Financial Markets This Week

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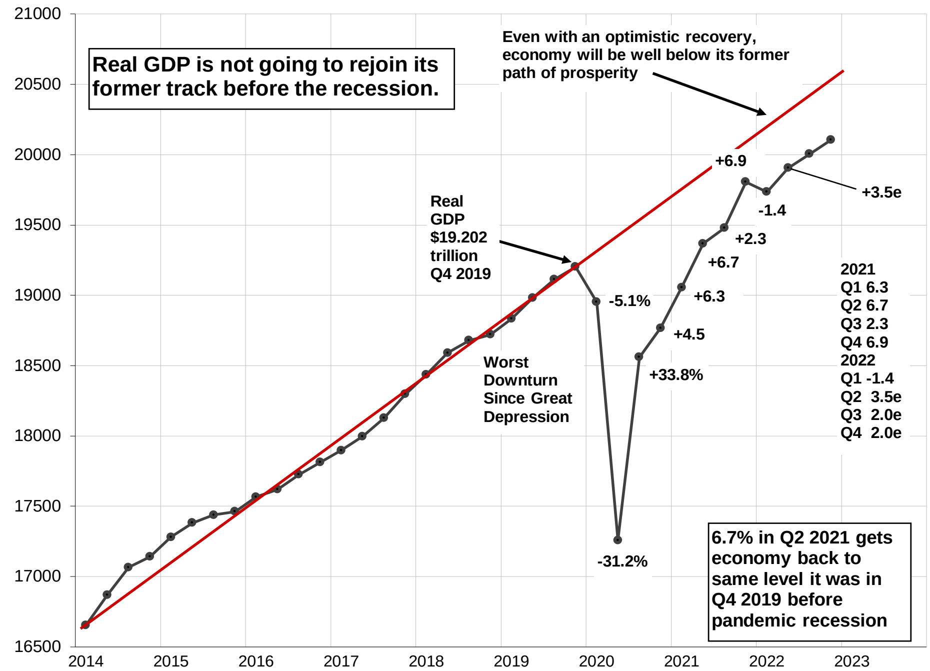
CAN'T HAVE STAGFLATION WITHOUT A LITTLE NEGATIVE GDP

Breaking economy news. The economy's jets suddenly went into reverse in the first quarter which may have important implications for next week's Federal Reserve meeting where those arguing for a more aggressive 75 bps rate hike have just had the ground cut out from under them. Real GDP fell 1.4% in an unwelcome start to the year for the economy. The optics don't look right for a supersized Fed rate hike next week when the economy is turning down even if the downturn is not in the key components of consumption and business investment in equipment.



It's not all bad news, and stock market investors barely winked at the downturn in the economy. The consumer is healthy with positive spending of 2.7% in Q1 2022 which was the normal pace before the pandemic. Consumer spending was 2.5% normal in Q4 2021 as well, so we are scratching our heads over just what happened to the Omicron effect. Consumer spending was strong this quarter because of services expenditures, including Health care, Housing and utilities, and Financial services. This is real spending not inflationary. Business spending on equipment is real, not inflationary, so the monthly record high in nondefense capital goods orders ex-aircraft earlier this week did not lie. Business equipment spending added 0.8 percentage points to GDP this quarter, the most

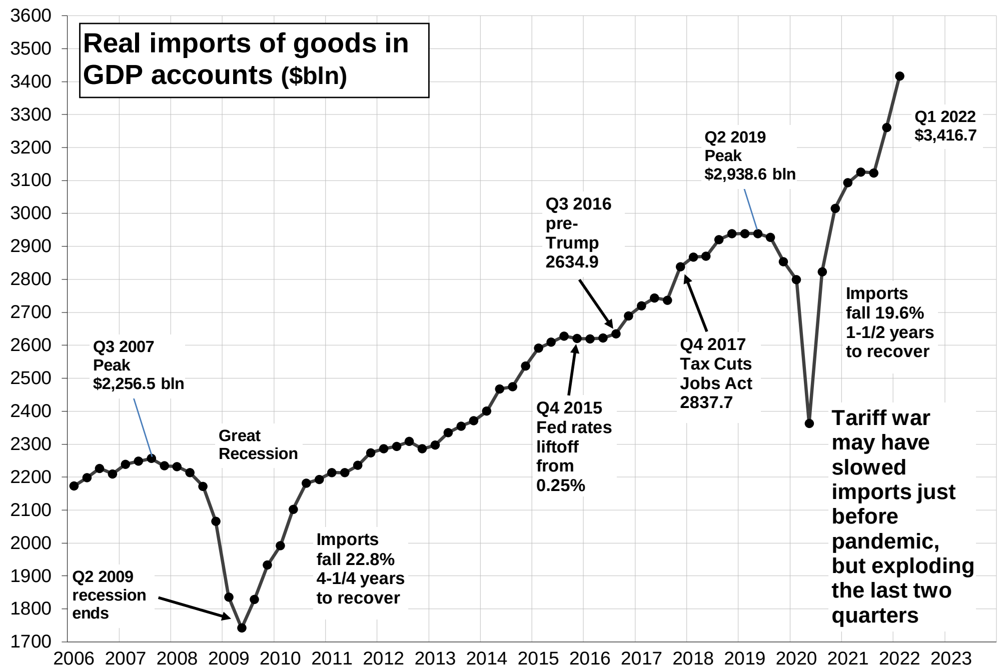
	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22p
REAL GDP	4.5	6.3	6.7	2.3	6.9	-1.4
REAL CONSUMPTION	3.4	11.4	12.0	2.0	2.5	2.7
CONSUMPTION	2.3	7.4	7.9	1.4	1.8	1.8
Durables	0.1	3.5	1.0	-2.5	0.2	0.4
Nondurables	-0.2	2.2	2.0	0.3	0.1	-0.4
Services	2.3	1.8	4.9	3.6	1.5	1.9
INVESTMENT	4.0	-0.4	-0.7	2.1	5.8	0.4
Business Plant	-0.2	0.1	-0.1	-0.1	-0.2	0.0
& Equipment and	1.3	0.8	0.7	-0.1	0.2	0.8
Intellectual Property	0.5	0.8	0.6	0.5	0.5	0.4
Homes	1.3	0.6	-0.6	-0.4	0.1	0.1
Inventories	1.1	-2.6	-1.3	2.2	5.3	-0.8
EXPORTS	2.1	-0.3	0.8	-0.6	2.2	-0.7
IMPORTS	-3.7	-1.3	-1.0	-0.7	-2.5	-2.5
GOVERNMENT	-0.1	0.8	-0.4	0.2	-0.5	-0.5
Federal defense	0.2	-0.3	0.0	-0.1	-0.2	-0.3
Fed nondefense	-0.4	1.0	-0.3	-0.3	-0.1	-0.1
State and local	0.1	0.0	0.0	0.5	-0.2	-0.1

Below line: Percentage point contributions to Q1 2022 -1.4% real GDP

Second estimate for Q1 is Thursday, May 26

since the fourth quarter of 2020. The biggest declines behind Thursday's negative 1.4% real GDP came from the contributions of net exports with -3.2 percentage points, inventories -0.8 percentage points, and government -0.5 percentage points. This is the most lopsided GDP report we have seen in a while with big-minuses nearly matched by big-pluses.

Globalization Not Dead Yet In America



Net, net, the economy fell unexpectedly in the first quarter and one more down quarter means the recession has started. The stagflation from the 80s is officially back with declining output and soaring inflation fires that the Federal Reserve is struggling to put out. They say they have what it takes to do the job in their toolkit, but we don't know. Nevertheless, if it is the start of a recession, consumers, businesses buying more equipment, and importers bringing in record amounts of goods don't know it. Moreover, the only thing missing for the recession to start are job losses and Thursday's rock-bottom low of 180 thousand initial unemployment claims for the April 23 week shows there are no job losses. Stay tuned. Reading the tea leaves of what lies ahead for the economy just got a whole lot harder. At least, we know that stagflation is officially back. Can't have stagflation without a little negative GDP and today we got it right between the eyes.

Equipment spending jumps in Q1 2022, computers/software remain strong — Real Percent Changes Annualized

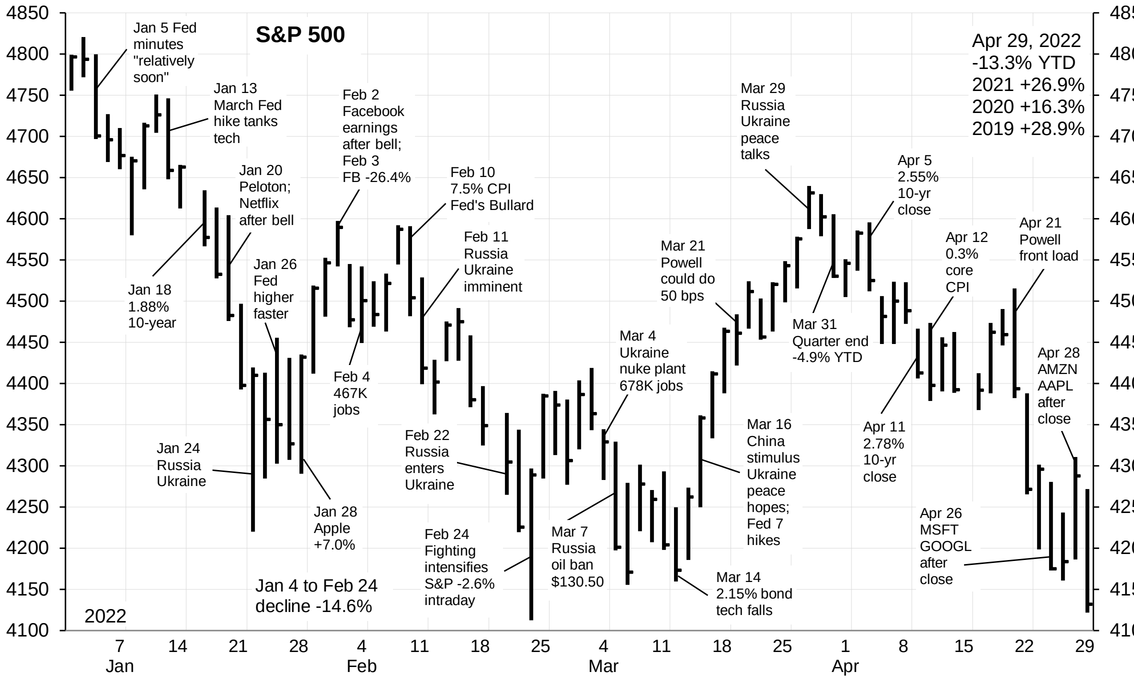
$BLN Nominal GDP expenditures	Q4 17	YOY%	Q4 18	YOY%	Q4 19	YOY%	Q4 20	YOY%	Q4 21	YOY%	Q2 21	Q3 21	Q4 21	Q1 22
Core Durable goods orders *	63,714	7.3	65,430	2.7	65,292	-0.2	70,603	8.1	79,035	11.9	19.1	8.0	9.0	6.9
EQUIPMENT	1152.0	6.7	1224.2	6.3	1210.3	-1.1	1197.5	-1.1	1307.7	9.2	12.1	-2.3	2.8	15.3
Information processing equipment	382.1	8.2	390.6	2.2	390.2	-0.1	447.3	14.6	492.1	10.0	-7.8	-1.4	28.7	22.4
Computers	108.2	10.0	119.2	10.2	118.9	-0.3	138.9	16.8	151.8	9.3	-35.8	12.2	23.5	42.3
Other processing equipment 1	273.9	7.5	271.4	-0.9	271.3	0.0	308.5	13.7	340.4	10.3	8.5	-6.7	31.0	14.2
Industrial equipment	231.7	8.1	250.1	7.9	247.8	-0.9	253.4	2.3	310.1	22.4	32.9	6.6	14.1	23.8
Transportation equipment	303.7	4.9	325.2	7.1	307.4	-5.5	217.1	-29.4	205.8	-5.2	52.1	-16.3	-35.6	-9.1
Other equipment 2	234.5	5.3	258.3	10.1	264.8	2.5	279.7	5.6	299.6	7.1	3.3	-0.6	-9.6	13.7
INTELLECTUAL PROPERTY	897.0	6.4	987.7	10.1	1057.0	7.0	1112.9	5.3	1246.0	12.0	12.5	9.1	8.9	8.1
Software	376.2	8.5	412.8	9.7	439.1	6.4	466.0	6.1	518.3	11.2	14.1	9.3	5.5	9.8
Research & Development (R&D)	433.8	5.2	483.7	11.5	524.3	8.4	561.3	7.1	625.6	11.5	11.2	7.2	9.5	6.3
Entertainment, literary, artistic	87.0	3.9	91.2	4.8	93.6	2.6	85.6	-8.5	102.1	19.3	12.2	21.0	24.1	10.3

1 Communication, medical, photocopy, office and accounting equipment; nonmedical instruments

2 Furniture; agriculture, construction, mining/oilfield, and service industry machinery; electrical equipment

* Nondefense capital goods orders ex-aircraft $mln: monthly proxy for business investment spending (not in GDP report)

INTEREST RATES

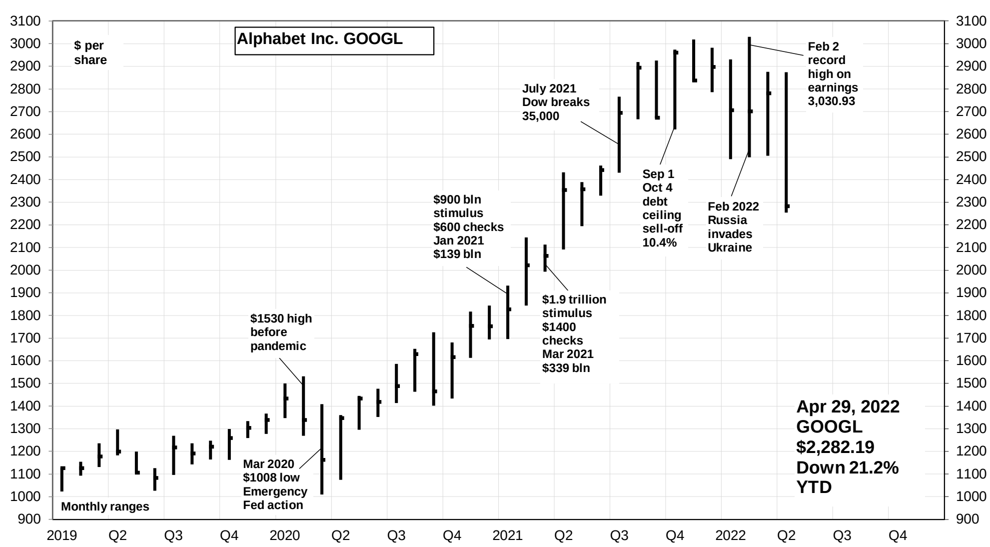


Bond yields fell with stocks Monday and Tuesday, but rallied back Wednesday when stocks just about stopped falling. There's a Fed meeting next week after all and some dealers are warning the Fed might have to jack rates up to 5-6 percent to break inflation. Thanks a lot. The S&P 500 tried but was unable to close below the old low close for the year on March 8 when stocks were down 12.5% YTD. Is that all? If it is really a recession, every recession since the 70s has led stocks to fall at least 20%. Stocks tried the year's closing low again Friday after earnings from Amazon and Apple Thursday night. **Made it, and Monday looks like it could be a disaster for the stock market. Bond yields moved higher Friday waiting on the Fed next week: QT announcement and 50 bps rate hike expected.

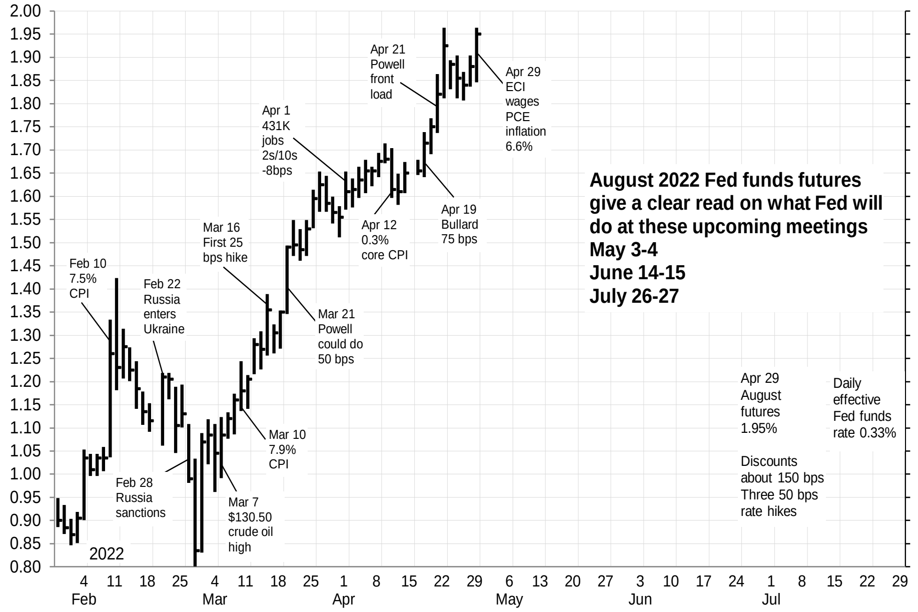
Alphabet, Inc. GOOGL 21.2% down on year with revenue slowdown

Alphabet fell after reporting earnings Tuesday by 3.7% on Wednesday. The stock's record high was made the day after last quarter's earnings report hitting $3,030.93 on February 2. A lot has changed in three months. The Street didn't like the company's slowdown in sales perhaps, 23.0% YOY versus 32.4% YOY in Q4 2021. YouTube ads disappointed at $6.869 billion; not sure how many social media videos the world can digest. Google Cloud sales up 43.8% to $5.821 billion, but still losing money.

S&P 500 Weights	
Top 6: 24% of S&P	
7.00	AAPL
5.99	MSFT
3.49	AMZN
2.03	TSLA
1.67	Berkshire
1.97	GOOGL
1.83	GOOG
23.98	Top 6



FEDERAL RESERVE POLICY



The Fed meets on May 3-4, 2022 to consider its monetary policy. A 50 bps rate hike is expected. The market expects a 50 bps rate hike at each of the next three Fed meetings in fact. That would put the Fed funds rate at 2.0% by the start of August so that means time to put some money in an online savings account that will pay 2% interest instead of zero that our bank offers savers. 2% will help make up for Friday's 3.6% S&P 500 loss on our 401K retirement savings.

Other than a 50, 75, 100 bps hike, hike, hike on Wednesday May 4 at 2pm ET, what else could go wrong. Right, balance sheet reduction, so-called quantitative tightening (QT). We aren't all that sure that messing with supply and demand of Treasury bonds has that great of an impact on paper anyway, but the announcement of QE and QT sure has a psychological impact on the markets, stocks and bonds, at least for a day or two.

Selected Fed assets and liabilities					March 11
Fed H.4.1 statistical release					2020**
billions, Wednesday data	27-Apr	20-Apr	13-Apr	6-Apr	pre-Covid
Factors adding reserves					
U.S. Treasury securities	5764.013	5763.035	5762.054	5761.052	2523.031
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347
Mortgage-backed securities (MBS)	2715.012	2730.687	2740.185	2715.355	1371.846
Repurchase agreements	0.000	0.000	0.001	0.003	242.375
Primary credit (Discount Window)	2.917	2.181	0.579	0.379	0.011
Paycheck Protection Facility	21.791	22.173	22.679	23.494	
Corporate Credit Facility (CCF)	0.000	0.000	0.000	0.000	
Municipal Liquidity Facility	6.657	6.656	6.655	6.654	
Main Street Lending Program	28.486	28.476	28.886	28.876	
Term Asset-Backed Facility (TALF II)	2.513	2.512	2.512	2.511	
Central bank liquidity swaps	0.214	0.237	0.233	0.366	0.058
Federal Reserve Assets	8988.2	9005.4	9015.0	8987.1	4360.0
~~3-month Libor %~~ SOFR %	0.28	0.27	0.29	0.30	1.15
Factors draining reserves					
Currency in circulation	2270.662	2270.489	2271.295	2270.982	1818.957
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	957.419	907.526	543.536	545.584	372.337
Treasury credit facilities contribution	21.258	21.258	21.258	21.258	
Reverse repurchases w/others	1803.333	1866.560	1815.555	1731.472	1.325
Reserve Balances (Net Liquidity)	3327.548	3326.857	3793.317	3849.872	1779.990
Treasuries within 15 days	78.805	87.731	80.221	82.461	21.427
Treasuries 16 to 90 days	328.227	327.570	325.527	323.510	221.961
Treasuries 91 days to 1 year	773.813	769.484	777.433	777.154	378.403
Treasuries over 1-yr to 5 years	2158.802	2158.441	2168.501	2168.112	915.101
Treasuries over 5-yrs to 10 years	1017.134	1016.826	1006.555	1006.251	327.906
Treasuries over 10-years	1407.233	1406.984	1403.816	1403.564	658.232

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

The Fed wants to retrace their steps, reset the clock, for some reason on the balance sheet. On April 27, they held $5.764 trillion U.S. government securities and before the pandemic they held $2.523 trillion. The March 15-16 FOMC meeting minutes said they were considering $60 billion per month runoff of Treasuries and $35 billion runoff of MBS. Monthly QE after the pandemic settled into $80 billion and $40 billion pace, respectively, once the crisis settled down until it finished in March this year. 60 X 12 equals a $720 billion annual reduction of Treasuries that will boost the amount of Treasury bonds that need to be auctioned next year in addition to financing the FY2023 $1.2 trillion Federal budget deficit. We will see if extra supply pushes yields higher, actually we won't be able to see or measure or isolate the effect. The MBS reductions are an accident waiting to happen where it could send the cost of borrowing to buy a new home soaring. They talk about wanting to reduce the $2.715 trillion MBS to zero someday way far down the road; they would have to sell them to the market to get rid of them.

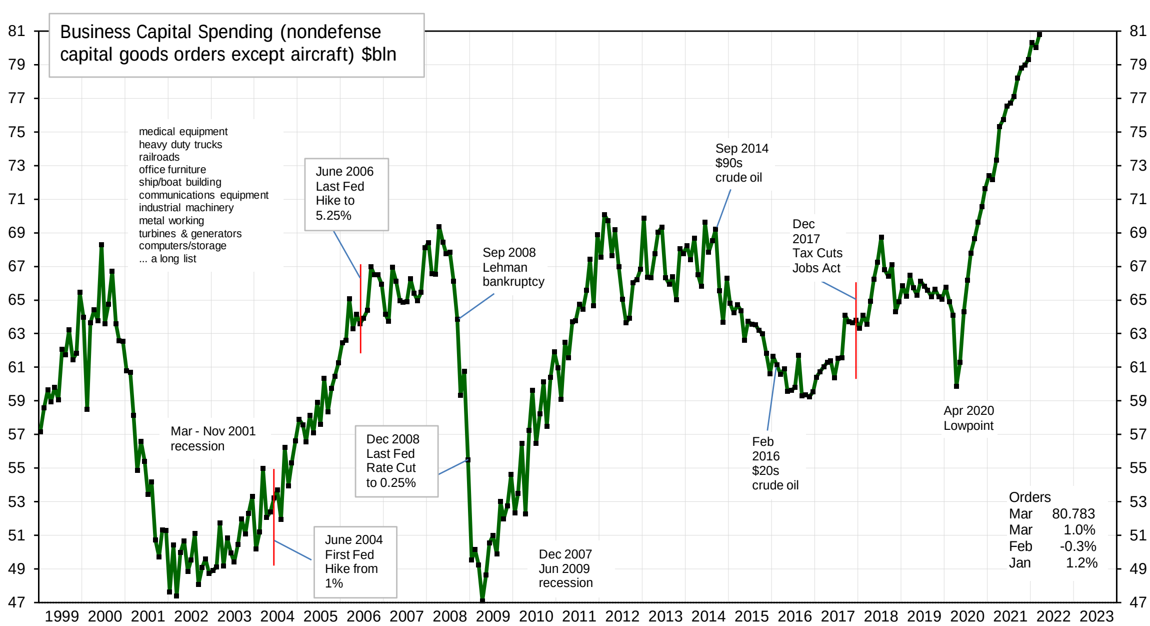
OTHER ECONOMIC NEWS

Full-speed ahead for U.S. manufacturing (Tuesday)

Breaking economy news. Nondefense capital goods orders ex-aircraft rose 1.0% to a new all-time high of $80.783 billion in March. Manufacturing remains strong in the face of uncertainty, but it isn't that strong as inflation is running the fastest in decades. Factories are shoving record dollar amounts of equipment out the door, but a lot of the final bill is the result of the higher cost of inflation.

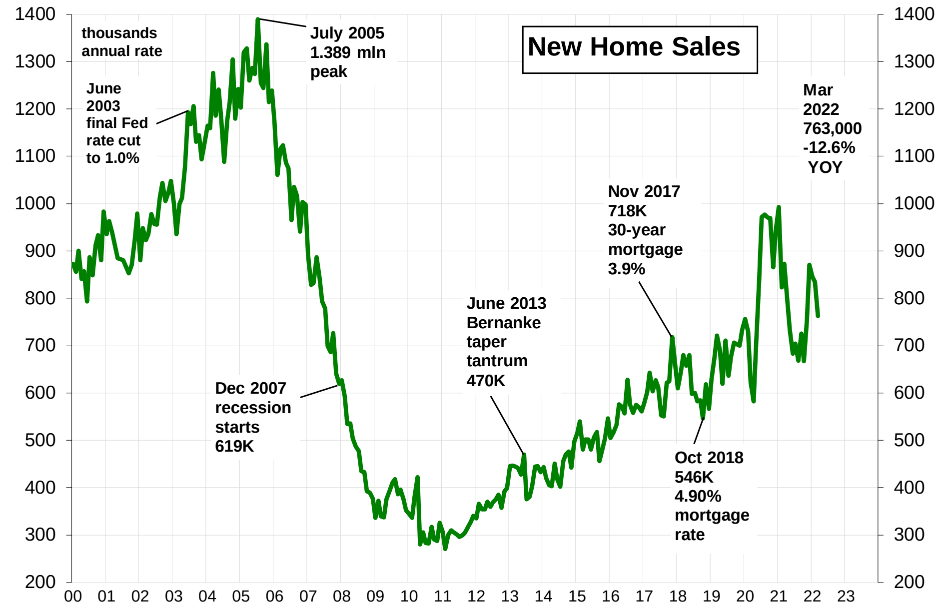
Nevertheless, the Fed is tightening its policy at a furious rate which could lead to a slowdown in the economy or outright downturn or recession. Nondefense capital goods orders ex-aircraft has been a good leading indicator of when the economy hits an air pocket and falls sharply. No sign of that happening in today's report as orders are still going straight up in a way that has not been seen coming out of the prior recessions of the 2000s. New orders in March, electrical equipment, appliances and equipment jumped 3.9%, computers and related products up 1.3%, communications equipment surged 7.0%. machinery orders up 0.7%. Everything is up, up, up.

Net, net, businesses are ordering record amounts of new equipment despite the uncertainty of war in Europe and tumbling financial markets which counts as great news except increasingly there is a lot of inflation behind this surge in new orders as the cost of everything everywhere is going up faster than anytime since the 1980s. Nonfuel import prices for example used in the manufacturing of goods in the U.S. are up 7.5% the last year and the year-on-year gain in nondefense capital goods orders ex-aircraft are up 10.4% for the first quarter. It's full speed ahead for business orders of key capital goods, but the only uncertainty is how much of it is real as opposed to inflationary. One thing is for sure and that is the Fed is way behind the curve in fighting inflation and behind the curve of market expectations. The durable goods report is one that tells Fed officials to go big next week, go 75 or 100 bps on a rate hike, they won't be surprising anyone, that's for sure.

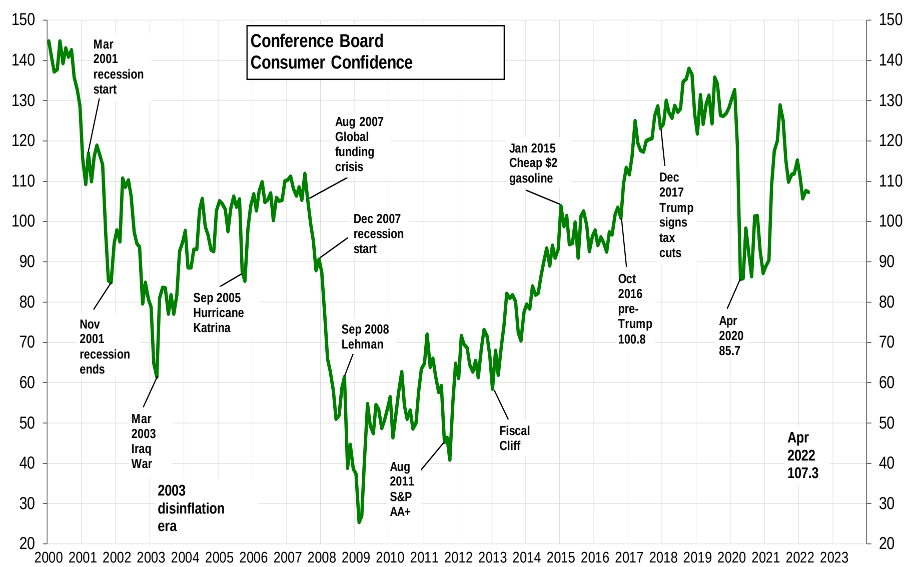


New home sales plummet, confidence holds (Tuesday)

Breaking economy news. New home sales tumbled 8.6% in March to 763 thousand at an annual rate. The data on sales from new homes is more immediate than existing home sales because new home sales data are recorded when the contract is signed. There is weakness in March and more pain may be on the way because mortgage rates had not risen above 5.0% yet until April. The cost of borrowing may be throwing the market for homes into a tailspin even if there is a huge shortage of homes available for sale. Meanwhile, new home prices jumped back in March after a brief decline in February. The median sales price is up 3.6% in March to $436,700 and incredibly it is 10.0% higher than the $397,100 average price for all of 2021. The Housing Bubble II continues to inflate which can only mean the Federal Reserve ain't done nothing yet if they are trying to slow economic activity down. Consumer confidence is holding for the moment at 107.3 in April down from 107.6 in March, but the heady days of optimism with the economy's reopening a year ago are gone.

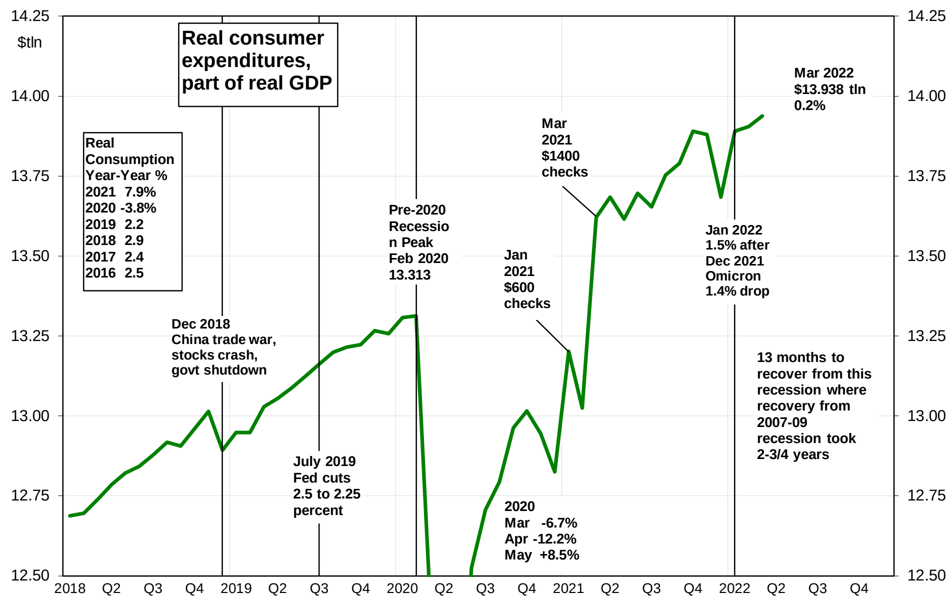


Net, net, confidence in the economic expansion is holding for the moment, but for how long is the question with new home sales tumbling and inflation robbing both consumers and businesses blind. Money illusion is back big time where you think you have more cash in your pocket only to find out it buys less and less at the supermarket or the mall. Let the buyer beware as New home sales are starting to retreat and that is the first sign historically that a downturn in the overall economy may be on the horizon as home price inflation and the Fed's messaging on rates is making it more costly to buy a new home. Inflation is robbing the economy blind. Bet on it. Buy stocks as a hedge.



Core consumer inflation peak, more wages for all (Friday)

Breaking economy news. Personal income report for March (if you have money left in the bank, spend it before inflation deflates the worth of your dollars any further) and employment cost index for Q1 2022. First we look at inflation then whether consumer spending is slowing to fight inflation. Pay no attention to that man behind the curtain, forget that you saw PCE headline inflation jump to 6.6% from 6.3% last month. It's all due to energy and food prices after Russia invaded Ukraine. Energy up 33.9% the last year has peaked for now. Food prices up 9.2% the last year are still rising. Core PCE inflation was 5.4% in February, but with today's data, February is 5.3% and March is 5.2%. Inflation has peaked! Based on the employment cost index for Q1 2022 workers may have just enough of a wage increase to offset core consumer inflation. Almost. Private industry wages and salaries year-to-year are up 5.0% in Q1 2022 versus being 5.0% higher in Q4 2021. Wages and prices spiraling upward together in beautiful harmony, and this is why inflation is going to persist.



ECB President Lagarde has said rate hikes can't stop inflation caused by lack of supply and higher oil prices, but we know that rate hikes can curb demand and stop other economic actors from matching that supply-chain and shortage inflation by pushing up their own prices of the goods and services they control. Anyway, the key finding today is that core consumer goods prices have peaked and perhaps wages have peaked as well at a year-over-year rate of roughly 5.0%. We guess this means the Fed no longer has to push interest rates to 6.0% like some Wall Street dealers are saying, something that would bankrupt many financial institutions at least on paper, just like the Fed engineered double-digit rates of the 80s did.

Net, net, the data have inflation peak written all over it this morning. Peaking at a very high level with the huge unknown on how quickly it will return to 2.0% target, but at least it isn't worsening. Consumers are the backbone of the economy and their spending continues at a normal rate despite everything the world has thrown at them in the first quarter this year from war in Europe to a stock market rout. Real consumption rose 0.2% in March (think 0.2 X 12 equals 2.4% normal) after some crazy revisions that had no net effect. February's 2.1% increase is now 1.5%, and March's 0.4% decline is now up 0.1%. We don't analyze it, we just report it. There's nothing about to go wrong with the economy with the consumer still cheerleading the way forward to prosperity. No recession on the horizon yet. Let's see what Fed officials do next week. Do they bring out the big guns or do they settle for Powell's 50 bps on the table.

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