

Financial Markets This Week

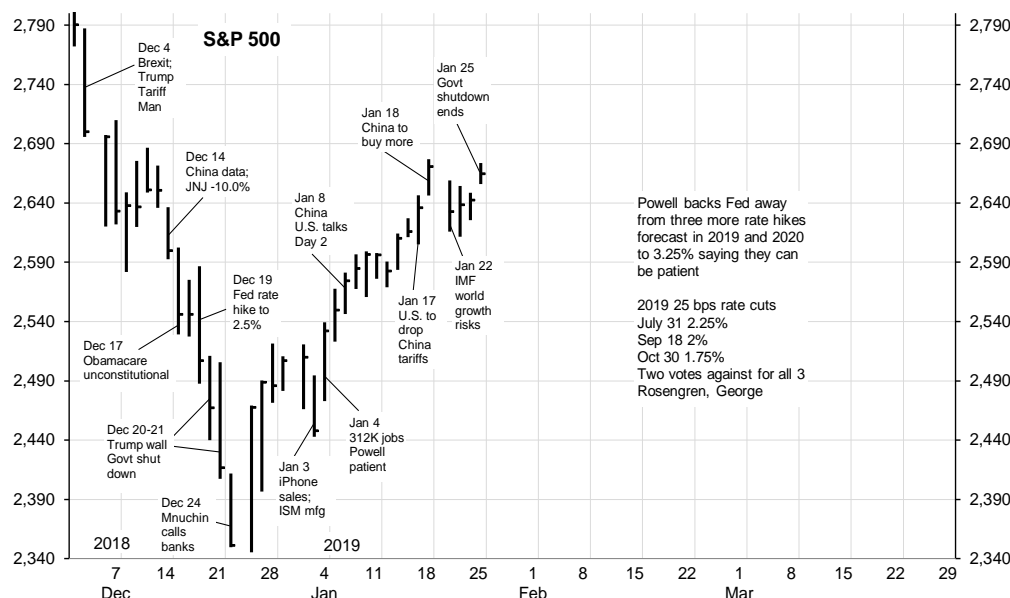
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THE LAST TIME I CUT RATES

The latest FOMC meeting transcripts were released for 2018 now, which is Powell's first year as Fed Chair. We can read what he said keeping in mind he had been a Fed Governor since May 2012, and he did hold a press conference after each meeting in 2018 and now of course. But the

transcript can provide less guarded comments and it is a good time to review the changeover from rate hikes to rate cuts that occurred from 2018 to 2019. It might happen again.



The Committee was raising rates at a pace of four 25 bps hikes per year in 2018 with the Trump administration complaining every step of the way. At the September 2018 meeting they hiked 25 bps to 2.25% and forecast 3.25% at the end of 2019 and 3.5% at the end of 2020; slowing down as they no longer saw a Fed funds rate of 2.25% as being accommodative at that September 2018 meeting. While they did hike rates 25 bps further to 2.5% at the December 2018 meeting, there was financial markets turbulence and they used the word “patient” a lot in the transcript, so they took one rate hike away, but still wanted to tighten with a 3.0% rate at the end of 2019 and 3.25% at the end of 2020.

Powell December 19, 2018 meeting
If the downside risks do not become realities and the data come in roughly as expected, I judge that some further gradual increases in the target range will be appropriate. If we do raise the federal funds rate today, that will be our ninth rate increase over three years. In addition, the balance sheet has declined materially, and that process will accelerate next year with another \$500 billion in runoff. Taken together, all of this has materially shifted the stance of monetary policy. With growth expected to decline to closer to trend next year, we can afford to be patient about further policy firming, especially in an environment in which inflation is still muted.

Markets had trouble with the Fed rate hikes, pushing up bond yields to a peak of 3.26% on October 9, 2018. There were trade jitters with Trump's “I am a Tariff Man” tweet on December 4, where the S&P 500 fell 3.2% that day. So there was some financial market turbulence, but the S&P 500 had only fallen as much as 14.0% from all-time highs, at the December 18 close, the night before the final

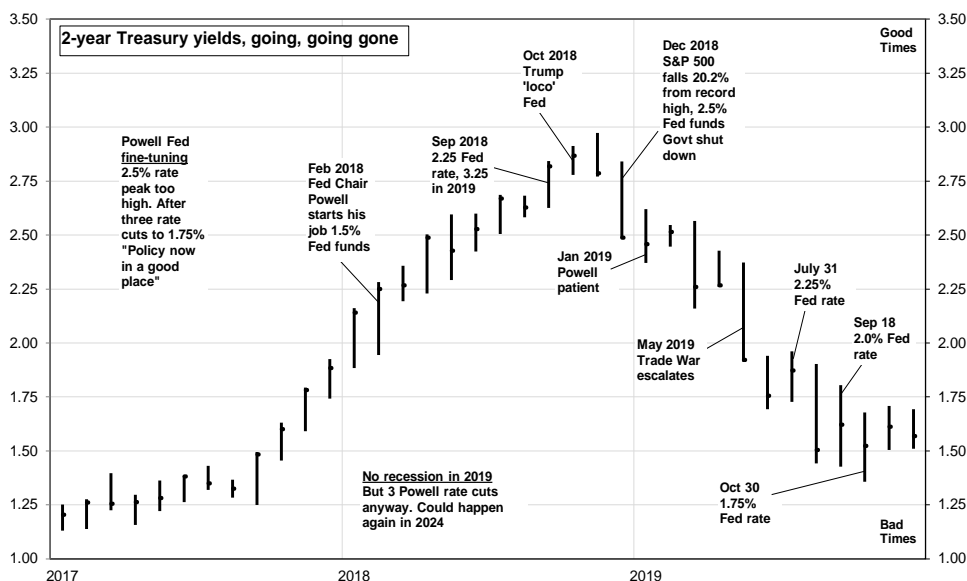
day of the Fed meeting and Powell's press conference. The market made new lows after the Fed's final 25 bps rate hike to 2.5% and kept falling straight down through the close on Christmas Eve, December 24, 2018. The total loss through December 26 (high-low from September 21 peak) was 20.2%, where a 20% loss is always one of recession-magnitude.

Powell did say in the transcripts they could be patient at the December 18-19, 2018 meeting about raising rates further, and the word "patient" was used frequently by various meeting participants. Powell also mentioned it briefly in the press conference, but "patient" did not mean stop the rate hikes. It was Powell's January

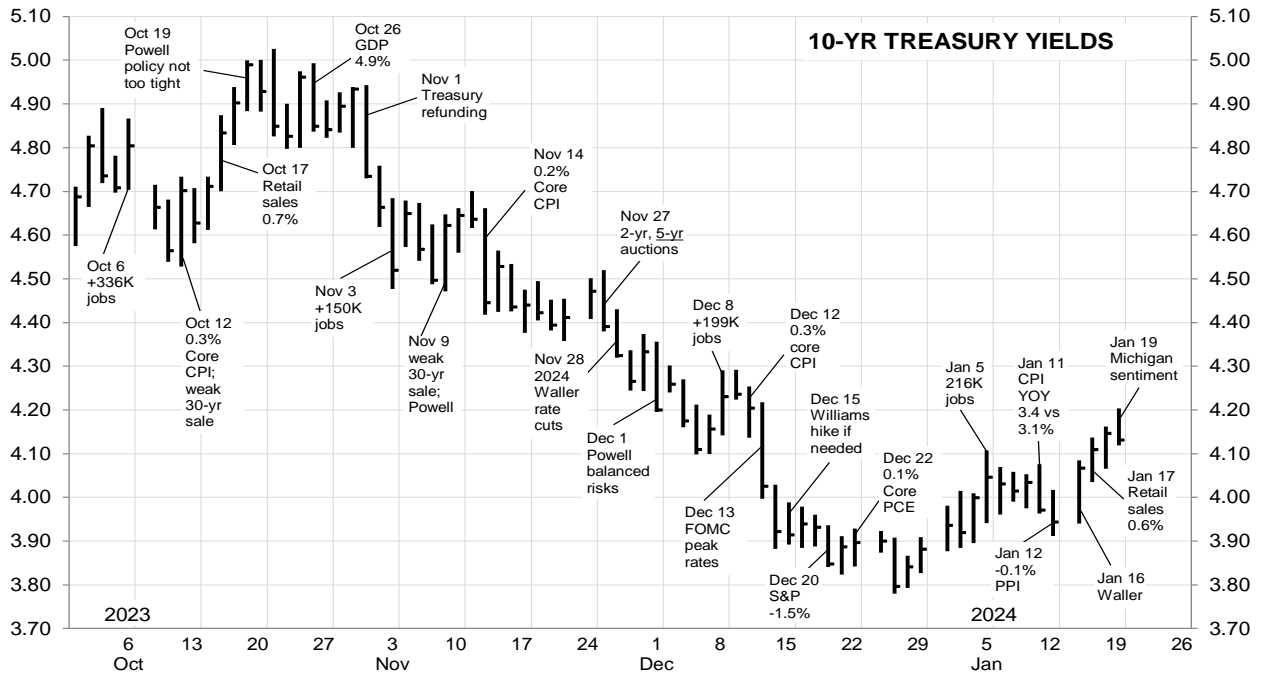
4, 2019 use of "patient" that got the market excited, especially when he also said QT could be up for discussion as well, and the stock market always loves QE, or in this case would like to see QT ended.

Looking back, the whole 2019 episode was a perfect example of unnecessary central bank monetary policy fine-tuning at its worst. First patient on the need for more rate hikes then impatient on downside economic risks, moving rates down from 2.5% like they were too restrictive, a noose around the economy's neck. 2.5% is not tight money now with the Fed funds rate at 5.5%... 2.5% should be the minimum risk-free rate that an economy needs to be successful. In early 2012 under Bernanke the first neutral rate was thought to be 4.25% and the December 2023 Fed forecasts say it is 2.5%. Unless the economy isn't normal, like in a recession and millions of unemployed are without a paycheck, there is no reason to send interest rates substantially lower. The country would be better served if Fed officials quit changing rates up and down by such a large magnitude. Inflation was a worry, 5.5% interest rates were the result. Okay, plenty of risks. But do not lower the boom on rates again and pretend a healthy economy needs significantly lower rates, specifically, that Fed forecast for 3% rates at the end of 2026. Get rid of it. Too low.

Market futures talked the Fed into rate cuts in 2019, and are doing the same thing in 2024. January 2025 Fed funds futures say rates will come down almost 150 bps from 5.5% to 4.13% by the final Fed meeting of 2024. Stay tuned. If you give the markets an inch, they will take a mile. In 2019, the Fed cut rates without severe downside risks to the economy like a recession with massive job losses. The market is putting pressure on the Fed by discounting nearly 6 rate cuts this year, but it is just following the Fed speak on real rates, where interest rates must move down with inflation to keep the real cost of borrowing from moving too high. Stay tuned. When the Fed cut rates in 2019, the press statements kept referring to uncertainties to the outlook even if they thought sustained expansion of economic activity and inflation near the 2% target was the most likely scenario. We will have to wait for the 2019 transcripts to be released early in January 2025 to get unscripted, and more detailed comments about the outlook uncertainties because the three Powell rate cuts were not without dissent in 2019.



INTEREST RATES

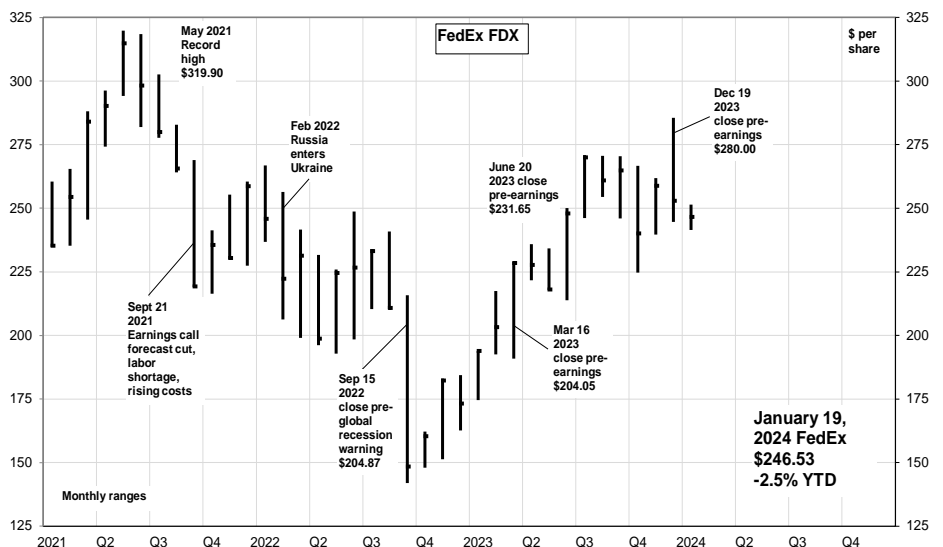


The [S&P 500 on Friday broke the record high](#) from January 2022 is the news, coming back from a large 27.5% peak-trough loss, as economists would call it, of 27.5%. Recession-magnitude minus the recession. On Friday, Michigan consumer sentiment jumped, and there was an options expiration. Next time stocks fall 27.5%, buy the market. Given Friday's close, it is hard to look back like anything else mattered. Fed Governor Waller likes to move the market as his mentor former St. Louis Fed President Bullard used to, the "no reason to move as quickly, cut as rapidly as in past" headline sending bond yields up from 4% on Tuesday at the start of the holiday-shortened week. Bonds hit the 4.20% yield high for the week on Friday after Michigan sentiment jumped at 10am ET, but came back down to close on Friday at 4.13%. Futures odds are still 50/50 on a March meeting Fed rate cut.

FedEx (FDX) down 2.5% YTD

Stock was \$280 before Q2 2024 earnings on Tuesday, December 19, the price crashed 12.1% the next day and has yet to recover meaningfully. The company had a stay-at-home covid boost with strong demand, residential deliveries surged, they raised prices. The stock peaked at \$319.90 in March 2021. FedEx Ground still holding up after getting UPS business after the strike. Company cut 2024 revenue forecast to low single-digit decline from prior flat expectation.

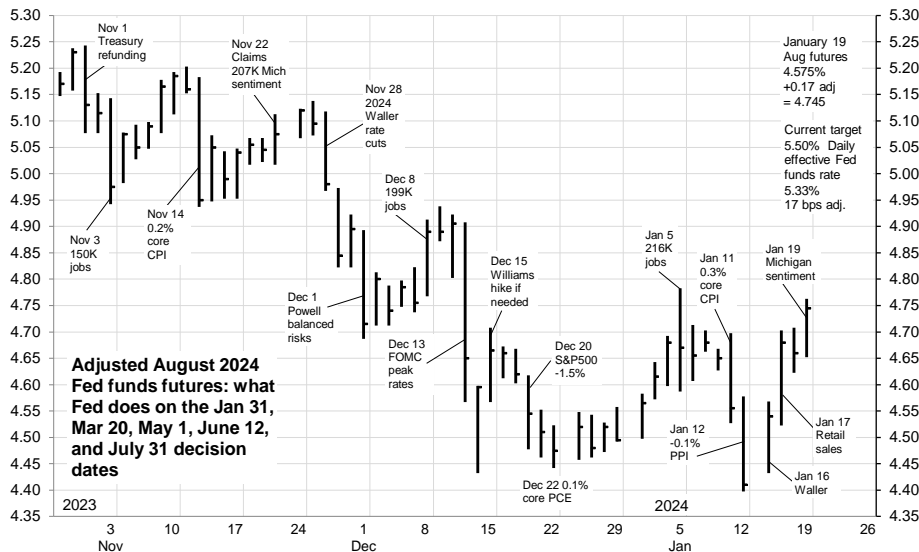
Operating Income	FedEx	FedEx	FedEx	Other;
Bln \$	Total	Express	Ground	Freight
11.30.23	1.276	0.137	0.900	0.487
8.31.23	1.485	0.205	1.103	0.481
11.30.22	1.176	0.341	0.598	0.440
FY 2023	4.912	1.064	3.140	1.925
FY 2022	6.245	2.922	2.642	1.663
FY 2021	5.857	2.810	3.193	1.005
FY 2020	2.417	0.996	2.014	0.580



FEDERAL RESERVE POLICY

The Fed meets January 30-31, 2024 to consider its monetary policy. With so much going on, hard to believe this do-nothing meeting is coming up. Fed Governor Waller said in a [virtual speech](#) at 11am ET Tuesday that he did not expect the Fed would be cutting rates as quickly as they have done historically. That may be for a technical reason as most of the rate cuts since Greenspan in 2001 have slashed the policy rate at great speed because of mounting job losses seen in recessions or during the pandemic. No recession is seen, the Fed is just cutting rates as inflation comes down. Maybe Powell will emphasize that at the press conference on Wednesday, January 31 at 230pm ET. Waller also cited private forecasts for core PCE inflation due out next week on Friday, July 26 at 830am ET, saying 0.2% was likely. Core PCE inflation year-to-year is 3.2% in November, and 0.2% means it could be 2.9 to 3.0 percent in December... not enough to start the ball rolling on serious rate cut discussions. But then again, Powell seems to like lower interest rates if there is no inflation, taking 2019 as an example.

Selected Fed assets and liabilities						Change from 3/11/20 to Jan 17
Fed H.4.1 statistical release	17-Jan	10-Jan	3-Jan	27-Dec	3/11/20*	
Factors adding reserves						
U.S. Treasury securities	4724.025	4751.515	4753.330	4790.547	2523.031	2200.994
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2431.710	2431.773	2431.773	2431.773	1371.846	1059.864
Repurchase agreements	0.000	0.000	0.000	0.000	242.375	-242.375
Primary credit (Discount Window)	2.295	2.106	2.159	2.492	0.011	2.284
Bank Term Funding Program	161.501	147.694	141.202	135.805		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	3.364	3.413	3.447	3.467		
Main Street Lending Program	15.375	16.192	16.173	16.156		
Municipal Liquidity Facility	0.214	0.214	0.213	0.213		
Term Asset-Backed Facility (TALF II)	0.046	0.046	0.046	0.046		
Central bank liquidity swaps	0.216	0.223	1.357	1.359	0.058	0.158
Federal Reserve Total Assets	7724.6	7737.5	7731.4	7763.5	4360.0	3364.581
3-month-Libor%- SOFR %	5.32	5.31	5.39	5.39	1.15	4.170
Factors draining reserves						
Currency in circulation	2335.971	2340.501	2348.237	2334.610	1818.957	517.014
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	773.544	727.856	743.464	713.064	372.337	401.207
Treasury credit facilities contribution	7.438	7.438	7.438	7.438		
Reverse repurchases w/others	590.191	679.961	719.897	818.869	1.325	588.866
Federal Reserve Liabilities	4132.281	4200.134	4271.980	4329.295	2580.036	1552.245
Reserve Balances (Net Liquidity)	3592.326	3537.383	3459.408	3434.213	1779.990	1812.336
Treasuries within 15 days	67.690	59.873	57.224	65.252	21.427	46.263
Treasuries 16 to 90 days	250.063	245.629	249.347	240.389	221.961	28.102
Treasuries 91 days to 1 year	556.572	554.436	554.981	572.986	378.403	178.169
Treasuries over 1-yr to 5 years	1594.890	1614.845	1614.938	1627.413	915.101	679.789
Treasuries over 5-yrs to 10 years	749.792	771.654	771.704	779.339	327.906	421.886
Treasuries over 10-years	1505.016	1505.076	1505.136	1505.168	658.232	846.784
Note: QT starts June 1, 2022	Change	1/17/2024	6/1/2022			
U.S. Treasury securities	-1046.754	4724.025	5770.779			
Mortgage-backed securities (MBS)	-275.736	2431.710	2707.446			



Fed funds futures call Fed hikes	
Current target: January 19 -- 5.50%	
Rate+0.17 Contract	Fed decision dates
5.370 Apr 2024	Jan 31, Mar 20
4.725 Aug 2024	May 1, Jun 12, Jul 31
Last trade, not settlement price	

Market still discounting 13 bps of a 25 bps rate cut on March 20, three rate cuts by July.

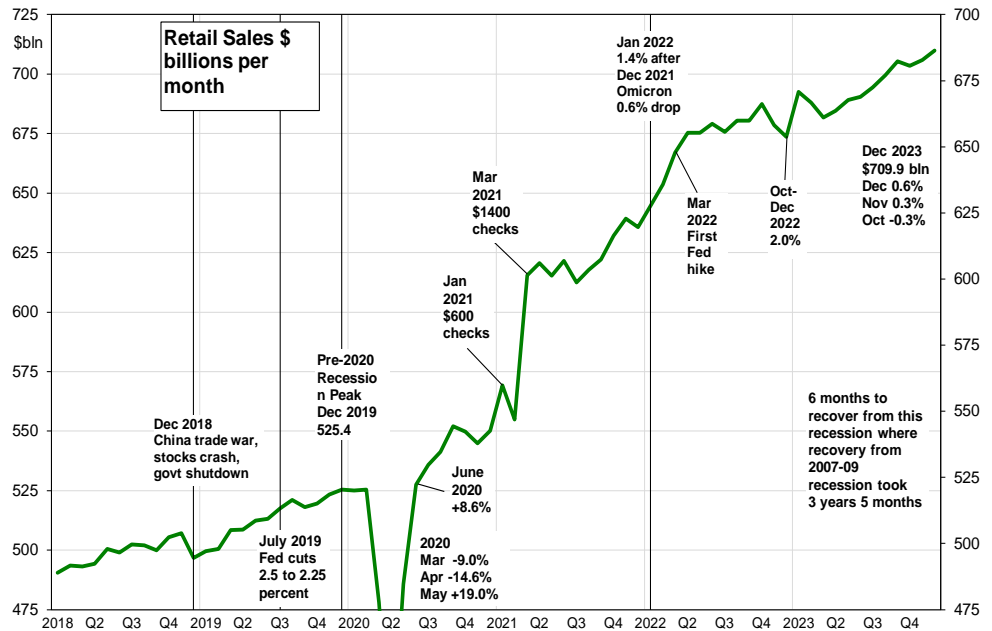
Next up: December PCE inflation report Friday, January 26

Monthly % Changes	2023										2022				
	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct
Core CPI inflation	0.3	0.3	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
Core PCE inflation		0.1	0.1	0.3	0.1	0.1	0.2	0.3	0.3	0.3	0.4	0.5	0.4	0.3	0.3
Core PCE YOY		3.2	3.4	3.6	3.7	4.2	4.3	4.7	4.8	4.8	4.8	4.9	4.9	5.1	5.3
Core CPI YOY	3.9	4.0	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

OTHER ECONOMIC NEWS

Sales and production are okay (Tuesday)

Breaking economy news. Retail sales and industrial production. Retail sales rose 0.6% in December, with some sectors increasing more than expected. Retail sales in the fourth quarter are now 3.9% versus just 3.1% a month ago with data only through November, and the economy has the wind at its back in the first quarter because spending is already running 2.0% in the first quarter using December's data.



To recap 2023, on a December-December basis only a few spending sectors were down: furniture and home furnishings stores -4.7%, building material and garden equipment dealers -2.3%, Department stores -2.7% and gasoline stations -6.6%.

Retail sales versus PCE sales that go into GDP

Qtrly SAAR %	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24
Retail sales	4.5	0.4	6.9	3.9	2.0
PCE nominal	8.1	3.3	5.8	3.6	
PCE real	3.8	0.8	3.1	2.1	
PCE "inflation"	4.3	2.5	2.7	1.5	

Q4 retail sales through December, PCE sales through November

Other news was nonfuel import prices were unchanged in December after a slim 0.1% increase in November. Team USA is still not importing much inflation from overseas as these import prices were flat to down from March through October earlier last year.

Industrial production. Much talk during this election cycle about bolstering manufacturing. Not sure who is going to work in those factories, but some want to bring the factories back to the USA from

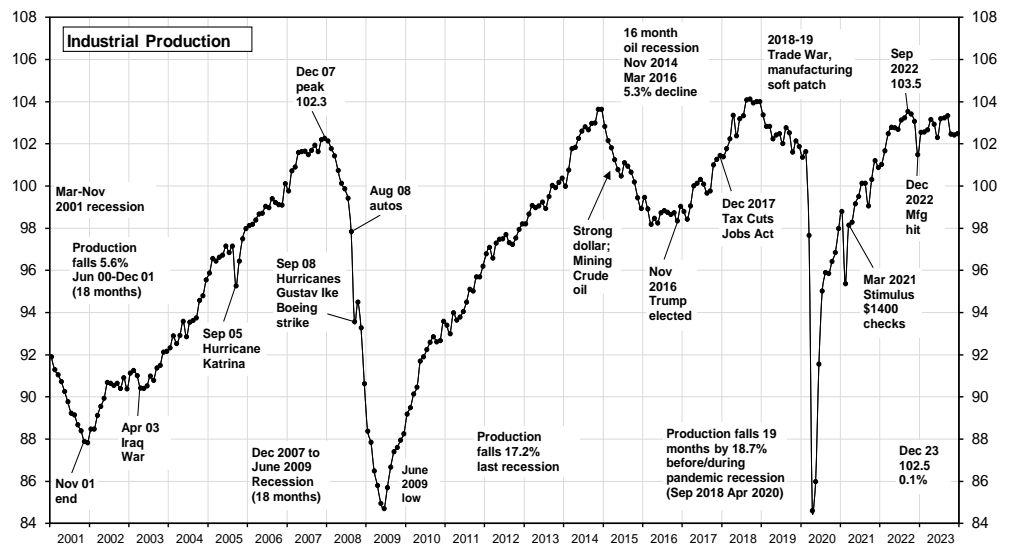
Retail spending, actual dollars, each month

	\$million	% to Total	Percent Changes %		
			Dec	Nov	Year/year
Total Retail Sales	709,890	100.0	0.6	0.3	5.6
Motor vehicles/parts	136,507	19.2	1.1	0.8	10.3
Furniture/furnishings	10,783	1.5	-1.0	2.4	-4.7
Electronics/appliances	7,679	1.1	-0.3	-1.8	10.7
Building materials/garden	41,665	5.9	0.4	-0.1	-2.3
Food & beverage	83,124	11.7	0.2	0.2	1.3
Health/personal care	36,802	5.2	-1.4	-0.2	10.7
Gasoline stations	53,169	7.5	-1.3	-3.4	-6.6
Clothing/accessories	26,611	3.7	1.5	1.0	4.3
Sporting goods, books	8,691	1.2	0.3	1.4	0.9
General merchandise	74,032	10.4	1.3	-0.2	3.3
Department stores	10,927	1.5	3.0	-2.1	-2.7
Miscellaneous retailers	15,772	2.2	0.7	-0.3	6.9
Nonstore retailers (internet)	120,496	17.0	1.5	1.2	9.7
Eating & drinking places	94,559	13.3	0.0	1.7	11.1

overseas. Consumers are not going to like the higher prices and factory workers are few and far between, but we shall see. Industrial production in manufacturing rose 0.1% in December, but was a touch lower than we thought in last month's report. The total index was also up 0.1% in December, and has shown no growth since the peak way back in September 2022, six months after the Fed started its rate hikes. If Washington wants to bring factories back to shore up production they better hurry, although keep in mind the US China trade war actually slowed exports and led to a manufacturing soft patch back in 2018.

Net, net, consumers celebrated at the end of the year taking more trips to the mall in December after lackluster retail sales in October and November. The boost in consumer spending at year-end will carry over into the first quarter of the new year providing evidence that the economy will not be slowing down as much as policy makers had thought. There may be a soft-landing for inflation, but the economy is still flying high enough to create new jobs and economists can take down those recession forecasts this year. Fed officials need to recalibrate their economic models because there is no way GDP growth will slow to 1.4% in 2024 as their forecasts say based on today's data. The Fed's interest rate policy isn't as powerful as it once was in bringing the economy to its knees and the fall off in inflation seems to be taking place regardless of the "restrictive" 5.5% Fed funds rate. Stay tuned. CEOs are cautious on the outlook this year, but there is no reason to worry after today's batch of economic data where

inflation remains under control and economic demand from consumers will keep the wheels turning with moderate 2%-plus GDP growth expected. For Fed officials the economy is not too hot and not too cold, but it is just right perhaps for a few interest rate cuts in 2024 as inflation continues to slow.

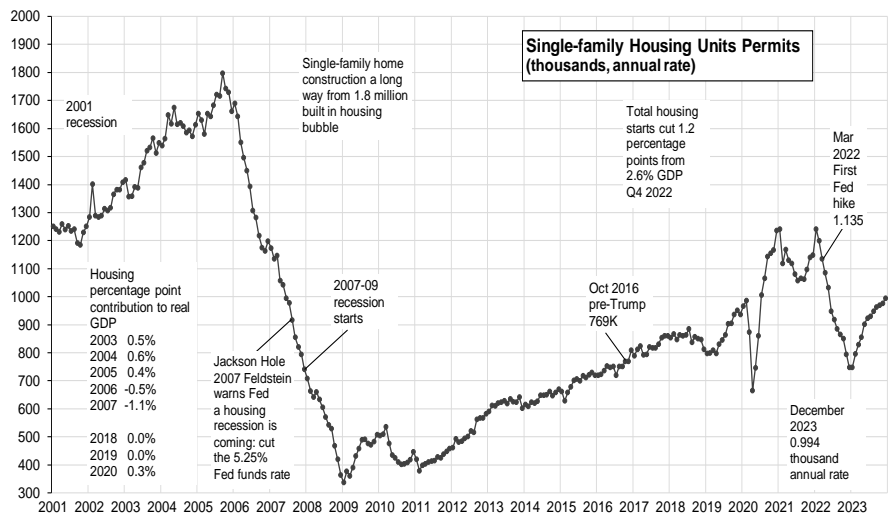


Percent changes		Industrial Production Dec 2023		
Oct	Nov	Dec	YOY	Weight
-0.8	0.0	0.1	<u>1.0 Total Index</u>	<u>100.0</u>
-0.8	0.2	0.1	1.2 Manufacturing	74.3
-0.9	-1.0	0.9	4.3 Mining	15.2
-0.9	-0.7	-1.0	-4.9 Utilities	10.5
			Manufacturing payroll jobs 13.0 million +12K YOY 9.7% of Private Payroll Jobs	

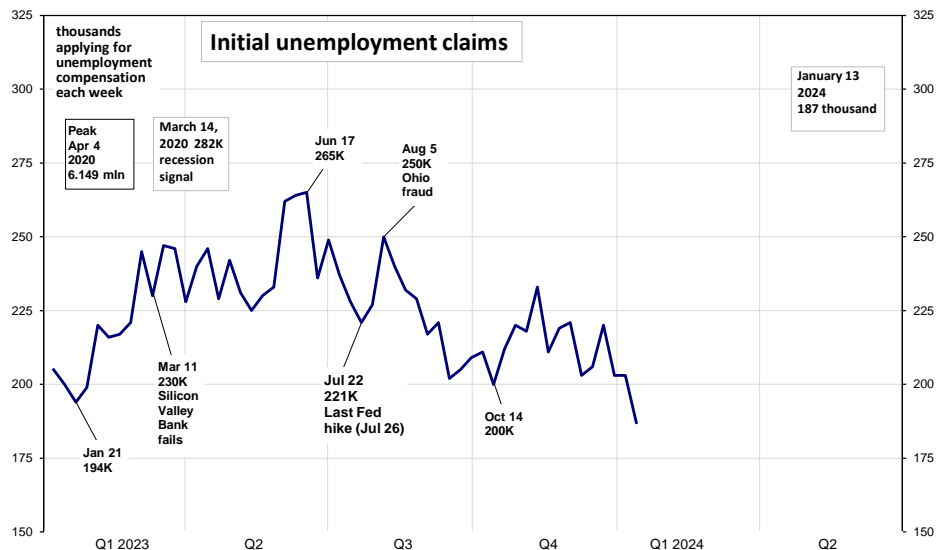
Housing construction up, job layoffs down (Thursday)

Breaking economy news. Residential housing construction and weekly job layoffs. Records were broken in 2023 for both. First time jobless claims tumbled 16K in the January 13 week to a new low of 187K, lower and better than any week in all of 2023. The results showing the labor market is no longer rebalancing are suspect as 17,176 of the 29,543 of the not seasonally adjusted decline was New York state. Residential housing construction continues to be on an upswing. Housing permits for single-family homes went out with a bang last year with permits increasing 1.7% in December to 994 thousand, the highest for all of 2023 and 32.9% greater than a year ago. The Federal Reserve did not say they had finished with rate hikes until December 13, but home builders are optimistic that the drop in mortgage rates will bring more demand for the new homes they put up.

Net, net, the labor market saw fewer job layoffs which doesn't scream rebalancing, but it was a cold week this winter with many states seeing big declines, along with the special case of New York filings plummeting. Meanwhile, you don't have to tell home builders twice, they can read the handwriting on the wall and if mortgage rates have made the turn and are coming back down, then home sales are bound to go back up. Build baby, build. Builders did not put as many shovels into the ground, but they sure took out the most single-family permits for all of 2023. Rates have turned the corner and so has the rush to build. Housing permits are a leading economic indicator and right now it is telling the story that economic growth will strengthen in 2024. Bet on it. Housing construction is up and job layoffs are down and that means economic growth continues to exhibit the soft-landing hopes that Fed officials have for it. No recession, in fact the Fed's 1.4% GDP forecast for 2024 looks too weak.

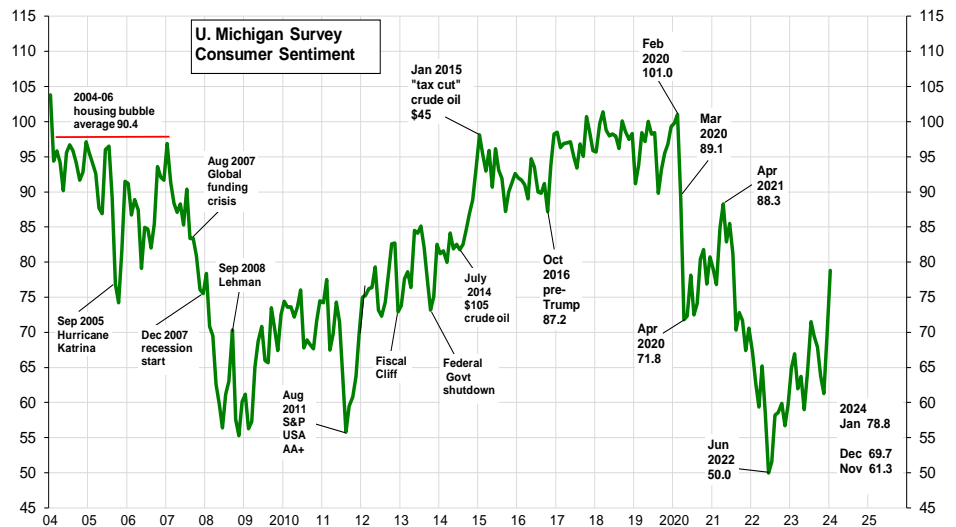


	United States		Northeast		Midwest		South		West		
	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit	
000s											
Dec 2023	1495	994	449	101	51	199	121	860	593	335	229
Nov 2023	1467	977	443	84	57	190	117	793	581	400	222
Dec 2022	1409	748	612	123	58	184	95	777	448	325	147
% Chgs											
Dec/Nov	1.9	1.7	...	20.2	-10.5	4.7	3.4	8.4	2.1	-16.3	3.2
Dec/Dec	6.1	32.9	...	-17.9	-12.1	8.2	27.4	10.7	32.4	3.1	55.8

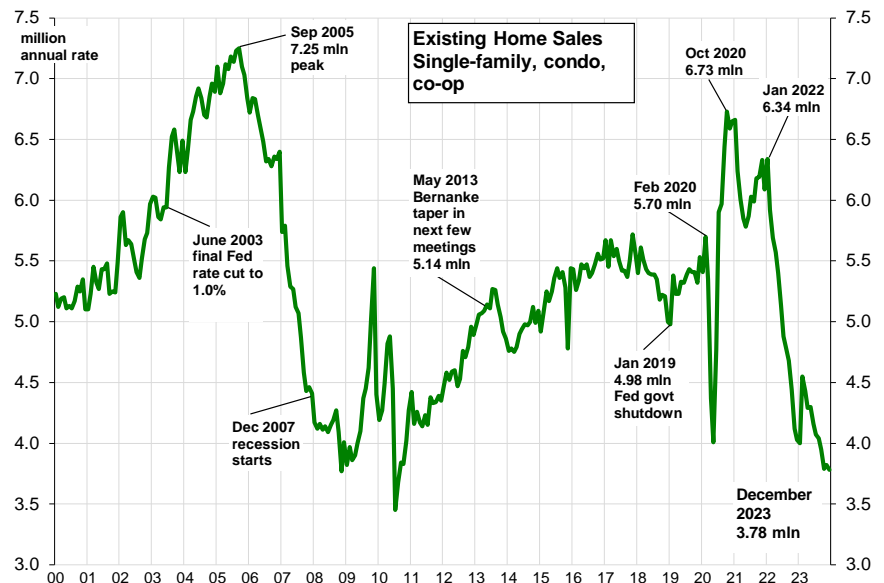


Consumer sentiment soars (Friday)

Breaking economy news. Consumer sentiment from the Michigan survey and existing home sales. Existing home sales and prices are never much to, well, write home about at the start of winter in December each year. Sales were down 1.0% to 3.78 million at an annual rate, and would have been weaker but for the 7.8% jump in sales out West. Single-family existing home prices were slightly more affordable at \$387,000 in December, where most of the weakness was out West even if sales jumped. For the record books, the pandemic home price surge has stabilized according to this measure; home prices averaged \$394,600 in 2023, \$392,800 in 2022 and \$357,100 in 2021. The 2022 increase in prices was 10.0%.

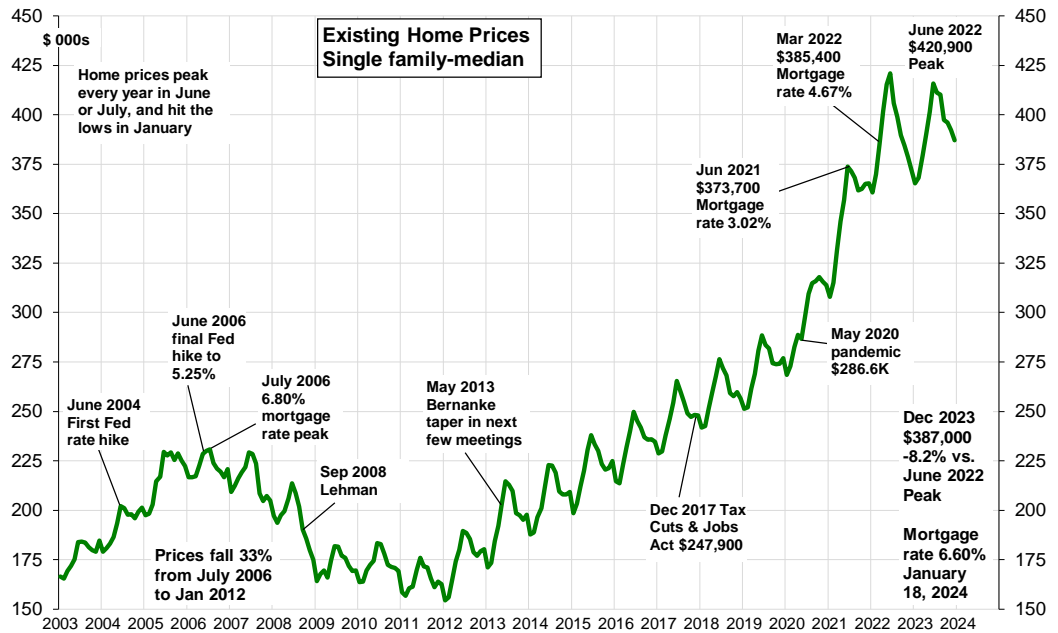


Consumer sentiment is the surprise today with all the earlier news reports getting it wrong where consumers are not downbeat, and they are staying more than resilient, their spirits are actually soaring at the start of 2024. The index of consumer sentiment increased to 78.8 in January from 69.7 in December which sets the stage for increased consumer spending to support the economy in 2024. The consumer also does not see as much of a chance for inflation to linger over the long run, so Fed officials can have their cake and eat it too with consumers highly confident, and yet inflation will remain under control and continue to fall back down to target. Year-ahead inflation expectations are back where it was before the pandemic so for the Fed, the mission has been accomplished, and policymakers can slowly move interest rates back down this year.



Net, net, the consumer is the bedrock of the economy and a happy consumer means more spending and more growth that increases the share of the economic pie for all Americans. The economy is not going backwards, it is going forwards at the start of 2024. The stock market is pointing that way and

the consumer knows it as well. The economic history textbooks are going to need to be rewritten. For the first time, massive interest rate hikes have not put a damper on economic growth, and the draconian Federal Reserve policy of 5.5% interest rates has not broken the back of the economy yet, far from it. There are many uncertainties in the world from war, threats of war, geopolitical risks and discord down in Washington, but the consumer remains upbeat and their confidence and spending will support the economy in 2024.



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