Financial Markets This Week

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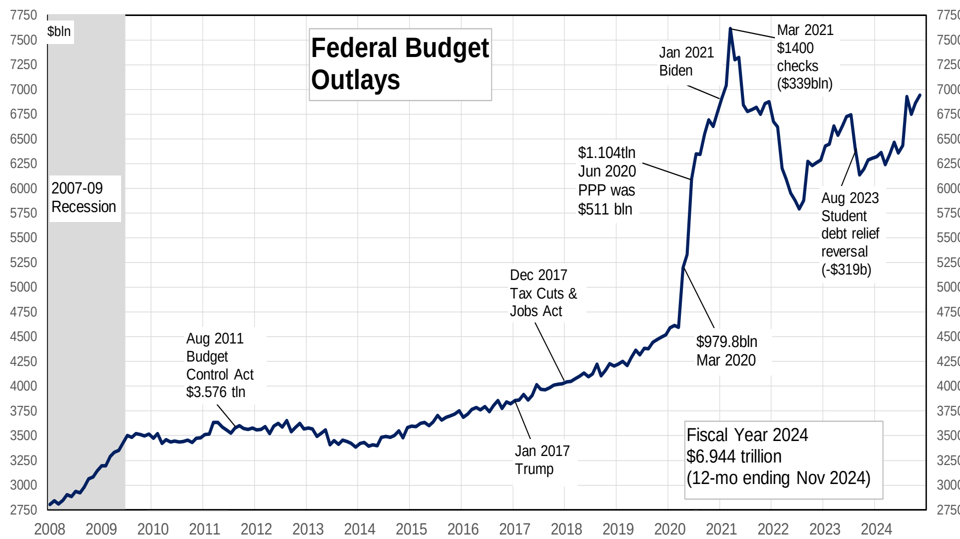
BUDGET MATTERS

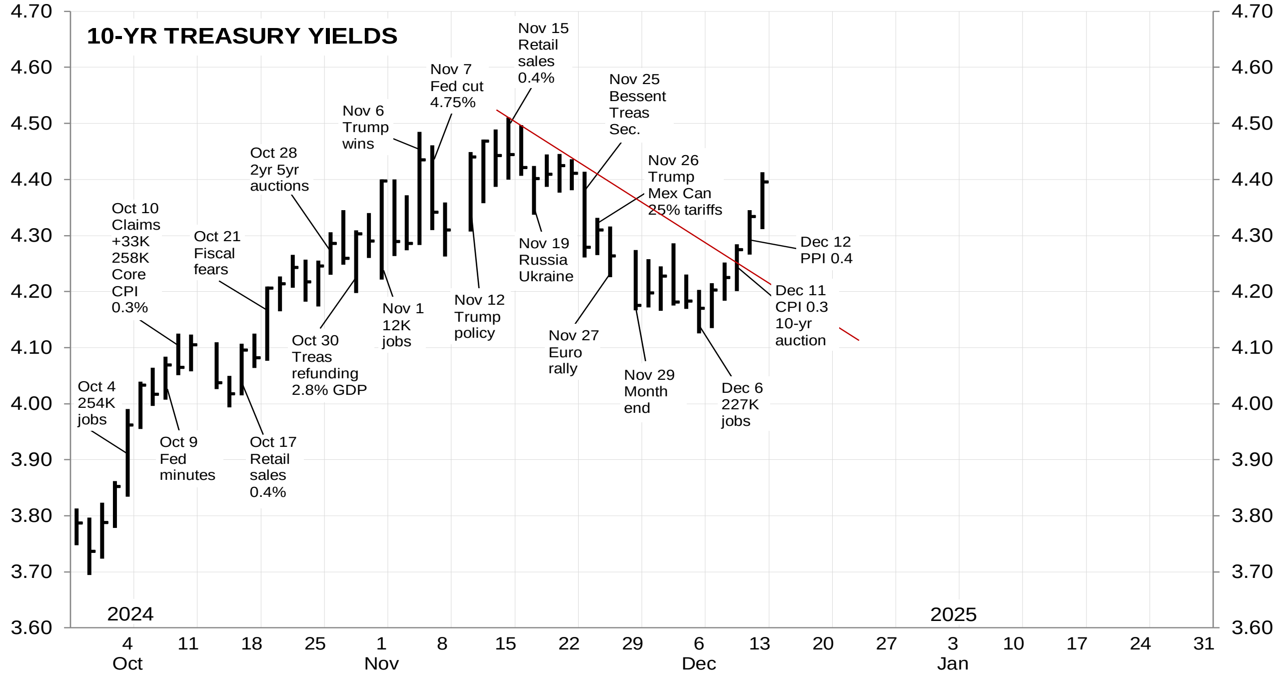
Fiscal year $bln	2024	% Total
Discretionary	1816	26.5
Nondefense	976	14.2
Defense	840	12.2
Mandatory	4147	60.4
Social Security	1454	21.2
Medicare	850	12.4
Medicaid	618	9.0
Other	1225	17.9
Net interest	899	13.1
Total Spending	6862	100.0

The Federal budget results for November released on Wednesday, a deficit of course. But the times they are a changin'. Maybe. Every President since George Washington wants to spend more for their constituents after coming into office with a mandate, but for many years now, if not decades, the newcomer, or in this case oldcomer, President coming into office, is constrained by reality: all of these guys, no women yet, should know better, if they had passed an 8th grade class in Social Studies, not even High School level. In Fiscal Year (FY) 2024 Total Federal government spending was $6.862 trillion, a big number, but just $976 billion was nondefense discretionary. That's what the President has to play with, $976 billion, assuming Congress votes through anything new that he wants to do. By the way, nondefense discretionary spending "to the penny" by the Federal government is hard to track in real-time, or in this case month-to-month. Anyway the actual total spending in FY2024 is close to the White House July 2024 Mid-Session Review baseline estimate from which the numbers in the table here are taken.



Federal government spending was $6.75 trillion in FY2024, and is running $6.94 trillion in November 2024 as a 12-month trailing sum, although November was more than November 2023 because December 1 fell on Sunday, so some payments were made early. The Federal agencies must be looking forward to the budget cutters coming into office. Not for anything but the Congressional Budget Office (CBO) has long given Congress a list of options to take if they wanted to reduce the "too-much government spending." Here are the options, not recommendations, for nondefense discretionary spending. If this is the only spending that can be cut by definition, it does not look like any budget cuts to these programs are easily doable, reading the Background section list of nondefense discretionary spending for programs like those for early childhood, scientific research, law enforcement programs, housing assistance. Stay tuned. Not much spending to cut that isn't mandatory, and discretionary spending cuts look difficult as well. Just keep the deficit under FY2024's $1.8 trillion is our recommendation; keeps national debt to GDP ratio steady and manageable, meaning financeable.

INTEREST RATES

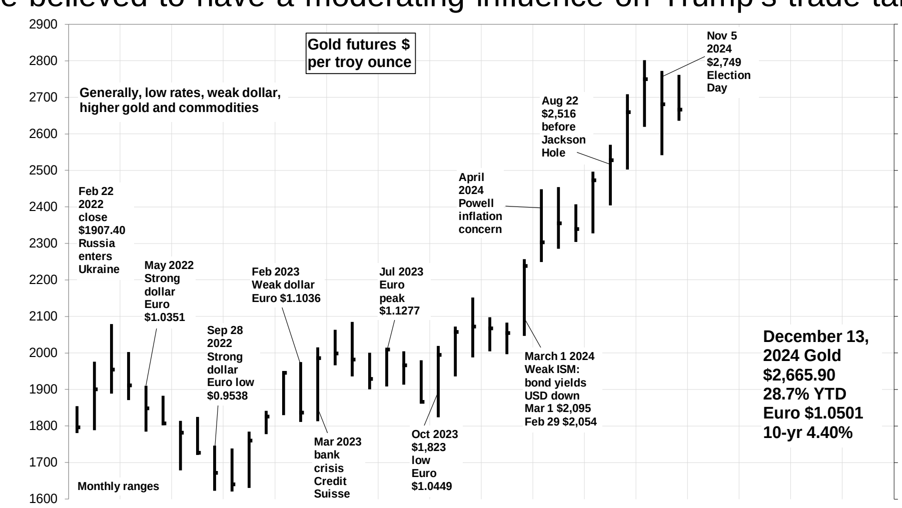


A big jump in 10-yr yields this week of 23 bps to 4.40%. The bond rally from the 4.51% 10-yr yield high on November 15 is apparently over. There seems to be a sense of dread when it comes to the president-elect's pro-growth agenda and what additional fiscal stimulus means for the interest rate outlook. The Fed is expected to cut rates fewer times next year when the forecasts come out at 2pm Wednesday, December 18; another 25 bps rate cut to 4.5% is discounted. There were Treasury auctions this week helping to push yields higher Tuesday, Wednesday, Thursday, 3-year, 10-year, 30-year securities, respectively. A reminder of more auctions to come, especially if the FY25 Federal deficit cannot even be held at the $1.8 trillion FY24 deficit. The stock market rallied on the 0.3% core CPI report Wednesday, for some reason, but could not break 6,100 for the S&P 500 again this week.

Gold futures up 28.7% YTD; S&P 500 up 26.9% YTD

Gold peaked a dollar or two above $2,800 at the end of October. Gold was $2,749 on Tuesday, November 5 Election Day. The two biggest one-day sell-offs were (1) -$73.40 or -2.7% to $2,676 the day after the Election as the dollar rallied. And (2) the price of gold also fell sharply on Monday, November 25 -$93.70 or -3.5% to $2,618 on an Israel-Hezbollah ceasefire and the naming of Bessent as Treasury Secretary, a candidate believed to have a moderating influence on Trump's trade tariff views.

S&P 500 Weights	
Top 6: 33% of S&P	
7.30	AAPL
6.60	NVIDIA
6.50	MSFT
4.20	AMZN
2.90	Meta
2.30	Tesla
2.20	GOOGL
1.80	GOOG
33.80	Top 6



FEDERAL RESERVE POLICY

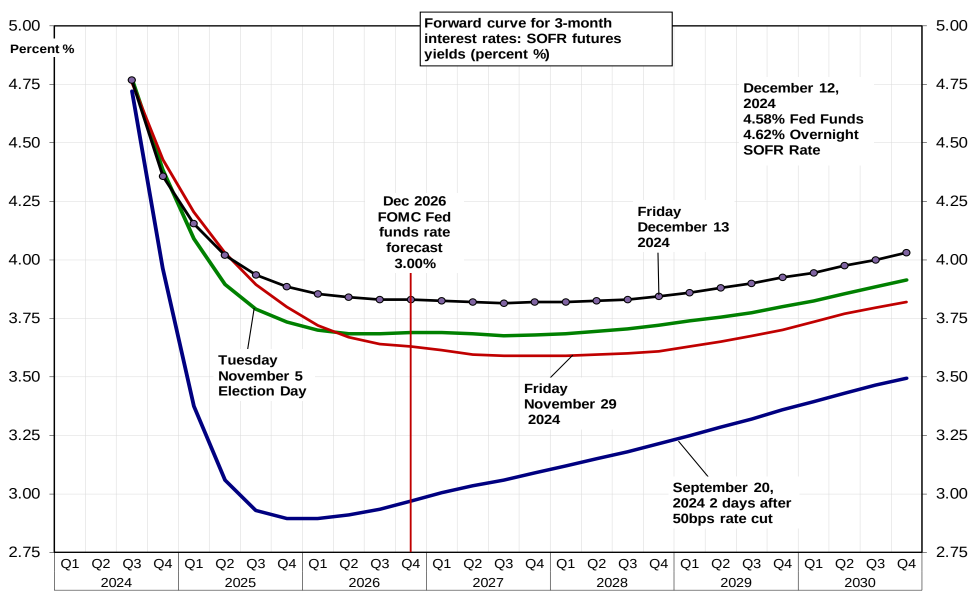
The Fed meets December 17-18, 2024 to consider its monetary policy. We would cut rates 25 bps more to 4.5%, basically because the market is discounting it. Rates were pushed to 5.5% in July 2023, a bank crisis in March 2023, and a growth scare after the August 2, 2024 employment report, and the two-tenths jump in unemployment to the 4.3% recession-signal level, but the economy did not tank with rates of 5.5%, so it is unclear with dropping rates 100 bps to 4.5% will do. In other words, the idea that rates had to be brought back down asap after the inflation peak, so that "higher" rates would not slow the economy down or tip it over, that idea or real rates theory does not seem to be workable. There is nothing to tell policymakers whether to set rates at 4.5, or 4.0, or 3.5, or 3.0 percent. Partly because this has not really been done before: the Fed lowering rates in peacetime or when there is no recession. Economist Greenspan saw some risks in the labor market and backed rates down in three steps from 6.0 to 5.25 percent in 1995-96 the so-called near-recession miss. Noneconomist Powell backed down rates in three steps from 2.5 to 1.75 percent in 2019 possibly because the president-elect yelled at him, although there was a trade war. Stay tuned to see where the Fed says rates go next.

Selected Fed assets and liabilities

Fed H.4.1 statistical release billions, Wednesday data	11-Dec	4-Dec	27-Nov	20-Nov	3/11/20*	Change from 3/11/20 to Dec 11
Factors adding reserves						
U.S. Treasury securities	4315.665	4315.545	4323.134	4322.938	2523.031	1792.634
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2248.982	2248.982	2248.982	2262.279	1371.846	877.136
Repurchase agreements	0.007	0.007	0.000	0.011	242.375	-242.368
Primary credit (Discount Window)	2.607	2.430	2.498	2.747	0.011	2.596
Bank Term Funding Program	15.603	17.147	18.509	21.423		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	1.988	1.992	2.009	2.014		
Main Street Lending Program	8.479	8.468	8.457	9.945		
Municipal Liquidity Facility	0.000	0.000	0.000	0.000		
Term Asset-Backed Facility (TALF II)	0.000	0.000	0.000	0.000		
Central bank liquidity swaps	0.097	0.101	0.128	0.132	0.058	0.039
Federal Reserve Total Assets	6948.7	6946.5	6955.5	6974.9	4360.0	2588.635
~~3-month Libor %~~ SOFR %	4.62	4.59	4.57	4.56	1.15	3.470
Factors draining reserves						
Currency in circulation	2359.411	2363.572	2362.860	2358.202	1818.957	540.454
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	711.354	815.011	782.704	737.834	372.337	339.017
Treasury credit facilities contribution	3.461	3.461	3.461	4.958		
Reverse repurchases w/others	180.120	162.866	169.815	217.793	1.325	178.795
Federal Reserve Liabilities	3674.856	3730.388	3721.477	3707.587	2580.036	1094.820
Reserve Balances (Net Liquidity)	3273.805	3216.149	3234.035	3267.319	1779.990	1493.815
Treasuries within 15 days	16.383	14.153	40.733	49.439	21.427	-5.044
Treasuries 16 to 90 days	277.832	280.053	244.124	232.067	221.961	55.871
Treasuries 91 days to 1 year	450.379	450.372	455.496	458.822	378.403	71.976
Treasuries over 1-yr to 5 years	1487.151	1487.098	1499.246	1499.158	915.101	572.050
Treasuries over 5-yrs to 10 years	548.237	548.221	549.009	548.983	327.906	220.331
Treasuries over 10-years	1535.683	1535.648	1534.525	1534.468	658.232	877.451
Note: QT starts June 1, 2022	Change	12/11/2024	6/1/2022			
U.S. Treasury securities	-1455.114	4315.665	5770.779			
Mortgage-backed securities (MBS)	-458.464	2248.982	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

Fed Policy-key variables	2024	2025	2026	2027	Long Term
Fed funds	4.4	3.4	2.9	2.9	2.9
PCE inflation	2.3	2.1	2.0	2.0	2.0
Core inflation	2.6	2.2	2.0	2.0	
Unemployed	4.4	4.4	4.3	4.2	4.2
GDP	2.0	2.0	2.0	2.0	1.8

September 2024 median Fed forecasts



All but 1 bps of a 25 bps rate cut is forecast in December. All but 8 bps of a 25 bps rate cut to 4.25% is forecast in March 2025. Nothing in January.

Fed funds futures call Fed policy

Current target: December 13 -- 4.75%

Rate+0.17	Contract	Fed decision dates
4.510	Jan 2025	Dec 18*
4.465	Feb 2025	Adds Jan 29
4.330	Apr 2025	Adds Mar 19

Last trade, not settlement price

* Not strictly true, Jan 2025 has Jan 29 Fed date, so 2 days could be a new interest rate

Next up: November PCE inflation report Friday, December 20

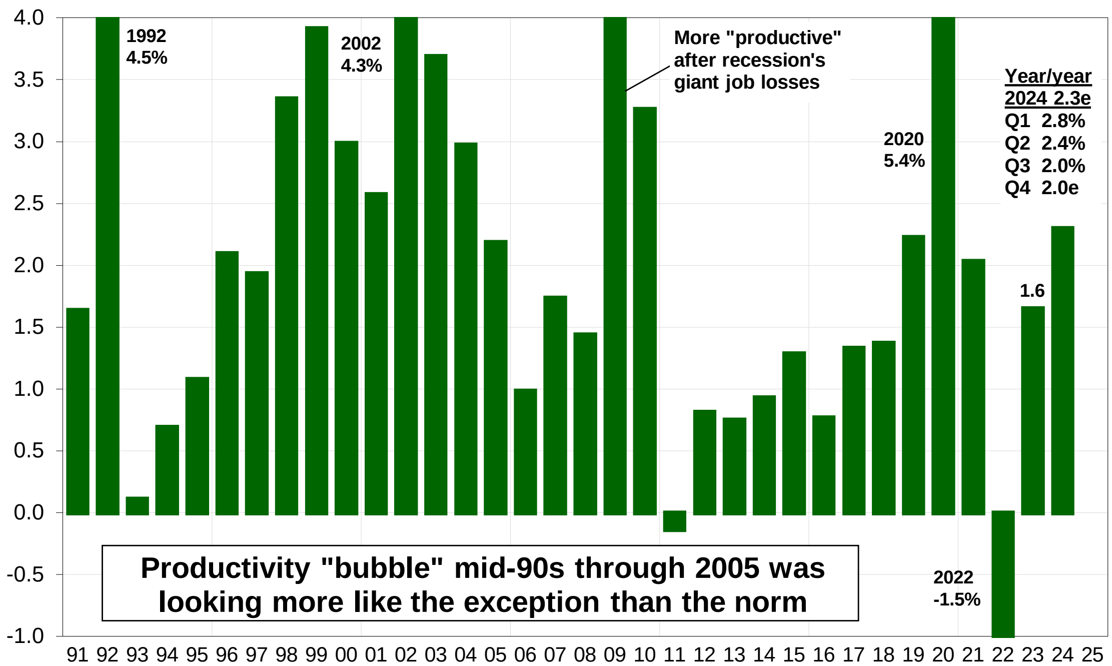
Monthly % Changes	2024 Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	2024 Jan	2023 Dec	Nov	Oct	2023 Sep
Core CPI inflation	0.3	0.3	0.3	0.3	0.2	0.1	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.2	0.3
Core PCE inflation		0.3	0.3	0.2	0.2	0.2	0.1	0.3	0.3	0.2	0.5	0.2	0.1	0.1	0.3
Core PCE YOY		2.8	2.7	2.7	2.7	2.6	2.7	2.9	3.0	2.9	3.1	3.0	3.2	3.4	3.7
Core CPI YOY	3.3	3.3	3.3	3.2	3.2	3.3	3.4	3.6	3.8	3.8	3.9	3.9	4.0	4.0	4.1

OTHER ECONOMIC NEWS

Productivity trend argues for higher neutral rates (Tuesday)

Breaking economy news. Nonfarm business productivity rose 2.0% in Q3 2024 from prior year levels in today's revised report. The positive productivity trend continues for a second year after increasing 2.7% year-on-year in Q4 2023 (1.6% full year 2023 versus 2022 in graph here). Wages are up but businesses can generally afford to pay their workers more because they are more productive. Hourly compensation or wages are volatile quarter to quarter and Q3 2024 is up 3.1% at a seasonally adjusted annual rate. The productivity trend argues for higher neutral rates.

Net, net, nonfarm business productivity continues to astound economists with solid gains near 2 percent for a second year in a row which calls into question just how restrictive the Federal Reserve's interest rate policy actually is. With productivity data like these in hand, the hawks at the Fed can argue that interest rates are closer to neutral than the committee previously believed. The stronger productivity trend probably does not stop the Fed from cutting rates again next week, but the number of rate cuts needed in 2025 remains an open question. Fewer than four rate cuts is our assumption for 2025 unless core consumer inflation moves down closer to 2% target.

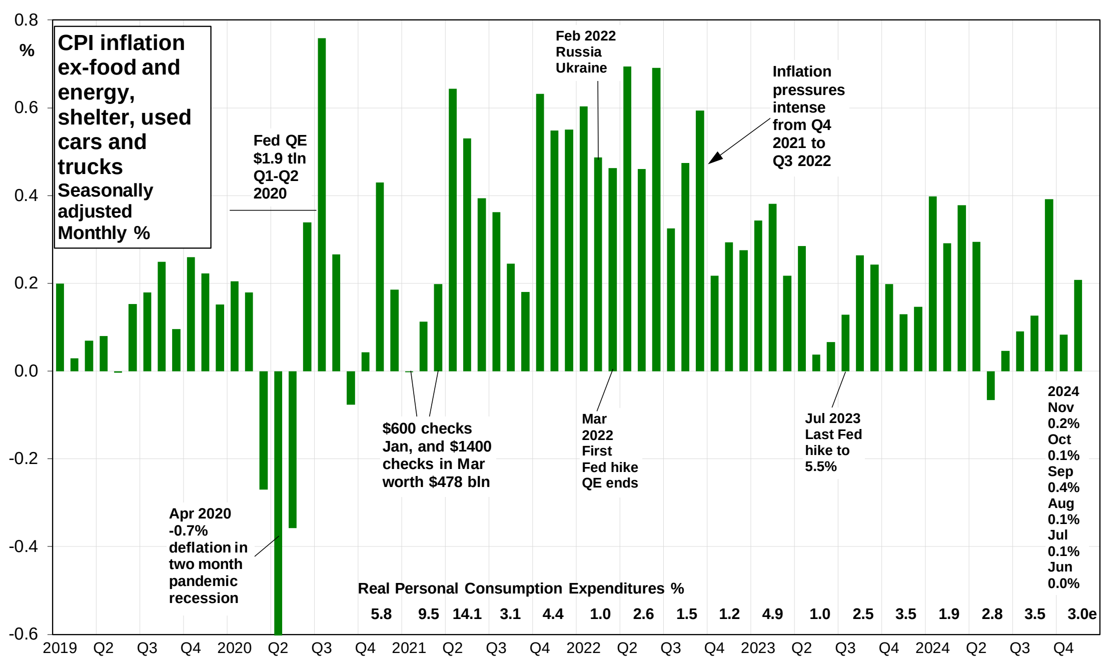


Core CPI inflation burning bright this holiday season (Wednesday)

Breaking economy news. Stock market went up immediately on the report. 0.3% core prices that Powell watches for inflation trends was the fourth straight month. Did not sound like good news that ushers in a final rate cut this year. But Fed funds futures now say 4.50% for Fed rates next week and were already at 4.53% on Tuesday before CPI. The extra core CPI favored by Greenspan originally and graphed here was 0.2% in this month and 0.1% in October, but it was held down by taking out the last two months of larger gains 2.7% in October, 2.0% in November for used cars/trucks.

Dec 23		Monthly Percent Changes			YOY %
Weight	CPI inflation	Sep 2024	Oct 2024	Nov 2024	Nov 2024
100.0	Total	0.2	0.2	0.2	2.7
13.555	Food	0.4	0.2	0.4	2.4
5.388	Food away from home	0.3	0.2	0.3	3.6
6.655	Energy	-4.0	-1.0	0.5	-8.5
79.790	Ex-food & energy	0.3	0.3	0.3	3.3
3.684	New vehicles	0.2	0.0	0.6	-0.7
2.012	Used cars/trucks	0.3	2.7	2.0	-3.4
2.512	Clothing	1.1	-1.5	0.2	1.1
1.489	Medical care goods	-0.7	-0.2	-0.1	0.4
36.191	Shelter	0.2	0.4	0.3	4.7
26.769	Owner equiv. rent	0.3	0.4	0.2	4.9
6.294	Transportation	1.4	0.4	0.0	7.1
6.515	Medical care services	0.7	0.4	0.4	3.7
	Special: Where inflation might come back down to				
60.899	Services ex-energy	0.4	0.3	0.3	4.6
18.891	Commodities (core)	0.2	0.0	0.3	-0.6

Net, net, the inflation needle looks stuck in a rut with more inflation not less as core consumer prices have risen 0.3% for four straight months. It is increasingly obvious that Fed officials cannot continue to say with confidence that they expect inflation pressures to moderate and for inflation to continue moving down lower to 2.0% target next year when inflation has not shown any directional movement towards a slowdown or cool down or whatever you want to call it for several months now. The million dollar question is why would Fed officials think they should cut rates again at this stage with a fourth month of solid 0.3% increases in core CPI and economic growth running close to 3.0% in this quarter. A rate cut at next week's meeting would be very difficult to explain to previous Fed Chairs, thinking of Greenspan, Bernanke and Yellen. Whatever are they doing placing another log on the fire to fuel growth when the inflation battle isn't won? Stay tuned. January Fed funds futures have barely budged on this latest CPI inflation report giving the Fed the go ahead next week with all but 3 bps of a 25 bps rate cut discounted, but should they stay or should they go? CPI inflation says no, no, no.

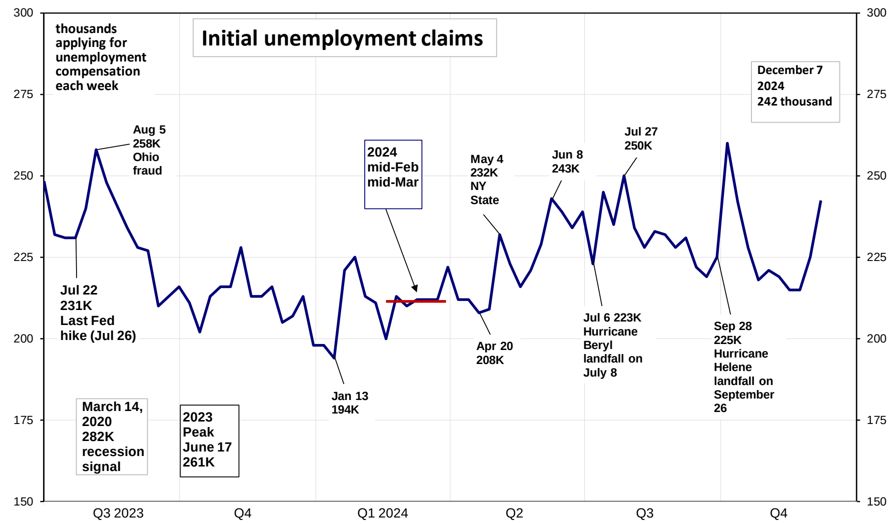


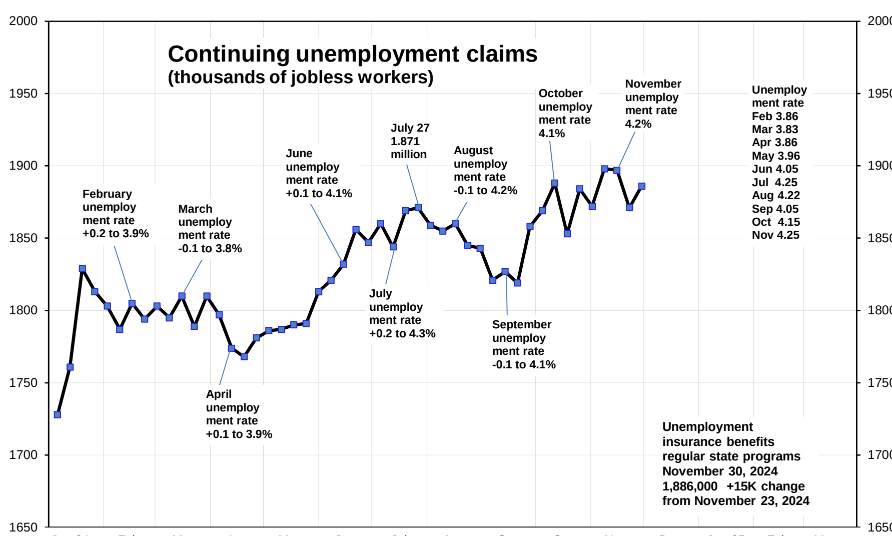
PPI and job layoffs up (Thursday)

Breaking economy news. Producer prices and weekly jobless claims. PPI for final demand rose 0.4% in November and is 3.0% higher than a year ago. The not seasonally adjusted change was 0.1%, and the seasonal factor may have boosted it too much. We prefer the old-fashioned goods PPI which is final demand goods less foods and energy and the monthly changes have run 0.2% for the last five months. Weekly jobless claims rose 17K to 242K in the December 7 week. It had been down at the "economy is fine" level of 215K just a couple of weeks ago. Too early to worry, start of winter layoffs that seasonal factors try to adjust for.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
PPI Final demand goods less foods/energy-- Monthly Percent Changes SA												
2023	0.6	0.3	0.2	0.1	0.1	-0.1	0.0	0.1	0.3	0.1	0.1	0.1
2024	0.3	0.3	0.0	0.3	0.2	0.1	0.2	0.2	0.2	0.2	0.2	
PPI Final demand goods less foods/energy-- Year/Year Percent Changes NSA												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2023	5.6	5.1	4.3	3.3	2.7	2.0	1.9	1.8	2.1	2.1	2.0	1.9
2024	1.6	1.6	1.4	1.6	1.7	1.9	2.1	2.2	2.0	2.2	2.2	

Net, net, factory prices are jumping even before the looming import tariffs jack up the costs of input prices to manufacturers' final products. Inflation is not dead but a Fed rate cut is almost completely discounted next week, and still on the way for reasons that are not completely understandable. Weekly job layoffs increased sharply this week so Fed officials can lean on a labor market that is showing signs of stress when they argue the need for another interest rate cut, but everyone and their brother knows that weekly layoffs jump at the start of winter which for jobless claims the kickoff is the December 7 week. Stay tuned. Inflation down at the producer prices level is starting to pick up again rising 3.0% the last year which is consistent with the stronger economy as real GDP is increasing an estimated 3% this quarter, no news here to stop the Fed rate cut next week as policymakers like most of the country favor an alternative reality where economic theory gets thrown out the window with traders not knowing right from wrong anymore and the markets have been taken over by people who think the coming tax cuts and import tariffs are going fire up the economy and bring about a great big beautiful tomorrow for everyone. The laws of economics have been repealed. Rejoice this holiday season and buy more stocks.





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