

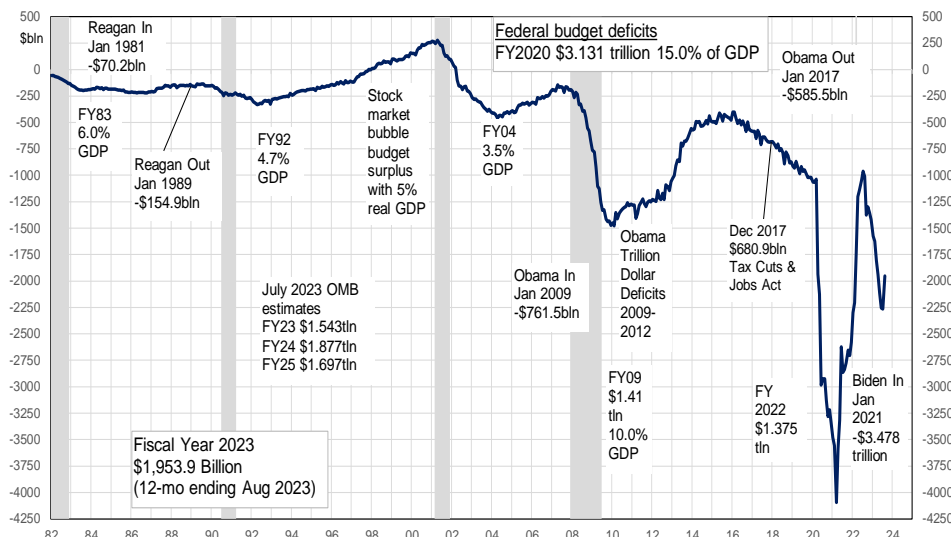
Financial Markets This Week

15 SEPTEMBER 2023

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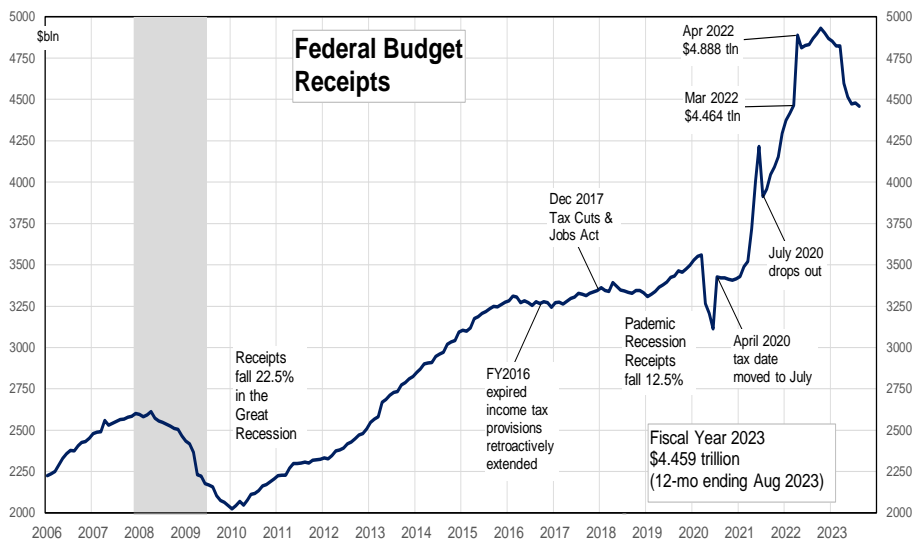
\$1.5 TRILLION DEFICIT

August Federal deficit results this week. \$1.524 trillion this fiscal year with only September left. Much has been made of the student loan forgiveness effect, but with the Fed's \$720 billion of QT each year, adding to the Treasury's borrowing needs, that is the least of our worries. Same story. If there's a



spending crisis down in Washington, keeping the national debt from growing more than the increase in nominal GDP would be a start: Q2 2023 nominal GDP increased 4.1% SAAR which means the \$32.98 trillion national debt cannot increase more than \$1.352 trillion this year to keep the debt-to-GDP ratio from worsening.

The Biden student loan forgiveness last year had to be charged off against the Federal budget deficit upfront, and the amount charged to the Department of Education in September 2022 added to the FY2022 \$1.375 trillion deficit. There have been some changes, but the August 2023 downward



modification to the Federal Direct Student Loans program was \$319 billion. Using this figure, it means the FY2022 \$1.375 trillion deficit was \$1.056 trillion without loan forgiveness, and correspondingly, the \$1.524 trillion deficit for the first eight months of FY2023 was actually \$1.843 trillion, a greater number that some people like to make hay about.

Apart from Federal government spending, tax receipts have slowed down and not sure yet if it is due to an economic slowdown that morphs into recession. Payroll jobs created and wages are certainly slower this year as the pandemic demand surge fades further back into history, so less for government to take from the hardworking American people. Private payroll jobs increased 1.8% or 2.316 million to 133.761 million in the first 11 months of FY2023 ending in August, where private payroll jobs increased 4.3% or 5.397 million in the comparable period of FY2022. On the same basis, wages of production and nonsupervisory workers were 4.1% so far this fiscal year down from 5.6% in 2022. This along with fewer capital gains taxes with the the S&P 500 +26.9% in calendar year 2021 versus -19.4% in calendar year 2022, and individual income tax refunds higher so far this year at \$365.6 billion YTD in FY2023 up from \$234.6 billion in 2022 for the same period.

What else to look at in the August 2023 Federal budget results besides everything? Probably should look at interest costs, though why bother if the Fed is going to cut interest rates 100 bps next year. Interest is \$807.8 billion YTD FY2023 (\$677.6 billion same period FY2022), but this number is gross interest, and undistributed offsetting receipts from the social security trust fund (among others) funny-money subtracts \$164.9 billion from this in YTD FY2023. Speaking of funny money, social security benefits paid in August of \$102.682 billion were \$25.887 billion more than social security taxes collected. Don't worry about the difference, the Treasury will auction more bonds to the market to pay for it because there is no real money in the trust fund. All make believe like Bitcoin. Don't know why Congress wants to shore up the trust fund so badly, generally by yanking benefits from current or future retirement beneficiaries.

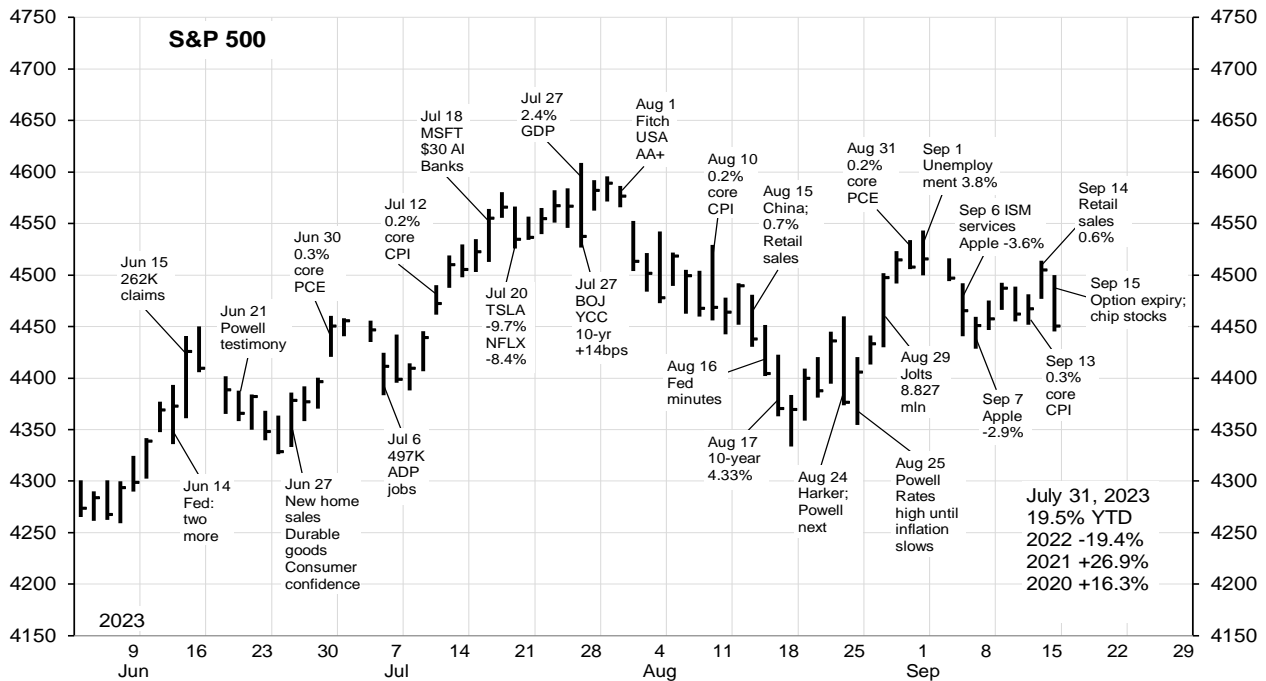
Social Security In/Out

\$ bln	Receipts	Payments	Red/Black
FY2019	770.282	888.080	-117.798
FY2020	825.307	940.221	-114.914
FY2021	814.034	982.673	-168.639
FY2022	911.191	1,063.897	-152.706
Jan 23	92.544	100.214	-7.67
Feb 23	80.264	100.780	-20.516
Mar 23	88.248	101.271	-13.023
Apr 23	102.702	101.773	0.929
May 23	80.874	101.271	-20.397
Jun 23	123.639	102.353	21.286
Jul 23	75.130	102.619	-27.489
Aug 23	76.795	102.682	-25.887

To conclude, the Federal budget deficit is higher this year, but this is unlikely to last into FY2024 given the current makeup of Congress. The Treasury said its borrowing needs in the months ahead were scary at the August 2023 quarterly refunding announcements. In calendar year 2023, the forecast for new cash raised is \$3.173 trillion roughly double the \$1.5 trillion new cash in 2022 and \$1.5 trillion in 2021. The jury is out on whether this supply deluge will keep 10-year Treasury yields higher for longer. They did say most of the cash raised would be through Treasury bills rather than notes and bonds in the months ahead. For now. The new cash forecast for Q3 2023 was \$1.007 trillion and through September 21 they have announced \$935.8 billion with 84.3% of this from Treasury bills. Again, the new cash need is not just the Federal budget deficit, it is also the Fed's QT wind down of its balance sheet to the tune of \$720 billion per year. The Fed can't just wish its Treasury securities holdings away, they have to sell it back to the market.

Treasury Borrowing \$bln			
	New		Notes &
2023	Cash	Bills	Bonds
Q1	657.2	380.2	277.0
Apr	-89.6	-125.9	36.3
May	137.2	51.1	86.1
Jun	610.0	485.0	125.0
Q2	657.6	410.2	247.4
Jul	307.3	314.1	-6.8
Aug	393.5	303.5	90.0
Sep	235.0	171.2	63.8
Q3	935.8	788.8	147.0
** through September 21			

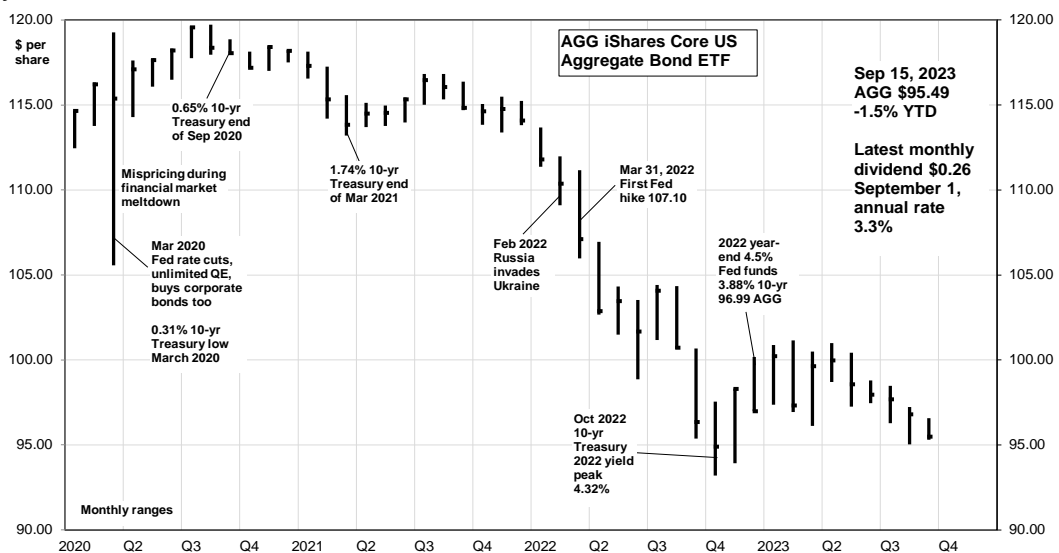
INTEREST RATES



Crazy up/down [wiggle-wiggle week for stocks](#), still working on the recovery from the July 27 to August 18 decline of 5.9%. Forget about it. S&P 500 up on Monday with Tesla’s 10.1% jump. Apple Event Day with new iPhones on Tuesday, a dud like many of these product announcement days, with the S&P 500 falling back 0.6%. Somehow stocks were higher on Wednesday after 0.3% surprise core CPI, and making the high for the week after 0.6% retail sales on Thursday with the consumer still spending. All this buildup looking good, which makes Friday’s 1.2% wipeout completely unfathomable regardless of falling chip stocks, an auto strike, higher crude oil/bond yields; we chock the Friday losses up to the options expiration that comes back to bite the markets sometimes at quarter-ends. 10-yr Treasury yields end 4.33% up from 4.27% last week. 2023 peak was 4.37% in August 2023.

AGG iShares Core US Aggregate Bond ETF down 1.5% YTD

The 40 side of a balanced and safe 60/40 equities/fixed income portfolio isn’t doing great, but it isn’t the disaster of 2022. The AGG ETF closed at 95.49 on Friday down 1.5% YTD, where the S&P 500 is still 15.9% YTD after Friday’s rout. There is a dividend. The last September 1 dividend was \$0.26 X 12 over Friday’s \$95.49 close which is 3.3%. AGG was 107.10 when the Fed first hiked rates.



FEDERAL RESERVE POLICY

The Fed meets September 19-20, 2023 to consider its monetary policy. On Wednesday, the BLS reported that core CPI inflation rose 0.3% in August after rising 0.2% in both June and in July, and still the market refuses to discount a 25 bps rate hike to 5.75%. Fed officials are data-dependent and watching closely, and it must count as some good news that core CPI remains high, but less so with the year-on-year rate falling to 4.3% in August from 4.7% in July. A similar four-tenths decline would bring August core PCE inflation (released Friday, September 29) down to 3.8%, already beyond the Fed's Q4 2023 forecast of 3.9% that they made in June. The Fed last meeting said the policy choice is to raise rates or do nothing, and the stock market is hoping Powell will say they are less certain on the need to hike further. Maybe a pause signal so subtle not everyone believes it. Like the ECB statement this week that read in part: "Based on our current assessment, we consider that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to our target." For the Fed it cannot be too long of a duration, as they define it, with the 100 bps of rate cuts by the end of 2024 to 4.75%. 100 bps to 4.75% was the June meeting forecast. September dead ahead.

At the moment, the market is betting on only 7.5 bps of a 25 bps rate hike on November 1.

Selected Fed assets and liabilities						Change from 3/11/20 to Sep 13
Fed H.4.1 statistical release billions, Wednesday data	13-Sep	6-Sep	30-Aug	23-Aug	3/11/20*	
Factors adding reserves						
U.S. Treasury securities	4982.479	4988.471	5006.839	5006.494	2523.031	2459.448
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2498.870	2498.870	2498.870	2513.140	1371.846	1127.024
Repurchase agreements	0.000	0.006	0.001	0.000	242.375	-242.375
Primary credit (Discount Window)	2.698	2.051	2.907	2.190	0.011	2.687
Bank Term Funding Program	107.993	107.855	107.527	107.386		
FDIC Loans to banks via Fed	133.369	133.796	134.369	137.171		
Paycheck Protection Facility	5.477	5.526	5.693	5.817		
Main Street Lending Program	19.579	19.556	19.534	19.512		
Municipal Liquidity Facility	5.623	5.621	5.618	5.615		
Term Asset-Backed Facility (TALF II)	1.218	1.216	1.583	1.581		
Central bank liquidity swaps	0.230	0.232	0.232	0.230	0.058	0.172
Federal Reserve Total Assets	8149.5	8151.4	8171.4	8189.8	4360.0	3789.432
3-month-Libor-% SOFR %	5.30	5.30	5.30	5.30	1.15	4.150
Factors draining reserves						
Currency in circulation	2329.820	2355.050	2331.504	2328.199	1818.957	510.863
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	537.364	481.552	500.702	416.031	372.337	165.027
Treasury credit facilities contribution	13.358	13.358	13.358	13.358		
Reverse repurchases w/others	1546.225	1606.244	1696.819	1816.533	1.325	1544.900
Federal Reserve Liabilities	4838.933	4860.964	4974.904	5012.398	2580.036	2258.897
Reserve Balances (Net Liquidity)	3310.525	3290.475	3196.542	3177.380	1779.990	1530.535
Treasuries within 15 days	42.893	41.877	65.077	68.144	21.427	21.466
Treasuries 16 to 90 days	273.167	279.944	255.130	251.632	221.961	51.206
Treasuries 91 days to 1 year	624.023	624.428	634.521	634.931	378.403	245.620
Treasuries over 1-yr to 5 years	1712.269	1712.154	1719.220	1719.070	915.101	797.168
Treasuries over 5-yr to 10 years	826.677	826.629	832.030	831.951	327.906	498.771
Treasuries over 10-years	1503.449	1503.441	1500.862	1500.768	658.232	845.217
Note: QT starts June 1, 2022	Change	9/13/2023	6/1/2022			
U.S. Treasury securities	-788.300	4982.479	5770.779			
Mortgage-backed securities (MBS)	-208.576	2498.870	2707.446			

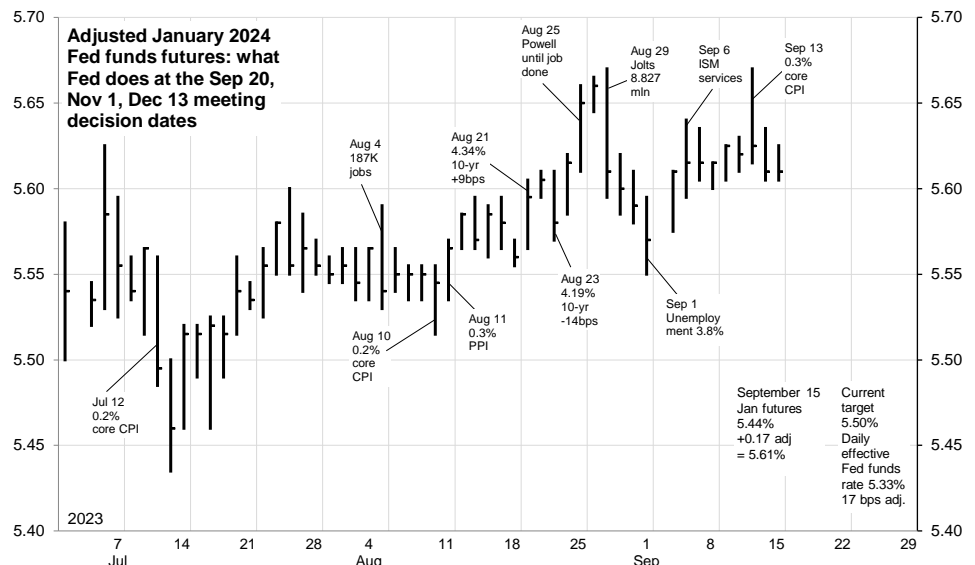
**March 11, 2020 start of coronavirus lockdown of country

Fed Individual Forecasts				
Fed funds rate at year-end				
Votes	2023 End	2024 End	2025 End	run
1	5.125	3.625	2.375	2.375
2	5.125	4.125	2.625	2.375
3	5.375	4.375	2.625	2.375
4	5.375	4.375	2.875	2.500
5	5.375	4.375	3.125	2.500
6	5.375	4.375	3.125	2.500
7	5.625	4.375	3.125	2.500
8	5.625	4.375	3.375	2.500
9	5.625	4.625	3.375	2.500
10	5.625	4.625	3.375	2.500
11	5.625	4.875	3.625	2.625
12	5.625	4.875	3.625	2.625
13	5.625	5.125	3.875	2.750
14	5.625	5.125	4.125	2.750
15	5.625	5.125	4.125	3.000
16	5.875	5.625	4.625	3.250
17	5.875	5.625	4.875	3.625
18	6.125	5.875	5.625	
Median Meeting	5.625	4.625	3.375	2.500

Fed Policy-key variables	2023	2024	2025	Long Term
Fed funds	5.6	4.6	3.4	2.5
PCE inflation	3.2	2.5	2.1	2.0
Core inflation	3.9	2.6	2.2	
Unemployed	4.1	4.5	4.5	4.0
GDP	1.0	1.1	1.8	1.8

June 2023 median Fed forecasts

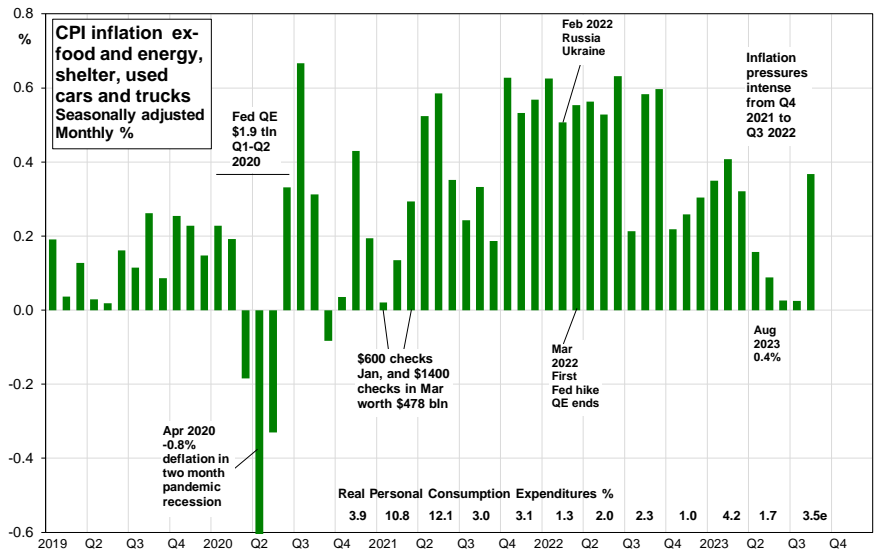
Fed funds futures call Fed hikes		
Current target: September 15 -- 5.50%		
Rate+0.17 Contract	Fed decision dates	
5.505 Oct 2023	Sep 20	
5.575 Nov 2023	Sep 20, Nov 1	
5.605 Jan 2024	Sep 20, Nov 1, Dec 13	
Last trade, not settlement price		



OTHER ECONOMIC NEWS

Inflation isn't dead yet (Wednesday)

Breaking economy news. Core CPI inflation rose 0.3% in August not 0.2% as expected. If you don't fly (+4.9%) or renew your car insurance policy (+2.4%), your basket of goods and services is probably not rising as fast as the prices in core CPI. Consumers look at gasoline prices and grocery store prices to judge inflation and the news here is not bad. Gasoline prices at the pump are virtually unchanged the last five weeks, so that 10.6% jump in CPI gasoline in August won't see a repeat in next month's report. Food at home prices have settled down with a 0.2% increase in August and grocery prices up 3.0% from a year ago.



Extra core inflation that strips out shelter and used cars and trucks in addition to food and energy, rose 0.4% this month, a disappointment after two straight months of 0.0 increases. More data is needed in the months ahead, but this increase may be a one-off.

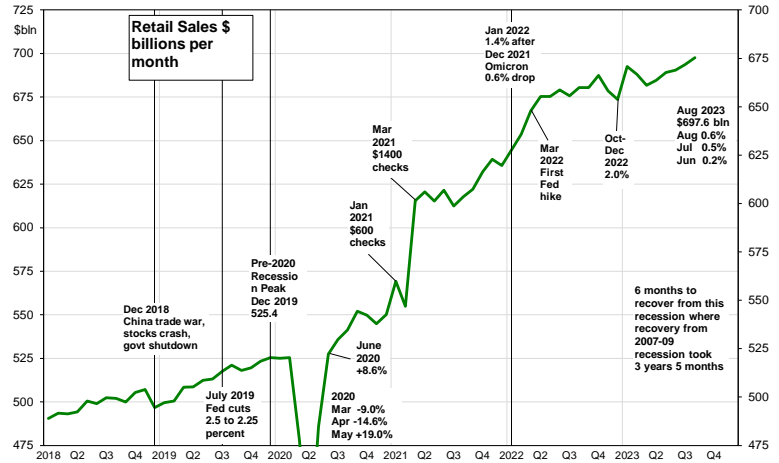
Net, net, Fed officials look at core consumer inflation and the results in August were slightly worse than they were at the start of the summer, but whether this automatically puts another rate hike on the table later this year is an open question. The market-based odds of another 25 bps rate hike in November and December is slightly above 50/50.

Dec 22 Weight	CPI inflation	Monthly Percent Changes			YOY %
		Jun 2023	Jul 2023	Aug 2023	Aug 2023
100.0	Total	0.2	0.2	0.6	3.7
13.531	Food	0.1	0.2	0.2	4.3
4.803	Food away from home	0.4	0.2	0.3	6.5
6.921	Energy	0.6	0.1	5.6	-3.6
79.548	Ex-food & energy	0.2	0.2	0.3	4.3
4.313	New vehicles	0.0	-0.1	0.3	2.9
2.668	Used cars/trucks	-0.5	-1.3	-1.2	-6.6
2.479	Clothing	0.3	0.0	0.2	3.1
1.455	Medical care goods	0.2	0.5	0.6	4.5
34.413	Shelter	0.4	0.4	0.3	7.3
25.424	Owner equiv. rent	0.4	0.5	0.4	7.3
5.750	Transportation	0.1	0.3	2.0	10.3
6.653	Medical care services	0.0	-0.4	0.1	-2.1
Special: Where inflation might come back down to					
58.187	Services ex-energy	0.3	0.4	0.4	5.9
21.261	Commodities (core)	-0.1	-0.3	-0.1	0.2

Stay tuned. The million dollar question whether inflation is cooling down or heating back up cannot be answered definitively today, but it is moving in the wrong direction certainly. Sure a 0.3% core monthly increase in August is disappointing after 0.2% increases in June and July. But the 2-digit changes are much slower the last three months than at the start of 2023. 0.15% June, 0.16% July, 0.278% August. Wait for the Fed's preferred PCE inflation for August on Friday, September 29 before jumping to conclusions. Our bet is the inflation story is still on its way out of the picture. Inflation is still too high with core CPI inflation of 4.3% year-on-year in August down from 4.7% in July, but it will fall to 4.0% in September even if the monthly change is 0.3% when last year's September 0.6% rise falls out of the picture. The Fed is still winning its inflation fight, but it is going to take a little longer and interest rates will likely remain higher for longer as well because inflation isn't dead yet even though after the massive interest rate hikes the last year it sure should be.

Economy steady with flood of data (Thursday)

Breaking economy news. Open the financial news flood gates with an ECB surprise rate hike at 815am ET this morning, followed by retail sales, PPI inflation and weekly jobless claims at 830am ET. The stock market seems to think the economy is in a good place even if some economists still predict a recession next year. The consumer continues to keep the economy afloat with a 0.6% jump in retail sales for August. How motor vehicle sales rose 0.3% in August is beyond us as unit auto and light truck sales tumbled 4.5% to 15.0 million at an annual rate. The monthly changes were revised down some for June and July, but the entire third quarter is still running at a healthy 4.4% clip, down from our 4.7% forecast made a month ago. Consumer spending is where those sky-high 5% GDP estimates come from for Q3 2023.



PPI inflation was higher in August, same as CPI yesterday, a jump in energy prices. Final demand goods prices less foods and energy rose 0.1%, and have been 0.1% or less since April this year. Inflation is winding down, not winding up so Fed officials can take their foot off the rates accelerator. Big jump in transportation and warehousing of personal consumption goods of 1.4% in August means inventory levels have been worked back down. This is the first increase since November last year. First-time applications for unemployment claims rose 3K to 220K in the September 9 week showing the labor market shows no sign of economic stress despite reports of companies tightening their belts and letting some workers go.

Retail spending, actual dollars, each month					
	\$million	% to	Percent Changes %		
	Aug	Total	Aug	Jul	Year/year
Total Retail Sales	697,557	100.0	0.6	0.5	2.5
Motor vehicles/parts	133,530	19.1	0.3	-0.4	4.4
Furniture/furnishings	10,932	1.6	-1.0	-1.9	-7.8
Electronics/appliances	7,732	1.1	0.7	-1.1	-1.8
Building materials/garden	41,502	5.9	0.1	0.2	-4.9
Food & beverage	82,326	11.8	0.4	0.7	2.1
Health/personal care	36,240	5.2	0.5	0.1	7.8
Gasoline stations	55,262	7.9	5.2	0.1	-10.3
Clothing/accessories	26,201	3.8	0.9	0.9	1.3
Sporting goods, books	8,550	1.2	-1.6	1.7	-1.4
General merchandise	73,228	10.5	0.3	0.8	2.0
Department stores	11,053	1.6	0.3	1.2	-3.4
Miscellaneous retailers	15,181	2.2	-1.3	-1.0	-0.4
Nonstore retailers (internet)	116,107	16.6	0.0	1.5	7.2
Eating & drinking places	90,766	13.0	0.3	0.8	8.5

Net, net, the consumer is alive and well, but they are not overspending, and demand pressures that could keep inflation higher for longer are not apparent. There is nothing in today's reports to prompt a Fed rates response next week, and there is not even enough hot data to hint at an interest rate hike in November either, even though the labor market remains out of balance with applications for jobless benefits near recent lows. Retail sales rose 0.6% today which means the economy is not nearing the cliffs of recession. The economy is in a good place for now with moderate consumer demand that is not hot enough to bring inflation back to life. Bet on it.

PPI Final demand goods less foods/energy-- Monthly Percent Changes SA												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2022	0.8	0.8	1.0	1.2	0.7	0.5	0.2	0.2	0.0	0.0	0.3	0.1
2023	0.6	0.3	0.2	0.1	0.1	-0.2	0.0	0.1				

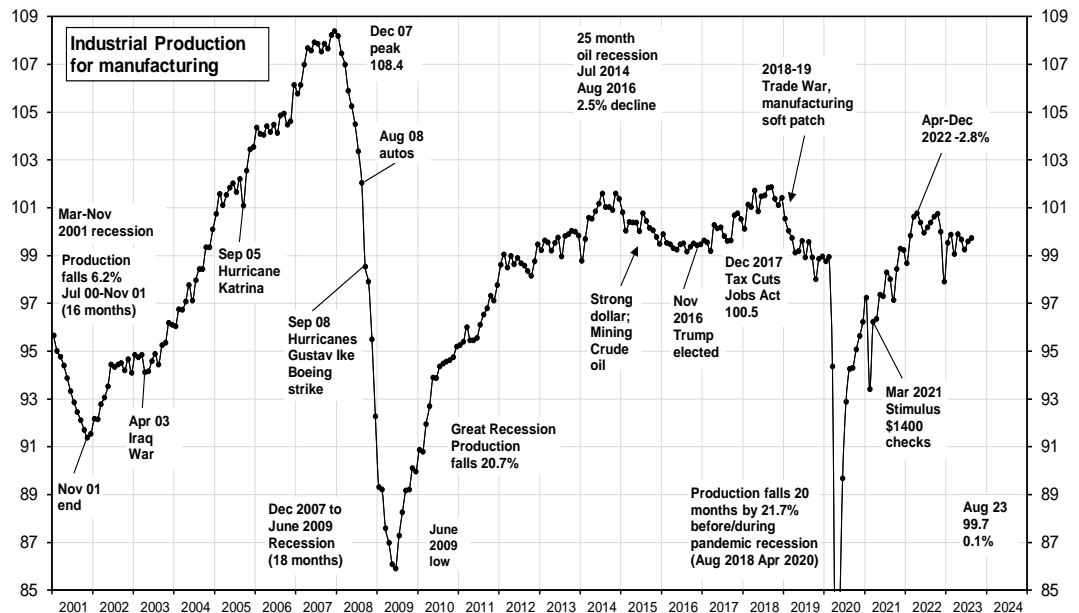
PPI Final demand goods less foods/energy-- Year/Year Percent Changes NSA												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2022	9.4	9.7	10.0	10.2	9.8	9.2	8.5	8.1	7.5	6.7	6.1	5.8
2023	5.6	5.1	4.3	3.3	2.6	2.0	1.9	1.8				

Import prices and industrial production help Fed inflation fight (Friday)

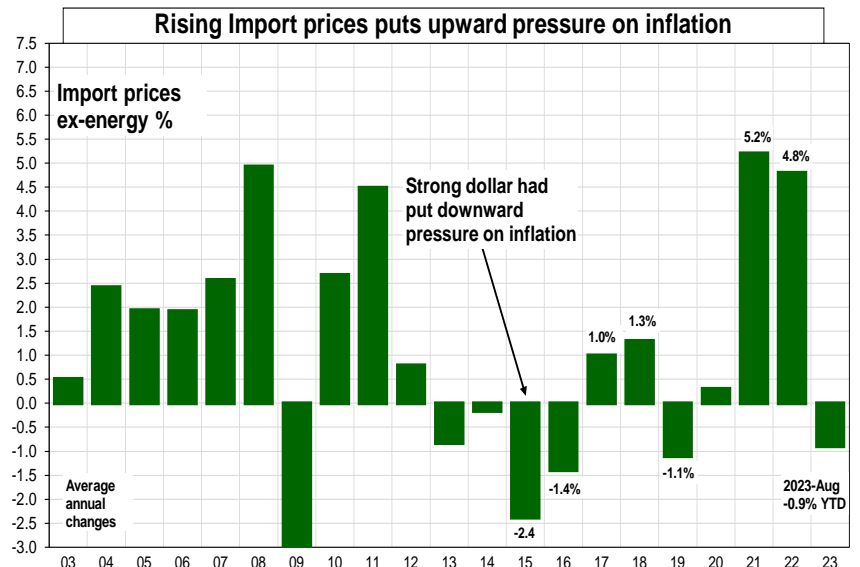
Breaking economy news. Industrial production increased 0.4% in August, but most of the gain is from utility output and oil and gas drilling. Manufacturing production inched up 0.1% and has been volatile lately even though the long term trend is down with a decline of 0.6% from last year. Manufacturing production's slim 0.1% rise was held down by a sharp 5% drop in motor vehicle and parts output, good timing with the autoworkers going on strike late last night.

Import prices (nonfuel) fell 0.1% in August and the trend has switched from inflationary to deflationary this year. In the twelve months ending August 2023, nonfuel import prices fell 0.8%, where in the twelve months ending August 2022 nonfuel import prices jumped 3.9%.

Net, net, signs of disinflation today with factory output limping along at a subpar pace and the price of imported goods ex fuel coming into the country and onto the store shelves for Americans to consume falling for six consecutive months. (Well, unchanged in May, all the other months since



March are down.) Falling import prices are helping the Fed in its inflation fight and manufacturing industrial production inched up in August which means aggregate demand from factories at least is cooling and unlikely to add to price pressures or inflation. If Fed officials only had import prices and industrial production to make their rate hike call next week, they would be unlikely to vote for another rate hike. Import prices and industrial production help the Fed's inflation fight so further interest rate increases are looking less and less likely this year.



Percent changes			Industrial Production	
Jun	Jul	Aug	YOY	Weight
-0.4	0.7	0.4	0.2	100.0
-0.4	0.4	0.1	-0.6	74.3
0.7	-0.2	1.4	3.9	15.2
-1.7	4.4	0.9	1.2	10.5
			Manufacturing payroll jobs 13.0 million +106K YOY 9.7% of Private Payroll Jobs	

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