Financial Markets This Week

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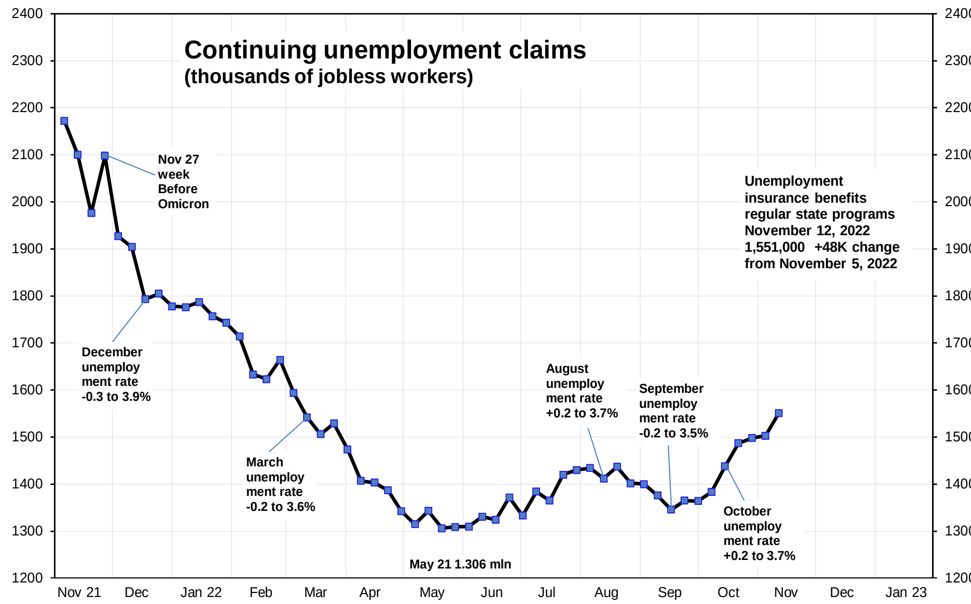
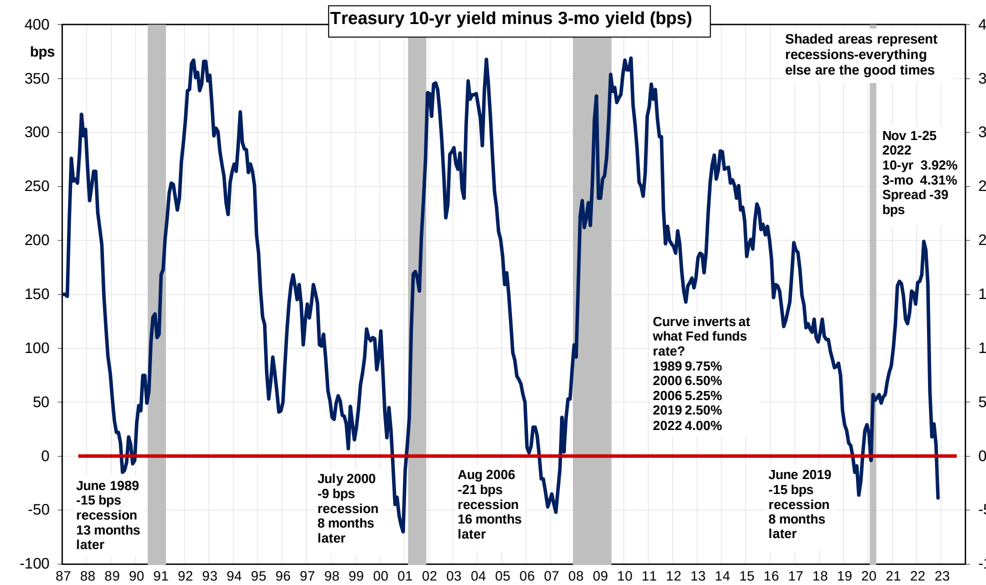
ECONOMY SKATES CLOSER TO RECESSION

Monthly payroll jobs are still increasing each month, but the more timely economic indicators, the weekly jobless claims data, are signaling conditions in the labor market are starting to deteriorate to the point of recession. Continuing unemployment claims, the total number of jobless Americans receiving unemployment benefits, jumped 48K to 1.551 million in the November 12 week. November 12 is the survey week for the employment report due out on Friday, December 2, so it is possible with continuing claims moving up from a month ago that the unemployment rate in November could tick up another 0.2 percentage points to 3.9%. Every time unemployment rises 0.5 percentage point from the low for the economic cycle, in this case 3.5%, then the economy has always gone into recession. There have been some widely reported layoffs at tech firms, but keep in mind, the losses are more than that, as seasonally adjusted first time applications for jobless claims were 240 thousand just in one week: November 19.

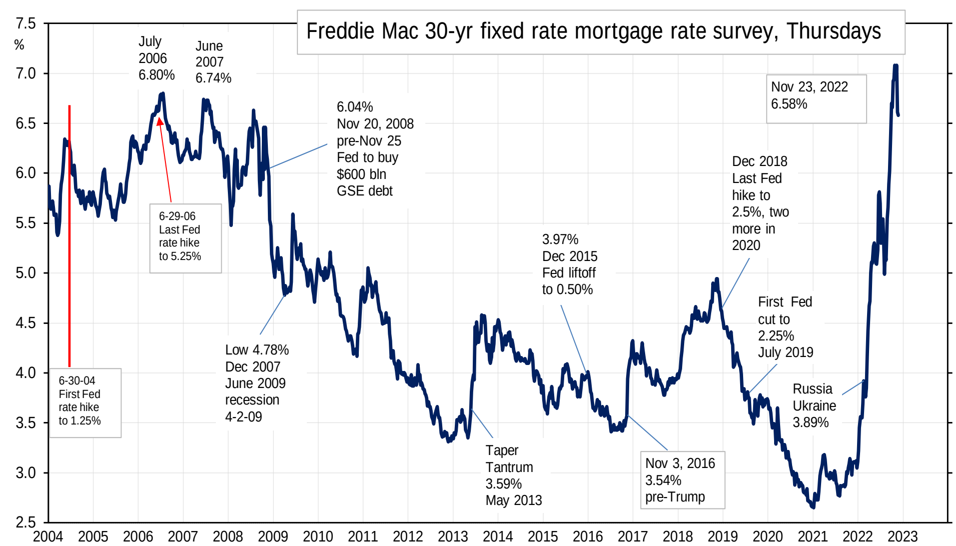


You don't have to tell the Treasury market recession is coming if we still care what the bond market thinks or if indeed it is capable of thinking. It is unclear what Fed officials would actually do, but some FOMC participants have said they would continue to move rates up or at least not cut interest rates if there is a mild recession. Talk is cheap. We will see. Anyway the yield curve has inverted in the Treasury market flashing a warning that recession is near. The 10-yr Treasury to 3-month Treasury yield spread went negative on October 25 and stayed negative ahead of the Fed's last 75 bps rate hike to 4.0% on November 2, so the first month of curve inversion will be November; from November 1-25 10-yr yields averaged 3.92%, the 3-month yield averaged 4.31% and the spread negative 39 bps. This yield curve has a perfect record forecasting recession looking back to the 1990-91 recession. A perfect track record is only good until it fails the first time, so it is important to gauge whether the curve inversion makes sense. How tight is tight when it comes to monetary policy: so in the graph here we put where the Fed funds rate was when the curve inverted. 4.0% for the Fed target rate seems restrictive based on the last couple of decades although it is not above the rate of consumer inflation so the cost of money is still free. The other thing to keep in mind is how luck factors into the curve inversion recession calls. The 3-month-10-year Treasury curve inverted in June 1989, 13 months ahead of the July 1990-June 1991 recession. There always seems to be an external shock that produces a recession, it is not just that credit conditions are tight and companies cannot borrow cheaply when the curve inverts. The shock in August 1990, the first month the economy turned down in the nine month 1990-91 recession, was Iraq invading Kuwait which sent crude oil prices surging.

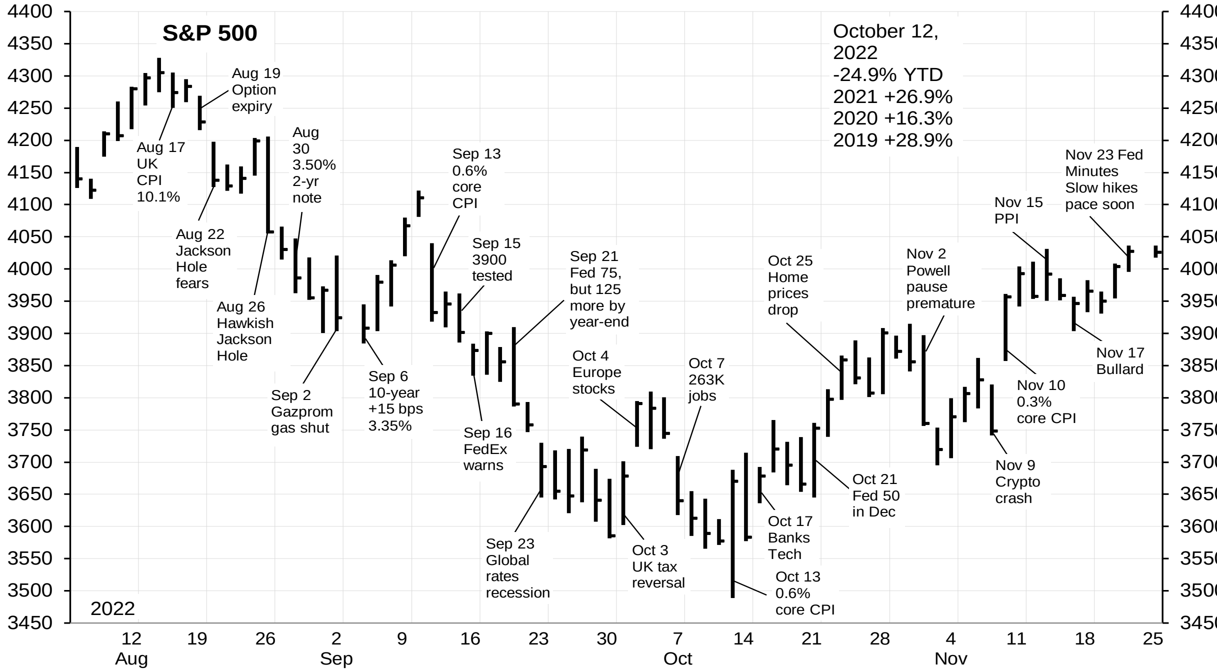


The recession signal before this month's had the 3-mo/10-yr curve inverting June 2019 when the bond market saw recession coming, too far in advance we would add, and while there was a recession eight months later, technically credit conditions were not tight, and the recession was caused by the pandemic sending people to their homes in isolation, shutting the economy down. Credit conditions weren't especially tight with the Fed funds rate peaking at 2.5% only in December 2018, and in fact novice Fed Chair Powell actually cut rates three times (in 2019: July 31, September 18, October 30) ahead of the surprise 2020 pandemic recession as the bond market chased the Fed away from their plans to push the Fed funds rate to 3.5%.

To conclude, the yield curve has inverted in November 2022 which looking back to the 90s means a recession is anywhere from 8 months to 16 months away. You have some time to get your affairs in order. The Fed has lifted the Fed funds rate to 4.0% which is still below headline, year-on-year consumer inflation of 8.2% for CPI or 6.2% PCE, so money is free if you can get the 4% rate. Mortgage borrowers certainly cannot get 4%, and soaring mortgage rates in the chart here looks like recession is certainly coming. Homeowners are wondering why they are part of the Fed's inflation battle and more confirmation is coming next week that home prices have fallen three consecutive months.



INTEREST RATES



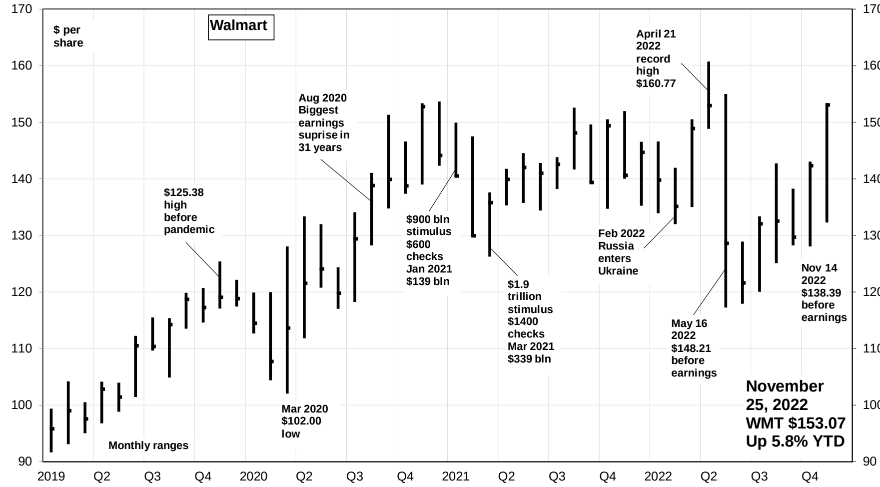
Stocks closed Thursday for Thanksgiving and an early 1pm ET close Friday. Not a lot of oomph, but the S&P 500 keeps moving up, gravitating like a moth to the flame toward the fabled 200-day moving average just inches away. Markets, stocks and bonds, seemed to like hearing yet again the Fed would slow its pace of rate hikes (to 50 bps) soon; that was in the Wednesday release of the November 1-2 Fed meeting minutes. 50 bps would put the Fed funds rate at 4.5% on the Fed's next December 14 decision date which is far above Friday's 3.69% 10-year Treasury yield close. Bond market must know what it is doing. Friday YTD closes: S&P 500 -15.5%, Dow industrials -5.5% only... maybe because the S&P 500 "tech" heavyweights in the index AMZN -44.0%, AAPL -16.6%, GOOGL -32.7%, MSFT -26.4%, and Tesla -48.1%. Next biggest weights Berkshire Hathaway +6.3%, UnitedHealth +7.1%.

Walmart (WMT) up 5.8% YTD

You're in the wrong stocks. The S&P 500 is down 15.5% YTD, but Walmart is up 5.8% this year. The May 17 earnings report has been forgotten when the stock collapsed 17.4% over two days from the close of May 16 the night before earnings. The stock jumped 6.5% on November 15 after earnings that morning. Earnings beat analyst expectations, but earnings are down, and Walmart isn't looking for a strong holiday quarter for sales. It's a good thing it isn't a tech company.

Bln $	Revenue	Operating Income	Same-store Sales YOY	13-weeks ending *
Q1 2020	134.6	5.2	10.3%	5/1/2020
Q2 2020	137.7	6.1	9.9%	7/31/2020
Q3 2020	134.7	5.8	7.1%	10/30/2020
Q4 2020	152.1	5.5	8.9%	1/29/2021
Q1 2021	138.3	6.9	6.2%	4/30/2021
Q2 2021	141.0	7.4	5.5%	7/30/2021
Q3 2021	140.5	5.8	9.9%	10/29/2021
Q4 2021	152.9	5.9	6.3%	1/29/2022
Q1 2022	141.6	5.3	4.0%	4/29/2022
Q2 2022	152.9	6.9	7.0%	7/29/2022
Q3 2022	152.8	2.7	8.5%	10/28/2022

* US comparable sales, incl. Sam's Club, ex-fuel

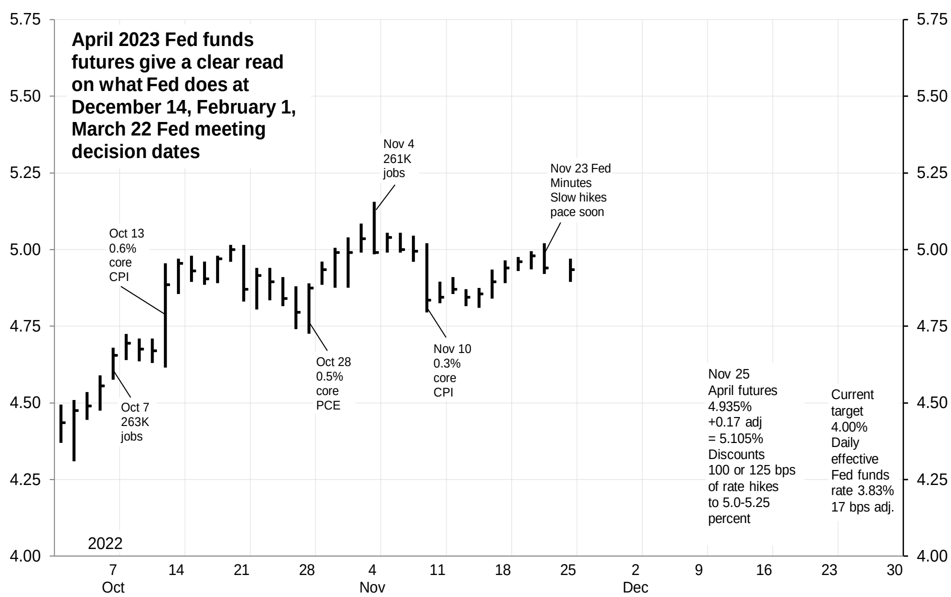


FEDERAL RESERVE POLICY

The Fed meets December 13-14, 2022 to consider its monetary policy. A 50 bps rate hike to 4.5%, a downshift, from the catch-up 75 bps pace at the June, July, September, November Fed meetings, is the call.

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	23-Nov	16-Nov	9-Nov	2-Nov	3/11/20*	3/11/20
Factors adding reserves						to Nov 23
U.S. Treasury securities	5535.323	5535.051	5575.232	5574.965	2523.031	3012.292
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2672.083	2676.881	2678.524	2678.523	1371.846	1300.237
Repurchase agreements	0.000	0.100	0.001	0.001	242.375	-242.375
Primary credit (Discount Window)	9.140	7.851	3.734	4.407	0.011	9.129
Paycheck Protection Facility	12.538	12.647	12.859	13.028		
Main Street Lending Program	22.775	25.191	25.659	25.637		
Municipal Liquidity Facility	5.557	5.579	5.576	5.574		
Term Asset-Backed Facility (TALF II)	1.995	2.106	2.105	2.103		
Central bank liquidity swaps	0.202	0.202	0.195	0.203	0.058	0.144
Federal Reserve Total Assets	8671.2	8675.6	8728.8	8726.8	4360.0	4311.185
~~3-month Libor %~~ SOFR %	3.79	3.81	3.78	3.05	1.15	2.640
Factors draining reserves						
Currency in circulation	2296.592	2293.437	2292.260	2286.678	1818.957	477.635
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	492.754	472.185	517.340	552.089	372.337	120.417
Treasury credit facilities contribution	15.347	17.940	17.940	17.940		
Reverse repurchases w/others	2069.174	2099.070	2237.812	2229.861	1.325	2067.849
Federal Reserve Liabilities	5502.362	5498.796	5657.572	5679.803	2580.036	2922.326
Reserve Balances (Net Liquidity)	3168.849	3176.796	3071.230	3046.975	1779.990	1388.859
Treasuries within 15 days	83.416	88.820	109.880	130.653	21.427	61.989
Treasuries 16 to 90 days	321.595	246.856	301.375	287.151	221.961	99.634
Treasuries 91 days to 1 year	754.177	823.500	789.366	782.805	378.403	375.774
Treasuries over 1-yr to 5 years	1956.645	1956.539	1939.222	1939.130	915.101	1041.544
Treasuries over 5-yrs to 10 years	957.046	944.689	980.441	980.346	327.906	629.140
Treasuries over 10-years	1462.446	1474.649	1454.949	1454.880	658.232	804.214
Note: QT starts June 1	Change	23-Nov	1-Jun			
U.S. Treasury securities	-235.456	5535.323	5770.779			
Mortgage-backed securities (MBS)	-35.363	2672.083	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

The Fed November meeting minutes 2pm ET Wednesday were somehow dovish saying once again that they would slow if that’s the word to just a 50 bps hike, something Fed funds futures have been saying for weeks now. “A number of participants judged that the risks regarding the outlook for economic activity were weighted to the downside, with various global headwinds being prominently cited.” There are 19 participants and no mention of how many “a number” are. The global headwinds risk for the American economy are China and Russia-Ukraine. Since the November 1-2 meeting, weekly jobless claims have picked up and this looks more to be domestic US economy risks. We will see if Powell rains on the stock market “Fed is near the end” rally when he speaks about the “Economic Outlook, Inflation, and the Labor Market” on Wednesday, November 30 at 130pm ET, the day before PCE inflation no less. He seems to want to communicate rates are going higher rather than talking about slowing to 50 bps from 75 bps. The September Fed forecasts showed a peak Fed funds rate of 4.75%, that was the median guess with 6 of 19 participants saying 5.0%. Nothing higher than 5.0% from Fed officials back then. Despite all the Fedspeak they needed to go higher recently, Fed funds futures are more or less split that the peak will be 5.0 or 5.25 percent.



Fed funds futures call Fed hikes	
Current target: Nov 25 -- 4.0%	
Rate+0.17 Contract	Fed decision dates
4.55 Jan 2023	Dec 14
4.92 Feb 2023	Dec 14, Feb 1
5.105 Apr 2023	Dec 14, Feb 1, Mar 22
5.14 Aug 2023	Dec, Feb, Mar, May, Jun, Jul Fed decision dates

Next up: October PCE inflation report Thursday, December 1

Monthly	2022									2022	2021								2021
% Changes	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	3.0

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