Financial Markets This Week

17 DECEMBER 2021

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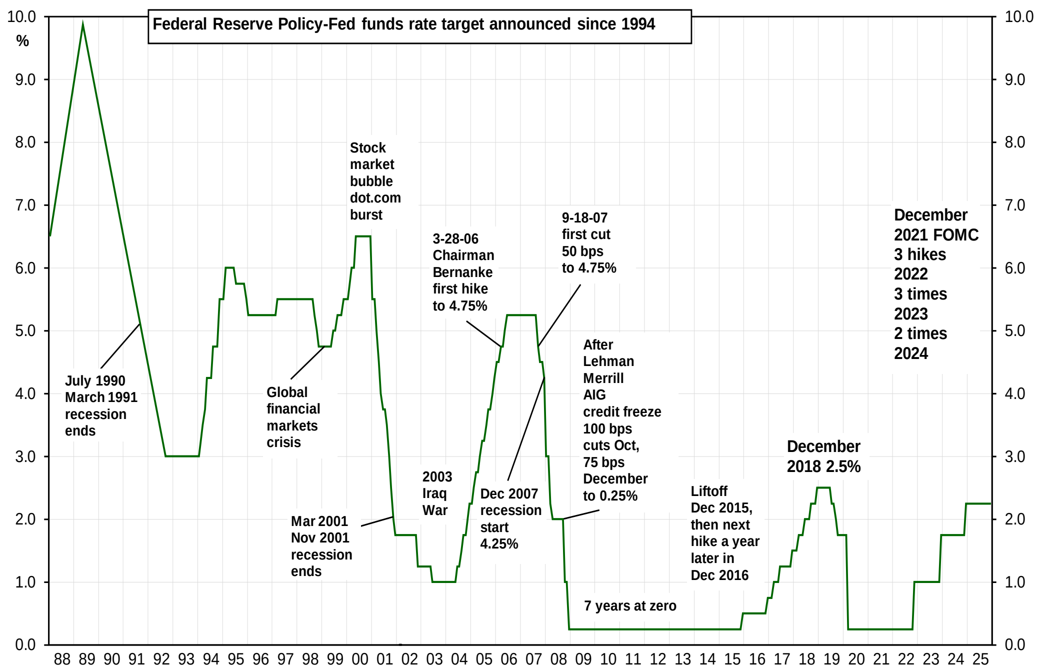
RAPID EVOLUTION OF ECONOMIC OUTLOOK CREATES PANIC AT THE FED

The Fed met on December 14-15, 2021 to consider its monetary policy. There wasn't panic in the room, but Fed officials' confidence has turned to fear of falling behind the curve after the deterioration in the inflation outlook and rapid improvement in the labor market since they met just a month ago. Plain and simple, a forecast error has left policy officials flat-footed and unable to bring a tighter monetary policy forward fast enough. They had to increase the taper at a faster $20 billion pace of reduction which is double the $10 billion pace announced just a month ago. They had to increase the tempo because all of a sudden Fed officials are looking for three rate hikes in 2022 up from just one hike (barely) in 2022 when they made their last forecasts at the September meeting. Three rate hikes in 2022 means June, September, December meetings we figure. What a difference three months make; inflation is no longer transient and they have to bring out the fire hoses to keep the fire from spreading. The million dollar question is will it be enough? Will bringing the Fed funds rate to 1% by the end of 2022, will that be restrictive enough to slow down the red-hot demand side of the economy which is bidding up the prices of goods and services at the producer and consumer level to an inflation rate not seen in decades. Forget about unemployment the Fed is saying today, the greater risk to the economy is not joblessness, it is inflation that is most worrying to the public.

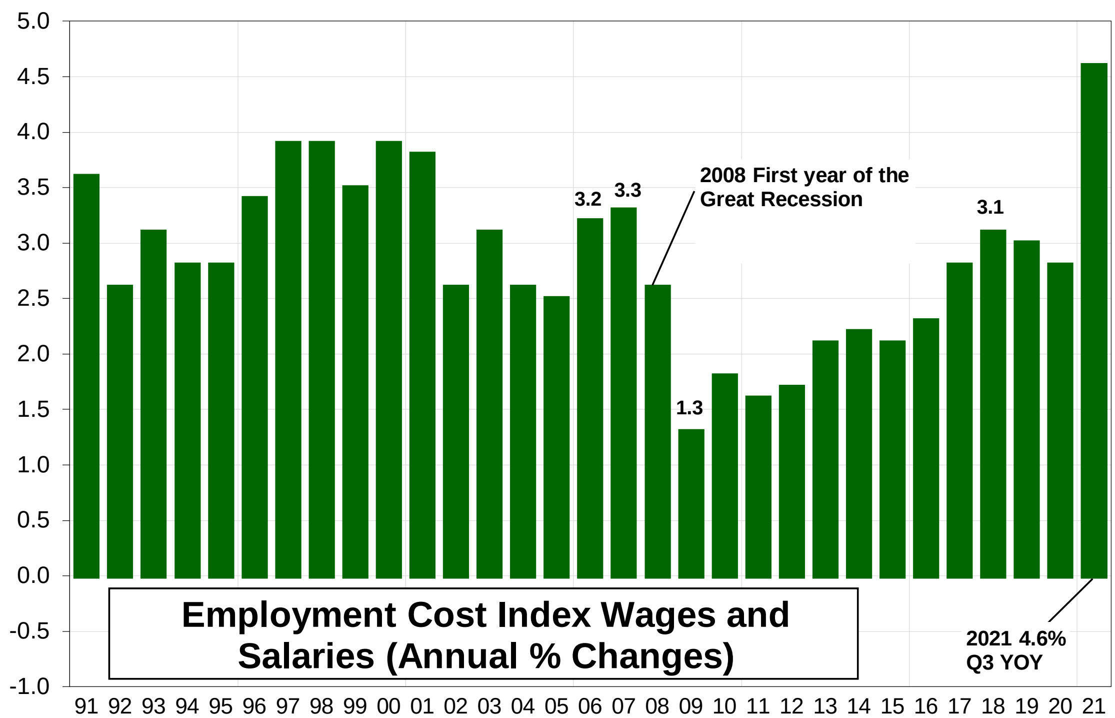


Fed Individual Forecasts				
Fed funds rate at year-end				Longer
Votes	2022 End	2023 End	2024 End	run
1	0.375	1.125	1.875	2.000
2	0.625	1.125	1.875	2.250
3	0.625	1.375	1.875	2.250
4	0.625	1.375	1.875	2.250
5	0.625	1.375	1.875	2.250
6	0.625	1.375	2.125	2.375
7	0.875	1.375	2.125	2.500
8	0.875	1.625	2.125	2.500
9	0.875	1.625	2.125	2.500
10	0.875	1.625	2.125	2.500
11	0.875	1.875	2.250	2.500
12	0.875	1.875	2.375	2.500
13	0.875	1.875	2.375	2.500
14	0.875	1.875	2.875	2.500
15	0.875	1.875	2.875	2.500
16	0.875	2.125	2.875	3.000
17	1.125	2.125	2.875	3.000
18	1.125	2.125	3.125	
Median	0.875	1.625	2.125	2.500
Meeting	Dec 22	Dec 22	Dec 22	Dec 22

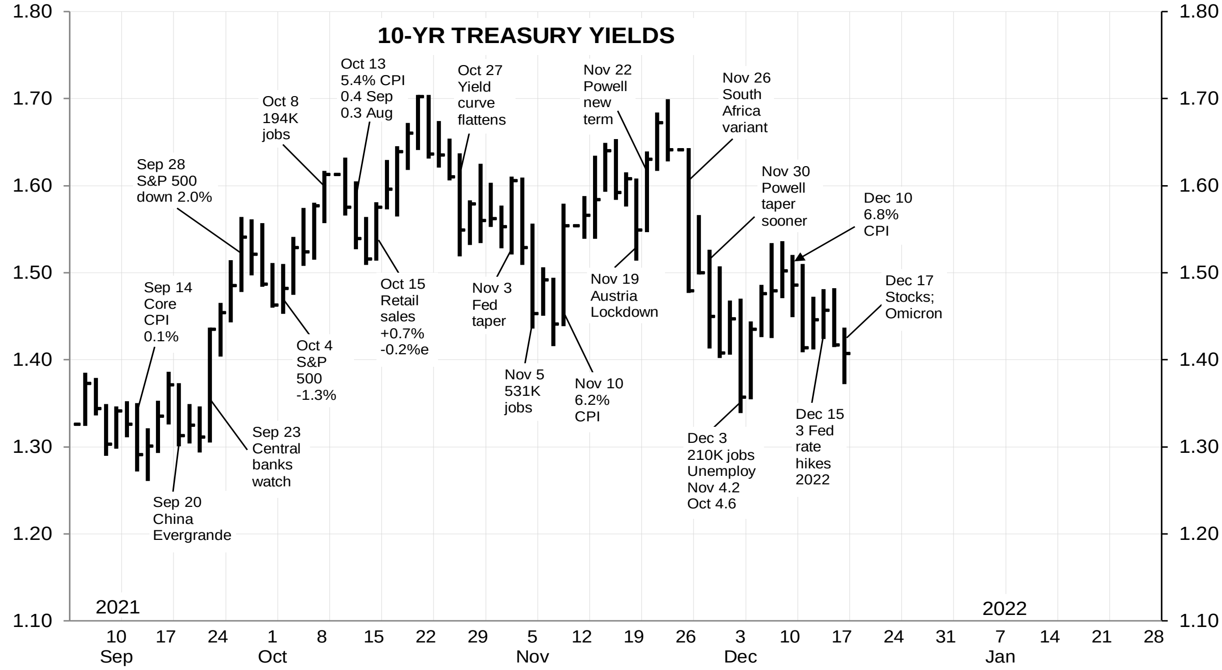
Net, net, inflation has struck fear into the hearts of Fed officials and now they have to quickly stop the supply of credit to the economy and wind down the asset purchases much more quickly. The Fed funds rate forecast is 1% for the end of 2022, although the Committee is still split where 12 see three or more rate hikes next year, and 5 foot-draggers see just two rate hikes and one lone-wolf Fed official is holding out for just one rate hike by the end of 2022. Stay tuned. Watch here where the world goes next. The pandemic-based jump in inflation has now spread to other areas like services. Powell said it, and we believe it. “While the drivers of higher inflation have been predominantly connected to the dislocations caused by the pandemic, price increases have now spread to a broader range of goods and services.”

Panic at the Fed. The inflation genie is out of her bottle and may bring down the entire economy if Fed officials aren’t careful. Let’s see if Fed messaging on the forward path of interest rates works to slow the economy even if a 2% Fed funds rate is a few years away from now. The 0.25% Fed funds rate will be 1% next year, 1.75% in 2023, and 2.25% in 2024. Three next year, three the year after, then slowing to just two in 2024, three years from now. They probably think their 2.5% Fed funds rate was too tight and caused the stock market to crash in December 2018. Wouldn’t want to overtighten.

Powell said the ECI data on Friday before the November meeting made him wonder whether they should speed up the QE taper even before the official $10 billion monthly pace was announced November 3



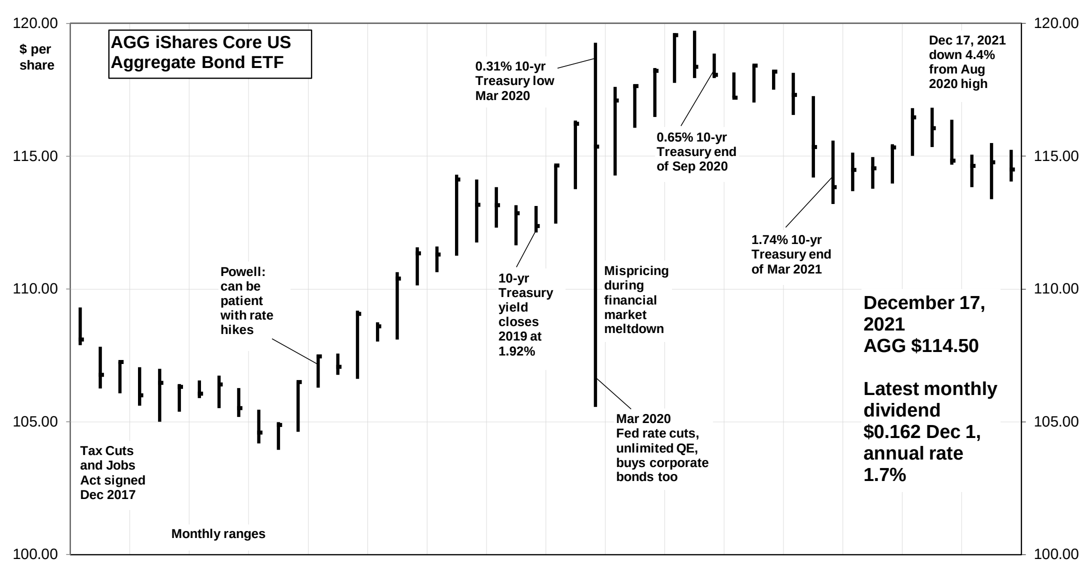
INTEREST RATES



Hard to characterize the bond market's direction if you are looking for that. 10-year yields up a couple times at 1.70%, and falling back to 1.40% a couple of times. Not counting the one-night Dec 3 close below 1.40% after the 210K jobs report. Was that ever a waste of time pretending it wasn't a strong economy report with the huge drop in unemployment. The bond market got 6.8% CPI inflation (biggest year-year jump since June 1982) and yields just sit. The Fed on Wednesday said three rate hikes to 1.0% in 2022: 10-year yields just sit. US yields moved up briefly then down on Bank of England rate hike Thursday, dipping below 1.40% briefly again on Friday, blame Omicron. Everyone else does.

The 40-fixed income side of the 60/40 stocks/bonds portfolio

Interest rates need to go higher the Fed said this week. How is the fixed income part of your investment portfolio doing? The AGG iShares Core US Aggregate Bond ETF paid out $2.02 in dividends in 2021 which would be 1.8% off Friday's 114.50 close. The AGG ETF is down 4.4% from the August 2020 high when 10-year Treasuries were 0.65%. You still have time before losing $$$. The Fed pulled the rate hikes forward but are looking for 2.25% in 2024 just modestly higher than 1.88% in September.



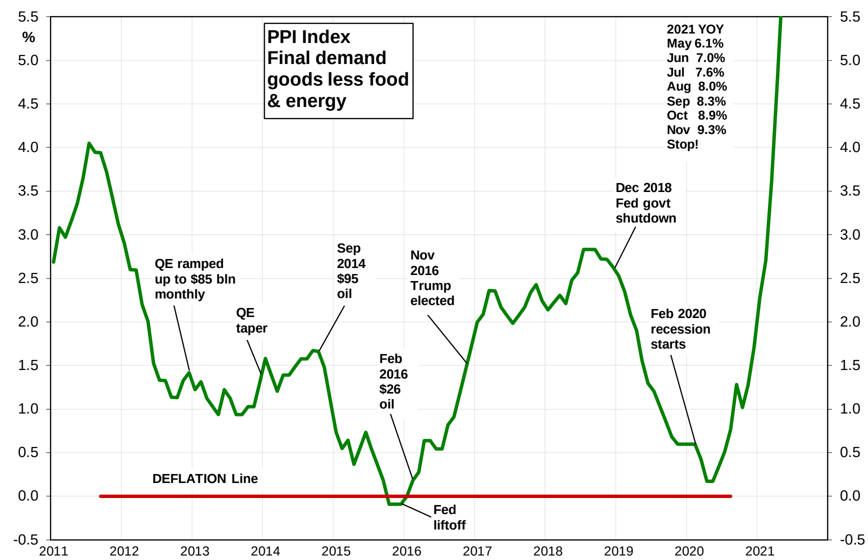
OTHER ECONOMIC NEWS

PPI inflation the most on record (Tuesday)

Breaking economy news. The Producer Price Index was the most on record which sounded bad except the data were calculated the first time in November 2010 when the BLS did a makeover of the PPI index. PPI and the trade deficit were once the two biggest market moving economic reports in the world and PPI briefly revisited those glory days on Tuesday. It is now called the Producer Price index for final demand which rose 0.6% in November and the year-on-year gain of 9.6% is the one that holds the record. Certainly PPI inflation was just as high if not higher back in the early 80s. The BLS also said that today's report is the first time that they will be calculating the index to three decimals if that's any help in the country's inflation fight.

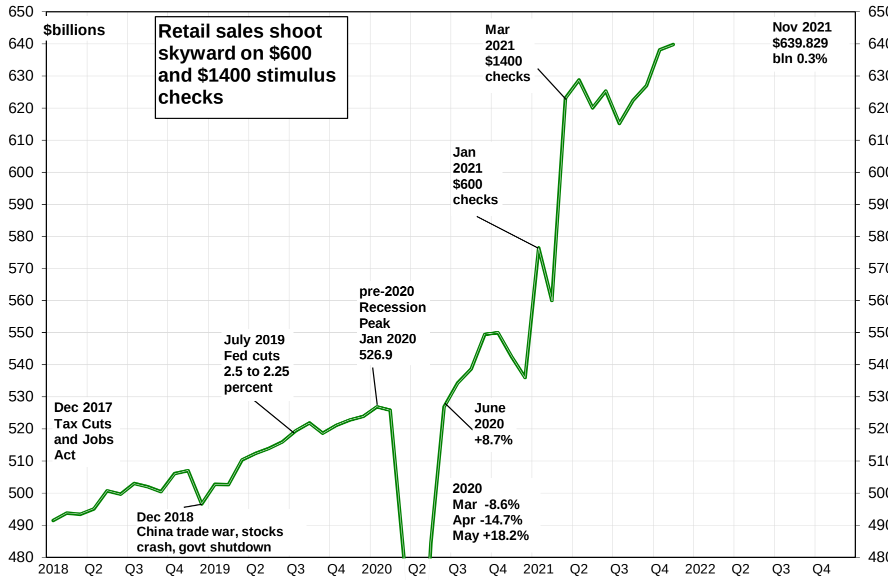
The redesign added services prices somehow to the Producer Price index. In November we were interested to read in the report that prices for portfolio management rose 2.9%. Not sure why anyone would pay more in an environment where stocks just go up. The S&P 500 was up 24.3% YTD Monday night after rising 16.3% in 2020. The same year 2020 that alledgedly had the economy in recession. To all of these hefty 2020-21 investment returns you can add in 2019's 28.9% gain to see why many choose not to work.

We prefer to look at an old-style PPI which is final demand goods less foods and energy: this increased 0.8% in November and 9.3% from November 2020. That is we used to like to look at this inflation reading until it went off the charts to a degree that makes the inflation meaningless it is so high. Stay tuned. Story developing. Not sure what the net, net conclusion to today's report is when inflation is coming at the economy from all sides.



Consumers spend less than expected in November (Wednesday)

Breaking economy news. Retail spending slowed in November to a 0.3% gain after jumping 1.8% in October. October had seen the most spending since 11.3% in March when consumers' pockets were stuffed with $1400 Federal government checks. No need to worry though that the consumer spent less than expected in November because economic growth in the fourth quarter of the year is still running at the fastest pace since the first half of the year. Consumers are putting the economy on course for a strong finish to the year.



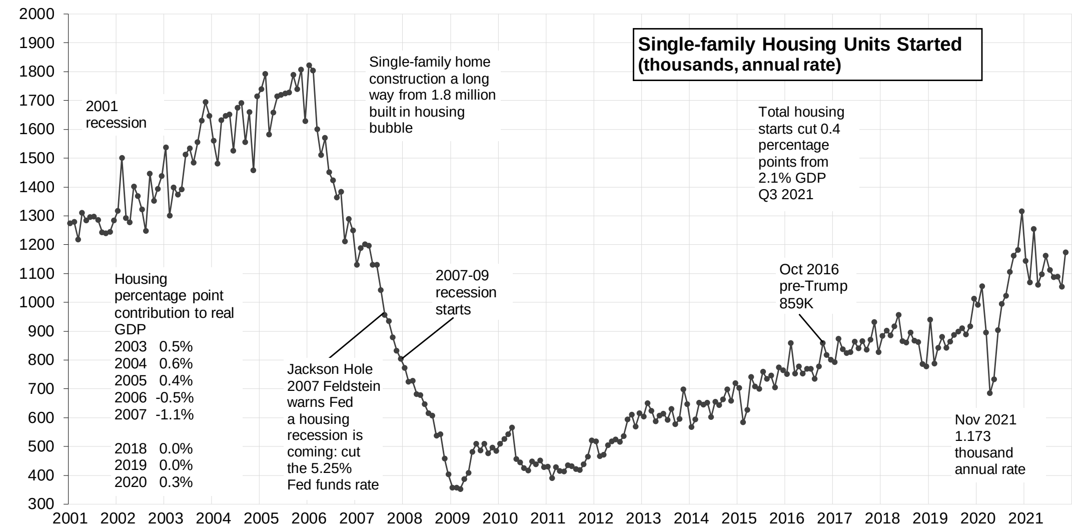
Retail sales rose at a more modest 0.3% pace in November, but it wasn't because of virus concerns that kept consumers at home. If consumers were at home they weren't on the couch ordering goods off the internet from their phones as nonstore retailers spending was unchanged in November even if sales are 12.1% above November 2020 levels. Furniture sales were also unchanged and Electronics and appliance stores actually dropped 4.6%. It wasn't the happiest time of the year for department stores either with a decline of 5.4% in November.

Retail spending, actual dollars, each month

	$million Nov 2021	% to Total	Percent Changes % Nov	Oct	Year/year
Total Retail Sales	639,829	100.0	0.3	1.8	18.2
Motor vehicles/parts	126,489	19.8	-0.1	1.7	13.4
Furniture/furnishings	12,447	1.9	0.0	2.8	16.3
Electronics/appliances	7,999	1.3	-4.6	3.1	16.8
Building materials/garden	40,579	6.3	0.7	2.5	9.3
Food & beverage	78,411	12.3	1.3	1.0	8.6
Health/personal care	31,656	4.9	-0.6	-1.4	7.2
Gasoline stations	54,868	8.6	1.7	3.7	52.3
Clothing/accessories	26,491	4.1	0.5	0.2	34.8
Sporting goods, books	9,464	1.5	1.3	0.7	20.0
General merchandise	70,654	11.0	-1.2	1.5	14.2
Department stores	11,753	1.8	-5.4	2.5	24.9
Miscellaneous retailers	14,886	2.3	-0.3	1.7	23.8
Nonstore retailers (internet)	92,154	14.4	0.0	4.1	12.1
Eating & drinking places	73,731	11.5	1.0	0.3	37.4

Net, net, consumers are still doing their best to keep the economy's sails full and the recovery on track. The jury's out on whether this month's slowdown is Omicron related, especially as much of the November growth soft patch occurred due to an actual decline in stay-at-home spending which implies consumers were still out and about. Make no mistake about it however, the economy is experiencing a once in a lifetime demand surge that has lit the fire under inflation that Federal Reserve officials are struggling to contain. The reason inflation is up nearly 7 percent the last year is because nominal retail spending at the shops and malls is up an astounding 18.2% year-to-year so it is no wonder retailers are having problems keeping the store shelves stocked. Of course consumer demand will slow in the future, how can it not as that 18.2% year-year retail sales gain was bought with $600 stimulus checks in January pushing retail sales up 7.6% and March's 11.3% one-month gain purchased by Uncle Sam's $1400 checks. Federal Reserve officials will not see today's retail sales report as a softening in demand. Inflation won't be slowing down anytime soon if the consumer has anything to say about it. Stay tuned. Fed meeting announcement at 2pm ET today. Wait for it. The economy's stronger than you think.

Economy looks strong with housing starts and low, low, low jobless claims (Thursday)



Breaking economy news. Housing starts jumped 11.8% in November to 1.679 million at an annual rate. Multifamily units of 5 or more rose 12.1% to 491 thousand at an annual rate and single-family starts rose 11.3% to 1.173 million at an annual rate. Single-family starts jumped most in the Northeast which is by far the smallest market in the U.S., and single-family starts in the South jumped 14.4% to 701 thousand which is the biggest region accounting for 60% of the total. There's a housing shortage in America so more building is all to the good even if it is still not enough to rein in home prices. The labor market remains tight as well with new filings for unemployment benefits rising 18K to 206K in the December 11 week. Jobless claims are one statistic that is back to the best economy in fifty years level before the pandemic hit in February 2020.

Net, net, it is time for Fed officials to retire the maximum employment goal as the rock-bottom lows for weekly jobless claims signal the labor supply pool is nearly empty and companies cannot afford to let anyone who works for them go. There are no workers to hire. The economy is as fully employed as it is going to get for this cycle. Time for the Fed to lift interest rates to apply the brakes to this economy that is experiencing the strongest consumer demand in history.

Meanwhile, even residential housing construction is coming back to life after many months in the doldrums. There's a new housing price bubble and the best way to deal with the demand is to build more homes. Stay tuned. Story developing.

Housing Starts Total, Single-Family, Multi-Family

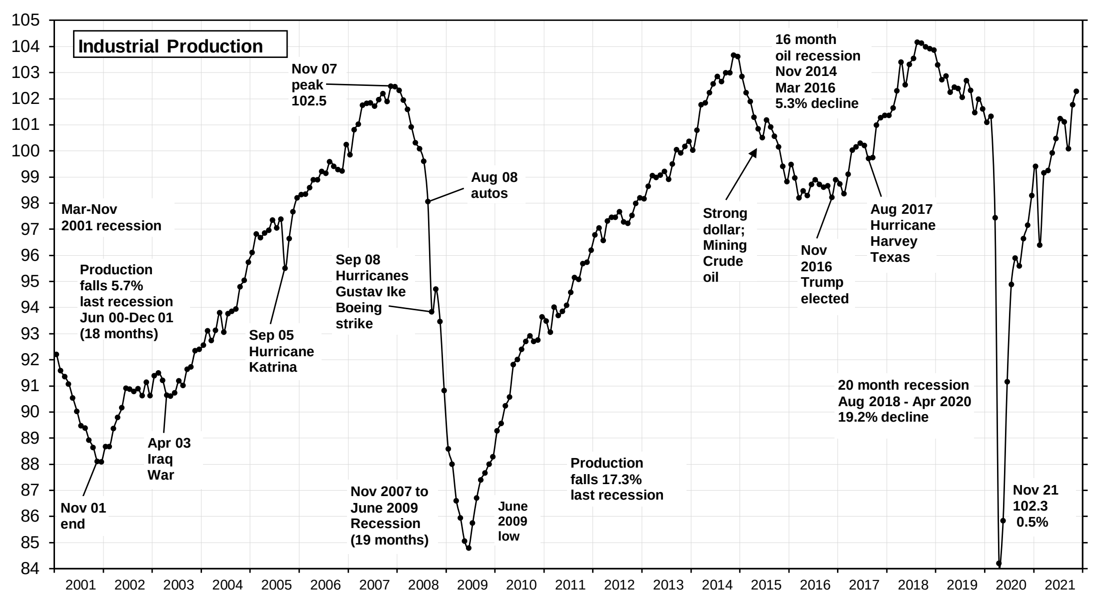
	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Nov 2021	1679	1173	491	130	66	204	129	933	701	412	277
Oct 2021	1502	1054	438	102	52	220	127	788	613	392	262
Nov 2020	1551	1182	353	143	71	189	134	806	659	413	318
% Chgs											
Nov/Oct	11.8	11.3	…	27.5	26.9	-7.3	1.6	18.4	14.4	5.1	5.7
Nov/Nov	8.3	-0.8	…	-9.1	-7.0	7.9	-3.7	15.8	6.4	-0.2	-12.9

Manufacturing output climbing again (Thursday)

Breaking economy news. The Federal Reserve's very own economic statistic: industrial production continues to climb after some storm related weakness in September from Hurricane Ida that hit mining production especially hard. Industrial production rose 0.5% in November after the Hurricane Ida bounce back of 1.7% in October. With manufacturing firing on all cylinders to meet the consumer's increasing demand for goods, the 2022 economic outlook looks to be a good one without a cloud in the sky.

Net, net, the factory lights were burning late into the night in November with manufacturing production at the highest level yet in this long recovery from the pandemic. Industrial production was not completely well in late 2019 in the best economy in fifty years before the pandemic. Manufacturing was in a soft spot with manufacturing industrial production actually hitting its all time high a year earlier in August 2018. Making goods here in America is talked about constantly as a priority, but manufacturing production is still 1.3% shy of the 2018 record.

Percent changes			Industrial Production Nov 2021		
Sep	Oct	Nov	YOY		Weight
-1.0	1.7	0.5	5.3	Total Index	100.0
-0.5	1.4	0.7	4.6	Manufacturing	75.9
-2.3	4.3	0.7	9.2	Mining	12.2
-2.9	0.6	-0.8	5.1	Utilities	11.9
			Manufacturing payroll jobs 12.5 million +350K YOY 9.9% of Private Payroll Jobs		



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