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The Trump Tax Plan Report Card

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When Republicans were pitching a massive tax cut for corporations and wealthy families last year, they promised voters many benefits: increased investment, higher wages and a tax cut that pays for itself. The tax plan, congressional leaders said, would turbocharge the American economy and provide a much-needed helping hand to working-class families.

''Most people, half the people in this country, live paycheck to paycheck, so there's a lot of economic anxiety,'' the House speaker, Paul Ryan, told The Times in November. ''And I think just one of the key solutions is faster economic growth, more jobs. And I think the best thing we could do to deliver that is tax reform.''

So, more than six months since President Trump signed the tax cut into law, is it delivering on the promises Mr. Ryan and other leaders made?

BUYBACKS REACH NEW HEIGHTS

The most notable outcome of the tax law is one that few Republicans talk about: Companies are buying back their own stock -- a lot of it. Stock buybacks are expected to reach a record $1 trillion this year. Since Congress reduced the top federal corporate tax rate from 35 percent to 21 percent, businesses are flush with cash. Lawmakers also let companies repatriate foreign earnings that they had been amassing at a rate of 15.5 percent for cash and 8 percent for other assets.

By buying back shares, businesses are boosting demand for, and thus the price of, their stock. It's no wonder, then, that the **S**.**&P**. **500 stock index** is trading near its high.

Share buybacks have an understandable appeal to executives, many of whom are compensated with stock, and to investors. But buybacks do little for workers, most of whom own little or no stock. It is not even clear that buybacks are in the long-term interest of companies since that money could be used to expand into new markets or invest in technology.

In fact, these buybacks amount to a huge wasted opportunity. And this waste wasn't unexpected. In 2004, Republicans temporarily cut the tax rate on foreign corporate profits, promising that the tax break would spur economic growth and increase wages. Instead, many corporations bought record amounts of their own shares.

INVESTMENTS HAVE FLATLINED

With so many firms focusing on buying back stock, a central Republican prediction -- that tax cuts would encourage spending on equipment and factories -- has not come to fruition. There has been a modest increase in investment this year compared with recent quarters. Companies in the **S**.**&P**. **500** had spent around $147 billion through the end of March. A recent modest uptick began in early 2017, long before the tax cut.

Investment as a percentage of economic output climbed in the first quarter but fell to 17.5 percent in the second, far below the nearly 20 percent it reached in 2006 before the recession. Growth in productivity -- which ought to accelerate when businesses invest -- was just 0.4 percent in the first quarter.

REAL WAGES HAVE DECLINED

And what happened to that promise of big raises for workers? There has been no sign of them yet.

The typical family would earn $3,000 to $7,000 more a year, the White House Council of Economic Advisers predicted. In fact, real wages are down, largely thanks to the rising price of oil, which has more than offset any increase in income.

Even ignoring inflation, wages are up only 2.7 percent over the last 12 months. Even with the unemployment rate at a low 3.9 percent, businesses are not offering higher pay yet.

The idea that the tax cuts were going to line workers' pockets was always a mirage. Most people will enjoy only a modest and temporary tax cut -- families making between $48,600 and $86,100 will save $930, according to the Urban-Brookings Tax Policy Center. Families in the top 1 percent, on the other hand, will save an average of $51,140.

TAX CUTS DON'T PAY FOR THEMSELVES

''Not only will this tax plan pay for itself, but it will pay down debt,'' Steven Mnuchin, the Treasury secretary, said. This statement was absurd when Mr. Mnuchin made it, but it looks even more ridiculous now. The deficit and the federal debt are growing -- and at a stunning pace. In the current fiscal year, the federal government will spend $912 billion more than it collects in revenue, an increase of 39 percent from the 2017 fiscal year, according to the Congressional Budget Office.

Thanks to the tax cut, the government will take in about 1 percent less in the 2018 fiscal year than it did the year before. Corporate tax revenue is plummeting -- the C.B.O. predicts a drop of 27 percent this year. At the same time, the federal government will spend nearly 5 percent more, due, in large part, to Mr. Trump's insistence on more military spending.

Over the coming decades, the federal debt could nearly triple as a share of the gross domestic product if Congress makes the Trump tax cuts and spending increases permanent, according to the Committee for a Responsible Federal Budget. Lawmakers have talked about extending the cuts in last year's law beyond the next 10 years -- something they did with some of the cuts passed during the George W. Bush administration.

Today, many Republicans seem to realize that the tax cut has become a political liability, which is why they aren't talking about it ahead of the November election. Even they realize that it hasn't done any of what they promised.

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CHARTS: Stock buybacks by quarter; Stock buybacks among select companies by quarter; Capital expenditures by quarter; Real wages; Federal deficit projections (Sources: S&P Dow Jones Indices (buybacks, capital expenditures); Bureau of Labor Statistics (real wages); Congressional Budget Office (deficit); Committee for a Responsible Federal Budget (deficit calculations))

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Business/Financial Desk; SECT
The Fed's Powell Misses an Opportunity at Jackson Hole

By PETER EAVIS
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Jerome H. Powell left us hanging.

The chairman of the Federal Reserve, in a much-anticipated speech on Friday, spent most of his time explaining the challenges facing the central bank as it conducts its monetary policy. Mr. Powell emphasized the difficulties of understanding America's changing economy and argued for a flexible approach.

But in concentrating on why macroeconomic forecasting is hard, Mr. Powell may have passed up a high-profile opportunity to drill down on some of the forces that could have a real bearing on the economy in the coming months -- and that have bedeviled Fed policymakers in the past. These include a **stock market** that hit an all-time high on Friday.

Mr. Powell was speaking at an annual gathering of central bankers at Jackson Hole in Wyoming. The venue has served in the past as an occasion for Fed chairs to go deep on specific challenges central banks face. Janet L. Yellen in her first year as Fed chairwoman four years ago spoke in detail about labor markets -- a crucial area for the Fed given its dual mandate of stable prices and full employment.

Now might have been a good time to hear more from Mr. Powell on **financial markets**. Not only has the **stock market** been setting records, there are signs that it is becoming overvalued. At the same time, risks are piling up in large swaths of the debt markets. Witness the large increase in the amount of debt issued at the lowest investment-grade credit rating.

Enticingly, Mr. Powell did refer in passing to the challenge posed by frothy **financial markets**. When inflation is low, it can make sense to keep monetary policy relatively loose, but doing so can drive stock and **bond prices** higher. "Whatever the cause, in the run-up to the past two recessions, destabilizing excesses appeared mainly in **financial markets** rather than in inflation," Mr. Powell said.

He could have added a lot more. What is the Fed's latest thinking on stock valuations? What might happen to the real economy if stocks tumble in the next few months? Is the Fed concerned about relaxed lending conditions in parts of the debt markets, like leveraged loans?

Mr. Powell probably isn't worried about the markets. In June, he said: "Today I see U.S. financial stability vulnerabilities as moderate and broadly in line with their long-run averages. While some asset prices are high by historical standards, I do not see broad signs of excessive borrowing or leverage."

His view may be correct, but Mr. Powell could explain how he arrived at that conclusion. And if stocks keep going up, and debt markets become more speculative, the Fed arguably owes it to the public to be more forthcoming.

No one wants dogma from central bankers, but Hamlet-like equivocation is of limited use. Real-world specifics are always appreciated from those steering the economy. Mr. Powell still has plenty of time to provide fresh thoughts on the economy the public lives and works in.

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Upbeat Earnings Give Shares a Boost

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Investors are rewarding companies that beat Wall Street's earnings expectations with the largest share-price gains in years, helping to underpin a U.S. **stock-market** rally rattled by this year's trade tensions and rising interest rates. Earnings for **S&P 500** companies are expected to log a rise of 24% for the second quarter, according to FactSet estimates. That would rank as the second-largest increase since 2010 and extend a streak of double-digit profit growth for U.S. companies that had in previous quarters failed to impress investors.

In recent weeks, upbeat results from tech giants like Apple Inc. and manufacturers like Caterpillar Inc. have helped to reassure investors that the corporate profit recovery remains on solid ground. Going into this earnings season, many investors had feared trade tensions, rising interest rates and higher costs for things like labor and commodities would drag down earnings and share prices.

"This is a market that is proving the skeptics wrong," said Jack Ablin, chief investment officer of Cresset Wealth Advisors. "There is a fair amount of resilience in corporate America and that's a good thing for equities."

Shares of companies that posted better-than-expected earnings and revenue in the second quarter have risen by an average of 1.5% after their reports, according to Bank of America Merrill Lynch. That is the largest gain since 2016 and is far higher than the 0.4% rise for the first quarter.

Strong earnings helped send the **S&P 500** up 3.6% in July, when companies began to report for the quarter, the best monthly gain since January. The index is now less than 2% from a record.

Investors point to strong results from large industrial companies such as United Technologies Corp., Boeing Co. and Honeywell International Inc. as a reason to remain optimistic about the path for U.S. stocks despite intensifying trade frictions. Those firms, which have large overseas businesses, were seen as particularly exposed to the tit-for-tat tariff spat between the U.S. and trade partners including China and Europe.

Industrial companies in the **S&P 500** are on track to deliver earnings growth of 17% in the second quarter, according to FactSet. The sector rose 7.3% last month, the strongest gain for any of the index's 11 groups.

Aviation giant Boeing, whose shares tumbled earlier in the year on tariff concerns, raised its revenue outlook for the year, citing strong global demand for its planes. Caterpillar also raised its profit outlook last month as demand for its machinery remains strong.

Shares of Harley-Davidson Inc., which has said it will move production overseas to avoid tariffs, rallied 7.7% after its earnings report as the company beat analysts' expectations. Before the report, the stock had fallen roughly 20% this year.

Meanwhile, strong earnings reports from tech giants such as Apple, Alphabet Inc. and Amazon.com Inc. helped ease concerns that regulation and market saturation will drag down the broader sector.

Apple's shares surged 5.9% on Wednesday to a record after it beat Wall Street expectations, helping propel the iPhone maker to a $1 trillion market valuation Thursday. Earnings for the S&P's information-technology sector are expected to post a rise of 32% for the quarter, according to FactSet.

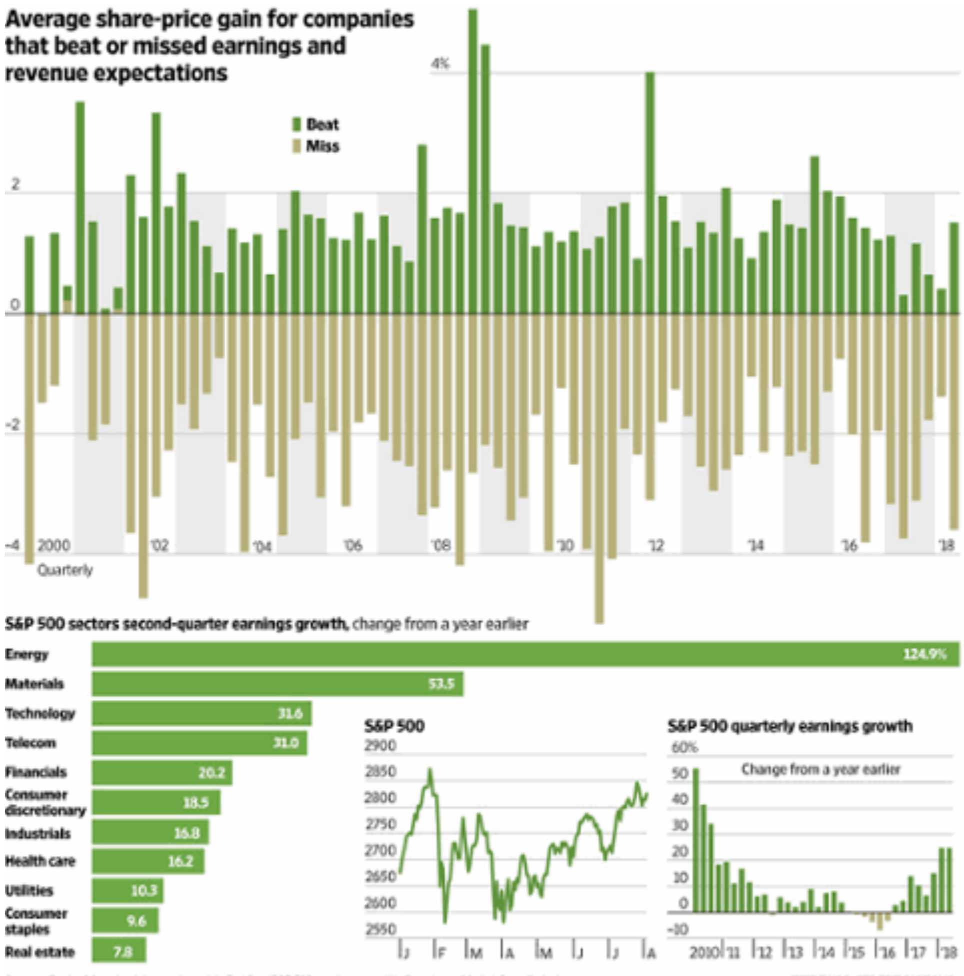
The strength of the tech sector has been a key driver of the broader market in recent years. Analysts say recent earnings suggest its influence over the broader market isn't yet under threat despite disappointing results from Facebook Inc. and Netflix Inc. that sparked steep declines in their stocks.

Disappointing earnings tend to drive larger market reactions: Shares of companies that have missed second-quarter earnings and revenue expectations have slid by 3.6%, according to Bank of America data.

Investors remain on alert for signs that the first half of this year represented a peak in earnings growth, which could pose a threat to the rally. Earnings growth is expected to slow in the quarters ahead as the effects of last year's tax overhaul begin to fade.

John Lynch, chief investment strategist at LPL Financial, says that the strength of the U.S. economy should help offset the impact of an earnings slowdown. U.S. gross domestic product rose 4.1% in the second quarter, the strongest rate of growth since 2014.

"Though earnings growth may be slowing, we believe the economic expansion has a good amount of runway left," said Mr. Lynch.



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The New York Times

Business Day
As Trade War Intensifies, China Moves to Bolster Its Economy

By Keith Bradsher
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SHANGHAI — As China's economy slows and the trade war with the United States intensifies, Beijing's economic bosses are swinging into action.

Chinese officials are pushing banks to lend more and allowing indebted local governments to spend money on big projects again. They have moved to shore up the value of the country's currency. They have also helped out the **stock market**, say financial analysts, as the government works to avert a **stock market** collapse like the one three years ago that shook the world.

"It's a line in the sand for the leadership" of China, said Hao Hong, the research director for the international operations of the Bank of Communications, a Shanghai-based financial institution.

China is taking action as its problems mount. On Thursday the United States formally enacted its previously threatened tariffs on $16 billion in Chinese-made goods. Beijing said it would immediately retaliate with its own tariffs and file a complaint with the World Trade Organization. The moves intensify a trade war that has already affected more than $100 billion of goods and cast a shadow over growth prospects for China and the world.

China is playing a difficult game. It must deal with its weakening economy without worsening its onerous debt problems. At the same time, it has to shore up the situation at home if it hopes to continue to retaliate against President Trump's trade war broadsides.

So far, the trade war has had only a minor impact on China's vast, $12 trillion economy. But the trade war complicates China's deeper problems with its onerous debt levels. China has worked to wean its economy off its dependence on borrowing, but the resulting slowdown in growth has undercut that effort, leading Beijing to relent somewhat from the initiative. Should the trade war take a greater toll, China could direct its banks to expand lending further.

"The Chinese government always oscillates between maintaining stability and achieving quality growth," said Zhigang Tao, a Hong Kong University economist. "When you see the government switch to stimulus, it generally means the government cares about stability."

China's softening economy has led some within the Trump Administration to believe Beijing is vulnerable, which could lead the White House to escalate the trade war even further. Larry Kudlow, the director of President Trump's National Economic Council, pointed out during a Cabinet meeting last week that China's own official statistics for business investment, retail sales and industrial production have shown weakness in recent months.

"Right now, their economy looks terrible," he said during the meeting, which was open to the media.

China's most recent quarterly economic figures suggest growth is continuing at a steady pace. But economists generally dismiss those official numbers, which are much smoother and more predictable than the economic figures posted by the United States and other major countries.

Other indicators suggest a mild softening. Some consumers appear to be holding back. Infrastructure spending, which encompasses up to one-sixth of the Chinese economy, slowed sharply through the first seven months of this year.

The city of Harbin, a provincial capital in northeastern China, ran out of money last month to pay pensioners, and had to rearrange its finances to pay them later. Corporate bond defaults have increased this year, although they are still low by international standards. The country's banks acknowledged last month a fairly sharp uptick in nonperforming loans, although that was partly driven by tighter auditing standards.

Signals of serious financial and economic weakness have prompted the Beijing authorities to rush out their series of measures since the end of July.

China is taking steps to make sure its companies and spenders have enough money. The central bank announced on Aug. 10 that it would make sure enough credit reached companies. China's banking regulator announced on Aug. 11 and again over the weekend that it wanted the country's state-controlled banking sector to provide ample credit to exporters, small and medium-size businesses and infrastructure projects.

Regulators are taking other steps to give banks the financial space needed to step up lending. The official China Securities Journal reported on Tuesday that financial regulations may soon be changed to let banks keep practically limitless holdings of local government bonds without including them in their calculations of their ability to endure hard times. The move won't help China deal with the huge debt racked up by local governments in recent years, but it does free up money for banks to lend.

The authorities are also encouraging local projects. The Finance Ministry is helping deeply indebted local governments borrow far more money this autumn so that they can restart stalled infrastructure projects. China's central planners have allowed a series of big local government projects to proceed that had previously been blocked because of debt concerns. This includes the construction of five subway and light rail lines in Changchun, a big industrial city in northeastern China where Toyota, the Japanese automaker, has extensive facilities.

The **financial markets** are getting a boost as well.

Through the spring and summer, share prices slid into a **bear market**, and China's currency, the renminbi, dropped nearly 10 percent against the dollar. Since then, China — which keeps a tight grip on the value of its currency — has pushed it to gain value against the dollar.

Meanwhile, the **stock market** has risen in a move that analysts say has been helped by intervention from big, government-connected investors, a group sometimes known as the National Team. On Friday, Chinese share prices fell to their lowest closing level since early 2016. But through Thursday, the Shanghai **stock market** has risen almost 2 percent this week.

China has also moved forcefully to reassure common investors. Its banking regulator has begun encouraging the country's four big asset management companies to aid highly speculative peer-to-peer lending schemes that have been collapsing in recent months, though the details of that help remain unclear. And the government has deferred plans for a more stringent crackdown on various kinds of informal lending, or shadow banking, including off-balance sheet lending by banks.

Other data show how China is trying to pull off a difficult balancing act. Even as Chinese officials push for more lending, a broader measure of borrowing showed the overall flow of fresh credit slowed in July. That suggested lingering effects from the authorities' previous efforts to crack down on some of the murkier parts of the vast but rickety Chinese financial system.

Tolerating even more borrowing by heavily indebted local governments is a short-term measure that could create long-term problems.

Liu He, a vice premier and close adviser to China's leader, Xi Jinping, pledged in January that Beijing would bring the country's debt under control within three years. Beijing had clamped down on some bank lending to state-owned enterprises over the last few years, data from the Bank of International Settlements has shown. Letting local governments borrow more runs counter to that.

"The focus is no longer on deleveraging, but on transferring leverage from one sector to another," said Zhu Ning, a Tsinghua University economist.

The injections of money by the government into the economy now may offset the withdrawal of money last spring during the deleveraging campaign, but may not be enough to spur an actual boom in the debt-laden Chinese economy, said Rodney Jones, a principal at Wigram Capital Advisors, a Beijing economic research firm.

"I'm really skeptical that stimulus creates a surge of growth like we have seen in the past," he said. "I think stimulus takes out some of the downside."

Ailin Tang contributed research.

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* U.S. and China to Rekindle Trade Talks as More Tariffs Loom

* China’s Economic Growth Looks Strong. Maybe Too Strong.

A construction worker in Chengdu, China. The country’s Finance Ministry is helping deeply indebted local governments borrow far more money this fall so they can restart stalled infrastructure projects. | China Network/Reuters

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Markets
Home-Builder Shares Miss Out on Stock Rally; Shares of home builders have fallen behind the broader market as data have suggested the housing market could be cooling

By Akane Otani
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Shares of home builders are struggling to catch up with the broader market, pointing to a potential trouble spot in an otherwise resilient U.S. economy.

Consumer confidence tracking near 18-year highs, strong corporate earnings and soaring retail sales haven't translated into gains across the housing market—something that has kept home-builder shares from reclaiming the highs they hit at the start of the year.

Even as the broader **stock market** has clawed its way back to all-time highs, big, publicly traded home builders have lagged behind, with shares of Lennar Corp. down 17% this year, D.R. Horton Inc. losing 12%, Toll Brothers Inc. down 23% and PulteGroup Inc. shedding 15%. In comparison, the **S&P 500** is up 9% this year.

Part of the problem stems from disappointing housing data. Average home prices in major metropolitan areas of the U.S. have slowed for three consecutive months, according to data released Tuesday from S&P Dow Jones Indices. Yet slowing home-price increases haven't done much to draw buyers into the market: Existing-home sales have fallen for four consecutive months, the longest such slide in five years, as mortgage rates have risen and buyers have been squeezed by the limited inventory of affordable housing. Data Wednesday showed the number of homes across the U.S. that went under contract unexpectedly fell in July, declining on an annual basis for the seventh consecutive month, according to the National Association of Realtors.

The streak of data have been notable enough to catch the attention of Federal Reserve officials, who flagged the possibility of a "significant weakening in the housing sector" as an economic risk in minutes from their July 31-Aug. 1 meeting.

"With the FOMC having elevated housing to a key downside risk to the U.S. economy…[disappointing data] should continue to raise caution around the housing market, though current levels are still suggesting resilient growth," said Jon Hill, rates strategist at BMO Capital Markets, in an email.

Some of the weakness may be temporary; analysts hope that a buoyant labor market, plus strong consumer confidence, will help offset the recent rise in mortgage rates.

"Confidence is soaring to new heights which makes us **bullish** on growth and forecasts that this expansion may indeed shatter records for longevity next summer," said Chris Rupkey, chief financial economist at MUFG, in an email. "The consumer says the economic times we live in is better than you think."

Shares of companies offering consumers ways to spruce up their homes have also held up relatively well, suggesting that investors aren't betting on a complete pullback in spending.

Big-box retailer Home Depot Inc. has risen 6.4% this year, adding to gains after soaring 41% in 2017. The company raised its earnings and sales target for the year in mid-August, buoyed by spending among consumers for home-improvement materials and growing online sales.

"We feel very positive about the strength of the home-improvement sector and the customers' willingness to spend," Chief Executive Craig Menear said on the firm's earnings call.

Lowe's Cos., which reported stronger sales and profit for its latest quarter, is up 17%, while paint maker Sherwin-Williams Co. has jumped 11%.

Sherwin-Williams, among other companies, is holding out hope that the recent streak of lukewarm housing data has more to do with a shortage of homes on the market than a weakening consumer.

"We believe the slower residential starts and resales in June are more indicative of supply constraint than they are weakening demand. So, there may be constraints out there in the market, but they don't seem to be interest-rate related at this stage," Robert Wells, senior vice president of corporate communications at Sherwin-Williams, said on the firm's July earnings call.

Yet the prolonged softness among home-builder stocks suggests investors still have their doubts.

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Markets
New 'Speed Bump' Planned for U.S. Stock Market; Cboe considers briefly delaying orders to trade stocks on EDGA, its smallest stock exchange

By Alexander Osipovich
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Cboe Global Markets Inc. is seeking to introduce a brief delay on one of its markets, becoming the latest U.S. stock-exchange group to attempt to hit the brakes on high-frequency traders, people familiar with the situation said.

The plan shows how "speed bumps" have proliferated among U.S. exchanges in recent years, even at market operators that initially opposed them. IEX Group Inc., the upstart exchange featured in Michael Lewis's book "Flash Boys," kicked off the trend and has since been followed by the New York Stock Exchange and others.

Speed bumps work by imposing a delay on orders to trade stocks, typically a fraction of a second. Proponents say that can foil high-tech traders that make money by forecasting tiny market moves and quickly buying or selling shares before others realize that prices are shifting.

Cboe hopes to add a speed bump to EDGA, the smallest of its four equities exchanges, people familiar with the situation said. The company has presented its plans to major trading firms in recent months, these people said.

"We discuss a range of innovative and flexible trading solutions with our customers on an ongoing basis," a Cboe spokeswoman said.

The plan would require approval from the Securities and Exchange Commission. Cboe has yet to file its proposal with the agency, and the company could still drop its plan.

Chicago-based Cboe is the third-largest U.S. stock-exchange operator after the NYSE and **Nasdaq** Inc., as measured by market share. It has handled 17.4% of equities volume so far this month, of which EDGA was 1.2%, according to research firm Tabb Group LLC. Cboe had the No. 2 spot earlier this year but slipped behind **Nasdaq** in June, Tabb data show.

Cboe executives have previously criticized speed bumps. "It's about having a market further complicated by delays," Chris Concannon, who is now Cboe's president and chief operating officer, told The Wall Street Journal in a 2016 interview about IEX's plans to launch a speed-bump exchange.

The speed bump under discussion at Cboe would differ in several ways from IEX's, according to people briefed on the plan. IEX delays orders to trade stocks by 350 millionths of a second. Cboe's speed bump would be around 10 times longer in duration, lasting three to four milliseconds, these people said. A millisecond is a thousandth of a second.

The delay wouldn't apply to all orders equally: Instead, it would affect only orders seeking to hit unexecuted buy or sell orders already posted on EDGA, the people said. Traders posting new orders to be displayed on EDGA wouldn't be affected.

Such a design would benefit market makers, the firms that facilitate trading by continuously quoting prices for stocks. Market makers would be able to cancel or adjust their quotes without having to wait several milliseconds.

But the delay could hurt speedy traders that try to "pick off" slightly out-of-date quotes posted by slower-moving market makers—in other words, buying just as the price is about to tick up a penny or selling just before the price drops. Effectively, market makers would gain a shield against such ultrafast strategies.

If approved, Cboe's plan could undermine one of the biggest plays in high-frequency trading, which involves zipping between markets centered in Chicago and New York at nearly the speed of light.

Ultrafast traders often monitor for price changes in **stock-market** futures listed on the Chicago Mercantile Exchange. If they detect a shift, they will fire off orders to buy or sell exchange-traded funds that track U.S. stocks, such as the popular SPDR **S&P 500** ETF Trust. For the strategy to work, the speedy trader must send electronic messages as quickly as possible from CME's data center in Aurora, Ill. to northern New Jersey, where all of the major U.S. stock exchanges locate their systems.

It takes about four milliseconds to send such messages using one of the microwave networks favored by high-frequency traders. Sending a similar order by cheaper fiber-optic cable takes several milliseconds longer. Cboe is considering a delay of three to four milliseconds because that would eliminate the advantage of microwave over cable along the Illinois-to-New Jersey corridor, according to people briefed on the company's plan.

Cboe's plan will likely be controversial. When the tiny Chicago Stock Exchange proposed a similar one-sided speed bump in 2016, critics said it would give market makers an unfair advantage. Some trading firms compared it with "last look"—a controversial practice from the foreign-exchange markets in which banks could pull out of trades at the last moment if prices moved against them. Supporters of the proposal said it would benefit investors, because it would let market makers tighten the difference between buying and selling prices.

The Chicago exchange ultimately withdrew the proposal in July after being acquired by NYSE owner Intercontinental Exchange Inc.

Under its speed-bump plan, Cboe wouldn't seek to benefit from an SEC rule that generally helps small exchanges, people briefed on the plan said. The rule lets exchanges offer "protected quotes"—meaning brokers must route customer orders to an exchange if its quote represents the best price for a particular stock. But for quotes to be protected, they must be "immediately accessible," the SEC has said. That requirement has tripped up other exchanges trying to implement speed bumps.

Cboe wouldn't seek protected-quote status for orders displayed on EDGA, the people said. Such a stance could help Cboe's plan win SEC approval.

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The New York Times

Opinion
The Big, Dangerous Bubble in Corporate Debt

By William D. Cohan
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The $30 trillion domestic **stock market** seems to get all the attention. When the **stock market** sets new highs, we instinctively feel things are good and getting better. When it tanks, as happened in the initial months of the 2008 financial crisis, we think things are going to hell.

But the larger domestic debt market — at around $41 trillion for the bond market alone — reveals more about our nation's financial health. And right now, the debt market is broadcasting a dangerous message: Investors, desperate for debt instruments that pay high interest, have been overpaying for riskier and riskier obligations. University endowments, pension funds, mutual funds and hedge funds have been pouring money into the bond market with little concern that bonds can be every bit as dangerous to own as stocks.

Unlike buying a stock, which is a calculated gamble, buying a bond or a loan is a contractual obligation: A borrower must repay a lender the borrowed amount, plus interest as compensation. The upside in a bond is limited to the contractual interest payments, but the downside is theoretically protected. Bondholders expect to get their money back, as long as the borrower doesn't default or go bankrupt.

But for much of the last decade, risk has been mispriced to a staggering degree. In other words, the prices of bonds (and corporate loans) have not accurately reflected the riskiness of the underlying borrower's credit. A company that is a poor credit risk, because it has too much debt or is struggling, should have to pay higher rates of interest. And investors would expect a higher yield — roughly the interest rate divided by the price paid for the bond or loan — for taking on that risk. Since the financial crisis, that simple calculus has been upended. Until recently, investors have been paying higher prices for the debt of riskier companies and not getting properly compensated for that risk.

The International Monetary Fund has noticed. In a recent blog post, an I.M.F. economist wrote that the current debt craze was "fueled by excessive optimism among investors," and he added: "When the economy is doing well and everybody seems to be making money, some investors assume that the good times will never end. They take on more risk than they can reasonably expect to handle."

For now, the bond market, like the **stock market**, looks robust. It has been a long bull run for both stocks and bonds, and borrower defaults have been at historically low levels for years. As has the "spread"— the difference between the yields — of Treasury-backed securities and riskier bonds. But as interest rates continue to rise, and some companies and other borrowers fail to meet their debt obligations, defaults will inevitably increase along with the spreads.

When they do, trillions of dollars in invested capital could be lost. If that happens, as it did after September 2008, access to credit for most borrowers could dry up, setting off yet another potentially devastating economic crisis. To be sure, the growing concern about the mispricing of risk doesn't mean we're on the verge of a recession. But the corporate debt bubble inevitably will play a role in causing it.

Here's the crux of the problem: After the financial crisis, the Federal Reserve Board under Ben Bernanke decided to lower short-term and long-term interest rates. Fed officials hoped that by flooding the zone with inexpensive credit, borrowers would have access to money to build new factories, buy new equipment, hire more employees and pay them higher wages. Mr. Bernanke's idea was that the Fed could engineer an economic recovery by making sure that most businesses that wanted capital could get it at an attractive price. It largely worked. His strategy was so successful that it was envied and then copied by central banks around the world.

To lower interest rates, the Fed employed two tactics. One was to cut the so-called Fed Funds rate — what the Fed charges the nation's biggest banks to borrow money on a short-term basis — to nearly zero, and keep it there for seven years. Lowering long-term rates required more creativity. Mr. Bernanke had a clever plan, what he called "quantitative easing": The Fed would buy trillions of dollars of toxic securities that had marred the balance sheets of the Wall Street banks.

By creating artificial demand for these securities, where there had been virtually none, the Fed helped big banks cleanse their balance sheets, reassuring investors and creditors. But like anything else, **bond prices** are subject to the vagaries of supply and demand; the Fed's gorging drove up not only the price of these particular bonds but also **bond prices** generally, lowering their yields. (When **bond prices** increase, yields decrease.)

The plan worked, perhaps too well. Both short- and long-term interest rates were reduced to levels rarely seen in our lifetimes. The Fed's balance sheet expanded to about $4.5 trillion, from less than $900 billion before the crisis, thanks to the purchase of squirrelly assets from Wall Street. The world was awash with cheap capital. (Of course, that didn't mean it was any easier for home buyers to get a mortgage or for small businesses to get loans.)

In the years leading up to the 2008 financial crisis, a sustained period of low interest rates led to a widespread deterioration of credit standards for mortgages, among other securities. The same thing is happening now for other kinds of loans and debt instruments. Only this time, the Fed has kept interest rates lower for longer.

An unintended consequence of keeping interest rates artificially low for so long is the mispricing of risk. The Fed's artificial demand has kept **bond prices** higher than they otherwise would have been, and their yields lower. But investors have an insatiable demand for higher yields, a collective hunger that Wall Street has been only too happy to feed.

Examples of mispriced risk are strewn across the financial landscape. In June, Asurion, an insurer of cellphones, closed on a $3.75 billion loan package from Wall Street's biggest banks, with minimal covenants — agreements to protect creditors by notifying them when certain red flags, like a higher than agreed-upon debt-to-cash flow ratio, are waving.

The proceeds of Asurion's "covenant-lite" or "cov-lite" loan were used to pay dividends to the three private-equity firms that own the company. Its debt load has increased to $11.3 billion, seven times its cash flow. For additional irresistible fees, Wall Street then repackaged the Asurion loans into securities and sold them to investors, who now own the debt of a highly leveraged company with far fewer protections.

According to LeveragedLoan.com, which monitors the corporate loan market, the issuance of cov-lite corporate loans has exploded in the past few years and reached a record in May. Cov-lite loans now account for nearly 77 percent of the estimated $1 trillion corporate loan market. And some of these loans are packaged and resold as bonds or as other complicated investments.

To help pay for its recently completed $8 billion buyout of the margarine and spreads business of Unilever — since renamed Flora Food Group — KKR, the private equity firm, offered investors 1.1 billion euros (about $1.3 billion) of senior notes with a minimal covenant package. Moody's rated it 4.99 on a scale of 1 to 5, with 5 being the weakest. Nevertheless, investors gobbled them up.

Or consider the mighty AT&T — now stuffed to the gills with an estimated $180 billion in debt following its $85 billion acquisition of TimeWarner. It is, according to Moody's, the "most indebted, nongovernment controlled, nonfinancial rated corporate issuer" and one now "beholden to the health of the capital markets." In other words, the company is so indebted that chances are high it will need continuing access to the credit markets to refinance and pay back its mountain of debt as it becomes due.

So-called junk bonds — issued by companies with poor credit ratings — historically have yielded around 10 percent or more, to compensate investors for taking the risk of buying the debt of such companies. These days, junk bonds yield around 6.25 percent, meaning that investors — still desperate for yield — have overpaid for these bonds sufficiently to drive down their effective yields to levels that fail to compensate them for the risks they are taking.

When junk bond yields return to more normal levels, as interest rates rise and investors' yield-fever breaks, the price of the bonds bought during the feeding frenzy will fall and billions of dollars stand to be lost — by endowments, pension funds and high-yield funds, among others — as bonds across the board are repriced by the market.

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When that happens, the entire credit market could start to contract, as it did after the 2008 crisis. When the pendulum swings away from fast-and-loose credit standards for corporations, lenders become more cautious. That means ordinary people will pay much higher rates for mortgages, car loans and small-business loans — if they can get them at all.

This is not a minor concern. In a July 30 interview on CNBC, Jamie Dimon, the chairman and chief executive of JPMorgan Chase, America's largest bank, said the biggest risks to the economy were the consequences of tariffs on China and the unwinding of the Fed's quantitative easing policies and its implications for **bond prices** and credit markets generally. "I don't want to scare the public," he said, "but we've never had QE [before]. We've never had the reversal."

It may not be too late for a course correction. Banks could tighten their underwriting standards — ratchet down the leverage, demand more covenants, nix loans that are used to pay big dividends — and investors could be more discerning about the prices they are willing to pay for high-yielding bonds. Regulators could be more vigilant about allowing such loans and bonds to be issued in the first place. Wall Street could also redesign its compensation system to reward bankers to be more cautious with their underwriting and to take fewer risks with other people's money.

In the meantime, we must inure ourselves to the inevitable. It may take yet another major financial crisis for things to change, or maybe things will never change. Either way, it's a lesson we never seem to learn until it's too late.

William D. Cohan is a special correspondent for Vanity Fair and the author of, most recently, "Why Wall Street Matters."

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THE WALL STREET JOURNAL.

Markets

U.S. Treasury Yields Fall as Stocks Drift Lower; Bond yields fell overnight as investors weighed the fallout of ex-Trump lawyer Michael Cohen's guilty plea and Paul Manafort's convictions

By Akane Otani
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U.S. government**bond prices** edged higher Wednesday as stocks paused after the **S&P 500** closed just shy of an all-time high.

The yield on the benchmark 10-year U.S. Treasury note settled at 2.823%, compared with 2.846% Tuesday. Yields fall as **bond prices** rise.

Bond yields fell overnight as investors weighed the fallout after President Trump's former lawyer, Michael Cohen, said Mr. Trump directed him to pay off women who said they had affairs with him. Separately, former Trump adviser Paul Manafort was convicted yesterday of eight charges related to tax and bank fraud.

"Investors found the safe haven trade more preferable than the risk-on trade ...at least for now," said Kevin Giddis, head of fixed-income capital markets at Raymond James, in an email. "In the absence of confidence, uncertainty is the Treasury market's best friend."

Treasury yields then bounced off their session lows and hovered in a narrow range after the Federal Reserve released minutes from its July 31–Aug. 1 meeting.

Analysts and investors had been looking for clues on how the Federal Reserve intends to steer policy in the second half of the year, as well as how policy makers are viewing the U.S. economy. Wednesday's minutes largely reaffirmed what many had expected: that the central bank is acknowledging potential risks posed by trade and the housing market but is still likely to raise short-term interest rates next month.

The move would bring the Fed to its third interest-rate increase of the year.

A strong U.S. economy has driven many investors to bet that the central bank will raise rates a total of four times in 2018. Federal-funds futures—which traders use to place bets on the course of interest rates—recently pointed to a 63% probability of the Fed raising interest rates four times by year end, according to CME Group.

The minutes show "the Fed believes we're not as late in the business cycle as some may think," said Mike Loewengart, vice president of investment strategy at E*Trade, in an email. "There's more steam left in the market, and untenable inflation is not quite banging on our door."

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THE WALL STREET JOURNAL.
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Trump Turns Up the Heat On Turkey as Lira Plunges

By David Gauthier-Villars and Jon Sindreu
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The Turkish lira fell sharply to its lowest level ever on worries about Ankara's economic stability, sending tremors through Europe and emerging markets amid renewed jousting between the country's leader and President Trump.

The lira dropped as much as 17% against the dollar, extending a tumble that ranks as one of the steepest in world markets this year.

President Recep Tayyip Erdogan defended his unorthodox policies in two speeches Friday, vowing to prevail in what he called an "economic war." Mr. Trump said he would double steel and aluminum tariffs on Turkey, a move that would prevent Turkish exports from becoming cheaper with the lira's fall and exacerbating worries of a prolonged trade spat between the two NATO allies.

The U.S. appeared likely to keep up pressure after calling for months for the release of a U.S. pastor detained in Turkey. "Our relations with Turkey are not good at this time!" Mr. Trump wrote on Twitter.

By the end of New York's trading day, a dollar bought 6.43 lira, a decline of 41% from the start of the year. The **Dow Jones Industrial Average** slumped 196 points or 0.8% to 25313, its third straight decline, while the dollar rose to a one-year high. In Europe, Turkey's woes hit shares in Spanish, Italian and French banks with large exposure to the Turkish economy.

The lira's rough ride was a far cry from Mr. Erdogan's promise that the near-absolute executive powers he gained upon winning re-election under an amended constitution in June would allow him to fix Turkey's economic challenges. The soured relationship between Messrs. Erdogan and Trump has only exposed the economic vulnerabilities that have built up under his leadership.

Despite accelerating inflation, which hit 16% last month, Turkey's central bank has kept its main lending rate steady since the election, fueling investor concern that it lacked the necessary independence from the government to fulfill its mandate.

Analysts and investors increasingly fear that Turkish businesses will struggle to pay down a debt load exceeding $300 billion because the bulk of it isn't backed by a steady revenue stream.

Turkey's external debt ranks among the largest among developing economies as a share of annual output, and its foreign-reserve pot is among the smallest, data from the World Bank and the International Monetary Fund show.

The chairman of Istanbul's Chamber of Industry, Erdal Bahcivan, sounded the alarm Friday, saying the falling lira was threatening businesses as well as Turkey's financial system. "Measures to protect the real economy must be put in place urgently," he said Friday.

Turkish sovereign bonds declined in price, with yields on 10-year debt exceeding 20% on Friday, the highest yield since 2008 and up from roughly 12% at the start of May.

Some analysts predicted the country would have no choice but to resort to stringent measures such as capital controls or seeking outside help from the IMF, though such aid would come with strings attached.

"I think they're going to need the IMF, and the sooner the better," said Paul McNamara, investment director for emerging-market debt at GAM International Management.

A Turkish official said the government had no plan to seek IMF assistance.

Investors are monitoring what the Turkish government will do to stem the rout, but plans disclosed Friday by Finance Minister Berat Albayrak -- Mr. Erdogan's son-in-law -- failed to ease concerns.

Opposition leader Muharrem Ince, who finished second in the June presidential election, urged Mr. Erdogan to change course. "Sack all your economy advisers starting with your son-in-law," he said Friday, and "leave the central bank in peace."

But delivering a speech from a small town in the Black Sea province -- his second televised address of the day -- Mr. Erdogan struck a defiant tone.

"Despite all the attacks against our country, we will continue to grow in the second quarter and we will end 2018 with record economic growth," he told supporters in Gumushane. "Those who think they can bring us to our knees with economic manipulation don't know this nation."

The immediate impact of a weaker Turkish economy on the global economy is expected to be relatively small. Carsten Hesse, economist at German bank Berenberg, said that even a 20% fall in eurozone exports to Turkey would subtract only 0.1 percentage point from the bloc's growth.

Some fund managers are concerned that fears about Turkey will trigger outflows from other emerging-market countries and push the dollar even higher, while stock investors are weighing the risk of a Turkish economic rout on the banking systems of nearby countries.

European banking shares dropped after it emerged that the European Central Bank was examining the banks' exposure to Turkey. Spain's BBVA SA fell 5.2%, France's BNP Paribas SA dropped 3%, and Italy's UniCredit SpA slid 4.7%.

During the eurozone's sovereign-debt crisis between 2010 and 2015, concerns over the financial frailty of Greece hit markets world-wide. A limited depreciation of China's currency in 2015 also sparked **stock-market** selloffs.

Some other emerging-market currencies also weakened, with the South African rand and the Hungarian forint falling about 2.6% and 1.7%, respectively. The Russian ruble fell 1.5% and hit a two-year low.

In the U.S., Citigroup Inc. dropped 2.7% and the KBW **Nasdaq** Bank Index, which tracks large U.S. commercial banks, slid 1.3%.

Charlie Robertson, global chief economist at Renaissance Capital, said that the longer-term "contagion effect" would be limited because Turkey has a small presence in the widely tracked MSCI Emerging Markets index, so investors exiting Turkey won't be forced to sell assets in other developing nations.

Money managers also said Friday's moves were accentuated by thin trading. The differences between quoted prices to buy and sell lira was "wide enough to park a bus," said Mr. McNamara, meaning that a $10 million sale was enough to move the currency a full percentage point.

Yeliz Candemir contributed to this article.

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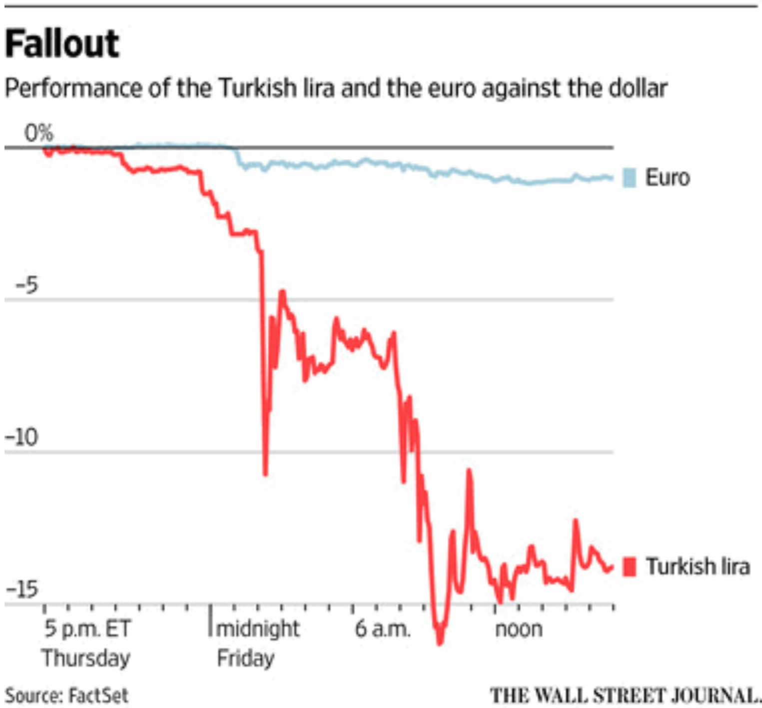

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Markets

Lira Volatility Forces Investors to Find New Hedge Against Turkey; Analysts warn that intervention to support the lira hasn't addressed the fundamental weakness of Turkey's economy

By Christopher Whittall and Patricia Kowsmann
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Turkey's attempts to stabilize its embattled **financial markets** had borne some fruit this week, sparking a brief relief rally in the lira, but investors are still looking for ways to hedge against any new shocks.

That negative sentiment toward Turkey was on full view again on Friday, when the lira sank around 5% against the dollar after the U.S. on Thursday threatened new penalties against the country over its detention of a U.S. pastor.

Friday's drop brought to an end three straight days of gains for the lira—which is still up 5% this week against the dollar—after it hit a record low on Monday. The rally came after Qatar announced a $15 billion support package and Turkey's banking regulator moved to limit the amount of the local currency banks can swap for foreign currencies with counterparts.

Investors say the intervention made it more expensive to bet on declines in the lira and helped provide some support for the currency. But analysts also warned that the measures haven't addressed concerns over the economic policies of President Recep Tayyip Erdogan, Turkey's runaway inflation, its souring relationship with the U.S. and its large foreign-currency debt that is due to mature over the next 12 months.

"I would compare it to taking painkillers when you have cancer. It will reduce the pain short term, but won't cure the underlying illness and problems of the Turkish economy," said Carsten Hesse, an economist at Berenberg.

Indeed, IMF data show that Turkey's pot of foreign-exchange reserves is ill-equipped to service its debt. Turkey's official foreign-exchange reserves stand at around $100 billion, but that figure could be inflated because of the large amounts of foreign-currency reserves and gold that Turkish banks are allowed to place at the central bank to comply with their reserve requirements.

The uncertainty over the long-term health of the Turkish economy has seen investors scramble for protection across a range of markets—not just selling the lira.

The amount of Turkish government dollar bonds on loan—a proxy for short demand—has grown to $1.4 billion from $350 million at the start of the year, according to IHS Markit. In the **equity market**, the short position in the iShares MSCI Turkey ETF hit a year-to-date high of 4.3 million shares this week, nearly double the short position at the start of the year.

Volumes have also been high in the credit-default swap market, according to Gavan Nolan, director at IHS Markit, where investors can buy insurance against a Turkish sovereign default.

Paul McNamara, a fund manager at GAM, said it is important to be discerning when choosing hedges. "You get what you pay for," he said. "At this point protection on most of the risks [is] expensive."

In a conference call with international investors on Thursday, Turkey's finance minister, Berat Albayrak, acknowledged the difficult conditions but vowed that his country will come out stronger, according to two participants in the call.

"With their backs against the wall, they had to do something and after this call investors might give him the benefit of the doubt," said Richard Segal, emerging-market analyst at Manulife Asset Management, who was on the call. "But there is still scope for things to go wrong."

The lira is down nearly 40% against the U.S. dollar this year. That selloff accelerated sharply last week after the U.S. imposed sanctions on Turkey over the detention of U.S. pastor Andrew Brunson. Tensions between the two countries escalated further as Washington and Ankara levied trade tariffs on each others' goods.

On Friday, a Turkish court rejected Mr. Brunson's latest appeal against his house arrest and lifting his travel ban.

Other emerging-market currencies were also under pressure Friday. The Brazilian real, Mexican peso and Russian ruble all fell 0.8% against the dollar in recent trade.

Jon Sindreu and Georgi Kantchev contributed to this article.

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THE WALL STREET JOURNAL.

Markets
Latest Economic Worries Crush Metals Prices; Copper is set to enter bear-market territory

By David Hodari and Amrith Ramkumar
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Copper closed in **bear-market** territory as metals fell across the board Wednesday, punished by the latest worries that a global economic slowdown will weaken demand.

Front-month copper for August delivery had its worst day of the year, slumping 4.4% to $2.5570 a pound on the Comex division of the New York Mercantile Exchange and hitting its lowest level since June 2017. The red metal entered a **bear market** for the first time since November 2016 and is now down 22% from its four-year highs set in June.

Gold also hit a new low for the year, with front-month futures dropping 1.3% to $1,177.50 a troy ounce. Palladium, silver, platinum, zinc, nickel and lead all fell at least 3%.

Metals are considered an economic indicator by some investors because of their widespread uses in construction and manufacturing. They are also closely tied to China, which accounts for about half the world's demand of certain industrial metals and is embroiled in a trade spat with the U.S.

Worries that tariffs will slow the Chinese economy and lower demand for materials have hurt metals this summer, and those concerns were magnified Tuesday by data showing Chinese spending on so-called fixed assets such as factory machinery and public-works projects cooled to the lowest point in nearly two decades in the first seven months of the year.

Some analysts also fear that weakness in other emerging markets like Turkey will hurt commodity consumption. Turkey sharply raised tariffs on some U.S. imports Wednesday, extending a fight between the two NATO allies that has sent the country's currency plummeting. Other emerging-market currencies have also dropped sharply recently.

The rout in currencies of countries that heavily produce and consume commodities has in turn pushed the U.S. dollar to its highest levels since May 2017. The dollar's strength has hurt metals by making them more expensive for overseas buyers. On Wednesday, the WSJ Dollar Index, which tracks the dollar against a basket of 16 other currencies, swung between small gains and losses and was recently down 0.1%.

Drops in metals accelerated Wednesday as investors sold other risky assets from stocks to oil, a sign to some that analysts are increasingly worried about the global economy slowing. Synchronized economic growth lifted stocks and commodities together last year.

"It's all one story. Continued macro concerns over trade have now added Turkey into the mix, and that adds to the premise of synchronized global growth being steadily undermined," said Oliver Nugent, a commodities strategist at ING.

Metals are particularly sensitive to global-growth sentiment, which has shifted as the trade fight between the U.S. and China has intensified this year. While Beijing has sought to assuage investor fears about the prospect of an economic slowdown by touting fiscal and monetary stimulus, many remain anxious about the country's future growth.

Tuesday's data showed Chinese retail sales grew in July, but not as sharply as analysts had expected. And unemployment ticked up to 5.1% last month, from 4.8% in June.

"There are still concerns of a slowdown in the second half of 2018 despite the stimuli, and the trade conflict with the U.S. shows no signs of cooling," said Vivienne Lloyd, senior analyst at Macquarie.

Analysts said technical selling accelerated the drops in metals prices Wednesday after copper dropped below $6,000 a metric ton in London, a closely watched level by traders.

One of the most-actively traded metals, copper has led other materials lower recently on signs that a labor dispute at the world's largest copper project could be avoided. Reports that BHP Billiton and the union at Chile's Escondida mine are closer to reaching a wage agreement have raised the possibility of steady copper supply, analysts say.

A 44-day strike at Escondida last year boosted prices, as did other supply disruptions.

"Yesterday [the two parties] seemed a lot closer to settlement, and their language seemed calmer and less combative than it tends to before a strike," said Macquarie's Ms. Lloyd.

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Markets

U.S.-Stock Funds Rose 2.5%, Brushing Off Worries; Some experts say strong earnings are compensating for geopolitical upheaval and other headwinds

By William Power
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Investors could make a long list of threats to the **stock market**. But so far, it's all on paper. The nine-year-plus **bull market** keeps grinding on.

The average U.S.-stock fund registered a total return of 2.5% for July, according to Thomson Reuters Lipper data, thanks largely to strong corporate earnings. Even the slide in well-known tech stocks didn't hold down the overall market.

The U.S. funds are up 5.9% for the year to date.

International-stock funds continue to trail their American cousins—up 2.1% for July but still down 0.7% so far this year.

John Serrapere, director of research at Arrow Funds in Laurel, Md., is struck by how the market remains calm despite the headwinds—stock valuations, bond-market credit quality, geopolitical upheaval. Through it all, the market's fear meter, the Cboe **Volatility** Index, remains low.

"The biggest disconnect in the market is how the VIX is priced," says Mr. Serrapere. "For a brief period in February we had that surge in **volatility**, and now it's gone away."

Perhaps it's all about the earnings and economic indicators.

Omar Aguilar, chief investment officer for equities at Charles Schwab Investment Management, San Francisco, sees challenges like trade disputes and the potential for an overheated economy if the Fed can't control it. Yet earnings are relentless.

"We are in an environment that is actually pretty benign for risky assets," meaning stocks in general, he says. "It's looking pretty good in terms of what the solid, hard data is, whether U.S. GDP growth or the latest readings on Europe or Japan."

Bond funds were little changed in July. Funds focusing on intermediate-maturity, investment-grade debt (the most common type of bond fund) were up 0.1%, leaving their year-to-date decline at 1.6%.

Still, what about that turmoil in Washington? The market often reacts to it, but just as quickly moves on.

Jae Yoon, chief investment officer of New York Life Investment Management, says, "It is really day by day for investors with the headlines. But there is some positive momentum that is still allowing us to recover from low points.…Our view is that equity markets will finish the year at new highs."

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.

Markets
David Einhorn's Bayer Pick Hit in Monsanto Ruling; Shares of Monsanto's parent fell after a jury ruling Monday, a potential hit for Einhorn's hedge fund

By Rachael Levy
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A top stock pick of hedge-fund manager David Einhorn was stung this week by the loss of a crucial case in California, the latest potential setback for the billionaire investor.

Shares in Bayer AG fell sharply on Monday after Monsanto Co.—which the German chemical company recently acquired—was ordered to pay $289.2 million in a landmark lawsuit over whether exposure to two of its weed killers caused cancer. The ruling by a California state jury on Friday found that Monsanto's Roundup and Ranger Pro products presented a "substantial danger" to consumers, and that the St. Louis-based company knew—or should have known—the potential risks they posed.

Bayer is among the top recent holdings at Mr. Einhorn's Greenlight Capital, according to a client update reviewed by The Wall Street Journal.

Bayer and four other holdings—Brighthouse Financial Inc., General Motors Co., gold and Green Brick Partners Inc.—were Mr. Einhorn's top five positions standing to benefit from a rise in price, according to the document.

Greenlight Capital has had a rough few years, with investors pulling money from the firm. A fund that roughly tracks Greenlight's flagship strategy fell 18.2% this year through the end of July, according to the recent update sent to clients.

"Over the past three years, our results have been far worse than we could have imagined, and it's been a **bull market** to boot," Mr. Einhorn wrote in a separate recent letter. "Right now the market is telling us we are wrong, wrong, wrong about nearly everything."

Separately Tuesday, Greenlight released its latest 13-F filing, which disclosed the firm's positions at the end of the second quarter.

In the filing, Greenlight Capital said it slashed its positions in Twitter Inc. and Apple Inc. from the end of the first to second quarter of this year. Both technology stocks have risen this year. Greenlight's current positions couldn't be learned.

The firm dropped its Apple stake by about 77%, from 628,100 shares at the end of the first quarter to 142,100 at the end of the second quarter, the filings show.

The firm slashed its Twitter position by about 36%, from about 2.5 million shares at the end of the first quarter to about 1.6 million shares at the end of the second quarter, the filings show.

Bayer, whose shares are down about 10% since last Friday, said Monday that the jury's verdict was "at odds with the weight of scientific evidence, decades of real world experience and the conclusions of regulators around the world." It also noted that the verdict remains subject to post-trial motions and an appeal.

Mr. Einhorn has been pushing a bet that shares in Tesla Inc., the carmaker run by Elon Musk, will fall. Tesla shares rose last week after Mr. Musk tweeted that he had "financing secured" for a deal to take Tesla private at $420 a share. In the last week, shares have fallen back and recently traded at about $354.

The value of an investment in Mr. Einhorn's main fund was down 11.3% at the end of 2017 from the end of 2014. The **S&P 500** rose 38.3%, including dividends, in the same period. The average stock-focused hedge fund gained 18.3% in the period, according to HFR, a firm that tracks hedge funds.

Write to Rachael Levy at rachael.levy@wsj.com

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Markets

Activist Elliott Management to Push Nielsen Holdings to Sell; The New York hedge fund has accumulated a stake of more than 8% in the TV-ratings company

By Cara Lombardo
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Activist investor Elliott Management Corp. has taken a big stake in Nielsen Holdings PLC and plans to push the TV-ratings company to sell itself.

The New York hedge fund owns 8.4% of Nielsen, worth about $660 million, according to a filing Monday. The Wall Street Journal first reported Sunday that Elliott had built a sizable position and planned to urge a sale.

Multiple private-equity firms already have expressed interest in Nielsen, people familiar with the matter said, and bidders could include Elliott itself.

The news sent Nielsen shares up more than 16% premarket Monday.

Nielsen, which measures how people shop and consume media such as radio and TV, has been hurt by a rapidly changing retail environment. The company has a market value of almost $8 billion and is the **S&P 500**'s third-worst performer in 2018, with its shares off around 40% so far this year.

Nielsen's **stock price** tumbled 25% in a single day last month after the company reported a weak second quarter and lowered its revenue estimates for the year. Chief Financial Officer Jamere Jackson said in July the second quarter "was one of the most challenging quarters for our business in over a decade." He cited challenging conditions for consumer-packaged-goods clients, which hurt its "buy" business, which measures retail and consumer behavior.

The company also said Chief Executive Mitch Barns would step down at year-end and initiated a search for his successor.

New York-based Nielsen also said at the time it will consider selling the "buy" segment, which provided nearly half of its $6.6 billion in revenue last year. The remainder comes from its core television-and-media ratings businesses, called its "watch" segment. That has been doing significantly better.

Elliott believes the "buy" segment has failed to keep up with competitors such as IRI, which has invested in data-intensive offerings, while Nielsen has continued to rely on its employees to provide analysis to clients, the people said. The hedge fund wants Nielsen to initiate a strategic review of the entire business rather than just the "buy" segment.

A Nielsen spokeswoman said the board continues to evaluate how to best position the business and welcomes the views of its owners, including Elliott.

Information-services companies have been popular among private-equity buyers recently. Dun & Bradstreet Corp. this month said it would be taken private and Thomson Reuters Corp. agreed to sell a stake in its financial unit to a group led by Blackstone Group LP earlier this year.

Nielsen was taken private by several buyout firms in 2006 and went public again in 2011.

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THE WALL STREET JOURNAL.

Markets

Strong Consumption Is Breathing New Life Into Retail Stocks; U.S. retailers haven't neutralized Amazon, but consumer spending is reinvigorating their stock prices all the same

By Ben Eisen
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U.S. consumer sentiment is so strong that it is even boosting shares of once-maligned retailers.

Target Corp.'s stock jumped 3.2% on Wednesday and gained another 0.9% on Thursday after the company reported its best quarterly results in more than a decade. The gains marked the first two record highs for the stock since 2015. The retailer's shares are up 33% this year, far surpassing the **S&P 500**'s 6.9% rise.

"Like others, we're currently benefiting from a very strong consumer environment, perhaps the strongest I've seen in my career," said the company's chief executive, Brian Cornell, on an earnings call Wednesday.

Other beneficiaries include Macy's Inc., whose shares have added 51% this year, Kohl's Corp., which has risen 49%, Nordstrom Inc., which has jumped 31%, and TJX Cos., which has gained 41%.

The SPDR S&P Retail exchange-traded fund has tacked on 16% this year, including 5.6% in August alone.

"Wages are up. Employment is up. Interest rates are low. So it's really a very good economic time for consumers," said Paul Hogan, a portfolio manager and analyst at Fenimore Asset Management, which counts Ross Stores Inc. among its holdings. The off-price retailer's stock has risen 18% this year, though shares declined in after-hours trade Thursday after the latest earnings report.

Not long ago, retail stocks were in free fall as investors worried that traditional retailers couldn't compete in the new world of e-commerce. Target shares dropped 9.7% last year even as the broader market surged, marking its third straight year of declines.

Target's rebound is due partly to recent efforts to improve stores and ratchet up its e-commerce business. Other bricks-and-mortar retailers have struggled. Lingerie company L Brands Inc., for example, reported a decline in comparable sales on Thursday for the latest quarter, pushing its shares down 11% for the day.

Even so, many brands are being helped along by Americans' increasing willingness to spend. Retail sales in July rose by 6.4% from a year earlier, data showed last week, suggesting that U.S. consumers are spending at a much faster pace than inflation as they benefit from a strong economy and tax cuts, economists say.

Years of an improving labor market have given households more money to spend. Though rising fuel prices may be one wild card for the pickup in consumption, economists say they aren't particularly worried about it yet.

Meanwhile, grocery stores, department stores, restaurants and clothing stores are all seeing stronger spending, the data show. While one measure of consumer sentiment hit a one-year low recently, it remains high by historical comparison.

Beyond the cyclical trends helping these companies, some investors are betting that younger customers will increasingly shop at traditional stores as they buy their own homes and have children.

"What people have doubted is that this next generation is going to care about bricks-and-mortar retail as boring as Target," said Tony Scherrer, director of research at Smead Capital Management, which owns stock in the company and has added to it this year. "We've taken the other side of the bet."

Though retail stocks aren't as cheap as they once were, they're still finding favor among Smead and other so-called value investors. The SPDR retail ETF currently traded this week at roughly 17 times earnings over the last 12 months, versus more than 21 times for the broader **S&P 500**.

Still, for all their recent gains, traditional retailers continue to lag behind Amazon.com Inc., whose stock has soared 63% in 2018 as it has scooped up e-commerce market share. A strong economy is helping retailers at the moment, but it isn't solving all their challenges.

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Markets

Pipeline Stocks Stage a Comeback; Over the past six months, the benchmark Alerian MLP Index has risen 8.9%, outpacing the S&P 500's 6.9% gain

By Ryan Dezember
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Pipeline stocks are back from the dead.

Revved up earnings, thanks to record U.S. oil and gas production, and clarity on a federal tax ruling have lifted shares of energy master limited partnerships, which own and operate pipelines.

These companies, known as MLPs, have helped themselves as well. They have sold assets to pay down debt, reduced dependence on stock offerings to raise cash and simplified corporate structures to eliminate governance issues. Over the past six months, the benchmark Alerian MLP Index has risen 8.9%, outpacing the **S&P 500**'s 6.9% gain.

MLPs, which avoid corporate taxes by paying out earnings to shareholders, gained popularity with yield-chasing investors over the past decade.

A period of historically low interest rates coincided with the shale boom, which necessitated big investments in infrastructure to carry oil and gas from new drilling fields unlocked by modern extraction techniques. More recently, rising interest rates and a prolonged slump in energy prices that prompted MLPs to cut their once sacrosanct distributions took some of the shine off the stocks.

"The market voted with their feet in late 2015 and 2016, and investors got a lot more picky in what they wanted in a stock," said Becca Followill, senior managing director at U.S. Capital Advisors LLC in Houston. "The last few years, you've seen these companies get fixed."

From a peak in August 2014, the Alerian MLP index lost 63% before bottoming out in February 2016. MLP shares rebounded somewhat alongside rising U.S. **oil prices** but were dealt a fresh blow in March.

On March 15, the Federal Energy Regulatory Commission announced a ruling that threatened tax advantages for some pipeline-owning MLPs. Shares of some of the country's largest pipeline operators, including Enbridge Energy Partners LP and Williams Cos., plunged more than 10% that day.

But regulators offered additional details last month around the ruling that alleviated many investor concerns. The sector index has since climbed 6.6%.

Pipeline operators have also broadly benefited from resurgent production in nearly every drilling region in the country and commodities prices that have stabilized amid strong demand. Ms. Followill wrote in a note to clients that third-quarter earnings results were broadly the pipeline sector's best since 2014.

As Energy Transfer Partners LP Chief Executive Kelcy Warren put it earlier this month: "A monkey could make money in this business right now. It's not hard."

Analysts and investors also point to a big reduction in equity issuance by pipeline operators, which in earlier years made a habit of tapping equity markets whenever they needed cash. Such offerings dilute the value of existing shares. Through July, MLPs issued $3.7 billion of equity, compared with nearly $36 billion in 2014, according to Goldman Sachs Asset Management Group.

Pipeline operators have in many cases turned to private-equity firms to make up the difference, selling assets and stakes in major projects to big investment firms, such as Blackstone Group LP, KKR & Co. and Global

Infrastructure Partners. Such firms have flocked to the pipeline business because it has historically been a way to invest large sums and receive reliable returns when other deals, such as leveraged buyouts and other infrastructure projects, have become more scarce.

There is more than $135 billion of ready-to-invest cash in North America-focused energy and infrastructure funds, according to private fund tracker Preqin.

"Private equity is filling the gap," said Jason Downie, managing partner at Tailwater Capital, a Dallas firm that recently raised $1 billion to invest in pipelines and other energy infrastructure.

This week, for instance, Tailwater's Silver Creek Midstream LLC agreed to pay Genesis Energy LP $300 million for a Wyoming oil pipeline system. Genesis said it would use the cash to pay down its debt.

Another trend that has been drawing investors to MLPs are mergers designed to streamline corporate structures and remove governance issues.

For instance, Energy Transfer Partners, Mr. Warren's company, is merging with its parent, Energy Transfer Equity LP, in a deal scheduled to close later this year. A key element of the combination will be the elimination of incentive distribution rights, which entitle Energy Transfer Equity to a larger cut of payouts from Energy Transfer Partners than other shareholders.

Such complexities are unique to MLPs and have "kept some investors on the sidelines," said Jeff Jorgensen, portfolio manager in Brookfield Asset Management Inc.'s public-equities arm.

The wave of simplification deals "demystifies what was a very niche asset class and gets the focus back on fundamentals," he said.

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Economy

Treasury Plans to Boost Borrowing as Trillion-Dollar Deficits Loom; Move could boost the cost of credit, rippling through the economy

By Josh Zumbrun and Daniel Kruger
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WASHINGTON—Rising federal budget deficits are boosting the U.S. Treasury's borrowing and could restrain a fast-growing economy as the cost of credit rises, too.

The yield of **10**-**year Treasury** notes climbed above 3% for the first time since June, as the Treasury Department announced it would increase auctions of U.S. debt by an additional $30 billion over the next three months. That included higher sales of two-year, three-year and five-year notes and the introduction of a new short-term security with a two-month maturity. The Treasury gets cash to fund the government in exchange for selling the securities.

In all, the Treasury plans to borrow $329 billion from July through September—up $56 billion from the agency's April estimate—in addition to $440 billion in October through December. The figures are 63% higher than what the Treasury borrowed during the same six-month period last year.

The Treasury's Borrowing Advisory Committee, made up of representatives from investment funds and banks, said the size of monthly debt auctions would need to continue ratcheting higher to fund government deficits in coming years.

The rising supply of debt could push up the cost of borrowing as the government seeks to attract investors, though many factors, including the inflation outlook, Federal Reserve decisions and shifting investor appetites for safe securities also play roles in setting interest rates.

The size of U.S. government borrowing in coming years is hanging over the bond market. In addition to the increased spending forecast for the federal government, there is concern about lower tax revenue.

"That's part of the equation people haven't been talking about," said Ian Lyngen, head of U.S. government bond strategy at BMO Capital Markets. "The notion that tax reforms are going to pay for themselves is being tested right now."

Many analysts and investors expect these developments will ultimately lead to higher borrowing costs for the U.S. government.

While the U.S. fiscal outlook, with years of trillion-dollar deficits ahead, concerns investors and analysts, many say its status of issuing the world's safest securities will help to restrain interest rates from rising too much.

"U.S. debt is considered such a solid place to park your money that we continue to see solid demand," said Anwiti Bahuguna, a portfolio manager with Columbia Threadneedle Investments.

Because Treasury securities are a benchmark used to help set interest rates on mortgages, business loans and consumer debt, analysts expect higher Treasury rates to ripple through the economy, potentially crowding out other borrowing and restraining an economy that has been on a tear.

"It's higher rates for everyone," said Andrew Brenner, head of global fixed-income at NatAlliance Securities.

Mortgage rates have moved higher over the past year—the average 30-year fixed-rate mortgage stood at 4.84% last week, near its highest level in seven years. Applications for mortgages to purchase homes have held steady, rising 1% over the year, according to Mortgage Bankers Association data released Wednesday.

Housing could "enter a period of slower sales and price increases," said Lou Barnes, a mortgage banker in Boulder, Colo. However he said that wasn't a signal of economic distress, because other factors are driving the slowdown, notably an insufficient supply of homes.

A 5% mortgage rate, he said, left mortgages in many parts of the country "eminently affordable." But he added he would be worried if rates rose to 6%.

Other consumer borrowing rates are climbing as the Fed raises short-term rates. The prime interest rate that many banks use to set credit card and personal loan rates was 5% in June, up from 4.25% a year ago.

The Fed has been raising short-term interest rates to ensure the fast-growing economy doesn't overheat. The central bank also has been gradually shrinking a portfolio of mortgage and Treasury securities it accumulated during and after the 2007-2009 recession, adding to the supply of bonds investors are being asked to soak up. On Wednesday, the Fed said in a policy statement after a two-day meeting the economy was strong and it would continue its strategy.

The government is likely to run trillion-dollar deficits—the amount by which spending will outpace revenue—for the next four years, according to Office of Management and Budget projections released last month.

Deficits are rising in part because federal spending has been ramped up and because corporate and individual tax rates were cut last year. White House officials say reductions in tax rates spur economic growth and raise tax revenue by boosting taxable household and business income.

For now, tax-rate reductions appear to be restraining government revenue because less tax is being generated for every dollar of household and business income earned. The Treasury Department said last month that tax receipts fell 7% in June from the same month a year ago, including a 33% drop in gross corporate taxes.

"Everyone thinks we won't have a problem financing trillion-dollar deficits until we have one," said Brian Edmonds, head of Treasury trading at Cantor Fitzgerald LP.

The Treasury made the announcement of increased auction sizes as part of its regular schedule of quarterly borrowing statements. Several investors and debt analysts said the Treasury's strategy remains consistent with expectations in the bond market, and that they expect demand to remain steady as auction sizes increase.

Yields on **10**-**year Treasury** notes, used as a reference for everything from mortgages to student loans, rose to 3.001% Wednesday, the highest level since May 23. The yield is up nearly three quarters of a percentage point in the past year.

The latest uptick was also influenced by the Bank of Japan's decision to lift a ceiling it had placed on Japanese government bond yields, a signal to investors that the central bank is loosening its support for bond markets.

With the backdrop of monetary policy around the world becoming tighter, it could increase pressure on bond yields around the world to rise, said Charlie Ripley, senior investment strategist at Allianz Investment Management.

Some investors have grown worried about the Treasury ramping up debt issuance, pointing out that bigger waves of debt are hitting the market when global central banks are beginning to wind down the massive bond-buying programs they put in place after the financial crisis.

The effect of increased debt levels "depends on how many people want to buy your debt," said Don Ellenberger, head of multiasset strategies at Federated Investors. The U.S. has benefited from demand for Treasurys from Europe and Asia, which has kept borrowing costs relatively low.

"As long as there's demand, you can deal with higher debt," Mr. Ellenberger said. Yet, "if you start to see rates rising higher in Germany and Japan, and investors get a better homegrown alternative, that would siphon off demand for U.S. Treasurys."

Bond yields, which rise as prices fall, had retreated in recent months as fractious negotiations between the U.S. and its trade partners sent investors to the safety of assets such as government bonds.

But in recent weeks, strong U.S. economic data, as well as announcements suggesting the U.S. and the European Union may be amenable to softening their trade stances, have chipped away at investor demand for safe havens.

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The Myth of the All-Powerful Federal Reserve

By David Ranson
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Many investors and policy makers are concerned about the narrowing gap between yields on short- and long-term Treasurys. They warn that an inverted yield curve -- when short-term Treasurys have higher yields than long-term ones -- would presage a recession. But evidence from the past six decades suggests the conventional wisdom is outdated: Federal Reserve interest-rate policy no longer plays a decisive role in determining economic growth.

The Fed remains intent on returning the short-term interest rate to its "normal," prerecession level. In 2007 the fed-funds rate averaged 5%. Today long-term Treasury bonds yield around 3%. That means that normalizing the federal-funds rate would require inverting the yield curve. Would this threaten the economy's newfound vitality?

Inverted yield curves and recessions have been linked for decades, but the connection is deceiving in two respects. First, it's the increase in rates, rather than their actual level, that correlates with recessions. Before 2007 recessions and inverted curves were always preceded by large hikes in the Fed's rate target. This gave the false impression that rate levels mattered.

Second, the change in short rates, rather than long rates, is what made the difference in the past. In my statistical analyses of how movements in short and long rates compete to explain growth, the long rate consistently loses. The long rate is statistically insignificant and can be safely ignored.

If the yield curve is irrelevant to economic growth, do any Fed rate actions influence the probability of a recession? They once did, but my research suggests the Fed no longer has that power. This may sound like a radical proposition. Yet there are numerous examples of significant economic relationships that work well for a time but eventually weaken and disappear.

In the 1960s growth in the money supply and the economy's performance were strongly correlated. But banking regulation, governing such matters as the payment of interest on deposits, changed. Financial institutions adjusted their practices, and over the years the meaning of "money" shifted. The correlation weakened. Economics moved on.

When the price of crude oil quadrupled without warning in 1973, the U.S. economy nearly turned upside down. Markets were unprepared for such an unprecedented event, but they learned. Further spikes in the **oil price** followed with less recessionary effect. Today few believe that an oil crisis alone could trigger a recession. The economy has become less vulnerable to imported oil, and markets expect **oil prices** to be **volatile** and now can cope better.

The vulnerability of the economy to an interruption in the normal course of business arises from two sources, each related to market unpreparedness. One is the shock effect: the sudden, surprising nature of the triggering force. The more warning given, the less damage done. The other is the depth and resilience of markets -- that is, their capacity to allow buyers and sellers to hedge.

The relationship between short-rate movements and economic growth resembles the oil story. The effect dissipated over time; in recent decades there has been little sign of a connection. The evidence of a slow decline can be summarized by dividing the past six decades into two 30-year periods. Between 1957 and 1987, I found the year-to-year correlation to be minus 0.73 and significant statistically at very high confidence. The subsequent 30 years produced an insignificant correlation, minus 0.02.

What could cause the disappearance of such a long-established connection between short-term rate increases and recessions? In the past the Fed not only relied on the shock value of its rate actions; it imposed them on **financial markets** that were far less sophisticated and resilient. The Fed's interest-rate actions are now gradual and telegraphed well in advance, and there are many more ways for investors to cope with interest-rate risk. Rate increases may or may not be desirable, but markets can take them in their stride.

Mr. Ranson is head of research at HCWE & Co. in Portland, Ore.

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business
Turkey's Financial Crisis Surprised Many. Except This Analyst.

By LANDON THOMAS Jr.
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For the last seven years, Tim Lee has been warning that a financial crisis in Turkey would set off a wider calamity in global markets.

Just about nobody listened — until now.

A plunge in the Turkish lira and the prospect that the country might soon need a bailout has spurred an investor exodus in Turkey, one that gathered steam on Friday as the currency dropped as much as 16 percent. Relative to the dollar, the lira is now down 70 percent this year; one dollar buys 6.4 lira, the most ever.

There are signs of the rout spreading beyond Turkey. The stock prices of European banks, which have been big lenders to their Turkish counterparts, dropped sharply on Friday, with investors worried that a wave of corporate bankruptcies in Turkey would lead to a banking bust in the country. The currencies of China, Brazil and Mexico also weakened. And in the United States, major **stock-market** indexes fell more than 1 percent before recovering slightly.

Suddenly, Mr. Lee's largely ignored prophecy — that a decade of Turkish companies and real estate developers gorging on cheap foreign debt would end badly, not just for Turkey but for the world — does not seem so outlandish.

"Turkey is the canary in the coal mine," Mr. Lee said Friday. "We are going have another crash that will be worse than 2008 in certain ways."

This is not a widely held view. Despite Friday's weakness, United States stock markets remain near their highs. Anxiety about trade wars with China and Europe has been largely cast aside. Even **financial markets** in developing countries, which tend to swoon in unison when one of their peers implodes, recently have been doing well.

Mr. Lee, 58, made his initial call — that Turkey was in deep financial trouble — in 2011.

A soft-spoken Englishman who eschews financial television and social media, Mr. Lee started writing an investment newsletter in 2003 after two decades working as an economist for the British mutual fund company GT Management.

He writes the newsletter, called piEconomics, from a Greenwich, Conn., office where he now works alone. The publication is simple: 10 pages of dense text supplemented with the occasional chart. His subscribers are a small cluster of European investment funds.

Toward the end of 2011, Mr. Lee published an installment of the newsletter in which he predicted that Turkey would need a $100 billion bailout.

At the time, central banks all over the world were pumping money into their economies, which were struggling to recuperate from the financial crisis.

Mr. Lee noticed that Turkish banks were borrowing in dollars to make other loans to fast-growing Turkish companies. He also saw that, over all, Turkey's economy was growing more reliant on financing from foreign investors. It struck him as similar to what had happened to Thailand in the years before the Asian financial crisis in 1997.

In his monthly notes to investors, he kept returning to the topic of Turkey and the risks there.

In a 2013 newsletter, he got more specific: The lira, then trading at 1.9 to the dollar, would crater to 7.2.

At the time, the Turkish economy was humming. The odds of a blowup looked remote. The idea of the lira ever trading at 7.2 seemed ludicrous. It was easy for people to ignore Mr. Lee's fantastical-sounding warning.

But Mr. Lee was on to something, even if his prediction was a half-decade premature. Over the next five years, the economic situation in Turkey deteriorated, as he had anticipated.

One side effect of having trillions of dollars of new money sloshing around courtesy of central banks was that it became much easier for governments and companies in hot economies like Turkey's to borrow money in dollars — as opposed to their own currencies — to finance their investments or other growth plans.

Today, according to the Institute of International Finance, a banking trade group, corporate debt in foreign currencies is $5.5 trillion, the most ever.

And Turkey relies on such foreign-currency debt more than any other major emerging market. Corporate, financial and other debt denominated in foreign currencies, mostly dollars, represents about 70 percent of Turkey's economy, according to the I.I.F. Turkish companies and real estate developers used borrowed dollars to pay for new factories, shopping malls and the skyscrapers that now define the Istanbul skyline.

The threat is that as the lira loses value, it becomes more expensive for Turkish companies to repay their dollar-denominated loans. Indeed, a growing number of companies in Turkey already have said they cannot repay these loans.

"Companies there just ignored all the risks and kept borrowing in dollars," Mr. Lee said.

And that has the potential to spread far and wide. American investors, for example, own nearly 25 percent of outstanding Turkish bonds and more than half of publicly traded Turkish stocks, according to the I.I.F.

Mr. Lee these days is far from the only one warning about the Turkish economy and financial system. The thing that really worries him and other **bearish** investors is that Turkey could be a signal for what lies ahead for assets and economies that were inflated by cheap debt.

"I think that most people have not thought through the broader implications of what is happening in Turkey," said Justin Leverenz, who manages the Oppenheimer Developing Markets Fund, the largest of its kind in the United States. "I could see global growth being much weaker than people think." Bracing for stressful times ahead, Mr. Leverenz recently reduced the fund's exposure to Turkey to nearly zero.

If Mr. Lee's 2011 call now looks prescient, it hasn't won him much new business.

Lately, just as Turkey began its crack up, a number of his clients have left him.

Yes, he might have been right on Turkey. But his persistent gloom was wearing thin, especially as the markets continued to soar.

"It has been some hard sledding," Mr. Lee admitted. "I have lost a lot of clients because I have been too **bearish**."

Yet he is doubling down on his doomsday message: The river of global cash will dry up, the dollar will spike and there will be a series of financial seizures. Investors, he thinks, will flee developing economies, then Europe and eventually the American stock and bond markets.

"It won't be a banking crisis this time around — it will be a **financial market** crisis," Mr. Lee said. "And I am very confident that it will happen."

* Tensions Between Turkey and U.S. Soar as Trump Orders New Sanctions

* Trump Hits Turkey When It's Down, Doubling Tariffs

* Turkey's Economy Is So Hot That It May Face a Meltdown

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EXCHANGE --- Banking & Finance News: Tesla Shorts Lose $1.7 Billion but Hold Firm

By Akane Otani
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Short sellers taking aim at Tesla Inc. are holding on to bets that the electric-car maker is on borrowed time, undeterred by the stock's biggest one-week rally in years.

Heading into the electric-car maker's earnings report late Wednesday, investors who had placed wagers on Tesla shares falling had racked up about $10.5 billion in short interest -- making Tesla the most shorted stock in the U.S. on a dollar basis, according to financial-analytics firm S3 Partners.

Short sellers borrow shares and then sell them, hoping to buy back the shares at lower prices and then pocket the difference.

Those bets turned into a $1.7 billion loss Thursday after Tesla's results showed it burned through less cash than investors expected. Tesla shares jumped 16% to $349.54, part of a weekly gain that was Tesla's biggest since 2013 and one that wiped out all of short sellers' profits for the year. The shares fell $1.37 Friday.

Despite the whiplash, there were few signs of naysayers rushing to dump their positions. As of Thursday morning, Tesla remained the most heavily shorted stock in the U.S., attracting $4 billion more short interest than the second-most-shorted stock on the list, Apple Inc., according to Ihor Dusaniwsky, head of predictive analytics at S3 Partners.

After the rally at the end of trading Thursday, Tesla short interest had increased to about $12.6 billion, S3 Partners added.

For longtime Tesla skeptics, the reason was simple: Betting against Tesla has long been a **volatile** and money-losing trade, with the company's shares up more than 1,900% from its 2010 initial public offering price of $17. One post-earnings rally isn't enough to shake their conviction that the company, whose electric cars have upended the conventional automobile industry, is running through cash at an unsustainable pace.

"It's pounded my fund's performance over the last 18 months . . . but I don't let the **stock price** change how I feel about the company," said Mark Spiegel, who says his hedge fund, Stanphyl Capital, has been shorting Tesla for years and would continue to do so for the foreseeable future.

Mr. Spiegel said he first began shorting Tesla around 2013, when its share price was trading in the high $90s. Once it got to around $200, "I thought, this is beyond ridiculous, and that's when I got a lot shorter," he said.

Wednesday's earnings report did little to impress Mr. Spiegel, who said he is troubled by competition from luxury auto makers that plan to roll out their own electric vehicles and issues with product delays, along with the pace at which the company has plowed through its cash.

Other investors with short positions in Tesla have cited skepticism over whether the company would be able to contend with challenges including product delays, layoffs and competition for the firm's Models S and X vehicles.

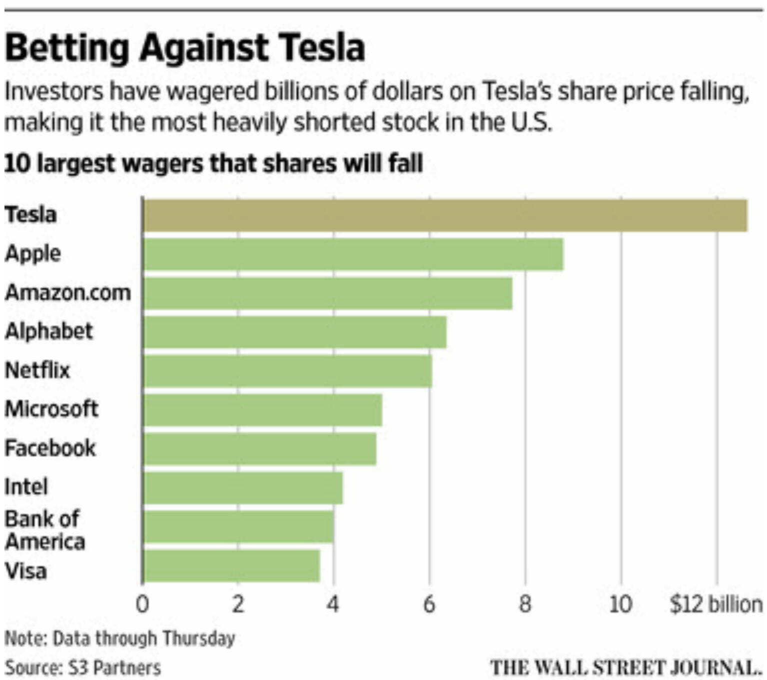
Hedge fund Greenlight Capital Inc.'s short position in Tesla, whose shares jumped 29% last quarter, was its second-biggest loser throughout that period, according to a letter the firm's president, David Einhorn, distributed to investors this past week. Still, in his letter, Mr. Einhorn maintained that 2019 would likely be "a very challenging year" for Tesla.

Tesla shorts still face a long road to profitability after the latest rally. Investors who had bet on shares sliding are down $1.4 billion year to date, data from S3 Partners show.

Going back to 2016, Tesla shorts are down $6.4 billion, making it the third-worst-performing short over that time behind Nvidia and Amazon.com, according to S3 Partners.

Tesla isn't the only high-profile tech stock investors are betting against. The eight most-shorted U.S. stocks are all in the technology industry, with Apple, Amazon.com Inc., Alphabet Inc. and Netflix Inc. rounding out the list of the top five most-shorted U.S. companies, according to S3 Partners.

The bets reflect broad skepticism that technology companies, which have dominated the latest leg of the **bull market**, can continue meeting investors' lofty expectations. Disappointing results from Netflix sent the stock last month on its biggest one-day slide in years, while Facebook Inc. notched the worst-ever one-day loss in market cap for a publicly traded U.S. firm following its latest quarterly earnings report.



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WSJ PRO CENTRAL BANKING

Economy
Jerome Powell Defends Policy of Gradually Raising Interest Rates; Remarks at Jackson Hole affirm Fed's plan to raise rates at least to a level that neither spurs nor slows growth

By Nick Timiraos
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JACKSON HOLE, Wyo.—Federal Reserve Chairman Jerome Powell defended the central bank's strategy of gradually raising interest rates against criticisms that the central bank is moving either too quickly or too slowly, jeopardizing the economy's expansion.

Mr. Powell, in remarks Friday at an annual central banking conference in the Grand Tetons, built out the case for lifting rates so long as inflation is stable and unemployment falling, in order to keep the economy on an even keel. He also pushed back against critiques that the Fed is risking high inflation or asset bubbles by raising rates too slowly.

The Fed faces two major risks, of "moving too fast and needlessly shortening the expansion, versus moving too slowly and risking a destabilizing overheating," he said. "The current path … [is] taking seriously both of these risks."

Minutes of the Fed's most recent policy meeting signaled officials are ready to raise their short-term benchmark rate at their Sept. 25-26 meeting. The Fed has raised the rate twice this year, most recently in June to a range between 1.75% and 2%.

Mr. Powell's remarks were his first public comments since President Trump's recent criticisms of the Fed's rate increases. While Mr. Powell's speech has been in the works for months, its message took on extra import after Mr. Trump chided the Fed's moves, which he said worked against his efforts to boost growth.

The president told donors recently he was annoyed that Mr. Powell, whom he selected last fall to succeed Janet Yellen, was raising rates. Such criticism marked the end of a 25-year period in which presidents refrained from publicly commenting on monetary policy.

Mr. Powell's speech underscored the Fed's intent to operate independently of any political pressure—even from the White House. Objections from politicians, including the president, will have no effect "at all," said Dallas Fed President Robert Kaplan in an interview Thursday.

Markets appeared to welcome the Fed chairman's stance, with U.S. stocks jumping and bond yields falling after his remarks were released. Bond yields fall as prices rise. The **Dow Jones Industrial Average** closed higher at 25790.35, up 0.52%.

Mr. Powell said he sees no signs of a sharp rise in inflation above the Fed's 2% target or an elevated risk of the economy overheating. "This is good news, and we believe that this good news results in part" from the Fed's recent policy moves, he said.

The speech offered his clearest thinking on why the Fed has adopted its strategy of raising rates at a slower pace than in past periods, even though it is closer than it has been in two decades to meeting its mandate of boosting employment and keeping prices stable, which it measures against the 2% inflation goal.

While Mr. Trump complains the Fed is moving too aggressively, other critics say it risks excessive inflation by raising rates too slowly.

Some of those warnings have come from Mr. Powell's own staff. A paper released Thursday from a quintet of senior Fed staff economists warned against ignoring continued declines in the unemployment rate once it has fallen to low levels. While Mr. Powell's speech cited the research, he didn't emphasize as strongly its conclusion.

Mr. Powell highlighted two contrasting historical episodes that he said should inform the Fed's current thinking. The first was the period of sustained, rising inflation during the 1970s.

In the second, the economic boom of the 1990s, traditional models suggested low unemployment should boost price pressures. Instead, inflation remained stable because then-Fed Chairman Alan Greenspan recognized before many others that the economy could grow faster than before without fanning price pressures. Eventually, though, the '90s expansion ended in a recession after the tech stock bubble burst.

Mr. Powell described several variables that can't be precisely identified but are critical to setting monetary policy as akin to stars that help sailors navigate on the open seas. These variables include a measure of an unemployment rate below which inflation pressures build, and a neutral level of interest rates that neither spurs nor slows growth.

He has voiced skepticism about putting too much emphasis on these "stars," saying Friday they "are sometimes far from where we perceive them to be."

Mr. Powell said the Fed in the mid-1990s avoided the mistakes of the 1970s, in which officials misdiagnosed those variables by "overemphasizing imprecise estimates of the stars."

Mr. Greenspan, in contrast, adopted a "wait-and-see" approach that boiled down to waiting from each Fed meeting to the next for signs of inflation before continuing with rate increases.

Moreover, because of changes in the behavior of inflation by the 1990s, "there was a smaller risk that an inflation uptick under Greenspan's ‘wait and see' approach would become a significant problem," Mr. Powell said.

The Fed should be more inclined to adopt a similar approach today, Mr. Powell said. "When you are uncertain about the effects of your actions, you should move conservatively," said Mr. Powell. "In other words, when unsure of the potency of a medicine, start with a somewhat smaller dose."

Mr. Powell outlined two exceptions to this rule: when inflation expectations are running too high, too quickly, and when the economy needs aggressive stimulus because interest rates have fallen to zero.

Mr. Powell also highlighted the risk of financial excesses, even if inflation remains tame. Because inflation has responded only weakly to declining labor slack, inflation "may no longer be the first or best indicator of a tight labor market and rising pressures on resource utilization," he said. "Thus, risk management suggests looking beyond inflation for signs of excesses."

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WSJ PRO CENTRAL BANKING

Economy

Transcript: St. Louis Fed President James Bullard; In CNBC interview, Bullard addresses why he's not a big believer in the Phillips curve and more

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Federal Reserve Bank of St. Louis President James Bullard sat down for an interview with CNBC's Steve Liesman, Becky Quick, Joe Kernen and Steve Grasso on Friday, Aug. 24, 2018. They discussed the yield curve, the Phillips curve, monetary policy and other topics. Here is a transcript of the exchange, lightly edited for length and clarity.

MR. LIESMAN: I think the yield curve might be an interesting place to start off. Twenty-one basis points separates the two-year note from the 10-year note. It's not very much. What signal does that send to you about the economy and about your outlook for where rates ought to go?

MR. BULLARD: Yeah, I started talking about this last December, and there has been a good debate on Wall Street and within the Fed about what to do. A lot of people have said maybe we shouldn't knowingly invert the yield curve. I agree with that. I don't think there's any reason to take on the yield curve, take on the possible recession risk that you'd be inviting. And so I think we should be very careful.

MR. LIESMAN: Is this the market saying no more—that you're here, you're where you want to be, you're at neutral already.

MR. BULLARD: The market is not seeing that much growth out in the future. They're not seeing that much inflation pressure, or maybe very little inflation pressure out there in the future, and that's why the **10**-**year** [**Treasury** note's yield] hasn't been able to meaningfully break through 3% and stay above. I think you could still cling to the hope as we continue to raise rates that the long end will go up, but it's not looking like it just sitting here today.

MR. LIESMAN: We just had a very strong quarter, 4.1% [annual rate of growth in gross domestic product in the second quarter.] Our CNBC rapid update tracking, other tracking forecast is at 3.2 [percent growth in the third quarter] this morning, another strong quarter after that. Have you changed your growth outlook for 2018? And do you think it continues?

MR. BULLARD: Well, I think it's going to be a good year, and part of that is fiscal stimulus and other factors that have come into this year. But the point is it's going to slow in 2019 and 2020. That's the standard forecast that's out there. So this is—as a baseline, I think that's what you should have in mind.

MR. LIESMAN: The administration has a point of view on this which seems to be different from what I'm hearing from a lot—from the Federal Reserve. The administration thinks it can sort of change the DNA of the economy, so to speak, in that it can raise potential growth by cutting taxes on corporations, increasing capital investment, increasing productivity, and ultimately this leads to real wage gains. Do you not buy into that scenario?

MR. BULLARD: No, those are beautiful things and laudable goals. And, you know, the deregulation agenda is pushing in that direction. The corporate tax cuts are pushing in that direction. But from a policy maker perspective, for monetary policy, that should not be our baseline case. Our baseline case should be probably the growth that we're seeing now taper off and it will go back to potential, which is pretty low.

MR. LIESMAN: So no change to the potential?

MR. BULLARD: So, you know, potential could come up to 2% or, you know, a lot of people in the Fed have it at 1¾, maybe 2%, maybe a little over 2%, but not 3 or 4%. But if it does happen, take that onboard. You know, we can make policy if that does happen.

MR. LIESMAN: So don't anticipate it, but be ready for it. OK.

MR. BULLARD: Yeah, you don't have to be pre-emptive about that. You can hope that that happens and not be pre-emptive about it.

BECKY QUICK: Just speaking about wage gains, we were having a conversation earlier this morning and Peter Boockvar posited that we are, in fact, seeing wage gains go to a broad array of people, but the reason he thinks it's not showing up in the average hourly earnings is because you have so many new people coming into the workforce and that they're going to be at lower levels; so maybe, if you look at average hourly earnings, it's masking a bigger number of wage gains that are really going to a lot of people. What do you think about that theory?

MR. BULLARD: Yeah, you do have other measures that you can look at. The Atlanta Fed's Wage Tracker is one. That compares people in the same jobs. You can also look at the employment cost index year over year. That's in the high 2s. So I think kind of no matter how you cut it, we're probably not seeing too much.

One thing I would say about wage gains, though, productivity gains have been low, around 1% on average, and inflation's been below 2. So if you're looking at nominal wages, you'd only expect something in the upper 2s. So I don't see it as being out of line with what has actually happened. It's just not as cyclical as maybe some people would have expected.

JOE KERNEN: Hey, Jim, we always talk about how crazy it is that, you know, we've been waiting so long for the **10**-**year** [**Treasury** note yield] to start heading higher. And then everybody says, well, it's tethered to the German bund, which is, you know, 30—whatever it is, 30 basis points, so it's tethered down there. So how do you know that this yield curve you are afraid to take on, how do you know that that's not a function of what's going on over in Europe? It just seems weird to me that the bond market is global but, you know, inflation is disparate and varied all over the world. So they got this crazy number over there and we're basing our yield curve on totally different economic conditions that are present in the rest of the world, and once again you might end up being behind the curve because we're responding to influences from a completely different place. And maybe inflation and other factors really warrant higher rates here.

MR. BULLARD: Joe, I was in the Fed in 2000-2001. The yield curve was inverted. We pooh-poohed it. We got it wrong. [Then-Fed Chairman Alan] Greenspan had it wrong. 2006, one of the first speeches [then-Fed Chairman Ben] Bernanke gave was on the yield curve. He pooh-poohed it. He got it wrong. I do not want to play this game over again. We have to take the signal seriously.

MR. KERNEN: So you don't care that we're basing our interest rates on economies that are multispeed all around the world, and we're tethered to these low rates but maybe we shouldn't be?

MR. BULLARD: I appreciate the global argument. But as far as inflation in the U.S., I just don't see much inflation pressure, and the reason you'd want to be pre-emptive would be to shut down incipient inflation. And the market is not seeing that. I'm not seeing it in the [Treasury inflation-protected securities] market. I'm an inflation hawk, but I just don't see that developing. And if it does develop, I think we could react and react appropriately. So I just don't think this is a situation where we have to be pre-emptive.

MR. LIESMAN: Let me see if I can wrap it up in terms of what your outlook is. You think the Fed ought to be done for the year in terms of raising rates?

MR. BULLARD: Yeah. I think, you know, if it was just me, I'd stand pat where we are and then I'd try to react to data as it comes in. I'd look for inflation or inflation expectations, see if they are moving up.

What I like about the TIPS-based measures of inflation expectations is they have already incorporated all this in. They have already thought about the German bund. They have already thought about the fiscal policy that has come onboard. They have already thought about the fast growth. They still don't see much inflation.

MR. LIESMAN: But they already may have factored in two Fed rate hikes.

MR. BULLARD: No, they are factoring in what they think we're going to do, but they're more dovish—the market is more dovish than the Fed.

MR. LIESMAN: That is true. The spreads are less.

MR. BULLARD: So they think we're going to be more dovish, and they still don't see very much inflation even with all those things going.

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MR. LIESMAN: Let me ask you how you react to comments by the president of the United States about Fed policy.

MR. BULLARD: We have a mandate by law, and so we do the best we can to try to hit the mandate. Lots of politicians comment, actually, on monetary policy. We have hearings before Congress. The senators and the congressmen get to comment. It's not unusual, historically, for presidents to comment. So I think in this day and age we're probably going to get comments from the White House.

STEVE GRASSO: So I love your perspective looking back at Greenspan because he did raise rates in the face of an inverted yield curve. That was the wrong thing to do, looking backwards. [Fed Chairman Jerome] Powell, he is boggled by the fact that there's no inflation. Why are we having this debate about raising rates?

MR. BULLARD: Because many people are sticking to their Phillips curve arguments. The Phillips curve has not been a very effective way to predict inflation over the last 20 years. And unemployment's low. A lot of people have in mind that that's going to lead to inflation, therefore we need to slow the economy down. I do not think that's a good way to think of policy in this particular environment, and I would focus more on where we think market expectations of inflation are.

MR. LIESMAN: Jim, where do you see the biggest risks right now?

MR. BULLARD: You know, I was thinking, coming out to Jackson Hole here, this—we've not been in as good a situation as we are today for a long time, I think, coming out here. A lot of times we were in crisis mode when we were doing this…So I do think we're in good shape for today. But monetary policy is about trying to think out—you know, to play it out two years ahead.

MR. LIESMAN: Sure. But if you have it wrong, is it wrong to the downside? Are you still more worried about lower inflation or disinflation—

MR. BULLARD: Inflation has been so slow, so sluggish, so low that I really think that if we all of a sudden got some heat we could just move rates up and probably contain it pretty easily. But what can happen here is that you tip—it's a long expansion here; you could tip into recession if we play this wrong.

MR. LIESMAN: But pick up on what Joe was saying, because I think he has…identified the right risk in terms of what people are talking about, which is, OK, right now the U.S. is tightening, but Europe and Japan remain very easy, and they appear to be easy out into the horizon that we can see.

What does the world look like if Europe and Japan start to tighten along with the United States? Are there risks out there? And especially, you know, something mentioned a lot by the critics of the Federal Reserve, which is that low interest rate policy has fueled misallocation of capital, which means that there's stuff that's going to burst when the Fed and everybody starts tightening.

MR. BULLARD: Yeah, I would say if they start tightening it's probably good news because it probably means they've got something good happening in their economies.

MR. LIESMAN: Fair enough.

MR. BULLARD: Europe did have a good year in 2017; a little bit weaker data this year. So, if they came around, I think it would probably be good news for…the G-7 economies, that they are picking up.

MR. LIESMAN: But you don't worry about an environment where all three central banks are taking out that easy monetary policy.

MR. BULLARD: Well, if they were doing it randomly, then I would worry about it. If they were doing it in response to better economic conditions or inflation pressure, I think that—you know, inflation in Europe is even lower than it is here on their preferred measures. And Japan has struggled, as well, to get their inflation rate up.

MR. KERNEN: Let's say someone asked me to write a history book and I had to—on one of the chapters it's how the Fed's response to the financial crisis, which was extraordinary and never anything like it before, can I write the history book now and say the Fed successfully navigated through the financial crisis and there was no problems with the unwind? Is that behind us? Because I still hear people saying the Fed still has this in front of it and we've never done it before. Can I write that history book, or will I need to send out an abridged edition or something?

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MR. BULLARD: (Laughs.) Well, it does seem like a never-ending story. I do think the Fed navigated the crisis. Whether we navigated it as successfully as we could, it'll now be a debate that rages on probably for 50 years or more.

As far as whether the normalization process is over, I'm very much of the mind that we should not think that we're hearkening back to the 1990s or 2000 or trying to get rates to those levels. If you look at short-term rates, they've been declining. Short-term real rates have been declining since the '80s, some 600 basis points lower than they once were. And so we're in this very low real rate era and we have to tread very lightly on what we're doing here. Two percent is not—2% today is certainly not what it was in the mid-'90s.

MR. LIESMAN: Jim, let me follow up here and maybe wrap this up in the question. There are protesters here who say the Fed wants higher unemployment and there are people who say that this is the wrong time to tap on the brakes. How far should the Fed let this economy run—3.9% unemployment, we're still [adding] 200,000 jobs a month in an economy that everybody thought was done or out of workers?

MR. BULLARD: You've got to love that number, yeah. (Laughs.)

MR. LIESMAN: You have to love it. But as a central banker—you describe yourself as an inflation hawk—it should make you nervous, given the Phillips curve—

MR. BULLARD: I'm an inflation hawk, but I'm not a very big believer in the Phillips curve.

So I just—yeah, I don't think that low employment's a threat, and it's really an opportunity to do a lot of good things in the labor market. You can pull African-American unemployment down to levels that are more consistent—Hispanic unemployment lower—that are more consistent with unemployment in the rest of the economy. You can get people into jobs who have been marginally attached to the workforce. That will set them up to survive the next recession, do better during the next recession. So I think there are a lot of good things that can happen. They can be developing human capital if we can get them into the game here. So, you know, like I said, I'm just not seeing that much on the inflation side, or, frankly, on the financial stability side either.

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Economy

U.S. Producer Prices Tame in July; Rising oil prices, demand from U.S. consumers and businesses have helped push annual index higher

By Sarah Chaney
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A measure of business inflation showed signs of moderating in July.

The producer-price index, a measure of the prices businesses receive for their goods and services, was flat in July from a month earlier, the Labor Department said Thursday.

A core measure of prices, which excludes the volatile food and energy categories, was up 0.1% in July from the prior month.

Rising oil prices and improved demand from U.S. consumers and businesses have helped push the annual index for overall prices higher over time. Even that measure took a pause at 3.3% in July after clocking in at 3.4% in June.

The producer-price report also specifically tracks intermediate demand prices, or the cost charged for goods and services sold to businesses as inputs in production. This is an indicator of cost pressures building in the pipeline for many businesses, which can be a precursor to broader inflation.

On a monthly basis, prices for processed goods for intermediate demand were unchanged. That gauge is up nearly 7% from a year earlier, well outpacing prices for final demand, but matching the June rate.

"Since we've seen them ease back a little bit over the past couple of months, I think it is going to be a pretty gradual pickup in the underlying pace of inflation," said Sarah House, senior economist at Wells Fargo.

Still, pipeline price pressures are elevated and could translate into a further pickup in consumer prices if businesses choose to pass along cost increases.

The Labor Department releases data on the July consumer-price index on Friday. The inflation measure has shown signs of firming in recent months, with consumer prices rising 2.9% in June from a year earlier.

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THE WALL STREET JOURNAL.

NewsPlus

Trump's New Tax Idea Could Be a Big Boon for These Ancient Funds; Investors could adjust the original purchase price of all assets for inflation, which would reduce the gain

By Leslie P. Norton
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The recent discussion about a change in capital gains taxation is making hearts beat faster, especially among a small group of die-hard fans of closed-end funds.

The Trump administration is studying using its regulatory power (without going through Congress) to change the way unrealized gains are calculated. Specifically, it's considering allowing investors to adjust the original purchase price of all assets -- stocks, funds, homes -- for inflation, which would reduce the gain.

That could be a boon for some of the ancient funds we wrote about early last year -- funds that survived the 1929 **stock market** crash, then marched along, offering solid performance, high yields, cheap valuations, and strong share-buyback programs. The funds included Central Securities (ticker: CET), Adams Diversified Equity (ADX), General American Investors (GAM), and Tri-Continental (TY).

Closed-end funds trade on an exchange, unlike open-end funds, and have a fixed number of shares, unlike exchange-traded funds. The price of the shares bears a loose relation to the actual value of the securities owned in the fund's portfolio. Typically they trade at discounts to net asset value. Ben Graham, Warren Buffett's mentor and the father of value investing, was a fan. So is Edward Thorp, the mathematician and top-performing hedge fund manager.

One theory for the discount is that funds are sitting on hefty unrealized gains. The smaller the gain, the lower the eventual tax bill. Consider General American Investors, where unrealized gains account for more than 50% of NAV. When Graham wrote about General American in 1970 in his seminal book, The Intelligent Investor, the discount was 7.6%. Today, the discount is 16.5%. Says Jeff Priest, the fund's manager: "Some of the discount is possibly due to a perceived tax bill....It probably weighs on investors' minds."

Then there is Central Securities, where unrealized gains account for 54% of net assets, partly because closely held insurer Plymouth Rock, a longstanding investment, accounts for 19% of assets. The fund trades at a 17.3% discount to NAV. It has been run by Wilmot Kidd since 1973, and has put up a stellar track record: Over the past 25 years, it has returned 11.1% a year, versus 9.8% for the **S&P 500**.

To be sure, a change in capital gains would benefit a range of investments, including the house that you've owned for decades. "It's an advantage to any person who's owned an asset for a very long time," says Mark Stoeckle, who has managed Adams Diversified since 2013. Unrealized gains at Adams Diversified are 32% of assets. Partly to close the discount, Adams some time ago began paying at least 6% dividends. Today, the fund trades at a 14% discount.

Discounts persist, and "the long-term stock holder shouldn't be bothered" by them, Kidd says.

Another potential beneficiary, says Jim Branscome, a longtime fan of closed-ends and retired director of investment analysis at S&P, is Boulder Growth & Income (BIF). The fund has a third of its assets in Berkshire Hathaway, 11% in cash, and the rest in such blue chips as JPMorgan Chase, Caterpillar, and Walmart. Net unrealized gains account for 52% of assets. Much of the fund, Branscome notes, is owned by a an early investor in Berkshire, Stewart Horejsi, who reportedly began buying Berkshire after reading about it in John Train's The Money Masters.

If nothing else, the prospects serve to highlight the charms of quirky, well-run funds trading at discounts whose managers continue to find opportunities in the market despite having vastly different views. Priest of General American follows a growth-at-a-reasonable price philosophy, looking to invest for three to seven years with corporate managers who are good capital allocators. He is a major shareholder of his fund.

General American recently added to existing positions in Anadarko (APC) and United Technologies (UTX), and eliminated Johnson Controls International (JCI) and Oracle (ORCL). Unless something goes "horribly awry" with the trade talks, says Priest, "there are still two more quarters at least of fairly significant earnings growth, and analysts estimates keep going up. As long as that's the case, it will be tough to take the market apart."

Meanwhile, Central Securities' Kidd shares that he recently bought Capital One (COF) and Alphabet (GOOG), quipping, "Isn't the argument that these are 21st century companies imprisoned in a 19th century accounting system?" Kidd himself believes that the market is risky today, but notes that "investments managers add most, if not all, of their value in bear markets."

Ever since he took over Adams Diversified, Mark Stoeckle has read everything he can get his hands on about why discounts persist. He's not holding his breath that a change in the tax structure will solve the problem. "As a rational person, that's the most frustrating part. I've read everything there is to read. I won't give this another thought until it gets closer."

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THE WALL STREET JOURNAL.

Markets

Oil Set for Gains Amid Iran Sanctions, Shrinking Supply; Brent could near $80 a barrel later this year, analysts say

By Christopher Alessi
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Banks raised their forecasts for **oil prices** for the 10th successive month in July amid anticipation of less Iranian crude and declining global inventories, factors that have already boosted the market this year.

Brent crude is expected to average $73.65 a barrel this year, according to a poll of nine investment banks surveyed by The Wall Street Journal. West Texas Intermediate, the U.S. standard, is projected to average just above $68 a barrel. Both estimates mark increases of roughly $2 on the forecasts from June's survey.

The revised forecasts come amid continued **volatility** in global oil markets. Investors are weighing **bullish** factors that include potential disruptions to Iranian crude exports against more **bearish** elements, including a ramp-up in production by the Organization of the Petroleum Exporting Countries and Russia.

OPEC and its production allies, including Russia, agreed in late June to begin increasing production by up to one million barrels a day starting this month, after more than a year of holding back output. The decision helped put a cap on prices, with Brent coming down more than 7% since it breached $80 a barrel in May for the first time since 2014.

Brent crude—the global oil benchmark—was trading down 0.5% at $72.05a barrel in morning trade Thursday.

The price jump earlier this year had been largely driven by President Donald Trump's decision to pull the U.S. out of a 2015 international agreement to curb Iran's nuclear program. The move set the stage for the reimposition of economic sanctions on the OPEC member that are expected to severely hinder its oil exports when they take effect in the coming weeks.

"Our **bullish** view is driven by the acceleration in the loss of Iranian crude oil exports from August onwards," said Harry Tchilinguirian, global head of commodities market strategy at BNP Paribas, one of the banks surveyed by the Journal.

"We believe that most key importers of Iranian crude, with the exception perhaps of China and to a lesser extent India, will seek to stop taking barrels now so as to be as compliant as possible with U.S. guidance come early November when U.S. oil sector specific sanctions snap back on," he added.

Mr. Tchilinguirian estimates that more than one million of Iran's roughly 2.5 million barrels a day in exports could be at risk, a number that other analysts concur with.

As a result, analysts at Goldman Sachs predict Brent is "likely to retest" $80 a barrel later this year.

Mr. Trump remains determined to "aggressively" reduce Iran's oil exports, while "the potential for further disruptions remains high in Libya, Venezuela and Nigeria," the analysts wrote in a recent note, citing supply outages in those other OPEC members.

At the same time, they added, "Saudi has little incentive to increase production to such a degree that inventories rise."

Analysts say that oil demand growth also remains robust, despite the risks of rising trade tensions.

Global oil inventories have been falling consistently over the past year, with declines led by falling stockpiles in the U.S.

Commercial petroleum inventories in the Organization for Economic Cooperation and Development—a group of industrialized, oil-consuming nations that includes the U.S.—stood in May at 23 million barrels below the key metric of the latest five-year average, according to the International Energy Agency's latest monthly oil-market report.

Looking ahead to 2019, banks now see prices rising even further, with Brent averaging $75.63 a barrel and WTI averaging $69.75 a barrel, according to the Journal survey.

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Goldman Crashes Party at End of Day

By Alexander Osipovich and Liz Hoffman
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Goldman Sachs Group Inc. is leading a pack of investment banks that are elbowing into the crucial stock-exchange business of end-of-day trading.

In the past, banks would route orders for such 4 p.m. trades to the New York Stock Exchange and **Nasdaq** Inc. But as the exchanges raised fees, banks such as Goldman and Morgan Stanley sought to execute more of these orders in private, off-exchange transactions. Credit Suisse Group AG and UBS Group AG have also recently stepped up businesses aimed at handling end-of-day trades.

The share of closing-price trades executed outside exchanges, by broker-dealers such as Goldman, doubled from mid-2015 through the end of last year, to 32% from 16%, according to Virtu Financial Inc., an electronic-trading firm in U.S. stocks.

The shift raises questions about transparency and comes as more financial activity of all stripes is moving away from public markets. Some traders and exchange executives worry that the NYSE's and **Nasdaq**'s end-of-day prices -- which serve as daily checkups on thousands of global companies -- could become less reliable measures of investors' sentiment. And some investors fret that banks might be extracting trading profits from clients' orders.

The change threatens the NYSE and **Nasdaq**, which have collected hundreds of millions of dollars in trading fees from their closing auctions in recent years. It also shows that some banks, after lean postcrisis years, are embracing their trading arms, eager to take on more risk in plain-vanilla businesses such as U.S. stocks.

Trading around 4 p.m. has surged over the past decade, in part because of the trillions of dollars flowing into index funds that mirror broad baskets of stocks. Such funds tend to do a lot of trading at the market's close because the indexes they track are based on end-of-day prices.

As index giants piled into the close, the flood of orders they brought with them attracted other investors, including more traditional stock pickers. Last year, trades in the closing auctions accounted for more than 8% of volume in **S&P 500** stocks, nearly four times the level in 2004, according to Credit Suisse.

That has led some banks to build up a business called the "guaranteed close."

It works like this: In lower Manhattan, the NYSE's bell rings at 4 p.m. ET each trading day, signaling a giant auction that determines the closing prices for thousands of stocks. Seconds later, across town, Goldman's trading systems pair up buyers and sellers on tens of millions of shares -- using the price published by the NYSE but avoiding the Big Board.

Investors looking to buy or sell shares of Apple Inc., for example, can get a guarantee from Goldman or another investment bank to honor their orders at the closing price set on **Nasdaq**, where Apple is listed.

At 4 p.m., the bank pairs Apple buyers with Apple sellers. It can send unmatched orders to the exchange or take the other side of the trade itself, storing the extra Apple shares or short interest on its books overnight.

Goldman is the largest competitor in this market, handling between 60 million and 80 million shares on a typical day, according to people familiar with the matter. Morgan Stanley, the top stock-trading shop on Wall Street, has a competing product, internally dubbed MOCHA, for "market on close handling aggregator."

What began at these firms as internal tools to help centralize orders has since been pitched to clients as a way to save on exchange fees. The products are used by index-fund managers including Vanguard Group and BlackRock Inc., as well as smaller broker-dealers, people familiar with the matter said.

Yet some clients are wary. "To me, it's a black box," said Mehmet Kinak, global head of systematic trading and market structure at T. Rowe Price Group Inc. He said T. Rowe, which manages $1.04 trillion, avoids guaranteed-close trading because it is "completely nontransparent."

The NYSE, owned by Intercontinental Exchange Inc., cut its closing-auction fees in January. The move was partly in response to the threat from the banks' bustling 4 p.m. business, a person familiar with the matter said.

Executives at NYSE and **Nasdaq** say they fear that if more trading moves to banks, it will make closing prices less trustworthy.

Generally, cheaper fees benefit investors. But some traders said they are worried about what happens if a bank can't find a matching order.

If Goldman has client orders to buy 100,000 shares of Apple and only 70,000 "sell" orders, the bank might need to scramble to fill the demand at the end of the day. So it might turn to the exchange and buy 30,000 Apple shares before 4 p.m., which solves its problem. That buying, though, could nudge up Apple's closing price -- resulting in a worse outcome for the buyers.

In an agreement that it asked one prospective client to sign, Goldman acknowledges that efforts to execute the trade while protecting itself from adverse price moves "may impact market prices" in ways that are unfavorable to its clients, according to a copy reviewed by The Wall Street Journal.

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Treat India's Stock Rally With Caution

By Andrew Peaple
288 words
20 August 2018
The Wall Street Journal
J
B10
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[Financial Analysis and Commentary]

"Incredible India," goes the tourism ad jingle. Incredible is one word for markets in India right now.

India's currency is under heavy pressure; the rupee is trading at or near record-lows against the dollar. Yet the country's main **stock index**, the Sensex, is trading near records, having risen nearly 11% this year, easily outpacing the **S&P 500**.

Investors should be wary of what the Sensex is telling them about India -- and worried about further pain for the country's currency.

The stock benchmark, which contains just 30 companies, has been driven upward by strong gains in around half of its stocks. Foreign investors have been net sellers, meanwhile. Trading at a punchy 22 times expected earnings, according to Thomson Reuters, the Sensex looks ripe for a pullback.

As for the rupee, things are set to get worse before they get better. India's trade deficit widened to a five-year high last month at $18 billion. The worry now is that portfolio outflows will gather pace again, say analysts at Bank of America-Merrill Lynch -- particularly as central-bank officials signaled a tolerance for the currency to get weaker.

For sure, India is no Turkey. With exports to the U.S. equivalent to just 2% of GDP, it should prove relatively resilient as global trade tensions grow. India's central bank has won plaudits for its inflation-targeting regime -- a stark contrast to its peer in Ankara. Even so, with countries running large external deficits coming into the firing line, heading back into Indian markets isn't for the fainthearted.

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THE WALL STREET JOURNAL.

Markets

Pension Funds Are Boosting Bull Market Bets as Stocks Climb Higher; Retirement systems that manage money for public workers had a median 59% of their assets in equities at June 30, their largest allocation to stocks since 2014

By Heather Gillers
572 words
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Public pension funds aren't backing away from stocks as the **bull market** grinds through its ninth year.

Retirement systems that manage money for U.S. firefighters, teachers and other public workers had a median 59% of their assets in domestic and international equities as of June 30, according to new data from Wilshire Trust Universe Comparison Service, up from 57% a year earlier. That is their largest allocation to stocks since 2014.

Thus far the aggressive stance is working. Stocks have delivered double-digit returns for the funds over the past two years ending June 30. Wilshire TUCS tracks about 1,300 U.S. plans, which are predominantly public pensions.

"They're being rewarded for it," said Robert J. Waid, managing director at Wilshire Associates.

One reason why public pensions remain so willing to bet on stocks is because of persistent funding problems at many systems that don't have enough assets to cover all future liabilities. Pensions rely partially on investment income to meet future obligations to workers and retirees; many depend on large allocations of stocks to meet their aggressive return targets of 7% to 8% a year.

The risks to these systems are sizable losses during market downturns. Public pension funds lost hundreds of billions during the last financial crisis largely because of their exposure to public markets. They had 62% of their portfolio allocated to equities in 2007, according to Wilshire.

The two largest public pensions in the U.S.—California Public Employees' Retirement System, known by its abbreviation Calpers, and the California State Teachers' Retirement System—lost nearly $100 billion in value during the year ended June 30, 2009.

In both cases equities remain their largest single holding nearly a decade later. Calpers increased its public equities target to 50% from 46% as of July. Calpers's assets totaled $359 billion as of Aug. 3. Assets for the California State Teachers' Retirement System, nicknamed Calstrs, totaled $224 billion as of June 30.

For some funds, their rise in equity allocation is the result of a decision to leave income from stocks untouched rather than redistributing it. "In large part, it's natural growth," said Keith Brainard, research director of the National Association of State Retirement Administrators.

More conservative fixed-income investments, meanwhile, are declining in size. In 2018 public pensions tracked by Wilshire TUCS had 21% of their portfolio in U.S. bonds as compared with 23% in 2017 and 25% in 2016.

Many pension funds have shifted that money into riskier alternative investments such as private equity and hedge funds because of the potential for higher returns. All public pension funds tracked by Wilshire TUCS had 4% of their assets in alternatives as of June 30.

That trend is even more pronounced among the biggest public pension funds, which now have more money in alternative investments than in bonds.

Funds with assets greater than $5 billion have a median 20% in alternatives, up from 18% in 2016 and 17% in 2017. They have a median 16% of their assets in U.S. bonds, down from 20% two years ago and 18% last year.

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THE WALL STREET JOURNAL.

Markets

After Tesla Buyout Tweet, Some Investors Wonder: Where Was Nasdaq? Elon Musk's 'financing secured' buyout tweet last week touched off 80 minutes of frenzied trading before Nasdaq called a halt

By Akane Otani
914 words
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09:00 AM
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WSJO
English
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Corrections & Amplifications

Nasdaq resumed trading in Tesla Inc. shares at 3:45 ET Tuesday after a halt. An earlier version of this article incorrectly stated that shares resumed trading at 2:45. (Aug. 12, 2018)

There's a nagging question on Wall Street after Tesla Inc. Chief Executive Elon Musk's buyout tweet last week: Why did Nasdaq let trading in Tesla shares continue for more than an hour afterward?

Mr. Musk tweeted at 12:48 p.m. ET on Tuesday that he had "financing secured" for a buyout of Tesla at $420 a share, a 16% premium to the share price at the time. The remark set off a frenzy of trading in Tesla shares, even as investors were struggling to discern whether the tweet was legitimate and what precisely it meant.

It wasn't until 2:08 p.m. that Nasdaq Inc. acted to halt trading in Tesla shares. In that 80-minute interim, investors who bought and sold the shares were potentially disadvantaged by the lack of clear information about the company, some investors said.

Typically, exchanges halt trading in a company's shares when it tells them it is about to release "material news," or information that could sway investors' trading decisions. An exchange typically keeps trading halted until a disclosure provides some clarity.

Other investors wondered why the exchange kept the halt in place for more than an hour and a half, and then why it chose to resume trading at 3:45 p.m.

It's the latest episode to raise questions about the governance of U.S. markets.

"We don't know what efforts Nasdaq engaged in to get a more discrete picture of what was happening," said Harvey Pitt, former chairman of the U.S. Securities and Exchange Commission and chief executive of consulting firm Kalorama Partners LLC. "All of this is unprecedented, it's highly problematic and it's not consistent with careful and thoughtful approaches to a difficult subject."

The decision-making behind the trading halt isn't the only mystery surrounding Mr. Musk's tweets. The SEC is looking into their truthfulness, The Wall Street Journal reported.

Nasdaq rules require listed companies to notify its MarketWatch division, via an electronic disclosure system, at least 10 minutes before publicly releasing "certain material news announcements" between the hours of 7 a.m. and 8 p.m. ET. Typically, the heads-up allows the exchange to coordinate with the company and evaluate whether to halt trading "pending news"—which compliance experts say levels the playing field for investors making trading decisions.

With Tesla, the time lag between Mr. Musk's tweet and Nasdaq's decision to halt trading suggests the exchange was blindsided by the CEO's tweet—which would constitute a violation of Nasdaq rules, several traders and regulatory experts said.

A Tesla spokesman declined to address whether Tesla had alerted Nasdaq ahead of Mr. Musk's tweet. Nasdaq declined to comment on its communications with Tesla around the tweet.

"In general, when a company discloses news that's potentially material, whether by tweet or otherwise, **Nasdaq**'s procedure is to contact the company immediately," said Joe Christinat, a **Nasdaq** spokesman. **Nasdaq** doesn't need a company's permission to halt trading in its shares.

Companies found to have violated exchange rules can be publicly reprimanded or even delisted, according to **Nasdaq** guidelines.

Some contend **Nasdaq** should have moved sooner, given the publicity and the spike in Tesla shares that followed both the tweet and a Financial Times report earlier that day about a Saudi sovereign wealth fund building a $2 billion stake in Tesla.

"Everyone I spoke to was wondering" why **Nasdaq** didn't halt Tesla earlier, said Michael Antonelli, equity sales trader at Baird.

Others say Tesla shouldn't have been allowed to resume trading.

"Trading should have been halted immediately and should not be resumed until Musk either presents or shows the absence of a written commitment to funding," said David Rocker, a retired hedge-fund manager who said the SEC and **Nasdaq** responses were insufficient. "A continuation of trading at this point is a disservice" to everyone holding or trading the shares.

Stock exchanges, for much of their existence, have operated as nonprofit organizations, each with its own listing standards that companies had to meet in order to be members. But as **Nasdaq** and the New York Stock Exchange became for-profit public companies in the 2000s and competition heated up to lure listings, some critics contend the exchanges have become beholden to the companies they list.

Unusual trading and unexplained halts are no small matter for U.S. markets that have long been considered the best in the world, experts say.

Reena Aggarwal, a finance professor at Georgetown University and director of the school's Center for **Financial Markets**, said, "If investors start losing trust in an exchange, then trading is going to move on from there."

Write to Akane Otani at akane.otani@wsj.com

More

* Why Musk's Private Tesla Dream Shouldn't Spook Public Markets

* Public or Private, Tesla Fans Are Along for the Ride

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* Elon Musk's Flawed Plan for Tesla Shareholders

* SEC Probes Tesla CEO Musk's Tweets

* Saudi Billionaire Resumes His Global Deal-Making

* Tesla's Big Question: Better or Worse Off as Private Company

* Tesla's Board Has Met Several Times to Discuss Going-Private Proposal

* Elon Musk Tweets He Is Considering Taking Tesla Private

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Economy

Things to Watch in the Jobs Report | Carney Warns on Brexit | Czech Central Bank Raises | Dubai Turns Investors Wary | Douglas's Take: The Neutral Rate and the New Normal; The Wall Street Journal's central banking newsletter for Friday, August 3, 2018

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Douglas's Take: The Neutral Rate and the New Normal

5 Things to Watch in the July Jobs Report

BOE's Carney Calls Risk of No-Deal Brexit ‘Uncomfortably High'

Czech Central Bank Raises Interest Rates

Once Billed as a Financial Haven in the Middle East, Dubai Turns Investors Wary

The Neutral Rate and the New Normal

The Bank of England published its estimate for the neutral rate of interest in the U.K. Thursday and it reinforces a key message central bankers have been pushing for a while: there are big forces reshaping what we think of as "normal" in the global economy.

The neutral rate of interest is the theoretical level of interest rates at which the economy would neither speed up or slow down. Put another way, set interest rates at neutral and the economy should grow at potential without spurring too much inflation, as long as there are no unemployed workers or other resources lying idle.

Trickily for central bankers, the neutral rate--also called the equilibrium or natural rate--is unobservable and varies over time. Some economists think the whole concept is probably wrong. Central bankers, the theory goes, control inflation by setting their policy rates in relation to the neutral rate: Set it higher and the economy will slow and inflation will cool. Lower, and the economy and inflation should accelerate.

The BOE estimates that the neutral rate in the U.K. has fallen over time and in nominal terms is probably somewhere around 2% to 3%. That compares with a past level of closer to 4.25% to 5.25%.

In the U.S., the Federal Reserve has reached a similar conclusion. Nine of 14 officials in June estimated the neutral rate in the U.S. economy is probably around 2.75% or 3%.

So what has driven the neutral rate lower? One big factor is demographics. Slower population growth and rising life expectancy tend to boost saving and bear down on interest rates. Another is poor productivity growth, which reduces the potential return on investment and thereby also suppresses interest rates.

This analysis is what lies behind central bankers' assertion that future increases in interest rates will be slow and modest and rates will probably settle at a level way below what used to be considered "normal" in the past. One consequence for policy is that central banks will in future have less room to cut interest rates, suggesting asset purchases will become a more regular tool in stabilization. Another possibility is that fiscal policy will need to play a greater role.

Unless these powerful underlying forces shift, that new normal is here to stay.

Key Developments Around the World

5 Things to Watch in the July 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 190,000 jobs in July and that the unemployment rate fell to 3.9% from 4.0% a month earlier. Here are five things to look for in the report.

BOE's Carney Calls Risk of No-Deal Brexit 'Uncomfortably High'

Bank of England Gov. Mark Carney said Friday the risk that Brexit talks founder and the U.K. leaves the European Union without a deal next year is "uncomfortably high," highlighting unease about limited progress in negotiations between London and Brussels. In an interview with the British Broadcasting Corp., Mr. Carney said a no-deal Brexit would likely disrupt trade, slow the economy and push up prices, an outcome he described as "highly undesirable."

BOE Takeaways: Unanimity Among Policy Makers Masks Brexit Uncertainty

Bank of Mexico Leaves Interest Rates Unchanged

The Bank of Mexicoleft interest rates unchanged Thursday, saying it expects the effects of higher energy costs will be temporary, with core inflation continuing to ease. The bank's board voted unanimously to keep the overnight interest rate unchanged at 7.75%, as expected, while leaving the door open for future increases if more inflation risks materialize. "In the presence and possible persistence of factors that, by their nature, involve risks to both inflation and inflation expectations, monetary policy will be adjusted in a timely and robust manner" to get inflation back to the 3% target, the central bank said.

Czech Central Bank Raises Interest Rates

The Czech National Bankraised its key interest rate Thursday for the fifth time in a year, confirming its status as the most aggressive of Europe's central banks in following the Federal Reserve's efforts to "normalize" its monetary policy. The CNB increased its two-week repo rate to 1.25% from 1% and its Lombard rate to 2.25% from 2%, citing a weakening of the koruna's exchange rate that risks pushing inflation higher as prices of imported goods and services climb.

Quick Hits: BOJ Signals More Flexibility in Unusual JGB Offer

The Bank of Japan signaled more flexibility with an unscheduled offer to buy government bonds, the Bank of England could remain on the sidelines for some time after Thursday's rate move, and progress of monsoon rainfall in India could be a swing factor for the next rate increase there. Here are quick hits on central banking and related market views from around the world.

FINANCIAL REGULATION ROUNDUP

Once Billed as a Financial Haven in the Middle East, Dubai Turns Investors Wary

Investors are questioning whether Dubai's young financial center can police itself as the meltdown of its marquee private-equity firm highlights broader concerns about placing money in the region. This emirate's top regulator, the Dubai Financial Services Authority, has been close to silent since allegations emerged that Abraaj Group misused hundreds of millions of dollars in investors' money, including that of the Bill and Melinda Gates Foundation and the World Bank. It has issued two short statements, seized some laptops from Abraaj and is in talks with at least one of the firm's auditors. Investors and executives say the authority's response has made them nervous about the regulatory environment in Dubai, which built a financial district of gleaming skyscrapers from scratch more than a decade ago.

AIG's Income Slides in Second Quarter

American International Group posted a 17% decline in second-quarter net income, weighed down by a $200 million pretax restructuring charge, lower investment income and another weak showing for its big business of selling property-casualty policies to corporate clients. AIG's overall net profit sank to $937 million as the turnaround effort of Chief Executive Brian Duperreault passed the one-year mark. AIG, which has about 50,000 employees, said the restructuring charge is related to efficiency initiatives, without elaborating further.

RBS Pays First Dividend Since Financial Crisis

Royal Bank of Scotland Group said Friday it would pay its first dividend in a decade, a milestone for a bank that was brought to its knees by the financial crisis. RBS, which was bailed out by British taxpayers and remains under the control of the U.K. government, said it intended to pay a dividend of 2 pence a share subject to finalizing a

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fine from the U.S. Justice Department for packaging toxic mortgage-backed securities. The bank said it envisaged share buybacks and ramping up the dividend to a 40% payout ratio, subject to balance sheet stress-test results and the impact of Brexit.

Friday

8:30 a.m. EDT

U.S. Commerce Department releases June international trade data

8:30 a.m. EDT

U.S. Labor Department releases July jobs report

Bank of Canada Staff Paper Examines Monetary and Fiscal Policy and Debt at Lower Bound

Dmitry Matveev studies "optimal discretionary monetary and fiscal policy when the lower bound on nominal interest rates is occasionally binding in a model with nominal rigidities and long-term government debt." He finds in a Bank of Canada staff working paper at "the lower bound it is optimal for the government to temporarily reduce debt. This decline stimulates output, which is inefficiently low during liquidity traps, by lowering expected real interest rates following the lift-off of the nominal rate from the lower bound. Away from the lower bound, the long-run level of government debt increases with the risk of reaching the lower bound. The accumulation of debt pushes up inflation expectations so as to offset the opposite effect due to the lower bound risk."

A Wake-Up Call From Japan

"What happens when you wake a market from deep slumber? Japan is the latest place investors should watch. For a long time, central banks have helped to tamp down swings in markets via ultraloose monetary policy, boosting risk appetite. But things are changing, even in the spiritual home of low interest rates," Richard Barley writes for The Wall Street Journal. This week's move higher in the 10-year Japanese government **bond yield** was "huge in a market where **bond prices** have moved only fractionally for months, thanks to the BoJ's policy of pinning yields close to zero. This could mark a regime change for markets, argue strategists at Mizuho."

The number of U.S. workers filing new applications for unemployment benefits ticked slightly higher last week but continued to hover near the lowest levels since the late 1960s.

A closely watched measure of business conditions in the New York metro area rose in July from the prior month. The New York chapter of the Institute for Supply Management said its current business conditions index rose to 75 in July from 55 in the previous month.

Growth in China's service sector slowed in July, a private gauge showed Friday, in line with an official data that also pointed to cooling activity in the sector.

Eurozone retail sales rose for the second straight month in June, in a sign that consumer spending is holding up in the face of rising energy prices.

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THE WALL STREET JOURNAL.

Economy

As Central Bankers Meet, Economic Uncertainties Weigh on Sunny Outlook; Tariffs, emerging markets and U.S. discord are likely to be the focus of side conversations at the Fed's annual mountain retreat

By Nick Timiraos
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23 August 2018
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The Wall Street Journal Online
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JACKSON HOLE, Wyo.—Global central bankers are navigating a new set of threats as they decide how aggressively to act in closing out an era of exceptionally easy money.

Uncertainties include the prospect of disruptions to economic activity from tariffs imposed by the U.S. on China, Europe, Canada and others, and counter-tariffs imposed by those nations on the U.S. Emerging markets also look vulnerable if capital flight spreads beyond a handful of countries grappling with currency crises. Then there is the potential for discord between the Federal Reserve and President Trump, who has criticized the U.S. central bank in recent weeks for raising interest rates.

Fed Chairman Jerome Powell headlines a long list of central bankers gathering in the Grand Tetons this week for the Fed's annual mountain retreat. The formal discussion will be about the impact of monopolies on economic activity, but these other issues are sure to dominate sideline talk over cocktails and mountain hiking.

Despite the uncertainties, the world's central banks are still managing a relatively bright global economic outlook. For the second straight year, all 45 countries tracked by the Organization for Economic Cooperation and Development are expected to see their economies grow, though just 20 are set to see output accelerate from last year, down from 33 in 2017.

The International Monetary Fund in July projected global economic output will grow 3.9% this year and next. That would represent the strongest two-year growth run since 2010 and '11, when economies enjoyed a short-lived rebound from the 2008 financial crisis. Inflation, meanwhile, has picked up to the modest levels many central bankers target after years of running very low.

"The reality is labor markets across the world have been tightening," said Raghuram Rajan, who led the Reserve Bank of India from 2013 to 2016. "There are various reasons why we haven't seen strong wage inflation, but those reasons are becoming weaker as we go further into this expansion."

Against that backdrop, policy makers have turned to slowly reversing low interest-rate policies that were meant to prevent a downward drift into deflation and recession.

"There is a sense that the global deflation risks have diminished," said Adam Posen, president of the Peterson Institute for International Economics in Washington. More policy makers "are looking at how the balance of risks has changed from being premature in tightening versus being behind the curve on high asset prices and credit lending booms."

The U.S. economy, poised for its best annual growth increase in more than a decade, is leading the way. Growth has been turbocharged for now by tax cuts and federal spending increases. The nine-year economic expansion is one year shy of becoming the longest on record. Stock markets this week touched new highs, and the **bull market** is on the verge of surpassing its longest-running rally.

Inflation has returned to the Fed's 2% target after falling short for several years, and that should keep the Fed on track to raise rates next month for the third time this year, to a range between 2% and 2.25%. The Fed raised rates three times last year and began to shrink its $4.5 trillion bond portfolio.

Fed officials are looking past Mr. Trump's critiques, and the markets so far seem convinced it is on the right path.

"Powell and the people he has there are going to stay on the course of what they independently assess is the appropriate path," said Michael Feroli, chief U.S. economist at JPMorgan Chase.

Several developed economies are following Washington's lead, though for differing reasons. Some that largely avoided housing and banking crises a decade ago now see potential excesses from exuberant property values. Others have tighter labor markets and steady inflation.

The Bank of England in early August raised its benchmark rate to its highest level in almost a decade, while the Bank of Canadaraised rates last month for the fourth time since mid-2017.

Officials in Norway have indicated a rate increase is likely next month. In the Czech Republic, officials raised their benchmark rate in August for the fifth time in less than a year. One year ago, the Czech central bank hadn't raised its policy rate in nearly a decade.

Though Europe's economy has slowed, the European Central Bank is poised to phase out its bond-buying program later this year. And Japan returned to solid growth in the April-to-June quarter on the back of higher wages and consumer spending.

"Even in Europe and Japan, you're seeing them try to move—albeit with baby steps—back to something that's not quite an emergency setting," said Mr. Feroli.

Emerging market economies are raising rates to protect local currencies from getting whacked by a stronger dollar. The list includes India, Mexico and Indonesia, and JPMorgan sees new moves by Chile, Thailand and Taiwan before the end of the year.

When the Fed raises rates, the higher return on U.S. fixed-income assets can lead to capital outflows from emerging markets that don't respond in kind, pushing local inflation up.

The collapse of the Turkish lira this month, which followed an earlier rout in the Argentine peso, has investors worried financial turbulence could spread to other vulnerable emerging markets, even though both Argentina and Turkey have a unique assemblage of economic woes.

"Turkey and Argentina have idiosyncratic arguments, but there was way too much capital going into these places that were very risky," said Robin Brooks, chief economist of the Institute of International Finance.

Emerging markets could reel further if the Chinese economy's slowdown worsens. China faces strengthening headwinds, from weakening consumption to slowed production and investment. The yuan has declined around 5% against the dollar in the past two months.

Worries about Chinese growth have weighed on global commodity prices in recent months. Since June, **oil prices** are down 4%, aluminum is 6% lower and copper is down 9%. That, in turn, has held U.S. investors' inflation expectations in check after a run-up earlier this year and could take some pressure off the Fed to act.

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WSJ PRO CENTRAL BANKING

Economy

The Other Amazon Effect: How Prices Have Become Less Insulated From Supply Shocks; Retailers' prices have grown more uniform across locations, finds a paper presented at Jackson Hole

By Nick Timiraos
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JACKSON HOLE, Wyo.—Increased online competition has made retailers faster to adjust prices and more likely to hold prices constant across geographic locations, according to new research presented here.

This could make retail prices more sensitive to shocks from tariffs or **oil prices** than they were in past periods, according to a paper released Saturday at the Kansas City Fed's annual symposium.

The popular press has focused on the disinflationary forces of online retailers, or the so-called Amazon effect, that has led to declines in consumer goods prices. Harvard Business School's Alberto Cavallo took a different tack in his paper examining pricing behaviors in the Amazon era. After all, the disinflationary effects of online retailing could eventually run their course because markups can only fall so far, he wrote.

Meantime, these other changes in pricing, where retailers have grown both more flexible and their prices have grown more uniform across locations, could prove longer-lasting.

Mr. Cavallo found the frequency of price changes in multichannel retailers—those that sell online and in bricks-and-mortar stores—has increased over the past decade. The average duration of regular price changes that exclude temporary discounts and sales has fallen from 6.7 months in 2008 to 2010 to 3.7 months in 2014 to 2017.

The increased frequency of pricing changes, moreover, is particularly pronounced in sectors where online retailers have a stronger presence, such as electronics and household goods.

Mr. Cavallo also examined how several large retailers—Amazon, Walmart, Best Buy and Safeway—set prices across different sales locations. Because Amazon is primarily an online retailer, its prices are the most uniform. But he found the degree to which the other retailers with predominantly bricks-and-mortar operations maintained uniform pricing was nearly as high as Amazon. Food and beverage sales, he found, are the one area in which prices are more geographically dispersed.

"The transparency of the web imposes a constraint on brick-and-mortar retailers' ability to price discriminate across locations," wrote Mr. Cavallo.

The upshot for policy makers, including central bankers that are on watch for higher inflation, suggests that retailers that are both faster to adjust prices and more likely to charge the same prices across locations will react faster to shocks, such as higher import tariffs or changing **oil prices**.

"These results suggest that retail prices are less insulated from this type of aggregate shock than in the past," wrote Mr. Cavallo.

Write to Nick Timiraos at nick.timiraos@wsj.com

Jackson Hole Research Papers

* More Amazon Effects: Online Competition and Pricing Behaviors

* Increasing Differences Between Firms: Market Power and the Macro-Economy

* Understanding Weak Capital Investment: the Role of Market Concentration and Intangibles

* Competition, Stability, and Efficiency in **Financial Markets**

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THE WALL STREET JOURNAL.

Markets

U.S. Government Bonds Rise After Soft Jobs Data, China Trade Warning; Investors and analysts had expected faster gains in wages this year following passage of tax cuts in December

By Daniel Kruger
492 words
3 August 2018
04:23 PM
The Wall Street Journal Online
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English
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Treasurys advanced Friday after the Labor Department said that the pace of hiring slowed in July and China said it would impose new tariffs on imports from the U.S.

The yield on the benchmark **10**-**year Treasury** note fell the most in one month to 2.952% from 2.986% Thursday. Yields fall as **bond prices** rise.

Yields fell after data showed the economy added 157,000 jobs last month, compared with a 190,000 estimate in a Wall Street Journal survey of economists. The unemployment rate fell to 3.9% from 4%, matching forecasts, while average hourly earnings rose 2.7% from the year before.

Many investors and analysts had expected faster gains in wages this year following passage of $1.5 trillion in tax cuts in December, with fiscal policy makers predicting companies would use some proceeds from the tax cuts to lift workers wages. Investors expected higher pay would spur consumption and lift inflation. Inflation poses a threat to the purchasing power of a bond's fixed interest and principal payments.

The slower pace of growth was "a slight disappointment," said George Goncalves, head of fixed-income strategy at Nomura Securities International. A more pressing concern is the slow pace of wage increases amid what appears to be a tight labor market. Hourly earnings "are going up, but they're not going up faster."

Friday's data is unlikely to alter the direction of Federal Reserve policy, investors said. The Fed held interest rates steady at its meeting this week, leaving them in a range between 1.75% and 2%. Policy makers have raised them two times this year.

Fed funds futures, which investors use to bet on the direction of central bank policy, early Friday suggested a 69% probability that the Fed will raise rates at least two more times this year, down from 71% a week ago.

While the labor data didn't change broad expectations about the economy, continued tensions between the U.S. and China, the world's two largest economies, could prove more disruptive, investors said.

Yields continued lower Friday after China said it would slap levies on $60 billion of U.S. products if Washington moves ahead with its tariff threats against Beijing. China also moved Friday to rein in the yuan's rapid depreciation as investors bid down the tightly controlled currency to its weakest level in more than a year amid growing worries over a bruising trade battle with the U.S.

"We're more worried about what the next trade headline is going to be," said Thomas Roth, managing director in the rates trading group at MUFG Securities Americas Inc. "That's unfortunately going to be with us."

Write to Daniel Kruger at Daniel.Kruger@wsj.com

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THE WALL STREET JOURNAL.

Markets

U.S. Government Bonds Advance on Mixed Data; Yields dipped as unemployment and homebuying data, among other indicators, sent investors mixed signals

By Daniel Kruger
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The Wall Street Journal Online
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U.S. government bonds edged higher Thursday after an array of economic reports delivered a mixed message.

The yield on the benchmark **10**-**year Treasury** note fell for a second consecutive trading session to 2.821% from 2.823% Wednesday. Yields drop as **bond prices** rise.

Yields rose briefly after the Labor Department said Thursday that the number of Americans filing applications for new unemployment benefits fell last week for the third straight week, continuing to hover near historic lows. Initial jobless claims, a proxy for layoffs across the U.S., dropped by 2,000 to a seasonally adjusted 210,000 in the week ended Aug. 18. Economists surveyed by The Wall Street Journal expected 215,000 new claims last week.

Yields slipped after the Commerce Department said Thursday that sales of new homes in the U.S. fell for the second straight month in July after a stark drop in June. Purchases of newly built single-family homes—a relatively narrow slice of all U.S. home sales—declined 1.7% to a seasonally adjusted annual rate of 627,000 in July. Economists surveyed by The Wall Street Journal had expected a 2.2% gain.

"That might mean economic growth is starting to decelerate a bit more quickly than people expected," said Chris Ahrens, chief market strategist at First Empire Securities, adding that it is also a sign that higher borrowing costs could become a stronger headwind to growth, he said,

The economy grew at a 4.1% annualized pace in the second quarter, the fastest rate since 2014.

Yields were weighed down by Wednesday's release of minutes from the Federal Reserve's July 31-Aug. 1 meeting, where officials discussed their concerns over how prolonged trade disputes could disrupt economic growth in greater detail.

The minutes also showed that policy makers discussed dropping language from their postmeeting statement that has for years described monetary policy as "accommodative," a term applied to policies that stimulate economic activity. Most officials have signaled they are eager to raise rates to a level that neither spurs nor slows growth, though there is considerable uncertainty about what constitutes this so-called neutral rate.

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THE WALL STREET JOURNAL.

Markets

Oil Prices Plunge as Stockpiles Jump; Crude slides to lowest close since June as fuel inventories reach seven-month record

By Dan Molinski and Sarah McFarlane
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Oil prices fell to their lowest level in nearly seven weeks Wednesday as total U.S. stockpiles of oil and fuel hit a seven-month high and U.S.-China trade tensions escalated.

Light, sweet crude for September delivery slid 3.2% to $66.94 a barrel on the New York Mercantile Exchange. That was its lowest close since June 21. Brent crude, the global benchmark, also fell 3.2%, to $72.28 a barrel.

The U.S. Energy Information Administration on Wednesday reported that crude-oil inventories alone declined slightly last week from the previous week.

But investors focused more on the broader gauge of total combined stockpiles of crude oil and fuels such as gasoline, which rose by 3.3 million barrels, to 1.21 billion barrels, the highest since early January. That is bearish for prices, because it suggests demand isn't keeping up with supplies.

"We do still have a lot of oil in the U.S.," said John Woods, president of JJ Woods Associates, adding that as refineries head toward maintenance season after the summer driving season, inventories could rise more. "There's room for [prices in] the crude market to soften a bit more," he said.

The EIA report indicated another weekly decline in U.S. oil production, to 10.8 million barrels a day, from 10.9 million a week earlier. This suggests that logistical problems in Texas, including a lack of sufficient pipelines, are forcing oil producers to tap the brakes on output until they can improve infrastructure.

An intensifying trade fight between the U.S. and China over tariffs also pressured oil prices. On Wednesday, China's commerce ministry, in a retaliatory move, said it would impose 25% tariffs on an additional $16 billion in U.S. imports, matching U.S. tariffs on China goods dollar-for-dollar. The tariffs will go into effect on Aug. 23, the same date as the U.S. ones. These trade tensions can push oil prices lower in two ways.

Investors worry that a potential global trade war could ensue, leading to softer economic growth throughout the world and possibly reducing demand for oil. Also, the ratcheting-up of tensions has been sending investors into haven assets such as the U.S. dollar, and since oil is bought and sold in greenbacks, a stronger currency tends to weaken oil prices.

"Headlines on trade duty implementation specifics from the U.S. and China look to have added to downside in oil," said analysts at Baird Equity Research.

Analysts said recent, tight-range trading may also have played a role in setting up Wednesday's dramatic, breakout move lower. Prices had been jiggling up and down between roughly $67 a barrel and $70 a barrel for most of the past month.

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THE WALL STREET JOURNAL.

Business

Coke Adds Coffee to Its Drinks Mix in $5.1 Billion Deal; Soda giant to buy U.K.-based Costa coffee chain and plans to roll out its cappuccino vending machines

By Jennifer Maloney in New York and Ian Walker in London
1,245 words
31 August 2018
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Coca-Cola Co. made the largest brand acquisition in its history, saying Friday that it would pay $5.1 billion for British coffee-shop chain Costa as the soda giant moves further from its soft-drink roots and joins a growing group of consumer-goods companies that are betting big on coffee.

The deal gives Coke a large brick-and-mortar retail presence and puts it in direct competition with Starbucks Corp., which has more than 27,000 cafes around the globe. Costa serves its red-and-white cups of coffee through its roughly 3,800 cafes, including about 2,500 in the U.K. and a growing presence in China. Founded in London in 1971, Costa also sells coffee in grocery stores and gas stations.

Some analysts questioned the rationale for paying what they said was such a steep price for Costa given that it is so heavily concentrated in the U.K. and little-known in many other big markets. They also questioned why Coke would enter the crowded world of physical retail, where it has no experience.

In an interview, Coca-Cola CEO James Quincey said the transaction was a bet on the fast-growing and still fragmented global coffee business. "This is a coffee strategy, not a retail strategy," said Mr. Quincey, a Briton who took over as Coke's CEO in May 2017.

Mr. Quincey said Coke has no current plans to open Costa coffee shops in the U.S., but the company will bring Costa coffee vending machines and beans to U.S. gas stations, college campuses and quick-service restaurants.

The CEO acknowledged that expanding into retail would pose a challenge for the beverage manufacturer, which currently relies on distributors, grocers and restaurants to sell its drinks. Retail is "clearly not our expertise," he said, adding that Coke would keep Costa's retail management team in place.

"Consumers continue to want to spend more money on beverages," Mr. Quincey said. "They just want greater diversity" including "coffee in its various formats."

Coke and its soda rivals have been searching for growth as consumers shift away from sugary soft drinks. PepsiCo Inc. in August agreed to buy seltzer-machine maker SodaStream International Ltd. for $3.2 billion. Smaller rival Dr Pepper Snapplemerged this summer with Keurig, the coffee company that popularized single-serve K-cups.

Coke already sells Dunkin' Donuts bottled coffee in the U.S. and a ready-to-drink coffee brand called Georgia that is popular in Japan, but Mr. Quincey said the company was missing out on the much larger hot-coffee market. In a conference call Friday, he said Coke plans to expand Costa's network of cafes in developing markets including China and use Costa's self-serve vending machines, which grind beans and steam milk, to sell hot drinks around the world. It also will sell Costa-branded bottled drinks and coffee beans. Rival PepsiCo has a longstanding partnership with Starbucks to sell its ready-to-drink beverages.

Coffee has recently been a hot industry for deal making. Nestlé SA this year bought the rights to sell Starbucks in grocery and retail stores for more than $7 billion. JAB Holding Co., a European holding company, has also moved aggressively to buy up coffee assets.

Coke is buying Costa from British leisure group Whitbread PLC, which also owns the Premier Inn hotel brand in the U.K. and Germany. The company, which first flagged a possible Costa spinoff in April, said it would return most of the money to its shareholders. Its shares closed up nearly 15% on Friday.

Whitbread had been pressured by activist investors to split with its coffee business. Coke approached the company about a potential acquisition in June, executives said.

Whitbread Chief Executive Alison Brittain said that Coke wasn't the only interested party, but suggested that the U.S. drinks giant's global reach allowed it to offer the most attractive deal. The agreement, expected to be completed in the first half of 2019, was signed just eight minutes before it was announced early Friday.

Costa generated revenue of £1.3 billion ($1.69 billion) in the year ended March 1 and earnings before interest, taxes, depreciation and amortization of £238 million. About 72% of its revenue came from its U.K. stores, according to a Coke presentation. By comparison, Starbucks had $22.4 billion in revenue in its last fiscal year and Coca-Cola had $35.4 billion.

Costa same-store sales have been flat, though overall sales have continued to grow as the company added outlets, including overseas, and expanded its express-coffee-machine network. Some of the sales through those machines —there are more than 7,000 in the U.K.—have cannibalized business from existing outlets, Ms. Brittain said on a conference call.

Costa has more locations in the U.K. than Starbucks but the brand is little known in North or South America, where Starbucks has more than 16,000 locations. Costa's biggest international market is China, where it has about 450 stores, but there too it is dwarfed by Starbucks' approximately 3,000 locations.

Costa's presence in China presents a growth opportunity for Coke, GlobalData analyst Jonathan Davison said. Hot-drinks-sales volume has more than doubled in volume there over the past five years, said Mr. Davison, who estimates the Chinese retail hot-drinks market will reach $34 billion by 2022.

Coke said it expects the deal to add slightly to its earnings the following year. The company said it wasn't changing its long-term financial targets.

When Mr. Quincey took over Coke from longtime leader Muhtar Kent, he pledged to speed the development of products beyond its namesake cola brand. The company's revenue has declined for several years, as it shed bottling operations and battled slowing soda volumes.

Coke's biggest brand acquisition until now was its $4.1 billion purchase in 2007 of Glaceau, the company behind the vitaminwater and smartwater brands. The company has struck smaller deals since Mr. Quincey took over, including buying Mexican seltzer maker Topo Chico and taking a stake in BodyArmor, a Gatorade rival.

Coca-Cola shares fell 38 cents Friday to $44.57. The stock has slipped 2% over the past year, missing out on a broad **stock-market** rally that has lifted the **S&P 500 Index** more than 17% to record highs.

Robert Wall contributed to this article.

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#BeyondSoda

Beverage makers are adding new flavors and new products as consumer tastes shift beyond traditional drinks like soda. The Wall Street Journal is exploring how the business is changing.

* Heard on the Street: Coca-Cola Pays Jittery Price for U.K. Coffee Chain

* Starbucks' Frappuccino Gets a Sugar Makeover

* Clear Beer? Don't Judge a Drink by Its Color

* Dull Skin? Restless Sleep? There's a Drink for That

* Liquid Diet: My Day of Drinks

* How Seltzer Is Upending Coffee and Beer

* Why Your Beverage Options Are Exploding

* Coca-Cola Launched 500 Drinks Last Year. Most Taste Nothing Like Coke.

* Mixed Drinks: How Do They Taste?

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WSJ PRO CENTRAL BANKING

Markets
Cryptocurrency Market Plumbs New Depths in 2018; At $191 billion, the total market value of cryptocurrencies world-wide is at its lowest since November

By Steven Russolillo, Paul Vigna and Akane Otani
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A broad investor retreat has pushed the market for digital currencies down 70% from its January high, reflecting user frustration over their modest inroads into commerce and a general shakeout in speculative investments.

The value of all cryptocurrencies in circulation this week fell below $200 billion for the first time in 2018, its lowest since November. The selling has been widespread and, some holders say, indiscriminate. Of the top 100 cryptocurrencies by market value, 98 were down over 24 hours, according to research site CoinMarketCap.

Cryptocurrencies are digital tokens that aim to allow users to exchange value online quickly and cheaply, mimicking some qualities of currencies such as the dollar and yen without the physical infrastructure. Proponents have said they will overtake such so-called fiat currencies, but so far few uses have emerged other than trading.

Bitcoin, by far the most widely used digital currency, this week fell below $6,000 for the first time since late June. Ether, the second-most-used coin, dropped 17% over 24 hours, according to CoinDesk.

Over the past two days, "enough people started freaking out" and selling assets that it led others to start selling as well, said Kyle Samani, managing partner at crypto hedge fund Multicoin Capital.

While the intense selling reflects a handful of market and economic factors, many users say plunging cryptocurrency prices point to the apparent failure of bitcoin, ether and other popular units to gain widespread adoption in the economy. Many view such a step as necessary to justify valuations that despite the recent selling remain well above year-ago levels.

Others say there is a growing recognition that prices may never again reach the high levels of January and foresee a rush to sell cryptocurrencies before losses deepen further. Financial products based on bitcoin and other currencies have in some cases failed to gain regulatory approval, and crypto investors have been hit with substantial losses repeatedly this year tied to hacks and other incidents in Asia.

"People are starting to realize that they drove this stuff up in a feeding frenzy, and they're starting to realize just how dangerous it is," said Mark Grant, chief global strategist and managing director at B. Riley FBR Inc., who has for months been warning clients against putting money into cryptocurrencies.

In part, the underlying sentiment shift is being driven by the rise of the dollar, amid solid U.S. growth, a series of Federal Reserve rate increases and a pullback from riskier securities issued in emerging markets such as Turkey. The MSCI World Index, a measure of global stocks, topped out in January and hasn't been able to reclaim its high since then, while bitcoin prices remain below their December peak.

Bitcoin and the wider market for cryptocurrencies often have been driven far more by so-called momentum trading than fundamentals. In 2017, investors scrambled to wager that crypto was going mainstream.

Products and services were going to emerge from the billions raised in the market for initial coin offerings that would bring in users. Wall Street and "institutional" money then would rush in to get a piece of the pie.

While the outreach to traditional markets continues—the owner of the New York Stock Exchange earlier this month launched a subsidiary to develop a compliant exchange for digital assets—there have been a number of prominent setbacks. A proposed bitcoin exchange-traded fund was in July rejected again by the Securities and Exchange Commission. The amount of institutional money flowing into the sector still appears to be small.

What's more, there still is virtually nothing holders of bitcoin, ether, or any other cryptocurrency can do besides trade it. They have no practical utility in traditional markets and in daily commerce.

Accordingly, investors are now judging that much of the market—which runs with little oversight from Wall Street regulators—is akin to "gambling," said Mr. Grant of B. Riley FBR.

Sharp declines are nothing new to users of these currencies. In 2017, bitcoin flipped between what is generally considered a bull or **bear market**—a rise or drop of 20% of more from a peak or valley—about once a month. In a particularly frenzied 40-hour run in December, it rose 40%. It proceeded to drop 25% in a subsequent 24-hour period.

That said, investors now are confronting a period in which many cryptocurrency projects have had well-publicized problems. The Ethereum network, where ether is used, has been bogged down in development. The EOS network, which was designed as a competitor to Ethereum, had several problems after its launch. For all the excitement over decentralized products and services, only a handful are actually live, and they have few users.

A highly anticipated prediction-markets service called Augur went live on the Ethereum network in July, after three years of development. After an initial burst of activity, it has failed to build any momentum, and the service remains only lightly used.

"Everyone has been searching for the killer app," said Sherwin Dowlat, a researcher at advisory firm Satis Group. "Augur's performance has left us waiting for another."

On another level, though, several people said this selloff was nothing unusual, certainly not for the hypervolatile cryptocurrency market.

"You have a crescendo, euphoria, a crash, and capitulation," said Mr. Samani of Multicoin Capital, adding this is the fourth time the market has gone through such a pronounced and well-defined cycle. His firm, in fact, had positioned itself for exactly this, despite being a long-biased fund.

"We're not as sad as you'd expect," he said.

Write to Steven Russolillo at steven.russolillo@wsj.com, Paul Vigna at paul.vigna@wsj.com and Akane Otani at akane.otani@wsj.com

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WSJ PRO CENTRAL BANKING

Markets

China Is Getting Even Tougher on Cryptocurrencies a Year After Its Crackdown; Authorities warn against virtual currency gatherings and fundraisings; some WeChat accounts blocked

By Steven Russolillo in Hong Kong and Chao Deng in Beijing
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05:46 AM
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China is tightening its clampdown on cryptocurrencies, nearly a year after the government imposed a wide-ranging ban on local exchanges and fundraising for digital currencies.

Financial officials in an eastern district of Beijing issued a notice last week to stores, hotels and offices urging them not to host any cryptocurrency-related speeches, events or activities. The document also asked that any activity be reported to local officials and said authorities were acting on behalf of a working group led by the central bank to clean up cryptocurrency trading.

In a commentary published in state media on Friday, Sheng Songcheng, an adviser to the People's Bank of China, said that after fundraisings called initial coin offerings were banned last year, government regulation will become even more restrictive. He wrote that earlier this week, authorities blocked a number of public accounts involving ICOs on the popular messaging app WeChat.

In a statement, WeChat's operator Tencent Holdings Ltd. said some WeChat accounts have published information about ICOs and cryptocurrency trading that violated government restrictions on messaging services, which were instituted in recent years. These accounts "were permanently blocked," a Tencent spokeswoman said.

Beijing's latest moves show how difficult it has been for the government to squash interest in digital currencies, despite its nationwide ban and the battering that cryptocurrencies have taken world-wide this year. China's banking and insurance regulator on Friday warned against virtual currency-related fundraising activities that occur under the guise of blockchain and financial innovation.

"Some individuals in chat groups claim they have obtained investment quotas for premium overseas blockchain investment projects," the China Banking Regulatory Commission said in a statement. "It could be an investment or could be fraudulent. These illegal activity funds mostly flow overseas, it's very hard to regulate and track."

One digital-currency venture capital fund in Shanghai was scheduled to host a blockchain event for about 300 people on Friday. After checking in with local authorities a few days ago, it was told to cancel the event, according to a person familiar with the matter.

China-founded Binance, the most popular cryptocurrency exchange world-wide by trading volume which now operates outside the country, canceled a media event that was scheduled to occur in Beijing on Friday, people familiar with the matter said.

A Binance spokeswoman said she wasn't aware of the event. "We have so many meetups around the world, and [they] may be canceled due to any reason," she said.

Cryptocurrencies have plunged into a deep **bear market** following a manic 2017 surge. The value of all cryptocurrencies in circulation fell below $200 billion last week for the first time this year, down from a high of more than $800 billion in January, according to research site CoinMarketCap. Cryptocurrencies are digital tokens that allow users to exchange financial value online quickly and cheaply, mimicking some qualities of currencies like the U.S. dollar and yen but without physical coins.

China was initially a major hub for bitcoin, which was created by an anonymous programmer during the depths of the 2008 financial crisis as an alternative to traditional currencies. Early last year, before China clamped down on trading in the country, more than 80% of global activity in bitcoin—the most popular digital currency—was conducted using yuan.

Worried about risks to investors and surreptitious money flows, China's government shut down cryptocurrency exchanges in September and banned ICOs. In February, state media reported that regulators planned to block websites, including foreign ones, related to cryptocurrency trading.

"The government is still trying to make the point that ICOs are banned," said Darren Li, a cryptocurrency investor in Beijing. A year after the official ban, he said: "I think they're sending a signal and making it clear how they stand."

Even so, many industry insiders said the burgeoning market for cryptocurrencies and the open-ledger blockchain technology that underpins them has continued to thrive in China, with some official support.

"China is the engine of blockchain application development in all of Asia," said Jehan Chu, co-founder and managing partner at Kenetic, an institutional investment and advisory platform for blockchain and cryptocurrencies in Hong Kong.

He said investors and entrepreneurs have figured out ways around the crackdown and startups haven't stopped innovating. He cited the central bank's research into digital currencies, as well as local governments' work with large companies on blockchain initiatives.

"I've always held strong to the idea that China, in the long term, is not trying to ban crypto," Mr. Chu said. "Instead, they're trying to reform it and clean it up so that they can roll it out in China the way they rolled out the internet, their own way with their own rules."

Stella Yifan Xie contributed to this article.

Write to Steven Russolillo at steven.russolillo@wsj.com and Chao Deng at Chao.Deng@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Reporter's Notebook: Ten Years After the Crisis, Jackson Hole Symposium Is a Quieter Affair; Instead of announcing any major policy shifts, the world's central bankers discussed esoteric research papers and participated in nature trips

By Paul Kiernan
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JACKSON HOLE, Wyo.—When the world's most powerful central banker walks through a room, heads turn.

Unless the room is mostly occupied by tourists and features a stuffed grizzly bear, a gift shop, and a 30-foot-high window with a panoramic view of pretty mountain scenery.

To be fair to Jerome Powell, he has only been chairman of the U.S. Federal Reserve since February. And a few guests at the Jackson Lake Lodge probably did suspect, as one middle-aged man in a biker outfit muttered, that "some politician is here."

But I didn't get the sense that being corrected by a reporter about the Fed's apolitical mandate to conduct monetary policy was what this gruff, bearded man—or many people at the lodge—had traveled to Grand Teton National Park for. When I tried to explain what central bankers were discussing at the Kansas City Fed's annual Jackson Hole symposium to a cashier in the gift shop, she responded, "Well I can see why you have a headache!" (I was purchasing ibuprofen for some mild altitude sickness).

Ten years after the financial crisis and Great Recession, no officials used the event as a platform to unveil any major policy shift, let alone plans to save the world economy from collapse. Instead they squinted to make out the Tetons through a haze of wildfire smoke, discussed esoteric research papers and participated in organized side trips to go hiking, horseback riding or floating on rafts down the turquoise-hued Snake River.

It is unclear whether such activities, undertaken in the presence of their peers, truly allow central bankers to step back from their day-to-day work and see the big picture. Over the course of cocktails and hikes, words like "my paper," and "fiscal deficit" echoed through the air.

This year's symposium was a quieter affair than on some past occasions. The top central bankers from the U.K., Japan and the eurozone were absent, while the heads of the Mexican and Brazilian central banks attended but declined to give interviews. No major news came out of the event.

That likely reflects the buoyant state of the U.S. economy. The expansion is humming into its 10th year, stocks are enjoying the lengthiest **bull market** on record, unemployment is around the lowest level in nearly two decades and inflation is right at the Fed's 2% target. Fed officials mostly agree that the current path of policy—to gradually remove crisis-era monetary stimulus by slowly raising interest rates—is the most prudent.

Though a number of uncertainties remain, neither Mr. Powell nor the Fed had much to gain by making a scene at Jackson Hole this year.

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WSJ PRO CENTRAL BANKING

Economy

Quick Hits: Hungary's Central Bank Keeps Rates on Hold; The European Central Bank could buy more Italian bonds in October

763 words
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Hungary's central bank kept rates on hold, India's currency still faces a number of risks, and a think tank made a plea for the Federal Reserve to allow the economy to run hot. Here are quick hits on central banking and related market views from around the world.

Hungarian Central Bank Keeps Rates on Hold

The Hungarian central bank kept its key interest rate unchanged at 0.90% at its monetary policy meeting, as expected. The Hungarian forint edged up slightly after the decision, with EUR/HUF recently down 0.23% at 323.12, versus 323.31 before the announcement. ING says as long as EUR/HUF fluctuates below the central bank's "pain threshold," which in their view is above 330, monetary policy is likely to remain accommodative.

Olga Cotaga

ECB to Temporarily Buy More Italian Bonds in October: Capital Economics

Capital Economics expects the European Central Bank to step up its purchases of Italian government bonds temporarily in October on technical grounds, as a large volume of bonds held by the central bank will mature, says Jack Allen at Capital Economics. More ECB purchases might help prevent bond yields from rising if Italy's government submits a very expansionary budget to the European Commission for approval that month, he says. "But any increase in purchases would be temporary, so [they] would not stop yields from rising over the coming years," Mr. Allen says, noting that a rise in net purchases in October implies that purchases would have to fall in November.

Emese Bartha

Think Tank Makes Another Plea for Fed to Run Economy Hot

While all indications are that the Federal Reserve is pressing forward with rate rises, there remains a camp of those who want rates kept low to help a robust labor market to spur meaningful wage gains. The Economic Policy Institute argues in new research that "the potential cost of running the economy ‘too hot' is dwarfed by the potential benefits stemming from faster and more equal wage growth and reduced race-based disparities in the labor market." The Fed appears to be more focused on rising inflation now and moving to what it views as a neutral funds rate, as price pressures are starting to overwhelm the modest wage gains workers have been able to score.

Michael S. Derby

Rupee Still Facing Risks

While the rupee may have stabilized for now, risks abound. Edelweiss Securities says the Indian currency's increased sensitivity to global **volatility** partly reflects its rising domestic macro vulnerabilities. The dollar hit a record high last week of INR70.39, but with the greenback's broader pullback it is back down to INR69.81. While the rupee's slide fueled chatter of a possible interest-rate move or reintroduction of the nonresident deposit scheme, Edelweiss sees a muted probability of unconventional steps to defend the currency. But it is possible if the rupee remains **volatile** and an emerging-markets outlier, the broker adds.

Debiprasad Nayak

Thailand Can Afford to Hold Off on Raising Interest Rates

Thailand's better than expected second-quarter gross domestic product data and the baht's recovery could help the Bank of Thailand stand pat, unlike Indonesia and India, which raised rates recently. The baht has been one of Asia's outperformers since July. A weaker currency stokes inflation and leads to foreign capital flight, but the baht will likely remain resilient as Thailand's economic performance should attract investments. ING sees Thailand's 2018 economic output expanding 4.3%, up from 4% seen earlier.

Kenan Machado

Inflation to Dictate South African Rand's Direction: Commerzbank

The South African rand has retraced some of the falls it made recently, with USD/ZAR hitting a five-day low of 14.3192 on Tuesday, according to FactSet. However, recent rand weakness has likely filtered through into higher inflation, which means the currency could be set to rise further, Commerzbank analysts say. "If inflation was to come in above expectations, this would probably fuel rate hike expectations, which might support the rand." The consensus in the market is that the inflation index has risen to 5.1% year-over-year in July, from 4.6% in June, the analysts say. "Conversely, a weaker than expected rate might provide additional depreciation pressure for the rand."

Olga Cotaga

(The items in this column come from Market Talk, a feature of Dow Jones Newswires that provides real-time analysis of news developments and market activity.)

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Markets

Carlyle's Results Beat Expectations; Carlyle reported second-quarter earnings that exceeded expectations, but economic net income fell and growth in its private-equity funds slowed

By Miriam Gottfried
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Carlyle Group LP reported second-quarter earnings Wednesday that exceeded expectations as the value of the private-equity firm's holdings climbed.

Economic net income, a closely watched measure that reflects changes in the value of unrealized investments, fell to $272.1 million, or 69 cents a share in the period, from $300.1 million, or 81 cents, a year earlier.

Still, the latest result was better than the 52 cents expected by analysts polled by FactSet.

The Washington, D.C., private-equity firm said net income rose 10% to $63.5 million, or 56 cents a share, from $57.6 million, or 59 cents. The value of its funds climbed 5% year-over-year in the quarter, bolstered by surging real estate and energy prices.

Investors cheered the results, with Carlyle shares rising 2.2% to $24.88 in midday trading. The stock has done little since Carlyle went public in 2012.

Also on Wednesday, Carlyle said it would acquire 19.9% of DSA Re from American International Group Inc. The partnership aims to build DSA Re, which currently manages $36 billion of AIG's life and general-insurance liabilities, into a stand-alone reinsurer. As part of the arrangement, DSA Re and AIG will invest a total of $6 billion in Carlyle's private-equity, real estate and private-credit funds.

The deal "sets up a really great path for potentially sticky assets to come to Carlyle in the future," co-Chief Executive Kewsong Lee said on a conference call with analysts.

For the second quarter, Carlyle's assets under management increased 24% from the prior year to $209.7 billion. The firm said it raised $12.3 billion in new capital in the quarter. The portion of assets that earn fees climbed 26% to $146.5 billion. Fee-related earnings were $57.8 million in the quarter, nearly triple the $20.2 million Carlyle reported a year earlier.

Growth in the firm's signature private-equity funds slowed to 3% from 4% in the first quarter and 8% a year earlier. Rival Blackstone Group LP said last month that the value of its private-equity portfolio climbed by 9.5% in the most recent quarter. The **S&P 500** rose 2.9% in the latest period.

Carlyle's distributable income, a key metric measuring the slice of profit available for payout to shareholders, fell to 29 cents a share from 56 cents a year earlier as realized net performance revenues fell. The firm said it would pay a 22 cent dividend, down from 42 cents in the second quarter of 2017.

During the quarter, Carlyle agreed to buy Australian vintner Accolade Wines Ltd. for 1 billion Australian dollars ($772 million), gaining a portfolio of popular mass-market brands.

Meanwhile, it unloaded Dutch internet and cloud-access provider Expereo BV to French private-equity firm Apax Partners, reaping a return of nearly five times its investment. Carlyle also agreed to sell South Korean security-services provider ADT Caps to SK Telecom Co.and Macquarie Group Ltd. for about $1.2 billion.

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Pricey Houses See Ready Buyers

By Laura Kusisto and Harriet Torry
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One of the nation's largest builders of high-end homes rode strong sales to a 30% jump in quarterly profit, bucking weakness in the broader U.S. housing market and bolstering evidence that the wealthiest Americans are spending big as the economy strengthens.

Toll Brothers Inc. said the profit surge came as its revenue for the quarter ended July 31 climbed 27% to $1.91 billion. Customers of the Horsham, Pa., company added $165,000 on average toward the customization and design of their houses in the period, Chief Executive Douglas Yearley Jr. said on a call with investors.

High-end retailers also have reported robust results, another sign that many wealthier Americans feel flush. Nordstrom Inc. said sales were up 7% in its most recent quarter, and Coach, which is owned by Tapestry Inc., reported a 5% increase.

Analysts expect strong results from Tiffany & Co. when it reports earnings next week. Kering, owner of Gucci, Saint Laurent and other luxury brands, said first-half revenue in North America surged 45%.

While U.S. consumer sentiment slid in early August, it remains strong among top-earning households, said Richard Curtin, chief economist for the University of Michigan's Surveys of Consumers. Households in the top third of income distribution -- who make up half of all retail spending -- "are well positioned," he said.

Those households reported greater income gains and believe their wealth will rise over the coming year. Top earners expect wage gains of 3% in the coming year, according to Mr. Curtin, while households in the bottom third of income distribution expect a pay raise of just 0.5%.

Toll Brothers said it expects the average price for its homes in the current fiscal year to be $835,000 to $860,000, raising the low end of its previous guidance by $5,000. Toll Brothers' share price surged nearly 14% Tuesday.

The builder's strong results contrast with weakness in the broader housing market. Rising prices, higher mortgage rates and a lack of inventory have pushed many less wealthy buyers out of the market. Sales of previously owned homes fell 2.2% in June from a year earlier, the fifth time in six months they declined on a year-over-year basis.

Affluent buyers are more easily able to shrug off higher mortgage rates and home prices than middle-class purchasers, analysts said.

U.S. household net worth passed $100 trillion in the first quarter, thanks in part to rising home values, according to a Federal Reserve report. Much of that is concentrated among high-end households.

"There's confidence in the economy," said Jack Micenko, a senior analyst at Susquehanna International Group. "People having equity in their homes is a huge confidence driver."

But weak wage increases combined with rising home prices, tighter credit and a lack of lower-priced houses made for a slow start to the recovery for the starter-home market, despite strong demand from millennials who increasingly have been trying to buy homes. At the same time, the higher end of the market has generally recovered strongly since the recession and housing-market crash.

Sales of existing homes over $1 million rose 7.6% in June compared with a year earlier, while sales of homes from $750,000 to $1 million rose 6%, according to the National Association of Realtors. At the same time, sales between $100,000 and $250,000 fell 7.1% -- further evidence that affordability poses a bigger challenge to middle-class buyers than higher-income ones.

Inflation also is edging up, which threatens to eat into wages of all Americans. But the more affluent tend to have much of their savings in stock and other financial instruments, which have been rising in recent years. U.S. stocks are on the verge of surpassing their longest-running rally, and on Tuesday the **S&P 500 stock index** rose to its first intraday record since January.

This has given many wealthy consumers the confidence to spend on big-ticket items like homes, despite a number of developments that economists say could derail the long expansion. The prospect of a trade war between the U.S. and major trading partners such as China and Europe is already slowing some business spending, and rising interest rates could slow borrowing and growth.

But executives at Toll said on an analyst call they see little evidence that rising rates are forcing their buyers to stretch financially. Buyers' loan-to-value ratio in the company's fiscal third quarter dropped to 67% from a more typical level of 70%. All-cash buyers jumped to 24% of all customers this year from a more typical 20%. Both metrics indicate that Toll buyers aren't straining and taking on more debt to afford houses.

Mr. Yearley said buyers are more willing to pay a bigger premium for a brand-new home than he has seen in his 28-year career.

Meantime, the market for $5 million-plus homes in New York City has slowed. Sales of apartments in that category fell 31% in the year's first half, compared with the 2017 period, according to a report by real-estate firm Stribling.

The top end of the market attracts foreign investors and ultra-high-net-worth individuals, and a slowdown doesn't necessarily portend trouble for Toll Brothers or less-wealthy buyers.

On Wednesday, economists will be looking to data from the Realtors on July existing-home sales for more clues on the market's direction.

Kimberly Chin contributed to this article.

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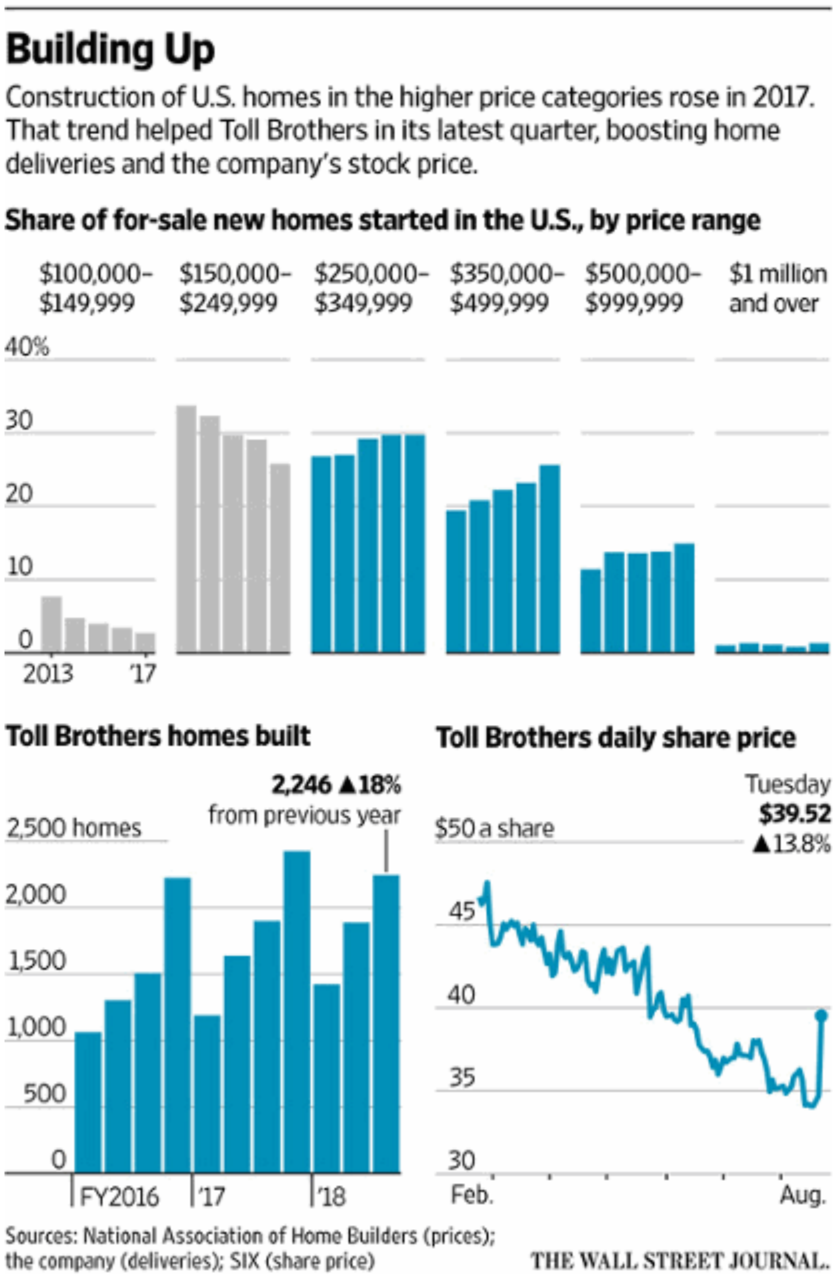

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THE WALL STREET JOURNAL.
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You Can Run, but You Can't Hide From Iran Sanctions

By Richard Goldberg and Behnam Ben Taleblu
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As the U.S. begins to reimpose tough sanctions on Iran, defenders of the 2015 nuclear deal are peddling myths. They say Russia, China and India will evade sanctions. They claim **oil prices** will skyrocket. And they predict Europe will establish a "sanctions free" payment channel to Iran. None of these warnings should slow President Trump's campaign to impose maximum pressure on the Islamic Republic.

Since the U.S. withdrew from the Joint Comprehensive Plan of Action in May, major companies like Siemens, Total and Maersk have announced their intention to stop doing business with Iran. But not only European firms must avoid the risk of sanctions. Chinese banks are highly exposed to the U.S. financial system. With China's economy cooling, and the country's banks potentially overextended on credit, state planners in Beijing can ill afford additional risk.

As the U.S. considers financial sanctions on Russia for its use of a nerve agent on British soil, Prime Minister Dmitry Medvedev recently declared that sanctions targeting his country's banks would be considered a "declaration of economic war." Why then would Russia seek to trigger mandatory U.S. sanctions on Russian banks by conducting transactions with Iran? The State Bank of India, meanwhile, has announced it will stop processing payments for Iranian oil beginning in November.

If JCPOA supporters are pegging their hopes on these countries conspiring to violate U.S. sanctions, they're going to be sorely disappointed. Their only hope is to persuade Mr. Trump not to impose the two most effective sanctions in November: one attacking Iran's largest source of revenue -- oil -- and the other attacking Iran's connection to the Swift financial messaging service.

JCPOA defenders think they can force Mr. Trump to back down on oil sanctions by spreading fear of higher prices. But the sanctions coming back in November are the same sanctions Congress enacted in 2011. At the time, the Obama administration urged Congress to reject the legislation, also claiming it would drive up **oil prices**.

What happened? In 2011, the average Brent crude **oil price** was $111 per barrel. The following year, Brent's average remained $111 despite U.S. sanctions taking 700,000 barrels per day of Iranian crude off the market. Iranian oil exports fell another 42% in 2013 while the Brent average fell slightly, to $108 per barrel, before falling below $100 in 2014.

Left alone to scare the markets, uninformed voices can produce brief upticks in **oil prices**. Accordingly, the Trump administration appears to be taking steps to calm the market's fears. In May the president issued a determination required by the sanctions law that "there is a sufficient supply of petroleum and petroleum products from countries other than Iran" to allow for a "significant reduction" in Iranian oil exports.

In June, Saudi Arabia, which strongly supports Mr. Trump's decision to reimpose sanctions on Tehran, pledged to increase oil production by as much as two million barrels a day to replace Iranian crude. Recent reporting shows Saudi Arabia and Iraq attempting to make up Iran's market share. Last week the Trump administration announced a release of 11 million barrels from America's strategic petroleum reserve.

If Mr. Trump stays the course, Iran's only hope of withstanding the pressure rests in a German plan to keep the Central Bank of Iran connected to Swift and dare the U.S. to impose sanctions on a European central bank for processing oil payments. But with the threat of financial sanctions looming over the banks represented on Swift's board -- including two American banks, Citi and JPMorgan -- the German scheme looks doubtful. Last week Sen. Ted Cruz (R., Texas) and 15 of his colleagues urged Treasury Secretary Steven Mnuchin to enforce U.S. sanctions against these banks if Swift fails to disconnect Iran by the November deadline.

Facing the likelihood that Swift will comply, German Foreign Minister Heiko Maas urged Europe to establish an alternative to Swift that could act outside of American influence. But given the current strength of the U.S. dollar and the deterrent power of secondary sanctions, no legitimate actor will want to use a payment channel that cannot do business in dollars and subjects all participants to a total cutoff from the U.S. financial system. Instead, Mr. Maas's Swift alternative would become a black market for rogue nations and illicit groups. Chancellor Angela Merkel, perhaps coming to terms with the futility of evading U.S. sanctions, threw cold water on the Maas proposal.

JCPOA defenders will continue to scorn renewed American efforts to pressure Tehran. But scorn cannot stop companies from fleeing Iran's risky business environment. Nor should it impede President Trump's resolve to reimpose and vigorously enforce the second, heavier batch of sanctions slated for November.

Mr. Goldberg is a senior adviser at the Foundation for Defense of Democracies, where Mr. Taleblu is a research fellow.

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THE WALL STREET JOURNAL.

Opinion
I Won't Ride the Trump Train Into a Trade War; Colleagues are appalled I support any of his policies. He may offset the good ones with reckless tariffs.

By Robert J. Barro
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Most of my academic colleagues are Democrats. But even the few who are Republicans are for the most part ardent Trump opponents. So I tend to get into trouble whenever I say something positive about administration policies. Common reactions include: "Are you a Trump supporter?" or "How the hell can you be a Trump supporter?" or similar queries that are more colorful.

The truth is the administration has notable achievements. The recent tax reform improved the structure of corporate taxation. This will contribute to long-term investment and economic growth. It will also increase employment and real wages. Tax-rate cuts on the individual side were mostly favorable, enhancing short-term growth prospects in particular. The strong growth of real gross domestic product in the second quarter provides some early evidence of tax reform's success.

Regulatory changes have also been pro-growth, particularly concerning energy, the environment and **financial markets**. And I have to mention the high quality of judicial appointments. Remarkably, this strong record of accomplishment has occurred despite nearly monolithic opposition from congressional Democrats.

Unfortunately, these successes may now be more than offset by President Trump's irrational trade war. It's a fair point that China and some other countries heavily restrict imports, constrain foreign businesses, and steal advanced technologies. Countering these actions is a worthy goal. But it won't work to punish China and others by curtailing the amounts that Americans buy from them through imports. The underlying mercantilist view—that there is no downside to cutting off imports because our benefits from international trade arise only from what we sell—is, frankly, ridiculous.

Living without foreign-produced goods hurts Americans more than our trading partners. And the calculations only get worse when one factors in the inevitable retaliation. Foreign countries have already begun restricting U.S. exports. They are also entering into free-trade arrangements that exclude the U.S. It is hard to complain about Japan expanding trade with other Asian countries or the European Union, but this expansion comes partly at the expense of U.S. exports.

The fundamental benefits of free trade remain, even if they escape the comprehension of the president and some of his advisers. Trade allows countries to concentrate their effort and production on goods and services for which they have comparative advantage, either because of underlying endowments or because of scale benefits from products in which they have chosen to specialize. It isn't a zero-sum game. Greater international trade benefits the whole world.

At first I thought the president's rhetoric about trade restrictions wouldn't be translated into major action. But it is now clear that he, reinforced particularly by Commerce Secretary Wilbur Ross, is committed to a trade war. This policy constitutes a serious depression risk, analogous to that from the Smoot-Hawley Tariff of the 1930s.

It is possible that actual and threatened tariffs will motivate other countries to join the U.S. in a mutual reduction of trade barriers. Mr. Trump's apparently constructive meeting with the president of the European Commission is a possible example. But there is extreme downside risk, with the most likely outcome being greater trade restrictions and reduced global commerce. In fact, a danger in the recent pleasantries from the Europeans is that they may encourage Mr. Trump to be even more aggressive in his dealings with China and others.

I expected that markets would react sharply to Mr. Trump's trade policies and that a sharp decline in stock prices would help limit how far he could go. While the market has fallen with each threat of a trade war, the overall effect has so far been mild. But Mr. Ross said last month that the administration wouldn't be deterred even if the **stock market** keeps falling, writing it off as **volatile** and uninformative. Apparently Messrs. Ross and Trump know better than **financial markets** and economists about the long-term consequences of trade wars. So far, we have been lucky to avoid a **stock-market** crash, but we are by no means safe from a future one.

To return to my musings about whether I support Mr. Trump, I recall a long ago assessment I made of President Nixon: He didn't deserve to be impeached for Watergate but did deserve to be impeached for price controls. Similarly, Mr. Trump doesn't deserve to be impeached for his myriad instances of political incorrectness, but he may deserve to be impeached for his trade war.

Mr. Barro is a professor of economics at Harvard University and a visiting scholar at American Enterprise Institute.

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I Won't Ride the Trump Train Into a Trade War

By Robert J. Barro
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market keeps falling, writing it off as **volatile** and uninformative. Apparently Messrs. Ross and Trump know better than **financial markets** and economists about the long-term consequences of trade wars. So far, we have been lucky to avoid a **stock-market** crash, but we are by no means safe from a future one.

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Mr. Barro is a professor of economics at Harvard University and a visiting scholar at American Enterprise Institute.

(See related letter: "Letters to the Editor: Tariffs Can Be Useful if They're Used Wisely" -- WSJ Aug. 20, 2018)

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THE WALL STREET JOURNAL.

Markets
Oil Prices Steady After Sharp Fall; China published a fresh list of tariffs on U.S. goods Wednesday. While crude was left off, traders see its eventual inclusion as inevitable.

By Sarah McFarlane
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Oil prices steadied Thursday after falling sharply on expectations that crude would be drawn into the U.S.-China trade dispute, along with downward pressure from **bearish** U.S. stocks data.

Light, sweet crude for September delivery closed down 0.2% to $66.81 a barrel on the New York Mercantile Exchange, reversing gains from earlier in the session. Brent, the global benchmark, fell 0.3% to $72.07.

China published a fresh list of tariffs on U.S. goods Wednesday as trade tensions escalated. While crude was left off the list of targeted products, analysts and traders see its inclusion as inevitable. Brent **oil prices**closed over 3% lower Wednesday.

"I think the question is not if, but when. Sinopec is already cutting its purchases of U.S. crude oil, so even though crude oil is not on the list, it is as good as if it was," said Olivier Jakob, head of energy consultancy Petromatrix.

The weakening demand for U.S. crude in China will mean more of it ends up in the Atlantic Basin, which is likely to pressure the North Sea benchmark Brent price lower, Mr. Jakob added.

The U.S. Energy Information Administration data published Wednesday showed U.S. crude stocks fell by 1.4 million barrels—less than expected—in the week ended Aug. 3. Meanwhile, total stockpiles of crude and fuels such as gasoline rose to the highest levels since early January.

"Disappointing weekly oil market statistics showing more ample than expected supplies added to the price slide," said Norbert Rücker, head of macro and commodity research at Julius Baer.

Further downside for prices is expected to be limited by the impending reinstatement of oil-related sanctions against Iran, due in November. Already, many buyers of Iranian crude have looked to alternative suppliers.

The worst case scenario could see between 1.5 million and 2 million barrels a day of Iranian crude removed from the market, said Tamas Varga, an analyst at brokerage PVM.

Gasoline futures declined 1% to $1.9999 a gallon and diesel futures fell 0.2% to $2.1119 a gallon.

Stephanie Yang contributed to this article.

Write to Sarah McFarlane at sarah.mcfarlane@wsj.com

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

This Year's Big Disrupter: The Dollar; Lucrative trades were upended by the second-quarter rise in the dollar. Getting the greenback's path right matters.

By Richard Barley
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Much of the disruption to global **financial markets** this year has come from a source close to home: the U.S. dollar.

Investors obsess over stock indexes and bond yields but the most important number in **financial markets** may be the dollar's exchange rate. That was clear when the dollar's sudden rise in the second quarter derailed many moneymaking trades and changed the path of economies and industries. In some places, the pain is extending: The Turkish lira went into meltdown this week, sending ripples through global markets. Friday, the ICE dollar index hit a fresh one-year high.

The dollar's rebound came after a broad decline in 2017, as growth outside the U.S. picked up. That lured investors into riskier bets: the MSCI Emerging Markets **stock index** gained over 30%.

This year kicked off in similar style. But then U.S. growth vaulted higher and momentum stalled elsewhere, sending the dollar on an unexpected upturn. It gained 5.5% against the euro and 4.2% against the yen in the second quarter; moves in emerging markets were even bigger, with the greenback up 17% against the Brazilian real and 16% against the South African rand.

Nearly everything that surged in 2017 has wilted in 2018. After months of tumult, there is reason to believe the rest of the year will be calmer for the dollar, meaning less risky for emerging markets and other **volatile** assets.

The oddity is that much of the uncertainty about global growth has been generated by unorthodox U.S. policy, whether on tax, trade, or political alliances such as NATO. But even as the U.S. becomes the global disrupter, its assets have proved more alluring for investors. The dollar has kept its role as a magnet in times of doubt.

That is in part because the dollar remains so dominant. In the $5.1-trillion-a-day foreign-exchange market, the U.S. currency is on one side of 88% of all trades, according to the Bank for International Settlements' 2016 survey. While its weight in foreign-exchange reserves has declined a little, it still accounts for 62.5% of the $10.4 trillion in allocated reserves identified by the International Monetary Fund. The euro, meanwhile, accounts for 20.4%. U.S. capital markets are the biggest and most liquid in the world, making the dollar attractive both to companies looking to raise finance and investors with cash to put to work.

The dollar's path not only reflects changes in global growth, but can also steer them. Most notably, a rising dollar tightens financial conditions in emerging markets: It may lead central banks to raise rates to shore up their currencies, for example, or dampen the appetite of commercial banks to lend in dollars since their chances of getting paid back declines as the local currency falls. While floating exchange rates in emerging markets have reduced the risk of sudden explosive crises, they come at this cost.

The dollar's performance in the second half could be less disruptive. Against major currencies like the euro, the greenback has stopped climbing. A good deal of divergence between growth and monetary policy in Europe and the U.S. already looks priced in.

Where the dollar's strength has exposed weak links in emerging markets, it may continue to cause problems. For countries like Turkey, where the lira is down 36% this year, the problem now is homegrown, not external: There is a serious loss of investor confidence that wouldn't be solved by a broad-based weakening in the dollar. The bigger picture will be influenced a good deal by the trade dispute between the U.S. and China and whether the Chinese yuan continues to fall, raising depreciation pressures on other currencies.

For all that the dollar's rise has accompanied stronger growth in the U.S.—with second-quarter gross domestic product expanding at a 4.1% annualized clip—there is a domestic downside. Over time, a stronger dollar can hurt U.S. corporate profits as exports become less competitive and foreign earnings are worth less translated back into dollars. While tax cuts have boosted economic growth, they have also raised the budget deficit, which may lead investors to start thinking about the scale of U.S. borrowing.

The flip side could be a debate about whether assets denominated in other currencies are cheap enough to be attractive. Growth outside the U.S. has shown signs of stabilizing, and overseas stocks have started to rebound. A less disruptive dollar could, given time, add to the momentum beyond American shores.

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WSJ PRO CENTRAL BANKING

Markets

A Messy Battle Brews in the Options Market; Craig Donohue, CEO of the only U.S. options clearinghouse, is clashing with traders over his plans

By Gunjan Banerji
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Craig Donohue's turnaround plan for the nation's options clearinghouse has hit a roadblock.

Mr. Donohue has boosted the prominence of Options Clearing Corp., which acts as a guarantor for every trade in the U.S. listed options market. Clearinghouses—critical parts of the financial system—came under greater scrutiny after the last financial crisis and are responsible for preventing potential defaults from rippling through markets.

But after four years at the helm, the OCC's executive chairman and chief is locked in a fierce battle with options traders who oppose his plan to boost income for OCC shareholders—three publicly listed exchange-operators—while trimming returns to traders.

A group of trading firms and smaller, competing exchanges, including Susquehanna International Group LLP and Virtu Financial Inc., made the unusual move of suing the Securities and Exchange Commission in 2016 for approving the OCC proposal early that year, throwing the plan's fate up in the air. The SEC is currently re-reviewing it on the order of a U.S. appeals court. A spokesman for the SEC declined to comment.

Though the plan remains in place and has been paying dividends to shareholders, its future is unknown. Shareholder payouts have been climbing since their inception in 2015, hitting a high in 2017, according to OCC financial statements and comments to the SEC.

Mr. Donohue defended his actions in an interview last November. "I'm confident that we did a professional and thorough job," he said. "We think this is the right plan." OCC had no additional comment this week.

The conflict is a setback for Mr. Donohue, a Chicago-area native who made a name for himself leading exchange giant CME Group Inc. During his time there, he helped oversee $20 billion in acquisitions and the company went through an initial public offering—the first U.S. exchange to go public.

Now the OCC is mired in uncertainty over the capital plan that Mr. Donohue helped devise years ago. In a separate pressure point, the SEC is investigating how the OCC handled a bout of market **volatility** this year, raising questionsabout an entity essential to the market's financial plumbing.

Just before Mr. Donohue became chief in 2014, the SEC hit OCC with a range of criticisms on how it manages risk. After the 2008 financial crisis, OCC was deemed one of a handful of financial institutions considered "systemically important." This designation led to Mr. Donohue's overhaul. When he joined the OCC, the clearinghouse had only enough cash to operate for about six weeks, he said in the November interview. He helped raise its cash stockpiles to $247 million from $25 million, giving it a bigger cushion to buffer against losses.

Mr. Donohue also raised the OCC's visibility. In late 2017, the firm's executives rang the closing bell at **Nasdaq** Inc. in Times Square—the first time in its four-decade existence that the clearinghouse participated in the tradition.

"He's taking his CME reinvention hat over to OCC," said Craig Pirrong, a professor at the University of Houston who has consulted for exchanges.

For decades, OCC's potential to generate cash had sat untapped. It essentially operated as a nonprofit utility for the industry. Money made from clearing fees was spent mostly on bare-bone expenses, and leftover cash was returned to members, like banks and other firms that give traders access to clearing.

Under the new plan spearheaded by Mr. Donohue, money is paid to the shareholders, which are the three biggest options-exchange operators—Intercontinental Exchange Inc.'s New York Stock Exchange, **Nasdaq** and Cboe Global Markets Inc.—in return for cash posted by the exchanges to OCC.

Options traders say the plan could hurt investors by making it more onerous to trade and potentially crimping liquidity in the markets, affecting how difficult it is to swoop in and out of positions. They say it exploits the clearinghouse's monopolistic position, since all listed options trades funnel through the central entity. Smaller exchange competitors have argued it gives the owner exchanges an additional stream of revenue and an unfair advantage in the fiercely competitive options market.

The shareholder returns "create a ‘golden goose'" that produces "outsized returns into perpetuity to the sole benefit of those shareholder exchanges," wrote David Thompson, a lawyer representing Susquehanna, Virtu and smaller exchanges at Cooper & Kirk PLLC in January.

A spokesman said the OCC is committed to a structure as an industry utility and still gives refunds to clearing members.

In a blow to the OCC, Chief Judge Merrick Garland of the U.S. Court of Appeals ordered the SEC to re-evaluate the OCC's proposal last year, saying it didn't do a rigorous job of determining whether the shareholder payouts hurt investors. "That is a central issue: if the dividend rate represents an unnecessary windfall for shareholders," he wrote.

If the SEC rejects the proposal after its review, Mr. Donohue will have to return to the drawing board and devise a new plan to meet regulator demands.

People who have worked with Mr. Donohue describe him as shrewd, precise and competitive. Equipped with a law degree and two master's degrees, he is known for sporting plaid blazers and driving a white Bentley convertible with "DONOHUE" on the vanity plate, they say.

Potentially adding uncertainty, the NYSE recently considered selling its stake in OCC, according to people with knowledge of the matter. The Depository Trust & Clearing Corp., a clearinghouse for stocks and bonds, approached the OCC about a potential merger, but those talks have since cooled, according to the people.

The DTCC is "continually assessing opportunities to enhance our support of clients, improve operational efficiencies and strengthen risk management across the industry," a spokesman said. "There is nothing specific to report at this time." Representatives of the NYSE and the OCC declined to comment on the matter.

At the heart of the OCC's recent conflict is whom the clearinghouse is supposed to serve: exchange owners or options traders.

Cboe, the NYSE and **Nasdaq** were all once member-owned organizations that went public. Their transformations into publicly traded, for-profit entities remains a contentious topic of debate on Wall Street.

Critics of Mr. Donohue's plan have pointed to the DTCC as an example of how clearinghouses should run, saying that it hasn't paid excessive profits to shareholders or hurt competition.

"Exchanges and clearers have these natural monopoly positions," said the University of Houston's Mr. Pirrong. "Their decisions have big impacts on how wealth and revenue is distributed among the industry."

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Economy

Japan Logs Bigger Than Expected Trade Deficit in July; Japan's trade surplus with the U.S. dropped 22%

By Mayumi Negishi
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TOKYO—Japan logged a bigger-than-expected trade deficit in July, its first in two months on a tumble in car exports to the U.S. and an increase in imports of crude oil and medical supplies, data from Japan's finance ministry showed Thursday.

Japan's exports to China continued to outweigh those to the U.S., the data showed, as the latter pursues President Trump's "America first" policy to curb imports, prompting manufacturers to turn to the Asian market.

Japan posted a trade deficit of ¥231 billion ($2.08 billion) in July, missing an estimate for a deficit of ¥50 billion in a Nikkei survey, amid the escalating global trade tensions.

Japan's exports to the U.S. fell 5% from a year ago, due to decline in shipments of cars, car parts and chip-making tools, the ministry said. Its trade surplus with the U.S. dropped 22% to ¥502.7 billion. Japan remains sensitive to Mr. Trump's criticism of Japan's high trade surplus with the U.S.

Meanwhile, Japan's exports to China jumped almost 12% from the previous year, as China seeks independence from Western countries for its semiconductor needs, and as Tokyo looks to strengthen ties with countries upholding more open trade.

July's 3.9% rise year on year in overall exports—a straight gain for 20 consecutive months—missed the 7.0% increase expected by economists polled by The Wall Street Journal, while overall imports rose 14.6% on a rise in crude **oil prices** and a jump in demand for medical supplies from Ireland.

Economists said they expected imports to level off in tandem with **oil prices**, but exports would continue to grow, although at a slower pace than last year, due to fears about a possible global trade war.

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The New York Times

Briefing
Michael Cohen, D.N.C., Tariffs: Your Wednesday Evening Briefing

By Joumana Khatib and Marcus Payadue
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(Want to get this briefing by email? Here's the sign-up.)

Good evening. Here's the latest.

1. A grim focus in the White House:

The morning after the conviction of Paul Manafort, his former campaign chairman, and a guilty plea by Michael Cohen, his former personal lawyer and fixer, President Trump monitored the headlines, sat for an interview with Fox News and discussed ways to try to seize the news cycle again.

But the legal setbacks — and the possibility that both defendants might cooperate with the special counsel — have all but collapsed the president's attempts to dismiss the criminal investigations engulfing his tenure. Even Mr. Trump's staunchest defenders acknowledge that he could be exposed to the possibility of impeachment.

We know it's a confusing story. Here's an overview of all the moving parts.

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2. The Democratic National Committee said it had warded off an attempt to hack its voter database.

The F.B.I. is investigating the attack, which the committee learned of this week, according to two officials. It was not immediately clear who was behind the hack. The committee was hacked in 2016 during the presidential election campaign, and the episode was later traced back to Russia.

"This attempt is further proof that there are constant threats as we head into midterm elections and we must remain vigilant in order to prevent future attacks," said Bob Lord, chief security officer for the committee.

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3. Facebook said it had removed 652 fake accounts, pages and groups that were trying to sow misinformation.

The activity originated in Iran and Russia, Facebook said. Unlike past influence operations on the social network, which largely targeted Americans, the fake accounts, pages and groups were this time also aimed at people in Latin America, Britain and the Middle East, the company said.

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4. By one measure, the **bull market** hit a milestone — but most Americans aren't at the party.

After 3,453 days, it ranks among the great booms in American market history. But as the **stock market** surged, prices for homes — the most important source and store of wealth for the American middle class — recovered much more slowly from the Great Recession and housing bust. Incomes, too, have barely budged.

One economics professor put it bluntly: "This is the decade in which wealth inequality has increased the most in U.S. history."

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5. For many consumers, the trade war with China will hit home this week, when the White House said it would impose a 10 percent tariff on another $16 billion worth of Chinese products. That will bring the total so far to $50 billion.

From bicycles to luxury handbags, here are eight ways you might feel the pinch.

As tensions ramped up, Chinese state media took a jab at President Trump in a satirical video, thanking him for helping make China stronger.

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6. Saudi Arabia is seeking the death penalty for Israa al-Ghomgham, a 29-year-old female activist accused of encouraging demonstrations for Shiites, Human Rights Watch said.

The kingdom has one of the highest rates of capital punishment in the world. But calls to execute a woman in a case of nonviolent political crime are highly unusual.

The move contradicts Crown Prince Mohammed bin Salman's efforts to brand himself as a reformer.

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7. For patients with an aggressive skin cancer that has spread to the brain, immune-activating drugs can shrink tumors and prolong survival, a new study found.

Melanoma is more likely than most cancers to spread to the brain, and once it gets there, fewer than 20 percent of patients survive one year with traditional treatments, an author of the study said. But this treatment could help many more patients.

In other health news, you've probably heard all about the benefits of vitamin D. But what most Americans don't know? The doctor whose enthusiasm for the supplement helped propel it to fame, above, has received hundreds of thousands of dollars from the vitamin D industry.

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8. Air pollution is shortening your life.

Months, and sometimes years, are being shaved off life expectancy, according to a new study.

Outdoor air pollution — fine particulate matter from sources like coal-fired power plants, truck tailpipes, wildfires and dust storms — reduces the worldwide average life expectancy at birth by one year, researchers found. The average Egyptian loses 1.9 years; the average Indian, 1.5 years; the average American, a little more than four months.

Many of the sources of outdoor air pollution are linked to greenhouse gas emissions, suggesting that moving to cleaner sources of energy could deliver public health dividends.

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9. Hawaii is bracing for Hurricane Lane, a Category 4 storm that forecasters say could bring whipping winds, flooding and high surf.

The state closed government offices, including public schools, on the Big Island and Maui, in anticipation of the storm, which has 155-m.p.h. winds.

For a brief period, Hurricane Lane was a Category 5, making it only the second storm at that strength to travel within 350 miles of Hawaii in the state's history, according to the National Weather Service.

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10. Finally, the Netherlands is trying out a new approach to treat patients with dementia, including simulated beach scenes and other sensory aids.

The treatment harnesses the power of relaxation, childhood memories, family structure and other tools to heal, calm and nurture the residents.

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It’s a sharp departure from the old prescription of bed rest, medication and, in some cases, physical restraints. And it seems to be making a difference: “It’s really about all the little things that make a normal life,” said one nurse.

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WSJ PRO PRIVATE EQUITY

Pro Private Markets

Fundraising Pulls Back as Investors Get Defensive; U.S. fundraising declines in the first half across a range of fund types, as investors become pickier about which groups they back.

By Chris Cumming, Tomio Geron and Laura Kreutzer
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Private-equity fundraising took a breather in the first half of the year, as flat public markets and fears of a slowdown caused investors to back off from the record-setting commitment pace of recent years.

The long private-equity fundraising boom didn't show any signs of stopping during the first six months of the year, but the level of investment tapered off from perhaps the highest ever to merely very good. Overall capital raised by private-equity and venture funds in the U.S. declined by a modest 13% to $173.05 billion from $199.92 billion during the same period a year earlier, according to LP Source, a data provider owned by WSJ Pro Private Equity publisher Dow Jones & Co. Capital raised dropped across nearly all major fund categories except for venture capital, and the overall number of fund closings dropped across the board.

Corporate Finance Dips in First Half as Megafunds Sit Out

The $121.25 billion raised by U.S. corporate-finance funds in the first half is a healthy sum by historical standards, but 15% lower than the 2017 pace, and the 210 funds that held closings represented a 14% drop, according to LP Source data.

Demand for private-equity funds is holding steady but isn't increasing as it did through 2016 and 2017. The **stock market** was flat over the first six months of 2018, which took pressure off limited partners to increase allocations to keep up with a rising market. Distributions have relaxed somewhat, reducing the urgency to keep pushing money out the door.

There also has been a subtle but clear shift by some LPs into a more risk-averse pose, industry observers said. Wary of signs of froth in the market, investors have become more selective when committing to new managers, and some have started to favor countercyclical strategies.

"We're starting to see an increased interest on the part of investors in defensive strategies," said Kevin Naughton, who co-leads the private-funds group at Credit Suisse Asset Management.

Fundraising declined across a broad swath of corporate-finance-fund types compared with the first half of 2017. Traditional buyout funds raised $53.24 billion, or 24% less capital than the same period last year. Growth and expansion funds raised 7% less than they did during the first half of 2017, while industry-focused funds rounded up 5% less. Meanwhile, capital collected for real-assets funds dropped 38%.

The only categories of U.S. corporate-finance funds that collected more money than they did a year earlier were restructuring and distressed-debt funds, which raised 3% more, and diversified private-equity funds, which raised 95% more. The latter category represents funds that invest across a broader capital structure than just buyouts, including venture and growth investments.

The popularity of distressed and diversified funds reflects concerns that high asset prices are making it harder for straight-down-the-middle buyout vehicles to earn the exceptional returns they once generated. Leverage multiples and underwriting criteria are becoming a bigger part of the due-diligence process, and LPs want to back sponsors that can unearth value in an overpriced market. As a result, so-called deep-value strategies, which target underpriced assets, and sponsors with specific operational expertise are becoming more in demand, placement agents said.

The largest distressed or restructuring fund to close in the first half was Strategic Value Partners' latest special-situations fund, which held a final closing on $2.85 billion, while the largest diversified private-equity fund to close was General Atlantic's General Atlantic Investment Partners 2017 LP, which closed with at least $3.29 billion.

There have been other surges of interest in distressed funds in recent years—for instance, following the 2014 **oil-price** decline and after the late-2015 stock selloffs in the U.S. and China—but managers often have struggled to access deals, as corporate defaults have remained low.

Nonetheless, after nearly a decade of economic expansion, many investors again feel confident that distressed funds will have their moment, if not this year then within the long-term time frame of a private-equity vehicle.

"Those that are interested in deep value and distressed are willing to sacrifice short-term performance for long-term outperformance," said Eric Zoller, founder of placement agent Sixpoint Partners.

Overall, the first half saw a lull in the fundraising cycle for the biggest managers, after Apollo Global Management LLC, KKR & Co., Silver Lake and others closed funds in the double-digit billions last year. The largest buyout fund that held a final closing in the first half of 2018 was American Securities' newest vehicle, which gathered $7 billion.

As the fundraising cycle accelerated in recent years and firms have shortened the interval between funds, re-ups with large, established firms have taken up a larger proportion of LPs' available cash. But when backing new groups, they often look for niche strategies such as ones with operational or sector specialties, or strategies that aren't correlated with broader markets, said Peter Martenson, a partner with placement agent Eaton Partners.

"If they're adding new strategies to developed programs, they're no longer going for broader generalist strategies," he said.

Along with an increase in operators raising funds, there has been a "continued resurgence" in venture and growth investing, said Mr. Martenson. For some LPs, high deal prices make quickly-expanding companies more appealing, Mr. Zoller said.

Growth-equity or expansion funds raised in the first half include Providence Equity Partners' Providence Strategic Growth III LP, which gathered $1.3 billion, and a $2.4 billion vehicle Thoma Bravo closed to back midmarket software deals.

However, there is some skepticism about tech buyouts, a sector many investors view as oversaturated. That isn't likely to stop the hottest players from raising new funds—Thoma Bravo and Vista Equity Partners are both in the process of raising funds targeting more than $10 billion, for instance—but many investors want to see more exits of recent big-money deals before committing more capital, placement agents said.

The private-debt market also strikes some LPs as oversaturated, with a number of firms having launched debt platforms in recent years. Private-debt fundraising fell 52% in the first half compared with the same period last year, and the number of closings declined by 26%. The bar for new investment in credit has risen simply because the field is so crowded with managers raising money, placement agents said.

Venture Capitalists Raise More Capital for Fewer Funds

Venture-capital firms continue to benefit from LP appetite for the latest hot startups this year as large offerings help drive fundraising totals.

During the first half, venture firms raised $26.66 billion, up about 19% from $22.33 billion in the first half of last year, driven partly by $6 billion raised for Sequoia Capital's global growth fund, according to LP Source. The overall number of funds raised declined by about 7%, however, to 297 funds during the first half from 321 offerings during the same period last year.

Fundraising accelerated in the second quarter with $17.74 billion raised, up 22% from $14.49 billion during the year-ago period. Even excluding Sequoia's fund, U.S. funds raised $11.74 billion in the quarter, which is the industry's largest quarterly haul since the second quarter of last year, when New Enterprise Associates closed its $3.3 billion fund.

Although industry veterans such as CRV, Meritech Capital Partners and Sequoia enjoyed fundraising success during the first half, investors also showed a willingness to bet on newer groups. At least 29 debut funds, often ones focused on very narrow strategies, have formed this year as of July 18, according to LP Source.

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The increase of capital pouring into late-stage funds hasn't slowed down, thanks almost entirely to Sequoia's new fund. That fund accounted for the lion's share of the $7.46 billion raised by nine late-stage offerings during the first half.

Firms that invest across multiple venture-capital stages saw the overall number of funds that held closings increase more dramatically than capital raised. During the first half, 68 funds raised money, up 19% from 57 funds that held closings in last year's first half. Capital collected, however, only rose by 9% during those periods to $10.23 billion during the first six months of this year.

Early-stage funds collected $8.30 billion in the first half, slightly less than the $8.48 billion raised in the comparable period last year. However, the number of early-stage closings declined by 17% to 202 fund closings during the first half from 244 in the year-earlier period. Early-stage investors that raised funds this year include veteran firms 8VC, Matrix Partners, Emergence Capital, Madrona Venture Group, Redpoint Ventures and Venrock, as well as newcomer Unusual Ventures.

Despite the increasing amount of capital flowing into startups, LPs continue to seek out venture funds where they can find strong returns, said Tim Porter, a managing director at Madrona, which recently raised a $300 million early-stage fund for startups in the Pacific Northwest.

"The LP community is receptive, assuming you post strong returns," he said.

Large Secondary Firms Pause to Reload

Fundraising for secondary vehicles has cooled off after a few years of furious growth, with $9.18 billion raised by U.S. and European managers in the first half, down substantially from $17.49 billion raised during the first half of 2017. When calculating secondary fund totals, WSJ Pro Private Equity combines U.S. and European data because those managers often invest their funds globally.

The decline from last year's first half stems from the fact that few, if any, of the largest secondary firms held big closings during the first six months of this year.

The first half belonged largely to firms targeting smaller deals or specialized strategies, including HQ Capital, PineBridge Investments and RCP Advisors. Among the largest funds to raise capital during the first half were a $1.75 billion real-assets secondary fund from Blackstone Group LP's Strategic Partners unit and a new midmarket-focused vehicle being marketed by Deutsche Bank AG spinout Glendower Capital. Glendower closed on $1.3 billion for the fund, putting it about halfway to a $2.5 billion hard cap.

The secondary fundraising lull comes as secondary deal making continues to move at a record pace. During the first half, alone, secondary deal volume hit $27 billion, putting it on track to exceed the record level hit in 2017, according to intermediary Greenhill & Co.

But the fundraising lull may be short-lived. Firms that include Coller Capital, Ardian and Lexington Partners are pitching massive new funds to investors. Lexington, for one, is expected to hold a substantial closing of its next flagship fund before year-end, said people with knowledge of the firm.

Preparing for a Second-Half Bump

Although it was a relatively quiet first half for the biggest private-equity firms, and a crowded field for the smaller players, sponsors with creative fund strategies remain in demand. As the year continues to unfold, anticipated closings from larger players such as Thoma Bravo, Vista, TCV and Lexington could substantially boost totals by year-end. Early in the third quarter, for example, Insight Venture Partners closed its 10th tech-focused fund at $6.3 billion.

The largest firms still dominate the fundraising market, but as their returns fall, investors are seeking out niche strategies for the kind of home-run returns that large-cap funds no longer consistently offer, said Christopher Godfrey, president of private-equity analytics company Cepres GmbH.

"Investors tend to be more attracted to the brand names for security but are looking around the fringes for increased performance," he said.

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EXCHANGE --- Bitcoin Offshoot Is Down Nearly 90%

By Alexander Osipovich
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The **bear market** in cryptocurrencies has punished investors who bought bitcoin at the height of cryptomania last year. But losses have been even more brutal for those who invested in once-promising rivals of bitcoin.

Consider Bitcoin Cash, an offshoot of bitcoin that launched on Aug. 1, 2017, and that moves independently of bitcoin itself.

While bitcoin has fallen 67% from its record intraday high of $20,089 in December, Bitcoin Cash is down a crushing 88% from its peak of $4,355.62, according to CoinMarketCap.com. Friday evening, it traded at around $533.

Hundreds of other coins have also plummeted in value, but the underperformance of Bitcoin Cash is notable because it touches on a bigger theme: whether virtual currencies can really become a means of payment that would supplant traditional money.

Supporters of Bitcoin Cash conceived it as a way to fix problems that they believed were impeding bitcoin from becoming a mainstream payment tool, akin to PayPal or Visa.

Boosters -- including Roger Ver, a prominent crypto investor often called Bitcoin Jesus -- argued that the original bitcoin network had become too slow and that users were paying overly hefty fees for sending each other bitcoins. This faction contended that bitcoin's clunkiness was causing people to treat it as a store of value, like gold, and not as a practical way to buy Big Macs or cappuccinos.

There is still a lively debate over whether bitcoin is any good as a medium of exchange. Many bitcoin holders view it as a hedge against the collapse of government-backed currencies, but don't often use it to pay for things.

After waging an unsuccessful campaign to change bitcoin from within, the rebels broke off and created Bitcoin Cash, in a so-called fork that bitterly split the virtual-currency community. The underlying technology of the new cryptocurrency was almost identical to that of bitcoin, except for tweaks aimed at speeding up transactions and lowering fees.

One year later, some research suggests the breakaway coin hasn't lived up to its promises. A study of activity by major cryptocurrency payment processors -- which help businesses accept payments in crypto -- found that just $3.8 million of payments were made in Bitcoin Cash in May. That is down from $10.5 million in March, according to Chainalysis, an analytics firm that carried out the study.

Backers of Bitcoin Cash note that payments in bitcoin are also down -- if not quite as sharply -- and that their preferred cryptocurrency is cheaper to use.

"Despite the decline in price, all the exciting innovation is happening in [Bitcoin Cash]," Mike Komaransky, an adviser to the Bitcoin Cash Association, a group that promotes the use of the cryptocurrency, said in an email. Mr. Ver, another adviser to the group, didn't respond to a request to comment.

There are many reasons why bitcoin and other cryptocurrencies haven't taken off as a form of payment, including their **volatility** and uncertain regulatory status, which has kept many businesses from embracing them.

Bitcoin Cash is still the fourth-most-valuable cryptocurrency by market capitalization, but its value relative to bitcoin has sagged, suggesting that investors who once bet on it may have shifted back to the original. One unit of

Bitcoin Cash is now worth about 8% of one bitcoin, down from 18% in early May, CoinMarketCap.com data shows.

For the average investor, the technical distinctions between the two may not be that important. Instead, the market seems to be favoring the one with the stronger brand, according to Martin Garcia, a managing director at Genesis Global Trading Inc., a digital-currency trading firm.

"Bitcoin is expressing itself as the more dominant token," he said.

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The New York Times

Business Day
Why Elon Musk Reversed Course on Taking Tesla Private

By David Gelles
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When Elon Musk declared this month that he wanted to take Tesla private, his board was caught off guard. Barely three weeks later, the chief executive told the board he had changed his mind. Tesla would be staying public, after all.

The startling reversal — announced late Friday in a blog post, a day after he discussed it with directors — capped a tumultuous series of moves that drew in Wall Street's biggest investment banks, prompted an investigation by regulators and raised fresh questions about Mr. Musk's leadership.

In that time, according to five people close to the events, Mr. Musk came to realize that his thinking had been overly simplistic. While going private might have removed some problems, it would have introduced new ones.

Among his concerns were ceding too much control to private investors — including conventional car companies and Saudi Arabia, a symbol of big oil — and shutting out smaller investors who might be unable to retain a stake.

Those were issues both symbolic and substantive for Tesla, which has staked its future on making electric vehicles the transportation of choice — a vision that has made it the nation's most highly valued car company. Even with its shares worth $55 billion, it faces concerns common to many young companies, including its vulnerability to the whims of public shareholders.

For his part, Mr. Musk has come under new scrutiny as his impulsiveness has played out in real time in the **stock market**, with billions of dollars on the line.

And even with the decision to stand pat, Mr. Musk and the company could remain in the sights of the Securities and Exchange Commission over the circumstances of the original announcement.

"Tesla investors must realize that they have a panicky, erratic, possibly self-destructive C.E.O. at the helm," said Jeffrey Sonnenfeld, a professor at the Yale School of Management. "No C.E.O. is ever this confused and confusing."

For years, Mr. Musk had romanticized the idea of Tesla going private. Doing so, he has mused publicly, would free him from the short-term pressures of the public markets, unburden him of the distractions of a **volatile stock price** and, more recently, get rid of the short sellers betting that Tesla would fail. Instead, Mr. Musk believed he could focus on Tesla's work of popularizing electric vehicles and reducing the world's dependence on fossil fuels.

But from the moment of his nine-word Twitter posting announcing his thoughts on Aug. 7 and saying that he had "funding secured," other considerations came into play.

In his note announcing that Tesla would remain public, Mr. Musk cited four main factors that changed his mind: existing shareholders believe Tesla is better off as a public company; not all existing investors would be able to own shares of a private company; it wasn't clear how individual investors would take part in a deal; and the process could distract the company from production of its first mass-market offering, the Model 3, which is crucial to its financial health.

By the account of people familiar with Mr. Musk's thinking, deepening ties with new private investors presented its own challenges. By taking money from Saudi Arabia's sovereign wealth fund — something Mr. Musk said he believed was a sure thing — Tesla would have been teaming up with a country whose very foundation is fossil fuels, and one often criticized on human-rights grounds.

That cognitive dissonance — an electric-car company backed by big oil — was pointed out to Mr. Musk several times, these people said.

As Tesla representatives reached out to officials at the Saudi fund and other sovereign funds, it also became clear that they might want more than just Tesla equity in exchange for an investment. Some, said someone briefed on those talks, would expect Tesla to open manufacturing operations in their countries, for example.

And while several big carmakers approached Tesla about funding a deal, people familiar with the discussions said, there were issues there, too. Some of those companies have their own reputational baggage. And Mr. Musk, proud that Tesla's cars are made in America, did not want to let foreign interests dictate his decisions about manufacturing.

At the same time, it became clear that not all of Tesla's big institutional shareholders would have been able to take part in a buyout. Many big investors hold Tesla stock in funds that can only own publicly traded stocks.

"On the whole, some of our clients will find it very difficult to follow," James Anderson, a partner at Baillie Gifford, which is Tesla's largest shareholder after Mr. Musk, said in an interview before Mr. Musk called off a deal. "We've had this conversation with Mr. Musk himself. He understands that there is an issue here."

The same was probably true for other institutional investors in Tesla, including T. Rowe Price, BlackRock and Fidelity. And Mr. Musk heard from many individual investors who wanted Tesla to stay public. On Thursday, a small Tesla investor released a public letter imploring Mr. Musk to keep Tesla public.

Those pleas were notable because many individual investors are not able to invest in private companies for regulatory reasons.

On Thursday morning, Elon Musk and Tesla's board gathered for a meeting on the factory floor of the company's manufacturing plant in Fremont, Calif., people with knowledge of the events said. They were joined by representatives from the investment bank Goldman Sachs and the private equity firm Silver Lake, which were advising on a deal.

After a Silver Lake representative made a presentation expressing confidence in their ability to manage the process of taking Tesla private — a transaction that could have required $24 billion or more — the Wall Street representatives left the room, and the floor was given to Mr. Musk.

But instead of telling his board just how far he'd come in securing new investors for a potential deal, Mr. Musk backtracked: He no longer believed going private was in the best interest of the company, and he would not be bringing forward a proposal to buy out the company.

Doing so would be too distracting, big institutional investors could not all take part and there was no easy path for retail shareholders to be involved, he told the board.

The directors — some of whom have expressed concern about Mr. Musk's use of Twitter and erratic behavior — were supportive.

During the meeting, the board voted to dissolve the special committee established to evaluate a potential deal. And before lunchtime, the meeting — held in the same room where Mr. Musk sometimes sleeps during late nights at the factory — was over.

Later that day, Mr. Musk drafted a statement announcing that Tesla would remain public, which the board approved Thursday night. On Friday, working from the office of SpaceX, his private rocket company, based near Los Angeles, Mr. Musk and his team refined the letter.

In the statement, even while retreating from the idea of going private, Mr. Musk doubled down on his original assertion that he had the financial backing. "My belief that there is more than enough funding to take Tesla private was reinforced during this process," he said.

Still, the S.E.C., which is investigating whether Mr. Musk's original tweet about a potential buyout violated securities law, may have more to say about the sequence of events — particularly the "funding secured" declaration. The initial tweet sent Tesla's stock soaring and caused a halt in trading pending a fuller announcement. The stock tapered off in ensuing weeks and never came close to the $420 buyout price that Mr. Musk had said was in prospect, indicating investor skepticism.

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“In a sense it lessens the impact of the initial tweet,” Peter Henning, professor of law at Wayne State University, said of the reversal. “But the S.E.C. looks at what happens at the time of the disclosure. Walking it back later doesn’t necessary mitigate the effect. And it was clearly incomplete.”

“You can’t throw out information that moves the market and say, ‘Never mind,’” Mr. Henning added. “This is the C.E.O. of the company. His statements are the company’s statements. Will they make an example of him? Maybe.”

And while Mr. Musk may have appeased some constituencies, management experts were left shaking their heads at the chaotic process, which began with a tweet as Mr. Musk drove his Tesla Model S through Los Angeles just over two weeks ago.

“A major enterprise should not navigate its ownership path and market valuation through the frantic, public, **volatile** impulses of the C.E.O.,” Mr. Sonnenfeld said. “Let alone through the selective disclosures of elite shareholder referenda.”

Kate Kelly and Jessica Silver-Greenberg contributed reporting.

* Tesla Will Not Go Private, Elon Musk Says, Capping Month of Turmoil

* How the S.E.C. May Pursue a Case Against Elon Musk and Tesla

* Elon Musk Details ‘Excruciating’ Personal Toll of Tesla Turmoil

* Inside Tesla’s Audacious Push to Reinvent the Way Cars Are Made

Weeks after a tweet that suggested an effort to take Tesla private, the company’s chief executive, Elon Musk, reversed himself, in another decision with billions of dollars on the line. | Joshua Lott/Getty Images | The Tesla factory in Fremont, Calif. Mr. Musk cited the need to focus on production goals without distractions as one of his reasons for dropping efforts to take the company private. | Christie Hemm Klok for The New York Times

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THE WALL STREET JOURNAL.

Markets

Big Banks, Flush With Profits, Catch Up to Smaller Rivals; The KBW Nasdaq Bank Index is on pace to notch its first positive quarter this year

By Michael Wursthorn
863 words
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The Wall Street Journal Online
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Shares of Wall Street's biggest banks are booming again after a string of strong earnings reports and higher payouts to shareholders re-established their status as some of the **stock market**'s most appealing investments.

An index of the 24 biggest banks in the U.S., known as the KBW **Nasdaq** Bank Index, is on pace to notch its first positive quarter this year. Its latest gains came after several lenders said steady economic growth around the world, a pickup in loan activity, rising interest rates and resurgent **volatility** in stock prices all helped to push profits and revenue sharply higher.

That's a sharp reversal from the second quarter of the year, when the index fell 2.5% to suffer its worst three-month stretch since early 2016. This quarter, those big banks are again outperforming their smaller, regional brethren, a sign that their massive scale offers the potential for more lucrative returns, some analysts said.

The strong performance, along with a changing economic landscape, are pushing more investors toward financial stocks, especially the big banks. BlackRock's iShares unit said in a recent report that it favored financial stocks in the second half of the year, while brokerage LPL Financial Holdings Inc. is encouraging its investors to increase allocations to bank stocks so they can benefit from a rising interest-rate environment, lower taxes and attractive valuations.

"Although smaller stocks have outperformed larger stocks this year, we still like them due to huge positives including economic strength, regulatory reform and the ability to return capital to shareholders," said Hank Smith, co-chief investment officer at Haverford Trust, referring to big banks like JPMorgan Chase & Co.

Shares of JPMorgan have jumped 12% so far this quarter after the lender showed strength across several of its key businesses, including trading, to report an 18% jump in profit. Revenue also exceeded analysts' expectations. Bank of America Corp. is also up 12% after increasing its second-quarter profit by 33% from a year earlier, thanks to rising interest rates and a lower tax bill.

Goldman Sachs Group Inc., Morgan Stanley and Citigroup Inc. also are all trading higher after reporting profits and revenue that topped estimates from analysts. Wells Fargo & Co., however, struggled under the weight of its regulatory issues and reported an 11% drop in second-quarter profit. Still, its shares are up 6.1% so far this quarter, cutting its decline for the year to 3%.

The big banks, including Bank of America, JPMorgan and Morgan Stanley, have also been deploying massive sums of capital back to shareholders. Using the savings from the corporate tax cut passed last year, banks have been increasing their dividends and buying back more stock, activities that tend to nudge share prices higher. Plus, the Federal Reserve cleared the way for most big banks to increase their dividends and share buybacks after passing the central bank's so-called stress tests.

But a bond-market development known as the flattening of the yield curve—a narrowing of the difference in the yields of shorter- and longer-term Treasurys—could be bad for banks since it would decrease the gap between what they pay on deposits and charge on loans. It has been pegged as one reason for the underperformance of big-bank stocks earlier this year. But some analysts warn the concern is overblown, since bank lending profits are usually tied to short-term rates, which have climbed more swiftly than longer-term ones.

The rising fortunes of the U.S.'s biggest banks are lifting their share-price performance past that of smaller lenders, which had been rising somewhat faster so far this year.

The KBW **Nasdaq** Regional Banking index of small banks is up 1.3% for the quarter so far and 4% for the year. KBW's index of large lenders is up 6.2% since the end of June and 3.4% in 2018. And while several of those smaller banks reported upbeat earnings for many of the same reasons as their bigger rivals, expectations for a flurry of merger activity among regional lenders hasn't materialized as investors expected. The benefits of the tax law are also growing less substantial as the year moves on, analysts said.

One of the bank deals—Fifth Third Bancorp's pricey acquisition of Chicago-based MB Financial Inc.—has been criticized by some investors and analysts as being too expensive, raising concerns around valuations. Fifth Third shares have fallen about 11% since the $4.7 billion deal was announced.

"The market started to push back a bit on regionals somewhat after the Fifth Third purchase," said Nick Kalivas, a senior equity product strategist with Invesco. "It cooled some of the M&A expectations and we haven't seen the consolidation in the sector that people had expected."

Write to Michael Wursthorn at Michael.Wursthorn@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Federal Reserve Holds Rates Steady, Says Economy Is Strong; Central bankers' optimistic economic outlook points to a rate raise at their next meeting

By Nick Timiraos
1,009 words
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English
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WASHINGTON—The Federal Reserve held short-term interest rates steady Wednesday and offered an upbeat assessment of the economy's performance, suggesting another interest-rate increase is likely at its next meeting.

The Fed repeatedly emphasized the economy's strength in a statement released after its two-day policy meeting. It offered nothing to dispel market expectations that it would deliver its third interest-rate increase of the year when it meets in late September.

"Economic activity has been rising at a strong rate," the statement said. In all, the Fed's rate-setting committee used the word "strong"—or a derivative of it—six times to describe the economy and labor markets.

Officials voted in June to raise their benchmark rate to a range between 1.75% and 2%. They voted unanimously on Wednesday to leave it there for now.

Overall U.S. economic output expanded at a 4.1% annual rate in the second quarter, the best three-month increase since 2014, the Commerce Department reported last week. During the first half of the year, the economy expanded at a 3.1% annual rate, slightly better than the 2.8% median forecast for the full year submitted by Fed officials in June.

The question looming over the Fed's meetings this spring and summer has centered on how much further officials believe they will need to raise rates over the next two years.

In June, Fed officials penciled in plans to raise rates two more times this year and three times next year, which would push their benchmark rate above 3%. Officials estimate that moving rates about that level would effectively be tapping brakes on economic growth.

Traders in futures markets largely agree with the Fed's outlook. On Wednesday, they placed a roughly 90% chance of a rate increase this September and a 70% chance of at least one more increase by December, according to CME Group.

The challenge for central bankers is to lift borrowing costs enough to prevent the economy from overheating but not so much that it tips into recession.

Inflation is close to the Fed's 2% target after undershooting it for many years. Consumer prices in June rose 2.2% from a year earlier. Excluding **volatile** food and energy categories, they rose 1.9%, according to the Fed's preferred inflation gauge. The Fed likes to maintain inflation around 2%, seeing it as a sign of a balanced economy.

The threat of trade disputes, meanwhile, has added another layer of uncertainty to the Fed's forecasts. Wednesday's statement made no mention of trade policy.

By raising goods prices, tariffs could result in slightly higher inflation, though Fed Chairman Jerome Powell has indicated the Fed would look past such one-time price increases. A stronger dollar could also offset some of these effects by making it cheaper for Americans to buy foreign goods, pushing down import prices.

A slowdown in global growth that spills back into the U.S., on the other hand, could prompt the Fed to reconsider its rate-rise plans.

"Although we believe the move toward protectionism is a material threat to corporate profits and the economy, we think the Fed's plan is unlikely to change," said Ron Temple, head of U.S. equities and co-head of multiasset investing for Lazard Asset Management.

Stronger U.S. economic growth over the past year hasn't resulted in accelerating price pressures even though unemployment has dipped to levels officials believe should force employers to raise wages and prices.

Mr. Powell offered a mostly **bullish** assessment over two days of congressional hearings last month. Pressed over whether inflation was more likely to be higher or lower than expected, he said he was "maybe slightly more worried about lower inflation," given the long period in which inflation defied Fed forecasts that predicted an imminent return to 2%.

The Labor Department is set to report on July hiring this Friday. In June, the unemployment rate ticked up from 3.8% in May despite strong employment gains, reflecting a surge of new workers who hadn't been actively looking for work.

This week's Fed meeting was the first since President Trump last month signaled his unhappiness with the Fed's rate-increase campaign, though Mr. Trump said he wouldn't interfere with their plans. Fed officials, including Mr. Powell, have said they won't react to political pressure and made no mention of it Wednesday.

Mr. Trump said on Twitter last month the Fed's efforts to slowly raise interest rates from unusually low levels "hurts all that we have done" to boost economic growth. In effect, Mr. Trump signaled his desire to enlist the Fed in his broader campaign to narrow trade deficits. Those efforts could be undermined if higher interest rates in the U.S. raise the value of the dollar against other currencies.

A stronger greenback makes U.S. exports relatively more expensive in world markets. Mr. Trump regards bilateral trade deficits as important benchmarks of economic vitality, though most economists don't see it that way.

Mr. Trump's own policies also have contributed to the stronger dollar because they are boosting growth and raising budget deficits, which places upward pressure on the U.S. currency.

A Trump administration official told The Wall Street Journal last month the White House was comfortable with one more rate increase this year—but not two.

Write to Nick Timiraos at nick.timiraos@wsj.com

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THE WALL STREET JOURNAL.

Markets
Investors Needn't Fear Trump Impeachment

By Spencer Jakab
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Assigning credit or blame to the man in the White House for the **stock market**'s performance is an unwinnable argument. Guessing what would happen if he were to unexpectedly leave office is another matter.

President Trump in an interview on Fox News that aired Thursday said he thinks "the market would crash" and that "everybody would be very poor" if he were impeached. History says otherwise. When John F. Kennedy was assassinated in November 1963, for example, the **S&P 500** fell 2.8% but recovered within a couple of days.

The near-impeachment of Richard Nixon and impeachment of Bill Clinton, meanwhile, happened during epic bear and bull markets, respectively, that continued after the events.

Or think back to January 1992, when President George H.W. Bush fainted while having dinner with Japan's prime minister. Rumors during U.S. market hours that he had died sent stocks down less than 1%. If the prospect of "President Quayle" didn't do the trick, then investors can breathe easy about Mr. Trump's legal travails.

Write to Spencer Jakab at spencer.jakab@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Turkey Pummels Emerging Markets | ECB Won't Accept Greek Debt | Eroding Wage Gains | Where Was Nasdaq? | Hannon's Take: In Search of Lost Credibility; The Wall Street Journal's central banking newsletter for Monday, August 13, 2018

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Hannon's Take: In Search of Lost Credibility

Turkish Drama Pummels Emerging Markets Around the World

ECB to Stop Accepting Junk-Rated Greek Debt as Collateral

Rising U.S. Consumer Prices Are Eroding Wage Gains

After Tesla Buyout Tweet, Some Investors Wonder: Where Was **Nasdaq**?

In Search of Lost Credibility

Turkey's plummeting lira is a lesson in what can happen if a central bank loses its reputation for exercising independent judgment.

The lira's plunge Friday, following months of accelerating depreciation, wasn't proximately the result of a misjudged monetary policy. A rapidly worsening relationship with the U.S.—once a highly valued and close ally—is the driving force.

But investors' loss of faith in the central bank of Turkey over recent years isn't helping. Put simply, they fear that monetary policy is heavily influenced by the personal views of President Recep Tayyip Erdogan, who among other things has asserted that higher interest rates cause, rather than restrain, inflation.

"The central bank has been conspicuously quiet during the sell-off, raising fears that it isn't being permitted to raise interest rates," wrote William Jackson, an analyst at Capital Economics, in a note to clients. "This is exacerbating the fall in the currency."

For doubters, the central bank's last policy meeting offered the clearest evidence yet of how constrained monetary policy has become. With the lira weakening and inflation set to far exceed the inflation target, rate setters decided against a rate rise.

Opinions differ on exactly how far the central bank will now have to go to regain some of its lost credibility. Economists at UBS think a rate rise of between 3.5 and 4 percentage points might steady the currency for now.

Others are looking for something more dramatic.

"An aggressive interest rate hike from the central bank would be a good start, something of the order of +1,000 [basis points] that Argentina delivered back in May would be appropriate at this juncture," said Paul Greer, a money manager at Fidelity International.

Perhaps that would do the trick. But many would see this as no more than an expedient response in a moment of crisis, easily reversed when calm returns. Over the longer term, a clearer demonstration of central bank independence is needed, something that would convince all that monetary policy is beyond the president's influence. It isn't clear how that can be accomplished.

Key Developments Around the World

Turkish Drama Pummels Emerging Markets Around the World

Turkey's currency plunged again Monday, rattling other vulnerable emerging markets, while the country's central bank made policy moves that failed to assuage investors about the economy's perilous financial condition.The lira fell as much as 10% in Asian morning trade to as low as 7.131 against the U.S. dollar, according to FactSet, before briefly paring some losses and trading 3.5% lower at 6.65 against the dollar. The currency remained steeply lower on the day, after the Turkish central bank pledged to provide "all the liquidity the banks need" in a statement Monday.

Emerging Markets Can Withstand Turkey Shock

Turkey's Central Bank to Support Embattled Lira

Turkey's central bank Monday announced a set of measures to support embattled currency and vowed to take all necessary measures to maintain financial stability, if deemed necessary. The statement came after Finance Minister Berat Albayrak—Mr. Erdogan's son-in-law—said the government had prepared an action plan to restore calm.

ECB to Stop Accepting Junk-Rated Greek Debt as Collateral

The European Central Bank on Friday said it would no longer accept junk-rated Greek government bonds as collateral in its cash operations after the country exits its international bailout. The decision will make it harder for Greek banks to access cheap ECB funding and casts a cloud over the nation's economic prospects. The ECB started accepting Greek government debt in its liquidity operations in June 2016, reinstating a waiver that allows holders of Greek government debt to bypass the ECB's strict credit-quality standards. But the ECB's waiver on sub-investment-grade Greek bonds was conditional on the country being under an international-bailout program. Greece is expected to exit its third international bailout on Aug. 20 and rely on **financial markets** for borrowing.

Optimism on European Growth Reverses as Headwinds Mount

Europe's economy has slowed, and seems unlikely to bounce back strongly in what remains of a year that began with high hopes and then hit a series of setbacks. With the eurozone economy facing capacity constraints as 2017 drew to a close, policy makers had hoped that optimistic businesses would go on an investment splurge. But as confidence ebbs in the face of global trade tensions and other uncertainties—most recently Europe's exposure to a brewing economic crisis in Turkey—the currency area risks getting stuck in a low-growth groove.

Transcripts: Richmond Fed's Thomas Barkin in Roanoke, Va.

Federal Reserve Bank of Richmond President Thomas Barkin discussed cryptocurrencies, cyberrisks and the opioid crisis while taking audience questions Wednesday at an event in Roanoke, Va. He also spoke separately with reporters, discussing the neutral rate of interest, how tariffs can affect the economy and how he approaches monetary policy meetings.

Rising U.S. Consumer Prices Are Eroding Wage Gains

A humming U.S. economy is pushing inflation up to levels that the central bank considers healthy. But there is a downside: Americans' paychecks are barely keeping up. Consumer prices rose 2.9% over the past year, a rate last exceeded in late 2011, the Labor Department said Friday. Core prices—those outside of **volatile** food and energy-related expenses—climbed 2.4%, the biggest annual gain since September 2008. For much of the expansion, inflation remained stubbornly low, prompting an unprecedented stimulus campaign from the Federal Reserve to counteract its anemia. But rising prices are now eating up much of Americans' wages gains, restraining their ability to spend in the future. For just the second time in four years, average hourly earnings—after inflation—fell over the past 12 months, a separate Labor Department report Friday showed.

What Will It Take for Workers to Demand Raises?

FINANCIAL REGULATION ROUNDUP

The Man Who Solved Bitcoin's Most Notorious Heist

Kim Nilsson was seething. It was 2014, and the software engineer discovered someone had disabled access to his bitcoins. A crime had apparently been committed, one that the police seemed unable to comprehend, much less solve. The coins went missing from a failed bitcoin exchange called Mt. Gox, and hundreds of investors found themselves demoralized, if not broke. More than $400 million had seemingly vanished into cyberspace.

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Unlike many victims, Mr. Nilsson resolved to fight back, and he teamed up with a lawyer and another partner who also lost bitcoins to track down the culprits. What ensued was a three-year journey through the internet's underbelly that ended last summer on a Greek beach. There, FBI agents arrested a Russian man and charged him with laundering bitcoin worth some $4 billion at recent exchange rates, one of the biggest crimes to be alleged in the brief history of cryptocurrencies.

GAM to Liquidate $7.3 Billion of Funds After Trader's Suspension

Swiss money manager GAM Holding AG said Friday it would liquidate 7.3 billion Swiss francs ($7.35 billion) of its funds following the suspension of a top bond fund manager last week. GAM, which suspended Tim Haywood for conduct "of significant concern," said the boards of nine of its funds decided to place them into liquidation, subject to shareholder and regulatory approvals. The news is the latest blow in a torrid couple of weeks for GAM, which last week was forced to block client withdrawals following what it described as a "high level" of investor redemption requests.

The New Business Banker: A Private-Equity Firm

Private-equity firms have long been some of the biggest owners of companies. Now they are vying to become some of their biggest lenders. Fueled by an influx of cash from yield-hungry investors, firms historically devoted to buyouts are now financing deals banks won't. Nonbanks—many private-equity firms—held more than half a trillion dollars worth of loans to midsize companies at the end of 2017, up from roughly $300 billion in 2012, according to estimates by private-equity firm Ares Management LP.

After Tesla Buyout Tweet, Some Investors Wonder: Where Was **Nasdaq**?

There is a nagging question on Wall Street after Tesla Inc. Chief Executive Elon Musk's buyout tweet last week: Why did **Nasdaq** let trading in Tesla shares continue for more than an hour afterward? Mr. Musk tweeted at 12:48 p.m. ET on Tuesday that he had "financing secured" for a buyout of Tesla at $420 a share, a 16% premium to the share price at the time. The remark set off a frenzy of trading in Tesla shares, even as investors were struggling to discern whether the tweet was legitimate and what precisely it meant. It wasn't until 2:08 p.m. that **Nasdaq** Inc.acted to halt trading in Tesla shares. In that 80-minute interim, investors who bought and sold the shares were potentially disadvantaged by the lack of clear information about the company, some investors said.

WEDNESDAY

8:30 a.m. EDT

U.S. Commerce Department releases July retail sales

9:15 a.m. EDT

Federal Reserve releases July U.S. industrial production

THURSDAY

Time N/A

Bank Indonesia releases policy statement

Time N/A

Central Bank of Egypt releases policy statement

4 a.m. EDT

Norway's Norges Bank releases policy statement

8:30 a.m. EDT

U.S. Commerce Department releases July housing starts

Protectionism and the Business Cycle

"Populist politicians argue that protectionism stimulates the domestic economy," Alessandro Barattieri, Matteo Cacciatore and Fabio Ghironi write in a VoxEU column. But the column's authors use "data on temporary trade

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barriers from antidumping investigations to show that when small open economies have imposed protectionist measures, it has caused inflation to rise and real economic activity to fall." They argue protectionism "has been costly even when used temporarily, even for economies stuck in liquidity traps, and regardless of the flexibility of the exchange rate."

The Trump Administration's Dead End on Trade

"The Trump administration has initiated a trade dispute with China with the stated goal of reducing America's bilateral deficit. But given the strengthening dollar and expansionary U.S. fiscal policies, the U.S. trade balance will almost certainly worsen for the foreseeable future," James McCormack writes for Project Syndicate. "The U.S. appears to have inadvertently entered a policy cul-de-sac on trade. By pursuing fiscal stimulus and talking up the importance of manufacturing, the Trump administration is encouraging investment spending, thus making the trade deficit worse. And with rising interest rates alongside strong growth, the dollar is likely to drift higher, adding to the headwind facing U.S. exports."

Integrity of EU Statistics In Doubt

The continued "persecution" of a former head of Greece's statistics agency by the country's political leaders weakens confidence in the European Union's ability to provide accurate information that is vital to its proper functioning, write Edwin M. Truman and Nicolas Véron for the Bruegel think tank. "The EU system is failing the most basic test of its ability to deter political pressures on official statistical production, with potential chilling effects on official statisticians in other member-states and more widely in countries around the world," they write. "Concerns about political manipulation of statistics are especially relevant for the euro area, where joint economic policies rely critically on the accuracy of national statistics on economic growth, budget outcomes, and sovereign debt, which are aggregated (but not compiled) by Eurostat, a department of the European Commission."

A Currency Board for Turkey

Turkish President Recep Tayyip Erdogan should adopt a currency board if he wishes to save the national currency from a "death spiral" and "crush" inflation, writes Steve H. Hanke for The Wall Street Journal. "To make the Turkish lira as good as gold—or some other anchor currency of choice, meaning the euro or U.S. dollar—Mr. Erdogan should announce today that Turkey will install a currency board in 30 days," he writes. "As part of that announcement, he should state that until the currency board is installed, the lira monetary base will be frozen and the lira will be permitted to freely float. At the end of the 30-day period, a fair exchange rate will be chosen to lock in the lira to its new anchor."

The U.S. government's budget deficit widened in the first 10 months of the fiscal year when compared with the same period a year earlier. The deficit totaled $684 billion in October through July, the Treasury Department said Friday. That was 21% more than the deficit of $566 billion during the same period a year earlier.

Job creation in Canada soared above expectations in July as large gains in part-time, public-sector positions helped nudge down the unemployment rate. The Canadian economy added a net 54,100 jobs in July on a seasonally adjusted basis, Statistics Canada said Friday. Market expectations were for a gain of 17,000 jobs, according to economists at Royal Bank of Canada.

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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Economy

Fed Signals Rate Rise | What to Watch at Jackson Hole | Key Fed Rate Ticks Higher | Weidmann: ECB to Gradually Unwind | Timiraos's Take: The Fed's Trade Warning; The Wall Street Journal's central banking newsletter for Thursday, August 23, 2018

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Timiraos's Take: The Fed Sees Trade as a Downside Risk, All the Way

Fed Signals Rate Increase Next Month

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Jackson Hole Gets Added Attention as Key Fed Rate Ticks Higher

ECB Will Gradually Unwind Stimulus, Weidmann Says

The Fed Sees Trade as a Downside Risk, All the Way

Federal Reserve Chairman Jerome Powell in congressional testimony last month presented uncertainty over Trump administration trade policies as having two potential outcomes—one good, and one bad.

"If it results in lower tariffs for everyone, that would be a good thing for the economy," he told lawmakers. "If it results in broader, higher tariffs…for a longer period of time, that would be bad for our economy and for other economies too."

Wednesday's minutes of the Federal Open Market Committee's most recent meeting show the rate-setting panel doesn't see any upside risk from the president's trade policies, which the administration says are needed to address unfair practices by trading partners. Instead, the minutes are chock-full of alarm, and with unusually blunt language.

"Most expressed the view that an escalation in international trade disputes was a potentially consequential downside risk for real activity," the minutes said. There is no two-sided-speak here.

The minutes said businesses hadn't yet cut back planned investments "but might do so if trade tensions were not resolved soon." They flagged several risks: a drop in crop and livestock prices, a weakening of the housing market, a sharp rise in **oil prices** and a "severe slowdown" in emerging markets.

"All participants pointed to ongoing trade disagreements as an important source of uncertainty and risks," the minutes said. A broad and prolonged trade fight would harm business spending, sentiment and hiring, officials said.

If these worrisome scenarios materialize, how would the Fed respond? Officials didn't give much of an answer to this question. "The complex nature of trade issues…presented a challenge in determining the appropriate monetary policy response," the minutes said.

Notably, the minutes don't indicate that the trade concerns, worrying as they are, constitute enough of a reason to refrain from the Fed's recent pattern of raising interest rates every quarter. At least, not yet.

The discussion over trade also stands out because most of the other discussions at the July 31-Aug. 1 meeting stayed on well-worn ground: whether and why to worry about raising short-term rates above long-term rates, which has often coincided with a recession; whether wages would soon rise given reports of insufficient labor; and whether inflation would hold steady or rise.

On most of these other debates, there were often a "few participants" on both sides.

Not so on trade.

Key Developments Around the World

Fed Signals Rate Increase Next Month

Federal Reserve officials at their last meeting signaled they were likely to raise interest rates next month and expressed more concerns than before that prolonged trade disputes could disrupt economic growth. If the economy performs in line with officials' expectations, "it would likely soon be appropriate to take another step" in raising the benchmark short-term rate, according to the minutes of the Fed's July 31-Aug. 1 meeting, which were released Wednesday. Officials also discussed dropping language from their postmeeting statement that has for years described policy as "accommodative," or designed to stimulate growth. The decision to pull back on this guidance bears the imprint of Fed Chairman Jerome Powell, who has signaled such language is no longer necessary as short-term rates edge closer to a neutral setting that is designed to neither spur nor slow growth.

What to Watch for at Fed's Jackson Hole Symposium

Central bankers and economists from around the world will gather in the mountain resort of Jackson Hole, Wyo., beginning Thursday for the Federal Reserve Bank of Kansas City's annual economic symposium. The theme of this year's conference, "Changing Market Structure and Implications for Monetary Policy," highlights the challenges to the economy stemming from monopoly power and corporate consolidation, including slower wage growth and capital investment. The conference is also set to cover issues such as the potential for technology to reshape how retailers set prices and the trade-offs between stability and competition in the banking sector. The main event will be a speech by Fed Chairman Jerome Powell at 10 a.m. Eastern on Friday. Here's what to watch for during the conference, which wraps up Saturday afternoon.

Jackson Hole Gets Added Attention as Key Fed Rate Ticks Higher

An uptick in the Federal Reserve's benchmark interest rate is putting more pressure on the central bank to clarify plans for its $4 trillion bond portfolio just as Fed officials prepare to convene at their annual Jackson Hole symposium, which kicks off Thursday. The effective federal-funds rate, the rate on overnight loans between banks that is the Fed's primary means of influencing the U.S. economy, inched back up to 1.92% last week—and remained there this week—after spending nearly two months at 1.91%. That put the rate just 0.08 percentage point from the top of the Fed's targeted range of 1.75% to 2%. If the rate knocks up against the top of the range, investors and traders may take it as a sign that the central bank is losing control of the rate.

Adviser to Bernanke, Yellen Will Reprise Role for Powell

Jon Faust, who served as a senior adviser to former Federal Reserve chiefs Janet Yellen and Ben Bernanke, has taken on a similar full-time role for Fed Chairman Jerome Powell, according to people familiar with the matter. Mr. Faust, a professor of economics at Johns Hopkins University, had returned to the Fed to advise Mr. Powell on a part-time basis earlier this year. He spent one day a week at the central bank until he completed his academic duties for the term. Mr. Faust attended the July 31-Aug. 1 Federal Open Market Committee meeting, according to minutes released Wednesday in which he is listed as a "senior special adviser" to Mr. Powell. Separately, Republican leaders in the Senate filed a procedural motion to move forward the nomination of Richard Clarida, an economist tapped by President Trump to serve as Mr. Powell's No. 2. A full Senate vote hasn't been set, but the motion indicates Mr. Clarida could be confirmed before the Fed's Sept. 25-26 policy meeting.

ECB Will Gradually Unwind Stimulus, Weidmann Says

Jens Weidmann, Germany's central bank head, said Thursday that the European Central Bank will unwind easy-money policies gradually despite a recovering economy, though he warned against any delays in starting the process. "The normalization process will probably take place only gradually over the next few years. That's exactly why it has been so important to actually get the ball rolling without undue delay," Mr. Weidmann said in prepared comments at an event with journalists in Berlin. The ECB has said it expects to phase out its bond-purchase program by the end of the year, although it has also signaled that its policy rates—which include a negative deposit rate—will stay where they are at least through next summer.

FINANCIAL REGULATION ROUNDUP

A Messy Battle Brews in the Options Market

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Craig Donohue's turnaround plan for the nation's options clearinghouse has hit a roadblock. Mr. Donohue has boosted the prominence of Options Clearing Corp., which acts as a guarantor for every trade in the U.S. listed options market. Clearinghouses—critical parts of the financial system—came under greater scrutiny after the last financial crisis and are responsible for preventing potential defaults from rippling through markets. But after four years at the helm, the OCC's executive chairman and chief is locked in a fierce battle with options traders who oppose his plan to boost income for OCC shareholders—three publicly listed exchange-operators—while trimming returns to traders.

SEC Rejects Nine Proposed Bitcoin Exchange-Traded Funds

The Securities and Exchange Commission rejected applications for nine separate bitcoin-based exchange-traded funds Wednesday, once again thwarting an attempt to build an ETF product based upon the **volatile** cryptocurrency. The commission issued three orders late Wednesday, one for each of the applications from the firms ProShares, Direxion and GraniteShares. The bitcoin and the ETF industries have been trying to get an ETF approved by the commission, beginning four years ago with one proposed by Cameron and Tyler Winklevoss. That ETF has been rejected twice. Another proposal from a firm called SolidX has also been rejected.

Manafort Attorneys Had Moved for Mistrial

Paul Manafort's defense attorneys unsuccessfully moved for a mistrial after at least one juror was overheard by a fellow juror talking about the quality of the case before they had begun deliberating, court transcripts unsealed Wednesday show. The issue arose on Aug. 10, when a juror told a court security officer she had heard the other juror say she didn't believe Mr. Manafort's defense had much of a case. The tip caused a daylong delay in the trial, which ended Tuesday when Mr. Manafort was convicted of eight counts of tax and bank fraud, with jurors deadlocked on 10 other counts.

Thursday

Time N/A

Kansas City Fed holds Jackson Hole economic symposium in Wyoming

7:30 a.m. EDT

European Central Bank releases July 25-26 meeting minutes

10 a.m. EDT

U.S. Commerce Department releases July new-home sales

7:50 p.m. EDT

Bank of Japan releases services PPI

Friday

Time N/A

Kansas City Fed holds Jackson Hole economic symposium in Wyoming

8:30 a.m. EDT

U.S. Commerce Department releases July durable-goods data

10 a.m. EDT

Fed's Powell speaks at Jackson Hole economic symposium in Wyoming

VoxEU Post Examines if Temporary Wage Gains Lead People to Work More

"Macroeconomists tend to assume that people work more when their wages are temporarily higher," Isabel Z. Martínez, Michael Siegenthaler and Emmanuel Saez write in a VoxEU column. But the authors found that Swiss workers didn't work more during income-tax holidays when earnings were exempted from income tax for one or two years. "People did not work more during the tax holiday, but the self-employed and high earners shifted earnings into the tax holiday years," they write. "The findings suggest that intertemporal labor supply responses are too small to be a key determinant in why recessions lead to large drops in employment."

It Isn't Unusual for a President to Fight the Fed

"Today's conventional wisdom, argues that Presidents have historically avoided criticizing the Federal Reserve," Richard X. Bove writes for CNBC. "However, any reading of history argues the opposite. Woodrow Wilson made sure that the Treasury Secretary and the Comptroller of the Currency were ex-official members of key Fed Boards. Harry Truman fought and lost an epic battle against the Fed. Lyndon Johnson, Ronald Reagan and George Bush I had troubles with the Fed. Richard Nixon gained total control of the agency. Jimmy Carter did not and paid a price. Thus, if Donald Trump goes to war against this institution he is more in line with his predecessors than Clinton and Bush II. Trump is in concert with history while his two predecessor were not."

Sales of previously owned homes in July continued their longest downward slide in five years, as rising home prices and higher mortgage rates price more potential buyers out of the market.

The Trump administration is finishing what's expected to be a crackdown on state laws circumventing the new $10,000 federal cap on individual deductions for state and local taxes.

Eurozone business activity edged higher in August, signaling steady growth, but manufacturers scaled back their business outlook amid heightened trade tensions and cooling export demand.

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WSJ PRO CENTRAL BANKING

Economy

U.S. Industrial Production Edged Up in July; Industrial production rose seasonally adjusted 0.1% From June

By Sarah Chaney and Paul Kiernan
273 words
15 August 2018
09:20 AM
WSJ Pro Central Banking
RSTPROCB
English
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WASHINGTON—U.S. industry output rose slowly in July, held down by weakness in the mining and utilities sectors.

Industrial production—a measure of output at factories, mines and utilities—inched up a seasonally adjusted 0.1% in July from the prior month, the Federal Reserve said Wednesday.

Economists surveyed by The Wall Street Journal had expected the index to rise 0.3%.

Output in the **volatile** mining sector, which includes oil and natural gas extraction, declined 0.3% in July. Utility output also dropped from the prior month.

Over a broader period, the picture for industrial output appears stronger. June industrial production growth was revised to up 1.0% from an originally reported 0.6% rise.

From a year earlier, industrial production was up 4.2% in July.

Further, despite the month-on-month decline in mining, output from that sector was up nearly 13% from July 2017.

Manufacturing output, the biggest component of industrial production, rose 0.3% last month from June and was up 2.8% from a year earlier. The segment showed particular robustness among autos and computers, considered long-lasting, or durable, goods.

Manufacturing production has been rising since mid-2016, when rising **oil prices** stimulated growth in the energy sector.

Capacity use, a measure of slack in the industrial economy, was unchanged from June's upwardly revised level of 78.1%, matching economist expectations.

Write to Sarah Chaney at sarah.chaney@wsj.com and Paul Kiernan at paul.kiernan@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Jobs Report Keeps Fed on Track | China Fights Back | Whistleblower Payouts Slow | Cryptocurrencies Make Big Coin | Torry's Take: With Labor Market Tight, Inflation Bites; The Wall Street Journal's central banking newsletter for Monday, August 6, 2018

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Torry's Take: With Labor Market Tight, Inflation Bites

Analysis: July Jobs Report Likely to Keep Fed on Track for Next Rate Increase

China Fights Back After Yuan Slide

SEC Whistleblower Payouts Slow Amid Deluge of Reward Seekers

Cryptocurrency Schemes Generate Big Coin

With Labor Market Tight, Inflation Bites

July's employment report confirmed what we've known for a while: The labor market remains tight.

Low unemployment and healthy job creation—together with an economy growing at a 4.1% annual rate in the second quarter and robust consumer spending—should equate to stronger wages.

Yet pay increases haven't been forthcoming. In July, average hourly earnings of private-sector employees rose 2.7% from a year earlier, in line with the pace seen in earlier months this year—even as inflation gains momentum.

In June, for a second month in a row, inflation fully offset average hourly wage growth over the previous year.

Still, all this could change quickly as the economy heats up. **S&P 500** companies are reporting strong quarterly earnings—lowering the bar for companies to reward employees with more of their profits.

A recent survey of 155 private-sector employers from Bank of America-owned U.S. Trust found 59% plan to increase wages this year.

Meanwhile, Federal Reserve Chairman Jerome Powell told lawmakers last month that recent wage growth readings remain above trend inflation, saying he thought workers are better off than a year ago.

What's more, according to Morgan Stanley's wage growth diffusion index, low-paying industries are starting to reap more of the fruits of the strong labor market.

Low-wage industries like construction, retail, and leisure and hospitality are among the industries with above-trend wage growth, while professional and business services, transportation, and manufacturing had below-trend growth in July.

The Morgan Stanley analysts expect wage growth will remain contained for a few more months before it starts rising. For workers, that suggests the sting of higher inflation might just last a while longer.

Key Developments Around the World

Analysis: July Jobs Report Likely to Keep Fed on Track for Next Rate Increase

The July employment report is likely to keep the Federal Reserve on track to raise interest rates at its next meeting in September, and does little to alter the outlook for gradually rising rates after that. Officials are watching employment and inflation data carefully for clues that might tell them for how long they will need to keep raising rates beyond this year. For now, Fed officials would likely be relieved to see the rate of hiring slow and unemployment stabilize at its current, historically low levels, all of which tamp down worries that growth is becoming unsustainable.

July Hiring Slowdown Masks Labor-Market Strength

Workers enjoyed a strong start to summer, with low unemployment and steady wage gains offering fresh incentive to jump into the job market. Employers slowed their hiring in July, adding 157,000 to payrolls, but had bulked up more than previously reported in May and June, reflecting an economy expanding at near the fastest rate since the recession ended nearly a decade ago. The unemployment rate ticked down to a seasonally adjusted 3.9%, from 4% the prior month, to just above the best rate in two decades, the Labor Department said Friday.

Stores, Factories Lead This Year's Unexpected Hiring Boom

China Fights Back After Yuan Slide

Beijing fought back against the sliding yuan on Friday, suggesting the currency had depreciated too fast. The move, late on Friday in China, came after the yuan had sunk toward a boundary, of 7 yuan per dollar, that held even during severe capital outflows two years ago. The People's Bank of China said it would reimpose a requirement that makes it more expensive to bet the yuan will weaken against the dollar. From Aug. 6, banks buying and selling what are called currency forwards denominated in U.S. dollars for clients will be asked to deposit 20% of their sales at the central bank. The move aims to prevent "macro financial risks," the PBOC said, pledging to keep the yuan largely stable.

Quick Hits: China Names New Central Bank Vice Governor

The People's Bank of China got a new vice governor, Bank of Japan minutes showed a split view on policy side effects, and a higher inflation report may not be enough to worry the Swiss National Bank. Here are quick hits on central banking and related market views from around the world.

After U.S. Push, Berlin Plans Rules That Could Block Iran Transaction

German authorities will introduce financial rules this month that could delay or even block an attempt by the liquidity-strapped Iranian regime to claim cash parked in Germany that has become an irritant in the relationship between Washington and Berlin. U.S. officials said new anti-money-laundering rules being drafted by the German central bank could complicate and perhaps stop Iran from shipping €300 million in cash currently held by an Iranian-controlled bank in Hamburg. The central bank confirmed the new rules without elaborating on the reasons for the change. The amendment follows intense lobbying of the German government and the central bank by the U.S. to stop the Islamic Republic from claiming the assets in what U.S. diplomats think is a desperate scramble to boost Iran's foreign reserves and shore up its own currency after Washington pulled out of the Iran nuclear deal.

Reserve Bank of New Zealand May Acknowledge More Dovish Risks

The Reserve Bank of New Zealand is under pressure to take a turn toward a more dovish outlook, which has shone a spotlight on Thursday's policy statement and economic forecasts. There is no expectation that the RBNZ will adjust its benchmark interest rate from 1.75%. That is pretty much locked in. But the New Zealand economy looks creakier today than it did just a few months ago, and some economists speculate the RBNZ will have to acknowledge the slowdown more fully.

FINANCIAL REGULATION ROUNDUP

SEC Whistleblower Payouts Slow Amid Deluge of Reward Seekers

Wall Street's top regulator now takes more than two years to hand rewards to tipsters who report wrongdoing, a process that lasts longer than the average time it takes to investigate and close an enforcement case. The Securities and Exchange Commission has become a magnet for tips—both good and bad—after publicizing its mega-bounties, including an $82 million award given in March to three tipsters who told regulators about a complex scheme at Bank of America Corp. involving misused customer cash and securities. The commission acknowledges the process can be improved, and partly blames requests from unworthy applicants trying to finagle windfalls from the program.

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Hiding Russian Money Was Easy. Quitting Was Harder

Benedict Worsley, a self-created British "fixer," would do just about anything for his clients—until the offshore network he built came crashing down.

Cryptocurrency Schemes Generate Big Coin

Dozens of trading groups are manipulating the price of cryptocurrencies on some of the largest online exchanges, generating at least $825 million in trading activity over the past six months—and hundreds of millions in losses for those caught on the wrong side, according to a Wall Street Journal analysis.

NYSE's Owner to Launch Bitcoin Firm, Futures Contracts

The owner of the New York Stock Exchange said it is launching a new bitcoin company and futures contracts based on the digital currency. Intercontinental Exchange Inc., or ICE, plans to create a new company called Bakkt (pronounced "backed"), which will offer a platform that allows customers to buy, sell, store and spend digital currencies, according to a statement Friday. The exchange also said it would launch one-day, physically delivered bitcoin futures in November, pending regulatory approval from the U.S. Commodity Futures Trading Commission.

Last Man Standing: James Dimon

A decade after the financial crisis, The Wall Street Journal has checked in on dozens of the bankers, government officials, chief executives, hedge-fund managers and others who left a mark on that period to find out what they are doing now. Today, we spotlight JPMorgan Chase CEO James Dimon.

Wells Fargo Faces Probes Over Low-Income Tax Credits

Federal agencies are scrutinizing how Wells Fargo & Co. purchased tax credits meant to fund housing for low-income people. San Francisco-based Wells Fargo disclosed in a securities filing Friday that federal agencies have "undertaken formal or informal inquiries or investigations" about how the bank purchased and negotiated to purchase "certain federal low income housing tax credits in connection with the financing of low income housing developments." The filing didn't specify which agencies were looking into the matter. A spokesman for Wells Fargo declined to comment on the matter Friday.

SEC Drops Probe of Exxon's Climate-Change Disclosures

Securities regulators dropped an investigation into whether Exxon Mobil Corp. misled investors about its accounting practices and the risks that climate change and greenhouse-gas regulations posed to its business. The Securities and Exchange Commission in a Thursday letter informed Exxon that it closed the probe and decided against trying to penalize the energy giant over its disclosures and how it valued oil and gas assets. The letter was reviewed by The Wall Street Journal.

TUESDAY

12:30 a.m. EDT

Reserve Bank of Australia releases policy statement

10 a.m. EDT

U.S. Labor Department releases June Job Openings and Labor Turnover Survey

3 p.m. EDT

Federal Reserve releases June U.S. consumer-credit data

7:50 p.m. EDT

Bank of Japan releases summary of opinions for July 30-31 meeting

Sources of **Volatility** in Small Economies

"Do sources of **volatility**differ by country characteristics such as the level of development, country size, quality of institutions, and presence of restrictions on fiscal policy?" Viktoria Hnatkovska and Friederike Koehler-Geib ask in a World Bank Group policy research working paper. After studying "a quarterly panel of 48 developed and

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developing countries for 1960-2015," they find "factors affecting gross domestic product **volatility** differ systematically by country size, development level, and whether a country has adopted fiscal rule(s)." They write, "The role of country size is particularly pronounced in developing countries. The paper shows that small developing countries are more prone to domestic output shocks, while shocks to the world interest rate and real exchange rate are more important in large developing countries. Small countries are also more susceptible to terms of trade shocks. These results suggest that stabilization policies must be designed with these country characteristics in mind."

There Are Limits to the Bank of Japan's Defence of Low Rates

"The Bank of Japan has proved inscrutable. The financial world was braced for an announcement that would portend the final end to post-crisis quantitative easing asset purchases, from the central bank that had bought up assets, and forced down bond yields, more enthusiastically than any other. When the BoJ did not fulfill those expectations, it created a big surprise," John Authers writes for the Financial Times. "An alternative narrative is that the BoJ ‘eased' once more by introducing forward guidance. Despite the widening band around the zero rate, the bank said it expected to keep rates at zero even as rates continue to rise in the US and elsewhere. That should at least in theory create a great new ‘carry trade' in which investors borrow in yen and park in higher-yielding currencies—great for a weaker yen and therefore stronger Japanese equities. The yen carry trade was one of the wonders of the age in the years leading up to the financial crisis, and enjoyed a great second act after Shinzo Abe was elected prime minister in late 2012. Appetite for a carry trade may return. For now, the jaded market belief is that the BoJ was never going to tighten aggressively, but that it has no choice but to tighten gently."

We Can't Make Unemployment Great Again

"Without some sort of unexpected demographic shift or economic slowdown, present trends look unsustainable. Either payroll growth will slow or wage growth will accelerate, and possibly both," writes Spencer Jakab for The Wall Street Journal. "The somewhat light U.S. nonfarm payrolls growth of 157,000, even as unemployment dipped back below 4%, is a return to the not-too-hot and not-too-cold pace of recent years. Wage growth, a concern recently given so much anecdotal evidence of a tight labor market, cooled off a bit, too. That at least shouldn't make Federal Reserve rate setters any more aggressive in their rate-raising cycle."

The U.S. service sector's rapid expansion cooled in July, though most industries indicated business remains solid.

Consumer confidence in Mexico jumped to its highest level in more than a decade following the presidential election victory of leftist nationalist Andrés Manuel López Obrador, with consumers especially optimistic about the economic outlook for the coming year.

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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WSJ PRO CENTRAL BANKING

Economy
U.S. Consumer Spending Rose 0.4% in July; The increased outlay partly reflects the fact that U.S. firms are charging more for goods and services

By Josh Mitchell
501 words
30 August 2018
10:51 AM
WSJ Pro Central Banking
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English
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Americans spent all of their income gains and then some in July, keeping the economy humming in the second half of year.

Household spending—or what Americans paid for all goods and services, such as groceries and health care—rose 0.4% in July, the Commerce Department said Thursday. That marked another healthy gain after months of strong growth.

The increase partly reflects higher prices that businesses are charging for their items, itself a sign that demand in the economy is strong.

It also reflects that Americans have more money in their pockets, thanks to robust job growth, rising pay and a tax cut that took effect early this year. Household income—including what Americans earned from salaries and investments—rose 0.3% in July.

Also, the booming **stock market** and rising home values are raising Americans' wealth, which tends to encourage them to spend more and save less.

The fact that spending rose faster than income shows how confident Americans are in the economy these days. After accounting for inflation, consumer spending rose 2.8% in July, compared with the same month a year ago—an annual gain last exceeded in March 2017.

"It's encouraging to see that the American consumer continues to spend confidently and on a steady basis, with the streak in real spending gains extending to five months as of July," said Admir Kolaj, an economist at TD Economics, in a note to clients.

Consumer spending, which represents more than two-thirds of demand in the economy, was the biggest factor behind the economy's rapid 4.2% annual growth in the spring. Many economists expect 3% growth or more in the current quarter, largely because of expectations of household spending gains.

But economists don't expect the economy to sustain that pace in the long term. An aging population and meager gains in productivity are likely to hold back growth in coming years, they say.

For now, strong growth and rising inflation are likely to keep the Federal Reserve on track to raise interest rates twice more this year. The central bank is looking to raise rates steadily to keep the economy growing at a healthy pace while reducing the risk of it overheating.

Thursday's report showed the price index for personal-consumption expenditures—the Fed's preferred inflation measure—grew 0.1% in July from a month earlier. Core prices, which exclude **volatile** food and energy components, grew 0.2%.

While the monthly gains were modest, inflation over the past year has increased steadily to the Fed's target. Overall prices grew 2.3% in July, compared with a year earlier, while core prices were up 2%. Before this year, inflation had remained below the Fed's 2% annual target since 2012.

Write to Josh Mitchell at joshua.mitchell@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Yield Curve Suggests Rising, But Still Low, Risk Of Recession, San Francisco Fed Says; New research paper suggests looking at relationship between 10-year and three-month Treasury rates

By Michael S. Derby
631 words
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01:27 PM
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English
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The bond market is signaling that the risk of recession is rising but a downturn is far from imminent, new research by the Federal Reserve Bank of San Francisco released Monday said.

The bank's paper looked at what has been happening with the Treasury **bond yield** curve, which tracks the return investors get based on the maturity of the security they own. Shorter-dated securities have lower yields because they carry less risk, while longer-dated bonds offer higher yields to cope with the greater uncertainty of holding an extended-term investment.

For much of this year, the normally positive difference between short-date and long-dated Treasury yields has been growing closer. If short-term yields moved above that of the long-end of the curve, it would represent what is called an inversion of the yield curve. And inversions have a long history of preceding economic downturns, which in turn has made the yield curve a closely watched signal of future economic performance.

Over the course of 2018, the difference between the two-year Treasury note and 10-year note has generally grown narrower, moving from a difference of around 50 basis points at the start of the year, to around 20 basis points in recent trading.

Fed officials largely agree that the short-term yields are rising because of the rate rises they have already implemented, and because the market is pricing in future increases the Fed has suggested are likely. Longer-dated yields are being kept down by a variety of factors.

There is widespread concern that if the Fed presses forward with rate increases, that alone could cause the yield curve to invert. For some officials like Atlanta Fed leader Raphael Bostic, the Fed might have to hold off on rate increases to stop an inversion from happening.

"I'm going to be very sensitive" to what the market is doing, Mr. Bostic said in a television interview Friday on the sidelines of the Kansas City Fed's annual Jackson Hole, Wyo., research conference. "I wouldn't knowingly" support a rate rise that would cause an inversion, he added.

Fed officials tend to focus on the relationship between the two- and 10-year note, but the San Francisco Fed paper said there is a more reliable way to link inversions and recessions.

"The difference between 10-year and three-month Treasury rates is the most useful term spread for forecasting recessions," bank economists Michael Bauer and Thomas Mertens wrote.

The authors cautioned, in a refrain common to central bankers, that it is unclear whether inversions cause recessions or correlate to them. But even so, inversions have been a "a reliable predictor" of recessions, they wrote.

The current difference between two- and 10-year notes suggests that one or two more Fed rate increases from the current overnight target rate of 1.75% and 2%, compared with the current two year note yield of 2.63%, could by themselves cause an inversion.

But looking at the three-month Treasury bill to the 10-year finds a lot more space for the Fed.

"Although this particular spread has narrowed recently like most other measures, it is still a comfortable distance from a yield curve inversion," the authors wrote.

"The recent evolution of the yield curve suggests that recession risk might be rising," they wrote. But, "the flattening yield curve provides no sign of an impending recession."

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

Read the San Francisco Fed's Research Paper

* FRBSF Economic Letter: Information in the Yield Curve About Future Recessions

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THE WALL STREET JOURNAL.

Economy

Jerome Powell Defends Policy of Gradually Raising Interest Rates; Remarks at Jackson Hole affirm Fed's plan to raise rates at least to a level that neither spurs nor slows growth

By Nick Timiraos
1,040 words
24 August 2018
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The Wall Street Journal Online
WSJO
English
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JACKSON HOLE, Wyo.—Federal Reserve Chairman Jerome Powell defended the central bank's strategy of gradually raising interest rates against criticisms that the central bank is moving either too quickly or too slowly, jeopardizing the economy's expansion.

Mr. Powell, in remarks Friday at an annual central banking conference in the Grand Tetons, built out the case for lifting rates so long as inflation is stable and unemployment falling, in order to keep the economy on an even keel. He also pushed back against critiques that the Fed is risking high inflation or asset bubbles by raising rates too slowly.

The Fed faces two major risks, of "moving too fast and needlessly shortening the expansion, versus moving too slowly and risking a destabilizing overheating," he said. "The current path … [is] taking seriously both of these risks."

Minutes of the Fed's most recent policy meeting signaled officials are ready to raise their short-term benchmark rate at their Sept. 25-26 meeting. The Fed has raised the rate twice this year, most recently in June to a range between 1.75% and 2%.

Mr. Powell's remarks were his first public comments since President Trump's recent criticisms of the Fed's rate increases. While Mr. Powell's speech has been in the works for months, its message took on extra import after Mr. Trump chided the Fed's moves, which he said worked against his efforts to boost growth.

The president told donors recently he was annoyed that Mr. Powell, whom he selected last fall to succeed Janet Yellen, was raising rates. Such criticism marked the end of a 25-year period in which presidents refrained from publicly commenting on monetary policy.

Mr. Powell's speech underscored the Fed's intent to operate independently of any political pressure—even from the White House. Objections from politicians, including the president, will have no effect "at all," said Dallas Fed President Robert Kaplan in an interview Thursday.

Markets appeared to welcome the Fed chairman's stance, with U.S. stocks jumping and bond yields falling after his remarks were released. Bond yields fall as prices rise. The **Dow Jones Industrial Average** closed higher at 25790.35, up 0.52%.

Mr. Powell said he sees no signs of a sharp rise in inflation above the Fed's 2% target or an elevated risk of the economy overheating. "This is good news, and we believe that this good news results in part" from the Fed's recent policy moves, he said.

The speech offered his clearest thinking on why the Fed has adopted its strategy of raising rates at a slower pace than in past periods, even though it is closer than it has been in two decades to meeting its mandate of boosting employment and keeping prices stable, which it measures against the 2% inflation goal.

While Mr. Trump complains the Fed is moving too aggressively, other critics say it risks excessive inflation by raising rates too slowly.

Some of those warnings have come from Mr. Powell's own staff. A paper released Thursday from a quintet of senior Fed staff economists warned against ignoring continued declines in the unemployment rate once it has fallen to low levels. While Mr. Powell's speech cited the research, he didn't emphasize as strongly its conclusion.

Mr. Powell highlighted two contrasting historical episodes that he said should inform the Fed's current thinking. The first was the period of sustained, rising inflation during the 1970s.

In the second, the economic boom of the 1990s, traditional models suggested low unemployment should boost price pressures. Instead, inflation remained stable because then-Fed Chairman Alan Greenspan recognized before many others that the economy could grow faster than before without fanning price pressures. Eventually, though, the '90s expansion ended in a recession after the tech stock bubble burst.

Mr. Powell described several variables that can't be precisely identified but are critical to setting monetary policy as akin to stars that help sailors navigate on the open seas. These variables include a measure of an unemployment rate below which inflation pressures build, and a neutral level of interest rates that neither spurs nor slows growth.

He has voiced skepticism about putting too much emphasis on these "stars," saying Friday they "are sometimes far from where we perceive them to be."

Mr. Powell said the Fed in the mid-1990s avoided the mistakes of the 1970s, in which officials misdiagnosed those variables by "overemphasizing imprecise estimates of the stars."

Mr. Greenspan, in contrast, adopted a "wait-and-see" approach that boiled down to waiting from each Fed meeting to the next for signs of inflation before continuing with rate increases.

Moreover, because of changes in the behavior of inflation by the 1990s, "there was a smaller risk that an inflation uptick under Greenspan's 'wait and see' approach would become a significant problem," Mr. Powell said.

The Fed should be more inclined to adopt a similar approach today, Mr. Powell said. "When you are uncertain about the effects of your actions, you should move conservatively," said Mr. Powell. "In other words, when unsure of the potency of a medicine, start with a somewhat smaller dose."

Mr. Powell outlined two exceptions to this rule: when inflation expectations are running too high, too quickly, and when the economy needs aggressive stimulus because interest rates have fallen to zero.

Mr. Powell also highlighted the risk of financial excesses, even if inflation remains tame. Because inflation has responded only weakly to declining labor slack, inflation "may no longer be the first or best indicator of a tight labor market and rising pressures on resource utilization," he said. "Thus, risk management suggests looking beyond inflation for signs of excesses."

Write to Nick Timiraos at nick.timiraos@wsj.com

Also

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THE WALL STREET JOURNAL.

World

Turkey's Erdogan Slams U.S. Over Tariff Move; White House has vowed to pile pressure on Turkey until detained U.S. pastor is freed

By David Gauthier-Villars
741 words
11 August 2018
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The Wall Street Journal Online
WSJO
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ISTANBUL—Turkey's President Recep Tayyip Erdogan lashed out at the U.S., blaming the Trump administration for stoking confrontational relations that have helped send the Turkish lira into a tailspin.

In several speeches in the Black Sea region on Saturday, Mr. Erdogan said that President Trump's decision to impose sanctions and tariffs on Turkey after months of negotiations failed to free an American pastor facing terrorism charges risked jeopardizing decades of partnership between the two North Atlantic Treaty Organization allies.

The Turkish leader said the dollar, which rose sharply against the lira,

was tantamount to a "missile" launched as part of an economic attack on Turkey, adding that Ankara was preparing to shun the U.S. currency when trading with countries such as China and Russia.

Mr. Erdogan had earlier warned in an opinion piece for the New York Times that Turkey would seek "new friends and allies" if Washington didn't reverse course.

"Shame on you, shame on you," Mr. Erdogan said in his speech to supporters in the Black Sea town of Unye. "You are swapping your strategic partner in NATO for a pastor."

Mr. Erdogan's barrage of speeches, which came a day after Mr. Trump announced punitive tariffs on some Turkish imports, could herald further escalation because the White House has vowed to pile pressure on Turkey until the pastor, Andrew Brunson, is on a plane to the U.S.

The deteriorating climate in U.S.-Turkey relations and renewed investor concerns about Turkish corporations' ability to honor a hefty debt load snowballed on Friday, causing panic on currency markets where the lira fell 17%.

Turkey's Finance Minister Berat Albayrak—Mr. Erdogan's son-in-law—held a news conference on Friday to outline his economic strategy. But short on details, the presentation failed to reassure investors the government has a plan to stop the lira's fall, boding for a chaotic reopening on currency and stock markets on Monday.

Most Turkish newspapers quoted Mr. Erdogan on their front pages Saturday saying Turkey would "win the economic war," with the pro-government Sabah saying the fall in the lira was the result of an attack comparable to the 2016 military coup attempt against the president.

Cumhuriyet, a rare independent voice in Turkey's media landscape, highlighted the lira's steep fall under a banner headline that said: "The crash of a model," a reference to Mr. Erdogan's policies.

Mr. Trump's announcement that he would double steel and aluminum tariffs on Turkey, a move that would prevent Turkish exports from becoming cheaper with the lira's fall, has exacerbated worries of a full-blown trade war between the two countries. It came less than two weeks after Mr. Trump imposed sanctions against two top Turkish officials over the country's refusal to free Mr. Brunson.

By the end of New York's trading day Friday, a dollar bought 6.43 lira, a decline of 41% from the start of the year. The **Dow Jones Industrial Average** slumped 196 points or 0.8% to 25313, its third straight decline, while the dollar rose to a one-year high. In Europe, Turkey's woes hit shares in Spanish, Italian and French banks with large exposure to the Turkish economy.

The lira's rough ride was a far cry from Mr. Erdogan's promise that the near-absolute executive powers he gained upon winning re-election under an amended constitution in June would allow him to fix Turkey's economic challenges.

Despite accelerating inflation, which hit 16% last month, Turkey's central bank has kept its main lending rate steady since the election, fueling investor concern that it lacked the necessary independence from the government to fulfill its mandate.

Analysts and investors increasingly fear that Turkish businesses will struggle to pay down a debt load exceeding $300 billion because the bulk of it isn't backed by a steady revenue stream.

Turkey's external debt ranks among the largest among developing economies as a share of annual output, and its foreign-reserve pot is among the smallest, data from the World Bank and the International Monetary Fund show.

Yeliz Candemir contributed to this article.

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The New York Times

Foreign Desk; SECTA
U.S. Action On Russia Sends Ruble Into Tailspin

By ANDREW E. KRAMER; Sophia Kishkovsky and Lincoln Pigman contributed reporting.
991 words
10 August 2018
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MOSCOW -- Russia's currency fell on Thursday to its lowest dollar value in nearly two years, jarred by new American sanctions imposed in response to a nerve-agent attack on a former Russian spy in Britain.

For several years, the Russian economy has appeared able mostly to shrug off the effects of a series of Western sanctions tied to its incursions into Ukraine and its election meddling. Buoyed by rising **oil prices**, the economy even grew modestly this year.

But the ruble's precipitous decline may be a clear sign that the sanctions have begun to cloud the country's long-term economic outlook.

As the ruble slumped through the day, officials in Moscow expressed dismay that the new restrictions came so soon after what they saw as a positive summit meeting between President Trump and Vladimir V. Putin, in Helsinki, Finland last month.

''Such decisions made by the American side are absolutely unfriendly, and you cannot associate them with the constructive, even if difficult, atmosphere we had during the last meeting of the two presidents,'' Dmitry S. Peskov, the Kremlin spokesman, told journalists in a conference call.

When Mr. Trump and Mr. Putin met, Russia's foreign minister, Sergey L. Lavrov, called the summit ''better than super'' for Russia. But investors were taking a different view this week.

A domestic bond issue was met with lackluster demand despite rising interest rates. And at times, Russian media reported, liquidity dried up on currency exchanges as ruble sellers far outnumbered buyers.

Market turmoil began earlier this month after Republican and Democratic lawmakers in the United States Congress introduced a draft bill to punish Russia for election meddling, and accelerated with the announcement of the separate chemical weapons sanctions on Wednesday.

Before the sanctions scare began, it cost just 62.5 rubles to buy a dollar, but by the end of the day Thursday, the Russian currency had weakened to 66.5 to the dollar. Russia's main **stock index**, the Micex, dipped on news of the chemical weapons sanctions but recovered losses by the close.

Some companies were hit harder. Shares in Aeroflot, the national airline, fell 11.4 percent before bouncing back later in the day. The chemical weapons sanctions could ban flights between the United States and Russia within three months, a State Department official told reporters in Washington.

The Trump administration said it was acting in compliance with the Chemical and Biological Weapons Control and Warfare Elimination Act of 1991, which mandates that once the government has determined that a country has used chemical or biological weapons in violation of international law, sanctions must be imposed.

British officials have declared that Russia was to blame for the poisoning of Sergei V. Skripal, a former Russian intelligence officer once imprisoned for selling secrets to the British, and his daughter, Yulia. They were exposed to a rare nerve agent belonging to a class of Soviet-developed chemical weapons known as Novichok. The Skripals survived, but a woman later exposed to the same chemical in Britain died.

The restrictions cover exports to Russia of anything with a potential national security purpose, such as gas turbine engines, electronics, and testing and calibration equipment.

The ruble tumbled despite what economists considered a modest direct effect on Russia's economy of this sanction, which will come into force later this month.

The new measures, wrote Lilit Gevorgyan, a principal economist at IHS Markit, are ''less menacing'' than sanctions announced in April that targeted politically connected oligarchs. But they unnerved investors because they signaled the American government's willingness to keep taking steps.

''The escalating 'sanctions war' between the U.S. and Russia, especially the uncertainty surrounding the long-term investments in critical energy projects, will damage the overall investment activity,'' Ms. Gevorgyan wrote. ''The investor community is unsettled.''

Most economists have attributed a recession in Russia that began in 2014, after the Russian annexation of Crimea and military intervention in eastern Ukraine, to falling global **oil prices** rather than Western sanctions. The economy has since resumed growing.

Russia has $458 billion in gold and hard currency reserves it could use to prop up the ruble, but the central bank has been allowing its value to drop, and did so again this week. The policy helps domestic industry and agriculture.

Russia has been subjected to successive waves of sanctions. The Obama administration imposed sanctions for Russia's actions in Ukraine and for meddling in the 2016 presidential election. The Trump administration in April sanctioned oligarchs and government officials over the election meddling and other ''malign'' activities, and this week over the nerve agent attack in Britain.

Russia has few economic means to retaliate. Sergey N. Ryabukhin, a member of the upper house of Parliament, suggested banning sales of Russian engines used on some American rockets, though the American space industry has other options.

In Moscow, some officials described the new sanctions in terms of American domestic politics. They were imposed, the Russians said, as part of a struggle in the United States between Mr. Trump and his supporters, who wanted to engage with Russia, and a ''deep state'' of national security bureaucrats, who were determined to worsen relations.

''This means more pressure on Russia as well as those U.S. politicians who want a rapprochement with Russia, with the ultimate aim of exacerbating the situation,'' Aleksei V. Chepa, the deputy chairman of Parliament's Foreign Affairs Committee, told the state-controlled broadcaster RT.

Vladimir I. Batyuk, a scholar of the United States at the Russian Academy of Sciences, told the RIA news agency that, ''all the positive moments that were noted after the meeting of the two presidents in Helsinki will be all but completely offset, naturally.''

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

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The New York Times

Business Day; DealBook
Two Huge Questions Hang Over Musk's $70 Billion Deal for Tesla

By Peter Eavis
800 words
8 August 2018
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Elon Musk is plotting the biggest ever attempt to take a company private, but it's unclear how he'll pay for it — or if it's really worth it.

Mr. Musk, Tesla's chief executive, shocked investors on Tuesday by tweeting that he was considering taking the company private at a **stock price** of $420. If he does, it would cost more than $70 billion. The company's board of directors met several times last week to discuss the idea, and six of its members issued a statement saying that it is "taking the appropriate next steps to evaluate" it.

Typically, those taking a company of Tesla's size private would borrow tens of billions of dollars to buy the shares held by public stockholders. But Mr. Musk provided scant details about his plan. In his first tweet on the transaction, he simply wrote: "Funding secured." He did not say how much money would be needed or from where it was going to come. When asked for more information on the financing, Tesla declined to comment.

Investors were not too bothered by this lack of clarity: Tesla's shares jumped 11 percent. They should be.

Tesla may find it difficult to line up banks and investors to lend it large sums. Typically, companies taken private have somewhat steady cash flows. Tesla does not. In the second quarter, it recorded another huge loss and burned through hundreds of millions of dollars in cash.

Companies that are taken private usually have low valuations and are unloved by investors. Tesla does not fit that description, either, which could prove partly useful.

In theory, Mr. Musk could pull off the transaction without taking on massive amounts of debt. He could persuade as many current investors as possible to exchange their public shares for new ones in the private company. The more that agree, the less debt needed.

Mr. Musk is Tesla's biggest shareholder, holding 20 percent of its stock. The next four largest hold nearly 30 percent combined. He might not get all of those to buy into his plan. (One, Fidelity, also has a stake in SpaceX, a private company led by Mr. Musk.)

He could also turn to his individual investors, who own nearly 13 percent of Tesla's shares. Many of those are incredibly **bullish** about the company.

To increase the chances of success with all of his investors, Mr. Musk has to convince them that their shares in a private Tesla will one day be worth more than the $420 that the transaction offers them.

Doing so will require convincing them that Tesla will perform better out of the spotlight. Shareholders would also have to be willing to potentially get less information about the company's performance and have less opportunity to sell their shares if it is no longer publicly traded.

Would Tesla perform better as a private company? Mr. Musk thinks so, on Tuesday writing:

Some companies have indeed done better after going private (though there are plenty of examples of those that have gone on to flounder). And Mr. Musk is correct that Tesla has attracted a large number of short sellers — investors who profit by betting on a stock's decline. (He has waged a very public fight against them.)

Arguably, though, the public markets have been very good to Tesla. The company has successfully tapped them for capital, and, even when it has racked up losses and consumed cash, its market value has marched higher and higher. Its **stock market** value currently exceeds that of General Motors.

Investors are, in effect, giving Tesla much the same leeway as it would get if it were private. Big institutional shareholders have remained patient as the company strives to achieve long-term objectives, and have stood by the company even when Mr. Musk's behavior was unorthodox. They have even tolerated a board that has been criticized for its oversight.

What is more, many of the problems at Tesla are of the company's own doing. Mr. Musk, for instance, last month described how problems with robots contributed to production problems. When asked how these difficulties had occurred, he told Bloomberg: "Because we were huge idiots and didn't know what we were doing."

Investors must now weigh whether giving even more freedom to Mr. Musk, and the extra debt the deal may incur, is worth it. It very well may not be.

Elon Musk wants to take Tesla private. Whether or not that should happen is not a clear-cut call for investors. | Drew Angerer/Getty Images

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THE WALL STREET JOURNAL.

The Intelligent Investor
Markets

The End of Quarterly Reporting? Not Much to Cheer About; Investors are still likely to overreact to disappointments, while it's not clear whether less reporting will change corporate behavior

By Jason Zweig
893 words
17 August 2018
05:08 PM
The Wall Street Journal Online
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English
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President Trump proposed Friday that public companies should report their financial results only twice a year instead of quarterly.

Such a move, he implied, would reduce companies' costs of complying with bureaucratic red tape and help corporate executives focus on longer-term goals. Mr. Trump called on the Securities and Exchange Commission to study the feasibility of scaling back the frequency of corporate reporting.

The proposal is in the same spirit as the suggestion by investor Warren Buffett and JPMorgan Chase & Co. Chief Executive James Dimon that

companies should reduce or eliminate quarterly earnings "guidance," in which management hints at the health of profits before final numbers are reported.

But is it a good idea? How much difference would it make?

As my colleague James Mackintosh has pointed out, there isn't much macroeconomic evidence to support the notion that reporting of short-term financial results pressures companies into compromising their long-term goals. Companies are spending more on research and development than ever before, for example.

That isn't how corporate insiders see it, however. In a 2003 survey of chief financial officers of public companies, finance professor Campbell Harvey of Duke University and his colleagues found that 78% of these executives would sacrifice long-term value in order to hit their quarterly earnings targets. Many of the CFOs also conceded they would cut spending, delay starting a beneficial project or book revenues ahead of time to meet short-term earnings expectations.

"What's really shocking is that 78% admitted destroying value to hit an earnings target," says Prof. Harvey. "The real numbers could be higher. We want our business leaders making decisions that are good for the long-term health of our country instead of just for the quarter at hand."

In a 2014 survey of giant pension-fund investors, Prof. Harvey found that most favored semiannual or annual over quarterly reporting, partly because less-frequent reports appear to lower the temptation for corporate executives to play games with earnings targets.

It isn't certain, though, that moving from quarterly to semiannual reporting would stop corporate managers from cutting any corners. "If companies report only every six months, then there could be more damage, not less," says Mark Roe, a professor of corporate and business law at Harvard Law School. Without quarterly updates, "the **stock price** could drift even farther out of whack from fundamentals, and then the temptation for management to distort earnings could potentially be even greater."

Of course, reliable access to corporate information—at any frequency—is a relatively new concept. Until the early 1930s, investors often had to travel to a company's headquarters to see its financial reports at all. Even then, they might be refused if they didn't already own the stock. In 1974, a survey of more than 400 of the largest U.S. public companies by Information for Business, a financial-research firm, found that 20% wouldn't provide copies of their annual reports free of charge to investors.

Prof. Harvey and his colleague Itzhak Ben-David, a finance professor at Ohio State University, have an even more-drastic idea: Companies should update their basic financial information—assets and liabilities, revenues and expenses—daily or even in real time. Firms wouldn't have to disclose anything they don't already list in their annual or quarterly reports, so competitors couldn't take advantage of their real-time disclosures. But such continuous updates would "decrease the possibility of misinformation and value distortion," says Prof. Harvey.

In the age of big data, such a development seems almost inevitable down the road, even if many companies lack the technology to implement it today.

A simple step the SEC could consider immediately: clarifying that it doesn't require companies to give quarterly guidance. Although only about 27% of public companies do so, "there seems to be a widespread belief, especially among newly public companies, that they have to provide earnings guidance," says Sarah Keohane Williamson, CEO of FCLTGlobal, a nonprofit consortium of corporations and institutional investors seeking to encourage long-term business thinking.

One thing seems likely: Slowing down the frequency of corporate reporting probably won't keep investors from overreacting to short-term disappointments.

The London stock trader Thomas Mortimer, in his book "Every Man His Own Broker," wrote that when bad news spreads quickly in the **stock market**, an investor "has an opportunity of selling at a small loss, four or five per cent." After longer delays between disclosures, however, "whenever a long concealed misfortune that has happened to any [company] comes to be divulged, or [the company] takes any unexpected measures, the fall on the shares in the stock…may be twenty or thirty per cent in one day."

In other words, the longer bad news is delayed, the worse the market's response.

Mortimer published his book, one of the earliest known guides to the **financial markets** for individual investors, in 1765. If companies stop reporting quarterly results, there's no reason to think the outcomes would be much different today.

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THE WALL STREET JOURNAL.

Markets
Trade Optimism Helps Some Asian Markets Inch Higher; A fresh round of U.S.-China trade talks is in focus

By Joanne Chiu
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17 August 2018
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The Wall Street Journal Online
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English
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Hong Kong's benchmark Hang Seng Index rebounded 0.5%, putting it on course to break a five-session losing streak, while Japan's Nikkei Stock Average advanced by similar amount after falling for two days. Stock indexes in South Korea, Taiwan and Singapore rose, while China's benchmark Shanghai Composite Index fell slightly.

Friday's Big Theme

A fresh round of U.S.-China trade talks next week and a Friday speech by Federal Reserve Chairman Jerome Powell are in focus for investors after a tumultuous week triggered by a currency crisis in Turkey.

What's Happening

The Chinese yuan was buoyed by the resumption in trade negotiations, strengthening 0.8% to 6.8792 yuan against the dollar Thursday. It weakened slightly to 6.8840 a dollar by midday Friday in Hong Kong.

Asia-Pacific markets have been battered by a selloff in technology shares, a strong dollar and trade tensions. The MSCI AC Asia Pacific Index is down nearly 14% from a high in January. As of Thursday's U.S. close, the index had lost 2.4% in four sessions, putting it on track for its worst week since March.

Across emerging markets, a key MSCI benchmark teetered on the edge of **bear-market** territory with a 19.8% drop as of Thursday's close, compared with its previous peak earlier in the year.

Turbulence in Turkey has crimped investor appetite for emerging-market assets, particularly in China and South Africa. Withdrawals from the two countries contributed more than two-thirds of the $1.4 billion in outflows from emerging stocks and bonds in the week ended Aug. 15, according to the Washington-based Institute of International Finance.

Market Reaction

Chris Weston, head of research at brokerage Pepperstone Group, said some investors took the reopening of trade talks as a cue to buy riskier assets, such as stocks. But he said a breakthrough is unlikely, given these would be relatively low-level talks, and the U.S. is still likely to place tariffs on another $200 billion of Chinese goods.

Peter Chia, senior foreign-exchange strategist at UOB Group, said souring U.S.-China trade relations could put more pressure on Southeast Asian currencies, since many regional economies rely heavily on business with China.

Elsewhere

Chinese tech stocks in Hong Kong regained some ground. Shares in Tencent Holdings Ltd. rose 2.9% to 335.20 Hong Kong dollars ($42.70), trimming losses this year to 17.4%. On Wednesday, the index heavyweight reported its first year-over-year drop in quarterly profit in more than a decade. Handset maker Xiaomi Corp. and online insurer ZhongAn Online P&C Insurance Co. advanced more than 1%.

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THE WALL STREET JOURNAL.
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Fed Chair Defends Gradual Increases

By Nick Timiraos
740 words
25 August 2018
The Wall Street Journal
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A1
English
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JACKSON HOLE, Wyo. -- Federal Reserve Chairman Jerome Powell defended the central bank's strategy of gradually raising interest rates against criticisms that the central bank is moving either too quickly or too slowly, jeopardizing the economy's expansion.

Mr. Powell, in remarks Friday at an annual central banking conference in the Grand Tetons, built out the case for lifting rates so long as inflation is stable and unemployment falling, in order to keep the economy on an even keel. He also pushed back against critiques that the Fed is risking high inflation or asset bubbles by raising rates too slowly.

The Fed faces two major risks, of "moving too fast and needlessly shortening the expansion, versus moving too slowly and risking a destabilizing overheating," he said. "The current path . . . [is] taking seriously both of these risks."

Minutes of the Fed's most recent policy meeting signaled officials are ready to raise their short-term benchmark rate at their Sept. 25-26 meeting. The Fed has raised the rate twice this year, most recently in June to a range between 1.75% and 2%.

Mr. Powell's remarks were his first public comments since President Trump's recent criticisms of the Fed's rate increases. While Mr. Powell's speech has been in the works for months, its message took on extra import after Mr. Trump chided the Fed's moves, which he said worked against his efforts to boost growth.

The president told donors recently he was annoyed that Mr. Powell, whom he selected last fall to succeed Janet Yellen, was raising rates. Such criticism marked the end of a 25-year period in which presidents refrained from publicly commenting on monetary policy.

Mr. Powell's speech underscored the Fed's intent to operate independently of any political pressure.

Markets appeared to welcome the Fed chairman's stance, with U.S. stocks jumping and bond yields falling after his remarks. Bond yields fall as prices rise. The **Dow Jones Industrial Average** closed higher at 25790.35, up 0.52%.

Mr. Powell said he sees no signs of a sharp rise in inflation above the Fed's 2% target or an elevated risk of the economy overheating. "This is good news, and we believe that this good news results in part" from the Fed's recent policy moves, he said.

While Mr. Trump complains the Fed is moving too aggressively, other critics say it risks excessive inflation by raising rates too slowly.

Some of those warnings have come from Mr. Powell's own staff. A paper released Thursday from a quintet of senior Fed economists warned against ignoring continued declines in the unemployment rate once it has fallen to low levels.

Mr. Powell highlighted two contrasting historical episodes that he said should inform the Fed's thinking. The first was the period of sustained, rising inflation during the 1970s.

In the second, the economic boom of the 1990s, traditional models suggested low unemployment should boost price pressures. Instead, inflation remained stable because then-Fed Chairman Alan Greenspan recognized before many others that the economy could grow faster than before without fanning price pressures.

Mr. Powell described several variables that can't be precisely identified but are critical to setting monetary policy as akin to stars that help sailors navigate. These variables include a measure of an unemployment rate below which inflation pressures build, and a neutral level of interest rates that neither spurs nor slows growth.

Mr. Powell said the Fed in the mid-1990s avoided the mistakes of the 1970s, in which officials misdiagnosed those variables by "overemphasizing imprecise estimates of the stars."

Mr. Greenspan, in contrast, adopted a "wait-and-see" approach that boiled down to waiting from each Fed meeting to the next for signs of inflation before continuing with rate increases.

The Fed should be more inclined to adopt a similar approach today, Mr. Powell said. "When you are uncertain about the effects of your actions, you should move conservatively," said Mr.Powell.

Mr. Powell also highlighted the risk of financial excesses, even if inflation remains tame. Because inflation has responded only weakly to declining labor slack, inflation "may no longer be the first or best indicator of a tight labor market and rising pressures on resource utilization," he said. "Thus, risk management suggests looking beyond inflation for signs of excesses."

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Economy

Rising U.S. Consumer Prices Are Eroding Wage Gains; Inflation is at 2.9% over the past 12 months, a gain last exceeded in late 2011

By Josh Mitchell
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WSJ Pro Central Banking
RSTPROCB
English
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Corrections & Amplifications

Average hourly earnings fell over the past 12 months for just the second time in the past four years. An earlier version of this article incorrectly stated they fell for just the second time in six years. (Aug. 10, 2018)

A humming U.S. economy is pushing inflation up to levels that the central bank considers healthy. But there's a downside: Americans' paychecks are barely keeping up.

Consumer prices rose 2.9% over the past year, a rate last exceeded in late 2011, the Labor Department said Friday. Core prices—those outside of **volatile** food and energy-related expenses—climbed 2.4%, the biggest annual gain since September 2008.

The rising cost of things like rent, gasoline and health care is another sign the economy is kicking into a higher gear after years of slower growth. Businesses raise prices when they feel Americans are able and willing to spend more. For much of the expansion, inflation remained stubbornly low, prompting an unprecedented stimulus campaign from the Federal Reserve to counteract its anemia.

But rising prices are now eating up much of Americans' wages gains, restraining their ability to spend in the future. For just the second time in four years, average hourly earnings—after inflation—fell over the past 12 months, a separate Labor Department report Friday showed.

Workers still came out ahead—barely—but only because they increased the number of hours they worked. Weekly earnings, adjusted for inflation, grew 0.1% in the past year.

"It seems like any time we get any kind of raise, any kind of opportunity, expenses rise," said Simeon Weinraub, a 49-year-old self-employed video producer.

His landlord this month raised by 10% the rent on the house he shares with his pregnant wife and two kids in Pasadena, Calif. Mr. Weinraub and his wife, a charter-school superintendent, make almost $200,000 combined. But with monthly rent now at $2,750, child care at about $1,000, and other expenses, the family feels squeezed, he said, adding: "It doesn't feel like it's sustainable."

Many economists expect inflation to slowly rise but remain tame, in part because the Fed plans to gradually raise interest rates to prevent the economy from overheating. Friday's report likely bolsters the central bank's plans for two more rate increases this year. The Fed prefers inflation at 2% annually—as measured by a separate Commerce Department gauge. Inflation by that measure appears to be roughly at the Fed's target after years running below it.

Rising consumer costs could upend any political messaging ahead of the November midterm elections. Gross domestic output grew at a 4.1% annual rate in the second quarter, the strongest quarter since 2014, and economists project growth will clock in at 3% for 2018 as a whole. President Trump, a Republican, has pointed to the GDP numbers as a sign his economic agenda—including deregulation, a tax cut and efforts to revamp trade deals—is working.

He also points to a historically low unemployment rate of 3.9%.

But along with such strong growth can come faster inflation, which cuts into purchasing power, and Democrats are pointing to modest wage growth as a sign the economy's gains aren't being spread evenly.

"Workers are not benefiting from the Trump economy," the Democratic National Committee said in a statement after Friday's report.

Many economists believe workers' wages will pick up. For one, the recent rise in inflation is partly due to higher energy costs, which tend to be **volatile** and could recede. Also, home sales have fallen and apartment construction has boosted inventory in some cities. Such developments could bring down rents and slow home-price growth, which have been among the biggest drivers of inflation in recent years.

Meanwhile, companies, which have raised wages in recent years as unemployment fell, may have to raise them further as workers become harder to find.

For now, price increases appear to be modest but not crippling.

In Boston, Tommie Chavis's landlord has raised his rent by $100, or 4%, over the past year for the apartment he shares with three roommates. They are set to pay $2,600 a month soon.

Mr. Chavis, 24, who recently earned a master's degree and is applying to dental school, is about to start a full-time job at Target to help cover costs.

"It's annoying, but if it was not split four ways it would be a hassle," Mr. Chavis said of the rental increase. He says he has kept the lid on his other costs—for example, his gym membership is only $10 a month.

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THE WALL STREET JOURNAL.

Markets

Apple's Market Cap Hits $1 Trillion; Technology giant hits new milestone that underscores the iPhone maker's explosive growth

By Tripp Mickle and Amrith Ramkumar
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Apple Inc. on Thursday became the first U.S. company to surpass $1 trillion in market value, underscoring the iPhone maker's explosive growth and its role in the technology industry's ascent to the forefront of the global economy and markets.

Shares of the world's most valuable public company rose $5.89, or 2.9%, to $207.39, making it worth slightly more than $1 trillion. Apple reached the milestone when it climbed above $207.04 in midday trading. The stock has risen 23% so far this year, its latest rally coming after it reported strong revenue and profit gains Tuesday as demand for high-price iPhones remained resilient and sales from the app store and other services hit all-time highs.

Apple's rise has been propelled by the sustained success of the iPhone developed under late co-founder Steve Jobs, a product visionary who helped revive the company from a death spiral in the late 1990s. His successor, Tim Cook, has turned Apple into a cash-generating giant by pushing its existing products to prominence in China and cultivating its rapidly growing services business—moves that have helped stave off concerns about the absence of a new, blockbuster device.

"We've heard a number of times since Mr. Jobs died that the company was going to slip and fall, but they've continued to execute," said Greg Hersch, founder of New York City-based Florence Capital Advisors, which has more than $400 million under management and counts Apple among its largest holdings.

Along the way, Apple has led a broader tech boom that has made a handful of giant companies central in people's daily lives and investment portfolios. The five most valuable companies—Apple, Amazon.com Inc., Google parent Alphabet Inc., Microsoft Corp. and Facebook Inc.—are all tech and internet firms, a level of industry dominance rare in recent markets history. Those five collectively accounted for nearly 15% of the total value of the **S&P 500** as of last month, according to Ned Davis Research.

The iPhone, and the smartphone era it birthed, helped lift other tech giants—and disrupted many other businesses. Smartphones drive mobile advertising businesses at Google and Facebook, and account for an increasing share of the e-commerce transactions lifting Amazon.

Technology's ubiquity, and the industry's swelling wealth and clout, also have triggered growing criticism and regulatory scrutiny—one of several factors that could undermine the boom. This year, Apple confronted investor pressure to address the public health risks of rising youth smartphone addiction. Facebook and Google were grilled by U.S. lawmakers over data privacy. Amazon's business practices were slammed by President Donald Trump.

Some money managers worry that a few highflying firms are powering the broader market, leaving stocks susceptible to a painful downturn if the rally ends.

Apple, founded as an upstart maker of personal computers in 1976, first took the crown as the largest company in August 2011 when it edged out Exxon Mobil Corp., signifying tech's displacement of energy as market king. At the time, Apple was valued at roughly $343 billion.

Mr. Jobs died a few months later, having transformed the company from a niche computer company to a global electronics powerhouse. But Apple kept rising, cementing its market-cap lead in August 2013 and holding it consistently since then except for a few days in 2016 when Alphabet was bigger.

More recently, Apple has had to hold off Amazon, which was worth just a third of Apple's value in 2011 but whose stock recently has surged as it shows it can grow profit as well as sales. Amazon was worth about $890 billion on Thursday, and Alphabet was worth about $860 billion. Microsoft, at more than $825 billion, isn't far behind.

The calculation of Apple's market value is based on the company's share count as of July 20. Share counts fluctuate day by day based on factors like stock buybacks, but generally aren't disclosed more than a few times a year.

Apple isn't the world's first company to claim the $1 trillion title. In 2007, PetroChina Co.'s market cap surpassed that level by some measures, though the Chinese oil and gas producer's corporate structure kept most of its shares locked up in government hands, making it difficult to determine the firm's actual value.

Outside of the public markets, there is Saudi Arabian Oil Co., the state-owned oil company. It weighed an initial public offering that could value the business at as much as $2 trillion. The plan has stalled however, and the actual value of the company, known as Saudi Aramco, isn't clear.

Apple's ascent is especially remarkable since its survival as a company was in doubt just over two decades ago. It lost $2 billion over two years in the mid-1990s, weighed a sale to Sun Microsystems, and churned through three CEOs in four years before bringing back Mr. Jobs. He revived the business by thinning Apple's product lineup and spearheading a trio of hits: the iPod, iPhone and iPad.

Mr. Cook, who took over in 2011, broadened the iPhone's reach, helping it become one of the best-selling products in history, with more than 1.4 billion devices sold. Huge numbers were sold in China, a market that exploded in 2015 after Apple signed a deal with the largest mobile operator. China now accounts for a fifth of Apple's sales.

The iPhone also underpinned Apple's services sales, which Mr. Cook set the goal of doubling in four years to $50 billion by 2020. On Tuesday, he said Apple is on track to hit that goal thanks to accelerating subscription sales, growing transactions on Apple Pay and other factors.

The iPhone X, which launched last November, has delivered minimal unit growth, but its $999 price tag has lifted total sales by raising average iPhone selling prices 15% higher to $750 in the nine months ended in June. In May, Apple announced it would add $100 billion in share repurchases, the largest ever announced by a company.

Unlike some peers that trade at lofty multiples, Apple is still relatively cheap based on its current performance. Some investors worry about the escalating trade dispute between the U.S. and China however. Apple acknowledged this week that those tensions could increase its manufacturing costs and dampen product sales.

In the longer term, investors worry about Apple's ability to launch another transformational product like the iPhone. Its smartwatch, which debuted in 2015, made Apple the world's largest watch company by sales but hasn't delivered the same type of boost that other hit products have.

"One of the things that has always concerned us is the concentration in the iPhone," said Trip Miller, managing partner at Gullane Capital Partners, which owns the stock. "But I don't think there is a risk that there is some gee-whiz product in the next 12 to 24 months that is going to unseat the iPhone as the king."

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THE WALL STREET JOURNAL.

Heard on the Street
Markets
Foreign Accents Will Lose Charm for U.S. Stocks; The boost U.S. companies have been getting from their overseas operations is about to go away

By Justin Lahart
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The world is about to become a tougher place for American companies.

U.S. corporate profits have been strong and, while a strong domestic economy and lower taxes have provided a huge boost, investors shouldn't discount the important role the global economy has played. An unusual period of synchronized growth has both bolstered companies' overseas sales and, until recently, strengthened other countries' currencies, lifting their value when translated into dollars. A recent FactSet analysis found that second-quarter earnings at **S&P 500** companies that do more than 50% of their sales from overseas was up 13.5% in the second quarter from a year earlier. At companies that did less than half of their business overseas, earnings grew by 8.6%.

Lately, though, there have been some cracks in the global growth story. Turkey's financial woes and collapsing currency have rekindled worries about emerging market vulnerabilities. China's economy is decelerating and a slowdown in Chinese investment suggests there is more to come. Manufacturing surveys show that global factory-sector growth reached its peak in January, falling since then. The trade spats the U.S. has entered into could weigh further on overseas growth, particularly for export-oriented economies. In turn, retaliatory tariffs against the U.S. could hurt American companies as customers overseas look for alternatives.

Compounding the problem for U.S. companies, all of these issues—Turkey's troubles, China's slowdown, cooler manufacturing growth and trade disputes—have bolstered the dollar's value. So far this quarter it is averaging 4.5% higher than a year ago, on a trade-weighted basis. That will exert a drag on U.S. companies' overseas profits for the first time in five quarters.

Meanwhile, the domestic economy continues to do well. A run of strong results from retailers such as Walmart in recent days suggests that Americans are stepping up spending. In the months ahead, companies that do all or most of their business at home ought to do well. Investors should notice this, gravitating toward stocks with a little less global flair.

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Streetwise: Shares Withstand Weaker Yuan

By James Mackintosh
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Three years ago, a drop of less than 3% in the yuan against the dollar was enough to create panic among investors world-wide. The **S&P 500** fell more than 10% within a few days, the usual definition of a correction, and global stocks plummeted. The plunge was repeated at the end of 2015, with the same effect. Yet this year, a far bigger drop in the Chinese currency has been all but ignored by U.S. stocks. What gives?

The answer is a reflection both of the relative strength of China and the U.S., and investors' views of Chinese policy. But the yuan still poses a threat, even to investors who care little about China.

Back in 2015 and early 2016, the drop in the currency was taken as a sign that the Chinese government had decided to devalue, as a way to boost the stuttering economy. The risk was that devaluation would spread falling prices from China's businesses to the rest of the world, when the global economy was already perilously close to deflation. Commodity prices crashed, and oil -- already halved by Saudi Arabia's 2014 production boost -- almost halved again. Investors raced for the safety of bonds.

Much is different this year. First is the sentiment about China. China's shift in August 2015 was to widen the trading band within which the currency could move each day, but investors regarded it as a simple devaluation. Then in December 2015, it pegged its currency to a basket of trading partners, rather than only to the dollar, and again the move was seen as a devaluation.

Since then, investors have come to accept both the wider trading band and the basket of currencies as normal. This year's fall in the yuan is being treated as a natural reaction to China's economic slowdown, monetary easing and U.S. tariffs, all of which justify a weaker currency.

Second is the sentiment inside China. In 2015, Chinese investors and companies had been betting that the yuan would keep getting stronger, and borrowing dollars to buy yuan. The shock of devaluation made those bets look mistaken, and they were rapidly unwound -- a shift of well over $100 billion in corporate "carry trades" alone, according to the Bank for International Settlements. Others raced to get their money out of China before the currency fell further, and such capital flight contributed to a loss of $1 trillion in foreign-exchange reserves before they bottomed out at the start of last year.

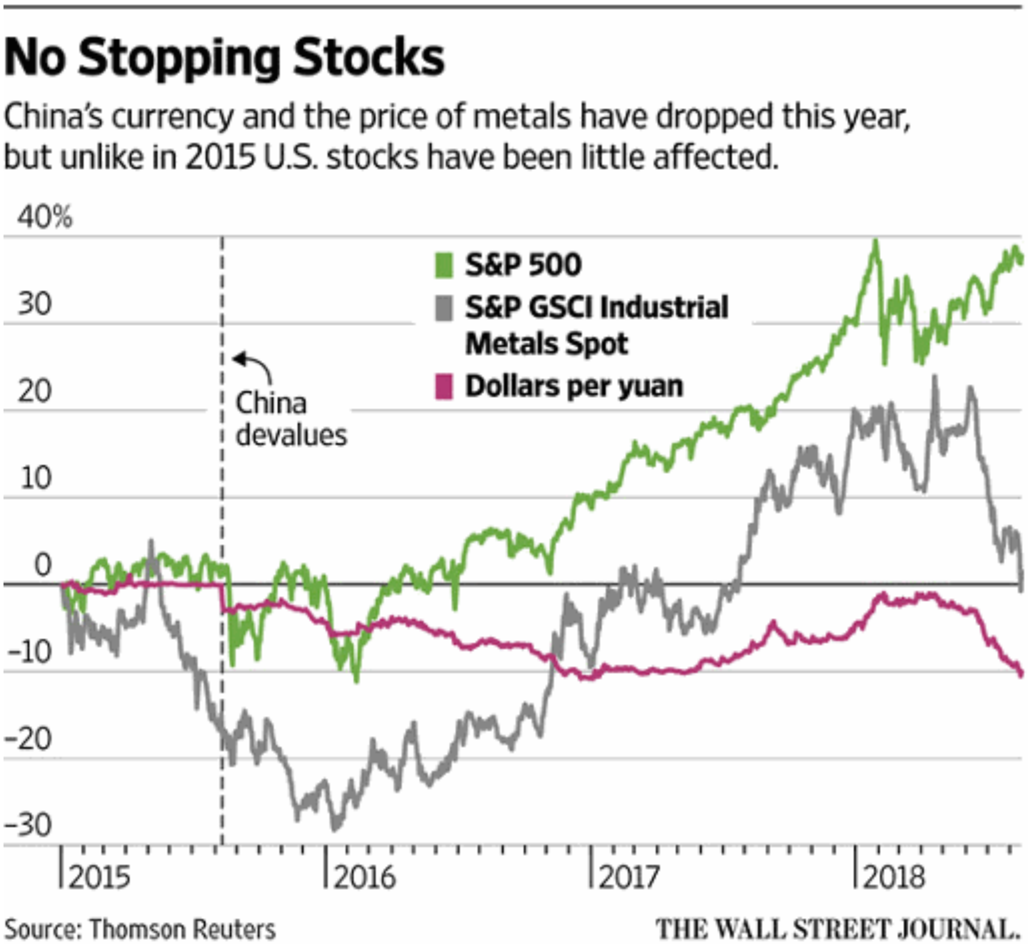
This year, yuan bets started out much smaller, partly because of the memory of recent losses and partly because capital controls have been tightened up. There is no sign of capital flight, with foreign-exchange reserves down less than 1% this year. In other words, in 2015 there was a run on the yuan, which could have forced a very large devaluation if it continued. This time, so far, there isn't.

Third is the global economic situation. The U.S. economy has powered ahead, and while Europe's growth has slowed from last year's frenetic pace, it is still solid. The world is better able to withstand a cheaper yuan.

All this explains why China hasn't had a bigger effect. But China's economic slowdown shouldn't be dismissed. China spent much of the past year choking off excessive lending, with notable success. The delayed effect is now hitting the economy and rippling out into the rest of the world through weaker commodity demand, as China built less infrastructure and invested less.

There are other similarities to 2015, with total social financing, a measure of credit, and Chinese producer prices both shrinking again.

Hopefully the world economy can withstand a China slowdown this time, and the country's policy makers can maintain growth without another credit binge. The danger is that China responds to the tariffs from the U.S. with an even bigger devaluation, and the fears of 2015 resurface to drag down global stocks.



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Heard on the Street
Foreign Accents Lose Charm in U.S.

By Justin Lahart
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[Financial Analysis and Commentary]

The world is about to become a tougher place for American companies.

Corporate profits have been strong and, while a strong domestic economy and lower taxes have provided a boost, investors shouldn't discount the important role the global economy has played. An unusual period of synchronized growth has both bolstered overseas sales and, until recently, strengthened foreign currencies, lifting their value when translated into dollars. A recent FactSet analysis found earnings at **S&P 500** companies that do more than 50% of their sales from overseas was up 13.5% in the second quarter from a year earlier. At companies that did less than half overseas, earnings grew by 8.6%.

Lately, though, Turkey's financial woes and collapsing currency have rekindled worries about emerging-market vulnerabilities. China's economy is decelerating. Manufacturing surveys show global factory-sector growth hit its peak in January, falling since then. The trade spats the U.S. has entered into could weigh further on overseas growth. In turn, retaliatory tariffs against the U.S. could hurt American companies as customers overseas seek alternatives.

Compounding the problem, all these issues have bolstered the dollar's value. So far this quarter, it is averaging 4.5% higher than a year ago, on a trade-weighted basis. That will exert a drag on U.S. companies' overseas profits for the first time in five quarters.

Meanwhile, the domestic economy continues to do well, aiding companies that do all or most of their business at home. Investors may start to prefer stocks with a little less global flair.

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Streetwise: FANG Group Has Stories With Bite

By James Mackintosh
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Tales told about stocks have a powerful hold on investors, and no story is more powerful today than the FANGs -- widened to include an array of technology companies beyond the original Facebook, Amazon, Netflix and Google, now Alphabet.

The past two weeks have shown both why the wider FANGs grouping makes little sense and at the same time how important it is to the bigger debate about whether to buy cheaper "value" stocks or pay up for expensive companies with better growth prospects.

Putting together a selection of big disruptive companies is a reasonable idea; it is growth investing in its purest form. But the original thought has been broadened to include anything big and vaguely techy: the widely referenced NYSE FANG+ index includes Tesla, Apple, Nvidia and Twitter, as well as two large Chinese companies, while last month Goldman Sachs analysts included Microsoft to get the "FAAMG." Needless to say, that acronym hasn't caught on.

The approach mixes disruption (Amazon, Tesla, social media, Netflix, Alphabet); high-margin network semi-monopolies (Facebook, Alphabet, Microsoft); high-margin brands (Apple) and technological leadership (Nvidia).

Yet, the moves in the FANG complex mattered, for two reasons. They have become synonymous with growth, so investors to some extent are happy to substitute one company for another, meaning moves in the price of one affect the price of the others. The FANGs-etc. are also huge: the FAAMGs are now the five biggest companies in the U.S.

As a result, the bad news from Facebook and Twitter, showing that social-media companies face higher costs to police their users' posts, rippled through the wider market -- even though the same issues don't apply to companies such as Amazon, Apple or Alphabet.

It wasn't just that the FANGs-etc. fell. The market had its biggest three-day swing away from growth stocks and into cheaper "value" stocks since 2009. Almost 60% of the companies in the **S&P 500** classified as growth were down in the three days to Monday's close, according to data from S&P Dow Jones Indices, while almost 60% of the "value" stocks were up.

There is a good case for a rotation out of growth and into value, because U.S. growth stocks have been doing phenomenally well and value stocks -- cheap stocks as measured by price-to-book, price/earnings or price-to-sales ratios -- far less well. Since the start of 2015, the Russell 1000 Growth index is up 65%, including dividends, while the value index returned only 30%. Growth stocks are also extremely expensive, with the Russell measure trading at 21.4 times estimated operating earnings over the next 12 months, close to the post-Lehman Brothers high reached in January. Value stocks have been much cheaper in the past, but at 14.3 times earnings they remain far cheaper than growth.

At some point the fascination with growth will break, but valuation is no guide to when.

Yet the second-quarter earnings reports of the FANGs-etc. offered a couple of pointers that shareholders might, just perhaps, be starting to shift away from the pursuit of growth at any cost.

Tesla is the most obvious example. Its shares jumped even as losses were bigger than expected, because it cut capital-spending plans, reduced cash outflow, and CEO Elon Musk showed some sensitivity toward Wall Street. Shareholders are more worried about future cash calls than they are excited about another round of expansion.

Another danger for the biggest companies is the threat of government intervention -- to limit their monopoly power, force them to pay higher taxes or apply old-world laws to cyberspace. Only the last of those seemed to bother investors in the latest quarter, with Alphabet stock shrugging off a $4.3 billion European antitrust fine and a higher effective tax rate.

Just as the political perils apply more to some companies than others, so does the growth story, because these companies are at very different levels of maturity. Yet Apple's blowout results still had the power to renew confidence in growth stocks in general on Wednesday, helping all but one of the U.S. members of the NYSE Fang+ to rise.

Better still for growth investors, the Russell 1000 Growth index had its third-best one-day performance against value this year.

The FANGs-etc. story doesn't appear to be over yet, even if it is becoming a little more nuanced.

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WSJ PRO CENTRAL BANKING

Markets

Turkish Lira Falls Further; Erdogan Fails to Assuage Investors' Concerns; Lira drops as much as 10%, shaking emerging markets world-wide

By Georgi Kantchev, Yeliz Candemir and Saumya Vaishampayan
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Turkey's currency plunged again, rattling other vulnerable emerging markets, as a defiant speech from President Recep Tayyip Erdogan and policy moves from the nation's central bank failed to assuage investors' concerns about the country's perilous financial condition.

The lira ended 6.6% lower at 6.88 against the U.S. dollar on Monday, after falling as much as 10% in Asian morning trading. The country's debt and stock markets were also swept up in the turmoil.

The lira is down more than 40% this year, battered by concerns about the North Atlantic Treaty Organization member's political and economic stability and a continuing trade spat with the U.S.

"We will not retreat from our position," Mr. Erdogan told a conference in Ankara, adding Turkey wouldn't allow the U.S. "to lay its hands on achievements we gained at the cost of blood."

As part of a plan announced earlier Monday, Turkish authorities made efforts to boost liquidity in the market, lowering the amount of liras and dollars lenders must park with the central bank against their liabilities. The move should help inject around 10 billion liras and $9 billion into the financial system, the central bank said.

But analysts said the measures won't have any direct impact on the lira because it doesn't ease a core concern—the hefty debt exposure of Turkish banks and corporations—and warned the central bank has limited reserves of its own to weather the storm.

"The lira is in a free fall and the measures announced so far simply aren't enough," said Kevin Daly, portfolio manager for emerging-market debt at Aberdeen Standard Investments. "It's fueling the negative sentiment and the disappointment among investors."

Other emerging markets, such as Indonesia and South Africa that are heavily reliant on foreign investors, also were rattled. Shares fell across Asia and Europe, though the declines abated in later trading. U.S. stock markets fell slightly. The turmoil hit southern European government bonds, with the 10-year Italian yield rising above 3%, its highest in two months.

"This is a very Turkey-specific issue, however general risk aversion will cause...nervous investors to hedge positions or outright sell in other emerging markets, for fear that there could be contagion," said Sacha Tihanyi, deputy head of emerging-markets strategy at TD Securities in New York.

The South African rand fell to a nearly two-year low against the dollar, sliding as much as 9.2%, though the falls moderated later in the day. The Chinese yuan neared its weakest level in more than a year, hitting 6.8911 to a dollar in Hong Kong. Investors flocked to haven currencies, with the Swiss franc and the Japanese yen gaining against the euro.

Turkey has become a primary cause for concerns on global **financial markets** in recent weeks, as tumultuous domestic politics have paired with a cocktail of economic vulnerabilities including high levels of foreign-currency debt, a current-account deficit and rising borrowing costs. As one of the world's largest oil importers, Turkey is also vulnerable to rising energy prices.

In addition, the country is in the midst of an escalating dispute with its core military ally, the U.S., over the fate of an American pastor. The White House has vowed to pile pressure on Ankara until the pastor, Andrew Brunson, who faces terrorism charges and up to 35 years in prison in Turkey, is on a plane to the U.S.

Mr. Erdogan has blamed the drop in the lira on what he calls "an economic war waged against Turkey."

On Monday, Turkey's Interior Ministry said it has taken legal actions against owners of 346 social media accounts it accused of having expressed views that harmed the lira, according to state-run Anadolu Agency.

Some people "are conducting economic terrorism on social media," Mr. Erdogan said at the Ankara conference. "This is treason."

Meanwhile, investors say more needs to be done to stem the crisis, and fast.

The actions by Turkish authorities so far "leave us with more questions than answers," said Claudia Calich, fund manager at M&G Investments. "As long as Erdogan continues to be defiant, that's the wrong message to send to markets."

Aberdeen's Mr. Daly said the currency would continue to weaken without a significant interest-rate increase by the central bank and a detente with the U.S. For now, he is short the lira, or betting against it.

"You have to be a very brave man to step in front of this train," Mr. Daly said.

Investors on Monday also sold Turkey's debt, pushing the yield on two-year government bonds to 25.12% while the stock benchmark BIST 100 shed around 2.5%.

The Turkey crisis comes as emerging markets are already under strain from rising U.S. interest rates, which increases the cost of borrowing in dollars and often cause a rally in the greenback at the same time. The WSJ Dollar Index, which measures the currency against a basket of 16 others, rose 0.3% Monday after its largest one-week point and percentage gain since late 2016.

"It's not an easy environment for emerging markets with shakier fundamentals. Those countries that didn't fix their roofs while the sun was shining will now see water pouring down their house," Ms. Calich said.

The International Monetary Fund attributes about $260 billion in portfolio investment in emerging markets since 2010 to the Federal Reserve's monetary policy. In its latest global financial stability report, the IMF suggested continuing U.S. tightening would reduce inflows to emerging markets by about $35 billion a year.

However, Turkey is especially vulnerable because of its hoard of hard-currency debts, which becomes harder to repay as the lira depreciates. Investors are also concerned about the central bank's ability to react, for example by raising interest rates, given President Erdogan has put in place measures that could curb its independence.

Executives from multinationals have watched the turmoil in Turkey. While a relatively small economy, Turkey has long been an attractive emerging market for everything from factory machinery to consumer goods. The economic headwinds have already taken their toll in some sectors.

Exports of German machinery to Turkey dropped 4.7% in the period from January to May this year, the German Mechanical Engineering Sector Association, the lobby organization for one of Germany's largest export sectors, said Monday.

"The negative development should continue over the coming months," the association said, citing the recent sharp fall in the lira's exchange rate against the euro. Turkey is the world's 12th largest market for mechanical engineering and plant automation, worth some €29 billion ($33 billion), the organization said.

Automotive sales in Turkey fell 11% in the first half of 2018, compared with a year earlier, plunging 39% in June alone, according to OSD, the country's automotive manufacturers association. That has had an impact on French auto maker Renault SA, which runs a factory there with a Turkish partner. Renault's first-half sales fell 8.9% from a year earlier and 33% in June, the company said in its earnings report last month.

Unlike Turkey, other developing nations such as China and India—the biggest emerging economies—are relatively less dependent on foreign debt. And some central banks have raised borrowing costs aggressively: Bank Indonesia, for example, has boosted benchmark rates by 1 percentage point in recent months to restrain the rupiah's slide.

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Trinh Nguyen, senior economist for emerging Asia at Natixis, said that Turkey's reluctance to raise interest rates stood out. "It's not that emerging markets elsewhere aren't impacted, but authorities are willing to react to currency slides, to signal that they will continue to react in the future."

Mike Bird, Manju Dalal and Bertrand Benoit contributed to this article.

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WSJ PRO CENTRAL BANKING

Economy
Australia's Central Bank Uneasy About ‘Problematic' U.S. Stimulus; Markets are not prepared for a repricing of Fed intentions, Mr. Lowe says

By James Glynn
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SYDNEY—Reserve Bank of Australia Governor Philip Lowe on Friday said the central bank was becoming increasingly uneasy about the potential for inflation to jump in the U.S., fanned by the country's "problematic" fiscal expansion.

"I am less relaxed. It is highly unusual to have such stimulatory fiscal policy when the economy is already operating at a very high level of capacity," Mr. Lowe said in testimony before parliament.

"One can't rule out the possibility that the Federal Reserve will have to withdraw monetary accommodation more quickly than currently projected, with possible disruptive consequences in **financial markets**," he warned.

Markets are not prepared for a repricing of Fed intentions, but the "probability of it happening is rising," Mr. Lowe said.

"With the U.S. economy doing well, and very low unemployment, it is the time of the cycle that should be back to budget balance…building insurance," Mr. Lowe said while pointing out that the U.S. was doing exactly the opposite.

The U.S. is planning to run budget deficits between 4-5% of GDP into the foreseeable future and added that U.S. public debt was already high.

Mr. Lowe also expressed concern that a trend toward fiscal expansion was spreading among major economies.

"We are also seeing a similar trend emerge in other countries, where governments, responding to the disillusionment in the electorate, and the international tax competition coming from the U.S., are feeling they have to respond," Mr. Lowe said.

Among OECD economies, more than half are having a fiscal expansion this year at a time when the world economy is doing well and unemployment rates are low and levels of public debt are very high, he added.

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WSJ PRO CENTRAL BANKING

Economy
Wessel's Take: For the Fed, Is It 1998 All Over Again? With ripple effects from Turkey's economic woes infecting other emerging markets, will the Federal Reserve reconsider plans to raise interest rates a couple more times this year?

By David Wessel
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The other day on CNBC I got a predictable question: With ripple effects from Turkey's economic woes infecting other emerging markets, will the Federal Reserve reconsider plans to raise interest rates a couple more times this year? When central bank Chairman Jerome Powell asks the Fed staff to respond to that question, someone is certain to recall how the Fed reacted to the Asian financial crisis.

For 18 months, the Fed hadn't reacted to the widening turmoil, but as the virus spread from Thailand to Brazil to Russia, then-Chairman Alan Greenspan declared in September 1998: "It is just not credible that the United States can remain an oasis of prosperity unaffected by a world that is experiencing greatly increased stress."

At the end of that month, Fed staff told the Federal Open Market Committee that the "financial tumult" was of "such a magnitude" that they were forecasting a sharp deceleration in U.S. economic growth.

The Fed cut interest rates then even though unemployment was a low 4.5% and there were worries about inflation. It cut rates twice more that year.

But six months later, citing the economy's "remarkable dynamism," the staff marked up its forecast. As the U.S. shrugged off the emerging-market crisis (and the collapse of hedge fund Long-Term Capital Management), the Fed reversed course and raised rates three times in 1999.

With the benefit of hindsight, it is now clear the Fed had overreacted by cutting rates. As David Stockton, then the Fed's chief forecaster, later recalled, "Part of our mistake in 1998 was a failure to appreciate just how strong the U.S. economy was as we entered that period."

Yet Mr. Greenspan had no regrets. The Fed, he wrote later in his memoir, reasoned that an "unlikely but potentially destabilizing event" was a greater threat than the inflation that might follow easier monetary policy.

Mr. Powell and his colleagues may soon have to make a similar judgment. The U.S. economy is at or near full employment and seems to have substantial momentum, fueled, in part, by some untimely fiscal stimulus. Inflation appears to be closing in on the Fed's 2% target. So there is a case for continuing to raise rates from today's still-low levels.

But the Fed will be watching to see how global developments affect the outlook for the U.S. economy. If the emerging-market turmoil intensifies and depresses U.S. **financial markets**, if China's big economy slows, and if President Trump's trade war damages U.S. business confidence and the near-term outlook for the U.S. economy, Mr. Powell may consider deferring a rate increase or two to see how events unfold.

(David Wessel is a contributing correspondent to The Wall Street Journal and director of the Hutchins Center on Fiscal & Monetary Policy at the Brookings Institution, www.brookings.edu/hutchinscenter)

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WSJ PRO CENTRAL BANKING

Economy

Turkey Shifts Toward Russia | Lacker Heads to University | Indonesia Raises Benchmark Rate | Coin Offerings Scrutinized | Timiraos's Take: Fed May Have to Deliver Some Surprises; The Wall Street Journal's central banking newsletter for Wednesday, August 15, 2018

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Timiraos's Take: To Listen to Markets, Powell's Fed May Have to Deliver Some Surprises

Turkey Shifts Toward Russia as Sanctions Sour U.S. Relations

Former Richmond Fed Chief Lacker Heads to Virginia Commonwealth University

Bank Indonesia Raises Benchmark Rate by a Quarter Point to 5.5%

Even Free Tokens Face Regulatory Heat as Coin Offerings Scrutinized

To Listen to Markets, Powell's Fed May Have to Deliver Some Surprises

Federal Reserve Chairman Jerome Powell has spent his first six months on the job dialing back how much guidance the central bank gives on the future path of interest rates.

It is a strategy that could help the Fed determine when it has reached a neutral rate setting that seeks to neither spur nor slow growth, by allowing it to read market signals that haven't been overly influenced by the Fed's own guidance.

It may also result in the Fed surprising markets more often than it has in recent years.

At a congressional hearing last month, Mr. Powell said he was paying close attention to market signals about a neutral rate in response to questions about the flattening yield curve in bond markets.

"The real question," he said, "is what's the story with long rates?"

The yield on the **10**-**year Treasury** includes the so-called term premium, or the extra compensation an investor demands for owning a long-dated bond rather than a shorter-maturity instrument. But after accounting for the term premium, "there's also sort of the market's estimate of the long-run neutral rate," he said. "So it's telling you something, and we're listening."

Mr. Powell's close study of markets for clues about the neutral rate is most effective if markets aren't being distorted, for example, by market guesswork about the Fed's intentions.

On a panel with Mr. Powell in 2016, former Fed governor Jeremy Stein warned the Fed can find itself in a "hall of mirrors" where investors look to the central bank for guidance about rates, and officials worry about taking actions that surprise markets.

Too much forward guidance, in other words, can blur the signal embedded in markets.

Fed officials moved toward dialing back such guidance when they shortened their postmeeting statement significantly in June. They dropped language that for years implied rates would remain historically low.

A period where the Fed is moving its benchmark short-term rate "well within the range of estimates of the normal long-run level…is an appropriate time to remove this forward guidance from our policy statement," Mr. Powell said at his June press conference.

If the Fed is committing to providing fewer signals about its policy plans, policy will become harder for markets to predict, and the Fed could at some point catch markets off guard.

Mr. Powell acknowledged this potential during the panel discussion with Mr. Stein in 2016. "A data-driven committee, making decisions meeting by meeting, is likely to surprise markets from time to time," he said.

Key Developments Around the World

Turkey Shifts Toward Russia as Sanctions Sour U.S. Relations

President Recep Tayyip Erdogan of Turkey stepped up his attacks on the U.S. on Tuesday, calling for a boycott of Apple Inc.'s iPhones and other U.S. electronic goods, while his foreign minister joined his Russian counterpart in criticizing Western sanctions. In recent weeks, Turkey and Russia have been the targets of U.S. sanctions while their currencies, the lira and the ruble, have dropped against the dollar. Mr. Erdogan's boycott is part of a wider campaign Turkey has launched to retaliate against the U.S. measures.

Turkey's Banks Bear Weight of Currency Crisis

Turkey Crisis Puts Spotlight on Emerging Market's Foreign-Currency Debt

Former Richmond Fed Chief Lacker Heads to Virginia Commonwealth University

Jeffrey Lacker, who resigned from the Federal Reserve Bank of Richmond last year over his role in a 2012 leak of confidential information, is heading to academia. Virginia Commonwealth University on Tuesday said Mr. Lacker, who led the Richmond Fed from 2004 to 2017, will become a professor in the Department of Economics starting Thursday. Mr. Lacker's new job brings him back to where his career began, as a professor. He taught at Purdue University between 1984 and 1989 before moving to the Richmond Fed. Mr. Lacker also taught at The College of William & Mary and New York University, and has published extensively in academic journals.

Bank Indonesia Raises Benchmark Rate by a Quarter Point to 5.5%

Bank Indonesia on Wednesday raised its benchmark seven-day reverse repo rate by a quarter point to 5.50% after the Turkish lira's meltdown hammered **financial markets** world-wide, especially in emerging economies like Indonesia. Seven out of 14 economists surveyed by The Wall Street Journal said they expected the central bank to keep its benchmark seven-day reverse repo rate unchanged at 5.25%. Five economists penciled in a quarter-point increase, while two said they expected a half-point move.

Wells Fargo Risk Executive to Leave Bank

One of Wells Fargo & Co.'s top risk-management executives is leaving the bank months after it was dealt an unprecedented enforcement action by the Federal Reserve. Chief Operational Risk Officer Mark D'Arcy is leaving Wells Fargo to "pursue opportunities outside of the company" and his last day is Aug. 21, according to an internal memo described to The Wall Street Journal that was sent to bank employees this month. Mr. D'Arcy, who joined Wells Fargo in February 2017, will be succeeded by Mark Weintraub, who was Wells Fargo's head of audit for consumer banking.

Quick Hits: China Appoints New Central Bank Vice Governor

A new vice governor was appointed at the People's Bank of China, and a Bank of Korea official said he sees limited domestic impact from the crisis in Turkey. Here are quick hits on central banking and related market views from around the world.

FINANCIAL REGULATION ROUNDUP

Even Free Tokens Face Regulatory Heat as Coin Offerings Scrutinized

Securities regulators Tuesday opened a new front in their campaign to crack down on fraud in the initial-coin-offering market by punishing a firm that didn't sell any tokens. The Securities and Exchange Commission said Tomahawk Exploration LLC and David Thompson Laurance tried to raise $5 million in 2017 by selling a token called "TOM," short for the firm's name. When the effort fizzled, Tomahawk wound up giving away 80,000 tokens to entities that helped promote the coin offering, the SEC alleged. The recipients later traded TOM tokens on a digital-asset exchange for other cryptocurrencies or tokens, the SEC said. Although Tomahawk failed to sell any tokens, the company and Mr. Laurance broke the law by misleading potential investors about details of

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their oil-drilling project and not telling potential investors that he was once convicted of criminal securities fraud, the SEC said.

Cryptocurrency Market Plumbs New Depths in 2018

The cryptocurrency market just hit another new low in 2018. A broad selloff in digital currencies has pushed the value of the entire market below $200 billion for the first time this year, according to research site CoinMarketCap, erasing more than 70% of its worth seven months ago. At $191 billion on Tuesday, the total market value of cryptocurrencies world-wide is now at its lowest since November. The market cap peaked at $814 billion in January.

Musk's Tweets on Tesla Buyout Face Scrutiny After Saudi Disclosure

Tesla Inc. Chief Executive Elon Musk's revelations that he has talked to Saudi Arabia's sovereign-wealth fund to provide the cash to take the company private gives regulators more ammunition to fault how he first disclosed it, securities law experts said. The Securities and Exchange Commission has inquired about Mr. Musk's basis for writing on Twitter last week that he had "funding secured" for the deal. Mr. Musk's Monday statement acknowledged that Saudi Arabia's participation hinges on "financial and other due diligence and their internal review process." The commission's inquiries, made last week, are preliminary, according to people familiar with the matter. It could become a formal investigation if officials believe a violation of law occurred and that Mr. Musk's conduct caused investor losses. An SEC spokesman declined to comment.

Match Group and IAC Face Lawsuit Over Tinder's Valuation

Three of Tinder's founders and a handful of current executives say the popular dating app's parent companies cheated them out of as much as $2 billion by manipulating financial information to undermine its valuation, according to a lawsuit filed Tuesday. The co-founders and executives claim that Match Group Inc. and IAC/InterActiveCorp. hid projections of Tinder's rapid growth to reduce payments to the holders of stock options, which were dependent on the company's valuation. The 10 plaintiffs to the suit filed it in New York Supreme Court and are seeking $2 billion.

Wednesday

8:30 a.m. EDT

U.S. Commerce Department releases July retail sales

9:15 a.m. EDT

Federal Reserve releases July U.S. industrial production

Thursday

Time N/A

Bank Indonesia releases policy statement

Time N/A

Central Bank of Egypt releases policy statement

4 a.m. EDT

Norges Bank releases policy statement

8:30 a.m. EDT

U.S. Commerce Department releases July housing starts

Friedman and Phelps on the Phillips Curve Viewed From a Half Century's Perspective

A National Bureau of Economic Research paper by Robert J. Gordon criticizes the underlying assumption behind the Friedman-Phelps Phillips curve that "the labor market continuously clears and that changes in unemployment down or up occur only in response to 'fooling' of workers, firms, or both." The paper concludes that "it remains to

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be seen whether the economy's response to low unemployment in the next several years is a one-shot increase of inflation or a steadily accelerating inflation rate as predicted 50 years ago by Friedman and Phelps."

The Gender Punishment Gap

Women in the U.S. financial advisory industry face more severe punishment at both the firm and industry level for similar missteps, write Mark Egan, Gregor Matvos and Amit Seru for Bank Underground. "After being reprimanded for misconduct, 46% of male advisers experience an employment separation," they write. "Conversely, 55% of female advisers experience an employment separation following misconduct. The results suggest that women are 20% more likely to lose their job following misconduct. The financial advisory industry is willing to give male advisers a second chance, while female advisers are cast from the industry for similar or less severe missteps. We find evidence that the gender punishment gap is driven by in-group favouritism. The effects of the gender punishment gap are costly, long-lasting, and may ultimately contribute to the glass ceiling faced by women in finance."

Prudence Needed as Lenders Raise Rates

Hong Kong banks once able to resist increases by the Federal Reserve are putting up their mortgage costs, and those buying homes had better be careful, according to an opinion piece in the South China Morning Post. "While interest rate cycles are common, there are special factors that set this one apart. One, of course, is the trade war unleashed by the United States, a threat to economic growth and stability to which Hong Kong is exposed by its externally oriented economy and import and re-export trade."

China's Housing-Market Headache

A jump in Chinese house prices is creating a huge headache for China's central bank, writes Nathaniel Taplin for The Wall Street Journal. "The situation is reminiscent of early 2015, another period of flagging growth and policy missteps by the People's Bank of China (PBOC) that presaged major market turbulence later that year," he writes. "Then, as now, one of the central bank's first policy responses was to push short-term interbank rates lower, hoping to stimulate lending. Then, as now, banks were still reluctant to lend because the government was simultaneously in the midst of a big crackdown on shadow finance, meaning many borrowers were in dire straits. Much of the extra liquidity from the PBOC's easing moves simply flowed into the **stock market** instead, resulting in a historic bubble followed by a crash a few months later and large-scale capital outflows."

The Turkish Deal

Turkey's economic salvation lies with its conventional Western allies, writes Jim O'Neill for Project Syndciate. "Despite his escalating rhetoric, (President Recep Tayyip) Erdoğan may soon find that he has little choice but to abandon his isolationist and antagonistic policies of the last few years," he writes. "If he does, many investors may look back next year and wish that they had snapped up a few lira when they had the chance. The last thing that Trump wants is a crumbling world economy and a massive dollar rally, which could derail his domestic economic ambitions. So a classic Trump "trade" is probably there for Erdoğan, if he is willing to come to the negotiating table."

Gradually rising interest rates have yet to dent Americans' appetite for borrowing, with the total stock of new debt climbing to $13.3 trillion in the second quarter, continuing a gradual rise in household borrowing over the past four years.

The credit scores of millions of U.S. consumers have risen following an overhaul of how credit-reporting firms handle negative credit information. Consumers who had at least one collections account removed from their files experienced an 11-point increase, on average, in their credit scores, according to a report released Tuesday by the New York Federal Reserve.

The number of workers in the U.K. from the European Union recorded its sharpest annual drop on record in the second quarter, highlighting how Brexit and economic recovery in the eurozone are denting Britain's appeal for European citizens.

Annual inflation in the U.K. accelerated in July, suggesting inflationary pressures persist in the British economy despite disappointing wage growth.

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THE WALL STREET JOURNAL.
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REVIEW & OUTLOOK (Editorial)
Coercive Economic Diplomacy

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James Carville famously quipped in the 1990s that he wanted to be reincarnated as a bond trader so he could "intimidate everybody." Today he'd probably want to return as a currency trader. With central banks holding down interest rates, currency traders are the new economic enforcers, as Friday's **volatile** markets showed.

The hottest flashpoint is the Turkish lira, which dropped more than 13% against the dollar amid a fight between President Recep Tayyip Erdogan and President Trump over American prisoners. The Russian ruble also hit a two-year low Friday on fears of more U.S. sanctions, and emerging markets in general are under pressure as global capital flows to the fast-growing U.S. economy. The Trump Treasury needs to be alert to the exchange-rate fallout.

More than any recent U.S. President, Mr. Trump is willing to use economic leverage for coercive diplomacy. He's now targeting Turkey to gain the release of American Christian pastor Andrew Brunson, who is being held on dubious charges of aiding a coup attempt. Mr. Trump threatened sanctions several weeks ago, and last week he followed through against two members of Turkey's cabinet.

Mr. Erdogan has vowed never to give in, but this week he sent an emissary to the U.S. for talks. After those failed to gain Mr. Brunson's release, Mr. Trump escalated with a Friday morning tweet vowing to double U.S. tariffs on Turkish aluminum to 20% and steel to 50%. The lira promptly fell to a new low and has lost more than 40% of its value in a year.

Turkey is vulnerable because of Mr. Erdogan's economic mismanagement. In the runup to June elections, he blew out the fisc on entitlements and public works. His son-in-law, Berat Albayrak, who is no Alexander Hamilton, runs the finance ministry. Mr. Erdogan has also meddled in monetary policy to keep interest rates low, at the cost of rising inflation that economist Steve Hanke estimates at 85%.

The trouble with sharp currency moves is that the damage can radiate beyond one country. Contagion is always possible. In Turkey's case, the concern is over dollar-denominated debt. About half of Turkey's debt is held in dollars, which becomes more expensive to finance when the lira is worth so much less. European banks hold a chunk of this debt, as they seem to in every sovereign financial panic.

The lira crisis looks to be containable, especially if Mr. Erdogan decides to cut his losses and release Mr. Brunson as well as NASA scientist Serkan Golge and Turkish employees of U.S. State Department missions in the country. The U.S. Congress is considering new sanctions against Ankara, and Mr. Erdogan's invocation that Allah is on his side won't stem further economic harm. With all due respect to Allah, an independent central bank will be more effective than prayer.

Mr. Trump should also want a happy resolution to stop any larger debt or currency damage to **financial markets**. The U.S. needs good relations with Turkey to pursue diplomatic solutions in Syria and Iraq.

As tempting as sanctions often are, they should be used sparingly and against the right targets. They make sense against genuine rogue states like Iran and North Korea, as well as to show Vladimir Putin that there are costs to invading neighbors or using chemical or biological weapons to kill exiles on foreign soil.

But sanctions against allies should be used only in rare cases. They would also be less risky if they weren't piled on top of Mr. Trump's tariff war. Mr. Trump's metals tariffs have made Europe even less willing to cooperate with the U.S. in enforcing renewed American sanctions against Iran.

If Mr. Trump is determined to use coercive economic diplomacy, including tariffs and sanctions, then the Treasury will have to be ready to deal with the collateral financial damage. Every recent Administration has dealt with a currency or financial surprise of some kind -- from the U.S-German dispute of 1987, the Mexican peso run of 1994, the Asian meltdown of 1997, the Argentine peso crisis of 2002, and the Chinese devaluation shock of 2015.

Some were worse than others, but each carried dangers of wider harm if not addressed. Those risks increase if a U.S. President is bent on using economic punishments to deliver political goals that aren't easily achievable. Financial sanctions in a world of fiat currencies are a powerful political tool. But the Trump Administration needs to use them with care, while the Treasury and Federal Reserve work with other central bankers and finance ministers to reduce **volatility** in the world's main currencies.

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THE WALL STREET JOURNAL.

Markets

Stock Market Is Taking Cues From the Private Market; Ample venture capital and low rates offer companies myriad options for raising capital without going through expensive IPOs

By Ben Eisen
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The rise of private markets where companies are free from the constraints of quarterly reporting is already reshaping the makeup of the public **stock market**.

It's sparked a secular decline in public listings. It's led a prominent CEO to recently declare his intention to take his company private. It could also result in a loosening of rules around what's required of public companies.

On Friday, President Trump said he instructed the Securities and Exchange Commission to study whether companies should release earnings twice a year, rather than four times. He tweeted that business leaders told him it "would allow greater flexibility & save money."

Such a practice, while potentially helping companies to move away from short-term profit goals, would also limit investors' visibility into corporate performance, a move that echoes the more-limited transparency among private companies.

It's a clear sign that for public-trading venues, private markets are tough competition. Ample venture-capital funding and low rates have left companies with myriad options for raising capital without going through an increasingly expensive initial-public-offering process and adhering to stringent listing requirements. There are now fewer public U.S. companies than in 1976, even though gross domestic product has grown sharply, according to a Credit Suisse report from last year.

The public markets could lose one more member if Tesla chief Elon Musk gets his way and completes a take-private deal. Though the outcome of that effort is uncertain, Mr. Musk indicated in a memo last week that his thinking is influenced by a grass-is-greener view of private markets. "Basically, I'm trying to accomplish an outcome where Tesla can operate at its best, free from as much distraction and short-term thinking as possible," he wrote.

Given this backdrop, it's not surprising that politicians want to reshape the **financial markets**. And it's not just Mr. Trump tossing out ideas. Massachusetts Sen. Elizabeth Warren recently proposed that large companies be required to consider the interests of all stakeholders, including workers, and not just focus on maximizing shareholder value.

The **stock market** is slowly transforming itself. Everyday investors should hope these changes don't reduce the transparency and access that public shareholders have historically enjoyed.

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Write to Ben Eisen at ben.eisen@wsj.com

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Economy

Timiraos's Take: Clarida's Warning on the Limits of Global Rate Divergence Could Prove Prescient; The soon-to-be Fed vice chairman said before his nomination the central bank would be constrained in rate rises if other central banks weren't also tightening

By Nick Timiraos
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When President Trump tapped Jerome Powell to lead the Federal Reserve, one market commentator outlined two of the biggest decisions Mr. Powell would face, likely in 2019 or later: when to stop raising interest rates and when to stop shrinking the Fed's balance sheet.

Mr. Powell appeared to have embraced the idea that the neutral level of interest—that is, the short-term benchmark rate that neither spurs nor slows growth—would be much lower than before the financial crisis, the commentator added.

But "Fed officials don't seem to agree on what this New Neutral level is, and Powell will need to forge a consensus," the commentator concluded.

The commentator was Richard Clarida, who is set to become Mr. Powell's second-in-command now that the Senate has confirmed his selection by Mr. Trump. He will play a key role shaping Mr. Powell's strategy to resolve both decisions he laid out last fall in a blog post for Pimco, where he served as a strategic adviser.

Fortunately for Fed geeks, Mr. Clarida has a lengthy paper trail in both academia and the popular press explaining how he has approached monetary policy questions.

Mr. Clarida published one such article shortly after Mr. Trump's election that could prove prescient for the coming deliberations on the Fed's 2019 strategy. Writing in the Financial Times, he said the Fed would be more constrained than in past periods in raising rates if other central banks weren't also lifting their benchmark rates.

"In a world of global capital flows, there will be a limit to how far U.S. rates can diverge from global interest rates without triggering **volatility** in markets and a much stronger dollar that reduces exports," he wrote.

Recent emerging-market **volatility**, largely confined so far to Argentina and Turkey, offers one example of international risks to the Fed's plans, though the situations in those two countries seem unlikely to slow the Fed's rate-rise campaign at this point.

While the 2016 U.S. election and the market rally that followed, based on expectations of new fiscal stimulus, changed the growth and inflation outlook for the U.S., "it has not materially changed the outlook for global expansion, saving and risk appetite," Mr. Clarida wrote.

Mr. Clarida's view about the U.S. rate position vis-à-vis other global central banks will be worth further attention if slow growth further delays efforts by the European Central Bank and Bank of Japan to reverse the emergency actions deployed earlier this decade.

Write to Nick Timiraos at nick.timiraos@wsj.com

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Strong Profits Fuel Rally in Large Lenders

By Michael Wursthorn
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6 August 2018
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Shares of Wall Street's biggest banks are booming again after a string of strong earnings reports and higher payouts to shareholders re-established their status as some of the **stock market**'s most appealing investments.

An index of the 24 biggest banks in the U.S., known as the KBW **Nasdaq** Bank Index, is on pace to notch its first positive quarter this year. Its latest gains came after several lenders said steady economic growth around the world, a pickup in loan activity, rising interest rates and resurgent **volatility** in stock prices all helped to push profits and revenue sharply higher.

That is a sharp reversal from the second quarter, when the index fell 2.5% to suffer its worst three-month stretch since early 2016. This quarter, those big banks are again outperforming their smaller, regional counterparts, a sign their massive scale offers the potential for more lucrative returns, some analysts said.

The strong performance, along with a changing economic landscape, is pushing more investors toward financial stocks, especially the big banks. BlackRock's iShares unit said in a recent report that it favored financial stocks in the second half of the year, while brokerage LPL Financial Holdings Inc. is encouraging its investors to increase allocations to bank stocks so they can benefit from a rising interest-rate environment, lower taxes and attractive valuations.

Shares of JPMorgan Chase & Co. have jumped 12% so far this quarter after the lender showed strength across several of its key businesses to report an 18% jump in profit. Revenue exceeded analysts' expectations. Bank of America Corp. is up 12% after increasing its second-quarter profit by 33% from a year earlier, thanks to rising interest rates and a lower tax bill.

Goldman Sachs Group Inc., Morgan Stanley and Citigroup Inc. also are all trading higher after reporting profits and revenue that topped estimates from analysts. Wells Fargo & Co., however, struggled under the weight of its regulatory issues and reported an 11% drop in second-quarter profit. Still, its shares are up 6.1% so far this quarter, cutting its decline for the year to 3%.

The big banks have also been deploying massive sums of capital back to shareholders. Using the savings from the corporate tax cut passed last year, banks have been increasing their dividends and buying back more stock, activities that tend to nudge share prices higher. Plus, the Federal Reserve cleared the way for most big banks to increase their dividends and share buybacks after passing the central bank's so-called stress tests.

The rising fortunes of the U.S.'s biggest banks are lifting their share-price performance past that of smaller lenders, which had been rising somewhat faster so far this year.

The KBW **Nasdaq** Regional Banking index of small banks is up 1.3% for the quarter. KBW's index of large lenders is up 6.2% since the end of June.

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International New York Times

opinion
Clouds Darken Trump's Sunny Economic View

By THE EDITORIAL BOARD
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Like a Volkswagen Beetle mounted with a V-8 engine, the American economy has a lot more power than it can handle right now, and it's making a lot of noise. So is President Trump, who takes singular credit for a robust second-quarter rise in the gross domestic product of 4.1 percent, something that hasn't happened under any other president since … Barack Obama. While Mr. Trump praised himself effusively — he's good at that, isn't he? — the **stock market** seemed unimpressed. Friday's announcement that 157,000 new jobs were added in July, a modest gain or perhaps a seasonal glitch, elicited an even more subdued reaction. That's because if you look down the line, there are few clear reasons to be so enthusiastic.

"Over all, we see this report as supportive of our views that the economy is currently firing on all cylinders," wrote Bricklin Dwyer, a senior economist with BNP Paribas, after the new G.D.P. numbers were announced. But there was a caveat: Mr. Dwyer said that "growth is likely peaking. Indeed, in our forecasts, [the second quarter] marks a high-water mark for growth."

For one thing, the initial jolt of the Republicans' $1.5 trillion tax cuts, mostly for corporations and the wealthy, is wearing off. Corporations have bought back $437 billion of their own shares, which leaves them that much less to invest in new production, or wages. In fact, spending on business equipment slowed.

Then there's the flattening yield curve, which the St. Louis Federal Reserve's president, James Bullard, warns could invert late this year if current conditions persist. That means short-term rates, such as those for two-year Treasury bonds, run higher than long-term rates, like the 10-year bond, a sign of pessimism that is a well-known red flag. Recessions tend to follow an inverted yield curve like a stray cat looking for a meal.

Purchases of goods drove about a third of that second-quarter economic increase, according to the St. Louis Fed. Consumers were in a spending mood this spring, an attitude that won't necessarily continue. In the prior quarter, they kept their hands in their pockets. At some point, they were spending the banks' money, though: Credit cards and other revolving loans had increased to an annual rate of 5.1 percent in June. A recent Reuters analysis found that the bottom 60 percent of income-earners have been fueling their spending, and thus the economy's, by using their savings or credit cards. They almost have to, because wage growth is expanding at a disappointing 2.7 percent annual clip — despite evidence that employers are finally throwing a few more pennies at workers.

The prospects for wage growth ought to be good, given the tighter labor supply. But American companies have made an art form of not sharing the wealth with workers. Productivity growth has vastly outstripped real wage growth since the 1970s, according to Deutsche Bank research. Yet employees are working harder and smarter and not getting commensurately remunerated, while corporations have a record share of the national wealth. That is to say, workers have been getting ripped off.

Inflation measured by the Consumer Price Index, which is up 2.9 percent over the past year, is absorbing some of those improving wages. Consumers are also running into higher gasoline prices — up more than 20 percent in the past year — thanks to rising **oil prices**, with the prospect of **volatility** in the Middle East not helping. Energy is excluded from the basic C.P.I.

Given that it is the Federal Reserve's job to hold inflation to 2 percent and keep the economy from overheating, interest rates have been rising, to Mr. Trump's expressed disapproval. Most economists expect two more rate increases this year, which will make housing more expensive. That has ever more implications for the housing market, which should be expanding and contributing to economic growth. Instead, housing is getting fenced in by rising mortgage rates, as well as high prices and low inventory. You may recall what happened the last time housing slumped, in 2007. Rising interest rates also make some revolving credit more expensive.

Now consider the administration's effort to apply the sledgehammer to the economy's toes via a trade war and ensuing tariffs on imported steel and aluminum, among other products. Alcoa, the country's largest aluminum maker, as well as a big aluminum importer, said its operating earnings could take as much as a $100 million hit. Not only have the tariffs contributed to $1 billion in higher costs for General Motors, they are now contributing to rising prices of everything from Cokes to vacuum cleaners as companies pass along those costs to consumers. Some of these are easily deferred purchases, and that's what consumers are doing in the case of Electrolux.

Nor are trade wars kind to exports. Trade contributed 1.1 points to that 4.1 percent second-quarter increase, including a huge bump in pretariff soybean exports to China. Kiss that goodbye. Expect to see one percentage point of G.D.P. wiped out in the third quarter, says Ian Shepherdson, chief economist of Pantheon Macroeconomics. Take that, China.

All of this seems like a pretty poor return on investment for Mr. Trump's $1.5 trillion tax cuts, at least for most working-class Americans, who benefited least from the tax cuts. None of these issues by themselves will put the brakes on an economy that is powering along with a 3.9 percent unemployment rate. But the friction is building. And just like any powerful car engine, economic expansions — and this one is in its 10th year — eventually run out of gas. Expect Mr. Trump, who never runs out of gas, to blame the Democrats for that.

Mr. President, while you like to take credit for positive economic trends that are well beyond your control, you will own the downside, too.

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DRAWING (DRAWING BY ALEXANDER GLANDIEN)

* Well-Heeled Investors Reap the Republican Tax Cut Bonanza

* A Historic Tax Heist

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THE WALL STREET JOURNAL.
U.S. EDITION

U.S., Mexico Reach Deal on Trade --- Trump threatens to freeze out Canada, proposes getting rid of the name Nafta

By Jacob M. Schlesinger and Josh Zumbrun in Washington and Robbie Whelan in Mexico City
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28 August 2018
The Wall Street Journal
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English
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President Trump moved closer to revising the North American Free Trade Agreement by striking a deal with Mexico, but cast new doubts over the quarter-century-old pact by threatening to leave out Canada.

While the deal was created to foster harmonized rules across the continent, Mr. Trump said on Monday he was happy to sever Washington's northern neighbor from that bloc if necessary. He proposed to rename the pact "the United States-Mexico Trade Agreement," while setting terms that will hinder Ottawa's efforts to join it.

The Trump administration said it would give Canada until Friday to iron out crucial differences, including a revision that makes it harder for Nafta members to challenge U.S. trade penalties. While Mexico accepted that change, Canadian officials have said for months that would be unacceptable.

Mr. Trump and Canada's Prime Minister Justin Trudeau spoke by phone on Monday and "agreed to continue productive conversations" about U.S.-Canada trade, according to a White House statement.

"We will see whether or not we decide to put up Canada or just do a separate deal with Canada -- if they want to make the deal," Mr. Trump said. He added that he might prefer to block Canadian imports rather than negotiate a new pact, saying: "I think with Canada, frankly, the easiest thing we can do is to tariff their cars coming in."

Mr. Trump's harsh rhetoric against Canada was the latest example of his hardball approach to trade policy, where he has chosen to impose intense pressure on other countries through threats or tariffs to try to win concessions.

His strategy is driven by a belief that the U.S. has significant clout over other nations eager to sell into the world's largest market and that prior administrations failed to make use of that.

A spokesman for Foreign Minister Chrystia Freeland of Canada said Monday's agreement was "encouraging," but cautioned Ottawa would only sign on to a revamped trilateral deal "that is good for Canada and good for the middle class."

The minister said she would cut short a scheduled trip to Europe and instead travel to Washington on Tuesday to begin talks with her U.S. counterparts.

Relief over progress on the trade front, despite the lingering tensions with Canada, helped drive the **Dow Jones Industrial Average** up 1%.

The deal includes several provisions to alter a pact Mr. Trump has long branded "a disaster" for what he considers incentives encouraging U.S. companies to shift production to Mexico.

The most significant is a clause that would boost the percentage of autos that would need to be made in North America to qualify for the tariff-free cross-border trade allowed by Nafta. It would also require a certain portion of cars to be made by high-wage workers -- a response to longstanding U.S. union complaints over low-wage Mexican labor.

Canada's position appeared increasingly difficult after Mexican Foreign Minister Luis Videgaray later said Mexico was also fine scrapping the old tripartite Nafta in favor of a bilateral deal with the U.S., a significant reversal from his government's longstanding insistence that any revised pact had to include Canada.

"There are many factors that we can't control -- including the relationship between the U.S. and Canada and actions taken by the government of Canada," Mr. Videgaray said. "In any scenario, we will have a free-trade agreement between Mexico and the U.S."

Mr. Trump, a Republican, faced pressure from GOP lawmakers and his own supporters in farm states to show that his "America First" trade policy will succeed in striking new trade-expanding agreements, rather than just making threats and imposing tariffs.

Mr. Trump's aggressive imposition of tariffs through this year -- on solar panels, washing machines, steel, aluminum, and a long list of Chinese goods -- has prompted retaliation from trading partners around the world.

That has inflicted significant economic pain in states that voted for him in 2016 and where Republicans face tight races in midterm elections.

In an attempt to ease political pressures from the Farm Belt, Mr. Trump's agriculture secretary, Sonny Perdue, announced plans Monday to make $4.7 billion in payments to farmers to help offset their losses from trade battles around the globe.

The U.S. Council for International Business, a group representing U.S. multinational firms, offered cautious praise, saying it hoped Monday's deal "signals a redirection of U.S. trade policy -- away from confrontation and toward cooperative efforts to open markets abroad."

Still, it remains unclear whether the administration's Nafta strategy will ultimately get support in Congress to enact a new deal. Many lawmakers and their aides said Monday that the administration hadn't given them sufficient details on the agreement to judge whether they can back it.

A key part of Mr. Trump's calculation is that he can win significant support from Democrats, who have long been opposed to new trade agreements, by including provisions aimed at raising wages in Mexico and strengthening Mexican labor unions.

Yet, Democrats who have long pushed for stronger labor provisions in trade agreements said they remain unconvinced. "I see nothing in this agreement that fixes the basic problem," Rep. Sandy Levin, a Michigan Democrat, said.

But the main concern expressed by lawmakers and businesses Monday was the prospect that a new Nafta may jettison Canada.

"It is critical that any modernized Nafta continue to include all three North American partners," said Rufus Yerxa, head of the National Foreign Trade Council, a leading free-trade business organization.

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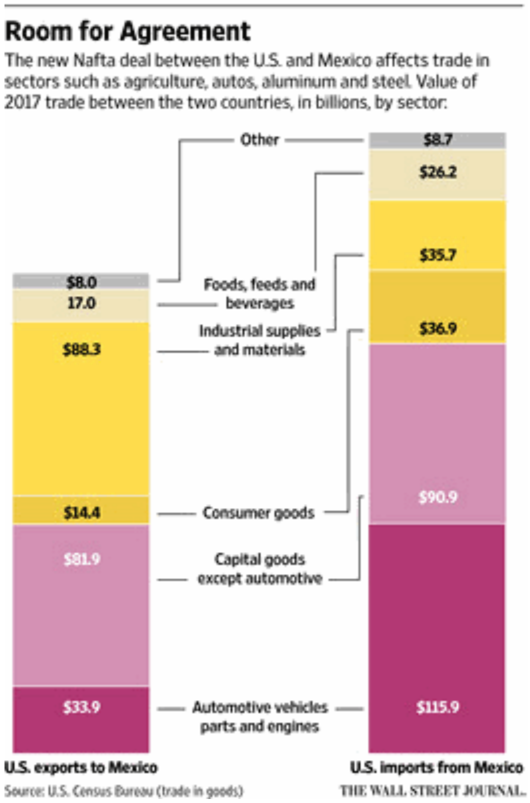

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Economy

Derby's Take: A Way to Profit From Fed Surprises; There is still money to be made by trading on Federal Reserve policy announcements.

By Michael S. Derby
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9 August 2018
05:55 AM
WSJ Pro Central Banking
RSTPROCB
English
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There is still money to be made by trading on Federal Reserve policy announcements.

A recent National Bureau of Economic Research paper concludes investors can trade profitably on the impact on the **stock market** made by surprise Fed announcements. The paper was written by Michael Weber of the University of Chicago's Booth School of Business and Andreas Neuhierl of the University of Notre Dame.

The authors say stock prices begin moving up about a month ahead of a Fed meeting in which investors expect to see some sort of policy action to provide economic stimulus, such as cutting interest rates. Stocks drift down over the same period if investors foresee the Fed doing something that would restrict economic growth, such as raising rates.

But investors are often wrong. Say, for example, they expected the Fed to lower rates and are surprised when officials hold them steady. The researchers found that stock prices tend to continue drifting along for a few weeks as if the Fed had indeed cut rates. This provides an opportunity to trade off that market error.

The same thing happens when investors mistakenly expect the Fed to raise rates.

The paper says this drift is marketwide, holds for all industries and is global in nature, though it doesn't explain why this happens.

There are some questions about whether the paper's findings apply today. For one thing, the study covered the period between 1994, when the Fed began public announcements of policy, and 2009, during the worst of the last recession.

Things have changed a lot since then. It has been a long time since there was a genuine policy surprise coming out of a Fed policy meeting. Officials have been slowly raising interest rates since late 2015, and each move was well telegraphed ahead of time.

Similarly, the Fed's plan to start shrinking its balance sheet last year was detailed in public communications well before it was launched.

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The New York Times

Wealth Matters
Your Money
Is Economic Growth Buoyant or a Blip? Here's How to Invest Either Way

By Paul Sullivan
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When it comes to how the latest economic data could have an impact on investors, two opposite interpretations emerge.

Growth of 4.1 percent in the second quarter is a sign of a buoyant economy set to keep growing for years to come, continuing a nearly decade-long expansion since the financial crisis in 2008.

Or growth of 4.1 percent in the second quarter is a short-term blip brought about by tax cuts that gave people a little extra money in their paycheck but is unsustainable in the face of mounting federal debt, higher tariffs and the prospect of a trade war that could hurt large portions of the United States economy.

On Friday, the Labor Department released the jobs report for July, showing the economy added 157,000 jobs, fewer than the expected gain of 190,000. The jobless rate dropped to 3.9 percent, suggesting slack in the labor market, but wages are growing slowly.

Your takeaway depends on your overall view of the country and the economy.

"In 23 years of doing this, I cannot really remember a time when a statistic comes out and you hear such diametrically opposed interpretations of it," said Andrew Crowell, vice chairman of wealth management at D. A. Davidson & Company, which manages $48.2 billion. "There is no gray zone. It's only black and white, which makes it an interesting time to be an investor."

Who's correct on the data will not be known until the economic impact is felt, which could take months or even years. But for investors, any plan based on waiting or wishing is not ideal.

After all, even before President Trump began to shake up economic norms, with his criticism of the Federal Reserve, threats of tariffs and nonchalance about government debt, investors were skeptical of the economic expansion, which has run, with a few minor dips, from March 2009 to the present.

A wait-and-see approach on investing can be costly, but moving too quickly at this stage could be ruinous if the market goes into a correction. Advisers to some of the country's wealthiest people say to keep investing but to do it wisely.

Here are four tips for investors in a time of caution:

Diversify Your Portfolio

Mr. Trump has made many comments that in a different time would have caused the economy to tank. Military threats against North Korea and Iran, tariffs against the United States' largest trading partners, all manner of statements about Russia — none of them has caused a market correction.

Instead, the opposite has happened this year, as investors find opportunities in market fluctuations. "We've seen cash come in to buy on the dips," Mr. Crowell said.

And for a seemingly sound reason: Companies continue to grow. The Republican tax cut that was enacted last year and a rollback of financial regulations have helped, but so have strong earnings that have outpaced price increases.

“The stimulative measures have bolstered confidence that growth and the economy is going to be strong over the next couple of years,” Mr. Crowell said.

Advisers agree that the recovery has been running for some time and is near the point where bull markets typically begin to falter. But that does not mean the run will end this year or next or even the year after that.

“Consumer wealth is at all-time highs when you factor in home prices and the **stock market**,” said Henry B. Smith, co-chief investment officer at the Haverford Trust Company, which manages $8 billion. “One of the lacking ingredients throughout this has been business investment, and that is starting to pick up.”

Mr. Smith is advising his clients to have the maximum exposure to equities that they can stomach. But he is also telling them to think more broadly about equities.

Investors often overlook the moderating role of value stocks, which are steady, dividend-paying stocks that can help weather various economic storms. Instead, they often pursue the higher returns of growth stocks, which are expected to grow at an above-average rate.

Mr. Smith said investors should think about trimming back investments in manufacturing, technology and financial services to increase holdings of consumer staples, health care, telecommunication and utility stocks, the basics of value investing.

He cited last week’s sudden drop in the value of Facebook as reason to broaden your view of equities. “Last week was a good reminder that stocks that go up sharply can also come down sharply,” he said.

Be Aware of Opportunities

Many investors seem willing to forget that the returns of the past decade have been strong and that replicating them going forward may be difficult. In other words, stay invested in riskier assets while they continue to run, because selling them too early could hurt your portfolio.

“When we look at demographics and economic projections, there isn’t going to be as much population growth and consumption,” said Anthony Roth, chief investment officer at Wilmington Trust. “Most of the world has a population moving to slower consumption as they age. While this economic cycle is continuing, the risk of missing out is even greater.”

Mr. Roth pointed to the reaction over the flattening of the yield curve, which tracks the difference between the interest rate on short-term bonds and long-term bonds. He said talk about the yield curve inverting — which means long-term borrowing costs become less than those in the short term — was premature.

“The strongest period of the market cycle is from the time of yield curve inversion to the peak of the **equity market**, which is usually nine to 12 months after that,” Mr. Roth said. “We haven’t even gotten to the inversion yet, which would suggest there’s significant opportunity right now.”

Yet investors need to pay attention. “The alarm is when the yield curve inverts,” he said. “It’s a predictor of both recessions and returns in the market.”

Actively monitoring economic data and what it presages is a smart strategy.

Pick Recession-Resistant Stocks

Most analysts believe that Mr. Trump is bluffing on tariffs and that they are being used as a negotiating tool. This comes from the school of thought that favors what the president does over what he says.

For instance, after saying so many harsh things about European trading partners, Mr. Trump embraced Jean-Claude Juncker, president of the European Commission, just last week.

“The worst case is, Trump just gets in a fight with China, Europe and everyone else and we see an escalation of tariffs that slows world trade and has a significant impact on the U.S. economic cycle, increases inflationary pressures and ultimately reduces output,” said John S. Osterweis, chairman and chief investment officer of Osterweis Capital Management, which manages about $7 billion.

That would be crushing, but it is not the only possible outcome.

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“The flip side is, Trump really is a master negotiator and what he’s doing is trying to move away from multilateral trade agreements to bilateral agreements,” Mr. Osterweis said. That may produce better trade deals, he said.

Lacking any idea as to which outcome to expect, Mr. Osterweis has been encouraging clients to invest in companies whose outlooks are less dependent on the economy or a particular industry, he said.

“You could think of a Google, where people’s search habits aren’t going to change dramatically if there’s a recession and there’s already an inexorable migration of ad dollars to that company,” he said. “You could look at a drug company with a blockbuster drug coming through the pipeline or a Disney, where they have the next unbelievably popular movie coming out.”

The opposite would be manufacturing companies like automakers that stockpile inventory and could struggle to sell it in a recession. Still, some combination of different types of companies is the more prudent bet.

Consider the Tax Implications

Facebook’s loss of nearly 20 percent of its value in one day was substantial. But Mr. Crowell said it should not cause people to run from the Big Tech stocks like Alphabet, Amazon, Facebook and Netflix.

What it should do is get people thinking about the need to examine their portfolios. “It’s prudent to be mindful that those four names don’t define a diversified portfolio,” he said.

Another reason not to sell off stocks that have appreciated greatly is taxes. People who have held those stocks for a long time have watched them run up in value, which means they are going to owe a lot of money in taxes when they sell them.

Todd Morgan, chairman of Bel Air Investment Advisors, which manages about $8 billion for high-net-worth families, said he shows clients how much the stock of a fundamentally strong company would have to fall before selling it made sense.

“People don’t look at the after-tax returns,” Mr. Morgan said. “I’ve had several calls about tech stocks the past few days, all asking, ‘Should we stay in or get out?’”

If an investor thinks a company is going to drop below what would be owed in capital gains taxes, then it is time to get out.

Investors need to keep paying attention to company fundamentals and economic indicators focused on inflation and wages. If either of those runs too high, the Federal Reserve is likely to raise interest rates, which could bring the equity party to an end.

Since neither is happening now, the best advice is to stay invested and stay alert.

* Economy Hits a High Note, and Trump Takes a Bow

* What’s the Yield Curve? ‘A Powerful Signal of Recessions’ Has Wall Street’s Attention

Most investment advisers believe President Trump is bluffing on tariffs and using them as a negotiating tool. | Dustin Chambers for The New York Times | President Trump with Jean-Claude Juncker, the president of the European Commission, last week. After harshly criticizing America’s European trading partners, he embraced Mr. Juncker and said the United States would work to reach a trade deal with the bloc. | Doug Mills/The New York Times

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The New York Times

Strategies
Business Day

Vanguard Warns of Worsening Odds for the Economy and Markets

By Jeff Sommer
1,239 words
10 August 2018
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NYTFEED
English
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The chances of a recession by the end of 2020 are mounting. And the prospects for the American **stock market** in the next decade have worsened appreciably.

Those are prognoses, not facts. But they're not just offhand projections, either. They are the sober assessments of Vanguard, the $5 trillion asset management firm. And they suggest that the current good times may amount to a reprieve: an opportunity to make sure that you are prepared for a storm.

Vanguard, known for its caution, emphasizes that this is a general forecast. "We don't make any actual predictions about where things are going next month or, in the markets, next year," Greg Davis, the company's chief investment officer, told me. "The **stock market** could rise a lot, short-term. We don't know."

The United States economy could well turn in another series of strong quarters, with the annualized growth rate of gross domestic product above 4 percent, and the unemployment rate below it. Those are statistics for the second quarter, and just may be surpassed over the next year.

But in the Vanguard view, the odds have increased sharply that more challenging times are coming. It is likely, Vanguard says, that the long stretches of sizzling stock markets since 2009 — bouts that have made investing a winner's game for those lucky enough to afford a seat at the table — will become much rarer.

Vanguard tracks data to predict the likelihood of a recession at certain points in the future. In recent years, the company has put the probability of a recession six months out at close to 10 percent. Now, Vanguard says the chances of one by late 2020 are between 30 and 40 percent. That's Vanguard's highest-ever estimate for that time frame, Mr. Davis said. (A six-month forecast reported a greater than 40 percent probability before the recession that started in December 2007.)

The recession projection is based largely on interest rate expectations using two criteria, according to Freddy Martino, a Vanguard spokesman. One is what economists refer to as a flattening yield curve, with the Federal Reserve expected to raise shorter-term rates faster than longer-term ones. The other is rising credit risk for below-investment-grade bonds.

If the facts change — with, say, the Federal Reserve delaying anticipated interest-rate hikes in response to a weaker economy — the recession forecast will change, too, Mr. Davis said. To be clear, Vanguard isn't predicting a recession; it is merely saying that the odds of one have risen.

"You could also say the chance of a recession not occurring by the end of 2020 are 60 to 70 percent," said Fran Kinniry, a principal in Vanguard's investment strategy group. "You want to be prepared for a downturn," he said, without becoming so risk-averse that you fail to benefit if investments rise.

The forecast suggests opportunities, not just problems, Mr. Davis said. The 10-year outlook, for example, includes lower projected annualized returns, but still positive ones, for these two stock categories:

■ United States stocks, an expected 10-year return of 3.9 percent, annualized, down from a projection of an 8 percent annualized return, made in March 2013;

■ Stocks from markets outside the United States, 6.5 percent, annualized, down from 8.7 percent in 2013.

Non-United States stocks are more attractive for equity investors, on a relative basis, than they were five years ago. (That is partly a reflection of the out-performance of domestic stocks, making them far pricier than they were before.) What's more, Vanguard projects improved 10-year annualized returns for these asset classes:

■ A diversified portfolio of United States bonds, 3.3 percent, annualized, up from 1.7 percent in March 2013;

■ Bonds from outside the United States, 2.9 percent, up from 1.8 percent;

■ Commodities, 5.9 percent, up from 4.2 percent;

■ United States Treasury bonds, 3 percent, up from 1.3 percent;

■ And cash, held in United States money market funds, savings accounts or other instruments, 2.9 percent, up from 1.5 percent. Short-term cash is becoming more attractive — with greater liquidity and, often, lower risk — compared with holding bonds.

Experienced investors who are "sophisticated enough to focus on these numbers and act on them themselves" can benefit by making their own adjustments, Mr. Davis said. Tried-and true investments like balanced funds and target date funds (which become more conservative as a given date nears) can make basic adjustments for you. Advisers can do this as well.

Tweaking investments can make it easier to live with them — and not panic — if markets fall, Mr. Kinniry said. At the moment, though, many Americans appear to be setting themselves up for trouble.

By the start of this year, the stock portion of investment portfolios swelled to 63 percent, the highest level in decades, according to a Vanguard analysis. That reflects the rising value of stocks after one of the greatest bull markets in history.

American portfolios had the same high proportion of stocks in September 2007. People bailed out as the market crashed a decade ago — taking huge losses after prices had already fallen — and reducing the equity proportion of their portfolios to only 38 percent in January 2009.

Yet in March 2009, stocks began rising. It would have been better to have held more stocks in early 2009, and to have reduced them when stock prices were high, as they are now. "You don't want to panic and sell after the market falls," Mr. Kinniry said, "but that's what a lot of people did."

Dividing a portfolio between stocks and bonds is a personal decision. If you can afford to ride out a major **stock market** decline, and truly don't need to touch your money for a decade or two, you might be fine with a broadly diversified portfolio that holds only stocks, Mr. Kinniry said.

After all, he said, it took only 3 years for such a portfolio to recover all of its losses after the roughly 50 percent **stock market** decline of the last crash. But withstanding losses like those without selling any holdings took extreme fortitude. That's why it was easier to live with a broadly diversified portfolio, with 50 percent stocks and 50 percent bonds. Such a portfolio recovered all of its losses in just one year, not three, according to data provided by Mr. Kinniry.

Doing a serious gut check and realistically assessing how you will behave if a major downturn occurs can prevent a lot of pain later. "You don't want to find out that you don't have enough car insurance or home insurance until after an accident happens," Mr. Kinniry said. "You're better off if you do the inventory now."

And if the markets do turn out to provide lower returns in the next decade than in the last one, it may be possible to compensate by taking measures that you can at least partly control, perhaps by working more, increasing savings or reducing spending.

The odds have worsened. Surely it's better to be prepared.

Follow Jeff Sommer on Twitter: @jeffsommer

* The **Stock Market** Is Shrinking. That's a Problem for Everyone.

* Thinking About Retirement? Consider Working a Little Longer

Minh Uong/The New York Times

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WSJ PRO CENTRAL BANKING

Economy

Central Bankers' Jackson Hole Gathering: a Cheat Sheet; Fed Chairman Jerome Powell will deliver a speech on 'Monetary Policy in a Changing Economy' Friday morning

By Nick Timiraos
1,280 words
23 August 2018
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English
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JACKSON HOLE, Wyo.—For the central bankers gathered in the Grand Tetons, a meaty discussion of corporate consolidation and declining economic dynamism will take precedence over fly fishing and mountaineering.

The Federal Reserve Bank of Kansas City's annual economic retreat began Thursday evening and runs through Saturday at its traditional venue, the Jackson Lake Lodge, selected decades ago for its appeal to former Fed Chairman Paul Volcker, a fly-fishing enthusiast.

Attendance is by invitation only. Here's a cheat sheet on what to expect over the next few days:

Talk of the Lodge

The theme of this year's conference is "Changing Market Structure and Implications for Monetary Policy":

Kansas City Fed President Esther George will host an opening reception Thursday evening. The conference gets under way in earnest Friday morning.

At 10 a.m. EDT Friday, Fed Chairman Jerome Powell will deliver a speech on "Monetary Policy in a Changing Economy." On Thursday, the Fed posted a paper from a group of senior Fed economists that warns against being too complacent in raising interest rates once unemployment drops to low levels because monetary policy operates with a lag. It is possible Mr. Powell will refer to this research in his speech.

After Mr. Powell's speech, two research papers will be presented and discussed, followed by a panel discussion that features Andrew Haldane, chief economist for the Bank of England. Princeton's Alan Krueger, who served as a top economist to President Barack Obama and has published leading research on labor economics, delivers the lunchtime keynote address.

On Saturday, two more research papers will be presented and discussed, followed by another panel discussion.

A concluding panel will feature Agustín Carstens, general manager of the Bank for International Settlements; Bank of Canada Gov. Stephen Poloz; and the University of Chicago's Raghuram Rajan, who led the Reserve Bank of India from 2013 to 2016.

Beyond the Agenda

The formal program will focus on serious economic questions, but a number of subplots will unfold into the weekend:

—Mr. Powell has been a regular attendee since joining the Fed's board as a governor in 2012, but this will be his first appearance since becoming the Fed's leader in February. While Mr. Powell isn't likely to say anything about it, his public appearance will be the first since President Trump criticized the Fed's campaign to raise interest rates, first last month and also last week when he told donors he hoped Mr. Powell wouldn't disappoint him.

Minutes of the Fed's most recent meeting, July 31-Aug.1, signaled that the central bank is ready to raise its benchmark short-term rate by another quarter percentage point at its Sept. 25-26 policy meeting. That would lift the rate to a range between 2% and 2.25%.

—Appearances by Mr. Carstens, the former head of Mexico's central bank, and Mr. Poloz will provide an opportunity for international perspectives on the Trump administration's aggressive trade posture.

Fed officials signaled in the minutes that they are uneasy over trade policy, but not so much that they're ready to scrap their plan to gradually push rates to a neutral setting that neither spurs nor slows economic growth.

In interviews on the sidelines of the conference, Fed officials are likely to drop more hints about the path forward for monetary policy. They are also set to resume a technical discussion this fall that could influence how much longer they will shrink their $4.2 trillion portfolio of bonds and other assets.

—For the fifth year in a row, the liberal Center for Popular Democracy's Fed Up campaign is on hand for the Jackson Hole gathering. It organized a Thursday panel on slow wage growth and market concentration.

—The conference roster is heavy on international central banking officials, and President Trump's frustration with the Fed and with U.S. trading partners could feed after-hours conversation. Mr. Trump's main path to remake the Fed, by appointing new members to the Fed's seven-member board of governors, has so far yielded mostly establishment types who aren't likely to take a sledgehammer to the institution's culture.

Roll Call

It is another star-studded attendance list for this year's conference, at least for the world of central banking.

—There is perfect attendance this year by all 11 of the Fed's sitting regional reserve bank presidents and by all three governors in Washington. (The San Francisco presidency is currently vacant, but the bank's research director, Mary Daly, is attending).

—The roster of international central bankers includes, in addition to Messrs. Carstens, Haldane and Poloz, Bundesbank Vice President Claudia Buch; Hong Kong Monetary Authority Chief Executive Norman Chan; Bank of Portugal Gov. Carlos Costa; Bank of Argentina Gov. Luis Caputo; Bank of Mexico Gov. Alejandro Díaz de León; Bank of Colombia Gov. Juan José Echavarría; Bank of Israel Gov. Karnit Flug; Bank of Brazil Gov. Ilan Goldfajn; Bank of Iceland Gov. Már Gudmundsson; South African Reserve Bank Deputy Gov. François Groepe; Sveriges Riksbank Gov. Stefan Ingves; Bank of Ireland Gov. Philip Lane; Bank of Chile Gov. Mario Marcel; Norges Bank Gov. Øystein Olsen; Bank of Finland Gov. Olli Rehn; Bank of Japan Deputy Gov. Masazumi Wakatabe; Reserve Bank of Peru Gov. Julio Velarde; Reserve Bank of Australia Assistant Gov. Christopher Kent; and Ayman AlSayari, the deputy governor for investment of the Saudi Arabian Monetary Authority.

—There are no attendees from the Trump administration this year. Marvin Goodfriend, the Carnegie Mellon University economist who has been nominated by Mr. Trump to be a Fed governor, is in attendance. Mr. Goodfriend's nomination advanced earlier this year through the Senate Banking Committee on a party-line vote and remains in doubt.

—A handful of industry economists are in attendance, including Pat Bajari, chief economist at Amazon, and Carolyn Evans, head economist at Intel Corp.

—Several former Fed officials also are set to join, including William Dudley, who retired as New York Fed president in June, and Stanley Fischer, who served as the Fed's vice chairman until last October. Other former Fed officials include Alan Blinder, Roger Ferguson, and Donald Kohn, who each served as vice chairman, and former Kansas City Fed President Thomas Hoenig.

—The list also includes a handful of former and current government officials, including Keith Hall, director of the Congressional Budget Office; Jason Furman, former chairman of the Council of Economic Advisers under President Barack Obama; Ron Jarmin, acting director of the U.S. Census Bureau; and Glenn Hubbard, who was chairman of the Council of Economic Advisers under President George W. Bush.

—And of course, the conference is full of high-profile academics, such as Harvard University's Martin Feldstein (a former CEA chairman under President Ronald Reagan), Janice Eberly of Northwestern University; Pete Klenow of Stanford University; Carl Shapiro of the University of California, Berkeley; and Kristin Forbes of the Massachusetts Institute of Technology.

Write to Nick Timiraos at nick.timiraos@wsj.com

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* What to Watch for at Fed's Jackson Hole Symposium

* U.S. Stocks Drift Lower as Trade Talks Begin

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THE WALL STREET JOURNAL.

Markets

Treasurys Fall Back as Investors Favor Stocks; A trade agreement reached between the U.S. and Mexico boosts demand for riskier assets

By Sam Goldfarb
324 words
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U.S. government**bond prices** inched lower Monday as a trade agreement between the U.S. and Mexico lifted demand for riskier assets at the expense of safe-haven debt.

The yield on the benchmark 10-year U.S. Treasury note settled at 2.848%, compared with 2.826% Friday.

Yields, which rise when **bond prices** fall, initially moved higher along with global stocks after U.S. and Mexican officials signaled they were close to resolving their bilateral differences in renegotiating the North American Free Trade Agreement. Yields then took another leg up when President Trump announced a deal, raising investors' hopes for a broad improvement in the global trade climate.

Concerns about trade tensions has helped to buoy demand for Treasurys this summer, pulling the 10-year yield below 3% after it popped above that level earlier in the year.

Also aiding the market is investors' confidence the Federal Reserve will keep to a gradual pace of interest-rate increases, a view that got support Friday when Fed Chairman Jerome Powell pushed back against critiques that the central bank is tightening too slowly.

Though Mr. Powell, in remarks at the Fed's annual Jackson Hole conference, also defended the need for rate increases, investors generally viewed "his comments as more dovish," said Mary Ann Hurley, vice president of fixed-income trading at D.A. Davidson & Co.

Another round of large debt auctions—part of the government's ongoing effort to fund an expanding federal budget deficit—is also testing investor support for Treasurys this week.

After selling $36 billion of two-year notes Monday, the Treasury Department will auction off $37 billion of five-year notes on Tuesday and $31 billion of seven-year notes on Wednesday.

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THE WALL STREET JOURNAL.

Markets

Regulators Probe Options Market's Major Clearinghouse; Investigations by SEC and CFTC were opened after February spike in market volatility

By Dave Michaels and Gunjan Banerji

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The company tasked with curbing risk in the U.S. options market is under investigation by federal regulators for how it handled a recent period of market turbulence, according to people familiar with the matter.

The probes from the Securities and Exchange Commission and Commodity Futures Trading Commission include concerns that Options Clearing Corp. failed to accurately forecast how much cash would be needed to cover trading losses triggered by a spike in **volatility** last February, some of the people said.

The turbulence wiped out exchange-traded funds that offered a way for investors to bet on **volatility** and left many traders with losses. The role of Options Clearing as a clearinghouse is to keep enough collateral on hand to protect trader defaults from rippling through markets and causing widespread losses.

The SEC and CFTC investigations place new scrutiny on an institution that U.S. regulators labeled "systemically important" in 2012, subjecting it to stricter standards. Clearinghouses are supposed to help reduce systemwide risk by guaranteeing trades between buyers and sellers. Their operations and financial health are considered critical to smooth market functioning.

A spokesman for Options Clearing declined to comment on the investigations.

The Chicago-based clearinghouse reported that the average size of traders' margin breaches in the first quarter was $61.4 million, up from $26,355 at the end of 2017, and a multiyear high.

Options Clearing conducts backtesting to gauge the quality of its models. A margin breach occurs when the actual amount posted as margin is less than what the **volatility** in markets indicates was needed. Options Clearing recently won approval to change its margin model and plans to make the shift in October.

Amy McCormick, first vice president of financial risk management at Options Clearing, said through a spokeswoman that the clearinghouse functioned properly and that the firm expects some breaches "when there are extraordinary events." She said there were no disruptions to clearing.

This isn't the first time the entity has attracted regulators' attention. The SEC in 2013 cited Options Clearing for a dozen deficiencies related to inadequate risk-management systems, corporate governance and compliance during regulatory exams conducted from 2011 to 2013.

The new enforcement probes by the SEC and CFTC began after the jump in market **volatility** during the first quarter of 2018, the people said. SEC and CFTC examiners became frustrated about the clearinghouse's models and referred their findings to their respective enforcement divisions, said people familiar with the matter.

The regulators are now looking into the clearinghouse's risk-management models and databases in an effort to determine if there are any violations of rules governing how Options Clearing calculates margin levels, stress tests its members' trading positions, and maintains its own critical computer systems, the people said.

Options Clearing protects against market meltdowns through a combination of margin accounts and a $13 billion guarantee fund, which includes contributions from other traders and brokers. When the level of collateral, known as margin, is too low, sudden price moves or upticks in **volatility** can result in losses for traders that exceed the balance of their margin accounts.

Brokerage firms have said the clearinghouse's models haven't accurately estimated the size of the guarantee fund. If set too high, the amount of money firms need to post at the clearing crimps the ability to trade, which hurts market liquidity and can even spur more **volatility**.

Regulators have in recent months given the green light for Options Clearing to make some changes to how it operates. In May, the SEC said the clearinghouse could use daily price data instead of monthly figures to calculate the cash cushion that traders post.

In June, Options Clearing asked the SEC to approve a change to how it calculates the size of its guarantee fund, or the money it has in case the other collateral posted is insufficient to cover a failure.

It said in that proposal there are "a number of limitations" to its models, which cause the size of the guarantee fund to fluctuate wildly even when **volatility** is fleeting. The SEC approved the change on July 27.

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Deficits Prompt Treasury To Boost Borrowing

By Josh Zumbrun and Daniel Kruger
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WASHINGTON -- Rising federal budget deficits are forcing the U.S. Treasury to ramp up its borrowing, pressuring a fast-growing economy as the cost of credit rises, too.

The higher-than-expected increase in borrowing needs -- the Treasury's total for the remainder of 2018 would be 63% higher than what it borrowed during the same six-month period last year -- helped drive the yield of **10**-**year Treasury** notes above 3% for the first time since June.

The Treasury announced it would increase auctions of U.S. debt by an additional $30 billion over the next three months. That included higher sales of two-year, three-year and five-year notes and the introduction of a new short-term security with a two-month maturity. The Treasury gets cash to fund the government in exchange for selling the securities.

The rising supply of debt could push up the cost of borrowing as the government seeks to attract investors, though many factors, including the inflation outlook, Federal Reserve decisions and shifting investor appetites for safe securities also play roles in setting interest rates.

The Fed has been raising short-term interest rates to ensure the fast-growing economy doesn't overheat. On Wednesday, the central bank ended a two-day meeting and indicated that it planned to continue its strategy of steady increases.

As well, the central bank has been gradually shrinking a portfolio of mortgage and Treasury securities it accumulated during and after the 2007-2009 recession, adding to the supply of bonds investors are being asked to soak up.

In all, the Treasury said it will borrow $329 billion from July through September -- up $56 billion from the agency's April estimate -- in addition to $440 billion in October through December.

The Treasury's Borrowing Advisory Committee, made up of representatives from investment funds and banks, said the size of monthly debt auctions would need to continue ratcheting higher to fund government deficits in coming years.

The size of U.S. government borrowing is hanging over the bond market. In addition to the increased spending forecast for the federal government, there is concern about lower tax revenue.

"That's part of the equation people haven't been talking about," said Ian Lyngen, head of U.S. government bond strategy at BMO Capital Markets. "The notion that tax reforms are going to pay for themselves is being tested right now."

Deficits are rising in part because federal spending has been ramped up and because corporate and individual tax rates were cut last year. White House officials say reductions in tax rates spur economic growth and raise tax revenue by boosting taxable household and business income.

Many analysts and investors expect these developments will ultimately lead to higher borrowing costs for the U.S. government.

While the U.S. fiscal outlook, with years of trillion-dollar deficits ahead, concerns investors and analysts, many say its status of issuing the world's safest securities will help to restrain interest rates from rising too much.

"U.S. debt is considered such a solid place to park your money that we continue to see solid demand," said Anwiti Bahuguna, a portfolio manager with Columbia Threadneedle Investments.

Because Treasury securities are a benchmark used to help set interest rates on mortgages, business loans and consumer debt, analysts expect higher Treasury rates to ripple through the economy, potentially crowding out other borrowing and restraining an economy that has been on a tear.

"It's higher rates for everyone," said Andrew Brenner, head of global fixed-income at NatAlliance Securities.

Mortgage rates have moved up over the past year -- the average 30-year fixed-rate mortgage stood at 4.84% last week, near its highest level in seven years. Applications for mortgages to purchase homes have held steady, rising 1% over the year, according to Mortgage Bankers Association data released Wednesday.

Housing could "enter a period of slower sales and price increases," said Lou Barnes, a mortgage banker in Boulder, Colo. However he said that wasn't a signal of economic distress, because other factors are driving the slowdown, notably an insufficient supply of homes.

A 5% mortgage rate, he said, left mortgages in many parts of the country "eminently affordable." But he added he would be worried if rates rose to 6%.

Other consumer borrowing rates are climbing as the Fed raises short-term rates. The prime interest rate that many banks use to set credit card and personal loan rates was 5% in June, up from 4.25% a year ago.

The government is likely to run trillion-dollar deficits -- the amount by which spending will outpace revenue -- for the next four years, according to Office of Management and Budget projections released last month.

For now, tax-rate reductions appear to be restraining government revenue because less tax is being generated for every dollar of household and business income earned. The Treasury Department said last month that tax receipts fell 7% in June from the same month a year ago, including a 33% drop in gross corporate taxes.

"Everyone thinks we won't have a problem financing trillion-dollar deficits until we have one," said Brian Edmonds, head of Treasury trading at Cantor Fitzgerald LP.

The Treasury made the announcement of increased auction sizes as part of its regular schedule of quarterly borrowing statements.

Akane Otani and Nick Timiraos contributed to this article.

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THE WALL STREET JOURNAL.

Politics

Trump Hails U.S.-Mexico Trade Pact, Says 'We'll See' With Canada; Trump also proposed getting rid of the name Nafta, saying it had bad connotations

By Jacob M. Schlesinger and Josh Zumbrun in Washington and Robbie Whelan in Mexico City
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President Trump moved closer to revising the North American Free Trade Agreement by striking a deal with Mexico, but cast new doubts over the quarter-century-old pact by threatening to leave out Canada.

While the deal was created to foster harmonized rules across the continent, Mr. Trump said on Monday he was happy to sever Washington's northern neighbor from that bloc if necessary. He proposed to rename the pact "the United States-Mexico Trade Agreement," while setting terms that will hinder Ottawa's efforts to join it.

The Trump administration said it would give Canada until Friday to iron out crucial differences, including a revision that makes it harder for Nafta members to challenge U.S. trade penalties. While Mexico accepted that change, Canadian officials have said for months that would be unacceptable.

"We will see whether or not we decide to put up Canada or just do a separate deal with Canada—if they want to make the deal," Mr. Trump said. He added that he might prefer to block Canadian imports rather than negotiate a new pact, saying: "I think with Canada, frankly, the easiest thing we can do is to tariff their cars coming in."

Mr. Trump and Canadian Prime Minister Justin Trudeau spoke by phone on Monday and "agreed to continue productive conversations" about U.S.-Canada trade, according to a White House statement.

Mr. Trump's harsh rhetoric against Canada was the latest example of his hardball approach to trade policy, where he has chosen to impose intense pressure on other countries through threats or tariffs to try to win concessions.

His strategy is driven by a belief that the U.S. has significant clout over other nations eager to sell into the world's largest market and that prior administrations failed to use that.

A spokesman for Foreign Minister Chrystia Freeland of Canada said Monday's agreement was "encouraging," but cautioned Ottawa would only sign on to a revamped trilateral deal "that is good for Canada and good for the middle class."

The minister said she would cut short a scheduled trip to Europe and instead travel to Washington on Tuesday to begin talks with her U.S. counterparts.

Relief over progress on the trade front, despite the lingering tensions with Canada, helped drive the **Dow Jones Industrial Average** up 1%.

The deal includes several provisions to alter a pact Mr. Trump has long branded "a disaster" for what he considers incentives encouraging U.S. companies to shift production to Mexico.

The most significant is a clause that would boost the percentage of autos that would need to be made in North America to qualify for the tariff-free cross-border trade allowed by Nafta. It would also require a certain portion of cars to be made by high-wage workers—a response to longstanding U.S. union complaints over low-wage Mexican labor.

The deal also includes provisions that would modernize the pact with rules governing digital commerce.

Canada's position appeared increasingly difficult after Mexican Foreign Minister Luis Videgaray later said Mexico was also fine scrapping the old tripartite Nafta in favor of a bilateral deal with the U.S., a significant reversal from his government's longstanding insistence that any revised pact had to include Canada.

"There are many factors that we can't control—including the relationship between the U.S. and Canada and actions taken by the government of Canada," Mr. Videgaray said. "In any scenario, we will have a free-trade agreement between Mexico and the U.S., regardless of what happens with Canada."

The new Mexican government, which takes office later this year, said it supported the new pact but stressed the importance of including Canada.

Canadian officials had joined earlier rounds of the Nafta talks, but were shut out in recent weeks as the U.S. chose to focus on striking a deal first with Mexico.

Mr. Trump, a Republican, faced pressure from GOP lawmakers and his own supporters in farm states to show that his "America First" trade policy will succeed in striking new trade-expanding agreements, rather than just making threats and imposing tariffs.

Mr. Trump's aggressive imposition of tariffs through this year—on solar panels, washing machines, steel, aluminum, and a long list of Chinese goods—has prompted retaliation from trading partners around the world.

That has inflicted significant economic pain in states that voted for him in 2016 and where Republicans face tight races in midterm elections.

In an attempt to ease political pressures from the Farm Belt, Mr. Trump's agriculture secretary, Sonny Perdue, announced plans Monday to make $4.7 billion in payments to farmers to help offset their losses from trade battles around the globe.

The U.S. Council for International Business, a group representing U.S. multinational firms, offered cautious praise, saying it hoped Monday's deal "signals a redirection of U.S. trade policy—away from confrontation and toward cooperative efforts to open markets abroad."

Still, it remains unclear whether the administration's Nafta strategy will ultimately get support in Congress to enact a new deal. Many lawmakers and their aides said Monday that the administration hadn't given them sufficient details on the agreement to judge whether they can back it.

A key part of Mr. Trump's calculation is that he can win significant support from Democrats, who have long been opposed to new trade agreements, by including provisions aimed at raising wages in Mexico and strengthening Mexican labor unions.

Yet, Democrats who have long pushed for stronger labor provisions in trade agreements said they remain unconvinced. "I see nothing in this agreement that fixes the basic problem," Rep. Sandy Levin in an interview from Mexico, where he is meeting this week with Mexican unions, a Michigan Democrat, said.

The new pact also risks alienating big business groups whose support has long been crucial to pushing trade pacts through Congress. The agreement waters down a part of Nafta that gives multinationals extra legal protections when investing overseas by allowing them to file complaints against the home governments in special NAFTA-run arbitration panels, rather than having to rely on local courts.

"This new agreement would curtail fundamental protections against expropriation, arbitrary and discriminatory government conduct, protection of long-term project contracts, rights to repatriate profits and capital, and the right of investors to enforce their rights in neutral arbitration tribunals," said Daniel Price, a top trade official in the George W. Bush administration, who had helped create and promote those investor protections as a U.S. negotiator.

"This is a dramatic reversal of longstanding U.S. policy supported by successive administrations," Mr. Price said.

But the main concern expressed by lawmakers and businesses Monday was the prospect that a new Nafta may jettison Canada, a change they said would diminish the benefits and efficiencies the pact has provided, and inject new uncertainties over supply chains and business deals built around the assumptions of a three-nation trade bloc.

"It is critical that any modernized Nafta continue to include all three North American partners," said Rufus Yerxa, head of the National Foreign Trade Council, a leading free-trade business organization. "The only way we can

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compete for global markets with Asian and European producers is to maintain and strengthen the entire North American production base," he added.

The big question hanging over Nafta this week is whether the U.S. can now persuade Canada to join by the end of the week, and how the Trump administration will proceed if that doesn't happen.

Officials say they rushed to get the deal done so that Mexican President Enrique Peña Nieto can sign it before leaving office at the end of November. The U.S. requires the president to send a formal announcement to Congress 90 days in advance of his signing a trade pact, prompting a Sept. 1 deadline.

But there are significant hurdles to reaching a deal with Canada so quickly. First, the two sides would need to reach agreement within four days on longstanding nettlesome trade fights that have festered for years, such as Canadian subsidies and tariffs on dairy products.

"We can't have that," Mr. Trump said Monday. "We're not going to stand for that."

The Canadian government will also likely issue strong objections to a changed agreed on by the U.S. and Mexico to remove a Nafta provision allowing the member states to use special Nafta panels to challenge certain tariffs imposed by governments against imports from the other partners.

Canada has long insisted on such protections for its companies, and has argued that their importance is even greater under the Trump administration, which has been more aggressive than previous U.S. governments in imposing tariffs on Canadian products.

At the outset of the Nafta renegotiations, Mr. Trudeau said preserving those Nafta courts was "absolutely essential for Canada."

Paul Vieira in Ottawa and Santiago Pérez in Mexico City contributed to this article.

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Pro Private Markets
Garcia's Take: A New Energy Fund's Investments Illustrate Several Energy Trends

By Luis Garcia
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Quantum Energy Partners, one of the largest private-equity investors in the U.S. energy industry, recently raised nearly $5.6 billion for a new fund and is deploying it at a rapid pace.

A look at the types of deals the firm made from the fund so far reveals several trends that are defining the energy private-**equity market** today.

Trading of noncore assets: Private-equity firms are targeting the noncore assets that publicly traded oil-and-gas producers

are selling to focus on their most profitable fields. Quantum-backed Middle Fork Energy Partners LLC, for example, last month acquired oil-and-gas assets in Utah's Uinta Basin from publicly traded QEP Resources Inc.

Holding assets longer: Public oil-and-gas companies are less inclined today to buy new land unless it is in a core shale play or comes with a lot of producing, revenue-generating wells. That is forcing private-equity firms to drill more wells in their assets to make them more attractive to a potential public buyer. Drilling more wells, in turn, means firms will have to hold assets for longer periods than they did until a year or so ago, when it was easier to flip undeveloped acreage to public companies.

Quantum expects more of its portfolio companies to reach the latter part of its fund's life, Quantum's founder and chief executive, Wil VanLoh, said earlier in March. "Whereas in the past we might monetize half of our companies in the first five years, now it might take seven years to get there, and eight or nine or 10 years to monetize all of them," he said.

Hanging on to the best plays: When it comes to the most popular shale plays, such as the Permian Basin of West Texas and southern New Mexico, private-equity firms are seeing more value in developing energy assets even if they could potentially find a buyer for them. That is because it is becoming harder for firms to reinvest in those plays after cashing out. Oil-and-gas companies FourPoint Energy LLC and Double Eagle Energy Holdings III, which are backed by Quantum and Apollo Global Management LLC, respectively, recently managed the difficult task of gathering large acreage positions in the Permian. Had it been 2016 or 2017, Quantum and Apollo might have sold the acreage to eager public buyers. Today, however, the two firms decided to combine the assets into a joint venture and develop them.

Expanding further into renewable energy: Established energy-focused firms are striving to expand their presence in the renewable sector, perhaps encouraged by its growth and by investor desire for exposure to it. Quantum used its latest fund to form a renewable-energy company, ConnectGen LLC, marking the first time it backed a business solely dedicated to the sector.

While the last trend is here to stay, the first three will largely depend on the future behavior of public oil-and-gas producers and their investors. As long as the companies continue to have limited access to equity and debt markets, they will need to sell noncore assets to fund their drilling programs. Only after the public markets open up for them again will they become more willing to buy the assets private-equity firms are developing today.

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THE WALL STREET JOURNAL.
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Banking & Finance: Turkey Volatility Socks Some Funds

By Laurence Fletcher
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Asset-management giant BlackRock Inc., a star bond trader at Barclays PLC and a major hedge fund are among the investors nursing losses from Turkey's violent market trading in recent days.

The Turkish lira's declines on Friday and Monday, which were among the largest moves in any currency in recent years, and spikes in the country's borrowing costs, caught several major investors wrong-footed.

BlackRock, the world's largest asset manager and the largest foreign holder of Turkish government bonds, had been running outsize positions in Turkey in some of its actively managed funds when the crisis hit.

The firm's $5.8 billion Emerging Markets Local Currency Bond Fund has fallen 7.1% this month through Tuesday, according to FactSet. The fund had a 7.6% exposure to Turkish government bonds at the end of July -- including a 5.5% weighting in the lira-denominated bonds -- compared with the benchmark's 5% weighting, said a person familiar with the matter.

The fund also had a larger-than-benchmark position in the lira itself. While BlackRock partially reduced this before the worst of the selloff last week, this still contributed to losses, the person said. The fund also was hit by **bullish** bets on wider emerging markets.

The firm's $3.5 billion Emerging Markets Bond Fund, which invests in dollar-denominated bonds, is down 3% this month. It had a 4.4% allocation to Turkey at the end of July, above the benchmark's 3.5%.

In a call with investors Tuesday, head of emerging-markets fixed-income Sergio Trigo Paz said he saw a 60% chance of a partial de-escalation of Turkey's problems, a 20% chance of a full policy U-turn by the Turkish government, and a 20% chance of an escalation in sanctions, leading to further contagion in emerging markets, the person said.

After Monday's fall, the Turkish lira has recovered somewhat the past two trading days, rising more than 6% at one point Wednesday.

A spokeswoman for BlackRock declined to comment.

Meanwhile, Tolga Kirbay, a star trader of Turkish assets recently hired by Barclays from BNP Paribas SA, had run up a loss of as much as roughly $20 million on his book, said a person familiar with the situation. However, that has been balanced by hedges elsewhere in the credit business, and the bank hasn't suffered any significant losses in its business overall, the person said.

Hedge fund firm H2O Asset Management, which runs $27.4 billion in assets, was also caught with positions in Turkey as the crisis unfolded, according to an update sent to clients on Tuesday and reviewed by The Wall Street Journal. The firm's Allegro fund, which specializes in trading currencies and bonds, is down 12.6% this month.

H2O said in the note that it increased its holdings of Turkish government bonds and the lira at the end of July and early this month. It said it expects the **volatility** to subside and said "a decisive domestic policy reaction is unavoidable." H2O didn't respond to a request for comment.

The losses come after a violent period for Turkey's markets, driven by U.S. sanctions and concern over President Recep Tayyip Erdogan's economic policies, coupled with a strengthening dollar and higher U.S. interest rates.

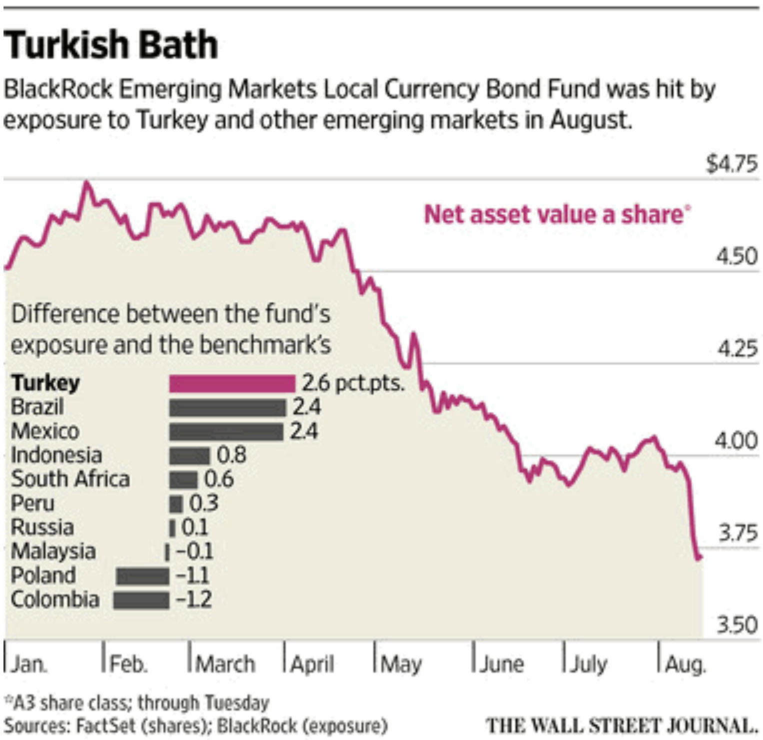
The lira has tumbled 20% this month.

Asset manager GMO LLC also took a hit on some holdings. It held positions in Turkish stocks such as Koc Holding, which is down nearly by half in dollar terms this year, and Turkiye Garanti Bank, which is down 65% this year, according to FactSet.

The fund has been **bullish** on emerging-market value stocks in general, a position it is sticking with, says Ben Inker, head of asset allocation.

"Part of investing in emerging markets is understanding that idiosyncratic challenges hit different countries at different times, often creating interesting investment opportunities," he said in a statement to the Journal.

Christopher Whittall contributed to this article.



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THE WALL STREET JOURNAL.

Markets

Turkey Needs Foreign Funds as Short-Term Debt Looms; For foreign investors still left in Turkey, are the heady yields worth the volatile ride?

By Christopher Whittall
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Turkey's embattled financial system needs foreign investors. Its plunging currency shows only the bravest are choosing to stick around.

Turkey has one of the biggest piles of foreign-denominated debt in the developing world, much of which comes due in the next year, and a currency whose dramatic decline makes it ever more expensive to pay off.

The lira has lost a quarter of its value this year against the dollar, and took another leg down Wednesday and Thursday after the Trump administration sanctioned two Turkish officials following Ankara's refusal to free an American pastor.

Bond yields have exploded higher amid very high inflation and stocks have fallen.

For those foreign investors still left in Turkey the question is: Are the heady yields the country's markets currently offer worth the **volatile** ride?

On Tuesday, Nishant Upadhyay, woke at 3 a.m. in New York to read Turkey's latest sky-high inflation figures. He didn't need an alarm.

"It's not like I can sleep easy with Turkey—I can't," said Mr. Upadhyay, who oversees more than $18 billion in assets as head of emerging-market debt at HSBC Global Asset Management, in an interview before the sanctions announcement.

Even so, the high yield from owning Turkish bonds means investors are highly compensated for taking the risk.

"The bar for us to give up on Turkey would be fairly high simply because" of that, he added.

Mr. Upadhyay isn't alone is staying in Turkey, but he is increasingly in the minority. Many foreign funds have already pulled back and Turkish markets reflect the exodus. The lira has plunged and the yield on dollar-denominated government debt maturing in 2028 has moved from 5.2% in January to 7.5% now, according to Tradeweb. Yields on Turkish lira bonds that mature in Nov. 2019 have risen from 13% to over 20%, according to Thomson Reuters.

Turkey's woes come against a backdrop of wider pressure on emerging markets, which have been hit this year amid a stronger dollar, higher U.S. interest rates and an escalating trade conflict between the U.S. and China. Argentina asked for a $50 billion credit line from the International Monetary Fund earlier this year.

But Turkey also has a long list of domestic troubles.

The International Monetary Fund forecasts the country's current-account deficit will be over 5% of gross-domestic product in 2018, the widest among emerging economies in the Group of 20 nations. Inflation spiraled to 15.4% in June, its highest annual rate in 15 years. Investors have questioned the central bank's ability to tame inflation as President Recep Tayyip Erdogan tightens his grip over the economy. The lira slid sharply in July after he made his son-in-law finance minister and received powers allowing him to appoint central bank governors.

Another big concern is the amount of debt Turkey owes in other currencies, which the IMF says stood at 53% of gross domestic product at the end of 2017. Over a third of that comes due within a year, while 40% is in floating rate debt, making it more expensive to pay off as interest rates rise.

In 2017, Turkey's economy expanded at the fastest rate in the Group of 20 leading economies. But a good part of that growth was fueled by credit partly guaranteed by the state. That program, known as the Credit Guarantee Fund, expanded 10-fold in 2017 to around 7% of GDP, according to the IMF.

That debt was channeled through local banks, and now problem loans are rising. Turkey's six largest banks notched a "significant" annual rise in nonperforming loans in the first quarter, according to S&P Global Market Intelligence, which warned those lenders are at risk of a further deterioration in asset quality.

Turkey's banks, like many of its companies, are also hugely reliant on foreign debt.

If that debt can't be rolled over, central-bank reserves aren't big enough to cover that shortfall as well as Turkey's current-account deficit, said Viktor Szabo, a senior investment manager at Aberdeen Standard Investments.

"That is one bit of concern. they're just huge numbers," he added.

Mr. Szabo has an underweight position on Turkey, but still holds three-year local-currency bonds that yield over 20%. The value of lira-denominated assets have already taken a substantial hit with the currency's slide this year. Investors buying the bonds now would have to see a 20% decline in the currency over the coming months for their returns to be wiped out entirely, he said.

"You probably need a real blow up for that to happen," said Mr. Szabo.

Many investors still hold Turkey to some degree because as one of the world's largest emerging markets it figures prominently in indexes against which they benchmark their performance. The same goes for passive index-tracking funds. For instance, Turkey was the largest government bondholding in a $13.5 billion emerging markets ETF run by BlackRock as of the end of July, according to BlackRock's website, with a 3.67% weighting in the fund.

HSBC's Mr. Upadhyay compared his **volatile** investment in Turkey to one he held in Brazil a few years ago when that country was going through a political crisis. Ultimately Brazilian markets rebounded, and he hopes for a similarly soft landing in Turkey.

"Stress is just a price you pay for having high conviction on things," he said.

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The New York Times

Asia and Australia Edition
Briefing
Malcolm Turnbull, Trade War, Amazon Tribe: Your Friday Briefing

By Charles McDermid
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(Want to get this briefing by email? Here's the sign-up.)

Good morning. A showdown in Canberra, profits and protections in China and images of an uncontacted tribe in the Amazon. Here's what you need to know:

• China's difficult game.

Trade talks in Washington were not expected to yield much. American tariffs on another $16 billion worth of Chinese imports have gone into effect, and President Trump is helping shape a new law that will beef up blocks to foreign investment.

As the trade war intensifies, China's economy is slowing. So Beijing is pushing banks to lend more, allowing indebted local governments to spend money on big projects again, and shoring up the value of the country's currency.

But Alibaba hasn't missed a beat: China's e-commerce leviathan reported a rise in sales of more than 60 percent in the latest quarter compared with a year earlier — even as many Chinese consumers are cutting back.

And trade wars aside, there's a futuristic tilt to a chunk of the Chinese economy that redefines the role of the human. An art critic and The Times's former Shanghai bureau chief discuss exactly that as they share thoughts on "Asia One," a video installation by the Guangzhou-born artist Cao Fei, on view in New York.

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• Washington turmoil.

Senior Republican leaders, fearing more scandals, started urging their most imperiled incumbents to speak out about the wrongdoing surrounding President Trump — even as Mr. Trump seemed to be digging in.

Attorney General Jeff Sessions pushed back against Mr. Trump's recent attack on him over the Russia investigation. "While I am attorney general," Mr. Sessions said in a rare public statement, "the actions of the Department of Justice will not be improperly influenced by political considerations."

Mr. Trump waded into new territory. He said on Twitter that he had asked Secretary of State Mike Pompeo to study "the large scale killing of farmers" in South Africa, which is disputed by official figures and one farmers' group. Here is an explanation of the issues.

And the arrest of an undocumented immigrant in the killing of an Iowa college student, Mollie Tibbetts, has inflamed the country's immigration debate.

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• Canberra's revolving door.

Three rivals are expected to challenge Prime Minister Malcolm Turnbull in a party ballot today: his return foe Peter Dutton; the treasurer, Scott Morrison; and Foreign Minister Julie Bishop.

"The public hate what is going on," Mr. Turnbull said of the focus on party strife rather than governance. No Australian prime minister has completed a full term in more than a decade. He said he would resign from Parliament if deposed.

Crikey asked political insiders which of the challengers the opposition Labor Party would prefer to see victorious. (The article is paywall-free for Times readers.)

And Australia banned two Chinese companies, Huawei and ZTE, from helping supply the country's new 5G telecommunications networks. Two Australian ministers, including Mr. Morrison, made clear their concern over security risks from foreign companies.

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• At least 581 years.

That's how long it would take for the world's 1.8 billion Muslims to all make the pilgrimage to Mecca, a once-in-a-lifetime obligation.

We analyzed the available data. At least a quarter of pilgrims every year come from Saudi Arabia. The Saudi government sets quotas for other countries based on their Muslim populations.

But even majority-Muslim countries can send only a fraction of their citizens. In Indonesia — with the world's largest Muslim population, more than 200 million — the wait time can range from seven to 37 years.

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• A glimpse of a world apart.

Drone video footage has revealed the first images of an isolated Amazon tribe that had no known contact with the outside world.

The National Indian Foundation, a Brazilian government agency commonly known as Funai, captured the images, including of tools and the thatched hut above.

Funai said its team had traveled more than 110 miles in "boats, trucks, motorcycles" and about 75 miles "on foot through dense forest" to reach the location.

Business

• Detect and delete: Facebook and other tech companies, for all of their wealth and security teams, often rely on outside firms and researchers. Here's how FireEye, a cybersecurity firm, helped Facebook remove more than 650 fake accounts and pages intended to influence global politics.

• "Small Fry": Lisa Brennan-Jobs has written a memoir about her famous father, Steve Jobs. The details are damning, but she doesn't want them to be.

• What's behind the record U.S. **bull market**? Here are three stealth drivers: a tame Wall Street, the Fed and lack of competition.

• U.S. stocks were down. Here's a snapshot of global markets.

In the News

• Hurricane Lane: The rare Category 4 storm lashed Hawaii's Big Island on Thursday morning. Check our live briefing. [The New York Times]

• The U.S. secretary of state, Mike Pompeo, announced that he would travel to North Korea next week and take with him Stephen Biegun, a Ford Motor executive and former White House aide, to help lead the negotiations. [The New York Times]

• China forced an American reporter for Buzzfeed to leave the country. Megha Rajagopalan has written extensively about the surveillance and mass incarceration of ethnic Uighurs and other Muslim minorities in Xinjiang. [The New York Times]

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• New South Wales, Australia's most populous state, has overcrowded prisons and courts, with backlogs and sentencing delays that can drift to more than a year for nonviolent crimes. [The New York Times]

• Abu Bakr al-Baghdadi, the leader of the Islamic State, resurfaced in the first audio recording of him to be released in nearly a year. He called on followers to attack Westerners with knives, guns, cars and bombs. [The New York Times]

• Hong Kong's murder trial: An Indonesian maid revealed details in court about the complicated life of a Malaysian doctor accused of killing his wife and daughter using a gas-filled yoga ball. [South China Morning Post]

• Breakthrough game: As the U.S. Open begins this week, Naomi Osaka, 20, is poised to burst into the top tier of women's tennis. Can she also burst Japan's expectations of what it means to be Japanese? [The New York Times]

Smarter Living

Tips for a more fulfilling life.

• Recipe of the day: The best (and easiest) vanilla ice cream.

• In skin care products: What is an essence?

• We've got answers to your questions about running.

Noteworthy

• "Calm down, it says; come closer." Holland Cotter, the co-chief art critic of The Times, shows us why this statue of the Buddha, probably cast in northern India in the early seventh century, has captured his heart.

• New Indian design: Ruchika Sachdeva, 31, has been called "a bellwether for a new kind of generational change." This year, she won the Woolmark Prize (past winners: Karl Lagerfeld and Yves Saint Laurent) with her label, Bodice Studio.

• And a "blended family": Her mother was Neanderthal, her father something else entirely. Genetic analysis of bones discovered in a Siberian cave hint that the prehistoric world may have been filled with "hybrid" humans.

Back Story

Get out the cast iron skillets, your best-looking livestock and indulge in fried Snickers.

It's the height of state fair season across the U.S., when competitors young and old vie for blue ribbons and a ride on the midway.

The oldest continuously run agricultural fair in North America is the Hants County Exhibition in Nova Scotia, dating to 1765. But America's state fair tradition dates to 1807, when Elkanah Watson, a businessman in Pittsfield, Mass., showcased his merino sheep under an elm tree on the public square.

The sheep drew such a crowd that Mr. Watson formed the Berkshire Agricultural Society. The society's first livestock competition in 1811 had 383 sheep, seven bulls, 109 oxen, nine cows, three heifers, two calves and one boar.

Today, there are about 2,000 fairs across the country. (Your Back Story writer recently competed in her own local fair last week.)

In recent years, state fairs have become a test ground for presidential ambitions, most notably the Iowa State Fair.

"Be one of the crowd," one fairgoer suggested for budding presidential candidates. "Be one of the people that can actually relate."

See you at the fair!

Remy Tumin wrote today's Back Story.

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And our Australia bureau chief offers a weekly letter adding analysis and conversations with readers.

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WSJ PRO CENTRAL BANKING

Economy

Federal Reserve's Kaplan Still Favors Gradual Path of Rate Increases; In an essay ahead of the Jackson Hole conference, he also warns that the central bank must proceed carefully

By Michael S. Derby
710 words
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Federal Reserve Bank of Dallas President Robert Kaplan said in an essay published Tuesday that he would like the central bank to press forward with rate increases amid a very strong job market and inflation hitting desired levels.

But he also warned that the central bank must proceed carefully, with bond market developments suggesting the long-running economic expansion is getting long in the tooth.

The Fed "is meeting its full employment and price stability objectives," Mr. Kaplan wrote. "As such, we should be removing accommodation in a gradual manner in order to get to a neutral policy stance."

Mr. Kaplan said when the Fed reaches what he sees as a neutral level of monetary policy, or a level of short-term rates that neither promotes nor restrains growth, it will be time to take stock of what to do next.

"I would be inclined to step back and assess the outlook for the economy and look at a range of other factors—including the levels and shape of the Treasury yield curve—before deciding what further actions, if any, might be appropriate," he wrote.

In the essay, Mr. Kaplan estimated a neutral level for monetary policy would have short-term rates around 2.50% to 2.75%. That compares with the Fed's current overnight interest rate target of 1.75% to 2%. "It would take approximately three or four more federal-funds rate increases of a quarter of a percent to get into the range of this estimated neutral level," the central banker wrote.

Mr. Kaplan's essay arrives just days before the beginning of the Kansas City Fed's annual research conference in Jackson Hole, Wyo. That event will feature a speech by Chairman Jerome Powell that will be closely looked to for clues as to whether the Fed will press forward with the rate rises most economists now expect to see.

With inflation finally moving toward the central bank's 2% target with expectations that it will go slightly higher, the Fed has a case to boost the cost of borrowing further. However, that path will likely become more controversial. President Donald Trump has already renewed his criticism of Fed rate increases and even lamented his selection of Mr. Powell to the Fed, believing the Fed leader was going to keep short-term rates lower than has proved to be the case.

At the same time, the difference between yields on short- and long-dated bonds has continued to grow smaller. If that normally positive spread turned negative it would become what is called an inversion of the yield curve, which is strongly associated with the onset of economic downturns.

Mr. Kaplan said the bond market is a factor in his thinking.

"The shape of the curve suggests to me we are 'late' in the economic cycle," he wrote, adding, "I do not discount the significance of an inverted yield curve—I believe it is worth paying attention to." Some other Fed officials have said they would favor stopping rate rises if that is what it took to avoid an inversion.

Mr. Kaplan's view of the economy was upbeat in the essay. He wrote that the Dallas Fed believes the current 3.9% jobless rate will fall to 3.7% by the end of this year and hit 3.5% by the second quarter of next year.

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The Dallas Fed believes "we are in a tight labor market and are already past the level of full employment in the U.S.," he wrote.

Mr. Kaplan said inflation should stay around the Fed's 2% target through the end of the year. He said "cyclical forces are creating upward pressure on inflation," while structural forces like globalization and automation are pushing back against those increases.

Mr. Kaplan also said that on the energy front "we believe that we are more likely to move to a global undersupply situation in the years ahead—with **oil-price** risk tilted to the upside."

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THE WALL STREET JOURNAL.

Markets

The Mystery Behind Tether, the Crypto World's Digital Dollar; The opaque way in which tether are created causes concern among market participants

By Paul Vigna and Steven Russolillo
1,048 words
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A fast-growing digital currency that claims to be backed by U.S. dollars has become a cornerstone of the **volatile** cryptocurrency market. The problem: There isn't hard evidence the cash supporting it exists.

Tether, whose main selling point is its tie to the U.S. dollar, has grown dramatically over the past year—its daily trading volume of around $3 billion trails only bitcoin's $5 billion. Tether has also become a "crypto bank" for cryptocurrency businesses that have trouble maintaining real-world banking relationships, providing liquidity and a place to park assets, according to a new study from blockchain research firm Chainalysis.

Tether has assumed this role because of its link to the dollar. Unlike other cryptocurrencies that fluctuate wildly in value, one tether generally equals one dollar. This makes it a sort of digital-dollar substitute.

That is also why it is important that Tether has dollar reserves backing each of its approximately $2.5 billion worth of coins in circulation.

But Tether has never produced an audit showing it has the purported reserves. The company that controls tether maintains it has the reserves, yet it has never named the banks it uses to hold these funds, nor said where they are based and regulated.

Last year, Tether hired accountants Friedman LLP, based in New York, to audit the reserves. The firm issued a preliminary report last year, but Tether says it released Friedman before a final audit was completed. Friedman declined to comment.

Leonardo Real, Tether's chief compliance officer, said that since then the company has had difficulty finding a reputable firm willing to take on a cryptocurrency client. He declined to say why Friedman was let go.

"There's nothing to hide here," said Mr. Real. "It's not three managers just cranking out money randomly in a dark basement somewhere."

In June, Tether hired law firm Freeh Sporkin & Sullivan LLP, co-founded by former Federal Bureau of Investigation Director Louis J. Freeh, which issued a report stating that it believed tether had full dollar backing. But the report, critics noted, wasn't an audit and the law firm wouldn't identify the banks it contacted to verify the reserves. Eugene R. Sullivan, a senior partner in the law firm, declined to comment, saying the report speaks for itself.

Mr. Real said Tether plans to release more evidence of its reserves.

The opaque way in which tether are created also causes concern among investors and market participants.

Unlike other cryptocurrencies, there isn't a set amount of tether in circulation. In theory, demand drives new issuance. Cryptocurrency exchange Bitfinex places orders for new tokens with Tether and wires dollars or euros to the company's bank account, according to both companies. Tether sends the newly created tokens to Bitfinex, which distributes them to investors.

Investors have little visibility into the process. Bitfinex shares ownership and management with Tether, and it is the only entity through which Tether issues tokens.

"It's sort of the central bank of crypto trading," said David Gerard, a programmer and author of "Attack of the 50 Foot Blockchain." Yet "they don't conduct themselves like you'd expect a responsible, sensible financial institution to do."

Kasper Rasmussen, the director of communications at Bitfinex, said Tether isn't a bank nor it is trying to be one, but that it does adhere to "applicable laws and regulations."

In the decade since bitcoin's introduction, cryptocurrencies have grown significantly, with assets in circulation worth about $216 billion. But the trading market is fractured and **volatile**.

Exchanges don't share trading data, there are no circuit breakers or other trading halts, and options for hedging or other sophisticated bets are limited. Moreover, many of those exchanges have trouble maintaining bank accounts, since regulated banks are wary about having any exposure to the sector.

Tether Ltd. marketed its cryptocurrency as a way to mediate the sector's **volatility**—offering the safety of the dollar along with the speed and anonymity of a digital currency.

The pitch worked. Tether's market value has risen steadily over the past 18 months, to $2.4 billion from about $10 million at the beginning of 2017. That has made it a crucial link in the wider cryptocurrency market.

Tether-based trading volume grew more than 15-fold between October 2017 and March 2018, Chainalysis found. U.S. dollar-based trading volume, meanwhile, tripled in that same period.

As a result, tether has become a key source of liquidity. At times this summer, tether has represented as much as 80% of bitcoin trading volume, according to research site CryptoCompare. When the year began, it accounted for about 10% of bitcoin trading volume.

Nearly half of tether's trading volume is among just a handful of tether-accepting exchanges, including some of the market's largest.

Some investors say tether has become systemically important within the cryptocurrency market. "There are a couple of forces in this market that if they failed, it would be catastrophic," said Ding'An Fei, a managing partner at Ledger Capital, a digital asset investment firm in Beijing. "Tether is one of them."

Chainalysisalso found tether trading is increasingly concentrated among smaller, more speculative digital currencies, a sign it is being used as a tool of "pump-and-dump" schemes, in which traders hype an asset, causing its price to rise, before dumping it for a profit.

Tether trading in newer tokens such as EOS and NEO has risen to about 20% of overall tether volume, according to the report.

The Securities and Exchange Commissionrecently singled out tether in its rejection of a proposed bitcoin-based ETF, citing studies that raised the possibility that the digital currency is being used to manipulate the bitcoin market.

Tether's Mr. Real contested such claims. "It's not anything about tether that enables this **volatility**," he said.

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More on Cryptocurrency

* Bitcoin Detectives: Cracking the Blockchain

* Overstock Agrees to Private-Equity Investment in Blockchain Company

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THE WALL STREET JOURNAL.

Markets

Emerging-Market Stocks Stand Out—in a Bad Way; This year's performance gap boils down partly to the U.S. and China

By Saumya Vaishampayan
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Asian stocks mostly rose Monday, led by a 1.5% rise in Indonesia's JSX Composite and a 0.9% gain in Hong Kong's Hang Seng. The Shenzhen Composite, however, dropped 0.7% to hit its lowest since January 2015.

Monday's Big Theme

The fortunes of emerging-market stocks and their peers in developed economies have diverged dramatically in the past three months.

What's Happening

The MSCI Emerging Markets Index has been flirting with **bear-market** territory—or a peak-to-trough decline of at least 20%. It is down 11.7% for the year, through Friday.

The recent collapse in the Turkish lira spooked investors, and emerging economies are grappling with a string of other challenges. Trade relations between China and the U.S. are strained. The dollar has strengthened, making hard-currency debt more expensive, and U.S. interest rates are rising, sucking capital out of riskier locations. Some flagship companies, such as Hong Kong-listed Tencent Holdings Ltd., are also stumbling.

Meanwhile, a similar gauge of stocks in mature markets has held on to its year-to-date gains. The MSCI World Index, which includes stocks in 23 developed countries, is up 1.6% this year through Friday.

The last time the emerging-market index fell on an annual basis was in 2015, when fears about China's economy gripped global markets. MSCI's emerging-market index dropped 17% in dollar terms that year, while the world index fell 2.7%, according to FactSet.

Market Reaction

This year's performance gap boils down partly to the U.S. and China. Strong corporate earnings, in part thanks to lower tax bills, have propelled U.S. shares higher this year.

To be sure, some stock markets in the developed world are also having a trying time. Benchmarks in Japan, Britain, Germany and Singapore are all down year to date, for example. But with U.S. companies making up more than 60% of the MSCI World, that is manageable.

"The U.S. economy and ability of U.S. companies to do well in the current environment stands out against their European competitors and others," said Greg McKenna, chief market strategist at AxiTrader in Sydney.

Chinese stocks have sunk this year, fueled by concerns that a trade standoff with the U.S. and Beijing's crackdown on financial risk could hurt growth.

Some analysts say those concerns might be overblown. Michael Parker, head of strategy for Asia Pacific at Bernstein Research in Hong Kong, said two proxies for the health of the Chinese economy—local housing prices and oil demand—suggest things are OK for now.

"It's just sentiment," he said. "This is a buying opportunity, at least in emerging Asia," he added.

Elsewhere

U.S. crude oil lost 0.4% to $65.67 a barrel.

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