What Caught Our Eye This Week
In the first half of 2018, 122 companies filed an Initial Public Offering (IPO), up 18% from 2017 and the most since 2014. Proceeds from the IPOs were up 31%. The strong IPO market has not impacted private market activity where many companies continue to raise large sums of cash. In 2017, $1 trillion was raised through private stock and debt sales. There are about 100 “unicorns”, startups that are financed by private money with valuations of $1 billion or more. These startups stay private longer and may not go public at all. There are 4,000 public companies today, down from nearly 8,000 in 1997. The Securities and Exchange Commission Chairman, Jay Clayton, wants to increase the interest in public markets while also giving more individuals a chance to invest in private companies that are not going public. To accomplish both, he is seeking comments on how to revamp the capital-raising process. Some say a good start would be to reduce the burden and costs associated with a public offering. To overhaul rules that protect small investors from investing in private companies will be a bigger challenge.

Economy
The most anticipated report this week was the retail sales report, which was released on Friday. Retail sales increased 0.1% in August and are now up 6.6% year-over-year. Retail sales have now grown for seven consecutive months, and the gains in August were broad-based with nine of thirteen major categories showing rising sales. The all important control category, which excludes food service, autos, gas and building materials also advanced by 0.1%. The headline figure was weaker than expected, as sales of motor vehicles declined by 0.8%. Also when examining the details of the “control” group, sales at apparel stores were down 1.7%. Earlier in the week, the producer price index surprisingly posted a 0.1% decline in August which was the first negative reading in 18 months. The decline was led by a drop in food prices and falling margins for machinery and equipment wholesalers. On Thursday, the consumer price index also disappointed with the “core” CPI showing an increase of 0.08% in August. This heavily scrutinized metric is now up 2.2% year-over-year. Once again, the apparel category showed considerable weakness with apparel prices dropping by 1.6%.

Fixed Income/Credit Market
Investment-grade credit spreads have continued to strengthen this week despite the deluge of supply that has priced this month. Just halfway through September, corporations have issued $808 of investment-grade debt which has been absorbed well by both the primary and secondary markets. Given that investment-grade bonds remain well bid in the marketplace, spreads continue to grind lower. In September, the 5-year AA, A, BBB-rated composites decreased 3.8 bps, 2.5 bps, and 3.2 bps, respectively. Over a one-year horizon, investment-grade credit spreads peaked on June 27, 2018 and since then spreads have compressed 13.4, 11.4 and 10.1 bps, respectively for AA, A and BBB-rated composites. In the high yield market, the spread decrease has been more pronounced in September. The 5-year BB and B-rated composites are trading 11 bps and 15.8 bps lower, respectively. The primary driver of lower spreads in the high yield sector has been the lack of supply with just $68 pricing month-to-date.

Equities
With the Fed tightening and global trade wars showing few signs of abating, major market indices opened lower on Monday before trading higher the rest of the week. Washington invited Beijing for new trade resolution talks mid-week and China welcomed the initiative. This temporarily eased trade tensions and alloyed investor fears of reduced fourth-quarter U.S. GDP growth, though the Trump administration indicated late Friday that it is prepared to proceed with $200 billion of tariffs. A rally led by the energy, technology, industrials, and telecom sectors helped stocks gain 1.6%. Growth stocks outperformed value stocks by 0.6%. Other highlights included a boost in the market capitalization of home improvement retailers related to anticipated hurricane damage, Apple’s introduction of its new iPhone and Apple Watch, the U.S. Food and Drug Administration (FDA) considering a ban on flavored e-cigarettes amidst an “epidemic” of youth e-cigarette use, and the much-anticipated tenth anniversary of the crash of Lehman Brothers. The week’s best performing sectors were telecom and energy.

Our View
Economic activity, according to the most recent FOMC statement, “has been rising at a strong rate”. A sizable contributor to the current economic strength is the Tax Cuts and Jobs Act which was signed into law in December of 2017. Many economists questioned the rationale for pushing through tax cuts at such a mature phase in the economic cycle, however, federal receipts have actually increased $26.2 billion in the first 10 months of the fiscal year. Examining the breakdown of federal revenue reveals that receipts from companies are lower compared to a year ago (mostly from accelerated depreciation due to capital expenditures), while individual tax receipts have more than compensated for the lower corporate tax receipts. Even with slightly higher revenues, the budget deficit has expanded dramatically due to the increase in spending that was authorized by Congress. Moreover, the Congressional Budget Office (CBO) estimates that fiscal 2018 will result in a deficit close to $800 billion. The gross national debt is projected to be $21.5 trillion by the end of fiscal year 2018 and the net federal debt is 78% of GDP. Based upon the projection of national debt growing faster than GDP moving forward, the CBO expects the net federal debt to be 100% of GDP by 2030. The two main ways to solve the issue would be to either cut spending or raise revenue. On the spending side, more than 60% of the budget is directed towards entitlements (Medicare, Medicaid and Social Security), which are politically very difficult to touch. On the revenue side, the goal is for GDP growth to accelerate, but without a meaningful increase in productivity lasting GDP growth will be hard to achieve. The current growth rate of the federal deficit is not sustainable and it will be a headwind for long-term secular economic growth.