Financial Markets This Week

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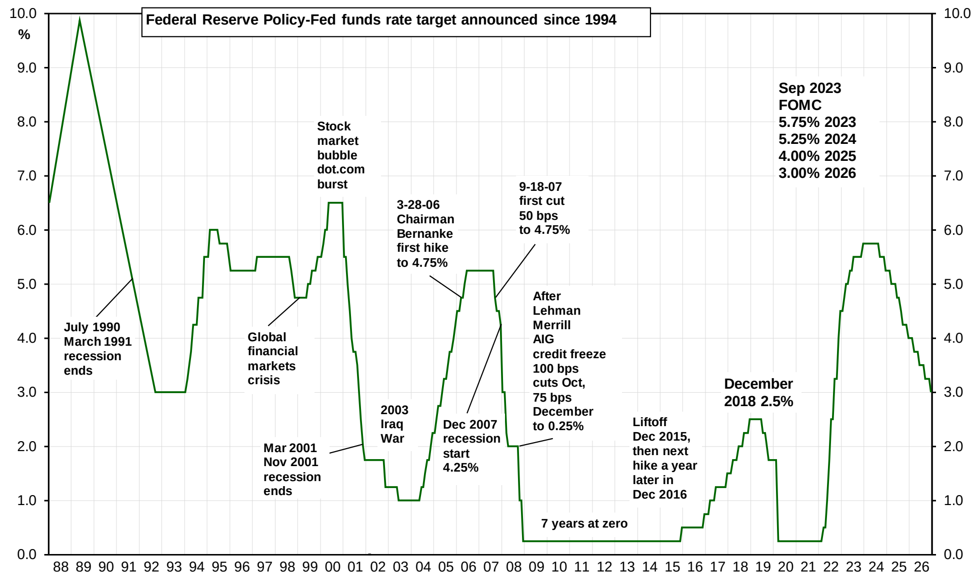
FED HIGHER LONGER

The Fed met Wednesday and the Executive Summary is the Fed funds rate will be 5.25% at the end of next year not 4.75%. One final 25 bps rate hike to 5.75% is still on the table for the last two meetings of the year, although the "vote" is split: 12 yea, 7 nay. And the stock market fell as it often does when Powell speaks, the S&P 500 down 0.9% Wednesday to 4,402.2. He also muttered something in the press conference about a stronger economy means higher interest rates, reaching for a textbook as he said it. The 10-yr yield went to a new high on Wednesday since the Fed started its rate hikes in March 2022, trading as high as 4.42%. That's it. That's it for Wednesday. On Thursday, the S&P 500 totally collapsed 1.6% down to 4,330.00, breaking the August 18 former low we thought the market had been recovering from. Part of the reason Thursday was the 10-yr yield going to a new high of 4.49%, and it wasn't all due to weekly jobless claims dropping 20K to 201K in the September 16 week. Before the 830am ET Thursday morning claims report, the 10-year yield was already 4.47%, and after the Bank of England surprise announcement to keep rates unchanged at 7am ET no less.



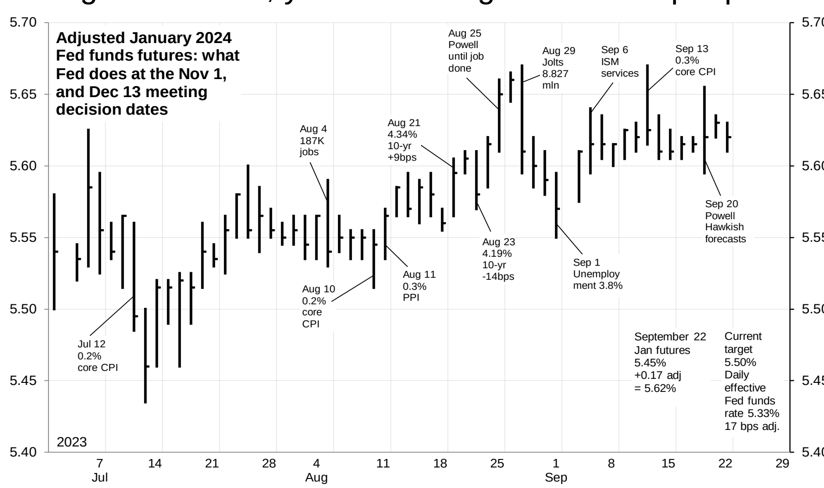
Fed Individual Forecasts					
Fed funds rate at year-end					Longer
Votes	2023 End	2024 End	2025 End	2026 End	run
1	5.375	4.375	2.625	2.375	2.375
2	5.375	4.375	2.875	2.375	2.375
3	5.375	4.625	3.125	2.375	2.375
4	5.375	4.625	3.375	2.500	2.500
5	5.375	4.625	3.375	2.625	2.500
6	5.375	4.875	3.375	2.625	2.500
7	5.375	4.875	3.625	2.625	2.500
8	5.625	4.875	3.625	2.625	2.500
9	5.625	4.875	3.625	2.625	2.500
10	5.625	5.125	3.875	2.875	2.500
11	5.625	5.125	3.875	2.875	2.500
12	5.625	5.125	4.125	3.125	2.625
13	5.625	5.125	4.125	3.125	2.625
14	5.625	5.375	4.125	3.875	3.000
15	5.625	5.375	4.625	4.125	3.250
16	5.625	5.375	4.875	4.125	3.500
17	6.625	5.375	5.125	4.625	3.750
18	5.625	5.625	5.375	4.875	3.750
19	5.625	6.125	5.625	4.875	
Median	5.625	5.125	3.875	2.875	2.500
Meeting	Sep 23	Sep 23	Sep 23	Sep 23	Sep 23

Back to the Fed meeting and its forecasts, Powell press conference, statement, etc. The individual rates forecasts. Powell downplayed their worth again as he has for years. 12 see 5.75% this year, and 7 see no more rate hikes in 2023. In June, it was the same: 12 saw 5.75% by the end of 2023, and 6 did not, with only 18 voting participants back then.

Before we get into any interesting Powell comments from the press conference, we want to look at the real interest rates idea which more or less means, the Fed cannot lower the Fed funds rate unless inflation comes down. Borrowing costs are not restrictive unless the real interest rate is over 200 bps, a concept that has not been used much since the Fed tightening cycle from 2004 to 2006. At first glance it looked odd that the midpoint of the Fed funds rate range in 2024 moved up in the September forecast by 50 bps, "higher for longer," while the inflation rates, headline and core, were little changed. But then if these forecasts are just the result of 19 people writing down their views on a piece of paper, then we probably cannot make too much of this; Powell also said another 25 bps rate hike did not mean much in macroeconomic terms. It will be interesting to see if rates come down in 2025 as the Committee feels real rates do not have to remain so high, the spread between the Fed funds rate and inflation can narrow. The economy may have lost some sensitivity to interest rates, let alone real rates after seven years of zero rates after the Great Recession. We would not recommend lowering rates below a "risk-free" 3% nominal Fed funds rate again. The need to cut rates 75 bps in three steps from the December 2018 2.5% peak seems to have been something Powell, and the policy members who voted for it, made up. Save the dramatic rate cuts for an emergency, like the pandemic recession, although even then, you are cutting rates when people are running for the exits terrified, and aren't about to borrow to increase investment in new projects. That's our view, out on X, formerly known as Twitter.

Fed Policy-key variables					Fed
	2023	2024	2025	2026	Meeting
Fed funds	5.6	5.1	3.9	2.9	Sep
PCE inflation	3.3	2.5	2.2	2.0	Sep
Real rates	2.3	2.6	1.7	0.9	Sep
Fed funds	5.6	4.6	3.4		Jun
PCE inflation	3.2	2.5	2.1		Jun
Real rates	2.4	2.1	1.3		Jun

Fed Policy-key variables					Long
	2023	2024	2025	2026	Term
Fed funds	5.6	5.1	3.9	2.9	2.5
PCE inflation	3.3	2.5	2.2	2.0	2.0
Core inflation	3.7	2.6	2.3	2.0	
Unemployed	3.8	4.1	4.1	4.0	4.0
GDP	2.1	1.5	1.8	1.8	1.8
September 2023 median Fed forecasts					



Other points Powell made besides forecasts are not a plan: tell the markets.

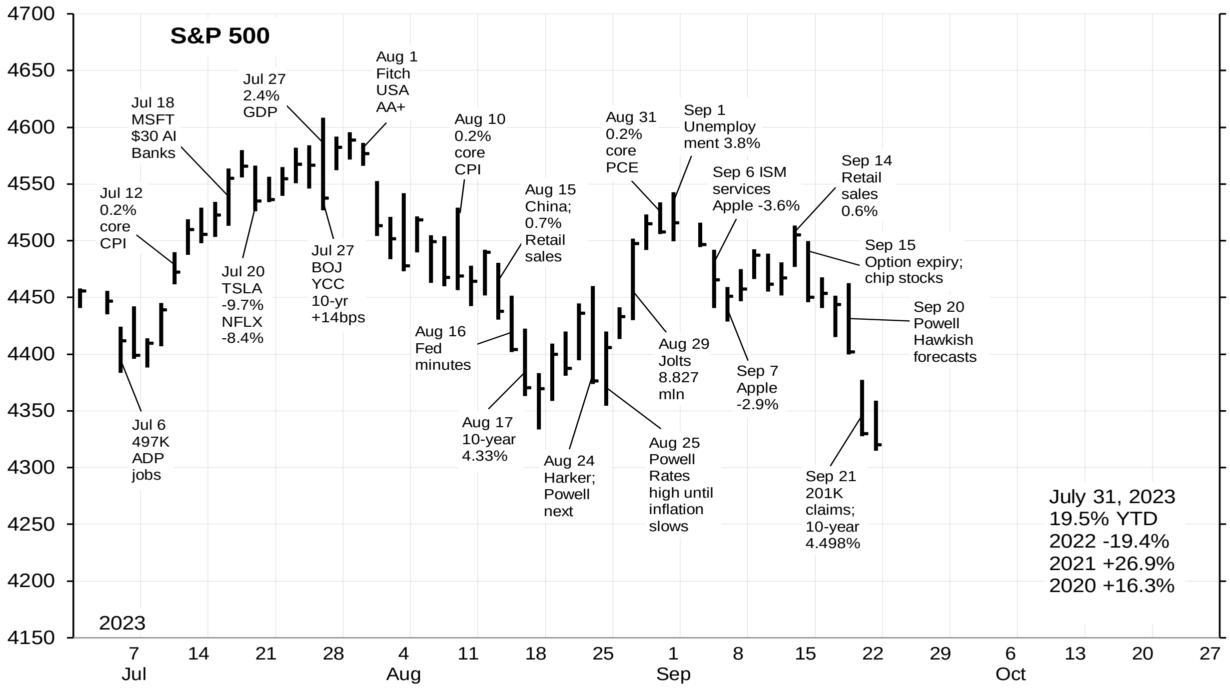
1) Month-to-month percent changes in core inflation are most important: Core CPI 0.15 June, 0.16 July, 0.278 August. Fed economists forecast August core PCE inflation year-on-year down to 3.9% from 4.2% in July to be reported Friday September 29, meaning the monthly change could be 0.2% or 0.3%. There will be an annual revision to the data going back in time however that could change the trend.

2) 3.8% unemployment is what Powell said he was looking for when it comes to the labor market rebalancing, but that could be a statistical trick and jobless claims show no layoffs.

3) Economy stronger than they had expected so rates higher next year. Atlanta GDPNow 4.9% Q3

4) Recession has come off the table of possibilities as the unemployment rate will peak at 4.1% next year down sharply from 4.5% in the June forecasts. There hasn't been a recession without job losses yet, so stop hoping one will somehow still happen.

INTEREST RATES

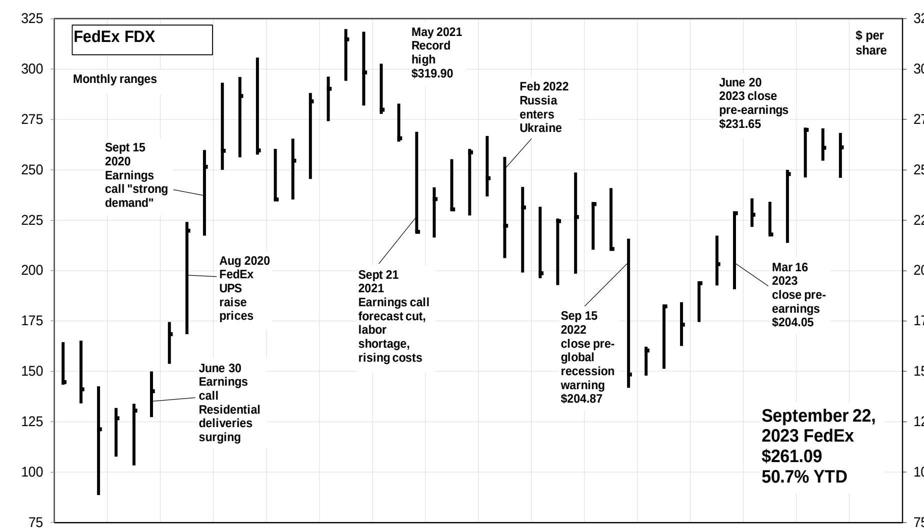


The Wednesday, September 20 Fed forecasts set off the selling in the stock and bond markets this week. Rates are coming down 50 bps to 5.25% at the end of 2024, where the FOMC forecasts made in June called for 100 bps of cuts to 4.75%. The 10-year Treasury yield was too low at 4.36% on Tuesday night so it moved as high as 4.498% on Thursday at the peak, up 14 bps, but 100 bps short of the 5.50% Fed funds rate. Not so bad maybe, but it is a new yield high since the Fed's first rate hike in March 2022. Bond yields closed 4.44% on Friday. Stocks made a new low, extending the July 27 sell-off another month to 6.3% high-low, where the old August 18 low was a 5.9% loss. Powell said he liked the last three monthly changes of CPI: 0.15% June, 0.16% July, 0.278% August. Core PCE is Friday, September 29: 0.21% June, 0.22% July, stay tuned for August and benchmark revisions.

FedEx (FDX) up 50.7% YTD, earnings beat, outlook less certain

The stock rallied 4.5% on Thursday after earnings Wednesday night. At least there was one stock that went up on Thursday after the Fed meeting. FY Q1 earnings were a beat. Optimization/severance is ongoing. FedEx Ground operating income improving. FedEx along with other trucking stocks jumped (5.0%) on Yellow bankruptcy talk back on June 27. Wall Street likes the stock.

Operating Income Bln $	Total	FedEx Express	FedEx Ground	FedEx Freight	Other; layoffs
8.31.23	1.485	0.205	1.103	0.481	-0.304
8.31.22	1.191	0.174	0.694	0.651	-0.328
FY 2023	4.912	1.064	3.140	1.925	-1.217
FY 2022	6.245	2.922	2.642	1.663	-0.982
FY 2021	5.857	2.810	3.193	1.005	-1.151
FY 2020	2.417	0.996	2.014	0.580	-1.173



OTHER ECONOMIC NEWS

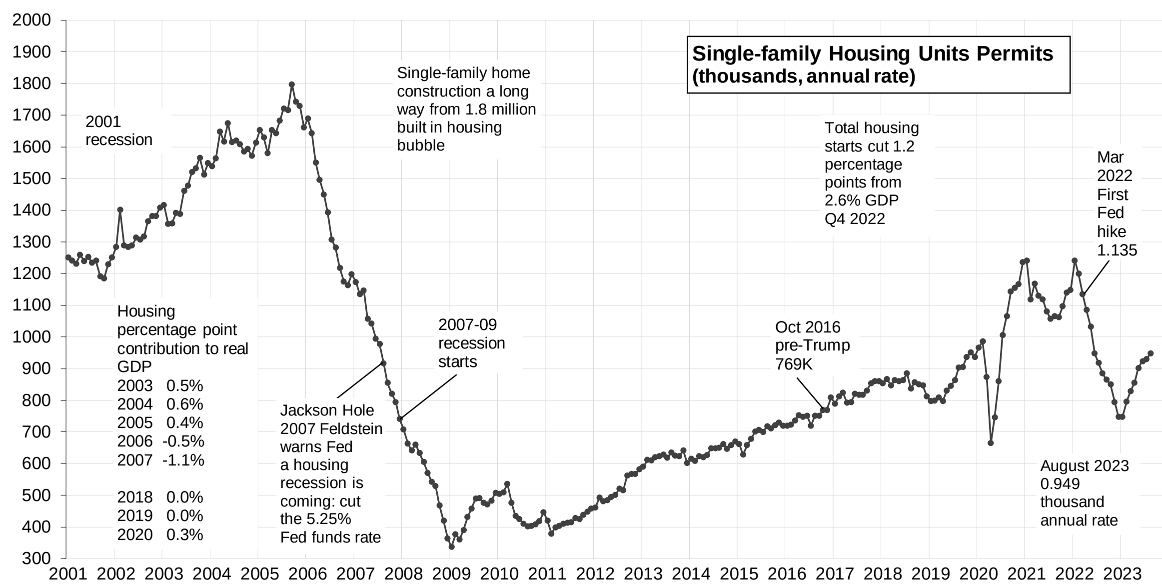
Starts down, permits up (Tuesday)

Breaking economy news. August housing statistics. The data are confusing with the 11.3% drop in housing starts to 1.283 million, while permits jumped 6.9% to 1.543 million. Permits are leading and starts are following the leader so the recovery trend in residential housing construction still looks on track. Hurricane Hilary dropped housing starts by 28.9% out West, but the storm could not dampen homebuilders spirits as they applied for 9.4% more permits out in the West. Housing is one of the most interest-sensitive sectors of the economy and the recovery trend for residential construction is on track in spite of the Federal Reserve's massive rate hikes the last year. Today's better data on residential housing construction is one reason Fed officials may leave open the possibility of another rate hike later on this year in their forecasts when they meet today and Wednesday.

Housing Starts Total, Single-Family, Multi-Family

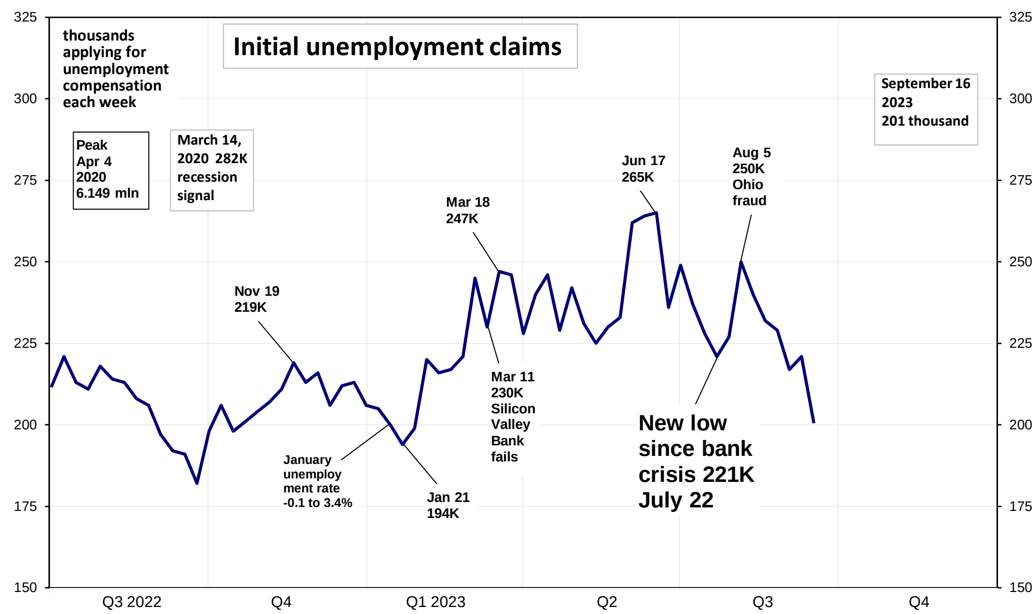
	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Aug 2023	1283	941	334	97	54	160	107	745	590	281	190
Jul 2023	1447	983	453	96	55	173	122	783	546	395	260
Aug 2022	1505	919	566	178	60	182	126	793	515	352	218
% Chgs											
Aug/Jul	-11.3	-4.3	…	1.0	-1.8	-7.5	-12.3	-4.9	8.1	-28.9	-26.9
Aug/Aug	-14.8	2.4	…	-45.5	-10.0	-12.1	-15.1	-6.1	14.6	-20.2	-12.8

Net, net, the residential housing construction market continues to recover with builders taking out more permits this month that will translate into more groundbreaking and starts in the months to come. Housing starts tumbled in August, but much of this can probably be attributed to storm damage from Hurricane Hilary out in the West. Single-family permits have climbed steadily all year long and at 949 thousand in August they are 16.4% below 1.135 million in March 2022 when the Fed first hiked rates. Mortgage rates are above 7 percent and home builder surveys are pessimistic so caution is warranted when it comes to assessing the outlook later this year. But if the Fed indicates it is near the end of its rate hikes at today and tomorrow's meetings, then homebuilders are likely to regain the wind in their sails once again. One thing is for certain and that is America needs more housing, and both single-family and multifamily units are needed. Stay tuned.

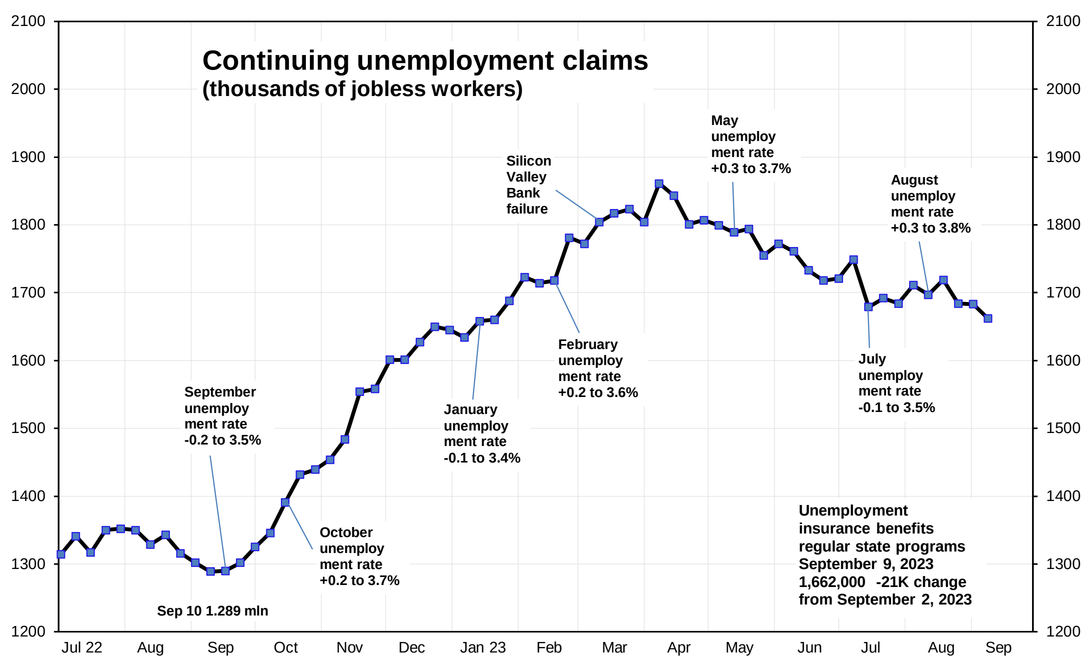


Jobless claims 201K not 221K (Thursday)

Net, net, the labor market is not just out of balance, it is completely out of whack and stronger and better than ever. There are no company layoffs, and as Powell reminded investors yesterday, a stronger economy means higher interest rates and that means the Fed's policy rate as well. The Fed was wise to keep another interest rate hike in their back pockets just in case, and it now looks like another rate hike is warranted. This economy is just not showing any sign of slowing down which hints that inflation will not be coming back down to target. Jobless claims are plummeting and back up those stronger 4% GDP forecasts for the third quarter. The economy is strong as a bull and the news is turning the bull market in equities into a bear market overnight.

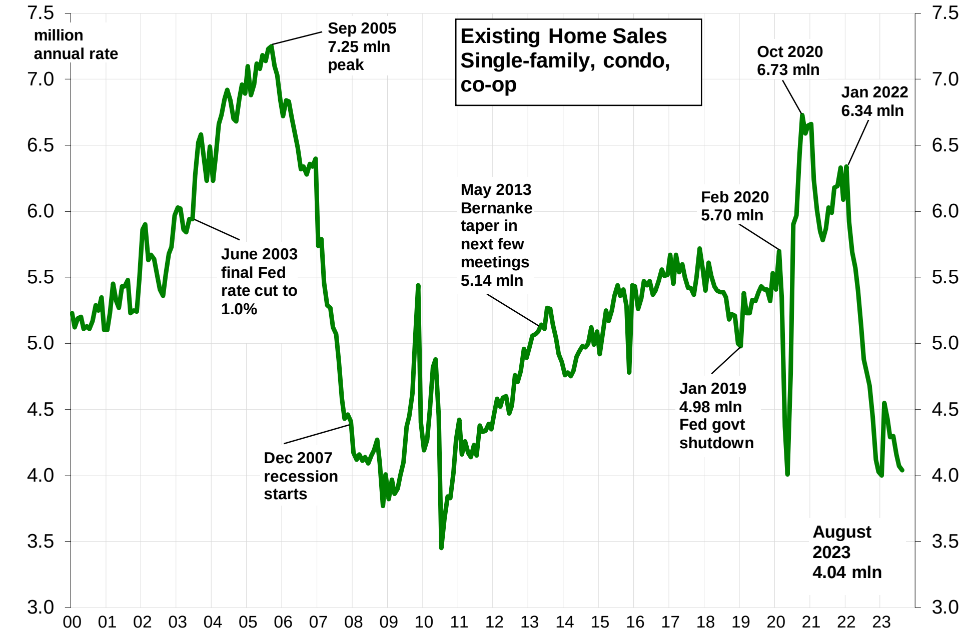


Powell said the employment report with the three-tenths jump in unemployment to 3.8% was just what the Fed was looking for, but for how long? That 3.8% unemployment rate will not stand if job layoffs are plummeting. Good news for the economy is back to being bad news for the markets with jobless claims sending bond and stock markets reeling.



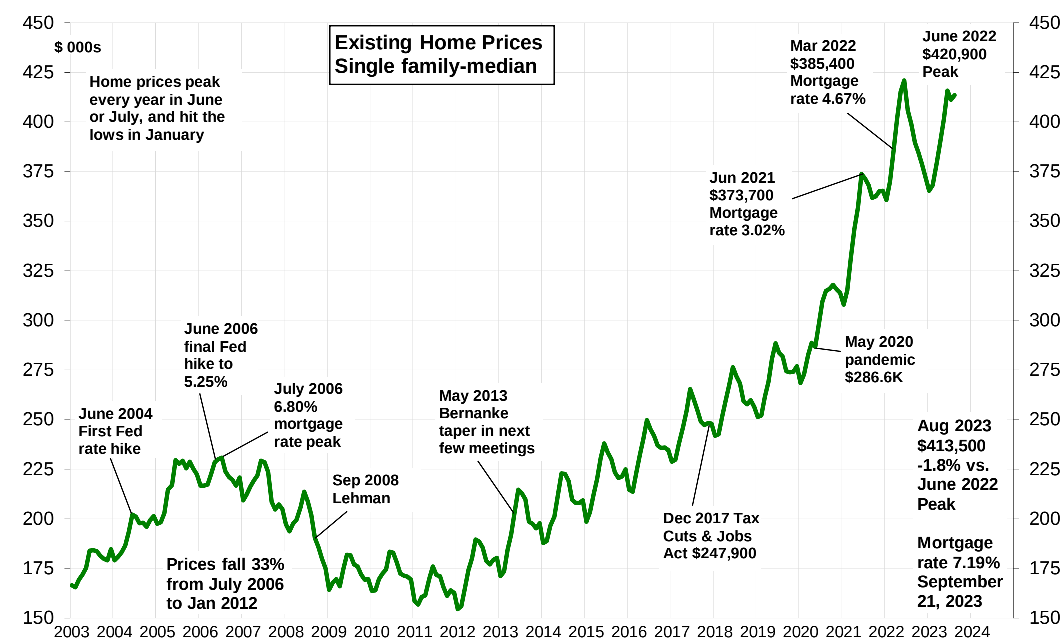
Homes sales down, home prices up (Thursday)

Breaking economy news. Existing home sales fell 0.7% to 4.04 million at an annual rate in August. Sales had recovered in the first quarter this year, but have now returned to the lows for the cycle, in part because existing homeowners do not want to trade their low rate mortgages in, when they buy a new home. The Fed's zero rates policy created a problem as it produced a situation where millions of Americans are locked in with mortgages closer to 3%. Regionally, the weakest area of the country was out West, falling 2.6% in August likely due in part to Hurricane Hilary.



Single-family home prices rose 0.6% in August to $413,500, where increases in August are rare, as the peak of the summer selling season is in June normally. This tells us that there is a shortage of homes, affordable or unaffordable, and that upward pressure on home prices will continue, shutting a generation out of the housing market.

Net, net, any hopes that realtors had that existing home sales were recovering have been dashed by 7% mortgage rates that are only going to move higher after the Federal Reserve's higher for longer rates strategy that Powell articulated at Wednesday's press conference. Home prices remain elevated and are going to stop the Fed from cutting interest rates aggressively in 2024 lest the drop in rates sets off a buying storm which will make the housing price bubble inflate even more. Nothing is in balance in this economy and that will require the central bank to hold rates higher for longer.



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