, so it's always nice to get some unexpected, encouraging news.

China's June purchasing managers index fit the bill; it ticked up after stalling out for two months, in a sign that this spring's crackdown on **financial-market** leverage has, so far, done limited damage to the real economy.

More important, the percentage of businesses reporting stable or improving export orders hit its highest level since early 2012, a **bullish** signal on global growth after a week of stock- and bond-market selloffs.

Weakening trade data from Taiwan and Korea, and faltering U.S. consumer confidence earlier in the second quarter had suggested a cautious outlook about global demand. But this latest China data, paired with **bullish** signals from Europe, suggest it is doing just fine. The selloff in oil, which some had taken as a signal of weakening growth, has also now reversed -- for now -- as initial signs of weaker U.S. supply growth boost sentiment.

There were some discouraging signs: The PMIs for small and medium-size enterprises were lower in May, although they still indicated growth. Smaller firms, which often need to rely on shadow banks for loans, may be feeling the hit from slower credit growth sooner than big state firms.

Manufacturing employment also weakened again. A weaker job market and tougher conditions for small firms could mean a deeper slowdown in the second half.

But for now, the message from China to the world is: steady onward.

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Search Summary

Text	S&P 500 index or Dow Jones index or Bond yield or oil price or stock index or stock market or DJIA or SPX or equity market or Dow Jones Industrial Average or S&P 500 or Standard & Poor's 500-stock index or U.S. treasury rates or U.S. treasury yield or stock price or earnings suprise or earnings surprises or oil prices or Nasdaq Composite or standard & poor's 500 index or 30-year Treasury bond or 10-year Treasury bond or 30-year Treasury or 10-year Treasury or Bond prices or bull market or bear market or bull market or bear market or bullish or bearish or financial markets or financial market or volatile or volatility or Nasdaq
Date	07/01/2017 to 07/31/2017
Source	The New York Times - All sources Or The Wall Street Journal
Author	All Authors
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Subject	Commodity/Financial Market News Or Economic News
Industry	All Industries
Region	United States
Language	All Languages
Results Found	155
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