

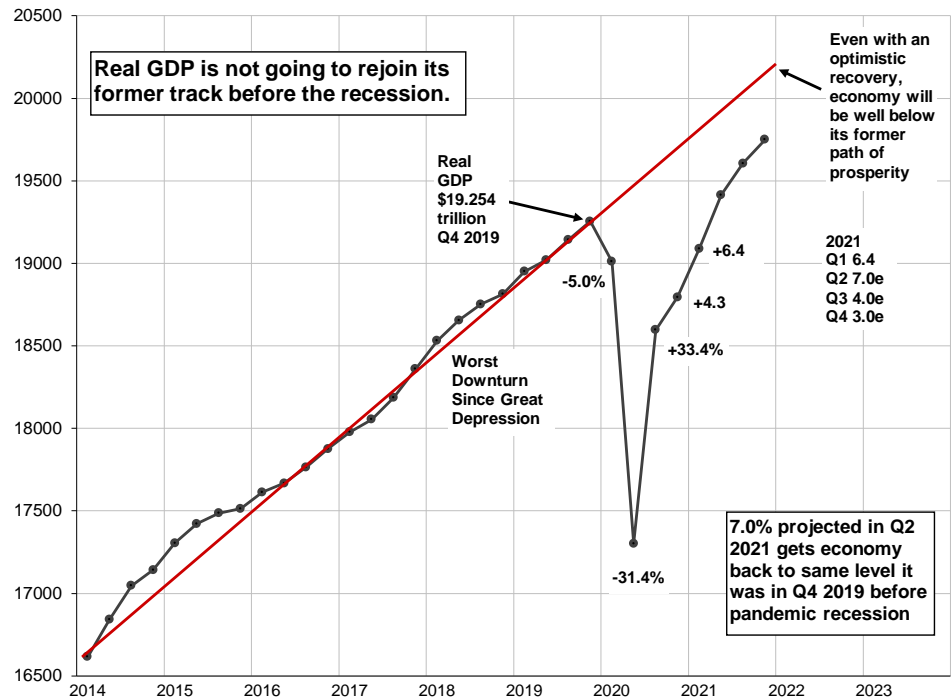
Financial Markets This Week

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ECONOMY IN A HIGHER GEAR FOR NOW

On Thursday, the economy is still running in a higher gear with better reports seen from a declining weekly jobless count, record business investment in capital goods, and a second look at first quarter growth unchanged at 6.4% real GDP. The country continues to open up and business leaders are bullish on America now that the virus has been beaten, but we still cannot shake the feeling that the economy's best days for growth are behind us.

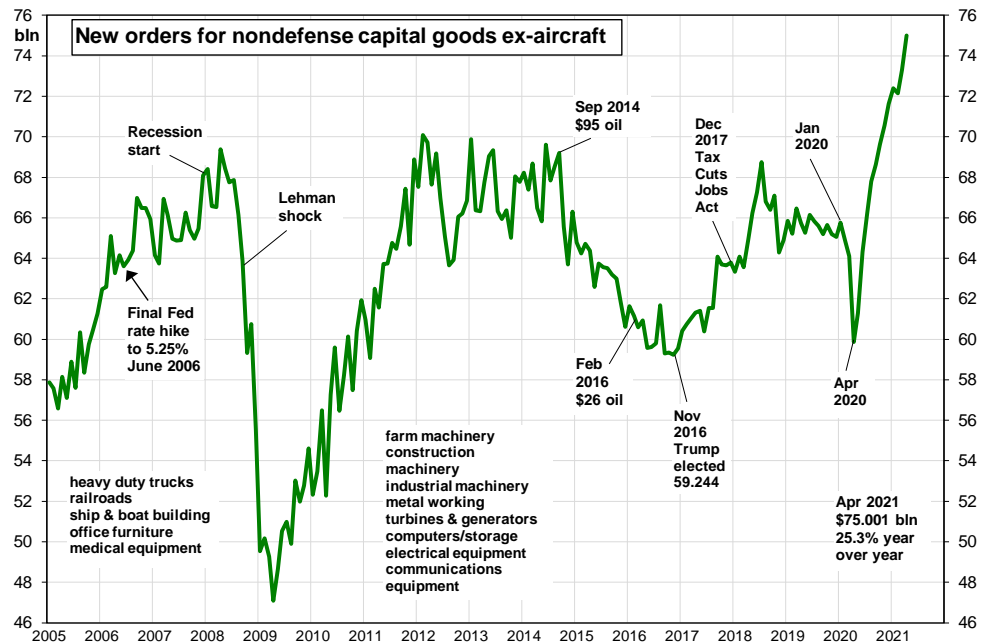


Consumers in the days and weeks ahead are merely going to swap groceries for dining out, and replace computers and furniture purchases with money spent instead on vacations and sporting events. How much more can consumers spend? Business isn't listening to our words of caution, they are too busy buying long-lived capital equipment to meet what they still see as a bright future for the sales of their goods and services. Nondefense capital goods orders ex-aircraft are at all-time highs with Thursday's 2.3% jump in April following on a strong 1.6% gain in March. They are buying more computers, but so much more as well including machinery equipment of every stripe and color. Heavy trucks too.

	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21p	Q1 21r
REAL GDP	2.4	-5.0	-31.4	33.4	4.3	6.4	6.4
REAL CONSUMPTION	1.6	-6.9	-33.2	41.0	2.3	10.7	11.3
CONSUMPTION	1.1	-4.8	-24.0	25.4	1.6	7.0	7.4
Durables	0.2	-0.9	0.0	5.2	-0.1	3.0	3.4
Nondurables	-0.1	1.0	-2.1	4.4	-0.2	2.0	2.0
Services	1.0	-4.8	-22.0	15.9	1.9	2.1	2.1
INVESTMENT	-0.6	-1.6	-8.8	12.0	4.4	-0.9	-0.8
Business Plant	-0.2	-0.1	-1.1	-0.5	-0.2	-0.1	-0.2
& Equipment and	-0.1	-0.9	-2.0	3.3	1.3	0.9	0.8
Intellectual Property	0.2	0.1	-0.5	0.5	0.5	0.5	0.8
Homes	0.2	0.7	-1.6	2.2	1.4	0.5	0.6
Inventories	-0.8	-1.3	-3.5	6.6	1.4	-2.6	-2.8
EXPORTS	0.4	-1.1	-9.5	4.9	2.0	-0.1	-0.3
IMPORTS	1.1	2.3	10.1	-8.1	-3.6	-0.8	-0.9
GOVERNMENT	0.4	0.2	0.8	-0.8	-0.1	1.1	1.0
Federal defense	0.3	0.0	0.2	0.2	0.2	-0.1	-0.1
Fed nondefense	0.0	0.1	1.0	-0.6	-0.3	1.1	1.1
State and local	0.2	0.1	-0.4	-0.4	-0.1	0.2	0.1

Below line: Percentage point contributions to Q1 2021 6.4% real GDP
Third estimate for Q1 is Thursday, June 24

For the record, GDP output is still short of where it was in Q4 2019 before the pandemic struck. The gap is 0.9% right now and we should easily fill that in the second quarter GDP report due out on July 29. Real consumption expenditures closed the gap with today's revision where it had been 0.1% below Q4 2019; now it is exactly even with where we started from.

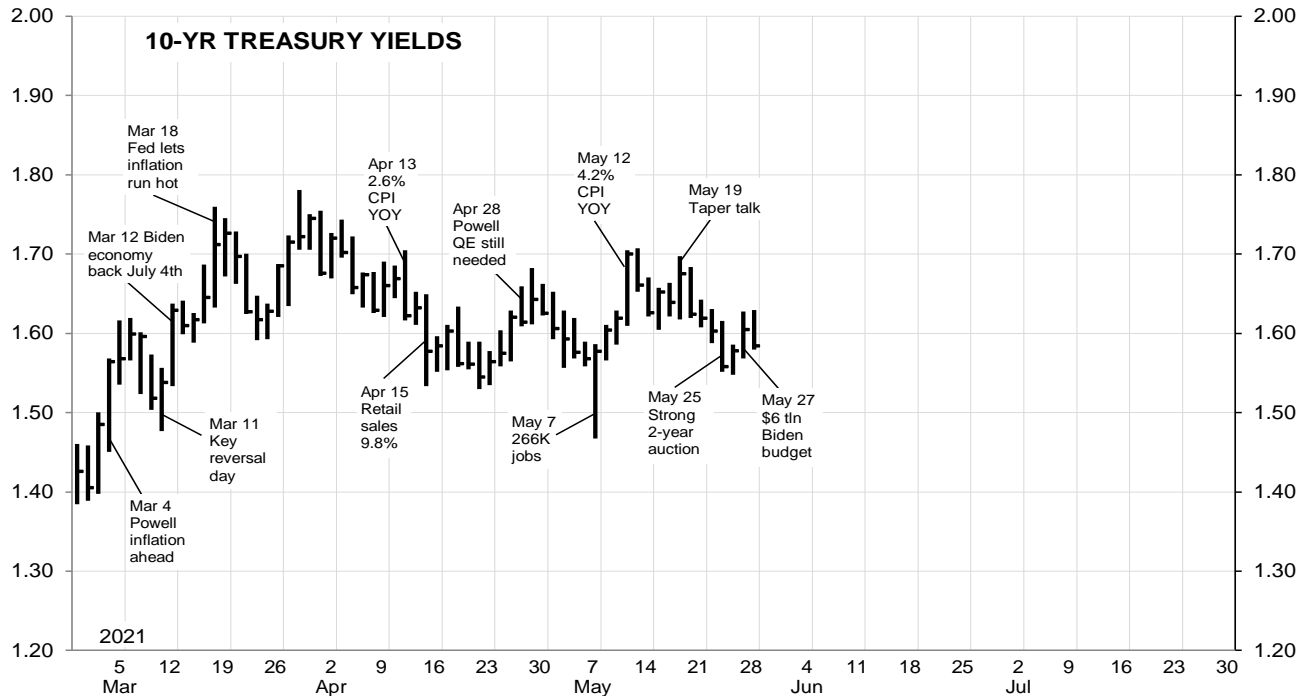


Final demand for goods and services may have set the high-water mark for 2021 in the first quarter thanks to the Federal government's relief stimulus. Many consumers won the lottery with a double-round of economic stimulus checks, first \$600 and then \$1400, all within the first quarter this year. The reopening hopes for the economy following the pandemic may turn out to be a mirage when it comes to future growth. Policymakers are waiting for stronger growth before they tap the brakes on their emergency stimulus purchases. They need to see more measurable progress on the labor market recovery relative to where the economy was in December when they set up their policy reaction function. The unemployment rate was 6.7% in December and it is 6.1% in April and this progress is unlikely to be satisfactory for Fed officials who continue to support the economy with all they've got.

To conclude, the economic recovery is still an uneven one with pandemic purchases of hard goods leading the way, while services spending, like doctor visits, dining out, and vacation travel, is still lagging behind. Business investment in computers and software is setting records, but the equipment spending seen during Covid is going to change radically when American workers go back to the office.

	Seasonally adjusted at annual rates							Change \$bil and %	
	2019		2020				2021	2019 Q4	2019 Q4
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	2021 Q1	2021 Q1
Real Gross domestic product (GDP)	19,141.7	19,254.0	19,010.8	17,302.5	18,596.5	18,794.4	19,088.1	-165.9	-0.9
Business Fixed investment	3,378.9	3,387.2	3,375.4	3,096.3	3,314.7	3,458.9	3,552.4	165.2	4.9
Nonresidential	2,783.9	2,781.5	2,733.8	2,525.5	2,659.0	2,742.0	2,812.9	31.4	1.1
Structures	552.6	545.1	540.0	487.5	464.7	457.3	450.6	-94.5	-17.3
Equipment	1,263.3	1,258.0	1,207.1	1,080.1	1,230.1	1,301.8	1,343.3	85.3	6.8
Information processing equipment	494.3	492.9	475.8	507.4	559.6	577.0	609.9	117.0	23.7
Industrial equipment	251.4	245.3	241.8	226.5	236.1	249.4	252.8	7.5	3.1
Transportation equipment	277.1	283.0	257.8	160.6	220.2	252.9	258.8	-24.2	-8.6
Other equipment	252.2	248.5	243.9	219.5	247.0	253.4	257.6	9.1	3.7
Intellectual property products	974.0	985.2	991.1	961.5	981.1	1,005.8	1,045.8	60.6	6.2
Software	452.9	461.8	472.5	465.4	476.4	487.8	522.3	60.5	13.1
Research and development	442.7	445.3	443.6	428.3	439.5	451.3	460.7	15.4	3.5
Entertainment, literary, and artistic originals	83.9	84.3	82.8	76.8	74.5	76.1	76.1	-8.2	-9.7
Residential	601.9	610.5	637.6	571.3	645.5	697.9	719.1	108.6	17.8

INTEREST RATES

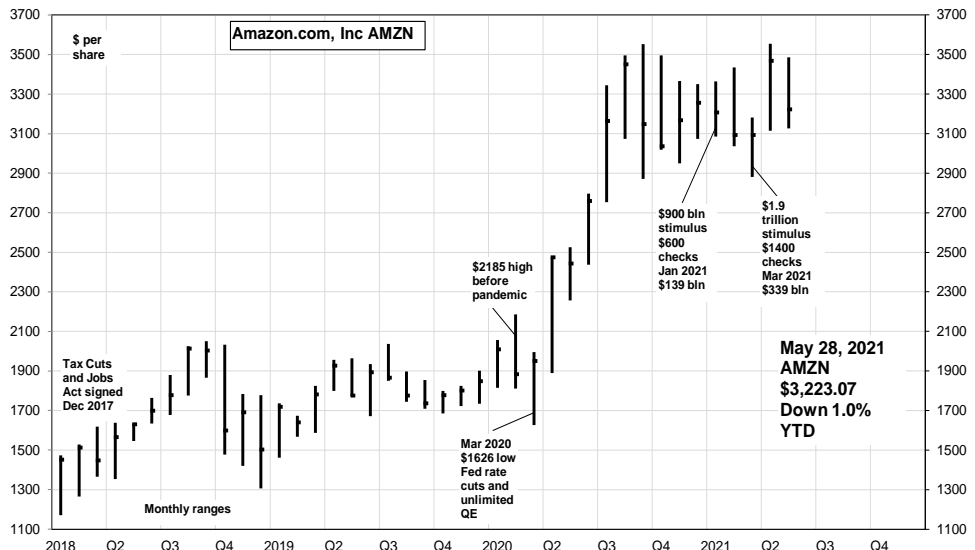


A quiet week. On Friday at 830am ET before the Memorial Day weekend, bonds barely reacted to the jump in April PCE inflation to 3.6% year-year from 2.4% year-year in March. The official Biden budget announcement was released at 2pm ET with even fewer people around watching and waiting. It's a big budget with outlays of \$6 trillion, but where's the economic boom. The economic forecast released with the budget shows GDP growth 5.2% this year, 3.2% 2022, 2.0% 2023. Stock investors can only talk about the close above 4,200 on the S&P 500 and investors remain positive on the outlook.

Amazon.com, Inc. AMZN down 1.0% YTD

Amazon in the news this week with its \$8.45 billion purchase of MGM. Expensive price to get James Bond films as part of its Prime membership offerings. The company reported March quarter earnings on April 29: sales are expected to slow to 24 to 30 percent year/year for the second quarter. Sales have been running an average of 40% year/year during the pandemic (Q2 2020 to Q1 2021). Cloud operating income is 47% of operating income. What happens when everyone is up in the Cloud?

S&P 500 Weights	
Top 6: 23% of S&P	
5.86	AAPL
5.37	MSFT
4.19	AMZN
2.21	FB
1.54	TSLA
2.00	GOOGL
1.96	GOOG
23.13	Top 6



FEDERAL RESERVE POLICY

The Fed meets June 15-16, 2021 to consider its monetary policy. They will issue new forecasts of the economy and interest rates. In the March forecast, four out of eighteen Fed meeting participants looked for a rate hike in 2022, that's by the end of 2022, no indication of when within the year.

There's been so much talk about whether the Federal Reserve is inching closer to talking about pulling back its extraordinary monetary stimulus left over from the pandemic recession if anyone remembers the recession with 6.4% real GDP growth in the first quarter. So much talk that it was good to have a Vice Chair that is known to relay Powell's views, Randal Quarles give a speech on [The Economic Outlook and Monetary Policy](#). He is the Vice Chair for Supervision and doesn't give lengthy remarks on the economy and policy all that often. "The guidance on asset purchases, introduced in December, commits us to increasing our holdings of securities at least at the current pace until substantial further progress has been made toward the Committee's maximum-employment and price-stability

goals." Okay. Then he added it was his view that they had made enough progress on the inflation goal in the guidance for purchases. But there had not been as much progress on the labor market goal as he'd like: the unemployment rate had only dropped 0.6 percentage points to 6.1% and the labor force participation rate is about the same as it was when policymakers met in December.

Quarles seems to have confidence in the economic outlook, that is, confidence the unemployment rate will fall further, so that "it will become important for the FOMC to begin discussing our plans to adjust the pace of asset purchases at upcoming meetings..." especially if the economic numbers come in even stronger than he anticipates. The decision on interest rates is much further down the line however. He noted that even those FOMC estimates looking for rate hikes next year thought the cumulative increase in interest rates would be "quite shallow." Interesting, except if you are retired and need a safe investment return above inflation, because the White House economic assumptions behind the 2022 Biden budget released Friday has the annual average Fed funds rate (91-day Treasury bills) rising to 0.8% in 2024, 1.2% in 2025, 1.5% in 2026 and still just 1.8% in 2029. Wait for it.

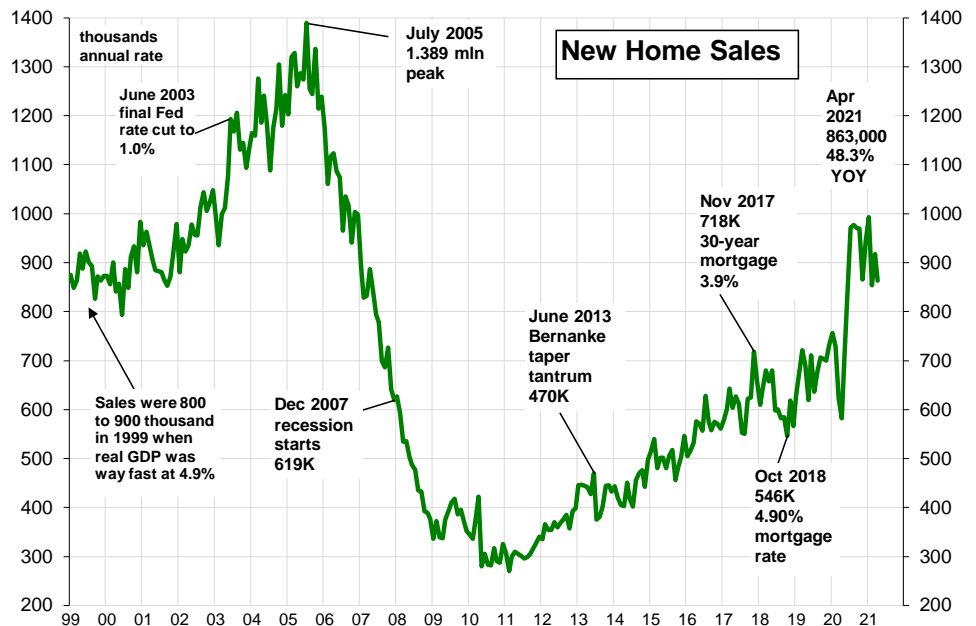
Selected Fed assets and liabilities					March 11 2020**
Fed H.4.1 statistical release billions, Wednesday data	26-May	19-May	12-May	5-May	pre-Covid
Factors adding reserves					
U.S. Treasury securities	5087.157	5071.821	5054.395	5040.418	2523.031
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347
Mortgage-backed securities (MBS)	2244.265	2277.561	2191.325	2191.325	1371.846
Repurchase agreements	0.000	0.000	0.001	0.000	242.375
Primary credit (Discount Window)	0.633	0.661	0.581	0.545	0.011
MMLF					
MMLF	0.000	0.000	0.000	0.000	
PDCF					
PDCF	0.000	0.000	0.000	0.000	
Commerical Paper Funding Facility					
Commerical Paper Funding Facility	8.554	8.554	8.556	8.556	
Paycheck Protection Facility					
Paycheck Protection Facility	84.258	82.635	79.922	76.453	
Corporate Credit Facility (CCF)					
Corporate Credit Facility (CCF)	26.037	25.966	25.901	25.996	
Municipal Liquidity Facility					
Municipal Liquidity Facility	10.879	11.127	11.125	11.123	
Main Street Lending Program					
Main Street Lending Program	30.559	30.550	30.668	30.659	
Term Asset-Backed Facility (TALF II)					
Term Asset-Backed Facility (TALF II)	4.923	4.922	4.922	4.922	
Central bank liquidity swaps					
Central bank liquidity swaps	0.678	0.652	0.587	0.653	0.058
Federal Reserve Assets					
Federal Reserve Assets	7952.7	7972.1	7879.8	7859.6	4360.0
3-month Labor %					
3-month Labor %	0.14	0.15	0.15	0.17	0.77
Factors draining reserves					
Currency in circulation					
Currency in circulation	2172.925	2169.173	2169.384	2167.663	1818.957
Term Deposit Facility					
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed					
U.S. Treasury Account at Fed	778.912	860.833	864.253	946.134	372.337
Treasury credit facilities contribution					
Treasury credit facilities contribution	50.278	50.278	50.278	50.278	
Reverse repurchases w/others					
Reverse repurchases w/others	450.283	293.998	209.257	162.800	1.325
Reserve Balances (Net Liquidity)					
Reserve Balances (Net Liquidity)	3851.623	3823.979	3955.864	3900.803	1779.990
Treasuries within 15 days					
Treasuries within 15 days	88.013	95.705	118.774	124.849	21.427
Treasuries 16 to 90 days					
Treasuries 16 to 90 days	303.665	300.258	283.706	278.205	221.961
Treasuries 91 days to 1 year					
Treasuries 91 days to 1 year	647.962	643.626	630.986	630.363	378.403
Treasuries over 1-yr to 5 years					
Treasuries over 1-yr to 5 years	1937.380	1933.283	1948.027	1942.674	915.101
Treasuries over 5-yrs to 10 years					
Treasuries over 5-yrs to 10 years	926.562	918.938	910.943	906.238	327.906
Treasuries over 10-years					
Treasuries over 10-years	1183.576	1180.011	1161.958	1158.090	658.232
**March 11, 2020 start of coronavirus lockdown of country					
MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds					
PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days					
CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)					

OTHER ECONOMIC NEWS

New home sales cool in April (Tuesday)

Breaking economy news. April new home sales fell 5.9% in April to 863 thousand at an annual rate. New home sales point the direction forward always relative to existing home sales as they are based on the signing of a sales contract as opposed to sales being recorded later at the closing. Existing home sales show the trend a month or two earlier. Sales in the biggest market in the South are near the highs of last year and were 545 thousand in April. April sales in the Northeast (44 thousand) and Midwest (110 thousand) are often too small to affect the monthly total. New home sales in the West were 164 thousand in April and are well off the pace of 250 to 270 thousand seen last summer; hard to know what is going on out there.

New home sales had been running at just under a 1 million annual pace starting in July 2020, so the 863 thousand reading in April 2021 today has to be viewed as a disappointment. New home sales are no longer soaring which means consumer spending on furnishings and appliances will be kept in check and the case for strong multiyear economic growth isn't assured. Strong growth means more corporate profits that is music to the stock market's



ears, but it isn't going to happen forever. In fact, the market's economic reopening hopes may turn out to be a bust for economic growth. Or more properly, the first quarter GDP with some spillover to the second quarter was bought by the Federal government with the sending of those \$600 and \$1400 checks that were both deposited in the first quarter of 2021.

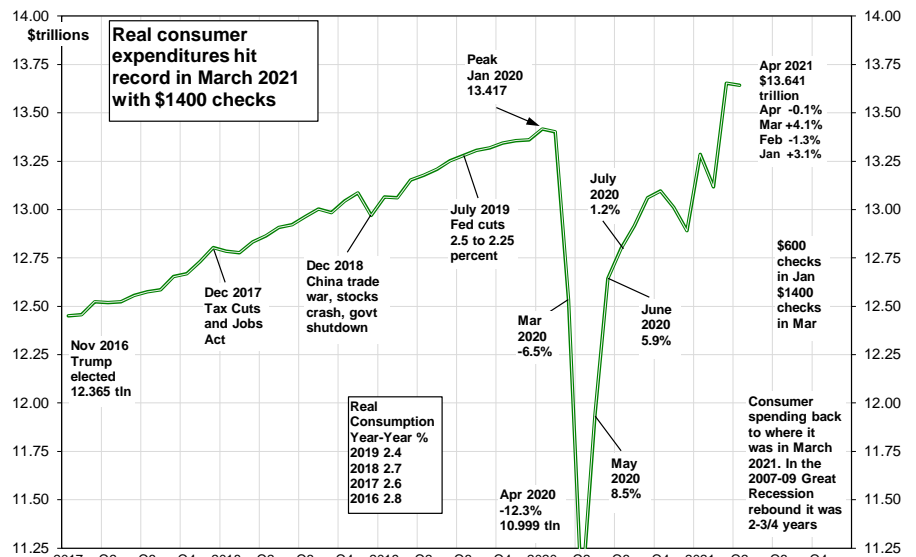
Net, net, the demand for new homes is well off the pace of earlier in the pandemic showing that the rush to buy is starting to exhaust itself and this is another sign the economy is getting back to normal. Covid-19 altered consumer buying patterns tremendously during the pandemic, but the winds are shifting and now consumption patterns will return to normal with no more pent-up demand and the rush to the suburbs or the mountains or the deserts or the beaches during the work-from-home experiment appears to be slowing.

The only good news is the realization that home builders took out permits to build 1.149 million single-family homes in April, permits have run more than 1 million every month since August last year, and with more supply on the way, we expect there will be demand from consumers as long as prices don't move up too high. The median sales price for a new home was a steep \$372,400 in April 2021 which is 20.1 percent higher than a year ago. The sales price in April is less than a thousand dollars away from the all-time record set in January this year. When consumers shop at the store, they don't load up the cart with items that are suddenly 20 percent higher than they were. We are keeping our fingers crossed that home prices will stop rising as quickly as higher prices could stop the housing recovery in its tracks. Bet on it.

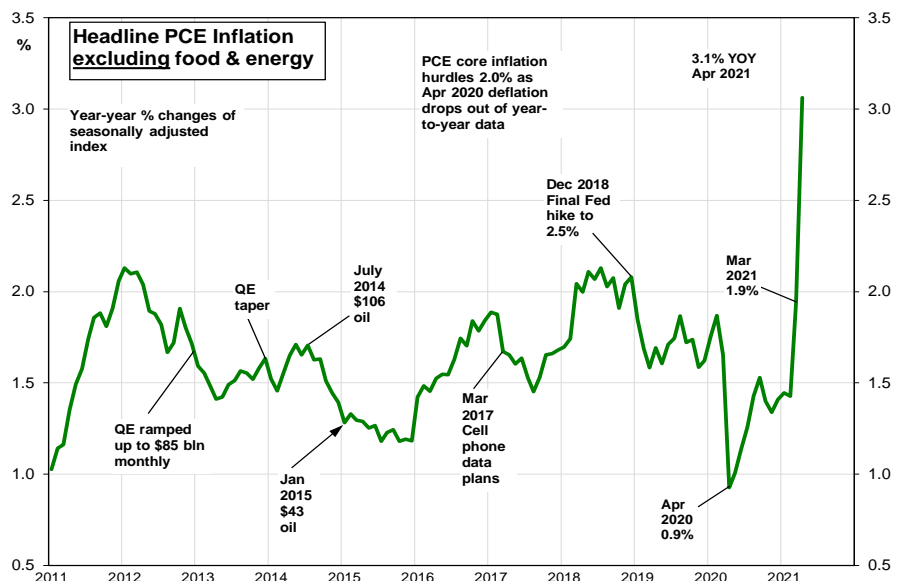
Personal income down 13.1%, core PCE inflation up 0.7% in April (Friday)

Breaking economy news. The April personal income report. There is none. No income. Personal income collapsed 13.1% after the Economic Impact Payments from the American Rescue Plan got distributed in March. The Fed thinks inflation is going up in part due to “base effects” as the deflation from April 2020 drops out of the year-to-year data, but core PCE inflation jumped 0.7% just in this one month, and yes, the year-to-year core PCE inflation rate is running hot at 3.1%. If it looks like inflation, then it is inflation. What was Occam’s Razor again? Something to do with relying on the simplest explanation. Inflation is here today, it looks real, and Fed officials telling us it is transitory when the Biden \$6 trillion budget is about to be announced officially this afternoon doesn’t cut it. The markets are right to worry about an inflation threat.

Headline inflation is up 3.6% the last year and core PCE inflation is up 3.1%. The biggest major category jump is motor vehicles 10.7%, furnishings and durable household equipment 4.5%, financial services and insurance 3.8%, food services and accommodations, and health care, both categories up 3.4%. With so many prices rising in services, we aren’t sure the Fed’s contention that supply constraints are the problem is correct. Inflation doesn’t look unreal.



How are we doing with our 7.0% real GDP forecast for Q2 2021? Real consumption expenditures are very strong in the second quarter with just April data, 9.0% versus 11.3% in the first quarter, but May and June consumer spending should slow further regardless of any consumer euphoria now that the virus restrictions have been all but eliminated.



Net, net, it is looking more like the economic reopening story was exaggerated by the \$1400 checks from the American Rescue plan. Personal income has plummeted and real consumer spending in the months ahead is likely to slow dramatically. The stronger economic growth looks to be a temporary phenomenon, but we are less certain that the inflation burst with 3.6% headline PCE inflation will be as transitory as Fed officials seem to believe. One thing is for certain, the consumer is between a rock and a hard place with incomes down and the price of everything they buy inflating like gangbusters. The consumer is in the driver’s seat when it comes to growth, but inflation may well cause them to run off the road and crash the outlook.

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