Financial Markets This Week

19 AUGUST 2022

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

TWO STRAIGHT QUARTERS OF NEGATIVE GDP

For the record, GDP does not normally fall every quarter of a recession.

Recession	July 1990-March 1991							
SAAR %	Q1 90	Q2 90	Q3 90	Q4 90	Q1 91	Q2 91		
GDP	4.4	1.5	0.3	-3.6	-1.9	3.2		
Consumer	3.4	1.2	1.6	-3.0	-1.5	3.4		
Recession	March 2001-November 2001							
SAAR %	Q3 00	Q4 00	Q1 01	Q2 01	Q3 01	Q4 01	Q1 02	
GDP	0.4	2.4	-1.3	2.5	-1.6	1.1	3.4	
Consumer	3.9	3.5	1.5	0.8	1.4	6.6	0.9	
Recession	December 2007-June 2009							
SAAR %	Q4 07	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09
GDP	2.5	-1.6	2.3	-2.1	-8.5	-4.6	-0.7	1.5
Consumer	1.6	-0.5	1.1	-3.0	-3.6	-1.0	-2.0	2.7

First month of recession dates is actually the last month of growth before turning down

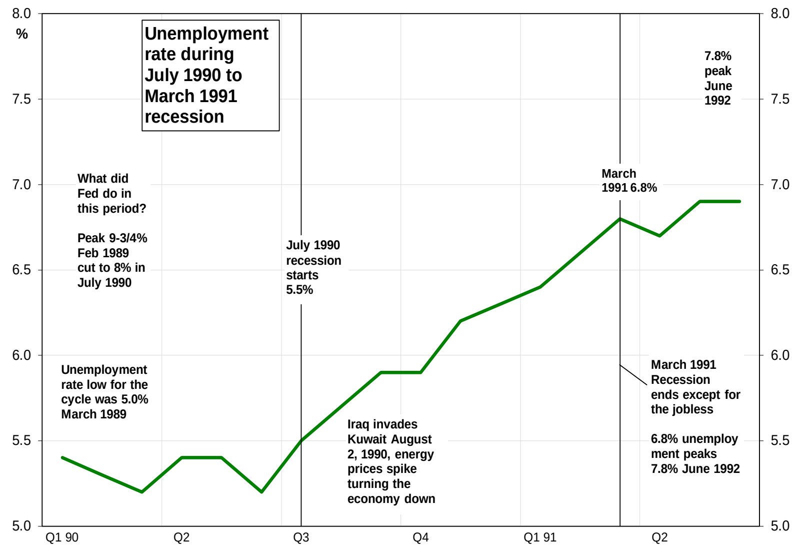
Two straight quarters of negative real GDP growth, is this a recession? It would be if unemployment was rising. There has to be severe economic distress in the country which means job losses. Fired workers who lose their paychecks cannot spend as much; the economy sinks, even if consumption doesn't always decline. The other thing to briefly keep in mind is the last three recessions had some terrific headwinds in hindsight. Are we sure the nation faces the same broad-brushed perils today? 2001 recession: stock market bubble; 2007-09 recession: housing bubble; 2020 recession: pandemic. What will history say was the reason for a 2022 recession that the 24.5% S&P 500 loss this year discounted? Keeping in mind the unemployment rate fell back to the "best economy in fifty years" level of 3.5% in a report early this month, a cause for a 2022 recession could be the Fed's fight with the worst inflation outbreak since the early 1980s with maybe a tech stock market bubble and housing price bubble thrown in for good measure.

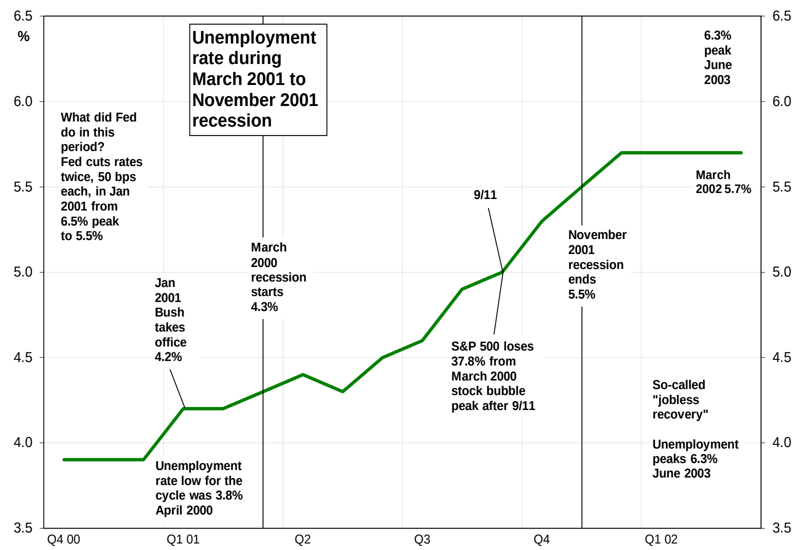
HOW RELEVANT IS REAL GDP GROWTH TO THE FED?

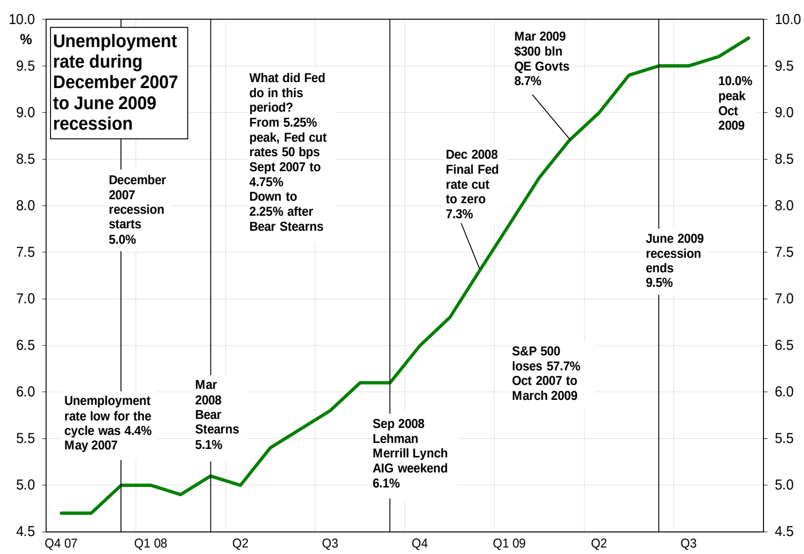
	Quarterly	Fed funds rate from 6.5 to 3.0 before first negative quarter of GDP reported							Fed funds	
Date	GDP ests	2000:1	2000:2	2000:3	2000:4	2001:1	2001:2	2001:3	2001:4	target	Date
12-21-00	Q3 00f	4.8	5.6	2.2						6.50	12-21-00
1-31-01	Q4 00a	4.8	5.6	2.2	1.4		2001 recession			5.50	1-31-01
2-28-01	Q4 00p	4.8	5.6	2.2	1.1		March-November 2001			5.50	2-28-01
3-29-01	Q4 00f	4.8	5.6	2.2	1.0		NBER called it 11-26-01			5.00	3-29-01
4-27-01	Q1 01a	4.8	5.6	2.2	1.0	2.0				4.50	4-27-01
5-25-01	Q1 01p	4.8	5.6	2.2	1.0	1.3				4.00	5-25-01
6-29-01	Q1 01f	4.8	5.6	2.2	1.0	1.2				3.75	6-29-01
7-27-01	Q2 01a	2.3	5.7	1.3	1.9	1.3	0.7			3.75	7-27-01
8-29-01	Q2 01p	2.3	5.7	1.3	1.9	1.3	0.2			3.50	8-29-01
9-28-01	Q2 01f	2.3	5.7	1.3	1.9	1.3	0.3			3.00	9-28-01
10-31-01	Q3 01a	2.3	5.7	1.3	1.9	1.3	0.3	-0.4		2.50	10-31-01
11-30-01	Q3 01p	2.3	5.7	1.3	1.9	1.3	0.3	-1.1		2.00	11-30-01
12-21-01	Q3 01f	2.3	5.7	1.3	1.9	1.3	0.3	-1.3		1.75	12-21-01
1-30-02	Q4 01a	2.3	5.7	1.3	1.9	1.3	0.3	-1.3	0.2	1.75	1-30-02
2-28-02	Q4 01p	2.3	5.7	1.3	1.9	1.3	0.3	-1.3	1.4	1.75	2-28-02
3-28-02	Q4 01f	2.3	5.7	1.3	1.9	1.3	0.3	-1.3	1.7	1.75	3-28-02
7-31-02	Benchmark	2.6	4.8	0.6	1.1	-0.6	-1.6	-0.3	2.7	1.75	7-31-02
		GDP estimates: a-advance, p-preliminary, f-final									

Okay, the consumer is two-thirds of the economy, but consumers on their own aren't enough to tip the economy into a downturn and often don't reduce their spending at all. Consumer expenditures never turned down in a single quarter during the March 2000 to November 2001 recession. That recession starting two months after President Bush took office had some real GDP recession-definition problems which we will cover now in this rather exhaustive table. GDP is released three times, advance, preliminary, and final reports. In 2001, the Fed cut interest rates from 6.5% down to 3.0% before there was one negative quarter of GDP reported. The National Bureau of Economic Research (NBER) called the recession on November 16, 2001, four days before it was over and with just one negative quarter of growth. In the next year's annual benchmark revision on July 31, 2002, GDP was revised to negative prints in Q1, Q2 and Q3 2001 satisfying the requirement for negative growth in recessions.

GDP and recessions are often bumping heads when it comes to getting the story right. But as all these charts of the last three recessions illustrate, it is the unemployment rate that dictates whether a recession is a recession. And because unemployment continues to rise after the recession is over, the public is skeptical that, well, the recession is over. As far as calling the recession based on the labor market, past recessions have often had a long fuse before mounting job layoffs blew the economy up and the best of best times started turning towards darkness. The cycle low for unemployment in the 1990-91 recession was way back in March 1989 (long story). The cycle low in the 2001 recession was 3.8% back in April 2020. The cycle low in the 2007-09 recession was 4.4% in May 2007.

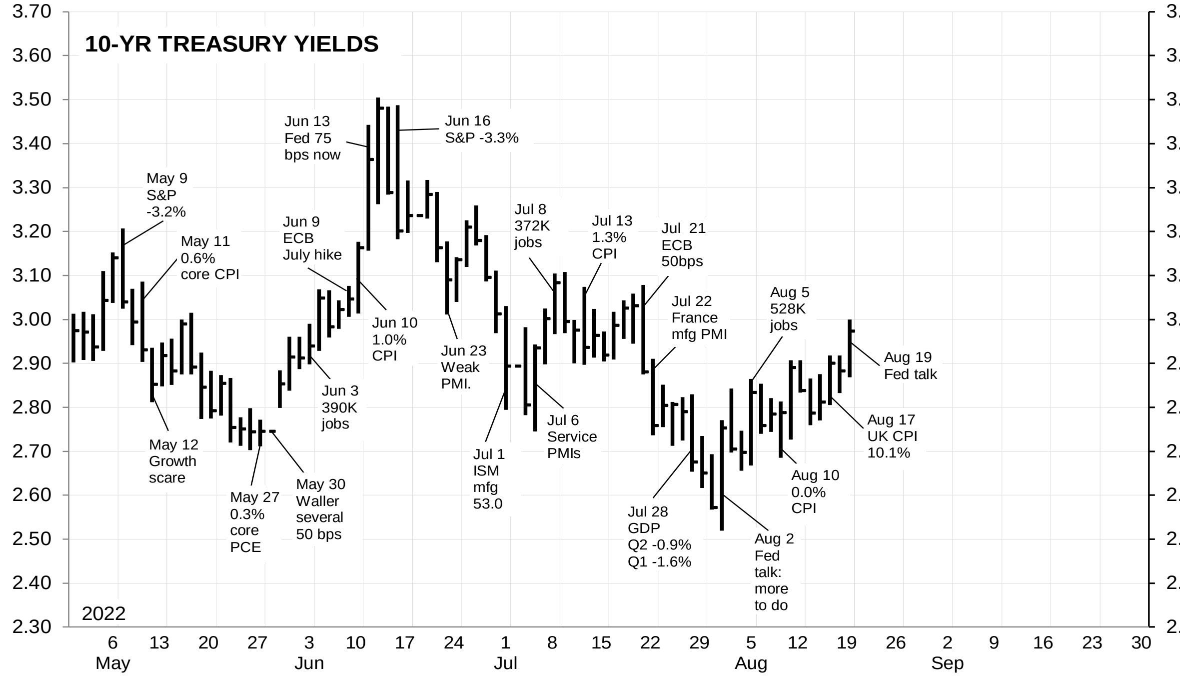






In summary, none of the last three proper recessions (over two months long) looking back to the 90s consistently showed a downturn in real GDP growth for each and every quarter. On the other hand, two consecutive negative real GDP quarters does look recessionistic. But again, the one common element of economic distress in every recession has been a sharply rising level of unemployment and job losses. The economy isn't there yet. The unemployment rate just fell back to the 3.5% lowest level in history in July. Stay tuned. Story developing.

INTEREST RATES



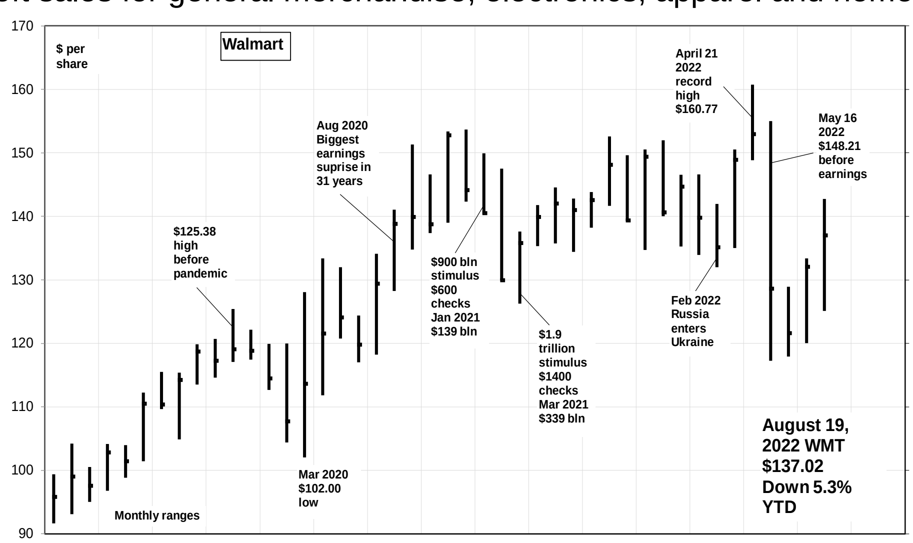
Bond yields moved higher this week continuing the trend. Yields fell on the second quarter of negative GDP late in July for a few days, recession meaning the Fed will halt, but Fed speak continues to say they are still going. The UK inflation report on Wednesday at 2am ET also helped push yields higher. 10-year yields reached 3.0% on Friday with bond investors trying to price in a 3.5% Fed funds rate at the end of the year, 100 bps higher than today. The September 21 Fed decision is still split between 50 or 75 bps based on October Fed funds futures. Stocks fell 1.3% Friday and we hope tech didn't drop on the 10-year yield's approach to 3.0%. Stocks also fell hard on Wednesday's higher inflation out the U.K. at 2am ET. There's a weekly downtrend line that stocks bounced off of at the week's 4,325 S&P 500 high on Tuesday. We will see if it can get through there next time.

Walmart (WMT) down 5.3% YTD. Was $148.21 before last quarter's earnings

Wall Street liked Walmart earnings this quarter with the stock closing 5.1% higher at $139.37 Tuesday. The stock almost made it back to $148.21 before the prior quarter's earnings disaster. The company said it is still working through excess inventory and has done markdowns especially in apparel. It said food sales were very strong with soft sales for general merchandise, electronics, apparel and home.

Bln $	Revenue	Operating Income	Same-store Sales YOY	13-weeks ending *
Q1 2020	134.6	5.2	10.3%	5/1/2020
Q2 2020	137.7	6.1	9.9%	7/31/2020
Q3 2020	134.7	5.8	7.1%	10/30/2020
Q4 2020	152.1	5.5	8.9%	1/29/2021
Q1 2021	138.3	6.9	6.2%	4/30/2021
Q2 2021	141.0	7.4	5.5%	7/30/2021
Q3 2021	140.5	5.8	9.9%	10/29/2021
Q4 2021	152.9	5.9	6.3%	1/29/2022
Q1 2022	141.6	5.3	4.0%	4/29/2022
Q2 2022	152.9	6.9	7.0%	7/29/2022

* US comparable sales, incl. Sam's Club, ex-fuel



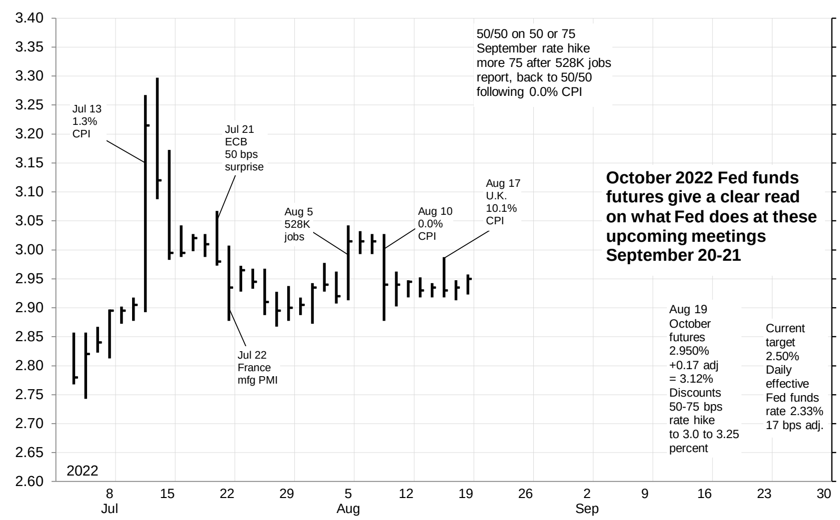
FEDERAL RESERVE POLICY

The Fed meets September 20-21, 2022 to consider its monetary policy. Jackson Hole is next week if Powell wants to add some color to the Fed's year-end 3.5% interest rate forecast… 100 bps more to go this year with three meetings left.

The market looked forward to the July 26-27 Fed meeting minutes released Wednesday, August 17 at 2pm ET. There was the comment yet again that the pace of rate hikes might have to slow. They have raised rates 75 bps at two consecutive meetings: 75 bps is a 600 bps annual rate for the eight meetings this year, so of course the pace will slow. On the other hand, the sentence after "slow the pace," said some officials thought rates would have to stay at the new higher, restrictive level to ensure inflation was on its way back down to 2%. The market wants a policy reversal, but this implies rate hikes won't change over to rate cuts like the three 25 bps rate cuts in 2019 after just hitting the peak of 2.5% in December 2018 last cycle.

There was another newish comment on the part of many officials that they might be overdoing it. Yields came down a little on the meeting minutes news headlines, but not so much. Earlier in the day yields had gone up significantly on the U.K. 10.1% CPI number at 2am ET. On the Fed minutes headlines themselves, October Fed funds futures yields fell at most 3.5 bps. October futures remain uncertain whether the September 21 hike will be 50 or 75 bps.

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	17-Aug	10-Aug	3-Aug	27-Jul	3/11/20*	3/11/20
Factors adding reserves						to Aug 17
U.S. Treasury securities	5699.175	5720.572	5719.119	5734.180	2523.031	3176.144
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2727.473	2717.568	2717.552	2717.379	1371.846	1355.627
Repurchase agreements	0.000	0.000	0.000	0.001	242.375	-242.375
Primary credit (Discount Window)	2.657	2.934	2.731	3.710	0.011	2.646
Paycheck Protection Facility	15.469	15.755	16.107	16.456		
Main Street Lending Program	25.902	26.154	26.138	26.053		
Municipal Liquidity Facility	5.552	5.551	5.549	5.547		
Term Asset-Backed Facility (TALF II)	2.159	2.158	2.157	2.182		
Central bank liquidity swaps	0.189	0.191	0.213	0.206	0.058	0.131
Federal Reserve Total Assets	8899.5	8928.9	8924.3	8939.3	4360.0	4539.469
~~3-month Libor %~~ SOFR %	2.29	2.28	2.29	1.53	1.15	1.140
Factors draining reserves						
Currency in circulation	2276.370	2276.462	2275.786	2274.830	1818.957	457.413
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	539.278	561.140	566.577	615.515	372.337	166.941
Treasury credit facilities contribution	17.940	17.940	17.940	17.940		
Reverse repurchases w/others	2199.631	2177.646	2182.238	2188.994	1.325	2198.306
Federal Reserve Liabilities	5565.800	5571.377	5581.813	5663.723	2580.036	2985.764
Reserve Balances (Net Liquidity)	3333.695	3357.493	3342.517	3275.609	1779.990	1553.705
Treasuries within 15 days	78.277	136.625	140.902	87.825	21.427	56.850
Treasuries 16 to 90 days	323.810	279.513	269.234	321.128	221.961	101.849
Treasuries 91 days to 1 year	819.992	809.524	815.460	816.043	378.403	441.589
Treasuries over 1-yr to 5 years	2017.163	2039.330	2038.765	2054.223	915.101	1102.062
Treasuries over 5-yrs to 10 years	986.738	1018.180	1017.734	1019.483	327.906	658.832
Treasuries over 10-years	1473.195	1437.400	1437.025	1435.479	658.232	814.963
Note: QT starts June 1	Change	17-Aug	1-Jun			
U.S. Treasury securities	-71.604	5699.175	5770.779			
Mortgage-backed securities (MBS)	20.027	2727.473	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						



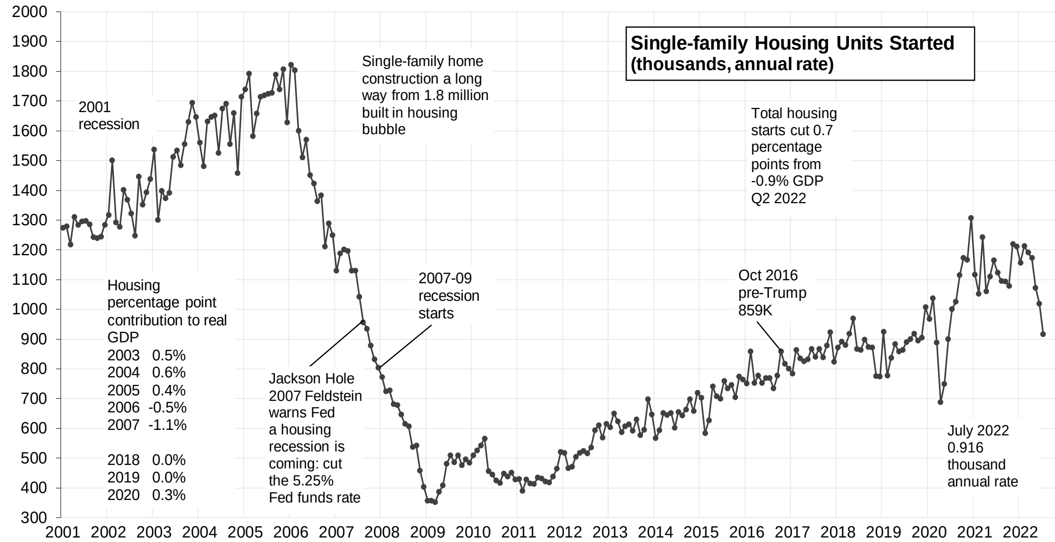
> Participants judged that, as the stance of monetary policy tightened further, it likely would become <u>appropriate at some point to slow the pace of policy rate increases</u> while assessing the effects of cumulative policy adjustments on economic activity and inflation. Some participants indicated that, once the policy rate had reached a sufficiently restrictive level, it likely would be appropriate to maintain that level for some time to ensure that inflation was firmly on a path back to 2 percent.

> Many participants remarked that, in view of the constantly changing nature of the economic environment and the existence of long and variable lags in monetary policy's effect on the economy, there was also a risk that the Committee could tighten the stance of policy by more than necessary to restore price stability. These participants highlighted this risk as underscoring the importance of the Committee's data-dependent approach to judging the pace and magnitude of policy firming over coming quarters.

OTHER ECONOMIC NEWS

Housing starts signal recession (Tuesday)

Breaking economy news. Housing starts fall 9.6% in July to 2.446 million at an annual rate. Add another leading indicator to the evidence piling up that the economy has entered the recession zone. Housing permits for single family units have now collapsed 22.9% from 1.204 million in February to 928 thousand in July because home builders aren't seeing as many buyers coming to the gates. The only mystery is why we are unable to get someone in to build a back fence at our house. Output of housing is starting to fall hard, but the demand for labor, not so much. Overall, the labor market returned to the 3.5% best level in fifty years in July's employment report.



You can't have a housing recession without job losses and right now there are none. Employees in construction of residential buildings totaled 901.7 thousand in July just below the 902.0 thousand record this building cycle set in May. Specialty trade contractors for residential buildings had a record 2.267 million employees in July, up 3.4% from year ago levels. Still not enough to build our fence.

Net, net, housing permits have been shrinking every month since the first Fed rate hike in March this year as home builders know what's-what and which way the winds are blowing. Recession has come to the residential construction markets right on schedule as interest-rate sensitive housing is the first sector to turn down when soaring mortgage rates make it more costly for home buyers. All housing needs are job losses in construction to make recession for the sector a stone-cold reality.

Housing Starts Total, Single-Family, Multi-Family

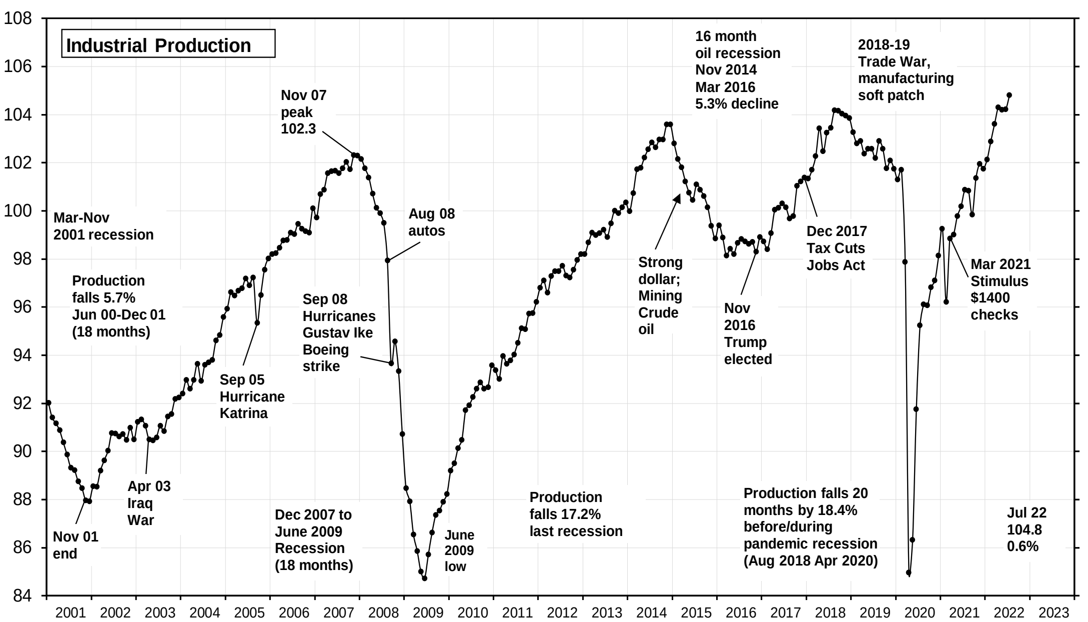
	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Jul 2022	1446	916	514	230	77	139	104	710	511	367	224
Jun 2022	1599	1019	571	139	48	210	144	873	621	377	206
Jul 2021	1573	1124	438	70	43	182	144	905	674	416	263
% Chgs											
Jul/Jun	-9.6	-10.1	…	65.5	60.4	-33.8	-27.8	-18.7	-17.7	-2.7	8.7
Jul/Jul	-8.1	-18.5	…	228.6	79.1	-23.6	-27.8	-21.5	-24.2	-11.8	-14.8

Industrial production says no recession (Tuesday)

Breaking economy news. Industrial production jumped to a new high in July, rising 0.6%, and June's 0.2% drop was revised away. They stuck in a 0.1% decline for May where previously production had been unchanged. Meanwhile, the nation's factory lights were turned back on with manufacturing production jumping 0.7% in July after 0.4% declines in both May and in June. The production of motor vehicles and parts exploded 6.6% as automakers pushed output to a new all-time high. Clearly, automakers are not home builders and see no waning demand for cars and light trucks on the part of the public.

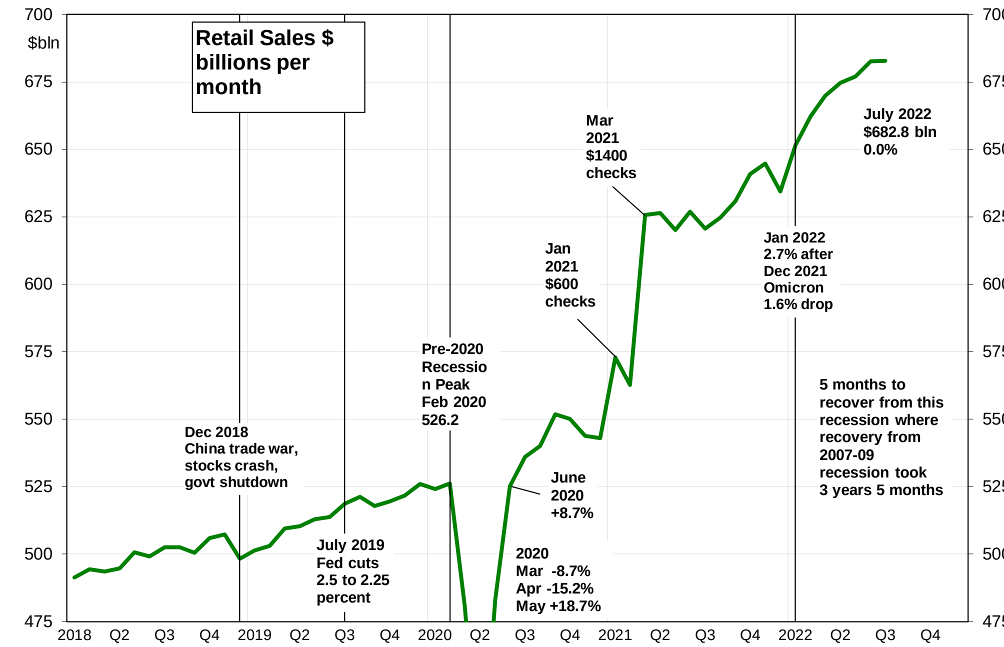
Percent changes			Industrial Production July 2022		
May	Jun	Jul	YOY		Weight
-0.1	0.0	0.6	3.9	Total Index	100.0
-0.4	-0.4	0.7	3.2	Manufacturing	74.5
0.9	2.0	0.7	7.9	Mining	13.7
0.2	-0.3	-0.8	2.2	Utilities	11.8
			Manufacturing payroll jobs 12.8 million +476K YOY 9.9% of Private Payroll Jobs		

Net, net, the Federal Reserve's own economic statistic of industrial production isn't forecasting a recession so policymakers are unlikely to be swayed by arguments they need to slow the pace of rate hikes. Another 75 bps rate hike is still on the table in September, and more economic data will be required to assess whether 50 or 75 bps is the right move. Industrial production has turned down in every economic recession in history so the record high this month is not consistent with a downturn even after two consecutive quarters of negative real GDP growth. Reading the tea leaves on the economy hasn't been this difficult in years. It's up, it's down, and today, the news is that the economy is up. Bet on it.



Consumer spending postpones recession another month (Wednesday)

Breaking economy news. Retail sales were unchanged where the bets were made for a good-sized decline because gasoline sales were thought to be in retreat from the sharp drop in prices at the pump in July. Summertime and the living is easy for consumers where most are fully employed with the lowest unemployment rate in the nation's history. They have paychecks and are still spending them, and maybe holding a little back for more cars to come to the dealer lots.



Retail sales were unchanged in July and they took away the 0.1% decline in May for good measure, saying now that May sales increased 0.4%. No decline in retail sales in any month January to July this year takes away any chance of recession based on this measure of consumer spending. The old rule of thumb was three consecutive declines in retail sales signals a recession. Of course, inflation is running so fast and furious, it is difficult to separate out what is actually real spending with more store-bought goods actually moving into the shopping carts.

Motor vehicle sales fell 1.6% after rising 0.5% in June even though unit car and light truck sales have been little changed on supply issues. Supply issues seem to be disappearing with production at a new record high in yesterday's industrial production data however. Meanwhile, the gasoline sales takedown of retail sales didn't happen with gasoline station sales only down 1.8% where CPI gasoline prices fell 7.7%. Retail sales excluding gasoline and motor vehicles rose 0.7% in July so the world isn't ending for the consumer yet.

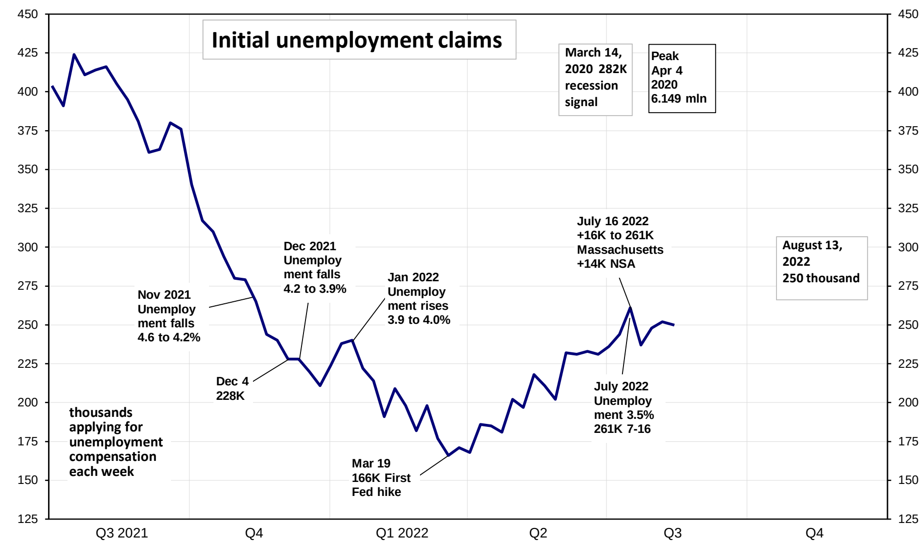
Retail spending, actual dollars, each month

	$million Jul 2022	% to Total	Percent Changes % Jul	Jun	Year/year
Total Retail Sales	682,815	100.0	0.0	0.8	10.3
Motor vehicles/parts	124,948	18.3	-1.6	0.5	2.1
Furniture/furnishings	12,122	1.8	0.2	-0.4	2.1
Electronics/appliances	7,619	1.1	0.4	-0.1	-9.9
Building materials/garden	42,655	6.2	1.5	-0.5	10.1
Food & beverage	78,964	11.6	0.2	0.9	8.4
Health/personal care	33,623	4.9	0.4	1.5	3.4
Gasoline stations	67,440	9.9	-1.8	2.5	39.9
Clothing/accessories	25,891	3.8	-0.6	0.9	2.3
Sporting goods, books	9,218	1.3	0.1	0.6	3.9
General merchandise	67,334	9.9	-0.7	-0.4	0.5
Department stores	11,191	1.6	-0.5	-2.4	-1.4
Miscellaneous retailers	16,327	2.4	1.5	3.7	17.8
Nonstore retailers (internet)	110,624	16.2	2.7	0.9	20.2
Eating & drinking places	86,050	12.6	0.1	0.8	11.6

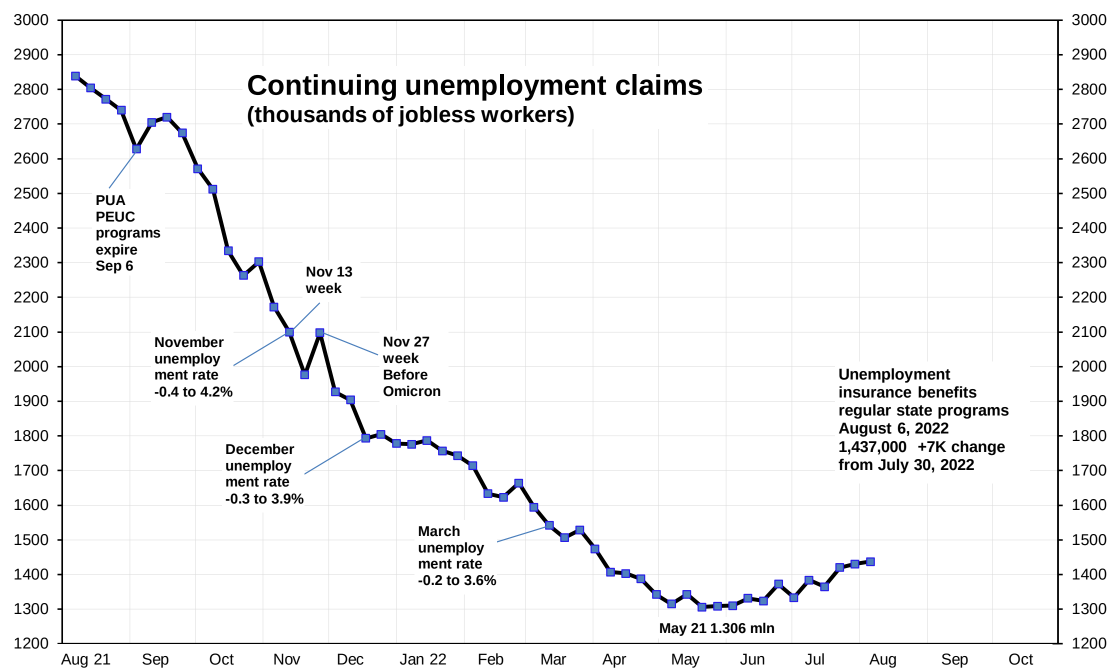
Net, net, the consumer certainly isn't losing any sleep over the market's recession talk as life continues on with pocketbooks and purses open and ready as they head to the malls across America. Real GDP declining the first and second quarters of 2022 means nothing to the average consumer in the country. Real GDP can decline all it wants, but real consumption expenditures remain on an upward trajectory. The good news today is the consumer is alive and well, and is another piece of the puzzle that questions whether the recession is still coming as it certainly isn't here yet. Stay tuned. Story developing. Consumer spending postpones recession for another month.

Jobless claims decline, outlook uncertain (Thursday)

Breaking economy news. First-time jobless claims fell 2K to 250K in the August 13 week, but mind the gap down the prior week where August 6's 262K claims are now 252K. Is it just us seeing this or have others noticed the big downward revisions in some of the last several weeks. Continuing claims with the total number of Americans receiving unemployment compensation barely budged at 1.437 million, up just 7 thousand from the week before. You can't have a recession without job losses, and right now we don't quite have the weekly data to forecast the record low 3.5% unemployment rate is about to turn upward. A Fed Governor said yesterday that retiree dropouts might need to look for work again because of inflation eroding their savings, and they might just be right. This example illustrates that there is still a shortage of labor out there despite two negative quarters of real GDP, which is almost unprecedented. Another thing to blame the baby boom generation for: labor shortages that won't allow a turndown in aggregate economic demand to blossom naturally into job layoffs and recession. Darn.



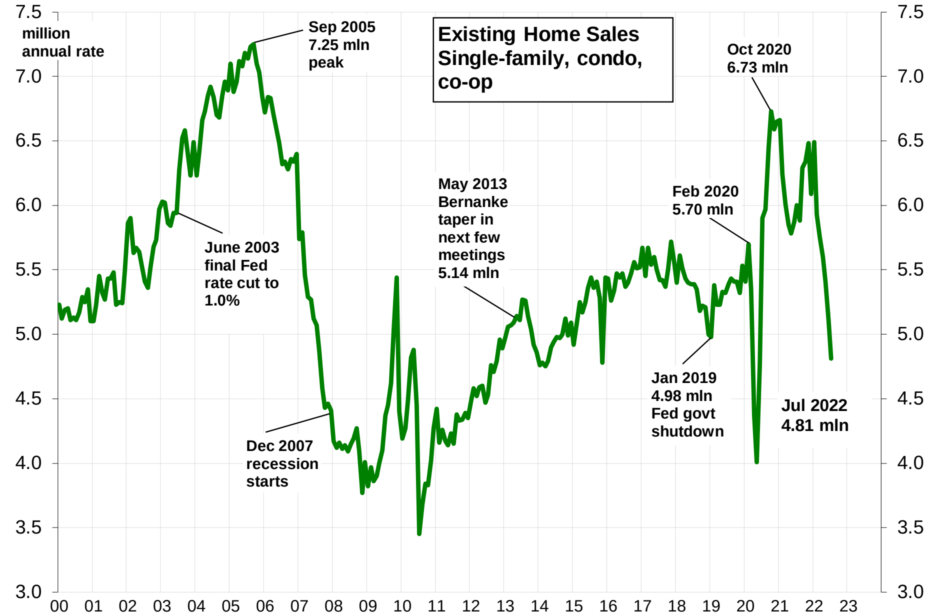
Net, net, the coast is clear for Fed officials to keep on pushing on interest rates to slow the economy because the earliest indicators showing distress in the labor market are not definitive on whether a recession is weeks away or months away or even coming at all. Stay tuned. Story developing.



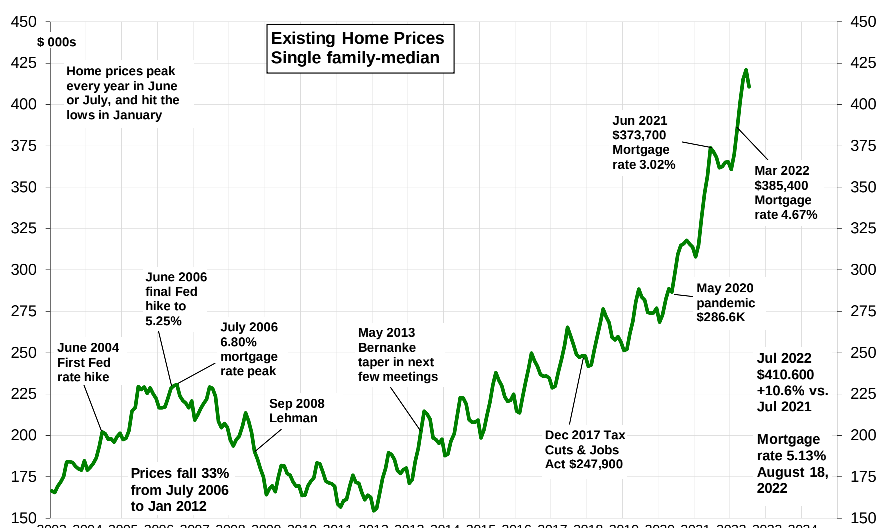
Home prices drop! (Thursday)

Breaking economy news. Existing homes sales fell 5.9% in July to 4.81 million at an annual rate and are down 20.2% from prior year levels. Activity in the most expensive region of the country out West looks dire with 870 thousand of sales in July down 32.6% from 1.290 million last November. Hard to know if the market is crashing as 2019 sales in the West were 1.120 million. Maybe the pandemic burst of home sales is simply normalizing, helped along by the Fed's anti-inflation measures that directly targets the housing sector by pushing up mortgage yields.

The home prices drop headline. Sorry for the hyperbole but the midterm elections are coming soon enough. Single family home prices did decline 2.4% in July to $410,600, but prices come down nearly every July each year after the peak of the selling season in the first month of summer. The jury is out on whether reduced sales mean prices will also continue to come down.



Net, net the sales turnover of existing homes is down sharply thanks to the Fed's attempt to wring inflation out of the economy. Existing home sales have not plummeted this fast since 2007 when the housing bubble burst. The Fed has housing in its sights, and homeowners are wondering if they are going to be sacrificed as well as they nervously check the internet for signs the value of their home-sweet-home is going down. Zillow, Redfin, Trulia, Realtor.com, Zillow, Redfin, Trulia, Realtor.com. Check it out.



Analyst Certification

The views expressed in this report accurately reflect the personal views of the research staff at FWDBONDS LLC, the primary analysts responsible for this report, about the subject securities or issuers referred to herein, and no part of such analysts' compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed herein.