THE WALL STREET JOURNAL.

Politics

Trump Plans to Rebrand Nafta, Warns Canada; President wants to call it the 'USMC' pact, telling donors he will drop the 'C' if Canada doesn't agree to changes

By Michael C. Bender
712 words
13 September 2018
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The Wall Street Journal Online
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English

WASHINGTON—President Trump revealed plans to rebrand the North American Free Trade Agreement as the "USMC" pact—for the U.S., Mexico and Canada—telling Republican donors at a private fundraiser Wednesday that he will drop the "C" if Canada doesn't agree to changes he is seeking, according to people familiar with the matter.

Mr. Trump groused about Canada during a private meeting with about a dozen supporters, complaining that officials from the U.S.'s northern neighbor describe themselves as good friends to America while imposing tariffs of more than 200% on some American dairy exports, these people said.

The president was described as jovial during the event—"He was in fine form," one Republican said—but his exasperation with Canada found a receptive audience in Dan Stamper, president of Detroit International Bridge Co., who was among about a dozen corporate executives, Republican officials and other donors who met privately with Mr. Trump for a half-hour.

The smaller meeting, designed to give donors more access to the president, cost $100,000 per seat. It was followed by a dinner of about 175 people that cost $35,000 a couple, according to a copy of the invitation.

The event raised $3 million for Trump Victory, a joint fundraising committee for the president's campaign and the Republican National Committee, a Republican official said.

A spokeswoman for the RNC, which organized the event, declined to comment.

Speaking with the president, Mr. Stamper repeated many of the points in a TV ad his company aired this summer during the "Fox & Friends" morning program on Fox News, which is among Mr. Trump's favorites. The spot implored the president to revoke permits issued by the Obama administration for construction of a publicly owned bridge between Detroit and Windsor, Ontario.

Mr. Stamper, who didn't immediately respond to a request for comment, runs the company that owns the 87-year-old Ambassador Bridge that spans the Detroit River and charges tolls.

Officials from the Michigan Department of Transportation have disputed several assertions in the private company's commercial and described it as misleading, according to the Detroit News.

The small group also included Dr. Rim Al-Bezem, a cardiologist whom the president credits with helping alert him to a potential massacre in Idlib, the northwestern province in Syria that has become the last refuge for millions of people and some 70,000 opposition fighters considered to be terrorists by the Assad regime, said people familiar with the matter.

The president referred to Dr. Al-Bezem without naming her in an interview with the Daily Caller this month, saying he met a woman in Indiana who warned him about the potential atrocity, and that he was thinking about her warning when he posted a message on Twitter saying it would be a "grave humanitarian mistake" for Syria, Russia and Iran if the attacks were carried out, said the people familiar with the matter.

Dr. Al-Bezem, whose identity hasn't been previously reported, told Mr. Trump on Wednesday that his tweet saved tens of thousands of lives, an analysis the president agreed with, one person said. Dr. Al-Bezem, who didn't immediately respond to a request for comment, also urged the president to send another tweet warning Syrian President Bashar al-Assad against using any conventional weapons in Idlib.

At the dinner, Mr. Trump listed dozens of economic statistics, including recent gains in the **stock market** and drops in the unemployment rate, said people familiar with the matter. Mr. Trump was joined at the dinner by Rep. Kevin Cramer, the Republican Senate nominee in North Dakota, and Sen. Mike Rounds (R., S.D.).

The president ticked through a list of employment rates for women, African-Americans and Asians, say they "should be voting for me." Mr. Trump added that he would be amazed, given these statistics, if any Republican who supports him would lose, one person said.

"How can we lose?" he said.

Julie Bykowicz contributed to this article.

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WSJ PRO CENTRAL BANKING

Economy

Consumer Prices Moderate After Run-Up Earlier in 2018; The consumer-price index rose a seasonally adjusted 0.2% in August from the prior month

By Eric Morath
809 words
13 September 2018
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WSJ Pro Central Banking
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English

WASHINGTON—Consumer-price pressures began to moderate in August after a buildup in inflation through much of the year, a positive signal for workers who have seen bigger paychecks largely eaten by price increases.

The consumer-price index, which gauges what Americans pay for everything from rent to razorblades, rose a seasonally adjusted 0.2% in August from the prior month, the Labor Department said Thursday. Excluding the **volatile** food and energy categories, prices increased 0.1%. Both increases were smaller than economists had expected.

From a year earlier, prices rose 2.7%, a slowdown from the near-3% annual gain the prior two months. August was first month this year that year-to-year price growth eased. Core inflation rose 2.2% from a year earlier, also slightly slower than July's annual gain.

"Peak inflation for this year is behind us," said Laura Rosner, senior economist at MacroPolicy Perspectives.

Inflation has muted the effect of higher pay. Labor Department data released last week showed workers' average hourly earnings rose 2.9% in August from a year earlier, the best rate since 2009. When adjusting for inflation, hourly earnings rose just 0.2% from a year earlier. While modest, that's an improvement from the prior three months when there was no real wage growth.

Modest inflation-adjusted wage growth indicates that some workers aren't fully feeling the benefits of historically low unemployment and strong economic growth. However, White House economists earlier this month said such measures don't fully account for increases in benefits, such as paid vacation time, and for demographic shifts, such as lower-paid younger workers replacing better-paid baby boomers.

A decline in the cost of apparel and medical care helped keep overall price growth modest in August. Another factor helping keep prices in check is a stronger dollar, which makes imported goods relatively more affordable. That's helping to offset price pressures tied to tariffs.

Most U.S. spending, 63%, is on services, while the rest is on goods.

The price of goods, excluding food and energy, fell 0.2% from a year earlier. That includes the cost of imported goods, such as clothing and electronics, but the report doesn't break out imports versus domestic products. One major exception is washer and dryer prices, up 13.6% from a year earlier. The Trump administration imposed tariffs on washing machines in January.

"With tariffs, there are lots of offsetting influences so there's really mixed effects," Ms. Rosner said. More than three-quarter of economists surveyed by The Wall Street Journal said tariffs so far don't seem to be having much of an effect on the broader U.S. economy.

Food inflation, up just 1.4% from a year earlier, is also growing slowly in part because trade barriers are increasing supplies available in the U.S.

Thursday's report showed that services, which are less likely to be imported, are the more persistent source of inflation.

Shelter and rent costs, which account for about a third of overall consumer spending, rose 0.3% in August from July and were up 3.4% from a year earlier.

Services prices outside of shelter rose 2.1% from a year earlier. That in part reflects solid consumer demand for services ranging from airfare to housecleaning.

Energy costs have also been rising. From a year earlier, energy prices were up 10.2%, led by a 20.3% increase in gasoline prices. Separate data from the U.S. Energy Information Administration showed a gallon of regular gasoline cost $2.84 in August, up nearly 50 cents from a year earlier.

Moderating overall inflation likely gives leeway to Federal Reserve policy makers to continue their path of gradual interest-rate increases. The Fed raised interest rates twice this year and penciled in two more increases by December. Central bankers meet later this month and are widely expected to increase the benchmark rate.

"At this point in the cycle the Fed's concerns appear to be shifting from undesirably low inflation to undesirably high inflation," said JPMorgan Chase economist Michael Feroli. Thursday's "cooler number could even be welcome, but will also do little to change their baseline outlook of continued gradual tightening," he said.

Late last week, Boston Fed President Eric Rosengren told The Wall Street Journal that economic growth would continue to tighten labor markets and put more upward pressure on inflation, but only modestly.

"We're not seeing a huge, surprising increase in inflation," he said. "So there is no reason to be moving with too much alacrity."

Nick Timiraos contributed to this article.

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The New York Times

Breakingviews
Business Day; DealBook
The Lives of the Wealthy Were Enriched Most After Lehman's Bust

By Edward Chancellor
1,115 words
13 September 2018
10:47 AM
NYTimes.com Feed
NYTFEED
English

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The impact of the easy money that followed Lehman Brothers' demise shows that inequality takes off when interest rates are maintained at artificially low levels.

In the decade after 2008, America's central bank has maintained its federal funds rate at a level below the rate of inflation. The Federal Reserve also used quantitative easing and other new monetary tools to bring down long-term interest rates. This unconventional monetary policy was intended to boost household wealth and spending. It ended up inflating a handful of asset price bubbles. Since wealth is unevenly distributed, the bulk of the gains in the United States and abroad have been enjoyed by the rich.

This is what happened in the U.K., where the Bank of England followed the Fed's playbook. A 2012 study by the bank found that quantitative easing had boosted household wealth by more than 600 billion pounds (around $775 billion), but that nearly two-thirds of these gains had gone to the richest 10 percent of households. Another study by S.&P. Capital IQ found that in the aftermath of the crisis the wealthiest decile of UK households had increased their share of financial assets at the expense of the poorest. As the former U.K. financial regulator Adair Turner wrote: "quantitative easing has been good for the rich, and ultra-easy monetary policy thus exacerbates inequality." Few would disagree with this conclusion.

American income inequality has been especially aggravated by the Fed's interest-rate policy. Most executive pay is linked to share-price performance. When easy money gooses the **stock market**, as it did in the years after the Lehman bust, corporate chieftains and their extended retinue receive an unearned windfall. Management has also used cheap debt to repurchase shares rather than invest in new plant and equipment, as the Fed intended. Since 2013, companies in the **S**.**&P**. **500 Index** bought back approximately $2.4 trillion of stock, helping boost share prices, according to Standard & Poor's. The executive pay bonanza got even bigger.

Easy money has particularly aided Wall Street as it recovered from the Lehman shock. The financial sector, including insurance and real estate, soon regained its position as a U.S. economic powerhouse, accounting for nearly a third of G.D.P. growth between 2010 to 2015, up from 14 percent between 1998 and 2008, according to the Bureau of Economic Analysis. Bankers' bonuses returned with a vengeance — with the average payout rising to the highest level since 2006, New York state's comptroller estimates. These bonuses derive largely from fees levied on securities issuance, corporate-finance activity and on assets under management.

U.S. corporate-debt levels doubled since 2008, says Goldman Sachs. M.&A. activity soared to a record $2.5 trillion in the first half of 2018, according to Thomson Reuters. AT&T's recent $85 billion takeover of Time Warner could generate up to $390 million in bank fees, Freeman & Co. has said. Investment-management fees also picked up as the **stock market** rebounded after 2009. Activists have pushed venerable companies from Procter & Gamble to Campbell Soup to engage in financial engineering to increase shareholder returns, and thereby justify their management fees.

Life has been particularly sweet for the private-equity world. The current leveraged-buyout boom has been spurred by some of the cheapest financing in history. Private-equity firms even used low-cost debt to snap up repossessed properties after the housing bust. Blackstone's residential business, Invitation Homes, has become one of the country's largest landlords. The buyout barons have never had it so good. Over the past five years, Blackstone founder Stephen Schwarzman is estimated by The Wall Street Journal to have earned more than $3.2 billion in dividends and fund payouts.

But consider how easy money has treated the not-so-privileged. The financial crisis hit them hard. As many as 10 million homes were repossessed, according to the St. Louis Fed. Since the middle classes have most of their wealth tied up in their houses, they experienced the greatest proportionate losses in the downturn. New York University economist Edward Wolff estimated that median wealth fell by 47 percent between 2007 and 2010. The surge in unemployment after the financial crisis and a weak jobs market in the subsequent years further contributed to income inequality.

Central bankers claim that ultralow interest rates have helped fix the jobs market. This year, the official unemployment rate has fallen below 4 percent, to its lowest level since 1969. That's good news, but the share of the work force employed or actively seeking work declined after 2008 and remains depressed at below 63 percent, the Bureau of Labor Statistics reports. Unconventional monetary policies contributed to the productivity slowdown which has hurt incomes. Until their recent pickup, U.S. wages stagnated in the years after 2008.

Nor did the poor benefit directly from the Fed's zero interest rates. In fact, interest charges for "subprime" households actually rose as banks tightened lending standards. Because the less well-off maintain a higher proportion of their liquid assets in cash, they have also suffered most from deposit rates being held below the level of inflation.

Most workers own financial assets indirectly through their pensions or retirement plans. The decline in long-term rates has pushed up the value of pension liabilities, more than offsetting gains from investments. A pensions crisis, affecting both private and public pension plans, looms on both sides of the Atlantic. Ultralow rates have sounded the death knell for the defined-benefit pensions which enabled the postwar generations to enjoy a secure retirement.

Commentators, from the Greek philosopher Aristotle to the French economist Thomas Piketty, have argued that high interest rates aggravate inequality. Yet the ultralow rates of recent years have made it harder for the "have-nots" to accumulate the resources to buy a home or build a nest egg. The "haves" have enjoyed soaring wealth gains. The chief beneficiaries of easy money have been those on Wall Street with access to cheap loans.

Michael Hartnett, the chief investment strategist at Bank of America Merrill Lynch, puts it this way: "Never in the field of monetary policy was so much gained by so few at the expense of so many." And he's right.

Bankers attend an emergency meeting at the London office of Lehman Brothers on Sept. 11, 2008. The company filed for bankruptcy days later. | Kevin Coombs/Reuters

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THE WALL STREET JOURNAL.

Economy
Jobless Claims Remain at Half-Century Low; Initial claims, a proxy for layoffs across the U.S., fell to 204,000 in the week ended Sept. 8

By Sharon Nunn and Eric Morath
271 words
13 September 2018
08:34 AM
The Wall Street Journal Online
WSJO
English

WASHINGTON—The number of Americans filing applications for new unemployment benefits fell last week, remaining at a half-century low for the second-straight week.

Initial jobless claims, a proxy for layoffs across the U.S., fell by 1,000 to a seasonally adjusted 204,000 in the week ended Sept. 8, the Labor Department said Thursday. This is the lowest level since December 1969. Unemployment benefit applications were near this level last week too.

Economists surveyed by The Wall Street Journal expected 210,000 new claims last week.

Data can be **volatile** from week to week. The four-week moving average of claims, a steadier measure, fell 2,000 to 208,000, also the lowest level since 1969.

Jobless claims have remained low in recent years, as the labor market continues to tighten and managers face difficulty finding qualified employees.

The August unemployment rate remained at 3.9% for the second straight month, just above the best rate in two decades. Hiring regained momentum in August, as employers added 201,000 workers to payrolls.

Thursday's report showed the number of claims workers made for longer than a week declined by 15,000 to 1,696,000 in the week ended Sept. 1. The figure, also known as continuing claims, is reported with a one-week lag.

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THE WALL STREET JOURNAL.

World

U.S. Proposing New Round of Trade Talks With China; Some Trump officials said they sense a new vulnerability—and possibly more flexibility—among Chinese officials

By Lingling Wei in Beijing and Jacob M. Schlesinger in Washington
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13 September 2018
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The Wall Street Journal Online
WSJO
English

The Trump administration is giving Beijing another chance to try to stave off new tariffs on $200 billion in Chinese exports, asking top officials for a fresh round of trade talks later this month, people briefed on the matter said.

The invitation from Treasury Secretary Steven Mnuchin comes as some Trump officials said they sense a new vulnerability—and possibly more flexibility—among Chinese officials pressured by U.S. tariffs imposed earlier this year and threats for more.

It also follows a steady rise in political pressure on President Trump to ease up on trade fights—which have pinched consumers and prompted painful retaliation against U.S. exports—ahead of November elections in which his Republican Party risks losing congressional control.

Given the difficult nature of the trade talks between the two countries over the past year, there is no guarantee the invitation will yield a meeting. On Thursday, China's Commerce Ministry confirmed it received the invitation.

Chinese officials said they have grown wary of the Trump administration's unpredictable decision-making process and may be hesitant to accept without a clear sign U.S. negotiators have authority to speak for the president.

The U.S. administration sent the invitation this week to a group of Chinese officials headed by Vice Premier Liu He. That follows an inconclusive session held in Washington last month among midlevel trade officials. The proposed higher-level talks might take place in Washington or Beijing, the people said.

"Most of us believe it's better to talk than not to talk, and I think the Chinese government is willing to talk," Lawrence Kudlow, head of the White House National Economic Council, said Wednesday. "You could say that communication has picked up a notch."

Mr. Kudlow said he couldn't provide further details, saying Mr. Mnuchin "is the leader on this."

A spokesman for Mr. Mnuchin declined to comment.

China has shown reluctance to address the issues raised by Washington, notably those concerning deeper structural changes to China's economy such as removals of subsidies to state-owned firms to give U.S. companies a fair playing field in Chinese markets.

People who have followed the Trump administration's China trade strategy closely cautioned against casting the invitation as a major breakthrough, saying the administration remained divided internally on its China strategy. They said talks would be unlikely to derail a planned round of tariffs on $200 billion in Chinese goods. That followed U.S. tariffs imposed on $50 billion earlier this year.

The new outreach to Beijing comes less than a week after Mr. Trump threatened not only to go forward with the planned tariffs but to add another $267 billion, effectively putting duties on all of China's shipments into the U.S.

Beijing has pledged to retaliate by subjecting as much as 85% of U.S. imports—totaling $110 billion—to tariffs. But China's leaders have begun to back off threats against U.S. businesses in China in a bid to get U.S. companies to lobby against the tariffs and keep foreign capital in China.

Mr. Trump has repeatedly mentioned in recent days the sharp drop in the Chinese **stock market** and new signs of fragility in the Chinese economy, contrasting them with more robust U.S. economic indicators.

The U.S. outreach to Beijing has once again divided Mr. Trump's top aides, people familiar with the discussions said.

The hawkish camp, led by U.S. Trade Representative Robert Lighthizer and trade adviser Peter Navarro, argues that additional tariffs should be imposed to increase American leverage. Asking for talks—the second time the U.S. has done so recently—puts the U.S. in a weaker bargaining position, they believe.

Mr. Mnuchin and his ally, Mr. Kudlow, make the opposite case. They are trying to ease trade frictions. They say Beijing may offer concessions now, especially as the trade team rushes to strike new pacts with partners from the European Union to Canada and Mexico.

"Because the U.S. economy is so strong, because some of these other trade deals are in the bank or on the precipice, they feel they are going to be negotiating with China from a stronger position than if we'd done this three months ago," said Steve Moore, a fellow at the Heritage Foundation, a conservative Washington think tank.

"It's like dominoes," said Mr. Moore, who worked on the Trump campaign and talks regularly with administration economic advisers. "It puts more pressure on the ones that don't have a deal."

At the same time, Mr. Trump—and Republican lawmakers seen as vulnerable in this fall's elections—are facing growing pressure from business and agriculture groups opposed to the tariffs and urging a new truce with China.

On Wednesday, organizations representing thousands of companies in industries including retailing, toy manufacturing, farming and technology said they are cooperating on a lobbying campaign called Tariffs Hurt the Heartland to oppose Mr. Trump's duties.

Retailers in particular have ramped up warnings that further tariffs, especially those aimed at consumer goods, are threatening to disrupt supplies for the year-end holiday shopping season.

"The tariffs are coming so fast and furiously, they're giving retailers large and small whiplash," said Christin Fernandez, vice president for communications for the Retail Industry Leaders Association.

Despite the efforts by Mr. Mnuchin, the administration remains divided over its China strategy, raising questions over what a new round of talks could accomplish—or whether Chinese officials would consider the session worth their effort.

"We're still in the same position of a lack of agreed-upon strategy within the U.S. government," said Naomi Wilson, director for China and greater Asia at the Information Technology Industry Council. "USTR, Treasury and Commerce have different objectives and different tactics," she added. "I'm not optimistic about the negotiations succeeding, but talking is better than not talking."

The offers China made during previous rounds of talks were largely limited to increased purchases of U.S. products and a gradual opening of financial-services sectors.

But the discussions did little more than reveal chasms between the two sides. The Chinese negotiators focused on their efforts to live up to World Trade Organization obligations and offered "conceptual" ideas for a deal, said people briefed on the talks. U.S. officials sought more concrete offers.

Structural changes are the toughest for China to meet. Beijing has denied that it pressures U.S. companies to hand over technology to Chinese firms, as Washington alleges. Chinese officials cite political and national-security reasons for resisting other U.S. demands, such as allowing U.S. cloud-computing companies to operate more freely.

At least one-fifth of the more than 100 U.S. demands, laid out in a U.S. proposal to the Chinese side in May, aren't open to negotiation, Chinese officials have indicated.

Myron Brilliant, the top international official at the U.S. Chamber of Commerce, said his group was "encouraged that the administration wants to re-engage with the Chinese government." But, he added, "there's still a long road ahead. There's still a gap between what China is willing to give and what the administration wants from these talks."

Bob Davis, Lin Zhu and Vivian Salama contributed to this article.

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WSJ PRO CENTRAL BANKING

Economy

Bank of England Holds Key Rate as It Warns on Trade Tension Threat; Protectionist measures by China and U.S. could have more of a negative impact on global growth than expected, says bank

By Paul Hannon
574 words
13 September 2018
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English

The Bank of England Thursday left its key interest rate unchanged, and warned of a growing threat to global economic growth from trade tensions between the U.S. and China.

The BOE last month raised its key interest rate to its highest level in almost a decade, and this month all nine of its policy makers voted to leave it at 0.75%.

The central bank repeated its view that further rate increases will be needed to bring inflation down to its 2% target from 2.5% in July and keep it there, but also repeated its message that those moves will be "limited and gradual."

There are signs the U.K. economy has gained some fresh momentum over recent months, potentially feeding inflationary pressures. The Office for National Statistics Monday said economic growth picked up in the three months through July, while wages during that period were 2.9% higher than a year earlier, an acceleration from the 2.7% increase recorded in the three months through June.

The BOE said those figures were in line with its August forecasts for U.K. growth and inflation. But it sounded a note of caution on the global economic outlook.

"Recent announcements of further protectionist measures by the United States and China, if implemented, could have a somewhat more negative impact on global growth than was anticipated," it said in a statement.

It also cited signs of slower growth in emerging markets economies, and noted U.K. trade and financial ties with Argentina and Turkey are "limited."

A key uncertainty dogging the U.K. economy is Britain's looming withdrawal from the European Union. The U.K. is scheduled to exit from the EU in March 2019, but key aspects of the country's withdrawal and its future relationship with the bloc haven't yet been agreed.

Negotiators once hoped to secure a deal by October, but officials have now set their sights on November.

Ratings agency Moody's Investors Service Thursday warned that a departure from the EU without a new trade deal would damage the U.K.'s economy.

"We still think the U.K. and the EU will eventually reach an agreement to preserve many—but not all—of their current trading arrangements, particularly around trade in goods," said Colin Ellis, Moody's chief credit officer for Europe, the Middle East and Africa. "However, we believe the prospect of the U.K. leaving the EU without any agreement has risen materially."

For its part, the BOE said there are signs in **financial markets** of "greater uncertainty" about the withdrawal process, while its regional agents reported that some businesses have cut back on their investment plans in response to the possibility of "increased trade frictions" with the EU.

The BOE's policy makers said their policy settings are based on the assumption that there will be a "smooth adjustment" to the new relationship between the U.K. and the EU.

"The BOE is likely to remain in a holding pattern until Brexit uncertainty passes," said Jonas Goltermann, an economist at ING Bank. "That means a rate hike is unlikely until May 2019, at the earliest."

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THE WALL STREET JOURNAL.
U.S. EDITION

Deepening Slump Tests Fans of Bitcoin

By Paul Vigna
746 words
13 September 2018
The Wall Street Journal
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B13
English

The cryptocurrency rout that began early this year with the popping of the bitcoin bubble has only gotten worse, and there is little sign things will get better soon.

The total value of all cryptocurrencies fell below $200 billion last weekend, down 76% from an all-time high of $832 billion in January. It is a dramatic decline for a sector that experienced furious growth in 2017, driven by a surge in speculative interest around bitcoin.

The cryptocurrency market is notoriously **volatile** and has weathered several boom-and-bust cycles in the nearly 10 years since the pseudonymous Satoshi Nakamoto unveiled bitcoin.

Bitcoin is a digital currency that isn't sponsored by any government or single entity; it runs on a platform known as blockchain, which is a decentralized, immutable ledger of transactions.

Last year's boom was marked by both mainstream interest in bitcoin and an explosion in the number of alternative cryptocurrencies and digital tokens. These dramatically increased opportunities for speculators and heightened **volatility** in the nascent market.

The problem is that such speculation wasn't matched by concrete activity. More people may have heard of bitcoin than a year ago, but even the ones who hold it still don't have much to do with it besides trade.

The selloff in recent months largely reflects doubts about the practical utility of cryptocurrencies. It is still difficult to use bitcoin and other, more established digital currencies to pay for goods and services, causing some investors to question their potential to transform commerce.

"This happens in all major technology development cycles," said Arianna Simpson, a managing director at venture firm Autonomous Partners. "You see a decoupling between the financial capital and where the technology actually is."

Bitcoin has fallen about 68% since its peak on Dec. 17. Yet it is smaller rivals, known as "altcoins," that have suffered the sharpest declines in recent months.

Ether, the second-most-valuable cryptocurrency behind bitcoin, is down 53% since June 30, while XRP, also called ripple, has fallen 43%. Bitcoin Cash declined 37% and EOS has slid 38%.

Bitcoin, by comparison, has fallen just 1.7% over the same period. It hasn't been a tranquil period, though. Bitcoin is down around 20% from a recent peak in late July.

Many "crypto tourists" who bought bitcoin and other tokens in 2017 when prices were soaring lost faith in the transformative potential of digital currency, said Dan McArdle, co-founder of cryptocurrency research firm Messari.

"We're just in one of those periods where the hype has died down," he said.

Take ether, the in-house currency for the Ethereum network: The project took bitcoin's core concepts and adapted them to a platform built to support apps, similar to Alphabet Inc.'s Android operating system.

The value of ether soared from $8 in January 2017 to $1,400 by January 2018 as investors sought to profit on Ethereum's potential. Yet there is still little commercial activity two years after its launch.

There are about 900 live "dapps" -- or, decentralized apps -- on the Ethereum network with several hundred more in development, according to data from the website State of the Dapps. But there are only 9,000 daily active users.

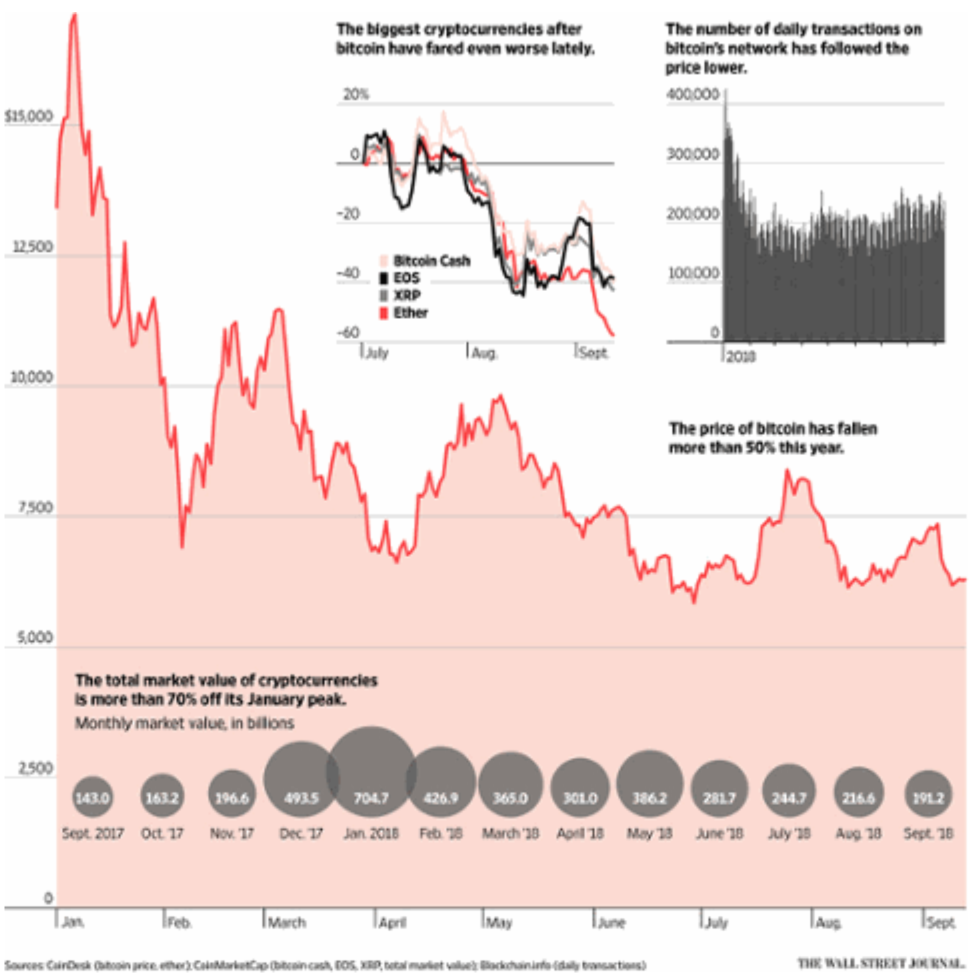
That isn't a lot of activity and helps explain the huge fall in value ether has experienced. At its height, ether was worth $133 billion. Today it is worth around $19 billion.

Regulatory issues also have weighed on the sector of late. The Securities and Exchange Commission continues to reject the idea of a bitcoin-based exchange-traded fund, and the Justice Department is investigating potential market manipulation. Wall Street's industry-funded regulator also recently brought a case involving digital currency.

Crypto veterans remain sanguine about the market's long-term potential, pointing to its short but turbulent history.

After trading as high as $1,1,47 in December 2013, bitcoin fell as much as 85% over the next year. It didn't surpass that previous high-water mark until the spring of 2017. In 2011, the price fell more than 90%, from about $30 to $2.

A return of 100 times in a year is delightful, said Ms. Simpson. "I enjoy that as much as anyone," she added. "But it's not realistic. The people who were coming in to get '100x' are in for a rude awakening."



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THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance: Popular Tech Stocks Poised for S&P Shift

By Ben Eisen
424 words
13 September 2018
The Wall Street Journal
J
B11
English

The **S&P 500** is getting a refresh later this month that may prove market moving.

Index providers S&P Dow Jones Indices and MSCI are officially creating a new communication-services sector to replace telecom, the smallest of the index's 11 segments. S&P will complete its reclassification Sept. 21, and many others who use the classifications will do so by Sept. 28. Some companies that are in the tech and consumer-discretionary sectors will move into the communication group.

As part of this shift, providers of exchange-traded funds need to rebalance the stocks in their sector ETFs while selling stocks moving to new sectors. Facebook Inc., for example, now comprises 5.8% of State Street's $23 billion Technology Select Sector SPDR ETF but must be sold as the social-media giant moves into the communication-services sector.

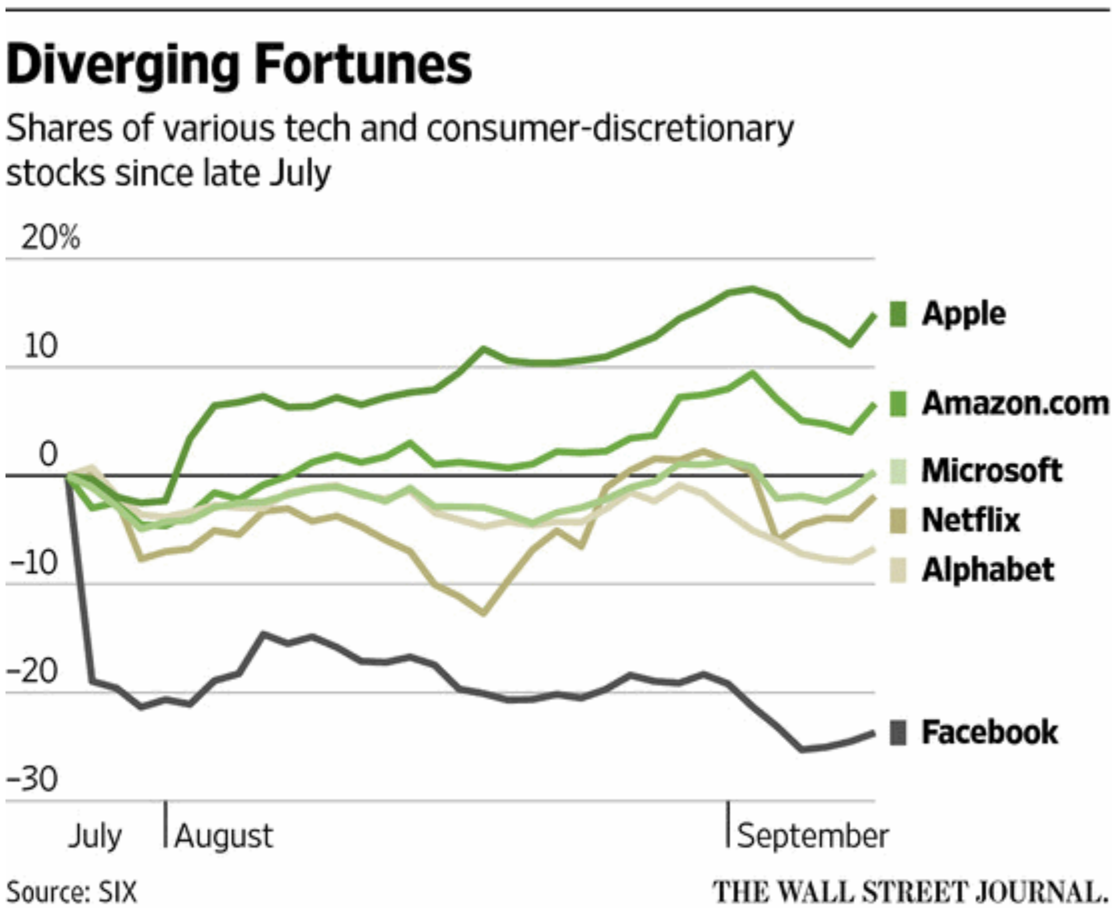
The Communication Services Select Sector SPDR ETF that State Street launched in June to track the new sector has nearly 18% of its assets in Facebook. But it has a comparably small $500 million in assets right now. State Street said it believes the ETF will gather more assets as the reclassification gets closer because investors will want to avoid throwing their portfolios out of whack. But right now, the communication ETF holds fewer Facebook shares than the tech ETF will need to sell.

State Street's funds will be rebalanced effective after the close Sept. 21. Vanguard began reweighting its funds in the second quarter. As ETF providers and other investors rearrange their holdings, it could move stock prices, some analysts say, though it isn't clear how.

"Around the time this occurs, there could be some dislocations depending on how investors are rebalancing their own portfolios," said Brian Hayes, a quantitative analyst at Morgan Stanley.

For one indicator of how this could affect the market, look to the recent past. Since late July, companies that are staying in the tech sector, such as Apple Inc. and Microsoft Inc., have outperformed those leaving, such as Facebook and Google parent Alphabet Inc., according to Morgan Stanley. Amazon.com Inc., which is staying in the consumer-discretionary sector, has outperformed Netflix Inc., which is leaving.

Many of those moves have been due to idiosyncratic factors, such as Facebook's earnings results that disappointed investors in late July. But as the reclassification gets closer, performance of these stocks could start to diverge further.



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THE WALL STREET JOURNAL.
U.S. EDITION

Transports Look Set to Drive Industrials

By Akane Otani
845 words
13 September 2018
The Wall Street Journal
J
B1
English

Shares of truckers, logistics operators and shipping companies are hitting fresh highs, a sign for investors that the **Dow Jones Industrial Average** could soon follow suit.

The Dow Jones Transportation Average, which includes 20 large companies ranging from railroad operator CSX Corp. to delivery firm United Parcel Service Inc., climbed Monday to its 11th record close of the year. After snapping out of a lull in August, the transport index is up 8.5% in 2018. That is nearly double the gains of the Dow industrials, which have languished this month as tense trade negotiations have kept investors cautious.

What's more, the Dow industrials haven't notched a record high in eight months. That is the longest drought for the average since it went without a new high for 289 trading days through July 2016, according to Dow Jones Market Data.

The index is the only one of the major U.S. benchmarks not to have eclipsed its January high. The **S&P 500** hit a series of new highs last month, while the **Nasdaq Composite** and Russell 2000 have climbed fairly steadily in recent months. The Dow industrials remain 2.3% below this year's Jan. 26 high.

The breakout by transportation stocks is viewed by some investors as a signal the industrials will soon regain momentum. At least, that is the belief of proponents of what is known as Dow Theory.

The roughly century-old theory says transportation stocks are a barometer of the health of the U.S. economy, tending to rise when businesses that ferry raw goods and materials are in demand and retreat when the economy looks poised for a slowdown. When the transport index hits new records, those who track the Dow Theory believe the broader **stock market** often follows suit.

"These stocks move and transport everything we buy and sell," said Chris Verrone, a partner and head of technical strategy at brokerage and advisory firm Strategas. "When you look historically, it's hard to find examples of a **bull market** ending with transportation stocks at new highs."

Railroad stocks have powered much of the transport index's gains this year as a solid U.S. economy has helped lift demand for cross-country transport. CSX has climbed 35%, Norfolk Southern Corp. has advanced 23%, and Union Pacific Corp. is up 17%.

More recently, shares of trucking and logistics firms have also rebounded, pointing to broadening strength among transportation companies.

Many such companies have benefited from a boom in demand for freight services by retailers, factories and consumers. This has squeezed truck availability and, in turn, driven the longest sustained period of pricing growth for truckers since 1980, according to online freight marketplace DAT Solutions.

J.B. Hunt Transport Services Inc. reported in July that second-quarter earnings soared 55% from the year-earlier period. Its shares are up 9% this year. Fellow trucking company Landstar System Inc. has risen 21%.

Meanwhile, a handful of airline shares have regained ground. They slumped in the year's first half on fears a price war could squeeze profit margins. Shares of United Continental Holdings Inc., whose revenue growth helped offset a jump in fuel prices over the summer, have climbed 30% this year. Delta Air Lines Inc. and American Airlines Group Inc., while down for the month of August, have added more than 4.5% apiece over the past four weeks.

"Everything we see today says demand is strong," United President Scott Kirby said on the company's July earnings call.

Analysts caution that headwinds remain. Transportation stocks slumped in June as a trade dispute between the U.S. and China heated up.

Those tensions revived fears among investors of tariffs slamming growth and stalling companies' investment plans. The transport index has held its ground this month even though President Trump has threatened a third round of tariffs on Chinese goods. Shares elsewhere, though, have come under pressure, raising the prospect of a broader decline.

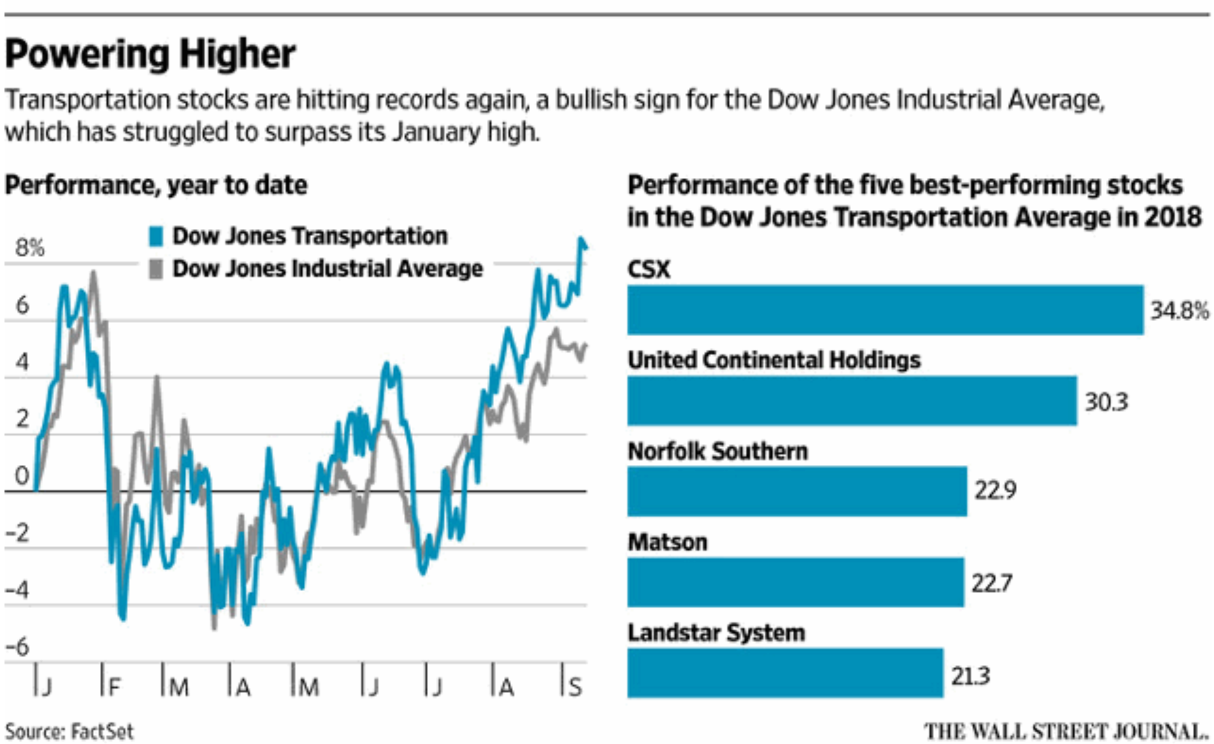
Hong Kong's Hang Seng Index and the Shanghai Composite are trading in **bear-market** territory, or 20% off recent closing highs. Trade-sensitive companies in the U.S. like Bunge Ltd., Century Aluminum Co. and U.S. Steel Corp. have all fallen more than 2% apiece in September.

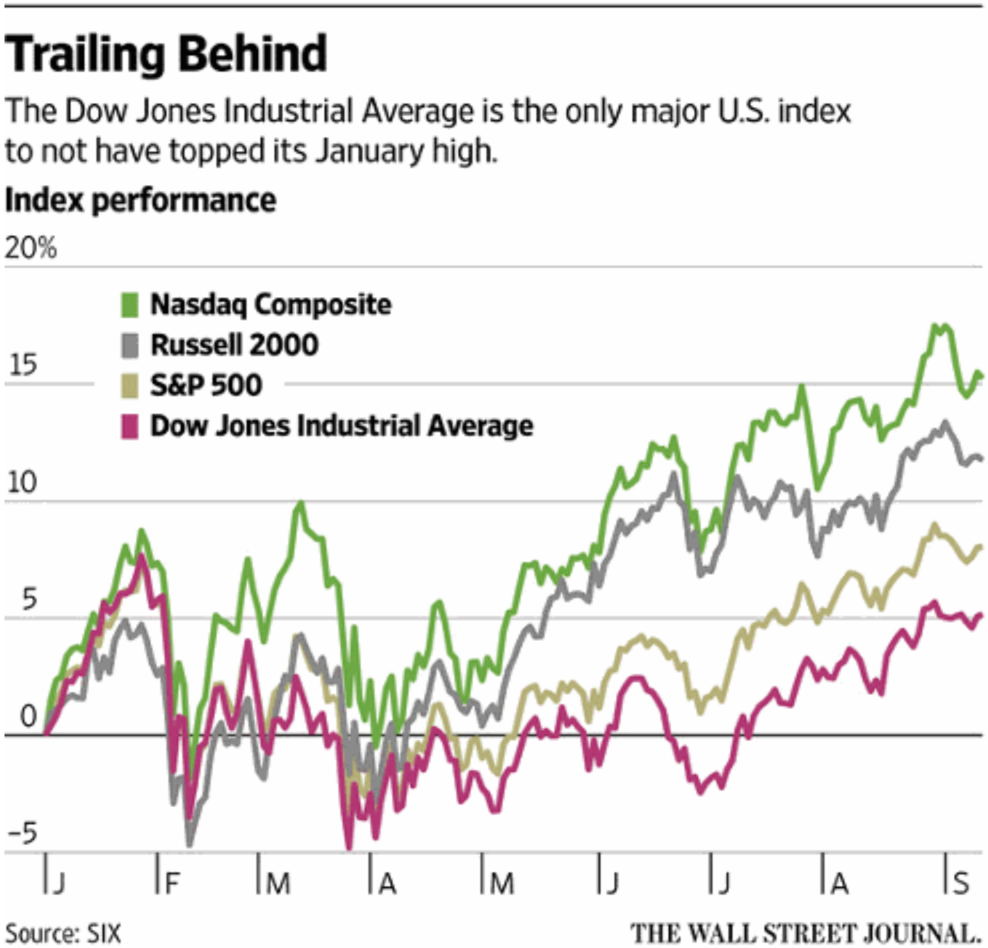
Another risk: **Oil prices**, which have backed off highs hit in the middle of the summer, could spike again. That could force airlines to again cut flights and raise fares.

So far, few investors see signs of an imminent slowdown. Data in recent weeks have shown the U.S. economy grew faster than initially estimated in the second quarter. Wages accelerated at the fastest pace of the current economic cycle and the unemployment rate continued to trend below 4%.

Corporate earnings are also projected to extend a streak of double-digit growth in the third quarter.

The transports aren't a "perfect indicator," Mr. Verrone said. But their gains still suggest that the economic backdrop remains "relatively robust here."





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THE WALL STREET JOURNAL.

Markets

Optimism Over Trade Talks Boosts Chinese Stocks; News of the proposed U.S.-China negotiations lifts Chinese stocks listed in Hong Kong and in the mainland

By Shen Hong
477 words
13 September 2018
05:38 AM
The Wall Street Journal Online
WSJO
English

Most Asian stock markets were higher Thursday, with Hong Kong's Hang Seng Index gaining 2.5%, its biggest single-day rally in more than two years, while Japan's Nikkei Stock Average rose 1%. South Korea's Kospi edged up 0.1%.

Thursday's Big Theme

Chinese stocks listed in Hong Kong and in the mainland rose on signs of a de-escalation in trade tensions between the U.S. and China.

What's Happening

Shares of Chinese state-owned enterprises gained, following news that U.S. Treasury Secretary Steven Mnuchin has invited a group of Chinese officials for a fresh round of trade talks in Washington later this month.

The proposed talks follow an inconclusive round of trade negotiations last month. They may not affect tariffs the U.S. has planned on $200 billion in Chinese goods, but the invitation is seen as a sign of the Trump administration's willingness to give Beijing a chance to try to avoid tariffs on another $267 billion in Chinese exports.

The Hang Seng China Enterprises Index, which tracks large, mostly state-run Chinese companies listed in Hong Kong, rose 2.6% for its best day in six months. Top gainers include PetroChina Co. and China Resources Land Ltd., which are up 5% and 7.2%, respectively. A 5% jump in index heavyweight Tencent Holdings Ltd., the videogaming and social-media company's best performance in more than two years, helped lift the main Hang Seng Index.

After a muted reaction in early trading, stocks in Shanghai enjoyed a late rebound as the rally in Hong Kong spread northward. The benchmark Shanghai Composite Index ended the day up 1.2% at 2686.58.

Market Reaction

"It's all because of the news of the renewed talks between Beijing and Washington. The yuan has strengthened as a result, which also helped the **stock market**," said Iris Pang, a Hong Kong-based economist at ING Bank.

However, Ms. Pang cautioned that the rally in Hong Kong might not be sustainable if the U.S. and China don't make meaningful progress in their coming trade negotiations. "Unless that happens, all these will be just a blink," Ms. Pang said.

Mainland investors were initially more skeptical about the latest sign of easing trade frictions, said Zhang Gang, Shanghai-based senior analyst at Central China Securities. He said overnight gains in international oil and commodity prices helped spur buying.

Elsewhere

The yuan strengthened 0.3% to 6.8459 to the dollar in China's onshore market, while the greenback was steady against the Chinese currency in the freely traded offshore currency markets.

Write to Shen Hong at hong.shen@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Brainard: Should Raise Rates for the Next Year or Two | Bullard: Trump Agenda Improving Outlook | Things to Watch at Thursday's Meetings | 'Fintech Charter' Has No Takers | Wessel's Take: Bernanke Probes Origins of the Great Recession; The Wall Street Journal's central banking newsletter for Thursday, September 13, 2018

2,411 words
13 September 2018
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Wessel's Take: Returning to His Academic Roots, Bernanke Probes Origins of the Great Recession

Fed Should Raise Rates for the Next Year or Two, Brainard Says

Fed's Bullard Sees Trump Agenda Improving Economic Outlook

Five Things to Watch at Thursday's Central-Bank Meetings

'Fintech Charter' Has No Early Takers as Lawsuit Looms

Returning to His Academic Roots, Bernanke Probes Origins of the Great Recession

Ten years after the global financial crisis, Ben Bernanke, the former Federal Reserve chairman and now my colleague at the Hutchins Center at Brookings, is returning to his academic roots to better understand what happened. In a 67-page paper for the Brookings Papers on Economic Activity conference, Mr. Bernanke covers a lot of ground. Along the way he poses two big questions:

(1) Even after the housing bubble burst, why did the Fed and other forecasters fail to foresee the depth and severity of the recession that lay ahead?

Due to his academic work on the Great Depression, Mr. Bernanke says he knew how big a risk a financial crisis posed to the economy. "However," he notes, "this general concern was not buttressed by much in the way of usable quantitative analyses." In October 2008, when the financial panic was at its most intense, Fed staff predicted that unemployment would peak a little above 7%; it actually hit 10% in the fall 2009.

Forecasting models, it turns out, were misleading. They don't adequately incorporate effects on the economy of disruptions in credit markets. Economists now are paying more attention to credit factors in modeling and forecasting; they should keep that up, Mr. Bernanke says.

(2) Did the housing bust and resulting damage to consumer finances fully explain why the recession was so bad?

Here Mr. Bernanke is responding to arguments made by economists Atif Mian and Amir Sufi, among others. They argue that the drop in house prices eroded household wealth and put many homeowners into financial distress. That led to sharp declines in consumer spending, which produced a deep recession. Mr. Bernanke acknowledges that was important, but argues the housing bust by itself wasn't sufficient to produce the Great Recession.

What was? A financial panic. The loss of confidence in subprime mortgages was followed by a panic that spread from mortgages to car loans to short-term corporate borrowing. Using a technique called factor analysis and daily financial data for 2006 to 2012, Mr. Bernanke documents an old-fashioned run—not on bank deposits, but on the short-term wholesale funding on which many financial institutions relied—and a retreat from securitized credit of all sorts. Absent the panic, he says, the recession likely would have been milder.

Why does this matter? If the Mian-Sufi diagnosis is correct, then policy makers should have spent even more effort stabilizing housing, modifying mortgages and helping homeowners. If the Bernanke hypothesis is correct, then the Fed and Treasury were wise to have invested so much in restarting credit markets and recapitalizing banks.

It was those still-controversial interventions that arrested the panic and prevented the Great Recession from deteriorating into a second Great Depression, Mr. Bernanke says. That is a lesson for future crisis fighters to remember.

(David Wessel is a contributing correspondent to The Wall Street Journal and director of the Hutchins Center on Fiscal and Monetary Policy at the Brookings Institution. Click here for a short video in which Mr. Bernanke talks about his paper with Mr. Wessel.)

Key Developments Around the World

Fed Should Raise Rates for the Next Year or Two, Brainard Says

A top Federal Reserve official argued strongly for raising interest rates more than many investors expect, saying recent tax cuts and federal spending increases have contributed to risks that the economy may overheat. Fed governor Lael Brainard, who last year advocated for caution in raising rates, said in a speech Wednesday in Detroit the Fed likely would want to bring rates higher than the long-run neutral level that would neither spur nor slow growth.

Transcript: Q&A With Lael Brainard in Detroit

Economy Grows Moderately, but Trade Fears Rise, Fed's Beige Book Says

Businesses voiced concern regarding mounting trade tensions, as recently imposed and proposed tariffs force companies to grapple with rising input costs, according to a Federal Reserve report released Wednesday. Reports across the Federal Reserve's 12 districts suggested the economy grew at a moderate pace at the end of summer, the Fed said in its latest roundup of anecdotal information about regional economic conditions known as the beige book. Wednesday's report showed that while businesses at large remained optimistic about the economic outlook, many expressed uncertainty over rising trade tensions. In some cases, climbing trade worries resulted in instances of postponing business investment.

Fed's Bullard Sees Trump Agenda Improving Economic Outlook

St. Louis Fed chief James Bullard said Wednesday the Trump administration's economic agenda seems to have brought fundamental improvements to the outlook. Mr. Bullard said his bank could raise its estimate of the U.S. economy's potential growth, to just over 2% annually, from slightly below 2% now. He said the wider community of economists could similarly revise their estimates. "I definitely think the political change had an influence" on how the economy has been performing since Donald Trump became president at the start of 2017, Mr. Bullard told reporters Wednesday after giving a speech in Chicago.

Bullard Reiterates Fed Should Listen More to Market

Five Things to Watch at Thursday's Central-Bank Meetings

A trio of central banks, in the U.K., eurozone and Turkey, are set to announce policy decisions within an hour of each other on Thursday, between 7 a.m. and 8 a.m. Eastern. They are likely to underscore weaknesses and vulnerabilities that have weighed on the world economy and **financial markets** this year. Europe's two most prominent central banks—the European Central Bank and Bank of England—are expected to signal caution, reinforcing a policy lag behind the Federal Reserve. Turkey's central bank, by contrast, could act vigorously to tame soaring inflation. Here are five issues to watch.

Erdogan Moves to Support Turkey's Embattled Lira With New Measures

Turkish President Recep Tayyip Erdogan moved to prop up the hard-hit lira by issuing a ban on domestic sales and rental transactions in foreign currencies, hours before a closely watched central-bank decision. In a ruling published in Thursday's Official Gazette, Mr. Erdogan also outlawed transactions in lira pegged to foreign currencies. Past transactions in foreign currencies must be converted to lira within 30 days at rates to be agreed between parties, the ruling said.

Bargain Hunters in Turkey, Argentina Struggle With Inflation

The currencies of developing nations like Turkey and Argentina have plummeted this summer, dangling the prospect of high returns before fund managers willing to purchase local shares and other assets at a discount. But even those eager to place such bets must first determine how much they expect inflation to erode the so-called real value of their investments over time, a calculus that is both central to the exercise and notoriously difficult.

FINANCIAL REGULATION ROUNDUP

'Fintech Charter' Has No Early Takers as Lawsuit Looms

A national banking regulator is offering cutting-edge financial firms a new pathway into the traditional banking system. So far, few of them are biting. The lack of immediate interest from the likes of LendingClub Corp., Square Inc., and others comes in large part from uncertainty about what activities the Office of the Comptroller of the Currency's so-called fintech charter will allow, what regulatory requirements it will carry, and whether it will hold up in court. That uncertainty grew Wednesday when the Conference of State Bank Supervisors, a group of state regulators, said it intends to file a lawsuit challenging the OCC's authority, renewing a previously unsuccessfully legal challenge.

United Technologies to Pay $13.9 Million to Settle SEC Bribery Case

United Technologies Corp. agreed to pay $13.9 million to settle U.S. allegations that it made illicit payments in its elevator and aircraft engine businesses. The company made illicit payments for business in Azerbaijan and China, and provided trips and gifts to foreign officials in multiple countries, primarily in Asia, through two subsidiaries to get business, according to the Securities and Exchange Commission. Such payments violate the Foreign Corrupt Practices Act, which bars the use of bribes to get or keep business. The law is jointly enforced by the SEC and the U.S. Justice Department. United Technologies, which is based in Farmington, Conn., agreed to the $13.9 million penalty without admitting or denying the SEC's allegations.

Democrats Attack SEC's Broker Advice Rule as Weak

Congressional Democrats have rebuked a proposal by the Securities and Exchange Commission to tighten rules governing brokers' financial advice. A group of 35 Senate and House Democrats wrote SEC Chairman Jay Clayton on Wednesday, saying the agency should drastically revise the proposal it issued in April. The Democrats' opposition signals they might target the proposal for intense scrutiny if they win control of the House or Senate in the midterm elections. That would allow Democrats to call Mr. Clayton to testify about the proposal before congressional committees. The SEC's plan would require that brokers provide financial advice in the best interest of clients, thereby eliminating some conflicts of interest. Many Democrats say the plan isn't strict enough. The five-member SEC must vote again to adopt a final version of the rule. --Dow Jones Newswires

Regulators Allow Zions Bancorp to Drop SIFI Tag

The Financial Stability Oversight Council formally allowed Zions Bancorp to break free from Federal Reserve oversight and shed the "systemically important" designation that triggers tougher regulatory requirements. "The Council determined that there is not a significant risk that Zions could pose a threat to U.S. financial stability," said Treasury Secretary Steven Mnuchin, who chairs the oversight council, in a statement. --Dow Jones Newswires

Thursday

7 a.m. EDT

Bank of England releases policy statement, minutes

7:45 a.m. EDT

European Central Bank releases policy statement

8:30 a.m. EDT

ECB's Draghi holds press conference in Frankfurt

8:30 a.m. EDT

U.S. Labor Department releases August CPI

1 p.m. EDT

Atlanta Fed's Bostic speaks on economy and monetary policy in Jackson, Miss.

7 p.m. EDT

Dallas Fed's Kaplan speaks at his bank

Friday

6 a.m. EDT

Bank of England's Carney speaks in Dublin

6:30 a.m. EDT

Bank of Russia releases policy statement

8:30 a.m. EDT

U.S. Commerce Department releases August retail sales

9 a.m. EDT

Chicago Fed's Evans speaks on economy and monetary policy in Fort Wayne, Ind.

9:15 a.m. EDT

Federal Reserve releases August U.S. industrial production

10 a.m. EDT

Boston Fed's Rosengren speaks on monetary policy framework at Brookings Institution in Washington

10 a.m. EDT

University of Michigan releases preliminary September U.S. consumer sentiment

The Hierarchy of Financial Policies

When it comes to government interaction with the financial sector, "the most powerful domain is fiscal policy, so the ministry of finance sits on top," a VoxEU article finds. This is followed by monetary policy, macroprudential policy and microprudential policy, in that order, according to authors Jon Danielsson and Robert Macrae. Although central banks enjoy independence, the article finds they are "still beholden to the ministry of finance, and perhaps increasingly so. Delegated power is only retained so long as the government is happy with it." The writers add: "Splitting financial policy into four distinct domains is sensible, but can lead to sub-optimal outcomes when the four domains overlap and compete. By contrast, housing them within the same institutions may reduce conflict and facilitate decision making but risks some areas being ignored. In either case, when things go wrong, the legitimacy of the financial authorities can be undermined. Recognizing the hierarchy and conflicts in policy and institution design might lead to better outcomes."

Why Bush's Quiet Role in Financial Crisis Deserves Attention Now

"The day after Lehman Brothers failed, Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke went to President George W. Bush with bad news. Insurer American International Group Inc. needed $85 billion or it, too, would collapse," The Wall Street Journal's Greg Ip recounts in his Capital Account column. "Though unhappy and frustrated, Mr. Bush approved the loan, saying, ‘If we suffer political damage, so be it,' Mr. Paulson later wrote." Mr. Ip writes that "scholars of the crisis rightly focus on the decisions that the three crisis managers—Mr. Paulson, Mr. Bernanke and New York Fed President Tim Geithner—made to rescue the financial system. Though unpopular at the time and still second-guessed, their actions were vital in avoiding a second Great Depression. Yet most would have been impossible without the president's support, which Mr. Bush gave unreservedly from start to finish. Mr. Bush's unsung role merits greater appreciation today. Ten years after the crisis, the financial system is stronger, but the political system is far more fragile. Polarization, populism and protectionism mean the next crisis will be met with far less political will than the last."

U.S. household incomes rose for the third straight year in 2017, according to census figures released Wednesday that suggest more Americans are benefiting from the robust economy.

A gauge of U.S. business prices in August clocked the first monthly decline in about a year and a half, driven largely by a downturn in trade services prices.

Employment growth in Australia soared in August, keeping the unemployment rate within striking distance of six-year lows and indicating slack in the labor market was diminishing.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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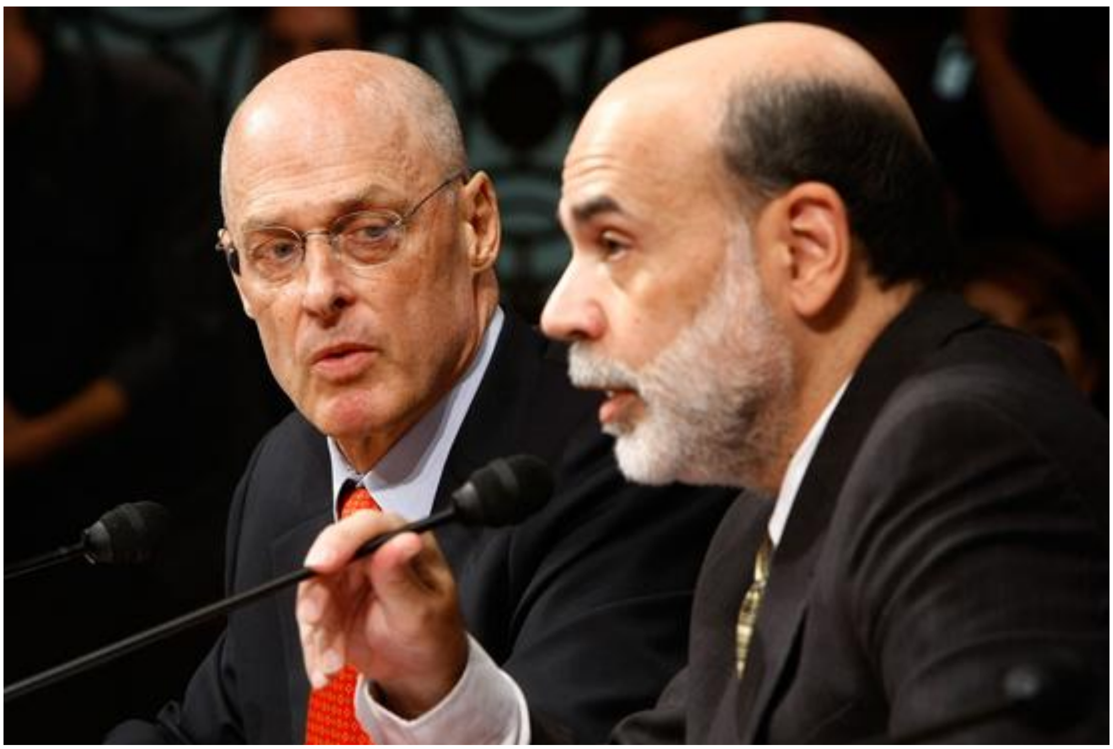

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The New York Times

Business/Financial Desk; SECTB
Markets Wobble as Trade Hopes Flicker and Tech Shares Slip

By THE ASSOCIATED PRESS
560 words
13 September 2018
The New York Times
NYTF
Late Edition - Final
4
English

Stocks in the United States wobbled between gains and losses then finished with a split decision Wednesday as technology companies dropped. That canceled out gains for energy companies.

Oil and gasoline prices continued to rise Wednesday after a big gain the day before, and United States crude reached its highest price in two months. Chipmakers fell, while Apple slipped after announcing new features for iPhones and Apple Watches.

The market staged a brief rally following a report that the United States was seeking new trade talks with China. Stocks climbed, but they retreated to their earlier levels in less than an hour.

Kristina Hooper, chief global market strategist for Invesco, said investors have learned from earlier trade updates that did not amount to much.

''Every other time this has happened, it wasn't worth the positive market move,'' she said. ''Investors ... are a lot more skeptical this time around, having been burned a few times with false optimism about positive trade developments.''

The **Standard & Poor's 500**-**stockindex** edged up 1.03 points to 2,888.92. The **Dow Jonesindustrial average** added 27.86 points, or 0.1 percent, to 25,998.92.

The losses for technology companies weighed on the **Nasdaq composite**, which slid 18.25 points, or 0.2 percent, to 7,954.23.

Oil prices built on Tuesday's gains after the Energy Information Administration said crude stockpiles in the United States fell by more than 5 million barrels last week. The prospect of tighter supplies and higher prices also helped energy company stocks.

Benchmark United States oil climbed $1.12 to $70.16 a barrel in New York.

Goldman Sachs analyst Mark Delaney downgraded Micron Technology stock to ''Neutral'' and said he expects weaker market conditions for several types of computer chips.

Micron fell 4.3 percent to $41.74 and Nvidia slipped 1.7 percent to $268.20.

Apple unveiled new iPhones with larger screens on Wednesday, and also said Apple Watches will have larger screens and new health-monitoring features.

Apple tends to trade lower on the days it announces new products, and it fell 1.2 percent to $221.07 Wednesday. It is up 31 percent in 2018, however.

As the Apple Watch updates were announced, shares of fitness tracker company Fitbit slumped 6.9 percent to $5.53.

According to The Wall Street Journal, United States officials recently proposed a new round of trade negotiations to give the Chinese government another chance to address American concerns before the Trump administration imposes bigger tariffs on goods imported from China.

The dollar weakened and interest rates dipped, which put pressure on bank stocks and also boosted commodities. The yield on the **10**-**year Treasury** note fell to 2.96 percent from 2.98 percent.

The dollar fell to 111.22 yen from 111.59 yen. The euro rose to $1.1625 from $1.1586.

Gold rose $9.30 to $1,204.70 an ounce.

This is a more complete version of the story than the one that appeared in print.

CHARTS: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Wednesday. (Source: Reuters); **10**-**Year Treasury** Notes: High yield in monthly refunding auction. (Source: Treasury Department)

Document NYTF000020180913ee9d0005c

The New York Times

Business Day; Economy
Edgy Investors Are Retreating From Risky Economies

By Matt Phillips
1,461 words
11 September 2018
11:45 PM
NYTimes.com Feed
NYTFEED
English

Cratering currencies, rising inflation, jumpy investors: A financial panic is again gripping some of the world's developing economies.

The sharp sell-off of emerging market currencies, stocks and bonds seems to stand in stark contrast to the United States, where a nearly decade-long **bull market** continues amid buoyant economic conditions.Higher interest rates in the United States and a stronger dollar rebalance the risks and rewards for investors the world over, and act as a kind of financial magnet, pulling them out of riskier investments.

When we've seen this before — in the Mexican peso crisis of 1994, the Thai baht collapse of 1997 and the Russian default of 1998 — investors had to contend with spillover of trouble from one country to others, dragging down economic growth or causing market stress.

So far in 2018, this kind of contagion has been limited. Economies as varied as Argentina, Russia, South Africa and Turkey are facing the maelstrom, but each has its own reasons for falling out of favor, and the turmoil has yet to raise anxiety about the world's biggest economies and markets. Here are the key issues that each is contending with.

Investors were already jumpy because of past crises

One of South America's largest economies, Argentina spent much of the last two decades locked out of global markets, in the aftermath of its 2001 financial meltdown.

But the 2015 election of President Mauricio Macri was a turning point. He focused on returning the country to the good graces of international investors, by removing restrictions on the flow of capital in and out of the country, and reaching settlements with creditors still owed money since the 2001 collapse.

Argentina was able to regain access to the bond market in April 2016, when it raised $16.5 billion from international investors. Once it did, Argentina repeatedly turned to global investors, tempting them with high bond yields and pledges to gradually bring the country's spending problems under control.

Then, almost as suddenly as it started, Argentina's honeymoon with global investors ended this year — for several reasons: A drought hit soy and corn production, which is crucial to the economy. The government showed little progress in reining in deficits. The central bank lowered interest rates even as inflation was rising fast, which was taken as a sign that it wasn't serious about keeping the peso on solid footing. Given Argentina's history — which includes crises in 1980, 1982, 1984, 1987, 1989 and 2001 — investors were not willing to wait to find out.

The peso began to slide in April and is now down more 50 percent against the dollar this year. It has continued to drop even after the central bank raised interest rates to a whopping 60 percent and the International Monetary Fundapproved a $50 billion line of credit in June.

A strongman took things too far, and big business followed his lead

The Turkish economy enjoyed a ripping run over the much of the last decade. Growth has averaged roughly 6.8 percent since 2010, beating the world economy's 3.9 percent and other emerging markets, according to I.M.F. data.

But much of that economic pep depended on a debt-fueled bubble. Turkish companies have binged on bonds, much of them denominated in the dollar and the euro.

President Recep Tayyip Erdogan's government has been spending, too, subsidizing big-ticket infrastructure projects.

All that money owed in other currencies makes the collapse of the Turkish lira particularly problematic. The currency has been sinking steadily for years, resulting in a persistently high rate of inflation, but the sell-off turned into a rout after Mr. Erdogan was re-elected in June and given broad new powers that strengthened his control over the nation.

Mr. Erdogan has repeatedly railed against high interest rates as the economy shows signs of slowing. And his growing control over economic policy — he installed his son-in-law as finance minister — has investors nervous about his strongman approach. President Trump's August decision to double the tariffs on Turkish steel and aluminum imports seemed a catalyst for investors to beat a rapid retreat out of the country.

Now, with the lira down about 40 percent against the dollar since Mr. Erdogan's re-election, companies that are earning lira but have to repay debts in dollars are struggling. Bankruptcies of Turkish corporations are expected to rise, and many economists now think Turkey will soon to fall into a recession.

A recession and a falling currency create a lose-lose situation

With one in four people living in extreme poverty, and an unemployment rate of more than 27 percent, South Africa's economy has long been one of the world's most precarious.

But in recent years, it has benefited from an influx of money from foreign investors. Much of that went to the government, which has tried to offset the nation's stark inequality — it is one of the world's most unequal countries — with large-scale social spending.

As a result, the country's external debts grew to roughly 50 percent of gross domestic product last year, from 37 percent in 2013. Much of that borrowing has been done via markets, making those investments much easier to dump when the going gets rough.

That's what investors have done. South Africa's currency, the rand, is down by roughly 18 percent this year, and second-quarter data this month showed that South Africa was already in a recession. That further complicates matters, as the cure for the weak rand — higher interest rates from the central bank — could make the downturn even worse.

Global politics are isolating the Russian economy

Russia's problems with global markets are fairly idiosyncratic.

Since January 2017, the Trump administration has mostly continued the Obama administration's policy of imposing sanctions on individuals with ties to the country, citing issues such as aggression in Ukraine, interference in American elections, support for Syria's Assad regime, the poisoning of a former spy and his daughter with a chemical weapon in England, and trade with North Korea.

As global investors factored in the country's increased isolation from the world economy, the ruble fell 18 percent this year. (Simply put, less integration and trade with Russia mean less demand for rubles, which you need to buy Russian goods.)

A weak currency makes imports more expensive. Russian inflation, while low, has picked up, and interest rates are rising, both of which could be a drag on growth.

The Russian government plans to increase government spending in an effort to keep the economy grinding ahead. In theory, Russia's relatively low debt level — government debt is less than 20 percent of G.D.P. — allows it plenty of breathing room to spend more on roads, health care and social welfare, as long as it can dig up the money somewhere.

But therein lies the rub. With international investors wary of investing in Russia, it has had to rely in part on reshuffling domestic spending. Finding that money could mean making some unpopular decisions, such as raising the retirement age. Proposals to do just that are being blamed for a marked decline in the popularity of President Vladimir V. Putin, rare public protests and weaker-than-expected showings for the ruling United Russia party in recent regional elections.

Good numbers don't mean anything without credibility

Where does all this stop? No one is sure.

It could be that the countries being battered may simply suffer from unique vulnerabilities to market pressure.

It's also possible that other countries will become the next focus for jittery investors eager to avoid losses. But predicting precisely where things will spread isn't simple.

Sure, there are some clues for what to look for. Investors are already looking askance at countries that owe a lot of money in foreign currency, for example. Screening for that kind of vulnerability would have identified Turkey as a potential problem spot.

The amount of such hard-currency debt to be paid off, however, is only part of the story. The level of interest rates, the reliance on foreign borrowers, refinancing needs, the size of government deficits and the stockpiles of foreign currency that can be used to push back market pressures all play a role.

Perhaps most important, and most difficult to measure, is a country's credibility with **financial markets**. If investors believe a country will continue to pay its bondholders in a currency that retains its value, they will likely put up with even the ugliest-looking levels of debt. If that trust starts to fray, look out below.

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The New York Times

Crisis and Consequences
The Upshot
The Policymakers Saved the Financial System. And America Never Forgave Them.

By Neil Irwin
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It's hard to overstate how deeply Americans despised their government's response to the global financial crisis. It has helped shape the last decade of American politics, fueling distrust of powerful institutions and speeding a drift toward ideological extremes.

But for all that anger, the engineers of the American crisis response got the economics mostly correct, and more right than most of those — including leading economic thinkers and prominent politicians — who were second-guessing them.

I was a beat reporter covering the events at the time and the key players — including the former Treasury secretaries Hank Paulson and Tim Geithner, and the former Federal Reserve chairman Ben Bernanke — and then wrote a book on the crisis. Looking back on it a decade later, I'm struck by the way that I, and they, misunderstood what "success" would actually mean.

The engineers of the response succeeded in their immediate goal, to preserve the financial system. But they — or, more precisely, they and their political leaders at the time — also left fissures that threaten to undermine the system they sought to preserve. The very underpinnings of modern capitalism are being questioned from all sides. A Republican administration has gleefully cast aside trade deals, for instance, and the energy among Democrats is around democratic socialism.

To understand the challenges and ultimately the failure of the politics of their response, it helps to put yourself back in 2008 and 2009, when the financial might of the United States government — trillions of dollars, cumulatively — was deployed to try to contain the crisis.

Rebuilding the status quo

Mr. Geithner, Mr. Paulson and Mr. Bernanke are centrists in the context of modern American politics, but they are conservatives in the traditional sense — people trying to preserve a system they inherited.

Their strategy was to patch things up as quickly as possible. The goal was not to try to reinvent Wall Street on the fly, but to keep the flow of capital coursing through the global economy while minimizing the depth and duration of the recession that the crisis had caused.

Some 230 academic economists signed a letter attacking the bank bailout legislation that Mr. Paulson proposed as unfair and a potential threat to the vibrancy of private markets.

Mr. Geithner's disinclination to nationalize banks drew fierce criticism from liberals who argued that the government was essentially funneling money to banks with little assurance they would resume lending.

"Whatever its merits, his bailout plan offers generous subsidies to banks and private investors while protecting bank management and creditors," John B. Judis wrote in 2009 in a New Republic article titled "The Geithner Disaster."

Mr. Bernanke's efforts to pump money into the economy by buying up bonds also met opposition. A group of conservative economists wrote a letter in 2010 arguing that the Fed's plans to engage in quantitative easing "risk currency debasement and inflation, and we do not think they will achieve the Fed's objective of promoting employment."

These attacks were misguided.

Mr. Paulson's financial rescue package did not herald an era of socialism on Wall Street; nor did it come at a huge continuing cost to taxpayers. By many measures, it made money.

Mr. Geithner's stress tests achieved their goal of restoring confidence in major banks without the cost and political damage of nationalizing them. They were successful enough that similar stress tests are now a part of regulators' tool kits both in the United States and overseas.

Mr. Bernanke's aggressive monetary policy probably played a role in getting the expansion on track starting in mid-2009. Quantitative easing and low interest rates did not cause a collapse of the dollar or spiraling inflation.

Nobody would argue that the United States economy is perfect, or that the policymakers got everything exactly right.

If Mr. Paulson had secured financial rescue legislation before Lehman Brothers went bankrupt, perhaps the most severe phase of the crisis could have been avoided altogether, though it is a puzzle how he could have gotten the votes for such a plan before the crisis became more severe. If Mr. Bernanke had moved faster — putting an open-ended quantitative easing program in place in 2009 or 2010 instead of waiting till 2012 — maybe full recovery would have come sooner.

It's not clear how the recovery might have looked had Mr. Geithner embraced a more activist approach to replacing management and taking greater government control of the most troubled large banks, notably Citigroup and Bank of America. Or if he had welcomed a larger program to help relieve borrowers who were underwater on their homes.

The tactics the men chose can be second-guessed, but the result of their efforts speaks for itself. The expansion has lasted nine years, the second longest on record. Although job gains were disappointingly slow for years, the unemployment rate is now 3.9 percent, among the lowest in decades.

From 2007 to 2017, per-person inflation-adjusted G.D.P. rose 6.3 percent in the United States, compared with only 3 percent in the eurozone, where similar policies were embraced more slowly.

In exhaustive research of the history of financial crises, the economists Carmen Reinhart and Kenneth Rogofffound that it takes eight years on average for a society to return to its level of per-person income. The United States did so in 2013, only six years after the peak of the crisis.

The political price

It was Feb. 19, 2009, less than a month into the Obama administration. Mr. Geithner and his colleagues had introduced plans to assist struggling homeowners, which many liberal critics considered deeply inadequate.

The human cost of the foreclosure crisis was indeed immense; there were 2.8 million foreclosures that year alone. But the politics of helping troubled homeowners were more toxic than the crisis managers had foreseen.

From the floor of the Chicago Mercantile Exchange, the CNBC broadcaster Rick Santelli began a rant for the ages. "How many of you people want to pay for your neighbor's mortgage that has an extra bathroom and can't pay their bills?" Mr. Santelli said, as traders cheered behind him. "President Obama, are you listening?"

"We're thinking about having a Chicago tea party in July," he continued.

[Video: Watch on YouTube.]

The term stuck, and was embraced by the conservative activists who propelled Republicans to victory in the 2010 midterm elections — driven, in no small part, by opposition to economic stimulus, financial bailouts and the work of the Federal Reserve.

The policymakers knew history's warnings about economic policy that reacts too sluggishly to financial crisis.

Mr. Geithner spent some evenings in the darkest days reading in Liaquat Ahamed's "Lords of Finance" about how an earlier generation of policymakers bungled the response to the Great Depression. Mr. Bernanke is a scholar of that era in his own right.

But they seemed to assume that if they got the economics right, popular support would follow. As Mr. Bernanke wrote in his memoir about the Santelli rant, “I remained perplexed that helping homeowners was not more politically popular.”

There’s a reason, of course, that they were in their roles as appointed technocrats and not politicians. But it isn’t clear that George W. Bush or Barack Obama had any better ideas for bringing along the public than did the men they chose to lead financial policy. The crisis response may well have been a Rubik’s Cube of political and economic challenges too complicated to solve.

It was foreseeable, perhaps, that many on the left would view the Geithner-Paulson-Bernanke strategy as too friendly to Wall Street interests. It was also foreseeable that the libertarian right would loathe the bailouts. More surprising were the ways in which some of the biggest beneficiaries of the strategy became vocal opponents.

The Geithner strategy was based on rescuing Wall Street, using hundreds of billions of taxpayer dollars — while building a more rigorous regulatory system to try to prevent a similar crisis.

But by the time what became the Dodd-Frank Act was on its way to passage in 2010, the financial industry and nearly all Republicans in Congress had committed to all-out opposition of industry regulation. Only three of 178 Republican House members, for example, supported the bill.

Even as Mr. Bernanke’s easy money policies pushed the **stock market** upward and coincided with a gradually improving economy and low inflation, the drumbeat of commentary was overwhelmingly negative.

You could turn on a financial network at nearly any hour of the trading day and hear complaints about how quantitative easing and zero interest rates were distorting markets. When Mr. Bernanke left office in early 2014, when the **stock market** was soaring and the unemployment rate was falling fast, only 28 percent of Republicans approved of his performance, according to a Gallup survey.

Success has rarely been so unpopular.

How the crisis broke our politics

In July, Mr. Bernanke, Mr. Geithner and Mr. Paulson were together again. They invited a handful of reporters to interview them in a conference room at the Brookings Institution, where they will be participating in a crisis retrospective in September.

Might the rise of anti-establishment parties around the world — not least Donald J. Trump on the right and Bernie Sanders-esque socialists on the left in the United States — be traced to their work as crisis responders?

“We know from history that financial crises, particularly big ones, do tend to get followed by a populist reaction,” Mr. Bernanke said. “I think we all tried our best to explain what we were doing and work with the politics, as difficult as it was. I think back to the crisis, we were very focused on preventing the collapse of the financial system. And developing our communication to the broad public wasn’t always our first priority.”

He argued, though, that longer-term trends — like stagnation in middle-class wages, social dysfunctions, rising mistrust in government and hostility to immigration — were a bigger explanation for the rise in a politics of extremes.

This analysis seems both correct and incomplete. Of course, the embrace of anti-immigrant nationalism on the right and of socialism on the left have roots considerably deeper than a bank bailout or a quantitative easing program.

But it was the experience of the crisis, and the sense among Americans of all ideological dispositions that they were being asked to foot the bill for someone else’s mistakes — whether by Wall Street C.E.O.s or by Mr. Santelli’s neighbor with the renovated bathroom — that helped make those long-simmering problems boil over.

The response to the crisis was in many ways the high-water mark for a mold of centrist, technocratic policymaking that seeks to tweak and nudge existing institutions toward better outcomes. It also undermined any widespread popular support for that mode of governing for the foreseeable future.

It turns out, when you throw trillions of dollars at rescuing a system that most people don’t like very much in the first place, the result isn’t relief.

It’s anger.

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THE WALL STREET JOURNAL.

Markets

'Flash Boys' Exchange IEX Wins First Listing; Interactive Brokers says it will switch its listing to the upstart market from Nasdaq Oct. 5

By Alexander Osipovich
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Upstart stock exchange IEX Group Inc. won its first listing, a victory in its efforts to enter a key business of the New York Stock Exchange and **Nasdaq** Inc.

Online brokerage Interactive Brokers Group Inc. said Wednesday it would switch its listing to IEX, becoming the first company to jump ship for the new exchange, which was made famous by Michael Lewis's 2014 book "Flash Boys." The Greenwich, Conn.-based brokerage is currently listed on **Nasdaq**.

The U.S. corporate-listings business, in which companies pay fees to an exchange for services tied to being the primary venue for the company's stock trading, has for years been an effective duopoly of the NYSE and **Nasdaq**. A third big exchange group, Cboe Global Markets Inc., lists exchange-traded funds and its own shares, but hasn't made a bid to attract other companies.

IEX has struggled to convince corporate executives to switch over from the Big Board and **Nasdaq**, and its timetable for the launch of listings had slipped repeatedly. One of its obstacles was that many companies were reluctant to be the first to switch--a hurdle that may be easier to clear now that IEX will be home to one listing.

Initially, people close to IEX had expected its first company to be casino operator Wynn Resorts Ltd., whose former chairman and Chief Executive Officer Steve Wynn was an outspoken supporter of IEX. But that plan fell through after Mr. Wynn resigned earlier this year.

Interactive Brokers is in some ways a natural fit for IEX. Its billionaire chairman and CEO, Thomas Peterffy, has criticized the impact of high-frequency trading and publicly denounced other practices he has said are unfair to investors, such as "payment for order flow," in which some retail brokers route their customers' orders to high-speed traders in exchange for cash.

IEX, founded in 2012, also styles itself as a crusader for market fairness. Its best-known feature is a brief delay—or "speed bump"—that it imposes on orders. The delay of 350 millionths of a second is designed to thwart aggressive ultrafast trading strategies.

In 2014, Mr. Peterffy proposed a mandatory speed bump of 10 to 200 milliseconds for a huge swath of orders on U.S. stock and options exchanges as a way to limit the impact of high-frequency trading, according to a letter to regulators posted on the Interactive Brokers website. A millisecond is a thousandth of a second.

Switching to IEX could hurt Interactive Brokers' share price, since the company will be removed from certain indexes--such as the **Nasdaq Composite**--that don't include IEX-listed stocks. That means index funds or ETFs tracking such indexes will need to sell Interactive Brokers shares. The brokerage's shares were down 2.1% Wednesday, while financial stocks in the **S&P 500** fell 0.9%.

"We at Interactive Brokers understand that being the first listing on a new exchange may entail certain risk, but we think that individual and institutional customers who own and trade our stock will receive better execution prices and that advantage will outweigh the risk," Mr. Peterffy said in a press release announcing the move.

IEX said it would list shares of Interactive Brokers starting Oct. 5. IEX CEO and co-founder Brad Katsuyama said in a press release that he was "honored" to have Interactive Brokers as the exchange's first listing. A **Nasdaq** spokesman declined to comment.

IEX has offered five years of free listings to the first batch of companies to switch over from the NYSE and **Nasdaq**, with some larger companies being eligible for as much as 10 years without having to pay IEX any listing fees. The incentive will apply to other companies that move to IEX within 120 days of Interactive Brokers' switch.

Companies that switch exchanges often do so in the last months of the year, before January, when NYSE and **Nasdaq** listing fees are due for the year ahead. That means there could be a three-way battle for switches between IEX and the two big incumbents in the closing months of 2018.

NYSE parent Intercontinental Exchange Inc. and **Nasdaq** earned a combined $684 million from listings last year, according to the two exchange groups.

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The New York Times

Opinion
An Insurance Executive Explains Why We Need a Carbon Tax

By Edward B. Rust Jr.
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In the past few years, we have seen substantial damage from storms and flooding in the United States. Hurricanes Harvey, Irma and Maria, which hit in August and September of last year, cost a combined $265 billion in what was a "historic" year for weather and climate-related disasters, according to the National Oceanic and Atmospheric Administration.

Now we're once again in the peak of hurricane season, with Hurricane Florence bearing down on the Southeast coast with frightening ferocity and two other storms, Issac and Helene, behind it.

Increasingly, extreme weather events are being influenced by the warming of the planet. Not every hot summer day or winter snowstorm can be chalked up to climate change, of course. But that doesn't mean the atmosphere is immune from the effects of carbon dioxide emissions from cars, industrial smokestacks and other sources.

For the insurance industry, which focuses on protecting against large events that we expect to happen but don't expect to happen to us, the trend lines are not encouraging.

As an insurance professional with over 40 years of experience, I learned quickly that when actuaries warn about risks, you listen. Consider then the Actuaries Climate Index, which tracks the frequency of extreme weather and the extent of sea level change relative to a reference period of 1961 to 1990. The five-year moving average of climate extremes across the United States and Canada reached a record high in the fall 2017, according to the most recent index, released Aug. 1.

What this reflects, according to the index, is a "continued deviation of climate and sea level extremes from historically expected patterns." Increased precipitation and rising sea levels were the leading factors driving the latest result, a fact that should be particularly concerning to coastal states from Texas to Maine.

With history as a guide and with a clear understanding of trend lines, insurance markets can work well and protect consumers efficiently. What the data tells us is that the greater losses we can expect from climate-related events, combined with greater uncertainty about where and when they will take place, will create substantial **volatility** in insurance payouts. For consumers, this will mean more costly premiums.

While new building standards have reduced losses for owners of new homes in some areas, most homes are older and more vulnerable, and improved building standards can do only so much to protect our housing stock. In the end, while robust building codes can help to mitigate losses, they do not reduce the risk of catastrophes. As sea levels rise, insuring against property losses will become more difficult and more expensive.

We must work to reduce these risks, and one key element of a long-term solution should be a revenue-neutral tax on emissions of carbon dioxide. This approach can spur the same reduction in carbon emissions that regulations can achieve, but without the unintended consequences that regulations inevitably bring.

A revenue-neutral carbon tax will encourage manufacturers to develop new ways to reduce their emissions and prompt consumers to be more environmentally responsible. The market will stimulate these choices, not the government. And the revenue raised from a carbon tax could be used to lower tax rates on work and savings.

We need to move away from the politically charged rhetoric about climate change and talk about its real, tangible consequences that threaten the lives and livelihoods of the people that insurance seeks to protect.

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WSJ PRO CENTRAL BANKING

Markets

'Fintech Charter' Has No Early Takers as Lawsuit Looms; State regulators are threatening to sue over a new national license for cutting-edge financial firms

By Lalita Clozel
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12 September 2018
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A national banking regulator is offering cutting-edge financial firms a new pathway into the traditional banking system. So far, few of them are biting.

The lack of immediate interest from the likes of LendingClub Corp., Square Inc., and others comes in large part from uncertainty about what activities the Office of the Comptroller of the Currency's so-called fintech charter will allow, what regulatory requirements it will carry, and whether it will hold up in court.

That uncertainty grew Wednesday when the Conference of State Bank Supervisors, a group of state regulators, said it intends to file a lawsuit challenging the OCC's authority, renewing a previously unsuccessfully legal challenge.

The OCC opened its door to formal applications July 31, giving the states a fresh legal angle to pursue after previous suits were deemed premature. The threat of a protracted battle could make eligible firms more hesitant to apply for the OCC charter, according to people in the industry.

"The OCC does not have the statutory authority to do what they are seeking to do," said Margaret Liu, deputy general counsel of the Conference of State Bank Supervisors. She wouldn't specify whether the state regulators planned to sue before or after a company had applied for the charter.

An OCC spokesman said the agency will "vigorously defend" its authority to charter "companies that are engaged in the business of banking, meet the qualifications for becoming a national bank, and apply to conduct business as part of the federal banking system".

Over the last decade, fintechs—typically nonbank companies offering financial services online—have grown more prominent in lending and payments. They have collected state licenses and joined with banks to connect to the mainstream financial system.

A national license would allow fintech firms to operate across the U.S. without having to comply with state-by-state rules, such as interest-rate limits.

No company has applied for the OCC's fintech charter yet. Jeffrey Hare, a banking lawyer at DLA Piper, said he is telling clients to take a wait-and-see approach: "You want to be first in line to be second."

Some firms are signaling they are in no rush to apply.

"The OCC's new charter is a huge step for regulatory modernization," said a statement from Richard Neiman, a former New York banking regulator who is head of regulatory affairs at LendingClub, an online marketplace lender. "But marketplace lenders with long track records and robust risk management processes will likely consider all their options."

Like other large fintech companies, LendingClub is already operating without a federal license. It partners with a bank to benefit from that institution's federal pre-emption over state laws, allowing it to avoid local interest-rate limits and licensing requirements.

For Square, a payments company that also offers loans to small businesses in its network, obtaining a national bank charter from the OCC could restrict its ability to own nonfinancial businesses, like its food-delivery service Caviar Inc.

"A full bank charter would not be appropriate for Square," said a company spokesman. "Our other, predominant lines of business are not in products and services that require a banking license."

Square instead is eyeing a Utah industrial loan company license, which would give it access to federal deposit insurance and avoid other states' interest-rate limits without needing the OCC charter. It says it is planning to refile an application with the Federal Deposit Insurance Corp., after withdrawing a previous application this summer.

PayPal Holdings Inc. already has licenses in dozens of states. When the OCC was preparing the fintech charter in January 2017, PayPal canceled a meeting with Beth Knickerbocker, who heads the OCC initiative, according to email records. "[We] don't feel that we would have much else to add," a PayPal representative said in an email.

PayPal declined to comment. "We do not comment on such conversations in advance of an application being submitted," said the OCC.

Banks generally face strict capital and liquidity requirements governing how they fund their operations, as well as requirements to lend to people of all income levels. The OCC hasn't spelled out detailed requirements for fintech firms.

Charter applicants have to submit detailed, long-term business plans. Bank investors must be vetted and share details of their financial history. "It's like an FBI background check," said Keith Noreika, a partner at Simpson Thacher & Bartlett LLP and former acting comptroller.

Payments companies, from startups to established players such as Western Union Co. and MoneyGram International Inc., could benefit by replacing state licenses with a national charter—particularly if it came with access to the Federal Reserve's nationwide payments system, according to industry lawyers.

The OCC said it is discussing this question with the central bank. It "is a matter for [the] Federal Reserve to decide, and I expect that decision will be made based on [the] particular facts and circumstances of each bank," said Stephen Lybarger, the OCC's head of licensing, in a statement. The Fed declined to comment.

On Aug. 31, the OCC conditionally approved a national bank charter for Varo Money Inc., a digital banking startup. Varo is seeking a traditional bank charter, rather than a new fintech-focused license, but the OCC's receptiveness was read by some as a **bullish** signal.

"It goes to the OCC's willingness to charter a nontraditional fintech business plan bank.," said Thomas Curry, a partner at Nutter McClennen & Fish LLP and the former comptroller who initiated the OCC's fintech charter work.

Ryan Tracy contributed to this article.

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THE WALL STREET JOURNAL.

U.S. Markets
Markets

S&P 500 Gains Amid Trade Hopes; The stock index ends higher after a report the U.S. is reaching out to China for a new round of trade talks

By Amrith Ramkumar and Christopher Whittall
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The Wall Street Journal Online
WSJO
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The **S&P 500** edged higher for the third straight session Wednesday, with gains in consumer-staples and trade-sensitive sectors offsetting declines in financial and technology firms.

Worries about tariffs slowing global growth and hurting multinational companies have kept major indexes wobbling near record levels lately. After the U.S. and Mexico reached a deal on trade recently, some investors are waiting to see if potential agreements with Canada, the European Union and China could boost global growth later in the year.

The **S&P 500** and **Dow Jones Industrial Average** eked out gains following a Wall Street Journal report that the U.S. is reaching out to China for a new round of trade talks. Some analysts have said the market is waiting for a resolution to the dispute to make bigger moves, following months of continuing threats and discussions.

"There's quite a lot more macro uncertainty, and a lot that has to do with the trade-war fears," said Isabelle Mateos y Lago, chief multiasset strategist at BlackRock. "It's not an environment in which many people are enthusiastic about taking risk."

Still, Ms. Mateos y Lago said she favors U.S. stocks in the current environment, adding that U.S. companies have "more dynamic earnings [and] more dynamic sales growth."

The **S&P 500** added 1.03 points, or less than 0.1%, to 2888.92. The Dow industrials closed up 27.86 points, or 0.1%, to 25998.92, after earlier climbing as much as 175 points. The tech-heavy **Nasdaq Composite** fell 18.24 points, or 0.2%, to 7954.23.

Trade-sensitive manufacturing and materials stocks rallied on the latest signs that the U.S. is willing to compromise on trade. Freeport-McMoRan, Stanley Black & Decker and Boeing were among the **S&P 500**'s leaders.

Meanwhile, rising **oil prices** continued to lift energy stocks around the world, as traders weighed possible supply disruptions and a larger-than-expected drop in U.S. stockpiles.

Consumer-staple stocks rose after data Wednesday showed a gauge of U.S. business prices in August logged the first monthly decline in about a year and a half, though annual gains remain steady. Worries about higher costs have hurt the sector throughout the year.

The sector's 1.3% climb helped lift the broader **S&P 500** despite a drop in financial stocks, which were hurt by falling Treasury yields that can portend lower lending profitability.

Declines in semiconductor stocks also led the broader technology sector lower, with the PHLX Semiconductor Index dropping for the fifth time in the past six sessions after Goldman Sachs downgraded the semiconductor capital-equipment space to "neutral" from "attractive." The bank also lowered its rating on Micron Technology to "neutral" from "buy."

Micron Technology shares fell $1.86, or 4.3%, to $41.74, making it one of the worst performers in the **S&P 500**, while Lam Research and KLA-Tencor also were among the broad index's laggards.

Internet firms, another market leader in recent years, also tumbled anew on fresh regulatory fears. The latest declines came after the Journal reported that the Senate Commerce Committee will hold a high-profile hearing on the privacy practices of big tech companies later this month. Twitter and Facebook each fell more than 2.3%.

Snap shares fell to a record low after BTIG analysts downgraded shares of the Snapchat parent to "sell."

And Apple dropped 2.78, or 1.2%, to 221.07 after it rolled out new gadgets during its annual product showcase. The technology giant is among the large companies that recently warned that further U.S. tariffs on Chinese goods could hurt its business.

Investors were parsing the latest inflation data showing the monthly drop in business prices. Despite the unexpected drop in the producer-price index, many analysts expect the Federal Reserve to stay on a gradual path of interest-rate increases and boost rates at its meeting later this month.

"It's certainly a big miss, and the real question is, 'What does [the consumer-price index] do tomorrow?'" said John Sheehan, a portfolio manager at Osterweis Capital Management. "If this is a consistent theme where PPI and CPI both miss, then we would start to change our opinion a little bit" about inflation and rates steadily climbing, he said.

The yield on the benchmark 10-year U.S. Treasury note fell to 2.963% from 2.979% Tuesday. Yields fall as **bond prices** rise. The WSJ Dollar Index, which tracks the dollar against a basket of 16 other currencies, fell 0.3%.

Elsewhere, gains in commodities-linked companies helped the Stoxx Europe 600 climb 0.5%.

Stocks in Asia continued to slide on trade fears. Hong Kong's Hang Seng, which recently entered **bear-market** territory, fell 0.3%. Japan's Nikkei Stock Average also shed 0.3%.

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The Bear Mauls Another Market

By Saumya Vaishampayan, Michael Wursthorn and Steven Russolillo
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Hong Kong's stocks fell into a **bear market** Tuesday, another casualty of an international selloff driven by trade tensions, a stronger dollar and worries about the resilience of developing economies.

It is the latest sign that stocks around the world are feeling the pressure of the trade fight, exposing the global market's fragility to the sparring between the U.S. and major trading partners in Europe and Asia.

To date, major U.S. indexes have mostly stood their ground, hitting new highs late last month, amid strong economic data and corporate earnings. The **S&P 500** and the **Dow Jones Industrial Average** both rose 0.4% Tuesday, while the **Nasdaq Composite** added 0.6%.

But resurgent trade tensions have knocked the S&P down 0.5% so far this month, putting it on pace for its first monthly loss since March.

And shares of several big American conglomerates, including heavy-equipment maker Caterpillar Inc., car maker General Motors Co. and aluminum-products maker Arconic Inc., have tumbled more than 20% from their recent highs, meeting the common definition of a **bear market**.

Hong Kong's Hang Seng Index reached the same milestone Tuesday, following China's benchmark Shanghai Composite in June and MSCI's flagship emerging-markets index last week. Investors have been feeling pain particularly in Turkey and Argentina as indexes in those emerging markets have struggled against the rising dollar.

The overseas selloff deepened Tuesday after reports that China plans to ask the World Trade Organization for permission to impose sanctions on the U.S., which just a week earlier said tariffs on an additional $267 billion in Chinese goods were ready to go. Trade negotiations between the European Union and U.S. haven't fared much better after officials failed to reach a breakthrough Monday, pushing off the possibility of a deal to the end of September, when trade officials said they would meet again.

"The president is gearing up to use more hawkish rhetoric on trade, escalating the potential for a trade war and rising uncertainty and concern among investors," said David Page, senior economist at AXA Investment Managers. "The markets are worried about retaliation and investors are going to have to navigate that over the next couple of months."

Fears of a trade war that had seemed remote and distant earlier this year are more pronounced, say investors who worry that the additional levies on a variety of items -- from agricultural goods to electronic parts -- will eat into companies' profit margins and consumers' wallets. And those concerns have sapped some of the positive momentum U.S. stocks enjoyed after reporting second-quarter earnings, which saw their biggest year-over-year gain in six years, according to the Commerce Department.

The turbulence is also expected to further hamper shares of the big U.S. manufacturers that have tumbled this year. Caterpillar, which is a component of the Dow industrials, slumped 23% from its January high to its low last month and remains off 17%. Both Arconic and metals-mining company Freeport-McMoRan Inc. are down more than 30% from their highs at the beginning of the year through their recent lows. And car makers GM and Ford Motor Co. are down nearly 30% from their previous highs.

Nearly 180 companies in the **S&P 500** mentioned "tariff" at least once during their latest earnings calls, underscoring the greater focus on trade. Ford, for example, said sales in China plunged 26% in the first half, compared with the same period a year earlier, as trade tensions forced the car maker to endure its poorest first-half showing in China since 2012.

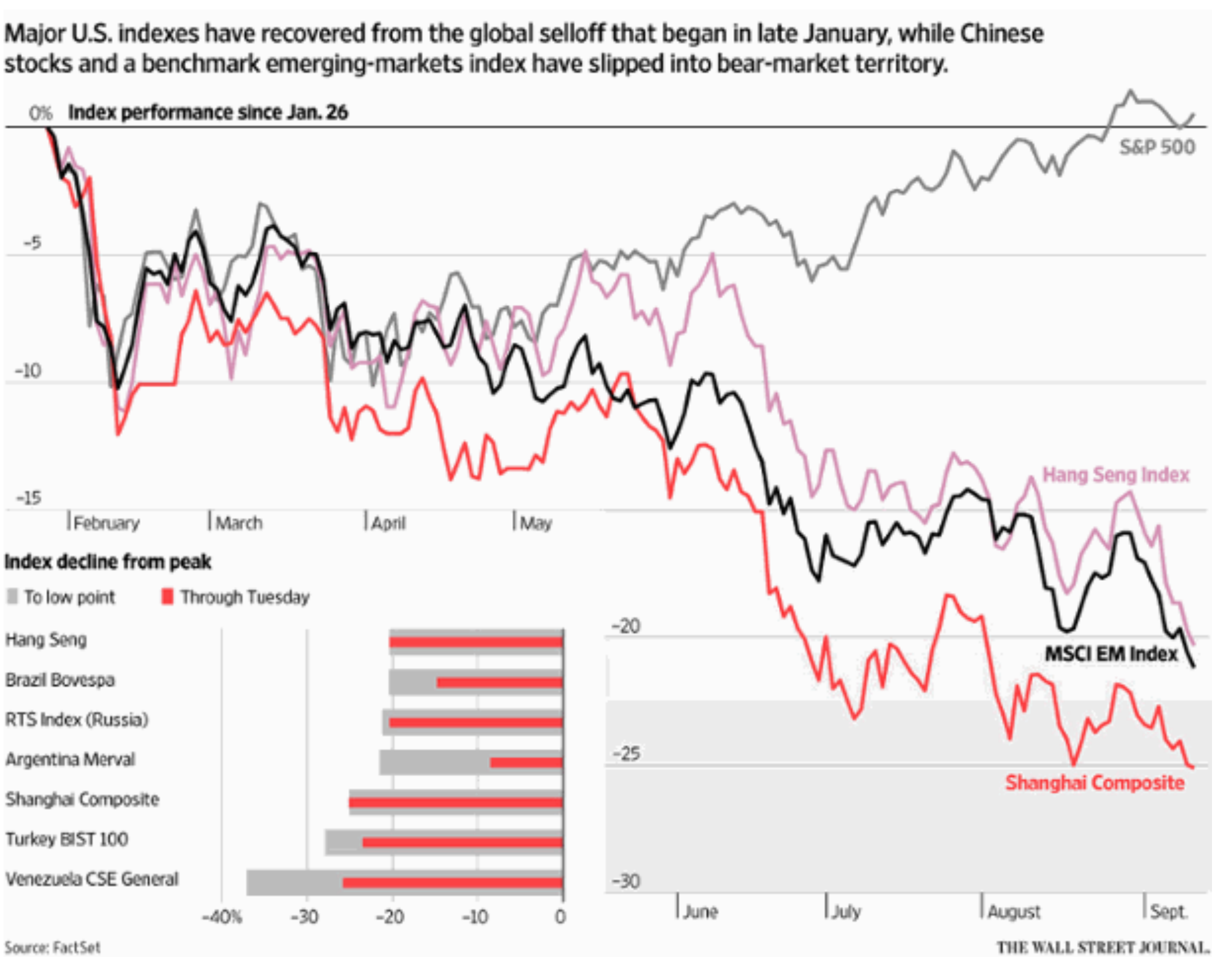
Analysts say an escalation in tariffs could cost a U.S.-based investor somewhere between 8% and 17% of their global portfolio's value, according to FactSet.

"The tone of the markets today has become somewhat anxious," Tom Stringfellow, president and chief investment officer of Frost Investment Advisors, wrote in a recent note. "While the domestic equity markets are higher on a year-to-date basis, they've not responded to the level we might have expected, given recent corporate earnings growth."

The declines have been broader in Asia, where the Hang Seng, which has a market capitalization of $2.1 trillion, dropped 0.7% Tuesday. Early Wednesday, the benchmark was down a further 0.7%. Slightly more than half of the index's 50 components are mainland Chinese companies -- including Tencent Holdings Ltd., China Construction Bank Corp. and China Mobile Ltd. -- making the index highly sensitive to concerns about the health of the world's second-largest economy.

Tencent, the most valuable company listed in Hong Kong, has particularly weighed on the index. It has lost more than $200 billion in market value from a peak in January, a sum larger than the market value of all but 23 companies in the **S&P 500**.

Back in the U.S., investors credit the booming economy for the U.S. **stock market**'s strength relative to the rest of the world. Profits among American companies continue to soar and have helped to keep the broad **S&P 500 index** from tumbling much lower, investors said.



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International New York Times

business

From Trump to Trade, the Financial Crisis Still Resonates 10 Years Later; DealBook

By ANDREW ROSS SORKIN
1,591 words
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INHT
English

This week is the 10th anniversary of the inflection point of the financial crisis: the collapse of Lehman Brothers, the biggest bankruptcy in history. To some, it feels like a long time ago.

Yet, its effects still echo in the way we live today — in the attitudes that pervade our economy, our culture and our politics. It is hardly a stretch to suggest that President Trump's election was a direct result of the financial crisis.

The crisis was a moment that cleaved our country. It broke a social contract between the plutocrats and everyone else. But it also broke a sense of trust, not just in financial institutions and the government that oversaw them, but in the very idea of experts and expertise. The past 10 years have seen an open revolt against the intelligentsia.

Mistrust led to new political movements: the Tea Party for those who didn't trust the government and Occupy Wall Street for those who didn't trust big business. These moved Democrats and Republicans away from each other in fundamental ways, and populist attitudes on both ends of the spectrum found champions in the 2016 presidential race in Senator Bernie Sanders and Donald J. Trump.

The depth of financial despair during the Great Recession and the invariably slow recovery have unleashed a sense of bitterness that dominates the political landscape, culminating in Mr. Trump's electoral victory.

"We are almost at each other's throats when times are good," said Ray Dalio, the founder of Bridgewater Associates, the largest hedge fund in the world with some $150 billion in assets, and the author of a new book, "A Template for Understanding Big Debt Crises," an exhaustive study of financial panics and the policies that both created and rescued them.

The deepest crises, he said, always lead to populism. And it should be no surprise that a crisis leads to conflict and, in some extreme cases, war. "I would be worried about the emergence of populism," he said, "because populists tend to want to fight with the other side rather than try to find ways of getting through it." Populists on every side of the political spectrum "have in common that they're confrontational," he said.

When I wrote "Too Big to Fail" nearly a decade ago, I knew that the crisis would redefine Wall Street and the economy, but I didn't appreciate how fundamentally it would redefine the political environment.

Amir Sufi, a professor of economics and public policy at University of Chicago's Booth School of Business and the co-author of "House of Debt," pointed to the financial crisis as the source of reduced civility a few months after Mr. Trump's victory. He conducted an analysis of 60 countries with his "House of Debt" co-author, Atif Mian of Princeton University, and Francesco Trebbi of the University of British Columbia. They found that such a response was "common and predictable," he wrote.

"Our conclusion: Financial crises tend to radicalize electorates," Mr. Sufi wrote. "After a banking, currency, or debt crisis, our data indicate, the share of centrists or moderates in a country went down, while the share of left- or right-wing radicals went up in most cases."

In the United States, the crisis exposed an economy that had been a charade — one that most Americans didn't understand or appreciate. The use of debt had masked the real problems underneath the surface: a significant decrease in worker participation, automation that would take jobs and stagnant wage growth.

These issues long predated the crisis. But as Warren Buffett famously said, "You only find out who is swimming naked when the tide goes out."

In truth, our economy today is in much better shape than you might expect, with unemployment at 3.9 percent — lower than it was before the crisis.

Yet debates persist about the way the government, first under President George W. Bush and then under President Barack Obama, chose to respond to the crisis. Should it have done more directly for homeowners? Should it have demanded more onerous terms for the hundreds of billions of dollars in loans to the banks and bankers, like restricting compensation and firing executives to demonstrate more accountability? Should some bankers have gone to jail?

For some, it is tempting to think that the government should have taken a more populist approach itself. If it had offered more help directly to the public rather than what was perceived as bailing out the banks, there is a suspicion that divisions could have been lessened, yielding a more united United States.

But would it?

In Britain, the government did all those politically popular things: It restricted banker pay, it fired executives, it lent money to banks on onerous terms, it restricted spending.

It didn't work. The British economy grew significantly slower than ours. And the resulting resentment and bitterness were much worse than our own, leading to a manifestation of populism even more drastic: the unimaginable vote to leave the European Union.

It's not popular to say, but it's clear that the financial crisis was so deep and so painful that whatever populist positions policymakers took, the positive feelings would have been short-lived.

Timothy F. Geithner, the Treasury secretary under Mr. Obama, recounted in his book "Stress Test" a conversation that he had with President Bill Clinton as he was considering a more populist approach. Mr. Clinton told him, "You could take Lloyd Blankfein into a dark alley, and slit his throat, and it would satisfy them for about two days. Then the blood lust would rise again."

It doesn't help that the economic medicine used by policymakers after a crisis exacerbates those feelings of anger. The most efficient fix — lowering interest rates — helps the wealthy because they end up with cheaper mortgages and enjoy the benefits that low rates have on corporate growth. Those lower on the economic ladder, on the other hand, get little in interest on their savings. The gap between the haves and the have-nots widens.

But that approach actually works, pulling everyone along with it, even if it is uneven and there are greater beneficiaries than others.

There is one question I get more than any other: "Will we have another crisis?" The answer, of course, is yes. But it's not a Wall Street crisis similar to 2008 that concerns me. I'm worried about something far bigger.

When I wrote "Too Big to Fail," that phrase was only used in the context of financial institutions. Today, it is used to refer to cities, municipalities, states and countries. If you look at the buildup of debt, that's the place to keep an eye on.

Unmanageable debt is the match that lights the fire of every crisis. You can have as many bad actors on stage as you want — greedy bankers, inept regulators, conflicted credit rating agencies — but unless there is significant leverage in the system, there's little danger of a crisis. Our national debt is more than $21 trillion, and it increased a trillion dollars in just six months under Mr. Trump, who rode populist and anti-establishment sentiment to the White House but whose policy choices have largely favored the wealthy.

That's not the only cause for concern, either. If history tells us the political divisions we have seen since the financial crisis were predictable, then what does history have to say about what comes next?

Mr. Dalio pointed to the chilling of international relationships that happened after the Great Depression as a worrying example of the divisions that can widen when populism fosters protectionism. "We started to have economic tariffs and we started to have back-and-forths of those things," he said.

He paused for a moment, signaling he didn't want to contemplate what that later manifested. But he continued, "Which then, 10 years later, led to Pearl Harbor."

There are, of course, many steps between populism and war. But Mr. Dalio said he saw similarities between the global environment that preceded World War II and the one we see today.

That’s reason enough to never forget this crisis and its lessons.

Andrew Ross Sorkin is a columnist for The New York Times and the author of “Too Big to Fail: How Wall Street and Washington Fought to Save the Financial System — and Themselves,” which was just rereleased with a new afterword for the 10th anniversary of the crisis.

PHOTOS: THE EXODUS: An employee of Lehman Brothers left the bank’s Manhattan headquarters on Sept. 15, 2008. Unemployment, now at a low 3.9 percent, reached 10 percent during the economic crisis. (PHOTOGRAPH BY CHRIS HONDROS/GETTY IMAGES); THE PLUNGE: The **Dow Jonesindustrial average** sank 4.4 percent on Sept. 18, 2008, three days after the investment bank Lehman Brothers went bankrupt, a key moment in the financial reckoning. (PHOTOGRAPH BY SPENCER PLATT/GETTY IMAGES); THE SLUMP: The subprime-mortgage meltdown exposed an economy that had been a charade. Most Americans didn’t appreciate that easy credit had masked real problems lurking below the surface. (PHOTOGRAPH BY HIROKO MASUIKE FOR THE NEW YORK TIMES); THE DIVIDE: The sharp downturn pushed the political poles further away from each other, touching off new political movements like the Tea Party on the right and Occupy Wall Street on the left. (PHOTOGRAPH BY EMMANUEL DUNAND/AGENCE FRANCE-PRESSE — GETTY IMAGES) (B6)

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Pro Bankruptcy
What J.P. Morgan Says Could Cause the Next Financial Crisis

By Ryan Vlastelica, MarketWatch
837 words
12 September 2018
02:37 PM
WSJ Pro Bankruptcy
RSTPROBK
English

Will yesterday's rescue be tomorrow's risk?

The U.S. **stock market** is now 10 years removed from the financial crisis, which sparked a deep recession, resulted in millions of people losing their jobs and homes, and decimated the **stock market**, with the **S&P 500** losing more than half its value. Massive steps were taken by governments and central banks across the world to stop the crisis, but in what could become an ironic outcome, those measures may have simply laid the foundation for the next crisis.

That's according to J.P. Morgan, which analyzed the causes of, and response to, the crisis in a recent note. According to the investment bank, the economy remains propped up by the extraordinary steps taken in 2008, and changes to this environment—which have already begun, and which will accelerate next year—are an underappreciated risk.

A primary step taken during the financial crisis was massive monetary stimulus, including both the Troubled Asset Relief Program—where the government bought toxic assets from weakened financial institutions—and quantitative easing, where the Federal Reserve bought government bonds in order to lower interest rates and spur more investments and make equities more attractive. Overall, central banks bought some $10 trillion in assets.

"This accommodation is now expected to reverse, starting meaningfully in 2019. Such outflows (or lack of new inflows) could lead to asset declines and liquidity disruptions, and potentially cause a financial crisis," J.P. Morgan wrote. "The main attribute of the next crisis will be severe liquidity disruptions resulting from these market developments since the last crisis."

Changes to central bank policy are widely seen as a risk to stocks, which by one measure have been in the longest **bull market** in history since the bottom of the crisis. Barry Bannister, head of institutional equity strategy at Stifel, recently wrote that stocks were in "the danger zone," and that rising interest rates could spark a **bear market** with "stocks falling faster than the Fed can react."

Separately, the Fed has been reducing the size of its balance sheet, which swelled to nearly $4.5 trillion with the various rounds of quantitative easing. The unwinding of the balance sheet is seen as removing a steady drumbeat of equity support from Wall Street.

J.P. Morgan referred to its hypothetical scenario as the "great liquidity crisis," and said that the timing of when it could occur "will largely be determined by the pace of central bank normalization, business cycle dynamics, and various idiosyncratic events such as escalation of trade war waged by the current U.S. administration," the report read.

Changes to monetary policy will also have implications for the bond market. Since hitting a record-low below 1.4% in July 2016, the yield on the U.S. **10**-**year Treasury** note has climbed to 2.97%. That means that **bond prices** have dropped, as prices and yields move inversely to each other. If June 2016 does mark a turning point for the bond **bull market**, that could have significant implications for risk across asset classes.

"Over the past two decades, most risk models were (correctly) counting on bonds to offset equity risk. At the turning point of monetary accommodation, this assumption will most likely fail. This increases tail risk for multiasset portfolios," J.P. Morgan wrote. "In the next crisis, bonds likely will not be able to offset equity losses (due to low rates and already large CB balance sheets)."

Last month, Jeffrey Kleintop, the chief global investment strategist at Charles Schwab, warned that global levels of debt could exacerbate the severity of the next financial crisis.

Citing data from the International Monetary Fund, he wrote that global debt stood at $164 trillion at the end of 2016, the most recent period for which data are available. That represents 225% of global GDP, and growth of $50 trillion from pre-financial-crisis levels.

"While a high debt burden isn't necessarily a problem by itself, it increases the vulnerability of the system to a shock—in particular, a shock that would lift interest rates," Mr. Kleintop wrote. "In theory, all that debt means the potential losses from a rise in interest rates would be more costly than in the past, especially combined with a stronger dollar pushing up the cost of dollar-denominated debt outside the United States."

J.P. Morgan didn't forecast a crisis in the near term, saying that current imbalances in the U.S. economy were "ample but not glaring," and that "the lack of severe imbalances suggests the next recession will be less likely to trigger a 2008-style crisis." The most likely recession scenario, it added, "seems milder than 2008 and more akin to 1990 or 2001."

Currently, it models a 25% chance of a recession starting in the next year, "not far from the historical average of 17%."

For more from MarketWatch: http://www.marketwatch.com/newsviewer

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The New York Times

Crisis and Consequences
Business Day
The Recovery Threw the Middle-Class Dream Under a Benz

By Nelson D. Schwartz
1,674 words
12 September 2018
05:00 AM
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English

Once a year or so, the economist Diane Swonk ventures into the basement of her 1891 Victorian house outside Chicago and opens a plastic box containing the items that mean the most to her: awards, wedding pictures, the clothes she was wearing at the World Trade Center on the day it was attacked. But what she seeks out again and again is a bound diary of the events of the financial crisis and their aftermath.

“It’s useful to go back and see what a chaotic time it was and how terrifying it was,” she said. “That time is seared in my mind. I looked at it again recently, and all the pain came flooding back.”

A decade later, things are eerily calm. The economy, by nearly any official measure, is robust. Wall Street is flirting with new highs. And the housing market, the epicenter of the crash, has recovered in many places. But like the diary stored in Ms. Swonk’s basement, the scars of the financial crisis and the ensuing Great Recession are still with us, just below the surface.

The most profound of these is that the uneven nature of the recovery compounded a long-term imbalance in the accumulation of wealth. As a consequence, what it means to be secure has changed. Wealth, real wealth, now comes from investment portfolios, not salaries. Fortunes are made through an initial public offering, a grant of stock options, a buyout or another form of what high-net-worth individuals call a liquidity event.

Data from the Federal Reserve show that over the last decade and a half, the proportion of family income from wages has dropped from nearly 70 percent to just under 61 percent. It’s an extraordinary shift, driven largely by the investment profits of the very wealthy. In short, the people who possess tradable assets, especially stocks, have enjoyed a recovery that Americans dependent on savings or income from their weekly paycheck have yet to see. Ten years after the financial crisis, getting ahead by going to work every day seems quaint, akin to using the phone book to find a number or renting a video at Blockbuster.

The financial crisis didn’t just kill the dream of getting rich from your day job. It also put an end to a fundamental belief of the middle class: that owning a home was always a good idea because prices moved in only one direction — up. The bubble, while it lasted, gave millions in the middle class a sense of validation of their financial acumen, and made them feel as if they had done the Right Thing.

In theory, if you lost your job, or suffered some other kind of financial setback, you could always sell into a real estate market that was forever rising. Ever-higher home prices became a steam valve, and the “greater fool” theory substituted for any conventional measure of value.

The kindling for the fire that consumed Wall Street and nearly the entire economy was mortgages that should never have been taken out in the first place. Homeowners figured the more house the better, whether or not their income could support the monthly payment, while greedy banks and middlemen were all too happy to encourage them.

When the bubble burst, the bedrock investment for many families was wiped out by a combination of falling home values and too much debt. A decade after this debacle, the typical middle-class family’s net worth is still more than $40,000 below where it was in 2007, according to the Federal Reserve. The damage done to the middle-class psyche is impossible to price, of course, but no one doubts that it was vast.

Banks were hurt, too, but aside from the collapse of Lehman Brothers, the pain proved transitory. Bankers themselves were never punished for their sins. In one form or another — the Troubled Asset Relief Program, quantitative easing, the Fed's discount window — the financial sector was supported in spectacular fashion.

Like the bankers, shareholders and investors were also bailed out. By cutting interest rates to near zero and pumping trillions — yes, you read that right — into the economy, the Federal Reserve essentially put a trampoline under the **stock market**. The subsequent bounce produced a windfall, but only for a limited group of beneficiaries. Only about half of American households have any exposure to the **stock market**, including 401(k)'s and retirement plans, and ownership of the shares of individual companies is clustered among upper-income families.

For homeowners, there wasn't much of a rescue package from Washington, and eight million succumbed to foreclosure. Sometimes, eviction came in the form of marshals with court orders; in other cases, families quietly handed over the keys to the bank and just walked away. Although home prices in hot markets have fully recovered, many homeowners are still underwater in the worst-hit states like Florida, Arizona and Nevada. Meanwhile, more Americans are renting and have little prospect of ever owning a home.

Worsening the picture, the post-crisis era has been marked by an increased disparity in wealth between white, Hispanic and African-American members of the middle class. That's according to an analysis of Fed data by the Pew Research Center, which found that families in the latter two groups were more dependent on housing as their principal form of investment. Not only were both minority groups harder hit by foreclosures, but Hispanics were also twice as likely as other Americans to be living in Sun Belt states where the housing crash was most severe.

In 2016, net worth among white middle-income families was 19 percent below 2007 levels, adjusted for inflation. But among blacks, it was down 40 percent, and Hispanics saw a drop of 46 percent. For many, old-fashioned hard work has simply not been a viable path out of this hole. After unemployment peaked in the fall of 2009, it took years for joblessness to return to pre-recession levels. Slack in the labor market left the employed and unemployed alike with little leverage to demand raises, even as corporate profits surged.

Maybe it was inevitable that when half the population watches its wages stagnate while the other half gets rich in the market, the result is President Donald Trump and Brexit.

"It peeled away the facade and revealed an anger that had been building for decades," said Ms. Swonk, who is chief economist at Grant Thornton in Chicago. "The crisis was horrific, but its legacy pushed us over the edge in terms of the discontent."

It also made inequality and the One Percent an urgent topic, and made unlikely celebrities of wonky intellectuals such as the economist Thomas Piketty. His best seller, "Capital in the Twenty-First Century," published in 2013, was 816 data-laden pages that laid out a grim diagnosis. Mr. Piketty argued that the decades after World War II, when the divisions between the classes narrowed and opportunities to move up the economic ladder expanded — that is, when the middle class as we knew it was formed — may actually have been an aberration. Society, Mr. Piketty wrote, risks a return to the historical norm of a yawning gap between rich and poor.

Whether or not he is right, the concentration of wealth that is a legacy of the financial crisis will make itself felt far into the future. Younger Americans, in particular, will be marked by the experience of 2008 much as the Crash of 1929 and the Great Depression haunted the generations who lived through it in the last century. Not only were they unable to accumulate assets in the lean years of the early recovery, but they also missed out on the recent **stock market** rally that benefited their older and richer peers.

A recent study by the Federal Reserve Bank of St. Louis found that while all birth cohorts lost wealth during the Great Recession, Americans born in the 1980s were at the "greatest risk for becoming a lost generation for wealth accumulation."

For those fortunate enough to still possess wealth after the crisis, the future looks very different. With the security provided by assets, rather than just income, they and especially their children are on a glide path for a gilded financial future.

"Over and over, you see that family wealth is an important determinant of opportunity for the next generation, over and above income," said Fabian T. Pfeffer, a sociologist at the University of Michigan. "Wealth serves as a private safety net that allows you to behave differently and plan differently."

A wealthy person who loses a job can afford to be more choosy and wait for an opportunity suited to his or her skills and experience. The risk of going to an expensive college and taking on debt is lower when there is parental wealth to fall back on.

Timothy Smeeding, who teaches public affairs and economics at the University of Wisconsin, put it more bluntly. “You can see dynasties starting to form,” he said.

Ten years have passed since the trauma of 2008, the nerves are still raw, and the pain still has a way of flaring up. Every time she goes down into the basement and peruses her diary, Diane Swonk feels it anew.

“It is the diary of an economist, as well as a mother and a human being,” Ms. Swonk said. It includes her published writings for clients, as well as her feelings, thoughts and fears as the crisis unfolded. She also recorded her impression of key figures she met during those fateful months, including Lawrence H. Summers, a top White House economic official at the time, and Ben S. Bernanke, then the chairman of the Federal Reserve.

“The financial crisis became a delineator,” she said. “There were those who could recoup their losses and those who could not. Some people have amnesia, but we are still living with the wounds.”

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WSJ PRO CENTRAL BANKING

Economy

U.S. Business Prices Continue to Pull Back at the End of Summer; Producer-price index posts first monthly drop since February 2017; recent summer price deceleration could be temporary

By Sharon Nunn
515 words
12 September 2018
10:03 AM
WSJ Pro Central Banking
RSTPROCB
English

WASHINGTON—A gauge of U.S. business prices in August clocked the first monthly decline in about a year and a half, driven largely by a downturn in trade services prices.

The producer-price index, a measure of the prices businesses receive for their goods and services, declined a seasonally adjusted 0.1% in August from a month earlier, the Labor Department said Wednesday. This is the first monthly drop since February 2017.

Economists had expected price growth in August, the second-straight month business prices came in weaker than expected.

The recent downtrend appears to be driven, in part, by a **volatile** gauge of margins called trade services. When excluding this measure, along with food and energy, two other **volatile** categories, prices rose in August.

"We doubt core PPI inflation has peaked, despite the unexpected weakness of the past two months' numbers; a sustained downward trend is even less likely," Ian Shepherdson, chief economist at Pantheon Macroeconomics, said in a note to clients Wednesday.

The headline index has risen on an annual, steadier basis since the beginning of 2016, while so-called core measures that remove **volatile** categories have also increased.

Gregory Daco, chief U.S. economist at Oxford Economics, expects businesses to exercise pricing power where possible and pass on some of these rising costs to consumers. "Still, we expect business margins to remain under pressure."

Other parts of the report showed lingering impacts from recent trade disputes. The Trump administration has imposed tariffs on steel and aluminum, and other countries have hit back with their own retaliatory trade actions.

August new-car prices lifted the annual price growth rate to 2.0%, but as recently as April, it was minus 1.8%, "so the tariffs on imported metals prices appear to be working through," Mr. Shepherdson said.

Meanwhile, food prices were down again on the wholesale level, as retaliatory tariffs against American farm products have softened their prices, according to Stephen Stanley, chief economist at Amherst Pierpont Securities.

The producer-price measure usually follows the same trends as other broad inflation gauges, though it doesn't always translate into what consumers pay. Signs of possible building inflation pressures have emerged in other recent reports.

The personal-consumption-expenditures price index, a broad inflation gauge closely watched by the Federal Reserve, rose 2.3% in July from the prior year, the biggest increase since early 2012. Meanwhile, the August unemployment rate remained at 3.9% for the second straight month, a historic low for the measure.

Ramped-up inflation and continued strong jobs growth could cause the Fed to reconsider its current pace of interest-rate increases. The Fed has signaled it plans to raise its baseline interest rate twice more before the end of 2018 at policy meetings in September and December, in 0.25-percentage-point increments.

Write to Sharon Nunn at sharon.nunn@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Fed's Bullard Reiterates Fed Should Listen More to Market; St. Louis Fed chief says, 'Financial market information can provide the basis for a better forward-looking monetary policy strategy'

By Michael S. Derby
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12 September 2018
09:40 AM
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English

Federal Reserve Bank of St. Louis President James Bullard reiterated Wednesday his belief the U.S. central bank should use market signals more to make monetary policy.

Mr. Bullard said market signals can be an important tool to gauge the economic outlook when the economic data that usually offers guidance doesn't seem to be doing the job.

"Handled properly, current **financial market** information can provide the basis for a better forward-looking monetary policy strategy," Mr. Bullard said.

Mr. Bullard, who isn't a voting member of the Federal Open Market Committee, has long opposed rate rises, but his colleagues seem set to increase their short-term interest-rate target when they meet later this month.

Write to Michael S. Derby at michael.derby@wsj.com

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THE WALL STREET JOURNAL.
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A Crypto Guru Faces The Bitcoin Crash --- Olaf Carlson-Wee got rich before 30, but now the blockchain trade is treacherous

By Rob Copeland
1,971 words
12 September 2018
The Wall Street Journal
J
A1
English

SAN FRANCISCO -- Olaf Carlson-Wee has crammed the highs and lows of a hedge-fund career into roughly one year -- all before his 30th birthday.

He turned $14,502 into a $150 million personal fortune by going all-in on cryptocurrencies right before bitcoin became a household name. His fund, Polychain Capital, earned investors including Silicon Valley heavyweight Andreessen Horowitz a staggering 2,303% last year, after fees -- among the best showings for a billion-dollar investment firm in history -- drawing comparisons to Wall Street traders such as John Paulson and George Soros.

Now, Mr. Carlson-Wee must prove he isn't a one-hit wonder. It isn't going well.

Polychain has shed around 40% of the $800 million it made for clients last year through a combination of investment losses and withdrawals by some of its earliest investors.Some backers grumble that Mr. Carlson-Wee refuses to change tactics despite a broad pullback from crypto. Mr. Carlson-Wee cashed out a big chunk of his personal haul in the fund months ago.

Prominent venture-capital firm Union Square Ventures has yanked some of its money, while others have fallen out privately with the firm. One investor is suing, suspecting he was underpaid when he moved to redeem his investment. Attorneys for Polychain and Mr. Carlson-Wee deny that.

Crypto fever, meanwhile, has broken. After capturing the attention of the investing world in 2017, bitcoin, the most well-known of a mushrooming collection of so-called digital assets, is down 55% this year. It recently traded for $6,301, down from its peak of nearly $19,280 in December.

"How much of it is luck, how much of it is skill and how much of it is luck disguised?" asks Fred Ehrsam, one of Polychain's first investors, who is now starting his own fund.

At the center of the maelstrom is Mr. Carlson-Wee, a Silicon Valley star who wears neon tracksuits, has five earrings and routinely eats only a plate of refried beans, garlic and cheese for dinner. He is treated as an oracle by wannabe cryptocurrency moguls who mob him in public.

In interviews, he compared his relationship with cryptocurrency to romantic love, and likened the current investment opportunity to the early days of the internet.

Through each dip downward, he has continued buying, particularly stakes in businesses tied to bitcoin rivals such as the cryptocurrency ether. He manages Polychain's roughly $650 million flagship fund -- the world's biggest in crypto -- from an Apple laptop in undisclosed, secret San Francisco warehouse offices.

"I want to emphasize how long I've been doing this," says Mr. Carlson-Wee, who turned 29 last month. "This is really just like breathing in and out for me."

This account of the windfall and subsequent struggles of Polychain and Mr. Carlson-Wee is based on multiple interviews with people close to the firm, as well as audits and other investor documents reviewed by the Journal.

Mr. Carlson-Wee's path to high-stakes investing began in Minnesota, in the suburbs of Fargo, N.D., where his parents were Lutheran pastors. In high school, Mr. Carlson-Wee wrote an SAT tutoring program in his spare time. He said he had few friends; his classmates voted him "most unique."

At Vassar College, he majored in sociology and against advice from his professors wrote a senior thesis on a virtually unknown digital currency named bitcoin.

Bitcoin is software that allows people to exchange value directly, without any government intermediary, essentially functioning as a digital form of money. It was created in 2008 by a person or people under the pseudonym Satoshi Nakamoto.

After graduation in 2012, Mr. Carlson-Wee became the first employee at Coinbase, a nascent cryptocurrency exchange. Until the morning of the interview, he owned only one pair of pants: jeans covered in sap from a short stint as a lumberjack. A shoestring acted as the belt. His $50,000 starting salary was paid in bitcoin.

In July 2016, Mr. Carlson-Wee quit to start one of the first-ever crypto funds out of an apartment he shared with seven roommates in San Francisco's gritty Mission District.

With a mullet, a wide collection of vintage windbreakers and a tendency to speak extemporaneously on esoteric topics, Mr. Carlson-Wee reminded some investors of the 1980s "Back to the Future" character Marty McFly.

The pitch worked: In December 2016, Union Square Ventures agreed to invest in the fledgling firm at a $5 million valuation, a steep price considering its total assets under management were roughly the same.

Venture capitalist Ramtin Naimi took a stake in Polychain at the same time, and afterward took Mr. Carlson-Wee out to lunch. Over avocado toast, he asked the manager how large Polychain could grow.

"Fifty million dollars is a great target," Mr. Carlson-Wee responded. A few months later, Mr. Naimi repeated the same question. "I think $400 million is really the right number," Mr. Carlson-Wee said.

Polychain was growing fast because cryptocurrency was suddenly mainstream. Hundreds if not thousands of startups were forming to use the blockchain, the software that underpins bitcoin. The blockchain is said to be able to help airlines track flights, banks settle accounts and grocers stock food, among other uses.

New, competing cryptocurrencies popped up rapidly via so-called initial coin offerings that could raise hundreds of millions of dollars instantly. The creators of some coins gave them away to Polychain, Mr. Carlson-Wee and other early adopters, hoping for the imprimatur of approval. Polychain would later sell some for profit.

Mr. Carlson-Wee spent hours each day at his computer, occasionally responding to strangers on social-media sites like Reddit, encouraging them to buy bitcoin and the like. More big names in Silicon Valley were beginning to invest in the fund including Sequoia Capital, Bain Capital Ventures and Peter Thiel's Founders Fund, all eager to get access and insight into the crypto phenomenon.

Around the summer of 2017, Polychain irked some of its earliest investors, including friends who had invested months earlier on little more than faith, when it demanded they each invest hundreds of thousands of dollars more. Some didn't have the cash, and were forced out. Mr. Carlson-Wee says the move was required as Polychain made changes to accommodate larger investors, and that only a small number of Polychain backers were affected.

Mr. Carlson-Wee was growing wary of onetime allies. He raged against an early backer, San Francisco firm Pantera Capital, which started a competing crypto fund while it still had access to Polychain's trading information. Mr. Carlson-Wee blocked Pantera from receiving updates on Polychain and threatened to force them and other early investors to sell their stakes, before backing down under promise of a prolonged legal fight.

In a statement, Pantera said it "denies that it misused any confidential Polychain information or otherwise violated any obligation to Polychain."

In early November, Mr. Carlson-Wee paid for around a dozen employees to fly to an oceanfront resort in Cancun. The crypto market was soaring and everyone was relaxed, say attendees; one afternoon, some in the group skipped an iPhone back-and-forth across the pool as they debated whether the device was waterproof. A few minutes later, the phone sank and was ruined.

Mr. Carlson-Wee blames a friend, Richard Craib, for the broken phone.

Mr. Craib was among the early investors having second thoughts. He had invented his own coin, dubbed the Numeraire, which briefly made him wealthy on paper as investors including Polychain bid it up. But Polychain subsequently sold some Numeraire, depressing the value of Mr. Craib's holdings. Mr. Craib shortly after redeemed his investment in Polychain funds, for what he says were unrelated reasons.

Union Square Ventures, one of Polychain's earliest backers, was also debating its investment. Polychain was racking up millions in gains, but only on paper, and the digital currency was **volatile**.

At a panel discussion during Union Square's annual investor meeting in November, one attendee asked for the firm's thoughts on Polychain. "Oh, Olaf," responded Union Square partner Albert Wenger, inserting an extended pause, according to an attendee. "He's a bit of a gunslinger."

Union Square co-founder Fred Wilson says he doesn't recall Mr. Wenger making such a comment and says the firm still has faith in Polychain. Still, Union Square decided to pull some of its money in Polychain late last year, he says, in an effort to "de-risk the investment." He says Mr. Carlson-Wee is "a quirky guy" who "makes up his own mind and figures things out in his own head."

Mr. Carlson-Wee isn't bothered by bitcoin's daily churns. On a recent weekday afternoon, he left his cellphone in his dusty, black Cadillac Escalade for a 90-minute, technology-free hike to the site of an ancient volcanic crater in the Oakland, Calif., hills.

In between digressions on movie trailers (he won't watch them, fearing spoilers) and capitalism (in a natural, but not imminent, decline), he talked about how he doesn't consider himself a trader.

"One thing I want to emphasize is that as a trader, when something doubles, you sell half -- or something like that," he says, making air quotes over the word "trader." At Polychain, he says, "We don't trade. We shift around positions."

Mr. Carlson-Wee describes his approach instead as "long-term, thesis-driven investing." This philosophy, shared by blue-chip technology investors such as Andreessen Horowitz, is that cryptocurrency is only one branch of a larger upending of the digital world. Most existing online entities, from dating applications to enterprise cloud computing, will be replaced on a less-expensive, decentralized infrastructure, the blockchain.

The question for evangelists is which of the hundreds of competing blockchain platforms will reach widespread adoption. Last year, Mr. Carlson-Wee was largely placing a bet that his favored platform, Ethereum, would win out; more than one-quarter of Polychain's main fund was invested in Ethereum, according to its most recent audit.

Ethereum is down 74% this year, and Polychain's main portfolio is down by about 31% through the end of July, the latest figures available. In communications this year with investors, the firm defended its performance as better than the crypto market at large.

Investors in the fund credit a shift from assets such as Ethereum into less-liquid, more stable stakes in crypto companies internationally. That's a less-**volatile** bet but one that's harder to get out of in the case of an extended decline.

Since the start of the year, Polychain has blocked investors from redeeming their money immediately, instead putting investments into a so-called side pocket that now makes up more than half the fund. That means investors can't cash out fully even if they want to.

Mr. Carlson-Wee is rich either way. Unlike many firms that hold illiquid assets that are paid only when they sell investments, Polychain's main fund takes its fees every year on paper gains. Mr. Carlson-Wee started last year with just $14,502 in the fund, and turned that into $150 million of fees. He cashed out $60 million, a move that raised concerns among investors about his commitment to his own fund.

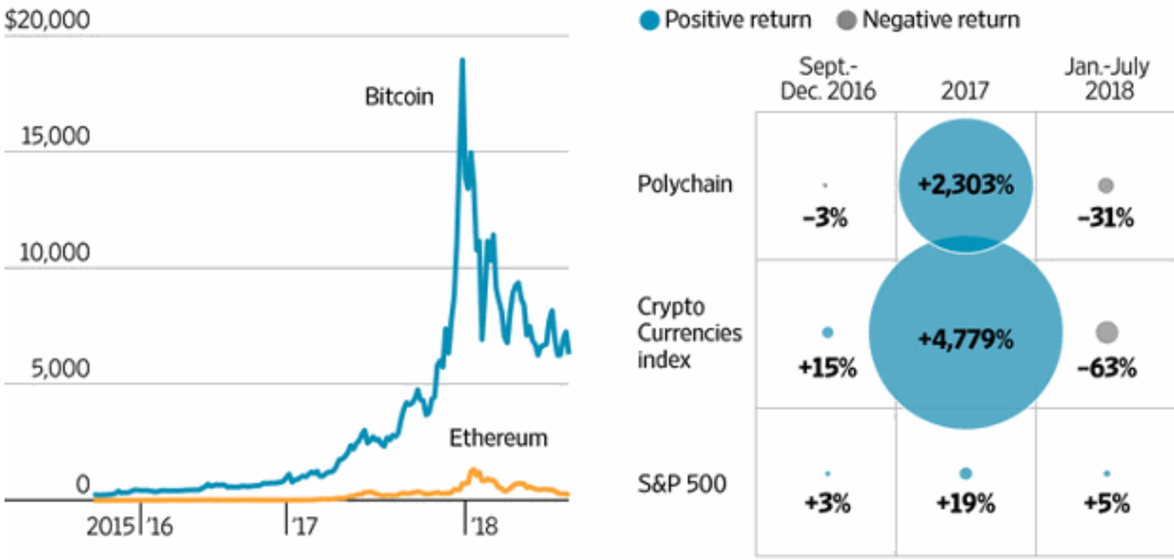
He says he set aside money for family, and subsequently invested more in the firm's funds.

"If cryptocurrencies go to zero, we go to zero," Mr. Carlson-Wee said. "I don't think anyone is under any illusions that's not the case."

A Bumpy Ride

Bitcoin and cryptocurrency competitor Ethereum have fallen sharply in value...

...while the world's biggest crypto fund, Polychain Capital, weathers dramatic swings.



Note: Fund performance net of fees.
Sources: Coindesk (prices); investors (Polychain); FactSet (S&P 500); Coin API (cryptocurrency index)

THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Indonesia Offers Reason to Worry

By Nathaniel Taplin
387 words
12 September 2018
The Wall Street Journal
J
B15
English

[Financial Analysis and Commentary]

Investors who gorged themselves on Turkish delight and Argentine beef have had a rude awakening in 2018: The two countries are at the heart of a broadening crisis that has sent emerging-market currencies tumbling.

In Asia, one name keeps coming up: Indonesia, which also has a growing trade deficit and lots of foreign debt. On paper, Indonesia has done everything right to reassure markets this summer, from raising interest rates to cutting spending and lifting import taxes.

Investors still aren't convinced. The Indonesian rupiah has dropped 10% against the dollar this year, back to levels last seen during the Asian financial crisis of the late 1990s.

Some of this can be attributed to contagion. But there are concrete reasons to refrain from bottom-fishing, even with benchmark Indonesian government-bond yields looking attractive at about 8%.

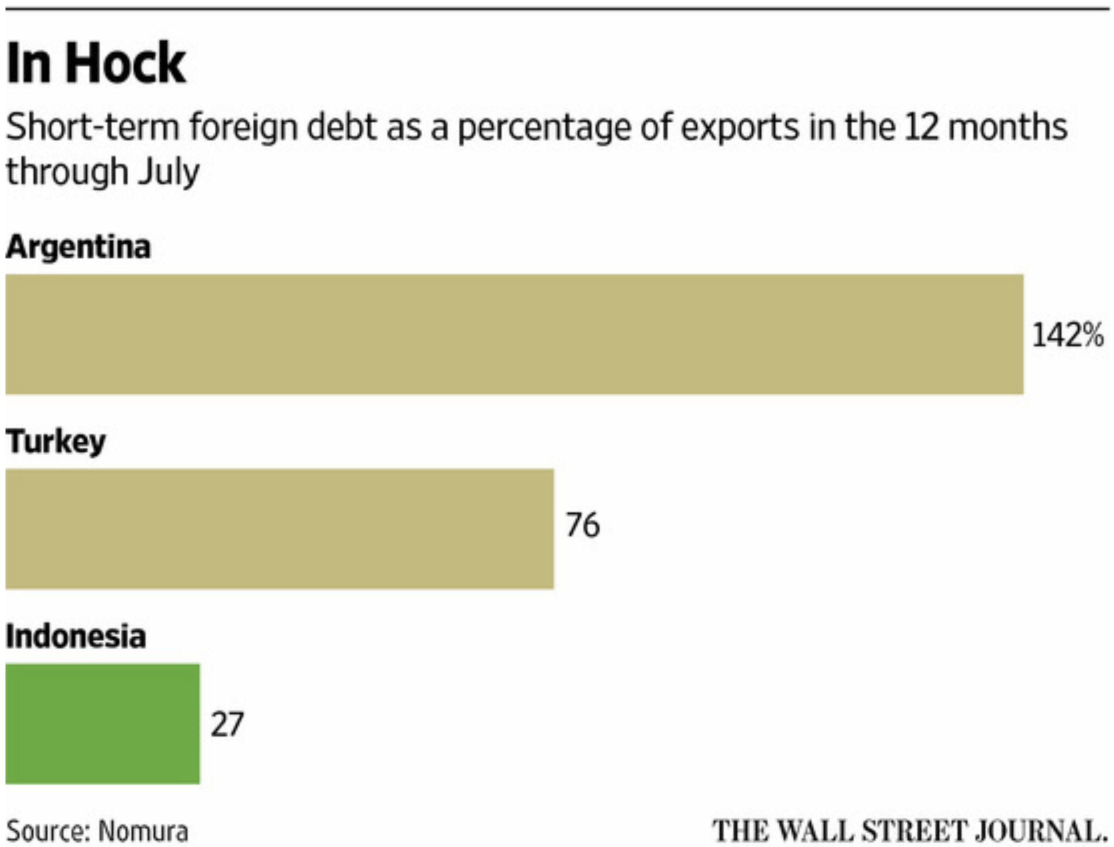
On the surface, Indonesia looks healthier than the likes of Argentina. Public debt, at 29% of GDP at the end of last year, was well below normal levels in many developed countries. And Indonesia is still earning plenty of cash from exports to help pay off its foreign creditors.

But Indonesia, like China, relies heavily on state-owned enterprises for investment -- and they aren't in great financial shape. Its top state-owned infrastructure companies had aggregate earnings before interest, taxes, depreciation and amortization equivalent to less than four times their interest expense by late 2017, according to Natixis economists Trinh Nguyen and Gary Ng, against a global median of eight times for the sector. The country's low direct government debt looks less convincing in that context.

Indonesia also looks vulnerable because it is both a big coal exporter and a net oil importer. The former makes it susceptible to a China slowdown -- prices for low-caloric value Indonesian coal have tumbled since June, while **oil prices** have remained high.

The country's monthly trade deficit in July was its largest since 2013, largely due to expensive energy imports.

Indonesia is no Turkey or Argentina, but investors are right to be concerned. Juicy bond yields notwithstanding, spelunking in Indonesia's coal mines while broader emerging markets are filling up with water looks like a risky business.



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THE WALL STREET JOURNAL.
U.S. EDITION

Lack of Volatility Sign of Investor Caution

By Amrith Ramkumar
763 words
12 September 2018
The Wall Street Journal
J
B15
English

Moves by major U.S. stock indexes have been subdued recently, a signal that investors are waiting for new catalysts before making big changes to their portfolios.

The **S&P 500** has gone 54 trading days without a move of 1% in either direction, the longest such streak since January and just the fifth time the benchmark index has moved less than 1% on 50 consecutive sessions in the past five years, according to Dow Jones Market Data.

It last moved at least 1% on June 25, falling 1.4% as trade fears gripped global markets. The **Dow Jones Industrial Average** and **Nasdaq Composite** have also been relatively calm recently, though certain sectors have at times been **volatile**.

Although trade barbs have intensified lately, with President Trump on Friday threatening tariffs on an additional $267 billion in Chinese goods, analysts say the market has grown more comfortable with the rhetoric and is now waiting for a resolution.

At the same time, investors also appear more confident that the U.S. economy can withstand gradually rising inflation and interest rates, with major indexes hardly budging after Friday's wage-growth figure matched the strongest monthly reading since 2009.

Analysts say investor comfort with the major issues dictating market moves shows many are looking for changes to that backdrop before adjusting their portfolios, a sign that the recent quiet period could continue as the third quarter comes to an end.

"The markets look like they're a little bit more in a 'wait-and-see' mode where they're used to a lot of the positioning," said Shawn Cruz, manager of trader strategy at TD Ameritrade. "It's in stark contrast to what happened earlier in the year."

Quiet summer trading has also continued into September, with lower-than-average trading volumes also contributing to the recent tranquility, analysts say. Roughly 6 billion shares on average have been traded daily on New York Stock Exchange and **Nasdaq** exchanges since the start of July, compared with the year-to-date average of 6.7 billion, according to Dow Jones Market Data.

And even though certain sectors have been **volatile** in recent weeks, other groups have often picked up the slack to stabilize the broader market.

The **S&P 500** information-technology sector fell for four consecutive sessions to start September, including a 1.5% drop Sept. 5, but other groups including telecommunications shares, industrial stocks and the utilities sector rose to largely offset the losses. Some analysts view that trend as a sign of strength because previous dips in the market's best-performing sector have often spread and sparked broader **volatility**.

Instead, Wall Street's "fear gauge," the Cboe **Volatility** Index, has largely been flat since spiking as stocks tumbled in February.

The VIX, which is based on the price of **S&P 500** options, is still near last year's historic low.

It also was low the last time the **S&P 500** went this long without a 1% move, in January.

That streak of 94 days was the longest since December 1995, as the **S&P 500** surged before tumbling during February's bout of **volatility**.

With corporate profits already growing at their quickest pace in years, some analysts think it will take a similar wave of selling or unexpected shift in economic or earnings data to jolt markets out of their recent lull.

Others think the key lies in ongoing trade discussions with China and the European Union.

Months of rhetoric between the world's two largest economies have some investors generally ignoring day-to-day headlines.

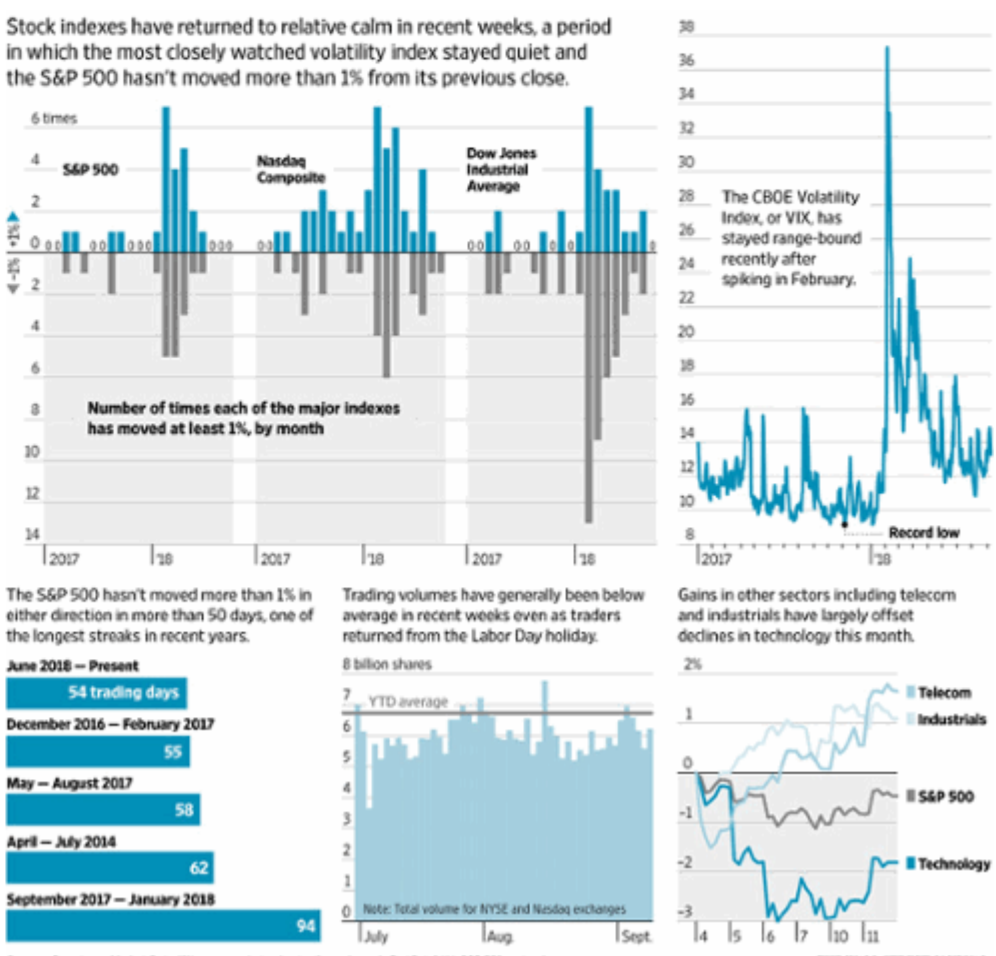
While stocks climbed after President Trump said the U.S. and Mexico had reached a trade agreement Aug. 27, the gains were contained as analysts looked ahead to progress with Canada, China and the EU.

Recent meetings between the U.S. and Canada have yielded little progress, but some investors say the most important trade talks are with China.

Growth in the world's largest consumer of a wide range of products and commodities already has shown signs of slowing, so analysts are largely shaking off rhetoric and keeping an eye on planned November meetings between Mr. Trump and Chinese leader Xi Jinping.

The two sides have laid out a path to end their fight by then, a broader goal that has taken attention away from the continuing threats.

"Markets are starting to look past that and waiting to see what actually gets done," Mr. Cruz said.



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THE WALL STREET JOURNAL.

Markets
Cars, Pigs and Handset Parts: Three Firms Show Troubles for Chinese Stocks

By Mike Bird
523 words
12 September 2018
05:09 AM
The Wall Street Journal Online
WSJO
English

Most Asian stock indexes dropped Wednesday. Hong Kong's Hang Seng fell 0.3%, as did Japan's Nikkei 225.

A 0.3% decline in the Shanghai Composite Index left the mainland Chinese stock benchmark just a fraction of a percent above the nadir it reached in January 2016.

Wednesday's Big Theme

Hong Kong's benchmark **stock index**dipped into **bear-market** territory at Tuesday's close. The index's worst-performing stocks show the breadth of the challenges facing Chinese markets.

What's Happening

The three biggest losers in the Hang Seng Index this year are Geely Automobile Holdings Ltd., AAC Technologies Holdings Inc. and WH Group Ltd. On Tuesday, the Hang Seng's decline left it more than 20% below its late-January high. But these stocks are each down by more than 40% in 2018.

Geely, like other car makers, is suffering as Chinese consumers lose confidence, denting buyers' appetite for vehicles and other big-ticket purchases. Auto sales dropped for a second-straight month in August.

Beijing's deleveraging campaign has also played a role. A series of peer-to-peer lending scandals sparked a crackdown on the practice, which is often used to fund car purchases.

Meanwhile, WH Group and AAC have both been knocked by political tensions. On Saturday, President Donald Trump called again on Apple Inc. to shift production from China to the U.S. Mr. Trump's tweet hit AAC, which is a supplier to Apple and other handset makers. Technology hardware companies like AAC are also grappling with a drop in global handset sales; a Thomson Reuters index of companies in the Asia Pacific region making electronic equipment and parts is down 18.4% this year.

WH Group makes about a third of its revenue in China. The price of soybeans, vital for feeding its pigs, has climbed in China this year after Beijing imposed tariffs on U.S. imports. The company's plan to export pork to China and elsewhere from its U.S. subsidiary Smithfield is also under threat from growing tensions over trade.

WH Group is also exposed to an outbreak of African swine fever, after 30 pigs at an external supplier were found to be infected, causing a six-week shutdown.

Market Reaction

Some analysts think trade relations may get even worse, after Mr. Trump said tariffs on another $267 billion in Chinese goods have been prepared—which would effectively expand levies to cover all the country's exports to the U.S.

"I don't believe the Trump administration is just posturing," said Kristina Hooper, chief global market strategist at Invesco. "I believe it is not only willing but eager to start a trade war with China. And I can't come up with any compelling reasons why China would acquiesce to the US's broad and confusing demands."

Elsewhere

The yuan was roughly flat against the U.S. dollar in offshore markets, with the Chinese currency at 6.8775 per greenback.

Write to Mike Bird at Mike.Bird@wsj.com

Document WSJO000020180912ee9c000jh

Economy

Carney Extends Tenure | ECB Set for a Slow Retreat | SEC Wins On Cryptocurrency Fraud | Finra Wades In | Derby's Take: New York Fed Offers a Look at R-Star; The Wall Street Journal's central banking newsletter for Wednesday, September 12, 2018

2,270 words
12 September 2018
06:20 AM
WSJ Pro Central Banking
RSTPROCB
English

Derby's Take: New York Fed Offers a Look at R-Star

Bank of England's Mark Carney Extends Tenure

ECB Set for a Slow Retreat From Easy Money

Judge Lets Cryptocurrency Fraud Case Go Forward, In Win for SEC

Finra Wades Into Cryptocurrency Enforcement

New York Fed Offers a Look at R-Star

The concept of R-star—or the natural rate of interest—is getting fresh attention at the New York Fed.

The bank recently launched a webpage showing estimates of this key variable, based on formulas that rely in large part on work done by the bank's new president, John Williams. But recent remarks by Fed Chairman Jerome Powell suggest this effort may have limited influence at the central bank.

R-star can be seen as an estimate of the long-run level of short-term interest rates minus inflation. With the Fed targeting 2% inflation, its 2.9% estimate for the longer-run federal-funds target suggests the Fed sees R-star at just under 1%. For reference, the New York Fed shows the R-star estimate for 1985 at just over 3.5%, and it has been, for the most part, on the decline since then.

The decline in R-star means the Fed doesn't have to raise rates as much to get its short-term interest-rate target to a neutral level. But it also means it doesn't have as much room to cut that rate when the next crisis arrives, increasing the risk officials will again have to resort to unorthodox stimulus strategies.

The New York Fed's tracker indicates R-star has been rising lately. But Mr. Williams in a conversation with reporters last week cautioned against making too much of that development.

That R-star view "stands out a bit because, first of all, those estimates were for a long time the lowest—among the lowest estimates out there," Mr. Williams explained. "And so they've gone from being the low end. Now they're more in the middle of the pack, if you will."

Mr. Williams also said that despite his extensive work on this issue, he doesn't view his formula as definitive. "It's important to say, I don't—first of all, don't trust any specific estimates…I look at a broad set."

Mr. Powell, in his Jackson Hole, Wyo., speech in late August, appeared to put the whole exercise of using R-star, and similar tools for other economic variables, on the back shelf.

Mr. Powell observed that calculations like R-star rely on estimating things about the economy that often have turned out to be wrong in hindsight. And that, in turn, has led the Fed to make policy mistakes.

"The stars are sometimes far from where we perceive them to be," Mr. Powell said, which suggests Fed officials should use a "a risk-management approach" to setting monetary policy that is careful not to rely too much on possibly misleading variables.

Key Developments Around the World

Bank of England's Mark Carney Extends Tenure

Bank of England Gov. Mark Carneyagreed to stay on at the central bank until 2020 to help steer the economy after the U.K. exits the European Union, the second time that Brexit has prompted the Canadian to delay his departure. His decision came as senior officials from London and Brussels reiterated they still hope to agree within the next two months on the terms of the U.K.'s withdrawal from the European Union, pushing back against concerns over the risk of an abrupt and messy break. The U.K. Treasury and the BOE said Tuesday that Mr. Carney extended his term of office by another seven months, to January 2020, to offer investors continuity during the Brexit process and give the government more time to select a successor.

ECB Set for a Slow Retreat From Easy Money

The European Central Bankis likely to confirm plans on Thursday for a slow retreat from years of easy money, brushing off concerns about a softening eurozone economy and fractious **financial markets**. The ECB's decision, announced in June, to wind down its bond purchases by the end of the year and to consider interest-rate increases in about a year's time—following the path the Federal Reserve set years ago—should better align its policies with an economy that is in its sixth straight year of growth.

Transcript: Eric Rosengren Presents Paper at Boston Fed Conference

Federal Reserve Bank of Boston President Eric Rosengren talked about the likelihood of interest rates hitting the zero lower bound again, capital buffers at banks and how the last recession affected U.S. states differently while presenting a research paper Saturday at an economic conference at his bank. Here is a transcript of his remarks.

Transcript: Rosengren Opens Boston Fed Economic Conference

Transcript: Q&A With Rosengren at Boston Fed Conference

Transcript: Cleveland Fed's Loretta Mester Speaks in Boston

Federal Reserve Bank of Cleveland President Loretta Mester discussed today's environment of low interest rates and why the U.S. central bank's rate outlook can change, during an appearance Friday at a Boston Fed conference. Here's a transcript of her comments.

FINANCIAL REGULATION ROUNDUP

Judge Lets Cryptocurrency Fraud Case Go Forward, In Win for SEC

Regulators scored a victory in their crackdown on cryptocurrency crimes as a judge ruled that initial coin offerings are subject to U.S. securities-fraud laws. Judge Raymond Dearie ruled Tuesday that Maksim Zaslavskiy would need to stand trial on fraud charges related to ICOs, rejecting the Brooklyn businessman's effort to have the case tossed out. The ruling in the Eastern District of New York was the first time a federal court had weighed in on the government's jurisdiction over ICOs in a criminal case, lawyers said. It will likely strengthen the hand of U.S. authorities going after alleged bad actors in the multibillion-dollar business.

SEC Takes First Action Against Hedge Fund Over Cryptocurrency Investments

Regulators fined a hedge-fund manager and two men who ran a website for selling cryptocurrencies in two cases that represent a new front in the government's campaign to police the market for digital assets. The settlements announced Tuesday are the Securities and Exchange Commission's first actions against a hedge fund and brokers involving virtual currencies or digital tokens.

Finra Wades Into Cryptocurrency Enforcement

The Financial Industry Regulatory Authorityhas issued its first disciplinary action involving cryptocurrencies. Finra, a self-regulatory organization, on Tuesday filed a complaint against Timothy Tilton Ayre, saying he committed securities fraud and unlawfully distributed HempCoin, an unregistered, cannabis-focused cryptocurrency security. Finra alleges in the complaint that between January 2013 and October 2016, Mr. Ayre, of Agawam, Mass., "attempted to lure public investment in his worthless public company," Rocky Mountain Ayre Inc. Mr. Ayre couldn't immediately be reached for comment.

ING Groep CFO Koos Timmermans Steps Down After Settlement

ING Groep NV said Chief Financial Officer Koos Timmermans is stepping down, a week after the Dutch lender agreed to pay a record penalty to settle an investigation on the failure of its money-laundering controls. Mr. Timmermans was a member of ING's management board and in charge of its operations in the Netherlands for much of the period covered by the investigation, ING said. Last week, the bank agreed to pay €775 million ($897.2 million) to settle the investigation by Dutch authorities on the shortcomings in its customer due-diligence policies between 2010 and 2016. The management change at ING comes amid increasing political pressure for personal accountability for corporate misconduct, analysts said.

Wednesday

8:30 a.m. EDT

U.S. Labor Department releases August PPI

9:40 a.m. EDT

St. Louis Fed's Bullard speaks on economy and monetary policy in Chicago

12:45 p.m. EDT

Fed's Brainard speaks on economic and monetary policy outlook to Detroit Economic Club

2 p.m. EDT

U.S. Federal Reserve releases beige book report on U.S. economic conditions

7:50 p.m. EDT

Bank of Japan releases August corporate goods price index

Thursday

Time N/A

Central Bank of the Republic of Turkey releases policy statement

7 a.m. EDT

Bank of England releases policy statement, minutes

7:45 a.m. EDT

European Central Bank releases policy statement

8:30 a.m. EDT

ECB's Draghi holds press conference in Frankfurt

8:30 a.m. EDT

U.S. Labor Department releases August CPI

10 a.m. EDT

Fed's Quarles testifies before Senate Banking Committee in Washington

12:15 p.m. EDT

Atlanta Fed's Bostic speaks on economy and monetary policy in Jackson, Miss.

7 p.m. EDT

Dallas Fed's Kaplan speaks at his bank

Whither Labor-Force Participation?

A Federal Reserve Bank of New York Liberty Street Economics post studies why the labor-force participation rate in the U.S. has flattened since 2016 after a nearly decadelong declining trend. "Our results imply that the tightening of labor market conditions explains about 60 percent of the flattening of the participation rate," write Rene Chalom, Fatih Karahan, Laura Pilossoph and Giorgio Topa. Still, the authors find that a strong jobs market can only do so much. They say their results "indicate that even a very robust labor market is unlikely to undo all the effects of an aging population, and that a lower labor force participation rate seems likely to persist in the future."

Repo Activity and the Leverage Ratio

The introduction of leverage ratios leads to a decline in repurchase agreements that particularly affects small lenders and nonbank financial institutions, according to Antonis Kotidis and Neeltje van Horen in a posting on Bank Underground. "Capital regulation has the potential to undermine the level playing field of small banks and nonbank financial institutions relative to their larger competitors as the increased cost of engaging in repo activity is disproportionately levied onto them," they write. Without other dealers stepping in, this implies that these smaller end-users ultimately have to pass on these costs to their clients. Furthermore, it can incentivise them to invest their cash more riskily (e.g. longer maturities or against lower quality or no collateral), it can impair their access to derivatives markets by making it harder to access high-quality securities (needed for collateral) through repo and it can increase the cost of hedging interest rate risk."

Working Less

When the financial crisis hit a decade ago, France used a program popular in Germany to cushion the effect on businesses: short-term work. Under these plans, people worked fewer hours, helping businesses reduce costs, but received subsidies to make up for lost pay. This kept people on payroll, and was especially helpful for firms facing sharp, but short-term, falls in revenues. A Bank of France paper examined the effects in France. "Short-time work had desirable properties when the Great Recession hit. But the effectiveness of short-time work hinges on its design," the authors wrote. One takeaway: "the scheme should be targeted at firms facing large drops in their revenues, and faced with credit constraints."

China Is the New Hotspot for the Products Behind the Financial Crisis

"China is celebrating the 10th anniversary of the global financial crisis with a securitization party," writes The Wall Street Journal's Andrew Peaple. "Products that became a symbol of Wall Street's unsustainable excesses a decade ago—such as mortgage-backed securities—are surging in popularity with Chinese investors. Just over $100 billion worth of asset-backed securities were issued in the first half of 2018 in China, according to S&P Global Ratings, a 44% year-over-year rise that put the country second, after the U.S., in terms of world-wide issuance. Enough differences exist between the U.S. in 2008 and China now to suggest this won't be the corner of markets that brings the global financial system to breaking point. That doesn't mean there's no cause for concern."

The number of available jobs in the U.S. exceeded the number of job seekers by more than 650,000 in July—a gap that has been growing—in a sign of an increasingly tight labor market that is altering how employers find workers.

The German economy could reach a symbolic watershed this year, crowning the government's decadelong campaign to rein in public spending in Europe, the country's finance minister said Tuesday. Olaf Scholz said Germany's public-sector debt was likely to fall in line with the European Union's fiscal rules, dropping below 60% of gross domestic product, later this year or in 2019 at the latest—for the first time since 2002.

Industrial production in the eurozone declined for the second straight month in July led by Germany and Italy, underpinning doubts about the strength of the economy ahead of Thursday's set of fresh economic projections by the European Central Bank's economists.

Send us your tips, suggestions and feedback. Write to:

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The New York Times

Business/Financial Desk; SECTB
Tech Companies Rebound; Storm Lifts Gas and Home Supply Sectors

By THE ASSOCIATED PRESS
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Stocks rallied Tuesday as technology companies continued to recover from their recent losses.

Hurricane Florence's approach lifted home improvement retailers and gas prices. Investors anticipated possible gas shortages from the storm. Wholesale gasoline futures surged 2.8 percent to $2.01 a gallon. Benchmark United States crude jumped 2.5 percent to $69.25 per barrel in New York. Brent crude, used to price international oils, rose 2.2 percent to $79.06 a barrel in London.

Home Depot rose 1.5 percent to $213.85, and Lowe's added 1.6 percent to $114.18 because damage from the storm could lead to a quick surge in sales.

According to a note published Sunday by the Morgan Stanley analyst Kai Pan, Allstate, Berkshire Hathaway and Travelers are some of the largest catastrophe insurers in the Carolinas and Virginia, and the largest property and casualty reinsurers include Axis Capital, Everest Re and RenaissanceRe. Most of those stocks inched up Tuesday but have fallen 3 to 5 percent over the last week.

The Department of Energy said it is seeing signs that shipments of oil from Iran are falling as the United States prepares to resume sanctions on the Iranian energy industry and pushes other countries to stop buying. The Energy Information Administration said there is evidence that several countries are buying significantly less oil from Iran.

Apple jumped 2.5 percent to $223.85. The Video game companies Activision Blizzard and Take-Two Interactive also jumped. Other big technology companies rose for a second day after big declines last week.

Brad McMillan, chief investment officer for Commonwealth Financial Network, said that when investors' confidence in the technology sector wavers, it tends to come back quickly because the companies are so profitable: Google and Facebook are free to use, and new users cost the companies practically nothing.

Amazon rallied 2.5 percent to $1,987.15. Microsoft picked up 1.7 percent to $111.24, and Alphabet climbed 1.3 percent to $1,189.99.

Big technology companies slumped last week as executives from Facebook and Twitter appeared before Congress at hearings about election meddling and political bias. That led to a rare decline for the sector. Facebook and Twitter have yet to recover from the big losses they absorbed in July after investors began to worry about their user growth.

The **Standard & Poor's 500**-**stockindex** rose 10.76 points, or 0.4 percent, to 2,887.89. The **Dow Jonesindustrial average** gained 113.99 points, or 0.4 percent, to 25,971.06. The **Nasdaq composite** index added 48.31 points, or 0.6 percent, to 7,972.47. The Russell 2000 index of smaller companies inched up 0.94 points, or 0.1 percent, to 1,718.40.

Chipmaker Integrated Device Technology soared after it agreed to be bought by Renesas Electronics of China for $49 a share, or $6.34 billion. IDT climbed 10.6 percent to $46.56.

Yum China Holdings dropped 13.3 percent to $31.94 after Bloomberg News reported that a Chinese consortium was ending its effort to buy the fast food company.

Bond prices fell. The yield on the **10**-**year Treasury** note rose to 2.98 percent from 2.94 percent.

The World Trade Organization says it will review China's request to be allowed to impose sanctions on the United States for failing to abide by W.T.O. rules. The dispute is linked to steps the United States took in 2013 over Chinese goods it said were "dumped," or sold for less than market value.

The dollar rose to 111.59 yen from 111.18 yen. The euro dipped to $1.1590 from $1.1596.

In other commodities trading, heating oil rose 1.5 percent to $2.25 a gallon. Natural gas added 0.9 percent to $2.83 per 1,000 cubic feet.

Gold rose to $1,195.40 an ounce. Silver fell 0.2 percent to $14.15 an ounce. Copper slipped 0.2 percent to $2.62 a pound.

CHARTS: The **S**.**&P**. **500 Index**: Position of the **S**.**& P**. **500 index** at 1-minute intervals on Tuesday. (Source: Reuters); 3-Year Treasury Notes: High yields in percent. (Source: Treasury Department)

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THE WALL STREET JOURNAL.

Markets

Hong Kong's $2.1 Trillion Benchmark Stock Index Tips Into Bear Market; The city's shares are another victim of the global selloff driven in part by trade tensions

By Saumya Vaishampayan, Michael Wursthorn and Steven Russolillo
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Hong Kong's stocks fell into a **bear market** Tuesday, another casualty of an international selloff driven by trade tensions, a stronger dollar and worries about the resilience of developing economies.

It is the latest sign that stocks around the world are feeling the pressure of the trade fight, exposing the global market's fragility to the sparring between the U.S. and major trading partners in Europe and Asia.

To date, major U.S. indexes have mostly stood their ground, hitting new highs late last month, amid strong economic data and corporate earnings. The **S&P 500** and the **Dow Jones Industrial Average** both rose 0.4% Tuesday, while the **Nasdaq Composite** added 0.6%.

But resurgent trade tensions have knocked the S&P down 0.5% so far this month, putting it on pace for its first monthly loss since March.

And shares of several big American conglomerates, including heavy-equipment maker Caterpillar Inc., car maker General Motors Co. and aluminum-products maker Arconic Inc., have tumbled more than 20% from their recent highs, meeting the common definition of a **bear market**.

Hong Kong's Hang Seng Index reached the same milestone Tuesday, following China's benchmark Shanghai Composite in June and MSCI's flagship emerging-markets index last week. Investors have been feeling pain particularly in Turkey and Argentina as indexes in those emerging markets have struggled against the rising dollar.

The overseas selloff deepened Tuesday after reports that China plans to ask the World Trade Organization for permission to impose sanctions on the U.S., which just a week earlier said an additional $267 billion in tariffs on Chinese goods were ready to go. Trade negotiations between the European Union and U.S. haven't fared much better after officials failed to reach a breakthrough Monday, pushing off the possibility of a deal to the end of September, when trade officials said they would meet again.

"The president is gearing up to use more hawkish rhetoric on trade, escalating the potential for a trade war and rising uncertainty and concern among investors," said David Page, senior economist at AXA Investment Managers. "The markets are worried about retaliation and investors are going to have to navigate that over the next couple of months."

Fears of a trade war that had seemed remote and distant earlier this year are more pronounced, say investors who worry that the additional levies on a variety of items—from agricultural goods to electronic parts—will eat into companies' profit margins and consumers' wallets. And those concerns have sapped some of the positive momentum U.S. stocks enjoyed after reporting second-quarter earnings, which saw their biggest year-over-year gain in six years, according to the Commerce Department.

The turbulence is also expected to further hamper shares of the big U.S. manufacturers that have tumbled this year. Caterpillar, which is a component of the Dow industrials, slumped 23% from its January high to its low last month and remains off 17%. Both Arconic and metals-mining company Freeport-McMoRan Inc. are down more than 30% from their highs at the beginning of the year through their recent lows. And car makers GM and Ford Motor Co. are down nearly 30% from their previous highs.

Nearly 180 companies in the **S&P 500** mentioned "tariff" at least once during their latest earnings calls, underscoring the greater focus on trade. Ford, for example, said sales in China plunged 26% in the first half, compared with the same period a year earlier, as trade tensions forced the car maker to endure its poorest first-half showing in China since 2012.

Analysts say an escalation in tariffs could cost a U.S.-based investor somewhere between 8% and 17% of their global portfolio's value, according to FactSet.

"The tone of the markets today has become somewhat anxious," Tom Stringfellow, president and chief investment officer of Frost Investment Advisors, wrote in a recent note. "While the domestic equity markets are higher on a year-to-date basis, they've not responded to the level we might have expected, given recent corporate earnings growth."

The declines have been broader in Asia, where the Hang Seng, which has a market capitalization of $2.1 trillion, dropped 0.7% Tuesday. Slightly more than half of the index's 50 components are mainland Chinese companies—including Tencent Holdings Ltd., China Construction Bank Corp. and China Mobile Ltd.—making the index highly sensitive to concerns about the health of the world's second-largest economy.

Tencent, the most valuable company listed in Hong Kong, has particularly weighed on the index. It has lost more than $200 billion in market value from a peak in January, a sum larger than the market value of all but 23 companies in the **S&P 500**.

Back in the U.S., investors credit the booming economy for the U.S. **stock market**'s strength relative to the rest of the world. Profits among American companies continue to soar and have helped to keep the broad **S&P 500 index** from tumbling much lower, investors said, and expectations continue to be robust heading into the third-quarter reporting period. FactSet estimates **S&P 500** companies will increase third-quarter profits 20% from a year earlier, which would be the third highest growth rate since the third quarter of 2010.

U.S. payrolls expanded a 95th consecutive month in August, while the unemployment rate stayed at 3.9% for a second month in a row. Wages are showing signs of moving higher after the Labor Department reported 2.9% growth from a year earlier. And the ISM survey of manufacturing is at its best since 2004.

"We remain bearly **bullish**," said Ed Keon, chief investment strategist at QMA, the $128 billion quantitative equity arm of PGIM Inc. "It's hard to underweight stocks in our global multiasset portfolios with earnings growth that is likely to be almost 25% in 2018 and GDP growth north of 3%."

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The New York Times

Feature
Magazine
Americans Want to Believe Jobs Are the Solution to Poverty. They're Not.

By Matthew Desmond
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Vanessa Solivan and her three children fled their last place in June 2015, after a young man was shot and killed around the corner. They found a floor to sleep on in Vanessa's parents' home on North Clinton Avenue in East Trenton. It wasn't a safer neighborhood, but it was a known one. Vanessa took only what she could cram into her station wagon, a 2004 Chrysler Pacifica, letting the bed bugs have the rest.

At her childhood home, Vanessa began caring for her ailing father. He had been a functional crack addict for most of her life, working as a landscaper in the warmer months and collecting unemployment when business slowed down. "It was something you got used to seeing," Vanessa said about her father's drug habit. "My dad was a junkie, but he never left us." Vanessa, 33, has black hair that is usually pulled into a bun and wire-framed glasses that slide down her nose; a shy smile peeks out when she feels proud of herself.

Vanessa's father died a year after Vanessa moved in. The family erected a shrine to him in the living room, a faded, large photo of a younger man surrounded by silk flowers and slowly sinking balloons. Vanessa's mother, Zaida, is 62 and from Puerto Rico, as was her husband. She uses a walker to get around. Her husband's death left her with little income, and Vanessa was often broke herself. Her health failing, Zaida could take only so much of Vanessa's children, Taliya, 17, Shamal, 14, and Tatiyana, 12. When things got too loud or one of her grandchildren gave her lip, she would ask Vanessa to take her children somewhere else.

If Vanessa had the money, or if a local nonprofit did, she would book a motel room. She liked the Red Roof Inn, which she saw as "more civilized" than many of the other motels she had stayed in. It looked like a highway motel: two stories with doors that opened to the outside. The last time the family checked in, the kids carried their homework up to the room as Vanessa followed with small grocery bags from the food pantry, passing two men sipping Modelos and apologizing for their loud music. Inside their room, Vanessa placed her insulin in the minifridge as her children chose beds, where they would sleep two to a mattress. Then she slid into a small chair, saying, "Y'all don't know how tired Mommy is." After a quiet moment, Vanessa reached over and rubbed Shamal's back, telling him, "I wish we had a nice place like this." Then her eye spotted a roach feeling its way over the stucco wall.

"Op! Not too nice," Vanessa said, grinning. With a flick, she sent the bug flying toward Taliya, who squealed and jerked back. Laughter burst from the room.

When Vanessa couldn't get a motel, the family spent the night in the Chrysler. The back of the station wagon held the essentials: pillows and blankets, combs and toothbrushes, extra clothes, jackets and nonperishable food. But there were also wrinkled photos of her kids. One showed Taliya at her eighth-grade graduation in a cream dress holding flowers. Another showed all three children at a quinceañera — Shamal kneeling in front, with a powder blue clip-on bow tie framing his baby face, and Tatiyana tucked in back with a deep-dimpled smile.

So that the kids wouldn't run away out of anger or shame, Vanessa learned to park off Route 1, in crevices of the city that were so still and abandoned that no one dared crack a door until daybreak. Come morning, Vanessa would drive to her mother's home so the kids could get ready for school and she could get ready for work.

In May, Vanessa finally secured a spot in public housing. But for almost three years, she had belonged to the "working homeless," a now-necessary phrase in today's low-wage/high-rent society. She is a home health aide, the same job her mother had until her knees and back gave out. Her work uniform is Betty Boop scrubs, sneakers and an ID badge that hangs on a red Bayada Home Healthcare lanyard. Vanessa works steady hours and likes her job, even the tougher bits like bathing the infirm or hoisting someone out of bed with a Hoyer lift. “I get to help people,” she said, “and be around older people and learn a lot of stuff from them.” Her rate fluctuates: She gets $10 an hour for one client, $14 for another. It doesn’t have to do with the nature of the work — “Sometimes the hardest ones can be the cheapest ones,” Vanessa said — but with reimbursement rates, which differ according to the client’s health care coverage. After juggling the kids and managing her diabetes, Vanessa is able to work 20 to 30 hours a week, which earns her around $1,200 a month. And that’s when things go well.

These days, we’re told that the American economy is strong. Unemployment is down, the **Dow Jonesindustrial average** is north of 25,000 and millions of jobs are going unfilled. But for people like Vanessa, the question is not, Can I land a job? (The answer is almost certainly, Yes, you can.) Instead the question is, What kinds of jobs are available to people without much education? By and large, the answer is: jobs that do not pay enough to live on.

In recent decades, the nation’s tremendous economic growth has not led to broad social uplift. Economists call it the “productivity-pay gap” — the fact that over the last 40 years, the economy has expanded and corporate profits have risen, but real wages have remained flat for workers without a college education. Since 1973, American productivity has increased by 77 percent, while hourly pay has grown by only 12 percent. If the federal minimum wage tracked productivity, it would be more than $20 an hour, not today’s poverty wage of $7.25.

American workers are being shut out of the profits they are helping to generate. The decline of unions is a big reason. During the 20th century, inequality in America decreased when unionization increased, but economic transformations and political attacks have crippled organized labor, emboldening corporate interests and disempowering the rank and file. This imbalanced economy explains why America’s poverty rate has remained consistent over the past several decades, even as per capita welfare spending has increased. It’s not that safety-net programs don’t help; on the contrary, they lift millions of families above the poverty line each year. But one of the most effective antipoverty solutions is a decent-paying job, and those have become scarce for people like Vanessa. Today, 41.7 million laborers — nearly a third of the American work force — earn less than $12 an hour, and almost none of their employers offer health insurance.

The Bureau of Labor Statistics defines a “working poor” person as someone below the poverty line who spent at least half the year either working or looking for employment. In 2016, there were roughly 7.6 million Americans who fell into this category. Most working poor people are over 35, while fewer than five in 100 are between the ages of 16 and 19. In other words, the working poor are not primarily teenagers bagging groceries or scooping ice cream in paper hats. They are adults — and often parents — wiping down hotel showers and toilets, taking food orders and bussing tables, eviscerating chickens at meat-processing plants, minding children at 24-hour day care centers, picking berries, emptying trash cans, stacking grocery shelves at midnight, driving taxis and Ubers, answering customer-service hotlines, smoothing hot asphalt on freeways, teaching community-college students as adjunct professors and, yes, bagging groceries and scooping ice cream in paper hats.

America prides itself on being the country of economic mobility, a place where your station in life is limited only by your ambition and grit. But changes in the labor market have shrunk the already slim odds of launching yourself from the mailroom to the boardroom. For one, the job market has bifurcated, increasing the distance between good and bad jobs. Working harder and longer will not translate into a promotion if employers pull up the ladders and offer supervisory positions exclusively to people with college degrees. Because large companies now farm out many positions to independent contractors, those who buff the floors at Microsoft or wash the sheets at the Sheraton typically are not employed by Microsoft or Sheraton, thwarting any hope of advancing within the company. Plus, working harder and longer often isn’t even an option for those at the mercy of an unpredictable schedule. Nearly 40 percent of full-time hourly workers know their work schedules just a week or less in advance. And if you give it your all in a job you can land with a high-school diploma (or less), that job might not exist for very long: Half of all new positions are eliminated within the first year. According to the labor sociologist Arne Kalleberg, permanent terminations have become “a basic component of employers’ restructuring strategies.”

Home health care has emerged as an archetypal job in this new, low-pay service economy. Demand for home health care has surged as the population has aged, but according to the latest data from the Bureau of Labor Statistics, the 2017 median annual income for home health aides in the United States was just $23,130. Half of these workers depend on public assistance to make ends meet. Vanessa formed a rapport with several of her clients, to whom she confided that she was homeless. One replied, “Oh, Vanessa, I wish I could do something for you.” When Vanessa told her supervisor about her situation, he asked if she wanted time off. “No!” Vanessa said. She needed the money and had been picking up fill-in shifts. The supervisor was prepared for the moment; he’d been there before. He reached into a drawer and gave her a $50 gas card to Shell and a $100 grocery card to ShopRite. Vanessa was grateful for the help. She thought Bayada was a generous and sympathetic employer, but her rate hadn’t changed much in the three years she had worked there. Vanessa earned $9,815.75 in 2015, $12,763.94 in 2016 and $10,446.81 last year.

To afford basic necessities, the federal government estimates that Vanessa's family would need to bring in $29,420 a year. Vanessa is not even close — and she is one of the lucky ones, at least among the poor. The nation's safety net now strongly favors the employed, with benefits like the earned-income tax credit, a once-a-year cash boost that applies only to people who work. Last year, Vanessa received a tax refund of around $5,000, which included earned-income and child tax credits. They helped raise her income, but not above the poverty line. If the working poor are doing better than the nonworking poor, which is the case, it's not so much because of their jobs per se, but because their employment status provides them access to desperately needed government help. This has caused growing inequality below the poverty line, with the working poor receiving much more social aid than the abandoned nonworking poor or the precariously employed, who are plunged into destitution.

When life feels especially grinding, Vanessa often rings up Sheri Sprouse, her best friend since middle school. "She's like me," Vanessa said. "She's strong." Sheri is a reserve of emotional support and perspective, often encouraging her friend to be patient and grateful for what she has. But Sheri herself is also just scraping by, raising two daughters on a fixed disability check. And because Sheri's housing is subsidized through a federally administered voucher, it is also monitored. "With Section 8, you can't have people staying with you," Vanessa said. "So I wouldn't want to mess that up." When Vanessa was homeless, Sheri couldn't offer her much else besides love.

Vanessa received some help last year, when her youngest child, Tatiyana, was approved for Supplemental Security Income because of a learning disability. Vanessa began receiving a monthly $766 disability check. But when the Mercer County Board of Social Services learned of this additional money, it sent Vanessa a letter announcing that her Supplemental Nutrition Assistance Program benefits would be reduced to $234 from $544. Food was a constant struggle, and this news didn't help. A 2013 study by Oxfam America found that two-thirds of working poor people worry about being able to afford enough food. When Vanessa stayed at a hotel, her food options were limited to what she could heat in the microwave; when she slept in her car, the family had to settle for grab-and-go options, which tend to be more expensive. Sometimes Vanessa stopped by a bodega and ordered four chicken-and-rice dishes for $15. Sometimes her kids went to school hungry. "I just didn't have nothing," Vanessa told me one morning. For dinner, she planned to stop by a food pantry, hoping they still had the mac-and-cheese that Shamal liked.

In America, if you work hard, you will succeed. So those who do not succeed have not worked hard. It's an idea found deep in the marrow of the nation. William Byrd, an 18th-century Virginia planter, wrote of poor men who were "intolerable lazy" and "Sloathful in everything but getting of Children." Thomas Jefferson advocated confinement in poorhouses for vagabonds who "waste their time in idle and dissolute courses." Leap into the 20th century, and there's Barry Goldwater saying that Americans with little education exhibit "low intelligence or low ambition" and Ronald Reagan disparaging "welfare queens." In 2004, Bill O'Reilly said of poor people: "You gotta look people in the eye and tell 'em they're irresponsible and lazy," and then continued, "Because that's what poverty is, ladies and gentlemen."

Americans often assume that the poor do not work. According to a 2016 survey conducted by the American Enterprise Institute, nearly two-thirds of respondents did not think most poor people held a steady job; in reality, that year a majority of nondisabled working-age adults were part of the labor force. Slightly over one-third of respondents in the survey believed that most welfare recipients would prefer to stay on welfare rather than earn a living. These sorts of assumptions about the poor are an American phenomenon. A 2013 study by the sociologist Ofer Sharone found that unemployed workers in the United States blame themselves, while unemployed workers in Israel blame the hiring system. When Americans see a homeless man cocooned in blankets, we often wonder how he failed. When the French see the same man, they wonder how the state failed him.

If you believe that people are poor because they are not working, then the solution is not to make work pay but to make the poor work — to force them to clock in somewhere, anywhere, and log as many hours as they can. But consider Vanessa. Her story is emblematic of a larger problem: the fact that millions of Americans work with little hope of finding security and comfort. In recent decades, America has witnessed the rise of bad jobs offering low pay, no benefits and little certainty. When it comes to poverty, a willingness to work is not the problem, and work itself is no longer the solution.

Until the late 18th century, poverty in the West was considered not only durable but desirable for economic growth. Mercantilism, the dominant economic theory of the early modern period, held that hunger incentivized work and kept wages low. Wards of public charity were jailed and required to work to eat. In the current era, politicians and their publics have continued to demand toil and sweat from the poor. In the 1980s, conservatives wanted to attach work requirements to food stamps. In the 1990s, they wanted to impose work requirements on subsidized-housing programs. Both proposals failed, but the impulse has endured.

Advocates of work requirements scored a landmark victory with welfare reform in the mid-1990s. Proposed by House Republicans, led by Speaker Newt Gingrich, and signed into law by President Bill Clinton, welfare reform affixed work requirements and time limits to cash assistance. Caseloads fell to 4.5 million in 2011 from 12.3 million in 1996. Did “welfare to work” in fact work? Was it a major success in reducing poverty and sowing prosperity? Hardly. As Kathryn Edin and Laura Lein showed in their landmark book, “Making Ends Meet,” single mothers pushed into the low-wage labor market earned more money than they did on welfare, but they also incurred more expenses, like transportation and child care, which nullified modest income gains. Most troubling, without guaranteed cash assistance for the most needy, extreme poverty in America surged. The number of Americans living on only $2 or less per person per day has more than doubled since welfare reform. Roughly three million children — which exceeds the population of Chicago — now suffer under these conditions. Most of those children live with an adult who held a job sometime during the year.

A top priority for the Trump administration is expanding work requirements for some of the nation’s biggest safety-net programs. In January, the federal government announced that it would let states require that Medicaid recipients work. A dozen states have formally applied for a federal waiver to affix work requirements to their Medicaid programs. Four have been approved. In June, Arkansas became the first to implement newly approved work requirements. If all states instated Medicaid work requirements similar to that of Arkansas, as many as four million Americans could lose their health insurance.

In April, President Trump issued an executive order mandating that federal agencies review welfare programs, from the Supplemental Nutrition Assistance Program to housing assistance, and propose new standards. Although SNAP already has work requirements, in June the House passed a draft farm bill that would deny able-bodied adults SNAP benefits for an entire year if they did not work or engage in work-related activities (like job training) for at least 20 hours a week during a single month. Falling short a second time could get you barred for three years. The Senate’s farm bill, a bipartisan effort, removed these rules and stringent penalties, setting up a showdown with the House, whose version Trump has endorsed. The Congressional Budget Office estimates that work requirements could deny 1.2 million people a benefit that they use to eat.

Work requirements affixed to other programs make similar demands. Kentucky’s proposed Medicaid requirements are satisfied only after 80 hours of work or work-related training each month. In a low-wage labor market characterized by fluctuating hours, tenuous employment and involuntary part-time work, a large share of vulnerable workers fall short of these requirements. Nationally representative data from the Survey of Income and Program Participation show that among workers who qualify for Medicaid, almost 50 percent logged fewer than 80 hours in at least one month.

In July, the White House Council of Economic Advisers issued a report enthusiastically endorsing work requirements for the nation’s largest welfare programs. The council favored “negative incentives,” tying aid to labor-market effort, and dismissed “positive incentives,” like tax benefits for low-income workers, because the former is cheaper. The council also claimed that America’s welfare policies have brought about a “decline in self-sufficiency.”

Is that true? Researchers set out to study welfare dependency in the 1980s and 1990s, when this issue dominated public debate. They didn’t find much evidence of it. Most people started using cash welfare after a divorce or separation and didn’t stay long on the dole, even if they returned to welfare periodically. One study found that 90 percent of young women on welfare stopped relying on it within two years of starting the program, but most of them returned to welfare sometime down the road. Even at its peak, welfare did not function as a dependency trap for a majority of recipients; rather, it was something people relied on when they were between jobs or after a family crisis. A 1988 review in Science concluded that “the welfare system does not foster reliance on welfare so much as it acts as insurance against temporary misfortune.”

Today as then, the able-bodied, poor and idle adult remains a rare creature. According to the Brookings Institution, in 2016 one-third of those living in poverty were children, 11 percent were elderly and 24 percent were working-age adults (18 to 64) in the labor force, working or seeking work. The majority of working-age poor people connected to the labor market were part-time workers. Most couldn’t take on many more hours either because of caregiver responsibilities, as with Vanessa, or because their employer didn’t offer this option, rendering them involuntary part-time workers. Among the remaining working-age adults, 12 percent were out of the labor force owing to a disability (including some enrolled in federal programs that limit work), 15 percent were either students or caregivers and 3 percent were early retirees. That leaves 2 percent of poor people who did not fit into one of these categories. That is, among the poor, two in 100 are working-age adults disconnected from the labor market for unknown reasons. The nonworking poor person getting something for nothing is a lot like the cheat committing voter fraud: pariahs who loom far larger in the American imagination than in real life.

When Vanessa was not working for Bayada, she was running after her kids. Vanessa worried over Shamal the most. At more than six feet tall, his size made him both a tool and a target in the neighborhood. Smaller kids wanted him to be their enforcer or trouble-starter. Harder kids saw him as a threat. Last year, Shamal was suspended twice for fighting. As punishment, Vanessa made him shave off his prized Afro. But she also set her children's outbursts against a larger backdrop. "How's their behavior supposed to be when we're out here on these streets?" she asked me in frustration. Shamal once told me that outsiders "probably think I'm selling drugs. But I'm not. I'm just a cool person that likes hanging out and making people laugh." He wanted to become a chef. Vanessa wondered if she could get Shamal a police-issued ankle bracelet, which would track his movements. It was impossible, of course, but Shamal liked the idea. "It could help me when my friends want me to go somewhere," he told me. That is, the bracelet would give him a good excuse to back down when his friends nudged him toward a risky path.

Shamal and Tatiyana's father had recently moved back to Trenton, "carrying a sack like a hobo," Vanessa remembered. Other than erratic child-support payments and a single trip to Chuck E. Cheese's, he doesn't play much of a role in his children's lives. Taliya's father went to prison when she was 1. He was released when she was 8 and was killed a few months later, shot in the chest. Sometimes Vanessa's three kids teased one another about their fathers. "Your dad is dead," Tatiyana would say. "Yeah? Your dad's around, but he don't give a crap about you," Taliya would shoot back.

Other times, though, the siblings offered soft reassurances that their fathers' absence wasn't their fault. "I don't have time for him," Tatiyana said once, as if it were her choice. "I have time for my real friends." Taliya looked at her baby sister and replied: "Watch. When you're doing good, he gonna start coming around."

If Vanessa clocked more hours, it would be difficult to keep up with all the ways she manages her family: doing the laundry, arranging dentist appointments, counseling the children about sex, studying their deep mysteries to extract their gifts and troubles. Yet our political leaders tend to refuse to view child care as work. During the early days of welfare reform, some local authorities thought up useless jobs for single mothers receiving the benefit. In one outrageous case, recipients were made to sort small plastic toys into different colors, only to have their supervisor end the day by mixing everything up, so the work could start anew the next morning. This was thought more important than keeping children safe and fed.

Caring for a sick or dying parent doesn't count either. Vanessa spooned arroz con gandules into her ailing father's mouth, refilled his medications and emptied his bedpan. But only when she does these things for virtual strangers, as a Bayada employee, does she "work" and therefore become worthy of concern. As Evelyn Nakano Glenn argues in her 2010 book, "Forced to Care," industrialization caused American families to become increasingly reliant on wages, which had the effect of reducing tasks that usually fell to women (homemaking, cooking, child care) to "moral and spiritual vocations." "In contrast to men's paid labor," Glenn writes, "women's unpaid caring was simultaneously priceless and worthless — that is, not monetized." She continues: "To add insult to injury, because they could not live up to the ideal of full-time motherhood, poor women of color were seen as deficient mothers and caregivers."

Vanessa attributed her own academic setbacks — a good student in middle school, she began cutting class and courting trouble in high school — to the fact that her parents were checked out. At a critical juncture when Vanessa needed guidance and discipline, her father was using drugs and her mother seemed always to be at work. She didn't want to make the same mistake with her kids. Vanessa's life revolved around a small routine: drop the kids off at school; work; try finding an apartment that rents for less than $1,000 a month; pick the kids up; feed them; sleep. She didn't spend her money on extras, including cigarettes and alcohol. She was trying to save "the little money that I got," she told me, "so when we do get a place, I can get the kids washcloths and towels."

We might think that the existence of millions of working poor Americans like Vanessa would cause us to question the notion that indolence and poverty go hand in hand. But no. While other inequality-justifying myths have withered under the force of collective rebuke, we cling to this devastatingly effective formula. Most of us lack a confident account for increasing political polarization, rising prescription drug costs, urban sprawl or any number of social ills. But ask us why the poor are poor, and we have a response quick at the ready, grasping for this palliative of explanation. We have to, or else the national shame would be too much to bear. How can a country with such a high poverty rate — higher than those in Latvia, Greece, Poland, Ireland and all other member countries of the Organization for Economic Cooperation and Development — lay claim to being the greatest on earth? Vanessa's presence is a judgment. But rather than hold itself accountable, America reverses roles by blaming the poor for their own miseries.

Here is the blueprint. First, valorize work as the ticket out of poverty, and debase caregiving as not work. Look at a single mother without a formal job, and say she is not working; spot one working part time and demand she work more. Transform love into laziness. Next, force the poor to log more hours in a labor market that treats them as expendables. Rest assured that you can pay them little and deny them sick time and health insurance because the American taxpayer will step in, subsidizing programs like the earned-income tax credit and food stamps on which your work force will rely. Watch welfare spending increase while the poverty rate stagnates because, well, you are hoarding profits. When that happens, skirt responsibility by blaming the safety net itself. From there, politicians will invent new ways of denying families relief, like slapping unrealistic work requirements on aid for the poor.

Democrats may scoff at Republicans' work requirements, but they have yet to challenge the dominant conception of poverty that feeds such meanspirited politics. Instead of offering a counternarrative to America's moral trope of deservedness, liberals have generally submitted to it, perhaps even embraced it, figuring that the public will not support aid that doesn't demand that the poor subject themselves to the low-paying jobs now available to them. Even stalwarts of the progressive movement seem to reserve economic prosperity for the full-time worker. Senator Bernie Sanders once declared, echoing a long line of Democrats who have come before and after him, "Nobody who works 40 hours a week should be living in poverty." Sure, but what about those who work 20 or 30 hours, like Vanessa?

Because liberals have allowed conservatives to set the terms of the poverty debate, they find themselves arguing about radical solutions that imagine either a fully employed nation (like a jobs guarantee) or a postwork society (like a universal basic income). Neither plan has the faintest hope of being actually implemented nationwide anytime soon, which means neither is any good to Vanessa and millions like her. When so much attention is spent on far-off, utopian solutions, we neglect the importance of the poverty fixes we already have. Safety-net programs that help families confront food insecurity, housing unaffordability and unemployment spells lift tens of millions of people above the poverty line each year. By itself, SNAP annually pulls over eight million people out of poverty. According to a 2015 study, without federal tax benefits and transfers, the number of Americans living in deep poverty (half below the poverty threshold) would jump from 5 percent to almost 19 percent. Effective social-mobility programs should be championed, expanded and stripped of draconian work requirements.

While Washington continues to require more of vulnerable workers, it has required little from employers in the form of living wages or job security, creating a labor market in which the biggest disincentive to work is not welfare but the lousy jobs that are available. Judging from the current state of the nation's poverty agenda, it appears that most people creating federal and state policy don't know many people like Vanessa. "Half of the people in City Hall don't even live in Trenton," Vanessa once told me, flustered. "They don't even know what goes on here." Meanwhile, this is the richest Congress on record, with one in 13 members belonging to the top 1 percent. From such a high perch, poverty appears a smaller problem, something less gutting, and work appears a bigger solution, something more gratifying. But when we shrink the problem, the solution shrinks with it; when small solutions are applied to a huge problem, they don't work; and when weak antipoverty initiatives don't work, many throw up their hands and argue that we should stop tossing money at the problem altogether. Cheap solutions only cheapen the problem.

This month, I had dinner with first-year honors students at a university in Massachusetts. Some leaned right, others left. But all of them were united in their inability to explain poverty in a way that didn't somehow hold the poor responsible for their predicament. Poor people lacked work ethic, they told me, or maybe a strong backbone or a commitment to a better life. I began to regret that alcohol hadn't been served when one student brought up the movie "The Pursuit of Happyness," in which Will Smith's character performs superhumanly well at his job to leap from homelessness to affluence. The student was no senator's son: He told us that times were lean after his parents divorced. As I watched this young man identify with Smith's character, it dawned on me that what his parents, preachers, teachers, coaches and guidance counselors had told him for motivation — "Study hard, stick to it, dream big and you will be successful" — had been internalized as a theory of life.

We need a new language for talking about poverty. "Nobody who works should be poor," we say. That's not good enough. Nobody in America should be poor, period. No single mother struggling to raise children on her own; no formerly incarcerated man who has served his time; no young heroin user struggling with addiction and pain; no retired bus driver whose pension was squandered; nobody. And if we respect hard work, then we should reward it, instead of deploying this value to shame the poor and justify our unconscionable and growing inequality. "I've worked hard to get where I am," you might say. Well, sure. But Vanessa has worked hard to get where she is, too.

Matthew Desmond is a contributing writer for the magazine and the author of "Evicted," which won the 2017 Pulitzer Prize for general nonfiction.

Vanessa Solivan at her mother’s house with Tatiyana and Shamal. | Devin Yalkin for The New York Times | Vanessa in the living room of her mother’s house with Tatiyana. | Devin Yalkin for The New York Times | Vanessa and her client Laura at Laura’s home in Hamilton, N.J. | Devin Yalkin for The New York Times | Vanessa and Laura going to buy groceries. | Devin Yalkin for The New York Times

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Why the 'Obama Recovery' Took So Long

By Peter J. Ferrara
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Barack Obama is back, and he wants credit for the booming economy. "When you hear how great the economy is doing right now," he said in a speech last week, "let's just remember when this recovery started." That would be in the summer of 2009, but the story is more complicated.

Milton Friedman was the first economist to notice a pattern in American economic history: The deeper the recession, the stronger the recovery. The economy has to grow even faster than normal for a while to catch up to where it would have been without the recession. The fundamentals of America's world-leading economy are so strong that the pattern held throughout the country's history.

Until the past decade. The 2008-09 recession was so bad, the economy should have come roaring back with a booming recovery -- even stronger than Reagan's boom in the 1980s. But Mr. Obama carefully, studiously pursued the opposite of every pro-growth policy Reagan had followed. What he got was the worst recovery from a recession since the Great Depression.

Before Mr. Obama, in the 11 previous recessions since the Depression, the economy recovered all jobs lost during the recession an average of 27 months after the recession began. In Mr. Obama's recovery, dating from the summer of 2009, the recession's job losses were not recovered until after 76 months -- more than six years.

America also suffered a severe recession during Reagan's early years, because of the tight monetary policy that broke the back of 1970s inflation. All the job losses from that recession were recovered after 35 months. Seventy-six months after that recession started, the number of jobs was up 12.8 million from the previous peak.

Before Mr. Obama, in the 11 previous post-Depression recessions, the economy recovered the gross domestic product lost during the recession within an average of 4.6 quarters, or a little over a year. It took Mr. Obama's recovery 14 quarters, or 3 1/2 years, to reach that point. The Reagan recovery took half that time.

Obama apologists argued America could no longer grow any faster than Mr. Obama's 2% real growth averaged over eight years. Slow growth was the "new normal." The American Dream was over. Get used to it. Hillary Clinton promised to continue Mr. Obama's economic policies. America's blue-collar voters rose up.

The recovery took off on Election Day 2016, as the **stock market** communicated. Mr. Trump's tax cuts and sweeping deregulation -- especially regarding energy -- fundamentally changed course from Mr. Obama. These policies have driven today's boom, increasing annual growth to more than 3% within six months and now to over 4%.

Will Democrats ever figure out what policies create jobs, economic growth and rising wages? If not, they'll wake up some Wednesday morning to find they have been routed in a fundamental realignment election, in which they have permanently lost the blue-collar vote -- once the backbone of their party.

Mr. Ferrara teaches economics at the King's College.

(See related letters: "Letters to the Editor: Present Economic Success Has Many Fathers" -- WSJ Sept. 18, 2018)

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The New York Times

Opinion
‘Anonymous’ Is Hiding in Plain Sight

By Thomas L. Friedman
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More and more, I wonder if the disgruntled senior Trump administration official who wrote the anonymous Op-Ed in The Times was actually representing a group — like a “Murder on the Orient Express” plotline where every senior Trump adviser was in on it. Why? Because the article so perfectly captured the devil’s bargain they’ve all struck with this president: Donald Trump is amoral, dishonest and disturbed, a man totally unfit to be president, but, as the anonymous author self-servingly wrote, “There are bright spots that the near-ceaseless negative coverage of the administration fails to capture: effective deregulation, historic tax reform, a more robust military and more.”

That’s the anonymous-G.O.P. credo today: We know Trump is a jerk, but you’ve gotta love the good stuff — you’ve got to admit that his tax cuts, deregulation, destruction of Obamacare and military buildup have fueled so much growth, defense spending and record **stock market** highs that we’re wealthier and more secure as a country, even if Trump is nuts. So our consciences are clear.

This view is not without foundation. Economic growth and employment have clearly been on a tear since Trump took office. I’m glad about that.

But what if Trump is actually heating up our economy by burning all the furniture in the house? It’s going to be nice and toasty for us — at least for a while — but where will our kids sleep?

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What if Trump’s tax cuts, deregulation, scrapping of Obamacare without any alternative and military spending surge were actually ill-thought-through, short-term-focused initiatives that all ignored expert opinion — because they mostly emerged from off-the-cuff remarks at Trump pep rallies — and collectively amount to a sugar high that not only will be unsustainable but will leave our economy far more vulnerable in the long term?

Let’s take that view for a spin: I favor corporate tax cuts — big ones. But I would have offset them with a carbon tax, a tax on sugar and a small financial transaction tax. That way, we’d unleash the energy of our corporations while mitigating climate change, spurring the next great global industry — clean power — curbing childhood asthma and diabetes and not adding to our national debt, thereby making ourselves more resilient as a country.

When Trump simultaneously cuts corporate taxes and withdraws America from the Paris climate accord, tries to revive the coal industry by lowering pollution standards and weakens fuel economy standards for U.S.-made cars and trucks, he is vastly adding to the financial debts and carbon debts that will burden our children.

And he is doing this despite many economists warning that increasing the deficit when your economy is already growing nicely is really, really reckless — because you may need that money to stimulate your way out of the next recession.

And he is doing this at a time when virtually every climate scientist has warned that global-warming-driven extreme weather events — droughts, floods and wildfires — are sharply on the rise and we are staring through the last window of time to mitigate climate change so that we can manage the impacts that are already unavoidable and avoid the impacts that will be terrifyingly unmanageable.

In June, The Associated Press reported on the latest International Monetary Fund survey of the U.S. economy, which concluded that as a result of Trump’s “tax cuts and expected increases in defense and domestic programs, the federal budget deficit as a percentage of the total economy will exceed 4.5 percent of G.D.P. by next year —

nearly double what it was just three years ago." Such a "big boost … has not been seen in the United States since President Lyndon Johnson in the late 1960s boosted spending on the Vietnam War at the same time it was adopting Johnson's Great Society programs."

Faced with so much debt, which the country will not be able to grow out of, The A.P. story continued, paraphrasing the I.M.F. report, the U.S. "may need to take politically painful steps," such as cutting Social Security benefits and imposing higher taxes on consumers. (We'll probably also have to limit spending on new roads, bridges and research.)

You might want to let your kids know that.

You might also want to share with your kids the recent study from a group of Australian climate scientists who modeled the damage to different economies if we don't work together to achieve the Paris climate accord's goal of limiting the increase in global average temperature by 2100 to less than two degrees Celsius above pre-industrial levels.

The rise in sea level will require massive movements of people and cities, and the soaring heat levels will cause losses in agricultural productivity and declines in human health across the globe. As a result, the study found, the economic impacts of ignoring the Paris limits will be "comparable to the Great Depression of the 1930s, with its global fall in G.D.P. of 15 percent, except these will occur year after year, with no way for effective redress. … Many governments around the globe won't be able to cope and will, to put it simply, fail."

There were responsible ways to cut taxes on things we want more of — like corporate investment — while boosting them on things we want less of — like carbon, reckless financial speculation and diabetes — that could have stimulated jobs and growth but also left us more financially and environmentally resilient. But both Trump and the anonymous-G.O.P. crowd rejected them, just as they rejected smart improvements to Obamacare, preferring a total scrapping.

So when Republicans say they're disgusted by Trump's ignorance and indecency but love his "deregulations" and "tax reforms" — those very sanitized words — this is what they love: taking huge fiscal and environmental risks — effectively throwing away our bumpers and spare tires that we may soon need to drive through the next financial or climate storm — for a short-term economic and political high.

How different is that from Trump's indecency? Let's be clear, Trump cheated on his wife, but his party's now cheating on their kids. You tell me who's worse.

And don't get me started on the recently signed $716 billion defense budget for the 2019 fiscal year — a spending hike so dramatic, as defense analyst Lawrence Korb pointed out, that it means since Trump took office under two years ago, "the defense budget will have grown by $133 billion, or 23 percent." And there's no major war going on.

Here again, the anonymous-Republicans equate a bigger defense budget and more weapons with strategy and strength. Thus, by definition, if Trump increased defense spending, he did something right. Did I miss the series of congressional hearings with independent military experts that addressed the question: What are the new (and old) threats we're facing today, and how will these new and vastly expensive weapons systems enable us to better address them?

Some of the smartest military analysts I know think that investing in so many big, new weapons systems is the equivalent of taking sledgehammers to droplets of quicksilver, considering that so many enemies we face today are super-empowered individuals or nations that have opted to hurt us with cheap cyberweapons and cheap but massive swarming tactics.

Did any of these Republican lawmakers take note of the Iranian naval exercise in the gulf in August? The Iranians took some big old ships from the shah's days and said "you will be the American Navy." And then they used swarming tactics to ravage those big ships — deploying scores of very small, cheap speedboats and kamikaze coastal craft, armed with light missiles and rocket-propelled grenades.

John Arquilla, a senior strategist at the Naval Postgraduate School, likes to say that in today's networked world — where ISIS was buying drones from online shopping sites and turning them into aerial grenade launchers — "many and small can beat few and large."

The Chinese, he notes, "are building sea power without a traditional navy," focusing on building hundreds of cheap, small missile and torpedo boats to take on our multibillion-dollar aircraft carriers and flotillas. Moreover, Arquilla notes, “when you have such a massive defense budget, you don’t have to ask yourself hard questions” such as: What the hell are we still doing in Afghanistan after 17 years of “failing to reroute the currents of history and culture there and make the place into a democracy by armed force?”

In sum, I believe in a robust military and U.S. global engagement. But this does not automatically translate into support for a radically higher defense budget.

So the next time anonymous-G.O.P. lawmakers tell you that while Trump is a moral wreck — and they are saving the nation from his wretchedness — they love his tax cuts, deregulation and military budget, ask them to describe the strategic vision behind that defense budget. Ask them if they really are unbothered by massively increasing the deficit at a time when our economy was already growing — just when we should be saving cash to soften our next recession. Ask them if they really think it is smart to roll back our auto mileage standards, when the last time we did that the more fuel-efficient Japanese and Korean auto industries nearly killed Detroit.

Lastly, ask them if they have kids — and how they think all these Trumpian policies that they like, even if they don’t like Trump, will serve the next generation.

President Trump promised to support the coal industry at a rally in Charleston, W.Va., in August. | Gabriella Demczuk for The New York Times | The National Debt Clock topped $21 trillion in July. | Michael Brochstein/Sipa, via Associated Press | Members of the Chinese Navy taking part in a review in the South China Sea in April. | VCG, via Getty Images

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THE WALL STREET JOURNAL.

Business

Steelworkers Demand Higher Pay as Tariffs Lift Profits; Strike authorized as employees look to get piece of 30% rise in U.S. steel prices this year

By Bob Tita
968 words
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Workers at two of the biggest U.S. steelmakers are demanding higher compensation as tariffs on foreign metal push prices and profits to their highest point in years in a buoyant economy.

Leaders for some 30,000 members of the United Steelworkers union say United States Steel Corp. and ArcelorMittal SA aren't passing those benefits to their workers, who have gone without raises in recent years even as wages have started to climb more broadly.

President Trump has said the 25% tariff his administration placed on steel imports earlier this year aimed to bring back good-paying blue collar jobs."The steel industry is one of the great things to be talking about," Mr. Trump told a crowd in North Dakota last week. "The manufacturing jobs are back."

U.S. steel companies are some of the clearest beneficiaries of the Trump administration's tariffs on foreign goods. The trade action has enabled them to raise prices in a strong economy that has boosted orders for steel.

The union's demands could put a damper of the sector's newfound fortune. Higher costs for wages and benefits would pressure steelmakers' profit margins that are only beginning to improve after many years of being squeezed by cheap imports

U.S. manufacturers in general are facing rising costs, even as they benefit from lower corporate taxes. Higher input prices, including for steel, have weighed on their business. Also wages are rising across the U.S. workforce as factories compete for a shrinking pool of available labor. Inflation is also picking up after years in low gear, putting pressure on employers to pay workers more.

"We feel we need some recognition and to share in the profits of the company," said Michael Young, president of the union local for U.S. Steel's Midwest Plant in Portage, Ind.

The United Steelworkers union is in a contract standoff with both companies. Workers have authorized union leaders to call a strike against U.S. Steel, and say they could do the same at ArcelorMittal if an agreement isn't reached soon. Contracts for both companies expired Sept. 1.

U.S. Steel said it doesn't anticipate a strike. "Talks are ongoing, and we continue to work diligently to reach a mutually agreeable conclusion," the company said. ArcelorMittal declined to comment on the strike threat.

U.S. Steel and ArcelorMittal account for 40% of the U.S. production capacity for flat-rolled steel used throughout manufacturing for products ranging from tin cans to car doors. The price of steel has risen by more than 30% this year, as the Trump administration's tariffs on foreign steel have taken effect.

U.S. Steel has forecast a more-than-60% increase in adjusted pretax income this year, compared with 2017. ArcelorMittal, which has mills throughout the world, doesn't issue a profit forecast for its U.S. operations.

A strike at either company could push domestic steel prices even higher, putting pressure on equipment and vehicle manufacturers—such as Deere & Co. and Winnebago Industries Inc.—that have already raised prices this year to cover higher costs.

Industry analysts say U.S. Steel already has higher labor expenses and older, more complicated production processes than competitors such as North Carolina-based Nucor Corp., where the workforce isn't unionized.

The contract negotiations give U.S. Steel executives an opportunity to restrain rising benefit costs, such as health insurance coverage, and align pay more closely with profits and demand, said Philip Gibbs, an analyst at KeyBanc Capital Markets.

"U.S. Steel wants and needs more labor flexibility to deal with the **volatility** in the industry," Mr. Gibbs said.

U.S. Steel workers agreed to forgo raises for three years when the recently expired contract was negotiated in 2015. The Pittsburgh-based company had been losing money amid a slump in the steel industry.

This year U.S. Steel has proposed a six-year contract with a raise of 4% in the first year and 3% in each of the next two. Annual raises would drop to 1% in the last three years, with the addition of new bonuses pegged to pretax profit. The lowest annual base wage, excluding profit-sharing and other variable pay, would rise to $71,726 in 2024 from $63,516 this year.

Union negotiators want U.S. Steel to provide bigger pay increases or drop a demand that workers pay part of their health-insurance premiums and higher copayments.

"They can use the windfalls of the tariffs and current industry climate we helped to create to pay themselves even more and then turn to us with dramatic cost shifting and wage packages that are far below what we've earned and deserve," the union wrote last week to its 16,000 members at U.S. Steel.

The union said ArcelorMittal's wage offer is also too low. The Luxembourg-based company offered a three-year contract with pay increases of 2% and 1.5% in the final two years. The union, which represents 15,000 ArcelorMittal employees, said the company also is seeking concessions on health insurance and other benefits that would cost workers more than their pay raises would provide.

"ArcelorMittal clearly intends to test our solidarity," the union said Friday in an online update on the negotiations.

Write to Bob Tita at robert.tita@wsj.com

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THE WALL STREET JOURNAL.

Markets

U.S. Stocks Gain Despite Trade Worries; Energy shares get boost from higher oil prices; Hang Seng enters bear market

By Riva Gold and Michael Wursthorn
740 words
11 September 2018
05:42 PM
The Wall Street Journal Online
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English

* U.S. stocks close higher after the day's swings

* European shares slide; Hang Seng falls into **bear market**

* Trade in focus

The **Dow Jones Industrial Average** rose more than 100 points Tuesday, as a surge in energy stocks and Apple helped the blue-chip index overcome another flare-up in trade tensions.

The Dow industrials swung 266 points from the day's low to the high to recoup an early loss and snap a two-session losing streak. Shares of energy companies such as Exxon Mobil and Chevron benefited from a lift in **oil prices**, which jumped after an attack on Libya's state-run oil company raised concerns of a possible supply disruption. Some investors also flocked to depressed shares of Apple that had fallen in the wake of comments from President Trump pressing the iPhone maker to shift production to the U.S.

While news that China will ask the World Trade Organization for permission to impose sanctions on the U.S. rattled stocks around the world, major indexes in the U.S. fared better as investors said they expected corporations to post another quarter of phenomenal earnings growth in the weeks ahead.

A humming U.S. economy has helped stave off deeper losses among shares of American companies, investors added. But markets in Europe and Asia haven't been as fortunate, as a combination of slowing growth and the specter of a trade war have driven stocks down in those regions, so much so that Hong Kong's Hang Seng Index fell into **bear-market** territory on Tuesday.

"There is very little potential upside, but there is a lot of potential downside," said Abi Oladimeji, chief investment officer at Thomas Miller Investment. "That clearly is a negative, especially at a time when I think the global growth outlook is quite precarious."

The Dow industrials added 113.99 points, or 0.4%, to 25971.06 after being down as much as 103 points earlier in the session. The **S&P 500** rose 10.76 points, or 0.4%, to 2887.89, while the **Nasdaq Composite** added 48.31 points, or 0.6%, to 7972.47.

Shares of Exxon Mobil added $1.15, or 1.4%, to $82.86, while Apple rose 5.52, or 2.5%, to 223.85 to lead the Dow industrials higher. Meanwhile, Post-it Notes maker 3M, which gets a significant portion of its revenue from overseas, shed 1.15, or 0.5%, to 211.78, and chip maker Intel fell 1.37, or 3%, to 44.93.

Even as trade concerns linger, several investors said the economic outlook in the U.S. remains upbeat. New economic data last week painted a strong U.S. economy, as wage growth picked up and the unemployment rate remained below 4%. That backdrop, along with the benefits of the sweeping tax overhaul passed last year, is expected to help companies report another quarter of double-digit profit growth, building on the 25% year-over-year jump in earnings that **S&P 500** companies reported for the three-month period ended in June.

So far, analysts estimate **S&P 500** companies' third-quarter earnings will increase 20% from a year earlier, which would be the third-fastest growth rate since the third quarter of 2010, according to FactSet.

But most other regions of the world haven't been able to keep pace with the U.S.'s growth, presenting another stumbling block to Europe and Asia as they also deal with trade.

"Europe is a very export-oriented economy, and trade is probably more important to Europe than it is to the U.S.," said Eddie Perkin, chief equity-investment officer at Eaton Vance, noting trade worries have been an overhang on the region in recent weeks but that valuations were starting to look attractive.

The Stoxx Europe 600 edged down less than 0.1%, while mixed trading in Asia sent Hong Kong's Hang Seng down for a fifth session into **bear-market** territory, defined as a 20% drop from a recent closing high.

The Shanghai Composite Index fell 0.2% to close at its lowest level since January 2016.

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Seasonal Malaise Threatens Oil Bulls

By Amrith Ramkumar
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11 September 2018
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English

U.S. **oil prices** have largely hovered between $65 and $70 a barrel since mid-July, but some analysts are worried a seasonal slowdown in demand will send prices tumbling out of that range.

Crude-oil futures settled Monday at $67.54 a barrel after falling for four consecutive sessions. **Oil prices** are up 12% for the year but are still well below their June multiyear high of $74.15 a barrel.

The supply disruptions that pushed up prices earlier in the year have largely eased, but some analysts now expect fading demand to weigh on one of the market's best-performing assets of 2018.

Energy demand typically surges in the summer during the busy travel season, and the U.S. economy has continued growing steadily, further supporting demand.

But the fall months are normally a different story for oil, which can experience a drop-off in consumption and subsequent price decline. Many refineries enter maintenance season, buying fewer barrels and contributing to weakening demand.

Signs of a possible slowdown already have started cropping up. Last Thursday's weekly government report showed a combined 5-million-barrel increase in gasoline and distillate stockpiles -- a much sharper rise than analysts expected -- and a 3.6-million-barrel rise in processed petroleum products for the week ended Aug. 31.

Prices fell on the data even though the report also showed a larger-than-expected decline in crude-oil stockpiles, a signal that traders are focusing more on hints that fall demand could drop.

"If you're in a $65-$70 range when demand is at its all-time high, what happens when demand begins to fall off?" said Stephen Schork, editor of the energy trading newsletter the Schork Report.

Ongoing trade tensions and signs of weak global growth also could dent the demand outlook for oil while supporting the dollar, analysts say.

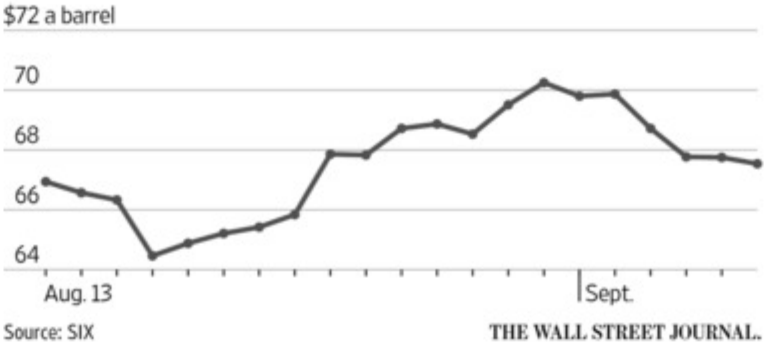
That scenario could present a further challenge because a stronger U.S. currency makes dollar-denominated commodities more expensive for overseas buyers.

Some analysts still say demand is strong enough to keep prices in their current range, noting that there is uncertainty regarding U.S. sanctions against Iran and future output from major producers.

But more **bearish** U.S. inventory data could send traders heading for the exits if a fall slowdown indeed materializes.

Contained

Some analysts think a seasonal drop in oil demand could send prices out of their current trading range between roughly $65 and $70.



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THE WALL STREET JOURNAL.
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Borrowers Struggle as Emerging Markets Slide

By Joe Wallace and Manju Dalal
755 words
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The steep falls in emerging markets have hurt the ability of developing-world companies and governments to issue bonds overseas, making it harder to pay back existing debt and putting potential pressure on economic growth there.

After a record 2017, emerging-market debt issuers raised less money abroad in June, July and August than in any summer since 2013 and the taper tantrum, when concern that the U.S. was rolling back monetary stimulus triggered a selloff across bond markets.

The current drop underscores the changing dynamics for emerging markets, which benefited from years of central-bank stimulus and a recent period of synchronized global growth. Now, U.S. interest rates are rising and the dollar is surging, making debt more expensive at a time of heightened concern over trade protectionism and domestic problems in giants such as Turkey and Argentina.

Emerging-market companies raised $28 billion in bonds outside their home market, mainly in dollars, this summer, a fall of more than 60% from last year, according to data provider Dealogic. Governments raised $21.2 billion, a decline of more than 40%.

New deals are being postponed or canceled and issuers coming to market are paying more for their dollar debt. This week, Papua New Guinea plans to issue a bond that will test investors' appetite for risk in emerging markets.

Investors and bankers expect issuance to stay subdued for the rest of the year.

"You would expect volumes to be lower than in 2017, when all the stars aligned," said Samad Sirohey, head of debt capital markets for central and Eastern Europe, the Middle East and Africa at Citigroup. But "the last four months have been really subpar," he said.

In early August, Indonesian property developer Intiland Development pulled an up-to-$250 million three-year bond deal despite offering a juicy yield of 11.5%. Theresia Rustandi, the company's corporate secretary, said they withdrew the deal because of unfavorable market conditions.

Those coming to market may have to pay more. Last week, China Petrochemical Corp., known as Sinopec, set out to raise $3 billion in debt but ended up with $2.4 billion as investors demanded a higher return from China's largest oil refiner. Sinopec didn't return phone calls seeking comment.

The concern is that a drop-off in credit growth will affect economic growth while making it harder to pay off outstanding debt. Asian companies have $38 billion of publicly issued dollar-denominated debt coming due this year, according to Dealogic.

Most analysts believe that even if bond markets remain weak during the rest of the year, most developing countries and companies should be able to ride it out. For a start, the maturity of hard-currency debt in emerging markets has lengthened in recent years, reducing the urgency that borrowers must repay or refinance outstanding debt. Issuance in some developing countries has held up well, including parts of Asia. Some companies and countries raised their money at the start of the year, expecting rates to rise, which may have front-loaded issuance in 2018, bankers say.

But if conditions remain stressed for longer, there would be a high risk of default in areas such as Turkish banks and the Argentine government, said William Jackson, an emerging-market specialist at Capital Economics.

Last week, MSCI's emerging-markets **stock index** fell into **bear-market** territory, commonly defined as a fall of 20% below its recent peak. Some currencies have gone into free fall, with Turkey's lira and Argentina's peso down 41% and 50%, respectively, against the dollarsince the start of the year.

In bond markets, yields onhard-currencyemerging-market debt have risen from 4.5% to 6%this year, according to the Bloomberg Barclays EM USD Aggregate index, which includes dollar-denominated sovereign, quasi sovereign and corporate bonds. Investors in hard-currency emerging-market debt have recorded a negative return of 3.7% this year, based on the index.

Charles Robertson, global chief economist at investment bank Renaissance Capital, said emerging-market companies are more exposed to the international bond market than they were during the financial crisis, when risk appetite also dried up and emerging markets struggled to raise cash.

That is because banks in developed economies have scaled back syndicated-loan operations outside their home markets, forcing some companies in poorer countries to turn to public bonds instead.

Christopher Whittall contributed to this article.

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WSJ PRO CENTRAL BANKING

Economy

States Face Crunch | Emerging-Market Borrowers | Trump's Tweet Corrected | ITT Trustee Sues Lenders | Timiraos's Take: What If Markets Are Wrong? The Wall Street Journal's central banking newsletter for Tuesday, September 11, 2018

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States Face Crunch If Fed's Tool Kit Is Limited

Emerging-Market Borrowers Struggle to Raise Funds

White House Corrects Trump's Tweet on GDP, Unemployment

Timiraos's Take: What If Markets Are Wrong About ‘Lower for Longer'?

ITT Bankruptcy Trustee Sues Lenders, Department of Education

What If Markets Are Wrong About ‘Lower for Longer'?

Last weekend, a Boston Fed conference cataloged the potential risks that have built up in the financial system from an era of exceptionally low interest rates.

The opening panel highlighted a risk that otherwise received little attention during the conference: What if markets and Fed officials turn out to be wrong about a structural decline in interest rates?

Jan Hatzius, chief economist at Goldman Sachs, echoed Federal Reserve Chairman Jerome Powell's recent emphasis on the uncertainty over estimates of the neutral level of interest that is estimated to prevail over the long run.

Mr. Hatzius cited Fed officials' quarterly projections of a long-run nominal rate in the so-called dot plot in calling for greater skepticism about where rates would settle as the Fed raises its short-term benchmark. "I'm not so sure how useful that [projection of the long-run rate] is because it's just very difficult to communicate how much uncertainty around that number there is," he said.

The risk, Mr. Hatzius said, is that markets grow "anchored into a view that there's no way real rates in the longer term could be back at 2%," which could lead to a nasty surprise if, in fact, neutral real rates aren't as "durably depressed" as widely believed.

So far, any market disconnect from the Fed's plans haven't been a problem. For most of the past two years, markets have expected fewer interest-rate increases from the central bank over the following 12 to 24 months than Fed officials have signaled in their quarterly projections.

Over that period, markets have moved up toward the Fed's view as inflation pressures have firmed, and this has occurred without much turbulence. Fed officials at their June meeting penciled in a total of four rate rises this year and three next year. Markets have priced in just one for next year.

A second danger would be not only that markets are underestimating how much higher interest rates will need to rise, but that Fed officials are also underrating rate increases, said Roger Ferguson, a former Fed vice chairman who is now chief executive of TIAA.

The prospect of an acceleration in price and wage pressures could force markets to more swiftly raise their rate projections, and any such rethink could ripple through stocks and other asset prices. Goldman expects the Fed will raise rates four times next year due in part to stronger price pressures.

"Where we get into trouble, by definition, is if you get an inflation scare, the Fed has to move up much more quickly," said Mr. Ferguson.

Assumptions that interest rates are likely to remain much lower than in the past have pushed up values of everything from stocks to bonds to real estate. If interest rates were to rise by more than expected, Wall Street could be in for a nasty surprise.

Key Developments Around the World

States Face Crunch If Fed's Tool Kit Is Limited in Next Recession

When the next recession comes, some states are likely to suffer much more than others if the Federal Reserve lacks ammunition to make economic downturns less severe, new research shows. In recent downturns, the Fed has cut its short-term benchmark interest rate by about 5 percentage points to stimulate growth. But in the future, that might be impossible because rates are still historically low. The Fed's benchmark rate is currently in a range between 1.75% and 2%. States with industries that are sensitive to both the economic cycle and interest rates—think of Michigan, with its heavy dependence on the auto industry—could face a much worse downturn than Midwestern states that are heavy in agriculture, which is less exposed to a cyclical downturn, the research showed.

Borrowers Struggle to Raise Funds as Emerging Markets Tumble

The steep falls in emerging markets have hurt the ability of developing-world companies and governments to issue bonds overseas, making it harder to pay back existing debt and putting potential pressure on economic growth there. The current falloff underscores the changing dynamics for emerging markets, which benefited from years of central bank stimulus and a recent period of synchronized global growth. Now, U.S. interest rates are rising and the dollar surging, making debt more expensive at a time of heightened concern over trade protectionism and domestic problems in giants like Turkey and Argentina.

White House Corrects Trump's Tweet on GDP, Unemployment

President Trump was incorrect when he tweeted that more than a century had passed since quarterly economic growth last outpaced the jobless rate, the White House's top economist said Monday. "The GDP Rate (4.2%) is higher than the Unemployment Rate (3.9%) for the first time in over 100 years!" Mr. Trump inaccurately tweeted earlier Monday. Economic data show this circumstance last occurred in early 2006, or about 12 years ago.

FINANCIAL REGULATION ROUNDUP

ITT Bankruptcy Trustee Sues Lenders, Department of Education

The bankruptcy trustee charged with cleaning up after failed for-profit schools operator ITT Educational Services Inc. is suing the U.S. Department of Education and financial backers of a private loan program, accusing them of helping ITT victimize students. Trustee Deborah J. Caruso says an assortment of financial institutions helped ITT through a loan program that allegedly preyed on low-income students who were considered credit risks. A lawyer for the lenders, a collection of investment firms from Connecticut to the Cayman Islands, couldn't immediately be reached Monday to respond to the trustee's allegations. Two of the lenders, Deutsche Bankand KKR& Co. Inc., declined to comment.

Cryptocurrency Startups Combine

Chain Inc., a startup working with **Nasdaq** Inc. and others to build a blockchain-based trading platform, is merging with another cryptocurrency startup, a sign that efforts to plug the technology behind bitcoin into the traditional markets are proving harder than expected. Lightyear Corp., a for-profit spinoff of the Stellar Foundation, will acquire Chain, combining the two companies into a new company called Interstellar, according to the Stellar Foundation.

Banks' Sharing Financial Crime Data Raises Questions on Ethics

Banks, regulators and law-enforcement agencies are sharing more intelligence through voluntary networks to deter money laundering and terrorism financing. The partnerships are evolving as a way to share patterns of criminality without regulatory burdens. But as more data is collected, these groups are facing ethical issues of privacy, disclosure and conflict of interest, according to experts who gathered last week at the International Symposium on Economic Crime at Cambridge University.

Tuesday

10 a.m. EDT

U.S. Labor Department releases July Job Openings and Labor Turnover Survey

Wednesday

8:30 a.m. EDT

U.S. Labor Department releases August PPI

9:40 a.m. EDT

St. Louis Fed's Bullard speaks on economy and monetary policy in Chicago

12:45 p.m. EDT

Fed's Brainard speaks on economic and monetary policy outlook to Detroit Economic Club

2 p.m. EDT

U.S. Federal Reserve releases beige book report on U.S. economic conditions

7:50 p.m. EDT

Bank of Japan releases August corporate goods price index

Chinese Imports and Domestic Employment Across 18 OECD Countries

Stefan Thewissen and Olaf van Vliet in a VoxEU article examine 18 Organization for Economic Cooperation and Development countries and find employment declines in sectors more exposed to imports from China. "Furthermore, within sectors, employment effects seem not to be equally shared across skill levels. The results suggest that low-skilled workers bear the brunt of the substitution of domestic production by Chinese imports, as well as of the increased competition from China in foreign export markets," they write. "All in all, we find that China's rapid rise on the global economic stage is associated with lower manufacturing employment levels and disproportionally fewer hours worked by low-skilled workers."

What Will Trigger the Next Crisis?

The person who predicts the next financial crisis, and there will be at least one, should get credit for luck rather than forecasting skill. A decade of extraordinarily low interest rates has created multiple distortions in the global economy and financial system. Any of those can unwind painfully, but predicting what factors would trigger a global downturn is near impossible. Here, five columnists from The Wall Street Journal's Heard on the Street give it a try.

Economic Confidence Is Really High. Perhaps It's Time to Sell.

Rarely have gauges of the American economy been stronger. It is time for investors to worry. Last week brought yet more strong figures from the U.S. economy, with another surprisingly strong jobs number, wages rising at the fastest since the last recession ended and the ISM survey of manufacturing the best since 2004. But if you buy because of what the economy did over the past year or the past quarter, you're making a big mistake. There is essentially no link between what the U.S. GDP did, and what stocks do over the next quarter or the next year, because what matters is what the economy will do in future, writes James Mackintosh in his latest Streetwise column.

A Return to Normalcy Will Be the Fed's Biggest Test

Federal Reserve Chairman Jerome Powell's job will get more difficult next year, as the central bank's policy rate closes in on its neutral level, writes Alan S. Blinder for The Wall Street Journal. "Hawks will clamor for more rate increases, seeking to head off inflation with rates well above the neutral level," he writes. "Doves will urge caution. Why kill the golden goose of low unemployment when inflation is nowhere in sight? How will Chairman Powell turn the coming hawk-dove battle into a workable compromise?"

Employment gains in the U.K. slowed in the three months through July and the number of people exiting the workforce rose, signs that a long spell of booming jobs growth may be coming to an end.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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Streetwise High Confidence Can Be Sell Signal for Investors

By James Mackintosh
784 words
11 September 2018
The Wall Street Journal
J
B1
English

Rarely have gauges of the American economy been stronger. It is time for investors to worry.

Last week brought yet more strong figures from the U.S. economy, with another surprisingly strong jobs number, wages rising the fastest since the last recession ended and the Institute for Supply Management survey of manufacturing the best since 2004. The previous week brought consumer- confidence measures at their highest since 2000, according to the Conference Board. What's not to like?

For investors, a lot. The problem is well-studied and should be obvious, yet continues to be ignored: When the economy is strong, stocks soar as confident investors bet that the good times will keep on rolling. When the economy struggles, investors assume it will never recover. Rather than look to the future, investors tend to extrapolate the recent past and mostly get it wrong.

This shows up most obviously by looking at how closely stocks move with gauges of consumer sentiment or the economy. Since 1974, there has been a 48% positive correlation between the change in the Conference Board consumer-confidence index and stock prices over the previous 12 months, meaning stocks have a fairly strong tendency to rise when consumers feel more positive. This should surprise nobody. Yet those who buy because of past changes will find a slight negative correlation between consumer confidence and returns over the next year -- because confidence typically doesn't keep on improving (or worsening).

There is an even more powerful effect with ISM manufacturing, frequently used as an indicator of the broader health of the U.S. economy. The 12-month change in ISM had a 44% correlation with the change in stock prices since 1974, again something which should elicit a big yawn, because we all know that when the economy gets better, stock prices rise. But the future returns have a tendency -- a notable but weak negative 20% correlation -- to move in the opposite direction. Again, it suggests investors assume that recent economic trends will continue and are wrong-footed when they don't.

The exact same effects apply to the overall economy, too. Armed with perfect hindsight, GDP is one of the best investment tools there is, as a better economy means higher share prices, and vice versa.

But if you buy because of what the economy did over the past year or the past quarter, you are making a big mistake. There is essentially no link between what U.S. GDP did and what stocks do over the next quarter or the next year, because what matters is what the economy will do in the future. If you think you know that, great, but your crystal-ball-gazing skills might not be quite so good as you imagine. Plenty of smart people are trying to predict the economy, and their record of getting it wrong is superb.

Academics Elroy Dimson, Paul Marsh and Mike Staunton in 2010 demonstrated that the same is true in lots of countries. They found no link between the latest report on the economy and future returns but a strong link between the -- unknown -- future state of the economy and future returns.

Even worse is that so many gauges are close to extremes. Buying stocks when confidence or growth is extremely high or selling when they are extremely low works even less well, because from extremes both tend to snap back a lot further. The current levels are truly extreme, with consumers more buoyant only during the excesses of the late 1960s and the late 1990s. Both times ended badly for shareholders when bubbles popped.

The hope for investors is that this time round a bubble might inflate too. Households aren't holding nearly as much debt as they were in the last economic cycle. If American consumers start to borrow to fund a spending splurge, stocks could rise a lot further -- even if it would ultimately end badly.

History provides the weakest of justifications for hope. Going back to the 1960s, on average stocks rose in the 12 months after consumer confidence came in very high, above 120 on the Conference Board index. But they only rose 3% on average, compared with the handy 14% average made by time travelers -- or perfect forecasters -- who bought 12 months before confidence rose to such levels. It was better to hold bonds than shares at such high levels, too, giving a better return and less **volatility**. Still, at least shareholders who were late to the party didn't lose money, so long as they sold promptly once confidence began to fall.

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The New York Times

Business/Financial Desk; SECTB
Market Finds Footing After Tough Week

By THE ASSOCIATED PRESS
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11 September 2018
The New York Times
NYTF
Late Edition - Final
4
English

Stocks broke a four-day losing streak on Monday as industrial companies and retailers rose. Technology companies recovered slightly from their steep losses last week.

Transportation and other industrial companies continued their recent rally, and retailers like Nike, Home Depot and Walmart all climbed. While technology companies rose over all, Apple fell after saying a new round of bigger tariffs could push it to raise prices.

CBS slipped after it announced the departure of its longtime chief executive, Leslie Moonves, and the Chinese internet retailer Alibaba skidded after it said its co-founder Jack Ma would step down as chairman in 2019.

Investors expect the United States to put new tariffs on Chinese imports soon. The Hang Seng index in Hong Kong fell 1.3 percent on Monday after President Trump again threatened to tax almost everything the United States imports from China. The index has tumbled almost 20 percent since late January as the dispute has escalated.

Randy Frederick, vice president for trading and derivatives at Charles Schwab, said investors felt China had much more to lose in the conflict than the United States did, since China exports much more to the United States than it imports from it.

''If Chinese businesses and Chinese consumers get uncomfortable with this whole battle, they get nervous and they get tentative,'' he said. ''When people do that, they stop spending.''

The **Standard & Poor's 500**-**stockindex** gained 5.45 points, or 0.2 percent, to 2,877.13. The **Dow Jonesindustrial average** lost 59.47 points, or 0.2 percent, to 25,857.07, as the health insurer UnitedHealth Group and the aerospace company Boeing traded lower.

The **Nasdaq composite** index edged up 21.62 points, or 0.3 percent, to 7,924.16. The Russell 2000 index of smaller-company stocks rose 4.29 points, or 0.3 percent, to 1,717.47.

Nike rose 2.2 percent to $82.10. The stock slumped 3 percent on Aug. 31 as investors worried about potential fallout from an advertising campaign featuring the former San Francisco 49ers quarterback Colin Kaepernick. Nike's stock has regained almost all the ground it lost since then.

Technology companies moved higher as Microsoft picked up 1.1 percent to $109.38, and Broadcom rose 3.5 percent to $240.61.

Apple fell 1.3 percent to $218.33 after it said it might raise prices on some of its products, including the Apple Watch and the Mac mini, in response to the tariffs.

CBS fell 1.5 percent to $55.20, and it has dropped 4 percent since allegations of sexual misconduct by Mr. Moonves surfaced in late July.

Alibaba slipped 3.7 percent to $156.36. The company's next chairman will be Daniel Zhang, who replaced Mr. Ma as chief executive in 2013.

In France, the CAC 40 added 0.3 percent, and the German DAX moved up 0.2 percent. In London, the FTSE 100 was unchanged as the pound climbed to $1.3026 from $1.2924.

Benchmark United States crude fell 0.3 percent to $67.54 a barrel in New York. Brent crude, used to price international oils, gained 0.7 percent to $77.37 a barrel in London.

Bond prices were little changed. The yield on the **10**-**year Treasury** note remained at 2.94 percent.

The dollar rose to 111.18 yen from 111.02 yen. The euro rose to $1.1596 from $1.1557.

Gold was steady at $1,193 an ounce. Silver rose 0.1 percent to $14.18 an ounce. Copper inched up 0.2 percent to $2.63 a pound.

This is a more complete version of the story than the one that appeared in print.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Monday. (Source: Reuters)

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Inside View: Lehman: Political and Personal

By Andy Kessler
851 words
10 September 2018
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A15
English

Lehman Brothers filed for bankruptcy on Sept. 15, 2008 -- left to twist in the wind by Treasury Secretary Hank Paulson. Ten years after, is Wall Street safe from another financial meltdown? Banks, pulling in record profits, appear to be in pretty good shape. But something seems wrong, as if the lessons of the financial crisis already have faded.

That's only an intuition, so I called someone who would know -- the former CEO of Lehman Brothers. No, not Dick Fuld, one of the public faces of Wall Street's collapse. Instead, I talked last month with Bryan Marsal, of Alvarez & Marsal, who led Lehman for the three years after its bankruptcy.

I asked Mr. Marsal why Lehman was allowed to fail and what lessons were learned. He responded with two words: political and personal. What made business or economic sense wasn't considered. Mr. Marsal explained that Mr. Paulson "had no standing in the Lehman bailout decision but seemed to dominate the entire process." The Bush administration already had bailed out Bear Stearns five months earlier, and Fannie Mae and Freddie Mac the week before. Using taxpayer money to bail out perceived Wall Street fat cats had become very unpopular.

Why was Mr. Paulson channeling Ralph Kramden? The Treasury secretary, Mr. Marsal thought, "should have taken a back seat and let the pros from the Federal Reserve drive the bus." Plus, as a former Goldman Sachs CEO, "Paulson simply didn't like Dick Fuld, and he had run out of patience." It didn't help that in 1998, when Long-Term Capital Management needed bailing out, Wall Street got together and everyone kicked in, except Mr. Fuld's Lehman.

On Sept. 9, Mr. Paulson told a group of CEOs about Lehman, "There's no government money here." Shortly thereafter, taxpayer money went into Goldman Sachs, Morgan Stanley, Citigroup and others. It seems Fed Chairman Ben Bernanke grabbed control of the bus from Mr. Paulson after the almost instant contagion and carnage from the Lehman bankruptcy. Withholding a bailout was a mistake. A subsidized merger or an orderly bankruptcy would have made more sense.

Why is this so important? Today there is nothing stopping the political and the personal from trumping rational economic decision-making in the next crisis. Sure, there's Dodd-Frank, which passed in 2010 after congressional blathering about arresting bankers. But Mr. Marsal suggested the law makes Wall Street less safe: "The Federal Reserve demonstrated that it had the power to stem a liquidity crisis before the Lehman fall, by virtue of the post-Lehman actions." But it was implicit, unstated. Now, it's explicit. Read Section 214 of Dodd-Frank: Prohibition on Taxpayer Funding. In a crisis, the Fed and Treasury could ask Congress for powers and probably get them, but that brings them back to the political and personal again.

Many of Lehman's creditors couldn't get paid back for years because much of the company's capital was domiciled in Europe. Unable to get their Lehman money, funds and individual investors sold anything liquid to have working capital and pay off debt. That's why the **stock market** sold off so hard in early 2009. Mr. Marsal explained, "In the U.S., a liquidation has its primary objective of recovery maximization to the creditors." Lehman would prepay as much as 90% of claims and finish returning all assets in 3<frac12> years.

In the U.K., on the other hand, the "primary objective is the minimization of liability to its receiver, encouraging decisions at glacier speed increasing the cost to the creditors." Ten years later in Europe, PwC is "still rolling along," presumably still collecting fees. This lesson of liquidity is rarely discussed, but it may have been the most important postbankruptcy menace.

Has anything changed? After dealing with Lehman's unwinding, Mr. Marsal had hoped for a cohesive regulatory framework from Washington. Instead the bureaucracy won. Still active and influential are the Federal Reserve, the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission -- plus the Treasury, which should stay out of bailouts, and a growing bureaucracy created by the Dodd-Frank Act. No entity is in charge, so everyone is in charge. Politics still reigns over sound policy.

There is more concentration in banks today than pre-Lehman. They're better capitalized with better reserves, but it's still fractional reserve banking. And the shadow banking business that got drenched in derivatives may be larger today than it was before the crisis. Leveraged loans are rampant. That doesn't point to stability.

In downturns, equity hurts but debt kills. Like an electrode-implanted rat that can't stop pushing a pleasure lever, banks will lend until they implode. A decade ago, the Fed failed as the lender of last resort. It's still failing at preventing the next crisis.

(See related letters: "Letters to the Editor: Considering Lehman's Failure 10 Years Later" -- WSJ Sept. 20, 2018)

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WSJ PRO CENTRAL BANKING

Economy

Transcript: WSJ Interview With Boston Fed President Eric Rosengren; The central banker weighed on economic and inflation outlook, global growth

By Nick Timiraos
2,070 words
10 September 2018
05:30 AM
WSJ Pro Central Banking
RSTPROCB
English

Boston Fed President Eric Rosengren spoke with The Wall Street Journal reporter Nick Timiraos on Saturday, Sept. 8, on the sidelines of a conference hosted by the reserve bank in Boston. He discussed the economic and inflation outlook, threats to global growth and the prospect for international spillovers to change the Fed's policy path. Here is a partial transcript of the interview, which has been lightly edited for clarity.

WSJ: Where do you think the end point is for the current tightening cycle, if that is even a fair question right now?

ERIC ROSENGREN: I think it's far enough in the future that it's not that interesting a question in that we're not very good at forecasting out two or three years. Probably focusing on what we should be doing over the next year is probably more relevant. Given where we are in the economy—we have GDP growth at roughly 3% for this quarter and next, the unemployment rate is likely to be trending down and inflation is already at our target—there is no reason that we don't get to what we think is the equilibrium interest rate. And I would say we don't know with any kind of precision what that is, but it's certainly higher than where we are now and is likely to be maybe a percentage point higher than we are now.

So the path for the next three or four hikes, unless something happens in the economy that we're not anticipating, that there is no reason we couldn't kind of gradually get up to that point. Who knows where the world is going to be at the time that we get to what we think is the equilibrium rate. When we are at that point, if we are still growing rapidly, and labor markets are very tight and inflation is above our target then its going to be pretty easy to say we need to do more, and if instead we're in a world where the economy is not growing all that much and we're right where we want to be then maybe we stay there. So I think it's very situational. And I don't think there is anything special about pausing at the point where we get to that equilibrium rate is and people are going to have different views about what that rate is and what we should be pausing even if they had that view. But I don't think there is anything special about pausing at any one point.

WSJ: So just to be clear, when you say you don't think there is anything special about pausing at that point, are you saying there is no reason to pause simply because you are at neutral?

MR. ROSENGREN: Correct. If you're at neutral but the economy is growing so rapidly that you're going to miss on your inflation rate target and your unemployment rate target and continue to miss more, then neutral is not where you want to be. So neutral is where you want to be if you are very content where you are and you don't want to move from that place.

WSJ: If I look at the central tendency in the summary of economic projections from June, you see inflation rising over the next year a little bit and you see growth slowing. If that is what happens—growth slows a little bit but inflation picks up—should you react more to one than the other because they might signal you should be doing different things with policy?

MR. ROSENGREN: If you look at what the growth is, it's above what most estimates of potential are. So as long as growth is above potential, saying labor markets are going to be tighter, inflation is going to be picking up more…I don't think anybody [had a projection that] was low enough that it would be below potential [growth] next year, which would mean [growth that is] continuing to tighten labor markets and continuing to put more upward pressure on inflation the rest of the year.

WSJ: Are you surprised we haven't seen more inflation pressure to this point?

MR. ROSENGREN: No. The Phillips curve is very flat, and wages have been going up. They've been going up quite gradually. I think if we push the economy too hard we might find that there are some nonlinearities in the Phillips curve. So I'd rather not test too much whether there are nonlinearities in the Philips curve. I think it's quite consistent with what we're doing right now, which is just gradually increasing the interest rates. And if we're right and the equilibrium rate is a little bit below 3%, we will be there…with three or four [additional quarter-percentage point rate increases] we should be in about the range. And we'll see where the economy is then.

WSJ: At the current pace, that would be roughly a year from now?

MR. ROSENGREN: Roughly a year from now.

WSJ: Do you see any reason to accelerate the pace—to raise rates in consecutive meetings?

MR. ROSENGREN: No. I'm comfortable with the gradual pace we've been doing. Inflation is right at 2%. To your previous question, we're not seeing a huge, surprising increase in inflation. So there is no reason to be moving with too much alacrity, and I would be concerned if we were moving with more alacrity, that we would run the risk that we would be curtailing the recovery that we've had. And that's the last thing I want to do is curtail the recovery.

WSJ: How do you think about federal fiscal policy in the sense that some of the fiscal impulse could fade next year? If you assume current policy, to extend spending at their current levels but not to increase them, does that change your view about the appropriate stance of policy?

MR. ROSENGREN: That's one reason we have the lower GDP for the out years, because the fiscal stimulus starts to wane. So if we're already about where we want to be, we probably don't want fiscal or monetary policy to be unduly accommodative.

WSJ: The balance sheet runoff gets to full velocity this fall. Do you expect that will raise term premia or have any other drag on growth?

MR. ROSENGREN: It's having some effect. It's pretty gradual. That was the intent—that it would be pretty gradual. So I would expect the term premium over time would be moving up not only because we are shrinking our balance sheet but because other countries are likely to get to the point where they no longer need to be nearly as accommodative as they've been. So it's not just what we're doing. It's what the [European Central Bank] is doing. It's what the Bank of Japan is doing. If we're fortunate enough that economies around the world continue to grow at a reasonable pace, they should be exiting from some of their unusual policies as well. So that combination should start pushing up term premia both here and abroad.

WSJ: On the international outlook, the minutes from the last meeting were more focused on some of the downside risks from trade policy and emerging-market developments. Turkey and Argentina aren't enough to change the U.S. outlook. But at what point could emerging market **volatility** begin to creep into your thinking, if at all, about a change in the policy stance?

MR. ROSENGREN: It is a downside risk. So if we have a broader contagion—you can imagine a scenario, a combination of tariffs and higher **oil prices** cause real stresses both on China and a lot of other emerging economies. And that might be an environment where global growth is much lower than we anticipate currently. That could be a problem for U.S. growth. We'll see if that actually materializes. That's not my expectation that that will happen, but it's one of the risks that we should be attentive to. And if it actually does occur, we wouldn't have to do as much monetary policy tightening. If the global economy slows our economy down, we don't need to slow it down as much... It's not my baseline forecast, but is it a significant risk? I think it is a significant risk.

WSJ: What indicators are you looking at to monitor whether that gets worse?

MR. ROSENGREN: If we saw global growth slowing down, if we saw it becoming more extensive to countries that didn't have clear imbalances in their own economies. A number of countries that have been hit to date are countries that have a lot of debt in dollars and exchange rates that are not stable right now, so it's not surprising that they are facing some challenges, particularly in an environment in which we are raising rates in the United States. The cost of U.S. dollar-denominated debt has been going up, and particularly if your exchange rate is going down, it makes it that much more costly for somebody who has decided to have that financing. But if you start to see countries that are not in that position start to have much more problems. If you were to see a major slowdown in China, it's a big economy, it does matter. It matters to China, but it also matters to everybody who trades with China, including ourselves.

WSJ: How has your outlook for the U.S. economy changed since the start of the year?

MR. ROSENGREN: Overall we were expecting growth around 3%, maybe a little bit below. It looks like it's going to come in a little above 3% or right around 3%. When you think of the standard errors around GDP [forecasts], we actually are pretty close to what we expected. The unemployment rate is below 4%. That is kind of what we expected. Inflation is at 2%. Given the standard errors when we make forecasts, actually I think we've done pretty well. So the economy despite the concerns about various shocks that are occurring around the world—we're on a pretty decent path. The economy is doing pretty well. It's doing about as we expected from the beginning of the year. Those are all positive things. It's not that we've hit everything perfectly, but given how much we can sometimes miss by, I don't think these are big misses at all.

WSJ: Rich Clarida and others have written about how international linkages have grown to the point that limits the ability of the U.S. to move rates too far ahead the rest of the world. How much do you buy into that story, compared to say 20 or 40 years ago, that the U.S. can diverge so much from the rest of the world?

MR. ROSENGREN: We are definitely a more open economy than we were. Net exports are an important component of GDP, so we have to be worried about that. That being said, if you're growing faster than potential and you're already at full employment and you think inflation's going to pick up, you need to slow down your economy somehow.

What that should argue is interest rates will have a much bigger impact if you start moving them. I don't know that we've seen evidence that there is a lot more sensitivity to interest-rate movements now than there was in the past, or at least the recent period, I mean maybe if you go back 20 years. I do think we have to think about what's happening in an open economy. But imports and exports are still a relatively small proportion of U.S. GDP. We're much less dependent on those channels than other countries. Yes, we have to think about it more than we used to. I'm not sure it prevents us from doing what we need to do for our domestic economy.

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THE WALL STREET JOURNAL.

Opinion
Why the 'Obama Recovery' Took So Long; The economy should have roared back. Instead it crawled.

By Peter J. Ferrara
532 words
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Barack Obama is back, and he wants credit for the booming economy. "When you hear how great the economy is doing right now," he said in a speech last week, "let's just remember when this recovery started." That would be in the summer of 2009, but the story is more complicated.

Milton Friedman was the first economist to notice a pattern in American economic history: The deeper the recession, the stronger the recovery. The economy has to grow even faster than normal for a while to catch up to where it would have been without the recession. The fundamentals of America's world-leading economy are so strong that the pattern held throughout the country's history.

Until the past decade. The 2008-09 recession was so bad, the economy should have come roaring back with a booming recovery—even stronger than Reagan's boom in the 1980s. But Mr. Obama carefully, studiously pursued the opposite of every pro-growth policy Reagan had followed. What he got was the worst recovery from a recession since the Great Depression.

Before Mr. Obama, in the 11 previous recessions since the Depression, the economy recovered all jobs lost during the recession an average of 27 months after the recession began. In Mr. Obama's recovery, dating from the summer of 2009, the recession's job losses were not recovered until after 76 months—more than six years.

America also suffered a severe recession during Reagan's early years, because of the tight monetary policy that broke the back of 1970s inflation. All the job losses from that recession were recovered after 35 months. Seventy-six months after that recession started, the number of jobs was up 12.8 million from the previous peak.

Before Mr. Obama, in the 11 previous post-Depression recessions, the economy recovered the gross domestic product lost during the recession within an average of 4.6 quarters, or a little over a year. It took Mr. Obama's recovery 14 quarters, or 3½ years, to reach that point. The Reagan recovery took half that time.

Obama apologists argued America could no longer grow any faster than Mr. Obama's 2% real growth averaged over eight years. Slow growth was the "new normal." The American Dream was over. Get used to it. Hillary Clinton promised to continue Mr. Obama's economic policies. America's blue-collar voters rose up.

The recovery took off on Election Day 2016, as the **stock market** communicated. Mr. Trump's tax cuts and sweeping deregulation—especially regarding energy—fundamentally changed course from Mr. Obama. These policies have driven today's boom, increasing annual growth to more than 3% within six months and now to over 4%.

Will Democrats ever figure out what policies create jobs, economic growth and rising wages? If not, they'll wake up some Wednesday morning to find they have been routed in a fundamental realignment election, in which they have permanently lost the blue-collar vote—once the backbone of their party.

Mr. Ferrara teaches economics at the King's College.

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THE WALL STREET JOURNAL.

Markets

Weakness Against Major Rivals Dims Dollar's Shine; The U.S. currency has surged against emerging markets, while holding relatively stable against the euro and yen

By Ira Iosebashvili
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English

This year has been a tale of two dollars.

The U.S. dollar's strength has buffeted stocks and bonds in poorer countries, raising concerns that further appreciation in coming months could destabilize the emerging world.

Yet the dollar in recent weeks has slipped against some of its developed-market peers like the euro and yen, even as the outlook for growth in some of those places has started to darken.

Investors now are grappling with the consequences of this split and how likely it is to persist or even intensify. The debate highlights the dollar's centrality to global markets and the potentially disparate consequences of trade tensions, the U.S. fiscal stimulus and expectations for more interest-rate increases from the Federal Reserve.

A weaker dollar against the yen and euro would likely be an unwelcome development in Japan and the eurozone because the gains in their currencies make exports less competitive and stifle inflation.

But that is the outcome some analysts expect as they look to year-end. The dollar's strength at the start of 2018 was just a blip in a broader downward trend that began in 2017, these analysts say.

An easing of trade tensions, the ebbing effects of U.S. tax cuts and any hesitation to tighten on the part of the Fed could spur the dollar lower, investors say.

The ICE Dollar Index, which measures the U.S. currency against a basket of six currencies including the euro and yen, has slipped 1.9% from its August peak. Those losses came even as the dollar surged in emerging markets, pummeling currencies such as the Turkish lira, Argentine peso and South African rand.

"We view the dollar strength this year as being a countertrend," said Jack McIntyre, portfolio manager at Brandywine Global, which oversees $74 billion. In late August, his fund held positions in the local-currency bonds of countries like Brazil, Mexico and Poland, which he believes have been unfairly punished and will rebound over the long term.

"The real trend is a weaker dollar," he said.

A run of solid economic data from the world's largest economies has kept the dollar relatively stable against the euro and yen.

In the U.S., Friday's jobs report showed workers' paychecks grew strongly, and the unemployment rate remained near record lows. Japan's economy returned to expansion in the second quarter after a contraction in the first three months of the year. While growth in the eurozone slipped in the second quarter, trade talks between the U.S. and Europe in July took away some uncertainty for the region's companies, and the European Central Bank's still-loose monetary policy is likely to support growth in the months ahead, analysts at ING said.

In contrast to the rout in emerging markets, Europe and Japan "are not really freaking investors out at this point in time," said Kit Juckes, a strategist at Société Générale.

Mr. Juckes estimates the dollar is about 10% overvalued against the currencies of major U.S. trade partners.

At the same time, the selling in emerging markets is unlikely to subside until the Fed indicates it is reaching the end of its current series of interest-rate increases, investors said. The dollar's gains against those currencies have rattled markets, driving stocks and bonds to multiyear lows. The MSCI Emerging Markets Index last week tipped into **bear-market** territory after a multiyear climb.

As U.S. rates creep higher, investors worry that these countries will have a difficult time servicing dollar-denominated debt accumulated in recent years. Yields in emerging markets also are becoming relatively less attractive. Rising rates in the U.S. offer investors a better payout with much less risk.

"The U.S. economy is far from a recession, and the Fed is unlikely to stop tightening just because of emerging markets," said Adnan Akant, head of currencies at BNP Paribas Asset Management. The selloff "can go on for a while, in fits and starts."

Federal-funds futures—which traders use to place bets on the course of interest rates—on Monday pointed to a 79% probability of the Fed raising rates another two or more times by the end of the year, compared with a nearly 60% probability a month ago, according to CME Group.

In the U.S., a fall in the dollar could ease pressure on multinational corporations whose earnings have suffered because they need to convert foreign profits into the U.S. currency. Globally, it could buoy commodities like oil and copper, which are priced in the U.S. currency and become more affordable to foreign buyers when the dollar weakens.

Oil prices were up 9.3% from their mid-August lows Monday, while copper prices are up 2.6%.

The dollar could still shoot higher if trade tensions mount, said Ben Randol, senior analyst of G-10 foreign-exchange strategy at Bank of America Merrill Lynch. He forecasts the euro will fall to $1.12 against the dollar in the third quarter, from around $1.16. That dollar strength is likely to be fleeting, however. The bank sees the euro strengthening to $1.20 over the next year.

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THE WALL STREET JOURNAL.

U.S. Markets
Markets

S&P 500 Rises Ahead of Economic Data; Stocks are lifted by industrial and technology companies; Apple suppliers tumble in Asia

By Jon Sindreu and Akane Otani
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10 September 2018
04:47 PM
The Wall Street Journal Online
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English

* **S&P 500**, **Nasdaq Composite** start week higher

* Shares of Apple suppliers fall in Asia

* Italian stocks and bonds rally on budget pledges

The **S&P 500** snapped a four-session losing streak Monday, buoyed by gains among industrial and technology companies, as investors looked ahead at a busy week for economic data.

Stocks opened the trading day at their highs and gave up ground shortly afterward, although the **S&P 500** and **Nasdaq Composite** managed to hold on to gains for the day.

With the second-quarter earnings season largely over, analysts said investors' attention would likely turn to economic data, with reports on producer prices, consumer prices and retail sales scheduled for release in the coming days.

Economic data have largely been upbeat this year, driving the U.S. dollar higher and helping offset investors' worries that tense trade negotiations could trigger a wave of protectionism across the globe. Many investors are looking at the U.S. midterm elections in November as a key date by which the magnitude of the trade dispute should be clearer.

"I think that after the midterm election, the trade issue will become somewhat resolved and we'll start focusing in fundamentals a bit more," said Mark Phelps, chief investment officer of concentrated global equities at AllianceBernstein.

The **S&P 500** climbed 5.45 points, or 0.2%, to 2877.13 and the **Nasdaq Composite** advanced 21.62 points, or 0.3%, to 7924.16. The **Dow Jones Industrial Average** fell 59.47 points, or 0.2%, to 25857.07.

Technology stocks advanced after losses in the sector had dragged the **Nasdaq** to its biggest one-week loss since March.

Chip maker Nvidia added $2.87, or 1.1%, to $274.73 and Advanced Micro Devices, whose price target was raised by Wells Fargo, jumped 2.51, or 9.2%, to 29.89.

Shares of industrial companies gave major indexes another boost, with United Rentals rising 7.69, or 5%, to 159.99 and notching its biggest one-day gain in more than a year after the company said it was acquiring equipment-rental company BlueLine Rental.

Meanwhile, Nike climbed 1.80, or 2.2%, to 82.10 after Wedbush raised its price target for the stock, paring declines it accumulated after unveiling an advertising campaign featuring former San Francisco 49ers quarterback Colin Kaepernick.

Elsewhere, the Stoxx Europe 600 added 0.5%, notching its biggest gain of the month, as optimism among investors about the budget that the new Italian government is set to pass later in September drove the Italian FTSE MIB higher.

Italian officials have lately signaled that they would limit spending to meet European budget rules and seek to reduce public-sector debt. That has helped reassure investors after earlier signs suggested the new ruling antiestablishment coalition would seek to defy the European Union, casting doubt on the political survival of the eurozone.

Italy's FTSE MIB jumped 2.3%, while Italian bonds also rallied, sending yields on 10-year government debt falling.

In Asia, however, Hong Kong's Hang Seng, the Shanghai Composite and Taiwan's Taiex fell more than 1% apiece as investors worried anew about flaring trade tensions between the U.S. and China.

Shares of companies that supply parts and assemble products for Apple were among the day's biggest decliners, after President Trump put pressure on the technology giant to shift production to the U.S.

iPhone assembler Hon Hai Precision Industry, known as Foxconn, fell 3.3% to a fresh two-year low.

Write to Jon Sindreu at jon.sindreu@wsj.com and Akane Otani at akane.otani@wsj.com

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THE WALL STREET JOURNAL.

Markets
Trump's Apple Tweet Takes a Bite Out of Asian Suppliers; Foxconn shares hit a two-year low

By Manju Dalal and Saumya Vaishampayan
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Hong Kong and Taiwan's main stock indexes were some of the biggest decliners in Asian trading on Monday, falling 1.3% and 1.1%, respectively. A late rebound meant Hong Kong's Hang Seng Index narrowly avoided closing in **bear-market** territory, or at least 20% below a recent peak. South Korea's Kospi and Japan's Topix ended slightly up.

Monday's Big Theme

Shares of companies that supply parts and assemble products for Apple Inc. slumped after President Trump called on the iPhone maker to shift production home.

What's Happening

Mr. Trump tweeted on Saturday that Apple should make devices in the U.S. rather than China if it wants to avoid tariffs. The comment came a day after he said tariffs on another $267 billion in Chinese goods could be rolled out on short notice.

IPhone assembler Hon Hai Precision Industry Co., better known as Foxconn, fell 3.3% to a fresh two-year low. The stock was the biggest drag on Taiwan's Taiex index, which declined 1.1%.

Also in Taiwan, shares of lens makers Genius Electronic Optical Co. and Largan Precision Co., case maker Catcher Technology Co. and rival assembler Pegatron Corp., dropped between 3% and 9%. In Hong Kong, AAC Technologies Holdings Inc., which produces acoustic parts, fell 3.6%.

AAC and Foxconn are each down more than 20% this year. Their other challenges include a global slowdown in smartphone sales.

Market Reaction

Kylie Huang, an analyst at Daiwa Capital Markets in Taipei, said suppliers' shares would suffer further if Apple agreed to move production to the U.S., but the effects would be uneven.

The biggest impact would probably be on the contract manufacturers that assemble Apple smartphones in China, such as Foxconn and Pegatron. That is because this discussion about making goods in the U.S. largely boils down to jobs, she said, and "assembly is more labor-intensive, compared with the components."

Most Apple products are assembled in China, but iPhone parts come from around the world, including Taiwan, South Korea, and the U.S. Ms. Huang said she doesn't expect Apple to change its camera-lens suppliers, for example, even if it moves some of its production to the U.S.

Elsewhere

The yuan weakened 0.4% against the dollar in onshore trading, hitting its lowest level in more than two weeks at 6.8655 per dollar.

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THE WALL STREET JOURNAL.

Markets

The Financial Crisis Made Us Afraid of Risk—For a While; Risk-taking never disappears, it just changes shape, often to slip past the institutional and psychological defenses erected after the last crisis

By Greg Ip
1,774 words
10 September 2018
05:00 PM
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Corrections & Amplifications

In 2007, 53% of American families held stocks directly or indirectly; by 2013, that had dropped to 49%. By 2016 it had returned to 52%. An earlier version of this article incorrectly said 24% of households held stocks in 2016, down from nearly 30% in 2007. (Sept. 10, 2018)

Ten years ago this month, the failure of Lehman Brothers exposed how cavalier the world had been toward risk. Households had bought homes they thought could never go down in price, banks had made loans they thought would never default and repackaged them into securities to make them seem riskless and governments, convinced depressions were a thing of the past, had stood by.

Since then, they have sought to ensure it never happens again. And thus, the world has retreated from risk. That retreat has reshaped institutions, regulations and attitudes, and in the process the economy: it is why economic growth has been so durable yet so muted, with less of the risk-taking that both drives booms and busts and raises long-run growth.

With time, even the deepest traumas wear off, and there are signs that risk-taking is returning, though in different forms from before. What remains unclear is whether it paves the way for years more of stable, crisis-free growth, or yet another bust.

The U.S. mortgage crisis and the eurozone crisis that soon followed were rooted not in the disregard for risk, but in its mispricing. The assumption that American home prices couldn't fall much nationally (since they hadn't since the 1930s) justified treating mortgages and the securities they backed as if they were government bonds. Lending to Lehman Brothers seemed safe since a systemically important U.S. financial firm had not failed since the 1930s. Lending to Greece seemed as safe as lending to Germany because they shared the same currency. That this sense of safety was so ingrained deepened the trauma when it was shattered.

Financial catastrophes usually alter attitudes to risk. Monetary historians Milton Friedman and Anna Schwartz wrote in 1963 that the Great Depression "instilled…an exaggerated fear of continued economic instability, of the danger of stagnation, of the possibility of recurrent unemployment." Americans decided to hold lots of cash. The federal government became the guarantor of economic security: banks got federal deposit insurance, the Federal Reserve devoted itself to preventing recessions, and the safety net was born with Social Security.

The global financial crisis was less severe than the Depression so the changes have been less sweeping, but they go in a similar direction. Bank regulations have expanded and tightened, cross-border financial linkages (such as via bank lending) have been truncated, and the Fed has worked far harder to support growth.

Households and investors are much warier of risk: Look no further than Treasury bonds which, adjusted for inflation, have yielded on average just 0.7% since Lehman failed, compared with more than 3% in the prior three decades. This is due both to central banks buying bonds and holding short-term rates near zero and to investors preferring safe securities to risky ones. In 2007, 53% of American families held stocks directly or indirectly; by 2013, that had dropped to 49%. By 2016 it had returned to 52%.

Jason Thomas, chief economist at private-equity manager Carlyle Group, examined the performance of hedge funds and concluded many spent the last decade preparing for the "next subprime" by investing in positions that lose modestly in ordinary times while yielding a spectacular payday when some market somewhere craters. Since the next subprime has yet to come, Mr. Thomas concludes this has cost them dearly: After outperforming the broader **stock market** by 6.6 percentage points a year from 1997 to 2009, hedge funds have since underperformed by 10.4 points.

This pessimism is why the **bull market** has lasted so long: There are fewer bulls forced to sell into downturns. The late economist Hyman Minsky anticipated the crisis with his thesis that "stability is destabilizing." Long periods of calm induce behavior and innovation that make the next downturn more violent. The converse explains the aftermath: Instability is stabilizing. "The events of 2008-09 create appreciation for the possibility of events like 2008-09, which prompts risk-reducing behavioral changes that make the system more stable," Mr. Thomas writes in a report. Among them: businesses hold more cash, banks are less leveraged, and policy makers intervene more to stabilize markets.

With less leverage and fewer channels of international contagion, financial disruptions burn themselves out before they become full-fledged crises, from the "taper tantrum" in 2013 when the Fed slowed its buying of bonds to the collapse in **oil prices** in 2014, China's bungled devaluation in 2015, and the problems now engulfing Turkey and Argentina.

The risk aversion apparent in markets shows up in the economy. A house is the biggest investment most American families can make, and far fewer make it now. In previous expansions, about 1.5 million new homes were built each year. In this one it is closer to 1 million. Young adults take longer to move out of their parents' home, marry, and have children. Some of this reflects demographic shifts that predate the crisis. Some is due to the shortage of land on which to build. But the crisis bears a lot of blame: regulators and banks have made it harder to get a mortgage and many young families see it as too risky a commitment.

Businesses have similarly lost their taste for gambling. Investment has been muted (relative to profits) while cash goes toward share repurchases and dividends. Iconic entrepreneurs like Jeff Bezos of Amazon.com Inc. and Elon Musk splurge on long-shots with high probability of failure, but it is striking how exceptional they are. Rather than become the next Google or Facebook, many startups aspire to be bought by Google or Facebook. Oil companies used to spend billions searching for oil and gas in remote and dangerous places until BP PLC was bled white by penalties and lawsuits for the Deepwater Horizon oil spill in 2010 and Royal Dutch Shell PLC spent $7 billion fruitlessly exploring north of Alaska. Now big oil plows its money into extracting oil from shale formations in the continental U.S. using hydraulic fracturing, a methodical, factory-like process with more predictable returns than deep-water drilling.

Today, nine years into a business expansion, residential and business investment together equal 17.6% of GDP, well below similar stages of previous cycles. Since investment booms often lead to busts, muted investment helps explain why the expansion is now the second longest on record. But because investment also drives productivity, it helps explain why it is one of the weakest.

One of the lessons of financial history is that risk-taking never disappears, it just changes shape, often to slip past the institutional and psychological defenses erected after the last crisis. That is already happening. Low interest rates have already bred imbalances: U.S. property and equity values are roughly back to the peaks, relative to national income, reached before the 2001 and 2007 recessions. In some foreign markets, property prices are even more extreme. Pessimism about stocks has faded, and regulators are chipping away at postcrisis financial rules.

Banks are certainly stronger than before the crisis, but innovation continues apace in the less-regulated "shadow" banking system. For example, in 2014, regulators cracked down on bank lending to highly leveraged companies. A study by three economists at the Federal Reserve Bank of New York found that leveraged lending migrated to investment banks, private-equity funds and business development companies, many of which borrowed from banks. So it isn't clear if the financial system is safer as a result. Certainly corporate leverage is at extremes, though companies have lately curbed their borrowing.

Mortgage borrowing, the culprit in countless crises through history, looks tame. But in its place a student debt bubble has inflated. Borrowing for higher education seems prudent, but then borrowing for a home was a no-brainer, too, until a decade ago. Student loans, even those that financed worthless degrees, won't tank the financial system: there aren't enough and most are federally guaranteed. But they can't be discharged in bankruptcy either (with rare exceptions), which means they'll haunt millions of borrowers for years to come.

Most emerging economies long ago abandoned the fixed exchange rates that encouraged foreign borrowing and precipitated the Mexican and Asian crises of the 1990s (and the eurozone crisis, since the euro is a type of fixed exchange rate). Yet that discipline has slipped in recent years: near-zero American interest rates encouraged emerging-market companies and governments to gorge on dollar loans, and they are being squeezed as the dollar rises against their own currencies. Turkey and Argentina may be isolated cases, or they may be the tip of the iceberg. An International Monetary Fund study recently found China's booming credit growth bore the hallmarks of an economy headed toward crisis.

The U.S. government has long been a stabilizing influence in past crises thanks to the stature of its currency, its debt, and its institutions such as the Fed and Congress. Yet arguably it is becoming a source of instability. In the past year Congress has passed a gargantuan tax cut and spending increase that, according to Deutsche Bank, represent the largest stimulus to the economy outside of a recession since the 1960s. It sets the federal debt, already the highest relative to GDP since the 1940s, on an even steeper trajectory, stimulates an economy already at or above full employment which could fuel inflation, and pressures the trade deficit—even as White House imposes tariffs on numerous trading partners in an effort to narrow it.

The U.S. can pursue such an unorthodox policy mix because in the postcrisis world investors seem ready to absorb any amount of supersafe Treasury debt, the Fed is willing to err on the side of higher inflation and the rest of the world is reluctant to antagonize the world's military and economic superpower. If any of those factors were to change, all bets are off.

Write to Greg Ip at greg.ip@wsj.com

The Crisis: A Decade Later

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THE WALL STREET JOURNAL.

Markets

Why the Traditional Way of Measuring 'Value' Stocks May Be History; Some argue that the price-to-book-value ratio has lost its relevance due to the increasing significance of intangible assets

By Mark Hulbert
1,243 words
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10:10 PM
The Wall Street Journal Online
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English

Is "value" dead? Or have we just been measuring it in the wrong way?

It's an urgent question, because value stocks—when defined according to the traditional criterion, low price-to-book-value ratios—have lagged behind growth stocks for at least a decade now. And though value stocks in the past have come roaring back after going through similarly long periods of lagging, some researchers are questioning whether they will do so again.

That's because a growing percentage of companies' market value now comes from intangible assets—things like patents, trademarks and research-and-development expenditures—that are either ignored in the book-value calculation or reflected inconsistently. Therefore, the researchers say, the price-to-book ratio has lost its relevance.

If they are right, we can't expect stocks with the lowest such ratios to reassert their historical dominance over stocks with the highest ratios. And it may call for using a new measure that more accurately measures value, once again allowing investors to feel comfortable about following a value strategy.

What is clear is that value as a stock-picking style has been a laggard in recent years. Over the past decade, growth stocks (as presented by the 50% of stocks with the highest price-to-book ratios) beat value by 1.9 annualized percentage points, according to data from Dartmouth CollegeProf. Kenneth French. That's a huge reversal from the previous eight decades, during which value (the 50% of stocks with the lowest price-to-book ratios) beat growth by 4.6 annualized percentage points.

There also can be little doubt that intangibles have grown in importance. According to Ocean Tomo, an intellectual-property consulting firm, 84% of the **S&P 500**'s market capitalization now comes from intangible assets, up from just 17% in 1975.

Losing relevance

Baruch Lev, a professor of accounting and finance at New York University, is one of those arguing most forcefully that the increasing significance of intangible assets is the leading cause of book value's loss of relevance. He says that the accounting treatment of intangible assets—under GAAP, or generally accepted accounting principles—is both outdated and inconsistent: When a company invests in developing patents, its brand or efficient business processes, for example, GAAP requires that the investment be treated as an expense rather than as an asset. But if the company buys an intangible asset instead of generating it internally, then GAAP calls for it to be listed as an asset on its balance sheet.

"Every aspect of the financial report is adversely affected by this dated, industrial-age treatment of intangible capital," Prof. Lev argued in his 2016 book, "The End of Accounting and the Path Forward for Investors and Managers," co-written with Feng Gu, a professor of accounting and law at the University at Buffalo. "And given the likely continued rise in the role of intangibles in corporate value creation, the decline in the usefulness of financial reports is all but certain to persist."

To be sure, not everyone is ready to write the price-to-book ratio's obituary. In an interview, Kent Daniel, a finance professor at Columbia University and a former co-chief investment officer at Goldman Sachs, acknowledges that GAAP's treatment of intangible assets leaves much to be desired. But he says the price-to-book ratio has always been an imperfect and noisy measure of a firm's value. For example, book value has never "captured the value of a firm's growth prospects at all." So its failure to fully and accurately reflect the value of intangible assets doesn't necessarily mean that it isn't able to do a decent job differentiating between underpriced and overpriced stocks.

In fact, Prof. Daniel says some researchers have found that the book-to-value ratio actually does a better job differentiating among companies that have spent the most on R&D than with firms that spend the least. Investment in R&D, of course, is one of the most significant categories of intangible assets.

Another clue that the price-to-book ratio may still be relevant comes when using it to forecast the **S&P 500**'s return over the subsequent 10 years. Its record since 1975 has been better than it was over the prior five decades.

Book value's problems

If the price-to-book ratio is still somewhat effective, then why has value lagged behind growth in recent years?

One answer comes from a study set to appear in the Journal of Financial Economics. Ray Ball, an accounting professor at the University of Chicago and a co-author, says the source of the deterioration is that book value has come to be dominated by one of its two main components.

This offending category is "contributed capital," or the sum of all of a company's past equity issuances, less share repurchases. Though a ratio of price to contributed capital per share has never had much predictive value, this didn't affect the effectiveness of the price-to-book ratio so long as contributed capital represented a small share of book value, Prof. Ball says. But as it has grown to be a larger share, the price-to-book ratio has lost much of its relevance.

The other major component of book value is retained earnings, and Prof. Ball says that a ratio of price to retained earnings per share remains as effective an indicator as ever in predicting stock returns. His recommendation to investors who have been relying on the price-to-book ratio is to focus instead on this modified ratio based on retained earnings.

Prof. Ball's recommendation points to a broader theme shared by many value-oriented advisers: "Value" is better seen as a reflection of many different indicators rather than of just book value alone. In a 2015 study in the Journal of Portfolio Management, Clifford Asness, founding co-principal of AQR Capital Management, along with three colleagues, mentioned the ratios of price to earnings, dividend, cash flow and sales. The study found that a composite value indicator based on these many different measures produced better risk-adjusted returns than the price-to-book ratio alone.

A long wait

Regardless of how value has been defined, however, the fact remains that value stocks on average have performed dismally over the past decade. But Prof. Daniel reminds us that value in the 1990s went through a similarly long period in which it lagged behind growth, and then—following the bursting of the internet-stock bubble—came roaring back.

"I would guess that something similar will occur in the future, but I'm not sure," he says, "and I've been wrong for a long time now!"

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* Reid Hoffman's Best and Worst Bets

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WSJ PRO BANKRUPTCY

Pro Bankruptcy

Reforms Haven't Eliminated Risk of Another Lehman-Type Failure; A non-bank firm would still file bankruptcy if not a SIFI, loopholes still promote low disclosure of off-balance sheet debt

By Francine McKenna, MarketWatch
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Reforms made in response to the bankruptcy of Lehman Brothers in 2008 won't prevent a repeat, experts told MarketWatch.

As the 10th anniversary of the Sept. 15, 2008 bankruptcy of investment bank Lehman Brothers approaches, MarketWatch looked at whether the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and other reforms will prevent another financial crisis if there's a messy failure of a non-bank financial institution like Lehman.

According to the law's preamble, Dodd-Frank's purpose is,"To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end too big to fail, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices and for other purposes."

MarketWatch looked at two areas of reform resulting from Lehman's bankruptcy and the effect the failure had on the financial crisis: the new Dodd-Frank orderly resolution authority that replaced bankruptcy for "too big to fail" banks, and the elimination by accounting standard setters of the loophole that enabled the use of Repo 105, an accounting technique Lehman that also allowed balance sheet "window dressing."

Anton Valukas, the Lehman bankruptcy examiner, wrote in 2010 that determining whether the bankruptcy filing made the financial crisis worse was beyond the scope of his investigation. However, what happened next suggests the Lehman bankruptcy filing had a significant impact on the depth of the crisis.

— The **Dow Jones Industrial Average** plunged 504 points on September 15, 2008.

— American International Group was on the verge of collapse on Sept. 16 and the government intervened with a financial bailout package that ultimately cost more $182 billion.

— Also on Sept. 16, the Primary Fund, a $62 billion money market fund, announced that because of the loss it suffered on its exposure to Lehman, it had "broken the buck," that is, its share price had fallen to less than $1 per share.

— On Oct. 3, 2008, President Bush signed the $700 billion Troubled Asset Relief Program, or TARP, rescue package into law.

In 2008, the Fed did have broad authority to lend to banks in trouble "in unusual and exigent circumstances" as long as the loan was "secured to the satisfaction of the Federal Reserve Bank," according to the Federal Reserve Act. At the time of Lehman's troubles, however, there were significant disagreements about the "true value" of Lehman's assets and whether it was insolvent or not.

Laurence Ball, an economics professor at Johns Hopkins University, told MarketWatch in July that the official version of why Lehman received no government bailout and had to file bankruptcy is incorrect.

"At this point it is possible to go back and put together the numbers, there is enough data on what Lehman's assets were, what its liquidity needs were, and if one actually does that exercise, it is clear that Lehman did have ample collateral for the loan it needed to survive. So, if the Fed had asked is there enough collateral, the answer would clearly have been yes. They could have made a loan, it would have been legal, it would not have been very risky, and probably the whole financial crisis and Great Recession would have been less severe," said Ball.

The Dodd-Frank Act of 2010 still allows the Fed to set up emergency loan facilities but prohibits it to bail out an insolvent firm. The bankruptcy code defines "insolvent" as a "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation."

At least five firms have to be eligible to borrow from the Fed's emergency loan program, so the loans can't be created to suit just one bank. One bank cannot borrow to lend to another that is insolvent.

Dodd-Frank gave the new Financial Stability Oversight Council, made up of top regulators led by the treasury secretary, the authority to designate as Strategically Important Financial Institutions, or SIFIs, any financial firm that "could pose a threat to the financial stability of the United States" if they failed or engaged in risky activities. That designation subjects the firm to stricter oversight from the Federal Reserve, including stricter capital requirements, participation in stress tests, the requirement to create living wills or bankruptcy contingency plans.

Before Dodd-Frank, the FDIC's resolution authority was restricted to commercial banks. According to the Brookings Institution, when investment banks Lehman Brothers and Bear Stearns and insurer American International Group ran into trouble, they were not eligible for FDIC receivership since they were not commercial banks.

They had a choice of either declaring bankruptcy, as Lehman did, or asking for emergency aid from the Federal Reserve, as Bear Stearns and AIG did. Citigroup and Merrill Lynch, for example, came close to failing and received temporary taxpayer support.

Systemically important financial institutions can include a holding company and potentially several more pieces such as an investment bank, broker-dealer, hedge funds and private equity firms, and maybe even an insurance company. Each piece, including the holding company, may be subject to a different regulatory authority or maybe no regulation at all and is subject to a different test for insolvency.

Title II of the Dodd-Frank Act now gives the FDIC extended authority to include the entire bank holding company. Its Orderly Liquidation Authority can finance the wind-up of a troubled firm through the Orderly Liquidation Fund.

Non-banks, however, have to be designated SIFIs to be subject to the enhanced regulatory oversight that would inform regulators help is needed and make the firms eligible for FDIC resolution.

The FDIC released a report in 2011, entitled "The Orderly Liquidation of Lehman Brothers Holdings Inc. Under the Dodd-Frank Act," that examines how it could have structured an orderly resolution of Lehman Brothers Holdings Inc. had the law been in effect in advance of Lehman's failure. The FDIC concluded that it could have acted "decisively to preserve asset value and structure a transaction to sell Lehman's valuable operations to interested buyers." Those actions could have "promoted systemic stability and made the shareholders and creditors, not taxpayers, bear the losses."

"The very availability of a comprehensive resolution system that sets forth in advance the rules under which the government will act following the appointment of a receiver could have helped to prevent a ‘run on the bank' and the resulting financial instability," according to the FDIC report.

Access to the OLF could be considered a competitive advantage and a good reason to want to be a SIFI. But, instead, complex non-bank financial institutions have fought the label.

MetLife rejected it and fought the SIFI designation. General Electric restructured itself to become smaller and therefore ineligible.

"The process looks at all kinds of systemic risk from any kind of institution. The problem is institutions can fight it as MetLife has done and as Prudential Financial likely will," says Mayra Rodríguez Valladares, managing principal of MRV Associates, a consulting firm focused on financial regulatory and risk based supervisory issues.

"Surely Lehman would have fought a SIFI designation, just like BlackRock has fought it and other non-bank institutions resist the additional regulatory oversight and the extra cost that comes with it," said Rodríguez.

BlackRock is the world's largest money manager with $6.3 trillion in assets.

Mike Konczal, a fellow with the Roosevelt Institute where he works on financial reform, told MarketWatch in an interview, "triggering OLA for any institution requires a lot of people to turn the key. It's not that easy," said Konczal.

"If the Trump administration doesn't use the SIFI tool, the economy is still at risk," according to Konczal.

Because OLA has never been triggered for a non-bank, it's not certain it will work.

"The FDIC is great at resolving banks," says Rodríguez, "but I am not so sure that it would be so easy peazy to resolve a complex institution that includes a hedge fund, broker dealer, and investment bank."

Lehman bankruptcy examiner Valukas wrote that the investment bank had removed approximately $49 billion in debt from its 2008 balance sheet via the use of Repo 105 transactions. In a Repo 105 transaction, Lehman pledged assets, usually Treasury securities, with a value of 105% or more of the cash received.

Accounting rules permitted the transactions to be treated as sales, which allowed Lehman to reduce its asset balance, since the cash received was less than the value of the assets it had pledged. However, the cash it received was not recorded as a loan, and the obligation to repay the loan and repurchase the Treasury security was not recognized as an increase in liabilities. Instead, the right to repurchase the collateral was recorded as a new asset, a derivative right to purchase securities in the future.

Valukas concluded that the transactions had no business purpose, according to the examiner's report. Lehman's "primary motive for undertaking tens of billions of dollars in Repo 105 transactions at or near each quarter-end in late 2007 and 2008 was to temporarily remove the securities inventory from its balance sheet in order to report lower leverage ratios than Lehman actually had," Valukas wrote.

Lehman also, "did not disclose its use — or the significant magnitude of its use — of Repo 105 to the Government, to the rating agencies, to its investors, or to its own Board of Directors. Lehman's auditors, Ernst & Young, were aware of but did not question Lehman's use and nondisclosure of the Repo 105 accounting transactions," the bankruptcy examiner's report said.

In 2010, the SEC proposed a rule response to Lehman's lack of disclosure of the Repo 105 liabilities. The proposal, called "Short term borrowings disclosure," said that "a critical component of a company's liquidity and capital resources is often its access to short-term borrowings for working capital and to fund its operations...Recent events have shown that these types of arrangements can be impacted, sometimes severely and rapidly, by illiquidity in the markets as a whole."

In a comment letter to the SEC on its proposal, then Sen. Carl Levin wrote, "Inaccurate accounting treatment of repurchase agreements was not confined to Lehman Brothers. Other investment banks, such as Bank of America and Citigroup, have, in response to SEC inquiries, acknowledged that they erroneously recorded repurchase agreements as sales rather than as financing transactions."

In April 2011, the FInancial Accounting Standards Board changed the rule that allowed Lehman to treat the repos as sales. FASB tweaked repo accounting rules again in June 2014 when MF Global, a global broker-dealer led by former N.J. Governor Jon Corzine, collapsed. MF Global could not meet margin calls when the value of European sovereign debt it used as collateral in repo transaction collapsed.

MF Global had recorded profit upfront from investing in the sovereign bonds and then using them as collateral in so-called "repo-to-maturity" contracts without fully disclosing its repo loan liabilities.

The SEC's 2010 proposal for better disclosure was never finalized. A spokeswoman for James Kroeker, who is now the vice chairman at the FASB but who was the SEC's chief accountant at the time of the proposal, declined to respond to a request for comment on the never-finalized proposal.

A spokeswoman for the SEC confirmed the proposal for enhanced disclosures was never finalized but declined further comment.

J. Edward Ketz, an accounting professor at Pennsylvania State University, told MarketWatch that despite the reactive fixes, "Managers will keep looking for loopholes that allow off-balance sheet treatment for repos. Auditors have to make sure they ‘know what they don't know' and that all off-balance sheet arrangements are disclosed in the footnotes," Ketz said.

In July the Treasury Department's Office of Financial Research proposed to collect more data on the U.S. repo market, to "enhance the ability of the Financial Stability Oversight Council to identify and monitor potential risks to U.S. financial stability by closing the data gap on centrally cleared repo transactions."

A Fed report said in early 2017 the Fixed Income Clearing Corporation processed about $400 billion each day in same-day settling overnight centrally cleared repo transactions collateralized with U.S. Treasury securities.

Even if this proposal is approved, the U.S. bilateral repo market would still be in the shadows according to Gregg Gelzinis, a research associate at the Center for American Progress, an independent nonpartisan policy institute.

In triparty repos, a clearing bank provides collateral valuation, margining, and management services to ensure the terms of the repo contract are met. In a bilateral repo, the lender drives the valuation and margin requirements on collateral pledged by the borrower.

"There's a gap here in a market that was systemically important during the financial crisis and still is. It is disappointing that the SEC never finalized the disclosure rules since it would have aligned non-bank disclosures with bank holding company requirements," Gelzinis told MarketWatch.

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs (A Special Report) --- Reflections on the 9 1/2 -Year-Long Bull Market

By John A. Prestbo
986 words
10 September 2018
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English

All hail the tenacious **bull market**.

Today marks 9 1/2 years of generally rising stock prices -- up 296% so far in the **Dow Jones Industrial Average**, or 406% including dividends. This prolonged upturn signified the end of the 2007-09 recession in which the Dow plunged 54% and some other broad-market indexes fell even further.

This bull run is far and away the Dow's longest, at 107 months through January's record close of 26616.71 -- and sitting at 115 months counting the trading since then. If the bull run extends to a full 10 years by March 9, it may surpass the stupendous percentage gains posted in the 1920s (up 495.2% over 96 months) and mid-1930s (up 371.6% in 56 months).

As the now-retired markets editor of The Wall Street Journal, I have seen many bull (and bear) markets come and go. To be honest, back in 2009 I didn't suspect the initially timid recovery would persist so long as to become epic. But a few key -- and coincident -- factors combined to stimulate longevity.

First, stocks' rebound from the deep dive in 2007-09 was s-l-o-w. This frustrated Wall Street, but it prevented the Dow from racing too far ahead of the economy. Many people were scared of the **stock market**, and they toe-dipped back in only after the market rebounded convincingly.

The Dow's recovery to its previous high of 14087.55, set in 2007, required 52 months, or more than four times as long as the average full restorations of the previous four bear markets. However, this wasn't surprising in the wake of a market collapse that was 191% worse than the average of those previous four bear markets.

Meanwhile, money was cheap and easy. To fight the recession, the Federal Reserve dropped interest rates to almost zero and flooded the monetary system with cash. Bonds were offering dismal yields, so investors were forced to take greater risks to get the returns they needed. For the most part, this meant buying stocks.

But when they did, they found fewer stocks to chase and fewer shares of those stocks available on the market. Because cheap money fostered robust merger-and-acquisition activity and extravagant share-buyback campaigns by many companies, the numbers of both listed stocks and shares outstanding have shrunk over the past decade. As a result, the money that investors poured into the market had a greater upward influence on prices than it otherwise would have.

The **stock market**, of course, didn't go straight up. It never does. It meanders above and below each previous day's close as some investors put money in and others take it out. It was to make longer-term trends more visible that Charles H. Dow devised stock indexes in the first place, back in the 1880s and 1890s.

Occasionally the market will dip or spurt over several days or weeks as it "corrects" or "rallies." By my count, there were seven corrections of 10% or more over the past 9 1/2 years, including one in 2011 of 19.4%. There also were four smaller pullbacks in the 6% to 8% range.

A minority of party-poopers argue that the market's double-dip corrections in 2015-16 broke the upward thrust of the bull that began in 2009. They insist that the current **bull market** isn't in its 10th year but rather began on Feb. 12, 2016, and thus is only 2 1/2 years old.

Of course, the conventional definitions of a correction being a drop of 10% to 20% and a **bear market** requiring a retreat of 20% or more are just rules of thumb, not scientifically explained calibrations. Some analysts have complicated matters by concocting "rules" about how much the Dow must rise over how many days following a decline to determine if a **bull market** is dead or still running. This is what's behind the party-pooper argument.

Bull markets have no "meaning" beyond the obvious: Stock prices are rising. Since those prices roughly reflect an upward trend in corporate earnings, which in turn depend upon economic conditions, bull markets confirm what we're experiencing -- that financial well being has come to pass.

However, the **stock market** is about what will happen next, which raises the question: Does this spectacularly long **bull market** say anything about what's coming? There is an adage on Wall Street that bull markets don't die of old age. Rather, something happens to change investors' expectations for the not-too-distant future.

In 2000-02, for example, investors soured on the manic buying of dot-com stocks that occurred in the late 1990s. Some of those companies had no real operations to support them. Investors decided that the mania had lifted most stocks to overly expensive levels and that prices weren't sustainable. They bailed out, taking the market down 38% with them.

This **bull market** will end, too, though nobody knows why or when. There are plenty of possible reasons, including global trade war, regular war, the midterm elections, rising interest rates, a weakening housing market, high-price stocks (again) and so forth. These and other concerns already are influencing some investors, but as yet not enough to hobble the bull.

So, if you're of a mind to celebrate the historic **bull market**, do so in appreciation of what it already has bestowed upon you. It makes no promises for tomorrow.

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THE WALL STREET JOURNAL.

Economy
Boston Fed President Backs Quarterly Rate Increases; Rosengren says continuing the current pace would push rates closer to a neutral level that would neither spur nor slow growth

By Nick Timiraos
667 words
10 September 2018
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BOSTON—Eric Rosengren, president of the Federal Reserve Bank of Boston, signaled the U.S. central bank should continue raising its benchmark short-term interest rate at its current quarterly pace over the coming year, including at policy meetings this September and December.

Raising rates at that pace over the next year would push them closer to a neutral level that would neither spur nor slow growth, Mr. Rosengren said in an interview with The Wall Street Journal on the sidelines of a conference at the Boston Fed.

After that point, he said it was likely tight labor markets and strong economic growth could prompt additional rate increases designed to deliberately slow the economy and prevent overheating.

"We don't know with any kind of precision" where a neutral interest-rate setting is, "but it's certainly higher than where we are now, and is likely to be maybe a percentage point higher than we are now," Mr. Rosengren said. "So the path for the next three or four hikes, unless something happens in the economy that we're not anticipating—there's no reason we couldn't gradually get up to that point."

Some of Mr. Rosengren's colleagues have said the Fed should pause its current pattern of quarterly rate increases once rates are closer to an estimated neutral setting, possibly as soon as the first half of next year. But Mr. Rosengren said he didn't see any reason to pause from raising rates simply because they are near such a neutral setting.

"I don't think there's anything special about pausing at any one point," he said. Instead, the economic outlook should guide any decisions.

If growth is strong, inflation is near 2% and unemployment is below the level officials estimate to be sustainable over the long run, "then it's going to be pretty easy to say we need to do more," said Mr. Rosengren. "If instead, we're in a world where the economy is not growing all that much…then maybe we stay there. It's very situational."

Fed officials have raised their benchmark rate twice this year, most recently in June, to a range between 1.75% and 2%. They have signaled they are likely to move again at their Sept. 25-26 policy meeting.

Mr. Rosengren said the economy was performing in line with his expectations, but slowdowns in international economies were a potential risk. The Trump administration has imposed some tariffs and threatened more, particularly on imported Chinese goods and foreign cars.

U.S. fiscal and monetary policy, together with the trade posture, has contributed to a stronger dollar. When the Fed raises rates, the higher return on U.S. fixed-income assets can lead to capital outflows from emerging markets, pushing local inflation up.

The collapse of the Turkish lira this summer, bookended by routs in the Argentine peso, has investors worried financial turbulence could spread to other vulnerable emerging markets, even though both Argentina and Turkey have unique economic woes.

Such countries "have a lot of debt in dollars and exchange rates that are not stable," said Mr. Rosengren. His level of concern would grow "if you start to see countries that are not in that position start to have much more problems," he said.

One troubling scenario would be if a combination of trade tariffs and higher **oil prices** put new stress on emerging-market economies that spills into China, an economy large enough to seriously slow global growth. "That could be a problem for U.S. growth," Mr. Rosengren said. "It's not my baseline forecast, but…it is a significant risk."

He added, "If it actually does occur, we wouldn't have to do as much monetary policy tightening."

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Investing in Funds & ETFs (A Special Report) --- As REITs Return to Life, Some Sectors Stand Out: Experts think these sectors look especially good

By Dan Weil
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10 September 2018
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R6
English

Real-estate investment trusts are rebounding after several years of sluggishness.

The S&P U.S. REIT Index returned 8.3% for the three months ended Aug. 31, outperforming the **S&P 500**, which returned 7.8% over the same period, notes Amanda Agati, co-chief investment strategist at PNC Financial Services Group.

The start of 2018 didn't look so promising for REIT investors. In the first two months, REITs were driven lower by fears of rapid interest-rate increases. Rising rates hurt REITs because the trusts compete with bonds partly on the basis of yields, and because higher rates raise borrowing costs for REITs, which often take on substantial debt to buy their properties.

More recently, however, worries about rising rates have faded. "Now the concern is about an economic slowdown in the second half," which suggests a more benign interest-rate environment, says Steven Brown, senior portfolio manager at American Century Investments.

"Today we feel good about real-estate fundamentals," says Tom Bohjalian, a portfolio manager at Cohen & Steers. Indeed, while expectations for higher interest rates have eased, he says, the economy remains strong enough to continue fueling demand in housing and a number of other real-estate sectors.

"While supply is higher than usual for this stage of the real-estate cycle, we think it will diminish in late 2018 and 2019," he says. "So REITs will have pricing power to raise rents on high levels of occupancy."

Some experts see opportunities in office REITs. Mr. Brown, for one, likes Boston Properties Inc. (BXP), whose shares, he says, are trading at a discount despite a portfolio concentrated in Washington, D.C., New York, Boston and San Francisco. Demand for top-quality office space remains strong in those cities, Mr. Brown says. While there is concern about weakness in financial jobs in those markets, he says, "media, telecom and technology have good job growth and tenant demand."

Other sectors in commercial real estate that industry insiders particularly like includes data centers and cellphone towers. Data-center and cellphone-tower REITs are benefiting from the explosion in data usage, including e-commerce and video on demand. The growth of cloud computing plays a big role as well for data centers.

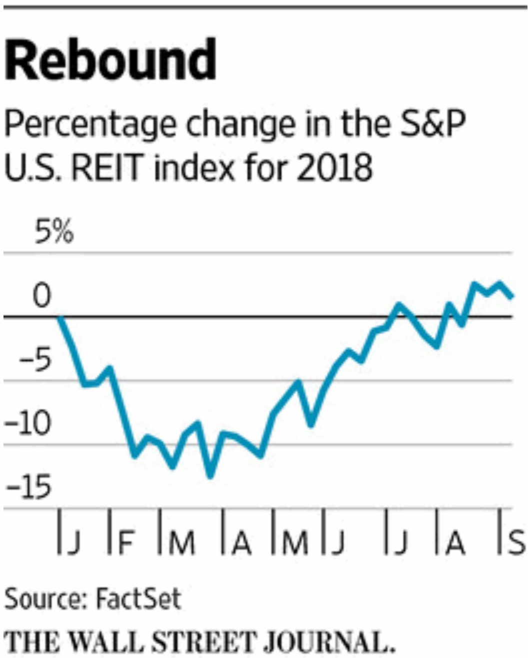
One data-center REIT experts recommend is Equinix Inc. (EQIX), the world's largest retail data-center provider by revenue, according to Morningstar. "The company has caught the tide of cloud computing at the right time since birth," Morningstar analyst Neil Macker writes in a report. "Key to its success is the business ecosystem joined by both magnetic cloud platforms, such as Amazon and Google, which attract other tenants to Equinix, as well as telecommunication carriers that offer connectivity services on site."

As for housing REITs, Mr. Bohjalian says the number of families in need of homes is expected to grow in the next three to five years, and demand will ultimately exceed supply. That bodes well, he says, for REITs that specialize in apartments, manufactured housing and single-family rentals. Experts also agree that the rising price of purchasing a single-family home will keep people in apartments longer, giving owners the ability to raise rents.

Mr. Brown recommends American Homes 4 Rent (AMH). This REIT's shares currently trade at roughly a 10% discount to net asset value, he says, and the value of its portfolio is rising. "They can raise rents higher than inflation," he says, thanks to rising demand from residents who can't afford to buy a home.

Mr. Brown even likes some REITs in the retail sector. Store closings are now running 50% to 60% below 2017 levels, he says. "That's having a positive impact on the leasing environment." And many retailers have begun to respond more effectively to Amazon.com Inc. and other e-commerce companies by beefing up their own e-commerce efforts and the portfolios of their bricks-and-mortar stores, he says.

Mr. Weil is a writer in West Palm Beach, Fla. He can be reached at reports@wsj.com.



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Investing in Funds & ETFs (A Special Report) -- Fixed-Income Investing --- The Best Moves to Make in an Inverted Yield Curve: A George Mason professor on what market history says about how investors should proceed

By Derek Horstmeyer
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10 September 2018
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Much has been said in recent months about the possibility of an "inverted yield curve." If any inversion actually occurs, how might it affect investors' portfolios, and is there anything individuals can do to protect themselves?

The yield curve -- the difference between the interest rates available on shorter-term and longer-term Treasury bonds, shown as one curved line -- generally slopes gently upward in normal times, as investors demand more return on investments that tie up their money for a longer period.

Recently, however, the yield curve has fallen to its flattest level since the onset of the 2007-09 recession. When rates of different maturity Treasurys get so similar, bond-market investors take notice and start bracing for a possible inversion of the curve, which is when short-term yields surpass long-term ones. A flattening of the yield curve suggests that investors are getting worried about near-term growth and leaves some pundits eager to predict the economy is headed for a downturn.

This past week, the spread between the 10-year and two-year Treasury was just 0.24 percentage point. Should it continue on this trajectory and actually invert, history shows that investors shouldn't hold out much hope for monumental returns across any asset class in the years that follow.

Is there anything investors can do to insulate themselves? If historical returns offer any direction, traditionally safe assets may prevail as the best strategy should the dreaded inversion occur.

An investigation of the 10 yield-curve inversions (when the rate on the two-year Treasury exceeded that of the **10**-**year Treasury**) that have occurred since the buildup in the 1920s to the Great Depression found that large-cap stocks delivered an average annual rate of return of just 1.5% in the two years following the inversion. Worse, small-capitalization stocks averaged minus 3.1% over the same time frame.

Counter to this, traditionally safe assets like long- and short-term bonds have fared a bit better following yield-curve inversions. Following the 10 inversions, long-term bond portfolios averaged an annual rate of return of 6.2% and short-term bond portfolios averaged 5.5% in the two years following an inversion.

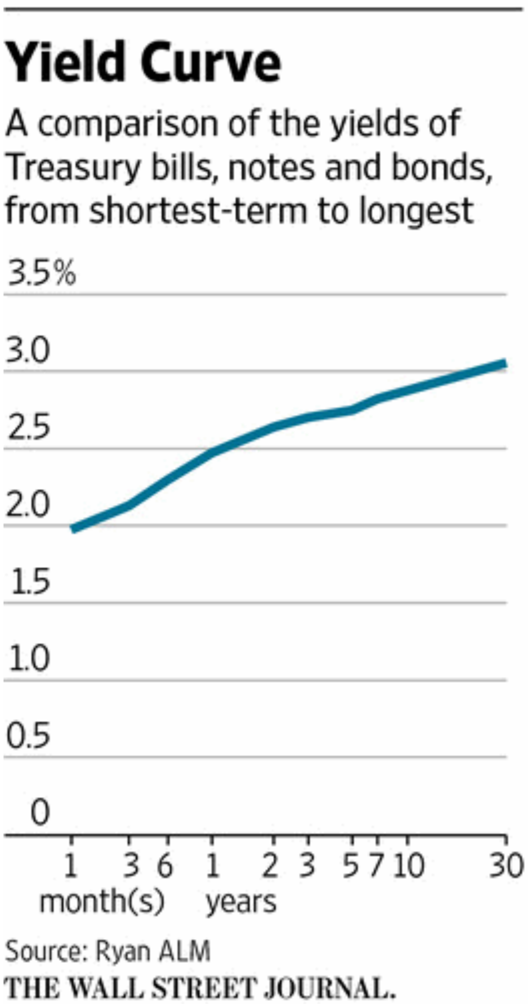
Not only do stocks appear to deliver the lowest returns following yield-curve inversions, they deliver the greatest **volatility** in these time periods, as well. For instance, large-cap stocks lost more than 50% of their value in a two-year period following the 1929 yield-curve inversion (leading into the Great Depression). On the positive side, large-caps delivered gains of more than 20% in the two years after the 1981 inversion.

While the historical evidence seems to suggest that safer assets perform better on average following an inversion, it is important to note that inflation has averaged 4.5% following these events. That further reduces the attractiveness of all of these investments. In fact, once the inflation rate is factored in, the only asset class that historically has even a positive real rate of return following an inverted curve are bonds, with an average portfolio of short- and long-term issues registering a paltry 1.3% annual real rate of return.

Interestingly, the yield curve has become a much better predictor of recessions in recent decades. An inverted yield curve has accurately predicted every recession going back to the mid-1960s, with only one false positive, in 1966. Yet, from 1926 to 1966, eight recessions occurred and only twice did an inverted yield curve manifest within a year before a given recession.

All told, the data suggest that prices (especially equities) respond much more to an inversion than to the actual recession, which comes on average 12 months later. In 75% of cases over the past 90 years, the two-year returns to large-cap stocks are significantly worse following an inversion than they are following an official recession.

Dr. Horstmeyer is an assistant professor of finance at George Mason University's Business School in Fairfax, Va. He can be reached at reports@wsj.com.



Prediction Scoreboard

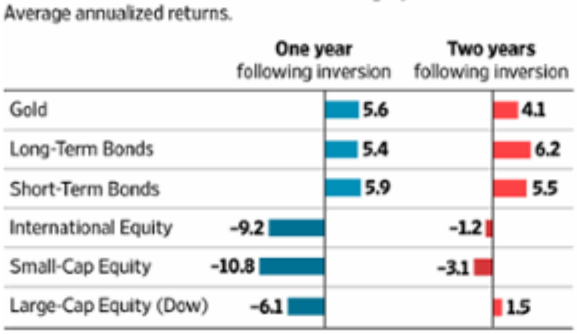
Did an inverted yield predict a coming recession?

Date	Correct A yield-curve inversion preceded a recession	False Positive An inversion but no recession followed	Missed It The yield curve didn't invert prior to the recession
October 1926	✔		
August 1929	✔		
May 1937			✔
February 1945			✔
November 1949			✔
July 1953			✔
August 1957			✔
April 1960			✔
September 1966		✔	
December 1969	✔		
November 1973	✔		
January 1980	✔		
July 1981	✔		
July 1990	✔		
March 2001	✔		
December 2007	✔		

Note: Inverted yield curve based on 10-year T-bond yield compared with two-year note

Inversion Blues

Performance of various investments following a yield-curve inversion. Average annualized returns.



Source: Derek Horstmeyer, George Mason University

THE WALL STREET JOURNAL.

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Economy

Derby's Take: The Yield Curve Could Rattle Fed's Rate Consensus; What happens with bond-market yields may hold the key to whether Federal Reserve officials will be able to maintain their fairly unified outlook for monetary policy.

By Michael S. Derby
479 words
10 September 2018
06:38 AM
WSJ Pro Central Banking
RSTPROCB
English

What happens with bond-market yields may hold the key to whether Federal Reserve officials will be able to maintain their fairly unified outlook for monetary policy.

Central bankers have been grappling over the meaning of this year's trend in which the difference between short- and long-dated Treasury yields has grown closer. So close, in fact, that the so-called yield curve could invert, with short-term yields rising above long-term yields. The difference between two-year and **10-year Treasury** yields is now around 23 basis points.

An inversion would put stress on Fed officials because such a development historically has preceded recessions. And officials widely agree that their rate raises are what's pushing up yields on short-dated securities while other factors hold down long-term yields.

So it could be up to the Fed whether the curve inverts or not. That has driven some officials to voice caution about further rate increases. Raphael Bostic of the Atlanta Fed, for example, recently said he wouldn't support another increase if that is what would cause an inversion.

Mr. Bostic has a vote on the rate-setting Federal Open Market Committee this year. But another voter, who also serves as the FOMC vice chairman, told reporters Thursday that there could be a case for shrugging off an inversion if other things in the economy look good enough to support further rate increases

"I think we need to make the right decisions based on our analysis of where the economy is and where it's heading," New York Fed chief John Williams said. "If that were to require us to move interest rates up to the point where the yield curve was flat or inverted, that would not be something I find worrisome on its own."

Former Fed Chairman Ben Bernanke recently told reporters he also was inclined to play down the implications of an inverted curve. But his "this time is different" argument also got an airing when the last inversion happened in 2006. A year later, the worst downturn since the Great Depression arrived.

It may also be that the Fed can proceed with the rate rises it has penciled in and the curve won't invert. Dallas Fed leader Robert Kaplan said Friday that, given where 10-year notes are—they yielded 2.94% late Friday, moving the Fed's short-term interest-rate target up to 2.5% to 2.75% might not cause an inversion. But he nevertheless said he's watching the curve carefully.

Write to Michael S. Derby at michael.derby@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Fed Considers New Tool | Rosengren Backs Quarterly Increases | Jobs Report Bolsters Fed | Laundering Probe Looks at $150 Billion | Derby's Take: The Yield Curve Could Rattle Fed's Rate Consensus; The Wall Street Journal's central banking newsletter for Monday, September 10, 2018

3,343 words
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Derby's Take: The Yield Curve Could Rattle Fed's Rate Consensus

Federal Reserve Considers a New Tool to Avert Crises

Boston Fed President Backs Quarterly Rate Increases

Jobs Report Bolsters Federal Reserve in Its Gradual Rate Increases

Russia-Linked Money-Laundering Probe Looks at $150 Billion in Transactions

The Yield Curve Could Rattle Fed's Rate Consensus

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Key Developments Around the World

Federal Reserve Considers a New Tool to Avert Crises

A decade after a financial crisis, Fed officials are debating how to apply one of the central lessons they drew from that dark episode. It involves preventing the next crisis from happening on their watch. The Fed has two tools for stamping out financial bubbles. It can use either regulation or interest-rate increases to prevent banks and other financial institutions from getting carried away during an economic boom. Many Fed officials concluded after the last crisis that it's best to use regulation. They can apply that tool surgically, while aggressive interest-rate increases might damage the broader economy. Some Fed officials want to use one of the regulatory tools the central bank developed after the crisis, called a countercyclical capital buffer. It can require big banks to sock away additional capital during good times so they have more to fall back on when loans go bad during bad times. But other officials, and the banking industry, have questioned why the tool is needed now, when bank capital levels are high and financial-stability risks appear in check.

Boston Fed President Backs Quarterly Rate Increases

Eric Rosengren, president of the Federal Reserve Bank of Boston, signaled the U.S. central bank should continue raising its benchmark short-term interest rate at its current quarterly pace over the coming year, including at policy meetings this September and December. Raising rates at that pace over the next year would push them closer to a neutral level that would neither spur nor slow growth, Mr. Rosengren said in an interview with The Wall Street Journal on the sidelines of a conference at the Boston Fed.

Transcript: WSJ Interview With Boston Fed President Eric Rosengren

Jobs Report Bolsters Federal Reserve in Its Gradual Rate Increases

Strong hiring and a pickup in wage growth last month are likely to reinforce the Federal Reserve's plan to continue gradually raising interest rates as the U.S. economy enters its 10th year of expansion. With unemployment near 18-year lows and inflation close to the central bank's 2% target, Fed officials say conditions for U.S. workers and consumers are right where they want them.

Strong Economy Drove Wages Higher in August as Hiring Heats Up

Wages Are Rising. Will Inflation Follow?

Fed's Powell Ramped up Hill Outreach in July

Federal Reserve Chairman Jerome Powell prepared for his second appearance before Congress with a slew of meetings on Capitol Hill in July, according to his calendar, which the Fed released Friday. The central bank leader sat down or spoke on the phone with more than a dozen lawmakers, including Senate Majority Leader Mitch McConnell (R., Ky.), Reps. Maxine Waters (D., Calif.) and Nydia Velazquez (D., N.Y.), and Sens. Ron Wyden (D., Ore.) and Roy Blunt (R., Mo.). He also had breakfast with former Fed governor Kevin Warsh, a one-time contender for the chairman's job. And he met with two Trump administration officials—Treasury Secretary Steven Mnuchin and National Economic Council official Andrew Olmem—in the days after the president criticized the Fed for raising interest rates. The calendar didn't detail what was discussed at the meetings. --Dow Jones Newswires

Transcript: Q&A With New York Fed's John Williams at the University at Buffalo

Federal Reserve Bank of New York President John Williams spoke Thursday at the University at Buffalo, where he discussed inflation, wage growth, interest-rate policy, financial regulation and the yield curve, among other topics. Here's a transcript.

Fed's Kaplan Says Trying to Fix U.S.-China Trade Issues Makes Sense

Federal Reserve Bank of Dallas leader Robert Kaplan said Friday it is understandable that the U.S. is taking a tough line in its trading relationship with China. Mr. Kaplan said he was hopeful for modernized trade agreements with Canada and Mexico. But he said the U.S.'s issues with China, with which it has run extensive trade deficits for years, need to be addressed. The central banker, speaking at an event at the Dallas Fed, declined to comment on Trump administration moves aimed at shrinking the trade gap. But he said there are real issues at play between the U.S. and China, and "if there's a fight to be had, that is the right fight."

Former Fed Official Calls for Increased Capital Requirements

The U.S. Federal Reserveshould require banks to raise their levels of loss-absorbing capital in preparation for a future downturn, a former vice chairman of the central bank said Friday. In a speech delivered in Denmark, Donald Kohn said the need to use "macroprudential" tools to guard against complacency in the financial system during good times was one of the lessons from the financial crisis. At issue is the countercyclical capital buffer, a framework completed in 2016 in which the Fed can require banks to set aside more capital when the economy is growing strongly, so as to be able to keep credit flowing during a downturn.

Australia's RBA Says a Household Debt Meltdown Not Imminent

Australia's central bank Monday said that while risks to the economy from record levels of household debt remain elevated, a crisis that could spill into the banking system and the mortgage sector isn't imminent. Michele Bullock, Assistant Governor at the Reserve Bank of Australia, with special responsibility for the financial system, said in a speech to a business group in New South Wales, that a number of factors were working to mitigate stresses link to the debt burden.

FINANCIAL REGULATION ROUNDUP

Russia-Linked Money-Laundering Probe Looks at $150 Billion in Transactions

Investigators at Denmark's largest bank are studying around $150 billion of transactions that flowed through its Estonian outpost between 2007 and 2015 as part of an internal money-laundering probe, according to people familiar with the matter. Much of that figure, which dwarfs Estonia's total deposits, came from companies with ties to Russia and the former Soviet Union. Danske Bank A/S has been criticized by its regulator for lax oversight of illicit money flows. The bank's investigators haven't determined if all $150 billion handled by non-Estonian entities should be deemed suspicious. But such a large flow of money suggests that roughly $8 billion of suspected money-laundering transactions previously reported by a Danish newspaper could grow higher.

Ex-Teva Chairman, Blockchain Investor Accused of Pump-and-Dump Scheme

A former chairman of Teva Pharmaceutical Industries Ltd. and an investor known for benefiting from the hype around cryptocurrencies were sued by regulators Friday over claims they masterminded a pump-and-dump scheme. The Securities and Exchange Commission alleged that Phillip Frost and Barry Honig, along with eight others, conspired to manipulate the prices of three microcap stocks so they could later sell their shares at inflated prices. The SEC alleged the fraud generated more than $27 million for those involved.

D.E. Shaw Partner Fights Back After Firing

A former partner at D.E. Shaw Group, one of the world's largest hedge funds, has filed a complaint against the firm accusing it of defaming him in communicating his firing. The complaint highlights a new challenge for employers, who in the age of #MeToo must decide what to say, if anything, upon terminating an employee alleged to have engaged in misconduct.

How Banks Lost the Battle for Power on Wall Street

Catch him in an unguarded moment, and Lloyd Blankfein will tell you his biggest strategic regret in 12 years running Goldman Sachs Group Inc. It isn't the mortgage trades that invited public wrath or the congressional testimony that fanned the flames, although there are things he would do differently on both fronts. It is a missed deal. In 2009, Goldman was outbid for an index-funds business that Barclays PLC was selling. Called iShares, it was a leading player in passive investing. iShares was sold to BlackRock Inc., where it became the backbone of what is today a $6.3 trillion empire, the largest asset manager in the world. That deal captures the shift that has reshaped Wall Street in the decade since the financial crisis. Profits, assets and influence have moved from investment banks such as Goldman to money-management giants such as BlackRock and Vanguard Group

Lehman's Last Hires Look Back

September 15, 2008, was one of the darkest days in the history of Wall Street. For four new college graduates, it was also their first day of work at Lehman Brothers Holdings Inc. Sohil Sheth, Luvleen Sidhu, Justin Gaines and Brian Grossman walked through the doors of Lehman just as the venerable investment bank filed for bankruptcy protection, an event that sent shock waves around the globe. The crisis provided these unlucky millennials with a new perspective. Big institutions were no longer infallible. Wall Street no longer offered a guaranteed career path. Life was more fragile than they knew. One thing was certain: Their world would never again look the same.

When You Lose 99.9%, You've Lost More Than Money

On Sept. 1, Barry Popik received a check for $35.98. That legal settlement is all that is left of the $25,000 he invested in Lehman Brothers preferred stock in February 2008. But money isn't all that Mr. Popik, and countless other investors like him, lost. Their faith in the fairness of **financial markets**is also broken.

Warren Buffett Recounts His Role During 2008 Financial Crisis

During the worst financial crisis in decades, Warren Buffett never lost his faith that the U.S. economy would recover. "The factories don't disappear, the farmland doesn't disappear, the skills of the people don't disappear" during a crisis, he told The Wall Street Journal recently. But "there's no way of knowing, when you're in a situation like we were in in the fall of 2008 or 2009, when or precisely how it will end."

The Financial Crisis Changed Home Buying Forever

It was easy—too easy—to buy a house in the years leading up to the housing crisis. Not today. Lenders have tightened their standards, and many banks now view mortgages as a side service to offer to a small group of wealthier customers rather than a big-volume revenue generator. What's more, developers have pulled back from building after getting stuck with a glut of half-built or unsold homes in the crisis. Getting a piece of the American dream looks a lot different than it used to.

A Decade Later: Full Coverage

Monday

12 p.m. EDT

Atlanta Fed's Bostic speaks on economic outlook in Albany, Ga.

3 p.m. EDT

Federal Reserve releases July U.S. consumer-credit data

Tuesday

10 a.m. EDT

U.S. Labor Department releases July Job Openings and Labor Turnover Survey

Bridging Between Policy Makers' and Economists' Views on Bubbles

Policy makers are grappling with a list of questions "as they attempt to formulate an appropriate response to the prospect of asset bubbles that existing models of bubbles have yet to address adequately," economist Gadi Barlevy writes in a Federal Reserve Bank of Chicago Economic Perspectives post. Such questions include: When is it better to act against bubbles and when is it better to wait to intervene? Should monetary or macroprudential policy be used? And what economic variables should policy makers use to determine if their interventions are working? Mr. Barlevy finds that "since it is essentially impossible to measure the fundamental value of an asset and determine whether an asset is a bubble in practice, questions about how to deal with asset bubbles ultimately require a theoretical framework to address…With existing models already containing some of the key features needed to provide these answers, and with capable researchers working on these questions, it shouldn't be too long before policymakers start to view theoretical models as a natural resource for aiding their policy discussions."

The Financial Crisis Made Us Afraid of Risk—For a While

"Ten years ago this month, the failure of Lehman Brothers exposed how cavalier the world had been towards risk," writes The Wall Street Journal's Greg Ip. "Households had bought homes they thought could never go down in price, banks had made loans they thought would never default and repackaged them into securities to make them seem riskless and governments, convinced depressions were a thing of the past, had stood by. Since then, they have sought to ensure it never happens again. And thus, the world has retreated from risk. That retreat has reshaped institutions, regulations and attitudes, and in the process the economy…With time, even the deepest traumas wear off, and there are signs that risk-taking is returning, though in different forms from before. What remains unclear is whether it paves the way for years more of stable, crisis-free growth, or yet another bust."

Job Market Slack Is History

"Workers almost always ask for raises. It looks like they are starting to get them," Justin Lahart writes for The Wall Street Journal. He says the biggest news out of Friday's August U.S. jobs report was "an unexpected jump in average hourly earnings that pushed wages up 2.9% from a year earlier. That compared to a 2.7% gain in July, and marked the strongest growth since 2009." He adds: "The report suggests the economy has hit an inflection point, where employers simply won't be able to hire and retain workers without paying them more. And this may only be the beginning of a significant increase in wages that could simultaneously weigh on corporate profit margins and lead the Federal Reserve to raise rates by more than investors had expected."

The Volcker Rule Needs Transparency More Than ‘Simplification'

Regulators need to publish a thorough analysis if they are to assure the public that proposed modifications to the Volcker are being used faithfully and rigorously to prevent the kind of reckless behavior that brought the economy to the brink a decade ago, write Sheila C. Bair and Gaurav Vasisht for The Wall Street Journal. "It's alarming that regulators are aiming to change the rule without making public an analysis of the reams of data they have collected from banks since the implementation of the rule, nor releasing the data publicly," they write. "This lack of transparency makes meaningful public input in the rule-making process more difficult. Self-interested industry advocates who do have access to the data have a steep informational advantage. The opaque process bolsters the view that the simplification effort may be a ruse to weaken the regulation."

The RBI Should let the Rupee Fall

The Reserve Bank of Indiashould resist mounting pressures to alter its policies in support of a weakening rupee, writes Ila Patnaik for Bloomberg View. "The RBI has used these instruments in the past—and the results haven't been pretty," she writes. "Every move—from tightening liquidity and raising interest rates to discussion of non-resident borrowing and restrictions on derivatives—was interpreted as a panic reaction that only confirmed the rupee was under pressure. Foreigners felt it was better to take money out of India sooner rather than later, and the fall of the rupee became a self-fulfilling prophecy. Currency and derivatives markets, money and credit markets, and high costs of borrowing all hurt the economy in subsequent months."

The Canadian economy unexpectedly shed jobs in August on a sharp drop in part-time work, helping to push the unemployment rate to 6%.

Mexico's inflation accelerated in August for a third consecutive month, pushed up by increases in energy and foods costs.

China's consumer inflation accelerated to a six-month high in August, driven by a faster increase in vegetable prices and softer decline in pork prices, official data showed Monday.

Japan's economy expanded at a significantly faster pace than initially estimated in the April-June quarter as companies made more spending than expected amid severe labor shortages, government data showed Monday.

The world's developed economies are set for a slowdown, although prospects for Asian giants China and India have brightened, according to leading indicators released Monday by the Organization for Economic Cooperation and Development.

The Turkish economy grew by 5.2% in the second quarter, official data showed Monday, losing pace from the first quarter amid worries of an economic slowdown caused by the lira's sharp drop in recent weeks.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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The New York Times

THE WEEK AHEAD
Business/Financial Desk; SECTB
Trade Talks to Resume; New iPhones Revealed

By THE NEW YORK TIMES
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10 September 2018
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NYTF
Late Edition - Final
2
English

Here's what to expect in the week ahead:

TRADE

U.S. and European officials seek a trade pact.

Senior trade officials from the United States and the European Union will meet on Monday in Brussels in an effort to avert an all-out trade war. Robert Lighthizer, the United States trade representative, and Cecilia Malmström, the European commissioner for trade, are trying to reach an agreement on a plan to cut tariffs on industrial goods to zero and prevent President Trump from carrying out a threat to impose 25 percent levies on car imports. An accord is unlikely on Monday, but businesses on both sides of the Atlantic will be looking for signs that the two sides are making progress.

-- Jack Ewing

AUTOs

An Investor lawsuit against Volkswagen opens.

A German court will begin hearing evidence on Monday in a lawsuit filed by aggrieved shareholders of the carmaker Volkswagen. The shareholders, who are seeking billions of euros in damages, contend that Volkswagen violated its legal responsibility to them when it deployed illegal software to cheat on emissions tests, then covered it up. The trial may be the first time high-ranking Volkswagen managers testify in open court about the origins of the scandal.

-- Jack Ewing

TECHNOLOGY

New Apple devices will be unveiled on Wednesday.

Apple is set to announce another round of iPhones on Wednesday, in its annual bid to get customers to buy devices that are a few centimeters larger with a few more features. Apple is expected to unveil iPhones based on its flagship iPhone X model, with a screen that takes up the entire face of the device, but a bit larger, according to news reports and leaked images. Apple is also expected to update the Apple Watch, the iPad and its Mac computers, according to the reports. Sales of iPhones have leveled off -- growth was less than 1 percent in the latest quarter -- but Apple has made iPhone revenues continue to surge by charging customers more. Its iPhone revenues rose 20 percent last quarter because customers paid nearly 20 percent more, on average, for the devices. The iPhone X already costs $1,000 so the question on Wednesday will be whether Apple is prepared to charge customers more than $1,000 for some iPhone models.

-- Jack Nicas

ECONOMY

Report will give a snapshot of household income.

The income of the median American household rose sharply in 2015 after years of stagnation, and continued to rise in 2016. On Wednesday, the Census Bureau will release an initial estimate for 2017, which is likely to show that growth continued for a third straight year. Median household income is a particularly telling measure of the health of the American economy. The rise of the **stock market** says that life is good at the top; the fall of the unemployment rate says that life is getting better at the bottom. Median household income is a snapshot of the middle, where most Americans live. As of the end of 2016, the median household was still making less than at the end of 2007. That gap may finally have closed last year.

-- Binyamin Appelbaum

Technology

European Parliament will vote on an internet copyright bill.

The European Parliament is scheduled to vote on Wednesday on an internet copyright bill that would require internet services to use filtering technology to screen out copyrighted music, writings and videos. Publishers, music companies and movie studios are among those pushing for the new law, saying it would limit internet companies' profiting off unlicensed content and help content creators receive fair compensation. Technology companies and open-internet supporters argue the proposal is overly aggressive, will create unfair legal liabilities for websites large and small, and will ultimately limit the information available online.

-- Adam Satariano

ENVIRONMENT

Government and business officials will discuss climate change.

About 4,500 governors, mayors, business executives and community leaders are set to meet in San Francisco for an international gathering on climate change beginning on Wednesday. The Global Climate Action Summit, which includes Gov. Jerry Brown of California and Michael Bloomberg, the former Mayor of New York as hosts, is a response to a United Nations request for renewed efforts to curb emissions following the Paris climate agreement.

During the three-day summit, attendees plan to announce new electric vehicle programs, energy storage projects and other initiatives. Some American cities and states have committed to the Paris accord despite President Trump's announced intention to withdraw from it.

-- Ivan Penn

ECONOMY

European Central Bank may signal the effects of the trade war.

Trade tensions will most likely be a key issue when Mario Draghi, the president of the European Central Bank, holds a news conference on Thursday after a meeting of the bank's Governing Council. The bank is not expected to make any major changes in policy, but its economists will issue their latest forecasts. Those should give an indication of how much the central bank believes that the trade war with the United States is hurting the eurozone economy.

-- Jack Ewing

ECONOMY

The Bank of England will probably keep rates steady.

The Bank of England raised its benchmark interest rate in August to 0.75 percent, its highest level since February 2009. Policymakers at the central bank will meet on Thursday, but are unlikely to raise rates again. They are more likely to do so later this year, but that would depend on how the economy fares and how expectations for inflation change as Britain's departure from the European Union draws closer. With Brexit looming, questions have been raised about whether Mark Carney, the governor of the Bank of England, will extend his time there. ''I am willing to do whatever else I can to ensure a smooth Brexit and an effective transition,'' Mr. Carney told British lawmakers at a Treasury Select Committee on Tuesday.

-- Amie Tsang

ECONOMY

Labor Department will reveal the August inflation rate.

On Thursday at 8:30 a.m., the Labor Department will release the latest reading on the Consumer Price Index for August. Inflation has been tame in recent months, despite faster economic growth, and economists expect the price index to rise by 0.3 percent. That would bring the year-over-year increase in prices to 2.8 percent.

-- Nelson D. Schwartz

RETAIL INDUSTRY

Retail industry hopes sales figures reflect bumper summer.

Retail sales figures, which the Census Bureau is scheduled to release on Friday, will be a good barometer of whether the solid economy is continuing to inspire Americans to open up their wallets and shop. This summer retailers have reported some of their best sales growth since the 2008 recession, reflecting a strong job market and a reordering in the retail industry after a wave of bankruptcies and store closures.

-- Michael Corkery

This is a more complete version of the story than the one that appeared in print.

Tim Cook, Apple's chief executive, at last year's unveiling. (PHOTOGRAPH BY JOSH EDELSON/AGENCE FRANCE-PRESSE -- GETTY IMAGES)

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THE WALL STREET JOURNAL.

Markets
Hedge Funds Are on the Way to a Bad 10-Year Streak; The funds continue to lag behind the stock market, despite a record level of assets. But a few managers are delivering.

By Eric Uhlfelder
1,289 words
9 September 2018
10:03 PM
The Wall Street Journal Online
WSJO
English

Hedge funds were finally hoping the return of volatility in 2018 was going to revive their fortunes.

But no such luck. Hedge funds are well on their way to their 10th straight year of underperforming U.S. stocks.

To assess what happened in the first half of 2018, global industry data tracker BarclayHedge ran a broad screen of several thousand hedge funds for The Wall Street Journal. BarclayHedge found the average hedge fund return to be a paltry half percent while the S&P 500 rose more than 2.5%. Incomplete returns through July so far show a significant widening of the year-to-date performance gap, with the market up nearly 6.5% while hedge funds gained 1.10%.

The Wall Street Journal sorted the funds by strategy, identifying the weakest first-half performers. They were led by emerging markets, commodity trading advisers, or CTAs, and global macro, which were down 4.7%, 2.2%, and 1.1%, respectively (see table).

"Emerging markets are being hurt by an appreciating U.S. dollar, the rising specters of trade wars and protectionism, political discord and macroeconomic turmoil, especially in Turkey, Argentina and Brazil," says Carl Tohme, manager of Jabre Capital EMEA fund, which outperformed the BarclayHedge EM index by 5.5 percentage points.

Global macro funds and CTAs—which both target broad asset-class exposure such as interest rates, currencies, stocks, bonds and commodities—took two major hits: the February reversal in the U.S. stock rally, and the return of volatility in European debt after the Italian election results in May.

A global macro fund that stood out for its first-half performance was AlphaQuest Original of Quest Partners LLC, which climbed nearly 21%. The fund uses quantitative models to target periods of rising volatility and short-term trade exposure. Quest President Prashant Kolluri says the fund's returns in the first half were boosted by quickly moving in and out of the U.S. stock rally that followed the tax-overhaul passage, and by being short Italian bonds and long in safe-haven bonds, such as German bunds. Bets on rising crude-oil futures also helped.

Still popular

Despite dull industry performance, investors still haven't lost their taste for hedge funds. According to Hedge Fund Research, assets grew to a record $3.236 trillion as of June, up from $3.211 trillion at the end of 2017, supported by some massive fund launches. These include Steve Cohen's $13 billion Point72, former Millennium Management executives Michael Gelband's and Hyung Soo Lee's $8 billion ExodusPoint, and former Viking Global CIO Daniel Sundheim's $4 billion D1 Capital.

While most strategies continue to struggle, the several that did outperform the market in the first half were led by distressed securities. Funds in this category, which generally focus on companies suffering from poor mergers, loss of industry leadership, shifting demand or restructuring, were up an average 6.26%. While the category is up more than 10% over the past year, this follows several years of lackluster returns.

One leading hedge-fund manager in this category is $281 million Man GLG European Distressed. Its U.S. Dollar Class A fund was up 11% for the first half, and nearly 15.5% over the past 12 months. Though it has an annualized rate of return of more than 11% since its launch a decade ago, with volatility under 9.5%, the fund is also recovering from sluggish performance over the past several years. A representative for the fund says it declines to comment.

While fixed-income funds as a whole didn't do much during the first half, several specialty fixed-income strategies managed decent returns, led by collateralized debt obligations, up 6.24%, asset-backed loans, which tacked on nearly 4%, and asset-backed securities, up 3.44%.

A lead performer in funds specializing in CDOs continues to be Hildene Opportunities Master. The $1.8 billion fund, launched a decade ago, has generated gains of nearly 23% a year with **volatility** of 8.4%. Hildene is keeping pace with its historic returns, with gains of over 10% through June.

A key driver of performance, says Hildene co-CIO Brett Jefferson, has been targeting exposure to specific, undervalued, trust-preferred CDOs of regional banks that are benefiting from improving credit conditions and ratings, and anticipated eligibility for auction. Trust-preferreds are hybrid securities that a company (typically a financial) establishes by creating a trust, which holds debt issued by the company; to raise more desirable Tier 1 capital, the company then issues preferred stock whose dividends are supported by company interest payments on that debt.

European plays

The third leading strategy, only marginally trailing the broader market, is European hedged equities, or funds that are both long and short European shares. These managers registered gains of 2.51%, an improvement over the past five years. These managers have so far been outpacing the BarclayHedge Equity Long/Short Index, which has a strong bias toward U.S. stocks, and which returned 1.63%.

Leading the continental pack is the $234 million Odey European Equity, a fund from London-based Odey Asset Management that uses long and short strategies. Its Sterling class was up 24% for the first six months, helped by two bets: shorting the pound and U.K. government bonds on the premise that Britain's exit from the European Union will harm the U.K. economy, and a long position in British telecom and media company Sky PLC, which is the target of a three-way bidding war.

But Odey's surge reflects the challenges of assessing funds by what they've done lately. Over the past three calendar years, the fund has lost more than 20% annually.

Looking ahead, Marc Sbeghen, partner of Iteram Group, an asset advisory and "fund of funds" based in Luxembourg and Switzerland with $1 billion under management, figures hedge funds generally will do better in the second half, especially hedged equity.

"We are in the most hated **bull market**, and a lot of people haven't stepped in," says Mr. Sbeghen, "but robust results in the next quarter and the result of U.S. midterm elections could push the market higher."

Many institutional investors have been perennially disappointed by global macro and CTAs. Cédric Vuignier, head of manager research and alternative investments at the Geneva-based SYZ Group, which manages $38 billion, says "normalization of interest rates and unwinding of quantitative easing should sustain directionality, which should finally boost returns of both strategies, helped further by higher cash yields."

"Broad market dynamics have broken down," says Panayiotis Lambropoulos, portfolio manager of hedge-fund investments at the $28 billion Employees Retirement System of Texas. He notes there has been an explosion of debt issuance and soaring equity valuations along with plenty of events to move prices, but a surprising lack of dispersion among assets.

"There seems to be a new rulebook out there," Mr. Lambropoulos says, "but its content, typically informed by established financial theories and experience, has turned increasingly indecipherable."

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THE WALL STREET JOURNAL.

Markets

REITs as an ETF: Pluses and Minuses; They generally feature low fees, a big advantage over actively managed real-estate funds

By Gerrard Cowan
702 words
9 September 2018
10:05 PM
The Wall Street Journal Online
WSJO
English

Exchange-traded funds that invest in real estate can be a low-cost way to play the property sector. However, there are reasons for caution.

Real-estate ETFs can consist of real-estate-investment trusts, or REITs, or a mixture of REITs and stocks of companies in the property sector. Some focus on the U.S. market, while others provide international exposure. They generally feature low fees, a big advantage over actively managed real-estate funds, says Ben Johnson, director of global ETF and passive strategies at Morningstar. Schwab U.S. REIT ETF (SCHH), for one, a $4.84 billion fund with a 5.44% return this year through August, charges expenses of 0.07%, he says, compared with a median of 1.10% for the Morningstar real-estate category, excluding ETFs.

Nevertheless, this has been a bumpy year for the funds. Mr. Johnson says funds in Morningstar's real-estate category (including ETFs) saw an average return of 3.63% through the end of August, compared with 10.5% for the MSCI USA Index. These "relatively lackluster" returns are partly attributable to rising interest rates, Mr. Johnson says, "which can serve as a short-term headwind for this rate-sensitive sector."

Michael Iachini, head of manager research for Charles Schwab Investment Advisory, says REIT ETFs "do not move in lockstep with either stocks or bonds." But they do offer the potential for diversification and income. Through the end of August, he says, Morningstar data show a trailing 12-month yield of 4.05% for the average ETF in the financial firm's real-estate category, compared with 1.38% for the average large-blend ETF.

When REIT ETFs are used to diversify a portfolio, investors should be comfortable with returns that vary from the broad market, depending on how much they invest in the area, says Rich Powers, head of ETF product management at Vanguard, which runs Vanguard Real Estate ETF (VNQ), the largest U.S. real-estate ETF, with assets of about $33 billion. More than 96% of the fund is invested in REITs, he says.

"These funds have historically provided investors with non-market-correlated returns and diversified income opportunities," he adds.

Daniel Prince, head of iShares U.S. Wealth Advisory Product Consulting, which runs U.S.-focused and global real-estate ETFs, says investors have started returning to real-estate ETFs after a rocky first half. In the first five months of 2018, he says, there were about $2.25 billion of outflows from U.S.-listed real-estate ETFs, and outflows of $116 million in those listed in other countries. However, June and July saw inflows of just under $1.68 billion in the U.S. and almost $2.6 billion internationally.

Experts agree that focusing too much on U.S. real estate can be a mistake. It is important to diversify internationally, says Matthew Bartolini, head of SPDR Americas Research at State Street Global Advisors, which runs a number of real-estate ETFs, including SPDR Dow Jones Global Real Estate ETF (RWO), a $2.4 billion fund that has seen returns of 2.05% through August. Mr. Bartolini says REIT ETF investors should invest in funds with properties "in the U.S. and outside." This reduces the risk of being overexposed to local economic sensitivities in a given country, he says.

Investors should remember that the real-estate market could fall in value, says Mr. Iachini. While REITs can help diversify a portfolio, they are "just one piece of the market, and focusing too heavily on them can lead to more portfolio risk than investors might want."

Mr. Cowan is a writer in Northern Ireland. He can be reached at reports@wsj.com.

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THE WALL STREET JOURNAL.

Markets

Military Spending Boosts an ETF; iShares U.S. Aerospace & Defense has surged over the past year, but trade-war fears are tempering optimism

By Gerrard Cowan
352 words
9 September 2018
10:02 PM
The Wall Street Journal Online
WSJO
English

The largest aerospace-and-defense exchange-traded fund has surged over the past year, though analysts say global trade disputes are tempering optimism for the sector.

The $5.73 billion iShares U.S. Aerospace & Defense ETF (ITA) follows a market-cap-weighted index of U.S. aerospace and defense companies, including giants Boeing Co., Lockheed Martin Corp. and United Technologies Corp. It has returned more than 10% year-to-date through August, and almost 23% over the past 12 months.

The earnings of many companies in the index have been strong recently, driven by robust global demand in both the civil aerospace and military domains, says Dhruv Nagrath, U.S. iShares investment strategist.

In the U.S., the Trump administration has made military spending a priority, which investors have viewed as a tailwind for the sector, says Mr. Nagrath.

However, Mr. Nagrath points to fears about what growing trade conflicts might mean for the civil aerospace industry, with companies like Boeing increasingly reliant on the international market. Boeing, for example, has estimated that Asia-Pacific will soak up 40% of airplane deliveries from 2018 to 2037.

Global spending on both aerospace and defense is continuing to rise, which could underpin ITA in the coming years, says Neena Mishra, director of ETF research at Zacks Investment Research. However, "there are concerns that a widening fiscal deficit could impact military spending [in the U.S.] in the early 2020s," she says, while trade disputes or **oil-price** increases could affect the commercial side.

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THE WALL STREET JOURNAL.

Markets

U.S.-Stock Funds Rose 3.1% in August, Adding To Their Global Lead; It was a good month for U.S. stocks, and positive for bonds. But international stocks fell back.

By William Power
411 words
9 September 2018
10:08 PM
The Wall Street Journal Online
WSJO
English

In the **stock-market** olympics, Americans won the medals this time.

U.S.-focused stocks, and the mutual funds and exchange-traded funds that invest in them, pulled away from the rest of the world in August. At a time when trade disputes were rattling many global investors, leading to a retreat in stock markets outside the U.S., the continued strength in U.S. corporate earnings and upbeat economic data benefited U.S. markets.

The result was that the average U.S.-stock fund registered a total return of 3.1% for August, according to Thomson Reuters Lipper data. These U.S.-focused funds are now up 9.3% for the year to date after having risen 18.3% for all of 2017.

It was a different story across the oceans. International-stock funds were down 1.8% for August and are now off 2.5% so far this year.

In the U.S., tech stocks in particular were strong. As a result, several Lipper fund categories had a robust month: Science and technology funds were up 5.4% (and now nearly 16% so far this year), and health/biotechnology was up 5.5% (and 18% for the year).

Funds that focus on small-capitalization stocks—which are less exposed to global turmoil, including trade disputes—continue to drub other U.S. categories. Small-cap growth funds rallied 8.2% in the month and are now up nearly 23% for the year. Small-cap fund managers have been dominating the list of top-performing stock pickers.

Bond funds gained on average in August, as some investors sought safety. Funds focusing on intermediate-maturity, investment-grade debt (the most common type of bond fund) were up 0.5%, shaving their year-to-date decline to just over 1%.

Mr. Power is a Wall Street Journal news editor in South Brunswick, N.J. Email him at william.power@wsj.com .

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THE WALL STREET JOURNAL.
U.S. EDITION

Conflicting Signals Stir Up Oil Market

By Dan Molinski
860 words
10 September 2018
The Wall Street Journal
J
B1
English

The oil market is at a crossroads after its worst week in almost two months prompted many investors to reassess whether global growth will continue stoking demand for fuel.

West Texas Intermediate slid 2.9%, the biggest weekly decline since July, to $67.75 a barrel. That is after the U.S. crude benchmark had capped August with one of its sharpest rallies of the year, jumping more than 7% from the middle of the month. Brent, the global barometer for crude, ended last week 1% lower at $76.83, after nearing an almost four-year high.

The rapid rise and fall in **oil prices** is a sign investors are weighing conflicting signals in the market. On one hand, robust developed-market economies have sustained demand for crude, while U.S. sanctions against Iran have led to shrinking oil exports from the country, draining global supplies. At the same time, emerging markets recently tipped into a **bear market**, spurring investors to monitor whether deeper declines will spill over into other assets.

Emerging markets are the main source of growth in oil demand, said Ole Hansen, head of commodity strategy at Saxo Bank. He expects crude prices to be rangebound but also that spikes may push U.S. gasoline prices higher, which could lead to lower oil consumption. Demand growth for crude would then be hit by a "perfect storm of rising **oil prices** and weaker currencies," he said.

Adding to pressures, the oil market is entering a season when demand typically weakens. Autumn is considered a "quiet period" for oil, with prices often declining as the summer driving season ends and refineries shut for maintenance.

U.S. **oil prices** have drifted between $64 and $74 since April, while $71 and $79 have been the bookends for Brent.

Data show demand for oil and fuel staying strong domestically. U.S. gasoline prices, which average $2.86 a gallon, are about 20 cents higher than they were last year at this time.

But U.S. motor gasoline supplied to the market -- a figure used by economists as a proxy for demand -- has averaged 9.4 million barrels a day so far this year, 1.3% higher than the figure at this point last year, according to the Energy Information Administration.

"Demand is quite strong despite the change in season and the worries over the emerging markets," said John Kilduff, managing partner at Again Capital, a New York-based alternative-investment-management firm specializing in commodities. He forecasts WTI will climb to $85 by the end of the year, which would be the highest price since late 2014.

But if **oil prices** push a few dollars above their recent range, analysts worry they could have a harmful effect on the economy. Prices are about 40% higher now than this time last year, and U.S. consumer wallets are already stretched paying for gasoline at the pump that is at a four-year high.

Dwindling crude shipments from Iran, combined with potential further declines in output from crisis-racked Venezuela, could also cause global supply shortages, pushing prices even higher. President Trump in May pulled the U.S. out of a 2015 international agreement to curb Iran's nuclear program, setting the stage for the reimposition of economic sanctions on the country's oil sector.

"I do believe the lost Iranian barrels will hit the market and consumers hard," Mr. Kilduff said.

Sharply higher **oil prices** could also stir inflation pressures, by some measures already above where the U.S. central bank expects them to be in the longer term. That would provide more reasons for the Federal Reserve to continue raising interest rates, a move that could cool both economic growth and **financial markets**.

"What goes on in energy markets has a critical impact on monetary policy," Federal Reserve Bank of Dallas President Robert Kaplan said at an energy conference Friday. "We've obviously had a drifting up in prices already. But if you have a spike up, that obviously has a big impact on the U.S. consumer."

All this is occurring as U.S. voters go to the polls in November for congressional midterm elections.

Most analysts don't expect oil to spike to $85. Many are confident simmering trade tensions between the U.S. and China will keep a lid on prices, as the dispute could weigh on economies world-wide and oil demand.

Analysts also said a ramp-up in oil production from Organization of the Petroleum Exporting Countries members such as Saudi Arabia, as well as nonmembers like Russia, could offset falling output from Iran. Market participants will monitor a meeting between OPEC and non-OPEC producers this month in Algeria.

Gene McGillian, vice president of research at Tradition Energy, said the most important factor for where **oil prices** are headed is how many Iranian barrels are taken off the market. While U.S. allies in Europe and elsewhere have moved to end their oil purchases from the country, other nations such as China haven't been as clear about plans.

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THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds & ETFs (A Special Report) --- Market Breadth

By Simon Constable
263 words
10 September 2018
The Wall Street Journal
J
R7
English

Some **stock-market** strategists are increasingly concerned about something called "market breadth," or rather the current lack of it. But what does it mean, and why should you care?

Market breadth is a measure of how many stocks are moving the major indexes. It can serve as one indicator of how much staying power a rally is likely to have.

Right now, the indications aren't good for stock investors. For instance, a recent report from Goldman Sachs notes that a mere 10 stocks in the **S&P 500 index** were responsible for generating more than half the gains in the index this year through late July.

Similarly, a recent report from Morgan Stanley notes that the number of stocks in the tech-stock-led **Nasdaq** index that are reaching record levels is falling. And that is happening even though the index itself keeps going higher.

The upshot is that "fewer stocks are carrying the load of the market," the report says, "a bad signal for further price gains."

Generally, rallies that have many stocks pushing up an index have more resilience than those that rely on a few stocks, says Don Coxe, chairman of Chicago-based Coxe Advisors LLC.

Mr. Coxe notes a classic example of lack of breadth signaling a market decline was in 2000 and 2001, when technology stocks kept pushing the broad index higher, without much help from other shares, until the rally collapsed and turned into a rout.

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THE WALL STREET JOURNAL.

Opinion

Lehman: Political and Personal; The man who led the firm after it collapsed says politics still reigns over policy.

By Andy Kessler
838 words
9 September 2018
04:19 PM
The Wall Street Journal Online
WSJO
English

Lehman Brothers filed for bankruptcy on Sept. 15, 2008—left to twist in the wind by Treasury Secretary Hank Paulson. Ten years after, is Wall Street safe from another financial meltdown? Banks, pulling in record profits, appear to be in pretty good shape. But something seems wrong, as if the lessons of the financial crisis already have faded.

That's only an intuition, so I called someone who would know—the former CEO of Lehman Brothers. No, not Dick Fuld, one of the public faces of Wall Street's collapse. Instead, I talked last month with Bryan Marsal, of Alvarez & Marsal, who led Lehman for the three years after its bankruptcy.

I asked Mr. Marsal why Lehman was allowed to fail and what lessons were learned. He responded with two words: political and personal. What made business or economic sense wasn't considered. Mr. Marsal explained that Mr. Paulson "had no standing in the Lehman bailout decision but seemed to dominate the entire process." The Bush administration already had bailed out Bear Stearns five months earlier, and Fannie Mae and Freddie Mac the week before. Using taxpayer money to bail out perceived Wall Street fat cats had become very unpopular.

Why was Mr. Paulson channeling Ralph Kramden? The Treasury secretary, Mr. Marsal thought, "should have taken a back seat and let the pros from the Federal Reserve drive the bus." Plus, as a former Goldman Sachs CEO, "Paulson simply didn't like Dick Fuld, and he had run out of patience." It didn't help that in 1998, when Long-Term Capital Management needed bailing out, Wall Street got together and everyone kicked in, except Mr. Fuld's Lehman.

On Sept. 9, Mr. Paulson told a group of CEOs about Lehman, "There's no government money here." Shortly thereafter, taxpayer money went into Goldman Sachs, Morgan Stanley, Citigroup and others. It seems Fed Chairman Ben Bernanke grabbed control of the bus from Mr. Paulson after the almost instant contagion and carnage from the Lehman bankruptcy. Withholding a bailout was a mistake. A subsidized merger or an orderly bankruptcy would have made more sense.

Why is this so important? Today there is nothing stopping the political and the personal from trumping rational economic decision-making in the next crisis. Sure, there's Dodd-Frank, which passed in 2010 after congressional blathering about arresting bankers. But Mr. Marsal suggested the law makes Wall Street less safe: "The Federal Reserve demonstrated that it had the power to stem a liquidity crisis before the Lehman fall, by virtue of the post-Lehman actions." But it was implicit, unstated. Now, it's explicit. Read Section 214 of Dodd-Frank: Prohibition on Taxpayer Funding. In a crisis, the Fed and Treasury could ask Congress for powers and probably get them, but that brings them back to the political and personal again.

Many of Lehman's creditors couldn't get paid back for years because much of the company's capital was domiciled in Europe. Unable to get their Lehman money, funds and individual investors sold anything liquid to have working capital and pay off debt. That's why the **stock market** sold off so hard in early 2009. Mr. Marsal explained, "In the U.S., a liquidation has its primary objective of recovery maximization to the creditors." Lehman would prepay as much as 90% of claims and finish returning all assets in 3½ years.

In the U.K., on the other hand, the "primary objective is the minimization of liability to its receiver, encouraging decisions at glacier speed increasing the cost to the creditors." Ten years later in Europe, PwC is "still rolling along," presumably still collecting fees. This lesson of liquidity is rarely discussed, but it may have been the most important postbankruptcy menace.

Has anything changed? After dealing with Lehman's unwinding, Mr. Marsal had hoped for a cohesive regulatory framework from Washington. Instead the bureaucracy won. Still active and influential are the Federal Reserve, the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission—plus the Treasury, which should stay out of bailouts, and a growing bureaucracy created by the Dodd-Frank Act. No entity is in charge, so everyone is in charge. Politics still reigns over sound policy.

There is more concentration in banks today than pre-Lehman. They're better capitalized with better reserves, but it's still fractional reserve banking. And the shadow banking business that got drenched in derivatives may be larger today than it was before the crisis. Leveraged loans are rampant. That doesn't point to stability.

In downturns, equity hurts but debt kills. Like an electrode-implanted rat that can't stop pushing a pleasure lever, banks will lend until they implode. A decade ago, the Fed failed as the lender of last resort. It's still failing at preventing the next crisis.

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THE WALL STREET JOURNAL.

Markets

Profits Jump at Japanese Companies, but Foreign Investors Don't Bite; Despite record profits, the Japanese stock market still isn't finding traction with mainstream equity investors from abroad

By Mike Bird
950 words
9 September 2018
01:00 PM
The Wall Street Journal Online
WSJO
English

Something strange is going on with corporate Japan: Profits have soared at Sony Corp., Suzuki Motor Corp. and many others. Yet foreign investors, by and large, aren't that interested.

Overall, Japanese companies have rarely been better at making money. After decades of stagnation, profitability has soared under Prime Minister Shinzo Abe's economic revival program, dubbed Abenomics. Profit margins at nonfinancial firms hit a record 7.7% in the second quarter. This ratio, which compares earnings before interest payments and taxes with sales, rarely topped 4% until a few years ago.

The trend has been sparked by both strengthening economic growth and changes to the way publicly traded businesses are run in Japan. As part of Mr. Abe's changes, companies have been encouraged to focus more on measures of efficiency, such as return on equity, and on being more responsive to shareholders, with better qualified and more independent boards. Complex corporate structures are being unwound. A stewardship code has prodded investors to be more demanding.

"You go back to the 1990s, small companies in Japan talked about growth as growth in revenue," said Travis Lundy, an independent analyst publishing at Smartkarma. "There's been an effort to get companies to think of themselves as profit engines, not just employment engines or revenue engines."

Suzuki Motor, the $32 billion car and motorbike manufacturer, exemplifies the trend in Japan. Its net margin hit 8.7% in the latest quarter. A decade ago, this figure rarely topped 3%. Earlier this year Sony, the entertainment and electronics giant, reported the largest annual operating profit in its 72-year history.

Some sophisticated Western investors, encouraged by the shift, have jumped in. Corporate relationships in which a publicly traded parent company owns controlling stakes in other listed companies are breaking down, creating opportunities for private-equity firms like KKR & Co. and hedge funds like Elliott Management Corp.

But the Japanese **stock market** still isn't finding traction with mainstream equity investors from abroad, who have actually sold down Japanese holdings this year. This is despite Japan appearing to be a relative bargain: The MSCI Japan index trades at just 12.7 times expected earnings, according to Datastream, a 16% discount to the MSCI AC World index.

Meanwhile, Japanese stocks have languished. The Nikkei 225 is down almost 2% in 2018 versus a nearly 8% gain year to date for the **S&P 500**.

"Japan is the only major country that is going through a structural improvement in corporate governance, and thus deserves special attention by global investors," said John Vail, chief global strategist at Nikko Asset Management, in a recent note to clients.

The changes are feeding through to the bottom lines of Japanese companies. Since the beginning of 2013, net margins, or net income as a share of revenue, have more than doubled to an average of 6%, according to a FactSet index covering over 2,500 listed Japanese companies.

The country still lags behind the U.S. and Europe, suggesting Tokyo is a long way from the point that it must worry about whether increasing profits are sustainable. Still, the recent improvement has been sharper than in the U.S. and Europe.

In the U.S., profit margins bounced back sharply after the financial crisis. But after peaking at nearly 12% in early 2012, they have been in a range of 9% to 10% for the past three years.

So why are investors, particularly foreign fund managers, balking? One problem is Japanese companies are sitting on what many investors think is too much cash.

Although companies are increasing dividends and stock buybacks, a mountain of cash on corporate balance sheets keeps growing. As of the first quarter of this year, nonfinancial companies held 273.76 trillion yen ($2.37 trillion) in currency and deposits, according to Bank of Japan data, a figure that has risen by almost half in 10 years.

Mr. Vail said Japanese companies need to hand more of this cash to shareholders to garner greater attention.

In general, Japanese companies still hoard more cash than U.S. and European peers. That is reflected in lower levels of debt: Japanese-listed companies have net debts of roughly 1.5 times earnings before interest, taxes, depreciation and amortization, according to FactSet. The equivalent U.S. figure is 2.3 times.

Another problem is that growth in global markets has been driven in part by the emergence of huge tech and internet companies. Japan lacks these.

"There aren't the sort of superstar firms in Japan that are the ones that have really benefited elsewhere," said Toby Nangle, head of multiasset allocation at Columbia Threadneedle. "There's no Google, no Amazon."

Broad-based improvements in governance and financial policies are less eye-catching than the emergence of a few globally recognized stars, said Mr. Nangle, who has been positive about Japanese stocks for several years under Abenomics.

His major concern, though, is the Bank of Japan's purchases of exchange-traded **stock index** funds, a radical step few other central banks have taken. The move has boosted stocks, but in the future policy makers could slow their buying or even sell holdings, potentially depressing the market.

Trade tensions between the U.S. and China may have also had an impact. "Japan is an important player in global trade and is not immune to protectionism, even if it is not directly targeted," said William Smith, a portfolio manager at Pimco.

Write to Mike Bird at Mike.Bird@wsj.com

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The New York Times

Business Day; DealBook
Tesla Needs to Build Investor Trust. The Exit of Its Accountant Won't Help.

By Peter Eavis
693 words
9 September 2018
05:42 PM
NYTimes.com Feed
NYTFEED
English

Companies can have unconventional chief executives, but not eccentric accounting.

Tesla, the electric-car maker, on Friday disclosed that its chief accounting officer had resigned and was leaving just weeks after his arrival. The announcement came hours after Elon Musk, Tesla's chief executive, appeared live on YouTube smoking what seemed to be a marijuana cigarette.

Those headlines only added to the turmoil that has surrounded Tesla this year. Last month, Mr. Musk started and ultimately aborted an ill-conceived attempt to take Tesla off the public **stock market**. For much of 2018, the company has struggled to hit production targets for the Model 3, the lower-priced car whose sales are supposed to finally make Tesla consistently profitable.

The departure of Tesla's chief accounting officer, David Morton, may be particularly concerning for investors because of its unfortunate timing. Tesla, which has seen its cash stockpile shrink in recent quarters as its debt has grown, is entering a crucial period in which there can be no qualms about its financial statements.

Much rides on Tesla hitting certain financial goals. Mr. Musk said last month that he expected the company to be profitable, under generally accepted accounting principles, in the last two quarters of this year. In less precise terms, Tesla also said it expected to show positive cash flows. Its executives have at times also made predictions about its automotive gross margin, which measures how much revenue is left after subtracting the costs closely associated with producing cars. Because such financial benchmarks are derived from inputs that investors often cannot see, Tesla must have their trust.

But with the sudden exit of Mr. Morton, investors might now fret about the reliability of Tesla's financial statements. Tesla's stock plunged on Friday and now trades 30 percent below the price it hit after Mr. Musk said in a tweet on Aug. 7 that he was considering taking the company private.

Mr. Morton could not be reached for comment.

It's possible his resignation signifies little. Mr. Morton was not Tesla's top accountant; that is Deepak Ahuja, the chief financial officer, who has been at the company for the better part of a decade. And in Tesla's filing on Friday, Mr. Morton said he had "no disagreements" with the company's financial reporting. "Since I joined Tesla on August 6th, the level of public attention placed on the company, as well as the pace within the company, have exceeded my expectations," Mr. Morton said.

Big questions remain, though, and his statement is unlikely to assuage investors.

Mr. Morton was previously the chief financial officer at Seagate, a company that makes disk drives for computers. When announcing his appointment, Tesla said he would "bring more than two decades of significant financial and accounting expertise to Tesla." Did he discover that his new working environment was difficult or in disarray? Was there something he was uncomfortable signing off on?

Mr. Morton's predecessor, Eric Branderiz, left after 14 months.

There’s a recent reason Tesla’s high-ranking accountants might feel uncomfortable. The Securities and Exchange Commission is investigating not only Mr. Musk’s tweets musing about taking Tesla private but also the company’s disclosures about certain production goals. Such investigations can broaden.

Before Mr. Musk tweeted about going private last month, Tesla’s promises about becoming profitable seemed to reassure investors. Shares jumped nearly 16 percent the following day. But the turbulence since then has only increased the pressure on Tesla. Not only does the company need to deliver on its promises, investors must be able to trust those results.

With the latest executive departure, that just became all the more difficult.

Elon Musk, Tesla’s chief executive, has promised the company would be profitable in the second half of the year. Investors will want to be certain they can trust the company’s numbers. | Kiichiro Sato/Associated Press

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THE WALL STREET JOURNAL.

Markets

Wages Are Rising. Will Inflation Follow? Should wages accelerate, some analysts expect the gains to power more consumer spending, leading to a cycle of price increases throughout the economy

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Inflation will be front and center for investors this week. Labor Department data out last Friday showed strong gains in U.S. workers' wages, sparking selling in government bonds. The declines sent the yield on the benchmark **10-year Treasury** note, which rises as **bond prices** fall, to its highest level since Aug. 8, widening the gap between the 10-year and two-year yields. Since the beginning of the year, investors have been searching for signs of inflation, which poses a threat to the value of a bond's fixed interest and principal. Should wages accelerate, some analysts expect the gains to power more consumer spending, leading to a cycle of price increases throughout the economy.

A larger-than-expected gain in average hourly wages raised new concerns on Friday about an acceleration in inflation. Wage gains are typically considered a precursor to inflation. The slow pace of pay increases earlier this year had been matched by rising prices for gasoline. That had diminished some of the increase to purchasing power that was expected to come from the 2017 tax cuts.

Investors, however, aren't betting on a large acceleration in price increases. A measure of bets on average annual inflation over the next 10 years, known as the 10-year break-even rate, rose modestly Friday to 2.11 percentage points. Bondholders have been reluctant to bet on a faster pace of consumer-price increases. Continued tension between the U.S. and its major trading partners has dampened economic activity and threatens to further restrain the pace of growth.

Investors will get a fresh look at inflation prospects next week when the Labor Department releases the consumer-price index. The index reached a six-year high earlier in 2018, propelled by rising prices for energy, transportation services and shelter.

Economists will watch for continued strength in consumer spending, an engine of the economy, when the Commerce Department releases August retail-sales data this Friday. Growth in retail sales in July was driven by stronger spending at grocery stores, restaurants, department stores and clothing stores.

Shares of retailers have been among the best performers in the **S&P 500** this year, an unexpected turnaround fueled by strong earnings, buoyant consumer confidence and a nationwide shopping spree. Department stores, discounters and auto-parts retailers are some of the biggest gainers.

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The New York Times

Money and Business/Financial Desk; SECTBU
This Could Be a Mid-1990s Moment for the Economy

By NEIL IRWIN
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5
English

A painful recession was fading into memory, yet the expansion felt unsatisfying to many. There was evidence of huge technological leaps everywhere except in the data on worker productivity. And the unemployment rate was falling to levels that forecasting models predicted would trigger a burst of inflation.

That was the economic situation in the mid-1990s, and it also describes 2018. An intriguing -- and optimistic -- possibility for the years ahead is that the parallels with the 1990s won't end there.

Back then, technological advances that had been building for years finally started to translate into higher rates of productivity growth economywide. Some feared inflation, but Alan Greenspan, the Federal Reserve chairman, decided not to move pre-emptively to choke off the expansion. Instead, he advocated patience to see just how hot the economy could get without setting off a spiral of rising prices.

The result was the strongest period of growth and prosperity in recent decades.

History, of course, may not repeat itself. The mix of technological advances and sound economic policy that generated the 1990s boom simply may not materialize this time. Plenty of threats could send this expansion hurtling toward recession instead.

A trade war or emerging markets crisis or economic policy mistake could prove more powerful than economic fundamentals. And some of the technological advances that seem on the verge of fueling a productivity boom may take longer to develop than their enthusiasts assert.

But it's clear that some senior economic policymakers are at least open to the possibility of a boom. In a speech last month, the Federal Reserve chairman, Jerome Powell, discussed the 1990s experience in detail, suggesting that Mr. Greenspan's strategy at that time was one to emulate.

In 1996, many Fed policymakers wanted to raise interest rates to head off the risk of inflation. ''But Chairman Greenspan had a hunch that the United States was experiencing the wonders of a 'new economy' in which improved productivity growth would allow faster output growth and lower unemployment, without serious inflation risks,'' Mr. Powell said.

''Meeting after meeting,'' he added, the Fed's policy committee ''held off on rate increases while believing that signs of rising inflation would soon appear. And meeting after meeting, inflation gradually declined.''

Mr. Powell wasn't forecasting that the same would happen in coming years; rather, he was preaching the virtues of Mr. Greenspan's strategy of risk management that allowed the boom to emerge.

The expansion of the last nine years has been steady and successful at putting millions of people to work, but it has fallen short in overall growth or in generating substantial boosts to incomes.

The culprit: productivity. The amount of output per hour of labor has been growing slowly. In the last five years, it has risen about 1 percent annually, compared with 2.1 percent on average since 1947.

If that changes, and businesses find ways to get more production of goods and services out of each hour of work, it should set the stage for higher wages and faster growth. That's what happened in the 1990s: Annual productivity rose an average of 1.8 percent from 1991 to 1995, then leapt to a 3 percent annual rate from 1996 to 2000.

What are the chances of a similar jump in the coming years, with similar beneficial results? Economists don't have a great understanding of what drives productivity advances, but there are three realistic possibilities of where gains might come from -- and they aren't mutually exclusive.

Solow's Paradox and Technological Diffusion

In 1987, the economist Robert Solow joked that ''you can see the computer age everywhere but in the productivity statistics.'' That is, even as there were remarkable advances in semiconductors, software and desktop computing, it wasn't evident in any efficiency improvements in the overall economy.

The surge didn't arrive until well into the 1990s, and that pattern -- a long lag between a technological innovation and its full economic impact -- makes sense when you think about it.

For example, fewer corporate executives have a full-time secretary now than they did in the 1980s, in part because of innovations like voice mail, email and desktop word processors. But it's not as if companies suddenly fired a bunch of secretaries on the day they got a voice-mail system. It was a gradual process as more people became accustomed to answering their own phones and typing their own memos.

Just because some high-performing companies have started using a productivity-enhancing technology doesn't mean it has spread throughout the business world. By the early 1990s, Walmart became efficient in using computers to manage its supply chain -- at a time many retailers were still using old-school cash registers. It would be years before the bulk of the industry caught up. The Walmart catch-up effect was a major part of the late 1990s overall productivity surge, according to research from the McKinsey Global Institute.

Moreover, sometimes big innovations can actually make the economy less productive while they are being introduced. An automobile factory that's installing a robotic assembly line might employ many robotics engineers, but also autoworkers still making cars the old way. Even if the innovation eventually results in higher productivity, the company might need more person-hours of work per car produced in the short run.

What are the potential parallels in 2018?

Technological optimists have argued for years that artificial intelligence, machine learning, advanced robotics, augmented reality and other areas offer huge potential efficiency gains. As in Solow's Paradox from an earlier era, there's no evidence yet in the economic data, but perhaps that will change, as it did with an earlier generation of advances.

That's exactly what McKinsey consultants found in research published in June.

One day driverless cars may be a boon for productivity -- but right now they are a drag on it as thousands of skilled engineers work to develop the technology without generating a dime of economic output.

Similarly, farms may eventually increase their yield with artificial intelligence that allows them to automate the pulling of weeds and the application of fertilizer. Electrical utilities may be able to become more efficient using smart grids. Hospitals may be able to deliver better care for less money when computers help diagnose patients.

Will technologies like those be ready for prime time soon, or ever? That's the part we don't know for sure.

But there are other forces that will more clearly affect the productivity outlook in the next few years.

Tax Cuts and a Capital Spending Surge

At the root of conservative economic philosophy is that low taxes on capital, along with light regulation, will encourage businesses to invest more heavily, resulting in a more productive economy in the long run.

The next few years will be a test of that proposition.

The corporate income tax rate was cut to 21 percent at the start of the year, from 35 percent. The Trump administration's deregulation-minded appointees have had a year and a half to go about their work.

Oh, and the **stock market** is booming, and interest rates remain low by historical standards, implying companies should have plenty of access to capital on favorable terms if they want to make those investments.

In short, this should be a conducive environment for businesses to increase their "capital stock" -- the accumulated facilities, equipment, software and other intangible investments -- to enable workers to be more productive.

Is this investment actually happening? The evidence isn't definitive at this point. Business investment rose at an 11.5 percent rate in the first quarter of 2018 and 8.5 percent in the second quarter, both substantially faster than the economy as a whole. But that was fueled in part by a boom in energy exploration that was probably more tied to the rise in **oil prices** in 2017 than tax policy.

The nascent trade war may create a layer of uncertainty for businesses that have major customer bases overseas as they weigh big-ticket investments, working at cross-purposes with the stated goal of the tax legislation.

But the verdict on whether pro-business policy out of Washington will drive a surge in investment spending, with big benefits for productivity, will depend on more than a couple of quarters, and remains a real possibility.

The Tight Labor Market

Finally, the tight labor market could force businesses to find more efficient ways to deploy workers.

With the unemployment rate at 3.9 percent, near a several-decade low, companies in a range of industries have been complaining about the difficulty of finding qualified labor.

This shows up in headlines about trucker shortages, construction worker shortages and oil field worker shortages. It may eventually show up in faster growth in wages, no matter what happens to technological advances or business investment.

But one distinct possibility is that it will force businesses to act more creatively and aggressively about squeezing more economic output from each hour of labor.

Companies could invest more heavily in new capital -- think of automated checkout kiosks at retail stores or restaurants. Or companies could provide extra training so that each worker can get more done.

It could also happen through experimentation with new management techniques or other business practices; these would show up in what economists call "total factor productivity."

This isn't the traditional way economists think about productivity, but we see it in other contexts. When the minimum wage is raised, companies sometimes try to replace human labor with machines or focus on making their workers more productive.

The ultralow unemployment may have the same effect in the years ahead.

There is, for good reason, a tendency to focus on the risks of what can go wrong in the economy. The current expansion could become the longest on record next year, which makes the recession risk talk all the more relevant.

But the 1990s are a reminder that there can be good economic surprises as well as bad ones. Predicting the future is hard. And the parallels aren't perfect. But there's reason to wonder if economic history just might repeat itself.

Treasury Secretary Robert E. Rubin, left, and the Federal Reserve chairman, Alan Greenspan, at a House committee hearing in 1995. Mr. Greenspan decided the following year not to move pre-emptively to choke off the economy's expansion, despite fears of inflation. (PHOTOGRAPH BY STEPHEN CROWLEY/THE NEW YORK TIMES)

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The New York Times

STRATEGIES
Money and Business/Financial Desk; SECTBU
Towering Over the Others, but at What Cost?

By JEFF SOMMER
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Much of the world has recovered from the global financial crisis of a decade ago, but one market has prospered above virtually all others: the United States **stock market**.

In addition to outpacing other major markets, the American market has outstripped the growth of the United States economy to such an extent that it is a global outlier. Whether the surge -- which has helped fuel economic inequality in the United States -- can continue, and what the domestic and global consequences might be, are unresolved questions.

The American market's exceptional performance stands in stark relief in a global survey of post-crisis markets and economies published this month by the Brookings Institution and conducted by Eswar Prasad, a Cornell University economics professor and senior fellow at Brookings, and Karim Foda, a former associate fellow at the institution.

''There has been a disconnection between stock markets and economies around the world, with stock markets generally outperforming their economies,'' Professor Prasad, a former International Monetary Fund official, said in an interview. ''But the United States stands out. There's a much greater degree of outperformance and disconnection from domestic economic growth. And you don't typically see a disconnect like this for such a long period.''

The Brookings survey shows, for example, that while the two biggest emerging market economies -- those of China and India -- have grown far faster than America's in the past decade, those countries' stock markets have not fared as well as their American counterpart. India's stock gains were substantial in its local currency, the rupee, but were almost eliminated when translated into dollars. The Chinese **stock market** has actually lost value since the financial crisis.

Since the end of 2007 through June of this year, the survey says, gross domestic product in the United States grew by 18 percent, after adjusting for inflation. ''The U.S. leads the pack among major advanced economies,'' the report says, while noting that the American economy's growth trailed that of emerging market economies like those of China and India.

In nominal terms, without the inflation adjustment, gross domestic product in the United States grew more: 38 percent. But the **Standard & Poor's 500-stockindex** nearly doubled from December 2007 through August 2018, a better return than other major stock markets experienced.

This trend -- stock markets growing much faster than domestic economies -- also appeared in advanced economies like those of Britain, France, Germany, and Japan, but it was much more extreme in the United States, the report says.

The American **stock market**'s outperformance can be explained by factors like the rising share of corporate profits in the domestic economy and by the sheer force of American financial power on a global scale, Professor Prasad said.

Although the United States contributed mightily to the global financial crisis, it has been a source of financial stability for most of the last 10 years, attracting investments from around the world. The dollar has strengthened against most other currencies in that time, becoming, if anything, an even more central part of the world financial system, he added.

What's more, the dollar's strength has magnified the outperformance of the American **stock market** when compared against markets in most other countries.

India outpaced the United States in economic growth, and its **stock market** rose roughly 90 percent from December 2007 through last month, almost as much as the American **stock market** did, when both are tracked in their domestic currencies. But the Indian rupee lost ground against the dollar, and its weakness has wiped out most of the value of its **stock market**'s gains: When converted into dollars, the Indian **stock market** rose only 6 percent.

China is the rare country whose currency, the renminbi, actually has strengthened modestly against the dollar since the end of 2007. But that was not enough to offset the decline of the Shanghai **stock market**, which fell 48 percent in renminbi and 45 percent in dollar terms.

The Chinese **stock market**, like the United States market, is an outlier, Professor Prasad said, but in a radically different dimension: The Chinese market has significantly trailed other markets as well as the Chinese economy.

One reason is that the Chinese **stock market**, to an even greater degree than the United States **stock market**, represents only a small slice of the country's overall economy. Publicly listed Chinese corporations, Professor Prasad said, tend to suffer from endemic structural problems: high debt levels, poor accounting disclosure and weak governance. Until these problems are solved, China may be risky for global stock investors.

The United States **stock market**, which has been a global magnet, is rife with its own anomalies. For one thing, Professor Prasad said, **stock market** growth has exceeded G.D.P. growth by so much and for so long that it bears close attention. "Over long periods there is typically a close correlation between **stock market** growth and economic growth," he said. "And this is already a long period."

That does not mean that the American **stock market** will necessarily fall soon. It is being supported by several macroeconomic factors, aside from cash inflows from foreigners. Corporate profits, supported in part by tax cuts and relaxed regulation and low interest rates, have been rising more rapidly than the G.D.P., while wage growth has been constrained.

Because stock ownership is concentrated among richer people, the rising market wealth has exacerbated economic inequality in the United States. "Most of the **stock market** wealth has been going to those who are already very rich rather than to the poor," Professor Prasad said. "The disconnect between the **stock market** and the real economy is manifest in the disconnect between corporate profits and real wages. It has potential sociopolitical implications."

In short, the American **stock market** could well keep rising for some time. But that might increase domestic political tensions, if increasing corporate and **stock market** riches are not accompanied by broad-based growth in wages.

From a global perspective, the American **stock market** appears to be attracting capital that might otherwise bolster other markets and economies. The United States market is exceptional and it has enriched stock investors. But the decade of outperformance has incurred mounting costs.

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THE WALL STREET JOURNAL.
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EXCHANGE --- Heard on the Street: Now May Be the Time To Ask for a Raise --- The jobs report suggests some employers can only get workers by paying them more

By Justin Lahart
438 words
8 September 2018
The Wall Street Journal
J
B18
English

[Financial Analysis and Commentary]

Workers almost always ask for raises. It looks like they are starting to get them.

August was another strong month for employment. The Labor Department on Friday reported the economy added 201,000 jobs, while the unemployment rate held steady at a low 3.9%. But the biggest news was an unexpected jump in average hourly earnings that pushed wages up 2.9% from a year earlier. That compared with a 2.7% gain in July, and marked the strongest growth since 2009.

The report suggests the economy has hit an inflection point, where employers simply won't be able to hire and retain workers without paying them more. And this may only be the beginning of a significant increase in wages that could simultaneously weigh on corporate profit margins and lead the Federal Reserve to raise rates by more than investors had expected.

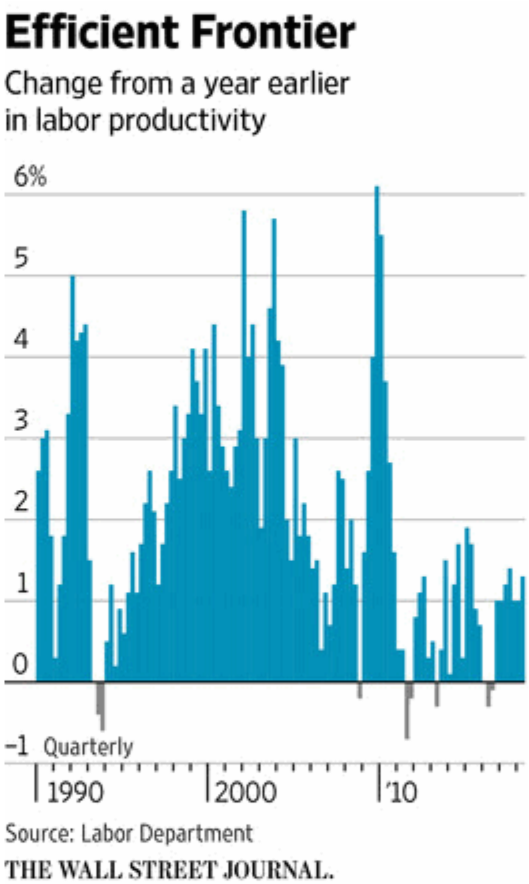
For a long time now, there has been little apparent slack in the labor market. The unemployment rate is at its lowest level in decades, the number of unfilled job openings has reached the point where it exceeds the number of unemployed workers, and companies have persistently complained about how hard it is to find workers.

Yet wage growth was muted, which led some economists to conclude there was a hidden pool of untapped workers that was filling the growing demand for employees. But Friday's jobs report makes this theory harder to believe.

Indeed, the report also showed that the labor-force participation rate -- the share of the working-age population with jobs or seeking them -- slipped to 62.7% from 62.9%. This is a **volatile** number, but it suggests people left the labor force even as wage gains picked up. So if companies want to get more of those people off the sidelines, or if they want to poach workers from their competitors, they are going to have to pay more.

And there can be little doubt that employers, who have added 2.3 million workers to payrolls over the past year, are going to need to hire more. Buoyed by tax cuts and increased government spending, the economy is growing strongly, increasing demand. With productivity growing slowly -- a symptom of years of low capital spending -- the only way to meet that demand is expanding the workforce.

Friday's report may be just the start.



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THE WALL STREET JOURNAL.

Markets

Emerging-Market Tremors Rattle Tennessee's Public Pensions; After expanding its emerging-market investments in recent years, the state's retirement system increasingly registers volatility overseas

By Asjylyn Loder and Julie Wernau
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The troubles hammering developing economies are reverberating as far as Tennessee, where the state's retirement system is the biggest shareholder of a dozen exchange-traded funds that buy stocks in those markets.

The rout has exposed the difficulties facing U.S. public pensions, many of which have embraced riskier assets in recent years hoping to boost returns.

The Tennessee Consolidated Retirement System, which manages $50 billion in pension assets for the state's public employees, has almost $2 billion invested in ETFs devoted to some of the hardest-hit markets such as South Africa, Indonesia and Turkey. Those investments have lost $243 million since the start of the year, according to FactSet.

Emerging-market countries have suffered in recent months as a rising dollar and higher U.S. interest rates have made their debt burdens more expensive. Those pressures pushed the MSCI Emerging Markets Index into **bear-market** territory Thursday, defined as a decline of more than 20% from a recent peak.

Public pension funds had hesitated to embrace emerging markets because of human rights abuses and government instability but have tiptoed in recently, looking for an alternative to the high valuations and slow growth in much of the developed world.

"Globally, pension funds have been investing less and less in equities and bonds and investing more in so-called other alternatives: private equity, infrastructure, emerging markets," said Olivia Mitchell, the International Foundation of Employee Benefit Plans Professor at the Wharton School of the University of Pennsylvania. "That's really a search for higher returns, and that also comes with higher risk."

The exposure of U.S. public pension funds to emerging-market equities now averages 4.5%, up from 2.9% a decade ago, according to eVestment, an investment data provider. Tennessee's is 4%.

Tennessee's emerging-markets exposure isn't unusually large, nor is the state's pension fund the only one that uses ETFs to invest in developing economies. For example, the Canada Pension Plan Investment Board is the second-largest holder of the $169 million iShares MSCI Philippines ETF, and the New Jersey Division of Investment is the third-largest investor in the $4 billion iShares MSCI Taiwan ETF, according to FactSet. Pension plans in Finland, Quebec and Alabama are among the top holders of the $30.1 billion iShares MSCI Emerging Markets ETF.

What is unusual is the breadth and size of Tennessee's single-country ETF holdings. It owns nearly 40% of the $338.6 million in the iShares MSCI South Africa ETF, almost 24% of the $803.8 million iShares India 50 ETF and more than 21% of the $169.2 million iShares MSCI Philippines ETF. In all, Tennessee owns 17 single-country ETFs that buy emerging-market stocks. It is the top shareholder of 12 of those and among the 10 largest investors in the other five.

When the pension plan decided to add emerging-markets exposure several years ago, its managers had concerns about corruption and undemocratic governments, said Michael Brakebill, the chief investment officer for the Tennessee retirement system. So, Tennessee scored countries based on Transparency International's Corruption Perceptions Index and The Economist Intelligence Unit's Democracy Index.

"The notion was that we would buy the country ETFs and avoid the other exposures," Mr. Brakebill said.

Notably, Tennessee's portfolio excludes China, the biggest slice of most traditional emerging-market indexes. China makes up 22% of the $48 billion iShares Core Emerging Markets ETF and 28% of the $58 billion Vanguard FTSE Emerging Markets ETF, according to FactSet. Tennessee doesn't invest in Russia either, which comprises 3% of the iShares ETF and 3.4% of the Vanguard fund.

Investors have to be mindful of turbulence in emerging markets, said Marina Gross, executive vice president of portfolio research and consulting at Natixis. She found that wealth managers put just 3.5% of their moderate-risk portfolios into emerging-market stocks, but even that small allocation drives 12% of their risk.

"Any more than 5% really starts to swamp the portfolio from a risk perspective," Ms. Gross said.

Mr. Brakebill said missing out on China's juggernaut has sometimes been painful, but he has concerns about its financial stability. That decision has helped this year: the benchmark Shanghai Composite has slumped more than 18% in 2018, making it one of the world's worst-performing big stock indexes.

"I don't have huge regrets that we don't have money there right now," he said.

So far this year, Tennessee's emerging-markets portfolio has declined 11.3%, in line with the performance of the broader emerging-markets ETF like the iShares and Vanguard ETFs, according to FactSet.

Mr. Brakebill said the recent turmoil hasn't scared him off. It makes sense to invest in emerging markets because they account for about 50% of the world's gross domestic product, he said.

"It is basically done and delivered what we thought it might," Mr. Brakebill said.

Ira Iosebashvili contributed to this article.

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EXCHANGE --- The Crisis: A Decade Later -- Housing: The Father Of Mortgage Bonds Has Regrets

By Cezary Podkul
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When Lewis Ranieri invented mortgage bonds, he never thought it would turn out this way.

Four decades ago, Mr. Ranieri was at the helm of a revolution in how Americans finance their homes. Until then, mortgages largely stayed on the books of local savings banks. Mr. Ranieri created a secondary market that packaged mortgages into securities sold to investors.

For that he was immortalized in Michael Lewis's book "Liar's Poker," which profiled Mr. Ranieri's mortgage-trading department at investment bank Salomon Brothers in the 1980s.

As the mortgage market grew, so did the securitization of increasingly risky and fraudulent loans. In 2008, the housing market collapsed, setting off one of the worst crises that has ever shaken the global financial system.

"I'm the guy who played a central role in this home thing and I regret it because . . . it got abused beyond everybody's imagination," says Mr. Ranieri, 71 years old.

A Catholic who keeps a crucifix on his desk, he doesn't shy away from his share of the blame.

"I will never, ever, ever, ever live out that scar that I carry for what happened with something I created," he says. "It did so much damage to so many people."

There's no going back. Today, the market for securities backed by Americans' mortgage payments totals about $7.2 trillion, according to data compiled by the Securities Industry and **Financial Markets** Association. That's about the same as in mid-2008.

Many of the families affected by the housing crisis were just like his own. Mr. Ranieri's father died when he was 12 and his mother struggled to support the family; money was so tight that he remembers searching for spare change in the coin slots of phone booths.

A classified ad led him to the night shift at the mailroom at Salomon Brothers and later its trading floor. His mortgage-trading desk became so profitable that Mr. Lewis dubbed them "the fat men and their marvelous money machine."

In his Uniondale, N.Y., office, surrounded by ancient vases and Civil War artifacts, he attempts to deconstruct what went wrong in the mortgage market. He holds up a photo of himself with President Reagan in 1984, when Mr. Reagan signed into law a bill Mr. Ranieri had championed.

"This is where it all started," he says.

Back then, investors could only hold mortgage-backed securities if they were sold by one of the big three government-sponsored guarantors -- Fannie Mae, Freddie Mac or Ginnie Mae.

Mr. Ranieri urged Congress to ease restrictions so more pension funds, insurance firms and banks could invest in privately issued mortgage securities. A law firm hired by Salomon Brothers suggested language for the bill and helped lobby for its passage.

To safeguard investors, the law defined mortgage securities as debt rated in one of the two highest categories by at least one credit-ratings firm. Mr. Ranieri told House lawmakers at a 1984 hearing that the requirement would "provide substantial investor protection."

He also testified that the Securities and Exchange Commission would require broker-dealers of mortgage securities to keep sufficient capital cushions and provide "adequate protection" against any problems. Loan underwriters would also help ensure the market's integrity, he predicted.

That's not what happened.

"All of the safeguards we thought we had got blown away like they were never there," Mr. Ranieri says as classical music plays in the background. He says he is most upset at the ratings firms.

"We put them in business. They were part of the bill," he says.

The problem was that security issuers pay the rating firms to rate their deals, resulting in pressure to inflate ratings. A decade after the collapse, that's still the industry's business model.

As for the SEC, Mr. Ranieri says the agency "never took jurisdiction" of the mortgage-backed-securities market, allowing it to become increasingly opaque. The SEC declined to comment.

In the spring of 2008, Mr. Ranieri confided to a close friend, Mark Goldhaber, that he couldn't understand the risks behind Wall Street's newest breed of mortgage-backed securities, collateralized debt obligations, after spending a day reading the prospectus of one of them.

"If you can't figure it out, that's a bad sign," Mr. Goldhaber told him.

The risks weren't well understood in other corners of the market, either. The U.S. government's official inquiry into the financial crisis faulted Fannie Mae and Freddie Mac for taking on more risk when the first cracks in the housing market started to show, including by buying tens of billions in subprime-mortgage-backed securities sold by Wall Street banks.

Mr. Ranieri traces the origins of Fannie Mae's risk-taking to the early 1980s, when the market feared Fannie Mae -- then a shareholder-owned corporation -- might default. If it did, it was unclear whether the federal government would come to the rescue.

The crisis was resolved in November 1982, when the Treasury Department sent Standard & Poor's a letter saying the "special status" of Fannie Mae's debt should be considered when evaluating the firm's securities.

The letter's author, then-Assistant Treasury Secretary Roger Mehle, says he didn't tell the market anything it "didn't already, or couldn't, know." Mr. Ranieri believes the letter cemented the market perception that the government would stand behind Fannie Mae in any crisis.

That prediction came true in 2008 when the government took over Fannie Mae and its competitor, Freddie Mac. Since then, Congress has failed to act on any plan to reorganize them and the two continue to pump massive leverage into the U.S. housing market; each has assets worth more than 400 times the equity on its books.

The two firms are highly leveraged because their capital rules have been suspended since 2008 while they're under government control, according to Sandra Thompson, a deputy director at the Federal Housing Finance Agency, which oversees Fannie and Freddie. She said the two firms are prohibited from buying the types of mortgages that got them into trouble before 2008 and are now transferring more of their risks to investors. Representatives for Fannie Mae and Freddie Mac said the two are very different companies compared with 10 years ago.

Mr. Ranieri thinks the debate over their future misses a bigger, more fundamental problem: While government financing remains plentiful, affordable housing is disappearing fast.

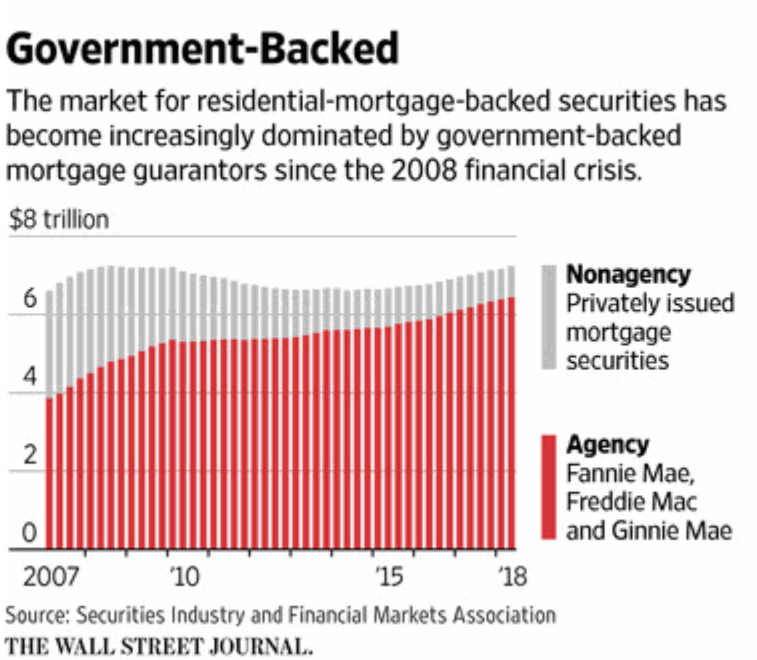
He doesn't think U.S. housing policy is helping to fix the problem. Size limits on mortgages guaranteed by Fannie Mae and Freddie Mac now far exceed median home sale prices. Mr. Ranieri worries such generous government support may ultimately encourage "financial engineering" to make homeownership more manageable. He believes that already definitions of reasonable debt-to-income ratios are being stretched, undermining safeguards put in place by the 2010 Dodd-Frank financial-overhaul law.

It's the thought of such lending practices reappearing in the market that most bothers Mr. Ranieri. After foreclosures began sweeping America in 2007, he raised private-equity funds to buy delinquent loans and launched Selene Finance, a company that serviced and sought to modify them to avoid foreclosure. The goal was to make money from loans whose borrowers resumed payments while also helping the victims of bad lending practices.

Mr. Ranieri sometimes personally advised homeowners on their options, even if Selene wasn't involved, according to Karen Bellezza, who worked on the mortgage modifications.

Mr. Ranieri recalls trying to help modify the toxic mortgage of a hospital worker who had sunk his life savings in a home for his family. When he told the man he had no choice but to give up his home, he broke down crying.

"It ripped my guts out," Mr. Ranieri says. It was a moment of realization that there were "hundreds of thousands of families who were being hurt."



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THE WALL STREET JOURNAL.
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Wages Gain, Payrolls Rise As Expansion Rolls Ahead

By Harriet Torry and Sarah Chaney
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8 September 2018
The Wall Street Journal
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A1
English

WASHINGTON -- A robust economy drove U.S. wages higher in August, new evidence that workers are gaining bargaining power with their employers as the nation's pool of available labor tightens.

The Labor Department reported Friday that worker payrolls expanded by 201,000 in August and private-sector hourly wages grew 2.9% from a year earlier. The payroll gain marked the record 95th consecutive month of job growth -- much of it near or slightly below that 200,000 monthly mark -- and the year-over-year wage increase was the largest since mid-2009.

The unemployment rate was 3.9% in August for the second month in a row.

Wage growth has been a missing ingredient in the expansion. It hovered for years below prerecession levels but has been creeping higher since 2015, with the August reading marking a new high for the expansion.

Many factors held wage growth down, including slack in the economy after the 2007-09 recession and increased competition in the U.S. from workers abroad. But as U.S. unemployment has declined, the supply of workers has diminished, giving individuals more leverage to demand and get better pay.

"Everybody is battling for the very few skilled people out there," like machinists and engineers, said Richard Huether, chief executive of Independent Can Co., based in Belcamp, Md. He said he had seen some employees resign without backup jobs, for instance to move back home, knowing they'll find something where they want it.

Good news for workers isn't always good news for investors. The wage increase suggested a modest buildup in inflation pressure that could encourage the Federal Reserve to keep raising short-term interest rates, which tends to push down stock and **bond prices**.

The **Dow Jones Industrial Average** dropped after the report, and yields on **10**-**year Treasury** notes, which move inversely with **bond prices**, rose. "You could see [the wage increase] leaking into broader measures of inflation," said Michael Arone, chief investment strategist at State Street Global Advisors.

Investors took note that the percentage of the adult population working or looking for work dropped slightly in August to 62.7%, from 62.9% the month before.

Labor-force participation faces downward pressure from retiring baby boomers. In recent months, however, the economy had been showing signs of drawing more potential workers from the fringes of the economy back into the labor market, a trend that could help keep inflation in check and investors pleased.

The August drop in labor-force participation suggested there was a limit to that trend, which helped to knock down stocks and bonds. However the drop in participation was concentrated among teenagers and might have been a seasonal or statistical quirk.

"Overall, the momentum in the economy looks solid," said Michael Feroli, chief U.S. economist at JPMorgan Chase & Co.

Revised figures from the Labor Department showed employers added 147,000 jobs in July and 208,000 in June, a net downward revision. Still, year-to-date job gains have averaged about 207,000 a month, compared with 189,000 in the year-earlier period.

Emily Reaves, an IT software analyst in Jacksonville, Fla., said she was "pretty scared" when she was recently let go. Yet she found a new position through a recruiter in a week and a half. "I feel good right now. I also know it's important to be cautiously optimistic," she said.

The Fed is on track to raise short-term interest rates, now in a range between 1.75% and 2%, by a quarter percentage point at its Sept. 25-26 policy meeting and again in December.

"Wages aren't yet rising fast enough to scare the Fed," Ian Shepherdson, chief economist at Pantheon Macroeconomics, said in a note to clients. "But the expectation that further gains are in the pipeline, given the lag from falling unemployment, explains policymakers' intentions to keep hiking," he wrote.

Tamra Kennedy, a franchise owner of eight Taco John's International Inc. restaurants in the Minneapolis-St. Paul area and one in Iowa, said competition for workers led her to start advertising jobs on the radio. She also started offering a $100 bonus for the first 100 hours worked by new hires, and raised wages in July by 13% or more.

As wages have risen, so has the cost of living. The Labor Department's consumer-price index increased 2.9% in the year to July, the same rate that average hourly earnings increased by over the year to August.

Democrats have argued that flat inflation-adjusted wages are evidence the strong economy isn't delivering improved well-being broadly to workers. The White House released a study this week showing that inflation-adjusted wages look better when using an inflation gauge produced by the Commerce Department that the Fed prefers. Add in tax cuts, the White House argued, and household pockets are fuller.

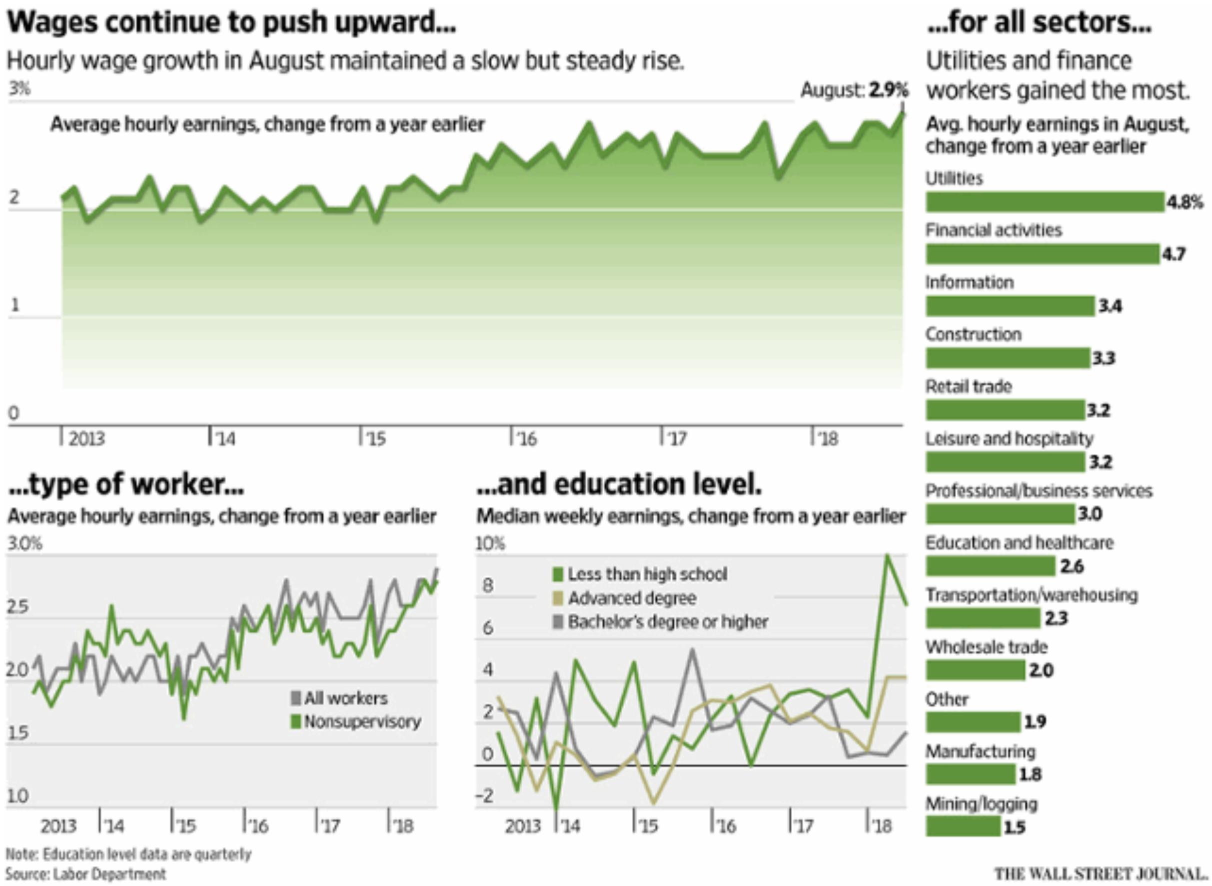
Hand & Stone Massage and Facial Spa, a massage and facial spa with 385 franchised locations, is seeking to expand. Chief Executive Todd Leff says the firm plans to open 55 to 60 spas.

Each new location will need to staff up with about 15 licensed therapists and five to seven sales associates.

"Our biggest challenge is finding people," Mr. Leff said. A downturn in enrollment at massage-therapy and skin-care schools means fewer available therapists, Mr. Leff said.

To help address this labor shortage, Hand & Stone offers tuition reimbursement for massage-therapy-school graduates of about $125 to $150 a month. The spas are also offering training for hot stone and Himalayan Salt treatments, as well as wage bumps of 5% to 7% for therapists to aid with retention.

Daniel Kruger contributed to this article.



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WSJ PRO CENTRAL BANKING

World

China's Trade Surplus With U.S. Hits New Record; U.S.-China trade gap widens to $31.05 billion

641 words
8 September 2018
05:09 AM
WSJ Pro Central Banking
RSTPROCB
English

BEIJING—China's trade surplus with the U.S. hit another record monthly high in August as the world's second-largest economy faced the threat of more tariffs from the Trump administration.

The trade gap between the two countries widened to $31.05 billion last month from $28.09 billion in July, while China's total trade surplus narrowed, data from the General Administration of Customs showed Saturday.

The data came as Washington prepared to roll out a third round of tariffs, moving it closer toward imposing levies on virtually all Chinese goods entering the U.S.

A combination of factors, including a weaker Chinese yuan and exporters' frontloading of shipments in anticipation of more tariffs, contributed to the worsening trade imbalance, said Liu Xuezhi, an economist with Bank of Communications.

"In the short term, it is difficult for the trade gap to narrow because American buyers cannot easily find alternatives to Chinese products," Mr. Liu said.

That suggests that the trade dispute, which is escalating, won't be resolved quickly, the Shanghai-based economist said.

The yuan slid nearly 9% against the U.S. dollar between April and July, but was little changed in August, according to Wind Information. Last month, China's central bank stepped up its intervention in the market to prevent the yuan from depreciating too rapidly.

A weaker yuan makes Chinese goods cheaper for U.S. consumers. China's exports to the U.S. rose 13.2% in August from a year earlier, accelerating from an 11.2% increase in July, according to calculations by The Wall Street Journal based on customs data.

President Trump said Friday the administration is ready to announce tariffs on another $267 billion in Chinese goods, on top of levies on $200 billion of Chinese products it has been preparing.

Tariffs on $50 billion of imports from China have already taken effect, which Beijing has matched dollar for dollar.

If enacted, the third round of tariffs would bring the total amount of goods subject to levies to more than the $505 billion of products the U.S. imported from China in 2017, according to the U.S. Census Bureau.

China's Commerce Ministry on Saturday didn't immediately respond to requests for comment about the proposed U.S. tariffs.

Vice Commerce Minister Wang Shouwen said at a forum Saturday that rising trade protectionism is threatening global economic growth, according to state media.

Mr. Wang led midlevel talks with U.S. officials in Washington last month, but discussions between the two countries failed to produce any visible sign of progress.

Globally, China reported a trade surplus of $27.91 billion in August, narrowing from a surplus of $28.05 billion a month earlier. Economists polled by the Journal had expected a $30.6 billion surplus.

Exports rose 9.8% from a year earlier, compared with July's 12.2% increase, customs data showed. Economists had forecast an 11% growth in overseas shipments. Imports were up 20% in August from a year earlier, slowing from a 27.3% increase the previous month and matching economists' median forecast.

Government measures such as stimulating infrastructure investment and injecting more funds into the **financial market** have boosted business confidence, Mr. Liu of Bank of Communications said.

He said he expects the Chinese economy to grow about 6.7% in the third quarter, holding steady from the second quarter.

Liyan Qi

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THE WALL STREET JOURNAL.
U.S. EDITION

EXCHANGE --- The Crisis: A Decade Later -- Heard on the Street: What Will Set Off The Next Crisis?

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8 September 2018
The Wall Street Journal
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B11
English

[Financial Analysis and Commentary]

The person who predicts the next financial crisis, and there will be at least one, should get credit for luck rather than skill. A decade of extraordinarily low interest rates has created multiple distortions in the global economy. Any of those can unwind painfully but predicting what factors would trigger a global downturn is near impossible. Five columnists from Heard on the Street give it a try.

Interest Rates Jump

The biggest distortion in global markets is also the most important. Rock-bottom interest rates, driven by central banks to allow economies to heal, have encouraged risk-taking. Barring a downturn, interest rates will rise in most of the world, and rising interest rates always expose cracks in the financial system.

That was clear in February when a slight uptick in U.S. inflation expectations sent rates higher and ultimately caused the implosion of a multibillion-dollar fund that bet against market **volatility**.

Higher rates have typically pushed down stocks and commodities. In a crisis scenario, that would be just the beginning. The losses could be magnified by leverage and lead to higher defaults on public and private corporate debt, which could trigger capital flight and currency depreciations in emerging markets. The result would be an economic slowdown that could make each of these problems worse.

Interest rates globally have never been this low for this long. A sustained increase puts the global financial system in uncharted territory.

-- Aaron Back

Bad-Loan Boom

The flip side to low interest rates has been a chase for yield that has driven investors to embrace riskier bonds. The result has been a boom in corporate borrowing and a race to the bottom both for high-quality and junk-rated companies. This drop in credit quality means that when the economy slows, losses are likely to be worse than in previous downturns.

Companies rated BBB, the lowest investment-grade rating, now account for almost half of all U.S. investment-grade corporate bonds by value, the highest share in more than 15 years. Among high-yield borrowers in bond and loan markets, new issuance from companies rated at the lowest B grade also make up a record share of new volume.

That raises the risk of significant losses for credit investors -- from pension funds and insurers to mutual funds, ETFs and banks. The downturn could be made worse because banks are less able to trade debt than in the past, leaving some investors unable to sell their holdings.

-- Paul J. Davies

Supply-Chain Disruptions

Catastrophe can strike at any moment -- and quickly reverberate. Decades of globalization and technological progress have made it easy for the fallout of natural or man-made disasters to become global.

Consider a handful of isolated events with outsize impact. In 2011, flooding in Thailand slowed the global supply chain for personal computers as makers of hard drives were shut down. Last year, a computer virus crippled the fleet of AP Moeller-Maersk, the world's largest container shipping firm. The 2011 earthquake and tsunami in Japan caused auto plants world-wide to shut down as key components became unavailable. In 2010, the eruption of an Icelandic volcano caused the cancellation of over 100,000 flights, affecting about 10 million passengers. And in 2016, a construction accident cut off a third of the U.S. East Coast's gasoline and jet-fuel supply, sparking price spikes and shortages.

Unpredictable weather and rogue nations could do far worse, enough to bankrupt major companies or spark a recession.

-- Spencer Jakab

Italy Dumps the Euro

The recovery of the eurozone from the 2012 bond crisis has been predicated on Italy, Spain and Portugal pledging to meet the European Union's budget rules, and Germany overlooking the fact they haven't. As long as countries stick with the project, markets have rightly ignored debts and deficits.

But Italy may be wavering. Italian bond yields spiked in May after two parties with anti-euro leanings tried to form a new government. The crisis could escalate again once politicians return from holidays. Some 59% of Italians want to keep the common currency, official surveys show -- the slimmest majority in the eurozone.

If Italy left the euro, Italian banks would face runs on their deposits and would be crushed -- sovereign debt accounts for 9% of their assets. This would paralyze lending and the economy. The shock waves would ripple abroad: Foreigners own 36% of Italian government debt. Markets would lose faith in Spain and Portugal's debt and eurozone banks outside of Italy, which own $140 billion of Italian debt. This would weigh on the eurozone, one of the world's three main economic engines.

-- Jon Sindreu

China Cracks

China and the U.S. are the two other big global economies. When external demand weakens, China pumps up investment at home, as it did in 2009. Its growth has been powered in part by one of the fastest buildups of debt in history by a major country. That would worsen any financial crisis at home.

China has so far weathered the dual threats of trade war and a rising dollar well. The most likely causes for a China-triggered global crisis would be a real-estate crash or rolling defaults by local government-owned fundraising vehicles, severely damaging bank balance sheets, tanking investment and driving big capital outflows.

Abroad, a weakening of China's economic might would drive down prices for commodities and the value of many emerging-market currencies, prompting widespread dollar-bond defaults which could damage Western lenders. Chinese capital fleeing the country would sharply drive up the dollar. Slower emerging market growth would hit U.S. and European exporters.

-- Nathaniel Taplin

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THE WALL STREET JOURNAL.
U.S. EDITION

EXCHANGE --- The Crisis: A Decade Later -- Timeline: 2008: How Disaster Unfolded

1,346 words
8 September 2018
The Wall Street Journal
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B4
English

Jan. 4: The U.S. unemployment rate hits 5%, its highest level in more than two years.

Jan. 22: The Federal Reserve's rate-setting committee, chaired by Ben Bernanke, surprises markets by cutting its interest-rate target three-quarters of a percentage point to 3.5% a week before it is scheduled to meet. It's the Fed's first emergency rate cut since 1998.

Jan. 30: At its scheduled meeting, the Fed cuts rates again, this time by half a percentage point.

Feb. 7: Congress approves a $168 billion economic-stimulus plan, paving the way for over 130 million households to get tax-rebate checks of $300 to $1,200.

March 14: In an effort to stave off the bankruptcy of Bear Stearns, the Fed gives the firm access to low-cost funds from its "discount window," something it hadn't done for an investment bank since the Great Depression.

March 16: After a frantic weekend, JPMorgan Chase agrees to buy Bear Stearns for the fire-sale price of $2 a share, or $236 million, amid fears that failing to find a buyer could deepen Wall Street's crisis of confidence. The Fed agrees to cover $30 billion of potential Bear Stearns losses to get JPMorgan to agree to a deal.

March 18: The Fed cuts its short-term interest-rate target three-quarters of a percentage point to 2.25%, sending the Dow industrials up 420 points, or 3.5%, at 12392.66. Shares of Lehman Brothers Holdings, under sharp pressure in recent days as investors fret about its mortgage bets, soar more than 46% after it releases first-quarter earnings.

March 24: JPMorgan CEO Jamie Dimon raises his firm's bid for Bear Stearns to $10 a share, or $1.2 billion, to quell objections to the deal. Bear had been worth about $20 billion at the start of 2007.

April 1: Lehman Brothers, which has been battling rumors that it is on the ropes, sells preferred convertible shares to raise $4 billion in new capital. Its shares rise 18%.

May 8: Insurer American International Group posts a $7.8 billion loss, and says it will raise $12.5 billion to replenish its balance sheet.

May 21: Hedge-fund manager David Einhorn tells a room full of high-profile investors at a conference that he is shorting Lehman. He questions the firm's accounting, and says Lehman will need to take significant writedowns when it next reports results.

June 15: AIG's board forces out CEO Martin Sullivan. He is succeeded by Chairman Robert Willumstad, who promises to have a "game plan" for turning around the struggling insurer by Labor Day.

June 16: Lehman Brothers posts a $2.8 billion quarterly loss, but CEO Richard Fuld insists the firm can "go it alone" without a bigger bank as a partner.

July 15: Treasury Sec. Henry Paulson asks Congress for an unlimited authorization to recapitalize mortgage giants Fannie Mae and Freddie Mac. Said Mr. Paulson: 'If you've got a bazooka, and people know you've got it, you may not have to take it out.'

Sept. 7: Mr. Paulson announces a plan to take control of Fannie and Freddie and replace their CEOs. Treasury pledges to provide as much as $200 billion to the companies as they cope with heavy losses on mortgage defaults.

Sept. 9: Lehman shares fall 45% after Korea Development Bank, which had been in talks with Lehman about providing a capital infusion, says it has closed the door on a possible deal.

Sept. 11: Lehman's Fuld spends the day looking for potential buyers for his firm in consultation with federal regulators. Bank of America is in preliminary discussions about a transaction. Lehman shares fall another 42%.

Sept. 12: S&P threatens to downgrade AIG; its shares fall 31%. Merrill Lynch, which has recently offloaded billions of dollars of mortgage assets at fire-sale prices, falls 12%. After markets close for the week, Treasury's Paulson, the Fed's Bernanke and his top New York lieutenant, Timothy Geithner, summon some 30 Wall Street executives for an emergency meeting at the Fed's offices in Lower Manhattan to discuss Lehman's future. Mr. Geithner tells the assembled executives: 'There is no political will for a federal bailout.'

Sept. 13: Bank of America backs away from a potential deal with Lehman as dozens of representatives from Wall Street firms debate ways to rescue the firm. Some still expect the government will step in.

Sept 14: Barclays, the U.K. bank, withdraws as the last potential buyer for Lehman. It becomes clear the bank will fail. AIG's Willumstad tells the Fed's Geithner the insurer needs a lifeline. Merrill Lynch CEO John Thain agrees to sell his firm to Bank of America for $50 billion.

Sept. 15: Lehman files for bankruptcy. The Dow industrials fall 504 points. Moody's and S&P cut their ratings on AIG, a move that means its trading partners can demand an additional $14.5 billion in collateral.

Sept 16: Markets rally sharply as word spreads that U.S. regulators have reversed course and will intervene to prevent AIG from falling into bankruptcy. After the close, the Fed promises $85 billion to the insurer. The Reserve Primary Fund, a money market fund, says losses on Lehman mean net asset value fell below $1 per share -- a rare development that sows panic in related assets.

Sept. 17: The Dow industrials fall 449 points; Morgan Stanley plunges 24%; Goldman drops 14% as investor concerns grow about whether another financial powerhouse is on the brink of failure.

Sept. 21: The Fed converts Morgan Stanley and Goldman Sachs into traditional bank holding companies, bringing them under the supervision of bank regulators.

Sept. 23: Warren Buffett's Berkshire Hathaway invests $5 billion in Goldman Sachs, getting preferred shares that pay a 10% dividend. The move is seen as a vote of confidence in the banking system by the famed investor.

Sept. 29: The U.S. House votes down the Bush administration's $700 billion rescue package. The Dow industrials plunge 777.68 points, or 7%, to 10365.45, its largest-ever point decline at the time.

Meanwhile, Japan's MUFG seals a deal to acquire a 21% stake in Morgan Stanley for $9 billion.

Oct. 3: After the House reverses itself and votes to pass the legislation, President Bush signs into law a $700 billion plan to rescue the U.S. financial system.

Oct. 8: The world's central banks launch a coordinated attack against the widening crisis, lowering short-term rates in unison by a half-percentage point. The Dow loses 189 points.

Oct. 10: The Dow swings 1,019 points in the index's most **volatile** session to date. It ends down 128 points on the day, concluding the worst week in the index's 112-year history.

Oct. 21: The Fed says it will lend as much as $540 billion to the money-market mutual-fund industry.

Oct. 29: The Fed cuts its benchmark rate by a half-point to 1%, the lowest level since 2004.

Nov. 17: Citigroup announces 25,000 job cuts. Combined with earlier cuts, the reduction will shrink the number of employees by 20% since CEO Vikram Pandit took over less than a year prior.

Nov. 23: The government guarantees more than $300 billion in troubled assets weighing on Citigroup's books and injects an additional $20 billion in capital into the company.

Dec. 5: The Labor Department says the U.S. lost half a million jobs in November, the largest monthly drop in 34 years. That pushes the unemployment rate to 6.7%, a 15-year high.

Dec. 16: In an unprecedented move, the Fed cuts rates to near zero and pledges to use "all available tools" to lift the U.S. out of its recession.

Dec. 31: The Dow industrials end the year down 33.8%, the largest percentage drop since 1931.

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THE WALL STREET JOURNAL.
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REVIEW & OUTLOOK (Editorial)
Real Wages Are Rising

556 words
8 September 2018
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A12
English

Most headlines from Friday's August jobs report concerned the 2.9% increase in wages over the last 12 months, the healthiest raise in some time. That figure was probably overstated due to a weak August 2017 falling off the 12-month comparison, but other data are showing that wages after inflation are finally rising as you'd expect in a tight labor market.

The August numbers reinforced the tightening trend. The unemployment rate stayed at 3.9%, and the rate for black Americans fell to a record low 6.3%; a year earlier the rate for blacks was 7.6%. The number of employed Americans fell, but much of that is explained by students returning to school. The same applies to the August dip in the labor participation rate. Overall the August snapshot shows a labor market in excellent shape, with nearly everyone who wants a job able to get one.

Which brings us to the wages debate. The economists who presided over the historically slow wage growth of the Obama years have been arguing that the Trump-era economic growth spurt is no big deal because wages after inflation aren't rising. Their evidence is the average hourly earning increase, which at 2.7% in July wasn't much above recent inflation that through July was 2.9%.

Part of that inflation burst has been the recovery in **oil prices** from the plunge of 2015, thanks in part to faster global economic growth. We'd worry more if **oil prices** hadn't flattened out in recent weeks. With the Federal Reserve tightening monetary policy and the dollar strong, a supply shock would be needed to cause another oil spike.

Other measures of wages also portend a faster pace of growth. The Atlanta Fed's "wage tracker" showed a 3.2% increase year-over-year for June. Most encouraging is this week's report of a bounce in labor productivity growth in the second quarter to 2.9%. That's the best jump since the first quarter of 2015, after which productivity suffered a two-year slump as the economic expansion lost steam. Higher productivity is essential for sustained wage growth.

Meanwhile, the White House Council of Economic Advisers weighed in this week with a useful study that adds further evidence that real wages are rising. Economist Kevin Hassett's crew examined the data and pointed out that average-hourly wages don't include bonuses and employee benefits, which have been increasing smartly.

They also looked at the demographic impact of more experienced (and higher paid) baby boomers leaving the workforce as younger, lower-paid workers join. The large number of baby-boom retirees may have caused the overall wage increase to be understated in recent years even as most current workers see gains.

Adding it all up, Mr. Hassett's team came up with an estimate of a real wage increase after taxes over the last year of 1.4%. that would be 3.4% in nominal terms. With capital spending booming at a 10% growth pace, labor productivity should continue to increase and that 1.4% real wage growth would also rise. More investment after tax reform and deregulation means faster economic growth and faster productivity gains that become higher wages.

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WSJ PRO CENTRAL BANKING

Markets

Ex-Teva Chairman, Blockchain Investor Accused of Pump-and-Dump Scheme; SEC alleges that Phillip Frost, Barry Honig and eight others conspired to defraud investors by manipulating prices of microcap stocks

By Dave Michaels
974 words
7 September 2018
09:56 PM
WSJ Pro Central Banking
RSTPROCB
English

A former chairman of Teva Pharmaceutical Industries Ltd. and an investor known for benefiting from the hype around cryptocurrencies were sued by regulators on Friday over claims they masterminded a pump-and-dump scheme.

The Securities and Exchange Commission alleged that Phillip Frost and Barry Honig, along with eight other individuals, conspired to manipulate the price of several small stocks so they could later sell their shares at inflated prices. The SEC alleged the fraud generated over $27 million for those involved with it.

In a pump and dump, traders talk up a stock's price by circulating rumors or fake news, and then sell at a profit while leaving the buyers with shares that will soon plummet in value. The SEC said Mr. Honig and other defendants used shell companies and reverse mergers to disguise their ownership in the firms. Each scheme was aided by misleading articles published on investing websites that touted the stocks, the SEC's complaint said.

The SEC didn't disclose the names of the microcap stocks in its complaint. But the names could be gleaned from the articles, which remain online and have publishing dates that match those listed in the SEC's complaint.

The companies, according to the articles, are BioZone Pharmaceuticals Inc., MGT Capital Investments Inc. and MabVax Therapeutics Holdings Inc.

BioZone is now known as Cocrystal Pharma Inc. after the two firms merged in 2014. A spokeswoman for Cocrystal declined to comment. An investor-relations representative listed for MGT Capital Investment didn't immediately return an email seeking comment. A spokesman for MabVax didn't immediately respond to an email seeking comment.

The schemes ran from 2013 to 2018, the SEC said in a lawsuit filed in Manhattan federal court, alleging that Mr. Honig was the leader of the group. Mr. Honig has been a large shareholder in Riot Blockchain Inc., a former biotech company that changed its name to indicate a focus on the technology underpinning cryptocurrencies. Riot's share price surged over 200%, to a high of $46, during a period of several months after it changed its name. Its share price has since fallen to just under $5.

Mr. Honig, a Florida investor, has scooped up shares in dozens of firms that sometimes morph into hot areas—vaping, solar energy, stem cells—and see a **stock-price** pop. Some have fizzled, raising the ire of other investors.

Mr. Frost, a billionaire biotech executive who was chairman of Teva until 2014, was involved in two of the three manipulation schemes, the SEC alleged. Teva is the world's largest generic drugmaker by sales. Mr. Frost didn't return a message seeking comment.

Opko Health Inc., the health-care company where Mr. Frost serves as chairman and CEO, said in a statement the SEC's complaint "contains serious factual inaccuracies."

"Opko and Dr. Frost have always prided themselves on adhering to the highest standards of financial disclosure, and they are confident that once a proper investigation is completed and the facts of the case have been fully disclosed, the matter will be resolved favorably for them," the company said.

Messrs. Honig and Frost, along with another Florida investor named Michael Brauser, took over BioZone in 2011 after promising to raise $8 to $15 million to support research and development by the company, the SEC said. Instead of following through with the R&D investment, they caused BioZone to issue millions of additional shares to them at low prices, the SEC said.

Mr. Honig later paid a "seasoned stock promoter," John H. Ford, to write an article on the website Seeking Alpha that touted Mr. Frost's involvement in the stock, the SEC alleged.

The article boosted trading interest in the stock, causing it to rise from 1,100 shares on the day before it published to over 4.5 million shares on the following day. Over the next three months, the group sold over 15 million shares of BioZone, earning over $9.2 million, the SEC said.

Mr. Honig sold Mr. Ford 180,000 BioZone shares at below-market prices, the SEC alleged. Mr. Ford's article didn't disclose that he was compensated to write the piece, the SEC said.

The SEC's lawsuit also named Mr. Ford and Elliot Maza, BioZone's former CEO, as defendants.

Mr. Ford couldn't be reached for comment.

"Honig and his associates engaged in brazen market manipulation that advanced their financial interests while fleecing innocent investors and undermining the integrity of our securities markets," said Sanjay Wadhwa, senior associate director in the SEC's enforcement division.

Seeking Alpha's editorial principles state that its authors must disclose if they own the stock they are writing about. Mr. Ford's article mentioned that he had a position in BioZone.

George Moriarty, executive editor of Seeking Alpha, said the company's policies don't allow contributors to receive compensation from third parties in exchange for writing articles. Mr. Ford hasn't been a contributor to the website since 2015.

The SEC's lawsuit asks a court to force the defendants to pay civil penalties and disgorge their trading gains.

An attorney for Mr. Honig didn't respond to a request seeking comment. Mr. Brauser didn't immediately reply to an email and LinkedIn message seeking comment. Nelson Boxer, an attorney at Petrillo Klein & Boxer LLP representing Mr. Maza, declined to comment.

Opko was also named as a defendant by the SEC, which claimed the company assisted in the fraud and failed to disclose its role in a group that controlled one of the companies whose shares were manipulated.

Jonathan D. Rockoff contributed to this article.

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WSJ PRO CENTRAL BANKING

Markets

How Banks Lost the Battle for Power on Wall Street; Profits, assets and influence have moved from investment banks like Goldman Sachs to money-management giants like BlackRock and Vanguard, the asset managers collectively known as the ‘buy side'

By Liz Hoffman
1,270 words
7 September 2018
05:30 AM
WSJ Pro Central Banking
RSTPROCB
English

Catch him in an unguarded moment, and Lloyd Blankfein will tell you his biggest strategic regret in 12 years running Goldman Sachs Group Inc.

It isn't the mortgage trades that invited public wrath or the congressional testimony that fanned the flames, although there are things he would do differently on both fronts. It is a missed deal.

In 2009, Goldman was outbid for an index-funds business that Barclays PLC, the British bank, was selling. Called iShares, it was a leading player in a fast-growing but still unproven business: passive investing, which doesn't try to beat the market but simply match its returns.

Instead, iShares was sold to BlackRock Inc., where it became the backbone of what is today a $6.3 trillion empire, the largest asset manager in the world.

That deal, more than any other struck during the financial crisis, captures the shift that has reshaped Wall Street in the decade since. Profits, assets and influence have moved from investment banks such as Goldman to money-management giants such as BlackRock and Vanguard Group Inc.

These firms were once sleepy clients of Wall Street. Today they are its power brokers, directing huge flows of capital and capturing the lion's share of the finance industry's fees.

In 2009, BlackRock faced criticism that it had overpaid for iShares. Today investment bankers and traders speak privately about needing to "feed the Fink"—to ensure that the firm, run since its 1988 founding by former bond trader Laurence Fink, receives sufficient fees and attention, given its clout.

Assets at BlackRock, Vanguard, State Street Inc. and Fidelity Investments have doubled since 2009, to $16.5 trillion. Vanguard, based in the Philadelphia suburb of Malvern, Pa. (population: 3,400), brought in $1 billion a day of new money last year.

Meanwhile, the country's 10 largest banks in 2007 are 6% smaller today.

It is a remarkable power shift between Wall Street's two camps: "sell-side" banks and their "buy-side" clients. Banks, which act as trading partner, lender and custodian, once firmly held the upper hand. They built complex securities—at times foisting them on unsophisticated investors, courts would later find—and charged high fees that they amplified with debt.

In the decade since the crisis, the pendulum has swung the other direction. Washington forced banks to get smaller and safer. The government flooded the economy with money, which acted as a financial lubricant, pushing markets higher and smoothing out the swings that Wall Street traders had once exploited for profit.

Meanwhile, low interest rates discouraged saving and incentivized a generation of scrimpers to invest in the market. When they did, they opted for the low-cost index funds rolling out at Vanguard and others on the buy side, which promised to capture the gains from a steadily rising **stock market** while charging fees that were near zero.

That shift appears to tell a reassuring story, as staid asset managers—some of them run for the benefit of private investors or mutual fund-holders, rather than profit-hungry public shareholders—dethrone the banks whose casino culture brought the economy to the brink of collapse

But "financial risk hasn't gone away," said Michael Silva, a former bank examiner at the Federal Reserve now at DLA Piper, a law firm. "All the risk that has come out of the banks just went somewhere else."

Giant asset managers, he said, share some similarities to the investment banks of the 2000s—"not as well understood by the market or regulators as they should be."

The market got a glimpse of those potential risks on Aug. 24, 2015. Fears of a downturn in the Chinese economy hit U.S. markets. Trading in many index funds was halted as stocks whipsawed. For a few hours, wide gaps opened up between the price of these funds' units and the prices of the basket of stocks they are meant to track, leaving investors holding the bag and suggesting that passive products are more complicated than they had been billed.

And that's just in U.S. stocks. Elsewhere, money managers have plowed billions of dollars into new products that wrap risky investments, such low-rated corporate debt, into instruments that imitate stocks. Known as "liquid alternatives," these funds are traded on exchanges and redeemable for cash daily.

More than $220 billion as of March was invested in such products, which haven't yet been tested in a prolonged downturn, according to Morningstar. Smaller tests haven't been entirely reassuring. During a December 2015 hiccup in the bond market, a $789 million fund run by Third Avenue Management LLC, packed with junk-rated debt, barred customers from withdrawing their money, saying it couldn't meet redemptions without selling assets at fire-sale prices. The fund is being wound down.

Some experts worry that when the next bout of turmoil hits, the concentration of assets at the biggest money managers will deepen the rout as everyone rushes for the exits. Unlike the largest banks, which since 2009 have submitted to annual Federal Reserve "stress tests" validating their soundness, asset managers haven't been subject to poking and prodding aimed at making sure they'll hold up in good times and bad.

"We are unlikely to have another banking crisis," Mr. Silva, the former Fed examiner, said. "But we are still as vulnerable—if not more so—to a financial crisis."

The financial sector as a whole hasn't shrunk since 2008. In fact, the pie is growing: Revenues across the industry have grown by 26% since 2006, to $671 billion last year, according to Boston Consulting Group.

Banks' share of that is shrinking, though, to one-third in 2017 from one-half in 2006, according to BCG. The proportion earned by money managers such as BlackRock rose to 49% from 39% over that period, and is now the largest single chunk. Exchanges and financial-technology firms have also gained at banks' expense.

Even inside Wall Street banks, the axis has shifted toward steadier buy-side businesses. Morgan Stanley and Bank of America Corp. have embraced retail, charging individual clients fees of as much as 1% to invest their wealth— asset-management writ small. Citigroup Inc. in August reorganized its consumer business around a U.S. strategy that will emphasize wealth and asset management.

At Goldman, the firm's asset-management arm accounts for 19% of firmwide revenue, compared to 10% in 2007. The trading division's share has slipped from 65% to 37% over that period.

And nearly a decade after missing out on iShares, Goldman is building its own passive index-funds business from scratch to compete. It has gathered $10 billion since the effort began in 2015. Over the same period, BlackRock added $1.2 trillion.

Write to Liz Hoffman at liz.hoffman@wsj.com

The Crisis: A Decade Later

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Corrections & Amplifications

A Labor Department report Thursday said U.S. worker productivity grew 2.9% in the second quarter from the first period, unrevised from an earlier report. A headline on a U.S. Watch article Friday incorrectly said productivity was revised upward.

(WSJ Sept. 8, 2018)

(END)

CINCINNATI

Gunman Kills Three

At Office Building

A gunman opened fire in a Cincinnati office building Thursday morning, killing three people before being shot and killed by police, authorities said.

Police received a call at 9:10 a.m. of shots fired at Fifth Third Center, in the city's Fountain Square area, Cincinnati Police Chief Eliot K. Isaac said.

The man entered through the loading dock and began firing, the chief said. He then entered the lobby area, where he continued shooting and exchanged gunfire with several officers and was killed.

Authorities identified the shooter as Omar Enrique Perez, 29 years old, of Northbend, Ohio.

A spokeswoman for Fifth Third Bancorp confirmed there had been a shooting at its headquarters and said the bank is working with authorities.

Five people in the building were injured, Mr. Isaac said.

Mr. Isaac said the investigation is just beginning and didn't give a motive.

-- Joe Barrett and Erin Ailworth

EMPLOYMENT

Initial Jobless Claims

Fall to a 49-Year Low

The number of Americans filing applications for new unemployment benefits fell at the end of August to a nearly five-decade low.

Initial jobless claims, a proxy for layoffs across the U.S., declined to a seasonally adjusted 203,000 in the last week of August, the Labor Department said Thursday. This is the lowest level of unemployment-benefit applications since the end of 1969.

Though data can be volatile from week to week, the four-week moving average of claims, a steadier measure, also fell to a 49-year low, signaling overwhelming tightness in the U.S. labor market.

Jobless claims have remained low in recent years, as the labor market continues to strengthen and managers face difficulty finding qualified employees. U.S. employers added 157,000 jobs and the unemployment rate fell back to 3.9% in July, hovering near the lowest level since April 2000, according to the Labor Department's latest jobs report.

-- Sharon Nunn

PRODUCTIVITY

Worker Productivity

Is Revised Upward

U.S. worker productivity rose this spring at the best quarterly pace in more than three years, newly revised numbers confirmed, though growth from a year earlier was more subdued.

The productivity of nonfarm workers, measured as the output of goods and services for each hour on the job, increased at an annualized and seasonally adjusted rate of 2.9% in the second quarter from the prior three months, the Labor Department said Thursday. It was the best quarterly growth rate since the first three months of 2015.

The new report, updating last month's initial release, did little to change the view of worker efficiency. Both output and hours worked were revised up, but the overall rate of productivity gain was unchanged and matched economists' expectations.

The second-quarter reading "represented a significant rebound" from the first quarter's slight increase, said Gregory Daco, chief U.S. economist at Oxford Economics. "However, on a year-on-year basis, productivity growth remains tepid."

From a year earlier, productivity advanced 1.3%. That matched the average annual rate recorded from 2007 to 2017, and was less than the 2.1% annual average recorded since the end of World War II.

Productivity has advanced at a 1% year-to-year pace or better for seven straight quarters. It is the longest such stretch since the period that ended in the fourth quarter of 2010.

-- Eric Morath

NORTH CAROLINA

Voting Records

Deadline Postponed

Federal prosecutors postponed a deadline for North Carolina election officials to provide voting records requested by federal immigration officials until after the Nov. 6 election.

The U.S. Attorney's office for the Eastern District of North Carolina said in a letter that prosecutors would postpone the deadline until January and consider modifying the request, as long as election officials verified in writing that they wouldn't destroy any relevant records.

Prosecutors, at the request of immigration officials, had originally requested more than 20 million county and state records covering an eight-year period to be turned over by Sept. 25. North Carolina election officials had argued the effort required to collect the records would jeopardize their ability to prepare for this fall's election.

The subpoenas are part of an investigation into voter fraud in which 19 foreigners were charged or indicted, according to a federal law-enforcement official.

The Justice Department has said the investigation was led by U.S. Immigration and Customs Enforcement, operating under the agency's newly created Document and Benefit Fraud Task Force.

-- Valerie Bauerlein

Document J000000020180907ee970002g

WSJ PRO CENTRAL BANKING

Markets

Lehman's Last Hires Look Back; Four people who started at Lehman Brothers the day it failed reflect on the lessons they've learned

By Corrie Driebusch
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English

September 15, 2008, was one of the darkest days in the history of Wall Street. For four new college graduates, it was also their first day of work at Lehman Brothers Holdings Inc.

Sohil Sheth, Luvleen Sidhu, Justin Gaines and Brian Grossman walked through the doors of Lehman just as the venerable investment bank filed for bankruptcy protection, an event that sent shockwaves around the globe. The aftershocks continue to define many aspects of American life a decade later.

The crisis provided these unlucky millennials with a new perspective. Big institutions were no longer infallible. Wall Street no longer offered a guaranteed career path. Life was more fragile than they knew.

One thing was certain: Their world would never again look the same.

Sohil Sheth

Works for Boston technology firm Harding Point

My junior year at Amherst, everyone was trying to get an internship in New York at a bank, and I got one with Lehman's investment management division. All we heard from executives was that Lehman was going to be the next Goldman Sachs.

The summer of 2008 I moved to New York for training. I was definitely getting nervous that maybe they would start laying people off. But the messaging at Lehman was ‘don't worry.' There's no way the government would let anything happen to a company as big as Lehman.

I was preparing for a licensing exam in my apartment on Sunday, Sept. 14, and there was a new news story every minute. I refreshed my computer browser and all a sudden there was a headline that Lehman declares bankruptcy. I got that feeling in the pit of my stomach. The next day we all went in to work, but everyone was a zombie.

I kept working there, but this cloud was hanging over us. I worked in the fund of hedge funds group for two and a half years, but then got super jaded. I went to Peru and worked for a nonprofit for almost a year.

A decade ago I defended the finance industry. Looking back, it's tough to be socially conscious and work in it. I'm not saying tech is saving the world, but there's more practical applications that can apply to a lot of people than just making the rich richer.

Luvleen Sidhu

Co-founded digital banking startup BankMobile

I interned at Lehman after my sophomore and junior years at Harvard. I graduated in 2008 and started six weeks of training, and the first day on the job was the bankruptcy. I remember contacting HR and I asked, should I come in? I've locked the response in my head because it was so unusual. The response was, ‘please come in, it's business as usual.'

My first day was kind of crazy, in an eerie way that we were ignoring reality. No one was acting panicked. No one was acting out of line, though maybe they were behind closed doors.

For it to happen the first day of my career, it really showed the fragility of things. I was gung-ho Lehman. I still have our Lehman bag. Lehman squishy ball. Lehman training binder. I thought I was going to a top investment bank.

I think it was for the best in hindsight. We had this clear trajectory: Go to a top undergrad school, do banking or consulting, then go to business school. All those things still happened, but what changed I think is entrepreneurship really blossomed. You realized that's not the only path in life to make you feel you accomplished something. There's impact that you can make in different ways.

Justin Gaines

Works for Matrix Private Capital LLC, the New York advisory firm founded by former Lehman CEO Dick Fuld

I moved to New York in June 2008, and began my training at Lehman the next month. I'd loved my internship the year before. Dick Fuld even hosted a breakfast for all interns from Middlebury [College] because he was a trustee there. But in summer 2008 all these rumors were swirling. We were watching the **stock market** and Lehman's stock kept falling. I bought some at $5 a share, and that was my first investment mistake.

I took my licensing exam the morning of September 15. I then went into work at Lehman's office on 40th and 3rd Avenue. There were some tumultuous times, but I was fortunate that my position was maintained at Neuberger Berman [an investment-management firm then owned by Lehman], and I spent eight years there.

Looking back, it helped me be able to think about markets differently. It's something most people will never forget, but to happen on the first day of my career, it's seared into my memory.

In a way I've come full circle. I now sit down the hall from Dick Fuld at Matrix.

Brian Grossman

Works for BlackRock Inc. in New York

In 2007 I went to campus recruiting by banks, and it was really attractive to go to a place like Lehman. People were advancing very quickly, getting a ton of experience and making money very quickly. The culture at Lehman was really strong, and there was a lot of pride in how it was competing as a smaller rival.

When I was on spring break in 2008 I didn't have reception on my phone. When my plane landed I had voicemails about Bear Stearns going under, and the news kept saying Lehman is next. That was pretty scary. So I started interviewing other places, but at the end of the day I decided to go through with Lehman.

During training, everyone was learning to do things like model Excel while we watched the **stock price** drop. The day we heard about the bankruptcy I was in my apartment preparing for a licensing exam and emailing with my analyst class. We decided we had to still take the exam that Monday morning because if they're going to make cuts if you fail you'll get cut.

It was sad to watch Lehman go under, but it was exciting to be in the early years of my career and able to witness the industry change during that time. That was one of the valuable lessons working toward my current position, which I see myself in long term.

These interviews have been lightly edited and condensed.

Write to Corrie Driebusch at corrie.driebusch@wsj.com

The Crisis: A Decade Later

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THE WALL STREET JOURNAL.

Heard on the Street
Markets
Tough Days for China's Tech Giants; Government pressure and new competitors mean Baidu, Alibaba and Tencent are no longer the unstoppable investments they've been for years

By Jacky Wong
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The harsh reality of doing business in China has caught up to the country's tech giants, upending one of the most profitable investments in global markets.

Baidu, Alibaba and Tencent—China's largest tech companies—have long seemed unstoppable, respectively dominating online search, e-commerce and videogames in the world's most populous nation.

This year, the so-called BATs no longer seem so unassailable—and nor do their shares. That matters to U.S. investors, who have feasted on gains that matched those generated by their U.S. equivalents, the FAANGs. This year, though, shares of Facebook, Apple, Amazon, Netflix and Google's parent Alphabet are up by 28%. The BATs, whose biggest shareholders include Vanguard Group and BlackRock, are down 12%.

The BATs' first big problem is Beijing. The tech giants' sheer size and pervasive presence in daily life in China mean they are increasingly falling under the gaze of a government that demands control of the economy.

For Tencent, which makes over 90% of its revenue in China, more government scrutiny has become a reality. Beijing has been holding up approvals for new games and sales of in-game items like virtual weapons—Tencent makes around half its annual revenue from the latter. The freeze caused the company's first year-over-year profit decline since the last quarter in 2005.

This doesn't seem like a hiccup. Beijing last week said it will continue limiting videogame releases and set restrictions on young people's playing time, while state media has been repeatedly lambasting game companies for creating social problems. **Nasdaq**-listed Baidu, too, has been reprimanded for hosting content that threatens China's "social order."

Regulators are also trying to limit the growth of fintech companies like Alibaba's affiliate Ant Financial and Tencent's WeChat Pay. Their dominance of online payments is siphoning deposits away from state-owned banks into financial products sold on their platforms, just when Beijing is trying to rein in lightly regulated investments.

The second big concern for the BATs is growing competition at home. The rise of new rivals in the all-important fight for Chinese users' attention may not lead to a collapse in revenue or market share. But the trend has weakened the perception of the BATs as de facto monopolies.

Take Bytedance, which operates news-aggregator Jinri Toutiao and short-video site Douyin. The company is hoping to raise $3 billion of private funding that would value it at $75 billion. Its apps now command 10% of Chinese mobile users' time, gaining at the expense of Tencent-related apps whose share has dropped to 48% from 54% over the past year, according to data research company Questmobile.

Fending off rivals is proving costly. Alibaba, which has long reigned supreme in Chinese e-commerce, is now facing competition from companies like Pinduoduo, which has been growing quickly by offering discounts to groups of consumers via social media. Alibaba has responded by investing billions into areas like bricks-and-mortar stores and online delivery to support its decelerating core business. But that spending has yet to generate much return.

Can the BATs beat back the tide? One option is to expand overseas. Tencent has already been exporting its long-held strategy of buying up smaller rivals, and has just entered an alliance with Japan's Square Enix, the maker of hits like "Tomb Raider." Alibaba has targeted e-commerce in Southeast Asia by acquiring local rival Lazada.

Still, Tencent generated only 3% of its revenue outside China last year. Alibaba's international e-commerce accounted for just 8% of total sales last quarter.

Squeezing more out of customers at home looks a better bet. Tencent could make more from social network WeChat, with its 1 billion-plus monthly active users. Last quarter the company earned just $2 per user from advertising, well below Facebook's $25 per user in North America. Even after adjusting for the difference in individual wealth between China and the U.S., that leaves a lot of upside for Tencent.

This year's selloff has only brought Alibaba and Tencent back to just below 30 times forward earnings, in line with their three-year average, while Baidu trades around 20 times. Yet expected growth, unless Beijing steps back and new competitors stumble, is clearly slower. The BATs' best days may be behind them.

Write to Jacky Wong at JACKY.WONG@wsj.com

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THE WALL STREET JOURNAL.

U.S. Markets
Markets
U.S. Stocks Slump on Fears of New China Tariffs; S&P 500, Dow industrials retreat; tech stocks recover some of their recent losses

By Corrie Driebusch and Ben St. Clair
786 words
7 September 2018
04:33 PM
The Wall Street Journal Online
WSJO
English

* Asian stocks finish with weekly loss

* Emerging markets slip into bear territory

* U.S. stocks lower following jobs report

A rough week for technology stocks battered the **Nasdaq Composite**, dragging the index to its worst week since March.

The tech-heavy index slipped Friday after President Trump said tariffs on an additional $267 billion in goods imported from China could be implemented on short notice. The ramped-up rhetoric around the trade dispute reverberated through the **stock market**, sending major indexes lower. Shares of technology companies, which had been trading higher earlier in the session, erased gains.

"If you're looking at trade war escalation, expect tech stocks to be hurt the most because of China supply issues," said Justin Wiggs, managing director in equity trading at Stifel Nicolaus.

The **Nasdaq Composite** fell 20.18 points, or 0.3%, to 7902.54, putting its weekly decline at 2.6%—its worst performance since the week ended March 23 when Facebook's data-privacy scandal erupted. The **S&P 500** shed 6.37 points, or 0.2%, to 2871.68 on Friday, while the **Dow Jones Industrial Average** lost 79.33 points, 0.3%, to 25916.54.

Fears of tariffs, increased government regulation and pricing pressures have weighed on tech companies in recent sessions. Internet companies such as Facebook and Twittertumbled earlier this week as executives testified before Congress about foreign influence on their platforms in the 2016 presidential election. On Thursday, semiconductor stocks slumped on lowered analyst expectations and ongoing worries about how resilient their revenue will be if the U.S. trade dispute with China grows.

Twitter's stock declined 32 cents, or 1%, to $30.49, putting its weekly loss at 13%. Facebook shares edged up 51 cents, or 0.3%, to 163.04 Friday, but ended the week down 7.2%.

And shares of Tesla dropped 17.71, or 6.3%, to 263.24 following executive departures and an interview that appeared to show Chief Executive Elon Musk smoking marijuana.

More broadly, stocks wobbled Friday after the August jobs report showed a pickup in hiring and healthy wage growth, bolstering the case for the Federal Reserve to continue raising rates at its current pace.

The Federal Reserve closely watches wage growth as an indicator of inflation, and some analysts have said the rise in wages could encourage more short-term rate increases from the Fed.

"We could see some jitters in markets," said Kristina Hooper, chief global market strategist for Invesco, adding that when wages last grew at nearly as high a pace earlier this year, it caused some turmoil in the **stock market**. "If inflation is going up too much, instead of the Fed pausing, it could need to tighten more," she said.

Labor Department data showed the U.S. added 201,000 jobs in August, ahead of forecasts for 192,000 additional jobs. Average hourly earnings were up 2.9% from a year earlier, while the unemployment rate held steady.

Yields on 10-year U.S. Treasurys edged higher to 2.944%, up from 2.877% Thursday. Yields move inversely to prices.

As the payout on Treasury bonds rises, the returns from utilities and real-estate company stocks, which offer bond-like distributions, can seem less attractive—and more risky—in comparison. Shares of utilities and real-estate investment trusts declined Friday.

The dollar turned higher against a basket of currencies; the ICE Dollar Index was recently up 0.3%.

Around the globe, fears of contagion in emerging markets and ongoing trade tensions have helped push Asian and European stocks lower this week. On Thursday, the MSCI Emerging Markets Index fell into **bear market** territory, defined as a 20% drop from a recent peak.

The Stoxx Europe 600 rose 0.1%, though banking stocks declined.

Shares in Deutsche Bank fell 1.5% after reports that Chinese conglomerate HNA Group, one of the bank's largest shareholders, planned to sell its 7.6% stake in the bank.

In Asia, Hong Kong's Hang Seng was flat and the Shanghai Composite Index rose 0.4%. Meanwhile, South Korea's Kospi fell 0.3% and Japan's Nikkei dropped 0.8%, with the Japanese index closing lower for the sixth consecutive trading day.

In commodities, U.S. crude fell 2.9% to $67.75 a barrel for the week after a report showed U.S. inventories of petroleum products were already starting to rise as the lower-demand fall season nears.

Write to Corrie Driebusch at corrie.driebusch@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Transcript: Q&A With New York Fed's John Williams at the University at Buffalo; Central banker talks about wage growth, interest-rate policy and financial regulation

6,828 words
7 September 2018
01:04 PM
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English

New York Fed President John Williams spoke before an audience at the University at Buffalo on Thursday, Sept. 6, 2018. He discussed inflation, wage growth, interest-rate policy, financial regulation and the yield curve, among other topics. The exchange was moderated by Paul Tesluk, dean of the University at Buffalo School of Management. Here is a transcript, lightly edited for length and clarity.

PAUL TESLUK: So welcome, John, to the Buffalo-Niagara region, to UB, and to the Jacobs School of Medicine and Biomedical Sciences' brand-new building that you're in here today. What do you think of it?

MR. WILLIAMS: Well, you know, it's been a very – I haven't been in Buffalo before, that's true. So we spent a lot of yesterday and today visiting all parts of Buffalo, and actually Niagara Falls too. And what's striking, I think, for my first two days here is just how much change is happening in this city and this region. You see this in terms of – (inaudible) – region. You see it in terms of, you know, new hotels, new development around the city. We just visited the – you know, a new workforce training center as well.

So, you know, when I think about the national economy, I think of this as being a pretty good time for the economy. But it's also a really important time for all of us in our – in our communities and in our – in our regions to really – to focus on some of the longer-run challenges, and I see a lot of that going on here. A lot of …communities coming together, working hard on some more difficult longer-term issues around, you know, workforce development, labor force issues…and quite honestly reinventing this economy.

So I come away very encouraged, very optimistic about what's happening here. I've also told people I've been meeting that I'm going to come back in a few years and see how some of these things play out and what are the lessons learned, what's worked well, and maybe some of the things that they need to rethink and redirect.

MR. TESLUK: Very good, all right. So, as the leader of the New York Fed and before that of the San Francisco Fed, you're a policy maker. You're responsible for guiding the economy. And when you think about the health of the economy, and now that you're here and seeing what it's like here in Buffalo and Western New York, what's your impression relative to where this region stands relative to the rest of the state, to the rest of the nation in terms of the regional economy?

MR. WILLIAMS: The Federal Reserve has what we call the dual mandate for monetary policy. We have two objectives, and that's maximum employment, which I think of as that everyone who wants a job can find one; and the other is price stability, which we think of as very low – low and stable inflation. In terms of those overall goals on the national scene, this is about as good as it gets. Inflation today is running at 2 percent. That's a target that we've set, that we want to average, inflation be low and stable, around 2 percent. And that's where we are. And then after, you know, obviously, the worst recession and slow recovery of hopefully our lifetimes, we've seen the economy actually recover and now we're in the second-longest expansion, actually, for the U.S. economy. Unemployment's below 4 percent and I expect that to come down. So that's the national context of where things are.

If you look at regionally in terms of the Second District – that's my district, which is basically New York state and northern New Jersey and a little bit of Connecticut – the trends are pretty consistent with that. The labor market has been robust. Job growth has been good. Unemployment has come way down. Now, if you zoom in here to, you know, Western New York and Buffalo and this area, I think you're seeing very much the same overall story in terms of job growth has been good, economic growth has been solid, unemployment has come down – it's a little higher than the national average, but still quite low compared to the last decade or so.

And so when I look at what's the same or different, I'm going to go back to some of my experience in San Francisco, where my region there covered a lot of similar kind of issues. You know, urban areas that are booming beyond belief, like the Bay Area or Seattle – for those of you who don't know, Amazon is not in the cloud, it's in Seattle. (Laughter.) And if you're in Seattle, you know that. They're building like crazy and there's congestion. And you see that in L.A. and Portland and places. And then the rest of the country, which is, you know, struggling with kind of redefining themselves, thinking about, you know, whether you have an industrial past or a resource-intensive industry past, how do you kind of take that history, continue with that, build on that, but also kind of redefine yourselves in terms of education, in terms of, you know, health care, the things you're seeing here.

So what I would say is what I'm seeing in this region in terms of the health of it is pretty similar in many ways to what I'm seeing, you know, in a lot of the country outside the big cities. The big cities I think are a little bit not representative of how the country's going.

I think a couple things I would just say. You know, there is no one economy. There's, you know, thousands of economies, and they're all unique in their own ways…When I visited here, I think what's interesting here is that – is the challenge of taking a city that has a very strong manufacturing past and thinking kind of how do you really leverage some of that, but also build on what are going to be the long-term growth drivers here, which is really what I think of as services industries such as education, health care, and – again, and technology.

MR. TESLUK: And so maybe kind of building on that theme about kind of the regional economy, when you think about this in terms of appropriate monetary policy for the nation, how do you take into account the regional differences that you're seeing?

MR. WILLIAMS: I'll be candid. We have an interest rate. I mean, monetary policy is complex and we take into account lots of information, lots of analysis and things. But in the end, you know, when we meet, basically, our main policy decision is should we raise interest rates, lower interest rates, or keep them the same. So that's the lever. And that's a national tool, right? Interest rates are overall. You know, they are interest rates across the United States and across the Federal Reserve banks in the United States.

And so the way I think about regional conditions is not that, oh, we can make monetary policy for one region or another, because again, it's a national policy. But I think what's important for us, and me in particular, to understand is so, you know, when I used to sit in my office on Market Street in San Francisco, is that I should not be looking out onto the street outside and thinking that's where the economy is because it's an outlier. So you – you know, the important thing is not to get fixated on where you live or where you work, but – and this would be true now in downtown Manhattan – is if I looked out the window and say, oh, America's going through the biggest construction boom ever because that's what I see outside my window. But then you get out of the city, you get out of where you are, and you go to other parts of the region, whether it's in rural areas or small-town America or, you know, medium-sized cities and metropolitan areas like this, you see that – you're getting the fuller, broader picture.

Now, I would say that, you know, even still, I mean, this – the picture is still wide across the country of an economy that's adding jobs across, you know – you know, across the states, most of them – the vast majority of them. We've seen low levels of unemployment and seen, you know, kind of positive developments. I also think that when you look across the country you also see some of the same challenges about stagnant wages, challenges – employers that can't find any workers and people are struggling to find better-paying jobs. So, again, you know, I see some of the differences, you know, from city to city, but I also see some of the common themes.

MR. TESLUK: So right now we're seeing unprecedented low rates of unemployment, and at the same time wage growth just has not – has not picked up. What do you think is behind that?

MR. WILLIAMS: So in terms of the low unemployment and low wage growth, so this is a big issue for the Federal Reserve. It's something we've been studying very carefully and continue to study. And importantly, continue – I think my thinking about this has also evolved over time. You know, we talk a lot at the Fed about being data-dependent. And what that means is not reacting to every piece of news, but really taking the data and information we have, the analysis, and trying to reassess, question our assumptions, and question our conclusions.

So this is one of the big issues. Normally, you think a very strong labor market, very low unemployment gives the ability of employees – employers will start bidding up wages to attract and retain employees, and that causes wage growth to pick up. Now, if you look at the data, wage growth in the United States has picked up. It was growing about 2 percent about four years ago. Wages are now growing on average around 2 ¾, maybe 3 percent. So we've seen some improvement in that as the economy strengthened.

It's still a little bit of a puzzle why we haven't seen wage growth pick up even more. And economists are, you know, studying this. I guess my conclusion – tentative conclusion as a policy maker is that this is maybe a good thing in terms of the ability– not a good thing in terms of wages--but a good sign that we can continue to let this economy run strong. I'm not worried about inflation pressures picking up anytime soon. And that means that we can be – continue to be relatively patient about normalizing monetary policy and allow this economy to continue to grow in a strong way with very robust job growth and continuing to see unemployment coming down lower.

So my exciting – or my new take-away from this is, you know, the fact that wages haven't grown a lot faster is a sign that this economy still has room to run and that we can allow and foster the conditions that will be, at least for the next few years, very strong job growth and continued, you know, economic expansion, consistent with our maximum employment mandate. So in a way, it's bit of a Goldilocks economy from a policy maker point of view. The economy's strong. Job growth is good. I love that. At the same time, we're not seeing inflationary pressures. So we're not under any kind of pressure, or any kind of – or, we don't need the need to raise interest rates more quickly than otherwise.

MR. TESLUK: So building off of that – off of that theme, we're now 10 years from the (financial) crisis. And now, as you just were describing, we've been going through one of the (longest) economic expansions on record. When you think about what are the risks to where we are as an economy from a financial stability standpoint, what do you see as the big – the big risks that are out there? And can you touch on that a little bit?

MR. WILLIAMS: I think that one of the major lessons from the financial crisis, which we and other – you know, Congress and – took to heart, was we needed to make sure that the banks and the major important financial institutions has sufficient or enough capital and liquidity – basically enough reserves, enough cushion to protect them in case of another economic downturn. So at the Fed and at the other regulatory agencies, in part because of our own actions, partly because of Dodd-Frank law, has required financial institutions, especially the largest financial institutions, to hold a lot more in reserves.

We put them through a stress test every year for the largest institutions, making sure then they're able to withstand the financial – you know, an economic downturn or some other kind of financial hit. So I think that the biggest lesson and the reason I think that we should be – feel at least good about that lesson is that we've implemented a lot of policies to strengthen our financial system and make it more resilient to whatever shock may happen.

So what are those shocks that keep – you know, keep me up at night? I think one of them, clearly, is the global economy and issues around – even though the U.S. economy is doing well, there's always risks around the world in terms of – we saw this with the euro crisis years ago. Today we're seeing clearly some disruptions or some kind of, you know, issues in some of the emerging market countries. So we're kind of watching the global economy, global financial system, to see where risks may be emerging. Right now I don't see those as significant risks in the U.S., but we need to be on top of that.

I think the other issue is really long expansions like ours don't die of old age…But they tend to die of something. And the last two expansions had ended with asset price declines. The **stock market** in the dot-com boom crash in 2001. We had the housing crash. So I'm always watching for what's happening in those areas in terms of excessive evaluations in markets, whether housing, stocks, bonds, or anything else. Looking for signs that as this expansion continues, do people start getting excessively optimistic? Do they start kind of getting over their skis a bit about, you know, really what are the values of stocks and things, and making decisions that might threaten the economy?

Right now, actually, even though asset prices are high--**stock market** is high, housing prices have come back--we're not seeing a lot of signs that the economy is really being fueled by that. And let me give you an example. In the housing market, even though house prices have recovered, home construction is not booming today. It's strengthened a lot from the recession. But we're not seeing signs of overbuilding that were kind of the – some of the things we saw in the early 2000s. We're not seeing people take money out of the value of their home and spend it on consumer goods, like we saw in the early 2000s.

We call that home equity withdrawal, which basically (is) when people refi their house they take that money and they go on a vacation or add a kitchen or buy a car. So we're seeing people being kind of very careful and cautious about how they spend their money. And I think we're still seeing businesses do that. But, again, these are the kind of areas where people – you know, they start believing that economic expansions are going to continue forever, good times will continue forever, and maybe end up taking too much risk. Right now, I don't see those as being, you know, flashing red or anything, but definitely things that we're very much tracking and studying to understand what's happening.

MR. TESLUK: I don't know if you would agree with this, but it seems like there's a trend toward deregulation. And if you do agree with that, is that a trend that concerns you?

MR. WILLIAMS: It would concern me if it really were a trend toward deregulation. I think so far what we've seen, at least in the financial sector in terms of regulation – I'm thinking regulation around banks and financial companies more generally – so far what we've been seeing is – the word we use at the Fed a lot is tailoring or maybe looking back at the Dodd-Frank Act and some of the regs that came out of that and thinking about which are the ones that are absolutely essential. And those would be the things around demanding the banks have a lot more reserves in terms of capital liquidity, having better methods in preparation for what we call resolution of a bank, meaning basically the process if a bank fails, making sure that that doesn't endanger the financial system and the economy.

So I think those things are still in place. We're not seeing a pullback from that. Clearly there's been some movement to the thinking about, hey, we have all these very tough, high-standard regulations and standards on the largest institutions, which is appropriate. Does that need to apply to the smallest community and regional banks? And so there's been some adjustment about that, and, again this idea that let's put – let's make this risk-based. Let's put the severest or toughest regulations and expectations and supervision around the institutions that really impose a major risk to the economy, and make sure we're not trying to do that to every single institution if it doesn't create as much risk.

So that part of what's happened so far doesn't bother me. I think that's just a healthy process, maybe recalibrating or tweaking some of the changes that were made after the crisis. What would worry me is if there were a move toward lightening the capital and liquidity standards or the resolution standards that were put in place after the crisis, or a notion that, you know, just – we should have a lighter touch around supervision of financial institutions. My personal view, having worked in the Fed a long time, is that, you know, that was an approach that we did take before, back in the '90s and early 2000s. And there was a strong view that market forces and market discipline would be a powerful kind of constraint on the activities of financial institutions.

Well, that – regardless of what you thought in the mid-'90s, you should think today that that didn't work. (Laughter.) Because it didn't. And so we got to make sure – we need to make sure that we don't forget the lessons of the past, you know, quarter-century. It's actually something that I would just reiterate. A lot of my colleagues at the New York Fed and around the Federal Reserve system, I mean, all of us lived through this period. All of us worked through the period of the financial crisis. And we lived through the period where, you know, I think there were missed opportunities to rein in some of the risks of the financial system. So this is all in our DNA. So, you know, there's a strong commitment to making sure that we have a financial system that's serving the American people that is robust and resilient, you know, in the future.

MR. TESLUK: What do you – you know, when you talk about the 2008 financial crisis so forth, the regulation that followed, do you think there's a kind of a lasting legacy of that, that will be really kind of known for what that is?

MR. WILLIAMS: So, you know, I think, first of all, the phrase, you know, "market discipline" isn't used very much anymore. So that's a good thing. In a way, you know, it will be interesting to see in behavioral economics – which is an area that's been developed over the last quarter century – I think they've had a number of important insights into human psychology and how it affects decision making. And one of the lessons of that is that we, as human beings, carry our experiences with us for the rest of our lives. So that sounds obvious, right? I mean, sure. But it also means that people's views on what is risk and what isn't – what is risky and what isn't, actually aren't – don't come from just some kind of value risk model that you ran this morning. They actually come from experience.

So we know from the Great Depression and that period there was a decade-long approach in business and in households to basically take less risk than you would normally think would be optimal. There was a whole literature about, you know, why is it that the returns of stocks are so much higher than bonds, and other things. So I think that might be, in a way, a somewhat positive development out of the crisis. And like I said, we're – people are – you know, even though house prices have increased dramatically, nobody's going out there and buying a boat. They're actually basically stocking away that – those gains and being more cautious around that. And I think we see this in the – in the business community too.

Now, you know, that's I think – so when I think about a long-run implication, one of my hopes is, is that, you know, having experienced a crisis like this, and how damaging and terrible it was for our country, that maybe that will give people more caution about taking the risk that happened back then.

MR. TESLUK: So the president touched on how important our international students are, part of the fabric of the University of Buffalo. And certainly that's – they're important also for the growth of our economy. And at the same time, what we're seeing are significant declines of international students coming to our programs. And what we're hearing from them is concerns around what their employment opportunities are, given our – the trend in our immigration policy. And at the same time, talking to regional business leaders, something I certainly hear is the need for talent. And where is that talent going to come from? So can you speak a little bit about that, about the importance of immigration policy and how do you see that, particularly as it relates to international students?

MR. WILLIAMS: You know, what I think of, as an economist – and I actually spent some of my career studying the economic growth and the drivers of long-run economic prosperity. What I'm about to say is neither controversial nor actually I think disputed I think by most people who study this. What – economic growth, economic prosperity in any country – it doesn't matter where it is – is going to driven by two basic factors. One is the population growth is obviously a factor in driving growth in the economy. And the second is productivity. When I think of productivity, you have to think about that not just in terms just about how much each person produces. So what are the drivers there? It's education. It's innovation. It's entrepreneurship. It's all the, you know, secret sauce of the things that we do well in our country of combining new ideas, technology, people to create new and more and better things.

So when I think of how immigration plays into that, first of all, it is a factor in terms of population growth. It's not that important a factor. It's part of the story. Immigration is not a big driver of U.S. population growth. But when you look at the big picture, I do think it's an important driver of the second part. When you think of innovation, you think about entrepreneurship, you think about diversity of views, and experience, and how all those come together, again, through the process of creative destruction and all these things that we're good at – or the U.S. education system excels at is developing, you know, creative minds, fostering a culture of looking ahead and, you know, doing things that no one has ever done before.

So when I think about the issue of immigration, I mean, in terms of education, obviously I go back to this idea that what we want to see is we want to see our economy reach its potential, we want our economy to do the best it can, and when you – if you cut off the flow of young, bright, energetic, entrepreneurial people, then obviously that's going to reduce your ability to achieve that potential.

That said, I do think what we need to be doing is doing that for everybody, not just for students from abroad, but obviously, in a lot of our conversations the last few days here in Buffalo, and quite honestly, the last few years for me, are really about how do we make sure that we also create those education opportunities, job training opportunities for the people who live in our – you know, are born in our communities, lived here a long time. So we want to – we want to be helping our economy and our people achieve their potential whether you just came here for your, you know, MBA, or whether you've been here for a long time.

You know, the other thing about immigration, the issues, especially around education is it is – we've talked about this already a bit – but, you know, it's not like this won't happen somewhere else. I mean, there are other countries – in fact, one that's very close here – it's very good at attracting foreign students, creating innovation incubators, you know, providing really high-paying jobs for people from around the world. So when we miss out on this opportunity, there are plenty of other countries who are looking for the opportunity to bring in the students and the – you know, what I think of as the future innovators and leaders in our economy.

Q: My question is about this call that started outside the U.S. to change the reserve currency from the U.S. currency. What is your view of that? Is it a real risk if it were to occur?

MR. WILLIAMS: So the question was about the possibility or maybe efforts to replace the U.S. dollar as the international reserve currency, and how do I think about this, and what would be the implications of that, right? OK.

So first of all, I mean, this is a topic – as I'm sure you know – has been around for decades: this idea that the U.S.'s unique position as the international currency would be threatened perhaps by – I think back in the day it was the Japanese yen, and then with the introduction of the euro in '99, and since then there has been a lot of discussion around that, and obviously there are other international currencies like the pound and things.

So when I go back to think about this, first of all, understand what is an international reserve currency. It's a currency that globally is used, whether it's to price goods and services for international trade, or it's the unit of account when it – for financial transactions. If you're going to borrow money internationally, is it in dollars, or is it in pound sterling, or is it in euros. And so it's true that, you know, for all of our lives, the U.S. dollar has played a predominant – a very predominant role in international financial and trade transactions, and that continues to this day. And one of the reasons is the dollar is an extremely stable currency in the big picture, it's the value of – the commitment of the U.S. government to back the U.S. dollar is held to be very – you know, by everybody very strongly. And there is a lot of confidence in the way – I think the most important part of this is when there is stress in the global environment, when there is a crisis or anything like that, what happens is that people say, well, where is the safe haven, and the safe haven is the U.S. dollar.

So you saw this in the Asia crisis of the '90s, you saw this in the financial crisis, and you actually see it any time there is a headline that there is something happening anywhere in the world where people are nervous. People say, well, where do I go? Do I go to the euro? Go to the yen? Do I go to the Swiss franc? No, you go to the dollar and it's actually gained value in periods of some stress. And so we've seen the dollar not only continue to be the international reserve currency, but actually – I think cement its role.

I think that there's a couple reasons why I'm not too worried about that changing, at least in the foreseeable future. One is although the euro is a very important currency globally, there is no such thing, as of yet, as a euro bond. There are French bonds in euros, there are German bonds in euros, there are Italian bonds in euros, there's lots of bonds measured in euros. But unlike the U.S. Treasury market, which is the deepest, largest, most, you know, mature government bond market, this is a nation-by-nation bond market.

In Japan, you know, most of that is held by either the – as I said, you know, by Japanese institutions or citizens, and it hasn't had that same role. So I don't see the euro as being an obvious replacement. I think the dollar has solidified its role because of recent crises that it served so well.

I guess the last thing you might say is, what about bitcoin or some cryptocurrency? My answer there is it doesn't meet these basic standards of what you want. You want certainty that that currency will actually be worth what you thought it was worth when you need it. You want to have complete confidence in its security and its validity, which is an issue with cryptocurrency, at least as of now. And you also want something that the Federal Reserve was created to do, and if you go to the Federal Reserve Act of 1913, we were – we created what's called an elastic currency, meaning that the money supply and the support for the dollar changes as economic conditions change. That doesn't mean that monetary policy – or however you think about this – has always been done in the best way, but what it does mean is that, unlike bitcoin or something like that, the supply of dollars into the U.S. and the global market is going to adjust – shrink and expand – as the global financial and economic conditions change. And I think that's just something that's fundamental to having an international reserve currency. The number of bitcoins is essentially capped, and the cost of mining them or any of the other cryptocurrencies has some of these flaws.

Now there are new ideas out there with blockchain to overcome that, but at least for the time being, I think, that's how I view that. And for the U.S. what it means is it's – you know, if you're trying to borrow or, you know – the U.S. dollar is still in very high demand. You know, it's still kind of the centerpiece of the global financial system.

Q: When you think of inflation, it's a very conservative 2 percent. What factors are not included in that market basket of metrics that would impinge upon the buying power of the consumer? For instance, a microcosm here is obviously price of gasoline, price of housing. Tell me what – you know, what other factors are not included in that 2 percent that would impact me as a consumer?

MR. WILLIAMS: Sure. And, you know, in the end, I personally think that the important thing for us at the Federal Reserve and other central banks throughout the world is not that we have the perfect measure of inflation, but we have a consistent one that is measured consistently over time, and that we set an objective for that measure. So I – you know, there is no such thing as a perfect measure of (gross domestic product), or inflation, or unemployment, as many people point out. To me the idea is if we're going to put out a 2 percent marker, let's be clear about what that marker measures and that it's consistently measured over time. And I think the measure we have has those features.

So what is in there and what isn't in there? So let me tell you some things that are in there. Health care is in there. Housing is in there, but as economists – for anybody who has studied this, it's done in terms of the cost of renting a home. So if you rent your apartment or your house, that's obvious, right? But if you own your home, there's this imputed kind of cost of what would it cost to rent your house. Now, so the house price is not in the consumer price index, so this is always an issue when house price runs up. You could say, hey, you guys aren't measuring the cost of housing. We are measuring it, but it's always measured in terms of what's the cost of – you know, if you will, how much would it cost to – just for the homeownership part? The rest of the price increase is somehow the – (inaudible) – valuation of the land and other things.

What else is included? Pretty much everything that a consumer spends on health care, education, goods and services is in there. It includes, like I said, health care and education.

The things that, you know, often get asked – you know, what about the **stock market**, or house prices, or gold, or something – those are viewed as assets in that those are bought and sold as assets, and those are not included there. So when the **stock market** is high, that doesn't get into there directly. Now, from a monetary policy point of view, we actually think that what we control is the overall price of goods and services. So if the asset markets go up or down for whatever reason, that doesn't seem to fit in there.

There has been a lot of research, by the way, about regional differences in the consumer price index – differences by age, differences by gender. They tend to all move up and down. There are differences, but they tend to move up and down together, so it's not that like one measure is clearly better than another. In terms of that, they capture most of what we're looking for. But again, I think the main point is when we said 2 percent in 2012, I want to make sure that the thing we're looking at today is the same thing we were looking when we said 2 percent.

Q: At least since the '80s, each recession was proceeded by an inversion of the yield curve with the Fed continuing to raise rates. How much is that – (off mic)?

MR. WILLIAMS: So the question was about the inverted yield curve, so the – and its predictive power of recessions, and how does the Fed think about that or how do we react to that.

So let me just first say that in macroeconomics – remember, macroeconomics, I say the whole economy is a system – it's rare to find a relationship that's as strong and robust as is inverted yield curve. So what it means is that the short-term interest rates – so think about this, a T-bill rate or a short-term, you know, overnight interest rate that you would get on a short-term Treasury security. If that's higher than a **10**-**year Treasury** yield, then typically – and almost every time in the post-World War II period – a recession has followed within a year or so. And actually there's very few misses, either, so there's – depending on how you measure this, maybe the mid-'60s was one instance, and '64, '67 was one example where the yield curve inverted but we didn't get a recession.

So this is a documented relationship. Basically, it's kind of obvious what it's telling you. You know, people expect interest rates to be – kind of be heading down in the future. That's a pessimistic view of the economy. So if investors are saying I see interest rates coming down from where they are today, they probably have, for whatever reason – thinking the economy is either a bit slow, or inflation is going to slow, or something is going to happen.

So how do I think about that? Speaking obviously for myself – not for my colleagues – this is a data point. This is – I read a paper on this – this is a very strong result. It's there, and we don't want to ignore it. I think we want to understand how to think about, and I think the right way to think about it, personally, is we should be paying attention to what asset prices and **financial market** conditions are telling us. You know, when you're seeing the **stock market** come down, it may not be – it may just be a reassessment of the value of a company. But if you are looking at – you know, broadly at financial conditions, studying them, understanding them – what are market participants thinking, why is it that long-term interest rates have stayed low, what are the factors driving that, is this an economic pessimism, is it the facts of our Fed's policies, is it this or that? So we spend a lot of time talking to market participants, trying to understand their views on this, and also doing a lot of research on that.

I think the big question today is, you know, would the Fed – you know, is the Fed nervous about this? And my own view on that is we need to do the right thing in terms of our monetary policy decisions and keep this economy at full strength, keep it humming along, keep inflation stable. What if the yield curve moves a little bit one way or another? That's not what I think we should be focused on. I think we should be focused on achieving our goals and adjusting policy as needed.

My view is – my strongly held view is that the path that we're on is a good one, gradually raising interest rates and then coming back to normal, and adjusting policy as the economy – (inaudible) – is – you know, is the right kind of approach, and it's not one that, you know, creates a lot of risk one way or the other. And I think it positions us, also, well to adjust to changing economic conditions.

So I definitely take seriously the fact that this inverted yield curve historically has given us strong signals. I think there are some reasons today – maybe not – (inaudible) – special circumstances, but in the end I think what we need to do is – what we should always do is do our best to achieve our goals and adjust our policy appropriately as new information rolls in.

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Oil Prices Drop As Total U.S. Fuel Inventories Rise

By Dan Molinski and Christopher Alessi
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U.S. oil prices fell sharply Thursday after a weekly report showed U.S. inventories of petroleum products are already starting to rise now that summer is ending and the lower-demand fall season is near.

Light, sweet crude for October delivery fell 1.4% to close at $67.77 a barrel on the New York Mercantile Exchange. Brent crude, the global benchmark, lost 1% to $76.50 a barrel.

The Energy Information Administration said Thursday that crude-oil inventories fell by 4.3 million barrels last week. And while that data point alone is bullish, the report also showed gasoline and distillates inventories rose by a combined 5 million barrels, and the grand total of crude oil and processed petroleum products rose by a bearish 3.6 million barrels.

"The fundamentals are starting to get a little bit questionable," said Ric Navy, senior vice president for energy futures at R.J. O'Brien & Associates.

The EIA report also showed U.S. crude oil exports fell 271,000 barrels a day last week, to 1.5 million barrels a day.

Mr. Navy said Thursday's report on U.S. oil inventories wasn't the only factor in oil's decline, noting overall global demand is also becoming a bigger concern.

"There are more clouds as far as economies go, and the tariff disputes are also a factor," he said.

Alfonso Esparza, senior analyst at foreign-exchange trading group Oanda, said additional tariffs may hurt demand for oil.

"The threat of a new round of tariffs on Chinese goods looms over the market," Mr. Esparza said. "China is expected to retaliate, escalating the trade war between the two economies and dragging down global growth forecasts."

The sharp drop in prices represents a quick reversal from earlier in the week, when prices jumped Tuesday on short-term supply concerns as tropical storm Gordon in the U.S. Gulf Coast was seen hitting oil production and refining activity.

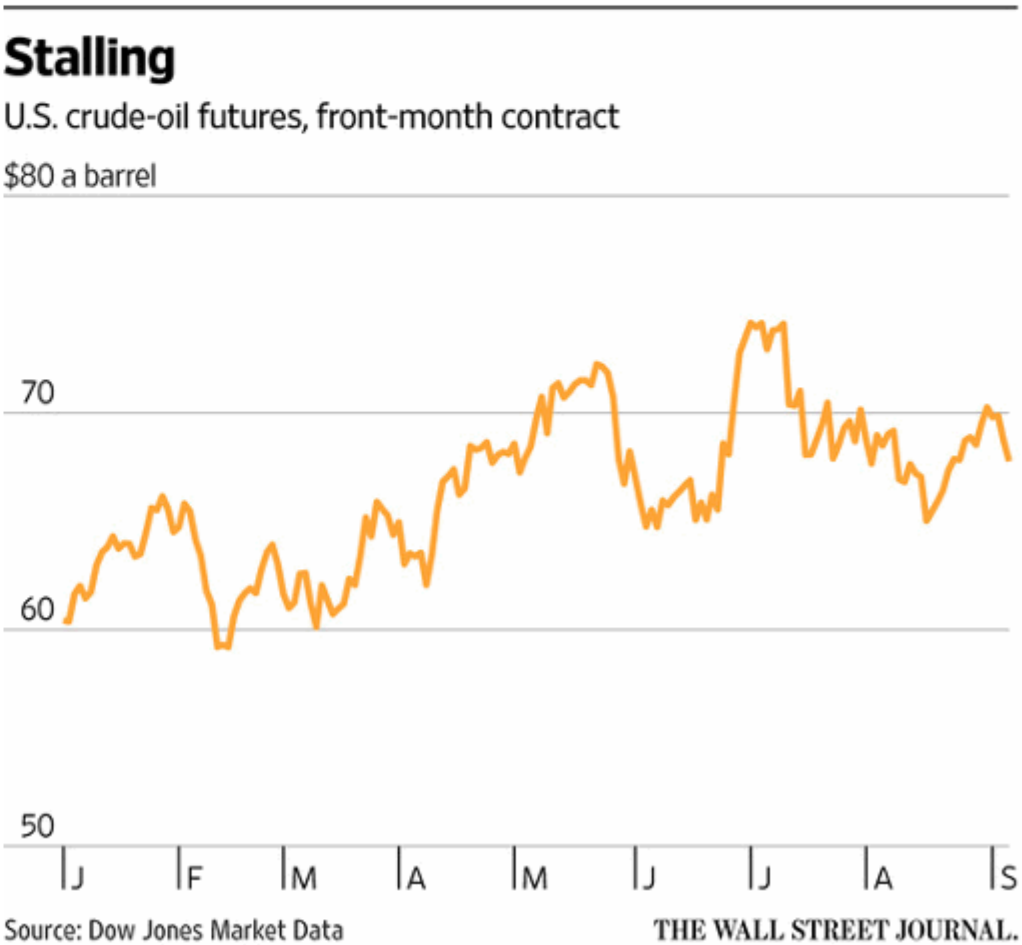
But the storm failed to strengthen into a hurricane, proving much less problematic for U.S. oil-and-refining operations than many investors feared.

"I believe the main reason [for Thursday's price decline] is a correction after prices rose ahead of Gordon," said Bernadette Johnson of Drillinginfo. "The storm was priced in, but then changed course and prices came back down a bit."

Oil-market participants are looking ahead to monthly reports out next week from the International Energy Agency and the Organization of the Petroleum Exporting Countries, with an eye to how much OPEC's output increased last month.

OPEC and its partner producers, including Russia, agreed in late June to start ramping up production in July after more than a year of holding back output. The move helped to cap rapidly rising prices.

Among refined products, gasoline futures for October delivery fell 0.7% to $1.9510 a gallon. Diesel futures declined 1.1%, to $2.2091 a gallon.



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WSJ PRO CENTRAL BANKING

Economy

Williams: Yield Curve Not Deciding Factor | Evans Favors Tightening Beyond Neutral | BOC Likely to Raise Rates | Justice Probes Wells Fargo | Blackstone's Take: Good News for Swiss Economy May Be Bad News for Central Bank; The Wall Street Journal's central banking newsletter for Friday, September 7, 2018

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Blackstone's Take: Good News for Swiss Economy May Be Bad News for Central Bank

Fed's Williams Says Yield Curve Not Deciding Factor in Setting Rates

Fed's Charles Evans Says He Favors Tightening Beyond Neutral

Bank of Canada Likely to Raise Rates, Even if Nafta Talks Collapse

Justice Department Probing Wells Fargo's Wholesale Banking Unit

Good News for Swiss Economy May Be Bad News for Central Bank

In Switzerland, great news on the economy may complicate life for its central bank, whose ultra-easy policies are premised on the idea that the strong Swiss franc is a risk to the economy.

That is getting to be a tougher case to make.

Swiss gross domestic product expanded 3.4% in the second quarter from one year earlier, the economic affairs ministry said Thursday, leading some analysts to pencil in 3% growth for 2018 as a whole. The gains were pretty broad based and, in a particularly good development for trade-dependent Switzerland, exports grew strongly.

So what's not to like?

For the Swiss National Bank, the sturdy growth figures suggest it will have to revise its 2% growth forecast this year higher. More important, they make this key sentence from the SNB's June policy statement difficult to justify: "The situation on the foreign exchange market thus remains fragile, and the negative interest rate and our willingness to intervene in the foreign exchange market as necessary therefore remain essential."

The SNB's policy rate, at minus 0.75%, is one of the lowest in the world. And though it doesn't appear to have intervened in currency markets in over one year, it has repeatedly said it stands ready to do so.

Neither instrument seems necessary when the economy is expanding strongly, the unemployment rate is under 3% and annual inflation, though low by global standards at 1.2%, is within the SNB's target range of zero to 2%.

But it will be hard for the SNB to change either of them when it meets Sept. 20. Like other small central banks in Europe that aren't part of the euro, the SNB depends heavily on what the European Central Bank does. Tightening policy ahead of the ECB could trigger a sharp rise in the franc.

Switzerland has proven to be more resilient than previously thought to the strong franc. Still a sudden, sharp rise would be unwelcome.

In a sign of how topsy-turvy things have gotten for the Swiss, hours after the strong GDP report, economists at Credit Suisse pushed back their forecast for the SNB's first rate increase of a new cycle: from March to September 2019. They cited the recent strengthening of the franc.

Key Developments Around the World

Fed's Williams Says Yield Curve Not Deciding Factor in Setting Rates

Federal Reserve Bank of New York leader John Williams said Thursday the prospect of a yield-curve inversion by itself wouldn't be enough to stop him from supporting further rate rises if he thought the economy called for them. "I think we need to make the right decisions based on our analysis of where the economy is and where it's heading," Mr. Williams said in Buffalo, N.Y. "If that were to require us to move interest rates up to the point where the yield curve was flat or inverted, that would not be something I find worrisome on its own." Mr. Williams was responding to a question about the narrowing in the difference between short- and long-dated Treasury yields. When short-term yields rise above long-term yields, that is known as an inversion in the yield curve, something that has often preceded a recession. "I don't see the flat yield curve or inverted yield curve as being the deciding factor in terms of where we should go with policy," he said.

Transcript: Media Q&A With New York Fed's John Williams in Buffalo

Fed's Charles Evans Says He Favors Tightening Beyond Neutral

Chicago Fed President Charles Evans said Thursday that he believes the central bank should raise interest rates enough to slightly curb economic growth to keep inflation under control. Federal Reserve officials should raise their benchmark short-term rate first to a so-called neutral level that would neither spur nor slow growth, and then a bit higher "to help transition the economy onto a long-run sustainable growth path," Mr. Evans said in remarks released Thursday. He had prepared them for delivery at a conference in Argentina that was canceled.

Transcript: Atlanta Fed President Raphael Bostic Speaks in Chicago

Atlanta Fed President Raphael Bostic spoke Wednesday to the Chicago Council on Global Affairs on "The Return of Inflation—and the Rethinking of Monetary Policy?" He also took questions from a moderator and the audience. The central banker discussed the U.S. economy, wages, the yield curve, financial stability and other topics. Here is a transcript of the event.

Five Things to Watch in the August Jobs Report

The Labor Department releases its monthly snapshot of the nation's labor market Friday. Economists surveyed by The Wall Street Journal expect it to show employers created 192,000 jobs in August and that the unemployment rate fell to 3.8% from 3.9% a month earlier. Here are five things to look for in the report.

Bank of Canada Likely to Raise Rates, Even if Nafta Talks Collapse

A breakdown in talks toward a revised North American Free Trade Agreementwouldn't necessarily prevent the Bank of Canada from raising interest rates, a senior official from the central bank said Thursday. Senior Deputy Governor Carolyn Wilkins said in a speech that tariffs and other protectionist measures can weigh on economic growth and incomes, particularly as businesses work to adjust to any policy changes. She said those same measures can also push consumer prices higher, a key concern for a central bank that sets policy to achieve and maintain 2% inflation.

FINANCIAL REGULATION ROUNDUP

Justice Department Probing Wells Fargo's Wholesale Banking Unit

The Justice Department is probing whether employees committed fraud in Wells Fargo & Co.'s wholesale banking unit, following revelations that employees improperly altered customer information, people familiar with the matter said. The Wall Street Journal previously reported that some employees in the unit added information on customer documents, such as Social Security numbers and dates of birth, without their consent. The Justice Department in recent weeks has sought more information from the bank to examine if management pressure prompted the employees to improperly alter or add the information, the people said. The employees at the time were working to get customer documents in order before a regulatory deadline. Wells Fargo spokesman Alan Elias said the bank doesn't comment on regulatory or Justice Department matters. A spokesman for the Justice Department declined to comment.

Branded a Villain, Lehman's Dick Fuld Chases Redemption

In the lobby of Dick Fuld's advisory firm a framed print greets visitors with a stark message: "That Was Then This Is Now." A decade after presiding over the collapse of Lehman Brothers Holdings Inc., Mr. Fuld is still working on the second act of a Wall Street career that many predicted had also expired in September 2008. But as the anniversary of Lehman's demise nears, friends and former colleagues say Mr. Fuld's mind is on what happened during Lehman's final days.

Lehman's Lessons, 10 Years Later

Ten years after the failure of Lehman Brothers, the publishing industry is still churning out tracts on what went wrong and how to stop it from happening again. Investors need not involve themselves in arguments about the best form of bank regulation or how to restructure derivatives counterparties, but the collapse of Lehman offers plenty of important lessons, many of which still haven't sunk in. Here are five.

The Regrets of Lewis Ranieri

When Lewis Ranieri invented mortgage bonds, he never thought it would turn out this way. Four decades ago, Mr. Ranieri was at the helm of a revolution in how Americans finance their homes. Until then, mortgages largely stayed on the books of local savings banks. Mr. Ranieri created a secondary market that packaged mortgages into securities sold to investors. As the mortgage market grew, so did the securitization of increasingly risky and fraudulent loans. In 2008, the housing market collapsed, setting off one of the worst crises that has ever shaken the global financial system. "I'm the guy who played a central role in this home thing and I regret it because…it got abused beyond everybody's imagination," says Mr. Ranieri, 71 years old.

The New Mortgage Kings: They're Not Banks

CFPB Issues First Supervision Report Under Mulvaney

The Consumer Financial Protection Bureau has in recent months found illegal activities in mortgage and auto-loan servicing and at payday-lending companies, a sign the bureau continues to scrutinize financial companies under the Trump administration. report released Thursday—the first since acting Director Mick Mulvaney took over in November 2017. Mr. Mulvaney, a Trump appointee who also serves as the White House budget chief, has introduced a more collaborative enforcement approach to companies the CFPB oversees than was the case during the Obama administration. That has prompted criticism from officials hired in the prior administration.

Friday

8:30 a.m. EDT

U.S. Labor Department releases August jobs report

8:30 a.m. EDT

Boston Fed's Rosengren gives opening remarks at Boston Fed economic conference

9 a.m. EDT

Cleveland Fed's Mester speaks at Boston Fed economic conference

1:20 p.m. EDT

Dallas Fed's Kaplan speaks on energy and the economy at Dallas Fed

Saturday

10:45 a.m. EDT

Boston Fed's Rosengren speaks at Boston Fed economic conference

How Likely Is a Return to the Zero Lower Bound?

An Economic Brief article from the Federal Reserve Bank of Richmond studies the likelihood of the U.S. central bank again finding itself at the zero lower bound, or the place at which it could no longer lower interest rates in response to an economic downturn. "Recent research at the Richmond Fed has used repeated simulations of the U.S. economy to estimate the probability of such an occurrence over the next ten years," authors Thomas A. Lubik, Christian Matthes and David A. Price write. "The estimated probability of returning to the zero lower bound one or more times during this period is approximately one chance in four." The research finds that "the probability is initially close to zero and increases over time to a little more than" 15% in 2028, with the cumulative probability of reaching the zero lower bound sometime over the 10-year period at 25%.

The Case for a U.S. Public Banking Option

"One in four households either does not have a bank account or must resort to high-cost or predatory services like payday loans," Thomas Herndon and Mark Paul write in a Project Syndicate column, citing Federal Deposit Insurance Corp. figures. "In either case, financial exclusion is preventing too many Americans from achieving basic economic security. To address this widespread failing, we propose a government-provided public option in consumer financial services. A public option would set a true floor in the banking sector, by providing the financial infrastructure needed to ensure universal access to basic services. And, by adding an element of public-private competition, it could be structured to prevent financial fraud and other abuses that currently run rampant in the industry." They add: "A public option would enable regulators to manage the distribution of risk in **financial markets**. Private financial services that heap too much risk on households would be rendered uncompetitive by the more affordable, stable public services."

The number of Americans filing applications for new unemployment benefits fell at the end of August to a nearly five-decade low.

U.S. worker productivity rose this spring at the best quarterly pace in more than three years, newly revised numbers confirmed, though growth from a year earlier was more subdued.

Emerging markets were teetering on the verge of bear territory Thursday as a rising dollar and higher U.S. interest rates are siphoning money from the developing world and making their debts more expensive.

The eurozone's economy slowed slightly in the three months through June as imports jumped despite weak household spending, with few signs that a rebound is in prospect soon.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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The New York Times

World; Middle East
Iran's Currency Crashes. Shortages and Fears Rise.

By The Associated Press
439 words
5 September 2018
10:01 PM
NYTimes.com Feed
NYTFEED
English

Iran's rial fell to a record low on Wednesday, part of a staggering drop in the currency's value since the United States pulled out of the nuclear deal only four months ago.

Those who went to work at the start of the Iranian week on Saturday saw their money shed a quarter of its value by the time they left the office on Wednesday. Signs of the currency chaos can be seen everywhere in Tehran: Worried residents lined up outside beleaguered money changers, travel agents offered vacation prices only in hard currency, and diapers disappeared from store shelves.

Many exchange shops in downtown Tehran simply turned off their electronic signs showing the current rate for the American dollar, while some Iranians who wanted hard currency sought out informal money traders on street corners. Exchange shops that remained open offered 150,000 rials to the U.S. dollar.

"Everyone's just nervous," said Mostafa Shahriar, 40, who was seeking dollars.

There was no immediate acknowledgement of the drop on state media.

Iran's economy has faced troubled times in the past, whether from the shah's overspending on military arms in the 1970s or the Western sanctions that came after the 1979 Islamic Revolution and United States Embassy takeover. Drastic fluctuations in **oil prices** have also taken a toll.

This time, however, feels different. The currency has crashed along with hope many felt following the 2015 nuclear deal Iran struck with world powers, including the administration of President Barack Obama.

In May, despite the United Nations repeatedly acknowledging Iran had lived up to the terms of the deal, President Trump withdrew America from the accord. He said he wanted stricter terms put on Iran that included limiting its ballistic missile program, curtailing its regional influence and forever limiting its nuclear activities.

Ayatollah Ali Khamenei, Iran's supreme leader, called the American moves economic "sabotage" this past weekend, and mentioned the diaper shortage. Some 70 percent of material for disposal diapers is imported. As the rial falls, it makes purchasing the material from abroad more expensive.

"Imagine that in Tehran or other major cities, baby diapers suddenly become scarce. This is happening, this is real, this is not make-believe. Baby diapers!" Ayatollah Khamenei said, according to a transcript on his official website. "This makes people angry. On the other side, the enemy wants people to be angry with the government and system. This is one of their ways."

People lined up outside a currency exchange in Tehran on Wednesday. | Ebrahim Noroozi/Associated Press

Document NYTFEED020180906ee9600105

WSJ PRO CENTRAL BANKING

Markets

SEC's Stock Trading Experiment Cost Investors Over $300 Million, Study Finds; Regulator's move to change 'tick size' of trading in certain stocks was designed to encourage IPOs

By Alexander Osipovich
864 words
6 September 2018
WSJ Pro Central Banking
RSTPROCB
English

A Securities and Exchange Commission experiment designed to stimulate trading in shares of smaller companies has cost investors more than $300 million in the past two years, according to a study released Thursday.

The study by brokerage Pragma Securities LLC adds to a growing body of research that suggests regulators' Tick Size Pilot Program has added to investors' costs without doing much for the small and midsize companies it was meant to help. The program was mandated by the SEC after pressure from some members of Congress.

New York-based Pragma Securities said total costs to investors could exceed $350 million by the time the program concludes its two-year run in October.

Under the program, the "tick size" for hundreds of companies was changed from one to 5 cents. That means instead of seeing prices such as $20.01, $20.02 and so on for stocks in the program, investors would only see prices that were multiples of a nickel.

The program's supporters said forcing small-cap stocks to trade at five-cent increments would make it more profitable for brokers to buy and sell such securities, leading them to publish more research about smaller companies. That in turn could generate interest in the companies' shares, and ultimately encourage more firms to go public, the supporters said.

Executives of smaller public companies have long complained that they are ignored by Wall Street analysts. But critics say the program was costly to implement and hasn't yielded more research on small-caps or improved the climate for initial public offerings.

If anything, Wall Street has slashed sell-side analyst jobs, said Curtis Pfeiffer, chief business officer of Pragma Securities. "We certainly don't see that there has been any increase in research on small-cap stocks," Mr. Pfeiffer said.

Pragma Securities, which is privately owned, sells technology for executing stock trades to banks, hedge funds and other institutional investors. Brokerage firms like Pragma had to bear additional costs to implement the SEC pilot program.

The firm's study is among the first attempts to calculate the total price tag of the pilot program for all investors. Pragma estimated such costs by examining millions of trades it carried out for clients between January 2017 and June and extrapolating the added costs it experienced to the broader market.

Critics of the Tick Size Pilot Program include BlackRock Inc., an investment giant that manages more than $6 trillion. An internal BlackRock analysis found that trading costs for stocks whose price increments were widened grew between 35% and 45% compared with those that remained untouched, the asset-management giant told the SEC in a letter in May. The program "harmed market efficiency by increasing trading costs for end-investors," BlackRock said in the letter.

Retail brokers such as Charles Schwab Corp. and TD Ameritrade Holding Corp. have also complained about the program.

Even the program's initial supporters, which included brokerage Cowen Inc. and David Weild, a former **Nasdaq** Inc. executive, expected it to lead to wider bid-ask spreads—the difference between the buying and selling prices of shares.

When such spreads widen, investors generally face higher costs for trading. But supporters of the program believed that such increased costs would be offset by a better environment for smaller companies.

Some of the program's early advocates say it suffered from design flaws. Tick sizes needed to be widened further, and the changes needed to be made permanent, for real improvements to occur in U.S. markets, according to Mr. Weild. "Nobody's going to hire research analysts on the basis of a two-year pilot," he said in an interview. Cowen Chief Executive Officer Jeffrey Solomon said that the program's design was "overly complicated."

In April, the head of the SEC's trading and markets division said he wouldn't recommend extending the wider tick sizes beyond the program's conclusion in October. An SEC spokesman declined to comment.

When the pilot kicked off, it was the first adjustment to tick sizes since "decimalization" in 2001, when the SEC forced exchanges to trade stocks at penny increments.

Companies such as hot-dog seller Nathan's Famous Inc. and clothing retailer Children's Place Inc. were chosen to have their "tick sizes" changed under the program. Class B shares of News Corp., parent company of The Wall Street Journal, also switched to five-cent increments.

In all, the program affected some 1,200 companies. Other smaller-cap companies were put in a control group, with no change to the pricing of their shares. That gave the SEC a baseline against which it could compare results.

The SEC is exploring other ideas for promoting ease of trading in smaller stocks, such as concentrating all orders for hard-to-trade stocks on a single exchange. Currently, stock trading is fragmented across 13 exchanges and dozens of over-the-counter venues known as dark pools.

Write to Alexander Osipovich at alexander.osipovich@dowjones.com

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THE WALL STREET JOURNAL.

Markets

Emerging-Market Stocks Enter Bear Territory; A rising dollar and higher U.S. interest rates are pressuring stocks, bonds and currencies in developing economies

By Mike Bird in Hong Kong, Riva Gold in London and Ira Iosebashvili in New York
1,012 words
6 September 2018
07:22 PM
The Wall Street Journal Online
WSJO
English

Emerging markets tipped into bear territory on Thursday, marking investors' retreat from risky assets amid growing concerns about the outlook for the global economy.

The MSCI Emerging Markets Index's 0.3% decline Thursday, led by selloffs in Russia and the Philippines, pushed that gauge of stocks in poorer countries 20% below its recent peak, the common definition of a **bear market**. The drop deepened a swoon that began last month with sharp falls in the shares and currencies of Turkey and Argentina, both of which are facing domestic economic and political crises.

The emerging-markets decline underscores the changing dynamics evident across **financial markets**, which have benefited from years of central bank stimulus and recently from a period of synchronized global growth but are now facing challenging conditions.

Tightening monetary policy, along with an upsurge of nationalism that has hampered global trade, is exacerbating the stresses in many developing countries, prompting investors to scramble to distinguish economies able to weather the storm from those too feeble to cope.

While U.S. stocks remain near records and signs of contagion are few, investors are closely watching the rout in emerging markets for signs that it is spilling over into the assets of developed countries.

"My fear of contagion is that right now the sentiment towards the whole emerging-market spectrum is very fragile," said Mario Castro, a Latin America currency strategist at Nomura.

Threading these economies together is their use of the dollar to borrow funds. When the U.S. economy looks to be in much better health than the rest of the world and the Federal Reserve lifts interest rates, pushing the greenback higher, upheaval often follows in the developing world.

Emerging markets have also been hit hard by concerns that tariffs applied by the U.S. and China on each others' goods could prompt further protectionist moves and upset global trade.

The Shanghai Composite Index has fallen 24% from its peak in January, while the yuan is down nearly 7% since June.

The recent bout of selling was partly triggered last month by sharp declines in the Turkish lira, which is down by more than 42% this year, and later the Argentine peso, which has fallen by around 50%. Elsewhere, the Indian rupee reached its weakest-ever levels this week, and the Indonesian rupiah is trading around two-decade lows.

This is neither a string of unrelated blowups nor a meltdown in which contagion spreads by panic selling moving from nation to nation. It is somewhere in the middle, creating both dangers and opportunities for investors.

Many markets face similar issues: While U.S. manufacturing output probably grew at its fastest in 14 years in August, according to Institute for Supply Management surveys, a poll of purchasing managers in manufacturing firms around the world, published by JPMorgan and IHS Markit, showed the slowest output growth in nearly two years.

Raw-materials prices have also faltered, with the Bloomberg Commodity Index falling nearly 10% since its peak in May. That puts pressure on major exporters of commodities other than oil, such as Brazil, Chile and Indonesia.

Moreover, many investors buy emerging-market assets in broad funds, rather than country by country. So when they reduce exposure, developing markets can be hit all at once.

"There are a lot of people out there who are distressed sellers or forced sellers," said Mark Tinker, head of the Framlington Equities Asia business at AXA Investment Managers.

The links extend into developed markets such as Western Europe, given the region's lending ties to countries including Russia and Turkey and its trading ties with China.

Mr. Castro said much was riding on a presidential vote this year in Brazil that will decide whether the country enacts changes to keep its economy healthy and debt in check. "There is a lot at play in the elections, and Brazil is systemically important for emerging markets," he said.

Money managers also say it is possible to distinguish clearly between different kinds of developing nations.

"There is a debt crisis in emerging markets. They've just racked up way too much debt, and those chickens are coming home to roost. But we need to differentiate clearly when we talk about these concerns," said Bryan Carter, head of emerging-market debt at BNP Paribas Asset Management.

"You can separate almost all countries into one or two camps: the countries with central banks that have decided to keep up with the Fed and hike rates, and those that have consciously decided not to," he added.

Argentina, Mr. Carter said, was in the first camp. The country's bonds were his largest single overweight position, he said, based in part on the country's orthodox economic governance. In contrast, Brazil and South Africa have allowed their currencies to take the strain rather than raise interest rates.

Others note that China has successfully taken yet another path, amping up spending and loosening monetary policy rather than following the Fed. As a consequence, while shares have fallen sharply this year, prices of Chinese government debt have risen, sending yields lower, in contrast to other emerging markets.

"My view is that China has already become less EM-like than it was in 2016," said Karthik Sankaran, director of global strategy at Eurasia Group. A previous growth scare gripped Chinese markets in 2015-16.

Even in more vulnerable countries, some fund managers are snapping up securities issued by companies that are stronger than their domestic economies. "You have companies in Indonesia that are very export oriented, with no foreign debt. That's an absolute winner," said Leon Goldfeld, a multiasset portfolio manager at J.P. Morgan Asset Management.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

This Railroad Can Keep Rolling; Norfolk Southern has plenty of scope to push rates higher and defend margins

By Nathaniel Taplin
566 words
6 September 2018
05:33 AM
The Wall Street Journal Online
WSJO
English

The U.S. economy is galloping along, but President Trump's infrastructure surge never materialized. That is great news for companies occupying key transport bottlenecks.

Railroads might seem like a very 19th-century investment, but as U.S. manufacturing shows glimmers of its olden-day prowess, buyers might find themselves rewarded. U.S. factories, running at their hottest since 2005, are churning out goods that need to reach market. Rising competition for scarce shipping capacity and already-pricey trucking mean railways still have plenty of scope to push rates higher and to defend margins as their own costs rise. Norfolk Southern Corp., with a network concentrated on the densely populated Eastern U.S., looks well-placed.

For the first time since at least the early 2000s, trucking costs are rising faster than rail costs, even though rail is often cheaper. As a result, manufacturers are beginning to substitute rail for long-haul trucking on larger portions of their routes, sacrificing speed for cost. Norfolk's revenue from so-called intermodal shipments—container traffic coming from or going to trucks and ships—was 20% higher last quarter than a year earlier, while per-unit pricing was up 8%. That far outpaced its overall operating revenue and pricing gains of 10% and 4%, respectively.

The trend is likely to accelerate in the third quarter. Long-distance trucking costs rose 12% on the year in July according to Labor Department statistics—the fastest since at least 2004. Rail costs rose by just 6.2%. As U.S. transport capacity keeps getting tighter, railroads still have plenty of scope to raise prices without losing customers. Norfolk, according to the company, has the most extensive intermodal network in the Eastern U.S.—leaving it uniquely well positioned to benefit from this trend. Railroads have their own congestion problems, but many of the recent issues have been at competitors such as CSX, which is in the midst of implementing a new "precision railroading" scheduling strategy, and at Union Pacific, which has been dealing with a major tunnel collapse in Oregon.

The cost side of the equation is equally important. Trucking companies are raising prices fast, but they are also getting killed on costs—the labor market for truckers is ultratight and fuel costs are high. As a result, even though trucking companies like JB Hunt are seeing sales grow briskly, their margins aren't great. JB's second-quarter operating margin was 10%, according to FactSet, down from 12% in late 2015. Norfolk's was 35%, near its highest this millennium, and up from 27% in 2015.

One concern is valuation. Norfolk Southern trades at 18 times forward earnings, a touch higher than the **S&P 500** at 17 times. But the capital-intensive nature of railways—and their position atop a crucial logistics bottleneck—means they can do well when the economy is running hot, rising variable costs are hitting competitors and spare capacity is limited. Investors should consider hopping aboard.

Write to Nathaniel Taplin at nathaniel.taplin@wsj.com

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Document WSJO000020180906ee960018h

THE WALL STREET JOURNAL.

U.S. Markets
Markets
Weak Tech Shares Pull Down S&P 500; Internet shares continued to decline following Facebook and Twitter executives' congressional testimony; semiconductor stocks also lagged

By Ben St. Clair and Amrith Ramkumar
705 words
6 September 2018
04:47 PM
The Wall Street Journal Online
WSJO
English

Weakness in technology shares hurt the S&P 500 for the third straight session Thursday, with worries about regulation and trade continuing to hang over the market's best-performing sector.

A day after internet shares led the group lower, semiconductor stocks were the laggard. Micron Technology shares slumped after Baird analysts lowered their price target on the stock, and KLA-Tencor, Lam Research and Applied Materials were also among the S&P 500's worst performers, with each of the four companies dropping at least 5%. Investors weighed mixed comments about industry pricing from executives at a Citigroup technology conference.

Trade developments have buffeted chip makers throughout the year because of their reliance on global commerce, particularly through China. While their shares recovered last month, some analysts expect swings to continue as trade discussions roll on.

More broadly, some investors predict the volatility that has engulfed stocks around the world will spread to the U.S. if the trade dispute with China intensifies.

The possibility of additional tariffs "doesn't seem particularly priced into U.S. markets," said Clark Fenton, managing partner and chief investment officer at Agilis Investment Management.

Investors are waiting to see if the Trump administration will move ahead with tariffs on an additional $200 billion of Chinese goods.

The tech-heavy Nasdaq Composite fell 0.9%, while the S&P 500 shed 0.4%. The Dow Jones Industrial Average inched up 21 points, or less than 0.1%, to 25996. Major indexes had fallen in three of the previous four sessions entering Thursday, though they remain near record levels.

Declines in internet stocks also continued Thursday, after Facebook and Twitter executives testified before Congress a day earlier about election interference on their platforms. Twitter dropped 5.9%, while Facebook was down 1.8% and Google parent Alphabet fell 1.3%. Amazon.com dropped 1.8%.

Despite recent volatility, some analysts expect consistent revenue growth to keep technology stocks as the market's leader. Dell Technologies boosted its full-year sales guidance after reporting a nearly 20% increase in total net revenue for the most recent quarter. Shares were up 0.2%.

Moves in most other sectors were muted, with analysts looking ahead to Friday's jobs report for the latest reading on the U.S. economy.

Data on Thursday showed the number of Americans filing applications for new unemployment benefits fell at the end of August to a nearly five-decade low, while U.S. worker productivity rose this spring at the best pace in more than three years.

Consistent U.S. economic figures have supported major indexes this year in the face of continuing trade disputes with China and Canada. At the same time, investors have said growth hasn't accelerated so quickly that the Federal Reserve will have to quicken its pace of interest-rate increases, keeping the backdrop favorable for U.S. stocks.

While assets more tied to global growth including commodities and emerging markets have wobbled, some analysts expect the U.S. to remain a favored region.

"In the short term, [trade is] not necessarily a huge story for the U.S.," said Jonas Goltermann, an economist at ING. "It's much worse for the Chinese."

The yield on the 10-year U.S. Treasury note fell to 2.877% from 2.902%. Yields fall as **bond prices** rise, and the drop Thursday dragged down shares of financial firms because higher yields tend to lift lending profitability.

The dollar weakened for the second straight session, boosting beaten-down commodities by making them cheaper for overseas buyers. The WSJ Dollar Index, which tracks the dollar against a basket of 16 other currencies, dropped 0.2%.

Elsewhere, the Stoxx Europe 600 dropped 0.6% and closed at a fresh five-month low.

Stocks in Asia continued to fall, with Hong Kong's Hang Seng shedding 1% and the Shanghai Composite down 0.5%. Japan's Nikkei Stock Average declined for the fifth straight session, closing down 0.4%.

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Document WSJO000020180906ee96000rt

THE WALL STREET JOURNAL.

Economy

Fed's Williams Says Yield Curve Not Deciding Factor in Setting Rates; New York Fed chief says gradually raising interest rates 'back to normal' is the right path

By Michael S. Derby
596 words
6 September 2018
01:17 PM
The Wall Street Journal Online
WSJO
English

BUFFALO, N.Y.—Federal Reserve Bank of New York leader John Williams said Thursday the prospect of a yield-curve inversion by itself wouldn't be enough to stop him from supporting further rate rises if he thought the economy called for them.

"I think we need to make the right decisions based on our analysis of where the economy is and where it's heading," Mr. Williams told reporters after a speech in Buffalo. "If that were to require us to move interest rates up to the point where the yield curve was flat or inverted, that would not be something I find worrisome on its own."

Mr. Williams was responding to a question about the narrowing in the difference between short- and long-dated Treasury yields. When short-term yields rise above long-term yields, that is known as an inversion in the yield curve, something that has often preceded a recession.

"I don't see the flat yield curve or inverted yield curve as being the deciding factor in terms of where we should go with policy," he said.

Mr. Williams said what is happening with bond yields this year is natural given the Fed's path of short-term rate rises. Meanwhile, long-term yields in part have been held lower by crisis-era stimulus efforts in which the central bank bought long-dated securities to depress their yields.

"I don't want to mechanically apply the math or the evidence from previous periods to this one" given these recent central bank actions, Mr. Williams told reporters.

Mr. Williams has a regular vote on monetary policy as New York Fed chief and also serves as vice chairman of the interest-rate-setting Federal Open Market Committee. The Fed is expected to raise its benchmark short-term interest-rate target at its meeting later this month from its current 1.75% to 2% range.

A number of Fed officials have signaled they don't want to raise rates further if that by itself causes the curve to invert. Given how close two- and **10-year Treasury** yields are now, one or two more rate rises could potentially drive that inversion.

In comments to a local audience, Mr. Williams remained upbeat on what he called a "goldilocks economy" that is enjoying steady job gains and inflation around the Fed's 2% target, with strong prospects that unemployment will fall further from already low levels.

Modest wage gains in the U.S. economy are "a good sign we can continue to let this economy run strong. I'm not worried about inflationary pressures picking up any time soon, and that means we can continue to be relatively patient about normalizing monetary policy and allow this economy to continue to grow and be strong," Mr. Williams said.

"We don't feel the need to raise interest rates more quickly" than the current path, he said, but didn't offer near-term predictions for rate rises. "The path we are on is a good one, gradually [raising rates] back to normal."

Mr. Williams also told the audience he sees no signs of any financial-sector imbalances causing the economy to grow more quickly than it otherwise would be. He also said he sees little threat to the dollar as the world's most important reserve currency.

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Document WSJO000020180906ee96006el

THE WALL STREET JOURNAL.

Markets

Marijuana Company Is Pressed to Make Deal by Activist Investor; Riposte Capital urges Hexo to seek investment, merger or sale

By Cara Lombardo
520 words
6 September 2018
03:12 PM
The Wall Street Journal Online
WSJO
English

Hexo Corp. has drawn interest from an occasional activist investor, who fears the Canadian marijuana company will miss out on a frenzy of deal making in the budding industry.

New York-based Riposte Capital LLC, Hexo's second-largest shareholder with a roughly 2.5% stake, published a letter Thursday urging the company to explore strategic alternatives and take advantage of the cannabis sector's rapid growth. The options could include selling the company, seeking a merger partner or soliciting a large investment from Molson Coors Brewing Co., with which it has a joint venture to develop nonalcoholic, cannabis-infused beverages, the people said.

Hexo Chief Executive Sébastien St-Louis said while he appreciates hearing from shareholders, he is focused on setting up additional joint ventures with large consumer packaged-goods companies that will bring Hexo into new industries, such as cosmetics and food.

"It's very likely we'll get acquired at some point, whether that is in one year or 10 years," he said in an interview.

Molson Coors declined to comment.

Hexo shares were up about 10% amid the news, first reported by The Wall Street Journal, and trading at 6.48 Canadian dollars (US$4.92) on Thursday afternoon.

Quebec-based Hexo grows and distributes medical marijuana under brands including Time of Day, with products such as Good Morning and Bedtime. It also sells cannabis powder and oils and will begin selling recreational marijuana when it becomes legal in Canada in mid-October.

Shares in Hexo, which trades on the Toronto Stock Exchange and has a market value of just over C$1.1 billion (US$835 million), have surged over 300% in the past year as investors have driven up the value of pot stocks.

Riposte, which has invested in Hexo for nearly a year, says the company is in an enviable position, having the Molson Coors joint venture and a potentially lucrative government contract as the preferred recreational cannabis supplier in Quebec. But its stock still trades at a discount to peers, which "significantly hampers the company in the race for global growth and expansion," Riposte says in in the letter, to Hexo's board.

The growing acceptance of marijuana use in Canada and much of the U.S. has sparked a whirl of recent deal activity. In addition to Molson Coors's venture with Hexo, Corona beer seller Constellation Brands Inc. announced plans to invest nearly $4 billion to increase its stake in Canopy Growth Corp. Tilray Inc. became the first cannabis company to go public on a major U.S. exchange when it made its debut on **Nasdaq** in July. Those shares have since rocketed upward, including a 17% gain Wednesday.

Riposte, which has less than $200 million under management, isn't usually an activist investor. The firm, founded in 2013, focuses on transportation, leisure and financial companies, but occasionally invests in other stocks it believes are misunderstood or overlooked.

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Document WSJO000020180906ee96000b6

WSJ PRO CENTRAL BANKING

Economy
Layoffs Just Reached a Half-Century Low; With too-few candidates, businesses hold tight to workers

By Sharon Nunn
495 words
6 September 2018
10:59 AM
WSJ Pro Central Banking
RSTPROCB
English

WASHINGTON—The number of Americans filing applications for new unemployment benefits fell at the end of August to a nearly five-decade low.

Initial jobless claims, a proxy for layoffs across the U.S., declined to a seasonally adjusted 203,000 in the last week of August, the Labor Department said Thursday. This is the lowest level of unemployment benefit applications since the end of 1969. Though data can be **volatile** from week to week, the four-week moving average of claims, a steadier measure, also fell to a 49-year low, signaling overwhelming tightness in the U.S. labor market.

"Job openings are plentiful, and the competition for skilled workers is intensifying," said Jim Baird, chief investment officer at Plante Moran Financial Advisors. "Employers are remiss to trim their respective workforces, particularly in an environment in which attracting and retaining workers is tougher."

Jobless claims have remained low in recent years, as the labor market continues to strengthen and managers face difficulty finding qualified employees. U.S. employers added 157,000 jobs and the unemployment rate fell back to 3.9% in July, hovering near the lowest level since April 2000, according to the Labor Department's latest jobs report. Meanwhile, the number of open jobs this spring exceeded the number of unemployed Americans seeking work for the first time in records going back to 2000.

The appearance of plentiful job openings is pulling people from the sidelines who may have been discouraged from looking earlier in the expansion, but businesses have engaged in extraordinary measures to recruit talent.

One manufacturer recruited at a high school parents' night, and a plumbing company began offering an on-site tap flows with craft beer to keep workers content. Meanwhile, some firms have turned to automation and other technology to ramp up output to meet demand.

Thursday's jobless claims report is one of several sets of economic data pointing to late business-cycle strength in the economy. Economic growth in the second quarter was the strongest since 2014, and the manufacturing industry appears to be hitting a second wind, clocking the strongest growth in 14 years.

The recent spurt of growth has led some analysts to argue the Federal Reserve may be allowing the economy to run too hot, while others think inflation isn't yet strong enough to warrant a major change in monetary policy. The Fed has penciled in two more rate increases this year, just as price increases appear to be hovering around 2%, the Fed's target.

"At this point, you have to take the Fed at its word," Mr. Baird said. "The employment picture matters, but so does inflation. Unless and until inflation accelerates at a pace that exceeds their expectations, the Fed appears likely to stay on their current path."

Write to Sharon Nunn at sharon.nunn@wsj.com

Document RSTPROCB20180906ee96000gp

THE WALL STREET JOURNAL.

Heard on the Street
Markets

The One Way Out for Struggling Consumer Companies; Sustained investment in innovation is the best tonic for what ails

By Aaron Back
414 words
6 September 2018
09:00 AM
The Wall Street Journal Online
WSJO
English

Makers of packaged foods and other household goods have been having a rough year. Sustained investment in innovation is the best tonic for what ails them.

The sector has been among the worst performing in the U.S. **stock market**. The **S&P 500** consumer staples subindex is down 5.2% so far this year, compared to an 8% rise in the broader index.

The Barclays Global Consumer Staples conference this week gave investors a clear picture of who was really innovating and who wasn't, and more important which companies could command higher prices for their products in the tough market.

Conagra Brands has emerged as a model for the packaged-food industry by successfully revamping old frozen brands like Banquet. Speaking at the conference, Chief Executive Sean Connolly emphasized how these improvements have "liberated" products from their old price points of around one dollar.

Colgate-Palmolive Chief Executive Ian Cook announced Wednesday a new line of Colgate Total toothpaste, which he said has been in development for 10 years. The company says it does a better job protecting enamel and fighting bad breath. Colgate has been struggling to push through price increases in developed markets, but when this product hits shelves at the start of next year, it should command a higher price. Colgate shares rose 2.1% Wednesday.

Not everyone has as strong an innovation story to tell. Kraft Heinz Chief Executive Bernardo Hees highlighted the company's new Heinz-brand mayonnaise, which he said goes for a more premium price than the company's Kraft brand of mayo. Perhaps so, but investors would be forgiven for not giving Mr. Hees high marks for innovation here.

Meanwhile, some product categories simply have less room for innovation. Kimberly-Clark Chief Operating Officer Michael Hsu mentioned the new "wavy clean ripple" texture of its Cottonelle toilet paper, which he said allowed for a "high single digit" price increase. Nonetheless, the likely direction for paper and tissue products like this is toward more commoditization, which will squeeze margins for branded producers like Kimberly-Clark and Procter & Gamble.

Brand value is not automatic or permanent. In this era of rapid change, investing in constant product improvement is more important than ever. Companies that fail to do so will keep facing hard times.

Write to Aaron Back at aaron.back@wsj.com

Document WSJO000020180906ee96002jz

WSJ PRO CENTRAL BANKING

Economy
Derby's Take: St. Louis Fed's Bullard Makes a Case for Focusing on Markets; It isn't likely other Fed officials will move market signals to the center of their thinking the way James Bullard has.

By Michael S. Derby
363 words
6 September 2018
05:58 AM
WSJ Pro Central Banking
RSTPROCB
English

St. Louis may not operate at a Wall Street level of financial activity, but that hasn't stopped the leader of the Federal Reserve Bank there from putting **financial markets** at the forefront of his monetary policy thinking.

In a speech Wednesday, Federal Reserve Bank of St. Louis President James Bullard said: "U.S. monetary policy makers should put more weight than usual on **financial market** signals," given an apparent undoing of the normal cycle where very low unemployment levels spur higher wage gains and inflation.

"Handled properly, current **financial market** information can provide the basis for a better forward-looking monetary policy strategy" when normal economic signposts aren't doing the job, he said.

Mr. Bullard's interest in the market data isn't new. He has long preferred to gauge inflation expectations through the pricing of Treasury inflation-indexed bonds. His colleagues generally prefer survey-based data.

Lately, he has been looking at the level of Treasury yields more generally to conclude that investors see no inflation threat, which means, to him, the Fed has no need to raise rates.

Mr. Bullard's interest in the yield curve is shared by his colleagues, but they are generally more circumspect in how they take signals from **financial markets**. Securities prices can be **volatile** and affected by more than just the economic outlook. Thus, while market signals are valuable, they must be weighed against the normal slate of economic data.

Fed officials are attentive to **financial markets** when they feel developments there could destabilize the economy. And they pay attention to how financial conditions—such as borrowing levels, stock prices and liquidity—can help determine the potency of a monetary policy setting.

But it isn't likely other Fed officials will move market signals to the center of their thinking the way Mr. Bullard has, even as others share his yield-curve concerns.

Write to Michael S. Derby at michael.derby@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Bank Sues Fed | BOJ's Kataoka Voices Opposition | Riksbank Rules Out October | FBI Investigating American Express | Derby's Take: Bullard Makes a Case for Focusing on Markets; The Wall Street Journal's central banking newsletter for Thursday, September 6, 2018

2,119 words
6 September 2018
05:47 AM
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RSTPROCB
English

Derby's Take: St. Louis Fed's Bullard Makes a Case for Focusing on Markets

Bank Sues New York Fed Over Lack of Account

BOJ's Kataoka Voices Opposition to Latest Policy Tweaks

Sweden's Riksbank Rules Out October Rate Rise, Striking Dovish Chord

FBI Investigating American Express Foreign-Exchange Pricing

St. Louis Fed's Bullard Makes a Case for Focusing on Markets

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Key Developments Around the World

Bank Sues New York Fed Over Lack of Account

A new bank is suing the Federal Reserve Bank of New York, saying it is unfairly preventing the firm from pursuing a novel business strategy. TNB USA Inc.—run by a former top New York Fed staffer—said its primary business activity will be to enable large institutional money-market investors to earn higher interest rates from the Federal

Reserve than they could otherwise, according a complaint filed in federal court Friday. Such investors include pension funds, companies and other entities managing large sums of money.

Bullard Says Fed Should Look More Closely at Market Data

Federal Reserve Bank of St. Louis President James Bullard said Wednesday the U.S. central bank should take more account of **financial market** issues when setting monetary policy. "U.S. monetary policy makers should put more weight than usual on **financial market** signals" now given that there seems to be a "breakdown" in the normal relationship between the strength of the job market and inflation, Mr. Bullard said. "Handled properly, current **financial market** information can provide the basis for a better forward-looking monetary policy strategy," he said at a conference in New York.

Bank of Canada Holds Benchmark Rate Steady

The Bank of Canada on Wednesday held its benchmark interest rate steady at 1.5% as it signaled that the outcome of North American Free Trade Agreement talks, which resumed Wednesday, could affect the pace of future rate increases. In a brief policy statement, the central bank reiterated its view that higher interest rates will be warranted to keep inflation close to its target of 2%. It said it would continue to take a gradual approach to moving rates higher, guided by incoming data and the economy's reaction to higher rates.

BOJ's Kataoka Voices Opposition to Latest Policy Tweaks

Bank of Japan policy board member Goushi Kataoka on Thursday voiced his opposition to the bank's latest policy tweaks, including a more flexible target for the 10-year **bond yield**, and said that they will reduce the effects of monetary easing and the changes wouldn't bring inflation to the bank's goal of 2%. "The current monetary easing framework isn't strong enough to achieve the inflation target at an early stage," Mr. Kataoka said in a speech to business leaders in Yokohama.

Wages Are Growing Faster Than You Think, White House Says

White House economists say common measures of how much Americans earn have been undershooting the pace of compensation growth, both during President Trump's time in office and his predecessor's. They offer an alternative approach, detailed in a paper released by the Council of Economic Advisers on Wednesday, that takes into account aging workers, a different inflation measure and changes to how workers are compensated. Their methodology shows adjusted total compensation rose 1% in the second quarter from a year earlier. That is a much faster rate of growth than the 0.1% increase the Labor Department reported for inflation-adjusted average hourly earnings.

Sweden's Riksbank Rules Out October Rate Rise, Striking Dovish Chord

Sweden's central bank struck a dovish chord on Thursday, saying that an October rate increase is now off the table and that it will wait until December or February next year before raising the key policy rate. "If the economy develops as expected, there will soon be scope to slowly reduce the support from monetary policy," the Riksbank said, after keeping the benchmark repo rate at minus 0.5%, where it has been since February 2016.

FINANCIAL REGULATION ROUNDUP

FBI Investigating American Express Foreign-Exchange Pricing

The Federal Bureau of Investigation has launched a probe into pricing practices within American Express Co.'s foreign-exchange unit, according to people familiar with the matter. The investigation, which is being run out of the FBI's Washington Field Office, is in its early stages and is focused on whether the foreign-exchange international payments department misrepresented pricing to clients to win their business, the people said. The FBI began its investigation in August, the people said, after The Wall Street Journal, citing current and former employees, reported that AmEx's foreign-exchange unit had recruited business clients with offers of low currency-conversion rates before raising prices without warning. An AmEx spokeswoman declined to comment on the FBI investigation.

SEC Is Back at Full Strength With Five Members

The Senate confirmed Elad Roisman to join the Securities and Exchange Commission, giving the regulator a fifth and final member as it prepares to impose restrictions on stockbroker advice while loosening the reins on some public companies. Mr. Roisman, 37 years old, will join the SEC after working for several years on the Senate

Banking Committee, where he was the panel's chief counsel. The Senate approved him 85 to 14 in Wednesday's vote.

SEC's Stock Trading Experiment Cost Investors Over $300 Million, Study Finds

London's Tribes of Finance Face Off

The U.K. is set to quit the European Union next year. The future of one of the world's biggest financial centers is at stake. But London's financiers are heading into Brexit at odds.

New Jersey Man Pleads Guilty to Stealing More Than $1 Million in Digital Currency

A New Jersey man admitted in court Wednesday to kidnapping a friend and then stealing more than a million dollars in cryptocurrency from him, an unusual crime that is among the first major cryptocurrency cases brought by Manhattan prosecutors. Louis Meza, of Passaic, N.J., pleaded guilty to second-degree kidnapping and first-degree grand larceny in state Supreme Court in Manhattan. Under the plea agreement, he agreed to a 10-year prison term, although his sentence will ultimately be determined by the judge.

Thursday

7:45 a.m. EDT

ECB's Lautenschläger speaks at Eurofi Financial Forum in Vienna

10 a.m. EDT

New York Fed's Williams speaks in Buffalo, N.Y.

2:45 p.m. EDT

Bank of Canada's Wilkins gives economic progress report in Regina, Saskatchewan

Friday

4:30 a.m. EDT

Bank of England releases TNS inflation attitudes survey

8:30 a.m. EDT

U.S. Labor Department releases August jobs report

8:30 a.m. EDT

Boston Fed's Rosengren gives opening remarks at Boston Fed economic conference

9 a.m. EDT

Cleveland Fed's Mester speaks at Boston Fed economic conference

1:20 p.m. EDT

Dallas Fed's Kaplan speaks on energy and the economy at Dallas Fed

Education's Role in Earnings, Employment and Economic Mobility

A post on the New York Fed's Liberty Street Economics studies how higher-education choices can affect earnings and employment. Authors Rajashri Chakrabarti and Michelle Jiang find an earnings premium of 11% in the medium term for those who attend selective colleges, compared with those who attend nonselective schools. Meanwhile, differences in employment are muted, as "selective college enrollment leads to only 1 percent higher employment than nonselective college enrollment." For long-term earnings measured 10 years after enrollment, the effects of college choice are more pronounced, with those who attended selective colleges seeing a 20% earnings premium. Employment probabilities in the long run remain similar, indicating that "the quality of jobs, rather than the probability of employment, is more relevant for the broadening of the earnings distribution across individuals."

The Fed Moves Global Asset Prices

Changes in the U.S. Federal Reserve's monetary policy are having an increasingly large impact on asset prices around the world, according to an analysis of 17 developed economies over the past 150 years by Felix Ward, Moritz Schularick, Òscar Jordà and Alan M Taylor. "Monetary policy in financial centers have become an important driver of global risk-taking and this is a new and recent phenomenon," they write in a posting on Bank Underground. "Possible explanations a shift from gold-backed to fiat currency, a more prominent role of leveraged financial intermediaries as shock amplifiers, growing use of the dollar as a funding currency, and growth in cross-border banks in the world economy today."

The Bank of England's Nuclear Option for a No-Deal Brexit

"For a staunch supporter of central bank 'forward guidance,' Mark Carney changes his mind a tad too often," Ferdinando Giugliano writes of the Bank of England governor for Bloomberg Opinion. "Yet on one crucial subject for the British economy, Carney has been uncharacteristically consistent: Don't rely on the Bank coming to the rescue by cutting rates in the event of a messy Brexit. The governor has said more than once that, should Britain crash out of the EU without a deal, the central bank response wouldn't be obvious. It was easy to imagine a scenario where 'policy would have to be tighter, not looser,' he told U.K. lawmakers on Tuesday." Mr. Giugliano says that Mr. Carney "is right to keep his options open…It will also help to remove any excuses from politicians. If a disorderly departure causes a recession, the Bank might be too busy fighting inflation to help the government out."

The U.S. trade deficit is widening even as the Trump administration pushes Canada, Mexico, China and other countries to recast their economic relations with the U.S.

A closely watched measure of business conditions in the New York metro area reached a 12-year high in August and sentiment about future conditions remained strong even as employment contracted for the second straight month, according to a report released Wednesday.

Germany's manufacturers registered weak orders in July amid a sharp drop in demand from outside the eurozone, a sign that global trade tensions are already weighing on companies' appetite for investments.

Global trade disputes have yet to disrupt one of the world's most export-dependent economies: Switzerland.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Katy Burne; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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THE WALL STREET JOURNAL.
U.S. EDITION

Bernie Sanders's Half-Truth on Wages

By Andy Puzder
561 words
6 September 2018
The Wall Street Journal
J
A17
English

Progressives are attempting to discredit the Trump economy by claiming workers aren't seeing the benefits. Sen. Bernie Sanders recently claimed that the increase in wages last year "nets out to zero" because of inflation and that "the average American worker today, despite the strong economy, is not getting ahead."

Mr. Sanders has half a point. According to the Bureau of Labor Statistics' latest report on real earnings, as of July average hourly earnings had increased 2.7% over the preceding year, while inflation was 2.9%, due in large part to a surge in **oil prices** -- a slight decrease in real terms.

But workers have benefited in other ways. The stronger economy has created opportunities to increase earnings by working more hours. Over the past year, the number of people working part time because they were unable to find full-time employment decreased by nearly 700,000 while the number of people working full time increased by more than three million. For those already employed full-time, there are more opportunities to work overtime at 50% higher hourly wages. The BLS credits increased hours with adding 0.3% to weekly earnings, for a combined earnings increase of 3%, slightly more than the 2.9% inflation rate.

None of this takes into account the effect of lower taxes. According to Sentier Research, an economic-research firm founded by former Census Bureau officials, median household income in July 2017 was $60,879. In 2017 a married couple with no children filing jointly with income of $60,879 would have taken a standard deduction of $12,700 plus personal exemptions of $8,100, resulting in taxable income of $40,079. Their tax rate would have been 15%, for a federal income-tax liability of $5,079. After paying payroll taxes of $4,657, this couple would have taken home $51,143.

This year, assuming the BLS's 3% increase in weekly earnings, the couple's income would rise to $62,705. Following the tax cuts, their standard deduction would increase to $24,000, for taxable income of $37,705. Their federal income-tax rate would be 12%, for an income-tax liability of $4,264. Their payroll taxes would rise with their income to $4,797.

All told, the couple would take home $53,644. That's an increase in take-home pay of $2,501, or 4.9% -- nearly 70% higher than the 2.9% rate of inflation, assuming the inflation rate holds at around 2.9% for the rest of the year. With the expanded child tax credit, if this couple had one child, their take-home pay would increase 5.5%, or 90% higher than the inflation rate. Since the new withholding tables went into effect on Feb. 15, employees have seen the difference in bigger paychecks. Little wonder the Conference Board recently reported that consumer confidence surged in August to its highest level since October 2000, while the Commerce Department reported that consumer spending increased 0.4% in July, the sixth straight month of healthy gains.

The progressives are wrong. Capitalism is working, for everybody.

Mr. Puzder is a former CEO of CKE Restaurants and author of "The Capitalist Comeback: The Trump Boom and the Left's Plot to Stop It."

Document J000000020180906ee960000l

The New York Times

Foreign Desk; SECT
Iran's Currency Crashes. Shortages and Fears Rise.

By THE ASSOCIATED PRESS
426 words
6 September 2018
The New York Times
NYTF
The New York Times on the Web
English

Iran's rial fell to a record low on Wednesday, part of a staggering 140 percent drop in the currency's value since the United States pulled out of the nuclear deal only four months ago.

Those who went to work at the start of the Iranian week on Saturday saw their money shed a quarter of its value by the time they left the office on Wednesday. Signs of the currency chaos can be seen everywhere in Tehran: Worried residents lined up outside beleaguered money changers, travel agents offered vacation prices only in hard currency, and diapers disappeared from store shelves.

Many exchange shops in downtown Tehran simply turned off their electronic signs showing the current rate for the American dollar, while some Iranians who wanted hard currency sought out informal money traders on street corners. Exchange shops that remained open offered 150,000 rials to the U.S. dollar.

''Everyone's just nervous,'' said Mostafa Shahriar, 40, who was seeking dollars.

There was no immediate acknowledgement of the drop on state media.

Iran's economy has faced troubled times in the past, whether from the shah overspending on military arms in the 1970s or the Western sanctions that came after the 1979 Islamic Revolution and United States Embassy takeover. Drastic fluctuations in **oil prices** have also taken a toll.

This time, however, feels different. The currency has crashed along with hope many felt following the 2015 nuclear deal Iran struck with world powers, including the administration of President Barack Obama.

In May, despite the United Nations repeatedly acknowledging Iran had lived up to the terms of the deal, President Donald Trump withdrew America from the accord. He said he wanted stricter terms put on Iran that included limiting its ballistic missile program, curtailing its regional influence and forever limiting its nuclear activities.

Ayatollah Ali Khamenei, Iran's supreme leader, called the American moves economic ''sabotage'' this past weekend, and mentioned the diaper shortage. Some 70 percent of material for disposal diapers is imported. As the rial falls, it makes purchasing the material from abroad more expensive.

''Imagine that in Tehran or other major cities, baby diapers suddenly become scarce. This is happening, this is real, this is not make-believe. Baby diapers!'' Ayatollah Khamenei said, according to a transcript on his official website. ''This makes people angry. On the other side, the enemy wants people to be angry with the government and system. This is one of their ways.''

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Markets
Banks Stick With This Year's Oil-Price Forecast but Lower 2019 Projection; Brent is expected to average $73.65 a barrel in 2018 and $74.55 next year

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LONDON—After a period of revising **oil-price** forecasts ever higher, analysts were keeping their prediction for the year unchanged in August, a sign that rising OPEC production is expected to keep a lid on prices despite risks to Iranian supply.

But the analysts nudged their expectations for next year's price lower on a belief that more OPEC oil, particularly from Saudi Arabia, will pressure the market.

For the first time in 11 months, a group of investment banks polled by The Wall Street Journal didn't, on average, raise their estimates for crude prices. The 11 banks surveyed continue to expect Brent crude, the global benchmark, to average $73.65 a barrel this year. West Texas Intermediate, the U.S. standard, is still projected to average roughly $68 a barrel, the poll showed.

Brent on Tuesday closed up less than 0.1% at $78.17 a barrel on London's Intercontinental Exchange. On the New York Mercantile Exchange, WTI rose 0.1% to close at $69.87 a barrel.

The August forecasts come as the Organization of the Petroleum Exporting Countries and its partner producers, including Russia, have begun to ramp up crude production after more than a year of holding back output.

"More OPEC and Russian barrels are hitting the market," and that is "putting a cap on prices," said Christyan Malek, head of oil research for Europe and the Middle East at JPMorgan.

OPEC and Russia agreed in late June to begin increasing production by as much as one million barrels a day starting in July. The oil cartel and its production allies had been holding back crude output by roughly 1.8 million barrels a day since the start of last year—part of a coordinated deal to rein in a supply overhang that had weighed on prices since late 2014.

The decision to boost output came after Brent temporarily breached the $80-a-barrel threshold in May for the first time in more than 3½ years on expectations of reduced crude exports from Iran, a member of OPEC. That prompted concerns among major producers, including the Saudis and the U.S., that high price levels could dent consumer demand and hurt global growth.

"In the near term, softening demand growth driven by global trade risks and surging Saudi/Russian production have put downward pressure on prices," Jason Gammel, an oil analyst at Jefferies, said in an email. "We expect, however, that the effects of Iranian sanctions on global supply and dwindling spare capacity will lead to a price rally by 4Q," he added.

President Trump in May pulled the U.S. out of a 2015 international agreement to curb Iran's nuclear program, setting the stage for the reimposition of economic sanctions on the Islamic Republic that are expected to paralyze its oil industry.

Iranian exports are already falling at a faster rate than expected, with officials at the state-run National Iranian Oil Co. provisionally expecting crude shipments to drop to around 1.5 million barrels a day in September, down from around 2.3 million barrels a day in June, according to people familiar with the matter.

"Sanctions on Iran are likely to remain the biggest influence" on the oil market, said Warren Patterson, an analyst at ING Bank. He estimated that roughly 500,000 barrels a day of Iranian crude would come off the market in the fourth quarter. "This leaves the global market still in balance, [but] a bigger decrease would push the global market into deficit," he added.

Looking ahead to next year, JPMorgan's Mr. Malek said he expected **oil prices** to come down slightly amid higher production from Saudi Arabia. "The Saudis are looking to take more market share from the Iranians," he said.

The banks in the Journal's August poll now project prices in 2019 will be lower than their forecasts in the July survey, with Brent coming down to an average of $74.55 a barrel, from a prior estimate of $75.63 a barrel. WTI, meanwhile, should average nearly $68 a barrel next year, down from the July forecast of $69.75 a barrel, they predict.

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