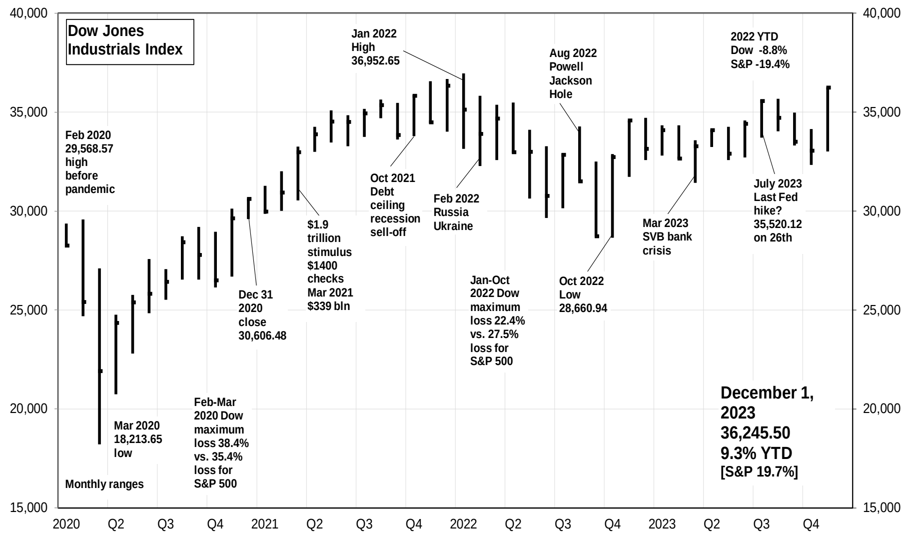
Financial Markets This Week

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

1 DECEMBER 2023

FED STOPS AND STOCKS GO UP

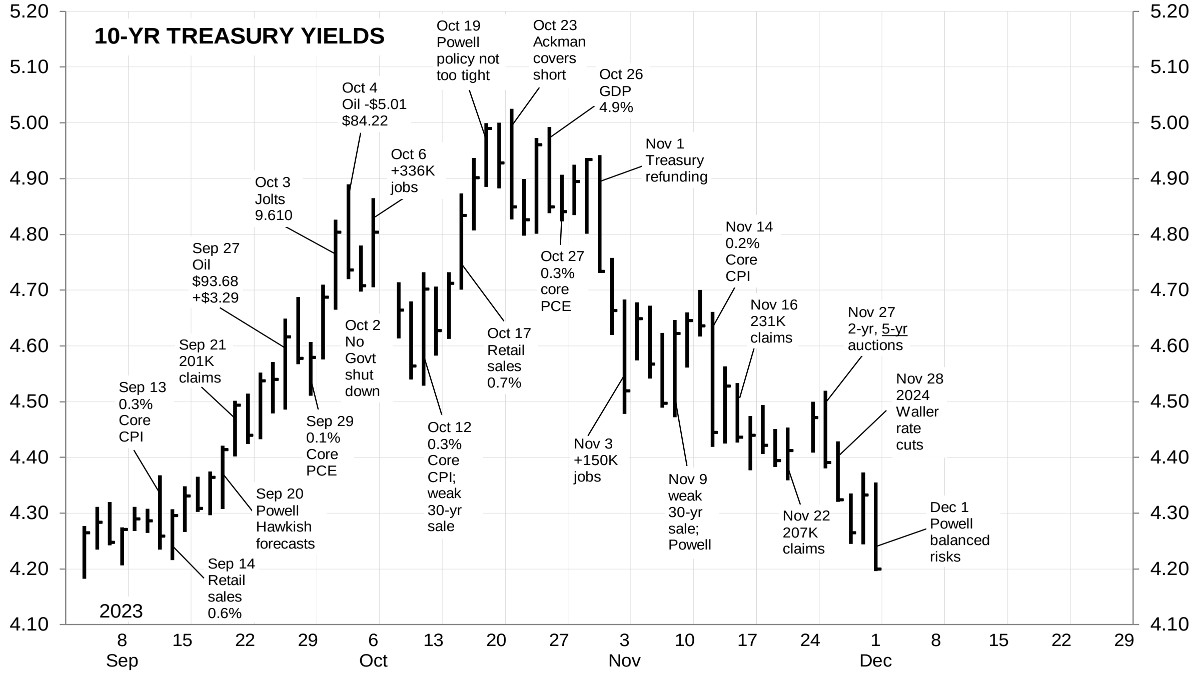
The stock market suffers as short-term interest rates look more attractive during monetary policy tightening periods. What happens when the Fed stops? The last interest rate hike was in July and while they "would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals," they have skipped the last two meetings. Maybe they are done.



Fed Rate Hikes and Stock Market Performance				
		Fed funds		
Tightening Episodes	First Hike	low-high	Last Hike	Days
2022-2023	3/16/2022	0.25-5.50	7/26/2023	497
Dow Industrials	34,063.10	4.3%	35,520.12	
2015-2018	12/16/2015	0.25-2.50	12/19/2018	1099
Dow Industrials	17,749.09	31.4%	23,323.66	
2004-2005	6/30/2004	1.00-5.25	6/29/2006	729
Dow Industrials	10,435.48	7.2%	11,190.80	
1999-2000	6/30/1999	4.75-6.50	5/16/2000	321
Dow Industrials	10,970.80	-0.3%	10,934.57	
1994-1995	2/4/1994	3.00-6.00	2/1/1995	362
Dow Industrials	3871.42	-0.6%	3847.56	

There are some caveats to just saying stocks go nowhere while the Fed hikes rates. Here is the record even if you don't know the date of the last hike in real time. It was okay to say this in the 90s. Stocks fell 0.6% from the first rate hike from 3% in February1994 to the last rate hike to 6% in February 1995. Similarly, the Fed cut rates in 1995 during the near-miss with recession, cut some more in the Global financial markets crisis in 1998. Then from June 30, 1999 to May 16, 2000 the Fed hiked rates from 4.75% to 6.5%, and stocks fell 0.3%. During the housing bubble, Dow industrials went sideways in the two years of rate hikes from 1 to 5.25% over the two year period of June 2004 to June 2006. Stocks rose 7.2% over the two years which at 3.6% per year is pretty much going nowhere. It did not work from December 2015 to December 2018: stocks jumped 31.4% or about 10% per year. It was a complicated period with the Yellen Fed lifting off from zero in December 2015 and not going with a second rate hike until a year later in December 2016. Even if you call it just a two year period of Fed hikes from December 2016 to December 2018, Dow industrials still rallied almost 10% each year. There were some reasons why stocks rallied 2015 to 2018 and while part of it was the Tax Cuts & Jobs Act with the huge corporate tax cut putting some E in the PE ratio, we think a lot of the rally was because stocks were so cheap after "going nowwhere" for 13 years from 2000 to 2012. That's right. Check it out. Ask your financial advisor. And hope you don't retire in another flat decade for stocks. It can happen. Meanwhile, focus on the current Fed policy tightening from March 2022 to so far July 2023. If the Fed is done, and you bought on July 26, 2023, you lost a quick 9% of your money, but now you are back to even.

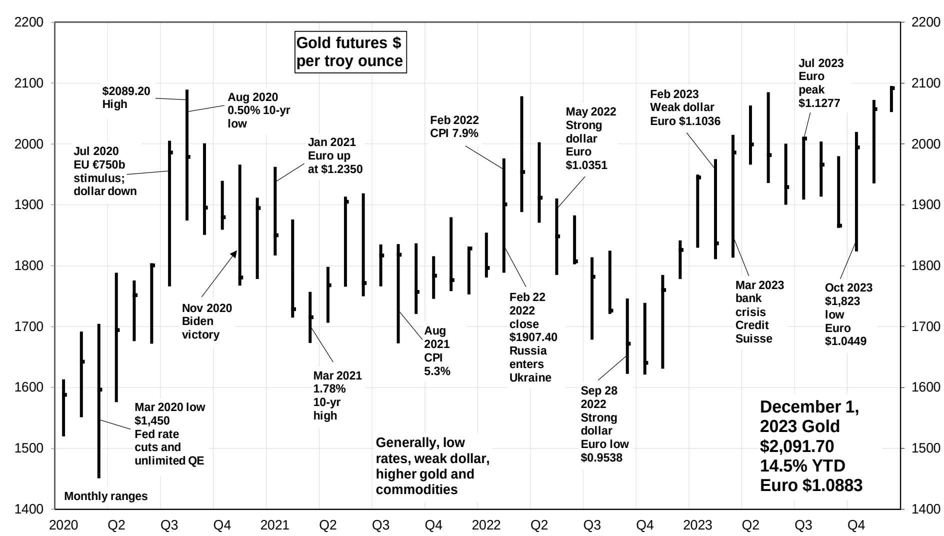
INTEREST RATES



New S&P 500 2024 closing high, +19.7% YTD, on Friday. Risks are balanced, Powell said. Core PCE inflation has been in the 2% vicinity for six months now. Fed Governor Waller said Tuesday he could see rate cuts next year if inflation reports continue going forward the same as the last six months. If inflation comes down, and the Fed funds rate stays at 5.5%, then real rates get more restrictive. 10-year yields closed 4.20% on Friday, an amazing turnaround from the 5.02% 2024 yield high on October 23. Not sure how next week's labor market data, Jolts on Tuesday, the monthly employment report on Friday, can change things. A recession finding would not be good of course. Continuing unemployment claims are moving upward in a way that looks like a possible recession and needs to be watched next Thursday as seasonal factors could be fluky. But still, lots of people on the dole.

Gold new record high

Gold futures, the continuous contract on the Comex, made a new high on Friday, but since the pandemic it has been up here a couple of times before and could not break $2,100. The dollar strength on the higher US rates story has been fading. Gold is behaving textbook style with the low of $1,823 in early October when the Euro was weak at $1.0449 and gold is moving up with the Euro at $1.0883 at Friday's close. Dollar down, commodities (and gold) up. Investors are not focused on US inflation coming down where there is less need to hedge with gold. There are geopolitical risks with gold as low as $1,823 on October 6, the weekend of the start of the Israel Hamas conflict, but these risks do not appear to be the primary driver of the gold rally.



FEDERAL RESERVE POLICY

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	29-Nov	22-Nov	15-Nov	8-Nov	3/11/20*	3/11/20
Factors adding reserves						to Nov 29
U.S. Treasury securities	4843.174	4842.936	4842.619	4872.914	2523.031	2320.143
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2447.035	2459.595	2462.931	2462.907	1371.846	1075.189
Repurchase agreements	0.003	0.000	0.076	0.000	242.375	-242.372
Primary credit (Discount Window)	2.242	2.442	2.241	2.229	0.011	2.231
Bank Term Funding Program	113.871	114.099	112.942	112.935		
FDIC Loans to banks via Fed	33.875	33.875	35.229	35.229		
Paycheck Protection Facility	3.896	4.029	4.146	4.244		
Main Street Lending Program	16.598	16.577	18.807	19.167		
Municipal Liquidity Facility	5.604	5.601	5.649	5.646		
Term Asset-Backed Facility (TALF II)	0.382	0.382	1.021	1.020		
Central bank liquidity swaps	0.234	0.237	0.287	0.236	0.058	0.176
Federal Reserve Total Assets	7846.4	7861.5	7865.8	7911.5	4360.0	3486.416
~~3-month Libor %~~ SOFR %	5.31	5.31	5.32	5.32	1.15	4.160
Factors draining reserves						
Currency in circulation	2332.634	2331.388	2327.100	2326.282	1818.957	513.677
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	753.570	693.007	669.976	763.459	372.337	381.233
Treasury credit facilities contribution	10.311	10.311	13.358	13.358		
Reverse repurchases w/others	914.187	931.604	944.241	1024.451	1.325	912.862
Federal Reserve Liabilities	4451.046	4406.431	4382.488	4551.040	2580.036	1871.010
Reserve Balances (Net Liquidity)	3395.396	3455.063	3483.325	3360.426	1779.990	1615.406
Treasuries within 15 days	59.566	65.379	74.094	61.587	21.427	38.139
Treasuries 16 to 90 days	259.110	250.158	201.695	246.781	221.961	37.149
Treasuries 91 days to 1 year	585.401	588.522	580.574	580.625	378.403	206.998
Treasuries over 1-yr to 5 years	1649.164	1649.063	1696.601	1671.662	915.101	734.063
Treasuries over 5-yrs to 10 years	784.916	784.862	784.028	807.928	327.906	457.010
Treasuries over 10-years	1505.017	1504.952	1505.626	1504.332	658.232	846.785
Note: QT starts June 1, 2022	Change	11/29/2023	6/1/2022			
U.S. Treasury securities	-927.605	4843.174	5770.779			
Mortgage-backed securities (MBS)	-260.411	2447.035	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

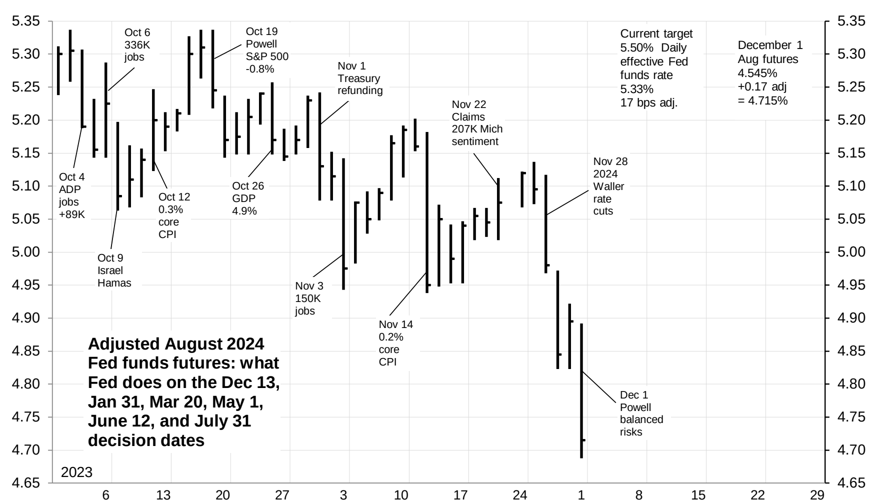
The Fed meets December 12-13, 2023 to consider its monetary policy. New York Fed President Williams said Thursday he would not speculate on the conditions it would take for the Fed to cut interest rates. But too late with Fed Governor Waller on Tuesday letting the cat out of the bag. For someone who is normally hawkish coming in from being research director at the St. Louis Fed, Waller said rate cuts were possible if inflation continued to come down next year and it had nothing to do with the Fed cutting rates to ride to the economy's rescue after falling into recession. Real rates. And if core PCE inflation comes down to the Fed's 2.6% 2024 forecast, the nominal 5.5% Fed funds rate will be too high above inflation and, and "cause the economy to fall." Maybe inflation is already there as Powell said in the opening statement today, "over the six months ending in October, core inflation ran at an annual rate of 2.5 percent." Fed funds futures read the headlines of Powell's remarks this morning and started discounting more rate cuts next year.

Fed Policy-key variables					Long
	2023	2024	2025	2026	Term
Fed funds	5.6	5.1	3.9	2.9	2.5
PCE inflation	3.3	2.5	2.2	2.0	2.0
Core inflation	3.7	2.6	2.3	2.0	
Unemployed	3.8	4.1	4.1	4.0	4.0
GDP	2.1	1.5	1.8	1.8	1.8
September 2023 median Fed forecasts					

Powell headlines 11am ET Friday
*Fed's Powell Signals Officials Are Likely Done Raising Rates
*Powell: Recent Inflation Declines Are Welcome but Must Continue
*Powell: Risks of Increasing Too Much or Too Little are 'Becoming More Balanced'

Amazing week for Fed policy expectations where roughly three rate cuts to 4.75% are seen by July 31 next year. Market view shifted starting with Waller Tuesday to Powell on Friday. Waller said if inflation continues to move in its current direction for three, four or five months, they could start cutting the Fed funds rate because inflation is lower. Nothing to do with recession.

Fed funds futures call Fed hikes	
Current target: December 1 -- 5.50%	
Rate+0.17 Contract	Fed decision dates
5.500 Jan 2024	Dec 13
5.315 Apr 2024	Jan 31, Mar 20
4.715 Aug 2024	May 1, Jun 12, Jul 31
Last trade, not settlement price	



Next up: November CPI inflation report Tuesday, December 12														
Monthly	2023								2023	2022				2022
% Changes	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug
Core CPI inflation	0.2	0.3	0.3	0.2	0.2	0.4	0.4	0.4	0.5	0.4	0.4	0.3	0.3	0.6	0.6
Core PCE inflation	0.2	0.3	0.1	0.2	0.2	0.3	0.3	0.3	0.4	0.5	0.4	0.3	0.3	0.5	0.5
Core PCE YOY	3.5	3.7	3.8	4.3	4.3	4.7	4.8	4.8	4.8	4.9	4.9	5.1	5.3	5.5	5.2
Core CPI YOY	4.0	4.1	4.3	4.7	4.8	5.3	5.5	5.6	5.5	5.6	5.7	6.0	6.3	6.6	6.3

OTHER ECONOMIC NEWS

GDP hits 5% (Wednesday)

Breaking economy news. The second look at real GDP shows third quarter growth at 5.2% now versus 4.9% in the first estimate made a month ago. Stronger growth in the rearview mirror except real consumer spending grew 3.6% now versus the stronger 4.0% pace in the first estimate. Ahead, the economic outlook is not as rosy as inventory accumulation added 1.4 percentage points to 5.2% growth in Q3 2023, and may reverse and subtract 0.7% percentage point in the third quarter. Depending on the consumer, we expect 2.5% real GDP in the fourth quarter which is still miles away from recession where the economy drops like a stone. One factor that continues to keep the economy afloat is state and local government spending which has added 0.5 percentage points to economic growth every quarter this year which is one reason the Fed's unprecedented monetary policy tightening has not taken the economy down over the cliff.

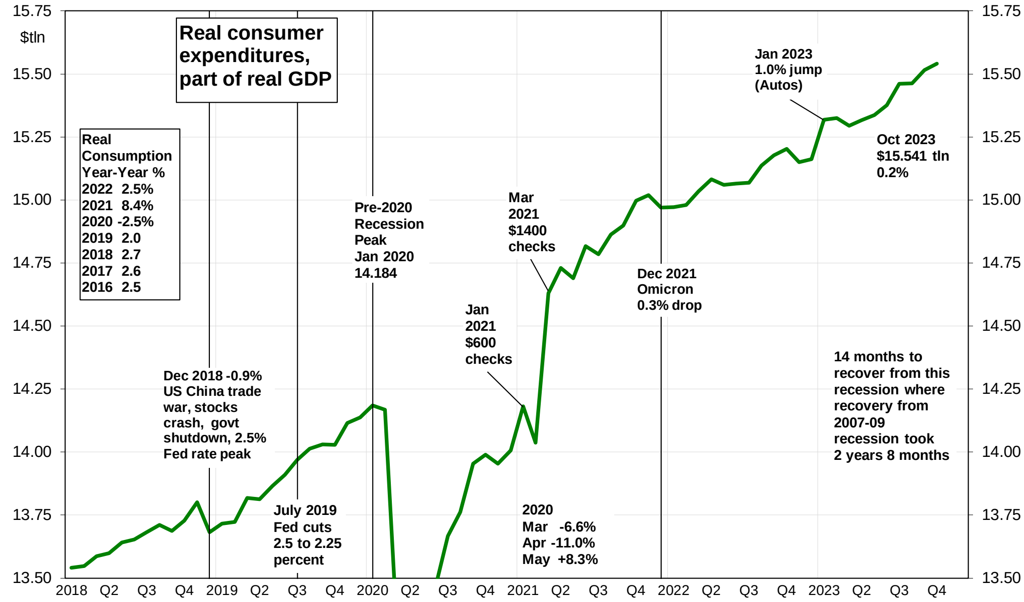
Net, net, real economic growth was even faster than we thought last quarter, but early indications point to a slowdown where there's simply not as much wind in the economy's sails in the final quarter this year. The consumer's tapped out with inflation, the resumption of student loan payments and higher consumer debt levels expected to take a toll on spending in the final quarter of the year.

The markets are rallying on the belief Fed officials are signaling they could be done and economic data showing growth is cooling will be critical in assessing the time when central bank rate hikes turn to rate cuts. The Federal Reserve needs to be careful when it comes to future policy changes as higher rates hit the economy with a lag so the worst could still be yet to come for the economy early next year. No sign of darkening skies for the economy in today's report, but growth is cooling, make no mistake about it.

	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23p	Q3 23r
REAL GDP	-0.6	2.7	2.6	2.2	2.1	4.9	5.2
REAL CONSUMPTION	2.0	1.6	1.2	3.8	0.8	4.0	3.6
CONSUMPTION	1.3	1.1	0.8	2.5	0.6	2.7	2.4
Durables	-0.1	0.1	-0.1	1.1	0.0	0.6	0.5
Nondurables	0.0	-0.3	0.1	0.1	0.1	0.5	0.5
Services	1.4	1.2	0.8	1.4	0.4	1.6	1.4
INVESTMENT	-2.1	-1.5	0.6	-1.7	0.9	1.5	1.8
Business Plant	0.0	0.0	0.2	0.8	0.5	0.1	0.2
& Equipment and	0.3	0.3	-0.3	-0.2	0.4	-0.2	-0.2
Intellectual Property	0.5	0.4	0.3	0.2	0.2	0.1	0.2
Homes	-0.7	-1.4	-1.2	-0.2	-0.1	0.2	0.2
Inventories	-2.1	-0.7	1.6	-2.2	0.0	1.3	1.4
EXPORTS	1.2	1.8	-0.4	0.8	-1.1	0.7	0.7
IMPORTS	-0.6	0.8	0.7	-0.2	1.1	-0.8	-0.7
GOVERNMENT	-0.3	0.5	0.9	0.8	0.6	0.8	0.9
Federal defense	0.0	0.0	0.3	0.1	0.1	0.3	0.3
Fed nondefense	-0.3	0.1	0.3	0.3	0.0	0.1	0.2
State and local	-0.1	0.4	0.3	0.5	0.5	0.4	0.5
Below line: Percentage point contributions to Q3 2023 5.2% real GDP							
Third estimate for Q3 is Thursday, December 21							

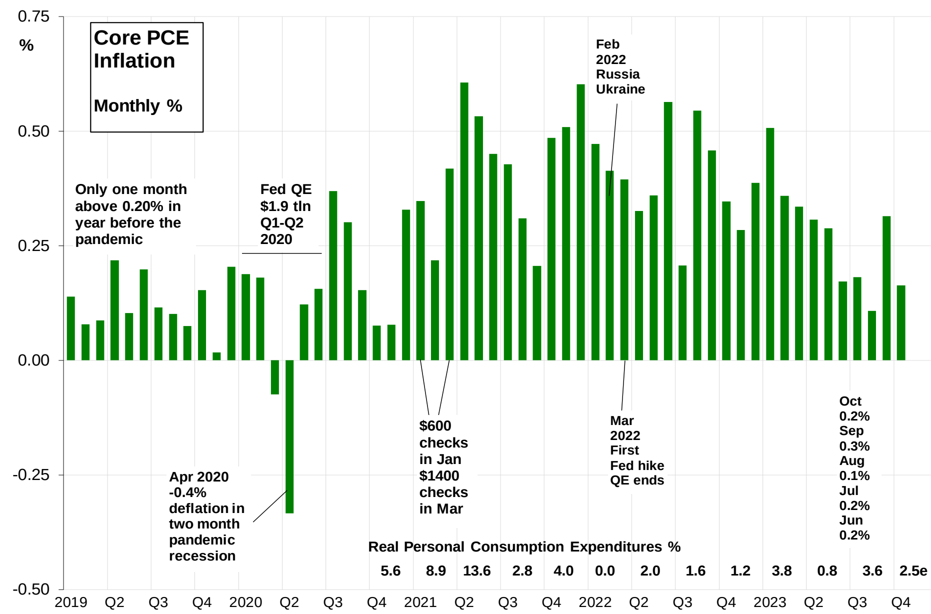
Consumer good, core consumer inflation good (Thursday)

Breaking economy news. Personal income and weekly jobless claims reports. The consumer is in rock-solid shape to keep the economic expansion going with stronger than expected real spending in October unlike the retail sales report earlier this month. Auto sales were down 1.0% in the October retail sales report and this is reflected in durable goods declining 0.3% in October, but real consumer spending still rose 0.2% in October after September's 0.3% increase. Real consumer spending is running 1.6% so far in the fourth quarter with only October data so far, which is down from 3.6% growth in Q3 2023, but still supportive of a 2.5% overall real GDP number in Q4. No recession this year with consumers spending their hearts out.

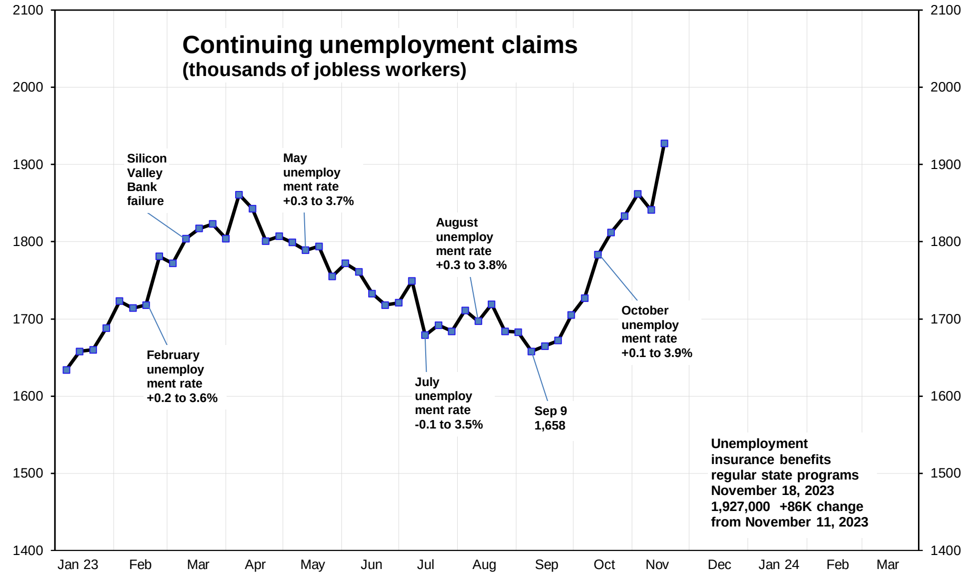


Fed officials must be counting themselves as incredibly lucky with core PCE inflation of 0.2% again this month (0.163) and it has averaged 0.2% since May. Year-on-year is 3.5% in October which is better than the Fed's 3.7% forecast for Q4 2023 and well on the way to achieving the Fed's 2.6% forecast for Q4 2024. Maybe we get rate cuts next year without a recession as the Fed forecasts say.

Meanwhile, don't forget the unemployment rate is 3.9% and the Fed's forecast of 4.1% in Q4 2024 would certainly be a recession magnitude for job losses historically. The weekly jobless claims data have been volatile in November and the total number of Americans on the unemployment rolls jumped 86K to 1.927 million in the November 18 week, an increase that was all due to the seasonal factor as the actual number fell 97.8K. We will see if this holds up in upcoming reports. For recession calls, we have a pile for yes, and for no, and for unclear, and the jobless claims data have to be put in the unclear pile or bin for the moment. The timeliest indicators are hard to analyze and the first-time jobless claims applications were just 218K in the November 25 Thanksgiving



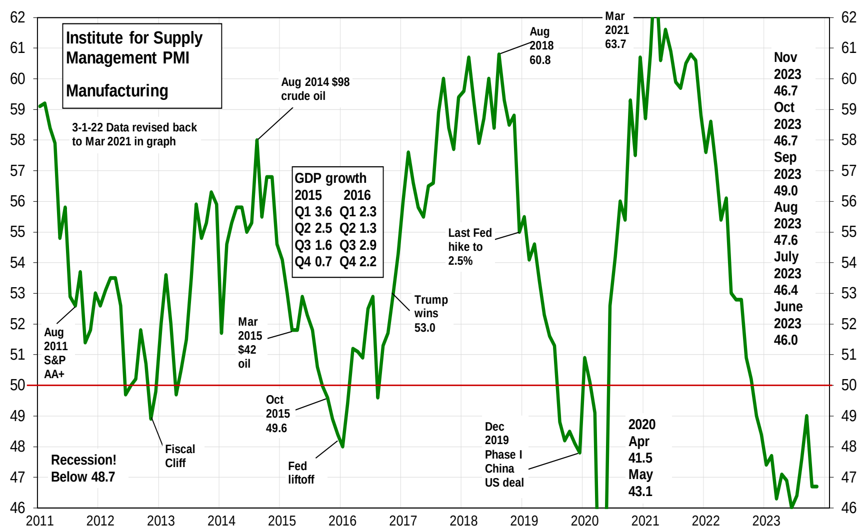
week and showing no particular labor market stress. Bosses may say they want to get costs under control, but they don't look like they are firing that many of us yet.



Net, net, consumer spending is strong right out of the gate at the start of the fourth quarter despite all the talk to the contrary, and Fed officials are keeping their fingers crossed the inflation moderation trend will continue, and bring inflation back to 2% target despite some mixed readings on the health of the labor market. We aren't sure whether the labor market is rebalancing or not, but there sure are a lot of people receiving unemployment checks in the mail. The unemployment rate of 3.9% last month may not be a fluke if the surge in continuing unemployment claims data are true. Stay tuned. Consumer spending good, consumer core inflation good, how about a new 2024 high for stocks today? Come on. Let's do it.

ISM manufacturing contracts, construction continues (Friday)

Breaking economy news. ISM manufacturing for November and construction for October. ISM manufacturing was unchanged at 46.7 in November, but employment conditions have worsened with the index at 45.8 in November down from 46.8 in October. Production had been positive at 50.4 in October but is contracting again with the index of 48.5 in November.



Total private nonresidential construction rose a slight 0.1% in October to $694.8 billion and is 22.4% higher than a year ago. It is not just the CHIPS Act effect on manufacturing construction, the biggest percentage gains anyway over the last year are 34.8% for Religious projects, and 25.7% for Educational construction. Many building categories are up double-digits the last year: Lodging 11.1%, Health care 13.2%, Power 11.6%. Higher interest rates haven't stopped construction projects yet, although this is very much a lagging economic indicator within the business cycle.

ISM manufacturing index				
	Nov	Oct 23	Sep 23	Aug 23
PMI index	46.7	46.7	49.0	47.6
Prices	49.9	45.1	43.8	48.4
Production	48.5	50.4	52.5	50.0
New orders	48.3	45.5	49.2	46.8
Supplier deliveries	46.2	47.7	46.4	48.6
Employment	45.8	46.8	51.2	48.5
Export orders	46.0	49.4	47.4	46.5

Net, net, the manufacturing sector is going nowhere fast in November according to purchasing managers with employment conditions worsening. After the slower pace of nonfarm payroll jobs in October of 150K, one wonders if you should pencil in a forecast of less than 100K in November's report due out on Friday, December 8. And in yet another indicator of recession, the Institute for Supply Management says an index reading below 48.7 means the broader US economy is in recession. Watch out below! Manufacturing activity is in decline according to purchasing managers which is hard to square with the manufacturing factory construction boom where construction rose 0.9% in October and is up a phenomenal 71.6% from year earlier levels thanks to the CHIPS Act signed in August 2022. Fixed investment in structures within the GDP accounts added 0.2 percentage points to 5.2% GDP in Q3 2023 after bigger contributions of 0.5 percentage points in Q2 2023 and 0.8 percentage points in Q1 2023. Stay tuned. Purchasing managers say the economy is back in a recession for a second month in a row and one of these days they just might end up being right.

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.