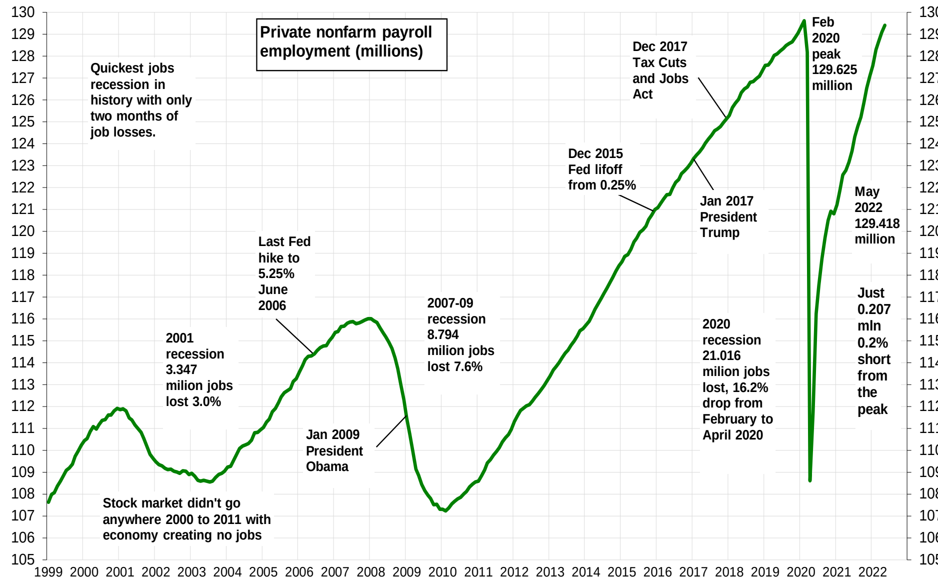
Financial Markets This Week

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

3 JUNE 2022

ECONOMY NOT SLOWING ENOUGH TO PUT THE INFLATION FIRES OUT



Breaking economy news. The monthly employment situation report for May. If Fed officials were banking on an economic slowdown to fight the fires of inflation they didn't get it in today's report. The bond market took the temperature of today's employment report and found it too hot with traders selling on the news, sending bond yields to a new high on the week. Payroll employment increased a respectable 390 thousand in May even with retail stores shedding 61 thousand positions. The unemployment rate stayed unchanged somehow even with the nation's unemployment rolls at all-time lows, and as a bonus, some labor force dropouts even decided to drop back in given the 11.4 million job openings out there in the country at the end of April.

Worker wages continue to move ever higher with those paychecks for nonsupervisory employees jumping 0.6% in May to $27.33 an hour which is 6.5% higher than last year. Fed officials may not believe in a wage-price spiral, but it is a fact that inflation won't come down if the variable hiring costs of companies don't come back down.

Monthly changes (000s)	May	Apr	Mar	Feb	Jan
Payroll employment	390	436	398	714	504
Private jobs	333	405	385	704	492
Leisure/Hospitality jobs	84	83	104	124	138
HH Employment Survey*	321	-353	736	548	1199
Unemployment rate %	3.6	3.6	3.6	3.8	4.0
Not in labor force (mln)	99.302	99.513	99.035	99.333	99.516
... and Want A Job (mln)	5.681	5.859	5.737	5.355	5.704
Average hourly earnings	$31.95	$31.85	$31.75	$31.60	$31.56
MTM % Chg	0.3	0.3	0.5	0.1	0.6
YOY % Chg	5.2	5.5	5.6	5.2	5.4

* Household (telephone) Survey of employment behind unemployment rate

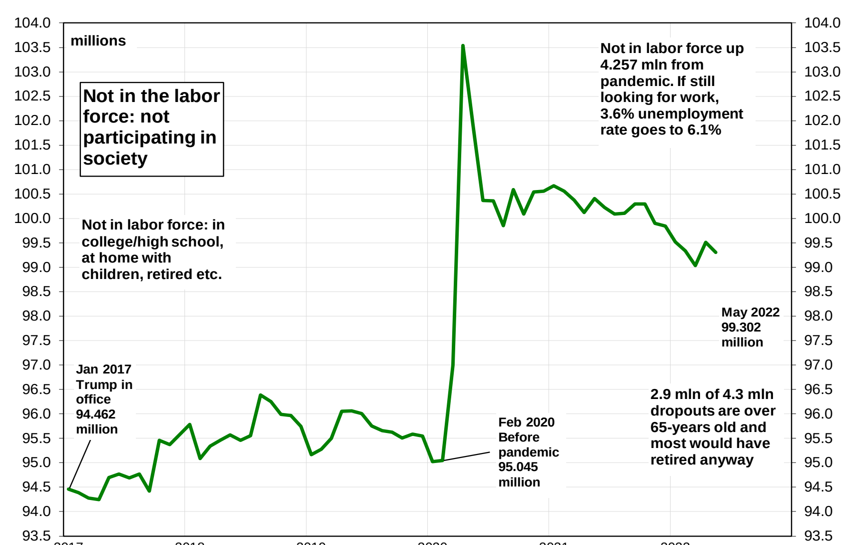
Net, net, if a storm is coming it's beyond the horizon for the labor markets today with moderate job gains and no hint of a slowdown for the economy in the near term. There are growing reports of CEOs wanting to rightsize their businesses ahead of the approaching storm, but hiring so far continues.

There are still dangers out there where the storm warnings for the economy could change to hurricane alerts if the Fed overdoes it with too many rate hikes. But the bottom line is the economy is miles away from being wrecked on the shores of recession with the economy continuing to hire workers at this fast of a clip. In recession, the payroll jobs count doesn't go up, it goes down. Hard. The Fed's work is not done, the only question left is how high they send interest rates above the neutral 2.5% level. Fed officials are human and it looks like they are close to losing patience with the persistence of inflation that wrecks all the economy's boats. For today, the economy is not slowing enough to put the inflation fire out. Bet on it. The bond market is.

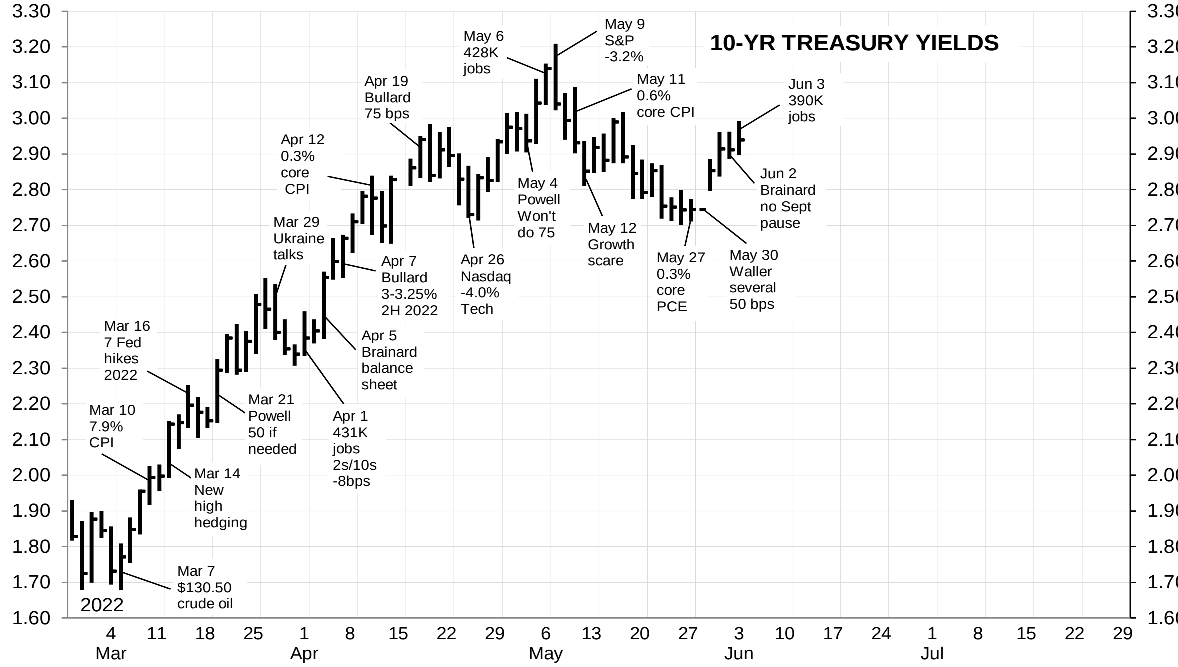
P.S. Some of the dropouts dropped back in this month so the participation rate nudged up to 62.3% from 62.2%. Participation is going down because the 58 to 76 year old baby boomers are retiring. Only politicians and Fed officials think if more workers came into the labor force, then there would be downward pressure on wages/inflation.

Payroll jobs fall from February 2020 peak as recession began

Data in thousands	May 22	Apr 22	Mar 22	27 months Feb 20 May 22	May 22	Feb 2020
Nonfarm Payroll Employment	390	436	398	-822	151,682	152,504
Total Private (ex-Govt)	333	405	385	-207	129,418	129,625
Goods-producing	59	69	85	-45	21,050	21,095
Mining	6	9	4	-64	574	639
Manufacturing	18	61	48	-17	12,768	12,785
Motor Vehicles & parts	-4	8	18	5	993	988
Construction	36	0	22	40	7,664	7,624
Private Service-providing	274	336	300	-162	108,368	108,530
Trade, transportation, utilities	1	81	7	819	28,651	27,832
Retail stores	-61	12	-23	159	15,757	15,598
General Merchandise	12	3	56	298	3,298	3,000
Food & Beverage stores	-33	3	-30	167	3,223	3,056
Transportation/warehousing	47	46	4	709	6,504	5,795
Truck transport	13	14	-3	66	1,581	1,515
Air transportation	6	4	10	33	549	516
Couriers/messengers	2	6	-7	243	1,118	875
Warehousing and storage	18	17	6	483	1,801	1,319
Utilities	1	1	-1	-8	539	547
Information	16	15	18	64	2,967	2,903
Financial	8	35	11	78	8,948	8,870
Insurance	-6	21	-4	-26	2,827	2,853
Real Estate	14	8	11	0	2,364	2,364
Commercial Banking	-4	-2	-4	-66	1,333	1,399
Securities/investments	1	5	5	55	1,019	965
Professional/business	75	49	94	821	22,214	21,393
Temp help services	19	7	8	262	3,167	2,906
Management of companies	7	-2	2	-51	2,372	2,423
Architectural/engineering	5	5	7	73	1,620	1,547
Computer systems/services	13	10	21	200	2,427	2,227
Legal services	1	3	1	16	1,179	1,163
Accounting/bookkeeping	16	8	15	72	1,102	1,030
Education and health	74	60	51	-340	24,258	24,598
Hospitals	16	7	5	-75	5,161	5,236
Educational services	33	16	13	-1	3,802	3,803
Leisure and hospitality	84	83	104	-1,345	15,638	16,983
Hotel/motels	21	23	22	-383	1,737	2,119
Eating & drinking places	46	42	58	-751	11,610	12,361
Government	57	31	13	-615	22,264	22,879
Federal ex-Post Office	9	0	0	15	2,276	2,261
State government	36	-12	-7	-50	5,260	5,310
State Govt Education	36	9	4	27	2,633	2,606
Local government	16	21	14	-584	14,124	14,708
Local Govt Education	14	15	12	-308	7,757	8,064



INTEREST RATES

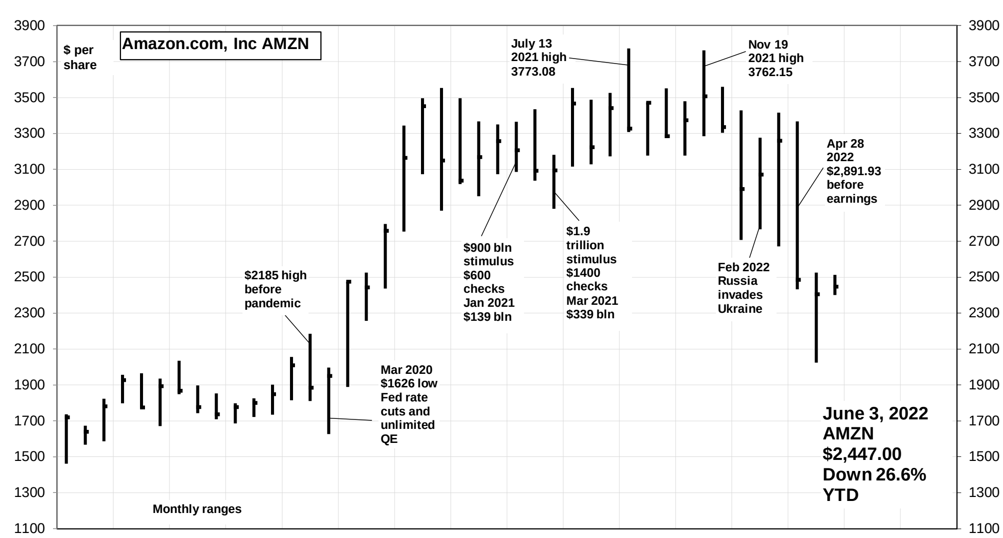


Bond yields crept higher all week long. More 50 bps rate hikes, no rest for the weary until the Fed gets rates to 2.5% neutral, and stronger than expected economic data that means for the market anyway that the Fed has to keep going. 10-year yields closed 2.94% up 20 bps from 2.745% last Friday. The ISM manufacturing survey was expected to fall but rose to 56.1 in May from 55.5 in April (the survey said employment was contracting but Friday's jobs report said +18K mfg jobs). Nonfarm payroll jobs were 390K and bonds fell immediately. After rallying 6.6% last week, the S&P 500 fell 1.2% this week. Everyone is waiting for the economy to slow so the Fed will pause. A Musk email Friday said there would be a 10% cut of employees; Tesla fell 9.2% to $703.92—peak was $1,243.49 last November.

Amazon AMZN down 26.6% YTD

The stock was trading a little below $2,900 on April 28 before first quarter earnings. From last year's record high in July, the stock was down as much as 46.3% at the worst point last month. Earnings were $3.669 billion, but were negative after accounting for AWS operating income of $6.518 billion. Without AWS, operating income has been negative for three straight quarters. Net sales were down to $116.4 billion in Q1 2022, about normal after the holidays. Amazon expects sales $116 to $121 billion in Q2 2022 assuming Prime Day in Q3.

S&P 500 Weights	
Top 6: 22% of S&P	
6.64	AAPL
5.83	MSFT
3.11	AMZN
1.84	TSLA
1.63	Berkshire
2.00	GOOGL
1.85	GOOG
22.90	Top 6



FEDERAL RESERVE POLICY

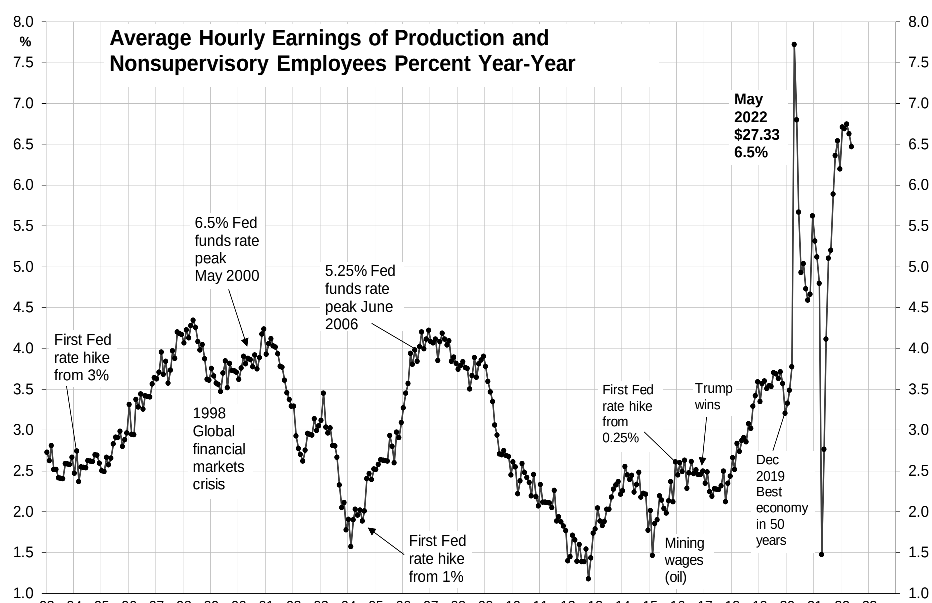
Selected Fed assets and liabilities					March 11
Fed H.4.1 statistical release					2020**
billions, Wednesday data	1-Jun	25-May	18-May	11-May	pre-Covid
Factors adding reserves					
U.S. Treasury securities	5770.779	5769.417	5768.021	5766.625	2523.031
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347
Mortgage-backed securities (MBS)	2707.446	2707.446	2733.823	2715.021	1371.846
Repurchase agreements	0.000	0.000	0.000	0.000	242.375
Primary credit (Discount Window)	0.870	0.913	0.856	0.834	0.011
Paycheck Protection Facility	19.792	20.204	20.537	20.929	
Corporate Credit Facility (CCF)	0.000	0.000	0.000	0.000	
Municipal Liquidity Facility	5.536	5.535	6.661	6.660	
Main Street Lending Program	26.676	26.665	28.438	28.651	
Term Asset-Backed Facility (TALF II)	2.195	2.288	2.466	2.466	
Central bank liquidity swaps	0.183	0.209	0.219	0.222	0.058
Federal Reserve Assets	8964.6	8963.8	8995.5	8991.6	4360.0
~~3-month Libor %~~ SOFR %	0.80	0.78	0.79	0.78	1.15
Factors draining reserves					
Currency in circulation	2280.223	2275.926	2273.025	2273.743	1818.957
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	780.575	801.714	866.726	919.331	372.337
Treasury credit facilities contribution	17.940	17.940	21.258	21.258	
Reverse repurchases w/others	1965.015	1995.750	1973.373	1876.119	1.325
Reserve Balances (Net Liquidity)	3357.395	3315.018	3297.142	3295.680	1779.990
Treasuries within 15 days	67.188	74.558	82.052	125.895	21.427
Treasuries 16 to 90 days	331.056	349.105	346.689	286.505	221.961
Treasuries 91 days to 1 year	833.614	774.087	768.924	802.274	378.403
Treasuries over 1-yr to 5 years	2083.210	2117.024	2116.508	2123.737	915.101
Treasuries over 5-yrs to 10 years	1026.609	1028.423	1027.982	1018.099	327.906
Treasuries over 10-years	1429.102	1426.220	1425.865	1410.114	658.232

**March 11, 2020 start of coronavirus lockdown of country

The Fed meets on June 14-15, 2022 to consider its monetary policy. It would be a shock if they did not hike 50 bps on June 15, and another 50 bps on July 27 as well to put the Fed funds rate at 2.0% in August 2022. Maybe put another 50 bps on the table for the September 20-21 meeting after this week's news: sounds like a majority might want to front-load rates until they get to neutral which is a 2.5% Fed funds rate and the sooner they get to neutral the better. Expeditiously as the Fed Chair called it.

Fed Governor Waller speaking 11am ET Monday mentioned he supported tightening another 50 bps for "several" meetings, superexpeditiously, or more than just the two 50 bps hikes on the table in June and July. On Thursday, Fed Vice Chair Brainard gave an interview on CNBC where it "was very hard to see the case" for a pause in September. Stocks fell to the low on the day although were unable to break Wednesday's low. For all we know stocks like a front-loading Fed policy now. For actual September Fed meeting rate hike odds, we can use the August and October Fed funds futures contracts. Friday, May 27 there was a 35 bps difference between August and October, 39.5 bps Tuesday after Waller, 41 bps on Wednesday after nobody, and 41 bps at Thursday's close after Brainard and before jobs report Friday. We guess Fed funds futures traders didn't read the Brainard stories on the wire about no pause, although she said 25 or 50 what's the difference, we mean, they will be data dependent on whether more or less is needed still in September.

Got the wages side of the wage-price spiral



On Friday after 390K jobs, the August-October Fed funds futures spread settled at 41.5 bps. At the end of the day, not completely pricing in 50 bps on September 21 where last Friday it was 35 bps. 37.5 means you can toss a coin on odds of whether September is 25 or 50 bps. Brainard also mentioned QT was worth two or three rate hikes. The only way to measure that is by looking at 10-year yields which move for a variety of reasons: the biggest reason for bond yields moving up currently is the guessing game on whether the Fed goes above neutral to 3.5% or higher to 5.25% like it did in the housing bubble economy in 2006. QT started June 1 with $5.770 trillion Treasuries on the balance sheet. Stay tuned.

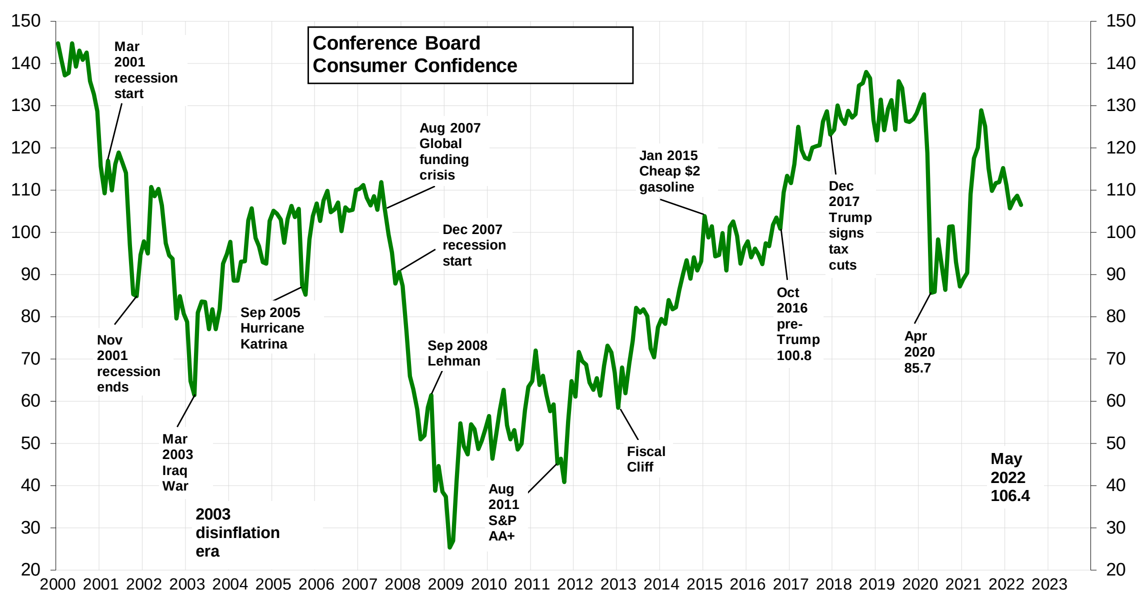
OTHER ECONOMIC NEWS

Consumer isn't confident they can afford a place to call home (Tuesday)

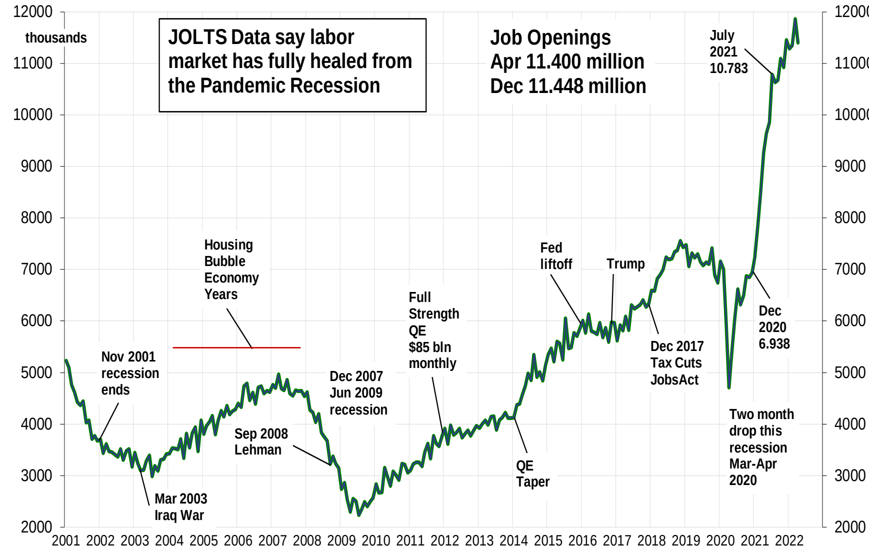
Breaking economy news. The Conference Board survey of consumer confidence fell to 106.4 in May from 108.6 in April. Consumer confidence is sliding in part due to housing affordability where home prices continue to rise roughly 20 percent above prior year levels. The labor market hasn't cracked yet with the Fed trying to whip inflation now with aggressive 50 bps rate hikes, but fewer consumers say jobs are plentiful with a reading of 51.8% in May down from 54.8% in April, and 12.5% say jobs are actually hard to get versus 10.1% the month before. There is still a mixed reading between the competing surveys of consumer attitudes from the Conference Board and the University of Michigan survey, where the latter survey's depressed readings are at levels that are rarely seen outside of economic recessions.

Net, net, a sharp change in the public's perception of the labor market is starting to dampen consumer confidence. We believe confidence is also down because it is increasingly more difficult to find a home that average Amercians can afford as the Fed's rate hikes have done nothing to stop the out of control housing inflation. The consumer isn't confident they can afford a place to call home that is for sure.

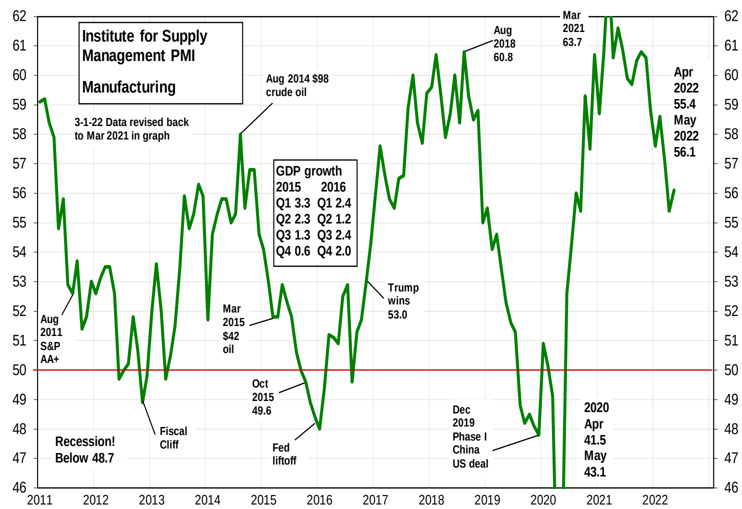
The house is on fire literally from inflation where the Fed's belt-tightening is doing nothing to stop the housing bubble from getting bigger and bigger. Home valuations rise steadily in the long run, but if you buy at the wrong time before the bubble bursts, you could be under water in your real estate investment for years or even a decade. It's a tricky time for home buyers and their continued caution could likely slow the overall economy later this year. Stay tuned. Story developing.



Too many jobs, too much factory production, Fed please try harder (Wednesday)



Breaking economy news. Too many jobs, too much opportunity for Americans to better their lives this month, so Fed officials will have to aim their anti-inflation measures better in order to achieve an economic slowdown. 11.400 million jobs wanted by employers at the end of April, and March was revised to a new record high of 11.855 million where a month ago the count was 11.549 million. Guess it looks like 50 bps rate hikes will be needed for several meetings now as one Fed governor said Monday when the market was on holiday.

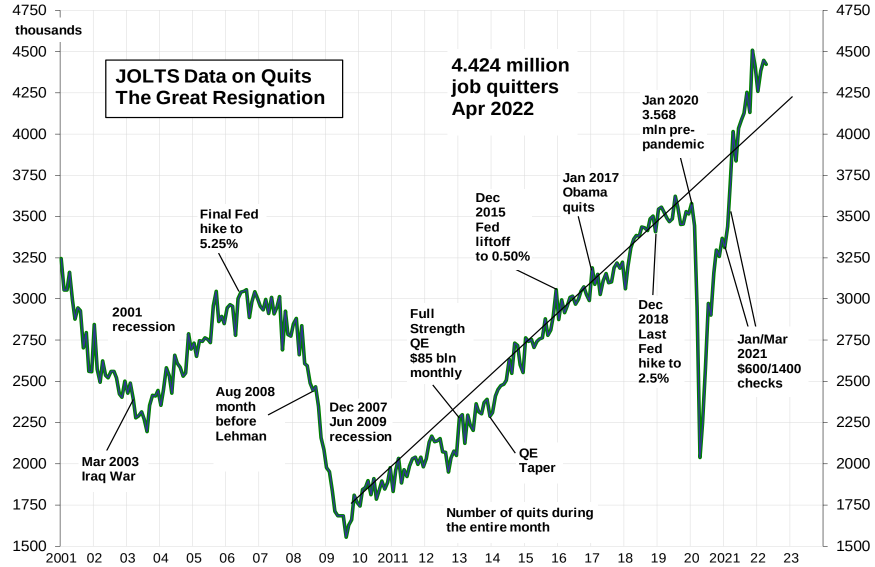


Don't look to factories to slow down in the months ahead. The ISM manufacturing index bumped back up to 56.1 in May from 55.4 in April. While the index is down from the pandemic recovery highs, factory output is still expanding as long as the index is above 50. Every industry is growing except for Furniture and related products which is decreasing. Maybe the weakness is housing related with home sales down, although furniture prices are through the roof and maybe there is some need for more output from the American furniture industry which has lost its share of the market dramatically the last two decades due to cheaper imports. New orders were strong and employment is suddenly in decline at 49.6 in May from 50.9 in April. We will find out on Friday with the release of the May Employment Situation report from the BLS. We guess it is all relative because the Jolts data this morning show manufacturers have posted 996 thousand job openings at the end of April up from 877 thousand in March. Doesn't sound like hiring at factories is in decline unless it is from the Musk workers told to go pretend to work somewhere else. We continue to work from home. Net, net, the jury is out on whether the Biden administration can take on inflation without sacrificing the employment gains made during the recovery from the pandemic even if inflation is really the Fed's job. Today's job openings report and the ISM manufacturing survey show the economy is not slowing appreciably and the labor market remains very, very strong with over two jobs

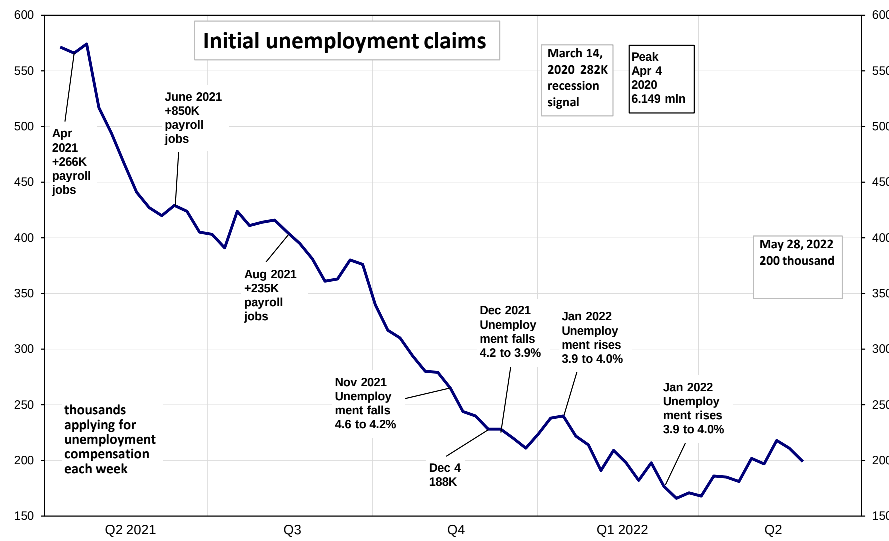
ISM manufacturing index

	May 22	Apr 22	Mar 22	Feb 22
PMI index	56.1	55.4	57.1	58.6
Prices	82.2	84.6	87.1	75.6
Production	54.2	53.6	54.5	58.5
New orders	55.1	53.5	53.8	61.7
Supplier deliveries	65.7	67.2	65.4	66.1
Employment	49.6	50.9	56.3	52.9
Export orders	52.9	52.7	53.2	57.1

available for the 5.941 million unemployed in April. Job openings are on the front lines of the Fed's inflation fight. Powell said while it is not easy to do, his tightening policies are meant to slow demand in the economy to the point where job openings move down "substantially." Maybe Powell could be more direct and ask companies to stop hiring. The bottom line is there are too many jobs, too much factory production, Fed please try harder.



Thursday Jobless claims were somewhat elevated in the May 19 week at 218 thousand, but have now fallen back two weeks in a row and are lower now at 200 thousand in the May 28 week. A widely-watched private nonfarm payroll survey estimates job creation has slowed to 128 thousand in May where the monthly payroll jobs estimate due Friday is about 300 thousand. The labor market may be cooling or at least it is not creating as many new opportunities for the unemployed, but the only industries seeing a decline in employment are construction and information which is understandable with Fed rate hikes hitting the housing sector and social media companies doing some layoffs.



Net, net, job gains across the country are slowing, but few workers are actually losing their jobs. This isn't a soft-landing or a hard-landing for the economy yet. No sign of company layoffs means the labor market isn't loosening up as much as Fed officials were hoping. Monetary policy tightening works by curbing economic demand, but the labor market is still going great guns and there is no diminution in the demand for more workers. There are millions of help-wanted signs posted all across the country so the Federal Reserve's job is not done yet and interest rates will continue to be front-loaded until the economy slows back down and inflation falls. Jobless claims were higher a couple weeks ago stoking some fears that the economy had suddenly hit a soft patch, but today's data indicate that a storm is not brewing in the labor markets. Quite the opposite, with the drop in the total number of people receiving unemployment compensation indicating the unemployment rate could drop in tomorrow's monthly report to a new record low. The Fed's job is not finished yet, not by a long shot.

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.