

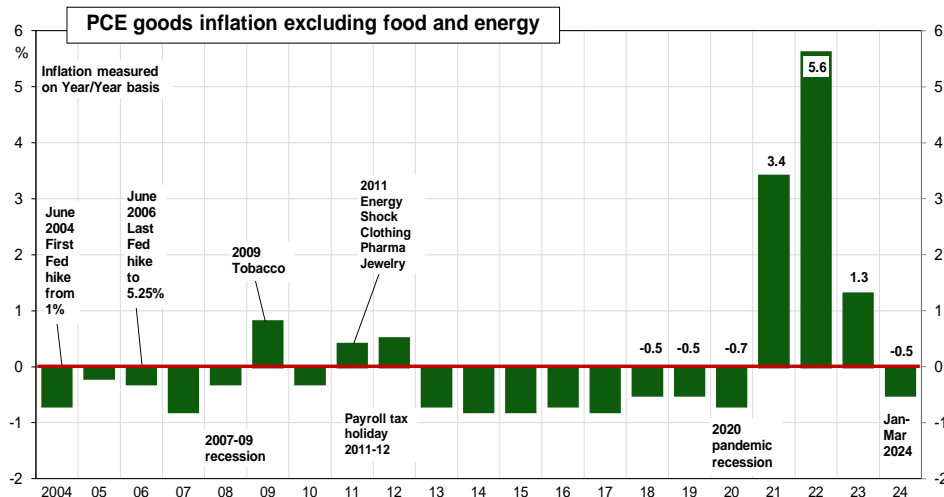
Financial Markets This Week

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INFLATION BACK TO NORMAL

The Fed cannot do anything about food or energy is the thinking, although if economic demand is hit hard enough by monetary or fiscal restraint, those prices for fuel going into the gas tank, and food and beverages on the store shelves, are going to come down, or at least the price increases should slow.

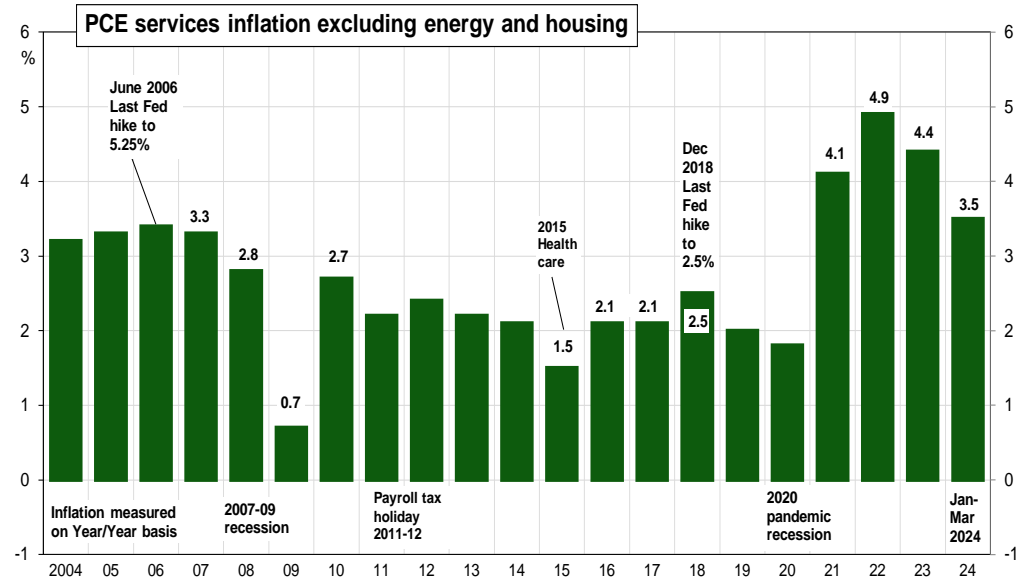


That leaves the Fed fighting commodities and services inflation, and right now commodities prices are back to doing what they used to do before the pandemic. Back to normal. PCE goods inflation doesn't always do what you expect inflation to do. The Fed raised rates to 5.25% "recession" levels before back in 2006, and core goods prices never even increased on a full year-on-year basis. Maybe because of all those cheap goods coming in from overseas as US companies moved their factories over there to cut costs. CEOs said investors told them to move their manufacturing operations to China. More recently, the pandemic outbreak in core goods prices erupted, moving from negative to plus 3.4% in 2021 and 5.6% at the worst point in 2022 where the Fed finally got interest rates raised to 4.5% by December of 2022. They were slow off the mark because they thought inflation was temporary. Anyway, core PCE goods inflation is running back at the old normal rate, where it is falling 0.5% year-on-year through the first three months of 2024, same as it was before the pandemic.

Every day it seems another FOMC member points to the failure of consumer inflation to fall further. It is still possible there is a first quarter problem where prices jump seasonally each year during winter, and the seasonal factors cannot tamp it down. The last two monthly core CPI changes were barely 0.4%. Maybe better days lie ahead.

Core CPI not seasonally adjusted monthly % changes												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2018	0.4	0.4	0.3	0.2	0.2	0.1	0.1	0.1	0.2	0.2	0.0	0.0
2019	0.4	0.4	0.3	0.2	0.1	0.2	0.1	0.2	0.1	0.2	0.0	-0.1
2020	0.4	0.5	0.0	-0.5	-0.1	0.2	0.5	0.4	0.1	0.1	0.1	-0.1
2021	0.2	0.3	0.4	0.8	0.7	0.8	0.3	0.1	0.1	0.6	0.4	0.4
2022	0.7	0.7	0.4	0.5	0.6	0.7	0.3	0.5	0.4	0.3	0.1	0.2
2023	0.6	0.7	0.5	0.5	0.4	0.3	0.2	0.2	0.2	0.2	0.1	0.1
2024	0.6	0.6	0.5									

Services prices are sticky coming back down or perhaps a better characterization is there is always higher services inflation historically looking back to the last housing bubble in the mid-2000s. PCE core prices in the graph here strip out energy and housing. This inflation was faster before the Great Recession in 2007-09, partly due to health care costs. Health care has one of the largest weights in PCE inflation. We look at this ex-housing because there may not be a lot that can be done to bring home prices down. Fed officials are often talking about what is happening on rents within housing prices, but housing is of much smaller importance in PCE than it is in CPI. Housing was 15% of PCE in December and housing in CPI was 36% in the latest report. Anyway, services inflation is coming down and is 3.5% year-to-year in Q1 2024 down from the 4.9% peak in 2022 and it was 2.0% or lower in 2019 and 2020 before the pandemic got rolling.



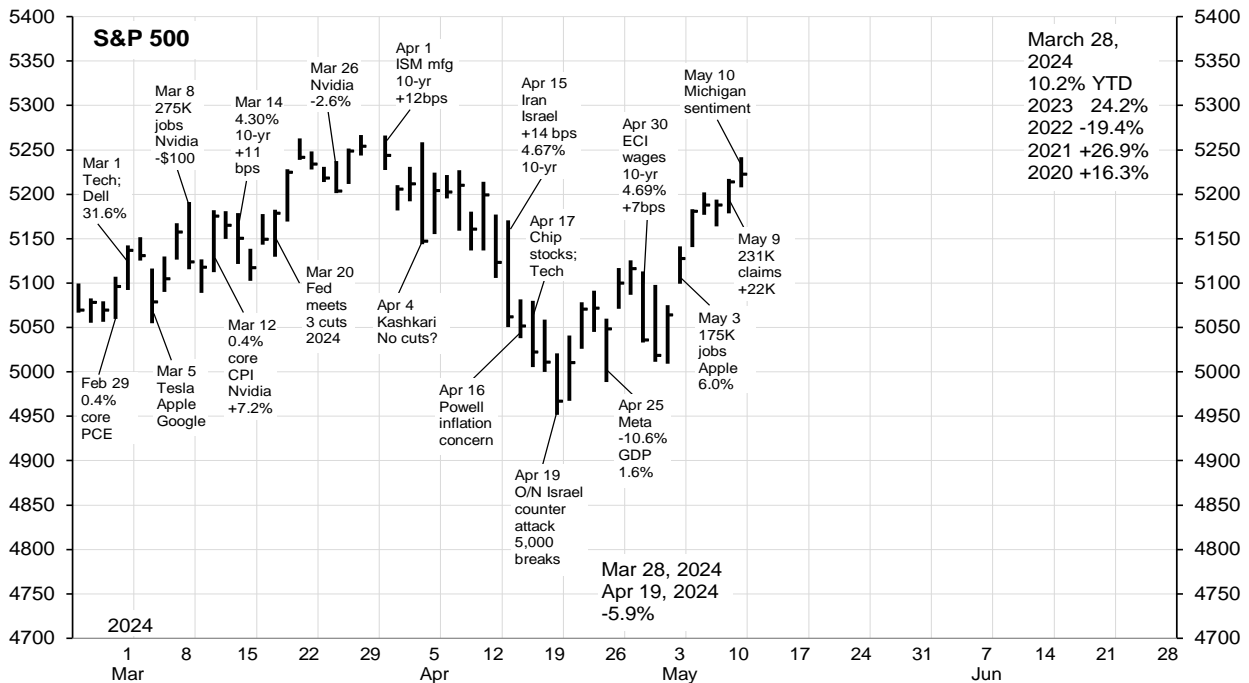
How are the other goods and services prices doing. Housing is 5.3% in Q1 2024 down from the 7.6% peak in 2023 and 3.4% in 2018-19 before the pandemic. Not a lot for the Fed to do here if 7% mortgage rates are not bringing home prices down. Food prices are back to normal, running 1.4% in Q1 2024. The Fed

Jan-Mar	2024	2023	2022	2021	2020	2019	2018
	2.6	3.7	6.5	4.2	1.1	1.4	2.0 PCE (100%)
	-0.5	1.3	5.6	3.4	-0.7	-0.5	-0.5 PCE goods x-food, energy (22.8%)
	3.5	4.4	4.9	4.1	1.8	2.0	2.5 PCE services x-energy, housing (50%)
	5.3	7.6	5.8	2.5	2.8	3.4	3.4 Housing x-utilities (15.4%)
	1.4	5.0	10.3	3.1	3.3	1.0	0.5 Food (7.7%)
	-1.5	-5.2	25.7	20.8	-8.5	-2.1	8.1 Energy (4.1%)
	(% Weights relative to total PCE)						
	3.1	2.3	2.4	2.9	2.5	1.8	1.9 Health care (16.3%) incl. svcs above
	2.9	4.1	5.2	3.6	1.3	1.6	1.9 Core PCE (88.2%) Fed target

and the White House are sorry shoppers, but food prices overall never seem to fall and offset the big jump for instance of 10.3% in 2022. Water under the bridge. Energy has its own story, but prices stable/falling for now. Health care could be a problem again like it was over twenty years ago and needs to be watched as it was 3.1% in Q4 2024 after being slightly under 2.0% prior to the pandemic.

Powell said the inflation data in Q1 2024 is not what they wanted to see. The others were listening closely the way employees always do to the boss, or maybe it is the other way around, but no rate cuts look teed up listening to the latest Fedspeak. Fed forecasts in March were for core PCE inflation to fall to 2.6% in Q4 2024 (it was 2.8% in March 2024 year-year) and they also said they would cut rates three times. 2.8% is close to enough to their 2.6% “expectations” you would think, but the Fed is concerned about the current 0.3% monthly run rate which would mean core PCE inflation of 3.6% pretty soon without some future 0.1 or 0.2% monthly changes somewhere, sometime down the road.

INTEREST RATES

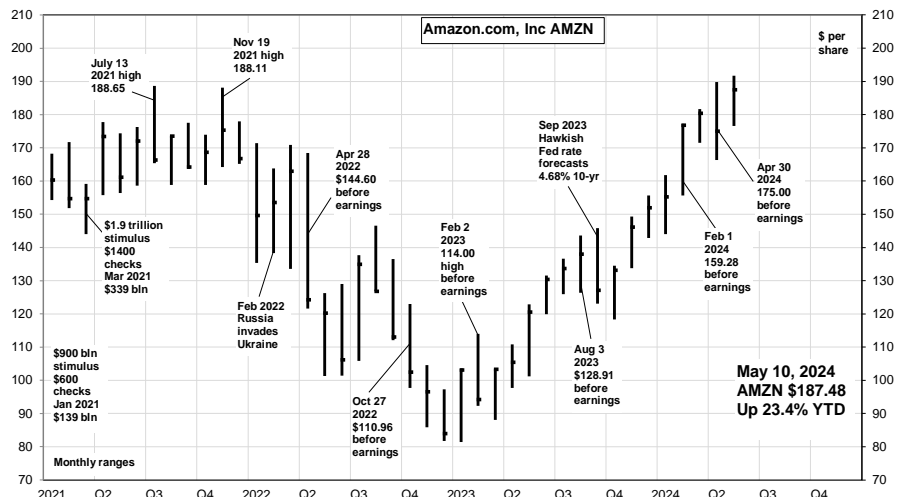


Bond yields moved sideways this week closing at 4.50% versus 4.52% the week before. Lots of Fed speak, little economic data, and the quarterly Treasury refunding auctions, all with minor intraday moves hard to explain although sometimes moving with European yields. The only day that was crystal clear was Thursday, when the 22K rise in jobless claims to 231K brought down yields and yields fell further after the 30-year auction results at 1pm. So much for the Federal government spending crisis stopping investors from buying US debt. Michigan consumer sentiment fell on Friday, but they saw more inflation ahead (how would they know?); Treasury yields had already risen a lot before the 10am ET release. We were planning to look at our 401K holdings after the close on Friday, but stocks did not like the Michigan sentiment report. CPI is May 15: core 0.4% (0.359) in March.

Amazon.com, Inc. (AMZN) up 23.4% YTD

Amazon reported Tuesday, April 30 after the bell and traded up as much as 5.8% the next day, falling from the highs after the failed Powell press conference rally. Earnings beat expectations and AWS income jumped year-on-year and quarter to quarter. Amazon income minus AWS did not fall much from Q4 2023 as well. The company did not make any money without AWS for all of 2022. The company volunteered that the web services revenue would be \$100 billion at some point.

Calendar Year	Net Sales Mln \$	Operating Income	AWS Sales	AWS Income	Income minus AWS
Q1 2024	143,313	15,307	25,037	9,421	5,886
Q4 2023	169,961	13,209	24,204	7,167	6,042
Q3 2023	143,083	11,188	23,059	6,976	4,212
Q2 2023	134,383	7,681	22,140	5,365	2,316
Q1 2023	127,358	4,774	21,354	5,123	-349
Q4 2022	149,204	2,737	21,378	5,205	-2,468
Q3 2022	127,101	2,525	20,538	5,403	-2,878
Q2 2022	121,234	3,317	19,739	5,715	-2,398
Q1 2022	116,444	3,669	18,441	6,518	-2,849



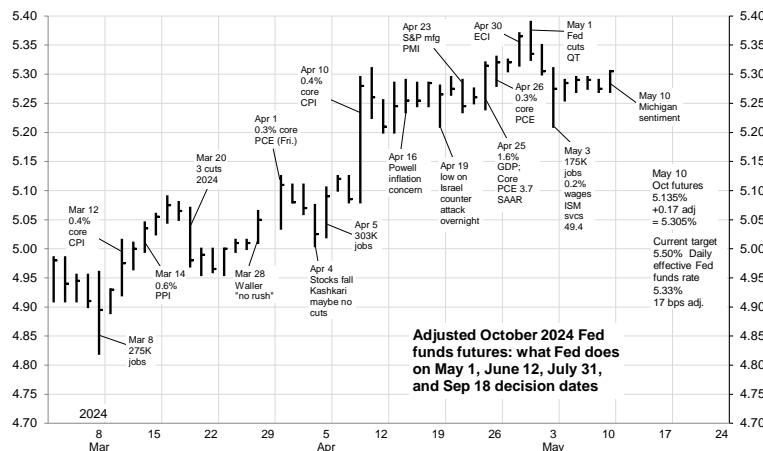
FEDERAL RESERVE POLICY

The Fed meets June 11-12, 2024 to consider its monetary policy. Heck, this was supposed to be the first of the three normal, regular quarterly 25 bps rate cuts this year, 75 bps in total for June, September, December. Fed officials are talking tough about how monetary policy is restrictive enough, but it needs more time to work. Core PCE inflation is 2.8% year-on-year and at some point Fed officials may need to tell us what will happen if it sticks at 2.8%, or if it is still 2.8% in December this year. The other problem is interest rate cuts may pump up the home price bubble and make the cost of a roof over your head even more unaffordable. It isn't clear what another rate hike might do to bring consumer inflation down any faster. Everyone is wondering whether a hard landing with millions of unemployed is necessary to bring inflation down. The Fed cannot change its 2.0% inflation target, but maybe it should remain aspirational like Rubin's strong dollar policy.

Selected Fed assets and liabilities						Change from
Fed H.4.1 statistical release	8-May	1-May	24-Apr	17-Apr	3/11/20*	3/11/20 to May 8
Factors adding reserves						
U.S. Treasury securities	4518.691	4517.906	4539.799	4539.133	2523.031	1995.660
Federal agency debt securities	2.347	2.347	2.347	2.347		0.000
Mortgage-backed securities (MBS)	2372.049	2372.049	2384.720	2388.241	1371.846	1000.203
Repurchase agreements	0.001	0.000	0.005	0.007	242.375	-242.374
Primary credit (Discount Window)	6.198	6.791	7.018	8.559	0.011	6.187
Bank Term Funding Program	112.663	124.117	125.492	125.706		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	2.949	2.962	2.975	3.017		
Main Street Lending Program	14.130	14.114	14.518	14.505		
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	0.125	0.124	0.137	0.174	0.058	0.067
Federal Reserve Total Assets	7404.5	7413.0	7453.4	7456.5	4360.0	3044.451
3-month Libor %	5.31	5.32	5.31	5.31	1.15	4.160
Factors draining reserves						
Currency in circulation	2348.973	2346.816	2344.784	2346.705	1818.957	530.016
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	816.809	890.442	929.379	929.932	372.337	444.472
Treasury credit facilities contribution	7.438	7.438	7.438	7.438		
Reverse repurchases w/others	493.427	438.148	441.215	440.508	1.325	492.102
Federal Reserve Liabilities	4073.790	4096.104	4181.725	4126.937	2580.036	1493.754
Reserve Balances (Net Liquidity)	3330.687	3316.943	3271.706	3329.532	1779.990	1550.697
Treasuries within 15 days	89.940	94.329	61.251	61.999	21.427	68.513
Treasuries 16 to 90 days	212.031	184.358	241.502	244.872	221.961	-9.930
Treasuries 91 days to 1 year	522.131	545.252	525.436	521.232	378.403	143.728
Treasuries over 1-yr to 5 years	1506.100	1505.775	1517.921	1517.634	915.101	590.999
Treasuries over 5-yr to 10 years	678.562	678.459	684.209	684.107	327.906	350.656
Treasuries over 10-years	1509.928	1509.733	1509.480	1509.289	658.232	851.696
Note: QT starts June 1, 2022	Change	Change	5/1/2024	6/1/2022		
U.S. Treasury securities	-5770.779	-1252.873	4517.906	5770.779		
Mortgage-backed securities (MBS)	-2707.446	-335.397	2372.049	2707.446		

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

Minneapolis Fed President Kashkari was on Tuesday, starting early, first with a [website presentation](#) before going somewhere for a fireside chat, where there were more headlines. He mentioned rate hikes. Just looking at Friday headlines, Fed Governor Bowman doesn't see a rate cut in 2024. Atlanta Fed President Bostic still sees just one rate cut. Fed members are talking away, higher rates forever, without waiting to see whether the first quarter inflation data was the outlier. The only good we see in these comments is the speculation that given the economy's strength, perhaps the long run neutral interest rate is not 2.5%, maybe it is higher. It was 4.25% in the FOMC first forecasts at the start of 2012. We don't want to see them cutting rates any lower than 3% once they reverse this policy restraint.



August Fed funds futures say it is not looking good on a rate cut by July 31. The last trade on the day Friday for October futures discount 20 bps of one 25 bps rate cut before the election, meaning September really. 80% chance.

Fed funds futures call Fed policy	
Current target: May 10 -- 5.50%	
Rate+0.17 Contract Fed decision dates	
5.420 Aug 2024	June 12, July 31
5.300 Oct 2024	Adds Sep 18
Last trade, not settlement price	

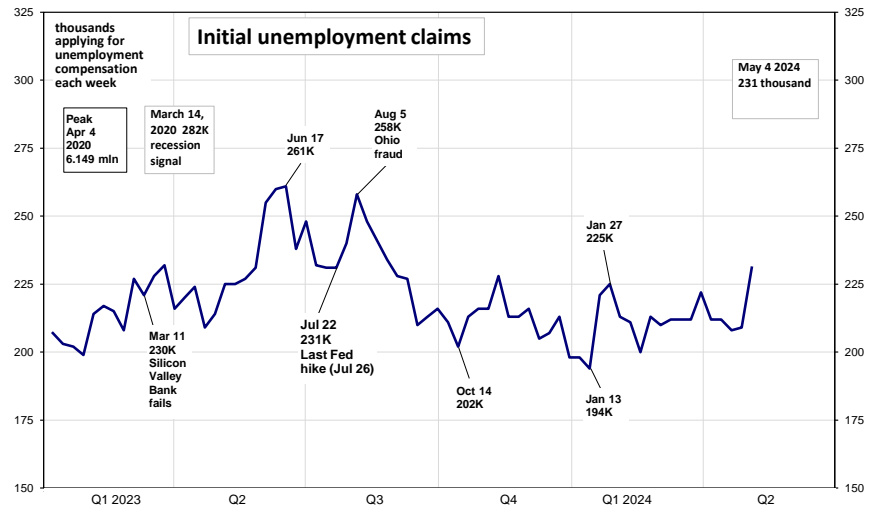
Next up: April CPI inflation report Wednesday, May 15															
Monthly	2024											2023			
% Changes	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan
Core CPI inflation	0.4	0.4	0.4	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.4	0.5	0.3	0.5	0.4
Core PCE inflation	0.3	0.3	0.5	0.2	0.1	0.1	0.3	0.1	0.1	0.2	0.3	0.3	0.3	0.4	0.5
Core PCE YOY	2.8	2.8	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

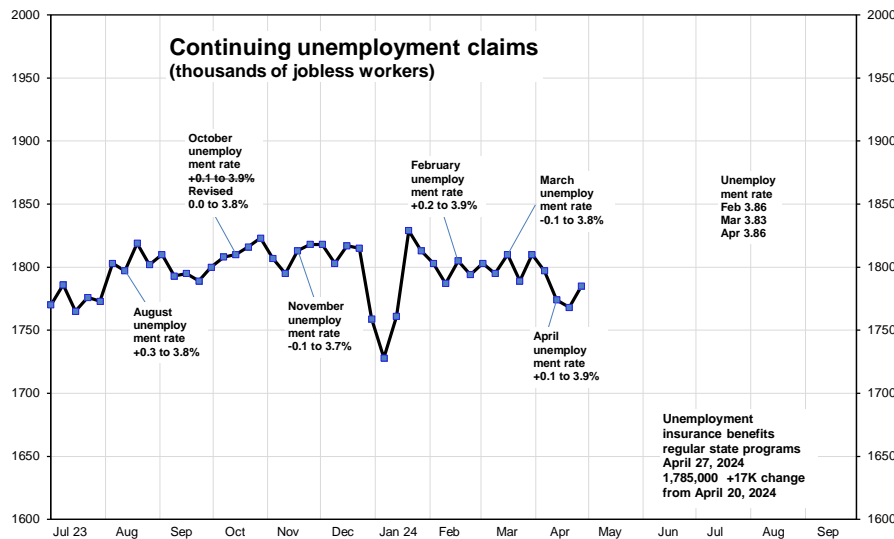
Jobless claims jump in New York (Thursday)

Breaking economy news. Weekly jobless claims jumped 22K to a new high of 231K in the May 4 week. The not seasonally adjusted rise was 19,690 but 10,248 of the increase was in New York. It's a good thing we are claiming to work from home instead of NYC.

Net, net, the all quiet on the labor market front was shattered by the surge in job layoffs at the start of May. It might be technical, but you never know. Perhaps the many Fed voices expressing concern about inflation and saying interest rates needed to remain restrictive for longer are causing companies to rethink their staffing needs. Weekly jobless claims are one of the timeliest indicators of when the economy is starting to undergo serious deterioration, and the magnitude of new layoffs this week looks worrisome. One week does not a trend make, but we can no longer be sure that calm seas lie ahead for the US economy if today's weekly jobless claims are any indication. The labor market shows some signs of rebalancing with fewer job openings posted around the country, and now company layoffs are picking up, hinting at caution on the part of companies as they weigh the outlook for the second half of the year. Some prominent corporations are scaling back and announcing job cuts on recent quarterly earnings calls and now it is starting to show up in the data. Stay tuned.



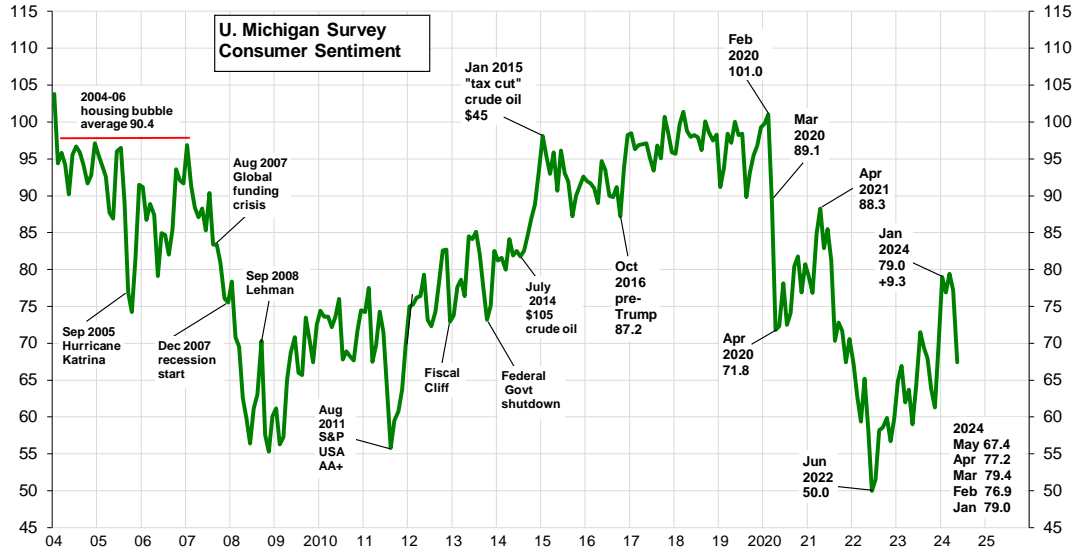
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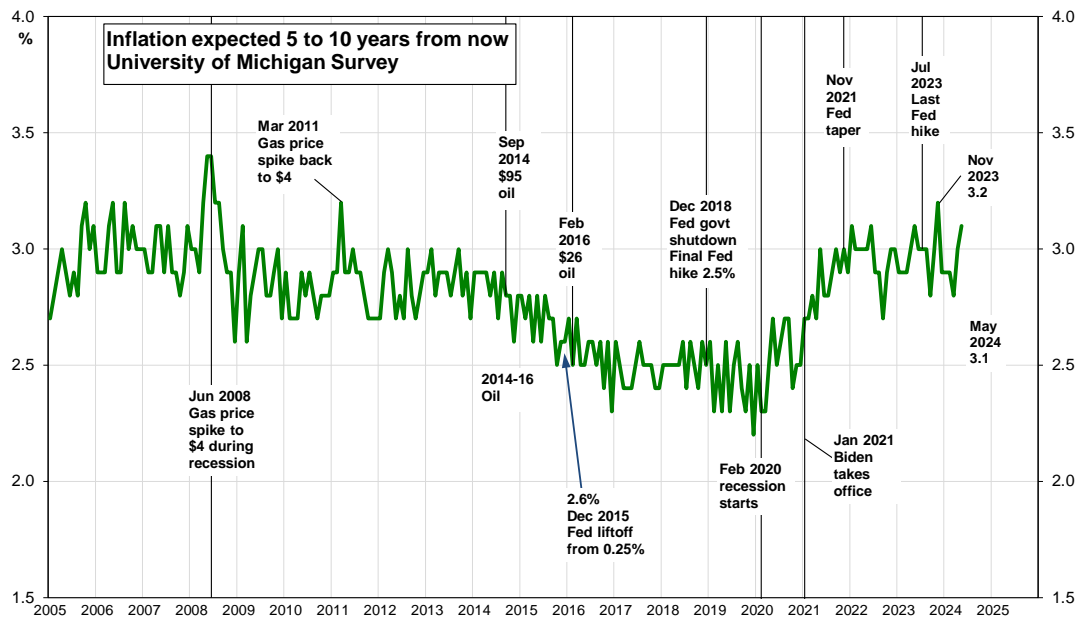
Consumers are cloudy and grey (Friday)

Breaking economy news. Consumer sentiment dropped nearly 10 points to 67.4 in May which was a surprise lightning bolt coming out of the blue. Consumers also expect to see higher prices which may be weighing down confidence about the outlook for the economy later on this year. Inflation expected over the year ahead fell in December and January at the same time consumer sentiment jumped.

Net, net, consumers are plainly worried about the outlook in May as sentiment tumbled in the latest survey. The equity market sell-off may have played a part even though stocks have been climbing in recent days. The stock market made its record high back on



the final trading day in March. Inflation and the cost of living is one factor depressing confidence that just won't go away even if the inflation rate has been cut in half from the peak of the outbreak a couple of years ago. Additionally, many companies have laid off workers as well and consumers perhaps sense that it is not as easy to get a new job. Time will tell if the sharp downward adjustment in sentiment means a reduction in consumer expenditures at the mall that are so critical to keeping the economy firing on all cylinders. For today, caution prevails for consumers who may be spooked by Fed officials shelving some of the planned rate cuts this year. If Fed officials are not sure inflation is under control, what is a poor consumer to think? Consumers see cloudy skies ahead for the economy this summer. Bet on it.



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