Financial Markets This Week

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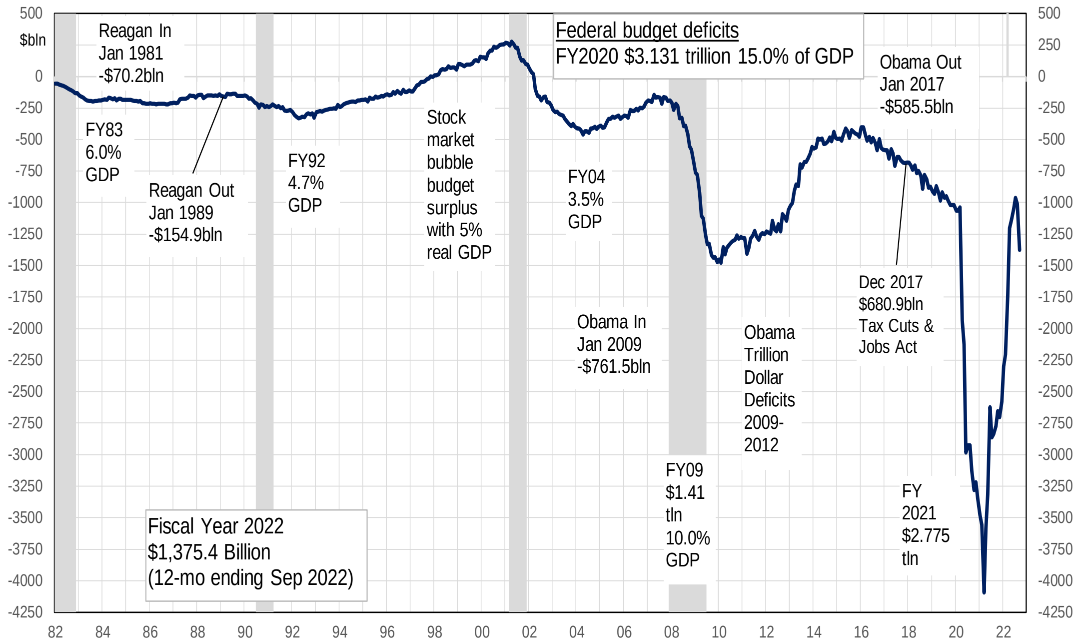
FY2022 FEDERAL BUDGET RESULTS ARE IN



The fiscal year (FY) 2022 Federal budget results came in on Friday and Secretary of the Treasury Janet Yellen and Director of Management and Budget (OMB) Shalanda Young gave a Joint Statement. Fiscal years ending September always. Before the pandemic in FY2019, Federal government outlays were $4.4 trillion. Pandemic relief stimulus, when the unemployment rate nearly reached 20%, produced mega-spending of $6.5 trillion in FY2020, and $6.8 trillion in FY2021. The pandemic recession ended back in April 2020, but Federal government outlays are still up there at $6.271 trillion in FY2022. There might be an inflation-effect starting to push government spending higher. The Social Security benefits COLA was 5.9% starting January 2022 and will be 8.7% higher beginning January 2023. The Department of Education's student loan debt forgiveness plan added a lot to FY2022 spending. As of this writing, a court order is temporarily blocking the Department of Education from processing debt discharges, but the hit to the budget is still there in the data. A complicated story on accounting for debt discharges and future income-driven repayment forgiveness, but in the table on the next page on Federal outlays, the Office

Federal Government: Where's the Money Coming From?

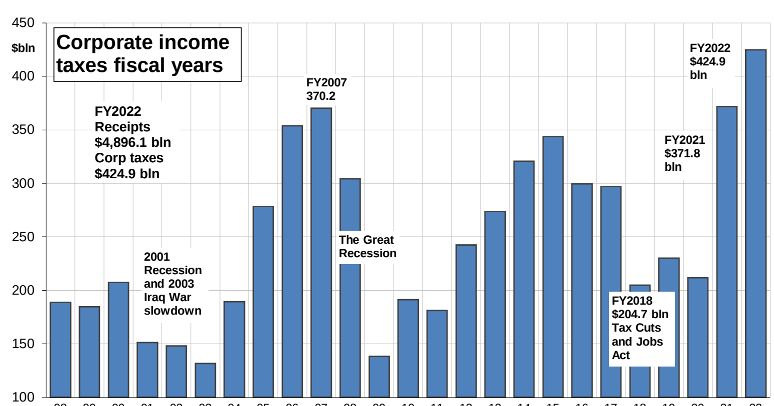
Fiscal Years $billons	Sep 2022	%	Sep 2021	%	Sep 2020	%	Sep 2019
Budget Receipts	$4896.1	21.0	$4046.0	18.3	$3420.0	-1.2	$3462.2
Income taxes	2,632.1	28.8	2,044.4	27.1	1,608.7	-6.4	1,717.9
Corporation taxes	424.9	14.3	371.8	75.5	211.8	-8.0	230.2
Social retirement taxes	1,410.7	12.7	1,251.9	-0.8	1,261.7	5.4	1,197.4
Unemployment insurance	66.5	17.5	56.6	31.3	43.1	5.4	40.9
Excise taxes	87.7	16.5	75.3	-13.3	86.8	-12.3	98.9
Estate and Gift Taxes	32.6	19.9	27.1	54.0	17.6	5.5	16.7
Customs Duties	99.9	24.9	80.0	16.7	68.6	-3.2	70.8
Miscellaneous	135.4	1.6	133.3	14.4	116.5	37.8	84.6

of Federal Student Aid had spending of $539.8 billion in FY2022 versus $170.4 billion in FY2021. The Federal budget deficit was looking more like $1 trillion this year before these Department of Education upfront accounting outlays appeared in September, and the FY2022 deficit was officially recorded at $1.375 trillion. Whatever the outlook for the deficit in FY2023 which is highly uncertain with the midterm elections, remember if you are in the market buying Treasury debt, make sure you add $720 billion more that needs to be auctioned because of the Federal Reserve's monthly QT of $60 billion per month running not so silently in the background.

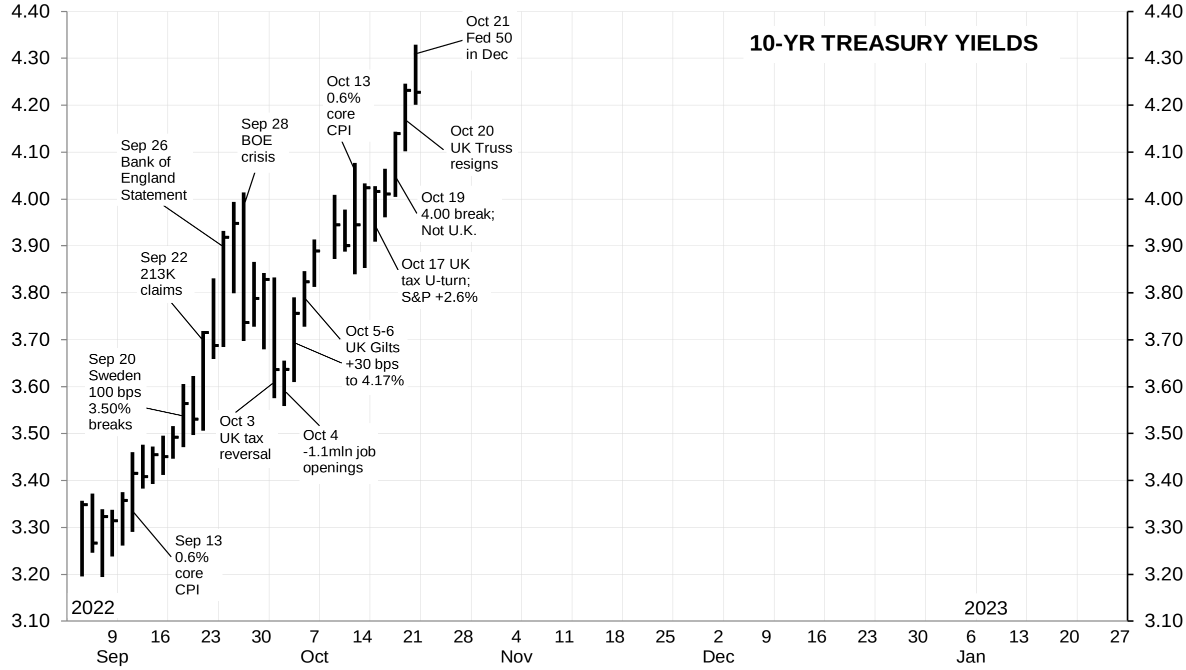
We don't want to leave the stock market out either. Corporate tax collections show companies are still making money. Corporate tax collections in the third calender year quarter are running 11.4% higher than a year earlier. FY2022 corporate taxes were $424.9 billion or 14.3% higher than FY2021.

To conclude, the deficit fell back to $1.375 trillion this year which is $1.4 trillion narrower than FY2021. Federal deficit red ink in the future is still a worry with inflation kicking up nominal government spending of everything, especially inflation-indexed social security benefits. The Fed just raised the Fed funds rate to 3.25% in September, but forecasts overnight rates of 4.75% in 2023. Interest on the public debt jumped 27.6% to $717.6 billion in FY2022 and is certainly going to go much higher.

Federal Government Spending ($bln) **Where to cut?**	4 Qtrs FY22 Q4 21-Q3 22	4 Qtrs FY21 Q4 20-Q3 21	Fiscal Year Changes	Fiscal Year % chg
TOTAL BUDGET OUTLAYS	6,271.508	6,821.554	-550.046	-8.1
Legislative	5.752	5.263	0.489	9.3
Judicial	8.720	8.310	0.410	4.9
Agriculture	245.216	235.193	10.023	4.3
Commodity Credit Corporation	6.647	10.548	-3.901	-37.0
Food Stamps	148.514	134.527	13.987	10.4
Child Nutrition	37.213	25.798	11.415	44.2
Commerce	11.734	13.134	-1.400	-10.7
Defense	726.571	717.585	8.986	1.3
Military Personnel	180.777	172.580	8.197	4.7
Operation Maintenance	291.208	286.183	5.025	1.8
Procurement	136.177	141.446	-5.269	-3.7
Research Development	107.059	105.665	1.394	1.3
Military Construction	9.726	9.147	0.579	6.3
Education	639.368	260.452	378.916	145.5
Office of Federal Student Aid	539.830	170.471	369.359	216.7
Energy	22.439	33.694	-11.255	-33.4
Health Human Services	1642.895	1466.673	176.222	12.0
Medicare	982.628	875.361	107.267	12.3
Medicaid States Grants	591.950	520.588	71.362	13.7
Homeland Security	80.865	91.069	-10.204	-11.2
Housing Urban Development	29.307	35.082	-5.775	-16.5
Interior	13.917	15.788	-1.871	-11.9
Justice	39.603	39.261	0.342	0.9
Labor	51.738	404.771	-353.033	-87.2
State Unemployment Benefits	26.715	222.335	-195.620	-88.0
Fed Additional Unemployment	3.612	162.697	-159.085	-97.8
State	33.231	35.814	-2.583	-7.2
Transportation	113.729	104.936	8.793	8.4
FAA	23.071	37.022	-13.951	-37.7
Federal Highway Admin.	168.138	61.218	106.920	174.7
Treasury	1162.222	1633.747	-471.525	-28.9
TARP	0.222	0.370	-0.148	-40.0
Coronavirus Relief Fund	105.929	243.460	-137.531	--
IRS	352.121	817.462	-465.341	--
Earned Income Credit	64.282	60.757	3.525	5.8
Child Tax Credit	31.435	78.959	-47.524	--
Economic Impact Payments	13.100	570.000	-556.900	--
Interest on Public Debt	717.611	562.388	155.223	27.6
Veterans Affairs	273.867	233.781	40.086	17.1
Corps of Engineers	8.181	7.936	0.245	3.1
Other Defense Civil Programs	56.870	58.085	-1.215	-2.1
Environmental Protection	9.279	8.309	0.970	11.7
Exec. Office of President	0.458	0.427	0.031	7.3
International Assistance	35.814	20.047	15.767	78.7
NASA	23.079	22.249	0.830	3.7
National Science Foundation	8.133	7.376	0.757	10.3
Personnel Management	113.072	108.552	4.520	4.2
Small Business Admin.	23.199	322.721	-299.522	--
Social Security Admin.	1282.056	1192.453	89.603	7.5
Retirement Benefits	1063.897	982.673	81.224	8.3
Federal Disability Payments	142.485	140.774	1.711	1.2
Other Independent Agencies	29.829	13.554	16.275	120.1



INTEREST RATES

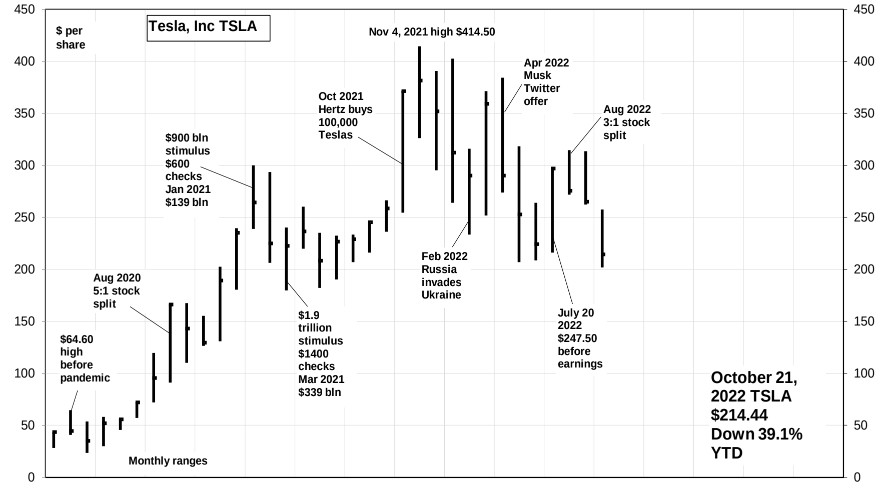


We were wondering about bond market valuation knowing the terminal Fed rate next year is 4.75%, and we got the answer this week. Bond yields closed above 4% (4.02) last Friday, and kept going this week, although it didn't seem to hold back the recovery in the stock market. Yield rallies tend to keep going for a time after breaking "major psychological resistance levels" like 4.00%. The 10-year yield reached as high as 4.325% on Friday before closing at 4.23%. Fed talk helped push yields up this week and suddenly Fed talk brought yields down and stocks up on Friday. Not sure how substantive the switch to Fed dovishness was on Friday using a Bernanke word, but market reasoning can change suddenly. Can't remember who it was who said market commentary shouldn't be a "macroeconomic description of a random walk." The S&P 500 rallied back this week; can't change the Friday close whatever the reason. Low close for 2022 -24.9% October 12, and -21.3% YTD on Friday.

Tesla down 48.3% from November 2021 high after earnings this week

Tesla fell 6.6% Thursday to $207.28 after earnings released after the market close on Wednesday. The company missed on its revenue expectations. Deliveries, revenue, income don't look that bad in the table here. There may be some concerns about shares sold to fund Twitter purchase.

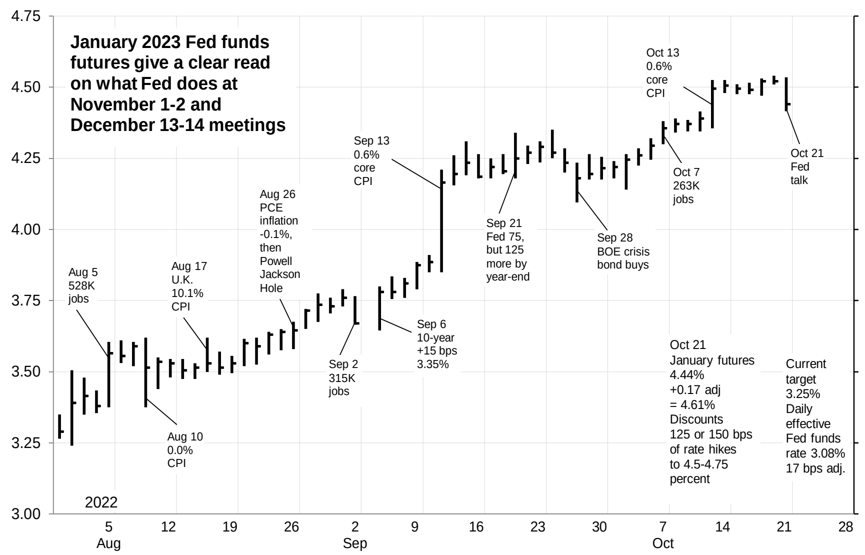
Mln $	Revenue	Operating Income	Model 3/Y Deliveries
Q1 2020	5,985	283	76,266
Q2 2020	6,036	327	80,277
Q3 2020	8,771	809	124,318
Q4 2020	10,744	575	161,701
Q1 2021	10,389	594	182,847
Q2 2021	11,958	1,312	199,409
Q3 2021	13,757	2,004	232,102
Q4 2021	17,719	2,613	296,884
Q1 2022	18,756	3,603	295,324
Q2 2022	16,934	2,464	238,533
Q3 2022	21,454	3,688	325,158



FEDERAL RESERVE POLICY

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	19-Oct	12-Oct	5-Oct	28-Sep	3/11/20*	3/11/20
Factors adding reserves						to Oct 19
U.S. Treasury securities	5611.953	5629.841	5633.926	5671.848	2523.031	3088.922
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2698.651	2698.158	2698.158	2698.158	1371.846	1326.805
Repurchase agreements	0.010	0.000	0.000	0.001	242.375	-242.365
Primary credit (Discount Window)	5.139	7.669	7.511	6.470	0.011	5.128
Paycheck Protection Facility	13.546	12.356	13.847	14.030		
Main Street Lending Program	25.203	25.742	25.722	25.704		
Municipal Liquidity Facility	5.570	5.567	5.565	5.563		
Term Asset-Backed Facility (TALF II)	2.138	2.137	2.136	2.149		
Central bank liquidity swaps	6.482	3.307	0.300	0.216	0.058	6.424
Federal Reserve Total Assets	8793.8	8808.8	8808.9	8844.9	4360.0	4433.817
~~3-month Libor %~~ SOFR %	3.04	3.04	3.04	2.98	1.15	1.890
Factors draining reserves						
Currency in circulation	2284.270	2287.827	2283.376	2278.657	1818.957	465.313
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	640.613	583.513	622.131	661.920	372.337	268.276
Treasury credit facilities contribution	17.940	17.940	17.940	17.940		
Reverse repurchases w/others	2241.835	2247.206	2230.799	2366.798	1.325	2240.510
Federal Reserve Liabilities	5753.066	5718.491	5732.414	5861.695	2580.036	3173.030
Reserve Balances (Net Liquidity)	3040.777	3090.307	3076.450	2983.206	1779.990	1260.787
Treasuries within 15 days	91.037	66.698	71.778	92.355	21.427	69.610
Treasuries 16 to 90 days	323.378	346.045	347.710	316.644	221.961	101.417
Treasuries 91 days to 1 year	784.695	790.328	787.632	813.531	378.403	406.292
Treasuries over 1-yr to 5 years	1966.054	1979.960	1979.974	1993.540	915.101	1050.953
Treasuries over 5-yrs to 10 years	991.959	991.971	991.982	1000.920	327.906	664.053
Treasuries over 10-years	1454.830	1454.839	1454.849	1454.857	658.232	796.598
Note: QT starts June 1	Change	19-Oct	1-Jun			
U.S. Treasury securities	-158.826	5611.953	5770.779			
Mortgage-backed securities (MBS)	-8.795	2698.651	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

The Fed meets November 1-2, 2022 to consider its monetary policy. A 75 bps rate hike to 4.0% is discounted, it is the final meeting of the year on December 13-14 that is the issue. Fed watches markets and markets watch Fed. Whatever you think of the WSJ Fed story before stocks opened on Friday, “Some officials are signaling greater unease with big rate rises to fight inflation,” or the San Francisco Fed President Daly comments later in the day, the market moved big. At least January 2023 Fed funds futures moved big and are no longer completely discounting a 75 bps rate hike to 4.75% at the December meeting. 75 bps in November and in December puts the Fed target at 4.75%, and on Thursday at one point the January futures were discounting 4.705%; after the Fed speak on Friday the contract closed at 4.61%, a little less than 50/50 for a second 75 bps rate hike in the next two meetings.



The dollar funding crisis the Swiss National Bank (SNB) is helping with got bigger for a third week. The SNB U.S. dollar liquidity swap is now $11.09 billion for a 7-day term maturing October 27 versus $6.27 billion the week before.

Core PCE inflation is coming up on Friday, October 28 and we will see if inflation-spreading news can tank the markets yet again. Current inflation has peaked although at an extremely high level that makes a peak meaningless, and it will be months to see if the core monthly increases will moderate. One would think the market might discount inflation at its current rate, but we don’t know what the Fed will do with the current terminal 4.75% Fed funds rate in 2023 in the next forecast due out on December 14 at 2pm ET.

Core Consumer Inflation and stickier services prices ex-energy

Monthly	2022							2022	2021								2021
% Changes	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr
Core CPI inflation	0.6	0.6	0.3	0.7	0.6	0.6	0.3	0.5	0.6	0.6	0.5	0.6	0.3	0.2	0.3	0.8	0.7	0.9
Services x-energy	0.8	0.6	0.4	0.7	0.6	0.7	0.6	0.5	0.4	0.3	0.4	0.4	0.2	0.1	0.3	0.4	0.4	0.5
Core PCE inflation		0.6	0.0	0.6	0.4	0.3	0.4	0.4	0.5	0.5	0.5	0.4	0.2	0.3	0.4	0.5	0.5	0.6
Services x-energy		0.6	0.0	0.6	0.4	0.4	0.5	0.3	0.3	0.5	0.6	0.3	0.2	0.3	0.4	0.4	0.4	0.4

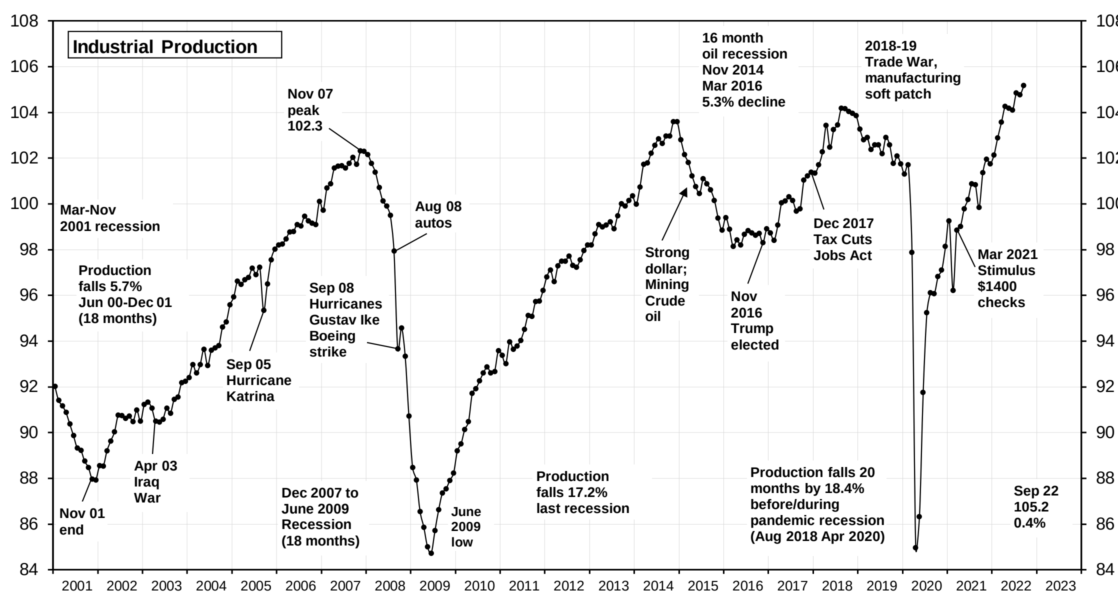
OTHER ECONOMIC NEWS

Manufacturing output continues apace (Tuesday)

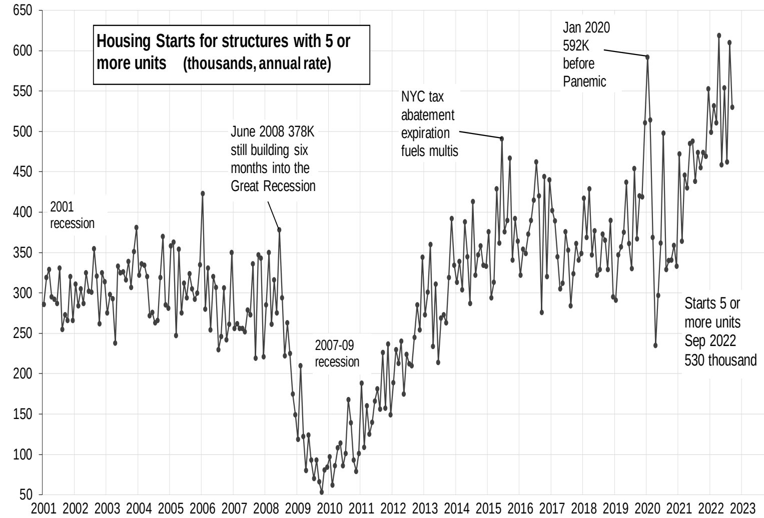
Breaking economy news. Industrial production bounced back 0.4% in September from a revised 0.1% drop in August. Manufacturing production has been strong every month this quarter since a brief downturn in May and June and could be benefiting from factories moving back to the US as more companies hit the pause button on the era of globalization. For all the talk of too many unwanted consumer goods on store shelves, the production of consumer goods bounced back by 0.6% in September after dropping 0.1% in August. There were big declines in consumer goods production in May and June, but now the restart of production could be a sign that inventories are no longer too high.

Percent changes			Industrial Production Sep 2022		
Jul	Aug	Sep	YOY		Weight
0.7	-0.1	0.4	5.3	Total Index	100.0
0.6	0.4	0.4	4.7	Manufacturing	74.4
1.2	0.0	0.6	11.1	Mining	15.5
0.4	-3.3	-0.3	0.5	Utilities	10.1
			Manufacturing payroll jobs 12.9 million +467K YOY 9.9% of Private Payroll Jobs		

Net, net, The good news is factory output continues apace and there is no sign of a manufacturing recession. Good news on manufaturing is bad news for Fed officials who are desperate to slow aggregate demand to put out the inflation fires that threaten the nation. Today's rise in manufacturing output keeps the Fed on course to hike rates another 75 bps at the November meeting. Bet on it.



Multifamily home construction continues for now (Wednesday)



Breaking economy news. Housing starts fell 8.1% in September to 1.439 million at an annual rate which is back down near the July 1.377 million lows for 2022. Single-family starts fell 4.7% to 892 thousand in September and starts of 5 units or more tumbled 13.1% which could have been impacted by Hurricane Ian in the South as single-family construction in the South actually rose 2.5%.

Permits for future construction were better at least for multifamily construction which continues to see strength based on rising rents and the home price bubble that forces those seeking shelter into apartments because they cannot afford to buy a single family house. Home prices have come down only modestly the last couple of months and are still 30 percent higher or more than before the pandemic.

Net, net, the housing crisis in construction is very real as builders assess the negative effect of 7% mortgage rates, but residential building construction is actually two different markets. Affordability is driving the construction of more multi-family units while single-family home building is slowing as you would expect in the rising interest rate environment and this is leading to the dramatic drop in builder confidence seen in surveys.

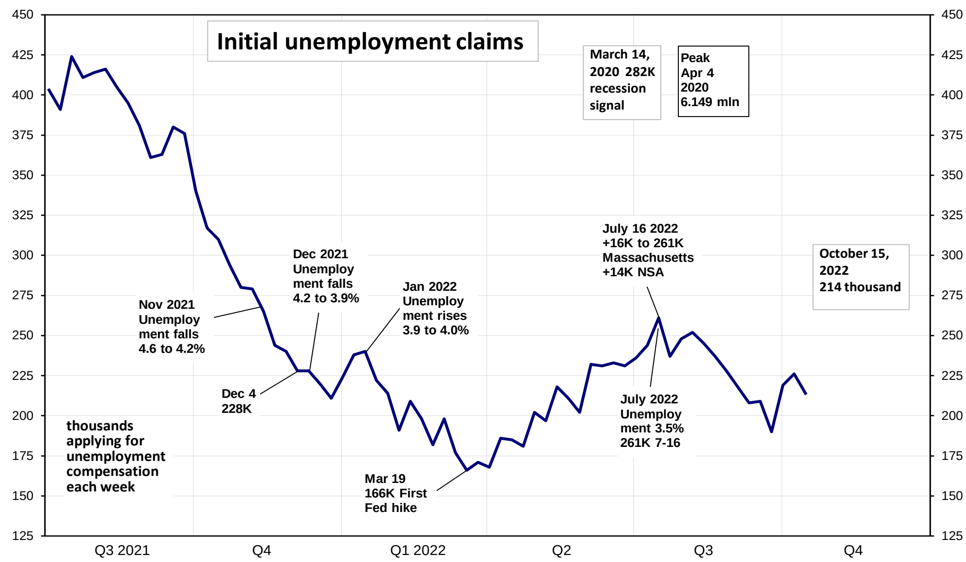
The split nature of the market can be seen in housing starts of 5 or more units rising 16.5% the last year, while single-family housing starts are down 18.5% since last year. To date, the rise in financing costs associated with the construction of apartment buildings has not hit levels high enough to scuttle the plans of builders. This will likely change in the months to come as the Fed's rates forecast becomes a reality, but for most of September the Fed funds rate was still relatively low at just 2.5%. Stay tuned. The worst for housing is yet to come as more Fed rate hikes on the horizon are likely to make the construction of multifamily units come tumbling down. At some point someone will point out that the Fed's rate hikes to fight inflation will cause even greater problems if there is not enough housing either affordable or unaffordable for Americans.

Housing Starts Total, Single-Family, Multi-Family

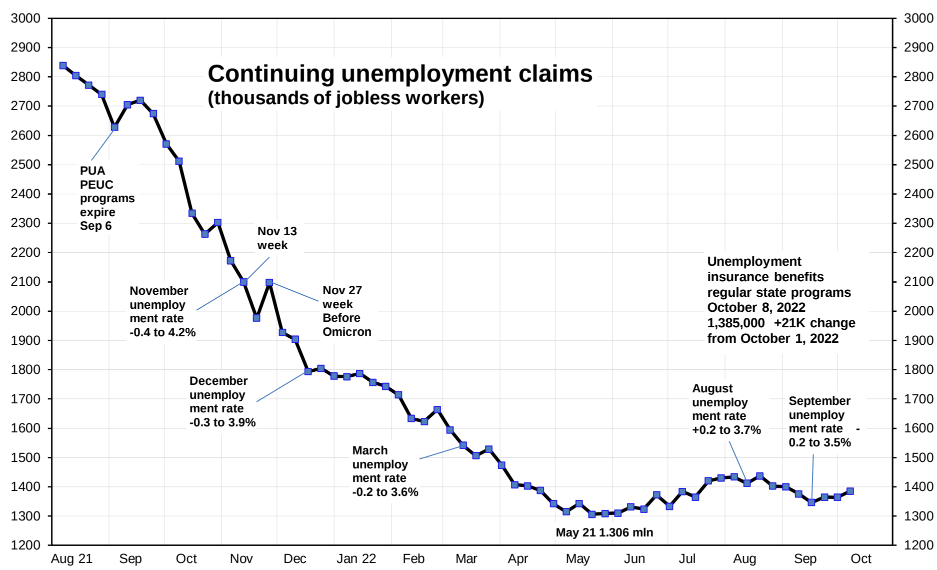
	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Sep 2022	1439	892	530	147	58	182	112	738	536	372	186
Aug 2022	1566	936	610	168	62	187	130	855	523	356	221
Sep 2021	1559	1094	455	127	69	204	132	809	627	419	266
% Chgs											
Sep/Aug	-8.1	-4.7	…	-12.5	-6.5	-2.7	-13.8	-13.7	2.5	4.5	-15.8
Sep/Sep	-7.7	-18.5	…	15.7	-15.9	-10.8	-15.2	-8.8	-14.5	-11.2	-30.1

Jobless recession continues (Thursday)

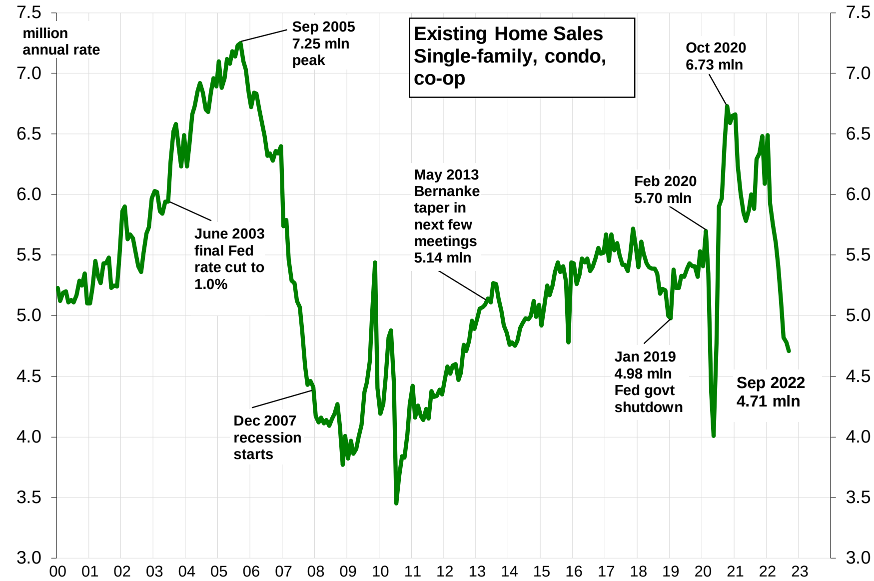
Breaking economy news. Close but no cigar if you were looking for job losses to firm up your recession forecast. Recession isn't just around the corner, it isn't coming at all based on today's weekly jobless claims data. October 15 initial unemployment claims fall back 12 thousand to 214K in the October 15 week. It's been almost a month since the last Fed 75 bps rate hike to 3.25%, but that level of interest rates isn't doing anything to slow down the pace of employment growth. The labor market is steady as a rock.



Net, net, the whole world seems to be betting on a US recession, but so far, the labor market refuses to support such a negative outlook for the economy. The jobless recession continues with negative economic growth in the first half of 2022, while first-time jobless claims remain below the level that would set the alarm bells blaring that the economy was nearing the edge of the proverbial cliff. You can't have an economic downturn without rising unemployment, and while cautious CEOs say they are considering job cuts in the next year, they haven't begun en masse to lay off workers.

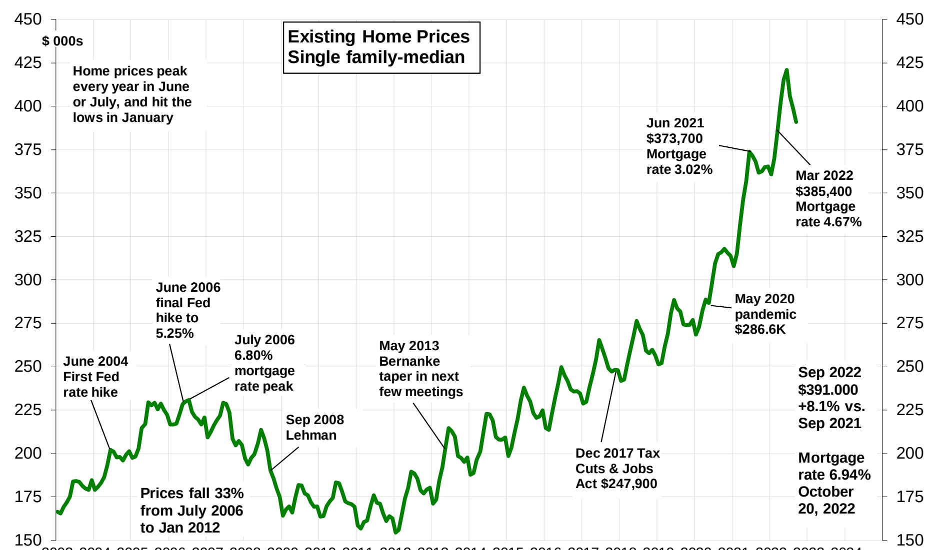


Existing single-family home prices drop 7.1% since June (Thursday)



Breaking economy news. The most troubling statistic in today's somber report from the National Association of Realtors is the slide in single-family home prices, down 7.1% since June. The fact that prices are still up 8.1% from year earlier levels is besides the point. Prices normally peak during the height of the summer selling season in June each year, but in 2022, the decline in prices looks somewhat greater than normal. If the decline in prices is seasonal, it won't be for long because 30-year mortgage rates are over 7% from 3% at the start of the year which really yanks the feet out from under home buyer traffic in the months ahead. Mortgage rates are higher than during the 2006 housing bubble even though the Fed funds rate peaked at 5.25% back then versus where it is today at 3.25%. How weird is that? Credit conditions and wider spreads to Treasuries can't possibly be worse than during the subprime housing market crisis.

Home sales, don't ask because the worst is yet to come. Home sales are collected at the time of closing which is at least a month later than when the sales contract was actually signed. Existing home sales were down 1.5% to 4.71 million at an annual rate in September and would have been worse if sales out West were not unchanged this month where every other region recorded declines. Year-over-year sales out West down 31.3% are much worse than the rest of the nation so perhaps sales earned a break this month.



Net, net, the housing market continues to take the aggressive Fed rate hikes on the chin more than any other sector of the US economy with plummeting sales of existing homes and prices of single-family homes sliding since the start of the summer. When it comes to consumer spending, perceptions of wealth matter and right now American workers are battered on two fronts with stock prices and now home prices falling. Everything is working against the American consumer with inflation destroying the purchasing power of paychecks and savings, and the value of financial assets like bonds, stocks and homes all adjusting downward at a quickening pace. Stay tuned. The effect of the Fed's anti-inflation measures are more lopsided than ever with housing slowing sharply while other important areas of the economy like the labor market remain immune for now. The Fed's rate hikes aren't working their magic yet with inflation not under control and asset values heading lower.

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