THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Inflation Gauges Send Mixed Signals

By Ben Leubsdorf
298 words
30 September 2017
The Wall Street Journal
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A2
English

Corrections & Amplifications

The U.S. Commerce Department's personal-consumption expenditures price index rose 0.2% in August from a month earlier. A U.S. News article Saturday about inflation gauges incorrectly said it was the change from a year earlier.

(WSJ October 7, 2017)

(END)

The Federal Reserve is facing mixed signals on U.S. inflation as it weighs whether to raise short-term interest rates one more time in 2017.

The Fed's preferred price gauge, the personal-consumption expenditures price index, rose 0.2% in August from a year earlier, the Commerce Department said Friday. Excluding **volatile** food and energy prices, the index rose a modest 0.1% for the month, less than economists had expected.

Compared with a year earlier, headline prices rose 1.4% and so-called core prices were up just 1.3% -- well below the Fed's long-elusive 2% annual target and showing little evidence of an incipient pickup.

The Fed needs to see "some firming" in the coming months to stay on track for a rate increase in December, said Gregory Daco, chief U.S. economist at Oxford Economics.

Another gauge of U.S. inflation, the Labor Department's consumer-price index, showed stronger growth in August.

Price growth has been subdued in recent months even with the unemployment rate hovering below 4.5%, surprising central-bank officials who expect price and wage pressures to build in response to a tightening labor market. Some have blamed one-off factors, such as a sharp decline this spring in prices for cellphone plans, while other policy makers have worried that the slump may reflect more fundamental forces.

"My colleagues and I currently think that this year's low inflation is probably temporary, so we continue to anticipate that inflation is likely to stabilize around 2% over the next few years," Fed Chairwoman Janet Yellen said Tuesday. "But," she added, "our understanding of the forces driving inflation is imperfect."

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THE WALL STREET JOURNAL.
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Heard on the Street
Vista Is Foggy, Investors See Sun

By Justin Lahart
478 words
30 September 2017
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B10
English

[Financial Analysis and Commentary]

To judge from the **stock market**, investors think the economy is about to take off. They better hope they are right.

The third quarter comes to a close on Saturday, and to judge from the reports that have been released so far, it was a less-than-stellar period for the economy. In the latest sign of slowing growth, the Commerce Department on Friday reported that consumer spending rose by just 0.1% in August from July and slipped 0.1% adjusting for inflation. Earnings estimates, meanwhile, have hooked lower due to the effects of hurricanes Harvey and Irma.

With little September data available, it is hard to know how much gross domestic product slowed. In any case, most economists reckon that any hurricane effects will be transitory, and that despite its recent choppiness -- up at just a 1.2% annual pace in the first quarter, then 3.1% in the second -- GDP will keep trending at about 2%.

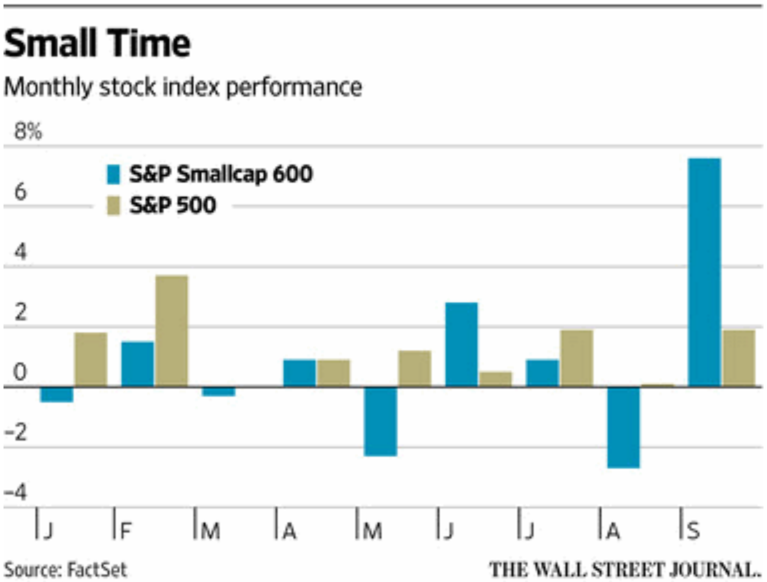
To surmise from the recent performance of stocks, many investors expect something more from the economy. In addition to being an unusually quiet period for markets, September was, for just the second time this year, a better month for small-cap stocks than for large-cap ones, with the **S&P 500** small-cap index rising 7.6% versus the **S&P 500**'s 1.8% gain. It was also a better month for value stocks than growth stocks, with the S&P value index up 3% versus 0.9% for growth.

The small-cap and value outperformance are the sort of thing one would expect to see when investors think that U.S. growth is going to improve. Small-cap stocks tend to be far more domestically focused than large-caps, which often do a substantial share of their business overseas, where growth has been improving. Value stocks are less expensive than growth stocks, but tend to do well when the economy accelerates, and earnings and sales growth are easier to come by.

What might be driving the optimism? One possibility is that economic improvement overseas might begin to bolster growth here. Another is that the Trump administration's lighter touch on regulation could boost economic performance. Then, there is enthusiasm over some sort of tax overhaul getting passed and stimulating growth.

Under normal circumstances, it would take just a month or two to see if the market is right. But recovery efforts from the hurricanes should boost growth at least through early next year. A tax revamp won't be quick and its true impact, rather than any boost it gives to sentiment, won't be known for months.

The time lag gives more space for confidence and complacency to build. When reality hits, watch out.



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'Trump Trade' Rebounds

By Akane Otani
1,152 words
30 September 2017
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The "Trump trade" is making a comeback, reflecting investors' renewed belief in the strength of the U.S. economy and hopes for business-boosting policy from Washington.

U.S. stocks keep chugging higher. The S&P 500 has risen 4% since June 30, notching its eighth consecutive quarterly advance. The Dow Jones Industrial Average added 4.9% in the third quarter, posting its longest streak of quarterly advances -- eight -- since 1997. The blue-chip index is up 13% this year.

In a throwback to the early days after President Donald Trump was elected, shares of U.S. banks and industrial companies are climbing and small-capitalization stocks are in record territory, while Treasury bonds and their stock-market proxies have fallen out of favor. The U.S. dollar, beaten down for much of 2017, is rebounding.

Underlying those trades are a combination of business fundamentals, economic data and policy expectations. Corporate earnings remain strong, and some say such results support a rally regardless of policy changes. But renewed expectations that the Federal Reserve will continue to raise interest rates are making bank stocks more attractive to investors. And while there is some skepticism that the Republicans' tax overhaul plan will pass, the fact that a proposal was put forth this week has tantalized investors with the prospect of improved earnings.

The developments could give investors fresh reason to believe stocks trading at or near records can keep rallying, despite concerns over pricey valuations and rising bond yields. Still, nascent signs of an inflation uptick and the outline of tax changes are no guarantee the bets will pay off.

Such wagers helped drive major U.S. stock indexes to records following the November election, but they faltered early this year. Uneven economic data cast doubt on the strength of the U.S. recovery, while congressional gridlock led many investors to downgrade expectations for policy change in Washington. By the end of the president's 100th day in office, the Trump trade looked done, many investors and analysts said.

"In the last month, the market seems to have completely changed its mind about what's going to happen," said Omar Aguilar, chief investment officer for equities at Charles Schwab Investment Management. He said sectors that tend to do well in stronger economic conditions, like industrial and financial stocks, are poised to outperform.

Those who are buying stocks now say a tax cut could prompt investors to sell bonds to buy other things.

Bank shares have gained due to expectations of rising rates, with the KBW Nasdaq Bank Index of large U.S. commercial lenders rising 6.8% in September compared with the S&P 500's 1.9% increase. Shares of industrial companies in the S&P 500 have risen 3.8%. The Russell 2000 index of small-capitalization companies, perceived to be some of the biggest beneficiaries of a tax overhaul because of their relatively heavy tax burden, climbed 6.1%.

That follows a period of underperformance for the Russell 2000. After rising for 15 consecutive trading days in November, notching several highs, the index fell behind the S&P 500 for months and is now back at records. The rally in bank and industrial stocks also lost some steam in early 2017 following sharp gains after the election.

Goldman Sachs Group Inc. said in a research note Monday that its economists believe a tentative Senate budget deal has increased the likelihood that a tax overhaul will be passed by 2018. Every percentage point reduction in the tax rate could boost the per-share earnings of the S&P 500 by a dollar, according to Goldman. The bank said its basket of stocks with the highest tax rates rallied in the two weeks ended Sept. 22 after underperforming the S&P 500 for most of the year.

J.P. Morgan Chase & Co. analysts opined similarly, saying in a research note earlier in September that "now is a good time to position for tax reform." The bank's analysts added that they expect investors to move from emerging-market stocks to U.S. stocks, from multinational to domestic companies and from large- to small-capitalization companies if Congress makes headway on taxes.

Others attribute the market's about-face to a consensus that the Fed will raise interest rates once more this year.

A measure of U.S. consumer prices jumped in August at the fastest pace since January, the Labor Department said, a report some analysts said should reassure the Fed after a string of muted inflation readings.

In September, a gauge used by central bankers to project where they think interest rates will go showed 12 of 16 officials expected at least one more rate increase this year and most expect at least three more next year.

The revelation surprised some investors who thought the central bank would delay rate increases. Investors now see a 78% chance of one or more additional rate increases by the end of the year, according to federal-funds futures tracked by CME Group Inc., up from about 50% before the September Fed meeting.

That put pressure on government bonds, whose fixed returns are worth less in a higher-rate environment. The yield on the **10**-**year Treasury** note, which rises as **bond prices** fall, climbed to 2.328% Friday from 2.122% at the end of August. Shares of utilities companies in the **S&P 500**, considered bondlike because of their relatively hefty dividends, lost 3% over the same period.

Meanwhile, the U.S. dollar, which typically rises on prospects of higher rates and a stronger economy, has rebounded, with the WSJ Dollar Index -- a measure of the U.S. currency against a basket of 16 others -- up 0.7% in September following six consecutive months of declines.

Despite the market's reversal over the past few weeks, signs of skepticism abound. Some say the shift is merely a rotation, a chance for investors to cheaply scoop up stocks that had fallen behind this year, while selling areas of the market in which they fear other traders have large and similar positions, possibly reducing potential returns.

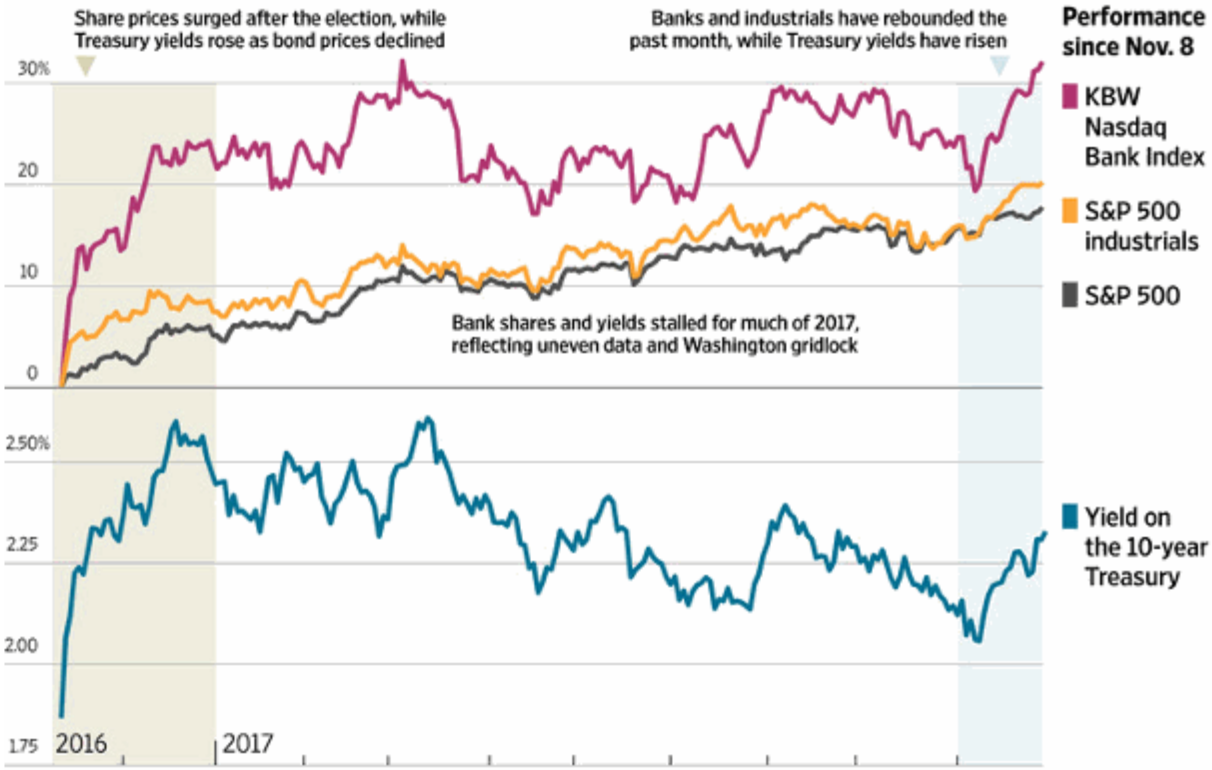
"We're still in a slow-growth, low-rate and tame-inflation environment," said Michael Arone, chief investment strategist at State Street Global Advisors. Mr. Arone said he believes central banks will keep rates lower for longer, despite hinting otherwise in recent months.

In another sign of wariness, fund flows show investors are continuing to pour money into technology companies, which are thought by some to offer the best returns in a sluggish economic environment.

Mutual funds and exchange-traded funds that invest in technology stocks drew in about $1 billion of inflows for the week ended Sept. 20, the second largest inflows for the sector on record, according to data from fund tracker EPFR Global.

Investors Bet on an Economic Revival

Gains in shares of industrial firms and banks have driven the S&P 500 to fresh records, while declining bond prices have sent Treasury yields to their highest level since July. The action reflects stronger global growth, along with expectations a tax overhaul will boost corporate profits and U.S. borrowing.



Sources: FactSet (indexes); Ryan ALM (Treasurys)

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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Markets Finish the Quarter On a 4-Day Winning Streak

By THE ASSOCIATED PRESS
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30 September 2017
The New York Times
NYTF
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English

Large technology and health care companies and smaller United States-focused companies rose again on Friday as stocks finished the third quarter at record highs.

Stocks were mixed at the start of trading, as they had been the day before. But chip makers and big-name technology companies pulled stocks higher, as they have done all year. Health care companies also did better than the rest of the market. Tyson Foods climbed after it gave strong profit forecasts, and investors cheered strong quarterly results from the home builder KB Home.

The market ended the quarter on a four-day winning streak that began after the Federal Reserve chairwoman, Janet L. Yellen, said the central bank planned to continue to raising interest rates.

''It's all about the confidence they have that despite low inflation, it still makes sense to raise interest rates,'' said Randy Frederick, vice president for trading and derivatives at the Schwab Center for Financial Research. ''She's confident in the economy, and the economic backdrop is very solid.''

The **Standard & Poor's 500**-**stockindex** rose 9.30 points, or 0.4 percent, to 2,519.36. The **Dow Jonesindustrial average** gained 23.89 points, or 0.1 percent, to 22,405.09. The **Nasdaq composite** index jumped 42.51 points, or 0.7 percent, to 6,495.96. The **S**.**&P**. **500** and **Nasdaq** closed at new highs.

The Russell 2000 index of small-company stocks added 2.08 points, or 0.1 percent, to 1,490.86. It is also at record highs after a big rally this month.

Tyson Foods jumped after the company raised its annual guidance and said profits for its beef business were better than expected. Thanks in part to cost cuts, Tyson also forecast a bigger profit than analysts expected for next year.

Tyson climbed $5, or 7.6 percent, to $70.45. The stock gained more ground on Friday than it had for the rest of this year put together. Its rival Hormel Foods, whose brands include Skippy, rose 43 cents, or 1.4 percent, to $32.14.

Technology companies rose further. The **S**.**&P**. **500** technology index has climbed 26 percent in 2017, while the **S**.**&P**. **500** is up 11.5 percent.

Facebook added $2.14, or 1.3 percent, to $170.87, and the chip equipment maker Applied Materials rose $1.47, or 2.9 percent, to $52.09. The chip maker Nvidia advanced $3.09, or 1.8 percent, to $178.77.

The recent gains for tech companies have come in spite of a slump for Apple, the world's most valuable publicly traded company. While Apple has soared this year, it is down 4 percent since it announced its new line of iPhones and other products on Sept. 12.

KB Home advanced after its third-quarter profit and sales beat estimates. The stock rose $1.90, or 8.6 percent, to $24.12. Other home builders also rose. Meritage Homes picked up 85 cents, or 2 percent, to $44.40, and D.R. Horton advanced 95 cents, or 2.4 percent, to $39.93.

Oil prices recovered and turned higher just before the close of trading. Benchmark United States crude rose 11 cents to $51.67 a barrel in New York. Brent crude, the standard for international **oil prices**, rose 13 cents to $57.54 a barrel in London.

In other energy trading, wholesale gasoline slid 3 cents to $1.61 a gallon. Heating oil declined 2 cents to $1.81 a gallon. Natural gas gave up 1 cent to $3.01 per 1,000 cubic feet.

Bond prices turned lower, pushing up the yield on the **10**-**year Treasury** note to 2.33 percent from 2.31 percent.

Gold lost $3.90 to $1,284.80 an ounce, and silver slid 17 cents to $16.68 an ounce.

The dollar rose to 112.51 yen from 112.39 yen. The euro rose to $1.1816 from $1.1791.

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

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The Intelligent Investor: Stocks Won't Stampede With the Bulls Forever

By Jason Zweig
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B1
English

With U.S. stocks hitting highs this past week and the calendar just about to flip to October, think 30 years back with me to Friday, Oct. 16, 1987.

The **stock market** is up more than 30% for the year. But traders are jittery: Interest rates are rising, tax rates are in flux and the U.S. is bickering with international trade partners and skirmishing with Iran.

James O'Shaughnessy, a young investor in St. Paul, Minn., has made a "five-figure" bet on **stock-index** put options, a way of profiting from a sharp fall in price on a basket of big U.S. stocks. Plugging his phone into a modem that dials up a stock-quotation service, he becomes more nervous as the day goes on and the **Dow Jones Industrial Average** falls a record 108.35 points on unprecedented volume of nearly 339 million shares.

The selling is "completely overdone," he thinks: Stocks are bound to bounce back big on Monday "and then I'll get killed" for hanging on to the **bearish** bet. "A feeling of panic washed over my entire body," Mr. O'Shaughnessy says. "I've just got to get out." He calls his broker a half-hour before the market closes and sells it all.

That weekend, Mr. O'Shaughnessy feels "greatly relieved," as if "I had just dodged being hit by a bullet." All the negative talk among investors has convinced him that stocks will have a "relief rally" on Monday; by selling his puts, he has surely averted a huge loss.

Then comes Monday. In New York, the Dow drops 208 points in the first 90 minutes, triggering a wave of selling by institutional investors using a technique called portfolio insurance to minimize losses. Futures traders in Chicago, who would normally buy, step back, expecting a further fall.

By day's end, the Dow has fallen 23%, "the worst day in Wall Street history," as journalist Diana Henriques calls Oct. 19, 1987, in her excellent new book, "A First-Class Catastrophe." An equivalent drop in 2017 would hack more than 5,000 points off the Dow in a day.

You can't survive a market crash if you think it can't happen. And something like Oct. 19, 1987, will happen again. In fact, it already has: On May 6, 2010, many stocks dropped 60% or more in a flash, although they bounced right back. On Aug. 24, 2015, the Dow fell more than 1,000 points, or 7%, in six minutes, before closing down nearly 4% for the day. Between the market's peak in October 2007 and its bottom on March 9, 2009, the **S&P 500** fell 55%, even after counting reinvested dividends.

Ms. Henriques's book, and the story Mr. O'Shaughnessy told me, are a reminder that "human nature can't be repealed," as she says. "Historical amnesia leaves us doomed to repeat our past disasters, and the only antidote is to remember accurately what happened."

Take it from Mr. O'Shaughnessy, who today manages nearly $6 billion at O'Shaughnessy Asset Management LLC in Stamford, Conn. Even though he based it on factors he no longer believes in, his original analysis was absolutely right: The **stock market** was overvalued. Between September 1986 and the end of August 1987, stocks had gone from trading at 16 times earnings to a price/earnings ratio of 21.4, a 33% rise that put the market's P/E at its highest level since the end of 1961.

His emotional reaction, however, was dead wrong. Had Mr. O'Shaughnessy held his ground for one more day, he would have made roughly 10 times his money, he recalls.

Ms. Henriques attributes the crash of 1987 to ineffectual regulation and breakdowns in the complex mechanics of trading. But no one knows for sure what caused it or the far more devastating crash of 1929 either, says financial historian and retired Goldman Sachs Group Inc. partner Barrie Wigmore.

History does offer a few clear lessons. Stocks have been overvalued, by long-term standards, for most of the past three decades. So, on average, you were more likely to have missed consistent gains than to have dodged a crash if you got out of the market entirely.

Investors today who hold large positions in the hottest stocks of the past few years -- the so-called FANGs, or Facebook Inc., Amazon.com Inc., Netflix Inc. and the parent company of Google -- should consider trimming their positions, however. In 1987, as in 1929, the stocks that had previously gone up the most tended to fall the furthest.

Above all, says Staley Cates, vice chairman of Southeastern Asset Management Inc. in Memphis, Tenn., "don't be afraid to hold cash." On Oct. 19, 1987, he and his young colleagues clustered around a Quotron machine putting in buy orders as they watched the market crash, "and the ultimate comfort we had that day was holding 25% to 30% of our portfolios in cash."

Without it, "we couldn't have bought stocks," he says. Having the cash to buy when others are selling is the surest source of courage in a crash.

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The New York Times

Fair Game
Business Day
New Skirmish in an Old Battle: Wall Street vs. the Customer

By GRETCHEN MORGENSON
1,153 words
29 September 2017
11:15 AM
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NYTFEED
English

A corrosive custom forced on investors is finally getting the ax under new regulations in Europe. Too bad some on Wall Street are working overtime to ensure that United States investors don't get the same deal.

The rule change governs how investors pay for brokerage-firm research. This may seem like a mundane administrative matter, but given the conflicts embedded in the process, it is not.

Currently, big institutional investors pay indirectly for research services provided by brokerage firms; they include analyses on industries and companies as well as access to top corporate executives in events sponsored by the Wall Street banks. Rather than pay cash for these services, the investors send trades to the firms, generating commissions.

Exchanging commissions on these trades for research — known in the vernacular as soft-dollar arrangements — has been the way of the world for decades. But pension funds and other institutions have chafed under the deals because they can harm investors while benefiting Wall Street.

After more than a decade of regulatory inquiry into these arrangements, European regulators didn't like what they saw. So they decided to separate the two functions, requiring payments in hard dollars for both research and trade executions.

The new rules go into effect in January as part of an effort in Europe to improve markets after the 2008 financial crisis. Investor protection is central to the new regulations, known as the Markets in Financial Instruments Directive, or MiFID.

As the regulators and others have noted, there are several problems with the research-for-commissions setup. One is a lack of transparency — bundling research costs with trading makes it difficult for investors to see what they are paying. Another downside: Exchanging trading commissions for research binds an investor to a firm regardless of how well or poorly it executes an investor's trades.

Tying trading to research also hurts smaller research outfits that may be producing outstanding analyses but that don't have the trade-execution capacity needed to receive soft-dollar payments. The inverse is also true: Brokerage firms that produce junk research — nonstop "buy" recommendations, for example — are perversely rewarded by the soft-dollar payments they receive on trades.

Howell E. Jackson, a professor at Harvard Law School and an expert in financial regulation, thinks the unbundling of trading and research costs would be a boon to investors because of the sunlight it would bring to the **financial markets**.

Under the European rule, Mr. Jackson said in an interview, "consumers can see how much of their commissions are going to research." The rule "also makes it easier to monitor best execution," and it could encourage the creation of high-quality independent research shops, he said.

But greater transparency is not something Wall Street generally wishes for, which might explain why some firms are opposing an unbundling of research and trading costs.

Another reason Wall Street prefers the status quo on research and trading is the information edge it provides. Big investor orders represent crucial information for brokerage firms, which can generate rich profits by trading around the transactions. If investors start sending orders to firms based only on superior execution, the big broker-dealers could lose that information source.

Under the European system, research and trading are likely to improve, investors say. That's because they'll be able to reward firms that produce meaningful investment analysis as well as those that generate excellence and efficiency in trade executions.

Investors' costs will also come down because they will no longer be at risk of paying up for bad executions or mediocre research. "Separately shopping for research and trading will significantly reduce investors' costs," said Tyler Gellasch, executive director of the Healthy Markets Association, a nonprofit organization focused on improving the integrity of the nation's **financial markets**. "That directly translates to higher returns and more money for retirees and college savings funds."

Even as Europe moves to a new and fairer regime, some on Wall Street are quietly urging the Securities and Exchange Commission to maintain the bundling of research and trading in American markets. Among them is Goldman Sachs, which has told some of its big investor clients that it opposes separating research from trading. A spokesman for Goldman declined to comment.

The main argument offered against separating research and trading is that broker-dealers that publish analysts' reports would have to register as investment advisers, subjecting them to an additional regulatory burden.

Kenneth E. Bentsen Jr., chief executive of the Securities Industry and **Financial Markets** Association, a top lobbying group, is leading the charge. In a statement, he said: "Our efforts reflect the fact that research plays a fundamental role in our capital markets and in the capital formation process, and the continued availability of research is essential to the vibrancy and health of our markets. Current U.S. law prohibits broker-dealers from providing unbundled research unless they register as an investment adviser, which could have an unintended but harmful effect on the markets and investors."

But many major firms are already registered as investment advisers. So all they would have to do to resolve the issue is move their research operations into their investment advisory units.

Not all brokerage firms are against the unbundling of research and trading. A spokeswoman for Bank of America Merrill Lynch confirmed what some of its clients have told me — that the firm is willing to receive cash payments for research.

This is good news to the Council of Institutional Investors, an association of more than 125 public and private pension plans, endowments and foundations. Jeff Mahoney, its general counsel, recently wrote a letter to Jay Clayton, the chairman of the S.E.C., asking that the agency allow brokerage firms to separate research and trading costs. Investors should be able to "purchase and budget for these services as they do any other expense of the plan," Mr. Mahoney wrote.

Still, Wall Street's arguments against unbundling seem to be gaining traction at the S.E.C. And some investors are worried that they are being made privately at the agency, not as part of a public comment process.

"Part of our concern is something seems to be going on behind closed doors," Ken Bertsch, the council's executive director, said in an interview. "My sense of what's going on is brokers want to limit this to clients for whom the European rules apply. But the council would like to see it benefit U.S. investors as well."

How the S.E.C. rules on this question will tell a lot about where Mr. Clayton and his new team stand — with Wall Street or its customers.

Tyler Gellasch, executive director of the Healthy Markets Association, says separating research and trading will save investors money. | Justin T. Gellerson for The New York Times

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U.S. News: Revision to GDP Shows Economic Output at 3.1%

By Josh Mitchell
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WASHINGTON -- U.S. economic output grew at a 3.1% annual rate in the second quarter, slightly stronger than previously thought and marking the best growth in two years.

The estimate, based on revised data released by the Commerce Department on Thursday, replaces a previous tally of 3% growth. Economists surveyed by The Wall Street Journal had expected the estimate to remain at 3%.

The agency said an upward revision to investment in business stockpiles, particularly farm inventories, led to the higher estimate of growth.

The report did little to alter the picture of an economy that rebounded in the spring after a lackluster winter and then lost momentum in recent months after hurricanes tore into Texas and Florida.

Many private-sector economists estimate economic output to grow at a rate of between 2% and 3% in the third quarter. They expect steady growth in the year's final months and early next year as hurricane-hit communities rebuild, consumers and businesses step up spending broadly, and the global economy gains traction.

"It will take more than one quarter of growth exceeding 3% to conclude that a stronger growth trajectory can be sustained, particularly in the absence of any meaningful fiscal stimulus as the [Federal Reserve] continues to gradually withdraw monetary support," Jim Baird of Plante Moran Financial Advisors said in a note to clients. "There's nothing in today's report that moves the needle in terms of the big picture."

The economy at its core remains stable, as steady job growth and a booming **stock market** encourage households to spend. Consumers, accounting for more than two-thirds of economic demand, increased spending at a 3.3% rate in the second quarter.

Businesses also continued to step up investment. Nonresidential fixed investment -- a measure of business spending on equipment, software and commercial space -- grew at a 6.7% rate in the spring, slightly lower than previously thought but marking the second consecutive quarter of solid growth.

Exports grew at a 3.5% rate, a slightly downward revision and about half of the prior quarter's rate. But the increase reflected a healthy development as stronger growth around the globe boosts business at U.S. manufacturers.

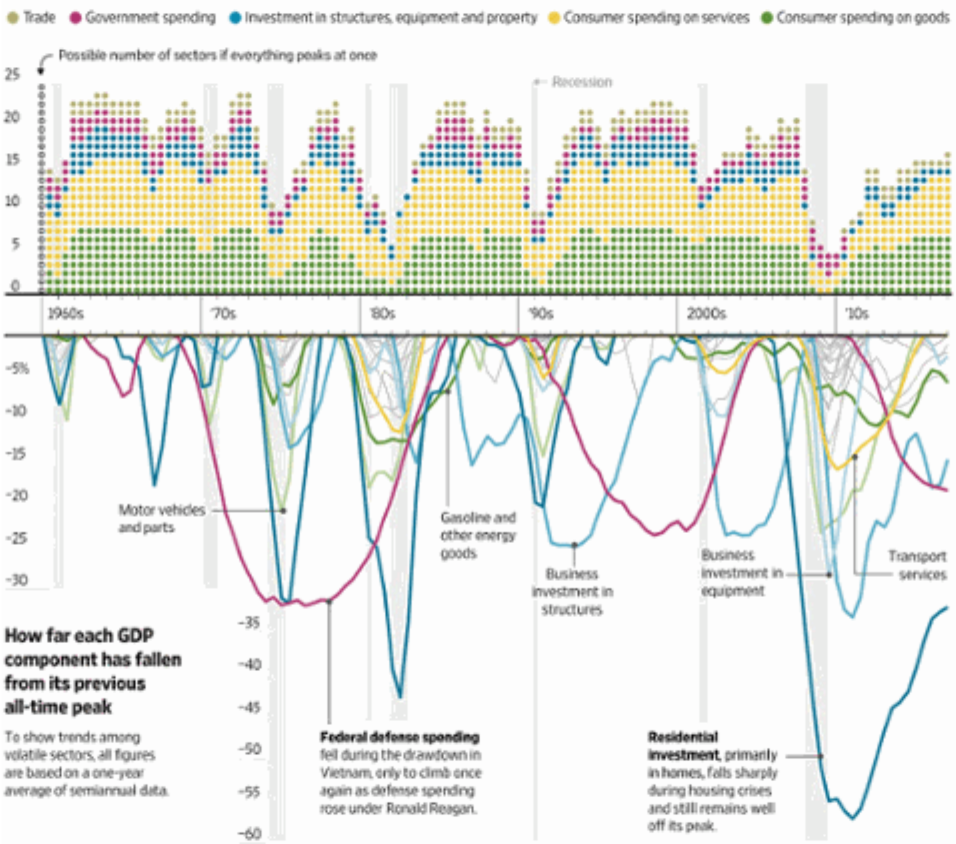
Thursday's report also showed corporate profits were weaker than previously thought in the spring. After-tax profits, without inventory valuation and capital consumption adjustments, dropped 2% from the first quarter instead of the previously reported 1.4%. Profits were still 7.4% higher from a year earlier.

Which Cylinders Are Firing and Which Aren't

The government estimates U.S. economic output by assessing the value of various aspects of economic activity. How much are households consuming; businesses investing; state, local and federal governments spending? It breaks these components down into finer detail, such as consumer spending on cars and furniture, business investment in buildings or software, federal spending on defense, etc. It adds these components up to figure out how much has to be produced to meet this demand, with adjustments for shifts in goods moving in and out of inventories.

For at least 50 years, broad-based expansions have been the norm, with most components of activity hitting new peaks when adjusted for inflation. That's not the case this time. Many components of activity have lagged through much of the economic expansion, failing to hit new peaks, including government defense spending, consumer spending on gasoline and financial services, exports of services and investment in housing.

Number of GDP components that were at their post-1960 inflation-adjusted peak in any given half-year period



Note: Includes imports, which are here treated as a positive category, but excludes change in private inventories. All figures are seasonally adjusted.

Source: Commerce Department

Andrew Van Dam/THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.
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Heard on the Street
Oil Prices Receive a Helping Hand

By Spencer Jakab
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29 September 2017
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B12
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[Financial Analysis and Commentary]

These days oil traders don't get their hands dirty, except perhaps in the figurative sense. A recent shift in the **financial market** for oil provides insights into the physical market and could boost **oil prices** beyond the normal impact of supply and demand.

Brent, the global crude benchmark, is now in a **bull market** and also in backwardation -- futures contracts expiring in later months are cheaper than nearby months. On Thursday, the October contract fetched $57.20, or $1.76 a barrel more than the one expiring in October 2018.

That makes sense. Users are typically willing to pay a little bit extra to be sure they get possession of a critical commodity. That pattern hadn't been the case as **oil prices** tumbled and then languished at low levels in the three years following the summer 2014 peak. For example, 18 months ago Brent futures expiring in a year were nearly $5 a barrel more expensive than the front month -- a situation called contango.

The fact that commercial crude and refined-product inventories surged to a record in the past three years while contango existed isn't a coincidence. Futures curves can act like the tail wagging the dog. By making physical crude cheap relative to futures, contango subsidizes stockpiling. Record inventories drive down prices.

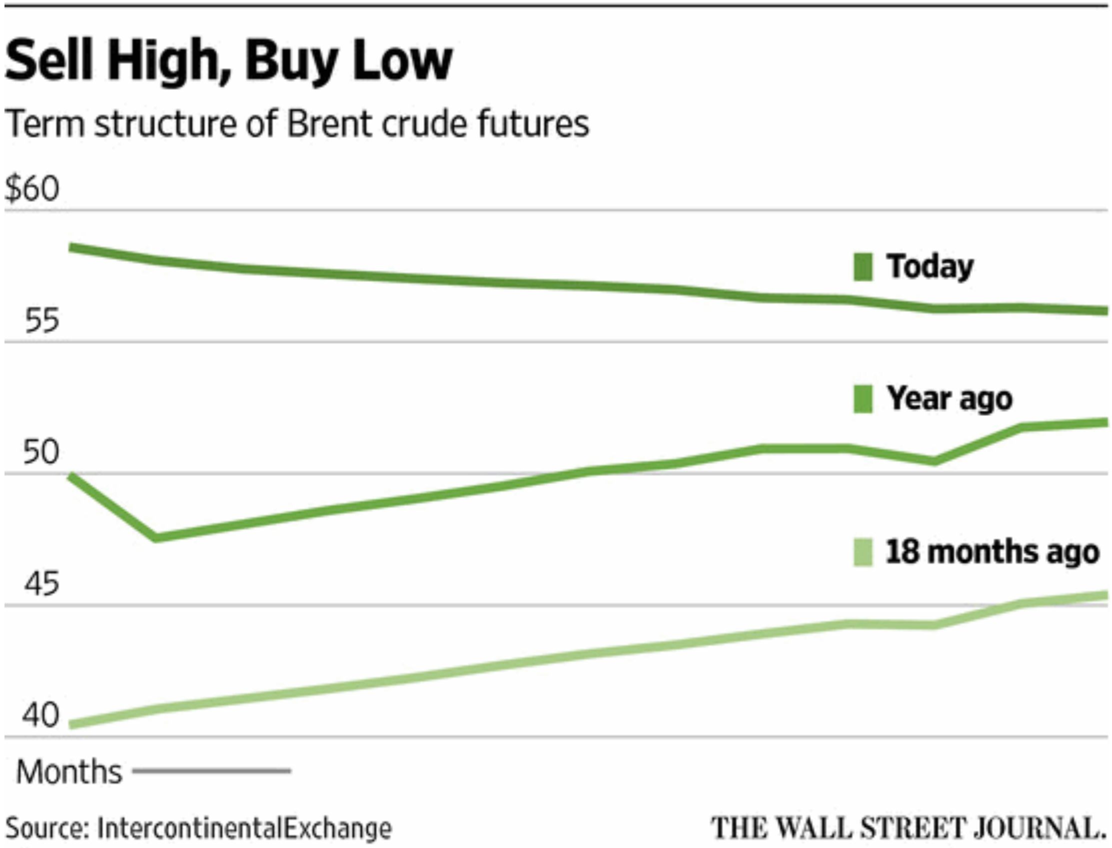
At an extreme, contango creates a guaranteed profit for anyone able to store oil because they can simultaneously sell a distant futures contract and keep the difference minus storage costs.

But low prices have a way of curing low prices: Consumers can afford more while producers cut back future supply. Lately, major oil exporters have helped by voluntarily curbing supply. The upshot of Thursday's backwardation isn't only that it reflects a tighter market, though it creates an incentive for oil traders to dump physical barrels and buy futures instead. Less inventory and more futures buying are good for prices.

Between July 2014 and July 2016, generally a period of contango, the International Energy Agency reported that commercial crude and refined-product inventories rose by 439 million barrels to over 3.1 billion. By July 2017 that had fallen by 89 million barrels.

The shift from contango to backwardation could push **oil prices** higher still because it could attract more passive investors, who can profit from buying and rolling over futures contracts as they expire. Under contango, they lose a bit of money every month, all else being equal. Before the relatively recent flood of money into passive commodity investments, backwardation was more common.

The futures market has a story to tell and it is music to producers' ears.



Document J000000020170929ed9t0000o

THE WALL STREET JOURNAL.
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Streetwise: Take Fed's Forecasts With Grain Of Salt

By James Mackintosh
785 words
29 September 2017
The Wall Street Journal
J
B1
English

The most important message for economists from the Federal Reserve last week was the lowering of rate-setters' long-run forecast for interest rates.

Fed policy makers dropped their average prediction for long-run interest rates from 3% to 2.8%, implying that if the economy were working perfectly, rates wouldn't need to be so high to stop inflation from taking off.

That should be great news for Treasurys, right? Lower yields mean higher prices, after all. Yet investors seem to have ignored the change. Traders focused instead on the prediction of another rate increase this year. The minireflation trade that was already under way has accelerated, helped by rising hopes of tax cuts. Bond yields have risen, which shareholders took as a cue to rotate out of the soar-away technology stocks into weaker sectors more likely to benefit from a stronger economy.

What is known as the long-run neutral rate of interest, the natural rate, or "r*," has a big influence on how policy makers set rates. It is the rate that should keep inflation steady when the economy is running at full capacity and is key to judging monetary policy. The further rates are below it, the more they boost the economy. And once they reach it, monetary stimulus has been fully withdrawn.

On the face of it the lower forecast last week suggests the Fed is doing less to help the economy than it previously thought.

Roberto Perli, partner at research firm Cornerstone Macro and a former Fed official, says the estimate is one of the influential factors underlying Fed rate decisions. He expects forecasts for the natural rate to drop even further and thinks it will act like gravity to bring down bond yields again, assuming President Donald Trump's tax cuts aren't passed.

However, there are three deep uncertainties about the Fed's natural-rate forecasts that make them hard to translate into **bond yield** estimates.

The first is the uncertainty about the natural rate itself. The "dot plot" of forecasts from each Fed policy maker range from 2.3% to 3.5% for the long run, a little lower than in June. How sure can bond investors be that it won't go back up as rapidly as it has come down?

Seth Carpenter, chief U.S. economist at UBS Group AG and another former Fed official, says estimates of the natural rate are "staggeringly imprecise," and Fed staff are constantly reminded of that.

Fed Chairwoman Janet Yellen emphasized the uncertainty about the natural rate again in a speech on Tuesday, when she said "its value at any point in time cannot be estimated or projected with much precision." In 2005, she suggested the natural-rate estimate had a 2-percentage-point error margin.

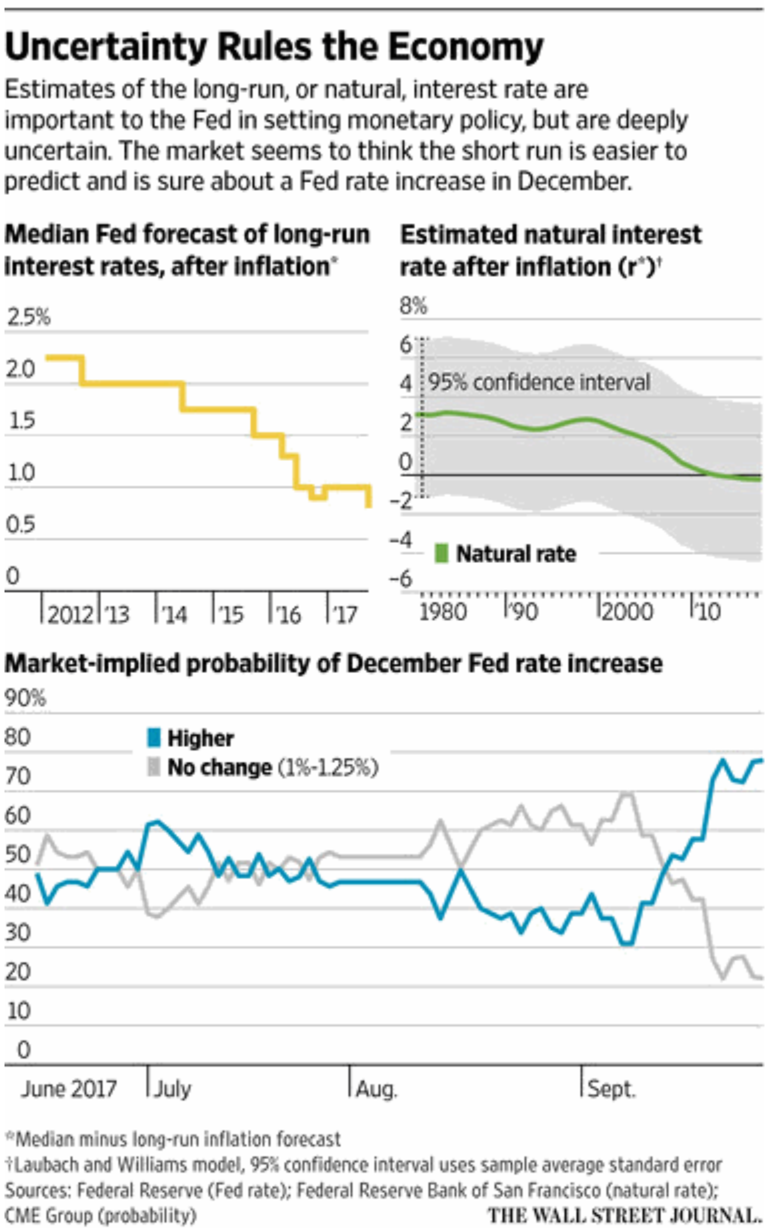
Other economists put an even bigger error margin around their estimates. The widely used estimates created by Thomas Laubach at the Fed in Washington and Federal Reserve Bank of San Francisco President John Williams show that while the central estimate of the natural rate has come down a lot in the past few decades, the margin of error is bigger than the change.

The second reason investors might ignore the change is the uncertainty about what it means. Even if we were sure that the natural rate has fallen, would that mean higher or lower bond yields? On the face of it the question might seem dumb. If interest rates will peak at 2.8% instead of 3%, long-term Treasury yields should also be lower.

Yet 10-year Treasury yields kept on rising, from 2.02% at their lows in early September to 2.33%. Mr. Perli puts this down to rising hopes of tax cuts. But as Valentijn van Nieuwenhuijzen, chief investment officer of NN Investment Partners in the Netherlands, points out, it could also be that the Treasury risk premium is rising because investors are less sure of where rates will eventually settle.

The final uncertainty is about the people making the forecasts. Ms. Yellen's term ends next February, Vice Chairman Stanley Fischer is stepping down in two weeks, and three board seats are unfilled. Just a few of the dots need to rise to pull up the average forecast for the natural rate again.

After almost a decade of superlow interest rates, it is hard to imagine the fed-funds rate returning to the 5.25% reached in August 2007, from today's 1%-1.25%. But we should put no faith in predictions that they will stick at 2.8% in the long run, either.



Document J000000020170929ed9t00024

The New York Times

Business/Financial Desk; SECTB
Markets Return to Record Highs on Drug and Tech Gains

By THE ASSOCIATED PRESS
780 words
29 September 2017
The New York Times
NYTF
Late Edition - Final
2
English

Stocks finished slightly higher in the United States on Thursday, led by technology companies and drugmakers. After a big move the day before, that was enough to take stocks back to record highs.

After a slow start, stocks gradually moved upward in afternoon trading as companies in technology, basic materials, real estate and finance contributed modest gains. Drugmaker AbbVie jumped after it reached a deal with a competitor that would delay competition for its anti-inflammatory treatment Humira, the biggest-selling drug in the world. Industrial firms took small losses as big names like Boeing and General Electric declined.

September is historically the weakest month of the year for stocks, but the **Standard & Poor's 500-stockindex** has risen 1.6 percent this month. The third quarter ends Friday, and the index has climbed 12 percent this year. That has some investors wondering if other markets are poised to do better than American stocks in the months to come.

''The U.S. economic cycle is so much further along than the Europe economic cycle,'' said Sameer Samana, global quantitative strategist for the Wells Fargo Investment Institute. He added that European stocks have not done as well as stocks in the United States in 2017, and with the European Central Bank getting ready to start raising interest rates, banks in Europe should start making more money.

But Samana thinks stocks that are linked to economic growth in the United States, like banks and industrial and consumer-focused companies, should continue to do well. Those stocks mostly climbed on Thursday.

Meanwhile, second-quarter growth in the United States was revised up slightly, to 3.1 percent from 3 percent.

The **Standard & Poor's 500-stockindex** rose 3.02 points, or 0.1 percent, to a record high of 2,510.06. The **Dow Jonesindustrial average** gained 40.49 points, or 0.2 percent, to 22,381.20. The **Nasdaq composite** inched up 0.19 points to 6,453.45. The Russell 2000 index of smaller-company stocks continued to set new highs as it advanced 3.97 points, or 0.3 percent, to 1,488.79.

Drugmaker AbbVie climbed after it resolved a patent dispute over Amgen's version of AbbVie's drug Humira, which is the source of most of its revenue. Amgen agreed not to sell its version of the anti-inflammatory medicine in Europe until October 2018, and the American version will not go on the market until 2023.

The settlement would mean billions of dollars in additional sales for AbbVie, which reported $16 billion in Humira sales in 2016. Its stock gained $4.21, or 5 percent, to $88.96 and Amgen rose 58 cents to $185.46.

Abbott Laboratories jumped after the Food and Drug Administration approved its FreeStyle Libre Flash glucose monitoring system for adults with Type 1 diabetes. The product uses a sensor inserted below the skin to measure blood glucose. Analysts say Abbott could have a competitive edge because the F.D.A. did not advise patients to take samples of their blood to confirm the system's readings.

Abbott rose $1.9, or 2.9 percent, to $53.64. DexCom, which gets all its revenue from selling its own blood glucose monitoring system, plunged $22.03, or 32.7 percent, to $45.44 in heavy trading.

Streaming video device maker Roku surged in its first day of trading. Its initial public offering priced at $14 a share and it jumped $9.50, or 67.9 percent, to finish at $23.50. The company makes boxes and sticks that let users watch Netflix, Hulu and other streaming networks on their TVs. Roku was an early entrant in that industry, but now faces competition from companies like Amazon, Apple and Google's parent company Alphabet.

Roku raised $219 million from the offering, which valued the company at $1.3 billion.

Benchmark United States crude gave up an early gain and fell 58 cents, or 1.1 percent, to $51.56 a barrel in New York. Brent crude, the standard for international **oil prices**, fell 49 cents to $57.41 per barrel in London.

Bond prices rebounded from an early slump. The yield on the **10**-**year Treasury** note remained at 2.31 percent.

Gold rose $2.10 to $1,285.50 an ounce.

The dollar dipped to 112.42 yen from 112.77 yen. The euro rose to $1.1778 from $1.1748.

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

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THE WALL STREET JOURNAL.
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Tax Proposal Is Winner for Wall Street

By Telis Demos and Liz Hoffman
996 words
29 September 2017
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B1
English

Wall Street has hungered for a tax overhaul, and with good reason. If it spurs stronger economic growth, corporate borrowing and finance firms' profits could jump.

A lower corporate tax rate as called for in the tax framework unveiled by the Trump administration Wednesday should immediately boost banks' own profits. Bankers expect some pain points but are confident the benefits will outweigh them.

Morgan Stanley Chief Executive James Gorman said at an industry conference in June that a 25% corporate tax rate would lift his bank's earnings by 15%, assuming no changes to the business mix. The Trump framework calls for a 20% rate, so the benefit could be even greater.

Citigroup Inc. has said that a cut to a 25% rate plus a tax holiday on foreign earnings would have boosted its annual net income by $800 million, or by about 5%. It also would improve the bank's return on equity by more than 1 percentage point, estimated John McDonald, an analyst at Sanford Bernstein.

Any fillip in economic growth could potentially help reverse a decline in business-loan growth experienced since late last year. Some bank executives have attributed this slowdown to clients waiting for a tax overhaul to be finalized before ramping up borrowing and investing in their businesses. A lack of clarity also has been cited as a slowing factor for deal making on companies' part.

Smaller banks could also reap bigger gains since they have relatively high effective tax rates and businesses that are almost purely domestic, Evercore ISI analysts said in a note. A potential tax cut to 28% from 35% could boost 2018 earnings for regional banks by a median of 9%, they said.

The Trump proposals also spare an important business for banks and other lenders: mortgages. The administration's document calls on Congress to retain the deduction for mortgage interest. A change to that could have disrupted housing markets.

While the framework would leave unchanged certain taxes on investments, including those on capital gains and dividends, the money-management industry also stands to benefit.

If a lower corporate tax rate lifts profits at many U.S. companies, this should add fuel to the **stock-market** rally and boost returns on equity funds. Smaller and midsize companies should make out particularly well because they tend to pay a higher tax rate than larger peers, said Joseph Amato, president of the $271 billion asset manager Neuberger Berman Group LLC.

Some money managers such as WisdomTree Investments Inc. would also benefit directly. In the latest quarter, it reported a 45.5% tax rate, largely due to overseas losses it couldn't deduct. Executives have said a lower rate would help it in that area as well as help support the company's dividend.

Not that there won't be some downsides.

Among them: A number of banks have what are called "deferred tax assets." These are created by losses, in many cases huge ones racked up during the financial crisis, and act as IOUs that can be used to offset future tax bills. Those will lose value.

Citigroup, for example, had $46 billion of the assets at the end of the second quarter. A reduction in the corporate tax rate to 20%, plus a shift to a territorial regime that taxes only income generated in the U.S., could reduce the assets' value by more than $15 billion, according to figures the bank has provided. Citigroup would have to take that charge as a one-time hit to profits.

Bank of America had $19.2 billion in net deferred-tax assets at the end of 2016. Only about $7 billion of these apply to the U.S. and so would be subject to revaluation. That would lead to a write-down of around $3 billion if the tax rate is lowered to 20%.

The benefit of lower rates, though, would likely make up for that within a year or so through higher profits, a person familiar with the matter said.

Another issue is a proposal to partially limit companies' ability to deduct net interest expense. The administration didn't define what partially limited means.

That is important: Bank executives have said that they hope this will mean that financial institutions are exempted. If not, their business model would be under threat.

Financial firms borrow huge amounts of money to lend out and invest. In that sense, money is their raw material. If banks couldn't deduct the interest expense, which is akin to nonfinancial companies' cost of goods sold, that would create a huge tax hit.

For bank clients, limiting the deductibility of net interest expense could make debt issuance less attractive. That, in turn, could crimp the business of helping companies raise and sell bonds and loans.

Debt-capital-markets businesses accounted for $10.4 billion in revenue at the dozen biggest global banks in the first half of 2017, or 13% of their total investment-banking and trading revenue, according to the industry data tracker Coalition.

That figure grew by 18% from a year earlier. And it was the only investment-banking business to have done better in 2016 than it did in 2015.

"Changing the deductibility of interest will have a profound impact on the foundations of corporate finance," said Reuben Daniels, managing partner at EA Markets LLC, which advises companies on capital raising.

For the private-equity industry, which relies heavily on debt financing, that change could translate into firms paying lower prices for assets.

That corporate interest is deductible, but dividend payments aren't, has skewed how companies fund their operations, creating a bias toward debt. In the 1980s, it enabled the rise of leveraged buyouts in which financiers borrowed heavily to buy companies, then wrote off the interest payments.

Justin Baer, Rachel Louise Ensign and Miriam Gottfried contributed to this article.

Document J000000020170929ed9t0002g

The New York Times

Business Day; DealBook
Rovio, Angry Birds Maker, Valued at $1 Billion in I.P.O.

By CHAD BRAY
612 words
28 September 2017
12:26 PM
NYTimes.com Feed
NYTFEED
English

LONDON — It turns out Angry Birds is a billion-dollar idea.

Rovio Entertainment, the company behind the Angry Birds empire that encompasses video games, films and merchandise, was valued at about $1 billion as it prepared to go public on Friday.

Rovio helped usher in the rise of smartphone games, with the release of the original Angry Birds in 2009. That original game, where players aimed a flock of birds at an array of evil green pigs, spawned several spinoff titles, all of which have ranked among the most downloaded apps on smartphones and tablets. Overall, Rovio's titles have been downloaded 3.7 billion times, the company said.

But the Finnish company, which initially charged for downloads, struggled financially following its initial Angry Birds success. Consumers gravitated to games offered through a so-called freemium model, in which players download the game for free and pay for additional features.

Rovio has since switched from paid apps to free downloads of its games, and its public offering is the latest sign of its changing fortunes. Angry Birds merchandise is widely available, and a sequel to the original Angry Birds film is slated for release in 2019.

The offering was priced at 11.50 euros a share, the top end of the price range announced this month, the company said. The company said that demand for its shares on offer was many times more than the amount available.

The pricing of its shares equates to a market capitalization of 896 million euros, or about $1 billion, when Rovio begins initial trading on **Nasdaq** Helsinki on Friday. That is below the $2 billion valuation that some had estimated the company could receive earlier this summer.

"We are extremely happy and proud of the great interest toward Rovio's I.P.O., both by Finnish and international investors," Kati Levoranta, the Rovio chief executive, said in a news release. "I would like to thank all who participated in the I.P.O. for their trust toward our company."

Rovio said it would receive about 30 million euros in gross proceeds from the sale of new shares. Existing shareholders, including the investment vehicle of its vice chairman, Kaj Hed, are expected to pocket 458 million euros from the sale of their shares.

The company has said that the aim of the initial public offering was to help it carry out a growth strategy, and that it would use its shares for possible acquisitions and rewards to its employees.

The public offering marks the latest step in a tumultuous journey for Rovio.

Mikael Hed, a co-founder, stepped down as its chief executive in 2014, and the company announced plans to cut nearly 40 percent of its work force the next year.

Mr. Hed is still executive chairman of Rovio Animation, which helped bring "The Angry Birds Movie" to the big screen last year.

Rovio returned to a profit in 2016 and reported revenue of 191.7 million euros last year.

Its games business, which includes the original Angry Birds and more than a dozen spinoff titles, accounted for 79 percent of its revenue in the 12 months through June.

Follow Chad Bray on Twitter @Chadbray.

* An Angry Birds Empire: Games, Toys, Movies and Now an I.P.O.

* 'Angry Birds Movie' Is Part of App Developer's Big Picture

* Chief Executive of Rovio, Maker of Angry Birds Game, to Step Down

Rovio Entertainment, the company behind the Angry Birds empire, was valued at about $1 billion as it prepared to go public. | Ilya S. Savenok/Getty Images

Document NYTFEED020170928ed9s004xt

THE WALL STREET JOURNAL.
U.S. EDITION

Equities: Media-Company Stocks Dealt a Blow --- Customers' move to streaming services, storm disruptions help push down shares

By Michael Wursthorn
613 words
28 September 2017
The Wall Street Journal
J
B11
English

Shares of cable providers and entertainment companies in the U.S. are suffering their worst stretch in nearly two years, as traditional players struggle to adapt to a shift toward streaming services.

Americans are ditching television subscriptions in favor of viewing movies and TV shows through online services. The move disrupts a delicate ecosystem of media companies sustaining themselves on subscription fees from pay-TV providers, and echoes Amazon.com Inc.'s upending of the brick-and-mortar retail landscape.

This shift, along with disruptions related to major summer storms, has been pushing down stocks of major cable and broadcast companies.

In a sign of the diverging fortunes, Roku Inc., an early player in streaming television, priced its initial public offering late Wednesday.

A group of 13 media companies in the **S&P 500** have fallen 3.5% so far in September, on track for its steepest monthly decline since December 2015, while the **S&P 500** has gained 1.4%.

Media shares got a bit of a reprieve Wednesday, rising 1% in their biggest gain since late July as the group joined an upswing in the broader market. Doug Mitchelson, a media analyst with UBS Group AG, attributed the gains to the Republican tax overhaul, which proposed sharply reduced tax rates on businesses and many individuals.

"One of the top reasons for cord-cutting is affordability," said Mr. Mitchelson. "A healthier consumer is a better spender for media companies."

A selloff in the sector gathered pace on Sept. 7, when two industry giants' updates disappointed investors. Comcast Corp. said it expects to lose as many as 150,000 video subscribers in the third quarter. Walt Disney Chief Executive Robert Iger said the company's earnings per share for its fiscal year ended Sept. 30 would be on par with last year, missing analysts' estimates for a small rise.

Hurricanes hitting Texas and Florida also disrupted operations, the companies added. Comcast said the hurricanes contributed to its decline in subscribers, while Disney was forced to cancel some cruises and briefly close its theme park in Orlando, Fla.

The shares of Comcast fell 6% that day; Disney shed 4%.

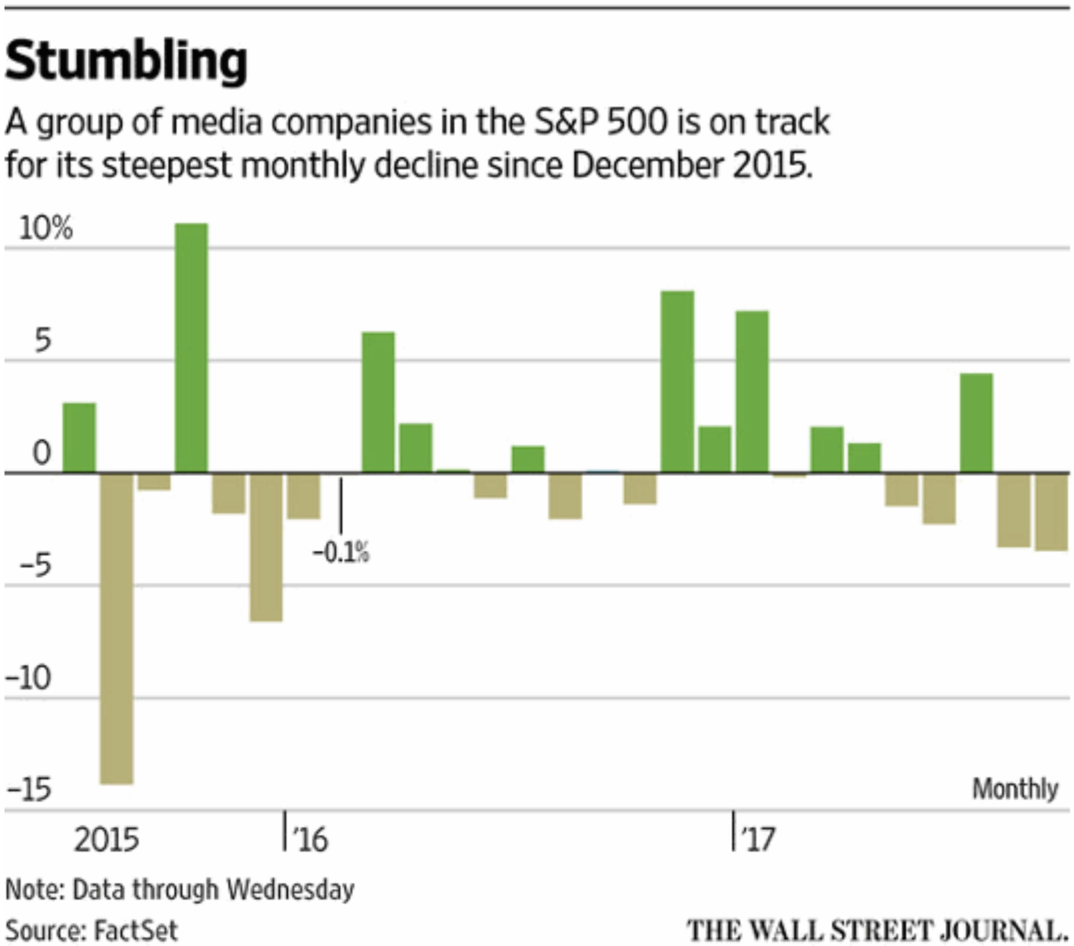
That rippled across the media landscape. Shares of Viacom dropped 4% that day, Dish Network Corp. lost 3.7% and Discovery Communications shed 2.3%. Viacom and Discovery are on track for double-digit losses this year, while Dish and Disney are off 8% and 4.8%, respectively. Comcast is up 12% in 2017.

"There's a general level of concern around the major media companies having to do with cord-cutting and audience trends," said Bryan Kraft, a media analyst with Deutsche Bank. "Those concerns aren't new, but when there's data to support they're getting worse, you tend to see the stocks react accordingly."

Even as the media sector overall holds on to gains for the year, up 3.9%, analysts say shares could slide further as companies cope with greater competition from rivals that are stepping up spending on content creation, such as Netflix Inc. and Apple Inc., as well as a challenging ratings environment.

Also, ratings for this season's National Football League games have been mostly flat or down from a year earlier.

And new online "skinny bundles" -- slimmed-down packages of channels from the likes of Hulu and YouTube TV -- have left out many cable channels. That will put pressure on some channel owners as more consumers sign up for those services, said Mr. Kraft at Deutsche Bank.



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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Markets Rise as Spending News Lifts Small Companies

By THE ASSOCIATED PRESS
1,025 words
28 September 2017
The New York Times
NYTF
Late Edition - Final
2
English

NEW YORK -- U.S. stocks climbed Wednesday as smaller companies soared following a report that showed business investment climbed in August. Investors also hoped stocks will benefit from tax cuts proposed by President Donald Trump and congressional Republicans.

The Labor Department said orders for long-lasting manufactured goods rose, and a gauge of business investment climbed for the second month in a row. Investors hope that means U.S. manufacturing is getting stronger as the global economy continues to improve, and they bet on continued growth: technology companies rallied for a second day, while the prices of traditionally safe investments like bonds and gold dropped.

"We've been waiting for that," said Kate Warne, an investment strategist for Edward Jones, of the recent improvement. "Business spending has been relatively weak," with spending by consumers keeping the economy afloat.

Smaller, domestically-focused banks and technology and industrial firms made especially large gains, and the Russell 2000 index of smaller-company stocks made its biggest gain since March. The tax proposal was similar to what investors had come to expect, and with months of negotiations likely ahead and key details missing, it's not clear what kind of plan might ultimately pass. But lower corporate taxes could help smaller companies more than large ones.

"A corporate tax cut tends to be better news for smaller companies because they don't have as many ways to reduce their tax rate," said Warne.

The proposal would cut tax rates for individuals and corporations. It would lower the top corporate tax rate to 25 percent from its current 35 percent, and also reduces the number of personal tax brackets and nearly doubles the standard deduction used by most Americans.

The **Standard & Poor**'**s500 index** added 10.20 points, or 0.4 percent, to 2,507.04. The **Dow Jonesindustrial average** rose 56.39 points, or 0.3 percent, to 22,340.71. The **Nasdaq composite** leaped 73.10 points, or 1.1 percent, to 6,453.26.

The Russell 2000 did even better and continued to set records. It gained 27.95 points, or 1.9 percent, to 1,484.81. After a sluggish few months, the Russell has jumped more than 9 percent since mid-August. The S&P mid-cap and small-cap indexes also climbed.

The Labor Department's report gave investors hope the economy will keep growing, and Wall Street bet that interest rates will keep rising. The yield on the **10**-**year Treasury** note climbed to 2.30 percent from 2.24 percent. That helped banks, as higher interest rates mean they can charge more to lend money. Bank of America picked up 60 cents, or 2.4 percent, to $25.41 and Citigroup rose $1.34, or 1.9 percent, to $72.28.

Meanwhile companies that pay big dividends took steep losses. Kimco Realty, a real estate investment trust that owns outdoor shopping centers, fell 75 cents, or 3.7 percent, to $19.41. Household products maker Procter & Gamble gave up $1.78, or 1.9 percent, to $90.87. Rising bond yields made government bonds a more appealing investment to investors seeking income.

The dollar got stronger and rose to 112.75 yen from 112.17 yen. The euro fell to $1.1756 from $1.1798.

Chipmaker Micron Technology had a better quarter than investors expected, and its stock rose $2.81, or 8.5 percent, to $37.09. Facebook climbed $3.47, or 2.1 percent, to $167.68 and Google's parent company Alphabet picked up $22.47, or 2.4 percent, to $959.90.

Shoe and athletic gear maker Nike said sales in the U.S. remained weak in its first fiscal quarter and steep discounts continued to affect its business. While its earnings and revenue were better than analysts expected, analysts chalked much of that up to lower taxes, stock repurchases, and spending cuts.

Nike lost $1.03, or 1.9 percent, to $52.67.

Utility company Scana took its biggest loss in almost nine years after state police in South Carolina said they are looking into "potential criminality" by the company after a nuclear plant construction project was shut down after some $10 billion had already been spent. Its South Carolina Electric & Gas unit and partner Santee Cooper canceled the project in July after contractor Westinghouse filed for bankruptcy.

Scana said it will cooperate fully with the inquiry. Its stock sank $4.35, or 7.8 percent, to a two-year low of $51.22.

Gold fell to its lowest in a month. The metal's price declined $13.90, or 1.1 percent, to $1,287.80 an ounce. Two weeks ago gold was at a 12-month high, but it's fallen sharply since then. Silver lost 6 cents to $16.83 an ounce. Copper rose 1 cent to $2.93 a pound.

Benchmark U.S. crude added 26 cents to $52.14 a barrel in New York while Brent crude, the standard for international **oil prices**, fell 54 cents, to $57.90 a barrel in London.

Wholesale gasoline fell 4 cents to $1.65 a gallon. Heating oil remained at $1.85 a gallon. Natural gas rose 6 cents to $2.97 per 1,000 cubic feet.

The FTSE 100 index in Britain rose 0.4 percent while Germany's DAX rose 0.4 percent. The CAC 40 in France added 0.3 percent. Japan's Nikkei 225 fell 0.3 percent and South Korea's Kospi dipped less than 0.1 percent. Hong Kong's Hang Seng index rose 0.5 percent.

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AP Markets Writer Marley Jay can be reached at http://twitter.com/MarleyJayAP His work can be found at https://apnews.com/search/marley%20jay

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

CHART:S The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Wednesday. (Source: Reuters); 5-Year Treasury Notes: High yields at auction. (Source: Treasury Department)

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Small-Cap Shares Claim a Crown

By Chris Dieterich
194 words
28 September 2017
The Wall Street Journal
J
B12
English

Shares of small U.S. companies rose to highs as investors piled into stocks they expect to benefit from a reduction in corporate tax rates.

The Russell 2000 index, a benchmark of small-capitalization U.S. stocks, climbed 1.9% to a record close of 1484.81, its biggest percentage advance since March.

The rally came as Republicans called for a reduction in the U.S. corporate tax rate as part of a broader overhaul. Analysts say a U.S. corporate tax cut is likely to provide the most benefit to small U.S. companies, which tend to have higher effective tax rates than firms with significant overseas operations.

Small-cap stocks picked up steam last week after Federal Reserve officials affirmed that the U.S. economy appears strong enough to justify a third interest-rate increase this year and three more next year. An acceleration in domestic growth is a boon for companies that focus on home markets.

For 2017, the Russell 2000 is up 9.4% versus a 12% advance for the **S&P 500**.

Document J000000020170928ed9s0000v

The New York Times

Business Day; Economy
Wealth Grew Broadly Over 3 Years, but Inequality Widened

By BEN CASSELMAN
1,054 words
27 September 2017
07:33 PM
NYTimes.com Feed
NYTFEED
English

Eight years after the Great Recession officially ended, the fruits of economic growth are finally spreading to low-wage workers, racial and ethnic minorities and other groups that were largely left out of the early stages of the recovery.

But in a pattern that has become familiar in recent decades, the biggest gains continued to flow to the richest Americans.

The typical American family had a net worth of $97,300 in 2016, up 16 percent from 2013 after adjusting for inflation, according to data released by the Federal Reserve Board on Wednesday. The gains were broad-based, cutting across racial, educational and economic categories — a significant shift from the years immediately after the recession, when both income and wealth continued to decline for many families.

But despite the gains, wealth also become more concentrated:

• The richest 1 percent of households controlled 38.6 percent of total wealth in 2016, up from 36.3 percent in 2013.

• The bottom 90 percent of households controlled 22.8 percent of all wealth.

Inequality could grow even starker under the tax plan unveiled Wednesday by President Trump and congressional Republicans. That plan would sharply reduce taxes on corporations and certain forms of business income, as well as eliminate the estate tax, which falls on only the wealthiest households. Mr. Trump has said his plan would not reduce taxes on the rich over all, but most independent experts are skeptical of that claim.

Wednesday's data, from the Federal Reserve's triennial Survey of Consumer Finances, shows the strength of the economic rebound in recent years, but also just how large a hole the recession left in many households' finances.

The survey is notable for providing information not just on Americans' yearly income but also on their assets, debts and overall net worth — measures that are in many ways more important to families' financial security. In terms of income, the typical American has made significant progress in recent years, with median household income nearly back to its prerecession peak.

The broader measures of household finances provided by the survey paint a less rosy picture. The recession sliced nearly 40 percent off the typical household's net worth, and even after the recent rebound, median net worth remains more than 30 percent below its 2007 level.

For many groups, the recovery is even more incomplete.

Younger, less-educated and lower-income workers have experienced relatively strong income gains in recent years, but remain far short of their prerecession level in both income and wealth. Only for the richest 10 percent of Americans does net worth surpass the 2007 level.

A Yawning Racial Gap

Racial and ethnic minorities experienced the strongest gains in wealth in the 2016 survey, a stark reversal from three years earlier, when the survey showed minority families losing ground even as white families experienced modest gains.

Black families' net worth rose 29 percent between 2013 and 2016, and Hispanic families had a 46 percent gain; white families saw a more modest 17 percent increase.

The racial wealth gap, however, remains large and continues to grow in absolute terms. The median white family had a net worth of $171,000 in 2016, nearly 10 times that of the median black family.

A Boom, but for Whom?

In recent years there has been a striking disconnect between the confidence shown by investors — who have pushed the **stock market** to record after record — and the comparative pessimism displayed by many Americans. Wednesday's data, however, makes clear that a small fraction of households enjoy an outsize share of the **stock-market** gains.

Just over half of American families — 52 percent — owned stock in 2016, the first time stockholders represented a majority of Americans since before the financial crisis. But only a relative handful of families own stock outside of retirement accounts, and even counting those accounts, their holdings are often small.

The typical stock owner held $40,000 in stock in 2016; among those in the top 10 percent of earners, that figure was nearly $365,000.

Back in the Black

Households have made significant progress in one area: debt.

Americans are significantly less indebted than before the recession and, significantly, they are better able to afford the debts they have. The median borrower had debts equal to 95.1 percent of income in 2016; the figure was 111.1 percent before the recession and rose to 118.8 percent in the immediate aftermath. Moreover, fewer Americans report being late on debt payments, filing for bankruptcy or taking out high-interest payday loans.

One type of debt is still rising, however: student loans. More than 22 percent of families reported having education debt in 2016, up from 15 percent before the recession. The median borrower owed $19,000.

Not-So-Golden Years

The oldest Americans have seen a significant rebound in their wealth in recent years; the typical household headed by someone 75 or older is now worth modestly more than before the recession, after adjusting for inflation. But younger retirees and those on the verge of retirement haven't come close to making up what they lost in the recession.

That's not surprising: Older workers were especially exposed to the **stock-market** plunge and didn't have much time to recover before retirement.

The median household headed by someone between the ages of 55 and 74 had less than $60,000 in financial assets in 2016, down from roughly $80,000 in 2007. Adding to the challenge, older Americans' homes — the principal nonfinancial asset for many families — are still worth less than before the recession.

"This is not good news for retirement security," said Monique Morrissey, an economist with the left-leaning Economic Policy Institute.

Follow Ben Casselman on Twitter: @bencasselman

* Trump Proposes the Most Sweeping Tax Overhaul in Decades

* Will a Corporate Tax Holiday Give Workers Anything to Cheer?

* A Start-Up Slump Is a Drag on the Economy. Big Business May Be to Blame.

* Bump in U.S. Incomes Doesn't Erase 50 Years of Pain

Younger, less-educated and lower-income workers have experienced relatively strong gains in income in recent years, but remain far short of their prerecession level in both income and wealth. | Lucas Jackson/Reuters

Document NYTFEED020170927ed9r006mz

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Emerging Markets Can Withstand Fed's Rate-Rise Plans

By Richard Barley
511 words
27 September 2017
The Wall Street Journal
J
B18
English

[Financial Analysis and Commentary]

It has been a hot year for emerging-market investments. With the U.S. Federal Reserve reaffirming its plans for rising rates, that might be cause for nerves. But the thing investors need to remember is just how long emerging markets spent out in the cold.

The gains in 2017 are remarkable. The MSCI emerging-market **stock index** is up 26% this year through Monday, while J.P. Morgan Chase's EMBI sovereign-bond index has returned 9%. The yield on the index of around 5.2% has fallen 0.6 percentage point this year and has only been lower for 7.5% of the time in the last 20 years. Currencies have rallied against the dollar.

Meanwhile, demand has surged for dollar-denominated bond sales from a range of riskier and rarer borrowers such as Belarus, Iraq and Tajikistan. Ukraine last week sold $3 billion of bonds just a little over two years after restructuring its debt in the wake of Russia's annexation of the Crimea. That kind of issuance might raise concerns that the market is getting frothy.

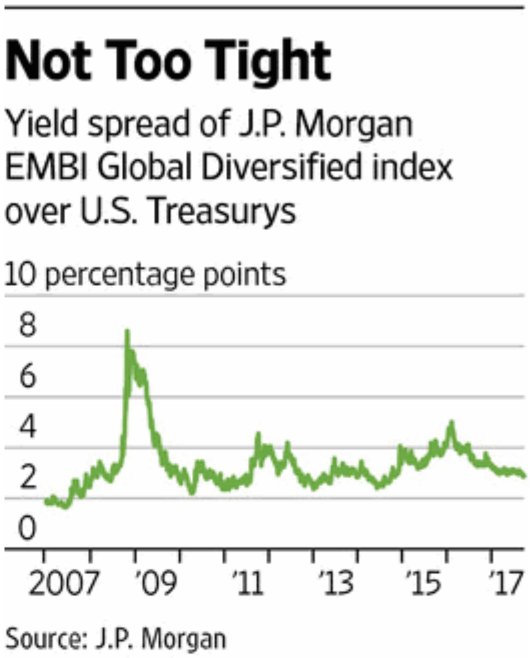
But there are some important counterweights. The most important is continued growth, which is proving more globally synchronized than at almost any time since the financial crisis. The Institute of International Finance estimates emerging-market growth of 5.4% annualized in the third quarter. China is the obvious risk to this picture, and a reminder was served last week by Standard & Poor's downgrade. But growth has broadened, with economies such as Brazil and Russia emerging from recession.

A crucial factor is that emerging markets already have been through an enormous test in the past few years. Investors spent years pulling money out of emerging markets, forcing economies to adjust by closing current-account deficits. The aggregate current-account surplus that has been built up as a result might now start being eroded, Citigroup thinks, but for good reason: Renewed capital inflows should help support economies, making domestic demand more robust.

Markets have swung rapidly to reflect the brighter picture. But they have still only taken back part of the downward move of recent years. Yields are low, but the spread over Treasurys on the EMBI index at 2.94 percentage points is well above its postcrisis tightest level of 2.2 points.

A hot market for new bond issues shows the strength of the search for yield. But many emerging-market countries are making greater use of domestic funding, meaning dollar-denominated funding isn't quite the harbinger of doom it was in the past: Even as government debt has risen, the share of foreign-currency debt has fallen to 14% in 2016, from 32% at end-2001, according to the Bank for International Settlements.

The Fed's apparent desire to push on with tightening policy may give emerging markets a pause. But if global growth continues, then a pause is all it should be.



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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
A Tax Cut's Unintended Result

By Justin Lahart
362 words
27 September 2017
The Wall Street Journal
J
B1
English

[Financial Analysis and Commentary]

What a tax cut could give the economy, the Federal Reserve could take away.

Republican leaders on Wednesday are expected to release a tax plan that would lower tax rates on individuals and corporations and allow companies to repatriate earnings held overseas at a low rate.

Under a deal Senate Republicans reached last week, the overhaul may reduce tax revenue by as much $1.5 trillion.

The tax plan will likely change and may not pass Congress. But if a significant tax cut becomes law, it would juice the economy at a time when the economic expansion is more than eight years old, the jobs market is tight and the Federal Reserve is pushing the other way.

The current economic expansion has been marked by disappointing growth, but even so, the unemployment rate has fallen to 4.4% from a 2009 peak of 10%. That indicates there is little slack left in the economy. If the tax cut boosts growth and drives up wages, the resulting inflation could prompt the Fed to raise rates at a faster pace.

Of course, if a tax cut makes the economy more productive -- one of its proponents' aims -- it would help the economy grow more quickly without overheating. The problem is that the pickup in growth would likely come before productivity gains kick in.

The same could be said for the fiscal spending plans that would be under discussion in the alternative universe where Hillary Clinton won the presidential election.

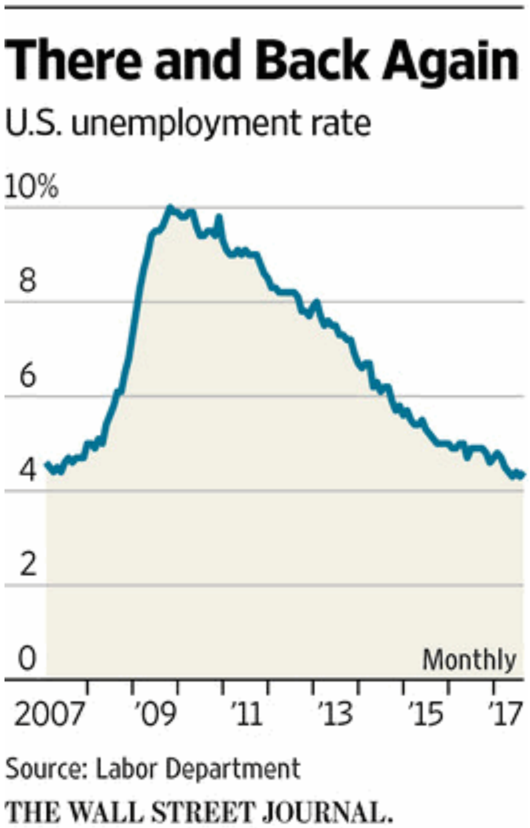
The extra heat tax cuts would throw off complicates the picture for the **stock market**.

Earnings, particularly at domestically focused companies, would certainly benefit from a lower corporate rate, while multinationals would do better on the repatriation front.

Lower individual tax rates, particularly those aimed at the middle class, should increase sales at consumer-facing companies.

But interest rates would likely head higher as the Fed took a more hawkish turn, hurting many of the companies that would benefit from a tax cut.

Investors could struggle to find places to put their windfall to work.



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The New York Times

ECONOMIC SCENE
Business/Financial Desk; SECTB
Will Tax Holiday Generate Jobs? It Didn't a Decade Ago

By EDUARDO PORTER
1,678 words
27 September 2017
The New York Times
NYTF
Late Edition - Final
1
English

It was the summer of 2004, and to the glee of multinational corporations across the United States, a bipartisan majority in Congress offered them a gift they had long sought: an opportunity to repatriate billions of dollars stashed overseas and pay just 5.25 percent in taxes, instead of the statutory corporate rate of 35 percent.

They had lobbied hard for this -- dangling before members of Congress the promise that the repatriated money would add more than 500,000 jobs in the United States over the next two years, as companies paid down debt and engaged in more capital spending, acquisitions, and research and development.

The jobs, however, didn't come. In an analysis a few years later, Kristin J. Forbes, an economist at the Massachusetts Institute of Technology who had been on President George W. Bush's Council of Economic Advisers when the tax holiday came into effect, and two colleagues from Harvard and the University of Illinois at Urbana-Champaign found that though $299 billion in corporate earnings flowed back into the country during the holiday year of 2005 -- almost five times the average of the preceding five years -- companies found a better way to use the money. "Repatriations did not lead to an increase in domestic investment, domestic employment or R.&D.," the authors wrote.

The smell of a tax holiday is back in the air. From Apple to Facebook to Starbucks, big business is waiting with bated breath for details on President Trump's promise to slash the tax rate on profits held abroad to encourage companies to bring the money home.

Apple alone is sitting on an overseas stash of almost $260 billion, according to Bloomberg, while Microsoft has more than $120 billion parked abroad. The pharmaceutical giant Pfizer does not regularly disclose how much of its offshore profits are stored in foreign tax havens, but the Institute on Taxation and Economic Policy estimates that at the end of 2016, it held almost $200 billion abroad.

Of course, the standard claims are being made about the vast stimulative effects of the repatriated cash. They are being met this time with vigorous counterclaims based on the results of the Bush administration's shot over a decade ago.

Back then, companies found their way around regulations forbidding this use of the money to simply benefit shareholders and corporate chiefs. A Senate commission reported that the top 15 repatriating corporations reduced their overall United States work force by 20,931 jobs, even as share buybacks increased and the annual compensation for their top five executives jumped 27 percent from 2004 to 2005 and another 30 percent the next year.

Pfizer, for instance, brought back $35.5 billion, the largest amount repatriated by a single company during the tax holiday, according to the Senate report. Then it turned around and spent over $20 billion in stock repurchases from 2005 to 2007. By 2007, the aggregate compensation of its top five executives was nearly $13 million higher than in 2004. Its United States payroll was 12,000 smaller.

The pattern was similar across most repatriating companies. Hewlett-Packard, which brought home $14.5 billion, bought back $22 billion worth of stock over the three years and cut its payroll by more than 8,500. The tobacco company Altria, which brought over $6 billion home during the holiday, spent $2.5 billion on share buybacks and bumped pay in the executive ranks by more than $50 million, but cut 6,000 jobs.

A few years back, Ms. Forbes explained to my colleague Floyd Norris how the computer manufacturer Dell had lobbied hard for the holiday -- claiming that part of the money would be used to build a plant in Winston-Salem, N.C. ''They did bring back $4 billion, and spent $100 million on the plant, which they admitted would have been built anyway,'' she said. ''About two months after that, they used $2 billion for a share buyback.''

With a new move afoot to put such holdings back on American books, there is a critical question that is too quickly glossed over: Why do businesses act this way? Why didn't corporate executives invest more in their businesses and their work forces? Why did they go to the trouble of dribbling around a rule forbidding the use of repatriated profits to pay themselves a bonus? (Note to Congress: Money is fungible.)

Call me naïve. Professor Forbes and her colleagues -- indeed, many economists -- might swat the question away by arguing that businesses didn't use the extra cash to invest and employ because they were well-run businesses, well invested and sufficiently staffed to maximize their profitability.

There is truth to this argument. In fact, most corporate investment today comes not from retained earnings but from borrowing. Bringing a foreign profit stash home has little effect on investment incentives.

Still, the question should resonate in an administration that came to power on a promise to address the plight of the working class. Because the working class stands on the other end of a deal with the corporate class. I don't think it is possible to fully address workers' demands without understanding, and changing, corporate motivations.

Many forces have shaped this deal, including technology, which replaced workers performing routine tasks, and globalization, which squeezed the margins of many businesses and exposed their workers to competition from cheap labor markets. And yet it would be a mistake to ignore the impact of a corporate ethos that has come to focus on rewarding shareholders and executives at the expense of any other consideration -- be it workers' welfare or even the company's long-term sustainability. Indeed, workers today amount to little more than a line on the cost side of businesses' balance sheets, with little claim to its prosperity.

Corporate profits have risen over the last quarter-century, as a share of the nation's income, even as the workers' share has shrunk. While executive pay has soared -- padded with stock options and shares -- the earnings of ordinary workers are below where they were in the 1970s. What's more, the pensions that ensured workers a retirement perch in the middle class have been replaced by 401(k) savings accounts -- which are cheaper for companies but put workers' retirement prospects at the mercy of the **stock market**.

''How you divide the pie is a choice,'' said Rick Wartzman, who heads the KH Moon Center for a Functioning Society at the Drucker Institute of Claremont Graduate University. ''It is being carved differently.''

The change has happened across the board. In his book ''The End of Loyalty,'' published in May by Public Affairs, Mr. Wartzman lays out a shift in corporate culture both in success stories like Coca-Cola and General Electric and in less successful ones, like Eastman Kodak and General Motors. ''For workers, the story was the same, whether they were working at a winner or a losing firm,'' he said.

The good news is that it is not impossible to modify the behavior of the corporate leaders who have so drastically altered the contract with their work force over the last few decades. While it may be tempting to cast the new breed of executives as selfish villains who somehow lost their sense of right and wrong, the shift in their behavior responded to a shift in the incentives they faced. It was fed by a belief that snaked its way three or four decades ago from the halls of the University of Chicago through investment-bank trading floors and into the corner offices of corporate America: that the interests of corporate managers must be brought into tight alignment with those of shareholders. It was accompanied by one of the most destabilizing propositions in the modern history of corporate governance: This alignment was best achieved by paying corporate managers almost exclusively with stock.

Mihir A. Desai of Harvard Business School argues that this strategy amounted to outsourcing corporate compensation decisions to the capital markets -- which have no way of telling whether the rise or fall in shares is caused by executives' strategies or simply luck. This produced an enormous bubble in chief executive pay -- which rose in tandem with the stock. It also made chief executives' jobs more uncertain, vulnerable to market downturns. And it vastly distorted their behavior, putting every decision at the service of the share price at the close of the quarter.

Professor Desai points out that in the end, this structure does not really serve shareholders, at least not those with an interest in a company's prosperity more than a few quarters down the road. ''Capitalism seems to be serving managers and investment managers at the expense of shareholders,'' he wrote.

Changing this behavior is not beyond the reach of policy. Just as changes in the tax treatment of executive pay in the 1990s encouraged stock-based remuneration, tax reforms might motivate corporate executives to invest for the long term rather than for an immediate stock bump -- maybe even encourage stable employment and worker training. Until then, offering tax breaks to American corporations seems more likely to line the pockets of executives and shareholders than to improve their long-term prospects or the prosperity of their workers.

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An Apple store in Shanghai. Apple is estimated to hold almost $260 billion overseas, out of the reach of United States tax authorities. During the Bush era, many companies used repatriated money to benefit shareholders and executives. (PHOTOGRAPH BY YUYANG LIU FOR THE NEW YORK TIMES) (B1); Pfizer products being packaged in Lincoln, Neb. The pharmaceutical giant spent billions in stock repurchases from 2005 to 2007. (PHOTOGRAPH BY DAVE WEAVER/ASSOCIATED PRESS) (B4) CHART: Profits Held Outside the U.S.: The 10 companies with the most profit held outside the United States last year, in billions. (Source: Institute on Taxation and Economic Policy) (B4)

Document NYTF000020170927ed9r0005q

The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Indexes Finish Slightly Higher as Tech Shares Rebound

By THE ASSOCIATED PRESS
765 words
27 September 2017
The New York Times
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Late Edition - Final
4
English

NEW YORK -- Stock indexes in the United States finished barely higher on Tuesday after a late slump erased most of an early gain. Technology companies recovered some of the losses they took a day earlier, but energy companies and banks slipped.

Strong gains for the software company Red Hat and recoveries for big names like Apple and Facebook helped technology companies move higher. Cruise lines rose after Carnival had a stronger third quarter than analysts expected. Small-company stocks continued to set record highs.

With little corporate or economic news to focus on, investors turned their attention to a speech by the Federal Reserve chairwoman, Janet L. Yellen, for clues about the Fed's thinking on interest rates.

Ms. Yellen told a conference of economists that the Fed is puzzled that inflation remains so low. While she and other policy makers still think inflation will eventually reach the Fed's 2 percent target, Ms. Yellen conceded that the Fed may need to change its assumptions.

Ms. Yellen also said the Fed should take care not to raise rates too slowly. J J Kinahan, chief strategist for TD Ameritrade, said that was notable.

''That was a little bit stronger language than we've seen before,'' he said. Mr. Kinahan said investors have concluded over the last two weeks that the Fed will raise interest rates again in December, and Ms. Yellen's remarks did nothing to dispel that idea.

The **Standard & Poor's 500**-**stockindex** added 0.18 points to 2,496.84. The **Dow Jonesindustrial average**, which rose as much as 73 points during the day, lost 11.77 points, almost 0.1 percent, to 22,284.32 as McDonald's fell and Chevron went into a late slide.

The **Nasdaq composite** index gained 9.57 points, or 0.2 percent, to 6,380.16 after a drop of 0.9 percent on Monday. The Russell 2000 index of smaller-company stocks gained 4.91 points, or 0.3 percent, to a record 1,456.86.

Carnival's third-quarter profit and revenue surpassed Wall Street's expectations. The cruise line raised its annual forecasts and said bookings and prices for next year are higher than at this time a year ago. Carnival gained $1.82, or 2.9 percent, to $65.32, and competitor Royal Caribbean Cruises rose $3.31, or 2.9 percent, to $117.19.

The open-source software maker Red Hat climbed $4.31, or 4.1 percent, to $110.07 after reporting a better-than-expected second quarter. The chip maker Nvidia rose after it said several major Chinese companies, including e-commerce giants Alibaba and Baidu, will use its products in data centers and cloud computing platforms. It added 96 cents to $171.96.

Apple picked up $2.59, or 1.7 percent, to $153.14, and Facebook rose $1.34 to $164.21.

Benchmark United States crude slid 34 cents to $51.88 a barrel in New York. Brent crude, the standard for international **oil prices**, gave up 58 cents to $58.44 a barrel in London. Chevron gave up 47 cents to $117.52, and Schlumberger fell 83 cents, or 1.2 percent, to $68.82.

Equifax announced the retirement of its chairman and chief executive, Richard F. Smith, as the credit reporting agency tries to clean up a mess left by a data breach that exposed highly sensitive information about 143 million Americans.

Equifax fell early on, but recovered to finish 96 cents higher at $106.05.

Wholesale gasoline lost 2 cents to $1.70 a gallon. Heating oil retreated 1 cent to $1.85 a gallon. Natural gas remained at $2.92 per 1,000 cubic feet.

Bond prices declined. The yield on the **10**-**year Treasury** note rose to 2.23 percent from 2.22 percent.

Gold lost $9.80 to $1,301.70 an ounce. Silver declined 26 cents to $16.88 an ounce. Copper fell 2 cents to $2.92 a pound.

The dollar rose to 112.17 yen from 111.61 yen. The euro fell to $1.1798 from $1.1846.

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AP Markets Writer Marley Jay can be reached at http://twitter.com/MarleyJayAP His work can be found at https://apnews.com/search/marley%20jay

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

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

Document NYTF000020170927ed9r0005c

The New York Times

White Collar Watch
Business Day; DealBook
S.E.C. Hacking Response Provides Road Map for Compromised Companies

By PETER J. HENNING
1,264 words
26 September 2017
03:38 PM
NYTimes.com Feed
NYTFEED
English

Guess whose database was hacked, exposing sensitive information that could be used for illegal profit, but who failed to disclose that information to the public in a timely manner?

If you picked Equifax, which disclosed a breach on Sept. 7 that resulted in the theft of personal financial information of as many as 143 million Americans, you would only be half right.

The Equifax hacking drew more attention because of its scope, but a potentially more threatening attack — for those who know what to do with the information — was the breach of the Securities and Exchange Commission electronic system known as Edgar, which receives 1.7 million corporate and securities filings a year.

In a late-evening statement last week, the S.E.C. chairman, Walter J. Clayton, said the commission learned last month that a digital breach it detected in 2016 "may have provided the basis for illicit gain through trading."

That information was buried in Mr. Clayton's statement, which otherwise appeared to concern the general matter of cybersecurity. In prepared testimony for his appearance on Tuesday before the Senate Banking Committee, he said he did not learn of the breach until August, when the investigation of possible illegal trading was brought to his attention.

For an agency that prizes prompt disclosure of accurate information and has pursued enforcement cases for companies that fail to disclose or update information for investors, it appears that the S.E.C. could use a dose of its own medicine.

But the hacking is more than a simple stumble for the S.E.C. It has provided a road map for what compromised companies can say in the future — using the S.E.C.'s own words — and raised the question of how the commission would secure hugely valuable information if it succeeds in its goal of collecting even more of it.

In announcing the breach last week, Mr. Clayton noted that "even the most diligent cybersecurity efforts will not address all cyberrisks that enterprises face." Those words are certain to be cited back to the S.E.C. by any company — especially Equifax — when questions are raised about the systems it uses to prevent digital attacks and make a timely disclosure to the public when they do occur.

The Edgar system has been misused before, including a 2015 scheme to manipulate the shares of Avon by filing a fake tender offer for the company that temporarily drove up the value of its shares. That is akin to a spam email or another type of spoof that has a modest impact on the market and does not raise questions about the probity of the financial system.

The more ominous message about the breach is that only recently has it come to light that the information may have been used to generate trading profit. Much of what is in the Edgar system is made available to the public, but any preview before the release of information can be turned into enormous profit now that trading strategies can be executed in milliseconds.

Although Mr. Clayton claimed that the hacking did not "result in systemic risk," the misuse of confidential information — especially when noticing it may have taken months — threatens the integrity of the **financial markets**.

The use of stolen information from the Edgar system has been likened to insider trading, but there is a crucial difference when hacking is involved. Insider trading requires showing a violation of a fiduciary duty in misusing the information for personal gain, but hackers are thieves who are bound by no such fiduciary duty.

It is no surprise that the hackers are at risk of penalties — in 2015, the Justice Department and the S.E.C. charged a group of Ukrainian hackers with fraud over trading on market-moving information before it was released to the public, generating profit of more than $100 million. A 2009 decision of the United States Court of Appeals for the Second Circuit in Manhattan in S.E.C. v. Dorozhko allowed civil securities fraud charges to proceed against a hacker who gained access to a company's earnings report to trade on it before its release.

But what of those who might have acquired that information from them? For a start, they are not at risk of insider trading charges. And criminal charges could hinge on proving that they knew the information had been acquired illegally.

The insider trading laws do not apply because someone who acquired the information would not be what is known as a "tippee" under the fiduciary duty analysis. But prosecution is possible under a federal statute, 18 U.S.C. § 641, that makes it a crime to receive "any record, voucher, money, or thing of value" knowing it has been stolen and using it for personal gain.

That provision has been interpreted by the federal appeals courts to cover intangible property, so anyone buying confidential information from the Edgar database could come within this prohibition. Proving knowledge when someone buys stolen property can be a challenge because one can always profess ignorance, but prosecutors have had success in showing that a buyer was deliberately ignorant of how information had been acquired. Keeping your head in the sand does not mean you lacked the requisite intent.

For the S.E.C., the hacking makes protecting private information even more important as it embarks on creating a new database known as the Consolidated Audit Trail that will host a trove of information about every order in the securities and options markets, including the identity of each account holder. The goal is to open a window for the agency into whether there is any manipulation of the markets or to provide a means to determine the cause of trading disruptions, such as the "flash crash" in 2010, when the **Dow Jonesindustrial average** dropped more than 600 points in a matter of minutes.

The C.A.T. will have enormous potential value — far beyond what is in the Edgar database — by potentially giving clues about the trading strategies of large investors, such as mutual funds and pensions, that buy and sell millions of shares daily. Imagine how much a peek at that information would be worth to traders looking to get out ahead of large transactions to profit from the small changes in stock prices when they hit the market.

The temptation to hack the database will be powerful, which means protecting it will be one of the S.E.C.'s highest priorities. Can the agency be trusted with that much valuable information? The industry has resisted the creation of the C.A.T., and the hacking at the S.E.C. will be an additional argument for those seeking to derail the program.

If Mr. Clayton is right that cyberattacks are going to happen even with the best defenses in place, then the small software flaws that hackers exploited at the S.E.C. and Equifax add fuel to the fire of doubt about how secure anyone's information can be.

* S.E.C. Rules to Protect Investors From Cyberthreats Fall Short

* S.E.C. Says It Was a Victim of Computer Hacking Last Year

* Equifax C.E.O. Richard Smith Is Out After Huge Data Breach

Walter J. Clayton, the chairman of the Securities and Exchange Commission, told a Senate panel on Tuesday that he was first told in August that the commission's systems were breached in 2016. | Pablo Martinez Monsivais/Associated Press

Document NYTFEED020170926ed9q006pp

THE WALL STREET JOURNAL.
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GOP's Next Uphill Job: Revamping Tax Code --- Treasury Secretary Mnuchin comes to the task as a political newcomer

By Richard Rubin and Kate Davidson
1,841 words
26 September 2017
The Wall Street Journal
J
A1
English

Steven Mnuchin is facing the biggest test of his short political career.

The Treasury secretary has been working for months to bridge divides between an impulsive president and a fractious Congress to deliver on the Republican Party's promise of a simpler tax code with lower rates.

He has a powerful tailwind. Both Donald Trump and Republican lawmakers have promised a tax overhaul, which now remains one of their biggest domestic policy priorities since their efforts to repeal or overhaul the Affordable Care Act have so far fallen flat.

Stacked against Mr. Mnuchin, as negotiations near the make-or-break stage, are unresolved intraparty disagreements over how much lost tax revenue is acceptable and how tax cuts should be apportioned among companies, high-income earners and the middle class. Lobbyists stand ready to resist almost any proposed changes.

Mr. Mnuchin is tackling this terrain with less political experience than any other recent Treasury secretary. He didn't follow the trajectory of Henry Paulson or Robert Rubin, who acquired Washington contacts while leading Goldman Sachs Group Inc. And while Mr. Mnuchin has a close relationship with the president, it doesn't appear to be like that of James Baker with Ronald Reagan, which allowed Mr. Baker to manage the last major revamp of the tax code.

By contrast, Mr. Mnuchin this month found himself overruled by the president on a policy issue, the debt ceiling.

"This tax policy is the first pitch over the plate that he's got to hit," said Tom Barrack, who worked with Mr. Mnuchin to raise money for the Trump campaign last year.

A sweeping tax-code rewrite hasn't happened since 1986, because tax overhauls are complex and touch almost every aspect of the economy. For this year's attempt, Congress must first agree on a fiscal 2018 budget, the vehicle through which tax changes could be passed on a party-line vote without Democratic support. Both houses are moving forward on the budget, most recently with a deal in a Senate panel that would permit tax cuts of up to $1.5 trillion over a decade.

The next step is the release of a GOP blueprint expected this week, which will spell out in more detail where the party, including Mr. Mnuchin, want to take tax policy. The plan is expected to call for lower tax rates on businesses and individuals, with the corporate tax rate in the low 20% range, setting a framework for Congress to fill in over coming months.

Mr. Mnuchin is playing two roles in the tax negotiations -- number cruncher and Trump liaison, both of which put him in a position to directly shape the legislation coming from Capitol Hill by helping lawmakers understand the White House's preferences.

That is a role he also played in the campaign, recalled Larry Kudlow, an economist and TV commentator who advised Mr. Trump during his run.

"He's a numbers guy, which we liked very much," Mr. Kudlow said of Mr. Mnuchin. "He rolled his sleeves up and got involved."

Lawmakers working most closely with Mr. Mnuchin on tax policy, such as House Ways and Means Chairman Kevin Brady (R., Texas) and Senate Majority Leader Mitch McConnell (R., Ky.), praise his hard work on the subject and say he is a valuable partner. "As [Mr. Mnuchin] regularly reminds us, this is a pass-fail exercise," Mr. Brady said in an interview.

Other corners of the Congress don't view him as favorably. The pressure he applied to House Republicans during a debate over the debt limit left a sour taste in some mouths. And some Democrats, particularly in the House, say they appreciate his outreach but aren't sure if he can represent Mr. Trump's positions in a negotiation.

"I don't know that yet, given the **volatile** nature of what the president does with technology," said Rep. Richard Neal of Massachusetts, the top Democrat on Ways and Means.

Mr. Mnuchin once foresaw a tax overhaul as early as the spring, then by August. Now the aim is to get it done by year-end. With only about 40 working days left on the congressional calendar, that timetable also is looking hard to meet. He has also found himself in the spotlight for reasons other than tax and financial policy, including his use of government planes and a public plug for "The Lego Batman Movie" he helped finance.

Rep. Jim Himes (D., Conn.), who like Mr. Mnuchin is a former Goldman Sachs banker, says people who come to government from business sometimes think hierarchically or assume negotiations can lead to a middle ground. But "in Washington, there are people who will stop you just to show that they can," Mr. Himes said. "It's a much, much more complicated negotiation."

Mr. Mnuchin's route to this job started almost by accident.

His career has taken him from Goldman, where he rose to chief information officer, to running a hedge-fund firm and then a mortgage lender, IndyMac Bank, purchased from the government after the lender's failure in 2008. Through the hedge fund he got into movie financing.

He and Mr. Trump became friends about 15 years ago, seeing each other socially and occasionally talking business opportunities. Mr. Mnuchin once considered investing in the firm that owned Mr. Trump's "The Apprentice" show, but a deal didn't pan out, Mr. Mnuchin said in an interview last month.

He had no formal campaign role until he stopped by Mr. Trump's New York primary victory party at Trump Tower on April 19, 2016, on his way to dinner. Mr. Trump spotted him while stepping off the elevator and invited him onto the stage.

"The next thing I know I'm standing right behind him, and I'm on national TV, on four different monitors, my phone is like going crazy buzzing," recalled Mr. Mnuchin, who is 54 years old. Mr. Trump phoned the next morning to offer him the job of campaign finance chairman.

Hedge-fund manager Eddie Lampert, who was Mr. Mnuchin's roommate at Yale, said the financier "was in a position where he was open to basically dedicating himself to something."

The road to a tax overhaul hasn't been a smooth one. One Friday in April, Mr. Trump unexpectedly told the Associated Press the Treasury would have a tax plan by the following Wednesday. Mr. Mnuchin had been saying publicly a plan wouldn't be released until more progress was made in talks with congressional Republicans.

West Wing officials cautioned that Mr. Trump's deadline was more of a suggestion, but an hour later he advertised it again. "We'll be having a big announcement on Wednesday," he said at a Treasury ceremony to sign executive orders, looking over his shoulder at Mr. Mnuchin standing behind him. "So go to it."

"I will, Mr. President," Mr. Mnuchin responded with a grin.

The following week, the White House released a one-page outline that called for lowering tax rates for all Americans, ending the federal estate tax and cutting the corporate tax rate to 15% from 35%. The plan drew criticism as less specific than Mr. Trump's campaign promises.

In a May dinner that included former Treasury and Federal Reserve leaders, Mr. Rubin and Lawrence Summers, both former Democratic Treasury secretaries, cautioned Mr. Mnuchin about making public statements that could undermine his credibility in markets, according to a person familiar with the matter.

Through the spring and summer, Mr. Mnuchin hashed out tax plans with Mr. McConnell, House Speaker Paul Ryan (R., Wis.), Senate Finance Committee Chairman Orrin Hatch (R., Utah) and House Ways and Means

Chairman Mr. Brady. Those five plus White House economic-policy director Gary Cohn released a statement of tax principles in late July, though little more specific than the April summary.

The main decision it included was dropping a House "border adjustment" proposal to tax imports and exempt exports, which might have generated $1 trillion to make up for lost revenue from rate reductions. The administration has publicly identified only one major tax break they would eliminate, the deduction for state and local income taxes. Officials stuck to their optimism that a tax overhaul would be done by year-end.

Eight months into his tenure, Mr. Mnuchin lacks a full roster of officials at the Treasury, though he has filled several senior tax jobs recently. The administration has decided for now not to fill the deputy secretary job, leaving others to report to Mr. Mnuchin directly.

On Mr. Mnuchin's side is his relationship with the president, to whom he has shown unfailing loyalty. Mr. Mnuchin said he and the president speak almost every day. Several administration officials and allies described Mr. Mnuchin as the "presidential whisperer."

In August, when the president was criticized for blaming "both sides" for the violence at a Charlottesville, Va., demonstration, Mr. Mnuchin issued a written statement defending Mr. Trump, which was approved in advance by the president, according to a White House official. It was a contrast with Mr. Cohn, who told the Financial Times the Trump administration must do better in "unequivocally condemning" such groups.

In a written statement, Mr. Trump said Mr. Mnuchin "works every day to put an end to the rigged economy and put money back in the pockets of hardworking Americans."

The closeness between the two men, however, doesn't mean they are always on the same page. At a key moment in an Oval Office negotiation this month, Mr. Trump cut Mr. Mnuchin off midsentence, ending his argument for a long-term extension of the debt ceiling. The president instead took a short-term deal offered by Democratic leaders.

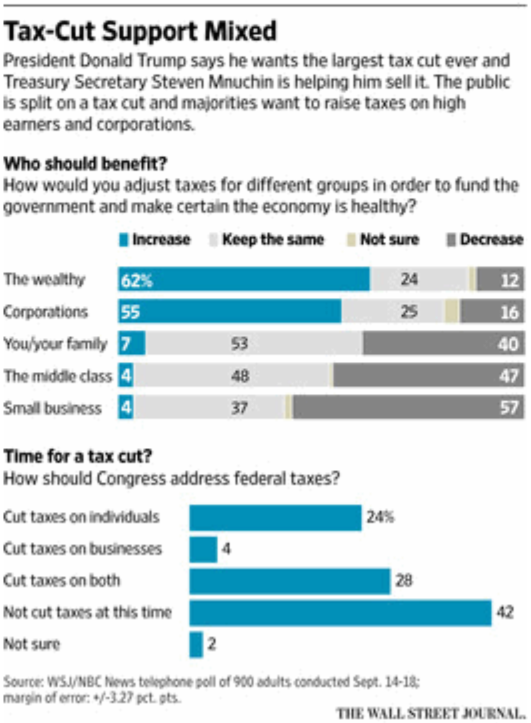
Two days later, Mr. Mnuchin urged House Republicans to go along with Mr. Trump's decision, at one point asking them to "vote for the debt ceiling increase for me," according to several House members. The pitch was met with disbelief by some. "I didn't buy it," said Rep. Dave Brat (R., Va.) "I just found it intellectually insulting."

Mr. Mnuchin, in the August interview, said, "I wouldn't be here if I were uncomfortable being able to voice my opinions on things, but again, to him they're my opinions. He as president has to make very difficult decisions."

Mr. Trump, by siding with Democrats on the debt ceiling and recently working with them to find common ground on immigration, has opened the possibility of a path that brings the opposition party along on taxes.

Most Democrats say any tax overhaul should not increase budget deficits or cut taxes for high-income households. The latter point would square with recent comments from Mr. Trump but not with the plan he and Mr. Mnuchin wrote during the campaign.

Nick Timiraos and Michael C. Bender contributed to this article.



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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Rare Stumble by Tech Shares Ensnares Broader Indexes

By THE ASSOCIATED PRESS
710 words
26 September 2017
The New York Times
NYTF
Late Edition - Final
2
English

Technology stocks slammed into reverse on Monday, and the losses overshadowed gains in other areas to send broad United States indexes lower.

Treasury **bond prices** and gold rose as investors looked for safer places for their money after the latest escalation in the heated exchanges between the United States and North Korea. Stock markets around the world were mixed after the leader of Europe's largest economy retained her position, though her political strength may have weakened.

The **Standard & Poor's 500**-**stockindex** dropped 5.56 points, or 0.2 percent, to 2,496.66. The **Dow Jonesindustrial average** fell 53.50 points, or 0.2 percent, to 22,296.09, and the **Nasdaq composite** index dropped 56.33, or 0.9 percent, to 6,370.59. Smaller stocks held up better than the rest of the market: The small-cap Russell 2000 index rose 1.18, or 0.1 percent, to 1,451.96.

The day's action was centered on the technology sector, and tech stocks in the **S**.**&P**. **500** lost 1.4 percent. That is more than three times the loss of any of the other 10 sectors that make up the index, and the losses were broad: Facebook and Nvidia each lost 4.5 percent, and the video game developer Electronic Arts lost 3.6 percent.

Any stumble for tech this year has been notable given how much better it has done than the rest of the market. Tech stocks in the **S**.**&P**. **500** have jumped 23 percent in 2017, double the index's overall gain.

''There have been a lot of dollars trafficking in these areas that have been winners the last year or so,'' said Nathan Thooft, senior portfolio manager at Manulife Asset Management. ''As people get scared -- as they see better opportunities elsewhere, or as they see someone else heading for the gates -- it's a bit of a self-fulfilling prophecy,'' he said, in which investors look to sell their tech stocks before everyone else does.

As investors moved out of tech stocks on Monday, some money flowed into areas of the market that have not done as well.

Energy stocks, which have been the worst performers in the **S**.**&P**. **500** this year, had the day's strongest gains. Marathon Oil gained 3.1 percent, and Noble Energy rose 2.7 percent.

They rose with the price of oil, which has been holding above $50 a barrel in recent days after spending most of the summer below that level. Benchmark United States crude rose $1.56 to settle at $52.22, and Brent crude, the international standard, jumped $2.31 to $59.17 a barrel.

Genuine Parts had the biggest gain in the **S**.**&P**. **500** after it said it would buy Alliance Automotive Group, a European distributor of auto parts, tools and workshop equipment. Genuine Parts valued the deal at $2 billion, including debt.

Genuine Parts gained $5.24, or 6 percent, to $93.22.

Investors were also keeping a close eye on tensions between North Korea and the United States. On Monday, North Korea's foreign minister said Mr. Trump's threat over the weekend that the country's leader, Kim Jong-un, may not be ''around much longer'' was a declaration of war.

Prices for United States Treasuries jumped after the North Korean official made his comments. The yield on the **10-year Treasury** note fell to 2.22 percent from 2.25 percent.

The price of gold had been down in morning trading, but it quickly reversed course after the North Korean statement. It rose $13.50 to $1,306.80 per ounce.

In overseas markets, the German DAX index was virtually flat after Chancellor Angela Merkel won a fourth term.

The euro fell to $1.1847 from $1.1931, and the British pound slipped to $1.3464 from $1.3518. The dollar fell to 111.65 Japanese yen from 112.46 yen.

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

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THE WALL STREET JOURNAL.
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The Future of Finance (A Special Report) --- Should We Move to a Mostly Cashless Society?

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25 September 2017
The Wall Street Journal
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R1
English

The role of cash in the U.S. economy is shrinking, thanks to technology that allows for so many other ways to pay for things.

American consumers used cash in 32% of all retail transactions in 2015, down from 40% in 2012, according to the Federal Reserve's most recent survey of payment choices. Cash accounted for just 9% of the value of payments by consumers in 2015, down from 14% in 2012.

But it's one thing for consumers to choose to use less cash. It's another for governments to dramatically reduce its supply. Supporters say that would crimp criminal activity, among other benefits, because criminals rely so heavily on cash transactions. But others worry that the impact on people who depend on cash for legal activities would be too high a price.

Yes:

It Would Mean Less Crime

And Greater Fed Flexibility

By Kenneth S. Rogoff

It is high time for governments in the U.S. and other countries with advanced economies to accelerate the move that has long been under way toward a smaller role for cash.

The payoff: reductions in crime and tax evasion, and greater flexibility for the Federal Reserve to stimulate the economy when necessary.

Although there are a number of approaches the U.S. government could take, an obvious and relatively benign way to start would be to gradually phase out large-denomination notes, of say $50 and above, over a period of five to seven years, after a period of study and public comment.

Let's look at where we are now. Currency use continues its long decline, thanks mainly to ever-improving alternatives including contactless payments and person-to-person payment networks such as Venmo.

Yet there are three dozen $100 bills in circulation for every man, woman and child in the U.S. If you don't have three dozen, or any, you're not alone. Only a fraction of paper currency can be accounted for in surveys of consumer and business holdings. So where is all that missing cash? Most of it is in the underground economy, where it fuels criminal activity and business that goes untaxed.

In the underground economy, cash plays a big, well-established role for which there is no remotely perfect substitute in terms of liquidity and universal acceptance. That's why reducing the supply of cash, particularly large bills, would reduce crime and tax evasion.

Without any $50 or $100 bills available, why wouldn't criminals and tax evaders simply switch to smaller bills? Consider this: $1 million in $100 bills weighs 22 pounds; the same amount in $20s would weigh 110 pounds, and take up a large suitcase instead of a small briefcase, making transport more difficult. Criminals and tax evaders also need to hide their cash. If you just have $100,000 to hide, the size of the bills hardly matters. But for wholesale crime and tax evasion -- which are rampant -- it is a big deal.

The concern that an absence of large bills would compel organized crime to involve legitimate businesses in the use of false invoices and bogus checks to pay for criminal transactions is overblown. This might happen on a very small scale, but not to an extent that would come close to outweighing the larger beneficial effect on crime.

Another advantage of eliminating large bills would be the effect on monetary policy. The Federal Reserve should be able to implement negative nominal interest rates vastly more effectively in the absence of large bills, which could prove quite important as a stimulative tool in the next financial crisis.

The biggest obstacle to deeply negative interest rates is the concern that they would cause big institutional investors to bail out of negative-rate Treasury bills and bonds and move that money into physical cash, to preserve its value. That would blunt the stimulative impact of the negative rates.

Getting rid of $50s and $100s would discourage such hoarding, because transporting, storing and protecting cash is costly. In general, it will be easier for the Fed to take steps to stem a run into cash if it has already become marginalized in legal use.

There are several problems with the alternative idea of raising the inflation target so that the resulting higher interest rates would give the Fed more room to lower rates in a crisis without going negative. Among the biggest: Ditching the Fed's longstanding commitment to low inflation would destabilize **financial markets**. Longer term, higher inflation would result in more frequent adjustment of prices and wages, lessening the impact of Fed policy throughout the cycle. Moreover, with the effects of cuts muted, the Fed would still quickly run out of ammunition in a crisis. And yes, inflated $100s would become more like smaller bills over time, but that would simply spark calls for printing larger denominations.

The phasing out of large bills should have relatively little impact on the vast bulk of the population, who make little use of $100s. For those who rely on cash because they don't have bank accounts, efforts to bring them into the banking system would help. If countries ranging from Sweden to India can efficiently provide free debit accounts to low-income individuals, so too can the U.S.

Abandoning cash entirely would be folly into the foreseeable future, for reasons of privacy, the need for cash in the wake of disasters like hurricanes, and the convenience of cash for small payments. But a society that uses far less cash is inevitable and desirable.

Dr. Rogoff is the Thomas D. Cabot professor of public policy at Harvard University, former chief economist at the International Monetary Fund and co-author of "The Curse of Cash: How Large- Denomination Notes Aid Crime and Tax Evasion and Constrain Monetary Policy." He can be reached at reports@wsj.com.

No:

It Would Hurt All Those

Without Bank Accounts

By James J. McAndrews

The U.S. won't become mostly cashless anytime soon, and that is a good thing, because millions of Americans depend on cash to keep themselves afloat financially.

As alternatives ranging from debit and credit cards to E-ZPass and others continue to grow in popularity, many consumers can lead a mostly cashless life if they so wish without facing too many inconveniences.

Others aren't so lucky. According to the 2013 U.S. Survey of Consumer Finance, about 7.5% of American households don't have bank accounts. Cash is an important way for them to participate in the economy -- to receive wages and to buy goods from a variety of sellers. Until the U.S. has a financial system that serves these people, cash is vital.

But what if we just phased out $50 and $100 bills? Would that harm these people? It would at least make life more difficult for them, and others. And, while it might help reduce certain types of crime and tax evasion because of the reliance of much criminal underground activity on large-denomination bills, It would fuel a different kind of crime: It would draw many legitimate businesses into criminal activity, because organized crime would forcibly involve them in noncash criminal transactions to get around the absence of large bills.

Surveys that reveal most people hold little cash don't reflect the urgent demands for high-denomination bills that many people have on occasion. For example, people seeking medical procedures they want to keep secret; the immigrant day laborer who sends cash to family in his home country; the wealthy homeowner after Hurricane Harvey who seeks to assist neighbors and restore her property.

These uses of high-denomination currency are extremely high-value to the individual and society. We would lose a lot if we eliminated the bills that can meet these urgent, and sometimes desperate, needs. Then there are the everyday uses of large bills. Day laborers, for instance, are paid in cash and pay their rent the same way.

Legitimate businesses, meanwhile, would be put at risk. Imagine a thief has stolen a valuable collection of art and arranged to sell it to the mafia. Today, the mob could pay the thief in $100s and there would be no record of the transaction. But in the absence of large bills, the mob needs another payment option that still obscures its involvement, and one way to do that is to draw in a third party through the use of fraudulent invoices.

The mob would force a legitimate business to write a check to the thief, disguised as a payment for an invoice from a nonexistent company for services that were never actually rendered. The legitimate business wouldn't lose that money -- the mob would deposit that amount in the business's account, disguised as a payment for goods or services. But the business would be guilty of criminal activity that could ultimately destroy it.

The mob can force companies to do this by threatening violence, or by threatening to expose a company's noncompliance with zoning laws or employment of undocumented workers. There are other ways for the mafia to deal with an absence of large bills, but I believe this scenario would be common.

There is a way to achieve the results promised by phasing out large bills -- disrupting criminal activity and giving the Fed more leeway in its interest-rate policy -- without also abruptly disrupting legitimate economic activity and creating unwilling new criminals: Raise the inflation target.

A higher inflation target would be followed by a higher inflation rate, which would be accompanied by higher nominal interest rates. That would give the Fed more room to cut rates without having to resort to negative nominal rates, removing the danger of negative rates causing a run to cash.

A higher inflation rate also would mean the real values of $50 and $100 bills would decline more quickly -- meaning criminal activity would be disrupted by the need to transport, store and exchange many more bills. Of course, this also would impose that same inconvenience on the legitimate uses of large bills. But while a higher inflation rate would accelerate the need for more bills to complete transactions, that would still happen over a much longer time frame than the phaseout of large bills envisioned in this discussion, giving people much more time to adjust.

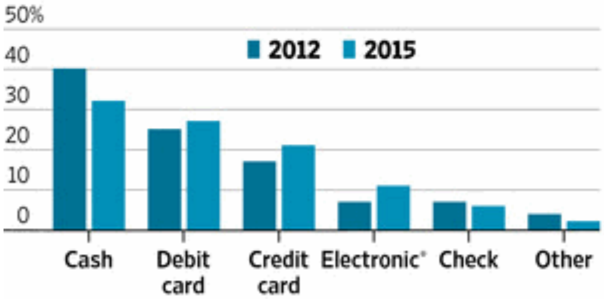
Whether we achieve a mostly cashless society sooner or later should be left to technological advancement. As all the uses of cash can be met in better ways, people will adopt those alternatives over time; to rush adoption of inferior alternatives would be a mistake.

Mr. McAndrews is an economist and fellow at the Wharton Financial Institutions Center and the former director of research atthe Federal Reserve Bank of New York. He can be reached at reports@wsj.com.

(See related letters: "Letters to the Editor: Would Cashlessness Work In Puerto Rico Sans Power?" -- WSJ Oct. 13, 2017)

Cash Is King...for Now

Cash was the most frequently used form of payment for retail transactions in the Fed's latest report, but its share declined. Transactions by payment type:



*Such as ACH transfers and online bill pay

Source: Federal Reserve, "The State of Cash"

Where It Goes

Share of cash transactions by category

Food and personal-care supplies	52%
Auto and vehicle related	16
Gifts and transfers to people	11
General merchandise	9
Entertainment and transportation	4
Medical, education, personal services	3
Government and nonprofit	3
Housing related	1
Financial, professional, misc. services	1

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Risky Loans Surge In U.S., Overseas

By Christopher Whittall
1,028 words
25 September 2017
The Wall Street Journal
J
A1
English

Lending to the most highly indebted companies has climbed by more than half this year, raising fears among some investors that a key corner of the **financial markets** is overheating.

The heavy debt loads accompanying the private-equity buyouts of companies including Team Health Holdings Inc. and USI Insurance Services run counter to efforts by regulators to tamp down on leverage in recent years to help reduce the risks in the financial system.

The risks of excessive lending were in sharp relief last week, when Toys "R" Us Inc. filed for bankruptcy protection. The toy seller's chief executive said in court papers that Toys "R" Us had been hampered by its "significant leverage" -- amounting to $5.3 billion of debt, much of it in the form of leveraged loans and high-yield, or "junk," bonds.

The volume of leveraged loans, a relatively risky form of corporate borrowing, is up 53% this year in the U.S., putting it on pace to surpass the 2007 record of $534 billion, according to S&P Global Market Intelligence's LCD unit.

What some see as froth in the market isn't confined to the U.S.

In Europe, recent loans offer fewer investor safeguards than in the past. This year, 70% of the region's new leveraged loans are known as covenant-lite, according to LCD. Covenants are the terms in a loan's contract that offer investor protections, such as limits on borrowers' ability to take on more debt or invest in projects.

Even though default levels are low now and global growth has been picking up, the lending boom could prove troublesome when market conditions change or the economy slows.

"If feels like the market is getting frothy," said Henrik Johnsson, co-head of global debt-capital markets at Deutsche Bank AG. "We're overdue a correction."

Before the financial crisis, the boom in leveraged loans was one of the signs of markets overheating. As the crisis intensified in 2008, investors in U.S. leveraged loans lost nearly 30%, according to the S&P/LSTA Leveraged Loan Index.

Regulators are noticing. In its last quarterly report, the Bank for International Settlement noted the growth of covenant-lite loans and pointed out that U.S. companies are more leveraged than at any time since the beginning of the millennium. That could harm the economy in the event of a downturn or a rise in interest rates, said the Switzerland-based central-bank group.

The leveraged-loan market has long been favored by private-equity firms raising cash to fund company takeovers. Investment banks arrange the loans and typically parcel them out.

Now, investors are jumping in because central-bank stimulus has pushed down bond-market returns. In the U.S. alone, investors have poured $16.9 billion into loan funds this year, taking total assets to a record $141.2 billion at the end of August, according to Thomson Reuters Lipper.

Some fund managers argue that current demand for loans and bonds is justified by the benign economic environment.

Mike Freno, global head of fixed income and multiasset at Barings, said that while there are some troubled sectors such as retail, overall the companies in his loan portfolios aren't showing "excessive leverage." Economic fundamentals are "very supportive," he said.

Loans to fund buyouts from private-equity firms are still well below where they were before the crisis. So far this year, U.S. loan issuance for leveraged buyouts is 34% lower than it was in 2007. While leveraged-buyout activity is rising in Europe, volumes are less than a quarter of their 2007 peak.

But some are uncomfortable with increasing levels of leverage.

That is particularly true in the U.S., where nearly a third of loans to private-equity- backed companies this year are leveraged six times or more, according to LCD's calculations of companies' debt to earnings before interest, taxes, depreciation and amortization. That is despite 2013 guidelines from U.S. regulators, including the Federal Reserve, on loan underwriting stating that leverage of more than six times "raises concerns for most industries."

Five of the six largest new loans backing leveraged buyouts this year have exceeded those levels, according to Dealogic and Moody's Investors Service.

The largest was a $3.15 billion loan taken earlier this year by Team Health to fund Blackstone Group LP's leveraged buyout of the health-care provider. In January, Moody's estimated that Team Health's leverage was at around 7.5 times.

Moody's estimated that insurance broker USI Insurance Services had leverage of just above eight times following its takeover by KKR & Co. and Caisse de depot et placement du Quebec that was followed by the issuance of $2 billion in leveraged loans.

Blackstone declined to comment, while KKR and Caisse de depot didn't respond to requests for comment.

In Europe, the pipeline for leveraged loan deals still to be sold was 7.6 billion euros ($9.1 billion) in August, according to LCD, the highest level in seven years.

Covenant-lite, or "cov-lite" loans, long the standard in the U.S., barely existed in Europe before the financial crisis. But loan terms are now "more aggressive here in Europe," said Christopher Kandel, a partner at law firm Latham & Watkins LLP, citing provisions giving borrowers greater flexibility to pay out dividends or incur additional debt.

Other corners of the market are showing signs of overheating. High-yield bonds, another source of funding for riskier companies, are trading at their highest levels since before the financial crisis.

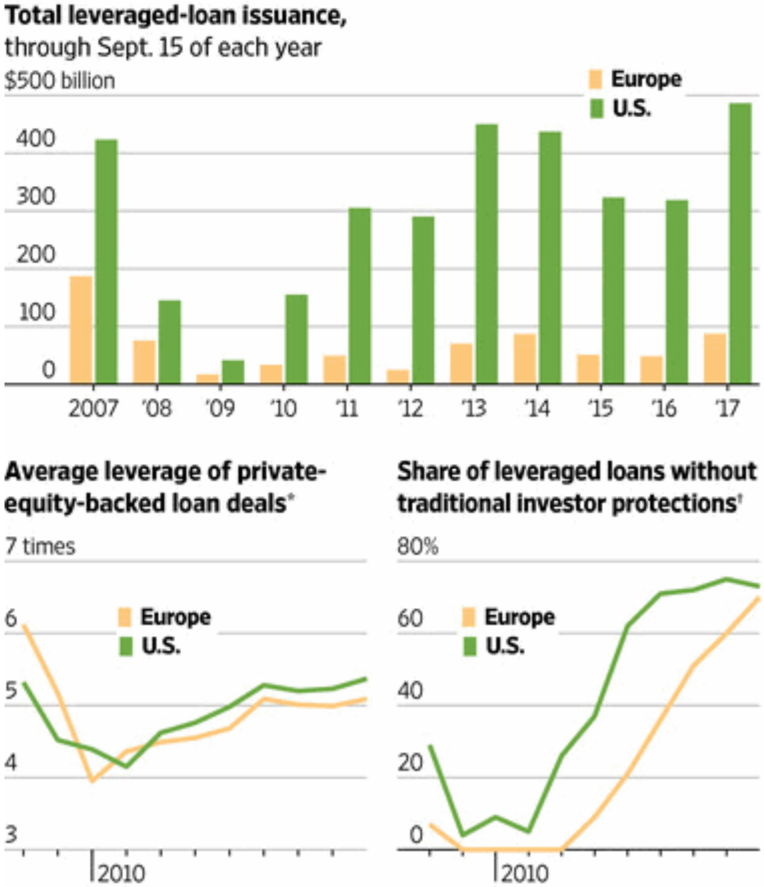
"If you get a spike in default rates, you're patently not getting compensated in high yield," said Zak Summerscale, head of credit fund management for Europe and Asia Pacific at Intermediate Capital Group.

Beth Maclean, a portfolio manager at Pacific Investment Management Co, said she has been reducing risk by favoring larger and better capitalized loans with higher ratings.

"We are seeing increasing risks across the board in the loan market in Europe and the U.S.," she said.

On a Roll

While the volume of leveraged loans is up, changing market conditions could become troublesome for the lending boom.



*Through August. Leverage is measured by debt to earnings before interest, tax, depreciation and amortization. †Through Sept. 15
Source: LCD, S&P Global Market Intelligence

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Banking & Finance: Shares of Lenders Are on the Rebound

By Akane Otani
254 words
25 September 2017
The Wall Street Journal
J
B10
English

Don't look now, but bank stocks are staging a comeback.

The KBW **Nasdaq** Bank Index of large U.S. commercial lenders rose 3.2% last week, jumping past the broader **S&P 500**.

Boosting the index's allure was a rise in bond yields. Treasury yields have climbed in recent sessions as investors increasingly believe the Federal Reserve will raise rates in December.

The yield on the benchmark 10-year U.S. Treasury note ended the week at 2.262%, compared with 2.202% the previous Friday.

On Wednesday, the Fed's dot plots showed that 12 of 16 central bank officials expected one more rate increase this year and three next year. The revelation surprised some investors. A streak of soft inflation data this summer had many investors and analysts doubting how quickly the Fed could raise rates.

Investors now see a 73% chance of one or more additional rate increases by the end of the year, according to federal-funds futures tracked by CME Group, compared with a roughly 50-50 split before the Fed's meeting.

Renewed bets on higher rates could give bank stocks a fresh boost. Expectations that President Donald Trump would slash taxes and loosen regulations pushed financial stocks higher in the months after the election. This year many of those Trump trades unwound or reversed as uncertainty grew about the course of policy changes in Washington.

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MoneyBeat: Small-Cap Stocks Rally

By Chris Dieterich
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25 September 2017
The Wall Street Journal
J
B11
English

Small-cap stocks are getting back in the groove.

The Russell 2000 Index, the best-known benchmark of small U.S. companies, notched its first record in nearly two months Friday.

In contrast, large-cap benchmarks have repeatedly hit new peaks during that span, including three for the **S&P 500** and **Dow Jones Industrial Average** last week.

All told, the **S&P 500** has captured 37 record closes this year, compared with 16 for the Russell 2000, much of which came during a midsummer rally.

Small caps have lagged behind larger ones in 2017. The Russell 2000 rallied late last year as optimism built for the Trump administration's goal of cutting taxes, reducing regulation and infrastructure spending. But hope soon faded in 2017 for quick passage of President Donald Trump's policy agenda. The Russell 2000 is up 6.9% versus 12% for the **S&P 500** excluding dividends.

The recent breakout for small-cap stocks comes as investors increasingly anticipate stronger U.S. economic growth and higher interest rates. That scenario could make large-cap stocks, which have powered the U.S. market higher, less appealing for investors, analysts say.

Profits at smaller U.S. companies are tightly linked to the pace of economic growth since they generate more of their revenue domestically. Multinational corporations tend to derive significant revenue abroad.

Shares of small, publicly traded U.S. companies tend to be sensitive to interest rates. Financial companies make up the biggest slice of the Russell 2000, while this sector ranks third in the **S&P 500**. Higher interest rates, generally, boost the shares of banks, which can earn more money from lending.

Last week, Federal Reserve officials affirmed that the U.S. economy appears strong enough to justify a third interest rate increase this year and three more next. Higher interest rates are likely to help support the U.S. dollar. A weaker dollar has bolstered earnings of large U.S. companies, which sell goods and services abroad.

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THE WALL STREET JOURNAL.
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Heard on the Street
Don't Get Flattened By the Fed

By Justin Lahart
274 words
25 September 2017
The Wall Street Journal
J
B11
English

[Financial Analysis and Commentary]

The Federal Reserve is telling investors it will flatten the yield curve. They should listen.

Last week, policy makers stuck to a projection that they will raise their target range on rates by another quarter point this year. But they also lowered their median projection of where they think rates will eventually be to 2.75% over the longer run versus their June forecast of 3%.

That matters to the bond market because Treasury yields reflect investors' expectation of what overnight rates will average across the maturity of Treasurys, plus the "term premium," the extra yield investors demand for the risk of lending over a longer term. Historically, term premiums have been positive but lately have been negative.

Based on the Fed's projected rate path and current term premiums, the **10**-**year Treasury** yield seems about right.

Nor should yields rise much as the Fed raises rates, because those rate increases would only raise the average level of short-term rates over the 10-year's maturity slightly.

Average rates over shorter maturities, such as for the two-year Treasury, would rise more. The Fed's projections suggest the yield curve will flatten.

The Fed's expected rate path might not come true. Low inflation could lead it to raise more slowly. High inflation could do the opposite. And even if the Fed turns out to have been right, an increase in term premiums could alter the curve's shape. But for now, investors should be careful not to get flattened.

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THE WALL STREET JOURNAL.
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Ray Dalio and the Market's Pulse

By Andy Kessler
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25 September 2017
The Wall Street Journal
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A19
English

Has Ray Dalio lost the pulse? The founder of the $160 billion hedge fund Bridgewater Associates is all over the place spouting his management philosophy of radical transparency. He has been making TV appearances, attending conferences, and whenever possible plugging his new book, "Principles." There's even a TED talk touting his "believability-weighted idea meritocracy" -- whatever that means. And now Mr. Dalio is trying to bust into China to manage even more money.

The investment whiz lives and manages by a set of principles that employees have to memorize. The list is filled with gems you might encounter at a silent yoga retreat. "Most problems are potential improvements screaming at you." Or this reworked cliche: "While most others seem to believe that pain is bad, I believe that pain is required to become stronger."

Speaking of pain, Bridgewater is losing money this year. Through July its flagship fund is down 3%, while the market is up more than 10%. Does this transparency stuff even work? Bridgewater videotapes every meeting and arms workers with iPads filled with apps like the emotion-relief Pain Button and the co-worker-rating Dot Collector. Mr. Dalio must figure that only under these conditions will employees tell the truth instead of what he wants to hear. Maybe this is all a distraction. But you've got to be a little cuckoo to run a giant hedge fund, and I think Mr. Dalio is crazy like a fox.

The core of investing is quite simple: Determine what everyone else thinks, and then figure out in which direction they are wrong. That's it. No one tells you what they think. You've got to feel it. That's why Wall Streeters say things like, "We are lowering our above consensus expectations earnings estimates." It's all about figuring out what is priced into a stock right now. That's the pulse of the market, the collective mind meld aggregated into stock prices. I know from experience this is the hardest part of running a hedge fund. You can find the greatest story ever, but if everyone already knows it, there's no money to be made.

And the pulse changes with each government statistic, each daily ringing of cash registers and satellite images taken of parking lots. That's why stocks trade every day. Real-world inputs and the drifting pulse drive the psychotic tick of the **stock market** tape. Once you feel the pulse, then and only then can you figure out how everyone's wrong about tomorrow, next month or next year. And believe me, they're always wrong. Stocks rarely tread water.

How do you find that pulse? It's hard enough to invest your IRA. Can you image managing $160 billion? Wall Street analysts have earnings estimates that no one trusts. There are whisper numbers and the chaos of message boards and tweets.

It's best to survey your own people. That's why Bridgewater has some 1,700 employees. A friend of mine learned you have to take a Myers-Briggs personality test before Bridgewater bothers to interview you. He was told he was "not right for the job." But it turns out that only a tiny handful of employees make any of the investment decisions anyway. Clearly Mr. Dalio doesn't trust them, so he tries to remove their biases surgically, hence the radical transparency and the illusion of a meritocracy. Mr. Dalio doesn't care about employees' opinions or ideas; he just wants to take their pulse to figure out what the market already knows. Or as he puts it: "The biggest mistake most people make is to not see themselves and others objectively."

This is not uncommon. I once visited the Wall Street offices of a well-known hedge fund guy you see on TV. He pulled me aside, pointed to his employees, and said, "You see these people? They might as well be holograms." He made every buy-and-sell decision himself.

Mr. Dalio is a great success story. His terrific returns attracted $160 billion in assets. But these things work until they don't work. Wall Street is littered this year with the roadkill of busted hedge funds. Pine River, Passport and Greenlight are downsizing involuntarily, meaning investors are redeeming their money from funds with awful returns. Others, like Seth Klarman's Baupost, are returning money because of "limited investment opportunities."

Too much capital is often a burden. There are only so many good investment ideas out there, and it's late in this cycle. Mr. Dalio's principles are unique but probably not applicable to many other businesses. As he says: "Truth -- more precisely, an accurate understanding of reality -- is the essential foundation for any good outcomes." Here's a truth: If Bridgewater has lost its mojo, Mr. Dalio would be smart to manage a much smaller pot of money rather than torture his employees.

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

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The New York Times

Business Day
Industry Under Pressure Gathers for Ad Week and a Deadline for Google

By THE NEW YORK TIMES
800 words
24 September 2017
09:00 PM
NYTimes.com Feed
NYTFEED
English

Here’s what to expect in the week ahead:

ADVERTISING

Advertisers, in throes of change, meet for week of talks.

Marketers and advertising types will gather this week in New York — mostly in the Times Square area — for the annual industry event known as Advertising Week. Panels and presentations like “Can Brands Actually Tell a Story in 6 Seconds?” and “Realizing The Full Potential of Audience Targeting” will aim to provide insights to an industry grappling with significant changes in technology, culture and consumer habits. Other hot topics of discussion: the recent criticism of the ad targeting practices of Google and Facebook, diversity within the advertising world and how well the industry knows Americans after a presidential election that caught most of its leaders by surprise. Sapna Maheshwari

ECONOMY

Mario Draghi will discuss monetary policy.

Mario Draghi, the president of the European Central Bank, will provide an update on monetary policy during an appearance at the European Parliament in Brussels on Monday. But Mr. Draghi is unlikely to offer much new information on the question that is occupying **financial markets**: when the central bank will ease its stimulus to the eurozone economy. Mr. Draghi appears periodically before the Economic and Monetary Affairs Committee and answers questions from representatives, but usually does not use the venue to signal major policy changes. Jack Ewing

Janet Yellen to speak about inflation.

“Inflation, Uncertainty and Monetary Policy” is not just the title of a speech that Janet L. Yellen, the Fed’s chairwoman, will deliver in Cleveland on Tuesday. It is also a pretty good title for the dilemma that is confronting the Federal Reserve. The Fed has undershot its target of 2 percent annual inflation for the last five years, and is likely to do so again this year. In recent months, inflation has weakened further, and Fed officials don’t really understand why (Ms. Yellen described it as a “mystery” last week). At stake is whether the Fed should raise its benchmark interest rate in December, or wait for inflation to show signs of a rebound. After Ms. Yellen’s speech, she will visit a community college job training program and participate in a discussion with students. Ms. Yellen has previously visited job training programs in Chicago, Boston and Philadelphia, making the trip something of an annual tradition. Binyamin Appelbaum

TRADE POLICY

A trade case could reshape the airplane industry.

The Department of Commerce is expected to issue an initial ruling Tuesday on imposing duties on the Canadian airplane maker Bombardier, after Boeing claimed that its Canadian rival had received government subsidies that allowed it to sell its products at unfairly low prices. Prime Minister Justin Trudeau of Canada and Prime Minister Theresa May of Britain, whose constituents help to manufacture the Bombardier jet, have urged President Trump to intervene to stop the case, but have so far been unsuccessful. If the United States rules in Boeing’s favor, it may impose duties making the Canadian aircraft substantially more expensive. Ana Swanson

TECHNOLOGY

Google faces deadline to comply with an antitrust order.

Google must be in compliance with an order from European Union regulators to modify its business practices by Thursday. The order was part of a decision in June by the European Commission that included a record fine of 2.4 billion euros ($2.7 billion). Google faced a 90-day deadline to respond to the regulator's demands or face penalties of up to 5 percent of the average daily global revenue of Alphabet, its parent company. In recent weeks, Google submitted proposals to the commission aimed at ensuring that rival shopping services are treated the same way as its Google Shopping service, but the company has not publicly disclosed them. James Kanter

ECONOMY

Bank of England marks two decades of independence.

The Bank of England will hold a conference on Thursday to mark 20 years since it was granted independence over monetary policy, giving the bank the ability to decide on interest rates without the government. The central bank's powers have since expanded to include the regulation of financial firms. Speakers at the conference will discuss the application of central bank independence and whether the model works. Mervyn King, governor of the Bank of England for 10 years until 2013, has written that, “independence is not an answer to all problems.” Amie Tsang

* Google Fined Record $2.7 Billion in E.U. Antitrust Ruling

* After Election Surprise, Marketers Rethink How to Study Consumers

* Fed Officials Confront New Reality: Low Inflation and Low Unemployment

Google was ordered to modify its business practices to level the playing field between Google Shopping and rival services. An important deadline is Thursday. | Dado Ruvic/Reuters

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THE WALL STREET JOURNAL.
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The Intelligent Investor: Why Bonds Are Luring Investors From Stocks

By Jason Zweig
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23 September 2017
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J
B1
English

Bonds have been in a **bull market** for most of the past 35 years or so. Many investors are still buying, but they aren't chasing past performance.

In August, more than 90% of the $30 billion that flowed into all mutual funds and exchange-traded funds went into taxable-bond funds.

Yet the bond market has squeezed out only a 3% return this year, according to one gauge, while the **S&P 500** is up more than 13%, including dividends.

Look at the money pouring into such funds as the iShares 20+ Year Treasury Bond ETF, which holds government debt maturing between 2036 and 2047. Through Sept. 20, this fund has had the strongest monthly, quarterly and year-to-date influx of money in its 15-year history. Investors have added $4.4 billion this year and $2.7 billion in September alone; the fund has nearly doubled in size, to $9.9 billion, since the end of February.

Fund investors are notorious for buying whatever has recently had hot returns, often right before it goes cold. If you map the performance of bonds against the money going into and out of bond funds over the past couple of decades, you can see the public chronically -- almost addictively -- buying after **bond prices** have shot up and selling after a drop.

What's happening now is the opposite. Investors seem to be moving from stocks, the hot asset, to bonds, the cold one.

Over the past year, long-term Treasury bonds have lost more than 4%, and the overall bond market has delivered a gain of less than 1%, counting interest payments.

What's more, at this past week's Federal Reserve policy meeting, officials left open the possibility of another interest-rate rise by year-end and lowered their forecast of rates over the longer run from 3% to 2.75%.

So why are investors buying bond funds hand over fist?

The figures commonly cited to show how much money the public puts into or takes out of mutual funds don't include any income from such funds that investors plow back into their accounts. Through July, according to the Investment Company Institute, those reinvested dividends totaled nearly $51 billion.

A "healthy mix of institutional and retail investors" have been buying the iShares long-term Treasury fund, says Karen Schenone, fixed-income strategist at the firm. "They seem to be saying, 'I've done well in the **stock market** in the past few years, so maybe it's time to take some of that risk off the table.'"

People are buying bond funds for their stability relative to stocks "rather than to take advantage of an expected rise in **bond prices**," says Van Hoisington, lead manager for the $363 million Wasatch-Hoisington U.S. Treasury Fund. "Maybe the average, supposedly unsophisticated investor is right."

Fran Kinniry, an investment strategist at Vanguard Group, points out that U.S. stocks have more than tripled since the financial crisis. So an investor who had 60% in stocks and 40% in bonds then would have more than 75% in stocks now.

Stocks have done so well that bond funds are only about 25% of investors' total portfolios, down from 31% in 2012, according to the ICI.

Getting those ratios back into balance requires buying a lot more bonds.

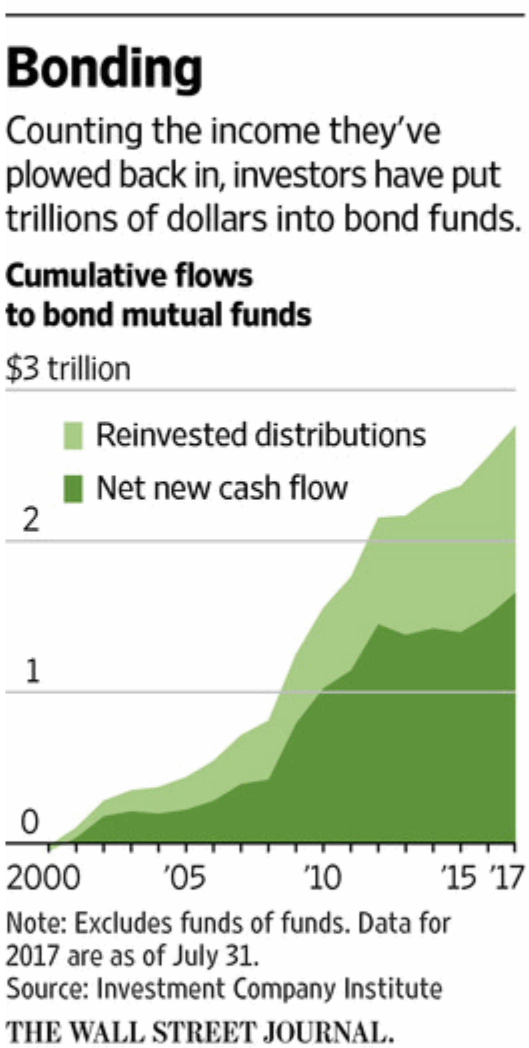
"Back in the late 1990s, investors were very momentum-based, buying stocks and selling bonds," says Mr. Kinniry. "But now, here we are in the midst of this giant **bull market** for stocks, and I love seeing that investors are buying bonds instead."

Yes, many long-term bond funds will fall in price by 15% or more on a rise in interest rates of just 1 percentage point. For the most part, though, investors aren't buying riskier vehicles like emerging-market bond funds or high-yield corporate funds. Instead, hordes of retirees and near-retirees are moving into more-conservative investment-grade and government funds with lower risk of default.

And with the **S&P 500** brushing highs and interest rates too low for bond funds to provide generous income, neither stocks nor bonds look particularly attractive.

During the financial crisis, however, high-quality bonds like Treasurys were one of the few assets that did well when stocks got trashed.

Government bonds "have continued to be the strongest flight-to-quality asset," says Mr. Kinniry, and remain likely to do well in future **stock-market** crashes unless interest rates unexpectedly rise at the same time. For many investors, bonds feel like the lesser of two evils.



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The New York Times

Business Day
Yellen and Cohn Said to Be on Shortlist for New Head of the Fed

By KATE KELLY and BINYAMIN APPELBAUM
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WASHINGTON — The White House has created a list of about a half-dozen candidates to be the next leader of the Federal Reserve, including its current chairwoman, Janet L. Yellen, and the president's chief economic adviser, Gary D. Cohn, according to two administration officials and a third person with knowledge of the process.

The list also includes Jerome H. Powell, a member of the Fed's board of governors; Kevin Warsh, a former Fed governor; and the Stanford University economist John B. Taylor, the officials said. Preliminary interviews with some candidates have already begun with an eye toward presenting finalists to President Trump later this year.

Ms. Yellen, whose four-year term ends in February, has been unusually successful in achieving the Fed's goals of minimizing unemployment and moderating inflation. But Mr. Trump, while praising her performance, has said that he may decide not to reappoint her.

"I like her and I respect her, but I haven't made that decision yet," Mr. Trump told reporters this month.

Uncertainty about Mr. Trump's decision is already causing some unease in **financial markets**. Ms. Yellen has charted a steady course for monetary policy in the coming years: gradual increases in interest rates and a gradual reduction in the Fed's bond holdings. But some of the candidates Mr. Trump is considering, including Mr. Warsh and Mr. Taylor, have argued that the Fed should raise rates and reverse its postcrisis buildup of bonds more quickly.

The Fed chairman also plays a leading role in financial regulation and will have to navigate calls by Republican leaders, including Mr. Trump, to roll back some of the rules put in place after the 2008 financial crisis. Ms. Yellen was a principal architect of those more stringent regulations and has said the financial system is much stronger as a result. Mr. Trump has criticized many of the banking rules, saying they are excessive and impeding economic growth. The candidates to replace Ms. Yellen all share those concerns to varying degrees.

Given the high stakes, Mr. Trump's decision has become a source of intrigue in political and economic circles this year. There is also a growing sense of urgency: Both Ms. Yellen and her predecessor, Ben S. Bernanke, were nominated in October, leaving ample time for the Senate to hold confirmation hearings. Mr. Trump has said he does not plan to make a decision until later in the year, leaving little time for the Senate to act given the tight calendar. Aides say he is not yet focused on the search. Additional candidates could ultimately be considered.

The administration officials and the other person with knowledge of the search requested anonymity because of the sensitive nature of the job in question. A White House spokeswoman had no immediate comment, and Mr. Cohn, Mr. Taylor and Mr. Warsh did not respond to requests for comment. A Fed spokeswoman said Ms. Yellen and Mr. Powell declined to comment.

The next Fed chairman is likely to begin the four-year term in an atmosphere of relative tranquillity during one of the longest economic expansions in American history. But the Fed is confronting a number of difficult issues. One question is whether it can do more to increase economic growth. Another is whether the Fed will be ready for the next economic downturn.

In addition to a Fed chairman, Mr. Trump also must fill four open seats on the seven-member board. That means he can immediately appoint a majority of Fed governors, putting his stamp on the institution. He has made just one choice so far, nominating Randal K. Quarles to be the Fed's vice chairman for supervision. That nomination is pending, though Mr. Quarles is expected to be confirmed.

Mr. Trump has deputized four officials to lead the selection process for the Fed's next chairman, said one person familiar with the search: Treasury Secretary Steven Mnuchin; two of Mr. Cohn's aides on the National Economic Council, Jeremy Katz and Andrew Olmem; and John DeStefano, the White House personnel director.

Mr. Cohn, who initially participated in conversations about the potential nominees for Fed governor seats, has removed himself from the discussions about the central bank's next chairman, given that he is a potential candidate for the job, said several people with knowledge of his involvement.

Mr. Cohn left the No. 2 position at Goldman Sachs to join Mr. Trump's administration as head of the National Economic Council. He quickly developed an easy rapport with the president, who is said to value Mr. Cohn's knowledge of markets and finance. Mr. Cohn has played a major role in the administration's push for a tax-cut bill; he also has been a moderating voice in internal debates on issues like restricting free trade.

In a July interview with The Wall Street Journal, Mr. Trump described Mr. Cohn and Ms. Yellen as candidates for the Fed job. The next month, Mr. Cohn publicly criticized the president's response to a white nationalist rally in Charlottesville, creating tension. But the two men have reestablished a comfort level, and Mr. Cohn remains a candidate.

Mr. Cohn is a strong advocate for easing financial regulation, which he argues is unnecessarily impeding economic activity. But he has rarely spoken publicly about monetary policy; the other four candidates whose names are known all have significant experience with monetary policy.

Mr. Warsh, who served on the Fed's board between 2006 and 2011, was a member of Mr. Trump's business advisory council and has informally advised him on a range of economic issues. That may be a significant advantage, given the president's demonstrated preference for people he knows and trusts. Mr. Warsh is married to Jane Lauder, the daughter of Ronald Lauder, a friend and occasional adviser to the president.

Mr. Warsh is a lawyer by training and a banker by trade before entering public service in 2002 as a member of President George W. Bush's National Economic Council. After leaving the Fed, he joined the Hoover Institution, a public-policy think tank run by Stanford, as a visiting fellow. He has been a vocal critic of the Fed's economic stimulus campaign under both Mr. Bernanke and Ms. Yellen, arguing it has been ineffective and may have dangerous side effects.

At a Hoover conference in May, he said the Fed needs to be "aggressive and powerful" in responding to financial crises, but remain "more traditional" when the market is not in crisis.

Mr. Taylor, a colleague of Mr. Warsh's at Hoover, has offered a similar critique of Fed policy. Mr. Taylor served in the Treasury Department during the Bush administration but he is best known as an academic economist. He wrote a formulaic approach to monetary policy, known as the "Taylor Rule," which suggests that the Fed should be raising rates more quickly. He also has closely advised House Republicans on legislation that would require the Fed to adopt such a policy rule.

Mr. Powell, the only Republican on the Fed's board, is regarded as a centrist voice on both monetary policy and regulatory issues. In internal discussions and public remarks, he has sometimes pushed back against the most ardent supporters of the Fed's postcrisis stimulus campaign. Similarly, he has sometimes raised questions about changes in financial regulation. But on both fronts he has consistently voted with the majority.

A Treasury Department official under President George H.W. Bush, Mr. Powell then built a fortune as a partner at the Carlyle Group, a private equity firm, before he was nominated to the Fed by President Obama in 2012. His experience at the Fed, and his connections both in the financial world and in the Republican Party, could make him an attractive candidate. But his track record suggests he may be less likely than some of the other candidates to press for dramatic changes in monetary and regulatory policies.

Maggie Haberman

Janet L. Yellen, chairwoman of the Federal Reserve Board, spoke in Washington on Wednesday. | Mark Wilson/Getty Images | Gary D. Cohn, president's chief economic adviser, walking on the South Lawn of the White House in August. Mr. Cohn has taken himself out of the discussions about the central bank's next chairman. | Al Drago for The New York Times

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THE WALL STREET JOURNAL.
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REVIEW --- Amazon Takes Over The World --- Jeff Bezos's company is poised to dominate -- with what consequences?

By Scott Galloway
1,441 words
23 September 2017
The Wall Street Journal
J
C3
English

Four tech giants -- Amazon, Apple, Facebook and Google -- have added $2 trillion to their combined market capitalization since the 2007-09 recession, a sum that approaches the GDP of India. The concentrated wealth and power of these companies has alarmed many observers, who see their growth as a threat not just to consumers and other businesses but to American society itself.

After spending most of the past decade researching these companies, I've come to the conclusion that our fears are misplaced in focusing on what I call the Four. We should instead be worrying about the One: one firm that will come to dominate search, hardware and cloud computing, that will control a vast network of far-flung businesses, that can ravage entire sectors of the economy simply by announcing its interest in them.

That firm is Amazon. Jeff Bezos has been disciplined and single-minded in his vision of investing in the most enduring consumer wants -- price, convenience and selection. Coupled with deft execution, it has made Amazon the most impressive and feared firm in business.

As for the other three, don't be misled by their current successes. They are falling behind as the One marches ahead.

Google seems to have a commanding market position when it comes to search functions. As European Union regulators pointed out in their recent antitrust finding, Google has an astonishing 90% share in the category in Europe. Its share in the U.S. is 64%. But it's a very different story in the narrower, and more lucrative, domain of product search. In 2015, more product searches in the U.S. began on Amazon than on search engines, including Google (44% vs. 34%), according to BloomReach. A year later, Amazon's share grew to 55%. Amazon could reasonably be described as a search engine with a warehouse attached to it.

For years, Apple has been the undisputed king of hardware innovation. But the prize for the most disruptive recent device goes to the hands-free, voice-controlled Amazon Echo speaker and its buttery voice, Alexa. Research firm Gartner predicts that 30% of computing will be screenless by 2020. So far, Apple looks to have blown an early lead in the great voice race: With 700 million iPhones in use world-wide, Apple's Siri still has the most share in voice overall. But Amazon's share of voice on home devices -- the next frontier -- is 70%.

Today's fastest-growing sector in tech is cloud computing. There are several big players in the field, including old and new tech: IBM, Microsoft, Google. The dominant player again is Amazon, with a business launched originally to support its internal computing needs. According to Synergy Research Group, Amazon's cloud offering (called Amazon Web Services) enjoys more than 30% of the market, triple the share of the No. 2, Microsoft's Azure, and will register $16 billion in revenue in 2017. Financial pundits, looking for something negative to say about Amazon's recent quarterly earnings, highlighted that growth in the company's cloud business had slowed to 43%. "Slowed to 43%" is not a phrase you read in any other equity analyst's write-up of a large company in 2017.

Amazon's consistent outperformance of the other three tech giants is distinct from its continued dominance of old-economy firms. With the acquisition of Whole Foods, Amazon will likely become the fastest-growing online and bricks-and-mortar retailer. The whole grocery sector -- with $612 billion in U.S. sales in 2016 -- has been disrupted overnight by Amazon. In the months between the announcement and closing of Amazon's acquisition of Whole Foods this year, the largest pure-play grocer, Kroger, lost nearly a third of its market value.

The late business professor C.K. Prahalad of the University of Michigan famously argued that the most successful firms focus not on one market but on one "core competence." Amazon has proved otherwise. What Amazon has accomplished across industries is unprecedented, even among the most successful businesses. Nike does not have a cloud business; Starbucks is not developing original TV content; Wal-Mart has not filed patents for warehouses in the sky. Amazon has recently been granted patents for a floating warehouse and small drones that can self-assemble into bigger drones capable of transporting larger packages, reflecting the ability, one day, to operate intricate networks of fulfillment by air. Other firms are punished for straying from their familiar areas of strength; Amazon sucks value from sectors in which it has had no previous involvement just by glancing at them.

At New York University's business school, where I teach, I have for years kept a close watch on which firms are winning the competition for the most talented students. A decade ago, the top recruiter was American Express, with investment banks vying for second position. Now the clear winner is Amazon: 12 students from my most recent class have opted for a life of rain and overrated coffee in the Pacific Northwest.

Why does Amazon's ascent matter? Aren't lower prices and greater efficiencies better for everyone? They are, in all the obvious ways, but that's not a complete picture. Amazon's seemingly boundless growth forces us to wrestle with difficult questions about the reasons for its dominance.

For one, Amazon, unlike any other firm its size, has changed the basic compact with **financial markets**. It has replaced the expectation for profits with a focus on vision and growth, managing its business to break even while investors bid up its **stock price**.

This radical approach has provided the company with a staggering advantage in free-flowing capital. Google, Facebook, Wal-Mart and most Fortune 500 companies are saddled with expectations of profits. Many firms would be much more innovative if they were given a license to operate without the nuisance of profitability. Amazon has thus had enormous capital on hand to invest in delivery networks, especially the crucial last link for getting goods to the doorsteps of consumers, without having to worry that they don't yield immediate profits.

Amazon's strategy of break-even operations also means that it has virtually no profits to tax. Since 2008, Wal-Mart has paid $64 billion in federal income taxes, while Amazon has paid just $1.4 billion. Yet, while paying low taxes, Amazon has added $220 billion in value to the stock held by its shareholders over the past 24 months -- equivalent to the entire market capitalization of Wal-Mart.

Something is deeply amiss when a company can ascend to almost a half trillion dollars in market value -- becoming the fifth most valuable firm in the world -- without paying any meaningful income tax. Does Amazon really owe so little to support public revenue and public needs? If a giant firm pays less than the average 24% in income taxes that the companies of the **S&P 500** pay, it logically means that less-successful firms pay more. In this way, Amazon further adds to the winner-take-all tendencies plaguing our economy.

Because Amazon is more efficient than other retailers, it is able to transact the same amount of business with half the number of employees. If Amazon continues to grow its business by $20 billion a year, the annual toll of lost jobs for merchants, buyers and cashiers will be in the tens of thousands by my calculations. Disruption in the U.S. labor force is nothing new -- but we have never dealt with a company that is so ruthless and single-minded about it.

I recently spoke at a conference the day after Jeff Bezos. During his talk, he made the case for a universal guaranteed income for all Americans. It is tempting to admire his progressive values and concern for the public welfare, but there is a dark implication here too. It appears that the most insightful mind in the business world has given up on the notion that our economy, or his firm, can support that pillar of American identity: a well-paying job.

Amazon has brought us many benefits, but we all must recognize that the rise of the One brings with it much more than free two-day delivery. "Alexa, is this a good thing?"

Scott Galloway is a professor of marketing at the NYU Stern School of Business and the author of "The Four: The Hidden DNA of Amazon, Apple, Facebook, and Google," to be published on Oct. 3 by Portfolio.

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U.S. Steps Up North Korea Pressure

By Ian Talley in Washington and Louise Radnofsky in New York
1,124 words
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President Donald Trump launched a new phase of a crackdown on North Korea on Thursday, expanding sanctions to hit any individuals, companies and financial institutions doing business with Pyongyang, not only those involved in aiding its weapons program or laundering funds.

North Korea's leader Kim Jong Un later Thursday let loose at Mr. Trump's speech Tuesday at the United Nations, in which the president had threatened to destroy North Korea if forced to defend the U.S. or its allies against it. The speech was "unprecedented rude nonsense" that showed Mr. Trump to be a "mentally deranged U.S. dotard" who was "playing with fire," Mr. Kim said in a rare statement attributed directly to him by Pyongyang's state mouthpiece, the Korean Central News Agency.

"We will consider with seriousness exercising of a corresponding, highest level of hard-line countermeasure in history," Mr. Kim said.

Hours later, North Korea's foreign minister suggested what that countermeasure might be, telling reporters the country could detonate a hydrogen bomb over the Pacific Ocean.

The threat would mark a dramatic escalation in action from Pyongyang, which in the past month has already launched two intermediate-range ballistic missiles over Japan and tested what it claimed was a hydrogen bomb.

"Maybe we might consider a historic hydrogen bomb test over the Pacific Ocean," Foreign Minister Ri Yong Ho said outside his New York hotel, according to a report by South Korea's quasiofficial Yonhap News Agency. He added he didn't know for sure exactly what Mr. Kim was planning.

The State Department didn't respond to a request for comment. South Korean President Moon Jae-in, who attended the U.N. General Assembly, was flying back to Seoul and didn't have a comment, a spokesman said.

Japan's top government spokesman said it was "completely unacceptable" that North Korea was threatening regional security.

President Trump on Thursday signed an executive order giving the U.S. Treasury Department the power to sanction any entity involved with North Korean trade or finance, freeze the U.S. assets of foreign banks working with the country and ban those institutions from accessing U.S. **financial markets**. The action steps up Washington's effort to strangle financing to the nuclear-armed state in the face of repeated missile tests by the Kim regime.

"Foreign banks will face a clear choice: doing business with the United States or facilitate trade with the lawless regime in North Korea," Mr. Trump said at a lunch with leaders of South Korea and Japan in New York, alongside U.N. meetings.

The presidential order authorizes Treasury to target a broad swath of North Korean trade, including textile and seafood exports, technology, and shipping networks. North Korean defectors, U.S. officials and analysts all have said those trade and finance networks are funneling cash into the country's nuclear-weapon and intercontinental-ballistic-missile programs.

"For far too long, North Korea has evaded sanctions and used the international financial system to facilitate funding for its weapons of mass destruction and ballistic-missile programs," Treasury Secretary Steven Mnuchin said on the sidelines of U.N. meetings. "No bank -- in any country -- should be used to facilitate Kim Jong Un's destructive behavior."

U.S. officials cast their moves as part of a growing international effort. Mr. Trump praised Chinese President Xi Jinping for a recent move by Beijing's central bank to bar transactions with North Korea. China accounts for more than 90% of Pyongyang's trade, and much of those transactions are conducted through the Chinese banking system.

"China, their central bank has told their other banks . . . to immediately stop doing business with North Korea," Mr. Trump said.

U.S. congressional leaders who have pressed for a tougher sanctions regime applauded the Trump administration's announcement. Many analysts have said the sanctions in place against North Korea pale in comparison to the efforts aimed at Iran before the 2015 accord preventing it from producing nuclear weapons.

In that case, the U.S. was able to convince much of the world -- notably its European allies -- to shut down investment and capital flows to Iran, with the U.S. levying multibillion-dollar fines against major European banks to enforce that effort.

The North Korean sanctions regime doesn't yet have that magnitude, but analysts say this latest effort is part of the administration's plan to steadily ratchet up economic pain on the country.

"Finally, we are beginning to apply maximum pressure on Kim Jong Un," said Rep. Ed Royce, the California Republican who heads the House Foreign Affairs Committee.

"It's a new level of pressure," said Patrick Cronin, senior director of the Asia-Pacific program at the Center for New American Security, a Washington think tank.

Mr. Trump said the new order would cut sources of revenue used to fund North Korea's efforts to develop nuclear weapons. "It is unacceptable that others financially support this criminal, rogue regime," he told South Korea's President Moon and Prime Minister Shinzo Abe of Japan, who were both present with delegations.

Mr. Abe replied, in remarks that were translated into English, that he considered the North Korean nuclear tests unacceptable, calling them "beyond the scale of Hiroshima," a reference to the first atomic bomb dropped by American forces during World War II.

The Treasury Department already has the power to ban foreign banks from accessing U.S. **financial markets**, as it recently did with China's small Bank of Dandong, saying it helped finance Pyongyang's weapons program.

Being banned from access to the world's deepest **financial market** and most traded currency can cripple a financial institution, preventing it from accessing the dollars that borrowers need to for deals and to keep their businesses afloat.

The latest order broadens that authority, Treasury said.

"What this does is take it a step further," U.S. Ambassador to the U.N. Nikki Haley said on Thursday. "This says that anyone that deals with North Korea, any financial institution that deals with North Korea, is going to be punished."

Mr. Cronin said Beijing's directive banning financial transactions with North Korea could make additional U.S. sanctions banning Chinese banks from the U.S. less likely for now. Secondary sanctions targeting banks are only necessary if other actors aren't taking the steps the U.S. believes are responsible actions, he said.

But that could change if China doesn't follow through, he said.

Paul Sonne in New York, Laurence Norman in Brussels and Jonathan Cheng in Seoul contributed to this article.

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THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Stocks, Housing Lift Household Net Worth

By Eric Morath
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The total net worth of U.S. households pushed farther into record territory, propped up by improving home values and stock prices.

The net worth of U.S. households and nonprofits, defined as the total of all assets minus all liabilities, rose by $1.7 trillion in the second quarter of 2017 to $96.2 trillion, according to a Federal Reserve report Thursday.

The increase was smaller than the $2.3 trillion advance in the first three months of the year, but marked the seventh straight quarter overall wealth rose in the U.S.

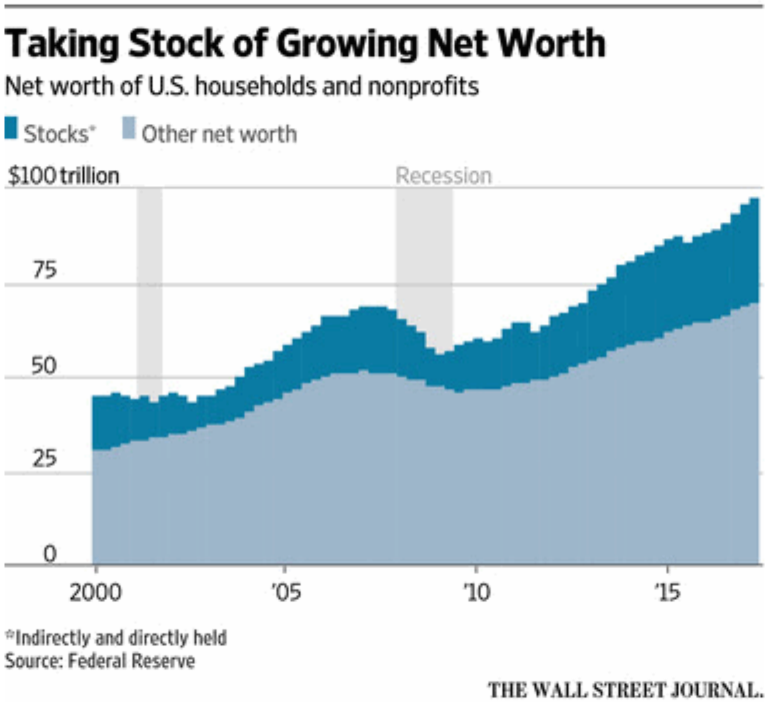
Meanwhile, total household liabilities rose by a modest $146 billion to $15.2 trillion. Household liabilities relative to net worth is at the lowest share since 2000, RBC Capital economist Tom Porcelli said.

"The healthy state of the U.S. household balance sheet continues to be one of the key themes underpinning our broad economic view that the current expansion is far from over," he said.

Household wealth in the **stock market** climbed by $1.1 trillion in the second quarter. While a slightly smaller increase than in the first quarter, the increase still reflected a steady upward trend in equities prices supported by solid business and consumer confidence and broad economic growth around the globe.

The value of real estate rose by $564 billion last quarter, a better gain than the prior quarter.

During the 2007-09 recession, when the housing market and **stock market** both fell, households lost nearly $12 trillion in wealth. But net worth fully recovered by the second half of 2012, and has risen most quarters since.



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The New York Times

The Contenders
The Upshot
Who Will Be Trump's Pick to Lead the Fed? We Asked Experts to Rate the Odds

By NEIL IRWIN
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The most important job in global economics is up for grabs in a mere four months. And it looks to be a wide-open race to fill the job.

Janet Yellen's term leading the Federal Reserve ends Feb. 3, and President Trump has offered few indications of his plans either to nominate a successor or to reappoint Ms. Yellen to a second four-year term as chairwoman.

So far, not even a credible list of the finalists has leaked from the White House. But given the impact Mr. Trump's choice will have on the world's economy, we've asked a panel of experts to give their best guess.

Specifically, we asked the panelists (they are listed at bottom) to give their odds on a list of people whose names have been publicly discussed for the post, in addition to a "rest of field" category to encompass names that have not yet surfaced. We averaged their answers to generate consensus odds.

Ms. Yellen has a possibility of being renominated, according to this consensus, but it is only 22 percent; experts think that Kevin Warsh, a former Fed governor with deep Republican ties, has a slightly better chance at 23 percent.

But those two top contenders combine for lower than 50 percent odds in our expert survey — meaning that our panelists thought there was a better-than-even chance that the appointment will be one of many contenders with individually modest but collectively high chances of rising to the top of the president's list.

Compared with PredictIt, an online marketplace based on news events, our experts saw slightly lower odds for either of them. On Thursday afternoon, trading on PredictIt implied 30 percent odds for Ms. Yellen and 28 percent for Mr. Warsh.

Using our expert survey — and comments from some of the participants in it — here's a guide to President Trump's options as he makes perhaps the single most consequential economic decision of his first year in office.

Yellen reappointment: continuity and bipartisanship

There's a tradition of reappointing Fed chairmen who were originally appointed by a member of the opposite party. President Obama did so with Ben Bernanke; Bill Clinton with Alan Greenspan; and Ronald Reagan with Paul Volcker.

That tradition has helped keep the Fed, with its vast power over the economy and financial system, insulated a bit from politics, but President Trump has no obligation to follow it.

The case for renominating Ms. Yellen is straightforward.

She has presided over four years of steady economic expansion and rising **financial markets**. She moved cautiously toward raising interest rates even though the economy seemed to be approaching full employment. By contrast, some more conservative contenders for the job have indicated they want to raise rates more quickly, which could endanger the economy as President Trump approaches midterm elections in 2018 and a potential re-election battle in 2020.

After criticizing her during his campaign, President Trump has had some kind words for her, saying in July that he liked her and that “she’s done a good job.”

Moreover, as President Trump dabbles in making deals with Democrats, reappointing Ms. Yellen could serve as an expression of good faith to Democratic senators. As administration officials focus on tax legislation and other priorities on Capitol Hill, it might be helpful to them to nominate someone who might sail through confirmation, rather than demand a bruising, time-consuming battle.

“She’s a known quantity, and there is less risk of disrupting the **financial markets** if the president renominates Dr. Yellen,” said Brian Gardner, managing director of Washington Research at Keefe, Bruyette & Woods, and one of the panelists. “Although President Trump is unorthodox in many ways, every president wants calm **financial markets**.”

The case against Ms. Yellen is similarly straightforward: She is a liberal economist in a government dominated by conservatives. She is a cerebral academic serving during the presidency of a bombastic businessman. And she is a staunch defender of the work the Fed and other bank regulators have done to try to limit risk in the financial system — including in a high-profile speech last month — amid an administration focused on deregulation.

Kevin Warsh: well connected, but with baggage

Our experts’ consensus was that Mr. Warsh has slightly better odds than Ms. Yellen. He was a Fed governor from 2006 to 2011, and was a member of Mr. Bernanke’s inner circle in shaping the Fed’s extraordinary (and often extraordinarily unpopular) actions to battle the global financial crisis.

He is well connected in conservative political circles and is now a distinguished visiting fellow at the Hoover Institution at Stanford. Before joining the Fed, where he was the youngest governor in the institution’s history, he worked in the George W. Bush White House and at Morgan Stanley. He has a law degree, but no advanced degree in economics.

Mr. Warsh has been a skeptic of the Fed’s efforts to boost the economy through quantitative easing and has advocated raising interest rates more quickly. He also has a regulatory philosophy more in line with the administration’s.

Another factor that might weigh in Mr. Warsh’s favor with the president? Mr. Warsh’s father-in-law is Ronald Lauder, of the Estée Lauder cosmetics fortune, a major Republican donor with longstanding ties to Mr. Trump.

If Mr. Warsh is nominated, expect significant blowback during the confirmation process from Democrats, who are likely to accuse the 47-year-old Mr. Warsh of being underqualified, of being responsible for the 2008 bank bailouts and inclined to regulate banks too lightly now, and of being too overtly political for the traditionally nonpartisan Fed chairmanship.

Whatever happened to Gary Cohn?

Not long ago, Gary Cohn, the head of the White House National Economic Council, looked like the leading candidate to be the next Fed chairman. In late July, his odds were 46 percent on PredictIt. But now our panel puts those odds at 12 percent, and PredictIt’s odds were about the same.

A former No. 2 at Goldman Sachs, Mr. Cohn has been reported to have swung out of favor with Mr. Trump after criticizing his response to racially motivated violence in Charlottesville, Va. But there were some reasons to be skeptical of Mr. Cohn’s appointment to the Fed chairmanship even before that.

Mr. Cohn has a hard-charging style that would be an unusual fit for an agency that is run more like an academic department. The last businessman to become Fed chairman, G. William Miller, was appointed by President Jimmy Carter and lasted only 18 months in the job.

And given his résumé, Mr. Cohn’s nomination would surely set off a heated confirmation battle. Democrats would be eager to criticize the administration for naming a recent top executive at Goldman Sachs to be the nation’s most powerful financial regulator. Some populist Republicans might join them.

Still, given the way people move in and out of Mr. Trump’s favor, and his preference for appointees with business experience, a Cohn appointment can’t be ruled out.

The other contenders

The expert consensus is that there is about a one-in-three chance collectively for the other possible nominees, even as each of them individually is viewed as having single-digit odds. Foremost among them are several of the names we would probably be hearing about if a conventional Republican president were in the White House.

John B. Taylor is a respected economist at Stanford who worked in the George W. Bush administration and has been an influential voice among congressional Republicans who want to see the Fed bound by stricter rules governing its actions.

Glenn Hubbard was a top economic adviser to Mr. Bush who is dean of Columbia Business School.

Larry Lindsey was another top adviser to Mr. Bush and a former Fed governor with an economics doctorate from Harvard.

Our panel's consensus odds for the three were 8, 7 and 6 percent, respectively. Their doctorates and affiliations with top universities may actually be downsides in an administration that has shown disdain for academic expertise.

Another intriguing possibility is Jerome Powell, known as Jay, a current Fed governor who served in the George H.W. Bush Treasury Department and was a partner at the Carlyle Group, the private equity firm. If Mr. Trump wanted a nominee who would probably maintain continuity with current Fed policy but was more conservative and business-minded than Ms. Yellen, Mr. Powell would be a below-the-radar option. The panel rates his odds of ending up in the job at 5 percent.

A range of other names has emerged in various reports, including the F.D.I.C. vice chairman Thomas Hoenig and John Allison, the former chief executive of BB&T bank, but our panel assigns them only long-shot odds.

The surprise factor

Mr. Trump loves a surprise. In his search for a secretary of state, for example, he considered numerous prominent options before going with Exxon's chief executive, Rex Tillerson, a bit of an out-of-left-field choice.

As he focuses on the choice for Fed chief, a similar pattern could reappear, and a less conventional choice could emerge. That's why the consensus of our panel is that there's a 10 percent chance the nominee is not on this list at all.

Then again, in another appointment that has some similarities to the Fed chairmanship, the selection of a Supreme Court nominee, Mr. Trump went with a respected conservative jurist in Neil Gorsuch.

As Mr. Trump starts focusing on the Fed chief decision in the months ahead, that may be the biggest decision of them all: whether to look at conventional qualifications, or go with a surprise. Either way, with Ms. Yellen's term coming to a close and a crowded calendar of Senate business that could stand in the way of a confirmation vote, the clock is ticking.

ABOUT OUR PANEL: The odds listed here are based on a survey of 11 savvy observers of the Fed and economic policy making who were asked to offer a probability on each of the potential nominees listed. Their probabilities were to add to 100 percent, including the odds on "rest of field," or another nominee emerging. Those odds were then averaged to create a consensus probability of each selection.

The participants were: Shehriyar Antia of Macro Insight Group; Tony Fratto of Hamilton Place Strategies; Brian Gardner of Keefe, Bruyette & Woods; Krishna Guha of Evercore I.S.I.; Roberto Perli of Cornerstone Macro; Douglas Rediker of International Capital Strategies; Michael Strain of the American Enterprise Institute; Phillip Swagel of the University of Maryland; Diane Swonk of DS Economics; Eric Winograd of AllianceBernstein; and Mark Zandi of Moody's Analytics.

Top images, from left: Will Oliver/European Pressphoto Agency; Pablo Martinez Monsivais/Associated Press; Alex Brandon/Associated Press; Ted S. Warren/Associated Press; Lucas Jackson/Reuters; Chip Somodevilla/Getty Images; Jim Bourg/Reuters; Jodi Hilton for The New York Times; Gary Cameron/Reuters; Win McNamee/Getty Images; Brennan Linsley/Associated Press

* Confident Fed Sets Stage for December Rate Increase

* To Understand Rising Inequality, Consider the Janitors at Two Top Companies, Then and Now

* Maybe We’ve Been Thinking About the Productivity Slump All Wrong

From left, Kevin Warsh, Janet Yellen, Gary Cohn, John Taylor, Glenn Hubbard, Larry Lindsey, Jay Powell, John Allison, Tom Hoenig, Richard Davis, Bill Dudley and the rest of the field. The width of each image reflects the odds 11 experts gave that person of being the next Fed chair.

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The New York Times

Strategies
Business Day
The Best Investment Since 1926? Apple

By JEFF SOMMER
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English

The iPhone helped to catapult Apple into its position as the world's most valuable publicly traded company. But now Apple has another and, arguably, more exalted **stock market** distinction.

In the history of the markets since 1926, Apple has generated more profit for investors than any other American company.

That conclusion emerges from a study of **stock market** returns by Hendrik Bessembinder, a finance professor at the W. P. Carey School of Business at Arizona State University. His broad findings on the market are startling: Most stocks aren't good investments. They don't even beat the paltry returns of one-month Treasury bills, he has found.

But a relative handful of stocks are extraordinary performers. Only 4 percent of all publicly traded stocks account for all of the net wealth earned by investors in the **stock market** since 1926, he has found. A mere 30 stocks account for 30 percent of the net wealth generated by stocks in that long period, and 50 stocks account for 40 percent of the net wealth.

I've written about Professor Bessembinder's broad findings before, and several readers asked to see all the stocks in the professor's lifetime wealth creation list. So at my request, he updated his calculations through December 2016 and provided fresh rankings in his paper "Do Stocks Outperform Treasury Bills." We've reproduced the crucial elements here, with an important revision: Today, in the iPhone's 10th anniversary year, Apple is No. 1.

In a phone conversation, Professor Bessembinder reminded me that the **stock market** is a moving target and that his rankings, while valid through the end of 2016, don't capture the sharp movements of this calendar year. In his 2016 rankings, Exxon Mobil, not Apple, appears at the top, with net wealth creation of more than $1 trillion. Apple lags at about $745 billion.

But it has been a wild year. Exxon Mobil shares have declined more than 11 percent at a time of weak energy prices, while Apple, which just introduced a raft of new iPhones, is on a spectacular stock surge, gaining more than 37 percent.

Run the numbers as I did, and it's clear that at this moment, Apple has pulled ahead of Exxon Mobil, with total net wealth creation of somewhere in the vicinity of $1 trillion. Counting dividends, Exxon Mobil's losses in the **stock market** have reduced its total to a bit over $910 billion. (Note that, as a technical matter, Professor Bessembinder defines net wealth creation as total stock returns in excess of one-month Treasury bill returns, which averaged an annualized 3.38 percent, so the actual stock returns for Apple, Exxon, and the others are even higher than indicated.)

"It's remarkable that Apple has generated so much wealth in such a short period of time," he said. "Exxon has had decades to pile up those returns."

Exxon is among the top wealth-creating companies that have been publicly trading — under the name of a predecessor, Standard Oil of New Jersey — since the inception of Professor Bessembinder's tally in July 1926. Others include General Electric, IBM, Altria, Coca-Cola, DuPont, PepsiCo and Schlumberger.

He relied on a database developed at the University of Chicago, known as CRSP, for the Center for Research in Security Prices, that contains virtually all publicly traded stocks in the United States. The Center for Research uses rigorous and logical criteria to determine when stocks enter and depart its listings, with some results that may seem surprising at first glance.

General Motors, for example, ranks eighth. It was publicly traded in 1926, but the list says it ceased to exist in June 2009. A company called General Motors exists today, of course, but as Chloe Fu, senior support and relationship manager at the Center for Research in Security Prices, explained it, G.M.'s bailout and bankruptcy led the center to declare the old company terminated, with a new G.M. coming to life in June 2009. Consequently, the new G.M. returns aren't included in the total for G.M. on the list.

The list is a fascinating ranking of big winners in the **stock market**. But for a variety of technical reasons, it isn't a straightforward table of the greatest wealth generators in market history. For example, the long-term gains generated by Exxon Mobil and its predecessors are understated because of the database's limited duration and strict criteria.

Exxon Mobil's wealth in the list doesn't include Mobil's, which Professor Bessembinder's listing says, ceased to exist in November 1999, when it merged with Exxon. And going back further, both Exxon and Mobil were among the descendants of the Standard Oil trust, established by John D. Rockefeller and his partners in the 19th century. The total wealth generated by the cluster of companies derived at least partially from the trust — which also include Amoco and Chevron — doesn't appear in a single notation, because of the list's logic.

Other apparent oddities are explained by Professor Bessembinder's application of the center's criteria. There are two companies on the list called AT&T, for example, neither capturing the total net wealth generated by an investment in the old American Telephone and Telegraph Company at its 19th century inception.

To start with, the "old" AT&T, a.k.a. "Ma Bell," is ranked 17th. It is said to have gone out of existence in November 2005. Another AT&T appears in the 33rd spot. That company came to life in March 1984 as Southwestern Bell, spun off from the old AT&T as a result of an antitrust suit. A descendant of Southwestern Bell bought the AT&T name in 2005 and operates under it today.

Other AT&T cousins are on the list: Verizon, as well as Comcast, which resulted from a merger between AT&T Broadband and an older company also known as Comcast.

The listings for most of the recently created companies are less tangled.

As I wrote in July, Amazon, which started trading in 1997, has soared to the 14th spot. Although it hasn't been in existence long compared with Exxon Mobil, its annualized return is the highest in the list, 37.4 percent through December. A group of young companies have also had remarkable results.

Facebook, which started trading in June 2012, is the youngest on the list, with an annualized return of 34.5 percent. Visa, which had its initial public offering of stock in 2008, is the second-newest company, with a 21 percent annualized return, followed by Alphabet (Google), ranked 11th with a 24.9 percent annualized return.

And then there is that great wealth machine, Microsoft, ranked as the third-greatest wealth creator. Since 1986, it has had an annualized return of 25 percent, making its founder, Bill Gates, the richest man in the world, with a net worth of more than $87 billion, according to Bloomberg.

No list of wealth-generating companies is complete without Berkshire Hathaway. It ranks 12th, just behind Alphabet, with an annualized return of 22.6 percent. By comparison, Exxon Mobil's annualized return was only 11.94 percent.

Why is Berkshire's annualized return so much higher?

It is because the return doesn't include decades of mediocre performance for the old textile company Berkshire Hathaway, which started in 1929. The Center for Research says the Berkshire on this list started in November 1976. It was a holding company for Warren E. Buffett, who guided it to fabulous gains. Thanks to Berkshire, Mr. Buffett is a rich man, with a net worth estimated by Bloomberg at $79 billion.

Anyone who invested in Apple or Microsoft or, really, in any of these companies at their inception and just held on did extraordinarily well. You might look at that record and conclude that you should just buy the best companies as a foolproof way to get rich.

If only it were that easy.

How do you find those companies? Not here.

“The problem is, I have no idea which companies will generate the best returns over the next 10 or 20 or 30 years, “ Professor Bessembinder said. “Probably it will be some companies we’ve never heard of. Maybe it will be companies that don’t even exist now.”

This list is worth studying for understanding the past. But, unfortunately, it’s not a guide to the future, except for this: “In a market where most of the gains are attributable to a few big winners that are hard to identify in advance,” Professor Bessembinder said, “it makes a lot of sense to diversify your position — to avoid the danger of omitting the big winners from your portfolio.”

* The Mind-Boggling Ascent of Amazon and Jeff Bezos

* Hot Stocks Can Make You Rich. But They Probably Won’t.

* At $1,000, Apple’s iPhone X Crosses a Pricing Threshold

* Exxon Mobil Shareholders Demand Accounting of Climate Change Policy Risks

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THE WALL STREET JOURNAL.
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Heard on the Street
Americans Are Richer; Why Are They Still So Cautious?

By Justin Lahart
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22 September 2017
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[Financial Analysis and Commentary]

Getting richer doesn't make people spend like it used to. That should give the Federal Reserve less to worry about when it comes to consumers, but more to worry about when it comes to asset prices.

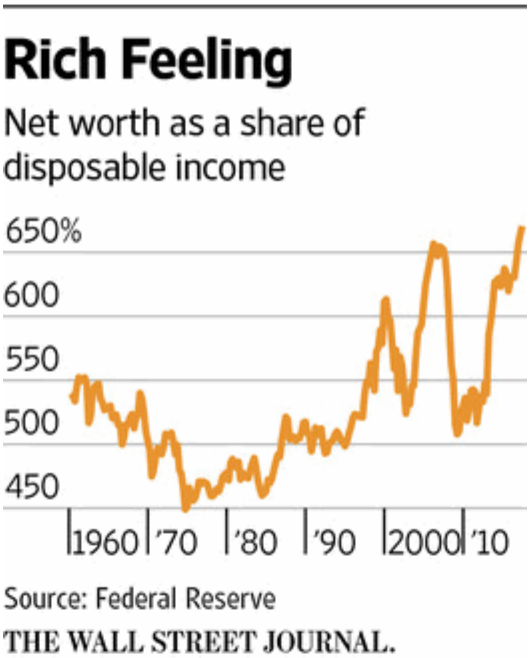
Lifted by rising home prices and a buoyant **stock market**, U.S. household net worth reached a record $96.2 trillion in the second quarter, the Fed reported Thursday, up $1.7 trillion from the first quarter. That compared with $68.2 trillion a decade earlier, just before the recession hit. The wealth-to-income ratio hit a new high of 670%.

But if households are feeling flush, they aren't acting like it. Consumer spending has been tepid, and people have been far less willing to tap wealth to fuel spending than they used to be. Bank of America Merrill Lynch estimates that for each dollar gain in housing wealth, people increase their spending by just two cents, versus five cents in the mid-1990s. For stock gains, the figure has slipped to one cent from four cents.

There are few likely reasons for the change in behavior. First, people don't put as much trust in the staying power of wealth gains. The big **stock market** drops following the dot-com bust and the financial crisis are hard to forget, and the housing bubble ended the old notion that home values are safe. Second, a greater share of U.S. **stock market** and housing wealth is concentrated in the hands of the rich, who don't boost their spending in response to wealth gains as much as other people do. Finally, tighter lending standards have made it more difficult to tap into housing wealth than it was before the financial crisis.

During the early years of the recovery, as asset prices rebounded but the economy only trudged along, the Fed probably wished Americans weren't so hesitant to spend their wealth. But now, with the economy healthier and the Fed tightening, the central bank is probably pleased that it doesn't have to rein in reckless consumer spending, says Merrill economist Michelle Meyer.

The downside is that if consumer behavior and asset prices continue to diverge, the Fed could face some hard choices. Say consumer spending stays muted, the economy grows at the same steady pace and inflation remains low. And say that stock prices keep on rising, stretching valuations to the point where they look frothy. Under those circumstances, should the Fed keep rates steady, and risk a bubble? Or raise rates to cool asset prices and risk pushing consumer spending and inflation dangerously lower?



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Stock Pickers Watch ETFs for Trade Ideas

By Chris Dieterich and Corrie Driebusch
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22 September 2017
The Wall Street Journal
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English

Stock pickers, who for so long decried the rise of passive investing, are now trying to profit from it.

In what is emerging as a nascent line of market research across Wall Street, investors are attempting to puzzle out how passive investing creates opportunities -- or pitfalls -- for individual stock trading. They are looking at factors such as the percentage of a stock owned by index funds and money flows into and out of such funds as they size up whether to buy or sell shares of a company.

This new type of analysis shows how the rise of passive investing -- tracking a basket of securities rather than picking individual ones -- is changing the makeup of markets. Even active investors are now resigning themselves to the influence of indexing and are contriving ways to take advantage of its impact.

The research, by investors and academics alike, is largely in its infancy, many say. And fundamental factors, such as valuations, generally remain most important to stock pickers.

But with passive investing this year representing about 29% of assets in domestic stock funds alone, according to Moody's Investors Service -- a figure the firm sees topping 50% as soon as 2021 -- investors who pick single stocks are paying attention.

"When I think about what makes a stock tick, it comes back to earnings, the quality of management and the ability of a company to execute, but being in an ETF is a factor to be aware of," said Christopher Marinac, director of research at Atlanta-based FIG Partners, of exchange-traded funds, a popular form of index investing.

"Passive ownership is not first or second on the list, but now it is definitely on that list," he said.

So far, researchers say, the influence of passive investing is most pronounced for midsize- and small-company stocks.

Pankaj Patel, head of quantitative research at Cirrus Research in Tarrytown, N.Y., earlier this year published a series of reports on ETF ownership of U.S. stocks, prompted by client demand. He found dozens of small and midsize companies with more than 20% of their shares outstanding owned by ETFs.

Mr. Patel said one-way money flows into or out of index funds potentially create opportunities for active managers who, for example, might opt to hold a stock longer than they might otherwise when inflows are cresting, or pare back a holding sooner if money is moving out.

"Portfolio managers should be aware of heavy ETF ownership," Mr. Patel said. "It can be an advantage when flows are positive, but you want to be careful when they turn around."

Analysts say November's presidential election provided a case study for the effects of passive investing on small-cap stocks.

Roughly $9 billion poured into more than two dozen financial-stock ETFs in the month following the election, according to Keefe, Bruyette & Woods. Melissa Roberts and Pell Bermingham, quantitative analysts at the firm, found that ETF flows had a meaningful impact both on the daily trading volumes and performance of certain financial-sector stocks. Shares of companies included in financial ETFs rose by a median 19.4% over the period, compared with 14.2% for financial stocks not in these ETFs, they found.

The passive effect was compounded, they said, because many financial-sector stocks are included in the Russell 2000 index of small-company shares.

Some $5 billion flowed into the largest ETF tied to this index, the iShares Russell 2000 ETF, in the month after the election.

"ETFs aren't really driving performance, but flows can exacerbate performance," Ms. Bermingham said.

Research from Savita Subramanian, equity and quantitative strategist at Bank of America Merrill Lynch, suggests that companies with a larger proportion of tradable shares in passive funds tend to see more choppiness since fewer shares are available for active traders. That is because the "true float" of available shares is diminished, she said.

"Stocks with more float held by passive funds exhibit, on the margin, higher **volatility**," Ms. Subramanian said.

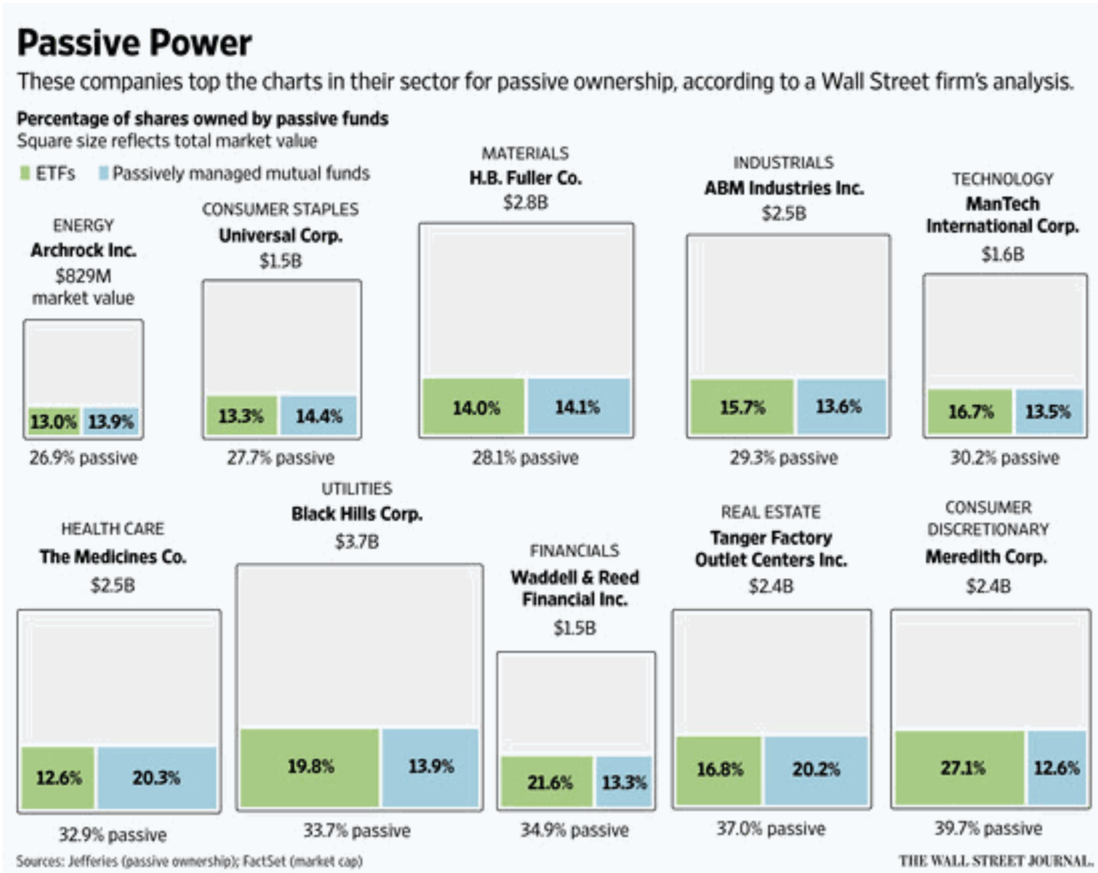
Still, being owned by indexes can be a good thing.

Nearly 40% of the tradable shares of Meredith Corp., a media company with a market capitalization of $2.4 billion, are owned by passive mutual and exchange-traded funds -- more than any stock in the U.S. market, according to Steven DeSanctis, a small- and midcap analyst at Jefferies.

Passive ownership in Meredith received a major boost in January, when the stock was tapped for inclusion in an index that powers the $16 billion SPDR **S&P 500** Dividend ETF. In a matter of days, the ETF bought nearly 3 million Meredith shares and became one of the stock's biggest single owners.

Trading volume during the session when Meredith was added to the index was the heaviest in more than a year, according to FactSet.

"We have seen inclusion in indexes add to demand for Meredith stock," said Mike Lovell, Meredith's director of investor relations.



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THE WALL STREET JOURNAL.
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U.S. Oil Exports Flow as Prices Decline --- Hurricane weighs on West Texas crude, boosting its appeal to refiners overseas

By Alison Sider and Lynn Cook
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English

U.S. oil is trading at the biggest discount to the global price in two years, helping extend a boom in exports of crude from American shale fields to refiners in Europe and Asia.

After Hurricane Harvey hammered the Gulf Coast last month, the price of West Texas Intermediate crude, the U.S. reference price, sank to as much as $6.30 a barrel below its European counterpart, Brent -- the widest gap since August 2015.

Harvey has passed, but analysts say the storm will reshape global crude flows for months. The difference between U.S. oil and Brent, the international benchmark, at $5.88 as of Thursday, is key in determining when it is profitable to ship oil from U.S. ports to places overseas.

A difference of at least $4 makes it attractive for a refiner in countries such as China or South Korea to buy oil from shale producers in Texas and North Dakota, said R.T. Dukes, an oil expert with consulting firm Wood Mackenzie.

"Get to a $4 spread, and you can take it anywhere in the world," he said.

Take Occidental Petroleum Corp., a major U.S. exporter and large producer in the Permian Basin of West Texas. Occidental is shipping more crude than ever as lower U.S. prices boost demand for oil from the Permian. The company recently struck new deals with customers in South Korea, India, China and countries in Southeast Asia, said Cynthia Walker, an Occidental senior vice president.

The U.S. had already become a disruptive force in global energy markets, sending oil overseas after a ban on most exports was lifted at the end of 2015. In recent years, the rise of the highly productive U.S. shale industry has pushed **oil prices** down world-wide. Exports have become a relief valve for U.S. drillers, who have continued to pump despite relatively low prices.

Because many big Gulf Coast refiners are largely geared to process heavy crude, such as the output from Canada and South America, they have continued to import barrels, while some of the output from shale formations has started to flow abroad to refiners set up to process the light, sweet variety.

"The export window is wide open," said Michael Wittner, global head of oil research at Societe Generale.

Leasing oil tankers can cost anywhere from under $1 a barrel to a few dollars, depending on the length of the trip. For instance, taking oil from Texas to Asia is more expensive since it is a longer voyage than to Argentina or the Netherlands. After tanker owners expanded their fleets in recent years, shipping rates have fallen sharply. They are down 20% to 30% in the past year, depending on where ships are loaded, according to shipping consultancy McQuilling Services LLC.

For now, the WTI-Brent spread is wide enough to offset the expense of loading supertankers that are too heavy for relatively shallow Texas ports, consultancy JBC Energy said. While the huge tankers generally have to wait offshore to be loaded by smaller vessels, their larger volumes make longer journeys more economical. Analysts at McQuilling Services expect at least 10 of these tankers to be loaded from the U.S. next month, a record.

One big obstacle to more exports could soon be resolved. The Louisiana Offshore Oil Port is the one place in the U.S. that is deep enough for supertankers that can most profitably make the journey to Asia. The LOOP is looking to add the capability to load those tankers next year.

U.S. and global **oil prices** had already drifted apart in August, and during Harvey's peak, WTI tumbled. More than a quarter of total U.S. refining capacity was offline as plants curtailed operations, causing demand for U.S. crude to dwindle. Some refineries are still struggling to return.

At the same time, global **oil prices** were on an upswing after more than eight months of production cuts by the Organization of the Petroleum Exporting Countries and strong summer demand.

Planned maintenance over the summer also limited output from one of the key oil fields in the North Sea that determines the price of Brent. European refiners cranked up output to pick up the slack for closed U.S. plants.

Harvey all but stopped the flow of oil to and from the U.S., but crude exports jumped back up by 775,000 barrels a day to 928,000 barrels a day in the first two weeks of September, as ports along the Gulf reopened following the storm.

Analysts expect crude exports to hit records in coming months. Volumes are likely to surge to 1.3 million barrels a day in the last three months of the year -- more than double amounts from the same time last year, analysts at Energy Aspects say.

Stephanie Yang contributed to this article.

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Streetwise: Trillions of Dollars Later, the Jury Is Still Out on Fed's Stimulus Program

By James Mackintosh
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B1
English

After spending $2 trillion on government bonds in an effort to stimulate the economy, the Federal Reserve can hardly admit that it doesn't know how, or even if, it worked.

Fed Chairwoman Janet Yellen on Wednesday came as close as she is ever likely to get to accepting that quantitative easing is still poorly understood even by the experts. Explaining why the central bank prefers to set short-term rates rather than buy or sell stuff, she said it was because "we believe we understand pretty well what the effects [of rate changes] are on the economy," and so do investors. Left unsaid: No one's really sure how, or if, QE works.

This matters enormously to investors as the Fed sets out on quantitative tightening. It's starting small, allowing a maximum of $10 billion of bonds a month to mature without the money being reinvested. But in a year, that will be up to $50 billion a month, more than the Fed bought each month during the first phase of QE3 in 2013.

The basic investor belief about QE is simple: It makes bond yields go down, shares go up and the currency go down. All make intuitive sense. Buying more bonds pushes up their price (so, reducing yield). Those who sold bonds have to redeploy their money and so buy shares, while the combination of lower yields and money creation weakens the currency. On top of this "portfolio balance" effect, there's a signaling effect, because QE suggests no rate increases for a long time.

One might then assume that reversing QE will mean the opposite: Bond yields rise, shares fall and the dollar strengthens. There are at least three reasons not to worry too much about this happening and one good reason to be concerned.

First, economists vary widely in their assessment of the size of the impact on bond yields, but it isn't nearly as big as one might expect. Studies suggest the effect of the $600 billion of Treasurys bought in QE2 was a drop in the **10**-**year Treasury** yield of between 0.16 percentage point and 0.45 percentage point, with big margins of error. To put that in context, yields have risen 0.23 point in the past two weeks alone.

Second, common sense makes the measures doubtful. One way economists come up with estimates is to look at price moves on days when news about QE was revealed, which is fair enough. But the same days that bond yields fell, stock prices often fell, too, the opposite of the usual story about QE. To make matters worse, look at the period as a whole, and during QE1, QE2 and QE3, bond yields went up, along with stock prices, while the dollar was mixed, plausibly a sign that QE had worked and boosted expectations of growth and inflation. If the markets have a similar delayed reaction to the end of QE, can we be sure which direction bond yields will move?

Third, the effects of QE clearly depend on what's going on in markets at the time. Every study finds a bigger impact from crisis-era QE than from the later versions, as would be expected. Central bank intervention helped fix dysfunctional markets, so it played a role beyond merely buying bonds. Effects on investor sentiment are likely to be bigger when sentiment is deeply depressed, too. A study by Bank of England staff and Tomasz Wieladek of Barclays PLC last year found QE had double the effect on U.S. economic growth during the panic period than later QE rounds.

At the moment, markets are functioning perfectly well and sentiment if anything is too positive, judging by high valuations for U.S. stocks and junk bonds. Reversing QE is thus likely to have less effect now than it would if markets were in turmoil. The natural assessment, then, is that the Fed reducing Treasury holdings will push up yields, but not by much. For one to think that yields will fall would require a belief that the economy won't be able to cope with the tightening effect at a time when it seems to be doing fine, if not spectacularly well.

Further, we can't be sure that QE had much, or any, effect on growth and inflation. Studies mostly find a noticeable impact, but teasing out how much of that was really down to QE requires too many assumptions to be reliable. As Claudio Borio and Anna Zabai of the Bank for International Settlements put it in a paper last year, "these results generally have to be taken with more than a pinch of salt."

Stock markets tend to tumble when bond yields fall because of economic concerns, and they tend to be less upset when yields go up, although usually the reason for a yield rise is faster growth, which shareholders like, not tighter monetary policy. So it's plausible that even if the reverse of QE does push up bond yields, shareholders won't be that bothered.

There's a good reason for investors to worry, however. At the moment, the one measure on which U.S. stocks don't look expensive is when they're compared with bond yields. If a rise in yields removes that advantage, it takes away the only valuation support for U.S. shares, making it even harder to justify buying at highs.

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The New York Times

Business/Financial Desk; SECTB
Markets Slip on Reining In of Galloping Technology Stocks

By THE ASSOCIATED PRESS
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22 September 2017
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NYTF
Late Edition - Final
2
English

A slide in technology companies weighed on stocks Thursday, pulling the American market lower for the first time this week and erasing modest gains from a day earlier.

Supermarket operators, beverage companies and other consumer-focused stocks also declined. Industrial companies and banks led the gainers. Trading was mostly subdued as investors sized up the latest company earnings and deal news.

The **Standard & Poor's 500-stockindex** lost 7.64 points, or 0.3 percent, to 2,500.60. The Dow Jones industrials fell 53.36 points, or 0.2 percent, to 22,359.23. Both indexes posted record highs on Wednesday. The **Nasdaq composite** lost 33.35 points, or 0.5 percent, to 6,422.69. The Russell 2000 index of smaller-company stocks gave up 1.24 points, or 0.1 percent, to 1,444.18.

The **stock market** was coming off modest gains on Wednesday following the latest policy update from the Federal Reserve. The central bank indicated that it remains on course to raise interest rates on several occasions over the coming year.

"The talk yesterday was still very much in generalities, without specific plans," said JJ Kinahan, chief strategist for TD Ameritrade. "As those details start to become more clarified, you may see a bigger reaction from the market."

Investors continued to rotate out of technology stocks. Despite the pullback, the sector remains up about 25 percent this year, well ahead of all other sectors in the **S.&P. 500**. Chip maker Nvidia slid $5.08, or 2.7 percent, to $180.76. Video game publisher Electronic Arts fell $2.32, or 1.9 percent, to $118.02.

Beverage, food and supermarket companies closed lower. Kroger dropped 58 cents, or 2.8 percent, to $20.22. Dr Pepper Snapple Group gave up $2.18, or 2.4 percent, to $89.50.

Health care stocks also declined. Allergan shares shed $7.34, or 3.5 percent, to $202.66.

"Harry Potter" publisher Scholastic fell 7.1 percent after reporting a disappointing quarter. The stock shed $2.72 to $35.79.

Industrial stocks got a strong lift as investors bid up shares in airlines and other big companies. American Airlines added 87 cents, or 1.9 percent, to $46.29. General Electric gained 43 cents, or 1.8 percent, to $24.75.

Financial stocks also got a boost Thursday. Citizens Financial Group picked up 48 cents, or 1.3 percent, to $36.27.

Traders welcomed news that Calgon Carbon agreed to be acquired by Kurary, a Japanese company, for $1.1 billion. Shares in the maker of water and air filtration systems soared $8.20, or 62.1 percent, to $21.40.

Separately, Ash Grove Cement jumped 82.5 percent after saying it would be bought by CRH. Ash Grove added $235 to $520.

Anadarko Petroleum vaulted 8.2 percent after the company announced a $2.5 billion share buyback authorization that runs through the end of next year. The stock added $3.68 to $48.49.

Bondck. The yield on the **10**-**year Treasury** note rose to 2.28 percent from 2.27 percent late Wednesday.

The dollar rose to 112.56 yen from 112.29 yen on Wednesday. The euro climbed to $1.1931 from $1.1889.

Benchmark United States crude fell 14 cents, or 0.3 percent, to settle at $50.55 a barrel on the New York Mercantile Exchange. Brent crude, used to price international oils, gained 14 cents, or 0.2 percent, to $56.43 a barrel in London. Heating oil added 1 cent to $1.82 a gallon. Wholesale gasoline slipped 1 cent to $1.64 a gallon. Natural gas declined 15 cents to $2.95 per 1,000 cubic feet.

In metals trading, gold fell $21.40 to $1,290.60 an ounce. Silver lost 32 cents to $17.02 an ounce. Copper slid 3 cents to $2.94 a pound.

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

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Fed to Unwind Crisis-Era Stimulus --- Central bank signals rate rise later this year is on track, as it begins shrinking bond portfolio

By Nick Timiraos
1,174 words
21 September 2017
The Wall Street Journal
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English

WASHINGTON -- The Federal Reserve indicated Wednesday it remained on track to raise short-term rates later this year and said it would begin shrinking its portfolio of bonds next month, starting to close the books on an unprecedented and sometimes controversial policy experiment.

The Fed left rates unchanged and penciled in one more rate rise in 2017, signaling continued optimism about the economy even though persistently low inflation has prompted some officials to voice greater skepticism about a move this year.

"The basic message here is U.S. economic performance has been good," Fed Chairwoman Janet Yellen said at a press conference after a two-day policy meeting that ended Wednesday. "The American people should feel the steps we have taken to normalize monetary policy . . . are well justified given the very substantial progress we've seen in the economy."

Stocks and bond yields moved a little higher after the Fed meeting. The **Dow Jones Industrial Average** gained 42 points, 0.2%, to 22413, a record, and the yield on the benchmark 10-year U.S. Treasury note edged up to 2.276%, according to Tradeweb, versus 2.238% ahead of the announcement.

The unanimous decision to reduce the holdings of bonds purchased after the financial crisis -- a program that lowered borrowing costs for homeowners, businesses and consumers to stimulate the economy and **financial markets** -- had been signaled for months.

The bigger question this week centered on how the Fed would frame the debate over raising rates in December and beyond. While officials' latest economic projections indicated they still expect to raise rates one more time this year, they also showed rate increases are likely to end at a lower point than they had previously projected.

The median projection for the longer-run level of interest rates edged down to 2.75% from 3% in June. This is considerably lower than where Fed officials have stopped raising rates in the past.

"A lower prospective terminal rate means that the Fed is less likely to over-tighten and harm the economy -- clearly a good thing for broad equity indexes," said Roberto Perli, an analyst at research firm Cornerstone Macro LP.

The Fed has raised rates by a quarter percentage point four times since late 2015, most recently in June to a range between 1% and 1.25%, after keeping them near zero for seven years.

Officials released their projection of interest rates for 2020 for the first time, and they implied many officials see little need to raise rates after 2019. They continue to expect three rate increases next year, two in 2019 and one in 2020.

Since officials met in July, the unemployment rate has held near a 16-year low, but inflation has stayed soft, challenging the expectation of top officials, including Ms. Yellen, that a deceleration in price pressures this spring would prove transitory.

The Fed's preferred annual inflation gauge, excluding **volatile** food and energy categories, was 1.4% in July, down from 1.9% in January and below the central bank's 2% target.

In recent years, easily observed developments such as a decline in commodities and energy prices, a stronger dollar and labor-market slack helped explain why inflation undershot the Fed's target, but those influences have faded and yet inflation hasn't rebounded.

In her press conference, Ms. Yellen acknowledged the inflation shortfall had proved more persistent and was more broad-based than officials had anticipated. "I can't say I can easily point to a sufficient set of factors that explain this year why inflation has been as low," she said.

She said officials had more work to do to determine if the inflation soft patch would continue, and if it did, it could require an even more gradual pace of rate rises.

Weather-related disruptions from hurricanes in Florida, Louisiana and Texas could distort economic data in the months ahead, complicating efforts to answer those questions. The Fed's postmeeting statement said it didn't expect the storms to change the economy's performance over time.

The combination of relatively stable economic projections and a shallower path for rate increases shows Fed officials think the economy either can't withstand or won't need very high interest rates to achieve the modest growth and low inflation forecast.

The Fed isn't likely to alter rates at its next meeting, held on Oct. 31-Nov. 1, leaving a mid-December policy meeting as its last scheduled chance to push rates higher this year.

Traders in futures markets placed a 70% probability on a rate increase by December, up from 57% before the meeting, according to CME Group.

Meantime, the Fed has managed to formulate plans to shrink its $4.5 trillion portfolio of bonds and other assets without provoking much concern from investors.

Markets haven't reacted much in part because other central banks are still buying government bonds and other assets and because the Fed's plan will unfold very gradually.

Mortgage rates, for example, which have benefited from the Fed's purchases of more than $1.7 trillion in mortgage-backed securities, are near their lowest levels of the year, the Mortgage Bankers Association said Wednesday.

"This has turned out to be a positive year for global economies and markets. Risk appetite is there. I think they saw an opportunity," said Richard Clarida, an economist at Pacific Investment Management Co., or Pimco.

Beginning in October, the Fed will end its practice of fully reinvesting the principal payments of maturing into new bonds and instead allow $10 billion in holdings to roll off without reinvestment every month. Those amounts will increase by $10 billion each quarter to a maximum of $50 billion.

Ms. Yellen said there was a "high bar" to resume reinvestments, and the Fed would only do so in the event of a "significant shock that's a material deterioration to the outlook." She didn't outline any circumstance under which the Fed would accelerate the runoff.

How Ms. Yellen navigates this final chapter could shape how future policy makers view the relative merits of the bond-buying episodes in subsequent downturns and could offer a road map for other central banks, especially the European Central Bank, that are preparing their own retreat.

Some uncertainty hangs over the policy path in the coming year because President Donald Trump will have the opportunity to nominate a new Fed chair and vice chair.

Ms. Yellen didn't say at the press conference whether she wanted to serve a second term, volunteering only that she had not met with Mr. Trump since an introductory meeting shortly after his inauguration.

Mr. Trump has been complimentary of Ms. Yellen's stewardship of the Fed when he has been asked, though he says he hasn't decided whether to ask her to serve a second term.

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States Face Crunch In Retiree Benefits

By Heather Gillers
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When Aurora, Ill., closed its books last December, about $150 million disappeared from the city's bottom line.

The Chicago suburb of 200,000 people hadn't become poorer. Instead, for the first time it recorded on its balance sheet the full cost of health care promised to public employees once they retire.

States and cities around the country will soon book similar losses because of new, widely followed accounting guidelines that apply to most governments starting in fiscal 2018 -- a shift that could potentially lead to cuts to retiree heath benefits.

The new Governmental Accounting Standards Board principles urge officials to record all health-care liabilities on their balance sheets instead of pushing a portion of the debt to footnotes.

The adjustments will show that U.S. states as a group have promised hundreds of billions more in retiree health benefits than they have saved up. The shortfall amounts to at least $645 billion, according to a new report from the nonprofit Pew Charitable Trusts based on 2015 data. That is in addition to the $1.1 trillion that states need to pay for promised pension benefits, according to Pew.

The new level of transparency around retiree health expenses for public workers could lower municipal-**bond prices** and force new decisions to reduce or scrap retiree health benefits as a way of coping with ballooning future costs, some analysts and researchers said. "I think the market has understated the concern," said Richard Ciccarone, president and chief executive of Merritt Research Services LLC, a research firm that tracks municipal bonds.

Rising retiree health-care costs are compounding government pressures when many state and local officials are struggling to manage ballooning pension liabilities and balance their budgets. Waves of baby boomers are already wrapping up their working lives, and expenses are expected to rise in coming years.

"By not dealing with it, we could be setting ourselves up for a very unwelcome surprise," said New York State Comptroller Thomas DiNapoli.

The change will lower bottom lines by tens of billions for some state governments. In New York, the state's health-care liabilities as reported on its balance sheet will jump to $72 billion once the new accounting rules are in place, up from $17 billion. That new total would be 10 times the state's pension liabilities, Mr. DiNapoli's office said.

Mr. DiNapoli said New York has been upfront with bond-rating firms about its retiree health liabilities, but he hopes the new numbers will provide a wake-up call for policy makers. For the last decade, he has helped draft legislation annually that would establish a fund to set money aside for retiree health costs, but he said those bills have stalled.

"If you can put money towards a school or a senior center today, that has a lot more appeal," Mr. DiNapoli said.

Most states have almost no money saved up for future retiree health-care costs and treat the benefits as an operating expense. States had just $48 billion in assets set aside as of 2015, compared with $693 billion in liabilities, according to Pew.

One state that has been setting aside more is Michigan, where retiree health-care liabilities have dropped by roughly $20 billion since 2012 partly because of added state payments. The state also stopped offering retiree health care to new employees, instead contributing an additional 2% of salary to their defined-contribution plans to limit the state's exposure to rising health costs.

"It's transferring the risk for those inflationary items from the state to the employees," said Kerrie Vanden Bosch, director of Michigan's Office of Retirement Services.

Even so, states' retiree health obligations are still much smaller than future pension promises, which are already reported this way. Even if states were to start setting aside money for future costs, annual state spending on retiree health care would still be just 3.4% of expenditures, compared with 1.4% today, according to a study by the National Association of State Retirement Administrators and the Center for State and Local Government Excellence.

States that want to bring their liabilities down will likely face fewer legal hurdles to benefit cuts than they have with public pensions, which enjoy ironclad legal protections in many states. Courts have often upheld employers' rights to increase health-care costs and reduce coverage unless the benefits are laid out in explicit detail in a collective-bargaining agreement or protected by a state constitution, said University of Minnesota Law School Professor Amy Monahan.

Among more than 80 state and local governments surveyed last year by Segal Consulting, 57% said they were somewhat or very likely to reduce benefits in response to the new accounting standards. The guidelines aren't mandatory, though they are widely followed and ignoring them can complicate audits.

The American Federation of State, County and Municipal Employees, which represents public-sector workers, opposed the new Governmental Accounting Standards Board guidelines. It said that "implementing new standards during a fragile recovery may lead to hasty and unwarranted decisions about retiree health benefits."

"If you're going to tell people that you're going to give the best years of your life as a firefighter or cop, you have to figure out a way to bridge those people to Medicare," said Steven Kreisberg, director of research and collective bargaining for the union.

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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB

After Fed Forecast, Indexes Wobble but Finish Higher

By THE ASSOCIATED PRESS
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English

Stock indexes in the United States overcame an afternoon wobble to close mostly higher on Wednesday after the Federal Reserve said it would start reducing its huge bond portfolio next month and was still on track to raise interest rates later this year.

The central bank's announcement drove bond yields higher, lifting shares in banks and other financial companies. Banks benefit from higher bond yields because it means they can charge higher interest rates on loans.

High-dividend stocks like utilities and household goods makers fell. Income-seeking investors find those stocks less appealing when bond yields move higher.

"The announcement was pretty much in line with what was expected," said David Chalupnik, head of equities at Nuveen Asset Management. "So far, the market is taking it in stride, but I don't know if it should. This will slowly impact growth."

The **Standard & Poor's 500-stockindex** inched up 1.59 points, or 0.1 percent, to 2,508.24. The **Dow Jonesindustrial average** rose 41.79 points, or 0.2 percent, to 22,412.59. The modest gains nudged both indexes to record highs, extending a run of milestones that stretches back to last week.

The **Nasdaq composite** lost 5.28 points, or 0.1 percent, to 6,456.04. The Russell 2000 index of smaller-company stocks added 5.02 points, or 0.4 percent, to 1,445.42.

Trading on Wall Street had been mostly subdued this week ahead of the Fed's announcement.

Fed policy makers decided to leave the central bank's short-term benchmark interest rate between 1 percent and 1.25 percent, but also said they still expect to increase the rate one more time this year and three times in 2018, if persistently low inflation rebounds.

The Fed has modestly raised the rate four times since December 2015 after keeping it at a record low for seven years after the 2008 financial crisis.

In addition, the Fed said it will begin to gradually unwind its $4.5 trillion balance sheet next month. The portfolio primarily consists of government and mortgage-backed bonds. The move will gradually increase long-term borrowing rates.

The prospect of another Fed rate hike this year, when the American economy is growing modestly and may slow somewhat from the impact of Hurricanes Harvey and Irma, could be bad news for stocks the next few weeks, Mr. Chalupnik said.

After the Fed's announcement, **bond prices** slumped, sending the yield on the **10-year Treasury** note to 2.27 percent from 2.25 percent late Tuesday.

The Fed statement also sent the dollar higher against other currencies. The dollar rose to 112.38 yen from 111.50 yen on Tuesday. The euro weakened to $1.1885 from $1.1997.

Technology companies were among the biggest decliners. Qorvo slid $4, or 5.4 percent, to $70.32. Adobe Systems also slumped. The business software company posted solid quarterly results, but investors were concerned about the performance of its cloud business. The stock lost $6.64, or 4.2 percent, to $149.96.

Bed Bath and Beyond plunged 15.9 percent after the home goods retailer reported that its latest quarterly sales at stores open at least a year fell short of analysts' forecasts. The stock lost $4.29 to $22.74.

Investors also weighed new data on the United States housing market that showed sales of previously occupied homes fell 1.7 percent in August. Over the past 12 months, home sales have risen only 0.2 percent. The report from the National Association of Realtors pulled down homebuilder shares. CalAtlantic Group fell the most, shedding 97 cents, or 2.7 percent, to $34.60.

Benchmark United States crude added 93 cents, or 1.9 percent, to settle at $50.41 a barrel on the New York Mercantile Exchange. Brent crude, used to price international oils, gained $1.15, or 2.1 percent, to $56.29 a barrel in London.

Wholesale gasoline was little changed at $1.66 a gallon. Heating oil added 3 cents to $1.81 a gallon. Natural gas declined 3 cents to $3.09 per 1,000 cubic feet.

Gold gained $5.80 to $1,316.40 an ounce. Silver rose 6 cents to $17.33 an ounce. Copper held steady at $2.97 a pound.

CHARTS: Existing-Home Sales: Annual pace of existing singlefamily homes sold during the month, seasonally adjusted. (Source: National Association of Realtors); The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Wednesday. (Source: Reuters)

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The New York Times

National Desk; SECTA
Fed Will Unwind Stimulus Effort

By BINYAMIN APPELBAUM; Tiffany Hsu contributed reporting from New York.
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WASHINGTON -- Nearly a decade after the Federal Reserve embarked on an unprecedented effort to shore up the collapsing American economy, the central bank said on Wednesday that it would begin withdrawing some of the trillions of dollars it invested in the wake of the 2008 financial crisis.

The decision, while widely expected, is nevertheless a significant sign that the Fed is confident that economic growth and low unemployment will continue. In other words, the central bank believes that the American economy has emerged safely from the crisis.

''The basic message here is U.S. economic performance has been good,'' Janet L. Yellen, the Fed's chairwoman, said at a news conference following a two-day meeting of the Fed's policy committee.

The Fed's retreat from its post-crisis stimulus campaign will be slow but steady as the central bank looks to shrink the enormous $4 trillion portfolio it amassed through a bond-buying spree.

Those efforts, known as quantitative easing, plunged the Fed into uncharted waters as it tried to navigate the worst financial crisis since the Great Depression. The Fed came under stiff criticism for the program, prompting many Republican lawmakers to question whether the Fed should remain independent.

The Fed, which stopped its buying spree in 2014, is now preparing to pare back its holdings by about $10 billion per month initially. That is likely to raise borrowing costs for consumers and businesses, but only very slowly. Indeed, since the Fed ended its bond-buying, countervailing factors have actually reduced some borrowing costs, like the average interest rate on 30-year mortgages.

Investors are watching warily, but so far there is little sign that the Fed's retreat is tightening financial conditions. Stock prices fell modestly after the Fed's 2 p.m. policy announcement, but bounced back by the end of the trading day. The **S&P 500 index** rose 1.59 points, closing at 2,508.24.

The yield on the benchmark **10**-**year Treasury** also rose 0.02 percentage points, closing at 2.27 percent.

''The Fed did an extremely good job of preparing us for commencing the balance sheet rundown,'' said Peter Hooper, chief economist at Deutsche Bank. ''That's happening with a whimper, but handled differently, it could have been a big event.''

The Fed, which has raised its benchmark interest rate twice this year, left that rate unchanged Wednesday, but indicated that it plans a third rate increase later this year as economic conditions continue to strengthen. The Fed said it expects the labor market to continue strengthening and the economy to expand at a moderate pace.

Twelve of the 16 officials on the Federal Open Market Committee predicted another rate increase this year, the same number as in the Fed's last round of forecasts in June.

In its post-meeting statement, the Fed pointed to the strength of job growth and increases in household and business spending. The official optimism went only so far, however. Growth remains weak by historical standards, and the Fed indicated it sees no evidence of acceleration. Fed officials once again reduced their expectations for rate increases in coming years. The median prediction Wednesday was that the benchmark rate will stabilize at 2.8 percent, down from a median estimate of 3 percent in June.

The Fed's benchmark rate now sits in a range between 1 percent and 1.25 percent, a level most Fed officials regard as providing modest encouragement for borrowing.

Expectations of a third rate increase this year strengthened after the Fed's announcement, rising from a 57 percent chance to a 71 percent chance, according to CME Group.

The Fed's next meeting is scheduled for Oct. 31 and Nov. 1, but the Fed is unlikely to raise rates any sooner than its final meeting of the year, in mid-December.

Some economic indicators suggest that higher rates are warranted: The unemployment rate, at 4.4 percent in August, is below the level most officials regard as sustainable. Moreover, Fed officials predicted that the rate would fall to 4.1 percent next year.

But other economic measures paint a contrasting picture. Job growth remains strong, suggesting that the work force is still expanding; wage growth is modest, suggesting employers are still able to find workers with relative ease; and inflation weakened in recent months, puzzling Fed officials and economists who had predicted that prices would begin to rise more quickly as labor market conditions tightened.

The Fed's preferred measure of price inflation increased by just 1.4 percent during the 12 months ending in July, the most recent available data. The Fed is likely to undershoot its target of 2 percent annual inflation for the sixth consecutive year. That has caused consternation among some economists and Fed officials, who are wary of raising rates given the Fed's inability so far to achieve its inflation objectives.

''I can't say this year that I can easily point to a sufficient set of factors'' to explain low inflation, Ms. Yellen said Wednesday. She added, however, that low inflation this year did not imply low inflation next year. ''What we need to do is figure out whether the factors that have lowered inflation are going to prove persistent,'' she said.

Ms. Yellen said that weak inflation readings earlier this year ''reflect developments that are largely unrelated to broader economic conditions.'' Similarly, she said that the Fed expected the impact of hurricanes on gas prices to increase inflation temporarily. So far, the Fed's assessment of underlying conditions remains unchanged: Ms. Yellen and her colleagues expect inflation to stabilize at its target of 2 percent a year.

The Fed wants to use its benchmark rate to manage economic conditions while gradually draining its investment portfolio in the background. When Ms. Yellen described the Fed's plans in June, she expressed hope that the process would be like ''watching paint dry.''

The Fed holds about $4.2 trillion in Treasury securities and mortgage bonds, which it accumulated to put downward pressure on interest rates. It must regularly replenish its holdings as bonds mature. Beginning in October, it plans to withhold $10 billion a month from the reinvestment process -- in effect causing that much money to disappear.

It will then increase the pace by $10 billion each quarter until reaching a monthly rate of $50 billion, and then maintain that pace until it reaches an unspecified finishing line.

Ms. Yellen emphasized that the Fed did not plan to adjust that schedule, although she added, ''unless we think that the threat to the economy is sufficiently great.''

The retreat will put modest upward pressure on borrowing costs, but businesses and consumers are unlikely to see much difference in the near term. ''You will see a gradual tightening of financial conditions that will come from the Fed shrinking its balance sheet,'' said Lewis Alexander, chief United States economist at Nomura Securities.

Still, questions remain, both about the market's reaction and about the goal. Before the crisis, the Fed held less than $900 billion in assets, and most analysts expect the Fed to maintain a significantly larger balance sheet going forward -- both because the financial system has grown and because the Fed has expanded its role in maintaining the system.

The Fed's slow pace also means it will take years to rebuild its ability to respond to crises. It does not expect its benchmark rate to reach 2.8 percent for three years, and it expects to take even longer to reduce its balance sheet.

''If we get a severe adverse shock in the next couple of years and interest rates are still pretty low and the balance sheet is still pretty big, what in the world are we going to do?'' asked Andrew Levin, a Dartmouth College professor of economics.

Ms. Yellen paused when she was asked that question on Wednesday.

''We have a certain amount of room now,'' she finally said.

She noted that the Fed could buy more bonds. It could also engage in ''forward guidance,'' or promising keep rates at a low level for a specified period.

The Fed also noted the impact of three recent hurricanes, including one that was striking Puerto Rico on Wednesday, but said the resulting economic disruptions were likely to be temporary.

''Hurricanes Harvey, Irma and Maria have devastated many communities, inflicting severe hardship,'' the Fed said. ''Storm-related disruptions and rebuilding will affect economic activity in the near term, but past experience suggests that the storms are unlikely to materially alter the course of the national economy over the medium term.''

Follow Binyamin Appelbaum on Twitter @bcappelbaum.

The Federal Reserve said the impact of three hurricanes would weigh on the economy only briefly. (PHOTOGRAPH BY KEVIN LAMARQUE/REUTERS) (A16)

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THE WALL STREET JOURNAL.
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Puerto Rico Bond Prices Decline

By Heather Gillers
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J
B10
English

It could take weeks to determine the full extent of the hurricane damage to Puerto Rico, but bondholders are already anticipating losses.

Prices have fallen as much as 4% since Monday on some bonds issued by the commonwealth, its public power company, and its water and sewer authority. Investors were already expecting deep haircuts as the commonwealth makes its way through a federally supervised restructuring process.

"How long will they be missing revenues because of people not getting power?" said Dan Solender, director of municipals at Lord Abbett & Co., which holds more than $100 million of Puerto Rico bonds.

Even before Hurricane Maria slammed into Puerto Rico on Wednesday, thousands of people had been without electricity for two weeks, since Hurricane Irma passed by the island's northern coast.

Puerto Rico owes roughly $70 billion to investors. Depending on the extent of the damage, the hurricane could factor into decisions by the federal control board on just how much investors will get paid, said Matt Fabian, a partner with Municipal Market Analytics.

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THE WALL STREET JOURNAL.
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Buffett: Dow to Go Over 1 Million --- Berkshire chief sees the blue-chip index topping seven figures in the next century

By Nicole Friedman and Ben Eisen
529 words
21 September 2017
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B10
English

You heard it from Warren Buffett first: The **Dow Jones Industrial Average** is headed above one million.

The blue chip stock benchmark is likely to be above that milestone in a hundred years' time, the Berkshire Hathaway Inc. chief executive and chairman said Tuesday night. It sounds eye-popping, but judging by past history, it is actually a fairly conservative bet.

"The Dow will be over a million, and that is not a ridiculous forecast at all if you do the math," he said.

Mr. Buffett, who is 87 years old, made his remarks at a celebration of the 100-year anniversary of Forbes. Afterward, he discussed the impact that Hurricanes Harvey and Irma had on one of his best-known businesses, car insurer Geico. Harvey, he said in an interview, caused more losses.

Geico is the biggest car insurer in Florida, where Irma made landfall earlier this month, and the second-biggest in Texas, where Harvey struck in August. But Harvey caused massive flooding, which can be more damaging to cars than wind. Mr. Buffett said in August that he expected Geico to report losses on about 50,000 cars following Harvey.

"It's very hard to give numbers but . . . there were more total losses by quite a margin in Harvey than in Irma," Mr. Buffett said Tuesday about Geico's business.

Berkshire used to be a big seller of reinsurance for catastrophes but has retreated from the market in recent years due to low prices. Mr. Buffett said he doesn't expect pricing to improve despite the string of hurricanes and other natural disasters in recent weeks.

It would take a 3.9% annual gain for the Dow industrials to hit Mr. Buffett's one-million milestone in September of 2117. For context, the Dow has climbed an average of 5.7% annually over the 100 years through Wednesday, when it closed at a record 22412.59.

Mr. Buffett himself has managed to do far better. Berkshire's latest annual report touts an annual return of 21% between 1965 and 2016 for Class A shares.

Apple Inc. shares are up 17% annually since 1980. Amazon.com Inc.'s shares are up 36% annually since 1997. And Tesla Inc. shares are up 46% annually since mid-2010.

Pointing to the long-term track record for stocks could assuage some investors who are getting nervous that growing geopolitical conflicts may send an already expensive **stock market** into a tailspin.

The continued climb is one reason Mr. Buffett cited for his optimism about America -- a sentiment he has long imparted to his followers, particularly during turbulent times such as the 2008 financial crisis. He said Tuesday that of the hundreds of people from all walks of life who have graced the well-known Forbes list of the wealthiest people, none have been short sellers.

"Being short America has been a loser's game," he said. "And it will continue to be a loser's game."

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The New York Times

Business Day; Economy
A Start-Up Slump Is a Drag on the Economy. Big Business May Be to Blame.

By BEN CASSELMAN
1,469 words
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English

Unemployment has fallen, and the **stock market** has soared. So why has the economic expansion since the recession been so tame, with sluggish productivity and, at least until recently, anemic wage growth?

Economists say the answer, to some degree, can be found in a start-up slump — a decline in the creation of new businesses — and a growing understanding of what's behind it.

A total of 414,000 businesses were formed in 2015, the latest year surveyed, the Census Bureau reported Wednesday. It was a slight increase from the previous year, but well below the 558,000 companies given birth in 2006, the year before the recession set in.

“We're still in a start-up funk,” said Robert Litan, an economist and antitrust lawyer who has studied the issue. “Obviously the recession had a lot to do with it, but then you're left with the conundrum: Why hasn't there been any recovery?”

Many economists say the answer could lie in the rising power of the biggest corporations, which they argue is stifling entrepreneurship by making it easier for incumbent businesses to swat away challengers — or else to swallow them before they become a serious threat.

“You've got rising market power,” said Marshall Steinbaum, an economist at the Roosevelt Institute, a liberal think tank. “In general, that makes it hard for new businesses to compete with incumbents. Market power is the story that explains everything.”

That argument comes at a potent political moment. Populists on both the left and right have responded to growing public unease about the corporate giants that increasingly dominate their online and offline lives. Polling data from Gallup and other organizations shows a long-running decline in confidence in banks and other big businesses — a concern not likely to abate after high-profile data breaches at Equifax and other companies.

The start-up slump has far-reaching implications. Small businesses in general are often cited as an exemplar of economic dynamism. But it is start-ups — and particularly the small subset of companies that grow quickly — that are key drivers of job creation and innovation, and have historically been a ladder into the middle class for less-educated workers and immigrants.

Perhaps most significant, start-ups play a critical role in making the economy as a whole more productive, as they invent new products and approaches, forcing existing businesses to compete or fall by the wayside.

“Across the decades, young companies are really the heavy hitters and the consistent hitters in terms of job creation,” said Arnobio Morelix, an economist at the Kauffman Foundation, a nonprofit in Kansas City, Mo., that studies and promotes entrepreneurship.

The start-up decline might defy expectations in the age of Uber and “Shark Tank.” But however counterintuitive, the trend is backed by multiple data sources and numerous economic studies.

In 1980, according to the Census Bureau data, roughly one in eight companies had been founded in the past year; by 2015, that ratio had fallen to fewer than one in 12. The downward trend cuts across regions and industries and, at least since 2000, includes even the beating heart of American entrepreneurship, high tech.

Although the overall slump dates back more than 30 years, economists are most concerned about a more recent trend. In the 1980s and 1990s, the entrepreneurial slowdown was concentrated in sectors such as retail, where corner stores and regional brands were being subsumed by national chains. That trend, though often painful for local communities, wasn't necessarily a drag on productivity more generally.

Since about 2000, however, the slowdown has spread to parts of the economy more often associated with high-growth entrepreneurship, including the technology sector. That decline has coincided with a period of weak productivity growth in the United States as a whole, a trend that has in turn been implicated in the patterns of fitful wage gains and sluggish economic growth since the recession. Recent research has suggested that the decline in entrepreneurship, and in other measures of business dynamism, is one cause of the prolonged stagnation in productivity.

"We've got lots of pieces now that say dynamism has gone down a lot since 2000," said John Haltiwanger, a University of Maryland economist who has done much of the pioneering work in the field. "Start-ups have gone down a lot since 2000, especially in the high-tech sectors, and there are increasingly strong links to productivity."

What is behind the decline in entrepreneurship is less clear. Economists and other experts have pointed to a range of possible explanations: The aging of the baby-boom generation has left fewer Americans in their prime business-starting years. The decline of community banks and the collapse of the market for home-equity loans may have made it harder for would-be entrepreneurs to get access to capital. Increased regulation, at both the state and federal levels, may be particularly burdensome for new businesses that lack well-staffed compliance departments. Those and other factors could well play a role, but none can fully explain the decline.

More recently, economists — especially but not exclusively on the left — have begun pointing the finger at big business, and in particular at the handful of companies that increasingly dominate many industries.

The evidence is largely circumstantial: The slump in entrepreneurship has coincided with a period of increasing concentration in nearly every major industry. Research from Mr. Haltiwanger and several co-authors has found that the most productive companies are growing more slowly than in the past, a hint that competitive pressures aren't forcing companies to react as quickly to new innovations.

A recent working paper from economists at Princeton and University College London found that American companies are increasingly able to demand prices well above their costs — which according to standard economic theory would lead new companies to enter the market. Yet that isn't happening.

"If we're in an era of excessive profits, in competitive markets we would see record firm entry, but we see the opposite," said Ian Hathaway, an economist who has studied the issue. That, Mr. Hathaway said, suggests that the market is not truly competitive — that existing companies have found ways to block competitors.

Experts also point to anecdotal examples that suggest that the rise of big businesses could be squelching competition. YouTube, Instagram and hundreds of lower-profile start-ups chose to sell out to industry heavyweights like Google and Facebook rather than try to take them on directly. The tech giants have likewise been accused of using the power of their platforms to favor their own offerings over those of competitors.

Most recently, Amazon openly called for a bidding war among cities for its second headquarters — hardly the kind of demand a new start-up could make. Mr. Morelix said the Amazon example was particularly striking.

"We're saying that it's O.K. that they shape how a city charges taxes?" Mr. Morelix said. "And what kind of regulations they have? That should be terrifying to anyone that wants a free market."

In Washington, where for years politicians have praised small businesses while catering to big ones, issues of competition and entrepreneurship are increasingly drawing bipartisan attention. Several Republican presidential candidates referred to the start-up slump during last year's primary campaign. Progressive Democrats such as Senators Elizabeth Warren of Massachusetts and Amy Klobuchar of Minnesota have pushed for stricter enforcement of antitrust rules. In a speech in March, Ms. Klobuchar explicitly tied the struggles of entrepreneurs to rising corporate concentration.

In July, entrepreneurs achieved a mark of political relevance: their own advocacy group. The newly formed Center for American Entrepreneurship will conduct research on the importance of new businesses to the economy and push for policies aimed at improving the start-up rate. Its founding president, John Dearie, comes from big business — he was most recently the acting head of the Financial Services Forum, which represents big financial institutions.

“Everybody loves entrepreneurship, but they’re not aware it’s in trouble,” Mr. Dearie said. “If new businesses are the engine of net new job creation, and if new businesses are the engine of innovation, and new business creation is at 30-year lows, that’s a national emergency.”

Follow Ben Casselman on Twitter: @bencasselman

* Bump in U.S. Incomes Doesn’t Erase 50 Years of Pain

* Maybe We’ve Been Thinking About the Productivity Slump All Wrong

* ‘Superstar Firms’ May Have Shrunk Workers’ Share of Income

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

The San Francisco office of Rhumbix, a construction technology start-up. | Jason Henry for The New York Times

Document NYTFEED020170920ed9k00911

THE WALL STREET JOURNAL.
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Heard on the Street
Unfinished Business: Why U.S. Oil Output Could Surprise

By Spencer Jakab
456 words
20 September 2017
The Wall Street Journal
J
B17
English

[Financial Analysis and Commentary]

There are signs that the surge in drilling by shale-oil producers has ended, reducing estimates of U.S. oil output and pushing up prices.

A bird's-eye look at the oil fields shows that investors still need to watch for a quick new boost in supply, though.

The U.S. Energy Information Administration last week cut estimated U.S. crude-oil production by 1.3% and 1.4%, respectively, for the third and fourth quarters of 2017 compared with August estimates. The government may be too optimistic in the short term and potentially too pessimistic over the longer term.

The former view comes from the analysts at Kayrros, which uses satellite data and machine learning to study individual oil wells. The research firm tallied the same drilling rigs tracked by the widely watched Baker Hughes North America Rig Count. Typically oil production follows changes in rig counts some months later. Between the end of July 2016 and the end of July 2017, the U.S. rig count mushroomed by 107%, though it has since retreated slightly.

But the crucial step between drilling wells and producing oil -- completion -- has lagged behind. That means that the backlog of drilled but uncompleted wells, or DUCs, has risen and oil production may be lower than expected in the coming months. In the prolific Permian Basin alone, the number of DUCs was 2,330 in July, according to the EIA -- an all-time high and an increase of 94% compared with a year earlier. Since that figure is now nearly two months old, the number might have continued moving higher even as the rig count declined.

The official estimates of production cuts has helped push up U.S. benchmark crude prices by about 8% to just under $50 over the past two months, with Brent rising even more.

Restraint by shale drillers unable to generate decent cash returns is a **bullish** sign for **oil prices**.

Yet the buildup of DUCs is also **bearish** since it creates latent supply. Because the incremental cash cost to start pumping crude is low for a DUC, the payback period for an oil company is only a year or so.

Even for wells not drilled, analysts at Citigroup estimate the break-even cost to drill and complete a well is just $29 a barrel on a production-weighted basis for the drillers they cover once the costs of acreage and sunk capital costs are excluded for the companies they cover.

Higher prices could get some of these wells pumping. **Oil-price** bulls need to get their DUCs in a row.

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THE WALL STREET JOURNAL.
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Markets Uneasy Over Fed Action --- Bonds slump as investors worry about how central bank will unwind balance sheet

By Daniel Kruger, Akane Otani and Chelsey Dulaney
769 words
20 September 2017
The Wall Street Journal
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B1
English

Bond markets are bracing for a historic moment: the beginning of the end of easy Federal Reserve policy. What comes next is anyone's guess.

The Fed is expected Wednesday to announce it will start unwinding the easy-money policies that it has pursued since the financial crisis.

Many investors are taking the expected Fed action as a vote of confidence that the economy can grow without persistent support. They add that the Fed has signaled its intentions clearly enough that a disorderly debt-market decline similar to the 2013 "taper tantrum" appears unlikely.

Yet U.S. government-debt prices have fallen for seven straight days through Tuesday, pushing up the yield for the benchmark 10-year U.S. Treasury note to 2.239%. Bond yields rise as prices fall.

The bond slump, the longest since March, reflects investors' growing unease about this week's Fed meeting. Investors remain wary that any mistake by the central bank, such as removing stimulus too quickly, could upend months of relative calm. Conversely, if the Fed falls behind and allows inflation to grow too quickly, that could also put the economic expansion at risk.

Bond yields tend to rise in periods when the economy is surging, reflecting investors' bets on continued growth. Yet in an economy dependent on consumer debt to finance purchases for everything from homes and cars to televisions, any policy that increases borrowing costs poses the risk of curbing the expansion.

The market's ambivalence heading into the Fed's meeting highlights the stakes for the Fed and investors alike. The central bank has helped engineer a more successful rebound from the financial crisis than many analysts would have thought possible. But at a time of near-record stock indexes, bond yields far below Wall Street's expectations at the start of the year and a declining dollar that continues to vex investors, the prospect of a textbook unwinding of expansive monetary policy seems almost too good to believe.

"There's always some risk that unwinding the balance sheet is going to be negative for risk assets," said Vassili Serebriakov, a currency strategist at Credit Agricole. "We know what the plan is, but it's possible it has a different impact than what the market expects."

In 2013, then-Fed chief Ben Bernanke indicated the central bank could soon end its quantitative-easing program. Treasury rates shot higher in what investors called the "taper tantrum" and the 10-year yield almost doubled to 3% by year-end.

Twenty-one percent of investors say a policy misstep by the Fed or the European Central Bank represents the biggest tail risk to the markets, according to a Bank of America Merrill Lynch survey conducted Sept. 1 to Sept. 7 of 214 investors with $629 billion in assets under management.

Gary Pollack, head of fixed-income trading at Deutsche Bank Private Wealth Management, has shifted Treasury portfolios into shorter-term securities. He attributed his move to "expectations longer term that yields are going to rise."

Others worry about the impact of the Fed's moves on a **bull market** in its ninth year. They warn the unwinding could gradually pressure stock valuations, which are often calculated relative to bond yields, as well as corporate-earnings growth -- a key driver of stocks' gains this year. Utilities shares, often thought of as bondlike because of their relatively hefty dividends, are likely to underperform if yields rise, Goldman Sachs said.

Not all stocks would necessarily suffer. A rise in Treasury yields could benefit bank stocks by increasing the gap between what they pay on deposits and charge on loans, according to Goldman Sachs research.

The bond market's reaction to Fed pullbacks suggests how difficult the task is. In four of five occasions when the central bank has ended or begun reducing a stimulus program since 2010, the yield on the benchmark **10-year Treasury** note was lower three months later as the economy struggled.

More recently, investors dumped global government bonds this summer after comments from the ECB, Bank of England and Bank of Canada fueled concerns that central banks were looking to move away from less-accommodative monetary policy.

The Fed meeting could also prompt repositioning around the globe. A tick-up in inflation last week sparked new bets the central bank will raise interest rates in December, which many saw as unlikely at the start of the month.

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U.S. News: Home Construction a Mixed Bag

By Laura Kusisto and Ben Leubsdorf
472 words
20 September 2017
The Wall Street Journal
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A2
English

WASHINGTON -- U.S. single-family housing starts continued to edge higher in August, in what could be the last snapshot of the market's health before the cleanup from major hurricanes begins to skew construction activity.

Overall housing starts, however, slipped 0.8% in August from the prior month to a seasonally adjusted annual rate of 1.18 million, driven by continued steep declines in multifamily building, the Commerce Department said Tuesday.

Single-family starts rose 1.6% in August, while starts for buildings with two or more units and fell 6.5%.

The report offers a mixed picture of a market in which single-family construction is gradually improving while multifamily construction is declining significantly due to an oversupply of apartments in many urban markets.

Starts were up 2.7% in the first eight months of 2017 compared with the same period a year earlier. Permits rose 7.5% from the first eight months of 2016. The three-month moving average for single-family home starts was the highest since the recession.

U.S. median household income, adjusted for inflation, set a record in 2016, surpassing the previous peak in 1999, the Census Bureau reported last week, as Americans enjoy a period of sustained income growth and economic prosperity. Despite those gains, new construction remains weak due to a shortage of labor, lack of available land and other factors.

"Almost every other item of investment, everything is up and recovered, but housing construction has not recovered," said Chris Rupkey, chief financial economist at MUFG Union Bank.

Monthly data on housing starts tend to be **volatile** and imprecise; August's 0.8% loss came with a margin of error of 9.6 percentage points. The 5.7% rise for permits had a 2-point margin of error.

Residential building permits, which provide a less **volatile** read on the market, rebounded in August. Permits, which typically lead starts by a month or two, rose 5.7% to a 1.3 million annual rate last month.

Permits fell 1.5% for single-family houses but jumped 19.6% last month for apartment buildings and other multifamily buildings.

Limited supply and fast-rising prices have squeezed many would-be home buyers this year, despite mortgage rates that moved lower during the spring and summer. In July, purchases of previously owned homes and newly built single-family homes both fell from the previous month.

August is likely to provide the last indication of the health of the housing market before storms in Florida and Texas weigh on the data. The Commerce Department on Tuesday said hurricane-affected counties in Florida and Texas accounted for about 13% of total U.S. building permits last year.

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The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Bank and Tech Shares Help Indexes Extend Record Streaks

By THE ASSOCIATED PRESS
749 words
20 September 2017
The New York Times
NYTF
Late Edition - Final
2
English

Wall Street capped a day of mostly listless trading on Tuesday with a slight gain, good enough to lift the major stock indexes in the United States to another set of record highs.

Banks, insurers and other financial companies led the gainers. Technology companies also helped lift the market. Health care stocks lagged the most, pulling down insurers, hospital operators and other companies as a Republican effort to repeal President Barack Obama's health care bill appeared to gain momentum. **Oil prices** fell.

Trading was subdued over all as investors looked ahead to Wednesday, when the Federal Reserve was expected to deliver an update on the central bank's view of the economy and the timing of its plans to raise interest rates and shrink its bond holdings.

''People are still, as they usually are the day before a Fed announcement, kind of in a wait-and-see mode,'' said Lindsey Bell, investment strategist at CFRA Research.

The **Standard & Poor's 500**-**stockindex** rose 2.78 points, or 0.1 percent, to 2,506.65. The index, regarded as the broadest measure of the **stock market**, has hit a record high three days in a row.

The **Dow Jonesindustrial average** gained 39.45 points, or 0.2 percent, to 22,370.80. The average is on a six-day streak of new highs.

The **Nasdaq composite** added 6.68 points, or 0.1 percent, to 6,461.32. The tech-heavy index also notched a new high, its first since last Wednesday.

The Russell 2000 index of smaller-company stocks declined 0.68 points, or 0.1 percent, to 1,440.40.

The major stock indexes wavered in early trading, but recovered to hold their small gains by afternoon. Investors sized up new economic data that showed the pace of home construction in the United States slowed in August because of a steep drop in apartment construction. A separate report on business confidence showed optimism among chief executives reached its highest level since early 2014.

Mostly, though, investors were focused on what the Fed will have to say on Wednesday.

Forecasters expect the Fed to leave interest rates unchanged and stick to plans to raise rates in December. But traders will be listening for word on whether the central bank is ready to begin shrinking its multitrillion-dollar stockpile of bonds.

Such a move would allow the Fed to effectively raise interest rates without touching its key short-term rate, known as the federal funds rate, said Phil Blancato, chief executive of Ladenburg Thalmann Asset Management.

Bond prices fell on Tuesday, sending the yield on the **10**-**year Treasury** note up to 2.24 percent from 2.23 percent late Monday.

Speculation that the Fed will announce plans to unwind its bond portfolio helped lift shares in banks and other financial companies. U.S. Bancorp added 78 cents, or 1.5 percent, to $53.16. Wells Fargo rose 65 cents, or 1.2 percent, to $53.36.

Progressive gained 2.9 percent after the insurer reported lower-than-expected losses from Hurricane Harvey. The company is the second insurer to report losses related to the hurricane, which battered Texas and Louisiana last month, that were far less than financial analysts expected. Progressive shares rose $1.32 to $47.63.

Technology stocks were also among the big movers. The sector is the biggest gainer this year, up 26 percent. NetApp climbed $1.08, or 2.7 percent, to $41.71.

Benchmark United States crude fell 43 cents, or 0.9 percent, to settle at $49.48 a barrel on the New York Mercantile Exchange. Brent crude, used to price international oils, gave up 34 cents, or 0.6 percent, to close at $55.14 a barrel in London.

Wholesale gasoline slid 1 cent to $1.66 a gallon. Heating oil fell 1 cent to $1.77 a gallon. Natural gas declined 2 cents to $3.12 per 1,000 cubic feet.

Gold slipped 20 cents to $1,310.60 an ounce. Silver gained 12 cents to $17.28 an ounce. Copper held steady at $2.97 a pound.

The dollar rose to 111.50 yen from 111.47 yen on Monday. The euro strengthened to $1.1997 from $1.1953.

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

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National Desk; SECTA
Fed Ready to Start Shrinking Its Bond Holdings

By BINYAMIN APPELBAUM
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4
English

WASHINGTON -- The Federal Reserve, which invested trillions of dollars to prop up the American economy after the 2008 financial crisis, is finally ready to take away the crutches.

The Fed is expected to announce on Wednesday that it will gradually reduce its $4.2 trillion portfolio of United States Treasury debt and mortgage-backed securities, a move that would amount to a vote of confidence that the economy's slow-but-steady growth is likely to continue.

The Fed, concerned about the reaction in **financial markets**, has tried to eliminate any suspense by publishing a detailed schedule and promising to move very slowly. But just as the Fed's bond purchases after the 2008 crisis were unprecedented, the retreat will again take the reserve banking system into uncharted territory. No one can be certain what will happen.

''What the Fed is going to do this week will not surprise anyone,'' said Lewis Alexander, chief United States economist at Nomura Securities. ''And the models predict a slow and smooth adjustment. But there is always a risk of more **volatility**.''

Two large and related questions also remain unanswered. The Fed has not said how large it would like its balance sheet to be, so there is no finish line for the retreat. Also, there is a good chance the Fed's current leadership will not complete the journey. Janet L. Yellen, the Fed chairwoman, ends a four-year term in early February, and President Trump has not announced whether he plans to nominate her for a second term.

The Fed responded to the crisis that began a decade ago by cutting its benchmark interest rate nearly to zero, and by vacuuming up huge quantities of bonds. Both measures were designed to revive economic activity by reducing borrowing costs for everything from mortgages to car loans.

The first round of bond-buying, often called ''quantitative easing,'' or QE, began during the crisis and there is broad agreement that it helped to bolster **financial markets**.

The second and third rounds, which came after the crisis, remain controversial.

Buying a bond is the same thing has lending money to the seller. Buyers compete by offering to accept lower rates. The Fed's massive purchases increased competition for available Treasuries and thus drove down interest rates.

In an April analysis, Fed economists reported that the purchases reduced the yield of the benchmark **10**-**year Treasury** by 1 percentage point.

The Fed's purchases of mortgage bonds had a similar effect.

Fed officials, and a wide range of independent economists, argue that the downward pressure on Treasury rates rippled outward to other kinds of borrowing costs, as private investors moved into other markets in search of better returns.

These impacts, however, are difficult to measure, and some independent economists argue that any broad economic benefits were modest, at best.

"There has been an explosion of research, dozens and dozens of papers, and almost all of them agree that QE lowered bond yields," said Joseph Gagnon, a senior fellow at the Peterson Institute for International Economics. "The **financial market** effects are very clear. Did that stimulate growth? Did that stimulate inflation? It's always impossible to prove, but all the models we have imply it should have helped."

Critics foresaw negative consequences. A group of prominent conservatives warned in an open letter in 2010 that the Fed's purchases "risk currency debasement and inflation." Four years later, some signatories doubled down on those warnings. But there has been no resurgence of inflation. Indeed, the Fed is struggling with the opposite problem: Inflation has remained persistently below its 2 percent annual target.

The Fed's program was intended to encourage risk-taking by investors, but some critics warned it would create new asset bubbles. Those warnings have not yet been borne out.

The Fed's retreat began two years ago, when the central bank raised its benchmark interest rate for the first time since the crisis. It now sits between 1 percent and 1.25 percent. The Fed is not expected to raise rates on Wednesday. Job growth has remained strong this year, but some officials are worried about the persistent weakness of inflation.

The Fed plans to reduce its bond holdings with similar care. It plans to cut $10 billion a month for the first three months, divided 60-40 between Treasuries and mortgage bonds. It will then raise the pace by $10 billion every three months.

Mr. Alexander, and other analysts, see a number of factors likely to limit the impact on interest rates, at least in the short term. Both the European Central Bank and the Bank of Japan continue to buy bonds, putting downward pressure on rates. And the Treasury is issuing less long-term debt at the moment, reducing the volume of new securities that markets must absorb.

It is also not clear how much shrinking the Fed plans to do. It needs to hold about $1.5 trillion in bonds to meet demand for currency, which it puts into circulation by purchasing bonds. That number is projected to nearly double over the next decade.

The Fed also needs to hold hundreds of billions of dollars in bonds to maintain its current system for controlling interest rates, which it adopted after the crisis.

Jerome H. Powell, a Fed governor, said earlier this year that the new system is working well and the balance sheet is unlikely to shrink much below $3 trillion.

But maintaining a large balance sheet also means the Fed would remain a more prominent presence in short-term funding markets, where it has displaced some private activity. William Nelson, chief economist at The Clearing House, a trade group representing large banks, said the Fed should return to its pre-crisis operating procedures, which required a much smaller balance sheet.

"The pre-crisis framework worked very well. The Fed had very good control of rates and economic activity," Mr. Nelson said. "Nobody was complaining that the Fed's control of interest rates pre-crisis was not precise enough."

Another open question is whether the Fed would buy bonds in responding to a future downturn. Fed officials predict the benchmark rate will not rise much above 3 percent. That's a problem because during the past nine recessions, the Fed has cut the rate by an average of 5.5 percentage points to stimulate the economy.

In a speech last year at the Fed's summer conference at Jackson Hole, Wyo., Ms. Yellen pointed to asset purchases and forward guidance as the Fed's fallback plan. Those tools, she said, "will remain important components of the Fed's policy tool kit."

But Mr. Trump could choose a Fed chairman who disagrees. Kevin Warsh, an adviser to Mr. Trump who is among the possible candidates, resigned as a Fed governor in 2011 in part because he opposed the Fed's second round of asset purchases.

Follow Binyamin Appelbaum on Twitter @bcappelbaum.

Janet L. Yellen, the Fed chairwoman, with Stanley Fischer, the central bank's vice chairman. (PHOTOGRAPH BY JIM LO SCALZO/EUROPEAN PRESS AGENCY)

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THE WALL STREET JOURNAL.
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The Fed Braces for The Great Unwinding --- Central bank will soon start letting go bonds bought to prop up economy

By Nick Timiraos
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A1
English

WASHINGTON -- The Federal Reserve resorted to a series of shock-and-awe stimulus campaigns to stabilize the economy after the financial crisis. Now the Fed is preparing the final move to unwind its support -- and it wants to be as boring as possible.

The central bank is likely to announce Wednesday it will start slowly shrinking its $4.2 trillion portfolio of mortgage and Treasury bonds purchased during and after the financial crisis. It will do so passively by allowing some bonds to mature without replacing them next month.

The markets haven't blinked at Fed signals for many months that this moment was nearing. But plenty could still go wrong. The central bank has never before had such a large balance sheet or attempted to do this.

If it succeeds, the central bank will quietly close a chapter on an extraordinary policy experiment that lowered borrowing costs for homeowners, businesses and consumers, and will provide a model for other central banks that followed suit. A misstep could disrupt growth at a time when major economies are finally expanding in sync.

Chairwoman Janet Yellen's management of the process will shape the final verdict on whether the bond-buying was successful, which in turn could determine whether it remains a policy tool for future downturns.

"She has reached agreement in a way that is really impressive. Markets didn't freak out. Nobody said 'boo,'" said Austan Goolsbee, who headed the White House Council of Economic Advisers in 2010-2011. Now, he said, "The final exam, with the grade yet to be determined, is can the Fed actually get out of this stuff."

Other central banks that adopted such programs are watching, particularly the European Central Bank, which is considering whether to wind down its asset purchases next year.

When central bankers began these unconventional campaigns, "we had no idea what we should buy, how much, for how long," said David Blanchflower, a Dartmouth College economist who was on the Bank of England's monetary policy committee from 2006 to 2009. Similarly, "there is no idea on the way going out."

Markets' ho-hum reaction so far prompted J.P. Morgan Chase & Co.'s James Dimon to warn this summer against complacency. The Fed's unwind "could be a little more disruptive than people think," the CEO said at a conference in Paris.With other central banks set to pull back on stimulus,"the tide is going out."

Added Matthew Jozoff, J.P. Morgan's mortgage-debt strategist: "We have never seen a central bank exit out of $1 trillion of mortgage-backed securities, so we are concerned about how this is going to go."

What could go wrong is hard to predict. When the Fed discussed plans to pare its purchases of new bonds in 2013, a tumble in prices sent yields soaring, in what was called the taper tantrum. The unanticipated turmoil included capital outflows from emerging markets. Fed officials' desire to avoid a replay has driven careful planning for the balance-sheet wind-down, according to current and former Fed officials.

The Fed launched its bond buying in late 2008, at the depth of the financial crisis, to shore up money-market funds, companies and banks.

A government takeover of housing-finance giants Fannie Mae and Freddie Mac had failed to thaw the mortgage market. So the Fed began buying hundreds of billions of dollars of their debt and mortgage-backed securities to get mortgage rates down. Rates fall as **bond prices** rise.

The Fed later decided it needed to do more to support the economic recovery, and over the next three years it launched two other bond-buying rounds to lower long-term interest rates and keep inflation from going below zero.

Buying long-term bonds sends some investors into riskier assets, buoying stocks, corporate bonds and real estate. Ultralow interest rates allowed millions of Americans to refinance, reducing foreclosures and freeing up cash for spending.

Problems some critics warned about, such as roaring inflation and currency debasement, haven't materialized. Labor markets have tightened, leaving unemployment at a 16-year low in July, while price pressures have been muted.

At the same time, the bond-buying has fueled concerns about frothy asset values, such as in commercial real estate. And while **financial markets** have boomed, economic growth and business investment have been unspectacular.

Research published by the Fed in April estimated its purchases have reduced by around one percentage point what economists call a "term premium," the extra yield investors demand for the risk of lending over a longer term.

Fed economists estimated this stimulus would decline slightly this year as markets anticipate a reduction in bond reinvestments. When the Fed's balance sheet returns to a more normal level, the term premium could still be around 0.25 percentage point lower than if the bond programs had never occurred.

The Fed, though it stopped adding to its holdings of bonds in 2014, has continued to reinvest the proceeds of those that mature. It owns $1.7 trillion in mortgage bonds issued by government-related entities, or around 29% of the market, and around $2.4 trillion in Treasurys, which is 17% of that market.

In June, the Fed said when it started to shrink its balance sheet it would do so by allowing a small initial amount of bonds -- $4 billion of mortgages and $6 billion in Treasurys per month -- to run off the portfolio without reinvestment. Every quarter, it will let a slightly larger amount do so, up to a maximum of $20 billion in mortgages and $30 billion in Treasurys per month.

For the next year or so, the Fed should still end up buying bonds in most months, since only a small fraction will mature and go not replaced, said Richard Clarida, an economist at Pacific Investment Management Co., or Pimco. He compared the start of the plan to losing weight by eating only two desserts a day instead of three.

One question the central bank hasn't yet decided: How large should its balance sheet be at the end of the process?

Its holdings have swelled to $4.5 trillion from less than $900 billion before 2008. Though they will fall, the Fed will end up with more assets than it had before the crisis because its liabilities have grown -- there's more currency in circulation. The balance sheet size could settle out at between $2.4 trillion and $3.5 trillion sometime early next decade, New York Fed President William Dudley said in a speech earlier this month.

That would mean the Fed would end up allowing only around $1 trillion to $2 trillion in securities to mature after having added $3.7 trillion between 2008 and 2014.

One reason markets have been relatively unfazed is that central banks in Europe and Japan are still purchasing assets. David Spector, CEO of mortgage originator PennyMac Financial Services Inc., expects the start of the Fed's unwinding to have little effect on mortgage rates, which inearly September hit their lowest levels of the year.

The Fed wants to move now because the economy is on stronger footing. Its large holdings have become a political liability, with critics saying the mortgage-debt buying, in particular, exceeded the Fed's mandate once normal market functioning had been restored.

Central bankers are "comfortable with the extraordinary actions they took during the crisis, and they know not everybody is," said Lou Crandall, chief economist at financial research firm Wrightson ICAP. "If the unwind is successful, it will bolster the case for" similar bond buying in the future.

Hanging over the discussions has been the question of who will lead the Fed next year. Ms. Yellen's term expires in February, and Vice Chairman Stanley Fischer is giving up his seat. There are three other vacancies on the seven-seat board of governors.

By reaching unanimous agreement on the balance-sheet plan this year, the Fed has essentially resolved the issue for any Yellen successor and given more certainty to markets, just as Ben Bernanke in 2013 announced plans to gradually reduce the Fed's purchases before his term as chairman ended in 2014.

The balance-sheet plan bears hallmarks of Ms. Yellen's meticulous, leave-nothing-to-chance leadership, say current and former Fed officials. The core of it came together three years ago. Officials said they would raise the federal-funds rate before starting on the balance sheet, and wouldn't be bond sellers.

The rate-setting committee ramped up discussions at its March 2017 meeting, weighing questions such as whether to set a fixed calendar or to condition a wind-down on economic conditions; the pros and cons of a phasing out of reinvestments vs. stopping cold turkey; and whether to treat mortgage bonds and Treasurys differently.

After the March discussion, a majority -- around 10 of the committee's 17 members -- appeared to form a consensus: The Fed's plans should be predictable and passive. Tapering the pace of bond reinvestments would extend the process by a year, reducing the chance of spike in bond yields.

It should be as exciting as watching paint dry, Philadelphia Fed President Patrick Harker later said.

In regular calls and meetings to gain more feedback from committee members after the March meeting, Ms. Yellen gently highlighted the growing consensus to those who had different ideas.

Meantime, when minutes of the meeting revealed details of the discussion, markets shrugged, helping to move off the fence some who worried about acting too soon. By the Fed's June meeting, officials who were uneasy about moving ahead with rate increases voiced little concern about starting the balance-sheet plan, largely because it was so gradual.

"We won't know until we actually take the action, but I'm reasonably confident that it's not likely to be much of an event," said Boston Fed President Eric Rosengren.

"We communicated it better this time."

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The New York Times

Business/Financial Desk; SECTB
Bank Shares Guide Indexes to Record Highs as Bond Yields Rise

By THE ASSOCIATED PRESS
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19 September 2017
The New York Times
NYTF
Late Edition - Final
4
English

Banks and other financial companies led United States stocks modestly higher on Monday, nudging the **stock market** to another record high.

Investors continued to bid up bank shares as interest rates rose. Banks benefit from higher rates, which can translate into higher profits from lending money.

The rise in bond yields also weighed on the stocks of utilities, real estate companies and other bond proxies. Shares of big retailers like Amazon.com were among the biggest decliners.

''This is really a day which is characterized by rates moving and equities being influenced by interest rates,'' said Bill Northey, a senior vice president for United States Bank Wealth Management.

The **Standard & Poor's 500**-**stockindex** rose 3.64 points, or 0.1 percent, to 2,503.87. The **Dow Jonesindustrial average** gained 63.01 points, or 0.3 percent, to 22,331.35. Both indexes closed at record highs on Friday.

The **Nasdaq composite** added 6.17 points, or 0.1 percent, to 6,454.64.

Investors were looking ahead to the latest two-day policy meeting of the Federal Reserve, which begins Tuesday. Forecasters expect the Fed to leave interest rates unchanged and stick to plans to raise rates in December.

Traders sent **bond prices** lower as the yield on the **10**-**year Treasury** note rose to 2.23 percent from 2.20 percent late Friday.

Citigroup was among the big banks to post gains. The stock added $1.56, or 2.3 percent, to $70.60, while shares of Wells Fargo & Co. rose $1.05, or 2 percent, to $52.71.

Industrials stocks were also big gainers, led by the defense contractor Northrop Grumman, which agreed to buy the aerospace manufacturer Orbital ATK for $7.8 billion. Shares in Northrop rose $8.94, or 3.3 percent, to $275.97. Orbital stock soared $22.21, or 20.2 percent, to $132.25.

But shares of several big retailers were down sharply, including Amazon.com, which slid $12.60, or 1.3 percent, to $974.19.

Stock in the toy makers Mattel and Hasbro slumped after it was reported that Toys ''R'' Us might file for bankruptcy protection before this holiday season. Mattel stock lost 99 cents, or 6.2 percent, to $14.87, while Hasbro shares fell $1.60, or 1.7 percent, to $93.24.

Benchmark United States crude rose 2 cents to settle at $49.91 a barrel on the New York Mercantile Exchange. Brent crude, used to price international oils, dropped 14 cents to $55.48 a barrel in London.

The dollar rose to 111.43 yen from 110.82 yen on Friday. The euro strengthened to $1.1951 from $1.1943.

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

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

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REVIEW & OUTLOOK (Editorial)
The Fed's Long March to Normal

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The Federal Reserve this week, at long last, may announce plans to begin unwinding its nearly nine-year experiment with unconventional monetary policy known as quantitative easing. The move is welcome, even if it brings more financial **volatility**, because for the sake of the economy and its own credibility the Fed needs to return to a more modest view of central banking.

Financial markets seem to be anticipating the decision without angst, and for that the Fed deserves some credit. Chair Janet Yellen and her colleagues have signaled the move well in advance, including what is an agonizingly slow wind down in its $4.5 trillion balance sheet. The Fed has said it expects to pare that by only $10 billion a month for three months, then $20 billion for another three, before rising to $50 billion a month within a year. This means the return to monetary normalcy won't arrive before 2021 or 2022 at the earliest, assuming no recession along the way.

This reflects the Fed's inherent caution and perhaps a belief in its own QE advertising. Keep in mind how former Chair Ben Bernanke sold the concept: By buying long-duration Treasurys and mortgage securities, the Fed would drive down bond yields and force investors into riskier assets as they searched for yield.

This was supposed to lift asset prices and spur faster economic growth. The faster growth never arrived -- despite Fed predictions for years that 3% annual GDP growth was right around the corner -- in what has been the slowest modern expansion on record. But prices have risen in stocks, real estate, emerging-market plays and other assets.

If the Fed calls that a success on Mr. Bernanke's terms, then shouldn't the reverse happen as the Fed unwinds? That is, as the Fed unloads long-duration bonds, will investors sell some of those riskier assets to buy the Treasurys and mortgage debt the Fed won't be buying? Will we see naked bodies if the tide recedes in some asset classes?

If we knew the answer, we'd be rich, but there's certainly a chance for more financial **volatility** as investors react. This concern may explain the Fed's slow unwinding, especially as it now pays such close attention to the **stock market**. The Fed seems to fear the effect of any stock correction on the "wealth effect," even if corrections are useful in heading off investor manias that can become bubbles. (See the dot-com **Nasdaq**, year 2000.)

The effect on the real economy may be more sanguine, and in that sense the Fed's timing is fortuitous. The world's major economies are all growing at once for a change, and bank balance sheets in the U.S. are strong. The Trump Administration and Congress are moving toward what we hope is a pro-growth tax reform. The dollar has weakened considerably so there is little fear that monetary tightening will lead to an overvalued greenback. Inflation is contained, though it bears watching.

As David Malpass has argued on these pages, paring the Fed balance sheet might even be a growth stimulus. The Fed's post-crisis policies have favored big business and governments that have been able to borrow at bargain rates. But that has meant less credit to the rest of the economy, especially small businesses that create most new jobs. Fed policy has also favored the affluent who have financial assets at the expense of savers and the middle class. Reversing all this could unleash more bank lending and perhaps more small-business hiring.

We are using "might" and "could" here because no one really knows. No central bank in a large, modern economy had previously embarked on such a vast bond-buying experiment, and thus none has ever tried to unwind it. Some modesty is warranted.

Yet that is all the more reason for the Fed to begin the long march back to normalcy. Whether or not you think its post-2008 exertions succeeded, they have taken the Fed far from its legal mandate.

Its purchase of mortgage securities in particular are a form of credit allocation that distorts **financial markets** and investment decisions. Its meddling in the long bond market abetted federal government borrowing by disguising the long-term cost of debt repayment. The Fed offered a free lunch for the Obama Administration with the bill presented to future Presidents and taxpayers.

The Fed needs to shrink these financial and political footprints. History shows central bankers have a hard enough time guiding interest-rate policy without producing either inflation or recessions. The longer they are viewed as economic maestros, or the wizards of helicopter money, the more they are able distort investment decisions and hijack economic policy from elected political actors.

One danger of this QE experiment is that too many in the political class and inside the Fed are already eager to call it a success and repeat it during the next recession. Historically slow growth and tepid income gains during an eight-year expansion aren't our idea of success, and they don't justify a Fed that continues to dominate economic decision-making.

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Heard on the Street
Overheard

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[Financial Analysis and Commentary]

Oil prices are starting to sound a bit funky in Caracas. While the price of a barrel of U.S. benchmark crude is just under $50 in capitals from Abuja to Zagreb, you may hear numbers like 41, 326 or 2,860 quoted in Venezuela.

Those would be the prices in euros, yuan or rubles, respectively, as the country's embattled leadership is no longer quoting crude in dollars.

"To fight against the economic blockade there will be a basket of currencies to liberate us from the dollar," said Venezuela's vice president.

Yet crude is universally quoted in greenbacks.

While U.S. economic sanctions may gum up transactions, simply quoting in those of friendly nations such as China and Russia won't change much. Venezuela's revenue is sinking as measured in any currency except perhaps its own rapidly depreciating one.

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The Fed Should Stop Worrying and Learn to Love Low Inflation

By William M. Isaac and Richard M. Kovacevich
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18 September 2017
The Wall Street Journal
J
A19
English

There's no excuse for the Federal Reserve's dawdling -- not even its obsessive concern that inflation is too low. At 1.4% year on year as of July, core inflation is below the Fed's target of 2%, but that goal is arbitrary and unrealistic for today's economy. When the Federal Open Market Committee meets this week it should put aside this inflation fixation and raise interest rates, which have been dangerously low for much too long.

The current economic recovery has been the slowest in recent times, despite the lowest interest rates in history for the longest time. Easy money has benefited mainly the wealthy, while average consumers have been getting close to zero interest on their savings accounts. This is particularly tough for retirees who do not participate in the **stock market**.

Low inflation, on the other hand, has been good for the U.S. economy, workers and the middle class, including retirees living on fixed incomes. Over the past five years, hourly earnings in the private workforce are up 2.2% a year on average, which is only about half of what might be expected in a normal economic recovery. But thanks to low inflation, workers have gained some real income.

If the Fed had been successful in achieving its 2% inflation target, it would have offset nearly all these wage gains. That in turn would have severely weakened the annual growth of consumer spending, which, at over 3%, is a bright spot in the economy.

Higher inflation does not create greater economic growth. To the contrary, it is greater economic growth that can lead to higher inflation. Therefore, the Fed ought to be focused on revving the economy and adding jobs -- period. One reason business investment has been very weak for eight years is the lack of confidence in Washington's monetary and fiscal policies.

The only legitimate reason to increase inflation artificially is to avoid deflation, which can indeed be dangerous. If consumers become convinced that prices will drop over time, they begin to postpone purchases, thereby slowing economic growth.

But to find out if this is happening, the metric to look at isn't inflation. It is the savings rate. If consumers have money and don't spend it, then obviously the savings rate must go up. There is no evidence that it has done so to any significant degree world-wide. In the U.S., the opposite is occurring: The savings rate slid to 3.5% as of July, down from 5.1% a year earlier.

As long as the economy and employment continue to improve, the Fed should stop fretting about low inflation and move to normalize monetary policy. Ideally it could reach interest rates of at least 2% by the middle of next year, up from 1.25% today. That would be a good middle ground. If economic growth then slowed, the Fed would have room to maneuver by ticking rates down. But if inflation increased, it could quickly raise rates to the equilibrium level.

The Fed should also start, at the FOMC meeting this week, reducing its outsize balance sheet, so as to let the markets begin to function properly. Before the recession of 2008-09, the Federal Reserve's balance sheet had never reached $1 trillion. Today it stands at $4.5 trillion, or 25% of Washington's entire public debt. The Fed's eight-year intervention in the markets has helped push asset prices -- including the **stock market**, long-term bonds, and at least some commercial real estate -- so high as to raise concerns of a bubble. Should it burst, the effects could be catastrophic, shattering confidence in the economy. The Fed would feel pressure once again to bail out the wealthy with monetary policies that artificially support risky assets.

The incomes of many Americans are flat or declining, and thousands who want work still cannot find a decent job. What built this country's prosperity was the unparalleled success of America's free-market system. If the Fed wants to help, it should forget its inflation worries, get out of the way, and let the markets operate.

Mr. Isaac, a consultant to financial institutions, is a former chairman of the Federal Deposit Insurance Corp. Mr. Kovacevich is a retired chairman and CEO of Wells Fargo & Co.

(See related letters: "Letters to the Editor: Maybe the Fed's Staffers Could Get a 2% Cut" -- WSJ September 26, 2017)

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The Week Ahead
Business Day
Europe Weighs Taxing Tech Companies and the Fed Meets

By THE NEW YORK TIMES
609 words
17 September 2017
05:04 PM
NYTimes.com Feed
NYTFEED
English

Here's what to expect in the week ahead:

TECHNOLOGY

Europe takes aim at a piece of tech company profits.

The European Commission is expected to publish on Monday a list of options for taxing technology companies like Google and Amazon. These companies have been in the cross hairs of European officials because of their efforts to minimize the taxes they pay by recording profits in lower tax jurisdictions, like Luxembourg and Ireland. Last year, the European Commission ordered Ireland to collect $14.5 billion in unpaid taxes from Apple in a record penalty, saying that the company's deals with the Irish government had allowed it to pay virtually nothing on its European business in some years. Amie Tsang

ECONOMY

Housing numbers get a baseline as uncertainty looms.

The housing market has been caught between two counteracting forces this year: a run of strong job growth that has lifted demand among home buyers, and a dearth of inventory that has kept many prospective home buyers finding nothing to buy. That has lead to seesaw numbers for a slew of housing data. Soon, the figures will get even harder to interpret, as the aftermath of Hurricane Harvey, which pummeled the nation's largest new-housing market, affects the data. Housing starts, which come out on Tuesday, and existing home sales, which come out on Wednesday, shouldn't be affected by the storm just yet. So consider those numbers a baseline before **volatility** sets in over the next few months as rebuilding efforts get underway. Conor Dougherty

A sell-off seems certain, but the Fed will move slowly.

The Federal Reserve is widely expected to announce that it will begin to reduce its vast holdings of Treasuries and mortgage-backed securities, an important step toward concluding its post-crisis economic stimulus campaign. The Fed's policy-making committee, which meets on Tuesday and Wednesday in Washington, is struggling to understand why inflation remains weak despite steady job growth and low unemployment. It is no longer clear whether the Fed will raise its benchmark interest rate again this year. But officials are sufficiently confident in the health of the economy to start whittling away at the $4 trillion bond portfolio, which was accumulated during the crisis to help hold down borrowing costs. The Fed plans to move slowly — minimizing the impact on economic conditions — initially reducing its holdings by just $10 billion a month. Binyamin Appelbaum

Nafta talks resume, with perhaps a sneak preview first.

United States trade negotiators travel to Ottawa next Saturday to begin the third round of negotiations with Canada and Mexico on the North American Free Trade Agreement. President Trump has said that he would like the deal to be finalized by the end of the year, but analysts say that may be a challenge. Some proposals by the United States, including one that would allow the agreement to expire after five years unless the three countries vote to continue it, have rankled Mexican and Canadian counterparts. The United States trade representative, Robert Lighthizer, who is the country's lead negotiator, may give some insight into the process as he outlines the administration's trade priorities in a speech on Monday. Ana Swanson

* Fed, Leaving Rates Unchanged, Expects to Wind Down Stimulus ‘Relatively Soon’

* Apple Owes $14.5 Billion in Back Taxes to Ireland, E.U. Says

The European Commission will consider ways to tax tech companies like Apple. Last year, the commission ordered Ireland to collect $14.5 billion in unpaid taxes from Apple. | Jim Wilson/The New York Times

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The Intelligent Investor: Private-Equity for Cheapskates Like You

By Jason Zweig
808 words
16 September 2017
The Wall Street Journal
J
B1
English

You probably can't get a Ferrari at the price of a Ford Fiesta, but some people can't resist trying to find a bargain.

That's the idea behind the latest attempt by exchange-traded funds to enable just about anybody to buy investments only the wealthiest could traditionally afford. This past week, a market-index firm and an ETF issuer moved to launch a benchmark and a fund that aim to produce returns similar to those of private-equity buyout funds.

Such portfolios have generally been available only to multimillionaires and pension funds and university endowments. With billions in capital committed for years on end, buyout funds take entire companies off the public market, clean them up and ultimately resell them. They crank up their returns with borrowed money.

Over the 10 years through March, private-equity funds returned an average of 9.9% annually, net of all fees, according to the American Investment Council, a trade group for the industry. That is well above the 7.5% return on U.S. stocks, including dividends.

Skeptics have long argued that you could come close to the performance of private-equity funds by using borrowed money to buy an index fund that invests in stocks that are cheaper and smaller than average.

While such a homemade buyout fund lacks the analytical skill, financial acumen and operational expertise that the world's greatest deal makers wield, it sure is cheap.

Buyout funds often charge as much as 2% of assets in management fees and 20% of profits, along with other expenses. All told, the cost of ownership in these funds can run roughly 3.5% annually.

Addressing pension-fund executives this past week, Laurence Fink, chief executive of BlackRock, the world's largest investment firm, said that good private-equity managers deserve to be paid well. But if future returns are lower, he said, "I do believe fees should be lower."

Had you used 50% borrowed money to buy Vanguard Mid-Cap Value Index Fund 10 years ago in March, and kept your borrowing level constant each year, you would have earned an average of 8.4% annually, reckons William Bernstein of Efficient Frontier Advisors in Eastford, Conn.

That fund, like other index funds and ETFs that buy cheap, midsize stocks, was a significant holder of office-equipment supplier Staples, which went private this past week in a buyout led by private-equity firm Sycamore Partners. In earlier years, such index funds held numerous energy and technology companies that ended up being acquired by deal makers.

Presumably, undervalued companies cluster in areas of the economy that go out of favor with investors. Think of energy stocks in 2014 and 2015, or retailing stocks in 2017; buyout funds specifically targeted both those industries. Sector exposure appears to account for about half of the long-term extra return of private equity, says David Turkington, head of portfolio and risk research at State Street Global Exchange.

In principle, an investor could use a benchmark such as State Street's Private Equity Index, which tracks investments by more than 2,700 buyout funds, to shadow them. Mark Kritzman of Windham Capital Management in Boston and his colleagues have estimated that an investor using industry-sector ETFs to mimic those deal-making patterns could have outperformed the overall **stock market** by more than 3 percentage points annually from 2002 through 2014.

This past week, SummerHaven Index Management, a research firm based in Stamford, Conn., introduced a market measure that will attempt to produce returns similar to those of private-equity funds. At the same time, USCF Advisers registered with the Securities and Exchange Commission to launch an ETF based on SummerHaven's index.

Based on research by Harvard Business School finance professor Erik Stafford, SummerHaven argues that the returns of buyout funds can be approximated with a basket of smaller companies that haven't been issuing large numbers of shares recently, are modestly profitable and are selling at low ratios of total capitalization to cash flow.

The proposed ETF hasn't yet stated its fees, but a commodities fund from SummerHaven and UCSF charges total expenses of 1.11% annually.

Andrew Lo, a finance professor at Massachusetts Institute of Technology who has helped design portfolios that replicate the returns of hedge funds, points out that no one would be interested in mimicking private equity if it hadn't had such torrid returns in recent years.

Such performance won't last forever. What's more, any rise in interest rates could hit returns hard.

Is it worth paying opulent expenses to masters of the universe once you can mimic them for peanuts? Price competition is finally coming to the palaces of the fee kings.

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The New York Times

Business Day
Simple Investing for Nonprofits

By GERALDINE FABRIKANT
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The boards of small nonprofit organizations must make major investment decisions, but they are often flying in the dark.

Handling large amounts of money simply isn't a risk-free proposition, and it can be difficult for those without a background in finance. "We probably get three or four calls a month from institutions that have $10 million to $30 million and don't know what to do," said D. Ellen Shuman, who oversees Edgehill Endowment Partners, which manages about $650 million in nonprofit money.

There is a simple answer, which works for many small institutions as well as for individuals saving for retirement. It is to put money into low-cost stock and bond funds, allocate the money appropriately and rebalance periodically. But the boards of nonprofits don't always find this straightforward approach appealing for a variety of reasons, many of them psychological.

For one thing, not every nonprofit has board members who want to take responsibility for decisions that could affect their institution's financial health. Even members with financial expertise may feel ill equipped to make an investment decision in a stressful market.

Hiring outside money managers to handle these burdens comes at a price and with no guarantee of success. Assembling a team of superb money managers, as Yale, Princeton and other universities have tried to do, may not be realistic for nonprofits that don't have an enormous endowment.

That's why Larry Kochard, who oversees the University of Virginia's $8.6 billion endowment and sits on the board of the $18 million Virginia Environmental Endowment, says the simple solution, equity and bond index funds, makes sense for smaller institutions.

Finding good outside advisers is possible for institutions without deep pockets, he said, but it is very difficult. "The odds of a small endowment finding the right managers are very slim," Mr. Kochard said.

For the most part, he advocated modest goals, saying: "If we are watching our allocations and spending and rebalancing, we are meeting our obligations."

Ms. Shuman also favors index funds for nonprofits, but warns that the success of index funds over the past several years has largely been driven by companies like Facebook, Amazon, Netflix and Google.

"They drove a disproportionate return," she said, and if these stocks decline, the indexes will fall, too. She recommends Vanguard's managed equity and international funds for low-cost but actively managed alternatives.

When considering whether to hold hedge funds, which often do not allow immediate liquidation of investments, many nonprofits may need to examine whether they can afford to forgo access to their money for long periods.

That's not always an issue, however. Before Patti Birch died in 2007, for example, she directed that her Patti and Everett B. Birch Foundation spend down all of its funds in the years ahead. The foundation's president, Vartan Gregorian, said it still gave money to "the arts, women's rights, religious and ethnic tolerance, freedom of speech and strengthening American democracy," all causes that were important to Ms. Birch. Mr. Gregorian is also president of the Carnegie Corporation.

The foundation's remaining funds are all being held in low-risk short-term bonds, said Mark Imowitz, whose firm, Imowitz Koenig and Company, handles the finances.

"Patti was not worried about having great appreciation in her investment assets," he said. "It was natural to keep them in low-return funds since the money was being spent down."

Many nonprofits have to think much longer term, however, and don't have the luxury of holding all of their assets in a single low-risk asset class.

Mike Kempner, who heads KS Capital Partners, a small hedge fund, is the treasurer of De La Salle Academy, a Manhattan school for low-income children that has a $9 million endowment and that plans on being around for many years. Commonfund, which advises many educational institutions, has managed La Salle's money, he said.

Roughly 80 percent of it is allocated to Commonfund's multistrategy equity fund, which includes a smattering of hedge funds, and it underperformed the **Standard & Poor**'**s500 stockindex** by 2.5 percentage points in the three years through April, Mr. Kempner said. The fund has improved lately, he said.

"You can't be complacent," he said. "If a manager underperforms their benchmarks, you should not just immediately trade managers. You have to understand what is wrong and how can they plan to fix it "

Fees vary widely and are not always transparent. Commonfund, which manages about $24 billion in nonprofit money for about 1,400 clients, charges an average fee of 0.3 percent directly, according to Keith Luke, Commonfund's president. But because the managers selected by Commonfund for nonprofit portfolios also charge fees and because there are additional expenses, the overall fee paid by nonprofits is about 1 percent on average, he said.

Commonfund "is like an institutional mutual fund," Mr. Luke said. "We create a commingled investment vehicle of managers who pick stocks across all strategies."

TIAA, which specializes in retirement plans for teachers, offers advice to nonprofits, as does Vanguard, the giant low-cost mutual fund manager. Vanguard manages about $23 billion in nonprofit funds, said Christopher Phillips, head of its institutional advisory services.

"There is scaled pricing," he said, "and the larger the portfolio, the smaller the fee." For sizable portfolios — about $20 million — the overall fee would be less than 0.14 percent with Vanguard, he said.

Geraldine Fabrikant is a member of the board of directors of the Committee to Protect Journalists, a nonprofit.

* Learning to Bridge a Generation Gap in Philanthropy

* Investing in Creativity, and in the Greater Good

* How to Fix a Retirement Plan at a School or Nonprofit

* Why Investing Is So Complicated, and How to Make It Simpler

D. Ellen Shuman, managing partner of Edgehill Endowment Partners, says strategies using low-cost index funds are often suitable for smaller nonprofits. | Greg Miller for The New York Times

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The New York Times

Business/Financial Desk; SECTB
Ebullient S.&P. 500 Reaches 2,500, a Record

By TIFFANY HSU
647 words
16 September 2017
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NYTF
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2
English

Stock markets continued their march higher Friday, with the **Standard & Poor's500 index** passing the threshold of 2,500 for the first time in its 60-year history.

Wall Street is riding the second-longest **bull market** in history, with investors repeatedly shrugging off domestic and international turmoil as they pile into shares of technology and other companies. On Friday, for example, the rally continued despite news that North Korea had launched its second missile in a month over Japan. Instead, the market focused on strong performances from tech stocks.

Standard & Poor's bellwether stocks index spent much of the day flirting with 2,500. In the final moments of the trading day, investors nudged the benchmark to 2,500.23, up nearly five points on the day. Other indexes, including the **Dow Jonesindustrial average**, also closed at record highs.

While the stock-buying spree continues, the market's upward march has left some investors nervous that a geopolitical crisis or a sudden bout of bad financial or economic news could spark a downturn.

''It doesn't appear to be alarmingly overvalued, but it's possible things have gone too far,'' said Paul Ashworth, chief United States economist at Capital Economics. ''Though obviously that's hard to judge, because it's something we'll only realize in hindsight.''

The S.&P. index has gained nearly 270 percent since March 2009, when the last **bear market** ended. A **bull market** is defined by a prolonged rally uninterrupted by any decline of 20 percent or more. The longest **bull market** lasted for roughly a decade between 1990 and 2000.

The **Dow Jonesindustrial average** closed at 22,268.34, rising 0.29 percent, or 64.86 points. The **Nasdaq composite** narrowly missed the record of 6,460.19 it set on Wednesday, closing up 0.30 percent, or 19.38 points, at 6,448.47.

Behind the recent rally are at least two trends. First, the technology sector has been on a tear, with investors racing to get a piece of companies that could become the next Apple or Google.

Among Friday's biggest winners was Nvidia, a chip maker in California. Its shares rose 6.3 percent, or $10.71, to $180.11 after its leadership in artificial-intelligence development was lauded in a client note from Evercore ISI.

Second, the extended period of ultralow interest rates has been a boon. The question is how long that will continue. Traders will closely monitor the Federal Reserve's meeting next week for any signs about its intentions. Inflation rose in August, increasing the likelihood that the Fed will lift rates by the end of the year.

Meanwhile, some investors are increasingly optimistic that Congress will enact some sort of tax reform, especially as President Trump courts support from Democrats. Such legislation has the potential to be a boon to corporate America and therefore to stocks.

''The good times should keep on rolling for a while,'' said Barry Sine, director of research at Drexel Hamilton. ''This is going to head to 2,800 by year end.''

Investors seemed to overlook recent economic indicators -- retail sales dipped 0.2 percent last month, and industrial output took its deepest dive in eight years -- in the belief that hurricanes had muddied the data.

"The initial impact of Harvey and Irma will be negative, but there's going to be a lot of economic activity -- a huge number of cars getting replaced, more building," Mr. Sine said. "And as that happens, we'll be going into the Christmas season."

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

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

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THE WALL STREET JOURNAL.
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Exchanges Warn Of Hacking Risks

By Dave Michaels
557 words
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B11
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WASHINGTON -- Stock-exchange executives are warning that a comprehensive data repository designed to help regulators detect market manipulation faces hacking risks, one week after Equifax Inc. disclosed one of the biggest data breaches in U.S. history.

Speaking Friday at the Security Traders Association conference here, executives from the New York Stock Exchange and Bats Global Markets Inc. expressed worry that the project, which is known as the Consolidated Audit Trail, or CAT, will be a juicy target for hackers.

The system will track the life cycle of every order in the stock and options markets and will include personal information about stockbrokers' customers, such as Social Security numbers and dates of birth.

"Now is the time to ask not can CAT be killed, but can we rethink what we've delivered thus far?" said Chris Concannon, president and chief operating officer of CBOE Holdings Inc., the parent company of Bats. "I am not comfortable with CAT going live unless we are certain the industry's data will be protected."

Stacey Cunningham, chief operating officer of NYSE Group Inc., said at the same conference where Mr. Concannon spoke that she fears hackers will target the database for the rich trove of personally identifiable information that it contains.

"I have concerns with the level of (personal information) and other commercially sensitive information that will be in that database," Ms. Cunningham said in a statement. "As we know and have recently seen, it is very hard to assure the protection of information."

U.S. regulators required Wall Street to build the Consolidated Audit Trail after a chaotic trading session on May 6, 2010, when the **Dow Jones Industrial Average** plunged nearly 1,000 points in a few minutes before rebounding.

It took the Securities and Exchange Commission and the Commodity Futures Trading Commission more than four months to reconstruct the cause of the so-called flash crash, because neither agency kept an inventory of all quotes and trades across equities, options and futures markets.

The audit trail will absorb orders from 21 stock and options exchanges and more than 40 private trading venues known as dark pools. The database also will include granular information on trades that are filled by large wholesale brokerages from their inventory.

The development of the audit trail has often been caught in red tape and industry fights over who will pay for it.

While the SEC mandated its creation, the project has been carried out by the exchanges, which are working on a new proposal for how costs will be divided after some options market makers and smaller trading venues complained they were being asked to pay too much.

Brokers have also complained that CAT is an expensive substitute for existing surveillance tools. The Financial Industry Regulatory Authority maintains an audit trail that records data on stock orders and executions, but doesn't include options data.

Republican SEC Commissioner Michael Piwowar raised expectations on Thursday that a delay or rethinking of CAT requirements might be in the offing. He told the traders conference that he feels comfortable with the project's data-security standards but wants "to make sure everything is locked down."

He declined to comment after his remarks about whether the SEC is weighing a delay.

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THE WALL STREET JOURNAL.
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A New Boom: First Texas Oil, Now Its Sand

By Ryan Dezember
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English

There is a new land grab going on in the oil-rich fields of West Texas. This time it is over sand.

Big oil-field sand suppliers, Wall Street firms and other investors have been buying up swaths of the West Texas desert. These investors aim to mine and sell the sand to drillers in the region's booming Permian Basin, which need large quantities of sand to extract oil and gas from shale formations.

Texas energy producers have typically bought the millions of pounds of sand that each well requires from mines located far from their drilling fields. After **oil prices** collapsed in late 2014, though, cost-conscious drillers reconsidered their well designs and recipes for the slurries they blast underground to unleash fuel from shale formations. Many West Texas drillers discovered that they could replace sand they had been shipping from mines 1,300 miles away in Wisconsin with finer grades found in dunes nearby. Doing so eliminates rail costs that sometimes are equal to or more than the sand itself.

Now investors are lining up to supply local sand to West Texas drillers.

"Local sand is a huge disrupter that is beneficial to the shale producers," said Ben "Bud" Brigham, an Austin geophysicist who built and sold two oil companies and now is plowing some of his profits into sand pits.

Mr. Brigham is using proceeds from his recent $2.55 billion sale of Brigham Resources to fund a Permian mining operation called Atlas Sand Co., which he expects to begin sand production in next year's second quarter.

The Atlas mine is one of at least 18 under way or proposed for the desert outside Midland, Texas, according to Jefferies analyst Brad Handler. The first, Hi-Crush Partners LP's 3-million-ton-a-year facility, began operations in July. More than a dozen plan to open over the next year.

The prospect of tens of millions of tons of Permian sand coming to market could drive down sand prices that have been rising nationally, Mr. Handler said. Analysts say that prices rose to as much as $45 a ton earlier in the year, from as little as $15 a ton last year.

With competition heating up in West Texas, analysts say it is unlikely that all the planned mines will get built.

"There'll likely be many losers who jumped into the game a bit late," said George O'Leary, an analyst at energy investment bank Tudor, Pickering, Holt & Co.

Mr. O'Leary said newcomers may not have the industry knowledge or contacts. Many wells might also require coarser grades of sand than can be found in West Texas. And though the long train ride is eliminated with local sand, logistical hurdles remain. Those include a tight labor market in the sparsely populated region and the potential for sand miners to wind up competing with their customers for the huge quantities of water both require.

The sheer number of trucks needed to move the sand around the Permian is daunting. Robert Rasmus, Hi-Crush's chief executive, recently told investors that it would take 120,000 truckloads to deliver the Permian facilities' annual output.

A few private-equity firms reaped big profits backing sand producers in Illinois and Wisconsin as shale drilling took off. Shares of such companies soared until the second half of 2014 when they collapsed along with **oil prices**, and concerns about too much supply.

Even as **oil prices** have stabilized and sand prices have risen, these stocks have continued to falter. The five big listed sand companies are each down more than 35% this year.

Hedge-fund manager Daniel Loeb is among those betting that sand stocks will fall further. In an April letter to his Third Point LLC investors, Mr. Loeb cited the "important shift" from special sand mined in the Midwest to abundant sand within drilling basins, including West Texas.

Miners with Midwestern operations say they are confident that the types of sand produced there will remain in demand in Texas and other drilling regions, such as those in North Dakota and Appalachia.

The cost of rail transportation from the Midwest typically makes up about a third of the total cost of sand. Permian oil producers estimate they will chop roughly 5% from their drilling costs by using local sand. At a typical well cost of about $8 million, that translates to savings of $400,000.

In shale drilling, sand is mixed with water and chemicals and blasted underground to crack open energy-bearing rock. In this process, known as hydraulic fracturing, it is the water pressure that cracks open the shale and the sand that props open the fissures to allow oil and gas molecules to seep out.

Many drillers have preferred coarser grades of sand that are better able to withstand the intense pressures miles deep beneath the surface and can hold cracks open wider than finer grains. A variety of sand called Northern White found mostly in Wisconsin and other Midwestern states has been prized for its uniformity, crush strength and grain size.

In response to low **oil prices**, however, producers such as Mr. Brigham were able to boost wells output by using larger quantities of finer sand, which propped open additional small fissures and reduced the chemicals needed to keep larger grains afloat in the water.

"People started looking around saying, where can we find this smaller mesh sand? And it was in the Permian Basin," said Hi-Crush finance chief Laura Fulton.

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THE WALL STREET JOURNAL.
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Streetwise: Stocks Pricey Amid Low Inflation

By James Mackintosh
781 words
15 September 2017
The Wall Street Journal
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B1
English

Hollywood isn't likely to make "Federal Reserve: The Movie" any time soon, and not just because Janet Yellen goes out of her way not to say anything meaningful if at all possible. The problem for the scriptwriters would be the absence of a villain for Ms. Yellen to fight now that inflation seems to have all but disappeared.

The film could be livened up with shots of rich investors partying like it is 1999, and they wouldn't be hard to find. Economists and central bankers might be frustrated by the failure of their models to predict such low inflation for so long, but investors are delighted by what they see as ideal conditions for stocks.

I have been skeptical of the market's confidence that inflation will stay low as unemployment drops. But another question looms large for investors: Even if inflation has been conquered, does that justify high stock prices?

The question might seem dumb. Low inflation means low interest rates and so higher prices for equities. As projected future profits are worth more in today's money, companies spend less to service their debts and shares become more attractive relative to low-yielding cash and bonds. What's not to like?

History confirms the simple view, in that stock valuations have on average been much higher when inflation is below 4% than when it is above. Even better, the **S&P 500** on average rose about 8% in the year following inflation coming in below 4%, against just 2% gains for faster inflation.

Unfortunately, averages conceal a lot, and in this case they hide the truth. The truth is that what matters most to stock prices isn't where inflation stands, but where it will stand in the future compared with what is currently priced in. Investors like low and stable inflation, but some of the best times to buy stocks have been when inflation is very high, and about to plummet, as in 1979. Equally, some of the worst times to buy stocks have been when inflation seems under control, but is about to take off, as for example at the end of 1936.

Even worse, the average hides massive variation. Data put together by Yale Prof. Robert Shiller for the S&P and U.S. inflation back to 1871 show that investing when inflation was between 1% and 2%, as it currently is, offered a one-year gain in the S&P averaging 8.6% -- with dividends on top. Not bad, you might think as you dial your broker. But the range was huge, from a whopping rise of 41% to a loss of 35% -- again depending on whether inflation subsequently rose or fell.

This might seem like ancient history, but in August 2007, considered by many to be the start of the financial crisis, inflation was below 2% and the **stock market** was booming.

Perhaps most relevant is late 1965. Inflation had been below 2% for seven years, stocks were on a roll and Beatlemania was at its height in America. Investors seemed to agree with John Lennon as he sang "I Feel Fine," and stock valuations hit their highest since 1929 on the widely used Shiller P/E ratio, which smooths the cycle by comparing price to 10 years of earnings.

Few trading today were even born in the 1960s, but Dan Fuss was trading bonds at the time. Now vice chairman at Loomis, Sayles & Co in Boston, he sees similarities with the 1964-66 period, when inflation was quiescent.

"The Fed chose to soak the field in gasoline so when the match came it would be a problem," he said of the 1960s. Just as then, he thinks the Fed is restrained by domestic politics from tightening policy, making it hard for policy makers to respond when inflation does start to pick up, and he is worried it is on its way.

The consensus is that inflation is going nowhere fast. U.S. consumer prices rose 1.9%, slightly more than forecast, in the past year, data on Thursday showed. Yet, almost all the increase came from surging prices of gas and shelter.

The risk is that investors are again being lulled into a false sense of security. The calm of the 1960s was broken in 1967, when core inflation -- taking out **volatile** energy and food prices -- jumped more than 2 percentage points in just 12 months, and highly valued stocks proved vulnerable. If the bad guy turns out to be lurking just off screen, Hollywood's scriptwriters may yet have a plot worth watching.

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THE WALL STREET JOURNAL.
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U.S. News: Inflation Rebounds Ahead of Fed Meeting

By Josh Mitchell
475 words
15 September 2017
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J
A3
English

WASHINGTON -- U.S. consumer prices rebounded in August, a sign of economic vigor that could nudge the Federal Reserve closer to raising a key interest rate.

The consumer-price index, which measures what Americans pay for everything from medicine to cars, grew 0.4% from a month earlier, the biggest jump since January, the Labor Department said on Thursday.

Much of the gain was owed to a sharp rise in gasoline prices caused by Hurricane Harvey, which temporarily shut down Texas refineries. But a range of other prices, particularly housing costs, also increased. Excluding food and energy, so-called core prices grew 0.2%, the most since February.

Thursday's report -- the final inflation gauge before Fed policy makers meet next week -- could bolster a view within the central bank that a drop in inflation earlier this year would be short-lived. Cellphone-plan prices, for example, fell early in the year due to industry competition, and hotel rates, which tend to be **volatile**, dropped in July but picked up last month.

Core prices have risen a modest 1.7% in the past year, but since June have climbed at an annual rate of 1.9%.

"After a five-month hiatus, core inflation came back to life in August," J.P. Morgan economist Michael Feroli said in a note to clients. "Today's report should ease some of the low inflation concerns among wavering FOMC officials, and we continue to expect the leadership will prevail in getting another (interest rate) hike in at the December meeting." The Fed's FOMC, or the Federal Open Market Committee, sets monetary policy.

Barclays analysts added that "the August report should assuage concerns in some parts of the (Fed) that the underlying rate of inflation has fallen too far" and bolstered the case for a December rate increase.

Fed officials have raised their benchmark interest rate twice this year and have indicated they expect to do so again, perhaps in December, if they see signs of higher inflation and a strong labor market. The Fed targets annual inflation of 2%, as measured by a separate Commerce Department index.

The labor market continues to exhibit strength, with unemployment -- at 4.4% in August -- staying below the Fed's long-term projections.

Inflation remains weaker than early this year. Overall prices rose 1.9% in the year through August, up from July's rate of 1.7% but below January's pace of 2.5%. Fed officials initially played down softer inflation pressures earlier this year, which they expected would prove transitory. Thursday's report is the first to provide evidence of that, which could make it easier for them to maintain forecasts that show inflation heading back toward its target.

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THE WALL STREET JOURNAL.
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Heard on the Street
China Slows Again: Hedge Growth Bets, but Don't Panic

By Nathaniel Taplin
510 words
15 September 2017
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

One month of weak data could be a fluke; China's record July temperatures led many to attribute the underperformance to a heat wave. Two in a row is harder to dismiss.

After a strong first half that confounded economists' predictions of slower growth, China is now clearly downshifting. August industrial production was the weakest since December, while investment growth in the year to date hit its lowest since 1999, according to official figures. That followed July data that undershot expectations.

Slower credit growth following Beijing's high-profile campaign against financial excesses earlier in the year, which pushed bond yields sharply higher, is finally beginning to bite.

In one sense this is a welcome development: The biggest slowdown last month was in infrastructure investment, which ticked down to 11% growth year over year from nearly 16% in July. Infrastructure projects of dubious merit are arguably the biggest source of China's bad debt problem. More than half of all new liabilities at state-owned firms built up between 2007 and 2015, some 40 trillion yuan ($6 trillion), were infrastructure- and public-service related according to Andrew Batson, China Research Director at Gavekal Dragonomics. Many of those projects are uneconomic and now spend their time weighing down bank balance sheets rather than contributing to growth.

The problem is that Chinese infrastructure is a huge driver of both domestic industry and demand for materials world-wide.

In line with slowing investment growth, most key Chinese industrial indicators moved lower last month: Steel output slowed while cement production dropped outright on the year, falling at its fastest rate since 2015. Electricity production growth nearly halved, while coal power output dropped from 10.5% growth in July to just 3.5% in August. Numbers like that will likely put a damper on recent rallies in iron ore and coal.

While this all sounds unpleasant, there are a few reasons for guarded optimism. First, real-estate investment in August ticked up again to 7.8% growth from the same time a year ago, reversing its drop to just 4.8% in July. The July figure was the lowest in a year and a **bearish** signal on the single most important sector for Chinese growth and commodity demand. Second, credit growth picked up again in July, in a sign that policy makers are also concerned that investment is now slowing too quickly.

With debt servicing costs at coal and steel plants still high, China's economic mandarins are unlikely to permit an overly sharp slowdown in investment that could tank commodity markets, particularly right ahead of the twice-a-decade Communist Party leadership shuffle kicking off in mid-October.

China is slowing again, which means the giddy part of the global commodities -- and associated reflation trades -- is likely over. It isn't time to run for the hills yet, but now would be a good time to start taking profit.

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The New York Times

Business/Financial Desk; SECTB
A Mixed Market as Consumer Price Data Weighs on Retailers

By THE ASSOCIATED PRESS
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English

It was a split decision on Wall Street on Thursday as stock gains in a handful of industrial and health care companies largely outweighed sluggishness elsewhere in the market, including the technology sector.

Sizable gains by Boeing and United Technology were enough to push the **Dow Jonesindustrial average** to another record, but other major indexes fell.

Shares of retailers were also weak after the government said prices paid by consumers jumped in August. That could prompt the Federal Reserve to raise interest rates sooner than expected to cool the economy and stave off inflation.

Energy company stocks rose as United States crude oil climbed to its highest price in six weeks.

The **Standard & Poor's 500-stockindex** slid 2.75 points, or 0.1 percent, to 2,495.62. The **Dow Jonesindustrial average** rose 45.30 points, or 0.2 percent, to 22,203.48. It was the Dow's third straight record high close.

The **Nasdaq composite** slumped 31.10 points, or 0.5 percent, to 6,429.08 as shares of big names like Facebook and Alphabet, Google's parent company, lost ground.

The Labor Department reported that consumer prices grew 0.4 percent in August as gas and housing costs rose. Prices were up 1.9 percent compared with last year. That could show inflation is speeding up, though it was not clear how much of the recent increase in gas prices was because of Hurricane Harvey, which deluged the Gulf Coast region in late August and caused many drilling rigs and refineries to shut down.

The Federal Reserve will meet next week; investors were assessing whether Thursday's consumer-price report would make it more likely that the Fed would raise interest rates later in the year. Higher interest rates reduce growth because they make borrowing more expensive.

Michael Scanlon, a portfolio manager for Manulife Asset Management, said if inflation did get stronger over the next few months, ''it would be a sign of more health in the economy over all.''

Urban Outfitters stock fell 77 cents, or 3.3 percent, to $22.77 and shares of the discount retailer Ross Stores lost 81 cents, or 1.3 percent, to $60.60. Amazon shares shed $7.39 to $992.21. Coca-Cola stock lost 38 cents to $46.11 and shares of the grocery store operator Kroger fell 47 cents, or 2.2 percent, to $21.26.

Shares of the jewelry seller Tiffany dropped $4.56, or 4.8 percent, to $90.95 after one of the company's biggest shareholders, Qatar's investment fund, said it sold some of its Tiffany stock.

Boeing stock rose another $3.30, or 1.4 percent, to $245.23. Its chief executive, Dennis Muilenburg, said the company expected to start delivering more planes. The stock rose 0.6 percent a day ago. Other industrial companies also benefited. United Technologies shares gained $2.86, or 2.6 percent, to $113.14.

Benchmark United States crude oil rose 59 cents, or 1.2 percent, to $49.89 a barrel. That was its highest closing price since the end of July. Brent crude, used to price international oils, gained 31 cents to $55.47 barrel in London.

Among energy companies, Schlumberger stock rose 78 cents, or 1.2 percent, to $67.70 and Anadarko Petroleum shares picked up 40 cents to $43.53.

Shares of the chip maker Lattice Semiconductor slipped after the United States government stopped its sale to a firm backed by the Chinese government because of national security concerns. Lattice accepted the $1.02 billion offer from Canyon Bridge Partners in November, but investors have long been skeptical the deal would be completed. Last week a United States government panel said the sale should be blocked.

Lattice stock wobbled between gains and losses and finished 2 cents lower at $5.70. Canyon Bridge agreed to pay $8.30 a share.

The yield on the **10**-**year Treasury** note was unchanged at 2.19 percent. The yield on the two-year note rose to 1.37 percent from 1.35 percent.

The dollar slid to 110.54 yen from 110.61 yen. The euro rose to $1.1903 from $1.1883. The pound jumped to $1.3399 from $1.3201.

CHARTS: The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Thursday. (Source: Reuters); Freddie Mac Yields: Average for some Federal Home Loan Mortgage Corp. securities. (Source: F.H.L.M.C.)

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THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance: China Readies Sale of U.S. Dollar Bonds

By Manju Dalal and Carolyn Cui
739 words
14 September 2017
The Wall Street Journal
J
B12
English

China is laying the groundwork for its first sale of U.S.-dollar sovereign bonds in more than a decade, a move toward expanding its ties with global investors as its economy improves.

The government is preparing to sell $2 billion in bonds this month, and investment banks are pitching for a role in the deal, according to bankers in Hong Kong.

While the planned sale isn't large and is mostly symbolic, it would be China's biggest-ever U.S.-dollar bond sale and its first since October 2004, when the country raised a total of about $1.7 billion from selling dollar- and euro-denominated bonds that matured in five and 10 years.

China's Ministry of Finance didn't respond to requests for comment.

China has about $200 million in outstanding U.S.-dollar sovereign-debt issues that it is scheduled to pay off in 2027 and 2096, and those bonds yield about 3.3% and 4%, respectively, according to the research firm CreditSights. The country issued several global bonds in the 1990s, including a 100-year $100 million bond in 1996 with a 9% coupon.

But the government has been largely absent from the market since 2004, as officials were coping with a continuous influx of "hot money" -- sudden rushes of investment cash -- and a rapid buildup of foreign reserves.

While China's economy has stabilized and its currency has strengthened against the dollar, the government's clampdown on capital outflows has hurt its credibility with many international investors. By issuing a dollar bond, China hopes to improve its standing with the global investment community and draw some interest to its bond market.

"China clearly does not need the money and selling a dollar-denominated bond certainly does not help its long-term objective of promoting the yuan's status as an international currency," said Eswar Prasad, a professor at Cornell University. "But at this stage, these objectives are overridden by the desire to rebuild investors' trust,"

The bond sale is coming as the cost of insuring Chinese government debt against default in recent months has fallen to its lowest level in two years, according to data from IHS Markit.

It costs $58,000 annually to protect $10 million of Chinese debt from default over five years, versus $100,000 in September 2015. Some investors use these credit-default swaps to hedge their holdings of Chinese debt investments. Falling costs of protection indicate lower investor anxiety about the possibility of a financial crisis developing in China.

CreditSights said in a note last week that the new Chinese sovereign bonds could be priced to yield 0.5 percentage point over comparable Treasury securities. The yield on the five-year Treasury note settled at 1.772% Wednesday, while the **10-year Treasury** yield was 2.194%.

Most buyers of the new U.S.-dollar bonds are expected to be Chinese investors and financial institutions, say analysts and bankers. Overseas investor demand for Chinese debt has been generally lackluster, despite stepped-up efforts by Beijing to attract foreign buyers to its bond market. Concerns over the value of China's currency and the country's overall debt burden have kept many foreign investors on the sidelines.

Still, a successful sovereign-bond sale could signal investor confidence in China's economic growth and its creditworthiness. The deal is likely to hit the market ahead of China's Communist Party Congress, which next month will chart the path of the country's leadership.

Plans for the sale have been in the works for some time.

In June, shortly after Moody's Investors Service downgraded China's sovereign rating by a notch to A1 from Aa3, citing concerns about rising debt and slowing economic growth, China's Ministry of Finance announced plans to sell $2 billion in bonds in the second half of this year.

The coming offering would be a first step toward building a liquid benchmark yield curve that could eventually help lower the cost of funding for Chinese companies, including state-owned enterprises, banks and private corporations.

In the offshore market, Chinese companies and local governments are active borrowers, raising a total of $379.7 billion this year through bond issues, according to Dealogic.

Yifan Xie and Shen Hong contributed to this article.

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THE WALL STREET JOURNAL.
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Banking & Finance: Exchange Looks at Marijuana Stocks

By David George-Cosh
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English

TORONTO -- As dozens of cannabis companies have flocked to raise capital on Canada's stock exchanges in recent years, the country's regulators are starting to question whether trading in their stock would run afoul of U.S. law.

The parent of the Toronto Stock Exchange and an umbrella organization of Canadian securities regulators are looking at cannabis companies with U.S. operations -- including growers, medical-marijuana distributors and pharmaceutical firms whose products include marijuana ingredients -- to determine whether trading their shares should be allowed to continue on Canadian exchanges.

The regulatory attention comes as the Toronto Stock Exchange and its smaller rival, the Canadian Securities Exchange, have been actively courting marijuana-company listings from around the world. Currently, roughly half the trading activity on the Canadian Securities Exchange is from marijuana-based businesses, a high-growth sector.

Medical marijuana has been legal in Canada since 2001 for patients with valid prescriptions, and Canada is expected to formally legalize marijuana by July 2018. In the U.S., while eight states plus the District of Columbia have legalized marijuana and an additional 20 states have legalized it for medical purposes, it remains illegal under federal law.

U.S. exchanges list shares of some companies indirectly involved in the pot business, such as real-estate firms that lease sites to marijuana growers. But neither the New York Stock Exchange nor **Nasdaq Stock Market** will allow trading of shares in companies that profit directly from growing or selling marijuana in the U.S., lawyers say.

TMX Group Ltd., parent of both the Toronto Stock Exchange and a clearinghouse unit, the Canadian Depository for Securities Ltd., a platform where Canadian exchanges settle equity, debt and money-market transactions, has sought clarity from Canadian regulators on the question of whether settling stock trades of cannabis companies with U.S. operations amounts to a violation of U.S. law, according to a TMX Group statement.

"This is a complex matter which touches multiple aspects across our capital market system, and as such requires close examination and careful consideration," said a TMX spokeswoman. The company is cooperating with Canadian Securities Administrators, the umbrella group of provincial and territorial securities regulators.

Any action by Canadian regulators is likely to be closely watched by other countries grappling with how to treat the trading and clearing of marijuana stocks. Exchanges in Germany and Israel, for example, two countries that recently legalized medical marijuana and have publicly listed cannabis firms, also have been weighing listing standards for such companies.

"The industry wants clarity," said Richard Carleton, chief executive of the Canadian Securities Exchange.

There are 69 cannabis-related companies, representing a combined market value of about C$7.8 billion (U.S. $6.4 billion), trading on the Toronto Stock Exchange, the smaller TSX Venture Exchange and the Canadian Securities Exchange. These include over a dozen fledgling U.S. marijuana entities that have turned to Canada to raise money, including 11 companies on the Canadian Securities Exchange with some assets or operations in the U.S., said Mr. Carleton. There are at least four on the other two exchanges.

Alexander Osipovich contributed to this article.

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THE WALL STREET JOURNAL.
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Dollar's Drop Lifts Emerging Markets

By Jon Sindreu
797 words
14 September 2017
The Wall Street Journal
J
B14
English

The U.S. dollar's nose dive is fueling a rally in emerging-market assets.

Since the start of this year, the dollar has fallen 8% against a basket of currencies, based on the WSJ Dollar Index.

That is good for emerging markets because their dollar-denominated debts become cheaper to service, roll over and pay back. Research also shows that international lenders are more willing to lend whenever the U.S. currency falls. Meanwhile, developing-market economies are in good shape, adding to the positive view of these markets.

The value of emerging-market equities and bonds has surged. The MSCI Emerging Markets **stock index** has returned more than 30% this year, compared with 15% for the developed-market MSCI World Index and 13% for the MSCI USA.

Netflows into emerging-market equity funds have increased this year by 0.5% of the total assets they manage, according to fund tracker EPFR Global. That compares with a 2% fall in the money going into richer nations.

That outperformance could be set to continue as the dollar stays weak. Strategists say stubbornly low inflation will ensure that the Federal Reserve's easy-money policies stay in place for longer, putting pressure on the currency.

"A weaker dollar eases global financial conditions," said Jack McIntyre, portfolio manager at Brandywine Global, because many companies in emerging nations borrow in dollars, "so if the dollar is strong, this means they have to pay back their debt in a higher currency."

A net 47% of investors are positioned to gain if developing-nation stocks go up -- a seven-year high -- while bets against the dollar have multiplied, according to a survey of fund managers published Tuesday by Bank of America Merrill Lynch.

Peter Elston, chief investment officer at Seneca Investment Managers, believes the U.S. economy is due to slow by 2020, so he is now selling stocks in the U.S. and buying them in emerging markets. "In some of our funds, we can't reduce U.S. stocks any further because we are already at zero," he said.

But much of the current bet on emerging markets is due to the declining greenback, rather than just robust economics.

Since the start of the year, emerging-market bonds issued in local currencies have returned 17%, compared with 10% for bonds in currencies such as dollars or euros, according to indexes published by J.P. Morgan Chase & Co.

Over the past year, Claudia Calich, who runs the Emerging Markets Bond Fund at M&G Investments, a GBP 281 billion ($373 billion) asset manager, has doubled the share of her allocations devoted to local-currency debt to almost 40%, including assets in Mexican pesos and Egyptian pounds.

Since the late 1990s, emerging-market equities have usually outperformed when the dollar declined and struggled when the greenback rallied.

This is in contrast with large-cap developed-market indexes, which usually move in lockstep with the dollar, since the multinational firms they track get most of their revenues in foreign currencies.

Emerging countries are different, analysts say, because their dependence on dollar credit is greater and a strengthening greenback makes it more costly to roll over loans. That offsets any gains from higher overseas income.

It isn't just that borrowing gets more expensive. International lenders -- who also rely on dollar funding -- can often close their wallets whenever the U.S. currency's value goes up, according to research by the Basel-based Bank for International Settlements, and that can hit emerging-markets the hardest.

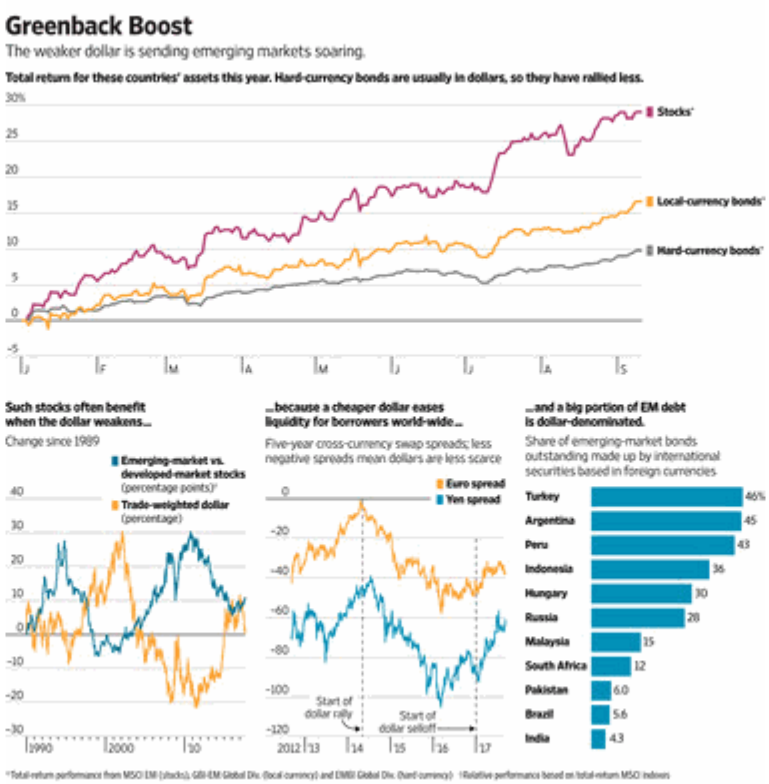
Signs of stress can be gauged by the cross-currency basis swap spread, which measures the gap between money-market and derivative-market rates when borrowing in dollars. When the dollar started rallying in 2014, it grew wider. As the U.S. currency sold off this year, that gap narrowed.

According to research by consultancy Oxford Economics, this "cross-border liquidity channel" linked to the dollar is crucial for developed markets, especially Latin America.

By share of bonds outstanding made up of international securities issued in foreign currencies, Turkey is the most exposed at 46%, BIS figures show, followed by Argentina and Peru.

Foreign borrowers also benefit from low dollar-lending rates. Yields on 10-year Treasurys are below 2.2%, from 2.5% at the start of the year.

For emerging markets, the situation is radically different from last year, when the prospect of higher fiscal spending in the U.S. boosted the dollar and Treasury yields. That led to a fear of an emerging-market selloff, like in 2015, when the MSCI Emerging Markets index fell 17% on concerns over the Chinese economy and the end of stimulative monetary policy.



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THE WALL STREET JOURNAL.
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U.S. News -- Capital Account: The Fed's Bad Options for Too-Low Inflation

By Greg Ip
762 words
14 September 2017
The Wall Street Journal
J
A2
English

Unemployment and inflation are near their lowest levels in decades. Who wouldn't love that?

Janet Yellen, for starters.

What looks like a dream economy could be a nightmare for the Federal Reserve chairwoman. Ms. Yellen's worldview assumes that when unemployment is this low -- 4.4% in August -- inflation should move up to the Fed's target of 2%. Instead, it may have stabilized around 1.5%. That presents the Fed with some unpalatable options: deliberately overheat the economy for years to get inflation back up, then potentially induce a recession to stop it from overshooting; or give up on the 2% target, which could hobble its ability to combat future recessions.

This isn't scaremongering: It's the logical consequence of how central banks believe inflation operates. At the center of their model is the Phillips curve, according to which inflation edges lower when unemployment is above its natural, equilibrium level and putting downward pressure on prices and wages. Below that natural rate, also known as full employment, inflation crawls higher.

This mostly describes how inflation fluctuates around its long-term trend over the course of the business cycle. Trend inflation, which prevails when the economy is at full employment, is determined largely by public expectations, which are in turn influenced by central banks and their inflation targets. When consumers, businesses and workers expect 2% inflation, they set prices and wages in a way that makes actual inflation hit 2%.

Since the current expansion began in 2009, inflation has persistently fallen short of 2%. Most of the time, that could be chalked up to the ample economic slack left over from the recession. Today, though, unemployment is around a 16-year low and below the Fed's estimate of its natural rate, 4.6%. Yet using the Fed's preferred gauge of "core" inflation, the price index of personal consumption expenditure minus food and energy, recently slipped to 1.4%.

There are three leading explanations.

One is that the economy actually isn't at full employment; either the natural rate has dropped or many unemployed aren't being counted properly. But history and mounting reports of labor shortages militate against that.

The second, Ms. Yellen's preferred theory, is noise: One-off drops in prices such as for cellphone plans are masking the underlying trend. But one-off movements can't explain years of undershooting. As Lael Brainard, a Fed governor, noted last week, some one-offs must be pushing the other way.

That leaves the third explanation: Trend inflation has fallen. Until recently, Fed officials noted surveys that suggest the public still expects inflation to return to 2% and credit their oft-repeated promise to hit their 2% target. But are they fooling themselves? Expectations of inflation are determined in great part by what inflation actually has been, and after every recession since 1982, core inflation has averaged less than in the previous business cycle.

To get inflation higher, the Fed would have to engineer a boom that drives unemployment below its natural rate until inflation returns to 2%. To achieve this, Ms. Brainard suggests rates shouldn't rise much more, if at all.

Lower trend inflation has much graver implications for the economy than appreciated. In recent decades, it has taken ever bigger swings in unemployment to affect inflation.

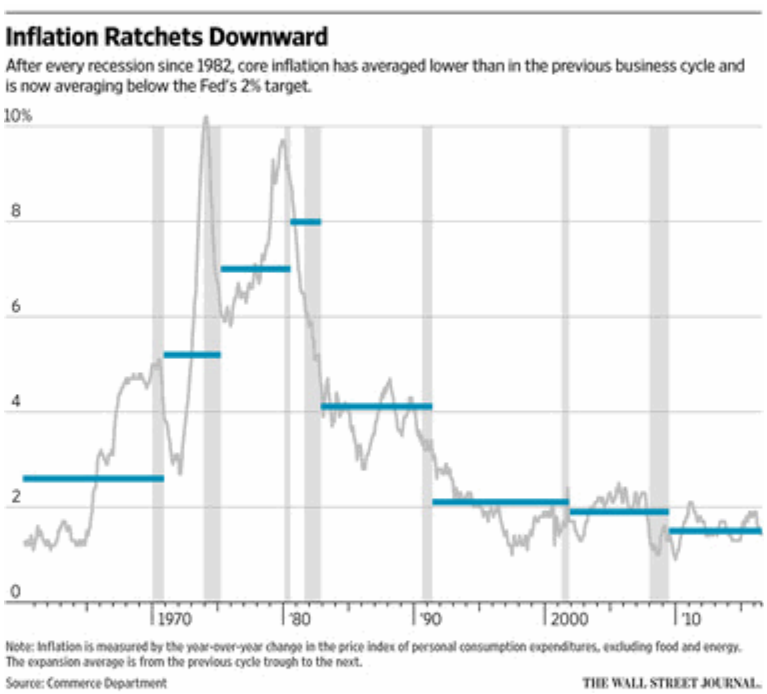
Raising inflation half a point could require letting unemployment drop to around 3.5% and keeping it there for five years. Then, the Fed would have to slow the economy and guide unemployment back over 4%. In theory it could do this gradually; in practice, the number of times since 1948 when unemployment has gone up that much without a recession is zero, according to Goldman Sachs.

This approach could aggravate another worry: financial excess. If stocks and property look bubbly now, imagine what five more years of very low interest rates would do.

The alternative is to ditch the 2% target and accept 1.5% as the new inflation trend. Besides shredding the Fed's credibility, that would mean lower trend interest rates and thus less rate-cutting ammunition to fend off the next recession.

Both options are unappetizing, but the second distinctly more so.

If Ms. Yellen eventuallyconcludes lower inflation reflects a trend rather than noise, prepare for unemployment to drop much more and interest rates to stay low for a lot longer -- with an attendant rise in financial and economic **volatility**.



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The New York Times

Business/Financial Desk; SECTB
'False Peace' for Markets? A Trader Is Betting on It

By LANDON THOMAS Jr.
1,279 words
14 September 2017
The New York Times
NYTF
Late Edition - Final
6
English

AUSTIN, Tex. -- Last Wednesday was another good day to make money on Wall Street: Stocks pushed up, interest rates were at rock bottom and the VIX gauge of investor unease was again trending downward.

But as investors celebrated yet another bounce-back from a market slip, Christopher Cole, a trader who runs a hedge fund here that makes bets on various forms of financial apocalypse, spotted something amid the sprawl of data and code that decorated the wall of screens before him.

''Optically, **volatility** is still very low, but fear is increasing,'' Mr. Cole said, pulling up a chart on one of his six trading windows. It showed that in the months beyond the 30-day period measured by the Chicago Board Options Exchange's VIX index, investors were expecting some violent moves to come in the **stock market**.

Betting against a flare-up of such turmoil has been one of the longest-running and most profitable trades in recent financial history.

Mr. Cole, who opened Artemis Capital to outside investors in 2012, is taking the opposite side, arguing with the passionate intensity of the true believer that this market calm cannot last.

In doing so, he draws parallels to the **stock market** crash of 1987, when investors were similarly lulled into believing that **volatility** would not erupt.

So far, those betting against chaos have carried the day.

From day traders perched in front of their living room laptops to sophisticated institutional investors the world over, many have made piles of money betting that the VIX will keep moving lower.

After peaking at close to 90 at the time of the financial crisis, the VIX recently sank to a multidecade low of just below 9, the occasional sharp spike upward notwithstanding. (As of Wednesday afternoon, it was 10.5.)

Several factors have helped along the way, analysts say. They include aggressive money printing and bond purchasing by global central banks and the profusion of exchange traded investments, which make it cheap and easy for professionals and amateurs alike to bet on a falling VIX.

Now, just a month ahead of the 30th anniversary of Black Monday, when the **Standard & Poor**'**s500 stockindex** plunged 20 percent, Mr. Cole is wagering on a similar calamity, underpinned by a vicious spike in the VIX and a steep sell-off in stocks.

''The fact that everyone has been incentivized to be short **volatility** has set up this reflexive stability -- a false peace,'' he said. ''But if we have some sort of shock to the system, all these self-reflexive elements reverse in the other direction and become destabilizing as opposed to stabilizing.''

Calling an end to the second-longest **bull market** in modern financial history has, understandably, become quite fashionable. Not just on the perma bear fringes, either. Wall Street houses talk regularly about overvalued stock markets, and establishment voices like Lloyd C. Blankfein, the chief executive of Goldman Sachs, have mused openly that ''things have been going up for too long.''

A little-known British investment firm, Ruffer Capital, has caused a stir by predicting a shattering denouement, and many hedge funds are buying up cheap VIX options, which will pay off handsomely if the index shoots up.

Artemis Capital is of a slightly different stripe. It is, as Mr. Cole likes to say, a hedge fund with a capital H. That means, in times of **bull market** fever, the fund will bet on a reversal, offering downside protection for cautious investors by finding creative ways to purchase exposure to financial chaos. These trades entail purchasing a variety of derivative instruments that pay off if there is a dramatic upward spike in the VIX, which can cause stocks to fall precipitously.

Of late, money managers seeking such a hedge have grown markedly. Mr. Cole, who started with $1 million in 2012, is now sitting on $200 million, and demand has been so strong recently that he expects to hit $300 million soon, at which point he will restrict further access.

Mr. Cole, 38, has the bouncy enthusiasm of a young child, and he spends each waking day reading, coding and free associating about what it will be that marks the **bull market**'s end.

Like many dyed-in-the-wool market skeptics, he has his quirks. To remind himself to make full use of each day, he wears a watch that counts off the time he has left to live -- 50 years and 4 months.

At the moment, Mr. Cole calculates that as much as $1.5 trillion in investor money is betting the markets will remain as they more or less have been since 2009: **volatility** free.

This sum, he says, includes about $60 billion in funds that are explicitly short **volatility** in its many forms. The bulk of this amount is in funds that deploy strategies where **volatility** is a critical input for allocating exposure to the **stock market**. So the lower **volatility** is, the more these funds load up on stocks.

Piling on to the low **volatility** trade have been corporations, which this year may buy back close to $1 trillion worth of stock, analysts estimate.

In 1987, portfolio insurance transformed a market decline into a historic rout when computer driven programs sold **stock market** futures into a panicked marketplace absent of willing buyers. Mr. Cole says this $1.5 trillion in short **volatility** money can play a similar role today if the fear gauge index spikes sharply.

All of a sudden VIX sellers will become VIX buyers, which will send the index soaring and stocks plummeting.

As he sees it, the formulaic strategies that sold **stock market** futures into a falling market in 1987 and the short **volatility** money of today are akin to barrels of petroleum that can turn a mere fire into a seismic conflagration.

''In 1987, we were in a **bull market**, and the Fed was behind the curve with regard to inflation and interest rates,'' Mr. Cole said. ''What could cause a crisis now is if rates suddenly spike higher, share buybacks seize up and then the **volatility** sellers turn into **volatility** buyers all at once.''

It is, in many ways, a moral argument for him.

Volatility sellers reap cheap and fleeting gains, which he compares to speeding, obesity and marrying for money. Those willing to suffer the immediate pain of being long **volatility** -- before the reward of calamity comes -- Mr. Cole sees as being more virtuous.

To say that Mr. Cole is obsessed with **volatility** -- as both a financial and a philosophical construct -- would be an understatement. In his investor letters and papers, he cites the poems of Goethe, the movies of William Friedkin and George Lucas, and Joseph Campbell's works on mythology as teaching tools for interpreting the whims of sudden change.

Ultimately, though, he believes that those who have held **volatility** in abeyance for so long -- from risk parity funds to global central banks -- will face a reckoning.

''**Volatility** is an instrument of truth, and the more you deny the truth, the more the truth will find you through **volatility**,'' Mr. Cole said. ''If central banks want to keep saving the day, that is fine. But **volatility** will then be transmuted through other forms like populism and identity politics and threaten the fabric of democracy. And that is something that my hedge fund will never be able to protect against.''

Christopher Cole, chief of Artemis Capital, in Austin, Tex. ''Optically, **volatility** is still very low,'' he said, ''but fear is increasing.'' (PHOTOGRAPH BY SARAH LIM FOR THE NEW YORK TIMES)

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THE WALL STREET JOURNAL.
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Heard on the Street
An Inflation Shock Could Hurt Bond Bulls

By Richard Barley
340 words
14 September 2017
The Wall Street Journal
J
B1
English

[Financial Analysis and Commentary]

Winning streaks can't last forever.

After a two-month run in which benchmark government-bond yields fell around the world, the start of this week brought a sharp reversal. With inflation moving into focus, investors may be wise to get used to the latest direction of travel.

The immediate cause of the upturn, which has taken **10-year Treasury** yields to 2.15% from post Trump-election lows of 2.04% and lifted yields in Germany and the U.K., is the waning of anumber of external risks.

That leaves a bigger, unresolved conflict around solid global growth, soggy inflation and the response of central banks. Bonds have done well, even as central banks, in particular the European Central Bank, have continued to signal comfort with the outlook for growth. The J.P. Morgan global composite purchasing managers index climbed in August to 53.9, its highest in more than two years. Risky assets like emerging-market stocks and bonds have gained.

But inflation, after being boosted at the start of 2017 by the rebound in **oil prices**, has come off the boil. The key now lies in the U.S., where the Citigroup inflation surprise index shows price pressures consistently undershooting expectations in recent months. That has led the market to pare back expectations that the Federal Reserve will continue raising interest rates. This Thursday's data will be closely watched for any sign of a pickup in inflation that might challenge this benign picture.

As long as growth remains robust and unemployment continues falling, it will be hard for central bankers to give up the idea that inflation shortfalls are temporary.

The hopes of bond bears have been disappointed this year. But if growth holds up, then it is hard to believe already-skinny bond yields have much room to fall. And if inflation shows any signs of life, then the correction could be sharp.

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THE WALL STREET JOURNAL.
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Cut Business Taxes for the 99.9%

By Juanita D. Duggan
531 words
14 September 2017
The Wall Street Journal
J
A15
English

Businesses with 500 employees or fewer are the cornerstone of the U.S. economy. There are 29.6 million of them in the U.S., and they represent 99.9% of all businesses. Small businesses employ 58 million Americans, or 48% of the workforce.

Congressional leaders and the White House have been working on tax reform. They say their aim is to boost the economy and make the tax system more competitive globally. Advocates correctly note that America's 35% corporate tax rate is much higher than in competing countries such as Ireland and China, with their 12.5% and 25% rates, respectively.

What gets lost in the conversation is that three-quarters of American small businesses pay taxes as individuals. Their top federal rate is 43.3%, which is substantially higher than the current top rate for large multinational firms. When state burdens are added, small businesses are sending close to half their income to the tax man.

Small businesses also face an enormous regulatory burden, forcing them to spend thousands of hours on compliance. It's no wonder the economy has been flat, despite a soaring **stock market**. If the point of tax reform is to boost the economy, it must start with small business.

The National Federation of Independent Business asks its members periodically to evaluate 75 commonly faced problems. Last year, 5 of the top 10 problems were related to taxes. Their taxes are too high, they tell us. The tax code is too complicated. The cost of compliance in terms of money and time is enormous. And the rules change too frequently.

We are encouraged that President Trump and congressional leaders acknowledge the need to reduce taxes for small businesses. Yet any change in rates that preserves the advantage currently enjoyed by large corporations would be a mistake.

Earlier this year, Mr. Trump proposed a tax-reform plan that would level the playing field by creating a single rate for all businesses. A single rate would be fairer, but tax reform must also ensure that the rates are lower for all small businesses.

No small business should pay more taxes than it currently does. That means a graduated system that cuts rates for the smallest businesses, allowing them to re-invest in new jobs, new machinery, new vehicles, technology and other capital improvements.

Tax reform cannot succeed if it doesn't simplify the tax code, which currently exceeds 70,000 pages. Each year, according to the Internal Revenue Service, small-business owners spend nearly two billion hours and $18 billion to pay their taxes. Large corporations are able to deal with taxes with legions of lawyers, accountants and compliance professionals. Small-business owners must either do the work themselves or hire costly consultants.

Congress and the president have one chance to get this right. It won't be easy. Tax reform is fraught with political challenges, and without support from the largest and most important part of the economy -- small business -- it will fail.

Ms. Duggan is president and CEO of the National Federation of Independent Business.

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THE WALL STREET JOURNAL.
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Heard on the Street
Gold Is Flashing an Inflation Signal, Not North Korea

By Nathaniel Taplin
446 words
13 September 2017
The Wall Street Journal
J
B16
English

[Financial Analysis and Commentary]

Gold loves inflation while Treasury bonds hate it. So why are both having such a smashing year?

Prices of the precious metal have moderated a bit in the past few days, but remain near a yearly high. The yield on 10-year Treasurys, meanwhile, touched a yearly low late last week. These simultaneous trends are unusual. Gold prices normally rise when investors are worried about inflation; **bond prices** normally go up when the opposite is the case.

One possible factor in gold's surge is its role as a haven in times of geopolitical trouble. That seems overblown, though: Tensions in North Korea may be ratcheting up but a full-blown conflict remains a low probability. Worries about the region probably only account for about 15% of gold's 10% rise since mid-July, estimates Jeff Currie, head of global commodities at Goldman Sachs Group.

What seems more likely is that gold investors are proving more sensitive to signs of global inflationary pressures.

Sure, most analysts expect another weak August inflation reading for the U.S. on Thursday, and continued tepid wage gains may bear that out. But there are plenty of reasons to expect steady, if not scorching, price gains in the West in the next 12 months. The most obvious is the U.S. dollar's decline this year, which has helped push up the price of all commodities, including gold.

A less appreciated factor is China, the world's largest goods exporter and biggest consumer of most industrial commodities. China's currency has risen sharply this summer, boosting the cost of Chinese goods. Meanwhile, inflation also has remained stubbornly high within China, in part due to Beijing's campaign to shut down excess factory capacity in steel, aluminum and other industrial sectors.

A pricier yuan and costlier goods in yuan terms are a double whammy for foreign buyers of Chinese goods, namely, everyone.

An inflationary blowout remains unlikely. Chinese policy makers are starting to signal discomfort with the pace of the yuan's rise; the nation's central bank eased two-year-old restrictions on betting against the currency over the weekend. And slower growth in China's property market, which drives demand for everything from cement to steel to copper wiring, will likely begin to put a damper on things in the closing months of 2017.

Still, the bubbly sentiment in Treasurys in recent days risks underestimating the chances of higher prices to come. This time around, it is gold bugs whose inflation antennae may be better attuned.

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THE WALL STREET JOURNAL.
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Skepticism Fails to Derail Stock Rally --- Reasons multiply for the bull to tire, but none drive investors to exits

By Akane Otani
698 words
13 September 2017
The Wall Street Journal
J
B16
English

Ask investors how they feel about the U.S. **stock market**, and a typical response is: cautiously optimistic.

Even with major indexes at records, many investors and analysts are finding reasons for the eight-year **bull market** to draw to an end. Some are concerned that stocks have risen with few prolonged interruptions, especially given the uneven pace of U.S. economic growth. And others are nervous that the Federal Reserve, which is looking to raise rates and wind down an unprecedented asset-purchase program, could send stocks tumbling.

"There's a lot of people out there wondering what could be the next catalyst for a market correction," said Marcelle Daher, senior managing director of asset allocation at Manulife Asset Management.

Last week, fears of an escalation in conflict between the U.S. and North Korea and the possibility of catastrophic damage from severe storms sent major indexes lower. But stocks bounced back, and on Tuesday the **S&P 500**, **Dow Jones Industrial Average** and **Nasdaq Composite** closed at records on the same day.

Even with stocks rebounding relatively quickly from pullbacks this year, investors have generally been lukewarm about the stock rally. The share of fund managers who have positioned their portfolios to be underweight U.S. stocks -- or holding a smaller share of U.S. stocks in a portfolio relative to its benchmark -- rose to a 10-year high in September, Bank of America Merrill Lynch found in its latest monthly global fund-manager survey. The survey, conducted between Sept. 1 and Sept. 7, included responses from 214 investors with $629 billion in assets under management.

U.S. stock funds ended the week ended Thursday with net outflows for 2017, according to EPFR Global data, after drawing in nearly $33 billion for the year as of the end of the first quarter.

Some investors and analysts say it is the length of the stock rally -- and its largely uninterrupted nature -- that concerns them. The **S&P 500** has posted a daily drop of at least 2% on 19 occasions over the past five years -- none of them in 2017.

Some worry that the pace of economic growth won't be able to support rising stock prices. Bets that the Trump administration would supercharge growth through tax cuts and fiscal stimulus helped U.S. stocks rally after the election, but many of the beneficiaries of such wagers, including shares of banks and industrial companies, have since pared their gains.

That hasn't stopped the Fed from signaling that it will move forward with plans to normalize monetary policy. With the central bank looking to raise rates and wind down an unprecedented asset-purchase program later this year, some worry that stocks are vulnerable. Loose monetary policy has helped stocks climb in the years since the financial crisis.

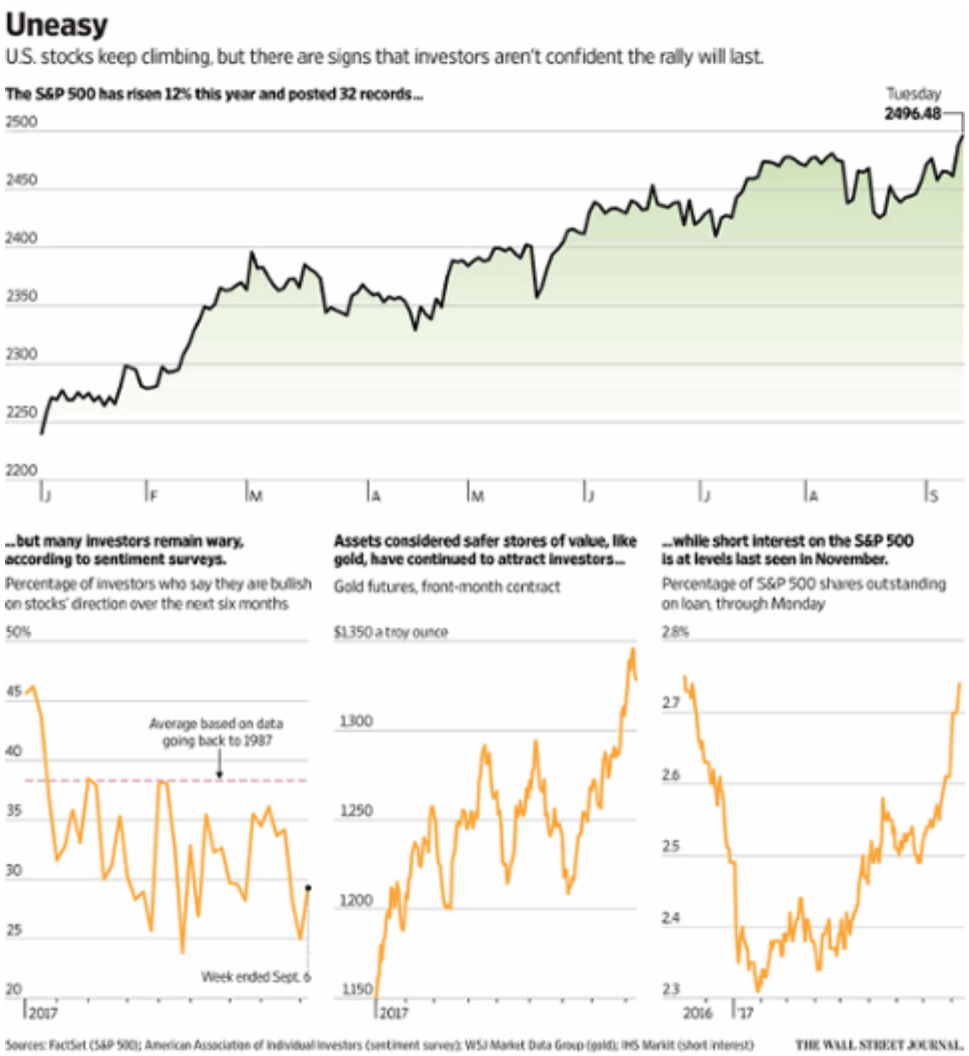
About a third of investors say escalating conflict in North Korea is the biggest risk to the markets, according to BAML's fund-manager survey, while 21% worry most about a "policy mistake" from the Fed or the European Central Bank and 15% worry about tightening credit conditions in China.

Some are placing wagers on a market reversal. The level of short interest, or **bearish** bets, on the **S&P 500** has risen in September to levels last seen in November, according to market-research firm IHS Markit.

Some take comfort in investors' misgivings: What would concern them most, they say, is if investors appeared to be charging into stocks with few hesitations. "When you hear about all of the concerns people have about growth, politics, valuations -- the list goes on and on -- it's hard to argue that there's complacency," Ms. Daher said.

And investors' skepticism has yet to derail the stock rally. The **S&P 500** is up 12% this year; the **Nasdaq** is up 20%.

"Every time you look for a reason to say this market should pull back, there are too many counterarguments keeping you in," said Art Hogan, chief market strategist at Wunderlich Securities.



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The New York Times

Business/Financial Desk; SECTB
Gains for Banks and Retailers Take Markets to Record Highs

By THE ASSOCIATED PRESS
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13 September 2017
The New York Times
NYTF
Late Edition - Final
3
English

Stocks rose to record highs Tuesday in the United States as banks kept rising and retailers climbed after some encouraging job data.

It was the second straight day for big gains in bank stocks as bond yields pushed higher, which allows banks to charge higher rates on loans. Retailers rose after the Labor Department said job openings and hiring both grew in July, and more people quit their jobs to take new ones. That left investors hopeful people will shop and spend more.

The chemicals company DowDuPont climbed after making changes to its breakup plans, something activist investors had pushed for. Apple's newest iPhones did not generate much excitement on Wall Street.

The bond market is ''moving back to a comfort zone,'' said Matt Toms, the chief investment officer for Voya Investment Management's fixed-income business. ''Just enough growth, just enough inflation, but not too much of either.''

The **Standard & Poor's 500-stockindex** rose 8.37 points, or 0.3 percent, to 2,496.48. The **Dow Jonesindustrial average** gained 61.49 points, or 0.3 percent, to 22,118.86. The **Nasdaq composite** index picked up 22.02 points, or 0.3 percent, to 6,454.28.

The **S.&P. 500** finished at a record Monday and the Dow finished a fraction of a point above the record it set in early August. The **Nasdaq** surpassed the record it set on Sept. 1.

Bond prices fell. The yield on the **10-year Treasury** note rose to 2.17 percent after it jumped to 2.13 percent Monday. That helped banks. Bank of America added 59 cents, or 2.5 percent, to $23.95, while Citizens Financial Group gained $1.02, or 3 percent, to $34.48. Companies that pay big dividends like utilities and real estate investment trusts did not do as well as the rest of the market, as income-seeking investors were drawn to bonds.

Stocks were coming off their best day since late April. They rose Monday as Hurricane Irma weakened without doing as much damage as some forecasts had predicted last week. Investors were also relieved that tensions between the United States and North Korea did not get any worse following a national holiday there.

DowDuPont, which was formed when two of the world's largest chemical companies combined in August, made some changes to its breakup plan after pressure from activist investors.

DowDuPont gained $1.67, or 2.5 percent, to $68.52.

Job openings posted by employers rose 0.9 percent to 6.2 million in July, the Labor Department said. That is the highest on records dating to 2000. Hiring also increased and more people quit their jobs, which often means they are leaving for jobs that pay better. That helped smaller, domestically focused companies and retailers. Gap jumped $1.67, or 6.4 percent, to $27.61, and Victoria's Secret parent L Brands advanced $1.46, or 3.9 percent, to $39.36.

Apple's stock gyrated as the company announced its newest iPhones and updates to other products. The new iPhone 8 will be able to shoot pictures with better colors and less distortion, particularly in low-light settings, and it will be out Sept. 22. The iPhone X has an edge-to-edge screen and can be unlocked with facial recognition, but will not go on sale until Nov. 3.

The iPhone is the source of most of Apple's revenue, and some investors have been worried that supply constraints will slow down its sales. Apple was down early in the day, climbed as much as 1.5 percent as it made its announcements, and then wound up with a loss of 64 cents to $160.86.

Energy companies traded higher as benchmark United States crude added 16 cents to $48.23 a barrel in New York. Brent crude, the standard for international **oil prices**, gained 43 cents to $54.27 a barrel in London.

Gold lost $3 to $1,328.00 an ounce. Silver dipped 1 cent to $17.89 an ounce. Copper fell 3 cents to $3.04 a pound.

The dollar rose to 110.19 yen from 109.46 yen. The euro edged up to $1.1966 from $1.1952. The British pound climbed to $1.3282 from $1.3165, its highest level in a year. That move came after inflation figures came in stronger than analysts expected, which left investors thinking the Bank of England may raise interest rates sooner than they had anticipated.

CHARTS: **10**-**Year Treasury** Notes: High yield in monthly refunding auction. (Source: Treasury Department); The Dow Minute by Minute: Position of the **Dow Jones industrial average** at 1-minute intervals on Wednesday. (Source: Reuters)

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The New York Times

Editorial
Opinion
Senators in Search of a Foreign Policy

By THE EDITORIAL BOARD
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13 September 2017
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NYTFEED
English

The range of problems facing the United States abroad is daunting: a **volatile** Middle East, an unpredictable, mischievous Russia, a truly menacing North Korea. To say nothing of destabilizing global challenges like the mass migration of desperate refugees, and climate change. President Trump's "America First" approach, which calls for disengagement from old alliances and responsibilities, is a dodge, not an answer. What's needed is a robust foreign policy led by a reinvigorated State Department that right now is suffering from presidential neglect, poor leadership and an absence of professional firepower in pivotal positions.

Two people who understand the urgency of helping the department recover from the damages inflicted by Mr. Trump are Senators Lindsey Graham, Republican of South Carolina, and Patrick Leahy, Democrat of Vermont. Leading members of the Senate Appropriations Committee, they have sought to rally their colleagues around a bipartisan spending bill for 2018 that would strengthen the department and replenish important foreign aid programs.

Last week, the two won unanimous committee approval for a $51 billion bill for the State Department and foreign aid, about $11 billion more than the administration requested. While the total is less than what Congress allocated for 2017, and less than necessary given the international challenges, it's nowhere near the 30 percent cut that Mr. Trump; his budget chief, Mick Mulvaney; and his secretary of state, Rex Tillerson, had absurdly insisted was imperative.

As interesting as the bipartisan vote was the Republican-led committee's report, which pulled no punches in blistering Mr. Trump and his aides for proposing a budget in May that amounted to an "apparent doctrine of retreat" from the world. "The lessons learned since September 11, 2001, include the reality that defense alone does not provide for American strength and resolve abroad," the report said. "Battlefield technology and firepower cannot replace diplomacy and development."

That argument strikes at the heart of Mr. Trump's approach, which favors warlike rhetoric and a reliance on the Pentagon as the primary levers of American power, while negotiation and diplomacy are given short shrift. At more than $600 billion annually, the military budget accounts for almost 19 percent of the federal budget, and Mr. Trump would add billions more for additional Navy ships and nuclear weapons. The State Department and its foreign aid programs account for 1 percent of the overall budget.

Sixteen years of war against terrorists in Afghanistan, Iraq and elsewhere have given the military what it and many others see as a priority claim on federal dollars, leaving the State Department in a subsidiary role. Mr. Trump reinforced that trend with his proposed budget cuts, which would eliminate more than 2,500 diplomatic and development jobs and make major reductions in diplomatic security (36 percent in budget cuts), H.I.V./AIDS programs (17 percent), international disaster assistance and food aid (a whopping 77 percent) and migration and refugee assistance (18 percent). When the "unjustified" budget cuts were announced, the committee report said, they caused so much concern in foreign capitals that China and Russia were able to "hijack our national security narrative" as a commanding and confident power capable of leading the world.

The committee bill would rescind many of these reductions and go beyond the numbers by imposing unprecedented restrictions to protect certain programs and operations from administrative meddling. The number of Foreign Service officer positions, for example, would not be permitted to go below 14,000; and the State Department's Bureau of Population, Refugees and Migration could not be eliminated.

There are two reasons for these rules. Senators were angered that Mr. Mulvaney arbitrarily took a meat ax to the State Department budget without understanding its programs or the consequences of reductions and without adequate consultation with Congress. There is also grave bipartisan concern about whether Mr. Tillerson, a former Exxon Mobil chief executive with no government experience, is over his head and, indeed, whether the reorganization he has promised will end up further weakening the department. The secretary is widely seen as lacking influence with Mr. Trump; often eclipsed on the world stage by the ambassador to the United Nations, Nikki Haley; accessible only to a small coterie of aides; and detached from an increasingly demoralized diplomatic corps. Many senior people have already left their jobs in an institution that many once saw as the government's crown jewel.

Like all institutions, the department can benefit from improvements. But there is no sign that Mr. Trump and his team understand its core mission and its importance in a turbulent world. With their bill, Mr. Graham, Mr. Leahy and their fellow committee members have ringingly reaffirmed that mission. The rest of Congress should ensure that a strong version of it becomes law.

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THE WALL STREET JOURNAL.
U.S. EDITION

The Republican Tax Plan Better Be Audacious

By David M. Smick
1,039 words
13 September 2017
The Wall Street Journal
J
A17
English

The big question on tax reform is President Trump: Can Republicans really trust him, in the end, to go along with their plan? Or will he pivot at the last minute and play nice with "Nancy" and "Chuck," his two new friends on Capitol Hill? The answer might depend on whether the GOP plan does enough to help average workers.

So far the effort on tax reform seems off kilter. Yes, reducing the corporate tax rate to improve American competitiveness makes sense. So does inducing companies to repatriate -- and then put to work -- the $2.5 trillion they have sitting idle offshore. Still, on tax policy the GOP has become like a boxer leading with his chin. Republicans appear a bit too concerned with CEOs and not enough with the wage earners who have been the big losers of the 21st century.

Since the financial crisis, American companies have fared well. Leveraging the Federal Reserve's low interest rates, they have bought back their own stock at an extraordinary clip. Since hitting bottom in March 2009, the **Standard & Poor**'**s500 index** has risen 265%. Meanwhile, wage earners haven't had a meaningful raise in real terms in decades.

Although Congress could help, the quirky way financial legislation is normally passed in the Senate -- via reconciliation, which requires only 51 votes -- means it probably won't. Imagine that President Trump announces, as promised, a "beautiful" plan that includes a permanent "big league" tax cut for middle-class families. The GOP's razor-thin Senate margin and the vagaries of reconciliation mean the Trump plan would have little chance of becoming long-term policy. At best, working families would get a temporary tax cut. More likely would be a repeat of what happened with the attempt to replace ObamaCare: A small group of Republican outliers in the Senate would say "no."

Fearing this outcome, Republican leaders are being tempted to play small ball. They might suggest modestly lowering the corporate tax rate. They might propose allowing full expensing of business investment, to be scaled back after several years. To help the middle class? They'll throw in a modest hike to the standard deduction. Anything to get something done.

Which brings us back to President Trump. After watching the country tear itself apart politically, economically and socially during more than a decade of mediocre GDP growth, can the GOP trust the president to play small ball? Or will the transactional Mr. Trump try to "triangulate" and undermine the Republican position? If the GOP plan is not bold enough in helping the little guy, my bet is the latter.

This is a unique moment in America's economic history. Wage earners are being held back by a combination of globalization and technological advancement. A tax reform geared toward middle-class families would help, but Republicans would do well to explore a third cause of the problem: Large multinational corporations, the institutions Washington favors most, are chilling wage gains in their relentless drive to lower consumer prices and grab market share.

Republican reformers are quick to counter that any corporate tax cut will include the "pass throughs," those smaller enterprises -- including partnerships, LLCs and S-Corps -- that use the personal tax code. What they don't say is how difficult it would be to cut the "pass through" rate for legitimate small businesses without opening the tax system to widespread abuse. Every billionaire could declare himself a one-man S-Corp, hoping to be taxed at the lower rate. That's why Congress needs a mini-Manhattan Project of tax specialists to figure out quickly how to help mom-and-pop businesses without inviting abuse and creating a revenue-losing free-for-all.

Ultimately, Republicans are being forced to play small ball because a group of GOP deficit hawks worry that a big tax reform would undermine the budget. This fear seems out of proportion. Since 2000, under a Republican president and then a Democratic one, the national debt has soared from $5 trillion to nearly $20 trillion. The fiscal situation will only worsen with the coming entitlement-funding nightmare. Fretting about the deficit now is like worrying about a flickering candle in the front parlor when the entire house is on fire and the roof is about to cave in. Besides, true tax reform would eliminate deductions just as boldly as it slashes rates, achieving revenue neutrality.

Republicans shouldn't play small ball. Their goal should be a tax-reform plan that will create robust economic growth, which in turn will help heal a bitterly divided nation. What would such a plan look like? Helping wage earners via tax policy is not a simple matter. People who earn less than $50,000 a year pay an average effective income-tax rate of 4.3%. What's killing them is the payroll tax combined with the rising cost of health care. At minimum, the standard deduction should be tripled. But reformers also need to think creatively. Tax reform, entitlement reform and health-care reform cannot be considered in isolation. Working families need relief across the board.

That requires a bigger play than what some on Capitol Hill have in mind. But in the end, growth is everything. As he was preparing to run for president in 1980, Ronald Reagan was warned in a strategy meeting I attended about John Connally, a fellow candidate in the Republican primary. Connally, a former Texas governor, was raising big bucks from big business. By comparison, Reagan's campaign coffers were lean. The future president's response was aggressive. "Let him have the Fortune 500," Reagan shouted. "I'll take Main Street over Wall Street."

This kind of "lunch pail" capitalism won Reagan the election and transformed the GOP -- and the country. Isn't it time for more "lunch pail" policy-making from Washington?

Mr. Smick's latest book is "The Great Equalizer: How Main Street Capitalism Can Create an Economy for Everyone" (Public Affairs, 2017). He was chief of staff to Rep. Jack Kemp from 1979-84 and advised on both the 1981 and 1986 tax reforms.

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Business News: Most of comScore Board Resigns Ahead of Review

By Ezequiel Minaya
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The Wall Street Journal
J
B5
English

ComScore Inc. said Monday that most of its board members will resign and it would complete a strategic review of the business amid pressure from shareholders over the media-analytics company's management and lack of transparency on finances.

ComScore, which has been dogged by accounting problems that led to it being delisted from the **Nasdaq** in May, named a new interim finance chief on Monday, but it also delayed the time frame on getting current on overdue financial disclosures because of the complexity of the task.

Earlier this year, ComScore said it expected to be done with revisions to financial statements and releasing new statements this summer. With autumn fast approaching, the firm which measures audience and advertising reach through various platforms including digital and television, now expects to be up-to-date on its filings by March 2018 at the earliest.

"We regret the need to extend further the date for filing our restated financials and we share the frustration of our stockholders," said Gian Fulgoni, comScore's co-founder and chief executive, in prepared remarks.

Shares in comScore, which now trade over the counter, fell 0.7% to $28.55 on Monday.

The company said in September 2016 that it needed to restate financial results for 2013, 2014 and 2015 after an internal investigation discovered problems with accounting for nonmonetary transactions. The company hasn't submitted its annual securities filing for 2015 or any of its filings for 2016 and 2017.

Starboard Value Fund LP, which the company said owns 4.9% of its shares, was among investors to criticize comScore amid concerns including that an annual meeting hadn't been held in more than two years.

Calls to Starboard and comScore weren't immediately returned.

With the resignations, comScore shrunk the size of its board to five members from 12 members.

The remaining members are Mr. Fulgoni, Bill Livek and Brent Rosenthal and special-committee members Jacques Kerrest and Sue Riley. The special committee is also charged with oversight of comScore's engagement process with Starboard.

Separately, comScore has named David Kay as its interim chief financial officer, replacing David Chemerow, who resigned from the position Friday. Mr. Kay is a co-founder and managing partner of CrossCountry Consulting LLC, which has been providing accounting consulting services to comScore since July 2016. Mr. Chemerow joined comScore last year following the company's merger with rival Rentrak Corp., where he was CFO. ComScore also said it has reached settlements in multiple legal proceedings, subject to court approval.

Under the terms of one proposed settlement, shareholders in a class-action suit filed against the company and current and former directors would receive $27.2 million in cash and $82.8 million in common stock.

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Battered Insurance Shares Are Recovering --- Cost to the industry appears to be lower than feared as Irma damage estimates fall

By Erik Holm
651 words
12 September 2017
The Wall Street Journal
J
B12
English

Hurricane Irma's brutality burdened millions. Wall Street was relieved it wasn't as intense as feared.

The insurance sector had been hit hard last week as the powerful storm headed toward Florida, but damage estimates indicate the cost to the insurance industry will be far less than was expected when the storm was forecast to pass closer to Miami.

Travelers Cos., the only insurer in the **Dow Jones Industrial Average**, rose 2.3% Monday, adding 19 points to the blue-chip index's 260-point climb. The business and home insurer had fallen in 12 of the 15 trading sessions through Thursday, declining 11% in that time, before beginning its recovery in Friday's session.

Reinsurer XL Group Ltd. rose 5% and Everest Re Group Ltd. rose 4.3%, among the best performers in the **S&P 500**. The reinsurance industry plays a large role in the Florida insurance market and was expected to bear the financial brunt of Hurricane Irma's damage to potentially millions of homes across the state.

A catastrophe-modeling firm, AIR Worldwide, early Monday estimated that Irma would cause private-sector insured losses in the U.S. of $20 billion to $40 billion. That is well below the more than $100 billion or more that was predicted by some insurance-industry experts on Friday. At that time, some projections for the storm had it hitting Miami and the east coast of Florida directly. Instead, the storm shifted west along the Gulf Coast.

The total insured value in coastal counties along the Gulf Coast up to Tampa is about $1 trillion, but "Irma's forward motion should prevent the kind of accumulations and resulting flooding seen two weeks ago in Texas" from Hurricane Harvey, AIR analysts noted. The firm's damage estimates are among those closely watched by the insurance industry after major natural disasters.

Elyse Greenspan, an analyst at Wells Fargo Securities, wrote in a note to clients that Irma didn't bring "the big hit to Miami that models had called for most of last week," but noted that the damage estimate indicates "this will still be a significant loss for the insurance industry."

Still, after declines last week, Chubb Ltd. gained 3.6%, Progressive Corp. climbed 2.2% and Allstate Corp. added 1.8% on Monday.

The **S&P 500**'s property-and-casualty insurers were up 2.7% as a group, reaching their highest point of the month and helping the financial sector lead the **S&P 500** higher.

Florida-based insurers were up even more sharply, with Heritage Insurance Holdings Inc. climbing 22%, HCI Group Inc. rising 17% and Universal Insurance Holdings Inc. shares up 13%.

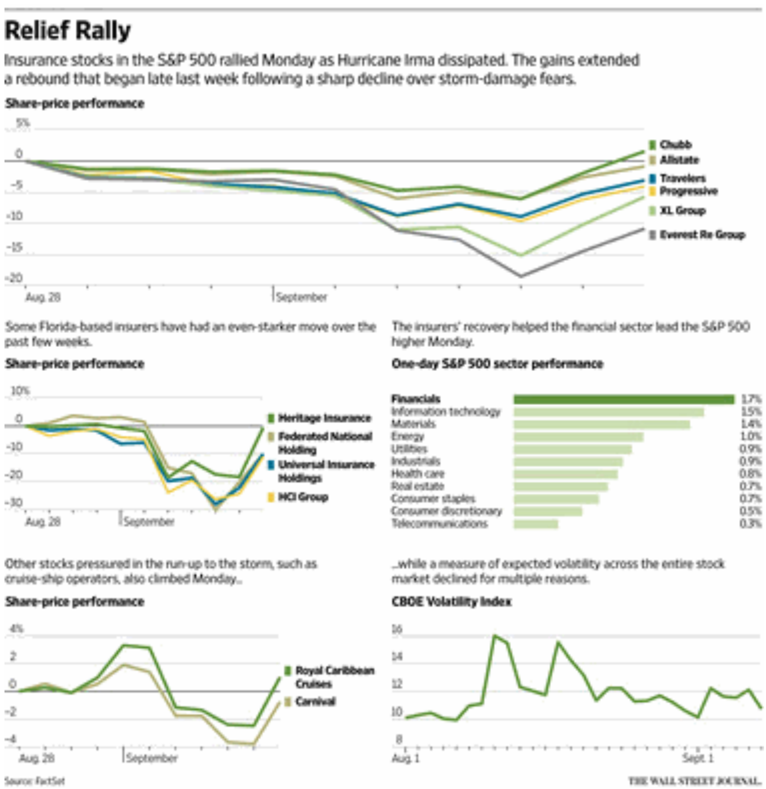
Such companies dominate the Florida home-insurance market, as bigger firms such as Allstate and Travelers have retreated from the state over the past two decades.

The smaller insurers are typically required by Florida regulators to buy reinsurance, which is backup protection that protects insurers from catastrophic losses. Both Irma and last month's Hurricane Harvey are expected to be costly events for the global reinsurance industry, but reinsurers have substantial capital cushions after several years without a major hurricane hitting the U.S.

Past catastrophes sapped enough capital from the industry that insurers and reinsurers raised prices, but some Wall Street analysts said Monday that they didn't appear likely to significantly raise prices from what they knew of Irma's damage so far.

Irma made landfall in the Florida Keys on Sunday morning as a Category 4 storm, weakened to a Category 2 by late afternoon and was downgraded to a tropical storm Monday morning. It moved into southern Georgia on Monday afternoon.

Leslie Scism and Nicole Friedman contributed to this article.



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The New York Times

Business/Financial Desk; SECTB
Amid Optimism, China's Currency Rises

By KEITH BRADSHER
1,337 words
12 September 2017
The New York Times
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Late Edition - Final
1
English

BEIJING -- For those who worry about the state of the world economy, China has long been a major reason to lose sleep. Its financial system labors under a mountain of loans, while weaker growth has prompted many Chinese people and companies to move their money overseas in recent years.

China still faces hefty debt and slowing growth. But even some vocal naysayers say the country has found ways to contain its problems -- at least for now.

That improving outlook is, in part, reflected in China's currency. The renminbi has surged in value in recent weeks, helped by growing confidence in the country's economic prospects and by a political push for stability.

On Monday, Beijing set the currency's value at its strongest level in nearly a year and a half. While China keeps a firm grip on its value, investor interest in the renminbi helps strengthen it.

Other signs point to China steadying its course after a **stock market** crash and surprise currency devaluation two years ago shook the financial world and brought the country's long-term problems to the fore. China's economic data suggest growth is continuing at a steady, if less heady, pace. Its **stock market** is rising again.

China has not solved its problems, of course. But investors and economists say its efforts to keep the economy under control have restored some faith in the country's economic stewardship. In a sign of the government's own confidence, it eliminated two policies over the weekend that made it more expensive for investors to bet that the renminbi would weaken, measures adopted after money began to leave the country two years ago.

''Maybe China is the black swan and everything we know does not apply to China,'' said Zhu Ning, a Tsinghua University economist who published a book last year critical of how the government has managed rising bank debt.

In terms of his earlier worries about China's debt, he added, ''I'm having doubts about what I believed as well.''

The currency, which is one of the main ways the government controls the economy, is a gauge of the country's health and a source of tension for the United States and other trading partners. As the economy boomed, the renminbi largely strengthened. When growth faltered in recent years, money flooded out of the country, putting pressure on the currency.

The currency's ups and downs play to the debt concerns.

China relied on a huge wave of lending to power its economy in the aftermath of the global financial crisis nearly a decade ago. While the strategy worked, it pushed China to similar debt levels, relative to the size of its economy, as the United States and other developed countries.

It did so in an extremely short amount of time, ringing alarm bells in Wall Street and elsewhere. As recently as May, Moody's Investors Service, a ratings firm, lowered its credit rating on the country's debt, saying China's spending spree would hurt long-term growth. The currency devaluation and market crash in 2015 also lessened confidence in Beijing.

Since then, the authorities have taken a number of steps that appear to be keeping the short-term problems at bay, though doing little for the longer term.

Beijing has strictly limited how much money can be sent abroad and has clamped down on what a growing number of the country's leaders considered wasteful corporate purchases. The government has even resorted to strategies like face recognition software at automated teller machines in Macau, a Chinese-controlled territory and gambling mecca that has its own, more readily convertible, currency and that has long had a reputation for money laundering.

The government has also kept lending from sources it trusts, like the country's state-run banks. The push has been strong enough to maintain growth, even as officials have cracked down on other types of lending that they see as potentially disruptive. The **stock market** has begun to recover from its rout two years ago as rising real estate prices reassure investors about the health of China's developers, and resilient economic growth suggests that corporate profits may rise.

Charlene Chu, a China analyst at Autonomous Research, a global company advising hedge funds and other international money managers, has long worried that China's debt accumulation was becoming unsustainable. Now, she said, Beijing has the ability to postpone its problems.

''What I appreciate now is there are just no independent actors here,'' Ms. Chu said. ''There is no bank that is going to say in November that 'our economic outlook is not good -- we're going to contract our loan book.' They can muddle on for a while.''

But Ms. Chu and others see Beijing's efforts as stopgaps: If it does not address its debt, China risks a long period of low growth, as in Japan. Some economic indicators suggest that China's growth will begin to slow in the second half of this year.

But China's surging currency suggests investors are not as worried as before. While China keeps a tight grip on the value of its currency, it allows the renminbi to move up or down by a certain amount in its local currency market.

After falling to almost 7 to the dollar at the end of last year, the renminbi has rebounded. On Monday morning, China's central bank set the currency slightly stronger than 6.5 to the dollar for the first time since May 2016.

''The market has turned around significantly its **bearish** view'' on the Chinese currency, said Zhou Hao, an economist in the Singapore office of Commerzbank.

The currency's rally is partly political. China is preparing for a twice-a-decade Communist Party Congress to begin in Beijing on Oct. 18. President Xi Jinping has made clear that he wants stability until then in practically every aspect of the country's life, including the economy.

Other currency moves -- particularly the United States dollar -- are contributing to the renminbi's strength. The dollar has weakened as the Federal Reserve has been slow to raise rates because the American economy has grown a little less vigorously than anticipated and as inflation in particular has fallen short of expectations.

In Europe, which is finally recovering from the global economic crisis, the euro has staged a powerful rally against the dollar over the past year. So while the renminbi has strengthened against the dollar, it has weakened against the euro. That blunts the impact of a stronger currency in Chinese factories when they export goods, as a strong currency makes them less competitive.

China can win some political gains from its stronger currency. President Trump, who has long criticized China's economic policies, has accused Beijing of keeping its currency artificially weak -- an accusation that had been true in the past but is not today. It could also ease its limit on money outflows, if it chooses.

''If the dollar is depreciating, China has a lot of easy policy options,'' said Brad W. Setser, a former deputy assistant secretary of the United States Treasury who is now a China specialist at the Council on Foreign Relations.

Mr. Zhu, of Tsinghua University, said he believed that the Chinese government could continue to postpone its problems. But he warned against complacency, saying China's debt could cause problems if it were not watched carefully.

''When will the bubble burst?'' he said. ''When nobody believes it's a bubble.''

Follow Keith Bradsher on Twitter @KeithBradsher.

Rising real estate prices are reassuring investors about the health of China's developers as the **stock market** recovers from a crash two years ago. (PHOTOGRAPH BY DAVID GRAY/REUTERS) (B1); Buildings under construction in the northeastern Chinese city of Qiqihar. China's economy has been growing steadily despite worries about debt and the renminbi. (PHOTOGRAPH BY GILLES SABRIÉ FOR THE NEW YORK TIMES) (B2)

Document NYTF000020170912ed9c00042

The New York Times

The Week Ahead
Business Day

Recovery From Two Hurricanes, and German Automakers Look Forward

By THE NEW YORK TIMES
1,216 words
10 September 2017
07:57 PM
NYTimes.com Feed
NYTFEED
English

Here's what to expect in the week ahead:

ECONOMY

Florida starts following Texas' lead.

As Texas continues to recover from Hurricane Harvey, businesses and residents in Florida will begin to assess the damages from Irma. Early reporting on the effects of the Houston storm showed that **financial markets** were less skittish than expected, and some analysts even predicted a modest economic bump in the region, spurred by construction projects as people restore their properties. Zach Wichter

AUTO INDUSTRY

The federal government weighs in on self-driving cars.

The auto industry is expected to receive guidelines from the Trump administration on Tuesday about how autonomous vehicles will be regulated in the future. Transportation Secretary Elaine L. Chao will make a "special announcement" related to the emerging technology at the self-driving test facility at the University of Michigan, where she will be joined by Mitch Bainwol, the president of the Alliance of Automobile Manufacturers. The event follows the House's passage of legislation last week that would allow individual carmakers to test up to 100,000 driverless vehicles on the nation's roads per year. Bill Vlasic

The German automakers try to put diesel problems behind them.

The International Motor Show begins in Frankfurt amid one of the worst crises to hit the German auto industry since the end of World War II. The huge exhibition, which opens to the news media on Tuesday and the public on Saturday, is traditionally an occasion for Daimler, BMW and Volkswagen to celebrate their domination of the high end of the car market. But this year, the companies have faced widespread criticism for deceiving the public about the health risks posed by the diesel passenger cars that they produce in enormous numbers. The automakers will do their best to look past the diesel issue and focus on their plans for electric and self-driving cars. The motor show, held in Frankfurt every two years, continues through Sept. 24. Jack Ewing

BANKING

Goldman Sachs offers its outlook, and has the ear of analysts.

At a financial services conference in New York on Tuesday morning, Harvey Schwartz, the president and co-chief operating officer of Goldman Sachs, will present his firm's current outlook. Attendees will probably be listening closely for any new details on Goldman's plans to bolster its ailing bond division. Historically a crucial component of Goldman's profits, bond trading revenues have been dented this year by an unfavorable mix of clients, ongoing regulatory curbs on riskier trading and losses on natural gas positions. Amid those troubles, Greg Agran, the head of commodities, has announced his plans to leave the firm. Analysts expect to see more evidence of retrenchment in the coming quarters. Kate Kelly

TECHNOLOGY

The new iPhone will tempt the eye and test the wallet.

On Tuesday, Apple will unveil its latest lineup of iPhones, including a special 10th anniversary edition that will start at about $1,000. The new phone will feature an edge-to-edge screen, facial recognition and augmented reality software. The company is also expected to announce an array of other products, including a Watch with a cellular data connection. Vindu Goel

ECONOMY

A report on the domestic economy could keep the good news coming.

The Census Bureau will publish a snapshot of America's economic welfare on Tuesday, including the median household income in 2016, the prevalence of poverty and the share of Americans covered by health insurance. Last year, the news was good. The government reported that the median household income rose sharply after years of stagnation, although the median income remained below the precrisis peak in 2007. The latest report is expected to show further progress. Binyamin Appelbaum

The Bank of England may move closer to raising rates.

The Bank of England will release its latest decision on interest rates on Thursday. The Monetary Policy Committee is widely expected to keep interest rates steady, but the decision comes as some members of the committee have become increasingly concerned about inflation. At its last meeting in August, the committee voted 6 to 2 to keep its benchmark interest rate at a historic low of 0.25 percent.

But Michael Saunders, a committee member who voted to raise rates, said in a speech last month that a "modest rise" in interest rates was needed to ensure that the inflation returns to the central bank's target over time.

In its latest inflation forecast in August, the Bank of England said it expected inflation to peak at 3 percent in October. Mark Carney, the Bank of England governor, said at the time that inflation was expected to ease early next year and reduce pressure on household incomes. Chad Bray

Consumer prices could hinge on the cost of energy.

On Thursday, the Labor Department will report August data on the Consumer Price Index. Economists expect overall prices to show a 0.3 percent increase while the core index, which excludes the **volatile** food and energy sectors, is estimated to have inched up by 0.2 percent. Rising energy prices are thought to have moved the index higher last month, a trend which will probably continue in September. The core may show the effect of rising prices for imports, which are being pushed up by the weak dollar. Nelson D. Schwartz

Jane Austen secures a place in your pocket.

A new British 10 pound note bearing the likeness of the novelist Jane Austen goes into circulation on Thursday in England and Wales. The bank note, worth about $13, is the second to be printed by the Bank of England using a polymer material instead of special cotton paper. The bill will join its cousin, the £5 note featuring the former Prime Minister Winston Churchill, which was introduced last year.

The new bills are supposed to last longer than traditional paper notes, and are able to withstand a washing machine cycle. The new notes also include updated security features to discourage counterfeiting. The final design was unveiled in July, timed to mark the 200th anniversary of Jane Austen's death. She is replacing Charles Darwin on the £10 note. Chad Bray

AUTO INDUSTRY

G.M.'s C.E.O. celebrates a milestone in China.

Mary Barra, the chairman and chief executive of General Motors, will attend a ceremony in Shanghai on Friday to mark the sale of the 15 millionth car by G.M.'s main joint venture in China, which started making cars in China in 1998. She is expected to talk about G.M.'s activities and plans in the world's largest car market. She will also join an annual meeting of foreign business leaders with the city's top officials. Han Zheng, the party secretary of Shanghai, is a possible candidate to join the Standing Committee of the Politburo, the handful of top Communist leaders who run China, at the twice-a-decade Communist Party Congress in Beijing starting on Oct. 18. Keith Bradsher

BMW has faced criticism over the health risks of diesel vehicles, but the International Auto Show this week in Frankfurt will be a chance for it and other German carmakers to look forward to a greener future. | Axel Schmidt/Reuters

Document NYTFEED020170910ed9a004jx

The New York Times

FAIR GAME
Money and Business/Financial Desk; SECTBU
Oversight Law Under Attack Aids Investors

By GRETCHEN MORGENSON
976 words
10 September 2017
The New York Times
NYTF
Late Edition - Final
1
English

Seismic accounting scandals like the ones that sank Enron and WorldCom in the early 2000s have, happily, been scarce in recent years. But they may well resurface if elements of the Sarbanes-Oxley Act, the law created to curtail accounting fraud, are rolled back as some corporate executives are urging.

Tom Farley, president of the NYSE Group, which operates the New York Stock Exchange, is among those leading the charge. In congressional testimony in July, he criticized the law's provision requiring auditors of publicly held companies to report on and attest to management's assessment of internal controls on financial reporting. The requirement is costly and burdensome to companies, Mr. Farley said, and helps to explain why the number of public corporations in the United States is declining.

He urged lawmakers to review the requirement because markets had evolved since it became law.

Mr. Farley's comments notwithstanding, it seems smart to have an outside auditor check on management's oversight of financial reporting. If a company does not have solid controls in place, how can investors trust its financial reports?

But investors do not seem to be a concern for Mr. Farley, who was speaking about the law (known as SOX) as an advocate for the big companies that list their shares on the New York Stock Exchange. ''Designing, implementing and maintaining complex systems required to satisfy SOX's internal controls over financial reporting requirements can command millions of dollars in outside consultant, legal and auditing fees, in addition to other internal costs,'' he said.

Through a spokesman, Mr. Farley declined my request to expand on his views in an interview.

Since 1977, companies have been required by law to have effective internal controls over their financial reporting. But many failed to comply, as the subsequent accounting frauds and numerous financial restatements showed. That is why Congress decided in 2002, as part of Sarbanes-Oxley, to make auditors attest to corporate controls on financial reporting.

Lynn E. Turner, a former chief accountant of the Securities and Exchange Commission and a trustee of the Colorado Public Employees' Retirement Association, said he knew well that many companies hate having auditors assess their internal controls. But the regulation has done a lot to prevent devastating accounting frauds, he said.

''Corporate frauds like Enron, WorldCom and Tyco cost investors hundreds of billions of dollars and the NYSE and **Nasdaq** trillions of dollars in lost market capitalization,'' Mr. Turner said. ''And they were a worldwide embarrassment to the United States.''

Critics of the provision on financial reporting contend that it has not prevented accounting fraud, but a new academic study shows otherwise.

The analysis concludes that the external auditor requirement on corporate financial reporting is a highly effective warning system for corporate fraud. The study was recently published in Auditing: A Journal of Practice & Theory, a journal from the American Accounting Association.

Its authors are Matthew S. Ege, an assistant professor of accounting of Texas A&M University, and Dain C. Donelson and John M. McInnis, both of the University of Texas at Austin. They say their work is the first to link weak internal controls on financial reporting with a higher risk of undisclosed accounting fraud at public companies. And proof of this link is an important consideration when weighing the costs and benefits of Sarbanes-Oxley.

The academics collected auditors' opinions on internal controls at companies with more than $75 million in publicly held stock -- about 3,500 companies per year -- from 2004 through 2007. They searched for those with material weaknesses. Then they compared their findings with reports of financial fraud in S.E.C. and Justice Department enforcement actions from 2005 through 2010 as well as settled securities class-action lawsuits during the period.

The exercise identified roughly 1,500 reports of material weakness at companies. And within three years, 127 of those companies faced legal actions that revealed fraud, the study said.

That's not a big number. But here's where the study gets compelling. Auditors had identified material weaknesses in financial reporting at about 30 percent of the companies that later disclosed accounting problems. Chief executives were named in 111 of the 127 fraud cases, and chief financial officers were identified in 108 of the cases.

''Over all, we believe this link should be of interest to regulators and the general public,'' Mr. Ege said in an interview. ''We need to ensure that entity-level weaknesses are being reported and not withheld.''

Here's another reason to keep the financial reporting audit requirement: Research indicates that companies with weak financial reporting controls significantly underperform those with stronger setups. A 2007 study by Glass, Lewis & Company, for example, found that companies disclosing material weaknesses in their financial reporting during each of the prior three years were conspicuous market laggards.

Although critics of Sarbanes-Oxley prefer to focus on its vexing costs, an analysis in May by Ernst & Young, a big accounting firm, highlighted the law's benefits. They include a ''decreased severity of financial restatements and increased investor confidence,'' the firm said.

Arguments like those raised by Mr. Farley of the NYSE Group and other corporate chiefs about accounting rules are nothing new, Mr. Turner said. During his years as the S.E.C.'s chief accountant, from 1998 to 2001, officials from the New York Stock Exchange would regularly request exemptions from reporting rules, he said. ''I never once agreed to what they were asking for,'' Mr. Turner recalled.

Clearly, investors will be hurt the most if this provision of Sarbanes-Oxley is watered down. Which raises a question, according to Mr. Turner: Why should a public company be able to raise money from investors if it can't generate accurate reports for them?

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THE WALL STREET JOURNAL.
U.S. EDITION

Pension Funds Are Dialing Up the Risk --- Plans look to boost returns as obligations climb and the number of retirees increases

By Donato Paolo Mancini and Jon Sindreu
729 words
8 September 2017
The Wall Street Journal
J
B10
English

LONDON -- As the developed world's population ages rapidly, pension funds are pushing into riskier assets.

Ultralow interest-rate policies at central banks have left pension plans grappling with huge deficits, just as the swelling ranks of retirees are adding to outflows of money. They are hard-pressed to squeeze more out of their investments.

So even as central banks are poised to start rolling back monetary-stimulus measures, pension plans' demand for risky, income-generating assets such as corporate bonds and real estate is likely to keep increasing, investors say.

"There's a trend towards less liquid structures," said David Rae, head of client strategy at Russell Investments, which provides management services to pension plans. "The focus now is on guaranteeing returns."

The world's six largest pension systems -- the U.S., the U.K., Japan, Netherlands, Canada and Australia -- will have a joint shortfall of $224 trillion by 2050, the World Economic Forum said in May. By that year, there will be only four workers for each pensioner, compared with eight now, according to the forum.

The Hoover Institution estimates that public-pension systems in U.S. states and cities have a funding hole of $3.8 trillion.

But the danger looms larger in Europe, which has the world's biggest pensioner population. And it is especially acute in Britain, where there are more corporate pension plans offering fixed payouts to clients, known as defined-benefit plans.

According to consulting firm Mercer, 55% of U.K. defined-benefit funds are cash-flow negative and, of those that aren't, nearly 85% are likely to be over the next decade.

Such plans have obligations that stretch far into the future, but their assets are often shorter-dated. So after interest rates fell to record lows, the value of what they owed rose at a much faster pace than the value of what they owned.

Many tried to plug the hole by making their assets as long-dated as their liabilities and created extraordinary demand for government debt maturing in 50, 80 or 100 years.

Now that central banks are expected to tighten policy, deficits have stopped increasing. Yet, many pension funds remain severely underfunded.

Corporations have ramped up contributions to compensate. Last year, Royal Bank of Scotland Group PLC made the largest pension payment ever by a British company by pouring GBP 4.2 billion ($5.47 billion) into its main pension plan, consulting firm LCP said.

In a survey this year, BlackRock Inc., the world's largest money manager by assets, found that, among global pension funds planning allocations for this year, 52% wanted more private credit, 24% more real estate and 23% more high-yield bonds. Most said they would cut exposure to stocks and government debt.

As a result, pressure is easing off the government-bond market and pushing up the prices of riskier assets, said James McAlevey, portfolio manager at Aviva Investors.

Yields on global high-yield corporate bonds are roughly 5.2%, not far from historic lows, according to Bank of America Merrill Lynch. Yields fall as **bond prices** rise. A recent survey by consulting firm bfinance found that managers of unlevered senior private debt funds expect a return of more than 8%, but are getting between 5% and 6%.

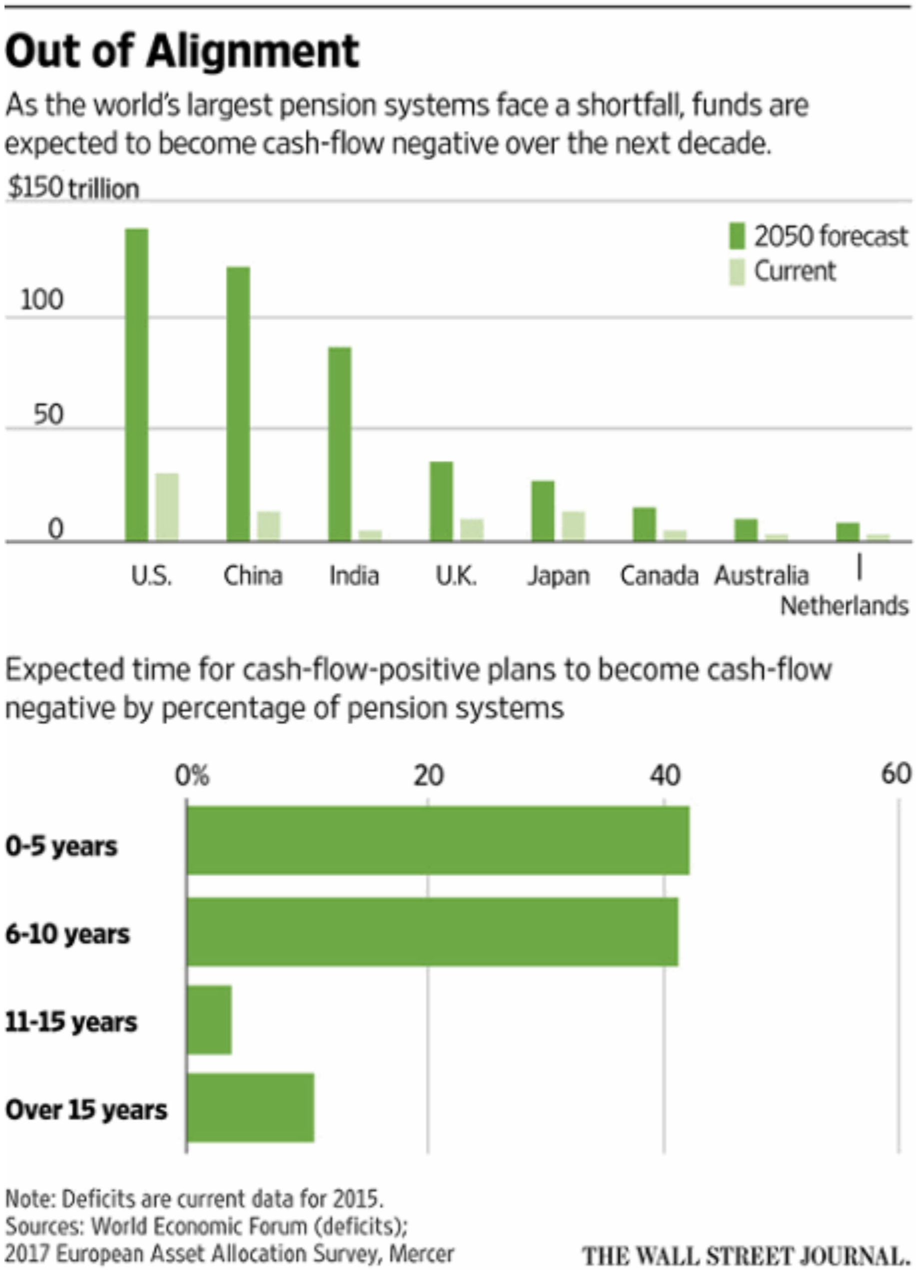
Focus on returns is often part of a new investment strategy called "cash-flow-driven investment," which aims to align inflows with outflows regardless of whether the fund is in deficit.

Simeon Willis, head of investment strategy at KPMG, defined it as "a mind-set change" over the past couple of years.

An example is the U.K.'s Local Pension Partnership, which manages more than GBP 10 billion of local government workers' pensions in London and Lancashire County. Its funds' outflows now outpace inflows, as retirees increase in number compared with workers enrolled.

Their answer has been to double the share of investments in infrastructure, real estate and corporate debt over the past five years.

"We are trying to invest into a balance of income and capital gains, whereas before it was mostly capital gains we focused on," said Chris Rule, LPP's chief investment officer.



Document J000000020170908ed980001l

THE WALL STREET JOURNAL.
U.S. EDITION

Streetwise: Dangerous Words for Investors To Buy Into: Inflation Is Dead

By James Mackintosh
748 words
8 September 2017
The Wall Street Journal
J
B1
English

Bonds, equities and commodities appear to be sending contradictory messages about the economy, adding to the confusion from central banks struggling with the breakdown of their inflation models. However, the markets can be reconciled -- and if they are right, the outlook is just dandy for Wall Street, if not so much for Main Street.

Unfortunately, the failure of central-bank models to predict the yearslong slowdown in global inflation leaves investors in the dark about the most important economic measure today and why it is so low. If policy makers and economists can't explain convincingly why inflation is where it is, why are investors putting so much faith in their forecasts of where it will go?

Start with what markets are telling us about the economy. Bonds have become significantly less optimistic this year, and this week futures traders started for the first time to price a -- tiny -- chance of a Federal Reserve rate cut at this month's meeting. Yet equity markets are booming, with the **S&P 500** just 1% below its all-time high. The price of copper has leapt by a quarter this year and industrial metals more broadly have jumped, suggesting robust demand.

So do the markets think the economic engine is purring along nicely or about to stall? Look below the hood and we can extract some consistency.

The place to start is with the **bond yield** curve, the extra yield on offer for holding longer-maturity Treasurys. The curve has been flattening and 10-year bonds now offer just 0.77 percentage point more than two-year bonds, usually a bad sign. Yet, while the outlook for growth may not be great, it doesn't signal immediate trouble, either.

The yield curve is still only as flat as it was in March 2005, February 1996 or July 1988, each of which was followed by **S&P 500** gains of at least 20% over the following two years, before recession hit. Recession eventually arrived, after the yield curve turned negative, but for now it is consistent with the U.S. being in the late stages of the economic cycle.

"People look to the yield curve as the ultimate arbiter and it says you should be taking risk," said Gregory Peters, senior investment officer of PGIM Fixed Income.

Headline equities may not seem to fit this story, but look a bit closer and they do. The market is being held up by growth stocks, less reliant on economic expansion for profits than on new technology and business models. The Russell 1000 growth index has outperformed value by 14 percentage points this year, an eight-month performance last beaten in the post-Lehman recovery and before that during the dot-com boom.

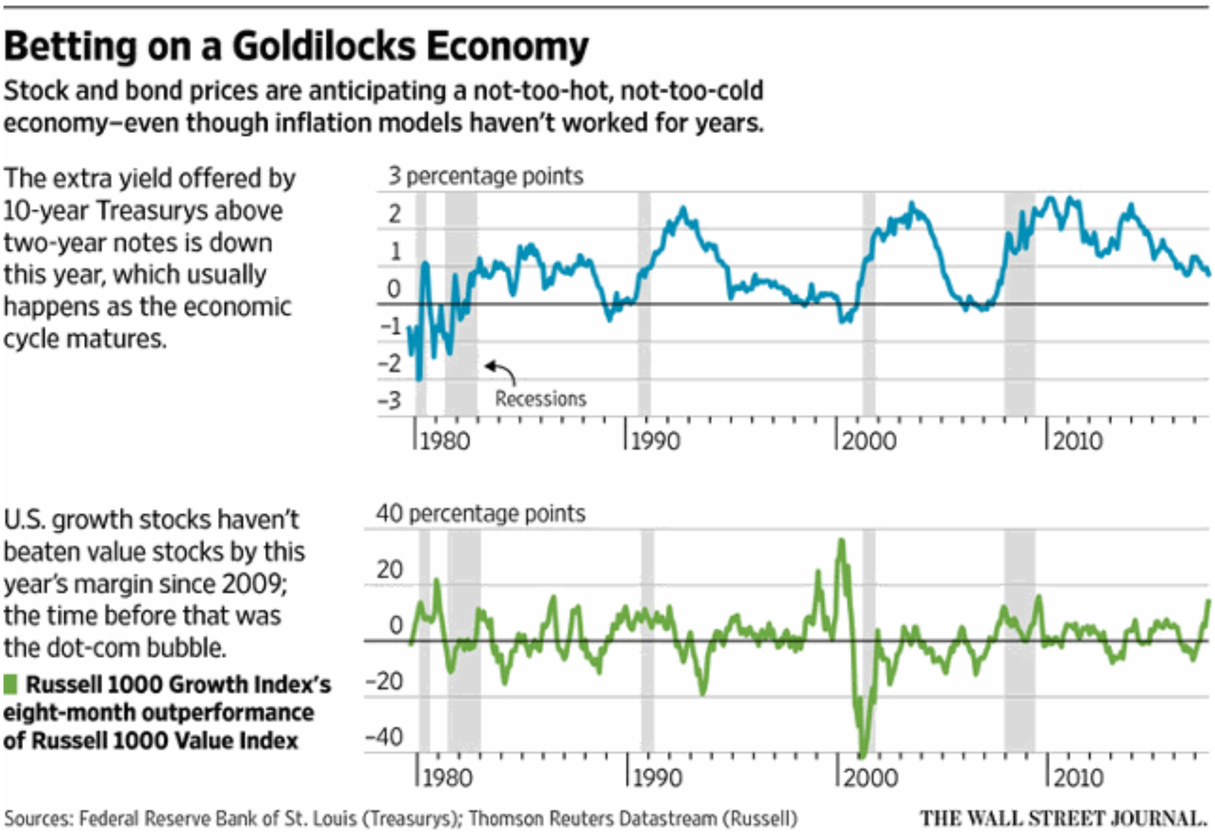
Metals are trickier. The rise in the price of copper and other industrial metals does tell us that the economy is picking up -- but in China, not the U.S.

The danger is that the low-inflation consensus has grown far too strong, on too little evidence. Sure, inflation has been weaker than economic models predicted for a long time. But without a decent explanation for why, forecasts of low inflation look like a classic case of recency bias, the tendency to look to the recent past for guidance.

The European Central Bank's predictions on Thursday perfectly fitted the pattern. Eurozone growth this year is now forecast to be the fastest since before the 2008 crisis, while inflation was revised down and will probably reach the target of just under 2% only in 2020, ECB President Mario Draghi said.

Investors should examine their assumptions. How sure are they that they really understand what is driving inflation? Adding together the effects of labor-market structures, globalization, declining union power, technology and monopolistic behavior, among much else, is something that has proved too hard for central banks. Why trust their or anyone else's predictions?

The markets want to believe the economy will stay in the sweet spot, growing just enough to avoid deflation concerns while avoiding pushing up inflation. But wanting something to be true don't make it so. Investors should pay more attention to the risk of a less-perfect future, and the best way is to lighten up on the growth stocks, which have made them so much money recently, and hold fewer Treasurys than usual.



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The New York Times

Business/Financial Desk; SECTB
Bank Signals Stimulus Era Nearing End For Europe

By JACK EWING
1,134 words
8 September 2017
The New York Times
NYTF
Late Edition - Final
1
English

FRANKFURT -- Europe has taken a small step in its long march toward economic normalcy.

The European Central Bank said on Thursday that it had pondered how to wind down its easy money policies, an enormous stimulus program aimed at promoting growth and inflation in the eurozone. But the bank also postponed a decision on when it would actually do so, and will likely decide at least some of the details at its next meeting in October, the bank's president, Mario Draghi, said.

Even though the eurozone is arguably in its best economic shape in a decade, Mr. Draghi and his colleagues on the bank's Governing Council have been exceedingly cautious about ending the emergency measures that helped prevent the euro from self-destructing after the global financial meltdown in 2008.

The Federal Reserve in the United States began raising interest rates at the end of 2015, but the European Central Bank continues to flood the 19-nation eurozone with cash as a way to reduce interest rates, stimulate growth and nudge inflation from levels considered to be dangerously low. The measures have worked, for the most part, helping the region overcome a prolonged slump.

But the program -- known as quantitative easing -- has also had side effects, including fueling a steep rise in real estate prices in Germany that have led to fears of a bubble.

Mr. Draghi said Thursday that the benefits have far outweighed any negative effects. Still, with the Fed moving in the opposite direction, the European Central Bank has been under pressure to shift its policy.

He began laying the foundation on Thursday for plans to ''taper'' the stimulus. Although the European Central Bank's Governing Council left monetary policy unchanged, Mr. Draghi said policy makers had preliminary discussions about the program, and said they would make the ''bulk'' of the decisions about tapering late next month.

Yet he also left himself plenty of wiggle room in case conditions change. In particular, the central bank will be keeping a close eye on the euro's growing strength compared to the dollar, which Mr. Draghi said could alter assumptions about how the eurozone economy will perform.

''The recent **volatility** in the exchange rate represents a source of uncertainty which requires monitoring,'' he said at a news conference.

The dollar has declined more than 13 percent against the euro this year, driven largely by tensions with North Korea and dysfunction in Washington.

When the euro rises against the dollar, European exports become more expensive -- not only in the United States but also in other countries, like China, whose currencies are linked with the dollar. That typically means that European companies will sell fewer goods abroad, hurting growth and prolonging the need for central bank stimulus.

A robust euro also undercuts the bank's efforts to jolt inflation back to the official target of 2 percent, a level considered healthy for growth. A strong euro holds down consumer prices by making imported oil and other goods cheaper for eurozone residents. That's not all bad for people who live in Europe, but low inflation means that Mr. Draghi has to keep printing money longer than he would like.

The eurozone's annual rate of inflation in August was 1.5 percent, and a substantial increase is nowhere in sight. According to forecasts by the central bank's staff, inflation will still be below the target in 2019.

''It became clear at the press conference just how important the euro-dollar exchange rate is to the E.C.B.,'' Jörg Krämer, the chief economist at Commerzbank in Frankfurt, said in a note to clients. ''If, contrary to our expectations, the euro makes further strong gains, the E.C.B. might slow down its tapering process.''

There's not much Mr. Draghi can do about the weak dollar, which analysts say reflects pessimism about the ability of President Trump and Congress to agree on legislation that many economists believe would help bolster growth in the United States, such as infrastructure programs or corporate tax reform.

''Investors no longer trust the American government to push through tax reform and fiscal stimulus,'' Alwin Schenk, a portfolio manager at the German bank Sal. Oppenheim, said in a note to clients.

The dollar's decline is also an expression of the nervousness investors feel about geopolitics, primarily nuclear saber-rattling by North Korea and bellicose rhetoric from Mr. Trump. The euro is seen as a safe haven from turmoil.

In addition, investors have sold dollars and bought euros after becoming more optimistic about the eurozone's prospects for growth.

Mr. Draghi may have tried to talk the euro down on Thursday by stressing that a stronger currency could alter assumptions about future inflation. But if that was his goal, the jawboning did not work -- the euro rose about 1 cent to $1.20 after his remarks.

The European Central Bank is running out of time. It has been printing money for more than two years, using newly created euros to buy government and corporate bonds. It hopes to make it easier for governments to deal with their debts and cheaper for corporations to raise money that they can invest.

The bank has said it will spend 60 billion euros, or $72 billion, a month in eurozone bond markets at least through December, but has not said what it will do after that. Mr. Draghi reiterated Thursday that it would not raise its benchmark interest rate, currently zero, until it has ended the bond purchases. That means rate increases are probably still years away.

There may be another reason the European Central Bank must dial back the stimulus -- the supply of bonds may be getting scarce.

When it announced its quantitative easing program, the bank promised not to buy more than 33 percent of any one bond issue, to avoid distorting the market too much. The limit is also designed to protect against legal challenges by critics who say the bond buying is illegal because the central bank is barred by law from using its printing presses to finance eurozone governments.

Many analysts believe that it is becoming increasingly difficult for the bank to avoid exceeding the limit for German Bunds and other kinds of bonds because it has already bought so many.

Mr. Draghi dismissed those concerns Thursday. ''These doubts were present at the very beginning of the program,'' he said. ''I'm confident we will be able to exploit all the flexibility the program has.''

Follow Jack Ewing on Twitter @JackEwingNYT.

Mario Draghi, president of the European Central Bank, began laying the foundation on Thursday for plans to ''taper'' the stimulus. (PHOTOGRAPH BY DANIEL ROLAND/AGENCE FRANCE-PRESSE -- GETTY IMAGES) (B2)

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THE WALL STREET JOURNAL.
U.S. EDITION

Declining Rates, Storm Batter Financial Shares

By Ben Eisen
314 words
8 September 2017
The Wall Street Journal
J
B10
English

Financial stocks are having a rough run this week as banks get hit hard by falling rates and insurer stocks get hammered by the expected impact of another hurricane.

The **S&P 500** financial sector fell 1.7% Thursday and 3.6% so far this week, making it the second-worst performer among the index's 11 sectors over both stretches, second only to minuscule telecommunications.

The **S&P 500** was down 0.02% Thursday and 0.5% this week.

Thursday's move was enough to push the financial sector below its 200-day moving average, its first close under that level in more than a year.

When an index or sector trades below the average of its recent performance, market technicians say it tends to signal a loss of momentum and can herald further weakness in the days ahead.

Just 15% of financial stocks are trading over their 50-day moving averages this week, marking a low point after dropping steadily during the course of the summer, according to Bespoke Investment Group. That "breakdown" in financials made it the weakest sector in the S&P, the firm said.

Bank stocks tend to get squeezed when long-term rates fall, because it narrows the difference between what banks can earn from borrowing on a short-term basis and lending on a long-term basis.

Shares of Bank of America Corp., one of the most rate sensitive of the big U.S. banks, are down 4.7% so far this week. Morgan Stanley is down 4.6%, while Goldman Sachs Group Inc. is down 4.4%.

Insurer stocks were also hit as Hurricane Irma took aim at Florida after hitting the Caribbean.

XL Group Ltd. fell 5.1% Thursday, and Everest Re Group Ltd. was down 6.8%.

Document J000000020170908ed9800011

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Why the Bank Stock Rally Is Over

By Aaron Back
414 words
7 September 2017
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

Bank stocks are having a hard time making the transition to autumn. The forecast is for chilly conditions to continue.

Following strong gains for most of the summer, the KBW **Nasdaq** Bank Index has fallen about 6% over the past month compared with a decline of less than 1% in the **S&P 500**. The immediate trigger appears to be a sharp move downward in long-term interest rates. This certainly isn't helpful to banks, but their biggest problems at the moment actually lie elsewhere.

The yield on 10-year Treasurys has fallen to 2.10% from 2.22% over the same period. One reason is that North Korean weapons tests have goosed demand for haven government bonds. Other factors include weakening employment growth.

There is a case to be made, though, that investors in bank stocks focus too much on the 10-year rate. After all, commercial banks don't typically hold many 10-year assets. In the second quarter, just 28% of total bank assets had terms of more than five years, according to data from the Federal Deposit Insurance Corp.

In a note on Wednesday, analysts at Goldman Sachs Group argued for a bet on bank shares. They pointed out that 54% of loans at the biggest lenders have floating rates, meaning they adjust automatically in line with short-term benchmark rates.

As a result, movements in short-term rates matter more for most banks' profitability than movements in long-term rates. This explains why banks' net interest margins have steadily expanded this year despite a flattening yield curve.

The big problem for banks right now is that short-term rates, which are largely controlled by the Federal Reserve, aren't likely to go higher for a while. Markets are now pricing in a 36% chance that the Fed will raise rates at its December meeting, according to CME Group, down from more than 50% in early July. Stubbornly low inflation, lukewarm employment reports and the uncertain fallout from one or possibly even two disastrous hurricanes have tempered rate bets.

Various other indicators also are pointing in the wrong direction for banks. Loan growth continues to be slow, capital markets activity is weak, and defaults on consumer loans are ticking up. The glorious bank rally following last year's presidential election suddenly seems like a long time ago.

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THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News -- Capital Account: Why the U.S. Economy Shrugs Off Politics

By Greg Ip
834 words
7 September 2017
The Wall Street Journal
J
A2
English

Just how much political risk can the U.S. economy tolerate? Quite a bit, it seems.

The federal government could shut down in a few weeks for lack of a budget. It could default on its obligations if the debt ceiling isn't raised. Trade treaties with Mexico, Canada and Korea may be torn up. North Korea has tested an apparent H-bomb and threatened to use it. And overseeing these challenges is an unpredictable and often-divisive president with associates embroiled in an investigation over ties to Russia.

Yet economic growth has remained largely unperturbed and, judging by the latest gross domestic product numbers, may have even accelerated ahead of two major hurricanes. Stock prices remain near record highs.

The reason for the dichotomy is that the impact of political risk depends on the risk. Government shutdowns, protectionism, scandals, even conventional wars have happened before and are thus knowable and sometimes quantifiable to businesses, consumers and investors.

Federal default or nuclear war fall in the category of unprecedented and unthinkable. Faced with such risks, the usual reaction is to assume they won't happen. Yet that assumption becomes a risk in itself: It alleviates the pressure to prepare for either and multiplies the damage if they do occur.

Because political risk has been a constant, it has lost some of its shock value. Investors have in effect built that risk into their assumptions; their demand for safety is one reason government bond yields around the world are so low.

Since 2009, hedge funds as a group have positioned themselves for another meltdown like the subprime bust, says Jason Thomas, head of economic research at Carlyle Group, a private-equity manager. But "the same psychological factors that make 'next subprime' investment strategies seem more appealing," he says, have also led businesses to favor cash retention or share buybacks over capital expenditure, and policy makers to regulate more. That depresses growth but also makes the economy less vulnerable to sudden shifts in sentiment.

As a result, hedge-fund performance has suffered from strategies designed to profit from a meltdown that has yet to happen. With **bearish** psychology already so prevalent, actual selloffs have been brief and the VIX, the market's so-called fear gauge, has been subdued.

Those who watch politics and policy for a living -- a sizable contingent on Wall Street and in Washington -- tend to overestimate how many ordinary people do the same, and thus how much their behavior will change because of politics.

In market economies, the natural rhythm of the business cycle easily drowns out politics. Big policy actions such as rising trade barriers or reduced immigration do take their toll, as the latest British data suggest, but slowly, not in a spasm of panic selling and recession.

What would overwhelm these coping mechanisms? Something previously unfathomable, like nuclear war.

No atomic weapons have been used since the U.S. dropped them on Hiroshima and Nagasaki. The public assumes global leaders won't let it happen again. As Capital Economics notes in a recent report, the market barely sold off during the Cuban missile crisis in 1962, the closest the world has come to nuclear war since 1945.

A nuclear attack on a U.S. ally, city or electrical grid via electromagnetic pulse is so alien to a business's frame of reference that it can't be planned for.

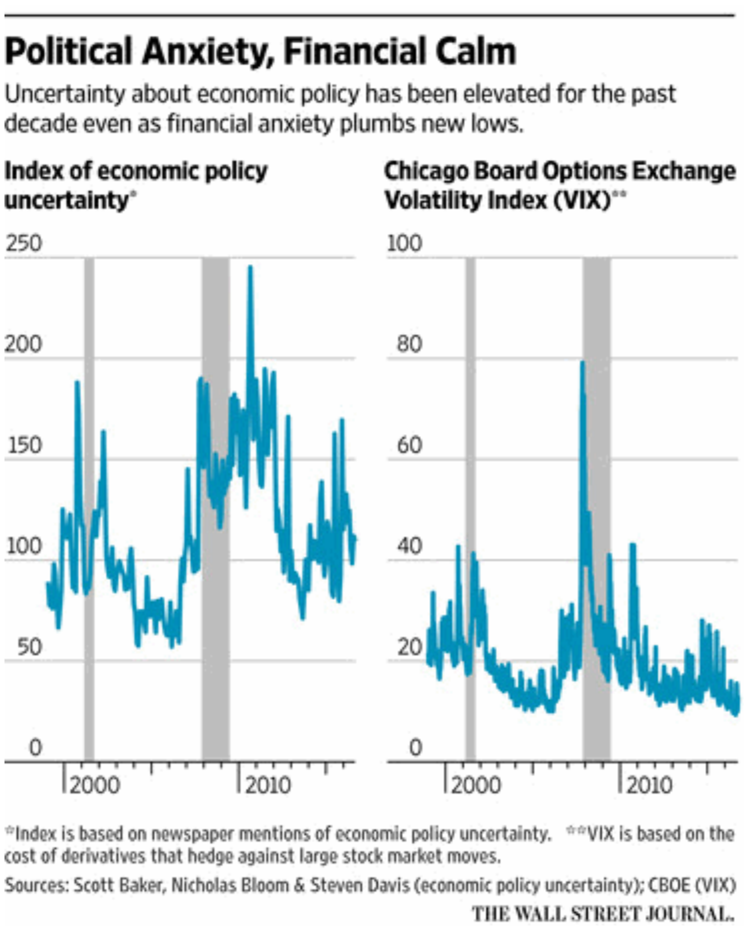
But North Korea may be a less rational actor than the Soviet Union was in 1962. Mr. Trump's willingness to go to war is also being underestimated, says Marc Sumerlin, a former economic aide to President George W. Bush who runs Evenflow Macro.

To say there is no military solution is to say Americans must accept living within missile range of a country whose leader may be unstable, he says: "That's not as easy a decision for someone who's taken an oath to defend the country as it is for someone sitting in a think tank."

As with nuclear war, the assumption the U.S. won't default is based on the fact that it hasn't done so since 1814, at least deliberately. It delayed payment on some Treasury bills in 1979 because of a technical glitch. Its refusal to repay some bonds in gold in 1933 also is considered by some a type of default.

The Fed and Treasury in 2011 drew up contingency plans if the debt ceiling wasn't raised to prioritize debt payments over other obligations such as Social Security benefits. Yet the deepening dysfunction of U.S. lawmaking means default by accident is a recurrent threat.

Political risk is part of a new normal. It takes its toll slowly and at the margin as decisions to hire or invest are deferred, rethought or resized. But until the unthinkable happens, don't expect it to tank the economy.



Document J000000020170907ed9700018

The New York Times

Business/Financial Desk; SECT
Morning Agenda: Intel Scores a Victory in Europe

By AMIE TSANG and MICHAEL J. de la MERCED
1,197 words
7 September 2017
The New York Times
NYTF
The New York Times on the Web
English

Intel has won a point in its antitrust battle with the European Commission -- and the American technology industry as a whole may be feeling a little victorious as well.

The Court of Justice of the European Union ordered a lower court on Wednesday to re-examine the 1.6 billion euro, or nearly $1.3 billion, fine imposed on Intel in 2009 for abuse of its dominant position in the computer chip market.

The decision is a setback for the European Union antitrust authorities who have been investigating American tech giants like Google and Qualcomm.

Here's what happened in the Intel case:

Intel had offered rebates to entice computer makers to buy all, or almost all, of their X86 central processing units from it.

The European Union's General Court upheld the 2009 fine in 2014.

Last October, the bloc's advocate general, Nils Wahl, recommended that the General Court return to the case. He found that the court had been mistaken in its consideration of the "exclusivity rebates" as an abuse of a dominant market position.

The fate of the Intel case is far from determined. And the European Commission still has other big investigations open:

Inquiries into Google center on two areas -- whether the internet giant used its market position in online search to prioritize its shopping service over that of rivals, and whether the company abused its dominant position by imposing restrictions on makers of Android devices.

The Qualcomm case is focused on whether the company's proposed acquisition of NXP could lead to higher prices, fewer choices or a drop in innovation.

North Korea and Debt Talks Weigh on Markets

Nervousness over North Korea and debt-ceiling discussions have rattled markets worldwide.

The **Dow Jonesindustrial average** slipped 234.25 points, or 1.07 percent, to close at 21,753.31 points on Tuesday.

The **Standard & Poor's 500-stockindex** dropped 18.7 points, or 0.76 percent, to 2,457.85.

The **Nasdaq composite** was down 59.76 points, or 0.93 percent, to 6,375.57.

Asian stocks fell on Wednesday. The Nikkei 225 in Tokyo, the Kospi index in Seoul, South Korea, and the Hang Seng index in Hong Kong all fell in early trading.

European stock indexes, including the Euronext 100, the FTSE 100 in London, the CAC 40 in Paris and the DAX in Frankfurt, were all down in early trading on Wednesday.

Business Leaders Lament DACA Decision

Business moguls are expressing their disapproval of President Trump's decision to end the Deferred Action for Childhood Arrivals program, known as DACA.

Brad Smith of Microsoft told NPR that if the government moved to deport any of its employees now shielded by DACA, "it's going to have to go through us to get that person."

Lloyd C. Blankfein of Goldman Sachs tweeted:

Timothy D. Cook of Apple said the company would fight for the people affected to be treated as equals.

Mark Zuckerberg of Facebook said in a statement:

"This is a sad day for our country. The decision to end DACA is not just wrong. It is particularly cruel to offer young people the American dream, encourage them to come out of the shadows and trust our government, and then punish them for it."

Robert Iger of Disney, who had already resigned from a presidential advisory council, said in a statement:

"The Dreamers impacted by this cruel and misguided decision make significant contributions to our economy and our country, and I urge Congress to take immediate bipartisan action to pass legislation that will protect these innocent people."

Randy Falco of Univision said, "This is a failure to live up to a commitment already made to Dreamers and is contrary to America's values and traditions."

United Technologies Deal Faces Skepticism

Buying Rockwell Collins for $23 billion was meant to be a crowning achievement for United Technologies, but it had a different effect on the purchaser's share price, which fell nearly 6 percent on Tuesday.

What's the problem? Skeptics call it an expensive proposition with few clear benefits.

Early on, it was thought that United Technologies would spin off its commercial unit, including Otis elevators and Carrier air-conditioners. The company's chief executive, Gregory J. Hayes, has told DealBook that any such breakup would be years down the road.

Shareholders are being asked to accept a halt to share buybacks for three to four years, and the company's credit rating may suffer.

Morningstar has estimated the deal's enterprise value of $30 billion to be about 14 times Rockwell's earnings before interest, tax, depreciation and amortization. Other big aerospace deals amounted to 13 times Ebitda.

Two big customers are fuming. Boeing warned that it would turn to regulators for help if the combination threatened competition in parts manufacturing. Airbus said it hoped the deal "would not distract UTC from their top operational priority."

A Houston Rockets Record

Three years ago, Steven A. Ballmer set a record for the N.B.A. when he bought the Los Angeles Clippers for $2 billion.

Now the billionaire Tilman J. Fertitta has surpassed that with his $2.2 billion purchase of the Houston Rockets. That makes a tidy profit for the team's previous owner, Leslie Alexander, who bought the franchise in 1993 for $85 million.

What's behind the ever-soaring price tags for professional basketball teams? An expanding global fan base and billions of dollars from television rights.

Who is Mr. Fertitta?

He's the owner of the Landry's restaurant chain, having taken the company private for $1.4 billion. (The Deal Professor memorably described the leveraged buyout as a "deal from hell.")

He's the star of CNBC's reality show ''Billion Dollar Buyer.''

Forbes estimates his net worth at $3.1 billion.

He's not the only Fertitta to have struck a big sports deal. His third cousins Frank and Lorenzo sold Ultimate Fighting Championship in July last year for $4 billion.

What does Mr. Fertitta get out of the deal? A successful franchise, which won 55 games last season, led by a superstar, James Harden. Also, the Toyota Center Arena.

''I am truly honored to have been chosen as the next owner of the Houston Rockets,'' Mr. Fertitta said in a statement announcing the sale. ''This is a lifelong dream come true.''

Revolving Door

Jeneration Capital Management has hired Tony Zhang, the former head of Asia at Coatue Management, as a partner.

General Atlantic has named Aaron Goldman, who had joined the firm in 2007 and was based in New York, to lead its financial services and software for Europe, the Middle East and Africa.

Citigroup has hired Jean-Baptiste Petard from UBS as a co-head of its industrial team's new independent services division. He will be based in London and will work with Chad Hoeft, who has been with Citi for 19 years and is based in New York.

Follow Amie Tsang @amietsang and Michael J. de la Merced @m_delamerced on Twitter.

Document NYTF000020170907ed970004h

THE WALL STREET JOURNAL.
U.S. EDITION

Business News: Holy Guacamole! Avocados Get Scarce

By Benjamin Parkin
483 words
7 September 2017
The Wall Street Journal
J
B3
English

Meager avocado harvests have caused a shortage of the fatty fruit, pushing prices to record highs.

Avocado farming is a **volatile** business. Output from avocado trees alternates from year to year, with a high-yield season one year typically followed by a leaner one the next. Packers and distributors usually offset a bad harvest in California, the largest U.S. growing state, with fruit from elsewhere in the Americas.

This summer a smaller crop in California coincided with a tough season in Mexico after a lack of rain delayed the main harvest there. As a result, wholesale prices have soared 75% since mid-July to around $80 for a case of 48 Hass avocados, according to the American Restaurant Association Inc. Average retail prices for avocados rose 35% in the first half of this year to $1.21 per avocado, according to the Hass Avocado Board, pushed higher by strong demand.

"There's just not enough supply out there," said David Maloni, president of the American Restaurant Association.

That is threatening the bottom line at restaurants like Chipotle Mexican Grill Inc. The burrito maker spends 10% of its food costs on avocados, Credit Suisse estimates, meaning the price surge could hurt Chipotle's earnings for the remainder of the year.

Chipotle declined to comment in detail ahead of its next earnings report in October. The company said it believes the impact of rising avocado prices would be temporary.

U.S. Vice President Mike Pence said on an August trip to Latin America that the U.S. would allow imports of Hass avocados, the most common variety, from Colombia to widen its supplier base. Scientists are also working to make crop cycles more uniform by developing strains of the fruit that grow more consistently.

"The market is growing faster than the supply," said Mary Lu Arpaia, a biologist breeding new avocado varieties at the University of California at Riverside.

U.S. consumption of avocados has quadrupled since 2000, the Hass Avocado Board said. Demand is also increasing in Europe and Asia.

Glowing publicity of the fruit's high nutrient and beneficial-fat content has driven its popularity, analysts say. High-end restaurants and food trucks increasingly use the fruit, said Erik Thoresen of restaurant consultancy Technomic, helping make it a staple in more than just guacamole.

The Whole Foods chain slashed prices for its avocados and many other products last month as Amazon.com Inc. assumed ownership of the natural-food grocer. Not many other retailers or restaurants can afford to follow suit with wholesale prices so high.

"We're paying a lot more for the product," said Robb Bertels, vice president of marketing at Mission Produce Inc. in Oxnard, Calif., one of the world's largest avocado distributors. "We're hoping production will ramp up."

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THE WALL STREET JOURNAL.
U.S. EDITION

Inflation and Growth Go Separate Ways --- Economies pick up but prices stall in shift with broad policy-making, market implications

By Jon Sindreu
916 words
7 September 2017
The Wall Street Journal
J
B1
English

The world's biggest economies are chalking up stronger growth. Yet what was once thought to be growth's constant companion is puzzlingly missing: inflation.

The U.S. economy grew at an annualized 3% in the second quarter, but in July consumer-price inflation advanced only 1.7% from the previous year.

Japan's economy grew by an annualized 4% in the same quarter, for its longest expansion since 2006. Yet inflation hovers around zero, as it has for most of two decades. Eurozone inflation is stuck at 1.5% despite the bloc's recovery.

Standard economics teaches that prices are ultimately set by supply and demand. When growth is strong, people demand more products and companies need to offer better pay to hire more workers, and so prices go up.

But there are signs the relationship is broken. If it is, the consequences are vast for economic policy making and **financial markets**.

"There's no question this is a very fundamental challenge to our knowledge and our policy making," said Adam Posen, president of the Peterson Institute for International Economics.

The growth-inflation relationship is the fulcrum of central banking: Central banks set an inflation target -- usually around 2% -- and then lower interest rates to help prices adjust whenever demand falters. If there is a risk that excessive spending pushes inflation over the target, they raise rates to retard growth.

It is essential to investors' decisions about where to put money: Bonds do well when interest rates fall, and falling interest rates traditionally are taken as signaling concerns about growth, so stocks and bonds typically cushion each other.

Yet in 2017, and for much of the postcrisis period, bonds and stocks have been going in the same direction. This year, the **S&P 500** has risen almost 10%, while **10**-**year Treasury** prices have gained 6%, pushing the benchmark U.S. **bond yield** down near 2% -- a level typically associated more with financial distress than with improving growth.

Explanations for the breakup of the growth-inflation marriage abound. European Central Bank President Mario Draghi argued in June that statistics miss people in temporary jobs or outside the labor force -- in other words, the economy isn't necessarily as strong as the numbers suggest.

In a speech Tuesday, Federal Reserve governor Lael Brainard said that "one simple explanation may be the experience of persistently low inflation": Because inflation has been low and often falling for much of the past decade, households and firms now expect low inflation in the future as well.

Paul Donovan, chief economist at UBS Wealth Management, believes the bond market is giving the wrong signal about inflation. "Bond markets are rigged," he said, by extraordinary demand for safe debt, created by an aging population, regulation and central-bank buying.

But it is also possible, investors say, that something deeper has changed. Candidates include globalization, the decline of labor unions and the rise of big multinationals holding down consumer prices in an effort to grab market share.

Bond markets aren't imagining low inflation. Unemployment across the developed world has fallen to where it was before 2008, so in theory companies should be offering more generous pay increases to attract workers and increasing prices to offset the cost. Neither is happening.

A partial explanation is that workers can't demand pay raises. In its annual report in June, the Bank for International Settlements found a "positive and significant" link between wages and the strength of unions. Unionization has dropped by half over four decades.

Enrique Martinez-Garcia, economist at the Federal Reserve Bank of Dallas, published research in July showing that globalization is part of why inflation has been low and unresponsive to growth.

Companies can outsource production or import if the wage bill starts to get too high, rather than raise prices. China has flooded international markets with cheaper goods, ultimately pushing down prices.

BIS data show that in the U.S., 10% of the change in labor costs between 2006 and 2016 was determined by the price of labor abroad, compared with 2% between 1995 and 2005. For the world overall, it is 22%, up from 11%.

The Dallas Fed has started "to seriously consider the impact of globalization on inflation," Mr. Martinez-Garcia said.

What makes the problem difficult to solve is that inflation hovered around policy makers' targets for more than two decades until 2008, after shooting up in the 1970s. Central banks were then credited with subduing inflation by raising rates and cooling the economy, but many investors now doubt they can manage the effect in reverse.

"Inflation is not a leading indicator" of growth anymore, said Didier Borowski, head of macroeconomic research at Amundi, Europe's largest asset manager. He said "much more competition at the global level" is leading producers to price more aggressively.

Indeed, the focus of many analysts is now on the market power of superstar firms, especially technology giants such as Alphabet Inc. or Amazon.com Inc., rather than on traditional supply-and-demand explanations.

"When Amazon enters a market, it drives prices down," said Jason Helfstein, a tech-sector analyst at Oppenheimer & Co.

Federal Reserve Bank of Chicago President Charles Evans referred to Amazon's purchase of Whole Foods Market Inc. as an example of "disruptive technology" that keeps inflation down.

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THE WALL STREET JOURNAL.
U.S. EDITION

Hurricane Irma Already Rattles Markets --- Insurance stocks drop again; possibility of direct hit on Florida raises futures prices

By Chris Dieterich, Julie Wernau and Leslie Scism
673 words
6 September 2017
The Wall Street Journal
J
B16
English

Traders were bracing for another hurricane to hit the U.S., sending insurance stocks lower and driving up the price of orange-juice futures.

The Category 5 storm, Hurricane Irma, raised severe threats to islands in the Caribbean on Tuesday as it grew into one of the most powerful storms ever recorded over the Atlantic Ocean.

Insurers, already grappling with the damage from Hurricane Harvey, are now facing the possibility of a direct strike on Florida.

Shares of reinsurers, which provide backup protection to insurance companies to protect them against major disasters, posted some of the biggest declines in the **S&P 500** on Tuesday.

Commodities traders, meanwhile, were attempting to assess the potential impact on crops in Florida or the Carolinas.

"We're fresh on the past week's events in Texas, and here's a hurricane that could hit the Carolinas," said Bill Nelson, senior economist at Doane Advisory Services in St. Louis. "No one wants to be caught off guard a second time."

Florida is home to most of the oranges used in U.S. juice. Futures prices for frozen concentrated orange juice for November delivery rose 6.2% to end at $1.45 a pound, the highest price for a most actively traded contract since May 12.

The industry has already struggled over the past decade with crop damage from an incurable disease that causes fruit to drop before it is ripe. The U.S. Agriculture Department is expected to put out its first estimate for the 2017-2018 crop next month, after last year's final estimate was the lowest output since 1964.

Cotton traders were still calculating the impact that Hurricane Harvey had on crops in Texas, the country's largest cotton-producing state. Cotton for December delivery rose 4.2% to close at 74.88 cents a pound on the ICE Futures U.S. exchange.

In the insurance industry, major household names such as Allstate Corp. and Liberty Mutual have sharply reduced their market shares in Florida over the past 15 years, as measured by the volume of insurance sold, state figures show.

Some of the largest home insurers in the state are now companies such as Fort Lauderdale-based Universal Insurance Holdings Inc., whose shares fell 15% Tuesday, and Clearwater-based Heritage Insurance Holdings Inc., which dropped 17%.

State insurance regulators require carriers to document that they have the financial resources in place to properly pay claims, and many rely heavily on reinsurers for backup protection.

No hurricane registering as a Category 3 or stronger has hit Florida since Wilma in 2005, meaning that Irma threatens to put the reinsurance industry on the hook for major Florida claims for the first time in years.

The value of the insured property in coastal areas of Florida is about $3.2 trillion in aggregate, according to an analysis by catastrophe-modeling company AIR Worldwide.

Reinsurer Everest Re Group Ltd. was off 6.9%, making it the worst-performing stock in the **S&P 500**, and XL Group Ltd. was down 5.8%.

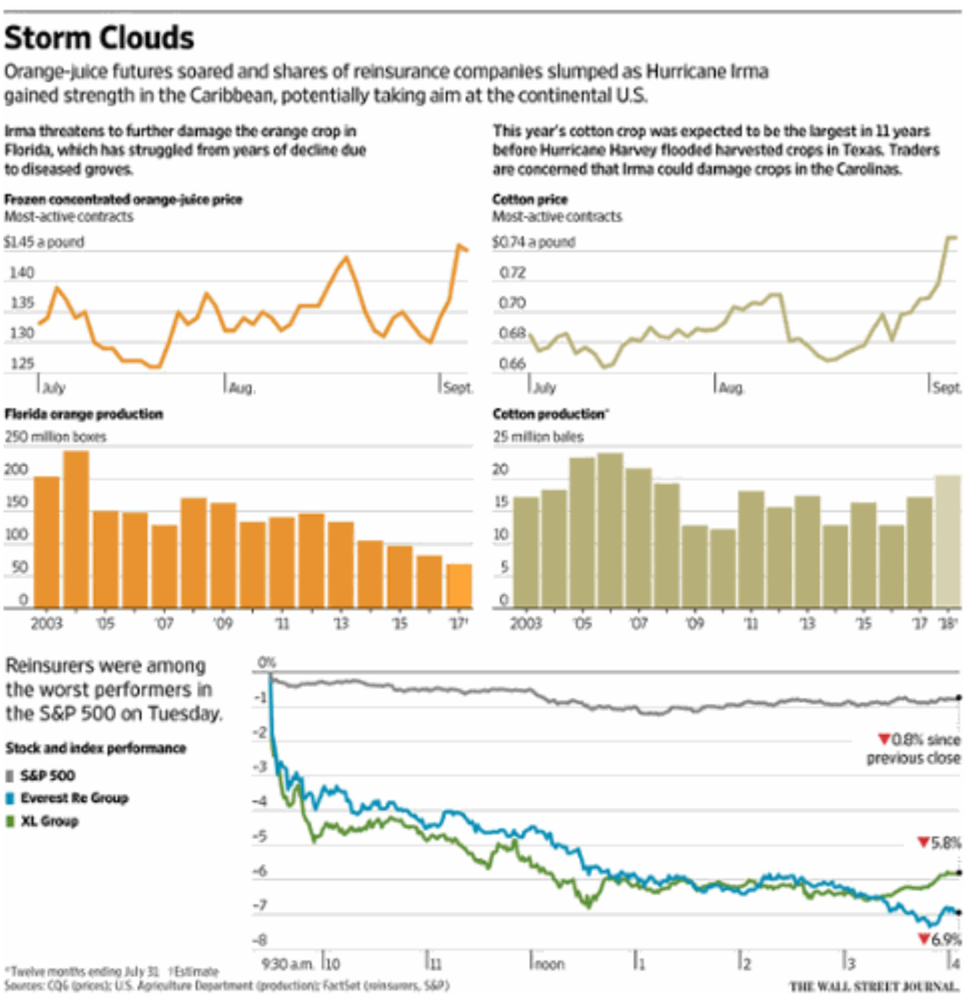
Other reinsurers not included in the benchmark dropped more, with Aspen Insurance Holdings Ltd. down 9.4% and Validus Holdings Ltd. falling 8.8%.

Cruise-ship companies that operate in the Caribbean were also among the big decliners in the **S&P 500**. Miami-based Royal Caribbean Cruises Ltd. tumbled 4.2%. Rival cruise operator Carnival Corp. declined 3.1%.

Shares of home-improvement companies climbed as the threat from Hurricane Irma grew.

Home Depot Inc. and Lowe's Cos. Inc. rose 1.4% apiece.

Shares of other building suppliers have catapulted higher on the heels of two strong storms. Beacon Roofing Supply Inc., based in Herndon, Va., climbed more than 17% over the nine trading sessions ended Friday. The stock rose another 2.4% Tuesday as the broader market slumped.



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THE WALL STREET JOURNAL.
U.S. EDITION

Array of Threats Stir Up Markets

By Sam Goldfarb and Ben Eisen
1,030 words
6 September 2017
The Wall Street Journal
J
A1
English

U.S. government bonds rallied and banking and insurance stocks tumbled in the latest signs of rising anxiety hitting **financial markets**.

The action reflects a warning from a Federal Reserve official Tuesday that persistently low inflation could make it difficult for the central bank to continue raising interest rates as many investors expect. Adding to the pressure, Hurricane Irma is threatening the U.S. coastline and the U.S. is facing a potential confrontation with North Korea over nuclear tests.

The **Dow Jones Industrial Average** fell 234.25 points, its largest one-day decline since Aug. 17, while gold, a haven in turbulent times, settled at its highest value since last September. The yield on the benchmark 10-year U.S. Treasury note fell to 2.072%, its lowest close since Nov. 9, the day after the U.S. presidential election. Bond yields fall as prices rise.

Tuesday's bond rally added to a two-month decline in Treasury yields, largely driven by a run of soft inflation data, which investors have been less willing to dismiss as resulting from one-time factors than some Federal Reserve officials.

Some investors said the combination of events Tuesday heightened concerns that many already had about the economy and global politics.

Skepticism toward the inflation outlook is shared broadly by investors, if not the majority of Fed policy makers, who have long said they expect inflation to trend higher. Implied inflation expectations, derived from the difference between nominal and inflation-adjusted Treasury yields, are forecast to be about 1.79% annually over the next decade, according to data from Tradeweb. That's down from more than 2% earlier in the year.

While North Korea's latest nuclear test and Hurricane Irma helped bolster Treasurys, the long-term argument for buying bonds also got a boost Tuesday from Federal Reserve governor Lael Brainard, who said in a speech that the Fed's "persistent failure" to hit its 2% inflation target could merit a slower path of interest-rate increases going forward.

"We have been falling short of our inflation objective not just in the past year, but over a longer period as well," she said. "My own view is that we should be cautious about tightening policy further until we are confident inflation is on track to achieve our target."

Ms. Brainard has expressed concern about low inflation before. But her latest remarks came at a critical time, as Fed officials gear up for a debate over whether to stick to the central bank's plan of raising interest rates a third time this year or hit the pause button to wait for more inflation data and see how the economy and markets react to the latest political fights in Washington and natural disasters.

The decline in yields and the low spread between the two- and **10**-**year Treasury** note are bad for banks. Banks in recent years have suffered from a narrow spread, which leads to a thinner gap between what they pay on deposits and charge on loans, a spread known as their net-interest margins.

Those margins had recently ticked up slightly, leading investors to expect bank profits could soon expand. Tuesday's bond-market action cast doubt on that expectation.

Shares of J.P. Morgan Chase & Co. fell 2.4%, BankAmerica Corp.'s shares fell 3.2% and Citigroup's shares lost 2.1%. Shares in financial firms that aren't as sensitive to interest rates and lending, such as Goldman Sachs Group Inc. and Morgan Stanley, also fell sharply.

Insurers were among the **S&P 500**'s biggest decliners, as Hurricane Irma threatened to do more damage to the U.S. coastline. Everest Re Group declined 6.9%, XL Group fell 5.8% and Travelers Cos. lost 3.7%.

Low inflation makes government bonds more appealing to investors because it helps preserve the purchasing power of their fixed payments. It also makes it less likely that the Fed will raise interest rates, which is another major threat to the value of outstanding Treasurys.

Since topping the Fed's 2% target in February, one of the Fed's preferred inflation measures, the personal-consumption expenditures price index, has been in retreat, rising just 1.4% in July from a year earlier, the Commerce Department said last week.

The inflation slowdown has surprised many investors and analysts because it has defied many economists' expectations that a low jobless rate should soon lead to higher wages and costlier goods and services.

The U.S. unemployment rate was 4.4% in August, just off a 16-year low, but wage growth and inflation have both remained sluggish. That has left investors debating whether tepid inflation and low bond yields could be the result of large, potentially intractable forces, such as globalization and technological advances, rather than just a consequence of the normal economic cycle.

"I think there's something really powerful" happening, said Rick Rieder, chief investment officer of global fixed income at BlackRock Inc., the world's largest asset manager. Technological innovation from companies like Amazon.com Inc. and Uber Technologies Inc., he added, are behind "the greatest cost revolution of all time," in a development that has far-reaching consequences for **financial markets**.

For years, some analysts have argued that technology and increased global competition as well as aging populations and mounting debt levels could all play some role in holding down economic growth, inflation and bond yields. What has changed, investors and analysts say, is how seriously these arguments are now being taken by market participants.

In recent years, investors have frequently blamed low yields on factors including monetary stimulus from major central banks or fears that the global economy could soon tip into another recession. But the Fed now has plans to start slowly reducing its large portfolio of Treasurys and mortgage-backed securities, after already raising interest rates twice this year.

Meanwhile, many investors also expect the European Central Bank to soon start scaling back its own stimulus program, as the entire global economy shows signs of improvement.

Lower Expectations

Bond market-derived expectations for annual inflation over the next decade have been falling for much of this year.

Source: Tradeweb

THE WALL STREET JOURNAL.

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The New York Times

Business/Financial Desk; SECTB
Wall Street Is Rattled By North Korea Tensions

By TIFFANY HSU
602 words
6 September 2017
The New York Times
NYTF
Late Edition - Final
2
English

Nervousness over North Korea and debt ceiling discussions in Washington sent stock indexes sliding on Tuesday to their largest single-day losses in three weeks.

The **Dow Jonesindustrial average** tumbled 234.25 points, or 1.07 percent, to 21,753.31. The **Standard & Poor's 500**-**stockindex** lost 18.7 points, or 0.76 percent, to 2,457.85. The **Nasdaq composite** sank 59.76 points, or 0.93 percent, to 6,375.57. The dips continued in Asia on Wednesday, with markets across the region all falling in early trading.

Each U.S. index had been on a multiday upward trend. The market close on Tuesday represented the steepest fall for each gauge since Aug. 17, when the markets were processing news of a terrorist attack in Barcelona and the dissolution of two of President Trump's business advisory councils.

Coming out of the Labor Day weekend, however, investor jitters stemmed from tensions in Asia. North Korea tested its sixth nuclear bomb on Sunday and drew warnings from the United States of a ''massive military response.''

Nikki R. Haley, the United States ambassador to the United Nations, told an emergency session of the United Nations Security Council on Monday that North Korea's leader, Kim Jong-un, ''is begging for war.''

The market is also wary of a potential fight in Congress over raising the debt limit. Treasury Secretary Steven Mnuchin has asked for an increase of statutory borrowing caps by Sept. 29, but it is likely to be met with demands that the increase come with spending cuts or resistance to proposals that it be tied to a Hurricane Harvey aid package.

But Bruce McCain, chief investment strategist at Key Private Bank, said he was not too concerned.

''In all probability, nothing serious will develop out of the Korean issue and in the 11th-and-a-half hour, we'll be able to extend the debt ceiling,'' he said. ''It doesn't stop investors from worrying -- it's part of human nature.''

If anything, the market swoon on Tuesday is evidence that all is well, Mr. McCain suggested.

''Worrying about something relatively unlikely may indicate that the economy is doing pretty well because there's nothing else there to worry about,'' he said.

Events like Mr. Trump's decision to end the Deferred Action for Childhood Arrivals program have broad social implications but much less influence on investors, Mr. McCain said.

Asian markets sank in morning trading. The Seoul KOSPI index deflated about 0.5 percent, while in Tokyo, the Nikkei 225 index fell about 0.3 percent. The Hang Seng Index in Hong Kong was down about 0.9 percent in early trading.

In Germany on Tuesday, the DAX index had gained 21.5 points, or 0.18 percent, to 12,123.71. But in London, the FTSE 100 metric fell 38.55 points, or 0.52 percent, to 7.372.92.

The 10-year benchmark Treasury yield dropped 8.7 basis points to 2.07 percent as investors sought haven assets.

Benchmark United States crude gained $1.37, or 2.9 percent, to settle at $48.66 a barrel on the New York Mercantile Exchange. Brent crude, used to price international oils, rose $1.04, or 2 percent, to close at $53.38 a barrel in London.

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

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Stock Investors Hedge as Autumn Nears --- A typically choppy season for market has participants readying for a bout of volatility

By Gunjan Banerji
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U.S. stock investors have been unfazed this year by everything from North Korean missile launches to the congressional debt ceiling deadline.

Now, as the most turbulent season for equities looms, hedging activity and money flows indicate that investors are starting to doubt that markets can only climb higher.

Some have protected against losses from this year's biggest winners. The number of **bearish** versus **bullish** options on the tech-heavy PowerShares QQQ Trust exchange-traded fund reached a two-year high in August. The most held contracts on a popular ETF that tracks high-yield bonds are **bearish**.

Some are wagering groups that have struggled, like small-cap companies, will continue to post losses. Speculators' net **bearish** futures positions on Russell 2000 index stocks last month reached the highest level since 2008, data from the Commodity Futures Trading Commission show.

People yanked funds from U.S. stocks for 10 straight weeks through Aug. 23, the biggest such streak in 13 years, according to data from Bank of America Merrill Lynch.

"We've gone from a period of potential complacency to one of caution over the last few weeks," Stewart Warther, New York-based derivatives strategist at BNP Paribas said in an interview in August.

After a stretch when political risks were largely ignored, investors are growing increasingly wary of them in recent weeks, Mr. Warther said.

Stocks dipped last month as unfounded rumors swirled that Gary Cohn, director of the National Economic Council, was resigning. Now, investors' attention turns to the deadline Treasury Secretary Steven Mnuchin has made for Congress to raise the debt limit.

Options trading on Wall Street's fear gauge hit a record one day in August. Investors may be hedging their holdings before one of the most **volatile** periods for stocks historically. October ranks as the month that has had the most deviation in price moves in the **S&P 500 index**, according to data from WSJ Market Data Group going back to 1928.

September and November follow, the data show. Stocks plunged in October 2014 as the Federal Reserve concluded quantitative easing. In September 2008, markets descended into turmoil amid the financial crisis.

Among those potentially hedging for a downturn are hedge-fund managers George Soros and Bill Ackman. Disclosures for Soros Fund Management showed **bearish** options holdings on ETFs for the **S&P 500** and technology stocks. Mr. Ackman of Pershing Square Capital Management said on an investor call that he recently allocated cash to options that pay out in the event of a significant market drop, like one stemming from conflict on the Korean Peninsula.

And stock investors may be the last to recognize the risks. U.S. equities posted gains last week, while the CBOE**Volatility** Index, which tracks **volatility** in stocks and is called VIX, fell 10% last week, its third consecutive week of declines.

Meanwhile, the U.S. dollar has already unwound its postelection gains and Treasury prices have risen, pushing yields down, according to a Barclays PLC August note.

This could be because hedging hasn't always paid off.

"The things we expect to react don't always react reliably" in selloffs, wrote Pravit Chintawongvanich, New York-based derivatives strategist at brokerage Macro Risk Advisors, in an Aug. 24 note.

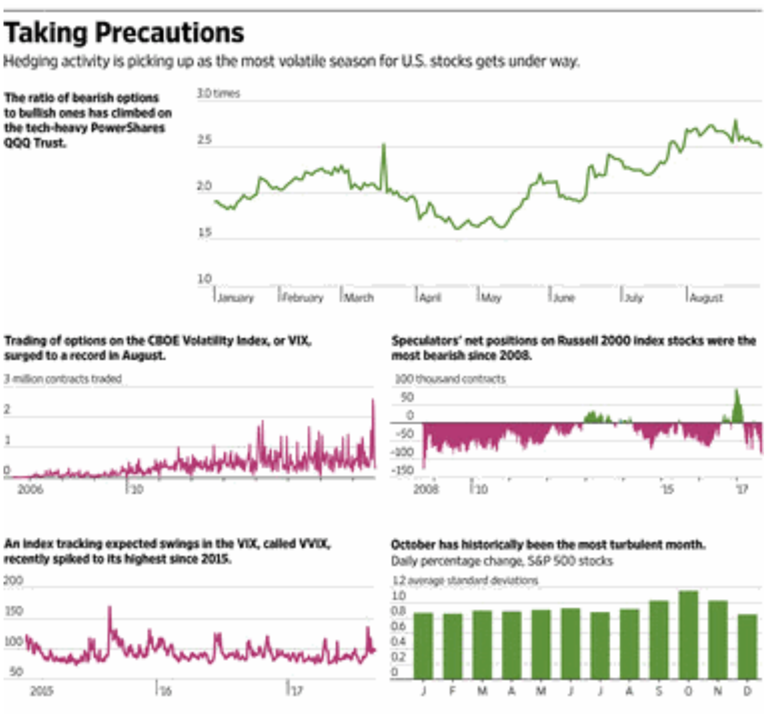
Hedges on a high-yield bond fund were "nearly useless" in August 2015, he wrote, even as the **S&P 500** tumbled 10% within just four days. In January 2016, when the benchmark equity index plummeted 10%, "VIX hedges were disappointing," he wrote.

Still, during the 16-day U.S. government shutdown in 2013, the fear gauge VIX soared as high as 20 from 13.

The VIX recorded some outsize moves relative to the **S&P 500** in August. The two are typically inversely correlated. Recently, a measure of expected swings in the gauge itself, known as VVIX, hit the highest level since August 2015, when U.S. equity markets swooned after China devalued the nation's currency.

Political news appears to be triggering market moves and has led to increased **volatility**, although it remains low relative to history, said Tobias Hekster, the Chicago-based co-chief investment officer of True Partner Advisor, which manages $350 million in **volatility** strategies.

"For the first time people got scared about a political impact," said Mr. Hekster. "In the past, we've had a lot of political grandstanding. This year, it looks like it's going to be worse."



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Investing in Funds & ETFs: A Monthly Analysis --- 5 Tips to Remember When Buying Foreign Stocks --- Non-U.S. stock funds are outperforming their American rivals, and it isn't too late to jump in; Here's how to do it right

By Michael A. Pollock
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With help from a weaker dollar and a rebound in overseas economies, long-suffering investors in foreign stocks are finally seeing a payoff.

So far this year, mutual funds and exchange-traded funds that own European stocks are up more than 18%, compared with a gain of just 9.1% in the average diversified U.S.-stock fund. Emerging markets have surged even more, by around 26%. It is all a turnaround from years of disappointment for investors who heeded the standard advice to keep some money in foreign markets, including within their 401(k)s.

Is it too late to jump on that speeding foreign train? No, market professionals say. But those who are thinking about leaping aboard should be aware of the things people often get wrong when deploying money overseas.

Navigating foreign markets is considerably more challenging than owning a U.S.-focused portfolio, says Jason White, a foreign-equity specialist at mutual-fund manager T. Rowe Price. Think of it as playing "an away game," he says.

He and other professionals suggest starting simple, with a broadly diversified mutual fund or ETF, and not buying hot single-country funds. Be realistic about results -- don't expect foreign stocks to jet-propel a portfolio. And avoid buying a fund hedged against currency moves; that can limit your returns and diversification.

Here are more tips from the experts about traveling abroad with a portfolio:

1. Take it slow

While it is unlikely that European and emerging-markets stocks will continue to surge as strongly in the months just ahead, their outlook is as bright as it has been in a long while, says Kate Moore, chief equity strategist at money manager BlackRock Inc. Major global economies are growing in sync at a "good clip," Ms. Moore says. Although investors have flocked to Europe this year, inflows so far haven't nearly made up for the roughly $100 billion that exited European stocks in 2016, she adds.

The upward move could last awhile; past bull markets in foreign stocks have run as long as seven or eight years, says Matthew Peterson, chief wealth strategist at the LPL Financial unit of LPL Financial Holdings Inc. "If you think we are at the beginning of a cycle where international is going to outperform U.S. markets, then we are very early in that cycle," he says.

But when adding foreign-stock mutual funds or ETFs, it is best to move gradually, professionals say. Global stocks may be overdue for a pullback. Using a dollar-cost-averaging approach -- such as adding a little to positions every month -- could reduce the risks of getting whipsawed by a reversal.

2. Decide on a strategic allocation

Although non-U.S. stocks represent about half the market capitalization of global indexes, many U.S. investors have only modest foreign holdings, if any. Advisers generally suggest putting around a third of the equity portion of a portfolio into non-U.S. assets.

At Harris Financial Group, in Richmond, Va., managing director Jamie Cox is recommending a foreign allocation of two-thirds of the stocks an investor owns. "U.S. stocks aren't over-, over-, overvalued, but you are getting to the point where expected returns on the earnings potential of companies are going to be hard to justify unless the economy really ramps up," he says.

Still, the foreign allocation should reflect an investor's willingness to cope with the added complexity, says T. Rowe Price's Mr. White. While U.S. stocks aren't less risky, "in the U.S., you are dealing with one currency and a single set of regulators, and you don't usually have time-zone or language issues." That is not the case in foreign equities, he notes.

3. Stay real about results

It might seem that adding a booming foreign fund now will supercharge a portfolio's performance over the next year or so. But there is a risk that foreign markets could cool off, cautions Richard Webb, chief investment officer at Pittsburgh-based Marbury Wealth Management LLC. That might happen if investor expectations about foreign corporate earnings prove overly optimistic, he says.

But it is still worth adding foreign exposure now, particularly for people who don't have much, he adds. Despite the potential for greater **volatility** in foreign stocks, adding them to a portfolio of U.S. stocks can reduce a portfolio's overall **volatility**, Mr. Webb says.

European stocks are about 10% more **volatile** than the **S&P 500**, but the European market's different composition -- including more cyclical industrial and mining stocks -- can help offset gyrations in U.S. equities, says Eddie Perkin, chief equity investment officer at Eaton Vance Management, Boston.

4. Know the nuances of indexing

The advantages of index investing -- mainly lower fees and a stronger likelihood of hitting benchmarks -- are well known to U.S. investors. But picking the right foreign index fund or ETF requires other considerations as well.

Foreign ETFs -- particularly those that focus on large-cap stocks -- may not give investors as much exposure to domestic growth in European or emerging markets as they expect, says Todd Rosenbluth, director of ETF and mutual-fund research at data provider CFRA. Most are weighted by market cap, and their largest holdings could be multinationals such as Nestle SA and Samsung Electronics Co., which get much of their revenue from the U.S.

For foreign ETFs that offer purer plays on overseas economies, consider one that owns midcap and small-cap stocks. One that CFRA recommends is iShares MSCI EAFE Small-Cap (SCZ), which holds more than 1,600 securities and charges 0.40% of assets in expenses. A similar ETF with lower expenses is Vanguard FTSE All-World ex-US Small-Cap ETF (VSS), which owns nearly 3,500 non-U.S. stocks and charges just 0.13%.

Many advisers prefer active managers for overseas exposure, believing that fund firms with "boots on the ground" abroad can turn up hidden growth opportunities.

But it is rare to see consistent, lasting outperformance by active funds, which also commonly charge expense ratios of more than 1% of assets annually, as much as 10 times the expense ratios of some ETFs.

5. Don't play the currency game

When the dollar weakens -- as it has this year -- stocks denominated in other currencies can gain relative value. Some investors now may be thinking of buying protection against any rebound in the dollar that would erode gains. It is possible to do that through a fund or ETF that hedges away currency movements.

With a boost from the euro's gain so far this year against the dollar, U.S. investors with an unhedged holding of European stocks have a nearly 18% return, on paper. The same position, if hedged against currency movements, would be up only about 4%, says Mr. Perkin of Eaton Vance.

The dollar's drop followed a surge that had left the U.S. currency expensive by historic measures, says Paul Quinsee, global head of equities at J.P. Morgan Asset Management. While its recent move has corrected some of that, "our view broadly is that there is about an equal chance of strength or weakness [in the dollar], longer term, from here," Mr. Quinsee adds.

That might make any wager involving the dollar a gamble.

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