Financial Markets This Week

11 MARCH 2022

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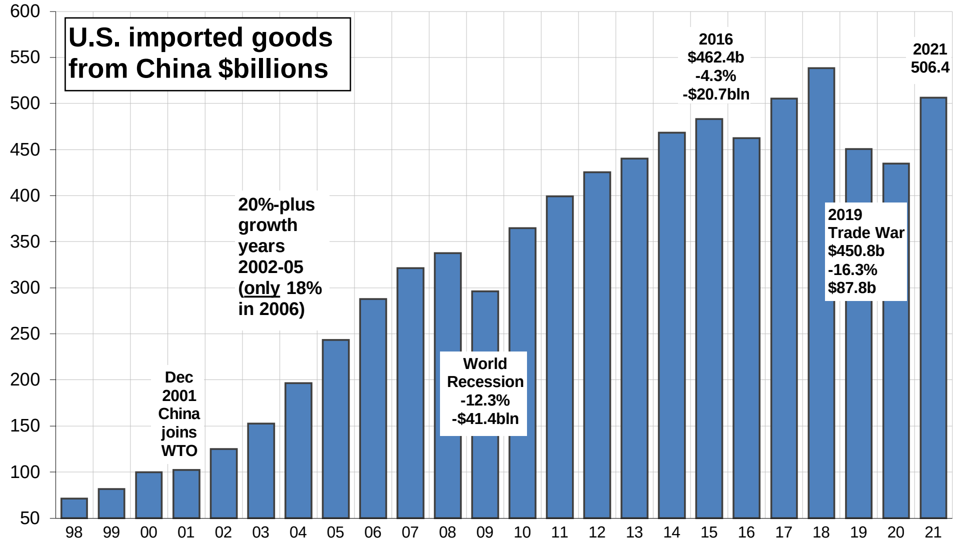
WORLD WILL BE A LESS FRIENDLY PLACE FOR TRADE



The world is no longer flat. There are still many unknowns for the world economy after Russia entered Ukraine two weeks ago, but markets are speculating the conflict will help speed the trend away from globalization and reliance on trading partners overseas to a new economy that relies on localization of production. Not sure how that works for raw materials imports. There is also a massive shortage of skilled labor in the U.S., even if new factories are starting to be constructed, mostly for the production of computer/electronic/electrical goods. Keep your fingers crossed: January 2022 manufacturing job openings were 855 thousand.

U.S. Imports of goods from China							
Billions of dollars	2015	2016	2017	2018	2019	2020	2021
Cell phones and other household goods	64.538	61.465	70.337	71.807	64.421	61.815	75.184
Computers	43.805	40.408	45.394	47.016	42.226	50.684	59.207
Toys, games, and sporting goods	26.355	25.044	26.724	28.154	26.387	27.632	39.682
Apparel, textiles, nonwool or cotton	25.645	24.143	24.098	25.049	24.411	34.450	24.300
Household appliances	14.218	13.716	14.151	16.015	14.060	16.120	19.114
Computer accessories	30.456	28.252	31.658	32.494	18.708	16.891	17.818
Furniture, household goods, etc.	17.894	18.645	20.677	22.625	16.855	14.116	17.434
Telecommunications equipment	27.085	29.037	33.451	33.858	23.886	17.661	16.984
Electric apparatus	13.627	13.132	14.192	16.021	12.771	11.483	15.477
Other parts and accessories of vehicles	14.868	14.232	14.385	16.335	12.932	10.578	13.563
Industrial machines, other	9.075	8.881	10.589	11.773	10.104	9.747	11.416
Cookware, cutlery, tools	6.709	7.038	7.196	7.914	8.347	8.874	11.037
Medicinal equipment	4.309	4.388	4.763	5.117	5.225	7.139	10.087
Photo, service industry machinery	8.356	8.587	9.556	10.751	9.524	8.673	9.930
Footwear	14.182	12.005	11.536	11.416	10.947	6.853	9.415
sub-total	321.123	308.974	338.707	356.345	300.803	302.716	350.648
Total	483.202	462.420	505.165	538.514	450.760	434.749	506.367

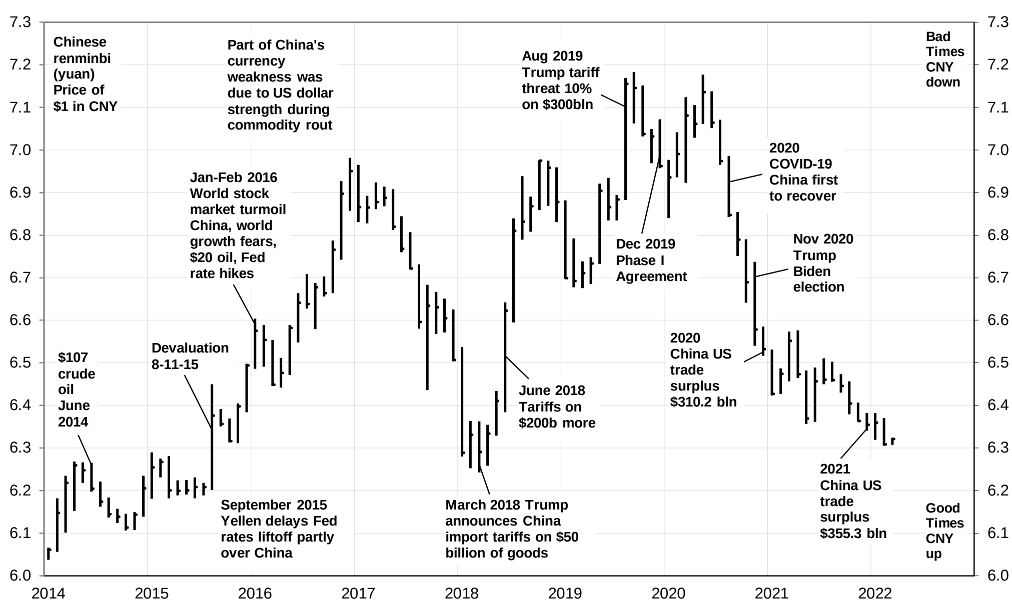
Looking this week at America's biggest trading partner, it is hard to imagine how the country's reliance on China could change quickly as the overall size and sheer number of products and goods coming into the U.S. are staggering. The import demand from China built to its current level steadily over two decades, taking a brief break, if that was the case during the Trump trade wars a few years ago, and finding new providers either overseas or sourced/produced locally for 2021's $506.4 billion of imports from China looks to be an impossible challenge in the near future. The table here is a small sample from the list of 5-digit end-use codes for the imported goods categories. Imports fall during recessions and imports from China were lower in 2016 as well when real consumer spending in the GDP accounts slowd to 2.5% from 3.3% in 2015. There was a "manufacturing recession" when oil prices collapsed and real GDP was 1.7% in 2016 versus 2.7% in 2015.

Imports fell dramatically in 2019 before the pandemic recession and for this we have to blame or applaud the U.S. trade war with China. The first $50 billion of tariffs coming to light in March 2018 were to protect U.S. intellectual property and technology. Telecommunications equipment imports fell from $33.9 billion in 2018 to $23.9 billion in 2019 and have never recovered. Computer accessories seemed to share the same fate declining to $18.7 billion in 2019 from $32.5 billion in 2018. Moving ahead, many import categories are at all-time highs in 2021: Cell phones $75.2 billion, Computers $59.2 billion, Toys, games, sporting goods $39.7 billion, Household appliances $19.1 billion. Records are being set even though many products still have tariffs that U.S. importers have to pay.

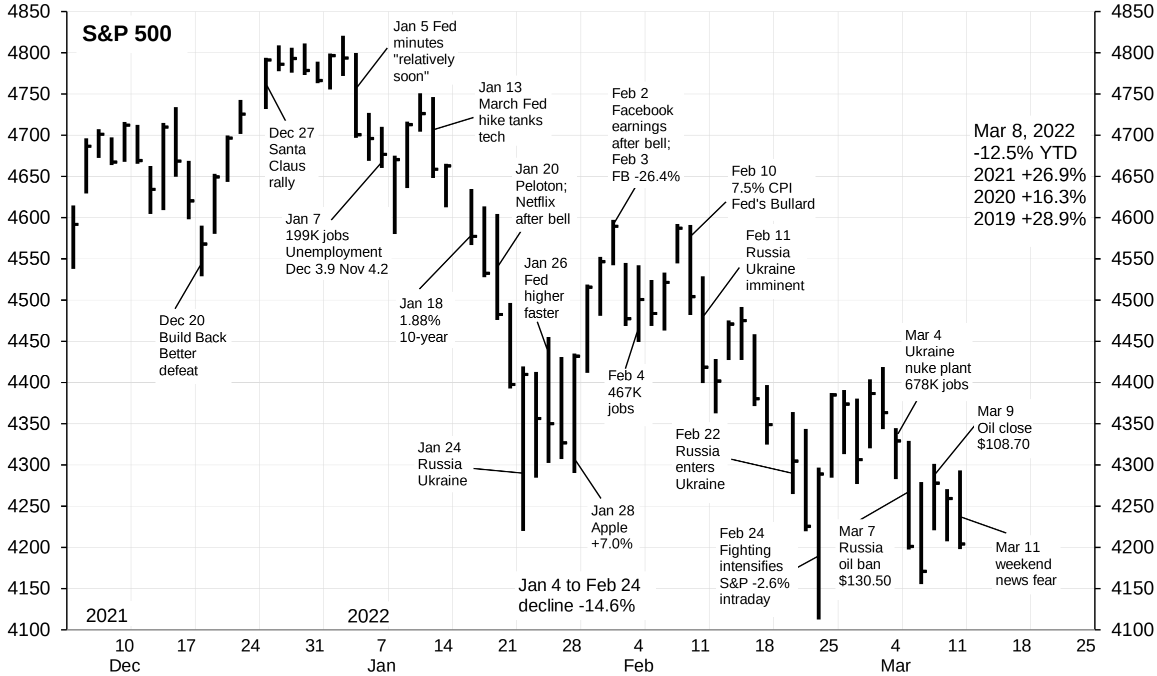
U.S. Exports of goods to China

Billions of dollars	2015	2016	2017	2018	2019	2020	2021
Soybeans	10.494	14.212	12.231	3.129	8.008	14.079	14.101
Semiconductors	5.976	5.956	6.279	7.278	9.031	11.269	13.426
Industrial machines, other	4.483	4.875	5.448	6.822	6.274	7.743	10.143
Pharmaceutical preparations	2.005	2.166	2.681	3.024	4.346	4.790	6.858
Passenger cars, new and used	9.056	8.843	10.208	6.668	7.231	6.090	6.599
Crude oil	0.015	0.361	4.379	5.418	2.960	6.806	5.911
Corn	0.219	0.051	0.152	0.060	0.057	1.226	5.099
Medicinal Equipment	2.887	3.231	3.453	3.727	4.138	4.108	4.835
Civilian aircraft, engines, equip, parts	15.440	14.577	16.264	18.221	10.427	4.397	4.715
Meat, poultry, etc.	0.549	0.786	0.750	0.698	1.429	3.385	4.222
Plastic materials	3.559	3.525	4.004	3.980	3.342	3.729	3.941
Chemicals-other	2.415	2.468	2.982	3.202	3.039	3.298	3.784
Gas-natural	0.000	0.115	0.424	0.464	0.062	1.260	3.562
Natural gas liquids	0.963	0.998	1.967	1.190	0.147	1.384	3.190
Precious metals, other	0.287	0.325	0.374	0.442	0.753	2.502	2.895
Measuring, testing, control instruments	2.639	2.649	2.765	3.126	2.796	2.625	2.858
sub-total	60.986	65.137	74.362	67.449	64.039	78.692	96.140
Total	115.873	115.595	129.997	120.281	106.448	124.485	151.065

If you can't beat 'em, join 'em, is one strategy to rein in the trade deficit. The U.S. China Phase I trade agreement was tweeted and announced many times before and after December 2019 with the final agreement completely spelled out on February 14, 2020. It is more complicated than we have time for here-- all we heard is something about buying $200 billion over some time period. U.S. exports to China jumped 21.4% to $151.1 billion in 2021. But this isn't much different than the Phase I 2017 base level of measurement for exports of $130.0 billion. Soybeans exports from America's farmers suffered early in the fallout of the trade war when China put tariffs on them, but are back at over $14 billion for a second year. Corn exports are new. $5.1 billion in 2021; reminds us of what other foreign officials used to say about America's trade deficit: "We would buy something from you if you had something of value we wanted." Speaking of which, semiconductors are the second biggest category of U.S. exports at $13.4 billion. U.S. oil exports to China were $5.9 billion in 2021. 2021 oil imports from Russia were $4.7 billion. It's a complicated world when it comes to America's trade with nations. Tariffs stay in place for now on $350 billion of imports from China, waiting for Godot, waiting for progress on the Phase I export promise.



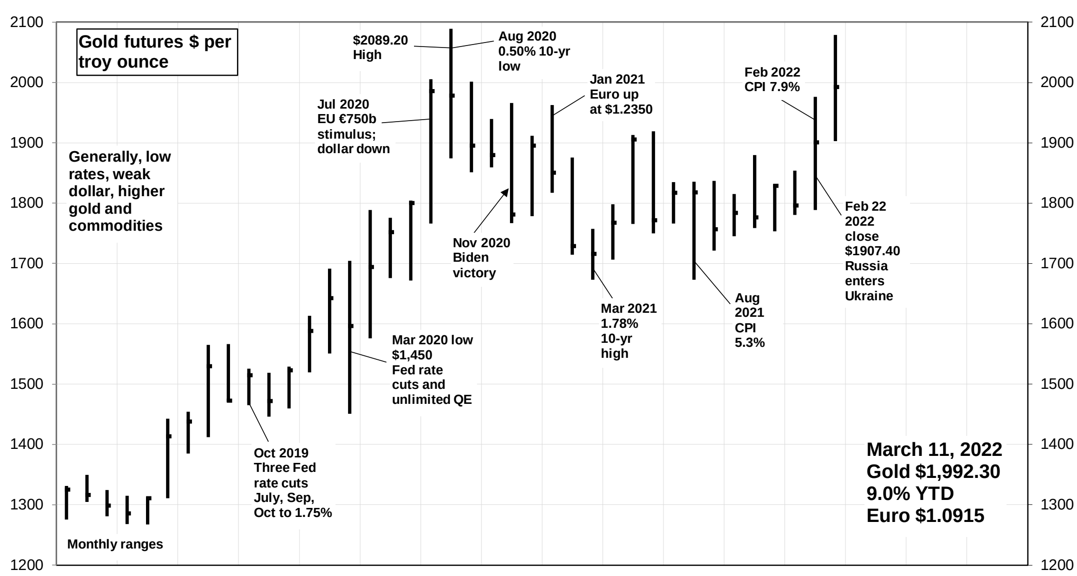
INTEREST RATES



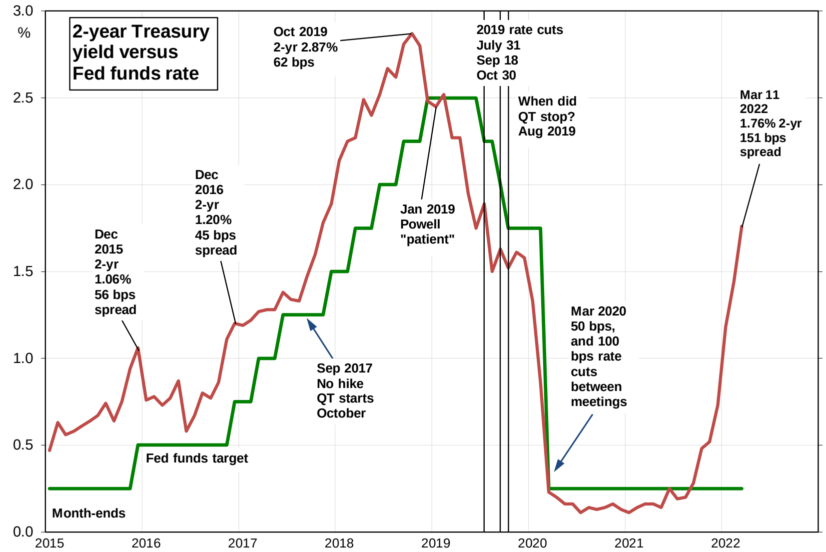
The market focus remains on the Russian invasion of Ukraine. Crude oil futures spiked to $130.50 on Monday on talk of the U.S. and Europe banning Russian oil. Stocks made a new low close Tuesday down 12.5% for the year. Stocks tried to bounce with oil falling back, but worries about war news over the weekend sent stocks lower on Friday. Next week's Fed meeting could change the focus away from Europe temporarily. 10-year Treasury yields closed Friday at 2.00% and the 2022 yield high of 2.06% from February 16 remains untested. Untested as 2-year yields went to a new 2022 high of 1.77% on Friday, discounting multiple Fed rate hikes. 2-yr/10-yr spread closed at 25 bps Friday.

Gold $1,992.30, up 9.0% YTD

The Russian invasion of Ukraine has boosted gold futures prices, closing 9.0% higher on Friday from $1,828.60 at the end of 2021. The high of $2,078.80 on March 8 this week was a little short of the prior $2,089.20 high back in August 2020 during the pandemic when the dollar was falling. Safe haven flows are benefiting the dollar and gold at the moment as markets follow the war in Europe. Inflation hedge: 7.9% CPI inflation going higher with gasoline $4.10 March 7 from $3.60 week before.



FEDERAL RESERVE POLICY



The Fed meets on March 15-16, 2022 to consider its monetary policy. A first strike 50 bps rate hike is no longer discounted. What hasn't gone away the bond market thinks, if the market thinks, is a faster pace of rate hikes—back to the measured pace of the Bernanke years with a 25 bps rate hike at every meeting. Seven meetings left this year, 175 bps in total, puts the Fed funds rate at 2.0% at the December 2022 meeting. A 2% Fed funds rate means the Fed is closer to being able to implement a tightening policy that theoretically slows the economy if inflation persists. Rates above 2.5% neutral are supposed to slow the economy. Although last time around, at the end of 2018 the market convinced novice Fed Chair Powell to back off any more rate hikes when the Fed funds rate was just 2.5%.

The 2-yr Treasury note yield is 1.76% on Friday, 151 bps higher than the 0.25% Fed funds rate. This is a much wider yield spread than the December 2015 Fed liftoff the last cycle. The November 2015 CPI inflation rate was 0.5% and this week's February 2022 CPI inflation rate is 7.9% for one thing which means the Fed has some work to do. On a month end basis, the 2-yr yield peaked at 2.87% last cycle in October 2019 with everyone knowing the Fed would raise rates again in December 2019. All eyes will be on the Fed rates forecasts released Wednesday, March 16 at 2pm ET. The December 2021 meeting forecasts looked for a 1.0% Fed funds rate at the end of 2022.

Fed Policy-key variables					Long
	2021	2022	2023	2024	Term
Fed funds	0.1	0.9	1.6	2.1	2.5
PCE inflation	5.3	2.6	2.3	2.1	2.0
Unemployed	4.3	3.5	3.5	3.5	4.0
GDP	5.5	4.0	2.2	2.0	1.8
December 2021 median Fed forecasts					

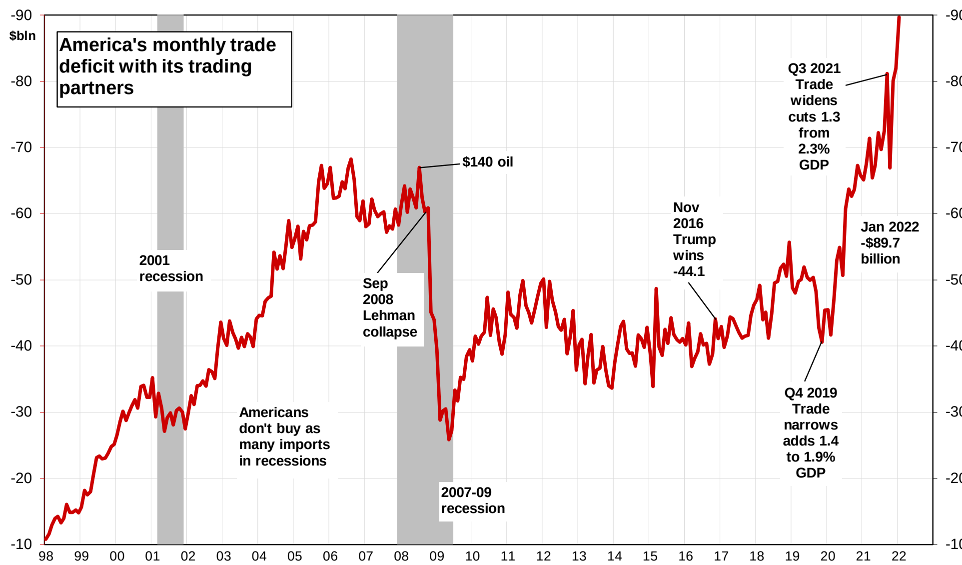
Fed Individual Forecasts				
Fed funds rate at year-end				Longer
Votes	2022 End	2023 End	2024 End	run
1	0.375	1.125	1.875	2.000
2	0.625	1.125	1.875	2.250
3	0.625	1.375	1.875	2.250
4	0.625	1.375	1.875	2.250
5	0.625	1.375	1.875	2.250
6	0.625	1.375	2.125	2.375
7	0.875	1.375	2.125	2.500
8	0.875	1.625	2.125	2.500
9	0.875	1.625	2.125	2.500
10	0.875	1.625	2.125	2.500
11	0.875	1.875	2.250	2.500
12	0.875	1.875	2.375	2.500
13	0.875	1.875	2.375	2.500
14	0.875	1.875	2.875	2.500
15	0.875	1.875	2.875	2.500
16	0.875	2.125	2.875	3.000
17	1.125	2.125	2.875	3.000
18	1.125	2.125	3.125	
Median	0.875	1.625	2.125	2.500
Meeting	Dec 22	Dec 22	Dec 22	Dec 22

OTHER ECONOMIC NEWS

Another month, another record for trade deficit red ink (Tuesday)

Breaking economy news. The trade deficit widened to a new record of $89.7 billion in January from $82.0 billion a month ago. Clearly, the America first policies from the last administration has done nothing to bring factories back to America. American imports of goods were $264.8 billion in January, which is a staggering 20.0% higher than a year ago. For January alone, the trade deficit was $7.7 billion wider with exports falling $3.9 billion and imports rising $3.8 billion.

Net, net, U.S. exports stumbled badly this month and America continues to rely too much, some would say, on the rest of the world for an increasing amount of factory and consumer goods. But for how long is the question with the Russian invasion of Ukraine setting off a reassessment in many countries about the risks of relying on other nations to provide them with strategic commodities and partially assembled products used in their own factories. For decades, nations were able to get cheaper goods from their overseas trading partners, but now the wisdom of doing so is being called into question if there is going to be a sea change in geopolitics where old alliances are being called into question. The world is no longer flat when it comes to trade and the future may see more barriers being put up as countries scramble to restart domestic manufacturing that had been allowed to become obsolete. Just in time production may see a change to do it yourself manufacturing as the record trade deficit news today is a wake up call that countries are too reliant on others to provide the goods they need to make the domestic economy grow.



Trade War 2021

Trade deficit in goods

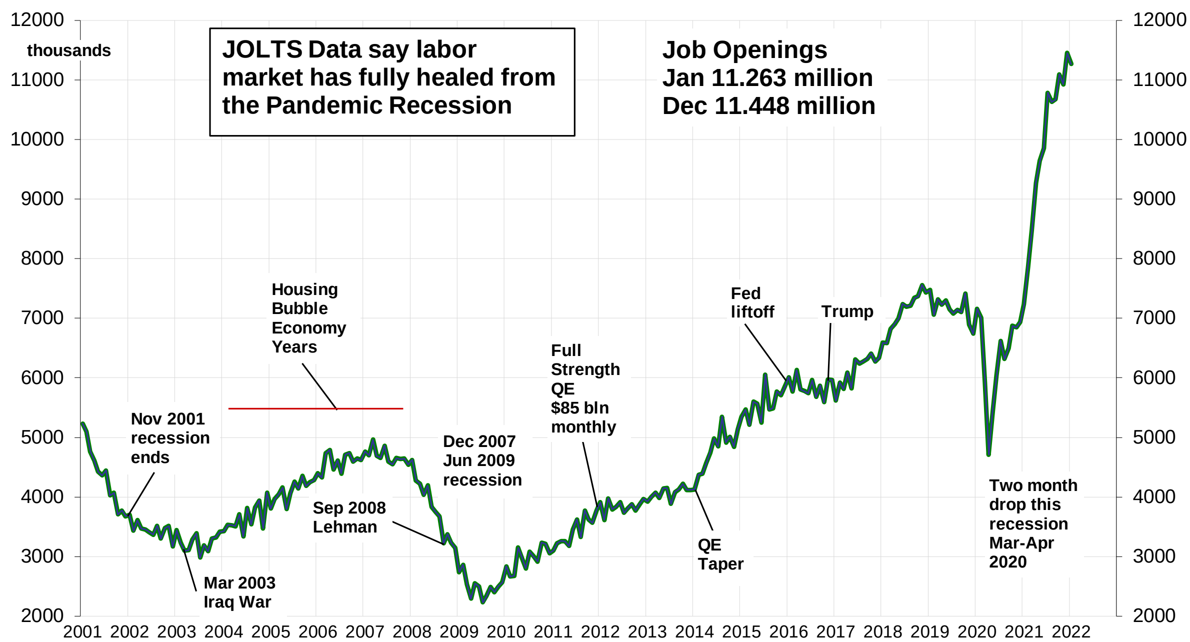
$ billions		Exports	Imports
China	355.3	151.1	506.4
EU	219.6	271.6	491.3
Germany	70.1	65.2	135.2
Mexico	108.2	276.5	384.7
Japan	60.2	75.0	135.1
Vietnam	91.0	10.9	101.9
South Korea	29.2	65.8	95.0
Canada	40.5	307.6	357.2
World	1078.6	1,754.5	2,833.1

Strongest labor market seen in history with for hire signs everywhere (Wednesday)

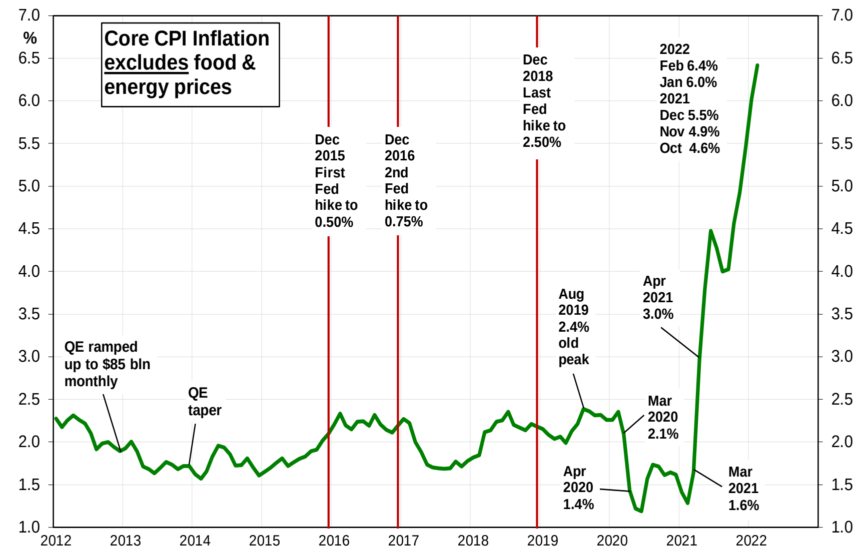
Breaking economy news. Job openings were at a new record high after annual revisions in December at 11.448 million, and came down barely to 11.263 million in January to start the year. The labor market is tight as a drum and this means wage pressures and inflation will persist. Fed officials are in a real pickle here as they are damned if they raise rates to slow inflation, sending the economy back into recession, and damned if they don't and rising prices continue to hurt low income workers where food and gasoline is a greater percent of their monthly budgets. Fed officials waited too long to start taking away the punch bowl and it will be in there in the history books for future generations to see. They fought joblessness for too long and now their stringent policies risk new joblessness if the economy slows too much.

Maybe it is not such a sociological phenomenon, burned out baby boomers or Millennials who won't listen to their bosses, but the number of quitters remains high as well at 4.252 million in January versus 3.311 million a year ago. The quits rate reflects the fact that wages are going straight up and labor has the opportunity to pick and choose where they work and what compensation they require.

Net, net, the economy is rock solid at the start of the year with over 11 million job openings. The pandemic is gone with jobs galore for those sectors of the economy which once required social-distancing and masks. Retail stores need 1.046 million workers versus 811 thousand a year ago. Hotels and restaurants need 1.497 million workers versus 689 thousand a year ago. The economy is on fire and so is inflation according to the job openings data. Time will tell if war in Europe and plummeting stock prices will slow down the demand for new hires in the months to come. Stay tuned. Story developing. For hire signs are everywhere you look and are a reflection of one of the strongest labor markets ever seen before in history. Get your new job today.



CPI inflation new high and jobless claims remain somewhat elevated (Thursday)



Breaking economy news. February CPI inflation is still jumping with headline inflation up 7.9% the last twelve months, the most since 1982. Core inflation up 6.4% year-year is also up the most since 1982. The bad news is the war in Europe has sent energy prices and other commodities soaring in March and this means next month's report will see even worse price pressures and another record month since the early 80s. The only mystery is how the Fed can have interest rates at zero when the 1980s saw rates of over 20%. Savers are seeing their wealth deteriorate at a rate not seen in decades with no risk free rate to compensate them. Consumers are up and arms as it is more expensive to drive to work and put food on the table. Fed officials took a gamble on fighting joblessness for too long and now they have lost control of the economy where their aggressive catchup policies to slow the economy could backfire and send the economy off the road and into a ditch.

Inflation shows no sign of slowing down with monthly percent changes in core prices rising 0.5 or 0.6 percent since last October. The only good news in the report is that prices of used cars and trucks fell 0.2%, the first decline since August 2021, although they are 41.2% higher than a year ago which counts as another black eye for low income workers who can't afford a new car that costs 12.4% more than a year ago. No one can afford a new car either with wages up 5.1% in last week's employment report. Inflation is hot, hot, hot, and there is no relief yet on the horizon for beleaguered consumers. The final insult to the public's intelligence is the BLS citing the 0.5% rise in shelter costs as the problem, where the year-year rate is 4.4%. Everyone knows that home prices are over 10% higher than last year, so maybe inflation is actually much, much worse.

		Monthly Percent Changes			YOY %
Weight	CPI inflation	Dec 2021	Jan 2022	Feb 2022	Feb 2022
100.0	Total	0.6	0.6	0.8	7.9
13.990	Food	0.5	0.9	1.0	7.9
6.269	Food away from home	0.6	0.7	0.4	6.8
7.542	Energy	0.9	0.9	3.5	25.6
78.468	Ex-food & energy	0.6	0.6	0.5	6.4
3.884	New vehicles	1.2	0.0	0.3	12.4
3.419	Used cars/trucks	3.3	1.5	-0.2	41.2
2.669	Clothing	1.1	1.1	0.7	6.6
1.487	Medical care goods	0.0	0.9	0.3	2.5
32.393	Shelter	0.4	0.3	0.5	4.7
23.509	Owner equiv. rent	0.4	0.4	0.4	4.3
5.046	Transportation	0.0	1.0	1.4	6.6
6.987	Medical care services	0.3	0.6	0.1	2.4
	Special: Where inflation might come back down to				
57.700	Services ex-energy	0.3	0.4	0.5	4.4

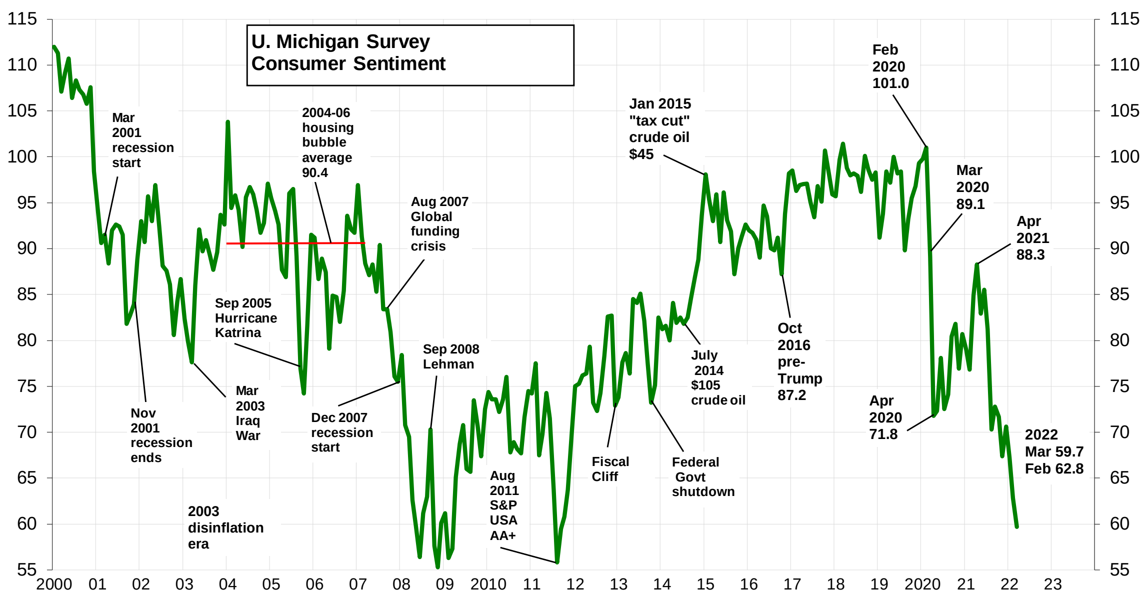
Net, net, the inflation fire was already hot and now with war-driven inflation added to the mix, it will grow even hotter, setting off a scramble by the world's central banks to pull back their stimulus earlier than expected. The ECB is ending its asset purchases early and the Federal Reserve next week may raise the curtain on a new policy that raises interest rates every meeting this year at a measured pace. A spike in inflation rates has preceded economic recessions historically and this time prices have soared to levels that once again pose a threat to growth. Markets were cheering this economic recovery and return to strong economic growth, but the cheers will turn to tears if the inflation outbreak pushes businesses and consumers to the brink of recession.

Consumers take another step closer to cliff's edge (Friday)

Breaking economy news. A new low for the Michigan survey of consumer sentiment at 59.7 in March even weaker than 62.8 in February. A year ago in March 2021 when the economy was rebounding from the pandemic, Michigan consumer sentiment was 84.9. The last time the consumer sentiment index fell into the 50s it was right after the Lehman bankruptcy in 2008. Right now consumers are as frightened as they were in the financial crisis and Great Recession over a decade ago.

If consumers cut their spending to match the sharp reduction in their confidence, the economy is in real trouble. Consumers are taking another step closer to the cliff's edge in March and it will be a miracle if they don't drag the economy with it. The best economy with the most jobs in fifty years will be gone in a heartbeat if Washington can't stop the upward price spiral of literally everything the consumer buys.

Net, net, consumers took another step closer to the edge of the cliff where worries over inflation and the ability of incomes to keep up have severely depressed public confidence in the economic outlook. We have rarely seen sentiment at such rock-bottom, woe-is-me levels, and if consumer spending falls to match the consumer's diminished confidence, then the economy will indeed go over the cliff and back down into recession. The pandemic recession was a short two months or two quarters depending how you count it, but the storm clouds gathering on the horizon right now look much more worrisome in the consumer's eyes. The economy can get well eventually if sickened by Covid-19, but the worst inflation since the 80s and war-driven surge in gasoline prices cannot be as easily cured by Washington officials. No wonder the consumer is depressed, a freight train is coming straight at them and they see no way to avoid a collision. The only known cure for inflation is recession historically. The consumer knows it, and the survey says they have recession level confidence. Their spending can make a recession a reality. Watch out below.



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