Financial Markets This Week

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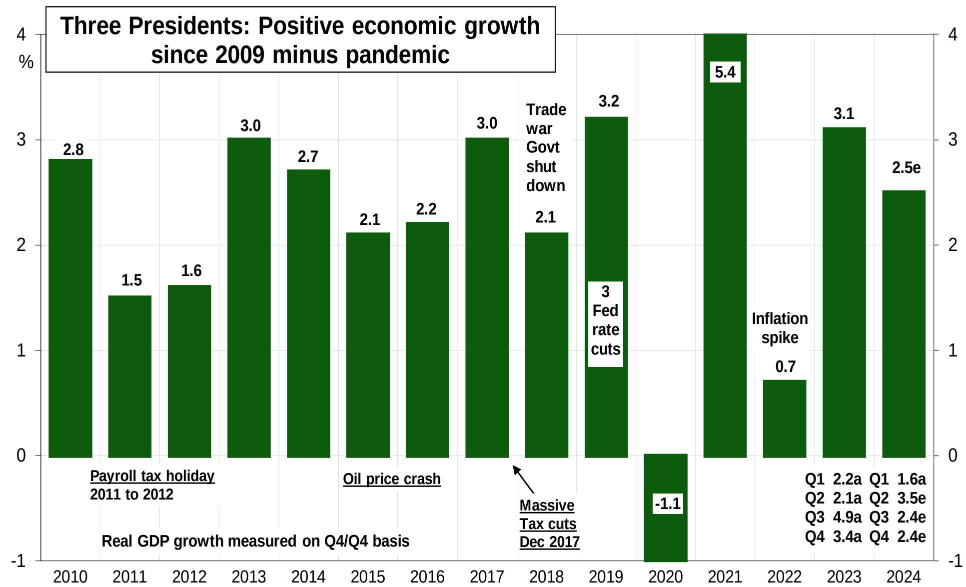
26 APRIL 2024

GDP DISAPPOINTS WHO?



Growth has been positive, not a recession, for a long time now, not counting the pandemic which does not count for economists anyway. Not a normal business, economic cycle, the sudden 2020 downturn. GDP was less than expected, a 1%-handle that was half of the fourth quarter advance. The mirror image (does that mean opposite) of the first look at Q4 2023 growth in a report three months ago where GDP was 3.4% which was more than double expectations. Life is full of surprises. Looks like market expectations are always wrong: good for brokers. The stock market seemed to dive on it even if Powell says economic weakness would be a reason to cut rates. Stocks were dealing with Meta earnings from Wednesday evening, and the Q1 2024 core PCE inflation number in the GDP report somehow caught people's attention even if we already had January and February results. There must have been some confused equity investors if they were selling stocks as core PCE rose 3.7% SAAR, get out the microscope, only slightly more than 3.4% expected. Guess it looked bad: 2.0% Q4 and now 3.7% Q1, but we already knew this. All water under the bridge, angst for nothing after Friday's March PCE data where the 0.3% increase in core PCE inflation met expectations.

	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24p
REAL GDP	2.6	2.2	2.1	4.9	3.4	1.6
REAL CONSUMPTION	1.2	3.8	0.8	3.1	3.3	2.5
CONSUMPTION	0.8	2.5	0.6	2.1	2.2	1.7
Durables	-0.1	1.1	0.0	0.5	0.3	-0.1
Nondurables	0.1	0.1	0.1	0.6	0.4	0.0
Services	0.8	1.4	0.4	1.0	1.5	1.8
INVESTMENT	0.6	-1.7	0.9	1.7	0.2	0.6
Business Plant	0.2	0.8	0.5	0.3	0.3	0.0
& Equipment and	-0.3	-0.2	0.4	-0.2	-0.1	0.1
Intellectual Property	0.3	0.2	0.2	0.1	0.2	0.3
Homes	-1.2	-0.2	-0.1	0.3	0.1	0.5
Inventories	1.6	-2.2	0.0	1.3	-0.5	-0.4
EXPORTS	-0.4	0.8	-1.1	0.6	0.6	0.1
IMPORTS	0.7	-0.2	1.1	-0.6	-0.3	-1.0
GOVERNMENT	0.9	0.8	0.6	1.0	0.8	0.2
Federal defense	0.3	0.1	0.1	0.3	0.0	0.0
Fed nondefense	0.3	0.3	0.0	0.2	0.1	0.0
State and local	0.3	0.5	0.5	0.5	0.6	0.2

Below line: Percentage point contributions to Q1 2024 1.6% real GDP

Second estimate for Q1 is Thursday, May 30

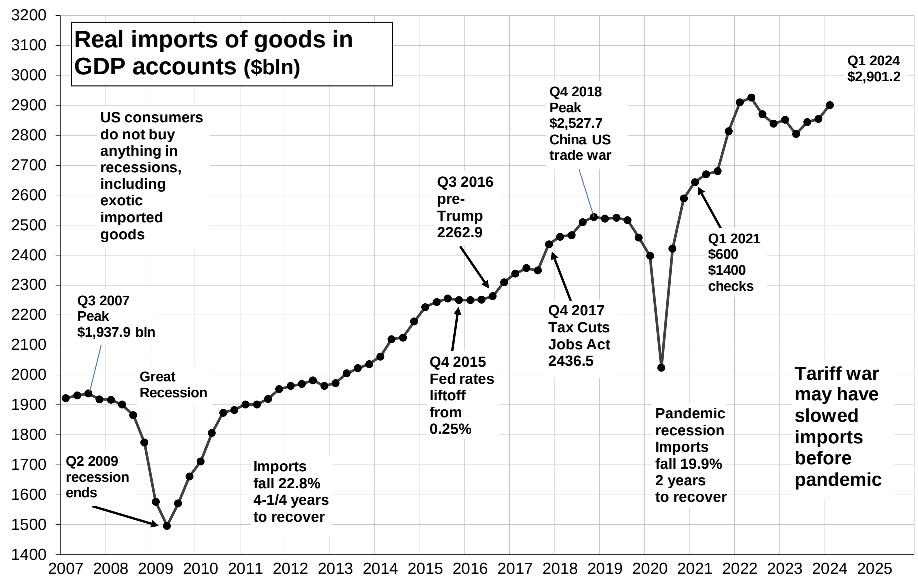
Back to GDP. We used to think that one percent GDP meant growth had slowed to the stall speed where bad things could happen and the economy could suddenly flip over and go into a ditch. We won't change our forecast for this year after the 1.6%. The Fed just gave up on slow economic growth in their March forecasts of 2.1% this year, an increase from just 1.4% in the December FOMC forecasts. We see growth of 2.5% this year. Consumer spending of 2.5% is fine even if it was over 3% in the second half of 2023. We would say about the solid consumption data that the consumer spent all their paychecks on services and nothing on durable or nondurable goods. Within services consumers are spending mostly on health care followed by financial services including insurance. Insurance costs are going up, but this is real data, and consumers are buying even more of it.

Real Business Investment (% change SAAR)

$bln 2023		2022	2023	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24
626.1	STRUCTURES	-2.1	13.2	30.3	16.1	11.2	10.9	-0.1
171.0	Commercial and health care	-8.7	0.7	-0.6	3.8	14.9	3.3	-6.5
127.1	Manufacturing	14.2	63.9	190.4	86.5	29.1	30.7	13.9
106.4	Power and communication	-14.6	3.0	25.5	-3.3	2.5	18.4	-1.8
107.2	Mining exploration, shafts, wells	19.8	0.6	13.2	-14.7	-26.0	-14.3	-7.7
111.6	Other structures 1	0.6	9.9	4.8	12.6	17.6	9.2	-2.1
1,245.9	EQUIPMENT	5.2	-0.3	-4.1	7.7	-4.4	-1.1	2.1
482.8	Information processing equipment	7.6	-5.3	-0.9	-6.1	-7.0	11.5	12.2
142.2	Computers	6.3	-9.1	-8.7	4.4	-19.1	25.5	44.2
340.7	Other processing equipment 2	8.3	-3.4	2.9	-10.6	-0.9	5.6	-0.7
251.8	Industrial equipment	3.6	-1.2	3.9	-5.1	-5.4	0.0	17.7
263.8	Transportation equipment	1.1	15.6	-12.5	66.0	-1.7	-21.7	-25.6
252.7	Other equipment 3	6.2	-3.6	-8.5	0.6	-2.2	2.6	2.3
1,398.7	INTELLECTUAL PROPERTY	9.1	4.5	3.8	2.7	1.8	4.3	5.4
720.9	Software	13.5	9.2	7.1	5.7	7.4	11.1	11.3
603.4	Research & Development (R&D)	5.7	1.0	1.4	0.1	-2.3	0.2	1.2
93.8	Entertainment, literary, artistic	8.7	1.9	1.1	2.4	-1.1	-4.5	0.5

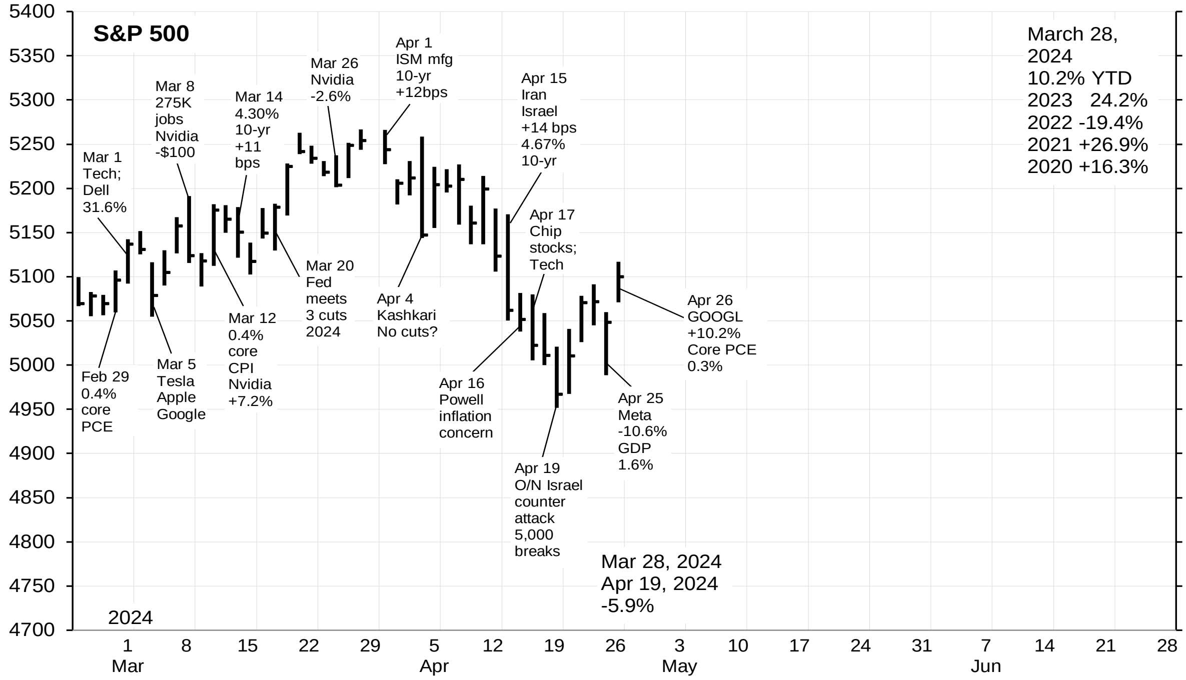
1 Religious, educational, vocational, lodging, railroads, farm, amusement/recreational, other
2 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments
3 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment

Consumption is two-thirds of GDP, business investment is thought to be an economic growth accelerator even if in real terms it is a much smaller amount of spending. Q1 2024 real GDP is $22,768.9 billion at an annual rate, and business investment counting structures, equipment, and intellectual property is just $3,270.7 billion. Equipment investment rose 5.2% in 2022 and then fell 0.3% in 2023 during the Fed rate hikes as we suppose it should do when the cost of financing goes up. But purchases of computers are up the last two quarters, probably AI related. Transportation has been volatile, but aircraft shipments in the durable goods report are certainly weak in the first quarter.



To conclude, we wouldn't say there is stagflation or use 1.6% GDP to say there is anything stagnant about the economy at least. The original stagflation in the 80s was more serious with double-digit unemployment and inflation rates, the inflation having built up over a decade before being addressed. The 1.6% weakness in first quarter growth comes in reduced state and local government spending and import demand surged as well. It is counterintuitive to think there can be a soft spot in overall economic demand when import demand is surging, but it is Gross Domestic Product, so imports are subtracted from the equation. Anyway, goods imports surged in late 2021, pandemic over-ordering maybe, without looking at the goods breakdown, fell back, and are starting to be a drag on GDP again, which is the long, long-term trend. America isn't making things here again yet. No one to work the factories for one thing. Finally one negative, GDP growth is closer to the 1% stall speed if we take out the 0.5 percentage point contributuion of residential construction which includes realtor fees. It is ironic that residential construction is the area of the economy that is expected to fall the hardest when the Fed applies the brakes of higher interest rates.

INTEREST RATES

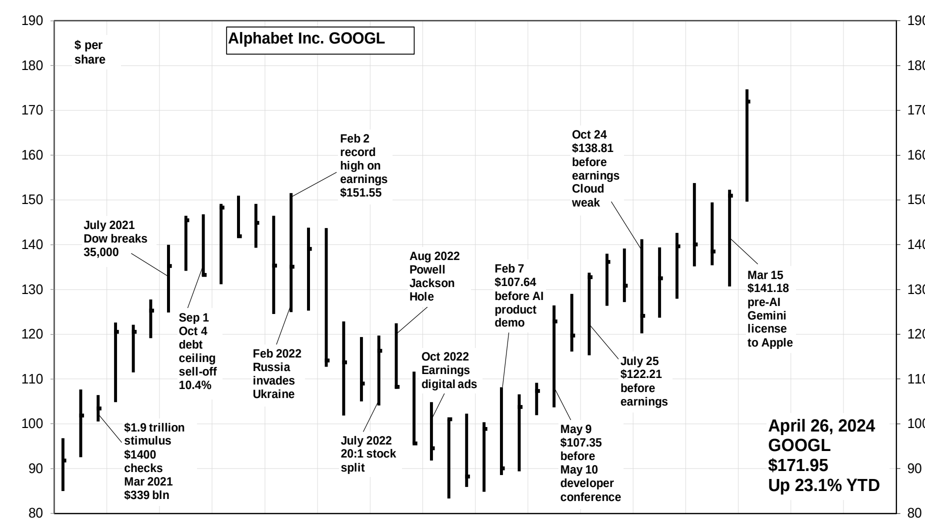


The market story this week is based on economic reports as told through the eyes of Fed funds futures. Odds of Fed rate cuts up with S&P manufacturing PMI dipping below 50 on Tuesday. Growth was weaker with first look at Q1 2024 GDP just 1.6%, but market looked instead at core PCE, like for the quarter, even though monthly data already out for January/February. Headline looked bad: 3.7% Q1 up from 2.0% in Q4. Friday consumer spending was stronger and 0.3% core PCE met expectations. Stocks bounce around on earnings reports. Meta earnings Wednesday evening dropped the stock 10.6% Thursday. Google and Microsoft Thursday evening better than expected: Google closing up 10.2% on Friday. Bonds closed 4.67%. If you don't like the national debt, Treasury announces its quarterly new cash needs at 3pm ET Monday, April 29 ahead of the May refunding.

Alphabet, Inc. (GOOGL) up 23.1% YTD

The stock was dragged as much as 5.2% lower on Thursday, closing -2.0%, by Meta's 10.6% fall. But earnings after the bell led to a 10.2% rebound on Friday. The company announced its first dividend and said it would buy back $70 billion in stock. Profit and sales beat expectations. Cloud services revenue grew faster, artificial-intelligence related, and so did capex as the company pushes AI into its products.

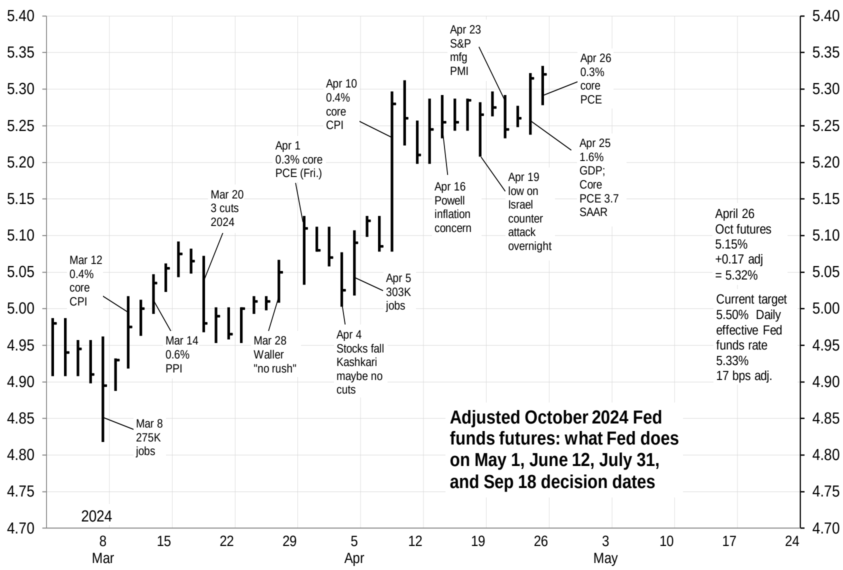
Calendar Year Mln $	Revenue	Advertising	Cloud	Operating Income
Q1 2024	80,539	61,659	9,574	25,472
Q4 2023	86,310	65,517	9,192	23,697
Q3 2023	76,693	59,647	8,411	21,343
Q2 2023	74,604	58,143	8,031	21,838
Q1 2023	69,787	54,548	7,454	17,415
Q4 2022	76,048	59,042	7,315	18,160
Q3 2022	69,092	54,482	6,868	17,135
Q2 2022	69,685	56,288	6,276	19,453
Q1 2022	68,011	54,661	5,821	20,094
Q4 2021	75,325	61,239	5,541	21,885



FEDERAL RESERVE POLICY

The Fed meets April 30-May 1, 2024 to consider its monetary policy. No Fedspeak as members are in their blackout period and the market got on fine without hearing from them or how many rate cuts each and every one has for this year. No forecasts until June 12. Not sure what Powell can say. He wants to be transparent and already read from a script sitting on a stage with the head of Canada's central bank on Tuesday, April 16, saying the recent inflation trend wasn't what Fed officials wanted to see to have the confidence inflation was returning to target. Hope this isn't another mistake like when Powell waited for unemployment to return to prepandemic levels ("target") before raising interest rates the first time. We thought the theory was interest rates should be at neutral (3.0%) when unemployment touched back down at 3.5%. That was the worst mistake made by a Fed Chairman in decades. Making a mistake this time by not cutting rates would mean significant, recession-style job losses. Waiting probably is not a mistake this time. It was interesting Powell keeps reminding us the Fed did not overreact or have confidence inflation was going their way in the second half of last year with the string of 0.1% monthly core PCE inflation reports: July, August, October, November. If that is what he needs to see again, maybe even a September first rate cut is off the table.

Selected Fed assets and liabilities Fed H.4.1 statistical release billions, Wednesday data	24-Apr	17-Apr	10-Apr	3-Apr	3/11/20*	Change from 3/11/20 to Apr 24
Factors adding reserves						
U.S. Treasury securities	4539.799	4539.133	4575.846	4575.162	2523.031	2016.768
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2384.720	2388.241	2388.435	2388.435	1371.846	1012.874
Repurchase agreements	0.005	0.007	0.001	0.002	242.375	-242.370
Primary credit (Discount Window)	7.018	8.559	5.053	5.451	0.011	7.007
Bank Term Funding Program	125.492	125.706	126.344	130.462		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	2.975	3.017	3.028	3.045		
Main Street Lending Program	14.518	14.505	14.705	14.688		
Municipal Liquidity Facility	0.000	0.000	0.000	0.000		
Term Asset-Backed Facility (TALF II)	0.000	0.000	0.000	0.000		
Central bank liquidity swaps	0.137	0.174	0.150	0.187	0.058	0.079
Federal Reserve Total Assets	7453.4	7456.5	7489.1	7490.0	4360.0	3093.406
~~3 month Libor %~~ SOFR %	5.31	5.31	5.31	5.32	1.15	4.160
Factors draining reserves						
Currency in circulation	2344.784	2346.705	2347.725	2347.145	1818.957	525.827
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	929.379	929.932	672.537	732.828	372.337	557.042
Treasury credit facilities contribution	7.438	7.438	7.438	7.438		
Reverse repurchases w/others	441.215	440.508	455.816	436.631	1.325	439.890
Federal Reserve Liabilities	4181.725	4126.937	3873.430	3948.818	2580.036	1601.689
Reserve Balances (Net Liquidity)	3271.706	3329.532	3615.691	3541.167	1779.990	1491.716
Treasuries within 15 days	61.251	61.999	70.295	70.985	21.427	39.824
Treasuries 16 to 90 days	241.502	244.872	239.556	239.513	221.961	19.541
Treasuries 91 days to 1 year	525.436	521.232	535.303	534.567	378.403	147.033
Treasuries over 1-yr to 5 years	1517.921	1517.634	1520.551	1520.273	915.101	602.820
Treasuries over 5-yrs to 10 years	684.209	684.107	701.407	701.279	327.906	356.303
Treasuries over 10-years	1509.480	1509.289	1508.735	1508.544	658.232	851.248
Note: QT starts June 1, 2022	Change	4/24/2024	6/1/2022			
U.S. Treasury securities	-1230.980	4539.799	5770.779			
Mortgage-backed securities (MBS)	-322.726	2384.720	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						



August Fed funds futures say it is not looking good on a rate cut by July 31. October futures say 72% chance of one 25 bps rate cut before the election, meaning September really. Last week it was 90%.

Fed funds futures call Fed policy Current target: April 26 -- 5.50%		
Rate+0.17	Contract	Fed decision dates
5.420	Aug 2024	May 1, Jun 12, Jul 31
5.320	Oct 2024	Adds Sep 18
Last trade, not settlement price		

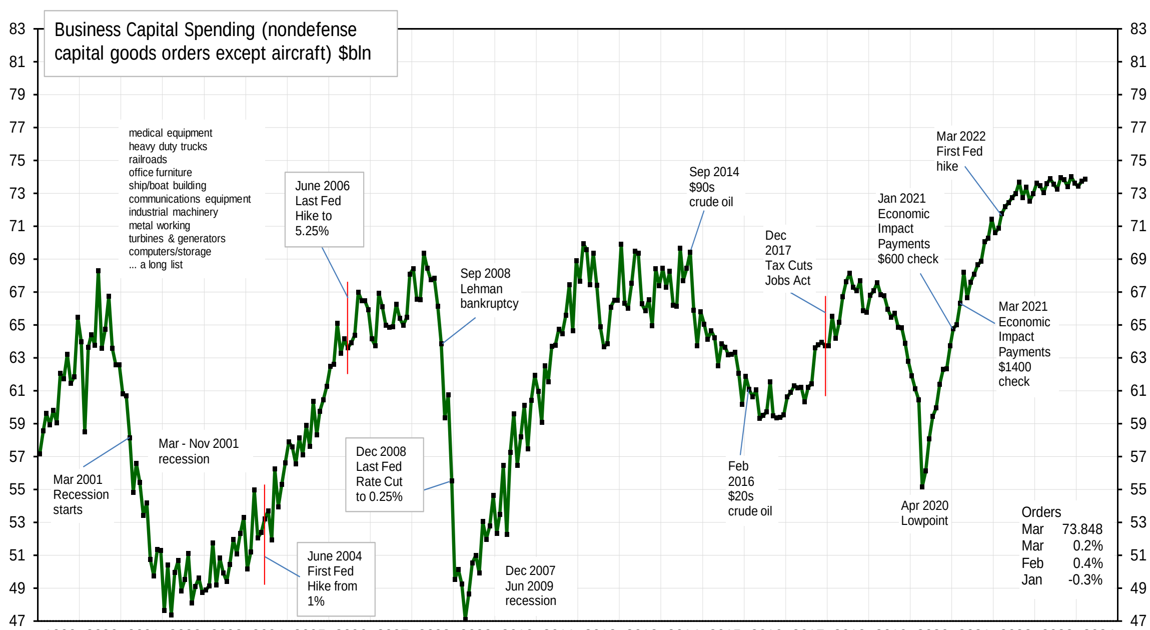
Next up: April CPI inflation report Wednesday, May 15														
Monthly			2024	2023										2023
% Changes	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Core CPI inflation	0.4	0.4	0.4	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.4	0.5	0.3	0.5	0.4
Core PCE inflation	0.3	0.3	0.5	0.2	0.1	0.1	0.3	0.1	0.1	0.2	0.3	0.3	0.3	0.4	0.5
Core PCE YOY	2.8	2.8	2.9	2.9	3.2	3.4	3.6	3.7	4.2	4.3	4.7	4.8	4.8	4.8	4.9
Core CPI YOY	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.3	4.7	4.8	5.3	5.5	5.6	5.5	5.6

OTHER ECONOMIC NEWS

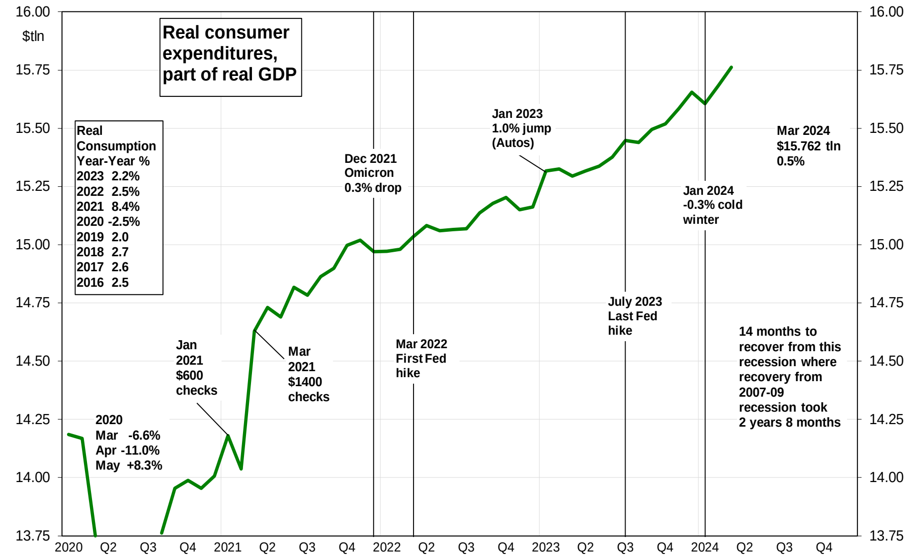
Durable orders flat (Tuesday)

Breaking economy news. March durable goods orders jumped 2.6% in March, but core orders which exclude transportation were up just 0.2%. Capital goods orders are going nowhere or at least are no higher than they were in last month's report. Nondefense capital goods orders ex-aircraft rose 0.7% in February, but now that increase was pared back to 0.4%, and today's March orders rose just 0.2% which means the level is slightly below where it was initially reported in February. Geopolitical risks seem to be top of mind for CEOs where caution prevails as they weigh whether to order more equipment to meet the needs of their customers in the months and quarters ahead.

Net, net, key capital goods orders continue to move sideways as corporations weigh the geopolitical risks before deciding to bring in the new equipment that helps grow their businesses. There is a lot of talk about how the economy is hot and inflation continues to burn, but we are not seeing it in new orders for long-lived capital goods. If markets rallied after new manufacturing weakness trends reported by purchasing managers yesterday, they ought to love the actual data for March new orders which show just modest growth and are barely keeping pace with inflation. New orders for nondefense capital goods excluding aircraft are only 0.6% higher than last year while CPI inflation is up 3.5%. Real business equipment won't be setting GDP growth on fire anytime soon. Bet on it.



Inflation hot, consumer spend even hotter (Friday)



Breaking economy news. March personal income report. Real consumer spending is very strong, 0.5% in February and again in March, after that cold weather dip in January. Lots of forward momentum for the economy and we forecast Q2 2024 real GDP of 3.5% after Q1 2024's slower 1.6% pace.

Inflation met expectations. Powell already implied that 0.4% monthly changes in core CPI prices in January, February, and March is not what they wanted to see to gain confidence inflation was going their way. At least core PCE inflation was less at 0.3% in February/March after 0.5% in January. Maybe just write off the whole first quarter as an outlier and see if inflation moderates later in the year. Core inflation that also subtracts shelter is doing about the same thing.

Net, net, this wasn't the data the doctor ordered for Fed officials looking for confidence that inflation was back on a downward path, so those three rate cuts penciled in for this year may get cut back to just a couple assuming inflation slows in the second quarter. Consumers spent at a blistering pace in February and March which puts real consumption in the second quarter at 2.0% already, nearly matching the Q1 2.5% pace, without any spending figures yet for April, May, and June. The 1.6% stall rate for real GDP was an anomaly. Bet on it. This economy is not weak. The consumer was not worried enough about the high cost of living to pare back their expenditures one bit.

		Year-Year % Change				Monthly % changes			
Dec 2022 Weight		Dec 2020	Dec 2021	Dec 2022	Dec 2023	Dec 2023	Jan 2024	Feb 2024	Mar 2024
1.000	PCE inflation	1.4	6.2	5.4	2.6	0.1	0.4	0.3	0.3
0.080	Food at home	3.9	5.7	11.1	1.4	0.0	0.5	0.1	0.0
0.025	Energy goods (gas)	-14.6	47.3	1.6	-1.3	-0.7	-3.3	3.4	1.4
0.019	Electricity/Gas	2.6	10.2	15.7	-2.3	0.3	1.4	0.7	0.7
0.876	Core PCE	1.6	5.2	4.9	2.9	0.2	0.5	0.3	0.3
	Durable goods								
0.021	New vehicles	1.8	11.5	7.0	1.0	0.2	-0.1	-0.1	-0.2
0.013	Used vehicles	10.3	37.0	-8.1	-1.0	0.6	-3.4	0.5	-1.1
0.026	Furnishings	3.6	8.5	4.9	-3.1	-0.2	0.5	-0.3	0.2
0.036	Recreational	-1.2	1.1	-1.5	-5.1	-1.8	1.6	1.2	0.4
	Nondurable goods								
0.028	Clothing	-4.4	5.6	2.9	1.6	-0.1	-0.7	1.0	0.6
0.027	Prescription drugs	-2.4	0.0	1.8	3.3	-0.4	-0.8	-0.1	0.3
0.010	Personal care	-0.3	0.4	8.1	3.7	-0.9	0.6	0.8	0.2
0.229	Goods x-foodenergy	0.1	6.2	3.1	-0.1	-0.3	-0.1	0.3	0.1
0.647	Services ex-energy	2.1	4.9	5.5	4.0	0.3	0.7	0.3	0.4
0.034	Rents	2.3	3.3	8.3	6.4	0.4	0.4	0.5	0.4
0.116	Home prices	2.2	3.8	7.5	6.3	0.4	0.6	0.4	0.4
0.160	Health care	2.6	2.7	2.6	2.5	0.2	0.6	0.2	0.1
0.033	Transportation	-2.9	8.8	12.4	3.6	-0.3	0.0	0.2	1.6
0.038	Recreation	1.6	4.3	5.8	4.9	0.9	0.4	0.5	-0.1
0.061	Food services	4.3	6.7	7.6	5.1	0.3	0.4	0.0	0.3
0.011	Hotels/Motels	-8.1	20.0	2.5	0.9	0.2	2.0	0.2	0.1
0.072	Financial/Insurance	2.7	7.1	3.8	3.1	0.8	1.7	0.4	0.5
0.083	Other services	1.5	2.8	3.9	2.8	0.1	0.9	-0.2	1.0
0.030	Nonprofits	2.2	13.3	8.7	4.5	-0.1	0.1	0.7	-0.1

Year-year is Dec/Dec Percent Change

The market's stagflation worry should start to recede because consumer spending picked up at the end of the first quarter with plenty of momentum to push real GDP at a faster pace in the current quarter. Weakness in the first quarter was really the result of colder than seasonal temps in January, but now the consumer is up and running fast. Consumers may say they are bummed out by the higher prices, but they continue to spend at a moderate pace that keeps the economy well away from the shores of recession even with the tightest Federal Reserve monetary policy in decades. Stay tuned.

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