

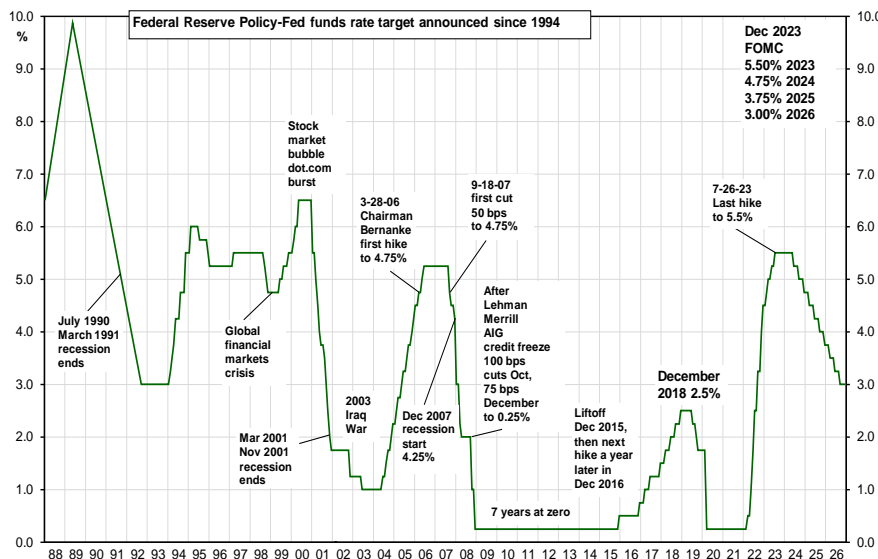
Financial Markets This Week

15 DECEMBER 2023

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RATES PEAK AT 5.5%

Rates are no longer higher for longer, they are going down 75 bps to 4.75% at the end of 2024, where at the September meeting they thought rates would be 5.25% at the end of 2024. Powell tried to say another rate hike is still possible if it looks like they aren't heading toward meeting their inflation goal, but there wasn't a single vote for a 5.75% Fed funds rate at the end of 2024, even if they don't vote on



these forecasts as Powell always reminds us. No one was listening in the bond market with a 10-yr yield of 4.20% Tuesday before the announcement heard round the world, falling 18 bps to 4.02% at Wednesday's close. 10-yr 4.02% and the Fed funds rate is 5.5%: no one expects another rate hike.

Comparing the September and December meeting forecasts, they shifted the rate cuts back into 2024 as they are making progress on inflation, and rates will still be 3.0% at the end of 2026. That 3% seems like a big mistake as there is a housing price bubble out there and neutral rates may be higher at 4%, or the 4.25% neutral rate the Fed thought when they did their first forecast under

Fed Individual Forecasts				
Fed funds rate at year-end				Longer
Votes	2024 End	2025 End	2026 End	run
1	3.875	2.375	2.375	2.375
2	4.375	2.875	2.375	2.375
3	4.375	3.125	2.375	2.375
4	4.375	3.125	2.500	2.500
5	4.375	3.375	2.625	2.500
6	4.625	3.375	2.625	2.500
7	4.625	3.375	2.625	2.500
8	4.625	3.375	2.625	2.500
9	4.625	3.375	2.875	2.500
10	4.625	3.625	2.875	2.500
11	4.625	3.625	2.875	2.500
12	4.875	3.625	2.875	2.625
13	4.875	3.875	3.125	2.750
14	4.875	3.875	3.125	2.875
15	4.875	3.875	3.125	3.000
16	4.875	3.875	3.125	3.500
17	5.125	4.125	3.375	3.500
18	5.375	4.375	3.625	3.750
19	5.375	5.375	4.875	
Median Meeting	Dec 23	Dec 23	Dec 23	Dec 23
Median	4.625	3.625	2.875	2.500

Fed Individual Forecasts					
Fed funds rate at year-end				Longer	
Votes	2023 End	2024 End	2025 End	2026 End	run
1	5.375	4.375	2.625	2.375	2.375
2	5.375	4.375	2.875	2.375	2.375
3	5.375	4.625	3.125	2.375	2.375
4	5.375	4.625	3.375	2.500	2.500
5	5.375	4.625	3.375	2.625	2.500
6	5.375	4.875	3.375	2.625	2.500
7	5.375	4.875	3.625	2.625	2.500
8	5.625	4.875	3.625	2.625	2.500
9	5.625	4.875	3.625	2.625	2.500
10	5.625	5.125	3.875	2.875	2.500
11	5.625	5.125	3.875	2.875	2.500
12	5.625	5.125	4.125	3.125	2.625
13	5.625	5.125	4.125	3.125	2.625
14	5.625	5.375	4.125	3.875	3.000
15	5.625	5.375	4.625	4.125	3.250
16	5.625	5.375	4.875	4.125	3.500
17	6.625	5.375	5.125	4.625	3.750
18	5.625	5.625	5.375	4.875	3.750
19	5.625	6.125	5.625	4.875	
Median Meeting	Sep 23	Sep 23	Sep 23	Sep 23	Sep 23
Median	5.625	5.125	3.875	2.875	2.500

Bernanke in 2012. Not sure we would welcome them taking down rates to 3.75% at the end of 2025 as they say in their forecasts that nobody votes on. [September forecast was 4.0% end of 2025.]

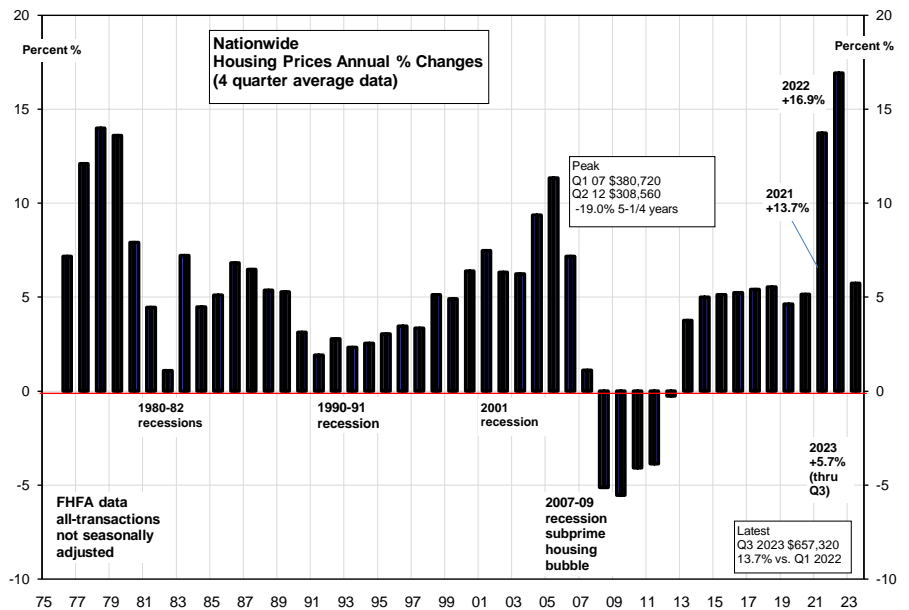
More progress on inflation is needed and Powell explained that core PCE inflation was running close

Next up: November PCE inflation report Friday, December 22

Monthly % Changes	2023										2022		2022		
	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep
Core CPI inflation	0.3	0.2	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
Core PCE inflation		0.2	0.3	0.1	0.2	0.2	0.3	0.3	0.3	0.4	0.5	0.4	0.3	0.3	0.5
Core PCE YOY		3.5	3.7	3.8	4.3	4.3	4.7	4.8	4.8	4.8	4.9	4.9	5.1	5.3	5.5
Core CPI YOY	4.0	4.0	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

to 2% over the last six months, but they want the trend to continue obviously because the latest core PCE inflation for October is 3.5% over the last twelve months. There are some bigger monthly changes coming up in the prior year, November 2022 to May 2023, that will drop out of the year-on-year change, and this could bring core PCE down from 3.5% to 2.4% if the stars all align and we get 0.2% monthly changes in November through May 2024... just in time for the first rate cut at the June 2024 meeting by our reckoning. Powell says more progress is needed, but some in the market look for a rate cut at the second meeting of 2024 on March 20.

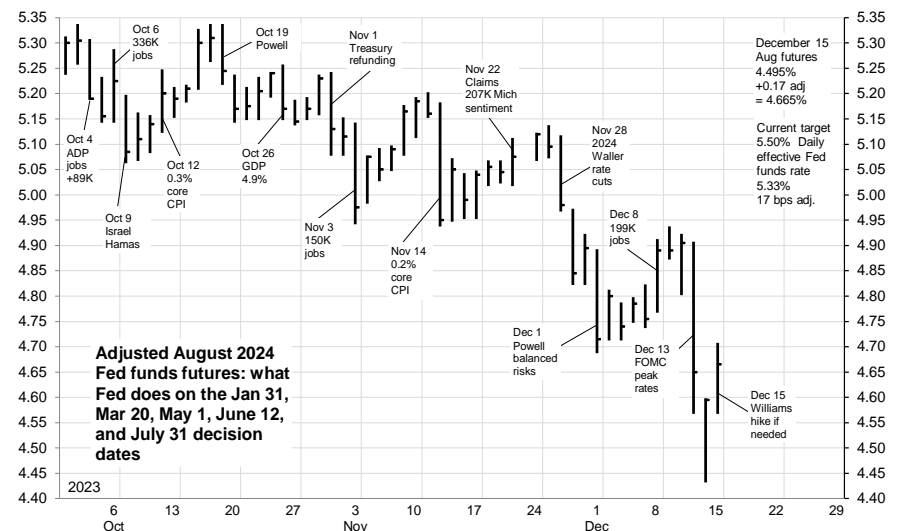
The Fed forecasts are somewhat problematic if we believe them because it looks like the three rate cuts in 2024 are dependent on core PCE falling to 2.4% in Q4 2024. That will take some doing, as it obviously means the monthly changes over all twelve months have to be 0.2% or less. From a 4.75% Fed funds rate and 2.4% core inflation at the end of 2024, the inflation forecast does not change much, 2.2% 2025, yet the Fed thinks it will squeeze some more



air out of the higher real rates with rate cuts of 100 bps. You wouldn't think you can steer the economy like a car using the real rate of interest, but maybe Fed officials think that's all they got. We are talking about people who used to set monetary policy based on money supply growth cones. 100 bps of cuts in 2025 brings the real rate against core inflation from 220 bps in 2024 to 140 bps in 2025. Real rates 90 bps in 2026 with 75 bps of cuts to 3.0%.

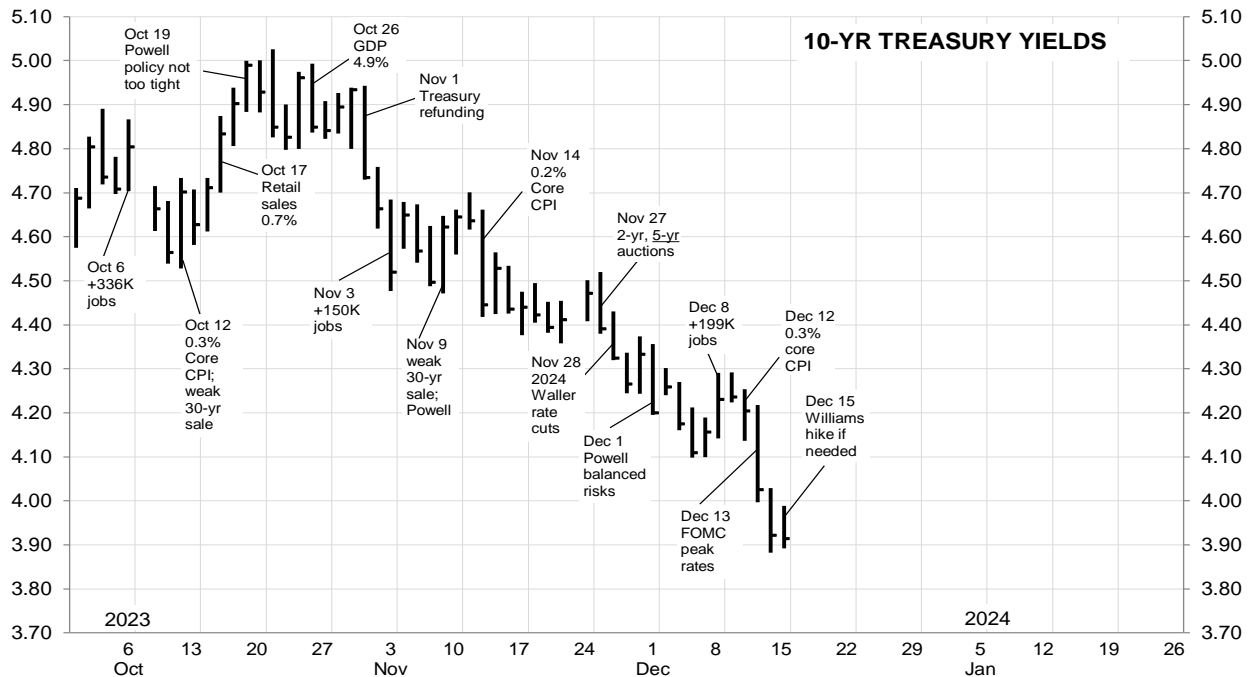
Fed Policy-key variables	2023	2024	2025	2026	Long Term
Fed funds	5.4	4.6	3.6	2.9	2.5
PCE inflation	2.8	2.4	2.1	2.0	2.0
Core inflation	3.2	2.4	2.2	2.0	
Unemployed	3.8	4.1	4.1	4.1	4.1
GDP	2.6	1.4	1.8	1.9	1.8

December 2023 median Fed forecasts



Hopefully, they will stop well before 3% because of the housing bubble. Stay tuned.

INTEREST RATES



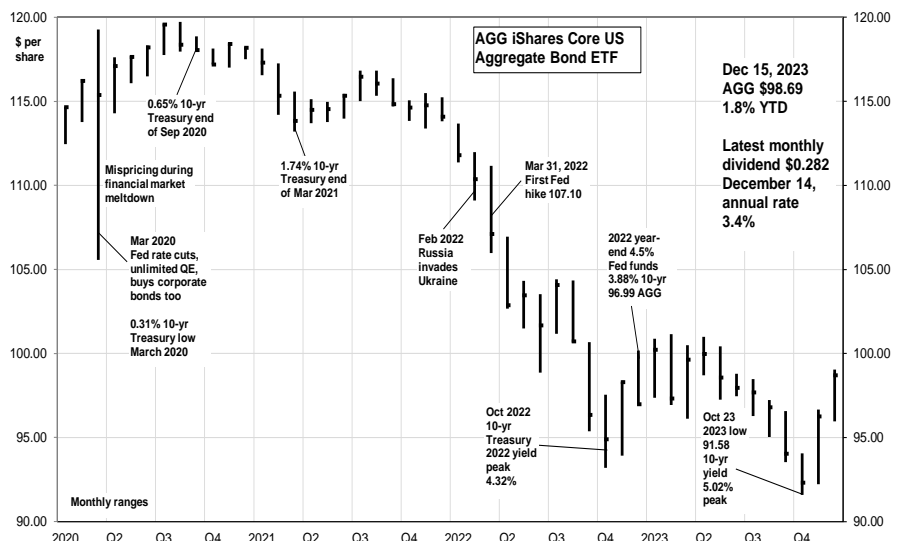
The Treasury rally continued with yields another 10 bps lower to 3.92% on Thursday as Europe reacted to the Fed meeting. The ECB met Thursday as well and like it or not some dealers think the first ECB rate cut could be in April 2024. Central bankers might be feeling rushed by markets, and Friday around 830am ET, New York Fed President Williams in an interview said they were not really talking about rate cuts right now. That's fine, but their forecasts have a 4.75% Fed funds rate at the end of 2024 and 3.75% at the end of 2025, so a 10-year yield of 4% can ride it out for now. A recession isn't necessary for rate cuts, and that is good because the labor market data including continuing unemployment claims are giving inconsistent readings on job losses; recession not needed but more progress, more 0.2% core PCE numbers for several months are what Powell is looking for.

AGG iShares Core US Aggregate Bond ETF up 1.8% YTD

The 40 side of a balanced and safe 60/40 equities/fixed income portfolio has improved from the October 23 YTD 5.6% loss the day the 10-yr Treasury yield hit its 2023 high of 5.02%. There has been a strong rally and AGG was 97.19 at Tuesday's close before the Fed peak rates announcement where rates won't be higher for longer after all. The dividend is 3.4% annual rate (paid monthly).

Treasury Borrowing \$bln			
	New	Bills	Notes & Bonds
2023 Q1	657.2	380.2	277.0
Apr	-89.6	-125.9	36.3
May	137.2	51.1	86.1
Jun	610.0	485.0	125.0
Q2	657.6	410.2	247.4
Jul	307.3	314.1	-6.8
Aug	393.5	303.5	90.0
Sep	310.1	207.2	102.9
Q3	1010.9	824.8	186.1
Oct	323.9	204.2	119.6
Nov	323.3	214.2	109.1
Dec	65.8	2.0	63.8
Q4	713.0	420.4	292.5

** through December 21

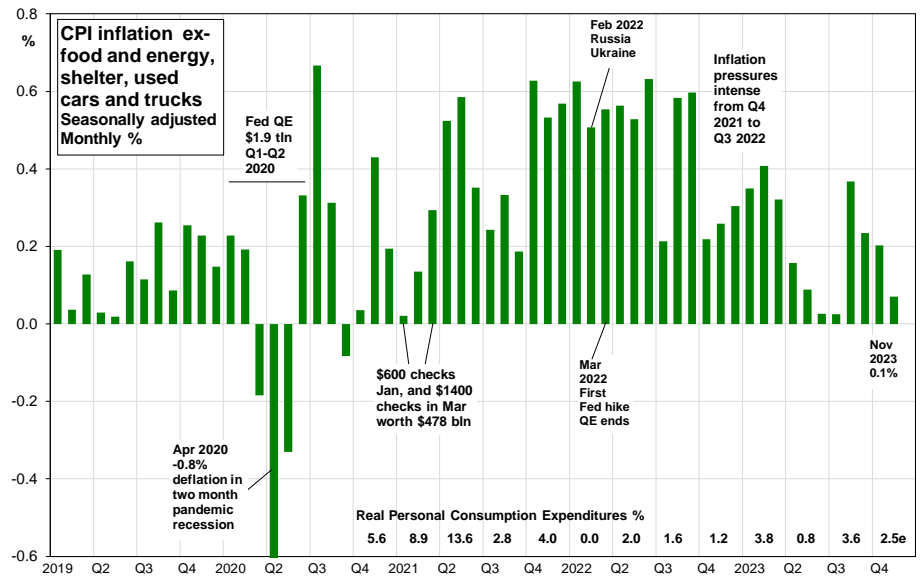


OTHER ECONOMIC NEWS

CPI meets expectations but little else (Tuesday)

Breaking economy news. The elites on Wall Street expected 0.3% core CPI inflation, but that is not going to cheer up Main Street Americans who are facing a cost-of-living crisis and do not welcome any further increase in prices. The only mystery is why the Administration is facing the heat on this failure to rein in costs and not the central bank that is actually charged with controlling inflation. Headline inflation rose just 0.1% in November after a flat reading in October as falling gasoline prices provide an offset to somewhat stickier core prices, mostly of services, although used car and trucks prices did rise 1.6% this month, the first increase since May this year.

Net, net, the public's inflation expectations are slipping, but the real thing is not as core inflation continues to rise faster than the Fed's target this month. Inflation isn't dead and inflation pressures are not fizzling out. To get inflation down to the 2% target, the Fed needs monthly changes of 0.2%, not the 0.3% November core CPI reading the markets got today. Of course the market does



not know what to do, as technically inflation met expectations for core CPI of 0.3% this month, but this is not a good report for Fed officials, although at least the price surge coming out of the pandemic may be over.

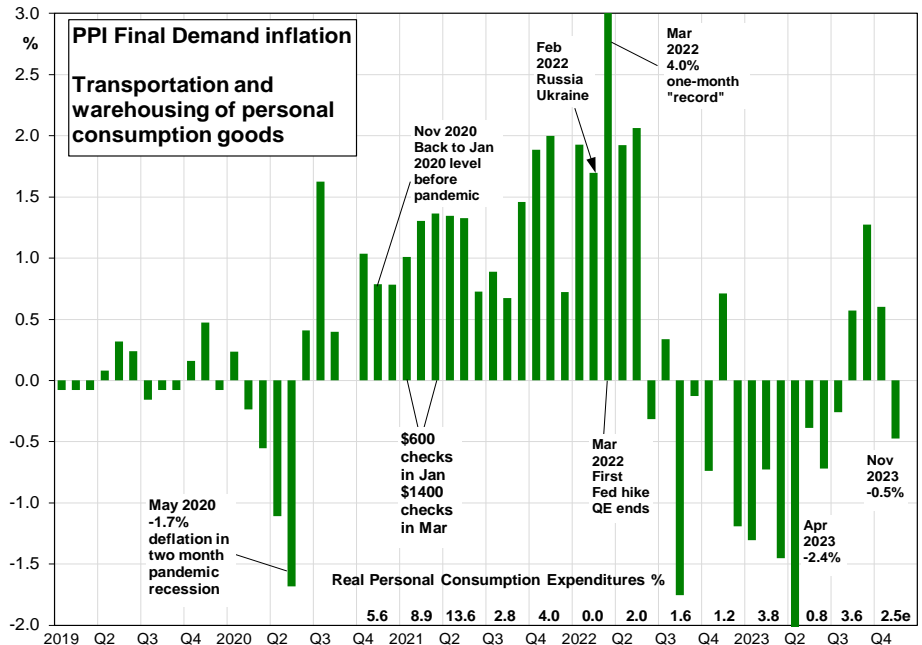
Fed officials have already prepared their interest rate forecasts coming in to today's meeting, but they probably do not need to rip up the script and prepare the world for big rate cuts next year even if they are closer to the end of winning the inflation fight than they are at the beginning. They are expected to forecast at most two or three rate cuts next year as they need to proceed carefully in case the labor markets do not rebalance and economic demand remains stronger than expected next year. Inflation is still a risk to this economy even if it has been moved to the back burner and is not as hot as it was a year ago. CPI inflation meets expectations but little else. Stay tuned. Fed officials were not thrown a curve ball today, they can keep with the forecasts for rate cuts next year that they made last weekend.

Dec 22 Weight	CPI inflation	Monthly Percent Changes			YOY % Nov 2023
		Sep 2023	Oct 2023	Nov 2023	
100.0	Total	0.4	0.0	0.1	3.1
13.531	Food	0.2	0.3	0.2	2.9
4.803	Food away from home	0.4	0.4	0.4	5.3
6.921	Energy	1.5	-2.5	-2.3	-5.4
79.548	Ex-food & energy	0.3	0.2	0.3	4.0
4.313	New vehicles	0.3	-0.1	-0.1	1.3
2.668	Used cars/trucks	-2.5	-0.8	1.6	-3.8
2.479	Clothing	-0.8	0.1	-1.3	1.1
1.455	Medical care goods	-0.3	0.4	0.5	5.0
34.413	Shelter	0.6	0.3	0.4	6.5
25.424	Owner equiv. rent	0.6	0.4	0.5	6.7
5.750	Transportation	0.7	0.8	1.1	10.1
6.653	Medical care services	0.3	0.3	0.6	-0.9
Special: Where inflation might come back down to					
58.187	Services ex-energy	0.6	0.3	0.5	5.5
21.261	Commodities (core)	-0.4	-0.1	-0.3	0.0

No inflation at producer level (Wednesday)

Breaking economy news. PPI index for November. Total final demand prices in November were unchanged in November after falling in October. Fed officials can thank their lucky stars that energy prices are down, -1.2% November and -6.7% October, and are still falling in December. There was good news for sticky services prices in CPI as Final demand services prices have been unchanged for two consecutive months now. Final demand core goods prices were up 0.2% in November, but are up just 1.8% from year earlier levels. Goods price inflation isn't dead, but if you hit it with a stick it isn't moving much.

Net, net, there isn't a lot of inflation teed up in the pipeline at the producer level as the pandemic supply shocks are long gone. Producer prices are showing weakness as manufacturing output at factories continues to sputter. Company executives have said consistently now that manufacturing is in a recession. The only conclusion Fed officials can make as they vote on policy is that there is no



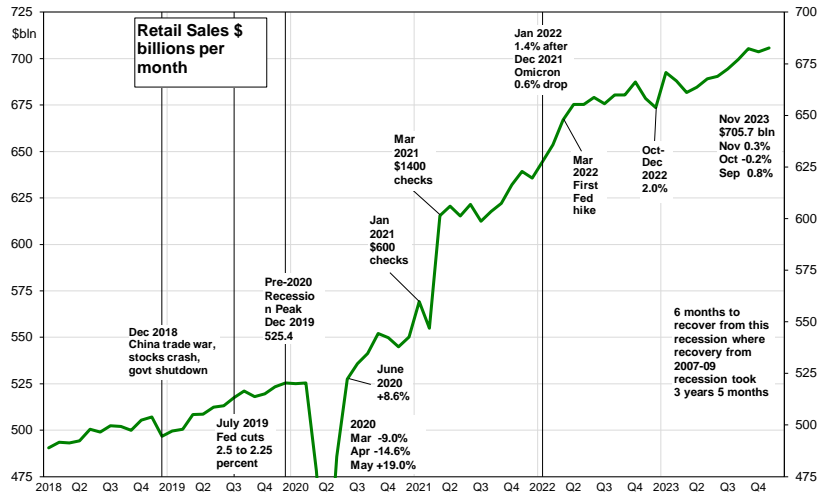
inflation at the producer level and this makes it even more likely they will bring inflation down for a soft landing without bringing the economy to its knees and engendering the huge job losses that occur in every recession. Fed officials are always nervous looking back over their shoulders to check if inflation pressures are still coming, but the good news today is that there are minimal price increases at the lower stages of factory production. Stay tuned.

PPI Final demand goods less foods/energy-- Monthly Percent Changes SA												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2022	0.8	0.8	1.0	1.2	0.7	0.5	0.2	0.2	0.0	0.0	0.3	0.1
2023	0.6	0.3	0.2	0.1	0.1	-0.2	0.0	0.1	0.2	0.0	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
2022	9.4	9.7	10.0	10.2	9.8	9.2	8.5	8.1	7.5	6.7	6.1	5.8
2023	5.6	5.1	4.3	3.3	2.6	2.0	1.9	1.8	1.9	2.0	1.8	

Sales rebound, layoffs fall (Thursday)

Breaking economy news. Retail sales, jobless claims, import prices. Retail sales rose 0.3% in November and are back to a record high after the 0.2% drop in October. Sales in the fourth quarter are running half the pace of the third quarter, 2.9% versus 6.9%, but 2.9% shows the consumer has not retreated in the face of student loan repayments and higher consumer debt levels. There are more consumers out there with the 199K payroll jobs report for November with paychecks to spend as well..

The labor market data continues to defy explanation. Based strictly on the numbers, layoffs are minimal with first-time applications tumbling 19K back to 202K in the December 9 week, while continuing claims, the total number receiving benefits remain elevated, and recovered 20K of the prior week's 69K drop, which means those on the unemployment rolls cannot find jobs to

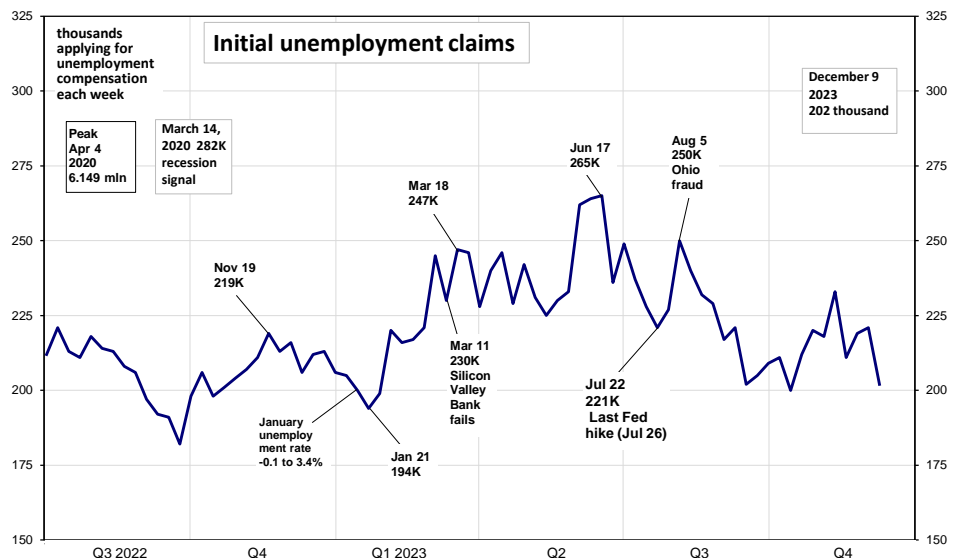


get off the unemployment rolls. Continuing claims are moving up in a recession-like way, but perhaps the seasonal factors are off somewhat after the huge surge in claims experienced in the pandemic. We cannot confirm anything is wrong with the seasonal factors for continuing jobless claims, but as usual, more weekly reports in the weeks ahead will settle the matter.

Retail spending, actual dollars, each month

	\$million	% to	Percent Changes %		
	Nov	Total	Nov	Oct	Year/year
Total Retail Sales	705,692	100.0	0.3	-0.2	4.1
Motor vehicles/parts	134,504	19.1	0.5	-1.1	6.1
Furniture/furnishings	10,736	1.5	0.9	-2.2	-7.3
Electronics/appliances	7,800	1.1	-1.1	1.1	12.0
Building materials/garden	41,295	5.9	-0.4	-0.1	-2.5
Food & beverage	82,839	11.7	0.2	0.1	0.4
Health/personal care	37,812	5.4	0.9	1.6	10.9
Gasoline stations	54,444	7.7	-2.9	-1.2	-9.4
Clothing/accessories	26,115	3.7	0.6	-0.1	1.3
Sporting goods, books	8,629	1.2	1.3	-0.2	0.2
General merchandise	72,906	10.3	-0.2	-0.2	1.1
Department stores	10,534	1.5	-2.5	-1.2	-5.2
Miscellaneous retailers	15,366	2.2	-2.0	0.7	4.5
Nonstore retailers (internet)	18,549	2.6	1.0	-0.3	10.6
Eating & drinking places	94,697	13.4	1.6	0.6	11.3

Net, net, the economy is not going over a cliff even if retail spend at the shops and malls is just half of the third quarter's blistering pace. The labor market may not be rebalancing as much as Fed officials hoped with layoffs low, but Powell was grilled on this yesterday, and said the primary focus was on inflation, and rate cuts in 2024 were not dependent on economic growth as long as price pressures continue to ease as they have the last six months. Fed policy may be in a perfect place where the economy continues to move ahead without growing fast enough to cause inflation to heat back up.



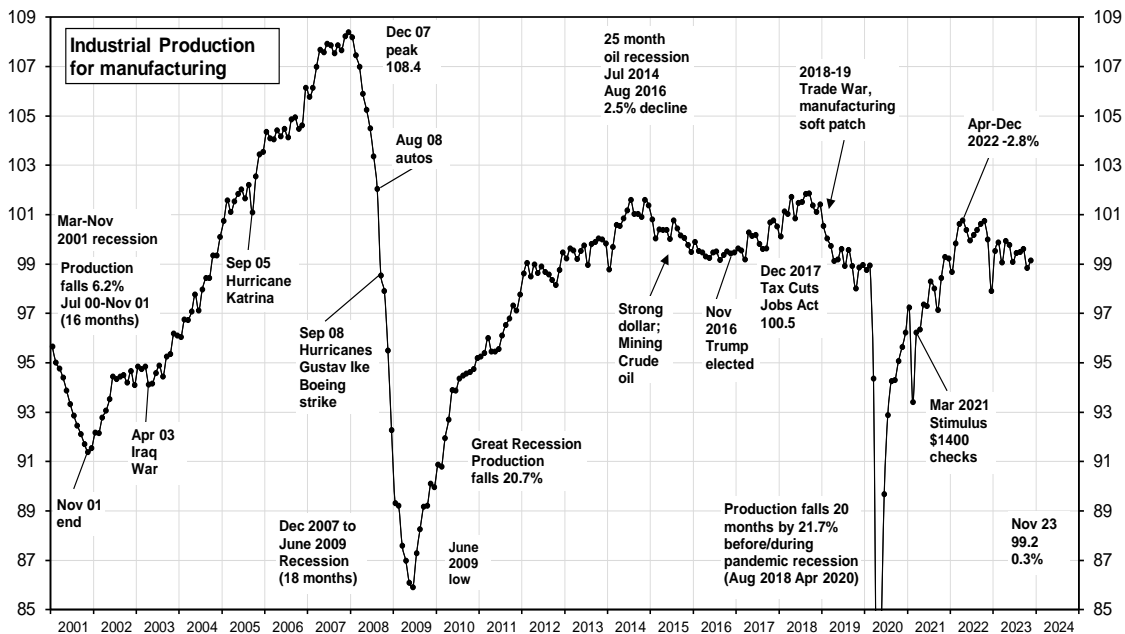
Industrial production limps along (Friday)

Breaking economy news. There was economic news out at 915am ET this morning, the Fed's own industrial production economic indicator. You might have failed to see it as you keep reading the tweet at 833am ET that New York Fed President Williams told TV, they weren't even really talking about rate cuts right now. Thanks a lot, now stocks are down on the day.

Industrial production rose 0.2% in November but the 0.6% drop in October was revised to a 0.9% decline, so there is no forward motion in output. Manufacturing output rose 0.3%, but that was because of the 7.1% increase in motor vehicles and parts following the resolution of the auto strikes. Manufacturing production continues to move sideways as it has since the start of 2023.

Percent changes			Industrial Production	
Sep	Oct	Nov	Nov 2023	
0.1	-0.9	0.2	YOY	Weight
0.1	-0.8	0.3	<u>-0.4</u> <u>Total Index</u>	<u>100.0</u>
0.9	-1.1	0.3	-0.8 Manufacturing	74.3
-0.9	-1.4	-0.4	2.3 Mining	15.2
			-1.0 Utilities	10.5
			Manufacturing payroll jobs	
			13.0 million +17K YOY	
			9.7% of Private Payroll Jobs	

Net, net, factory output showed a weak rebound this month as the autoworkers strike was settled, but pulling back the curtain, one can see industrial activity is not firing on all cylinders. Manufacturing is not out of the woods by any stretch of the imagination. Purchasing managers say manufacturing is in recession, and we are starting to agree with them, the people who order scissors and pencils and paper for companies. The broader economy keeps growing, but manufacturing industrial production peaked way back in April 2022. Manufacturing continues to limp along and is unlikely to provide the fuel for economic growth in the near term.



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