THE WALL STREET JOURNAL.

Markets

Bitcoin Continues Steep Fall as Cryptocurrency Collapse Worsens; The digital currency plunged below $4,000 over the weekend and below $3,650 late Monday

By Steven Russolillo
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Bitcoin slumped 10% Monday, continuing a steep slide and bucking a modest rebound in stocks and oil.

The cryptocurrency plunged below $4,000 over the weekend and fell below $3,650 late Monday. Last week, it lost nearly a third of its value in seven days, one of its worst weekly selloffs on record. The digital currency has now fallen by about 80% since peaking near $20,000 late last year.

Tony Gu, founding partner at NEO Global Capital, said the rout was down to just one thing: "panic."

Many speculators have fled the market, as shown by falling trading volumes. And a split this month in a smaller currency called Bitcoin Cash has created tensions. The prospect of large investors selling bitcoin to cover the risks of a fall in the value of their Bitcoin Cash holdings has hurt sentiment.

Now, another worry has emerged: Cryptocurrency miners, the outfits that solve complex equations to generate new digital coins, seem to be losing interest. The amount of computing effort expended by miners, known as the hash rate, has started falling.

The hash rate rose for much of the year even as cryptocurrency prices slumped, suggesting people remained optimistic prices would bounce back. But it has fallen sharply in recent weeks, according to Blockchain Ltd., a cryptocurrency-wallet service and data firm. That suggests fewer miners are jumping into the network.

"Bitcoin's value is always driven by the intensity of demand and supply," says Edith Yeung, a partner at 500 Startups, an early-stage venture fund. "If the miners stop mining, bitcoin will not function…and the overall market will lose confidence. If there is no confidence, people will freak out and sell even more."

Rival digital currencies such as ripple and ether have also fallen sharply. The total market value of cryptocurrencies stands at about $130 billion, down from a record high above $800 billion in January, according to research site CoinMarketCap.

The sour mood stands in contrast to a year ago, when cryptocurrencies captured the imagination of individual investors as prices skyrocketed.

Mr. Gu, whose blockchain investment fund in Singapore manages about $400 million in assets, is optimistic the market will recover. "Money is made when there is blood in the streets," he said.

But others say there could still be pain ahead.

"It's hard to look at the price charts of the big crypto assets and not cringe," Fred Wilson, a partner at Union Square Ventures in New York and an early bitcoin investor, wrote on his blog. He drew a parallel to the moves seen when the tech bubble burst.

Back then, Amazon.com Inc. lost 95% of its value from December 1999 through October 2001. The online retail giant has long since recovered.

"I think things will get worse before they get better," Mr. Wilson said.

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THE WALL STREET JOURNAL.

Markets
U.S. Stocks Rise, Led by Retailers; Shopping season fuels gains, a respite for investors after turbulent week

By Corrie Driebusch and Avantika Chilkoti
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Corrections & Amplifications

The head of emerging markets at Amundi is Yerlan Syzdykov. An earlier version of this article misspelled his surname as Syzdyko. (Nov. 26, 2018)

U.S. stocks rebounded Monday, led by shares of retailers as shoppers spent billions of dollars online and in stores over the Thanksgiving weekend, commencing what is expected to be one of the strongest holiday seasons in years.

The rise provided some respite for major indexes after a turbulent week for stocks, when a plunge in **oil prices**, the prospect of an economic slowdown and global trade tensions rattled markets.

The **S&P 500** rose 1.6%, while the **Dow Jones Industrial Average** added more than 350 points, or 1.5%, to 24486. The **Nasdaq Composite** rose 2.1%. All three indexes remain down more than 1% in November.

Among the biggest gainers was Amazon.com, which is expected to account for nearly a fifth of holiday sales this year. The online retailer's stock rose 5.3%. Other retailers also gained, with Target up 2.8%, Macy's rising 1.7% and Kohl's adding 2.9%. The SPDR S&P Retail ETF climbed 2%.

Retailers are expected to get another sales boost this week, as many are offering online promotions as part of Cyber Monday.

Also helping to buoy stocks was a bounceback in the price of oil, which has been battered in recent weeks. U.S.-traded crude oil rose 2.4% to $51.63 a barrel Monday, making up some of last week's slump, the largest one-week decline since January 2016. Crude oil has fallen more than 20% so far this month, and on Friday settled at its lowest level in more than a year on concerns of global oversupply.

Stocks around the world also rose Monday, with the Stoxx Europe 600 index up 1.2% while Japan's Nikkei Stock Average added 0.8%.

The gains follow a rough few weeks for global markets as concerns around a glut of oil fed unease and investors watched closely for signs of an end to expansion in the U.S. economy.

"Once you see any slowdown in the data, people are going to pile on that trend and start focusing on the turn in the economic cycle and a turn in the dollar as well," says Peter Kisler, portfolio manager at North Asset Management.

Investors were also watching for developments related to Brexit, after the European Union on Sunday approved a treaty that outlined divorce terms with the U.K., which many analysts saw as a mere formality. The next hurdle for British Prime Minister Theresa May is pushing the deal through a vote in a divided Parliament.

The British pound Monday edged up 0.2% against the U.S. dollar.

Markets are also eyeing U.S.-China trade relations ahead of a Group of 20 summit in Argentina at the end of the week.

Any deterioration in relations could weigh on markets further by threatening global growth, analysts say. The U.S. already plans to increase tariffs on $200 billion of Chinese imports to 25% in January, unless some agreement is made.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

The World's Priciest Property Market Is Getting (a Bit) Cheaper; Slower spending by rich Chinese home buyers is among the negative factors for Hong Kong's housing market.

By Jacky Wong
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Is the world's most expensive property heading for a **bear market**? Probably.

Hong Kong apartments have been an excellent investment: Prices have tripled in the past decade. A tiny flat, slightly bigger than a parking space, can go for as much as $1 million in the city's most expensive areas.

But the market that only ever seemed to go up has started to turn lately. A housing-price index compiled by property agent Centaline has dropped 5% from its August peak. The aggregate number probably doesn't reflect the market's gloomy sentiment—prices in some housing estates have fallen more than 10% in just the past month. Turnover has dried up, indicating buyers are still waiting for homeowners to slash prices further.

The normal laws of property markets don't really apply in Hong Kong. Prices for reasonable living quarters in the semiautonomous Chinese city are far out of reach for average residents, but it has been that way for a long time. Research company Demographia has ranked Hong Kong as the world's least affordable city for eight straight years.

What matters more for the property market are the economic outlook and financial conditions locally and in mainland China, both of which have been worsening. Hong Kong's equity benchmark has fallen around 20% since mid-January: In previous cycles since the late 1990s, a property **bear market** has usually followed one in stocks in Hong Kong, according to Deutsche Bank research.

Meanwhile, buyers from mainland China—which accounted for around a quarter of luxury apartment purchases in Hong Kong last year according to Centaline—may also be tightening their purse strings as the Chinese economy decelerates. Slowdowns in revenue from high-rollers in gambling center Macau and sales for luxury watchmaker Richemont are anecdotal indicators that rich Chinese people are spending less.

The sliding yuan is another negative factor—it has dropped around 10% since March against the Hong Kong dollar, which is pegged to its U.S. counterpart. Property markets in other popular destinations for Chinese home buyers have also slowed recently: Housing prices in Sydney, for example, have dropped 7% from a year ago, according to property data company CoreLogic.

How bad could things get? Hong Kong property prices fell by around 13% during the previous downturn in 2015 and 2016, which was triggered by a surprise yuan depreciation and **stock-market** meltdown in China. Things, though, could get even worse this time around, especially against the backdrop of rising U.S. interest rates.

Bargain hunting in this nonbargain market will require some patience.

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THE WALL STREET JOURNAL.

Life

This Website Is the Stock Market for Nikes and Rolexes; StockX, a Dan Gilbert backed start-up has revolutionized the secondary market for sneakers, streetwear, handbags and watches. With a new London office, it has its sights set on global expansion

By Jacob Gallagher
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Corrections & Amplifications

An earlier version of this article incorrectly stated that StockX took 14.5% of the proceeds of any watch sale. It takes 9.9% of any watch sale. (Nov. 26, 2018)

It was Tuesday, Nov. 13, 2018. Though Josh Luber would rather it didn't, in three days, Adidas was planning to re-release the Yeezy Boost 350 V2 "Zebra," a black-and-white striped version of its Kanye-West-designed sneaker. Mr. Luber, co-founder of StockX, an online trading platform for sneakers, streetwear, handbags and watches, hates when companies disrupt his market strategy. "The one thing that breaks the supply-and-demand model and the purity of it in the secondary market is when brands artificially f--- with it when they restock stuff," said Mr. Luber, a scruffy 40-year-old who wore a hoodie throughout our interview. Within a week, his hypothesis was confirmed: Yeezy Zebras were trading for about $270 on StockX, just $50 above retail and well below their peak of $2,000.

Tracking sneaker values has long been Mr. Luber's obsession. In the late 2000s, he was a strategy analyst at IBM in New York who spent his nights trawling eBay for data on how much sought-after shoes were selling for on the secondary market. He compiled those figures into Campless, a sort of Kelly Blue Book for sneaker-resale value. But Mr. Luber wasn't satisfied with eBay. His beefs weren't limited to the bad photos that sellers posted or their habit of selling fakes. What really bugged him was the absence of price standardization. One dealer might peddle a pair of Nike Dunks for $100 and another might list the same shoes for $300. Mr. Luber envisioned a more orderly market, with a New York Stock Exchange-style ticker, that would make the value of a pair of sneakers transparent, in real time. When those Dunks sold for $100, everyone on the market would know about it, thus forcing other sellers to knock their prices down to the going rate.

Around that same time, Dan Gilbert, the founder of mortgage lending company Quicken Loans, noticed that his teenage son was flipping sneakers on eBay for profit. Intrigued, Mr. Gilbert founded a research team on sneaker reselling who discovered what Mr. Luber was working on. Mr. Gilbert bought Campless in 2015 and the pair joined forces (along with COO Greg Schwartz), launching StockX, "the **stock market** of things," based in Mr. Gilbert's hometown of Detroit in February 2016.

Today, StockX employs nearly 550 people worldwide, and has added watches, handbags and streetwear (including widely hyped hoodies, T-shirts and even skateboards from brands like Fear of God, Off-White and Bathing Ape) to its marketplace. Mr. Luber explained that StockX only deals in rarefied products that balance liquidity and scarcity. A J. Crew gingham shirt will never be on StockX because it's too common, nor will a Picasso painting, because it's too rare. A variety of Nike Air Jordans of which only 1,000 pairs may exist is ripe for StockX's marketplace.

Because of these items' scarcity, fakes remain a major issue on the resale market. StockX only accepts new merchandise and employs over 100 authenticators to identify counterfeits. "When we started the business three years ago, we couldn't go to LinkedIn and find sneaker authenticators," said Mr. Luber. "We basically created that career." It takes about 90 days to train authenticators who use scales, durometers (to measure density) and apps to spot fakes. Korre Jefferson, 20, a retail associate in Brooklyn, N.Y., said he liked knowing that someone had validated the authenticity of the sweater and pair of sneakers he purchased on StockX this year: "Sometimes on [resale marketplace] Grailed you might have someone selling something that's clearly fake, so it's nice to have that security with StockX." Over email, Grailed co-founder Jake Metzger explained, "We have a team of experienced moderators combing the site every day looking for suspicious users and listings. Any user caught actively selling fake merchandise is banned from the platform."

When a transaction is "completed" on StockX's website, that's really only the beginning. The seller then sends the shoes to one of StockX's four authentication centers (Detroit, Tempe, Ariz., Moonachie, N.J. and the latest outpost in London), where they are authenticated and shipped out to the buyer. If all goes to plan, the turnaround at the authentication center takes less than a day.

Further mitigating risk for the buyer, StockX acts as a middleman for payment and does not release proceeds of the sale to the seller until the shoes have been verified. Carlos Chavez, 34, an engineer and part-time sneaker seller in Los Angeles, prefers using StockX (or GOAT, a rival app) to eBay, after he experienced a "chargeback," in which PayPal froze his proceeds of a sale for two weeks because the buyer used a counterfeit payment.

"I've sold on both eBay and Grailed but the big reason I prefer StockX for shoes is to not be scammed," said Mr. Chavez, who in September used his funds from flipping sneakers to finance a vacation to Oaxaca with his wife. In a statement, an eBay spokesperson noted that it offers a money-back guarantee if a buyer identifies a counterfeit and that since 1998 it has had the Verified Rights Owner Program (VeRO), which allows brands themselves to more easily report fake items on eBay. Further, in October 2017 eBay launched "eBay Authenticate" which inspects and validates luxury items such as Prada handbags and Rolex watches.

For its part, StockX takes a cut of every sale: 9.5% on sneakers and streetwear, 9.9% on any watch sale and 14.5% for any handbag sale. The vast majority of transactions involve sneakers or streetwear, with items from the highly sought-after brand Supreme comprising about 85% of StockX's clothing sales.

Though expansion across all four categories is important, Mr. Luber stressed that StockX's future success really lies in expanding the sneaker-buying market. His target buyer, he said, is "that guy who bought his last pair of shoes at Foot Locker or Nike.com, and never in a million years would've tried to wade through eBay to buy a pair of Jordans or Yeezys." By Mr. Luber's estimation, the United States sneaker resale market is currently a $2 billion industry, while the primary sneaker market is at $19.6 billion according to the market analysts at NPD Group. If StockX can convert a sliver of those primary market customers, the website's profits could be significant.

The aim is not to turn novices into sneakerheads willing to pay 11 times the retail cost for a pair of Nike's Off-White Air Jordans. Rather Mr. Luber would like to create a destination for sneaker buyers of every ilk. He noted that a lot of items on StockX do sell for less than their sticker price: "Sometimes it's just access. It's a general-release shoe from three years ago, but it's just not available on Nike.com so now you can get it on StockX."

In further attempts to expand its reach, last month StockX opened an office in London and has its sights set on China. There are regional differences here and there—fewer basketball sneakers in Europe, more Nike Air Force Ones in New York—but by and large, users want the same sneakers and clothes whether they're in Brussels or Brooklyn. Often these days, that means Yeezys, Off-White Nikes and Supreme.

For Lucio Nunes, 20, a student in Switzerland who has sold shoes on StockX for two years, using the London office has improved his selling experience. Shipping rates are cheaper, as he no longer has to send his shoes further abroad, and his money clears faster. Still he said, the one downside to StockX is that it has lowered prices throughout the sneaker flipping-world. "The prices are much more visible because everyone looks at StockX and takes it as the market price," said Mr. Nunes. It's harder to cheat the market when the ticker price is just a click away.

Write to Jacob Gallagher at Jacob.Gallagher@wsj.com

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The New York Times

Business; DealBook
‘Sleepwalking’ Markets Woke Up This Year. That’s a Good Thing.

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If 2018 feels **volatile** to stock investors, it may be a reflection of how placid 2017 was.

The **S&P 500** closed up 1.6 percent Monday. It marked the 53rd day the index has risen or fallen 1 percent or more this year. Including Monday’s gain, 17 of those moves have come since the start of October, when concerns about trade, slowing global economic growth and higher interest rates began to batter stocks.

That’s not far from how things usually go with stocks. Since 1928, the **S&P 500** has averaged 62 days of moves that were 1 percent or greater per year, according to data from Howard Silverblatt, senior index analyst for S&P Dow Jones Indices.

But 2018’s moves do represent a significant uptick from 2017, when stocks steadily climbed higher in anticipation of a cut to the corporate tax rate. Last year, there were just eight days in which stocks rose or fell by 1 percent or more. That’s the lowest number in at least 15 years, Mr. Silverblatt said.

Many **stock market** watchers view the return of **volatility** as healthy, claiming it serves as a reminder that investing is risky and markets don’t just march higher. That can help prevent bubbles from forming.

“It only feels abnormal because investors and market pundits anchor their expectations on the recent sleepwalking past,” said Nicholas Colas, the co-founder of DataTrek Research.

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Stocks, Bonds Face Year in Red

By Akane Otani and Michael Wursthorn
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Stocks, bonds and commodities from copper to crude oil to burlap are staging a rare simultaneous retreat, putting global markets on track for one of their worst years on record and deepening a sense of unease on Wall Street.

Data show global stocks and bonds could both finish the year in the red for the first time in at least a quarter-century, according to BlackRock Inc.

Major stock benchmarks in the U.S., Europe, China and South Korea have all slid 10% or more from recent highs. Crude oil's tumble has dragged it well into **bear-market** territory, emerging-market currencies have broadly fallen against the dollar, and bitcoin's price -- which had a meteoric rally last year -- crashed below $5,000 last week for the first time since October 2017.

Havens such as U.S. Treasury bonds and gold rallied this fall as U.S. stocks and industrial commodities staged their fourth-quarter swoon.

But both are still down on a price basis for the year, reflecting solid economic growth and tighter Federal Reserve policy that have begun to push interest rates higher.

All told, 90% of the 70 asset classes tracked by Deutsche Bank are posting negative total returns in dollar terms for the year through mid-November. The previous high was in 1920, when 84% of 37 asset classes were negative. Last year, just 1% of asset classes delivered negative returns.

The broad pullback in markets is leaving fund managers scrambling to find places to park their money. But with global growth showing signs of slowing and monetary policy expected to tighten further, few are eager to place large wagers and risk compounding earlier failures. Indeed, the simultaneous failure of so many investment strategies is being viewed by some as a warning of what could come.

"It's been a difficult year," said Ed Keon, chief investment strategist at asset-management firm QMA, which continues to favor stocks over bonds. "All investors have goals, and none of those can be fulfilled with negative returns."

Few investors believe a recession, particularly in the U.S., is imminent. Yet the strength of the U.S. economy has allowed the Fed to continue stepping further away from the regime of rock-bottom interest rates and bond-buying put in place after the financial crisis. That has, in turn, diminished the premium investors get for taking on risky assets, pressuring a variety of markets.

Hedge-fund manager Pierre Andurand, who earlier in the year bet oil could soon hit $100 a barrel, saw his $1 billion Andurand Commodities Fund suffer its largest monthly loss ever in October. Funds that had built up large stakes in fast-growing technology companies were also stung by sharp reversals. Twenty-six funds dumped their entire stakes in Facebook Inc. in the third quarter, according to a Goldman Sachs Group analysis of 13-F filings, including billionaire Daniel Loeb's Third Point LLC, which offloaded 4 million shares, citing "a very disappointing quarter" for Facebook.

Some contend the market's 2018 stumbles aren't all bad. The declines across stocks, bonds and commodities that had finished last year in the green reflect in part a healthy, albeit painful readjustment of expectations, some investors say.

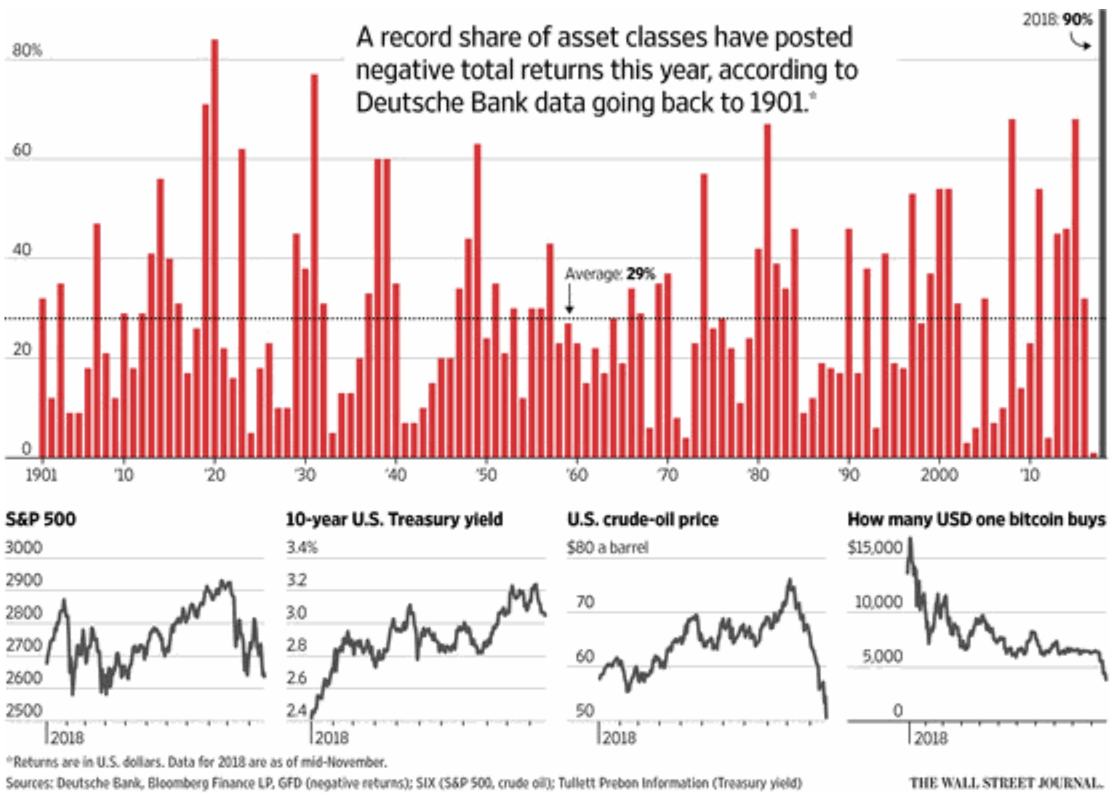
"A year like this -- it shakes out some of the situations that were out of kilter with the rest of the economy," said Jason Pride, chief investment officer for private clients at Glenmede Trust Co.

He, like many others, is betting the **bull market** in U.S. stocks still has longer to run. While U.S. economic data have been bumpier as of late, with the housing and auto sectors in particular showing signs of strain, the overall picture still looks solid, Mr. Pride said.

Still, the broad selling has made conditions difficult for many investors.

"It hasn't felt like a bad year, but retrospectively, it's been a pretty miserable year," said Thomas Poullaouec, head of multiasset solutions for Asia Pacific at T. Rowe Price in Hong Kong.

"2019 isn't looking to be any better either."



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The New York Times

World; Asia Pacific
The Land That Failed to Fail

By Philip P. Pan
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The United States has been the world's leading economy for more than a century, but China is set to surpass it in a matter of years. By some measures, it already has. And yet many Americans have barely begun to think about what this means. That's not entirely a surprise. There's a lot going on out there, especially since the election of President Trump. Sometimes, though, the biggest stories are the ones that sneak up on us when we're distracted. Almost a year in the making, and with collaboration from nearly all corners of the newsroom and correspondents on six continents, this series, China Rules, explores how and why China is changing the world.

In the uncertain years after Mao's death, long before China became an industrial juggernaut, before the Communist Party went on a winning streak that would reshape the world, a group of economics students gathered at a mountain retreat outside Shanghai. There, in the bamboo forests of Moganshan, the young scholars grappled with a pressing question: How could China catch up with the West?

It was the autumn of 1984, and on the other side of the world, Ronald Reagan was promising "morning again in America." China, meanwhile, was just recovering from decades of political and economic turmoil. There had been progress in the countryside, but more than three-quarters of the population still lived in extreme poverty. The state decided where everyone worked, what every factory made and how much everything cost.

The students and researchers attending the Academic Symposium of Middle-Aged and Young Economists wanted to unleash market forces but worried about crashing the economy — and alarming the party bureaucrats and ideologues who controlled it.

Late one night, they reached a consensus: Factories should meet state quotas but sell anything extra they made at any price they chose. It was a clever, quietly radical proposal to undercut the planned economy — and it intrigued a young party official in the room who had no background in economics. "As they were discussing the problem, I didn't say anything at all," recalled Xu Jing'an, now 76 and retired. "I was thinking, how do we make this work?"

Read more about how China became a superpower

The American Dream Is Alive. In China.

How China Made Its Own Internet

How China Took Over Your TV

How China Is Rewriting Its Own Script

The World, Built By China

The Chinese economy has grown so fast for so long now that it is easy to forget how unlikely its metamorphosis into a global powerhouse was, how much of its ascent was improvised and born of desperation. The proposal that Mr. Xu took from the mountain retreat, soon adopted as government policy, was a pivotal early step in this astounding transformation.

China now leads the world in the number of homeowners, internet users, college graduates and, by some counts, billionaires. Extreme poverty has fallen to less than 1 percent. An isolated, impoverished backwater has evolved into the most significant rival to the United States since the fall of the Soviet Union.

An epochal contest is underway. With President Xi Jinping pushing a more assertive agenda overseas and tightening controls at home, the Trump administration has launched a trade war and is gearing up for what could be a new Cold War. Meanwhile, in Beijing the question these days is less how to catch up with the West than how to pull ahead — and how to do so in a new era of American hostility.

The pattern is familiar to historians, a rising power challenging an established one, with a familiar complication: For decades, the United States encouraged and aided China's rise, working with its leaders and its people to build the most important economic partnership in the world, one that has lifted both nations.

During this time, eight American presidents assumed, or hoped, that China would eventually bend to what were considered the established rules of modernization: Prosperity would fuel popular demands for political freedom and bring China into the fold of democratic nations. Or the Chinese economy would falter under the weight of authoritarian rule and bureaucratic rot.

But neither happened. Instead, China's Communist leaders have defied expectations again and again. They embraced capitalism even as they continued to call themselves Marxists. They used repression to maintain power but without stifling entrepreneurship or innovation. Surrounded by foes and rivals, they avoided war, with one brief exception, even as they fanned nationalist sentiment at home. And they presided over 40 years of uninterrupted growth, often with unorthodox policies the textbooks said would fail.

In late September, the People's Republic of China marked a milestone, surpassing the Soviet Union in longevity. Days later, it celebrated a record 69 years of Communist rule. And China may be just hitting its stride — a new superpower with an economy on track to become not just the world's largest but, quite soon, the largest by a wide margin.

The world thought it could change China, and in many ways it has. But China's success has been so spectacular that it has just as often changed the world — and the American understanding of how the world works.

There is no simple explanation for how China's leaders pulled this off. There was foresight and luck, skill and violent resolve, but perhaps most important was the fear — a sense of crisis among Mao's successors that they never shook, and that intensified after the Tiananmen Square massacre and the collapse of the Soviet Union.

Even as they put the disasters of Mao's rule behind them, China's Communists studied and obsessed over the fate of their old ideological allies in Moscow, determined to learn from their mistakes. They drew two lessons: The party needed to embrace "reform" to survive — but "reform" must never include democratization.

China has veered between these competing impulses ever since, between opening up and clamping down, between experimenting with change and resisting it, always pulling back before going too far in either direction for fear of running aground.

Many people said that the party would fail, that this tension between openness and repression would be too much for a nation as big as China to sustain. But it may be precisely why China soared.

Whether it can continue to do so with the United States trying to stop it is another question entirely.

Apparatchiks Into Capitalists

None of the participants at the Moganshan conference could have predicted how China would take off, much less the roles they would play in the boom ahead. They had come of age in an era of tumult, almost entirely isolated from the rest of the world, with little to prepare them for the challenge they faced. To succeed, the party had to both reinvent its ideology and reprogram its best and brightest to carry it out.

Mr. Xu, for example, had graduated with a degree in journalism on the eve of Mao's violent Cultural Revolution, during which millions of people were purged, persecuted and killed. He spent those years at a "cadre school" doing manual labor and teaching Marxism in an army unit. After Mao's death, he was assigned to a state research institute tasked with fixing the economy. His first job was figuring out how to give factories more power to make decisions, a subject he knew almost nothing about. Yet he went on to a distinguished career as an economic policymaker, helping launch China's first **stock market** in Shenzhen.

Among the other young participants in Moganshan were Zhou Xiaochuan, who would later lead China's central bank for 15 years; Lou Jiwei, who ran China's sovereign wealth fund and recently stepped down as finance minister; and an agricultural policy specialist named Wang Qishan, who rose higher than any of them.

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Mr. Wang headed China's first investment bank and helped steer the nation through the Asian financial crisis. As Beijing's mayor, he hosted the 2008 Olympics. Then he oversaw the party's recent high-stakes crackdown on corruption. Now he is China's vice president, second in authority only to Xi Jinping, the party's leader.

The careers of these men from Moganshan highlight an important aspect of China's success: It turned its apparatchiks into capitalists.

Bureaucrats who were once obstacles to growth became engines of growth. Officials devoted to class warfare and price controls began chasing investment and promoting private enterprise. Every day now, the leader of a Chinese district, city or province makes a pitch like the one Yan Chaojun made at a business forum in September.

"Sanya," Mr. Yan said, referring to the southern resort town he leads, "must be a good butler, nanny, driver and cleaning person for businesses, and welcome investment from foreign companies."

It was a remarkable act of reinvention, one that eluded the Soviets. In both China and the Soviet Union, vast Stalinist bureaucracies had smothered economic growth, with officials who wielded unchecked power resisting change that threatened their privileges.

Mikhail Gorbachev, the last leader of the Soviet Union, tried to break the hold of these bureaucrats on the economy by opening up the political system. Decades later, Chinese officials still take classes on why that was a mistake. The party even produced a documentary series on the subject in 2006, distributing it on classified DVDs for officials at all levels to watch.

Afraid to open up politically but unwilling to stand still, the party found another way. It moved gradually and followed the pattern of the compromise at Moganshan, which left the planned economy intact while allowing a market economy to flourish and outgrow it.

Party leaders called this go-slow, experimental approach "crossing the river by feeling the stones" — allowing farmers to grow and sell their own crops, for example, while retaining state ownership of the land; lifting investment restrictions in "special economic zones," while leaving them in place in the rest of the country; or introducing privatization by selling only minority stakes in state firms at first.

"There was resistance," Mr. Xu said. "Satisfying the reformers and the opposition was an art."

American economists were skeptical. Market forces needed to be introduced quickly, they argued; otherwise, the bureaucracy would mobilize to block necessary changes. After a visit to China in 1988, the Nobel laureate Milton Friedman called the party's strategy "an open invitation to corruption and inefficiency."

But China had a strange advantage in battling bureaucratic resistance. The nation's long economic boom followed one of the darkest chapters of its history, the Cultural Revolution, which decimated the party apparatus and left it in shambles. In effect, autocratic excess set the stage for Mao's eventual successor, Deng Xiaoping, to lead the party in a radically more open direction.

That included sending generations of young party officials to the United States and elsewhere to study how modern economies worked. Sometimes they enrolled in universities, sometimes they found jobs, and sometimes they went on brief "study tours." When they returned, the party promoted their careers and arranged for others to learn from them.

At the same time, the party invested in education, expanding access to schools and universities, and all but eliminating illiteracy. Many critics focus on the weaknesses of the Chinese system — the emphasis on tests and memorization, the political constraints, the discrimination against rural students. But mainland China now produces more graduates in science and engineering every year than the United States, Japan, South Korea and Taiwan combined.

In cities like Shanghai, Chinese schoolchildren outperform peers around the world. For many parents, though, even that is not enough. Because of new wealth, a traditional emphasis on education as a path to social mobility and the state's hypercompetitive college entrance exam, most students also enroll in after-school tutoring programs — a market worth $125 billion, according to one study, or as much as half the government's annual military budget.

Another explanation for the party's transformation lies in bureaucratic mechanics. Analysts sometimes say that China embraced economic reform while resisting political reform. But in reality, the party made changes after Mao's death that fell short of free elections or independent courts yet were nevertheless significant.

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The party introduced term limits and mandatory retirement ages, for example, making it easier to flush out incompetent officials. And it revamped the internal report cards it used to evaluate local leaders for promotions and bonuses, focusing them almost exclusively on concrete economic targets.

These seemingly minor adjustments had an outsize impact, injecting a dose of accountability — and competition — into the political system, said Yuen Yuen Ang, a political scientist at the University of Michigan. “China created a unique hybrid,” she said, “an autocracy with democratic characteristics.”

As the economy flourished, officials with a single-minded focus on growth often ignored widespread pollution, violations of labor standards, and tainted food and medical supplies. They were rewarded with soaring tax revenues and opportunities to enrich their friends, their relatives and themselves. A wave of officials abandoned the state and went into business. Over time, the party elite amassed great wealth, which cemented its support for the privatization of much of the economy it once controlled.

The private sector now produces more than 60 percent of the nation’s economic output, employs over 80 percent of workers in cities and towns, and generates 90 percent of new jobs, a senior official said in a speech last year. As often as not, the bureaucrats stay out of the way.

“I basically don’t see them even once a year,” said James Ni, chairman and founder of Mlily, a mattress manufacturer in eastern China. “I’m creating jobs, generating tax revenue. Why should they bother me?”

In recent years, President Xi has sought to assert the party’s authority inside private firms. He has also bolstered state-owned enterprises with subsidies while preserving barriers to foreign competition. And he has endorsed demands that American companies surrender technology in exchange for market access.

In doing so, he is betting that the Chinese state has changed so much that it should play a leading role in the economy — that it can build and run “national champions” capable of outcompeting the United States for control of the high-tech industries of the future. But he has also provoked a backlash in Washington.

‘Opening Up’

In December, the Communist Party will celebrate the 40th anniversary of the “reform and opening up” policies that transformed China. The triumphant propaganda has already begun, with Mr. Xi putting himself front and center, as if taking a victory lap for the nation.

He is the party’s most powerful leader since Deng and the son of a senior official who served Deng, but even as he wraps himself in Deng’s legacy, Mr. Xi has set himself apart in an important way: Deng encouraged the party to seek help and expertise overseas, but Mr. Xi preaches self-reliance and warns of the threats posed by “hostile foreign forces.”

In other words, he appears to have less use for the “opening up” part of Deng’s slogan.

Of the many risks that the party took in its pursuit of growth, perhaps the biggest was letting in foreign investment, trade and ideas. It was an exceptional gamble by a country once as isolated as North Korea is today, and it paid off in an exceptional way: China tapped into a wave of globalization sweeping the world and emerged as the world’s factory. China’s embrace of the internet, within limits, helped make it a leader in technology. And foreign advice helped China reshape its banks, build a legal system and create modern corporations.

The party prefers a different narrative these days, presenting the economic boom as “grown out of the soil of China” and primarily the result of its leadership. But this obscures one of the great ironies of China’s rise — that Beijing’s former enemies helped make it possible.

The United States and Japan, both routinely vilified by party propagandists, became major trading partners and were important sources of aid, investment and expertise. The real game changers, though, were people like Tony Lin, a factory manager who made his first trip to the mainland in 1988.

Mr. Lin was born and raised in Taiwan, the self-governing island where those who lost the Chinese civil war fled after the Communist Revolution. As a schoolboy, he was taught that mainland China was the enemy.

But in the late 1980s, the sneaker factory he managed in central Taiwan was having trouble finding workers, and its biggest customer, Nike, suggested moving some production to China. Mr. Lin set aside his fears and made the trip. What he found surprised him: a large and willing work force, and officials so eager for capital and know-how that they offered the use of a state factory free and a five-year break on taxes.

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Mr. Lin spent the next decade shuttling to and from southern China, spending months at a time there and returning home only for short breaks to see his wife and children. He built and ran five sneaker factories, including Nike's largest Chinese supplier.

"China's policies were tremendous," he recalled. "They were like a sponge absorbing water, money, technology, everything."

Mr. Lin was part of a torrent of investment from ethnic Chinese enclaves in Hong Kong, Taiwan, Singapore and beyond that washed over China — and gave it a leg up on other developing countries. Without this diaspora, some economists argue, the mainland's transformation might have stalled at the level of a country like Indonesia or Mexico.

The timing worked out for China, which opened up just as Taiwan was outgrowing its place in the global manufacturing chain. China benefited from Taiwan's money, but also its managerial experience, technology and relationships with customers around the world. In effect, Taiwan jump-started capitalism in China and plugged it into the global economy.

Before long, the government in Taiwan began to worry about relying so much on its onetime enemy and tried to shift investment elsewhere. But the mainland was too cheap, too close and, with a common language and heritage, too familiar. Mr. Lin tried opening factories in Thailand, Vietnam and Indonesia but always came back to China.

Now Taiwan finds itself increasingly dependent on a much more powerful China, which is pushing ever harder for unification, and the island's future is uncertain.

There are echoes of Taiwan's predicament around the world, where many are having second thoughts about how they rushed to embrace Beijing with trade and investment.

The remorse may be strongest in the United States, which brought China into the World Trade Organization, became China's largest customer and now accuses it of large-scale theft of technology — what one official called "the greatest transfer of wealth in history."

Many in Washington predicted that trade would bring political change. It did, but not in China. "Opening up" ended up strengthening the party's hold on power rather than weakening it. The shock of China's rise as an export colossus, however, was felt in factory towns around the world.

In the United States, economists say at least two million jobs disappeared as a result, many in districts that ended up voting for President Trump.

Selective Repression

Over lunch at a luxurious private club on the 50th floor of an apartment tower in central Beijing, one of China's most successful real estate tycoons explained why he had left his job at a government research center after the crackdown on the student-led democracy movement in Tiananmen Square.

"It was very easy," said Feng Lun, the chairman of Vantone Holdings, which manages a multibillion-dollar portfolio of properties around the world. "One day, I woke up and everyone had run away. So I ran, too."

Until the soldiers opened fire, he said, he had planned to spend his entire career in the civil service. Instead, as the party was pushing out those who had sympathized with the students, he joined the exodus of officials who started over as entrepreneurs in the 1990s.

"At the time, if you held a meeting and told us to go into business, we wouldn't have gone," he recalled. "So this incident, it unintentionally planted seeds in the market economy."

Such has been the seesaw pattern of the party's success.

The pro-democracy movement in 1989 was the closest the party ever came to political liberalization after Mao's death, and the crackdown that followed was the furthest it went in the other direction, toward repression and control. After the massacre, the economy stalled and retrenchment seemed certain. Yet three years later, Deng used a tour of southern China to wrestle the party back to "reform and opening up" once more.

Many who had left the government, like Mr. Feng, suddenly found themselves leading the nation's transformation from the outside, as its first generation of private entrepreneurs.

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Now Mr. Xi is steering the party toward repression again, tightening its grip on society, concentrating power in his own hands and setting himself up to rule for life by abolishing the presidential term limit. Will the party loosen up again, as it did a few years after Tiananmen, or is this a more permanent shift? If it is, what will it mean for the Chinese economic miracle?

The fear is that Mr. Xi is attempting to rewrite the recipe behind China's rise, replacing selective repression with something more severe.

The party has always been vigilant about crushing potential threats — a fledgling opposition party, a popular spiritual movement, even a dissident writer awarded the Nobel Peace Prize. But with some big exceptions, it has also generally retreated from people's personal lives and given them enough freedom to keep the economy growing.

The internet is an example of how it has benefited by striking a balance. The party let the nation go online with barely an inkling of what that might mean, then reaped the economic benefits while controlling the spread of information that could hurt it.

In 2011, it confronted a crisis. After a high-speed train crash in eastern China, more than 30 million messages criticizing the party's handling of the fatal accident flooded social media — faster than censors could screen them.

Panicked officials considered shutting down the most popular service, Weibo, the Chinese equivalent of Twitter, but the authorities were afraid of how the public would respond. In the end, they let Weibo stay open but invested much more in tightening controls and ordered companies to do the same.

The compromise worked. Now, many companies assign hundreds of employees to censorship duties — and China has become a giant on the global internet landscape.

"The cost of censorship is quite limited compared to the great value created by the internet," said Chen Tong, an industry pioneer. "We still get the information we need for economic progress."

A 'New Era'

China is not the only country that has squared the demands of authoritarian rule with the needs of free markets. But it has done so for longer, at greater scale and with more convincing results than any other.

The question now is whether it can sustain this model with the United States as an adversary rather than a partner.

The trade war has only just begun. And it is not just a trade war. American warships and planes are challenging Chinese claims to disputed waters with increasing frequency even as China keeps ratcheting up military spending. And Washington is maneuvering to counter Beijing's growing influence around the world, warning that a Chinese spending spree on global infrastructure comes with strings attached.

The two nations may yet reach some accommodation. But both left and right in America have portrayed China as the champion of an alternative global order, one that embraces autocratic values and undermines fair competition. It is a rare consensus for the United States, which is deeply divided about so much else, including how it has wielded power abroad in recent decades — and how it should do so now.

Mr. Xi, on the other hand, has shown no sign of abandoning what he calls "the great rejuvenation of the Chinese nation." Some in his corner have been itching to take on the United States since the 2008 financial crisis and see the Trump administration's policies as proof of what they have always suspected — that America is determined to keep China down.

At the same time, there is also widespread anxiety over the new acrimony, because the United States has long inspired admiration and envy in China, and because of a gnawing sense that the party's formula for success may be faltering.

Prosperity has brought rising expectations in China; the public wants more than just economic growth. It wants cleaner air, safer food and medicine, better health care and schools, less corruption and greater equality. The party is struggling to deliver, and tweaks to the report cards it uses to measure the performance of officials hardly seem enough.

"The basic problem is, who is growth for?" said Mr. Xu, the retired official who wrote the Moganshan report. "We haven't solved this problem."

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Growth has begun to slow, which may be better for the economy in the long term but could shake public confidence. The party is investing ever more in censorship to control discussion of the challenges the nation faces: widening inequality, dangerous debt levels, an aging population.

Mr. Xi himself has acknowledged that the party must adapt, declaring that the nation is entering a “new era” requiring new methods. But his prescription has largely been a throwback to repression, including vast internment camps targeting Muslim ethnic minorities. “Opening up” has been replaced by an outward push, with huge loans that critics describe as predatory and other efforts to gain influence — or interfere — in the politics of other countries. At home, experimentation is out while political orthodoxy and discipline are in.

In effect, Mr. Xi seems to believe that China has been so successful that the party can return to a more conventional authoritarian posture — and that to survive and surpass the United States it must.

Certainly, the momentum is still with the party. Over the past four decades, economic growth in China has been 10 times faster than in the United States, and it is still more than twice as fast. The party appears to enjoy broad public support, and many around the world are convinced that Mr. Trump’s America is in retreat while China’s moment is just beginning.

Then again, China has a way of defying expectations.

Philip P. Pan is The Times’s Asia Editor and author of “Out of Mao’s Shadow: The Struggle for the Soul of a New China.” He has lived in and reported on China for nearly two decades. Jonathan Ansfield and Keith Bradsher contributed reporting from Beijing. Claire Fu, Zoe Mou and Iris Zhao contributed research from Beijing, and Carolyn Zhang from Shanghai.

China today might be unrecognizable to its Communist founders, but the past still holds a powerful allure. “Red tourism” is a big industry. | Bryan Denton for The New York Times | It is less worried now about catching up to the West. Instead, it wonders how to pull ahead. | Bryan Denton for The New York Times | The country leads the world in the number of internet users and college graduates. It is now working to land a person on the moon. | Bryan Denton for The New York Times | Gone are the days when the state decided where everyone worked and what every factory made. | Bryan Denton for The New York Times | The world thought it would change China, but China’s success has been so spectacular that it has changed the world. | Bryan Denton for The New York Times | Once an impoverished backwater, China is now the most significant rival to the United States. Wuhan, a former river town, has swelled into a metropolis of over 10 million. | Bryan Denton for The New York Times | A businessman stretched before a round of video golf at a hotel he built in Kunming. | Bryan Denton for The New York Times | Rising incomes have turned China into a nation of consumers. | Bryan Denton for The New York Times | In cities like Shanghai, Chinese schoolchildren outperform peers around the world. | Bryan Denton for The New York Times | Western economists doubted that innovation could take place under China’s rigid bureaucracy. They were proved wrong. | Bryan Denton for The New York Times | President Xi Jinping has shown no sign of abandoning what he calls “the great rejuvenation of the Chinese nation.” The observation deck of the Shanghai Tower, the world’s second-tallest building. | Bryan Denton for The New York Times | A Communist Party Congress. Mr. Xi seems to believe that China has been so successful that the party can return to its authoritarian past. | Bryan Denton for The New York Times | China tapped into a wave of globalization and emerged as the world’s factory. Advertising for day laborers in Shenzhen. | Bryan Denton for The New York Times | A fashion design employee at a bridal wear exhibition in Beijing may have taken the opportunity for a break, but no one calls China a sleeping giant anymore. | Bryan Denton for The New York Times | Installing solar panels on a 47-story residential development. China succeeded by leaving a planned economy intact and allowing a market economy to flourish and outgrow it. | Bryan Denton for The New York Times | For decades, China has veered between openness and repression, including of the ethnic Uighur minority. | Bryan Denton for The New York Times | Since the Tiananmen movement, the government has been vigilant about crushing potential threats. Surveillance cameras in Beijing. | Bryan Denton for The New York Times | China’s high-speed rail network, the largest in the world, has changed the way its people move. In Hangzhou, passengers waited outside the railway station. | Bryan Denton for The New York Times | As China opened up, farmers were allowed to grow and sell their own crops, while the state retained ownership of the land. Greenhouses filled with bok choy and yellow cabbage abut investment properties and golf courses. | Under Mao, many educated Chinese were sent to “cadre schools,” where they did manual labor. In May, these real estate agency employees went for a morning run as part of a company team-building exercise. | Bryan Denton for The New York Times

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THE WALL STREET JOURNAL.

Markets
Greece's Eurobank to Acquire Grivalia Properties; Plan Would Lift Capital, Speed Up Bad-Loans Reduction

By Nektaria Stamouli and Vipal Monga
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ATHENS—Greece's Eurobank Ergasias SA said it will acquire real-estate company Grivalia Properties REIC, boosting its capital and paving the way for the creation of a "bad bank" to help deplete its pile of nonperforming loans.

The deal gives Fairfax Financial Holdings Ltd., under Chairman Prem Watsa, a 32.9% stake in the merged entity. The Canada-based insurer currently holds an 18.2% stake in Eurobank, Greece's third-largest lender by assets, and a 51.4% stake in Grivalia.

Eurobank on Monday said it plans to buy Grivalia in an all-share acquisition that values the real-estate firm at €780 million ($884.4 million). That will strengthen its capital base by around €900 million, and the merger will be completed by April, the bank said.

Greece's state bailout fund for banks' share in Eurobank will decrease after the deal to 1.4% from 2.4%. The fund was set up in 2010 to oversee three recapitalizations to the sector completed with the help of state aid and still holds stakes in Greek banks.

Mr. Watsa, one of Canada's best-known investors, has made **bullish** statements on Greece's recovery. Fairfax has been investing money in Greece since 2010, but Mr. Watsa's bets haven't turned out well so far. Fairfax put roughly $1.42 billion into the country and lost almost 30% on the investments by the end of last year, according to the company's annual report.

Greek banks have been under heavy pressure for the past several months amid fears that they can't digest their mountain of bad loans and might need fresh capital. Nonperforming loans and other assets at Greek banks, which have been recapitalized three times during the country's debt crisis, total around half of their entire portfolio.

Still, Mr. Watsa said he expects Greece's economy to grow between 2% and 3% starting next year, and growth could surpass that expectation. "They've been in a depression," he said, of Greece's economy. "On the way up and out, economic growth can be significant."

Fokion Karavias, Eurobank's chief executive, and George Chryssikos, Grivalia's CEO, came up with the acquisition plan and presented it to Fairfax in September, said Mr. Watsa, in an interview. "The opportunity is very significant," he said. "We liked it."

Mr. Karavias will be the combined bank's CEO, while Mr. Chryssikos will become nonexecutive vice chairman of the board. Mr. Watsa said the two will work together on the merged bank's plans, including any expansion.

Eurobank said the acquisition would allow it to cut its ratio of nonperforming loans to 15% of its total loan portfolio by the end of 2019 and reduce it to single digits by 2021, from the current 39%.

After the merger, Eurobank will proceed with plans to create the bad bank, where it would transfer some €7 billion of its bad loans. Those loans are considered the "worst of the total sour loans," an official from the bank said.

It is estimated that unloading these sore loans will reduce the bank's capital by €1.1 billion to €1.4 billion, which will be covered by the capital boost from the merger as well as a strategic investor Eurobank intends to seek for its loan servicer, Eurobank Financial Planning Services SA.

Eurobank said its plans for reducing its pile on nonperforming loans been approved by the banking-supervision unit of the European Central Bank. An ECB official declined to comment.

Greece's central bank and the government's bailout fund for banks are currently working on two separate plans to finance a bad bank. The biggest question is whether the European Commission will deem the plans legal under the bloc's rules limiting state aid for companies.

Eurobank said both plans, if eventually approved, could be combined with its nonperforming-loan reduction plan.

Eurobank stock, which jumped as much 25% during the session, ended the session 4.3% higher, while Grivalia gained 6.3%. Despite the initial jump in the banking sector after the deal was announced, the banking-stocks index dropped 0.1%. Greek bank stocks have lost some 40% in the past three months.

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THE WALL STREET JOURNAL.
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Bookshelf
The Last Monetary Hero

By James Grant
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Keeping At It

By Paul A. Volcker

(PublicAffairs, 286 pages, $28)

In August 1979, when Paul Volcker began what would prove to be an eight-year stint as chairman of the Federal Reserve, inflation was running at a rate of more than 11% a year. Soon Americans would rub their eyes to behold a 16% Treasury-bill yield and an 18% mortgage rate. How these things happened and what put a stop to them furnishes the most striking portions of Mr. Volcker's engaging and -- from the current vantage point of 2.5% inflation and 5% mortgage rates -- seemingly incredible memoir.

Before Jay Powell and Janet Yellen, before Ben Bernanke and Alan Greenspan, there was "tall Paul," the thrifty, 6-foot-7 career civil servant who smoked cheap cigars and fished for trout with a fly rod. His policy, announced in an extraordinary Saturday press conference just two months after he took office, was the polar opposite of the radical "stimulus" imposed after the downfall of Lehman Brothers in 2008. If Mr. Bernanke opened the monetary spigots and pressed down interest rates, Mr. Volcker shut the flood gates and jacked up interest rates. The Bernanke Fed egged on inflation; the Volcker Fed vowed to kill it.

"Keeping At It" is part autobiography, part monetary history, part plea for the restoration of trust in American political institutions. The son of the city manager of Teaneck, N.J., Mr. Volcker extols public service and beats the drum for graduate-level instruction in the nitty-gritty of "public administration" -- including perhaps, a New Yorker may hope, a course in coping with a small snowstorm.

Young Paul, according to the 91-year-old memoirist, was a slacker who nonetheless won admission to Princeton, Harvard and the London School of Economics, finally emerging as a not-quite doctor of economics (lacking only the dissertation). Early in the 1950s, he went to work for the Federal Reserve Bank of New York before taking up duties as chief financial economist at the Chase Manhattan Bank under its superlative president, the aptly named George Champion. In 1962, it was back to the government, soon to serve as undersecretary of the Treasury for monetary affairs in the brand-new Kennedy administration. He made an interim stop as president of the New York Fed in 1975 before his five-alarm summons to Washington to lead the Federal Reserve's fight against the inflation that it itself had instigated, a case of the arsonist grabbing a fire hose. At a salary of $57,500 a year, America's monetary chief made his Washington pied-a-terre in a collegiate-grade one-bedroom apartment (his wife, Barbara, remaining in New York).

The final 100 pages of this concise narrative deal with Mr. Volcker's post-Fed career. Investment-minded readers may wish that there were more on the Fed and rather less on Mr. Volcker's teaching career at Princeton's Woodrow Wilson School or his activities at the Trilateral Commission or at the head of commissions to investigate corruption at the World Bank and United Nations. More in keeping with the dossier of a retired central banker is Mr. Volcker's account of his attempt to improve the quality of accounting standards and to prohibit the too-big-to-fail banks from speculating with the depositors' money. The so-called Volcker rule, the nearly 1,000-page appendage to the Dodd-Frank Wall Street Reform Act of 2010, may or may not be keeping banks on the straight and narrow, but it does provide much lucrative work to the law firms that purport to understand its stupefying detail.

"Good government" and "sound" money are Mr. Volcker's themes, in life as in print. What the author doesn't seem to consider is whether an excess of government might be the unmaking of the kind of money he favors, the kind that serves not only as a medium of exchange but also as a store of value. Drop a gold coin on a counter and it rings -- hence, "sound." No such music emanates from the Federal Reserve's computers, on which Mr. Volcker's successors effortlessly materialized some $4 trillion in digital scrip to quash interest rates, lift the **stock market** and rescue the overextended American financial system in the wake of the 2008 crisis.

Mr. Volcker came of age when the dollar was still defined as a weight of gold (foreign governments could exchange $35 for an ounce) and banks still trembled at memories of the Great Depression. By the 1960s, bankers had stopped trembling. One, indeed, appeared fearless. Walter Wriston, chairman and president of what is today Citigroup, went so far as to deny that any well-managed bank (his own, for instance) needed any capital, a claim that seemed brash when he made it, risible following Citi's near death in 2008-09. In 1971, the dollar was cut loose from its golden anchor -- henceforth, the U.S. could issue as many greenbacks, and run up as much debt, as the traffic would bear. Thus did an age of relatively restrained finance give way to the Age of Inflation and, its evil twin, the Age of Bailouts.

In a sense, Mr. Volcker made a career of trying to replace the conservatism inherent in the gold-based system with the caution imposed by regulation. The former chairman of the Fed doesn't put it quite this way, though he does concede that something is wrong with both high finance and the favor-grubbing politics that infests it. Washington in the early 1960s was a "comfortable, convenient medium-sized city," he writes; its law firms were "entirely local and small, occupying maybe a floor or two in a K Street office building." Today the capital is "a very different, unpleasant, place, dominated by wealth and lobbyists who are joined at the hip with the Congress and too many officials. I stay away."

Humility is one of the charms of both the man and his book (written with Christine Harper, editor in chief of Bloomberg Markets). Though his kindergarten teacher, Miss Palmer, saw in young Paul a worrying lack of self-confidence, the grown man stuck to his anti-inflationary guns, let joblessness mount, bankruptcies climb and brickbats rain down. Refusing to flinch, he made the paper dollar, if not actually sound, then respectable. Tall Paul, indeed.

Mr. Grant is the editor of Grant's Interest Rate Observer. His "Bagehot: The Life and Times of the Greatest Victorian" will be published in July.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

Wait for a Better Bargain on Visa, Mastercard Shares; Excitement over payments plus economic optimism have made shares of the companies too pricey

By Aaron Back
512 words
25 November 2018
10:03 AM
The Wall Street Journal Online
WSJO
English
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Corrections & Amplifications

Visa and Mastercard collect fees on every transaction that runs over their networks, sharing them with card-issuing banks. An earlier version of this article didn't make clear that the fees, typically around 1% to 2%, are shared with card-issuing banks. (Nov. 26, 2018)

No matter what you have bought this past weekend and how you paid for it, chances are that Visa, Mastercard or American Express are taking a slice of the action. These payment networks have become investor darlings, thanks to their market dominance and the continuing world-wide shift away from cash.

Nonetheless, their shares have taken a nasty spill lately, underperforming a weak market in a reminder that even the most attractive investment story works only at the right price.

Outside of China, where they have been cut out of the loop by local regulators and the likes of Alipay and WePay, Visa and Mastercard have around 90% global card network market share, according to MoffettNathanson. They collect fees on every transaction that runs over their networks, sharing those fees with card-issuing banks. These vary widely by transaction type and geography, but in the U.S. are typically around 1% to 2%.

Revenue growth is driven not just by a steady rise in global transactions, but also by the secular trend toward electronic payments. Outside of China, would-be disrupters such as PayPal have largely bowed to these incumbents, routing most consumer purchases over their networks. MoffettNathanson figures Visa and Mastercard can boost revenue at a compound annual rate of 13% and 17%, respectively, over the next three years.

Visa and Mastercard have generated total shareholder returns of 174% and 154%, respectively, over the last five years, compared with 63% for the **S&P 500**. In contrast, American Express, a niche payment network compared with its two rivals that trades more like a credit-card lender, has returned just 36% over this period.

The main risks are that someone disintermediates these networks and pressures fees, or that a global recession drags down spending growth. So far, there is little sign of the former, though it can't be ruled out eventually. However, recent signs of economic weakness outside the U.S. are a more immediate worry for these companies—particularly Mastercard, which is more exposed to Europe.

That could help explain why shares in Visa and Mastercard have fared particularly poorly in the recent market downturn, falling 8.5% and 12.6% since Nov. 8, compared with a 6.2% decline in the **S&P 500**.

But the bigger reason may simply be that shares of these companies have been bid up too high amid general investor euphoria for the payments space. At their peaks in late September, Visa and Mastercard were trading at 28 and 31 times forward earnings, respectively, according to FactSet—far higher than the 10-year average multiple of 21 times for both companies.

Both now fetch around 25 times forward earnings, still a significant premium to their historical averages. Investors should wait to see if economic pessimism lays the ground for an even better sale on their shares.

Aaron Back

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THE WALL STREET JOURNAL.

Markets

No Refuge for Investors as 2018 Rout Sends Stocks, Bonds, Oil Lower; The failure of so many investment strategies is viewed by some as a warning of what could come following years of above-average returns

By Akane Otani and Michael Wursthorn
1,070 words
25 November 2018
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WSJO
English
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Stocks, bonds and commodities from copper to crude oil to burlap are staging a rare simultaneous retreat, putting global markets on track for one of their worst years on record and deepening a sense of unease on Wall Street.

Data show global stocks and bonds could both finish the year in the red for the first time in at least a quarter-century, according to BlackRock Inc.

Major stock benchmarks in the U.S., Europe, China and South Korea have all slid 10% or more from recent highs. Crude oil's tumble has dragged it well into **bear-market** territory, emerging-market currencies have broadly fallen against the dollar, and bitcoin's price—which had a meteoric rally last year—crashed below $5,000 last week for the first time since October 2017.

Havens such as U.S. Treasury bonds and gold rallied this fall as U.S. stocks and industrial commodities staged their fourth-quarter swoon. But both are still down on a price basis for the year, reflecting solid economic growth and tighter Federal Reserve policy that have begun to push interest rates out of their post-financial crisis doldrums.

All told, 90% of the 70 asset classes tracked by Deutsche Bank are posting negative total returns in dollar terms for the year through mid-November. The previous high was in 1920, when 84% of 37 asset classes were negative. Last year, just 1% of asset classes delivered negative returns.

The broad pullback in markets is leaving fund managers scrambling to find places to park their money. But with global growth showing signs of slowing and monetary policy expected to tighten further, few are eager to place large wagers and risk compounding earlier failures to generate expected gains. Indeed, the simultaneous failure of so many investment strategies is being viewed by some as a warning of what could come following years of above-average returns.

"It's been a difficult year," said Ed Keon, chief investment strategist at asset-management firm QMA, which continues to favor stocks over bonds. "All investors have goals, and none of those can be fulfilled with negative returns."

Few investors believe a recession, particularly in the U.S., is imminent. Yet the strength of the U.S. economy has allowed the Fed to continue stepping further away from the regime of rock-bottom interest rates and bond-buying put in place after the financial crisis. That has, in turn, diminished the premium investors get for taking on risky assets, pressuring a variety of markets.

Hedge-fund manager Pierre Andurand, who earlier in the year bet oil could soon hit $100 a barrel, saw his $1 billion Andurand Commodities Fund suffer its largest monthly loss ever in October. Funds that had built up large stakes in fast-growing technology companies were also stung by sharp reversals. Twenty-six funds dumped their entire stakes in Facebook Inc. in the third quarter, according to a Goldman Sachs Group analysis of 13-F filings, including billionaire Daniel Loeb's Third Point LLC, which offloaded 4 million shares, citing "a very disappointing quarter" for Facebook.

Some contend the market's 2018 stumbles aren't all bad. The declines across stocks, bonds and commodities that had finished last year in the green reflect in part a healthy, albeit painful readjustment of expectations, some investors say.

"A year like this—it shakes out some of the situations that were out of kilter with the rest of the economy," said Jason Pride, chief investment officer for private clients at Glenmede Trust Co. After markets around the world soared to records last year, buoyed in part by synchronized global economic growth but also by a surge in investor optimism, "we actually needed to take some air out of the system," Mr. Pride said.

He, like many others, is betting the **bull market** in U.S. stocks still has longer to run before the economic expansion morphs into a downturn. While U.S. economic data have been bumpier as of late, with the housing and auto sectors in particular showing signs of strain, the overall picture still looks solid, Mr. Pride said.

Still, even those betting on continued—if more modest—gains in stocks say they have had to take on a more cautious approach as the **bull market** has aged.

Last year, Glenmede began paring its exposure to some of the fast-growing technology stocks that had run up sharply, betting their outperformance would fade.

"The feedback loop felt horrible—absolutely horrible," Mr. Pride said, recalling presentations he gave where some clients questioned why the firm had pulled out of stocks that had rallied more than 50% in the past year. That decision has seemed easier to justify more recently, with many former big hitters such as Facebook, Apple Inc. and Netflix Inc. tumbling, he said.

Other firms have told clients to stay invested in stocks but take on a more defensive stance.

UBS Group AG's wealth-management arm is urging its wealthy clients to hold on to bets on the **S&P 500**, but with some caveats, using instruments like put options—which typically allow the buyer to profit when asset prices fall—to protect against further pullbacks.

"We're cautiously optimistic," said Jerry Lucas, a senior strategist at UBS Global Wealth Management's chief investment office. "It's worthwhile to be a little more conservative and have some hedges on to reduce your risk."

Still, the broad selling has made conditions difficult for many investors.

"It hasn't felt like a bad year, but retrospectively, it's been a pretty miserable year," said Thomas Poullaouec, head of multiasset solutions for Asia Pacific at T. Rowe Price in Hong Kong. "2019 isn't looking to be any better either."

Steve Russolillo and Mike Bird contributed to this article.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets
Relax, Falling Oil Prices Are Mostly a Good Thing; The negative economic impact of falling oil prices is less significant than it was four years ago while the positive aspects are just as strong

By Justin Lahart
483 words
25 November 2018
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The Wall Street Journal Online
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Is the big drop in **oil prices** going to be good or bad for the U.S. economy? Probably good, but getting to that answer isn't as simple as it used to be.

It used to be straightforward: Falling **oil prices** were good. That is because the U.S. consumed far more petroleum than it produced. When prices fell, the U.S. spent less on imported energy, leaving consumers with more money to spend on other, mostly homegrown goods and services.

The shale revolution, which dramatically increased the amount of oil the U.S. produced, changed that. The drop that brought crude **oil prices** from more than $100 a barrel in mid-2014 to below $30 in early 2016 cast a pall over the economy. This came as a surprise to many economists and investors, since the country still imported more oil and other petroleum products than it exported (something that continues to be true).

But there was considerable investment associated with the shale boom. When **oil prices** fell, that investment dried up, sapping overall U.S. capital spending. And while the U.S. overall continued to generate solid job growth, places like Texas's shale-producing region and North Dakota experienced significant job losses. That weighed on consumer spending. People who have lost—or are worried about losing—their jobs curtail their spending by a lot more than people saving a bit of money at the gas pump increase theirs.

Oil prices are falling again and, while the slide so far isn't as severe as in the 2014 to 2016 rout, its intensity has been remarkable. In New York trading Friday, oil settled at $50.42 a barrel, down from an early October high of $76.41.

But even if prices keep dropping, it probably won't be as disruptive as before.

That is because the shale production is far less speculative, and far more efficient, than it was a few years ago. Even though the U.S. is pumping much more crude now than when production peaked in 2015, the oil industry accounts for a smaller share of overall capital spending. It also employs fewer people. As of last month, there were 153,200 oil and gas extraction jobs in the country, according to the Labor Department, which compares with 200,700 jobs four years earlier.

Will the drop in **oil prices** cool capital spending and lead some people to tighten their belts? Sure—but not by as much as it did during the last big price drop, and probably not by enough to offset the positives of low gasoline prices.

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WSJ PRO BANKRUPTCY

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Helicopter-Leasing Company Waypoint Files for Bankruptcy; Company says it expects to emerge from bankruptcy protection under new ownership

By Patrick Fitzgerald
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English
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Waypoint Leasing Holdings Ltd., a helicopter-leasing business focused on serving offshore oil drillers and backed by Michael Dell and George Soros, filed for bankruptcy protection on Sunday and put its business on the auction block.

Hooman Yazhari, Waypoint's chief executive, said the bankruptcy is "the next step" in the company's bid to restructure its balance sheet. Waypoint has been in talks with lenders for months and after putting itself up for sale has received bids from "numerous parties," according to a statement.

The company, which will continue operating during the chapter 11 case, says it expects to emerge from bankruptcy protection under new ownership.

Based in Limerick, Ireland, Waypoint owns more than 160 aircraft, and the company's investors include MSD Partners LP, an affiliate of Michael Dell's family investment firm MSD Capital; George Soros's Quantum Strategic Partners and private-equity firm Cartesian Capital Group, LLC.

A Waypoint representative wasn't immediately available for comment.

The company rents its helicopters to businesses that ferry workers and supplies for offshore oil drillers. It listed assets and debts each of $1 billion to $10 billion in a filing with the U.S. Bankruptcy Court in New York.

Waypoint was able to weather the deep downturn in **oil prices** that began in 2014, which saw benchmark U.S. crude prices hit a 15-year low. **Oil prices** eventually rebounded, but with U.S. crude again falling to around $50 a barrel, energy companies are cutting back on production, which could hurt demand for Waypoint's helicopters.

The downturn that began in 2014 forced one of Waypoint's biggest customers, CHC Group, to file for bankruptcy protection two years later. The helicopter operator emerged from chapter 11 protection under the control of its bondholders in 2017.

Mr. Yazhari, CHC's former general counsel, replaced Waypoint founder Ed Washecka as Waypoint's chief executive earlier this year.

The company's bankruptcy advisers include law firm Weil Gotshal & Manges LLP, investment bank Houlihan Lokey Capital, financial adviser FTI Consulting and corporate adviser Accenture LLP.

The case number is 18-13648

Write to Patrick Fitzgerald at patrick.fitzgerald@wsj.com

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![The New York Times]

with interest
Business
The Week in Business: Stock Market Falters, and the U.S.-China Trade War Brings Drama to the G-20

By Charlotte Cowles
1,009 words
25 November 2018
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NYTimes.com Feed
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Hello! Welcome to With Interest. For those of you joining us for the first time, this Sunday newsletter contains the most important business and tech news, highlighting the essentials from the past week and what's in store for the next. Tell friends they can sign up here.

Let's get started. Cyber Week is upon us, and if you want to be part of a national trend, don't even leave your kitchen: For the first time ever, Americans are expected to buy more holiday goods via mobile device than computer or (heaven forbid) leaving the house for a brick-and-mortar store. So take a bite of leftovers, flex your thumbs and help break some spending records — sales in the United States are predicted to top $1 trillion this year. Just make sure you've got a napkin handy. Your screen doesn't want any cranberry sauce.

What's Up?

The economy may be soaring, but the **stock market** is getting airsick. A brutal midweek sell-off added up to a collective $800 billion in value lost by the tech giants Facebook, Amazon, Apple, Netflix and Google's parent, Alphabet. (The **S&P 500** was down 3.8 percent, one of its worst performances ever during a Thanksgiving week.) Analysts attribute the turbulence to President Trump's global trade conflicts, a tightening labor market and rising interest rates, all of which threaten corporate profits. It may also be a sign that we're headed for an inevitable slowdown in growth, ending one of the longest bull markets in history.

In a written statement packed with exclamation points, Mr. Trump pledged his support for Saudi Arabia despite the C.I.A.'s conclusion that the country's de facto ruler ordered the grisly murder of an American resident, the journalist Jamal Khashoggi. Mr. Trump cited United States-Saudi economic interests, including a $110 billion arms deal and $340 billion in other promised investments, although those numbers were quickly contested by experts. Mr. Trump also thanked Saudi Arabia for keeping a lid on **oil prices** and Iranian power. Critics say the president is emboldening a dangerous regime, while others say his strategy — while morally repugnant — is a pragmatic one.

Carlos Ghosn started the week as chairman of Nissan, chief executive of Renault and chairman of the board at Mitsubishi. But since his arrest in Tokyo on Monday for financial misconduct — over allegations that he underreported his pay package by almost half — Mr. Ghosn has been removed as chairman of Nissan and will probably remain in custody for a while. A larger-than-life figure (he rented out Versailles for his 2016 wedding), Mr. Ghosn is known in France as "le cost killer." The alliance he engineered between Nissan and Renault effectively created the world's largest carmaker, and his downfall leaves a gaping vacuum in an industry that's already faltering under trade tensions and shifting consumer demands.

What's Next?

Mr. Trump will face off — er, gather — this week with world leaders at the annual conference of the Group of 20 nations. On the docket: a meeting with President Vladimir Putin of Russia, with whom he recently crossed paths (and exchanged public smiles) in Paris, as well as talks with President Xi Jinping of China, who will presumably not be smiling. The prospects for a trade truce between the United States and China do not look good, and other nations are feeling heat to pick sides. At the recent Pacific Rim trade summit, officials from the two countries argued so bitterly that no resolution could be reached — a first in the conference's three-decade history.

The Federal Reserve Board on Wednesday will publish its first-ever Financial Stability Report, a new assessment of the country's potential "vulnerabilities" based on financial data like bank loans and household borrowing. Announced earlier this month, the report will be issued twice a year from now on. The central bank is also mulling changes to the annual stress tests it has imposed on the country's biggest banks since the 2008 financial crisis. Separately, the Fed is expected to raise interest rates again in December, despite pressure from Mr. Trump.

On Dec. 1, Andrés Manuel López Obrador will be inaugurated as president of Mexico, succeeding Enrique Peña Nieto. Known as AMLO, the incoming leader is Mexico's first leftist president in decades, and has already become the object of widespread denunciation for inviting Nicolas Maduro, the embattled president of Venezuela, to his swearing-in. (Vice President Mike Pence will also attend.) Mr. López Obrador has embraced Mr. Trump's trade deal with Canada and Mexico so that he can focus on his own country's flagging economy, but the two presidents may be headed for a showdown over immigration, a topic on which they do not agree, to put it mildly.

What Else?

David's Bridal, the country's largest wedding retailer, has filed for bankruptcy protection — but don't worry! Brides will still get their dresses. Also, Taylor Swift signed withUniversal Music Group's Republic Records for an undisclosed amount after parting with her previous label of 12 years, Big Machine Records. And now, another reason to envy French women: A new law takes aim at the gender pay gap in France by requiring companies to report how much they pay female and male employees. If there's a discrepancy, the company has three years to fix it, or else they'll face a fine of 1 percent of their total payroll.

22 million: The number of Chinese citizens who could be "punished" by Beijing's new rating system, which will track and score the city's population based on their "social credit" by 2021. Those who exhibit "pro-social behavior," like volunteering, will be rewarded with better medical and transportation services, while criminals and government dissenters will be subjected to higher surveillance.

Giacomo Bagnara

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THE WALL STREET JOURNAL.

Markets

The Standout Markets in a Tough Year; Why some indexes are rising as others are pressured by sliding commodities prices and fears of slowing economic growth

By Akane Otani
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The long **bull market** hit speed bumps this year as sliding commodities prices, fears of slowing economic growth and the global trade fight chipped away at investors' optimism. Still, some stock markets—including Brazil's, Abu Dhabi's and Norway's—have managed to buck the trend. Here are some reasons why.

OUTPERFORMERS:

Brazil Bovespa:

Stocks surged to a record after Brazil elected ex-army captain Jair Bolsonaro as the country's president. Investors are betting on Mr. Bolsonaro's promises to stamp out corruption and overhaul the country's pension system, although some are wary of his rhetoric.

Abu Dhabi:

Although it has given up some of its gains recently as **oil prices** have slumped, Abu Dhabi's **stock market** remains among the best performers in the world. That is thanks to a more-than 40% rally in index-heavyweight First Abu Dhabi Bank and still-hefty gains across its energy sector.

Norway:

Soaring shares of salmon farmers and distributors have given the country's benchmark index a boost. Among the stocks that have rallied: Scottish Salmon Company and SalMar ASA, which have surged 103% and 80% respectively in 2018. A commodities boom earlier in the year also benefited the energy industry.

OTHER INDEXES:

S&P 500:

U.S. stocks have struggled to break out of an autumn rut as investors have grown increasingly skittish of the mega-cap technology shares that drove much of the **bull market**'s gains in 2017.

Shanghai Composite:

Worries about the U.S. and China's prolonged trade fight, as well as signs of economic growth fading, have taken the index down 22% this year.

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THE WALL STREET JOURNAL.
U.S. EDITION

EXCHANGE --- Streetwise: How Worried Should You Be About a Selloff?

By James Mackintosh
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The Wall Street Journal
J
B1
English
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A rat-tat-tat of bad news hit stocks over the past two months, Wall Street strategists are obsessing over the odds of recession, and bears outnumber bulls in one popular investor survey. Was it merely bad luck that so many bad things happened all at once? Or is something wrong deep in the financial and economic system, that could tip the sharp selloff since late September into a **bear market**?

The answer may be both. Bad things happen all the time, but when there's nothing deep to worry about, they have little wider effect. Only when there are broader problems do idiosyncratic events build into broader trouble. This selloff may blow over, but conditions are getting ripe for a bigger market disruption soon.

"Everyone always wants to know which match starts the forest fire," says Matt King, credit strategist at Citigroup. "But the match that starts the fire is identical to all the other matches being struck all the time. What you need to do is work out if the forest is vulnerable."

On the face of it, the U.S. market should be fine. Earnings have soared. The economy has been doing great, and economists' forecasts for this year and next year have been upgraded slightly since the start of last month, according to daily predictions collected by Consensus Economics. Valuations are still high by historical standards, but the forward price-earnings ratio for the **S&P 500** -- a widely used valuation tool -- is back down to where it stood in the summer of 2014, after reaching a 16-year high in January.

Yet there's no denying the bad news hammering particular companies and sectors:

-- Microchip shares were crushed by the trade battle with China. The collapse of the bitcoin bubble added to the pain for chip makers who supply cryptocurrency "miners" with specialized gear.

-- Oil companies have been hit hard by the slump in **oil prices** as supply was strong due to White House waivers for more Iranian oil sales than expected. President Trump's friendly relations with Saudi Arabia could keep taps flowing, too. Meanwhile, demand will also be lower if the global economy slows more than was thought.

-- Apple and its suppliers have been hurt by lower-than-expected orders for new iPhones.

-- General Electric is in deep trouble, and investors fear the heavily indebted American manufacturer may be downgraded to junk-bond status.

-- China's economy was struggling with a slowdown in lending even before the extra hit from U.S. tariffs.

-- On top of that, the economies of Germany and Japan both shrank in the third quarter, although economists put this down to one-off effects of new auto emissions rules in Europe and natural disasters in Japan.

Each hit hurts the overall market, justifying a small drop. Taken together, they could justify a big fall, as we've seen.

The big threat, and thus the risk of a broader downturn, comes if markets are proving sensitive to these quirky events because they detect deeper troubles, perhaps even a common cause, as the economy approaches the end of its cycle and interest rates rise.

There was a common cause to the tech-stock mayhem. But stocks with strong momentum have a tendency to get carried away -- as the FANGs did, and how -- then correct hard, so their fall tells us little about the future. True, in an efficient market, higher rates and bond yields ought to hurt fast-growing stocks because their value depends on future earnings; but investors had ignored rising yields for months, so the Fed is more a background worry than the trigger for the tech fall.

For the broader market, the Fed is a worry for two reasons. First, because companies have been borrowing heavily, providing dry tinder that could be ignited by a spark from policy makers. Second, because Fed rate increases make cash a much more attractive alternative to stocks than it was, with the best dollar certificates of deposit now offering almost 3% with a two-year lockup, up from next to nothing a couple of years ago.

Higher rates wouldn't matter if global economic and earnings outlooks had improved too. That was the case last year. Not anymore. Economic data in a weighted average of the 10 largest industrialized countries has come in below forecasts recently, according to Citigroup's surprise index. U.S. companies rely on foreign sales for almost half their revenue, so a global slowdown hurts.

This all has investors moving into a new regime of lower returns, because economic and earnings growth and the housing market are all slowing while corporate leverage is high.

"It doesn't necessarily mean we move into a **bear market**," says Pascal Blanque, chief investment officer of Paris-based fund manager Amundi. "To get a **bear market**/crisis you have got to have negative debt dynamics, you've got to have deleveraging, typically involving real estate. It's difficult to see today that there are obvious components flashing red in the global system."

Stocks have caught the whiff of a slowdown. The most economically sensitive sectors of industrials and consumer discretionary have fallen almost as much as technology since the start of October, with energy hit hard. Meanwhile, those with steady revenues -- led by utilities, consumer staples and big pharmaceuticals -- have been fine.

Investors who know the economic cycle is long in the tooth should be more sensitive to idiosyncratic bad news, as they watch for hints that the good times are over.

An alternative explanation is that investors were cocky. Tech stocks were one sign, but gauges of investor sentiment from surveys such as the weekly American Association of Individual Investors and from positioning in stock options also showed strong faith in the **bull market**. One note of caution: Sentiment has reversed hard this week, but investors are not yet as gloomy as after the 12% fall in the **S&P 500** in the summer of 2015.

Despite the rat-tat-tat of negativity, I'm inclined toward the positive in the short run. The froth has blown off tech stocks, the U.S. economy has yet to show any signs of trouble, and there has been a correction in the S&P.

But over the next couple of years, the forest is vulnerable to flying sparks from the trade war, while the Fed is dropping lighted matches into a leveraged economy every few months. One of these small fires will eventually spread.

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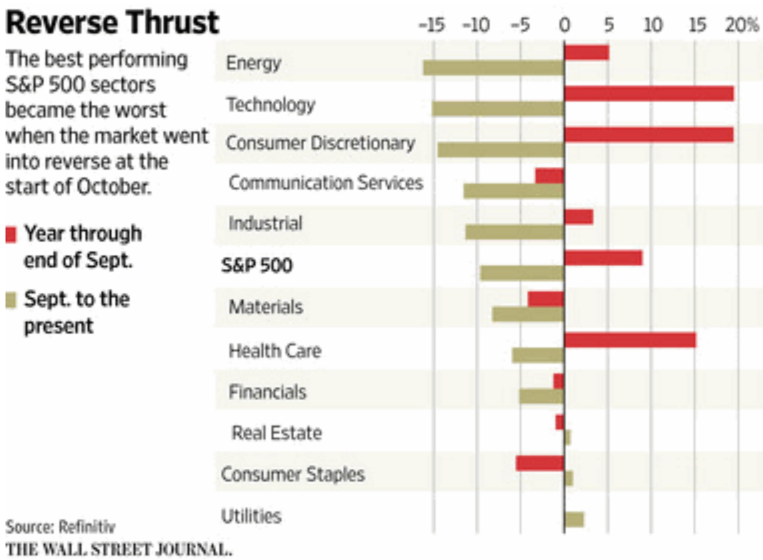

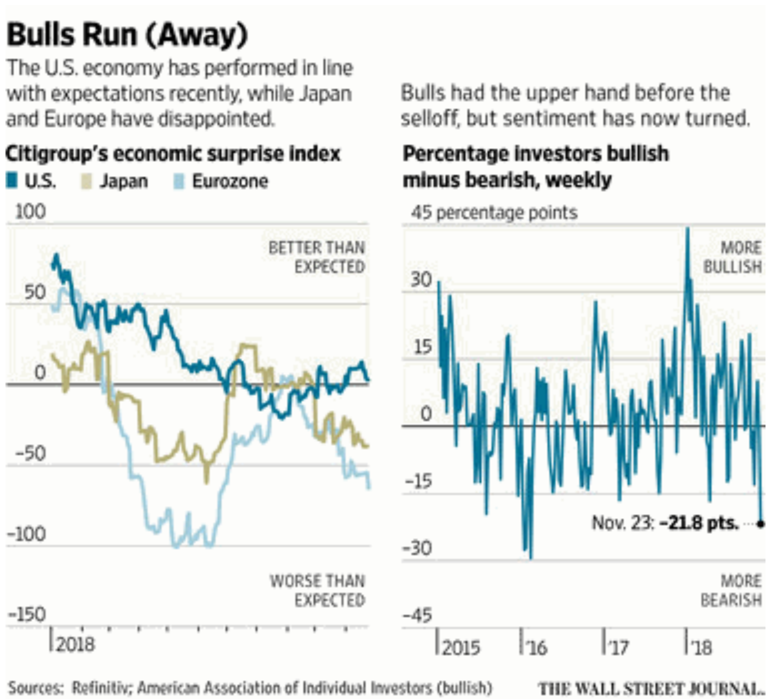

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International New York Times

technology
5 Reasons Cryptocurrency Prices Are Plunging Again

By NATHANIEL POPPER
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© 2018 The New York Times Company. All Rights Reserved.

SAN FRANCISCO — The news on Wall Street this week has been bleak: sharp declines, fears of a **bear market** and high-flying technology stocks that suddenly took a tumble.

Traditional stock investors may be taking a beating, but they should be glad they didn't put their money in cryptocurrencies. As of Wednesday, the price of a Bitcoin had fallen about 25 percent in a week and was down more than 75 percent from its peak in December.

Other digital tokens have fallen even more sharply in value.

The latest declines are occurring almost a year after cryptocurrency markets, fueled by a rush of new, wealthy investors, went into overdrive. There are several factors behind the collapse in prices, with many of them the flip side of what drew people to cryptocurrencies in the first place.

Relying on unregulated infrastructure and exchanges is risky.

Most cryptocurrency trading happens outside the United States on exchanges with little or no regulatory oversight. That allowed investors to pile in with abandon, but the inherent dangers have long been clear.

This year, researchers at the University of Texas published evidence suggesting that one of the largest exchanges, Bitfinex, had helped create a proprietary cryptocurrency, Tether, that was used to artificially pump up the price of Bitcoin and other digital tokens.

Bloomberg reported on Tuesday that the Justice Department was conducting a criminal investigation of price manipulation using Tether, one of many issues related to Tether that are scaring investors away. Every unit of Tether is supposed to be backed by a dollar in a bank, but managers of Bitfinex and Tether have struggled to show that they even have bank accounts. Many traders have been selling Tether at a loss just so they can take their money out.

The activities of another large exchange, OKEx, have also led traders to question whether they can trust the institutions at the center of the cryptocurrency industry.

OKEx, which began in China, altered some trading rules without advance notice, according to a large hedge fund, Amber AI, which published a post on Medium about the changes. AmberAI said customers appeared to have lost millions of dollars because of the changes. OKEx, without acknowledging the losses, apologized to customers for some of the changes, which it said had been made to cope with chaotic trading.

Regulators are cracking down.

Much of the excitement surrounding the cryptocurrency markets last year was stirred up by companies that raised money selling custom cryptocurrencies in so-called initial coin offerings, which let start-ups raise money without going through regulators.

At the time, lawyers warned that these offerings would probably run afoul of securities rules. The Securities and Exchange Commission recently stepped up punishment of companies that violated securities law with their offerings. In the most chilling case, the commission punished two companies on Friday for their initial coin offerings, forcing them to return money to investors while saying the cases would be templates for future actions.

Cryptocurrencies are managed by communities of developers. That can get messy.

The Bitcoin network was created with so-called open-source software released to the world in January 2009. For many years, members of the Bitcoin community worked together to improve the software. That collegiality has faded. Last year, after a bitter fight, one group released a new version of Bitcoin software with slightly different rules that gave rise to a new cryptocurrency, Bitcoin Cash.

The people backing Bitcoin Cash subsequently had their own disagreements. This week, they splintered into two groups. In the software world, it's known as a fork: Bitcoin Cash was split into two new cryptocurrencies, Bitcoin ABC and Bitcoin SV.

The new forks have not altered the original Bitcoin. But they have created chaos in the trading markets, as exchanges struggle to define which coin customers are trading. The battles have also raised questions about one of the fundamental attractions of cryptocurrencies: their apparent scarcity.

The creator of Bitcoin said only 21 million Bitcoins would ever be created. But how scarce do those 21 million Bitcoins seem if there are also 21 million tokens of each new copycat?

As Naeem Aslam, the chief market analyst at the trading firm ThinkMarkets, put it in a note to clients this week: “Forking has become so common that it puts at risk the notion of limited supply altogether.”

Cryptocurrencies were going to solve all kinds of real-world problems. But the real world hasn't had much use for cryptocurrencies.

Bitcoin was supposed to make it easier to send payments instantly over international borders. Ethereum, the second-largest cryptocurrency network until recently, was going to create a kind of global super computer. Thousands of other tokens were also designed to be used for high-minded purposes. But so far, about the only thing the tokens have been used for is speculative trading.

Developers have complained that Bitcoin, Ethereum and most other networks are hobbled by technical problems that make their tokens hard to use in real-world transactions. Those working on the cryptocurrencies have promised solutions, but they have been slow to produce them.

Governments could get into cryptocurrencies, and do a better job of managing them.

One hopeful sign for digital tokens came from Christine Lagarde, the leader of the International Monetary Fund. In a speech last week, she made a case for why countries and central banks might want to issue digital currencies similar to Bitcoin. (Some countries are already experimenting with this.)

But Ms. Lagarde added a note of caution. While saying cryptocurrencies could improve on current payment networks, she also said governments could manage them more effectively and eliminate the issues of trust that have hobbled them. The remarks could have a chilling effect on existing, nongovernmental tokens.

Follow Nathaniel Popper on Twitter: @nathanielpopper.

PHOTO: A Bitcoin center in Quebec. The price of the cryptocurrency is down more than 75 percent from its December peak. (PHOTOGRAPH BY LARS HAGBERG/AGENCE FRANCE-PRESSE — GETTY IMAGES)

* Bitcoin's Price Was Artificially Inflated, Fueling Skyrocketing Value, Researchers Say

* Worries Grow That the Price of Bitcoin Is Being Propped Up

* Bitcoin Falls Below $10,000 as Virtual Currency Bubble Deflates

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THE WALL STREET JOURNAL.

Oil Markets
Markets

Frackers Fret as Trump Tweets for Lower Oil Prices; President's call for prices to go lower concerns some in U.S. oil patch, who worry companies would have to curb drilling

By Christopher M. Matthews and Bradley Olson
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English
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President Trump's comments calling for **oil prices** to keep falling have some American shale drillers seething.

The U.S. is pumping all-time-record levels of oil. But a sharp decline in prices in recent months, continuing Friday with a steep drop that took prices down to nearly $50 a barrel, has begun to threaten shale companies' profitability and may force some to dial back on growth next year.

In tweets and remarks this week, Mr. Trump has expressed hope that prices will keep falling. "**Oil prices** getting lower. Great! Like a big Tax Cut for America and the World. Enjoy! $54, was just $82. Thank you to Saudi Arabia, but let's go lower!" he tweeted Wednesday. Mr. Trump drew sharp political blowbacklast week for comments in support of Saudi Arabia after U.S. intelligence officials concluded the Saudi crown prince had ordered the killing of a journalist.

The remarks have frustrated some in America's oil patch, who say further drops in prices could take a toll on them and hurt the Trump administration's stated goal of "energy dominance."

"The American oil and gas producer has shown that our economy doesn't have to rely as much on foreign sources of oil anymore, but the country needs to realize that higher prices are a part of that equation," said Kirk Edwards, president of MacLondon Energy, an independent producer in West Texas. "We need a $60 or $70 crude price in order for the business to stay healthy."

Few industry participants were willing to discuss the president's remarks publicly, but people at several of the largest U.S. shale producers privately expressed unhappiness. One such executive said Mr. Trump's tweet Wednesday had frustrated company leaders.

The White House didn't immediately respond to requests for comment.

Shale companies have begun laying out their capital plans for 2019 and, so far, haven't broadly curtailed spending. Continental Resources Inc., a large North Dakota producer, has said it would increase production in 2019, but Chief Executive Harold Hamm warned lower prices can always impact capital expenditure.

"You have to weather the storm through the downturn and you hope it will be short-lived," said Mr. Hamm, who has advised Mr. Trump on energy issues.

While some shale producers are upset about Mr. Trump's recent comments, many still broadly support his agenda, which has included rolling back regulations unpopular with many companies.

"Clearly this administration has done so much good for the domestic economy and for the oil-and-gas industry," said Ben "Bud" Brigham, who made hundreds of millions of dollars as an oilman in areas including Texas, New Mexico and North Dakota before starting Atlas Sand Co. LLC, which supplies companies with one of the key materials used in fracking. "But I would encourage the president to cheer on domestic producers to increase their production and not foreign countries."

While lower **oil prices** benefit most American consumers, they can harm economies in states with large oil and gas industries. If prices fall much lower, drilling and fracking would likely decline, causing layoffs in the country's oil basins, said Mr. Brigham. During the last oil downturn earlier this decade, the industry laid off more than 180,000 U.S. workers.

U.S. oil and gas producers have dramatically increased spending over the last two years, spurred by higher **oil prices** and technological advances that allowed them to produce oil more economically. Frackers spent more than $72 billion in 2017 and are on pace to spend around $100 billion in 2018, according to energy consultant IHS Markit.

But rising stockpiles of U.S. crude oil, coupled with Mr. Trump's comments thanking Saudi Arabia for lowering prices—by producing more in advance of U.S. sanctions on Iran—have pressured U.S. and global price benchmarks, according to oil and gas analytics firm Drillinginfo.

The pullback comes months after the U.S. surpassed Saudi Arabia and Russia as the world's largest crude-oil producer and ahead of a potential milestone: The U.S. could soon export more crude oil and petroleum products than it imports. That threshold has already been crossed for natural gas, and some analysts believe it could happen for oil and fuels such as gasoline as soon as next year.

Shale producers largely accept the president's earlier advocacy, intended to prevent damaging spikes in crude prices, but they are very concerned about his recent remarks, said Robert McNally, president of Rapidan Energy Group, an analysis firm that advises oil-and-gas companies on public policy and markets.

"The president is shifting from protecting the ceiling to delivering a tax cut via indefinitely lower **oil prices**, and this poses a real risk to shale finance and economics," said Mr. McNally, who has discussed the issue with energy executives. "Memories of February 2016, when prices went below $30 a barrel, are fresh in the shale sector and among investors."

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THE WALL STREET JOURNAL.

Politics

Trump Faults Treasury Secretary Over Fed Pick; President publicly signals support for Steven Mnuchin but has expressed unhappiness to advisers in recent weeks

By Peter Nicholas, Nick Timiraos and Bob Davis
1,248 words
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President Trump has expressed dissatisfaction with Treasury Secretary Steven Mnuchin, blaming him for the appointment of a Federal Reserve chairman who has been raising interest rates, a move Mr. Trump worries will jeopardize economic gains as his 2020 re-election campaign approaches, people familiar with the matter said.

In conversations with advisers in recent weeks, Mr. Trump also has voiced displeasure with Mr. Mnuchin over the turbulent **stock market** and the Treasury chief's skepticism toward the sort of punitive trade actions the White House has taken against China, the people said.

Looking back to his appointment of Mr. Mnuchin in 2016, Mr. Trump has mused to advisers about whether he should have tapped someone else, mentioning JPMorgan Chase & Co. Chief Executive James Dimon as an alternative. A spokesman for Mr. Dimon declined to comment.

Aides fall in and out of favor in a White House known for high turnover, and Mr. Trump's pique doesn't necessarily mean Mr. Mnuchin is in danger of losing influence or being replaced. As Mr. Trump prepares for a meeting with Chinese leader Xi Jinping at the Group of 20 summit on Nov. 30, he has relied on Mr. Mnuchin in sounding out Beijing on a trade deal.

White House spokeswoman Lindsay Walters said Mr. Trump appreciates the secretary's work and that he "has been effective in carrying out the president's agenda."

After this article was published online, Mr. Trump tweeted that he was "extremely happy and proud" of Mr. Mnuchin's performance. He attributed reports to the contrary to "phony sources or jealous people" and incorrectly implied The Wall Street Journal didn't seek his comment for the article. "They never like to ask me for a quote b/c it would kill their story," he said.

The Journal made repeated requests for comment this week, including a request for comment from Mr. Trump. The Journal sent the White House a detailed list of questions Friday morning. After initially declining comment, the White House issued statements Friday afternoon, followed by the president's tweet.

Mr. Trump's private complaints have sparked concerns among some of Mr. Mnuchin's supporters that he might be tracing the same downward path as some of the other ex-cabinet members who have run afoul of the president, such as former Secretary of State Rex Tillerson and Attorney General Jeff Sessions.

In a conversation with someone who praised Mr. Mnuchin's performance, Mr. Trump mentioned the **volatile stock market**. Aides have said he views the market as a barometer of his White House performance every bit as important as his poll ratings. "If he's so good, why is this happening?" Mr. Trump said of Mr. Mnuchin, according to a person familiar with the matter.

Working in Mr. Mnuchin's favor is his history with Mr. Trump. Unlike some other cabinet members, the president has known Mr. Mnuchin for years, having crossed paths in New York's social scene. Mr. Trump last year attended Mr. Mnuchin's wedding.

Mr. Mnuchin is viewed on Wall Street as an unswerving Trump loyalist because he has taken pains not to let private disagreements spill into public view.

Some supporters of Mr. Mnuchin see Mr. Trump's criticism of him as unfair. In corporate earnings calls this past quarter, the Fed hasn't been a primary source of concern among executives, who have instead cited uncertainty over trade policy as an economic headwind. Mr. Mnuchin has led efforts to broker a trade deal with China in hopes of easing such qualms.

Phillip Swagel, who served as a top Treasury official in the George W. Bush administration, said that to the extent Mr. Trump is unhappy about the **stock market**'s recent declines, "the trade war probably has a lot to do with that. This is not the Treasury secretary's fault."

Shaping Mr. Trump's perception of Mr. Mnuchin is his annoyance with the head of the Federal Reserve: Jerome Powell. Mr. Trump picked Mr. Powell for the Fed chairmanship last year, relying on the recommendation of Mr. Mnuchin, among others, people close to the White House said.

When Mr. Trump sours on an appointee, his irritation often extends to whoever it was who promoted that official for the job, people familiar with the matter said. Speaking about Mr. Powell in a conversation in the past few weeks, Mr. Trump told Mr. Mnuchin: "I thought you told me he was going to be good," according to people briefed on the conversation.

An independent body, the Fed's rate-setting committee has raised its benchmark rate by a unanimous vote three times this year, most recently in September to a range between 2% and 2.25%.

Mr. Trump recoiled at the move. In an interview with the Wall Street Journal last month, he cast the Federal Reserveas the biggest threat to the economy and claimed that Mr. Powell relished raising rates.

Mr. Powell's policy moves this year, though, haven't surprised markets. While Mr. Trump wants faster growth, the Fed sees its job as ensuring the economy doesn't revert to a boom-and-bust cycle, a role made potentially more challenging by recent tax cuts and federal spending increases approved by Mr. Trump.

After Mr. Trump mentioned his disappointment with Mr. Powell this summer, Mr. Mnuchin publicly came to the defense of the Fed chief, who goes by Jay. "I think Jay has been a phenomenal leader at the Fed," he said.

Mr. Trump had considered a more high-profile pick for the Treasury post, particularly Mr. Dimon. He ultimately opted for a campaign loyalist, Mr. Mnuchin, who served as his finance chairman and assisted in the presidential transition.

As Treasury secretary, Mr. Mnuchin helped shape and sell the tax cut that Mr. Trump signed into law last year. Once the tax cut passed, Mr. Mnuchin moved to expand his influence on trade policy and has sought to moderate Mr. Trump's policies, especially when it comes to China. He has repeatedly persuaded Mr. Trump to ditch a campaign promise to label China a currency manipulator.

But his efforts to craft a China trade deal have come up short. At least three times since the spring, Mr. Mnuchin has worked with Chinese Vice Premier Liu He to start negotiations to settle the trade fight after Mr. Trump had threatened to levy tariffs, only to have Mr. Trump ultimately reject a potential deal and impose the levies.

"The secretary fell into a Chinese trap, becoming the advocate of compromise and accommodation—and Trump saw that," said Mr. Trump's former chief strategist, Steve Bannon.

Mr. Trump has made note of Mr. Mnuchin's trepidation about tariffs. At a meeting to discuss China trade policies in the past month, Mr. Mnuchin at one point mentioned that "our trade strategy with China is working really well." He then used the word "we" in reference to the administration's tough-on-China trade practices.

"What do you mean 'we,' Steve?" Mr. Trump said, people familiar with the meeting said.

Write to Peter Nicholas at peter.nicholas@wsj.com, Nick Timiraos at nick.timiraos@wsj.com and Bob Davis at bob.davis@wsj.com

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World

Saudis Mull Quiet Cuts to OPEC Production; The kingdom seeks to curb plunge in oil prices without raising the ire of U.S. President Trump

By Benoit Faucon and Summer Said
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02:35 PM
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Saudi Arabia and OPEC are inching toward a compromise between pleasing the U.S. with policies that won't lead to price spikes and throttling back the flow of its oil to rebalance oversupplied global markets.

The solution the cartel is considering: A production cut that doesn't look like a production cut.

Under such a scenario, the Organization of the Petroleum Exporting Countries would announce plans to retain current output targets, first set in 2016. That move would imply a production pullback because Saudi Arabia is overproducing by nearly 1 million barrels a day, according to people familiar with the matter.

"It will be still a big cut but less pronounced," a senior Saudi oil adviser said.

The proposal, gaining traction among OPEC officials this week, follows recent accusations by U.S. President Trump that the 15-nation cartel is driving **oil prices** higher. Earlier this week, Mr. Trump thanked Saudi Arabia for lower **oil prices**. A day earlier, he defied a CIA assessment that concluded Prince Mohammed bin Salman ordered the killing of journalist Jamal Khashoggi. Mr. Trump said he wouldn't let the incident jeopardize relations with the kingdom.

The cut "would be more discrete," said an OPEC official, who added the production cut and U.S. silence on **oil prices** "would be a quid-pro-quo" between the Saudis and Mr. Trump. It also would avoid a confrontation with non-OPEC member Russia, which has shown no appetite for a new cut, the official said.

Saudi Arabia, OPEC's de factor leader, had initially favored an outright cut of up to 1.4 million barrels a day from October's production level to bring it in line with the cartel's projected 2019 demand for its oil, about 31.5 million barrels a day. But the kingdom and the rest of OPEC are now increasingly leaning toward a less spectacular move to avoid sparking the ire of Mr. Trump.

"It is quite a political move. The last thing Saudi Arabia wants to do at the moment is to risk upsetting Trump," the senior Saudi oil adviser said.

Despite bipartisan outcry in Congress over Mr. Khashoggi's killing, Mr. Trump wants to maintain a strategic alliance with the kingdom. This has encouraged the Saudis to view his reelection positively.

"They need him and they want him to stay for another term," the senior Saudi oil adviser added.

The overall production cut could go beyond Saudi Arabia's move to end its overproduction by about 1 million barrels a day. Output in Venezuela and Iran is decreasing, which would pull more barrels of crude off the market.

Riyadh, which earlier this month saw its production surge to a record near 11 million barrels a day, has already said it supports a deep output cut and as a first step will reduce its shipments by 500,000 barrels a day in December.

OPEC's moves under the proposal would have less impact on **oil prices** and are less likely to incense Mr. Trump, according to OPEC officials.

Meanwhile, the Saudis are facing a host of threats beyond the fallout from Mr. Khashoggi's death.

Mr. Trump has threatened to support legislation that would effectively label OPEC an illegal cartel. The proposed measure, dubbed NOPEC, has withered during several U.S. administrations, but its bipartisan backers have said they think it might fare better under Mr. Trump.

"Because of Khashoggi, the Saudis will do anything to make sure Trump doesn't do anything nasty" to them, said an OPEC official said.

In addition, **oil prices** have fallen in just over a month far below the $88-a-barrel level that the International Monetary Fund says Saudi Arabia needs to balance its budget.

The $88-a-barrel price the IMF referred to was for Brent crude, the global benchmark, which on Friday broke below $60 for the first time in over a year.

"The current situation is very unusual for the kingdom. U-turns are made quickly and unexpectedly—and things have never been that political for a very long time," another Saudi official said.

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THE WALL STREET JOURNAL.

Markets
Copper Prices Dragged Down by Oil Drop, Stronger Dollar

By Ira Iosebashvili
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English
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Copper prices fell Friday, pressured by a sharp drop in **oil prices** and a stronger dollar.

Copper for November delivery fell 0.9% to $2.7705 a pound on the Comex division of the New York Mercantile Exchange.

U.S. **oil prices** on Friday fell 7.7% to their lowest level in over a year, weighing on copper and other commodities as investors worried about weak demand for raw materials. Sharp swings in oil also tend to sway copper prices because many investors trade the two commodities as part of a single basket, with a greater share devoted to oil.

A stronger dollar also pressured copper, which is denominated in the U.S. currency and becomes less affordable to foreign investors when the dollar appreciates. The WSJ Dollar Index rose 0.3% to 90.42.

In precious metals, gold for November delivery fell 0.4% to $1,221 a troy ounce.

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THE WALL STREET JOURNAL.

Markets

Dollar Strengthens as Crude Sinks; Volatility in the oil markets made traditionally safer assets like the dollar more attractive

By Gunjan Banerji
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The U.S. dollar strengthened Friday amid **volatility** in **oil prices**.

The WSJ Dollar Index, which measures the U.S. currency against a basket of 16 others, gained 0.3% to 90.42.

The greenback rose 0.4% this week, capping off its biggest one-week advance since early October, as crude continued its bout of turbulence.

Geopolitical concerns, weak economic data and growing supply-and-demand concerns dragged crude prices to their lowest level in more than a year Friday, helping attract investors to traditionally safer assets such as U.S. government bonds and the dollar.

Meanwhile, the yield on the benchmark **10**-**year Treasury** note fell for the third consecutive week as **bond prices** rose. Higher interest rates tend to attract yield-seeking investors to a currency.

The dollar's strength has also put pressure on oil, making it more expensive for foreign buyers to purchase crude, which is priced in the U.S. currency.

Shares of energy companies fell Friday, weighing on major stock indexes, which finished with weekly declines. The **S&P 500** closed 3.8% lower this week, the first decline during a Thanksgiving week since 2011.

The euro fell 0.6% to $1.1329 after a key business survey Friday showed that the bloc's economy is weighed down by faltering exports.

The dollar was flat against the yen, hovering at ¥112.95.

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U.S. Markets
Markets
U.S. Stocks Slide as Oil Prices Tumble; Declining oil prices drag energy companies lower during a holiday-shortened session

By David Hodari and Akane Otani
706 words
23 November 2018
03:09 PM
The Wall Street Journal Online
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English
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U.S. stocks slipped Friday as **oil prices** tumbled to their lowest levels in more than a year, dragging shares of energy companies lower.

The latest rout in **oil prices** added to the downbeat mood in markets, increasing concerns about the pace of economic growth and sending shares of energy firms such as Concho Resources, Devon Energy and EOG Resources down at least 5% apiece.

Oil's fall is the latest obstacle for major indexes struggling to break a stretch of shaky trading. Investors are grappling with concerns including the course of Federal Reserve policy, tepid economic data and a slide in technology stocks that had helped lead the **bull market** earlier in the year.

Some of the swings were likely exacerbated by relatively low trading volumes heading into the weekend, with the U.S. **stock market** closing early after Thanksgiving and Japanese markets shut for a public holiday, analysts said.

Still, the decline in **oil prices**—which analysts have attributed to worries about an impending glut of oil and fears of an economic slowdown—has deepened investors' unease.

Major indexes remain well off the highs they hit earlier in the year. The **Nasdaq Composite** posted a 4.3% weekly decline, its worst since March. The **S&P 500** was down 3.8%, while the **Dow Jones Industrial Average** fell 4.4%.

For the day, the blue-chip index lost 178.74 points, or 0.7%, to 24285.95. The **S&P 500** lost 17.37 points, or 0.7%, to 2632.56 and the **Nasdaq Composite** declined 33.27 points, or 0.5%, to 6938.98.

In recent weeks, some uneven economic data have "cast more doubt on how aggressive the Fed can be in raising rates and how good the growth outlook is for the U.S. given high rates, a strong dollar, and fading support from fiscal stimulus at a time of trade protectionism and weaker global growth," said James Knightley, chief international economist at ING.

Elsewhere, the Stoxx Europe 600 index rose 0.4%, but logged its second consecutive weekly decline, as investors awaited a scheduled meeting between U.K. and European Union lawmakers over the weekend to discuss a Brexit deal.

Both parties said Thursday that they had made progress in outlining their future relationship. Still, the deal faces fierce opposition in both the U.K. and the rest of the EU.

Rising trade tensions also weighed on stocks heading into the weekend.

The Shanghai Composite Index lost 2.5% on Friday and the tech-heavy Shenzhen A-Share dropped 3.7% after The Wall Street Journal reported that the U.S. government had attempted to persuade foreign allies to avoid telecommunications equipment from China's Huawei Technologies due to what they see as cybersecurity risks.

That marked the latest attempt by the Trump administration to tighten restrictions on Chinese telecom firms. The White House banned U.S. suppliers from selling components to ZTE, a sector-peer of Huawei, earlier this year before reversing the ban in June. ZTE shares fell 2% Friday.

Some investors said they're increasingly optimistic about relations between the world's two largest economies and viewed this week's developments as a part of the U.S.'s negotiating strategy. President Trump and China's President Xi Jinping are due to meet at the Group of 20 summit in Buenos Aires later this month.

"There's clearly a good-cop-bad-cop dynamic here with the new USTR report aimed at keeping pressure on China," said Isabelle Mateos y Lago, chief multiasset strategist for BlackRock Inc. "Markets are already pricing in some kind of good outcome from the meeting and the baseline not yet fully priced in is that further escalations in U.S. tariffs are put on hold."

Steven Russolillo contributed to this article.

Write to David Hodari at David.Hodari@dowjones.com and Akane Otani at akane.otani@wsj.com

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WSJ PRO CENTRAL BANKING

Economy
Canada Inflation Accelerated in October, But Interest-Rate Path Looks Unchanged; Consumer prices rose 2.4%, surpassing market expectations

By Kim Mackrael
540 words
23 November 2018
10:17 AM
WSJ Pro Central Banking
RSTPROCB
English
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OTTAWA—Inflation in Canada accelerated unexpectedly in October, beating market expectations, but leaving the outlook for the Bank of Canada's interest-rate path largely unchanged.

Canada's consumer-price index advanced 2.4% on a year-over-year basis in October, Statistics Canada said Friday, following a 2.2% rise in the previous month. Market expectations were for a 2.2% gain in October.

On a month-over-month basis, the CPI rose 0.3%.

The Bank of Canada's preferred measures for underlying inflation were little changed in October. Core-inflation prices rose in a range from 1.9% to 2.1% for an average of 2.0%, up slightly from the previous month's revised 1.9% average.

Canada's central bank sets rate policy to achieve and maintain 2% inflation. The headline annual inflation rate in Canada has come in at 2% or higher for nine straight months.

Meanwhile, retail sales rose unexpectedly in September, led by gains in food and beverage sales. September retail sales rose 0.2% from the previous month, to a seasonally adjusted 50.93 billion Canadian dollars ($38.57 billion), Statistics Canada said Friday.

The Bank of Canada said last month that interest rates will ultimately need to reach a neutral level of around 2.5% to 3.5% to keep inflation on track. The central bank has raised its benchmark overnight rate five times since mid-2017, most recently in October, bringing it to the current level of 1.75%.

Ahead of Friday's data releases, market expectations were for the central bank to remain on pause at its next rate decision in early December, in part because of the steep discount energy producers face on Alberta heavy crude, which is hurting the country's energy industry. New tax measures introduced by the federal government earlier this week should help support business investment, economists said, but weren't expected to prompt a December rate move.

BMO Capital Markets chief economist Doug Porter said the inflation and retail sales data released on Friday marked upside surprises that have been a rarity for Canada in recent months. "However, the modest high-side readings won't do much to counter the much bigger force of rapidly fading **oil prices**, for both the inflation and growth outlook over the near term," he said.

Friday's inflation data aren't shifting expectations that the Bank of Canada will stay on hold at its Dec. 5 meeting, Mr. Porter said. He said the stronger data slightly strengthen the case for a January rate rise, but the central bank would likely need to see some recovery in **oil prices** for that to happen.

The October inflation report showed that all major components tracked by Statistics Canada rose on a 12-month basis.

Gasoline prices increased 12% in October, matching the previous month's advance. Higher mortgage interest costs, reflecting rate increases over the past year, and higher prices for food purchased from restaurants also contributed to the year-over-year advance in consumer prices.

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THE WALL STREET JOURNAL.
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Frackers Face Impact of Oil Drop

By Rebecca Elliott
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23 November 2018
The Wall Street Journal
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Falling **oil prices** are likely to have a limited impact for now on U.S. crude production but threaten to stunt growth next year.

Many frackers have protected themselves from **volatility** by hedging their oil and gas output. Those derivatives contracts on average begin protecting top drillers, if oil drops below $56 a barrel, according to energy consulting firm Wood Mackenzie.

Hedging was a drag on profits earlier this year, preventing many companies from fully benefiting from a rise in **oil prices** during much of 2018.

It could insulate the companies from a recent plunge that pushed prices for West Texas Intermediate down 6.6% Tuesday to $53.43, the lowest level in more than a year. It settled Wednesday at $54.63.

Shale drillers even stand to wring a little money from the derivatives contracts now that oil is lower than the average hedging price.

However, not all of their production is insulated from price swings, and many of those protections expire next year.

While current **oil prices** aren't low enough for companies to put off fracking wells near term, sustained lower prices could prompt companies to dial back next year's capital-spending plans.

"Lower **oil prices** could mitigate some of the growth ambitions companies previously had," Wood Mackenzie analyst Andrew McConn said.

U.S. oil production topped 11 million barrels a day this year, a record, and is projected to surpass 12 million barrels daily next year, according to the Energy Information Administration.

Companies like EOG Resources Inc. are monitoring prices as they develop 2019 spending plans. EOG would scale back its production if oil falls below $50 a barrel, Lloyd Helms Jr., the company's chief operating officer, said last week at a conference.

"We're going to maintain our discipline in how we allocate capital," he said. "We're building a business that's going to be sustainable through the commodity price whether the **oil price** is $40 or $80."

Frackers generally are more exposed to price **volatility** next year than they were this year. U.S. drillers have used derivatives contracts to protect about 25% of their output in 2019, compared with 45% this year, according to a Wood Mackenzie analysis of the larger companies that hedge their oil and natural-gas liquids production.

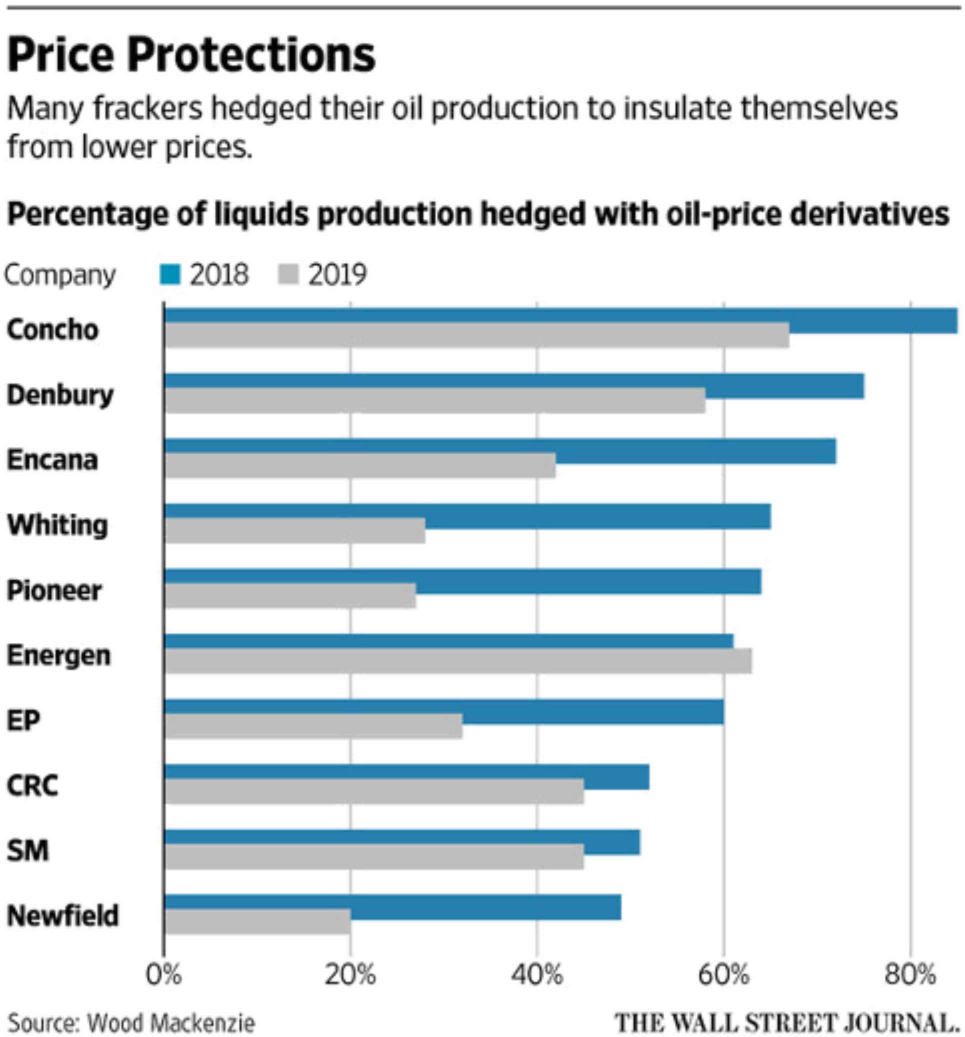
Some also hedge much more than others. Concho Resources Inc., a company active in the Permian Basin of Texas and New Mexico, has among the largest hedging programs, with about two-thirds of next year's oil and natural-gas liquids output covered, according to Wood Mackenzie.

Continental Resources Inc., an Oklahoma-based company that is among the pioneers of North Dakota's Bakken Shale formation, doesn't hedge its oil production.

Matthew Portillo, a managing director at energy investment bank Tudor, Pickering, Holt & Co., said sustained cheap oil likely would disproportionately affect drilling plans in places like North Dakota and Canada.

Producers there are far from export markets and are already having to sell some of their crude at a discount because of pipeline bottlenecks.

"There's very minimal price protection in place," he said, speaking of the sector as a whole. As prices fall, he added, "We're approaching a point where industry participants are likely to start pulling back."



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International New York Times

business
Turbulent Stock Market Is Flashing a Warning About the Economy

By MATT PHILLIPS
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22 November 2018
International New York Times
INHT
English
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Unemployment is near lows not seen in half a century. The American economy is set for its best year since 2005. Large corporations are producing giant profits. Even wages are starting to rise.

And the stock markets are a mess.

On Tuesday, the **S&P 500**-**stock index** turned negative for the year, stoking fears that one of the longest bull markets in history could be at risk.

The **stock market**'s struggles may seem incongruous against the backdrop of strong economic growth. But stocks often act as an early warning system, picking up subtle changes before they appear in the economic data.

In recent weeks, retail stocks have been hit over concerns of rising costs, a sign that President Trump's global trade battles may be starting to take a toll and that higher wages are cutting into profits. Commodities and the companies that depend on them have been pummeled by the prospect of weaker demand should the global economy slow. Five tech giants — Facebook, Amazon, Alphabet, Apple and Netflix — have shed more than $800 billion in market value since the end of August, the fallout from slowing growth and regulatory scrutiny.

The **S&P 500** closed on Tuesday at 2,641.89, down 1.8 percent. Other markets also flashed warnings, with oil dropping by 6.8 percent, falling deeper into bear territory.

The pressure eased on Wednesday, with the **S&P 500** rising about half a percent in early trading after Asian markets ended the day largely positive and shares in Britain, France and Germany began the day higher.

The sell-off doesn't mean the United States is headed into a recession. The **stock market** suffered several sharp stumbles in recent years before climbing to new highs on the back of booming corporate profits and strong economic growth.

But the recent market drop could portend problems. In 2018, a hefty dose of fiscal stimulus, in the form of tax cuts, allowed the United States to shake off the growth worries in China, Europe and the rest of the world. It won't have the same potency next year, leaving the American economy and stocks more vulnerable to a range of risks, including a slowing global economy and continued rate increases by the Federal Reserve.

"I think there are very clear signs that investors are beginning to worry about weaker growth in the coming year or so, and how that's going to feed through to corporate earnings," said Michael Pearce, senior United States economist with Capital Economics.

Mr. Trump, on Tuesday, pointed to the health of the economy and instead blamed the Fed for contributing to the sell-off. Mr. Trump, who has taken credit for the rising **stock market**, has been critical of the rate increases, saying they undermine growth.

"I would like to see the Fed with a lower interest rate," he said. "I think the rate is too high."

Until recently, investors were willing to ignore the domestic political dramas, geopolitical turmoil and other issues clouding the outlook for American companies. Now they appear jittery, selling stocks at small signs that vague risks may become realities.

So far this year, strong growth and deep corporate tax cuts have supercharged corporate profits. Once all the results are tallied up, the third-quarter earnings for companies in the **S&P 500** are expected to be up more than 28 percent from a year earlier — outpacing previous quarters, according to the financial data company Refinitiv.

But those numbers haven't satisfied the markets. Investors have instead grown concerned about risks they face both from continued economic strength and, alternatively, an economic slowdown. Either path could upend a nearly decade-long rally that has lifted the **S&P 500** nearly 300 percent.

Strong economic growth at home would most likely mean a prolonged rise in interest rates and rising costs in areas like wages, which would hurt corporate profitability. Weaker growth abroad would cut into sales.

In recent days, both forms of fear have fed the market decline.

On Tuesday, shares of the retailer Target dropped by more than 10 percent, on worries that rising costs — from increased wages to higher prices for the Chinese goods facing tariffs — could continue to crimp profits. Investors also dumped shares of Kohl's and TJX, the owner of T. J. Maxx, which both saw freight costs eat into earnings.

Apple continued its slide on worries about softening demand. The tech giant tumbled 4.8 percent after Goldman Sachs equity analysts cut their price target, citing deteriorating demand, especially in China.

China, the world's largest consumer of oil, has also been weighing on commodities. The price of crude, now just above $53 a barrel, has fallen nearly 30 percent since early October. On Tuesday, energy was the worst-performing part of the **S&P 500**, with companies like Exxon Mobil, Chevron and the oil-field services provider Schlumberger losing more than 2.5 percent.

Oil prices have been sliding despite signs that major producers like Saudi Arabia are considering cutting production. And that has amplified worries that China and the rest of the global economy may be in a weaker spot than markets realized.

Last quarter, China's growth slowed to its lowest level since 2009, during the depths of the global financial crisis. Japan, the world's third-largest economy, is also looking shaky, with the economy contracting in the third quarter, amid a slowdown in trade and investment.

Germany, the powerhouse behind Europe, also shrank unexpectedly during the third quarter as trade slumped and car production faltered. If Germany stumbles, it will add to the economic and political turmoil in a region already dealing with Britain's chaotic exit from the European Union and Italy's budget dispute with the bloc.

In 2018, America's economy proved largely immune to such issues. But the global slowdown could eventually spill over into the United States, particularly as the impact of this year's tax cuts fades in the coming years. Economists expect that domestic growth, which is close to 3 percent this year, will slow to 2 percent by 2020, according to estimates published by FactSet.

For the economy, that is a respectable performance. But for investors, a slowdown is likely to be uncomfortable.

Disappointing data and earnings updates could ignite periodic panics over the threat of recession, even if remote. Markets are likely to be much choppier that than they've been in recent years. Gains could be lower.

In other words, the market may be messy for a while.

"I think this is what a low-return environment starts to feel like," said Joe Davis, chief economist with Vanguard. "The past five years, although entirely welcome from an investment standpoint, is clearly unsustainable."

Clifford Krauss and Stephen Grocer contributed reporting.

PHOTOS: The New York Stock Exchange on Tuesday, when a dive sent the **S&P 500** into the red for the year. (PHOTOGRAPH BY HILARY SWIFT FOR THE NEW YORK TIMES) (A1); The **S&P 500** closed down 1.8 percent on Tuesday, after shedding 1.7 percent the day before. (PHOTOGRAPH BY JUSTIN LANE/EPA, VIA SHUTTERSTOCK) (A14)

* The Tech Stock Fall Lost These 5 Companies $800 Billion in Market Value

* Stocks Fall, Wiping Out Gains for 2018

* Amazon, Apple and Facebook Once Led the Market. Now They Are Driving it Down.

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WSJ PRO CENTRAL BANKING

WSJ Pro
BOE's Saunders Sees Faster Rate Increases if Brexit Goes Smoothly; Monetary Policy Committee member says interest rates will probably need to rise faster than investors expect

By Jason Douglas
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RSTPROCB
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LONDON—A top Bank of England official said Thursday that interest rates in the U.K. will probably need to rise faster in the next few years than investors expect, assuming Britain's exit from the European Union goes smoothly.

Michael Saunders, one of four members of the BOE's nine-strong Monetary Policy Committee drawn from outside the central bank's staff, said in a speech in Wales that inflationary pressures are building in the U.K. economy now that it has reached full employment.

He said he expects wage growth to pick up faster than central-bank forecasts suggest, boosting inflation.

"In this case, we would probably need to return to something like a neutral stance rather earlier than implied by the current yield curve," Mr. Saunders said, according to a text of his remarks published by the central bank.

The BOE said in August that the neutral rate of interest in the U.K., what is needed to keep the economy growing without stoking inflation, is probably between 2% and 3%. Borrowing costs in **financial markets** imply short-term interest rates will still be almost a percentage point lower than 2% three years ahead.

Mr. Saunders said his forecast hinges on whether the U.K. has an orderly withdrawal from the EU in March. A smooth exit into a relatively close economic partnership with the EU would probably give the economy a lift, he said, while a messy and abrupt break would hit investment and hiring.

The bulk of Mr. Saunders' speech focused on demographic shifts in the U.K. He said the country's aging population will probably weigh on already subdued productivity growth in the years ahead.

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The New York Times

Business; Economy

Holiday Spending Should Be Strong. And Then?

By Ben Casselman
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Americans are upbeat about the economy heading into the holiday shopping season. But that good cheer may not last long.

With the lowest unemployment rate in nearly half a century, and wage growth starting to pick up, economists expect shoppers to open their wallets. A survey by the National Retail Federation, a trade group, points to 4.1 percent more holiday spending than last year, and some forecasters expect even stronger growth. Measures of consumer confidence are near post-recession highs.

"You see momentum going into the season, cutting across a large range of categories," said Stephen Sadove, a former Saks Fifth Avenue chief who is now a senior adviser for Mastercard. "It's probably the healthiest growth we've seen in the past half-dozen years."

But those projections predate the latest round of steep **stock-market** declines, which this week pushed the **S&P 500 index** into negative territory for the year.

It's too soon to say whether the drop will rattle consumers. But even before the sell-off, many economists were warning that a combination of factors — including rising interest rates, a weakening housing market and a new round of tariffs set to take effect in January — could begin to slow down the economy in 2019.

Consumers are feeling good.

Last year's holiday season was the best for retailers in more than a decade. Americans are feeling even better this year.

Thirty-seven percent of Americans say their finances are in better shape than they were a year ago, while 17 percent say they are worse off, according to a survey conducted for The New York Times in early November by the online research platform SurveyMonkey. Last November, just 28 percent said they were better off.

Consumers say they are feeling even more positive about the future. Forty-one percent expect to be better off financially a year from now — versus just 14 percent who expect to be worse off — and a majority of survey respondents said "continuous good times economically" were in store over the next five years.

Other surveys show similar optimism. The University of Michigan on Wednesday reported that consumer sentiment had ticked down slightly in November but that the index remained high by historical standards.

That confidence is leading consumers to loosen their purse strings, said Diane Swonk, an economist for the accounting firm Grant Thornton. She noted that spending was up in discretionary categories like restaurant meals, travel and clothing.

"Consumers are dressing up and stepping out a bit," Ms. Swonk said. "They've got money for discretionary spending, they're traveling a lot."

Low gasoline prices may provide a dividend.

Consumers have plenty of reasons for feeling good. Economic growth is on track for its best annual performance since 2005. And crucially, the tight labor market at last appears to be translating into faster wage growth for workers. Average hourly earnings were up 3.1 percent in October from a year earlier, their fastest growth since before the recession.

Households are also getting help from gasoline prices, which have fallen sharply in the last month after rising earlier in the year.

“If gas prices go down, it basically acts like a tax cut,” said Joseph Song, an economist for Bank of America Merrill Lynch.

Then there is the actual tax cut. The $1.5 trillion tax law that Republicans passed last year helped pump up consumer spending earlier this year, and economists said the effect is lingering into this holiday season. Over all, households’ finances are in their strongest shape in years, with low levels of debt and rising after-tax income.

But warning signals are flashing.

United States gross domestic product has posted two straight quarters of strong growth, driven largely by robust consumer spending. Most economists expect that growth to slow in the final three months of the year as the effects of the tax cuts fade.

“There’s a very clear spike in sales in the middle of the year obviously driven by the tax cuts, and there’s an equally clear reversal in the second half of the year,” said Ian Shepherdson, an economist for Pantheon Macroeconomics, a research firm. “It’s the sugar rush followed by the comedown.”

That slowdown, by itself, isn’t much cause for concern, Mr. Shepherdson said. But there are other hints of trouble on the horizon. The housing market has slowed markedly this year, as interest rates have risen and prices have outstripped income growth. And additional tariffs on Chinese goods are set to take effect in January, which could push up consumer prices.

“Consumers are at the heart of what’s gone right in the economy the past couple years, and I think they’re going to be the biggest contributor to the slowdown,” said James Bohnaker, an economist for IHS, a research firm.

Those concerns may be part of what has driven the **stock market**’s recent drop. Retail stocks fell on Tuesday despite strong results, as investors worried that rising costs could eat into earnings.

The market turmoil could affect consumer sentiment, especially among wealthier households more likely to own stocks. The University of Michigan survey found that confidence fell more among higher-earning households in November.

But falling share prices are unlikely to hurt holiday sales much, Mr. Song said. Most Americans don’t own stocks outside of their retirement accounts, and many have already set their holiday budgets — or have even begun to shop. A Bank of America survey found that about 20 percent of consumers started their holiday shopping before November, and 67 percent said they planned to shop over the extended Thanksgiving weekend.

“I have a tough time really seeing this hurting consumer spending,” Mr. Song said of the market declines. “A lot of the shopping is already baked in.”

And for some, the election was a damper.

Ever since President Trump took office, consumer confidence has shown a sharp partisan split, with Republicans feeling far better about the economy than Democrats. This month’s midterm elections, in which Democrats retook control of the House of Representatives, may have begun to narrow that gap.

SurveyMonkey took its survey the week of the election, conducting about 4,300 online interviews on or before Election Day and 5,000 after the results were known. Among Democrats and independents, the results changed little over the course of the survey.

But for Republicans, there was a clear shift in outlook: Among Republicans interviewed before the election, 66 percent said they expected their finances to improve over the next year. Among those interviewed afterward, that share fell to 59 percent. The effect was particularly pronounced among strong supporters of Mr. Trump, who showed a nine-point decline after the election in the share expecting their finances to be better a year from now.

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The New York Times

Business/Financial Desk; SECTB
Markets Edge Up After 2 Days of Losses

By THE ASSOCIATED PRESS
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Stocks in the United States finished mostly higher Wednesday, a break after two days of steep losses. Technology and internet companies and retailers were responsible for most of the gains.

The gains came from high-growth stocks such as retail and industrial companies, and energy companies benefited as crude oil rose about 2 percent. Smaller and more domestically focused companies surged. Those sectors have slumped over the last two months.

Alec Young, managing director of global markets research at FTSE Russell, said the market has tumbled this autumn because growth in the global economy and in company profits is slowing down, and investors are worried that the situation will get worse.

Mr. Young said Wall Street essentially has a two-item wish list for the holidays: a general trade agreement between the United States and China, and a sign the Fed will raise interest rates at a more gradual clip. If those things transpire, he said, the **stock market** will settle down.

President Trump and China's Xi Jinping are scheduled to meet at the end of this month.

''All they have to do is agree on a high-level framework that can delay the increase in the tariffs,'' Mr. Young said. ''If the Fed is more dovish and we get some positive news on China, we can have a solid end to the year.''

The **S&P 500** rose as much as 1.1 percent in early trading, but finished with a gain of just 8.04 points, or 0.3 percent, at 2,649.93.

The **Dow Jonesindustrial average** slipped 0.95 points to 24,464.69. The **Nasdaq composite** climbed 63.43 points, or 0.9 percent, to 6,972.25.

Trading was relatively quiet ahead of the Thanksgiving holiday. United States markets will be closed Thursday, and will be open for a half-day on Friday.

Strong reports from companies including Foot Locker helped retailers. The company climbed 14.9 percent to $52.96 after its third-quarter profit and revenue surpassed expectations. Gap rose 4.7 percent to $25.81 after reporting solid quarterly results and saying it will close more struggling Gap locations.

That contributed to a rebound for retailers after they dropped on Tuesday. Home improvement company Lowe's gained 2.5 percent to $88.37 and Nike rose 1.8 percent to $72.37.

Technology companies recovered a sliver of their recent losses. Adobe rose 2.8 percent to $225.98 and design software maker Autodesk climbed 9.7 percent to $135.04 after a strong quarterly report. The company also said it is buying construction software company PlanGrid for $875 million.

Amazon rose 1.4 percent to $1,516.73 and Facebook jumped 1.8 percent to $134.75. Microsoft picked up 1.4 percent to $103.11, but Apple lost 0.1 percent to $176.89.

Apple's market value has dropped by $264 billion since early October and Amazon has fallen by $251 billion since early September. Since late July, Facebook has lost $241 billion and Alphabet is down by $169 billion. That's $925 billion in value lost by just those four companies, more than any **S&P 500** company is worth.

Oil prices rebounded as benchmark United States crude gained 2.2 percent to $54.63 a barrel in New York. It fell 6.6 percent on Tuesday and finished at its lowest price in a year.

Chevron rose 1.3 percent to $117.57 and Exxon Mobil gained 0.8 percent to $77.56.

Crude prices have plunged since early October as global stockpiles surged. Production increased after the United States said it would re-impose sanctions on Iran's energy sector, but it later granted waivers that allowed many countries that buy oil from Iran to continue making those purchases.

Bond prices fell. The yield on the **10**-**year Treasury** note rose to 3.07 percent from 3.06 percent.

Gold gained 0.6 percent to $1,228 an ounce.

The dollar rose to 113.06 yen from 112.40 yen. The euro edged down to $1.1388 from $1.1399.

CHARTS: The **S&P 500 Index**: Position of the **S&P 500 index** at 1-minute intervals on Wednesday. (Source: Refinitiv); Durable Goods Orders: Manufacturers' total new orders for durable goods, seasonally adjusted. (Source: Commerce Department)

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The New York Times

Business/Financial Desk; SECTB
Cryptocurrency Prices Are Plummeting. Why?

By NATHANIEL POPPER
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SAN FRANCISCO -- The news on Wall Street this week has been bleak: sharp declines, fears of a **bear market** and high-flying technology stocks that suddenly took a tumble.

Traditional stock investors may be taking a beating, but they should be glad they didn't put their money in cryptocurrencies. As of Wednesday, the price of a Bitcoin had fallen about 25 percent in a week and was down more than 75 percent from its peak in December.

Other digital tokens have fallen even more sharply in value.

The latest declines are occurring almost a year after cryptocurrency markets, fueled by a rush of new, wealthy investors, went into overdrive. There are several factors behind the collapse in prices, with many of them the flip side of what drew people to cryptocurrencies in the first place.

Relying on unregulated infrastructure and exchanges is risky.

Most cryptocurrency trading happens outside the United States on exchanges with little or no regulatory oversight. That allowed investors to pile in with abandon, but the inherent dangers have long been clear.

This year, researchers at the University of Texas published evidence suggesting that one of the largest exchanges, Bitfinex, had helped create a proprietary cryptocurrency, Tether, that was used to artificially pump up the price of Bitcoin and other digital tokens.

Bloomberg reported on Tuesday that the Justice Department was conducting a criminal investigation of price manipulation using Tether, one of many issues related to Tether that are scaring investors away. Every unit of Tether is supposed to be backed by a dollar in a bank, but managers of Bitfinex and Tether have struggled to show that they even have bank accounts. Many traders have been selling Tether at a loss just so they can take their money out.

The activities of another large exchange, OKEx, have also led traders to question whether they can trust the institutions at the center of the cryptocurrency industry.

OKEx, which began in China, altered some trading rules without advance notice, according to a large hedge fund, Amber AI, which published a post on Medium about the changes. AmberAI said customers appeared to have lost millions of dollars because of the changes. OKEx, without acknowledging the losses, apologized to customers for some of the changes, which it said had been made to cope with chaotic trading.

Regulators are cracking down.

Much of the excitement surrounding the cryptocurrency markets last year was stirred up by companies that raised money selling custom cryptocurrencies in so-called initial coin offerings, which let start-ups raise money without going through regulators.

At the time, lawyers warned that these offerings would probably run afoul of securities rules. The Securities and Exchange Commission recently stepped up punishment of companies that violated securities law with their offerings. In the most chilling case, the commission punished two companies on Friday for their initial coin offerings, forcing them to return money to investors while saying the cases would be templates for future actions.

Cryptocurrencies are managed by communities of developers. That can get messy.

The Bitcoin network was created with so-called open-source software released to the world in January 2009. For many years, members of the Bitcoin community worked together to improve the software. That collegiality has faded. Last year, after a bitter fight, one group released a new version of Bitcoin software with slightly different rules that gave rise to a new cryptocurrency, Bitcoin Cash.

The people backing Bitcoin Cash subsequently had their own disagreements. This week, they splintered into two groups. In the software world, it's known as a fork: Bitcoin Cash was split into two new cryptocurrencies, Bitcoin ABC and Bitcoin SV.

The new forks have not altered the original Bitcoin. But they have created chaos in the trading markets, as exchanges struggle to define which coin customers are trading. The battles have also raised questions about one of the fundamental attractions of cryptocurrencies: their apparent scarcity.

The creator of Bitcoin said only 21 million Bitcoins would ever be created. But how scarce do those 21 million Bitcoins seem if there are also 21 million tokens of each new copycat?

As Naeem Aslam, the chief market analyst at the trading firm ThinkMarkets, put it in a note to clients this week: ''Forking has become so common that it puts at risk the notion of limited supply altogether.''

Cryptocurrencies were going to solve all kinds of real-world problems. But the real world hasn't had much use for cryptocurrencies.

Bitcoin was supposed to make it easier to send payments instantly over international borders. Ethereum, the second-largest cryptocurrency network until recently, was going to create a kind of global super computer. Thousands of other tokens were also designed to be used for high-minded purposes. But so far, about the only thing the tokens have been used for is speculative trading.

Developers have complained that Bitcoin, Ethereum and most other networks are hobbled by technical problems that make their tokens hard to use in real-world transactions. Those working on the cryptocurrencies have promised solutions, but they have been slow to produce them.

Governments could get into cryptocurrencies, and do a better job of managing them.

One hopeful sign for digital tokens came from Christine Lagarde, the leader of the International Monetary Fund. In a speech last week, she made a case for why countries and central banks might want to issue digital currencies similar to Bitcoin. (Some countries are already experimenting with this.)

But Ms. Lagarde added a note of caution. While saying cryptocurrencies could improve on current payment networks, she also said governments could manage them more effectively and eliminate the issues of trust that have hobbled them. The remarks could have a chilling effect on existing, nongovernmental tokens.

Follow Nathaniel Popper on Twitter: @nathanielpopper.

A Bitcoin center in Quebec. The price of the cryptocurrency is down more than 75 percent from its December peak. (PHOTOGRAPH BY LARS HAGBERG/AGENCE FRANCE-PRESSE -- GETTY IMAGES)

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The New York Times

Foreign Desk; SECTA
Italy May Face Penalty for Financial 'Sleepwalking'

By JASON HOROWITZ; Jack Ewing contributed reporting from New York, and Milan Schreuer from Brussels.
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ROME -- The European Union upped the ante in a standoff with Italy on Wednesday, taking another step toward punishing a government that has repeatedly flouted its fiscal rules by insisting on a heavy-spending budget that fails to bring down the country's burdensome debt.

''With what the Italian government has put on the table, we see a risk of the country sleepwalking into instability,'' said Valdis Dombrovskis, the European Commission vice president.

The country, which is led by populist and anti-establishment forces, was a case of ''particularly serious noncompliance,'' he added.

The European Commission, the bloc's executive branch, will now turn its negative assessment of the budget over to eurozone countries. In two weeks, they could give the commission the green light to start an ''excessive deficit procedure'' against Italy, which could lead to steep fines.

Italy is the eurozone's third-largest economy, and its crippling debt and minuscule growth is a source of deep concern in Brussels and international markets. A financial collapse there has the potential to infect and, some say, sink the entire European economy.

Within Italy, the budget has exposed tensions and the opposing priorities of the populist coalition government, led by Matteo Salvini, of the populist League party, and Luigi Di Maio, of the Five Star Movement.

But both are happy to fight the European Union, and both have a history of skepticism when it comes to membership of the euro. Ahead of European Parliament elections in May, both parties need an enemy to run against, and with migrant landings down, bureaucrats in Brussels fit the bill nicely.

Brussels had rejected a previous version of the budget, but the Italian government responded this month with only small amendments. The new round of budget rejection and Italian defiance on Wednesday, when the commission made its annual review of eurozone spending plans, was completely expected.

''We are still committed to our budget,'' Prime Minister Giuseppe Conte told reporters, adding that the Italian government was sure of its position but that he would ''be very willing'' to discuss it with Jean-Claude Juncker, the president of the European Commission, when they met to discuss next steps at a dinner in Brussels on Saturday.

''A letter arrived from Brussels? I was expecting one from Santa Claus,'' said Mr. Salvini, the deputy prime minister and the most powerful force in the Italian government, who has suggested that Mr. Juncker has a drinking problem.

He added that he would be polite in discussing the budget with European Union officials but would not be persuaded to reinstate the previous government's pension reductions. ''Italy has a need to grow,'' he told reporters.

A report in the Turin-based newspaper La Stampa, citing anonymous sources, suggested that Mr. Salvini could be willing to significantly soften his position. That appeared to mute the market reaction, but a spokeswoman for Mr. Salvini disputed the report on Wednesday.

''To the citizens we say have no fear because we will not retreat,'' said Francesco D'Uva, a member of Parliament with the Five Star Movement. ''We weren't elected to enact the same destructive policies of the old governments.''

The Italians say that austerity measures imposed by Brussels and the powerful northern European countries that have sway there have suffocated the Italian economy.

They argue that only through spending -- on a citizens' income, generous pensions, and reduced taxes -- can they stimulate the stuck Italian economy, and that they will then bring down their deficit -- currently at 132 percent of output, more than twice the European Union limit -- through growth.

But the European Union, and other international institutions and ratings services, have deemed Italian growth projections to be fanciful and overly optimistic. The reality, critics and opponents of the government said, was that Wednesday marked a decline in the country's standing.

''Today a very sad thing happened to our country,'' said Pier Carlo Padoan, the finance minister in the previous Democratic Party administration.

''I am very worried,'' said Antonio Tajani, the president of European Parliament and a top official in Forza Italia, the center-right party of the former prime minister Silvio Berlusconi.

He pointed to the risk premium on Italian government bonds that consistently hovers in dangerous territory, to the poor performance of the Italian **stock market** and to rising investor anxiety.

''The Italian citizens don't deserve this disaster due to an irresponsible government that, instead of resolving the problems of Italians, everyday invents new enemies,'' Mr. Tajani said.

Despite the posturing of both sides, the process leading to sanctions is lengthy, and leaves plenty of time for Brussels and Rome to find a compromise and avoid a confrontation that would further destabilize the European Union when it is already struggling with slower economic growth and Britain's planned departure.

The Italian Parliament has to approve a budget by Dec. 31, which leaves time to change proposals. And some members of European Parliament have suggested that Brussels should bend.

Sven Giegold, a German member of the European Parliament from the Green Party, said that, while the excessive deficit procedure against Italy was unavoidable under European Union rules, the commission should be willing to compromise.

''More spending could be sensible if it revives Italy's economy,'' Mr. Giegold said in a statement. ''Both sides should give ground.''

The question is whether Brussels will stand firm and whether there is any pressure -- outside of crippling market reactions -- large enough to change the political calculus that appears to be motivating Italy's coalition partners to refuse to budge. Both the League and Five Star are looking to increase their domestic popularity, and leverage, ahead of May's elections.

''We are convinced of the numbers we put in our budget,'' Mr. Salvini said on Wednesday. ''We'll go forward.''

Valdis Dombrovskis, the European Commission vice president, said Italy's budget was in ''serious noncompliance.'' (PHOTOGRAPH BY JOHN THYS/A.F.P. -- GETTY IMAGES)

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THE WALL STREET JOURNAL.

Markets

Natural High: Gas Sellers Spared From China's Market Slump; Gainers in this downbeat year include China Gas Holdings, China Resources Gas, ENN Energy and Kunlun Energy

By Kevin Kingsbury
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22 November 2018
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The Wall Street Journal Online
WSJO
English
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China's big gas distributors are among the few **stock-market** winners this year, despite higher fuel prices' cutting into profit margins.

What's Happening

Trade tensions and economic weakness have driven most mainland Chinese companies listed in Hong Kong lower this year. Less than a third of stocks in the Hang Seng's mainland-focused HSM 100 index are in positive territory for 2018.

Among the gainers, however, are gas distributors such as China Gas Holdings, with a market cap of $16 billion, and smaller rivals China Resources Gas Group, ENN Energy Holdings and Kunlun Energy Co.

Chinese President Xi Jinping has tried to curb pollution, partly by reining in coal use. That has increased gas consumption, which was up 19% from a year earlier in the first nine months of 2018.

The sudden expansion of the market has brought teething problems. A shortage late last year briefly tripled prices of liquefied natural gas, or LNG, causing some factories to close and pressuring the margins of local providers, which struggled to pass all of the increased cost to customers.

There could be some supply tightness again this winter, but Fitch Ratings sees the sector as better prepared overall. China increased both its import and storage capacity, and distributors have stocked up.

What it Means

Analysts at Nomura Securities say "gas-supply tightness will become the new normal" for China as demand growth keeps outstripping increases in domestic supply, requiring LNG imports to cover the gap. They foresee roughly 20% compound annual growth in earnings for China Gas and CR Gas over the next three years.

Their peers at Goldman Sachs are also **bullish** about China Gas, noting it has grown rapidly as coal-fired power stations switch to natural gas.

China's growing appetite is good for global LNG prices. The country's sharply increased imports over the past few years have made it the world's second-largest customer behind Japan.

At the same time, though, suppliers such as the U.S. and Australia have boosted production and export capabilities—which helps explain why prices remain well below the highs of earlier this decade.

Write to Kevin Kingsbury at kevin.kingsbury@wsj.com

Asia Markets Snapshot

* Trading volumes were thin ahead of the Thanksgiving holiday in the U.S.

* Most Asian equity indexes were little changed, while large Chinese stocks fell 0.5%.

* Hyundai, Kia fell 5% as Reuters reports the U.S. is probing the auto makers' prior recalls.

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THE WALL STREET JOURNAL.

Page One
What's News: Business & Finance

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22 November 2018
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Technology and other fast-growing stocks rebounded, halting a **stock-market** selloff that has left investors on edge as to whether the longest **bull market** ever can regain its step.

Only half of the Amazon jobs that the company has promised to bring to its two new headquarters in New York and Virginia will be tech jobs, government officials in both states say.

An Abu Dhabi sovereign-wealth fund accused Goldman Sachs of playing a "central role" in the 1MDB scandal.

Existing-home sales posted their largest annual decline since 2014 in October, as the housing market continues to sputter.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

Short Sellers vs. Chinese Companies—a War, Not a Battle; Blue Orca is finding it harder to take on Chinese tech firm Pinduoduo than Samsonite

By Jacky Wong
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Pinduoduo's rapid rise on China's e-commerce scene has been pretty astonishing. Its recent share-price rally is equally bewildering.

The **Nasdaq**-listed company's app, which offers users Groupon-like discounts on a plethora of goods and services, has gone viral in the past year. In turn, its revenue has rocketed—in the last quarter it was eight times what it was for the same period last year—while the number of its annual active buyers has more than doubled. By that active-buyers measure, Pinduoduo has already surpassed JD.com as China's second-largest e-commerce company.

This stellar growth still doesn't explain the 35% surge in Pinduoduo's shares in the last five trading days—especially since the rally got under way after U.S.-based short seller Blue Orca accused the company of hiding costs and embellishing its revenue. The stock jumped 12% alone on Nov. 14 when Blue Orca's report was published. Pinduoduo has said it is in full compliance on all the issues raised, without offering specific rebuttals.

The move in its shares stands in contrast to what happened last May when Blue Orca issued a similar takedown of Hong Kong-listed suitcase maker Samsonite, whose stock immediately plunged 10%.

One lesson here is that shorting Chinese companies is pretty tricky, especially as they often have a small public float. More than 80% of Pinduoduo's shares are owned by its founder and three other pre-IPO investors including tech giant Tencent and Sequoia Capital. Such concentrated ownership makes it easier to squeeze short sellers, who typically have to borrow stock to carry out their trading strategies. The cost of borrowing Pinduoduo's shares has risen to about 20% recently, as the supply of its stock suddenly dried up.

Blue Orca may have lost the battle, but it and other Pinduoduo doubters could still win the war. The company appears to have achieved much of its extraordinary growth by offering heavy discounts and promotions: Its sales and marketing expenses are now roughly the same level as its revenue, meaning it spends almost all of the money it generates on attracting customers.

Pinduoduo isn't yet making a profit, though it trades at an eye-watering 26 times its trailing revenue, about three times the ratio for much larger and profitable rival Alibaba. Whether it can maintain such a premium valuation will hinge on whether the company can keep growing its revenue at its recent rapid clip while actually turning that into a profit. That is no guaranteed deal.

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THE WALL STREET JOURNAL.

U.S. Markets
Markets
Tech, Oil Stocks Help Markets Stabilize; Investors take advantage of deep drawdowns some stocks suffered in recent days

By Georgi Kantchev and Michael Wursthorn
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Technology and other fast-growing stocks rebounded Wednesday, halting a **stock-market** selloff that has left investors on edge as to whether the longest **bull market** ever can regain its step.

Shares of social-networking firm Facebook, Google parent Alphabet and retail giant Amazon.com all notched gains to pull the **S&P 500** higher after two days of selling wiped out $810 billion in value from the benchmark index. A recovery in **oil prices** helped send shares of Chevron and Exxon Mobil up, while a handful of upbeat earnings reports also contributed to the gains.

Investors were taking advantage of the deep drawdowns those stocks suffered in recent days, analysts said. The gains also followed news that Amazon.com is working on efforts to expand the retailer's digital payment business, and a TV interview in which Facebook's chief executive addressed several controversies swirling around the social-media giant.

Those stocks' ability to buoy major indexes and stem the pullback underscores their influence, analysts said, making them a closely watched group for investors who are hoping the **S&P 500** can avoid further drawdowns.

"You need technology to help lead this market out of the rut it's currently in," said Lindsey Bell, an investment strategist at CFRA Research, adding that the market capitalizations of those stocks make up a significant portion of the **S&P 500**.

Trading was light on Wednesday, a day before the Thanksgiving holiday. Roughly 6.4 billion shares changed hands, the lowest trading volume since Sept. 27. The **S&P 500** rose 8.04 points, or 0.3%, to 2649.93 to snap a two-day losing streak, while the tech-heavy **Nasdaq Composite** gained 63.43 points, or 0.9%, to 6972.25, its first advance in four trading sessions.

The **Dow Jones Industrial Average**, meanwhile, ended the day flat, falling less than a point to 24464.69. The blue-chip index had been up more than 150 points earlier in the session, but those gains were eroded after an appeals court ruled that generic versions of Johnson & Johnson's prostate-cancer treatment Zytiga may go on sale, sending shares of the company down $4.46, or 3%, to $141.99.

Both the Dow industrials and the **S&P 500** remain down for the year, leaving the indexes at risk for their first annual loss since 2015. The **Nasdaq** is up just 1% for 2018, on pace for its weakest gain in seven years.

A crush of concerns threatens to unravel stocks even further, from signs of slowing economic growth, which have the potential to crimp profits, to a continuing trade spat that has exacerbated investors' dismay, analysts said.

Also among those worries: Investors are increasingly fearful that the Federal Reserve could commit a misstep if it proceeds with an aggressive pace of interest-rate increases.

Some investors, however, see little evidence of a looming recession and point to still-strong corporate earnings. Investment firm Icon Advisers has avoided selling during the drawdown, believing the **bull market** remains intact, said Craig Callahan, the firm's president. "We are riding through this," he added.

UBS Global Wealth Management said in a note that it recently increased its exposure to stocks around the world, saying the selloff was a necessary repricing, making equities more desirable.

Among Wednesday's gainers were shares of Amazon and Facebook. The internet retail giant added 21.27, or 1.4%, to 1,516.73 after The Wall Street Journal reported the company is working to persuade bricks-and-mortar merchants to accept its Amazon Pay digital wallet.

Facebook shares gained 2.39, or 1.8%, to 134.82 after CEO Mark Zuckerbergresponded to recent criticism directed at the company and said he hoped to continue working with his longtime chief operating officer, Sheryl Sandberg.

Shares of other tech giants, including Alphabet and Microsoft, also rose to help pare their losses for the month.

S&P 500 energy stocks contributed to the **S&P 500**'s gain, with those companies adding 1.6% after a bounce back in **oil prices**.

The broad index's best-performing stock, Foot Locker, added 6.87, or 15%, to 52.96 after the sporting-goods retailer reported strong same-store sales late in the day on Tuesday.

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Economy

Existing-Home Sales Suffer Largest Annual Drop in Four Years; Sales fell on an annual basis in October, as higher mortgage rates reduce home affordability

By Laura Kusisto and Sarah Chaney
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WASHINGTON—Sales of previously owned U.S. homes posted their largest annual decline since 2014 in October, as the housing market continues to sputter due to higher mortgage rates that are reducing home affordability.

The latest data offered a mixed picture of a market that isn't in free fall but also is far from robust. Existing-home sales edged up 1.4% in October from the previous month to a seasonally adjusted annual rate of 5.22 million, the National Association of Realtors said Wednesday. That broke a six-month streak when sales declined compared with a month earlier.

Sales, however, posted a sharp 5.1% drop compared with a year earlier, indicating the market is likely to end the year on a sluggish note.

Lawrence Yun, the trade group's chief economist, said the annual decline signals softness in the housing sector that is likely to persist in the months to come.

"There is some feeling that the market could actually go even lower than what it is now in terms of sales," Mr. Yun said.

When sales began slowing this spring, economists initially blamed a shortage of inventory, which has plagued the housing market throughout the recovery. But rising mortgage rates are playing a bigger role in slowing buyer demand than many economists had expected, shaking confidence that now is a good time to buy a home, according to recent surveys.

Mr. Yun said higher interest rates appear to be choking off buyer demand, and said the Federal Reserve should consider pausing its rate increases to give the housing sector time "to be on firmer ground."

Mike Fratantoni, chief economist at the Mortgage Bankers Association, said recent declines in the **stock market**are also causing fresh unease. "The level of **volatility** in the **stock market** is reflecting a lot of uncertainty about where we are with the broader economy. There is a little bit of increased anxiety about how much things are going to slow," he said.

The good news for buyers is that conditions are becoming friendlier to them, as mortgage rate and home-price increases slow and inventory of homes for sale is growing compared with last year.

The rate for a 30-year fixed rate mortgage averaged 4.81% this week, down from 4.94% a week earlier, according to data released by Freddie Mac on Wednesday. Rates are still up significantly from a year ago, when they averaged 3.92%.

The median sale price for an existing home in October was $255,400, up 3.8% from a year earlier. That shows a cooling from a year ago, when prices rose about 5.5%.

There was a 4.3-months' supply of homes on the market at the end of October, based on the current sales pace, down from 4.4 months in September but up from 3.9 months a year ago.

Mr. Fratantoni said the combination of more muted price growth and a greater number of homes for sale could boost the housing market in the spring, especially if wages continue to rise.

"We're in this awkward place right now," he said.

Purchases of previously owned homes account for the bulk of U.S. homebuying activity. The Commerce Department releases data on October new-home sales next Wednesday.

Home construction is weakening some, too. Starts fell in October for single-family construction, and permits, which can signal how much construction is planned, dropped 0.6% from September to an annual pace of 1.263 million last month.

Builders are taking a cautious stance given the Federal Reserve's plan to continue gradually raising interest rates, the National Association of Home Builders said Monday. The trade group's gauge of U.S. home-builder confidence fell sharply in November, dragged down by heightened concerns about affordability in the housing market.

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THE WALL STREET JOURNAL.

Economy

With Central Banks Out of Ammo, Governments Urged to Ready Stimulus for Next Downturn; OECD warns that countries need to prepare plans for a synchronized spending boost to fight a slowdown, but trade tensions could make that difficult

By Paul Hannon
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Governments around the world must prepare spending plans they can roll out quickly and in concert should the global economy slow sharply, given that central banks have largely run out of ammunition to fight a slowdown, the Organization for Economic Cooperation and Development said.

However, tensions among the world's largest economies over trade and other issues could make such fiscal coordination particularly difficult.

The OECD still expects the global economy to experience a soft landing over the coming years, but warned Wednesday of a growing risk that higher barriers to trade, capital outflows from developing economies, and higher **oil prices** could push it off track.

Central banks did most of the heavy lifting in steering the global economy out of the sharp slowdown that accompanied the financial crisis. But they are largely out of ammunition, the OECD said. Policy interest rates are already negative across much of Europe and Japan, meaning banks have to pay central banks to park their money with them, while central banks' balance sheets have been swollen by purchases of government bonds and other securities.

With central banks sidelined, it would be down to other parts of governments to provide the stimulus needed to support growth in a future crisis.

"You can't put too much of a burden on the shoulders of central bankers," said Laurence Boone, the OECD's chief economist, in an interview. "The fiscal authorities should do their job."

The OECD advises its member governments—which include the U.S.—on economic policy, although they don't always listen.

Governments increased spending as an immediate response to the 2008 financial crisis, but central bankers quickly took the lead in efforts to turn the global economy around, often working closely together.

One big question mark hanging over the OECD's plan is whether governments that have increasingly been at odds over trade, efforts to tackle climate change and other issues could set their differences aside to coordinate a fiscal stimulus.

"Look, things could get worse, and in that case you better prepare to work together," Ms. Boone said. "What we're trying to say is, be prepared to talk, and the quicker you talk, the better."

In new forecasts published Wednesday, the OECD said global economic growth has likely reached a peak of 3.7% this year, and is expected to slow in 2019 and 2020 to 3.5%. In September, it forecast global growth of 3.7% in 2019.

The OECD left its growth forecasts for the U.S. unchanged at 2.9% in 2018 and 2.7% in 2019, and sees a slowdown to 2.1% in 2020 as the impact of tax cuts and government-spending increases fade and the Federal Reserve's rate rises start to bite.

The organization lowered its growth forecasts for the eurozone, Japan and China this year and next, and sees growth slowing in those areas during 2020.

However, a number of headwinds could weaken that outlook significantly. The OECD said expanded tariffs on U.S.-China trade, faster outflows of capital from developing economies and higher **oil prices** could together reduce global growth to less than 3% by 2020, even approaching 2.5% annualized growth if business investment weakened sharply in response to greater uncertainty.

To avert such a slowdown, governments would get greater traction if they acted in sync to boost spending, the OECD said, partly because such a show of common purpose would help restore lost business confidence.

The research body said governments should start preparing those spending plans now so as to be able to act quickly should they be needed.

"If they are well prepared, they can act immediately," Ms. Boone said.

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Economy

Durable-Goods Orders Decrease, a Sign of Slowing Momentum in Fourth Quarter; Long-lasting factory goods orders have declined in three of the last four months

By Harriet Torry
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WASHINGTON—A decline in orders for long-lasting factory goods in October suggests business investment is softening, a discouraging sign for economic growth in the fourth quarter.

Business investment, a strong spot for the economy in the first half of the year, moderated in the third quarter and appears to have started the fourth quarter on a weak footing. Worries about a trade war, a drop in **oil prices** hitting energy investment and a stronger dollar making U.S.-made goods pricier for foreign buyers all appear to be offsetting tailwinds from last year's tax overhaul and strong corporate profits.

Orders for durable goods—products designed to last at least three years, such as computers and machinery—decreased 4.4% from the prior month in October, the Commerce Department said Wednesday. That was the biggest monthly decline in new orders since July 2017, and it was much steeper than the 2.6% drop Wall Street analysts had expected.

Separately, a decline in consumer sentiment and a jump in a key gauge of layoffs among U.S. workers added to hints of potential trouble for the fast-growing economy Wednesday.

Gross domestic product—a measure of how much the U.S. produces in goods and services—grew at a 3.5% annual rate in the third quarter. That came on the heels of a strong 4.2% growth rate in the second quarter. Economists expect the pace of growth to slow considerably in the final quarter of this year.

Private forecasting firm Macroeconomic Advisers' projection for fourth-quarter gross domestic product growth is 2.5%. The Federal Reserve Bank of Atlanta's GDPNow model's latest estimate is for 2.5% growth.

New durable goods orders have declined in three of the last four months. Orders for September were reduced to a 0.1% decline from a previous estimate of a 0.7% increase.

Monthly durable goods orders are turbulent, and last month's decline was influenced by an outsize drop in aircraft orders. The report showed orders in the **volatile** civilian aircraft category declined 21.4% in October. Still, a closely watched proxy for business investment—new orders for nondefense capital goods excluding aircraft—was flat in October after declining 0.5% in September and 0.2% in August.

Tax-law changes approved late last year were designed to incentivize business investment, which expanded at an 11.5% annual rate in the first quarter, but slowed to a 0.8% rate in the third.

"The genuine bad news here is the fact that underlying capital-goods orders and shipments have leveled off over the past three months," Michael Pearce, an economist at Capital Economics, said in a note to clients. "That suggests the sudden weakness in business-equipment investment in the third quarter was not a one-off," he added.

Semiconductor-equipment supplier Applied Materials Inc. last week issued disappointing guidance, and Chief Executive Gary Dickerson described market conditions in the second half of the year as challenging. During an earnings call Thursday, he cited elevated macroeconomic risks, global trade tensions and a pullback in investment in the industry.

Farm machinery maker Deere & Co. said Wednesday that sales and profits in its latest quarter were lifted by demand in its construction and farming markets. Still, the company said that it was pressured by rising raw-material costs, especially in steel, as well as logistics expenses. It has been working to cut costs and raise prices as a result, the company said.

Separately, the Labor Department said Wednesday that the number of U.S. workers filing new applications for unemployment benefits rose last week to the highest reading since June, though they remained near historically low levels. Initial jobless claims, an indication of layoffs across the U.S., increased by 3,000 to a seasonally adjusted 224,000 in the week ended Nov. 17.

Consumer sentiment also cooled slightly just ahead of Black Friday and the peak of the holiday-shopping season. The University of Michigan on Wednesday said its final consumer sentiment index for November was 97.5. That was down from a preliminary reading of 98.3 released earlier this month and a decrease from 98.6 in October.

Despite some somber economic readings, Federal Reserve officials have signaled in recent days they plan to proceed with another quarter-percentage-point increase in their benchmark short-term interest rate when they meet Dec. 19, marking their fourth rate increase this year.

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THE WALL STREET JOURNAL.

World

Italy's Big Budget, Designed to Help Business, Is Hurting It; Company loans are becoming more costly after lofty government spending prompted higher rates on Italian bonds, raising banks' borrowing costs

By Eric Sylvers
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MILAN—Gian Enrico Grugni's dairy farm near Italy's financial capital shows how the country's big-spending budget, which the government says will spur growth, is so far hurting the companies it is supposed to help.

Soon after Mr. Grugni applied for a €400,000 bank loan to buy land and build new cow stalls, Italy unveiled plans for a budget deficit that violated the European Union's rules on fiscal discipline. Investors in turn demanded higher risk premiums for holding Italian bonds. And that led to bigger borrowing costs for Italian banks.

The increase trickled down to Mr. Grugni, who said that while his application was pending the interest rate the bank will charge rose by almost half a percentage point, leaving him less money to invest in his business.

"When you consider the interest-rate increase over the 15 years of the loan, that's a lot of money you're losing," Mr. Grugni said.

Italy's coalition government of the antiestablishment 5 Star Movement and nativist League is staking its future on a budget that lowers the pension age, raises welfare benefits for the poor and jobless and cuts income taxes. The measures are popular with voters but criticized by business associations, many economists and the EU.

On Wednesday, the EU's executive body said Italy's 2019 budget is "a particularly serious case of noncompliance" with the bloc's recommendations. The EU is expected in December to begin disciplinary proceedings against Italy that could lead to fines. The Italian government Wednesday reiterated its commitment to the budget.

Italy says the budget will stimulate growth. If that isn't the case, Italy will be left with an even bigger debt burden, already one of the largest in the world. That could lead to further market turbulence, credit downgrades, and more problems for Italian companies.

Italian banks are better equipped than at the height of Europe's financial crisis in 2011-12 to face a possible downturn and an increase in loan defaults. But many economists say rising borrowing costs could eventually be followed by banks closing the taps to all but the safest borrowers, as happened early this decade.

Already, Italian companies seeking new loans and credit lines faced notably tighter lending conditions—including higher rates and increased collateral—in the third quarter compared with the previous three months, according to the European Central Bank's most recent lending survey. In contrast, lending conditions eased in Germany, Spain and the Netherlands and were unchanged in France.

The financial tensions in Italy, the eurozone's third-largest economy behind Germany and France, are compounding an already dimming global economic outlook, partly due to U.S. trade tensions with China and the EU.

The International Monetary Fund's former chief economist Olivier Blanchard estimates that the credit tightening triggered by Italy's budget plan is already slowing economic growth, projected by the European Commission to be 1.2% next year, more than the fiscal stimulus stands to boost it.

Such predictions have weighed on Italy's benchmark **stock index**, which has lost a fifth of its value since the government began to take shape in May. The shares of the country's two biggest banks—UniCredit SpA and Intesa Sanpaolo SpA—are down by nearly 40%.

But Italy's small- and medium-size companies, 90% of which rely on bank loans for financing, according to credit rating agency CRIF Ratings, will be hardest hit by rising borrowing costs. The loans often have variable rates, meaning that **financial-market** movements affect businesses quickly, and many companies have revolving credit lines that must be renegotiated every year.

"These companies have very little room to maneuver," said CRIF Director Simone Mirani. "Any negative change in market conditions puts them at risk. The situation isn't yet critical, but as interest rates rise, an increase in the default rate is inevitable."

The difference between Italian and German 10-year bonds, a closely watched benchmark used as a barometer for borrowing costs, is now around 3 percentage points—about 2 points higher than before government coalition talks began.

Interest rates remain at historic lows, but with the ECB due to phase out its purchases of eurozone government bonds, many companies in Italy are bracing for hard times ahead.

The new financial terrain is also taking a toll on companies that had sought financing on the equity markets, with about 20 shelving plans for initial public offerings over the past few months, according to financial advisers. Despite tax breaks introduced this year to encourage companies to list shares, only five IPOs have happened in Italy since the recent rise in borrowing costs, compared with 12 in last three months of 2017.

Those companies that have forged ahead have accepted lower valuations than the market was offering until recently, giving them fewer funds to invest.

Tere Group, which makes bioplastic products out of algae, had planned an initial share sale to fund a new headquarters and research center south of Milan. The company recently ditched those plans and the jobs that would have accompanied it. General Manager Michael Magri said he hoped markets would stabilize and the IPO can take place early next year.

"It's out of our hands now and all we can do is wait," said Mr. Magri.

Giovanni Legorano in Rome contributed to this article.

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Trade and Tech Threaten Market Streak --- The S&P 500 rose on Thanksgiving week for six years, but now the run is at risk

By Amrith Ramkumar
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21 November 2018
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English
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Anxiety about global trade policy and a continuing rout of technology stocks have put the **S&P 500** in danger of ending its six-year streak of Thanksgiving week gains, the latest milestone threatened by recent market turbulence.

In one of the more obscure, but timely, feats of the nine-year-old **bull market**, the benchmark **stock index**, which has fallen 3.4% so far this week and is 9.9% below its Sept. 20 record, has climbed every week of Thanksgiving going back to 2012, according to Dow Jones Market Data.

In the past 10 years, the index has averaged a 1.3% advance during Thanksgiving week, and posted a 0.7% climb on average that week going back to 1950. That compares to a 0.2% average climb in an ordinary week.

Internet stocks have driven much of the recent success, with the tech-heavy **Nasdaq Composite** averaging a 1.3% rise the week of Thanksgiving in the past 20 years.

But tech has struggled in recent weeks, illustrating a continuing tension as investors debate whether stocks can continue climbing with leadership from other sectors. The **Nasdaq** has fallen 4.7% through Monday and Tuesday, putting it 15% below its August record.

Apple Inc., Amazon.com Inc., Google parent Alphabet Inc., Microsoft Corp., Facebook Inc. and Netflix Inc. have all fallen at least 3.5% so far this week.

The latest leg lower for U.S. stocks came after a weekend economic summit of world leaders ended in acrimony, the latest setback for investors hoping that a resolved U.S.-China tariff fight will help markets stabilize late in the year.

Continued trade uncertainty and concern about peaking profit growth have also threatened other **stock-market** achievements recently. The **S&P 500** ended a six-month winning streak last month.

The largest technology companies have lost hundreds of billions of dollars in market value, pulling Apple and Amazon well below $1 trillion after the duo became the first U.S. companies to reach the threshold earlier this year.

Many of the market's leaders from recent years are now in bear markets, defined as a drop of 20% from a recent peak.

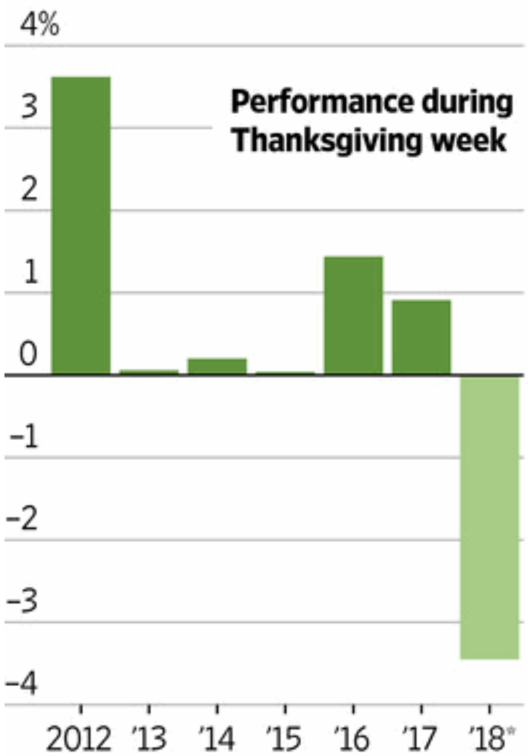
And even with companies posting their largest profit increases in several years, this week's heavy losses have pushed the **S&P 500** down more than 1% for 2018, after climbing in five of the past six years.

Investors banking on a rebound this week and in December hope coming retail earnings or positive trade news could improve that mark in the coming days. History could also provide some solace: The **S&P 500** has risen 85% of the time on the Tuesday through Friday of Thanksgiving week since 1950.

Kenny Jimenez contributed to this article.

In Jeopardy

The S&P 500 is in danger of halting a streak of six consecutive advances during the week of Thanksgiving.



*Through Tuesday

Source: Dow Jones Market Data

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Economy

U.S. Jobless Claims Rose Last Week; Initial claims, an indication of layoffs across the U.S., increased by 3,000

By Paul Kiernan and Harriet Torry
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WASHINGTON—The number of U.S. workers filing new applications for unemployment benefits continued to rise last week after hitting a nearly five-decade low in September, though they remained near historically low levels.

Initial jobless claims, an indication of layoffs across the U.S., increased by 3,000 to a seasonally adjusted 224,000 in the week ended Nov. 17, the Labor Department said Wednesday.

Economists surveyed by The Wall Street Journal had forecast 214,000 new applications for jobless benefits last week.

Claims for the week ended Nov. 10 were revised higher to 221,000 from

an initially reported 216,000.

Jobless claims can be **volatile** from week to week. The four-week moving average of claims, a steadier measure, also rose last week to 218,500. That was 2,000 more than the previous week's upwardly revised average.

The report showed the number of continuing unemployment benefit claims—those drawn by workers for more than a week—falling by 2,000 to 1,668,000 in the week ended Nov. 10. Continuing claims are reported with a one-week lag.

The number of workers requesting unemployment insurance was equivalent to 1.2% of employed workers paying into the system in the week ended Nov. 10, down from 1.4% a year earlier.

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THE WALL STREET JOURNAL.
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Selloff Erases Market's 2018 Gains --- Fed still plans to raise rates next month, even as turmoil in stocks rattles investors

By Nick Timiraos and Gregory Zuckerman
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Market turbulence is leading some investors to call on the Federal Reserve to halt its campaign of interest-rate increases, but the selloff in stocks and corporate bonds is unlikely to stop the central bank from raising rates next month.

Fed leaders have signaled in recent days they plan to proceed with another quarter percentage point increase in their benchmark short-term interest rate when they meet Dec. 19, marking their fourth rate increase this year. But the market pullback underscores the uncertain outlook for what the Fed will do after that.

Fed officials are divided over how many times the central bank will raise rates next year. Projections released after the Fed's meeting in September showed officials are about equally split over whether the economy will require two, three or four rate rises next year.

The Fed will update its projections when it meets in December. Some officials could reduce their estimates for the number of rate increases required next year if the market rout continues, or if their expectations for growth or inflation next year recede.

The **Dow Jones Industrial Average** fell sharply Tuesday to its sixth drop in eight trading days, a move that has wiped out its 2018 gains.

For the Fed to change its December plan, the selloff would likely need to signal some broader deterioration in the U.S. outlook. Recent economic data show few signs of that.

"Interest rates are still very low. We've raised them, but they are still at a very low level," New York Fed President John Williams said on Monday.

Some investors worry that recent troubles in stocks and bonds could portend more economic weakness than Fed officials are counting on, and that a rate increase in that environment would be dangerous.

"I would pause and see if the market knows something we don't," said Stanley Druckenmiller, who once ran George Soros's hedge fund and today manages his own money. He has been a vocal critic of the Fed's reluctance to boost rates in recent years and other efforts to stimulate the economy. But he points to a number of signs of trouble in the market as reasons to hold off on a rate increase next month.

Complicating matters is the fact that President Trump has been calling on the central bank to halt interest-rate increases. Some investors might interpret a central bank decision to stop now as a bend to political pressure, which would hurt the Fed's inflation-fighting credibility.

The Republican president continued his pressure campaign on Tuesday. "I'd like to see the Fed with a lower interest rate," he said outside the White House. "We have much more of a Fed problem than we have a problem with anyone else." A Fed spokeswoman declined to comment.

Though the U.S. economy looks strong -- especially the job market-**financial markets** are sending some worrying signals. Retail stocks have sold off lately, a possible indicator that consumers -- who powered the expansion in 2018 -- could be faltering. On Tuesday, shares of Target Corp. and Kohl's Corp. dropped 11% and 9%, respectively, after releasing quarterly results.

Credit spreads, reflecting the difference in yields between corporate bonds and safe Treasury securities, have jumped lately, a shift that in some past instances has foreshadowed a weakening economy. Interest rates on speculative-grade U.S. corporate bonds were on average 4.18 percentage points above comparable Treasury securities Monday, up from a multiyear low of 3.03 percentage points in early October, according to Bloomberg Barclays data.

Still, these spreads aren't yet at alarming highs. They remain well below levels reached in a 2016 market rout, when they exceeded 8 percentage points above Treasurys, or during the financial crisis, when they hit nearly 20 percentage points above Treasurys.

Rising mortgage rates are another potential trouble spot for the economy. They have exacerbated affordability problems in the housing market, weighing on the interest-sensitive sector. Building permits for new housing units, a leading indicator of construction activity, stood 6% below their year earlier level in October, the Commerce Department said Tuesday.

Speaking in Dallas last week, Fed Chairman Jerome Powell said the recent market selloff could reduce growth by tightening financial conditions, but he did not suggest it had been enough for the Fed to change its policy plans.

Market conditions are "one of many factors" the Fed considers when deciding where to set its rate, he said.

He also said the Fed would carefully watch credit spreads, which have been narrow because investors have been optimistic about the economy's prospects. Mr. Powell is scheduled to speak in New York next week and to testify on Capitol Hill on Dec. 5.

The Fed's forecasts already incorporate some slowdown in the economy's growth rate next year, to 2.5% from 3.1% this year.

The Fed sees the unemployment rate dropping to 3.5% next year from 3.7% in October, and inflation remaining near its 2% target.

(See related article: "Concern rises that **bull market** is losing steam as tech rout deepens, affecting other sectors" -- WSJ November 21, 2018)

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Signs of Stress

The stock-market selloff of the past two months has been accompanied by a rise in the yield demanded by corporate bond investors and a decline in market rate-increase expectations.

*Option-adjusted spread

Sources: Bloomberg Barclays (spread); CME Group

THE WALL STREET JOURNAL.

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The New York Times

The Upshot
Markets Are Revealing the Sum of All Risks

By Neil Irwin
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The most telling thing about the pummeling that the **stock market** has taken recently, and especially this week, is that there's no simple single cause to point to.

That reflects the fundamental economic risk for 2019 and beyond. There isn't a lone caution on the horizon that can be identified and monitored and that policymakers can respond to.

Rather, markets reflect a widening sense of unease that several different types of risks are rising at once — and that although any one of them might be manageable, together they could lead the economy into serious trouble in 2019 or 2020.

This emerging conventional wisdom is far ahead of the facts on the ground: Most economic data lately has pointed to continued healthy growth.

And while stocks are down 9.5 percent since early October, the yield on longer-term Treasury bonds is at about the same level. The bond market tends to be more closely tethered to the direction of the overall economy than stocks, so that suggests investors in recent weeks have not radically reshaped their view on future growth.

But when you tick through the list of fears causing the sell-off, it's easy to see why stock investors in particular are getting jittery, driving steep market drops Monday and Tuesday.

The giant tech companies that have propelled the market for years are facing risks of slowing growth (especially Apple) and new regulation (especially Facebook). **Oil prices** are plummeting, sending the share prices of energy companies downward. Investors are starting to worry that companies with heavy debt loads could struggle to handle them, with General Electric as Exhibit A. The trade war, long at a steady simmer, could boil over at any time.

Oh, and economic growth seems to be slowing worldwide. The United States housing market is in a slump. And forecasters expect the stimulative effects of tax cuts to fade in the coming quarters. That makes a slowdown in the rate of growth appear more likely than not, especially if the Federal Reserve persists with interest rate increases amid a slower-growing economy.

But before running for the hills in panic, there are a few things worth considering. First, bad things happen all the time in the economy, and in markets. Usually, the damage is localized to the industries directly affected.

Take the tightening of corporate credit that is underway, with interest rates for riskier companies soaring. It has echoes of the not-too-distant past. In the mid-2000s, American automakers were overleveraged and facing a difficult environment. General Motors and Ford bonds were cut to junk status in 2005.

Bondholders and credit ratings agencies lost confidence in those industrial icons' corporate debt, causing plenty of pain for the automakers' employees and stock prices. But the overall economy kept humming along. (It was a recession rooted in other sectors, three years later, that dragged American automakers toward bankruptcy.)

Similarly, it's easy to look at the slowdown in home sales and building activity, for example, and fear that it could lead to a repeat of the 2008 recession.

But in that episode, housing starts peaked in January 2006. For nearly two years, the economy largely held up; as housing contracted, other sectors grew. It was only after the housing downturn triggered a financial crisis that a recession began in December 2007.

In terms of a slowing global economy, in 1998 an emerging markets crisis seemed to endanger a booming American economy enough that the Federal Reserve cut interest rates late that year to try to guard against damage. As it turned out, 1999 was a boom year.

What these episodes all show is that adjustments — whether in the credit markets, the housing market or emerging markets — tend to cause huge economic disruption only if there are compounding factors, or inadequate policy responses.

Already in the last couple of weeks, top Federal Reserve officials have softened their tone about how high they will eventually push interest rates.

The implicit message: If all of these negative forces really do start to harm growth, the Fed will slow the pace of rate increases, rather than stick to some preordained path.

The great fear for the economy in the next couple of years shouldn't be the risks we know about. It is that those risks will materialize and interact in unpredictable ways, and together cause damage that none of them alone could. And if that happens, the last few weeks will look like a crucial moment when it began.

Markets are reflecting gathering risks. A view of the New York Stock Exchange from Federal Hall National Memorial. | Mary Altaffer/Associated Press

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The New York Times

National Desk; SECTA
The Economy Is Purring, but Stocks Are Growling

By MATT PHILLIPS; Clifford Krauss and Stephen Grocer contributed reporting.
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Unemployment is near lows not seen in half a century. The American economy is set for its best year since 2005. Large corporations are producing giant profits. Even wages are starting to rise.

And the stock markets are a mess.

The losses extended on Tuesday, as the **S&P 500**-**stock index** turned negative for the year, stoking fears that one of the longest bull markets in history could be at risk.

The **stock market**'s struggles may seem incongruous against the backdrop of strong economic growth. But stocks often act as an early warning system, picking up subtle changes before they appear in the economic data.

In recent weeks, retail stocks have been hit over concerns of rising costs, a sign that President Trump's global trade battles may be starting to take a toll and that higher wages are cutting into profits. Commodities and the companies that depend on them have been pummeled by the prospect of weaker demand should the global economy slow. Five tech giants -- Facebook, Amazon, Alphabet, Apple and Netflix -- have shed more than $800 billion in market value since the end of August, the fallout from slowing growth and regulatory scrutiny.

The **S&P 500** closed on Tuesday at 2,641.89, down 1.8 percent. Other markets also flashed warnings, with oil dropping by 6.8 percent, falling deeper into bear territory.

Asian markets on Wednesday signaled a potential respite. Stocks in China, Japan and Hong Kong were lower in morning trading, but to a lesser extent than on Wall Street. Futures contracts that predict how American markets will perform suggested Wall Street could open higher on Wednesday.

The sell-off doesn't mean the United States is headed into a recession. The **stock market** suffered several sharp stumbles in recent years before climbing to new highs on the back of booming corporate profits and strong economic growth.

But the recent market drop could portend problems. In 2018, a hefty dose of fiscal stimulus, in the form of tax cuts, allowed the United States to shake off the growth worries in China, Europe and the rest of the world. It won't have the same potency next year, leaving the American economy and stocks more vulnerable to a range of risks, including a slowing global economy and continued rate increases by the Federal Reserve.

''I think there are very clear signs that investors are beginning to worry about weaker growth in the coming year or so, and how that's going to feed through to corporate earnings,'' said Michael Pearce, senior United States economist with Capital Economics.

Mr. Trump, on Tuesday, pointed to the health of the economy and instead blamed the Fed for contributing to the sell-off. Mr. Trump, who has taken credit for the rising **stock market**, has been critical of the rate increases, saying they undermine growth.

''I would like to see the Fed with a lower interest rate,'' he said. ''I think the rate is too high.''

Until recently, investors were willing to ignore the domestic political dramas, geopolitical turmoil and other issues clouding the outlook for American companies. Now they appear jittery, selling stocks at small signs that vague risks may become realities.

So far this year, strong growth and deep corporate tax cuts have supercharged corporate profits. Once all the results are tallied up, the third-quarter earnings for companies in the **S&P 500** are expected to be up more than 28 percent from a year earlier -- outpacing previous quarters, according to the financial data company Refinitiv.

But those numbers haven't satisfied the markets. Investors have instead grown concerned about risks they face both from continued economic strength and, alternatively, an economic slowdown. Either path could upend a nearly decade-long rally that has lifted the **S&P 500** nearly 300 percent.

Strong economic growth at home would most likely mean a prolonged rise in interest rates and rising costs in areas like wages, which would hurt corporate profitability. Weaker growth abroad would cut into sales.

In recent days, both forms of fear have fed the market decline.

On Tuesday, shares of the retailer Target dropped by more than 10 percent, on worries that rising costs -- from increased wages to higher prices for the Chinese goods facing tariffs -- could continue to crimp profits. Investors also dumped shares of Kohl's and TJX, the owner of T. J. Maxx, which both saw freight costs eat into earnings.

Apple continued its slide on worries about softening demand. The tech giant tumbled 4.8 percent after Goldman Sachs equity analysts cut their price target, citing deteriorating demand, especially in China.

China, the world's largest consumer of oil, has also been weighing on commodities. The price of crude, now just above $53 a barrel, has fallen nearly 30 percent since early October. On Tuesday, energy was the worst-performing part of the **S&P 500**, with companies like Exxon Mobil, Chevron and the oil-field services provider Schlumberger losing more than 2.5 percent.

Oil prices have been sliding despite signs that major producers like Saudi Arabia are considering cutting production. And that has amplified worries that China and the rest of the global economy may be in a weaker spot than markets realized.

Last quarter, China's growth slowed to its lowest level since 2009, during the depths of the global financial crisis. Japan, the world's third-largest economy, is also looking shaky, with the economy contracting in the third quarter, amid a slowdown in trade and investment.

Germany, the powerhouse behind Europe, also shrank unexpectedly during the third quarter as trade slumped and car production faltered. If Germany stumbles, it will add to the economic and political turmoil in a region already dealing with Britain's chaotic exit from the European Union and Italy's budget dispute with the bloc.

In 2018, America's economy proved largely immune to such issues. But the global slowdown could eventually spill over into the United States, particularly as the impact of this year's tax cuts fades in the coming years. Economists expect that domestic growth, which is close to 3 percent this year, will slow to 2 percent by 2020, according to estimates published by FactSet.

For the economy, that is a respectable performance. But for investors, a slowdown is likely to be uncomfortable.

Disappointing data and earnings updates could ignite periodic panics over the threat of recession, even if remote. Markets are likely to be much choppier that than they've been in recent years. Gains could be lower.

In other words, the market may be messy for a while.

''I think this is what a low-return environment starts to feel like,'' said Joe Davis, chief economist with Vanguard. ''The past five years, although entirely welcome from an investment standpoint, is clearly unsustainable.''

The New York Stock Exchange on Tuesday, when a dive sent the **S&P 500** into the red for the year. (PHOTOGRAPH BY HILARY SWIFT FOR THE NEW YORK TIMES) (A1); The **S&P 500** closed down 1.8 percent on Tuesday, after shedding 1.7 percent the day before. (PHOTOGRAPH BY JUSTIN LANE/EPA, VIA SHUTTERSTOCK) (A14)

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THE WALL STREET JOURNAL.

Page One

What's News: Business & Finance

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Rising concerns about economic growth spurred fresh declines in stocks around the globe, wiping out all of 2018's gains for the **S&P 500** and the Dow, which slid 1.8% and 2.2%, respectively. The **Nasdaq** dropped 1.7%.

Market tumult is unlikely to stop Fed officials from raising interest rates at their meeting next month.

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Facebook's Zuckerberg, in a CNN interview, pushed back against calls for him to step down as chairman.

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WSJ PRO BANKRUPTCY

Markets

SpaceX Launches First Loan; The loan opens a new fundraising avenue for SpaceX as it looks to finance multibillion-dollar projects in coming years

By Sam Goldfarb and Andy Pasztor
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Elon Musk's SpaceX raised $250 million from its first-ever high-yield loan sale, shrinking the size of the loan by $500 million after the company encountered a mixed reception from investors and worsening credit-market conditions.

The loan, facilitated by Bank of America Corp. and slated to fund general corporate purposes, opens a new avenue for fundraising for SpaceX as it looks to pay for massive projects demanding many billions of dollars over the next few years.

Based in Hawthorne, Calif., SpaceX makes money by launching commercial and government satellites but has larger ambitions to send astronauts into orbit and eventually to carry humans to Mars. It has previously relied on private-equity funding that valued the company at more than $20 billion.

SpaceX marketed its loan only to a select group of investors.

Some investors who were offered the loan expressed misgivings about the company's record of burning through cash and its experience with high-profile accidents, which have previously led to dips in revenue. Other concerns include the company's large investment plans and its connection to Mr. Musk, the founder and chief executive of SpaceX, whose **volatile** behavior has led to turmoil at the electric-car maker Tesla Inc., where he also is chief executive.

Still, the loan intrigued some, based in part on SpaceX's lofty equity valuation, which implies its assets are worth more than its debt. SpaceX also holds a prominent position in a business with high barriers to entry.

Doug Wooden, a senior analyst at DDJ Capital Management, said DDJ had been interested in buying the loan based on the value of SpaceX's core business. The firm passed on the debt only after it was shrunk to $250 million, because that promised to make it harder to trade in the secondary market, he said.

The environment for issuing new bonds and loans has deteriorated in recent weeks, making SpaceX's debt sale more difficult. Demand for loans has generally outpaced other fixed-income assets because their variable-rate coupons rise as the Federal Reserve lifts benchmark interest rates. Even so, the average price of loans in the S&P/LSTA Leveraged Loan Index has dropped by 0.3 percentage point over the past week to 97.7 cents on the dollar as of Monday, according to LCD, a unit of S&P Global Market Intelligence, indicating investors see greater risk in the asset class.

The SpaceX loan was issued late Monday at 99 cents on the dollar with a coupon of 4.25 percentage points above the benchmark London interbank offered rate. That was at the high end of original guidance.

In a gesture to investors in the late stages of the debt sale, SpaceX tweaked certain terms, generally making it likelier that the company will be on solid financial footing before it does things in the future like issue more debt or make certain investments.

Despite shrinking the size of the loan, Bank of America received more than $750 million in orders from investors for the debt, according to a person familiar with the situation—enough to sell the loan at its original size. SpaceX decided to go with the smaller loan because it is comfortable with its cash-generating ability, the person said. Issuing less debt could also make it easier for SpaceX to revise the terms of the loan later if market conditions improve, investors noted.

SpaceX's existing businesses currently take in revenue of about $2.5 billion a year, according to industry officials. Profit margins are constrained in part by a payroll of some 7,000 employees, the cost of operating three launchpads and expenditures for developing a fourth site. In years when has suffered rocket explosions, SpaceX has lost money.

Mr. Musk and his team are pushing ahead with a multibillion-dollar plan to launch more than 7,000 small communication satellites into low-earth orbit. Another part of the company is proposing to spend many times that sum over the next 10 to 20 years to develop and test the BFR, a mammoth rocket and capsule larger than any built before, to transport people to Mars.

Over the years, Mr. Musk has talked about the importance of maintaining focus on Mars exploration and said such ambitious goals wouldn't be supported if the company went public or if his controlling stake was diluted. Now, though, according to some industry analysts and aerospace industry officials, the loan appears to be part of a shorter-term initiative to accelerate development of a full-size version, or perhaps a smaller, less-capable test, of what was formerly the BFR.

The loan activity comes as global demand for launching commercial satellites is stagnant, and SpaceX is just beginning to see its U.S. government business ramp up. There doesn't appear to be any prospect, at least for the foreseeable future, of federal dollars providing significant funding to help development of the proposed giant rocket or planned small satellites.

Earlier this year, SpaceX was shut out in a U.S. Air Force competition that awarded more than $2 billion in contracts to three other rocket makers to develop various smaller boosters intended to begin lifting U.S. military and spy satellites around the mid-2020s.

Soma Biswas contributed to this article.

Write to Sam Goldfarb at sam.goldfarb@wsj.com and Andy Pasztor at andy.pasztor@wsj.com

More

* Elon Musk's Right-Hand Woman Is Steadying Force at SpaceX (Sept. 30)

* Jeff Bezos' Space Startup to Supply Engines for Boeing-Lockheed Rocket Venture (Sept. 27)

* One Small Step for Yusaku Maezawa, One Giant Leap for Elon Musk's SpaceX (Sept. 18)

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What's News
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THE WALL STREET JOURNAL.
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Energy Shares Shed Their Ties With Oil Prices

By Kevin Kingsbury
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The link between crude prices and shares in oil producers has weakened. With the commodity losing a quarter of its value in six weeks, that is a relief for investors.

Oil bottomed in early 2016 after falling steeply over the previous two years and then rebounded sharply. Prices had roughly tripled by early October, when Brent, the benchmark, briefly topped $85 a barrel. Yet the gains for energy companies, especially larger ones, fell well short of that. Hong Kong-listed shares in PetroChina Co. rose 62% from January 2016 to a high in June.

In another sign of divergence, many equity prices in the sector notched 2018 highs well before October. PetroChina peaked four months earlier.

There has been "a disconnect between energy stocks and commodity prices throughout this rally" from early 2016, said Pavel Molchanov, at Raymond James in Houston.

A measure of correlation shows the linkage between the Dow Jones Oil and Gas Titans index and West Texas Intermediate, the U.S. crude benchmark, remains high but has fallen. In the past year this measure was 0.79, Refinitiv data show, down from above 0.9 over the prior 20 years. Scores above zero mean the two prices tend to move together in the same direction, with the relationship strengthening as the measure gets closer to 1.

Mr. Molchanov says one explanation lies in oil futures markets. For much of 2018, spot prices, which reflect the cost of buying oil for delivery now, have been higher than futures contracts. That signals a cautious longer-term view on crude.

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THE WALL STREET JOURNAL.
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REVIEW & OUTLOOK (Editorial)
The Trade Canary

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With another 2% or so decline on Tuesday, U.S. stock indices have given up their gains for the year. The rout that started in tech stocks has moved to oil shares amid worries about global demand, as well as to retail stocks, which suggests concern about whether consumers will continue their pace of spending as asset prices fall.

It's a legitimate worry. The job market has been strong, and small business confidence remains high, but those tend to be lagging indicators. With the world economy showing strains, the chances of a significant U.S. growth slowdown can no longer be ruled out. We'd note that our contributor Donald Luskin, the financial adviser and long-time growth optimist, has put himself on recession watch.

Trade flows aren't a perfect proxy for GDP, but trade in an expanding economy tends to increase at a faster pace than overall growth. The average annual increase from 1987-2007 was 7.1%. Trade volume naturally fell during the recession but rebounded to 12% growth in 2010. But it stagnated at 3% from 2012-2014, and then went below 2% in 2015 when the economy barely escaped another recession.

Trade flows revived along with growth in 2017, but they fell again this year as Donald Trump unveiled his global tariff assault after tax reform passed. The World Trade Organization hasn't yet reported third quarter trade data, but a fair guess would be continuing doldrums, as global growth has slowed and the threat of more tariffs hangs over supply chains, investment decisions and confidence.

We hope someone at the White House is listening to this trade canary. Mr. Trump is expected to meet Chinese President Xi Jinping later this month at the G-20 meeting, and the world will be watching to see if they strike a trade truce. The chances of a deal have seemed slim, but the logic of a truce grows stronger as the **stock market** falls further.

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THE WALL STREET JOURNAL.

Markets
Share Buybacks, the Latest Tool to Calm Markets, Surge in China

By Shen Hong
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Chinese companies have bought back record amounts of stock this year, helping offset souring market sentiment caused by trade tensions and economic weakness.

What's Happening

Some 913 companies listed in Shanghai and Shenzhen have repurchased a total 35.5 billion yuan ($5.1 billion) of shares this year, Wind data shows. That's nearly four times the sums spent in all of last year, by roughly half as many companies.

To be sure, the absolute haul remains tiny for two markets worth a total $6.4 trillion—or compared with the $645.8 billion that companies listed in the U.S. **S&P 500** spent in the 12 months to June. Neither companies listed in mainland China nor Hong Kong have been active repurchasers of stock, compared with their U.S. counterparts.

Still, the outlays are likely to get a lot larger. Until October, buybacks were only allowed for limited purposes such as employee stock incentives. But a legal change, at the urging of the securities regulator, means they can now be used for much broader reasons, such as to "defend corporate value" and or "protect shareholders' interests."

Beijing has its own, very particular reasons for embracing this internationally popular tool. The main Shanghai Composite Index is down roughly 20% this year. That has put pressure on many companies whose major shareholders have pledged shares as collateral for loans from banks and brokerages.

Slightly more than 10% of shares traded on the country's two bourses are used in this way. This has led to a vicious cycle. As shares fall, lenders ask for more collateral. If investors can't cough up the cash needed, that can trigger so-called forced selling of shares to settle the loan. That further depresses stock prices, prompting fresh demands for collateral.

What It Means

Some observers say the Chinese buybacks defy economic logic.

"In developed markets like the U.S., companies typically initiate share buybacks when they think their stocks are undervalued despite their belief in their long-term prospects," said Hu Yifan, Hong Kong-based chief economist for China at UBS Wealth Management. "They also do it only if they have lots of cash in hand."

Mainland shares are cheap by historical standards: Shanghai A-shares trade at just 9.7 times estimated earnings, Refinitiv data shows, nearly 20% cheaper than the average in the past 10 years. However, many companies buying back stock are either short of cash or are suffering from margin calls on pledged shares, said Ms. Hu.

Jacky Zhang, a Shanghai-based analyst at BOC International, said: "In other markets, companies buy back their stocks in a **bull market**. Here, we do it so as to heed the regulator's call to rescue the market."

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

Asia Markets Snapshot

* Regional stock indexes fell, but not as sharply as an overnight selloff on Wall Street

* South Korea's Kospi lost 1% while Japan's Nikkei 225 declined 0.7%

* Australia's ASX 200 hit a 21-month intraday low before paring some losses

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THE WALL STREET JOURNAL.

Markets
Dollar Rises as Stocks and Oil Sink; U.S. currency gains against Canadian dollar and Norwegian krone

By Sam Goldfarb
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Corrections & Amplifications

The dollar rose Tuesday as stocks and **oil prices** extended recent declines, bolstering demand for safer assets.

The WSJ Dollar Index, which measures the U.S. currency against a basket of 16 others, climbed 0.5% to 90.39.

The dollar's climb came as stocks tumbled once again, wiping out yearly gains for major U.S. indexes. **Oil prices** were also sharply lower, weighing on the currencies of commodity-producing countries such as Canada and Norway.

The U.S. dollar gained 1% against the Canadian dollar at 1.331 loonies per U.S. dollar and 1.2% against the Norwegian krone at 8.580 krone per dollar.

Relative to other currencies, the Japanese yen, a traditional haven asset, held its ground, with the dollar rising just 0.2% against the currency to 112.754 yen per dollar.

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THE WALL STREET JOURNAL.

Markets

Federal Reserve Not Likely Swayed by Recent Stock Market Declines; Central bank officials have indicated they plan to proceed with a December rate hike

By Nick Timiraos and Gregory Zuckerman
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Market turbulence is leading some investors to call on the Federal Reserve to halt its campaign of interest rate increases, but the selloff in stocks and corporate bonds that accelerated Tuesday is unlikely to stop the central bank from raising rates when it meets again next month.

Fed officials have signaled in recent days they plan to proceed with another quarter percentage point increase in their benchmark short-term interest rate when they meet Dec. 19, marking their fourth rate increase this year. The market pullback does underscore however the uncertain outlook for what the Fed will do after that.

Fed officials are divided over how many times the central bank will raise rates next year. Projections released after the Fed's meeting in September showed officials are roughly equally split over whether the economy will require two, three or four rate rises next year.

Officials will update their projections when they meet in December. Some officials could reduce their estimates for the number of rate increases required next year if the market rout continues, or if their expectations for growth or inflation next year recede.

The **Dow Jones Industrial Average** fell sharply Tuesday to its sixth drop in eight trading days, a move that has wiped out its gains for the year.

For the Fed to change its December plan, the market selloff would likely need to signal some broader deterioration in the U.S. outlook. Recent economic data shows few signs of a slowdown outside of the rate-sensitive housing sector. A continued run of strong labor-market data, in particular, would make it difficult for the Fed to justify a pause.

"Interest rates are still very low. We've raised them, but they are still at a very low level," said New York Fed President John Williams on Monday. He reiterated the Fed's plans to pursue a "gradual path" of rate rises.

Some investors worry that recent troubles in stocks and bonds could portend more economic weakness in the U.S. and abroad than Fed officials are counting on, and that a rate increase in that environment would be dangerous.

"I would pause and see if the market knows something we don't," said Stanley Druckenmiller, who once ran George Soros's hedge fund and today manages his own money. He has been a vocal critic of the Fed's reluctance to boost rates in recent years and other efforts to stimulate the economy. But he points to a number of signs of trouble in the market as reasons to hold off on a rate increase next month.

In recent weeks, Ray Dalio, founder of $160 billion hedge-fund firm Bridgewater Associates LP, has argued that the Fed's interest-rate hikes will hurt asset prices, and that such share weakness will in turn undercut the economy. He's also spoken of the risks of boosting rates, partly because the Fed is in an unusually weak position to aid the economy if a downturn results and such help becomes needed, partly because interest rates remain quite low.

Complicating matters for the Fed is the fact that President Donald Trump has been calling on the central bank to halt interest rate increases. Some investors might interpret a central bank decision to stop now as a bend to political pressure, which would hurt the Fed's inflation-fighting credibility.

Mr. Trump continued his pressure campaign on Tuesday. "I'd like to see the Fed with a lower interest rate," he told reporters outside the White House. "We have much more of a Fed problem than we have a problem with anyone else." A Fed spokeswoman declined to comment.

Though the U.S. economy looks strong – especially the job market – **financial markets** are sending some worrying signals. Among them, retail stocks have experienced especially heavy selling lately, a possible indicator that consumers – who powered the expansion in 2018 – could be faltering. On Tuesday, shares of Target Corp. and Kohl's Corp. dropped 11% and 9%, respectively, after releasing quarterly results.

Credit spreads, reflecting the difference in yields between corporate bonds and safe Treasury securities, have jumped lately, a shift that in some past instances has foreshadowed a weakening economy. Interest rates on speculative-grade U.S. corporate bonds were on average 4.18 percentage above comparable Treasury securities Monday, up from a multiyear low of 3.03 percentage points in early October, according to Bloomberg Barclays data.

Still, these spreads aren't yet at alarming highs. They remain well below levels reached in a 2016 market rout, when they exceeded 8 percentage points above Treasurys, or during the financial crisis, when they hit nearly 20 percentage points above Treasurys.

Rising mortgage rates are another potential trouble spot for the economy. They have exacerbated affordability problems in the housing market, weighing on the interest-sensitive sector. Building permits for new housing units, a leading indicator of construction activity, stood 6% below their year earlier level in October, the Commerce Department said Tuesday.

Speaking in Dallas last week, Fed Chairman Jerome Powell acknowledged the recent market selloff could reduce growth by tightening financial conditions, but he did not suggest it had been enough for the Fed to change its policy plans.

Market conditions are "one of many factors" the Fed considers when deciding where to set its benchmark rate, he said.

He also said the Fed would carefully watch credit spreads, which have been narrow recently because investors have been optimistic about the economy's prospects.

"When credit spreads are low they can sometimes move up quickly and that can have negative effects," said Mr. Powell.

Mr. Powell will have ample opportunity to clarify how the Fed's outlook has changed if the market rout deepens. He is scheduled to speak in New York next week and to testify on Capitol Hill on Dec. 5.

The Fed's forecasts already incorporate some slowdown in the economy's growth rate next year, to 2.5% from 3.1% this year. The Fed sees the unemployment rate dropping to 3.5% next year from 3.7% in October and inflation remaining near its 2% target. Without the interest rate increases, the Fed's forecasts imply, inflation would be moving above its goal.

How many rate increases is a matter of great debate on Wall Street and inside the Fed itself. Economists at Goldman Sachs and JPMorgan Chase expect the Fed will raise rates four times next year. This camp sees inflation pressure building as unemployment drops.

Forecasters at Morgan Stanley and Nomura Securities see the Fed raising rates only twice in 2019, in part due to headwinds from trade disputes and the fading boost from tax cuts and federal spending increases.

Interest rate increases are meant to make the financial system a little less accommodating toward borrowing, spending and growth, to prevent the economy from overheating.

Mr. Williams pointed to another benefit of rate increases last month, noting it reduced the risk of another financial bubble. The last two expansions were upended by bubbles in tech stocks in the late 1990s and home prices in the 2000s.

The Fed responded to the last crisis by accumulating a large portfolio of Treasury and mortgage bonds, to help lower long-term interest rates in addition to short-term interest rates. It has been slowly reducing those holdings as the economy heals.

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Scott Bessent, who runs hedge fund Key Square Group, which manages about $4 billion, argues that the Fed's simultaneous effort to raise rates while shrinking its holdings "is a science experiment that they have no way of knowing the outcome."

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* Stocks Tumble as Tech Selloff Deepens

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

FDA Menthol Ban Will Be a Slow Burn; Tougher U.S. regulations will take time to implement but make Big Tobacco stocks a less predictable bet

By Carol Ryan
523 words
20 November 2018
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The Food and Drug Administration's war on menthol cigarettes could take years. Investors have time to sift the ashes and decide which tobacco stocks are best prepared for tougher U.S. regulations and a shift to alternative forms of smoking.

FDA Commissioner Scott Gottlieb last week said he wants to ban menthol brands, which are more addictive than regular tobacco, but didn't give a timeline. He will immediately restrict sales of flavored e-cigarettes to fight rocketing use among young Americans—3.6 million middle- and high-school students are now e-smokers, up from 2.1 million in 2017. That will hurt rapidly growing Juul Labs. The electronic cigarette startup makes 58% of group sales from the flavored tobaccos that will be restricted under the new rules, Bernstein estimates.

The proposed menthol ban is a big problem for established tobacco players. Investors have wiped a combined $35 billion off the value of Altria and British American Tobacco since news reports of an FDA crackdown emerged earlier this month. Lucky Strike owner BAT, which makes a fifth of its operating profit from minty brands like Newport in the U.S., according to UBS, has been worst hit.

But any restrictions will take time. The FDA needs to meet a high bar for a ban and the consensus in the industry is that Mr. Gottlieb doesn't yet have the scientific evidence he needs. Big Tobacco would almost certainly mount legal challenges that could drag through the courts for years. That gives tobacco investors time to figure out whether U.S. menthol smokers are likely to quit, switch to traditional tobacco or opt for alternatives.

For investors, the most promising cigarette alternative is IQOS, a supposedly smokeless heated-tobacco product developed by Philip Morris International, which sells the Marlboro brand outside the U.S. Following investments totaling $5 billion in recent years, so-called lower-risk smoking products generated 13% of PMI's group sales in the nine months through September. Altria has the exclusive right to sell IQOS in the U.S. if it receives regulatory approval. The FDA may weigh in early next year.

BAT has developed a heated tobacco product to rival IQOS, but is much further behind. Its early efforts to invest in cigarette alternatives focused on vaping. As the meteoric rise of Juul in the U.S. has demonstrated, this is a classic consumer-electronics industry with few barriers to new entrants.

Longer term, the question for shareholders is whether tougher regulation will make the industry's big dividends unsustainable. An average yield of 6.3% for the top three players is more than triple the **S&P 500** average. While Big Tobacco weathered a global wave of smoking bans in bars a decade ago with its profits intact, concerns are growing that the industry will finally be disrupted by better alternatives to cigarettes. Add a more hard-line FDA and tobacco is becoming a less dependable bet.

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THE WALL STREET JOURNAL.

Markets
Energy Shares Shed Crude Relationship With Oil Prices

By Kevin Kingsbury
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The link between crude prices and shares in oil-producing companies has weakened. With the commodity losing a quarter of its value in six weeks, that is a relief for investors.

What's Happening

Oil bottomed in early 2016 after falling steeply over the previous two years and then rebounded sharply. Prices had roughly tripled by early October, when Brent, the global benchmark, briefly topped $85 a barrel.

Yet the gains for energy companies, especially larger ones, fell well short of that. Hong Kong-listed shares in PetroChina Co. rose just 62% from January 2016 to a high in June. The company, which also has Shanghai-traded stock, has a market value of roughly $200 billion, making it Asia's largest listed oil major.

In another sign of divergence, many equity prices in the sector notched 2018 highs well before October. PetroChina peaked four months earlier, while its smaller rival China Petroleum and Chemical Corp., also known as Sinopec, hit a high in May.

The flip side is less pain during oil's pullback. PetroChina's shares, for example, have only declined 14% since Brent crude topped out on Oct. 3.

Of course, company-specific issues can play a role. Exxon Mobil Corp., the U.S. giant that is the world's largest publicly traded energy group by market value, has recently faced operational challenges, although earlier this month it reported its highest third-quarter profit in four years.

What it Means

There's been "a disconnect between energy stocks and commodity prices throughout this rally" from early 2016, said Pavel Molchanov, an equities analyst at Raymond James in Houston.

A measure of correlation shows the linkage between the Dow Jones Oil and Gas Titans index and West Texas Intermediate, the U.S. crude benchmark, remains high but has fallen. In the past year this measure was 0.79, Refinitiv data show, down from above 0.9 over the prior 20 years. Scores above zero mean the two prices tend to move together in the same direction, with the relationship strengthening as the measure gets closer to 1.

Mr. Molchanov says one explanation lies in oil futures markets. For much of 2018, spot prices, which reflect the cost of buying oil for delivery now, have been higher than futures contracts, which don't expire for months or years. Pricing curves like this signal a cautious longer-term view on crude. In turn, that makes energy shares less attractive to investors, since their value hinges on a company's future cash flows.

Oil firms have also learned the hard way to be more resilient. When prices previously started slumping in 2014, "the industry was massively overspending," said Roberto Cominotto, an analyst with Julius Baer in Switzerland. But he said firms are now much more disciplined. That means they can turn a profit at a far lower **oil price**, which helps insulate investors from weaker commodity prices.

Write to Kevin Kingsbury at kevin.kingsbury@wsj.com

ASIA MARKETS SNAPSHOT

* Many stock indexes slid at least 1%, following declines in U.S. equities.

* Nissan fell 5.5% on Chairman Carlos Ghosn's arrest. Partner Mitsubishi dropped 6.8%.

* Regional credit risk, as measured by an index of credit default swaps, hit a 19-month high.

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THE WALL STREET JOURNAL.

Markets

Bond Traders Are Starting to Doubt the Fed Again; Fed-funds futures show the market expects a 10% chance of at least three rate rises next year, the slimmest percentage since early September

By Akane Otani
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The Federal Reservehas flagged that it plans to raise short-term interest rates three times next year. Bond traders are increasingly skeptical that it will.

The recent tumult across **financial markets** has chipped away at traders' confidence that the Fed can keep increasing rates at the pace it has signaled, bringing a market-based measure of interest-rate expectations for 2019 to its lowest level in months.

Federal-funds futures showed the market late Tuesday pricing in a 10% chance of the Fed raising rates at least three times next year, according to data from CME Group. That's down from 21% a week ago and 28% a month ago, as well as the slimmest percentage since early September.

The slide in the futures market is the latest sign that the stock slump has taken a toll on traders' faith that the Fed can raise rates at the pace that it had telegraphed at its September meeting.

U.S. economic data, while still pointing to broad top-line growth, have increasingly shown signs of strain in pivotal sectors like the housing and auto markets. Dimming optimism about the economy has been one of the reasons analysts say stocks have struggled in November, with the **S&P 500** and **Dow Jones Industrial Average** off more than 5% apiece from their all-time highs. It is also partly why Treasury yields have come well down from their highs for the year.

Yet there is an important caveat: Many traders believe that Fed Chairman Jerome Powell may be less likely than his predecessors to step in and exercise the "Fed put." That's the idea, born during the tenure of then-Fed Chairman Alan Greenspan, that the central bank would slow its pace of rate increases—or even lower rates—if the markets showed signs of duress.

So far, Mr. Powell hasn't shown as much concern as the markets when it comes to the economy. Although he acknowledged at a November event in Dallas that the global economy had begun showing signs of a slowdown, he remained upbeat about the domestic picture.

"I'm very happy about the state of the economy now," Mr. Powell said. "Our policy is part of the reason why our economy is in such a good place right now."

That's all to say, the **volatility** gripping markets might not have much sway on the Fed.

But that's not going to stop bond traders from placing bets on a more gradual rate path anyway.

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THE WALL STREET JOURNAL.

Markets

Nvidia No Longer Comes Up Short; Citron Research says Nvidia's shares finally offer 'an appealing risk-reward to investors'

By Dan Gallagher
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Time apparently heals all wounds—even for a maimed short seller.

Citron Research recommended that investors start shorting chip maker Nvidiaback in December of 2016. That was a painful trade. Nvidia's shares, which had already tripled over the previous year, went on to gain another 147% over the next 21 months until the stock peaked on Oct. 1.

Then came the market's big tech rout, following by Nvidia's own disappointing forecast issued late last week. By the close of trading Monday, the chip maker had shed half its market value in less than two months.

That gave even Citron a change of heart. The short seller tweeted Tuesday that Nvidia's shares finally offer "an appealing risk-reward to investors," and it projected that the **stock price** will bounce back to $165—about 14% up from their last close. That is more than 80% above the original $90 target Citron first proposed, though is only about 28 times Nvidia's forward earnings compared with the 33 times implied by the original target.

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WSJ PRO CENTRAL BANKING

Economy

U.S. Housing Starts Increased in October; Underlying figures, however, signal weakness in the construction pipeline

By Sarah Chaney
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English
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U.S. housing starts rose last month on a bounceback in multifamily building, but underlying figures signal weakness in the construction pipeline.

Housing starts climbed 1.5% in October from the prior month to a seasonally adjusted annual rate of 1.228 million, the Commerce Department said Tuesday. The growth was due to a rebound in construction of buildings with two or more units. Starts fell in October for single-family construction.

Residential building permits, which can signal how much construction is planned, dropped 0.6% from September to an annual pace of 1.263 million last month. Permits were down for single-family homes as well as buildings with multiple units.

Consumer optimism toward home buying is waning and builders are beginning to take note, said Danielle Hale, chief economist for realtor.com, in a note to clients.

"Looking ahead, starts could slip further if builders believe the consumer pause will continue and they adjust production accordingly," Ms. Hale said, pointing to rising home prices and mortgage rates as hurdles to home buying.

Cost increases for materials are also adding to builders' challenge of constructing homes at lower-price points, economists say.

Housing-starts data are **volatile** from month to month and can be subject to large revisions. October's 1.5% increase for starts came with a margin of error of 12.9 percentage points.

The broader trend shows some pickup this year, as starts grew by 5.6% in the first 10 months of 2018 compared with the same period a year earlier. This growth is modest, though, given strong economic growth this year and a historically low unemployment rate—conditions that normally tend to buoy demand for new homes. Factors such as rising prices and borrowing costs are locking some would-be buyers out of the market.

Builders are taking a cautious stance given the Federal Reserve's plan to continue gradually raising interest rates, the National Association of Home Builders said Monday. The trade group's gauge of U.S. home-builder confidence fell sharply in November, dragged down by heightened concerns about affordability in the housing market.

The National Association of Realtors releases data on October existing-home sales, which account for the bulk of the market, Wednesday.

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THE WALL STREET JOURNAL.
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REVIEW & OUTLOOK (Editorial)
Macron and the Yellow Vests

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20 November 2018
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Protests in France are so common it's easy to miss the important ones. Make no mistake, the weekend's widespread marches against Emmanuel Macron's plan to raise fuel taxes are the most serious political threat since the French president took office in 2017.

More than 250,000 people are estimated to have turned out against higher fuel costs driven by global **oil-price** developments and Mr. Macron's tax increase. Irate motorists blocked roads and highways across the country, and some marches turned violent or nearly so. One elderly woman was killed by a panicked motorist who allegedly accelerated when her car was surrounded. The protesters are calling themselves the Yellow Vests, after the safety apparel they wear.

Every French president faces protests in the streets over something, and Mr. Macron has stared down a rail strike and marches against his labor reforms. But this unrest is more widespread geographically with more diverse protestors, who are emerging in large numbers from the rural and exurban middle class.

The protests also are about more than the details of the fuel tax -- a bad idea Mr. Macron is pursuing apparently to bolster his green credentials. The president's popularity has plummeted since the summer amid a string of personnel scandals and political gaffes that emphasized his aloof persona and distracted him from economic reform.

Many of the Yellow Vests probably didn't vote for Mr. Macron last year, and the fuel-tax plan plays into their worst perceptions of him. A recurring theme in interviews of Yellow Vests is that the city-slicker Mr. Macron and his wealthy pals in Paris don't understand how important cars are to ordinary folks in areas that lack public transport.

The worry for the president is that large numbers of voters, including some of his supporters from 2017, may agree that Mr. Macron is losing touch. Polls show broader public sympathy by far for the Yellow Vests -- nearly 75% support -- than there was for striking railway workers.

That makes the fuel tax a needless waste of Mr. Macron's diminishing political capital. Unlike labor reforms or rail overhauls, the fuel tax has nothing to do with Mr. Macron's economic-growth agenda. It's not even about boosting revenue. It's simply about discouraging the French from driving too much for environmental reasons.

Expensive green piety is not why voters embraced Mr. Macron last year, and now the bubbling frustration endangers the economic change the French voted for. Important reforms, including to the pension system, may now need to wait until next summer while Mr. Macron regroups, if new reforms happen at all after these political and policy missteps.

Mr. Macron shows no signs of backing down on the fuel tax, and maybe he can brazen out the protests. But with European Parliament elections looming next May, he can't afford many more policy fumbles. The Yellow Vests are a warning to return to what voters elected him to do -- create jobs and make the French economy great again.

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THE WALL STREET JOURNAL.

Markets
Energy Stocks Try to Shed Reputation as the 'Fifth Beatle'; Investors are shifting from technology into the energy sector amid soaring profits, lower share prices

By Jessica Menton
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19 November 2018
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The Wall Street Journal Online
WSJO
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Investors have been moving into shares of energy companies, lured by the firms' strong earnings growth and cheap valuations, as they aim to diversify beyond some of the big technology stocks that led the recent **stock-market** rout.

Energy companies have posted the strongest earnings growth of the 11 sectors in the **S&P 500** in every quarter this year, according to FactSet. With third-quarter results in from all 29 companies in the sector, profits have more than doubled from the same period a year earlier. That compares with a 22% increase from other companies in the index, excluding energy.

Lori Calvasina, head of U.S. equity strategy at RBC Capital Markets, said she has been "patiently **bullish**" on energy stocks and has noticed a trend of investors moving out of technology stocks this year and into energy.

Ms. Calvasina said her firm has advised clients all year to increase their energy exposure and has recommended reducing tech positions since April.

Energy stocks have been on a wild ride. They have slumped 11.8% in the fourth quarter as crude-**oil prices** tumbled into a **bear market**—typically defined as a 20% fall from a recent high. But they have fared better since the beginning of November, posting a more modest 0.6% decline. Tech stocks, meanwhile, have tumbled 13.1% in the quarter to date and 5.5% in November.

"Energy has quietly gotten cheaper and cheaper," Ms. Calvasina said. "People had their eyes glazed over when I would talk to them about energy in the first half of the year. But in the second half, there's been more openness to it."

The energy sector's forward price/earnings ratio was 13.9 as of Friday, down from 25.7 at the start of the year, while the **S&P 500**'s ratio was down to 15.6 from 18.1, according to FactSet.

Patrick Kaser, portfolio manager at Brandywine Global, said his firm nearly doubled its position in oil-field service provider Schlumberger Ltd. during October's market selloff because of its attractive valuation.

Schlumberger's shares have tumbled 28% this year and are hovering near their lowest levels since 2009. The company last month reported a double-digit quarterly profit increase, benefiting from stronger energy-development activity world-wide.

Another reason investors are looking at energy shares: They historically perform well during the latter part of an economic expansion as inflation and interest rates rise, according to Sam Stovall, chief investment strategist at financial-research company CFRA. The Federal Reserve's plan to continue tightening monetary policy through next year has boosted energy's appeal, Mr. Stovall said.

His firm's data show energy has been the second-best-performing sector, behind only technology, since 1970 in periods when the yield on the **10**-**year Treasury** note rose from the prior month.

Meanwhile, energy has been among the better-performing sectors in a **bear market** after consumer staples, health care and utilities since World War II, according to CFRA.

"Energy is like the fifth Beatle. Nobody remembers," Mr. Stovall said.

But a recent rise in the dollar and oversupply concerns in the oil market have dented some of the enthusiasm for the energy sector.

U.S. **oil prices** have tumbled 25.7% from their Oct. 3 high and recently suffered their longest losing streak since 1983 amid worries of excess supply.

Even so, Bill Costello, senior portfolio manager at Westwood, said his firm increased its exposure to small-cap energy stocks such as Callon Petroleum Co., Jagged Peak Energy Inc. and WPX Energy Inc. in October and early November. He said he thinks those stocks are trading at a big discount to where crude-**oil prices** will be over the longer term.

"Commodity-price movements like this, which cause stock prices to collapse, are opportunities for us to add to positions," Mr. Costello said.

But there is one thing Mr. Costello said could change his view on energy stocks: signs of a further slowdown in oil demand because of a strong dollar or a weaker global economy.

Other portfolio managers are also watching to see whether the dollar's climb will set the stage for a perfect storm in the oil market. A stronger dollar makes buying dollar-denominated oil more expensive for holders of other currencies outside the U.S. The WSJ Dollar Index, which measures the U.S. currency against a basket of 16 others, has climbed 4.6% in 2018 although it is down 1.1% so far this month.

Tim Seymour, founder and chief investment officer of Seymour Asset Management, said the dollar has the potential to move even higher, pointing to political and economic tensions in Europe.

He said that could spark a further decline in the euro, which has already shed 4.6% against the dollar in 2018.

"You can't invest in a bad neighborhood," Mr. Seymour said. "The question is whether energy is a bad neighborhood if the dollar moves appreciably higher."

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THE WALL STREET JOURNAL.

Markets

Aramco Abandons Plan for Massive Corporate-Bond Sales to Fund Sabic Deal; Saudi oil company concerned about disclosure requirements and uncertain outlook for oil prices

By Summer Said and Rory Jones
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DUBAI—Saudi Aramco no longer plans to launch what would have been one of the world's largest-ever corporate-bond sales to fund a roughly $70 billion stake in the kingdom's national petrochemical firm, looking instead to options requiring less public disclosure, people familiar with the matter said.

Saudi Arabian Oil Co., as the company is officially known, had considered issuing up to $40 billion in bonds to help buy 70% of Saudi Basic Industries Corp., The Wall Street Journal has reported.

But people familiar with Aramco's financing discussions say the oil firm is now worried about the level of disclosure required for a bond issue and whether the uncertain outlook for the oil market might damp demand for debt or increase the cost of borrowing.

Aramco executives also have raised concerns that the recent diplomatic fallout from the murder of Saudi dissident journalist Jamal Khashoggi might affect investors' appetite for Saudi debt, the people said.

The Saudi government is encouraging Aramco to buy the stake to inject cash into its sovereign-wealth fund, the Public Investment Fund, or PIF, which owns the stake in the petrochemicals firm.

Instead of a bond, Aramco is now looking at a combination of other potential financing options, people familiar with the matter said.

It could organize a syndicated loan with banks and use Sabic's balance sheet to raise debt to pay for some of the roughly $70 billion cost, the people said. The oil firm also could reduce the amount of cash it pays in royalties to the Saudi finance ministry for public spending and instead transfer money to PIF, or stagger payments from its cash flow to the fund over time, these people added.

Aramco declined to comment. Representatives for PIF and Sabic didn't immediately respond to requests for comment.

The potential bond sale had excited bankers hoping to win a place arranging the capital raising. JPMorgan and Morgan Stanley are already acting as advisers for Aramco on the Sabic purchase and Goldman Sachs and Bank of America Merrill Lynch are working with PIF, according people familiar with the matter.

The Aramco acquisition of the Sabic stake is expected to infuse PIF with billions of dollars to invest in technology companies and diversify the kingdom's oil-dependent economy. PIF already has committed $65 billion to two outside funds—one for infrastructure investment managed by Blackstone Group LP and $45 billion for a technology fund led by SoftBank Group. It has also said it would develop new billion-dollar industries in tourism, entertainment and defense.

Proceeds of a roughly $100 billion IPO of Aramco had been earmarked for the sovereign-wealth fund, but that process has since stalled in part because of the level of scrutiny a listing would have brought to Saudi Arabia's state oil giant.

Although not as detailed as an IPO, a corporate bond sale on international markets typically would require a company to publicly disclose three years of audited financial statements and highlight key risks to operations. Aramco currently doesn't disclose income statements, and its balance sheet is a black hole for analysts.

Neither Aramco nor Sabic is enthusiastic about the deal, but the two companies have acquiesced under pressure from government officials, The Wall Street Journal has reported, citing people familiar with the matter.

Aramco executives also are now concerned that market conditions aren't ideal for bond sales.

Oil prices have fallen more than 20% over the past month and a half, dropping most dramatically since the U.S. government exempted hundreds of thousands of barrels a day of Iranian crude from new American sanctions. Saudi Arabia is moving to prop up prices with a production cut, but uncertainty over how much it will cut and whether it will boost prices has clouded the outlook for oil traders and producers.

Aramco executives also have tussled with PIF over the price of Sabic, further complicating the deal. Any agreement below Sabic's listed market price would inject less capital into the sovereign-wealth fund and likely force down Sabic's listed shares, hurting minority shareholders, analysts say.

Sabic lists 25% of its shares on the Saudi Stock Exchange and has a market capitalization of roughly $100 billion.

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The New York Times

Business
Amazon, Apple and Facebook Once Led the Market. Now They Are Driving It Down.

By Matt Phillips
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Apple was worth more than $1 trillion at the start of November. Now, it's valued at $880 billion.

The mighty tech titans and their seemingly endless pipeline of profits, which powered one of the longest bull markets in stocks, are looking a little less invincible. Shares of Google's parent company, Alphabet, are down more than 10 percent since the market peaked, while Facebook and Amazon have dropped more than 20 percent.

Investors' faith has been eroded by slowing growth and a trade war with China, as well as a steady stream of revelations about privacy lapses, security issues and mismanagement. If tech stocks cannot shake the fears, the rest of the market could feel the pain.

The sheer bulk of the technology companies gives them outsize influence over the market — in both directions. The tumult in tech on Monday pushed major **stock market** indexes into negative territory for November, leaving investors clinging to a gain of less than 1 percent for the year.

The sentiment spilled over into European and Asian markets on Tuesday, with European blue-chip stocks reaching the lowest mark in about three weeks. In Asia, trade concerns helped to push the stocks of Chinese semiconductor makers and other big technology companies into the red.

"You're seeing extreme selling in the only favored area that everybody ran to," said Tony Dwyer, chief market strategist with the brokerage firm Canaccord Genuity in New York.

The **stock market** would seem disconnected from the rest of the American economy. Unemployment remains low and growth is on track for its best annual performance since 2005. Third-quarter profits in the **S&P 500** companies are expected to be up 28 percent, according to data company Refinitiv.

But investors are increasingly skittish about companies' prospects. Europe and China are facing economic weakness, while margins could be pinched by higher interest rates and rising labor costs.

"There's definitely a slowdown underway globally," said James Bianco, president of **financial market** research firm Bianco Research in Chicago. "The U.S. has definitely been stronger than the rest of the world. But the fear is, that can't hold. If the rest of the world slows down, that will eventually slow us, too."

Shares in industrial companies, viewed as particularly vulnerable to rising trade tensions with China, have dropped more than 10 percent since September. Economically sensitive financial stocks have slid 7.5 percent. Shares of homebuilders, which are vulnerable to rising rates, have fallen more than 30 percent.

The potential for higher borrowing costs is also weighing on smaller companies that often borrow money by issuing floating rate debt, which can become more difficult to pay off as interest rates rise. The Russell 2000 index of small capitalization stocks is down 14 percent from its high.

"This is simply a continuation of the recent repricing of risk, or growth scare, that we've basically been seeing since the end of September," said Talley Leger, an equity strategist with Oppenheimer Funds.

When the **stock market** hit its peak in September, technology had led the way, accounting for 50 percent of the gains for the year. The tech giants, at first, seemed immune to the sell-off that followed on broader economic worries.

Not anymore. Through Friday, roughly a quarter of the market's decline since September was because of Amazon, Apple, Facebook and Alphabet, according to data collected by S&P Capital IQ. The sharp sell-off on Monday will only add to that tally.

Investors appear especially focused on any signs that extraordinary profits generated by these giant tech companies are under threat.

The specter of regulation is looming over the shares of Facebook, as it deals with the fallout and costs from a data breach, privacy lapses and management missteps. The pressure has only been amplified by renewed scrutiny over its response to Russian efforts to use it to influence the 2016 presidential election. The stock dropped another 5.7 percent on Monday.

Alphabet likewise faces a regulatory crack down on business practices in Europe, and concern from elected officials in the United States about political bias. Its shares fell nearly 4 percent Monday.

Regulation broadly is worrying technology investors. Apple's chief executive, Tim Cook, has been warning that the new rules for the industry are "inevitable," as he told Axios in an interview that aired on Sunday.

"I'm a big believer in the free market. But we have to admit when the free market is not working," he said, "I think the Congress and the administration at some point will pass something."

Whether technology stocks can slough off the worries will depend, in part, on whether the companies can continue to deliver strong earnings growth even if the global economy does soften significantly. Recent earnings reports from major tech companies have done little to reassure investors.

Soft demand for Apple's new phones has hurt its shares and those of its suppliers. The month started with Apple issuing a lower-than-expected forecast for sales. Last week, a supplier warned investors that one of its biggest customers had cut orders.

Since Apple's share price peaked at just over $232 on Oct. 3, the stock has plummeted by nearly 20 percent, lopping more than $200 billion off the company's market value. Its shares were down nearly 4 percent Monday.

Amazon reported a slowdown in its core retail revenue growth in late October, sending the shares lower. To investors, who often view revenue numbers as a good gauge of the strength of demand in the economy, that was more important than the $2.9 billion in profit the company reported.

But if they actually produce the numbers that Wall Street analysts expect, the recent slump in large technology stocks could present a buying opportunity for some investors. Key valuation measures of Apple and Alphabet hit multiyear highs this summer. But the recent drop has left those valuations substantially lower. Prices of Facebook and Amazon are relatively low compared with expected profits, meaning these stocks look "cheap" for certain investors.

But they might have to get even cheaper before investors are tempted to snap them up. That's why some expect the sentiment in the market to get much worse before stocks can resume their climb.

"I'm sort of looking for a little more bearishness," said King Lip, chief strategist at the wealth management company Baker Avenue.

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THE WALL STREET JOURNAL.

Markets

The Price of a Bad Year for Money Managers: Fewer Jobs, Less Pay in 2019; In the face of heightened competition, U.S. asset managers are taking steps to rein in everything from pay to jobs to travel

By Dawn Lim and Justin Baer
871 words
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Pacific Investment Management Co. Chief Executive Emmanuel Roman had a warning for his workers when he spoke at a staff meeting on the morning of Oct. 29.

Pimco was doing well, he said, despite pressure from money management rivals that charge investors less. But employee pay could be "flattish" for 2018.

U.S. money managers are taking steps to rein in everything from pay to jobs to travel as they try to sustain margins in the face of heightened competition.

OppenheimerFunds Inc. and Invesco Ltd. are expected to shrink their combined workforce by roughly 1,000 after the two firms merge next year, according to a person familiar with the matter. T. Rowe Price said it is planning to close an operations center in Tampa. At BlackRock Inc., the world's biggest money manager, costs surrounding internal staff meetings are being scrutinized more closely, according to people familiar with the matter.

"Asset managers were complacent," said Amanda Walters, a senior manager at Deloitte consulting group Casey Quirk. "People are now asking, 'How can I sustain my business?'"

Before this year parts of the asset management industry were already in turmoil as clients pulled money from traditional stock-and-bond pickers and embraced cheaper investment funds that mirrored indexes. The changes ratcheted up a price war across the investing world.

Only 30% of asset managers were able to expand assets, boost revenue faster than costs and invest in themselves between 2014 and 2017, according to Deloitte consulting group Casey Quirk. That is down from the about half that did so between 2011 and 2014.

But a decadelong rally in the U.S. **stock market** papered over some of those troubles. Rising securities prices lifted assets under management for certain firms and boosted revenue even as clients moved some money to lower-cost options. Industry pay also continued to grow.

What changed in 2018 is that markets became more **volatile** and investors turned increasingly cautious, slowing the flood of new money into cheaper index funds. A decline in assets—and revenue—is no longer a dormant threat for managers. And many are warning it's going to get worse.

"2019 will be the start of much tougher years for asset managers," said Alan Johnson, managing director at compensation consultant Johnson Associates.

This year incentive bonuses for asset managers are expected to rise 5%, according to the firm, but that is down from a 7% boost in 2017. Next year, Mr. Johnson predicts bonuses will retract by 5%.

At Pimco staffers will see compensation rise by single digits in 2018, said a person familiar with the matter, but that is down from the increases of 2017.

"We had a great year in 2017," Pimco's CEO told staff at the Oct. 29 meeting. "We can't repeat that every year and we need to acknowledge this."

Others are expected to lose their jobs as asset management firms cut back on staff amid the market shifts. JPMorgan Chase & Co. has been in the process of laying off around 100 employees in its asset-management division as part of a push to simplify the business, according to people familiar with the matter.

T. Rowe Price announced the closing of a 400-person Tampa operations center, which will result in roughly 150 job cuts. Many of the jobs being axed involve call center roles that aren't needed as more customers get their questions answered online, a person said.

Invesco also said it plans $475 million in cost cuts over two years as part of its purchase of Oppenheimer. The combined firm's head count is expected to fall by about 1,000 from the roughly 9,000 employees after the deal closes next year, said a person familiar with the matter. The exact number could be more or less depending on discussions now under way between Invesco and Oppenheimer executives, people said.

Even the industry's biggest company is taking a closer look at costs. BlackRock finance executives are scrutinizing the expense of flying and hosting staff for internal events more than before, said people familiar with the matter. Some managers are also trying to fill open positions quickly because they fear the jobs will disappear if they don't lock in hires by year-end.

BlackRock executives told analysts in an October call that controlling costs is a focus while it spends on the expansion of businesses like illiquid alternatives that it hopes will be lucrative. The Wall Street giant in the third quarter recorded its lowest net inflow into asset management products in two years—and first overall net outflow since 2015.

"We remain margin-aware especially in the current environment," said Chief Financial Officer Gary Shedlin.

Write to Dawn Lim at dawn.lim@wsj.com and Justin Baer at justin.baer@wsj.com

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* BlackRock Reports First Investor Outflow in Three Years (Oct. 16)

* JPMorgan Laying Off Around 100 Employees in Asset-Management Business (Aug. 22)

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THE WALL STREET JOURNAL.

Markets

Vanguard Ratchets Up Index-Fund Price Battle; Indexing giant lowers bar for investors to get into cheaper admiral shares of some funds

By Dawn Lim
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Vanguard Group is lowering the minimum amount customers need to invest to get cheaper prices on more than three dozen of its index funds.

The $5.3 trillion indexing giant's move is the latest salvo in its push to lure investors from rivals as asset managers come under pressure to slash the costs of funds.

Starting Monday, the firm is lowering the minimum investments for admiral shares—a share class that has lower fees than regular investor classes—to $3,000 from $10,000 for 38 index mutual funds. The funds make up the majority of Vanguard's index funds that are available to individual investors and include some of the industry's largest stock and bond index funds.

Vanguard became the world's second-largest asset manager after BlackRock Inc. by launching some of the cheapest funds in the industry. Rivals have sought to match or undercut Vanguard on fees, pushing down customers' costs of investing in basic portfolios of stocks and bonds.

Now the Malvern, Pa., firm faces a challenge: how to keep growing as the market for low-cost funds that track markets gets more crowded.

After record flows for the firm in 2017, Vanguard's net inflows this year have been slowing. Aside from having more investment choices, investors have also turned more cautious as they question the longevity of a decadelong **bull market**.

Under new Chief Executive Mortimer J. 'Tim' Buckley, who took the helm this year, Vanguard is looking to invest more in the firm's financial advice business and looking to press further overseas.

Meanwhile, other firms have aggressively rolled out cheap funds.

Earlier this year, Fidelity Investments took steps to cut pricing on stock and bond index mutual funds and launched what it advertised as zero-fee index funds.

A spokeswoman said Vanguard's latest changes weren't a response to Fidelity's steps.

Vanguard's move could reduce expense ratios for investors transferred into admiral shares by between 15% and 71%, depending on the specific fund in which they are investing. The firm is also launching new admiral shares on five index funds with those new minimums.

The firm created admiral shares in 2000 to give discounted pricing to investors who invested larger amounts of money in certain funds. Over the years, the mutual-fund company has reduced minimum investments tied to that share class.

Its latest changes affect only index funds. The minimum requirement that investors must make to qualify for admiral shares of funds run by teams that make investments of their choosing, rather than those that track markets, remains at $50,000.

Write to Dawn Lim at dawn.lim@wsj.com

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* Stock Pickers Struggle to Beat Index Funds Once Again (Sept. 29)

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WSJ PRO CENTRAL BANKING

Economy
New York Fed Chief Expects Gradual Rate Rises; John Williams says the U.S. economy remains strong but that data will determine future Fed moves

By Michael S. Derby
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NEW YORK—New York Fed President John Williams said he expects the U.S. central bank to press forward with its slow and steady pace of rate rises.

"We are going to be doing what we've been doing, as best we can" and pursue "a gradual path" of getting back to more normal interest rates, Mr. Williams said Monday as part of an appearance at a community event in the Bronx in New York City. "Interest rates are still very low. We've raised them but they are still at a low level."

Mr. Williams, who also serves as vice chairman of the interest-rate setting Federal Open Market Committee, didn't offer much in the way of specific guidance about the outlook for rates. Fed officials are widely expected to raise what's now a short-term interest-rate target range that stands at between 2% and 2.25% next month and to press forward with more increases next year.

But that outlook for policy is being questioned by many in **financial markets**, amid an unexpected slowdown in global growth and decidedly unsettled markets. Fed officials are also raising rates to temper the possibility that a very strong job market will cause inflation to rise more than they'd like. But recent data suggests that after picking up, inflation pressures may begin to ease again.

On Friday, in a Wall Street Journal interview, Philadelphia Fed leader Patrick Harker said, "At this point, I'm not convinced a December rate move is the right move." He explained that "we're not seeing the recent data telling us that inflation's moving rapidly past our target. So I think we have some time to let this evolve."

Mr. Williams has been a steadfast supporter of rate increases. But he did observe in his comments on Monday that "we are not on a preset course" for rate increases and what happens with the data will determine what the central bank does.

But Mr. Williams was upbeat about the economy. "We are in a great position" with good growth and job gains. At the Fed, "our goal is to keep the economy strong, keep this expansion going as long as possible."

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

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THE WALL STREET JOURNAL.
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Corporate Borrowing Turns Less Favorable

By Sam Goldfarb
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Signs of stress are mounting in the corporate-bond market, where rising interest rates and lackluster demand for new debt have investors questioning whether a long run of favorable borrowing conditions for U.S. companies is ending or merely hitting a rough patch.

The amount of extra yield, or spread, that investors demand to hold investment-grade U.S. corporate bonds instead of benchmark U.S. Treasurys in recent days reached its highest level in nearly two years, while spreads on junk-rated bonds hit a 19-month high.

The widening gap comes despite a relative dearth of new bond sales from U.S. companies, a sign that investors' demand has slowed faster than supply. When businesses have sold debt recently, they have often struggled to attract much interest, giving investors more say over interest rates and other key terms.

One source of stress has come from a sharp drop in **oil prices**, which exert an especially strong influence on junk bonds because of the large amount of debt issued by speculative-grade energy companies. There have also been company-specific problems that have happened to befall particularly large debt issuers, such as General Electric Co. and PG&E Corp.

Investors and economists closely watch the corporate-debt market because changes in borrowing costs can alter investment decisions and mean the difference between viability and bankruptcy for businesses at the bottom end of the ratings spectrum.

The recent turbulence in the corporate-bond market has largely followed swings in stocks, in contrast to some past episodes. To some investors and analysts, that suggests the latest wave of selling could reflect a temporary shift in investor sentiment, rather than fundamental problems with the economy.

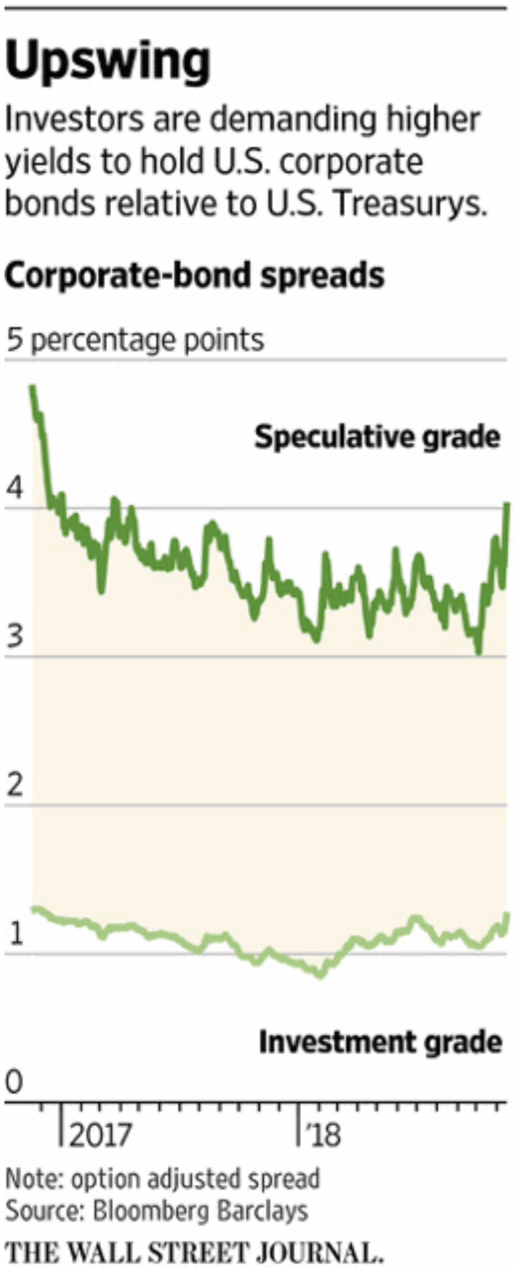
Still, there is little doubt that bonds, like stocks, face challenges. Those start with steadily tightening monetary policy from the Federal Reserve, which has expressed public concern with lofty asset prices.

"Fundamentally, the economy is still in good shape and corporate profits are in good shape, but we just have so many one-off situations. . .that everybody is looking for the next problem," said Kenneth Harris, senior portfolio manager at Segall Bryant & Hamill.

As of Thursday, the average investment-grade corporate- bond spread was 1.28 percentage points, up from 0.85 percentage point in February but below the 2.15 level it reached in February 2016, according to Bloomberg Barclays data. The average speculative-grade spread was 4.04 percentage points, compared with 3.03 in October and 8.39 in February 2016.

Corporate-bond spreads are still far off the highs they reached in early 2016, when U.S. crude oil was trading at roughly half current prices and investors were concerned about the potential for an imminent recession, let alone during the financial crisis.

And despite the spread widening, investors said, the debt markets remain far from closed off. In some cases, riskier borrowers have only needed to move from bonds to loans to raise funds, given continued demand for debt with floating interest rates.



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THE WALL STREET JOURNAL.

Markets

With Apple Near a Bear Market, Stocks Lack a Clear Leader; Spooked by the iPhone maker's slump, some investors have embraced sectors such as health care

By Amrith Ramkumar
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The nine-year-old **bull market** is hunting for a new leader.

Apple Inc. is on the cusp of a **bear market**, a troubling sign for some investors who question whether the U.S. stock rally can regain its footing without the leadership of the world's most valuable public company.

Investors have flocked for years toward Apple and a handful of other companies in the technology sector because of their ability to consistently increase sales regardless of global economic growth. But recent trade tensions between the U.S. and China and signs of slowing tech-sector revenue growth have dimmed their prospects.

The iPhone maker, which in August became the first U.S. firm to top $1 trillion in market capitalization, has lost nearly $200 billion in value from its Oct. 3 peak. The stock has slumped 17% to $193.53, putting the tech behemoth in danger of ending a bull run that stretches back to May 2016, according to Dow Jones Market Data. A close at or below $185.65 would push Apple to the 20% decline that typically characterizes a **bear market**.

What's more, Apple appeared to be a safety play during much of October's rout that erased roughly $5.5 trillion in global **stock-market** value. As investors fretted about softening global growth, trade tensions, rising interest rates and peaking corporate profits, Apple's shares remained relatively resilient: They dropped just 3%, while other highflying stocks like Amazon.com Inc. and Netflix Inc. tumbled by double digits.

Then, at the beginning of this month, Apple issued a tepid revenue forecast for the holiday quarter. That stripped the company of its $1 trillion mantle and extended declines in the broader market as well. The market retreat accelerated this week after two key iPhone suppliers cut their earnings projections for the coming months.

It makes investors very afraid when Apple and other tech companies start slumping, said Kim Forrest, senior portfolio manager at Fort Pitt Capital Group. "Times of transition are especially troubling for people, and that is what we're seeing."

During many of the market's recent selloffs, analysts have said early-day weakness in the technology sector has quickly spread to other industries. That reflects the outsize sway of the sector and the sprawling supply chains of many companies in it.

Apple makes up about 4% of the **S&P 500**, which is weighted by market value, and roughly 5% of the price-weighted **Dow Jones Industrial Average**. It accounted for nearly 13% of the **S&P 500**'s total return for the year through September, according to S&P Dow Jones Indices, trailing only Amazon. Those two stocks and Microsoft Corp. together represented more than 35% of the index's return in the first nine months of the year, before the tech rally stalled.

Since then, Apple has been the largest drag on the benchmark index's total drop, accounting for 11% of its negative return through Thursday. Apple won't be alone in the bear cave: It would join Amazon, Facebook Inc., Netflix and the PHLX Semiconductor Index, a striking reversal for a group that had powered major indexes higher in recent years.

Apple is still one of the most widely held stocks among institutional and retail investors, and some of the world's largest asset managers, including Vanguard Group, BlackRock Inc. and Fidelity, are among its biggest shareholders. Warren Buffett's Berkshire Hathaway Inc., which added to its Apple stake in the third quarter, has also been a big beneficiary of Apple's meteoric rise in recent years.

Those investors are still looking at impressive gains: Apple's market value has more than quadrupled in the past decade even with its recent drop.

Apple declined to comment.

For some investors, Apple's recent slump is a sign of the lingering trade and global-growth concerns stirring angst heading into the year's end. The company is among the multinationals that have urged President Trump to avoid a trade battle with China, saying it would hurt U.S. firms.

"Everything has been pulling back on the larger fears around global growth and higher interest rates," said Sylvia Jablonski, head of capital markets and institutional strategy at asset manager Direxion Investments.

Ms. Jablonski said she has observed some investors buying some of Direxion's technology-focused exchange-traded funds following the sector's recent slump. Many, though, are also embracing other sectors such as health care, now the **S&P 500**'s best-performing group in 2018.

Others say they prefer stocks with more stable profit growth and higher dividends, the kind of stocks that for years have taken a back seat to fast-growing technology companies.

"We are finding value in other places," said Trip Miller, managing partner at Gullane Capital Partners, which owns Apple shares. "This is a slow-growth period for them, and they're so dependent on the phones."

Mr. Miller said his firm hasn't recently added to its position in Apple but has instead been buying shares of companies such as Wynn Resorts Ltd. and FedEx Corp. that he considers less expensive.

Still others expect technology to eventually resume its leadership position, noting that far-reaching concerns about trade tensions aren't exclusive to the tech sector.

"The question is what takes the leadership role, and that's a little bit uncertain right now," said Jim Tierney, chief investment officer of concentrated U.S. growth at AllianceBernstein.

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THE WALL STREET JOURNAL.

Markets

Debt-Market Slowdown Troubles Investors; Recent turbulence in the corporate-bond market is attributed to Fed's tightening monetary policy and weaker appetite for debt

By Sam Goldfarb
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Signs of stress are mounting in the corporate-bond market, where rising interest rates and lackluster demand for new debt have investors questioning whether a long run of favorable borrowing conditions for U.S. companies is ending or merely hitting a rough patch.

The amount of extra yield, or spread, that investors demand to hold investment-grade U.S. corporate bonds instead of benchmark U.S. Treasurys in recent days reached its highest level in nearly two years, while spreads on junk-rated bonds hit a 19-month high.

The widening gap comes despite a relative dearth of new bond sales from U.S. companies, a sign that investors' demand has slowed faster than supply. When businesses have sold debt recently, they have often struggled to attract much interest, giving investors more say over interest rates and other key terms.

One source of stress has come from a sharp drop in **oil prices**, which exert an especially strong influence on junk bonds because of the large amount of debt issued by speculative-grade energy companies. There have also been company-specific problems that have happened to befall particularly large debt issuers, such as General Electric Co. and PG&E Corp.

Investors and economists closely watch the corporate-debt market because changes in borrowing costs can alter investment decisions and mean the difference between viability and bankruptcy for businesses at the bottom end of the ratings spectrum.

The recent turbulence in the corporate-bond market has largely followed swings in stocks, in contrast to some past episodes. To some investors and analysts, that suggests the latest wave of selling could reflect a temporary shift in investor sentiment, rather than fundamental problems with the economy.

Still, there is little doubt that bonds, like stocks, face challenges. Those start with steadily tightening monetary policy from the Federal Reserve, which has expressed public concern with lofty asset prices.

"Fundamentally, the economy is still in good shape and corporate profits are in good shape, but we just have so many one-off situations… that everybody is looking for the next problem," said Kenneth Harris, senior portfolio manager at Segall Bryant & Hamill. Mr. Harris has been reducing risk in his bond portfolios throughout the year by buying shorter-term bonds and those with higher credit ratings.

As of Thursday, the average investment-grade corporate bond spread was 1.28 percentage points, up from 0.85 percentage point in February but below the 2.15 level it reached in Feb. 2016, according to Bloomberg Barclays data. The average speculative-grade spread was 4.04 percentage points, compared with 3.03 percentage points in October and 8.39 percentage points in Feb. 2016.

For much of the past decade, analysts have expressed alarm as a prolonged period of low interest rates has encouraged U.S. companies to add large amounts of debt to their balance sheets. Even the lowest-rated borrowers have often been able to issue bonds and loans that featured minimal protections for investors, making the debt riskier even as more of it sloshes around the financial system.

Before traders began selling riskier assets near the start of October, companies had already started to borrow a little less while their earnings rose, leading to some modest improvement in overall corporate leverage ratios.

There are recent hints, however, that the mostly-voluntary slowdown in borrowing could be exacerbated now by a turn in the market, which some worry could spell trouble for the economy.

In the past week, for example, hospital operator LifePoint Health Inc. was forced to make a rash of investor-friendly changes to a nearly $5 billion bond-and-loan package backing its merger with private-equity firm Apollo Global Management-owned RCCH HealthCare Partners.

Several investors expressed concern about the company's reliance on rural hospitals, which have struggled recently as a result of declining foot-traffic and efforts by insurers to reduce health-care costs. Still, the tone of the market aggravated those concerns. Bonds backing several recent leveraged-buyouts have fallen below par in recent weeks, and that inevitably led to second thoughts about buying the latest such offering, investors said.

After shifting $150 million from the bond portion of the deal to the loan portion, LifePoint ultimately priced $1.425 billion of bonds at par with a 9.75% coupon, up from initial guidance in the 9%-9.25% range. Even so, the bonds immediately fell in the secondary market, trading Friday afternoon at around 98 cents on the dollar for a yield of just over 10%, according to MarketAxess.

The LifePoint deal was notable because it was the largest sale of junk-rated debt since riskier assets started to come under pressure more than a month ago. It came after a few companies, including oil and gas company GEP Haynesville and brokerage firm INTL FCStone Inc., were forced to cancel smaller bond sales in recent weeks.

Attracting demand for sales of debt from highly rated companies hasn't been as challenging. But it also hasn't been as easy as it once was. On Wednesday, DowDuPont Inc. was able to sell $12.7 billion of bonds to fund the spinoff of its agriculture and materials units. Still, the chemical company only did so at higher-than-expected yield-premiums – in some cases nearly 0.3 percentage point above what its existing bonds were yielding as they were headed into the sale.

Corporate bond spreads are still far off the highs they reached in early 2016, when U.S. crude oil was trading at roughly half current prices and investors were concerned about the potential for an imminent recession, let alone during the financial crisis. And despite the spread widening, investors said, the debt markets remain far from closed off. In some cases, riskier borrowers have only needed to move from bonds to loans to raise funds, given continued demand for debt with floating interest rates.

Still, the DowDuPont sale was one sign that even investment-grade companies have recently been having a challenging time, said Ron Quigley, managing director and head of fixed-income syndicate at broker-dealer Mischler Financial Group Inc. Another is the 27 investment-grade companies and countries that are known to be waiting to issue bonds, which is an immense amount to have in the pipeline, he added.

DowDuPont bonds have held their ground in the secondary market. A 3.766% note due 2020 was trading at a spread to Treasurys of around 0.8 percentage point Friday, down from 0.9 percentage point at issuance, according to MarketAxess.

Write to Sam Goldfarb at sam.goldfarb@wsj.com

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THE WALL STREET JOURNAL.

Markets

Buying Stakes in Private-Equity Firms, Not Just Their Funds, Pays Big; For investors such as Dyal Capital Partners, it means getting a direct cut of the hefty fees buyout firms charge and the profits from their deals

By Miriam Gottfried
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Private-equity firms take fund investors' cash and earn handsome returns buying and selling companies.

But an increasingly powerful type of investor is betting there's an even more profitable way in: by buying stakes in the private-equity firms themselves. That means getting a direct cut of the hefty fees buyout firms charge and the profits from their deals.

The biggest player in the burgeoning trade is Dyal Capital Partners, founded in 2011 by Lehman Brothers veteran Michael Rees. Dyal's third fund, a $5.3 billion vehicle it finished raising in 2016, has posted annualized returns of 26% net of fees, according to people familiar with the matter. By contrast, buyout funds of a similar size and vintage have notched returns of 17.6%, according to Cobalt GP data.

A unit of asset manager Neuberger Berman Group LLC, Dyal owns nonvoting stakes of usually between 10% and 20% in 19 private-equity firms, a roster that has nearly doubled in the past year. Its portfolio is a who's who of the industry's most successful players, including technology-focused buyout firms Silver Lake and Vista Equity Partners.

As pension and other institutional money managers continue to pour more money into private-equity funds, Dyal and its rivals have placed a bet that owning slices of buyout firms themselves will produce even better returns with lower risk. Instead of waiting for a private-equity fund's investments to appreciate in value—and paying fees—they can start collecting income from day one.

Private-equity firms pair the money they raise from investors with debt to buy companies, in the hope of selling them for a higher price later. They charge management fees to their so-called limited-partner investors—usually between 1% and 2%—and typically collect around 20% of a given deal's profits.

More than a decade after Blackstone Group LP became the first major private-equity firm to go public, its shares have performed roughly in line with the **S&P 500**, factoring in dividends. Meanwhile, Dyal and its chief competitors —a unit of Blackstone and Petershill LP, a unit of Goldman Sachs Group Inc. —have recently been paying prices that imply higher valuation multiples than the ones publicly traded private-equity firms trade at.

The wave of stake sales comes at pivotal moment for the industry. Private-equity founders who got their start decades ago need money to incentivize the next generation of leaders. Others want to expand into new business lines like lending to mid-sized companies and need cash to hire employees. Many like the fact that firms like Dyal take a hands-off approach.

That has led to a land grab among Dyal and its competitors, some of which are offering extra services to their targets like help with fundraising or technology to land stakes in the most coveted firms.

Of the top 75 private-equity firms by current fund size, six have gone public and 29 have sold a stake, said Saul Goodman, head of private equity and alternatives at Evercore. He has placed stakes in nearly 25 firms over the past three years, primarily with Dyal, Blackstone and Petershill but also with sovereign-wealth funds and family offices.

"There are only a certain number of high-quality, scale players," he said. "You have a shrinking pond."

That has fed concerns that the returns Dyal has enjoyed may not be sustainable. In recent years, the options for buyout firms to borrow money at relatively low rates from investors and other lenders have grown, in some cases making a stake-sale less attractive to private-equity founders.

Dyal is trying to raise a new $7 billion fund and some institutional investors worry it may be forced to pay even bigger prices or settle for lower-quality players.

Mr. Rees, 43 years old, has told investors he only has 10 to 15 more firms he wants to add to his stable, according to people familiar with the matter. After that, Dyal may add to its stakes in private-equity firms already in its portfolio, as it has done with Vista and H.I.G. Capital LLC. At some point, Mr. Rees may opt to take Dyal or some of its holdings public, the people said.

Mr. Rees struggled for two years to raise his first fund, a $1.3 billion vehicle that closed in 2012. He had been on the team at Lehman that took stakes in hedge funds and wanted to continue the strategy after Neuberger was spun off in 2009 following Lehman's bankruptcy.

Mr. Rees was chief operating officer of Neuberger's alternatives division. Investors were wary of tying up money indefinitely, but he believed it was crucial to not be pressured to return cash at inopportune times. Investors gradually warmed to the idea. Mr. Rees is now one of the most highly paid employees at Neuberger, according to people close to the firm.

Blackstone and Petershill, which began buying private-equity stakes in 2017 and 2016, respectively, now also employ so-called permanent capital, which does not need to be returned to investors over a given time period.

Dyal's first fund primarily bought stakes in hedge-fund firms, but it also invested in Providence Equity Partners LLC. The buyout firm was struggling with some of its large pre-crisis deals. It wasn't until Vista sold a stake to Dyal in 2015 that other private-equity managers were convinced they could do so from a position of strength. This early stamp of approval helped the business gain momentum.

Blackstone is currently investing out of a $3.3 billion fund and is trying to raise another pool of at least $3.3 billion. Petershill has a $2.5 billion fund.

Dawn Lim contributed to this article.

Write to Miriam Gottfried at Miriam.Gottfried@wsj.com

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The New York Times

Business; DealBook
Slowing Global Growth May Lessen the Threat of Rising Rates

By Peter Eavis
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One of the biggest threats to stock prices is suddenly looking less scary.

Investors' concerns about rising interest rates have helped fuel the recent selling that has left the **S&P 500 stock index** nearly 6.6 percent off its high. But there have been signs in recent days that interest rates may not rise as quickly as investors previously expected.

Officials at the Federal Reserve, which sets interest rates, made remarks last week that suggested they were becoming more mindful of a slowing global economy.

While that may mean stock investors will soon be able to worry less about rising rates, the slowdown in growth could still weigh on stock prices.

Central bank policymakers tend to hold off on raising interest rates if they believe the economy is decelerating. Higher rates push up borrowing costs for companies and consumers. That, in turn, may prompt them to spend less, which can weaken the economy.

Rising rates can hurt stock prices in another way. They make the returns from bonds more attractive compared with stocks. That may cause investors to shift some of their money to bonds from stocks.

The Fed has pressed ahead with rate increases as the economy has strengthened this year. Already, it has raised its main policy rate three times and is expected to do so again next month. President Trump has repeatedly complained this year about the Fed's decision to keep raising rates.

But the case for steadily higher rates may be weakening.

The growth of several big economies has slowed recently. Germany's gross domestic product unexpectedly shrank in the third quarter. And American growth is expected to cool next year as the effect of the tax cuts enacted last year wears off.

The bond markets are signaling increasing concerns about global economic growth. After hitting 3.24 percent earlier this month — a move that underscored investors' belief that rates were on their way up — the yield on the **10**-**year Treasury** note fell last week to close at 3.07 percent on Friday.

A shift is also occurring in the market that investors use to bet on the Fed's future interest rate decisions. A majority of investors no longer expect the central bank to raise rates twice between now and when policymakers meet in March. A week ago, investors were forecasting a 54 percent chance of two increases.

While the tone of Fed officials may also have softened a bit, they have not said they will hold off on interest rate increases. The gentler tone is apparent in comments about growth. When asked last week what headwinds the economy faces, Jerome H. Powell, the chairman of the Federal Reserve, mentioned slowing global growth, calling that "a real thing." He also listed the waning effect of the United States' tax cuts and the Fed's own interest rate increases.

“These are things we are well aware of, though,” Mr. Powell said. “We know that when we’re making policy, and we think about those, and kind of have a sense of what they might be.”

On Friday, the Fed’s vice chairman, Richard H. Clarida, noted that slowing abroad could affect the United States’ economy. “It impacts big parts of the economy through trade and through capital markets and the like,” he said in an interview with CNBC.

Jerome H. Powell, the chairman of the Federal Reserve. Last week he mentioned slowing global growth as a potential headwind for the economy. | Alexander Drago/Reuters

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THE WALL STREET JOURNAL.

Markets

Taking Toll of Tech's Tumble; The popular FAANG stocks of Facebook, Amazon, Apple, Netflix and Google parent Alphabet have lost about $575 billion in market value since the beginning of October

By Michael Wursthorn
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Wall Street has been souring since October on one of the year's most popular trades, sparking a selloff that has erased roughly $575 billion in market value from Facebook Inc., Amazon.com Inc., Apple Inc., Netflix Inc. and Google parent Alphabet Inc. The quintet—commonly known as the FAANG stocks—has suffered steep losses as investors rethink their lofty valuations and projected growth in the months ahead. But their combined market cap still totals nearly $3 trillion, giving them considerable heft in the **S&P 500 index**.

—Facebook is the worst-performing stock of the FAANG group, shedding 21% so far this year, amid questions over its handling of user data. Losses have been mounting since July, when the social-networking firm warned about slowing growth, putting Facebook on pace for its worst year since going public in 2012.

—Amazon.com posted its second straight quarter of record profitability last month, but slowing revenue growth spooked investors, sending shares down 20% in October alone.

—The selloff robbed Apple of its $1 trillion market cap, leaving it dangerously close to entering **bear-market** territory, marked by a fall of at least 20% from a recent high. The iPhone maker's losses have accelerated since the beginning of the month, when Apple offered investors a tepid revenue forecast for the current quarter.

—Netflix had been one of the best-performing stocks in the **S&P 500** throughout the first half of the year, avoiding some of the **volatility** that rattled other tech giants in the early spring. But the video-streaming company reported weaker-than-expected subscriber growth in July, kicking off a decline that accelerated in October.

—Alphabet also has shown signs of slowing growth, stirring further angst among investors over tech's durability during an economic slowdown. The search-engine giant has suffered a bruising period after reporting a surging profit on slowing growth in sales, setting up shares of Alphabet for their weakest year since 2014.

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The New York Times

SpecialSections; SECTF
To Rent or Buy? Weighing the Options

By PAUL SULLIVAN
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Do I rent or do I buy? It's an eternal question, one that can't be solved with economics alone.

This is particularly fraught time to make such a seemingly monumental decision. Interest rates are rising, which means mortgage payments are going up as well. Lock in those rates now or face the prospect of their going back to, well, normal levels (over 6 percent, from today's 4.5 percent).

The **stock market**, except for a few small corrections, has continued to soar. What that means depends on your outlook: It may be a good time to pull some money out of equity investments and put it into a more stable (and usable) asset like a home, or it may not be the right time, since stocks could continue to rise, increasing your wealth.

Unemployment is near historic lows, so people's finances may look as good as they have in a decade.

But layer over all of this the current political environment and the fears -- which have persisted for years -- that an economic correction must be around the corner, and making what should be a straightforward financial decision becomes tougher.

So what do you do? The only thing you can. Draw up a list of pros and cons, just as real estate agents often suggest.

Reasons to Buy

HOW LONG WILL YOU STAY? If it's one or two years, then rent. The costs to buy and sell the house -- like that pesky 5 percent to 6 percent brokers' commission -- will make it hard for you not to lose money, Chris Herbert, managing director of Harvard University's Joint Center for Housing Studies, pointed out. But if it's more than five to seven years, buy. Even if the housing market falls in value, your home is likely to rebound, at least to the price you paid, by the time you're ready to sell. And you get to live there and accrue equity from paying down the mortgage.

ARE YOU SETTLED? If you have small children who want outdoor space to play -- or you're tired of bundling them up and taking them to the playground when you really just want to read the paper -- a house with a yard probably looks appealing. You're settled and are likely to be in the same place for a while, dream as you might for that carefree city life of your single days.

WEIGH THE COSTS Homeownership is more cost-effective than renting. Rent rises with inflation. You can potentially lock in your mortgage payment for the next 30 years. While rates rise, you have nothing to worry about. But if they drop below what you're paying, you can refinance and pay less.

YOU HAVE FREEDOM You can do what you want with your home. ''You get to paint the walls the color you want,'' said Christopher J. Mayer, co-director of the Paul Milstein Center for Real Estate at Columbia Business School. ''You get to have the funky granite countertop that no one else but you likes.''

Reasons to Rent

YOU'RE FREE You have no children, no responsibilities to anyone but yourself (or perhaps a partner or spouse), and no real ties to where you're living and working. Rent away. It's almost a classic example of what economists call sunk costs, -- the home -- versus opportunity costs, which is the ability to move when and if you want, albeit at the price of uncertain rent.

HOME PRICES ARE RISING The supply of housing is low and house values are appreciating quickly. Renting is cheaper in this scenario because of what real estate economists call the price-to-rent ratio. Consider the San Francisco area, where tiny houses can cost big money. Professor Mayer warns that people who plan to stay in a place like the Bay Area may find themselves continually priced out of the housing market. ''In San Francisco, home prices have been going up faster than other cities for 60 years,'' he said.

HEED THE WARNINGS The housing market is due for a correction, so now may be the time to wait. ''There are a lot of reasons why there might be some red lights flashing on the dashboard,'' Mr. Herbert said. ''We're coming off a period of very strong growth where house prices are beating inflation. What's enabled them to grow faster is this longer trend putting downward pressure on interest rates.'' With a bit of inflation, the cooling could surely start. so timing the real estate market in the short term is just as difficult as timing any other market

REALITY CHECK You don't have the down payment for a home or a steady job to pay the mortgage. Your decision is made for you.

DRAWING (DRAWING BY MARK CONLAN)

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THE WALL STREET JOURNAL.

Markets

Finra Arbitrators Let Thousands of Brokers Purge Infraction Records; Brokers with scrubbed records are more likely to generate complaints, two academics found

By Jean Eaglesham and Coulter Jones
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Thousands of brokers have scrubbed their records clean of complaints by customers and employers, allowing them to hide information from potential investors, according to a new study.

These brokers were more likely than other ones to receive additional complaints or other allegations of misconduct after their records were cleaned, according to the academic paper, which analyzed public regulatory records from 2007 to 2016.

The scrubbing process, known as expungement, is overseen by the Financial Industry Regulatory Authority, the industry-funded brokerage regulator. Under Finra rules, arbitrators are expected to allow a record to be deleted from the public "BrokerCheck" website only if an allegation against a broker is factually impossible, "clearly erroneous" or the broker wasn't involved in an alleged misconduct.

Expungement is meant to be a rare event, regulators say. But the study, which analyzed BrokerCheck records and other regulatory information, found that arbitrators granted requests nearly 70% of the time.

Scrubbing so many records — 4,572 of the 6,700 requests were agreed to— makes it hard to track bad actors and harms "the ability for regulators and consumers to monitor brokers," according to the study by Colleen Honigsberg, an assistant law professor at Stanford University, and Matthew Jacob, an economics pre-doctoral research fellow at Harvard University.

Last year, Finra proposed changes to make it harder for brokers to scrub records but has yet to issue a final rule. A spokeswoman said the regulator is still reviewing and considering comments received and that it looks forward to reviewing the final version of the study. The spokeswoman added that the regulator is "committed to ensuring that Finra arbitration is a fair dispute resolution system for all parties."

There are about 630,000 active brokers registered with Finra. Most don't have any complaints or expungement requests.

One who did was Stuart Siegel. The Florida broker in 2013 declared on his BrokerCheck page that he had enjoyed an "unblemished record over a 35 year career in the securities industry with never having been accused of misconduct by any customer."

Potential clients wouldn't know by looking at the page that Mr. Siegel got approval in 2011 to delete an earlier complaint by an investor that alleged he'd given the client poor investment advice, arbitration records show. The matter was settled for $14,500; Mr. Siegel was dismissed as a party to the claim before it settled.

Two years after the complaint was scrubbed, Finra filed unrelated civil charges against Mr. Siegel alleging he had used tens of thousands of dollars of charitable funds he oversaw for his personal benefit. Mr. Siegel repaid the money and in 2014 agreed to be barred from the securities industry without admitting or denying the allegations, according to Finra records.

Finra declined to comment on the matter, while Mr. Siegel couldn't be reached for comment. His lawyer during the expungement claim, Marc Dobin, said, "at the time the expungement was granted, there was no indication of any hint of a regulatory problem."

A state regulators' group this year called for changes to the expungement system, which it says is "broken" and removes valuable information from the records.

The Securities Industry and **Financial Markets** Association, an industry body, said in its response to Finra's proposals that the "existing rules … provide sufficient safeguards."

Finra urges investors to check brokers' disciplinary records, using its BrokerCheck system. But these records don't show attempts to scrub complaints, even though such requests are a red flag, according to the study.

Mr. Dobin says it has gotten much harder for brokers to clean records in recent years. In particular, brokers can no longer make offers to settle complaints that hinge on the client agreeing not to fight an expungement. "Finra's demonstrated a growing hostility to expungements," he added.

A recent surge in brokered sales of private stakes in companies, known as private placements, could fuel new requests to scrub records. Brokers who sold these deals were four times more likely to seek expungement than the industry average, according to an analysis of arbitrators' records by Ms. Honigsberg and Mr. Jacob. Their success rate – 62% -- is slightly worse than the industry average, the analysis found.

More than one in five brokers who were denied requests to scrub red flags went on to rack up additional allegations of misconduct, the study found. That compares with only 4% of all brokers who received any allegation of misconduct from 2007 to 2017, according to the study.

Former stockbroker Anastasios Belesis, known as Tommy, tried eight times to scrub complaints filed between 2012 and 2015 -- none passed, according to regulatory records. He's now barred permanently and the firm where he served as CEO, John Thomas Financial, has been expelled from the industry.

Mr. Belesis, whose firm sold penny stocks to investors, declined to comment on the expungement process, saying he had "nothing to do with the industry any more, it's irrelevant to me." He added that "these are all past events that occurred in another lifetime to me and a lot of that was sensationalized from the regulators."

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ECONOMY

Industrial Production Inches Higher

United States industry expanded slightly in October, with manufacturing growth offsetting declines in mining and utility production.

Industrial production ticked up a modest 0.1 percent last month, the Federal Reserve reported Friday. It was the fifth straight monthly gain and left output up 4.1 percent on a year-over-year basis.

The Fed said that recent hurricanes lowered production by about 0.1 percentage point in both September and October.

The economy has been growing at a solid rate this year. The gross domestic product expanded at an annual rate of 3.5 percent in the July-September quarter, with manufacturing contributing to the momentum.

But there are concerns that the strong dollar and a slowdown in global growth could hurt future American export sales. There are also worries about labor shortages and the impact of President Trump's get-tough trade policies, which have featured higher tariffs on aluminum and steel along with penalty tariffs on a range of Chinese goods. China. Other countries have already retaliated with penalty tariffs on American products. A.P.

MEDIA

Viacom's Deal With Netflix Sets Strategy

Viacom on Friday announced a multi-picture deal with Netflix, and promised to make more films and TV shows for other companies, further signaling that it will not directly take on big tech rivals that stream to consumers and will instead supply them with content.

This strategy and the strength of the Tom Cruise-helmed ''Mission: Impossible -- Fallout'' at the box office helped Viacom beat profit and revenue expectations in the quarter ended Sept. 30.

As media giants like the Walt Disney Company and AT&T mobilize their extensive film and TV libraries to start rivals to Netflix and Amazon Prime, smaller companies such as Viacom and sister company CBS are redoubling efforts to become original content resources for other distributors.

The upbeat quarterly results and the Netflix deal boosted the company's shares, which were up 3.6 percent at $32.99 at the close of trading on the **Nasdaq**.

On an adjusted basis, Viacom earned 99 cents per share on revenue of $3.49 billion. Analysts on average expected a profit of 95 cents per share and revenue of $3.37 billion. REUTERS

TRAVEL

Airbnb's Revenue Surges Past $1 Billion

Airbnb had its best quarter ever, even as cities across the United States have started clamping down on the short-term rental market.

Revenue during the third quarter breezed past the $1 billion level as guest reservations boomed internationally in places like Beijing, Mexico City and Birmingham, England, the San Francisco company said Friday.

Airbnb expects a record one million guests to stay at Airbnb listings across the United States during the Thanksgiving holiday.

Airbnb acts as an online booking agent for homeowners to rent rooms, apartments and houses. Its growth has drawn the ire of the hotel industry and communities in the United States and abroad, where locals are uneasy with the constant turnaround of guests. A.P.

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

Steel in a warehouse in Chester, Va. (PHOTOGRAPH BY STEVE HELBER/ASSOCIATED PRESS)

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THE WALL STREET JOURNAL.
U.S. EDITION

World News: Saudi Arabia to Counter U.S. Oil Strategy --- Secrecy surrounding deals the U.S. struck with crude importers is stoking confusion

By Benoit Faucon, Summer Said and Sarah McFarlane
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Saudi Arabia is moving to cut the world's oil supply after U.S. government deals allowed hundreds of thousands of barrels a day of Iranian crude to flow onto world markets, driving down prices.

The deals put Saudi Arabia at odds with Washington at a time when relations already are strained by the murder of journalist Jamal Khashoggi.

The kingdom wants to trim production to boost **oil prices** to about $80 a barrel in support of its economy, Saudi advisers say. President Trump has warned against a production cut and called for lower prices.

The Trump administration had threatened a complete halt to Iranian oil exports, prompting other producers to boost output to compensate. Earlier this month, the U.S. made deals authorizing exemptions to eight countries, without disclosing the terms.

But people familiar with the sanctions waivers say U.S. officials are forecasting some 900,000 barrels a day of Iranian crude sales by April. That would be down at least 40% from pre-sanction levels.

The shifts are rattling oil markets. In just over a month, Brent -- the global benchmark -- fell more than 21%. While maintaining it still wants bring Tehran's crude exports to zero, the administration isn't saying how much Iranian oil the eight countries are allowed to buy. The nations, including China and India, have negotiated limits in secret with the U.S.

Saudi oil officials say they are considering advocating a production cut of as much as 1.4 million barrels a day at the Organization of the Petroleum Exporting Countries's next meeting on Dec. 6.

But OPEC officials say they are having difficulty calculating how much to produce because of U.S. secrecy surrounding its Iran sanctions efforts. That opacity, they say, already tripped up an OPEC-Russia alliance formed to pump extra oil into markets to stabilize supplies and prices.

The lack of detail about the size of the waivers is "confusing for markets," said Sara Vakhshouri, president of Washington-based consulting firm SVB Energy International.

Buyers, too, are withholding details of their agreed-to reductions. "It's confidential," India's oil minister Dharmendra Pradhan said when asked about his country's deal with Washington.

U.S. officials say they won't disclose their agreements with Iran's oil buyers because they fear complaints that some were asked to cut more than others. "We do not discuss the private diplomatic discussions that led to agreements with the various jurisdictions on the volume of oil imports," a State Department representative said.

The U.S. sanctions, which Mr. Trump announced in May as he withdrew from the Iran nuclear accord, are aimed at containing the Islamic Republic's regional influence and military capabilities, a goal Saudi Arabia shares. But Saudi officials say they feel betrayed by the Trump administration's lack of candor around the sanctions and will chart an oil policy that is more independent of U.S. goals.

They say Mr. Trump strong-armed Saudi Crown Prince Mohammed bin Salman into throttling up oil output to record levels to cool off prices ahead of the revival of tough sanctions on Iran's petroleum industry on Nov. 5.

Mr. Trump told Saudi leaders there would be no exceptions from sanctions for Iranian oil buyers, the officials said, which would have potentially wiped more than a million barrels of oil off the market and sent prices soaring.

And if the Saudis didn't raise production to make up for Iranian losses, Mr. Trump threatened to support a congressional bill allowing antitrust action against OPEC members, who he says act as a cartel, the advisers said.

Instead the Trump administration issued the exemptions -- a move that relieved market worries about Iran's supply outages but has sent **oil prices** skittering. "They feel they were used," a Saudi adviser to the kingdom's leaders said.

The White House referred questions to national security adviser John Bolton's comments earlier this week in Singapore, where he said the objective of the waivers was to "get oil exports from Iran down to zero."

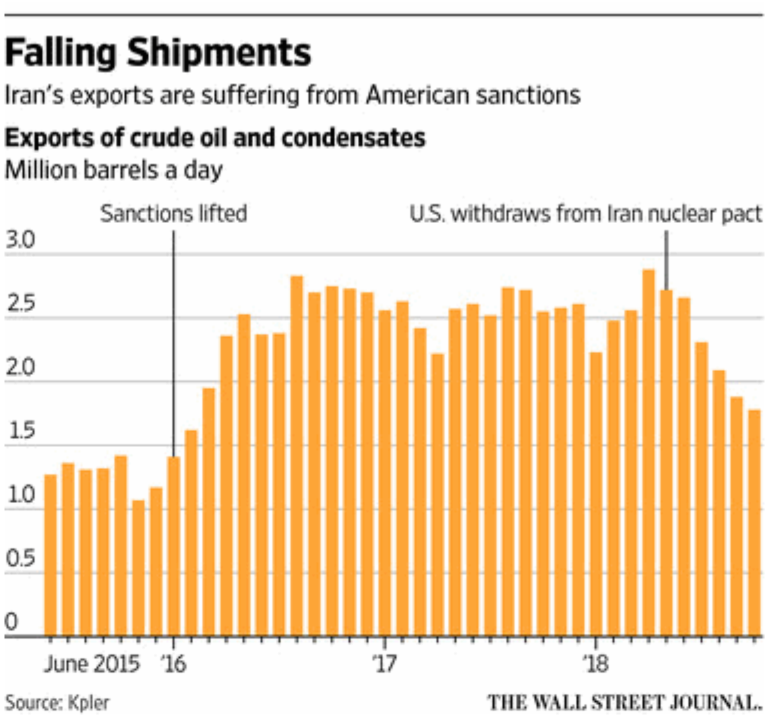
"We do not want to cause unnecessary damage to our friends who are helping us, but we intend, as I say, to squeeze," Mr. Bolton said. "And so we have talked to a lot of countries, and we will continue to do that because we're concerned not only about Iran's continued pursuit of nuclear weapons, but its support for international terrorism."

Prince Mohammed's attention has turned to his oil-dependent economy as the kingdom's leadership faces its biggest crisis in a generation with Mr. Khashoggi's murder in Istanbul by a group of Saudi government operatives. In just over a month, **oil prices** have fallen far below the $88 a barrel that the International Monetary Fund says Saudi Arabia needs to balance its budget.

"Saudi Arabia has major financial commitments to meet and price drops don't help," a senior Saudi energy adviser said.

A strong economy is important as the kingdom wages an expensive war in Yemen and girds for an economic showdown with Iran.

Rebecca Ballhaus contributed to this article.



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The New York Times

BREAKINGVIEWS
Business/Financial Desk; SECT
To Gauge Concerns About Brexit, Look at British Bonds

By SWAHA PATTANAIK
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Get the DealBook newsletter to make sense of major business and policy headlines -- and the power-brokers who shape them.

The British pound is the most sensitive barometer of Brexit fears. The currency slumps each time it looks more likely that Britain may crash out of the European Union without a deal. At the same time, however, British government**bond prices** strengthen because bleak economic prospects mean higher interest rates are less likely. The clearest sign that investors have had enough of the United Kingdom would be when both weaken at the same time.

Britain's currency and its government bonds, known as gilts, have tended to react to political turmoil by moving in opposite directions. The pound fell nearly 2 percent against the dollar and euro on Thursday after a string of cabinet resignations cast doubt on the future of Prime Minister Theresa May and her draft Brexit deal. But even as the pound suffered its worst day since Oct. 2016, gilts rallied. The yield, which drops when prices rise, on 10-year UK government bonds fell more than 10 basis points, to as low as 1.35 percent.

Even more telling was that British sovereign debt performed better than German and American alternatives. That would not have been the case if investors had become wary of Britain altogether. The gap between the yield on gilts and German bonds narrowed by roughly 10 basis points on Thursday. Meanwhile 10-year United States government bonds yielded as much as 174 basis points more than comparable gilts -- the widest difference since 1984.

Like currency traders, bond investors think that the British economy would be damaged by a chaotic no-deal Brexit. But they believe this would force the Bank of England governor Mark J. Carney to defer further interest rate rises, which is typically good for debt prices. That investors can still apply normal bond logic shows that they are not yet panicky.

It would take a full-blown pound crisis for the British central bank to respond by raising rates, ignoring the temporary slump in the pound as it did after the 2016 Brexit referendum. If bond investors believed that was likely, they would be as keen to ditch gilts as currency traders are to sell pounds.

For now, however, Britain's political crisis has yet to become a financial one.

Swaha Pattanaik is global economics editor of Reuters Breakingviews. For more independent commentary and analysis, visit breakingviews.com

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EXCHANGE --- FHA Flags Inflated Appraisals --- Housing agency warns of growing insurance losses

By Cezary Podkul
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Inflated home appraisals are fueling losses at the Federal Housing Administration, which said this week that it expects a $14.4 billion drain from its mortgage insurance fund in coming years.

The shortfall stems from the FHA's portfolio of reverse-mortgage insurance, but the agency's chief, Brian Montgomery, says he fears inflated appraisals may also be lurking in its much-larger portfolio of traditional mortgage insurance.

If the FHA's insurance fund losses grow significantly, that could have broad implications for the housing agency and borrowers, who might see higher insurance premiums on FHA-backed mortgages. The agency estimates it insures about 11% of all U.S. single-family residential mortgage debt.

In a reverse mortgage, a homeowner borrows against the value of his or her house; the lender is repaid when the house sells. An inflated appraisal leaves the lender at risk of recouping too little -- and the FHA on the hook for the difference.

The FHA's review began in early June, shortly after Mr. Montgomery took over as commissioner.

His staff scoured 134,000 reverse mortgages and found at least 37% appeared to be overvalued by 3% or more. The agency expects they will contribute to higher claims out of the FHA's $34.9 billion mortgage insurance fund. Reverse mortgages constitute only about 6% of the insurance portfolio, yet they're responsible for all of the fund's expected future losses.

The fund insures more than eight million reverse and traditional mortgages totaling $1.26 trillion.

The FHA could be forced to seek a cash injection from the U.S. Treasury, like it did in 2013, if its finances were to erode heavily. To prevent that possibility, in October the FHA put in a new appraisal-review process for reverse mortgages, among other steps aimed at stemming losses. "We're trying to protect the taxpayers," Mr. Montgomery said.

Inflated appraisals were a major contributor to the housing bubble that burst a decade ago. The 2010 Dodd-Frank financial overhaul law prohibited anyone involved in mortgage origination from hiring or influencing appraisers.

The FHA's struggles indicate inflated appraisals are still a problem in the $10.7 trillion home loan market. A 2017 study by housing officials concluded that "appraisers seeking future business have little incentive in jeopardizing a loan closing by underestimating the collateral value." Mr. Montgomery said the study prompted the review.

Reverse mortgages provide a window into the problem of inflated appraisals. Unlike traditional mortgages, reverse mortgages don't require monthly payments. Instead, the loans are repaid from proceeds of a sale once a homeowner moves or dies. Meanwhile, interest accrues and gets added to the original principal. That's why an accurate appraisal is crucial for the math to work out in the FHA's favor: If a home is overvalued, lenders originate larger loans that get even bigger over time and later have to be repaid with smaller-than-expected sale proceeds.

"That's where the claims come in," said Adolfo Marzol, senior adviser to Housing and Urban Development Secretary Ben Carson. "Time is not our friend, given the math."

The mortgages were designed to give seniors short on cash an ability to stay in their homes. The program became popular after the 2008 financial crisis, when the **stock market**'s historic tumble wiped away trillions of retirement savings.

Gerald Kifer, who was director of the FHA's office of home valuation from 2010-11, said the FHA has long allowed lenders to select which appraisers they want to work for them from a roster provided by the agency. He found that problematic.

"If you're the one who can select the appraiser, who are you going to select? You're going to select the guy who always hits the mark for you," Mr. Kifer said.

To comply with Dodd-Frank's appraisal independence requirements, many lenders now use middlemen known as appraisal management companies, or AMCs, which hire and pay appraisers on their behalf. More than 50% of home appraisals go through AMCs, according to an industry group.

Mr. Montgomery said inflated appraisals lessened in recent years but persisted even after the rise of AMCs.

AMCs say their industry improves the appraisal process by helping lenders comply with Dodd-Frank independence rules and ensuring quality control.

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The Weekend Interview with Claudio Borio: Why Central Bankers Missed the Crisis

By Joseph C. Sternberg
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Basel, Switzerland -- It's been a rough decade for most developed economies, as businesses, politicians, policy makers and voters have struggled with the aftermath of a global financial panic and deep recession. So it's a good time to ask what we've learned -- especially about the causes and cures of the financial instability that caused so many problems. Claudio Borio's answer is sobering: We know less than we think we do, and our ignorance could cost us.

Mr. Borio is worth heeding from his unique perch running the economic-research department at the Bank for International Settlements. The BIS is an informational clearinghouse for the world's central banks, providing data, convening meetings, and guiding debates on financial regulation. So he can draw on the practical insights that come from extensive contacts with policy makers -- a distinct advantage over many academic economists. But in contrast to economists who've served in governments, Mr. Borio is not politically invested in one policy choice or another.

That allows him to start our conversation on a crisp autumn morning with a startling observation: "The state of knowledge is that we're all struggling!"

He doesn't mean that as a criticism of central banks, which, Mr. Borio says, acted quickly and correctly 10 years ago to stabilize the financial system. "The response to the crisis worked very well," he says. "It was central banks pulling out all the stops and coordinating with each other. That helped at preventing the situation from running completely out of the control, stabilizing the financial system, stabilizing the economy," and staving off a depression.

The problem is that politicians have come to rely too heavily on central banks to stimulate growth since the crisis. Mr. Borio describes the institutions as "overburdened." At the same time, central banks are constrained by economic theories that offer little meaningful guidance for how to sustain growth and financial stability.

Here, broadly, is what mainstream monetary economists think they know: Inflation, employment and economic growth change in relation to each other in predictable ways. The central relationship between inflation and employment is described by a concept called the Phillips curve: As unemployment falls, inflation rises. The theory has been poked and prodded, bashed and battered since it was first proposed in the 1950s, but all variations share the belief that deflation is a result of economic slack.

Central banks can't tolerate deflation because it signifies slower-than-natural growth in which too few people have jobs. Yet they have limited scope to influence the economy, according to the dominant theory. Over the longer term, financial, product and labor markets find their own equilibriums. Central banks can provide only limited jolts by tweaking short-term interest rates.

Mr. Borio thinks there's a better approach. "Monetary policy has been reduced to very, very simple relationships that are built on a system that is self-equilibrating," independent of anything central banks do. "Financial factors don't really fit into it, and therefore monetary factors don't really fit into it. The only thing you really have is an interest rate, for instance, that in the short run may affect output but in the long run ends up affecting only inflation."

In other words, the dominant theories of monetary economics omit the most interesting, and important, consequences of monetary policy. When this model "talks about financial aspects like the financial system," he says, "the only thing the financial system does is to allocate resources, given resources." Yet financial systems also create resources by extending credit in response to monetary-policy incentives.

Nor can one elide the question of exactly how those resources are distributed. At the heart of Mr. Borio's work is an insight most contemporary theorists miss: One needs to examine "how resources are allocated across different sectors in ways that may not be optimal." It's very different from the orthodox view that a rising tide of new money lifts all boats.

With that point in mind, economists need to go back to the drawing board. Another way of thinking about the breakdown of the Phillips curve "is that there may be longer-term structural forces that are in play here," he says. "And personally, I've always felt that the way in which structural forces may actually be reflected in the failure of the Phillips curve to work has not been given the attention it deserves." The big structural force Mr. Borio identifies is globalization, under which international competition puts sustained downward pressure on inflation.

Similar observations underlie the next big thing in monetary orthodoxy: "secular stagnation." A 1930s-era Keynesian theory dusted off in late 2013 by Harvard economist and former Obama adviser Larry Summers as an explanation for the slow recovery, secular stagnation has gained academic currency as a way to revise the Phillips curve by incorporating more variables. Aging populations are consuming less and productivity is growing more slowly, the argument goes, leading to a sustained period of slack demand. But Mr. Borio interprets "structural forces" differently. The main drivers of deflation at the moment "are good forces," he says. "They improve the capacity of the economy to produce and boost growth. Think of it as a benign increase in supply."

In a 2015 paper Mr. Borio and colleagues examined 140 years of data from 38 countries and concluded that consumer-price deflation frequently coincides with healthy economic growth. If he's right, central banks have spent years fighting disinflation or deflation when they shouldn't have, and in the process they've endangered the economy more than they realize.

"By keeping interest rates very, very, very low," he warns, "you are contributing to the buildup of risks in the financial system through excessive credit growth, through excessive increases in asset prices, that at some point have to correct themselves. So what you have is a financial boom that necessarily at some point will turn into a bust because things have to adjust."

He describes this as a "pincer movement" in a working paper he wrote with several colleagues this year. On one hand, globalization and other (often benign) factors make it harder for central banks to gin up inflation by cutting interest rates. On the other hand, by slashing rates in pursuit of that hard-to-attain inflation target, they create imbalances in the financial system that lead to crises like the one in 2008.

It's not that other economists are blind to financial instability. They're just strangely unconcerned about it. "There are a number of proponents of secular stagnation who acknowledge, very explicitly, that low interest rates create problems for the future because they're generating all these financial booms and busts," Mr. Borio says. Yet they still believe central banks must set ultralow short-term rates to support economic growth -- and if that destabilizes the financial system, it's the will of the economic gods.

Mr. Borio thinks monetary economists and central bankers need to take more responsibility -- that especially after 2008, such indifference to **financial markets** ought to discredit an economic theory. If economists think "structural forces" dictate policies that destabilize **financial markets**, that should be a clue that they misunderstand the forces in play: "How could financial and macroeconomic stability be in tension?"

The financial panic caught experts by surprise because they had assumed that the financial system (and the economy as a whole) would, through the inscrutable workings of the invisible hand, find a sustainable balance of saving, investment, consumption and other variables independent of central-bank policies.

Mr. Borio, in contrast, can explain exactly where dangerous financial imbalances come from: the incentives policy makers accidentally create for bad decisions on Main Street about borrowing and investment. The misallocation of resources during the booms requires a prolonged and miserable process of reallocation during and after a recession.

We should expect any serious monetary theory to explain a financial crisis, Mr. Borio insists. The only time he sounds genuinely dismissive of conventional wisdom during our conversation is on this point: "You know, in many of these models, how do they explain the Great Financial Crisis? They explain it as a meteorite coming from nowhere -- it's an exogenous shock, it's productivity that all of a sudden for some unexplained reason collapsed, or people all of a sudden decided to save more, but without an explanation. In my most cynical moments, I say 'shocks' are a measure of our ignorance, not a measure of our knowledge."

So what's a central banker to do? "I think that if I were a policy maker actually in charge of making policy, I would find it extremely challenging," Mr. Borio says puckishly before offering a few ideas:

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Above all, "it's important to be thinking of these things all the time." Policy makers should keep a constantly watchful eye on financial conditions, not only in the depth of a crisis or the height of a worrisome bubble. The problem comes when "95% of the time you carry out your policy as if these factors didn't matter, and then when you see that the economy is running red hot and you see obvious signs of financial imbalances, you start moving."

Central banks and other authorities have tended to approach financial stability from a regulatory perspective, and this is the thrust of the high-profile Basel standards the Bank for International Settlements has helped craft. Mr. Borio says this is necessary but far from sufficient. There's a limit to how successfully such rules can row against the broader policy tide. The entire monetary-policy framework needs to be reoriented toward financial stability.

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World

Brazil Signals Hawkish Approach on Its Big Budget Deficit; Analysts hope President-elect Jair Bolsonaro's appointments to his economic team will help address the country's budget crisis

By Paulo Trevisani
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BRASÍLIA—Brazil's president-elect has put together a team of fiscal hawks to lead the economy, winning cautious approval from markets worried about the country's ballooning debt.

Jair Bolsonaro's designated economy minister, Paulo Guedes, on Thursday proposed U.S.-trained economists Roberto Campos Neto, 49, to lead the central bank and Mansueto Almeida, 51, to stay on as head of the national treasury.

Earlier this week the president-elect said former Finance Minister Joaquim Levy, 57, will lead Brazil's large development bank, known as BNDES, the main source of funds for much-needed infrastructure projects in the country, but which until recently has also been a burden for taxpayers.

Analysts hope the new team will balance a budget that has been bleeding red ink for years.

"It's an excellent sign regarding the biggest problem in Brazil, which is the budget," said economist Fernanda Consorte, currency strategist at brokerage firm Ourinvest. "Markets were very anxious for these announcements."

Mr. Almeida, who has been with the government since 2016, expressed hopes fiscal adjustment will be more likely under the new administration as Mr. Bolsonaro won 55% of the vote in last month's election.

"Chances of fiscal reform are bigger because the next administration had a strong victory in the election," he said to The Wall Street Journal.

Mr. Levy declined to comment. Mr. Campos Neto didn't respond to requests for comments.

The Brazilian real traded at 3.74 per dollar early on Friday, stronger than 3.79 at closing on Wednesday. The Ibovespa **stock index** was up 1.34%, to 87.122 points.

Markets have been concerned as Brazil struggles to plug a budget deficit equal to 7.2% of gross domestic product. Economists say the first step would be closing loopholes that allow public servants to retire as early as in their mid-50s with a full salary for life.

Previous administrations have tried to trim pension costs, but lawmakers refused to pass measures they thought likely to anger voters. The election of right-wing Mr. Bolsonaro has fed hopes that pension reform could now be approved, but analysts remain worried.

"We still don't know what exactly Bolsonaro will propose to overhaul social security," said Andre Perfeito, from Spinelli brokerage firm. "What I am more concerned at this point isn't the names, but the president's ability to make the reform happen."

Economists see pension reform as the main roadblock to balance the budget.

"A social security reform in the first year in office is the necessary—but not sufficient—condition to deliver a meaningful fiscal adjustment," said Goldman Sachs' Latin America economist Alberto Ramos.

The BNDES development bank is also important for the federal budget. Previous administrations used the bank to offer subsidized loans to corporations large and small in efforts to prop up the economy that often failed and resulted in large losses for the taxpayer.

The administration of outgoing President Michel Temer implemented new policies substantially reducing those subsidies and the BNDES has even returned funds to the treasury, a policy Mr. Levy is expected to continue.

Mr. Levy oversaw the economy in 2015 under President Dilma Rousseff, who was impeached in 2016. His fiscal-austerity agenda was shot down by an unruly Congress and he left the post in December 2015. He has since been working at the World Bank.

Analysts say the biggest issue for leadership at the central bank is maintaining credibility with markets.

Mr. Campos Neto, 49, an executive at the local unit of Spain's Santander financial group, will replace Ilan Goldfajn, who since 2016 has overseen a major reduction in borrowing costs thanks to declining inflation, which gained him wide appreciation from investors.

Mr. Goldfajn said the appointee is an "experienced and respected professional with an ample understanding of the financial system and the economy."

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Heard on the Street
Markets

Vivendi Rides Spotify's Coattails; The French company owns Universal Music, which may be the biggest beneficiary of the music industry's revival

By Stephen Wilmot
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Spotify has resurrected the music industry but Vivendi's shareholders may be the biggest winners.

Revenue at Vivendi's Universal Music, owner of the world's largest record collection, grew 13.5% in the third quarter versus the year before, stripping out currency changes. That was better than analysts expected after slower growth in the first half. Streaming revenue, up 38.6%, led the growth. Vivendi shares jumped Friday after the results were posted late Thursday.

Spotify reported third-quarter revenue growth of 31% earlier this month. But the shares fell almost 6% on the results and are now well below the price set by April's initial public offering.

Spotify's problem is exorbitant expectations. Its valuation only adds up if the company follows Netflix's playbook and disrupts the music industry with exclusive content. There isn't much evidence this is achievable, and recent newsflow has underlined the power of rights owners. India is the latest battleground, with whispers that Spotify's launch has been held up by licensing problems.

Growth can be **volatile** at Universal Music: The latest quarter benefited from a new album by Canadian rapper Drake. Still, with a roughly 30% share of recorded music revenues globally last year, the company looks to be the biggest beneficiary of the industry's resurgence.

The problem for investors is that Vivendi makes an unappealing owner. Universal still only accounts for 42% of consolidated revenue. Much of the rest comes from Canal+, a struggling cable channel, but the bigger problem is governance. Controlled by French billionaire Vincent Bolloré, Vivendi resembles a family-owned conglomerate more than a classic multinational. Last year Vivendibought a controlling stake in Havas, a portfolio of advertising agencies, from Mr. Bolloré's investment company just as a downturn plunged the ad industry into crisis.

Vivendi last year said it might sell a minority stake in Universal through an initial public offering but in July ditched the plan in favor of finding a deep-pocketed partner. Investors now have no choice but to buy Vivendi stock if they want exposure to the world's top music company. The question is whether good music is worth bad governance.

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U.S. Markets
Markets

U.S. Stocks Post Weekly Loss in Volatile Trading; Disappointing results from Nvidia and Nordstrom spook investors

By Christopher Whittall and Michael Wursthorn
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Corrections & Amplifications

A chart in an earlier version of this article mislabeled pounds and dollars.

The **S&P 500** edged higher Friday, but steep losses from earlier in the week pushed the broad index to its first weekly loss of November.

Fears that business growth is slowing and the U.S. economy is headed for a rockier road in 2019 were heightened after several more companies, including chip maker Nvidia and retailer Nordstrom, reported disappointing earnings results.

Fresh economic data darkened the picture, with U.S. industrial output for October coming in below analysts' expectations and household indebtedness climbing, according to the Federal Reserve.

Even a fresh bout of optimism that the U.S. and China may be showing signs of progress on a trade deal wasn't enough to kick-start a significant rally, leaving the **S&P 500** down 1.6% for the week, its first weekly loss since Oct. 26.

"We're tilted toward a negative near-term outcome and expect a slowdown," said Barry Bannister, head of institutional equity strategy at Stifel Nicolaus. Mr. Bannister said the outlook has been shaped by ongoing trade tensions and concerns about the Federal Reserve's pace of interest-rate increases.

Stifel and other investors have been paring their exposure to shares of technology companies to spread cash across companies that tend to be more durable in an economic slowdown—and that continued Friday, with the **S&P 500**'s energy, consumer-staples, health-care and utility sectors all posting gains while the market's growth corners, like tech and consumer discretionary, fell.

But the loss of technology stocks as the market's clear leader has sapped investors of their conviction that the **S&P 500** will be able to end the year firmly higher. The latest bout of selling in tech shares, along with a sharp drop in **oil prices** and concerns around trade, contributed to a painful five-day stretch for the **S&P 500** earlier this week that shaved 4% off the index.

The index added 6.07 points, or 0.2%, to 2736.27 on Friday, while the **Dow Jones Industrial Average** added 123.95 points, or 0.5%, to 25413.22, finishing the week down 2.2%. The **Nasdaq Composite** declined 11.16 points, or 0.2%, to 7247.87, putting it deeper into correction territory, typically defined as a 10% fall from a recent high.

"There's concern about how close we are to the end of the bull cycle," said Mark Esposito, president of Dallas-based Esposito Securities. "Any [earnings shortfalls] have a huge negative impact on investors psychologically."

Chip maker Nvidia fell $37.96, or 19%, to $164.43 after it reported quarterly sales below analyst expectations and provided downbeat forecasts for the current quarter, making it the worst-performing stock in the **S&P 500** on Friday.

Losses among retail stocks added pressure. Nordstrom shares tumbled 8.06, or 8.1%, to 50.93 after the retailer said a multimillion-dollar charge related to delinquent credit-card debt ate into its profit. Other retailers, including Target and Kohl's, also sank.

Trying to offset those losses were shares of utility companies, which rose 1.2% across the **S&P 500**. The sector got a boost after a top California official said a bankruptcy of PG&E, owner of Pacific Gas & Electric, over wildfire-related liabilities wouldn't be good for California citizens.

PG&E added 6.66, or 38%, to 24.40, its biggest-ever gain, after suffering a brutal six-session run of heavy losses. The gains pulled up shares of most other utility companies, including Edison International.

Major indexes made a bigger rally at one point Friday after President Trump said he may hold off on imposing additional tariffs and that he doesn't want to put "China in a bad position," according to reports. But most of that bounce faded, leaving stocks only slightly higher by Friday's close.

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Markets

Inflated Home Appraisals Drain Billions From Government Insurance Fund; Federal Housing Administration says it expects to lose $14.4 billion in coming years, potentially raising premiums on mortgages insured by the FHA

By Cezary Podkul
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Inflated home appraisals are fueling losses at the Federal Housing Administration, which said this week that it expects a $14.4 billion drain from its mortgage insurance fund in coming years.

The shortfall stems from the FHA's portfolio of reverse-mortgage insurance, but the agency's chief, Brian Montgomery, says he fears inflated appraisals may also be lurking in its much-larger portfolio of traditional mortgage insurance.

If the FHA's insurance fund losses grow significantly, that could have broad implications for the housing agency and borrowers, who might see higher insurance premiums on FHA-backed mortgages. The agency insures about 11% of all U.S. single-family residential mortgage debt, it estimates.

In a reverse mortgage, a

homeowner borrows against the value of his or her house; the lender is repaid when the house is sold. The FHA insures the loans. An inflated appraisal leaves the lender with the prospect of recouping too little—and the insurer on the hook for the difference.

The FHA's review began in early June, shortly after Mr. Montgomery took over as the agency's commissioner. Mr. Montgomery said in an interview he wondered why the agency's mortgage insurance fund was "hemorrhaging money" despite low interest rates and rising home prices.

To find out, his staff scoured 134,000 reverse mortgages and found at least 37% appeared to be overvalued by 3% or more. The agency expects they will contribute to higher claims out of the FHA's $34.9 billion mortgage insurance fund. Reverse mortgages constitute only about 6% of the insurance portfolio, yet they're responsible for all of the fund's expected future losses. Since October 2011, the insurance fund has paid more than $19 billion in claims on reverse mortgages alone, FHA data show.

The fund provides insurance for more than 8 million reverse and traditional mortgages totaling $1.26 trillion.

The FHA could be forced to seek a cash injection from the U.S. Treasury, like it did in 2013, if its finances were to erode heavily. To prevent that possibility, in October the FHA put in place a new appraisal-review process for reverse mortgages, among other steps aimed at stemming losses. "We're trying to protect the taxpayers," Mr. Montgomery said.

Inflated appraisals were a major contributor to the housing bubble that burst a decade ago. The 2010 Dodd-Frank financial overhaul law prohibited anyone involved in mortgage origination from hiring or influencing appraisers.

The FHA's struggles indicate inflated appraisals are still a problem in the $10.7 trillion home loan market. A 2017 study by the Department of Housing and Urban Development concluded that "appraisers seeking future business have little incentive in jeopardizing a loan closing by underestimating the collateral value." Mr. Montgomery said the study's findings prompted FHA officials to review reverse mortgage appraisals.

Reverse mortgages provide a window into the problem of inflated appraisals. Unlike traditional mortgages, reverse mortgages don't require monthly payments. Instead, the loans are repaid from proceeds of a sale once a homeowner moves or dies. Meanwhile, interest accrues and gets added to the original principal. That's why an accurate appraisal is crucial for the math to work out in the FHA's favor: If a home is overvalued, lenders originate larger loans that get even bigger over time and later have to be repaid with smaller-than-expected sale proceeds.

"That's where the claims come in," said Adolfo Marzol, senior adviser to Housing and Urban Development Secretary Ben Carson . "Time is not our friend, given the math."

The mortgages were designed to give seniors short on cash an ability to stay in their homes. The program became popular after the 2008 financial crisis, when the **stock market**'s historic tumble wiped away trillions of retirement savings. The FHA insured about 114,000 reverse mortgages in 2009, more than double 2005 volumes.

The FHA was founded during the Great Depression to expand homeownership. As part of that mandate, it insures mortgages against default so that lenders can provide loans to borrowers who might not qualify on their own. FHA-insured loans are popular with first-time homebuyers since they require lower minimum credit scores and down payments than traditional mortgages.

Gerald Kifer, who was director of the FHA's office of home valuation from 2010-11, said the FHA has long allowed lenders to select which appraisers they want to work for them from a roster provided by the agency. He found that problematic.

"If you're the one who can select the appraiser, who are you going to select? You're going to select the guy who always hits the mark for you," Mr. Kifer said. "That's human nature."

To comply with Dodd-Frank's appraisal independence requirements, many lenders now use middlemen known as appraisal management companies, or AMCs, which hire and pay appraisers on their behalf. More than 50% of home appraisals go through AMCs, according to the Real Estate Valuation Advocacy Association, which represents the industry.

Mr. Montgomery said inflated appraisals lessened in recent years but persisted even after the rise of AMCs.

That's what happened at Pacific Union Financial, a Texas-based nonbank mortgage lender, according to a 2017 internal memo reviewed by the Journal. That memo found loan officers at one of its Minnesota branches selected appraisers and submitted them to an AMC who paid them above-market rates and kept using them.

"Their use is being mandated by the branch and is knowingly facilitated by the AMC," said the memo, which found a "material misrepresentation of value" in the appraisers' work. One appraiser received 213 assignments in one year alone, according to the memo.

Pacific Union said in a statement that "at all times" it has "maintained controls for compliance with applicable appraiser independence requirements." It said those controls are reviewed regularly by counterparties and regulators.

AMCs say their industry improves the appraisal process by helping lenders comply with Dodd-Frank independence rules and ensuring quality control.

The FHA announced in late September that it will now review all appraisals submitted under its reverse-mortgage insurance program. Lenders aren't able to close a loan until the review is completed, and if the FHA believes a home is overvalued, it may require a second appraisal, according to a statement.

The new policy took effect Oct. 1. Mr. Montgomery said that, so far, 22% of reverse mortgages have required a second appraisal.

"It's something we're monitoring closely," Mr. Montgomery said.

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THE WALL STREET JOURNAL.

Economy
Federal Reserve's Richard Clarida Defends Gradual Interest-Rate Increases; Central bank's vice chairman emphasizes importance of economic data as rates approach so-called neutral rate

By Kate Davidson
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Federal Reserve Vice Chairman Richard Clarida on Friday defended the Fed's pace of gradual increases to its benchmark federal-funds rate, saying the central bank's current policy stance isn't slowing the U.S. economy.

Asked whether recent **stock-market volatility** reflects concerns that the central bank is moving too far, too fast, Mr. Clarida said the Fed began raising interest rates nearly three years ago.

"The policy rate that we set is now just barely above the rate of inflation for the first time in a decade, so I wouldn't agree with that," he said in an interview on CNBC. He pointed to robust economic growth this year, and a pickup in labor-force participation and productivity, as evidence of the continued health of the U.S. economy.

He also emphasized the importance of relying on incoming economic data as interest rates approach a so-called neutral rate, neither spurring economic growth nor slowing it down.

"The economy is doing well, we're looking for signals from the labor market, from inflation, to get a sense of both the pace and the destination for policy," he said. "So this is very much in data-dependent mode right now."

Though rates are still below neutral, they are "getting closer" to that point, which he said is important. "Certainly where the economy is today and the Fed's projection for where it's going, being at neutral would make sense," he added.

A sudden pickup in inflation could cause him to adjust his outlook for the path of rates, Mr. Clarida said, but he added that he doesn't expect that at the moment. He also pointed to slowing global economic growth as a factor in his outlook.

Mr. Clarida's remarks echoed those he made last month, when he endorsed the Fed's plan to raise rates gradually and said the behavior of inflation is key to deciding when to stop.

"If the data come in as I expect, I believe that some further gradual adjustment in the federal-funds rate will be appropriate," he said at the time.

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WSJ PRO CENTRAL BANKING

Economy

Fed's Patrick Harker 'Not Convinced' a December Rate Rise Is Prudent; 'I need to watch the data over the next few weeks,' says Harker, president of Federal Reserve Bank of Philadelphia

By Michael S. Derby
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Federal Reserve Bank of Philadelphia President Patrick Harker said Friday he isn't ready to support the central bank raising short-term interest rates again next month, given the modest outlook for inflation.

"At this point, I'm not convinced a December rate move is the right move," Mr. Harker said in an interview with The Wall Street Journal. "But I need to watch the data over the next few weeks" before determining whether it is prudent to boost the cost of borrowing again, he said.

The current state of inflation argues against action, Mr. Harker said. "We're not seeing the recent data telling us that inflation's moving rapidly past our target. So I think we have some time to let this evolve," he said.

"In the beginning of the year, I had put in my forecast three 25-basis-point rate increases, and I haven't moved from this too much," Mr. Harker said. "Over the next year and a half, we can move slowly up to what I see as the nominal neutral rate, which I see as 3%."

Mr. Harker said the economy should continue to do well, but he flagged a rising tide of uncertainty among his contacts that gives him some pause. Trade and political issues and market **volatility** are giving many a sense of concern, Mr. Harker said, and he will monitor this as he thinks about how the Fed should manage monetary policy.

The interview with Mr. Harker represented his first substantive public comments on the outlook since the rate-setting Federal Open Market Committee held its overnight federal-funds rate target range steady at between 2% and 2.25% earlier this month.

The FOMC has raised rates three times this year, and it is expected to increase rates again when it meets Dec. 18-19. Fed officials generally support gradual rate rises as a way to temper potential inflation pressures in a strong economy while keeping activity moving forward. The Fed is expected to continue raising rates next year. Due to the rotation of Fed voting members, Mr. Harker will regain an FOMC vote in 2020.

Some other Fed officials have grown more cautious about the outlook. Speaking in Spain on Thursday, Atlanta Fed leader Raphael Bostic said, "I don't think we are too far from a neutral policy, and neutral is where we want to be." He added: "We may not be there quite yet, but I am inclined to think that a tentative approach as we proceed would be appropriate."

Most in the Fed want to move monetary policy to a place where it is neutral in regards to its impact on the economy, while some have suggested the central bank may need to boost short-term rates to a level that would slow the economy somewhat. Mr. Harker said in the interview it is hard to know exactly how potent monetary policy is at any given point, and said that concept wasn't critical to his interest-rate outlook.

"I don't think the goal is to become restrictive. The goal is to continue to allow the economy to grow," Mr. Harker said. When it comes to rate rises, "we may inadvertently overshoot a little bit, but that's not my goal. I'd like to get to neutral and stay there for a while and see how things evolve."

Mr. Harker's caution over raising rates doesn't mean he isn't hopeful for the economy, he said. He described overall activity and job growth as strong and said he expects to see gross domestic product growth over 3% this year before it moderates. He also believes today's 3.7% jobless rate will fall to 3.5% by next year before moving higher.

Mr. Harker expects that inflation will slightly overshoot the Fed's 2% target, but he added there is no reason to think a big surge is likely. He described the current state of price pressures as "well-anchored."

Mr. Harker said while he is sanguine about the health of banks, he does have concerns about unregulated financial activity and the state of leveraged loans. The high level of student loans is also a concern, he said, but he added none of this has risen to a level where he sees a broader threat to the functioning of the financial system.

As for stock prices, "**financial markets** are clearly choppy, **volatility** has increased. Some of this is natural at this course in the cycle," Mr. Harker said.

He said officials should do all they can to be ready for when the next downturn arrives. To that end, he said it is important to do what it takes to get everybody working who wants to work, to make sure banks have the capital they need to withstand trouble and to fine-tune financial regulation.

"It continues to be a very good economy, and this is the time in a good economy that we should start planning for when it's not such a good economy," Mr. Harker said.

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

Transcript

* WSJ Interview With Philadelphia Fed's Patrick Harker

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WSJ PRO CENTRAL BANKING

Economy
Transcript: WSJ Interview With Philadelphia Fed's Patrick Harker; Official discusses his outlook for interest rates and the economy, market volatility, and climate change

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Federal Reserve Bank of Philadelphia President Patrick Harker sat down for an interview with Wall Street Journal reporter Michael S. Derby on Friday, Nov. 16, 2018. Mr. Harker discussed his outlook for interest rates and the economy, market volatility, climate change, and the struggle many companies are having to find workers. Here is a transcript of the interview, lightly edited for length and clarity.

MICHAEL S. DERBY: Well, I will start off where I usually start off, which is sort of general economic outlook questions, and get your sense of where you feel we are in the economy right now and how you feel it playing out over the next year or two – just ask, you know, broadly/generally how you feel about it. So whatever way you want to find your way into that, you know, in terms of growth or ... how you want focus on it.

PATRICK T. HARKER: Sure. So, again, these are my thoughts alone and nobody else in the Federal Reserve System, because I think that's important to say.

Because I think we're at a point right now where, at least for me, I think the economy is very strong. We continue to see a very strong, in some cases surprisingly strong, labor market. But there are some risks that are starting to emerge in the – in the economy that give me some concern.

So start with our estimate of [gross domestic product] growth. We see GDP coming in above – slightly above 3 percent this year and then starting to trend down over the next year or two to trend growth of 2 percent. Unemployment, we see it going down to about 3.5 percent before it starts to tick back up over the next couple of years.

MR. DERBY: Do you know when you'll get to 3.5? This year, or –

MR. HARKER: We're estimating sometime, say, in the second half of '19, maybe.

MR. DERBY: OK.

MR. HARKER: But again, these numbers have been surprising.

But I also don't think that those numbers of 200,000-plus are sustainable in the long run. We know that the sustainable number is somewhere between 90 and 110,000 a month when we've reached neutral, and at some point we'll get to that just because of the demographics of the American workforce.

MR. DERBY: OK.

MR. HARKER: Inflation is at or near our 2 percent target, but in the last couple of months it's been a little soft. I mean, we've seen a little bit of softening there, and that does give me some concern. Or you may say it's not concern. I mean, this is a really good economy. If we can keep inflation where it is and continue to produce a robust number of jobs, that's good for the American economy and that's good for the American worker. So I don't see why we'd want that to stop. It will naturally start to slow down over time just as the economy is destined to do, in some ways, but we shouldn't rush that process.

MR. DERBY: If you see a balance of risks around inflation, what is your balance of risk for inflation?

MR. HARKER: I think right now if – I see actually no acceleration of inflation currently, significant acceleration of inflation. Some of that is due to what we're seeing globally in terms of global demand. It seems to be softening a little bit as some of the global economies seem to be slowing. We're just not seeing rapid increase in inflation. Oil will have an influence, as well, in tamping down inflation. So right now if there is a risk – I don't see a large risk, but if there's a risk it's slightly undershooting our 2 percent target in the short term. Over the planning horizon we will clearly stay around 2 percent and maybe slightly overshoot it.

MR. DERBY: So in the near term a risk of undershooting. Still, over time, you expect to overshoot modestly or something?

MR. HARKER: Modestly, but – and I think that's appropriate given our symmetric target. But I don't see any real risk right now, substantial risk I should say, of inflation running out of control.

MR. DERBY: So when you say you – there are some things out there that are starting to give you concern, what are – what are those things?

MR. HARKER: I think we can broadly characterize it. What I hear from our contacts is just uncertainty. There's a host of things that are weighing on people. We can go through the list.

One is domestically how policy will evolve over the next couple of years. I mean, these tax cuts aren't forever, and so there is some question about what will happen there.

There's clearly uncertainty around trade policy that's weighing on particularly people in manufacturing.

There's uncertainty around how many more workers we have to bring into the workforce. And what we're hearing from lots of contacts is that their growth is being limited by just not being able to find the people.

Turning to the global markets, a clear uncertainty around how Brexit will evolve; how other issues will evolve in the world; how trade policy, again, will evolve; the growth or acceleration or slowdown of global growth in certain countries.

All this is weighing on people right now to where they're more cautious. I mean, the tone I pick up from our contacts is they're just more cautious this time around. They also anticipate – fully anticipate that 2019 will not be 2018 in terms of profit growth, simply because of the one-time effects of the tax cut and other issues.

And lastly in terms of risk, we – one of the concerns we have in this district we're also seeing nationally is a slowdown in the housing market. Lots of reasons why that might be the case, but some of it clearly is mortgage interest going up, but some of it is we hear from people they can't find buildable lots where people want to live, they don't – they can't find the labor to build, and there just seems to be some general softening of the market overall. Again, this is by region. I don't think – if you ask my colleagues, say, in the West they'd have a different answer. But right here in the Northeast, particularly in this district, we are seeing some softening of housing, which is a concern.

MR. DERBY: So when you talk about people finding a challenge – you know, a challenge in finding workers, how much – of course, this would get into an immigration – well, I mean, this is actually an immigration-related issue. But I've heard stories about people who can't get their lawns cut, you know, things like that. And when you talk about building, I mean, obviously, a lot of building is done by undocumented workers. I mean, at least that's certainly my impression from looking around. How much, you know, the crackdown on immigration do you see as limiting, you know, workforce?

MR. HARKER: So I'll start with, again, the headline event, which is people need – companies need more workers. I mean, I think there is no question about that. We're hearing this repeatedly. We're seeing it in the data. Some of that's at the skills level; so machinists, diesel mechanics, electricians, et cetera. But there also are people – laborers, whether it's on farms or on construction sites, that people – what we hear is they can't find the people to do that work right now.

MR. DERBY: So your colleague Neel Kashkari [president of the Minneapolis Fed] repeatedly says if you can't find the workers the problem is you're not paying enough to get them. So wage gains have been – I guess they're only finally now ticking up to – I mean, I'd be curious to hear your assessment of where wage gains are but, you know, they've been ticking up. But if companies can't find workers, why aren't – you know, especially at a time where profits are pretty good, why aren't they paying up to get – to get people?

MR. HARKER: What we're hearing is they are starting to do that. I mean, they're building in for this coming year pretty substantial increases in salaries. They are – we had situations this year where companies were getting midyear salary increases to try to not just attract, but also retain their existing workforce. And again, this may not be the workforce as a whole, but may be in certain skilled positions. That's all true.

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That said, if there are – if I can steal an electrician from you but we're not growing the number of electricians in the country, we're still short of electricians. So while that – and that's a longer lag. I mean, as those salaries go up over time, of course, more people may be attracted, although it's an area that we're focused on. There are other inhibitors to people taking on those careers that we've spent a lot of time on with "Investing in America's Workforce" and so forth, that book and the work we're doing here in Philadelphia. But that's a – that's a lag. I mean, it's not like all of a sudden somebody could say, gee, I'll be an electrician tomorrow. I mean, you have to go through an apprenticeship. You've got to learn how to do the job, and that's a multiyear effort.

MR. DERBY: So simply saying, like, boy, I'm really short electricians or I'm really short plumbers, I'm going to – you know, instead of offering 20 bucks an hour I'm going to offer 30 bucks an hour, they don't just magically – yeah.

MR. HARKER: They just don't come out of the ether, right? (Laughs.)

MR. DERBY: Yeah, right, right.

MR. HARKER: Somehow we need programs, whether it's unions training or other kind of training programs. We need to bring more people into those professions. And again, this is an area in Philadelphia we've been very focused on through our Economic Growth and Mobility Project, trying to think carefully about what kind of careers people can have that can bring them into the middle class, solidly into the middle class, with opportunity.

I think we – and I've said this in previous speeches – I think – and it's an odd thing for a former university president to say, but I think we encourage too many young people to go directly from high school into college without thinking about other opportunities, or I should say more precisely four-year college. There are other opportunities they can pursue.

MR. DERBY: Right. So what is your view on wage gains? I mean, we did have that, I think it was 3.1 percent annualized wage gains.

MR. HARKER: Yeah. So it's ticked up, but it's not – again, I don't see any rapid acceleration of it. It is ticking up. But it is – it's also something I'm very aware of and watching carefully because, given the anecdotes we're hearing, it may translate into overall numbers. But that hasn't happened for a while, so we'll have to see how this plays out over the next couple of months.

MR. DERBY: Any other risks, you know, major risks that you're seeing out there? I mean, I was going to ask you a little bit later about this, but **financial markets** seem to be pretty unsettled and you're seeing all these different talks about this sector looks problematic, this sector looks problematic. What are you – what are you feeling about **financial markets**?

MR. HARKER: I think **financial markets** are clearly choppy. **Volatility** has increased. Some of that, I think, is natural during this course in a cycle. But that said, there are some risks that I'm watching.

Probably the most prominent is in the leveraged lending space. I mean, that's grown quite substantially, and we – and it's in many ways outside of the regulated banking industry. And so it is something that we have to continue to monitor and understand its implications for potential **volatility** in the markets and in the economy.

MR. DERBY: Do you see any systemic risks there?

MR. HARKER: Not yet, but it is something I'm concerned about.

MR. DERBY: Any other parts of the markets that worry you outside of just **volatility**?

MR. HARKER: No, I think it's just general **volatility**. And I think that's reflective of the general level of uncertainty people are feeling right now, where things are going.

MR. DERBY: So, from that point, I'd like to ask you about monetary policy –

MR. HARKER: Sure.

MR. DERBY: – because some of this does feed into monetary policy. I suppose first I'll just ask you: What is your baseline outlook for interest rates right now?

MR. HARKER: Yeah. So my neutral nominal rate is 3 percent. We're 25 basis points away from that, -ish. (Laughs.) And so I – we're looking at, again, being quite close to where we forecast neutral to be. So, as a result, I

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don't see any rush to move there. I think we can let this economy evolve over time. We can let some of the uncertainties resolve themselves. So at this point I am not convinced that a December rate move is the right move, but I need to watch the data over the next few weeks.

Again, I go back to inflation. We're not seeing the recent data telling us that inflation's moving rapidly past our target. So I think we have some time to let this evolve.

And at the beginning of the year I had put in my forecast three 25-basis-point rate increases. And that – I haven't moved from that too much because – and again, I think next year or the next, say, year and a half we can move slowly up to what I see as the neutral – the nominal neutral rate, which is 3 percent.

MR. DERBY: Do you believe we have to go beyond neutral?

MR. HARKER: No, not necessarily. We might a little bit because you don't know you've hit neutral till you get there, right?

MR. DERBY: Yeah.

MR. HARKER: But we'll start to see that in terms of the job numbers coming down and so forth. So we'll just have to let this evolve over time.

MR. DERBY: So, I mean, it's – potential Fed policy might have to become restrictive, but it's hard to even know whether it actually is or not.

MR. HARKER: Yeah.

MR. DERBY: And you're not – you don't necessarily believe there's any rush or any need to get to anything restrictive.

MR. HARKER: No. No, and I don't – if we – I don't think the goal is to become restrictive. I think the goal is to continue to allow the economy to grow. We may inadvertently overshoot a little bit, but that's not my goal. I would like to just sort of get to neutral and stay there for a while and see how things evolve.

MR. DERBY: Have you – it seems to be [New York Fed President] John Williams has gone through a little bit of a different way of looking at R-star issues with a – you know, with a – I mean, just it's we've gone from bright shining light to a fuzzy blur. How do you feel about neutral, you know, the R-star concept, and just all of those kind of variables that it seems like the chairman kind of pushed to the side in Jackson Hole?

MR. HARKER: Yeah. The stars are twinkling a lot right now. (Laughter.)

MR. DERBY: OK.

MR. HARKER: Right? There's a – there's a lot of cloud in front of those stars.

So, again, this is where we have to look at what we can actually measure as opposed to derive a measure, like R – like an R-star. And so let's see how the unemployment situation, the employment situation more generally evolves over time, let's see how inflation evolves over time, and just be pragmatic about this and adjust accordingly.

MR. DERBY: But if you're being pragmatic in I guess sort of tactically, you know, move, take some time, but then we get into the long and variable lags question, so the things you do take a long time to have an impact. So how do you square – how do you square those two realities?

MR. HARKER: Well, there is a question about how long and variable the lags are in our world today as opposed to, say, 10, 20 years ago. There still clearly are lags. The question is – and I've not seen a good answer to this – how long are they today, given how rapidly **financial markets** adjust?

So if I saw the potential of rapid acceleration of, say, inflation, I would be more concerned. I just don't right now. I think inflation is well anchored at 2 percent, and I don't see a lot of movement where that will become unanchored.

MR. DERBY: So as long as it's fairly well anchored, that just gives you a lot of – gives you a lot of maneuvering room to move slowly if you –

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MR. HARKER: Right. If we start to get the sense that that is not the case, then yeah, I think we'd have to do something different. But –

MR. DERBY: Now, I've heard the argument from some quarters that because the president has pressured the Fed not to raise rates that that somehow might affect the choices you actually have to make, and that if – now, I'm not saying this is an argument I endorse, but I mean, it is an argument that's out there – the idea that in order to prove the Fed is independent you have to raise in December just to prove that, you know – that was – that was what had been kind of penciled in, so you have to deliver on it in order to prove, you know, that you're – the Fed is serious on following through on what it said it was going to do. So what do you – what do you say to that?

MR. HARKER: So I can only speak for myself. I hadn't penciled that in. I was one of the dots – (laughs) –

MR. DERBY: OK.

MR. HARKER: – that was not moving in December.

So we have lots of people – prominent groups, prominent individuals – giving us lots of advice at the Fed all the time, whether it's in the media, or whether it's in meetings we have with people. I take all that in. I listen to it. But at the end of the day, I just – my policy position is based on what I see the fact – what the facts are on the ground and what seems appropriate at the time.

MR. DERBY: When the president criticizes the Fed on monetary policy, does that affect anything that you think about monetary policy?

MR. HARKER: Not me, no.

MR. DERBY: OK. And then, just to be clear about your outlook for next year for interest rates, so I mean, it's get up to around 3 percent and –

MR. HARKER: Yeah. So, again, it could be – I have – I have two and two for the next two years. So, again, that could change depending on how the data evolves, but we're looking at a slow, gradual path to neutral and maybe slightly above neutral.

MR. DERBY: So about the balance sheet, we haven't – you know, we've been on autopilot and we haven't really talked a lot about where that's going to go. And I've seen commentary about, you know, some of the **volatility** in the **stock market** might have something to do with – you know, with the balance sheet drawdown. Do you have any new thinking or things you'd like to say now about where you want the balance sheet to be heading in terms of size?

MR. HARKER: Yeah. So this relates to, I think, a larger question that we've actually spent a lot of time here in Philadelphia thinking about, our economists led by Roc Armenter and our research group, has had some – and with his colleagues – some really, I think, substantial thinking about this. And what I think at least from my position is not so much the balance sheet, but what kind of monetary policy regime do we want to run.

I think for us, for me, a floor system, we know how to run that floor system. It would provide continuity from where we are now to the future. The only uncertainty there is what is the demand for reserves. We're trying to get a handle on that, but it's something that we won't know until we see it, in many ways. I mean, there's lots of models trying to estimate what that demand is so that we can stay on the flat part of the demand curve, but we don't know that precisely.

And I think – my view is that it may be impossible a priori to know it precisely. So that's why I think we just need to continue on the path we're on with that balance sheet normalization. As we start to see some signals that we should back off – that is, we're approaching a place where we have enough excess – you know, we have the appropriate amount of excess reserves, but no more – then we'll know to stop.

MR. DERBY: What are the signals?

MR. HARKER: I think the markets will help tell us that. I mean, for me, I think some of the signals I watch are market reactions to this.

MR. DERBY: And which –

MR. HARKER: Over time. Over time. I mean, let's look at things like the yield curve and –

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MR. DERBY: OK.

MR. HARKER: So there's lots of reasons why a floor system continues to make sense. But again, there is some uncertainty, at least in my mind and in our collective minds here in the team in Philadelphia, about exactly when you reach that. So that's why we don't rush it. We just sort of continue on the path. And if we need to adjust anything in the meantime, in my view it would be the path of the increases in the effective fed-funds rate, not on the balance sheet normalization process. I mean, we have two very – two things we can adjust.

MR. DERBY: Yeah. Any sense at all that the path the balance sheet's been on so far has been disruptive in any way?

MR. HARKER: I've heard that argument, but at least the evidence I've seen to date does not substantiate that argument in my mind. It's had an effect, there's no question. We knew it was going to have an effect, right?

MR. DERBY: But nothing disruptive so far. I mean, just –

MR. HARKER: Not in my view. I think there are other things that are much more disruptive to the market than that.

MR. DERBY: So the – so the yield curve, that could be one signal that the balance sheet drawdown is – so what would – what would the yield curve do that would tell you that there was an issue there?

MR. HARKER: Well, first, let me start without the balance sheet issue. I mean, one of – there's an active debate and an understandable active debate on yield curve inversion, good or bad, harbinger of recession or not. In some ways I think it's irrelevant to me. If the market believes it has an effect, it will have an effect, right? It's Behavioral Economics 101. So we can argue ad nauseum whether it will have an effect or not, but if the market believes it will, it will.

MR. DERBY: OK.

MR. HARKER: So this is where I, again, am cautious in terms of our policy path. I don't see – I don't think the policy path should be overly sensitive to inverting the yield curve, but we should be aware that that is a risk and that if we can avoid it we should. So that's why I'm not supportive of a more – a steeper path, policy path, right now.

So that may be one of many signals that you might see. And again, I think we can avoid that.

MR. DERBY: And I guess you've gotten some relief on the yield curve front. I mean, it's – it has – that's gone the other direction.

MR. HARKER: Yeah. But it could go back the other way too. (Laughs.)

MR. DERBY: Oh, yeah, yeah.

MR. HARKER: So we just have to be aware of that and be slow and steady in our process.

MR. DERBY: So it sounds like you are, so far, in favor or at least inclined to support maintaining the floor system right now that we have –

MR. HARKER: Yes, I am.

MR. DERBY: – with interest on excess reserves and reverse repos and all of that.

MR. HARKER: Yeah, yeah.

MR. DERBY: I know some people do want to get back to the old way of doing things. And what's the argument against going back to, you know, targeting –

MR. HARKER: In some ways this is simply simpler. (Laughs.) Plus, we've been operating in this regime now for quite a while. The markets understand it. We understand it. We know how to execute in this system. I don't see a compelling reason to change right now. If the reason is nostalgia – let's go back to the way we used to do it – I don't think that's a sufficient reason to change.

MR. DERBY: Are there any issues for the Fed that come from continuing to operate the system? I mean, I know that, you know, there's the talk of – well, it's not – I mean, since the Fed can create money, I mean, it's not

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actually the issue that maybe some people see; but the political aspect of it, that more and more Fed profits will be used to – you know, as interest rates go up, you have to pay the banks to isolate – you know, to keep this money on the sidelines, and therefore the Fed might not be turning over as much in profits to the – to the – to the Treasury. A lot of that money will be going to foreign banks. The political issues that might come from this.

MR. HARKER: Yeah, I think those are real. The issues in the political economy are real. But that shouldn't stop us from using what we believe is an effective tool and an effective regime for interest rate control.

MR. DERBY: OK. So it's been a – it's been a good and effective tool.

MR. HARKER: Yeah, I think so. I think if you look at the history through the Great Recession until now, I mean, the desk has done with this system a marvelous job of interest rate control. And that's really, at the end of the day, what we're trying to do, stay within that range that the [Federal Open Market Committee] has set.

MR. DERBY: Now, there has been some issue getting the fed-funds rate to trade where the Fed wants it to trade.

MR. HARKER: Yeah, yeah.

MR. DERBY: So what are you thinking about that? I mean, we've already had one tweak. It seems like a lot of people think another tweak in [the interest rate on excess reserves] is coming.

MR. HARKER: Yeah, so there's two questions. One is the potential tweaks, and there are potential tweaks in the future. But moreover, I think there's a question of the depth of the fed-funds market versus other alternatives.

And that's part of the conversation that we are trying to have not just within the Fed, but really across the community, the community writ large, about what – again, at the end of the day, we need a tool to execute monetary policy, and we need a robust market that is in existence to execute that tool. And if, in fact – and it's an "if" – the fed-funds market is not deep enough to execute that, then we might have to consider other alternatives. But right now it's at the just consideration level. At least in my mind, I've made no firm decision on that.

MR. DERBY: OK. So you're saying there is a potential that maybe the Fed is going to have to make another additional technical adjustment to where IOER trades just to keep the fed-funds rate –

MR. HARKER: Potentially, yeah.

MR. DERBY: OK. So potentially that's there. But if there were a broader conversation of whether or not the fed-funds market was on its own deep enough or not deep enough, what would you do? Because, I mean, obviously, we talk about – we defined it in terms of a fed-funds range, and up until June we – the high end was interest on excess reserves and the low end was reverse repos.

MR. HARKER: Right, right.

MR. DERBY: Now interest on excess reserves is below the fed-funds range, but then if the fed-funds market isn't really even healthy enough or deep enough or broad enough to support it, what would you do then?

MR. HARKER: Well, there are some other – there are – there are some other rates that we could target. There are some other – and that would – in doing so would potentially open up the market to other players to trade in. So there are things we could do.

MR. DERBY: OK. OK. Well, I suppose that also might get you even into the – you know, the Fed announced the new communications strategy.

MR. HARKER: Right, exactly.

MR. DERBY: And so, you know, I've come across, from talking to people about all of this, is that – you know, there was one guy speaking to it at a think tank, you know: back in the old days we had the fed-funds rate, which was clearly communicated but was often communicated in a very complex and opaque way. And now the verbal communications are much more transparent, but you've got this, like, range of interest rates, and now they're all kind of moving around, you know, I mean, in that – as we were just talking about interest on excess reserves now actually isn't really the top end of –

MR. HARKER: Right.

MR. DERBY: You know, it's operationally pretty complex.

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MR. HARKER: Right.

MR. DERBY: So what do you want out of this communications effort? What do you personally want to see happen?

MR. HARKER: So I – what I think we need to do here is, A, listen very carefully to what the markets are telling us. This is the time to do it, right? The economy is good. We have a very slow and steady path. I think we've communicated very clearly what that path is. So this is the time to say, OK, there's no rush in having this conversation, but we really should think about what the future is. When there is another downturn, and there always will be at some future date, you know, let's make sure we have the toolkit in place to be effective in that situation.

So, again, I think this is where we need to – through this communications plan, the communication isn't just us communicating. It's really listening back to the – from the markets about what would work, what wouldn't work, and what would be simple. You know, Occam's razor is always – (laughs) – let's go with the simplest thing we can do to effectively manage monetary policy. And I think that's where we need to – where we need to listen. Lots of research has been done within the Fed. There's research that's been done within the academic community. Let's figure out where the – where the center is of that thinking, what makes the most sense.

MR. DERBY: What do you – what do you like and not like about how the Fed communicates now?

MR. HARKER: So actually I think we communicate very well. I mean, one of the issues we often think about is, well, our verbal communication. Well, that's one form of – you know, through our statements and so forth. But with the [summary of economic projections] I think we communicate very clearly at least where our views are, you know, and that – and I think there are some useful communication and not just the median of the dots but, of course, the spread of the dots, the spread of the thinking in the committee. That's the strength of the committee, we don't all think alike. So I think you can see that reflected in the dot plot.

I also applaud Chairman [Jerome] Powell for now having a press conference every meeting. This is another step forward in transparency, A. And, B, it then allows every meeting to be considered live. Now, we've always said every meeting's live, but I don't think people believed us. (Laughs.) And in this case, it's just taking that off the table. So in the future event that we would have to move more rapidly than every other meeting, we now have that option.

MR. DERBY: Yeah, so you've given yourself some probably pretty welcome flexibility with the press conference.

MR. HARKER: Yeah, exactly.

MR. DERBY: Well, I didn't hear in any of that anything you'd like to taken out of – I mean, you just spoke favorably about dot plots, but a lot of people –

MR. HARKER: Well, one of the – one of the things we've started – one of the things we've started to take out, and I think appropriately so, is some of the forward guidance language. In other words, we've come to neutral. I think we don't – during the crisis, it was critical to have that language in there. I'm not so sure it's critical now. I think – again, you can see what at least each one of us individually, and in terms of the median collectively, think about what the future looks like through the SEP. I'm not sure that language is adding much right now.

MR. DERBY: OK. Is there anything you're not doing now that you'd like to see get done?

MR. HARKER: In terms of communication?

MR. DERBY: Yeah.

MR. HARKER: Well, there's some criticism that we communicate too much. That especially the fed presidents, we're all out there. No, I think we've – I think we've struck a healthy balance of being as transparent as I believe we can. And, again, I applaud the chairman for his willingness to be even more transparent.

MR. DERBY: Do you expect there's any potential that this effort could lead to something – you know, a radically different regime? Or do you expect something evolutionary?

MR. HARKER: No, I think it's going to be evolutionary.

MR. DERBY: And actually, on the point where you talked about the speaking too much, you know, I have –

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MR. HARKER: I didn't say that. Other people have said that. (Laughs.)

MR. DERBY: Well, I remember there was a – there was a Dallas Fed paper that talked about, you know, there's too much and they needed to rein it in. But, you know, and I get asked about it sometimes. You know, is it too much, too little? And my answer is usually, well, you know, you guys are speaking to different audiences for different reasons, and that – you know, that maybe people don't get that. You know, when you go to speak to, like, a bunch of different Rotary Clubs and say something fairly similar, you know, in a series, you are trying to communicate on a ground level. And it might – so, like, to markets or other people seem like too much coming at them, but you're trying to speak to different constituencies. I'm just curious your perspective on this.

MR. HARKER: No, because, again, communication's a two-way street. So the purpose of going to the local Rotary Club is not just to talk to them, but for them to talk back to us, right? So, yeah, we're going to say similar things. My policy stance doesn't change day to day, week to week that much, unless some data changes dramatically. So, yeah, you would expect us to have very similar comments. But, again, my purpose in going out and doing a lot of these events is to hear back from what people are thinking and how they're feeling – getting a pulse of are they anxious, are they excited about the economy? You know, those animal spirits are very real. And you're not going to get that through data necessarily.

MR. DERBY: Yeah. So it helps flesh out the anecdotal part of the puzzle.

MR. HARKER: Yeah. Absolutely.

MR. DERBY: Yeah. So you know, I'm just trying to think of anything else on the communication front that we could talk about just in terms of – I mean, do you think the way interest rates are communicated now with this complicated range, is – does it cause any issues? Or do you think that is it pretty well understood?

MR. HARKER: No, I think pretty much people understand it.

MR. DERBY: OK.

MR. HARKER: And I have not heard a lot of complaint about that.

MR. DERBY: OK. All right. Yeah. Just wanted to ask about that.

So, I mean, I guess, I just wanted to check one more thing about, you know, **financial market** risk. So, you know, outside of the leverage limits, which you mentioned already, anything else out there?

MR. HARKER: Well, the other big risk, which is a long-term risk that we've been doing a lot of work on here through our consumer finance institute, is the implications of student lending and the student loan debt. I mean, it's clearly having an effect on a variety of things – household formation, home purchase, and people's ability to, you know, have the middle class or better lifestyle that they thought they were going to get when they went to college. I mean, this has become a serious issue for the U.S. economy. I mean, it's the second-largest slice of the consumer debt pie. And it's growing fast.

And so – the implications of that that we are researching here and elsewhere. But it's also, particularly the case here in this district. There's a recent report that just came out – was it Pew or was it the Inquirer? I forget who put it out; it was just the other day – on Pennsylvania in particular has some of the highest student debt loads of any state, and New Jersey. So the implications for us in particular are quite severe.

MR. DERBY: So when does student – when does it become such an issue that something really must change? Or has it already crossed that point?

MR. HARKER: Oh, I think if you ask the average American – average American household things they worry about, health care is at the top of the list, you know, keeping their job and getting – but clearly one of the issues – and I heard this repeatedly as a university president, how can I afford to get my children to college, or post-high school education? Because, again, I think there's – we tend to have too many people go directly to a four-year degree. And there are other alternatives. So, yeah, it's at the top of the American people's list of what to do about this. And, again, it's so large now that it is having an effect on economic behavior, as you would expect.

MR. DERBY: Does the actual debt load or the – because obviously you can't get out of it. You know, I mean, it's on you forever.

MR. HARKER: Well, you can default. (Laughs.)

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MR. DERBY: Well, you can default and not pay it back.

MR. HARKER: That's not a good option.

MR. DERBY: But, I mean, but you can't go through bankruptcy and get rid of it. At what point does it become an actual systemic financial risk?

MR. HARKER: I don't know yet. That's some of the research we're trying to do. There are – there's evidence that it does stymie small business development, because, again, how am I going to start a business if I have all this debt? I mean, it's clearly having some effect, at least in certain markets, on household formation and household purchase. How am I going to get that mortgage when I've got all this debt? And a variety of other measures. There's evidence that is mounting out of – here out of the Philadelphia bank, our consumer finance institute and elsewhere, that this is having an effect. Now large yet we don't really know. It's something we're thinking a lot about here.

MR. DERBY: Yeah. I just know on a personal level, I mean, I know how much debt I came out of college with back in – back in the day. And it seemed bad to me. But it wasn't. And when I run into people now, or even younger people, and you find out how much they are carrying. And it's just –

MR. HARKER: Yeah. And not just for the four-year degree. I mean, it has an effect on – you talk to any dean of a medical school, right? It's hard to find general practitioners, pediatricians and so forth, because these are lower paying but incredibly important roles within our medical system. But if I have my undergraduate debt and my medical school debt, can I afford to take that lower-paying profession? This is what individuals are thinking about all the time. And individuals will make the decision that's right for them, and appropriately so. But is it right for our society as whole when communities around America can't find a general practitioner, or a pediatrician, or an OB-GYN to practice in their community?

MR. DERBY: Is there anything that regulators can do with lenders to help?

MR. HARKER: I don't think it's a lending issue. I mean, I think it's a complex issue because the main lender's the federal government. And so it's really – I mean, by a lot the main lender is the federal government. So there are lots of proposals on the table for change. Again, we're trying to sort those here in Philadelphia to see what makes sense, what doesn't in terms of effective changes so that more people have access and so that they're not overly burdened.

MR. DERBY: So a semi-related financial issue since I, you know, asked about regulation there. I was at an event last week where [former Fed Vice Chairman] Stan Fischer spoke. And he only spoke very briefly at the end, but in the few times I've seen him out and about since leaving the Fed, he had lamented the regulatory rollback that's happening in the financial sector. And I realize it's not massive, but regulations are being changed and, in some cases, eased. Are you at all worried or do you – I mean, what kind of – do you support what's happening in the regulatory front right now? Is this a good thing?

MR. HARKER: So I think we need to parse this question a little bit. I think on the community bank side and some regional banks, I think it's highly appropriate what we're doing. They did – when – it is natural when the regulatory pendulum swings, we swing it, and everybody gets affected. But then we start to ask the question: Who's systemically important and risky in the American economy? Those banks are incredibly important to their community, but they're not going to create a systemic risk for the U.S. economy. So can we ease their burden? And I think that process is underway. I think there is more we can possibly do. And I'm not talking about just capital levels and so forth.

It's just if you ask a small, community banker – you know, I can't afford to get a Bank Secrecy Act person here to manage this process, right? And then I've got that. And I've got the money laundering. And I'm in a competitive market. And I can't find these people. Can someone please – can we share resources with another institution? I mean, how can we deal with this? This is the concern they have? It's not – it may be somewhat capital-related, but I hear over and over it's other forms of regulation that they would like to some help with, right?

So I think that was highly appropriate. And I think there's also – it was also appropriate at the larger institutions to start to relax some of their regulatory burden. That said, I do think, and I am increasingly becoming convinced, that it makes some sense that when things are good, OK, to save our seed corn for the bad times. And that doesn't mean, yeah, a countercyclical capital buffer that's somewhere above zero. So, I mean, it's just sort of – my own sense of this is, you know, this is the time you do it. We're not going to do it when things are bad. So if we're going to add a capital buffer, it seems it would be – now is the time. How large? Again, that's out of my wheelhouse. That's – but I do think it's worth considering.

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I mean, I have not come to any conclusion on that in my own mind right now, but common sense says this is the time to think about it.

MR. DERBY: In a strong, healthy, economy, now is the time – and when banks are profitable – now is good time to think about whether or not there should be more reserves or – to set aside for when times – yeah.

MR. HARKER: Right. Again, I've – right, I've come to no conclusion on that. But I do think it is time to think about it.

MR. DERBY: Do you feel that there's momentum in that direction or not?

MR. HARKER: I don't know. I mean, it is a conversation that others are having, not – and we're having inside our own bank. And I think it is – and it's a conversation more broadly I think people are having across the economy. Yeah, it just makes sense to at least consider. I don't think that's the bigger risk. I think the bigger risk right now is in the unregulated space, right? So there I think there are questions about how that will evolve over time. I mean, that has grown naturally, right, as regulation came down on the regulated sector of the industry, it's natural that things move to the unregulated side. But is that creating systemic risk? That I think is the more important question. I think right now we have a very healthy regulated financial system.

Now, we could tweak the capital buffer. We could do a countercyclical capital buffer. There are other things we could do. I don't think that right now is – if you look at, for example, these rapid increases we were talking about earlier of leveraged lending, that's not in the regulated industry, by and large. I mean, that's – it's in the [collateralized loan obligations] and other places. And the increase has been pretty dramatic, if you look at the data. So those are the – those are the concerns I have. I'm going to spend time thinking about something that's more there than it is on tweaking capital buffers.

Again, we should consider that, but if I rank order the risks I think the unregulated industry provides not only at the area of, say, corporate lending and so forth, but we're also – we just did a two-day conference here on fintech. And, you know, even in the consumer space, in the small lending side of the house, there are risks there. They may not be systemic financial risks, but there are consumer compliance risks and other risks that – and, again, these firms never been through a downcycle of – with the economy.

MR. DERBY: Yeah, because they're all totally new, yeah.

MR. HARKER: Right. So we'll have to see how – so I think there are risks on both ends, on the – because what we heard, what I heard in the conference is a lot of the fintech companies at least who were presenting here, it makes sense, right? The biggest part of the market is not the prime market. It's the near prime or the subprime market, and how do you lend to that market. And that's what they're trying to figure out. There's a lot of good reason to do that, not just for them but also for those consumers. But there's some potential risk there that we don't quite – I don't quite understand.

MR. DERBY: Well, the financial crisis came out of a lot of unregulated lending as well. And what would it take to – it sounds like you're early in the process, but what does it take to address these risks in the unregulated space? I mean, to force them into regulation, expand regulation? What do you do to address that risk?

MR. HARKER: There's all of the above. There's a lot of options that one could consider. But at the same time, you don't want to stymie the innovation, that that sector of financial services often provides. Again, forget for a moment things like leveraged lending, for a moment. You just look at the fintech companies and the sheer amount of innovation that's going on there. The banks are now partnering with them. And as one speaker – I like the way he put it – you know, this is a – it's an interesting process we're going through, regulated and the unregulated fintechs. It's like chocolate and peanut butter. Together, it's really good. (Laughs.) But we can imagine chocolate and something else and it may not be so good.

And so it's trying to work together, and that's – that will continue to evolve. I mean, there's no question that that process of regulating unregulated institutions, particularly in the fintech space, working together is going to be the way it's going to be for the foreseeable future.

MR. DERBY: But if you go back to some of the leveraged loans, which is I guess –

MR. HARKER: That's another matter.

MR. DERBY: – much less of a fintech –

MR. HARKER: Yeah, now that's another matter, yeah.

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MR. DERBY: – and that's more of a – yeah, and that also gets you a bit back to shades of pre-financial crisis, too.

MR. HARKER: Yeah, that could be – that could be creating these risks that – and why I think it's an increasing concern for me.

MR. DERBY: Is the – I mean, maybe you can't speak to this, but is the Fed looking at doing something here, because it does seem that the pendulum is swinging the other way.

MR. HARKER: Yeah, that I don't – yeah, I won't comment on that.

MR. DERBY: OK. And this has also been a – you know, a thing that has come up with Stan Fischer, is just this idea of like just people – again, times are good, have been good for a while, forget that bad things happen.

Do you get the sense among regulators that, you know, the experience of the financial crisis – is it still there?

MR. HARKER: There's concern.

MR. DERBY: Yeah.

MR. HARKER: I mean, because some of it is generational, right? Some people have left the industry, new faces have come in. That's natural. But yeah, we're starting to see some signs – and I would say it's early – but some signs of – forget the rise of, say, leverage lending or lending more generally, but covenants are being relaxed so these covenant-lite type of loans.

That is causing some traditional bankers some real – when you talk to the traditional bankers –

MR. DERBY: Yeah.

MR. HARKER: That's causing them some heartburn, saying, oh, boy, we've seen this before.

MR. DERBY: Yeah.

MR. HARKER: Now, is it a significant risk? I don't think so yet, but it is something we clearly have to watch.

MR. DERBY: And how do you – again, how do you address it? If you see these things starting to boil in a way – and I know that expansion – you know, this idea that expansions don't die of old age, but something gets them –

MR. HARKER: Right.

MR. DERBY: And so a downturn will arrive. If you see issues in these unregulated spaces, you know, when do you act?

MR. HARKER: Yeah, so –

MR. DERBY: When – I mean, well, especially now, if it's only just now kind of like at a concerning point, is now the time to start speaking up more?

MR. HARKER: So – yeah, so the first – for me, the first question is how is that going to affect the regulated financial services industry. I mean, how is it going to affect the banks?

Right now – at least the evidence I've seen to date, but it's early on, at least in my own mind – is it doesn't have a substantial effect, but it's the first question you have to ask because that is our charge, right, is to regulate it – that sector of the industry.

After that then you have to ask – but it's a broader question, not just for the Fed, but for the federal regulatory system, you know, and for Congress. If this is building – if there is a risk building, what are the appropriate steps? I don't have a clear answer for that at this point, but I think we need to have that conversation across the financial regulatory community, and I think that is beginning. But – and other significant players including the appropriate members of Congress who have oversight over these areas.

MR. DERBY: OK.

MR. HARKER: Because, again, some of this is outside our regulatory authority so we need to make sure that somebody has that regulatory authority if it in fact becomes a systemic risk. And again, I want to reemphasize I don't think it is yet, but it has the potential to be one.

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MR. DERBY: Well, I know we're coming up – getting up close to the end, so actually I'd kind of like you to sort of tie up, you know, your economic and – this is a, I guess, a – basically a balance-of-risk question because, you know, you have these kind of like little – regulated space looks good, some concerns about the unregulated financial space. There's a lot of uncertainty out there broadly from a lot of different events. You face no real urgency on the inflation front to raise interest rates. What is sort of your balance, you know, if you look out over the future, if you add this all up together – bright future, concerning future – you know, how does – how does that shape up for you?

MR. HARKER: So I think it's – it continues to be a very good economy, and this is the time in a good economy that we should start planning for when it's not going to be such a good economy. And I'm – and that means in a variety of things we need to do. One is what we're talking about with respect to potential regulatory tweaks and changes. I also think – again, this is because we've worked very hard at this in Philadelphia – this is the time to get more people off the sidelines, get them the skills they need so that they can withstand and – whatever that future downturn is because they have the skillset that employers will continue to want, even through those down cycles.

The good news is we are bringing people off the sidelines. The bad news is there aren't enough people and we need to bring more into the economy. I mean, this is the limit to growth right now that I'm hearing repeatedly, as we were talking about earlier. So I think this is the time to start making those investments. If we don't do it now, when would we do it?

MR. DERBY: So the limit – the limit to growth is just people.

MR. HARKER: The people.

MR. DERBY: And –

MR. HARKER: Skilled people – the people with the right skill set.

MR. DERBY: And I'm guessing there is an immigration part of that that –

MR. HARKER: Yeah, I mean, it's – sensible immigration policy is something that clearly we should have for the country, but we also should work hard to bring people who are in the country right now into the workforce with the skills they need.

MR. DERBY: Right, it's –

MR. HARKER: And again, that's an area we've really dedicated a lot of resources here to.

MR. DERBY: OK. And so this is – I mentioned we were going to talk about this – this is – I don't even know if there is even a really good answer to this one, but I'm just curious how, seeing more and more talk on Wall Street about how to factor in environmental-related –

MR. HARKER: Yeah, I know.

MR. DERBY: – contingencies for the future and, you know, how to invest, you know, in – with these things happening. Is the Fed at all starting to think about – you know, even the Defense Department is – thinks about how climate change will affect, you know, the things that it will be doing, so is the Fed at all starting to think about, going beyond, oh, there was a hurricane, it might have this kind of impact but, you know, how a changing environment might affect the economy over the longer period of time.

MR. HARKER: Yeah, so I can't speak for the Fed – (laughter) –

MR. DERBY: Yeah, OK, but are you?

MR. HARKER: – but I am.

MR. DERBY: Yeah.

MR. HARKER: And so in my previous life as president of the University of Delaware, we invested very heavily in research programs, and hiring faculty in exactly this space. And there are a host of things that one can imagine. So I will give you just two examples.

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So Ag faculty – we're working – Delaware has the unique property of being the only state that is entirely a coastal zone, right?

MR. DERBY: Yeah.

MR. HARKER: So if any place was going to worry about this, it's the state of Delaware. We are already seeing saltwater encroachment into farmland, so some of our faculty were working with farmers to say, well, you're not going to grow soybeans on that land any more, but you can grow other things where you can create biofuels out of these plants, and they can exist in a briny condition.

Other faculty were working on hardening infrastructure and approaches the hardened infrastructure like roads and bridges to sustain ongoing flooding and other activity. So there's risk in this – absolutely. It is happening. I think when we – when people talk about climate change, some people say, well, it isn't happening. It is happening; I mean, the evidence is overwhelming. It is happening.

Now I think some people argue that – why it's happening. That's a – it is happening –

MR. DERBY: Yeah.

MR. HARKER: – so I think the question is how do you mitigate those risks, and what are the opportunities for new technologies, new infrastructure, new ways of approaching how to deal with this changing climate. I think there – it is appropriate to start thinking about that now.

It also will affect, obviously, different geographies differently, and so, again, Delaware being the extreme example – I mean, they are thinking about this a lot because they have to.

MR. DERBY: Uh-huh. But in terms of like macroeconomic statistics yet, is there –

MR. HARKER: Not there, and I think it's too – way too early for the United States. Now there are other countries where, again, the geography really matters – I mean, where it has a much larger impact. But I think there is no question we're going to have to start factoring this more and more.

And it's the **volatility**, right? It's just the sheer **volatility** of the climate. This is the other thing I think gets lost in the – in this conversation. Yeah, but we had one of the snowiest winters. Exactly. This is exactly what climate scientists would predict.

MR. DERBY: Yeah, yeah.

MR. HARKER: It's the **volatility** of the climate that increases with increasing temperatures; it's not that the earth warms up uniformly everywhere and always at the same time, right?

MR. DERBY: Yeah, yeah.

MR. HARKER: It's just not the way the climate works, so how to deal with that **volatility**. You saw that in the pictures that came out of the devastation in the Florida panhandle. There was one picture that really struck me – was just everything in this one town was flattened except one building that was built to the new standards with the new technology.

We can do some of this. I mean, we have this – we have this potential, but it means we need to dedicate research, we need to dedicate resources to figure out how to do it.

MR. DERBY: So the **volatility** of the climate – I mean, that's just one other factor that adds to that general uncertainty issue, but it's not the – we're not in the kind of place yet where we can say potential GDP will be affected because we expect there to be more storms or disrupted environments.

MR. HARKER: Well, I mean, it could potentially, right? I mean, one of my old colleagues, Howard Kunreuther at the Wharton School, and his colleagues, have done work for years on what they call – and the industry, insurance industry calls Act of God bonds, right?

MR. DERBY: Yeah.

MR. HARKER: And so there are people who, for a long time, have been thinking about this – how do you – how do you insure against these risks, how do you mitigate these risks. Again, this is not new thinking, but I think we have to have more people involved in thinking about this issue because it's not going away.

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MR. DERBY: Yeah.

MR. HARKER: And again, there could be risk to, say, the insurance industry, and the reinsurance industry if these losses become larger than they had historically predicted, and this is where my old colleagues at Wharton have done a lot of work on this, right – what are those models for predicting what those future risks are going to look like – not what we're already seeing historically, but knowing the **volatility** is going up, can we predict this.

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* Fed's Patrick Harker ‘Not Convinced' a December Rate Rise Is Prudent

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THE WALL STREET JOURNAL.

Markets
Copper Gains as Dollar Weakens; A rebound in oil prices also gives the metal a tailwind

By Ira Iosebashvili
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The Wall Street Journal Online
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Copper prices rose to their highest level in two weeks Friday, boosted by a weaker dollar and rebounding **oil prices**.

Copper for December delivery was up 1.9% at $2.7985 a pound, the highest level since Nov. 2.

A falling dollar tends to buoy prices for copper and other commodities, which are priced in the U.S. currency and become more affordable to foreign investors when the dollar declines.

The WSJ Dollar Index, which measures the U.S. currency against a basket of 16 others, was recently down 0.6% at 90.02.

A rebound in **oil prices**, on track for their third straight day of gains, has also given copper a tailwind. Many investors trade oil and copper as part of a single basket of commodities, with a larger share devoted to crude.

Prices for copper have also received a lift from hopes of progress in trade relations between the U.S. and China, after talks between top officials resumed earlier this week. China is the world's largest copper consumer, accounting for nearly 50% of global demand.

Economists at Barclays downgraded their Chinese growth forecasts this week but noted pockets of strength in copper-intensive sectors such as transport.

In precious metals, gold for December delivery was up 0.7% at $1,222.90 a troy ounce.

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Economy

U.S. Industrial Production Edged Up in October; Manufacturing production continued to grow at a solid pace for the fifth straight month

By Sharon Nunn and Eric Morath
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WASHINGTON—U.S. industrial output ticked up in October, as ramped up factory production offset declines in mining and utilities output.

Industrial production, a measure of manufacturing, mining and utility output, rose a seasonally adjusted 0.1% in October from the prior month, the Federal Reserve said Friday. Economists surveyed by The Wall Street Journal had expected a 0.2% gain for October.

From a year earlier, industrial production rose 4.1% in October.

Manufacturing production, which accounts for three-quarters of the overall index, continued to grow at a solid pace for the fifth straight month, advancing 0.3% in October from the prior month. Meanwhile, output in the utilities and mining industries fell for the second month in a row in October, declining 0.5% and 0.3%, respectively.

Low unemployment and ramped up wage growth have helped spur consumer demand. At the same time, the late-2017 tax cuts helped stoke business investment, and the U.S. government has increased its defense spending. Rising crude prices in recent years helped the manufacturing industry too, though **oil prices** have declined in recent weeks.

Capacity utilization, which reflects how much industries are producing compared with what they could potentially produce, fell by 0.1 percentage point to 78.4% in October. Economists had expected 78.2%. Utilization has trended up in recent years, but remains 1.4 percentage points below its long-run average recorded from 1972 to 2017.

Manufacturing production has been rising since mid-2016, when rising **oil prices** helped reverse a hit to U.S. energy production. The manufacturing sector was hit hard by the 2007-09 recession and later by a big drop in **oil prices**, which hurt energy production. More broadly, it has been buffeted by years of competition from low-cost countries such as China.

Last month, gains for machinery, metal and aerospace production, as well as output of military and space equipment supported growth in manufacturing output despite a large drop in automotive related production.

The Fed said recent hurricanes lowered the level of industrial production by a small amount in both September and October.

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The New York Times

Breakingviews
Business; DealBook
Why G.E.'s Credit Problem Is a Warning to All Debt Investors

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General Electric may be the canary in the credit market's coal mine.

The company's bonds fell sharply this week even as an asset sale briefly lifted its shares. That's a warning shot for all debt investors. American companies owe more money than ever, and the quality of their loans and bonds has deteriorated. Rising interest rates and slowing growth could make this a big problem.

The ailing $75 billion conglomerate is an extreme case, but it exemplifies much of what has happened in corporate America and around the world over the past decade. Historically low interest rates fueled a massive borrowing boom, enabling healthy companies to expand operations or buy back shares, and zombies to keep staggering along.

United States nonfinancial corporate debt stands at a record level of more than 73 percent of gross domestic product, according to the Bank for International Settlements. It never exceeded 65 percent before the 2008 financial crisis. France's corporate debt-to-G.D.P. ratio has risen by nearly a third over the past decade, and China's by more than two-thirds.

This growing quantity has been accompanied by a marked decline in quality. G.E., which recently lost its coveted single-A credit rating, is again illustrative. Many other U.S. companies have been downgraded. As a result, the debt of those carrying triple-B ratings — the lowest investment-grade category — more than doubled from pre-crisis days to a record $2.7 trillion at the end of 2017, according to S&P Global Ratings.

At the same time the United States junk-bond market has swelled to more than $1.2 trillion and leveraged loans now total $1.3 trillion, much of it in so-called covenant-lite products with few investor protections. That prompted Senator Elizabeth Warren on Thursday to warn that leveraged lending "exhibits many of the characteristics" of the subprime mortgage boom that triggered the 2008 financial crisis.

Up until now, many investors have shrugged off such risks, comforted by surging corporate earnings — which were up nearly 29 percent for the **S&P 500 index** in the third quarter of 2018. But earnings growth is expected to drop into single digits next year, according to estimates from the data and insights company Refinitiv . Meanwhile the expected interest rate increase by the Federal Reserve next month will ratchet up the cost of borrowing.

The numbers don't add up to a crisis yet, but the trend is heading in that direction.

American companies owe more money than ever, and the quality of their loans and bonds has deteriorated. | Toby Melville/Reuters

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THE WALL STREET JOURNAL.
U.S. EDITION

Junk Bonds Hold Steady as Volatility Returns

By Christopher Whittall
784 words
16 November 2018
The Wall Street Journal
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High-yield bonds, one of the **stock market**'s best-known bellwethers of doom and gloom, might be missing a beat when it comes to predicting the next meltdown.

As the **S&P 500** hovers around 7% below its recent peak, investors are looking for clues as to whether the recent selloff is a blip or the start of something more. In past selloffs, including during the financial crisis of 2007-2008 and the 1998 Russian debt crisis, junk bonds have often been a precursor for stocks to follow.

So far, the evidence is leaving investors scratching their heads. High-yield credit spreads -- the extra yield investors demand to hold junk bonds over ultrasafe Treasurys -- narrowed in the months leading up to the **S&P 500** slumping 7% in October, its worst month in over seven years. Junk bonds outperformed during that selloff, with the ICE BofAML U.S. High Yield Index declining only 2% last month.

That could mean all is well with stocks. But some wonder if the predictive power of junk bonds won't work this time. Market changes, central banks distorting asset prices, and the surge of tech stocks, which don't tend to issue junk bonds, have sapped high yield of its previous predictive quality.

"The structure of debt markets doesn't necessarily reflect the structure of the **equity market**," said Paul Markham, a portfolio manager at Newton Investment Management.

The composition of ICE BofAML's $1.2 trillion bond index differs markedly from the **S&P 500**, with junk bonds now heavily skewed toward the energy sector and equities toward large technology companies.

"Equities are being driven by technology and high yield has virtually no technology," said Fraser Lundie, co-head of credit at Hermes Investment Management, adding that there has been greater equity and credit divergence in recent years.

The predictive history of junk bonds is august. High-yield credit spreads drifted wider in 1998 in the months leading up to Russia defaulting on its debt. That event triggered a cascade of losses across **financial markets**, including the bankruptcy of giant hedge fund Long Term Capital Management. The **S&P 500** plunged to the brink of **bear market** territory, commonly defined as a 20% fall from a recent peak.

Credit spreads moved wider ahead of the dot-com bust in the early 2000s and the credit crunch in 2007 leading up to the financial crisis the following year.

More recently, the signals have been mixed. The slump in energy prices starting in 2014 triggered heavy losses in high-yield bonds but only a temporary blip in the **S&P 500**. One reason: By September that year, the shale revolution had catapulted energy companies into being the largest issuers in the junk bond universe, up from fourth biggest in 2008. By contrast, energy was the sixth biggest sector in the **S&P 500** in September 2014, down from the third at the start of 2008.

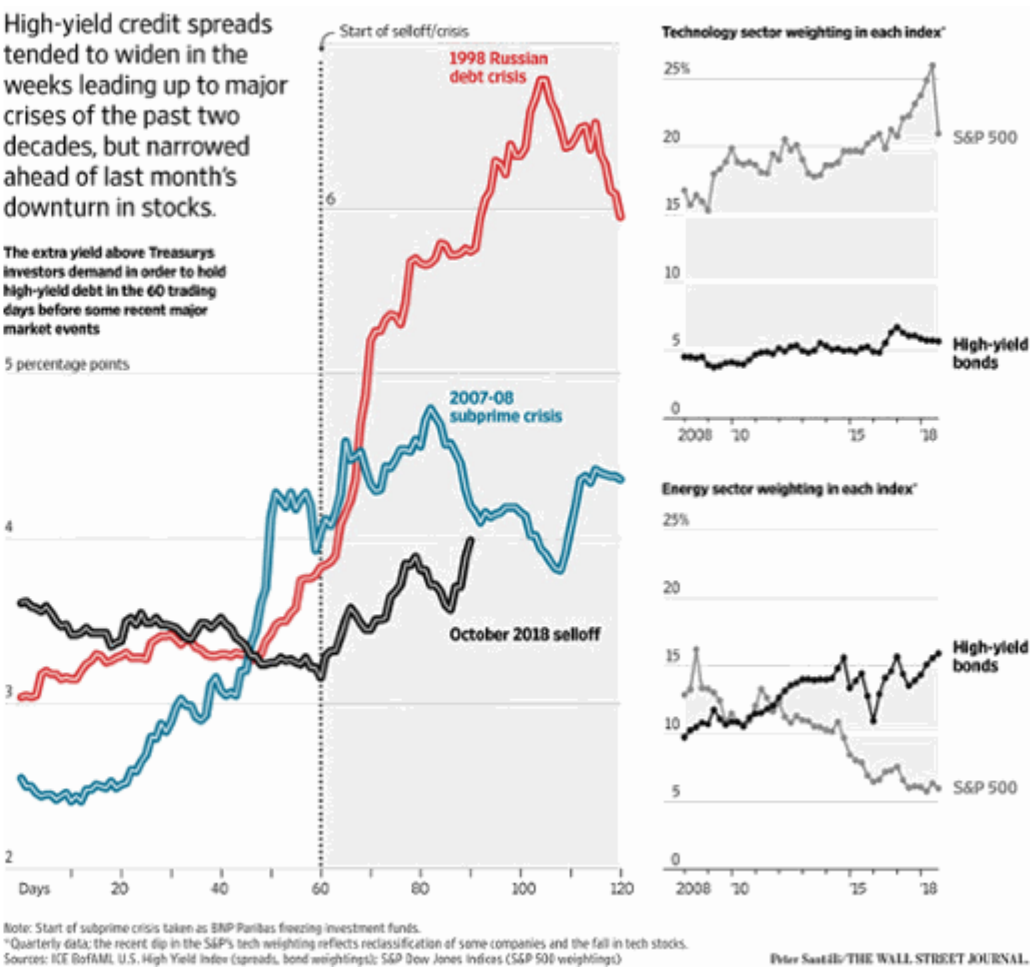
This year, high-yield bonds weathered the October selloff far better than equities. One reason may be the role of technology stocks. In August, tech giants like Apple, Amazon and Google, accounted for over a quarter of the **S&P 500**, making it by far the biggest component, according to FactSet. That compares with a 16% weighting in the index 10 years ago. Meanwhile, technology makes up just 5.6% of the junk bond market, up from 4.4% a decade ago.

Other factors might be hiding the junk market signals. As rates have increased and borrowing costs with them, lower-rated companies sold nearly 30% fewer bonds in the first 10 months of 2018 compared with the same period in 2017, according to data provider Dealogic. The juicy yields offered by existing bonds have also attracted investors. That imbalance between supply and demand has lent support to junk bonds.

Some note the dynamics could shift. There's a record amount of corporate debt rated just above junk and the total amount of high-yield bonds could expand dramatically if struggling companies such as General Electric Co. encounter further downgrades. GE has so much debt that it would become about one-tenth of the market, according to data from Fitch Ratings.

Analysts note warning signs in other parts of credit markets in 2018. Even as stocks advanced in the first part of the year, high-grade credit spreads edged wider. That would caution against disregarding signals from credit markets altogether.

"The next crisis, when it comes, you'll see in the credit market first," said Mr. Brill. "I don't think we're there yet."



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THE WALL STREET JOURNAL.
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Energy Turmoil Wallops Giant Fund

By Rachael Levy, Georgi Kantchev and Gregory Zuckerman
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One of the last oil hedge funds standing has become a high-profile victim of the recent rout in crude prices.

Pierre Andurand, who earlier in 2018 predicted oil could soon hit $100 a barrel, suffered the largest-ever monthly loss of his flagship fund in October. The $1 billion Andurand Commodities Fund lost 20.9% last month, taking the fund down more than 12% for the year, according to numbers sent to investors and reviewed by The Wall Street Journal.

A spokesman for Mr. Andurand declined to comment on the fund's performance.

The losses are due to a sharp U-turn in **oil prices** since a peak in early October, as fears of oversupply engulfed the market. Brent, the global benchmark, entered a **bear market** this month -- defined as a 20% drop from a recent peak -- and on Thursday, Brent was trading at $66.62 a barrel, near its lowest point since March.

Energy investors have also been whipsawed by **volatility** outside the oil market. Natural-gas futures soared early in the week as low inventories and colder-than-forecast weather pushed prices to their highest level in 4 1/2 years. The market then reversed Thursday, tumbling 17%, as some investors took profits and reassessed supply data.

Oil prices took a plunge Tuesday, with U.S. crude sliding 7.1%, its steepest fall in over three years. That led to market speculation that a large hedge fund had got into trouble, with some pointing the finger at Mr. Andurand's fund.

Mr. Andurand is one of the most prominent oil traders in a sector littered with casualties, though he has dealt with losses before. His previous fund closed shop in 2012

"It was nothing to do with us," Mr. Andurand told The Wall Street Journal on Wednesday. "I do not think the move is related to large funds in trouble."

In a call with investors Tuesday, which lasted around 40 minutes, Mr. Andurand didn't discuss performance, according to people familiar with the call. Mr. Andurand said he had believed that President Trump would go through with sanctions against Iran, but when a lot of the market was exempted, he started to take off risk.

The Trump administration granted waivers to some buyers of Iranian crude, softening sanctions against Tehran that took effect in November and were predicted to push prices higher.

In June, Mr. Andurand, who runs his fund out of offices opposite London luxury department store Harrods, said **oil prices** were in a "multiyear bull run" and could hit $100 in 2018, a level unseen since 2014. He also said that prices could hit as high as $300 a barrel in a few years, although that wasn't his forecast.

Prices initially followed his prediction. Brent broke above $86 a barrel in early October, its highest level in four years.

However, then crude prices quickly reversed on news of the Iran waivers and U.S. oil output hitting record highs. Brent lost nearly 9% in October and continued to fall into November.

Years of choppy and often falling markets have obliterated a once-prominent group of hedge funds, collectively running billions of dollars, that bet on commodities. Among firms that have shut commodities funds are Astenbeck Capital Management, Armajaro Asset Management, Clive Capital, Centaurus Capital and Brevan Howard.

Mr. Andurand, who has a reputation for aggressive trades, made his name during the 2008 financial crisis when his previous fund, BlueGold Capital, made a staggering 209% that year, after betting against oil in the final four months of the year, as Lehman Brothers collapsed and oil lost more than half its value.

But the venture didn't end well. BlueGold shut down in 2012 after losing more than one third of its value the previous year. It lost 23% in May 2011 alone, as its **bullish** bets were hit by falling prices.

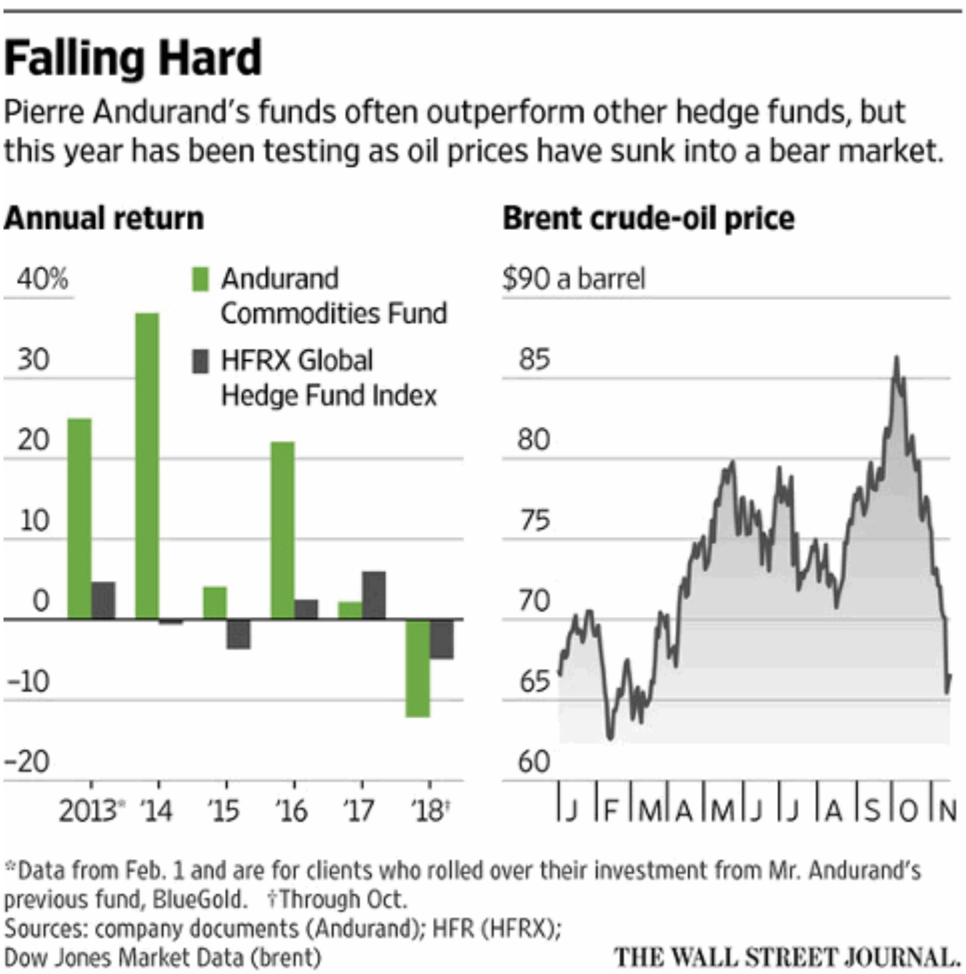
Mr. Andurand has said the closure was unrelated to the losses and instead due to his desire to part ways with his partner.

Coming back from behind isn't unheard of in hedge-fund land. Some hedge-fund investors favor managers who have suffered deep losses on the assumption that their creative trades might bring big winners in the future.

Some have said the losses of the past month might not be enough to cause Mr. Andurand's clients to flee, given the **volatility** of commodity markets on which the hedge-fund manager focuses.

"Losing 20% is within the range of **volatility** for him," said Geoffrey Stern, who invested with Mr. Andurand in the past and now runs Muirfield Capital Global Advisors, which invests in hedge funds. "I doubt any of his investors are shocked by it . . . he can make 100% in a year, as he's done in the past."

Mr. Andurand's new fund, the Andurand Commodities Fund, has gained every year since its 2013 inception, helped by **bullish** bets, including buying one day after oil hit a 13-year low in 2016. That year, the fund gained 22.1%. The fund is still up around 100% since its start.



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The New York Times

National Desk; SECTA
Why Housing Is Moving Slowly Despite a Booming Economy

By NEIL IRWIN
1,279 words
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These should be happy times for the housing sector. The economy is booming, with more people working at higher pay, and with the sizable millennial generation reaching prime home buying age.

Instead, the housing market has gone soft, acting as a drag on the overall economy rather than as a force propelling it forward.

Sales of new single-family homes were down 22 percent in September from their recent high in November 2017, and existing home sales in September were down 10 percent. This tepid residential investment subtracted from G.D.P. growth in each of the first three quarters of 2018.

Home prices have not declined nationally, at least according to the most widely followed indexes. But their rate of increase has declined, and more and more home sellers are finding they must reduce asking prices to find a buyer.

Given how central housing is to the broader economy -- it is the biggest driver of both wealth and indebtedness for most families, and its fluctuations have frequently been major factors in past booms and busts -- this slump isn't something to be taken lightly for anyone hoping the good times will last.

So what's going on?

When you look closely at the data, it appears this paradox of a strong economy and a weak housing market is, at its core, an illustration of a fundamental rule in economics: If something can't go on forever, it won't.

Home prices in a given location are ultimately tethered to the incomes of the people who either live there or want to. But for much of the last six years, that relationship has come undone.

Nationally, personal income per capita has risen 25 percent since the end of 2011, while the S&P/Case-Shiller national home price index is up 48 percent (neither figure is adjusted for inflation).

The gap is even larger in the big coastal cities with high wages and booming job markets, but where legal and other barriers make it hard for builders to add to the supply of homes. In the San Francisco metro area, per capita personal income rose 40 percent from 2011 to 2017, while home prices rose 96 percent. Similar patterns are evident in Los Angeles, Seattle, Boston, New York and Washington.

In less high-flying markets, there was still a disconnect. In the Minneapolis area, for example, incomes rose 22 percent while home prices rose 46 percent.

Those rising home prices got help from years of very low mortgage rates, which put more expensive homes within reach for people at a given income level. Activity was also probably boosted by some bounce-back effect after the housing market crash of 2007-09, a result of pent-up demand for homes that were not bought while the market was collapsing.

Rates bottomed out in late 2012 at 3.31 percent for a 30-year fixed-rate mortgage. They have been moving upward in fits and starts since, including a full percentage point in the last year alone to nearly 5 percent -- still low by historical standards, but high compared with the ultralow levels that had enabled these huge price gains.

There's no doubt that demographics are favorable for housing demand. The peak birth year for millennials was 1990; it's a group that is turning 28 this year and thus entering prime years for home buying. As it happens, 28 is exactly the median response in a Bankrate survey that asked adults for the ideal age to buy a home.

But that doesn't matter if prices are out of reach relative to incomes. Moreover, lending standards have remained more rigorous than they were during the last housing boom, so it has been harder for people to stretch to buy a home. The inability of people to buy homes they can't really afford is great news in terms of avoiding another crisis, but not so great for the near-term outlook for housing.

''Buyers can only stomach so many price increases until it gets unsustainable,'' said Daryl Fairweather, the chief economist at the online brokerage Redfin. ''Prices reached a breaking point where buyers were fed up and started to consider other options,'' she said, including renting and moving away from the expensive coastal markets where prices are most out of whack with incomes.

As Economics 101 teaches, price movements are the way that supply and demand match up with each other. But in the housing sector especially, that adjustment can take a while.

In contrast with the **stock market**, where relatively unemotional traders are buying and selling shares every day and the market stays liquid, home purchase and sales decisions can take months and are deeply emotional for the participants.

What seems to be happening is that sellers are trying to cling to the spring 2018 prices that their neighbors received, while there aren't enough buyers in late 2018 willing or able to pay those prices.

In a Fannie Mae survey of home purchase sentiment, the proportion of people who think it is a good time to buy a home has decreased significantly since the spring, to a net 21 percent from 29 percent. But so has the proportion who think it is a good time to sell, which has dropped to 35 percent from 45 percent.

You would expect, in a zero-sum transaction like a home sale, for those numbers to move in opposite directions. Instead, it seems that sellers are unhappily realizing that they aren't going to get what they thought their house was worth six months ago, and buyers still think homes are too expensive.

That helps explain why transaction volume, especially for new houses, has fallen substantially while prices haven't (at least yet). It's a standoff. And the outcome of the standoff will, in the aggregate, play a role in shaping the future of the economy.

There is precedent for this, and it isn't a happy one. In the last housing boom, new home sales peaked in July 2005, and home prices didn't start declining until May 2006. It didn't start to hurt the overall economy until December 2007, when the damage had spread through an overleveraged global financial system.

But that doesn't mean this episode has to end in tears. Home prices are not nearly as out of line with incomes as they were then; speculative activity hasn't been nearly as frothy; and consumer debt levels are considerably more measured.

''I think income growth will help us get out of this period,'' said Robert Dietz, the chief economist at the National Association of Home Builders. ''We're probably looking at a period where existing home sales volume is flat to declining, and it now looks like 2017 was the peak year for transaction volume.''

A strong (nonhousing) economy makes it more likely that this housing slump will end without a steep 2008-style downturn. So does the basic reality that young adults are forming families and need a place to house them.

But in the meantime, it could be a soft few months or even years of standoffs between buyers and sellers, with the big question of which comes first: sellers who settle for less after recognizing that the price they thought they would get is beyond the reach of buyers, or incomes that catch up with a housing market that got a little ahead of itself.

An open house in Waukee, Iowa, earlier this year. Housing sales have slumped in recent months. (PHOTOGRAPH BY CHARLIE NEIBERGALL/ASSOCIATED PRESS)

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The New York Times

Business/Financial Desk; SECTB
Fed Chief Seeks to Reassure Those Left Behind by Expanding Economy

By BINYAMIN APPELBAUM
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HOUSTON -- Jerome H. Powell walked the streets of a struggling neighborhood in this otherwise prospering city on Thursday before meeting with community leaders in a visit intended to demonstrate the Fed's concern about those who have been left behind by a decade of economic growth.

Mr. Powell, the Federal Reserve chairman, delivered his standard upbeat message about the health of the broader economy, but he added, "I want you to know that we are well aware and very focused on the fact that there are some people who are outside of that."

The steady expansion of the American economy has driven the **stock market** to record heights and dropped the unemployment rate to 3.7 percent, the lowest level in a half-century. But the gains are uneven. The wealthy have prospered while median wages have only recently started to rise at a stronger pace, and millions of adults, especially younger men, have dropped out of the work force.

As is often the case, minority communities have seen the smallest gains.

And the Fed is slowly raising its benchmark interest rate, prompting concerns that higher rates will abbreviate the economic expansion. The rate, currently 2 percent to 2.25 percent, is approaching the level that the Fed regards as neutral, meaning that it would neither stimulate nor impede economic activity.

The central bank is widely expected to raise the rate by another quarter point at its next policymaking meeting, in mid-December.

Mr. Powell did not address the Fed's specific plans for monetary policy, but he said the central bank wanted to extend the current economic expansion for as long as possible.

Mr. Powell's Texas swing, which began Wednesday with a question-and-answer session in Dallas, is part of his effort to improve the Fed's public image, in part by taking the time to explain the work of the central bank.

On Wednesday, Mr. Powell, a lawyer by training, joked that for most his life he also did not understand what the Fed did. On Thursday, it announced a review of its communications practices, including a conference in June that will address the "strategies, tools and communication practices it uses to pursue its congressionally assigned mandate of maximum employment and price stability."

The Fed mostly focuses on communicating its plans to sophisticated investors, but its policies ripple throughout the economy, affecting millions of people who have only the vaguest understanding of its role and its responsibilities.

Mr. Powell has sought to put a friendly face on those decisions by engaging with the public in a wide range of venues.

His tour of Houston on Wednesday began at a Habitat for Humanity building site in the Fifth Ward, a lower-income community that was struggling even before Hurricane Harvey flooded parts of the neighborhood in August 2017. Next, he popped into a recently opened all-male public high school. He finished the morning at the restored DeLuxe Theater, where the leaders of local nonprofits talked about the recovery process.

Sherman Lewis III, the chairman of Houston Habitat for Humanity, owns 48 Shell stations and Jack in the Box restaurants around the Houston area. He said 13 were damaged by flooding, along with the homes of many of his employees. All of those stores have reopened, but sales remain lower than before the storm.

Anna M. Babin, the chief executive of the United Way of Greater Houston, told Mr. Powell that mortgage and rent assistance calls are up 27 percent year over year.

''We had so many people living in the edge, very vulnerable,'' she said. ''This storm pushed them down further.'' She noted much of the aid promised by the federal government has yet to arrive, including $5 billion for housing redevelopment.

Kathy Flanagan Payton, the president of the Fifth Ward Community Redevelopment Corporation, said she thought it was important for Mr. Powell to see the challenges facing her neighborhood. She drew a contrast between the Fifth Ward's recovery from the storm, and the recovery in the affluent River Oaks neighborhood.

''People in River Oaks set mattresses out in the trash to be picked up,'' she said. ''People in Fifth Ward set their mattresses out in the sun to dry them.''

The Fed, she said, could help by making sure banks are serving the community.

''I think it's an underutilized resource in terms of making sure that we've got our banking partners at the table and we're getting enough from that community,'' she said.

Federal regulators are considering changes to the Community Reinvestment Act, which requires banks to make loans throughout the regions where they collect deposits. Mr. Powell said on Thursday that the goal was improvement. ''We're deeply committed to the mission of the C.R.A.,'' he said of the act. ''We're only looking to make it more effective.''

In one respect, however, the Fed is poised to make life here more difficult.

Houston Habitat for Humanity makes mortgage loans to its home buyers, and it has continued to charge 3 percent interest even as the Fed has raised its benchmark interest rate and as the average rate on a 30-year fixed-rate loan has climbed to 4.94 percent.

But Allison Hay, the executive director of Houston Habitat for Humanity, said she did not expect to be able to keep the rate at 3 percent for much longer. If the Fed, as expected, continues to raise rates, she said she will need to do so, too.

Habitat already is struggling to keep the price of its homes at an affordable level. Land prices in the Fifth Ward are rising as the city continues to grow.

A higher interest rate means applicants will need more income to become homeowners.

Mr. Powell's visit continues the practice of his predecessor, Janet L. Yellen, who made a public trip to a struggling community in each year of her tenure as Fed chairwoman. Ms. Yellen's trips tended to focus on education and job-training programs.

Robert S. Kaplan, the president of the Federal Reserve Bank of Dallas, arranged the tour and accompanied Mr. Powell on Thursday. Mr. Kaplan said that while it was right to celebrate economic growth in Texas, the struggling parts of the state deserved more attention. He said he had considered taking Mr. Powell to other struggling areas of the state, including parts of Dallas and communities along the southern border.

Elizabeth Powell, 63, lives one block from the house that Mr. Powell visited. Her home flooded during Harvey; the high-water mark is clearly visible on the walls. The storm also took her 2006 Cadillac, which was completely paid off.

She bought a new car, but now she has a monthly payment.

And Ms. Powell said she has not received any aid from the federal government.

''This is the first time I've seen anybody from the federal government,'' she said.

She said she had not heard of Mr. Powell, but she did know a little about the Fed.

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"That's where they keep the money," she said. "They need to invest more of that in the inner city."

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ECONOMY

Retail Sales Rebounded In the U.S. in October

Retail sales in the United States rose at a solid pace in October, though the gains were boosted by one-time factors such as hurricane recovery spending and higher gas prices.

Retail sales rose a seasonally adjusted 0.8 percent last month, following two months of slight declines, the Commerce Department reported Thursday. Excluding gasoline sales, which were inflated, sales climbed 0.5 percent.

The figures suggest that consumers are pulling back a bit on their spending, which is likely to slow growth in the final three months of the year. Americans had lifted their spending over the summer and fall at the fastest six-month pace in four years. Yet business spending on machinery, computers and buildings barely increased in the July-September quarter, leaving consumers shouldering more of the burden of maintaining growth.

Economists saw the report as evidence that Americans will not be able to spend as freely in the fourth quarter as they did in the previous two. Excluding **volatile** categories such as gas, auto and food services, retail sales rose just 0.3 percent. A.P.

RETAIL

Walmart Expects Sales

To Be Strong for Holidays

Walmart may be bruised by Amazon, but it's learning to fight back.

The world's largest retailer delivered strong third-quarter results Thursday, extending a streak of sales growth into its 11th straight quarter that was helped by services such as online grocery pickup. It also raised profit expectations for the year heading into the holiday shopping season.

Like other retailers, Walmart is benefiting from a strong job market and rising consumer confidence. But retailers are also benefiting from the misfortunes of others. Toys R Us and Bon-Ton Stores have gone out of business, while the Sears bankruptcy is creating more opportunities to grab sales.

Walmart posted strong sales across a wide range of products from toys and back-to-school items to fresh food. That helped sales at stores open at least a year rise 3.4 percent, a bit slower from the previous quarter's 4.5 percent at Walmart's U.S. division, which marked its best performance in more than a decade. A.P.

BOARDROOM

Activist Fund Gets Backing In Fight Against Campbell

Shareholder advisory firms Institutional Shareholder Services and Glass Lewis backed a push by Daniel Loeb's hedge fund to make changes at Campbell Soup, including replacing some board members.

ISS recommended that investors elect all five of Mr. Loeb's Third Point board nominees, giving a boost to the activist firm, which is fighting a high-profile proxy battle with the company.

"The dissident slate seems well qualified to contribute to the company's turnaround by providing relevant industry expertise, fresh ideas, and a greater sense of urgency," ISS said in a report, adding, "As such, votes FOR all dissident nominees are warranted."

Days ago Mr. Loeb backed off his call to replace the entire 12-person Campbell board. Investors are expected to vote on directors at the Nov. 29 annual meeting. ISS is generally seen as reluctant to recommend ousting all board members. REUTERS

Campbell Soup is under fire. (PHOTOGRAPH BY CHRIS HELGREN/REUTERS)

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THE WALL STREET JOURNAL.

Opinion
America Is Not an Island; As the world economy slows, Trump and the Fed need to adapt.

By The Editorial Board
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President Trump's biggest achievement has been the revival of faster U.S. economic growth, but past performance is no guarantee of future results. The White House should be worried about growing economic strains in the rest of the world, and policy makers need to prepare. The U.S. is not an island.

For now the American economy and especially the labor market seem strong as tax reform and deregulation unleash animal spirits. But the German economy shrank 0.2% in the latest quarter, the first contraction since 2015. Europe's largest economy will still grow this year, but a trade surplus and negative interest rates aren't a growth tonic. Europe in general seems to be reverting back to its post-crisis mean of meager growth.

Japan contracted 0.3% in the last quarter, perhaps ending its modest growth spurt. Beijing last month said China's economy grew a surprisingly slow 6.5% year-on-year in its latest quarter, and that official figure is usually an overstatement.

Some of this is due to such one-time factors as bad weather, but anxious markets are signaling larger concern. German auto exports are weak, and China is trying to sustain growth without adding to its debt overhang. The high-yield bond market has the jimmy legs, and **oil prices** are down on weaker demand. Even Federal Reserve Chairman Jerome Powell, the insouciant one, on Wednesday called events "concerning."

Add currency shifts to those worry beads, as the U.S. dollar soars. Beijing is trying to stem flight from the yuan, and the pound fell another 1.5% against the dollar on Thursday on Brexit woes. The euro's decline against the dollar needs particular watching because it's the world's most important price and contributes to investment uncertainty. Sharp changes in the euro-dollar rate contributed to the global financial panic in 2008.

European political risks may increase, as Germany could soon gain a new leader and the European Union tries to bludgeon Italy into an anti-growth budget. Prime Minister Theresa May's government in London is hanging by a thread as she struggles to sell a European Union divorce deal to Parliament.

The world's fifth-largest economy could crash out of its most important trading relationship with no alternative in place. A disorderly Brexit could also usher in a socialist Labour government led by Jeremy Corbyn, and watch the pound fall if that happens.

All of this is a warning for Mr. Trump and others in Washington: No moat can protect the U.S. economy, and they need to adapt.

Start with the Fed, which should rethink its December rate increase. No other major central bank is likely to raise its rates soon. The Fed needs to weigh whether it should expand the gulf between U.S. and foreign monetary policies at a fragile moment as global investors demand more dollars.

Mr. Powell will be wary of seeming pliable amid Mr. Trump's demands for lower rates, but tighter credit conditions and low inflation support a pause independent of Mr. Trump's bluster. Now is not the time for a doctrinaire march toward "normalcy," which the Fed can resume in 2019 if the data warrant.

Mr. Trump should also settle his trade tempests. He wants Germany to export less, and look at the result after a quarter of soft auto sales abroad. Trade uncertainty is weighing on business investment much as Barack Obama's regulatory assaults did. If you're a CEO and don't know how global supply chains will be affected by tariffs or new trade deals, you delay investment.

Mr. Trump's steel tariffs are still hitting Mexico and Canada even after the revised Nafta deal, and his 25% car tariff reappears now and again like Freddy Krueger. Adviser Peter Navarro suggested a long trade war with China last week, and stocks promptly sold off.

***

Mr. Trump claims the U.S. economy is strong enough to ride out his trade wars. Well, how lucky does he feel? Last week the President suffered a bruising midterm election defeat even with a strong economy. If the U.S. starts to slow like its major economic partners, he's going to lose the 2020 election before anyone has time to "win" a trade war.

This month's G-20 summit is a chance for Mr. Trump to show some economic statesmanship and look for a trade truce. This needn't be a show of weakness as he can continue negotiations to press market reforms abroad on China's intellectual-property theft or Europe's tax assaults on American tech companies. But he needs to signal that the U.S. won't continue punitive tariff attacks on allies.

With his polarizing political style, Mr. Trump even more than most Presidents will succeed or fail based on economic results. He should appreciate that a recession in the rest of the world is a threat to the U.S. economy and his Presidency.

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GE Credit Slide Rattles Markets

By Matt Wirz
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Corrections & Amplifications

General Electric Co. held a triple-A credit rating until 2009. A Page One article on Nov. 15 about the company incorrectly said it lost the rating in 2015.

(WSJ Nov. 30, 2018)

(END)

GE was recently one of the safest bets in the bond market. Now, it is hurtling toward junk.

General Electric Co. amassed $115 billion of debt on a reputation as one of the U.S.'s safest borrowers. But revelations of losses and questions about its accounting have brought **financial markets** to a pivotal moment.

GE had a sterling triple-A credit rating as recently as 2015. This month, investors have pummeled its **bond prices** into junk territory. Once a giant issuer of ultrasafe commercial paper, it now relies on $41 billion in revolving credit lines from more than 30 banks -- the corporate finance equivalent of a wallet stuffed with credit cards.

GE stock has lost about half its value in 2018, and ratings firms cut its credit rating in recent weeks to BBB-plus, three notches above junk. GE's various bonds have tumbled about 5% to 18% since late October, according to MarketAxess, showing that some investors expect further downgrades. Trade in derivatives protecting against a GE default also surged on buying from banks and bond funds.

Newly installed Chief Executive Larry Culp is selling parts of the company to raise cash and slash debt, including Tuesday's announcement that GE would sell a $3.7 billion stake in Baker Hughes, a GE Co., which sent GE's shares up 7.8%.

A slide below investment grade by GE -- a name many people associate with safe and boring investing -- could reshape the junk-bond market. GE has so much debt that it would become about one-tenth of the $1.2 trillion market, according to data from Fitch Ratings. The shift also would force fund managers to question how well they understand the risk in their investments and potentially hurt prices for other high-yield debt.

"It's a relatively systemic company," said David Meneret, founder of hedge fund Mill Hill Capital, which has been betting against GE by using credit-default swaps, or CDS, since July. "It would be extremely concerning to have that much paper moving from investment grade to high yield."

Bond investors said they are selling in part because GE's complex financial reporting makes it hard to analyze if more unexpected losses will be revealed, triggering another sudden downgrade. The company is considering breaking out financial performance of individual subsidiaries to provide greater transparency to investors, a person familiar with the matter said

GE management aims to recapture a single-A credit rating through divestitures and by refocusing on its power and aviation manufacturing businesses.

GE became a bond-market titan in the late 1990s when its triple-A credit rating helped it borrow cheaply to fund manufacturing and to raise money for its financing arm GE Capital to lend. The company has cut debt from a peak of $336 billion in 2009 but lost its triple-A rating in 2015.

Its bonds remain widely held by insurers, pensions and mutual funds, many of which have ratings requirements that force them to sell bonds rated below investment grade. A short-term bond fund operated by Vanguard Group owned $1.4 billion in GE bonds as of October, representing 2.4% of its assets, according to data from Morningstar Inc. The fund can invest no more than 5% in junk debt, a spokesman said. MetLife Inc. owned about $300 million in June but has since reduced its holdings, which now make up a fraction of 1% of its investments, a company spokesman said.

Bond prices began their recent fall in late October when GE disclosed $22 billion in unexpected charges tied to its power unit after reporting a $6 billion shortfall in insurance reserves in the first quarter. GE's bonds have been the most actively traded in the U.S. corporate-debt market over the past two weeks with more than $10 billion changing hands, according to MarketAxess.

Some bondholders are purchasing credit-default swaps, which pay out if GE defaults, to protect themselves, while hedge funds are buying the swaps in a bet that they will rise in value as the company's fortunes worsen. Prices of GE CDS roughly doubled in November and the dollar amount of swaps outstanding quadrupled to $836 million, the highest amount of any corporate borrower in the world, according to IHS Markit and DTCC Data.

Wall Street banks with lending commitments to GE also are buying CDS to protect loans to the company, according to people familiar with the trades. Banks account for about 10% of the recent GE CDS transactions, one of the people said.

The recent downgrades made borrowing through commercial paper more difficult for GE and the company is increasingly drawing on $41 billion of credit lines provided by more than 30 banks to fund itself, according to its quarterly earnings report. GE's lenders include Citigroup Inc., Goldman Sachs Group Inc. and Morgan Stanley, according to its 2017 annual report.

"We currently are using $2 billion of these facilities as well as the commercial paper market for general intraquarter working capital needs," said GE's Treasurer Jennifer VanBelle.

The more GE borrows from the banks, the more CDS they will buy, pushing the cost of the swaps higher and increasing the perceived risk of default, Mr. Meneret said. Current CDS prices imply a default risk over the next five years of about 16%, almost twice the approximately 9% risk implied at the end of October.

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Economy

Consumer Spending Rose in October; Sales at stores and restaurants rose 0.8% after two months of declines, fueled largely by gains in automotive, gasoline and building-and-garden sales

By Harriet Torry
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WASHINGTON—Retail spending by American households rose in October, a sign outlays started on a strong footing headed into the holiday shopping season.

Sales at retail stores and restaurants rose 0.8% from the prior month, the Commerce Department said Thursday. That exceeded the 0.5% increase economists surveyed by The Wall Street Journal had expected.

Consumer spending is a major driver of the U.S. economy, representing about two-thirds of economic output. Retail sales jumped after two months of reported declines, as consumers spent more on clothing, sporting goods and electronics.

Retail sales for the prior two months were revised lower, to a 0.1% decline in both September and August from a previous estimate of a 0.1% increase in both months. Consumer spending was a major driver of third-quarter gross domestic product, though the revisions suggested spending might not have been as strong as first reported.

"The details aren't as good as the headlines, or as we'd hoped," Ian Shepherdson, chief economist at Pantheon Macroeconomics, said in a note to clients. "This looks very much like the end of the boost from the tax cuts, and it strengthens our conviction that [gross domestic product] growth has peaked," he added.

Following the retail sales data, private forecasting firm Macroeconomic Advisers cut its estimate of third-quarter GDP growth to 3.4% and lowered its tracking forecast of fourth-quarter GDP growth to 2.5%.

October's retail sales gain was due in part to a 3.5% month-over-month increase in spending at gasoline stations. Gas was slightly pricier for U.S. drivers in October, costing $2.86 a gallon on average, up two cents from September, according to the U.S. Energy Information Administration. Higher automotive sales and stronger spending at building and garden suppliers also provided a boost, and were likely driven by hurricanes that hit the East Coast in September and October.

Michael Pearce, senior U.S. economist at Capital Economics, said the report showed "there are signs that underlying spending growth has begun to slow," since much of October's advance was due to people spending more on gasoline and autos.

Excluding motor vehicles, sales were up 0.7% in October, and excluding gasoline, sales were up 0.5%. Excluding both categories, sales were up 0.3% last month.

Retail sales data can be **volatile** from month to month. The Commerce Department said it couldn't isolate the effects of two recent hurricanes—Michael and Florence—in the report.

The release came as several major U.S. retailers reported strong earnings reports for the third quarter.

Walmart Inc. on Thursday reported higher sales in the third quarter and Chief Executive Doug McMillon said the retailer is benefiting from "a favorable economic environment in the U.S."

Earlier this week, Home Depot Inc. reported higher third-quarter earnings and raised its full-year guidance.

"The economy is good," Chief Financial Officer Carol Tomé said during an earnings call Tuesday. "People are employed, they have more income, they've got more to come with tax reform. So fundamentally, we feel very good about just the drivers of the spend in our business," she added.

Macy's Inc. also delivered healthy sales growth in its latest quarter and raised its guidance for the year, positioning the retailer for a strong holiday shopping season.

Consumer spending, which rose 3.0% in the third quarter from the same period of 2017, will likely be supported in the months ahead by several factors. The unemployment rate remained a low 3.7% in October, a positive sign for earnings growth and outlays.

Consumer sentiment also remained strong in early November, according to a report from the University of Michigan last week. A survey of consumer expectations by the Federal Reserve Bank of New York released earlier this week found household income growth and spending expectations increased notably in October.

That suggests Americans could increase their spending heading into the holiday retail season. A recent survey of about 2,000 people by The Conference Board found consumers intend to spend about $627 on gifts this season, up from an estimated $560 last year.

The Federal Reserve closely watches consumer--spending data as a gauge of economic growth, and central bank officials said after their meeting earlier this month that household spending "has continued to grow strongly." Officials last raised their benchmark interest rate in September to a range between 2% and 2.25%, and they are widely expected to raise the rate again by a quarter percentage point in December.

Fed Chairman Jerome Powell said in Dallas Wednesday that the economy is "in a good place now," adding "I do believe our economy can grow and grow faster."

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Markets

Retailers Slump as Market Volatility Spreads; Strong third-quarter earnings didn't prevent retail selloff, which signals larger anxieties about growth

By Amrith Ramkumar
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Shares of retailers are sliding despite third-quarter results that suggest consumer spending is strong, the latest signal that investors are focused on broader worries about global growth and higher interest rates.

Walmart Inc., Macy's Inc. and Home Depot Inc. have suffered steep share-price losses this week, even after posting relatively robust results. Walmart reported a rise in quarterly sales and boosted its profit outlook for the year Thursday, but its shares slipped 2%, extending their losses for the week to 5.7%.

A day earlier, Macy's fell 7.2% even after delivering healthy sales growth in its latest quarter and raising its guidance for the year. The department-store operator's shares continued falling Thursday, sliding 2.9%. The stock is off 15% this week but still up 28% for the year.

Home Depot slipped 0.2% Tuesday after similarly upbeat results, but the home-improvement retailer's shares are off 4.6% this week, including a 1.4% decline Thursday.

The downturn has extended to other retailers that are scheduled to report results next week. Target Corp. has shed 7.1% this week, while Kohl's Corp. is off 11%.

Those declines have weighed on the **S&P 500**'s consumer-discretionary sector, which snapped a four-session losing streak Thursday but is down 10.2% since the start of October. Consumer-staples stocks slipped 0.3% Thursday, taking a hit from Walmart, while the broader **S&P 500** climbed 1.1%.

The retail selloff is a sign that larger anxieties about growth and **volatility** in sectors such as technology are rippling to other corners of the market, analysts said. It marks a departure from earlier in the year, when steady consumer data reinvigorated retail stocks.

The Commerce Department reported Thursday that retail sales grew last month more than economists expected, though figures for the prior two months were revised lower. Shoppers spent more on clothing, sporting goods and electronics last month, giving some analysts confidence that retailers could enjoy a robust holiday season.

Consumer spending has generally been a bright spot for the U.S. economy this year, with wages last month growing at their quickest annual pace in nearly a decade and unemployment at its lowest level in nearly 50 years.

"When we look at the fourth quarter, we're obviously looking at a very strong environment that we're playing on along with our competitors," Macy's Chief Executive Jeff Gennette said on the company's earnings call Wednesday. "It's a very good backdrop for us."

Yet the recent **stock-price** drop for companies selling consumer goods is a sign to some investors that the recent **volatility** could continue. The tension mirrors what is occurring in the broader market, with major indexes seeking a fresh catalyst and struggling for traction despite generally steady economic and earnings data points.

Some investors expect updates on trade policy with China to provide more clarity about growth by the end of the year, easing some concern about the health of the economy.

"Some conviction that the 25% tariffs don't hit in January, that's probably the biggest news that's going to move the market in the next few weeks," said Jim Tierney, chief investment officer of concentrated U.S. growth at AllianceBernstein.

One retailer that bucked the trend Thursday is J.C. Penney Co. The beleaguered company posted lower sales and a wider loss for its latest quarter, in addition to cutting its sales guidance for the year. Still, the stock added 11% to $1.36, cutting its 2018 drop to 57%.

The gains have been few and far between for retailers this week, though. Even specialty retailers such as Nike Inc. have fallen ahead of Black Friday next week.

Some analysts said one reason retailers fell even as major indexes stabilized Thursday was that the October retail sales report and other recent strong data points could give the Federal Reserve a freer hand to continue gradually raising interest rates. Higher rates can make investors more hesitant to seek greater yields in stocks and push up borrowing costs for companies, hurting profits.

Many analysts expect the central bank to raise rates again next month, and the Fed is currently targeting multiple increases in 2019.

Fed Chairman Jerome Powell delivered another upbeat assessment of the U.S. economy at a public event in Houston Thursday, saying it is in "good shape" and calling last month's jobs report "very strong."

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Markets
Brexit Market Turmoil Pummels Pound, British Banks; Resignations from Theresa May's cabinet over Brexit deal send pound lower, dragging U.K. banks along with it

By Margot Patrick and Georgi Kantchev
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The Brexit drama unfolding Thursday sent the pound sharply lower and intensified the selloff in British bank shares, some of the biggest losers from the U.K.'s decision to leave the European Union.

The British pound plunged 1.97% against the dollar Thursday, the currency's biggest percentage fall since July 2016, after U.K. Brexit Secretary Dominic Raab resigned from the government. One pound bought as little as $1.2730, a stark reversal from a rally in recent days on hopes Prime Minister Theresa May would succeed in pushing through a Brexit blueprint she hammered out with EU counterparts.

Mr. Raab's resignation heightened fears the deal would stall and the U.K. economy could be left floundering without a clear path toward an orderly Brexit. The yield on British government bonds fell, while the FTSE 250 index, which is made up of domestically oriented U.K. companies, ended the session down 1.3%.

"This is a clear U-turn in sentiment when it comes to the pound," said Petr Krpata, foreign-exchange strategist at ING Bank in London. "It's increasing the odds that the deal may fall apart."

Shares in Britain's biggest domestic banks were hit particularly hard on worries that further political disruption or a no-deal Brexit would hamper economic growth or spark a recession. Barclays PLC shares dropped 4.1% and the Royal Bank of Scotland Group PLC fell 9.6%. The stocks slid after news that euroskeptics in Mrs. May's Conservative Party had submitted letters calling for a no-confidence vote in her leadership.

If Britain crashes out of the EU without a deal, investors fear business investment will collapse and unemployment will rise, hitting banks' bread-and-butter business lending and residential mortgage books. Falling U.K. rates also pressure already slim net interest margins. A final deal, in contrast, is seen as giving the economy boost as companies regain confidence.

While bank stocks globally have performed badly this year on fears of slowing global growth, shares in Royal Bank of Scotland Group PLC, Lloyds Banking Group PLC and Barclays PLC have fallen more than global peers, a kind of Brexit overhang that reflects the uncertainty that U.K.-EU negotiations might not pan out.

A related, lingering fear among investors is that Mrs. May's party will lose power and be replaced by the Labour Party, whose latest manifesto includes pledges to consult on breaking up RBS and to make it harder for banks to shut branches.

"The risk is ongoing political dislocation. Investors would see a Labour government as negative for banks," said Joseph Dickerson, a bank analyst at Jefferies Group.

So far this year, Brexit's effect on markets has remained mostly a U.K. affair, though some European stock markets turned negative on Mr. Raab's resignation news Thursday. Germany's DAX index fell 0.5% while France's CAC 40 was down 0.7%. The euro was broadly flat against the dollar at $1.1317.

The **S&P 500** was flat early Thursday.

"At this point this seems like a U.K.-centered, idiosyncratic issue rather than a global problem," Mr. Krpata said.

Investors are staying on guard, as the current situation resurrects memories of 2016 when U.K.'s vote to divorce from the European Union rocked global markets.

Work and Pensions Secretary Esther McVey resigned shortly after Mr. Raab, if other senior ministers follow their lead, Mrs. May could face an open challenge to her leadership, analysts say. Mrs. May is already facing a challenge in pushing her Brexit package through Parliament.

"We think Dominic Raab's resignation is a big blow, without question," Jordan Rochester, currency strategist at Nomura, wrote in a note to clients. "Right now the market is trying to price in a level of uncertainty that is extremely high. That is bad for the pound."

ING's Mr. Krpata said that if Mrs. May is toppled in a leadership contest, the pound could fall to as low as $1.22.

On the flip side, if Mrs. May hangs on to her job and the deal manages to pass the various political hurdles, a strong rally could be in the offing given the pervasive pessimism surrounding the U.K.

Mike Amey, head of sterling portfolios at Pimco, expects in that case the Bank of England would raise interest rates more than is currently priced in by markets—two rises over the next two years—which would in turn, support the pound. It would also increase profitability at the banks.

UBS analysts, also anticipating two rate increases, said U.K. economic growth should rebound next year if Mrs. May succeeds in a deal. "No deal would likely entail significant economic disruption and a more cautious BoE," they wrote in a note.

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Markets

Natural Gas Falls Nearly 17% One Day After Meteoric Rise; Natural gas for December delivery logged its sharpest one-day decline since February 2003

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Natural-gas prices had their worst day in 15 years—just one day after a historic rally—a bout of **volatility** that left traders saying technical forces outweighed fundamental factors like supply and demand.

Natural gas for December delivery settled Thursday nearly 17% lower at $4.038 a million British thermal units on the New York Mercantile Exchange—the sharpest one-day decline since February 2003.

The drop largely reversed Wednesday's meteoric 18% increase to $4.837/mmBtu—the biggest one-day rally in 14 years and the highest closing price since 2014.

The sharp moves caught many in the market off guard. Cold weather forecasts and low stockpiles drove prices higher on Wednesday, then was exacerbated by a short squeeze as **bearish** traders were forced to close positions, market participants said. Prices then retreated on Thursday as some bet that the surge was overdone.

"It certainly had the feel of a market where people were getting blown out, and reaching their pain tolerance on short positions," said Michael Hiley, head of energy trading at LPS Futures. "The past couple days felt like the perfect storm of fundamentals and position management. It's been years since we've had a move like this."

Some market participants said Wednesday's rally looked like it was driven by one large player that got stopped out of a short position in natural gas. Without such buying support on Thursday, prices gave back much of their gains.

"We had some violent stop-loss buying that came into the market" on Wednesday, said Patricia Hemsworth, senior vice president of institutional sales at Paragon Global Markets. "It was over, and the markets just dropped. It's like we fell into this vacuum that was caused by panicked buying."

Analysts at Austin, Texas-based Drillinginfo said the shake-up in natural gas was likely linked to the recent plunge in oil. U.S. crude prices are now in a **bear market** after shedding more than 20% from a multiyear high in early October.

While fundamental factors like weather, storage, production and demand all played a role, hedge funds that had been long crude and short natural gas for the winter were forced to unwind their positions this week, feeding **volatility** in the market, according to the analysts in a note.

Adding to the **bearish** sentiment Thursday, a storage report from the Energy Information Administration showed U.S. natural-gas stockpiles rose by 39 billion cubic feet in the week ended Nov. 9, exceeding the 34 billion cubic feet rise analysts, on average, were expecting in a Wall Street Journal survey.

Still, analysts noted total storage remains about 16% less than normal for this time of year—a setup that could boost natural-gas prices going forward.

John Woods, president of trading firm J.J. Woods and Associates, said this week's wild ride is typical for the days before Thanksgiving.

"It was your classic turkey-day profit-taking move," said Mr. Woods. "I've seen it for years and years and years."

With the rest of the heating season still ahead, Mr. Hiley said there is plenty of potential for more **volatility**: "I don't feel like it's over yet. If you look at the inventories, they're the lowest they've been in awhile."

"It certainly makes the market very susceptible to cold snaps," he added. "We're just getting started on winter."

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THE WALL STREET JOURNAL.

Markets

Oil Hedge Fund Giant Hammered in Crude's Slide; Pierre Andurand, who runs one of the last big oil-focused hedge funds, took significant losses in October as petroleum prices cratered

By Rachael Levy, Georgi Kantchev and Gregory Zuckerman
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One of the last oil hedge funds standing has become a high-profile victim of the recent rout in crude prices.

Pierre Andurand, who earlier in 2018 predicted oil could soon hit $100 a barrel, suffered the largest-ever monthly loss of his flagship fund in October. The $1 billion Andurand Commodities Fund lost 20.9% last month, taking the fund down more than 12% for the year, according to numbers sent to investors and reviewed by The Wall Street Journal.

A spokesman for Mr. Andurand declined to comment on the fund's performance.

Mr. Andurand is one of the most prominent oil traders in a sector littered with casualties, though he has dealt with losses before. His previous fund closed shop in 2012.

The losses are due to a sharp U-turn in **oil prices** since a peak in early October, as fears of oversupply engulfed the market. The Trump administration granted waivers to some buyers of Iranian crude, softening sanctions against Tehran that went into effect in November and were predicted to push prices higher.

Brent, the global benchmark, entered a **bear market** this month—defined as a 20% drop from a recent peak—and on Thursday, Brent was trading at $66.62 a barrel, near its lowest point since March.

Energy investors have also been whipsawed by **volatility** outside the oil market. Natural-gas futures soared early in the week as low inventories and colder-than-forecast weather pushed prices to their highest level in 4½ years. The market then reversed Thursday, tumbling 17%, as some investors took profits and reassessed supply data.

Oil prices took a plunge Tuesday, with U.S. crude sliding 7.1%, its steepest fall in over three years. That led to market speculation that a large hedge fund had got into trouble, with some pointing the finger at Mr. Andurand's fund.

"It was nothing to do with us," Mr. Andurand told The Wall Street Journal on Wednesday. "I do not think the move is related to large funds in trouble."

In a call with investors Tuesday, which lasted around 40 minutes, Mr. Andurand didn't discuss performance, according to people familiar with the call. Mr. Andurand said he had believed that President Trump would go through with sanctions against Iran, but when a lot of the market was exempted, he started to take off risk.

In June, Mr. Andurand, who runs his fund out of offices opposite London luxury department store Harrods, said **oil prices** were in a "multiyear bull run" and could hit $100 in 2018, a level unseen since 2014. He also said that prices could hit as high as $300 a barrel in a few years, although that wasn't his forecast.

Prices initially followed his prediction. Brent broke above $86 a barrel in early October, its highest level in four years.

However, then crude prices quickly reversed on news of the Iran waivers and U.S. oil production hitting record highs. Brent lost nearly 9% in October and continued to fall into November.

Years of choppy and often falling markets have obliterated a once-prominent group of hedge funds, collectively running billions of dollars, that bet on commodities. Among firms that have shut commodities funds are Astenbeck Capital Management, Armajaro Asset Management, Clive Capital, Centaurus Capital and Brevan Howard.

Mr. Andurand, a kickboxing devotee with a reputation for aggressive trades, made his name during the 2008 financial crisis when his previous fund, BlueGold Capital, made a staggering 209% that year, after betting against oil in the final four months of the year, as Lehman Brothers collapsed and oil lost more than half its value.

But the venture didn't end well. BlueGold shut down in 2012 after losing more than one third of its value the previous year. It lost 23% in May 2011 alone, as its **bullish** bets were hit by falling prices. Mr. Andurand has said the closure was unrelated to the losses and instead due to his desire to part ways with his partner.

Coming back from behind isn't unheard of in hedge-fund land. Some hedge-fund investors favor managers who have suffered deep losses on the assumption that their creative trades might bring big winners in the future.

Some have said the losses of the past month might not be enough to cause Mr. Andurand's clients to flee, given the **volatility** of commodity markets on which the hedge-fund manager focuses.

"Losing 20% is within the range of **volatility** for him," said Geoffrey Stern, who invested with Mr. Andurand in the past and now runs Muirfield Capital Global Advisors, which invests in hedge funds. "I doubt any of his investors are shocked by it…he can make 100% in a year, as he's done in the past."

Mr. Andurand's new fund, the Andurand Commodities Fund, has gained every year since its 2013 inception, helped by **bullish** bets, including buying one day after oil hit a 13-year low in 2016. That year, the fund gained 22.1%. The fund is still up around 100% since its start.

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Heard on the Street
Markets

Hey, Big Spenders: Stock Market Doesn't Dent Retail Enthusiasm; Sales strength comes even after the S&P 500 in October logged its largest monthly decline in seven years.

By Justin Lahart
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If Americans are getting worried about **volatility** in the **stock market**, it sure isn't showing up in their spending.

Retail sales were strong last month, the Commerce Department reported Thursday, rising 0.8% from September and 4.6% from a year earlier. And while there were some special factors that helped boost the overall number—higher gasoline prices increased service-station sales and hurricane-related sales helped hardware stores—business was generally good all over. Clothing stores and sporting goods stores both registered sales growth of 0.5% on the month, for example, and department store sales were up 1.3%.

The strength came despite a rough period in the **stock market**, with the **S&P 500** in October logging its largest monthly decline in seven years. One might think that seeing a portion of their net worth evaporate would give people a bit of pause.

But such wealth effects don't seem as influential as they used to be, and they have never been as important as what people are experiencing in the job market. With unemployment at just 3.7%, hiring strong and wage gains beginning to take hold, most people aren't going to let a little thing like a hiccup in their 401(k) slow them down. And, for Americans in the lower income tiers, who have more unfilled needs and whose stockholdings tend to be small (if they hold them at all), any gains in income tend to translate directly into spending gains.

For investors wishing that the Federal Reserve would respond to the **stock market**'s recent woes and dial back its rate increase plans, Thursday's retail sales report is yet another sign that those wishes will likely go unfulfilled. It is clear, as reinforced by strong results from Walmart on Thursday and Macy's and Home Depot earlier in the week, that U.S. consumer are doing their part in powering the economy despite the financial headlines. That counts as something to cheer about.

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