

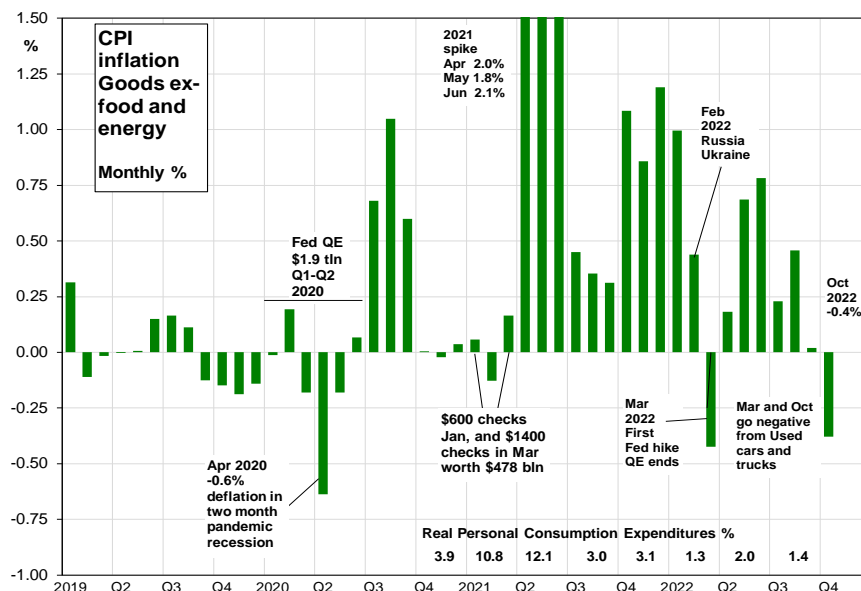
Financial Markets This Week

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CPI INFLATION MODERATES THIS MONTH

CPI inflation moderated finally this month for October. Moderate as in less of an increase in consumer prices. CPI inflation rose 0.4% in October, 0.3% for core CPI, versus forecasts of 0.6% headline and 0.5% core. Not all that much better, a couple of tenths on the month, but the market took off thinking the Fed's policy tightening medicine was starting to work. The S&P 500 ETF was up 0.3% at 830am ET before the report on Thursday morning, up 3.0% just minutes later, closing Thursday up 5.5%. Stocks by this measure had collapsed 2.1% Wednesday on the crypto crash, but the rally was impressive and about as understandable as the market reaction to last month's CPI number. Stocks fell 2.4% on the stronger 0.6% core CPI print on October 13 to the low for the year, only to rally back 5.1%. There wasn't much explanation for that rally either although on October 13 stocks were down as much as 27.5% from record highs, which is a recession-magnitude loss that probably wasn't warranted as there isn't a recession and the stock market collapse was too far ahead of any possible bad outcome for the economy or corporate earnings.

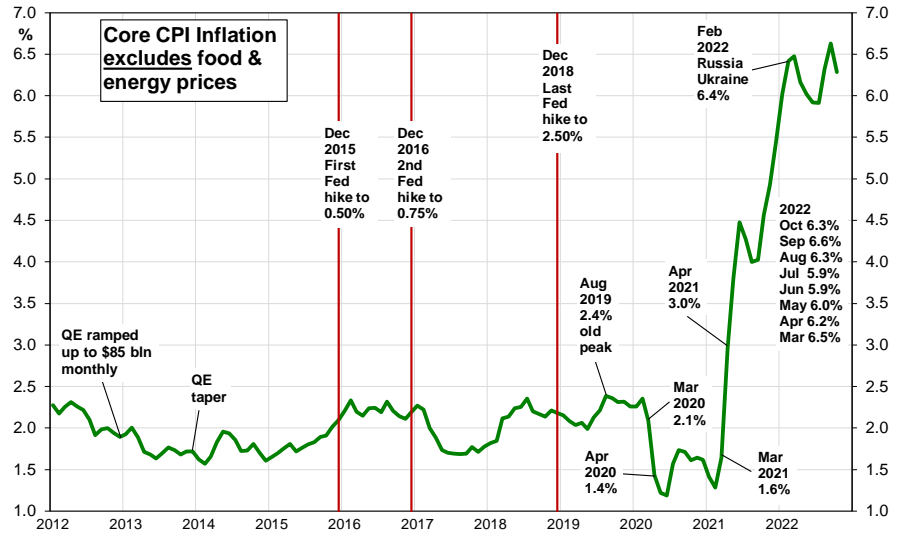


Bond yields fell as well by 28 bps to 3.82% Thursday for 10-year Treasuries. The market apparently believes inflation has peaked as prices of homes and various industrial commodities are falling, even if it is not being picked up by CPI yet, as the earlier supply disruptions and shortages from the pandemic demand surge start to fade. In most cycles, rising commodity prices from supply shocks give inflation its start, spreading on to services prices, and falling commodity prices signal inflation has peaked and is coming back down. How reasonable is it that commodity prices lead the way down for inflation? Check out this first chart where CPI commodities less food and energy commodities fell 0.4% in October, the first drop since March this year. These commodities fell in 0.4% March this year as

What did Powell say at the November 2 press conference? "...as the supply side problems have resolved themselves, we would have expected goods inflation to come down by now, long since by now... it has come down, but not to the extent that we had hoped."

well, but the reason is tied to sharp declines in used cars and truck prices down 3.8% in March and 2.4% in October. If we look back to the 2001 and 2007-09 recessions, core CPI commodity prices don't actually decline as much as we thought we had remembered. Looking back to earlier recessions we also never had an explosion for core commodity CPI prices like we saw in this cycle with sky-high monthly changes averaging 2.0% in April, May, and June 2021. [Not to confuse, but keep in mind this was double the inflation PCE saw.]

If you want to play the Washington inflation blame game, you don't need to be an econometrician to see the \$600 and \$1400 economic impact payments in January and March 2021, \$478 billion, line up with more money chasing not enough goods forcing core CPI commodity prices higher in the second quarter of 2021. We don't need to keep the Fed out of this blame game either with their QE



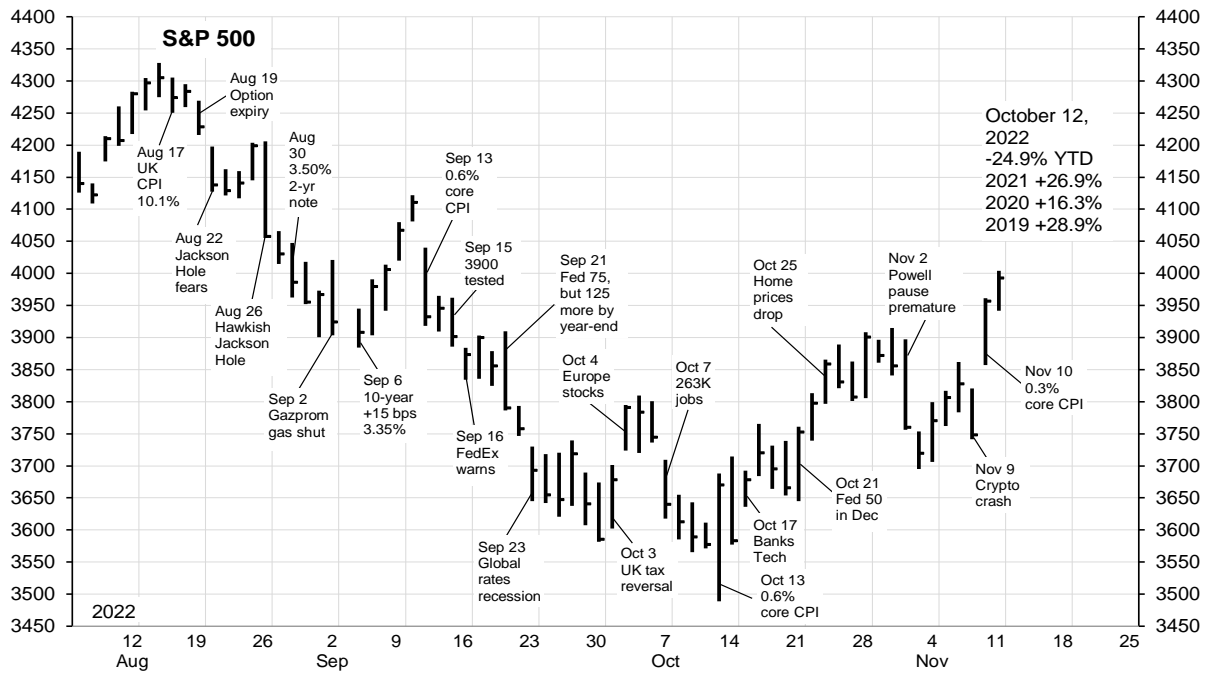
U.S. government securities purchases in the first half of 2020 a staggering total of \$1.9 trillion. Maybe, maybe that led to or at least matches up with the higher core CPI commodity prices the first time this cycle in the third quarter of 2020.

There's other goods that consumers purchase of course, some highly visible that lead consumers to think inflation overall is moving higher. Food at restaurants shows no sign of slowing, up 0.9% in October and 8.6% higher than last year. Gasoline prices at the pump are famous for igniting the public's inflation expectations and these rose 4.0% in October, up 17.5% the last year, even if it looks like prices came back down a little in November. The November CPI report is due out 830am ET on Tuesday, December 13 before Powell's December meeting press conference the next day at 2pm ET on Wednesday, December 14. Not sure how that is going to work for the Fed's quarterly forecasts on inflation, the economy, and the path of interest rates.

Sep 22	Weight	CPI inflation	Monthly Percent Changes			YOY %
			Aug 2022	Sep 2022	Oct 2022	Oct 2022
100.0	Total		0.1	0.4	0.4	7.7
13.705	Food		0.8	0.8	0.6	10.9
5.197	Food away from home		0.9	0.9	0.9	8.6
8.010	Energy		-5.0	-2.1	1.8	17.6
78.285	Ex-food & energy		0.6	0.6	0.3	6.3
4.056	New vehicles		0.8	0.7	0.4	8.4
3.830	Used cars/trucks		-0.1	-1.1	-2.4	2.0
2.482	Clothing		0.2	-0.3	-0.7	4.1
1.474	Medical care goods		0.2	-0.1	0.0	3.1
32.622	Shelter		0.7	0.7	0.8	6.9
23.977	Owner equiv. rent		0.7	0.8	0.6	6.9
5.946	Transportation		0.5	1.9	0.8	15.2
6.894	Medical care services		0.8	1.0	-0.6	5.4
Special: Where inflation might come back down to						
57.110	Services ex-energy		0.6	0.8	0.5	6.7
21.175	Commodities (core)		0.5	0.0	-0.4	5.1

To conclude, consumer demand has slowed to 1 to 2 percent every quarter in 2022, and maybe this will restrain the upward climb in consumer inflation. The market is hopeful the Fed has won an important battle in its war on inflation with core CPI inflation slowing to just 0.3% in October. Inflation slowing without a rise in unemployment past 3.7% so far would be a central banker soft-landing dream. The biggest drop in core commodity CPI prices since 2019 was 0.6% in April 2020 when payroll jobs fell 20.493 million just for the month of April and the unemployment rate, properly surveyed with the right responses to BLS questions, was "almost 20%," so we hope the Fed doesn't have to wreck aggregate demand in the economy with job losses to this degree to get core CPI commodity prices to fall.

INTEREST RATES



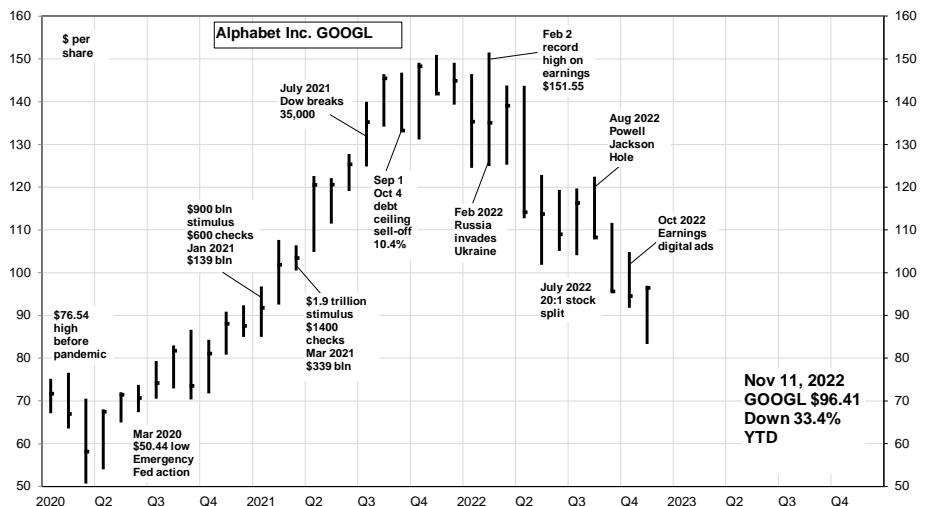
Lots of news this week, and the stock market kept climbing higher. Stocks rallied Monday and Tuesday ahead of the midterm election results, something to do with a red wave that would limit Democrats from doing additional Federal government spending maybe. The crypto crash brought stocks down with Bitcoin down to \$15,682 on our screen after being over \$68,000 in late 2021. CPI inflation on Thursday was tamer than expected, but the one-day market response still seems over-the-top. S&P 500 rallied 5.5% and 10-yields plummeted 28 bps to 3.82%. Stocks kept going on Friday while bonds were closed for Veterans Day. On Friday, the S&P 500 closed down 17.1% from the high of the year versus the worst day in 2022 after last month's CPI report with the S&P 500 down 27.5% for the year. No recession with October retail sales up 1% on Wednesday, November 16. Car/SUV sales up big.

Alphabet, Inc. GOOGL: advertising leading economic indicator, first expense cut

Alphabet fell 9.1% to \$94.93 on Wednesday, October 26 after the earnings call Tuesday evening. Stockholders are rejoicing with the 0.3% core CPI this week lifting share prices back from \$87.32 Wednesday to \$93.94 Thursday. The pullback in digital search ads seems tied to the housing recession (mortgage, insurance) and crypto. Search ads were \$39.5 billion vs year ago \$37.9 billion.

Calendar
Year

Mln \$	Revenue	Advertising	Cloud
Q3 2022	69,092	54,482	6,868
Q2 2022	69,685	56,288	6,276
Q1 2022	68,011	54,661	5,821
Q4 2021	75,325	61,239	5,541
Q3 2021	65,118	53,130	4,990



FEDERAL RESERVE POLICY

The Fed meets December 13-14, 2022 to consider its monetary policy. The huge stock and bond market rally on the peak inflation CPI report on Thursday brought Fed funds futures odds down to a 50 bps hike (4.52%) from a 4.585% adjusted yield close on Wednesday night. The market was already thinking no on a 75 bps rate hike to 4.75%.

We had some Fed speakers after CPI this week. Friday as well when the bond market was closed for Veterans Day, but stocks traded on. The Fed officials didn't stick their necks out very far on what the CPI moderation meant. Maybe noticing that the October monthly changes in core CPI and CPI services ex-energy were the same slower pace as in July. Still, 0.3 is 0.3 if it sticks. $0.3 \times 12 = 3.6\%$, where the September Fed forecast has core PCE inflation back down to 3.1% at the end of 2023.

On Friday, Boston Fed President Collins, who just took office in July coming over from the University of Michigan, said she saw a need for the Fed funds rate to go higher next year than she thought at the time the September forecasts were made. Fed funds futures don't go even 25 bps higher than 5.0% right now, so it is unclear how high she is thinking. The median forecast for the Fed funds rate at the end of 2023 is 4.75%, but seven votes are 4.5% or less, six votes are for 4.75%, and six votes for 5.0%. It looks like Powell would like to see the Fed funds rate at least 200 bps higher than next year's forecast of core PCE inflation of 3.1%.

Cleveland Fed President Mester Thursday said it was a positive sign that the three-month changes in core CPI slowed to 1.4% in October from a recent high of 1.9% in June, but both numbers remain high. If you don't like your inflation with three-month changes, [Kansas City Fed President George](#) (retiring January 2023) put out a new one on Thursday after CPI. Some have argued she said that policy is not restrictive until there is a positive real interest rate and she used the measure of inflation as the Michigan consumer survey that expects inflation to run about 5 percent over the next year. That would be a ways to go. The day after she spoke the median year-ahead inflation rate moved up to 5.1% in November from 5.0% in the University of Michigan survey. Rates are still going up even if at a reduced 50 bps pace.

Selected Fed assets and liabilities						Change from 3/11/20 to Nov 9
Fed H.4.1 statistical release billions, Wednesday data	9-Nov	2-Nov	26-Oct	19-Oct	3/11/20*	3/11/20 to Nov 9
Factors adding reserves						
U.S. Treasury securities	5575.232	5574.965	5608.738	5611.953	2523.031	3052.201
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2678.524	2678.523	2678.519	2698.651	1371.846	1306.678
Repurchase agreements	0.001	0.001	0.001	0.010	242.375	-242.374
Primary credit (Discount Window)	3.734	4.407	5.585	5.139	0.011	3.723
Paycheck Protection Facility	12.859	13.028	13.408	13.546		
Main Street Lending Program	25.659	25.637	25.225	25.203		
Municipal Liquidity Facility	5.576	5.574	5.572	5.570		
Term Asset-Backed Facility (TALF II)	2.105	2.103	2.140	2.138		
Central bank liquidity swaps	0.195	0.203	11.302	6.482	0.058	0.137
Federal Reserve Total Assets	8728.8	8726.8	8772.6	8793.8	4360.0	4368.776
3-month Libor %	3.78	3.05	3.03	3.04	1.15	2.630
Factors draining reserves						
Currency in circulation	2292.260	2286.678	2284.547	2284.270	1818.957	473.303
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	517.340	552.089	636.327	640.613	372.337	145.003
Treasury credit facilities contribution	17.940	17.940	17.940	17.940		
Reverse repurchases w/others	2237.812	2229.861	2186.856	2241.835	1.325	2236.487
Federal Reserve Liabilities	5657.572	5679.803	5664.483	5753.066	2580.036	3077.536
Reserve Balances (Net Liquidity)	3071.230	3046.975	3108.146	3040.777	1779.990	1291.240
Treasuries within 15 days	109.880	130.653	87.888	91.037	21.427	88.453
Treasuries 16 to 90 days	301.375	287.151	323.110	323.378	221.961	79.414
Treasuries 91 days to 1 year	789.366	782.805	784.922	784.695	378.403	410.963
Treasuries over 1-yr to 5 years	1939.222	1939.130	1966.052	1966.054	915.101	1024.121
Treasuries over 5-yr to 10 years	980.441	980.346	991.947	991.959	327.906	652.535
Treasuries over 10-years	1454.949	1454.880	1454.819	1454.830	658.232	796.717
Note: QT starts June 1	Change	9-Nov	1-Jun			
U.S. Treasury securities	-195.547	5575.232	5770.779			
Mortgage-backed securities (MBS)	-28.922	2678.524	2707.446			

*March 11, 2020 start of coronavirus lockdown of country

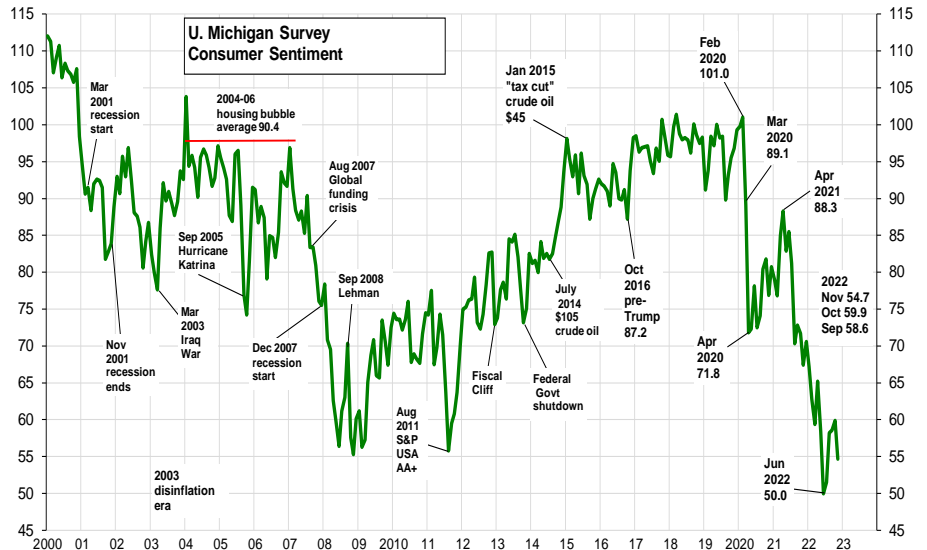
Fed funds futures call Fed hikes	
Current target: Nov 11 -- 4.0%	
Rate+0.17 Contract	Fed decision dates
4.52 Jan 2023	Dec 14
4.845 Feb 2023	Dec 14, Feb 1
5.005 Apr 2023	Dec 14, Feb 1, Mar 22

Next up: October PCE inflation report Thursday, December 1																			
Monthly % Changes	2022										2021								
	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr
Core CPI inflation	0.3	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	0.5	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		0.5	0.5	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		0.5	0.5	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
Core PCE YOY		5.1	4.9	4.7	5.0	4.9	5.0	5.4	5.4	5.2	5.0	4.8	4.3	3.9	3.9	3.9	3.8	3.5	3.1
Core CPI YOY		6.3	6.6	6.3	5.9	5.9	6.0	6.2	6.5	6.4	6.0	5.5	4.9	4.6	4.0	4.0	4.3	4.5	3.8

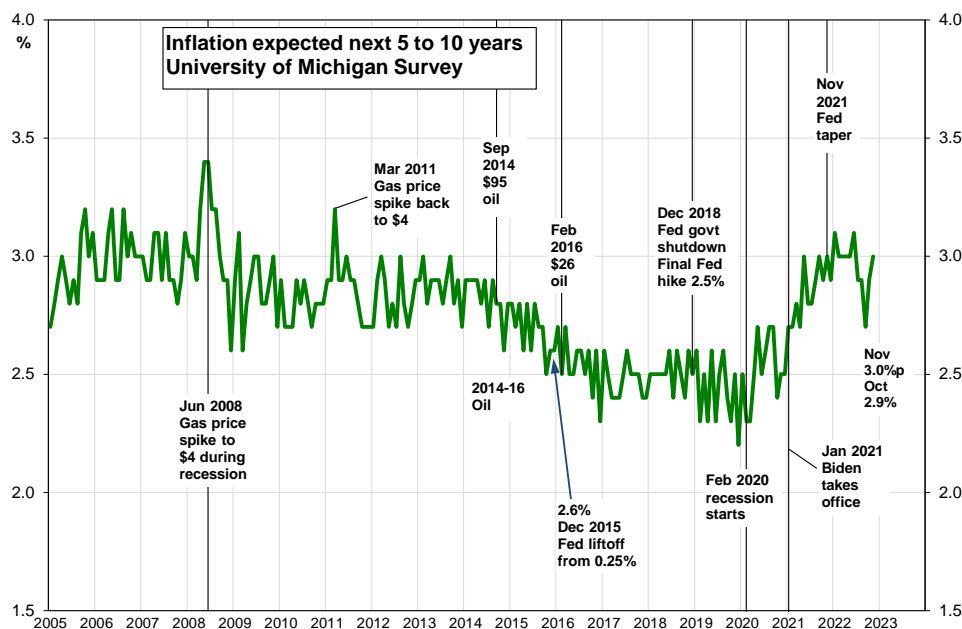
OTHER ECONOMIC NEWS

Michigan survey of consumer sentiment (Friday)

Breaking economy news. The Michigan University survey of the consumer was released at 10am ET on Friday, shortly after the news that crypto firm FTX was starting Chapter 11 bankruptcy. Consumer sentiment fell to 54.7 in November from 59.9 in October. The low for 2022 was 50.0 in June. This indicator of consumer confidence is thought to react to the trend in the stock market, but lately it is all about inflation. Consumer spending has slowed with the collapse of consumer sentiment this year, but it was still positive at 1.4% in the third quarter, and likely to pick up to 3% in the fourth quarter on momentum and a jump in car and SUV sales in October.



Powell has said the Fed is watching inflation expectations closely. Long-term expected inflation for the period five to ten years from now rose back to 3.0% in November. The University of Michigan noted in the writeup that although it is elevated, long-term expectations have stayed in a narrow 2.9 to 3.1 percent range for 15 of the last 16 months. Expected inflation next year moved up to 5.1% in October from 5.0% in September. It was higher at 5.4% in March and April.



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