Financial Markets This Week

10 SEPTEMBER 2021

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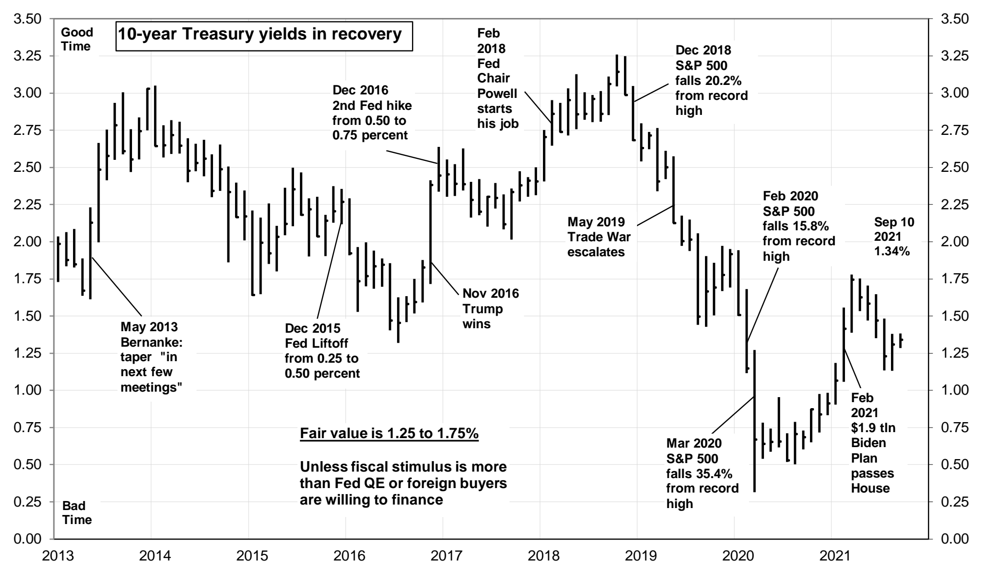
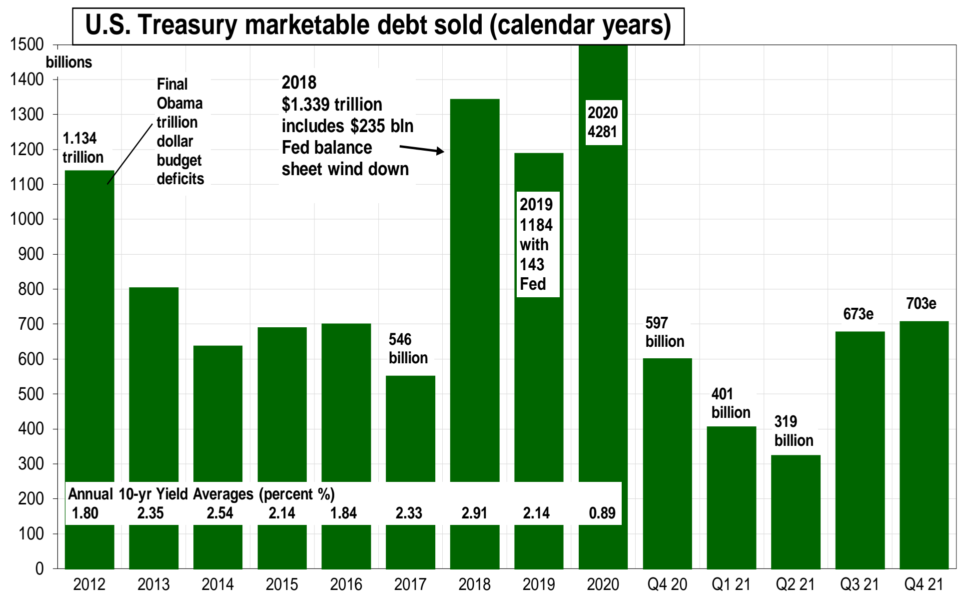
BOND MARKET VALUATION

Market expectations of better days ahead aren't moving bond yields up that's for sure. We saw this movie before the last time the Fed dropped rates to zero in December 2008 during a recession and financial crisis and kept them there for the seven long years of yieldless draught in the fixed income markets. Every time you think a Fed rate hike is coming, the timing keeps getting put off. Waiting for Godot. Remember him? Bond yield rallies from this point forward could again prove to be just as premature as the one earlier this year. Some are saying bond yields are down low because they are sniffing out an economic growth slowdown in the not-so-distant future. You don't have to be a bloodhound to guess the economy might be slowing from real GDP of 6.3% in Q1 2021 and 6.6% in Q2 2021. That hyper-growth was bought for you by Uncle Sam sending out $600 checks in January and $1400 checks in March. That's why real consumption was 11.4% in Q1 2021 and 11.9% in Q2 2021. No more so-called Economic Impact (and how) Payment checks, then no more sky-high consumer spending regardless if the Delta variant stops spreading. In terms of the enormous Federal budget deficit when it comes to measuring supply of Treasuries, the latest Treasury estimates are that $2.1 trillion of new cash will be raised from Treasury auctions in calendar year 2021 so it is good we guess the Fed continues for now to buy Treasuries each month at a $960 billion annual rate.

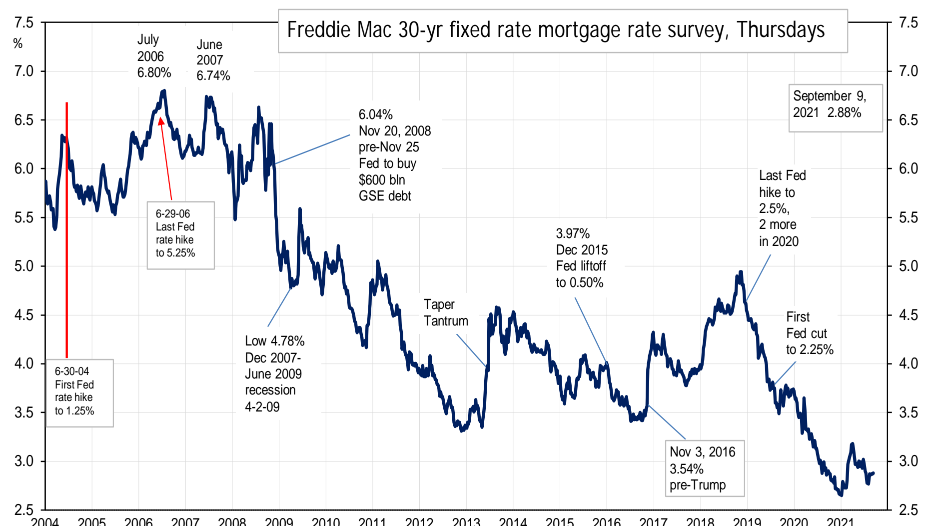


Our bond model has the Fed funds rate in it that gives bond yields their spine, inflation, and supply and demand. We can't tell you what the coefficients are probably because we haven't run a regression on economic variables in a decade or two. Bond yields have no spine and if you don't believe us look at the current 5-year Treasury yield. A 5-year yield will be a 1-year yield four years from now: with 5-yr Treasuries at 0.82%, do they really think the Fed funds rate will still only be 0.25 or 0.50 or 0.75

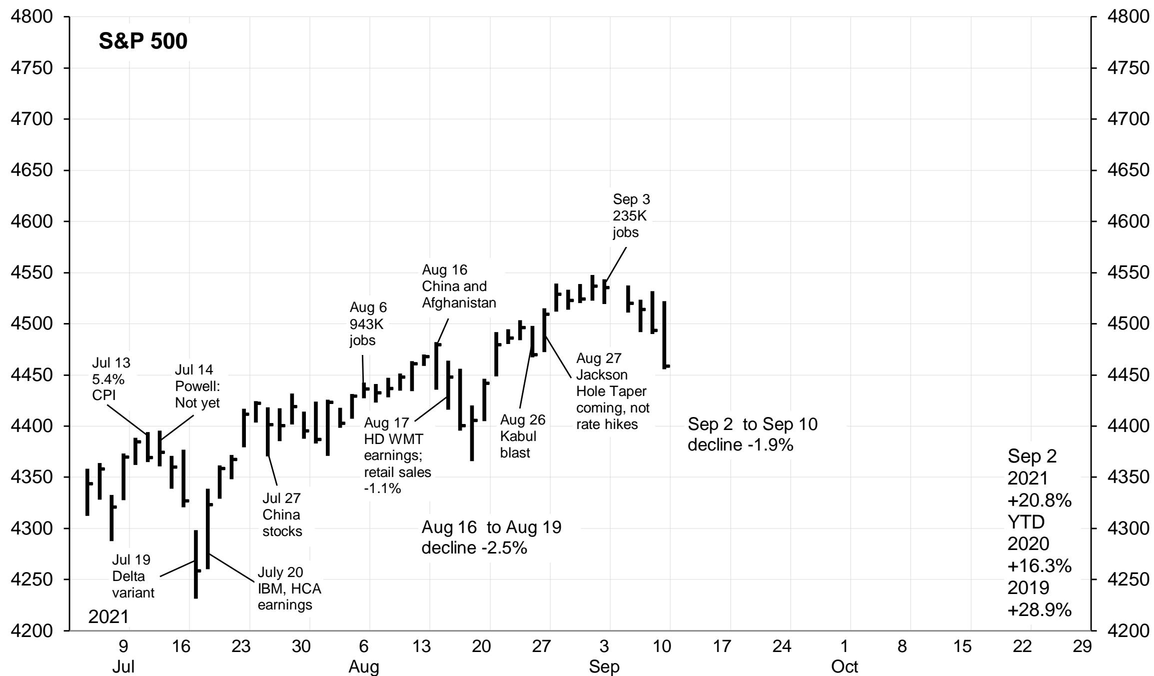
percent at the end of 2025? There's inflation in the bond model, but bonds are content to ignore inflation for now if the Federal Reserve is. We mentioned supply where the Treasury raised $4.3 trillion new cash in 2020 and is projecting $2.1 trillion this year. Fed demand for Treasuries is going away and there is no special demand from foreigners or financial institutions. Then there's a fear factor driving expectations and trading and the direction of bond yields as well, like the famous taper tantrum in 2003 when Bernanke said they might taper their QE purchases. This tantrum looks like less of a fear than it deserves at least on this graph at the top. It is one thing if QE purchases are holding down Treasury 10-year yields and it is another thing if the QE tapering heralds the start of Fed rate hikes from zero. For the former, the Fed was buying $45 billion per month of Treasuries which is $500 billion, for the latter, the actual rates liftoff under Fed Chair Yellen didn't occur until December 2015 and the second rate hike to all of 0.75% did not occur until December 2016 after Trump was elected.



Finally, we always like to say Fed policy isn't doing anything with rates at zero and the mindless emergency QE purchases of $120 billion Government securities and mortgage-backed securities per month. And we didn't like Fed Chair Powell saying in Jackson Hole a premature policy exit could be harmful. Ever since Greenspan, the Fed has been overly timid about pushing up interest rates to normal. But monetary policy and interest rates are still important for one important interest-rate sensitive sector of the economy which is the housing market. If mortgage rates went up it could slow housing demand which isn't all that strong after its pandemic short-term bounce. Slower demand and higher mortgage rates could bring down that 20% increase in home prices since the pandemic. On the other hand, when it comes to demand for homes, if home buyers can afford a new house at a price 20% higher than last year, they can probably pay a mortgage rate of 4% if Treasury bond yields were to resume their climb from earlier this year.



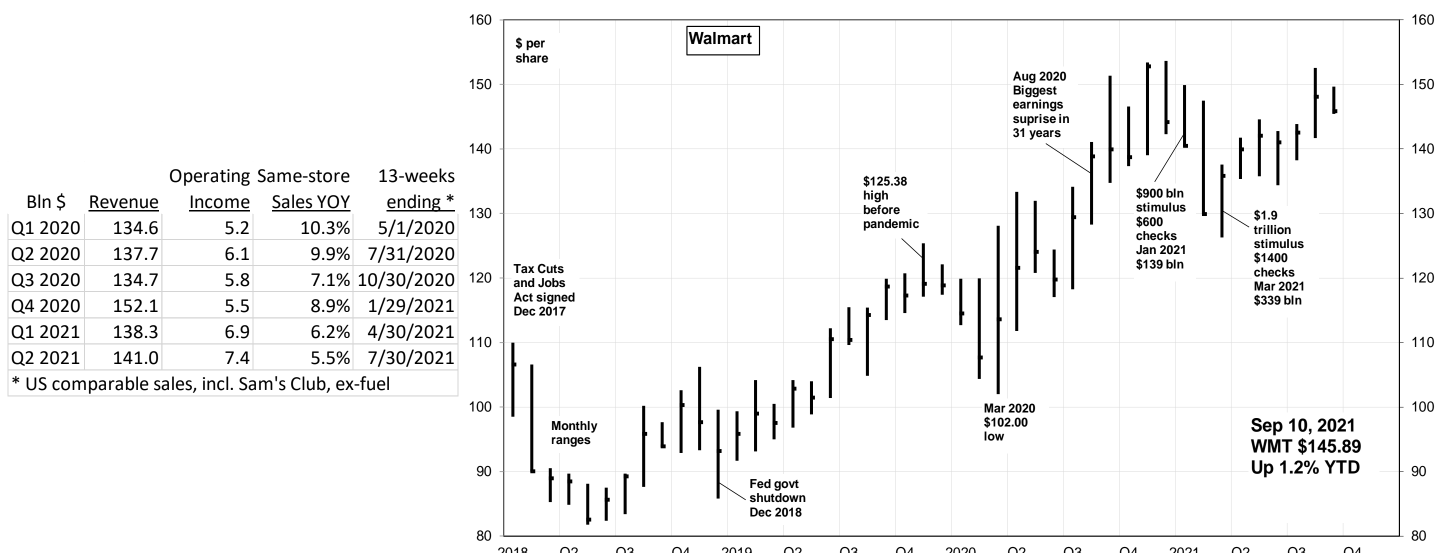
INTEREST RATES



The stock market fell this week on economic uncertainty. Some banks said GDP was slowing, some other banks said the stock market would fall later this year. Stocks fell hardest on Friday, but didn't bring 10-yr yields down. There was a news story Friday before the NY open about a Fed taper announcement at the November 2-3 meeting, but it was hard to see an immediate reaction. Yields rose initially on Tuesday with yields in Europe. The range was 1.29 to 1.38, closing at 1.34 percent. The S&P 500 is now down as much as 1.9% from Thursday, September 2's record high. The last sell-off starting August 16 on weak China data and the Afghanistan withdrawal was a drop of 2.5%.

Walmart WMT up 1.2% YTD

The largest retailer in the U.S. reported second quarter earnings on August 17, 2021. Total revenue is up 2.4% to $141.0 billion. Its U.S. Walmart sales were up 5.3% to $98.2 billion with operating income of $6.1 billion. Comparable store sales ex-fuel in the 13-week period ending July 30, 2021 were up 5.5% from last year including Sam's Club where we shop. The company's Walmart U.S. guidance for Q3 2021 is comparable sales growth excluding fuel of 6 to 7 percent versus a year ago.



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

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

FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					March 11
Fed H.4.1 statistical release					2020**
billions, Wednesday data	8-Sep	1-Sep	25-Aug	18-Aug	pre-Covid
Factors adding reserves					
U.S. Treasury securities	5372.741	5365.670	5346.372	5323.651	2523.031
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347
Mortgage-backed securities (MBS)	2438.068	2438.068	2438.067	2465.638	1371.846
Repurchase agreements	0.000	0.000	0.000	0.000	242.375
Primary credit (Discount Window)	0.245	0.338	0.278	0.291	0.011
MMLF	0.000	0.000	0.000	0.000	
PDCF	0.000	0.000	0.000	0.000	
Commerical Paper Funding Facility	0.000	0.000	0.000	0.000	
Paycheck Protection Facility	72.697	74.441	77.788	80.489	
Corporate Credit Facility (CCF)	17.117	17.117	17.116	17.116	
Municipal Liquidity Facility	9.771	9.769	9.768	9.766	
Main Street Lending Program	30.558	30.550	30.543	30.534	
Term Asset-Backed Facility (TALF II)	4.512	4.511	4.514	4.513	
Central bank liquidity swaps	0.329	0.336	0.326	0.488	0.058
Federal Reserve Assets	8406.7	8398.1	8382.1	8392.0	4360.0
3-month Libor %	0.12	0.08	0.12	0.13	0.77
Factors draining reserves					
Currency in circulation	2198.561	2192.423	2188.700	2188.089	1818.957
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	200.702	296.934	258.200	313.651	372.337
Treasury credit facilities contribution	40.278	40.278	40.278	40.278	
Reverse repurchases w/others	1115.229	1084.115	1147.089	1115.656	1.325
Reserve Balances (Net Liquidity)	4259.603	4206.449	4203.475	4162.165	1779.990
Treasuries within 15 days	52.447	63.019	79.378	79.791	21.427
Treasuries 16 to 90 days	319.834	304.096	297.972	297.515	221.961
Treasuries 91 days to 1 year	699.105	704.235	696.821	696.797	378.403
Treasuries over 1-yr to 5 years	2049.420	2049.268	2033.296	2021.245	915.101
Treasuries over 5-yrs to 10 years	981.498	978.139	981.487	973.108	327.906
Treasuries over 10-years	1270.437	1266.913	1257.417	1255.194	658.232

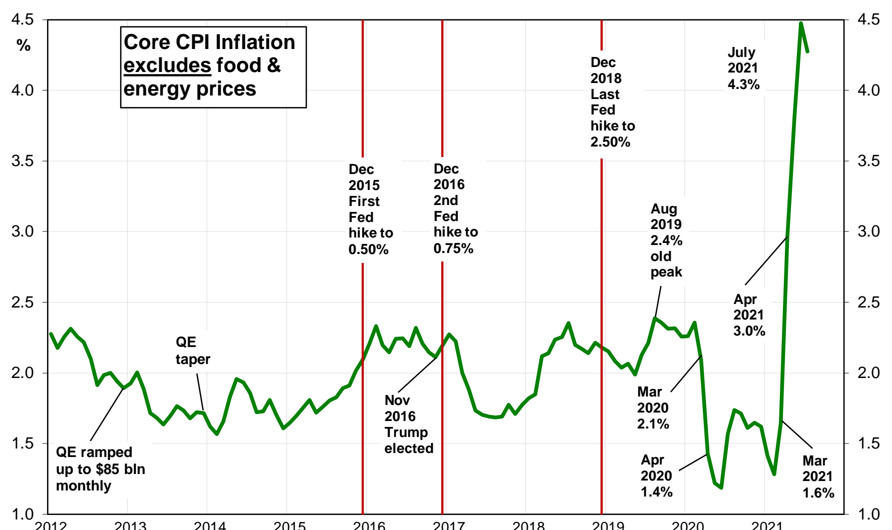
**March 11, 2020 start of coronavirus lockdown of country
MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds
PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days
CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)

The Fed meets on September 21-22, 2021 to consider its monetary policy. Based on news stories this week it sounds, it sounds, it sounds like Fed tapering is dead ahead despite the relatively weak 235K jobs report this month. Thank goodness. Retirees living on fixed incomes can finally have some interest on their savings perhaps sooner than last time with its long drought of seven years of zero rates after the 2007-09 recession.

The muddled news reports seemed to hint the Fed will say at the September meeting that they will formally announce the QE taper details at the November 2-3 meeting and finish taking down the entire $80 billion monthly Treasury purchases amount to zero by the middle of 2022 in order to be ready to hike interest rates if they need to. If they need to? The only economic theory we remember on this is that a normal economy with a return-to-normal 3.5% unemployment rate means the Fed funds rate should be at a normal 2.5%. It doesn't look like the Fed funds rate will be at 2.5% for baby boom savers when the economy gets to normal. There was so much finger-pointing and shouting about the last round of Fed rate hikes to 2.5%, we would recommend a slower pace: a 25 bps rate hike every quarter until 1.5%, and then go 25 bps every six months until you get to 3.0%.

It took a year to taper the $45 billion monthly Treasury purchases starting in January 2014 under Bernanke after making the announcement at the December 18, 2013 Fed meeting. If they announce a taper in November 2021 and start dropping it $10 billion a month to zero, that's 70 November, 60 December, 50 January… they would be down to zero purchases in June 2022. Sounds good to us. We left out the tapering of the $40 billion monthly mortgage-backed securities purchases only because we are uncertain of the effect it will have on mortgage rates. It is possible that mortgage rates could rise faster than Treasury yields if the Fed stops its purchases.

Bonds have lost interest in inflation for now. CPI is released Tuesday, September 14 at 830am ET

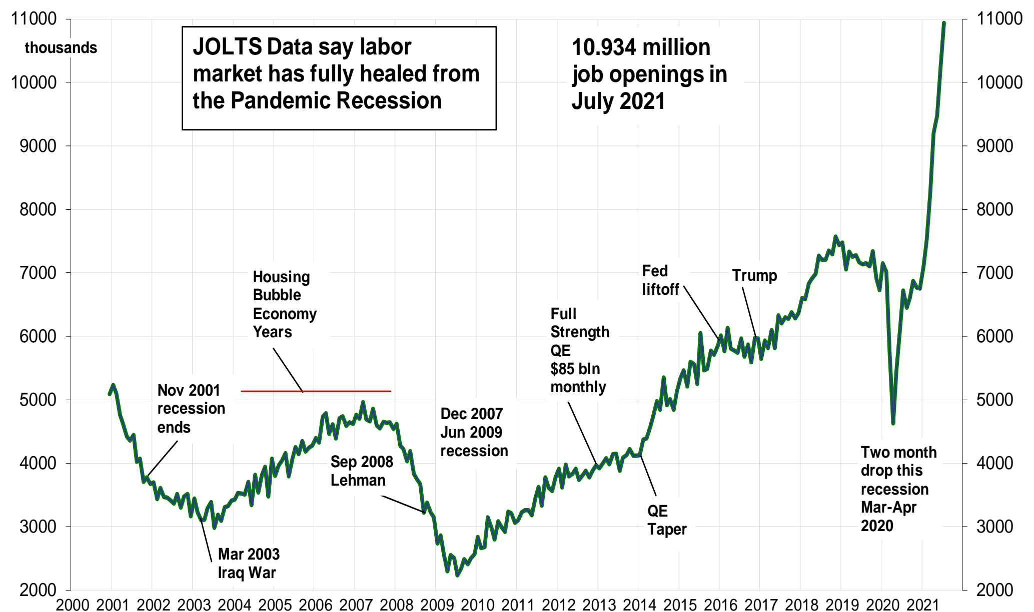


OTHER ECONOMIC NEWS

JOLTS: You've got to be kidding me (Wednesday)

Breaking economy news. Record jobs available at the end of July at 10.934 million swamp the number of jobless Americans in the country and make this the strangest recovery from any recession we have ever experienced in our career as an economist. JOLTS data, you've got to be kidding me. Sorry, we are in NYC currently watching US Open tennis and telling our company we are working from home. JOLTS data, even if they are overestimated by a change in the way America posts Job Listings possibly, we get multiple listings of the same economist jobs from several different online headhunters. The BLS says it is surveying firms though and not simply counting postings on jobs boards. Nevertheless, even if over-estimated, this one labor market statistic tells us the labor market is tight as a drum with the demand for labor the highest in history. Why then does the Fed continue to support the economy at high-alert, danger-danger, emergency stimulus levels? Even with the "best economy in fifty years" before the pandemic that the Fed Chair lauds, there were still 5.717 million out of work before the pandemic recession.

Back to today's data, 10.934 million openings. How many people are still out of work after the pandemic? Well one measure is the level of private payroll jobs which are down 4.543 million in August 2021 after the monthly employment situation report, down we say from the pre-pandemic peak in February 2020. Private job openings were 9.881 million in July. Clearly there is a big mismatch and Fed policy is too easy given the availability of jobs which shows up in the very strong wage growth we have seen as companies try to outbid each other to onboard their employees needed to keep the factories humming and the store shelves stocked.

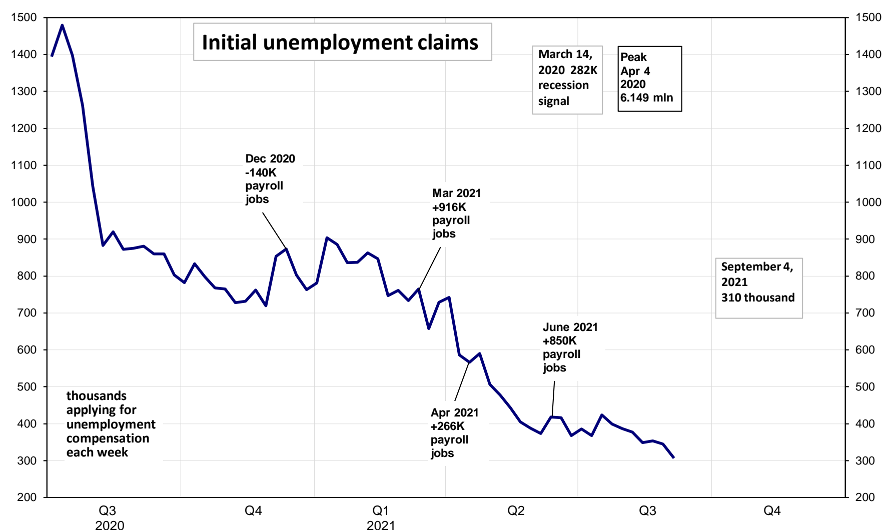


Net, net, Federal Reserve officials are behind the curve in keeping rates low to support labor market healing because the jobs available are enormous and overwhelm the numbers of job seekers who say they are unemployed. Let's not forget there are always unemployed persons in the economy, even in the best economy in fifty years before the pandemic there were 5.717 million out of work behind the record low 3.5% unemployment rate in February 2020. In last week's employment report for August the unemployed behind the 5.2% unemployment rate were 8.384 million. The 235K jobs report may have got the labor market's condition all wrong because the record job openings are telling Fed officials to taper immediately. This is not an economy experiencing a crisis or meaningful economic weakness that needs the support of the Federal Reserve. Bet on it.

New low for new claims for unemployment since the pandemic (Thursday)

Breaking economy news. New low in the number of new jobless workers this year shows the labor market continues to recover strongly. Jobless claims in the September 4 week were 310 thousand down from 345 thousand the week before. Companies are laying off fewer workers and the data today argue strongly for a return to the big monthly payroll jobs numbers in September and suggest the 235K weakness in August was an anomaly. 310 thousand jobless claims are telling the Fed to taper sooner rather than later.

In the August 21 week, there were 5.090 million receiving benefits in the Pandemic Unemployment Assistance program and 3.087 million receiving benefits in the Pandemic Emergency UC program and both these programs have now expired. Time will tell if the sharp drop in money paid to millions of still jobless workers will put a dent in the economy's record recovery run in the months to come.



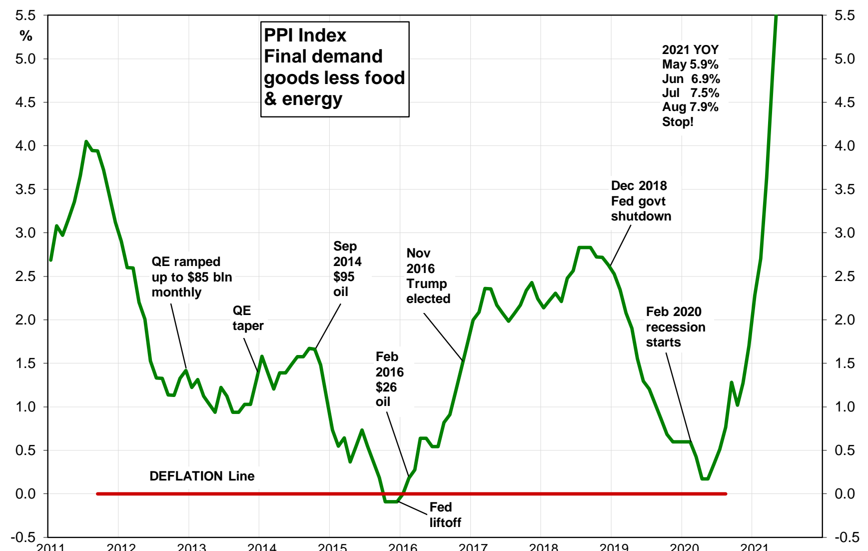
Net, net, layoffs this week fell sharply to a new post-pandemic low as companies are holding onto their employees for dear life because they know there is an enormous shortage of help out there in the country. Skilled labor hiring? Forget about it. Baby boomers are retiring in record numbers and there is no one stepping up to the plate to replace them. There is likely to be a fierce debate at the coming Fed meeting on how tight the labor market is, but if policy makers focus on the most timely data we got, they will realize that the labor market is close to meeting their more stringent criteria for an interest rate hike let alone the trigger for QE tapering. This is not an economy that needs the support of the Federal Reserve. The Delta variant is not slowing the economy in a worrisome way. Economic growth is slowing from 6% to 3% and that is not a slowdown that counts. Growth is returning to normal, the labor market is returning to normal, it is the Fed's emergency stimulus this late in the game that is decidedly abnormal. Bet on it.

Unemployment Benefits Recipients		
21-Aug-21	Program	Prior Year
2,662,831	Regular State	13,036,361
8,298	Federal Employees	13,588
5,987	Newly Discharged Veterans	12,936
5,090,524	Pandemic Unemployment Assistance	15,265,660
3,807,646	Pandemic Emergency UC	1,588,668
311,337	Extended Benefits	254,109
1,098	State Additional Benefits	2,337
42,694	STC/Workshare	253,431
11,930,415	TOTAL	30,427,090

PPI inflation drops (Friday)

Breaking economy news. Hope you are enjoying the headline because it is not the complete truth like so many things nowadays. Total final demand producer prices rose just 0.7% in August after rising 1.0% in July… a three-tenths drop that shows inflation is cooling. Too late though because the cost of producing goods is well, costlier for factories out there and the price runup this year is creating confusion and contributing to supply bottlenecks.

PPI continues to measure services prices like transportation and warehousing which may be interesting now that there is concern about shipping costs. But we prefer to focus more on the old-fashioned PPI which now is called Final demand goods prices less foods and energy. These traditional PPI prices cooled as well in August to a gain of 0.6% from steady 1.0% gains in each of the months of April, May, June, and July. And 0.6% is not much to crow about as the annual times 12 rate is 7.2%. Behind the 0.6% core goods increase were higher prices for industrial chemicals, motor vehicles and steel mill products that was tempered somewhat by a 3.7% drop in iron and steel scrap prices. We have some steel iron pipes left in our basement that the plumber changing the main line left behind if anyone would like it. Maybe will try to sell it on eBay. Look out for our post.



Net, net, producer prices didn't rise as much this month, but the increase is still bringing a match to the inflation fire that the Fed officials continue to support with their emergency QE purchases of securities even though the recession ended way back in April 2020. The danger with inflation is once prices go up, they don't go back down and the economy and producers and consumers all have to live in a costlier world where many don't have the means to do more than just barely survive. There's a cost-of-living crisis and it comes around every time central banks focus more on the labor market and growth than they focus on inflation. The only way you can survive inflation is if you try to pass the price increases on to someone else. Stay tuned. Story developing.

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