Financial Markets This Week

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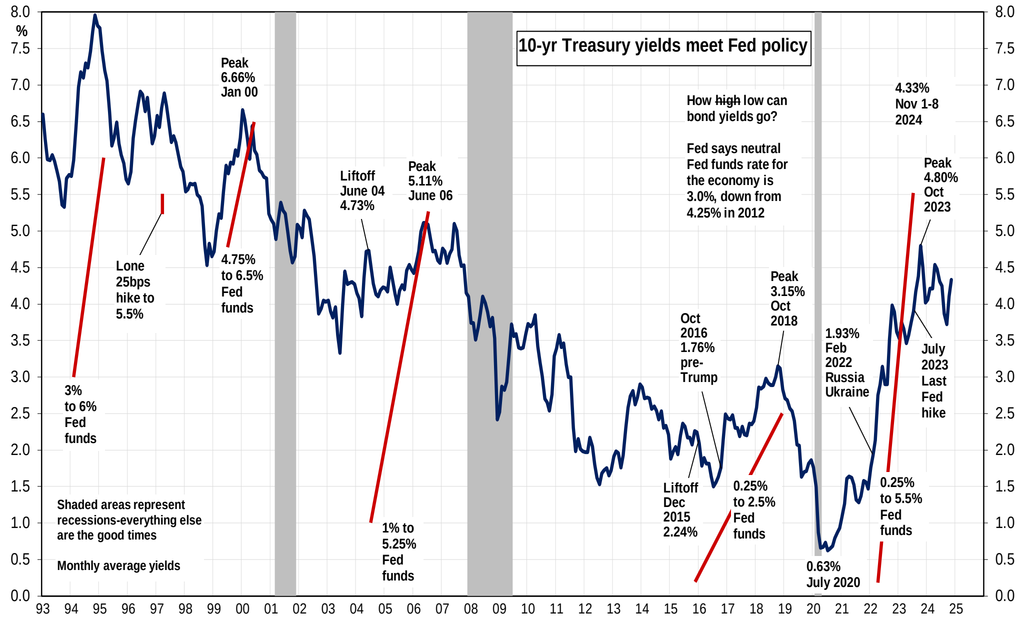
BOND YIELD RALLY



Bond yields have backed up dramatically as the fears of a Trump presidency suddenly became a reality. The bond market was leery of the ability of both candidates to address the nation's fiscal challenges, warned about by no less than the IMF, and the Trump tariff threats (inflationary) served as a reminder about what happened in his first administration. The yield backup in 10-yr Treasury yields has been dramatic, but on a monthly average basis in the graph above, there is no reason to panic yet, and indeed the one thing markets have learned is that the Trump administration policy initiatives have been difficult to anticipate until it actually happens. The Fed is cutting interest rates regardless of bond yields as inflation has fallen, if not to the 2.0% target, it is close enough to start returning rates to neutral. Looking back in the graph here, Powell backed interest rates down in three 25 moves July, September, October 2019 from 2.5% to 1.75%, and 10-yr yields fell to 1.63% on a monthly basis in August 2019, holding that low until the pandemic.

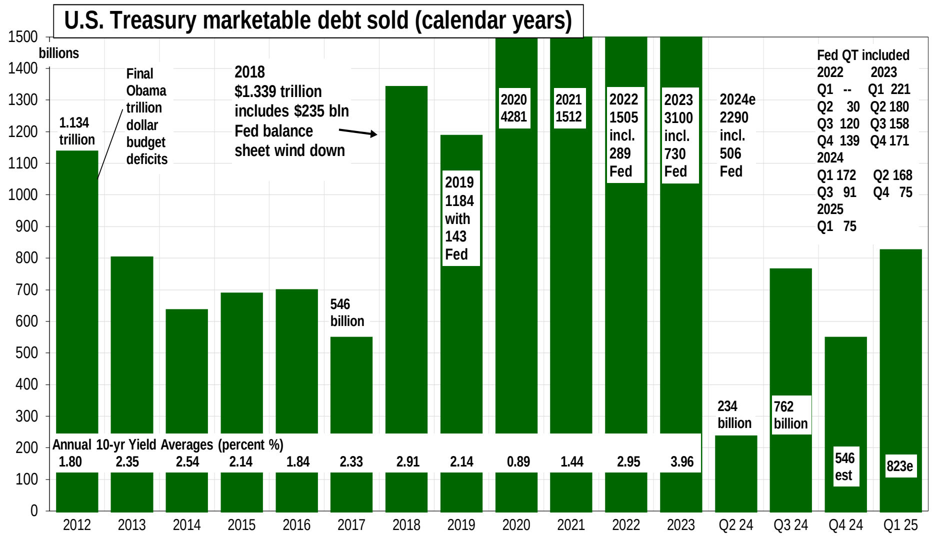
%	Core CPI	Core PCE	Diff
2002	2.4	1.7	0.7
2003	1.4	1.6	-0.2
2004	1.8	2.0	-0.2
2005	2.2	2.2	0.0
2006	2.5	2.4	0.1
2007	2.3	2.2	0.1
2008	2.3	2.0	0.3
2009	1.7	0.9	0.8
2010	1.0	1.4	-0.4
2011	1.7	1.6	0.1
2012	2.1	1.9	0.2
2013	1.8	1.5	0.3
2014	1.7	1.5	0.2
2015	1.8	1.2	0.6
2016	2.2	1.6	0.6
2017	1.8	1.6	0.2
2018	2.1	1.9	0.2
2019	2.2	1.6	0.6
2020	1.7	1.3	0.4
2021	3.6	3.6	0.0
2022	6.2	5.4	0.8
2023	4.8	4.1	0.7
2024	3.5	2.8	0.7

2024-to September

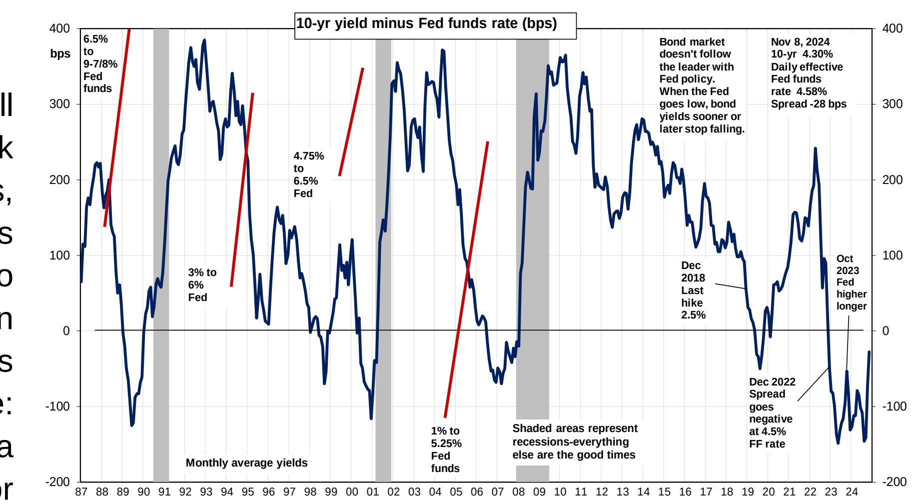
	10-yr Treasury Yield	Core CPI	Real Yield bps
2002	4.61	2.4	221
2003	4.01	1.4	261
2004	4.27	1.8	247
2005	4.29	2.2	209
2006	4.80	2.5	230
2007	4.63	2.3	233
2008	3.66	2.3	136
2009	3.26	1.7	156
2010	3.22	1.0	222
2011	2.78	1.7	108
2012	1.80	2.1	-30
2013	2.35	1.8	55
2014	2.54	1.7	84
2015	2.14	1.8	34
2016	1.84	2.2	-36
2017	2.33	1.8	53
2018	2.91	2.1	81
2019	2.14	2.2	-6
2020	0.89	1.7	-81
2021	1.44	3.6	-216
2022	2.95	6.2	-325
2023	3.96	4.8	-84
2024	4.18	3.5	68

2024-to September

Okay, aside from future Fed policy moves, "the backbone" holding up 10-yr benchmark Treasury yields, how are 10-year yields doing against the other two valuation markers of inflation and supply/demand, the latter having been reduced to simply supply, something that is directly measurable. Real rates have moved back to positive, 68 bps through September this year with a 10-yr yield of 4.18% and 3.5% core CPI. Nothing like the 200 bps real rates in the early 2000s.



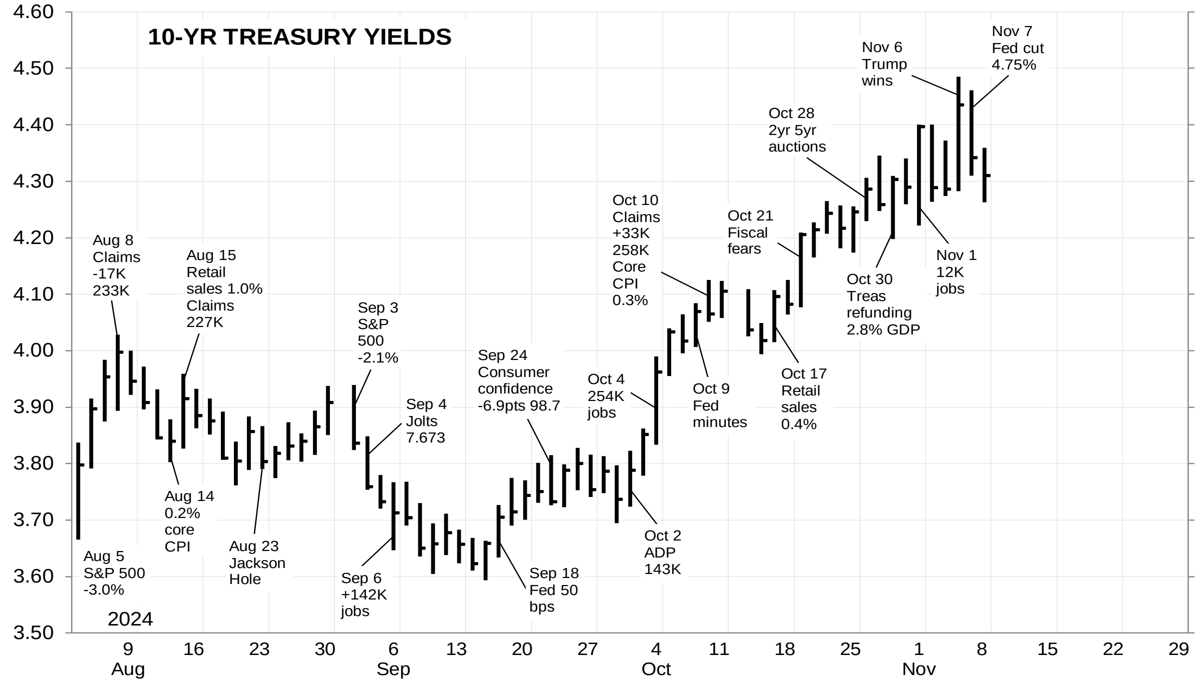
Aside from inflation, the market is worried about the national debt, a large number which is going higher with social security benefits for retiring baby boomers and their meds and therapy. The Federal budget deficit was $1.8 trillion in FY2024 but the Treasury borrowed $2.5 trillion from the market. Borrowing needs are coming down as the Fed QT shrinks from $720 billion to a $300 billion annual rate. The Treasury Q1 2025 new cash estimate is still up there at $823 billion versus $748 billion a year earlier in Q1 2024. The new cash estimate was made or released on Monday, October 28 at 3pm ET before the election result. Despite all the talk during the election campaign of tax cuts, historically the Republicans in Congress have been dead set against increasing Federal budget deficits. Hard to know how this will play out in the first 100 days of the new administration next year.



The press conference with Powell on Thursday tried to get him to talk about the recent rise in bond yields, essentially don't higher bond yields work against what you are trying to do in bringing short-term rates down and making monetary policy less restrictive. He would not go there: the fiscal fears of rising deficits, as a reason for the higher bond yields for example. He said they were a long way from trying to assess potential fiscal policy changes, the process has to play out over some time, the legislation would have to be passed first, they would model the policy changes etc. Anyway he did not think higher bond yields were caused by increased inflation expectations, the tariff threat and fiscal changes, he just put it down to downside risks having diminished and the economy is stronger. Indeed, the 10-yr yield mid-September 3.6% low was on recession fears and the multiple Fed rate cuts that would be needed to stabilize the economy's ship.

The yield curve between the Fed funds rate and the 10-year yield was going to steepen at some point. Maybe the spread does not go out to 200 bps again, but 100 bps seems plausible which means a 10-yr yield still at 4.0% if the Fed cuts its rate (promises kept) to 3.0% at the end of 2026. Can't wait. Stay tuned.

INTEREST RATES

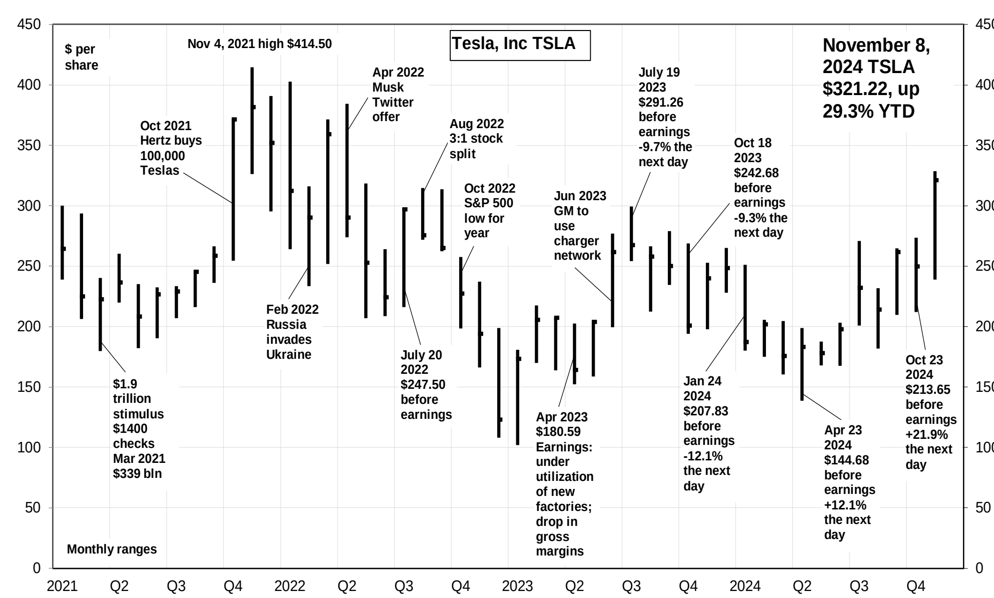


The market for one certainly celebrated the outcome of the presidential election partly as the downside risks went away with a quick decisive vote count and partly looking forward to what lies ahead maybe. Bank stocks looked forward to less regulation in Wednesday trading with Chase +11.5%, Citi +8.4%, Goldman +13.1%. The S&P 500 was up 2.5% Wednesday looking forward to a lower corporate tax rate, pro-business administration. Hard to know what to say. 10-year Treasury yields jumped 15 bps to 4.44% on Wednesday looking forward to more deficit spending. April Fed funds futures are not as friendly for 50 more bps of rate cuts to 4.25% by the end of the first quarter next year. We thought the president-elect liked low rates. Stay tuned. The best is yet to come. Trade friction, higher inflation too.

Tesla, Inc. (TSLA) up 29.3% YTD

The stock jumped 21.9% to $260.48 on Thursday, October 24, after earnings Wednesday afternoon. Investors seemed to like the forecast. That was just the start with the stock Wednesday moving 14.8% higher to $288.53 after Trump's victory. The stock closed above $1 trillion in market value on Friday as CEO Musk is anticipated to benefit from the president-elect's term in office.

Mln $	Revenue	Operating Income	Model 3/Y Deliveries
Q1 2020	5,985	283	76,266
Q2 2020	6,036	327	80,277
Q3 2020	8,771	809	124,318
Q4 2020	10,744	575	161,701
Q1 2021	10,389	594	182,847
Q2 2021	11,958	1,312	199,409
Q3 2021	13,757	2,004	232,102
Q4 2021	17,719	2,613	296,884
Q1 2022	18,756	3,603	295,324
Q2 2022	16,934	2,464	238,533
Q3 2022	21,454	3,688	325,158
Q4 2022	24,318	3,901	388,131
Q1 2023	23,329	2,664	412,180
Q2 2023	24,927	2,399	446,915
Q3 2023	23,350	1,764	419,074
Q4 2023	25,167	2,064	461,538
Q1 2024	21,301	1,171	369,783
Q2 2024	25,500	1,605	422,405
Q3 2024	25,182	2,717	439,975



FEDERAL RESERVE POLICY

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	6-Nov	30-Oct	23-Oct	16-Oct	3/11/20*	3/11/20
Factors adding reserves						to Nov 6
U.S. Treasury securities	4339.963	4357.825	4357.656	4357.572	2523.031	1816.932
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2265.963	2265.963	2282.088	2282.088	1371.846	894.117
Repurchase agreements	0.101	0.031	0.000	0.001	242.375	-242.274
Primary credit (Discount Window)	1.600	1.505	1.768	1.879	0.011	1.589
Bank Term Funding Program	59.758	57.831	59.717	66.833		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	2.049	2.090	2.124	2.201		
Main Street Lending Program	10.143	10.158	10.145	10.135		
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	0.151	0.157	0.163	0.159	0.058	0.093
Federal Reserve Total Assets	7045.6	7063.7	7080.7	7090.3	4360.0	2685.598
~~3-month Libor %~~ SOFR %	4.81	4.81	4.83	4.86	1.15	3.660
Factors draining reserves						
Currency in circulation	2359.810	2356.502	2355.493	2358.793	1818.957	540.853
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	840.227	847.137	817.410	814.751	372.337	467.890
Treasury credit facilities contribution	4.958	4.958	4.958	4.958		
Reverse repurchases w/others	177.871	228.946	270.839	272.071	1.325	176.546
Federal Reserve Liabilities	3790.092	3847.954	3852.216	3861.423	2580.036	1210.056
Reserve Balances (Net Liquidity)	3255.532	3215.794	3228.462	3228.838	1779.990	1475.542
Treasuries within 15 days	86.296	70.055	64.724	61.915	21.427	64.869
Treasuries 16 to 90 days	193.934	215.127	217.895	178.430	221.961	-28.027
Treasuries 91 days to 1 year	485.953	484.413	486.965	529.229	378.403	107.550
Treasuries over 1-yr to 5 years	1452.216	1467.694	1467.656	1467.618	915.101	537.115
Treasuries over 5-yrs to 10 years	593.275	592.512	592.501	592.491	327.906	265.369
Treasuries over 10-years	1528.291	1528.024	1527.915	1527.890	658.232	870.059
Note: QT starts June 1, 2022	Change	11/6/2024	6/1/2022			
U.S. Treasury securities	-1430.816	4339.963	5770.779			
Mortgage-backed securities (MBS)	-441.483	2265.963	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

The Fed met November 6-7, 2024 to consider its monetary policy. After a first 50 bps rate cut from 5.5% in September, they downshifted to a 25 bps rate cut to 4.75%. There was nothing in the press conference to suggest their September meeting forecasts will not be acted on again in the future which means one final 25 bps rate cut in December to 4.5%. In 2025, it looks like 25 bps per quarter ending at 3.5%. We would not mind for our money market fund if they stopped at 4.0% and then leave the building. They probably have other ideas as they search for the mythical level of neutral rates that does not slow the economy down or speed it up. Common sense should tell you that 3% or 4% probably makes little difference, it is only 100 bps. Cannot be that critical. The only thing different this time is homeowners like their 3% mortgages and the Fed cannot get them those rates again unless they cut rates to emergency 0.25% levels again. Powell did cut rates twice between meetings from 1.75% to 0.25% in the first days of the pandemic. In terms of finding neutral, in response to a question, Powell said there was no hurry to get there. They are seeing strong economic activity after all. Powell added, “So we think the right way to find neutral, if you will, is carefully, patiently.” Looks like no reason to go back to a 50 bps rate cut as the earlier growth scare triggered by the two-tenths jump to 4.3% unemployment on Friday, August 2, has largely disappeared.

Fed Policy-key variables					Long
	2024	2025	2026	2027	Term
Fed funds	4.4	3.4	2.9	2.9	2.9
PCE inflation	2.3	2.1	2.0	2.0	2.0
Core inflation	2.6	2.2	2.0	2.0	
Unemployed	4.4	4.4	4.3	4.2	4.2
GDP	2.0	2.0	2.0	2.0	1.8
September 2024 median Fed forecasts					

All but 7.5 bps is discounted for a 25 bps rate cut December 18. January meeting will be skipped.

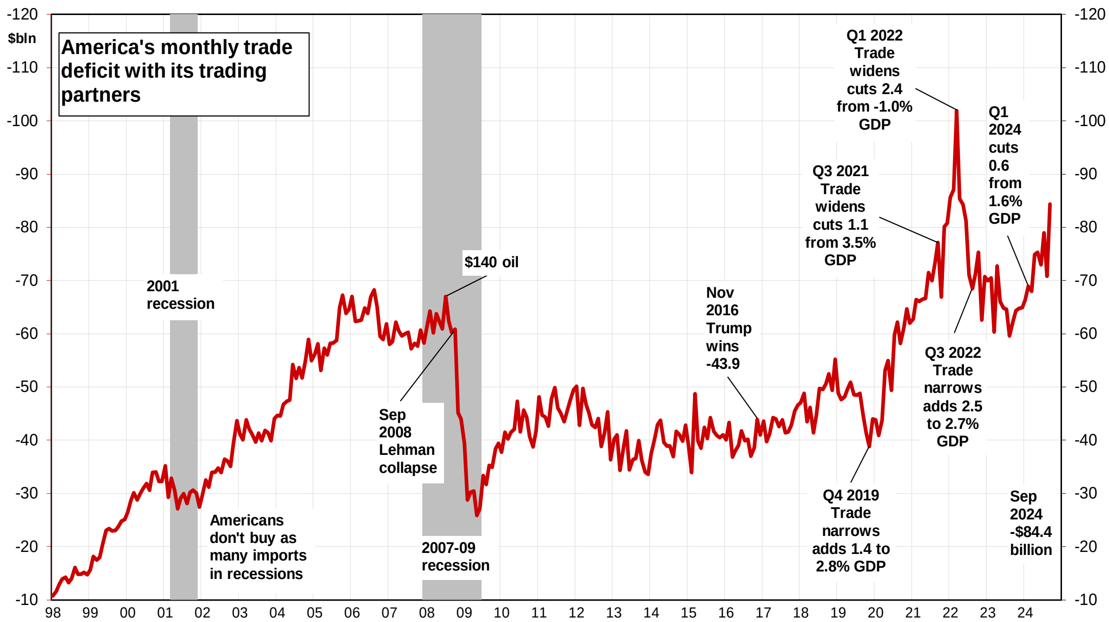
Fed funds futures call Fed policy		
Current target: November 8 -- 4.75%		
Rate+0.17	Contract	Fed decision dates
4.575	Jan 2025	Dec 18*
4.495	Feb 2025	Adds Jan 29
Last trade, not settlement price		
* Not strictly true, Jan 2025 has Jan 29 Fed date, so 2 days could be a new interest rate		

Next up: October CPI inflation report Wednesday, November 13														
Monthly	2024								2024	2023				2023
% Changes	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug
Core CPI inflation		0.3	0.3	0.2	0.1	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.2	0.3	0.2
Core PCE inflation		0.3	0.2	0.2	0.2	0.1	0.3	0.3	0.2	0.5	0.2	0.1	0.1	0.3	0.1
Core PCE YOY		2.7	2.7	2.7	2.6	2.7	2.9	3.0	2.9	3.1	3.0	3.2	3.4	3.7	3.8
Core CPI YOY		3.3	3.2	3.2	3.3	3.4	3.6	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.3

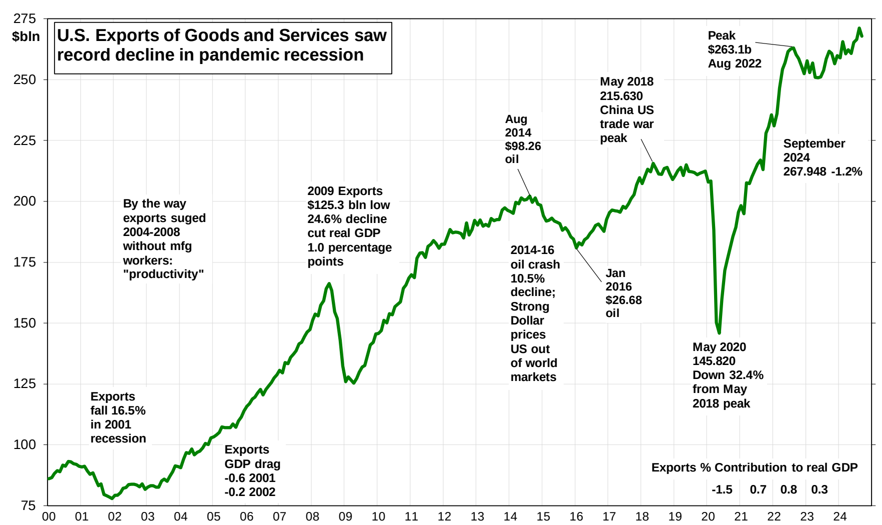
OTHER ECONOMIC NEWS

Trade deficit more red ink (Tuesday)

Breaking economy news. The September 2024 trade deficit widened to $84.4 billion from $70.8 billion in August. The goods deficit is $109.0 billion in September versus $94.8 billion in August. Imports were up and exports were down in September. Exports had been at record highs in August which is consistent with the record high in nondefense capital goods orders ex-aircraft in September. Purchasing managers say manufacturing is in a recession, but exports keep climbing.

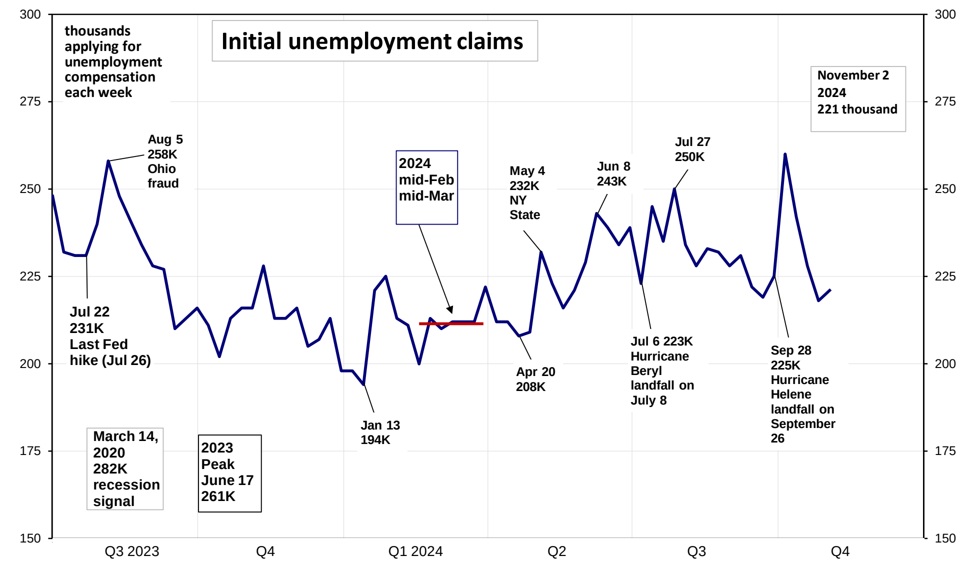


Net, net, the US trade deficit red ink soared to new heights in September and shows a dramatic worsening trend despite the volatility seen in the third quarter. Imports subtracted 1.5 percentage point from Q3 2024 2.8% real GDP growth, the most since Q1 2022, and are likely to take a toll on growth again in the current quarter. Imported goods jumped 4.0% in September, but America's reliance on imports may be coming to an end depending upon the outcome of the national elections. There were trade wars and tariffs in the first Trump administration and it appears that tariffs will be used to try to change America's industrial policy again based on the rhetoric at recent campaign rallies. Based on imports so far this year, the top two countries being targeted for tariffs and sanctions are the $378.9 billion of imports from Mexico, and China at $322.2 billion, keeping in mind total US imports this year are $2.419 trillion. Both countries are part of the problem if that is what American consumer purchases of imported goods is. Stay tuned. Story deteriorating. For now.

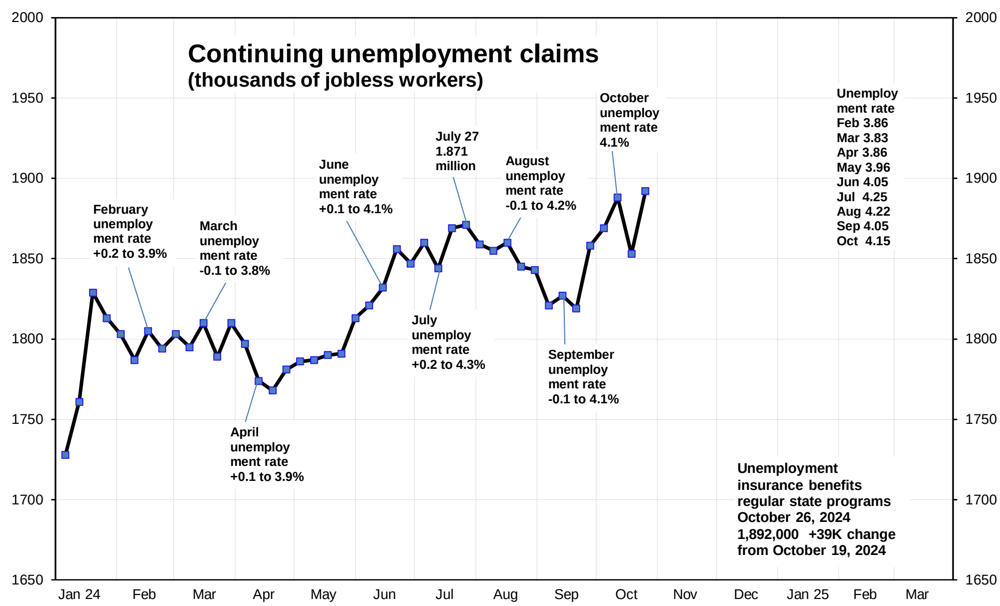


Labor market calm for now (Thursday)

Breaking economy news. First-time applications for jobless benefits rose 3K to 221K in the November 2 week. Total claims increased 39K to 1.892 million however which is a new 2024 high.



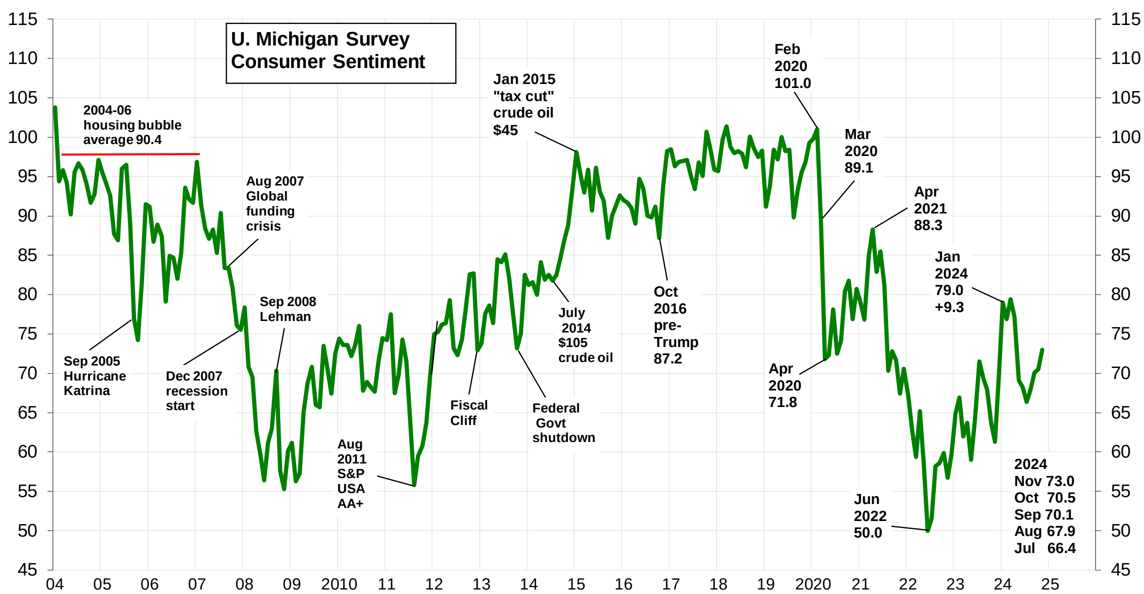
Net, net, the labor market remained calm in the final week's runup before the national elections with job layoffs at minimal levels showing an absence of stress in the overall economy. Companies exhibited an absence of worry or concern about the outlook, but that could change with the unexpected victory by Republicans likely to take policy and tax and spending initiatives in a new direction. There was a large increase in the number of unemployed Americans receiving jobless benefits, up 39K to 1.892 million in the October 26 week, but this is hard to reconcile with the jobless count behind the official 4.1% unemployment rate in October. Stay tuned. All is quiet on the jobs markets front, but that could change in a heartbeat depending on what changes will be coming down in Washington early next year. The bond market is plainly worried that potential tax cuts of various stripes and colors will not be offset by reductions in Federal government outlays. Time will tell if the rise in bond yields turns out to be right and that Washington will be unable to get its fiscal house in order with the coming change of administrations.



Michigan sentiment rising (Friday)

Breaking economy news. The University of Michigan consumer sentiment survey improved to 73.0 in November from 70.5 in October. In November 2023 it was way down at 61.3. The index is rebounding slowly from the big drop in May this year that was hard to explain. The stock market was declining in April for Iran and Israel attack reasons and Powell was concerned about inflation.

Net, net, for all the talk of consumers worrying about their personal finances and the job market and inflation, consumer sentiment was ascending to six-month highs right before the election. The cutoff on the Michigan survey was on Monday this week. Long-run business conditions are nearly the best they have been in almost four years. Today's report on the consumer shows American's concerns about the economy broadly speaking was unlikely to be the sole reason for the surprising election result. Election results where the party in power loses is often said to be the result of, "It's the economy, stupid," but consumer confidence appears to be holding up fairly well. There's talk of major changes coming down there in Washington, but ahead of the election, consumer sentiment was fairly upbeat. For now. The winds of change are coming though. Bet on it.



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