Financial Markets This Week

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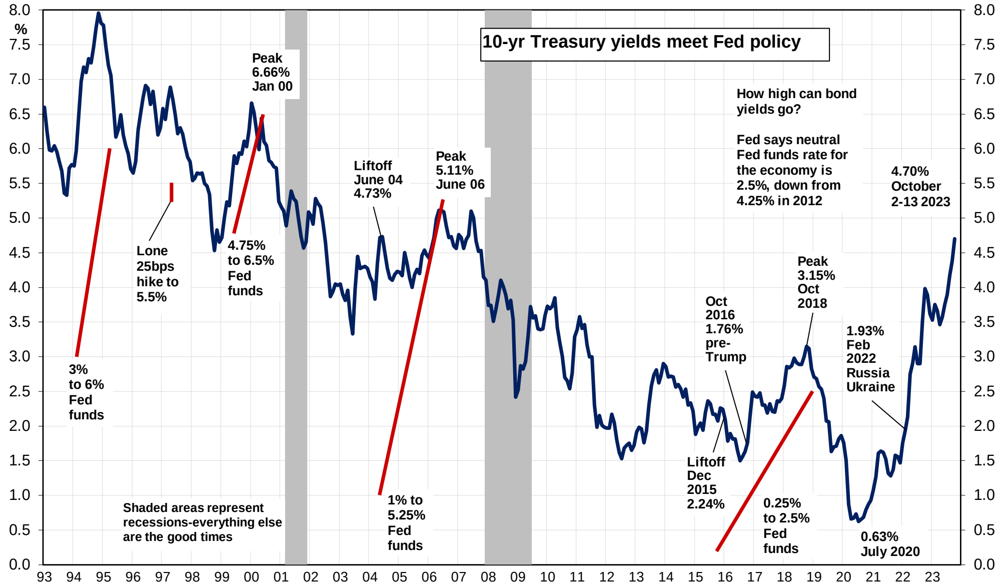
BOND MARKET VALUATION



10-yr Treasury yields pole-vaulted over 4.50% and then 4.75% the last few weeks. It was always a puzzle, historically speaking, why 10-year yields didn't match where the central bank down in Washington puts the Fed funds rate: 5.50% currently. Fed rates are supposed to be the spine holding up 10-year yields and most cycles the two match up at the end. 10-year Treasury yields did overshoot the Fed funds rate target in 2018 and are undershooting still in this cycle. Could blame the Fed each time. Those individual forecasts written on a scrap of paper by each participant become much more important when aggregated together, despite Powell saying it is not a plan. They never voted on it. Bond yields overshot the 2.5% Fed funds rate in 2018 as the Fed forecasts had been even higher at 3.5% earlier in 2018. Bond yields undershot in 2023 as Fed forecasts were looking for 100 bps of rate cuts in 2024 so no need for 10-year yields to go all the way up to the 5.5% Fed funds rate. The Fed said on September 20 that they were only looking for 50 bps of cuts back to 5.25% at the end of 2024 and bond yields adjusted upward.

Fed officials ask themselves why bond yields are rising, but you can follow the news each day well enough. The hawkish Fed forecasts sent 10-yr yields above 4.40% the first time this year, and next morning, the labor market was tight with weekly jobless claims tumbling 20K to 201K. An important yield level of 4.50% broke the next Monday, and crude oil jumping above $90 was part of the more inflation story that bonds never like. Finally in the first week of October, bond yields lifted when there was no Federal government shutdown over the weekend, no safe haven reason need to buy. And then Tuesday, August 4, the Jolts job openings data went up, not down, 690K to 9.610 million sending yields above 4.80%.

For bond valuation, there is Fed policy, inflation and supply/demand. For all the talk of higher real long-term yields bringing a textbook theoretical hammer down on economic growth, we have seen these levels before, twenty years ago during the early housing bubble days. 10-yr yields before the pandemic were running 50 to 100 bps above PCE inflation, although this headline PCE inflation, including food and energy, was weak at less than 2.0% from 2016 to 2019. In the table, yields of 3.80% from January to September this year are 40 bps below average PCE inflation of 4.2% from January to August. Real yields have gone over 100 bps positive with August year-to-year PCE inflation of 3.5% versus the 4.89% 10-yr yield high for the year made after the Jolts data on October 4. Bond yields could be at their limit, looking just at 3.5% inflation.

	10-yr Treasury Yield	PCE Inflation	Real Yield bps
2002	4.61	1.3	331
2003	4.02	2.1	192
2004	4.27	2.5	177
2005	4.29	2.9	139
2006	4.79	2.8	199
2007	4.63	2.6	203
2008	3.67	3.0	67
2009	3.26	-0.3	356
2010	3.21	1.8	141
2011	2.79	2.5	29
2012	1.80	1.9	-10
2013	2.35	1.3	105
2014	2.54	1.4	114
2015	2.14	0.2	194
2016	1.84	1.0	84
2017	2.33	1.7	63
2018	2.91	2.0	91
2019	2.14	1.4	74
2020	0.89	1.1	-21
2021	1.44	4.2	-276
2022	2.95	6.5	-355
2023	3.80	4.2	-40

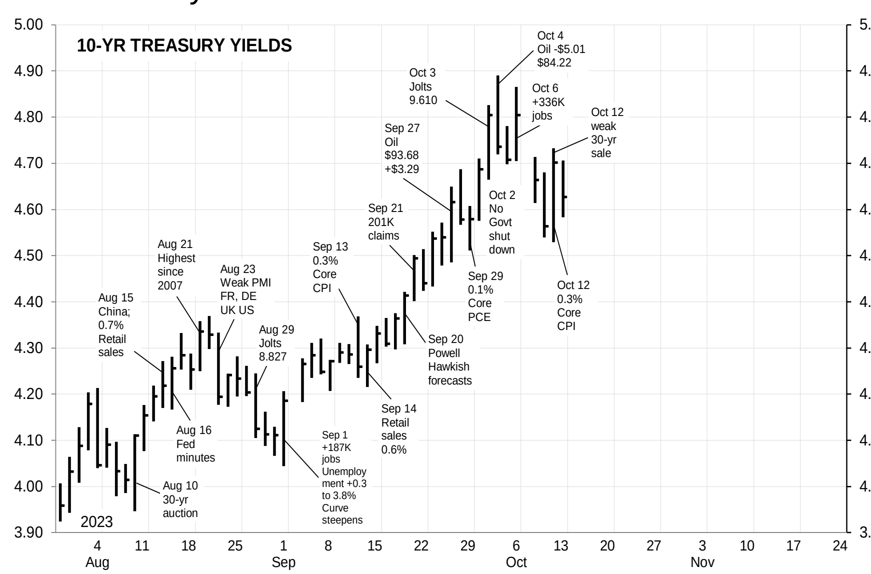
2023-to Sept 10-yr, Aug PCE

Supply is another factor. The FY2023 deficit is about $1.7 trillion and add in another $720 billion that needs to be auctioned to the public from the Fed's QT. There is the auction and then there is the announcement effect, where yields were still below 4.00% on July 31 when the Treasury announced its quarterly financing estimates, followed up with the August Quarterly Refunding announcement on August 2. The markets including equities were rocked by a poorly received 30-yr Treasury auction on Thursday this week. Happens time to time. There are a lot of Treasury auctions each month in the regular market, not including short-term Treasury bills, TIPS, FRNs that often seem to trade in their own parallel universe. At the start of the month there is the series of 3-yr, 10-yr and 30-yr auctions that settle on the 15th of the month. The 2-yr, 5-yr and 7-yr auctions are near the end of the month and settle on the final business day. Ditto for the 20-yr bond auction a week earlier with the same settlement date. Treasury sold $246 billion in September (not all for new cash, investors with maturing securities tend to roll it into the new securities) where it was $222 billion before the August refunding announcement. Heads up: Treasury announces new Financing Estimates on October 30 at 3pm ET, and the November Quarterly Refunding is announced 830am ET, Wednesday, November 1. Stay tuned. Supply and inflation worries haven't sent 10-yr yields up to match the 5.5% Fed funds rate yet.

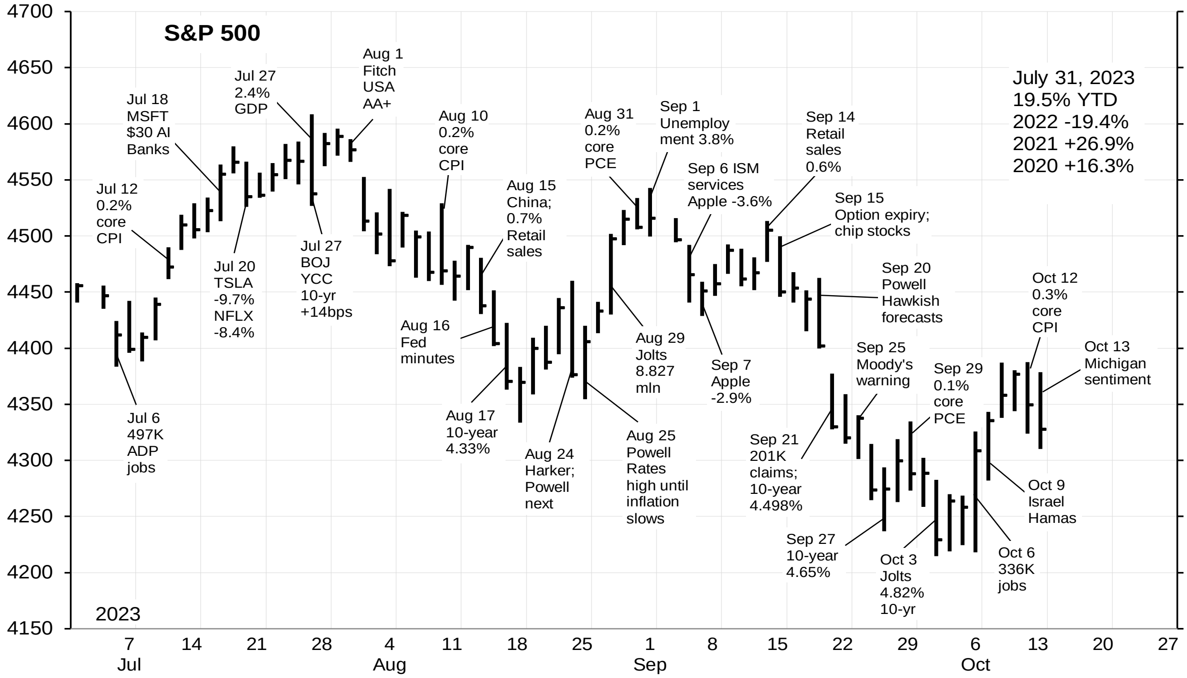
2023 Treasury auction amounts (notes/bonds)

$ bln	Total	2-yr	5-yr	7-yr	3-yr	10-yr	30-yr	20-yr
Apr	222	42	43	35	40	32	18	12
May	231	42	43	35	40	35	21	15
Jun	222	42	43	35	40	32	18	12
Jul	222	42	43	35	40	32	18	12
Aug	246	45	46	36	42	38	23	16
Sep	246	48	49	37	44	35	20	13
Oct					46	35	20	13

2,5,7,20 years settle last day of month; 3,10,30 on the 15th



INTEREST RATES



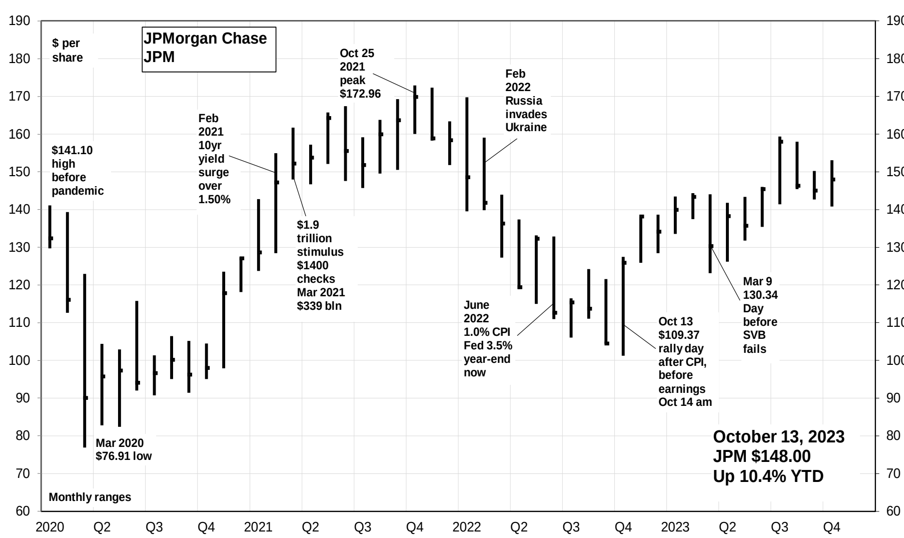
Bond yields were at 2023 highs of 4.89% in the Europe trading session Wednesday October 4 following the US Jolts data on Tuesday morning. Closing last week at 4.80% before the Saturday Hamas attack in Israel. Cash bonds were closed Monday, but bond futures tumbled. 10-yr yields were as low as 4.62% on Tuesday with the safe haven buying. Yields fell further on Wednesday during the Europe session again around 3am ET, there was an ECB inflation survey at 4am ET, and the Fed minutes "proceed cautiously" at 2pm ET. Yields rebound on Thursday's 0.3% core CPI report, and a weak 30-year auction at 1pm ET sent yields as high as 4.73%. On Friday, some caution going into the weekend, still no speaker of the House of Representatives. Stocks seemed to fall Friday on the drop in consumer sentiment, while bonds ignored the report. Stocks +12.7% YTD, bonds close 4.63%.

JPMorgan (JPM) up 10.4% YTD

The stock is matching the overall S&P 500 decline of 8.1% from the end of July to the market low last week. JPM fell 11.6% from the end of July to last week's low on October 5. The stock was $145.81 Thursday night before earnings, jumped 5.0% to $153.11 after earnings before settling at $148.00. Earnings beat, but the Chairman's "most dangerous time in decades" comment attracted attention.

JPM results (billions)

Quarter	Net Income	Provision for Credit Losses	Stock price Qtr end
9.30.2023	13.151	1.384	145.02
6.30.2023	14.472	2.899	145.44
3.31.2023	12.622	2.275	130.31
12.31.2022	11.008	2.288	134.10
9.30.2022	9.737	1.537	104.50
6.30.2022	8.649	1.101	112.61
3.31.2022	8.282	1.463	136.32
12.31.2021	10.399	-1.288	158.35
9.30.2021	11.687	-1.527	163.69
6.30.2021	11.948	-2.285	155.54
3.31.2021	14.300	-4.156	152.23
12.31.2020	12.136	-1.889	127.07
9.30.2020	9.443	0.611	96.27
6.30.2020	4.687	10.473	94.06
3.31.2020	2.865	8.285	90.03



FEDERAL RESERVE POLICY

The Fed meets October 31-November 1, 2023 to consider its monetary policy. On Monday with the bond market closed for the Columbus Day holiday (stocks were open), Dallas Fed President Logan and Fed Vice Chair Jefferson said the same thing: the higher bond yields of late were doing the work of tightening the screws on monetary policy further for the Fed so they do not need to raise rates another 25 bps at least on the next November 1 decision date. That is what the market thinks it heard. It's ironic that bond yields collapsed on Monday on safe haven buying over the weekend Hamas-Israel conflict. (Bond futures were open Monday, and tumbling as the speakers gave their update.) Bond yields are no longer doing the work for the Fed in ratcheting up rates. You be the judge. Treasury 10-yr yields were 4.41% on Wednesday, September 20 when the Fed last met, and 4.63% at the close on Friday, October 13, an increase of 22 bps.

Selected Fed assets and liabilities

Fed H.4.1 statistical release billions, Wednesday data	11-Oct	4-Oct	27-Sep	20-Sep	3/11/20*	Change from 3/11/20 to Oct 11
Factors adding reserves						
U.S. Treasury securities	4928.507	4930.410	4958.138	4960.735	2523.031	2405.476
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2479.726	2479.726	2479.726	2494.460	1371.846	1107.880
Repurchase agreements	0.000	0.000	0.000	0.000	242.375	-242.375
Primary credit (Discount Window)	2.580	2.773	3.193	3.078	0.011	2.569
Bank Term Funding Program	108.884	107.665	107.715	107.599		
FDIC Loans to banks via Fed	58.257	63.702	81.883	85.005		
Paycheck Protection Facility	4.777	4.868	5.178	5.339		
Main Street Lending Program	19.409	19.397	19.352	19.326		
Municipal Liquidity Facility	5.635	5.632	5.629	5.626		
Term Asset-Backed Facility (TALF II)	1.221	1.220	1.220	1.219		
Central bank liquidity swaps	0.230	0.229	0.238	0.247	0.058	0.172
Federal Reserve Total Assets	8002.7	8006.1	8052.5	8074.8	4360.0	3642.712
~~3-month Libor %~~ SOFR %	5.31	5.32	5.32	5.30	1.15	4.160
Factors draining reserves						
Currency in circulation	2328.017	2326.425	2324.023	2325.195	1818.957	509.060
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	713.000	678.959	672.142	661.717	372.337	340.663
Treasury credit facilities contribution	13.358	13.358	13.358	13.358		
Reverse repurchases w/others	1239.382	1242.031	1442.805	1486.984	1.325	1238.057
Federal Reserve Liabilities	4687.650	4765.385	4884.031	4930.373	2580.036	2107.614
Reserve Balances (Net Liquidity)	3315.650	3240.707	3168.502	3144.404	1779.990	1535.660
Treasuries within 15 days	48.629	53.759	62.350	55.950	21.427	27.202
Treasuries 16 to 90 days	264.135	264.497	245.934	254.315	221.961	42.174
Treasuries 91 days to 1 year	602.710	599.561	613.336	614.151	378.403	224.307
Treasuries over 1-yr to 5 years	1690.875	1690.672	1706.178	1706.087	915.101	775.774
Treasuries over 5-yrs to 10 years	818.366	818.258	826.774	826.726	327.906	490.460
Treasuries over 10-years	1503.793	1503.664	1503.565	1503.507	658.232	845.561
Note: QT starts June 1, 2022	Change	10/11/2023	6/1/2022			
U.S. Treasury securities	-842.272	4928.507	5770.779			
Mortgage-backed securities (MBS)	-227.720	2479.726	2707.446			

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

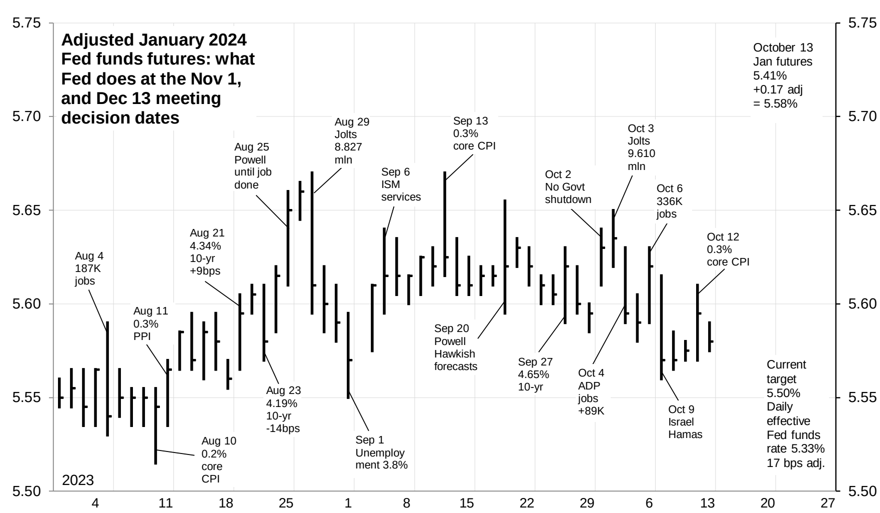
Fed officials maintain they still want to see the labor market rebalance to make sure the conditions for 2% inflation are there. Actual inflation, core inflation, was not as good as we had expected this week. About the only good thing about it was "over half" the increase was from shelter prices and shelter has a much smaller weight in core PCE inflation (17.3%) than it does in core CPI inflation (43.7%), so perhaps the October 27 report of PCE inflation for September will not be as bad. Stay tuned. Watch here where the world goes next.

Fed funds futures call Fed hikes

Current target: October 13 -- 5.50%		
Rate+0.17	Contract	Fed decision dates
5.520	Nov 2023	Nov 1
5.580	Jan 2024	Nov 1, Dec 13
Last trade, not settlement price		

Fed Policy-key variables	2023	2024	2025	2026	Long 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



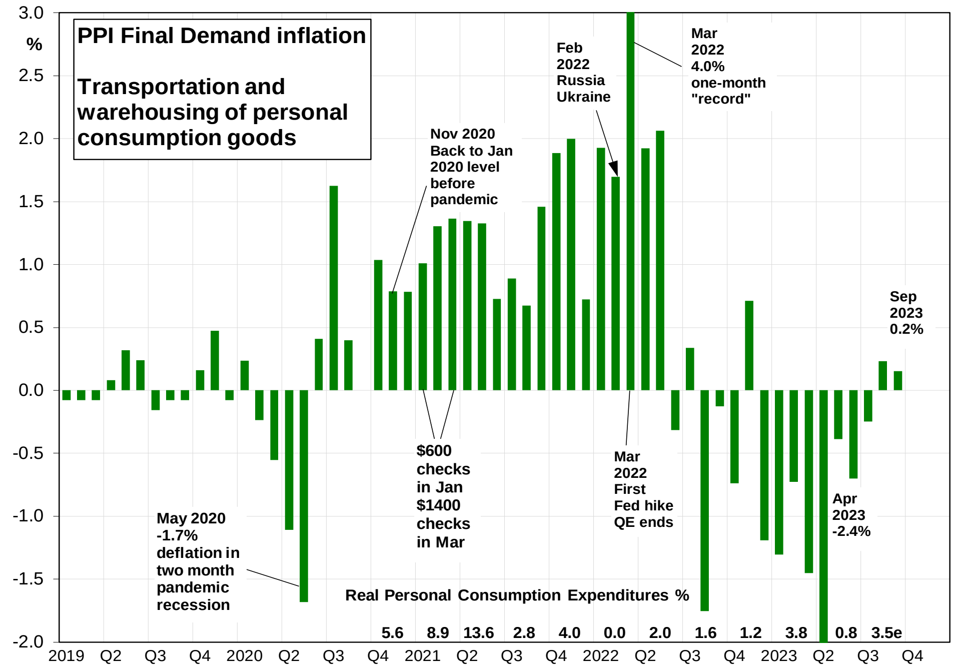
Next up: September PCE inflation report Friday, October 27

Monthly % Changes	2023 Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	2023 Jan	2022 Dec	Nov	Oct	Sep	Aug	2022 Jul
Core CPI inflation	0.3	0.3	0.2	0.2	0.4	0.4	0.4	0.5	0.4	0.4	0.3	0.3	0.6	0.6	0.3
Core PCE inflation		0.1	0.2	0.2	0.3	0.3	0.3	0.4	0.5	0.4	0.3	0.3	0.5	0.5	0.2
Core PCE YOY		3.9	4.3	4.3	4.7	4.8	4.8	4.8	4.9	4.9	5.1	5.3	5.5	5.2	5.0
Core CPI YOY	4.1	4.3	4.7	4.8	5.3	5.5	5.6	5.5	5.6	5.7	6.0	6.3	6.6	6.3	5.9

OTHER ECONOMIC NEWS

Relax, PPI inflation is just food and energy (Wednesday)

Breaking economy news. PPI final demand inflation rose 0.5% in September which is a continuation of the somewhat troubling pattern seen the last three months now, after progress made earlier in the year. The three hot spots in the third quarter PPI inflation results are food, energy and trade services. In September, food prices rose 0.9% and energy rose 3.3% and trade services rose 0.5%.



The good news in the report is that final demand goods prices less foods and energy were benign, rising just 0.1% in September: these core goods prices have risen only 0.1% or less since April this year showing that supply chain disruptions, that added to product costs during the pandemic, have virtually disappeared.

Net, net, the Fed has not finished the job and stamped inflation out completely yet, and if anything, policymakers have their work cut out for them as much of the inflation we see in producer prices is coming from food and energy prices that monetary policy has less effect on. The bond market rally on Fed speak suggesting policymakers are done with rate hikes for now may be premature. Food and energy and some services price inflation is resilient and may yet prompt another Fed rate hike before this interest rate cycle is done and gone. Stay tuned. Story developing. All eyes on CPI inflation for September due out Thursday morning. The Fed's work is never done. Bet on it. Fed officials cannot let down their guard simply because PPI inflation is just food and energy.

	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	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	2.0			

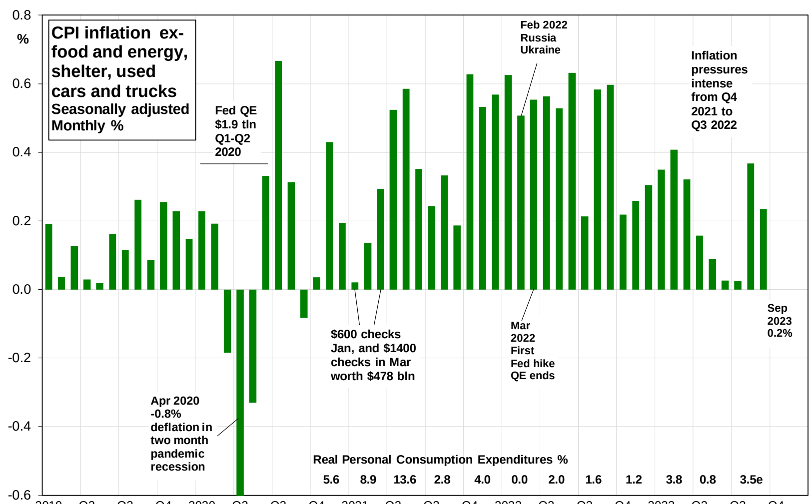
Cost of living crisis resilient (Thursday)

Breaking economy news. It looks like inflation is heating back up after the more benign readings seen at the start of summer. Core CPI increased the most since May and is running 3.1% SAAR the last three months. When you add in food and energy prices it looks like inflation in total is persisting. It is Economics 101 that if economic growth remains resilient, then price pressures will too.

Technically the 0.4% rise in headline CPI to 3.7% year-on-year in September was half due to shelter costs with another kick up from gasoline prices, the latter of which have moderated recently. Gasoline prices jumped 10.5% in August and rose 2.3% in September. Fed officials may draw some comfort from the fact that PCE inflation is moderating more than CPI inflation, at least until we get September PCE inflation on Friday, October 27. But most Americans will tell their elected officials that there is still a cost-of-living crisis that is making their lives more difficult. We have not seen an economic cycle yet where consumer prices fall across the board. The cost-of-living crisis will not go away overnight. The best senior monetary officials down in Washington can do is slow the rate of increase in prices.

Dec 22		Monthly Percent Changes			YOY %
Weight	CPI inflation	Jul 2023	Aug 2023	Sep 2023	Sep 2023
100.0	Total	0.2	0.6	0.4	3.7
13.531	Food	0.2	0.2	0.2	3.7
4.803	Food away from home	0.2	0.3	0.4	6.0
6.921	Energy	0.1	5.6	1.5	-0.5
79.548	Ex-food & energy	0.2	0.3	0.3	4.1
4.313	New vehicles	-0.1	0.3	0.3	2.5
2.668	Used cars/trucks	-1.3	-1.2	-2.5	-8.0
2.479	Clothing	0.0	0.2	-0.8	2.3
1.455	Medical care goods	0.5	0.6	-0.3	4.2
34.413	Shelter	0.4	0.3	0.6	7.2
25.424	Owner equiv. rent	0.5	0.4	0.6	7.1
5.750	Transportation	0.3	2.0	0.7	9.1
6.653	Medical care services	-0.4	0.1	0.3	-2.6
	Special: Where inflation might come back down to				
58.187	Services ex-energy	0.4	0.4	0.6	5.7
21.261	Commodities (core)	-0.3	-0.1	-0.4	0.0

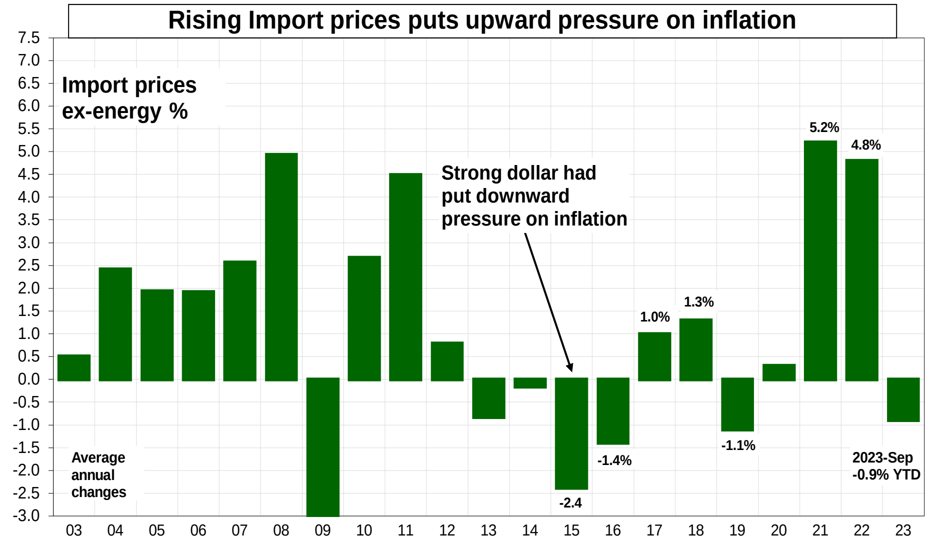
Net, net, it looks like inflation is lingering and could stick around higher for longer which means Fed officials really have their hands full and that the inflation battle is not over yet. Shelter prices are picking up and although it is measured differently, it cannot be good for the inflation outlook that home prices have hit record levels recently. The Fed's dramatic interest rate hikes have not done much to arrest the upward movement in the cost of a roof over your head. Stay tuned. The cost-of-living crisis for Americans is not getting any better and policymakers are finding it harder than they expected to put the inflation genie back in the bottle. The progress on bringing core consumer prices back to 2% target looked better in June and July with 0.2% monthly changes, but now those hopes have been dashed with two straight months of 0.3% increases in August and September.



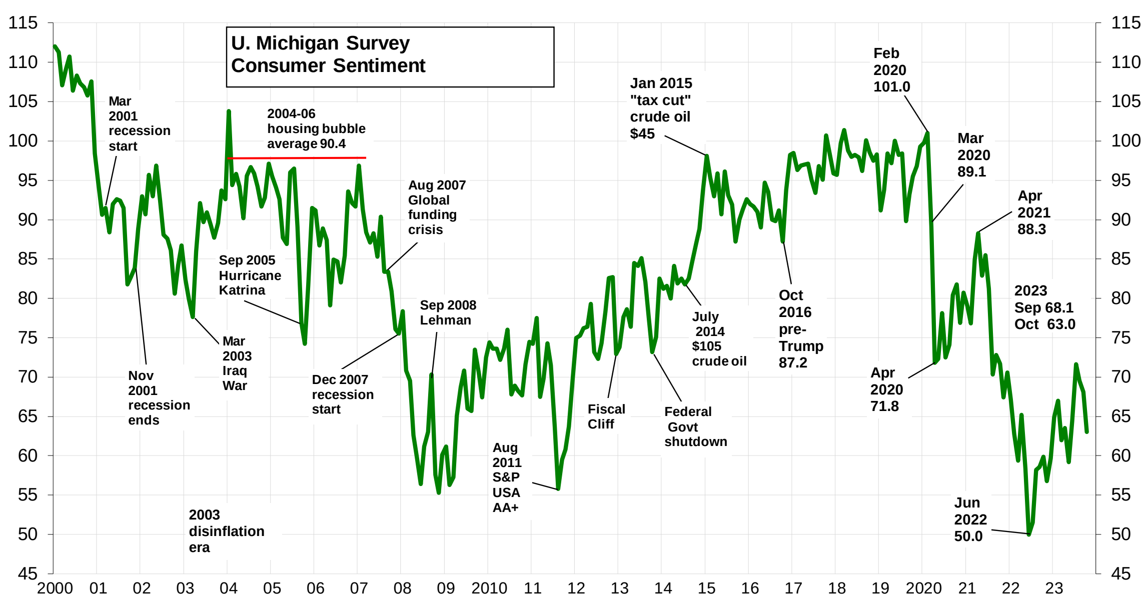
Import price deflation (Friday)

Breaking economy news. Nonfuel import prices have been unchanged or down since March this year, and are falling 0.2% in September. Imported goods coming into the country were more expensive and helping to fuel inflation but now the shoe is on the other foot with the Fed's rate hikes giving the dollar a boost and turning the trend completely around from a headwind to a tailwind for the central bank's inflation battle. The trend has completely reversed direction by 180 degrees with import prices down 0.8% in the year ending September 2023 from an increase of 3.5% the year before in the twelve months ending September 2022.

Net, net, the U.S. stronger dollar on the back of higher bond yields may be in danger of pricing American exports out of world markets, but it is doing one good thing which is tamping down the prices of imported goods coming into the country and aiding the Fed's inflation fight. Import prices have switched sides in America's inflation fight and cheaper imported goods prices are making the cost-of-living crisis a little more bearable for now.



Stock market went down starting at 10am ET Friday after Michigan sentiment fell to 63.0 in October.



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