The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
Yields Rise and S.&P. Falls After Fed Testimony

By THE ASSOCIATED PRESS
939 words
28 February 2018
The New York Times
NYTF
Late Edition - Final
4
English

Treasury yields rose Tuesday, and the **Standard & Poor's500 index** slid to its first loss in four days after the head of the Federal Reserve said that he's feeling more optimistic about the economy.

The testimony by Fed Chairman Jerome Powell before Congress was highly anticipated, and he gave encouraging words about the economic data that have arrived in recent weeks. But some investors speculated they could mean the central bank will get more aggressive in raising interest rates than the market has prepared for.

"My personal outlook for the economy has strengthened since December," Powell said in response to a question about whether the recently passed tax cut and other moves by Congress have changed his outlook for how quickly the Fed will raise interest rates.

The immediate reaction in the bond market was to send Treasury yields higher, and the yield on the 10-year note climbed to 2.90 percent from 2.86 percent late Monday. It had been down earlier in the morning.

Higher interest rates can hurt stock prices by making bonds more attractive. Generally, when interest rates are rising, companies need to produce bigger profits just for their stock prices to stay flat.

The **S&P 500** fell 35.32 points, or 1.3 percent, to 2,744.28. It had been bouncing between modest gains and losses early in the morning, but the losses accelerated after Powell began answering questions on Capitol Hill.

The **Dow Jonesindustrial average** lost 299.24, or 1.2 percent, to 25,410.03, and the **Nasdaq composite** fell 91.11, or 1.2 percent, to 7,330.35.

The Fed raised its key policy interest rate three times last year and has signaled that another three increases may be coming in 2018. Powell reaffirmed to the House Financial Services Committee that the central bank plans to raise interest rates gradually as the economy improves.

The market got spooked earlier this month when potential signs of inflation strengthened, which raised speculation that the Fed may speed up its timetable. Stocks around the world fell sharply as a result, with the **S&P 500** losing 10 percent from its record high at one point.

If the Fed does raise rates four times this year, it could upset markets when many investors have been preparing for only three increases, said Rich Weiss, chief investment officer of multi-asset strategies at American Century Investments.

What may make things even more muddled is how long it's been since investors have had to contend with a market where inflation is a threat and interest rates are rising, Weiss said. The last time was before the 2008 financial crisis.

"You have a generation of brokers and advisers who have not experienced this side of the economic cycle," he said.

The rise in Treasury yields sent stocks that pay big dividends to some of the market's steepest losses. When bonds are paying more in interest, they can lure income investors away from dividend-paying stocks.

Real-estate investment trusts in the **S&P 500**, which are among the biggest dividend payers, lost 2.1 percent for the biggest loss among the 11 sectors that make up the index. Utilities fell 1.7 percent.

Comcast had one of the biggest losses in the **S&P 500** after it launched a bid for European pay TV broadcaster Sky. The buyout offer is for 22.1 billion pounds ($29.5 billion), and Comcast's Class A shares lost $2.92, or 7.4 percent, to $36.66.

Shares of Walt Disney also fell because the Comcast bid could disrupt its takeover offer for 21st Century Fox. Disney lost $4.94, or 4.5 percent, to $104.87.

On the winning end was Macy's, which jumped to one of the biggest gains in the **S&P 500** after reporting sales and profits that were comfortably ahead of expectations. The retail giant also gave a forecast for 2018 earnings that was higher than analysts expected.

Macy's rose 95 cents, or 3.5 percent, to $28.40.

In Europe, stock indexes were mixed with France's CAC 40 close to flat and Germany's DAX down 0.3 percent. The FTSE 100 in London was down 0.1 percent.

In Asia, Japan's Nikkei 225 jumped 1.1 percent, South Korea's Kospi dipped 0.1 percent and the Hang Seng in Hong Kong lost 0.7 percent.

In the commodities markets, benchmark U.S. crude fell 90 cents to settle at $63.01 per barrel. Brent crude, the international standard, dropped 87 cents to $66.63 per barrel.

Natural gas was nearly flat at $2.68 per 1,000 cubic feet, heating oil fell 2 cents to $1.96 per gallon and wholesale gasoline lost 2 cents to $1.80 per gallon.

Gold dropped $14.20 to $1,318.60 per ounce, silver lost 19 cents to $16.43 per ounce and copper fell 4 cents to $3.19 per pound.

The dollar rose to 107.42 Japanese yen from 106.91 yen late Monday. The euro dipped to $1.2236 from $1.2312, and the British pound fell to $1.3916 from $1.3968.

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

CHARTS: Consumer Confidence: Index measures attitudes toward the economy, 1985 = 100. (Source: The Conference Board); The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Tuesday. (Source: Reuters)

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THE WALL STREET JOURNAL.
U.S. EDITION

The Property Report
Foreign Investors Go Back to School

By Esther Fung
673 words
28 February 2018
The Wall Street Journal
J
B6
English

Foreign investors once flocked to trophy real-estate assets in the U.S. such as fancy hotels and sky-high towers.

Now, as the commercial real-estate market appears to be entering the late innings of a **bull market**, foreigners are diving into a less exotic sector: student housing.

In January, a joint venture between the Canada Pension Plan Investment Board, Singapore sovereign-wealth fund GIC Pte. Ltd. and Chicago-based student housing owner Scion Group LLC said that it acquired a portfolio of 22 student-housing properties for $1 billion.

All told, the venture has purchased more than $4 billion of student housing totaling 46,555 beds in 52 university markets since 2016.

Also last month, Mapletree Investments Pte. Ltd., owned by Singapore state investor Temasek Holdings Pte. Ltd., bought Cira Centre South, an 850-bed student housing high-rise facility in Philadelphia, for $197.5 million. That added to its portfolio of 17 student housing holdings of more than 11,000 beds in the U.S.

Meanwhile, Safanad Ltd., an investment firm with offices in Dubai, London and New York, on Jan. 30 invested $69.5 million in a pair of student housing buildings in Hyattsville, Md., bringing its U.S. student housing portfolio to about 11,000 beds valued at $800 million.

"It's an asset class like social infrastructure," said Christopher Merrill, co-founder, president and chief executive officer of Harrison Street Real Estate Capital, a closely held firm that sold the $1 billion student housing portfolio last month to the joint venture that included Scion Group. "People will attend universities in good and bad times."

During the early stages of the **bull market** for commercial property, foreign investors loaded up on iconic assets such as the Waldorf Astoria Hotel and One Chase Manhattan Plaza in New York. But with the expansion in its eighth year and interest rates poised to rise further, some foreign investors are seeking assets perceived as safer.

They say the anticyclical nature of student housing and the modernization of these facilities and operations offer attractive yields relative to the risk.

In all, foreign capital has accounted for 42% of student housing transactions this year, compared with 36% in all of 2017 and 21% in 2016, according to data from property investment advisory firm ARA Newmark.

Ryan Lang, executive managing director at ARA Newmark and head of its national student housing group, said he has handled transactions with overseas family offices, institutional investors and private capital, including from China, Russia, the Netherlands and the Middle East. He said they are looking to diversify their holdings and added that student housing is seen as a safer alternative at this point in the cycle.

While overall college enrollment in the U.S. has been decreasing since 2010, enrollment in public universities is expanding.

Residences located near the campuses of big, tier-one state schools such as the University of Texas, and colleges with strong science, technology, engineering and math programs as well as high-profile sports teams are highly sought after.

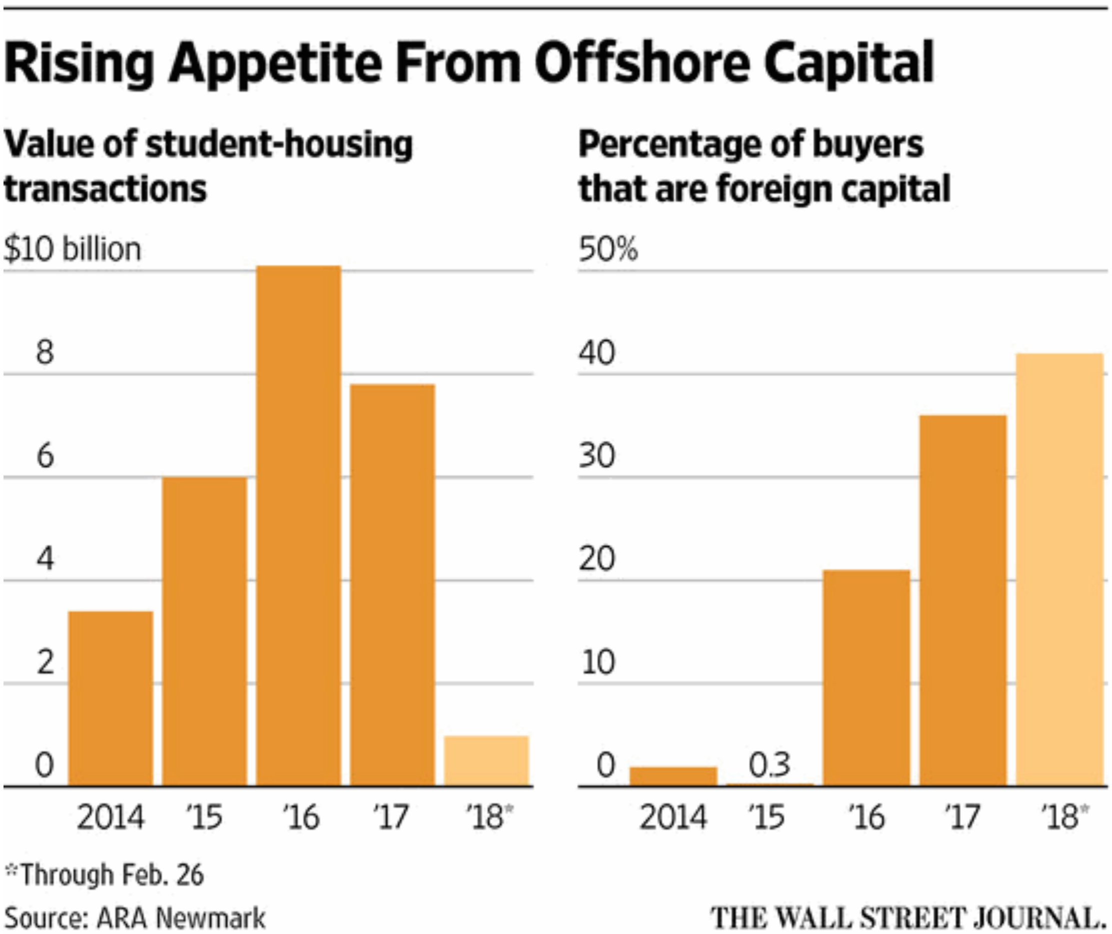
"Public institutions get a lot of attention," said Mr. Lang.

The sector isn't without risks. There is a higher attrition rate in student housing than in multifamily real-estate investment, and missteps in leasing could cause rooms to be empty for a semester or even an entire academic year.

But students' strong preference to be as close as possible to school keeps demand strong.

For traditional investors such as student housing real-estate investment trusts like Education Realty Trust Inc. and American Campus Communities Inc., the wave of deep-pocketed foreign investors makes it tough to match their previous returns, said Ryan Burke and Ryan Lumb, analysts at real-estate research firm Green Street Advisors in a research note.

"Greater competition brings acquisitions at higher valuations, developments at lower yields, and less of a competitive advantage on operations relative to the past," said the analysts.



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Document J000000020180228ee2s0001u

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Consumers Voice Optimism

By Eric Morath
414 words
28 February 2018
The Wall Street Journal
J
A2
English

U.S. consumer confidence rose to its highest level since 2000 in February, showing Americans shrugged off **financial market** gyrations earlier in the month.

The Conference Board said Tuesday its measure of U.S. consumer confidence increased to 130.8 in February from 124.3 in January.

"Despite the recent **stock-market volatility**, consumers expressed greater optimism about short-term prospects for business and labor market conditions, as well as their financial prospects," said Lynn Franco, director of economic indicators at the Conference Board.

February's reading was the highest monthly level since November 2000.

The increase in the Conference Board reading reflected that Americans feel better about both the current and future state of the economy.

The present situation index rose to 162.4 from 154.7; the expectations index rose to 109.7 from 104.0.

Ms. Franco said the labor force was the main driver of the improvement.

The unemployment rate has held at a 17-year low since October, and wages grew at the best year-over-year pace in January since the recession ended in June 2009.

"Short-term prospects are increasing and that shows the much-anticipated improvement in the labor markets is finally helping household budgets," said Robert Frick, corporate economist with Navy Federal Credit Union.

The Conference Board survey ran through Feb. 15, so it captured the most severe **financial market volatility** this month.

U.S. equity markets fell sharply in early February, in part because emerging signs of stronger inflation caused investors to worry that the Federal Reserve could be more aggressive in raising interest rates, a move that could hurt stock values.

Stock prices rose later in the month, but haven't fully recovered losses.

Federal Reserve Chairman Jerome Powell said in testimony to Congress on Tuesday that the economic outlook remains strong and should justify further gradual increases in the central bank's benchmark interest rate.

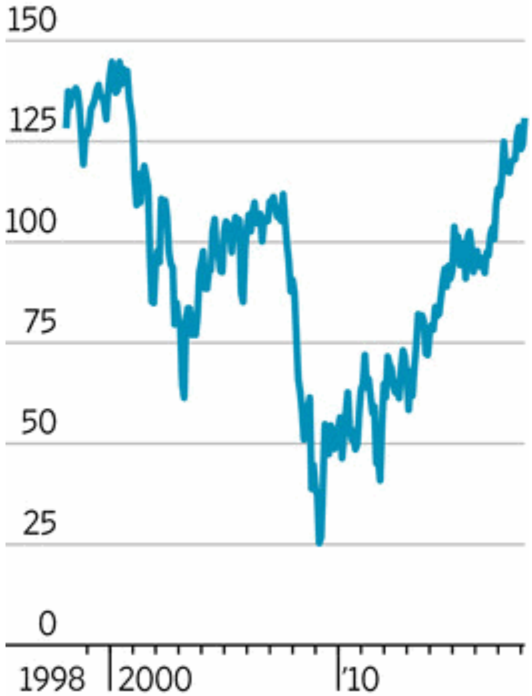
Larger paychecks for most workers this month, reflecting changes to the tax code that took effect, may have supported better confidence.

Solid confidence could be a sign that Americans plan to spend that extra cash. Spending at U.S. retailers fell in January, before the tax-law changes showed up in take-home pay.

Consumer confidence and sentiment figures are watched as indicators for whether shoppers will step up spending. However, they aren't always reliable gauges for actual outlays.

Feeling Good

Consumer confidence index, monthly



Source: The Conference Board

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Document J000000020180228ee2s0002e

THE WALL STREET JOURNAL.
U.S. EDITION

Global Stocks Set to Snap Bullish Run --- A decline this month by world-wide index would halt consecutive advances at 15

By Steven Russolillo
699 words
28 February 2018
The Wall Street Journal
J
B14
English

A record-long **bullish** streak for global stocks is about to fall by the wayside.

The MSCI All Country World Index, a barometer of stocks around the world, is set for its first monthly decline since before the 2016 U.S. presidential election. It is down about 3.3% this month, which would be its worst since January 2016, when a steep selloff in Chinese markets dragged global stocks lower.

This month's decline comes after the index, which captures equity returns from 23 developed and 24 emerging markets, had risen for 15 straight months through January, its longest consecutive streak of gains. That included gains every month in 2017, the first time it had gone a full calendar year without a monthly drop.

The rally gained even more momentum in January, when the index rose nearly 6% in one of its best starts to a year.

But the calm in **financial markets** came to a screeching halt earlier this month, when rising bond yields and a spike in market **volatility** sent stocks swooning.

More than $5 trillion in market value world-wide was wiped out from Jan. 26 to Feb. 8. Many markets, including in the U.S., Japan, China and Hong Kong, fell into correction territory, down at least 10% from their recent highs.

The world index fell 9% from Jan. 26 through the bottom in early February. It has since risen roughly 4.6%, tracking how many markets around the globe have bounced back over the past few weeks. Many analysts are confident that the rebound will continue.

"So far, there have been no signs of 'end-of-cycle themes,'" said Sean Darby, chief global equity strategist at Jefferies in Hong Kong, noting that corporate-earnings growth remains strong and analysts continue to revise their earnings estimates higher. "The evidence continues to build of a broadening in U.S. and global economic growth," he said.

In Asia, Japan's Nikkei Stock Average slumped about 12% from its late January high to Feb. 14. It has since recovered about half of those losses. Similar trajectories hold true for China and Hong Kong stock benchmarks.

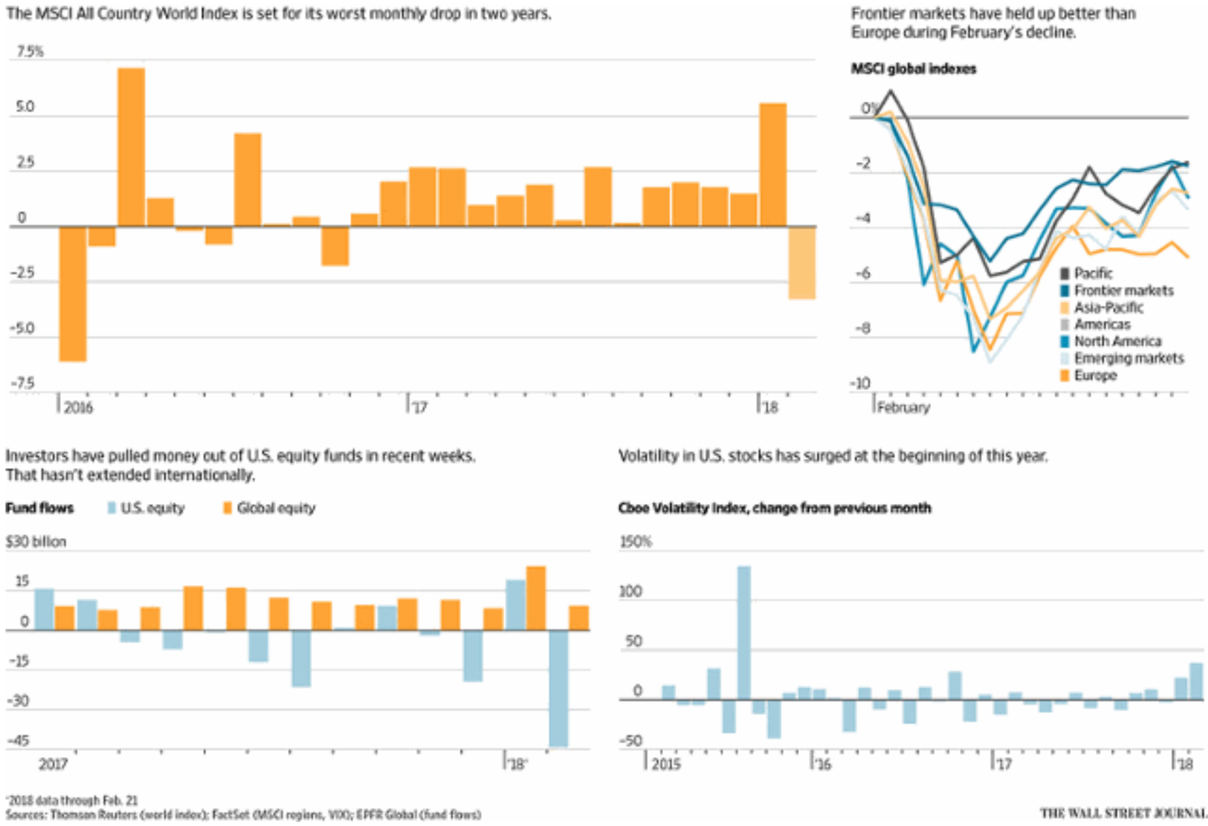
Other markets, such as Australia and Singapore, are back in positive territory for February. And in the U.S., the **S&P 500** is only 4.5% from its record close. The **Nasdaq Composite** is just 2.3% from last month's all-time high, as tech stocks have bounced back. The NYSE FANG+ Index -- which tracks tech heavyweights such as Facebook, Amazon.com, Netflix and Google parent Alphabet, as well as Chinese tech giants Alibaba Group Holding and Baidu -- hit a record on Monday.

Still, risks remain: Since 1980, the world index has averaged a 15% pullback from a recent high each year. That means its recent pullback was only about half of what typically takes place in a given year.

The worst occurred during the 2008 financial crisis, as the index dropped as much as 51% that year. The smallest pullback took place in 2017, when it fell 2% from its high to its low.

And should bond yields keep climbing at a rapid pace, that could hinder stocks' recent rebound. In a note to clients over the weekend, Goldman Sachs warned that if the benchmark **10-year Treasury** yield surges to 4.5% by year-end, stocks could fall by 20% to 25%. The bank doesn't expect that to come to pass, indicating its base case is for the 10-year yield to hit 3.25% by the end of the year. It rose to 2.910% on Tuesday, from 2.862% Monday.

"This is the battle in **financial markets** at the moment," says Torsten Slok, chief international economist at Deutsche Bank Securities. He noted that strong economic and earnings data should be good for both bond yields and stock prices but that "we will have a problem once the grind higher in Treasury yields begins to have a negative impact on consumer spending and capex."



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THE WALL STREET JOURNAL.
U.S. EDITION

Companies Sweeten Dividends --- Over one-fifth of S&P 500 lift payouts and none cut them; bonds prove tough rival

By Michael Wursthorn
835 words
28 February 2018
The Wall Street Journal
J
B1
English

Dividends are on the rise at a time investors have fewer reasons to buy the stocks that pay them out.

More than one-fifth of the companies in the S&P 500 have boosted their dividends to shareholders so far this year, while no firms have slashed their payouts, a first since 2011, according to S&P Dow Jones Indices.

The increases -- from an array of companies including cable-giant Comcast Corp., asset-management firm T. Rowe Price Group and consumer-products company Kimberly-Clark Corp. -- are getting bigger, too, with companies on average raising their payouts by 14%, the biggest jump since 2014.

The dividend boosts, which come as companies report some of their best earnings and sales in years, partly result from last year's $1.5 trillion tax cut that spurred corporations to put their extra cash to work. But they also coincide with a rise in bond yields that threatens to diminish the allure of stocks.

Bond yields have flirted with multiyear highs this month amid signs that long-dormant inflation could be picking up enough to force the Federal Reserve to speed up the pace of interest-rate increases.

Those jitters sent stocks sputtering in early February, pushing the S&P 500 into correction territory for the first time in two years. Although stocks have regained much of their footing since then, with the broad index off just 4.5% from its all-time highs, increased volatility has kept investors on edge.

Bonds are relatively more attractive than they have been in years, and high-dividend stocks like utilities and real-estate companies are among the worst performers in the S&P 500 this year.

The yield on the two-year U.S. Treasury note surpassed the income investors could earn from dividends on the S&P 500 in December for the first time since the throes of the financial crisis in September 2008.

The spread between the two has continued to widen this year with two-year bonds touching a high of 2.27% in February, nearly half a percentage point greater than what the S&P 500 had been yielding.

But bond yields are still relatively low and would have to move higher, with the benchmark 10-year U.S. Treasuryyield at least above 3%, to spark a bigger rotation out of equities and into bonds, money managers say.

"Now that rates are higher, bonds are more attractive enough to start some sort of shift," said Jay Jacobs, director of research at exchange-traded-funds provider Global Management Co. "But the case for keeping equity payers in a portfolio is still very strong."

Utilities and real-estate companies in the S&P 500 tend to pay bigger dividends relative to their share price than most other sectors and continue to offer better yields than short-term bonds as well as the 10-year Treasury note, whose yield rose Tuesday to 2.910%.

But those stocks have been struggling since November as bond yields ticked higher, drawing investors on the hunt for yield.

About $2.1 billion has flowed out of dividend-heavy exchange-traded funds over the five-week period ended Feb. 14, up from the $648.6 million in redemptions for the prior five-week period, according to data provider EPFR Global.

The pace of those redemptions appeared to be slowing, however. About $118 million flowed into those funds in the most recent week, according to EPFR's data.

"Now that rates are going higher, it's going to make bonds a lot more attractive," said Mr. Jacobs. "What's probably at the most risk right now is those lower-yielding stocks."

Eight of the 11 major **S&P 500** sectors are generating a higher dividend yield than last year, including energy, consumer staples and health-care companies.

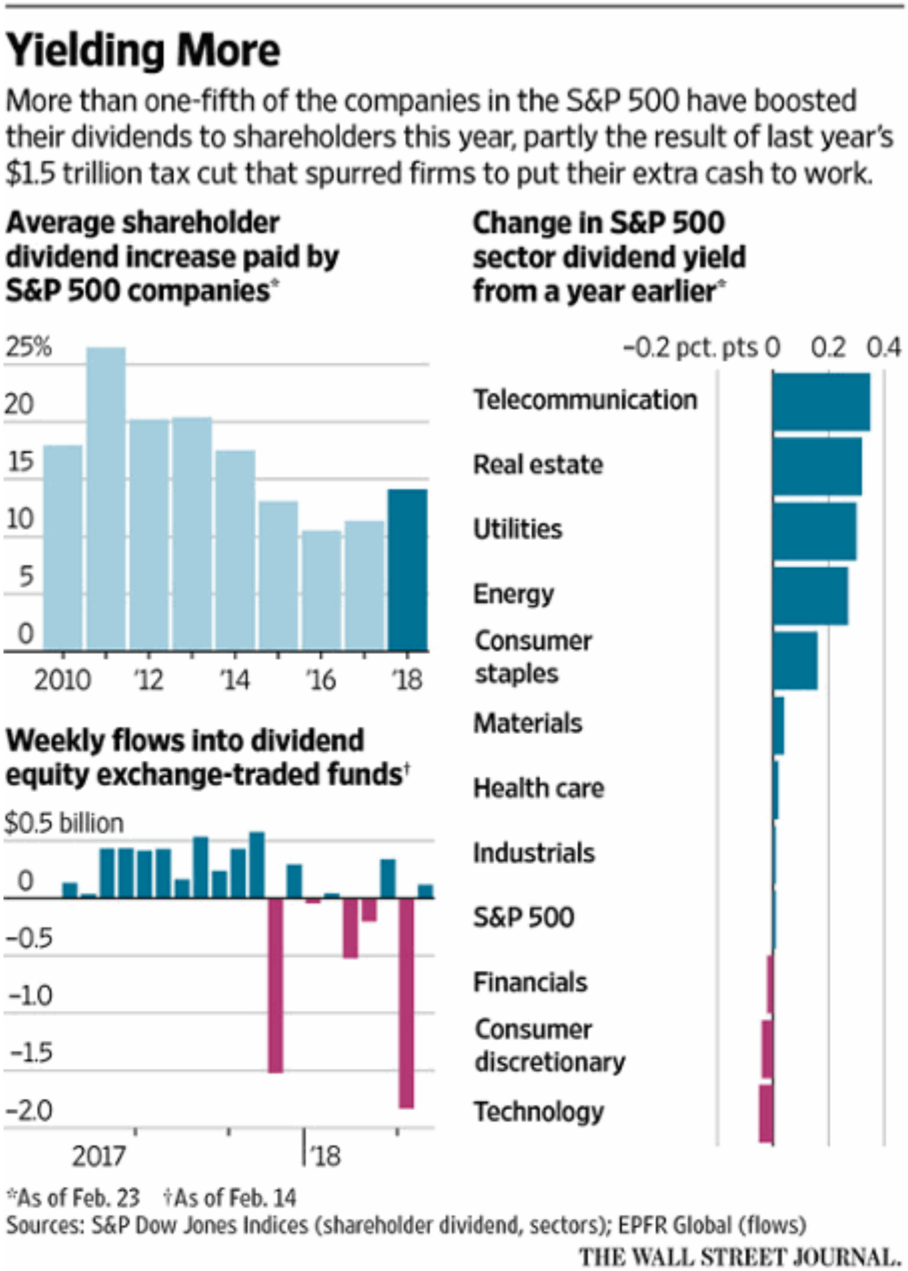
Energy firms are seeing some of the biggest dividend increases, with three companies -- Anadarko Petroleum Corp., Pioneer Natural Resources Co. and Cimarex Energy -- at least doubling their payouts this month.

In total, four companies in the **S&P 500** have at least doubled their dividends to shareholders this year, matching the number for all of last year.

February is typically the busiest month for dividends as companies roll out their annual results and reward shareholders ahead of their annual meetings.

Historically, more than half of the companies in the **S&P 500** increase their dividends each year, and in recent years, 60% or more of the index boosted their payouts, according to S&P Dow Jones Indices.

"It's a function of the strong economic backdrop coupled with the changes to the tax code," said Mike Allison, a portfolio manager with Eaton Vance. "A healthy earnings backdrop and lack of anything better to do with capital other than to return it to shareholders is something we like."



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THE WALL STREET JOURNAL.
U.S. EDITION

Oil Feels Squeeze From Several Sides

By Stephanie Yang
235 words
28 February 2018
The Wall Street Journal
J
B13
English

Oil prices declined, under pressure from a rising dollar, falling stocks and an expected increase in crude stockpiles.

Light, sweet crude for April delivery fell 90 cents, or 1.4%, to $63.01 a barrel on the New York Mercantile Exchange. Brent, the global benchmark, lost 87 cents, or 1.3%, to $66.63 a barrel.

Analysts said **oil prices** moved in tandem with broader markets, as statements from Federal Reserve Chairman Jerome Powell made traders more wary of higher interest rates this year.

U.S. stocks dropped after Mr. Powell indicated that the central bank is on track to raise interest rates and perhaps even pick up the pace this year. The **S&P 500** closed down 1.3%, while the WSJ Dollar Index rose 0.5%.

"Right now, everything's going to be much more tied to the macro, capital market issues," said John Saucer, vice president of research and analysis at Mobius Risk Group. "Any time you see that big risk-off in equities, you're going to see that in crude."

Traders were awaiting data from the U.S. Energy Information Administration on the amount of crude in storage. The American Petroleum Institute, an industry group, said late Tuesday that its data for the week showed a 933,000-barrel increase in oil supplies.

Document J000000020180228ee2s00013

The New York Times

Business/Financial Desk; SECTB
You May Own Guns, Even if You've Never Fired a Single Round

By LANDON THOMAS Jr. and STEPHEN GROCER
732 words
27 February 2018
The New York Times
NYTF
Late Edition - Final
3
English

You probably are a gun owner.

You might not actually possess a gun. But if you have a pension or a 401(k) or an investment in index funds, there's a good chance that, directly or indirectly, you own shares of one or more gun manufacturers.

Like it or not, that means that your financial incentives are at least partly aligned with those of gunmakers. And in general, the more guns they sell, the more money their shareholders -- in other words, you -- make.

The school shooting this month that killed 17 people in Parkland, Fla., has intensified scrutiny on the various ways in which financial institutions and other companies prop up the firearms industry, whether through lending money to gun companies or having marketing partnerships with the National Rifle Association.

Many companies have severed their ties to the N.R.A. Blackstone, the private equity giant, recently contacted the hedge funds that it owns, asking about their holdings of gun stocks.

Here is how individual investors, including people whose only investments are through their retirement plans, are financially connected to the gun industry -- even if they don't realize it.

Pension Funds

A number of state pension funds own shares in the gun makers. For example, pension funds for public employees in Florida, Texas, Wisconsin and Ohio all have stakes of less than 1 percent in American Outdoor Brands, formerly known as Smith & Wesson, which is the manufacturer of the AR-15-style semiautomatic rifle that has been used in a number of recent mass shootings.

TIAA, which oversees retirement investments for educators and teachers, has small stakes in American Outdoor Brands and two other publicly traded gun companies. The pension fund for teachers in New York State also has very small positions in the gun companies Sturm Ruger and Vista Outdoor.

The investments represent slivers of the pension funds' overall assets, but they nonetheless are generating debate. New Jersey lawmakers last week moved to cut off investments in gunmakers by the state pension plan.

Index Funds

Exchange-traded index funds, which are designed to track the performance of various market indexes, are all the rage these days. They hold the shares of every company in whatever index they're tracking. These indexes include the Russell 2000 index for small companies and the Standard & Poor's Aerospace & Defense Select Industry index.

That means these investment firms own the stocks, not because they see investment value in them, but because they are part of a broad **stock index**.

Two of the world's biggest asset managers, the index giants BlackRock and Vanguard, are now among the top shareholders of three publicly traded gun companies: Sturm Ruger, American Outdoor Brands and Vista Outdoor.

BlackRock has an 11 percent stake in American Outdoor Brands, while Vanguard's stake is 8 percent. For Sturm Ruger, BlackRock owns 17 percent while Vanguard has 9.5 percent.

BlackRock said it would be contacting officials at the three publicly traded firearms companies, asking them about how they were responding to the shootings.

Vanguard has taken a more cautious stance. With 20 million clients, the firm said it was unrealistic to cater to such a wide variety of views on pressing social topics. ''We believe mutual funds are not optimal agents of social change,'' a spokesman said.

Vanguard does offer clients a way to screen funds for stocks that they do not want to invest in.

Stock Pickers

While index funds are prominent shareholders of these gun companies, some large mutual funds -- in which portfolio managers individually pick stocks -- are also substantial owners.

One of the world's biggest fund companies, Capital Group, which oversees $1.6 trillion in assets, has an 8 percent stake in Sturm Ruger.

A spokesman for Capital said on Monday that the investment firm ''was engaging with gun manufacturers to understand their plans to ensure the safe use of these products.''

And the mutual fund giant Fidelity is the top shareholder of Vista Outdoor, with 15 percent of the company. The stake is held largely through Fidelity's actively managed funds.

Scott Rollf on Sunday at a gun show in Tampa, Fla. Stock ownership connects many Americans to the gun industry. (PHOTOGRAPH BY ZACK WITTMAN FOR THE NEW YORK TIMES)

Document NYTF000020180303ee2r0000q

The New York Times

Business/Financial Desk; SECTB
Unexpected Rally Stretches Into Third Day of Gains

By THE ASSOCIATED PRESS
715 words
27 February 2018
The New York Times
NYTF
Late Edition - Final
2
English

Stocks jumped on Monday, with gains again accelerating in the last hour of trading, as markets around the world continue to claw back from a sharp tumble this month.

The **Standard & Poor's 500**-**stockindex** powered to a third straight gain, and the index has erased about two-thirds of its 10 percent loss since setting a record a month ago.

Analysts said a main reason for Monday's gain was a drop in Treasury yields, which have been at the center of worries for stock investors in recent weeks, but some were still surprised by how much the market climbed.

The **S**.**&P**. **500** gained 32.30 points, or 1.2 percent, to 2,779.60, with telecoms and technology stocks leading the way. For the second straight day, the market turned higher as the day wore on.

The **Dow Jonesindustrial average** rose 399.28, or 1.6 percent, to 25,709.27, and the **Nasdaq composite** index gained 84.07, or 1.1 percent, to 7,421.46. All three measures are back within 3.4 percent of their record highs.

''I think you can very confidently say the worst is over for now,'' said Randy Frederick, vice president for trading and derivatives at the Schwab Center for Financial Research. ''The concern I have is that it's recovering too quickly. Today's rally has been very surprising.''

Mr. Frederick said he saw few reasons for a big move higher in stocks on Monday, with no big-ticket earnings or economic reports on the calendar. If the market continues rising at this rate, it could hit record heights again in the next couple of weeks. ''And then we'd be vulnerable to another correction, so I'd prefer it to slow down a bit here,'' Mr. Frederick said.

What set off the first correction, which is what traders call a 10 percent drop in stock prices, was fear that interest rates were set to march much higher, and quickly. Treasury yields have been climbing over the last month for a number of reasons, including higher expectations for inflation, a strengthening American economy and the federal government's increased need to borrow.

Higher interest rates can hurt stock prices by making bonds look more attractive as investments, and Wall Street is split on how high they can climb. Most of Wall Street is anticipating a gradual increase, as the Federal Reserve moves short-term rates higher.

That is why an appearance this week by the Fed's new chairman is so widely anticipated. Jerome H. Powell is scheduled to deliver his first testimony as chairman to Congress, and he will speak about monetary policy before the House Financial Services Committee Tuesday morning. Ahead of the testimony, the yield on the **10**-**year Treasury** note slipped to 2.86 percent from 2.87 percent late Friday.

One driver for stocks in recent weeks was how impressive corporate profit reports have been.

Roughly 90 percent of **S**.**&P**. **500** companies have said how much they earned during the last three months of 2017, and three-quarters of them made more than analysts expected, according to S&P Global Market Intelligence. More important to investors is that 75 percent of companies reported more revenue than expected. Revenue growth is on pace to be the best since the summer of 2011, according to FactSet.

In the commodities markets, benchmark United States crude oil rose 36 cents to settle at $63.91 a barrel. Brent crude, the international standard, gained 19 cents to $67.50 a barrel.

Gold added $2.10 to settle at $1,330.30 an ounce. Silver rose 7 cents to $16.55 an ounce, and copper fell 1 cent to $3.22 a pound.

The dollar inched up to 106.91 Japanese yen from 106.87 yen late Friday. The euro rose to $1.2311 from $1.2294, and the British pound edged down to $1.3964 from $1.3965.

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

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Monday. (Source: Reuters)

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THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance: Hedge Funds Feast on Choppy Markets --- Volatility's return is a welcome development for investors that profit on price swings

By Laurence Fletcher
805 words
27 February 2018
The Wall Street Journal
J
B10
English

For years, hedge funds have been able to blame their lackluster performance on central-bank interference in markets. As expansionary monetary policy programs wind down, a turbulent start to 2018 has provided the kind of conditions some of these funds have been craving.

Among funds in the black this year are several that lost money in 2017. These include funds run by New York-based Caxton Associates as well as Graham Capital Management and Tudor Investment Corp., both based in Greenwich, Conn.

Many of the funds that have done particularly well are so-called macro funds which invest across a range of assets and try to profit from vigorous price moves.

These funds have found it especially difficult to cope with asset prices that have been closely correlated with one another as central banks have intervened in markets over the past decade.

The vast amounts of central-bank stimulus have pushed up asset prices and made markets less **volatile**. Macrohedge funds have often contended this has made life tougher for them, with fewer large price moves to trade. Assets moving higher in unison also are a headache for funds that like to trade one asset against another.

Over the past five years, macro funds -- which trade global bonds, stocks and currencies -- on average have lost money in two calendar years, according to Chicago-based data group HFR, while average gains in 2016 and 2017 were 1% and 2.2%, respectively. Cheap market-tracking funds have delivered much higher returns. Investors have pulled out billions of dollars from macro hedge funds and some funds have shut.

Many managers now welcome what they say is a sea change in market conditions, which they hope will create more opportunities but will offer fewer hiding places if performance continues to lag.

The sharp rise in Treasury yields so far -- the **10**-**year Treasury** yield has risen to 2.86% from 2.41% at the start of the year -- has been key for money managers. Many funds for years have been betting in vain on a pickup in yields -- kept low by quantitative easing -- and have begun profiting in recent months as central banks begin to unwind stimulus programs.

A rise in **volatility** since the **Dow Jones Industrial Average**'s record slump earlier this month also is helping, as hedge funds prefer trading more vigorous price moves. Becalmed markets offer less dispersion in price moves that these funds can exploit.

And this month's selloff in stocks is hitting them less than more traditional investors as they tend to have much lower exposure to bets on rising stock prices, if any at all.

"Most of the influential conditions that have prevailed for the last decade post the great financial crisis have now changed, some completely," wrote Caxton's Andrew Law in a letter to investors this month, reviewed by The Wall Street Journal.

A new fund at Caxton run by Mr. Law has gained 8.3% this year through Feb. 16, one of the biggest hedge-fund gains of 2018, an investor said.

Caxton's main Global fund, which lost 13.3% last year as Treasury yields moved lower for much of 2017, is up 5.4% this year through Feb. 16, the investor said. The **S&P 500** rose 2.2% over that period while hedge funds on average gained 1.4%, according to data group HFR.

Caxton has profited this year from the rise in bond yields and the fall in the dollar, the investor said.

"We believe that the altered environment will create opportunities," wrote Mr. Law in the investor letter. If the change in market conditions continues it will likely lead to a rising yield curve and higher **volatility**, he wrote.

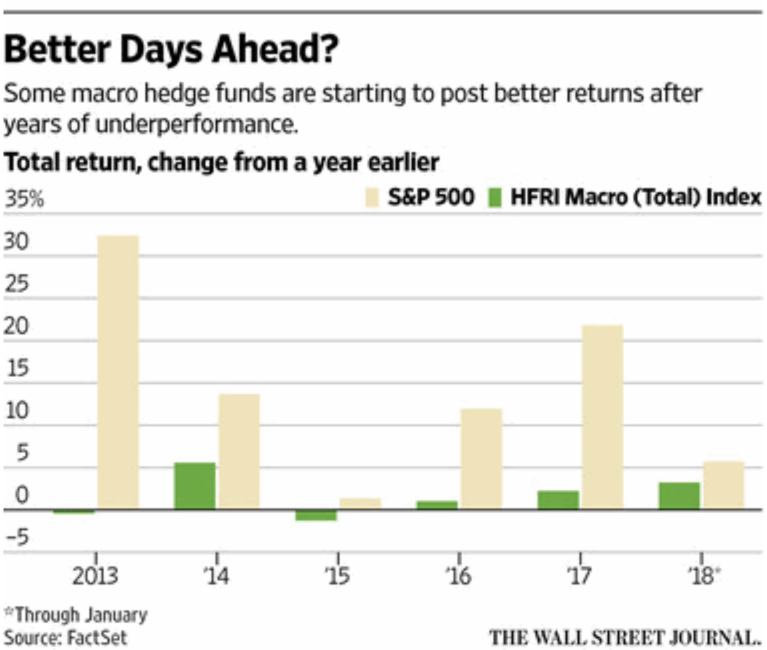
In the wake of this month's increase in **volatility**, Sandy Rattray, chief investment officer at Man Group and co-inventor of the Cboe **Volatility** Index (VIX), said "it certainly feels as though the long period of low **volatility** may well have come to an end."

Kenneth Tropin's Graham Capital Management, which runs $17 billion in assets, has gained 8.8% through Feb. 16 in its Global Investment Fund-Discretionary Enhanced Vol fund, said a person familiar with the matter. Its Absolute Return Fund has gained 6.3%.

Tudor Investment, founded by Paul Tudor Jones, has returned 5% in its Global fund through Feb. 16.

All three funds posted losses last year.

However, not all funds have ridden this month's market turmoil so well. Computer-driven hedge funds, which have profited from long-running trends in markets, have suffered large losses this month as many of those trends have reversed.



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Document J000000020180227ee2r0000r

THE WALL STREET JOURNAL.
U.S. EDITION

Streetwise: A Crowd Around the Bond Story

By James Mackintosh
896 words
27 February 2018
The Wall Street Journal
J
B1
English

The reality of inflation and growth has shifted only a little in the past few months. Beliefs about inflation and growth, however, have moved a lot, and investors hoping they will rise fast could be in trouble if reality doesn't catch up soon.

This is most obvious in the bond market. Last summer, gloom about the prospects for inflation prevailed, with hedge funds having more bets on bond yields falling than rising. No longer. The narrative has shifted, and fast money has shifted with it, making some of the biggest bets ever on yields rising.

The risk for investors is that the move from worrying about deflation to worrying about inflation won't happen smoothly. In other words, reality might once again disappoint the market. Yes, bond yields should go up -- over time. But they have soared this year, to the point that the fall in **bond prices**, which go down when yields go up, is as quick as it has been only four other times since the end of the recession in 2009. Each of those times prices fell too fast and popped back up.

"Cyclically, everyone's very excited," said Chris Watling, founder of consulting firm Longview Economics. "Every asset allocator you talk to seems to be short the **10**-**year**" **Treasury**.

Many of the biggest recent swings in bond yields have come when investors were crowded into wrong-way bets. In April 2010, futures traders had what was then a record bet on rising yields, reflecting a consensus that the economy was in a normal postrecession rebound. Suffice to say it wasn't, and those bets were quickly reversed. The same happened at the end of 2016, when postelection excitement about rising yields led to a record bet, but again proved wildly overdone.

The opposite happened in May 2013 and last summer, when investors had some of their biggest postcrisis bets using futures and options on bond yields falling. In both cases, 10-year yields subsequently jumped by close to a percentage point. This month the net bet on rising **10**-**year Treasury** yields reached the second biggest, behind only the rise after the election, while the number of futures-only bets on rising yields hit a record.

This isn't to say that the new consensus is wrong. Global economic growth brings with it a tighter jobs market and more demand, which ought to be inflationary. The worry is that it doesn't arrive quickly enough to confirm investors in their new belief and disappointment sets in. Leveraged funds with large positions would then look exposed, something that often prompts them to close out their bets and would push down bond yields. With tens of billions of dollars of outstanding bets against bond futures, such a rush to cover short positions could have a big effect.

The new market story is of synchronized global growth, tighter monetary policy and higher wages and inflation. The short-term issue isn't so much whether it is right or wrong, but whether everyone yet believes in it. If there are more investors out there who haven't been converted, then economic data supporting the story could push up bond yields further still. If everyone and his dog is already betting on growth and inflation, then the very same data might disappoint those hoping for more.

In Europe, there are already signs of disappointment. Economic data have been coming in below forecasts, pushing Citigroup Inc.'s measure of "economic surprise" negative for the first time since September 2016. Again, this suggests not that the eurozone is in trouble, but merely that economists upgraded their forecasts too enthusiastically.

Now, I'm a natural contrarian and may again be overestimating how far the story has to run. After the U.S. election I thought it was right that bond yields should rise, but that they had gone up far too quickly given the uncertainties about Donald Trump's policies. I was too early, and **10-year Treasury** yields rose another 0.3 percentage point -- a fall of almost 3% in price -- before the market began to share my concerns about how long it would take to implement tax cuts and infrastructure spending.

A repeat is possible. Fund-manager sentiment toward bonds is very negative, but not as negative as it was after the election or during the 2013 taper tantrum. Bond yields have risen fast, but not as fast as they did after the election. Bets on inflation over the next five years being above 3% -- derived from inflation options -- are still below where they stood after the election, too. All these measures could run further, and hedge funds and others could pile on even bigger bets on rising yields.

Yet, the balance of risks has shifted. Wage growth that would have been a positive surprise last summer would today be a damp squib for investors who are expecting a continuation of last month's fireworks. U.S. Treasurys may still look unattractive at a 10-year yield of just under 2.9%, but remember that it has only been above 3% for two days since July 2011. The market is adopting a new narrative, but it would be normal to have plot twists as the story works out.

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Document J000000020180227ee2r0001b

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Weather Blamed for Big Decline in New-Home Sales

By Sharon Nunn
428 words
27 February 2018
The Wall Street Journal
J
A2
English

WASHINGTON -- Two months of steep declines in sales of new homes across the U.S. haven't persuaded many economists that the housing market is turning lower.

Purchases of newly built single-family homes -- a relatively narrow slice of all U.S. home sales -- fell 7.8% in January after dropping 7.6% in December, according to data released Monday by the Commerce Department.

Purchases have declined for four of the past six months.

The January drop bucked the 4.0% growth economists surveyed by The Wall Street Journal had expected.

Analysts are pointing to weather and the **volatile** nature of the new-home sales data to explain away what could be seen as an emerging downtrend in the housing market.

"If the drop in January were related primarily to economic factors, it is likely that all regions would have experienced declines," Nationwide chief economist David Berson said.

Instead, the declines were concentrated in the Northeast and South. Winter weather, particularly in Southern states, might have kept prospective buyers from the search, some economists said.

Regardless of the weather's impact on home buyers, the numbers themselves tend to be unreliable in the short term.

New-home-sales data produced by the Commerce Department are highly **volatile**, with large statistical margins of error, and subject to extensive revisions months after initial data are released.

"The national and all four regional sales estimates were statistically insignificant," said Patrick Newport, IHS Markit executive director for U.S. economics.

Given the large margins of error, he noted, it is uncertain whether there was even an increase or decrease for the month.

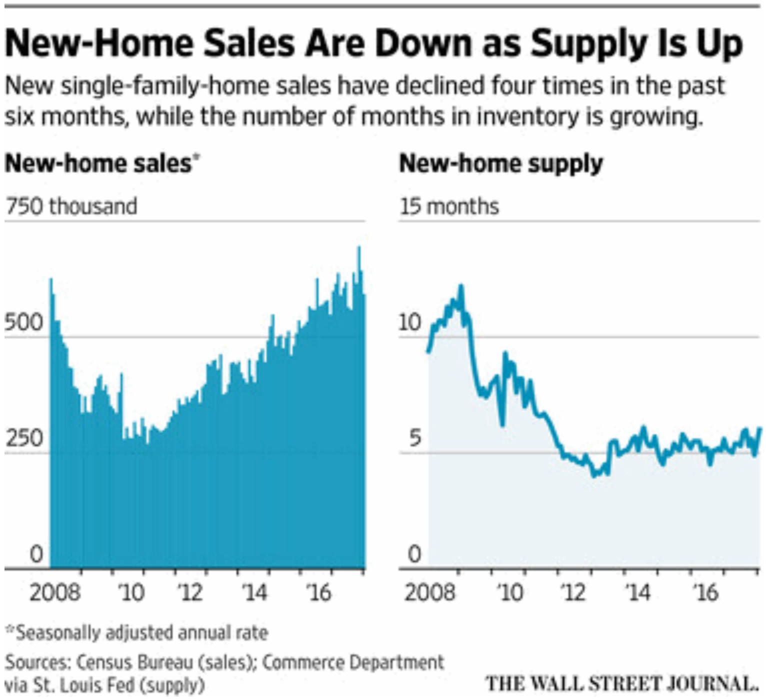
Still, there are reasons to be on the watch for softness in sales data.

Last year's tax overhaul made it more expensive to live in some high-cost areas, including the Northeast, and to take out big mortgages.

Mortgage rates have moved higher rapidly since the beginning of 2018, making purchasing a home more expensive.

Moreover, housing inventory has been tight, driving up home prices and pricing some potential buyers out of the market. In January, sales of previously owned homes, which represent the bulk of the U.S. market, experienced their sharpest year-over-year drop in more than three years.

But inventory might be turning. In January, at the current sales pace, new-home supply reached 6.1 months, the highest level since the middle of 2014. That could ease upward pressure on prices.



Document J000000020180227ee2r00034

The New York Times

Business/Financial Desk; SECTB
Tax Savings Unleashing A Bonanza Of Buybacks

By MATT PHILLIPS
1,238 words
27 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

President Trump promised that his tax cut would encourage companies to invest in factories, workers and wages, setting off a spending spree that would reinvigorate the American economy.

Companies have announced plans for some of those investments. But so far, companies are using much of the money for something with a more narrow benefit: buying their own shares.

Those so-called buybacks are good for shareholders, including the senior executives who tend to be big owners of their companies' stock. A company purchasing its own shares is a time-tested way to bolster its **stock price**.

But the purchases can come at the expense of investments in things like hiring, research and development and building new plants -- the sort of investments that directly help the overall economy. The buybacks are also most likely to worsen economic inequality because the benefits of stocks purchases flow disproportionately to the richest Americans.

The tax overhaul is the cornerstone of Mr. Trump's economic plan. It has been a big win for companies, offering lower corporate rates and a permanent break on overseas profits. Warren E. Buffett said in his annual letter to investors on Saturday that his company, Berkshire Hathaway, enjoyed a $29 billion gain thanks to the new tax law.

What companies do with the trillions of dollars they're bringing back to the United States, and the money they will save each year on their tax bills, will in large part determine whether the plan is a success or a failure.

As the tax cuts kick in, companies have laid out a variety of uses for the money. Some are paying out one-time bonuses to employees. Others are raising salaries. Others plan to open new factories.

In the fourth quarter, American companies' investments in things like factories and business equipment grew by 6.8 percent. That was the fastest growth rate since 2014, but far from the giant surge in capital spending that was promised ahead of the tax overhaul.

But the buying back of shares is also at record levels.

Almost 100 American corporations have trumpeted such plans in the past month. American companies have announced more than $178 billion in planned buybacks -- the largest amount unveiled in a single quarter, according to Birinyi Associates, a market research firm.

Such purchases reduce a company's total number of outstanding shares, giving each remaining share a slightly bigger piece of the profit pie.

Cisco said this month that in response to the tax package, it would bring back to the United States $67 billion of overseas cash, using $25 billion to finance additional share repurchases. Alphabet, the parent company of Google, authorized up to $8.6 billion in stock purchases. PepsiCo announced a fresh $15 billion in planned buybacks. Chip gear maker Applied Materials disclosed plans for a $6 billion program to buy shares. Late last month, home improvement retailer Lowe's unveiled plans for $5 billion in purchases.

On Monday, Mr. Buffett said on CNBC that Berkshire might be open to buy some of its shares. The remarks helped send Berkshire's stock -- and the broader market -- higher.

More buybacks are almost certainly on the way. UBS analysts covering Apple said the iPhone maker might authorize another $30 billion in share purchases when it reports its next quarterly earnings in April. That would be on top of the $30 billion it already spends each year to buy back its shares.

"I'm expecting buybacks to get to a record for 2018," said Howard Silverblatt, a senior index analyst with S.&P. Dow Jones Indices. "And if I'm disappointed, there's a lot of people with me."

The flurry of planned buybacks has been good for the **stock market**. Early this month, stocks were down more than 10 percent from their January peak. The prospect of companies flooding markets with "buy" orders helped the market recoup some of its losses.

The broader impact on the economy is less clear. Economists believe a rising **stock market** benefits the economy, helping support consumer and business confidence. But the vast majority of the billions of dollars in planned share purchases will benefit the richest 10 percent of American households, who own 84 percent of all stocks. The top 1 percent of households own about 40 percent of all stocks.

Ultimately, the effect of the rising **stock market** depends on how those wealthy investors use their windfall. It helps the economy more, for example, if they put the money toward productive new companies than if they invest in government bonds.

Companies typically decide to make long-term investments in things like new workers and factories based on whether they will make the company more profitable -- not merely because the companies are sitting on a pile of money that they otherwise would have paid in taxes.

At a news conference Thursday, the head of the White House's Council of Economic Advisers, Kevin Hassett, acknowledged that many companies were spending their money on buying their own shares.

"Right now we're going to have an adjustment where you see probably more dividends and share buybacks than wage increases," Mr. Hassett said. "But going forward we're going to see a lot of capital formation and wage growth."

That is not what happened in 2005, when a one-time tax holiday allowed companies to repatriate money on the cheap. That plan, championed by President George W. Bush, was sold as a way to get American companies to invest more in the domestic economy.

Some $300 billion came back to the United States that year. But economists estimated that as much as 92 percent of it may have been paid out to companies' shareholders -- mostly in the form of buybacks.

Studies have shown that the tax change lifted companies' stock prices but did not expand their American work forces.

Until the early 1980s, the practice of buying shares with corporate money was considered borderline illegal because it was thought to potentially open the company up to charges of manipulating share prices.

But in 1982 the Securities and Exchange Commission adopted a rule that gave the green light to most share repurchases, as long as they followed certain rules.

Historically, American companies had paid out profits with a quarterly check, known as a dividend. But after the S.E.C.'s rule change, companies started using more of their profits to buy their own shares, in the process giving their shareholders a bigger piece of the company.

Buybacks soon soared. By 2016, the most recent year for which there is complete data, companies spent $536 billion on purchasing their own shares, according to data from S. & P. Dow Jones Indices.

That was about 5 percent less than those companies spent on new plants, research and development and other investments. By contrast, 20 years ago, companies spent four times as much on such investments as they did on buybacks.

Some economists think the surge in share buybacks has something to do with the relative decline in capital investments, which recently have been lower than expected.

"We have some causal evidence that because of short-termism companies are doing some stock repurchases that maybe they shouldn't do," said Heitor Almeida, a professor of corporate finance at the University of Illinois at Urbana-Champaign. "And maybe that's causing them to reduce investment."

Document NYTF000020180227ee2r0003q

International New York Times

business
Trump’s Tax Cuts in Hand, Companies Spend More on Themselves Than on Wages

By MATT PHILLIPS
1,285 words
26 February 2018
International New York Times
INHT
English

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* Well-Heeled Investors Reap the Republican Tax Cut Bonanza

* Apple, Capitalizing on New Tax Law, Plans to Bring Billions in Cash Back to U.S.

* Bonuses Aside, Tax Law’s Trickle-Down Impact Not Yet Clear

* Tax Overhaul Gains Public Support, Buoying Republicans

Document INHT000020180227ee2q0000u

The New York Times

Business Day
You Might Be Giving Gun Companies Money, Even if You Don't Own a Gun

By Landon Thomas Jr. and Stephen Grocer
770 words
26 February 2018
04:53 PM
NYTimes.com Feed
NYTFEED
English

You probably are a gun owner.

You might not actually possess a gun. But if you have a pension or a 401(k) or an investment in index funds, there's a good chance that, directly or indirectly, you own shares of one or more gun manufacturers.

Like it or not, that means that your financial incentives are at least partly aligned with those of gunmakers. And in general, the more guns they sell, the more money their shareholders — in other words, you — make.

The school shooting this month that killed 17 people in Parkland, Fla., has intensified scrutiny on the various ways in which financial institutions and other companies prop up the firearms industry, whether through lending money to gun companies or having marketing partnerships with the National Rifle Association.

Many companies have severed their ties to the N.R.A. Blackstone, the private equity giant, recently contacted the hedge funds that it owns, asking about their holdings of gun stocks.

Here is how individual investors, including people whose only investments are through their retirement plans, are financially connected to the gun industry — even if they don't realize it.

Pension Funds

A number of state pension funds own shares in the gun makers. For example, pension funds for public employees in Florida, Texas, Wisconsin and Ohio all have stakes of less than 1 percent in American Outdoor Brands, formerly known as Smith & Wesson, which is the manufacturer of the AR-15-style semiautomatic rifle that has been used in a number of recent mass shootings.

TIAA, which oversees retirement investments for educators and teachers, has small stakes in American Outdoor Brands and two other publicly traded gun companies. The pension fund for teachers in New York State also has very small positions in the gun companies Sturm Ruger and Vista Outdoor.

The investments represent slivers of the pension funds' overall assets, but they nonetheless are generating debate. New Jersey lawmakers last week moved to cut off investments in gunmakers by the state pension plan.

Index Funds

Exchange-traded index funds, which are designed to track the performance of various market indexes, are all the rage these days. They hold the shares of every company in whatever index they're tracking. These indexes include the Russell 2000 index for small companies and the Standard & Poor's Aerospace & Defense Select Industry index.

That means these investment firms own the stocks, not because they see investment value in them, but because they are part of a broad **stock index**.

Two of the world's biggest asset managers, the index giants BlackRock and Vanguard, are now among the top shareholders of three publicly traded gun companies: Sturm Ruger, American Outdoor Brands and Vista Outdoor.

BlackRock has an 11 percent stake in American Outdoor Brands, while Vanguard's stake is 8 percent. For Sturm Ruger, BlackRock owns 17 percent while Vanguard has 9.5 percent.

BlackRock said it would be contacting officials at the three publicly traded firearms companies, asking them about how they were responding to the shootings.

Vanguard has taken a more cautious stance. With 20 million clients, the firm said it was unrealistic to cater to such a wide variety of views on pressing social topics. “We believe mutual funds are not optimal agents of social change,” a spokesman said.

Vanguard does offer clients a way to screen funds for stocks that they do not want to invest in.

Stock Pickers

While index funds are prominent shareholders of these gun companies, some large mutual funds — in which portfolio managers individually pick stocks — are also substantial owners.

One of the world’s biggest fund companies, Capital Group, which oversees $1.6 trillion in assets, has an 8 percent stake in Sturm Ruger.

A spokesman for Capital said on Monday that the investment firm “was engaging with gun manufacturers to understand their plans to ensure the safe use of these products.”

And the mutual fund giant Fidelity is the top shareholder of Vista Outdoor, with 15 percent of the company. The stake is held largely through Fidelity’s actively managed funds.

* How Banks Could Control Gun Sales if Washington Won’t

* Companies Cut Ties to the N.R.A., but Find There Is No Neutral Ground

* A List of the Companies Cutting Ties With the N.R.A.

People who do not own a firearm or attend gun shows may still be financially connected to the gun industry through their investments. | Zack Wittman for The New York Times

Document NYTFEED020180226ee2q007hh

The New York Times

Business Day; Retirement
Millennials Are Saving for the Future, if They Can Afford To

By Zach Wichter
1,452 words
26 February 2018
05:00 AM
NYTimes.com Feed
NYTFEED
English

Millennials are often criticized for not doing enough to plan for retirement, and the advice they get is usually from their parents or financial advisers who are much older and in different financial situations. Recently, a group of people in their 20s — four of whom went to college with the writer — took part in a Google Hangout to discuss their thoughts on retirement and what they are doing to save. The conversation has been edited and condensed.

The participants:

Emily Davidson, 27, Baltimore, brand consultant at a financial services firm.

Mauricio Maluff Masi, 27, Madison, Wis., technical services analyst at a health care software company.

Travis Olson, 27, Silver Spring, Md., program associate at a nonprofit education policy program.

Morgan Richardson, 27, Chicago, career adviser at a professional coaching and training firm.

Kirk Vaclavik, 26, Chicago, brand strategist at a digital ad agency.

Brian Williams, 23, New York, licensing assistant at Tory Burch.

Garrett Young, 26, Boston, bank examiner at the Massachusetts Division of Banks.

Zach: What does “retiring” mean to you?

Morgan: Retirement for me is saving up as much as I can so that by hopefully 60 at the latest, I have enough money to live off for a good 20 years. Maybe somewhere warm.

Kirk: It’s not a one-and-done moment in life in my mind at all, it’s going to be more like a slow fade of reaching a point where I’m financially independent enough to make whatever choice I want about how I spend my time.

Brian: I don’t know if it’s just because I’ve been working for a short amount of time, retirement doesn’t seem exciting. I feel like I don’t want to work to just retire.

Garrett: Retirement to me is just not having to work. Not necessarily that you won’t work, but there’s no necessity for it.

Emily: The idea of sitting in a condo in Boca fills me more with dread than anything. Maybe that’s just a foolish millennial dream, thinking you won’t be tired at the end and want to put your feet up for 20 years, but the idea of not working if I have my mind and my health doesn’t feel like me.

Zach: What are you doing to save? And does your savings plan affect your life at all?

Travis: I’ve recently been trying to figure out the investing game using some educational apps like Stash — putting a little away here and there, and learning about what it actually means to invest in the **stock market**. Learning how it all works so it’s not just magic numbers behind closed doors.

Garrett: I’ve been pretty aggressively investing in mostly index funds since I got out of college.

Morgan: I used to have crazy online shopping binges. So now it's like, O.K., be a responsible adult and put that money in your I.R.A. instead of just spending it. So I wouldn't say I'm making any sacrifices, I'm just being responsible. I have a Roth I.R.A. and I put the maximum in it annually that I can.

Travis: My partner and I consciously chose to live in Maryland in the suburbs because it was just too expensive to live closer to work in D.C.

Emily: I don't think I've ever taken a vacation as an adult — a real vacation, not driving home or flying home for Thanksgiving to go spend three days in your mother's house.

Kirk: For me the "set it and forget it" type of savings methods have definitely been what helps. I would say that 90 percent of what I've saved has been through passive methods.

Brian: I opened a C.D. after graduating college, with my savings, and I'm putting into my 401(k). I've been treating the rest of my income as fun money, but my mind-set has really changed in the past few months. I've started to cut down on my excess spending.

Zach: What's the best and worst financial advice you've received?

Emily: I knew it was going to be bad advice when my mother prefaced it the first time with, "So, I know I'm a boomer and that means that you think that I don't know anything but …" and then she started pushing me to start looking for at least a condo to buy, or a house, even saying the classic phrase, "Don't waste your money paying your landlord's mortgage."

I said, "O.K., but then when the laundry machines stop working the same month that the heat goes out and they have to replace everything, it's also not my checkbook."

Morgan: The best advice I got was not dumping out my retirement fund to pay for my year living in London, because now I still have that. It would be bad if I had no retirement at all. It's better to take out student loans than empty your savings.

Kirk: I think "never break the habit" was the best advice I ever got. Even when you're dirt poor, just completely broke, still at least throw a dollar into your savings account. I think that building habits is so hard to do, and breaking them can be so easy to do.

Travis: I'm going to start telling my younger siblings that they have to start investing because it's so easy now with these apps like Stash. It invests $5 for you every week. I had $5 when I was 16 and that would be worth so much more now.

Zach: What about retiring hasn't come up that we should be talking about?

Mauricio: I want to question the assumption that to have a decent retirement requires a high amount of literacy right now. It doesn't have to be that way. I'm playing the game as much as anybody, and I'm doing whatever I can to save as much money for myself, but there are alternative systems that wouldn't require that every individual be thinking about this and picking the best mutual fund or that sort of thing. The older model of pensions or something like that on a national scale would mean that people can retire without having to be financial gurus by the time they're 60.

Kirk: I'm worried that we're just not on a good track. And it's not just about the Social Security rug getting pulled out from under us. It's about our own personal habits. I don't know that we're putting less into our personal savings than previous generations, but we don't have pensions to fall back on in the way that they did, and if it's all on our own behavior and our own responsibility, I think a lot of us are going to be in trouble.

Emily: What if you work a 9-to-5 making a decent salary but you're a contract worker with no access to benefits? A huge percentage of people our age are in contract positions. They're like internships. You may get to 28, 30, 35 and you're building up work history, but you're structurally not given 401(k)s or things like that.

Travis: I think it's a good idea that we do the work, but I also think it's a good example of how millennials are being told that we're lazy because we're not doing this work that no one else had to do before us. It's something that people have to get angry about and start organizing around, that all of these systemic protections are being taken apart. It's really easy to play into this narrative that millennials are doing everything wrong and they're not planning, but there's limits to individual behavior. At some point, there also has to be systemic support.

* For Millennial Investors, a Harsh Lesson in Market Gyrations

* Personal Finance for Those Who Don’t Have a Clue

Morgan Richardson, 27, near her office in Chicago. “I’m just being responsible,” she said of saving for retirement. “I have a Roth I.R.A. and I put the maximum in it annually that I can.” | Alyssa Schukar for The New York Times | Travis Olson, 27, works in Washington, D.C. He and his partner moved to Silver Spring, Md., to save money. | Lexey Swall for The New York Times

Document NYTFEED020180226ee2q002bh

The New York Times

Foreign Desk; SECTA
Low Oil Prices Spur the Saudis To Play the Field

By CLIFFORD KRAUSS
1,561 words
26 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

Saudi Arabia has long been the dominant force in oil, leaving the world at the mercy of its ambitions and its interests. Now the kingdom must refresh its strategy to reflect a weaker hand -- and in many ways, a different game.

The changing nature of the energy industry -- the oil production boom in American shale fields, the persistence of lower crude prices, and the rise of natural gas -- has transformed the geopolitical equation.

While Saudi Arabia is still a major energy producer, it must compensate for its lost revenue. And the United States, China and Russia are all circling in hopes of gaining a financial advantage.

Russia, smarting from Western sanctions and lower **oil prices**, is moving to embrace Saudi Arabia for energy deals despite their rivalry in Syria, where the two countries support competing sides. China, with its domestic oil production in steep decline, seeks a stable flow not just of Saudi oil but of Saudi investment in its growing petrochemical and refinery industries.

And Washington is willing to overlook those flirtations in the hope that Saudi Arabia will continue to be a strategic bulwark against Iran.

The desires of all three superpowers fit neatly into Saudi Arabia's strategy to find new investment partners as part of a broader push to diversify its oil-dependent economy, trim large budget deficits and secure the future of both the kingdom's welfare state and its monarchy.

The keystone to the project is the proposed initial public stock offering of Saudi Aramco, the national oil company, a deal that could be worth hundreds of billions of dollars.

The changing geopolitical game was on full display in December when Saudi Arabia's energy minister, Khalid al-Falih, braved the Russian arctic cold as President Vladimir V. Putin's guest of honor at the opening of a giant natural-gas export terminal.

For Mr. Putin, it was an audacious embrace of an American ally as he moved to expand his nation's energy riches despite the current sanctions. For Mr. al-Falih, it was a chance to discuss future gas sales, attract investment in Saudi Aramco and coordinate efforts to prop up global **oil prices**.

''If we continue to work the way we do, we will turn from rivals to partners,'' Mr. Putin told Mr. al-Falih at the public ceremony. The Saudi official readily agreed.

The ultimate success of the Saudi Aramco public offering and the entirety of the kingdom's economic reform remain in question, and progress so far has been mixed. Nevertheless, American, Chinese and even Russian financiers are entwined in a complex dance around the initial public offering, which is promised for later this year.

President Trump has publicly called for the I.P.O. to be listed in New York. A Saudi listing now appears more likely, with additional trading in London or Hong Kong. Global financiers say they want a piece of the action wherever it occurs.

The interest in the I.P.O. has given the kingdom greater leverage at a time when the Organization of the Petroleum Exporting Countries, through which it has long wielded power, has lost much of its clout.

"The Saudis are compensating for their lost power in OPEC and they are showing pure geopolitical pragmatism in their new energy and foreign policy," said Bill Richardson, a former energy secretary and ambassador to the United Nations. "But they are not just compensating for lost power. They are adding to their power in world politics."

Saudi Arabia has had a central role in global energy since at least World War II. When the kingdom created a global glut of oil to gain market share in the mid-1980s, it sent prices into a tailspin that contributed to the bankruptcy of the Soviet Union at the same time that it was financing Afghan rebels fighting the Soviets.

The kingdom was such a crucial supplier of oil to the United States that Washington went to war in the early 1990s in part to protect it from a possible Iraqi invasion. And when China needed new energy supplies for its expanding economy in the early years of the new century, Saudi Arabia was there with an ambitious oil exploration program to meet the new demand.

But OPEC can no longer control **oil prices** alone. A flood of oil from American shale fields has enabled the United States to slash imports of OPEC oil and begin exporting to markets that were once dominated by Saudi crude.

The Saudis, led by Crown Prince Mohammed bin Salman, are seeking to link cuts in OPEC production over the past two years with cuts by Russia, another oil-exporting powerhouse, to buoy prices. Over the longer term, the Saudis want to import natural gas to replace domestic consumption of oil for electricity, freeing more crude for export.

At the same time, the country is expanding its investments in refineries and petrochemical plants around Asia and the United States to guarantee markets for its crude while making additional sales of higher-value gasoline, diesel and other refined products.

"Low **oil prices** have made the Saudi way of life unsustainable, so they have to find alternatives," said Bruce Riedel, a former Middle East analyst for the Central Intelligence Agency and the author of "Kings and Presidents: Saudi Arabia and the United States Since F.D.R." "Any partner they can find that can help them do that, they are going to embrace enthusiastically."

The most surprising partner is Russia, which remains on the opposite side of the Syrian civil war and is also trying to build better relations with Iran, Saudi Arabia's bitter regional rival.

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Such deals also promote Saudi Aramco's efforts to become a global refining powerhouse. That can only increase the value of the proposed initial public offering of the company, which already produces more crude than any other in the world.

Many international banks, including JPMorgan Chase, HSBC, Goldman Sachs, Citigroup, Morgan Stanley and Credit Suisse, have been seeking to advise the kingdom and have a role in the eventual deal.

"Every global investment bank should be interested in a lead role given the quality of the company and the fact that it would be the largest I.P.O. in history," said Osmar Abib, global head of oil and gas at Credit Suisse Securities.

The kingdom has valued the company at $2 trillion, a number that investment bankers say would be realistic only if oil were worth $100 a barrel, nearly $40 more than the current price.

Many energy experts doubt that the stock offering will be completed because of persistent questions about the rule of law in Saudi Arabia, as well as the special privileges granted to Saudi royalty. They predict that members of the royal family will be reluctant to give up the confidentiality of their earnings from the company, which are now hidden from the public. At the same time, international investors have been shaken by the recent roundup of wealthy Saudis who were forced to pay large sums of money for their freedom from confinement in a hotel.

''It's going to be very hard for them to persuade anybody to buy a hunk of Aramco until they figure out how to be more transparent about the royals' take and the actual value of the company,'' said David L. Goldwyn, who was the State Department's top energy official early in the Barack Obama administration.

Saudi oil executives say the issues of valuation and governance will be worked out in the end because the crown prince and his father view the public offering as central to remaking the economy with more foreign investment.

''There is no backtracking,'' Mr. al-Husseini said. ''The I.P.O. commitment is driven by a central leadership, by people who are empowered to make decisions. It's not a winding narrow road that comes to no conclusion.''

An oil field in Saudi Arabia. The kingdom, seeking to replace revenue lost from sinking **oil prices**, has widened its circle of friends. (PHOTOGRAPH BY CHRISTOPHE VISEUX FOR THE NEW YORK TIMES) (A7)

Document NYTF000020180226ee2q00059

Business/Financial Desk; SECTB
As Economy Grows, Fed Arms Itself for the Next Downturn

By BINYAMIN APPELBAUM
909 words
26 February 2018
The New York Times
NYTF
Late Edition - Final
2
English

The Federal Reserve on Friday described recent **volatility** in **financial markets** as a brief blip and affirmed its plans to raise its benchmark interest rate in the coming months.

The Fed painted economic conditions in bright and happy colors in its biannual report to Congress on the conduct of monetary policy. It said the labor market was ''near or a little beyond full employment,'' an important milestone in the recovery from the 2008 crisis.

''The U.S. economy appears to be performing very well and, certainly, is in the best shape that it has been in since the crisis and, by many metrics, since well before the crisis,'' Randal K. Quarles, the Fed's vice chairman for supervision, said Thursday in Tokyo.

The immediate problem confronting the Fed is how quickly to raise interest rates. The Fed forecast in December that it would raise rates three times in 2018, just as it did in 2017. Fed officials say stronger growth is fortifying those intentions, and the next rate increase is expected in March. A growing number of Wall Street analysts predict the improving economic forecast will persuade the Fed to raise rates four times this year.

The hot topic on Friday, however, at a conference attended by several Fed officials in New York, was whether the Fed would be ready for the next economic downturn.

The Fed's benchmark rate is in a range of 1.25 percent to 1.5 percent, and the Fed does not expect it to rise much higher than 3 percent in the current economic expansion. That's a problem given that, in the last four downturns, the Fed has cut rates by an average of 5.5 percentage points to stimulate renewed growth.

During the last downturn, the Fed reduced the benchmark rate to nearly zero in 2008, and then supplemented its efforts by pledging to keep interest rates at a low level and by purchasing large quantities of Treasuries and mortgage-backed bonds.

Fed officials have said that those policies benefited the economy, and could be used again during a future downturn. Other central banks have relied on similar policies in recent years, and have reached similar conclusions. BenoÃ®t CÅ“urÃ©, a board member of the European Central Bank, said economic research was ''fairly clear'' that such asset purchases helped to hold down interest rates.

But the main paper presented at the conference on Friday, which is hosted by the University of Chicago's Booth School of Business, asserted that bond-buying had little economic benefit.

''Our conclusion is that the most important and reliable instrument of monetary policy is the short term interest rate,'' wrote the authors, a team of two academics and two bank economists-

The danger of a rapid return to near-zero interest rates seemed particularly acute in the immediate aftermath of the 2008 financial crisis, as the Fed repeatedly delayed any increase in rates. Now, the economy has gained strength and the Fed has raised rates five times. Jan Hatzius, chief economist at Goldman Sachs, said the progress showed the Fed's policies had helped, and that the Fed might be able to raise interest rates above current expectations.

''My own view about what is possible at the zero lower bound is quite a bit more optimistic than it was back then,'' Mr. Hatzius said.

An account of the Fed's most recent policymaking meeting, in January, reported that some officials had shared that optimism, expressing the view that the Fed might be able to increase its benchmark rate somewhat closer to its precrisis level.

Nonetheless, there is growing support among Fed officials for a review of the Fed's approach to policy, and of alternatives that might allow it to respond more forcefully to future downturns.

Loretta Mester, the relatively conservative president of the Federal Reserve Bank of Cleveland, told the conference she favored starting such a study "later this year."

The Fed aims to keep inflation at an annual pace of 2 percent a year, by raising and lower interest rates and by training the public to expect a certain level of inflation, disciplining the pricing decisions of businesses and the wage demands of workers.

Alternative approaches fall into two broad categories: Permanently replace the Fed's 2 percent target, or set it aside in the aftermath of downturns.

Raising the target is a simple way of creating more room to respond to crises. Interest rates include expected inflation, so higher inflation would raise rates.

Embracing higher inflation, however, could cause political problems for the Fed.

Alternatively, the Fed could tolerate higher inflation on a temporary basis. For example, the Fed could aim to maintain average inflation at 2 percent over some specified period, meaning that it would compensate for periods of lower inflation, as during the last six years, by allowing periods of higher inflation, thus maintaining a 2 percent average.

Last year, the Fed began to include a comparison between its actual management of interest rates, and the results produced by alternative approaches to monetary policy.

The report on Friday included an inflation-averaging approach among those alternatives for the first time.

Follow Binyamin Appelbaum on Twitter @bcappelbaum.

Jerome H. Powell, the chairman of the Federal Reserve, which is confronting the question of how quickly to raise interest rates. (PHOTOGRAPH BY JOSHUA ROBERTS/REUTERS)

Document NYTF000020180226ee2q0003y

International New York Times

business

Lower Oil Prices Force Saudis to Widen Their Circle of Friends

By CLIFFORD KRAUSS
1,606 words
25 February 2018
International New York Times
INHT
English

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PHOTO: An oil field in Saudi Arabia. The kingdom, seeking to replace revenue lost from sinking **oil prices**, has widened its circle of friends. (PHOTOGRAPH BY CHRISTOPHE VISEUX FOR THE NEW YORK TIMES) (A7)

* From Oil to Solar: Saudi Arabia Plots a Shift to Renewables

* Investors Worldwide Size Up Palace Intrigue in Oil-Rich Kingdom

* Trump Pushes for Record-Setting Saudi Aramco I.P.O. in U.S.

* ‘Transformation Is Happening’: Saudi Aramco’s Chief on Future of Oil

Document INHT000020180227ee2p0000s

The New York Times

Money and Business/Financial Desk; SECTBU
Federal Law Gives Municipal Bonds a New Allure

By CARLA FRIED
1,308 words
25 February 2018
The New York Times
NYTF
Late Edition - Final
10
English

For many people with hefty state and local tax bills, the new federal tax law gives municipal bonds a powerful new appeal.

That is because the new law caps the state and local tax deduction that can be claimed on federal returns at $10,000. For many households, that cap will outweigh any potential benefits from other changes in the law.

For such people, tax-free investment income becomes ever more valuable -- and municipal bonds can fit the bill.

The interest income paid on municipal bonds is exempt from federal tax. And if you own municipal bonds issued within your state, the interest income can also be free of state (and often local) tax.

What's more, the economic backdrop for 2018 could make municipal bonds one of the better slices of the fixed-income market. Municipal bonds are less sensitive to interest rate changes than, say, Treasury bonds, whose yields have been rising as Federal Reserve interest rate policy shifts, and with glimmers of inflation getting off the floor.

A high-grade, 10-year municipal bond issue currently has an average yield of roughly 2.5 percent. That compares with a 3.3 percent taxable yield for someone in the 24 percent federal tax bracket, and 4 percent for a taxpayer paying the top federal rate of 37 percent. The taxable equivalent yield is even higher if the income is also exempt from a state tax.

By comparison, the yield on a **10**-**year Treasury bond** is below 3 percent and the yield on the Vanguard Total Bond Market Index fund, which invests in taxable government and corporate bonds, was recently only 2.5 percent.

Despite the appeal of munis, though, you need to be careful: The muni market can be tricky.

For one thing, amid fiscal belt tightening since the financial crisis, the pace of new municipal bonds hitting the market has declined. The tax law revision also eliminated advance refunding issues, a type of municipal bond financing that accounts for around 15 percent of the market, intensifying supply constraints.

At the same time, individual investors own about 70 percent of the municipal bonds, and demand from them seems likely to remain strong. Morningstar Direct reported $34 billion in net inflows to municipal bond funds and exchange-traded funds in 2017 -- even before investors in high-tax states had the chance to huddle with their advisers to assess the impact of the new tax law.

With hungry investors chasing a smaller pool of municipal issues, the prices of bonds are likely to be bid higher. (In the world of bonds, yields move in the opposite direction from prices; so higher **bond prices** mean lower yields.)

That pressure has already caused the yield difference between municipal bonds and comparable Treasuries to widen -- reducing the muni advantage. For much of the last decade, the tax-free yield on a 10-year high-grade municipal bond was at least 90 percent of the taxable yield on a **10**-**year Treasury**. That ratio is now down to the low 80s. Hugh McGuirk, head of the municipal bond team at T. Rowe Price, expects that this ratio will "be even under more pressure" as a result of these supply and demand issues.

Municipal bonds issued within your home state can be enticing because of the extra tax features. Around one-quarter of the nearly $700 billion in muni bond funds and E.T.F.s is invested in single-state portfolios, according to Morningstar Direct.

But Adam Stern, co-head of research at the fixed-income specialist Breckinridge Capital Advisors, cautioned that sticking with in-state issuers could be difficult. "In California, where there are hundreds of different issuers, you can create a pretty-well-diversified portfolio. But a state like New Jersey is a little tougher. With fewer issuers, it's harder to figure out a diversified portfolio."

Mr. McGuirk said the national funds run by T. Rowe Price usually own issues backed by 250 to 300 guarantors, compared with just 60 to 80 for single-state funds. Owning out-of-state bonds in a national fund can provide diversification, though you will pocket only the federal interest-income tax break, and have a liability for state and local taxes. Bonds from five states account for about half the assets in the Fidelity Intermediate Municipal Income fund, which has a recent yield of 2.6 percent.

High-yield municipal bonds carry more risk, but John Miller, co-head of fixed income at Nuveen Asset Management, expects them to have a solid 2018, mainly because he does not see a recession on the near-term horizon. With low unemployment and rising home values, the vast majority of municipalities are seeing tax revenue increase.

"Ninety-nine percent of last year's default were in Puerto Rican issues," he said. "All other defaults were less than $1 billion." That's a rounding error in a $3.8 trillion market.

Actively managed high-yield muni funds actually invest mainly in high-grade issues, with a heavy seasoning of high-yield. The average high-yield municipal fund currently has about 60 percent of its assets parked in investment-grade bonds, according to Morningstar Direct. T. Rowe Price Tax-Free High Yield fund, which earns a top Morningstar analyst rating, currently has about 62 percent invested in high-grade issues. Vanguard High-Yield Tax Exempt fund has more than 80 percent invested in high-grade bonds. Still, both portfolios have current yields above 3.7 percent.

Troubles loom on the horizon, though.

Underfunded state and local pensions are a festering issue for muni bonds. Chicago's woes are well known, but even New York City is under some financial pressure. The fiscal health of issuers determines their credit rating; if that rating falls, so will the price of its bonds.

Moreover, the $10,000 federal cap on state and local tax deductions may make it harder for local officials to sell tax increases. If residents balk at higher taxes, future revenue increases will increasingly be generated through less-predictable fees and fines. Over time, that sort of shift could impair a city's or state's financial health. "It may be a subtle year-over-year change where the cumulative impact over a decade could be meaningful," said Mr. Stern of Breckinridge.

That would hurt general obligation municipal bonds, which are backed by the taxing power of a municipality. Mr. McGuirk of T. Rowe Price said that while these bonds account for about one-third of new muni issues annually, his firm's municipal bond funds usually have 15 percent or less invested in them.

"That's our long-term concern, baked in for the challenges of state and local issuers to finance obligations," he said. It is a concern that seems to be shared by many managers; according to Morningstar Direct, the average muni fund allocates 15 percent to those bonds.

Another type of muni, a general revenue issue, is an alternative. Such bonds rely on the income generated by a specific project, like a water and electricity project. That income source could be quite reliable, because households and businesses are likely to keep paying their utility bills. For households now facing higher personal income tax bills because of the reduction in the state and local income tax break, these bonds might rate as essential tools to generate tax-free income.

Hugh McGuirk, the head of the municipal bond team at T. Rowe Price. Municipal bonds that rely on income from projects, like transit upgrades, to cover interest payments could be more reliable after tax reform than bonds tied to tax revenue. (PHOTOGRAPHS BY ANDREW MANGUM FOR THE NEW YORK TIMES; HILARY SWIFT FOR THE NEW YORK TIMES)

Document NYTF000020180225ee2p0007l

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Washington Wire

295 words
24 February 2018
The Wall Street Journal
J
A5
English

WHITE HOUSE

Vehicle Crashes Into

White House Barrier

A woman drove a passenger vehicle into a security barrier Friday near the White House and was immediately apprehended, the Secret Service said.

The vehicle didn't breach the barrier near the White House complex and no shots were fired in the incident, the Secret Service posted on Twitter.

The incident took place at a security barrier on the west side of the White House. The Secret Service referred a request for further details to its tweets.

The White House building and its surroundings have been a regular target for fence-hoppers and others who wish to disrupt the government or potentially talk to or harm the president.

-- WSJ roundup

FEDERAL RESERVE

Fed Seems Unfazed

By Market **Volatility**

The Federal Reserve signaled Friday it is unperturbed by the **volatility** in **financial markets** earlier this month and remains on track to raise rates gradually this year.

In its semiannual monetary policy report to Congress, the Fed said it still sees equity prices as elevated despite the selloff in early February, but noted that "overall vulnerabilities in the U.S. financial system remain moderate on balance."

Stock-price pressures edged up from already elevated levels over the second half of 2017, the Fed said, and are higher than would be expected given the current level of longer-term Treasury yields. The Fed attributed the increase in part to growing anticipation of the boost to earnings from the $1.5 trillion tax cut enacted at the end of 2018.

The Fed said it continues to view wage gains as moderate, "likely held down in part by the weak pace of productivity growth in recent years."

-- Kate Davidson

Document J000000020180224ee2o0002n

THE WALL STREET JOURNAL.
U.S. EDITION

Streetwise: Bonus in Higher Bond Yields

By James Mackintosh
940 words
23 February 2018
The Wall Street Journal
J
B11
English

Little matters more to shareholders now than interpreting the message from the bond markets. After the scare at the start of the month that knocked 10% off U.S. stocks, there are indications of possible good news hidden in rising bond yields. Yet, the danger remains that massive tax cuts will push up yields to the point where they become bad for shares -- and identifying that point is one of the big challenges for investors.

Start with the potential good news: Bond investors seem finally to be anticipating stronger growth in the real economy and a better long-term outlook, a sharp change from the previous assumption that the main effect of U.S. tax cuts would be to boost inflation.

Investors have pushed up real **10**-**year Treasury** yields this month, while inflation expectations finally stopped rising. Bond markets appear to be anticipating more productivity-boosting investment, which would make the tight jobs market less likely to spark inflation.

Even better, real yields on **30**-**year Treasury** inflation-protected securities, the longest-dated U.S. bonds, have also been rising, reversing a decline that set in last summer. Investors are pricing in a better long-term outlook, which would make higher Federal Reserve interest rates possible without damaging the economy -- or stock prices.

This good news comes with caveats. It is never a good idea to read too much into a three-week move, even one that has pushed 30-year yields almost all the way back up to where they stood in July. The bond market believing in a better economy doesn't make it so, either. Finally, the move can be interpreted a different way, as a reward for rising uncertainty about where long-run interest rates will eventually land. If rising yields reflect doubts about secular stagnation, that isn't nearly as good for stocks as the belief that the postcrisis economic torpor is finally in the past.

Certainly economists are treating White House forecasts of a productivity renaissance with skepticism. Nathan Sheets, chief economist at PGIM Fixed Income and a former Treasury official, expects the Trump tax cuts to boost economic growth by 0.5 percentage point or a little more for each of the next two years. But he predicts only an annual 0.1 point extra on long-run potential growth, resulting from higher corporate investment.

The huge federal deficits likely to be incurred in the latest U.S. budget come at a time when the jobs market is already tight and there are signs that wage rises may finally be accelerating.

The tax cuts add fiscal fuel only poured in this amount into a late-cycle economy twice since World War II, according to Gerard Minack, of Sydney-based Minack Advisors: the Vietnam War spending of the late 1960s and the 1986 Reagan tax cut. In both periods, bond yields rose sharply as inflation picked up, while stocks soared, plunged and then soared again before the eventual recession.

The problem for shareholders watching the bond market is that rising inflation expectations are good for stocks until they are bad. One theory for why is simple enough: When investors are worried about deflation, higher inflation reduces the danger and so helps stocks even as it pushes up bond yields. Deflation fears have now gone away, so the question is at what point inflation fears will take over, and rising bond yields will be bad for stocks.

One answer is when yields reach the point that they anticipate the Fed actively trying to slow the economy. Higher yields will no longer mean higher profits, leaving nothing to offset the hit to valuations that comes with a higher discount rate.

In economic terms this means bonds being priced for an interest rate above the so-called neutral rate, either because inflation is getting out of hand or because the Fed has made a mistake; either would be bad for both shares and bonds. Fed policy makers estimate the long-run neutral fed-funds rate is 2.8%, about where the 10-year currently stands, but bonds typically offer extra yield to compensate for uncertainty over their term.

Credit Suisse's chief U.S. equity strategist, Jonathan Golub, thinks the switch happens at a 10-year yield of 3.5%, above which further rises start to be progressively worse for stocks. He derives the number by looking at how stocks performed just on days when yields rose, with a strong relationship since 2014 showing stocks gained less the higher yields were.

In the past the number was much higher, averaging above 7% since 1980, but Mr. Golub says it has dropped because investors, like the Fed, think a weaker economy can't cope with such high rates as it once could.

Bank of America Merrill Lynch analysts say the "sweet spot" for shares is a **10-year Treasury** yield between 1% and 3%, with stocks more likely to fret about rises above that.

Investors shouldn't get hung up on any precise number, as the turning point is inherently uncertain and shifts with changing beliefs about the economy.

What is more certain is that there is a regime shift under way. In the past few years, investors justified buying shares at very high valuations because bonds looked even worse. As Treasury yields rise, expensive shares will look less attractive -- so companies will need the prospect of big rises in profits to maintain their appeal. The more it is real rather than nominal bond yields rising, the better for shareholders.

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Document J000000020180223ee2n00032

The New York Times

The Upshot
Why Markets Have Gotten So Jumpy

By Neil Irwin
1,047 words
23 February 2018
05:01 AM
NYTimes.com Feed
NYTFEED
English

To understand why global **financial markets** have been so **volatile** the last few weeks, imagine a town full of farmers who have been living through a decade-long drought.

The first few years of the drought, they probably adapted by shifting to crops that could grow without much water, but at the same time they probably kept renewing their flood insurance. After all, the drought could end at any time, and losses caused by too much water are every bit as painful as those caused by too little.

But after years and years of writing checks for flood insurance, our farmers might get a little tired of throwing money away to protect against a risk that never seems to materialize. By the seventh or eighth year of the drought, they might just say “forget it” and let flood insurance lapse.

Then, with the 10-year mark approaching, it rains. Not very hard: Imagine a perfectly normal rainstorm by pre-drought standards, not enough to cause a flood, but enough to make the farmers think flooding just might be a possibility again.

What would the farmers do? There’s a good chance that they would call their insurance broker and very quickly, even desperately, sign up for flood insurance once again.

And that helps explain why the markets have been so topsy-turvy of late.

Rain, in this metaphor, is inflation — and the decade-long drought is the near-decade that global inflation and interest rates have been persistently low.

In the last few months, there have been the earliest stirrings that this situation could — emphasis on could — be on track to change. A tax bill was passed in December that is expected to act as an economic stimulus in the short run. The January employment report reflected fairly strong growth in average hourly earnings. The Consumer Price Index came in a little higher than forecasters had been expecting.

When you pick apart the shifts in the **financial markets**, they are consistent with the idea that investors are not yet betting on an inflationary flood but are opening their minds to the idea that it could happen.

For example, by comparing the prices of regular Treasury bonds with inflation-protected bonds, you can get a sense of how worried investors are about inflation. On Dec. 1, those prices were such that an investor would break even if from five to 10 years in the future — December 2022 through December 2027 — consumer prices rose 1.78 percent a year.

That has now risen to 2.21 percent, which is quite a large swing by the standards of the generally staid bond market.

Here’s an important wrinkle: While economists often talk about those numbers as a measure of investors’ inflation expectations, they can just as easily be a measure of investors’ level of worry about inflation risk. What’s the difference? One is about what seems likely to happen, while the other is about an increase in the chances of an unlikely — but costly — outcome.

Back to the drought metaphor: The farmers might still think that another dry year is the most likely result, but if recent showers make them worry more about the risk of flooding, and they all try to buy insurance at the same time, this drives up the price. That seems to be what has happened in the last two months in the market for inflation-protected bonds, which essentially function as insurance against future rises in prices.

This framework also helps explain why there have been such big swings in **financial markets** lately.

Analysts at Deutsche Asset Management noted recently that government bonds from the United States and Germany — generally considered some of the world's bedrock safe assets — have been more **volatile** lately than bonds issued by emerging market countries like Indonesia and Mexico.

And the Standard & Poor's 500 has moved more than 1 percent on eight of 16 trading days in February thus far, which doesn't make much sense if you're looking for fundamentals-based reasons for such big moves in stock prices. It makes more sense if you believe that investors are trying to extrapolate from tiny fragments of information the potential risk of a radically different economic and **financial market** environment in the years ahead.

The swings in stock prices appear to be intimately linked to movement in long-term interest rates, which in turn hinges on those expectations of inflation and how the Federal Reserve will respond if inflation does rise.

On Wednesday, for example, the **stock market** had been on track for a sharply positive day until the Fed released minutes of its last policy meeting at 2 p.m. Soon after, the **stock market** plunged and bond yields rose, as investors evidently concluded that the Fed was inclined toward a somewhat faster rate of interest rate increases than had been assumed.

But you can also interpret swings like that one as a result of investors trying to draw big conclusions about the economic future from incremental pieces of information.

In December, Fed officials projected that the main interest rate the central bank targets would be 2.8 percent in the longer run. But when it first started publishing its consensus of that number, in June 2015, it was 3.8 percent. If the economy evolves in a direction that causes the earlier estimate to prove more accurate, it implies that a wide range of assets are priced incorrectly (in particular, it would mean that prices for long-term bonds should be a lot lower and their yields higher).

So as long as this pattern continues, you can interpret every day's economic news and market swings as a referendum on which state of the world is more likely. Are we still in the world of 2009 to 2017, in which inflation and interest rates stayed low and asset prices continued their steady rise? Or are we returning to the pre-2008 levels of each, a possibility that is perhaps less probable but would be hugely consequential if it happens?

If that world does arrive, the people who re-upped their flood insurance at the first sign of rain will be glad they did.

Document NYTFEED020180223ee2n002q0

The New York Times

Business/Financial Desk; SECTB
Industrials Drive U.S. Markets Mostly Higher

By THE ASSOCIATED PRESS
619 words
23 February 2018
The New York Times
NYTF
Late Edition - Final
5
English

Stocks in the United States closed mostly higher Thursday after a late-afternoon wave of selling erased much of a midday rally.

Gains in industrial companies and other sectors outweighed losses in banks and health care stocks. Energy companies also rose after crude **oil prices** recovered from an early slide.

Bond yields declined after spiking to four-year highs a day earlier amid rekindled fears of higher inflation and interest rates.

"The yields easing back a little bit is probably reassuring people on a very short-term kind of basis," said Erik Wytenus, global investment specialist, J.P. Morgan Private Bank. "That big, nasty intraday reversal yesterday was probably a little bit excessive."

The **Standard & Poor's 500**-**stockindex** rose 2.63 points, or 0.1 percent, to 2,703.96. The **Dow Jonesindustrial average** gained 164.70 points, or 0.7 percent, to 24,962.48. The 30-company average was up briefly by more than 350 points. The Dow and the **S**.**&P**. **500** snapped a two-day losing streak.

The **Nasdaq** had been up much of the day, but closed lower. It fell 8.14 points, or 0.1 percent, to 7,210.09.

The stock indexes are on track to close lower for the week.

Bond prices rose. The yield on the **10**-**year Treasury** fell to 2.92 percent from a day earlier, when it climbed to 2.95 percent, the highest level since January 2014. Wednesday's spike in bond yields came after the Federal Reserve's minutes from its January policy meeting showed **bullish** sentiment among policymakers, confirming their intention to raise interest rates this year.

Higher yields generally hurt stock prices by making bonds more appealing to investors. They also make it more expensive for people and companies to borrow money. Earlier this month, global stock markets, particularly those in the U.S., suffered big losses amid mounting concerns over the pace of inflation and Fed policy tightening.

"**Volatility** is back, and I actually would argue that it's a healthier state of affairs," Mr. Wytenus said. "The constant melt-up that we saw in 2017 is actually quite historically abnormal."

Shares in industrials companies posted solid gains. United Technologies rose after its chief executive said management is looking into the possibility of splitting up the industrial conglomerate into three separate businesses. The stock rose $4.32, or 3.3 percent, to $133.58. Caterpillar also notched gains, climbing $3.63, or 2.3 percent, to $158.86.

Investors bid up shares in several companies that reported encouraging results or outlooks.

Chesapeake Energy was the biggest gainer in the **S**.**&P**. **500**, vaulting 57 cents, or 21.7 percent, to $3.20. The company led an energy sector rally.

Avis Budget Group shares also got an earnings boost. The car rental company added $5.24, or 13.4 percent, to $44.20.

Roku slumped 17.7 percent after the video streaming device company's latest guidance disappointed analysts. The stock lost $9.05 to $42.05.

Banks and other financial stocks lagged the most. Brighthouse Financial slid $2.27, or 4 percent, to $55.17.

Benchmark United States crude recovered from an early slide, adding $1.09, or 1.8 percent, to settle at $62.77 a barrel in New York.

The dollar slid to 106.75 yen from 107.65 yen on Wednesday. The euro strengthened to $1.2324 from $1.2288.

Gold rose 60 cents to $1,330.60 an ounce.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Thursday. (Source: Reuters)

Document NYTF000020180223ee2n0005f

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Fed's Dudley Warns on Mania Around Cryptocurrencies

By Michael S. Derby
517 words
23 February 2018
The Wall Street Journal
J
A2
English

Federal Reserve Bank of New York President William Dudley warned that investing in privately issued digital money such as bitcoin could end in big financial losses for those involved.

"There is a bit of a, I would say, speculative mania around cryptocurrencies in terms of their valuations, which I view as pretty dangerous, because I don't really see what the actual true underlying value of some of these cryptocurrencies actually is in practice," Mr. Dudley said Thursday in New York.

For privately issued digital money, "it's essentially what people think it's worth, which seems to me somewhat dangerous," Mr. Dudley said. He spoke at a press briefing on the progress of recovery efforts in Puerto Rico and the U.S. Virgin Islands since last year's destructive hurricanes. He was responding to a question about cryptocurrency advocates setting up shop in Puerto Rico's economy.

Mr. Dudley appeared to ramp up central bankers' warnings on the issue, after months of heavy **volatility** and frenzied activity throughout the young world of these unregulated digital currencies. Digital currencies exist exclusively in electronic form, and aren't connected to governments and their policy decisions.

European Central Bank President Mario Draghi earlier this month warned that digital currencies should be regarded as "very risky assets."

Bank of England Governor Mark Carney on Monday said bitcoin had "pretty much failed thus far" as a form of money, Reuters reported.

Bitcoin's ride has been a wild one. Over the past year, its price has ranged from a low of $945.59 on March 20, 2017, to the Dec. 18 high of $19,501.03, and it has plummeted since to just under $10,000.

While Mr. Dudley warned about potentially serious consequences for individual investors, Fed officials have largely shrugged off the tumult as no danger to the financial system.

The Fed's vice chairman for supervision, Randal Quarles, said in November, "While these digital currencies may not pose major concerns at their current levels of use, more serious financial-stability issues may result if they achieve wide-scale usage."

According to the website CoinMarketCap, all private digital currencies now total just under $450 billion, compared with Fed data that says there is around $1.6 trillion in U.S. currency now circulating.

Digital currency supporters have touted the virtual money as a way to sidestep what they see as too much state control of economies. They also see private digital money as a way to enhance privacy and make the payment system more efficient.

But Fed officials have signaled doubts about the benefits. Central bankers have said repeatedly the U.S. dollar is largely stable and universally accepted.

Bert Ely, a banking consultant, said Mr. Dudley is "dead on target" with his warning. Mr. Ely pointed to evidence that many cryptocurrency investors have been borrowing to buy digital money. That means that as losses pile up, these people are likely to suffer real financial pain.

Document J000000020180223ee2n0004k

THE WALL STREET JOURNAL.
U.S. EDITION

Why America Is Going Broke

By John F. Cogan
1,031 words
22 February 2018
The Wall Street Journal
J
A17
English

The federal deficit is big and getting bigger. President Trump's budget estimates a deficit of nearly $900 billion for 2018 and nearly $1 trillion (with total spending of $4.4 trillion) for 2019. Its balance sheet reveals that the public debt will reach $15.7 trillion by October. This works out to $48,081.61 for every man, woman and child in the U.S. That doesn't count unfunded liabilities, reported by the Social Security and Medicare Trustees, that are four times the current public debt.

How did the federal government's finances degenerate this far? It didn't happen overnight. For seven decades, high tax rates and a growing economy have produced record revenue, but not enough to keep pace with Congress's voracious appetite for spending. Since the end of World War II, federal tax revenue has grown 15% faster than national income -- while federal spending has grown 50% faster.

While most Americans are aware of the budgetary importance of entitlements, the accompanying chart clarifies the magnitude of the problem. It shows the importance of entitlements in determining past and present budget trends, and where they will take us if Congress fails to reform them.

The chart shows federal spending relative to gross domestic product since World War II, broken into three categories. Entitlements are depicted in red. This includes Social Security, Medicare, Medicaid, disability insurance, food stamps and a host of other welfare programs. National defense is shown in blue. All other nondefense spending is in yellow. Interest on the public debt isn't included. Because of currently low rates, interest payments amount to less than half what the government spends on all other nondefense programs.

As the chart makes clear, all -- yes, all -- of the increase in federal spending relative to GDP over the past seven decades is attributable to entitlement spending. Since the late 1940s, entitlement claims on the nation's output of goods and services have risen from less than 4% to 14%. Surprising as it may seem, the share of GDP that is spent on national defense and nondefense discretionary programs combined is no higher today than it was seven decades ago.

The contrast between the long-term increase in entitlement spending and the long-term decline in defense spending reflects the profound transformation of the federal government's priorities from providing for the nation's defense to redistributing income. The Vietnam War, President Reagan's defense buildup, and the Iraq and Afghanistan wars were costly, but the increase in defense spending in each case pales in comparison with the astonishing growth in entitlement spending.

If you're seeking the reason for the federal government's chronic budget deficits and crushing national debt, look no further than entitlement programs. Show the accompanying chart to your friends or acquaintances who continue to assert that defense spending is causing the budget deficit. Since the early 1970s, entitlements have been the federal budget's largest spending category, the sole source of the federal budget's growth relative to GDP, and the primary cause of chronic budget deficits.

Today, entitlement spending accounts for nearly two-thirds of federal spending. Defense spending still only accounts for about a sixth of the federal budget, even with recent increases. Defense spending could be doubled and it would still be only half what the federal government spends on entitlements. Significant reductions in the budget deficit can only be achieved by restraining the growth of entitlement spending.

History shows that such restraint is not possible without presidential leadership. Unfortunately, President Trump has failed to step up. His budget proposes to shave a mere 1% from entitlement spending that is growing at 6% a year. The president has ruled out any significant reform of Social Security and Medicare, the two largest entitlement programs. His budget shows that this year Social Security and Medicare expenditures will exceed the payroll taxes and premium payments dedicated to supporting them by $420 billion. Social Security and Medicare deficits will account for half this year's total budget deficit.

The situation is no better at the other end of Pennsylvania Avenue. Democrats are getting domestic spending increases and Republicans are getting increases to the defense budget. Instead of offsetting higher spending with reductions elsewhere, Congress simply increased both defense and domestic spending in the recently enacted continuing resolution to fund the government. At the same time, by eliminating the need to vote on a debt ceiling this year and ruling out the reconciliation process for any budget bill, Congress signaled that it has no stomach for entitlement restraint.

The continuing resolution's two-year spending binge has been rightly criticized as excessive. But the size of the increase in spending it authorizes should be kept in perspective. The Congressional Budget Office estimates that the resolution will add $174 billion in discretionary spending to the budget in 2019, the year of its maximum impact. At the same time, entitlement expenditures will automatically increase by about the same amount.

What about the future? Social Security and Medicare expenditures are accelerating now that baby boomers have begun to collect their government-financed retirement and health-care benefits. If left unchecked, these programs will push government spending to levels never seen during peacetime.

Financing this spending will require either record levels of taxation or debt. Economics teaches us that high tax rates reduce economic growth and living standards. History teaches us that high public debt aggravates economic **volatility** and makes a country's financial system more prone to crisis. Congress can avoid these harmful outcomes only by taking action soon. Its first step should be to send the president's budget proposal back with a request that he come up with a plan to rein in entitlement spending.

Mr. Cogan is the Leonard and Shirley Ely Senior Fellow at Stanford University's Hoover Institution and author of "The High Cost of Good Intentions: A History of U.S. Federal Entitlement Programs" (Stanford University Press, 2017).

(See related letters: "Letters to the Editor: One Man's Entitlement is Another's Lifeline" -- WSJ Feb. 27, 2018)

Document J000000020180222ee2m0000c

The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB
A Scare From Bond Yields Keeps the Market in Check

By THE ASSOCIATED PRESS
895 words
22 February 2018
The New York Times
NYTF
Late Edition - Final
2
English

U.S. stocks closed broadly lower Wednesday, erasing an early gain, as investors reacted to a late-afternoon surge in bond yields.

Bond yields climbed to their highest level in four years after the Federal Reserve released minutes from its latest policy meeting. The minutes showed **bullish** sentiment among policymakers, confirming their intention to raise interest rates this year.

The yield on the **10**-**year Treasury** note rose sharply after the minutes came out, touching 2.95 percent, its highest level since January 2014. Higher bond yields indicate investors expect more risk of inflation. They also can threaten stock prices by making bonds more appealing versus stocks.

"We're moving back to normal **volatility**, we're moving back toward normal interest rates, normal inflation," said Erik Davidson, chief investment officer for Wells Fargo Private Bank. "This is what normal looks like."

The **Standard & Poor**'**s500 index** fell 14.93 points, or 0.5 percent, to 2,701.33. The **Dow Jonesindustrial average** lost 166.97 points, or 0.7 percent, to 24,797.78. The blue chip average had been 300 points higher before the late-afternoon slide.

The **Nasdaq** gave up 16.08 points, or 0.2 percent, to 7,218.23. The Russell 2000 index of smaller-company stocks shed most of its gains from earlier in the day. It inched up 1.84 points, or 0.1 percent, to 1,531.84.

The major stock indexes started the day on pace to recoup some of the market's losses from a day earlier as investors sized up the latest crop of company earnings.

Technology companies, retailers and industrial stocks led the way for much of the day. The rally kicked into a higher gear shortly after the Fed minutes release.

Traders appeared to initially welcome the details in the meeting minutes, which show that a majority of Fed officials at the meeting believed that improving global economic prospects and the effects of recently passed tax cuts had raised the prospect for solid economic growth and for continued interest rate increases in 2018.

The Fed did not raise rates at the January meeting, which occurred before the February **stock market** plunge and turbulence.

Then bond yields began to climb, and the **stock market** rally began to evaporate. For a while, bank shares jumped in response to the rise in bond yields, which can benefit banks by allowing them to charge higher interest rates on loans. But soon banks stocks also slid into the red.

The yield on the **10**-**year Treasury**, which is used as a benchmark for mortgages and other loans, has been rising in recent months from a recent low of 2.04 percent in September.

The pickup in yields has begun to make bonds more attractive as an alternative to stocks, which makes some investors uneasy.

Despite the broader market slide, investors bid up shares in some companies that reported better-than-expected earnings or outlooks Wednesday.

Advance Auto Parts vaulted 8.2 percent after reporting better earnings than analysts were expecting. The stock was the biggest gainer in the **S&P 500**, adding $8.65 to $114. Shares in rival auto parts retailer AutoZone also rose, climbing $6.26, or 0.9 percent, to $719.49.

La-Z-Boy also got a lift from its latest quarterly report card, rising $2.85, or 9.9 percent, to $31.75.

Walmart shares continued to slide Wednesday, a day after posting its biggest single-day drop in 30 years. The stock lost $2.59, or 2.8 percent, to $91.52.

Devon Energy slid 11.8 percent after the energy company disclosed a smaller-than-expected profit and 2018 forecast that raised concerns with analysts. The stock gave up $4.08 to $30.57.

Benchmark U.S. crude fell 11 cents to settle at $61.68 per barrel in New York. Brent crude, used to price international oils, rose 17 cents to close at $65.42 per barrel in London.

In other energy futures trading, heating oil was little changed at $1.93 a gallon. Wholesale gasoline added a penny to $1.76 a gallon. Natural gas rose 4 cents to $2.66 per 1,000 cubic feet.

The dollar rose to 107.78 yen from 107.30 yen on Tuesday. The euro weakened to $1.2300 from $1.2336.

Gold rose 90 cents to $1,332.10 an ounce. Silver added 18 cents to $16.62 an ounce. Copper gained 3 cents to $3.22 a pound.

Major indexes in Europe ended mostly higher. Germany's DAX slipped 0.1 percent, while France's CAC 40 rose 0.2 percent and Britain's FTSE 100 added 0.5 percent.

In Asia, Japan's Nikkei 225 index climbed 0.2 percent and Hong Kong's Hang Seng gained 1.8 percent. Australia's S&P ASX 200 edged 0.1 percent higher. The Kospi in South Korea added 0.6 percent. India's Sensex gained 0.3 percent. Shares in Southeast Asia were mixed.

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

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Wednesday. (Source: Reuters)

Document NYTF000020180223ee2m0000u

THE WALL STREET JOURNAL.
U.S. EDITION

Index of 500 Stocks Is Powered by Just 3

By Akane Otani
898 words
22 February 2018
The Wall Street Journal
J
A1
English

Three technology titans have powered nearly half of the **S&P 500**'s advance this year, a worrying sign for investors expecting a strengthening economy to lift shares of manufacturers, oil companies and other businesses whose fortunes typically improve with growth.

Amazon.com Inc. accounted for 27% of the broader index's 1.6% gain through Tuesday, according to S&P Dow Jones Indices' data. The online retailer is followed by Microsoft Corp., which contributed 13%, and Netflix Inc. at 8.3%.

U.S. stocks fell Wednesday, but Amazon and Netflix extended their 2018 gains, adding to their dominance over the **S&P 500**.

"When you see a Netflix or Amazon leading, it's not necessarily a great sign of investor confidence, since you know those names can always deliver growth no matter what's going on," said Jack Ablin, founding partner and chief investment officer at Cresset Wealth Advisors.

Investors have fretted in recent years about the dominance of a single sector or stock in the market, but those fears have generally proved unfounded. Markets continued marching higher even after shares of Apple Inc., which was a driver of the rally, stalled for part of 2016.

The **S&P 500** technology sector has driven more than three quarters of the index's gains, according to S&P Dow Jones Indices. The next biggest contributor is the consumer-discretionary sector -- which includes tech-focused Amazon and Netflix -- with more than a third of the advance.

To some investors, the continued outperformance of technology-oriented companies is surprising. After the tech sector jumped 37% in 2017, nearly doubling the broader **S&P 500**'s advance, many investors expected the rally to stall or be overtaken by other industries.

Among those expected to gain were cyclical stocks like commodity producers, manufacturers and banks whose businesses tend to improve as the economy strengthens and prices rise.

Instead, energy shares have extended their rout, even as U.S. crude prices have bounced off their 2014 lows. Exxon Mobil Corp. and Chevron Corp. have together chipped away about 12% from the **S&P 500**'s year-to-date advance. And industrial companies, which soared after the 2016 presidential election on bets that the Trump administration would pump up infrastructure spending, have lagged behind the **S&P 500**, as some investors question how the administration will secure funding for its plan.

Other investors predicted that bank shares would begin outperforming the broader market again after the passage of the Republican tax overhaul. And those companies have seen a boost: JPMorgan Chase & Co. and Bank of America Corp. together have made up 12% of the **S&P 500**'s 2018 gains, according to S&P Dow Jones Indices.

Yet enthusiasm for technology stocks hasn't tapered off. Roughly a third of global fund managers say they are overweight in technology stocks in their portfolios, according to a Bank of America Merrill Lynch survey conducted at the start of the month. That was the highest share of overweights of all 11 **S&P 500** sectors.

Meantime, tech's dominance has helped the **Nasdaq Composite**, which heavily weights shares of technology companies, outperform other indexes so far this year.

The three stocks leading this year's advance -- Amazon, Microsoft and Netflix -- have benefited from strong earnings showing their businesses are continuing to grow at a rapid clip.

Amazon, whose shares are up 27% this year, got a boost after it said it was teaming up with Berkshire Hathaway Inc. and JPMorgan Chase to try to reduce health-care costs for their workers. And they took another leg higher after the company said in February that its quarterly profit topped $1 billion for the first time, thanks to record holiday sales.

Shares of Microsoft -- whose booming cloud business has helped it reclaim dominance in the tech industry even as global sales of personal computers that use its software have slowed -- are up 7% in 2018. Streaming giant Netflix, whose investments in original shows helped it claim new subscribers at a record rate in the fourth quarter, is up 46% this year.

"When you have something that can really grow and innovate, there's really no limit to the upside," said Thomas Plumb, president of Wisconsin Capital Management, whose Plumb Equity Fund includes holdings in **S&P 500** tech-sector names including Visa Inc. and Alphabet Inc., as well as Ansys Inc., which makes engineering simulation software.

Last year's rally was largely driven by five companies known as the FAANG stocks, which include Amazon and Netflix, along with Facebook Inc., Apple and Google parent Alphabet. But the latter three companies haven't kept pace in 2018, following a batch of mixed earnings reports and increased pressure from regulators.

Facebook is contending with scrutiny prompted by a U.S. indictment alleging that Russia manipulated social-media platforms. Apple has come under pressure amid falling iPhone sales, as well as blowback over its decision to slow performance on older iPhones. And Alphabet stumbled after reporting higher quarterly expenses.

Their shares have lagged behind Amazon, Microsoft and Netflix this year after all six notched double-digit percentage gains in 2017: Facebook is up 0.8% so far in 2018, while Apple is up 1.1% and Alphabet has risen 5.7%.

Document J000000020180222ee2m0001z

THE WALL STREET JOURNAL.
U.S. EDITION

Bitcoin Factories Spring Into Action

By Stephanie Yang
970 words
22 February 2018
The Wall Street Journal
J
B1
English

Michael Poteat, an engineering student at Old Dominion University in Norfolk, Va., decided to start mining bitcoin four months ago.

Using some of his bitcoin holdings, he purchased 20 "mining rigs," computers that solve complex equations to generate new coins.

But while running one rig, he kept tripping the circuit breaker in his home. So the 20-year-old looked into leasing commercial space but struggled to find a large-enough place without neighbors who would mind the noise.

As the surge in bitcoin's price lures both individuals and corporations to try their hand at mining cryptocurrencies, many people are facing similar problems. That is giving rise to "hosting" or "colocation" services that make mining easier for the masses by providing ready infrastructure, security and electricity.

In February, Mr. Poteat moved his equipment into a data center run by Bcause, a five-year-old company that is laying out plans to build the largest bitcoin mining operation in North America.

"It's just difficult as an individual to handle all the logistics," Mr. Poteat said.

Bitcoin miners are rewarded with new coins and transaction fees for performing the calculations that make the bitcoin network tick. The more valuable a bitcoin is, the greater the incentive to start mining. But the more miners who participate, the more computations are needed to earn rewards.

The process can be expensive and cumbersome, requiring specialized hardware and large amounts of power. Such challenges have long prompted miners to share space and resources. Now, companies that harbor mining equipment are fielding more requests than ever.

Even as bitcoin prices have tumbled about 40% from a peak in December, the amount of computing effort expended by miners, also known as the hash rate, has continued climbing. That likely indicates more miners are jumping into the network, according to market observers.

Bcause is one of the firms that have sprung up to cater to aspiring bitcoin miners. In an old beverage warehouse in Virginia Beach, the startup is running thousands of rigs for clients from the U.S. to Asia. It has received $5 million in funding, led by Japanese financial-services firm SBI Holdings Inc., and plans to raise more.

Bcause has contracts with wholesale clients to house about 60,000 mining rigs and will serve retail clients by renting out spare machines, a process known as "cloud mining." It has about 5,000 machines up and running and plans to outfit another site in eastern Pennsylvania.

The company was initially founded to provide bitcoin options contracts for investors trying to hedge cryptocurrency investments.

But the team decided to incorporate hosting services last year as bitcoin surged and mining became profitable again.

"The demand is overwhelming," said Fred Grede, chief executive officer of Bcause and a former executive at the Hong Kong stock exchange and Chicago Board of Trade. "That's where the revenue is."

One of the most popular mining machines, known as the Antminer S9, is frequently sold out, forcing customers to wait months for delivery. Each rig costs about $2,300 but can go for as much as $5,000 on the secondary market.

Bcause's retail clients can rent an Antminer S9 for about $4,800 for one year. The company declined to provide prices for institutional clients, who purchase their own machines.

Traditionally, the world's biggest bitcoin miners have set up shop in places with low-cost electricity and cool climates to accommodate the heat given off by the mining rigs. However, the spectacular rise in bitcoin has afforded more location flexibility, miners say.

China's crackdown on domestic mining could also lead many in the country to consider alternative areas to run their operations.

"A lot of people don't trust going to China and putting all that investment into China," said Michael Adolphi, chief operating officer at Bcause. "We've made it economically feasible for them to bring it here."

Still, the **volatility** of bitcoin has some questioning how long the mining boom will last.

In mid-2014, when bitcoin fell more than 50% from the end of 2013 to about $500, mining operations were forced to consolidate, said Garrick Hileman, chief executive of research firm Mosaic.io.

"A combination of inefficient hardware and declining bitcoin price led a lot of them to close up shop," Mr. Hileman said. The industry could experience a similar shakeout if prices start to drop again, he said.

The bitcoin price at which miners can still profitably run rigs varies depending on electricity costs, scale and the difficulty of mining. Some miners estimated the cutoff to be about $1,000 per bitcoin, though one small-scale miner pinned his exit level at about $4,000.

Late Wednesday, bitcoin was trading at $10,291.12, according to CoinDesk Inc.

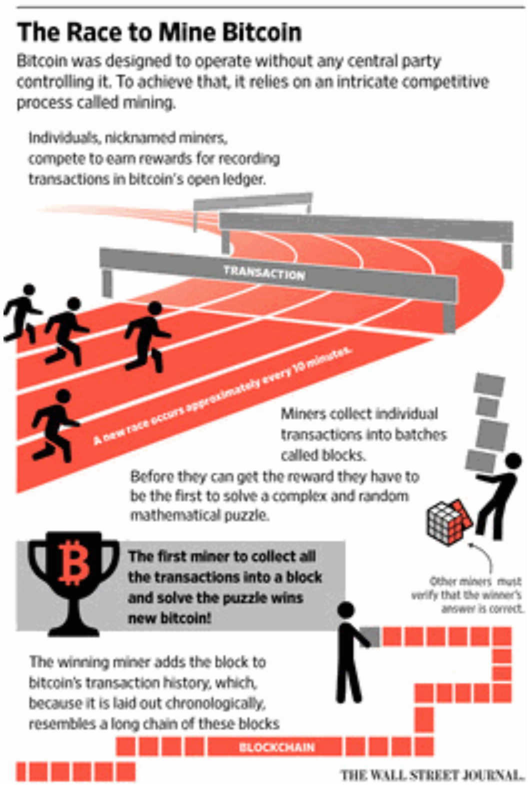
"Mining is still insanely profitable at the moment," said a spokesman for Genesis Mining, a cloud mining company that rents computing power to customers. "One of the biggest challenges in the space is just building out the mining capacity to meet the demand."

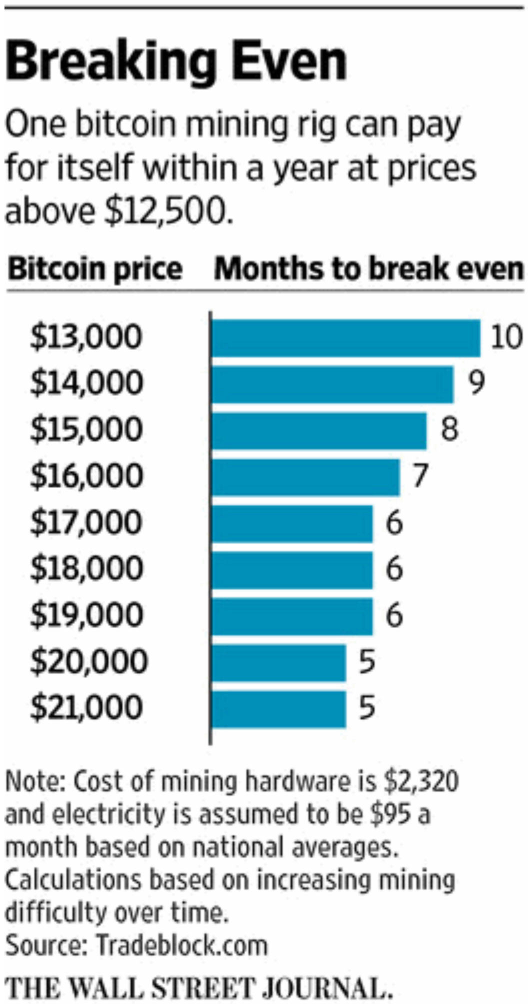
As a hosting service, Bcause says it is insulated from major price shocks because it doesn't invest in the mining equipment or the cryptocurrency itself.

It plans to build out a one-stop shop for trading bitcoin, with spot and derivatives exchanges, as well as a clearinghouse, pending regulatory approval.

David Bowman, who operates a small mining facility in Plattsburgh, N.Y., said he started selling contracts for cloud mining for the steadier revenue. However, he acknowledged the risks.

"The difficult part is the price," said Mr. Bowman, who has 30 machines running in an office space. "The price is anyone's guess. It's kind of a shot in the dark sometimes."


The Race to Mine Bitcoin
Bitcoin was designed to operate without any central party controlling it. To achieve that, it relies on an intricate competitive process called mining.
Individuals, nicknamed miners, compete to earn rewards for recording transactions in bitcoin's open ledger.
TRANSACTION
A new race occurs approximately every 10 minutes.
Miners collect individual transactions into batches called blocks.
Before they can get the reward they have to be the first to solve a complex and random mathematical puzzle.
The first miner to collect all the transactions into a block and solve the puzzle wins new bitcoin!
Other miners must verify that the winner's answer is correct.
The winning miner adds the block to bitcoin's transaction history, which, because it is laid out chronologically, resembles a long chain of these blocks
BLOCKCHAIN
THE WALL STREET JOURNAL.



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THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News -- Capital Account: A Nascent Petro-Economy Flips Oil's Impact

By Greg Ip
910 words
22 February 2018
The Wall Street Journal
J
A2
English

The effect of **oil prices** on the U.S. economy used to be straightforward: Higher was bad. Yet between 2014 and early 2016, as oil collapsed, growth slowed sharply. Since then oil has doubled, yet the economy has accelerated.

Credit this to the emergence of the U.S. as a leading oil producer and, soon, net energy exporter. More expensive oil is still a tax on consumers. But that tax is increasingly offset by the boost to energy investment, production and jobs. The U.S. business cycle is thus now tied in complex and surprising ways to the global oil market.

The rise in U.S. oil production is nothing short of spectacular. The federal Energy Information Administration projects that daily output, which was the highest since 1972 last year, will rise to a record 10.6 million barrels this year. BP PLC's latest world energy outlook predicts the U.S. will account for 18% of world oil and related liquids output in a little over two decades, well ahead of second-place Saudi Arabia at 13%.

Even more consequential: The U.S. deficit in crude oil and refined products shriveled to four million barrels a day last year from 12 million in 2007. The EIA predicts the U.S. will become a small net exporter by 2029, and if all other energy is included, in just four years.

The U.S. has plentiful reserves of "tight" oil -- primarily brittle rock formations such as shale -- that was unprofitable to extract until the adoption of seismic imaging, hydraulic fracturing of rock and horizontal drilling in the mid-2000s. It now accounts for more than half of U.S. crude output.

Oil's share of U.S. gross domestic product, at 2.7%, is only marginally above its three-decade average and nowhere near as important as in true petrostates such as Russia and Saudi Arabia. But it plays an outsize role in year-to-year growth fluctuations because shale drillers respond so quickly to market conditions.

Indeed, a recent study by Richard Newell, president of the think tank Resources for the Future, and Brian Prest of Duke University finds shale output rises nine times as much as conventional output for a given price rise, for two reasons: More wells are drilled, and each well is far more productive. (That advantage declines over time, as shale wells are exhausted more quickly.)

Each new well drilled triggers related demand, from pumps and fabricated metal to truckers. The reverse is also true. Rob Martin, an economist at UBS, estimates that after **oil prices** tanked in 2014, collapsing energy investment wiped a full percentage point off growth in 2015 and nearly half a point in 2016. Then as **oil prices** recovered, energy investment contributed 0.6 point to last year's 2.5% growth.

This is a sharp contrast to historic patterns. When **oil prices** plunged in 1998 because of the Asian financial crisis, U.S. growth got a boost. When they skyrocketed in 2008, it pummeled an economy already wilting from the mortgage crisis.

Mr. Martin also found oil has had a huge influence on manufacturing. By the end of 2015, near the nadir of prices, shipments of manufactured goods potentially tied to commodities such as fabricated metal products, construction machinery and heavy-duty trucks were down 12% from a year earlier. As oil activity recovered, they turned and by late last year were up 9%.

Not all of this was homegrown. American manufacturers also benefited from recovering activity in foreign oil producers. Nonetheless, it left an imprint on regional growth. From mid-2016 through the middle of last year, more than half the net U.S. jobs created in manufacturing were in Texas, home of the tight oil-rich Permian Basin, according to UBS.

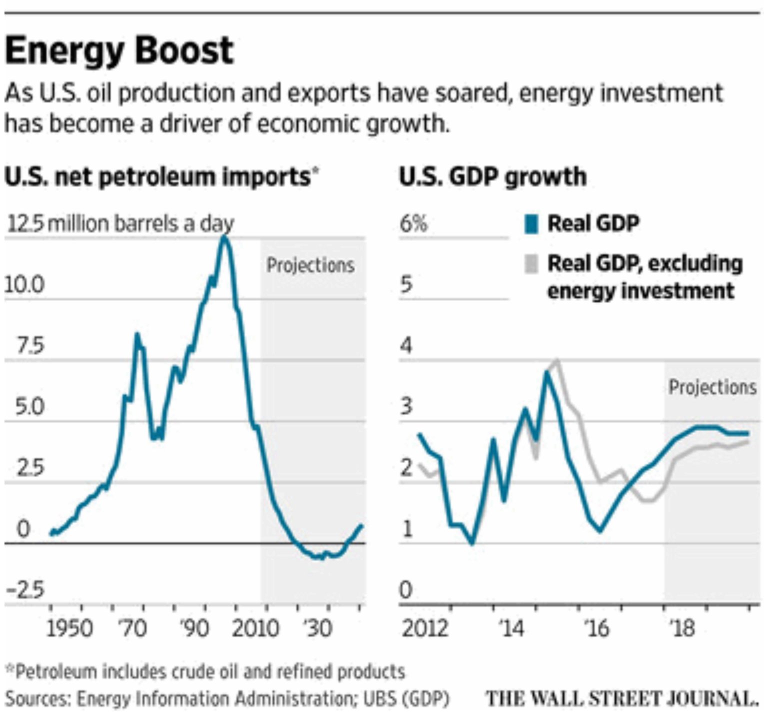
Since mid-2017 that effect has moderated as the recovery in both business investment and factory jobs has spread beyond energy. Nonetheless, Mr. Martin predicts that energy investment will contribute a tenth of the 2.9% growth rate projected for the U.S. this year.

Many crosscutting forces will determine if oil continues to exercise the same influence over the business cycle. The decision by the Organization of the Petroleum Exporting Countries and Russia to curb output a few weeks after Donald Trump was elected president in 2016 was particularly advantageous to American producers, who benefited from both a higher price and an expanded market share. OPEC and Russia may not hold back as stronger global growth propels demand.

Shale producers are also dependent on fickle stock and bond markets to finance operations. The recent surge in **stock-market volatility** dragged down **oil prices**.

Bob McNally, president of Rapidan Energy Group, a consulting firm, warns the last price bust depressed global oil investment while ensuring U.S. gasoline consumption will keep rising, contrary to the EIA's prediction of an imminent peak. As global growth picks up, global oil supply will be slow to respond, which Mr. McNally said is a recipe for oil to top $100 a barrel and gasoline to hit $4 a gallon, with the usual pain for consumers and the broader economy.

So oil hasn't lost its capacity to hurt. But its capacity to help will be an important and unpredictable force for at least a few years yet.



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Document J000000020180222ee2m0000v

The New York Times

Business/Financial Desk; SECTB
Fed Says Economy Can Sustain Higher Rates

By BINYAMIN APPELBAUM
958 words
22 February 2018
The New York Times
NYTF
Late Edition - Final
3
English

WASHINGTON -- Robust economic growth has increased the confidence of Federal Reserve officials that the economy is ready for higher interest rates, according to an official account of the central bank's most recent policymaking meeting in late January.

The Fed did not raise its benchmark interest rate at the meeting on Jan. 30 and 31, but the account reinforced investor expectations the Fed would raise rates at its next meeting in March.

The account said Fed officials have upgraded their economic outlooks since the beginning of the year and listed three main reasons: The strength of recent economic data, accommodative financial conditions and the expected impact of the $1.5 trillion tax cut that took effect in January.

''The effects of recently enacted tax changes -- while still uncertain -- might be somewhat larger in the near term than previously thought,'' said the meeting account, which the Fed published Wednesday after a standard three-week delay.

The Fed is seeking to raise rates gradually to maintain control of inflation without impeding an economic expansion that is nearing the end of its ninth year, one of the longest stretches of continuous economic growth in American history.

A wave of turbulence passed through global equity markets in the days after the Fed's January meeting. The government reported an unexpected increase in wages, and investors worried the Fed would respond by raising rates a little more quickly. Then Congress passed a plan increasing government spending, tossing more logs onto the fire.

So far, however, Fed officials have treated the stronger economic news as a reason to carry out their plans for gradual rate hikes, rather than as a reason to start raising rates more quickly. Most Fed officials predicted in December the Fed would raise rates three times in 2018, as it did last year.

''If the economy evolves as I anticipate, I believe further increases in interest rates will be appropriate this year and next year, at a pace similar to last year's,'' Loretta Mester, president of the Federal Reserve Bank of Cleveland, said this month.

In the policy statement the Fed issued after the January meeting, the central bank outlined its approach to raising rates, saying it ''expects that economic conditions will evolve in a manner that will warrant further gradual increases in the federal funds rate.''

The meeting account said the addition of the word ''further'' in that statement reflected the increased confidence among officials that the Fed would continue raising rates.

Jesse Edgerton, an economist at JPMorgan Chase, said the Fed's increased confidence was likely to translate eventually into more interest rate increases than the three Fed officials predicted.

''We think increased confidence in the need for further hikes will accompany a perceived need for more than three hikes among a growing portion of the committee,'' he wrote Wednesday.

And the minutes did suggest the Fed might eventually raise rates to a level higher than **financial markets** presently anticipate. Fed officials predicted in December that the Fed's benchmark rate would come to rest around 2.8 percent, well below its precrisis level. The rate is currently in a range between 1.25 percent and 1.5 percent.

At the January meeting, some Fed officials raised the possibility that the strength of economic growth might raise that ceiling. The Fed would welcome such a development, because it would preserve more room to reduce rates in future downturns.

The persistent question mark is inflation. The Fed aims to keep prices rising at an annual rate of 2 percent, but it has consistently fallen short of that goal since the end of the last recession in 2009.

The minutes said the Fed has gained some confidence in its prediction that inflation will rise toward 2 percent. The economy continues to gain strength, and the minutes said a decline in the foreign exchange value of the dollar was also likely to put upward pressure on inflation. Lower exchange rates translate into higher prices for imported goods.

But the Fed has made the same predictions repeatedly, without success, and the minutes said the Fed intends to raise rates slowly as it continues to watch inflation closely. Some officials argue that the Fed should stop raising rates until inflation shows clear signs of revival.

The Fed has good reason for its uncertainty about inflation: It lacks a convincing explanation of what causes inflation, or a model that accurately predicts future inflation.

In a presentation at the January meeting, economists on the Fed's staff told policymakers that the most popular explanations had significant flaws. One class of theories says inflation is produced by excess demand for available resources. This suggests inflation should rise as growth approaches its natural speed limit, a pattern that can be seen in some historical data but is difficult to find in recent decades. Another class of theories argues, with some circularity, that inflation is determined by expectations about inflation. It is not clear, however, how those expectations are formed.

The account said that "almost all" Fed officials responded by expressing a continued commitment to both theories. They said they intended to raise interest rates as the economy gains strength, and to seek to maintain public confidence in the 2 percent inflation target.

The January meeting was the final meeting for Janet L. Yellen, who concluded her four-year term as the Fed's chairwoman in early February. Her successor, Jerome H. Powell, is scheduled to make his public debut when he testifies before House and Senate committees next week.

Follow Binyamin Appelbaum on Twitter @bcappelbaum.

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

Document NYTF000020180222ee2m00045

THE WALL STREET JOURNAL.
U.S. EDITION

Fed Gives Bullish Signals on Economy

By Nick Timiraos
978 words
22 February 2018
The Wall Street Journal
J
A1
English

WASHINGTON -- Federal Reserve officials signaled growing confidence in the U.S. economy when they met in January, bolstering their plans to continue raising short-term interest rates as soon as next month.

Several Fed officials late last month believed the economy was set to grow even faster than when they elevated their growth projections at their December meeting, according to minutes of the Jan. 30-31 session, which were released Wednesday. Some officials also appeared more certain inflation would return to their 2% target over the coming year after years of consistently lagging behind.

The minutes were keenly parsed by investors, who are eager for any sign the Fed is likely to accelerate its plan to raise interest rates as the economy picks up. In December, the officials boosted rates to a range between 1.25% and 1.5% and penciled in three more increases this year. Investors have been on edge for signs the Fed might lift rates a fourth time in 2018.

The minutes didn't signal any immediate change in the Fed's likely path of increases. But the stronger growth outlook, which was made before Congress approved a separate spending bill that should further boost economic demand this year and next, supports the current rate path and could serve as an important prerequisite for moving a touch more aggressively later this year.

Markets gyrated Wednesday. Investors appeared to initially welcome the Fed minutes, relieved that they didn't signal the central bank was poised to ramp up its tightening efforts. But stocks and bonds fell after it became clearer the Fed might move more aggressively than anticipated later this year.

The **Dow Jones Industrial Average** initially rose as much as 300 points but closed down 166.97 points, or 0.67%, at 24797.78. Government bonds also sold off after the release of the minutes. The **10**-**year Treasury** yield closed at 2.943%, from 2.895% Tuesday.

After holding its benchmark federal-funds rate near zero for seven years, the Fed has raised it five times since late 2015.

The Fed left rates unchanged at the January meeting and is likely to boost them at its next gathering, March 20-21, which will be the first led by its new chairman, Jerome Powell.

"A majority of participants noted that a stronger outlook for economic growth raised the likelihood that further gradual policy firming would be appropriate," the minutes said.

Investors are focused on whether the Fed will raise rates more than anticipated currently, decisions that would ripple through the economy by affecting asset prices and borrowing costs for consumers and businesses.

The answer largely turns on inflation, which has remains below the central bank's 2% target.

In December, the Fed's preferred inflation gauge, excluding **volatile** food and energy categories, rose 1.5% from a year earlier. At the January Fed meeting, staff economists projected this measure would rise "notably faster in 2018" before reaching the 2% target in 2019 and remaining there after that.

"There was no sign of inflation anxiety in the minutes," said Roberto Perli, an analyst at research firm Cornerstone Macro, referring to concerns about inflation rising too quickly.

Inflation was already expected to pick up over the coming months because weak readings last March and April will no longer be included in year-over-year comparisons. But the staff forecast also projected a rebound in inflation due to further declines in slack across the economy.

Officials raised their growth projections when they met in mid-December because Congress was close to agreement on a $1.5 trillion tax-cut package.

When officials met in January, several had further lifted their growth forecasts, citing rising stock prices, relatively low bond yields and a final tax package that was somewhat more generous in providing cuts over the next few years than previously expected, the minutes said.

Others said the prospects for the economy to perform better than they expected had also increased.

Meanwhile, after the January meeting, Congress approved a larger-than-expected government spending plan, which should provide more fuel for economic growth.

The spending boost has prompted more economists in recent days to project the Fed will raise rates slightly faster this year and next.

The challenge for the Fed is that many economists don't see either the tax cuts or the federal funding increase doing much to raise the economy's long-run growth rate, even though many anticipate they will provide a short-term boost.

Economists at JPMorgan Chase & Co. and UBS Group AG project the unemployment rate will fall to 3.2% next year, the lowest level in 65 years and more than a percentage point below the level most Fed officials expect is sustainable over the long run.

To engineer a so-called soft landing, where the economy doesn't overheat or pull back sharply, officials would need to slow down growth and guide the unemployment rate gently higher from low levels.

"Historically, the hardest part of monetary policy is the soft landing. You can tell it's the hardest part because they've never achieved it before," said Seth Carpenter, chief U.S. economist at UBS and a former Fed official.

If Fed officials grow more confident that inflation is rising toward their 2% target over time, they could stick to their tentative plan for three rate increases this year. But if it looks like new federal spending, tax cuts, a weaker dollar and lower unemployment will lead to acceleration in price pressures, the policy makers could act more aggressively.

Several officials in recent weeks have played down the difference between three or four rate rises this year, in part because they have plenty of time to adjust their plans as the year unfolds.

Document J000000020180222ee2m0002b

THE WALL STREET JOURNAL.
U.S. EDITION

Stocks Vex Pension Funds

By Heather Gillers
861 words
21 February 2018
The Wall Street Journal
J
B1
English

Public pension funds that lost hundreds of billions of dollars during the last financial crisis still face significant risk from one basic investment: stocks.

That vulnerability came into focus earlier this month as markets descended into correction territory for the first time since February 2016. The California Public Employees' Retirement System, the largest public pension fund in the U.S., lost $18.5 billion in value over a 10-day trading period ended Feb. 9, according to figures provided by the system.

The sudden drop represented 5% of total assets held by the pension fund, which had roughly half of its portfolio in equities as of late 2017. It gained back $8.1 billion through last Friday as markets recovered.

"It looks like 2018 is likely to be more turbulent than what we have experienced the last couple of years," the fund's chief investment officer, Ted Eliopoulos, told his board last Monday at a public meeting.

Retirement systems that manage money for firefighters, police officers, teachers and other public workers are increasingly reliant on stocks for returns as the **bull market** nears its ninth year. By the end of 2017, equities had surged to an average 53.6% of public pension portfolios from 50.3% a year earlier, according to figures released earlier this month by the Wilshire Trust Universe Comparison Service.

Those average holdings were the highest on a percentage basis since 2010, according to the Wilshire Trust Universe Comparison Service data, and near the 54.6% average these funds held at the end of 2007.

One reason public pensions are so willing to bet on stocks is because of aggressive investment targets designed to fulfill mounting obligations to millions of government workers.

The goal of most pension funds is to pay for those future benefits by earning 7% to 8% a year.

"Equities always take up a disproportionate share of the risk budget that any plan has," said Wilshire Consulting President Andrew Junkin, who advises public pension funds. "You can never get away from it."

That stance paid off during 2017's market rally as public pensions had one of their best years of the past decade.

They earned 12.4% in the 2017 fiscal year ended June 30, according to Wilshire Trust Universe Comparison Service.

But the risks can bring sizable losses during market downturns, which then can lead to deeper funding problems. The two largest public pensions in the U.S. -- California Public Employees' Retirement System, known by its abbreviation Calpers, and the California State Teachers' Retirement System -- lost nearly $100 billion in value during the fiscal year ended June 30, 2009.

Nearly a decade later, neither fund has enough assets on hand to meet all future obligations to their workers and retirees.

Many funds burned by the 2008-2009 downturn tried to diversify their investment mix. They lowered their holdings of bonds as interest rates dropped and turned to real estate, commodities, hedge funds and private-equity holdings.

These so-called alternative investments rose to 26% of holdings at about 150 of the biggest U.S. funds in 2016, according to the Public Plans Database, compared with 7% more than a decade earlier.

At the same time, the amount invested in stocks crept upward as markets roared back -- and equities remain the single largest holding among all funds. The $209.1 billion New York State Common Retirement Fund increased its equity holdings to 58.1% as of Dec. 31 as compared with 56% as of June 30. That allocation is now higher than the 54% held as of March 31, 2008.

The $19.9 billion Teachers' Retirement System of Kentucky now has 62% of its assets in equities, close to the 64% it had in 2007. It sold $303 million in stocks Jan. 19-20 to rebalance its portfolio following gains. From Feb. 6-8, as U.S. markets plunged, the fund bought another $103.5 million of stocks.

"We are definitely a long-term investor and look to **volatility** as an investing opportunity," said Beau Barnes, the system's deputy executive secretary and general counsel.

Calpers had a chance to pull back on stocks in December and decided against it. Directors considered a 34% allocation to equities, down from 50%. They also considered a higher allocation.

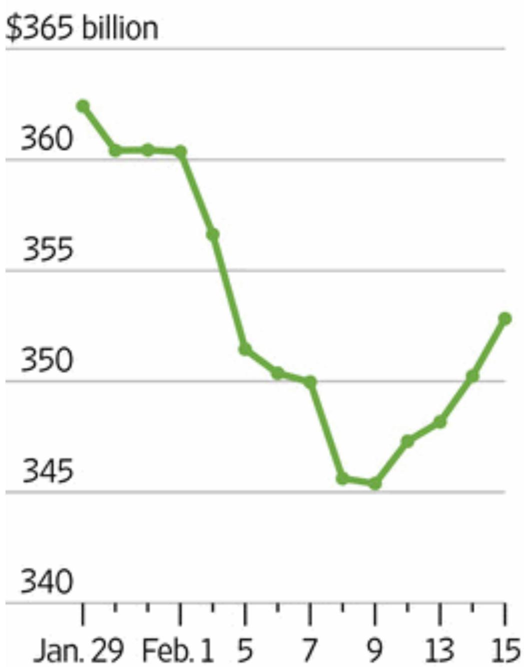
In the end, the fund opted to raise its equities target to 50% from 46% as of July 1and its fixed-income target to 28% from 20%. It had 49.8% of its portfolio in equities as of Oct. 31, according to the fund's website. That is close to the 51.6% it had in stocks for the fiscal year ended June 30, 2008.

A Calpers spokesman said any ups or downs that happen in between fiscal years are a "snapshot in time" and that Calpers is up nearly 16% since the start of the calendar year.

The fund's chief investment officer, Mr. Eliopoulos, told the Calpers board last week that Calpers's loss during the recent correction was less than the overall **stock-market** drop, showing the fund is diversified.

Roller Coaster

Calpers, the nation's largest pension fund, lost 5% of its market value over 10 trading days before rebounding somewhat.



Source: California Public Employees' Retirement System

THE WALL STREET JOURNAL.

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Document J000000020180221ee2l0001p

THE WALL STREET JOURNAL.
U.S. EDITION

Stocks of Home Builders Are Going Up --- Housing market gains strength amid higher wages, an improved economy, tax overhaul

By Ben Eisen
766 words
21 February 2018
The Wall Street Journal
J
B14
English

The housing market is heating up, providing another pillar of support for the **stock market** and U.S. economy.

The SPDR S&P Homebuilders exchange-traded fund, which holds shares of home-builder companies and other housing-related firms, has climbed 20% over the past 12 months, topping the **S&P 500**'s 16% rise.

Despite paring gains recently alongside a broader market selloff, some individual companies are faring particularly well. D.R. Horton Inc. is up 48% over the past 12 months, Lennar Corp. has jumped 30% and PulteGroup is up 38%.

Outside of home builders, related stocks are outperforming, including home-improvement supplies retailer Home Depot Inc. The company's shares slid 0.1% Tuesday, falling less than the **S&P 500**'s 0.6% drop, after it reported faster-than-expected sales growth for the most recent quarter and projected same-store sales growth this year. Over the past 12 months, it is up 31%.

These companies are benefiting from continued strength in the labor market, where the unemployment rate has been lingering at its lowest since 2000. Data suggest that workers' wages are finally perking up, giving would-be buyers more money to spend on housing.

A decade ago, the housing market was the U.S. economy's biggest weakness. Now, it offers crucial support.

Housing is a key segment of the economy, and it is aiding a continued acceleration in growth. The Federal Reserve Bank of Atlanta's GDPNow real-time tracker for economic growth, which takes into account housing-starts data and other indicators, currently projects the U.S. economy will grow at an annualized pace of 3.2% in the first three months of this year. If that holds up, it would continue a streak of faster gross-domestic-product growth readings in recent quarters.

Analysts also say many housing-related companies will be beneficiaries from a drop in the corporate-tax rate to 21% from 35%, which was signed into law late last year. Such a benefit could offset any potential decline in housing demand due to new caps on the amount of property and state income taxes filers can deduct.

"The U.S. economy is strong and tax reform is net positive for the housing industry," said Carol Tome, Home Depot's chief financial officer, on a conference call with analysts Tuesday morning.

This week is likely to bring fresh evidence that demand for homes is growing, with the release of data from the National Association of Realtors on Wednesday. Sales of previously owned U.S. homes are expected to have climbed 1.3% in January to 5.64 million, according to a survey of economists, resuming an upward trend in recent months.

Other data also show a sanguine market. The number of new units under construction rose 9.7% to 1.326 million in January, Commerce Department data showed Friday. That was the third increase in four months, and it came despite cold weather, suggesting a shortage of housing supply is prompting builders to pick up the pace of construction.

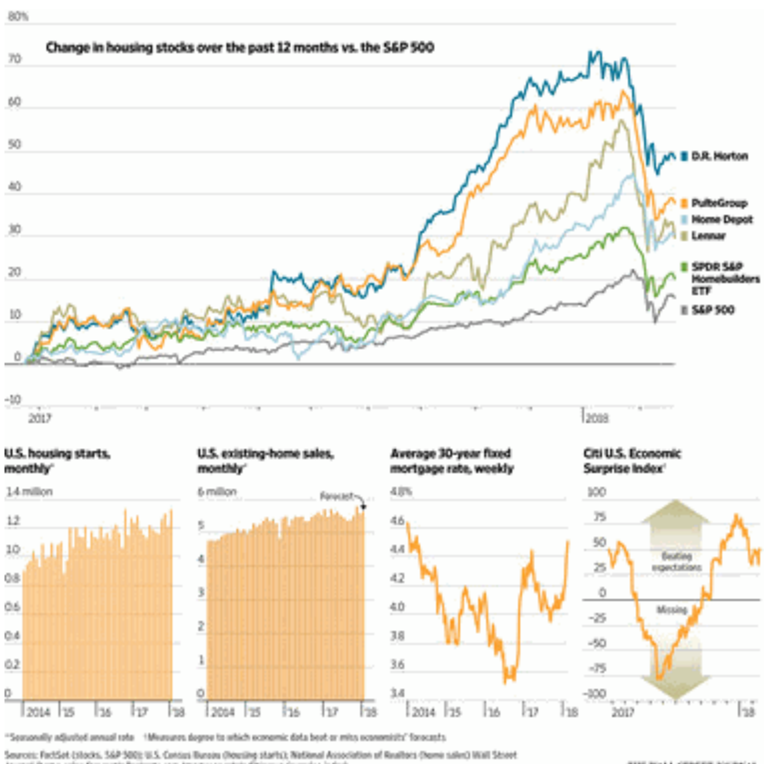
The housing market has been on a plodding path higher for some time as it gradually recovered from the financial meltdown nearly a decade ago. But it has gained additional strength lately, despite broadly higher home prices.

The last time there was a massive housing boom, it ended with a financial crisis as speculation led to a bubble that subsequently popped. But while home prices may be starting to get frothy in cities such as Austin, Texas; Nashville, Tenn.; and Denver, according to Lindsey Piegza, chief economist at Stifel, there aren't yet echoes of the last economic cycle.

Not all of the recent news is good for the housing market: A rise in mortgage rates, prompted by higher Treasury yields, could eventually cut into demand for new homes. The benchmark 30-year fixed mortgage rate was at about 4.5% this month, its highest since early 2014, according to weekly data from Bankrate.com. As recently as September, it was below 4%.

Still, the economy is stronger than it was the last time rates spiked in 2013, which means the housing market has more ability to withstand higher mortgage rates than it used to, analysts say.

"Higher mortgage rates may rob the housing market of some momentum but it won't derail the housing market altogether," said Greg McBride, chief financial analyst at Bankrate.com.



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Document J000000020180221ee2l0000x

The New York Times

ECONOMIC SCENE
Business/Financial Desk; SECTB
When Next Recession Hits, Don't Count on the Safety Net

By EDUARDO PORTER
1,255 words
21 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

What will President Trump's first recession look like?

The question is not that far-fetched. The current economic expansion is already the third longest since the middle of the 19th century, according to the National Bureau of Economic Research. If it makes it past June of next year it will be the longest on record.

While the economy is hardly booming, trundling along at an annual growth rate of about 2.5 percent, investors are getting jittery.

The **stock market** tumble after the government reported an uptick in wages last month suggests just how worried investors on Wall Street are that the Federal Reserve might start increasing interest rates more aggressively to forestall inflation. And the tax cuts and spending increases pumped into an expanding economy since December shorten the odds that the Fed will step in forcefully in the not-too-distant future to bring an overheated expansion to an end.

It is hardly premature to ask, in this light, how the Trump administration might manage the fallout from the economic downturn that everybody knows will happen. Unfortunately, the United States could hardly be less prepared.

Not only does the government have precious few tools at its disposal to combat a downturn. By slashing taxes while increasing spending, President Trump and his allies in Congress have further boxed the economy into a corner, reducing the space for emergency government action were it to be needed.

The federal debt burden is now the heaviest it has been in 70 years. And it is expected to get progressively heavier, as the budget deficit swells.

To top it off, a Republican president and a Republican Congress seem set on completing the longstanding Republican project to gut the safety net built by Presidents Franklin D. Roosevelt and Lyndon B. Johnson, which they blame for encouraging sloth, and replace it with a leaner welfare regime that closely ties government benefits to hard work.

As noted in a new set of proposals by leading academics to combat poverty, published Tuesday by the Russell Sage Foundation, anti-poverty policies and related social-welfare benefits over the last quarter-century "have largely shifted from a system of guaranteed income support to a work-based safety net."

The economists Hilary Hoynes of the University of California, Berkeley, and Marianne Bitler of the University of California, Davis, pointed out in a recent paper that "the safety net for low-income families with children has transformed from one subsidizing out-of-work families into one subsidizing in-work families."

And yet, as many unemployed Americans discovered the last time recession hit, government benefits that require recipients to hold a job become worthless when there is no work to be had.

Consider what happened the last time around, when the bursting of the housing bubble pushed millions of workers out of their jobs. The Fed quickly slashed interest rates to zero. Months later it started buying billions of dollars' worth of bonds from financial institutions to lower long-term interest rates and encourage borrowing.

The Obama administration hurried to cobble together an economic stimulus package of more than $1 trillion to get money to families that needed it most. It expanded the eligibility for unemployment insurance to its longest duration ever, 99 weeks. It raised the earned-income tax credit for low-wage workers. It more than doubled the budget for food stamps -- the poor's last line of defense.

The economy failed to snap back as the administration hoped. Unemployment remained at 9 percent or more for over two years. But the administration's intervention to bolster the nation's welfare programs made a decisive difference for millions who otherwise would have fallen through the cracks of the nation's threadbare safety net.

Using a broad definition of income and poverty that includes the effects of the complete array of government tools to support low-income families, Professors Hoynes and Bitler concluded that food stamps were critical to stem poverty.

Had food stamps not been available, they estimated, the share of Americans under 65 living below the poverty line would have exceeded 11 percent in 2010, almost 1.5 percentage points more than was the case. The share of Americans in extreme poverty -- with less than half the resources of the simply poor -- would have exceeded 4 percent, about a third more than it turned out to be. Unemployment insurance had a roughly similar impact on poverty levels.

What is critical to note is that each of the two programs did more to relieve extreme poverty during the depths of the Great Recession than even the earned-income tax credit, the main source of government support for low-income Americans.

Indeed, expenditures per capita from the earned-income tax credit increased only modestly after the recession hit. And spending by Temporary Assistance for Needy Families, the patchwork of state-run programs that emerged from welfare reform in 1996 to replace the poor's entitlement to federal cash assistance, did not respond to the recession at all.

This is a problem for vulnerable Americans bracing for the next economic shock, because if Mr. Trump and his colleagues in Congress have their way, the only surviving bit of the social safety net when the next recession hits will probably require beneficiaries to work. The earned-income tax credit is likely to survive unscathed. Food stamps are not.

Assiduously looking for places to cut spending to temper a growing budget deficit, the White House seems more than willing to pare the safety net. The budget it unveiled this month called for a 27 percent cut to the food stamp budget and a 20 percent cut to Section 8 housing assistance by 2028.

The administration already allows states to impose work requirements on Medicaid beneficiaries to shave the program's costs. And the latest White House budget requested a 22.5 percent cut to Medicaid and Obamacare subsidies by 2028 by repealing and replacing the Affordable Care Act.

While the Trump administration is unlikely to end unemployment insurance, the Emergency Unemployment Compensation program expired at the end of 2013. In some states, benefits expire in as little as 12 weeks.

Policy could change in the face of a new economic downturn, to be sure. There are plenty of places where the social safety net could be improved. The Russell Sage proposals include everything from a universal child allowance to a renter's tax credit; from subsidizing employment to a public works program paying a living wage.

Yet somehow I can't see Mr. Trump and Republican allies like the House speaker, Paul D. Ryan of Wisconsin, allowing able-bodied Americans off the hook. They may not quite endorse the infamous words attributed by President Herbert Hoover to his Treasury secretary, Andrew Mellon, as the Great Depression bore down on the economy -- ''Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate'' -- but I wouldn't be surprised if all they have to say when the next recession liquidates work is ''Get a job.''

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Lining up for a job fair in Midtown Manhattan in 2009, when the nation's unemployment rate hit 10 percent. (PHOTOGRAPH BY CASEY KELBAUGH FOR THE NEW YORK TIMES) (B1); Loading groceries in Jefferson City, Mo. A study found that food stamps were crucial to alleviating poverty in the last recession. (PHOTOGRAPH BY DAVID A. LIEB/ASSOCIATED PRESS) (B2)

Document NYTF000020180221ee2l0005w

STOCKS & BONDS
Business/Financial Desk; SECTB
Walmart's Biggest Drop in Decades Trips Up the Market

By THE ASSOCIATED PRESS
1,000 words
21 February 2018
The New York Times
NYTF
Late Edition - Final
4
English

The biggest drop in Walmart's stock in 30 years and losses in other sectors pulled U.S. indexes lower Tuesday, snapping a six-day winning streak.

The losses deepened in the last hour of trading into a broad sell-off that erased early gains led by technology companies.

Walmart plunged 10 percent after reporting weak online sales and disappointing earnings. Grocery store operators, retailers, health care companies and industrial stocks accounted for much of the market's slide.

"Investors have been lulled into a false sense that stock markets are not **volatile**," said Doug Cote, chief market strategist for Voya Investment Management. "Last week was one of the best weeks in years, and as we go back to normal **volatility**, you're going to see what you would expect: normal ups and downs."

The **Standard & Poor**'**s500 index** fell 15.96 points, or 0.6 percent, to 2,716.26. The **Dow Jonesindustrial average** slid 254.63 points, or 1 percent, to 24,964.75. The **Nasdaq** lost 5.16 points, or 0.1 percent, to 7,234.31. The Russell 2000 index of smaller-company stocks gave up 13.56 points, or 0.9 percent, to 1,529.99.

The **S&P 500**, a benchmark for many index funds, capped its strongest week in five years on Friday, recovering more than half of the losses it suffered in a plunge at the beginning of this month. Stocks began giving back some of those gains early Tuesday as trading reopened after a long holiday weekend and investors began sizing up company earnings while keeping an eye on the bond market.

The yield on the **10**-**year Treasury**, which is used as a benchmark for mortgages and other loans, has been rising in recent months from a low of 2.04 percent in September. Higher bond yields indicate investors expect more risk of inflation, and they also can threaten stock prices by making bonds more appealing versus stocks.

"Some of the broader concerns on investors' minds right now are looking across to the bond market and seeing the **10**-**year Treasury** starting to approach that 3 percent level," said Bill Northey, vice president at U.S. Bank Wealth Management.

Bond prices, which had been declining early Tuesday, ended up little changed. The yield on the **10**-**year Treasury** held at 2.88.

Walmart posted the biggest loss in the Dow and **S&P 500**. The tumble represents the stock's worst single-day drop since January 1988. Investors were disappointed with the retail giant's fourth-quarter results, which missed Wall Street's expectations as the company wrestled with slower e-commerce sales during the busiest time of the year.

The stock shed $10.67, or 10.2 percent, to $94.11.

Several big retailers also fell, including Target, which slid $2.22, or 3 percent, to $72.86. Ross Stores dropped $2.19, or 2.7 percent, to $77.98.

Gap declined 5 percent after the clothing chain said the head of the Gap brand will leave the company. Jeff Kirwan, who has been with the company since 2004, had led the namesake brand since the end of 2014. The

Gap said Kirwan had failed to achieve "the operational excellence and accelerated profit growth" that the company expected for the Gap brand. The stock lost $1.66 to $31.61.

Genuine Parts gave up 5.2 percent after the auto and industrial parts company gave a disappointing profit forecast for 2018. The stock fell $5.16 to $94.67.

Company deals offset some of the market slide.

NXP Semiconductor jumped 6 percent after Qualcomm raised its offer for the company to $127.50 a share, or $43.22 billion, from $110 a share. The move comes as Broadcom is trying to buy Qualcomm. Shares in NXP added $7.06 to $125.56. Qualcomm lost 86 cents, or 1.3 percent, to $63.99.

Traders also welcomed news that grocery store operator Albertsons agreed to buy more than 2,500 Rite Aid stores. Albertsons owns brands including Safeway. The deal will double the amount of drugstores it owns.

Last year, Rite Aid had agreed to sell almost 2,000 locations to Walgreens after a larger deal fell apart. Rite Aid's stock, which has shed more than half its value over the past year, rose 7 cents, or 3.3 percent, to $2.20.

Benchmark U.S. crude rose 22 cents to settle at $61.90 per barrel in New York. Brent crude, used to price international oils, shed 42 cents to close at $65.25 a barrel.

In other energy futures trading, heating oil added 2 cents to $1.93 a gallon. Wholesale gasoline was little changed at $1.75 a gallon. Natural gas rose 6 cents to $2.62 per 1,000 cubic feet.

Gold fell $25, or 1.8 percent, to $1,331.20 an ounce. Silver dropped 27 cents to $16.44 an ounce. Copper slid 6 cents to $3.19 a pound.

The dollar rose to 107.30 yen from 106.55 yen on Friday. The euro weakened to $1.2336 from $1.2408.

Major indexes in Europe ended mostly higher. Germany's DAX rose 0.8 percent, while France's CAC 40 gained 0.6 percent. Britain's FTSE 100 was flat.

Earlier in Asia, Japan's benchmark Nikkei 225 lost 1 percent, while Australia's S&P/ASX 200 inched lower. South Korea's Kospi lost 1.1 percent. Hong Kong's Hang Seng fell 0.8 percent. Stocks were mixed in Southeast Asia, while markets in mainland China were still closed for lunar new year holidays.

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

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Tuesday. (Source: Reuters)

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THE WALL STREET JOURNAL.
U.S. EDITION

'Financial-Storm Forecaster' Agency Does Little, Spends $500 Million --- Trump administration puts Office of Financial Research on notice; 'you should leave'

By Ryan Tracy
1,932 words
20 February 2018
The Wall Street Journal
J
A1
English

Congress created a brand new agency after the 2008 financial crisis with a gargantuan mission: Serve as the finance world's version of the National Weather Service.

The new Office of Financial Research wasn't expected to prevent economic storms, but it was supposed to anticipate them and issue warnings to help authorities contain the damage.

Almost a decade and nearly $500 million later, the agency has struggled to establish a place for itself in Washington. Major projects have been delayed or scaled back. Morale has suffered amid turf battles with other regulators and opposition from Republicans. And one of its most ambitious initiatives -- developing a database for recording financial contracts -- has progressed no further than a 16-page paper calling for "information gathering sessions" among constituents.

As the administration of President Donald Trump works to change financial policies it views as governmental overreach, the OFR's record of underachievement has made it an easy target. In November, Treasury Department officials told OFR employees that the agency's budget would be cut by one-quarter and its staff by more than one-third.

"If you're not happy here, you should leave," Craig Phillips, a counselor to Treasury Secretary Steven Mnuchin, told the staff.

The OFR's early backers thought it would become an authoritative source when **financial markets** experienced **volatility**, as they have of late. The agency does publish a monitor of financial vulnerabilities, but it isn't widely cited and is mostly based on already available information, not the private data Congress empowered the agency to collect.

The agency's creation "was a major opportunity to both reduce the burden of regulation and significantly improve regulatory oversight of financial risk, and it was squandered," says economist Allan Mendelowitz, a former federal housing-finance regulator who helped write the legislation creating the agency.

Richard Berner, who led the agency from its early days until the end of last year, told a congressional committee in December he was proud of its accomplishments "despite headwinds from working for a startup amid persistent uncertainties about existential threats to the OFR."

Mr. Berner declined to comment for this article, which is based on internal agency documents and interviews with current and former government officials.

The Trump administration appointed Ken Phelan, the Treasury's chief risk officer, as acting OFR chief while it searches for a permanent director. "Treasury is taking action to improve the management of OFR, right-size its resources and sharpen its focus," a Treasury spokesman said. "We are building a leaner, more effective organization." Mr. Phelan declined to comment.

Democratic senators who support the agency have spoken out against budget cuts, saying in a letter last year that the OFR provides "independent and apolitical analysis of the risks that could threaten our economy" and "should be fully funded and given every opportunity to do its work."

The idea for the agency took shape in a committee formed in 2009 by a group of academics, finance-industry executives and other self-described financial-data geeks, including Mr. Mendelowitz. During the economic turmoil, they concluded, regulators and industry didn't have a clear enough sense of what was going on throughout the financial system.

They argued the government needed a new agency to, among other things, vacuum up and standardize Wall Street trading and lending data and store it in a central data repository. That would make it easier, they felt, to identify systemic risks like the buildup of debt that bankrupted Lehman Brothers Holdings in 2008 and boomeranged through the economy.

They won over a key lawmaker, Sen. Jack Reed (D., R.I.), who had the influence to insert their idea into the 2010 Dodd-Frank Act, which sought to overhaul U.S. financial regulation.

The goal, from the outset, was ambitious, and the agency's defenders say it has made progress in a new arena for government. "It was a total cold start," says Lewis Alexander, U.S. chief economist at Nomura Holdings Inc., referring to early deliberations within the Treasury, where he was a counselor helping to launch the agency.

Mr. Berner, then co-head of global economics at Morgan Stanley, was selected by President Barack Obama and approved by the Senate for a six-year term. He had wide discretion to determine OFR's agenda.

He started in April 2011 with a skeleton staff crammed into the second floor of an ancillary Treasury office building. Although OFR was established as a quasi-independent agency, funded by fees from big finance firms, it also is an arm of the Treasury and must consult with the Treasury on budgeting.

Treasury officials, including Deputy Secretary Neal Wolin, were skeptical that creating a financial early-warning system was possible. Mr. Wolin counseled Mr. Berner against setting unrealistic goals, according to people familiar with their discussion. Be practical, he told the new director.

Almost immediately, the agency came under attack from Republicans such as House Financial Services Committee Chairman Jeb Hensarling (R., Texas), who labeled it "big data for Big Brother." In 2012, the committee released a video titled "The Office of Financial Research Is Watching You." It suggested OFR would have unfettered access to Americans' personal financial information.

The committee voted to abolish the agency. That measure died. A similar proposal was contained in a bill passed by House Republicans last year, although it stalled in the Senate.

Mr. Berner set a goal of about 300 employees. Rather than a data hub and financial-storm forecaster, he envisioned the OFR primarily as a sort of independent financial think tank, according to officials who worked with him in the agency's early months. He recruited researchers and gave them significant leeway.

Its first big assignment came in the spring of 2012, when senior regulators asked for an analysis of risks posed by the asset-management industry. OFR began developing a report, with no clear deadline. In the summer of 2013, Mary Miller, the Treasury Department's undersecretary for domestic finance, called Mr. Berner to her office for a status update, and grew incredulous that the project didn't sound close to completion, according to a person familiar with the meeting.

"Dick," she asked, "how are we going to land this plane?"

The OFR team shared drafts of the report with Ms. Miller and her Treasury colleagues and with officials from the Securities and Exchange Commission, which regulates asset managers. Officials at both agencies were alarmed to see lengthy descriptions of potential risks without empirical analysis, according to former officials at those agencies. They suggested edits, and the document was trimmed by about two-thirds.

SEC officials bridled at the OFR's failure to formally solicit public feedback. The SEC opened a forum on its own website. Treasury and OFR officials were furious, believing the SEC was providing a platform for criticism of an agency whose work had encroached on its turf, the former officials say. The SEC didn't back down.

The Sept. 30, 2013, report concluded that asset managers could threaten financial stability. Industry lobbyists blitzed Capitol Hill and blasted OFR in letters posted on the SEC website. They saw the report as a precursor to stricter federal regulation.

Fidelity's lobbyists complained the agency hadn't checked basic facts. A lobbyist for Fidelity Investments told congressional staffers that the report misstated the firm's assets under management by $200 billion, pointing the staffers to a public financial disclosure that backed up their claim, according to people familiar with the matter.

Mr. Berner said at a later Senate hearing that the agency had engaged in "a vigorous give and take" with the industry and others about the report. He was personally involved in drafting it and was surprised by the strength of the backlash, people familiar with the matter say. These people say the experience reinforced for him the need for the agency to tread softly to survive.

OFR developed a series of tools for monitoring financial risks, including a tracker of the multitrillion dollar money-market-fund industry and a new barcode-like device the helps regulators keep track of financial firms and what they own. Separate OFR research papers have drawn attention to holes or unintended consequences in banking regulations.

The agency built a system to store and analyze huge amounts of financial data. The problem has been getting the actual numbers. Other agencies were slow in fulfilling data requests, according to OFR and Treasury officials. The data OFR has purchased, or collected on a voluntary basis, is incomplete and misses trillions of dollars in financial transactions, employees say. The agency hasn't ever used its data-collection subpoena authority.

The possibility of using that subpoena power came up after Oct. 15, 2014, when Treasury **bond prices** suddenly surged and then crashed for no apparent reason.

Anxious analysts in the Treasury Department dialed up traders, asking what happened. They couldn't fact-check what they heard because the government lacked data on Treasurys trading.

To some, the lack of data looked like a problem tailor-made for the OFR to solve. Mr. Berner was invited to a meeting at the Treasury Department with representatives of the major financial regulators, including the Commodity Futures Trading Commission, the SEC and the Fed.

When discussion turned to obstacles to gathering trading data on Treasury bills, Mr. Berner was asked about the OFR using its subpoena authority to gather the information, according to attendees.

He replied he wasn't sure the agency had that authority, and even if it did, it wouldn't use it in this case, recall two attendees.

Mr. Berner worried that forcing the handover of information could make enemies of other agencies it needed for other projects, according to people who worked with him. OFR's lawyers also believed the subpoena authority would hold up only in limited circumstances.

Mr. Berner faced "very difficult politics around data collection and analysis," says Amias Gerety, a former senior Treasury official who worked with him. "Dick definitely believed you could catch more flies with honey than with vinegar."

Nevertheless, Mr. Berner's statement stunned some who heard it. Not only had he questioned his own authority to use subpoenas, he had removed the threat of using it.

When Treasury and other agencies published a report on the **volatile** Oct. 15 trading, the OFR wasn't part of it.

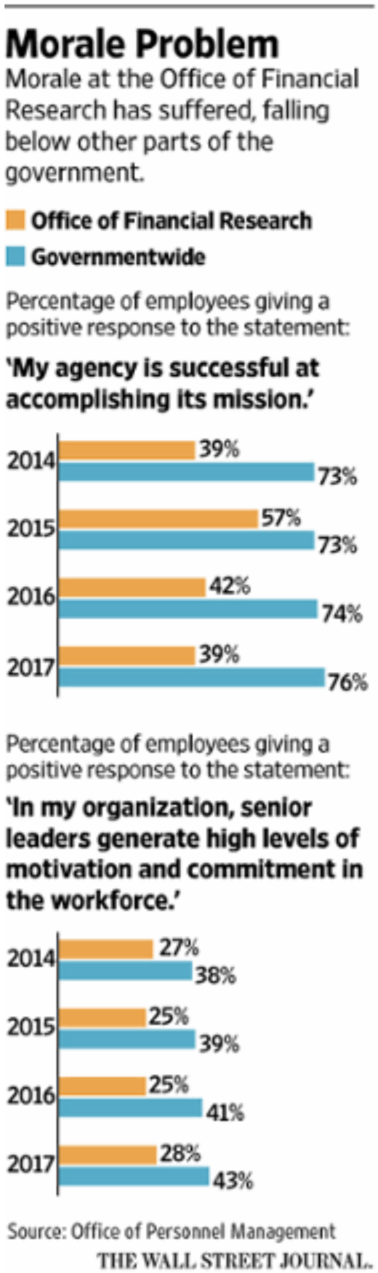
That and other incidents fueled employee criticism that Mr. Berner was reluctant to embrace his powers, preferring to avoid controversy, according to current and former employees. Surveys of employees suggest that morale inside the agency has flagged.

Last March, the OFR published its 16-page paper on the development of the database for recording financial contracts, following years of false starts and infighting, according to employees. Mr. Berner weighed in on final drafts.

"We should be prepared that people will be underwhelmed," another OFR official predicted, according to one employee's notes about the project, known officially as the financial instrument reference database.

The prediction was accurate. Mr. Berner canceled an April public discussion about the initiative with OFR's advisory panel, then placed the project on hold, pending review by the Trump administration.

He announced his resignation in November, more than a year before his term expired, saying he wanted to spend more time with his family. He is now an adjunct professor and executive in residence at New York University's business school.


Morale Problem
Morale at the Office of Financial Research has suffered, falling below other parts of the government.
Office of Financial Research
Governmentwide
Percentage of employees giving a positive response to the statement:
'My agency is successful at accomplishing its mission.'
2014
39%
73%
2015
57%
73%
2016
42%
74%
2017
39%
76%
Percentage of employees giving a positive response to the statement:
'In my organization, senior leaders generate high levels of motivation and commitment in the workforce.'
2014
27%
38%
2015
25%
39%
2016
25%
41%
2017
28%
43%
Source: Office of Personnel Management
THE WALL STREET JOURNAL.

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Document J000000020180220ee2k00048

The New York Times

Business/Financial Desk; SECTB
Global Markets Sag as Holiday Calm Prompts a Sell-Off

By REUTERS
524 words
20 February 2018
The New York Times
NYTF
Late Edition - Final
2
English

World stocks were set to post their first loss in five days on Monday, breaking a winning streak in which they recovered almost half their losses from a violent sell-off two weeks ago.

In a day of relatively quiet trading owing to market holidays in the United States and China, losses in Europe weighed on stocks globally, which had been propped up by gains in Japan.

The Nikkei 225 in Tokyo closed about 2 percent higher, and the South Korean Kospi rose 0.9 percent. In London, the FTSE 100 dipped 0.6 percent, and in Paris, the CAC 40 fell 0.5 percent.

January's two-week rout wiped out more than $6 trillion of the value of global stock markets. The sell-off took place despite global growth that was helping improve the corporate earnings outlook.

Just before the plunge, world shares were trading at 16.66 times expected earnings, the highest levels since 2004, according to Thomson Reuters Datastream. They are currently at 15.33 times.

''Investors knew market volatility would be low as the U.S. and Canada celebrate public holidays, and that weighed on enthusiasm in this part of the world,'' said David Madden, markets analyst at CMC Markets. ''Dealers decided to lock in their profits.''

Equity investors have drawn some reassurance from a fall in the VIX -- a measure of implied volatility on the Standard & Poor's 500-stockindex, also known as Wall Street's ''fear gauge.''

The index has remained below 20 for three days, last reading at 19.46. It spiked to a two-and-a-half-year high of 50.3 two weeks ago, a jump that caused huge losses among investors who had bet that equity markets would remain stable.

The minutes of the Federal Reserve's last policy meeting, held during the market tumble on Jan. 30 and 31, are due on Wednesday. Besides the outlook on rates, investors will be keen to see what, if anything, the Fed makes of the market gyrations.

The dollar edged up from three-year lows against a basket of currencies.

The euro stood at $1.2396, backing down from Friday's three-year high of $1.2556.

The dollar traded at 106.53 Japanese yen, bouncing back from its 15-month low of 105.545, set on Feb. 16.

The dollar has been weighed down by various factors, including worries about widening United States trade and budget deficits and speculation that Washington might pursue a weak-dollar strategy.

There is also talk that foreign central banks may be reallocating their reserves out of the dollar.

Commodities, which enjoyed gains as the dollar weakened, were steady.

Oil prices hit their highest levels in nearly two weeks, lifted by the recovery in stocks and by tensions in the Middle East.

West Texas Intermediate crude, the United States benchmark, rose 1.3 percent to $62.50 a barrel.

Brent crude, an international standard, rose over 1 percent to $65.52 a barrel in London.

Gold was flat at $1,346.46.

Document NYTF000020180220ee2k0004j

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
A Regime Change in Markets Is On Its Way

By Richard Barley
379 words
20 February 2018
The Wall Street Journal
J
B9
English

[Financial Analysis and Commentary]

The dust appears to be settling in markets; stocks rebounded sharply last week. But compared with previous market wobbles, there are key differences. Central bankers especially will take this as an important cue.

The most notable development of the past two weeks is that in the face of turbulent stock markets, with the **S&P 500** dropping 10% from its peak then rebounding nearly 6%, government bond yields haven't fallen. The U.S. **10**-**year Treasury** yield last week set a four-year high above 2.9%.

There has been no flight to safety, because this time the worry is inflation, not growth. The global economy picked up in 2017, particularly in Europe. The U.S. tax and spending policy seems about to deliver a further boost. Risk appetite has proved resilient.

Central banks will respond differently to a big slug of **volatility**. A phase that started with quantitative easing from the Federal Reserve, followed by the European Central Bank's pledge to do "whatever it takes" and the Bank of Japan's efforts to fix long-dated bond yields close to zero, is coming to an end. As a result, investors in bonds, as the most direct beneficiary of previous central-bank efforts, have more to worry about than stock investors.

Financial markets' knee-jerk response to turmoil is to wonder whether it will generate a reaction from central banks: the famous "put" that provides support for financial assets. But that ignores the better fundamental picture, which means that monetary policy needs to evolve, too. Markets may be more vulnerable to disconcerting swings as the safety net recedes. That is a challenge: Bank of England Gov. Mark Carney recently noted that the rise in market **volatility** wasn't surprising, but added: "One hesitates to say [it's] welcome."

Ultimately, while times were bad, central bankers could always err on the side of doing more and take the risk of doing too much. The consequences of those choices, and the need to unwind policy, were always going to be a problem for another day. Better growth means that day is now closer.

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Document J000000020180220ee2k00010

The New York Times

Business/Financial Desk; SECTB
Congress Sets Path To Fix Crisis In Pensions

By JIM TANKERSLEY and ALAN RAPPEPORT
1,654 words
19 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

WASHINGTON -- The sprawling agreement to boost government spending reached by Republicans and Democrats this month quietly included a step toward defusing what could be a financial time bomb for 1.5 million retirees and hundreds of companies in the industrial Midwest and the South.

The deal creates a select congressional committee to craft what could effectively be a federal rescue of as many as 200 so-called "multiemployer" pension plans -- in which employers and labor unions band together to provide retirement benefits to employees.

Many of these plans are hurtling toward insolvency in the coming decade, with benefits owed to retirees projected to swamp what the plans can afford to pay. The 16-member, bipartisan committee will have to come up with a solution and legislation by the end of November, which the full Senate would need to vote on by the end of the year.

Select congressional committees have long struggled to produce results, like one during the Barack Obama administration meant to reduce the growth of the national debt. This committee's work will be complicated by disagreements over whether companies, retirees or taxpayers should bear the brunt of the cost for shoring up pension plans that would otherwise run out of money.

"A solution that works is going to be challenging for all parties, and that's going to make it hard to get political buy-in," said Aliya Wong, the executive director of retirement policy at the U.S. Chamber of Commerce, which has pushed Congress to solve the multiemployer pension problem. "The biggest issue is, where do you get the money from? Every source seems to be tapped out."

Pension plans across the nation are facing shortfalls, with both corporate plans and those for public employees like teachers and firefighters owing more to retirees than the investment funds can possibly pay. But the looming collapse of the multiemployer pension system is significant given the sheer number of people affected and the potential for a devastating economic ripple effect: retirees losing the pension checks that keep them afloat and a potential wave of bankruptcies among the companies that once employed those workers.

The situation has been brewing since the 2008 financial crisis, as investments plummeted, leaving many plans in the red. The slow economic recovery and recent **stock market** rally have not been sufficient to reinvigorate the plans, which are jointly funded by labor unions and employers whose workers participate in them.

According to Boston College's Center for Retirement Research, the nation's 1,400 multiemployer plans are facing a $553 billion "hole" of unfunded liabilities, meaning they don't have sufficient assets to cover what they owe workers. About a fourth of these plans are in the so-called "red zone," where insolvency is more imminent, potentially within the next 10 to 20 years. Most of the participants in these plans work in the transportation, services and manufacturing industries. Their employers, many of which have been trying to withdraw from the plans, include companies like United Parcel Service and Kroger.

U.P.S. said in 2016 that it could be responsible for nearly $4 billion in benefits payments if the Central States Pension Fund, the largest multiemployer plan facing insolvency, slashes benefits to retirees or becomes insolvent. In the past year, U.P.S., which participates in more than two dozen pension plans, has been working with lawmakers on Capitol Hill to help develop pension legislation. It has also offered its own proposals.

"We want the system stabilized and fixed in the long term because we're in so many plans and we have a lot of employees in the plans," said Chris Langan, vice president of finance at U.P.S. "It's something that is not wise to wait on."

Now, Congress must decide whether to rescue these funds with low-cost loans, force them to cut benefit payments or let the funds go bankrupt and wipe out retirees' entire pensions.

Ms. Wong and other advocates of congressional action say they are optimistic that the committee can achieve rare bipartisan success. Members of Congress across the aisle, they say, are coming to grips with the cost of doing nothing.

"This committee forces Congress to get serious," said Senator Sherrod Brown, Democrat of Ohio, a longtime champion of unions who represents many retirees covered by the pension plans, and who fought for the committee's creation in the spending bill. "It forces us to come together and work out differences."

The strain on the multiemployer pension system carries another risk -- the potential annihilation of the Pension Benefit Guaranty Corporation, the government agency that insures pension plans. The P.B.G.C. said in its latest annual report that its multiemployer program is likely to run out of money by the end of fiscal year 2025 because of the "rapid decline" in the P.B.G.C.'s financial position. In 2017, the agency paid $141 million in financial assistance to 72 multiemployer pension plans and that number is expected to rise as more plans collapse.

If the multiemployer pension plans go broke, the federal safety net created to protect retirees will not have enough money to make good on the promised benefits, leaving workers with little to no retirement benefits.

"It's an urgent problem that needs to be fixed," said Alicia H. Munnell, a management professor at Boston College and the director of its Center for Retirement Research. "Unfortunately there's an ideological divide -- do you bail these people out or not?"

"No one wants to see old, poor people penniless in retirement," she said.

Mike Walden, a retired Teamster and the president of the National United Committee to Protect Pensions, has led fellow retirees to Washington for several years to pressure members of Congress to fix the problem. Retirees, already squeezed by living on a fixed income, are frustrated at the prospect of seeing their benefits reduced or eliminated if Congress does not act, he said. "I don't think they understand, when they take money away from us, how much they're going to hurt the economy."

Mr. Walden called the creation of the committee a "meaningful step" to soothe nervous retirees. "It's been way too long -- just talk, talk, talk, talk," he said.

To succeed, the committee must navigate Washington's aversion to anything that resembles a bailout, particularly as the government is running large deficits that are projected to grow $7 trillion over the next decade -- and when many Republicans see unions as political enemies.

And Congress has already tried to help these plans, with little success. In 2014, the Multiemployer Pension Reform Act was enacted to help funds develop rescue plans, including by reducing benefits to retirees. In 2015, Central States submitted such a plan to the Treasury Department, but it was rejected the following year on the grounds that the proposed benefit reductions were unlikely to help the fund avoid insolvency.

Mr. Brown and Representative Richard E. Neal of Massachusetts, a Democrat, have pushed an effort that would attempt to stabilize plans with 30-year loans from the Treasury Department, as long as plan managers could demonstrate the money would put them on a path to solvency -- and not invest it in risky assets. Fiscal hawks, like the Committee for a Responsible Federal Budget, warn that the bill could leave taxpayers responsible for as much as $100 billion if the loans are not repaid. Backers of the bill say taxpayers should not end up paying a dime.

"This is beyond party affiliation, this really cuts to the root of what retirement is going to look like," said Mr. Neal, who will be a member of the special committee and has been working to recruit more House Republicans to support his proposal.

Mr. Neal has six Republican co-sponsors on his bill and said that several others have expressed support. A handful of Republican senators have also been engaged on the issue, including Shelley Moore Capito of West Virginia, who said this month that she was pleased the spending bill "recognizes the urgent need to help tens of thousands of retired coal miners."

The Trump administration has been largely quiet on the situation, but when asked about it at a congressional hearing last week, Steven Mnuchin, the Treasury secretary, noted that it was a ''significant'' issue and promised to offer technical assistance to support any solution that lawmakers find.

As congressional negotiators homed in on a spending deal early this year, Mr. Brown pushed Senator Chuck Schumer of New York, the minority leader, to attach his pension language to the larger budget agreement. The bill establishes a process to ensure that if the commission produces a bill supported by a majority of its Democratic and Republican members, the Senate will vote on that bill before a new Congress convenes next year.

If concern over retirees is not enough to get lawmakers to act, those who represent pension funds hope that concern about the broader economy will. Michael D. Scott, executive director for the National Coordinating Committee for Multiemployer Plans, projects that if all of the pension plans that are in ''critical'' and ''critical and declining'' condition go broke, the federal government would face a half trillion dollars in lost tax revenue over the next decade because of the taxes that the active funds currently pay.

''I think ultimately the government is going to look at how much tax revenue it is going to lose without a solution,'' Mr. Scott said.

Senator Sherrod Brown, Democrat of Ohio, fought for the creation of a select congressional committee to tackle the plans. (PHOTOGRAPH BY ERIN SCHAFF FOR THE NEW YORK TIMES); A United Parcel Service driver. U.P.S. is worried about nearly $4 billion in benefits payments. (PHOTOGRAPH BY MARK LENNIHAN/ASSOCIATED PRESS) (B4)

Document NYTF000020180219ee2j00049

THE WEEK AHEAD
Business/Financial Desk; SECTB
Walmart Earnings; Warren Buffett's Letter

By THE NEW YORK TIMES
909 words
19 February 2018
The New York Times
NYTF
Late Edition - Final
2
English

Here's what to expect in the week ahead:

MARKETS

Markets will be closed for Presidents' Day.

In observance of Presidents' Day, **financial markets** and most banks in the United States will be closed on Monday. The holiday, established in 1885 in recognition of President George Washington, is now generally viewed as a day to celebrate all United States presidents. For most Americans, though, the day has become an occasion to hit the stores for sales over the long weekend. Mathew Brownstein

ECONOMY

The European Central Bank picks a new vice president.

Finance ministers from the eurozone, meeting in Brussels, are expected on Monday to recommend a replacement for Vítor Constâncio, the vice president of the European Central Bank, whose term expires at the end of May. The only two candidates are Luis de Guindos, the economics minister of Spain, who is the favorite; and Philip Lane, the governor of Ireland's central bank. The selection of a new vice president is the first in a series of major personnel decisions that could alter the character of the central bank. The culmination will be the choice of a successor to Mario Draghi, the president, whose term expires in October 2019. Jack Ewing

RETAIL

Walmart's earnings may show the strength of e-commerce.

Walmart reports its fourth quarter earnings on Tuesday. Analysts will bee looking for signs that the nation's largest retailer can continue to build out its e-commerce business without greatly eroding profits. Walmart is also expected to release details on its sales from the holidays, which were strong for many retailers. Michael Corkery

BANKING

Big British banks will report earnings.

Investors will be focused on British banks as that nation's largest lenders are scheduled report their fourth-quarter results, including HSBC on Tuesday, Lloyds Banking Group on Wednesday, Barclays on Thursday and Royal Bank of Scotland on Friday.

Several of Europe's biggest banks have taken large charges in the fourth quarter as they have been hit by changing tax laws, particularly in the United States. Last week, Credit Suisse reported a fourth-quarter loss of 2.13 billion francs, or about $2.3 billion, driven primarily by 2.23 billion francs in income tax expenses as a result of tax changes in the United States. Chad Bray

ECONOMY

The Fed will release details about its January meeting.

The Federal Reserve spent much of last year debating whether inflation was rising too slowly. New year, new problem: A federal tax cut took effect in January, the unemployment rate is just 4.1 percent and investors are now worried that inflation might start rising too quickly. That, in turn, could prompt the Fed to accelerate the upward drift of its benchmark interest rate. So far, there's no sign that the Fed has adjusted its plans. The central bank, as expected, left the benchmark rate unchanged at its first meeting of the year, in late January. It will publish an account of that meeting on Wednesday, providing at least a little more information about its outlook and its plans for the coming year. Binyamin Appelbaum

The E.C.B. sheds light on the eurozone economy.

The European Central Bank will publish on Thursday an account of the discussion that took place last month when its Governing Council met to decide monetary policy. Investors and analysts will dissect the minutes for clues about how fast the central bank will wind down its stimulus to the eurozone economy. Interest in the European Central Bank's intentions is particularly acute. One of the main things causing turmoil in global stock markets recently is uncertainty about how soon central banks will bring an end to the easy credit that has prevailed for the decade since the financial crisis. Jack Ewing

AUTO INDUSTRY

Diesel may have a day of reckoning in Germany.

Germany's highest administrative court, based in Leipzig, will hear arguments on Thursday -- and may issue a ruling -- on whether cities should be forced to take stronger action to address auto emissions. That could include bans on diesel cars. An environmental group filed the suit arguing that measures taken so far by Düsseldorf and Stuttgart are inadequate, exposing citizens to nitrogen oxide emissions that regularly exceed legal limits. A ruling against the cities would have far-reaching effects in Germany, where many urban areas suffer from excess pollution that comes mainly from diesels. Jack Ewing

INSURANCE

Warren Buffett sends his annual letter.

Warren Buffett's annual letter to Berkshire Hathaway's shareholders has become one of corporate America's most combed-over dispatches. For more than 50 years, Mr. Buffett's letter has not just expounded on the conglomerate's performance but also dispensed investment advice, folksy wisdom and a few corny jokes. The latest missive arrives on Saturday. Last year, Berkshire Hathaway's insurance business was hit by hurricanes Harvey, Irma and Maria and an earthquake in Mexico. The company also made another bet on the United States economy with its purchase of a nearly 40 percent stake in Pilot Travel Centers, a truck stop operator. But investors will also be looking for any further discussion of succession after Berkshire Hathaway promoted Gregory Abel and Ajit Jain to oversee the company's many and varied businesses. Stephen Grocer

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

Document NYTF000020180219ee2j0003q

THE WALL STREET JOURNAL.
U.S. EDITION

What Wall Street Worries? Stocks Make a Comeback

By Amrith Ramkumar, Akane Otani and Ira Iosebashvili
1,001 words
17 February 2018
The Wall Street Journal
J
A1
English

Wall Street finished its best week in years as stocks staged a recovery from a tumultuous period that pushed major indexes into correction territory, a sign that **bullish** sentiment remained intact.

Both the **S&P 500** and the **Dow Jones Industrial Average** climbed 4.3% for the week, the **S&P 500**'s biggest gain in more than five years and the best performance for the Dow since the 2016 presidential election. The indexes have risen for six consecutive sessions, the Dow's longest winning streak since November. The blue-chip index has now recovered roughly half of its more than 10% decline from its January peak. For the year, the Dow is up 2%.

For some, this week's rebound makes sense. The rout reflected concerns that valuations were getting too high, and the sudden rise in **volatility** made the selling worse, they say. After last week's selling, metrics like price-to-earnings ratios have come down.

Global growth is improving and U.S. corporate earnings look healthy. Interest rates and inflation remain low by historical standards despite recent signs they may be rising. All this should push share prices higher, these investors suggest.

"The backdrop is as strong as I've ever seen," said Craig Hodges , portfolio manager for Hodges Funds, who bought stocks including Bank of America and Micron Technology over the past week. While he thinks price **volatility** may return, "I do believe all the selloffs long term will be buying opportunities."

Still, some investors worry that if the rally continues at the current pace, it could raise some of the same issues that rattled stocks earlier: concerns that shares are rising too quickly, bond yields are increasing faster than anticipated and that the Federal Reserve will raise interest rates at a quicker pace than expected to keep inflation in check.

"It's risk on now," said Francois Bourdon, global chief investment officer for Fiera Capital. "It could be risk off tomorrow."

Stocks' sudden resurgence -- which coincides with gains in emerging markets, commodities and other risky investments -- is giving many investors whiplash as they try to make sense of the wild price moves that have left many confused.

"If you've been a bull it's pretty good, and if you're **bearish**, you're starting to question your thinking," said Jim Paulsen, chief investment strategist at research firm Leuthold Group . "If you go back five days ago, it would be just the opposite."

January featured a record $102 billion of inflows into mutual funds and exchange-traded funds that invest in stocks globally, helping push stock markets to all-time highs. Some analysts referred to a "melt-up" phenomenon where investors jumped in without bothering about fundamentals.

But at the start of February, as bond yields nudged higher and data showed faster wage growth, investors started to fret that inflation could be coming back. Stocks suffered their worst selling in two years and global and U.S. stock funds experienced their highest-ever weekly outflows through Feb. 7, according to fund tracker EPFR Global.

Now, many are starting to pile back in, or saying they will soon, including retail investors. The share of individual investors who think the **stock market** will rise over the next six months jumped 12 percentage points to 49% in the week through Wednesday, according to the American Association of Individual Investors . Outflows from U.S. stock mutual funds and exchange-traded funds dropped to $7.2 billion in the second week of February, from $22.9 billion the previous week, EPFR data showed.

Technology stocks on the **S&P 500** have rebounded by 8.5% since Feb. 8, compared with a 5.1% rise in the utility sector, suggesting that investors are shifting away from safe areas and back into comparatively risky plays.

The MSCI Emerging Markets Index is also up 5% from its recent low, **oil prices** have edged higher, and copper is back near the roughly four-year high it reached in December. Even the price of bitcoin has come roaring back.

The cryptocurrency was recently trading at $10,057.88, about 45% higher than its recent low on Feb. 5, according to CoinDesk.

News on Wednesday that consumer prices in January rose higher than expected initially weighed on stocks, but the market later rallied and share prices closed higher.

Those gains were a sign that investors are less fearful of inflation than last week's rout would suggest, said Tim Rudderow, chief investment officer at Mount Lucas Management LP .

Investors have decided the recent inflation reading is "just good growth, not the end of the world," he said. He owns stocks like General Motors and Kohl's that he thinks will benefit as investors turn from technology names that have led the markets higher in recent years.

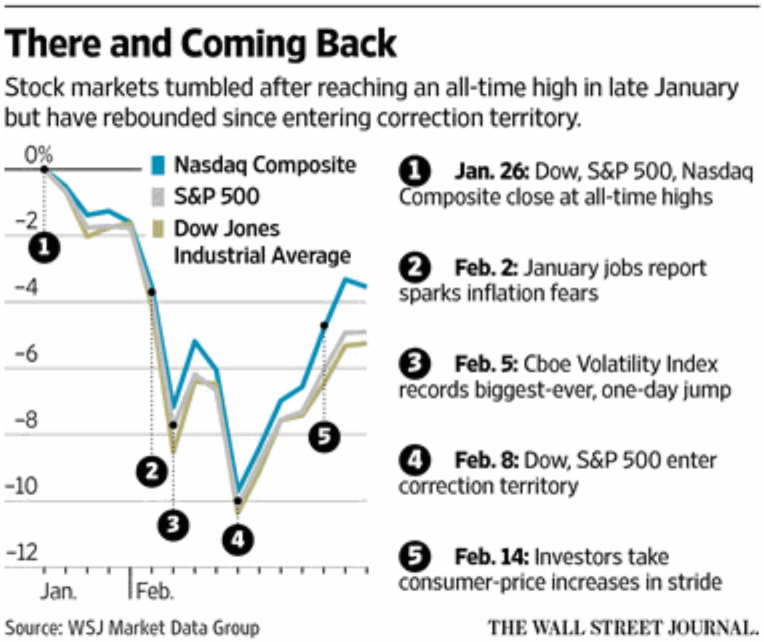
But many remain cautious. The close-knit moves between stocks, commodities and other risky bets could contribute to further swings in global markets as traders unwind popular trades from last year.

Average correlations between the **S&P 500**, 10-year **U**.**S**. **Treasuryyield**, euro and oil are higher than they have been for much of the past four years, according to Deutsche Bank .

Fund managers shed their stockholdings in February, pushing the share of investors who say they are overweight equities in their portfolios to 43% from 55%, according to a Bank of America Merrill Lynch fund-manager survey conducted at the start of the month. That marked the biggest one-month drop in equity allocations in two years.

Cash holdings are up, and more investors are watching the price swings from the sidelines. Average daily trading volumes since Feb. 9 have been 22% lower than they were from Feb. 2 to Feb. 8.

"The market has bounced back way too fast, and we're in danger of seeing another stall-out," said Kenny Polcari, managing director at broker-dealer O'Neil Securities.



Document J000000020180217ee2h0005e

The New York Times

WEALTH MATTERS
Business/Financial Desk; SECTB
Five Tips to Ride Out a Wildly Swinging Stock Market

By PAUL SULLIVAN
1,340 words
17 February 2018
The New York Times
NYTF
Late Edition - Final
3
English

The **stock market** has been shaken by turbulence in the last few weeks, something it hasn't experienced in a few years.

The **Standard & Poor's 500**-**stockindex** plunged more than 10 percent from Jan. 26 to Feb. 8, a sell-off that pushed the market into a correction. The S.&P. has since rebounded, regaining much of those losses. That type of **volatility** is a normal occurrence, but theories abound to explain what caused it.

Adam I. Taback, deputy chief investment officer for Wells Fargo Private Bank, said the **volatility** was the result of the economic expansion's being in the seventh or eighth inning of a baseball game.

''We may have extra innings in this cycle,'' he said. ''But people are more cognizant that the equity markets have more risk in them. They're happy that their portfolios are diversified but worried where they are in the economic cycle.''

Some try to take a more historical view. Jack Ablin, founding partner and chief investment officer at Cresset Wealth Advisors, said **volatility** typically arose for three reasons: a technical correction where stocks pause but continue rising because company fundamentals are sound; a correction that reflects a change in the business cycle; or a systemic correction, like the 1929 **stock market** crash or 2008 financial crisis.

''The one we experienced last week was the mildest,'' Mr. Ablin said. In other words, just a technical correction.

Others think it was a return to the normal function of a **stock market**: Some days, investors sell more stock than they buy.

''When the Dow drops 1,000 points, that's more a testament to the growth of the Dow,'' said Francis M. Kinniry, head of portfolio construction at Vanguard. ''That's still just a 4 percent move, because the Dow is at 25,000. Dropping 100 points on the **S**.**&P**. **500** doesn't get people upset, but it's the same thing.''

Who is correct won't be known for months, or years, when market historians look back. That's cold comfort for investors who are worried now. A report on Wednesday showed that inflation pressures appeared to be building, heightening the anxiety among investors.

Don't fret. Here are five tips from professionals that could help ensure that a **volatile** ride doesn't derail your financial planning.

Pick individual winners. With wild swings in the markets, active investment managers -- those who buy and sell individual stocks instead of allocating money to an investment fund that tracks an index -- say their skills are more in need now.

They argue that stocks are going to begin to show differences and that their skills at stock selection will keep investors' portfolios from being dragged down with an entire index. In other words, in a market where everything isn't going up, selecting the best individual companies makes more sense.

Francisco Bido, the head of quantitative research and a portfolio manager at Cognios Capital, said he had reduced the number of stocks he invested in after the recent **volatility**. The move came out of conviction, not fear, he said.

"A lot of those big passive vehicles out there buy so many stocks because they have a mandate to track an index," he said. "I think it helps to be a bit more concentrated. It allows investors to find a different avenue."

His strategy is also an argument to know what you own. That's good advice in any market.

But an indexing behemoth like Vanguard says that is an overused argument. Nearly 90 percent of active managers have underperformed the indexes they track, Mr. Kinniry said.

"It's not an active versus index story," he said. "It's high cost versus low cost. They underperform because they're charging too much for the 'alpha' they generate," he added, referring to the return in excess of the market return.

Mr. Kinniry is correct that fees eat into any return, regardless of how **volatile** the market is.

Consider bonds carefully. Years of low interest rates have had the same lulling effect on investors as the steadily climbing **stock market**. But bonds, which remained low for years, are now returning a higher yield, adding pressure to the shaky **stock market**.

But rising interest rates could eat away returns for individual investors. Driving this worry is a new chairman of the Federal Reserve, Jerome H. Powell, who took charge on Feb. 5, as the **stock market** dipped.

An alternative to bonds for affluent investors is private debt, which provides loans to small and medium-size companies. The loans are generally just a few years in duration and pay an annual yield of about 10 percent. The risk is in the credit quality of the borrower.

Mr. Taback of Wells Fargo Private Bank said that although there was credit risk in the loans, private debt does not feel the same impact that bond portfolios do when interest rates rise. "Now that you're seeing losses in bond portfolios, clients are more receptive to this," he said.

Find alternative strategies. Alternative investments are the province of investors who are willing to sacrifice access to their money for higher returns. But when markets were posting double-digit gains, they became less attractive.

Hedge funds, in particular, earned a bad reputation for the high fees they charge to manage money on top of taking a share of any profits. Some sophisticated institutional managers, like the California Public Employees' Retirement System, announced in 2014 that it was getting out of hedge funds because they were too expense and complex.

But financial advisers and money managers are arguing that in a **volatile** investing environment, investors should reconsider hedge funds and other alternative assets like private equity, private debt and real estate. Their returns, they say, are less correlated to the fluctuations of the stock and bond markets and thus provide a steadying force.

"Last year, you could ignore risk and focus on return," said Jae Yoon, chief investment officer of New York Life Investment Management. "This year, we're getting more normal **volatility**, and most clients will find they don't have enough alternative strategies."

Go global. In Europe and Japan, the economic recovery started later and, the thinking goes, still has years to run. In some cases, the recoveries in Europe and Japan started in 2014, as opposed to 2009 in the United States, said Darrell L. Cronk, president of the Wells Fargo Investment Institute.

He said the strong rally in the United States markets had many investors with overweight investments in American stocks, a phenomenon known as home-country bias.

But since last year, many developed and emerging markets have begun to perform strongly. "The more explosive growth is happening in the younger economies around the world," said Rick Pitcairn, chief investment officer of Pitcairn, an investment adviser to wealthy families.

Enjoy the ride. Once markets become **volatile**, they tend to stay that way for a while. It's a shift in investor sentiment.

"There's persistence in **volatility**," Mr. Kinniry said.

But **volatility** is not necessary a bad thing when you have a plan. Mr. Cronk pointed out that even big corrections were a normal part of an economic cycle.

The last two economic recovery cycles, in the 1990s and the 2000s, had three corrections apiece toward the end, he said. Investors who bailed after the first correction in each recovery missed out because the markets rose 20 percent afterward.

''Corrections are normal and healthy,'' Mr. Cronk said. ''Investors should look at them opportunistically more so than be afraid of them.''

Darrell L. Cronk, president of the Wells Fargo Investment Institute, said that big corrections were a ''normal and healthy'' part of an economic cycle. (PHOTOGRAPH BY JEENAH MOON FOR THE NEW YORK TIMES); Traders on the floor of the New York Stock Exchange on Thursday, one week after the **Standard & Poor**'**s** **500**-**stockindex** entered correction territory. (PHOTOGRAPH BY LUCAS JACKSON/REUTERS)

Document NYTF000020180217ee2h0005z

The New York Times

Business/Financial Desk; SECTB
Winning Streak Extends To 6th Day on Wall St.

By THE ASSOCIATED PRESS
562 words
17 February 2018
The New York Times
NYTF
Late Edition - Final
4
English

Stocks closed out their strongest week in five years on Friday and have now recovered more than half of the losses they suffered in a plunge at the beginning of the month.

Investors got back to buying stocks almost as quickly as they started dumping them. The gain on Friday was the sixth in a row for the **Standard & Poor's 500**-**stockindex**. A combination of cheaper prices for stocks as well as solid company profits put investors back in a buying mood.

The **S**.**&P**. **500**, which many index funds track, has risen almost 6 percent in its current streak. Investors haven't hesitated to buy the same types of stocks that did well before the market's recent slump, including technology companies and banks.

In a typical market downturn, investors might avoid stocks that have had huge run-ups out of fear they had gotten too expensive. Instead, investors are still betting on more strength in the economy and are buying companies that tend to do better in times of faster growth.

The **S**.**&P**. **500** gained 1.02 points, or less than 0.1 percent, at 2,732.22. That includes a gain of 4.3 percent this week.

The **Dow Jonesindustrial average** rose 19.01 points, or 0.1 percent, to 25,219.38. The **Nasdaq composite** lost 16.96 points, or 0.2 percent, to 7,239.47. The Russell 2000 index of smaller company stocks climbed 6.35 points, or 0.4 percent, to 1,543.55.

Homebuilders rose after the Commerce Department reported that construction of new homes jumped 9.7 percent in January. That was the highest level since October 2016, and permits, a sign of future construction, also climbed. NVR gained $131.23, or 4.3 percent, to $3,208.23 while D.R. Horton rose 46 cents, or 1 percent, to $45.57.

Among health care companies, drugmaker AbbVie jumped $3.70, or 3.2 percent, to $118.60 and Johnson & Johnson rose $1.92, or 1.5 percent, to $133.15.

Friday's gains didn't come without some bumps. The Dow was up 232 points at about 12:30 p.m., shortly before the special counsel, Robert S. Mueller III, announced the indictment of 13 Russians and three Russian organizations in a plot to interfere in the 2016 presidential election. Stocks gave up their gains after that and spent the afternoon meandering between small gains and losses.

The indictment says the Russians used social media propaganda, at times helping Donald J. Trump and harming the prospects of Hillary Clinton. Facebook fell $2.60, or 1.4 percent, to $117.36, and Twitter fell 55 cents, or 1.6 percent, to $33.06

Bond prices rose. The yield on the **10**-**year Treasury** note fell to 2.87 percent from 2.91 percent.

U.S. crude oil picked up 34 cents to $61.68 a barrel in New York.

Gold inched up 90 cents to $1,356.20 an ounce.

The dollar edged up to 106.30 yen from 106.27 yen. The euro fell to $1.2413 from $1.2506.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Friday. (Source: Reuters)

Document NYTF000020180217ee2h0004k

THE WALL STREET JOURNAL.
U.S. EDITION

Corrections & Amplifications
Corrections & Amplifications

185 words
17 February 2018
The Wall Street Journal
J
A2
English

The Cboe **Volatility** Index rose 116% on Feb. 5. A Page One article on Feb. 6 about the **stock market** incorrectly said it rose 117%.

(See: "Stock Plunge Erases 2018 Gains --- Dow industrials fall over 1,100 in biggest point drop ever; overseas indexes sink" -- WSJ Feb. 6, 2018)

In the Closed-End Funds tables in Monday's Business & Finance section, the column representing "12-month yield" for loan-participation funds, high-yield-bond funds, other domestic taxable-bond funds and world income funds was incorrectly labeled as "total return."

The names of hairstylist Nicole Mangrum and makeup artist Derrick Rutledge were incorrectly swapped in the credits for the photos of Oprah Winfrey with an article about her in the March WSJ. Magazine.

Anders Hayward was the movement director for the article "Chasing Rainbows" in the March WSJ. Magazine. His name was left out of the credits.

Readers can alert The Wall Street Journal to any errors in news articles by e-mailing wsjcontact@wsj.com or by calling 888-410-2667.

Document J000000020180217ee2h0004n

THE WALL STREET JOURNAL.
U.S. EDITION

Markets & Finance: Chicago Exchange Denial Was Emphatic --- The SEC's unanimous rejection of a sale to Chinese investors was tied to transparency

By Dave Michaels
821 words
17 February 2018
The Wall Street Journal
J
B9
English

WASHINGTON -- A political battle raged for nearly two years over a bid by Chinese investors to purchase the Chicago Stock Exchange. In the end, the government's decision to reject it wasn't a close call.

The five-member Securities and Exchange Commission voted unanimously to deny the sale, according to a commission disclosure on Friday. The regulator also agreed with critics who said the proposed investors might have concealed financial ties between them that could have undermined the exchange's integrity and its ability to protect investors.

The decision leaves the Chicago exchange without a clear path to challenge the decision, said Dave Herron, a former chief executive of CHX Holdings Inc., the venue's parent company. "Generally it's not a good idea to sue the government," he said. "Their pockets are very deep."

Exchange officials on Friday issued a rebuke of the SEC's decision, which they said "contains logic and representations with which CHX strongly disagrees."

The exchange didn't disclose whether it would appeal the order.

"By disapproving the transaction, the SEC has denied the American public an historic and unprecedented opportunity to build a mutually beneficial economic bridge between the world's largest economies, while unfairly disadvantaging our company and shareholders," the exchange said.

A lawyer for the investment group couldn't be reached to comment.

The ruling is a blow to the exchange's plan to a Western listings outpost for Chinese firms.

The unusual proposal sparked opposition in Congress, lobbying by other suitors and a spate of fake letters that purported to oppose the deal.

SEC commissioners voted against the deal six months after their staff recommended its approval. The commissioners' move to reconsider the deal last year gave them more time to demand records from the little-known Chinese companies seeking to buy the 136-year-old market.

The regulator faced persistent pressure from congressional critics to block the sale, with lawmakers saying the Chinese government would have been able to influence the exchange's operations or use it to rig the plumbing of the U.S. **stock market**.

The Chicago bourse first sought approval for the sale in December 2016.

The SEC said in an order posted Thursday that it didn't consider the threat of Chinese government involvement because the deal fell so short of the standard needed to approve it.

For instance, the SEC said it found that one of the entities, Xian Tong Enterprises Inc., may have received funding from people with family ties to a father-and-son duo who constituted the lead investors. Undisclosed financial links between investors could have violated rules that limit the control any one entity has over a stock exchange.

The limits exist because U.S. law grants exchanges quasi-governmental powers as regulators of their own markets.

The lead investor in the deal, Chongqing Casin Enterprise Group Co., would have owned 29% of the exchange's parent company. Chongqing Casin is controlled by Shengju Lu, whose son Jay Lu, a U.S. citizen, would have owned an 11% stake.

The SEC also said it found the source of funds pledged by two other Chinese entities, Chongqing Jintian Industrial Co. and Chongqing Longshang Decoration Co., to be murky. Shortly after regulators last year asked for more information about the sources of their cash, the two entities dropped out of the deal, the SEC's order said.

The SEC also questioned the roles of two U.S. investors in the deal: Raptor Group, the family office of former hedge-fund manager Jim Pallotta; and Anthony Saliba, a current board member of CHX Holdings who runs an options-trading and technology firm, Matrix Holding Group. The U.S. investors had the right to sell their stakes to the other owners after two years for a guaranteed rate of return.

John Jacobs, a former **Nasdaq** Inc. executive, said he wasn't surprised by the SEC decision -- the regulator has long insisted on transparency in who owns and controls a stock exchange, which is a corporation trying to maximize profits and a regulator charged with overseeing fair dealing.

"That was pretty clear they had serious issues there and a concern about the voting, too," said Mr. Jacobs, who is executive director of Georgetown University's Center for **Financial Markets** and Policy.

Mr. Herron, the former Chicago exchange executive, said he still found the rejection baffling, in part because that another government panel that reviews cross-border deals for national-security risks approved it in 2016.

But the Trump administration has taken a tougher stance on trade fights with China.

A White House spokeswoman, Lindsay Walters, said Friday that the Trump administration wasn't involved in the SEC's move to deny the deal.

Document J000000020180217ee2h0003z

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Fed Chief Envisions Sticking to Rate Path

By Nick Timiraos
442 words
17 February 2018
The Wall Street Journal
J
A2
English

Jerome Powell is stressing continuity as he takes over as Fed chairman, which suggests the central bank will keep gradually raising interest rates this year, unperturbed by recent market **volatility** and signs of firming inflation.

Fed officials are on track to raise interest rates at their March meeting, as widely anticipated by investors.

But a bigger question for markets is whether officials pencil in a total of three rate increases this year, as they did in December, or if strong growth and new fiscal-stimulus measures prompt them to add a fourth.

Policy makers don't see such projections as particularly consequential now, according to recent interviews and public statements, because they will have plenty of time to adjust their plans as the year unfolds.

"While the challenges we face are always evolving, the Fed's approach will remain the same," said Mr. Powell at his swearing-in ceremony this past week. "We are in the process of gradually normalizing both interest-rate policy and our balance sheet with a view to extending the recovery."

The Fed has raised its benchmark short-term rate five times since December 2015 to a range between 1.25% and 1.5%. Officials have largely shrugged off the **stock market**'s recent turbulence as unlikely to hurt the economy, which has been growing at a solid pace. It would take a more serious **financial-market** disturbance to prompt a change in plans.

"My outlook hasn't changed because the **stock market** is a little bit lower than it was a few days ago," said New York Fed President William Dudley. "It's still up sharply from where it was a year ago."

Fed officials also welcome signs inflation is rising toward their 2% target, a level they view as consistent with a healthy, expanding economy.

Prices excluding the **volatile** food and energy categories rose 2.6% in January on a six-month annualized basis, up from a 1.1% gain in July and one of the strongest periods in years, according to the Labor Department's consumer-price index released this past week. The Fed's preferred inflation gauge, the personal-consumption-expenditures index, is projected to rise 1.6% in January from a year earlier, according to Morgan Stanley economists.

Top officials are unlikely to change course in response to such figures, just as they didn't veer from their path last year when inflation was weaker than they expected. They also don't yet see signs inflation is headed much above their target.

Document J000000020180217ee2h0003u

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Infrastructure Plan Is Clunker for Investors

By Spencer Jakab
484 words
17 February 2018
The Wall Street Journal
J
B10
English

[Financial Analysis and Commentary]

Maybe it should be called "Infrastructure Weak."

In the days following the 2016 U.S. presidential election, investors took President-elect Donald Trump at his word that he would open the floodgates of federal spending and deregulation to fix America's creaking transport, energy and water systems.

A basket of 10 U.S. stocks with exposure to infrastructure spending beat the **S&P 500** by nearly 13 percentage points in the eight trading sessions through Nov. 17, 2016. In the four sessions following Monday's much-delayed release of the White House's infrastructure plan, though, the same stocks lagged behind the broader market.

Whether one calls it a $1.5 trillion plan or a $200 billion plan -- the latter is the actual value of proposed new federal spending over a decade -- investors clearly sense that there is less to it than meets the eye.

One reason is the assumed ratio of funding. The largest chunk, $100 billion for the Incentives Program, would be awarded based largely on an at least 4-to-1 ratio of nonfederal to federal money. That gets the value of the administration's plan to $1.5 trillion. Most of the nonfederal money must come from state or local governments rather than private entities.

That ratio is far above the 1-to-1 typical of large projects such as the recently completed new Mario Cuomo Bridge in New York. A more serious problem is that the White House's budget proposal would reduce existing federal infrastructure funding elsewhere.

The recently passed tax cut also weighs on the infrastructure plan. The expanding federal budget deficit and rising bond yields have made borrowing more expensive for state and local governments. A lower marginal top tax rate makes municipal bonds less attractive to wealthy individuals, their biggest buyers. And limits on deductions for state and local taxes makes it harder for governments to raise taxes.

Unless the federal government comes up with more funding for existing programs like the Highway Trust Fund, whatever gains are achieved by the infrastructure programs will be offset by cuts elsewhere.

The Highway Trust Fund, which was bailed out in 2016, will need about $100 billion in the next decade to stay solvent, based on Congressional Budget Office projections, the same amount as the proposed Incentives Program. The U.S. Chamber of Commerce, which praised the infrastructure program, also called this past week for a gasoline tax increase of 25 cents a gallon to support the highway fund.

Gaudy headline numbers aside, investors are clear in their view that Mr. Trump's infrastructure plan, even if adopted, would do little to boost overall spending. New rules and incentives are nice, but more spending and the revenue to back it up are the missing ingredient.

page,5043
Document J000000020180217ee2h0003r

The New York Times

Business/Financial Desk; SECTB
S.E.C. Blocks Chinese Deal for Exchange

By EMILY FLITTER
552 words
16 February 2018
The New York Times
NYTF
Late Edition - Final
4
English

A federal securities regulator on Thursday struck down the proposed $20 million acquisition of a Chicago-based trading hub, the Chicago Stock Exchange, by a Chinese-owned company.

The Securities and Exchange Commission said it blocked the deal because of a lack of transparency in the details, including an inability to identify who exactly would control the exchange.

The proposed deal, in which a subsidiary of the Chongqing Casin Enterprise Group was to buy the exchange, drew sharp criticisms from Republican and Democratic lawmakers, who said it could put the security and stability of United States **financial markets** at risk.

President Trump has railed against the proposed acquisition. During a presidential debate in South Carolina in 2016 after the deal was announced, he said: ''China bought the Chicago Stock Exchange -- China, a Chinese company. They are taking our jobs. They are taking our wealth. They are taking our base.''

Lawmakers applauded the S.E.C.'s action on Thursday.

''This has been a long fight, and I am grateful that we have a president who recognizes the security threats from Chinese government-affiliated ownership of the Chicago Stock Exchange,'' Representative Robert Pittenger, Republican of North Carolina, said in an emailed statement. ''Recall, the Obama administration was misguided and fully endorsed this transaction.''

Other Chinese-backed deals have come under scrutiny, including a partnership between Goldman Sachs and China's sovereign wealth fund, the China Investment Corporation; a hotel buying spree by the Chinese insurance company Anbang; and an effort by Huawei Technologies to purchase a stake in 3Com, an American maker of internet routers and networking equipment.

Supporters of the Chicago Stock Exchange proposal said it could help bring more Chinese companies to United States **financial markets**. And it would also have helped revive a marketplace where activity was dwindling. The Chicago Stock Exchange handles only a small fraction of the stock trades that take place every day.

A spokesman for the Chicago Stock Exchange declined to comment. Representatives of Chongqing Casin could not be reached for comment.

The proposed acquisition had been approved in late 2016 by the Committee on Foreign Investment in the United States, which reviews deals for national security concerns. The deal had been recommended for approval by the S.E.C. staff, but was delayed by the chairman, Jay Clayton, who was appointed by Mr. Trump.

In its decision to reject the deal, the S.E.C. said the proposal left too many unanswered questions about who would ultimately have control over big decisions at the exchange. The S.E.C. said it was also not sure it would have access to the exchange's books and records after the deal.

The commission said it did not consider broader criticisms of the deal's potential impact on market security or whether Chongqing Casin had ties to the Chinese government. In an order made public on Thursday, the commission said it was ''not necessary'' to consider those concerns, because the structure of the deal itself was problematic enough on its own.

Follow Emily Flitter on Twitter: @FlitterOnFraud

President Trump has railed against the proposed acquisition of the Chicago Stock Exchange by a Chinese-owned company. (PHOTOGRAPH BY M. SPENCER GREEN/ASSOCIATED PRESS)

Document NYTF000020180217ee2g0000n

The New York Times

Business Day
Gun Makers Are Reeling Even as Threat of Regulation Recedes

By Michael Corkery and Tiffany Hsu
1,159 words
16 February 2018
06:38 PM
NYTimes.com Feed
NYTFEED
English

As the school shooting in Parkland, Fla., stokes the national debate over firearms, it may be easy to overlook another major development in the gun world this week.

One of the nation's oldest and largest gun makers, Remington, said it was nearing a bankruptcy filing.

Hit with slumping sales and unable to sell itself, Remington has negotiated a deal with its lenders to cut its debt and keep operating.

Other gun makers are also struggling. Colt completed its trip through bankruptcy last year, while sales and profits at Smith & Wesson's parent company have plummeted and its **stock price** is sagging. All three companies make a version of the AR-15-style semiautomatic rifle, which was used by the killer in Parkland on Wednesday and is the weapon of choice for mass shootings.

The problems demonstrate the paradoxical and tumultuous nature of the gun industry. It has prospered when the prospect of tighter regulations induces people to buy more guns.

And it slumps when that threat of new regulation subsides, as it has done during the Trump administration. President Trump, who has called himself a "true friend and champion" of guns, did not mention gun control in his remarks on Thursday about the Parkland shooting. And many leaders in the Republican-controlled Congress, where gun restrictions have withered over the years, have shown no change of heart in light of this week's school shooting.

"When people feared there would be increased gun regulation, they went out and bought more guns," said Kevin Cassidy, an analyst at Moody's Investors Service, who covers the gun manufacturers.

During the Obama administration, F.B.I. background checks on prospective firearms buyers — a rough proxy for sales — surged nearly 50 percent in the month of the Sandy Hook attack in 2012, compared with the same month a year earlier, as calls rang out for tighter legislation. Similarly, the number of background checks swung up more than 43 percent after the shooting in San Bernardino, Calif., in 2015 and nearly 40 percent after the massacre in Orlando six months later.

But that trend has reversed since Mr. Trump has been in office. In October, when a gunman killed 58 people in Las Vegas and injured hundreds, background checks slumped, falling 13 percent from the same month a year earlier.

Over all, background checks tumbled more than 8 percent last year, the largest fall since the F.B.I. began keeping track in 1998.

"There is no panic buying of guns because there is clearly no threat of federal government action in response to mass shootings that would restrict or regulate firearms," Daniel Webster, the director of the Johns Hopkins Center for Gun Policy and Research, wrote in an email. "The gun lobby can't scare their followers into thinking Donald Trump would sign any piece of gun control legislation as they could under an Obama presidency."

Remington, founded in upstate New York by Eliphalet Remington II in 1816, is the oldest manufacturer of rifles and shotguns in the country.

DuPont, the chemical company, bought a majority share in Remington in 1933, purchased the firearms maker outright in 1980 and then sold it to an investment firm in New York in 1993. The private equity firm Cerberus Capital Managementbought the company in 2007 for $118 million and rolled it up with other gun manufacturers into a conglomerate called Freedom Group.

Under Cerberus, the company enjoyed years of expanding gun sales. In 2012, the number of guns made in the United States totaled 8.5 million, more than double the 3.3 million that were produced a decade earlier.

But in December 2012, a gunman walked into Sandy Hook Elementary School in Newtown, Conn., and killed 20 children and six adults. When the authorities reported that the gunman had used an AR-15-style rifle made by Remington, public anger focused on the manufacturer.

Large investors, like the California State Teachers' Retirement System, began taking steps to divest from the gun maker. Cerberus said it would seek to sell the company.

Despite the public outcry, the fallout from Sandy Hook helped the company's bottom line. Spurred by calls that gun controls were imminent, buyers purchased more Remington firearms, and sales surged 36 percent, to $1.3 billion in 2013, Moody's said.

Some investors may have had objections to Remington, but not everyone. After the Sandy Hook shooting, Remington was able to borrow millions more as gun production boomed, particularly heading into the 2016 presidential election because Hillary Clinton was expected to win and push for tighter gun controls.

The company borrowed $12.5 million from the City of Huntsville, Ala., in 2014 to open up a new plant there. The city has agreed to eventually forgive the loan if Remington meets hiring targets over a number of years, said Chip Cherry, chief executive of the Chamber of Commerce of Huntsville and Madison County.

Remington also borrowed $175 million to buy out investors that wanted to divest. (Remington has paid out a total of $48 million, according to a company filing.)

The company does not disclose its lenders, but an analysis by Morningstar shows that some of Remington's debt is held in funds managed by JPMorgan Chase. Oppenheimer, the large mutual fund company, also owned some of the bonds issued by Remington, but said it sold its debt holdings last year.

In 2017, Mr. Trump's first year in office, sales fell 27 percent in the first nine months (the most recent data available) from the same period a year earlier. After production was ramped up in expectation of a Clinton presidency, gun inventories have piled up.

On Monday, Remington announced that its lenders had agreed to cut its $948 million debt load by $700 million in exchange for an ownership stake in the company. Analysts said at the time that even with its lower debt, the company still faced a challenging sales environment.

But this week, things are looking up to some on Wall Street. The price of Remington's bonds have increased more than 16 percent since Wednesday — a sign that some investors believe the company has promise.

Michael Corkery and Tiffany Hsu on Twitter: @mcorkery5 and@tiffkhsu.

* 'How Did This Happen?': Grief and Fury After Florida Shooting

* After Florida Shooting, Trump Focuses on Mental Health Over Guns

* 6 Stories and Charts to Help You Better Understand Gun Violence in the U.S.

* Frustration Grows as Congress Shows Inability to Pass Even Modest Gun Measures

A customer holding an AR-15-style semiautomatic rifle at an Orem, Utah, gun store. F.B.I. background checks for gun purchases fell 8 percent last year. | George Frey/Bloomberg | Gun-control initiatives in the wake of mass shootings used to spur gun purchases, but not lately. | Doug Mills/The New York Times

Document NYTFEED020180216ee2g009vl

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Inflation Gauge Increases

By Eric Morath
515 words
16 February 2018
The Wall Street Journal
J
A2
English

WASHINGTON -- U.S. producer prices rose in January, the latest sign of building inflation pressure in the economy.

The producer-price index, a measure of the prices businesses charge for their goods and services, rose a seasonally adjusted 0.4% in January from a month earlier, the Labor Department said Thursday. From a year earlier, producer prices advanced 2.7% last month.

The report is the latest showing that inflation is building after a long period of small price increases.

Wednesday's consumer-price-index report showed prices rising 0.5% in January, and they were up 0.349% when excluding food and energy, the strongest one-month increase since March 2005. Separately, nominal hourly wages in January rose at the best rate from a year earlier since the recession ended in mid-2009.

"Inflation pressures are finally building in earnest," said Stephen Stanley, chief economist at Amherst Pierpont Securities. "I do not fear runaway inflation, but we are going to plow right through 2% this year."

The Federal Reserve's preferred inflation measure, the Commerce Department's personal-consumption-expenditures price index, has undershot the central bank's 2% target for annual inflation in 66 of the past 68 months. But the producer-price data, which highlighted rising medical costs last month, suggest the January PCE index may advance more strongly when released on March 1. The PCE index is more weighted toward health care than the consumer-price index.

Stronger inflation could cause the Federal Reserve to consider picking up the pace of short-term rate increases. The Fed's next policy meeting is March 20-21. Officials in December penciled in three interest-rate increases for this year.

The producer-price report tends to be a less reliable measure of inflation, but economists track the index for early signs of where consumer prices -- the main gauge of inflation -- are headed. The producer-price gauge captures changes in what firms charge consumers, other businesses and government entities for their products.

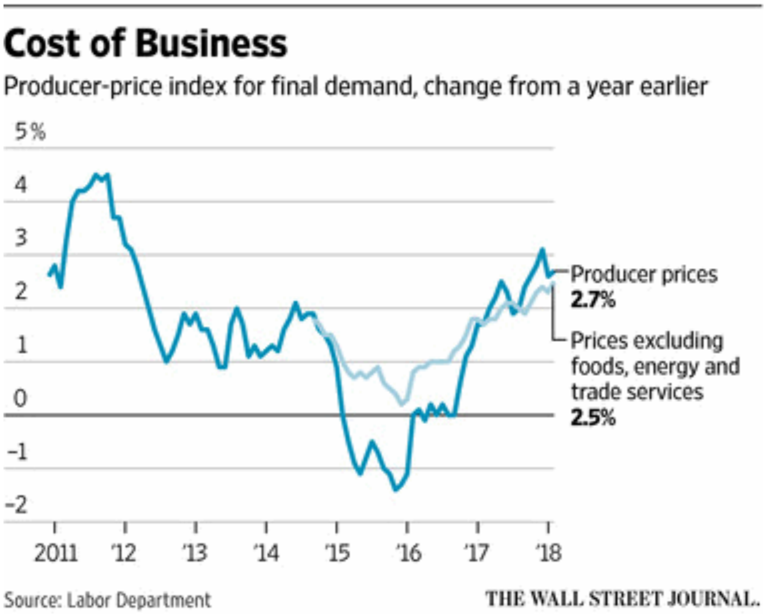
Producers prices were flat in December, revised data showed. Before that month, prices had risen steadily in the second half of last year.

January's price increase was fairly broad-based.

Excluding food, energy and the **volatile** trade-services category, prices also rose 0.4%. That was largest monthly advance since April 2017. From a year earlier, so-called core prices increased 2.5%, the largest annual increase on records back to 2014. Thursday's report showed energy prices rising 3.4% in January from a month earlier, led by increases in jet fuel and gasoline.

Separately, U.S. industries cut output for the first time since last summer in January, suggesting key sectors of the economy remain subdued.

Industrial production -- a measure of everything made by factories, mines and utilities -- fell 0.1% from a month earlier, the Federal Reserve said. Utility production picked up last month, largely reflecting cold weather. That gain was offset by flat manufacturing output and a drop in mining production.



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Document J000000020180216ee2g0002q

THE WALL STREET JOURNAL.
U.S. EDITION

A Value Proposition for Value Over Growth

By Steven Russolillo
503 words
16 February 2018
The Wall Street Journal
J
B11
English

A little **volatility** might be what value stocks need to get their mojo back.

Such stocks, which tend to have slow but steady earnings growth and cheap valuations, vastly underperformed their pricier growth counterparts globally last year, compounding a gap that has persisted since the end of the financial crisis. Just think of the surging shares in sectors such as tech, led by the likes of Facebook Inc. and Tencent Holdings Ltd., compared with relative underperformers such as utilities stocks.

Last summer, Goldman Sachs Group Inc. even questioned whether the markets were witnessing the death of value investing.

But if the recent market swoon world-wide is any indication, value stocks could be poised for a comeback, according to an analysis by Morgan Stanley.

Value stocks have historically tended to outperform growth in high-**volatility** environments, as investors seek what are perceived as safer and steadier stocks. Morgan Stanley defines high **volatility** as being when the Cboe **Volatility** Index, or VIX, rises over 30. The VIX surged 116% on Feb. 5, its biggest one-day gain ever, finishing that day at 37.3, its highest since August 2015. On Thursday, the VIX fell 0.7%, to 19.13, near its long-term average.

"We find high-**volatility** regimes tend to favor a rotation into value," says Steven Ye, a quantitative analyst at Morgan Stanley in Hong Kong. In previous instances when the VIX rose to what he called extreme levels, as in 1987, 1998, 2008, 2010 and 2015, it has tended to remain elevated for several months.

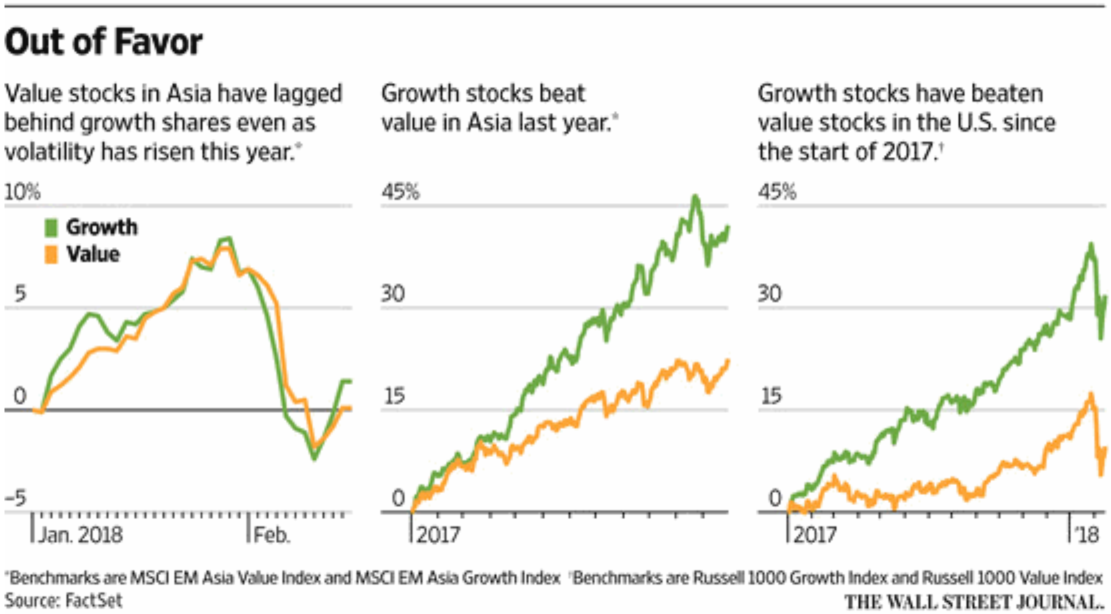
"It is important to distinguish the current correction as a valuation-driven one, since macro and earnings trends remain positive," Mr. Ye said. "In such a correction, we would look for value with cash flows and avoid both expensive growth stocks" and bondlike stocks that pay high dividends.

Morgan Stanley's positive call on value stocks hasn't fully come to fruition, although the gap between the performance of value and growth stocks appears to be narrowing.

In Asia, an index of value stocks provided by MSCI Inc. is roughly unchanged in 2018, compared with a 1.4% gain for a rival growth-stocks index. Last year, growth stocks outperformed value in Asia by 20 percentage points.

A similar trend holds true in the U.S. The Russell 1000 Growth Index is up 2.7% this year, compared with a 1.1% drop for its value counterpart. Growth stocks rose 28% last year, compared with an 11% increase for value stocks.

Moreover, markets have calmed in recent days. Most Asian stock indexes rose Thursday after strong overnight gains in the U.S. and Europe. That comes after several indexes around the world, including Japan's Nikkei Stock Average, Hong Kong's Hang Seng Index and the **S&P 500** in the U.S. all fell into correction territory last week, down at least 10% from a recent high.



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THE WALL STREET JOURNAL.
U.S. EDITION

Risks Seen as Stocks Move in Tandem --- Individual companies' potential gets lost in one-sided shifts for all S&P 500 sectors

By Akane Otani
895 words
16 February 2018
The Wall Street Journal
J
B12
English

Shares of everything from manufacturers to banks to oil-production companies are rebounding together after tumbling in unison earlier this month, a phenomenon that could lead to more turbulence ahead.

Correlations among the S&P 500's 11 sectors, a measure of how different stock groups move in relation to one another, spiked as the index last week suffered its first correction in two years and increased further when stocks began bouncing back from those lows. They recently hit the highest level since the U.S. presidential election in 2016, according to a Goldman Sachs Group analysis.

In other words: S&P 500 sectors are moving together more than they have in quite some time. For some investors, that raises red flags.

Rising correlations can create more violent downturns when stocks do fall, as factors such as individual companies' earnings potential or financial track records tend to become less important than the broader fears driving selling in the stock market.

"People end up throwing the good out with the bad," especially if they are primarily invested in the stock market through broad exchange-traded funds tracking major indexes, said Art Hogan, chief market strategist at investment bank B. Riley FBR.

The popularity of ETFs in recent years has likely helped push correlations higher, Mr. Hogan added, as investors in index-tracking funds who want to increase or decrease their exposure to stocks during market swings can buy or sell only broadly -- not pick and choose shares.

"What we saw was when the stock market is selling off, it didn't matter what your business does or what sector you fall in -- you were for sale because you were part of the S&P 500," Mr. Hogan said.

The three-month rolling correlation between S&P 500 sectors rose to 0.73 Monday, Goldman Sachs's data show, up from 0.72 on Feb. 8, the day the index fell into correction territory -- a 10% drop from its Jan. 26 high. That is nearly double last year's average of 0.37 and above the 2016 average of 0.64.

In two recent instances when stocks fell sharply -- in January 2016 and in August 2015 -- the S&P 500's sectors carried an average three-month rolling correlation of 0.72 and 0.70, respectively, according to Goldman Sachs data.

A correlation of 1 signals that assets are moving in perfect lockstep, while a correlation of 0 suggests no relationship between asset movements and a correlation of negative 1 shows assets are moving in opposite directions.

Stocks have rebounded with a vengeance since tumbling when bond yields shot to multiyear highs and a number of volatility-tied bets collapsed. The S&P 500 has climbed 5.8% over the past five sessions, rising every day since falling into a correction.

Some investors say the rebound makes sense, given that the outlook for global growth remains positive. But others say the pace of the gains has made them wary that another pullback is around the corner -- especially since some of the concerns that pressured shares at the start of the month have persisted.

The yield on the 10-year U.S. Treasury note climbed to a four-year high Wednesday, after data showed consumer prices -- one gauge of inflation -- rising more than expected in January. And a measure of producer prices Thursday also rose, adding to recent signs that inflationary pressures are picking up.

The pattern of broad selling has led to one-sided moves in the **stock market** this month -- even among sectors that are thought to benefit from rising bond yields.

For instance, shares of banks, whose net-interest margins -- a key measure of lending profitability -- are boosted by higher interest rates, have fallen with the broader market, with the **S&P 500** financial sector down 2.5% for the month. The **S&P 500** is down 3.3% for February. Meanwhile, energy, telecommunications services, industrials, consumer staples, health care, utilities, materials and real-estate shares in the **S&P 500** have all lost more than 3% in February.

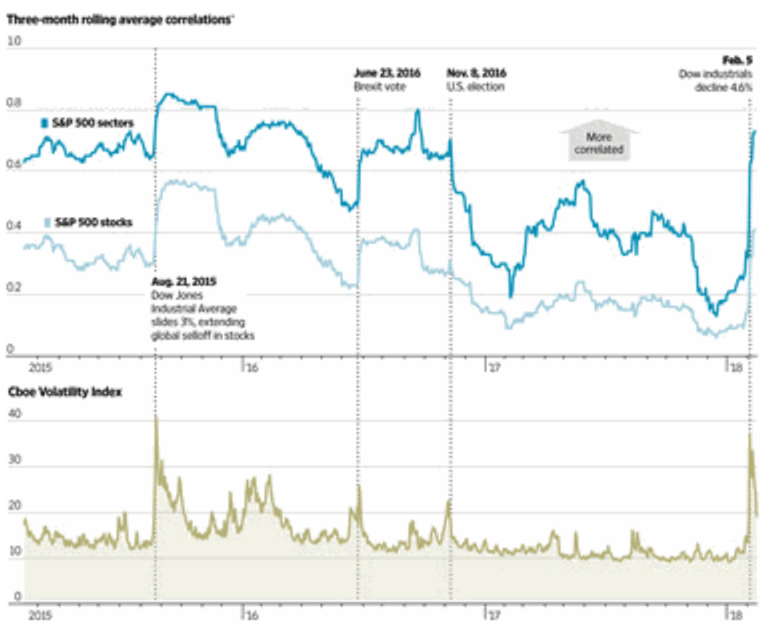
But in the past week, as the broader market has regained its footing, so have stocks across all industries, with all 11 **S&P 500** sectors headed for weekly gains.

The one-sided movements have made it difficult for investors to pick and choose any winners in the **stock market**, said Andrew Thrasher, portfolio manager for Indiana-based asset-management firm Financial Enhancement Group.

Some analysts say stocks should begin to move more independently again as the market stabilizes. Data still suggest global growth is accelerating and U.S. corporate earnings are solid, two factors that investors say should push stocks higher.

The global economy is expected to grow 3.9% a year in 2018 and 2019, which would mark the fastest pace of growth since 2011, according to forecasts from the International Monetary Fund.

"I think most investors recognize by now that last week's correction was largely driven by technical factors, not due to changes in the fundamental backdrop. If that holds, I would expect correlation to continue to normalize going forward," said Mandy Xu, equity derivatives strategist at Credit Suisse.



*A correlation of 1 indicates assets are moving in perfect lockstep. Correlation data are through Feb. 12.
Sources: Goldman Sachs Group (correlation); WSJ Market Data Group (VIX)

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Document J000000020180216ee2g00011

The New York Times

COMMON SENSE
Business/Financial Desk; SECTB
Jitters Rising, With Stocks And Inflation

By JAMES B. STEWART
1,196 words
16 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

Two weeks ago, fears of higher-than-expected inflation and interest rates sent stocks into a historic and nerve-rattling plunge. This week, those fears were borne out: Consumer prices rose more than expected in January, and interest rates jumped.

The **stock market** rallied.

It's long been a truism that higher inflation and its close cousin, higher interest rates, are deadly for stock prices. But in the wake of this month's correction, and the ensuing recovery in stock prices, some market experts are saying that stocks can continue to rally even if interest rates and inflation rise, as they did Wednesday.

The bulls are backed by data showing that, during the six periods of rising **10**-**year Treasury** rates since 1988, the **Standard & Poor**'**s 500**-**stockindex** has gained an average of 23 percent. Stocks declined in only one of those periods, and then only modestly.

''For the past 20 years, we've had a period of strong correlation between stocks and interest rates,'' said Brian Nick, chief investment strategist for Nuveen, a TIAA subsidiary.

But ''that wasn't the case for the 30 years before that,'' he added. And looking only at the start and end points of periods of rising rates masks considerable **volatility** in between, not to mention what lies just outside those periods. As rates were rising from 1998 into 2000, for instance, stocks were in one of the biggest bull markets ever, only to plunge after the technology bubble burst.

Nearly all mainstream economists agree that at some point, higher interest rates and inflation hurt stock prices. ''Investors are right to be concerned,'' said Alan Blinder, professor of economics at Princeton and former vice chairman of the Federal Reserve.

Nuveen's Mr. Nick said it's important for investors to look beyond the headlines about rising interest rates to ask why they're going up. Rising rates can be a sign of a healthy, growing economy, and if the Fed can keep it from overheating, it may well be good for stocks. But if the Fed is forced to raise rates to ward off inflation, the risks of a recession -- and lower earnings and stock prices -- are much greater.

Mr. Nick said the current situation ''looks like a little bit of both,'' which leaves him cautiously optimistic, but in no rush to add to stock positions. He hasn't made any changes to Nuveen's model portfolio allocations.

''Unlike the last few corrections, we don't see this as a V-shape recovery, where investors might blink and miss it,'' he said. ''I think stocks can rise by the end of the year, but it will be a slower grind back.''

Others are less sanguine. The Harvard economist Martin Feldstein, who has long studied the complex relationship among interest rates, inflation and stock prices, has been warning for months that markets are highly vulnerable to rate increases and inflation. Markets face ''a fragile financial situation, and potentially a steep drop somewhere up ahead,'' he wrote in an op-ed piece in The Wall Street Journal just weeks before the recent correction.

Even after the recent pullback, he expects more declines. ''When interest rates rise back to normal levels, share prices are also likely to revert to previous norms,'' Mr. Feldstein told me this week.

That could be a long decline. Even after the recent 10 percent correction, stocks remain richly valued by historical norms. James Stack, a market historian and president of InvesTech Research, pointed out that a common valuation measure -- the price-to-earnings multiple for the **S**.**&P**. **500** -- recently went from 26 times earnings to 23.4 after the correction, which is a level reached less than 10 percent of the time since 1928. (The long-term average price-to-earnings ratio for the **stock market**, excluding extreme periods, is about 14.) "This is a very richly priced market no matter how you slice it," he said.

Mr. Stack recently lowered the stock portion of his model portfolio to 72 percent from 82 percent out of concern over high valuations and rising rates. He noted that during 11 periods since 1955 when the Federal Reserve was tightening credit, a so-called soft landing was achieved only twice -- in the mid-1960s and mid-1990s -- and that a recession followed in every other instance.

"Once the Fed starts a tightening cycle, it is very difficult to avoid a recession before it is over," he said. He hasn't increased the allocation since the sell-off.

Mr. Blinder told me that stock valuations reached such extreme levels that he started reducing his equity holdings several months ago. "I sold too early," he said with the benefit of hindsight. "I missed the last 15 percent gain, and I missed the 7 percent drop." He hasn't resumed buying at current levels.

The Fed is now two full years into its current cycle of rate increases, which is already longer than most tightening periods. But the benchmark interest rate for 10-year Treasuries, which has recently risen to just over 2.9 percent, still has a long way to go before reaching its long-term average of 6.24 percent. The Fed has forecast three more quarter-point rate increases this year, but that would bring the Federal funds rate only to 2.25 percent.

"Historically it's impossible to name any threshold at which rising rates might trigger a rush for the exit or a **bear market**," Mr. Stack said. "In most cases, stock prices can weather rising interest rates until they reach 5 to 6 percent, which was the case in 2000 and 2007."

But after years of such low interest rates, and with stock valuations extremely high, he said, "we're dealing with what might be the most interest rate-sensitive **stock market** in our lifetime."

If this is, indeed, the last stage of the long-running **bull market**, and interest rates continue to rise, as the Fed has suggested, some sectors typically perform better than others. According to InvesTech, the best performing sectors during periods of rising rates since 1972 have been health care, energy, consumer staples and telecommunications. During the last year of a **bull market**, the best performing sectors have been energy, health care and technology. Health care and energy show up in both categories.

Of course no one knows for sure when the **bull market** will end -- or whether it already has. But investors are clearly on edge, and the last few weeks may be a preview of what the end looks like.

"There are a lot of very bright people on Wall Street who are all counting on being the first out the door when the party ends," Mr. Stack said. The recent plunge, added, "showed just how small that door may get."

A view from the floor of the New York Stock Exchange. The Federal Reserve is now two full years into its current cycle of rate increases, which is already longer than most tightening periods. (PHOTOGRAPH BY SAM HODGSON FOR THE NEW YORK TIMES) (B4)

Document NYTF000020180216ee2g0006p

THE WALL STREET JOURNAL.
U.S. EDITION

As Boomers Go Gray, Even 2% Growth Will Be Hard to Sustain

By Jason Furman
1,103 words
15 February 2018
The Wall Street Journal
J
A17
English

Most of what was good in the American economy last year was unsustainable, and most of what was sustainable was not good. A decade after the financial crisis, there is still no sign the economy can generate the consistent growth of 3% a year many continue to hope for. The growth rate for 2017 was just 2.5%, and even that seems unlikely to last. Is this the new normal?

Not exactly. Instead it's a return to the old normal, a reversion that was widely expected after baby boomers began to retire. While policy makers should do what they can to increase the economy's long-run growth rate, they also need to avoid making decisions based on unrealistic expectations.

Economic growth comes from two sources. First is a cyclical rebound in demand as the economy gets closer to full capacity (or even proceeds beyond it). Second is an increase in the economy's underlying potential output -- also called the supply side -- driven by growth in either the workforce or productivity.

The trouble is that more than half of last year's economic growth came from the cyclical factors, which have little left to contribute given that we're at or near full employment. What this means is that absent much bigger productivity improvements, it will be a challenge for the U.S. to achieve sustained economic growth of even 2%.

The **stock market**'s recent travails provide a vivid illustration of unsustainable growth. Last year the market went up 19%, which boosted consumer spending through a wealth effect. This surge in consumption probably accounted for about 0.75 percentage point of the growth in gross domestic product. For four straight years, consumer spending has risen faster than GDP, causing the personal-savings rate to drop to 2.4% -- nearly the lowest on record.

Now a market correction has happened, and even with their recent rebound stocks are still 6% off their highs, as of close on Wednesday. Whatever may happen in the market, it's sobering to listen to the people arguing that stocks are correctly valued. The theory that today's high price/earnings ratios are justified -- meaning it simply has become more expensive to buy a given return -- implies lower earnings going forward. That, too, would undercut the consumption-fueled growth the U.S. has been enjoying, leaving households vulnerable after the past several years in which they took on increased debt and reduced their personal savings.

Another unsustainable boost to the economy has been the falling dollar. Last year the dollar's effective exchange rate -- a measure that compares the dollar against a basket of currencies weighted by trade volume -- fell 7%. Although the U.S. pursued a de facto strong-dollar policy through higher interest rates and larger budget deficits, this was more than offset by unexpectedly strong global growth. The weak dollar helped roughly stabilize the trade deficit, meaning net exports only subtracted 0.1 percentage point from GDP growth in 2017, compared with an average of 0.5 point a year from 2013-16.

The momentum in GDP growth could continue into 2018, especially given that tax cuts and the recent spending bill will provide about $250 billion in new demand-side fiscal stimulus this year. The unemployment rate, now 4.1%, could fall into the 3% range, a welcome development. Lagging benefits from the weakening of the dollar may arrive. Beyond 2018, however, these factors will begin to lose their force, especially since the Federal Reserve is sure to raise interest rates to offset any additional fiscal stimulus. More important, while predictions about markets are uncertain, it is a mathematical fact that the unemployment rate cannot indefinitely fall by 0.6 percentage point a year, as it did in 2017.

Growth will therefore have to come from the supply side. But a bigger workforce is an unlikely candidate. Assuming that current immigration rates continue and that employment rates by age are stable, the workforce will expand by 0.5 percentage point a year over the next decade. It is theoretically possible that people out of the workforce today could return. Betting on this, though, would be imprudent, given the steady decline in labor-force participation for men since the 1950s and for women since around 2000.

That leaves productivity growth, which is even less certain. The statistics usually reported exclude farms and the government, meaning they cover only a faster-growing subset of businesses. Instead let's look at economywide productivity, which is what's relevant for predicting overall economic growth. In 2017 economywide productivity increased 0.9%, slightly below its 1% annual pace over the past decade. If that average rate continues, overall economic growth in coming years will average only 1.5%. But maybe the productivity figure for 2007-17 is too pessimistic, reflecting a combination of fallout from the global financial crisis and bad luck. In that case we might look to the average economywide productivity growth of the past 50 years, 1.6%. That would push the baseline for overall growth to 2.1%.

Actual growth over the next five or 10 years could vary from this range of 1.5% to 2.1%, but there is little basis for a forecast that diverges significantly. As an analogy, imagine you're asked to predict the high temperature in Boston on Christmas Day. You might say 43 degrees (the average over the past decade) or 40 degrees (the average over the past 50 years). It could well end up being 20 degrees or 60 degrees, but those would be foolish predictions.

Slower growth is less the fault of President Trump than of his generation. Mr. Trump, born in 1946, was in the first wave of boomers. Forty percent of the people born that year have left the workforce. This was predictable, which is why in 2005 the Social Security Trustees projected that the economy would grow 1.8% a year from 2020-30. If anything, additional data since then would lead us to revise that forecast down. Americans simply have forgotten this basic reality. To the degree that policy and business decisions are based on false hopes for much higher growth, the result can only be dashed expectations.

Mr. Furman, a professor of practice at the Harvard Kennedy School, was chairman of the White House Council of Economic Advisers, 2013-17.

(See related letters: "Letters to the Editor: Despite Demographics, 3% Growth Is Possible" -- WSJ Feb. 20, 2018)

Document J000000020180215ee2f0000p

STOCKS & BONDS
Business/Financial Desk; SECTB
Market Chugs On as Investors Wave Off Inflation Worries

By THE ASSOCIATED PRESS
1,069 words
15 February 2018
The New York Times
NYTF
Late Edition - Final
4
English

Investors saw some new hints that inflation is increasing on Wednesday, but they still sent banks, technology firms, and consumer-focused companies climbing. That was a big change after the market's inflation-inspired plunge earlier this month.

After a shaky start, stocks rose for the fourth straight day, and banks made some of the largest gains as bond yields reached new four-year highs. The move in yields came after the government said consumer prices climbed in January a slightly faster pace than economists had expected. A different government report showed retail sales were unchanged in December and slipped last month.

"I think the fears of the economy overheating have been a little bit balanced out with the combination of these two numbers," said Katie Nixon, chief investment officer for Northern Trust Wealth Management. "The bond market is not suggesting that runaway inflation is a deep concern."

Stocks began plunging Feb. 1 after the Labor Department said wages grew at a rapid clip in January. Investors worried that that meant inflation was rising and that it would push the Federal Reserve to start raising interest rates more quickly, making it more expensive for people and businesses to borrow money. That would slow down economic growth as well growth in as corporate profits. Nixon said that Wednesday's reports show inflation probably isn't rising that fast.

The **Standard & Poor**'**s500 index** rose 35.69 points, or 1.3 percent, to 2,698.63. The **Dow Jonesindustrial average** added 253.04 points, or 1 percent, to 24,893.49. The **Nasdaq composite** climbed 130.10 points, or 1.9 percent, to 7,143.62. The Russell 2000 index of smaller-company stocks rose 27.15 points, or 1.8 percent, to 1,522.10.

After a 10 percent plunge in just nine days, the **S&P 500** has risen 4.5 percent in the last four days.

The Labor Department said prices paid by consumers rose 0.3 percent in January, excluding **volatile** items like food and energy. That's the most in a year, and it sent bond yields and gold prices higher.

The yield on the **10**-**year Treasury** note rose to 2.91 percent, its highest mark in four years, from 2.84 percent a day earlier. That helped banks, as the higher interest rates make lending more profitable. But it hurt high-dividend companies like utility and phone companies. Those stocks are often compared to bonds because of their big dividend payments and relatively steady prices, but investors find them less appealing when bond yields are rising.

Americans cut back on purchases of cars, furniture and a variety of other products in January. The Commerce Department also lowered its estimate for spending in December. That came after a three-month stretch that included the strongest holiday sales in a decade.

Retailers traded higher despite the tepid numbers in the report. Amazon rose $36.54, or 2.6 percent, to a record high of $1,451.05 and Tiffany added $2.15, or 2.1 percent, to $103.11. Nike picked up $2.09, or 3.2 percent, to $67.96.

Nixon, of Northern Trust, said she doesn't expect inflation to increase very much, but it can be unpredictable from month to month. She noted that it could go higher as people who received tax cuts or bonuses spend their extra pay.

Netflix climbed after the streaming video company said it signed another big-name TV writer and producer to a production deal. According to reports, "Glee" and "American Horror Story" producer Ryan Murphy received a $300 million deal that will span five years. In August Netflix announced a deal with "Scandal" and "Gray's Anatomy" creator and producer Shonda Rhimes.

Netflix climbed $7.73, or 3 percent, to $266.

Chipotle Mexican Grill soared after naming Taco Bell CEO Brian Niccol to lead the company. Chipotle has been hit hard by food safety scares over the last few years and has had trouble winning back customers. Niccol launched breakfast at Taco Bell and also introduced mobile ordering from its restaurants, and investors felt he might improve the company's fortunes. Founder Steve Ells resigned as CEO in November.

The stock rose $38.58, or 15.4 percent, to $289.91. It traded above $700 in mid-2015.

After years of declines, watchmaker Fossil soared $7.93, or 87.7 percent, to $16.97 after it did far better than Wall Street expected in the fourth quarter. The stock was worth more than $100 at the end of 2014, but plunged as competition from smart watches and fitness trackers eroded its sales.

Gold jumped $27.60, or 2.1 percent, to $1,358 an ounce. Silver rose 35 cents, or 2.1 percent, to $16.88 an ounce. Copper picked up 7 cents, or 2.3 percent, to $3.24 a pound.

U.S. crude rose $1.41, or 2.4 percent, to $60.60 a barrel in New York. Brent crude, used to price international oils, gained $1.64, or 2.6 percent, to $64.36 a barrel in London.

Wholesale gasoline added 3 cents to $1.71 a gallon. Heating oil rose 5 cents to $1.88 a gallon. Natural gas lost 1 cent to $2.59 per 1,000 cubic feet.

The dollar fell to 107.09 yen from 107.69 yen. The euro dipped to $1.2435 from $1.2355.

The DAX in Germany rose 1.2 percent and the French CAC 40 added 1.1 percent. The FTSE 100 in Britain picked up 0.6 percent. Japan's benchmark Nikkei 225 slipped 0.4 percent after its economy grew at a slower-than-expected pace in the fourth quarter. South Korea's Kospi gained 1.1 percent and Hong Kong's Hang Seng rose 2.3 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%20jayt .

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

CHARTS: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Wednesday. (Source: Reuters); Retail Sales: Total retail and food services sales, seasonally adjusted. (Source: Commerce Department)

Document NYTF000020180216ee2f0000j

THE WALL STREET JOURNAL.
U.S. EDITION

Wagers on Calm Market Turn Sour

By Gregory Zuckerman, Gunjan Banerji and Heather Gillers
1,628 words
15 February 2018
The Wall Street Journal
J
A1
English

A decade of low bond yields pushed some of the most stability-minded investors to dabble in risky investments that depended on markets being orderly. Now, those bets are looking problematic.

In the past, pension funds, endowments and family offices pursued relatively safe investments. After interest rates collapsed on the heels of the financial crisis, they ran into challenges paying pensioners and filling university budgets, and added riskier bets on hedge funds and venture capital in the hopes of winning better returns.

More recently, some of these investors also made big, unpublicized wagers seeking to benefit from what had been an unusually long period of low **volatility**, according to pension-fund consultants and others who deal with these institutions. The strategies, often involving the writing of complicated options contracts, were for years a source of easy money. Markets hadn't been so calm since the 1950s.

Among those making such bets were Harvard University's endowment, the Employees' Retirement System of the State of Hawaii and the Illinois State Universities Retirement System.

Yet **volatility** has now returned to markets, with a vengeance. When the **Dow Jones Industrial Average** lost more than 2,400 points in a week, intraday market swings also surged. The Cboe **Volatility** Index, or VIX, a measure of expected swings in the **S&P 500**, closed at its highest level last week since August 2015, recording its biggest one-day jump ever on Feb. 5 as it surged to 37.32 from 17.31 the prior day.

The $16.9 billion Hawaii fund in 2016 began earning money selling "put" options -- essentially a bet that markets would stay calm or rise. When markets fall, Hawaii is on the hook to pay out.

"We've taken some losses that you'd expect with these sharp moves," said Vijoy Chattergy, the fund's chief investment officer, on Feb. 8. He also said "they're within expectations."

For now, investors express confidence these strategies will work out. Others in the market, however, worry that any additional turmoil could spur institutions to quit their "low-vol" strategies. "Our fear is when these strategies unwind," said Alberto Gallo, a portfolio manager at Algebris Investments in London.

Mr. Gallo estimates more than $500 billion of investment strategies globally are dependent on **volatility** remaining low. These trades include funds that target or sell **volatility** by using various derivatives.

The rise of low-**volatility** bets is among the reasons this downturn is different, investors say, and difficult to predict. Some trades are hard to track. It's also challenging to quantify how much money is in investments betting against **volatility** or dependent on placid markets. One thing seems certain: with central banks gradually withdrawing their support for the market, the subdued calm of recent years is unlikely to return.

Wagers on low **volatility** vary by investor. In one popular move, investors bought two exchange-traded products that bet on continued stability for stocks -- the ProShares Short VIX Short-Term Futures exchange-traded fund and the VelocityShares Daily Inverse VIX Short-Term exchange-traded note. These were a wager that the key **volatility** index would fall and stay low.

Together, these funds managed $4 billion until the recent market turbulence, with much of that money coming from the likes of big investors such as Harvard University.

Harvard's endowment, Harvard Management Co., owned over 100,000 shares of the ProShares Short VIX fund as of the end of the third quarter of 2017, filings with the Securities and Exchange Commission show. Its fourth-quarter filing indicate it sold the position, though Harvard's current holdings are unclear.

"There's a tsunami of money going into" these types of strategies, said Don Dale, a managing member of consultant Equity Risk Control Group. The firm advises large pension funds and endowments.

Pension funds, endowments and family offices took other steps, including selling VIX futures and options, selling options on the **S&P 500** or other indexes and selling options on individual shares or other indexes.

"The low-return environment pushes people into investments they wouldn't have made eight to 10 years ago," said David Morehead, senior director of investments at Baylor University's endowment. "While institutions may not be explicitly trading **volatility**, more have been pushed into assets with lower quality, higher leverage, and more illiquidity."

Donald Pierce, the chief investment officer of the $9.3 billion San Bernardino County Employees' Retirement Association, has been trading **volatility** for about six years, most recently by buying options on stock indexes, often with trades equivalent to about $300 million of risk for the plan.

Sometimes, Mr. Pierce buys products betting on rising **volatility**. Other times he sells these products, depending on his view of where U.S., Japanese, Russian, Brazilian and other markets are headed. Mr. Pierce says his trading has saved the county millions recently and that he will continue to make **volatility** trades.

"We take an opportunistic approach," he said. "For us, it's a substitute for equities."

Other pensions take more one-way bets, including the Hawaii pension system. The put options it began selling in 2016 give holders the right, but not the obligation, to sell stocks at a certain level. When markets are calm, Hawaii receives a check each month from whoever is buying a put option. If markets fall, whoever bought the put can collect.

The fund's Mr. Chattergy, while worried about an extended downturn, says Hawaii has taken steps to mitigate losses. He said Hawaii will continue to sell these put contracts, convinced the income will offset market turbulence. "We're continuing to trade the strategy."

The low-vol trade has worked every year since markets began rebounding in early 2009. Until Feb. 6, the **S&P 500** had enjoyed 404 consecutive trading days without a 5% correction, the longest such streak since September 1959, according to Bianco Research LLC. The average close of the Cboe **Volatility** Index was 11.09 last year, the lowest average on record going back to 1990.

Many big investors who flocked to these products have been under unique pressures to generate returns. Pension funds across the U.S. typically need to earn 7% to 8% each year to meet obligations. In the past decade, they have struggled to meet that target, while their total assets have fallen as retirement payouts have increased.

As a result, many have lowered their bondholdings and turned to real estate, commodities, hedge funds and private-equity holdings. These so-called alternative investments rose to 26% of holdings at about 150 of the biggest U.S. funds in 2016, compared with 7% more than a decade earlier, according to the Public Plans Database, which is run by a group of nonprofits.

Bondholdings by major public pension plans fell to 21.09% in December 2017 from 25.32% in December 2007, according to Wilshire Trust Universe Comparison Service.

More recently, the army of consulting firms that advise pension funds, such as Wilshire Consulting, has recommended some public-pension-fund clients write put contracts. As recently as 2013, hardly any public pension funds used this strategy, according to Wilshire Consulting President Andrew Junkin. He estimated more than 60 of the nation's more than 6,000 pension funds now do.

A growing number of Wall Street firms have been selling **volatility**-related strategies to pension funds and other big investors. Neuberger Berman's U.S. Equity Index PutWrite Strategy sells puts on stock indexes. Part of the value of a put relates to the **volatility** of underlying stocks. By selling the puts, the fund aims to generate steady income in stable markets.

In a document prepared for an Illinois pension fund, the firm argued that behavioral biases in **financial markets** mean investors "ultimately overpay for protection." The Neuberger Berman options products have attracted about $3 billion over the past two years.

But the strategy suffers losses when stocks fall. So far this month, the fund has lost 4.37%, through Feb 12, though that tops a loss of 4.52% for its benchmark, a mix of puts on stock indexes and compares with a 5.90% loss for the **S&P 500** through that date.

The Neuberger Berman products have outperformed their benchmarks in recent years and the firm notes the price for the puts rises when markets tumble, making the fund a lower-risk way to invest in stocks.

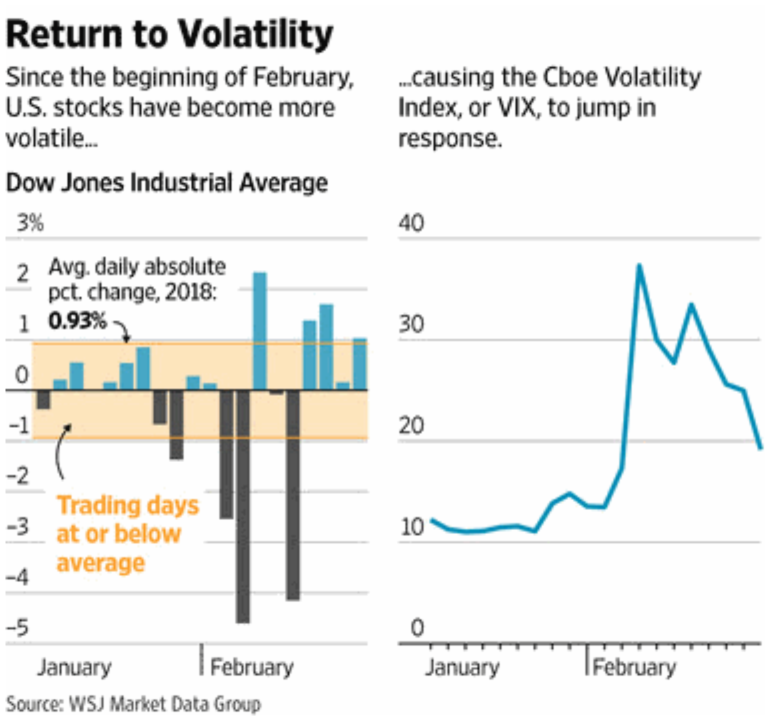
"The efficacy of these strategies manifests itself over months and quarters," said Doug Kramer, who oversees the strategy at Neuberger. "Everything's functioning as designed. We're happy to have higher **volatility** and be able to underwrite higher option premiums."

Public pension plans including the Illinois State Universities Retirement System have invested in these products. Illinois SURS declined to be interviewed for this article.

The market's rebound over the past few days has sparked a new round of investments in some of the riskiest of the **volatility** trades. The ProShares Short VIX fund, which posted a 97% drop in net asset value last week from its high price in January, has since rebounded -- even though **volatility** indexes such as the one the fund is designed to track can have outsize moves, and likely would see heavy losses and face possible liquidation if **volatility** spikes again.

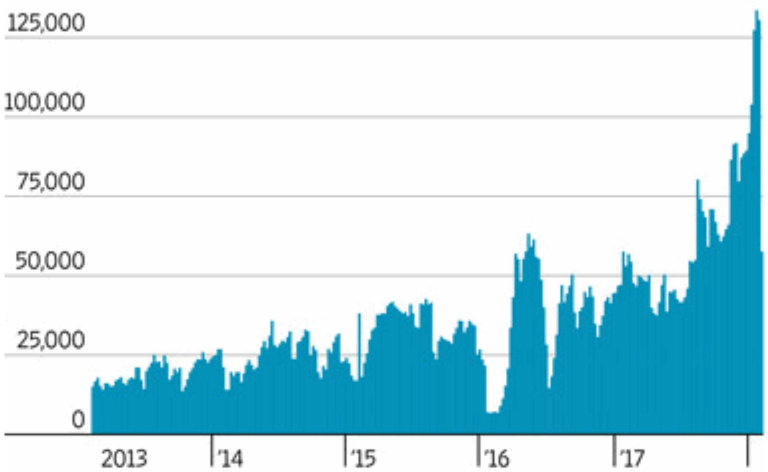
On Tuesday, it closed at $11.29, up from a low of $9.58 on Feb. 8, and its market value is now nearly $800 million, up from $300 million just last week.

"People are jumping back into this product again," said Pav Sethi, chief investment officer of Gladius Capital Management, an investment firm focused on **volatility** strategies, "despite the clear structural risks."



Betting Against Fear

The number of bets against volatility, as measured by the Cboe Volatility Index, held by asset managers, including pensions, endowments and others



Note: Includes futures and options
Source: FactSet

THE WALL STREET JOURNAL.

Document J000000020180215ee2f0001z

THE WALL STREET JOURNAL.
U.S. EDITION

Prices Rise as Economy Heats Up

By Harriet Torry
964 words
15 February 2018
The Wall Street Journal
J
A1
English

WASHINGTON -- Prices rose more than expected for U.S. consumers last month, offering fresh evidence that a long run of exceptionally low inflation is ending and teeing up the expected first interest-rate increase of the year in March.

Fears that rising inflation would prompt the Federal Reserve to pick up the pace of rate increases in 2018 stoked the **stock market**'s turmoil in recent weeks.

A monthly measure of what households pay for everything except gasoline and food rose a seasonally adjusted 0.349% in January -- the strongest one-month increase since March 2005 -- driven by broad-based increases in costs like rent, clothing and medical services.

Wednesday's inflation data, which were highly anticipated because of the recent market tumult, caused bond yields to jump. The 10-year U.S. Treasury note rose to its highest level in four years -- 2.913% -- while the two-year Treasury yield reached a level last seen in early September 2008.

Yet stocks took the inflation data and yield increases in stride. After meandering in the wake of the consumer-price release, the **Dow Jones Industrial Average** advanced strongly to notch a fourth consecutive session of gains, closing up 253 points, or about 1%, to 24893.4.

While the consumer-price data suggested that inflation is growing, some analysts said it is doing so at a manageable pace. That is unlikely to cause the Fed to alter radically the pace of interest-rate increases it has signaled, analysts said.

Stock investors' measured approach was a contrast to their recent behavior. The period of turbulence that sent the Dow into correction territory in recent weeks was blamed in part on a rise in 10-year yields to the 2.88% level, which was viewed as signaling a sharp pickup in inflation worries.

In all, the consumer-price index, which measures what Americans pay for everything from salad dressing to fares on public transportation, rose 0.5% in January, the Labor Department said Wednesday.

In the 12 months to January, overall prices rose 2.1%, beating economists' expectations of a 1.9% rise. A jump in gasoline prices in January helped drive the increase. When stripped of **volatile** energy and food prices, the index was up 1.8% from a year earlier.

These aren't huge increases, but they do suggest an uptrend after years of inflation running below the Fed's 2% target.

Last month, Amazon.com Inc. raised its monthly Prime membership fee 18.2% to $12.99 from $10.99, though it said it would keep its annual fee at $99. In a sign services inflation appears set to continue rising, Walt Disney Co. said this week it was raising rates at its U.S. theme parks.

"Firms are testing their pricing power," said Sarah House, an economist at Wells Fargo Securities, which she said is "a good sign" that they are confident enough to pass higher costs on to customers.

Analysts cautioned that a few components of the consumer-price report could prove to be aberrations. Apparel prices reversed three months of declines in January, rising 1.7%, the largest monthly boost since February 1990. That category has experienced deflation for large parts of the last two decades because of a flood of cheap imports, and few analysts see it becoming a new source of inflation now.

In another potential aberration, the cost of vehicle insurance rose 1.3%, its largest monthly increase since November 2001.

Still, the broad inflation trend shows signs of firming as U.S. unemployment falls and the global economy heats up, pressuring the costs of labor and globally traded goods.

Higher commodity prices, driven in part by world-wide economic growth, made PPG Industries Inc., the Pittsburgh-based maker of paints and coatings, focus on "further offsetting this persistent inflation" by raising the prices it charges consumers, Chief Executive Michael McGarry said in a Jan. 18 call with Wall Street analysts.

More increases in the consumer-price index could be in store. Price drops last spring for a handful of items, such as wireless-phone plans, led to a string of soft inflation readings. Fed officials said they expected this would prove transitory. With last year's price cuts fading into the past, annual measures of inflation are on track to pick up in the months ahead.

Fed officials view 2% inflation as consistent with a healthy economy, but don't want it to shoot much higher.

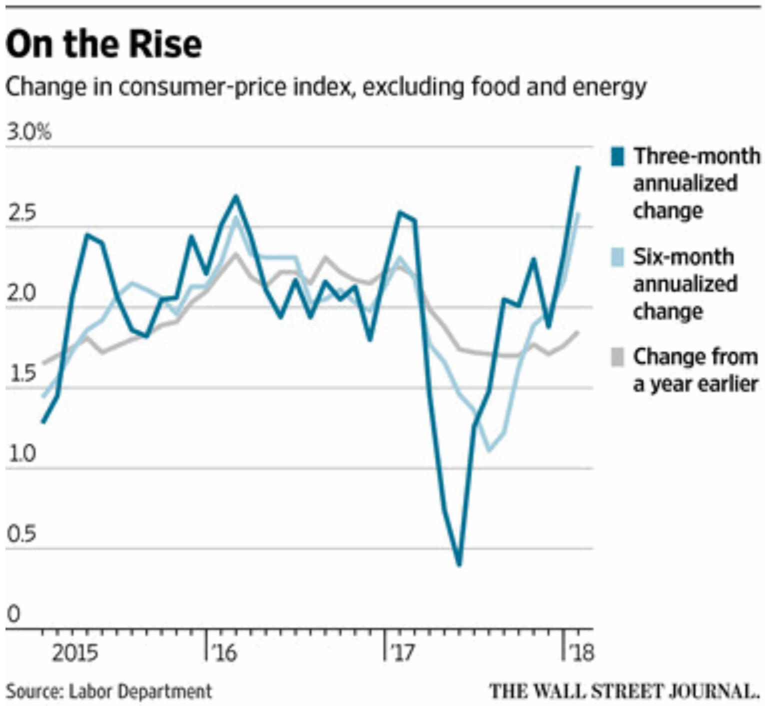
The Fed's 2% goal is based on officials' preferred price measure, the Commerce Department's personal-consumption expenditures price index. This index was up 1.7% in December from a year earlier, and prices excluding food and energy rose 1.5% over the year. Data for January are due to be released March 1.

The Fed's next policy meeting is March 20-21. Fed officials in December penciled in three rate increases this year. Investors currently see an 83% probability that the central bank will raise rates a quarter percentage point from their current range of between 1.25% and 1.5% at the March meeting, according to Fed-funds futures tracked by CME Group.

Market participants are pricing in a 63% probability of at least three interest-rate increases by the end of the year and a 26% probability of at least four, according to CME.

Wednesday's higher-than-expected consumer-price index reading "does not constitute an inflation disaster, but it's clearly a threat to markets which still don't fully price in the three hikes the Fed expects," Ian Shepherdson, chief economist at Pantheon Macroeconomics, wrote in a note to clients.

Andrew Tangel contributed to this article.



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Document J000000020180215ee2f0001x

THE WALL STREET JOURNAL.
U.S. EDITION

'Buy the Dip' Goes Abroad --- Emerging-market stocks and bonds in portfolios are still below peaks

By Saumya Vaishampayan
443 words
15 February 2018
The Wall Street Journal
J
B10
English

Investors have relentlessly bought U.S. stocks after market pullbacks in the past nine years, largely because the U.S. was the most attractive destination for their cash.

Though it is early days, recent fund flows suggest that similar behavior may be starting to reveal itself in emerging markets.

During the early part of this month's market rout, emerging-market stock and bond funds notched net inflows in the week through Feb. 7 -- even as data from EPFR Global showed investors yanking a record amount out of U.S. equity funds. Typically, investors tend to sour on risky emerging-market assets in periods of market stress.

"There's a 'buy the dip' mentality in emerging markets," according to JC Sambor, deputy head of emerging-market fixed income at BNP Paribas Asset Management. On the debt side, that is especially the case for high-yielding local currency bond markets like Indonesia, he added.

Investors have poured money into emerging markets since last year, drawn by the allure of high bond yields, relatively cheap equity valuations, and a recovering global economy. "Every single dedicated investor we have met in the last few weeks is **bullish** [on emerging markets]," Bank of America Merrill Lynch strategist Claudio Irigoyen said in a note.

The U.S. economy is also growing, but Mr. Sambor called that a well-known story that many investors have already accounted for in their portfolios.

February's **stock-market** slump left few countries untouched. Investors also dumped bonds, which drove yields higher around the world.

But there is a key piece of support for emerging markets: Investors haven't yet had their fill. And that sentiment is no longer as strong for U.S. markets, Mr. Sambor said.

Billions of dollars have already been poured into emerging markets in the past year. Even so, shares of those stocks and bonds in investors' portfolios remain below recent peaks hit earlier this decade, according to data from the Institute of International Finance.

That suggests the powerful surge of money into emerging markets could continue -- with selloffs in bonds and stocks luring investors back in.

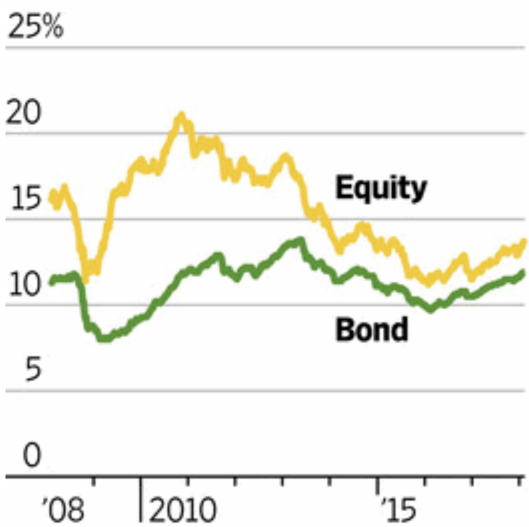
The share of emerging-market bonds in investors' portfolios stood at 11.9% on Feb. 7, below its decade high of 13.8% in May 2013, and just before the now infamous taper tantrum that sent investors running from risky assets.

The share of emerging-market stocks rose to 13.6% last week, well below the decade high of 21.1% in November 2010.

Not There Yet

Investors have poured money into emerging-market stocks and bonds, but remain less invested than at peaks earlier this decade.

Share of emerging markets in portfolios



Source: Institute of International Finance

THE WALL STREET JOURNAL.

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Document J000000020180215ee2f0000q

The New York Times

Business/Financial Desk; SECTB
Trump's Bold Projections for Economic Growth Don't Quite Add Up

By NEIL IRWIN
1,596 words
15 February 2018
The New York Times
NYTF
Late Edition - Final
3
English

President Trump has been nothing if not bold in his promises to generate supercharged economic growth.

When a report showed a strong 3.3 percent growth rate last fall, he said, ''I see no reason why we don't go to 4 percent, 5 percent, and even 6 percent,'' and he has spoken wistfully of emerging economies where growth can reach higher than that.

Even if you treat those musings as presidential bombast, his administration is making detailed projections that the economy will expand much faster in the decade ahead than it has in recent years -- a forecast that underpins the Trump policy agenda.

The administration forecasts growth in the neighborhood of 3 percent through the next decade, compared with around 2 percent projected by private forecasters and the economists at the Congressional Budget Office and the Federal Reserve. If the administration's forecast comes true, it will imply an economy 12 percent bigger in 2028 than that projected by the more cautious forecasts -- an extra $2.8 trillion in economic activity that year, in today's dollars.

But when you look closely at the details of the forecast, not all of it quite adds up. To come true, it would require some of the strongest improvements in productivity seen in decades, yet also require that interest rates not react the way they have historically when growth strengthens.

To understand some of the Trump administration's buoyant assumptions and the apparent contradictions buried within them, it helps to go step by step on where economic growth comes from and how it relates to interest rates, employment and inflation.

Capital spending can fuel higher growth, but not forever

Think of the simplest arithmetic on how a single company can produce more goods and services. There are three ways:

â– Workers can put in more hours of labor. If the company hires more people, or has current workers do longer shifts, it can increase production.

â– The business can invest in more capital to make workers more effective. The latest equipment or software can mean each hour of labor creates more stuff.

â– The business can adjust its management techniques and how it operates to try to get more productivity out of the same workers and equipment.

The same idea applies to the economy as a whole. Growth comes from either more hours being worked, or more capital for each worker, or the third, which is called ''total factor productivity.''

The Trump administration leans heavily on the second of these -- more capital -- as justification for its optimism. With lower taxes on business, as well as regulatory policies that are more favorable to capital, the budget statement says, it will unleash ''growth-enhancing policies'' in terms of more capital in the economy per worker.

It is indeed plausible that these policies will encourage more capital investment in the next few years, said Joel Prakken, chief U.S. economist at Macroeconomic Advisers, with higher productivity growth as a consequence.

But that should be a one-time adjustment, after businesses increase their capital stock in response to more favorable policies. Once that process is complete and has resulted in higher productivity, there's no reason to think that capital investment would keep rising as a share of the economy.

In other words, the benefits in terms of productivity growth and economic growth should fade over time, which the administration acknowledges.

''The new tax law would be a one-time shift, spread out over several years, after which there would be a new steady state growth path for labor productivity,'' DJ Nordquist, chief of staff at the White House Council of Economic Advisers, said in an email. ''Nevertheless, in that new steady state, faster growth than we have seen in recent years can still be expected because of the elimination of excessive regulations, to which this administration is committed and because of our infrastructure plan. This deregulation will have enduring benefits to the rate of growth.''

Some private economists are not persuaded these effects are powerful enough to account for continued strong growth a decade from now. ''I try to fit these numbers into a mainstream paradigm and I can't make them fit,'' Mr. Prakken said.

What about other sources of growth?

But even if higher capital investment can't do all the lifting of generating 3 percent growth, there remain those other two possibilities, of hours worked or total factor productivity, that could help achieve the 3 percent growth forecast even after the lift from tax cuts and capital investment fades.

But demographic trends are putting a lid on potential growth from more hours of work. The retirement of the baby boomers and stabilization of the proportion of women in the work force mean that potential hours worked will rise only 0.4 percent a year in the coming decade, according to the C.B.O.'s forecast (compared with 1.3 percent a year from 1950 to 2016).

Moreover, the Trump administration's immigration policies, if anything, would tilt that number in a negative direction, as deportations, tighter border security and more restrictive issuance of work visas reduces the potential supply of labor.

Ms. Nordquist argued that Trump administration policies would help increase the labor force, and hence growth potential.

''We think that labor force participation has dropped in the past decade in part because of government policies that discourage work,'' said Ms. Norquist, including growth in Social Security disability insurance and the Affordable Care Act. ''There is much room for the Trump administration to improve on those policies, for example through marginal individual income tax rate cuts,'' citing evidence that older, near-retirement workers may be more likely to work when taxes are lower.

Then there's total factor productivity, the black-box driver of growth. Economists don't really understand it, and calculate it only as a residual -- it is the number left over after calculating how much a rise in output comes from more hours worked or more capital.

It would be great for the long-term prospects for the economy -- and for the Trump administration's forecast -- if total factor productivity started rising faster. But it's hard to predict, and it doesn't show much relationship with either corporate taxes or government regulation. For example, it was quite high from 1950 to 1973, when corporate income taxes were between 48 and 52 percent (they were recently cut to 21 percent). And it was quite low from 1982 to 1990, amid the Reagan era tax cuts and deregulation.

The interest rate paradox

Suppose the Trump administration's growth forecast really does materialize: Tax cuts and deregulation fuel productivity-enhancing capital spending; some good fortune arises in terms of the labor force and total factor productivity; and economic growth returns to its pre-2000 norm of around 3 percent. That would be positive news for the economy. But it also would be likely to have other effects, particularly on interest rates.

Over time, interest rates tend to move in tandem with the nominal growth rate. Part of the reason interest rates have fallen sharply in the last decade is that low growth has translated into what economists call a low ''natural rate'' of interest and low inflation levels.

But the Trump administration projects similar interest rates to those envisioned by more cautious forecasters, despite projecting higher growth.

It implies something of an immaculate expansion: returning to pre-2000 growth rates without also returning to pre-2000 interest rates.

In the 1990s, for example, G.D.P. growth averaged 3.3 percent per year, and the **10-year Treasury bond yield** averaged 6.7 percent. The administration projects economic growth nearly that strong, but rates peaking at 3.7 percent.

Even some who are on board with more optimistic forecasts of growth say that higher interest rates and inflation are likely to accompany it. Allen Sinai, a longtime forecaster, shares the administration's view that businesses will invest in more capital because of the tax law, thus achieving higher productivity.

But in addition to that, he argues, the economy will be at risk of overheating. He sees inflation rising to between 2.5 percent and 3 percent by late 2019, which could send long-term Treasury bond yields up to 5 percent, well above the 2.9 percent today and the 3.1 percent the administration forecasts for 2019.

''At some point inflation gets high enough, and the market takes interest rates up,'' said Mr. Sinai, the chief economist at Decision Economics. And higher rates, it's worth adding, would raise the cost for the government to service the national debt, in turn making deficits higher.

Ms. Nordquist notes that the forecasts published Monday were developed in November, when interest rates were lower than they are now. ''If we were to redo the interest rate forecast today, we would project higher rates,'' she said.

The art of the forecast

Have some sympathy for those who build these forecasts. Predicting anything 10 years in advance is inherently hard, and no forecast is ever perfectly correct. As the last 10 years show, there is a lot that is just unknowable about the forces that will buffet the economy.

But you do want those forecasts to line up with what we already know about the economic and demographic forces that will shape the future. And a lot will have to go right for the Trump administration's forecasts to come true.

Document NYTF000020180215ee2f0006f

The New York Times

Business/Financial Desk; SECT
Wall St. Gains as Investors Weigh Inflation and Retail Data

By PRASHANT S. RAO
473 words
15 February 2018
The New York Times
NYTF
The New York Times on the Web
English

Stocks on Wall Street finished higher on Wednesday, as a report of higher-than-expected inflation was tempered by data showing weaker retail sales.

Wall Street indexes hit all-time highs in January, driven in large part by a bevy of positive economic data, a new tax law that would drastically cut the overall corporate tax rate, and years of easy access to money as a result of central bank policies.

But a long-running **bull market** has reversed sharply in the past two weeks. Central banks appear to be tightening monetary policy, which would raise the cost of borrowing and could eat into corporate profits, and data suggests that wage growth is accelerating in the United States. Several days of sell-offs last week pushed the United States **stock market** into a correction, indicating a severe downward trend.

Since then, stocks have risen four days in a row.

Stocks initially dropped on Wednesday, reflecting the January inflation data that was released before the market opened. Prices rose 0.5 percent last month and 2.1 percent over the past 12 months, beating analysts' expectations.

The yield on the United States Treasury's 10-year note rose sharply through the day, reaching 2.90 percent.

The inflation data was countered by unexpectedly poor retail sales figures. The Commerce Department reported that sales decreased 0.3 percent in January, and the figure for December was revised to show sales unchanged instead of rising 0.4 percent as previously reported.

Investors fear the accelerating pace of inflation in the United States could prompt the Federal Reserve to quicken its pace of interest rate increases.

It is the latest sign that central banks in Europe and the United States plan to raise interest rates after keeping them at or near historic lows for years, a shift that has weighed on stocks. The low rates were intended to bolster economic growth in the wake of the financial crisis, pushing market rates lower and helping companies borrow more cheaply.

The Bank of England was the latest to warn of a shift, saying last week after a meeting of its monetary policy committee that it may have to raise interest rates "somewhat earlier and by a somewhat greater extent" than it had estimated late last year.

The comments contributed to rising yields on government bonds, which move inversely to prices. That can make borrowing money more expensive not just for governments, but also for companies.

Stock markets in Asia and Europe showed limited movement on Wednesday. Japan's benchmark index, the Nikkei 225, was down less than 0.5 percent at the close, while markets in London, Frankfurt and Paris all closed higher.

Follow Prashant S. Rao on Twitter: @prashantrao.

Document NYTF000020180215ee2f00057

The New York Times

WHITE COLLAR WATCH
Business/Financial Desk; SECT
Oversight of Virtual Currencies May Require a Regulator

By PETER J. HENNING
827 words
15 February 2018
The New York Times
NYTF
The New York Times on the Web
English

Cryptocurrencies like Bitcoin and Ether have seeped into the public consciousness. Colleges including Duke and the Massachusetts Institute of Technology are offering classes in the blockchain technology that undergirds these virtual currencies to crowds of eager students.

The mania has also gotten the attention of regulators at the Securities and Exchange Commission and the Commodity Futures Trading Commission. But both can only look on -- perhaps in horror -- at what is happening. Laws adopted decades ago give the two regulators have little authority to engage in oversight of the burgeoning market in cryptocurrencies.

That may change if Congress can muster the political will to extend the oversight responsibilities of two agencies it has been rather hostile to in recent years. A better way may be to create a new agency -- one that does not carry the baggage that the S.E.C. and C.F.T.C. do on Capitol Hill and that does not try to put the square peg of cryptocurrencies in the round holes of securities and commodities trading.

At a recent hearing of the Senate Banking, Housing and Urban Affairs Committee, Jay Clayton, the chairman of the S.E.C., and J. Christopher Giancarlo, the chairman of the C.F.T.C., spoke about their limited power to regulate the use of cryptocurrencies.

Mr. Clayton highlighted the risks posed by cryptocurrency trading platforms that call themselves ''exchanges,'' which gives the impression that they are regulated like the New York Stock Exchange and the **Nasdaq**. But investors using such platforms ''do not receive many of the market protections that they would when transacting through broker-dealers on registered exchanges,'' Mr. Clayton said. Instead, the cryptocurrency exchanges are considered ''money transmission'' businesses, subject to a hodgepodge of state and federal rules that provide little protection to those who use their services.

There are distinctions between cryptocurrencies like Bitcoin, which are not tied to a single company but instead operate more like regular money, and tokens issued by firms to help raise money in initial coin offerings, or I.C.O.s. Mr. Clayton announced a much tougher stand on that second form of virtual assets. ''The structures of I.C.O.s that I have seen involve the offer and sale of securities and directly implicate the securities registration requirements,'' he said. The S.E.C. has filed cases against companies making coin offerings for selling unregistered securities, and more are certainly on the way.

Mr. Giancarlo explained that his agency does regulate futures contracts that are tied to cryptocurrencies, and it can police firms executing transactions involving the contracts. But he pointed out that the C.F.T.C. ''does not have regulatory jurisdiction over markets or platforms conducting cash or 'spot' transactions in virtual currencies, or over participants on those platforms.'' To reach actual trading in cryptocurrencies, Congress would have to extend its authority to cover a cash commodity market, something lawmakers have not done.

Investors need protection. Virtual currency firms have seen a rash of large-scale thefts from customer accounts. An Italian cryptocurrency exchange called BitGrail reported on Saturday that tokens called Nano worth approximately $170 million had gone missing in unauthorized transactions. An exchange in Japan called Coincheck disclosed in late January that hackers had stolen $530 million from the accounts of cryptocurrency investors.

Any theft can be prosecuted under a range of federal laws, including the Computer Fraud and Abuse Act and the wire fraud statute because cryptocurrencies are a form of property, even though they are intangible. But criminal prosecution is not a particularly effective weapon for battling hackers who plunder cryptocurrency wallets. Many of the exchanges are outside the United States, so finding those responsible is a challenge.

Regulating the exchanges would be a significant step toward ensuring there is at least some protection for those buying and selling cryptocurrencies. That comes at a substantial cost, however, because the compliance requirements and reporting obligations for an exchange would be substantial. Operating with little government oversight has been a selling point for adherents of cryptocurrencies, but the growth in the market that has given rise to large-scale thefts and fraudulent schemes is fueling greater demand for some measure of accountability.

Whether the S.E.C. or the C.F.T.C. are the best venues for this type of regulation is something Congress will have to decide. Neither agency has experience in overseeing virtual currencies, so assigning responsibility to one (or both) will require increased appropriations to develop rules and effective oversight.

Perhaps a new agency is needed. The S.E.C. was created by Congress in 1934 to implement greater federal regulation of the securities markets. The creation of, say, a Cryptocurrency Exchange Commission, or C.E.C., could address a rapidly developing product that defies easy categorization without having to deal with the demands -- and foibles -- of an entrenched bureaucracy.

Document NYTF000020180215ee2f0004c

THE WALL STREET JOURNAL.
U.S. EDITION

Business & Finance
What's News
Business & Finance

246 words
15 February 2018
The Wall Street Journal
J
A1
English

Consumer prices in January rose more than forecast, teeing up the expected first interest-rate increase of the year in March.

The **10**-**year Treasury**'s yield closed at a four-year high. Stocks advanced for a fourth day, with the Dow rising 253.04 to 24893.49.

AT&T is considering the gambit of seeking testimony from the Justice Department's antitrust chief in the trial over its bid to buy Time Warner.

Google's Chrome browser has begun blocking certain types of online ads, a move the firm said is user friendly but critics call self-serving.

Cisco said it would repatriate $67 billion of its foreign cash holdings to the U.S. this quarter, following changes to U.S. tax law.

Fannie reported a $6.5 billion loss, triggering what is expected to be a $3.7 billion taxpayer-funded infusion.

The FCC chairman recommended approving SpaceX's plan to use satellites to provide broadband service.

British officials blamed Russia for a June cyberattack that crippled networks at multinational firms.

Sky shares rose above the price that Fox offered for the U.K. pay-TV firm for the first time since the bid.

Credit Suisse posted an annual loss as the U.S. tax overhaul forced it to write down deferred-tax assets.

Saudi Arabia said the kingdom and OPEC were committed to sticking to oil-output cuts through 2018.

Document J000000020180215ee2f0002e

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Fed's Big Worry Is Inflation, Not Markets

By Justin Lahart
363 words
15 February 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

With the economy throwing off more heat, the biggest risk for the Federal Reserve is that it falls behind on raising interest rates. And if investors suffer as a result? So be it.

Inflation picked up again last month. The Labor Department on Wednesday reported that consumer prices rose 0.5% in January from December, putting them 2.1% above their year-earlier level. Core prices, which exclude food and energy, rose 0.3% for a 1.8% gain on the year. Both measures were stronger than economists expected.

That got investors worrying again that the Fed will raise rates more than expected. The yield on 10-year Treasurys rose to a four-year high.

The inflation figures were just the latest batch of data suggesting the economy is running up against capacity constraints.

The January job report, which kicked off this month's sharp drop in stocks, showed unexpected wage growth -- a sign that the job market has tightened to the point that companies need to pay workers more. The National Federation of Independent Business on Tuesday said the share of small businesses raising employee compensation was at the highest level since 2000.

Fed policy makers expect to raise rates three times this year. Investors are skeptical that there will be that many increases, though they have grown less skeptical since the start of the year.

What is different this time is the economy is about to get a double dose of stimulus from the tax cut and the budget deal. Coming at a time when the job market is already tight, the expected boost in growth may force the Fed to raise more than three times to keep inflation in check. That isn't something investors expect.

If the Fed does opt to raise rates more aggressively, **financial markets** aren't likely to take it well. But if it is trying to lower the danger of the economy running too hot, the Fed will consider its actions as necessary, even if the markets suffer collateral damage.

page,5043

Document J000000020180215ee2f0000w

THE WALL STREET JOURNAL.
U.S. EDITION

REVIEW & OUTLOOK (Editorial)
The Inflation Surge

598 words
15 February 2018
The Wall Street Journal
J
A16
English

New Federal Reserve Chairman Jerome Powell can thank predecessor Janet Yellen for another parting gift: rising prices. The Labor Department reported Wednesday that consumer inflation rose 0.5% in January, or 2.1% over the past year, a bigger spike than most economists predicted.

The markets reacted better than expected with stocks rising after early losses. But the yield on the **30-year Treasury bond** popped above 3.16% and is near its two previous peaks of the past three years. The yield on the **10-year Treasury** note also climbed above 2.9%. The cost of money is going up, which by itself isn't alarming as economic growth accelerates.

The bigger question is whether the Fed is repeating its mistake from the early 2000s when it kept interest rates too low for too long even as the economy surged after the 2003 tax cut. This fed the housing bubble, commodity price spikes and a general financial mania that ended in panic and crash.

The January report is at least a warning. Core prices, which exclude food and energy, were more restrained, rising 0.3% for the month, or 1.82% over the past 12 months. The price of oil rose above $66 a barrel in January and has since fallen below $61. But the overall increase in prices is still notable amid modest wage gains.

The price trend of recent months should certainly rid the Fed of any residual deflation worries. That delusion drove the monetary mistakes of 2003-2005. Recall Ben Bernanke's famous speech in late 2002 in which he warned of deflation even after the GOP midterm election victory and plans to cut taxes were developing. The current Fed has stuck to its accommodative policies because prices haven't climbed above its 2% inflation target, and some on the Federal Open Market Committee have wanted to push even past 2%.

The potential game-changer now is faster economic growth from the new policy mix of tax reform and deregulation. The Fed has been operating under the assumption of Obama-era "secular stagnation," in economist Larry Summers' phrase, and even today it is assuming tax reform won't help growth. New York Fed President William Dudley said recently that growth in 2018 will increase to 2.75% but tax reform will hurt the economy overall.

But what if he's wrong and growth does accelerate above 3%? Mr. Dudley and Ms. Yellen have left Mr. Powell to play the bad cop and raise rates faster to avoid a rerun of the Alan Greenspan-Ben Bernanke mid-2000s.

The political risk of rising prices is clear from the Labor Department's other report Wednesday on real earnings. Average hourly earnings for production and nonsupervisory workers -- that is, Trump voters -- fell 0.5% for the month. Average wages rose modestly but that was erased by the increase in consumer prices. One reason Americans were never thrilled by the GDP growth of the Bush era is because earnings gains were undercut by rising food and energy prices.

Faster growth amid tight labor markets should lead to higher wages, but the Fed needs to make sure the gains aren't stolen by higher prices. That's what has happened in the United Kingdom, where inflation is above 3%. The Tories can tell you how that played in last year's election. Ms. Yellen recently said she regretted not being reappointed to a second term as Fed Chair, but she is underestimating the challenge she left Mr. Powell.

Document J000000020180215ee2f0000g

The New York Times

STOCKS & BONDS
Business/Financial Desk; SECTB

Third Day of Gains Restores Some Calm on Wall Street

By THE NEW YORK TIMES
1,019 words
14 February 2018
The New York Times
NYTF
Late Edition - Final
4
English

NEW YORK -- Stocks in the United States rose for the third day in a row on Tuesday, led by banks, retailers and technology companies. The rebound over the last few days follows a harrowing drop of more than 10 percent over the previous two weeks.

After a wobbly start, stocks started climbing in the early afternoon and wound up with their most placid day in the last few weeks.

Amazon climbed once again, and athletic apparel companies rose following solid fourth-quarter results from Under Armour.

Apple continued to recoup some of its recent losses. Energy companies slipped again, and companies that distribute prescription drugs and medical supplies slumped.

Stocks have been making big swerves higher and lower recently. Last week the **Dow Jonesindustrial average** twice fell 1,000 points in a day, sometimes gaining or losing hundreds of points in a few minutes. But on Tuesday, the gap between the Dow's highest mark and its lowest was a more modest 284 points.

Mark Hackett, chief of investment research at Nationwide Investment Management, said investors who have steered clear of the **stock market** started to pile in over the last few months, but that round of buying ended abruptly.

"The pattern that we saw over the last month and a half is not by any stretch of the imagination unusual," he said, "But it is compressed. It normally doesn't happen over a six-week period."

Hackett said he feels stocks have fallen to more reasonable prices, partly because of the market slump and partly because corporate earnings grew at a strong clip in the fourth quarter.

The **Standard & Poor**'**s500 index** rose 6.94 points, or 0.3 percent, to 2,662.94. The Dow added 39.18 points, or 0.2 percent, to 24,640.45. The **Nasdaq composite** gained 31.55 points, or 0.5 percent, to 7,013.51. The Russell 2000 index of smaller-company stocks finished up 3.97 points, or 0.3 percent, at 1,494.95.

On Wednesday the Labor Department will issue its monthly report on consumer prices. Investors will be watching carefully because the recent bout of market **volatility** was touched off by worries that inflation might be increasing.

Under Armour climbed after it reported better-than-expected sales as shoe and accessory revenue picked up. The stock had plunged 50 percent in 2017 on top of a 30 percent decline in 2016. It rose $2.47, or 17.2 percent, to $16.70. Athletic apparel retailer Foot Locker also gained ground.

Amazon climbed $28.28, or 2 percent, to $1,414.51, and dollar stores, department stores and clothing companies made gains as well.

Prescription drug distributor AmerisourceBergen jumped $8.32, or 9.3 percent, to $97.77 after The Wall Street Journal reported that Walgreens Boots Alliance wants to buy the rest of the company. It already owns 26 percent of AmerisourceBergen, one of the largest prescription drug distributors in the U.S. It also distributes products to hospitals and other health systems. The Wall Street Journal said Walgreens made an approach several weeks ago that no offer has been made. Walgreens lost 17 cents to $68.29.

Separately, the Journal reported that Amazon is looking to win over hospitals and clinics to distribute a variety of medical products. Two other distributors of prescription drugs also fell. Cardinal Health lost $2.34, or 3.4 percent, to $65.69 and McKesson fell $2.84, or 1.9 percent, to $146.18.

In January Amazon announced a partnership with JPMorgan Chase and Berkshire Hathaway aimed at reducing health care costs. It's widely believed to have designs on a larger role in the health care system.

The Federal Trade Commission said it is suing three large dental product suppliers for conspiring to deny discounts to groups that buy products for small practices. Henry Schein, Patterson, and privately-held Benco control 85 percent of the $10 billion market for products like gloves, sterilization products, lights and dentists' chairs.

The companies rejected the allegations and said they will defend themselves in court. Henry Schein fell $4.79, or 6.6 percent, to $67.39 and Patterson sank $1.71, or 5.2 percent, to $31.21.

Nutrition supplement company GNC Holdings soared 18 percent after it formed a joint venture with Harbin Pharmaceutical Group of China. Harbin is investing $300 million in GNC, which will make it the company's largest shareholder. The stock rose 76 cents to $4.96.

Bond prices rose. The yield on the **10**-**year Treasury** note fell to 2.83 percent from 2.86 percent.

Energy companies declined, and benchmark U.S. crude fell 10 cents to $59.19 a barrel in New York. Brent crude, used to price international oils, added 13 cents to $62.72 a barrel in London.

Wholesale gasoline add 1 cent to $1.69 a gallon. Heating oil stayed at $1.84 a gallon. Natural gas rose 4 cents to $2.59 per 1,000 cubic feet.

Gold rose $4 to $1,330.40 an ounce. Silver slipped 4 cents to $16.53 an ounce. Copper climbed 8 cents to $3.16 a pound.

The dollar fell to 107.69 yen from 108.67 yen. The euro rose to $1.2355 from $1.2284.

Germany's DAX shed 0.7 percent and the CAC 40 of France fell 0.6 percent. Britain's FTSE 100 lost 0.1 percent. Japan's Nikkei 225 lost 0.7 percent and Hong Kong's Hang Seng index added 1.4 percent. South Korea's Kospi rose 1.1 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%20jayt .

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

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Tuesday. (Source: Reuters)

Document NYTF000020180215ee2e0000l

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Inflation Data Keep Markets on Edge

By Richard Barley
380 words
14 February 2018
The Wall Street Journal
J
B1
English

[Financial Analysis and Commentary]

Throughout last year, investors worried about a phantom menace that could upset markets: higher U.S. inflation. They were wrong, to their own pleasant surprise. Now they could be right, which creates its own complications.

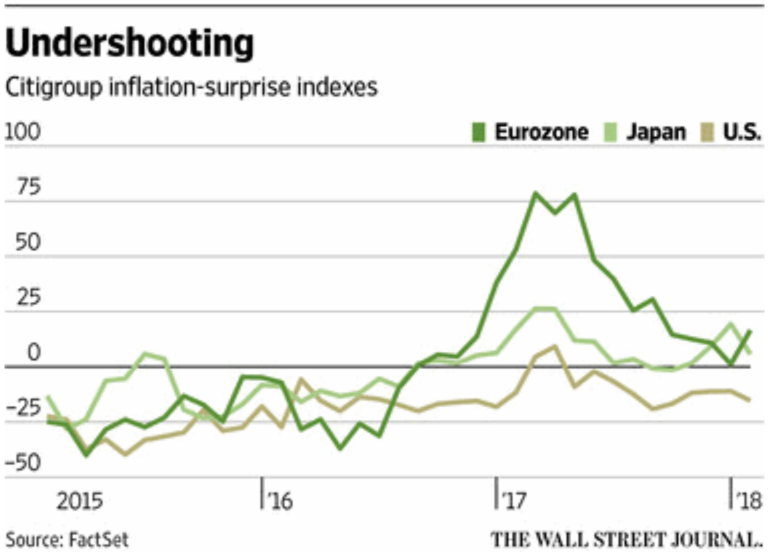
The key thing to consider is the power of expectations -- perhaps the most important force in **financial markets**. For some, higher inflation has been a worry ever since global central banks engaged in extraordinary monetary policy. But consumer-price inflation has been puzzlingly absent: Last year, former Federal Reserve Chairwoman Janet Yellen labeled the behavior of U.S. inflation a "mystery."

The fuss now might seem odd given headline inflation has been rising since its nadir in 2015. But crucially, it didn't rise as much as expected last year, and a lot of the move was down to a rebound in energy prices. Economists, who help shape market expectations, persistently forecast higher U.S. inflation than what emerged. That can be seen in Citigroup's U.S. inflation surprise index, which has been in negative territory even as its eurozone and Japanese peers have picked up.

The lack of inflationary worries meant stronger global growth captured investors' attention last year. Equity markets posted big gains, while fixed-income investors were remarkably relaxed about U.S. monetary policy, keeping long-term bond yields contained. Combined with better growth, particularly in Europe, the dollar weakened throughout 2017. That helped support risk appetite in emerging markets, brightening the economic outlook further.

But the backdrop has changed. The recent violent market swings started with an apparent pickup in U.S. wage growth. Added to that are concerns about U.S. tax and spending policy, piled on top of already loose monetary policy. U.S. bond yields haven't fallen even as markets have grown turbulent.

January inflation data out Wednesday is therefore key. Economists polled by The Wall Street Journal expect headline inflation at 1.9% and core inflation, excluding food and energy, at 1.7%. If the numbers start overshooting expectations, markets could get another jolt. So many got inflation wrong for so long, that getting it right is its own form of surprise.



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THE WALL STREET JOURNAL.
U.S. EDITION

Warning Is Sounded on Shale --- Energy group says that record U.S. output threatens recovery in oil market

By Christopher Alessi
796 words
14 February 2018
The Wall Street Journal
J
B1
English

LONDON -- U.S. shale companies are churning out crude oil at a record pace that could overwhelm global demand and reverse the oil market's fragile recovery, a top energy-market observer said Tuesday.

U.S. shale production is growing faster in 2018 than it did even during the boom years of $100 a barrel **oil prices** from 2011 to 2014, said the International Energy Agency in its closely watched monthly report. The difference this time: **Oil prices** are about 40% lower.

The situation is "reminiscent of the first wave of U.S. shale growth," when a flood of American oil built up a global glut and sent prices crashing over four years ago, said the Paris-based IEA, which advises governments and corporations on energy trends.

U.S. crude settled down 10 cents a barrel, or 0.17%, to $59.19. But the global benchmark Brent rose 13 cents, or 0.21%, a barrel to $62.72.

Shale producers "cut costs dramatically" during the oil-industry downturn, the IEA said.

They then took advantage of the Organization of the Petroleum Exporting Countries cartel's decision last year to cut its own output, which helped prices rise from the low $40s to over $70 a barrel in January.

Unlike countries like Russia, shale-oil companies -- using techniques like hydraulic fracturing, or fracking -- are able to pounce when prices rise and pull back when the market falls. They can drill wells and then wait to complete the process until it is profitable.

Shale-oil producers had promised investors that they would focus on profits this year as prices rose and abandon the pump-at-any-cost mentality that crashed the market. But shale companies have a backlog of nearly 7,000 wells that have been drilled but not completed. That allows operators to increase production by extracting oil from the backlog rather than spending significant amounts on drilling, meaning U.S. output could rise even higher than expected.

U.S. oil output could rise as high as 11 million barrels a day by 2019, some oil-industry analysts say, rivaling that of Russia, the world's biggest crude producer. The U.S. currently pumps over 10 million barrels a day, the most since 1970.

"All the indicators that suggest continued fast growth in the U.S. are in perfect alignment," the IEA said.

Led by U.S. shale companies, crude output from non-OPEC nations is expected to outpace the growth in oil demand in 2018, the IEA said. That is an important data point for oil traders who have been watching to see if shale production could catch up to robust demand that has been fueled by a strong global economy.

"U.S. shale is growing as sharply as it was in 2013-2014," said Bjarne Schieldrop, chief commodities analyst at SEB Markets. But the situation is different now because of the OPEC-led agreement to curb production, Mr. Schieldrop added.

OPEC and 10 other countries including Russia -- whose combined output accounts for over 55% of global supply -- have cut far more than the 1.8 million barrels a day they promised, according to the IEA.

The shale-oil growth will apply downward pressure on prices in the coming weeks. But as long as OPEC sticks to the deal, there won't be a dramatic correction, Mr. Schieldrop said.

Saudi Arabia's oil minister, Khalid al-Falih, has said there is an "oversized focus" on shale production growth. "I don't lose sleep over it," Mr. Falih said during the World Economic Forum last month in Davos, Switzerland.

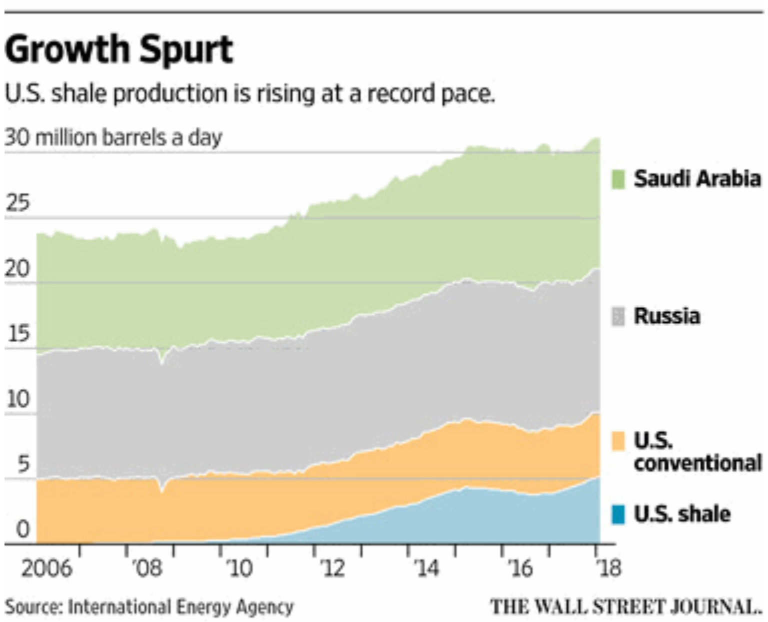
Until two weeks ago, **oil prices** had risen almost nonstop for over six months.

The optimistic sentiment was driven not only by OPEC, but also by strong economic news, geopolitical flare-ups in Iraq, Saudi Arabia and Iran, and supply outages in Venezuela and the U.K. Separately, oil storage levels around the world have fallen.

The IEA said commercial oil inventories in the Organization for Economic Cooperation and Development -- a group of industrialized, oil-consuming nations, including the U.S. -- fell by 55.6 million barrels in December, in the largest drop since 2011.

"The huge drop in inventories is a **bullish** signal," said Giovanni Staunovo, commodities analyst at UBS Wealth Management.

But inventory levels in the U.S. have begun to rise again, after months of falling, as U.S. output rises. The IEA on Tuesday noted that as "**oil price** rises have come to a halt and gone into reverse . . . so might the decline in oil stocks, at least in the early part of this year."



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THE WALL STREET JOURNAL.
U.S. EDITION

Bond Investors Ready for Tax Overhaul's Long-Term Cost

By Daniel Kruger and Michael S. Derby
802 words
14 February 2018
The Wall Street Journal
J
B13
English

Bond investors are grappling with concerns that the U.S. government's decisions to cut taxes and increase spending are stoking an economy that doesn't need a boost, at the expense of long-term financial health.

Selling in government bonds that began after the passage of tax cuts and accelerated amid fears of a pickup in inflation has darkened investors' outlook in recent weeks.

Even as the government boosts its borrowing, the Federal Reserve has stepped away from bond purchases and is now shrinking its holdings, raising worries about the appetite from private investors who will need to make up the difference.

Because the **10**-**year Treasury** note is a bedrock of global **financial markets**, rising yields -- which climb as **bond prices** fall -- can lift borrowing costs, affecting everything from state and local governments to mortgages, credit cards and corporate loans. Rising yields also can spook stock investors, reducing the appeal of riskier assets relative to Treasurys.

After years of central-bank support for markets helped cap **volatility**, investors are becoming increasingly worried that the Fed's decision to step back from crisis-era policies is pulling cash from the economy at a time when many financial assets are perceived as relatively overvalued.

The new course of U.S. spending comes at a time when the bond market is wrestling with a significant shift in global economic performance, with improving growth in the U.S. and elsewhere broadly credited for propelling an increase in real yields, which measure the purchasing power of bonds' fixed payments after accounting for inflation.

The upswing in inflation expectations reflects investors' concerns about everything from the effect of U.S. expansion to rising commodities prices. Investors will get a new view of inflation -- which threatens the value of government bonds because it erodes that purchasing power -- from Wednesday's release of January's consumer-price index.

The crosscurrents of rising government-bond yields and increased **volatility** in other assets last week contributed to the largest weekly percentage decline for the **Dow Jones Industrial Average** in two years, underscoring the importance of the bond market's reaction to a surge of fiscal stimulus and borrowing that comes after eight years of slow but steady economic expansion.

U.S. government-bond yields have risen to multiyear highs since Congress passed the tax cuts, which economists and investors have said will modestly accelerate growth, potentially leading employers to raise wages and increase capital investment.

To fund it, the government began increasing the amount of bonds it will sell, and analysts expect it will announce additional increases in May. Analysts say new budget plans and a possible increase in infrastructure spending also could boost issuance.

Moody's Investors Service said in a report Friday that "the federal government's balance sheet is set to deteriorate materially" as mandated spending on Social Security, Medicare and debt service, along with a jump in military spending and a decline in tax revenue, weakens the U.S. fiscal outlook.

Concerns about inflation also have contributed to the selling in government debt. Signs of accelerating wage growth in January helped push a market-based measure of inflation expectations to an average of 2.14% through 2028, the highest since September 2014, according to Thomson Reuters data.

That break-even rate reflects the difference in yield between the **10-year Treasury** note and its inflation-protected counterpart. A wider gap attracts investors seeking protection from rising consumer prices.

Fed officials don't seem to be all that worried by the recent rise in yields, but they are becoming increasingly anxious about the longer-run outlook for the market and the cost of credit in the U.S. economy.

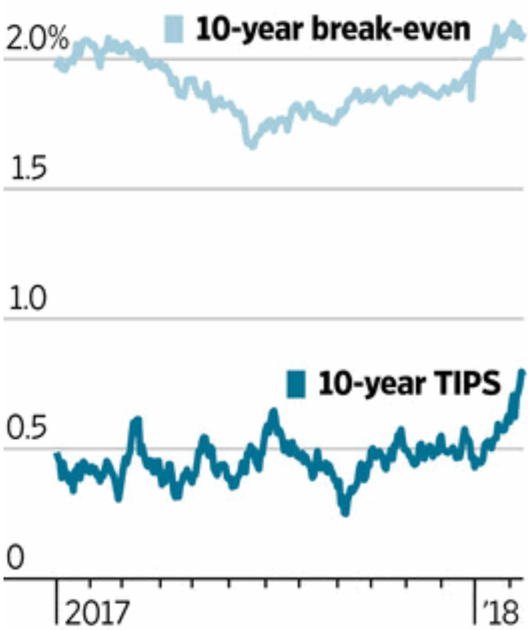
Some Fed officials view the recent uptick in government borrowing costs in a somewhat positive light, saying the bond-market shift appears to reflect investors finally coming to terms with the fact that major central banks' crisis-era easy-money policies are coming to an end. But they worry there is a bigger storm looming.

Although they usually refrain from offering opinions about government spending, Fed officials have long warned that a surge in social-welfare spending -- as baby boomers retire in an economy with a smaller labor force and already large deficits -- is unsustainable.

"There is no such thing as a free lunch," Federal Reserve Bank of New York President William Dudley said in mid-January, after the tax bill's passage but before the market's recent turmoil. The tax law "will increase the nation's longer-term fiscal burden, which is already facing other pressures, such as higher debt service costs and entitlement spending as the baby-boom generation retires."

Crosscurrents

Inflation expectations have risen, but so have yields on inflation-protected securities, suggesting demand for protection is limited.



Source: Thomson Reuters

THE WALL STREET JOURNAL.

Document J000000020180214ee2e00026

THE WALL STREET JOURNAL.
U.S. EDITION

How a Popular Trade Reversed in a Hurry

By Jon Sindreu
635 words
14 February 2018
The Wall Street Journal
J
B13
English

Investors' bet on calm markets shifted to a record trade in favor of **volatility** last week, new data show, a move that unleashed a wave of selling that analysts say fueled the worst equity rout in years.

After a long period of market calm, many investors were betting against swings in equities through futures on the Cboe **Volatility** Index, or VIX, which tracks how much **volatility** investors expect on the **S&P 500**.

They did that by selling VIX futures to insure against market swings, taking up the profitable role of insurer. When markets turned, investors scrambled to offset the damage either by buying back those futures -- or selling stocks, which drop as **volatility** increases -- overwhelming the market with sellers.

That sudden shift from selling VIX futures to buying them was loud and clear in weekly data from the U.S. Commodity Futures Trading Commission released late Friday.

Speculative investors, or those classed as noncommercial by the CFTC, swung from a net 60,000 contracts that wagered against the VIX the week before the market turned, to an 86,000-contract bet in its favor by this past Friday. That is both the largest ever shift in these positions by speculative investors and their biggest bet in favor of the VIX since records start in 2006.

A closer look at the figures also shows some interesting trends that were at the center of last week's roller-coaster ride in global markets.

The CFTC breaks down investors in terms of dealers, which are mostly banks providing clients with a counterparty for their trades, asset managers, which include steady institutional investors like pension funds and insurers, and leveraged-funds investors, which are hedge funds and other speculators -- similar to the noncommercial category.

Over the past few years, speculators have doubled down on their bets against the VIX, in expectation that the long period of calm markets would continue and forcing dealer banks to take the other side of those trades.

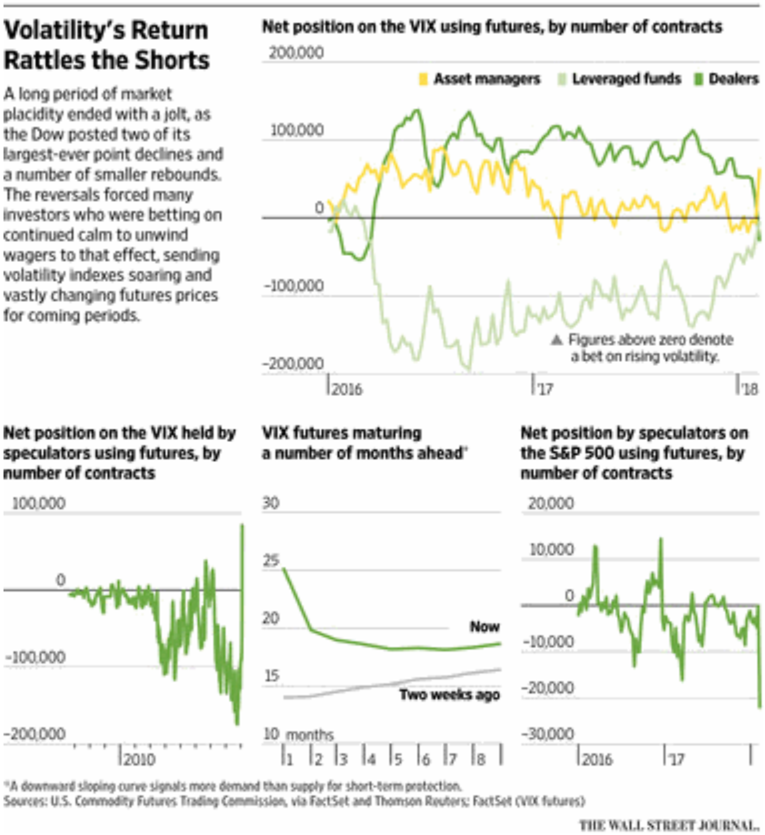
Analysts say that this can mellow market swings in itself, as banks offset these exposures by buying stocks as they fall and selling them as they rise. This can create a feedback loop in which betting against **volatility** suppresses it.

The CFTC numbers show that even institutional investors -- who have usually been the main buyers of insurance against sharp market moves -- began moving the other way in 2016, forcing banks into even larger positions in favor of the VIX. In late 2017, even pension funds were net sellers of insurance as they looked to cash in on what had been a profitable trade.

Last week, it all sharply corrected, with asset managers and speculators scrambling for insurance to offset their misfired bets, and banks selling that insurance -- bets on the VIX that the market will be **volatile** -- at high premiums.The feedback loop reversed, analysts say, as expensive insurance drove investors to offset their losses by betting against the **S&P 500**, both through futures and by selling actual stocks, because stock markets usually fall as **volatility** rises. CFTC data show that as speculators launched their bets in favor of the VIX last week, they simultaneously started betting heavily against the **S&P 500**.

There is one bit of good news in the CFTC numbers: It suggests many investors have already offset their losing bets. An analysis by statistical research firm Quant Insight finds that the VIX's moves are now once again explained by economic and stock-market trends, which hadn't been the case in 2017, as the market was inundated by new volatility sellers.

Some analysts warn, however, that a large chunk of the so-called short-volatility trade could still be unaccounted for.



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THE WALL STREET JOURNAL.
U.S. EDITION

Stock Market 'Fear Index' Faces Probe

By Gunjan Banerji
1,076 words
14 February 2018
The Wall Street Journal
J
A1
English

A U.S. regulator is looking into whether prices linked to the **stock market**'s widely watched "fear index" have been manipulated, according to people with knowledge of the matter.

The Cboe **Volatility** Index, known as the VIX, is derived from **S&P 500** options prices. The Financial Industry Regulatory Authority is scrutinizing whether traders placed bets on **S&P 500** options to influence prices for VIX futures, the people said.

Separately, a letter from a law firm Monday representing an unidentified client urged U.S. regulators to investigate VIX manipulation, claiming it has cost investors hundreds of millions of dollars in losses each month.

If evidence of manipulation is found, it would be a black mark for the VIX, which has soared in popularity over the last decade as a hedging tool for investors. The VIX is designed to track investor anxiety and tends to move in the opposite direction of the benchmark **S&P 500 index**. Investors purchase VIX futures and options to protect against declines in stocks.

Finra is Wall Street's self-regulator. It isn't a government entity but is overseen by the Securities and Exchange Commission. It provides oversight to Wall Street firms such as brokerages and exchanges.

It is unclear whether Finra's activities on the VIX amount to a formal investigation by the organization. Finra could also reach the conclusion that prices for VIX futures haven't been manipulated.

A probe by Finra or another U.S. regulator would be another setback for Cboe Global Markets Inc. The VIX is Cboe's marquee franchise, with a slew of products including futures, options and exchange-traded products that track it. Finra works with Cboe Global Markets to help with surveillance of its market.

Last week, the resurgence of market **volatility** triggered a spike in the VIX and the collapse of a widely traded ETP that buys and sells VIX futures. The ETP's demise helped send Cboe's shares sliding 18% over the next four days amid speculation that losses like those suffered by the ETP's investors could lead to greater regulatory scrutiny for the VIX going forward.

"Cboe has a dedicated regulatory department that works with Finra to monitor certain trading activity for our securities markets, including trading activity that could impact the VIX settlement," said Greg Hoogasian, Cboe's chief regulatory officer.

A spokesman for Finra declined to comment.

Manipulation is a civil and criminal violation under commodities law, said Craig Pirrong, a professor of finance at the University of Houston. It can be harmful to people trying to hedge their portfolios. Investors frequently turn to futures contracts for this purpose.

Moreover, distorting prices can undermine the "fundamental purposes of the markets," he said, creating a situation in which the forces of supply and demand cease to become a reliable indicator of prices.

Here's how VIX manipulation could occur: Traders trying to move prices for VIX futures and options could achieve this by betting on the options at a special auction that takes place each month to calculate settlement values.

Volume tends to spike around the time of the settlement auction and only in **S&P 500** options that tend to have an outsize influence on the VIX's final level, according to research by John Griffin and Amin Shams, professors at the University of Texas at Austin who wrote a paper on the topic in May.

Proving manipulation is difficult, lawyers and academics say. The regulator must prove that a person or firm had the ability to move prices and did so intentionally. In addition, the regulator must show that the person intended to create artificial prices, said Prof. Pirrong.

Since the Commodity Futures Trading Commission's creation in 1975, it has won only one manipulation case against a trader who wouldn't settle as of late 2016.

Cboe said the University of Texas professors' research is based on "fundamental misunderstandings" about the VIX and its derivatives. It also said it has safeguards that make it difficult to manipulate the **volatility** gauge.

"The VIX index formula calculation performs exactly as intended, and we do not think that there is a problem with the VIX settlement process," a Cboe spokesman said in December.

Lawyers from the Washington-based law firm Zuckerman Law said in a letter Monday that a client is urging the SEC and CFTC to investigate possible VIX manipulation.

According to the letter, the client found a flaw that allows "trading firms with sophisticated algorithms to move the VIX up or down by simply posting quotes on S&P options and without needing to physically engage in any trading or deploying any capital."

Some market participants and observers of derivatives markets say VIX manipulation is feasible. More than a dozen traders and brokers told the The Wall Street Journal that they avoid the expiration days for VIX futures or advise their clients to do so, with some citing manipulation fears.

"There's smoke there," said Prof. Pirrong. "It's definitely worth further inquiry."

There have also been at least two crackdowns surrounding **volatility** products in the past year by Cboe itself, disciplinary filings show.

Chicago-based DRW Securities LLC was fined in December for bets on **volatility** contracts that track oil, Brazilian equities and emerging markets. These derivatives are similar to VIX futures, though not as popular.

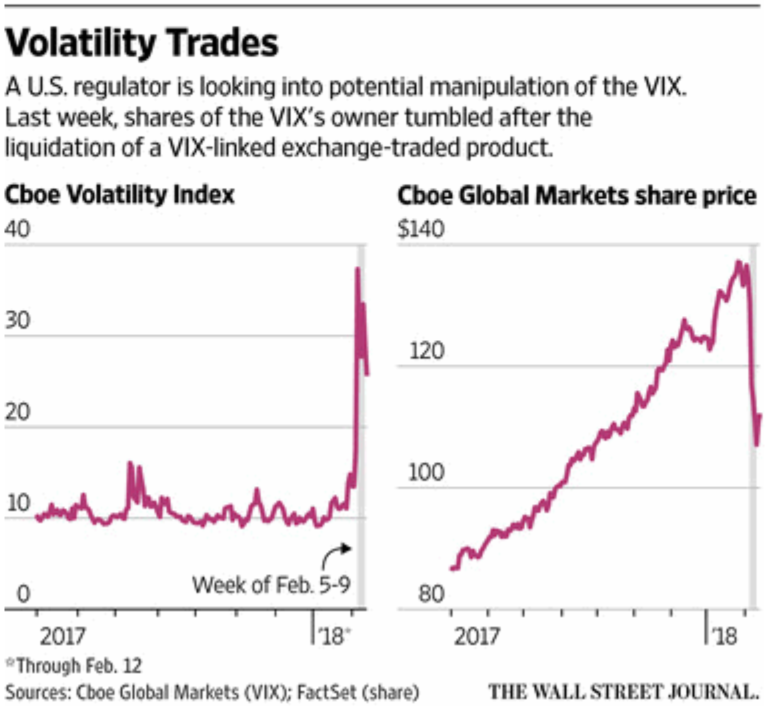
"Cboe has consistently denied any validity to our paper. . .but they recently fined a firm for exactly the same activity we identified in our paper," Prof. Griffin, one of the authors of the May paper, said in an email.

A DRW spokeswoman said the firm is pleased the matter is resolved and that it takes obligations to comply with regulations seriously. Cboe declined to comment on the DRW fine.

Equitec Proprietary Markets LLC, a Chicago-based trading firm, was fined in April 2017 for options orders it made related to the VIX futures settlement value. Equitec declined to comment.

For now, some market players simply avoid the VIX settlement date. Mark Guthner, an editor at the Options Edge, said he has noticed oddities with how final VIX futures contracts are priced and modified his trading.

"I just see some rabbit feet in the snow from time to time," Mr. Guthner said of the trading patterns. "It looks funny and if you're an investor, why subject yourself to that?"



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The New York Times

ECONOMIC SCENE
Business/Financial Desk; SECTB
A Stock Windfall for Titans, A Debacle for Everyone Else

By EDUARDO PORTER
1,374 words
14 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

Stocks are too expensive.

This is not a market forecast. I wouldn't be particularly surprised if the Dow shrugged off its recent turbulence and continued its long upward thrust. What I contend is that if the American economy behaved in the way that most economists say market economies should, stocks would in all likelihood be cheaper.

It is a grim proposition. Wall Street's titans might welcome the fact that equity prices have grossly exceeded what a well-functioning, competitive economy should deliver. But for almost everybody else, it amounts to a disaster. From wage stagnation to the depressed investment rates that are holding back long-term economic growth, many of the fault lines running through the American economy can be traced back to the same root cause powering the rise of America's overpriced stocks.

Consider a few facts. The average financial wealth of American households -- the market value of housing, stocks, bonds, business assets and the like, beyond their liabilities -- has grown much faster than the nation's income over the last half-century.

This would not be weird were American households saving more and investing their savings in productive ventures. They are not. The personal savings rate has declined sharply. The ratio of the capital stock -- the value of factories, machines and such -- to the nation's economic output has actually declined a little since the 1970s.

What has enhanced wealth in recent years is the huge rise in stock prices. The **Standard & Poor's 500-stockindex** increased 8 percent per year from 1970 to 2015, on average. According to an analysis by Germán Gutiérrez and Thomas Philippon of New York University, the ratio of the market value of American corporations to the replacement value of their capital stock has roughly tripled since the 1970s.

What makes this particularly puzzling for scholars reared on the classical models of competitive economies is that all this happened despite a persistent decline in real interest rates. In a more orthodox economy, declining rates on corporate bonds would encourage a surge in corporate investment. As companies invested more and more capital, the returns on investments would gradually decline until companies' returns matched their cost of capital: the interest rate they pay to borrow.

In the United States, neither has occurred. Investment has been stuck at stubbornly low rates. And even as interest rates have fallen, the average return on productive capital has stayed roughly constant.

In a nutshell, the United States has built an economy where businesses don't invest even though it has rarely been cheaper to finance investment. Still, they reap spectacular profits that warrant runaway share prices.

''These are not your father's growth facts,'' wrote Gauti Eggertsson, Jacob A. Robbins and Ella Getz Wold of Brown University in an analysis published this week by the Washington Center for Equitable Growth. The puzzling facts of contemporary America suggest an economy poised to fail.

What happened? It turns out that there is one straightforward reason for the American economy's unorthodox behavior. As Mr. Eggertsson and his colleagues argue, the standard economic theory based on competitive markets cannot apply when markets are not competitive. And competition, in the United States, is shriveling.

The scholars argue that the American economy is afflicted by "rents" -- returns in excess of what investments would yield in a competitive economy, where fat margins are quickly whittled away by competition.

These rents don't fall from the sky. Companies free of competitive pressures, with the power to set prices more or less at will, squeeze them from their customers and their workers. They pad corporate profits and send stock prices sky high.

Executives love it. The critical question is what these rents hold in store for the rest of us.

This doesn't necessarily mean, by the way, that the corporate landscape has been taken over by evil monopolists that resort to illegal tricks to keep competitors out. High-tech titans like Google and Facebook may just have the ability and the deep pockets to out-innovate everybody -- delivering wonderful new experiences to consumers along the way, and maintaining monopoly control over their latest innovations. One intriguing theory is that the globalized economy is reorganizing the business landscape, encouraging the rise of corporate superstars.

Not everybody agrees that competition is waning. Hal Varian, Google's chief economist, argues plausibly in a recent study that the case to worry about market concentration across the economy is weak. Even as concentration has increased in many sectors, there is plenty of competition in most industries and markets. Carl Shapiro, an antitrust scholar from the University of California, Berkeley, who served in President Barack Obama's Justice Department, worries that the new populism infecting American politics could prompt antitrust policy to take aim at all big successful companies.

Still, there are good reasons to worry about rising rents, no matter where they come from. Mr. Shapiro argues that while some measures of market concentration may not be meaningful, persistently high profits are of themselves a cause for concern.

Profits as a share of output have risen by half over the last 30 years. Combined with evidence that large corporations are accounting for an increasing share of revenue and employment, Mr. Shapiro writes, "it certainly appears that many large U.S. corporations are earning substantial incumbency rents, and have been doing so for at least 10 years, apart from during the depths of the Great Recession."

This is particularly true in the tech sector, where a handful of dominant companies -- you know the ones I'm talking about -- have sustained spectacular profits for years. Their sky-high stock prices suggest that investors expect high profits to continue as well.

"They probably are geniuses; what they are doing is wonderful," Mr. Shapiro told me. "Still, you would expect competition to erode away the excess profits over time."

Here is why we should worry.

Mr. Eggertsson and his colleagues built an alternative model of the American economy by doing away with the assumption of perfect competition. They contend that there are barriers to entry that stop competitors and allow rents to persist.

In this economy, stock prices don't just reflect the future stream of normal economic returns that would accrue to a company's capital investment. They also include a claim to a stream of rents that generate "pure profits." These profits can't be replicated by another company's capital investment. They are owned by a specific company.

So what features might an economy like this possess? Wages are unlikely to rise much in a job market dominated by a few big employers. As I speculated last week, markets dominated by a few businesses will most likely deter start-ups from appearing on the scene.

Rising rents will take larger shares of the nation's income. That will bolster the proportion of income that goes to corporate profits but squeeze the share that flows to workers -- in wages and benefits -- and to productive capital. This will discourage both work and capital investment. It will weigh on overall economic growth.

Rents interfere with incentives in a big way. Companies will spend more time and effort trying to preserve those rents -- often by working to block rivals from their markets. Rivals will fight to grab a share of those rents for themselves, perhaps through lobbying. Amid all this jockeying, investment in productive capabilities will most likely be neglected as a secondary consideration.

And inevitably, inequality will rise: The owners of the shares in the powerful corporations capturing the economy's growing monopoly rents will peel further and further away from the average Jane and Joe, who own little but their labor.

This is not the kind of economy proposed by classical economic theory. It is not the kind of country portrayed by evangelists of the American dream. But it looks as if we are stuck with it, regardless of what the **stock market** does tomorrow.

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A New Balance factory in Lawrence, Mass. The rise in stock prices has passed many workers by. (PHOTOGRAPH BY ADAM GLANZMAN/GETTY IMAGES) (B4)

Document NYTF000020180214ee2e0005n

The New York Times

Business/Financial Desk; SECTB
From Boom To Gloom

By CONOR DOUGHERTY
1,204 words
14 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

SAN FRANCISCO -- The United States is on track to achieve the second-longest economic expansion in its history. Unemployment is at a 17-year low. And California's state budget has a multibillion-dollar surplus.

So why is its longtime governor, Jerry Brown, issuing prophecies of doom?

''What's out there is darkness, uncertainty, decline and recession,'' Mr. Brown said recently after presenting his final budget to legislators.

California has accounted for about 20 percent of the nation's economic growth since 2010, significantly more than its share of the population or overall output. But Mr. Brown, in his final year in office, has raised the question on the minds of those paid to think about the economy: How long can this last?

For California and the nation, there is a long list of things that could go wrong. A surging budget deficit could stoke higher interest rates. And if the recent upheaval in stocks signals a longer-term decline, it would hurt California in particular because its budget relies heavily on high earners whose incomes rise and fall with the market. President Trump's moves to upend longstanding trade arrangements could be a setback for the state, home of the country's biggest port complex. And because the growth of the technology industry has played a huge role in California's recent boom, a drop in company valuations or in venture capital investments would reverberate swiftly through the state's economy and tax receipts.

''I don't think there's any reason to believe we are going to have a recession this year or the next year,'' said Christopher Thornberg, founding partner of Beacon Economics, a consulting firm in Los Angeles, referring to Mr. Brown's grim forecast. ''He's just pointing out the obvious, which is that things feel good now but there is going to come a time when all hell is going to break loose -- and we better be ready for it.''

Mr. Brown's statements highlight California's distinction as a state of high highs and low lows. From the recession of the early 1990s to the 2001 dot-com crash to the housing collapse of a decade ago, downturns often end up being more pronounced in the state than elsewhere. The next recession, whenever it comes, will almost certainly land harder here than it does in the rest of the country. And that boom-bust pattern is especially tough on California's budget -- something that Mr. Brown, who was first elected governor more than four decades ago, knows well.

In 2009, as the last recession took hold, California state revenue fell 19 percent, versus 8 percent for state revenues nationwide, according to Moody's Analytics. There has been a strong rebound since then, but the gains are unlikely to last. That is because California's government relies on a heavily progressive income tax that generates most of its revenue from a relatively small number of wealthy taxpayers whose incomes are erratic.

Even a blip in the **stock market** can punch holes in the state's budget. And because stock prices have more than doubled during Mr. Brown's term, it seems like a good bet that whoever succeeds him will face challenges. If and when that day comes, any proposal to increase taxes will probably be unpopular. Mr. Brown already raised income taxes to address the state's last budget mess, and California taxpayers took a further hit as a result of the new tax bill, which curbed the deductibility of state and local taxes on federal returns.

"His successor gets a world in which revenues are more volatile," without the option of raising taxes, said David Crane, a lecturer in public policy at Stanford University and a former adviser to Mr. Brown's predecessor, Gov. Arnold Schwarzenegger. "That's a really tough world to operate in."

A recession would also further expose problems that have festered for decades. Across California, cities and school districts are having trouble keeping up with ballooning pension obligations, squeezing teacher salaries and state services. In warning about budget troubles to come, Mr. Brown was making a case for adding more of today's surplus to the state's rainy day fund to cushion the blow of the next downturn.

Mr. Brown's final State of the State speech also included plenty of optimistic notes and pushes for big spending in the future on items mostly outside the state's general fund. He talked about "setting the pace for the entire nation" and embracing big infrastructure projects like a high-speed rail line despite doubts about its viability as costs mount.

"You have all of these projects that he wants to do," said Stephen Levy, the director of the Center for Continuing Study of the California Economy, an independent research organization. "He's saying, this year may be rosy, but watch out, it ain't going to continue. And I agree."

Even in prosperity, California has plenty of problems. The bulk of its recent gains have flowed to wealthier coastal cities, leaving inland areas behind, and a severe housing shortage has led to punishing rent increases and rising homelessness.

Still, economists generally agree that the state's long-term prospects are bright. It is home to many of the world's most valuable and innovative companies, and it attracts an outsize portion of the skilled work force and venture capital financing, helping it create new industries as old ones slow down or fade away.

And recession forecasting is a tough business even for those whose livelihoods depend on it, like Ed Del Beccaro, a senior managing director in the Walnut Creek office of Transwestern, a commercial real estate brokerage. He manages a team of brokers and travels around the Bay Area giving speeches and forecasts to chambers of commerce and other business groups.

"Two years ago I was predicting a recession in September of 2017, and in October I said we were going to have a recession at the end of 2018," he said. "Today I think that unless we get bombed by North Korea, we will have a pretty amazing two years of growth."

With a sudden spurt in demand for office space, Mr. Del Beccaro said, he is hiring new workers and spending more on marketing to prospective clients. "I was just authorized to go out and get more brokers and offer them incentives to hopefully get them to switch over from other companies," he said.

But winter will come eventually, and when it does, Mr. Brown's counsel about planning ahead may help shape how California weathers it.

Dolores Park in San Francisco. Whether in recessions or booms, California's economic cycles tend to be more volatile than overall national trends. (PHOTOGRAPH BY JASON HENRY FOR THE NEW YORK TIMES) (B1); A construction project in Los Angeles. The state has accounted for about 20 percent of the nation's economic growth since 2010, far more than its share of the population or overall output. (PHOTOGRAPH BY MONICA ALMEIDA FOR THE NEW YORK TIMES) (B2) CHART: California's employment volatility, relative to the U.S. average (Source: Moody's Analytics)

Document NYTF000020180214ee2e0003p

The New York Times

Business/Financial Desk; SECTB
Market Shakes Off Turbulent Week With a Tech Rally

By THE ASSOCIATED PRESS
687 words
13 February 2018
The New York Times
NYTF
Late Edition - Final
2
English

Stocks powered higher on Monday, sending the **Dow Jonesindustrial average** up 410.37 points, as the market clawed back more of its losses from the past two weeks.

Apple jumped 4 percent and led a rally in technology companies, while industrial companies, banks, and consumer-focused companies like retailers also rose.

Netflix and Amazon surged again as stocks that led the market higher in 2017 recovered more of the ground they lost recently. Energy companies got some relief as **oil prices** turned higher. All that helped stocks build on the market's gains from late Friday.

Some market watchers say the recent bout of turbulence may not be over. Jim Paulsen, chief investment strategist for the Leuthold Group , said he thought stocks and bonds would fall further as investors consider the likelihood that interest rates will keep rising and inflation will increase. Inflation and higher wages can cut into profits, and higher interest rates slow down economic growth.

Paulsen said the consumer prices report on Wednesday or the February employment report due next month could both have major effects on the market.

The **Standard & Poor's 500-stockindex** gained 36.45 points, or 1.4 percent, to 2,656. The Dow climbed 1.7 percent to 24,601.27. It had risen as much as 574, led by big gains for Boeing and Apple.

The **Nasdaq composite** index advanced 107.47 points, or 1.6 percent, to 6,981.96. The Russell 2000 index of smaller-company stocks rose 13.15 points, or 0.9 percent, to 1,490.98.

It took just nine days for stocks to plunge 10 percent from their latest peak, which they reached on Jan. 26. According to LPL Financial , it was the swiftest move from a record high to a market correction in the history of the **S.&P. 500**. The index rose about 1.4 percent Friday but still wound up with its worst weekly loss in more than two years. Despite the two-day recovery, the **S.&P. 500** is down 7.5 percent from its record high.

That comes after a remarkably calm year for stocks: There were only eight days in 2017 in which the **S.&P. 500** rose or fell at least 1 percent. But it has happened six times in the last seven trading days, and eight times since Jan. 26. That includes several drops that were far larger than anything the market endured last year.

Other gainers in the technology industry included Cisco Systems , which rose $1.07, or 2.7 percent, to $40.60. The chip makers Broadcom and Qualcomm each climbed after CNBC reported that they would meet this week to discuss Broadcom 's $121 billion offer to buy Qualcomm . Broadcom was up $8.90, or 3.8 percent, to $244.40, and Qualcomm rose $1.67, or 2.6 percent, to $65.66.

Benchmark United States crude gained 9 cents to $59.08 a barrel in New York. Brent crude, used to price international oils, fell 20 cents to $62.59 a barrel in London.

Bonds were little changed. The yield on the **10-year Treasury** note stayed at 2.86 percent and the price dipped slightly to $991/32.

In other energy trading, wholesale gasoline fell 2 cents to $1.68 a gallon. Heating oil fell 2 cents to $1.84 a gallon. Natural gas slid 3 cents to $2.55 per 1,000 cubic feet.

The dollar fell to 108.60 yen from 108.78 yen. The euro rose to $1.2289 from $1.2235.

Gold rose $11.10 to $1,324.20 an ounce. Silver jumped 43 cents, or 2.7 percent, to $16.57 an ounce. Copper added 5 cents, or 1.7 percent, to close at $3.09 a pound.

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

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Monday. (Source: Reuters)

Document NYTF000020180213ee2d0005j

THE WALL STREET JOURNAL.
U.S. EDITION

Congress Flirts With Disaster on Bank Leverage Ratios

By Sheila Bair
861 words
13 February 2018
The Wall Street Journal
J
A17
English

The **stock market**'s recent **volatility** is a reminder that financial conditions can change quickly. Whether periods of stress turn into severe economic downturns depends in large part on whether the nation's major banks are sufficiently capitalized to weather the market's ups and downs.

Regulators have worked hard to increase bank capital levels since the 2008 financial crisis, when major U.S. banks collapsed under the weight of their own debt obligations. It is alarming that several senators are now considering legislation that would weaken a key constraint against excessive leverage.

The Economic Growth, Regulatory Relief and Consumer Protection Act is a bipartisan bill that contains many good provisions to help community and regional banks. But one provision, Section 402, would shortsightedly enable banks to increase their reliance on debt. It is a technical change, but it needs to be understood, as it could undermine an important guarantor of financial stability and recreate part of the dangerous pre-crisis status quo.

In setting capital requirements prior to the financial crisis, regulators erroneously judged certain assets -- such as mortgage securities, derivatives and European sovereign debt -- as having little if any risk. Banks piled into these assets because regulators let them leverage returns with borrowed money.

Because their judgments about risk had been so wrong, regulators after the financial crisis have made greater use of capital standards that don't rely on government risk assumptions. For big banks, the most important of these is the "supplemental leverage ratio," which requires big banks to fund themselves with at least 5% common equity, effectively limiting their reliance on debt to 95%.

Section 402 would weaken this modest constraint on leverage by excluding central-bank deposits from this debt-to-equity ratio. This includes deposits not only at the Federal Reserve but also at central banks in countries not always viewed as paragons of stability, such as Turkey and Greece.

Big banks keep a lot of money on deposit with central banks, so removing those deposits from the leverage calculation could lead to capital reductions approaching 30% at some banks. The bill intends to limit these capital reductions to "custodian" banks, usually understood to mean specialized banks that safeguard customer assets. But the bill's definition of "custodian" bank is so broad that any big bank might qualify.

The stated purpose of the Senate bill is to realign incentives in the financial sector to support economic growth. But Section 402 will not encourage banks to make business and consumer loans; it will simply encourage them to park money with central banks so they can take on more leverage. In fact, with this provision, they can take clients' near-zero-interest-rate deposits and place them in their entirety at the Fed, where they will earn a 1.5% return -- an effortless way to make a profit that will become more attractive as the Fed raises rates later this year.

One possible argument for Section 402 is that the new incentive to invest will help expand central banks' balance sheets, strengthening their ability to fight economic crises. Late last year, the Basel Committee, an international regulatory forum that includes central-bank supervisors, expressed some sympathy for removing central-bank deposits from the leverage ratio, but only temporarily and amid exceptional macroeconomic circumstances. Even assuming quantitative easing is a worthwhile strategy, however, this legislation is not necessary to facilitate it. The Fed already has the power to ease capital requirements temporarily to support its market interventions.

Of all the Basel Committee member countries, only the Brexit-challenged U.K. has taken the step of removing central-bank deposits from its leverage calculation. Notably, it also increased its leverage ratio to mitigate the reduction in capital levels, something the Senate bill does not do.

Why does Congress think it is wise to designate particular banking activities as low- or no-risk when expert financial regulators failed so spectacularly in this exercise prior to the crisis? The virtue of the existing leverage calculation is that it does not reflect government judgments about risk. Central-bank deposits might appear to be low-risk today, but other items could be added to the list tomorrow. The Treasury wants U.S. government securities removed from the leverage ratio, notwithstanding their significant interest rate risk. What's next? Housing agency debt? How about triple-A-rated corporate bonds? Section 402 will create an uneven playing field by giving big systemic banks a special capital break not applicable to community and regional institutions.

Government judgments favoring one financial activity over another inevitably distort and weaken markets. It would be the height of irresponsibility for Congress to loosen capital requirements now, when big banks need to prepare for rough times that may lie ahead. Capital buffers should be built up, not chipped away.

Ms. Bair was chairman of the Federal Deposit Insurance Corp from 2006-11 and is currently founding chair of the Systemic Risk Council.

(See related letter: "Letters to the Editor: Are Central Banks Moving To Become Hedge Funds?" -- WSJ Feb. 26, 2018)

Document J000000020180213ee2d0000g

THE WALL STREET JOURNAL.
U.S. EDITION

Stock Valuations Get More Appealing --- Last week's selloff eases some concerns shares are expensive by historical standards

By Jon Sindreu
676 words
13 February 2018
The Wall Street Journal
J
B12
English

For investors who have complained about the **stock market** being too expensive, last week's sudden rout has something good to offer.

Major U.S. indexes ended the week Friday more than 5% lower, marking their worst loss in more than two years, despite a growing global economy and optimism about corporate profitability. Analysts blame the stock selloff on a series of misfired bets on low **volatility** and on higher bond yields, which make stocks less attractive compared with low-risk government paper.

This was troublesome, analysts and investors said, because the **stock market**'s price/earnings ratio -- how many times stocks trade above the earnings they are expected to generate over the next year -- was high by historical standards. This means that, even as analysts expected corporations to continue delivering strong earnings, their shares looked expensive.

"We have written many times about our concerns on valuations on both bond and equity markets," said Paul Flood, multiasset portfolio manager at Newton Investment Management. "Many investors had started to view markets priced to perfection as the only likely path forward."

Last week's sharp correction, which didn't alter analysts' optimistic view about the economy and corporate earnings, could alleviate some of those concerns.

Companies in the **S&P 500** are trading at 16.5 times their earnings, according to Morgan Stanley data, which blend firms' past profits with forecasts for the next year. That compares with the index trading at 18.1 times those earnings two weeks ago, and it is much closer to the **S&P 500**'s 10-year average of about 15.

Price/earnings ratios for stock markets in Europe, Japan and emerging-market economies have fallen by almost as much as in the U.S., even though they all traded at cheaper levels to start with.

Even with the lower valuations, the prospect of rising U.S. bond yields remains a concern for stock purchasers, particularly those who believe inflation is set to go up by more than previously expected. Higher inflation could prompt central banks to tighten monetary policy at a faster rate.

But stocks have also gained some small amount of ground on government debt. Another valuation measure for the **S&P 500**, which calculates the extra compensation that investors receive for buying stocks rather than inflation-linked U.S. government bonds, has now climbed above its long-term average going back to 2000.

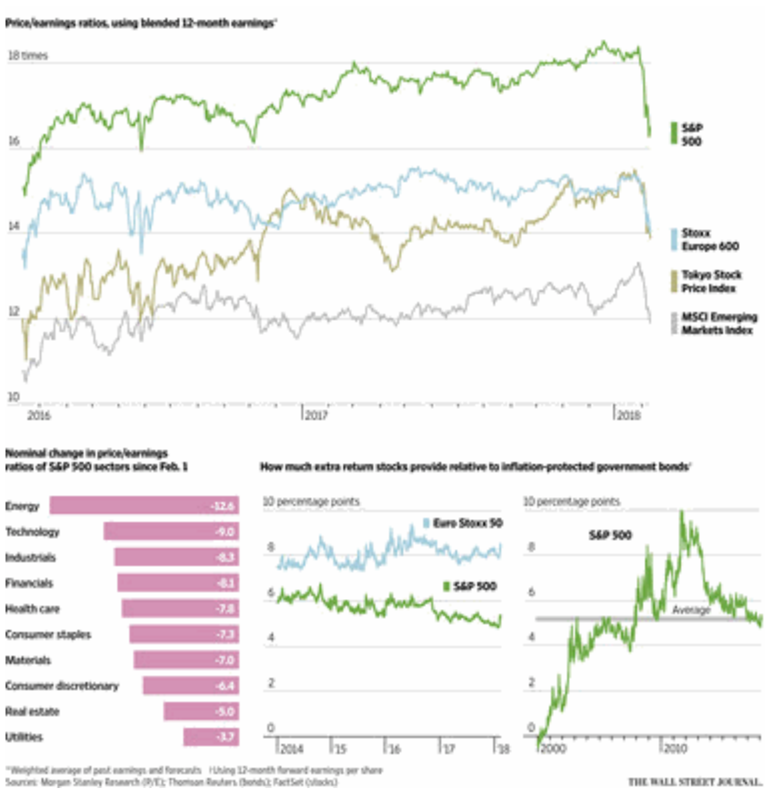
The U.S. selloff was also across most corporate sectors, further evidence that the declines were triggered by prior bets that **volatility** would remain low as investors scrambled to cover their losses, some analysts say.That meant investors were less discriminate and that companies that could benefit from the recent rise in bond yields, such as banks, were sold along with the rest.

Investors who are waiting to "buy the dip" can often allow corrections to run their course, instead of stepping in immediately, in order to scoop up even bigger bargains. But after closing higher on Friday, global stock markets had another positive day on Monday, suggesting that some money managers were already ready to buy these cheaper stocks.

"Time to pick stocks," equity strategists at Morgan Stanley told clients in a research note on Monday. "We have advocated patience in buying this dip," they said, adding that current measures of stock valuation were now attractive enough for "disciplined buyers."

Many investors point out that stock markets have usually recovered quite well from sudden selloffs that happened after a period of market optimism. A classic example is Black Monday in 1987, when the **Dow Jones Industrial Average** had its worst single day on record -- it plunged 22.6% -- but afterward enjoyed years of rallies.

"If history is any guide, most bull markets end because we are going into recession, not because of an overvalued market," said Chris Zaccarelli, chief investment officer at Independent Advisor Alliance LLC.



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Document J000000020180213ee2d0000j

THE WALL STREET JOURNAL.
U.S. EDITION

Corrections & Amplifications
Corrections & Amplifications

444 words
13 February 2018
The Wall Street Journal
J
A2
English

The Cboe **Volatility** Index, or VIX, known as the "fear gauge" for the U.S. **stock market**, hit its highest intraday level since 2015 on Feb 6. A Markets article on Thursday about Wednesday's trading incorrectly said it was the highest level since 2009.

(See: "Dow Swings 500 Points, Closes Lower --- Interest-rate worries, drop in **oil prices** continue to weigh on major stock indexes" -- WSJ Feb. 8, 2018)

The Cboe **Volatility** Index rose sharply on Feb. 5. A Page One article on Saturday about U.S. stocks closing out their most turbulent week in years incorrectly said the index declined sharply.

(See: "Wild Week for Stocks Ends in Gain --- Final-hour bounce caps worst week in 2 years for U.S. equities, with **volatility** seen ahead" -- WSJ Feb. 10, 2018)

A Hershey's milk chocolate bar contains 31% cacao. An essay in Saturday's Review section about the health benefits of chocolate incorrectly said that the percentage is 11%.

(See: "REVIEW --- The Bitter Truth About Chocolate --- People have made exorbitant claims about the power of cocoa for centuries; But is it really a health food?" -- WSJ Feb. 10, 2018)

Late in New York on Wednesday, the Venezuela strong bolivar traded at 24987.5001 per U.S. dollar, or $0.00004 to the bolivar; the year-to-date change for the dollar was 241515.4%. The table of foreign-exchange rates published in Thursday's Markets Digest incorrectly listed 10.2087 strong bolivars per dollar, or $0.097956 to the bolivar, and a year-to-date change for the dollar of -1.3%.

Over the past 32 quarters, Alphabet Inc. has averaged revenue growth of 23%, when adjusting for currency movements. A Page One article on Feb. 2 about tech giants' financial results incorrectly said Alphabet had 32 consecutive quarters of revenue growth of at least 20%.

(See: "Tech Giants Power to New Heights" -- WSJ Feb. 2, 2018)

On Jan. 26, Western Canadian Select blend oil was priced at a discount of around $28 per barrel to West Texas Intermediate oil. A chart with a Markets article on Jan. 29 about Canadian oil producers was incorrectly labeled in billion dollars per barrel.

(See: "Canada's Oil Producers Miss Rally" -- WSJ Jan. 29, 2018)

A photo caption with a Wealth Management report article on Monday about collecting loose change incorrectly identified the author's most lucrative year. It was 2003, with $135.65 found, not 2013.

Readers can alert The Wall Street Journal to any errors in news articles by e-mailing wsjcontact@wsj.com or by calling 888-410-2667.

Document J000000020180213ee2d00015

THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance -- Analysis: Market Appears to Take a Detour

By Greg Ip
837 words
13 February 2018
The Wall Street Journal
J
B10
English

Is it 1998 or 2007?

Last week's **stock-market** dive has triggered a search for parallels: Was it like the stock drops of 1987 and 1998, frightening but of little lasting economic consequence? Or was it more like 2007 when several failed hedge funds and subprime lenders were the tip of an iceberg that sank the entire economy?

So far, the right analogies appear to be 1987 or 1998, both cases when some market players were clobbered but, unlike in 2007, had few linkages to the real economy.

In 1987, as now, there were fears of a weak dollar, rising bond yields and inflation just as a new Federal Reserve chairman, in that case Alan Greenspan, was determined to prove his credentials. Congress was mulling a tax change to discourage leveraged corporate buyouts, a big driver of that year's **bull market**. But these were merely catalysts. The driver of the Oct. 19, 1987, crash was "portfolio insurance," a strategy that effectively forced big investors to sell into a falling market.

In 1998, Russia's debt default was the catalyst that forced Long Term Capital Management, a massive hedge fund, to suffer large losses. As it liquidated positions, the **Dow Jones Industrial Average** dove 19% and other market prices went haywire.

By contrast, in 2007 the failure of hedge funds operated by Bear Stearns Cos. and steep losses on subprime loans such as at HSBC Holdings PLC turned out to be symptoms, not the cause, of the problem: trillions of dollars of shoddily underwritten mortgages backed by soon-to-collapse housing prices.

The latest selloff was triggered by worries that central banks would respond to stirrings of inflation with more rapid interest-rate increases. That, however, was merely the spark. The fuel was a market belief, implemented in complex trades, that a period of low market **volatility** would persist.

The late economist Hyman Minsky once said that stability is destabilizing: Long periods of calm encourage risk-taking that aggravates the eventual bust. For the same reason, stocks and **bond prices** went in opposite directions, meaning the two are negatively correlated and thus naturally hedge each other.

Investors devised strategies to exploit this, such as betting that the VIX, a barometer of market **volatility** derived from options prices, would stay low. As those bets increased, they in turn damped **volatility** further. Also in play were "risk-parity" trades that use borrowed money to take larger positions in stocks and bonds as **volatility** drops.

Once **volatility** rose and stock and **bond prices** became positively correlated, though, those strategies sustained steep reversals, and as they closed out positions or reduced borrowing, **volatility** spiked further.

Like in 1987 and 1998, these moves are self-reinforcing: As positions are liquidated, they force prices to levels that inflict losses on other players, forcing them to liquidate. Such selling eventually burns itself out, though it's impossible to predict when.

In 1987 and 1998, this sort of forced selling was just a temporary detour for the economy. This could be a repeat.

"I hope I'm not just convincing myself that this has nothing to do with fundamentals," said one nervous fund manager. "But I still think that's the case."

Even if the inflation scare is overdone, events have clearly shifted the bond market's mood. **Bond prices** have been sky-high. Now, bond investors worry that low unemployment, higher **oil prices**, a lower dollar, and protectionism could shift inflation higher. That, along with U.S. budget deficits topping $1 trillion and central banks shrinking their bondholdings, would push **bond prices** down and yields up.

Monetary policy is also a question mark. "We had a strong sense of what [former Fed chief] Janet Yellen was going to do," one hedge-fund manager said. "We don't know what Jerome Powell is going to do."

Although Mr. Powell hasn't addressed the market turmoil since being sworn in as chairman last week, his colleagues have played it down, even welcomed it.

As investors reassess the risk of inflation and higher interest rates, bond yields and **volatility** could grind higher, which would depress stock valuations even if profits are fine. And eventually, market moves don't just reflect the economy; they can also drive the economy.

The turmoil in 1987, 1998 and 2007-08 inflicted damaging losses on market participants that required intervention by the Fed. Postcrisis overhauls have strengthened the financial system but **volatility** may expose weak links. When the dot-com bubble burst in 2000, that sapped spending by wealthy stockholders and tech companies who could no longer issue bonds and shares.

"What if we get a tightening in financial conditions because of this forced deleveraging that spills into auto loans and subprime and housing?" one manager warned. "It's classic late cycle, but each time is different. That's what I'm worried about. This needs to burn itself out, fast."

Document J000000020180213ee2d0000o

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Beijing Hasn't Stopped Paying Attention to the Markets

By Andrew Peaple
419 words
12 February 2018
The Wall Street Journal
J
B10
English

[Financial Analysis and Commentary]

Has Beijing suddenly become a fan of free markets? The Chinese authorities have largely stayed on the sidelines this week as the global roller-coaster ride has spread to its shores.

The Shanghai Composite, the country's main equities benchmark, slipped 4.1% Friday, its worst one-day drop since August 2015.

On Thursday, the yuan suffered its sharpest one-day slide against the dollar since its surprise devaluation that same summer.

The sudden laissez-faire attitude is a bit surprising, if only because Chinese markets had gone a long way to shedding their casinolike reputation.

Since the market crash of 2015 and early 2016, huge state-backed investment funds have regularly stepped in to buy up Chinese stocks when the market looked like it was getting hairy.

That, and tighter regulation, made Chinese equities a yawn last year: The Shanghai market moved up or down by more than 1% on only 12 trading days in 2017. In 2015, that number was 141 days.

The yuan, too, has been relatively unexciting, rising steadily against the dollar along with most other major global currencies.

Beijing's motives can be hard to divine, but it appears to have made a sensible decision in allowing the market calm to shatter. Why spend treasure trying to fight against global market forces, after all?

The country's central bank has been relaxed so far, too, refraining from flooding the market with cash for 12 straight trading days.

Regulators may also have reasoned that after a long run-up, both Shanghai stocks and the yuan could do with having some air let out.

Investors ought not take this as a sign that the Chinese state has come over all Milton Friedman.

The broader backdrop in Xi Jinping's China is still one in which the state is taking more control of the economy, not less. Future **stock-market** tumbles caused more by domestic factors -- as in 2015 -- are likely to be met again with strenuous resistance efforts.

The Shanghai market isn't particularly expensive right now, trading at 13 times expected earnings, around middle of the range in the past two years.

Beijing might not be averse to future intervention if it falls too far out of line. Nor will it want the yuan to slide out of control.

Don't take this week's seeming indifference for inattention.

page,5043

Document J000000020180212ee2c0002s

THE WALL STREET JOURNAL.
U.S. EDITION

Investors Discern Parallels to '87 Market --- Comparison with worst day in Dow's history carries hope that a rally will follow

By Mike Bird
768 words
12 February 2018
The Wall Street Journal
J
B9
English

The first **stock-market** correction in two years is prompting analysts and investors to look at previous declines to glean what might come next.

The retreat in the **Dow Jones Industrial Average** marks the fifth time in the **bull market** that U.S. stock indexes have suffered 10%-or-more declines. The others were in 2011, after the S&P Ratings Services downgrade of U.S. debt; in 2013, during the "taper tantrum" over Federal Reserve stimulus-reduction plans; in 2015, following the devaluation of the Chinese yuan; and 2016, in response to the spread of negative interest rates.

Some investors and analysts are reaching back to Black Monday in 1987, drawing parallels despite important differences with the Dow's worst day on record -- a 22.6% plunge.

This comparison comes with a hint of hope. While other sharp declines in U.S. equities, such as those in 1929 and 2008, heralded a recession, U.S. stock markets began to rally after the crash of 1987.

"With the illuminating hindsight of history, we simply saw equities get pushed back to the big trend that preceded it," said Deutsche Bank strategist Alan Ruskin.

Both the selloff of the past week and 1987 crash began after a run for stocks, as analysts weighed the effect of U.S. tax overhauls and while Treasury yields were accelerating.

In 1987 growth was picking up, which drove bond yields higher. U.S. **10-year Treasury** yields soared from around 7.25% at the beginning of the year to a high of more than 10% before the October crash.

Bond yields were far higher than today, and moves often much larger. The federal-funds rate was above 6% throughout 1987, compared with between 1.25% and 1.5% today.

That acceleration makes the recent pickup -- from 2.06% in September to 2.85% now -- look tame. But in both cases, rising yields played a part in the market drop. With interest rates so low for several years, other markets like stocks are increasingly sensitive to movements in bond yields.

"In 2018, there has been a similar re-rating of equities relative to bonds as shares have performed well in the last 12-18 months and bond yields have backed up in the last [four to five] months," noted equity analysts at Citi Research last week, adding that the magnitudes of both the move in equities and the move in bonds was far smaller than 1987.

One thing that differentiates corrections is their wealth effect on ordinary Americans.

"If markets drop precipitously and stay down -- down for two or three months, not weeks -- they start to have an impact on the real economy, particularly the unemployment rate," said Roger Farmer, an economics professor and research director at the U.K.'s National Institute of Social and Economic Research. "You look at your 401(k) a few months later and that's when you decide not to take your vacation."

After Black Monday, investors clamored for new Fed Chairman Alan Greenspan to act, and the Fed quickly cut interest rates. Two weeks later, excess reserves in the U.S. financial system rose by 61% to $1.6 billion as the Fed engaged in open-market operations.

"It looks like a simple correction right now, but the Fed has no room today to do what it did in 1987," added Prof. Farmer. "That's the one thing that would be keeping me up at night."

The 1987 crash also came at a time of positive expectations for earnings. "Stock prices have collapsed, but profits are soaring," read The Wall Street Journal's Oct. 21, 1987, coverage. "And the earnings outlook, barring a recession arising from the trauma in world **financial markets**, is bright."

Earnings per share on the **S&P 500** rose from $14.48 at the end of 1986 to $17.50 at the end of 1987, and surged to $23.75 by the end of 1988.

"Our mind-set is very much to buy the dip given that we think this is technically driven," said Lars Kreckel, global equity strategist at LGIM.

Not all investors are sanguine, noting that a sustained fall in the **stock market** could weaken financial conditions and the broader economy.

"During the last three downturns, the causality ran from **financial markets** into the economy, not the other way round," said Dhaval Joshi, chief European investment strategist at BCA Research.

Document J000000020180212ee2c00021

THE WALL STREET JOURNAL.
U.S. EDITION

MoneyBeat: Stock-Trading Volume Is Soaring As Volatility Returns to the Markets

By Chelsey Dulaney
358 words
12 February 2018
The Wall Street Journal
J
B9
English

The number of shares traded last week on U.S. exchanges soared to its highest level in nearly seven years, the latest sign of resurgent **volatility**.

Nearly 55 billion shares changed hands on U.S. exchanges last week as a resurgence in market **volatility** drove stocks to their worst week in more than two years.

It was the biggest-volume week for U.S. equities since August 2011, according to WSJ Market Data Group. The New York Stock Exchange and **Nasdaq Stock Market** reported their highest-volume days of the year.

Stock trading picked up as a swoon in global stocks turned into an all-out rout on Monday. The **Dow Jones Industrial Average** plunged nearly 1,200 points in its largest-ever daily decline.

The selloff reverberated across the globe, sending stocks from Hong Kong to Barcelona lower throughout the week. The **S&P 500** and **Dow Jones Industrial Average** bounced back on Friday but remained down 5.2% for the week, their largest weekly percentage losses since January 2016.

Investors cited a number of potential catalysts for the selloff. Some say a surge in U.S. bond yields that has taken the yield on the benchmark **10**-**year Treasury** note near 2.9%, its highest level since 2014, spooked stock investors.

Yields have been rising as investors bet the era of easy central-bank policy that has helped support the nine-year-old U.S. bull **stock market** is drawing to an end. Higher interest rates and bond yields can pressure stocks by making it more expensive for companies to borrow and by reducing the attractiveness of stock dividends.

Others cited the reversal of a popular bet against **volatility** for the market rout. A prolonged stretch of depressed market **volatility** led investors to pile into funds that bet against future market swings. Last week's resurgence in **volatility** led to big losses on those bets.

The highest-volume day for U.S. stocks came Tuesday, when more than 12 billion shares were traded.

Document J000000020180212ee2c00020

The New York Times

The Week Ahead
Business Day
A (Largely Irrelevant) Budget, a Report on Prices and an Infrastructure Plan

By The New York Times
632 words
11 February 2018
09:00 PM
NYTimes.com Feed
NYTFEED
English

Here’s what to expect in the week ahead:

ECONOMY

White House budget to reflect new spending bill.

The White House will release its 2019 budget request on Monday, but the big spending bill passed by Congress and signed by President Trump on Friday morning means that the outline of the Trump administration’s spending priorities is largely seen as irrelevant.

The White House budget office said on Friday that it would modify its request to reflect the new budget cap levels established by the agreement reached in Congress. The budget request will also come with an “addendum” that will offer guidance to “account for the increased spending caps in a responsible manner.”

The budget addendum will also come with a “limited set” of administrative priorities and ideas for fixing budget gimmicks that the administration says are being used to circumvent the spending caps. Alan Rappeport

Trump’s infrastructure plan to be unveiled

President Trump is expected to unveil on Monday his plan to rebuild, restore and modernize the nation’s aging infrastructure. As one of the administration’s main legislative ambitions, the $1.5 trillion proposal is expected to include upgrades to public works like roads, bridges, railways and airports. The plan calls for $200 billion in federal spending over the next decade to spur, administration officials said, an additional $1.3 trillion in spending from cities, states and private companies. Will Dudding

New data coming on consumer prices.

Last week’s **stock-market** sell-off was driven in part by investor fears that the improving economy and tightening labor market could lead to faster inflation. That, in turn, could force the Federal Reserve to raise interest rates faster than planned, slowing the economy and hurting stock prices.

On Wednesday, the Bureau of Labor Statistics will give investors new evidence to consider when it releases data on consumer prices in January. Economists surveyed by Bloomberg expect the report to show that the annual rate of inflation slowed to start the year despite an increase in **oil prices** (which has since partly reversed). A surprise uptick in consumer prices, however, could suggest that inflation fears are well-founded and add to the recent market turmoil. Ben Casselman

RETAIL

Slow retail sales expected, as usual, for January.

The Commerce Department is scheduled on Wednesday to report retail sales in January. While the first month of the year can typically be slow after the Christmas rush, economists and investors will be watching to see whether consumer sentiment dipped after a robust holiday season, when shoppers came out in droves both online and in stores. Michael Corkery

MANUFACTURING

Airbus earnings are expected to be strong.

The European aircraft manufacturer Airbus will brief investors Thursday on its earnings in the fourth quarter of 2017. Analysts have a generally positive view of the company's prospects because of a large backlog of orders, and because sales of newer designs like the A350 wide-body passenger jet are gaining momentum. The A380 super jumbo, whose future was in doubt because of poor sales, won a reprieve last month after Emirates ordered 36 planes. Jack Ewing

* Trump Signs Budget Deal to Raise Spending and Reopen Government

* With New Budget Deal, Trump Surrenders to the Administrative State

* Trump's $1.5 Trillion Infrastructure Plan Is Light on Federal Funds, and Details

* The **Stock Market** Is Worried About Inflation. Should It Be?

The recent **volatility** of the **stock market** has been linked to worries that rising inflation could cause interest rates to rise more quickly than expected. A consumer price report scheduled for Wednesday could add to the market turmoil if there is a surprise uptick in prices. | Richard Drew/Associated Press

Document NYTFEED020180212ee2c000m9

The New York Times

FEATURE
Magazine Desk; SECTMM
Great Walls

By PANKAJ MISHRA
4,659 words
11 February 2018
The New York Times
NYTF
Late Edition - Final
42
English

'America first does not mean America alone,'' President Trump declared last month at the World Economic Forum in Davos, Switzerland. This sudden burst of pragmatism from an avowed nationalist showed what a difference a year can make. Denouncing the ''false song of globalism'' during his presidential campaign, Trump, on his third full day in office, canceled the Trans-Pacific Partnership, a regional trade deal with Japan and 10 other countries. He then denounced Canada, Germany and South Korea for exporting more to the United States than they import. He promised to renegotiate trade pacts with Europe, Canada and Mexico and get a better deal for American workers. In Davos, however, he reached out with conciliatory words to the very free-trading and globalizing elites he has consistently maligned.

Clearly, Trump's views on trade and globalization have evolved since his insurgent campaign. This may well be because of the rapid gains in the past year of a country he did not mention by name. In fact, Trump chose in Davos to affirm that ''America is open for business'' because it was in these same Alpine heights, three days before Trump was inaugurated as president, that China seized the opportunity to claim leadership of the global economy. With the United States seemingly in a protectionist crouch, China had become, despite all its problems, indispensable. ''In a world marked by great uncertainty and **volatility**, the international community is looking to China,'' Klaus Schwab, the founder of the World Economic Forum, said last year while introducing his guest, the Chinese president and general secretary of China's Communist Party, Xi Jinping.

As the usual gaggle of hedge-funders, Silicon Valley executives and government officials looked on, Xi rose to defend free trade and globalization against the relentless attacks of Trump. ''Some people blame economic globalization for the chaos in our world,'' Xi said. ''One should not retreat to the harbor when encountering a storm, for this will never get us to the other shore of the ocean.'' Xi then confidently quoted Dickens. '' 'It was the best of times, it was the worst of times.' These are the words used by the English writer Charles Dickens to describe the world after the Industrial Revolution. Today, we also live in a world of contradictions.''

Never mind that Dickens was actually describing the world before the French Revolution. Xi's claim of openness was, to say the least, riddled with contradictions of its own. It is increasingly difficult for foreign companies to do business in China; Beijing's ''Made in China 2025'' industrial policy aims to increase ''indigenous innovation'' and self-reliance. When Trump, a year later in Davos, denounced such ''unfair economic practices'' as ''industrial subsidies and pervasive state-led economic planning,'' there was little doubt which nation he had in mind.

Yet Xi is entitled to some of his rhetorical point-scoring. The financial crisis of 2008 greatly weakened the American economy, but it left China relatively unscathed. More important, China, whose share of world trade in the mid-1970s was less than 0.5 percent, is today the world's leading exporter -- the hub of new and increasingly dense transcontinental trading networks that bypass the United States. ''When the United States grows, so does the world,'' Trump claimed in Davos. But America's status as the linchpin of the global economic order is now endangered. The trading system China dominates has reduced the long dependency of Latin American and sub-Saharan African countries on American and European markets. China is now bringing to a close the first phase of globalization, begun by Europe and the United States in the 19th century. In the process, it is making East Asia the new center of the world economy.

It has fallen upon Trump, as president of the United States, to respond to this momentous historic shift, and he has done so with his characteristic mix of threats, boasts and volte-faces. But to grasp China's economic achievement, and its ramifications, it is imperative to ask: Why has a market economy directed by a Communist state become the world's second-largest? Or, to rephrase the question: Why shouldn't it have? Why shouldn't China's rise have happened the way it did, with state-led economic planning, industrial subsidies and little or no regard for the rules of "free trade"?

The economic success of East Asian countries like Japan in the 20th century had already invalidated the article of faith invoked by Trump in Davos: that nations can advance only by eliminating barriers to the free movement of goods and capital and by minimizing the role of government in the economy. But these historical lessons have long been obscured by economic orthodoxy, one that Trump's -- and China's -- unexpected ascents have now exposed to critical scrutiny.

In his most recent book, "Straight Talk on Trade," the Harvard professor Dani Rodrik castigates fellow economists for holding fast to a simple-minded view of free trade and globalization, one that he believes has caused economic chaos and political backlash across the West. "Are economists," he asks, "responsible for Donald Trump's shocking victory in the U.S. presidential election?" This might be overstating the case. But it is true that the argument that free markets equal progress was most eloquently and influentially advocated by the American economist Milton Friedman.

The paradoxes of China's rise today are best illuminated by Friedman's querulous visit to the country in 1980, when China was desperately poor. The Nobel laureate from Chicago was then cementing his reputation as an apostle of free markets. He had just published "Free to Choose," a book that was written with his wife, Rose, and later turned into a television series featuring, among others, Ronald Reagan, Arnold Schwarzenegger and Donald Rumsfeld. Friedman's argument, that "the world runs on individuals pursuing their separate interests," would shape American economic policy for decades to come. He helped disparage the idea, exemplified most vividly by Franklin Roosevelt's New Deal, that government had a legitimate, and often indispensable, role to play in advancing economic development and protecting the vulnerable. As his keen disciple Reagan famously put it, "Government is not the solution to our problem; government is the problem."

Friedman's fervent advocacy of free trade and the efficiency of unregulated markets gave intellectual ballast to the so-called Washington Consensus. Free markets, the thinking went, not only generated wealth for all nations but also maximized consumer choice, reduced prices and optimized the use of scarce resources. Friedman's faith in the efficiency of markets came to constitute what John Stuart Mill referred to as "the deep slumber of a decided opinion."

Friedman was the most influential proponent of free trade since Adam Smith declared it, in 1776, the basis of the wealth of nations. But in 1980, few people in China, including the academics who invited Friedman to a lecture tour, knew that their American guest was an impatient, even **volatile**, ideologue.

A series of (often comical) misunderstandings ensued. Friedman complained about the Chinese man with a "terrible body odor" who received him at the Beijing airport; the man turned out to be one of his academic hosts. Friedman's lectures in praise of free markets were met with bewilderment. His assertion that capitalism was superior to socialism disturbed the Chinese greatly. Some of the more agitated Chinese economists went in a delegation to Friedman's hotel to lecture him about the achievements of their regime.

Friedman, who (erroneously) saw Japan and South Korea as brilliant examples of open, competitive markets, was understandably impatient in China; the country embodied everything that was wrong with government planning. Indeed, China in 1980 was just lurching out of Mao Zedong's calamitous experiments. Deng Xiaoping's government was trying to improvise new solutions to the country's economic backwardness, which officials thought had exposed China to humiliation in the 19th and early 20th centuries. "Development," Deng said, "is the only truth. If we don't develop, we will be bullied." And national development, in Deng's view, could be achieved by a variety of means. His flexible attitude was summed up by a much-popularized Chinese maxim: "Cross the river by feeling for the stones."

The Chinese couldn't help bristling at Friedman's blunt dismissals of their government. Despite horrific disasters, the Chinese state had drastically raised literacy and life-expectancy levels. Also, the Chinese were then seeking a third way: They looked to Japan and Singapore rather than the United States for economic models that would accelerate growth without endangering the authority of the Communist Party. The Chinese saw little of value in an American proponent of laissez faire. Friedman left China, angrily claiming that his hosts were "unbelievably ignorant about how a market or capitalist system works."

Friedman died in 2006, shortly before the financial crisis of 2007 and 2008. The extensive political aftershocks of that crisis arguably include the election of a protectionist to the highest office in the United States, who has threatened to cancel decades of commitments to free trade at the risk of alienating his country's closest allies.

As bewildered (and appalled) as Friedman would most likely have been by Trump's demonization of free trade, he would have found it still harder to explain why China, run by a Communist Party, has emerged as central to the global capitalist economy. For the Chinese regime achieved this not by liberating its 1.4 billion citizens to maximize their private interests in unfettered markets but by controlling its currency, owning large businesses and intervening heavily in investment decisions by private companies.

Indeed, economic history reveals that great economic powers have always become great because of activist states. Regardless of the mystical properties claimed for it, the invisible hand of self-interest depends on the visible and often heavy hand of government. To take only one instance, British gunboats helped impose free trade on 19th-century China -- a lesson not lost on the Chinese. Britain was protectionist before it was a free-trading nation. The United States itself was, while industrializing, the ''mother country,'' as the economic historian Paul Bairoch wrote, ''and bastion of modern protectionism.'' Its average tariffs in the late 19th century were nearly as high -- 45 percent -- as the steepest ones Trump has slapped on imports of washing machines. The philosophical father of economic protectionism is, in fact, Alexander Hamilton, the founder of the American financial system, whose pupils included the Germans, the Japanese and, indirectly, the Chinese.

No story is as instructive as that of the Japanese, arguably the most diligent of Hamilton's disciples. Post-1945 Japan preceded China as the hub of regional and intercontinental trade networks. Soon after its disastrous part in World War II, Japan helped revitalize Asia and by the mid '90s was the biggest investor and exporter in most East Asian countries; it gave more foreign aid and sent more tourists to them and was the biggest buyer of their raw commodities. What's more, it offered a model for development that combined a market economy with state intervention -- one that China was even then beginning to learn from.

How did Japan, a country devastated by a world war that had few natural resources of its own, achieve economic primacy in Asia? Friedman's explanation in ''Free to Choose'' was that ''free trade set off a process that revolutionized Japan and the lives of its people.'' Francis Fukuyama, who proclaimed the end of history in 1989, credited Japan's success to ''economic liberalism'' of the kind espoused by Adam Smith. But the Japanese followed a very different model, one adopted from Hamilton.

Japan learned early the political risks of economic stagnation. At the height of 19th-century imperialism, it signed a humiliating treaty that subjected its trade policy to the control of five Western powers, deprived it of the right to impose tariffs, set radically low import duties and gave foreign residents in trading ports extraterritorial status. Smarting from such insults, the conservative Meiji rulers of Japan became obsessed with regaining their sovereignty and protecting themselves from foreign tormentors.

In this endeavor, they looked to Germany. Unified in 1871, Germany was scrambling to catch up with industrialized Britain. To do so, it borrowed from recipes of national development proposed by Hamilton soon after the Americans broke free of their British overlords. In his ''Report on the Subject of Manufactures,'' submitted to Congress in 1791, Hamilton used the potent term ''infant'' industries to argue for economic protectionism. Hamilton's father was Scottish. Born in the West Indies, then a British colony, Hamilton was keenly aware of how the British practiced protectionism: preventing colonies from competing while selling their own goods around the world. In his view, infant nations needed room to maneuver before they could compete with established industrial powers. The United States embraced many of Hamilton's recommendations; the beneficiaries were, first, the textile and iron industries and then steel.

It was Hamilton's formula, rather than free trade, that made the United States the world's fastest-growing economy in the 19th century and into the 1920s. And that formula was embraced by other nations coming late to international economic competition. Hamilton's most influential student was a German economist named Friedrich List, who lived in the United States from 1825 until the 1830s and wrote a book titled ''Outlines of American Political Economy.'' On his return to Germany, List attacked the free-market gospel preached by Britain as sheer opportunism. In his view, the British could afford to kick away the ladder of protectionism they had climbed to the summit of global industry and manufacture. He was all for free trade, but only after young industries had been nurtured in a protective environment. Applying List's lessons, Germany moved with spectacular speed from an agrarian to an industrial economy.

The stakes were higher for Japan. There was hardly a country in Asia that had not been forced by Britain, Holland and France into unequal trade agreements. Economic liberalism was not a feasible option. The visible hand -- the state rather than the market -- was needed to guide development. Closely following Germany's example, Japan heavily subsidized its first factories, copied British design and imported foreign machinery and engineers. It not only protected many of its businesses from excessive competition but also guaranteed them a minimum profit.

When World War I disrupted Europe's monopolies in its Asian colonies, Japanese companies moved in with their textiles, bicycles and canned foods. Following Europe's free-trading imperialists, Japan had invaded and occupied

Taiwan and then Korea, turning them into protected markets for its small industries. In a further refinement, the Japanese state bribed and coerced manufacturing companies. It gave them subsidies to export more, which in turn helped the companies fund innovations and become internationally competitive.

World War II proved only a brief interruption in Japan's policy of protection. Utterly devastated, Japan still managed to rid Asia of its European competitors. It was during the American occupation, as the historian John Dower notes, that Japan instituted what an economist described as the most ''restrictive foreign-trade and foreign-exchange control system ever devised by a major free nation.''

Given unlimited powers by their American occupiers to get the country going again, the bureaucrats of Japan's Ministry of International Trade and Industry laid the foundations of a world-class manufacturing economy. Nationalism was a great stimulus. As Dower put it, ''National pride -- acute, wounded, wedded to a profound sense of vulnerability -- lay behind the single-minded pursuit of economic growth that created a momentary superpower a mere quarter-century after humiliating defeat.'' But Japan would have struggled had war not erupted on the Korean Peninsula in 1950 and made Japan the main source of American procurements. The path of Japan's protectionist state was now set -- the country's prime minister, Shigeru Yoshida, would call the destructive Korean War a ''gift of the gods.''

In the 1950s, Korea and Taiwan, both former Japanese colonies, inherited Japan's institutions and protectionist practices. This was most striking in Korea, which was intensely poor in the early 1950s; its few industries were built by Japan during the 1930s. South Korea, too, found solutions for its problems in Friedrich List rather than Adam Smith. The country's leader, Park Chung-hee, the military general who came to power in 1961, had worked for the Japanese colonialist regime. A fervent autodidact, Park was also deeply familiar with German theories of protectionism. (The economist Robert Wade reported coming across whole shelves of books by List in Seoul bookstores in the 1970s.) During his long years in power, Park nurtured South Korea's chaebol business groups -- Hyundai, Daewoo and Samsung -- and boldly ventured into steel-making.

Because the United States saw Korea, Taiwan and Japan as a buffer against Communism, it helped promote such neomercantilist strategies -- a mix of import substitution and export-oriented industrialization. American cold warriors also gave their strategic allies unhindered access to U.S. markets while tolerating the closure of their own to American investment. By the time the United States realized that its biggest Asian ward had grown too big, it was too late. Japan had taken many products invented in the United States (automobiles, consumer electronics) and manufactured them more cheaply and with superior quality. By the 1980s, Japan had supplanted the United States in aid and investments in East Asia. When the United States sought to limit Japanese exports, the Japanese responded by deepening their investment in Asia, moving factories and improving industrial skills and technology wherever they went.

In 1994, when I first left India to travel to Southeast Asia, I found Japan everywhere, as both promise and rebuke. The renovation of Thailand, South Korea and Taiwan under Japanese auspices was then an established fact -- and a standing reproach for us in India, which had failed to match East Asia's success in manufacturing and trade. Like most countries in the world after 1945, France as much as Japan, India embraced a model of state-led development. Its aim, as in many nations liberated from colonial rule, was not so much the growth of private wealth as the strengthening of national power. Friedman described Indians in ''Free to Choose'' as deluded followers of Mahatma Gandhi, idly spinning cotton in cottage industries subsidized by the state. India, he said, was blind to industrialization and, furthermore, believed in central planning. This was a caricature: India had an ambitious industrialization program, and its economy mixed private markets with state-owned enterprises, even if its historical experience of British rule predisposed it to suspect that free trade benefited only developed industrial economies. Nevertheless, Friedman was broadly right in his view of India as a social and economic laggard.

India, following a model of import-substitution growth, barely participated in world trade. Its factories produced shoddy goods that you bought only because there were no alternatives. And so I was dazzled by what was on offer in Southeast Asia. The emblems of pop American culture -- Kentucky Fried Chicken, McDonald's, Madonna -- were everywhere. But the most seductive consumer goods were almost invariably Japanese: Sony, Sanyo, National, Mitsubishi, Hitachi, Fuji.

Feeling inadequate before East Asia's progress, many middle-class Indians longed for what Chalmers Johnson, in a book about Japan's unique growth, called the ''capitalist developmental state.'' In such states, skilled bureaucracies led by authoritarian leaders promoted a project of national development (while either paying lip service to, or ignoring, democratic norms). Private entrepreneurs made socially beneficial investments; government policies helped build their comparative advantage while also facilitating social stability with land reforms, education and other efforts to address income equality.

The "developmental state" assumed that market failures were to be expected and that the state played a necessary role in designing industrial and financial policy. These included not only trade protection and government subsidies but also, as the political economists Robert and Jean M. Gilpin wrote in "Global Political Economy" in 2003, "selective credit allocation and deliberate distortion of interest rates in order to channel cheap credit to favored economic sectors." Governments were, in fact, very much part of the solution, as even the World Bank, beholden to the Washington Consensus, grudgingly acknowledged in its well-known 1993 report, "East Asian Miracle." The high-performing Asian economies, it noted, "have achieved unusually low and declining levels of inequality, contrary to historical experience and contemporary evidence in other regions."

The hero of many middle-class Indians was the authoritarian leader of Singapore, Lee Kuan Yew, whose success in turning Singapore from an economic backwater into one of the world's major commercial cities was much admired by Deng Xiaoping. We might have also revered, had we known more about him, South Korea's technocratic despot Park Chung-hee, who accomplished economic goals with the help of highly trained managers, and who also appeared to reduce inequality and build what we in India sorely lacked: social cohesion.

But little did I know that Hamilton (and List) would achieve their greatest influence in post-Mao China. "The rise of China resembles that of the United States a century ago," the Chinese scholar Hu Angang writes. He is not exaggerating. Friedman may have been right that the Chinese Communists were hopelessly ignorant of how free markets work, but ending state intervention in the economy was never on the agenda. After Mao, Chinese leaders looked to Japanese and other East Asian developers, just as the East Asians had once looked to Germany.

The first investments in China in the 1980s came from Japan as well as from transnational Chinese business networks based in East Asia. China benefited from the market networks, management and technical know-how that accompanied these investments. Encouraged by the Clinton administration, it entered the World Trade Organization in 2001 and quickly seized the opportunity -- limitless export markets -- opened by American insistence on free trade.

Once Japan became the leading investor in Asia, regional production chains began to link those countries with one another. As Korea, Hong Kong, Singapore and Taiwan moved up the technology and value chains, they invested in developing countries, like Vietnam and Indonesia. This process of regionalizing investment and production, which largely dispenses with Europe and America, has now been accelerated by China's rise as a manufacturing power. The biggest investor in Vietnam today, for instance, is South Korea, whose biggest trading partner is China.

The success of China's state-led economy presents, in many ways, the same economic (and ideological) quandary that Japan unexpectedly threw up before the United States when, in the 1980s, it became the world's leading creditor. A regional trading system dominated by China will make Asian countries less likely to enlist in American geopolitical objectives. Locked into boundary disputes with its neighbors, China has accelerated the militarization of the South China Sea, acquiring more than 3,200 acres of land on reefs and outcrops and installing runways, ports and hangars. But it has also abandoned its abrasive attitude, making determined efforts to pivot Asia away from Trump's America. And it seems to be succeeding.

With China offering generous infrastructure deals to the former American territory of the Philippines, President Rodrigo Duterte announced that "it is time to say goodbye" to the United States -- previously he threatened to ride a jet ski to a Chinese man-made island in the South China Sea and plant his country's flag there. Other rival claimants to parts of the South China Sea -- Malaysia, Vietnam and Brunei -- have also moved closer to Beijing since Trump's election. Smaller countries like Cambodia and Laos now resemble Chinese client-states. China is also trying to repair long-strained relations with Japan by inviting investments by Japanese multinationals.

These attempts to win over major American allies in Asia complement Xi's ambitious One Belt, One Road initiative, which aims to put China at the center of global affairs through a network of trade links and infrastructure projects stretching from Asia to the Middle East to Africa and Europe. Investing more than $1 trillion in more than 60 countries -- ports in Pakistan and Sri Lanka, high-speed railways in East Africa, gas pipelines in Central Asia -- the initiative can claim to be the largest overseas investment drive ever undertaken by a single country. The 11 European Union members and five non-E.U. Central and Eastern European countries that have joined the China-led political and commercial group called 16+1 have all signed major infrastructure deals with China, enhancing Beijing's influence in the E.U. The remaining 11 members of the Trans-Pacific Partnership have gone ahead without the United States; they are expected to sign a final agreement in March.

By pulling out of the TPP and threatening trade sanctions, Trump encouraged Japan to seek a deal with Europe that shuts out the United States. Britain, another stalwart American ally, is considering joining the TPP. China, meanwhile, is hectically negotiating more than a dozen trade agreements in Asia while proposing its own alternative to the TPP, a trade agreement called the Regional Comprehensive Economic Partnership. China has also intensified efforts to build alternatives to such Western international institutions as the World Bank and the International Monetary Fund. In 2014, China inaugurated, against staunch American opposition, the Asian Infrastructure Investment Bank, whose members now include all Asian states except Japan.

There is little doubt that Beijing is presenting itself as a benign alternative to the United States. In a speech just before his second term as the party's general secretary, Xi claimed that there were more takers internationally for Chinese ''values.'' China, he said, offers ''a new option for other countries and nations who want to speed up their development while preserving their independence.''

It was always wildly optimistic to suppose that China would eventually be integrated into an American-dominated order and persuaded, if not forced, to adopt its norms. A postcolonial Indian like myself, who traveled to China and read in its modern history and literature over the last decade and half, could only be skeptical of such claims. It was never less than clear to me, whether in the suburbs of Lhasa, Tibet (demographically altered by Han immigration), or in the bookstores of Shanghai (stacked with best sellers with titles like ''China Can Say No''), that the quest for national sovereignty and regained strength defines China's party state and its economic policies.

Belying predictions of doom, China has again demonstrated the power of what Dower, speaking of Japan, called ''national pride -- acute, wounded, wedded to a profound sense of vulnerability.'' The United States never knew this single-minded ambition of the historical loser to avenge his losses; American leaders now reckon with it at home, in the wake of a nationalistic backlash against free trade and globalization. Some confused policies and mixed signals have accordingly defined the American position on China. During the American presidential campaign in 2016, all the main candidates, Bernie Sanders and Hillary Clinton as well as Trump, opposed the TPP, which was intended to contain China in its own region. Then, in Trump's chaotic first year, the United States seemed to be forced back by Hamilton's shrewd East Asian disciples into its historical role as the mother country of protectionism. Trump now says that America first does not mean America alone, and he is open to rejoining the TPP. There may be more such reversals ahead. For Trump is only just beginning to acknowledge, after a year of bluster, the formidable challenge of China and the arduous effort needed for the United States to match its most determined and resourceful rival yet.

(PHOTOGRAPHS BY GETTY IMAGES) (MM42-MM43; MM47) DRAWINGS (DRAWINGS BY TAMARA SHOPSIN) (MM42-MM43; MM47)

Document NYTF000020180211ee2b00068

The New York Times

National Desk; SECTA
What Happened to Your Raise? It Could Have Become a Bonus

By PATRICIA COHEN; Noam Scheiber contributed reporting.
1,254 words
11 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

The recent **stock market** rumpus has been set off in part by fears that a tight labor market and quickening wage growth are a foretaste of higher inflation and interest rates. But sustained raises for American workers may be possible only if employers can break a habit: handing out one-time bonuses in place of salary increases.

A growing preference among employers for one-time awards instead of raises that keep building over time has been quietly transforming the employment landscape for two decades. But it was accelerated by the recession's intensity, which made employers especially cautious about increasing labor costs.

The stream of companies announcing bonuses for their employees in the wake of the newly minted tax cuts is just the latest expression of the trend.

This little-noticed shift in how employers compensate workers could also help explain one of the economy's most persistent puzzles: why a hot labor market has failed to ignite bigger increases in wages.

There has been ''a continuing dramatic shift in the mix of compensation,'' Aon Hewitt, the human resources consulting firm, noted last summer in its latest annual survey of company pay practices.

In 1991, for example, spending on temporary rewards and bonuses for salaried employees, known as variable pay, accounted for an average of 3.1 percent of total compensation budgets, while salary increases amounted to 5 percent.

In 2017, one-time payments consumed 12.7 percent to those budgets; raises amounted to just 2.9 percent.

''Pressure to increase productivity and minimize costs,'' the report concluded, had pushed employers to forgo raises and rely more on short-term awards ''as the primary means of rewarding for performance.''

Ordinarily, the jobless rate and wage growth are like two ends of a seesaw: When one drops, the other is supposed to rise. But that link seems broken, and like film-noir detectives, analysts have scrutinized hard-edge statistics and fuzzier psychological indicators for clues about why.

In the recession that began a decade ago, the businesses most likely to survive tended to be the most conservative spenders, said Douglas G. Duncan, the chief economist at Fannie Mae. That approach was rewarded and has now been reinforced, he said, helping to restrain the growth of full-time work forces and salaries.

Aon Hewitt's annual surveys seem to bear that out. The practice of spending more on variable pay than on permanent raises took root in the 1990s, when growing competition from abroad increased pressure on companies to keep a lid on prices and production costs.

Pay-for-performance and other bonuses increasingly functioned as a release valve. Companies could offer more money to attract talent or when profits were strong, and pull back when business was slow.

After the recession, the trend accelerated.

"The response in 2009 was unlike any prior response to a recession or depression in that organizations actually reduced salaries, they didn't just freeze them as a means of allegedly avoiding greater layoffs," said Ken Abosch, a partner at Aon Hewitt. "I think there's been a lesson learned from that." That lesson: Stay nimble.

The recessionary hangover encouraged employers to avoid adding fixed costs and to be as flexible as possible in staffing and compensation. The trend toward outsourcing work that was once handled in house as a way of saving money fits in with that story line.

The percentage spent on salary increases never returned to its pre-2009 levels, the Aon Hewitt surveys show, while the percentage spent on bonuses and other short-term rewards climbed to new levels. "I don't believe we'll see a long-term increase in real wage growth," Mr. Abosch said.

So far, Wall Street has drawn a different conclusion, although several economists question whether the 2.9 percent jump in hourly average earnings in January from a year earlier signaled a turning point. Paul Ashworth, chief North American economist at Capital Economics, attributed wage pickup last month to unusually cold weather, which reduced the number of hours that low-wage workers clocked.

The reasons for sluggish wage growth, of course, are a complex weave. Declining unionization, noncompete contracts, tepid minimum-wage increases, globalization and sluggish productivity have all played a role.

Whatever the cause, the consequences can be profound. Salary increases compound over time, offering greater financial security. Moreover, bonuses have not made up for wage stagnation. The inflation-adjusted median income of men working full time was lower in 2016 than it was in 1973. And their lifetime earnings -- which include salary, wages, bonuses and exercised stock options -- have mostly dropped since then.

Most bonuses still come in traditional forms: payoffs for executive-suite occupants and deal hunters, or sweeteners for newly hired employees. Certain industries, like finance and insurance, with their longer tradition of year-end and performance-based rewards, continue to have much bigger bonus budgets than sectors like retail.

But the practice has expanded. In 1991, fewer than half of companies that Aon Hewitt surveyed had a broad-based rewards program. Last year, 88 percent did.

"It's now widespread across all industry sectors, even some that were holdbacks such as utilities, health care, not-for-profits and government," Mr. Abosch said.

Salaried workers, rather than hourly wage earners, remain much more likely to be the recipients of such extra payments.

In tracking compensation, the Bureau of Labor Statistics does not differentiate between hourly workers and those on a set salary. Still, Jesus Ranon, supervisory labor economist at the bureau, said, "You can see in terms of percent of compensation there is an increase in these bonus components."

In March 2004, bonuses accounted for 1.6 percent of total compensation (including wages, salaries and benefits). In March 2017, they accounted for 2.6 percent. The wage and salary share of total compensation budgets fell by nearly 2 percent over the same period.

If given a choice, most workers would take a raise. When Aon Hewitt asked 2,079 American workers in a second, newly completed survey what they would like to see their employers do with their tax-cut windfall, 65 percent chose a pay raise -- twice as many as any other option, including a bonus or a 401(k) contribution.

Takisha Gower, a passenger service agent for Envoy, the air carrier that was previously known as American Eagle and is owned by American Airlines, welcomed her recent $1,000 bonus, which the company credited to the "new tax structure." She is much more concerned, however, about her base pay week to week, a subject of longstanding contract negotiations.

"It was appreciated, but it doesn't fix the long term," Ms. Gower said of the bonus. "We need a livable wage that we can support our families off."

"A lot of employees qualify for government assistance," she added. "Some have to work 60 hours a week to make ends meet."

Follow Patricia Cohen on Twitter: @PatcohenNYT

Employees at Envoy, formerly American Eagle, recently got a $1,000 bonus. But base pay remains an issue in contract negotiations. (PHOTOGRAPH BY KARSTEN MORAN FOR THE NEW YORK TIMES) (A19) CHART: The Envelope, Please: Since the late 1980s, an increasing share of companies' payrolls has gone toward one-time bonuses and awards, while the share devoted to salary increases has fallen, according to data collected by Aon Hewitt, a human resources consulting firm. (Source: Aon Hewitt) (A19)

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THE WALL STREET JOURNAL.
U.S. EDITION

Crude's Decline Picks Up Speed

By Alison Sider
581 words
10 February 2018
The Wall Street Journal
J
B1
English

Oil prices slid below $60 a barrel, posting their biggest weekly slump in more than two years, as sharp swings in other **financial markets** spilled over and investors faced an onslaught of U.S. production.

U.S. crude prices fell 9.5% this past week, their steepest fall since January 2016. On Friday, prices fell $1.95, or 3.2%, to $59.20 a barrel on the New York Mercantile Exchange. Brent crude, the global benchmark, declined $2.02, or 3.1%, to $62.79 a barrel on ICE Futures Europe, the biggest one-day percentage drop since July.

Earlier this year, it had seemed that nothing could knock oil off its upward trajectory. Surging economic growth around the world has created more appetite for oil and fuel, helping propel crude prices to their highest level in more than three years in January. U.S. prices rose to more than $66 a barrel, a 55% rally from a low in June. Meanwhile, Brent topped $70.50 last month.

But after six straight days of declines, **oil prices** are now back to where they were in December.

Volatility in stock markets has weighed on **oil prices** this week. U.S. shares rebounded toward the end of the day Friday, but the **Dow Jones Industrial Average** still posted its biggest weekly percentage drop since January 2016.

"There's a sense of nervousness right now. People are starting to look at whether there will be some kind of contagion; what's out there?" said Ric Navy, senior vice president for energy futures at R.J. O'Brien & Associates LLC.

One of the biggest shifts in the oil market has been a string of data pointing to an unrelenting rise in U.S. oil production, something investors have largely ignored earlier this year.

Another 26 oil rigs went to work this week, according to Baker Hughes, the biggest weekly jump since January 2017.

This past week, the U.S. Energy Information Administration raised its forecast for production this year to 10.6 million barrels a day.

That is up about 300,000 barrels a day from what it expected just a month ago and would best a 1970 record by about one million barrels a day.

The agency said output already rose to 10.25 million barrels a day last week, the highest level ever.

Investors had amassed record net **bullish** positions in oil in recent weeks, betting that cutbacks by the Organization of the Petroleum Exporting Countries, escalating geopolitical tensions, and expanding economies across the globe would do away once and for all with a glut of oil that weighed on the market for more than three years.

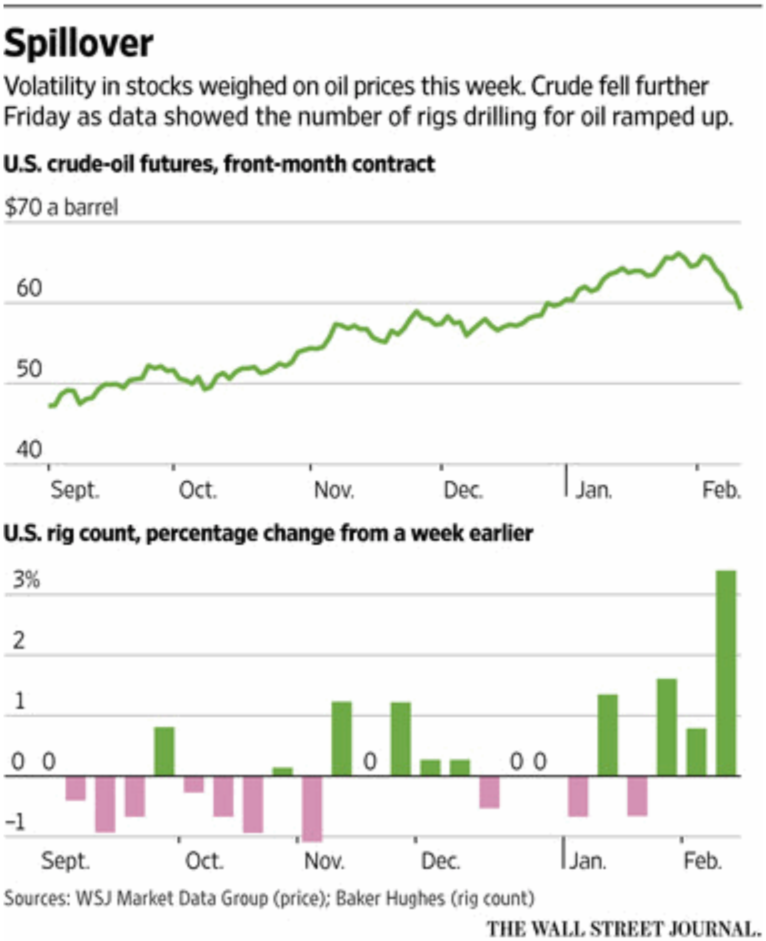
But they have been retreating from those bets, according to the most recent data from the Commodity Futures Trading Commission.

Some investors said they are watching to see whether the **stock market**'s tumble affects how much consumers are spending and what that means for oil demand.

"If we see some consumer spending pattern change, that could have a downside consequence, but right now we're not too worried," said Darwei Kung, portfolio manager of the Deutsche Enhanced Commodity Strategy Fund. "The underlying economic numbers are very robust."

Energy stocks in the **S&P 500** were the only group out of 11 sectors in the benchmark on Friday to retreat, declining 0.4%.

Neanda Salvaterra contributed to this article.



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Document J000000020180210ee2a0002v

THE WALL STREET JOURNAL.
U.S. EDITION

In Asia, Stock Market's Rout Is Worse Than the U.S. Selloff

By Steven Russolillo
417 words
10 February 2018
The Wall Street Journal
J
B11
English

The **stock market** rout that started in the U.S. has spread to Asia, leaving many indexes deep in correction territory.

While the **Dow Jones Industrial Average** and **S&P 500** are each down about 9% from last month's records, the declines have been even steeper for stock benchmarks in Japan, China and Hong Kong. A correction is a drop of 10% or more from a recent high.

All three Asian indexes are down for the year, just like their U.S. counterparts, which entered into correction on Thursday but rebounded on Friday.

"This is a powerful market selloff," said Chris Rupkey, chief financial economist at financial firm Mitsubishi UFJ Financial Group Inc. "The era of low interest rates is at an end, which means the proverbial punch in the punch bowl is leaving the party."

China's Shanghai Composite Index fell 4.1% on Friday, its worst one-day percentage drop since February 2016. It is down 12% from a 52-week high hit last month.

Japan's Nikkei Stock Average has slumped 11% from a 52-week peak in January. The Nikkei, in particular, had enjoyed a stunning move higher late last year that spilled into the beginning of 2018. That included a stretch in October that saw it rise for 16 straight days, its longest-ever consecutive streak of gains.

The Nikkei rose 25% from September through Jan. 23. But the recent selloff has erased about half of those gains.

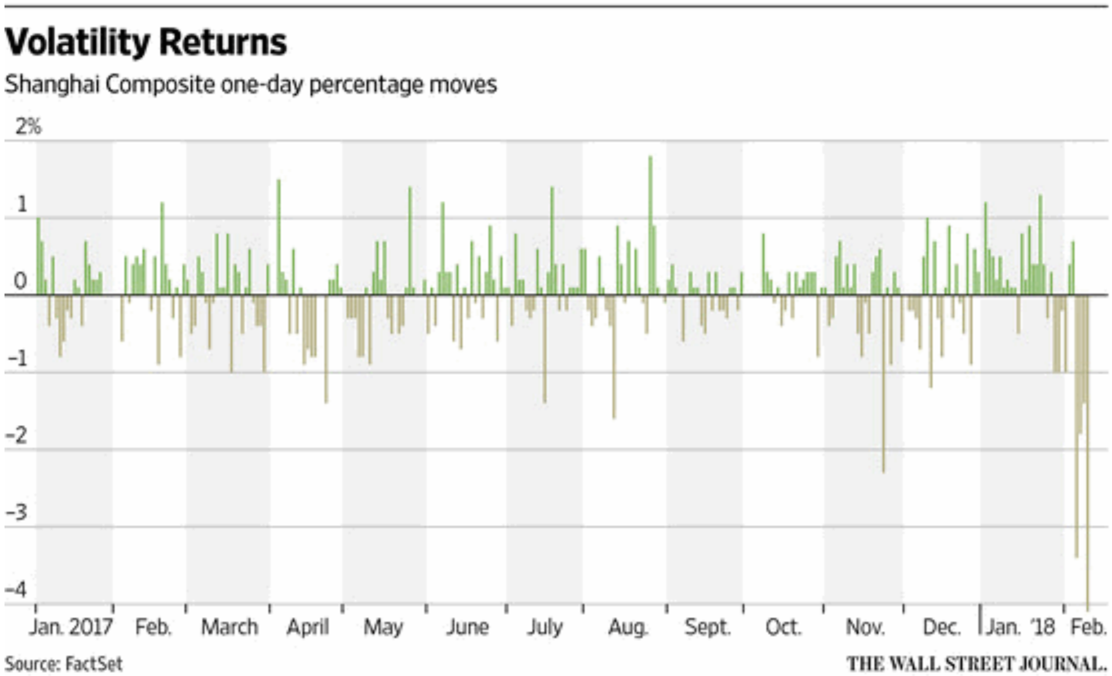
In Hong Kong, the Hang Seng Index is down 11% from a 52-week high hit last month, dragged lower by Tencent Holdings Ltd.'s 14% decline.

The silver lining is that markets around the world have gotten cheaper than they were two weeks ago.

By traditional valuation metrics, Asian stocks look like much more of a bargain than the U.S. market.

The Hang Seng Index trades at 12.4 times projected earnings over the next 12 months, and the Nikkei Stock Average trades at 16 times projected earnings, according to research firm FactSet. Both multiples are cheaper than their respective averages over the past year. By comparison, the **S&P 500** trades at about 17 times projected earnings.

The Kospi index is down 9% from last month's 52-week high. It also trades at just 8.9 times projected earnings, its cheapest multiple since August 2013.



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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Venezuela's Pain Is OPEC's Gain in Production-Cut Deal

By Spencer Jakab
443 words
10 February 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

The cut in oil production engineered by OPEC and Russia is now in its second year, defying skeptics and helping to boost crude prices. But the cartel's compliance owes a big debt these days to a single member: Venezuela.

A founding member of the Organization of the Petroleum Exporting Countries, Venezuela pumped only 1.64 million barrels a day last month, well below its 1.97 million barrel-a-day allocation, according to estimates by S&P Global Platts.

That gap of 330,000 barrels a day is marginally more than the amount that the entire cartel is undershooting its 32.73 million barrel-a-day target.

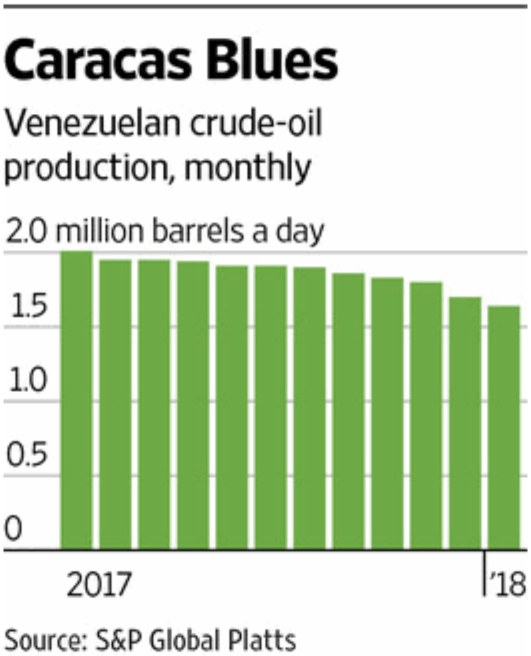
There is every sign that the chaos in Caracas will give OPEC even more breathing room. In fact, it is probably self-reinforcing. The lower Venezuela's output, the less foreign currency it brings in for necessities like food and medicine to placate its restive people, and the greater the chances of an even sharper collapse due to political unrest.

Less cash flow also means less money to invest in creaking infrastructure and to pay foreign contractors. Much of Venezuela's output already is dedicated to covering loans from friendly nations like Russia, and cargoes are in occasional danger of being seized by creditors.

Calling even the decline so far in Venezuela's petroleum industry historic is almost an understatement. Just last year, output was down by almost 30%. In percentage terms, that is worse than in major producing countries that broke apart and saw their economies collapse, such as the former Soviet Union, and Iraq in 2003. In terms of barrels lost a year, it is about twice those lost during the disruptive strike by workers at state oil company Petroleos de Venezuela 15 years ago to protest late strongman Hugo Chavez.

Now PdVSA is in chaos and the Chavistas are to blame. Since late last year dozens of experienced employees have been purged, and a national-guard general with no industry experience has been put in charge. He claims that output will recover this year. Some credible analysts instead see drops of over 40% on tap. January's dire output estimate would support their projections.

A tragedy for its people, Venezuela's woes are helping its fellow cartel members maintain output in the face of surging U.S. production stimulated by higher **oil prices**. Given another year or so and that will no longer be the case because Venezuela won't have much further to fall.



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Document J000000020180210ee2a0001h

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Stocks Are Cheaper but Not Cheap

By Justin Lahart
478 words
10 February 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

Stocks are a lot less expensive than they were two weeks ago. Unfortunately, they are still far from cheap.

The **S&P 500** has fallen 8.8% from the record it hit last month, and if you want to point fingers at reasons why, there are plenty of targets.

Worries over how much the Federal Reserve will have to raise interest rates certainly helped get the tumble going. The wipeout in products that bet against **volatility** played a role as well. So might the automatic dumping of stocks by some risk-parity funds. The expected swelling of the budget deficit as a result of tax cuts and a new budget deal certainly didn't help either.

But the thing that made the **stock market** vulnerable in the first place was its price.

At its peak last month, the S&P traded at 18.5 times expected earnings, according to FactSet, reaching its highest level since 2002. Since then, it has fallen to 16.9. That is still high; the median level over the past 20 years is 15.2.

Moreover, while for much of last year it was possible to argue that the market's high forward price/earnings ratio was justifiable because it didn't reflect the possibility of corporate tax cuts, that is no longer the case. Analysts have now largely incorporated them into their estimates.

There is now even a worry they have been too optimistic, failing to recognize how much of the extra cash from corporate tax cuts will end up getting spent on wages and other costs.

No valuation measure is perfect, but other **stock-market** yardsticks also remain rich. As a percentage of gross domestic product, the value of U.S. stocks remains near levels last seen in 2000, which by many measures was the most expensive period on record. The cyclically adjusted P/E popularized by economist Robert Shiller is at levels eclipsed only just before the 1929 crash and in the years surrounding the dot-com bubble.

The problem with high valuations when stocks falter is that they make it harder for investors to gain the confidence to step in and buy. Adding a further complication, rising Treasury yields are taking away the excuse many investors were offering for high stock valuations. Bonds are now a more viable alternative.

Furthermore, because tax cuts and increased government spending seem likely to make an already tight labor market throw off more heat, the Fed seems unlikely to back off on raising interest rates for the sake of fretful investors.

None of this means stocks are doomed to keep on sliding, though they might. But investors have gotten a lot more nervous, and it seems that they probably should be.

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THE WALL STREET JOURNAL.
U.S. EDITION

The Baffling Moves Behind Stock Rout

By Jon Sindreu and Mike Bird
878 words
10 February 2018
The Wall Street Journal
J
B12
English

U.S. stocks sank into correction territory Thursday for the first time since 2016, yet many investors still don't understand what's driving the rout.

While fears about inflation and rising bond yields have played a role, markets aren't behaving as they usually do during big stock selloffs. That could point to a market still driven by the aftershocks of misfired bets on low **volatility**, rather than a reappraisal of the global economy.

While the **volatility**-trading shakeout may bring further bouts of pain, stock markets will recover and continue to do well against a backdrop of healthy economic growth and strong earnings, many analysts say.

Here are some of the mysterious market moves that point that way:

The hardest-hit investors have been those who were betting against swings in the U.S. **stock market**, often through the Cboe **Volatility** Index, or VIX. When shares dropped, the VIX surged.

But aside from taking their own losses, they may also have turned a small slump into a full-blown correction.

Research suggests that short-**volatility** strategies can fuel drastic reversals in stock markets as investors scramble to offset the damage either by buying back the asset they sold in the first place -- in this case, **volatility** through futures -- or selling stocks, which drop as **volatility** increases. This means the wider **stock market** is overwhelmed by sellers.

In a note on Friday, UBS said the VIX's record percentage jump Monday was "extremely rare" by historical standards, even for a day when the **stock market** fell 4%.

One key sign that investors are still cleaning up after their misfired **volatility** bet is that Thursday's selloff looked quite similar to Monday's, when the VIX first blew up.

In the 80 days before this week's rout, an average down day on the **S&P 500** would lead the index to slide gradually lower, market data show. But Monday's and Thursday's selloffs were marked by sudden plunges as trading came to a close, which is when many investors need to rebalance their exposures.

UBS data show that volumes in VIX futures surged at the same time.

"When you have bouts of **volatility**, they don't usually last one or two days. They can last weeks to months," said Lance Humphrey, executive director of global multiasset for USAA Asset Management.

Some analysts estimate that about $250 billion in stocks need to be sold before **volatility**-targeting investors can rest easy. Still, analysts at JPMorgan Chase & Co. suggested Friday that at least some of these investors -- called risk-parity funds and commodity trade advisers -- have already sold most of what they needed to.

When investors sell because they are re-evaluating just how good earnings and the economy will be, some sectors will typically suffer more than others. But this isn't happening now.

"The stocks which have gone up the most, you would expect to be falling the hardest," said Eoin Murray, head of investment at Hermes Investment Management.

On the way up, the MSCI USA Cyclical Sectors Index -- which includes stocks that outperform as the economy improves, such as banks -- rose by nearly 30% in the year to Jan. 26, when U.S. stocks peaked.

Defensive sectors, which typically outperform in tougher times, rose by around 16% in the same period.

During U.S. **stock-market** corrections in late 2015 and early 2016, cyclical stocks drastically underperformed defensive shares. But this time around, the two have been falling almost in tandem. In fact, cyclical stocks have declined slightly less.

Bespoke Investment Group says that this selloff has been indiscriminate, with selling across companies, regardless of their sector, size or earnings prospects. U.S. financial firms, which in theory would benefit most from higher interest rates, have been the second hardest-hit over the past week.

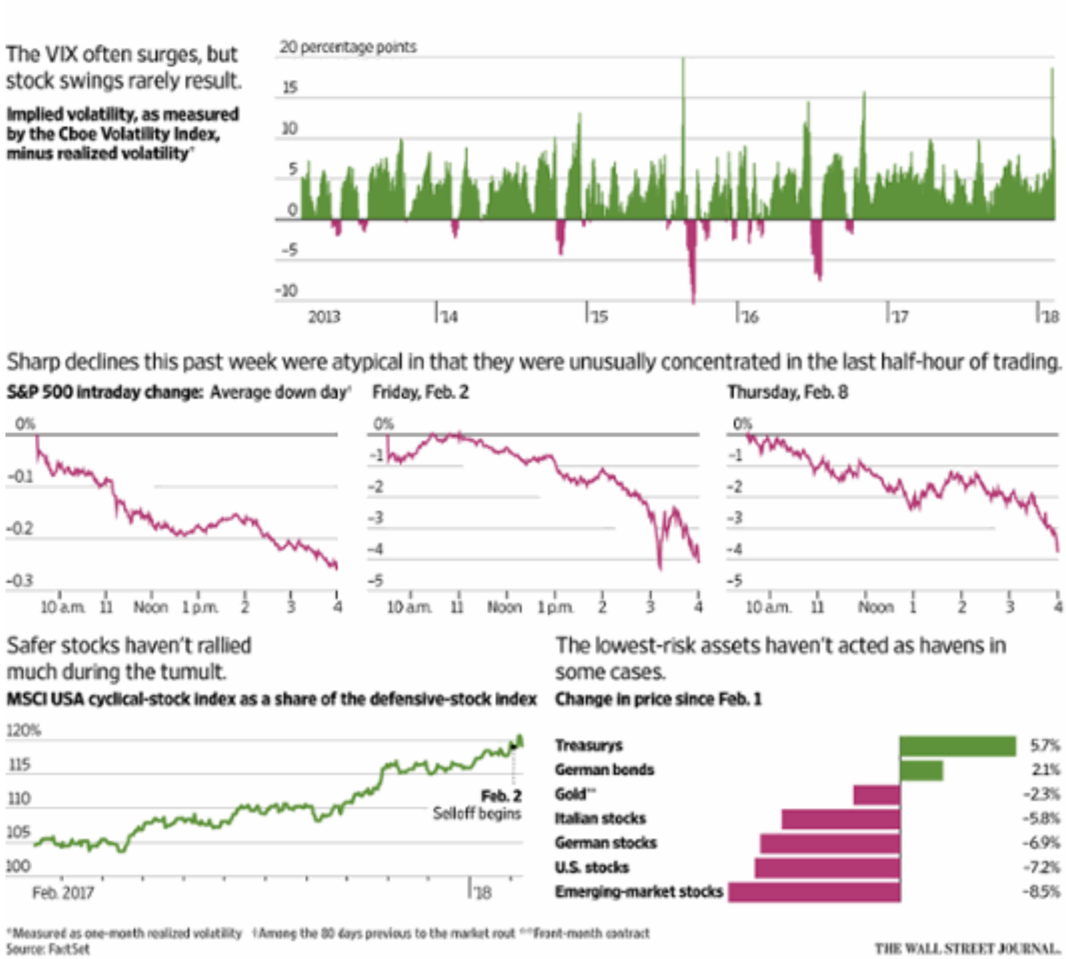
So far, the downturn has affected stocks and left many other markets mostly unruffled, which shouldn't happen if investors are truly concerned about the economy. Even markets and assets that are perceived as being risky aren't being hit the hardest.

Take Italy. Its flagship **stock index** is one of the few globally that is still in positive territory this year. Based on how Italian stocks usually react when people sell elsewhere in the world, these shares should have sold off by around 2 percentage points more than they did between Jan. 26 and Feb. 6, according to Goldman Sachs.

In one key measure of how investors judge Italian risk, spreads between 10-year Italian sovereign-bond yields and German government bonds hit 1.26 percentage points on Thursday, the narrowest gap in around 16 months. Yet, Italy goes to the polls on March 4 for an election that last year was seen as being one of the big risks in European markets.

Many other markets also aren't conforming to the idea that investor sentiment has turned. Havens such as German government bonds or gold, which should do well when money managers are jittery, have edged down during the past week.

Yet riskier assets such as junk bonds and some emerging markets have weathered the blow unexpectedly well.



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THE WALL STREET JOURNAL.
U.S. EDITION

Inflation Creeps Into U.S. Supply Chain

By Andrew Tangel, Harriet Torry and Heather Haddon
865 words
10 February 2018
The Wall Street Journal
J
B1
English

U.S. manufacturers and food companies are grappling with rising material and ingredient costs on top of pressure from higher wages -- a potential double whammy that could force them to raise prices or accept lower profit margins.

"We just see the inflation trends creeping in on many parts of our value chain," Whirlpool Corp. Chief Executive Marc Bitzer told analysts recently. The Michigan-based appliance giant projected that additional raw-material costs, driven by rising prices of steel and resin, would shave as much as $250 million off its profit this year.

Fears that higher wages would push central banks to raise interest rates more aggressively to tamp down inflation have fed the global market selloff. U.S. inflation has largely been muted since the 2007-2009 recession -- which economists attribute in part to weak demand, soft wage growth and cheap imports due to a strong dollar. Over the past six months, however, the world's major economies have been enjoying a rare spell of synchronized growth, boosting commodity prices.

The economic rebound is raising demand for materials like steel, aluminum and copper used to build everything from houses and office buildings to automobiles and smartphones. Prices of steel and aluminum could also rise for U.S. companies if the Trump administration imposes the tariffs it is considering for those metals.

Many companies, including auto maker Ford Motor Co. and heavy-machinery giant Caterpillar Inc., have pointed to rising material costs as a hurdle in the coming year. Some food wholesalers, retailers and caterers say they are contending with escalating costs for staples such as beef, vegetables and eggs that end up on supermarket shelves, in restaurants and corporate kitchens. Sysco Corp., the world's largest food-service distributor, saw overall food inflation of more than 3% during its most recent quarter.

Few economists see inflation taking off, partly because consumer prices gains have been running below the Federal Reserve's annual 2% target for years.

Yet at 4.1% in January, the unemployment rate was at its lowest level in 17 years, and average hourly earnings for private-sector workers rose 2.9% from a year earlier, their largest year-over-year increase since June 2009. Restaurants, manufacturers and other businesses are now fretting over increased payroll costs amid the tight labor market, especially for skilled workers.

B&G Foods Inc. CEO Bob Cantwell told a conference recently: "We're seeing the inflation that the rest of the industry is," referring to higher packaging as well as transport costs. Increased cargo shipments have led to a nationwide shortage of trucks, forcing many companies to pay more to transport goods or cut back.

The Federal Reserve said in last month's report on regional economic conditions known as the beige book that companies in several parts of the country "noted increases in manufacturing, construction, or transportation input costs." Most areas reported modest to moderate growth in prices.

Motorcycle maker Harley-Davidson Inc. has benefited from a weaker dollar in recent months that has helped U.S. manufacturers boost overseas sales. But Chief Financial Officer John Olin told analysts last month that the help from the currency exchange will be "more than offset" by expenses including rising steel and aluminum costs this year.

Paint maker Sherwin-Williams Co. said its outlook this year was tempered by industrywide raw-material inflation as high as 6%. Food distributor Performance Food Group Co. on Wednesday reported higher inflation for meat, eggs, and produce during its most recent quarter, and executives at the supplier to restaurants and other businesses expect food costs to continue to grow around 2.5% during the year.

Higher costs are already rippling into broad measures of what manufacturers pay and receive for commodities and other products. The Institute for Supply Management's manufacturing index in January reported its price index surged to the highest level since May 2011, as 47% of respondents reported paying higher raw-materials prices.

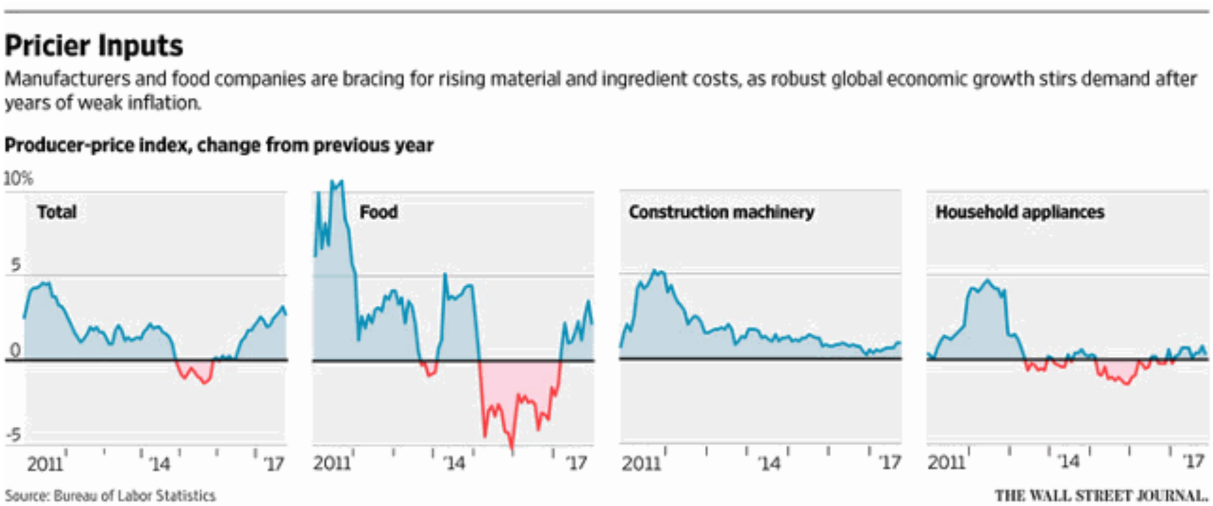
The Labor Department's producer-price index, a measure of inflation experienced by businesses, increased 2.6% last year. January data are due in the coming week. In 2017, prices of steel-mill products rose 7.8%, while industrial chemicals rose 11.7%, according to the Labor Department.

Food prices were more **volatile**: raw-milk prices dropped 10% while prices of slaughter hogs jumped 14% and the cost of wheat increased nearly 13%.

"The question is to what extent will that turn into inflation in the retail level," said Richard Moody, chief economist of Regions Financial Corp. Current high corporate profit margins offer companies the capacity "to eat some of these price increases" rather than pass them on to customers, Mr. Moody said.

Most restaurant companies have been raising menu prices to help offset rising ingredient, labor and rent costs. For instance, McDonald's Corp. said its overall menu prices in the fourth quarter were up 3% from the year-earlier period to help counter increased expenses and protect margins in advance of launching a new dollar menu.

Julie Jargon contributed to this article.



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Document J000000020180210ee2a0002f

The New York Times

National Desk; SECTA
Austerity Era Comes to End

By NEIL IRWIN
1,429 words
10 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

The last seven weeks amount to a sea change in United States economic policy. The era of fiscal austerity is over, and the era of big deficits is back. The trillion dollar question is how it will affect the economy.

In the short run, expect some of the strongest economic growth the country has experienced in years, and some subtle but real benefits from a higher supply of Treasury bonds in a world that is thirsty for them.

In the medium run, there is now more risk of surging inflation and higher interest rates -- fears that were behind a steep **stock market** sell-off in the last two weeks.

In the long run, the United States risks two grave problems. It may find itself with less flexibility to combat the next recession or unexpected crisis. And higher interest payments could prove a burden on the federal Treasury and on economic growth. This is particularly true given that the ballooning debt comes at a time when the economy is already strong and the costs of paying retirement benefits for baby boomers are starting to mount.

It's hard to overstate how abrupt the shift has been.

When the Congressional Budget Office last forecast the nation's fiscal future in June, it projected a $689 billion budget deficit in the fiscal year that begins this coming fall. Analysts now think it will turn out to be about $1.2 trillion.

One major reason is the tax law that passed on Dec. 20, which is estimated to reduce federal revenue by about $1.5 trillion over the next decade, or $1 trillion when pro-growth economic effects modeled by the congressional Joint Committee on Taxation are factored in. A budget deal passed in the early hours of Friday morning includes $300 billion in new spending over the next two years for all sorts of government programs and $90 billion in disaster relief, without corresponding cuts elsewhere in the budget.

It is a stark reversal from 2010 to 2016, when congressional Republicans insisted upon spending cuts and the Obama administration insisted on raising taxes (or, more precisely, allowing some of the Bush administration's tax cuts to expire). Those steps, combined with an improving economy, cut the budget deficit from around 9 percent of G.D.P. in 2010 to 3 percent in 2016.

The Near Term: Strong Growth in 2018

In almost any economic model you choose, the new era of fiscal profligacy will create a near-term economic boost. For example, Evercore ISI, the research arm of the investment bank Evercore, estimates that the combination of tax cuts and spending increases will contribute an extra 0.7 to 0.8 percentage points to the growth rate in 2018, compared with the policy path the nation was on previously.

Economists generally think that these policies will have a lower ''multiplier'' than these policies would have if they took place during a recession, when there is more spare capacity in the economy. But that doesn't mean the multiplier becomes zero.

''Some people assume that because this was a bad process and the tax bill is really regressive that it won't have a short-term growth impact, but I think that's wrong,'' said Adam Posen, president of the Peterson Institute for International Economics. ''We shouldn't confuse whatever distaste one has for the composition of the package for totally overwhelming the multiplier effects.''

Put a different way, it would be very hard for the government to pump an extra half-trillion dollars into the economy in a single year without getting some extra economic activity out of it.

Another potential near-term positive for the global financial system could be the effect of billions of dollars in bonds issued by the Treasury. For years the world has experienced what some analysts call a ''safe asset shortage,'' too few government bonds and other investments viewed as reliable relative to demand.

This has arguably been a factor in depressed interest rates and sluggish growth across much of the advanced world. More Treasury bonds floating around might reduce those pressures.

The Medium Term: Depends on Economic Slack, and the Fed

Over the next two or three years, things get more murky. What happens will depend on how the economy responds to the additional fiscal stimulus, and how the Fed responds to that.

The big question is whether the economy has the room to keep growing without higher inflation emerging. The unemployment rate is already low at 4.1 percent, so there aren't exactly hordes of jobless people available to be put back to work. That means there is a chance that all this extra money flooding into the economy doesn't go toward more economic output but just bids up wages and ultimately consumer prices.

If that happens, the Federal Reserve would almost certainly raise interest rates more than it now plans, essentially engineering an economic slowdown to try to keep inflation from accelerating. In that scenario, the apparent benefits of tax cuts and spending increases would be short-lived.

But there's no certainty that will happen. It may be that the United States has more growth potential than standard models suggest. Perhaps corporate income tax cuts and looser regulation on business will unleash more capital investment and higher productivity, as conservatives argue. Maybe some of the millions of prime-age adults who have dropped out of the labor force in recent years will come back in, creating more economic potential.

''The really big question mark we have is how much slack there really is in the economy,'' said Donald Marron, a scholar at the Urban Institute who was once acting director of the Congressional Budget Office. ''If you look at conventional measures, unemployment looks really low, but on the other hand if you look back to what we used to think of the potential of the economy a few years ago, we may have some room to grow.''

The Long Run: Higher Debt-Service Costs and Less Room to Maneuver

The public debt was already on track to rise relative to the size of the economy before the new tax and spending deals; now it will probably rise faster. The Congressional Budget Office projected last June that the nation's debt-to-G.D.P. ratio would rise to 91 percent in 2027, from 77 percent in 2017.

The C.B.O. hasn't updated those numbers to reflect the new tax and spending legislation, but the Committee for a Responsible Federal Budget estimates that it will turn out to be between 99 and 109 percent, depending on whether provisions of the tax law are allowed to expire as they are scheduled to.

But those numbers are just an abstraction. The question is what effects higher debt loads might have for Americans in 2027 and beyond.

Higher debt service costs are one big one. Taxpayers in 2027 were forecast to pay $818 billion a year in interest costs even before the tax cuts and spending increases, or 2.4 percent of G.D.P. That will presumably be higher, because taxpayers will be paying interest costs on more debt, and probably at higher interest rates.

And there is probably some point at which the amount of debt the government takes on crowds out private investment; to the degree that the supply of funds to borrow is finite, every dollar the government borrows is not available to be lent to a homeowner taking out a mortgage or a business looking to expand. That said, in practice, the supply of loanable funds is not finite -- households may save more with higher interest rates, for example, and foreign capital might flow in.

The bigger costs of a high national debt may come in how much flexibility policymakers have to respond to a future recession or crisis. If the United States finds itself in a major war or a deep recession, its starting point in terms of debt load will be much higher than it was at the onset of the Iraq War or the 2008 financial crisis.

''It's about risk management,'' Mr. Posen said. ''We may need that fiscal capacity for something else.''

Paul D. Ryan of Wisconsin issued dire warnings in 2012 about the national debt. As speaker, he passed a tax plan that inflated it. (PHOTOGRAPH BY BRIAN SNYDER/REUTERS) (A13) CHART: U.S Debt Is Set to Rise (Sources: Congressional Budget Office; Center for a Responsible Federal Budget) (A13)

Document NYTF000020180210ee2a00064

The New York Times

Business/Financial Desk; SECTB
Quiet Player In Volatility Of Market: Computers

By LANDON THOMAS Jr.
1,231 words
10 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

A decade ago, the center of gravity on Wall Street were raucous trading desks and stock exchange floors. These days, the locus has shifted to far quieter places, where computers are in charge.

The transition has been years in the making, but its effect has been on full display over the past week. After propelling the market to historic highs, passive investment strategies -- which follow a simple set of rules and are carried out by sophisticated computer programs, not humans -- are among the factors fueling the market's recent plunge.

This is the new reality of today's **stock market**: Funds that track financial indexes have become a dominant force, and they can act as accelerants, adding momentum to the market's rise and fall.

This week, as markets shuddered, exchange-traded index funds were responsible for 38 percent of total stock trading on some days, an astonishing figure given that these funds were just a curiosity 10 years ago. Indexing giants like BlackRock and Vanguard now own vast swaths of the market and are the largest shareholders in just about all the major companies in the **Standard & Poor's 500-stockindex**.

In many ways, this stampede toward passive investing -- in which people put their money into funds that track indexes and broader market themes as opposed to relying on human stock pickers -- is uncharted territory. Now the key question is how this transformed market holds up during a financial storm that lasts more than a few days.

''These flows have had a big effect on the market,'' said Peter Tchir, a strategist at Academy Securities. ''And when people want to get out, there is a similar effect.''

Cheaply priced exchange-traded and index funds have pumped trillions of dollars into the **stock market** since early 2009. They now own close to 40 percent of stocks in the United States, according to research by Bank of America Merrill Lynch.

Unlike mutual funds, E.T.F.s are listed on public exchanges, which makes many of them very easy to trade even if the securities they hold may not be. On Thursday, for example, the second most actively traded security in the **equity market** was a BlackRock fund that invests in large companies in emerging markets.

As stocks plunged Thursday afternoon, the global markets desk at BlackRock, the world's largest asset manager, was calm. There were no traders or portfolio managers barking ''Buy!'' or ''Sell!'' -- just a cluster of 15 people in front of computer screens monitoring the firm's fleet of passive investment funds.

There was a lot to keep an eye on.

BlackRock, which manages $6 trillion overall, is the leading issuer of exchange-traded funds, with $1.3 trillion under management. But as the market fell and trading in BlackRock funds accelerated, there was little sign of panic or emotion among the E.T.F. specialists at the firm.

They fielded phone calls from clients and let the computers do their work.

Martin Small, who oversees United States-based E.T.F.s at the firm, said the high share of E.T.F. trading was positive for the markets. That is because on days when fearful investors want to sell, large, easy-to-trade E.T.F.s serve as a critical release valve.

"Everything worked," Mr. Small said. "Volumes were higher and more people were watching, but our funds did what they were supposed to do."

Investing on the basis of what machines, as opposed to humans, do has been a trend in **financial markets** for years. What's different now is that so much money has poured into a specific type of computer-driven trading.

From cost-conscious millennials to the world's largest pension and sovereign wealth funds, E.T.F.s have become a preferred investment choice. In addition to all the major stock and bond indexes, they enable investors to get a piece of the action in arcane areas like junk bonds, bank loans and stocks in Pakistan. There is even an E.T.F. that tracks companies that make whiskey.

The popularity of E.T.F.s has concentrated unparalleled financial power in BlackRock and Vanguard, the two biggest providers of index funds and E.T.F.s. Together, they sit on $10.5 trillion in assets and control 65 percent of the 1,700 exchange-traded funds that exist.

Relying on sophisticated computer programs, they funnel investor money into the stocks and bonds that make up indexes around the world. As the flows have grown in volume, much of these funds have gone toward index heavyweights like Amazon, Apple and Facebook, pushing their valuations ever higher.

This makes some regulators, academics and investors nervous. What happens, they ask, when passive investors own 80 percent of stocks as opposed to the 40 percent they control today?

Active fund managers -- human stock pickers -- will be marginalized, the argument goes. And that could cause harm, because they are the ones who buy when others sell. So when stocks suddenly plummet, there will be fewer funds to step in, extending the fall.

An analyst at Sanford C. Bernstein even compared passive investing to Marxism, in its sweeping conformity and its degradation of the independent-minded, active investor.

"For years, this has been an E.T.F. market -- its robots buying stocks just as they were programmed to do," said Steven Bregman of Horizon Kinetics, a firm that hunts for undervalued stocks. "But so much money has gone into just a few hundred stocks. Everyone owns the same stuff. So when they want to get out, who are they going to sell to?"

Compounding these worries is the rise of algorithm-driven trading strategies at large hedge funds. They get their buy and sell signals not from a human but from indexes that measure sharp swings in the market. Earlier this week, they were big sellers when the so-called VIX index -- a measure of anticipated market **volatility** -- skyrocketed.

E.T.F. proponents argue that their industry's growth is just the latest stage of the stock-indexing revolution that began in the early 1970s. That was when John C. Bogle founded Vanguard and began to launch index funds.

His argument, which soon became a form of religion to his followers, was that over the long term, a cheap fund that tracks a broad index will perform better than expensive alternatives managed by stock pickers who believe they can outfox the market.

Wesley R. Gray of Alpha Architect, a rules-based investment firm, is one such true believer. He argues that his computer models do a better job creating stock portfolios than humans can ever do.

So when stocks sank this week, he barely glanced at his trading screens. Whether the market goes up or down does not matter to him because the computers control his suite of exchange-traded funds -- not him.

"If the market goes down 4 percent, I don't even care," Mr. Gray said. "That is the beauty of systems. Once you build it, there is literally nothing left to do."

Outside the New York Stock Exchange. On some days this week, E.T.F.s were responsible for 38 percent of total stock trading. (PHOTOGRAPH BY SAM HODGSON FOR THE NEW YORK TIMES) (B4)

Document NYTF000020180210ee2a00060

The New York Times

NEWS ANALYSIS
National Desk; SECTA
In Chaotic Days, The President Just Stands Aside

By PETER BAKER; Thomas Kaplan contributed reporting.
1,554 words
10 February 2018
The New York Times
NYTF
Late Edition - Final
13
English

WASHINGTON -- When he took office a year ago, President Trump vowed that the ''hour of action'' had arrived. But as momentous events whipsawed Washington and Wall Street in recent days, Mr. Trump seemed oddly offstage, more of a spectator than the star.

He stayed largely out of sight as the **stock market** plummeted in its most **volatile** week in years. He was largely uninvolved as Congress crafted a two-year budget agreement without him, ending a brief, middle-of-the-night shutdown Friday morning after just a few hours rather than allowing the full shutdown he wanted to force an immigration deal. And he angrily chastised aides for keeping him out of the loop on spousal abuse allegations against a top aide.

There are times when it serves a president's interests to step back and let events play out around him, but it goes against the grain for Mr. Trump, who has always styled himself as the master of his universe. The passive presidency of recent days presumably will not last, but even when he tries to impose his will on the capital and the world, Mr. Trump has found that there are limits to his ability to shape events.

''The president prides himself on being a great deal maker and understanding the art of the deal,'' Senator Chris Coons, Democrat of Delaware, said this week during negotiations on immigration. ''Sometimes he makes the best contribution when he makes his position known and then steps back and lets us work out the details and decide what he can and can't accept.''

Mr. Trump is not a detail person even in his more active days, but his natural instinct is to involve himself in the broad strokes. His often impulsive Twitter blasts can upend negotiations and shift the focus of events, sometimes at odds with the official position of his own White House. And so his relatively low profile in recent days has been striking.

Even some of his top advisers sounded surprisingly passive this week on different issues. Secretary of State Rex W. Tillerson said that Russia was already trying to interfere in the midterm congressional elections this year, but there was not much the United States could do to stop it. ''If it's their intention to interfere, they are going to find ways to do that,'' he told Fox News. ''We can take steps we can take, but this is something that, once they decide they are going to do it, it's very difficult to pre-empt it.''

Vice President Mike Pence, who is in South Korea for the opening of the Olympics, likewise sounded relatively detached from the spending debate involving his former colleagues in Congress back home. Asked whether he had called any lawmakers, he said he had only talked with the White House unit that lobbies Congress. ''I've been in touch with the legislative office and the president and I have talked frequently,'' he told reporters, ''but we're on standby as the vote approaches.''

Other presidents have discovered that there can be benefits from staying on standby. When President Bill Clinton assigned Hillary Clinton to lead an effort to pass universal health care, she and a task force crafted a highly detailed plan that died on Capitol Hill. The lesson that Mr. Clinton and his successors took from that is that sometimes it is better to set a broad goal but let Congress figure out how it wants to proceed. President George W. Bush did that with his No Child Left Behind education program and President Barack Obama did that with health care and some spending fights.

But Mr. Trump has proved a divisive force so that even his broad direction is now sometimes ignored. Just this week he declared that he wanted Congress to let the government shut down rather than pass spending measures if there were no agreement on immigration. But Senate leaders of both parties disregarded him altogether and drafted their own deal without immigration.

"The other players in Washington, whether it's Congress or the Senate leadership, really have come to the conclusion: Let's ignore him, because we have things to do," said Maria Echaveste, a former deputy White House chief of staff under Mr. Clinton. "The budget deal is a perfect example of that. He's not constructive so they're ignoring him."

Speaking after reaching the budget deal with his Republican counterpart, Senator Chuck Schumer of New York, the Democratic minority leader, said he had learned to proceed without bothering with the president. "Often times we can get a lot more done working with one another and let the White House just sit on the sidelines, because you don't know what their positions are," he said.

The president's hands-off approach on the budget deal worked for him to the extent that it included the boost in military spending that he has been demanding, but it also included a large increase in domestic spending as well.

As a result, the federal deficit will balloon to nearly $1.2 trillion by 2019, despite Mr. Trump's campaign promise to get the nation's fiscal house in order. At one point during the campaign, Mr. Trump even promised to eliminate not just the annual deficit but the entire national debt accumulated over decades and now totaling more than $20 trillion. Instead, at this rate, he will pile up trillions of dollars of additional borrowing.

Conservatives complained that he should have played a more active role in the negotiations to avoid that. "I think it would have made a big difference if Trump had pushed hard for lower spending numbers, particularly if he had pushed a consistent message," said Chris Edwards, the director of tax policy studies at the Cato Institute. He noted that Democrats backed down during the last government shutdown. "That would have given Trump power," he said.

The White House was, again, not engaging on Friday. It held no news briefing and a spokesman did not respond to a request for comment on the president's approach. But on Twitter, Mr. Trump blamed Democrats for the spending increases in the budget deal. Even though Republicans control both chambers, they need Democratic votes to end filibusters in the Senate.

"Without more Republicans in Congress, we were forced to increase spending on things we do not like or want in order to finally, after many years of depletion, take care of our Military," Mr. Trump wrote. "Sadly, we needed some Dem votes for passage. Must elect more Republicans in 2018 Election!"

Still, some Republicans said Mr. Trump may be most successful by setting the larger goals and then backing off. "Different presidents have different interest levels in being in the weeds on policy details," said J. Scott Jennings, who was a special assistant to Mr. Bush and is now a fellow at the Harvard Institute of Politics. "This one, it seems to me, works best when he lays out broad priorities -- more defense spending, cut taxes -- and then allows the tacticians to engage and make it so."

After a fractious first year between Mr. Trump and Senator Mitch McConnell of Kentucky, the Republican majority leader, Mr. Jennings said the president seemed to have finally found traction in the relationship, trusting the leader to manage legislative strategy. "Once they found their groove, things started working," he said. "Trump's job approval has gone up, the numbers on the economy have improved and the generic ballot has begun to shrink."

Still, there is the danger of looking as if he is too removed. He did not sound particularly aggressive about domestic violence after his staff secretary, Rob Porter, was accused of beating two former wives and resigned. Instead, his only public comment was to praise Mr. Porter and express sadness for him. In private, advisers said Mr. Trump was angry both that he had not been informed earlier about the allegations and that he had not been consulted on the initial White House response.

He likewise remained generally quiet about the tumble of the **stock market**, which has now reached an official correction, after lauding its increases for a year. Critics said he could not have it both ways, claiming credit when share prices rise while avoiding blame when they fall.

Democrats and some Republicans said Congress is dysfunctional enough without Mr. Trump getting involved. "I am absolutely convinced that at this point in time the best thing for everyone involved is for this president to stay as far away as possible," said Jim Manley, a former top Democratic aide in the Senate. "The last thing this chaotic institution needs is for him to wreak more havoc by getting involved."

The one exception, he added, would be immigration, where Mr. Trump should play more of a role. "The issue is so toxic," he said, "that they're never going to get anything done unless he leans in and gives some cover to the Republicans."

Follow Peter Baker on Twitter: @peterbakernyt.

President Trump has stayed largely on the sidelines as the market tanked, lawmakers sealed a deal, and a top aide was ousted. (PHOTOGRAPH BY TOM BRENNER/THE NEW YORK TIMES)

Document NYTF000020180210ee2a00044

The New York Times

Business/Financial Desk; SECTB
Unexpected Opposition Imperils a Fed Nominee

By BINYAMIN APPELBAUM
925 words
10 February 2018
The New York Times
NYTF
Late Edition - Final
2
English

WASHINGTON -- The Trump administration is struggling to muster the necessary Senate votes to put the conservative economist Marvin Goodfriend onto the Federal Reserve's board of governors.

Senator Rand Paul, Republican of Kentucky, said Thursday that he would vote against Mr. Goodfriend, who has also yet to attract any support from Democratic senators.

In the narrowly divided Senate, that could be enough to sink Mr. Goodfriend's confirmation.

The unexpected opposition is a setback for the Trump administration, which has struggled to pick qualified candidates for the Fed's board. The central bank, which sets monetary policy and plays a leading role in financial regulation, now has just three governors on its seven-seat board, the fewest in the Fed's modern history.

''Three is really thin,'' said Ian Katz, a financial policy analyst at Capital Alpha Partners, a research firm for investors.

Mr. Katz noted that the Fed under its new chairman, Jerome H. Powell, was conducting a wide-ranging review of regulations, part of the Trump administration's effort to give greater leeway to financial institutions. It also must wrestle with the implications of recent **financial market volatility**.

''Fed governors have even more on their plates and minds than just a week ago,'' he said.

Mr. Goodfriend is a professor at Carnegie Mellon University and a former monetary policy adviser to the Federal Reserve Bank of Richmond, Va. He is widely regarded as a leading academic proponent of the views that the Fed should focus on controlling inflation and minimize its interference with **financial markets**, both popular positions among conservative Republicans.

Those views and his stumbling performance at his January confirmation hearing, in which he struggled to explain why his inflation predictions after the economic crisis a decade ago were wrong, have solidified Democratic opposition. Senator Sherrod Brown, Democrat of Ohio, said he was voting against Mr. Goodfriend because he questioned his commitment to the Fed's dual mandate, which requires the central bank to pursue maximum employment in addition to stabilizing inflation.

He said Mr. Goodfriend, who repeatedly criticized the Fed's post-crisis economic stimulus campaign, had a record of ''prioritizing hypothetical inflation over real people losing jobs.''

Senator Jon Tester, a Montana Democrat who has often voted for the Trump administration's nominees, said he opposed Mr. Goodfriend because of his comments at the hearing that there was no need for the federal government to guarantee 30-year fixed-rate mortgage loans.

Mr. Tester said Mr. Goodfriend was ''unqualified for a leadership role at the Fed.''

Mr. Paul's opposition has very different roots. He said Thursday that he was concerned about a paper Mr. Goodfriend wrote in 2000 proposing that the government put magnetic strips on money so it could, under certain circumstances, impose a tax on cash. The proposal was intended to help the government encourage spending during periods of low inflation and low interest rates.

"That doesn't sound very exciting to me," Mr. Paul, a libertarian, said Thursday.

Mr. Goodfriend has since abandoned the specific proposal, but in his academic writings he has continued to advocate other forms of "negative interest rates" -- policies that make it expensive to hold money when the government wants to encourage spending.

Republicans have a 51-vote Senate majority, and Vice President Mike Pence is available to break ties. If Mr. Paul remains opposed, Mr. Goodfriend's chances could rest on Senator John McCain, Republican of Arizona, who is in his home state undergoing treatment for cancer.

The White House said in a statement that it continued to support Mr. Goodfriend.

"The president stands behind his nomination of Marvin Goodfriend, who is incredibly qualified for the Federal Reserve board of governors," it said. "We hope the Senate confirms Mr. Goodfriend swiftly given the importance of the Federal Reserve to the American economy."

The Senate Banking Committee approved Mr. Goodfriend's nomination in a 13-to-12 party-line vote on Thursday. Republicans have not yet scheduled a final vote by the full Senate.

The political polarization of the Senate has made it increasingly difficult for presidents to secure the confirmation of their Fed nominees. Democrats in 2008 refused to vote on a pair of President George W. Bush's nominees. Republicans responded two years later by blocking the confirmation of Peter Diamond, who won a Nobel Prize in economics while he was waiting for a Senate vote. Senator Richard Shelby, the Alabama Republican who chaired the Banking Committee at the time, said after the prize was announced that Mr. Diamond was still unqualified.

Mr. Trump has not announced nominees for the other three board seats. The White House has focused on its search for a vice chairman, a job that has been vacant since October. Lawrence B. Lindsey, a former Fed governor who was considered a leading candidate, said this week in a note to clients of his economic advisory firm that he was withdrawing from consideration. Mr. Lindsey's decision was reported earlier by The Wall Street Journal.

Others who have been considered, according to a person familiar with the search process, include Richard Clarida, a Columbia University economist and a managing director at the investment firm Pimco; Mohamed A. El-Erian, chief economic adviser at the financial conglomerate Allianz; and John Williams, president of the Federal Reserve Bank of San Francisco.

Follow Binyamin Appelbaum on Twitter: @bcappelbaum.

Marvin Goodfriend is seeking to join the Fed's board of governors. (PHOTOGRAPH BY JACQUELYN MARTIN/ASSOCIATED PRESS)

Document NYTF000020180210ee2a00048

The New York Times

Business/Financial Desk; SECTB
Tumultuous Week on Wall Street Finishes With a Small Rebound

By EMILY FLITTER and ALEXANDRA STEVENSON; Jack Ewing contributed reporting from Frankfurt.
855 words
10 February 2018
The New York Times
NYTF
Late Edition - Final
4
English

Stocks on Wall Street ended a **volatile** week on an upswing, as the **Standard & Poor's 500-stockindex** ended Friday's trading session about 1.4 percent higher.

After Thursday's session marked a 10 percent drop from the market's peak in January, the **S.&P. 500** and **Dow Jonesindustrial average** started higher on Friday, then plummeted, then swung back into positive territory in the afternoon.

Asian and European markets tumbled on Friday. Chinese stocks were among the biggest casualties in a broad sell-off across Asia. It was a stunning reversal for Chinese shares, which investors had been snapping up only days before.

The cause of one of the most turbulent weeks in recent memory, market participants in the United States said, appeared to be widespread expectations that the global economy is improving and that growth would accelerate in the near future.

That has led to fears that interest rate increases could cheapen the value of certain kinds of investments.

''Even if stocks continue to rise, they could rise more slowly and could be subject to large drops,'' said Kate Warne, an investment strategist at Edward Jones.

She said investors were moving money out of riskier stocks like Apple and Disney, which are considered ''consumer discretionary'' stocks because they don't serve basic daily needs, and into safer areas like utility stocks and United States Treasury notes.

''Longer-term investors should stay invested and not let this worry them. This is an opportunity to buy at lower prices,'' Ms. Warne said.

Many investors are now growing nervous that central banks will raise interest rates in a bid to keep inflation at bay. If policymakers move too quickly, their efforts could temper the global growth.

Anthony Clemente, the chief executive of Canaras Capital, which specializes in high-yield loans and has $1.3 billion under management, said some of the market movement appeared to be an effort by portfolio managers to protect themselves from **volatility** in stocks rather than a broader fear of market turmoil.

''It's really out of equities and inflows into the debt markets,'' he said. ''There's an expectations that yields -- fixed income and debt instrument -- are the place where you will want to be at some point.''

Whatever the cause, there is now little doubt that markets are jittery.

After being lulled into a sense of complacency by years of steadily rising stocks, even small worries can snowball into a bad day for stocks. The losses can then feed on themselves in a financial industry dominated by computerized trading systems, with the weakness in the United States spreading around the world.

''Asia is going to be the tail that gets wagged by the U.S. dog,'' Timothy Moe, chief Asia Pacific strategist at Goldman Sachs, said on Friday.

As with stocks in the United States, Chinese shares have surged in recent months, on the back of a strong economy. An improved global outlook has led to more buying of Chinese exports. The authorities also seem to have slowed what had been an alarming borrowing binge.

But the Chinese market does offer reasons for concern. Investors kept a careful eye this week on China's currency, the renminbi, which is carefully managed by the Chinese government. It took a hit on Thursday, falling as much as 1.2 percent before strengthening a bit on Friday.

Before that, the renminbi had been rising steadily against the American dollar, leading to worries that Beijing might step in further to contain it. World markets can be sensitive to sharp swings in China's currency.

The tough day of trading on Friday put Chinese shares by some measures into correction territory. "We are witnessing the longest rally in the history of Chinese stocks," analysts at Goldman Sachs wrote to clients early this week, adding, "A tactical correction appears overdue, and markets could fall further."

Shares in Shanghai fell about 4 percent on Friday, while Hong Kong shares lost 3.1 percent. Shares in Tokyo fell 2.3 percent. In Europe, stocks wavered, off more than 1 percent in afternoon trading.

In the logic of stock markets, bad news can sometimes be good news. Recent gains in the value of the euro against the dollar and other major currencies were expected to slow exports and potentially put the brakes on the eurozone economy.

Slower growth would, in turn, dissuade the European Central Bank from raising interest rates too soon, prolonging the cheap money that has been partly responsible for the **bull market**.

"The E.C.B. has, in fact, a vital interest in keeping euro area interest rates at low levels," Ralph Solveen, an analyst at Commerzbank, said in a note to clients on Friday.

CHART: Many Gains Slip Away: The **Standard & Poor**'**s 500**-**stockindex** climbed 27 percent since President Trump took office, but by Friday it had given up more than a third of those gains since peaking on Jan. 26. (Source: Thomson Reuters)

Document NYTF000020180210ee2a0003z

The New York Times

Business/Financial Desk; SECT
Are Debt Problems Lurking Below the Surface?

By PETER EAVIS
937 words
10 February 2018
The New York Times
NYTF
The New York Times on the Web
English

A decade ago, concerns that companies and individuals had borrowed too much money toppled the **stock market** from what was then its all-time high.

Now, with stocks again tumbling from record levels, are debt problems rumbling beneath the surface of what seems like a strong economy? The short answer is that, in most places in the world, the reckless borrowing that led up to the financial crisis of 2008 does not seem to have reoccurred. Still, when a long period of low interest rates ends, as appears to be the case now, all the borrowers and lenders who have grown used to cheap credit may retrench in ways that may not be initially obvious. In other words, debt has a propensity to bite the economy on the behind just when it least expects it.

Individuals look pretty good for now. Over the past decade since the housing crisis, many households have done much to repair their finances. Household debt is now equivalent to 51 percent of gross domestic product, down from 73 percent in 2008, according to Federal Reserve data. The sort of loose mortgage lending that contributed to the financial crisis has not returned, in large part because of new regulations that stop lenders from making loans that would be hard to repay.

But problems may be brewing. As my colleagues Jessica Silver-Greenberg and Stacy Cowley recently showed, credit card debt has been rising, burdening some borrowers. But this debt does not right now pose the sort of systemic threat that mortgages did a decade ago.

Something to watch: Check out the Fed's special indicator for showing how much of people's paychecks are being used to make payments on their borrowings. This is down a lot in recent years, but a prolonged rise could signal trouble.

Wall Street, for once, does not seem to be a pressing problem. Leverage is finance jargon for borrowing, and the big banks had a ton of leverage heading into the financial crisis. Banks get the money they use to make loans and trade from two main sources: They borrow it from depositors and creditors (who can demand their money back), or they get it from shareholders (who cannot demand repayment).

The more a bank relies on shareholder funds, or equity, the less leveraged it is. And, crucially, it is also at less risk of the sort of bank runs that threatened the global financial system in 2008. The good news is that banks are using a lot more equity these days. As the Fed noted after conducting stress tests of large lenders last year, banks had common equity capital, a metric regulators use to assess the strength of a lender's balance sheet, that was equivalent to 12.5 percent of their assets, which was more than double the 5.5 percent they had at the start of 2009.

Something to watch: Regulators are thinking about loosening a regulation that limits leverage.

Companies may be the weak point. Corporations have gorged on debt since the financial crisis. Corporate bond issuance is up over $3.5 trillion, or 67 percent, since the end of 2007, according to calculations using data from the Securities Industry and **Financial Markets** Association, or Sifma. All other types of debt issuance, excluding United States Treasury debt, are either down or more or less flat over the period. Bank lending to companies and commercial real estate projects is up $1.2 trillion, or 40 percent, since the end of 2007, according to Fed data.

One of the reasons investors have kept buying corporate bonds is that, while some measurements of indebtedness flashed warnings, plenty of others did not. But there are signs that the binge had gone too far, even for these easy money times.

The yield on junk bonds, as measured by BofA Merrill Lynch's high yield index, was close to historic lows last year, making the market vulnerable to any interest rate rises. What is more, in recent months the cost of corporate borrowing, on an inflation-adjusted basis, has sunk to what looks like an unsustainable low. In December, the yield on a bond rated Baa by Moody's was 2.1 percent after subtracting the rate of inflation for that month. That figure was well below the average since 1950, but also significantly smaller than averages for the last five or 10 years.

Something to watch: Corporations may borrow less in coming months, which can have knock-on effects in the **stock market** and wider economy. When companies borrow less, they may have less money to spend on new investments or to buy back shares, an activity that has given support to stock prices. Track Sifma's tally of corporate debt issuance, on a monthly basis, here.

What about the government deficit? Over the last 10 years, federal government debt has ballooned to over 100 percent of gross domestic product from around 60 percent. And the amount of outstanding Treasury debt has increased by roughly $10 trillion. Investors have been more than willing to buy Treasurys. But the recent tax cuts, which are expected to add to the deficit, and fears of inflation may lower demand for Treasurys, pushing up the borrowing costs for the government and others.

Something to watch: The yield on the **10**-**year Treasury** note, which can be found here. On Friday, the note's yield, which moves in the opposite direction to its price, was 2.81 percent, well up on 2.41 percent at the end of 2017.

Document NYTF000020180210ee2a0003y

THE WALL STREET JOURNAL.
U.S. EDITION

REVIEW & OUTLOOK (Editorial)
The Bernanke Correction

692 words
10 February 2018
The Wall Street Journal
J
A12
English

The **stock market** continued its wild swings Friday, finishing up for the day but still concluding the worst week in nearly a decade. Look for more such gyrations as investors adapt to the return of market-based interest rates.

In his typical way, Donald Trump lumbered into part of the truth this week with a tweet. "In the 'old days,' when good news was reported, the **Stock Market** would go up," he wrote. "Today, when good news is reported, the **Stock Market** goes down. Big mistake, and we have so much good (great) news about the economy!"

He's referring to the paradox that stock prices fell despite a strengthening U.S. and global economy. But Mr. Trump is missing that faster growth requires a fundamental shift in the monetary policy of the past decade. In particular this means the looming end to the financial repression that the Federal Reserve has been practicing since the financial panic. In that sense this is the Ben Bernanke correction, as the Fed and other central banks unwind the former Fed chairman's unprecedented monetary experiment.

For nearly a decade the Fed has intervened in **financial markets** to repress the long end of the bond market. It scooped up the bulk of new long Treasury bonds, as the European and Japanese central banks later did in their economies. The idea was to push investors into riskier assets like real estate, junk bonds and stocks as they sought greater returns that they couldn't get in Treasurys. The policy worked as asset prices rose, though it did far less for the real economy and workers without assets.

Janet Yellen maintained the Bernanke policy as long as she could, and only recently has the Fed started to unwind its asset purchases and raise interest rates. Europe and Japan still haven't begun, but faster growth suggests the end of the Bernanke era beckons there too. This is what investors are anticipating, even as they see the good news that economic growth is accelerating.

Volatility and interest-rate risk are thus returning to equities. This doesn't mean all of the stock gains in recent years have been an artificial "sugar high." Higher earnings have also been important. But it does mean that asset prices will reset based on the anticipation of more normal monetary policy and the return of real interest rates.

Keep in mind that no one really knows how this will turn out because there is literally no precedent for the monetary policy of the past decade. Mr. Bernanke and Ms. Yellen have left new Chairman Jay Powell the difficult task of reversing their Fed policy without tanking the economy. Eventually asset prices will find a new level that reflects economic fundamentals, but the process may be messy, as this week suggests.

The good news is that U.S. economic fundamentals are as strong as they've been since 2005, and maybe 1999. And in that sense the Trump-GOP policy mix of tax reform and deregulation is well timed. The Trump policies and faster growth around the world are crucial if we are going to keep the expansion going and live through the end of financial repression. We need supply-side incentives to drive growth to survive the Bernanke-Yellen monetary correction.

One irony of the current moment is that the Keynesians who presided over nearly a decade of secular stagnation are now worried that the economy is "overheating." Then again, they said faster growth wasn't possible, so they almost have to dismiss it.

Mr. Trump's instinct as a real-estate guy is always to want lower interest rates. But the more he demands low rates amid faster economic growth, the higher rates he is likely to see and sooner than he imagines. Faster economic growth and a tight labor market will mean rising wages for the working men and women who elevated him to the White House. Stocks will eventually adjust and follow a growing economy, and Mr. Trump needs to let the Fed continue on its path back to normal.

Document J000000020180210ee2a00026

THE WALL STREET JOURNAL.
U.S. EDITION

Weekend Investor: Third Avenue Fund Sinks Anew

By Justin Baer
345 words
10 February 2018
The Wall Street Journal
J
B5
English

Third Avenue Management LLC's Focused Credit Fund imploded in late 2015 when credit markets turned rocky. On Wednesday, Third Avenue told investors it marked down the value of its remaining positions by more than 50%.

The timing coincided with a selloff on Wall Street as the **Dow Jones Industrial Average** experienced its steepest weekly loss in more than two years.

But a person familiar with the matter said the move to lower the valuations had nothing to do with the recent market declines. Investors often move to lower the value of their holdings as the issuers of those securities restructure.

"This evening, the fund's published net asset value was $0.51, a reduction of $0.61 from its previous net asset value," Third Avenue wrote in its letter to investors on Wednesday.

"At this time, because of our confidentiality obligations, the fund is extremely limited regarding the information it may disclose regarding the NAV change. We will provide additional information when we are permitted to do so."

A junk-bond selloff in December 2015 forced Third Avenue to liquidate its Focused Credit Fund and suspend redemptions, a meltdown that deepened investor fears about the market's riskier debt securities and cost David Barse, the money manager's chief executive, his job.

Third Avenue has since sold nearly all of the fund's positions, returning nearly $590 million to shareholders. The fund managed $132 million as of Dec. 31, some 40% of which was cash.

The fund's largest remaining position, accounting for more than 58% of its assets as of December, was in Ideal Standard International SA, a Belgian maker of bathroom sinks and fixtures.

Ideal Standard bonds that mature in May last traded in November, dropping to $40 from $75, according to MarketAxess.

Ideal Standard didn't respond to an email seeking comment.

Third Avenue wrote that it would tell investors how it plans to return its remaining cash "within the next several months."

Document J000000020180210ee2a0001f

THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Overheard

176 words
10 February 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

Are these guys smoking something? Well, maybe, but the way that traders in marijuana stocks reacted to this week's **stock market** selloff only looks strange.

On Monday, the first time that the **Dow Jones Industrial Average** ever lost over 1,000 points in one session, cannabis companies defied gravity despite being risky on multiple levels. Such firms usually do worse than the market during tumbles, but a fund representing the industry, the ETFMG Alternative Harvest ETF, barely fell. Three days later, when the Dow had its second 1,000-point drop in history, the ETF fell but by less than half of what the index did in percentage terms.

The likely answer is that short sellers had targeted constituent companies such as Canopy Growth and MedReleaf, selling 7.5% and 8.9% of their available shares short, respectively. As traders took chips off the table, they probably rushed to buy back shares of pot stocks, of which they were skeptical.

page,5043

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Boring Is No Longer So Beautiful

By Aaron Back
263 words
10 February 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

Strategies that have protected investors in past selloffs aren't doing so now. In a rising rate environment, investors need to rethink where to seek shelter.

A selection of eight of the largest exchange-traded funds with strategies generally regarded as "defensive" -- comprising two low-**volatility** ETFs, four high-dividend or dividend appreciation ETFs, a consumer-staples fund and a utilities fund -- for the most part declined sharply in the five sessions through Thursday.

Granted, they had slightly outperformed the market, declining by an average 7.3% over the period compared with an 8.5% decline in the **S&P 500**. But customers are unlikely to be satisfied with that kind of performance from products sold to them as safe. Strikingly, among the worst performers have been the low-**volatility** funds.

All of these defensive funds have something in common: They tend to have high concentrations in sectors like consumer staples, utilities, and other high-dividend payers. The individual stocks these funds invest in are viewed as "bondlike" by investors for their steady businesses and high, dependable dividend yields.

This style of investing generally does well during an economic downturn or a market panic, but not in a rising interest-rate environment. That is a problem now because rising interest rates are a main cause of the selloff.

When actual bonds start paying decent rates, the appeal of "bondlike" stocks fades. If rates keep rising, this defense won't hold.

page,5043
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The New York Times

Strategies
Business Day

The Stock Market Has Turned Nasty. It Was Long Overdue.

By Jeff Sommer
1,439 words
9 February 2018
04:14 PM
NYTimes.com Feed
NYTFEED
English

Until this month, the scariest thing about the stock market was its uncanny calm and stability. Like the opening sequences of a classic horror movie, the market last year was relentlessly and unnaturally cheerful.

Well, now the ax has fallen and the stock market has begun a “correction” — financial jargon for a decline of at least 10 percent.

The scariest thing about the market right now is the shocked response of traders who had become accustomed to the unsustainably placid conditions that have been unceremoniously swept away.

The precise timing of the market plunge was a surprise, and it has evidently unnerved some investors. But while it may seem harsh to say so, after so many months of fizzy profits, a downturn was long overdue.

“The movements we’ve been having the last couple of weeks may not be pleasant but they are entirely normal, on a historical basis, “ said Ryan Detrick, a senior market strategist for LPL Financial.

Based on the historical record, “normal” in the stock market includes unsettling conditions of the kind we have been experiencing lately. More of the same is likely in the months ahead: gut-wrenching swings down as well as up, rather than the steady gains that evidently lulled some investors into complacency.

That is not a declaration that the market is in deep trouble. Far from it. I don’t know where stocks are heading in the weeks ahead, but I assume, based on history, that they will eventually rise. “Eventually” is a word with a lot of wiggle room, however. Markets tend to overshoot, up and down, and they could certainly plunge much further.

That said, a good argument can be made that the underlying stock market fundamentals today are better now than they were a few months ago. After all, the economy appears to be fairly strong in the United States and in much of the rest of the world, and corporate earnings have been rising. Higher earnings and cheaper stock prices are an appealing combination. Using classic definitions, stock valuations have markedly improved in just a few months.

Last summer, when stock valuations seemed too rich, I followed my own advice and began to rebalance my 401(k) portfolio, reducing the ballooning proportion of stock, increasing short-term bonds and cash. That kind of heightened caution still seems wise but stocks (in the form of index funds) are beginning to look more appealing.

Still, the current downturn is a harsh reminder: The stock market entails risk, pain and losses, and it isn’t for everyone. Whatever “normal” is, it is nothing like the benign stock market of late 2016 or 2017.

“What we have seen in the last week or two is minuscule compared with the amount of real risk that is coming in the months and years ahead,” said Salil Mehta, an independent statistician with deep experience in troubled markets and their consequences. He was the director of research and analytics for the federal Pension Benefit Guaranty Corporation and for the Treasury’s Troubled Asset Relief Program, which was set up to help stabilize the financial system in the 2008 crisis.

Mr. Mehta’s view, which I share, is that a stock market decline of the kind we have been experiencing was overdue and that there is probably even greater volatility ahead. My own admittedly hopeful perspective is that declines now may reduce and postpone extreme speculative excesses later. Such excesses eventually lead to big market crashes and real pain for the broader economy.

In that context, the marvelous market conditions of last year were dangerous precisely because they were so seductive. As I wrote in August, the **stock market** in 2017 was magical — so strangely sedate that it was statistically improbable. That relentlessly rising market was an outlier that could not be sustained.

Consider that since the election in November 2016 through January, stock returns, including dividends, increased every month. That was the longest such streak since 1928, when reliable records began to be kept, Mr. Detrick says.

And it's not just that stocks moved up every month. They did so on a daily basis in the gentlest and steadiest of fashions. The average daily change in the benchmark **Standard & Poor**'**s 500**-**stockindex** for all of 2017 was a mere 0.30 percent up or down. That is the lowest number — and the most stable market, based on that metric — since 1964.

No wonder the **stock market** seems so unsettling in 2018. Through Thursday, the average daily change, up or down, was 0.84 percent. That is a big increase. Yet going back to 1928, the average has been 0.75 percent. The current market, which has been depicted as wildly disruptive is, basically, just an average one, Mr. Detrick said.

Recall that in June 2016, after British voters said they wanted to leave the European Union, the stock markets fell into what seemed, at the time, to be a major panic. Less than a week after that vote, though, markets resumed their rise. Since then, the American market, measured by the **S**.**&P**. **500**, was in positive territory every single day — until the cumulative declines of 2018 pulled the index into the red on Feb. 5 and into a correction on Feb. 8. On Friday, the **S**.**&P**. **500** closed at 2619.55.

Even if the current downturn doesn't deepen, some sectors are already feeling severe pain. Traders who had bet that calm conditions would continue have lost fortunes. In just two days, the assets in two funds that trade in instruments linked to the VIX — officially, the Chicago Board Options Exchange**Volatility** Index — shrank from a combined total of $3 billion to about $150 million. There are few indications so far that trading losses in those instruments — or in the battered cryptocurrency markets — have damaged the overall financial system, but that is a worry in a serious downturn.

There have been major losses in the broader market, however. Through Thursday, the stocks in the **S**.**&P**. **500** had lost $5.2 trillion from the index's peak on Jan. 26, according to Howard Silverblatt, senior index analyst at S.&P. Dow Jones Indices. That is a staggering amount, but even with those losses, the **S**.**&P**. **500** through Thursday had swollen by $3.55 trillion since the 2016 election.

How far will the current market decline go? I wish I knew. One troubling factor is the change in the leadership of the Federal Reserve, with Jerome H. Powelltaking over as chairman on Feb. 3, succeedingJanet L. Yellen. In his confirmation hearings, Mr. Powell signaled a continuation of Fed policy, but the markets are testing him and it is not clear how he will respond.

The timing is awkward. The Fed has been tightening monetary policy while the federal government is loosening fiscal policy by cutting taxes, and then adding hundreds of billions of dollars in government spending in a last-minute budget deal on Friday. Furthermore, the Trump administration has been pushing for lighter regulation of **financial markets**. These shifts during a period of stress raise short-term risks for investors in stocks and bonds.

Bear markets in stocks — defined as downturns, from peak to trough, of at least 20 percent — rarely occur without a recession, and, at the moment, none is visible. That's one reason for Mr. Detrick's belief that the market is "probably getting fairly close to its bottom now."

While that history is comforting, the 20 percent threshold for a **bear market** is arbitrary, and the link between recessions and the **stock market** is not ironclad. The **bear market** of 1987 occurred without a recession, for example. And who would really be surprised if the unusual political conditions in the United States today fostered unexpected patterns in the economy and **stock market**?

What is safe to say is that the market has entered a new, troubling phase. The current turmoil may turn out to be blissfully brief, but it makes sense to be ready for the worst.

Follow Jeff Sommer on Twitter: @jeffsommer

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The floor of the New York Stock Exchange on Tuesday. | Sam Hodgson for The New York Times | Traders on the floor of the New York Stock Exchange on Thursday as the **stock market** plunged. | Spencer Platt/Getty Images

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