Financial Markets This Week

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

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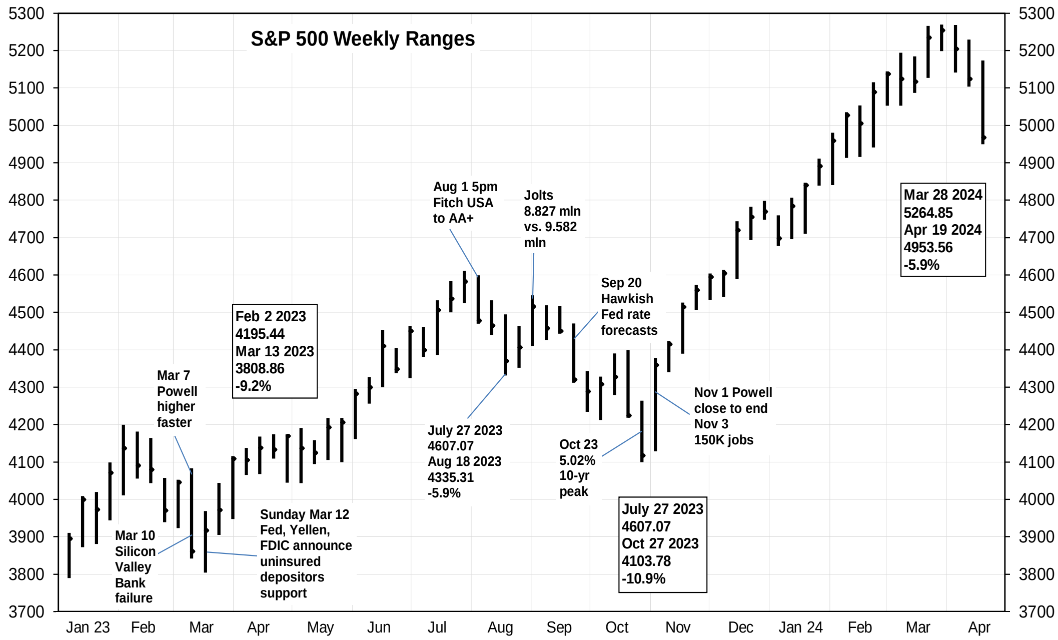
STOCKS SELL OFF



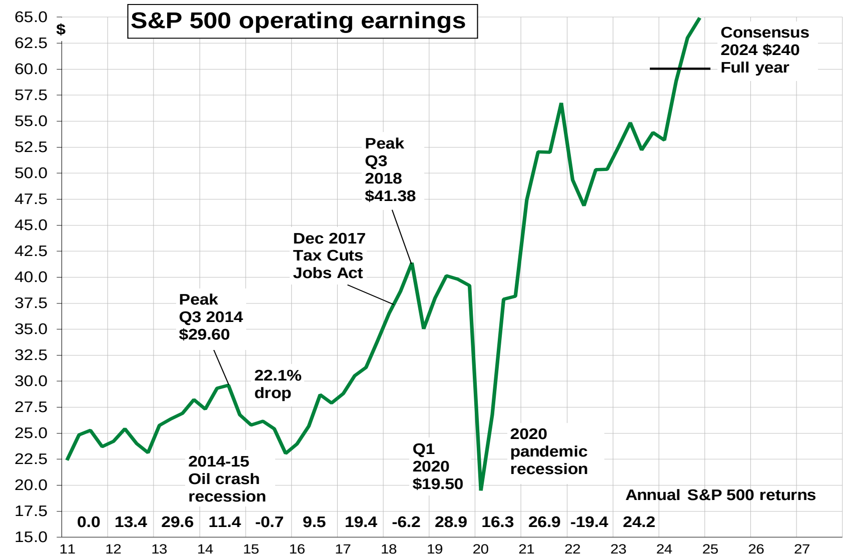
It has been a while since stocks have sold off to this degree. The S&P 500 has fallen as much as 5.9% on Friday, from the March 28 record high this year. 10-yr yields started moving up, Minneapolis Fed President Kashkari said maybe no rate cuts this year if inflation did not do what they expected, and sure enough the April 10 core CPI report was 0.4% for a third straight month (0.4X12=4.8% YOY consumer inflation; Fed target 2%). Markets waited for an imminent attack on Israel from Iran on Friday, April 12 ahead of the weekend. And this week Powell did indeed say inflation wasn't doing what they wanted to see.

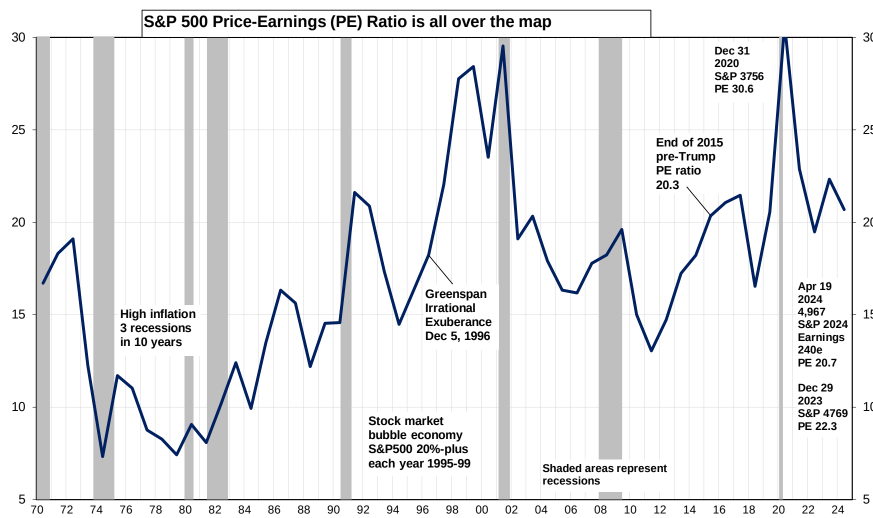
Stocks fell twice this hard in 2023. There was the bank crisis in March 2023 and the S&P 500 fell 9.2%. Silicon Valley Bank failed on Friday, March 10 and stocks made the low on Monday, March 13. Maybe stocks thought the Fed would pause its rate hikes at 4.75%, and indeed they did pause for a time. Or at least they hiked 25 bps to 5.0% on March 22, 2023 and held the terminal rate at 5.25%, partly on the bank crisis with the worry that financial institutions might cut back on the provision of credit which is the lifeblood of the economy.

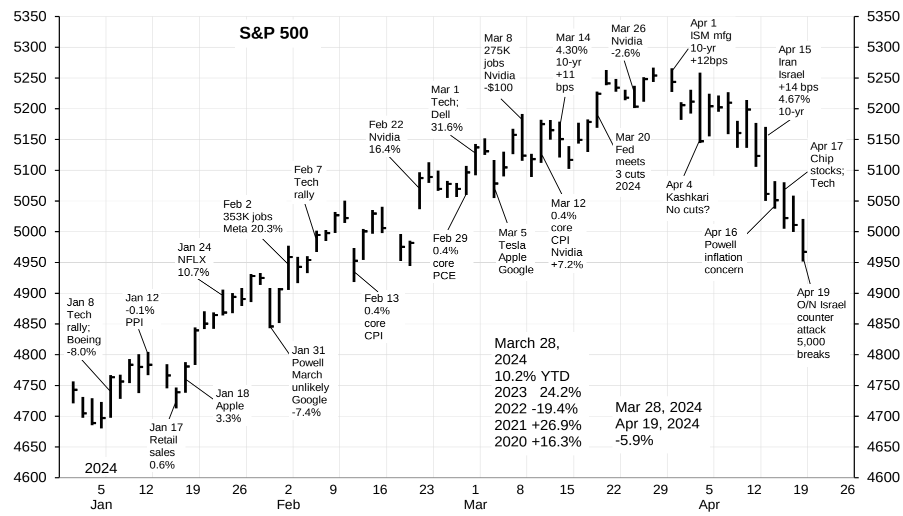
The next July-October 2023 sell-off last year took longer: stocks were down as much as 5.9% on August 18 before a sharp rally. That rally failed, and the total loss to October 27, 2023 was as much as 10.9%. In keeping with the spirit that history is less of a guide and old relationships don't hold true, stocks peaked on July 27, 2023, the day after the Fed turned out to have made its last move for this cycle after hiking 25 bps to 5.5% at the July 2023 meeting. Stocks are supposed to rally when the Fed stops tightening, and instead equities fell double-digits.

It is not just the Fed and interest rates and the economy when it comes to stock market valuation, there are actual earnings and how far out in front of future earnings stocks are trading. Wall Street seems to think full year earnings for the S&P 500 will be $240 in 2024. This is up about 12% from 2023, keeping in mind these consensus earnings don't pan out, or get revised before the final results are in. Since the Fed's first rate hike in March 2022, operating earnings have done nothing but go up although the record high profits are forecasts starting in the second quarter of 2024.

The PE ratio for the S&P 500 is based on twelve month trailing earnings and the PE ratio was 22.3 at the end of 2023 with the S&P 500 closing the year at 4,769. The PE ratio is down to 20.7 with on Friday with the S&P 500 at 4,967 using the full year 2024 operating earnings of $240. Not easy to trade off of the PE ratio, and valuations are still higher than they were when Greenspan made his irrational exuberance remarks back in December 1996. He was unique as an economist, always focusing on the stock market and forward earnings estimates from the Street.

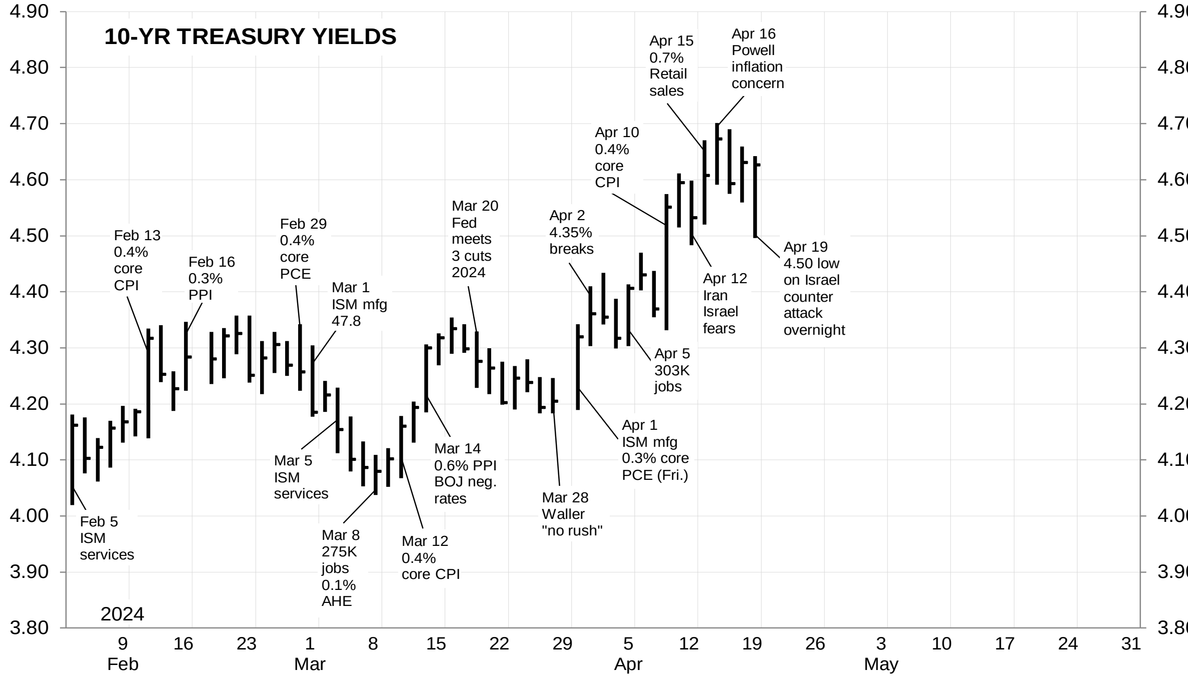






To conclude, the stock sell-off gained momentum all through the week and is down 5.9% versus the long 10.9% decline from July-October 2023, and the short 9.2% drop in the February-March 2023 bank crisis. Stocks bottomed the day after Silicon Valley Bank was closed, and the Sunday evening announcement of support for uninsured depositors changed the market's direction. It was harder to stop the selling later in the year. Powell was market friendly at the Fed meeting press conference on November 1, but it was really the quarterly Treasury refunding announcement earlier that morning that caused a dramatic fall in bond yields. Then the soft 150K jobs report with downward revisions Friday, November 3 sent bond yields tumbling further, closing that week at 4.52% after the yield peak of 5.01% on October 23. That's the news that it takes to turn stocks around, maybe this time it will be better company earnings. Stay tuned.

INTEREST RATES



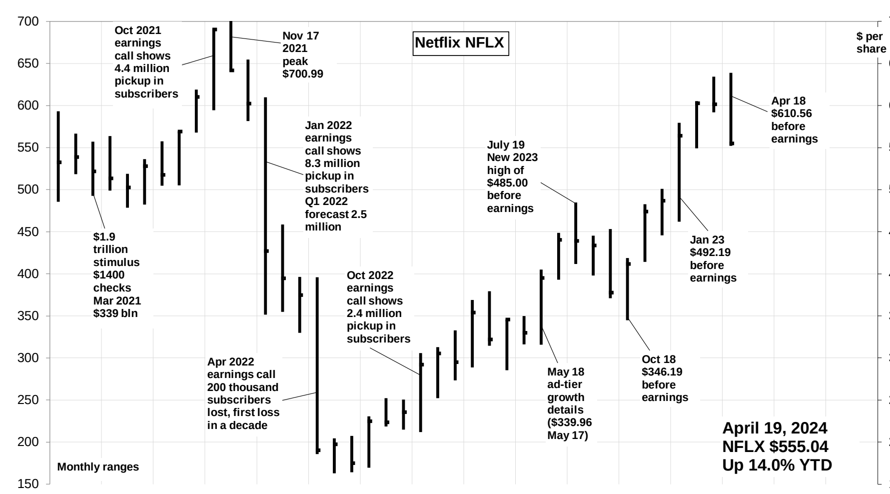
All downhill for stocks and bond prices this week, with the yield rally held back by weak stocks. Retail sales were stronger than expected at 0.7% on Monday, bond yields jumped as much as 14 bps to 4.67%, and higher yields brought the stock market rally on retail sales back down. Fears about a retaliation by Israel after the Iran attack over the weekend also sent stocks lower. Powell comments on Tuesday has the market jumping to conclusion that there will be no rate cuts this year even if Fed funds futures have one cut priced in by September. Core CPI was just barely 0.4% the last two months but markets fear rates higher for longer with some nervousness about rate hikes as the economy is not slowing. Surprisingly modest bond response to Powell saying Tuesday that inflation was not giving policymakers the confidence they needed to cut rates, although 10-yr yields went to the 4.70% high for week. Stocks down 5.9% from highs on Friday at the worst point, closing up 4.1% YTD.

Netflix (NFLX) falls 9.1% Friday after earnings

The stock rallied after the prior two quarterly earnings reports, but sank like a stone after earnings after the close on Thursday. The whole market fell on Friday with fellow high-flyer Nvidia down 10.0%. Wall Street likes the quarterly new subscriber numbers, but the company's shareholder letter said they would stop providing this data in 2025 because each new membership has different revenue implications.

Netflix results (millions)

Quarter	Memberships Paid	Net Additions
3.31.2024	269.60	9.33
12.31.2023	260.28	13.12
9.30.2023	247.15	8.76
6.30.2023	238.39	5.89
3.31.2023	232.50	1.75
12.31.2022	230.75	7.66
9.30.2022	223.09	2.41
6.30.2022	220.67	-0.97
3.31.2022	221.64	-0.20
12.31.2021	221.84	8.28



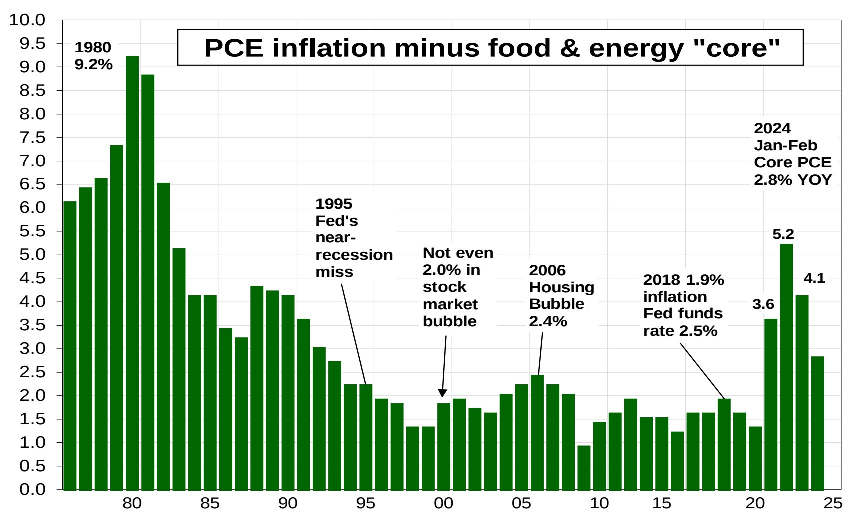
FEDERAL RESERVE POLICY

The Fed meets April 30-May 1, 2024 to consider its monetary policy. After hearing from various members over the last week, Powell confirmed the FOMC does not have the confidence to cut rates, where the inflation data are not running its way. It is still there in the March 2024 meeting forecast, three rate cuts this year on the expectation as well that core PCE inflation will average 2.6% in Q4 2024. Core PCE will be 2.8% in March, released on April 26, but it is not close enough as the monthly changes are running 0.3% the last two months, February, and March (estimated), and the January number was 0.5%.

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	17-Apr	10-Apr	3-Apr	27-Mar	3/11/20*	3/11/20
Factors adding reserves						to Apr 17
U.S. Treasury securities	4539.133	4575.846	4575.162	4618.082	2523.031	2016.102
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2388.241	2388.435	2388.435	2388.435	1371.846	1016.395
Repurchase agreements	0.007	0.001	0.002	0.000	242.375	-242.368
Primary credit (Discount Window)	8.559	5.053	5.451	6.270	0.011	8.548
Bank Term Funding Program	125.706	126.344	130.462	132.806		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	3.017	3.028	3.045	3.059		
Main Street Lending Program	14.505	14.705	14.688	14.671		
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	0.174	0.150	0.187	0.179	0.058	0.116
Federal Reserve Total Assets	7456.5	7489.1	7490.0	7535.5	4360.0	3096.443
~~3-month Libor %~~ SOFR %	5.31	5.31	5.32	5.33	1.15	4.160
Factors draining reserves						
Currency in circulation	2346.705	2347.725	2347.145	2344.024	1818.957	527.748
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	929.932	672.537	732.828	772.260	372.337	557.595
Treasury credit facilities contribution	7.438	7.438	7.438	7.438		
Reverse repurchases w/others	440.508	455.816	436.631	518.357	1.325	439.183
Federal Reserve Liabilities	4126.937	3873.430	3948.818	4063.142	2580.036	1546.901
Reserve Balances (Net Liquidity)	3329.532	3615.691	3541.167	3472.403	1779.990	1549.542
Treasuries within 15 days	61.999	70.295	70.985	63.612	21.427	40.572
Treasuries 16 to 90 days	244.872	239.556	239.513	265.894	221.961	22.911
Treasuries 91 days to 1 year	521.232	535.303	534.567	533.751	378.403	142.829
Treasuries over 1-yr to 5 years	1517.634	1520.551	1520.273	1536.540	915.101	602.533
Treasuries over 5-yrs to 10 years	684.107	701.407	701.279	709.916	327.906	356.201
Treasuries over 10-years	1509.289	1508.735	1508.544	1508.369	658.232	851.057
Note: QT starts June 1, 2022	Change	4/17/2024	6/1/2022			
U.S. Treasury securities	-1231.646	4539.133	5770.779			
Mortgage-backed securities (MBS)	-319.205	2388.241	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

This points out the problem with the 2.0% Fed inflation target. It took a long time to wring inflation out of the economy during the Volcker years in the 80s. Maybe 2.0% is not achievable, or at least a period of 0.2 and 0.1 percent monthly core PCE changes is not doable. Or final at least, keeping the Fed funds rate high at 5.5% will not bring a 2.0% pre-pandemic inflation environment back. There's a lot that economists don't understand about inflation looking back to the early 2000s when a stock market bubble and 5% real GDP growth didn't produce any inflation, at least in the PCE index measure.

> Tuesday, April 16, 2024
> 6:53 in to Powell clip; The recent data have clearly not given us greater confidence and instead indicate that it is likely to take longer than expected to achieve to that confidence.
>
> If higher inflation does persist we can maintain the current level of restriction for as long as needed. At the same time we have significant space to ease should the labor market unexpectedly weaken.



August Fed funds futures are 50/50 on odds of a 25 bps rate cut at the next three meetings. Last week it was a 70% chance. October futures say 90% chance of one cut before the election.

Fed funds futures call Fed policy		
Current target: April 19 -- 5.50%		
Rate+0.17	Contract	Fed decision dates
5.380	Aug 2024	May 1, Jun 12, Jul 31
5.275	Oct 2024	Adds Sep 18
Last trade, not settlement price		

Next up: March PCE inflation report Friday, April 26

Monthly			2024	2023											2023
% Changes	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Core CPI inflation	0.4	0.4	0.4	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.4	0.5	0.3	0.5	0.4
Core PCE inflation		0.3	0.5	0.2	0.1	0.1	0.3	0.1	0.1	0.2	0.3	0.3	0.3	0.4	0.5
Core PCE YOY		2.8	2.9	2.9	3.2	3.4	3.6	3.7	4.2	4.3	4.7	4.8	4.8	4.8	4.9
Core CPI YOY	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.3	4.7	4.8	5.3	5.5	5.6	5.5	5.6

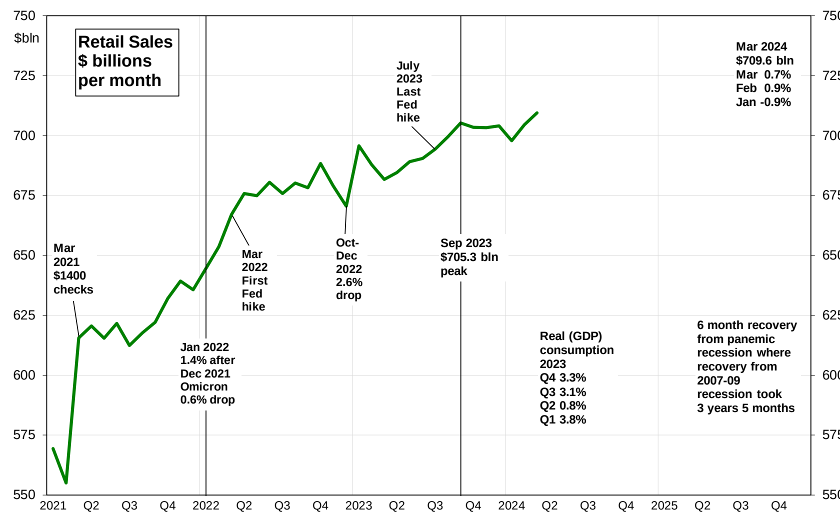
OTHER ECONOMIC NEWS

Consumer out of control (Monday)

Breaking economy news. Retail sales jumped more than expected at 0.7% in March with upward revisions that turned the story around 180 degrees from pessimism to optimism and steady resolve. January was down 1.1% with the cold winter weather at the start of the year, and now that is revised to -0.9%. The February rebound of 0.6% has now been revised to a solid 0.9% gain.

March was strong even with auto sales falling 0.7% because internet sales made all the difference. Nonstore retailers sales rose 2.7% which accounted for nearly two-thirds of the entire 0.7% retail sales increase in March. The consumer may have shied away from some storefronts but more than made up for it with purchases made on their cell phones sitting on the couch at home.

Net, net, it is time to stop all the worrying about the consumer because they bought everything that wasn't nailed down in March and momentum is strong which points to spillover moderate economic growth into the second quarter. There are plenty of risks and concerns about the outlook, and mixed readings on consumer confidence as well, but the consumer is alive and well according to retail sales at the end of the first quarter. Consumers hit it out of the park this month where retail sales in February looked weak at -2.8% for the first quarter, but now with March data and upward revisions to January and February, retail spending in Q1 2023 is up 0.2%. Don't count the consumer and the economy out yet as retail spending in Q2 2024 is running 3.2% without any data for January, February, and March. And don't forget services spending is not included in today's report, outside of restaurants and bars, and services spending is where the consumer has concentrated their dollars recently as opposed to hard goods.



Retail spending, actual dollars, each month					
	$million	% to	Percent Changes %		
	Mar	Total	Mar	Feb	Year/year
Total Retail Sales	709,590	100.0	0.7	0.9	4.0
Motor vehicles/parts	134,058	18.9	-0.7	2.5	2.8
Furniture/furnishings	10,678	1.5	-0.3	-0.3	-6.1
Electronics/appliances	7,635	1.1	-1.2	1.3	-0.6
Building materials/garden	40,881	5.8	0.7	2.3	-0.6
Food & beverage	83,047	11.7	0.5	0.2	1.4
Health/personal care	36,248	5.1	0.4	0.0	2.3
Gasoline stations	54,623	7.7	2.1	1.6	-0.7
Clothing/accessories	26,037	3.7	-1.6	0.2	1.4
Sporting goods, books	8,350	1.2	-1.8	0.7	-3.9
General merchandise	75,195	10.6	1.1	0.6	5.7
Department stores	10,923	1.5	-1.1	-0.4	-2.5
Miscellaneous retailers	16,137	2.3	2.1	1.0	6.1
Nonstore retailers (internet)	122,973	17.3	2.7	0.2	11.3
Eating & drinking places	93,728	13.2	0.4	0.5	6.5

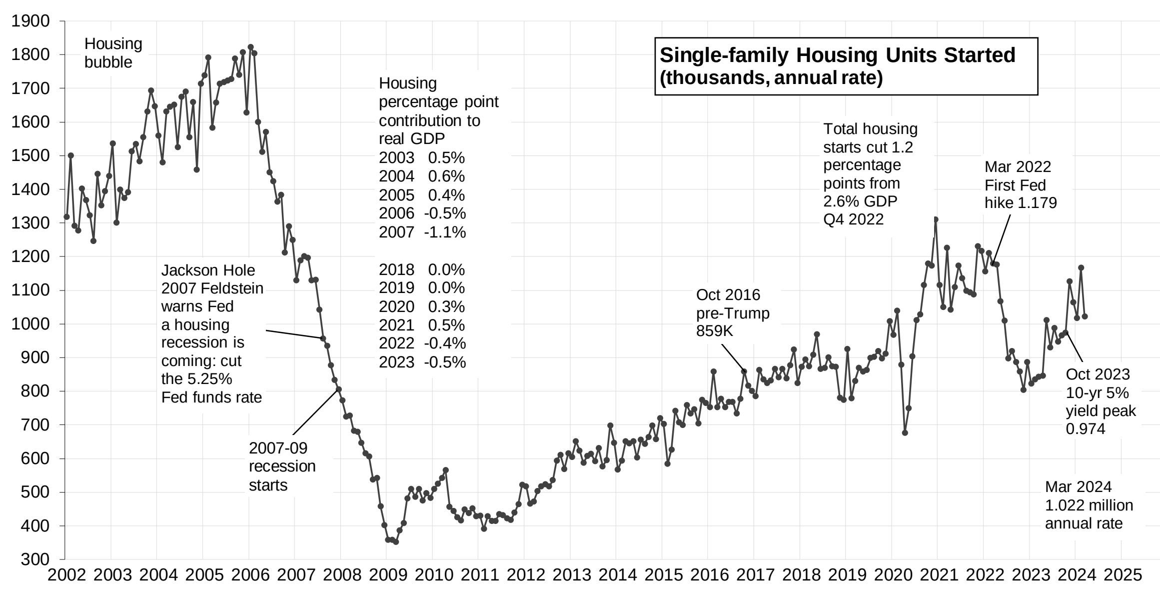
Housing recovery stalls (Tuesday)

Breaking economy news. March housing permits fell 4.3% in March to 1.458 million at an annual rate more than reversing the 2.3% gain in February. Housing starts data are more volatile tumbling 14.7% in March to 1.321 million at an annual rate after jumping 12.7% in February. Homebuilders had become more optimistic and plans to build were starting to materialize, but it is possible the recent increase in interest rates with the string of hotter inflation reports has dented the confidence of builders who are seeking lower costs of financing to jumpstart their businesses.

Net, net, the recovery in housing stumbled in March as new residential construction started dropped at double-digit rates across much of the nation, reversing a double-digit gain in February. The weather has blown hot and cold on the residential construction industry and this month it was wet and cold, or at least wet in the South where single-family home starts dropped 12.9%. Single-family construction is significantly off the lows from last year, but multifamily construction has hit the skids collapsing a spectacular 43.7% from last year. Housing construction is impacted by higher interest rates, but this is especially true for the construction of housing with 5 units or more. Fed officials have been blindsided by a string of hotter inflation and consumer spending reports, but today they received some news that their restrictive monetary policy has not yet relaxed its grip on the nation's housing markets. The housing recovery has stalled for now as home builder expectations of sharply lower interest rates this year have faded. One thing is for certain and that is home prices are going to be on an upward, more unaffordable trend without more supply, and it looks for today anyway, that more supply is not on the way.

Housing Starts Total, Single-Family, Multi-Family

	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Mar 2024	1321	1022	290	80	52	157	130	736	609	348	231
Feb 2024	1549	1167	366	125	88	204	152	895	699	325	228
Mar 2023	1380	843	515	185	67	133	113	827	535	235	128
% Chgs											
Mar/Feb	-14.7	-12.4	…	-36.0	-40.9	-23.0	-14.5	-17.8	-12.9	7.1	1.3
Mar/Mar	-4.3	21.2	…	-56.8	-22.4	18.0	15.0	-11.0	13.8	48.1	80.5



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