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Markets

U.S. Sanctions Give Russian Economy an Unintended Boost; For months, rising dollar-denominated oil prices, falling ruble have worked to Moscow's benefit

By Avantika Chilkoti
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Corrections & Amplifications

The MOEX Russia Index, Russia's main ruble-denominated **stock index** previously known as the MICEX Index, has risen 13% this year; an earlier chart incorrectly showed the share performance of Moscow Exchange MICEX-RTS, the exchange operator. Also, since the start of the year, the yield on a U.S. dollar-denominated Russian government bond maturing in September 2023 has risen to around 4.275% from around 3.28%; an earlier version of this article incorrectly said the bond matured in September 2012. (Oct. 16)

U.S. sanctions have driven the price of oil and the ruble apart—leaving Russia with expensive crude and a cheaper currency, a combination that is helping its economy.

The price of oil, Russia's main export, has risen almost 14% since mid-August. This is largely because of the coming resumption of U.S. sanctions against Iran, choking off the supply of crude from that country.

Meanwhile, the ruble has declined 15% since April, when Washington imposed sanctions on Russia for alleged meddling in U.S. elections and other aggressions.

So, just as the price of dollar-denominated oil rises, those greenbacks are worth more when translated back into a weaker ruble.

In recent days, oil and the ruble have changed directions again, with both crude and the dollar declining. But for months, the Russian economy benefited as a rising **oil price** and a falling ruble refilled government coffers and sent profit soaring at the country's giant energy groups. This year, shares of oil producers Rosneft Oil Co. and Lukoil Oil Co. are up 56% and 39%, respectively, handily outperforming Western peers.

"Russia is much better off with higher oil and a weaker ruble because, from a budgetary perspective, that's a double positive," said Viktor Szabo, emerging-markets debt-portfolio manager at Aberdeen Standard Investments.

Emerging markets generally have been hit by the rising U.S. dollar and interest rates, trade worries and domestic political concerns in individual countries such as Turkey. The ruble has the added weight of U.S. sanctions.

In August, the ruble fell further after the U.S. slapped further sanctions on Russia over an alleged nerve-agent attack in the U.K. and threatened to follow through with a second round of measures in 90 days' time if Russia doesn't meet a list of three criteria involving stopping the use of biological and chemical weapons.

The risk for the U.S. is that sanctions aren't having the intended effect, given how the combination of a weaker ruble and higher **oil price** is playing out.

At the end of last year, a barrel of oil brought in just over 3,835 rubles for Russian sellers, when translated back from the dollars it is sold in. Now, each barrel brings in 5,262 rubles, an increase of almost 40%.

Rosneft, the world's largest listed oil producer, is one of those reaping the benefit. It reported a near-50% increase in earnings before interest, tax, depreciation and amortization in the second quarter, compared with the previous three months.

The sanctions are also helping the country lower its foreign debt at a time it had started to rise for the government and companies, according to Société Générale. That is occurring both as the fall in the ruble deters issuers from taking on dollar-denominated debt and amid concern the U.S. will impose sanctions on trading in Russia's dollar debt.

Russian private and government debt held by foreign investors has been falling since 2016, reaching 32% of gross domestic product in the first quarter, according to Société Générale. Meanwhile, Russia's current-account surplus, a measure of its transactions with the rest of the world, has climbed to $18.3 billion in March, up from $14.6 billion in the previous quarter.

"Russia has adapted to low **oil prices** and sanctions impressively," analysts at CreditSights said in a note to clients. "Sovereign debt remains reasonably low, and the stock of external liabilities is now significantly lower."

To be sure, years of sanctions have hurt the Russian economy. A spate of Western penalties against Russia since Vladimir Putin's decision to annex Crimea in 2014 have wiped out half the ruble's value and reduced investment in the energy sector.

Some Russian markets have also suffered more recently. Since the start of this year, the yield on a U.S. dollar-denominated Russian government bond maturing in September 2023 has risen to around 4.275% from around 3.28%.

The weak currency is also feeding through into inflation, which the central bank expects to rise to as much as 5.5% by the end of next year, well above its 4% target. In September, the Russian central bank surprised markets with a quarter-point increase to 7.5% as it sought to target inflation.

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THE WALL STREET JOURNAL.

Business
BP Swimming in Cash as Earnings Soar on High Oil Prices; Oil giant says it's generating so much cash it will pay for its near $11 billion acquisition of BHP Billiton's onshore U.S. oil and gas assets entirely in cash

By Sarah Kent
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Corrections & Amplifications

The company will pay for its near $11 billion acquisition of BHP Billiton Ltd's onshore U.S. oil and gas assets entirely in cash. An earlier version of this article misspelled BHP Billiton.

LONDON—BP PLC said Tuesday its profit more than doubled in the third quarter, as strong crude prices put Big Oil on track to deliver record levels of cash this year.

London-based BP said its replacement cost profit—a number analogous to the net income that U.S. oil companies report—was $3.1 billion in the third quarter, compared with $1.4 billion in the same period a year earlier. Its underlying profits rose to $3.8 billion, a five-year high and roughly a third higher than analysts expected.

BP shares were up about 4% in early trading in London.

Exxon Mobil Corp., Chevron Corp. and Royal Dutch Shell PLC are all due to report results later this week.

Years of cost-cutting caused by the slump in **oil prices** are beginning to pay dividends for the industry's giants as the market rebounds. But investors remain skeptical, making solid delivery on results crucial for companies like BP.

Last week, French oil giant Total SA and Norway's Equinor ASA—formerly known as Statoil—both announced a sharp increase in earnings for the third quarter, while continuing to emphasize their commitment to control spending and grow production.

BP echoed that sentiment. The company said it remains committed to capital discipline and growing distributions to shareholders. The British oil giant has already delivered on popular shareholder programs, increasing its dividend in July.

BP said it's generating so much cash at the moment that, provided **oil prices** remain around their current range, the company will pay for its near $11 billion acquisition of BHP Billiton Ltd's onshore U.S. oil and gas assets entirely in cash. When the deal was announced in July, BP had planned to fund 50% of the purchase through equity.

"We're very confident in the outlook for the company," Chief Financial Officer Brian Gilvary said. "The **oil price** is currently north of $75; we break even at $50…we have more than sufficient surplus cash."

BP said it expects to complete the BHP transaction Wednesday. Linked to the deal, BP is planning $5 billion-$6 billion-worth of divestments, with the proceeds intended to pay down the company's debt.

It's also closing in on its ambition to return to production levels last seen before the company's fatal blowout in the Gulf of Mexico eight years ago. To pay for the disaster, which killed 11 people and caused the worst offshore oil spill in U.S. history, BP sold off billions of dollars of assets, shrinking its production. In addition to its acquisition of BHP's assets, BP started production from two new major projects this month.

"The key focus is growing the company," Mr. Gilvary said. "We laid out a program for 2021 with growth targets. We're ahead of those targets."

BP said payments related to the 2010 disaster amounted to $500 million in the third quarter, and are expected to total just over $3 billion this year. BP's landmark $20 billion settlement with the U.S. government in 2015 requires the company to make annual payments of around $1 billion through the end of the next decade.

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Related

* BP to Buy BHP Shale Assets for More Than $10 Billion (July 27, 2018)

* BP's Deepwater Horizon Bill Grows by $1.7 Billion (Jan. 16, 2018)

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WSJ PRO CENTRAL BANKING

US

Trump Takes Swipe at Fed as Stocks Tumble; President says Federal Reserve has 'gone crazy' on short-term interest rates

By Vivian Salama and Nick Timiraos
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President Trump put the Federal Reserve at the middle of Wednesday's **stock-market** selloff just minutes after the White House issued a statement playing down the drop by pointing to solid economic fundamentals.

"The Fed is making a mistake," Mr. Trump told reporters in Erie, Pa., after stock markets suffered their biggest decline in more than seven months. "I think the Fed has gone crazy."

Mr. Trump has for weeks grumbled about the central bank's campaign to gradually lift short-term rates, which the Fed has been doing to guard against inflation and economic overheating. Wednesday's comments were the first time he said the Fed had been responsible for inflicting market losses.

Of the **stock market**, he said, "Actually, it's a correction that we've been waiting for, for a long time. But I really disagree with what the Fed is doing, OK?"

The Fed has raised its benchmark short-term interest rate three times this year, most recently last month by a quarter-percentage-point to a range between 2% and 2.25%. Officials have indicated they expect another percentage point in rate increases will be needed to keep the economy on an even keel through 2019.

Earlier Wednesday, the White House said in a statement that the "fundamentals and future of the U.S. economy remain incredibly strong," and ticked off positive news on employment and other measures.

Mr. Trump has regularly pointed to the **stock market**'s gains as validation of his economic policies.

A Fed spokeswoman declined to comment on Wednesday. Fed Chairman Jerome Powell said last week the Fed's nine-person rate-setting committee is guided solely by its reading of economic data when it fashions a consensus around where to set its policy rate. "This is just who we are and, I think, who we'll always be," he said, dismissing concerns that politics would enter into officials' decision-making.

Expectations of stronger growth are one reason why stock investors have followed bond markets in realigning their expectations for how much further the Federal Reserve will raise interest rates.

The Fed will go further than previously expected, investors increasingly believe, though expectations for policy inside the Fed itself haven't notably shifted in recent weeks.

Bond markets slumped last week, sending up yields on long-term Treasury bonds, after a string of strong economic data provided firmer evidence that the Fed could continue to raise rates.

An increased supply of Treasury debt, stemming from a rising federal budget deficit, is another reason analysts say yields have moved higher this year. Last week, yields on the benchmark **10**-**year Treasury** climbed to their highest levels since May 2011 as investors took more seriously the prospect of future rate increases amid stronger economic growth.

For most of the last two years, investors have generally expected fewer increases in short-term rates than those signaled in quarterly projections by central bank officials themselves.

When the Fed raises rates, it is trying to influence financial conditions—as reflected in the values of stocks, bonds, currencies, real estate and other assets. Until recently, these conditions have remained easy, making stocks and bonds more valuable, even though the Fed began to raise short-term interest rates three years ago.

The 10-year yield, which incorporates expectations for interest rates, inflation, economic growth and other factors, rose to 3.227% last Friday, a seven-year high, as investors began to anticipate that the Fed would deliver on more rate increases.

"There is a repricing going on. It is not that big," said Roberto Perli, an analyst at Cornerstone Macro.

On Wednesday, it was the **stock market**'s turn to adjust its expectations. "There is a lagged acceptance of the Fed's certainty that they can get to 3.25% without slowing the economy," said Jim Vogel, an interest-rate strategist at FTN Financial.

Fed officials haven't telegraphed changes to their rate strategy in recent days, but they have reinforced their plans to continue raising rates.

Last week, Fed Chairman Jerome Powell observed that the central bank "probably" had a "long way" to go before its benchmark short-term interest rate could be considered neutral—meaning that it is neither so low that it is spurring very fast growth or so high that it is slowing growth down. His suggestion that it was a long way from neutral could be taken as a sign he sees more rate increases to come, though several Fed analysts said markets had overreacted to his comment.

Then on Wednesday, New York Fed President John Williams said he believed the central bank's current quarterly path of rate increases would reach such a neutral setting in "the next year or so," another indication of more rate increases to come.

The comments helped to dismantle market speculation that had crept in this summer about the potential for the central bank to pause from its rate-raising campaign earlier than mid-2019.

One important factor for the Fed will be the behavior of inflation in the months ahead. A shortfall of inflation could spur the Fed to slow its campaign, but inflation near or above the Fed's 2% target could encourage officials to keep going in an environment of very low unemployment.

It also isn't clear how the Fed will respond once it gets to a neutral rate setting of around 3% or a bit higher. Typically, the Fed has lifted the rates higher than neutral in a fast-growing economy to prevent it from overheating. If inflation and asset prices are modest, the Fed could stop near neutral.

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Economy
Bond Investors Catch Up With Fed's Plans; Strong economic data erase doubts about Fed's tightening timetable

By Paul Kiernan
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The bond market is starting to believe the Federal Reserve.

Investors sold off U.S. government bonds Friday after fresh data showed the labor market continued to tighten in September, more reason for the Fed stick to its plans to keep gradually raising interest rates.

The U.S. unemployment rate fell to 3.7%, its lowest level since 1969, the Labor Department reported Friday. Average hourly earnings, meanwhile, rose a seasonally adjusted 0.3% from August—the third straight month of solid, inflation-beating gains.

The news pushed up the yield on the **10**-**year Treasury** note, which had already surged to a multiyear high earlier this week on strong economic data. Yields rise as **bond prices** fall.

The 10-year yield—which incorporates expectations for interest rates, inflation, economic growth and other factors—rose to 3.227% from 3.196% Thursday. A week ago, on Sept. 28, the yield was 3.062%.

The market movements indicate many investors are likely resetting their expectations for the path of Fed rate increases in light of the brightening economic picture.

"In the wake of a financial crisis, the market has seen more downside risks over time than upside risks," said Matthew Hornbach, global head of interest-rate strategy at Morgan Stanley. "I think the data that we've had over the past two months has led investors to reassess their view over the medium to long term."

Fed officials raised their benchmark short-term rate last week and penciled in four more quarter-percentage-point increases through the end of 2019. That would lift the rate to a range between 3% and 3.25%. Until recently, many investors doubted the Fed would go that far.

Last Friday, Sept. 28, futures contracts suggested investors believed the Fed was unlikely to raise rates more than two more times through October 2019, according to CME Group. After the September jobs report was released, the probability of at least three rate increases by next October was seen at 59.3%.

The Fed is raising rates to keep the economy from overheating, which could send inflation too high or fuel dangerous asset bubbles.

Some economists worry the tight job market will lead to accelerating wage growth, which companies might pass on to consumers in the form of higher prices. If inflation shows signs of going too far above the Fed's 2% target, the central bank would raise interest rates faster than it plans, potentially choking the economy.

Fed Chairman Jerome Powell, in a speech Tuesday, said this risk was unlikely to materialize. Inflation shows little sign of picking up, he said, while expectations for prices increases are well anchored.

He said a recent pickup in wages and compensation has happened "in a way that is quite welcome."

"The rise in wages is broadly consistent with observed rates of price inflation and labor productivity growth and therefore doesn't point to an overheating labor market," Mr. Powell said. "Further, higher wage growth alone need not be inflationary."

Speaking Friday on Bloomberg TV, New York Fed President John Williams echoed Mr. Powell's sentiment, saying the recent uptick bond yields doesn't appear to suggest inflation fears among market participants. Rather, he said, they reflect an increasingly favorable view of the economic outlook.

As for the drop in the unemployment rate last month, Mr. Williams said, "It doesn't scare me at all. It's great for the American people."

Paul Kiernan

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Heard on the Street
Goldilocks Could Be Bear for Stocks

By Justin Lahart
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[Financial Analysis and Commentary]

Investors spend a lot of time worrying about what might happen if the Federal Reserve gets the economy wrong. Maybe they should worry about what might happen if the Fed gets it right.

The Fed has been raising rates steadily and, with the economy strong and unemployment at 3.7%, more increases seem like a foregone conclusion. It is a situation that gives rise to two obvious risks. One is that Fed policy makers' current pace of tightening -- they have been increasing rates every other meeting -- will end up being more than the economy can bear. The other is that they aren't tightening fast enough, putting the economy at risk of overheating. In either case, the eventual outcome would be a downturn.

Obviously, Fed policy makers would like to strike the correct balance. Their projections show how they think that might happen, so investors should consider what those projections, if they came true, would mean for stocks.

On balance, policy makers expect to raise rates four more times by the end of next year. The economy will slow, with gross domestic product up 2.5% on the year in the fourth quarter of 2019. The unemployment rate will drift a bit lower to 3.5%, and inflation will come in at 2%.

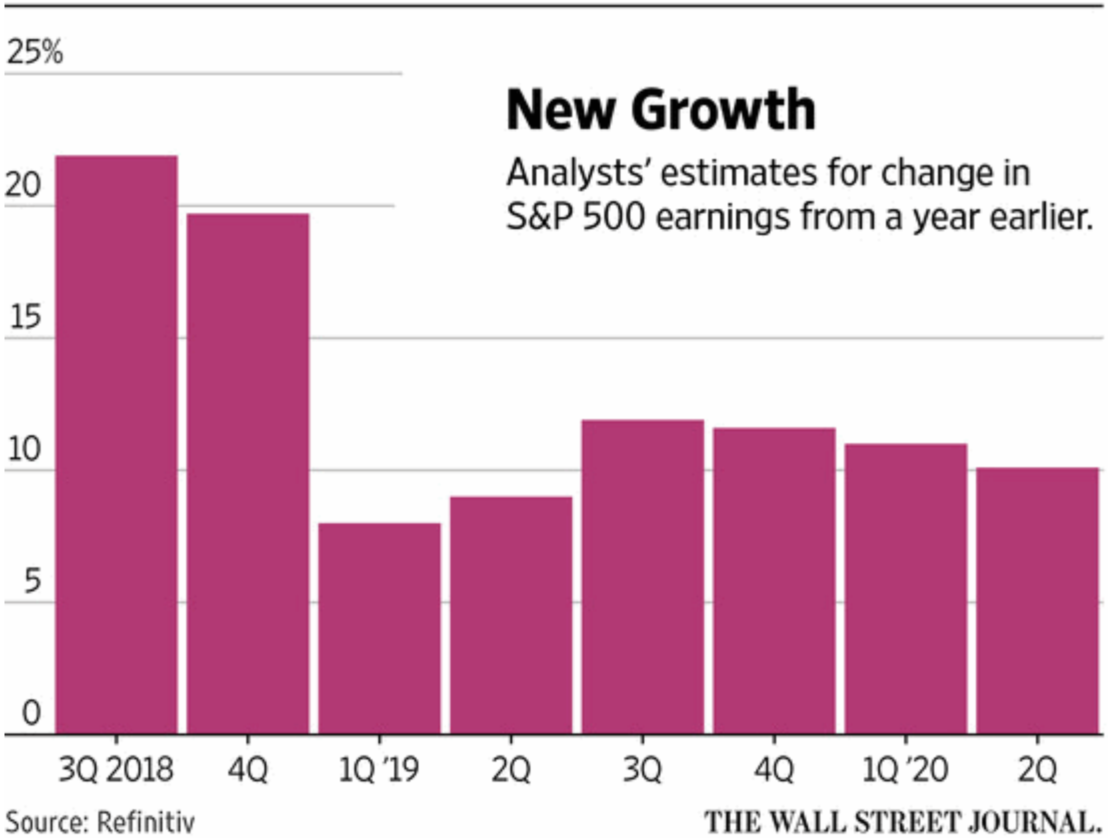
What is the outlook for companies under that scenario? If their demand grows about as fast as the economy, adding in inflation, sales would be up about 4.5% in the fourth quarter of next year. So the only way for profits to grow at a faster clip would be for profit margins to expand.

That seems like a bad bet. Even after adjusting for the effects of this year's tax cut, profit margins for companies in the **S&P 500** are historically quite high. Then consider how hard it would be to contain, much less cut, labor costs with an unemployment rate at 3.5%.

But while Wall Street analysts' revenue expectations are in keeping with the Fed's projections, they expect earnings will grow 11.6% in next year's fourth quarter, according to Refinitiv. Judging by stocks' relatively high valuations -- the **S&P 500** is trading at 16 times expected earnings -- investors also have heady expectations for profits.

Meanwhile, interest-rate futures imply that investors think the Fed will have raised rates only three more times, rather than four, by the end of next year. The only way it seems like that could happen is if the economy -- and therefore profits -- fares worse than the Fed expects.

So not only do earnings expectations seem high, but rate expectations are low relative to the Fed's projections. Both those things present a challenge to valuations. If the central bank is right about the economy, things could go quite wrong for the **stock market**.



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WSJ PRO CENTRAL BANKING

Markets
China Sets Official Yuan Rate at Weakest in a Decade

By Saumya Vaishampayan and Mike Bird
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China guided the yuan to its weakest official level in a decade on Tuesday—a move that could fuel expectations of a further, self-reinforcing slide.

The yuan's depreciation puts pressure on Chinese policy makers, who want to give investors a bigger say in determining the currency's value but appear uncomfortable with letting the yuan fall beyond a symbolic seven to the dollar. The recent slide has reignited speculation about whether further weakness could spark capital flight, which would in turn exacerbate the currency's swoon.

On Tuesday, the central bank set the dollar's reference rate at 6.9574 yuan, putting the Chinese currency at its weakest since May 2008. The yuan slid to a decade low once mainland trading started 15 minutes later, with one dollar buying as many as 6.9724 yuan, according to Wind.

The yuan has been hit this year by an economic slowdown, which could be worsened by U.S. tariffs on hundreds of billions of dollars of Chinese goods, as well as the diverging outlook for monetary policy in the two economies.

The People's Bank of China sets a daily reference rate for the dollar against the yuan in the domestic market and allows it to trade in a range around that level. The rate partly depends on where the currency pair closed the day before and overnight market moves. But the central bank also has some discretion, allowing it to downplay sharp swings.

As the yuan gets close to breaking the seven-per-dollar level, currency traders at China's big four banks as well as some government advisers say the PBOC is unlikely to let that happen without putting up a fight.

Pan Gongsheng, a vice governor at the central bank, on Friday effectively warned investors to stop betting against the currency. His comments led to a short-lived bounce in the yuan.

China's central bank has in the past targeted **bearish** investors, or short sellers, by making offshore borrowing costs for the yuan prohibitively expensive. It has also resorted to outright intervention, dipping into its hoard of foreign-exchange reserves to defend the yuan in 2016.

So far this year, the central bank has largely refrained from propping up the currency by selling dollars and buying yuan. Chinese officials say this shows Beijing is allowing markets greater sway. But this also comes when a weaker yuan suits Beijing's interests, since a cheaper currency makes Chinese products more competitive abroad.

The yuan's move against the dollar this year has partly been driven by the broader strength of the greenback: against a basket of 24 currencies, the yuan has declined by just 2.7% this year, compared with a fall of 6.7% against the dollar.

Some analysts have become gloomier in recent months. U.S. banks including Bank of America, JPMorgan and Goldman Sachs expect the yuan to depreciate beyond seven per dollar in the coming months.

Similarly, demand for options that protect against a weaker yuan in the next month has ballooned recently to one of the strongest levels in the past two years, based on a measure known as a risk reversal, which compares the prices of put and call options.

Chinese commercial banks sold a net $17.6 billion of foreign exchange in September, the most in 15 months, official data showed last week, adding to signs of increasing capital outflow pressure.

Lingling Wei contributed to this article.

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THE WALL STREET JOURNAL.

Markets

IPO Market Has Never Been This Forgiving to Money-Losing Firms; Money-losing companies are going public at a record rate as investors hunger for new issues

By Corrie Driebusch and Maureen Farrell
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Stock investors are welcoming money-losing companies into the public markets this year with open arms.

About 83% of U.S.-listed initial public offerings in 2018's first three quarters involve companies that lost money in the 12 months leading up to their debut, according to data compiled by University of Florida finance professor Jay Ritter. That is the highest proportion on record, according to Mr. Ritter, an IPO expert whose data goes back to 1980.

Some analysts and market watchers are concerned. They see similarities with the dot-com bubble of nearly two decades ago that left many investors with enormous losses. The prior high-water mark for money-losing companies going public was 2000, when 81% of **stock-market** debutantes were unprofitable, according to Mr. Ritter's data.

Kevin Landis, chief investment officer of tech-focused Firsthand Capital Management, said he is wary of money rushing into unprofitable companies. "The lesson from 2000 is don't chase what everyone else is chasing," he said.

There are differences from back then. By one measure, the current class of technology IPOs is in a bit better shape than that of the dot-com era: In 2000, just 14% of tech companies listing shares in the U.S. were profitable, compared with 19% so far this year, according to Mr. Ritter's data.

And the warm welcome today is being extended to more than just money-losing internet and tech companies. A surge in biotech offerings has pushed up the current tally of newly traded companies without earnings.

Investors' tolerance for red ink has been rewarded so far in 2018. Stocks of money-losing companies listing in the U.S. soared 36% on average from their IPO price through Thursday. That is better than the 32% return for IPO stocks with earnings and the 9% gain for the **S&P 500 index**.

The euphoria has powered a surge in new listings. More than 180 companies raised over $50 billion in IPOs in the U.S. in the first three quarters, putting 2018 on track to be the busiest year for new issuance by both measures since 2014, according to Dealogic. That year, IPOs jumped thanks in part to Alibaba Group Holding Ltd.'s $25 billion offering as well as a surge in biotech companies going public.

This past Wednesday, online-survey provider SurveyMonkey's parentSVMK Inc., which hasn't had a profitable year and posted a $24 million net loss in 2017, jumped more than 40% in its debut after pricing above its targeted range. Shares of Tilray Inc., an unprofitable Canadian cannabis retailer that is one of the few pot companies listed in the U.S., soared more than 800% since its Nasdaq debut this summer.

Meanwhile, biotechnology companySolid Biosciences Inc., which hadn't yet generated revenue—let alone earnings—informed the market ahead of its January IPO that one of its clinical trials was put on hold. Investors ignored that potential red flag and the company raised $144 million. Its stock has nearly tripled since then.

Helping explain investors' hearty appetite is that, even with the uptick in IPO volume, the number of public companies overall has been in historic decline and many of the hottest startups of recent years, such as Uber Technologies Inc. and Airbnb Inc., are staying private longer. As a result, there has been a feeding frenzy around companies that do go public, as many of them have outsize growth prospects.

Mr. Ritter's figures exclude companies that don't list on major exchanges, real-estate investment trusts, and blank-check companies, which typically use the money raised in an offering to acquire assets.

Many of the companies with negative earnings that listed shares during the dot-com era, such as internet-services provider Genuity Inc. and Viasystems Group Inc., a maker of circuit boards, didn't live up to their promise; both companies filed for bankruptcy protection in 2002.

Mr. Landis of Firsthand Capital Management said some companies may be more eager to go public without earnings rather than wait until they have small profits—and a lopsided price-to-earnings ratio, something he refers to as the valley of death.

Not all IPO stocks have fared well lately. ADT Inc., which priced well below the middle of its initial target range in January, fell 12% in its first day of trading and now the security company's shares are down more than 30%.

Among big money-losing companies to go public in recent years is Snap Inc. The Snapchat parent's stock, which made its debut early last year, is down by roughly half from its IPO price as growth has disappointed investors and it suffered an exodus of key executives.

"The problem with young growth companies where investors have built in really optimistic assumptions is if the company doesn't deliver, it can get revalued in a heartbeat," Mr. Ritter said.

For now, investor fear of missing out on a rally is trumping such concerns, as major stock indexes trade near records.

Zander Lurie, chief executive of SurveyMonkey's parent, said investors were likely willing to overlook the company's net losses because it has strong cash flow. Profitability for the 19-year-old company is still likely several years away, he said in an interview.

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Economy
Bank of Japan Warns of Pressures From Global 'Protectionist Moves'; Policy board votes to maintain short-term interest rates at minus 0.1%

By Megumi Fujikawa
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TOKYO—The Bank of Japan kept its ultra-easy monetary policy in place and cited U.S.-China trade tensions as one of the biggest risks for the Japanese economy.

"As protectionist moves and trade friction between the U.S. and China escalate, we pay the most attention to the downside risk that they could pose to their own countries and also global trade and the world economy," said BOJ Gov. Haruhiko Kuroda at a news conference.

The BOJ's policy board voted 7-2 on Wednesday to maintain its main policies, including setting short-term interest rates at minus 0.1% and the target for the 10-year Japanese government **bond yield** at around zero. The BOJ reiterated that it would keep "extremely" low interest rates "for an extended period."

Mr. Kuroda said the BOJ's recent corporate survey and discussions with companies found limited effects so far from U.S.-China trade frictions but they could eventually affect sentiment and destabilize **financial markets**.

Mitsubishi UFJ Morgan Stanley Securities economist Shuji Tonouchi said uncertainties caused by trade friction would make Japanese companies more hesitant to raise wages at annual negotiations early next year. The Japanese central bank believes a virtuous cycle of strong corporate earnings and higher wages will lift Japan's inflation eventually.

The BOJ governor said the bank would take additional easing action—such as rate cuts and expansion of monetary base or asset purchases—if downside risks materialize. He said that isn't the bank's main scenario.

The bank's policy board projected core consumer prices—excluding fresh food—would rise 0.9% in the year ending March 2019, compared with the previous forecast for a 1.1% increase. It stuck to its view that inflation won't reach the BOJ's 2% target until at least March 2021.

Also Wednesday, the BOJ retained a promise to buy government bonds at an annual pace of around ¥80 trillion ($707 billion), although the actual pace of JGB purchases fell to around ¥43 trillion in the most recent 12-month period.

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THE WALL STREET JOURNAL.

Markets
Emerging Market Currencies Rebound, but Risks Remain; U.S. interest rates and a strong dollar saw emerging market currencies spiral through the summer

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Emerging market currencies are recovering as U.S. Treasury yields and the dollar falls back from the highs that sparked sharp falls across the developing world.

Still, investors expect further **volatility** for emerging markets, given continued trade tensions between the U.S. and China and uncertainty over global economic growth.

From the end of April to August, the Turkish lira and Argentine peso fell by about 40% and 50% against the dollar respectively. The lira has gained 20% since its August low, while the peso is up 15% since that month. The Mexican peso, Russian ruble and South African rand are also higher, while the Indian rupee's steep decline appears to have abated.

Emerging market currencies spiraled lower through the summer as U.S. interest rates and the greenback rose, making dollar-denominated debt more expensive and risk-free Treasury yields more attractive. Trade tensions added to the negative conditions, as did domestic troubles in countries like Argentina and Turkey.

But the WSJ Dollar Index, which tracks the greenback against a basket of 16 other currencies, has fallen by nearly 1% since the beginning of October, while the **10**-**year Treasury** yield has fallen back from 3.24% to 3.16% during that period.

"The dollar has been on the back foot against its major counterparts over the past week, with the pullback in the 10-year [U.S.] yield offering support for higher-yielding currencies," said Kenneth Broux, a currency strategist at Société Générale in a research note on Tuesday.

Investors' belief that trade tensions between the U.S. and China are easing has also fueled the decline.

For Turkey, the release of U.S. pastorAndrew Brunson last Friday helped send the lira to a two-month high against the dollar on Monday. U.S. sanctions related to Mr. Brunson's detention on terrorism charges had added further pressure on the lira.

On Wednesday, Turkey was able to issue its first bond since April.

Fund managers remain cautious on the lira, however. Turkish inflation continues to rise, yet investors don't believe the central bank will tackle it with further interest rate rises. The country's foreign-denominated debt is the highest in the developing world, at about 70% of gross domestic product.

Instead, many investors say they like the South African rand and the Mexican peso. The deal between Mexico, the U.S. and Canada to revise the North American Free Trade Agreement lifted pressure off the peso, and analysts say government bond yields still offer high returns.

The yield for a 10-year South African government bond was last at around 9.21%, one of the highest in the in emerging markets, outside of Turkey and Argentina, which investors believe carry a lot more risk.

South Africa's 10-year government bond yields are "hard to beat," said Esther Law, an emerging market debt fund manager at Amundi Asset Management.

To be sure, the emerging market recovery may be temporary, analysts say. The U.S. economy remains strong and the Federal Reserveis expected to continue raising rates.

While the yield on 10-year Treasurys has fallen back, it is still above the levels it was during the summer.

Trade tensions between the U.S. and China also haven't gone away and questions remain over growth in emerging markets.

"The external factors that contributed to the summer selloff in emerging markets remain," ING analysts wrote in a note on Wednesday.

Write to Olga Cotaga at Olga.Cotaga@wsj.com

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THE WALL STREET JOURNAL.

Markets

Commodities Investors Enter October Bracing for Losses; October has been the worst month for gold, silver and Brent and the second-worst month for U.S. crude and copper

By Amrith Ramkumar
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October got off to a bumpy start for many commodities markets, and history shows things could get worse.

October has historically been the worst month for gold, silver and Brent—the global benchmark for **oil prices**—according to an analysis going back to 1990 by Dow Jones Market Data. October also is the second-worst month for U.S. crude and copper, as well as the only month during which gold, silver and copper have all three posted losses on average.

That is causing commodities investors to worry in a year that has already been roiled by simmering trade tensions between the world's two biggest economies. Copper and silver are down about 15% this year on concerns that a trade dispute will crimp demand for the metals. Meanwhile, gold has fallen 9% on expectations of higher interest rates. The precious metal struggles to compete with yield-bearing assets when rates rise.

On Monday, the most-active silver futures fell 1.4% to $14.507 a troy ounce. Gold sank 0.4% to $1,191.70, while copper shed 0.6% to $2.7975 a pound. Other industrial metals including nickel and lead fell on the London Metal Exchange. The declines came after weekend data showed the Caixin China manufacturing purchasing managers index, a gauge of economic activity in the country, fell in August to end 15 straight months of expansion.

Tighter supplies have boosted prices of Brent and West Texas Intermediate, the benchmark for U.S. crude, this year. But even oil markets were on a wild ride at times over the summer because of the trade spat between the U.S. and China, as well as signs of weakness in emerging markets.

It doesn't help investor confidence that the autumn months tend to be a tricky time for other risky markets. Since 1990, October has actually been the second-best month for the **S&P 500**, with gains averaging 1.7%. But some of the most infamous **stock-market** crashes ever have also happened in October: 1929, 1987, and a smaller but more recent tumble in 2014. These episodes scarred investors, making them jittery during this period.

There are also events on the horizon that could stir up more unrest for **financial markets**: November meetings between U.S. and Chinese leaders aimed at resolving the monthslong trade spat and U.S. congressional elections on Nov. 6.

"The trade fight is the main aspect the markets will look at," said Edward Meir, a consultant at broker-dealer INTL FCStone. "If there's pressure, it will come from that side of it."

Paradoxically, adding to the worries of materials markets is the robust U.S. economy and the investors who have been flocking there for its relative safety. The country's favorable economic data have pushed investors to the dollar and benchmarks such as the **S&P 500**.

A stronger dollar makes materials denominated in the U.S. currency more expensive for overseas buyers. The WSJ Dollar Index rose for a fourth consecutive session on Monday, and some analysts think it could climb further. October has traditionally been kind to the dollar, so a continuation of that trend also could signal more pain for commodities ahead.

Kenny Jimenez contributed to this article.

To receive our Markets newsletter every morning in your inbox, click here.

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International New York Times

opinion
How Trump Could Fatally Weaken the Dollar

By Eswar Prasad
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The United States dollar seems to be under threat from multiple quarters. Countries that have been hit by American sanctions, such as Iran and Russia, economic rivals like China, and even allies in the European Union want to shake off the dollar's tight grip on global finance.

For now, they are out of luck. The American economy and **financial markets** are the largest in the world, and there are no good alternatives.

In the long run, however, the rest of the world might get its wish. The dollar's status as the dominant global reserve currency is the result of faith in America's strong institutions. This includes the checks and balances among different arms of government, the rule of law and an independent central bank. These institutions have proved durable and earned the trust of global investors, who see the dollar as a safe haven in troubled times. But President Trump and his acolytes are undermining those very institutions with their words and actions.

Other countries have long chafed at the dollar's dominance in global finance. Nearly two-thirds of the foreign exchange reserves held by the world's central banks', essentially their rainy-day funds, are held in dollars. It is the currency used to denominate and settle a significant part of international financial transactions. Almost all commodity contracts, including those for oil, are priced and settled in dollars.

This gives the United States a lot of power. Since dollar transactions usually involve the American banking system, the United States government can put a chokehold on countries like Iran and Russia by limiting their access to global finance.

Emerging markets' fortunes remain tied to the dollar. In the aftermath of the financial crisis, when interest rates in the United States fell toward zero, investors looking for higher yields poured money into emerging markets, causing sharp increases in stock prices and inflation. When the Fed started raising interest rates, capital quickly fled. Countries such as Turkey, India and South Africa, which have borrowed extensively in dollars, face another problem. When American interest rates rise and the dollar strengthens, their debt burden becomes worse.

Emerging markets are keen to shift away from a dollar-dependent global financial system so they are not subject to the spillover effects of the Fed's actions. China and Russia are setting up their own payment systems to lessen their dependence on American banks. Eurozone officials are eager to do the same so their banks are not held hostage, as they see it, by regulators in the United States.

In the past, none of this would have made a dent in the dollar's dominance. No other country has the unmatchable combination of size, trust and influence enjoyed by the United States. The global ripple effects of last week's **stock market** fluctuations were a clear illustration.

But the Trump administration, and its allies in Congress, are wreaking havoc on the institutions that have made the dollar dominant for so long.

Republicans in Congress have abrogated their role to act as a check on the powers of the President. They have merrily gone along with harmful economic policies, including tax cuts that will add at least $1 trillion to government debt when the economy is doing well and needs no help from the government. And they have willingly accepted weakening of regulation on banks and other parts of the economy, raising the risks of **financial market** problems in the future.

The rule of law is being eviscerated by an administration that is openly venal and sees itself as above the law. And stacking the courts with judges who are chosen for their willingness to advance a particular agenda is eroding confidence in the judicial system.

Finally, Mr. Trump's open attacks on the Federal Reserve could hurt its credibility. Households, firms and investors trust the Fed to do what's necessary to manage inflation, even if that means taking politically unpopular decisions such as raising interest rates when the economy is growing fast. When the president says that the Fed is "crazy" and "out of control" or comments that he is "not happy" or "disappointed" with the Fed's rate decisions, he could cause irreparable damage. Investors' confidence in the Fed as an institution that is unmoved by shifting political winds is essential to keeping the dollar strong.

The dollar's dominance may outlast the Trump era, but it is not inevitable. If the president continues to hack away at America's institutions, the dollar, too, will suffer. This might end up becoming one of the biggest scars the administration leaves on the American economy.

PHOTO: President Trump escalated his attacks on the Federal Reserve after recent **volatility** in the **stock market**. (PHOTOGRAPH BY Chris Wattie/Reuters FOR THE NEW YORK TIMES)

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Economy
U.S. Consumer Confidence Surged in October to 18-Year High; Strong employment growth buoys consumers' assessment of economic conditions

By Sharon Nunn
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Corrections & Amplifications

The unemployment rate is 3.7%, the lowest level since 1969. An earlier version of this article incorrectly stated it was the lowest level in almost two decades. (Oct. 30, 2018)

WASHINGTON—A measure of U.S. consumer confidence rose in October to an almost two-decade high, as Americans expected economic and jobs growth to power ahead despite recent **stock-market volatility**.

The Conference Board on Tuesday said its index of U.S. consumer confidence rose to 137.9 in October, the highest level since September 2000.

At the same time, U.S. stocks have dropped since the beginning of October. Private analysts and the Federal Reserve think an economic slowdown is looming.

"While market participants seem to be extremely eager to call for a recession, consumers have a brighter view of the landscape," Stephen Stanley, chief economist at Amherst Pierpont Securities, said in a note to clients.

Americans' assessment of present conditions remained positive, primarily because of strong employment growth, according to Lynn Franco, senior director of economic indicators at the Conference Board.

"The Expectations Index posted another gain in October, suggesting that consumers do not foresee the economy losing steam anytime soon," she said. "Rather, they expect the strong pace of growth to carry over into early 2019."

Stocks tend to be held by wealthier Americans, and job prospects appear to matter more to lower income consumers when gauging sentiment; the jobless rate is at the lowest level since 1969, potentially explaining the **stock market**-sentiment disparity.

Indeed, Richard Curtin, chief economist of another sentiment survey done by the University of Michigan, said last week his consumer survey is increasingly driven by jobs growth. That gauge ticked down in October but remained elevated.

The Conference Board's October survey found the proportion of consumers expecting fewer jobs in the coming months declined and the percentage of consumers foreseeing an improvement in income prospects rose.

Despite an apparently slowing housing market and rising interest rates, the proportion of consumers who say they plan to buy a home in the next six months rose in October. A larger proportion of Americans said they planned to buy a car in the coming months.

"That provides some reassurance that spending in the most rate-sensitive areas of consumption is not about to fall off a cliff, though note that in every case, those balances are still below their recent peaks," according to Michael Pearce, senior U.S. economist at Capital Economics.

Measures of how consumers feel about the economy climbed after President Trump was elected in 2016 and have been buoyed by strong economic growth, low unemployment and rising wealth. Gross domestic product grew at the fastest pace in nearly four years in the second quarter and continued to grow at a solid 3.5% annual rate from July through September.

Still, **stock-market** movements and other headwinds could muddy the economic outlook, with rising interest rates, trade tensions and political uncertainty threatening the recent spurt of robust economic growth.

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

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THE WALL STREET JOURNAL.

Economy
Behind Market Turmoil, Potentially Good News; Interest rates are far below historical definitions of normal. Optimistic analysts believe the economy could have years left to run.

By Greg Ip
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Bond yields are a barometer of where investors think growth and inflation are going—which, for much of the last decade, has been nowhere fast. In that sense, the run-up in long-term interest rates that rattled the **stock market** this week is good news. With both growth and inflation looking much healthier, the Federal Reserve and investors have concluded that interest rates also need to return to more normal levels.

If all goes according to plan, the **stock market** selloff will prove to be a temporary bout of indigestion.

After the financial crisis, the economy struggled to grow more than 2%, and inflation repeatedly fell short of the Fed's 2% target. In response, the Fed cut interest rates to close to zero and bought long-term bonds to bring down long-term interest rates.

By 2017, the recession's restraining effects on risk-taking had faded, the global economy was in a synchronized upswing, and the election of Donald Trump boosted business confidence. Congress slashed taxes and **oil prices** climbed, fueling business investment and household spending. Growth has climbed to 3% over the past year, unemployment has fallen to a 49-year low of 3.7%, and inflation has returned to 2%.

Still, interest rates are far below historic definitions of normal. The Fed's short-term target, at 2% to 2.25%, remains "a long way from neutral," a level that sustains growth without fueling inflation, Fed Chairman Jerome Powell said last week.

Bond investors have belatedly reached the same conclusion, pushing yields on **10**-**year Treasury** notes up to 3.1%. That is still lower than where 3% growth and 2% inflation would historically predict.

When bond yields are rising toward normal, stocks tend to sink, but only temporarily, says Roberto Perli, an economist at Cornerstone Macro, an investment advisory, citing precedents in 1994, 2006 and this past February. The real problem is when stocks sell off amid falling bond yields, he said. That tends to precede recession.

Nonetheless, the market drop did contain warning signs for an expansion already looking long in the tooth.

The behavior of stock, bond and commodity markets last week showed investors' main concern that higher **oil prices** would feed into inflation and interest rates, says Charles Himmelberg, chief markets economist at Goldman Sachs. This week, he saw more evidence from those markets that investors are retreating from risk and worrying about economic growth; for example, bond yields actually dropped Wednesday and Thursday. They edged higher Friday as stocks rebounded.

The current expansion is now the second oldest in U.S. history and within a year will be the longest, reason enough to question its longevity. Many conditions that preceded previous recessions are present: Unemployment is below 5%, a sign the economy has little unused slack; **oil prices** are rising; the Fed is tightening; and interest-sensitive home sales have softened.

In its semiannual outlook released this week, the International Monetary Fund said the U.S. economy is already operating above its normal capacity, and the fiscal boost coming from lower taxes and increased spending "could lead to an inflation surprise," triggering rapid rate increases, global financial turmoil, and a stronger dollar, all bad for global growth. It says Mr. Trump's higher tariffs, in particular on Chinese imports, and resulting retaliation, could further hurt growth. J.P. Morgan estimates tariffs could temporarily boost inflation 0.2 to 0.3 percentage points next year.

One pessimistic scenario is that the threat of inflation from tight labor markets, higher **oil prices** and tariffs will spur the Fed to raise interest rates above neutral into restrictive territory, just as the stimulus from tax cuts fades around 2020.

Much depends on how much room the Fed thinks the economy has to run. Optimistic analysts think it has a lot. The expansion since 2009 has been long in part because the postcrisis environment has discouraged the sorts of risk-taking and imbalances that bring on a recession, such as heavy private sector borrowing. The household saving rate hasn't dropped much, despite a surge in wealth, cushioning consumers from a drop in property or stock prices.

And while anecdotes of labor shortages multiply, some economists see evidence there could be plenty more workers available to keep growth going. Ernie Tedeschi of the investment firm Evercore ISI says employment as a share of the population, which some argue is a more comprehensive gauge of the job market than unemployment—once adjusted for the aging population—is still lower than in 2001 or 2007.

Low unemployment may not have the inflationary impact it once did given labor's weakened bargaining power. Both the Bank of England and the Federal Reserve have sharply reduced their estimates of the natural unemployment rate, below which inflation picks up, notes a report for the International Center for Monetary and Banking Studies by economists David Miles, Ugo Panizza, Ricardo Reis and Ángel Ubide. They argue labor markets have arrived at a "new postcrisis equilibrium, with more job creation and less wage growth."

Widespread fears of inflation are at odds with actual inflation behavior. In September, consumer prices rose by less than economists expected for the fourth straight month. Excluding food and energy, they're up at a 1.8% annual rate in the last three months, the Labor Department reported Thursday.

For now, the economy seems to have plenty of room to run.

Write to Greg Ip at greg.ip@wsj.com

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THE WALL STREET JOURNAL.

Markets

Oil Prices Could Fall Further on Rising U.S. Supplies, OPEC Report Says; Cartel issues internal warning as oil prices slide

By Benoit Faucon
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Rising crude oil inventories and increased output in the U.S. could push oil prices down in the coming weeks, an internal OPEC report said Thursday.

A coming "seasonal scale back in refinery demand...could result in oil stock builds," said an internal market report, which was circulated late Thursday within the Organization of the Petroleum Exporting Countries and reviewed by The Wall Street Journal.

The buildup, "amid the upward trend in US crude oil production, could be a bearish factor for oil prices in the coming few weeks," the report said.

OPEC's assessment came as Brent crude, the global oil benchmark, fell below the $80-a-barrel threshold for the first time in nearly a month on Thursday, after data showed an unexpected rise in U.S. inventories.

Late Thursday afternoon, light, sweet crude for November delivery was 0.9% lower at $69.14 a barrel on the New York Mercantile Exchange. Brent crude was 0.3% lower at $79.78 a barrel.

At a meeting last month, the cartel and its allies debated how much they should open up their spigots to make up for Iranian oil exports, which will fall under a U.S. ban next month.

But while Saudi Arabia and Russia have boosted output, some OPEC officials are worried about a global oil surplus.

The U.S. Energy Information Administration said Monday it expects American tight-oil production to rise by 98,000 barrels a day from October to November.

The planned maintenance of Russian refineries could hit oil prices charged by Moscow and its competitors in Europe in particular, the OPEC report said.

Meanwhile, revisions to global economic forecasts by the International Monetary Fund, fueled by trade disputes between the U.S. and its partners, "cast more uncertainty over oil demand growth in 2019," the document said.

The U.S. Energy Information Administration on Wednesday reported crude oil stockpiles had risen by 6.5 million barrels last week, to stand at 416.4 million barrels.

Earlier in October, Brent breached the $85-a-barrel level for the first time in roughly four years. But prices have come under pressure in the past week, amid global stock market turmoil and signs of weakening oil demand.

Christopher Alessi contributed to this article

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THE WALL STREET JOURNAL.

Markets
U.S. Bond Yields Fall Amid Tepid Economic Data; Ten-year yield slides to 3.122% on European manufacturing, U.S. housing reports

By Akane Otani
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U.S. Treasurys extended a rally Wednesday as downbeat data on the domestic housing market and eurozone manufacturing sapped investors' appetite for risk.

The yield on the benchmark 10-year U.S. Treasury note settled at 3.122%, compared with 3.166% Tuesday.

Yields, which fall as **bond prices** rise, declined overnight after IHS Markit reports showed manufacturing activity in the eurozone, Germany and France expanded at a slower pace than analysts had expected in October.

Treasury yields then fell further after Commerce Department data showed sales of new U.S. homes fell 5.5% in September, notching their fourth consecutive monthly decline and far surpassing the 0.6% drop that economists surveyed by The Wall Street Journal had expected.

Taken together, the data added to a recent streak of tepid economic reports, driving up demand for Treasurys, which investors tend to scoop up when the growth outlook appears more uncertain.

"The Fed's rising interest rates may be more harmful for economic growth than they thought, chiefly because of its effect on long-term interest rates and hence mortgage rates," said Chris Rupkey, managing director and chief financial economist at MUFG.

Further signs of economic activity cooling could send bond yields lower. The Federal Reserve's beige book report, a roundup of anecdotal information about regional economic conditions, showed Wednesday that businesses have growing concerns about tariffs pushing up their production costs.

Still, some traders say after the drop in bond yields this week, Treasurys may not have much further to fall in the short term. The yield on the **10**-**year Treasury** note is on track to end lower for the fourth time in five trading days.

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WSJ PRO CENTRAL BANKING

Economy

Fed Vice Chairman: Strong Growth Supports Case for Continued Rate Rises; In his first public remarks since being sworn in, Richard Clarida highlights reasons why stronger growth might not generate an inflation upswing

By Nick Timiraos and Paul Kiernan
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WASHINGTON—Federal Reserve Vice Chairman Richard Clarida endorsed the central bank's plans to gradually raise interest rates and pinpointed the behavior of inflation as key to deciding when to stop.

After years in which the central bank held rates very low to boost economic growth and hiring, the Fed's current policy stance was providing support to an economy that no longer needed it, Mr. Clarida said in a speech at the Peterson Institute for International Economics. The key question now, he said, is how to preserve recent economic gains.

"If the data come in as I expect, I believe that some further gradual adjustment in the federal funds rate will be appropriate," Mr. Clarida said in his first public remarks since joining the Fed as its No. 2 official last month.

Fed officials raised their benchmark federal-funds rate a quarter percentage point last month to between 2% and 2.25%. They signaled they expect to raise it again this year, likely in December, and penciled in around three increases next year.

Mr. Clarida addressed the recent **stock market** selloff during a question-and-answer session. The economy is "very, very solid," he said, but changes in financial conditions "are something that is relevant for the economic outlook."

If tighter financial conditions, which can show up through falling stock and **bond prices** and a stronger dollar, are sustained, policy makers would need to take that data into account when making economic forecasts, he said.

The "some further" description caught the attention of a few Wall Street analysts because in the past the Fed has used the subtle phrase to signal that officials are debating an end to rate increases. It's premature to infer Mr. Clarida was signaling such a shift because that phrase hasn't shown up in policy statements, minutes of policy meetings or Fed Chairman Jerome Powell's own commentary.

In his remarks, Mr. Clarida highlighted reasons why stronger economic growth might not lead to an inflation upturn that some colleagues have indicated could require more aggressive rate increases.

One camp of Fed officials says that so long as unemployment keeps falling below the level they project is consistent with stable inflation, they should raise rates to a level designed to restrict growth to prevent the economy from overheating. This is what the Fed has typically done in the later stages of an expansion.

Others have indicated they might support a relatively unusual departure from this stance. They say if inflation doesn't appear to be accelerating beyond the Fed's 2% target, they might want to slow or suspend rate rises earlier than would normally be the case.

Mr. Clarida's speech didn't explicitly embrace one approach over the other. But he identified possible reasons inflation might remain modest enough to allow this latter approach to gain more consideration.

He said the economy's underlying growth rate might be faster than he thought several years ago and that the level of unemployment consistent with stable inflation might be lower.

Some economists have said the recent increase in business investment has primarily reflected spending in the energy sector. Mr. Clarida said he saw evidence that this investment upturn "is not just an ‘oil patch' story," which could reflect ways in which tax cuts are boosting the economy's long-run capacity to grow.

Mr. Clarida also pointed to signs that worker output per hour is picking up from very low levels and that more workers on the sidelines of the job market might be encouraged to return to work. If sustained, both developments would allow the economy to grow faster without fueling more inflation.

"Even with today's very low unemployment rate, the labor market might not be as tight—and inflationary pressures not as strong—as I once would have thought," he said. "I am certainly not alone in this thinking."

Altogether, these developments mean that rising wages might not push up prices as much as in the past. "The traditional indicators of cost-push price pressures are not flashing red right now," he said.

Mr. Clarida said inflation data as well as indicators of businesses' and consumers' expectations of future inflation would weigh heavily in determining how to set the fed-funds rate.

If strong job and economic growth continue next year together with a "material rise" in inflation, additional rate increases "might well be required beyond what I currently expect," he said, without specifying what he expects.

On the other hand, if strong growth continues with "stable inflation, inflation expectations and expectations for Fed policy" such a scenario "would argue against raising short-term interest rates by more than I currently expect," he said.

Mr. Clarida also said, in response to a question, that President Trump's sustained criticism of the Fed's interest-rate increases would have no bearing on its policy decisions. Mr. Trump said in an interview with The Wall Street Journal on Tuesday that he viewed the central bank as the greatest threat to the economic expansion.

Such criticism "will in no way be a consideration as far as I'm concerned," said Mr. Clarida. "Our job is to sustain what is a very healthy and robust economy right now." He said history had shown central banks achieved the best outcomes for their economies when they are free to set rates as they see fit.

Write to Nick Timiraos at nick.timiraos@wsj.com and Paul Kiernan at paul.kiernan@wsj.com

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* Fed Minutes Point to Continued, Gradual Interest-Rate Increases (Oct. 17)

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THE WALL STREET JOURNAL.

Markets
Traders Bet on Return of $100 Oil; Narrowing supplies from Iran and robust global growth drive market's bullish sentiment

By Gunjan Banerji
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8 October 2018
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A hot streak in the oil market is setting off a wave of bets on how high prices can go.

With crude prices rallying for four straight weeks, trading of oil options—contracts that give the right but not the obligation to buy or sell—has surged.

The number of **bullish** contracts that pay out if Brent futures surpass $100 a barrel by January—up 19% from the current level—has more than doubled since the beginning of September, data from Intercontinental Exchange analyzed by QuikStrike show.

Shrinking supplies from Iran, along with strong global growth, have fired up **bullish** sentiment in the oil market.

Uncertainty over how much politically troubled OPEC members can pump to make up for production shortfalls could propel prices to $100, say analysts and officials in the Organization of the Petroleum Exporting Countries.

Oil prices fell Monday as reports emerged that the U.S. could give some buyers of Iranian crude waivers when sanctions on the country start in November. Still, Brent, the benchmark for global crude prices, has soared 25% this year to $83.91, while West Texas Intermediate, the reference price for U.S. crude, has risen 23% to $74.29.

Investors who missed the rally are now weighing **bullish** options to capture any additional gains, said Chris Kettenmann, chief energy strategist at New York-based brokerage Macro Risk Advisors.

"The market is considering $100 oil for the first time in five years," he said.

Options tied to Brent prices hitting $95 have ramped up as well, more than quadrupling since the start of September, the data show.

Investors have also turned to **bullish** options on oil exchange-traded funds and shares of energy companies.

An options measure known as skew on the United States Oil Fund, a popular oil exchange-traded fund called USO, is near the lowest point in a year, Trade Alert data show. Skew tracks how much it costs to protect against declines, so a low level tends to indicate investor confidence.

The **bullish** trades are a shift from earlier this year, when investors were more interested in hedging their oil investments with **bearish** options, Mr. Kettenmann said.

Still, there are signs of caution. USO, which has $1.7 billion in assets, has recorded about $850 million of outflows this year, FactSet data show. That is after investors pulled more than $1 billion last year. The ETF has climbed 31% this year to $15.68 a share Monday.

"It's surprising because typically money will flow in when the underlying asset is performing well," said Todd Rosenbluth, New York-based director of fund research at CFRA.

Mr. Rosenbluth said investors have turned **bullish** on commodities and stocks with the strength of the U.S. economy, propping up oil demand. But ETFs such as USO can be used more for short-term trading purposes than long-term wagers, he said.

Some investors have preferred wagering on energy companies directly. Options on U.S.-listed shares of Brazilian oil company Petróleo Brasileiro SA have experienced a flurry of recent **bullish** activity. The stock has rallied about 49% this year to $15.38 Monday as investors anticipate the company will benefit from rising **oil prices**.

Petrobras also recently settled corruption probes in Brazil and the U.S., concluding a multiyear investigation. Investors also turned to options on the company ahead of Brazil's election Sunday. The winner's economic agenda could affect state-run Petrobras.

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THE WALL STREET JOURNAL.

Economy

India's Government Loses Patience With Central Bank; Rupee weakens amid signs the central bank is stuck in a power struggle with Prime Minister Narendra Modi's government

By Corinne Abrams, Rajesh Roy and Debiprasad Nayak
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MUMBAI—The rupee weakened amid signs India's central bank is stuck in a power struggle with Prime Minister Narendra Modi's government, which is eager to kick-start lending to stimulate the economy.

The rupee fell to as low as 74.14 rupees to the dollar Wednesday, its lowest level since Oct. 11, following local media reports that the government was putting pressure on the Reserve Bank of India to ease up on monetary policy and lending restrictions. RBI Gov. Urjit Patel was considering resigning, the reports said. The rupee recovered to around 73.97 later in the day.

An RBI spokesman declined to comment.

The government has been frustrated by the RBI's reluctance to reduce interest rates to boost economic activities, officials at the Finance Ministry said.

The Finance Ministry has been sending letters to the central bank, asking it to consider easing restrictions that were imposed on lending by 11 state-run banks to help the banks recover from racking up nonperforming loans.

Under the central bank's code, the government can direct it to act if it believes it is in the public interest. The government issued a statement Wednesday saying that the autonomy of the central bank is essential but that the government consults with the RBI in the public interest.

"The government, through these consultations, places its assessment on issues and suggests possible solutions," the statement said.

Finance Minister Arun Jaitley criticized the RBI on Tuesday for not doing enough to stop banks from racking up about $135 billion in bad loans.

"During 2008-14, after the global economic crisis, to keep the economy artificially going, banks were told to open their doors and lend indiscriminately. The central bank looked the other way," Mr. Jaitley said in a televised interview at a meeting organized by the U.S-India Strategic Partnership Forum.

Mr. Jaitley's criticism followed a speech by the RBI's deputy governor, Viral Acharya, on Friday in which he underlined the importance of the RBI's independence.

"Governments that do not respect central-bank independence will sooner or later incur the wrath of **financial markets**," he said.

Mr. Modi's party is seeking to hold on to its majority in elections next year, and the prime minister is eager to keep the country on firm financial footing.

Foreign investors have pulled $8.5 billion from India's debt market since the beginning of the year and $5.5 billion from stocks amid an emerging-market selloff. The rupee has fallen 16% since January on higher **oil prices** and an outflow of funds.

Other governments have come up against their central banks recently. President Trump criticized the Federal Reserve in October after stock markets fell.

Turkey's PresidentRecep Tayyip Erdogan said in September that he wouldn't tolerate higher rates for long after the central bank lifted borrowing costs in an attempt to calm the country's currency crisis.

The yield on India's 10-year government bond rose to 7.88% from 7.83% on Tuesday. Bond yields rise as prices fall.

Saumya Vaishampayan in Hong Kong contributed to this article.

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Markets
Gold Slips as Broader Markets Calm

By David Hodari
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Gold prices slipped further Tuesday, with traders remaining focused on moves in broader markets and geopolitical headlines.

Gold for December delivery was down 0.1% at $1,226.40 a troy ounce on the Comex division of the New York Mercantile Exchange.

Copper for December delivery also slipped 2% to $2.6870 a pound in New York.

Equities markets stabilized after a fresh wave of tumult late Monday, when U.S. tech stocks once again plunged, with Amazon.com slipping into **bear market** territory.

Gold's weakness also came after reassuring comments from President Trump on the continuing U.S.-China trade row. A Bloomberg report said the Trump administration was readying itself to impose tariffs on all Chinese imports, but Mr. Trump told Fox News that the U.S. will "make a great deal with China."

"The gold market this morning is a good example of how differently news can be interpreted," Commerzbank analysts said in a note.

Gold's slip also came in the wake of a rise in the U.S. dollar, with the haven currency retaining its gains so far this year amid the recent market turmoil.

The dollar and gold tend to move in opposite directions, and the WSJ Dollar Index was last up 0.1%, extending its gains over the past three months to 2.7%.

Investors were awaiting Chinese manufacturing and nonmanufacturing purchasing managers index numbers, due out Wednesday, for clues on the health of the world's second-largest economy.

Among precious metals, silver was down 0.41% at $14.40 a troy ounce, palladium was down 0.09% at $1,089 a troy ounce and platinum was down 0.02% at $832.30 a troy ounce.

Among base metals, aluminum was down 0.08% at $1,976.50 a metric ton, zinc was down 0.28% at $2,600 a metric ton, tin was down 0.1% at $19,090 a metric ton, nickel was up 0.17% at $11,755 a metric ton and lead was down 1.10% at $1,940 a metric ton.

Stephanie Yang contributed to this article.

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Volatility Ripples Across the World --- Index-tracking ETFs drive turbulence at end of trading day, indicating their clout

By Michael Wursthorn and Christopher Whittall
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A surge in late-day trading activity has magnified major indexes' declines over the past two days, stoking investors' anxieties amid one of the **stock market**'s most violent pullbacks this year.

The **Dow Jones Industrial Average** suffered triple-digit drawdowns in the final trading hours of Wednesday and Thursday, extending the blue-chip index's loss over those two days to more than 1,300 points.

Trading at the close has become more important as exchange-traded funds and other vehicles that look to match the moves of an index have grown more popular with investors. The managers of those funds are required to keep their portfolios closely in line with the benchmarks they track, and many aim to execute trades as late in the day as possible to avoid any deviation.

"More fund managers are doing their business at the end of the day," said Paul Karrlsson-Willis, head of global equity sales and trading at Cabrera Capital Markets. "That's a big change from what it was just a few years ago. That's where the liquidity seems to be."

On Thursday, for example, the Dow tumbled about 240 points in the final 90 minutes of the session, marking about half of its losses for the day. Trading volume over that period on exchanges operated by the New York Stock Exchange and Nasdaq represented 33% of the day's total, greater than the 30% of volume typically seen throughout the year.

The explosion of ETFs over the years continues to push volumes in the final hour even higher. In 2012, just 17% of all trading on the New York Stock Exchange's flagship exchange took place in the last hour of the day, compared with 26% last year, according to data from the exchange.

In turn, other investors, including those that employ quantitative-trading strategies, have moved to conduct more of their trading activity in the final hour of the day to take advantage of the added liquidity offered by ETFs and other passive strategies.

But during periods of extreme **volatility**, like those experienced on Wednesday and Thursday, late trading can exaggerate a downward move to extreme levels, money managers said.

"Quant funds and index funds adjust exposure at the end of the day, and as markets show weakness it forces them to sell more to limit exposure for the following day," said Doron Barness, global head of trading at Oppenheimer.

(See related article: "Tencent Music delays highly anticipated IPO in U.S. amid worries over market turmoil" -- WSJ Oct. 12, 2018)

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THE WALL STREET JOURNAL.

Markets

HSBC Reins in Costs, Logs Strong Growth in Quarterly Profit; CEO John Flint predicts a 'fundamental change' in the relationship between the U.S. and China

By Margot Patrick
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HSBC Holdings PLC said loan growth in Asia and rising interest rates fueled a better than expected third quarter, sending its shares up 5% Monday.

The Asia-focused U.K. banking giant said it increased revenue and reined in costs to make a quarterly net profit of $3.9 billion, 32% higher than last year's $2.96 billion in the comparable period.

HSBC Chief Executive John Flint has been under pressure to keep costs down while increasing revenue. Third-quarter operating expenses were $7.97 billion on $13.8 billion revenue, compared with $8.55 billion costs and $12.98 billion revenue in third-quarter 2017.

In an interview, Mr. Flint said geopolitical concerns including U.S.-China trade tensions and the U.K.'s planned exit from the European Union were clouding the global outlook. But he said economic growth was holding up and called the recent equity selloff a "healthy correction."

On the U.S.-China trade dispute, Mr. Flint said customers were discussing what it means for their businesses but hadn't made significant changes yet to their activities or supply chains.

"Our view is there will be a fundamental change in the nature of the relationship between the two countries," he said.

He added that there was so far no real impact on the bank from the U.K.'s upcoming Brexit, either in terms of credit quality or revenue.

HSBC grew its loan books in the quarter, while revenue growth in retail banking and wealth management came primarily from current accounts, savings and deposits, particularly in Hong Kong.

Mr. Flint took the job in February after a career-long apprenticeship in other top HSBC jobs. He has stressed continuity not revolution in keeping HSBC focused on Asia, global commercial banking and its core retail markets in the U.K., Hong Kong and Mexico.

With Chairman Mark Tucker in the job for a year, Mr. Flint is seeking to put the bank's scandalous years of alleged sanctions busting and money laundering behind it and oversee a phase of growth powered by rising interest rates and intra-Asian trade.

Higher rates, which helped spark **stock market** selling in recent weeks, are boosting net interest income, or what the bank earns between paying depositors and earnings on loans. The measure grew to $7.68 billion in the third quarter from $7.13 billion a year earlier.

Mr. Flint pointed to the bank's recently established securities joint venture in China as a source of growth. The business now has more than 150 employees, Mr. Flint said, and has set up branches in Shanghai and Beijing. The bank said last year it would raise head count to about 300 employees.

The joint venture with Qianhai Financial Holdings Co., in which HSBC owns a 51% stake, allows the bank to underwrite initial public offerings and trade stocks and bonds. Yet HSBC is investing at a turbulent time for Chinese stocks, which are in a **bear market**, while technology valuations in particular, in both public and private markets, are cooling.

"If it is slow for a year or two, that wouldn't worry me in the slightest," Mr. Flint said, adding the bank is looking at China as a long-term opportunity.

He said HSBC is still open for business with Saudi Arabia, amid global outrage over the alleged involvement of Saudi officials in the death of Jamal Khashoggi in Turkey. Saudi authorities say they have detained 18 people in connection with the journalist's death and are continuing to investigate in cooperation with Turkish authorities.

Mr. Flint, who opted not to attend the kingdom's flagship business conference last week, said HSBC was the largest foreign investor in Saudi Arabia's financial sector and that the country would continue to be "an integral part of the world economy," because of its oil.

Julie Steinberg and Kenan Machado in Hong Kong contributed to this article

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Markets Review & Outlook: Third Quarter --- Stock Pickers Fail to Match Index Funds

By Dawn Lim
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This year was supposed to be stock pickers' big comeback. So far, it hasn't been.

As the year started, the specter of interest-rate increases and a jump in market **volatility** set the stage for active managers to exploit possible ups and downs in prices. Adding to factors lining up in active managers' favor were investor concerns about a downturn and a possible trade war that slowed flows into funds that mimic markets.

Net inflows into cheap index funds abated, raising active managers' hopes that stock picking would stage a resurgence.

But in the race for returns in the past year, passively managed funds won again: Just 36% of actively managed U.S. stock funds outperformed index mutual funds and exchange-traded funds in the year ended June 30, according to data compiled by research firm Morningstar Inc. That is down from the 43% that did so in 2017.

The decadeslong shift into low-price passive investments that made BlackRock Inc. and Vanguard Group two of the largest financial firms in the world has continued as the **bull market** marches on.

"It's been a tough run" for U.S. equity managers, said Timothy McCusker, chief investment officer at Boston consulting firm NEPC LLC. "We expect active managers to underperform in euphoric markets. We're in the late stage of a market where fundamentals are being less rewarded."

One of the main issues for active managers has been the fact that a handful of highflying tech giants have held outsize sway over the market. Amazon.com Inc., Apple Inc. and Microsoft Corp. were the biggest contributors to the **S&P 500**'s total return in the year ended June 30, contributing one-quarter of gains, according to data from S&P Dow Jones Indices.

Stock pickers that didn't wager on the handful of names leading the market were challenged.

Managers focused on large growth stocks were the only group of U.S. equity investors more successful in outperforming passive peers than in the previous year, Morningstar data show.

Value managers, which buy out-of-favor stocks in hopes of profiting when they bounce back, were hit. As money has gravitated toward hot companies, many value stocks have languished.

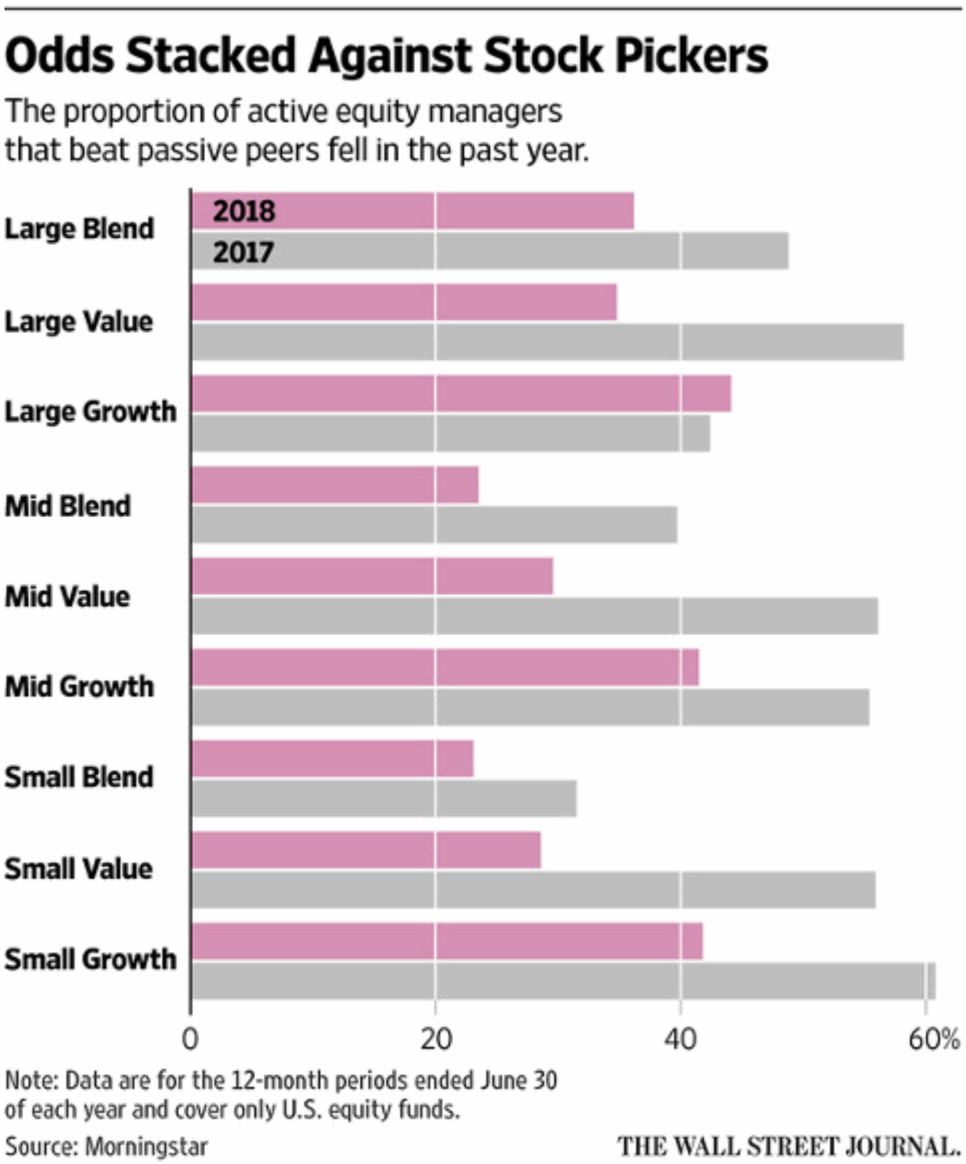
"Passive investing has worked so well because of the dominance of growth stocks in the indices," Mr. McCusker said. His firm, NEPC, expects to have more conversations with clients in the coming year to make sure that they are rebalancing the mix of growth and value strategies. "Growth can win for a long time, but the tide can turn."

Notably, big technology companies such as Facebook and Google parent Alphabet Inc. that powered the recent rally came under pressure in recent months, pulling down the broader market as concerns over regulation of the sector mounted.

While some observers watch for signs of a shift in the balance of power between passive and active managers, a continuing price war between investment firms will further unsettle the industry.

On the passive side, State Street Global Advisors rolled out low-cost exchange-traded-fund offerings over the past year, while Fidelity Investments launched zero-fee funds and slashed costs on other funds.

Some active mutual-fund managers have lowered fees or moved to tie them more closely to performance. A fee-cutting push among passive funds means active managers, which charge higher fees, will face pressure to score more gains to beat the performance of index funds.



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WSJ PRO CENTRAL BANKING

Heard on the Street
Markets
Why Trump's Fed Bashing Is Encouraging; Criticism of the central bank has usually meant that it is taking politically unpopular but economically important steps

By Spencer Jakab
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Donald Trump is none too pleased with the Federal Reserve. That is a good thing.

On Thursday, the president launched into a third day of verbal abuse of the central bank.

"The Fed is getting a little too cute," he told Fox & Friends. "That's all. It's ridiculous what they're doing."

On Wednesday afternoon, following the 831-point plunge in the Dow industrials, he said that the "Fed has gone crazy." He made somewhat milder remarks on Tuesday.

The tone of Mr. Trump's comments may be unique, but criticism of the legally independent institution is older than the Fed itself. Even before its establishment in 1913, during earlier, abortive attempts to create a permanent U.S. central bank, sniping from the White House and Congress was frequent. Such criticism has usually meant that it was doing something necessary but unpopular.

Politicians are naturally pro-growth, except in rare cases when that growth agenda rankles their particular constituents or they are out of power. For example, back in 2010, before he was vice president, Mike Pence lamented ultra-loose monetary policy during the early Obama administration. He had little patience for the full-employment side of its dual mandate.

"It's time that the Fed focus solely on price stability and the dollar," he said.

Facing re-election in 1972, recordings that later became public showed that Richard Nixon pressured Fed chief Arthur Burns to ease up. Mr. Nixon went on to win in a landslide, but the 1970s saw rampant inflation until Fed chief Paul Volcker took draconian steps to break its back. Appointed by Jimmy Carter, he helped stain the president's legacy in the process, sparking a recession.

Mr. Volcker's bold action has made him a central-banking hero and underpinned back-to-back decades of robust stock- and-bond market gains. Toward the end of that run, when Alan Greenspan occupied the role, Mr. Greenspan was openly praised by President Bill Clinton. With the benefit of hindsight, though, the greatest **bull market** of all time should have been nipped in the bud before it turned into a speculative mania.

Which brings us to today. Jerome Powell's Fed shows no sign of flinching in its intent to tighten. The Trump tax cuts and government-spending increases at a time when unemployment is at its lowest since the 1960s are creating unheard of stimulus. The resulting rise in bond yields might damage the **stock-market** gains for which Mr. Trump has, unusually, claimed explicit credit.

He must grasp, though, that the Fed isn't an instrument for supporting stock gains or even the man who appointed its chairman. His public ire is a sign to the world that the Fed's independence is intact.

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THE WALL STREET JOURNAL.

Markets

The Shale Boom Calmed Oil Markets, but for How Much Longer? Supply worries are back: As U.S. bonanza nears limits, the world is thirstier than ever for crude

By Russell Gold
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For the past decade, enough oil has flowed from America's shale boom to allay worries that demand for the world's most important commodity would outstrip supply.

Now, new **volatility** in global **oil prices**—which are up 15% since the start of the year—signals that the calming effect of the shale bonanza is reaching its limits.

For perspective on shale's impact, rewind to 2007, when some industry leaders saw world demand hitting a wall once it rose to 100 million barrels a day—a level they thought supplies would have trouble matching.

"Where is all that going to come from?" said James Mulva, the former chief executive of ConocoPhillips, that year, when the world produced and consumed about 85 million barrels a day.

In August, global oil demand reached 100 million barrels a day, and the world hardly noticed. What happened? Shale.

Using techniques such as hydraulic fracturing and horizontal drilling, U.S. oil drillers figured out how to get crude oil from ultradense shale rocks in North Dakota, Texas and Oklahoma. U.S. oil output rose from 5 million barrels a day in 2007, when Mr. Mulva raised his concerns, to a record of nearly 11 million a day in August, a remarkable increase that has rarely been replicated anywhere in the history of oil.

While this has helped the world meet rising demand for years, it cannot go on forever. Signs are mounting that shale won't keep growing at the same rate in the U.S. Drillers face pipeline bottlenecks moving crude out of West Texas. This week, Halliburton Co. Chief Executive Jeff Miller said its oil-producing clients were facing "budget exhaustion" and he expected some to take extended breaks from drilling new shale wells. That is coinciding with warnings of plateauing, or even declining, production elsewhere in the world.

All the while, global economic growth has been strong for several quarters and oil demand continues to grow. Since its last year-over-year decline at the end of 2011, oil demand has grown annually by 1.5 million barrels a day, according to International Energy Agency data.

The steady upward march of oil demand has left oil markets prone to price swings and spikes. The price of a barrel of Brent crude, the leading global benchmark, is up to near $77 a barrel, from $67 at the beginning of the year.

If U.S. production fails to grow at recent rates, it is far from clear that the world's two other oil superpowers, Russia and Saudi Arabia, can pick up the slack. Russia is already pumping 10.8 million barrels a day of crude, a level unseen since the Soviet Union. Saudi Arabia, currently at 10.4 million barrels a day, is headed toward record-level output.

"The Saudis are just about out of spare capacity," said Robert McNally, a former energy adviser to President George W. Bush who heads the Rapidan Energy Group, a Washington consulting firm.

Saudi Energy Minister Khalid al-Falih said this week, according to Russian news agency TASS, that the country would bump up its production to 11 million barrels a day to cool off the oil market, although some oil observers wonder if the kingdom would be able to fulfill this promise.

Meanwhile, exports from two other key oil-producing nations are falling.

In the midst of an economic meltdown under President Nicolás Maduro, Venezuela, the country with the world's largest oil reserves, has seen its production fall to 1.2 million barrels a day today from 3.2 million barrels in 2006, according to the Organization of the Petroleum Exporting Countries.

U.S. sanctions on Iran's oil sector are set to take effect Nov. 4, barring companies from buying Iranian exports. Oil traders are still assessing how effective those sanctions will be at crimping Iran's oil industry, but analysts say they could remove anywhere from 1 million to 1.5 million barrels a day from global oil markets.

"This is the year geopolitics came back to the oil markets and it is back with a vengeance," said Helima Croft, global head of commodity strategy at RBC Capital Markets. In recent weeks, the oil market has carefully watched growing strains in the U.S.-Saudi relationship over the killing of Saudi journalist Jamal Khashoggi.

The impact of Iranian sanctions or Venezuela's falling output would have been muted a couple of years ago, when supply was plentiful. The rising demand means this is no longer the case.

"Geopolitics matter more when markets are tight," said Sarah O. Ladislaw, director of the energy and national security program at the Center for Strategic and International Studies.

There are so far no signs of any actual supply squeeze and some believe that without the current geopolitical uncertainties, **oil prices** would still be stable. "Based on market fundamentals, there is absolutely no reason **oil prices** should be at this level," said Ali Moshiri, chairman of Amos Global Energy LLC, a Houston-based oil producer and a longtime Chevron Corp. executive.

But if oil demand continues to rise—and Iranian exports are curtailed—prices could rise dramatically. A couple of years ago, such a rise might have been short-lived as shale producers accelerated operations and added more oil to the global market.

Geopolitical shifts also make for uncertain longer-term forecasts and price swings. While the U.S. hardline approach to Iran could lead to a rise in **oil prices** now, down the line the trade policies could erode oil demand and lead to future price drops.

For the U.S. to pursue both Iran sanctions and toughening trade policy at the same time "is a really big risk," said Philip Verleger, an energy economist. "If we're not careful, we could have a repeat of 2008 when **oil prices** started at $90 a barrel, went up to $140 and ended around $30," he said.

For years, shale helped keep enough spare capacity in global markets that **volatility** began to feel like a relic of the past. In the years to come, the world may no longer have that shale shock absorber, ending a relatively peaceful decade in oil markets.

Bradley Olson contributed to this article.

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The New York Times

Strategies
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Netflix's Audience Is Multiplying. But So Is Its Debt.

By Jeff Sommer
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Netflix, the streaming-video juggernaut, is growing with astonishing speed. And if you ignore the fact that it borrows billions to finance that growth, the company is a classic success story.

Its ability to expand its global audience is truly impressive. The latest numbers show that Netflix gained more than six million paid subscribers around the world in the three months through September. That's about 66,000 more paid subscribers every day, bringing its total to more than 130 million.

Netflix's extraordinary growth has disrupted the media landscape and entranced the **stock market**. As my colleague, Edmund Lee, has written, Netflix's challenge has helped to motivate, if not entirely provoke, a series of mergers, acquisitions and realignments among giant companies. Disney and Fox, AT&T and Time Warner, Comcast, Amazon, Apple, Google and more: All have had to respond, many by increasing their own spending on TV and video.

Wall Street has embraced Netflix as one of the so-called Faangs — short for Facebook, Amazon, Apple, Netflix and Google (which trades as Alphabet). The technology titans propelled investors to enormous profits for much of this year.

With Netflix's resounding success in forging — and, so far, dominating — the global market for streaming video, it may seem churlish to harbor any misgivings.

Yet Netflix poses a difficult problem for investors. All of those movies and TV shows are expensive, and in order to fuel its explosive expansion, the company has been spending faster than it has been taking in cash — and expects to keep doing so for years. Netflix has built its business on a mountain of junk-rated debt.

Despite this, the Wall Street consensus is **bullish**. The company predicts that within a few years, costs will start to grow more slowly than revenues. In a conference call this month, David Wells, the company's chief financial officer, projected "material improvements" in 2020. "We still think it's going to be a few years toward break-even," he said. Wall Street has largely accepted that forecast, expecting that at some point, Netflix won't need to borrow to pay its bills, and profits will grow.

Not everyone is persuaded, however.

"Netflix's fundamental business model seems unsustainable," said Aswath Damodaran, a New York University finance professor, who has examined the company's numbers closely. "I don't see how it is going to work out."

With increased competition looming in streaming video, he said, Netflix must keep spending enormous sums on content and marketing. If it cuts spending, he said, it is likely to lose much of its precious audience.

"Sure, the company is growing rapidly now," he said. "It has an amazing number of new movies and TV shows. For a consumer, that's great. But for an investor, it's a different story: The more Netflix grows, the more its costs grow and the more money it burns. I'm not sure how it's ever going to turn that around."

Professor Damodaran posted a valuation model for Netflix on his blog, as an instruction tool. His model is based on a straightforward, well-established method — the discounted cash flow approach used by investment analysts around the world. At my request, he plugged the company's latest numbers into that model to figure out what Netflix's shares appear to be really worth. The results were startling.

The company's shares, in his estimation, are worth buying as a serious investment only at about $177. But Netflix has been trading around $310 a share lately, after surpassing $400 earlier this year.

In a nutshell, the problem is the disparity between money in and money out — and Professor Damodaran's presumption that Netflix's costs must remain high, if it is to keep growing.

Netflix's cash-flow statement indicates that in the 12 months through September, it spent $11.7 billion on new content. But its income statement indicates that total revenues were $14.9 billion, leaving it only about $3.2 billion to pay for marketing and the rest of its operations. That wasn't enough to run the business, so the company has borrowed money.

On Monday, Netflixannounced that it intended to borrow more, by selling $2 billion worth of bonds, which rating agencies say is below investment-grade. That comes on top of $8.3 billion in speculative-grade debt already on its balance sheet. The borrowing is likely to continue to grow as long as the company burns cash faster than its millions of subscribers send in money.

Professor Damodaran is not the only Netflix skeptic. In a note to investors on Oct. 17, Michael Nathanson, a senior analyst with MoffettNathanson, said that the company's **stock price** was baffling, and he estimated that a more realistic level was about $210.

In a similar vein, Michael Pachter, managing director of equity research for Wedbush Securities and a longtime critic, said he expected Netflix to continue to have difficulty matching costs and cash flow, given increasing competition in streaming video — and the likely loss of movies and TV shows controlled by its competitors.

Disney and Time Warner (which owns HBO) are revamping their offerings. And Hulu (owned collectively by Disney and Comcast), Apple, Amazon and Google (which owns YouTube) are now all serious adversaries, he said. In his estimation, Netflix stock is worth only about $150 a share.

If Netflix were to fall anywhere near that level — losing a gut-wrenching half of its market value — its corporate competitors would presumably be powering ahead with their own streaming offerings. Yet it would not be surprising if some of them — the recently merged AT&T-Time Warner entity, for example — wondered whether their own marriages made much sense without Netflix's unbidden influence.

How worried should the **stock market** be about Netflix? It has shrugged off such concerns most of this year: From Jan. 1 through July 9, Netflix's shares returned a staggering 118 percent.

Since July 9, however, tech stocks have fallen and Netflix has been pummeled. Despite brief surges, its share price has dropped more than 25 percent since that peak.

Netflix executives say they are building their business for the long run. Last year, Reed Hastings, co-founder and chief executive of the company, said traditional competition didn't worry him. Netflix was so compelling, he said, that its main adversary was sleep.

"You get a show or a movie you're really dying to watch, and you end up staying up late at night, so we actually compete with sleep," he said. "And we're winning!"

In the latest earnings call, he said that deep-pocketed companies, like Disney, AT&T and Google, were real competitors. "Someday there will have to be competition for wallet share; we're not naïve about that," he said. "But it seems very far off from everything we've seen."

Netflix, he said, needs to continue to be "focusing on our fundamentals" — supplying viewers with compelling entertainment and delivering it in innovative ways.

But that will cost the company a lot of money. For consumers, that may not be a problem at all. Netflix has already made video entertainment far more abundant and diverse than it was just a few years ago, and as other companies join the fray, the cornucopia of choices is likely to become even deeper.

But does that make Netflix a great stock? You may want to look closely at the numbers.

Follow Jeff Sommer on Twitter: @jeffsommer

Five actors in "Stranger Things 2," a popular show streaming on Netflix. | Netflix | Robin Wright in Season 5 of "House of Cards." | Netflix

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THE WALL STREET JOURNAL.

Markets
Gold Prices Decline on Stronger Dollar, Stock Rebound; A rally in U.S. equity markets also dimmed gold's allure

By Ira Iosebashvili
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Gold prices fell Wednesday, pressured by a stronger dollar and a rebound in stocks.

Gold for December delivery was recently down 0.7% to $1,216.30 a troy ounce on the Comex division of the New York Mercantile Exchange.

The Wall Street Journal Dollar Index, which measures the U.S. currency against a basket of 16 others, was recently up 0.2% to 90.99. A stronger dollar tends to weigh on prices for gold, which is denominated in the U.S. currency and becomes more expensive to foreign buyers when the dollar rises.

A rally in U.S. equity markets also dimmed gold's allure. The **S&P 500** was recently up 1.8% and was on pace to climb in consecutive sessions for the first time since Sept. 20, but still post its largest one-month drop in more than seven years. Sharp declines in stocks this month have boosted gold, a popular destination for nervous investors.

In base metals, copper for December delivery fell 0.2% to $2.6590 a pound.

Write to Ira Iosebashvili at ira.iosebashvili@wsj.com

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THE WALL STREET JOURNAL.

Markets

Steak Dinner and Annuities: Retirement Product Surges After Fiduciary Rule's Demise; Annuity sales were $59.5 billion from April to June, the highest since late 2015

By Ben Eisen and Lisa Beilfuss
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Corrections & Amplifications

LPL Financial says its brokers don't sell annuities from Athene Holding Ltd. An earlier version of this article didn't make that clear. (Oct. 31, 2018)

A retirement investment product associated with steak-dinner sales pitches is flourishing thanks to the death of a regulation once expected to curtail it.

Annuity sales totaled $59.5 billion in the April-to-June period, the highest since late 2015, according to the Limra Secure Retirement Institute. Sales are expected to remain strong through at least the rest of the year.

The boom shows how Washington's push to roll back financial regulations is giving new life to products that industry watchdogs say aren't always good for investors. The annuities resurrection stems from the demise of the Labor Department's fiduciary rule, an Obama-era proposal that would have required brokers who oversee retirement savings to act in their clients' best interests.

Annuities protect customers from losing principal, and they are typically sold to retirees or those close to retirement. Customers pay a lump sum to an insurance company, then can effectively get back their money plus a potential return for a set number of years or their lifetime in regular payments. In some cases, buyers can win if they live longer than expected but lose if they don't. They can also pay hefty penalties if they withdraw money early.

Lawmakers have panned the product's high commissions, and Sen. Elizabeth Warren (D., Mass.) has criticized the prizes given to sales agents, like expensive vacations. The estimated average commission received by agents selling certain types of annuities is more than 6%, according to Wink Inc., an industry market-research firm. In those cases, if a customer buys an annuity for $150,000, the agent would make around $9,000 in commission.

Eloise Prevost of Peoria, Ariz., invested much of her savings in annuities several years ago, after getting a flier in the mail for dinner at a nice local restaurant with an annuity salesman. With the financial crisis on her mind, she liked the idea of not losing principal. The salesman sent her chocolates and invited her to holiday and Valentine's Day parties.

"He was offering a meal," Ms. Prevost said, "and I thought, 'Knowledge is power.'"

But Ms. Prevost, a 65-year-old retired tour-bus driver, recently attended a dinner with another salesman and decided to switch. At his encouragement, she paid steep penalties to withdraw her money and invest in a new portfolio that included, among other things, several annuities.

Both advisers have blemishes on their record, according to the Financial Industry Regulatory Authority's BrokerCheck records. One was banned for 10 years from securities sales in Canada; the other has multiple customer complaints concerning annuity and life insurance recommendations, as well as criminal charges.

Ms. Prevost said she deems her current adviser's blemishes less worrisome, as some of them were personal in nature and not relating to his job.

Some types of annuities can be big moneymakers for the industry. Insurance companies get a bundle of cash to invest for profit, and extra revenue from withdrawal fines or fees for add-ons. Sales agents typically get commissions from the insurance companies.

The fiduciary rule wouldn't have prevented all unscrupulous sales practices. But it could have forced brokers to be more transparent about their commissions and constrained them from putting customers in high-fee annuities if similar low-fee products were available.

Executives and brokers have cheered the reversal of the fiduciary rule, and analysts say it has already been a boon to the industry.

"Our regulatory environment has really changed," said Todd Giesing, director of annuity research at Limra, which is funded by the insurance industry. "It takes away a lot of uncertainty."

The annuities job market is also booming. The number of posts on Indeed.com targeting annuity specialists climbed 29% in the six months after the fiduciary rule was thrown out in March versus the same period a year earlier, according to data from the nation's biggest online job board.

But consumer protections remain in flux. Companies involved with annuities say they welcome a potential alternative regulation from the Securities and Exchange Commission, but it wouldn't go into effect for several years and would likely be less restrictive than the fiduciary rule. States have historically regulated insurance sales, and some have recently moved to tighten standards on brokers and insurance sellers.

Investor advocates and attorneys say annuity sales practices are as aggressive as ever. "The door has opened for bad brokers to have more free rein with these things," said Michael Lynch, an attorney in Winter Park, Fla.

Rising interest rates are also driving some annuity sales. Fixed annuities, which pay out regular interest, had their largest volume of sales in more than two years in the second quarter.

Indexed annuities, whose returns are tied to a benchmark like the **S&P 500**, had record sales. Variable annuities, whose returns are based on the performance of an investment, have also been up.

The gains are trickling through the financial system. Athene Holding Ltd., a big provider of annuities often sold through independent agents and brokers, said retail annuity revenue climbed 25% in its second quarter from a year earlier. At LPL Financial, one of the nation's largest networks of independent brokers, commission revenue from both fixed and variable annuities rose 17%. Brokers at LPL and other firms earn commissions on annuities they sell from companies like Athene. (LPL says its brokers don't sell annuities from Athene.)

Annuities carry tax advantages, and some customers prefer a guaranteed payment over the big gains—and losses—of other investments. But they often don't know the right questions to ask about what they're buying.

Jen Winterberg, 38, of Bismarck, N.D., went to a dinner seminar this summer at the suggestion of her father. Before the chicken and steak entrees arrived, she and the other attendees, most of whom were near retirement age, listened to a 40-minute presentation about indexed annuities.

She said that when she later tried to get the salesman to answer questions via email, he refused to do so unless she made an appointment to come to his office. A series of tense exchanges followed, and she decided against investing.

"I felt bullied personally into doing something that I wasn't ready to do," Ms. Winterberg said.

Her father still works with the adviser and holds the type of indexed annuity she was pitched, she said.

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THE WALL STREET JOURNAL.

Opinion

Investors, Look Up From Your Algorithms; 'Virtualization' means the old strategies may no longer apply. How to adapt? Use common sense.

By Daniel J. Arbess
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Why all the drama in the **stock market**? There are big economic challenges over the horizon, but corporate earnings and the global economy remain relatively healthy. Stocks are also reasonably priced. The recent selloffs have probably been amplified by investors' growing reliance on automated trading strategies at the expense of basic common sense.

Trading algorithms primarily use deductive logic, extrapolating the future from past patterns. But past performance is no guarantee of future outcomes. Some of the assumptions that drive passive trading strategies may no longer fit the conditions of the information economy.

Start with the business cycle. The present 10-year recovery is one of America's longest. Does that mean the expansion must soon end? Not necessarily. The economy likely is still at the start of a profound economic transformation, comparable to the late 19th-century transition from farm to factory and services.

In the new "virtualization" economy, intelligent software applications are easing industry's need for capital and labor. These technologies—including data analytics and the cloud-based process management of the "Industrial Internet of Things"—improve efficiency. They've led to stable or declining consumer prices, alleviating wage and other inflationary pressures.

The economics of virtualization are showing up in corporate earnings. For the third quarter, 77% of **S&P 500** companies beat analysts' estimates on earnings, outpacing their 59% beats on revenues. This suggests efficiency gains, not just higher revenues, are increasingly driving growth in corporate earnings.

Virtualization is helping the U.S. economy sustain Goldilocks conditions—strong growth, low unemployment and moderate inflation. The economy now seems resilient enough to continue without the training wheels of extraordinary monetary or fiscal policies. After a decade of substantial government intervention, investors are finally free to evaluate corporate earnings and price markets on their own merits. Update that algorithm.

What about the formula under which higher interest rates lead to growth-stock selloffs? In theory, that's bad news for the software and services titans that contributed more than 100% of the markets' gains earlier this year. Not so fast. Unlike traditional industrial growth companies, which relied on debt-financed capital investment in plant and equipment to fuel their growth, the modern cohort of growth stocks are high-margin, high-multiple companies. They require relatively little capital expenditure, often have cash-rich balance sheets with no need for debt, and attain near-utility levels of customer loyalty.

Revenue growth estimates inevitably slow as companies mature. But if profit margins keep expanding, should companies like Google and Amazon really be punished by markets as severely as they were after last week's earnings releases? Investors may look back on this moment as a buying opportunity.

The assumption that today's trade disputes herald the end of global free-trade arrangements also deserves closer attention. Look past President Trump's tweets and consider what he's achieving. His administration has reached a trade agreement with Canada and Mexico that combats technology coercion and theft and proscribes agreeing to trade deals with "nonmarket countries," which presumably includes China. It is working toward deals with Japan and the European Union.

These look like the opening steps in a dance that will align U.S. allies to pressure China into accepting truly free global trade if it wants to stay in the World Trade Organization. Mr. Trump must also know that slapping tariffs on China's exports only incentivizes the Chinese to depreciate their currency, and with it their consumers' power to buy American. China's exports are becoming less competitive anyway, thanks to the tech-driven U.S. manufacturing renaissance.

The greatest challenge to U.S. markets and the broader economy is the huge burden that kick-the-can fiscal policies have imposed on coming generations. The Trump administration's tax reform and spending increases will increase the deficit above $1 trillion starting next year. U.S. federal debt held by the public is 78% of gross domestic product and rising, and the nation is facing tens if not hundreds of trillions of dollars in future obligations, according to different projections presented to Congress. Older generations consider these "entitlements," but we'll see about that.

Today's polarized politics are leading to absurdly binary policy outcomes: From Mr. Trump to the Italian fiscal opera, politicians try to cut taxes while spending more. No algorithm is going to make sense of that. We still need some good old human inductive reasoning to connect the dots and make sound economic and financial decisions.

Mr. Arbess is CEO of Xerion Investments.

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Banks Brace for Downside of Higher Rates

By Ben Eisen and Christina Rexrode
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Banks have enjoyed a profit boost from rising interest rates over the past couple of years. But now those higher rates could turn into a drag.

Higher rates enable banks to charge more on loans. But they also can hit the banks' mortgage businesses, since the higher interest payments could make some consumers think twice about buying a home or refinancing. What's more, rising rates are forcing banks to start paying some depositors more.

The yield on the benchmark **10**-**year Treasury** note, which is tied to commonly used mortgage rates and many other borrowing costs, recently hit a fresh seven-year high. The Federal Reserve has lifted its key policy rate three times this year, with one more increase expected in 2018.

For years, as the Fed kept interest rates near zero, banks blamed superlow rates for crimping their ability to make money. Now that rates are rising, banks are finding their effect is more nuanced.

At the start of a rate-raising cycle, banks can usually increase the rates they charge on loans before raising the rates they pay on deposits. But as the rate-raising cycle moves into its later stages, some analysts and investors are concerned about the newfound pressure that may put on bank margins, undoing some of the profit boom that followed the central bank's rate increases over the past three years.

"The benefits of rising rates will probably run their course later this year into next year," said Gerard Cassidy, an analyst at RBC Capital Markets. "Over time, rising rates will work against the banks."

The rate environment is an important topic as banks begin reporting results on Friday for the July-to-September period. Bank stocks have been in a funk this year. The KBW Nasdaq Bank Index is roughly flat, far underperforming the 8% rise in the **S&P 500**. Goldman Sachs Group Inc. and Morgan Stanley are down more than 10% this year, while Citigroup Inc. has fallen 2.7% and Wells Fargo & Co. has dropped 12%.

Banks, of course, are finding they can charge more for many products as rates rise. The average rate on a home-equity line has risen to 6.18% from 4.75% in December 2015, when the Fed began the rate-raising cycle, according to Bankrate.com, a personal-finance website. The average rate on a credit card rose to 17.4% from 15.78%.

Another benefit from higher rates: Banks can earn more on the securities they hold. As those investments mature, the banks can often reinvest in them at higher rates.

But banks are preparing for the downside of higher rates, too. The average rate on a 30-year fixed-rate mortgage is 4.71%, according to Freddie Mac data released Thursday, up from 3.95% at the beginning of the year. Already, some mortgage lenders have raised their rates to 5% or more as the **10**-**year Treasury** yield keeps rising.

While that could spur some consumers to buy before rates potentially go higher, many would-be buyers already dealing with sky-high home prices are becoming wary of taking on a mortgage.

So far this year, mortgage volume has fallen at Wells Fargo, JPMorgan Chase & Co., Bank of America Corp. and other big lenders, according to research group Inside Mortgage Finance.

The refinancing business, which buoyed banks in the years after the financial crisis, is perhaps most vulnerable to rising rates. Mortgage origination volume is expected to fall 6% this year, driven by a 24% drop in refis, according to the Mortgage Bankers Association.

As rates keep rising, banks are also finding they may need to start ramping up what they pay savers. Banks tend to try to keep deposit rates low for as long as customers will tolerate it, and so far many customers have been accommodating. The average rate on a money-market deposit account, a widespread type of savings account, was 0.1% right before the Fed started raising rates, according to Bankrate.com. The average rate is now at 0.2%, even though the Fed has raised rates 2 percentage points since December 2015.

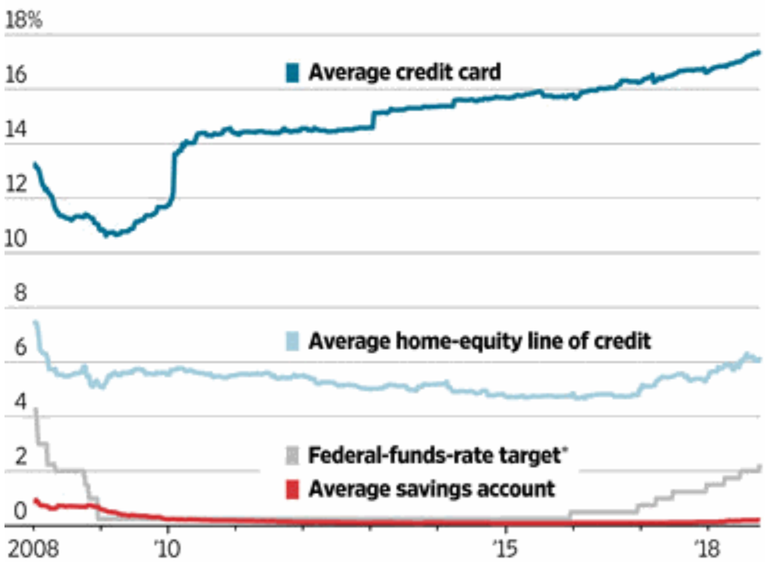
But smaller banks and online-only institutions have been raising their rates, a move that some analysts believe may put even more pressure on larger banks to pay up. And banks have been more willing to raise deposit rates for customers with large accounts or who are more likely to take their business elsewhere, such as business clients or wealth-management customers.

"Deposits were sticky for so long that it felt like it was structural," said Jim Vogel, an interest-rate strategist at FTN Financial. "But as competition heats up and as people realize that maybe they do have enough money in the bank, they are looking for better yields."

Banks are also having to pay up in the capital markets. One benchmark for their short-term borrowing, the three-month U.S. dollar London interbank offered rate, has climbed to 2.41%, from about 0.5% when the Fed first raised rates in 2015.

Left Behind

Banks have been quick to raise the rates they charge on loans but slower to raise what they pay on deposits.



*Upper limit of target range since December 2008
Sources: Bankrate.com (credit cards, Heloc, savings); Federal Reserve (fed-funds rate)
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WSJ PRO CENTRAL BANKING

Economy

Turkey Central Bank Lifts Inflation Forecasts, Pledges Tighter Policy if Needed; The central bank lifted its 2018 inflation projection to 23.5% from 13.4%

By Yeliz Candemir
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ISTANBUL—Turkey's central bank Wednesday sharply raised its inflation forecasts for 2018 and next year and vowed to tighten monetary policy further if needed amid concerns over slowing economic growth.

The central bank lifted its 2018 inflation projection to 23.5% from 13.4%, and raised its 2019 inflation forecast to 15.2% from 9.3%, citing upward revisions in the assumptions for **oil prices** and food prices as well as currency depreciation.

Governor Murat Cetinkaya said the central bank raised its 2020 inflation forecast to 9.3% from 6.7% and inflation will stabilize around 5% in the medium term as tight monetary policy will support the slowdown.

"The central bank will continue to use all available instruments in pursuit of the price-stability objective," Mr. Cetinkaya said, in response to investors' concerns over the central bank's independence.

Annual inflation hit a 15-year high of 24.5% in September, nearly five times the central bank's official target of 5%.

Mr. Cetinkaya said the central bank doesn't plan to revise its official inflation target and the slowdown in economic activity will help to ease upward inflationary pressures.

The central bank last week held interest rates steady after the Turkish currency recently rallied on the back of a sharp interest-rate increase in September and improving relations between Ankara and Washington over the release of American pastor Andrew Brunson, held in Turkey on terrorism charges.

At the central bank's meeting in September, policy makers lifted its main interest rate by 625 basis points in a bid to tame inflation.

The easing of tensions with the U.S. has supported a rebound in the Turkish lira. Nonetheless, the lira is still down 31% against the dollar so far this year, reflecting ongoing concerns about an economy that has boomed on the back of a government-backed debt binge. The Turkish economy last year grew 7.4%, the fastest pace of any Group-of-20 country.

Under the new economic plan, the government expects the Turkish economy to slow to 3.8% this year and 2.3% next year. The International Monetary Fund projects Turkey's growth at 3.5% this year, falling to 0.4% next year.

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Business
Corporate Loans Help Investors Fight the Fed; Once-niche market becomes a haven as rising interest rates hurt stock and bond prices

By Matt Wirz
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Corporate loans have outperformed almost every asset class this month as climbing interest rates hit stock and **bond prices**, defying analysts' warnings about rising risk in funds that buy below-investment-grade loans.

While stocks bore the brunt of the recent selling, even investments that typically profit when rates rise have declined, leaving investors with few havens. The resilience of so-called leveraged loans in this environment helps explain the rising popularity of the once-niche market, which grew to a record $1.2 trillion this year, overtaking the amount of outstanding junk bonds for the first time.

Leveraged loans to companies with junk credit ratings have grown increasingly popular among individual and institutional investors because they pay relatively high interest that moves in lockstep with benchmark interest rates. That feature insulates the loans from rate increases by the Federal Reserve, which have weighed on corporate and government bonds throughout the year and sent stock prices tumbling in recent days, analysts said.

"It's a Wall Street truism that you can't fight the Fed—except, maybe, with loans," said Steve Miller, a loan-market analyst and chief executive of Fulcrum Financial Data.

Rising interest rates hurt the value of outstanding bonds, pushing yields higher, and can trigger stock declines by slowing economic growth over the long term. Treasury inflation-protected securities, or TIPS, typically rise in value with interest rates, but prices of the securities have fallen this year because the Fed is raising rates despite little change in expectations for inflation.

Some investors buy commodities as a buffer against rising prices but so far inflation has been muted in the U.S. The price of gold, a traditional inflation hedge, has dropped 6.3% this year to $1,223.50 a troy ounce.

Fear of rising rates pushed prices lower across markets this month, hitting junk bonds, investment-grade corporate bonds and global stocks, but an S&P index of leveraged loans returned 0.16% in October, counting price changes and interest payments, bringing its 2018 returns to 4.13% as of Wednesday. The **S&P 500** had returned more than 9% for the year before this week's steep decline, which brought the 2018 total to 5.76% as of Wednesday.

Leveraged-loan returns have beaten investment-grade and high-yield bonds in only five of the past 26 years and in four of those years the Fed raised rates, Mr. Miller said.

"Loans perform best relative to other asset classes when rates are going up and the economy is still solid and that's exactly what's happening now," he said.

The outperformance of leveraged loans marks a recovery for the asset class. Investors piled in during 2013, betting that rates would rise, only to be disappointed by tepid returns when the Fed kept rates low in response to sluggish global growth. Appetite for loans picked up again this year and loan mutual funds attracted a net $16.5 billion through October, the third-largest annual inflow ever for the asset class, according to data from Morningstar Inc.

The flood of money has raised some warning flags in the loan market, analysts and investors say. Junk-rated companies have capitalized on investor demand for loans by taking on historically high levels of debt without giving loan investors the same protections, or covenants, they historically offered.

"There are these free-floating fears about leveraged loans and they're not completely misplaced about the most aggressive loans being made," said Scott Page, co-head of Eaton Vance Corp.'s loan investing team.

But most new deals remain relatively safe because the loans are secured by corporate assets and long-term returns should remain consistent through the coming credit cycle, he said. Eaton Vance's flagship fund has averaged annual gross returns of 6.85% since inception in 1989, he said.

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Related

* U.S. Stocks Extend Losses on Heels of Wednesday Rout

* Leveraged Loans Not as Safe as They Once Were (Aug. 16)

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EXCHANGE --- Chinese Shares Show Resilience After Deep Selloff

By Steven Russolillo and Shen Hong
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Chinese stocks, among the biggest losers in a global market selloff this week, rose Friday in a **volatile** trading session as investors reassessed the impact of the U.S.-China trade spat on the country's economy and its markets.

The Shanghai Composite rose 0.9% after earlier falling as much as 1.8%. The tech-heavy Shenzhen market was 0.2% higher after earlier tumbling as much as 3.1%. The moves came after both indexes on Thursday logged their worst one-day drops since February 2016.

Some investors were encouraged by trade data released Friday that showed better-than-expected growth in Chinese exports. That helped ease concerns about the damage to China's economy from U.S. tariffs and other trade friction.

"The strong data definitely was a shot in the arm for a badly beaten-up market," said Zhang Yanbing, senior analyst at Zheshang Securities Co.

Still, China remains one of the world's worst-performing equity markets this year, with Shanghai down 21% and Shenzhen off 32%.

"After yesterday's steep, panicky selloff, investors have turned extremely pessimistic and it's hard to see any major upside in the foreseeable future," said Jacky Zhang, an analyst at BOC International.

Global market **volatility** aside, there are rising concerns about a lack of clear economic policy direction from Beijing to counter slowing growth, Mr. Zhang said. "The market would like to see more potent measures such as deeper tax cuts and other reforms but they remain absent," he added.

Other markets also had a reprieve. Indexes in South Korea and Hong Kong gained 1.5% and 2.1%, respectively, Friday while Japan's Nikkei 225 index rose 0.5%. Taiwan's Taiex gained 2.4%, recovering some after falling 6.3% a day earlier, its worst one-day slide since January 2008.

The moves followed another **volatile** trading session in the U.S., where the **S&P 500** tumbled 2.1%, capping a two-day selloff as investors refocused on the Federal Reserve's interest-rate increases and rising bond yields, coupled with evidence of slowing global growth and escalating trade tensions.

"The U.S. expansion is getting older and the Fed is ever tighter," said Steven Wieting, managing director and global chief investment strategist at Citi Private Bank. "This impacts every global asset class to some degree and suggests a gradual shift to a more defensive asset allocation over time."

Chinese tech companies have been some of the market's biggest victims this year, finding themselves hurt by two forces: a broad selloff in internet companies, and an escalating trade spat between Beijing and Washington that has an outsize impact on China's biggest tech suppliers.

"Investors are currently most concerned about the protracted China-U.S. trade dispute, which seems to be expanding beyond trade itself," strategists at Goldman Sachs wrote in a note to clients.

One standout gainer on Friday was Tencent Holdings Ltd., the Chinese internet giant that has been clobbered in recent days. Shares jumped 8%, snapping a record 10-day losing streak. Hong Kong-listed Tencent has lost more than a quarter of its value this year; more than $250 billion had been wiped off its market value from its record high in January through Thursday.

Shares in Chinese smartphone giant Xiaomi Corp. and smartphone camera lens-maker Sunny Optical Technology Co. also picked up, rising 3.2% and 10.7%, respectively. Hong Kong-listed shares of ZTE Corp., a top seller of smartphones to the U.S. for years, rose, as did Lenovo Group Ltd., a Chinese maker of PCs and servers.

Meanwhile, the yuan rose against the dollar in China's domestic market, following news that the White House has decided to move ahead with plans for President Trump to meet with Chinese leader Xi Jinping at the Group of 20 summit in Buenos Aires next month. One dollar bought 6.9040 yuan, down from 6.9268 Thursday.

The yuan's rebound came despite a surprise move by China's central bank to set the daily reference rate weaker against the greenback before trading began on Friday. The People's Bank of China set the so-called dollar-yuan fix at 6.9120 versus 6.9098 Thursday. A weaker yuan helps China's exports.

Outside of mainland China, a dollar recently bought 6.8989 yuan.

Elsewhere, stocks in some of the Asia-Pacific region's smaller markets were higher on Friday. After its worst day in nearly a decade, New Zealand's NZX-50 index rose 1.4%.

Mike Bird contributed to this article.

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WSJ PRO CENTRAL BANKING

Markets
Wall Street Fractures Over Stock Exchanges' Data Sales; Some traders say exchanges have a monopoly over certain data, allowing them to charge too much

By Dave Michaels
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WASHINGTON—Stock exchanges and traders clashed on Thursday over the cost of crucial market data that powers the decisions of everyone from computer-driven traders to mutual-fund managers.

The fight, staged at two days of public hearings at the Securities and Exchange Commission, opened one week after the regulator decided that the New York Stock Exchange and Nasdaq Inc. didn't justify fees they charged for a pair of market-data products. The panel's competing interests—exchanges on one side, brokers and investors on the other—accused each other of misleading the public about the scope and origins of the problem.

Data has emerged as an important business for the three big exchange groups that dominate the U.S. **stock market**: NYSE parent Intercontinental Exchange Inc., known as ICE; Nasdaq; and Cboe Global Markets Inc. Revenue from ICE's and Nasdaq's various data-related businesses rivals what the companies make from trading.

Douglas Cifu, chief executive officer of global market-maker Virtu Financial Inc., said his firm's total costs to access U.S. **stock-market** data is five times what he collectively pays to 225 exchanges in 35 other countries.

"The fix is, make it competitive," Mr. Cifu said. "This is the cable company, the telephone company, before it was broken up." Mr. Cifu kicked off the hearings by displaying a spool of yellow cable for which exchanges charge certain traders about $20,000 per month. Mr. Cifu, whose firm pays the fee, said he could purchase the same equipment from Amazon for about $88.

Exchange executives defended prices on data containing current stock prices and recent trades, as well as on how much supply and demand there is for stocks at different price levels. The executives said firms such as Virtu have twisted the narrative in an effort to sway regulators toward their own needs.

"Virtu is notorious for being a cost-cutting organization," Stacey Cunningham, NYSE's president, said in an interview after her panel ended. "It's not surprising that he's trying to take every last bit of cost out that he can."

The debate at the SEC's panel often took a heated tone.

Chris Concannon, the president and chief operating officer of Cboe Global Markets Inc., said his company had little appetite for compromise because of "the recent unprecedented and unwarranted public assaults on exchanges."

The exchanges earlier this week appealed the SEC's decision against them to the U.S. Court of Appeals for the District of Columbia Circuit.

Mr. Concannon said he thought Mr. Cifu's data cable was a prop that mischaracterized the economics of the exchange business. Exchanges levy such fees, he said, because they have to invest in sophisticated computer systems that process billions of electronic messages every day. Regulators require that exchanges be able to process spikes in order traffic without their systems going down.

Disclosures from ICE, Nasdaq and Cboe show that their combined **stock-market** data revenues were around $560 million in 2017, although those don't include connection fees that traders and brokers pay to access the data.

Costs for exchanges' data have grown over the past eight years at a compound average growth rate 11.7%, according to industry consultant Larry Tabb.

Mr. Tabb, who is scheduled to testify at the hearings, said much of that increase stems from exchanges charging licensing fees, which requires brokers to pay multiple times for the same data, depending on the business purpose they have for using it.

Mehmet Kinak, global head of systematic trading at T. Rowe Price Group Inc., said fund managers such as his company are exposed to rising data costs through their trading commissions, because their brokers feel compelled to use the fastest and richest market-data feeds from every stock exchange.

"If I am slower than the other person, I lose," Mr. Kinak said. "This arms race was built by the exchanges."

Virtu, which handles as much as 20% of all stock trading, has asked the SEC to make exchanges periodically disclose how much money they earn from each data product and how much it costs to compile and distribute the data.

It is unclear how the testimony at Thursday's hearing may affect potential new regulations. Most of the SEC's five-member commission signaled they are open-minded about whether new restrictions are needed.

SEC Chairman Jay Clayton said that businesses have "emotionally held" views about the cost of market data. "If you want to appeal to me, explain to me why what you want is in the interest of people who are in the market for the long term," Mr. Clayton said.

Robert J. Jackson Jr., a Democratic member of the SEC, said mom-and-pop investors may pay too much to trade because their brokers are squeezed by rising data costs.

"The time for transparency into these markets is long overdue," Mr. Jackson said.

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* SEC Ruling Takes Aim at Stock-Exchange Profits (Oct. 16)

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THE WALL STREET JOURNAL.

Markets

Why Fund Investors Should Look Beyond Fees; Funds tracking the same index can produce different results for reasons other than fees, so it's important to look under the hood

By Jeff Brown
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Fidelity Investments recently escalated the cost-cutting wars among index-fund giants such as Vanguard Group, Charles Schwab Corp. and State Street Corp. by launching four index funds that charge no management fees.

The zero-fee funds are the latest salvo in a years' long price war among fund firms seeking to attract cost-conscious investors who have been flocking to plain vanilla funds that track indexes like the **S&P 500**, instead of spending big money on funds run by hotshot managers.

But the race to zero has also left some investors wondering: In a world where fees are so low already, should cost be the most important factor when choosing among funds that track the same index?

Investing experts say funds tracking the same index aren't necessarily clones, which is why investors shouldn't base their buying decisions on fees alone. Indeed, some funds do a better job mirroring the returns of their underlying index than seemingly identical peers, and the reasons for that can be found under a fund's hood.

Practices such as sampling (when a fund holds a sample of securities in an index rather than fully replicating it), use of derivatives, turnover, tax management and securities lending can lead to different results among funds tracking the same index. Details on fund policies are available from research firms such as Morningstar Inc. and in fund disclosures, including the prospectus.

"Just because a fund calls itself an index fund doesn't mean it will have exactly the same holdings as the benchmark," says Andy Kapyrin, partner and director of research at wealth-management firm RegentAtlantic in Morristown, N.J. Some do strive to own all the securities in the underlying index, some choose a representative sample that may allow for "small differences," he says.

Reality check

Fees, or "expense ratios," are a percentage of the investor's holdings charged for managing the fund. While investors pay about 0.6% on average for actively managed funds, index funds typically charge less than 0.1%, according to industry trade group Investment Company Institute. Index investors pay less because they are content to match market gains rather than taking bigger risks swinging for the fences.

At the end of 2017, 37% of all assets in U.S. mutual funds and exchange-traded funds were in index funds, up from 3% in 1995 and 14% in 2005, according to the Federal Reserve Bank of Boston.

Low fees are such a big selling point that fund firms have engaged in a price war. This summer, Fidelity launched four zero-fee funds: Fidelity ZERO Large Cap Index (FNILX) and Fidelity ZERO Extended Market Index (FZIPX), Fidelity ZERO Total Market Index (FZROX), Fidelity ZERO International Index (FZILX). Already, the funds have amassed close to $1.5 billion in assets, according to Morningstar.

But that doesn't necessarily mean investors should dump similar index products they have already. Daniel Kern, chief investment officer at TFC Financial Management in Boston, recommends a reality check.

"The difference in cost between Fidelity's ZERO Total Market Index fund and competing funds offered by Schwab, BlackRock Inc.'s iShares and State Street is 0.03%," he says. "For someone investing $10,000, the cost savings amounts to only $3 a year," he says. "The tax and/or transaction costs associated with switching from an existing index fund holding would be far higher than the cost savings for many consumers."

Even if the fund is held in an IRA or 401(k), and thus protected from immediate taxes on gains after a sale, there is no guarantee the cheaper fund will do better. Derek Hagen, founder of Hagen Financial in Minneapolis, says that, in addition to looking at return data, fund shoppers should look at "tracking error," a gauge of how well a fund mirrors the performance of its index.

"Ideally, you would like to see the fund have tracking error that is less than or equal to the expense ratio," Mr. Hagen says. That would mean the error is caused by the expenses and not some mismatch in the fund's holdings and the index.

Tracking error can arise from various factors, like a fund owning just a sample of securities in the index or employing options or futures contracts to stand in for hard-to-trade securities. Small and foreign stocks and bonds, for example, may be expensive to buy and sell due to large spreads between bid and asked prices, so a sample or derivative may be used instead.

"Funds tracking broad **stock-market** indices like the **S&P 500** rarely have trading problems, but funds that track indices of foreign stocks or smaller companies can deviate from the value of the underlying holdings," Mr. Kapyrin says.

He says ETFs, which trade like stocks, typically track their indexes very well, but that investors should be wary of those with a large bid/ask spreads, caused by differences in supply and demand. A large spread means you are paying more than what you could get if you wanted to sell the fund immediately.

Turnover's effect

Tracking error also can be enlarged by turnover, or the percentage of a fund's total value that changes hands each year due to investor purchases and redemptions. Lots of redemptions force the fund to sell assets to pay the departing shareholders. This can increase a fund's costs and result in poor timing, such as buying when prices are up and selling when they're down.

For investors using taxable accounts, sales of profitable assets to meet redemptions can trigger tax bills on profits paid out to shareholders in year-end distributions. For these shareholders, the index product with lower turnover would generally be best. (Redemptions aren't an issue with ETFs because investors who get out simply sell shares to other investors, and the fund company doesn't have to sell holdings to raise cash.)

Some funds try to curb turnover by prohibiting investors from buying shares soon after selling them. Long-term investors might value that.

And some fund managers strive to reduce the gains booked in these forced asset sales by selling the assets purchased at the highest prices. That's possible because index funds must buy and sell the same securities over and over as investors move money in and out, so different blocks are purchased at varying prices.

Mr. Hagen says some fund managers offset expenses and reduce tracking error by lending securities for a fee to short sellers.

"Securities lending is a source of revenue for many index funds," Mr. Kern says. Details on lending can be found in the fund's Statement of Additional Information (SAI), he says.

Mr. Brown is a writer in Livingston, Mont. You can email him at reports@wsj.com.

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* Tax Trap for Mutual-Fund Investors

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THE WALL STREET JOURNAL.

Page One
What's News: Business & Finance

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5 October 2018
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The Trump administration aims to step up trade talks with other countries using its new pact with Canada and Mexico as a template, and trade partners are girding for contentious talks.

U.S. stocks slumped as a selloff in government bonds reverberated around the world. The **S&P 500** fell 0.8%, while the **10**-**year Treasury** yield rose to 3.196%.

Musk risked reigniting a battle with federal securities regulators when he appeared to openly mock the SEC only days after the Tesla chief settled fraud charges with the agency.

Campbell Soup is in talks to sell its fresh-foods business, including Bolthouse Farms, to investors led by that brand's former chief.

SoftBank has teamed up with Toyota to deliver meals, health care and other services in self-driving cars to an aging populace in Japan.

GE agreed to pay its new CEO as much as $21 million a year for four years, with the potential for more depending on the stock's performance.

Samsung Electronics expects third-quarter operating profit will be its highest ever, as demand for its electronic components remains high.

A U.S. judge committed Chinese telecommunications firm ZTE to another two years of scrutiny by a court-appointed monitor.

Hedge fund Criterion is shutting down, the second large fund to announce its closure this week.

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WSJ PRO CENTRAL BANKING

Economy

U.S. Consumer Sentiment Ticked Down at the End of October; University of Michigan's consumer sentiment index was 98.6, down from an initial 99.0 reading earlier this month

By Sharon Nunn
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WASHINGTON—American households became slightly less confident about the economy in late October, but their overall outlook remained elevated despite rising financial and political uncertainty.

The University of Michigan on Friday said its consumer sentiment index was 98.6 in October, ticking down from an initial 99.0 reading published earlier this month. Economists surveyed by The Wall Street Journal had expected the final reading to stay at 99.0 for October.

Consumers' view of current economic conditions and expectations for the future darkened in October, bringing the overall index down slightly. **Stock market volatility**, rising interest rates and a harsh political climate are likely some of the key driving factors. The survey also showed Americans increasingly think inflation will flare in the next year.

These issues "have not acted to undermine consumer confidence," said Richard Curtin, the Michigan survey's chief economist. "Needless to say, consumers are not immune to these negative factors. The data only indicate that the tipping point toward escalating pessimism has not been reached."

Indeed, despite the month's slight downdrift, the index has remained higher in 2018 than in any year since the turn of the century. Measures of how consumers feel about the economy climbed after President Trump was elected in 2016 and have been buoyed by strong economic growth, low unemployment and rising wealth.

Households now appear to believe the economy will continue to churn out jobs like it has in recent years, despite sluggish wage growth. The unemployment rate fell to the lowest level since 1969 in September, while average hourly earnings rose 2.8% from a year earlier. Many analysts think wage growth should have picked up to a much higher rate because of how hard employers have had to look to find qualified talent in recent months.

Historically, paycheck gains helped drive consumer sentiment, but that shifted in the 1980s. Now, Americans appear to care more about job security, largely because of job losses during the recession as well as the aging of the labor force, according to Mr. Curtin.

"Older folks are more likely to fear a job loss than if they get a percentage point less in their pay...it's difficult to change jobs or careers when you're 55 or 60," Mr. Curtin said. "Young people are very concerned about this as well because of what occurred during the [recent] recession when many were growing up."

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THE WALL STREET JOURNAL.

Economy

Treasury Department to Increase Size of Debt Auctions; Swelling deficits and a shrinking Federal Reserve portfolio increase government's borrowing needs

By Kate Davidson and Daniel Kruger
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WASHINGTON—The Treasury Department said Wednesday it would again boost the size of its debt auctions to meet funding needs caused by swelling budget deficits and a shrinking Federal Reserve portfolio.

Debt levels are rising at the same time the Federal Reserve is raising interest rates—factors that have led bond yields to rise and prices to fall in recent months. Treasury issuance is testing investor appetite for U.S. government debt, and so far demand for the securities has held up.

"The Treasury is pushing the boundaries and not breaking them," said Jim Vogel, head of interest-rate strategy at FTN Financial.

The Treasury's approach of slow, steady increases to auction sizes has mirrored the Fed's gradual approach to raising interest rates, analysts said. The predictable path of both policies has helped to limit **volatility** in the bond market, which has encouraged many people to continue investing even as **bond prices** have fallen, which pushes their yields higher.

The Treasury said this week it expects to issue $1.34 trillion in debt by the end of 2018, the most since 2010, when the U.S. economy was struggling to regain its footing following a deep recession. The Treasury gets cash to fund the government in exchange for selling the securities.

The increase in borrowing is happening at an unusual moment for the U.S. economy. Economic growth has accelerated since mid-2017 and the unemployment rate, at 3.7% in September, is the lowest it has been in nearly 50 years. Deficits typically fall during economic expansions, as the bigger workforce and rising incomes push up tax revenue.

The $1.5 trillion tax cut enacted late last year and a two-year budget agreement to boost federal spending is pushing up deficits, however, at the same time interest expenses on the debt are climbing as bond yields rise.

Economists and investors are unsure whether the recent pickup in growth will be sustained once the recent fiscal support wanes, raising questions about the long-term risks to the nation's economic outlook. Rising deficits could restrain economic growth as the cost of credit also rises.

The Treasury said earlier this month the deficit grew 17% in the fiscal year that ended Sept. 30, amid higher spending and sluggish revenues. The deficit is headed toward $1 trillion in the current fiscal year, the White House and Congressional Budget Office said.

The Treasury's announced increases in monthly bond auctions through January are somewhat more modest than those it unveiled in February, May and August. The department said Wednesday it expects to boost the size of its 2-, 3-, and 5-year note auctions by $1 billion a month in November and December, and would increase the size of its floating-rate note auction by $1 billion in November.

The Treasury also said it would increase auction sizes for its 7- and 10-year notes and its 30-year bonds by $1 billion in November, and would hold the rate steady at that level through January.

In addition, the Treasury said it would introduce a new five-year security starting in 2019, and would increase total TIPS issuance—Treasury inflation-protected securities—by $20 billion to $30 billion, with much of the increase focused on the new five-year security.

The Treasury began adjusting the size of its nominal coupon and two-year floating-rate note auction sizes earlier this year. Its two-year note auctions have increased to a planned $39 billion in November from $26 billion a year ago, while 30-year bond offerings have risen to $19 billion from $15 billion during the same period.

"We've been able to finance the deficit effectively through all kinds of economic environments," said Brian Smith, the deputy assistant Treasury secretary for federal finance. "I'm confident that we'll be able to continue to issue securities and fund the government at the lowest cost to the taxpayer," despite the challenges, he said.

A group of private banks that advise the Treasury—known as the Treasury Borrowing Advisory Committee, or TBAC—said that after the borrowing increases over the next two months it expects "nominal issuance increases to be limited for the remainder of [fiscal year] 2019."

Other analysts said the government could opt to continue raising the size of its debt auctions throughout the course of 2019. One reason is that tax revenue hasn't grown to match the cost of the government's 2017 tax cut. Another is that the Treasury must adjust its borrowing schedule around the Fed's plans to continue reducing the size of its bond portfolio, said Thomas Simons, a money market economist at Jefferies Financial Group Inc. The TBAC appears to have taken "a very short-term view" about the extent of the Fed's balance sheet reduction, which could lead the group to underestimate the government's borrowing needs, he said.

The central bank expects for an indefinite period to cut back its holdings by about $30 billion a month in Treasury securities and $20 billion a month in mortgage debt. The Fed's portfolio reached a peak of $4.2 trillion as the central bank bought Treasury and mortgage bonds to help stimulate the economy after the financial crisis. As those bonds mature, the Fed is allowing some of that debt to roll off its balance sheet. This is forcing the Treasury to sell more government securities to private investors.

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THE WALL STREET JOURNAL.

Markets
Rates Are Rising, But Banks Aren't Worried About Consumers; Earnings from JPMorgan, Citigroup others show the U.S. economy is performing well, executives say

By Telis Demos, Peter Rudegeair and Emily Glazer
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The good times keep rolling for the biggest U.S. banks, with consumers easily absorbing higher borrowing costs and the economy shrugging off trade spats, political strife and market swoons.

JPMorgan Chase & Co., Citigroup Inc. and Wells Fargo & Co. posted double-digit profit increases in the third-quarter, largely because of a pickup in income from consumer lending and spending.

Rising interest rates make it more expensive for households to maintain a borrowing binge that has reached record highs in some categories, yet banks reported Friday that default rates nonetheless improved in the third quarter.

Markets around the world have struggled this week to come to terms with how rising interest rates and government bond yields will ripple through the economy, as well as with the impact of the U.S.'s antagonism toward key trading partners.

Fears that higher borrowing costs could lead to a slowdown in consumer spending and business investment helped drive the **Dow Jones Industrial Average** down 5% over Wednesday and Thursday. President Donald Trump blamed the steep drop in markets this week on the Federal Reserve's decision to raise short-term rates: "I think the Fed has gone crazy," he said.

Yet bank executives said underlying economic trends are encouraging.

"Most of the consumer credit written since the Great Recession has been pretty damn good," JPMorgan Chief Executive James Dimon said a conference call Friday morning. He added that didn't expect the strong performance of the U.S. economy to diminish soon "in spite of these increasing overseas geopolitical issues bursting all over the place."

Executives brushed off the market's sharp move this week, which roiled their own stocks.

"The U.S. economy is performing very, very well, and the Fed has been moving steadily upward over the past two years," Citigroup Chief Financial Officer John Gerspach told reporters on a conference call on Friday. "Now, the market is going to have to react to somewhat of a return to a more normal short-term rate structure."

JPMorgan's third-quarter profit rose 24% from a year ago, to $8.4 billion, and Wells Fargo was up 32% to $6 billion. Citigroup's net income rose 12%. All three banks also continued to benefit from a tax-code overhaul that slashed the corporate rate.

JPMorgan shares were trading down 1.4% midday Friday, while Citigroup rose 0.56% and Wells Fargo was up 0.12%. Bank stocks, broadly, have underperformed this year. The Nasdaq KBW Bank index is down about 6% this year, versus a 3% rise in the broader **S&P 500**.

U.S. consumers, excluding their mortgages, now owe a record $4 trillion in the form of student loans, auto loans and credit cards. Despite higher debt loads, households are paying out just under 10% of their disposable income on interest payments, according to Federal Reserve data. That is down from over 13% in the run-up to the financial crisis.

Citigroup reported a 4% jump in North American credit-card borrowing, to $137 billion, even as rates charged on those loans ticked higher. Credit-card balances were up 5% to $148 billion at JPMorgan.

A trend of rising defaults for card loans over the last several quarters slowed. Citigroup reported that 2.91% of loans on the bank's branded cards were lost to defaults, higher than a year ago but below the 3.04% rate in the second quarter.

Overall default rates continued to trend lower. JPMorgan charged off 0.45% of its loan portfolio during the third quarter, down from 0.58% a year go. Wells Fargo's overall charge-off rate fell to 0.29% of its loan book.

The banks' mortgage businesses, however, have suffered as rates have risen. The pace of new mortgage lending in the third quarter dropped 16% at JPMorgan and 22% at Wells Fargo.

Mortgage rates hit their highest level in more than seven years this week, a level that some fear could cause even more consumers to think twice about buying homes.

JPMorgan shareholder Matt Watson of James Investment Research Inc. said he expects rising rates to continue to put pressure on banks' mortgage businesses.

"Rising rates is not necessarily a panacea for large banks, it's a spread between the two," said Mr. Watson, whose Alpha, Ohio, firm owns around $46 million worth of JPMorgan stock.

With the slowdown, banks are looking to cut costs in the business. The Wall Street Journal reported recently that JPMorgan is laying off around 400 employees in its mortgage division and Wells Fargo is laying off around 650 mortgage employees to help cope with a slowdown in the market. Wells Fargo CEO Timothy Sloan said on a conference call with analysts that the mortgage-banking industry is "in overcapacity right now."

"It's unclear exactly how long it's going to take that to shake out," he added.

Banks also reported rising pressure in the form of consumers and businesses pressing for higher deposit rates.

Wells Fargo said deposits fell 3% from a year ago, to $1.27 trillion, as consumers were seeking to move their extra money "to higher-rate alternatives." Citigroup, whose North American retail deposits also fell, said it faced new pressure from small- and medium-size business customers who wanted to move money elsewhere.

Consumers aren't the only borrowers in the spotlight. Companies are by some measures as extended as ever, fueled by years of historically cheap borrowing costs. As of the first quarter, U.S. corporate debt as a percentage of GDP stood at 45.2%, topping the highest point in the run up to the financial crisis, according to Moody's Corp.

But even as some onetime retailer leaders, such as Sears Holding Corp. or Toys "R" Us, have been threatened by changing consumer habits, banks didn't report any particular concerns about their exposure to highly leveraged companies.

"It's a different business [today] than it was during the crisis and precrisis," Citigroup's Mr. Gerspach told reporters on Friday.

Write to Telis Demos at telis.demos@wsj.com, Peter Rudegeair at Peter.Rudegeair@wsj.com and Emily Glazer at emily.glazer@wsj.com

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Markets
Gold Prices Gain as Stocks Slump; Volatile stock markets have helped boost gold around 2.9% since late September

By Ira Iosebashvili
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Gold prices rose to their highest level since July on Tuesday, as a sharp decline in stocks fueled demand for safe-haven assets.

Gold for December delivery was recently up 1.3% at $1,240.70 a troy ounce on the Comex division of the New York Mercantile Exchange.

Stocks sold off around the world Tuesday on fresh fears about the health of China's economy and a slew of geopolitical concerns. The **S&P 500** was recently down 1.4%.

Some investors buy gold during times of economic or political uncertainty, believing it will hold its value better than other assets when markets turn rocky. **Volatile** stock markets have helped boost gold around 2.9% since late September.

The Japanese yen, another popular destination for nervous investors, was up 0.7% against the dollar.

In base metals, copper for December delivery was recently down 1.3% to $2.7485 a pound. China is the world's largest copper consumer, and worries over the country's economic health tend to weigh on copper prices.

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Streetwise: Bond Woe May Spark A Healthy Change

By James Mackintosh
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Rising bond yields sound like a **stock-market** killer. The good news for shareholders is that the market overall might be fine. The trouble lies with the FANGs and other acronym stocks that have been leading indexes higher.

Treasury yields have accelerated their climb, but it has been the wrong sort of rise: mainly due to an increase in uncertainty, rather than expectations of a stronger economy and higher interest rates. Luckily for stock investors, the trouble, largely contained to the big tech disrupters, isn't widespread.

The rise in bond yields has been fast and painful. An investor who held benchmark 10-year Treasurys this year would have lost 5.8% by the end of last week, even after reinvesting the coupon.

Until last week this wasn't a problem for the **S&P 500**. But the most recent **bond-yield** rise -- the biggest in four days since the 2016 election -- hurt shares because it wasn't, contrary to what some may think, about a stronger economy and higher interest rates.

Instead, bond yields were pushed up almost entirely by a higher term premium, the extra yield offered above expected interest rates for locking up money for 10 years. (In a post-quantitative-easing quirk of the bond market, this term premium is currently negative, but less negative than it was.)

Bond investors are less sure where they stand, and so demand a higher term premium. Inflation is uncertain, with anecdotal evidence of bottlenecks and worker shortages even as hard data suggest price rises are well under control. The economic cycle is long in the tooth, with lots of debate about when the next recession will come. And Federal Reserve Chairman Jerome Powell has been emphasizing how little the central bank knows about the future.

Sure enough, shares are down a bit, and the highest-flying growth stocks are down a lot. Even Amazon.com was down almost 10% from its late-summer high to Monday's low, while glamour stock Netflix lost even more in just four days.

There are three reasons to worry. The first is that the acronym stocks -- Facebook, Amazon, Apple, Google parent Alphabet, Netflix, Microsoft and others arranged into the FANGs, FAAMGs and so on -- flew too high, and will now fall hard. They were propelled by strong fundamentals and helped by low bond yields making profits far in the future look attractive by comparison.

If rising yields have broken their upward momentum, it might turn into a downward spiral as investors try to cash in their paper profits on the acronym stocks before they vanish.

The second reason for concern is that if the term premium keeps going up, the acronym stocks should keep suffering as a result. A simple return of the term premium to where it stood three years ago, just before the Fed rate rises began, could power 10-year yields to 3.75%; a return to what used to count as normal would take it well above 4%. Discount future profits back to today at a higher interest rate and they are worth less, and that hits rapidly growing companies more than the rest of the market because more (in some cases all) of their profits are far in the future.

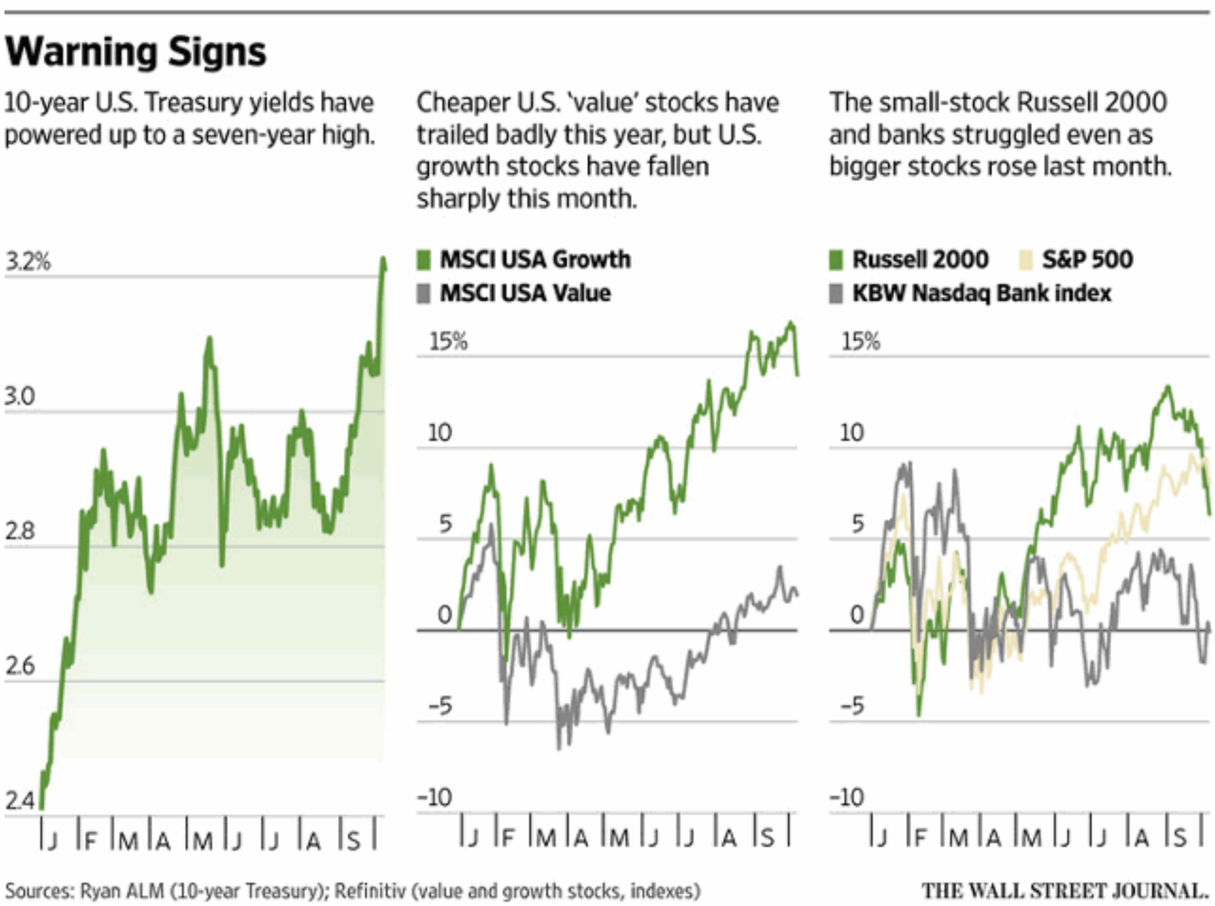
The third worry is that the **stock market** already was looking unhealthy. Since the start of September, smaller companies have been having a terrible time and bank stocks have fallen sharply. Both suggest a lack of confidence in the economic outlook. The overall market was held up by the performance of a relatively small number of large stocks in high-growth sectors, so if they stumble, the outlook is grim.

These are powerful arguments, but I am hopeful that rather than a full-blown market correction, this will be merely a rotation away from the overdone highfliers and back into some of the cheaper laggards.

The gap between cheap "value" stocks and expensive growth stocks this year was huge: On MSCI's indexes, U.S. value stocks were up just 1.6% by the end of September, while growth stocks rose 16.5%.

A shift back to value would be a welcome recognition that the future of the economy doesn't rest with just a handful of companies. The last really big example of a rising term premium and uncertainty also worked out OK for stocks: In the 2013 taper tantrum, the term premium and yields rose further and faster than they have recently, and U.S. stocks made back their losses within a month.

There are no guarantees, and companies are both more leveraged and more highly valued than they were in 2013. But at the very least it is too early to panic about bond yields.



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Markets
ETF Terminology, in English; Exchange-traded funds have a vocabulary all their own. Here's a guide for the curious investor.

By Ari I. Weinberg
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Corrections & Amplifications

The first name of ETF.com's Lara Crigger was misspelled as Laura in an earlier version of this article. (Oct. 8, 2018)

When it comes to exchange-traded funds, the most difficult part for investors may not be deciding which strategy to pursue. It may be understanding the language that describes those strategies.

Smart beta. Multifactor. Quantitative. Self-indexed. What do any of those even mean?

In the interest of bringing the ETF world and the English-language world together, here are some common terms, and what they refer to.

• Smart beta: Mostly a marketing term, a play on the financial term "beta," which measures a security's **volatility** relative to a benchmark, usually one representing an entire market, geography or sector.

Because there was never an agreed-upon definition in the ETF world, however, smart beta has come to represent any ETF that weights holdings by something other than just market capitalization. That includes not only funds that weight holdings based on factors such as a company's size, book value and trading momentum, but also those focused on a security's **volatility**, dividends or corporate-earnings quality—or any other investing idea.

"The term has been a constant source of confusion among investors," says Michael Venuto, chief investment officer and co-founder of New York-based Toroso Investments. "It lumps in too many things."

Morrison Warren, a partner at Chapman & Cutler LLP, tells investors: "Lean on the prospectus or summary prospectus. Check the index. Read the white paper."

• Factor: Spawned by research out of the University of Chicago, factors are attributes of a security that indicate it has the potential to provide a higher risk-adjusted return than the overall market. Early on, attributes such as size, value and momentum were identified as factors that could lead to outperformance, which gave rise to index funds and eventually ETFs that weighted holdings based on such attributes.

However, with endless computing power and limitless data, academics began testing every possible investment statistic for a link to returns, and factor investing evolved into a zoo, University of Chicago economist John Cochrane said in a 2011 address.

Research Affiliates, an early adopter of fundamental investing, has gone so far as to declare that most so-called factors can be ignored. "The sheer variety seems to serve the purposes of publication for [academic] tenure and product creation more than better investor outcomes," Research Affiliates partners Jason Hsu and Vitali Kalesnik wrote in 2014.

• Multifactor: A stock strategy that attempts to derive returns by including more than one factor. Some of the ETFs that engage in this strategy are fixed, meaning they try to constantly exploit the same two factors; others, such as the $139 million Oppenheimer Russell 1000 Dynamic Multifactor ETF (OMFL), try to shift with the economic tides by weighting value, momentum, quality, low **volatility** and size based on economic expansion, slowdown, contraction and recovery. How should multifactor ETFs be used? "Carefully," said ETF.com's Lara Crigger in a

May article that analyzed the over 300 ETFs in the FactSet "multifactor" universe. "Their performance leaves something to be desired, but they appear to meet their promises when it comes to lower **volatility** and risk reduction," she wrote.

• Tilt: A more-roundabout way into factor investing that starts with a market-cap-weighted index, and then slightly overweights stocks in the index with certain characteristics. In the case of the $1.3 billion FlexShares Morningstar U.S. Market Factor Tilt Index Fund (TILT) from Northern Trust, there is a "tilt" toward small-cap and value stocks. The term "tilt" is also used by active managers to describe a preferred style of investing such as value or growth, says Mr. Venuto.

• Quantitative: A strategy in which technology and mathematical formulas drive investment decisions.

"It's a lot of different things," writes diligence consultant Tom Brakke at his blog the Research Puzzle. In fact, some say the term could be used to describe any fund that tracks an index.

While factor investing rules the roost in this category, quantitative strategies also include "the emergent areas of artificial intelligence (AI) and machine learning," says Mr. Brakke, which have led to two actively managed "AI powered" equity ETFs. At their core, however, many quantitative strategies employ methodologies that aren't transparent, as opposed to published index methodologies that can be tested and replicated (though few try).

• Self-indexed: Asset managers, attempting to remove as many costs as possible from their investment strategies, are sidestepping name-brand index firms, such as S&P Dow Jones Indices, MSCI or FTSE Russell, and bringing out comparable products without licensing fees. This is how Fidelity Investments brought out several zero-expense-ratio funds in August. Mr. Warren says, however, that the SEC is taking a deeper look at the role of index firms, including self-indexers, and related disclosures.

• Leveraged and Inverse and Inverse Leveraged: These types of products generally use core holdings (think the **S&P 500**) and futures contracts or swaps to provide daily multiple returns of an individual index or sector. Because they reset every day—the goal is to magnify a single day's returns, long or short, every day—the results can be confusing, and long-term investors are advised to stay away. According to research firm XTF, leveraged ETFs run from 1.25 times to 4 times; inverse ETFs attempt to deliver minus 1 time the daily index performance, while inverse leveraged ETFs can run from minus 0.5 time to minus 4 times. Got it?

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• Hedged: A general term to imply some level of risk control, often using short selling, options, futures or swaps. A few years ago, ETFs that attempted to capture international equity returns while eliminating short-term currency fluctuations were all the rage. Now, the hot trend is fixed-income products that manage interest-rate and duration risk.

Then there are the old reliables, but even they are getting harder to define:

• Active: This term generally implies an old-fashioned investment strategy, where managers research and pick securities to try to outperform a benchmark index or manage downside risk. Unfortunately for investors seeking clarity, a series of ETFs from Goldman Sachs Asset Management dubbed ActiveBeta might leave some questioning what "active" really means. The ETFs in this case engage in a multifactor strategy combining value, momentum, quality and low **volatility**.

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Mr. Weinberg is a writer in Connecticut. He can be reached at reports@wsj.com.

Journal Report

* Insights from The Experts

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THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds & ETFs (A Special Report) --- ETF Terminology, in English: Exchange-traded funds have a vocabulary all their own; Here's a guide for the curious investor

By Ari I. Weinberg
1,255 words
8 October 2018
The Wall Street Journal
J
R4
English
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Corrections & Amplifications

The first name of ETF.com's Lara Crigger was misspelled as Laura in an Investing in Funds report article Monday about exchange-traded fund terminology.

(WSJ October 10, 2018)

(END)

When it comes to exchange-traded funds, the most difficult part for investors may not be deciding which strategy to pursue. It may be understanding the language that describes those strategies.

Smart beta. Multifactor. Quantitative. Self-indexed. What do any of those even mean?

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WSJ PRO CENTRAL BANKING

Economy

Volcker Sees Fed Rate Increases, Strong Regulations as Key to Stable Growth; The former central-bank chief reflects on economic life lessons ahead of his new book, 'Keeping At It'

By Daniel Kruger
653 words
26 October 2018
07:00 AM
WSJ Pro Central Banking
RSTPROCB
English
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The strong performance of the U.S. economy supports the Federal Reserve's policy of gradually lifting interest rates, former Fed Chairman Paul Volcker said.

A decade of accommodative central-bank policy has created conditions that could lead to speculative excess, necessitating higher rates, Mr. Volcker said. Fed officials raised rates at their September meeting and penciled in four more increases through the end of 2019.

Mr. Volcker's comments come ahead of the publication of his book, "Keeping At It," written with Christine Harper, editor in chief of Bloomberg Markets. It is scheduled for release Tuesday by PublicAffairs, a division of Hachette Book Group. In it, Mr. Volcker, 91, who spent the bulk of his career as a government official and central banker, recounts his life and takes stock of the state of the economy and **financial markets**.

Mr. Volcker was appointed Fed chairman by President Carter in 1979, elevating him from his position as president of the Fed's New York branch. He ran the central bank until 1987, when President Reagan appointed Alan Greenspan to replace him. Among his bold moves, Mr. Volcker raised the fed-funds rate to an unprecedented 20% to contain double-digit inflation. Many investors say his determination set the stage for bull markets in stocks and bonds that lasted through most of the 1980s.

"These **financial markets** are going wild, and they were helped by these invisibly low interest rates," Mr. Volcker said in an interview at his Manhattan apartment. He spoke in a gravelly voice, his long legs elevated on an ottoman in his dimly lit study, walls lined with shelves of books. "There's so much confusion, risk-taking, leveraging, debt increases—but who's minding the store?"

The complexity of markets, and the way each one reacts so quickly to developments around the world, suggest that the next crisis could originate anywhere, Mr. Volcker said. Problems that could serve as a trigger include rising debt burdens around the world.

"It's not just in the United States," he said. "Emerging countries are in difficulty, borrowing too many dollars. Italy's in difficulty, Greece is still in difficulty."

The strongest bulwark against the risk of any future crisis continues to be maintaining prudent regulations, he said.

"It's very hard to mind the store," Mr. Volcker said. "And my answer to the great concern about another financial crisis is you'd better have good, tough regulation. Of course, as soon as things are going better, people try to tear down the regulation."

In 2010, Congress passed the Dodd-Frank Act, which was meant to limit the damage a failing bank could do to the economy. The revisions Congress made to the Obama-era financial regulations under the legislation can be legitimately seen as simplifications or improvements, Mr. Volcker said.

The modifications Congress passed earlier this year cut regulations for small banks while raising the asset threshold at which larger regional lenders automatically face stricter rules. Lawmakers left untouched most of Dodd-Frank's major planks, such as emergency government powers and curbs on derivatives.

"I don't think they've done any irreparable damage—until they try to go further," Mr. Volcker said.

One part of the 2010 law which remains in place is the Volcker rule, named for the former Fed leader. Congress told regulators to draft the rule in 2010 to bar big banks from hedge-fund-like speculative trading activities. The rule remains crucial in the eyes of Mr. Volcker.

Unshackling the banks to allow them have proprietary trading accounts would ultimately "screw the customers," Mr. Volcker said. "Banks are not supposed to do that crap."

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

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THE WALL STREET JOURNAL.
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U.S. News: Alaska Awakens From Recession --- State's annual checks to residents jump 60% due to oil-price rise, end of a political standoff

By Jim Carlton
876 words
24 October 2018
The Wall Street Journal
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English
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ANCHORAGE, Alaska -- Brooks Range Petroleum Corp., a small independent oil producer here in Alaska's biggest city, is planning to boost its workforce to more than 300 people next year, up from about 50 this year and just 15 people in 2016, according to Chief Executive Bart Armfield.

Such hiring sprees aren't big news in a U.S. economy with the lowest unemployment rate in nearly 50 years. But they are in Alaska, which has been stuck in a recession for the past three years while the rest of the U.S. has enjoyed the biggest boom in a generation.

Battered by low oil prices and fiscal turmoil in state government, Alaska's unemployment rate reached a high of 7.3% earlier this year, about 3 percentage points above the national rate. Its September rate of 6.5% was still the highest of the states, according to the Bureau of Labor Statistics.

Now, the Last Frontier state is finally poised to join the rest of the U.S. economy, thanks to a recovery in oil prices and political compromises in the state capital, Juneau.

The change was evident one day earlier this month, as the long days started to shorten and the leaves changed colors. Residents were busy shopping at storefronts covered in signs advertising a type of sale unique to Alaska: discounts tied to annual oil royalty checks that go to every man, woman and child, which increased 60% this year.

The Anchorage metropolitan area -- which represents more than half the state population of 740,000 -- will exit from recession by the first quarter of 2019, according to a forecast by the Anchorage Economic Development Corp. It is likely Alaska as a whole will follow soon after, given Anchorage's role as a key economic indicator of the state, said Bill Popp, the group's CEO.

The Alaskan economy has benefited from the settlement of a multiyear fight between Gov. Bill Walker and the Legislature over budget issues, including how to use the $65 billion Alaska Permanent Fund, an investment fund fueled primarily by oil royalties. In 2016, Mr. Walker cut in half to $1,000 the dividend checks Alaskans receive from the fund, to help the cash-strapped state government fund services including public safety.

Mr. Walker's decision to cut that dividend has been a key criticism of two challengers -- Republican Mike Dunleavy and Democrat Mark Begich -- who have been seeking to unseat the political independent next month. On Friday, Mr. Walker said that he would suspend his re-election bid amid low support.

Alaska wasn't the only oil-dependent state hit hard by the fall in oil prices four years ago. North Dakota, Wyoming and Louisiana all have had slowdowns. But Alaska fell the hardest and has been the slowest to recover.

Oil and gas represent about 27% of Alaska's gross domestic product, versus 2% of the national GDP. The price for a barrel of Alaska's North Slope crude fell from more than $100 a barrel in 2014 to as low as $27 in 2016. Prices have since slowly rebounded to more than $80.

Oil companies have said they are planning as much as a $20 billion investment in development and production costs of expanded fields in the next several years. Brooks Range Petroleum is dusting off a nearly $500 million drilling project it put on hold when the recession hit.

Nine Star Education and Employment Services, a nonprofit job-placement firm in Anchorage, helped put more than 3,000 clients back to work in the fiscal year ended July 31, a 27% increase from the prior year, said CEO

Ruth Schoenleben. Among them was Jasmin Smith, who returned to her job as a workforce trainer in 2017 after being unemployed for two years, during which she went on public assistance and moved back in with her parents.

"As soon as the recession hit, my clients felt like our services were a luxury and not a necessity," said Ms. Smith, 33, a single mother of twin 4-year-olds.

In the past year, Mr. Walker and the Legislature have been able to reach a budget compromise that increased the annual checks to residents to $1,600. That infused an estimated $1 billion into the Alaskan economy after checks went out Oct. 4 -- prompting companies from airlines to car dealerships to offer "PFD," or Permanent Fund Dividend, sales.

That same afternoon, Gabby Anderson, 22, visited Mountain View Sports Fly Shop in south Anchorage to spend part of her dividend. "I'm treating myself," said Ms. Anderson, an emergency medical technician who was shopping for wool clothing.

The nascent recovery is fragile, though. Another sharp drop in oil prices could derail the economy again. Longer term, business leaders here say Alaska needs to diversify its economy.

"Oil was the horse we rode in on," said Ethan Berkowitz, the mayor of Anchorage, who is touting growing local industries such as health care and logistics. "Now we need for it to be just one of them."

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THE WALL STREET JOURNAL.

Business

GE Ousts CEO John Flannery in Surprise Move After Missed Targets; Deep problems in troubled power unit will cause the company to miss its profit and cash targets for the year; Larry Culp is appointed successor

By Thomas Gryta and David Benoit
1,409 words
1 October 2018
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The Wall Street Journal Online
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General Electric Co. fired Chief Executive John Flannery after 14 months in the job as deeper problems in the conglomerate's troubled power unit blindsided the board and caused GE to warn it would miss profit and cash targets.

The company named board member Larry Culp, who became a director in April, its new chairman and CEO, effective immediately. Mr. Culp, a former CEO of Danaher Corp., had joined GE's board as part of a broader shake-up of the struggling conglomerate.

Shares of GE, which have tumbled by half during the past year after the company slashed its dividend and missed financial targets, rallied on the news. On Monday, the stock rose 7.1% to $12.09.

GE warned it would miss its profit and cash-flow goals for 2018. GE also said it planned to take an accounting charge as large as $23 billion for its power business, which makes turbines for power plants and has been struggling with weak demand.

Much of the charge would be related to the 2015 acquisition of the power business of France's Alstom SA, people familiar with the matter said. The deal, intended to bulk up GE's market share, backfired as global demand for power generation sharply declined. That left GE with factories filled with extra inventory and little cash coming in from customers.

The GE board held a series of unscheduled calls in recent days and decided to replace Mr. Flannery amid concerns that he wasn't moving quickly enough to address the company's issues, according to people familiar with the matter. Mr. Culp is expected to continue with the strategy to spin off GE's health-care business and sell two other big units, these people said, leaving the company focused on its power and aviation units.

The board's concerns about Mr. Flannery, 57 years old, came to a head when it learned last week about the potential charge, the people said. "That was kind of the last straw," one person said. In January, Mr. Flannery had surprised investors and directors when GE disclosed a $15 billion shortfall in reserves for a legacy insurance business.

Several GE directors, particularly the recent additions, and some members of the company's management, grew frustrated in recent weeks with the slow progress on the breakup plan, people familiar with that matter said. They were hearing from investors and customers about similar concerns, they said.

After a meeting Wednesday, the board approached Mr. Culp first and asked if he was willing to take the job; the board formally informed Mr. Flannery over the weekend of the change, the people said. One concern among directors was a feeling that GE's bureaucracy created the slowness, a reason the board went with an outsider.

Activist investor Trian Fund Management, which took a large stake in GE in 2015 and holds a seat on the board, has long admired Danaher for its performance and willingness to spin off businesses.

GE declined to make Messrs. Culp and Flannery available for interviews.

GE was once a symbol of U.S. manufacturing might but has struggled after the financial crisis forced the company to shrink its big lending business and more recently has dealt with weak performance in its industrial units. Earlier this year, GE said it would essentially break itself apart, selling off three major units: health care, transportation and oil and gas.

Although GE was removed in June from the **Dow Jones Industrial Average**, the 126-year-old company remains among the most widely held U.S. stocks.

Mr. Flannery, a 30-year GE veteran, was named to take over the company in June 2017 after longtime leader Jeff Immelt stepped down on Aug. 1 amid pressure from shareholders. Mr. Flannery's ouster on Monday surprised some inside the company, who had anticipated the possibility of leadership changes given the struggles of the power business—but not a CEO exit.

Mr. Flannery joined GE in 1987 and spent most of his early career in its financial services business, GE Capital. Like many GE executives, he worked around the globe, including a stint running GE's business in India. He took over as CEO of the health-care unit in 2014, which he led until he won the competition to succeed Mr. Immelt last year.

Upon getting the job, Mr. Flannery began a monthslong review of the company, a pace that frustrated some on Wall Street as there were major questions about GE's financial projections and prospects. He provided an update in November 2017 that underwhelmed investors.

Following yet another review and the April board restructuring, Mr. Flannery detailed a new strategy in June that focused on the power and energy businesses.

Some outside the company wanted Mr. Flannery to also lay out a vision for the future. While the new CEO was often reaching out for advice, the differing opinions sometimes made it harder for him to reach a final decision, according to people who worked with him.

Mr. Culp, 55 years old, is the first outsider tapped to run GE, which has a history of grooming its own leaders and letting them run the company for long stretches. Former CEO Jack Welch was chairman and CEO for 20 years, while Mr. Immelt steered GE for 16 years through ups and downs.

Both Mr. Welch and Mr. Immelt weighed in Monday on the CEO change, thanking Mr. Flannery for his contributions and praising Mr. Culp.

Mr. Welch said Mr. Flannery had inherited a company with "a very difficult balance sheet position" but had worked to outline a "new direction."

Mr. Immelt said the recent troubles in the power business could be addressed by the new leadership team. "This is a business that generated strong earnings and cash flow for many years," he said. "It will recover and regain market leadership."

Mr. Culp served as CEO of Danaher from 2001 until early 2015, starting in the job when he was only 37 years old. A devotee of lean manufacturing and deal making, he led the conglomerate through several major acquisitions. In his tenure, total shareholder return was 465%, compared with about 105% for the **S&P 500** during the same period.

Though far smaller than GE, Danaher under Mr. Culp was a frequently invoked as a model of what a successful conglomerate might be: a tightly focused portfolio of business units whose overlapping interests were well understood by investors.

He joined as part of a revamp that shrank the 18-person board to 12 members and removed many of the longest-serving directors. The current board includes Trian co-founder Ed Garden and former American Airlines CEO Thomas Horton, who on Monday was named lead independent director.

The new CEO spent his first day in the company's Boston headquarters, calling investors, and he was expected to move quickly to reinforce the June board breakup plan, which he had voted for as a director, the people said. "He feels some ownership of that plan," one person said.

Ted Mann contributed to this article.

Write to Thomas Gryta at thomas.gryta@wsj.com and David Benoit at david.benoit@wsj.com

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* Meet the Next CEO of General Electric: John Flannery (June 2017)

Bio of H. Lawrence 'Larry' Culp

* Named CEO of GE, becoming the first outsider to run the company.

* Became a member of GE's board in April, and named lead director in June.

* Served as CEO and president of Danaher Corp. from 2001-2015.

* Joined Danaher in 1990 and held various roles before leading the company.

* During tenure, total shareholder return was 465% vs. about 105% for the **S&P 500**.

* Danaher's market cap grew from $20 billion to $50 billion under Mr. Culp.

* Received a bachelor's in economics from Washington College and an MBA from Harvard.

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WSJ PRO CENTRAL BANKING

Markets

Fed Prepares New Way to Tailor Rules for Big Banks; Regulator is considering dividing banks into categories based on risk factors, including international activity and off-balance-sheet exposures

By Ryan Tracy
594 words
29 October 2018
04:09 PM
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RSTPROCB
English
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WASHINGTON—The Federal Reserve is set to propose a new way of deciding which large banks get hit with its toughest regulations, according to people familiar with the matter.

The expected plan may lower regulatory costs for regional U.S. lenders under the $700 billion asset line, from Discover Financial Services Inc. at around $100 billion in assets to U.S. Bancorp with its roughly $460 billion. The changes under consideration appear to be less beneficial to the very largest U.S. banks considered "systemically important" to the global financial system, such as Bank of America Corp. or Citigroup Inc.

The proposal, which hasn't been made public and is scheduled for a vote by the Fed's governing board on Wednesday, would create new regulatory categories of banks based on size as well as other risk factors, such as international activity, off-balance-sheet exposures, and reliance on **volatile** forms of short-term funding, the people said.

The proposal would also revise how the Fed defines a large, internationally active bank for purposes of its "advanced approaches capital rules," these people said. That threshold would be set at $700 billion in total assets and $75 billion in cross-border activity, as opposed to the current levels of $250 billion in assets and $10 billion in foreign exposure, these people said.

A Fed spokesman declined to comment.

The 2010 Dodd-Frank financial-regulatory law drew a line at $50 billion in total assets. Any bank above that size faced mandatory "enhanced" scrutiny through annual stress tests and other rules. During the Trump administration, both Congress and regulators have been considering ways to redefine what a big bank is.

In May, Congress gave banks with $50 billion to $100 billion in assets a reprieve from mandatory Dodd-Frank rules and told the Fed to decide which banks above the $100 billion line would get relief. Wednesday's proposal responds to that direction.

Additional details of the proposal, such as how the changes will affect the Fed's annual stress tests, couldn't be determined. As is always the case with bank regulation, the fine print of the Fed's rules will matter in assessing their impact. Banks will be reading closely Wednesday to see precisely how the Fed is proposing to tweak capital and liquidity regulations.

One key question is how the Fed will change the "liquidity coverage ratio," which requires banks to maintain adequate funding to meet their liabilities for 30 days. That rule is one of many that incorporates the "advanced approaches" threshold, which people familiar with the matter say the Fed is considering raising to $700 billion in assets and $75 billion in cross-border activity.

Fed Vice Chairman for Supervision Randal Quarles has mentioned the broad use of the advanced-approaches threshold as part of his arguments that the Fed needs to better tailor its regulations to different banks.

Mr. Quarles has also suggested the Fed should consider short-term funding, international activity, trading and other activities when it assesses banks' risks.

"To date, our tailoring of regulations has been based largely—but not exclusively—on asset size, which reflects an unduly one-dimensional approach," Mr. Quarles said in a July speech. "We have been evaluating additional criteria that may provide for greater regulatory differentiation across large banks."

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THE WALL STREET JOURNAL.
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Rout Tests Strategy To Protect Pensions

By Gregory Zuckerman
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15 October 2018
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Large pension funds are snapping up Wall Street protection against a market crash, but it isn't clear the products will help limit losses in the current pullback.

Worried their portfolios were too risky, public-pension managers in California, Hawaii and Rhode Island have shifted more than $25 billion over two years or so into "crisis-risk offset" strategies, while others are in the process of such moves. Typically, these tactics aim to limit investor losses by buying long-term Treasury bonds, whose prices often rise during market downturns, and investing in "trend-following" hedge funds, which buy stocks and other investments during a sustained rise and bet against them as they fall.

The crisis category was developed in just the past few years by consultants to address pension funds' concerns that prices across many markets could fall in lockstep in the next recession, much as they did a decade ago, placing the funds at risk. But the limits of these strategies are coming into view with the sharp retreat that has rocked U.S. stock indexes in October.

For one thing, crisis-risk offset strategies are unlikely to provide much shelter if the value of long-term bonds comes under pressure, consultants say. Yet that is exactly what has been going on lately, as investors worry the economy's strength and continued interest-rate increases by the Federal Reserve will pressure bonds.

The yield on the 10-year U.S. Treasury note this month hit its highest level since 2011, including an unusual rise during the early hours of Wednesday's stock meltdown. Yields rise when **bond prices** fall. Though yields dropped in the latter stages of the past week's tumult, many investors expect them to resume rising in coming months.

At the same time, trend-following tactics generally only work in an extended downturn of several weeks or even longer. That is because it takes a while for the funds' models to adjust to lower stock prices.

Crisis-risk offset is "not designed to offset a correction that's part of a larger **bull market**," said John Linder, who helped develop the category at pension consultant Pension Consulting Alliance in Portland, Ore., and now works on similar strategies for Ryan Labs, based in New York. "Unless this turns into something more nefarious, the gains may not kick in."

Funds pursuing crisis-risk offset strategies include the California State Teachers' Retirement System, the State of Hawaii Employees' Retirement System, San Joaquin County Employees' Retirement Association and the Employees' Retirement System of Rhode Island, consultants and filings say.

Evan England, spokesman for Rhode Island General Treasurer Seth Magaziner, said the state remains comfortable with its use of crisis risk offset strategies, which represent about 8% of assets of the state pension.

"It's fairly **volatile** and it's supposed to be," he said. "Month to month we see it swing a little bit. But that's expected."

A representative of the Hawaii fund wouldn't comment.

A representative of CalSTRS said: "CalSTRS is a long-term investor, and as such we focus on a 30-year horizon while also taking actions to allocate the assets in a manner that mitigates risks."

A representative of the San Joaquin fund didn't respond.

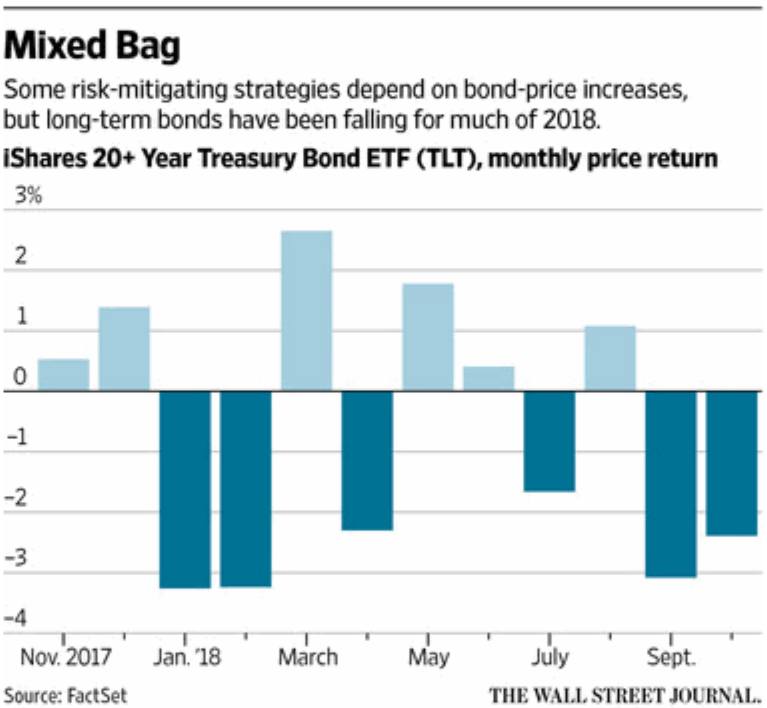
Pensions and those working on crisis strategies say they are aware these products may only provide protection in a sustained downturn, rather than a short, vicious decline in stocks.

Mr. Linder and other fans make few apologies for the limits of crisis-risk-offset tactics, saying these strategies aren't aimed to protect against a drop of only 10% or so.

Still, some who sell products in the category worry investors may feel a false sense of security.

"These strategies really only do very well if the crisis sustains in time," said Anthony Lawler, co-head of GAM Systematic.

Heather Gillers contributed to this article.



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WSJ PRO CENTRAL BANKING

Economy

Fed Officials See Strong Economy Justifying Interest Rate Rises; Though the central bank has boosted rates, it sees falling unemployment, economic growth and federal deficits as other factors behind rise

By Nick Timiraos
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WASHINGTON—The Federal Reserve has become the center of attention at the White House and on Wall Street for rising interest rates that helped knock stocks off balance this week.

Inside the central bank, however, officials see broader forces—including declining unemployment, inflation's return to normalcy and a fast-growing economy—pushing interest rates higher.

Federal budget deficits, driven by tax cuts and spending increases, are also at play. Larger deficits mean the U.S. Treasury is issuing more bonds and bills to finance the shortfall, prompting investors to demand a higher interest rate in return.

President Trump this week amplified his criticism of the Fed, saying its rate increases were "out of control" and that the increases were making it harder to finance the federal deficit. He said he wouldn't fire Fed Chairman Jerome Powell—which the law only allows him to do for cause—even though he is disappointed in the central bank's behavior.

The Fed has been raising short-term interest rates since December 2015 and for many months has telegraphed further increases. Many investors believe "rates have to go up because the economy is good, and the Treasury is issuing a lot more debt," said Roberto Perli, an analyst at Cornerstone Macro.

Higher rates are meant to prevent the economy from overheating and causing inflation or a financial bubble. After holding rates near zero following the 2008 financial crisis, the Fed has raised its benchmark rate eight times since December 2015, including three times this year. Last month, officials boosted the rate to a range between 2% and 2.25%. But it remains low historically: It averaged 4% over the 1990s and 2000s.

Mr. Trump worries that higher borrowing costs will slow economic growth and cool the **stock market**.

The Fed is responding to a broad constellation of forces that central bank officials believe leave them with few alternatives but to keep lifting rates, albeit at a slower pace than they have in the past.

The U.S. unemployment rate dropped to 3.7% in September, its lowest level since 1969, and inflation this year has returned to the Fed's 2% target after many years of falling short. Fed officials project the jobless rate will decline to 3.5% by December.

With unemployment low and inflation nearing normal, Fed officials figure interest rates need to return to normal as well to prevent the economy from overheating.

What's normal? Projections from Fed officials last month suggest many of them think a rate around 2.75% or 3% would mop up much of the added stimulus the Fed provided to the economy after the last recession. The central bank would need to raise rates at least again in December and next March to get there. Fed officials see themselves getting to 3.375% by the end of next year.

One latent source of tension between Mr. Trump and the Fed is a disagreement over how the economy will respond to tax cuts and federal spending increases enacted over the past year.

The White House says tax cuts will lift the economy's growth potential, positioning the Fed to allow the economy to run hotter with lower rates. The Fed isn't so sure and wants to proceed with caution.

Central bank officials worry that fiscal stimulus will hit the economy when it already faces resource constraints, which could lead to more inflation.

The Fed's current strategy of quarterly rate increases is trying to balance against the risk of two potential policy mistakes.

"The first risk is that we move too quickly, and we prematurely end the expansion and inflation never gets solidly back to 2%," Mr. Powell said last week. "The alternative risk is that we move too slowly and the economy overheats, and that can show up in the form of too high inflation or **financial market** imbalances."

For now, inflation doesn't appear to be a problem. U.S. consumer prices rose only slightly in September. Core prices, which exclude the **volatile** food and energy categories, were up 2.2%, the same rate as in August. That should translate into inflation of around 2% in September using the Fed's preferred gauge, according to economists at Morgan Stanley.

Budget deficits represent a related source of tension. The Trump administration has said stronger growth would yield higher government tax revenue, offsetting the decline in receipts from lower tax rates.

That is yet to occur, and has sent the federal deficit to unusually high levels for an economy that isn't in recession. Last week, the Congressional Budget Office projected the deficit stood at 3.9% of gross domestic product for the fiscal year that ended last month, up from 3.5% in the fiscal prior year and 3.1% two years ago.

Higher rates will further boost the deficit by raising federal debt-service costs. "I'm paying interest at a higher rate because of our Fed," Mr. Trump said in an interview Thursday on Fox News.

The Fed may not be troubled about this week's **stock market** selloff because its officials have been uneasy about historically lofty asset valuations for the past year and attentive to the risk of another financial bubble.

When the Fed raises its benchmark rate, it aims to tighten financial conditions, which are reflected in the prices of stocks, bonds, real estate and other assets. If asset prices continue to rally as rates rise, that could suggest the Fed has to raise borrowing costs even more to keep the economy on an even keel.

Already, there are some signs the Fed's rate increases have begun to cool some parts of the economy. The 30-year mortgage rate is close to crossing 5% for the first time in seven years, which is robbing home buyers of purchasing power and forcing sellers to raise prices less aggressively or even to lower them.

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THE WALL STREET JOURNAL.

Markets

October Rout Will Test Pensions' Wall Street Crash Protection; Limits of crisis-risk offset strategies are coming into view with the sharp retreat that has rocked U.S. stock indexes

By Gregory Zuckerman
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14 October 2018
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Large pension funds are snapping up Wall Street protection against a market crash, but it isn't clear the products will help limit losses in the current pullback.

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The crisis category was developed in just the past few years by consultants to address pension funds' concerns that prices across many markets could fall in lockstep in the next recession, much as they did a decade ago, placing them at risk. But the limits of these strategies are coming into view with the sharp retreat that has rocked U.S. stock indexes in October.

For one thing, crisis-risk offset strategies are unlikely to provide much shelter if the value of long-term bonds comes under pressure, consultants say. Yet that is exactly what has been going on lately, as investors worry the economy's strength and continued interest-rate increases by the Federal Reserve will pressure bonds.

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At the same time, trend-following tactics generally only work in an extended downturn of several weeks or even longer. That is because it takes a while for the funds' models to adjust to lower stock prices.

Crisis-risk offset is "not designed to offset a correction that's part of a larger **bull market**," says John Linder, who helped develop the category at pension consultant Pension Consulting Alliance in Portland, Ore., and now works on similar strategies for Ryan Labs, based in New York. "Unless this turns into something more nefarious, the gains may not kick in."

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Pensions and those working on crisis strategies say they are aware these products may only provide protection in a sustained downturn, rather than a short, vicious decline in stocks.

The popularity of the crisis-risk-offset category reflects a realization pensions came to several years ago that they may not be well-prepared for a sustained downturn.

Before 2008, some funds felt secure with a mix of investments, but the financial crisis demonstrated how few asset classes can provide safety in a deep downturn. Interest in this category underscores the wariness a number of pension funds began to feel around 2013 about how expensive both stock and bond markets had become, some consultants say. This concern has increased lately.

Neil Rue, a managing director at PCA, says the crisis strategies are especially popular among pensions that face funding and cash-flow challenges and therefore have a low tolerance for risk.

Pension funds have been edging away from hedge funds and other high-cost products. Though some high-cost hedge funds are placed in the crisis category, most of these strategies charge lower fees than those many pensions traditionally relied upon on to shield themselves, such as buying equity put-option contracts or investing with market-neutral hedge funds.

They are also generally investments made in a "systematic" way that typically is reliant on computer models. That is a popular tactic as investors embrace quantitative and passive investing.

Unlike some strategies that tend to provide safety in bear markets for stocks, crisis-risk-offset investments can handle billions of cash from these big investors, another reason they have caught on. Last month, for example, the $18.1 billion State Universities Retirement System of Illinois decided to put up to 20% of its assets in crisis-risk offset products in the next four years.

"Historically when there's a large market correction there's a flight to quality, which means bond yields dropping," says Doug Wesley, chief investment officer of the Illinois pension.

Additional pensions are examining newer allocations, consultants say. Different organizations call the category by different names, with some calling them "risk mitigating strategies."

Financial firms selling this insurance have seen an influx of interest, especially so-called trend followers, despite the subpar returns the strategy has produced. Aspect Capital Ltd., a London hedge fund, has pulled in about $1.5 billion in new investments from clients even as its biggest fund fell a bit this year, through early October, and rose just 5% in 2017, trailing the overall market.

The fund scored gains of about 25% during market routs in 2000 and 2008 thanks to a computer-aided approach that aims to ride distinct trends in the market, both higher and lower.

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Still, some who sell products in the category worry investors may feel a false sense of security.

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Heather Gillers contributed to this article.

Write to Gregory Zuckerman at gregory.zuckerman@wsj.com

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THE WALL STREET JOURNAL.

Economy

U.S. Unemployment Rate Falls to Lowest Level Since 1969; Nonfarm payrolls rose a seasonally adjusted 134,000 in September, the smallest gain in a year

By Eric Morath and Harriet Torry
1,330 words
5 October 2018
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WASHINGTON—Unemployment in September hit the lowest level since the Vietnam War, with little indication it is going to shoot back up in the near term.

The jobless rate fell to 3.7%, the lowest since December 1969, the Labor Department said Friday. Employers added 134,000 jobs to payrolls, a record 96th straight month of gains. Wages rose 2.8% from a year earlier, a solid if still unspectacular rise.

"This is the best job market in a generation or more," said Andrew Chamberlain, chief economist at recruiting site Glassdoor.

Unemployment rates below 4% are extremely rare in 70 years of modern record-keeping. The two longest sustained periods came during the Korean and Vietnam Wars, when the combination of strong growth and the enlistment of young men from the civilian labor force helped to largely wring unemployment out of the economy.

In 1953, the year the Korean War ended, the jobless rate got as low as 2.5%. In the 1960s, it stayed below 4% for nearly four years, until a bout of rising inflation and interest rates led to recession and rising joblessness. Another run below 4% in 2000 lasted just a few months, burst by a bubble in technology stocks.

Federal Reserve officials believe the current period can be sustained. They project the jobless rate will sink to 3.5% next year and remain below 4% through 2021. Fed officials see the current economy playing out differently than the 1960s. They estimate inflation will remain subdued, allowing them to keep short-term interest rates relatively low.

Bond investors have been reassessing the economic and financial outlook in recent days. With the economy running so strong, they have come to the conclusion the Fed will keep raising short-term rates next year to keep it from overheating.

That is pushing long-term rates up too. Yields on **10**-**year Treasury** notes rose Friday to 3.227%, the highest level since May 2011. Rate increases helped to drive stock prices lower. The **Dow Jones Industrial Average** closed down 180.43 points, or 0.7%, to 26447.05.

Still, the bond market is one signal of how much different the economy is today than it was the last time unemployment got this low. Back then, with inflation topping 6% and heading higher, yields on bonds neared 8% and spelled the undoing of a long expansion. Inflation now is right near the Fed's 2% target.

In a speech earlier this week, Fed Chairman Jerome Powell suggested he sees little urgency to accelerate the central bank's pace of interest-rate increases or to signal a more restrictive policy path ahead, in part because inflation is so low and stable.

"Removing accommodation too quickly could needlessly foreshorten the expansion," Mr. Powell said.

The Vietnam War drafted thousands of young men out of the civilian labor force, many with lower levels of education, who might otherwise have been counted as unemployed. At the same time, while the share of women working was growing, less than half had jobs or sought employment.

Today, a different factor is at play: retiring baby boomers leave fewer people to work. Both demographic factors mean a smaller share of the population is available to work in comparison to other boom times, such as the 1990s.

A return to 3.7% unemployment "shows how resilient and adaptable the American economy is," said Carl Tannenbaum, chief economist at Northern Trust. "To think about the multitude of global and technological changes that occurred since 1969, reorienting the labor force to keep such a large fraction of the population at work is quite an achievement."

Low unemployment is a talking point for Republicans a month away from the midterm election. They describe low unemployment as proof President Trump is delivering on his economic promises. Democrats paint the election as a referendum on his personality and character, not the economy.

The unemployment rate also was 3.7% just before the 1966 midterm elections. Lyndon Johnson, a Democrat, was president and his party lost seats in both the House and Senate, but maintained the majority.

Whether the low rate of unemployment can be sustained is another question. Mr. Chamberlain described the current environment as a "sugar high," spurred on by tax cuts and defense spending, that will likely fade and cause unemployment to drift back up.

Fed officials don't believe the economy's growth rate, now near 3%, will stay at that level. They see it sinking back toward the 2% rate that prevailed for much of the expansion.

Other economists say changes to the corporate-tax code can stoke better investment and productivity needed to sustain fast growth.

In the near term, many businesses are struggling to find workers.

Peerfit Inc., a national fitness-benefits manager, has built its staff to nearly 100 this year from fewer than 20 at the start of last year. In the hunt for workers, it increased wages 5% to 10% on average over the last year, said Chief Executive Ed Buckley, of Tampa, Fla. Still, the company has had to turn down three major projects because teams didn't have the bandwidth to quickly hire and train new staff.

In response, it widened the pool of workers it considered for jobs, from those with four-year college degrees to those with vocational backgrounds.

"It's tough finding good people," he said.

Those who lose jobs are getting scooped up quickly. One example: Last week, a chain of sandwich shops called Taylor Gourmet closed in the Washington, D.C., area. Two days later, a competitor, Cava Group Inc., held job fairs nearby for Taylor's displaced workers. In the first week, it hired five of them and called back half of the 50 workers who showed up.

"We knew a group of workers would be immediately seeking an opportunity," said Cava Chief Executive Brett Schulman. "We wanted to mitigate that situation, help them get on pathway to a great career, and tell them 'We need you.'"

Cava has raised its wages to $13.50 an hour and offers benefits including health insurance and a free meal with every shift to help attract and retain workers.

Hurricane Florence, which struck the Carolinas last month, may have curtailed overall employment growth in some sectors, the Labor Department said, but it couldn't quantify the impact. Jobs lost in retail and leisure and hospitality, two sectors that can be susceptible to bad weather, at least in part explain why September produced the worst job growth in a year.

Last month, 1.49 million Americans worked fewer hours due to bad weather and nearly 300,000 didn't work at all during the Labor Department's survey period, though they are not counted as unemployed. Those figures are elevated compared with a typical September—more in line with winter months—but are well below a year earlier. Hurricanes Harvey and Irma caused nearly three million people to work fewer hours and 1.47 million to miss work entirely in September 2017.

More broadly, job gains were revised up for July and August, pushing the average number of workers added to payrolls each month this year to 211,000, well outpacing average monthly growth of 182,000 in 2017. That runs counter to economists' expectation for hiring to broadly ease as the labor market tightens.

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THE WALL STREET JOURNAL.

Markets

Drilling Down Into the Volatility in Financial Markets; Investor nervousness has spread to credit markets and commodities

By Riva Gold
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A steep selloff in stocks sent ripples into other corners of the market last week. Warnings from industrial companies, concerns about global growth and ongoing political risks prompted investors in bonds, commodities and currencies to reassess asset values. Where those head next may depend in large part on the release this Friday of the latest U.S. jobs report and what it says about the outlook for growth.

Prices of industrial metals sensitive to expectations about the economy fell sharply amid worries about the outlook for China, the world's largest consumer of base metals. **Oil prices** also fell last week and began to move more closely in line with stocks as investors broadly shed risk.

Gold, a popular destination for nervous investors, has recovered some of this year's losses…

…while shares of utilities, perceived as relatively secure in times of market turmoil, have eked out gains this month.

While prices of Treasurys rallied last week amid stock swings, sending yields lower, a few signs of unease could be seen in credit markets. An index of North American junk-bond credit-default swaps, which falls as the perceived risk of defaults increases, hit a two-year low as investors bought more credit protection.…

…and the cost of protecting investors against a default by European banks has ticked up lately, while remaining well below highs hit in times of crisis.

Friday's jobs report could further test investor sentiment as markets gauge the strength of the U.S. economy and prospects for rising wages to spur inflation. Signs of weakness in wages or in the number of workers added could raise additional concerns about whether trade tensions are dragging on growth. That could lead investors to demand a higher yield premium for taking on the risk of lending to low-rated companies.

The WSJ Dollar Index rose to its highest level since May 2017 last week. A stronger dollar could complicate the outlook for corporate earnings by weighing on the balance sheets of multinational companies. It also risks sparking another wave of emerging-market turmoil by pressuring developing countries with large amounts of debt denominated in the U.S. currency. A strong U.S. employment number on Friday could bolster the case for the Federal Reserve to continue raising rates at its current pace and further boost the dollar.

Ira Iosebashvili and Matt Wirz contributed to this article.

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THE Week Ahead
Business Day
A U.S. Trade Complaint, Tech Earnings and Jobs Numbers

By The New York Times
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NYTFEED
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Here’s what to expect in the week ahead:

World Trade Organization to hear U.S. complaint on China.

On Monday, the dispute resolution body of the World Trade Organization in Geneva will hear a complaint filed by the United States alleging that China’s regulation of foreign companies violates international rules protecting intellectual property rights. The complaint, part of President Trump’s effort to check China's growing economic influence, accuses Chinese companies of breaking patent laws by pilfering technologies after licensing agreements with American companies end. Under W.T.O. rules, China could block the first hearing but cannot block a second one from being held, probably as early as next month, according to American officials.

Investors will be looking for G.E.’s turnaround plan.

H. Lawrence Culp Jr., the new chief executive at General Electric, has been on the job for less than a month. So when the troubled industrial icon reports results on Tuesday, analysts will be looking less at the third-quarter numbers than the broad contours of the new chief's turnaround plan. Two issues for the company: how to pull its power generation business out of its tailspin, and the fate of the dividend. Analysts expect the 48-cent yearly payout to be cut by up to 90 percent, to conserve cash.

Wall St. to watch both Facebook’s earnings and user numbers.

Facebook will report its earnings for the third quarter on Tuesday, an event sure to be closely monitored by investors. The company has been battered throughout 2018, thanks in part to wide-ranging market **volatility** and controversy surrounding foreign influence campaigns operating across the service. But Wall Street was also shocked in July, when Facebook reported sales growth lagging far below expectations and company executives said little to explain the shortcomings. Expect the Street to keep a close eye on revenue growth trajectory, and if Facebook's user numbers have flagged in the wake of major changes to how the News Feed operates.

New figures expected to show slower growth in eurozone.

Official European Union figures coming out on Tuesday are expected to show that growth in the eurozone slowed significantly from July through September. A period of unusually strong expansion has been interrupted by **stock market** turmoil, trade tensions, Brexit and even new emissions rules that slowed delivery of new cars. But Mario Draghi, the president of the European Central Bank, insisted last week that although the eurozone is growing more slowly, it is not sinking into recession.

Apple is predicted to post strong quarterly earnings.

Apple is scheduled to report quarterly earnings on Thursday and analysts who track the company predict — surprise — that the good times are likely to continue for Apple, the world’s most valuable public company. Sales of iPhones have leveled off in recent quarters but people have been paying more for each device, sustaining a steady growth rate for the $1 trillion company. Apple is also expected to continue lifting revenues via its services businesses, including Apple Music, iCloud and its share of app sales. Only a fraction of the sales of Apple’s newest phones, including the iPhone XS, will be included in the earnings report because the phones went on sale about a week before the end of the quarter on Sept. 30.

Dip is expected for new vehicle sales in October.

Automakers will report on Thursday the number of new vehicles sold in October, and analysts are forecasting about a 2 percent decline compared with October 2017. The drop is part of the downward trend that the industry has experienced since sales hit a record in 2016. On the brighter side, however, the pace of sales remains brisk and the total for this year is still expected to exceed 17 million.

Last jobs report before midterm elections.

On Friday, at 8:30 a.m., the Labor Department is scheduled to release its report on the nation's hiring and unemployment for October, the last official snapshot of the economy before Americans vote in the midterms elections. After Hurricane Florence dampened growth in September, most Wall Street analysts are expecting payrolls to bounce back, with a monthly increase of 190,000. The jobless rate is expected to remain at the 3.7 percent level it hit in September, which was a nearly five-decade low. After two months of 0.3 percent growth in average hourly earnings, economists are expecting the pace to tick down to 0.2 percent. Even a slowdown from the previous months, however, would mean an improvement in the year-over-year figure (because the weak showing from October 2017 would drop out of the 12-month average). A rate of 3.1 percent would represent the strongest annual growth since April 2009.

Alibaba to announce earnings as China's economic woes deepen.

On Friday, the Alibaba Group, China's biggest online shopping platform, will announce how its financials fared during the quarter through September, a period of deepening gloom for the Chinese economy. The currency has been falling. Businesses and consumers are growing nervous about the possibility of a drawn-out trade war between China and the United States. Overall economic growth was the slowest in nearly a decade. In recent weeks, some analysts have been lowering their target price for Alibaba's stock, expecting also that the company's spending on new business areas — such as brick-and-mortar stores and food delivery — will continue to weigh on profits.

Stress test results on European banks will be released.

European bank supervisors on Friday will publish results of the latest tests of lenders' ability to weather financial or economic crises. The so-called stress tests examine what happens to banks' capital and cash reserves in the event of various doomsday scenarios. Attention will be focused on banks in Italy, which could become collateral damage in their government's dispute with the European Union. Italian banks are vulnerable because they have invested much of their capital in Italian government bonds, which have lost value as investors begin to doubt Italy's solvency.

Exxon Mobil and other oil companies to report earnings.

Exxon Mobil, Chevron and Royal Dutch Shell all report their third-quarter earnings this week, and analysts and shareholders will be listening carefully to their guidance on future spending and the outlook for increased oil and gas production. Rising **oil prices** in the quarter should help profits. But prices are suddenly declining again owing to slowing global economic growth, plentiful stockpiles and increased production from Saudi Arabia and Russia. How executives view the future will help decide levels of investment, and offer clues to the profit picture for next year.

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THE WALL STREET JOURNAL.

Best of the Web
Opinion
The American Wage Boom; Raises for U.S. workers are creating very confident consumers.

By James Freeman
1,135 words
31 October 2018
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The Wall Street Journal Online
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English
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History says that the incumbent President's party should lose two or three dozen House seats in Tuesday's midterm elections. But as Republicans prepare to make their closing arguments to U.S. voters, GOP candidates can justly say that their policies have yielded exceptional results. The economic revival they promised in 2016 has come to pass. Tax cuts and deregulation have sparked faster economic growth, and the winners are not just investors in U.S. stocks.

Today brings more news confirming that Americans are better off than they were in 2016. Eric Morath reports in the Journal:

Compensation for U.S. workers grew at an accelerating rate in the third quarter, a sign a historically tight labor market is yielding better pay for employees...

The increase was led by improving pay for private-sector workers. Wages and salaries, which account for about 70% of total compensation, rose 3.1% from a year earlier for private-sector workers. That was the strongest year-over-year gain since the second quarter of 2008.

Total compensation for those workers increased 0.8% on the quarter and 2.9% from a year earlier... Worker compensation is now rising at a faster pace than prices. The consumer-price index rose 2.3% from a year earlier in September, the Labor Department said.

And the recipients of these real wage gains have obviously noticed. Pollsters may claim that few taxpayers realize they received a tax cut this year—even though almost all of them did—but it's clear that Americans up and down the income scale are enjoying the fruits of an expanding economy. Yesterday the Journal's Sharon Nunn reported:

A measure of U.S. consumer confidence rose in October to an almost two-decade high, as Americans expected economic and jobs growth to power ahead despite recent **stock-market volatility**.

The Conference Board on Tuesday said its index of U.S. consumer confidence rose to 137.9 in October, the highest level since September 2000.

At the same time, U.S. stocks have dropped since the beginning of October. Private analysts and the Federal Reserve think an economic slowdown is looming.

"While market participants seem to be extremely eager to call for a recession, consumers have a brighter view of the landscape," Stephen Stanley, chief economist at Amherst Pierpont Securities, said in a note to clients.

The story of the 2016 campaign was one of coastal experts ignoring the economic pain in Middle America. Are professionals concentrated on the coasts now underestimating the burgeoning relief? Of course this column doesn't know what we would do without experts, and the ones tracking consumer sentiment—whether at the Conference Board or the University of Michigan or just about anywhere else—are seeing lots of happy and confident shoppers.

The country has lately been so prosperous that we've had the luxury of being disappointed in some of the underlying data in Friday's report of robust 3.5% economic growth for the third quarter. This column was as disappointed as anyone that business investment didn't show another sharp increase after the stellar numbers posted in previous quarters.

But the overall growth reported by the Commerce Department's Bureau of Economic Analysis was strong. And former Bush economist Larry Lindsey's consulting firm Lindsey Group argues in a recent note to clients that it's bound to look even stronger as the data becomes more refined:

... the BEA reported investment number was a real head-scratcher. They reported a 1.6 percent annualized increase in equipment investment, quarter over quarter in nominal terms. But, nondefense capital goods shipments (a reasonable proxy for equipment) were 1.46 percent higher quarter over quarter non-annualized, or 6.0 percent at an annual rate. Excluding aircraft, the figure was even higher – 7.7 percent at an annual rate. Moreover, imports of capital goods were 5.5 percent higher at an annual rate. And, new-orders for non-defense capital goods rose at a 9 percent annual rate in the third quarter relative to the second quarter. So, all the related data indicates the investment boom is still on, despite what BEA reported on Friday...

It seems quite reasonable that there will be an upward revision in equipment investment (and possibly other investment as well) in the post-election report for the third quarter that will at least triple the increase in nominal equipment investment and add about ¼ point and possibly more to third quarter growth.

It seems extremely reasonable to assume that America's new competitive corporate tax system will continue to attract investment to the United States.

If so, one of the few remaining clouds on the economic horizon would be the President's stare-down over trade with the current head of the Chinese regime, Xi Jinping. Mr. Xi is recognized as dictator-for-life, but perhaps he can be encouraged to resume the economic liberalization initiated decades ago by Chinese leader Deng Xiaoping. For a note of optimism, we turn to an intriguing report in the South China Morning Post:

An influential son of Deng Xiaoping, the former Chinese leader who steered the country towards decades of economic growth, urged his government to "keep a sober mind" and "know its place", delivering a counterpoint to Beijing's increasingly ambitious foreign policy and military assertiveness.

"We must seek truth from fact, keep a sober mind and know our own place," Deng Pufang, the eldest son of Deng Xiaoping, said in a recent speech that was not made public but was obtained by the South China Morning Post. "We should neither be overbearing or belittle ourselves."

Later in the speech, Deng urged China to embrace a "cooperative and win-win international environment".

Nothing would say cooperation and "win-win" better than reducing trade barriers and respecting the property rights of both foreign and domestic companies operating in China.

***

Bottom Stories of the Day

Best Job Market Ever "Now Hiring: Get Paid $100/Hour To Pet Puppies At Restaurant," KTVT, Oct. 30

A Smoking Solo from Neal Schon? "'Suspicious package' that started uptown Charlotte bomb scare was a Journey cassette," Charlotte Observer, Oct. 30

A Whiff of Justice "Appeals judges: Gag order in hog smells cases went too far," Associated Press, Oct. 29

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My-ku?

Ah, to enjoy Myles

without counting syllables

Left-right brain movement

-- C. Rucker

***

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(Teresa Vozzo helps compile Best of the Web. Thanks to Tony Lima, Jacob Shepherd and Bill Ledsham.)

***

Mr. Freeman is the co-author of "Borrowed Time," now available from HarperBusiness.

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THE WALL STREET JOURNAL.

Markets
U.S. Charges Three Futures Traders With Spoofing; Prosecutors say they manipulated stock-futures contracts, resulting in more than $60 million in losses for the firm that traded with them

By Dave Michaels
581 words
12 October 2018
06:32 PM
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WSJO
English
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Three futures traders were charged with manipulating stock-futures contracts that resulted in more than $60 million in losses for the firm that traded with them, according to prosecutors.

Yuchun "Bruce" Mao was indicted on charges of commodities fraud and spoofing, a type of illicit trading that involves sending phony orders with the intent to manipulate prices. Two other traders, Kamaldeep Gandhi and Krishna Mohan, agreed to plead guilty to commodities fraud, wire fraud and spoofing, according to an announcement from the U.S. Department of Justice on Friday.

Mr. Mao allegedly submitted large orders in 2013 and 2014 on E-mini **S&P 500** futures—a heavily traded contract that tracks the **S&P 500 stock-market** index and is often used by investors to hedge against major market moves— that he intended to cancel once they triggered other market participants to react to them, according to court records.

By placing such fake orders, traders can create the illusion of supply or demand and cause prices to swing up or down, then profit from the move back when the market reverts to normal levels.

Messrs. Gandhi and Mohan assisted in the plan, according to prosecutors. Congress made it a criminal violation to engage in that tactic, known as spoofing, through the 2010 Dodd-Frank Act.

Mr. Mao worked for Tower Research Capital LLC, a global high-frequency trading firm, during the period when prosecutors allege he manipulated futures markets, according to records maintained by the Financial Industry Regulatory Authority. Tower executives didn't respond to phone messages and emails seeking comment and he couldn't immediately be reached.

Mr. Gandhi couldn't be reached for comment. An attorney for Mr. Mohan declined to comment.

Prosecutors and regulators have cracked down on spoofing in recent years, saying the tactic deceives other traders. The victim was a quantitative trading firm in Houston, according to the indictment, which doesn't name the company.

"These individuals engaged in a sophisticated scheme to distort the futures market for their own advantage by placing large 'spoofed' trading orders that they never intended to execute," said Assistant Attorney General Brian A. Benczkowski.

A U.S. magistrate judge issued a warrant for Mr. Mao's arrest, according to federal court records filed in Houston.

A trader with the name Bruce Mao lists himself on a LinkedIn profile as a director and portfolio manager at Tower Research Capital and says he lives in Hawaii.

Court records don't disclose the employer of Messrs. Gandhi and Mohan, but prosecutors said Friday that they worked with Mr. Mao at the same firm.

Separately, Mr. Gandhi settled civil claims with the Commodity Futures Trading Commission on Friday involving "thousands of acts of spoofing" in a variety of futures products traded on the Chicago Mercantile Exchange, Chicago Board of Trade, New York Mercantile Exchange, and the Commodity Exchange Inc.

Mr. Gandhi agreed to a permanent bar from trading and other activities in CFTC-regulated markets, the regulator said.

The CFTC sued Mr. Mohan in federal court in January, alleging he engaged in spoofing on tens of thousands of occasions in 2013, according to court records. A judge agreed to pause action in the case in May based on a request filed by prosecutors.

Alexander Osipovich contributed to this article.

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Business & Finance
What's News
Business & Finance

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The Trump administration aims to step up trade talks with other countries, with its new pact with Canada and Mexico as a template. U.S. trade partners are preparing for contentious talks.

Stocks slumped as a government-bond selloff reverberated world-wide. The Dow, **S&P 500** and Nasdaq lost 0.7%, 0.8% and 1.8%, respectively, while the **10**-**year Treasury** yield rose to 3.196%.

Musk risked reigniting a battle with federal securities regulators when he appeared to openly mock the SEC only days after the Tesla chief settled fraud charges with the agency.

Campbell Soup is in talks to sell its fresh-foods business, including Bolthouse Farms, to investors led by that brand's former chief.

SoftBank has teamed up with Toyota to deliver meals, health care and other services in self-driving cars to an aging populace in Japan.

GE agreed to pay its new CEO as much as $21 million a year for four years, with the potential for more depending on the stock's performance.

Samsung Electronics expects third-quarter operating profit will be its highest ever, as demand for its electronic components remains high.

A U.S. judge committed Chinese telecommunications firm ZTE to another two years of scrutiny by a court-appointed monitor.

Hedge fund Criterion is shutting down, the second large fund to announce its closure this week.

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THE WALL STREET JOURNAL.

Markets

Investors Are Digging Gold Again; The ascent of companies like Barrick Gold, AngloGold Ashanti and Acacia Mining marks a turnaround from recent episodes of jittery markets

By Riva Gold
681 words
18 October 2018
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The Wall Street Journal Online
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In times of market turmoil, investors often embrace gold. And when that happens, gold-mining stocks tend to do even better.

That has certainly been the case so far this month. New York gold futures are up about 3% so far in October versus a roughly 4% decline for the **S&P 500**. Shares of many of the world's biggest gold miners, meanwhile, have notched double-digit gains.

Companies like Toronto's Barrick Gold Corp, South Africa's AngloGold Ashanti and Acacia Mining are all up around 15% to 19% after a bruising summer. The VanEck Vectors Gold Miners exchange-traded fund and the iShares MSCI Global Gold Miners fund—which track indexes of global gold-mining firms—are up around 9% to 11% this month.

Gold-miner stocks allow investors to double down on bets the gold price will rise. These companies have higher fixed-investment costs and can become much more profitable when gold prices climb. Many of these companies pay out hefty dividends, too.

An added bonus: Hopes for further consolidation are adding to the momentum after Barrick Gold in September agreed to buy Randgold Resources Ltd. for $6 billion.

Investors have poured $278 million into the VanEck gold miner ETF over the past month, according to FactSet, while flows into EPFR-tracked gold funds climbed to an 11-week high last week.

Gold miners' rapid ascent during the selloff marks a turnaround from other recent episodes of market turbulence. While gold and related assets have historically been used as safe places to invest during times of economic or political stress, they found few fans during the downturn at the start of the year or during the summer turmoil in emerging markets.

Because concerns largely centered around the prospect of rising U.S. interest rates, investors sought shelter in the U.S. dollar instead, in turn making gold less attractive to overseas buyers. The WSJ Dollar Index climbed 9.4% from a low in February through early October, while New York gold futures fell about 12% and the VanEck gold miner fund fell about 20%. Rising rates also make assets like gold less attractive, because they don't offer a yield.

And both gold and miners haven't fared so well in recent years. From highs in 2011, prices of the metal and the VanEck ETF are down around 35% and 70%, respectively. The iShares fund has also tumbled about 70% since its inception in 2012, and was hovering around its lowest since 2016 in September.

This time is different. The ICE Dollar Index has barely budged during this month's selloff, the Federal Reserve's plans for interest rates are well telegraphed and investors have turned skeptical that the dollar has much further room to rise.

Speculators' long positions on the dollar have been fairly stable since August, data from the Commodity Futures Trading Commission suggests.

"Given the strength of the U.S. dollar we've seen and slight concern now about the fiscal position in the U.S. following stimulus measures and tax reform, there's some concern around the U.S. dollar as an ultimate safe haven," said Roger Jones, head of equities at London & Capital.

The U.S. government ran its largest budget deficit in six years during the fiscal year that ended last month, totaling $779 billion.

Meanwhile, "this [selloff] is more about a growth scare than February-March, when it was more about a rate-hike scare," Mr. Jones said. "If there's another slowdown in growth, gold-mining stocks will be at the forefront of investors' minds."

Fund managers surveyed by Bank of America Merrill Lynch in October were the most **bearish** on global growth since 2008.

Earlier this month, the International Monetary Fund lowered its forecasts for global economic growth this year and next, citing a rise in trade protectionism and concerns about emerging markets.

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Economy

U.S. Consumer Sentiment Cooled Slightly in Early October; University of Michigan's index was pulled down by consumers' less optimistic evaluation of their personal finances

By Sarah Chaney
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WSJ Pro Central Banking
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English
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A measure of economic confidence among American households edged down in early October but remained at a high level.

The University of Michigan on Friday said its preliminary index of U.S. consumer sentiment dropped to 99.0 in October from 100.1 in September.

David Deull, economist at IHS Markit, said confidence appears to be strong despite the small monthly decline.

"Labor markets that are tight are bringing salary increases to lower-income workers," Mr. Deull said, noting the U.S. **stock market** continued to rise over the survey period.

Sentiment about current economic conditions took a step back in October, while economic expectations also weakened.

Richard Curtin, the survey's chief economist, said sentiment was pulled down by consumers' less optimistic evaluation of their personal finances.

"Unfortunately, the downward revisions in the rate of growth in household incomes were accompanied by upward revisions in the year-ahead expected inflation rate, weakening real income expectations," Mr. Curtin said.

Expectations for stronger inflation had been building this year. Short-term inflation expectations rose in October to 2.8% from 2.7% a month earlier. Longer-term inflation expectations slipped, though.

More broadly, measures of consumer confidence have significantly improved since late 2016, buttressed by a historically low unemployment rate, steady income gains and a rising **stock market**. In September, the Conference Board's measure hit an 18-year high.

Earlier this week, stock markets across the globe suffered their biggest shakeout since February on concerns around the steep climb in bond yields, higher **oil prices** and building trade tensions.

While **stock-market** fluctuations can influence consumer confidence, Mr. Curtin said the **stock market** selloff had "virtually no influence" on the preliminary October data, as only one day of market turbulence overlapped with the survey period.

Elsewhere in Friday's report, confidence in the government's economic policies climbed in October to the highest level in 15 years, primarily due to Democrats expressing slightly more confidence, though still much less than Republicans.

Since the 2016 presidential election, divergence in sentiment by political party has been particularly pronounced, with a split between downbeat Democrats and upbeat Republicans. The index for self-identified Democrats clocked in at 81.8 in October versus 128.2 for Republicans.

When asked about whether economic conditions would be better if Democrats or Republicans won the coming congressional election, consumers more frequently cited Republicans. A large portion said there wouldn't be much difference.

Write to Sarah Chaney at sarah.chaney@wsj.com

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

New U.S. Loan-Loss Rules for Banks Will Be Volatile—Just Look at Britain; Charges based on changing expectations for bad loans has meant big swings for U.K. banks' profits

By Paul J. Davies
482 words
29 October 2018
07:00 AM
The Wall Street Journal Online
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English
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As U.S. banks battle to water down new rules on how to account for loan losses, British banks are showing how similar rules create wild swings in profits depending on executives' economic outlooks.

Royal Bank of Scotland took an extra £100 million (about $128 million) impairment charge in its third-quarter results on Friday, blaming the chaotic state of the U.K.'s Brexit talks for greater economic uncertainty.

But just a day before, Lloyds Banking Group, Britain's biggest mortgage lender, had taken no extra charges for possible future loan losses in its third quarter, while earlier in the week Barclays reported an £86 million improvement in U.K. loan-loss charges versus the third quarter last year.

Impairment charges under the new rules are meant to give investors a better picture of the true current value of a bank's loans. The **volatility** they produce means that investors are already looking past them to assess underlying performance, though.

The point of the rule changes is fairly simple: In the past banks only took losses on loans once they turned bad, so even when investors knew the economic outlook was worsening they wouldn't get to see the damage to a bank's loan book until it was done. In 2008, investors were kept in the dark too long.

Under the new rule in international accounting standards and the version set to be introduced in the U.S. in 2020, banks are meant to book some impairments on all loans based on their expected performance over their lifetime. For very safe mortgages, this will be extremely small; for credit cards, somewhat larger from day one.

U.S. banks are worried partly about the large initial charge they might have to take at the time the rules are introduced: Some European banks took large charges at the time, but none were big enough to leave them short of capital.

But the rules are making results more **volatile**. Executives have to take account of an array of economic scenarios and many rely on external forecasts, but their assessment of these is subjective.

Their different approaches made a big difference to quarterly profits: Without its U.K. charge RBS pretax profits would have been up more than 20% instead of just 10% higher. At Barclays group pretax profits would have been down 8% without the improvement in expected loan losses in the U.K. and the U.S., rather than up 32% as reported.

This kind of disclosure is better than being kept in the dark, but for investors it takes some getting used to.

Write to Paul J. Davies at paul.davies@wsj.com

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THE WALL STREET JOURNAL.

Heard on the Street
Markets
No One's Feeling Chipper About Chips; Shares in Samsung and SK Hynix have suffered despite both companies reporting record earnings

By Jacky Wong
453 words
25 October 2018
07:03 AM
The Wall Street Journal Online
WSJO
English
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Almost all the gains in U.S. technology stocks have now been wiped out this year. Across the Pacific, the rout has been going on for some time already.

Korea's benchmark Kospi Composite Index fell into a **bear market** Thursday, dragged down by Samsung Electronics and memory-chip maker SK Hynix. The two companies, which together account for around a quarter of the index, have fallen around 30% from their peaks late last year, despite both continuing to report record earnings. SK Hynix said Thursday its operating profit last quarter rose 73% to $5.7 billion. Samsung said earlier this month its third-quarter operating income would be its highest ever, up 20% from last year.

The market's worry is that the boom in memory-chip prices, which lies behind these record profits, is ending. Heavy demand from data centers, boosted by the increasing use of cloud computing and artificial intelligence, had pushed prices of DRAM—a type of memory chip used in data processing—to more than double in the past two years. Now, supply is catching up. Capital spending on DRAM globally has grown 40% this year to $22.9 billion, according to market research company IC Insights.

As the market rebalances, DRAM prices could fall by 5% this quarter from the last one, research company DRAMeXchange predicts, ending a nine-quarter growth streak. They could fall a further 15% to 20% next year, it reckons. Meanwhile, prices for NAND—another type of chip used in storage that both Samsung and SK Hynix manufacture—have already been falling and could plunge by 25% to 30% next year.

The good news is that the downturn in chips could prove less severe this time than in previous cycles, largely because the market has become more consolidated. Three companies—the two Korean giants and Micron from the U.S.—basically control the whole DRAM market. And their share prices now reflect much of the pessimistic outlook. Samsung trades with an enterprise value a mere 2.3 times its expected earnings before interest, taxes, depreciation and amortization—a five-year low.

That doesn't mean that it's time now for investors to jump in, especially when the U.S. tech selloff seems to be picking up steam. The PHLX Semiconductor Index—a gauge of U.S.-listed chip stocks—has lost 10% in the past week, but has still outperformed the Kospi this year.

The chips may be down but it's worth waiting for cheaper bargains in chip stocks.

Write to Jacky Wong at JACKY.WONG@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Fed's Kaplan: Too Soon to Know How Saudi Tensions Could Affect Economy; Dallas Fed chief sees a risk of rising energy prices as Iran faces sanctions, buys says the Saudi situation is unpredictable

By Michael S. Derby
515 words
19 October 2018
04:47 PM
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English
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Federal Reserve Bank of Dallas President Robert Kaplan said Friday it is too soon to say what rising tensions with Saudi Arabia over the suspected killing of a Saudi journalist might mean for the U.S. economy, but he acknowledged the issue is on his dashboard of risks.

Some U.S. lawmakers have called for sanctions against Saudi Arabia over the presumed killing of Jamal Khashoggi in Saudi Arabia's Istanbul consulate. If sanctions were imposed, the nation could strike back and drive **oil prices** higher when planned sanctions on Iran already have raised concerns about supply constraints. An **oil price** shock, if big enough, could risk a global recession.

"For me at the moment, it's probably not material enough to have a significant effect on my thoughts on monetary policy," Mr. Kaplan said of the Saudi situation. The tensions are "part of the whole mosaic of global insecurity, global instability, tariffs, issues with China, this dollar exposure by certain countries," he told reporters after speaking to the Shadow Open Market Committee in New York.

"I'm just watching again, the global instability impact on global growth, does it spill back here? I don't see that alone having a material effect at this point," said Mr. Kaplan, whose bank has strong connections to energy production given its prominence in the Texas economy.

Turkish officials have cited evidence suggesting that Mr. Khashoggi was killed while in the consulate by men with Saudi government connections, though Saudi officials have denied any foul play. U.S. Treasury Secretary Steven Mnuchin this week canceled a planned appearance at a Saudi investment conference.

Mr. Kaplan said Friday he sees a risk of rising energy prices, in part because Iran's oil supply may be taken off the market due to U.S. sanctions over the country's nuclear program.

"What's going on with Iran I can come up with a thesis on. Five hundred thousand or a million barrels a day come off the market, which is a distinct possibility, that's going to have a significant effect" on energy markets, Mr. Kaplan said. The Saudi situation is "so unpredictable, there are so many factors I can't judge," he added.

Mr. Kaplan also told reporters he wasn't that worried about a slowdown in housing activity, as affordability has declined and the industry has faced supply constraints unrelated to demand. "I'm not sure it's a forward indicator of a weakening in the economy," he said.

In his comments to the audience, Mr. Kaplan reiterated his conditional support for the Fed pursuing around three more rate rises into next summer. He said he is still unwilling to say what happens after that. He said the Fed was doing a good job achieving its job and inflation goals.

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

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THE WALL STREET JOURNAL.

Business
Are Companies' Price Increases Painting Them Into a Corner? Earnings reports show the peril of higher price tags; as a can of paint gets more expensive, DIY projects slow

By John D. Stoll
937 words
26 October 2018
11:09 AM
The Wall Street Journal Online
WSJO
English
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For a solid barometer on the American consumer, look no further than the humble can of paint.

Home Depot Inc. sold $8 billion worth of paint last year, and sales grew in the first half, making it among the highest-revenue lines at the company.

Home Depot Chief Financial Officer Carol Tome told me recently that she sees the category as reflective of broader sentiment because "the No. 1 'DIY' project is painting." Even the least-handy among us feels qualified to slosh our way through a gallon of matte enamel or premium semigloss.

It's not all Sunkissed Yellow and Summer Sky in the paint aisle, though, and that may spell trouble for the wider economy. The price of a gallon of paint is rapidly increasing. Home Depot's key supplier, PPG Industries Inc., raised prices 2% over the summer, while rival Sherwin-Williams Corp. is bumping them at least 4%. Both companies will keep raising prices through 2019.

As if on cue, Sherwin-Williams on Thursday noted a slowdown in DIY growth. The company suggested it could be just a blip in a fickle slice of the market. But analysts say it could prove that customers will balk when price tags get too steep.

It has become clear as third-quarter earnings reports roll out that companies beyond the roller pan are ready to see how far pocketbooks can stretch. A broad range of buyers are getting stuck with the bill for new tariffs and rising labor and raw-material costs.

"I can't recall any time so many companies say they need to raise prices and to this degree," said Scott Mushkin, a retail and staples analyst with Wolfe Research. "All they talk about is raising prices, raising prices."

Companies selling everything from bulldozers to Big Macs say higher prices are the only way to protect margin growth, an important metric to Wall Street during a particularly **volatile** moment for investors. JetBlue, United Technologies, Unilever, Procter & Gamble and UPS have all signaled they plan to raise prices. And that list barely scratches the surface.

For nearly a decade, Americans have enjoyed an era where price cuts were more common than increases. Charles Lindsey, a professor at the University at Buffalo School of Management, said companies are prudent to raise prices while unemployment is low, the economy is fairly strong and confidence is high.

"Companies realize there may be more inflationary pressure in the next few years, and maybe consumers will react favorably right now," he said. But "customers are always on a budget and will always feel pressure."

U.S. Bank's recent Possibility Index survey found nearly half of the 2,000 polled said they struggle to cover basic expenses or are concerned with paying bills on time.

Consumers are accustomed to wild fluctuations in prices for energy and certain foods. Steep annual increases can also be common in housing, higher education or health care.

But prices for staples, apparel, postage, home-improvement supplies or restaurants have been relatively stable since 2008. Mr. Lindsey said big-ticket items, such as washing machines, could be particularly sensitive to price increases, but so could lower-cost items that, unlike hotel or airline rates, can't be adjusted in real-time.

On Friday, the University of Michigan said its consumer-sentiment index ticked down slightly in October.

Kimberly-Clark Corp. provided a recent example of how a company can get stung. During the third quarter, it raised the net price of tissue products by 2% to offset raw material costs, and reported a North American sales decline of 5%. "That suggests that the consumer is pretty sensitive to these," Mr. Mushkin said.

Company executives said shifts in advertising spending affected sales results.

If there is backlash against modest hikes on a box of Kleenex or roll of toilet paper, how will customers react to bigger price increases that are likely in the pipeline? The potential upcoming shift in tariffs on certain Chinese-made goods to a 25% rate is an event that will challenge executives.

Earlier this week, iRobot Corp., maker of the Roomba autonomous vacuum cleaner, said it didn't raise prices even after a 10% tariff was imposed on Chinese imports in September. It said it will try to manage costs as duties rise to 25%, but stopped short of saying it could hold the line.

Ms. Tome, the Home Depot finance chief, said "the consumer is in a pretty good place right now," especially when considering the growth in home values. "Homeowners have seen equity values increase in their homes 138% since 2011—on average that's $73,000 a home."

Those homeowners have gotten used to steady prices since, though. In the 12 months through September, overall prices rose 2.3%. That rate was cooler than the near-3% year-over-year increases clocked over the summer, but still higher than any point over the decade.

Whether it's on a box of Kleenex or a gallon of primer, Mr. Mushkin, the Wolfe analyst, said customers will reach a breaking point.

"Paint's only one part of it," he said. "It's really a problem when a project that would have cost me $10,000 in labor and materials is now going to cost $12,000. At that point, someone may decide not to spend the money."

Write to John D. Stoll at john.stoll@wsj.com

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The New York Times

Business/Financial Desk; SECTB
7

By KEITH BRADSHER
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BEIJING -- As the United States and China swap threats and mete out increasingly punishing tariffs, the world is watching to see whether Beijing turns to one of its most potent economic weapons. It involves the number 7.

China's currency, the renminbi, has been gradually losing value since mid-April, and on Tuesday it was at its weakest point in a decade. If the currency weakens any further, it could fall below the psychologically important level of 7 renminbi to the dollar. The last time it took more than 7 renminbi to buy a dollar was in May 2008, as the world was slipping into a financial crisis.

The Trump administration doesn't like the idea of a weaker Chinese currency. That could give what it considers an unfair advantage to China's exporters. In the arsenal of trade disputes, currencies can be potent weapons.

But China has good reason to keep its currency from weakening, and it appears to have acted in recent weeks to prop it up. Currencies may be potent weapons, but they are blunt ones -- and they can boomerang against those who use them.

What happens if the renminbi falls past 7 to the dollar?

There is nothing particularly threatening about the number 7 itself. The renminbi at 7.002 to the dollar is pretty similar to the currency at 6.998 to the dollar.

But passing that number would be significant symbolically. It would suggest China is prepared to let its currency weaken further still. That would give China's factory owners an advantage when they sell their goods in the United States. It would also undermine the tariffs the Trump administration has levied on more than $250 billion in Chinese-made products.

How would that help China?

Say you own a Chinese factory making lawn ornaments, and you sell a lot of pink flamingos to an American retailer. You price each at $1 -- they may sell for far more in the United States, but shipping and storage account for most of that. When the renminbi is 6 to the dollar, that translates to 6 renminbi in sales.

But when the currency depreciates to 7 to the dollar, that $1 flamingo is worth 7 renminbi in sales to you. Or you can cut the price -- say, from $1 to 85.7 cents -- and still make your original 6 renminbi in sales. Your American competitor, who has to buy and sell in dollars, has to grudgingly cut prices to compete.

(It's a lot more complicated in the real world. The plastic and metal for the plastic flamingo may have been imported to China and are priced in dollars. But bear with us.)

A weaker currency can also help Chinese exporters beat President Trump's tariffs. Right now, the United States imposes tariffs of about 10 percent on a wide variety of Chinese goods that arrive at an American port. If the renminbi has fallen 10 percent, the tariff is basically nullified.

What's driving the decline?

Some politicians in the United States and elsewhere have long said that China manipulates its currency, even though Washington officials -- including in the Trump administration -- have stopped short of official accusations. But in this case, many of the forces weakening the currency are beyond Beijing's immediate control.

China's financial system is firmly controlled by the government, giving the country's leaders a great degree of control over how much the renminbi is worth. Officials set a daily benchmark rate for the renminbi and allow its value to move a smidgen above or below that level in currency markets. Chinese officials say each day's trading activity helps determine the value they set for the renminbi the next day, but they disclose few details about how that works.

On Tuesday, Beijing set that guidepost at 6.9574, just a hair's breadth stronger than 7. In the world of foreign exchange, a higher number means a weaker currency.

Right now, traders are sending Beijing a single message: The renminbi should be worth less. The people and companies that hold the currency have become increasingly nervous about China's slowing economic growth, slumping **stock market**, fragile real estate market and seemingly intractable trade war with the United States. Inflation has begun to tick upward, and rising prices tend to make holding the relevant currency less attractive.

There are other reasons. Since late July, Beijing has tried to prop up the economy by having the state-controlled banking sector increase lending, making money more available. That means even more renminbi sloshing around, weakening the currency's value.

While China hasn't raised interest rates, the Federal Reserve in Washington has. That makes it attractive for many people to sell their renminbi and buy dollars. Would you rather have a one-year renminbi certificate of deposit that pays 1.5 percent interest now, or a one-year dollar C.D. that pays out 2.6 percent or more?

Is the drop deliberate on Beijing's part?

Not quite. If anything, Beijing is trying to keep the renminbi from falling too fast.

China has a number of ways to bolster the currency's value. One option is to follow the Fed's example and raise interest rates. That would give Chinese families and companies more incentive to keep their money in China. But that would raise the cost of borrowing in China, just as the economy is slowing.

Beijing could buy up its own currency instead. Like anything else, the renminbi's value rises when it is scarcer.

Thanks to the way it has managed its currency over the years, China has amassed the world's largest foreign exchange reserves -- a $3 trillion stash of money it keeps in dollars, euros, pounds, yen and other currencies. It has begun to tap that stash. When China's central bank released its monthly balance sheet a week ago, it showed a drop of almost $20 billion in foreign currency just during September.

''Selling almost $20 billion in a month won't break the bank,'' said Brad W. Setser, an economist at the Council on Foreign Relations in New York. ''But it does indicate the direction of current market pressure.''

What are the broader risks?

Three years ago, as its economy slowed, China devalued the renminbi in part to give its factories a helping hand. The financial world was shocked. Markets plunged.

As Chinese officials hurried to explain themselves, people and companies began shifting their money -- money that China's economy needed -- outside the country. A year later, China had spent more than $500 billion from its reserves in an effort to shore up the renminbi. It later tightened controls on the financial system to shut off many ways people used to get money out of the country.

Should the trade war intensify, China may look to make more aggressive moves with its currency. But as history shows, there can be a price to pay.

Follow Keith Bradsher on Twitter: @KeithBradsher.

DRAWING (B1); CHART: China Is Flirting With 7 Again: Renminbi per dollar (Sources: People's Bank of China, via CEIC Data) (B2)

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Business & Finance
What's News
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The economy powered ahead last quarter, driven by consumer and government spending, though Friday's GDP report included warning signs that the business sector faces turbulence.

The FBI is examining whether Tesla misstated information about production of its Model 3 sedans and misled investors about the company's business.

A rocky Friday session put the **S&P 500** on the cusp of correction territory, with the index falling 1.7%. The Nasdaq slid 2.1% and the Dow ended 1.2% lower.

NBC News has ended Megyn Kelly's morning show, days after she came under fire for remarks viewed as racially insensitive.

Epic Games, creator of the hit videogame "Fortnite," is valued at almost $15 billion as part of a major new investment round.

China warned investors to stop betting against the yuan, boosting the currency after it had fallen to nearly its weakest in a decade.

Microsoft's top executives defended supplying technology to the U.S. military, in the face of objections from employees.

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The New York Times

Money and Business/Financial Desk; SECTBU
Interest Rates Are Rising. That's O.K.

By NEIL IRWIN
1,060 words
14 October 2018
The New York Times
NYTF
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The cost to borrow money is on the rise. That is bad news for home buyers and other prospective borrowers. It helped cause a **stock market** sell-off on Wednesday and Thursday, and prompted President Trump to say that the Federal Reserve has "gone crazy."

But it amounts to good news for the long-term direction of the economy.

In effect, the multi-trillion dollar global bond market is signaling a little greater confidence than it did just a few weeks ago that the nine-year expansion in the United States may have room to keep going for years to come, and without inflation taking off.

The yield on 10-year United States Treasury bonds reached a seven-year high this week of 3.25 percent (it receded amid plunging stocks Wednesday and Thursday), up from 2.82 percent in August. The 10-year rate was below 1.4 percent as recently as July 2016.

But beyond those headline numbers, the details of how the prices of different types of securities have moved relative to one another tell a story that is decidedly optimistic.

For much of the last couple of years, short-term interest rates, which the Fed controls directly, have risen much faster than longer-term rates, which are set based on global supply and demand for bonds. The Fed was plowing ahead with rate increases, while investors were evidently skeptical that growth would be persistent enough to justify higher long-term rates.

In late August, the rate on 10-year government bonds was only 0.18 percent higher than for two-year government bonds, a phenomenon known as a flat yield curve. (When that number turns negative, it's considered an "inverted yield curve" and is often a measure of looming recession.)

Since then, longer-term rates have risen faster than shorter-term ones. While the yield curve remains flat by historical standards (the gap between 10-year and two-year bonds was up to only 0.33 percent in recent days), it has moved in a direction consistent with a more optimistic outlook.

"The long end of the yield curve has finally moved to the view that this could be a more persistent recovery," said Michelle Meyer, head of U.S. economics at Bank of America-Merrill Lynch. "It's reflecting the possibility that this recovery has further legs."

But, crucially, the higher long-term interest rates don't seem to be driven by expectations that inflation will soar higher.

The yields of inflation-protected bonds have moved mostly in lock step with traditional bonds in recent weeks, suggesting that traders haven't become more worried about inflation.

For example, inflation of 2.16 percent a year over the coming decade was implied by the price gap between the two types of bonds as of the middle of last week, up only a smidgen since August and below its level in May.

The rise in longer-term interest rates is driven mainly not by a rise in inflation expectations, but rather by a rise in investors' expectations for what the Fed will do and for how much compensation bond investors are demanding in lending over long time horizons.

Leaders of the Fed have indicated that they expect to keep raising their target interest rate to around 3.4 percent by the end of 2020, up from the current level of just above 2 percent.

In previous years, **financial markets** have been doubtful that the Fed would follow through with its forecasts for rate increases. Now the Fed's own projections are consistent with the path of rate increases priced into markets.

''The market seems to have accepted the Fed's rate path,'' said Megan Greene, chief economist at Manulife Asset Management.

Moreover, Roberto Perli of Cornerstone Macro calculates that a big part of the higher rates is an increase in the ''term premium.'' That means investors are demanding more compensation than they did a few weeks ago for tying their money up for many years. This implies they now see a greater possibility that growth and short-term interest rates could surprise by rising faster than forecasters now project.

''The markets are bringing up their expectations for growth, and have been bringing them up all year,'' Mr. Perli said. ''The trend is clearly up, and the market is betting that will continue.''

Add it all up, and it means the world's most savvy investors are betting that the United States economy will keep growing at a healthy clip, without inflation emerging, but that the Fed will have to keep raising rates well above current levels in order to prevent that inflation.

Of course, there are downsides to the higher rates. The recent **stock market volatility** has been fueled in part by the realization that higher rates will mean higher borrowing costs for corporations.

And the housing sector is especially sensitive to the longer-term interest rates set on the bond market, which in turn determine mortgage rates. Housing has already shown softness in some markets in recent months.

The average rate for a 30-year fixed-rate mortgage rose to 4.9 percent, from below 4 percent at the end of 2017, according to data from Freddie Mac.

''We are getting into that zone where the typical mortgage payment is increasing much faster than incomes, and that's going to put a brake on some markets,'' said Aaron Terrazas, a senior economist at the real estate site Zillow.

In effect, higher mortgage rates could depress the rate of price appreciation of houses, as home buyers cannot bid as aggressively for properties as they could when rates were lower.

And markets, even deep and liquid ones like the bond market, aren't always right, and are frequently wrong. No one would argue that the details of the yield curve, for example, offer some unassailable prediction of the future.

But for all the **stock market** palpitations and risks to particular interest-rate sensitive industries, the message to take from the recent rise in interest rates is an unambiguously good one: This expansion may have some life in it yet.

The housing sector is sensitive to longer-term interest rates set on the bond market. (PHOTOGRAPH BY BEN NELMS/REUTERS) (BU7)

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The New York Times

The Upshot
Interest Rates Are Rising for All the Right Reasons

By Neil Irwin
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The housing sector is especially sensitive to the longer-term interest rates set on the bond market, which in turn determine mortgage rates. | Ben Nelms/Reuters

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THE WALL STREET JOURNAL.
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Trade Pact Soothes Investors, Businesses

By Josh Zumbrun and Siobhan Hughes
994 words
2 October 2018
The Wall Street Journal
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English
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WASHINGTON -- Investors greeted the completion of a new North American trade pact with relief Monday, lifting most indexes, as the Trump administration turned its focus on getting the deal through a divided Congress and toward even larger economic feuds with China.

Uncertainty about trade has been a worry of businesses and investors for months, after Mr. Trump began advancing an ambitious agenda that included a new North American Free Trade Agreement, tariffs on U.S. metals imports and a rewrite of U.S. economic ties with China.

The new U.S. Mexico Canada Agreement, which will replace Nafta, alleviated some, if not all, of those concerns. Among other things, it allows auto makers and other multinational companies to keep intact the complex and costly supply chains built across the continent since Nafta was completed in 1994.

It also won new concessions for U.S. farmers and created new rules for digital commerce across the continent.

General Motors Co. applauded the accord, saying it has long supported efforts to modernize the trilateral accord. "This agreement is vital to the success of the North American auto industry," the auto maker said.

"This gives some sign that [President] Trump is at some point willing to agree to some new trade deals," said Jeroen Blokland, a multiasset portfolio manager at Dutch asset manager Robeco.

At a White House ceremony Monday, Mr. Trump touted the deal as a big win for U.S. workers. Among other things, it requires that duty-free cars produced in North America have at least 75% of their content produced in the region and 40% of their content produced by $16-an-hour labor. Those provisions could lead to more auto production and jobs in the U.S. and Canada.

U.S. dairy farmers also got what they wanted when Canada agreed to drop its complex "Class 7" system, which limited imports of certain dairy products from the U.S. It was a tough concession by Canadians that led to the weekend breakthrough after sometime bitter talks between the U.S. and its northern neighbor in the months leading up to the agreement.

"We had to make compromises," Prime Minister Justin Trudeau of Canada said Monday. "And some were more difficult than others. We never believed it would be easy, and it wasn't."

The **Dow Jones Industrial Average** rose 0.7%, extending advances after posting its biggest one-quarter gain of the year. The **S&P 500** climbed 0.4%, just short of its record. The Nasdaq dipped.

The North American pact allows Mr. Trump to turn his attention to China, where trade disagreements are even thornier, and may free up U.S. negotiators to devote more attention to their nascent talks with the European Union and Japan.

The tensions are highest with Beijing. The Trump administration has imposed tariffs on $250 billion of imported goods from China and threatened more if steps aren't taken to close a more than $300 billion trade surplus with the U.S., block alleged intellectual property theft and reduce state support for the private sector.

Mr. Trump, a Republican, must turn to political rivals at home to make the North American trade deal the law of the land, a test of bipartisanship in Washington at a moment of extreme political discord.

Mr. Trump is counting on Democrats and traditional allies of Democrats including labor unions to help push the new pact through Congress and replace what Mr. Trump has long called the worst trade deal in history.

The rules requiring car production by high wage workers could please U.S. labor unions and their allies among Democrats. But in approving the deal, Democrats would be handing Mr. Trump a victory on a pledge that helped to define his 2016 election and could be a signature of his 2020 campaign for reelection.

On Saturday, at a political rally in West Virginia, the president called his rival party a "disgrace."

"I can't tell you whether or not they will obstruct, whether or not they'll resist," Mr. Trump said. "They might be willing to throw [away] one of the great deals for people and the workers -- they might be willing to do that for political purposes, because frankly they'll have 2020 in mind."

Once Mr. Trump and his counterparts in Canada and Mexico sign the deal, targeted for the end of November, the new pact must win congressional approval to take force. Lawmakers will have an opportunity to weigh in, to request side deals or insist on special legislative provisions.

The administration has said the congressional vote is likely to be in 2019. By then Democrats may have taken control of the House, and even if they haven't, Mr. Trump's trade advisers have long counted on Democrats to help advance a new North American trade deal through Congress.

"I think this will pass with a substantial majority. The fact of the matters is, this is not a Republican-only agreement," U.S. Trade Representative Robert Lighthizer said Monday. "It was never designed to be a Republican-only agreement."

Democrats treaded carefully, acknowledging they could support the new pact but hesitated to commit.

"As someone who voted against Nafta and opposed it for many years, I knew it needed fixing," said Sen. Chuck Schumer of New York, the Democratic leader. "The president deserves praise for taking large steps to improve it."

Mr. Schumer, however, said he still needed to see more details on labor provisions. By leaving open the possibility of Democratic support for the deal, the Democrats also retain leverage to shape the legislation that will need to be passed by Congress to implement three-country the trade pact.

Two major unions, the Teamsters and the AFL-CIO, stopped short of endorsements but appeared supportive, a shift from their oft-adversarial approach on trade deals.

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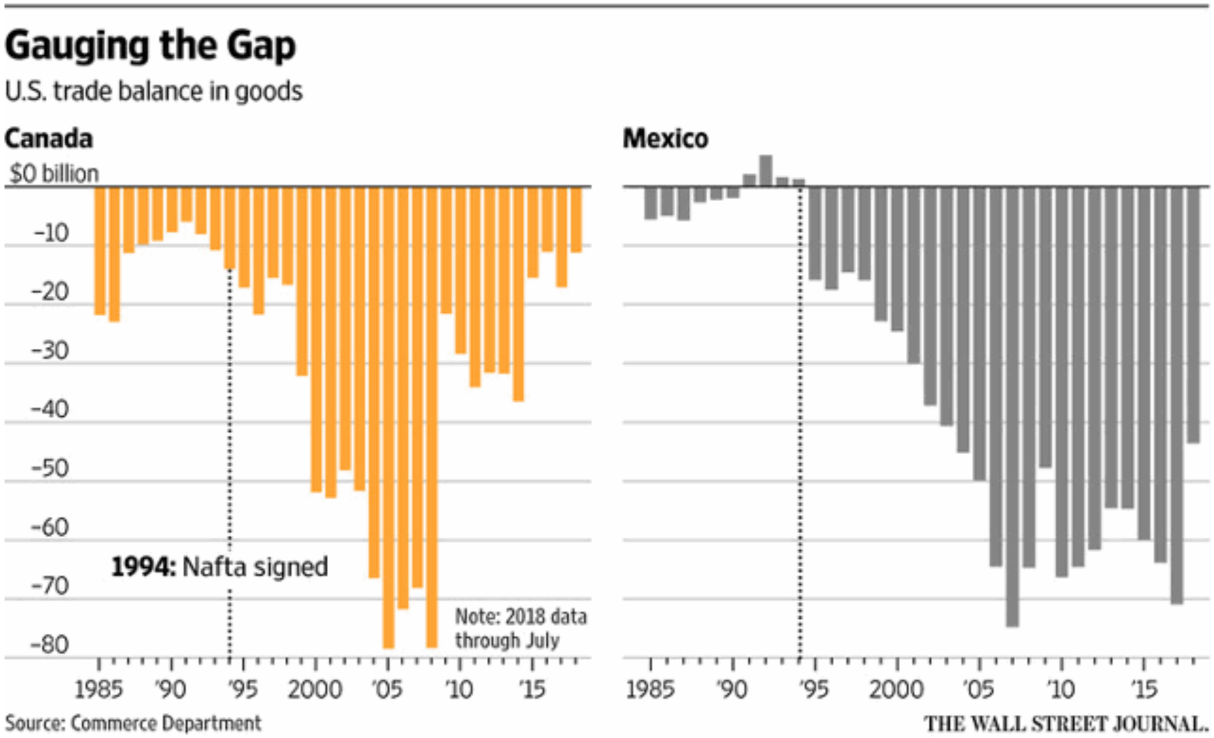

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World

Turkey Holds Rates Steady as Political Pressure Starts to Abate; The country's economy has come under immense pressure in recent months amid a global selloff in emerging markets

By Yeliz Candemir
603 words
25 October 2018
08:00 AM
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English
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ISTANBUL—As political and market pressure eases on Turkey, the country's central bank kept interest rates steady Thursday, even as investor doubts persist that the government will manage to orchestrate a soft landing for an economy that was among the fastest-growing in the world last year.

Turkey's central bank kept its main policy rate at 24%, as market pressure to raise interest rates has eased somewhat recently. In its meeting last month, policy makers lifted its main rate by 625 basis points in a bid to tame inflation that hit 25% in September, to reach a 15-year high.

In a statement, the central bank said it could further restrict monetary policy if inflation doesn't come down.

The lira was up over 1% against the dollar on Thursday, extending its recent rally. The lira is now up 7.4% against the dollar this month, recouping some of its losses from earlier in the year. It is now down around 33% against the dollar this year,.

In recent months, Turkey has come under immense market pressure, due to a global selloff in emerging markets and a bitter geopolitical clash with the U.S.

The Trump administration had been demanding President Recep Tayyip Erdogan release an American pastor, Andrew Brunson, held in Turkey on terrorism charges. Washington and Ankara levied tariffs on each other's goods and President Trump imposed sanctions against two top Turkish officials, freezing U.S. assets held by Turkey's justice and interior ministers. Mr. Erdogan has accused Washington of waging an economic war against Turkey.

Earlier this month, Turkish officials released Mr. Brunson and some expect the U.S. to lift the sanctions.

The easing of tensions with the U.S. has supported a rebound in the Turkish lira. Nonetheless, the lira is still down 33% against the dollar so far this year, reflecting ongoing concerns about an economy that has boomed on the back of a government-backed debt binge. Last year, the Turkish economy grew 7.4%, the fastest pace of any Group-of-20 country.

Last month, Turkey's Finance Minister Berat Albayrak, who is Mr. Erdogan's son-in-law, announced a new plan to engineer a smooth landing for the economy and bring inflation down to 20.8% this year, before easing to 15.9% in 2019.

Investors, however, have expressed skepticism on the plan, which lacked detail as to how the government will slow the economy without provoking a crash. Under its new plan, the government expects the Turkish economy to slow to 3.8% this year and 2.3% next year. The International Monetary Fund projects Turkey's growth at 3.5% this year and to drop to 0.4% next year.

With relations with Washington improving, Mr. Erdogan may now push the Trump administration to receive an exemption from sanctions that will soon be applied on Iranian oil exports. Such a move would be a major boost for Turkey given that the country imports virtually all of its energy needs. The fall in the lira and a rise in **oil prices** have been a major factor in pushing up Turkish inflation.

The government has also been urging Turkish business to cut prices by at least 10% on goods included in the basket of items used to calculate inflation. Businesses would apply any price cuts voluntarily.

Write to Yeliz Candemir at yeliz.candemir@wsj.com

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The New York Times

Business Day
How to Respond When the Market Turns

By Jeff Sommer
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Many investors received a nasty reminder in early October: that they could lose a lot of money in a very short time.

Stocks fell for six consecutive days, reversing the gains of a third quarter that had been remarkable chiefly for its lack of stress. That October shock may have been just a blip in a long **bull market**, but it pointed out that American stocks clearly can't rise forever. What is a long-term investor to do?

Our quarterly survey contains some lessons and suggestions. Prospecting for stocks in other countries is favored by some strategists now. Buffering stocks with bonds — and taking advantage of the higher interest rates available in shorter-term securities — is widely recommended. Of course, staying calm and sticking to a plan — as many index fund investors do — is always in fashion.

In a new book and interview, the investor Howard Marks explains why most people can't beat the market. And if you're worried about climate change — and want your portfolio to reflect your concerns — we've got some ideas for you.

For entertainment, try John Schwartz's essay on the profit-making possibilities in mind-altering drugs, which he, personally, doesn't use. But, he says, "Some people might benefit. Shouldn't it be our humanitarian goal to make money off them?"

U.S. Stocks Became Expensive. Are Other Countries' Stocks Better Bets?

The extended **bull market** has made stocks fairly expensive in the United States. For investors capable of handling the stress, neglected foreign markets may offer better prospects, according to some — though by no means, all — strategists.

These Funds Aim to Power Their Returns With Clean Energy

Renewable energy funds can't shutter a coal plant tomorrow, if that's your goal, but they can pair profits with a commitment to a green economy.

Finding a Fortune in the Market for Bliss

Somebody is going to get rich from legal, psychoactive drugs linked to blockchain technology, our columnist says. Why not him?

Income Investors Finally Have a Chance to Cash In

A decade after the financial crisis, multiple Federal Reserve rate increases are at last making it possible to earn a decent yield with little risk.

Index Fund Investors' Simpler Approach May Enrich Returns

Fund investors often earn less than they could because emotions get in the way. People who use index funds seem to make fewer and better choices.

Big Bets Are Great, When They're Right

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WSJ PRO CENTRAL BANKING

Markets

NYSE, Nasdaq Take It on the Chin in Washington; SEC's move to block fee increases is latest setback in exchanges' growing list of disputes with regulators

By Dave Michaels
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The country's biggest stock exchanges are on a losing streak in Washington.

The Securities and Exchange Commission's decision this week to block the exchanges from raising fees on some data products is the latest example. The three main exchange operators also are fighting to kill off a two-year SEC initiative to test lower trading fees. Separately, the SEC has rebuffed their requests to delay and pare back a surveillance database that exchanges are nearly a year late in delivering.

The exchanges, including the New York Stock Exchange and Nasdaq Inc., were once powerful interests in Washington. And for decades the SEC deferred to the exchanges and didn't dictate the plumbing of markets.

That started to change in the late 1990s and early 2000s as a mix of new regulations and technology-driven competitors challenged the slower NYSE, leading to more competitive trading and erosion of NYSE's power and market share.

"Generally speaking, the SEC would always try to adopt a light touch, and guide and provide expertise," Ken Durr, a historian who has studied the SEC, said of the agency's earlier approach.

Now the tide appears to have turned, with the SEC taking a more forceful stance on key aspects of the exchange business. In the recent clash over market data, the exchanges claim the SEC has taken sides in a debate that pits them against the biggest banks and savviest traders.

"The SEC is proactively picking commercial winners and losers," said Tom Farley, a former NYSE president. "The exchanges seem to be losing out to the big institutions every time."

Despite their storied history, the exchanges have a smaller presence in Washington than Wall Street's big banks. The Securities Industry and **Financial Markets** Association, which sued to overturn the exchanges' market-data fee increases, spent over $8 million on lobbying in 2017, according to Senate records. NYSE, Nasdaq and Cboe Global Markets Inc., the third major exchange operator, spent a combined $4.2 million.

Since at least 2013, the exchanges have tried unsuccessfully to get congressional support to force more trading onto their markets. Their share of U.S. trading has fallen to about 63% as more orders migrated to private platforms run by brokers.

In the current dispute over market-data prices, the SEC's decision to shoot down a pair of NYSE and Nasdaq fee raises marked the first time the five-member commission has rejected increases for the exchanges' most lucrative class of **stock-market** data feeds.

The SEC has in the past seen those products as a luxury reserved for high-speed traders and the biggest Wall Street banks and brokers. Sifma successfully argued that brokers and traders need the richer, faster data to compete in the age of electronic trading.

The fight is likely next headed to the U.S. Court of Appeals for the D.C. Circuit, as the exchanges have said they plan to appeal.

The SEC dealt the exchanges another blow this week, ordering them to study over 400 other market-data fee decisions to which brokers had objected. The exchanges have one year to resubmit the proposals to the SEC with more evidence supporting the fees' fairness.

A spokeswoman for NYSE declined to comment beyond earlier statements that it intends to appeal the SEC's decision. A Nasdaq spokesman referred to an investor presentation issued Wednesday that said: "The decisions seek to establish an unworkable and unnecessary regulatory regime in an already competitive market."

NYSE, Nasdaq and Cboe are also fighting the SEC over a different plan targeting a pricing strategy used by many exchanges. The SEC proposal, issued in March, would lower trading fees for some stocks, with the goal of also reducing payments that exchanges offer to attract orders.

Critics of the pricing system, known as maker-taker, say it creates a conflict of interest for brokers, who might route orders to exchanges that pay more for orders, instead of using other venues where the incentives aren't available.

Exchanges argue the pilot program is an experiment in price controls, according to a letter Nasdaq sent to the SEC in May. Cboe's president, Chris Concannon, in early October said the SEC's trading-fee trial "is not logical" and tramples on exchanges' rights to negotiate their own prices.

The exchanges have also butted heads with the SEC over the surveillance database, known as the Consolidated Audit Trail. The SEC declined to give the exchanges a one-year extension of their deadline to launch the project. The exchanges are now in violation of the rule that requires them to build the repository, although the SEC hasn't taken enforcement action over it.

Eric Noll, a former Nasdaq executive who also ran brokerage firm Convergex, said the latest confrontations stem partly from complaints from institutional investors, who believe stock markets evolved in ways that hurt them.

The exchange business consolidated over the past 15 years as their owners responded to regulatory incentives to make markets faster and more transparent, Mr. Noll said. Those structural changes aided the rise of high-frequency traders, who need lightning-quick information about price moves.

"It's bad for the exchanges right now," Mr. Noll said. "At the root is the feeling that exchanges have not met the needs of the institutional community."

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WSJ PRO CENTRAL BANKING

Economy

Transcript: WSJ Interview With Dallas Fed President Robert Kaplan; Official talks about his interest-rate outlook, the importance of central bank independence and what he sees as the biggest challenges facing the economy

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Federal Reserve Bank of Dallas President Robert Kaplan sat down for an interview with The Wall Street Journal on Tuesday, Oct. 9, 2018, in which he discussed his interest-rate outlook, the lack of pricing power many businesses face, the importance of central bank independence and what he sees as the biggest challenges facing the U.S. economy. Here is a transcript of the exchange, lightly edited for length and clarity.

Q: Perhaps just to start off sort of a broad question, and it's prompted by, you know, thinking about what [Fed] Chairman [Jerome] Powell had said in Jackson Hole when he sort of swept the stars away, it seemed.

ROBERT S. KAPLAN: Right.

Q: Do you have any sort of broad thoughts about how monetary policy is now being done in the – in the Powell Fed, you know, in light of this moving away from harder to, you know, sort of ephemeral guideposts – you know, we're not using these guideposts in the same way that maybe we once did?

MR. KAPLAN: So here's the way I would say it. I think – I've always felt you were very well served if you're going to talk about the natural rate of unemployment, U-starred, or the natural rate of interest, R-starred, that you emphasize they're inherently imprecise and uncertain. And I make as a point I don't comment – I won't comment on his speech; I'll let him interpret it. But I'll give you my own view. It's inherently uncertain. We are wise publicly to emphasize that R-starred and U-starred and these other estimates are inherently uncertain, OK?

Having said that, I also think we're wise to say while they're inherently uncertain and imprecise and they're subject to change and all those comments, that does not mean we don't work very hard to try to make judgments about them. So that's where I might put this in a different framing. But I think it's important to explain to the public and in our own work, while we're trying to make judgments on them, we are wise to acknowledge to the public and to ourselves that we all need a degree of humility in terms of imprecision and uncertainty about these.

But I don't think it changes at all the need to make judgments about where neutral is, how tight the labor force is. I still – I'm still continuing to try to make those judgments. But I think – you know, I'm just emphasizing – just worth emphasizing every time, and including this morning when I talk about them, here's why they're uncertain and there's a lot of things we don't know.

And one of the biggest, for example, is what's productivity growth going to be? Very hard to forecast. And what productivity growth is in '19 and '20 will have a big impact on those questions, and it's a very hard thing to forecast. But it doesn't stop us from trying to still make judgments on it.

Q: So how do you know, then, when monetary policy is even in the vicinity of neutral?

MR. KAPLAN: You still have to make – I still, Rob Kaplan – I still have to make a judgment on where I think the range of neutral is. I have to do that.

Q: So how do you do that?

MR. KAPLAN: Same way – same way I did it – I've always done it. You do – you look at models. So I'll go through all the different things you look at.

You look at models. And there's the Evan Koenig model, there's the Laubach-Williams model, there's a whole bunch of other models. Some forecast short-term – so-called short-term R-star, sometimes longer term. So I look at all the models. That's number one.

And for me, I'm less interested in what the output of the model is. I'm much more interested in what the inputs in the model are. Why? Because the thing I always talk to, for example, Evan Koenig about is, explain to me what drives this model. And what I've learned is in some of the models changes in wealth, shape of the yield curve, expectations for future growth, those are all, for example, factors that drive the models. So you look at that.

Number two, you look at how the economy is performing, understanding that monetary policy acts with a lag and whatever you're seeing today may be different in the future. And also have to understand that fiscal stimulus is at its height right now. But you look at how the economy's performing and what our outlook is.

You do all the talks with people about what are they seeing in their business – all the CEO calls, all our surveys about how tight is the labor force, what are you seeing in terms of your own business in terms of productivity, what are you seeing in your own business in terms of pricing power, all those conversations.

The yield curve is a reality check also.

So I look at all those things and more, and then I come up with kind of a picture on what I think – for me, what I try to judge then is what the sustainable rate, I believe, of economic growth is in the United States. I look a little bit past the shorter-term factors and look at what are the – what do I think is a sustainable growth rate. And based on that, it feels to me – you know, I make a judgment as to what I think the range is likely to be for the neutral rate. And then the last thing I do is acknowledge explicitly I reserve the right to amend and update my views.

Q: As we stand right now, how do you feel the range of neutral rates might be?

MR. KAPLAN: I still think – this is why I've said publicly and this morning my own view is it'll take probably three rate increases from here, which would get us in the range of 2¾ to 3 [percent]. That, for now, is probably my best – that gets us in the vicinity – and I would underline the word "vicinity," "neighborhood," whatever adjective you want to use there – that gets us in the vicinity of neutral. Neutral could be a little lower than that, by the way. Neutral could be a little higher than that. But that probably is my best judgment.

And what you also heard me say this morning is then – so that tells me a pretty good idea what we should be doing in December, March and June, unless something changes. And then that gives me, I would say, what is it, nine months to keep updating all the dashboard I just went through with you and updating those views and see whether, yeah, still kind of the same place; or, no, I think I'm a little higher; no, I think I'm a little lower. And that's what I'll be doing. I'll be updating all those views about how the economy is performing, what I think the job market is likely to do, what is my view still on the range of possibilities for neutral, and I'll be doing all that.

And the big imponderable which is going to affect my view when we sit there in the spring of next year is, what's the outlook for – what are we seeing in productivity and what's the outlook for productivity growth? Because that's the one thing. We can measure workforce growth. We got a pretty good grip on what – how much more hours people can work and, you know, the demographic issues that are going to affect participation. The part that could surprise us to positively or negatively is productivity.

Q: Are you hopeful, though, for productivity in '19 and '20?

MR. KAPLAN: Of course.

Q: Yeah?

MR. KAPLAN: Very. Yeah. Listen, logic – and I'm a former businessperson. So, you know, let me give you the pro and the con on why productivity may be better or worse than we think.

The pro is – why it might be higher is – oh my lord, you know, every industry is busy replacing people with technology and labor-saving devices, and you go every single industry, OK. That's the – and you'd say maybe there's a lag effect, you know, all the different arguments that have been made. And history has shown that sometimes it takes a lag – and this was true in the '90s – before all of a sudden you see. So fair enough, that could happen.

The concerning things are this issue of lagging education, lagging skills training that I'd put under the category of it would help for this to happen if we had more labor force adaptability, you know, that could take advantage of all

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this technology investment. And right now I think we're lagging in this country structurally in education and skills training that can make our labor force more adaptable. That's probably the primary concern I have.

And the other thing I'm aware of is there's the manufacturing sector of the economy and there's the service sector. We know the service sector is larger, and we also know it's notoriously difficult in the service sector to create productivity improvements.

The last thing I would say is we know that this government spending – part of the growth in [gross domestic product] is the spike in – the change in government spending. How sustainable is that? How sustainable is the [capital expenditure] improvement, understanding some portion of it is due to energy? That may be sustainable because I think the energy outlook is going to be relatively positive. I think the consumer is going to stay strong.

So the thing that could happen is if we really lack capacity here, what you'd see is net exports pick up. If we don't have an increase in productivity but we still have strong demand, the danger is if we can't fill it here you'll just have more net exports, which do not go into GDP. But I don't know. That's the thing I'm going to be watching.

I'm talking to my team about all these factors and what are we seeing, and they warn me: Historically, Rob, we're good at forecasting certain things; we're not good at forecasting productivity growth. We're just not.

Q: Your colleague Jim Bullard spoke recently about kind of almost an animal spirits sort of argument that, you know, under the Trump administration there had been a sort of change in the business – you know, businesspeople were talking about a different – I mean, whether or not it's, you know, factually true – you know, a different feeling about the business outlook, about regulation, and that therefore they kind of had a spring in their step and were willing to take on more things and do more things.

MR. KAPLAN: I don't – so I am a – I am a businessperson, and I know how it feels to have a spring in your step and what's that like. And again, I'm also – had a business career where my experience is when things feel really good you shouldn't read too much from it because within 12 months things can feel dramatically different. And businesspeople are quite capable, including me, of changing my view, because you have to, to adapt.

So I talk to businesspeople constantly. I have these conversations. I do the surveys. I look at them. I'm a little – I'm just aware, based on my own history and experience, that you don't want to overread that.

You know, animal spirits can be helpful, but they can change on a dime. And sometimes you look back in hindsight and you're surprised why they changed, but it can happen. And it normally happens when things are good that they change on a dime.

Q: So be cautious in things like animal spirits will – yeah.

MR. KAPLAN: Vigilance. Be vigilant about that, yeah. I'm not – that alone is not – attitudes and sentiment can change dramatically and quickly, to where you get whiplash. And so – and including – and a good CEO is going to have to prepare for the best – you know, prepare for the – you know, hope for the best and prepare for the worst. A good CEO is going to have – they've got a downside plan and they're always – in my conversations with them, they're always weighing both, or else they're not doing their job.

Q: OK.

MR. KAPLAN: And this is why they've been very careful, you know, CEOs, on this issue of wage increases. One-time bonuses? Yes. Other elements? Yes. More contract workers? Yes. Actual fundamental increases in underlying wage rates? They've been cautious. Why? Because they know from experience they want to be very careful about their – in a downturn what their cost base is, and I'm noticing that very widely.

Q: This deep into an expansion, you know, one that's supposed to be on track for one of the longest ever, if they can't gain enough confidence in what's going on to boost wages now, when does that ever arrive?

MR. KAPLAN: I think that this gets back, for me, to the skills and quality of the workforce. Again, I think if you have a highly skilled worker, a business is more willing to pay for highly skilled workers than they're willing to pay at the low end because of churn. The low end I'm talking $10 to $15 an hour. In the middle, you know – what's going on here which is new in my – well, there's always been something, but there's two powerful forces going on, which are automation and globalization, and they're affecting – for certain jobs they're affecting negotiating power and wage demanding power. And what I've noticed in most CEOs I speak with, when they are having issues in having to increase wages, the next thing they talk about is their plans to replace people with technology. And I in my mind as I'm talking to them go through lots of examples where they say five years from now we plan to reduce our headcount in blank, and we're going to – we're trying very hard to increase technology, and we will have fewer workers in the following areas, and we intend to have more output because we think we have to because we can't – we don't have pricing power.

The big change for many businesses is the lack of pricing power. That's a big change. And the reason – the big driver of that change is the consumer today has in the palm of his or her hand more computing power than most companies did 20 years ago.

Q: Right.

MR. KAPLAN: And we take it for granted a little bit, but we shouldn't. It has been a powerful – been a powerful leveler of the relationship between the person selling goods or services and the person buying them, and it's had a – it's a dramatic effect.

And I give the example – you may have heard me give the example of a new car. Have you heard me talk about that before?

Q: I probably have. But just the idea that you have such –

MR. KAPLAN: So that's an example, and I could go through it by industry. Fifteen years ago or even 10 years ago, if you went in to buy a car you dealt with a salesperson. That person negotiated with you. It might have been a frustrating/harrowing experience for the buyer. And they made a reasonable margin on new cars. OK?

Roll forward to today. Today, if you're going to buy a new car – and by the way, the salesperson was the highest-paid person in the auto dealer, most likely. Today, you roll forward, you look online. You're looking at four or five dealers. You're shopping for price. By the time you go into the store, you already know the price, you know, the car, and the salesperson who you used to deal with probably doesn't work there anymore. And if he or she does, they make a fraction of what they used to make. That person is now called the product specialist. There is no negotiating. You already know the price because you've already done the comparing because of technology.

It is very hard to make a good margin now on new cars. Prices of new cars have been – there hasn't been much pricing power. And there is a person in the car dealer that is the highest-paid person and the most valuable person now. Which person? That's the automotive technician. That person makes 150 grand a year and there aren't enough of them. And probably the person who used to do that job 15 years ago may not be there unless they were able to get retrained. And now it's the case where the car – the dealer makes most of their money on service and used cars, that they're not – it's hard to make a margin on new cars. So that's an example.

So then the question is, if that's going on – give me an industry, I'll give you the story, including the newspaper business.

Q: Oh, yeah, yeah.

MR. KAPLAN: Right? I don't even need to tell you. I mean, it's been so dramatic you're sort of getting used to it. And lack of pricing power, and it's had a profound impact on wages and compensation, and this trend is accelerating. It's not slowing. From everything I can tell, this technology trend – including in the media business – is accelerating.

And this also helps explain why you see all this merger activity, which I don't need to tell you, even in your industry. Why is it happening? Because of this issue. It is: "I don't have pricing power. I need more scale." Content, something differentiating that can't be commoditized, is more and more valuable. And things that we used to charge for we now give away for free.

Q: Some of your colleagues have talked about tariffs giving rise to opportunistic price increases.

MR. KAPLAN: It's happening.

Q: OK.

MR. KAPLAN: So input costs are going up: steel, aluminum, energy, certainly wages. So then the question is – and that's pretty true for almost every company I talk to. Very unusual not to have that situation.

Q: And is this tariff-related or is this just generally?

MR. KAPLAN: It's across the board. It's tariff-related. It's tight-labor-market related. It's energy-related, price-of-oil related, you know, global supply/demand issues. But it's all having the effect of raising input costs.

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Then the question is, what does – what is different is certain industries tell me they think they can pass on those prices, depending on the dynamics of the industry. And lots of industries – particularly ones consumer-facing – tell me we're having all these increase; we don't think we can – we don't think we can raise prices. So what are you going to do? We've got to introduce more technology to – and we need more scale. And they're struggling with that.

Q: So you're seeing, like – say you are, like, a steel manufacturer. You might say, well, my – I am going to be able to pass it on because, you know, tariffs and various things like that.

MR. KAPLAN: I'll give you a good example. If you're an oil field service supplier, the industry is doing well. Prices are going up. There's a lot of growth. And so you probably can have reasonable confidence even though your costs are going up you can pass them on. If, on the other hand, I sell – I'm in the car business and selling cars, I don't know. But my costs are still going up. We use a lot of these input costs, but I'm going to have to find other ways to, you know, control my costs, because otherwise my margins are squeezed. Businesses are doing a very good job adapting to that.

But what's happening – so this is why the inflation numbers, when you get back to headline inflation, it doesn't surprise me that while it's gradually moving up it's not – it's not – it's been gradual. And certainly at this tight of a labor market it may be more gradual than we would historically have expected. So this issue of how flat is the Phillips curve, I think the structural changes are affecting the shape of the Phillips curve.

Q: Mmm hmm. Do you want to stay on markets?

MR. KAPLAN: Or anything you want.

Q: Yeah. I also wanted to ask about inflation, because, you know, we've seen bond yields rise, you know, fairly significantly the last few weeks. And one of the things that's been notable about it is that the break-even, you know, rates have not risen, you know, with the bond yields, that most of this rise in yields seems to be in the absence of concern about inflation. So I was wondering, to what extent do you think that this stable inflationary situation is with us. You know, is it going to change? A lot of people had thought wages would be the thing that spurred inflation, as the stimulus came through the economy.

MR. KAPLAN: Well, so let's take a few things and let's break them apart. So there's what's going on with the curve, which over a long period of time – this is somebody who's been in – as somebody who's been in the markets. What goes on in a three-week period – you know, I watch, I observe, I try to understand, but I'm careful about not to draw too many conclusions because, A, it can reverse; B, it could go further. So I say I'm just watching it. I'm very vigilant and watching carefully.

Over an extended period of time, though, we know that the curve overall has flattened. And I think, as I said this morning, the front end of the curve I think is responding very heavily to the Fed dot plot, the one- and the two-years and shorter. And the long end of the curve is responding to a whole range of factors – the expectations for future growth, there's a lot of global liquidity, whenever there's turmoil in the world people who want to buy often gravitate to the **10**-**year Treasury**, a lot of pension fund money.

Although – and then there's this question of, are expectations for future growth improving? And then the expectations for higher inflation firming? Those are possibilities. I don't know. But those were all the things I think about and try to understand. And I think on these things, in the same way where I'm very careful of a **stock market** move over three or four weeks. I just watch. Over a lengthy period of time, you can make more definitive statements about it. So I'm – right at the moment I'm just watching.

Q: It did seem that the market did start to move rather significantly after the last meeting, where the new SEP [Fed's summary of economic projections] came out, and where –

MR. KAPLAN: See, and that didn't change – so the reality is, that SEP was almost the same as the previous one. So my guess is it wasn't that specifically. But I think what may – it's possible what may be happening is people are getting a little more confident – rightly or wrongly, by the way – about expectations for future growth and inflation firming. But the only caution I would give is they could just as easily in three weeks change their minds.

And the other thing that's changed since the last meeting is the deal with Canada did finally get agreed, at least in principle. And I think that took a meaningful – that may be the most significant, for me, news event since the last meeting, is that we now are going to have an agreement between Mexico and Canada and the United States. And I wouldn't underestimate that.

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Q: Because when I talk to investors about inflation, particularly the people who invest in TIPS [Treasury inflation-protected securities], you know, they say that they feel very confident that the Fed has inflation under control, that they feel that, you know, there's a very clear and gradual course of action that's been laid out. And you guys have given yourselves enough wiggle room to adjust that, you know, in a manner that gives investors enough time to make their own decisions. I mean, I don't know if you want to declare victory right now –

MR. KAPLAN: No, I don't. (Laughter.) Listen, our job, my job, to analyze the economy, make judgements on monetary policy. And the other part of the job is to clearly communicate how we're thinking about what we're doing. And it's just as important for me to explain what we have – what I think we know. And it's just as important to explain what I think we don't know and what we're uncertain about. And I think we – I make an effort, and I think others around the table are going to make an effort to be transparent enough that – which goes back to the – and I think that's a healthy thing, in that – I think it's just as healthy to explain what we're uncertain about and is imprecise. I think that's very helpful, because it's transparent. It explains how we're thinking.

Q: One thing that I – looking at some of the data about who holds government bonds, I've noticed that this year federal debt has increased by about $600 billion through July. And through that same period, foreign holdings have increased by only $42 billion. So they have increased their holdings by only about 7 percent of that additional debt. The long-term trends since the crisis have been for more domestic ownership of debt. To what degree –

MR. KAPLAN: Including from the Fed.

Q: Yes. Yes. Although, you know, as the Fed unrolls, you know, some if its holdings, that has not –

MR. KAPLAN: No, but since the crisis it's still true.

Q: Yeah. Yeah. No, but what I'm wondering is, you know, the Fed has been reducing its balance sheet this year. And the trend has, you know, been – even despite the Fed holding less, domestic investors continue to buy more.

MR. KAPLAN: Yes.

Q: To what degree does the Fed, you know, concern – are you guys at all concerned that overseas investors aren't adding to their Treasury holdings?

MR. KAPLAN: So let me put it this way: I look holistically, as best I can, at supply and demand, how much of new issuance. And there obviously is more supply. And then I look holistically at what the flow of funds are. I try to understand that – how much has happened globally, how much is coming from pension funds. How much is coming from domestic – what's going on with broken pension fund assets? Corporate pension funds is a part of that. What the – what the Fed is doing – but I would state one fact. You have to keep in mind, – these are rough numbers. Roughly speaking, in 2008 global central banks held about $4½ trillion on their balance sheets. Today that number is closer to, roughly, you know, $24 to $25 trillion.

And the Fed is one of the few central banks that is gradually letting our maturities run off. We still have substantial global liquidity. And in addition to central bank assets, you've had growth in pension fund assets that need to buy out, you know, longer-term securities. So the thing we'll have to see, and I don't know the answer, is we're increasing our new issuance here. And we'll just have to see how that plays out. And like a lot of things in the market, I'm watching carefully.

Q: Do you worry at all that there – I mean, given the arc of the deficits, that there's not going to be enough people out there to buy all that debt?

MR. KAPLAN: There'll be people to buy it. Here's what I am a little bit – and this is not a short-term concern. This is a longer-term concern. We are very fortunate in the United States that the dollar is the reserve currency, that in times of stress people want – people are – there's a strong demand for safe assets globally. And among safe assets, the Treasury 10-year, 30-year, other Treasurys along the curve are very attractive places to put your money. If over the next – I think this may take 20 years – but over the next 20 years, will other economies develop, improve, restructure, modernize to where people will feel more comfortable owning securities other than the Treasury as an alternative home for safe assets? And I don't know if that'll happen or not, but I think we're going to have to – can't discount that as a possibility. Which would make it – if that happens, it makes it more expensive for us to issue debt.

Given that's a possibility, it would stand to reason – and I've said this – while the fiscal stimulus and increasing debt to GDP is a tailwind right now – which is helping GDP growth – we have to keep in mind – it's one of my four

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big drivers – we have to keep in mind in the medium term, that tailwind could turn into a headwind if the U.S. decides it needs to do things to moderate its debt growth in the future. And the other part of that potential headwind is we have to keep in mind that with this much debt, our economy is much more interest-rate-sensitive even than it was even 10 years ago. And meaning, a rise in rates affects debt service costs more. Corporate debt is higher, although I think it's probably manageable. And we know government debt is dramatically higher.

And so those are two – those are both vulnerabilities, you know, that do concern me, and I'm watching carefully. And I mention them almost every speech I give for that reason.

Q: When you speak to people in business, executives, how concerned are they about both their own debt levels and those of, you know, the government?

MR. KAPLAN: You know, I think – I think it's logical when you talk to businesspeople, businesspeople are trained when you are – when you have higher leverage – they're trained that you probably don't want to – that you'd like to deleverage – depending where you are in the business cycle. So that's a natural reaction of a businessperson, including mine. Now, government leverage is different from corporate leverage, is different than household leverage. And the government has other options.

But I think it naturally, as a businessperson, makes you more uncomfortable if you see government debt-to-GDP going up, and you see annual deficits exceeding a trillion dollars. Plus, before – when we're in an expansion period, it naturally concerns me. And it naturally concerns – I think it's visceral and natural for most businesspeople to be concerned by that, because we're trained to – that you don't want to – you want to be deleveraging when you can and don't get yourself into a vulnerable position, as a business.

And the advice – I used to be a banker. And my advice always was to people in various industries, particularly cyclical industries, is, you know, take the opportunity to deleverage when you can. Staying power, sustainability is very critical in an entity. And so that would be your natural reaction for the U.S. government.

Q: And the curve – you know, most people look at 2s [two-year Treasurys], 10s [10-year Treasurys]. I know that, like, economists prefer to look at three-month bills versus –

MR. KAPLAN: And you look at all the – I look at both.

Q: Yeah. But given that the yield curve inverting has a track record of, you know, coming before recessions. Given various lag times, how, you know, concerned are people – is the Fed actively talking about the yield curve at its meetings, and –

MR. KAPLAN: Yes. I – yes. And I've said publicly, and I still – on the one hand, I am hopeful that we can remove accommodation, raise the fedfunds rate, and get to where we need to go without the curve inverting. But on the other hand, I've also said I am not – I would – I do not want to knowingly invert the yield curve. I'm hopeful we won't, by the way. We can still do with the path that I talked about without doing it.

So why am I concerned about the yield curve – especially if there's an inversion of any size and duration? The reason – yes, I know it's a strong indicator historically, and it's been a good forward indicator. And I know the arguments that, "Gee, maybe this is different because there's so much global liquidity." Here's where I'm coming from – again, maybe as a former businessperson. What I'm sensitive to, if you get in a situation where a financial intermediary cannot borrow short and lend long and make a spread because of inversion, it's logical to me that it's going to put strains on credit creation. And it may well create, if it goes on long enough, a tightening in financial conditions, which, all things being equal, can have a slowing effect on the economy.

That, for me, is very – is very logical. And I spend a lot of time, by the way, talking to banks and other financial intermediaries and asking them how the inversion would affect the way they think about lending. And I knew this from my own career. There's probably a good reason why inversions historically have tended to precede, you know, eventual recessions. And I think it has to do with this. Can you, as a financial intermediary, borrow short, lend long, and make a spread? And when you get into a scenario where you can't, it tends to limit credit creation, which is an important part of a growing economy.

Q: There does seem to be a sense though – of "this time is different" thinking going on at the top of the Fed when it comes to this issue. And are you – do you feel there's an appropriate level of anxiousness around the yield-curve question?

MR. KAPLAN: I'll speak for myself. The fact that there's – the part that's different, which I'm – which I agree with – is there's a lot of global liquidity, as I mentioned earlier. Central bank balance sheets, pension funds, and so on. I

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agree with that. The impact, though, an inversion has on financial intermediaries I don't think has changed. And so I think – I, for one, have said, and will say today, I think a flattened yield curve is one thing. And inverted yield curve, I think, I would say is absolutely worth paying attention to, and something I'll be watching very carefully.

Q: So it's – the impact on intermediaries is perhaps more important than the fact about the yield curve itself?

MR. KAPLAN: I'm worried about credit creation and financial conditions and how tight they are, and what the impact an inversion – now, if it's a short inversion or a very modest inversion, that's one thing. But an inversion of some materiality and duration, it's logical to me that that would have some constraining effect on financial conditions. That makes sense to me. And that part I don't see as – I don't see why that should be different. And I think it would – I'd be careful not to go too far. It's good to point out what's different about this time, but you won't hear me go too far and explain away completely that this time is different. I won't be – I doubt I'll be doing that.

Q: And you say you look at different things. But obviously the methodology of determining whether we're inverted does matter. So –

MR. KAPLAN: I look at all of it.

Q: Yeah. But, I mean, like, it would – you know, the San Francisco Fed had a paper out that said that three months to 10 years is the most reliable way. But – I mean, but there's going to be a line that gets – a bell that's going to go off someday and –

MR. KAPLAN: Here's what – when there's debates like that, you know, that never do get – (laughs) – that never get resolved, I just – I resolve that debate by saying: I'll look at both.

Q: (Laughs.) OK.

MR. KAPLAN: OK? And it only takes me another 10 seconds to look at both. So why not look at both?

Q: OK.

MR. KAPLAN: And the reason I – it probably sounds right to me why the three month is a little more appropriate, is I'm thinking about deposit rates. You know, where do banks and most lenders get their funds? And they tend to – they tend to pay shorter-term rates. So that's probably – it sounds logical to me.

Q: OK.

MR. KAPLAN: Right?

Q: Yeah, yeah. Fair enough.

Q: In terms of the term premium between, you know, the 10-year, two-year Treasury debt, do you have any thoughts on that? You know, are investors being, you know, compensated appropriately for –

MR. KAPLAN: It tells you their – it tells me that – the term premium specifically tells me there's a lot of global liquidity. That's the only way I can explain it.

Q: Can I ask you about mechanics of Fed monetary policy, because that's an unresolved question but we're getting close to needing to say what the regime is going to be. So where are you with this floor, corridor? How do you –

MR. KAPLAN: I'm watching very carefully, you know, how the fed-funds rate, the setting, is reacting to what we're doing and the level of reserves and trying to learn from that. I would say at this stage we don't need to decide. I would say it's probably more likely that we're going to have a floor system than a corridor system. As to what the natural resting place is of the Fed balance sheet, I don't know yet. I haven't come to a conclusion yet.

Q: Could you walk us through these technical tweaks you've been making to interest on excess reserves, because I'm trying to, you know, get a sense of if it's economically meaningful or if it's just purely a technical thing to defend the range.

MR. KAPLAN: Well, I think it's – at this stage, I think it's primarily technical. But it raises questions which I don't have the answer to yet as to what is the demand for reserves in the system? And that's one of the questions that I, for one, am trying to decipher. What does it tell me about that? And I don't know the answer yet, but I'm – we're having – I mean, I'm asking a lot of questions. We're having lengthy conversations about it.

Q: Do you think there's going to have to be another – I've seen some analysts that have sort of said you're probably going to have to lower that spread a little bit.

MR. KAPLAN: It's possible. I don't know. And I think – you know, there's no textbook. There was no textbook probably for the [quantitative-easing] buildup. And there's no textbook for the balance-sheet rundown and the setting of the fed-funds rate. We've tried to think this through as we've gone. So I think as you've heard me say before, the most important quality in sitting in this seat and in this job is being open to learning, you know? And to not try to answer things that I don't know the answer to, and to be open to learning. I think this an example where we're learning. I'm learning. I'll speak for myself. I'm learning. And I'm open to trying to understand, because I think this is somewhat uncharted.

Q: Do you support – some of your colleagues have been talking about a more formalized review process for monetary policy. So, like, every five years get together?

MR. KAPLAN: Yeah, I think – listen, again, I come from the corporate sector, where I always think it's healthy. And I think it's important for institutions – particularly the Fed, where independence is essential – I think it's important to do a regular – some periodic review of your frameworks, governance, other approaches, to take input from the outside. And not only to do it, but to be seen to do it I think is important. And I think that discipline comes with an independent central bank. I know other countries – U.K., others – have some type of process. I think that's a healthy thing. So I'd be supportive of it.

Q: And have you gotten any leanings one way or another about some of these alternative strategies, like price-level targeting. I mean, there's a whole bunch of them.

MR. KAPLAN: Yeah. And you may know, we do a lot of work on this. We have a number of economists at the Dallas Fed that have done a lot of work on price-level targeting, nominal GDP targeting, and even – I'll just tell you – at our place, we've even role – we've done exercises to roleplay through if you were using this approach how would you do it. And I think that's been useful, because you realize there's not only the execution issues and challenges, but there's the communication issues and challenges.

And so I think this is a healthy thing to be – in the same way we look at the – before every FOMC [Federal Open Market Committee] meeting, we always look – I always look at the Taylor rule, and different variations on the Taylor rule. And even though we don't use that rule, and some would say we, you know, criticizing, we've departed from that rule, I always like to look at that rule. And I think, for me, you know, looking at nominal GDP – for me, I prefer to look at nominal GDP targeting over price-level targeting, but I'm open to exploring both. But I think looking at that and trying to understand it and see whether it could be useful I think is a healthy thing.

Q: If the Fed was doing nominal GDP targeting, would monetary policy be that much different than what it actually is now?

MR. KAPLAN: I think the tricky part – you always have to go back. We're now at a certain stage in the economic cycle. It might have been more illuminating if we'd done it earlier. So strike that. So I would say, would it be different? The answer is on balance it could be in the years to come, sure. Here's why. Let me just explain – and I'm not advocating, and I'm not prepared to advocate – nominal GDP targeting means you start with a base level of GDP – nominal GDP. And then you have growth. You have the real rate of growth and you have inflation rate. And it means you could be a little light on real growth, but if inflation were a little higher you still might have a certain level of nominal growth.

And it does make sense. It's locked in. And the reason I'm – I just like, at least, looking at it, is nominal GDP is what services government debt. Real GDP is not what services debt. It's nominal GDP. In other words, you know, what is your pretax cash flow? It's nominal GDP. That's what services debt. And in a country that has this amount of leverage and, you know, debt, you know, your nominal GDP is very important.

So, for example, it appeared where you're growing GDP faster, that inflation is very low. So nominal GDP is somewhat lower. Is it worth paying attention to that? Yeah, it would be worth paying attention to that, because in a period where GDP – real GDP is a little lower but nominal GDP is higher because inflation's higher, and so you're generating more cash flow to service debt, is that something, as a former businessman, I would like to pay attention to? Yes. Should it be a new policy? I don't know about that. But do I – but I think is it worth doing more work on it? Yeah, it's worth doing more work on it.

Q: OK.

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Q: [Former Fed Chairman] Paul Volcker has a book coming out. And I was wondering, you know, you having been in business early in your career at a period when Treasury yields got as high as, you know, 15 percent and inflation just about the same, I was wondering if you could put him in context in terms of, you know, what he did, how important it was, whether he changed central banking in the U.S. in any meaningful way, whether the transition from Arthur Burns to, you know –

MR. KAPLAN: Sure. So it – obviously his era predates me. And what I know about Paul Volcker, I know as a businessperson, following him and reading the papers, like all the rest of us. But clearly there was an inflation dynamic in the United States, and he took very bold – very bold steps in order to try to address it. And I remember at the time, you know, very controversial, I'm sure unpopular, very high unemployment rate. You had a substantial inversion of the yield curve. And it was a difficult period. But the United States appeared to come out the other end.

And so I don't have a lot of – I'm not – I wouldn't have a lot of insight to add other than, you know, I admire his courage and his backbone in making some extremely tough decisions that could not have been popular; popular with very few constituencies.

Q: Given the unpopular nature of the decisions he had to make, how important does that suggest, you know, Fed independence should be from the political winds that blow back and forth?

MR. KAPLAN: Listen, I think Fed independence is extremely important. And I think one of the marks of a successful country is an independent central bank. Having said that, that independence should never be taken – it could be fragile; should never be taken for granted. And it's up to us at the Fed to conduct ourselves in a manner divorced from politics, without consideration of political influence, and continue to strive to adhere to that discipline and this governance and review of our frameworks; and be willing to be introspective and be open-minded and take outside comment and consider changes, I think, is also an important part of that; and be willing to be self-critical, I think, is an important part of that.

Q: President Trump has taken a couple of cracks at the Fed over rate rises. What do you say about that?

MR. KAPLAN: I don't have anything to say about it. You know, it – over the years and decades, understandably, elected and appointed officials have had comments made about the Fed. It comes with the territory. And our job – our job remains to analyze the economy, make recommendations and decisions on monetary policy without regard to political considerations or political influence. And that remains the same. And I think criticism comes with the territory.

Q: And no sense in which him, the president, saying, I want – I don't want – I don't like rate rises, in fact, almost commits the Fed to pursuing a path of rate rises in order to show its independence?

MR. KAPLAN: I think we have to work – listen, we're human beings, but I think we have to work very hard to divorce our analysis and our decisions from political considerations or political influence. And that's the discipline. That's why – one of the reasons why people – I came to the Fed. I think it helps to be older, maybe more experienced, have a thicker skin. You're here to serve the country. And I think that's part of the job.

Q: To ask the question a little differently, some have – you know, the benefit that we derive from being a reserve currency is lower borrowing costs you know, the liquidity of the dollar. Anywhere in the world that you go, the dollar is worth something. You can't say that really for any other currency.

To what extent does – do comments like – does the Fed independence, you know, help ensure the U.S. status as a safe-haven asset among investors?

MR. KAPLAN: I'd just – listen, Fed independence is a critical part of the success of the United States. And our job is to continue to do the work in the way I described and never take that for granted.

Q: Well, we're coming up towards the end of our time, but just to ask you, what is the biggest risk that you see out there on the horizon right now? Is there a single biggest thing that worries you that could derail the expansion, that sort of thing?

MR. KAPLAN: So people have asked me a number of times, you know, the term black swan. What are the things that could come out of the blue and surprise you? And I've half-jokingly but seriously said back, my definition of the term black swan is the thing that's staring you in the face that you refer to – that you refuse to acknowledge, even though it is obvious to you.

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So what are the things like that right now that are just staring us in the face and it pays to acknowledge? Aging population, slowing workforce growth, is one element that we just have to call out and be willing to manage; lagging education, especially math, science, and reading, and the skills gap, inability – you know, we need to improve education and skills training in this country. And I think that's staring us in the face, I mean, up close. So we shouldn't act – we wonder why labor force is not more adaptable.

And then the other thing that's staring us in the face is the path of U.S. government debt, which is – the question is, is it sustainable? It's not a secret. It's not hidden. It's very explicit. And – but we sort of feel like somehow we can manage it. But it's – if it keeps growing at the rate it is, you know, is it going to eventually create some headwind for economic growth?

These are things that are explicit. They're not secrets. They're out there. And so it's those things that are standing in front of it in plain daylight that we're looking at. It keeps me up at night if we see those things and they're right staring us in the face and we're not acknowledging them and talking about them, which is why I try – to ease my anxiety, I try to regularly talk about them, because they are the issues that are staring us in the face. I don't think we're talking about them nearly enough. I would feel better and I would sleep better at night if I heard more of a national discussion on these issues and then actions, which we're quite capable of taking, to address them.

Q: OK.

Do you have any final –

Q: Overall, at the risk of going into political waters, what role would help – would immigration help in the, you know, labor force?

MR. KAPLAN: So I'll stay away from the – I'll just stick to the economic elements of it. We've said – and again, we've shared this research with appointed, elected officials, both sides of the aisle – state, local, federal – and in very constructive conversations, which is what makes up GDP, growth in the workforce, growth in productivity? And in that context, then we say – we talk about education and we talk about what are ways to grow the workforce.

And then the second thing, we share our research, which Pia Orrenius and our team in Dallas Fed has done, that indicates that we might be well served in this country to base our immigration structure more on skills and employer-based, like Canada – more like Canada, where we go interview and canvass employers, find out what the needs are, and backward immigrate.

And so I think that's been a useful thing to share. And the only thing that, just mathematically, we pointed out, if you're going to cut the number of immigrants, you'll either have to find other ways to grow the workforce or you'll have to make up for that by higher productivity, which is difficult to count on. And our job is to point that out.

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Economy

Derby's Take: A Warning on the Fed's Balance-Sheet Unwinding; Reducing the balance sheet too much could make it more difficult for the Fed to keep control over short-term interest rates

By Michael S. Derby
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The Federal Reserve could go too far in cutting the size of its balance sheet, warns the chief U.S. economist at RBC Capital Markets.

Tom Porcelli wrote in a note to clients that an excessive balance-sheet drawdown could unleash forces that would make it hard for the central bank to keep control over short-term interest rates, which are the chief way monetary policy affects the economy.

"We are fearful that the Fed will shrink its balance sheet too far, causing a massive amount of **volatility** in very short rates," Mr. Porcelli tells clients, and he suspects this could happen in the final three months of next year.

"At some point the demand curve for reserves will shift from flat to sharply upward sloping," Mr. Porcelli said. "No one knows exactly where that transition takes place, and relative price swings between Treasuries and reserves could cause enormous swings in where the transition occurs." This could lead to "very large" moves in short-term rates.

Mr. Porcelli's note doesn't say how far too far is for the balance-sheet drawdown, which lowers banking-sector reserves.

The Fed has reduced its balance sheet to just over $4.2 trillion, down from a peak of $4.5 trillion after the financial crisis, by not replacing its bondholdings as they mature. That process is continuing.

The Federal Reserve built up its portfolio of mostly mortgage and Treasury securities during and after the last recession in an effort to boost **financial markets** and the economy.

The Fed hasn't said how far it plans to reduce its holdings, which were less than $900 billion in 2007, ahead of the financial crisis. A New York Fed report this spring suggested holdings could fall to $3 trillion by 2021. Inside and outside the Fed, some have suggested there are benefits to keeping the system operating with large reserves, which suggests little chance the Fed will go back to its old way of doing business.

Still, it's a lot to leave unresolved. Part of the question of how much reserves are enough may come down to whether the Fed wants to maintain its system of setting a hard range for short-term rates. That would allow for the continuance of large reserves, but the Fed would still have to determine the level. If Mr. Porcelli is right, the Fed may want to favor a higher number.

Mr. Porcelli says there's an "outside chance" the Fed could shed some light on its monetary policy mechanics plans and view on the size of the balance sheet in the meeting minutes for the September Federal Open Market Committee meeting, which will be released Wednesday.

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THE WALL STREET JOURNAL.

Markets

Last-Minute Trades Accelerate U.S. Share Declines; Did index-tracking-fund investors exacerbate the stock-market selloff?

By Christopher Whittall
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The selloff in U.S. equities on Wednesday accelerated just before markets closed—an increasingly familiar dynamic that may confirm the growing sway of index-tracking funds.

The final minutes of trading before stock markets close has grown in importance in recent years as more money has headed into passive investments such as exchange-traded funds, or ETFs, that look to mimic the holdings of major indexes. These index-tracking funds often depend on buying and selling shares using the very last price of the day, causing a surge of activity late in the afternoon.

Last year, 26% of all trading activity on the New York Stock Exchange's flagship exchange took place in the last trade of the day, up from 17% in 2012, exchange data show. Fund managers fear that if they miss a last-minute price move, they will deviate from the index or market they are supposed to track.

Traders and analysts say there was a late flurry of trading on Wednesday that likely was linked to ETFs.

The acceleration in the selloff late Wednesday "is testament to the ETF flow," said Charles Hepworth, an investment director at GAM Holding. "They are the market movers these days."

Whether funds like ETFs are exacerbating market moves has important implications for other investors. In the short-term, the activity of these passive funds can fuel **volatility** as their portfolios are rebalanced. But this end-of-day rush could also mean investors shouldn't read too much into late and sharp market moves that may be exacerbated by technical factors.

"These things have a habit of sharply overreacting on the downside and then coming back," said Mr. Hepworth.

Traders said trading volumes in the ETFs themselves were substantial on Wednesday, with flows data from FactSet suggesting there were many buyers as well as sellers.

Investors pulled $332 million out of the Invesco QQQ ETF, which has $68 billion in assets and focuses on the tech-heavy Nasdaq 100 index, according to FactSet. That was the seventh straight day of outflows, bringing the total to $3.5 billion. Tech shares have taken the brunt of selling in recent sessions.

But at the same time, investors poured $934 million into the SPDR **S&P 500** ETF Trust, the biggest U.S. large-cap ETF, with around $280 billion in assets, according to FactSet.

Corrie Driebusch contributed to this article.

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The New York Times

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As New Sanctions Loom, U.S. Push Against Iran Faces Steep Obstacles

By Gardiner Harris
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WASHINGTON — President Trump called on world leaders in September to slash their purchases of Iran's oil before the imposition on Nov. 5 of major sanctions, the last major pieces of the administration's blockade of the Iranian economy.

"We ask all nations to isolate Iran's regime as long as its aggression continues," Mr. Trump said at the United Nations.

But less than a week before the crucial deadline this Monday, the campaign against Iran is facing severe challenges. China and India, the largest buyers of Iranian oil, will continue making huge purchases, with Turkey and perhaps Russia following suit. Britain, France and Germany have promised to continue doing business with Tehran.

And Saudi Arabia, the administration's crucial partner in its anti-Iran efforts, is facing global censure and threats of sanctions from Congress after the killing of Jamal Khashoggi, a journalist and Saudi dissident. Penalties against Saudi Arabia could undercut efforts to keep global **oil prices** stable as Iran's exports plunge.

The problems have piled up as European diplomats and oil analysts say that even after the sanctions go into effect, Iran will most likely sell at least one million barrels of crude oil a day — a sharp decline from last year but perhaps enough to sustain its economy and wait out Mr. Trump's term.

The administration's stated goal for its sanctions campaign is for Iran to make a dozen fundamental changes to its domestic and foreign policies, including ending its support for Hezbollah in Lebanon, Hamas in Gaza and the Houthi rebels in Yemen. Few analysts believe the present Iranian government could fulfill the demands and survive.

"There is no way the Trump administration will be able to achieve its 12 stated objectives because they're utterly unrealistic," said Robert Einhorn, a senior fellow at the Brookings Institution. "Unless significant changes are made, it's a policy destined to fail."

But efforts to tighten the screws on Tehran in the coming months could further alienate European allies, freight the relationship with China with yet another difficult dispute, undermine decades of efforts to woo India, and impede the stabilization of Syria and the battle against the Islamic State.

Administration officials dismiss these risks in part because earlier warnings by critics about the downsides of leaving the Iran nuclear deal largely proved false.

Iran

At the heart of Iran's financial future are its oil and gas exports, and Trump administration officials have adamantly said for months that they intend to reduce those exports to zero and penalize any country that continues purchases after Nov. 4 — which would effectively destroy Iran's economy. On Tuesday, a State Department spokesman retreated from those implacable demands.

"Our goal remains to get to zero oil purchases from Iran as quickly as possible. That's not changed," the spokesman, Robert Palladino, said during a press briefing, adding, "But we are prepared to work with countries that are reducing their imports on a case-by-case basis."

The Nov. 5 sanctions target Iran's central bank, oil sales and shipping companies, and come on top of a set of sanctions that went into effect in August. Administration threats have already persuaded buyers in Europe, Japan and South Korea to largely stop purchasing from Iran.

As a result, Iran's crude oil exports loaded on tankers plunged by more than 20 percent to 1.8 million barrels per day in September, down from 2.3 million in May. Oil exports continued to decline in October, according to IHS Markit, an energy analytical firm.

But during the United Nations General Assembly in September, foreign ministers from Britain, France, Germany and the European Union joined those from Russia, China and Iran in promising to collaborate on the creation of a "special purpose vehicle" independent of the dollar to continue commercial relations. Trump administration officials reacted to the announcement with derision and fury.

Even in Europe, economists and officials doubt the new financial channel will yield significant economic benefits for Iran or threaten the global dominance of the dollar anytime soon. And yet its symbolism was profound. Any sanctions on the new channel or other European efforts to save the nuclear deal would worsen already seriously strained trans-Atlantic ties.

China, India and Turkey

Beijing presents another challenge. China is the largest buyer of Iranian oil and, although Beijing recently instructed two large state oil companies to stop purchases for a time, China will most likely remain the biggest buyer. The Trump administration has given Beijing "no reason to be in compliance with U.S. law on Iran," said Sung-Yoon Lee of Tufts University's Fletcher School of Law and Diplomacy in Medford, Mass. Oil executives and analysts agree.

Some are predicting that the administration will announce penalties against some Chinese entities on Nov. 5 to show toughness against Beijing, popular with Mr. Trump's voters, ahead of the midterm elections the next day. But such sanctions will most likely be largely symbolic. Tariffs against China have already spooked Wall Street and lowered global growth projections. Broad sanctions could set off a panic.

In India, the second-largest buyer of Iranian oil, private companies like the energy giant Reliance have largely stopped buying it. Government entities ramped up purchases over the summer so they could show reductions next year, analysts said. But significant purchases will most likely continue.

Prime Minister Narendra Modi's re-election campaign, scheduled for next spring, will prevent him from acceding to American demands on Iran, said Mohan Guruswamy, a distinguished fellow at the Observer Research Foundation in India.

"Modi can't be seen as buckling on Iran since public sentiment is not with the U.S. on these new sanctions," Mr. Guruswamy said.

Heather Nauert, the State Department's spokeswoman, recently called India's continuing purchases of Iranian oil "not helpful" and said that "India will find out" if sanctions result.

But sanctions against India would do violence to a host of American priorities, including efforts to bolster Afghanistan; counter China and Pakistan; and ramp up sales of American oil, natural gas and military equipment.

Turkey, which gets most of its oil and natural gas from Iran and Russia, will continue oil purchases and other commercial relations with Iran, diplomats and analysts said. A recent warming between Ankara and Washington after the release from detention of an American pastor would be dashed by penalties, said Soner Cagaptay, director of the Turkish Research Program at the Washington Institute for Near East Policy.

Victory Lap

Sanctions have caused pain, but they have yet to produce clear strategic victories for the Trump administration. Despite sanctions on North Korea, Russia and Venezuela, Pyongyang has so far shown no signs of slowing its nuclear and ballistic missile weapons production, President Vladimir V. Putin has only grown bolder and Venezuela continues to slide into anarchy.

But administration officials will take a victory lap on Nov. 5. They are mindful that when Mr. Trump announced in May that he was walking away from the Iran nuclear deal, critics predicted that Tehran would soon restart its nuclear program, that **oil prices** would soar, and that sanctions would never truly bite without the support of others in the deal.

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None of those warnings proved true, giving administration officials a great sense of confidence in their policy.

* Trump Abandons Iran Nuclear Deal He Long Scorned

* Bolton Warns of ‘Terrible Consequences’ for Those Doing Business with Iran

* U.S. to Restore Sanctions on Iran, Deepening Divide With Europe

A bazaar in Tehran. The Trump administration hopes sanctions will force Iran to make a dozen fundamental changes to its domestic and foreign policies. | Ebrahim Noroozi/Associated Press | Exchanging Iranian rials in Tehran. The Nov. 5 sanctions target Iran’s central bank, oil sales and shipping companies. | Atta Kenare/Agence France-Presse — Getty Images

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WSJ PRO CENTRAL BANKING

Economy
U.S. Economy Flashes Signs It's Downhill From Here; A slowdown in growth would have big implications for stocks, the Fed and President Trump

By Jon Hilsenrath and Harriet Torry
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What if that was as good as it gets?

The Commerce Department reported Friday that U.S. gross domestic product expanded at a 3.5% annual rate in the third quarter.

Coming off a 4.2% growth rate in the second quarter, it marked one of the best six-month stretches for the U.S. economy in the past decade.

However, private analysts and the Federal Reserve say a slowdown is looming. Economists surveyed by The Wall Street Journal estimate the growth rate will slow to 2.5% by the first quarter of next year and 2.3% by the third quarter of 2019. The Fed is expecting growth to slow further to a 1.8% rate by 2021.

"We think U.S. growth may have just peaked," said Michael Gapen, chief U.S. economist for Barclays Capital, who is in Wall Street's big-slowdown camp.

Few believe a recession is near, and the expansion is widely expected to become the longest on record next year. Still, a slowdown in growth would have big implications for stocks, the central bank and President Trump. The White House says faster growth is evidence that tax cuts and its deregulatory stance are working, and that the growth acceleration they produced are sustainable.

Mr. Gapen said two big drivers of growth this year—consumers and government spending—will slow in the months ahead. Consumer spending has picked up, thanks to tax cuts. He says the spending impetus from income-tax cuts tends to be greatest in the first two quarters after they're enacted, and then fades over about eight quarters. Thus consumer-spending growth, which hit a robust 4% annual rate in the third quarter, should slow in the months ahead, though he said strong household saving and low unemployment will prevent a sharp drop-off.

In February, the White House and Congress agreed to increase federal government spending by $300 billion above earlier spending caps. That will propel government spending for several more months, boosting growth, but the budget agreement runs out next September. That means its impact, too, will fade, unless the next Congress agrees to more.

Mr. Gapen noted that the big wild card for growth is business investment. Business tax cuts are meant to increase investment in software, plants and equipment, boosting the economy's growth rate now and its potential to grow far into the future.

The White House projection of sustained 3% growth hinges on a business-investment boom. It looked like that was happening early in the year. Business investment grew at an 11.5% rate in the first quarter, with gains across many categories, including machines, intellectual property and big structures. But it has faded since, registering just 0.8% growth in the third quarter. That includes a drop in investment in structures such as oil-and-gas rigs, which had been a big driver of growth.

"That's a worry, particularly after (businesses) got a nice big check from Uncle Sam," said Beth Ann Bovino, an economist at S&P Global Ratings.

For the White House forecast to play out, business investment would have to rebound. A lower corporate tax rate—down to 21% from 35%—might help. But uncertainty about U.S. trade disputes with China and others might be making business executives wary about proceeding aggressively with new projects.

"The economy is still strong other than some of this noise introduced by the trade tariffs and whatnot," said Douglas Waggoner, chief executive of freight broker Echo Global Logistics Inc., during an earnings call Wednesday. "We don't really have a read whether this is just a temporary glitch or a start of a trend."

The investment picture matters immensely for the Fed as well. If businesses plow money into new software and machines, it increases the chances worker productivity will rise, allowing the economy to grow faster without causing inflation. Stronger productivity would take pressure off the central bank to keep raising interest rates. Without follow-through on business investment, the U.S. could face a different outcome: less growth and more inflation that requires the Fed to keep pushing rates higher.

Interest rate-sensitive sectors already show signs of wobbling. Home building has contracted in five of the past six quarters. Moreover, a stronger dollar, which raises the cost of exports to foreign buyers, could weigh on U.S. trade.

Why has the **stock market** stumbled of late? Mr. Gapen said investors appear to be sniffing out the slowdown that economists have been calling for several months. While earnings growth was strong in the third quarter, and many analysts still expect double-digit earnings growth through next year, some executives sound wary.

Garbage-hauling and recycling company Waste Management Inc. said Thursday that net income was up 29% from a year earlier in the third quarter, but Devina Rankin, chief financial officer, said "the economy is probably at a peak."

"There's definitely some room to go from here," she said. "But we talked about the length of growth in this economy and the expectation that it could turn from here."

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Economy

U.S. Manufacturing Capacity Increases for 16th Month in a Row; Factory output also rose in September, helping drive overall industrial production up 0.3% for month

By Sarah Chaney
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WASHINGTON—U.S. manufacturers increased their capacity for the 16th straight month in September, fresh evidence that a strengthening economy is helping to propel a U.S. industrial rebound.

The Trump Administration has prioritized increasing manufacturing investment in the U.S. with tax cuts and tariffs on a range of imported goods. Manufacturing capacity, tracked by the Federal Reserve, is a measure of how much production plants could achieve if running at full steam, a proxy for how much they are expanding their plants and productivity.

Manufacturing capacity began recovering from a steep decline in 2011, faded in 2014 and resumed a modest march higher in mid-2015. In September it was up 1.4% from a year earlier. The report suggests investment in U.S. manufacturing has been increasing at a steady pace over the past three years. In June it passed its 2008 peak.

The latest Fed manufacturing report showed factory output also rose in September, helping drive overall industrial production up 0.3% for the month.

The Fed noted that output was "held down slightly" by Hurricane Florence but that the estimated effect was less than 0.1 percentage point.

The pickup in manufacturing production and capacity in recent years reflects a strong global economy and could also be tied to a resurgence in U.S. oil and gas output, said Kathy Bostjancic, head U.S. **financial-market** economist at Oxford Economics.

"The shale operators obviously are very sensitive to prices. So as we saw price declines, they were going to pull back on operations and production," she said, adding that recovering **oil prices** are helping spur production activity. "Any of the ancillary...manufacturers related to shale operations will also get a boost," Ms. Bostjancic said.

The manufacturing sector was hit hard by the 2007-09 recession and later by a big drop in **oil prices**, which hurt energy production. It also has been buffeted by years of competition from low-cost countries such as China.

The Trump administration has imposed tariffs on imported steel and aluminum and also on a wide range of imports from China, moves meant to encourage more production in the U.S. at the expense of foreign competitors by driving up the price of imported goods. Cuts in U.S. corporate tax rates also were meant to spur domestic investment.

"We are in the midst of a manufacturing renaissance—something which nobody thought you'd hear-–which means more jobs for our great electrical contractors," President Trump said this month at an electrical-contractors convention in Philadelphia.

While some steelmakers have expanded U.S. production in the wake of the tariffs, other U.S. manufacturers remain heavily dependent on imported metals and have been constrained by the higher costs associated with tariffs.

Evidence of slack in the industrial sector persists. Manufacturers operated at 75.9% of their capacity in September, below a long-run average of 78.3%.

"That suggests there's still excess capacity in manufacturing," Ms. Bostjancic said, adding, "that's a reason why goods prices are still deflationary. The global economy is still producing too much goods relative to demand."

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WSJ PRO PRIVATE EQUITY

Pro Private Markets

Coronado Prices IPO at Bottom of Range; Coal producer raises more than $500 million ahead of Australia listing

By Robb M. Stewart
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Corrections & Amplifications

The company's name is Coronado. An earlier version of this article misspelled the company's name as Coronada in the headline. (Oct. 21, 2018)

MELBOURNE, Australia—Private-equity firm Energy & Minerals Group scaled back the initial public offering for coal producer Coronado Global Resources Inc. and priced the deal at the bottom of the offer's range, as **volatility** in global stock markets weighed on demand for the deal.

Coronado's float follows a strong rebound in prices for metallurgical coal this year driven by supply constraints and steady demand from China, but global equity markets have been **volatile** over the past two weeks because of rising Treasurys and worries about trade tensions.

The IPO, which raised 774 million Australian dollars (US$550.8 million), could have raised as much as A$1.39 billion at the top of the A$4.00-A$4.80 price range. The U.S. mining company comes to the market with an implied enterprise value of A$3.79 billion and is set to begin trading on the Australian Securities Exchange on a limited basis on Tuesday.

Energy & Minerals chose to cut the number of Chess depository interests to about 193 million from the 290 million it had previously proposed, after the offer price valued the coal miner at the low end of its expectations. CDIs refer to securities that allow international investors to trade on the Australian Securities Exchange.

The private-equity company, which manages a series of specialized private-equity funds with about US$15 billion in assets under management, will retain a stake of almost 79% in Coronado. It will hold its remaining shares in voluntary escrow until early 2020, the coal producer said.

Coronado was founded in 2011 by Energy & Minerals, Garold Spindler and James Campbell. Mr. Spindler will continue as managing director and chief executive, while Mr. Campbell will continue to be president and chief operating officer.

Earlier this year, Coronado bought the Curragh mining operations in eastern Australia from conglomerate Wesfarmers Ltd. for US$564 million to add to a portfolio that includes three producing operations in the central Appalachian region in Virginia and West Virginia.

Registered in Delaware, Coronado produced 20.2 million metric tons of mainly metallurgical coal last year, making it one of the biggest producers of steelmaking coal in the world after diversified miners such as BHP Billiton Ltd.

"In the current environment of strong met coal prices, we are extremely fortunate to be in a position where we can accelerate the production of the incremental tons available at our Curragh mine and at the same time deliver our cost efficiency initiatives," Mr. Spindler said.

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WSJ PRO CENTRAL BANKING

Economy
Timiraos's Take: How the Market Selloff Could Keep the Fed on Track; A surging stock market this year may have unnerved central bankers worried about economic overheating

By Nick Timiraos
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This month's **stock-market** selloffs prompted President Trump to lash out at the Fed. But for top central bank officials, the selloffs may not have been particularly unfortunate developments.

In fact, for much of the year, the **stock market**'s party may have unnerved Federal Reserve officials who have mused openly about whether an overheated economy might reveal itself in financial froth rather than inflation.

If that is the case, then seeing markets go down—admittedly, in an orderly way that doesn't badly injure broader business and consumer confidence—could assure the Fed that rate increases are having their intended effect.

When the Fed raises rates, it is trying to moderate the economy's growth rate by tightening financial conditions, which requires some combination of an increase in bond yields or the dollar, or a decline in equity prices.

In research published last week, economists at Goldman Sachs estimate that tightening financial conditions this month should offset the boost the economy is expected to receive from recent fiscal policy stimulus by the first half of 2019.

In other words, if the Fed is trying to slow the economy's growth rate from its recent range of 3% to 4% down to something closer to the slightly less than 2% rate officials think is likely to prevail over the longer run, the Fed should be able to achieve that as soon as mid-2019, assuming it also follows through on two benchmark rate increases already priced in by markets.

Goldman economists still expect the economy to grow stronger than its 1.8% potential growth rate next year because of other forces at play. Including self-feeding momentum. Those forces will likely require the additional rate increases in 2019 currently projected by many Fed officials.

But to the extent Fed officials viewed this year's market rally warily because it implied they might have to raise rates for longer to keep the economy on an even keel, the recent selloff should be counterintuitively assuring because it suggests they may be closer to staying on course.

Goldman's economists, for example, see the Fed raising rates five more times through the end of 2019, which is one more than the median projection from Fed officials in September. But where Goldman once saw the risks "skewed quite strongly to the upside" of their baseline forecast, the market selloff in recent weeks makes the risks "only modestly tilted to the upside."

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THE WALL STREET JOURNAL.

Economy

Fed Vice Chairman: Strong Growth Supports Case for Continued Rate Rises; In his first public remarks since being sworn in, Richard Clarida highlights reasons why stronger growth might not generate an inflation upswing

By Nick Timiraos and Paul Kiernan
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WASHINGTON—Federal Reserve Vice Chairman Richard Clarida endorsed the central bank's plans to gradually raise interest rates and pinpointed the behavior of inflation as key to deciding when to stop.

After years in which the central bank held rates very low to boost economic growth and hiring, the Fed's current policy stance was providing support to an economy that no longer needed it, Mr. Clarida said in a speech at the Peterson Institute for International Economics. The key question now, he said, is how to preserve recent economic gains.

"If the data come in as I expect, I believe that some further gradual adjustment in the federal funds rate will be appropriate," Mr. Clarida said in his first public remarks since joining the Fed as its No. 2 official last month.

Fed officials raised their benchmark federal-funds rate a quarter percentage point last month to between 2% and 2.25%. They signaled they expect to raise it again this year, likely in December, and penciled in around three increases next year.

Mr. Clarida addressed the recent **stock market** selloff during a question-and-answer session. The economy is "very, very solid," he said, but changes in financial conditions "are something that is relevant for the economic outlook."

If tighter financial conditions, which can show up through falling stock and **bond prices** and a stronger dollar, are sustained, policy makers would need to take that data into account when making economic forecasts, he said.

The "some further" description caught the attention of a few Wall Street analysts because in the past the Fed has used the subtle phrase to signal that officials are debating an end to rate increases. It's premature to infer Mr. Clarida was signaling such a shift because that phrase hasn't shown up in policy statements, minutes of policy meetings or Fed Chairman Jerome Powell's own commentary.

In his remarks, Mr. Clarida highlighted reasons why stronger economic growth might not lead to an inflation upturn that some colleagues have indicated could require more aggressive rate increases.

One camp of Fed officials says that so long as unemployment keeps falling below the level they project is consistent with stable inflation, they should raise rates to a level designed to restrict growth to prevent the economy from overheating. This is what the Fed has typically done in the later stages of an expansion.

Others have indicated they might support a relatively unusual departure from this stance. They say if inflation doesn't appear to be accelerating beyond the Fed's 2% target, they might want to slow or suspend rate rises earlier than would normally be the case.

Mr. Clarida's speech didn't explicitly embrace one approach over the other. But he identified possible reasons inflation might remain modest enough to allow this latter approach to gain more consideration.

He said the economy's underlying growth rate might be faster than he thought several years ago and that the level of unemployment consistent with stable inflation might be lower.

Some economists have said the recent increase in business investment has primarily reflected spending in the energy sector. Mr. Clarida said he saw evidence that this investment upturn "is not just an 'oil patch' story," which could reflect ways in which tax cuts are boosting the economy's long-run capacity to grow.

Mr. Clarida also pointed to signs that worker output per hour is picking up from very low levels and that more workers on the sidelines of the job market might be encouraged to return to work. If sustained, both developments would allow the economy to grow faster without fueling more inflation.

"Even with today's very low unemployment rate, the labor market might not be as tight—and inflationary pressures not as strong—as I once would have thought," he said. "I am certainly not alone in this thinking."

Altogether, these developments mean that rising wages might not push up prices as much as in the past. "The traditional indicators of cost-push price pressures are not flashing red right now," he said.

Mr. Clarida said inflation data as well as indicators of businesses' and consumers' expectations of future inflation would weigh heavily in determining how to set the fed-funds rate.

If strong job and economic growth continue next year together with a "material rise" in inflation, additional rate increases "might well be required beyond what I currently expect," he said, without specifying what he expects.

On the other hand, if strong growth continues with "stable inflation, inflation expectations and expectations for Fed policy" such a scenario "would argue against raising short-term interest rates by more than I currently expect," he said.

Mr. Clarida also said, in response to a question, that President Trump's sustained criticism of the Fed's interest-rate increases would have no bearing on its policy decisions. Mr. Trump said in an interview with The Wall Street Journal on Tuesday that he viewed the central bank as the greatest threat to the economic expansion.

Such criticism "will in no way be a consideration as far as I'm concerned," said Mr. Clarida. "Our job is to sustain what is a very healthy and robust economy right now." He said history had shown central banks achieved the best outcomes for their economies when they are free to set rates as they see fit.

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* Trump Steps Up Attacks on Fed Chairman Jerome Powell (Oct. 23)

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THE WALL STREET JOURNAL.

Markets

As Global Stocks Fall, Investors Put Trust in Brazil; Brazilian assets surge after a first round of the presidential election, giving some analysts hope about the country's economy

By Julie Wernau
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Investors searching for bright spots in last week's global stock tumble found one in Brazil.

Assets in the struggling South American country surged early in the week following a first round of the presidential election that handed a win to leading candidate Jair Bolsonaro. His economic adviser, Paulo Guedes, has the market betting that Brazil will soon emerge from a long economic slump.

Following the first-round vote in which Mr. Bolsonaro outpaced his left-wing opponent and narrowly missed avoiding a runoff bid, the MSCI Brazil **stock index** rose 7.8% and **bond prices** rose 1.1%. The week's gains held even after a global stock selloff and news that

Mr. Guedes is being investigated for fraud.

Brazilian stocks were up 3.2% to end the week and bonds rose 1.1%, among a handful of gainers in the emerging world.

Brazilian stocks pared their early-week gains after reports that prosecutors are investigating Mr. Guedes, a University of Chicago-trained economist, for allegedly obtaining investment funds from state-controlled entities in an illegal operation for outsize personal profit. Mr. Bolsonaro, who is running on an anticorruption platform, has been favored among investors largely because of the policies of Mr. Guedes.

Some investors still see hope that the policies proposed by Mr. Guedes will make their way to Brazil's next administration regardless. But some analysts worry that investors have prematurely picked Brazil as the next market darling as they search for growth in an emerging world that is stagnating.

"People tend to gravitate toward the happy story and away from the story that is either difficult to understand or isn't such a great story, irrespective of value. It's a behavioral issue we all suffer from," said Phil Torres, global co-head of emerging markets and director of emerging markets research at Aegon Asset Management.

The day after the first-round election in Brazil, interest rose in the iShares MSCI Brazil ETF, with more than $3.2 billion changing hands, four times the average daily volume. In the week before the election, Brazil bond funds recorded their biggest inflow in over 16 months, according to EPFR Global.

"Emerging-markets dedicated investors are in desperate need for positive idiosyncratic stories and there is a risk of trades becoming crowded a bit too fast," said Alejo Czerwonko, emerging market strategist at UBS Global Wealth Management's Chief Investment Office.

In his economic agenda, Mr. Guedes has floated everything from privatizing public assets to slashing public sector jobs, reducing government ministries and reforming the pension system.

But some investors say it is unclear how many of those economic policies are endorsed by Mr. Bolsonaro, whose statements at times have conflicted with those of his economic adviser. Mr. Bolsonaro has said he intends to appoint Mr. Guedes as his finance minister if he is elected Oct. 28.

"I think a part of this market reaction is pure irrational euphoria," said Roberto Simon, senior director for policy, Americas Society and Council of the Americas. "The market is only listening to him when he says what the market wants to hear."

Some analysts have compared Mr. Bolsonaro's rise to that of President Trump, leftist nationalist Andrés Manuel López Obrador in Mexico or the "leave" camp in the U.K. Brexit referendum—votes against the status quo.

"This is a vote for something way different," said Kathryn Rooney Vera, head of research and strategy at broker and investment bank Bulltick in Miami, which has recommended a **bullish** position in Brazilian equities since mid-September.

Pension and labor reforms have been sticking points in Brazil for years and while Mr. Bolsonaro's party has gained seats in Brazil's fragmented Congress, some prominent members of that party have actively campaigned against pension reform in the past.

Following a severe recession in 2015-2016, Brazil's real GDP grew 1% in 2017. In its most recent report on Brazil, the International Monetary Fund said even with a recent constitutional rule capping expenditures, public debt is expected to rise, topping out above 90% of GDP in 2023.

"The issues facing Brazil are still there and won't be easy to resolve. It will require political capital and willingness to find alliances in government," said Wim Vandenhoeck, a portfolio manager for emerging market bonds at Oppenheimer Funds.

Brazil's growing debt burden and lack of momentum on pension reform have investors anticipating a ratings downgrade. In a note following Sunday's vote, Moody's signaled its concerns about the country's move away from the center.

"Political polarization puts a premium on the ability of the next president to establish a good working relationship with lawmakers in order to approve reforms, which we see as necessary to maintain investor confidence, preserve financial stability and lay the foundations for sustained growth," said Samar Maziad, vice president and senior analyst at Moody's.

Luciana Magalhaes contributed to this article.

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The New York Times

Opinion
The Economy Is Great, Really, for Now

By Ruchir Sharma
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Whatever one thinks of President Trump, it's hard to deny that much of America is feeling great again.

Surveys show that consumers have been this confident only twice before, at the height of the economic booms of the 1960s and 1990s, and their mood is bright across income groups, not just among the rich. Small business confidence has not been higher since the surveys began nearly five decades ago. The misery index, invented in the 1970s to describe the agonizing combination of inflation and unemployment, is now just 6 percent, matching the lowest levels of the last half century.

This year in particular, the economy has performed exceptionally well. Among major economies, only the United States has accelerated significantly in 2018, while Europe, Japan and many emerging economies have slowed markedly. The Commerce Department reported Friday that the economy grew at a very strong pace of 3.5 percent in the third quarter, putting it on track for its best year in more than a decade. This raises a question: Why has the **stock market**, which normally rises when investors anticipate strong economic growth, been gyrating wildly?

Investors may now be expecting America to peak after a hot decade. Even with recent setbacks, the performance gap between the United States **stock market** and the rest of the global markets is close to a 100-year high. Money flowing into the United States has also driven up the value of the dollar, which has never been more dominant as the world's preferred currency.

Trump doubters say that this boom began before he took office, in the aftermath of the global financial crisis of 2008, and they have a point. With its more flexible economic system, the United States responded faster than its peers to the debt problems exposed by the crisis. The United States forced households and troubled financial institutions to rapidly reduce their debt, and easy money provided by the Federal Reserve allowed them to start spending again. Money flowed into the giant tech companies that have underpinned the American economic surge.

Just as the 1980s belonged to Japan and the 2000s to emerging nations, the last decade belonged to America. Still, the gap in performance between America and the rest of the world has widened in the last two years under Mr. Trump, as his tax cuts and deregulation turbocharged the American economy and its markets. His policies have spurred consumption, and have incentivized companies to buy back more of their stock and bring home some of the money they had stashed overseas.

But economies that are hot in one decade rarely stay hot in the next. Every boom eventually creates excesses that sow the seeds of its own destruction, and the excesses that could end the American decade are coming into view.

The United States economy has been expanding for nine years in a row and if this streak carries on until August next year it will be the longest economic expansion in the country's history. Within a few years after the crisis of 2008, American companies had started running up debts again. It's not unusual for companies to get overconfident and become saddled with heavy debts late in an expansion. But it is unusual to see the government follow suit, as it has this time. Owing in part to the Trump tax cuts, the United States budget deficit is now around 4 percent of gross domestic product — the highest it has been outside the immediate aftermath of a recession or a war.

That will make it very hard for the government to keep stimulating the economy. Growth is expected to slow next year as the impact of the tax cuts fades and the strong dollar cuts into exports. The Fed has been raising rates, and the end of the long easy money party is starting to have an impact on the housing and stock markets, helping to explain the recent correction.

Nonetheless, the United States **stock market** is still swollen — and it seems unlikely to keep expanding from here. The **stock market** is now 60 percent larger than the American economy, a scale it has reached only twice in the past century, during the manias of the 1920s and late 1990s. Moreover, the giant tech companies that have been driving the economy and markets now face a regulatory backlash that could cut into their extraordinarily high profit margins.

Trump haters may be tempted to conclude from all this that he is about to lead America into a sudden decline, but that is not the point. This American decade started under President Obama, continued under Mr. Trump and survived congressional gridlock throughout, showing that the economy often rises above politics. The economy is driven less by ideology than by its own internal cycles, and this cycle has been turning in America's favor for so long that it is unlikely to last much longer.

While the excesses of corporate exuberance and government debt are rising in the United States, countries from France to Brazil are in the cleanup phase that often precedes an economic comeback. Most are a long way from working out the excesses of the last decade, and they may suffer further setbacks. But they are approaching the start of a new cycle, while the United States nears the end of an old one. If history is any guide, the next decade is less likely to be great for America than it is for the rest of the world.

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THE WALL STREET JOURNAL.

Best of the Web
Opinion

Trump Makes a Deal; The revised North American trade agreement could have been so much worse.

By James Freeman
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Consumers will be paying more for automobiles, but the good news is that President Donald Trump's rewrite of the North American Free Trade Agreement appears to inflict relatively little economic damage. Investors celebrated Monday morning as Mr. Trump fulfilled a key campaign pledge without disrupting U.S. trade with Canada and Mexico.

It seems odd celebrating an agreement on the grounds that it could have been much worse, but the bar is low here for good reason. The Trump tax and deregulation cuts have the economy humming, so simply avoiding a disaster on the trade agenda represents success.

One industry with a huge stake in the continued flow of goods throughout North America is signalling relief. Edward Hamberger, head of the Association of American Railroads, says in a statement:

The private freight railroad industry is pleased that negotiators from Canada, Mexico and the United States have reached an agreement to preserve free trade between our nations. The free flow of goods across North America without burdensome tariffs is a net positive for U.S. workers, bedrock industries and the economy.

The **Dow Jones Industrial Average**, the market index comprised of only huge multinationals and therefore highly exposed to global trade, also rallied on news of the Sunday night agreement.

To escape tariffs under the new deal, auto makers will need to include in their vehicles more parts made in North America and to pay higher wages, which will make cars more expensive. Also, companies will have less ability to challenge trade barriers erected by the participating governments.

On the plus side, U.S. farmers get easier access to sell wheat, poultry, eggs and dairy products into Canada. Also, the new deal reduces some trade barriers facing the technology industry and doubles the patent life for biologic drugs to 10 years from five. Encouraging technological innovation is a benefit to every country but is especially welcome in the country that leads the world in such innovation. In related news today, a U.S. scientist shared the Nobel prize in medicine for "a landmark in our fight against cancer," which "takes advantage of the immune system's ability to attack cancer cells," according to the Swedish Academy.

After so many angry words among friends in North America, it was refreshing to hear President Trump declare on Monday, "We've formed a great partnership with Mexico and with Canada." He expressed his "highest regards" for Canadian Prime Minister Justin Trudeau and had equally kind words for Mexican President Enrique Peña Nieto as well as his successor, President-Elect Andrés Manuel López Obrador.

Investors watching the President's Monday press conference in the Rose Garden might have gotten a bit giddy thinking that the President might be done arguing with friends over trade and would now focus on Chinese theft and coercion of American companies to share technology.

Mr. Trump signalled that he's not quite done trying to rewrite other trade deals. He called India "the tariff king" but reported that India's Prime Minister Narendra Modi plans to reduce tariffs "very substantially." Mr. Trump said he's heard that the Indian government is negotiating in order to keep the U.S. President happy and concluded, "Isn't that nice?"

This suggests more trade uncertainty ahead. But fortunately the headline of the day is trade peace with U.S. neighbors. Dan Clifton of Strategas Research wrote this morning in a note to clients:

At the beginning of the 3rd quarter, President Trump made a critical decision on trade policy by realizing he could not fight three trade wars at one time. If China is the real target, then the US would need to accelerate NAFTA discussions immediately and form a peace treaty with the EU so that it could focus on China. Stocks have been well served by Trump's ringfencing of trade issues with the **S&P 500** up 7.7 percent since the decision was made.

Making peace with our friends and demanding that a communist government improve its treatment of U.S. businesses. Isn't that nice?

***

Bottom Stories of the Day will return tomorrow.

***

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(Teresa Vozzo helps compile Best of the Web.)

***

Mr. Freeman is the co-author of "Borrowed Time," now available from HarperBusiness.

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THE WALL STREET JOURNAL.

Markets
Gold Edges Lower as U.S. Stocks Climb; Prices of the metal pulled back as the U.S. dollar strengthened; copper rose on signs of falling supply

By Stephanie Yang and David Hodari
354 words
3 October 2018
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The Wall Street Journal Online
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Gold prices traded lower Wednesday, weighed down by a stronger dollar and the prospect of fresh records for U.S. stocks.

Gold for December delivery declined 0.3% to $1,202.90 a troy ounce on the Comex division of the New York Mercantile Exchange.

The **Dow Jones Industrial Average** and **S&P 500** were on track for record highs on optimism over the strength of the U.S. economy. Such confidence dimmed the appeal of gold, which investors buy in times of economic and political uncertainty.

Gold prices got a boost Tuesday along with other safe-haven assets on concerns of

political instability in Italy, but pulled back Wednesday as some tensions eased, analysts said.

"Worldwide attention, especially in Europe, is on the new anti-establishment Italian government's plans to deal with Italy's financial and economic problems," said Jim Wyckoff, senior analyst at Kitco Metals.

Meanwhile, the WSJ Dollar Index, which measures the U.S. currency against a basket of 16 others, was up 0.4% at 90.26. Gold is priced in dollars and becomes more expensive for foreign buyers when the U.S. currency strengthens.

Copper futures for December delivery rose 1% to $2.8340 a pound in New York, boosted by signs of falling supply.

Aluminum prices also jumped Wednesday, climbing 4% to $2,245 a metric ton, after Norsk Hydro announced it plans to close its Alunorte alumina refinery in Brazil. While the plant had already been operating at 50% capacity, the operation's closure means the loss of a further three million tons in annual production for the global aluminum market.

Chinese public holidays meant that trading volumes were lower than usual, and investors were otherwise focused on European political headlines and any further policy signaling out of Federal Reserve Board member speeches.

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Transport Stocks Join Correction Club

By Akane Otani
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Transportation stocks have become the latest group to fall into correction territory, a potentially ominous sign the downturn that has swept major indexes in October could intensify.

The transports had rallied this summer and hit a record in mid-September, buoyed by strong economic data as well as increased demand for freight services among retailers and consumers.

But the sector has been caught in the broader-market slide, pulling the Dow Jones Transportation Average -- which tracks the performance of 20 large U.S. airlines, truckers, railroads and shippers -- down more than 10% from its Sept. 14 high.

That puts it firmly in correction territory, alongside the Russell 2000 index of small-capitalization companies, the KBW Nasdaq Bank Index and the Nasdaq Biotechnology Index.

The slump bodes poorly for not just the transports but also potentially the **stock market** as a whole: Believers in the "Dow Theory" say weakness in shares of companies that transport raw goods and materials can point to turmoil for the broader market.

Some of the group's woes stem from industry-specific issues. United Parcel Service Inc. said Wednesday that profit fell in its domestic package business in the third quarter, hurt by higher pension costs and expenses related to adding new buildings to its network. Shares of the company have slid 9.5% this year.

Airlines have struggled to reassure investors that they can keep rising fuel prices from denting profitability. American Airlines Group Inc. has fallen 38% this year, while JetBlue Airways Corp. has lost 26% and Alaska Air Group Inc. is down 14%.

Then there are freight-transportation companies, which Morgan Stanley analysts say are likely to get hit by slowing demand in 2019.

"We are concerned that 2019 could be similar to 2015-16, when the transportation complex went through a freight recession even as the overall economy held up," Morgan Stanley analysts wrote in a note this week. They said they are especially worried about freight brokers and companies offering rail and parcel services.

Yet other factors that have dragged on transport stocks are things that have been weighing on the **stock market** at large.

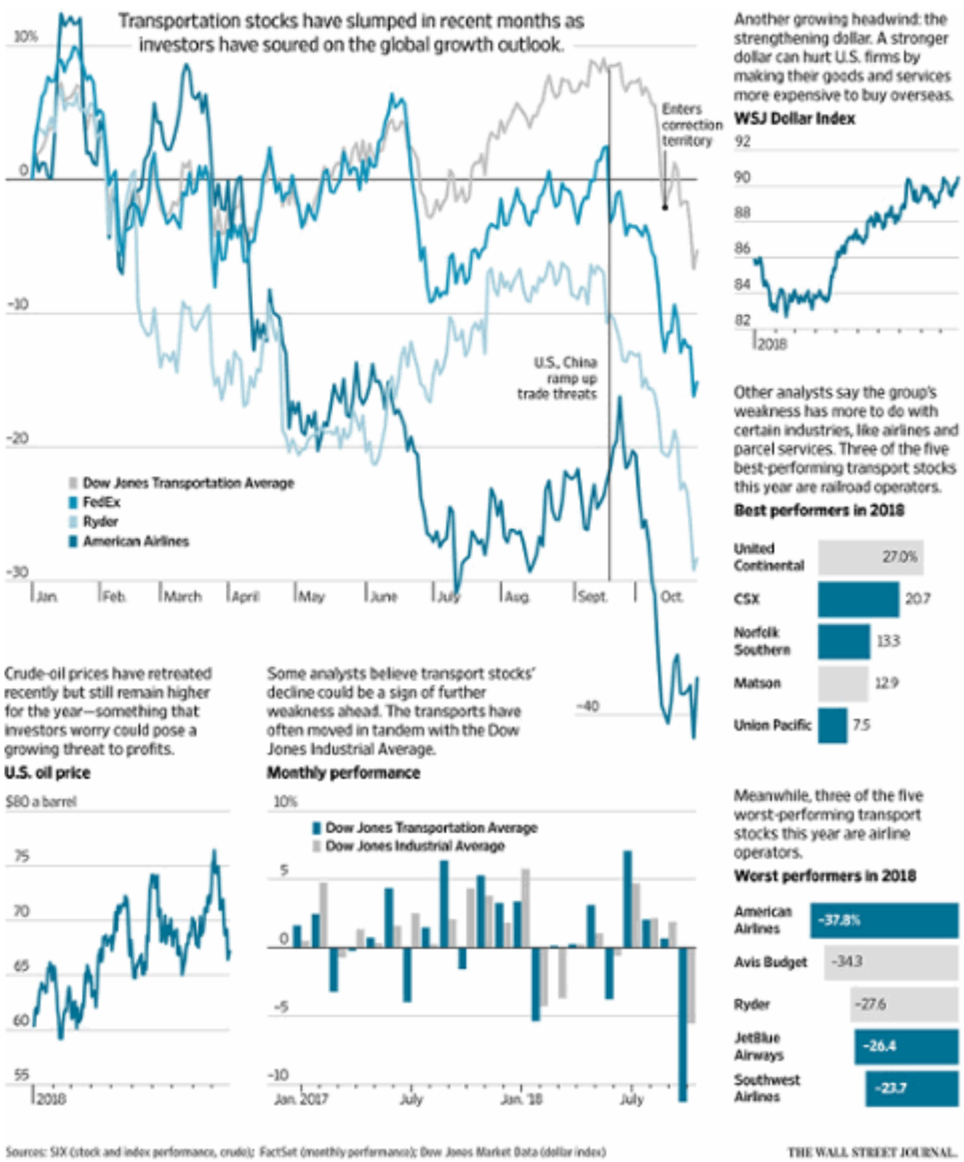
Investors are contending with signs that China's economy is slowing as well as a dimmer forecast for global growth. The International Monetary Fund earlier this month cut its forecast for global economic growth for 2018 to 3.7% from an April estimate of 3.9%.

Risks such as "rising trade barriers and a reversal of capital flows to emerging-market economies with weaker fundamentals, and higher political risk . . . have become more pronounced or have partially materialized," the IMF said in a release that accompanied its forecast.

Even the U.S., which many regard as being on relatively strong footing, has shown some signs of weakness: Data Wednesday showed new-home sales slipping for a fourth consecutive month.

Few believe that the U.S. economy is close to a recession. And some analysts say the stock market's declines over the past month are partially a function of investors coming to terms with a murkier global outlook and tighter monetary policy.

Watch the transports to get a sense of whether the broader stock market could take another leg lower.



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WSJ PRO CENTRAL BANKING

Economy

Derby's Take: Latest Expectations Data Point to Tame Inflation Outlook

By Michael S. Derby
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As **financial markets** take on board the prospect the Fed is in for a sustained period of rate rises, inflation-related data released last week suggested there's no great urgency to speed up those increases.

Two separate reports showed no evidence that the public's expectations of future inflation levels are heating up. That's important because central bankers generally agree that where the public sees inflation going in the future exerts a strong influence on where inflation is now. Expectations that are "well anchored" help reduce fears of a price surge at some point in the future.

The New York Fed reported Tuesday that in September consumers' expectations of inflation a year and three years from now held steady at 3% for both time frames. The bank noted that expectations have been "virtually unchanged" since April, amid declining uncertainty about the price outlook.

Meanwhile, the October University of Michigan consumer sentiment survey saw expected inflation a year from now tick up a hair to 2.8%, from 2.7% the prior month. But five years from now, the survey found households see inflation at 2.3%, down from September's 2.5%.

The two reports are good news for a Fed that believes it has essentially achieved its 2% annual inflation objective. While Fed officials collectively expect to modestly overshoot their 2% target in coming years, the expectations data helps bolster confidence that nothing ominous lies ahead.

It also helps that **financial markets**, while **volatile** last week, don't appear overly worried about inflation. Treasury inflation-indexed bonds have been slowly pricing in more expected price pressures, but recent readings suggest that five years from now markets see inflation just a touch above 2%.

Some level of inflation overshoot isn't a big deal for most Fed officials, especially considering how strong the job market has been and as uncertainties remain about how very low unemployment levels relate to inflation. In an interview Friday on CNBC, Chicago Fed leader Charles Evans said "this is an environment where I'm not worried about inflation," even though he suspects it might rise to as much as 2.3%.

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Markets

Third Point Wants Campbell to Explore a Split; Loeb's plan for company, if he wins proxy fight, is to decide on a split within 100 days

By Cara Lombardo
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Third Point LLC's initial plan to revamp Campbell Soup Co. includes exploring a breakup of the company as one of its central tenets.

Daniel Loeb's activist hedge fund is waging an uphill battle in a proxy fight to replace Campbell's entire 12-person board. If it wins the board, Third Point believes the company should decide within 100 days whether to break up into two major units, one focused on meals and beverages and the other focused on snacks, according to a presentation released by Third Point on Tuesday detailing its plan.

The Wall Street Journal first reported Third Point's plans on Monday.

Third Point, which has said the only justifiable option under the current board is a full sale of the company, believes a split would make the company more attractive to investors and potential buyers down the line, according to people familiar with the plans. Earlier this month it mentioned a split as one of many ideas its slate would consider.

Campbell has been hit by falling soup sales, a botched expansion into fresh foods and a sharply higher debt load because of its Snyder's-Lance snacks acquisition. Campbell's **stock price** has been battered, down roughly 22% this year. In August it announced a plan to sell its fresh-foods and international units and focus on North American meals, beverages and snacks. Interim Chief Executive Keith McLoughlin, who replaced former CEO Denise Morrison after her abrupt departure in May, said at the time the company had considered a range of options including a full sale or splitting itself in two.

In a statement Tuesday, Campbell said Third Point doesn't understand the food industry. A split, for instance, creates more costs and is riskier, the company says.

Third Point also wants the company to focus on revamping its soup business, consider selling noncore assets such as Pepperidge Farm frozen cakes, and buy smaller, healthier snack brands, according to the plans.

Third Point believes Campbell is overlooking the potential to revive its soup business and thinks Campbell's soup business could benefit by adapting Conagra Brands Inc.'s frozen-foods playbook, which involved modernizing packaging, flavors and ingredients.

People familiar with the company's plans say frozen foods aren't the same as soup and deny it has shifted its focus from its soups. Campbell has said its plans for stabilizing its U.S. soup business include targeting consumers in their late 30s to mid-50s and focusing on convenience, affordability and taste for its namesake brands; it also plans on growing its largely organic Pacific brand and improving cash flow and margins for other brands.

Third Point supports company initiatives already under way to cut costs and streamline its snack distribution network, the people said, but believes they could be better executed under new leadership.

Third Point and Campbell heir George Strawbridge Jr. have teamed up and together own roughly 10% of Campbell's stock. They are stacked up against other Campbell heirs who own roughly 41% of the company, three of whom are current directors, and who plan to support the incumbent board at a shareholder vote scheduled for Nov. 29.

Campbell Chairman Les Vinney criticized Third Point last week for lacking a cogent plan or new ideas and said Third Point's only goal is to sell the company.

Campbell has said it plans to revitalize the company by investing the proceeds from the planned sales to pay down debt, which ballooned after a recent acquisition of snack-maker Snyder's-Lance, cut costs and improve operations. Campbell has also said it expects to name a new CEO by the end of the year.

Third Point has said the company should refrain from appointing a new CEO until after the vote. It notes in its presentation that one of its nominees, former Hostess Brands Inc. CEO Bill Toler, is ready to replace Mr. McLoughlin as interim CEO.

Third Point on Friday sued Campbell and its board, alleging the food maker distributed misleading and incomplete information to win shareholders' support in the proxy fight. A New Jersey judge is expected to issue a ruling Friday on whether Third Point can move forward with discovery.

Annie Gasparro contributed to this article.

Write to Cara Lombardo at cara.lombardo@wsj.com

Related Reading

* Campbell Soup-Maker Descendants Say They Support Board (Oct. 17)

* Third Point Aims to Replace Campbell Soup's Entire Board (Sept. 7)

* Campbell Soup to Sell International Business and Fresh Unit (Aug. 30)

* Campbell CEO Departs After Bet On Fresh Food Falls Short (May 18)

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

High-Flying Pet Insurer Faces New Risk; Trupanion must prove that its growth isn't dependent on a veterinary rewards program it plans to end

By Charley Grant
582 words
31 October 2018
05:47 PM
The Wall Street Journal Online
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A fast-growing seller of pet health insurance is ending a controversial rewards program for veterinarians that is under scrutiny by regulators.

Trupanion shares have more than tripled since the start of 2015. Wall Street analysts have credited its use of referrals by veterinarians for strong patient growth. Critics of the company have said that those referrals violate regulations because insurance can only be sold by licensed agents.

Trupanion says that veterinarians aren't asked to sell or solicit insurance. Analysts at Raymond James acknowledged that regulatory ambiguity in September. "It has been suggested that the compensation structure violates regulations because it implies that Territory Partners and/or vets are paid for referrals," they wrote.

The referrals were also controversial because Trupanion ran a rewards program for veterinarians that allowed them to earn points redeemable for travel and merchandise if they used the company's proprietary reimbursement software to process claims or fulfill a medical records request for a new pet that will eventually visit the veterinarian's office. Veterinarians were also able to earn rewards by sharing Trupanion posts on social media.

Trupanion informed veterinarians in an email on Monday that the company's rewards program will terminate at the end of this year. Wednesday is the last day that vets can earn points under the program. Trupanion said it ended the program because it was ineffective.

Washington state's Office of the Insurance Commissioner said in October they are "investigating whether Trupanion is offering inducements to organizations in exchange for referrals to purchase Trupanion's insurance products," according to an office representative, who cautioned that the investigation hasn't reached any conclusions.

Trupanion has said it views such dialogue with regulators as a routine part of conducting business. Trupanion is also confident that the end of the rewards program won't impair its growth outlook.

In a statement filed Tuesday with the Securities and Exchange Commission, the company said, "We are not aware of any regulatory matters that we think will have a material impact on our current or future business." Company officials said vets have redeemed less than $100,000 worth of points over two years for this program.

The winding down of the rewards program should help resolve any regulatory problems, but that decision marks a possible threat to the **stock price**.

Investors love Trupanion because the company, the only publicly traded pure-play pet insurer, grows faster than the pet insurance industry, which is itself growing rapidly. In the second quarter, total enrolled pets grew 23% from a year earlier. Wall Street analysts have credited Trupanion's use of veterinarians for helping achieve that growth. The Raymond James analysts, who rate the shares "outperform," said in September that nearly half the company's leads come from vets. That strategy represents "a challenge for competitors to usurp Trupanion's position," the analysts wrote.

Trupanion's lofty valuation means investors have a lot to lose if that analysis proves incorrect. The company barely generates profits, but the shares still trade at seven times book value, a much higher valuation than a typical insurer.

The stock has performed admirably, but has lately sold off. Now, Trupanion needs to prove that its growth wasn't dependent on the rewards it paid to veterinarians.

Write to Charley Grant at charles.grant@wsj.com

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Heard on the Street
Markets

The False Sense of Security Behind Corporate Debt; High equity valuations may be encouraging corporate borrowing in an unhealthy way

By Paul J. Davies
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Seen from one angle, big companies look as unsafe as houses.

The last mortgage boom saw homeowners borrow ever-larger amounts on the back of gravity-defying house prices. Something similar is boosting corporate debt markets.

Nonfinancial companies have been loading up on debt in the past few years, often to fund deals and share buybacks that in turn can boost **stock-market** values. In the past decade, the total value of investment-grade U.S. corporate bonds has risen from $2.5 trillion to $6.3 trillion, while total nonfinancial U.S. corporate debt is more than $9 trillion.

Debt has been cheap and plentiful, but companies may also have been encouraged to borrow by high and rising stock prices. Steven Blitz, U.S. economist at TS Lombard, thinks public companies and their lenders have gotten too comfortable with high equity valuations when thinking about debt levels, rather than focusing on income or cash on hand. This is a bit like mortgage lenders relying on home values rather than households' ability to repay, even if public corporate equity can't literally be used as collateral in the way homes are.

High equity values can make indebted companies appear healthy. Total debt at nonfinancial companies in the **S&P 500** is worth less than 23% of their market capitalization, according to FactSet, and this month touched its lowest level since May 2008. This is like loan-to-value measures that made mortgages look fine in the last housing boom—until households began struggling to service their debt and then defaulting in ever larger numbers.

Measuring indebtedness next to operational health makes all the difference. Mr. Blitz looks at the relation of all U.S. corporate debt to final sales of domestic production, which has risen sharply in recent years. A similar trend is discernible among **S&P 500** nonfinancial companies when comparing total debt and sales. This is like comparing debt to GDP at a country level and it shows that public-company debt has grown more quickly than their business activity.

Versus profits, a more conventional benchmark, U.S. investment-grade corporate debt is near its highest in more than a decade, according to CreditSights, a research firm, at almost three times earnings before interest, taxes, depreciation and amortization.

The problem looming in years ahead is refinancing risk. Interest rates are moving higher, which will means higher debt costs in future, and there is likely to be an earnings slowdown as the business cycle matures. Both factors will hit equity values, making indebtedness against equity values look less healthy.

For most investment-grade companies, this should only mean rising debt costs—and probably some ratings downgrades—rather than default, according to Erin Lyons, senior U.S. strategist at CreditSights. But for equity investors, these higher debt costs will mean less money available for dividends, buybacks and all the other shareholder-friendly policies they have got used to over the past decade. Look out for a bumpy ride.

Write to Paul J. Davies at paul.davies@wsj.com

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Heard on the Street
False Security in Corporate Debt

By Paul J. Davies
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[Financial Analysis and Commentary]

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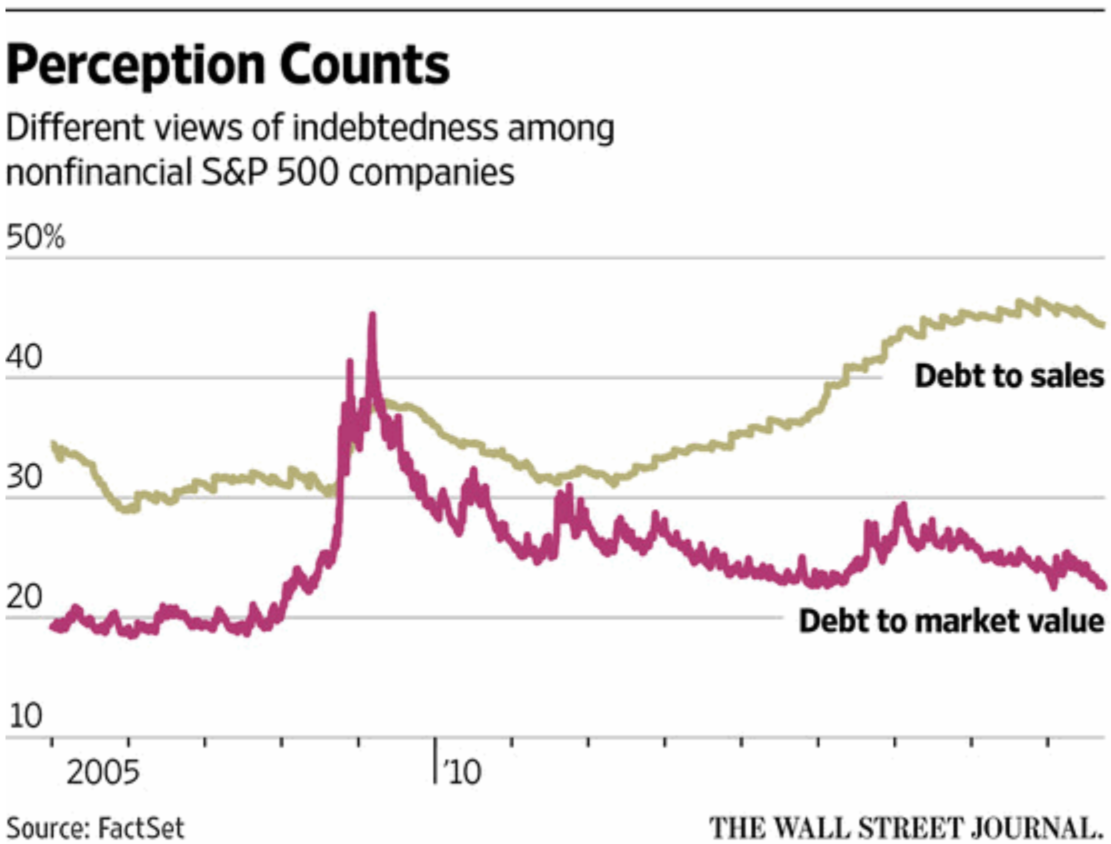

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THE WALL STREET JOURNAL.
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EXCHANGE --- Declines Don't Faze Tech Buyers

By Corrie Driebusch
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27 October 2018
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The past week's 3.8% decline in the **Nasdaq Composite** Index hasn't shaken the faith of many investors in technology shares.

When clients call Steven Dudash and ask the Chicago-based financial adviser to sell shares of Amazon.com Inc. and Netflix Inc., he responds this way: "No. I'm going to buy you more."

Mr. Dudash, whose IHT Wealth Management manages $3 billion, said he has been buying up more consumer tech shares and selling some of clients' bonds and real-estate stocks, which he views as having poor prospects as interest rates rise. "To me, this screams go buy everything you can," he said.

An October stock rout is placing investors like Mr. Dudash at a crossroads, and the path they choose will have a significant impact on the market's course in coming months.

On Friday, sellers were out in force yet again in the wake of soft revenue figures from Amazon and Alphabet Inc. Amazon was down 7.8% and Alphabet was off 1.8%.

For now, many investors' belief in tech shares seems largely unshaken despite the declines. Interviews with half a dozen portfolio managers indicate none are selling hot shares, though some have expressed concern about the market environment and signs that demand for products such as semiconductors is softening.

Jason Tauber, a portfolio manager for Neuberger Berman's Disrupters All-Cap Growth strategy, has held on to shares of Cognex Corp., which makes vision sensors used by global manufacturers including those in China, and IPG Photonics Corp., which also sells its lasers to Chinese customers. Cognex's shares have slumped roughly 26% so far this month, while IPG Photonics is down 14%.

"It's been painful," he said.

Although these companies have been hit by a slowdown in Chinese industrial orders, due in part to tariffs, Mr. Tauber said he still believes in their ability to boost sales. "I don't think this is going to spark a global recession," he said.

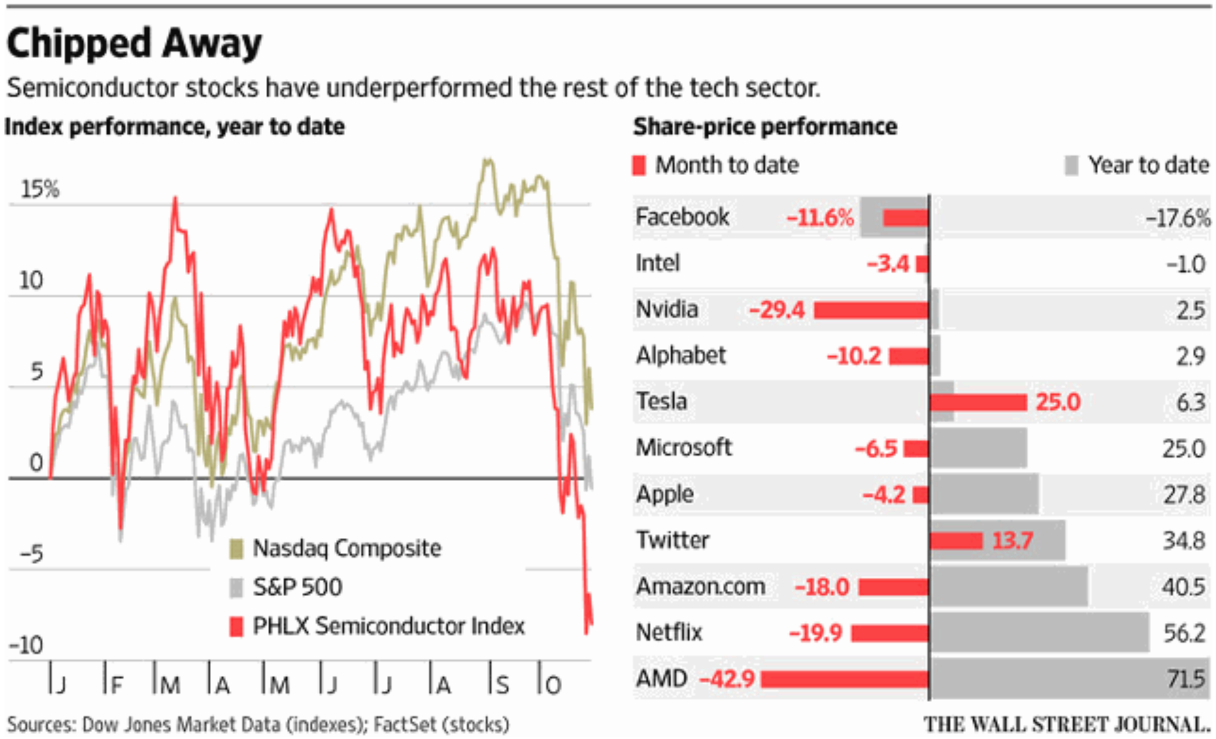
Jim Callinan, portfolio manager at Osterweis Capital Management in San Francisco, said he unloaded his stake in two tech companies he deemed "lower quality." Due to their debt and leverage, he said he worried about their prospects in a rising interest-rate environment.

Dan Morgan, a portfolio manager at Synovus Trust Co., is watching the **volatility** from the sidelines. "Six months ago, you couldn't go wrong in tech," he said. "It didn't matter what you picked, it went up."

His positions in tech behemoths such as Amazon, Apple and Google parent Alphabet are down this month, but he said he hasn't seen shifts in consumer demand for iPhones or changes in terms of projections for advertising compared with a month ago.

More concerning to Mr. Morgan are comments about softening demand from executives at chip makers.

Semiconductor stocks as measured by the PHLX Semiconductor Index are down 15% since the start of October.



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Markets
Which Stocks Do Best When Interest Rates Rise; If history is any guide, it isn't the ones you think

By Derek Horstmeyer
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For investors who want to protect their portfolio against rising interest rates, the conventional wisdom says it's best to shift into the stocks of safe, dividend-paying, large companies.

But the data suggest that is likely the wrong strategy.

Examining the five periods over the past 30 years when the Federal Reserve raised rates, in fact, shows that large, dividend-paying, safe companies may be the ones you want to avoid. And with the market participants betting that the Fed will incrementally raise interest rates another percentage point over the next year, this advice could be especially timely.

When bulls prevail

The Fed tends to raise rates at times when it thinks the economy shows signs of overheating—to tighten credit and reduce the chance of rampant inflation. But while rates are rising and the economy is still growing at a healthy rate, it isn't uncommon for a general bullishness about stocks to prevail. Over the past five rate-increase cycles, in fact, the **S&P 500** averaged 13.2% a year, well above its historical average of 9.6%.

This excess performance, meanwhile, is most concentrated in the types of companies one would expect to do well in a booming economy—smaller businesses and those in cyclical industries. In fact, a look at the performance of all mutual funds over the past 30 years, partitioned by the focus of the fund, shows that if you were to hold an average small-cap mutual fund as opposed to a large-cap fund, you would have gained an extra 3.62 percentage points a year in returns over the five rate-increase cycles (15.13% versus 11.51%).

Why be 'defensive'?

Similarly, mutual funds focused on growth stocks and cyclical industries held an edge of 4.65 percentage points a year over value and defensive stocks during the rate-increase cycles. And finally, mutual funds that focus on dividend-paying companies underperformed mutual funds focusing on nonpayers by 5.38 percentage points over the past five rate-increase cycles.

It should be noted that funds focused on small-caps, growth stocks and nonpayers of dividends did come with slightly elevated levels of **volatility** over those same rate-increase cycles, compared with their safer counterparts. But in finance, the bigger rewards do tend to come with the bigger risks.

Thus, with the Fed showing no signs of letting up on rate increases for the next year, it may be the riskier types of funds, rather than those that invest in safe, dividend-paying and large-cap stocks, that deliver the bigger rewards.

Dr. Horstmeyer is an assistant professor of finance at George Mason University's Business School in Fairfax, Va. He can be reached at reports@wsj.com.

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Backlash Builds Against Beijing

By Michael Auslin
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After nearly three decades of unprecedented growth, Chinese leaders, borrowing Barack Obama's favorite cliche, would say they were on the right side of history. That was a few years ago. Then Donald Trump's election seemed to offer them another boost. The new president's withdrawal from the Trans-Pacific Partnership and his questioning of America's Asian alliances appeared to presage a broader U.S. retreat from the world. President Xi Jinping proclaimed before the Davos elite that China had become the defender of the postwar global trading system. Yet Beijing's overreach has resulted in global blowback, possibly signaling the end of China's recent dominance.

China will remain an integral part of the global economy. Its strengthening military will give it influence beyond Asia. And its political voice will be heard in international councils. Yet the world now understands the dark side of doing business with Beijing, while Chinese citizens chafe against Mr. Xi's increasing domestic repression. With the Chinese Communist Party unwilling to reform, Beijing faces major strains ahead.

The Chinese government has linked economic aid to its strategic objectives. In particular, its Belt and Road initiative has promised $1 trillion of infrastructure spending throughout Eurasia. But Chinese aid increasingly is seen as a "debt trap" ensnaring less-powerful nations. They often surrender key facilities or agree to a greater Chinese presence in their countries after they becoming unable to repay development loans.

Malaysia and longtime Chinese ally Pakistan have announced they will be cutting back on Sino-funded projects for fear of indebtedness to Beijing. A recent election in the Maldives oriented the small Indian Ocean nation away from China. Expect more skittishness on the part of potential Chinese partners in vital locations around the globe.

Beijing's heavy hand against foreign corporations -- for example, demanding they list Taiwan as part of China or risk repercussions to their businesses -- also is wearing Western patience thin. And the U.S. and Europe are angry over decades of rampant intellectual-property theft. Many companies are playing along for fear of losing China's market, but they will take the first opportunity to rebuff Beijing's demands.

Another blow has come courtesy of Mr. Trump. However much criticized at home, his tariff war is hitting China's economy hard. Its **stock market** is around a four-year low, while Beijing's bluster is offset by repeated overtures to resolve the confrontation. Thanks to China's $350 billion trade surplus with the U.S., Washington can target a broad range of Chinese goods with tariffs. The damage to American firms from the current trade war may be significant, but China can't weather a prolonged battle nearly as well.

The trade war has highlighted other weaknesses in the Chinese economy. Doubts about the country's official 6.7% economic growth are widespread, while its massive debt burden, estimated at 300% of gross domestic product, raises alarms, especially within the private and state-owned-enterprise sector. Some Chinese businesses have gone on foreign spending sprees and now seek to unload their holdings. Insurance giant Anbang, for example, wants to sell its $5.5 billion real estate portfolio, which includes the Waldorf Astoria Hotel. Beijing has clamped down on other big spenders, due to fears of corporate failures as well as an overheated property market. Rampant speculation has led to regional bans on corporate property purchases amid concerns of a real estate bubble.

All these problems come on the heels of increased repression in China. Mr. Xi, now president for life, has created a cult of personality unseen since the Mao era. He dominates his putative co-leaders, and his anticorruption campaign served to eliminate potential elite opposition figures. He has clamped down on civil society with impunity.

The country also is poised to become the world's first total surveillance state. It already has 200 million surveillance cameras and plans to operate more than 600 million, all using the most advanced facial recognition software. This even extends to special glasses worn by the police.

Despite Mr. Xi's repressive policies, the first signs of discontent have emerged. Mr. Xi's ambitious reform program, first unveiled in 2013, has resulted in little change. A critique of the government from a professor at the prestigious Tsinghua University recently went viral, while Chinese officials have begun to walk back their boastfulness about the state of the economy. Mr. Xi has had to defend his propaganda blitz.

There are still hundreds, likely thousands, of protests every year against official corruption and the government's heavy hand. Then there is the severe yet largely hidden repression of Muslim Uighurs in Xinjiang, where as many as one million are reported to be held in modern concentration camps. Combined with its repressive policies in Tibet, the Chinese Communist Party has engendered a seething hatred from the country's minorities.

No one should expect a revolution soon in China. And as shown by El Salvador's recent switch of diplomatic recognition from Taipei to Beijing, its economic pull remains attractive to many poor nations. But China's road ahead is increasingly rocky. Far from adopting many of the norms of the postwar world, Beijing has attempted to rewrite them in its own favor. Now the question is how far will China's leaders go in curbing their assertive behavior and rapacious policies. Sticking to the current path will lead to greater tension between China and the world and risk more unrest at home.

Mr. Auslin, a fellow at Stanford University's Hoover Institution, is author of "The End of the Asian Century" (Yale, 2017).

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THE WALL STREET JOURNAL.
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SEC Ruling Hits at Exchanges' Profit

By Alexander Osipovich, Dave Michaels and Gretchen Morgenson
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The Securities and Exchange Commission ruled against the New York Stock Exchange and Nasdaq Inc. over the fees they charge Wall Street banks and traders for market data, casting doubt on a crucial revenue stream that has helped make up for falling income from trading.

The five-member commission on Tuesday unanimously shot down a pair of requests to raise fees for certain NYSE and Nasdaq data, saying the exchanges hadn't justified the price increases. The decision is the first time the SEC has rejected fee increases for the exchanges' most lucrative class of **stock-market** data feeds.

The SEC's decision sided with the Securities Industry and **Financial Markets** Association, or Sifma, a major financial-industry trade group that had accused the exchanges of "exploiting their monopoly over market data." Brokers say big and small investors alike will benefit if regulators rein in skyrocketing market-data costs.

The SEC also put into limbo over 400 other market-data fee increases that were challenged by Sifma. The regulator didn't reject those price increases but told the exchanges to review brokers' complaints that they undermine competition, giving the exchanges a year to do so. The move puts pressure on the exchanges to restrain fees or disclose more about why they are necessary.

"Today's decision is a victory for ordinary investors in our stock markets -- who have, for too long, been paying steep costs for an uneven playing field," said SEC Commissioner Robert J. Jackson Jr.

A NYSE spokeswoman said the decision represents a "troubling shift by the SEC" toward "regulatory overreach prioritizing the interests of powerful Wall Street interests," adding the exchange didn't believe the decision would withstand its challenge. Nasdaq said in a statement that it was "disappointed" by the ruling and would appeal in federal court. "This decision represents the latest in a 20-year-long series of attempts to over regulate the best capital markets in the world, in order to benefit the largest financial institutions," it said.

Brokers, including those that serve retail-oriented investors such as mutual and pension funds, say they are essentially required by SEC rules to buy the data. The costs, brokers say, act as a tax on the industry, which they either swallow or pass on to customers.

Data has emerged as a lucrative business for the three big exchange groups that dominate the U.S. **stock market**: NYSE parent Intercontinental Exchange Inc., known as ICE, Nasdaq and Cboe Global Markets Inc. Until the 2000s, exchanges made only a small share of revenue from data and sometimes even gave data away free. Now, revenues from ICE's and Nasdaq's various data-related businesses rival what the companies make from trading.

That shift coincided with an explosion in demand. The importance and sheer volume of market data has grown in the past few decades due to the widespread adoption of electronic trading and the rise of ultrafast traders who need lightning-quick information about price moves.

Exchanges sell data on current stock prices and recent trades, as well as on how much supply and demand there is for stocks at different price levels. High-frequency traders use such data to power their computerized trading strategies. Brokerages, including banks UBS Group AG and JPMorgan Chase & Co., use it to ensure they are giving their clients -- hedge funds, pension funds and other big investors -- the best price on each trade.

Building on their core equities-data business, exchanges have pushed into related areas, such as bond-price data and market-analysis software. From 2014 to 2017, total annual revenues from market-data services for the big three exchange companies surged 45% to $2.3 billion, according to an analysis by the Committee on Capital Markets Regulation, a research group whose members include big banks and asset managers.

Exchanges said the analysis overstates the size and growth rate of their data business. Disclosures from ICE, Nasdaq and Cboe show their combined **stock-market** data revenues were around $560 million in 2017, although that doesn't include connection fees that traders and brokers must pay to access such data. The figure also excludes sales of options and futures data.

So far, small investors haven't seen much impact from rising data costs, and their overall trading costs have generally fallen in recent years. Well-known names in retail investing have nonetheless joined Wall Street banks in complaining about fee increases. Charles Schwab Corp., Fidelity Investments and T. Rowe Price Group Inc. were among 24 companies that signed a letter to the SEC in December blasting the exchanges' "oligopoly" over **stock-market** data.

Clearpool Group Inc., a startup electronic brokerage whose office is just a few blocks from the Big Board's historic headquarters in lower Manhattan, said its yearly outlays for NYSE equities data climbed to $343,000 in 2015 from $212,000 in 2013, a 62% increase. Since then, Clearpool's NYSE data expenses have dropped, because it stopped paying for the priciest data feeds, the company said. "What we've seen is a steady increase in the pricing," said Clearpool CEO Joe Wald.

The SEC's ruling will likely make it tougher for exchanges to raise fees for data and related charges for connecting to their computer systems. The SEC has already started to scrutinize such fee increases more closely, in a broad effort to ensure they don't undermine competition, according to regulators and traders involved in the fight.

U.S. stock exchanges have long used their status as pillars of American capitalism to get their way in Washington. From 2016 through September, the SEC didn't reject any of 95 exchange proposals related to connection fees, according to an analysis by Mr. Jackson, the SEC commissioner.

The SEC's Sifma ruling reopens fundamental questions about the role of exchanges. Should they be utilities working for the good of markets, or, as for-profit companies, should they focus on making money for shareholders?

The NYSE's metamorphosis into a Big Data company started in the 2000s, after new SEC rules aimed at breaking the decades-old NYSE-Nasdaq duopoly took effect. As recently as the 1990s, it handled more than two-thirds of U.S. equities trading on a dollar basis.

The rise of rival exchanges and electronic trading platforms eroded the Big Board's market share. Today the NYSE handles about 23% of U.S. stock-trading volume.

As it battled low-cost competitors, the exchange's traditional business suffered. From 2008 to 2017, the NYSE's net revenue from transaction fees fell by more than 40% to $196 million, according to an analysis by Equity Research Desk, a research firm.

Seeking to lift its flagging fortunes, the NYSE turned to its trove of trading data. On an average day, around 1.7 billion shares change hands on the NYSE's markets. Vast volumes of digital messages zip around the Big Board's 400,000-square-foot data center in Mahwah, N.J., each of which represents a trade or a pending order to buy or sell stocks. The NYSE compiles those messages into high-speed electronic feeds that it sells to brokers and traders.

The NYSE also broadcasts stock prices through a cheaper, slower public data feed, called the securities information processor, or SIP. This is used by retail brokers such as TD Ameritrade Holding Corp. and internet search engines like Google and Yahoo.

Banks and electronic-trading firms say the SIP is too slow to be useful. Sifma has accused the NYSE and other exchanges of underinvesting in the SIP to steer big-ticket customers to pricier data feeds. The NYSE and other exchanges deny that contention.

Liz Hoffman contributed to this article.

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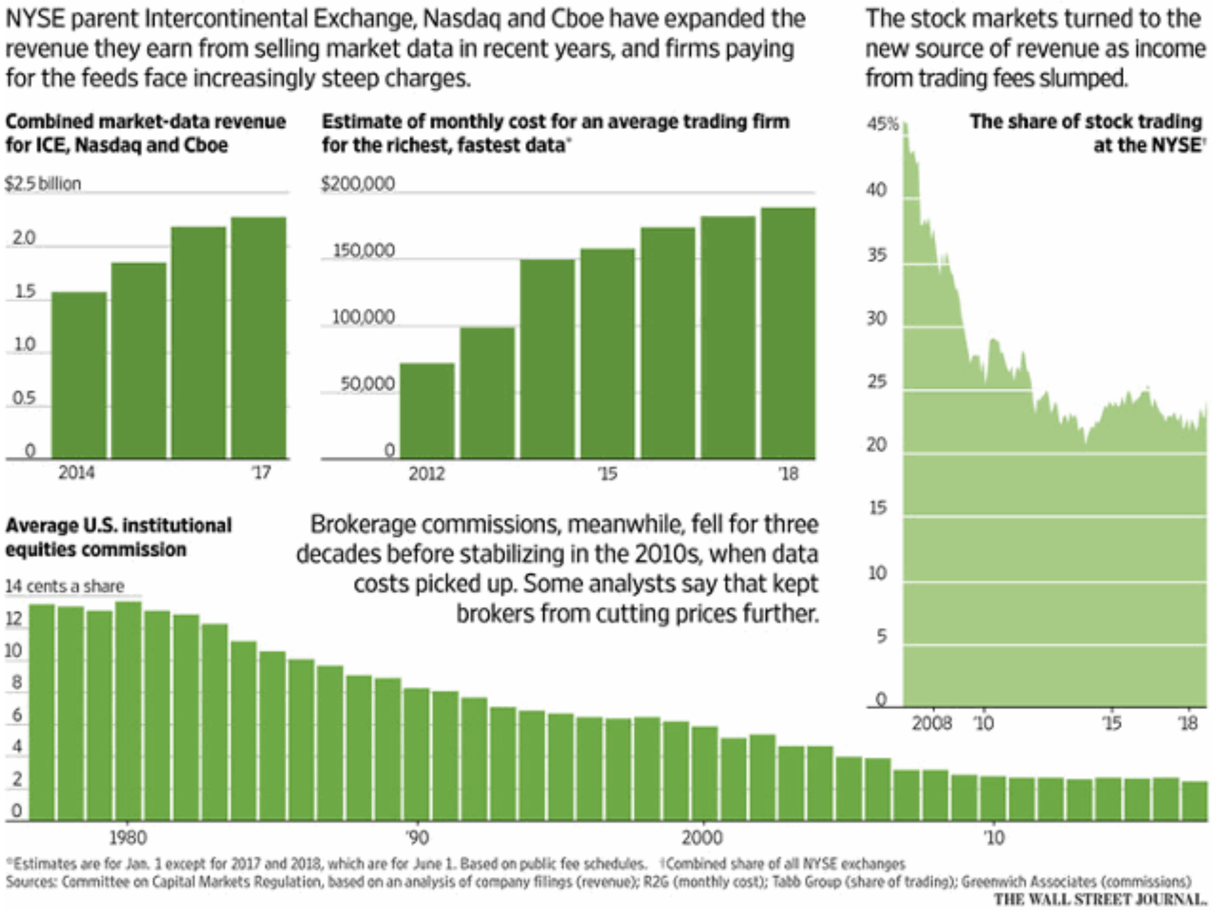

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WSJ PRO CENTRAL BANKING

Heard on the Street
Markets
U.S. Inflation Data Key to Global Markets' Next Moves

By Nathaniel Taplin
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Don't expect the Fed to save U.S. stocks—or emerging-market economies—even if the sound of crumbling markets gets much louder.

Following Wednesday's big U.S. selloff, the American grizzly moved decisively into Asia and Europe on Thursday. Shares in Shanghai closed down 5.2%, their worst single day since early 2016, while Japan's Topix dropped 3.5% and Korea's Kospi fell 4.4%. The Stoxx Europe 600 slid by 1.8% in early trading.

Voices from President Trump down are already calling for the Federal Reserve to moderate its rate-hiking course—as it has often done before when panic hit stocks. But with U.S. unemployment at its lowest since the 1960s, **oil prices**above $80 a barrel, and leading inflation indicators such as wages moving higher, it will take something worse than a **stock-market** hiccup and presidential grumbling to move the Fed.

Nor will pressure from overseas derail the U.S. central bank: Mr. Trump isn't the only policy maker following an "America first" line. In 2015, the Fed was willing to hold fire to let China fight off large-scale capital outflows and a debt-deflation trap. Three years on, Chinese markets are tumbling again and its currency is under pressure. But money has yet to start flooding out of China and official data so far show growth holding up. With the trade conflict heating up, there seems little spirit of generosity toward China in the U.S. right now.

If even China's concerns can't move the Fed, policy makers in lesser emerging markets look out of luck. The finance minister of Indonesia—where the central bank has been raising rates rapidly to defend its currency—this week openly pressed the Fed to take emerging markets' problems into account. But while China accounts for roughly 15% of global gross domestic product, Indonesia's share is just 1%.

Several emerging markets have already been hammered this year. The bad news is that they nearly always come off even worse during periods when U.S. stocks are declining sharply. That makes Thursday's U.S. inflation data key. A soft reading might induce investors to quickly forget this week's kerfuffle. But if it surprises on the upside, expect more carnage in U.S. markets—with few places to hide at home or abroad.

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THE WALL STREET JOURNAL.

Markets

China Puts Yuan Skeptics on Notice as Currency Nears Decade Low; After a nearly 7% selloff this year, the currency is at the brink of hitting 7 per dollar

By Saumya Vaishampayan and Ben Eisen
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A top Chinese policy maker warned investors to stop betting against the country's currency Friday, boosting the yuan after it had fallen to nearly its weakest in a decade.

"For forces that try to short renminbi, we fought hand to hand a few years ago, and we are very familiar with each other," said Pan Gongsheng, a vice governor of the People's Bank of China, at a briefing on Friday. "I think it's still fresh in both of our memories."

After a nearly 7% selloff this year, the yuan is at the brink of hitting 7 per dollar—a closely watched threshold that could trigger further selling if Chinese businesses and individuals decide that means they need to expatriate capital before any further decline. The yuan last traded weaker than 7 per dollar in May 2008 in the onshore market, while offshore trading was only introduced in 2010.

The comments from Mr. Pan, who is also the head of the country's foreign-exchange regulator, were the latest sign that Beijing is growing concerned about its currency again, more than three years after a previous bout of depreciation sparked global market havoc.

China has made it more expensive this year for traders to place bets against the currency and tweaked the mechanism for setting its official daily trading range—efforts aimed at reining in the yuan's tumble.

In the tightly controlled onshore market, the Chinese currency fell as low as 6.9647 per dollar on Friday—0.03% away from its lowest level in a decade. It later recovered from its 0.2% drop to end roughly flat after Mr. Pan's news conference, in which he also said the central bank wouldn't engage in competitive depreciation and that it would continue to take steps to stabilize expectations for the yuan.

"Seven is an important level for them," said Eric Liu, a fixed-income portfolio manager at Manulife Asset Management, pointing to the timing of Mr. Pan's remarks, the same day the currency neared its weakest since 2008. Mr. Liu doesn't expect the yuan to breach that level this year.

The U.S. dollar has rallied in 2018 against many currencies including the yuan. The WSJ Dollar Index, which measures the currency against a basket of peers, has climbed for five of the past seven trading days, closing Thursday at its highest since May 2017.

Still, China is dealing with other issues that have further fueled its currency's drop: chiefly, trade tensions with Washington and a slowdown in growth. As a result, the yuan's declines against the dollar have overshadowed those of many of its peers, helping send its value against a basket of its trading partners' currencies to a record low.

The currency weakness came amid **stock-market volatility** this week that started in China and quickly went global. The Shanghai Composite jumped 4.1% on Monday and slid 2.3% on Tuesday, then seesawed through the rest of the week. Major U.S. indexes swung wildly on Wednesday and Thursday.

The yuan's decline against the dollar is symptomatic of the diverging directions of each country's economy and monetary policy. China said last week that gross domestic product rose by 6.5% in the third quarter, the slowest since 2009, prompting a coordinated effort to calm investors. In the U.S., GDP growth hit a near four-year high in the second quarter.

The U.S. has lifted interest rates three times this year and penciled in a fourth. China has moved to ease policy, helping hold down bond yields, and unveiled various stimulus measures, although those have fallen short for some investors.

"They are making all the right noises in terms of the stimulus packages they are putting together, but it does seem rather underwhelming at the moment in terms of the quantum of support that is being brought to bear," said Aninda Mitra, a senior sovereign analyst in Singapore at BNY Mellon Investment Management.

A weakening yuan is likely to help Chinese exporters that price their goods in dollars but pay most costs in their home currency. However, the decline may add to tensions between the U.S. and China. Both countries have placed billions of dollars worth of tariffs on each other's goods. President Donald Trump has repeatedly asserted that China is artificially holding down its currency.

As well as tweaking its currency regime and sounding verbal warnings, there are signs Beijing has acted to slow the yuan's decline more directly. The Chinese central bank sold $17.4 billion of foreign exchange last month, which RBC Capital Markets said amounted to its biggest such intervention since early 2017.

Grace Zhu contributed to this article.

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Asia Markets Snapshot

* Stock indexes across Asia fell. South Korea's Kospi touched its lowest level since December 2016.

* Hong Kong's Hang Seng declined 1.4%.

* China's yuan traded 0.2% lower in the offshore market, at 6.9725 per dollar.

Heard on the Street

* Seven Is No Magic Number for the Yuan

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THE WALL STREET JOURNAL.

Markets
Asian Markets Sell Off as Geopolitical Concerns Rise

By Joanne Chiu
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Tuesday's Big Theme

Asian stocks tumbled, as Chinese shares partly reversed their biggest two-day rally in years. The region was hit by geopolitical strains, currency weakness and lingering trade frictions with the U.S.

What's Happening

Asian markets fell as investors fretted over fresh tensions among the U.S., Saudi Arabia and Russia, said Steven Leung, executive director of institutional sales at UOB Kay Hian in Hong Kong. The transit of two U.S. warships through the Taiwan Strait could also put further pressure on relations between China and the U.S., he said.

"Investors' confidence in the **financial market** is fragile at the moment, given a lack of clarity about global economic health and political stability", Mr. Leung said.

The Chinese **stock market**'s sharpest two-day advance since 2015, over the previous two sessions, proved short-lived despite coordinated efforts from leaders and regulators to calm investors.

The Shanghai Composite closed 2.3% lower. Meanwhile, Hong Kong's Hang Seng declined 3.1%, a deeper fall than the previous day's gain. Export-led, technology heavy benchmarks elsewhere in North Asia suffered too, with Taiwan's Taiex falling 2% to an 18-month closing low, and South Korea's Kospi retreating 2.6% to its lowest close since March 2017.

Separately, an overnight rally in the U.S. dollar caused the Chinese yuan to depreciate 0.1% to 6.9449 per dollar in offshore trading. The nearly three-year-old CFETS RMB Index, a gauge of the yuan's relative strength against two dozen currencies, hit a fresh low of 92.15 on Friday, showing the currency has been weakening versus a range of peers, not just the greenback.

What It Means

China's economic slowdown is weighing on its currency and **stock market**, which has lost more than a fifth of its value this year.

"The outlook is still negative," said Andy Maynard, managing director of equities sales trading at China Renaissance Securities. Despite many supportive measures and reassurances from top Chinese government officials in recent days, concerns about the nation's underlying economic health are still giving investors pause. Not much has changed in terms of the uncertainties surrounding global growth and China's trade tensions with the U.S., he added.

Proposals floated by China include personal tax cuts and higher spending on infrastructure. Authorities also pledged to help support the country's private sector.

Economists at Goldman Sachs and its Chinese joint-venture partner said in a note Tuesday there could be further loosening measures until "the economy and markets show clear evidence of an apparent stabilization."

Nomura chief China economist Ting Lu estimated the latest tax-cut proposal could increase consumption growth and nominal GDP by 0.22 and 0.08 percentage points respectively. That won't be sufficient to stimulate the weakening economy, he said, adding he expects more substantial tax reforms in coming months.

Write to Joanne Chiu at joanne.chiu@wsj.com

Asian Markets Snapshot

* Stock indexes fell, led by Hong Kong's Hang Seng, which dropped 3.1%.

* Japan's Nikkei 225 declined 2.7% while South Korea's Kospi fell 2.6% to a 19-month low.

* China's yuan weakened 0.1% lower offshore, to 6.9449 per dollar.

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THE WALL STREET JOURNAL.

Markets

An Unusual Year for Haven Assets Continues; Prices of gold, the dollar and 10-year U.S. Treasury notes rose on the same day for just the fifth time in the past six months

By Amrith Ramkumar
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The Wall Street Journal Online
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Gold prices rose in unison with the U.S. dollar and government bonds on Tuesday, a rare example of investors favoring safer assets across the board and a reminder of the continuing risks hanging over **financial markets**.

Tuesday was just the fifth time in the past six months that the prices of gold, the dollar and 10-year U.S. Treasury notes rose on the same day, according to Dow Jones Market Data. Bond yields fall when prices rise.

Gold is considered a haven asset by many investors, so confidence in the U.S. economy this year has punished the metal while leading some to favor the dollar and U.S. Treasurys instead. Gold also struggles to compete with yield-bearing assets such as Treasurys when interest rates rise, and a stronger dollar makes gold more expensive for overseas buyers.

That's why Tuesday's trading was so unusual: Haven buying this year has been concentrated in the currency and bond markets and rarely spilled over into commodities. Gold, the dollar and bonds have risen together on the same day just 11 times in 2018, compared with more than 20 days in each of the previous four years. On Wednesday, gold and bonds fell as the dollar rose.

A day earlier, analysts said budget targets from Italy's populist government that could put the country in conflict with the European Union have stoked broader worries about economic stability in the region.

"It's a lingering fear out there with the eurozone," said Bob Haberkorn, senior market strategist at RJO Futures.

Traders said that on Tuesday, there was enough **bullish** sentiment toward gold to finally push prices higher. Some worries over Italy eased Wednesday following media reports that the Italian government was considering a lower deficit target. But analysts still expect **volatility** in the region to persist.

That could be a boon for gold bulls, who have been frustrated by expectations for higher interest rates throughout the year.

Hedge funds have recently pushed net bets on lower gold prices near record levels, according to Commodity Futures Trading Commission data going back to 2006. **Bearish** bets on gold by speculative investors outnumbered **bullish** wagers by 77,313 contracts during the week ended Sept. 25, the most recent figures show.

Some analysts said Tuesday's rise in gold was caused by some investors covering their short positions, rather than a long-term shift in sentiment toward the metal. That is another reason some say gold could experience more wild swings, especially with several market-driving events on the horizon.

The congressional midterm elections next month and meetings between U.S. and Chinese leaders are among the major events coming up. The world's two largest economies will try to resolve the ongoing tariff dispute during the November gathering.

While these events may trigger another bout of **volatility**, which could push gold prices higher, many analysts expect investors will continue to favor the dollar for safety as interest rates rise. Indeed, gold prices fell Wednesday while the U.S. currency climbed for a sixth consecutive session.

"This pop [in gold] could have some follow-through for a day or two, but I look at it as an opportunity to short it," Mr. Haberkorn said.

To receive our Markets newsletter every morning in your inbox, click here.

Write to Amrith Ramkumar at amrith.ramkumar@wsj.com

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THE WALL STREET JOURNAL.

Markets

Oil Prices Gain for Third Session in a Row; Iran's crude exports have declined at a faster-than-expected pace, but this is being offset by supply from other major producers

By Dan Molinski and Neanda Salvaterra
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Oil prices rose for a third straight session Tuesday as a surge in stock markets led oil investors to resume their focus on tightening global supplies due largely to U.S. sanctions on Iran.

Light, sweet crude for November delivery ended 0.2% higher at $71.92 a barrel on the New York Mercantile Exchange. Brent crude, the global benchmark, rose 0.8% to $81.41 a barrel.

U.S. benchmark oil prices hit a nearly four-year high of $76 a barrel at the beginning of this month on concerns that as much as 2 million barrels a day of Iranian exports could come off the global market once U.S. sanctions start to take full effect next month. But oil prices retreated quickly from those highs last week when a huge drop in stocks on Wall Street reduced risk appetite for oil and created worries of a weaker global economy.

"We've endured a nice pullback after reaching four-year highs, and now we're finding support once again from whether or not the loss the Iranian oil will create a tight global supply of oil," said Eugene McGillian, vice president, market research, at Tradition Energy.

He added that while the stock market's tumble last week spurred concerns of a weaker global economy and lower oil demand, "we're not seeing any demand drop in the numbers yet. Energy demand remains strong."

Iran's crude exports have declined at a faster-than-expected pace ahead of the U.S. sanctions next month, and that helped push Brent above $80 a barrel. Still, some analysts say these lost barrels are already being offset by increased supply from major producers such as Saudi Arabia and Russia.

"Iranian exports will fall quite sharply from November onwards, so there is a bit of timing mismatch as the Saudis and others have already offset that Iranian falloff," said Amrita Sen, analyst at consultancy Energy Aspects.

OPEC crude output rose by 100,000 barrels a day in September, to 32.78 million barrels a day, with the biggest increase coming from Saudi Arabia. Additional supply is also coming from elsewhere, including the U.S.

Still, politics in the Middle East continues to disturb the balance of oil supply. Washington has threatened to sanction Riyadh over the suspected killing of a dissident Saudi journalist and the Saudi's have said they could retaliate by increasing the price of crude to well above $100 a barrel.

Many analysts viewed the Saudi statements as bluster. "I don't think this is going to be the case," said Olivier Jakob, head of consultancy Petromatrix. "Using oil as a weapon is the last bullet for any country, so I don't think they will do that because it would totally destroy their standing as a reliable source of energy."

Oil investors will watch Wednesday morning for weekly data on U.S. oil inventories from the Energy Information Administration. A survey of analysts by The Wall Street Journal shows an average forecast for a 1.5-million-barrel rise in oil stockpiles in the week ended Oct. 12, which would mark a fourth straight week of increases.

The American Petroleum Institute, an industry group, said late Tuesday that its own data for the week showed a 2.1-million-barrel decrease in crude supplies, a 3.4-million-barrel fall in gasoline stocks and a 246,000-barrel decrease in distillate inventories, according to a market participant.

Among refined products, gasoline futures for November delivery rose 1.7% Tuesday to $1.9773 a gallon. Diesel futures fell 0.6%, to $2.3402 a gallon.

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The New York Times

Technology
Alphabet Shrugs Off Bad News With Big Quarter

By Daisuke Wakabayashi
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SAN FRANCISCO — The headlines swirling around Alphabet, the parent company of Google, are not positive: European regulators are cracking down on its business practices, politicians are expressing concern about political bias, and there are growing fears about how it is pushing the boundaries on user privacy.

But those clouds have done little to darken Alphabet's earnings — a testament to the enduring strength of Google's core search business. In 2018, Google is expected to capture about 60 percent of global search advertising spending, according to the research firm eMarketer.

On Thursday, Alphabet reported a net profit of $9.19 billion in the third quarter, up 37 percent from a year earlier. Quarterly revenue was $33.74 billion, an increase of 21 percent but slightly lower than analysts expected, pushing the company's **stock price** down about 5 percent in after-hours trading.

Alphabet's profits, however, exceeded analysts' estimates, reflecting a lower tax rate that it attributed to the impact of tax cuts passed in the United States last year. Alphabet's quarterly tax rate was 9 percent versus 16 percent a year earlier.

The company appeared to be trying to demonstrate that those tax cuts are benefiting American workers. Google said 80 percent of its capital spending during the third quarter was used in the United States. Alphabet said it had hired 9,000 employees in the United States this year, raising its total to 94,372 as of September, an increase of more than 16,000 from a year earlier.

In a conference call with analysts, Sundar Pichai, Google's chief executive, said it was still too early to determine the potential impact of new policies that the company was putting in place in Europe.

The European Union fined Google $5.1 billion in July for abusing its market dominance in smartphone software. Last week, the company said it would start charging handset manufacturers a licensing fee to install popular applications such as Gmail and Google Maps for phones running Android in the European Union.

In a sign of Google's online dominance, Alphabet said Google Drive — its suite of productivity software — was now its eighth product to have more than one billion monthly active users. The others include YouTube, Google search and Gmail.

Alphabet said it continued to see an increase in traffic acquisition costs — the fees Google pays companies like Apple to ensure that its search engine is the default option when people open a browser on the iPhone. Google said it had paid out $6.58 billion in such costs, compared with $5.5 billion in the year-earlier period.

Alphabet also said it has logged a $1.4 billion gain on equity investments made by the company's venture capital arms.

Follow Daisuke Wakabayashi on Twitter: @daiwaka.

* Google Plus Will Be Shut Down After User Information Was Exposed

* Google Shrugs Off $5.1 Billion Fine With Another Big Quarter

* Google to Charge Phone Makers for Android Apps in Europe

Alphabet, the parent company of Google, reported third-quarter revenue of $33.74 billion, with a net profit of $9.19 billion, on Thursday. | Aly Song/Reuters

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Economy

Fed's Williams Says Jobs Data Reflects Strong Economy; 'This is a bit of a Goldilocks economy'

By Michael S. Derby
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Federal Reserve Bank of New York President John Williams embraced as good news on Friday September hiring data and reiterated his view that the U.S. is enjoying a "Goldilocks" economy.

The jobs data is "a continuation of a strong U.S. economy" that shows "good momentum going forward," Mr. Williams said in an interview on Bloomberg's television channel. "This is a bit of a Goldilocks economy" where growth is strong and sustainable amid an absence of big upward inflation pressures.

Mr. Williams spoke in the wake of the release of the September jobs report. That report showed a lower than expected 134,000 jobs gain for the month. But the jobless rate fell to 3.7% from 3.9%, for the lowest reading since the Vietnam War.

The jobs data appeared to keep the Fed on track to press forward with interest rate rises. The Fed raised its short-term target rate range for the third time this year last week, boosting it to between 2% and 2.25%. It is widely expected to raise rates again in December, and the jobs data helps keep it on that track.

The rock-bottom level of the jobless rate will like fall further and go under 3.5% at some point next year, Mr. Williams said. But he isn't worried that the superlow unemployment rate, which historically would be a significant factor that could push inflation up, is a problem. He said of the 3.7% jobless rate: "It doesn't scare me at all. It's great for the American people."

Mr. Williams didn't comment directly on what he expects for monetary policy. But he did say the Fed has a "ways to go" before its rate rises move from being stimulative of the economy to a level that is neutral.

He noted that the Fed's forecasts show the Fed will likely go beyond a neutral fed-funds rate, and he said that the central bank's official rate projections are "reasonable." But he declined to predict how future rate rises would go, and said what the Fed does with rates will be driven by how the economy performs.

Mr. Williams commented on the unsettled state of **financial markets** and said rising bond yields don't appear to suggest rising inflation fears among **financial-market** participants. Instead, they show market participants holding a positive view of the outlook.

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Economy

Analysis: Tightening in Financial Conditions Could Affect Fed Outlook; Morgan Stanley report says financial conditions have tightened about 50 basis points from the end of September

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Financial-market tumult appears to be boosting the headwinds facing the U.S. economy.

A report Thursday from Morgan Stanley says what's happened with markets over recent weeks is equivalent to the impact of the Federal Reserve raising its short-term target rate two times.

"Financial conditions have tightened about 10 basis points from last Friday and about 50 basis points from the end of September," the Morgan Stanley report says. "That compares with the experience from early February this year when financial conditions tightened about 80 basis points over a two-week period."

The Morgan Stanley analysts said their assessment of financial conditions is based on the performance of market variables in the Fed's model of the economy.

The Fed has raised rates three times this year, taking its overnight target rate range from between 1.25% and 1.5% to its current 2% to 2.25%. That has helped take the two-year Treasury note, which is highly responsive to monetary policy shifts, from about 1.9% at the start of the year to 2.852% in recent trading.

A report from Capital Economics, also released Thursday, flagged the longer-term market reaction to the Fed's rate rises.

"What is often underappreciated," the firm said, "is that policy tightening has translated into a larger than usual increase in market interest rates." It explained that "adjusted for inflation, the rise in interest rates charged on a range of household and corporate borrowing has already matched or exceeded the average trough-to-peak increase in past tightening cycles."

That broader tightening is likely to drag growth "sharply lower" in 2019 when the impact of government fiscal stimulus tied to tax cuts fades, Capital Economics said.

Fed officials set monetary policy based on what's happening with employment and inflation. But they also believe the overall level of financial conditions are important, since that's the vector that connects changes in monetary policy with activity in the broader economy.

The Morgan Stanley report doesn't offer any assessment about how the tightening in **financial markets** will affect the economy or monetary policy choices faced by the Fed. The central bank is widely expected to raise rates at its December meeting and then press forward with more increases next year.

At least part of the market's recent moves have been ascribed to investors finally taking on board the idea the Fed has a number of rate rises ahead of it, and pricing their holdings accordingly.

Given how the Fed thinks about financial conditions, a market that prices in tighter monetary policy may actually take some pressure off the central bank to deliver on those increases. That said, any shift in market levels would have to be enduring.

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