Financial Markets This Week

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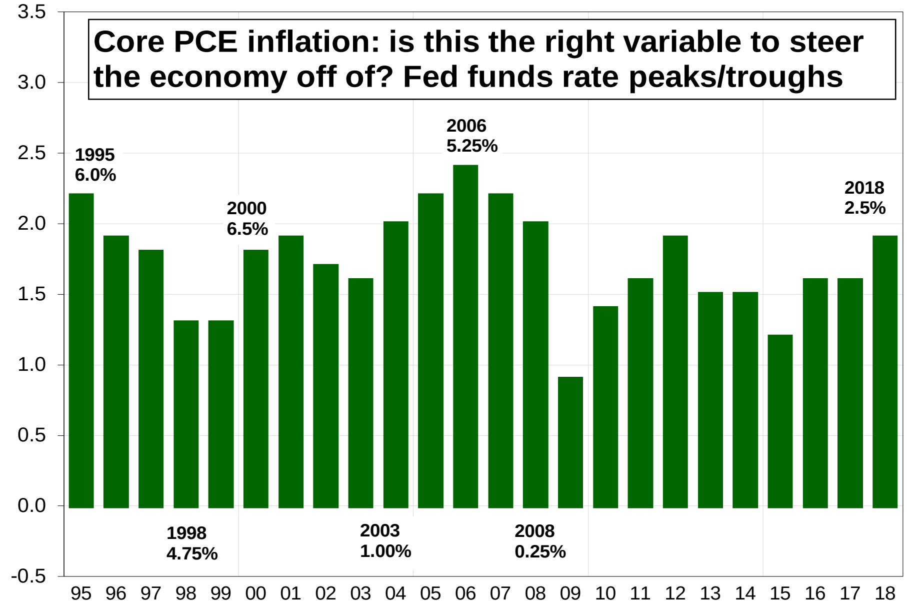
FED 2000

There's Fed 1.0 still in the building and next week's Fed 2.0 meeting, but we thought we would re-run the inflation and interest rate numbers from the year 2000. Maybe you tune in here to see where the stock market is going, but after Tuesday's price action, Fed 2000 is all we got.



Everyone has to agree on what index measure of inflation is the one to target or this isn't going to work, cost-of-living crisis worries aside. The Fed slowly made its way from CPI to PCE inflation as the best target under Greenspan starting in 2000. Warsh likes the Dallas Fed Trimmed Mean PCE inflation rate, even if the Dallas Fed President does not, and ex-Fed gov Miran thinks PCE inflation is inflated falsely by portfolio management fees: both of them seem to be bending over backwards to say, yep, we find no inflation risks, in order to lower the boom on interest rates like the President has wanted for years.

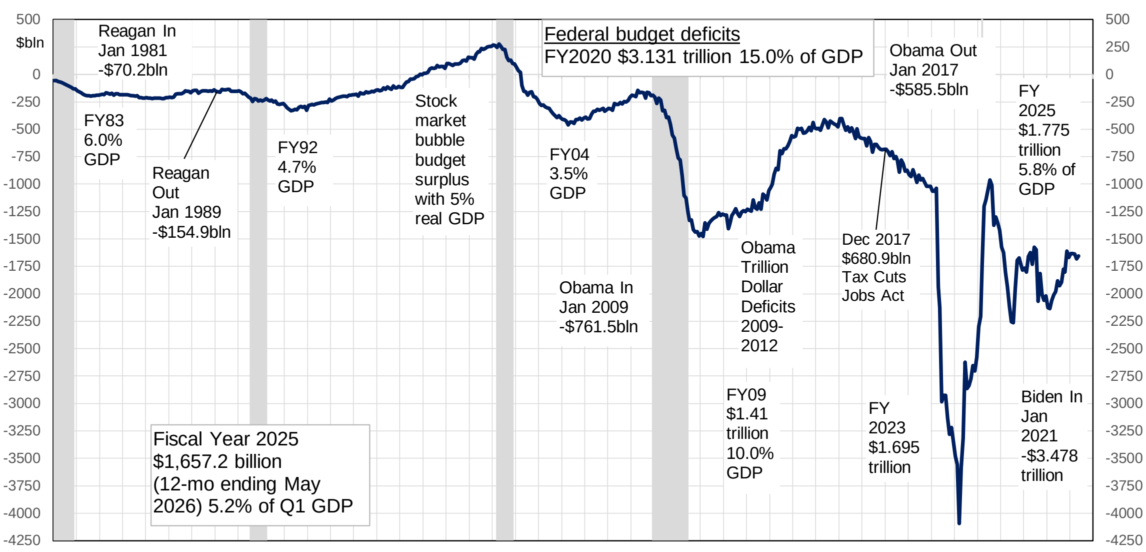
We have often wondered whether PCE inflation is the right target. It doesn't matter so much, just need to have everyone agree that this is the target and when it deviates we, Fed officials, will take (contemplate taking) action. This chart here is of core PCE inflation over the interest rate cycles. The Fed is often swayed by one month's number, one of the year-on-year or monthly percent changes within the year, but looking back historically on this 1995-2018 chart we just use annual core inflation averages. The first thing to note is inflation was only above 2.0% for a handful of years. Maybe the Fed peak rates kept inflation from moving higher. Maybe. A 6.0% Fed funds rate in 1995, up 300 bps in a year with some big 50 and 75 bps moves, caused the 1995-near recession miss. Rates fell back to 4.75% and inflation under 1.5% in 1998 with the Global financial markets crisis. Rates back to 6.5% in 2000 even though core PCE inflation never rose to 2.0%. There was a long jobless recovery from the short March-November 2001 recession and inflation only fell as low as 1.6% during the 2003 Iraq War economic growth slowdown. Bernanke took over from Greenspan and only raised rates three times to the 5.25% peak, and that was enough monetary restraint to keep peak-cycle inflation under 2.5% apparently during the housing bubble economy. BTW-PCE inflation keeps getting revised and for the longest time the numbers were steady at just 2.2% from 2005-07. The PCE inflation data now have a prominent 2.4% peak in 2006, a perfect look for economic theory now at the end of an expansion. It is often said the Fed should shift quickly to downside economy risks even if current inflation remains high. The Great Recession 2007-09 certainly qualifies and core PCE inflation was still 2.2% in 2007 (okay, okay) as the Fed cut rates to zero by December 2008 after the Federal government let Lehman go bankrupt. Inflation got as low as 0.9% in 2009. Fed rates were left at zero until Yellen raised it the first time by 25 bps at the end of 2015. Powell took over at a funds rate of 1.5% and raised it to the 2.5% Fed rate peak at the end of 2018 and then judged rates were too high for the economy to handle. A long discussion of yesterday, but the point is core PCE inflation has historically made only very modest changes and yet Fed policy has been making huge swings from the highs to lows for interest rates based in large part by the signals about the economy generated by core PCE inflation. Greenspan started the shift to PCE inflation in February 2000, but the irony is core PCE inflation never even rose to the now 2.0% target in 2000 when Fed rates peaked at 6.5% in May 2000, fighting a stock bubble.

Core PCE inflation is elevated at 3.3% in April 2026 and investors are thinking there is a potential for rate hikes in the future. The President is saying jobs growth is good so why raise interest rates which is a question that comes up from time to time. Looking backwards this week, we found then Fed governor Bernanke giving a [speech in September 2003] about how growth does not mean rate hikes. The market thought they heard Bernanke say growth would not mean rate hikes as much as it did in other cycles. There was a reason however as "inflation was low and inflation pressures remain subdued," he said.

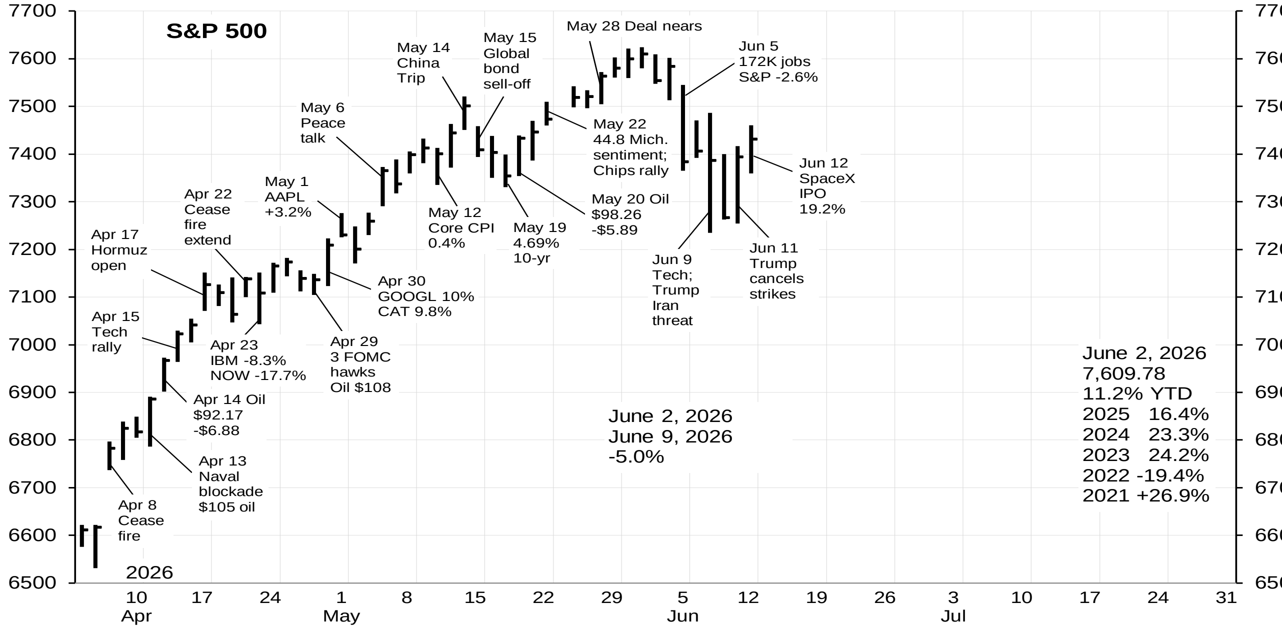
> In past Monetary Policy Reports to the Congress, the FOMC has framed its inflation forecasts in terms of the consumer price index. The chain-type price index for PCE draws extensively on data from the consumer price index but, while not entirely free of measurement problems, has several advantages relative to the CPI. The PCE chain-type index is constructed from a formula that reflects the changing composition of spending and thereby avoids some of the upward bias associated with the fixed-weight nature of the CPI. In addition, the weights are based on a more comprehensive measure of expenditures. Finally, historical data used in the PCE price index can be revised to account for newly available information and for improvements in measurement techniques, including those that affect source data from the CPI; the result is a more consistent series over time. This switch in presentation notwithstanding, the FOMC will continue to rely on a variety of aggregate price measures, as well as other information on prices and costs, in assessing the path of inflation.
> February 17, 2000 Greenspan

We are about to find out what incoming Fed Chairman Warsh thinks about the setting of monetary policy. Core PCE inflation is high, the payroll jobs data are booming, although rates of 3.75% are near neutral levels "where they have no effect on the economy" and may not need a tweak. Stay tuned.

Final note: May 2026 budget results on Wednesday. Deficit is 5.2% of nominal GDP and will slowly make its way to 3.0% "neutral" in a few years if they can hold it here.



INTEREST RATES



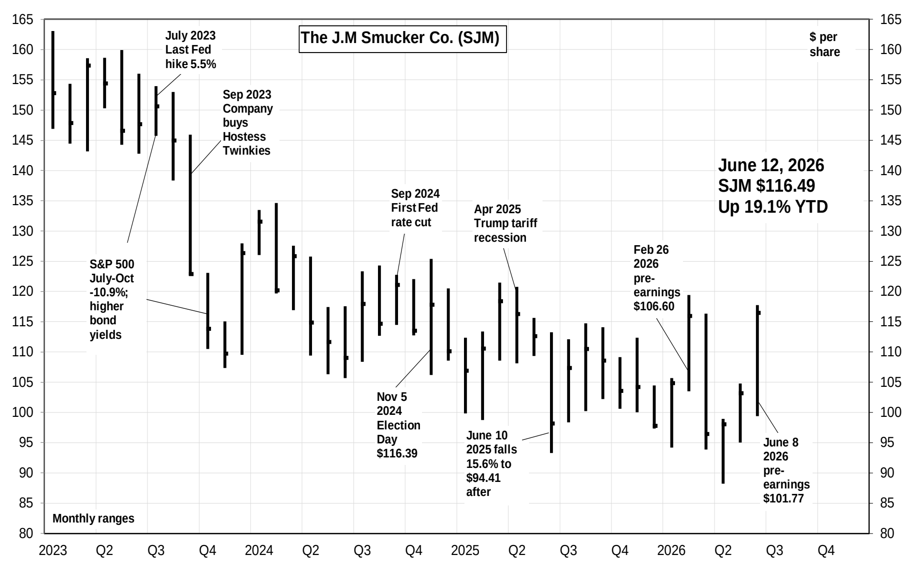
It looked dire at last Friday's close after the stronger payroll jobs report, and it kept falling this week with the S&P 500 suspiciously off exactly 5.0% from the June 2 record high. Tech and a Trump threat were the reasons Tuesday, and that could be the same reason for many sell-off this year; sometimes within the same day, like later on Thursday with the morning's post on hitting Iran VERY HARD TONIGHT, followed by a 130pm post canceling the threatened strikes and suggesting peace was at hand. Chip stocks (SOX Index) recovered 7.9% Thursday and another 1.5% Friday, the day of the SpaceX IPO closing up 19.2% at $160.95 (4pm). Bond market followed crude oil and Iran headlines. 10-yr yields were still as high as 4.57% Thursday before the afternoon post pulling the strikes. Bonds closed at 4.49% on Friday, and S&P 500 recovered partially from 172K jobs and YTD is 8.6% higher.

J.M. Smucker Company (SJM) up 10.4% on Wednesday after earnings

Nice safe stock. The company had better than expected earnings reported Tuesday before the bell for the April 30 quarter. It is generally a hedge against tech sell-offs, but moves around a lot on earnings results. Did better than last year after earnings when it fell 15.6%. Products you probably shop for in addition to jams are Hostess Twinkies, Folgers, Jif Peanut Butter, Cat/Dog food (Meow Mix/Milk Bones). The dividend is 3.8% off of Friday's close.

SJM results (billions)

Quarter	Net Sales	Operating Income	Pet food sales	Profit Margin
4.30.2026	2,268.1	444.5	401.7	31.3%
1.31.2026	2,339.4	(548.4)	417.1	22.8%
10.31.2025	2,330.1	418.5	413.2	30.1%
7.31.2025	2,113.3	45.6	368.0	27.5%
4.30.2025	2,143.8	(599.1)	395.5	26.8%

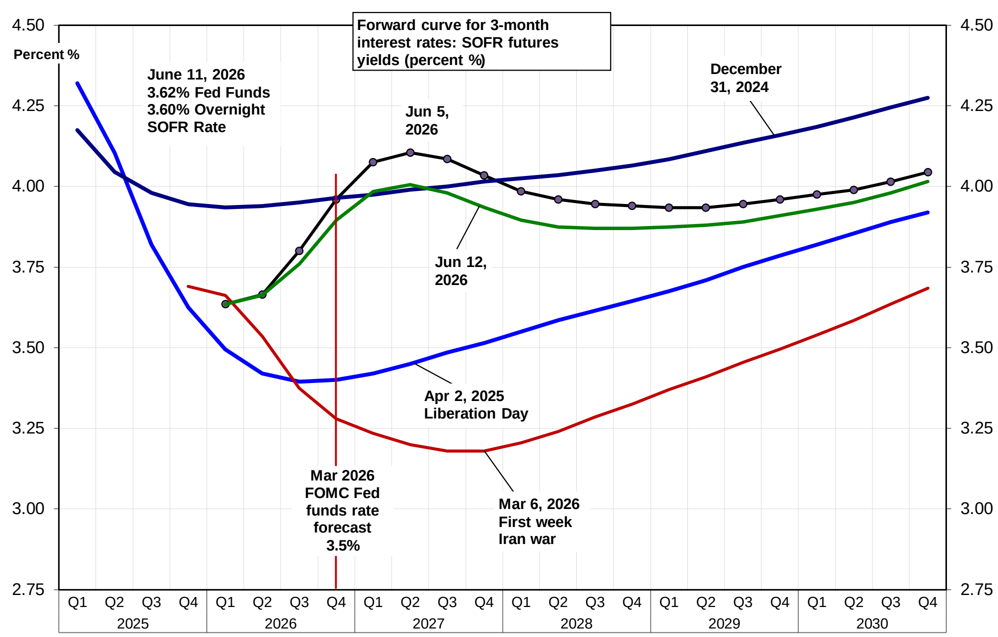


FEDERAL RESERVE POLICY

The Fed meets June 16-17, 2026 to consider its monetary policy. The first reform Chairman meeting, and maybe his thoughts on this will come at the 230pm press conference. We just want to know if the Fed funds rate is going up or down and we need the forward guidance of the dot-plot interest rate forecasts out through 2028. We are not money market traders so we don't have interest in the Fed balance sheet or why the Fed funds rate might bump around a (very) little within its 3.5-3.75% range. It is better to stick with the top of the range, one number, for the setting of interest rates and in this case 3.75%. The Fed rates forecasts could be important as some on the Committee seem to want to change the press statement language to prepare for a possible interest rate hike due to inflation risks. The March meeting forecasts still show one rate cut this year. The ECB sees inflation, and jumped their rate 25 bps to 2.25% on Thursday. Stay tuned.

Selected Fed assets and liabilities Fed H.4.1 statistical release billions, Wednesday data	10-Jun	3-Jun	27-May	20-May	3/11/20*	Change from 3/11/20 to Jun 10
Factors adding reserves						
U.S. Treasury securities	4479.919	4469.293	4461.901	4457.712	2523.031	1956.888
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1964.786	1964.786	1964.786	1977.661	1371.846	592.940
Repurchase agreements	0.005	0.004	0.111	0.007	242.375	-242.370
Primary credit (Discount Window)	6.606	6.072	6.362	5.599	0.011	6.595
Bank Term Funding Program	0.000	0.000	0.000	0.000		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	0.025	0.026	0.026	0.027		
Main Street Lending Program	0.602	0.600	0.599	1.420		
Term Asset-Backed Facility (TALF II)	0.000	0.000	0.000	0.000		
Gold stock	11.041	11.041	11.041	11.041	11.041	0.000
Central bank liquidity swaps	0.028	0.116	0.050	0.016	0.058	-0.030
Federal Reserve Total Assets	6776.8	6763.0	6755.7	6765.1	4360.0	2416.789
~~3-month Libor %~~ SOFR %	3.59	3.61	3.63	3.50	1.15	2.440
Factors draining reserves						
Currency in circulation	2467.346	2466.972	2465.412	2461.745	1818.957	648.389
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	801.084	845.722	842.660	781.979	372.337	428.747
Treasury credit facilities contribution	0.000	0.000	0.000	0.821		
Reverse repurchases w/others	0.387	2.062	1.853	24.867	1.325	-0.938
Federal Reserve Liabilities	3665.361	3717.333	3688.720	3658.367	2580.036	1085.325
Reserve Balances (Net Liquidity)	3111.454	3045.654	3067.025	3106.715	1779.990	1331.464
Treasuries within 15 days	80.855	78.762	93.305	88.919	21.427	59.428
Treasuries 16 to 90 days	371.295	371.017	347.048	343.911	221.961	149.334
Treasuries 91 days to 1 year	503.555	495.977	500.718	504.852	378.403	125.152
Treasuries over 1-yr to 5 years	1426.683	1426.360	1430.262	1429.880	915.101	511.582
Treasuries over 5-yrs to 10 years	485.348	485.277	481.343	481.258	327.906	157.442
Treasuries over 10-years	1612.183	1611.899	1609.226	1608.892	658.232	953.951
Note: QT starts June 1, 2022	Change	6/10/2026	6/1/2022			
U.S. Treasury securities	-1290.860	4479.919	5770.779			
Mortgage-backed securities (MBS)	-742.660	1964.786	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

Fed Policy-key variables	2026	2027	2028	Long Term
Fed funds	3.4	3.1	3.1	3.1
PCE inflation	2.7	2.2	2.0	2.0
Core inflation	2.7	2.2	2.0	
Unemployed	4.4	4.3	4.2	4.2
GDP	2.4	2.3	2.1	2.0
March 2026 median Fed forecasts				



8 bps of a 25 bps rate hike is discounted by the September 2026 meeting.

Fed funds futures call Fed policy		
Current target: June 12 -- 3.75%		
Rate+0.13	Contract	Fed decision dates
3.755	Jul 2026	Jun 17*
3.830	Oct 2026	Adds Jul 29, Sep 16*
*July 2026 could be two days at a new rate		
*Oct 2026 could be 3 days at a new rate		

Next up: May PCE inflation Thursday, June 25 830am ET

Monthly	2026					2025									
% Changes	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar
Core CPI inflation	0.2	0.4	0.2	0.2	0.3	0.2	na	na	0.2	0.3	0.3	0.2	0.1	0.2	0.1
Core PCE inflation		0.2	0.3	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.1
Core PCE YOY		3.3	3.2	3.0	3.1	3.0	2.8	2.8	2.8	2.9	2.9	2.8	2.8	2.6	2.7
Core CPI YOY	2.9	2.8	2.6	2.5	2.5	2.6	2.6	na	3.0	3.1	3.1	2.9	2.8	2.8	2.8

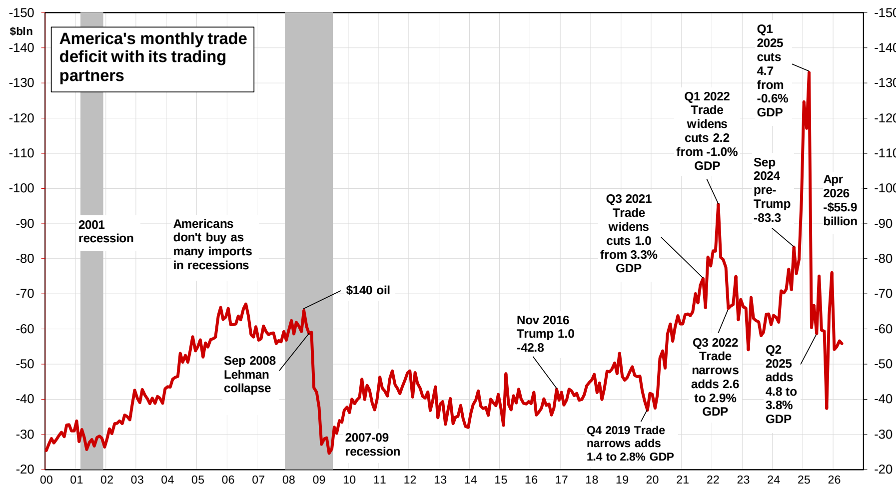
OTHER ECONOMIC NEWS

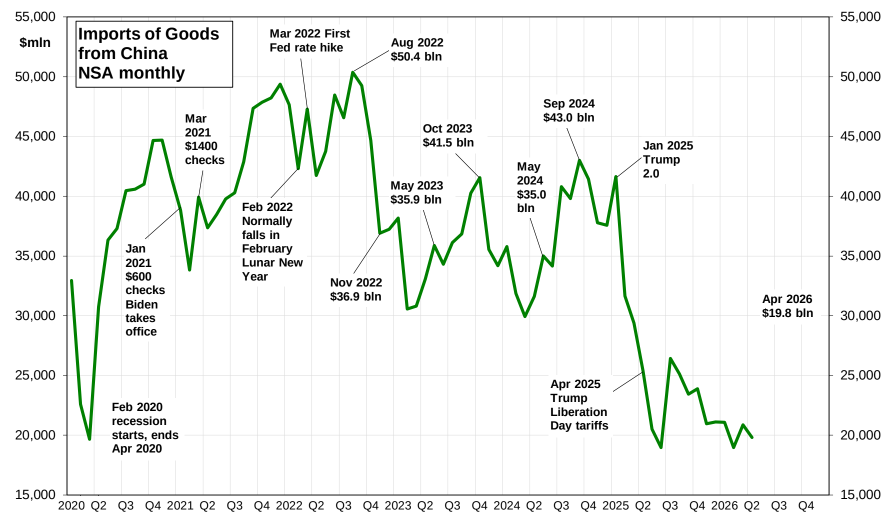
Trade picture improves (Tuesday)

Breaking economy news. The trade deficit has been remarkably steady this year. April was $55.9 billion versus $56.6 billion in March, which was revised down sharply from $60.3 billion initially with the extensive revision in all the data back to 1999. We are not sure how many more soybeans China promised to buy, but year-to-date total US soybean exports are $9.4 billion up from $6.3 trillion in the first four months of 2025. The volumes are picking up at $3.1 billion just for April. The overall US trade imbalance with China has come crashing down since the April 2025 Liberation Day. The trade deficit is running just $43.9 billion in the first four months of 2026 versus $202.7 billion for all of 2025.

$mln	Trade balance			Exports			Imports		
	Total	Goods	Services	Total	Goods	Services	Total	Goods	Services
Mar 2026	-56,585	-86,077	29,493	318,776	212,514	106,262	375,360	298,591	76,770
Apr 2026	-55,881	-83,687	27,806	327,101	221,263	105,839	382,982	304,949	78,033
Change	704	2,390	-1,687	8,325	8,749	-423	7,622	6,358	1,263

Net, net, the good news is that the trade picture is moving into better balance at the start of the second quarter as tariffs keep the growth of imports down relative to surprising strength seen in exports, but the bad news is the export growth looks uncertain as much of it appears to be the result of higher energy prices from the Iran conflict. On the imports side especially, the AI spending momentum is leading to greater demand for computers, semiconductors and telecom equipment. Capital goods imports were $7.0 billion, more than accounting for the $6.4 billion total import goods increase in April. Trump administration economic officials will be pleased that the trade imbalance is coming into line with the President's wishes. There is a chance that trade could add to real GDP growth in the second quarter although it would be a modest contribution.



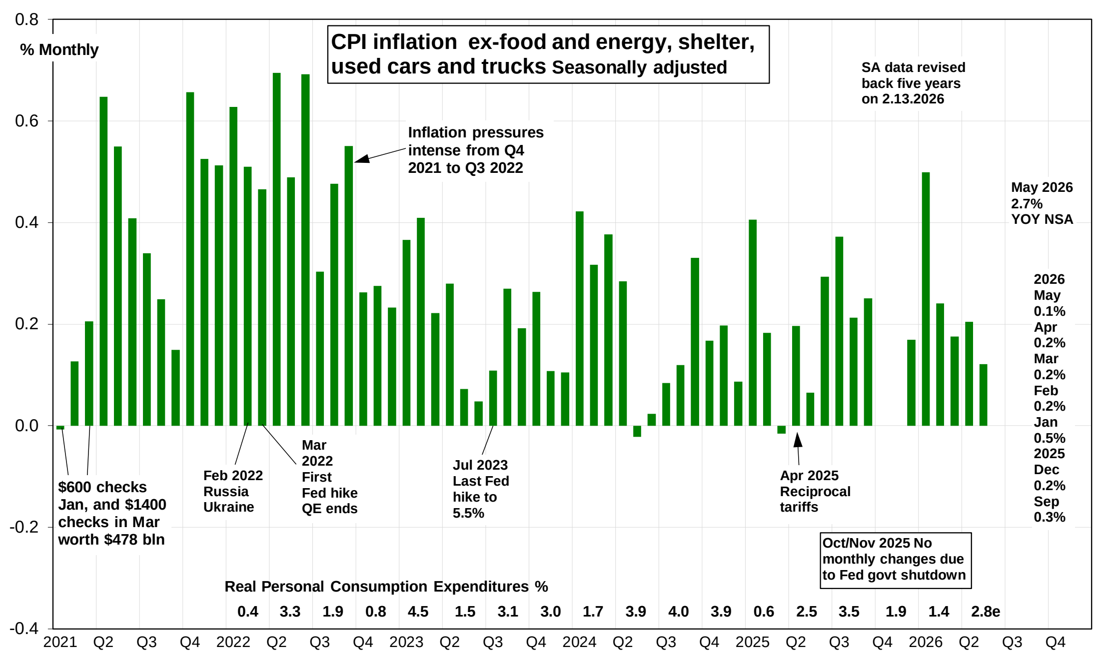


Inflation in retreat except for energy (Wednesday)

Dec 25		Monthly Percent Changes			YOY %
Weight	CPI inflation	Mar 2026	Apr 2026	May 2026	May 2026
100.0	Total	0.9	0.6	0.5	4.2
13.698	Food	0.0	0.5	0.2	3.1
8.325	Food at home	-0.2	0.7	0.1	2.7
5.373	Food away from home	0.2	0.2	0.3	3.5
6.383	Energy	10.9	3.8	3.9	23.5
2.895	Gasoline	21.2	5.4	7.0	40.5
79.919	Ex-food & energy	0.2	0.4	0.2	2.9
3.838	New vehicles	0.1	-0.2	-0.3	0.2
2.759	Used cars/trucks	-0.4	0.0	0.1	-2.0
2.368	Clothing	1.0	0.6	0.3	4.8
1.489	Medical care goods	-1.0	-0.4	-0.7	-1.8
35.625	Shelter	0.3	0.6	0.3	3.4
26.204	Owner equiv. rent	0.3	0.5	0.3	3.3
6.315	Transportation	0.6	0.3	-0.6	4.1
6.935	Medical care services	0.0	0.0	0.5	3.6
	Special: Where inflation might come back down to				
60.744	Services ex-energy	0.2	0.5	0.3	3.4
19.176	Commodities (core)	0.1	0.0	-0.1	1.1

Breaking economy news. Headline CPI rose 0.5% in May and is 4.2% higher than a year ago which should make social security recipients happy since many of them don't drive much and put gasoline in the car that is rusting in the driveway. Core CPI cooled to 0.2% (0.21) and is 2.9% higher than a year ago. Commodities less food and energy commodities that are susceptible to import tariffs fell 0.1%. Medical care commodities dropped 0.7%. Apparel had shown large "tariff" increases perhaps, 1.3% February, 1.0% March, 0.6% April, but were just 0.3% in May. Didn't Powell say once that the Fed economists thought the inflation effect would peak early in 2026? In any event, it looks like the 0.4% core CPI increase in April was a one-off due to an odd one-month jump in shelter costs.

Net, net, core CPI rose just 0.2% in May which stops the alarm bell set off by last month's 0.4% core CPI jump in April. False alarm. Those waiting for import tariffs to jack up prices are going to have to wait even longer as today's CPI report for May finds core commodities prices are actually falling not rising after showing no change the month before. Economists cannot keep cautioning that the worst inflation is yet to come if we keep getting benign reports like this. Gasoline jumped 7.0% in May and is 40.5% higher than a year ago, but so far merchants and companies have not tacked on these energy costs to other goods and services. It is a puzzle for which economists have no answer. Today's report is going to cause plenty of debate around the table at Warsh's first FOMC meeting next week with policymakers likely to hold their powder on interest rate hikes for now. Washington economic officials are going to redouble their efforts to tell Americans there isn't a cost-of-living crisis. Stay tuned. The sky isn't falling after all and the inflation risks for core consumer goods are in retreat for now.

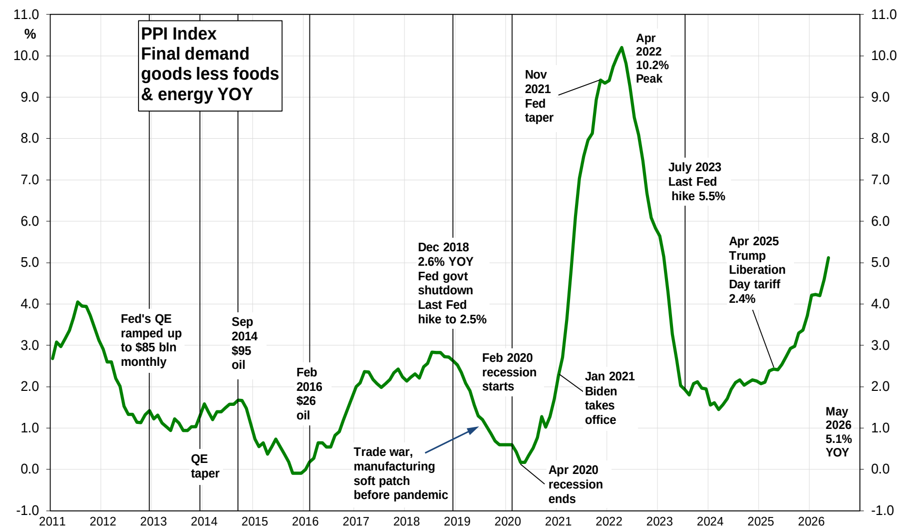


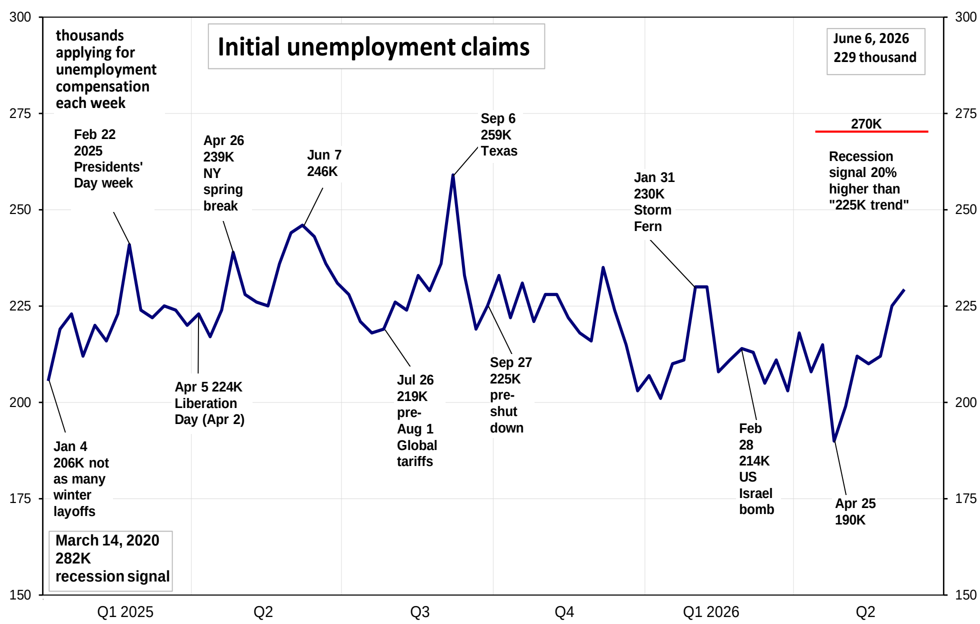
PPI inflation and weekly jobless claims rise (Thursday)

Monthly % SA 2026	Total final demand	Final demand goods: Total	Foods	Energy	**Less foods and energy	Final demand services: Total	Trade	Transportation and warehousing	Other
Jan	0.6	-0.1	-1.3	-1.7	0.7	0.9	2.0	1.0	0.3
Feb	0.5	1.0	2.3	2.1	0.3	0.3	-0.3	0.8	0.5
Mar	0.7	2.0	-0.6	10.4	0.3	0.2	0.4	2.1	0.0
Apr	1.1	1.9	0.2	7.5	0.7	0.7	1.3	3.8	0.1
May	1.1	2.8	0.6	10.7	0.8	0.3	-1.1	2.6	0.7

**Final demand goods, less foods and energy is old-fashioned PPI

Breaking economy news. PPI inflation rose 1.1% in May identical to the increase in April. Energy prices have been a driver of producer price inflation since the Iran war broke out at the end of February. Old-fashioned PPI with the focus on core commodities rose 0.8% in May and is 5.1% higher than a year ago; the maximum level set off after the pandemic was 10.2% year-on-year in April 2022, a month after the Fed's first rate hike for the cycle to 0.5%. Portfolio management fees jumped 4.9% with stock prices and is one reason for a potential 0.4% core PCE inflation rate in May to 3.4% year-on-year to be released Thursday, June 25, and we will look to Warsh to confirm this in his Fed meeting press conference on Wednesday, June 17. Weekly jobless claims rose 4K to 229K in the June 6 week following a 13K rise the week before during the Memorial Day holiday.





Net, net, another big one for the Producer price index where at some point the dam is going to break and companies will have to pass the higher energy costs from the Iran conflict on to the consumer. Core final demand commodities rose 0.8% in May after rising 0.7% in April. Meanwhile, the labor market has seen some big monthly job gains, but the weekly first-time filings for unemployment compensation are starting to look troubling as claims did not fall back after climbing during the Memorial Day holiday week. Stay tuned. The economy is weathering the war in the Middle East for now, but for how long is the question as inflation at the factory level is surging and job layoffs are mounting as well. As the economy heads into the summer months, the latest economic reports are troubling for the outlook. Fed officials will have their hands full on weighing the risks from job losses versus the jump in the price of goods produced by factories. Companies have not reached the breaking point where they have to pass on the higher energy costs to the consumer, but they will soon if the war in the Middle East does not wind down soon.

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