

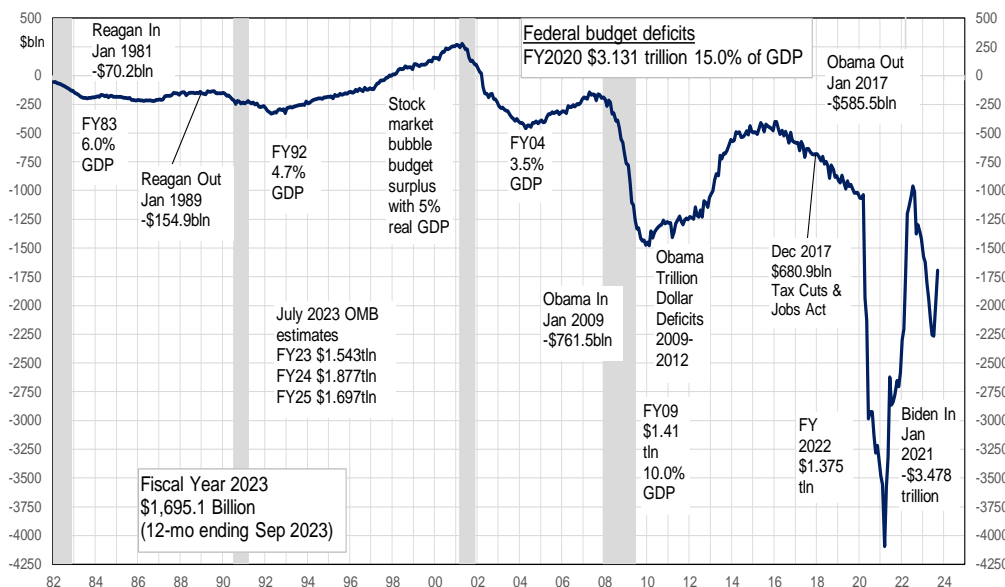
# Financial Markets This Week

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## THE NUMBER IS \$1.7 TRILLION

We guess the FY2023 Federal budget deficit results were not released late on a Friday afternoon to sneak the bad news, red-ink, too much government spending results past the public. The world is already on edge from the Israel-Hamas war. There is still no Speaker of the U.S. House of Representatives. The



number is \$1.695 trillion for the Fiscal Year (FY) 2023 budget deficit ending September versus \$1.375 trillion the year before. The Student Loan forgiveness, charged off in FY2022 and taken away and added back in FY2023, call it \$319 billion, means FY2023 really doubled to 1.695 + .319 equals \$2.014 trillion in FY2023 versus 1.375 - .319 equals \$1.056 trillion in FY2022. Much of the difference is on the receipts side, according to the [joint statement](#) released Friday from Treasury Secretary Yellen and OMB Director Young. The record capital gains taxes in FY2022 with stocks up 26.9% in calendar year 2021, went away with the S&P 500 falling 19.4% in calendar year 2022. Besides the stock market, part of the weakness in individual income taxes is refunds were higher, \$373.3 billion FY2023 versus \$246.3 billion in FY2022. Other factors behind the revenue decline: California had a 2022 tax

deadline postponed to October 16, 2023 due to the prior year winter storms. Payment of taxes due for most individuals and businesses were extended. It is the biggest state in the union. That explains why corporate taxes this month through October 19, 2023 are running \$50.3 billion where October corporate taxes the last two years have only been about \$14 billion.

Federal Government: Where's the Money Coming From?

Fiscal Years \$billions	Sep 2023	%	Sep 2022	%	Sep 2021	%	Sep 2020	%	Sep 2019
<b>Budget Receipts</b>	4,439.3	-9.3	\$4896.1	21.0	\$4046.0	18.3	\$3420.0	-1.2	\$3462.2
Income taxes	2,176.5	-17.3	2,632.1	28.8	2,044.4	27.1	1,608.7	-6.4	1,717.9
Corporation taxes	419.6	-1.2	424.9	14.3	371.8	75.5	211.8	-8.0	230.2
Social retirement taxes	1,558.1	10.4	1,410.7	12.7	1,251.9	-0.8	1,261.7	5.4	1,197.4
Unemployment insurance	49.4	-25.7	66.5	17.5	56.6	31.3	43.1	5.4	40.9
Excise taxes	75.8	-13.6	87.7	16.5	75.3	-13.3	86.8	-12.3	98.9
Estate and Gift Taxes	33.7	3.4	32.6	19.9	27.1	54.0	17.6	5.5	16.7
Customs Duties	80.3	-19.6	99.9	24.9	80.0	16.7	68.6	-3.2	70.8
Miscellaneous	39.0	-71.2	135.4	1.6	133.3	14.4	116.5	37.8	84.6

On the spending side where the big disagreements in Congress lie, outlays dropped \$137 billion or 2.2% to \$6.134 trillion in FY2023. Spending was \$4.446 trillion in FY2019 before the pandemic. Almost nothing went down besides the Department of Education student loan forgiveness that wasn't, except food stamps and child nutrition and tax credits, if you want to count those as wins. Medicare and Medicaid increased \$65 billion, Social Security retirement and disability payments increased \$135 billion. The Other Independent Agencies increase was from the FDIC (\$91.7 billion) after the bank crisis in March.

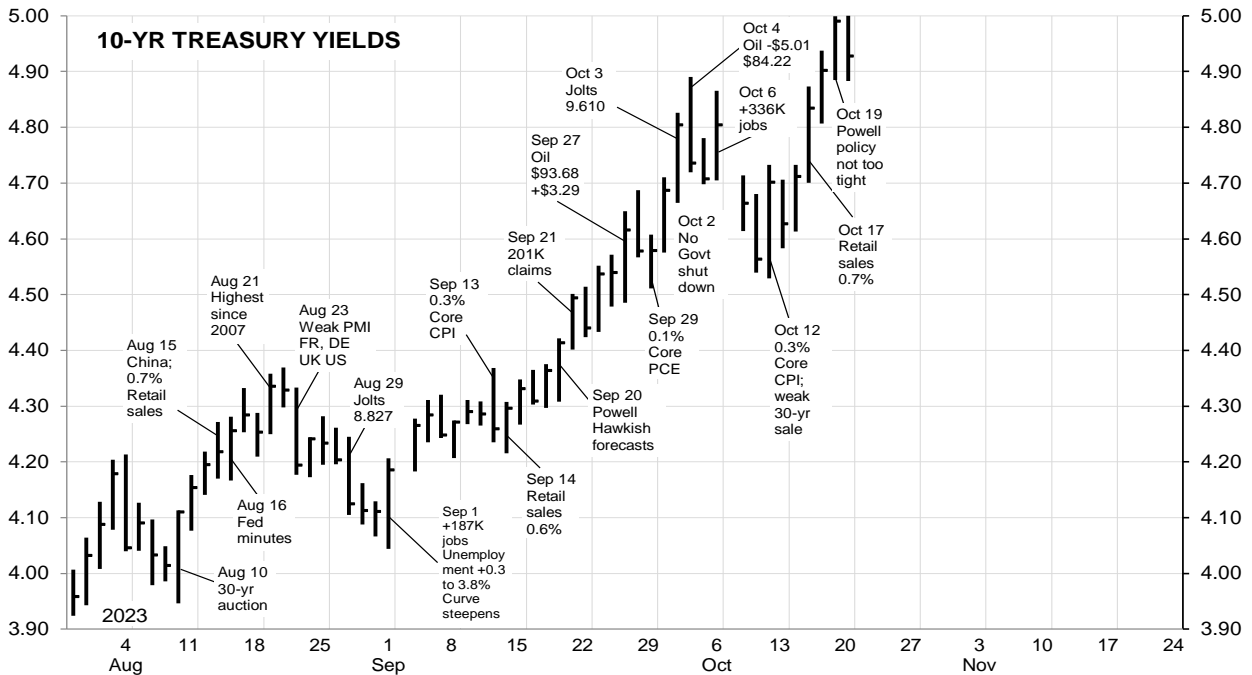
Currently, the outlay to hate is interest on the public debt that increased \$161.6 billion to \$879.3 billion from the Fed's rate hikes starting in March 2022. Not quite that bad. To get net interest, you have to subtract the interest payments to the social security trust fund of \$169 billion. Nothing crazier in Washington than Congress borrowing from social security to buy tanks and food stamps and then charging ourselves interest on the money we took out of the trust fund.

To conclude, much has been made of the \$1 trillion jump in the deficit this year adjusting for in/out student loan forgiveness adjustments. Our view

remains to keep the deficit below the increase in nominal GDP growth in order to keep the debt/GDP ratio unchanged, and the burden to society. Nominal GDP will be higher in Q3 released Thursday, October 26, than Q2 2023's 3.8% SAAR. If it increases to 6% like Q1 2023, it means the FY2024 deficit needs to be less than \$1.98 trillion or 6% of the \$33 trillion [national debt](#). (We know this leaves out the \$720 billion in Fed QT.) Stay tuned.

Federal Government Spending (\$bln) Where to cut?	4 Qtrs FY23	4 Qtrs FY22	Fiscal	Fiscal
	Q4 22-Q3 23	Q4 21-Q3 22	Year	Year
			Changes	% chg
TOTAL BUDGET OUTLAYS	6,134.432	6,271.600	-137.168	-2.2
Legislative	6.515	5.752	0.763	13.3
Judicial	8.995	8.720	0.275	3.2
Agriculture	228.887	245.210	-16.323	-6.7
Commodity Credit Corporation	7.318	6.647	0.671	10.1
Food Stamps	134.634	148.514	-13.880	-9.3
Child Nutrition	29.235	37.213	-7.978	-21.4
Commerce	12.045	11.734	0.311	2.7
Defense	775.872	726.627	49.245	6.8
Military Personnel	183.898	180.777	3.121	1.7
Operation Maintenance	317.563	291.264	26.299	9.0
Procurement	141.749	136.177	5.572	4.1
Research Development	121.954	107.059	14.895	13.9
Military Construction	10.344	9.726	0.618	6.4
Education	-41.108	639.370	-680.478	-106.4
Office of Federal Student Aid	188.369	539.830	-351.461	-65.1
Energy	34.423	22.439	11.984	53.4
Health Human Services	1708.521	1642.922	65.599	4.0
Medicare	1024.288	982.628	41.660	4.2
Medicaid States Grants	615.772	591.950	23.822	4.0
Homeland Security	89.032	80.865	8.167	10.1
Housing Urban Development	55.194	29.307	25.887	88.3
Interior	15.865	13.916	1.949	14.0
Justice	44.327	39.603	4.724	11.9
Labor	87.530	51.737	35.793	69.2
State Unemployment Benefits	30.181	26.715	3.466	13.0
Fed Additional Unemployment	-0.459	3.612	-4.071	--
State	32.997	33.231	-0.234	-0.7
Transportation	109.786	113.729	-3.943	-3.5
FAA	23.824	23.071	0.753	3.3
Federal Highway Admin.	54.018	168.138	-114.120	-67.9
Treasury	1106.950	1162.222	-55.272	-4.8
TARP	0.115	0.222	-0.107	-48.2
Coronavirus Relief Fund	0.954	105.929	-104.975	-99.1
IRS	254.964	352.121	-97.157	--
Earned Income Credit	55.468	64.282	-8.814	-13.7
Child Tax Credit	28.768	131.435	-102.667	--
Interest on Public Debt	879.307	717.611	161.696	22.5
Veterans Affairs	301.026	273.867	27.159	9.9
Corps of Engineers	7.806	8.176	-0.370	-4.5
Other Defense Civil Programs	68.928	56.870	12.058	21.2
Environmental Protection	12.586	9.279	3.307	35.6
Exec. Office of President	0.543	0.458	0.085	18.6
International Assistance	36.050	35.834	0.216	0.6
NASA	25.319	23.079	2.240	9.7
National Science Foundation	8.951	8.133	0.818	10.1
Personnel Management	122.508	113.572	8.936	7.9
Small Business Admin.	26.072	23.199	2.873	12.4
Social Security Admin.	1416.328	1282.056	134.272	10.5
Retirement Benefits	1192.149	1063.897	128.252	12.1
Federal Disability Payments	149.667	142.485	7.182	5.0
Other Independent Agencies	134.262	29.829	104.433	350.1

INTEREST RATES

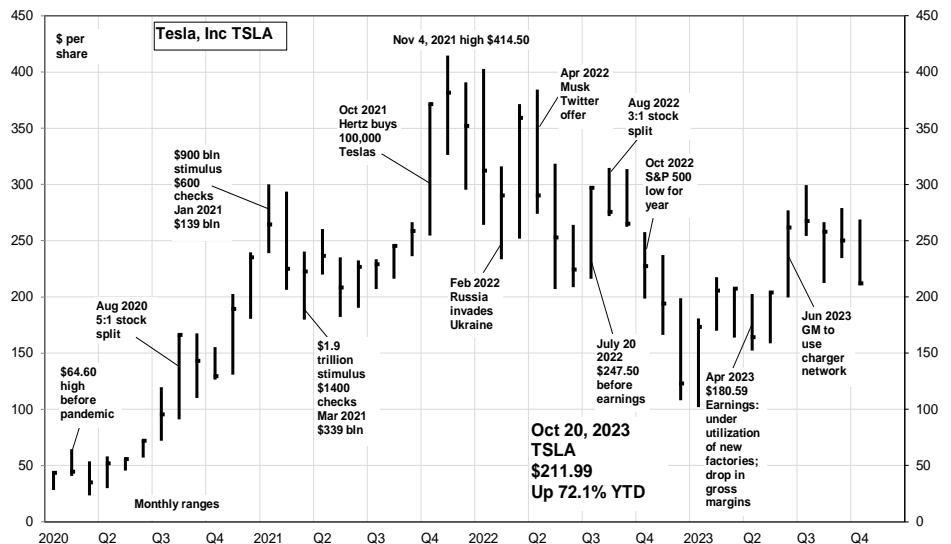


We cannot point to any mispricing with 10-yr yields rising to just short of 5.00% this week as the Fed funds rate is still higher at 5.5%. Powell’s remarks on Thursday, planned or not, sent yields up the most, breaking the prior 2023 4.89% high after Jolts on October 4. Stronger retail sales on Tuesday started the week’s yield rally on its way. Even Powell is pointing to the [Atlanta Fed GDPNow](#) Q3 estimate of 5.4%. Stocks follow bonds and equities dropped, the markets finding offense Thursday most with [Powell saying](#) [32:40] “the evidence is policy is not too tight now.” Stocks are finding it heavy going for now with higher rates, the last move in rates on Friday was a record high for 30-yr yields with the curve steepening. S&P 500 fell 8.5% from July 26 to October 3, with the low barely holding this week despite Powell and stronger retail sales. The 10-yr Treasury yield closed the week at 4.93%.

Tesla falls again after earnings release

Tesla was \$242.68 on Wednesday before earnings after the bell and fell 9.3% on Thursday. The stock fell 9.7% after the July 19 earnings date from \$291.26. The press conference, “we dug our own grave with Cybertruck,” didn’t go over well. Musk said it would be difficult to bring it to market, sell it with enough volume to make the truck cash flow positive at a price the public could afford. Operating income lowest since Q2 2021.

	Operating Model 3/Y		
Mln \$	Revenue	Income	Deliveries
Q1 2020	5,985	283	76,266
Q2 2020	6,036	327	80,277
Q3 2020	8,771	809	124,318
Q4 2020	10,744	575	161,701
Q1 2021	10,389	594	182,847
Q2 2021	11,958	1,312	199,409
Q3 2021	13,757	2,004	232,102
Q4 2021	17,719	2,613	296,884
Q1 2022	18,756	3,603	295,324
Q2 2022	16,934	2,464	238,533
Q3 2022	21,454	3,688	325,158
Q4 2022	24,318	3,901	388,131
Q1 2023	23,329	2,664	412,180
Q2 2023	24,927	2,399	446,915
Q3 2023	23,350	1,764	419,074



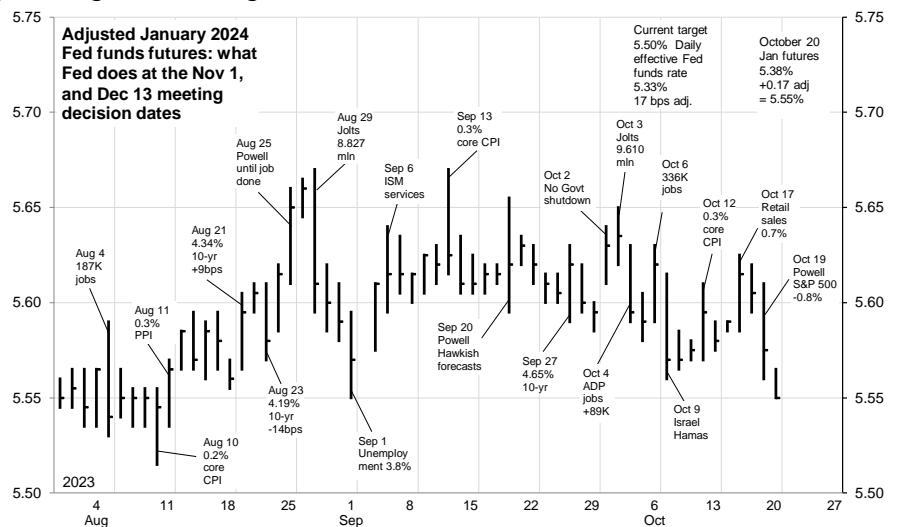
**FEDERAL RESERVE POLICY**

The Fed meets October 31-November 1, 2023 to consider its monetary policy. It was all Powell on Thursday talking strong growth, does not know if rates are high enough etc. It was interesting that Fed funds futures yields dropped on the posting of his speech at 12 noon, and did not wait for his lunch conversation where bond and stock markets thought they heard interest rates might need to go higher even if policymakers would be careful and take their time. We've heard enough from Fed officials for now. Fed speak has hit its saturation point with 6 other speakers all on Thursday: Vice Chair Jefferson, Chicago Fed Goolsbee, Vice Chair for Supervision Barr, Atlanta Fed Bostic, Philly Fed Harker, Dallas Fed Logan. At some point they will have to go with less truth-telling and analysis, and go instead with the former Treasury Secretary Rubin mantra, saying the US has a strong dollar policy regardless if the dollar was not strengthening. The 2% target may not be hit, but it will be close enough, and they can continue to say they have a 2% inflation target and that they are confident they will reach this target even if they never do. Their forecasts do say they will cut rates before inflation reaches exactly 2.0, although they think inflation will be 2.6% in Q4 2024 and the Fed funds rate will be 5.25%. 2.6% is a tall order as it would mean 10 months of 0.2% monthly increases, and 2 months of 0.3% numbers. Speaking of inflation, core PCE inflation for September is Friday, October 27 and Powell spilled the beans on his economists' forecast for it ahead of time again in his formal Thursday remarks. August core PCE is 3.9% year-year, and Powell said 3.7% for September which means a 0.3% monthly change matching the core CPI results. This does not account for revisions however: 0.2 is possible.

Selected Fed assets and liabilities						Change from 3/11/20 to Oct 18
Fed H.4.1 statistical release billions, Wednesday data	18-Oct	11-Oct	4-Oct	27-Sep	3/11/20*	
<b>Factors adding reserves</b>						
U.S. Treasury securities	4913.457	4928.507	4930.410	4958.138	2523.031	2390.426
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2479.652	2479.726	2479.726	2479.726	1371.846	1107.806
Repurchase agreements	0.000	0.000	0.000	0.000	242.375	-242.375
Primary credit (Discount Window)	2.962	2.580	2.773	3.193	0.011	2.951
Bank Term Funding Program	108.818	108.884	107.665	107.715		
FDIC Loans to banks via Fed	53.156	58.257	63.702	81.883		
Paycheck Protection Facility	4.633	4.777	4.868	5.178		
Main Street Lending Program	19.011	19.409	19.397	19.352		
Municipal Liquidity Facility	5.638	5.635	5.632	5.629		
Term Asset-Backed Facility (TALF II)	1.222	1.221	1.220	1.220		
Central bank liquidity swaps	0.231	0.230	0.229	0.238	0.058	0.173
<b>Federal Reserve Total Assets</b>	<b>7983.9</b>	<b>8002.7</b>	<b>8006.1</b>	<b>8052.5</b>	<b>4360.0</b>	<b>3623.840</b>
3-month Libor % SOFR %	5.30	5.31	5.32	5.32	1.15	4.150
<b>Factors draining reserves</b>						
Currency in circulation	2324.467	2328.017	2326.425	2324.023	1818.957	505.510
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	841.103	713.000	678.959	672.142	372.337	468.766
Treasury credit facilities contribution	13.358	13.358	13.358	13.358		
Reverse repurchases w/others	1150.781	1239.382	1242.031	1442.805	1.325	1149.456
<b>Federal Reserve Liabilities</b>	<b>4733.636</b>	<b>4687.650</b>	<b>4765.385</b>	<b>4884.031</b>	<b>2580.036</b>	<b>2153.600</b>
<b>Reserve Balances (Net Liquidity)</b>	<b>3250.230</b>	<b>3315.650</b>	<b>3240.707</b>	<b>3168.502</b>	<b>1779.990</b>	<b>1470.240</b>
Treasuries within 15 days	83.503	48.629	53.759	62.350	21.427	62.076
Treasuries 16 to 90 days	240.051	264.135	264.497	245.934	221.961	18.090
Treasuries 91 days to 1 year	584.932	602.710	599.561	613.336	378.403	206.529
Treasuries over 1-yr to 5 years	1682.577	1690.875	1690.672	1706.178	915.101	767.476
Treasuries over 5-yrs to 10 years	818.473	818.366	818.258	826.774	327.906	490.567
Treasuries over 10-years	1503.922	1503.793	1503.664	1503.565	658.232	845.690
Note: QT starts June 1, 2022	Change 10/18/2023	6/1/2022				
U.S. Treasury securities	-857.322	4913.457	5770.779			
Mortgage-backed securities (MBS)	-227.794	2479.652	2707.446			
*March 11, 2020 start of coronavirus lockdown of country						

Fed funds futures call Fed hikes		
Current target: October 20 -- 5.50%		
Rate+0.17 Contract	Fed decision dates	
5.500 Nov 2023	Nov 1	
5.550 Jan 2024	Nov 1, Dec 13	
Last trade, not settlement price		

Fed Policy-key variables	2023				Long Term
	2023	2024	2025	2026	
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					

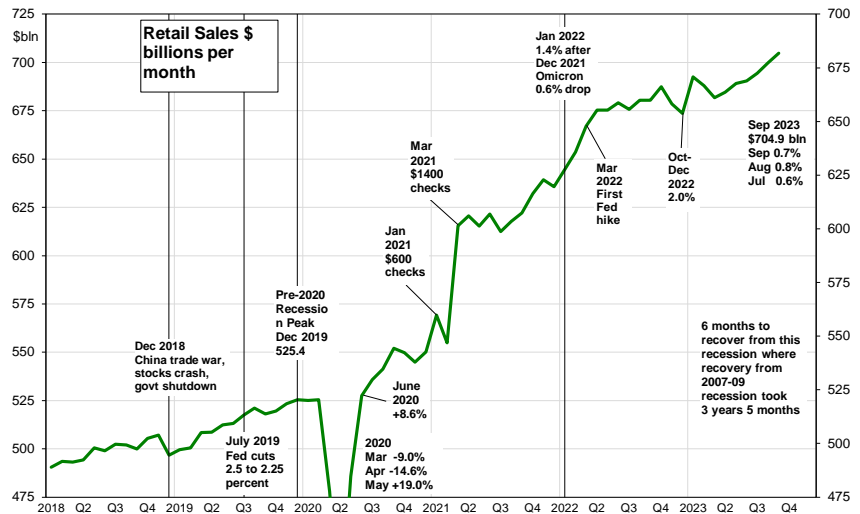


Next up: September PCE inflation report Friday, October 27															
Monthly % Changes	2023				2022							2022			
	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul
Core CPI inflation	0.3	0.3	0.2	0.2	0.4	0.4	0.4	0.5	0.4	0.4	0.3	0.3	0.6	0.6	0.3
Core PCE inflation		0.1	0.2	0.2	0.3	0.3	0.3	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

Shop till they drop (Tuesday)

Breaking economy news. Retail sales are literally on fire which means the Federal Reserve hasn't accomplished the mission yet to slow the economy and bring inflation to heel. If they're still shopping the economy ain't dropping, so put up another rate hike to cool the economy down. Retail sales were strong at 0.7% in September and that 0.6% increase in August is now revised up to 0.8%. July was 0.5% and now is up 0.6%. Maybe there was some weakness from the student loan payments restart with clothing sales down 0.8%, but that was pretty much it except for electronics and appliances down 0.8% and building material and garden supply stores off 0.2%. The student loan repayments were only a loss of about \$5 billion this month which is a drop in the bucket next to the \$704 billion of retail sales in September. There were 336 thousand more workers with paychecks in the payroll jobs data for September and it looks like they rushed out and spent every dime. Hold onto your hats when it comes to the third quarter GDP figures next week because retail sales in the third quarter are now 6.9% up from the 4.4% pace we thought after last month's retail sales report. And don't cry me a river about the fourth quarter because using September data, retail sales is up 3.0% on momentum from the third quarter. This economy won't be stopped.



Net, net, if the cost-of-living crisis has hit consumer confidence you wouldn't know it judging by a second month of strong retail sales with the consumer buying everything that wasn't nailed down. The economy is not rebalancing and economic demand from consumers is red hot this quarter which will power real GDP higher. The economy looks like it is getting used to the new normal of interest rates being higher for longer because shoppers are not taking a break that's for sure. Fed officials have another rate hike this year up on their forecast board, and they will need to use it, if the economic data continues to surprise economists on the upside. The economy won't be going into a recession anytime soon if consumers continue to shop until they drop. Bet on it.

Retail spending, actual dollars, each month					
	\$million	% to	Percent Changes %		
	Sep	Total	Sep	Aug	Year/year
Total Retail Sales	704,881	100.0	0.7	0.8	3.8
Motor vehicles/parts	135,226	19.2	1.0	0.4	6.2
Furniture/furnishings	10,998	1.6	0.0	-0.6	-5.9
Electronics/appliances	7,715	1.1	-0.8	1.2	-2.2
Building materials/garden	41,606	5.9	-0.2	0.6	-4.0
Food & beverage	82,530	11.7	0.4	0.3	1.6
Health/personal care	36,726	5.2	0.8	1.1	8.3
Gasoline stations	56,677	8.0	0.9	6.7	-3.5
Clothing/accessories	26,017	3.7	-0.8	0.7	0.1
Sporting goods, books	8,506	1.2	0.0	-2.0	-2.1
General merchandise	73,784	10.5	0.4	0.4	2.0
Department stores	11,062	1.6	0.0	0.3	-4.7
Miscellaneous retailers	15,207	2.2	3.0	-3.6	-0.2
Nonstore retailers (internet)	118,024	16.7	1.1	0.4	8.4
Eating & drinking places	91,865	13.0	0.9	0.4	9.2

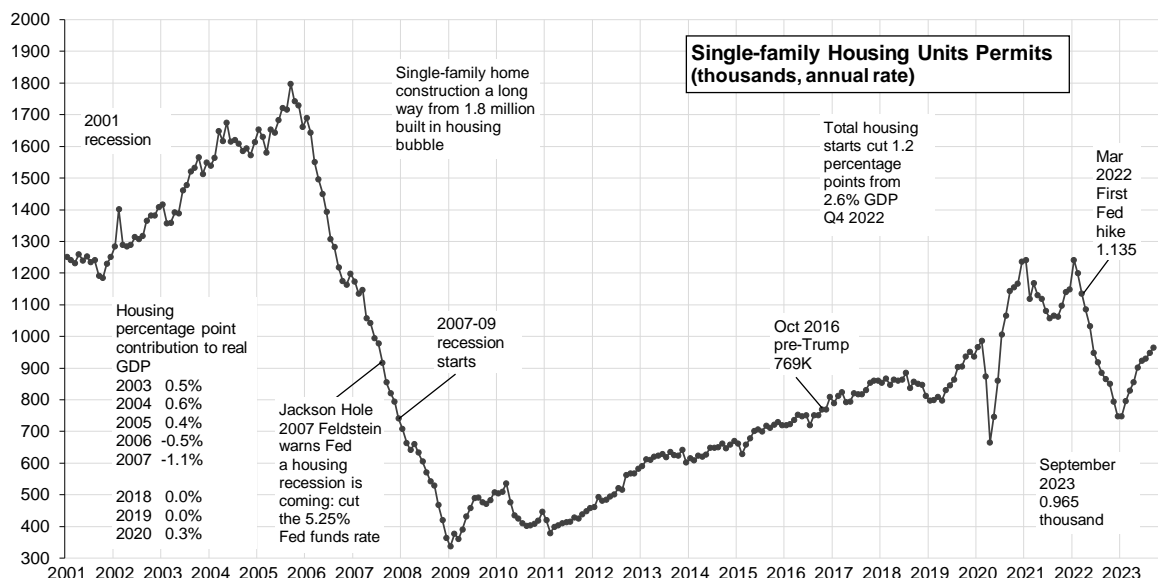
## Housing starts up this month (Wednesday)

Breaking economy news. Housing starts jumped 7.0% to 1.358 million in September after tumbling 12.5% in August, a decline in part due the storms out West in August. Housing starts rose 7.0% in September, but permits fell 4.4% so the pipeline for new projects in the future is not as strong. The permits data are volatile as permits of 5 units or more fell 14.0% in September after a surprise 14.6% increase in August that was apparently a one-off. The decline in multifamily construction permits was in every region of the country in September and may reflect homebuilder caution given the big increase in mortgage rates the last month.

Housing Starts Total, Single-Family, Multi-Family											
000s	United States			Northeast		Midwest		South		West	
	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Sep 2023	1358	963	383	83	47	203	121	772	593	300	202
Aug 2023	1269	933	327	110	58	150	106	725	577	284	192
Sep 2022	1463	887	559	148	60	210	123	738	511	367	193
% Chgs											
Sep/Aug	7.0	3.2	...	-24.5	-19.0	35.3	14.2	6.5	2.8	5.6	5.2
Sep/Sep	-7.2	8.6	...	-43.9	-21.7	-3.3	-1.6	4.6	16.0	-18.3	4.7

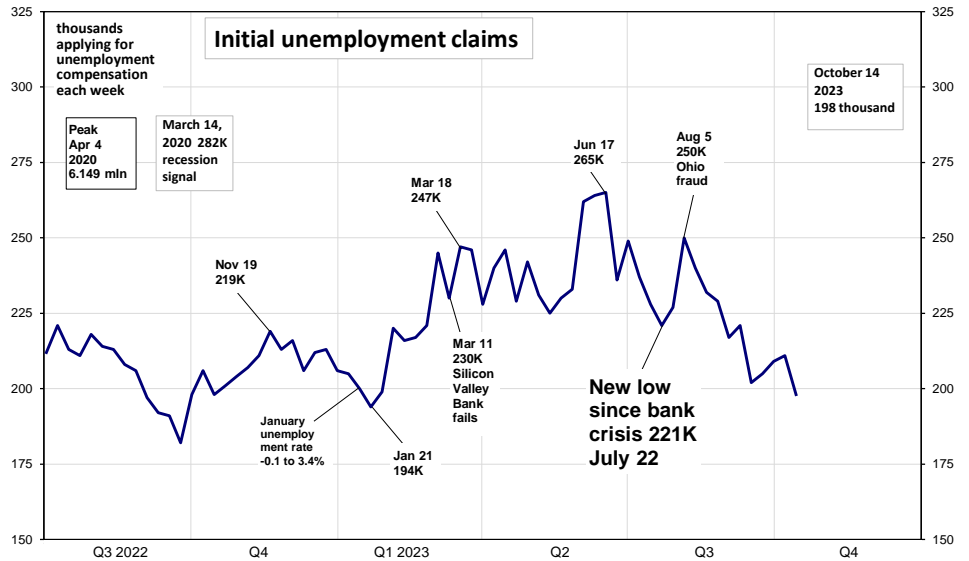
At least single-family permits continue to increase as they have every month this year, where they are now 11.6% higher than a year ago. Just the opposite trend is seen in permits of 5 units or more that have slumped 31.6% from year ago levels.

Net, net, housing starts rebounded part way in September from the steep decline in August, but for how long given the body blow of new highs in the cost of financing the purchase of residential housing in America. We believe much of the increase in housing starts comes from the last several months of increasing permits that builders have taken out to start construction. Overall, the recovery in residential housing construction was slowly making progress before being slapped back down by 7.5% mortgage rates. Higher for longer Fed policy has sent bond yields soaring, making it even more costly to borrow to buy a home. Mortgage rates were down at 3% at the end of 2021, and none of those homeowners are going to trade out of that mortgage rate anytime soon. Builders can build, but the million dollar question is whether anyone can afford it with borrowing costs and home prices setting fresh 2023 highs. Stay tuned. Watch here as the housing markets churn. It's not lights out for homebuilding, but we don't know how many more body blows with the Fed's interest-rate hammer the nation's housing sector can withstand.

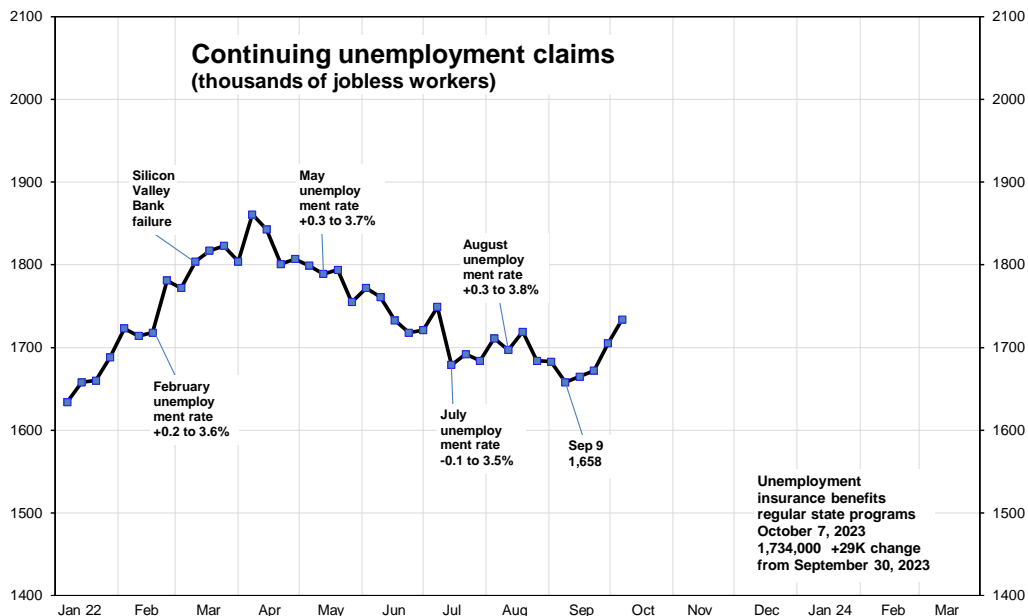


### 198K jobless claims (Thursday)

Breaking economy news. Weekly jobless claims are out with initial claims falling 13K to 198K in the October 14 week, while continuing unemployment claims jumped 29K to 1.734 million in the October 7 week. Make up your mind, is the labor market slowing or booming? The data can be volatile week to week and there was the Columbus Day partial-holiday to adjust for, but our advice is to fade the increase in the total number of jobless Americans on the unemployment rolls shown by rising continuing unemployment claims because the pipeline of first-time applications is the lowest it has been since January this year. The higher for longer bond yields may be doing the Fed's monetary policy tightening for them, but if so, it isn't enough because the labor markets remain tight as a drum. The economy is strengthening and may eventually lead to renewed inflationary pressures.



Net, net, sidelined, wait-and-see Fed officials have some explaining to do as the labor market continues to tighten up with fewer layoffs a couple of weeks past the 5% real GDP shoot-the-lights out third quarter. Companies on earnings calls may warn about the outlook and risks ahead, but they are still holding on tight to their workers as good help is increasingly hard to find. The economy and labor markets are simply not slowing down and time will tell if this will reignite the inflation fires that until recently were looking contained. You can't have an old-fashioned recession without job losses and the unemployment insurance claims say there are none. Those calling for recession any day now look like a bunch of Chicken Littles saying the sky is falling.

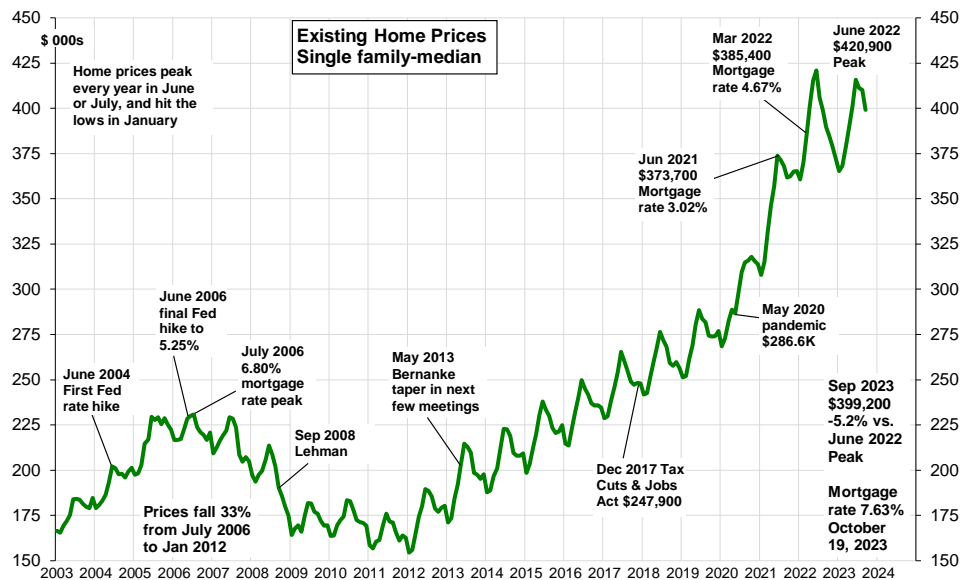
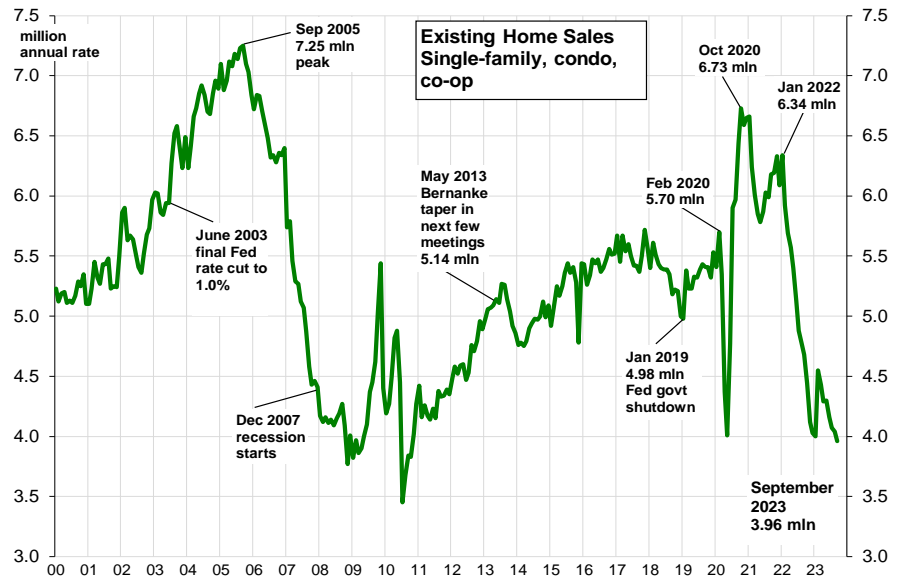


## Homes are cheaper by the dozen this month (Thursday)

Breaking economy news. Sales of existing homes fell 2.0% to 3.96 million in September at an annual rate, the lowest turnover since 2010 after the last big recession. Sales were down across the board with only sales down South doing slightly better than the rest of the country as it counts fast-growing states like Florida and Texas where everyone seems to want to move to.

Single-family existing home prices have come down off the boil, falling 2.7% to \$399,200 with prices in the Northeast, Pennsylvania, New Jersey and above, falling 3.9% in September. Time will tell how low home prices fall this winter, but the first shoe has dropped from the peak of \$415,700 in June 2023.

Net, net, Fed officials got some good news today if they are really trying to put a stake in the heart of the nation's housing sector. The housing price bubble stopped inflating for a third month and sales activity slowed even before 30-year mortgage rates jumped above 7.5% on the Fed's higher for longer forecasts that sent bond yields soaring. The monetary policy transmission process is different this cycle where the fastest rate hikes since the 80s has frozen would be home buyers in place, trapped by the 3% mortgages they enjoy where they would have to pay over 7% to borrow to buy a new roof over their heads if they moved. There are 10 thousand baby boomers turning 65 years old every day, but they won't be downsizing right now because the costs engendered by the Fed's tight monetary policy are just too great. The Fed got what it wanted today with sales activity at a new low for this cycle, a rate not seen since the Great Recession after the housing bubble burst, but the effect on the overall economy is hard to see with real GDP economic growth possibly north of 5% in the third quarter. Stay tuned. Watch here where the world goes next.





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