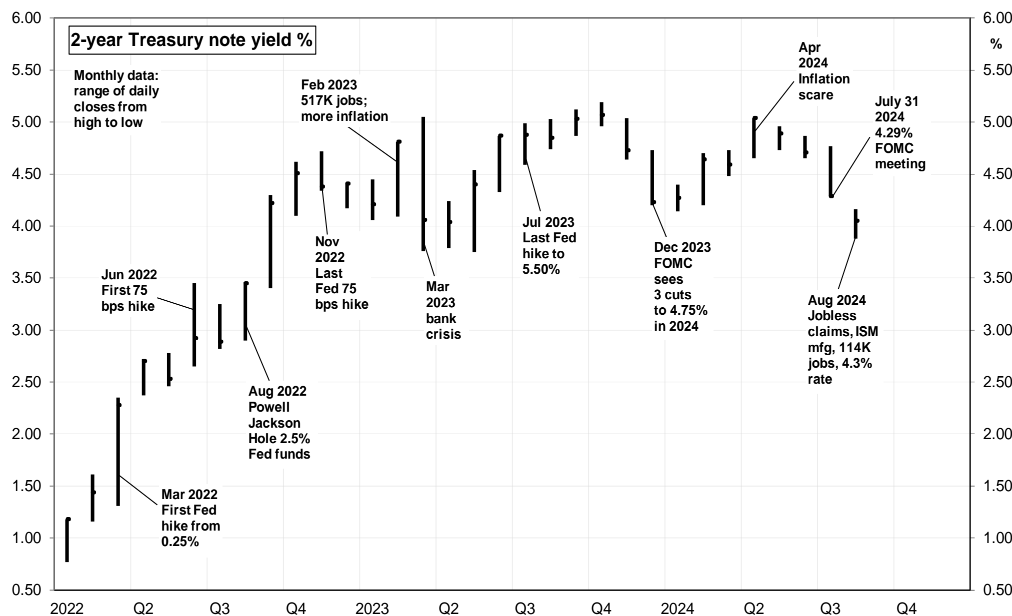
Financial Markets This Week

9 AUGUST 2024

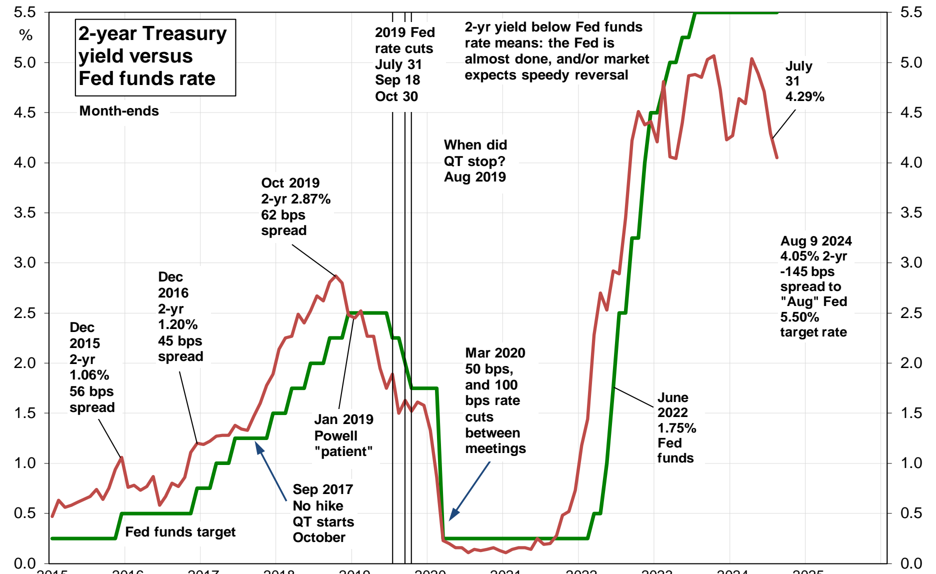
Christopher S. Rupkey, CFA
Chief Economist
crupkey@fwdbonds.com

BOND MARKET RECESSION



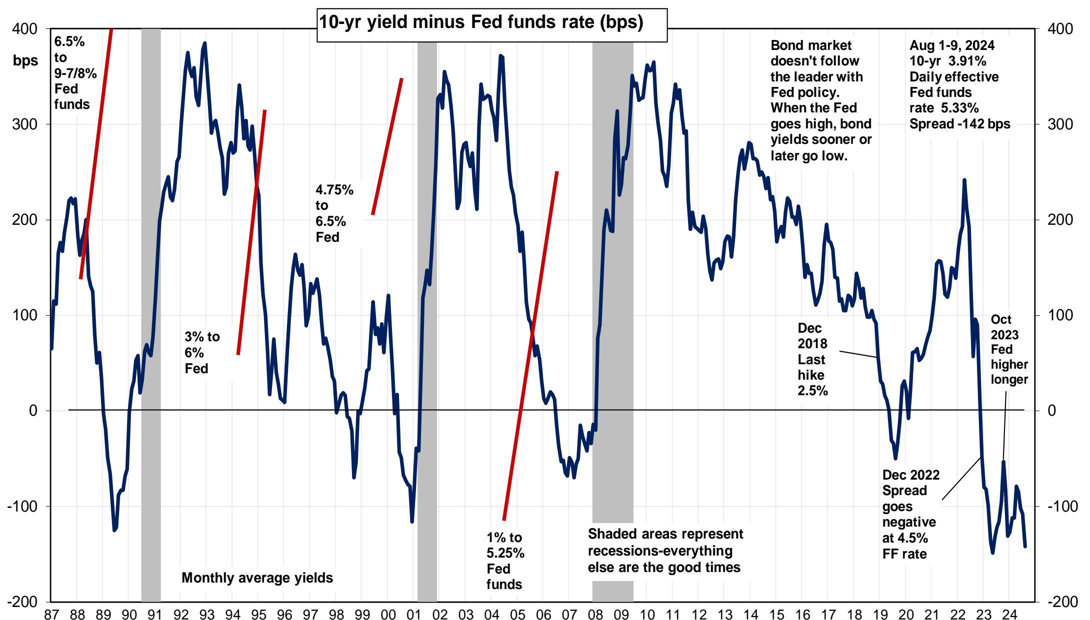
Shoot first and ask questions later is what the bond market does best. Paul Samuelson said dramatic sell-offs in the stock market had forecast nine of the last five recessions, but this could be just as true if not truer, truist, for bond market rallies where yields come crashing down in expectation of multiple, emergency Federal Reserve rate cuts rarely seen outside of recessions.

Looking at 2-year Treasury notes at the short-end of the yield curve, the 2-yr yield was 4.29% after the Fed meeting on July 31, and fell as low as 3.66% on Monday this week when talk of US recession was in the air and the world was ending with Black Monday in Japan where the Nikkei fell 12.4% on the day. Yields did not stick there as other world markets recovered somewhat; the 2-year note yield range in the graph here is the highest and lowest of the daily closes each month. (Hey, "the close is the most important price of the day.") The 2-year yield is supposed to stick close to the Fed funds rate, 5.50% currently. The FOMC current Fed rate forecasts are 4.25% at the end of 2025, so 2-year yields are ahead of the Fed game in terms of the future policymakers saw in their forecasts back on June 12, 2024. On the other hand, 2-year yields never broke above the 5.50% Fed funds rate target in this cycle, and that was hard to explain unless fixed income investors thought the rapid Fed rate hikes would bring about a recession, and quick reversal of monetary policy tightening. No reversal yet. The March 2023 bank crisis brought 2-year yields down, recessions need an external shock and this looked like it could be one. The 90s recession had a thrift crisis and the final straw was the crude oil spike after Iraq invaded Kuwait. The 2001 recession had the dot-com stock market bubble that burst. The 2007-09 recession had a housing bubble that burst. This external shock of the March 2023 bank crisis did not actually trigger one (although unemployment has been rising ever since April 2023), and the Fed economic staff, according to the Fed meeting minutes, even forecast a mild recession later in 2023 at the March, May, and June 2023 FOMC meetings before giving up and



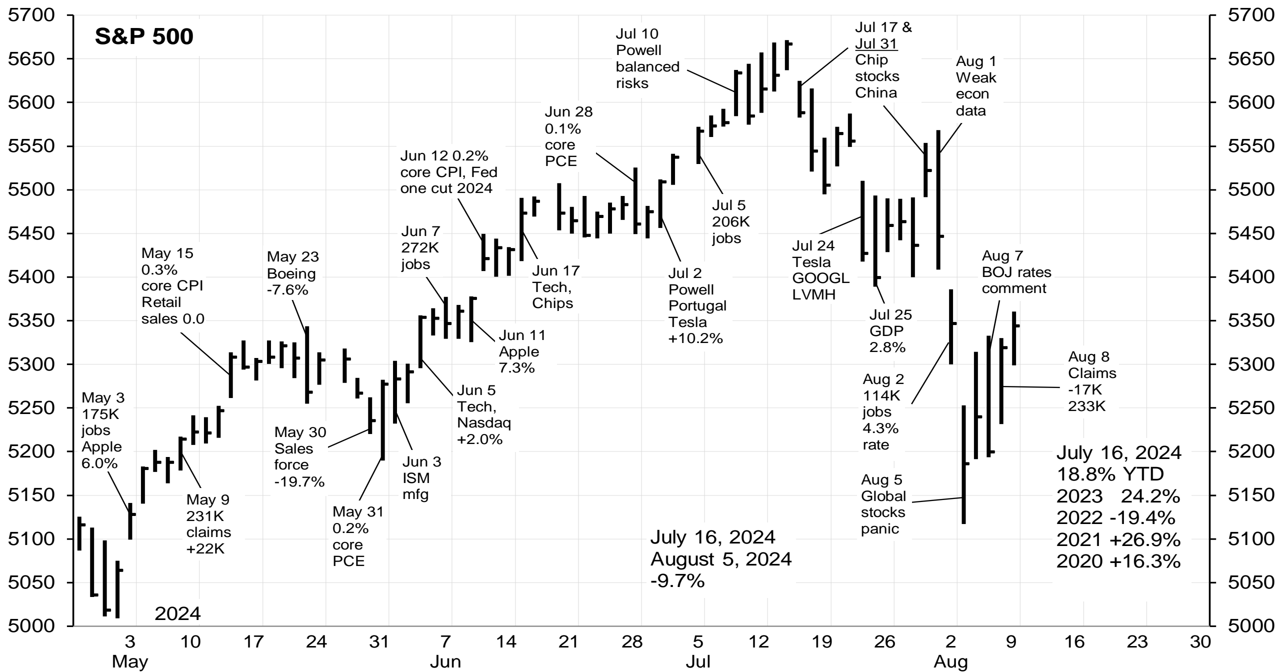
throwing in the towel. "We were wrong." We always thought Fed economists thought a recession could not be forecast, modeled, predicted, whatever, and for the doomed economy it is simply "All of sudden things go vertical." We guess that is where the external shock comes in as a recession indicator for the mad modelers of the economy and business conditions. Right now it is hard to identify an external shock even with the S&P 500 falling almost 10% from the highs of the year earlier this week (sounds bad), wars and rumors of wars, and US national elections that "threaten the world." Stay tuned. It is always darkest before the dawn and this week, not as dark with weekly jobless claims falling. It cannot come down to just one number can it?

Back to the bond market. 2-year yields are supposed to stick close to the Fed funds rate in theory, 10-year yields further out the curve can move around a lot. And if you are still worried about the national debt, bond traders say don't, as 10-year yields fell as low as 3.67% this Black Monday thanks to Tokyo stocks among other reasons; the yield peak was 5.02% back on October 23, 2023. The Treasury quarterly borrowing requirements were a big problem for the markets this time a year ago ahead of the August 2023 refunding, but this year crickets. Supply is not pushing bond yields up certainly despite the national debt hitting $35 trillion.



We had the idea once upon a time that 10-year yields would stick around 4-1/4 percent as the yield curve normalized after the Fed cut its interest rates back to neutral. Neutral is the equilibrium level of interest rates that neither boosts the economy nor subtracts from economic growth. If we assume neutral is the Fed's 3.25% 2026 forecast, then a normal yield spread between the Fed funds rate and 10-year yields based on the historical graph here should be 100 bps at least which means a 4.25% 10-year yield. The bond rally looks overdone, but then it is recession fear driven and thinking the Fed will push rates to zero again. Hope not. Stay tuned. Recession not confirmed until payroll jobs decline. 114K away for now.

INTEREST RATES

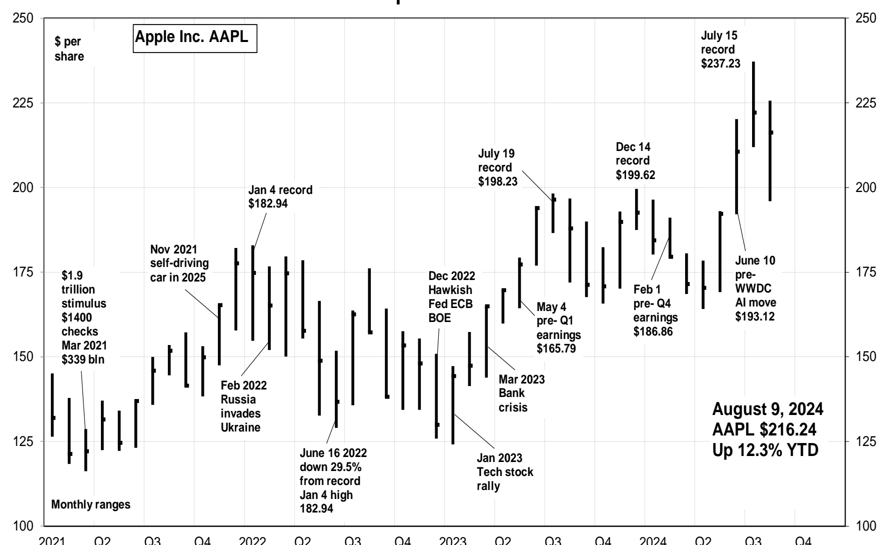


Major meltdown for stocks with the low at Monday's 930am ET open. After falling on Friday from recession fears sparked by the weak jobs report, S&P futures fell 4.8% at the worst point on Monday. For the what-happened record, the Nikkei fell 12.4% on Monday. Stocks were lower in the Mideast on fears of Iran attacking Israel. Buffet cut his Apple stock holding in half, announced over the weekend. S&P stock futures bottomed out an hour before cash markets opened at 930am ET but other news hit during Monday. Schwab and Fidelity reported outages at the volatile opening. Nvidia had a chips production problem, and in the afternoon, Google lost its antitrust case. Recession is still bad news for stocks so there was a rally when unemployment claims fell back some. By the end of the week, stocks had retraced about a third of the drop. 10-yr yields closed 3.95% versus 3.79% last week.

Apple, Inc. (AAPL) up 12.8% YTD

After reporting earnings Thursday, August 1 it was one of the few stocks that rallied (0.7%) on Friday, August 2 after the jobs report that set off the market's recession fears. Selling had to wait until Monday, August 5 (-4.8%) after over the weekend Buffet news of cutting his Apple stock holdings. Earlier the stock had jumped above $200 in June after its Worldwide Developers Conference was deemed AI news friendly.

Calendar Year Mln $	Operating Income	Net Sales	iPhone	Greater China
Q2 2024	25,352	85,777	39,296	14,728
Q1 2024	27,900	90,753	45,963	16,372
Q4 2023	40,373	119,575	69,702	20,819
Q3 2023	26,969	89,498	43,805	15,084
Q2 2023	22,998	81,797	39,669	15,758
Q1 2023	28,318	94,836	51,334	17,812
Q4 2022	36,016	117,154	65,775	23,905
Q3 2022	24,894	90,146	42,626	15,470
Q2 2022	23,076	82,959	40,665	14,604

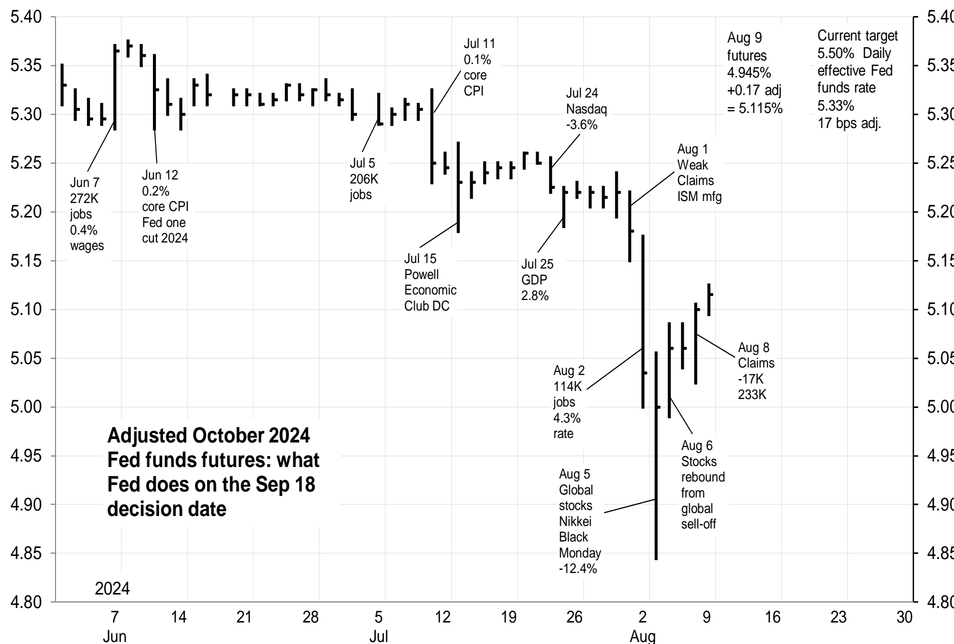


FEDERAL RESERVE POLICY

The Fed meets September 17-18, 2024 to consider its monetary policy. At this meeting, the forecasts made every quarter will be extended through 2027. Core inflation forecasts remain close to 2.0% for the next couple of years so policymakers think they have to reduce the Fed funds rate so that real rates do not remain too high and become more restrictive. That's the theory. Like driving a car. There is a risk that interest rate cuts will set off or blow more hot air into the housing price bubble. We would not like to see the Fed funds rate come down below 3%--there has to be a risk-free rate of interest for savers. Fed officials do not seem to be in a hurry to cut interest rates after the softer 114K payroll jobs report and two-tenths rise in unemployment to 4.3%. The new guy at the Kansas City Fed President Schmid said the labor market might need to cool even more. He did say inflation was going the right way and if it continues to come in low, it would be appropriate to cut interest rates. It appears that unemployment has to go even higher, or for payroll jobs to actually decline before Fed officials will say there is "economic weakness."

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	7-Aug	31-Jul	24-Jul	17-Jul	3/11/20*	3/11/20
Factors adding reserves						to Aug 7
U.S. Treasury securities	4413.650	4413.615	4423.725	4423.552	2523.031	1890.619
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2318.190	2318.190	2332.216	2335.932	1371.846	946.344
Repurchase agreements	0.010	0.005	0.000	0.100	242.375	-242.365
Primary credit (Discount Window)	2.232	6.925	6.751	6.634	0.011	2.221
Bank Term Funding Program	100.858	102.066	102.410	103.248		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	2.615	2.698	2.715	2.735		
Main Street Lending Program	10.891	10.879	10.880	10.869		
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	0.149	0.155	0.159	0.163	0.058	0.091
Federal Reserve Total Assets	7226.5	7228.9	7256.7	7259.5	4360.0	2866.462
~~3-month Libor %~~ SOFR %	5.33	5.38	5.34	5.35	1.15	4.180
Factors draining reserves						
Currency in circulation	2350.210	2348.663	2347.678	2350.408	1818.957	531.253
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	785.233	854.001	767.419	766.779	372.337	412.896
Treasury credit facilities contribution	4.958	4.958	4.958	4.958		
Reverse repurchases w/others	286.660	413.200	399.121	399.401	1.325	285.335
Federal Reserve Liabilities	3853.572	4050.212	3980.838	3937.028	2580.036	1273.536
Reserve Balances (Net Liquidity)	3372.916	3178.700	3275.885	3322.446	1779.990	1592.926
Treasuries within 15 days	79.828	84.041	63.939	57.058	21.427	58.401
Treasuries 16 to 90 days	166.965	135.154	178.740	184.932	221.961	-54.996
Treasuries 91 days to 1 year	535.307	562.900	543.643	544.310	378.403	156.904
Treasuries over 1-yr to 5 years	1472.812	1472.796	1479.645	1479.567	915.101	557.711
Treasuries over 5-yrs to 10 years	637.854	637.850	637.651	637.630	327.906	309.948
Treasuries over 10-years	1520.884	1520.874	1520.107	1520.056	658.232	862.652
Note: QT starts June 1, 2022	Change	8/7/2024	6/1/2022			
U.S. Treasury securities	-1357.129	4413.650	5770.779			
Mortgage-backed securities (MBS)	-389.256	2318.190	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

Fed Policy-key variables	2024	2025	2026	Long Term
Fed funds	5.1	4.1	3.1	2.8
PCE inflation	2.6	2.3	2.0	2.0
Core inflation	2.8	2.3	2.0	
Unemployed	4.0	4.2	4.1	4.2
GDP	2.1	2.0	2.0	1.8
June 2024 median Fed forecasts				



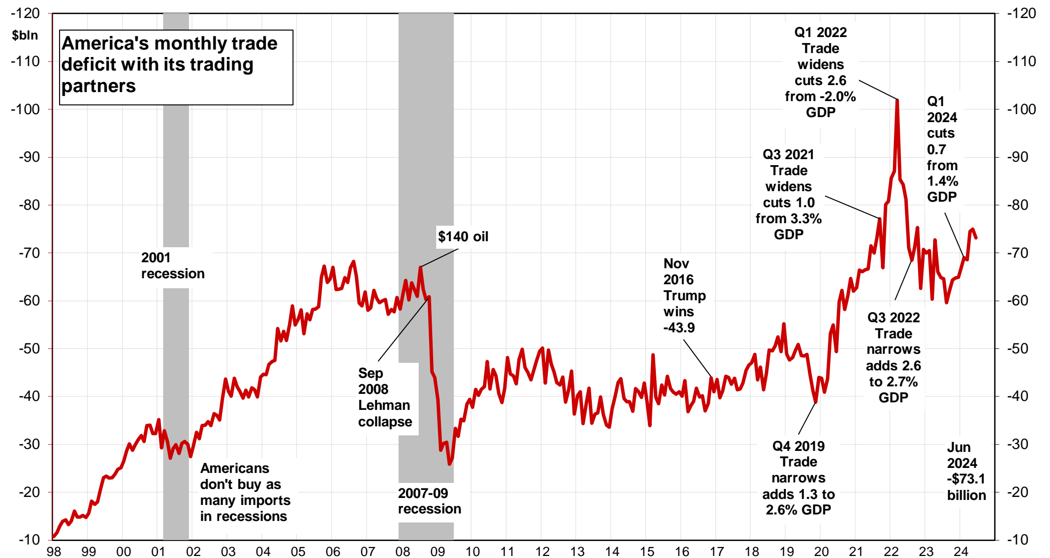
October Fed funds futures are split on whether there is a 25 bps, or a 50 bps rate cut on September 18. Over 100 bps of rate cuts are discounted this year.

Fed funds futures call Fed policy		
Current target: August 9 -- 5.50%		
Rate+0.17	Contract	Fed decision dates
5.493	Aug 2024	Intermeeting
5.125	Oct 2024	Sep 18
4.465	Jan 2025	Add Nov 7, Dec 18*
Last trade, not settlement price		
* Not strictly true, Jan 2025 has Jan 29 Fed date, so 2 days could be a new interest rate		

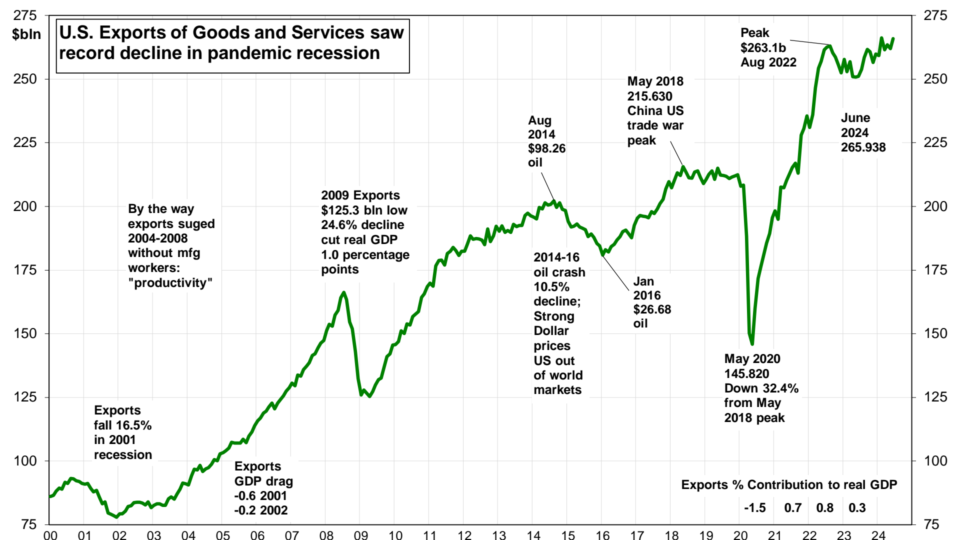
Next up: July CPI inflation report Wednesday, August 14														
Monthly					2024	2023								2023
% Changes	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr
Core CPI inflation	0.1	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.4	0.5
Core PCE inflation	0.2	0.1	0.3	0.3	0.3	0.5	0.2	0.1	0.1	0.3	0.1	0.1	0.2	0.3	0.3
Core PCE YOY	2.6	2.6	2.8	2.8	2.8	2.9	2.9	3.2	3.4	3.6	3.7	4.2	4.3	4.7	4.8
Core CPI YOY	3.3	3.4	3.6	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.3	4.7	4.8	5.3	5.5

OTHER ECONOMIC NEWS

Trade picture improves (Tuesday)

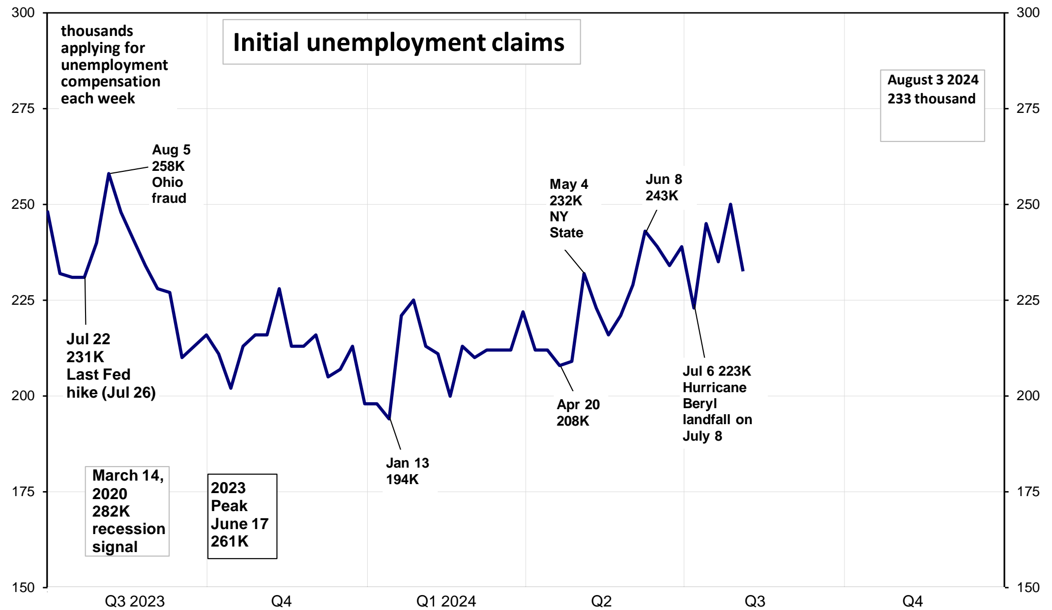


Breaking economy news. The US trade deficit fell slightly to $73.1 billion in June from $75.0 billion in May. The trade deficit widened this year, thanks to consumers and businesses purchasing more imports, which is a drag on GDP; 0.7 percentage points subtracted from Q1 1.4% real GDP, and again from 2.8% real GDP in the second quarter. About the only time the trade deficit drops is during recessions when there is less demand for everything including imports.

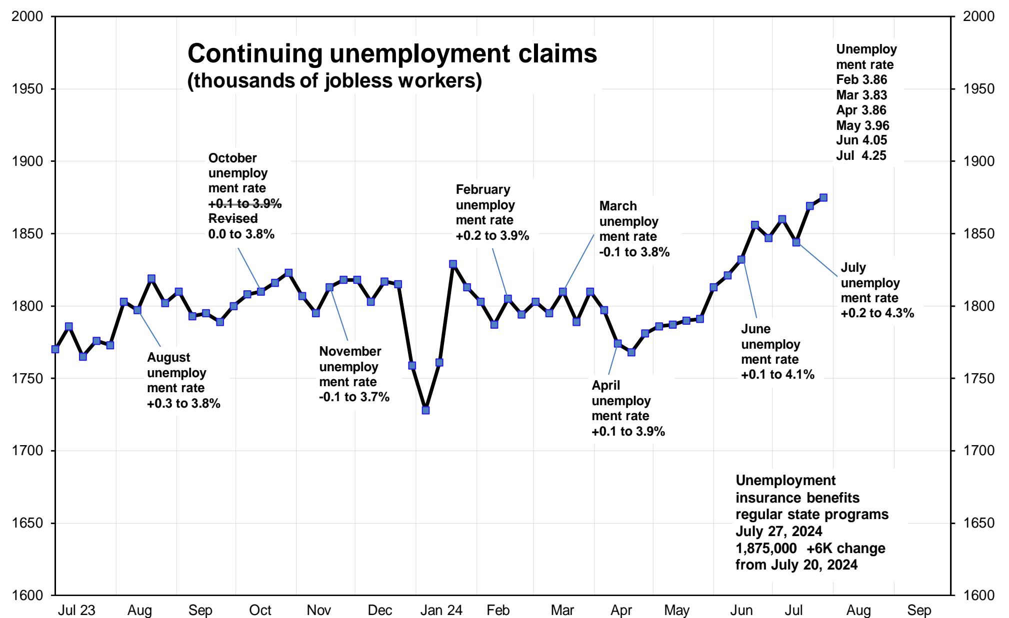


Net, net, the trade picture improved slightly in June where the deficit red ink with America's trading partners came down from the 2024 peak reached in May. The good news is that US manufacturers sent more exports abroad so the world economy can't be going off the rails despite heightened geopolitical risks. Industrial manufacturing output saw stronger activity at the end of the second quarter as factories churned out more goods to export overseas. Purchasing managers surveys show the manufacturing sector is in a downturn, but today's trade results with rebounding goods exports tell a more positive story. Talk of new tariffs and a return of trade wars would pose a risk to the US economy as exports added 0.2 percentage points to Q2 2024 2.8% real GDP growth, and this contribution could come to a halt potentially if there is retaliation from the country's foreign trading partners. Stay tuned. American consumers are still purchasing imported goods in June so the talk of recession is all talk until spending turns down. Rising joblessness over the last year has not weighed on economic demand yet. Imports of goods from China are running about the same in May and June as they were a year ago, so the war of words and threats has not stopped importers from bringing Chinese made goods into the country yet. There were $426.9 billion imports of goods from China brought into the US in 2023 and it will be difficult to find other factories and other countries to meet this demand and lessen the dependence on our biggest trading partner.

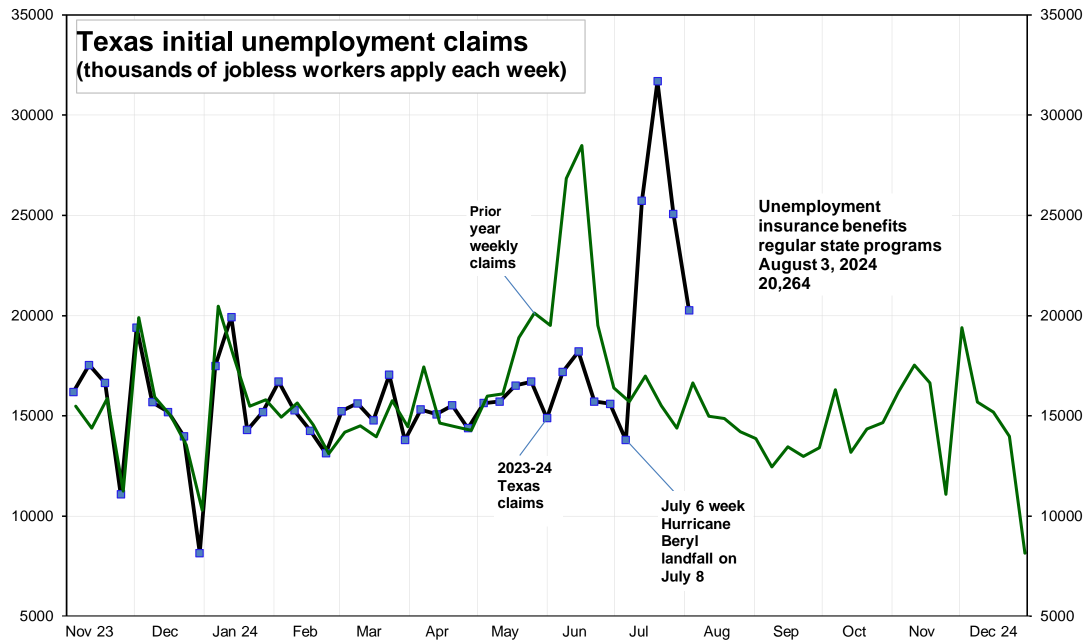
Darn, no recession today (Thursday)



Breaking economy news. Weekly jobless claims fell back 17K to 233K in the August 3 week from 250K in the July 27 week. Simply put, 250K looks like a recession magnitude pace of layoffs where 233K does not quite look like a recession is coming. At least we cannot be sure, and Texas claims fell 4,812 as the storm surge in filings after Hurricane Beryl continue to subside; this is the most of any state except Michigan's 7,401 decline. This week-to-week of anxious waiting is going to continue for a while as the threat of recession is not going to go away while the Fed continues to keep monetary policy at restrictive levels meant to fight inflation.



Net, net, markets and Fed officials and economists can all collectively let out a great big sigh of relief that no, a recession is not coming, or at least the weekly job layoffs are not as bad as feared for this first week in August anyway. Americans are at the beach this August and not standing in line for unemployment benefits. It will be this way for a while unfortunately that this recession watch will focus on the timeliest indicators which are the weekly layoffs. If you are betting on a recession, you will have to wait another week to get your is it or isn't it fix. Many companies have announced layoffs during this earnings reports season, but there are not enough jobless workers out there yet to make a sure thing recession call. There is no cumulative deterioration in the labor markets at this point in time. The Fed does not have to hurry and move from its position of seeing balanced risks to one that sees labor market weakness as the biggest worry and concern. The threat of recession remains, but the labor markets are not pointing the way downward for the economy as of yet. The stock market fell for many reasons in recent days, but at least it knows bad news when it sees it again, and today's jobless claims fell back and with it the fear of recession can wait for another day. No recession today, come back tomorrow and we will see if we can find one for you.


Texas initial unemployment claims
(thousands of jobless workers apply each week)
Prior year weekly claims
2023-24 Texas claims
July 6 week Hurricane Beryl landfall on July 8
Unemployment insurance benefits regular state programs August 3, 2024 20,264
35000
30000
25000
20000
15000
10000
5000
Nov 23
Dec
Jan 24
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec 24

Analyst Certification

The views expressed in this report accurately reflect the personal views of the research staff at FWDBONDS LLC, the primary analysts responsible for this report, about the subject securities or issuers referred to herein, and no part of such analysts' compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.

The information herein is provided for information purposes only, and is not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. Neither this nor any other communication prepared by FWDBONDS LLC should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective in light of your business objectives or operations. Before entering into any particular transaction, you are advised to obtain such independent financial, legal, accounting and other advice as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by FWDBONDS LLC. FWDBONDS LLC hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting or other issues or risks that may arise in connection with any particular transaction or business strategy. While FWDBONDS LLC believes that any relevant factual statements herein and any assumptions on which information herein are based, are in each case accurate, FWDBONDS LLC makes no representation or warranty regarding such accuracy and shall not be responsible for any inaccuracy in such statements or assumptions. Note that FWDBONDS LLC may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information set forth herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the analysts who prepared them, and FWDBONDS LLC is under no obligation to ensure that such other reports are brought to your attention.

Copyright 2024 FWDBONDS LLC All Rights Reserved

The articles and opinions in this publication are for general information only, are subject to change, and are not intended to provide specific investment, legal, tax or other advice or recommendations. The information contained herein reflects the thoughts and opinions of the noted authors only. We are not offering or soliciting any transaction based on this information. We suggest that you consult your attorney, accountant or tax or financial advisor with regard to your situation. Although information has been obtained from sources we believe to be reliable, neither the authors nor FWDBONDS LLC vouch for its accuracy, and such information may be incomplete or condensed. Neither the authors nor FWDBONDS LLC shall be liable for any typographical errors or incorrect data obtained from reliable sources or factual information.

Opinions, estimates, forecasts, and other views contained in this document are those of the FWDBONDS LLC research group, and does not necessarily represent the views of FWDBONDS LLC or its management. Although the Financial Markets This Week newsletter attempts to provide reliable, useful information, it does not guarantee that the information or other content in this document is accurate, current or suitable for any particular purpose. All content is subject to change without notice. All content is provided on an "as is" basis, with no warranties of any kind whatsoever. Information from this document may be used with proper attribution. Alteration of this document or its content is strictly prohibited. ©2024 by FWDBONDS LLC.

By the way, in the way of the usual disclaimers, this is a final legal reminder that there is no investment advice offered or given anywhere in this newsletter or on the fwdbonds.com website. These are just the things we would like to see before we save, invest, spend, and otherwise plan for the future, which of course is always uncertain.