

Baker Market Update: Week in Review

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What do a Supreme Court case from 55 years ago and the FOMC have in common? Well, maybe more than one might think. In *Jacobellis vs. Ohio*, a 1964 lawsuit about a racy movie shown in Cleveland Heights, Justice Potter Stewart got the assignment to write the opinion for the majority. The Court ruled against Ohio and overturned the State's decision that the film was obscene. Although his opinion never specifically defined obscenity, the Justice famously said "I know it when I see it."

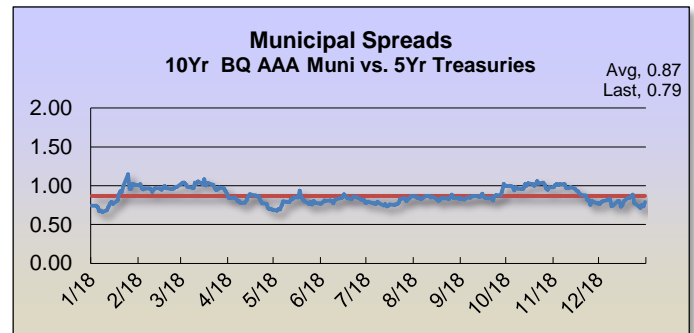
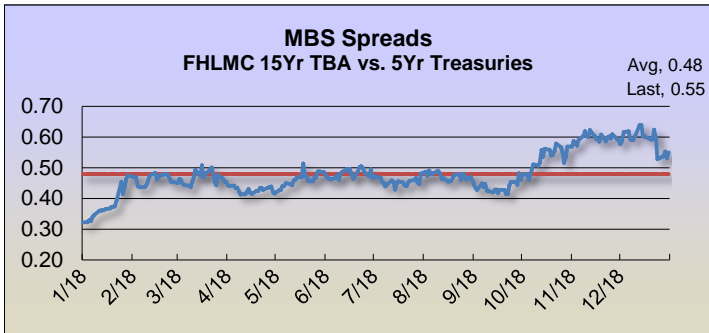
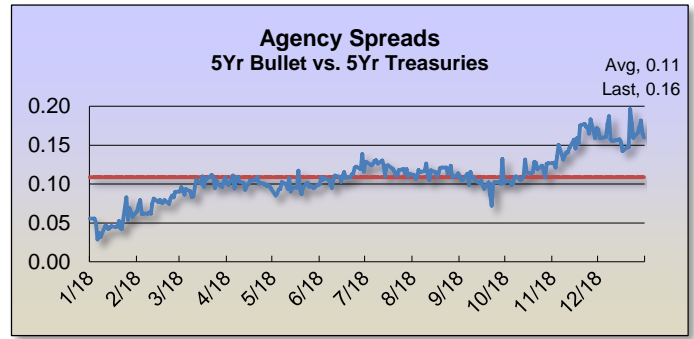
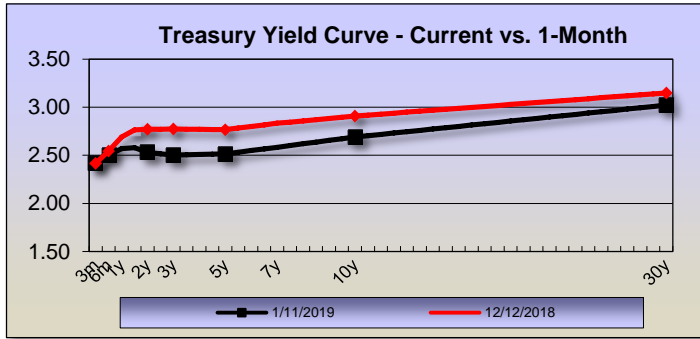
That sounds a lot like the Fed talking about the "neutral" rate of interest. They can't exactly tell us what it is, but, one hopes, they'll know it when they see it. Federal Reserve Vice-Chairman Richard Clarida thinks he can see it now. Kind of. In a speech given yesterday at New York University, Mr. Clarida observed that "the federal funds rate is now equal to the lower end of the range of Committee participants' estimates of its longer-run equilibrium level." Macroeconomic nerds refer to this nirvana-like rate of neutrality as r^* , and the Vice-Chairman reminded everyone that it is both unobservable and varies over time. So, it's like when the wind comes sweeping down the plain, it can't be seen, it can only be inferred from the data; or the tumbleweeds.

Mr. Clarida's boss was also out and about yesterday and appeared at the Economic Club of Washington, D.C. for a question-and-answer session. His answers sounded much like his lieutenant's diatribe as he described a strong domestic economy, a troubled landscape abroad, and several reminders to all about what a patient person he is. There's really not much else he *could* say after raising the policy rate just a few weeks ago.

His patience, and that of his Committee's, will come in handy since the prospect of an inflationary dumpster fire becomes less and less likely. Just this morning, the Bureau of Labor Statistics reported that the Consumer Price Index fell from a 2.2% year-over-year rate to just 1.9%. That's the headline rate. Without food & energy, the core CPI remained unchanged at 2.2% year-over-year. Definitely not a dumpster fire. The inflation picture will be more complete when, on the 31st, the Bureau of Economic Analysis (BEA) is scheduled to publish a fresh report on the Personal Consumption Expenditures Index; the inflation measurement the Fed most favors. Since the BEA is part of the PGS (partial government shutdown) that report may, or may not, be forthcoming. Optimistic observers are hoping that that situation gets resolved before then.

Small business owners have certainly been forthcoming with their optimistic outlook. The National Federation of Independent Businesses Optimism Index only slipped a little bit in a month that it was expected to slip a lot. November's reading of 104.8 only drifted slightly down to 104.4 in December, as experts predicted a plummet to 103. Optimism is alive and well. That's good, because the week got started with some disappointing news from the Institute of Supply Management (ISM). After seeing its manufacturing index plummet last week, the non-manufacturing or Services Index followed suit with a sharper-than-expected decline to 57.6 from 60.7. The BLS also reported that, despite the putatively, ultra-tight labor market, the number of open employment positions fell to 6,888k from 7,131k. That's not a decline that one would expect to see in the context of current circumstances.

But, and here's the good news, those folks that are currently working have gained some more purchasing power. Adjusted for inflation, Real Averagely Hourly Earnings grew in December by 1.1%, and that's up from November's growth of just 0.8%. Nevertheless, this is America, and if you *really* want to acquire some more purchasing power, just borrow it. The Federal Reserve reported that Consumer Credit grew by more than \$22B in November when it was only "supposed" to grow by \$17.5B. Consumers aren't the only ones borrowing money these days. The Treasury held auctions this week for \$78B worth of 3's, 10's, and 30's. The Ten-Year auction went okay, but decidedly lower Bid-to-Cover ratios for the 3's and 30's have some analysts concerned that investor appetite might be on the wane. Also on the wane this morning are Treasury yields. This morning's CPI report seems to have sparked a significant rally that has pushed the Ten-Year yield below 2.70% while the Two-Year is a nudge over 2.50%. So, despite the fact that about 25% of the government remains shuttered, the part that borrows money is open for business. When will a resolution to this shutdown dilemma be achieved and what will it look like? Unfortunately, nothing is certain on that score, but, hopefully, we'll all know it when we see it. Have a great weekend; be careful out there.



Treasury Market -- Historical						Fixed Rate Market											
Maty	Current	1Wk Change	Historical			Maty /AL	N-Call Agency	US Swap	AAA BQ Muni		Tax Muni	Agency Calls - Euro					
			1 Mo	6 Mo	1 Yr				C-Corp ²	S-Corp ³		Mty	3Mo	6mo	1Yr	2Yr	
3mo	2.42	0.01	2.39	1.96	1.43	2yr	2.59	2.69	2.42	2.58	20.00	2Yr	1.94	1.94	1.94	-	
6mo	2.50	(0.00)	2.55	2.14	1.59	3yr	2.57	2.63	2.46	2.62	27.33	3Yr	2.10	2.11	2.11	2.10	
1yr	2.57	0.00	2.70	2.33	1.77	5yr	2.63	2.60	2.63	2.80	42.00	5Yr	2.19	2.22	2.24	2.24	
2yr	2.53	0.04	2.77	2.58	1.98	7yr	2.79	2.64	2.79	2.97	57.00	7Yr	2.42	2.47	2.52	2.53	
3yr	2.50	0.03	2.76	2.68	2.10	10yr	3.05	2.72	3.14	3.34	69.00	10Yr	2.57	2.62	2.69	2.72	
5yr	2.52	0.01	2.74	2.75	2.33	15yr	3.22	2.81	3.64	3.87	99.00	February TBA MBS					
7yr	2.59	0.02	2.80	2.82	2.47	20yr	3.40	2.84	4.05	4.31	94.00	Cpn	15Yr -Yld/AL	30Yr -Yld/AL			
10yr	2.69	0.02	2.88	2.85	2.54	25yr	3.57	2.84	4.16	4.43	97.50	2.00	3.06	4.8y			
30yr	3.02	0.04	3.13	2.95	2.87	30yr		2.84	4.27	4.54	101.00	2.50	2.94	5.1y			
												3.00	3.01	5.3y	3.32	9.4y	
												3.50	3.11	4.9y	3.49	8.8y	
												4.00			3.60	6.4y	
												4.50			3.72	5.7y	

* Interpolated

Key Market Indices					
Index	Current	1Wk Change	Historical		
			1 Mo	6 Mo	1 Yr
Fed Funds	2.50	--	2.25	2.00	1.50
Primary Discount	3.00	--	2.75	2.50	2.00
2ndary Discount	3.50	--	3.25	3.00	2.50
Prime Rate	5.50	--	5.25	5.00	4.50
Sec. O.N. Finance	2.43	(0.27)	2.22	1.89	--
1 Month LIBOR	2.51	--	2.42	2.07	1.55
3 Month LIBOR	2.80	--	2.78	2.34	1.71
6 Month LIBOR	2.86	--	2.88	2.51	1.87
1 Year LIBOR	3.02	0.01	3.08	2.78	2.16
6 Month CD	2.84	--	2.87	2.50	1.87
1 Year CMT	2.59	0.09	2.69	2.36	1.78
REPO O/N	2.46	--	2.31	1.88	1.54
REPO 1Wk	2.44	--	2.24	1.98	1.46
CoF Federal	2.188	--	2.132	1.877	1.506
11th D. CoF (Nov)	1.060	--	1.079	0.885	0.746

FHLB Fixed Advance Rates			
Maturity	Chicago	Boston	Topeka
3mo	2.61	2.72	2.78
6mo	2.67	2.75	2.80
1yr	2.77	2.78	2.93
2yr	2.74	2.90	2.96
3yr	2.74	2.92	2.97
4yr	2.79	2.97	3.02
5yr	2.83	3.01	3.05
7yr	3.05	3.28	3.20
10yr	3.30	3.55	3.45
5yr Am	2.80		3.02
10yr Am	3.09		3.30

Fed Fund Futures	
Maturity	Rate
Jan-19	2.403
Feb-19	2.400
Mar-19	2.410
Apr-19	2.405
May-19	2.425
Jun-19	2.435
Jul-19	2.450
Aug-19	2.445
Sep-19	2.445
Oct-19	2.435
Nov-19	2.425

Weekly Economic Calendar						
This Week & Next						
Date	Release	Per.	Est.	Actual	Prior	Revised
01/07	ISM Non-Manufacturing Index	Dec	58.50	57.60	60.70	--
01/08	NFIB Small Business Optimism	Dec	103.00	104.40	104.80	--
01/08	JOLTS Job Openings	Nov	7050.00	6888.00	7079.00	7131.00
01/08	Consumer Credit	Nov	\$17.500b	\$22.149b	\$25.384b	\$24.980b
01/09	MBA Mortgage Applications	1/4	--	23.50%	-8.50%	--
01/10	Initial Jobless Claims	1/5	226k	216k	234k	233k
01/10	Continuing Claims	12/29	1740k	1722k	1740k	1750k
01/10	Bloomberg Consumer Comfort	1/6	--	58.50	59.60	--
01/11	CPI YoY	Dec	1.90%	1.90%	2.20%	--
01/11	CPI Ex Food and Energy YoY	Dec	2.20%	2.20%	2.20%	--
01/11	CPI Core Index SA	Dec	259.99	260.03	259.48	--
01/11	CPI Index NSA	Dec	251.07	251.23	252.04	--
01/11	Real Avg Weekly Earnings YoY	Dec	1.20%	1.20%	0.50%	0.60%
01/11	Real Avg Hourly Earning YoY	Dec	--	1.10%	0.80%	--
01/14	Advance Goods Trade Balance	Nov	-\$76.1b	--	-\$77.2b	-\$77.0b
01/14	Wholesale Inventories MoM	Nov P	0.50%	--	0.80%	--
01/14	Retail Inventories MoM	Nov	--	--	0.90%	0.80%
01/14	New Home Sales	Nov	567k	--	544k	--
01/14	Factory Orders Ex Trans	Nov F	--	--	0.30%	--
01/14	Durables Ex Transportation	Nov F	--	--	-0.30%	--
01/14	Cap Goods Ship Nondef Ex Air	Nov F	--	--	-0.10%	--
01/14	Trade Balance	Nov	-\$54.0b	--	-\$55.5b	--
01/14	Wholesale Trade Sales MoM	Nov	--	--	-0.20%	--
01/14	Monthly Budget Statement	Dec	-\$7.0b	--	-\$204.9b	--
01/15	Empire Manufacturing	Jan	12.00	--	10.90	--
01/15	PPI Final Demand YoY	Dec	2.50%	--	2.50%	--
01/15	PPI Ex Food and Energy YoY	Dec	3.00%	--	2.70%	--
01/15	PPI Ex Food, Energy, Trade YoY	Dec	--	--	2.80%	--
01/16	Retail Sales Ex Auto and Gas	Dec	0.40%	--	0.50%	--
01/16	Retail Sales Control Group	Dec	0.40%	--	0.90%	--
01/16	Import Price Index YoY	Dec	--	--	0.70%	--
01/16	Export Price Index YoY	Dec	--	--	1.80%	--
01/16	Business Inventories	Nov	0.30%	--	0.60%	--
01/16	NAHB Housing Market Index	Jan	56.00	--	56.00	--
01/16	Total Net TIC Flows	Nov	--	--	\$42.0b	--
01/16	Net Long-term TIC Flows	Nov	--	--	\$31.3b	--
01/17	Building Permits	Dec	1288k	--	1328k	--
01/17	Housing Starts	Dec	1253k	--	1256k	--
01/17	Philadelphia Fed Business Outlook	Jan	10.00	--	9.40	9.10
01/17	Initial Jobless Claims	1/12	223k	--	216k	--
01/17	Continuing Claims	1/5	--	--	1722k	--
01/17	Bloomberg Consumer Comfort	1/13	--	--	58.50	--
01/18	Manufacturing (SIC) Production	Dec	0.30%	--	0.00%	--
01/18	Capacity Utilization	Dec	0.79	--	0.79	--
01/18	U. of Mich. Sentiment	Jan P	96.00	--	98.30	--
01/18	U. of Mich. Current Conditions	Jan P	--	--	116.10	--
01/18	U. of Mich. 1 Yr Inflation	Jan P	--	--	2.70%	--

MBS Prepayments ⁴						
3-Month CPR						
Type	2.0	2.5	3.0	3.5	4.0	4.5
FN 10y	10.5	11.8	13.7	14.3	16.1	33.9
FH/FN 15y	5.6	5.8	6.4	7.6	13.1	15.0
GN 15y	6.8	9.3	11.1	12.6	12.2	11.3
FH/FN 20y		5.3	6.6	7.6	7.9	9.6
FH/FN 30y	1.3	4.9	3.9	3.5	4.5	7.5
GN 30y	8.6	8.8	10.8	13.6	11.6	12.1

CPR Projections						
Type	2.0	2.5	3.0	3.5	4.0	4.5
FN 10y	11.9	12.1	12.6	18.8	12.8	25.1
FH/FN 15y	7.6	8.1	7.8	10.3	12.6	21.3
GN 15y	9.0	10.2	13.4	15.0	14.9	14.4
FH/FN 20y	0.1	6.8	8.0	11.2	14.9	14.4
FH/FN 30y	5.0	5.6	6.4	7.6	12.3	14.1
GN 30y	8.5	8.0	9.2	12.0	16.0	19.5

Other Markets					
Index	Current	1Wk Chng	Historical		
			1 Mo	6 Mo	1 Yr
Currencies					
Japanese Yen	108.36	(0.15)	113.38	112.01	111.26
Euro	1.15	0.01	1.13	1.17	1.20
Dollar Index	95.56	(0.62)	97.39	94.72	91.85
Major Stock Indices					
Dow Jones	23,948	514	24,370	24,700	25,575
S&P 500	2,591.7	59.8	2,636.8	2,774.0	2,767.6
NASDAQ	6,963.5	225	7,031.8	7,716.6	7,211.8
Commodities					
Gold	1,290.3	4.5	1,247.2	1,244.4	1,322.5
Crude Oil	51.85	3.89	51.65	70.38	63.80
Natural Gas	3.08	0.03	4.41	2.83	3.08
Wheat	521.5	4.5	521.0	471.8	433.3
Corn	377.5	-5.5	384.8	340.0	348.8

Notes	
1 Call Agy = Maturity at left w/ a 1-Year Call at Par	
2 Muni TEY (21% Fed, 0.5% CoF)	
3 S-Corp TEY Muni (29.6%, no TEFERA)	
4 MBS Prepayments are provided by Bloomberg	

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