

Baker Market Update: Week in Review

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Christmas has a new Grinch, and his name is Jerome. As Chairman of the FOMC, Mr. Powell has gotten a lot of grief since his post-meeting press conference on Wednesday. Does he deserve it? The announcement of the central bank's ninth quarter-point rate-hike of this cycle should not have been a surprise to anyone, and it wasn't. So, why did equity markets react like they found a lump of coal in their stockings? Well, it wasn't so much about what the Fed Chairman did, it's about what he said. More precisely, it's what he *didn't* say. He didn't say the Fed would be slowing down on balance sheet reduction and he didn't say that Wednesday's hike would be the last one for a while. He didn't say the Committee would be taking a time-out to reassess conditions; he didn't say there would be a pause. That doesn't mean there won't be one, but investors wanted to hear him say it. He didn't say it because his perception of the data that drives such decisions was different than that of many others.

So, is it Mr. Powell's fault that investors misperceived his perceptions? Careful readers may remember the note of caution that was earlier issued to those engaged in such behavior, so no, the nosedive of the Dow was not the fault of the Fed.

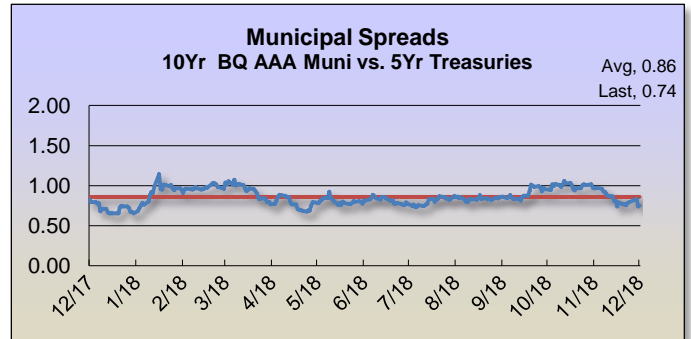
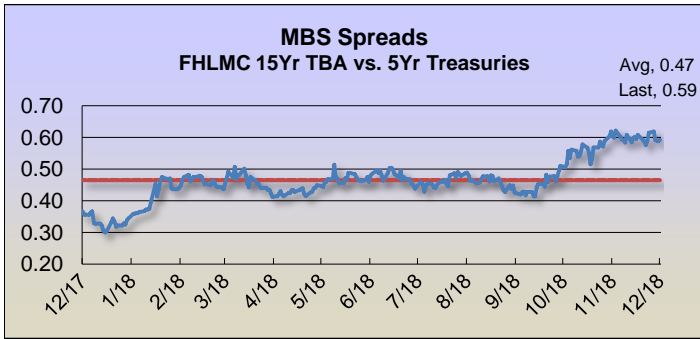
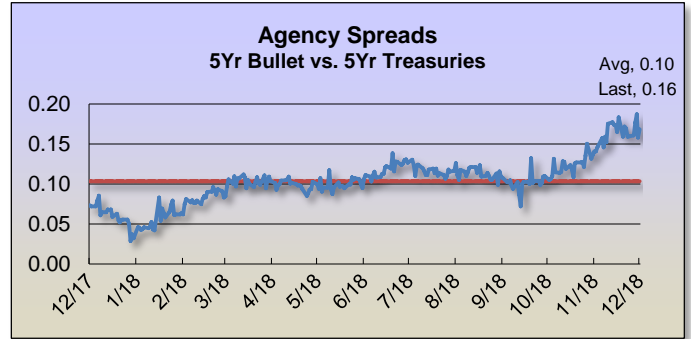
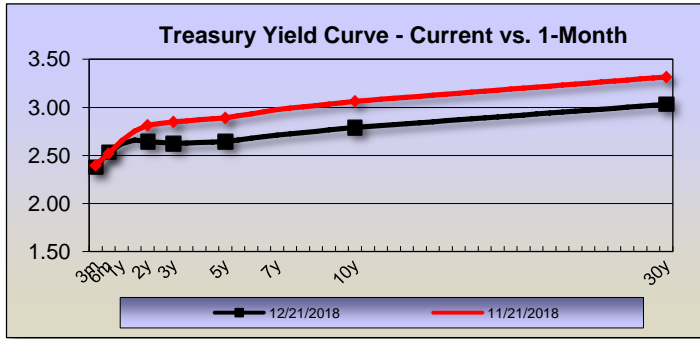
Before absolving our favorite central bankers of all complicity, the statement issued by the data-driven Committee was puzzling to many with its description of inflation expectations as "stable", when clearly, they're not. In mid-October, the Five-Year Breakeven Inflation Rate implied by the TIPS market was 2%. Today, it sits uncomfortably at 1.54%. The Fed's Five-Year, Five-Year Forward Breakeven rate, an estimation of inflation for the five-year period following the next five years was slightly over 2% as recently as three weeks ago. It's currently estimated to be 1.83%. Describing the expectations situation as "stable" appears to be ignoring a key piece of the data that's supposed to be doing the driving. Nevertheless, during the Chairman's Press Conference, Mr. Powell made it clear that the Committee was not abandoning its plan of continued, gradual rate hikes; a message most investors were not expecting. But still, the Fed is not responsible for the expectations of others.

Many of those others expected the final count of Q3 GDP to hold steady at 3.5%, but they learned this morning that it slipped a bit to 3.4%. Also slipping, and this was more than "a bit", was the Philadelphia Fed's Business Conditions Index. Its plunge to 9.4 from 12.9 was expected to go the other way, clear up to 15. There's that expectations thing again. On Monday, we saw a similar reversal in the Empire Manufacturing Index with its slide to 10.9 from 23.3. And just to pile on, the Kansas City Fed announced this morning that its Manufacturing Index plummeted to 3 from 15. A majestic plummet matched only by the dismal outlook published by FedEx. Jerome, are you watching the data?

More encouraging data came this week in the form of an unexpected rise of 2% in Existing Home Sales and a nudge of 0.2% in the Conference Board's Index of Leading Indicators. The Committee may find some solace in today's report that its preferred inflation measure, the core Personal Consumption Expenditures Index (PCE), rose by one-tenth last month bringing the year-over-year rate back up to 1.9%. For the third quarter, the core PCE rate was 1.6%. In the same report from the Bureau of Economic Analysis (BEA), it was also reported that Personal Income rose by 0.2% while Personal Spending rose by 0.4%. Clearly, spending money is easier than making it.

The consumers that spend that money appear to remain unfazed by the current environment of economic and political disquiet. The University of Michigan Index of Consumer Sentiment rose to 98.3 from 97.5, and that's a lot better Christmas story than the one that ends with a government shutdown. Still no word on how that little melodrama will play out, but let's hope they spare the Grand Canyon this time. And depending on how that awkward situation plays out, the rally in Treasury bonds could very well accelerate, although yesterday's uncertainty triggered a slight sell-off. Maybe the credit markets have been a little over-served and while the way forward may not be obvious to all, it's obvious enough to pull the Ten-Year yield below 2.80%, and keep the curve's short-term inversion in place.

The economy will survive the Fed's latest rate hike, but how will it fare with the next one? As for the Grinch, he can't be all bad; he's a dog owner after all. Have a great weekend and 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	2.38	(0.03)	2.40	1.93	1.35	2yr	2.71	2.82	2.49	2.65	22.00	2Yr	1.94	1.94	1.94	-
6mo	2.53	(0.01)	2.52	2.11	1.53	3yr	2.71	2.77	2.55	2.71	29.33	3Yr	2.10	2.11	2.11	2.10
1yr	2.62	(0.05)	2.66	2.32	1.71	5yr	2.81	2.75	2.73	2.91	44.00	5Yr	2.19	2.22	2.24	2.24
2yr	2.65	(0.09)	2.81	2.54	1.88	7yr	2.92	2.78	2.93	3.11	62.00	7Yr	2.42	2.47	2.52	2.53
3yr	2.62	(0.10)	2.85	2.65	2.00	10yr	3.12	2.84	3.23	3.44	76.00	10Yr	2.57	2.62	2.69	2.72
5yr	2.64	(0.09)	2.89	2.77	2.25	15yr	3.28	2.90	3.64	3.87	103.00	January TBA MBS				
7yr	2.71	(0.09)	2.98	2.86	2.40	20yr	3.36	2.92	4.02	4.28	98.00	Cpn	15Yr -Yld/AL		30Yr -Yld/AL	
10yr	2.79	(0.10)	3.06	2.90	2.48	25yr	3.49	2.92	4.14	4.40	100.50	2.00	3.13	4.9y		
30yr	3.03	(0.11)	3.32	3.04	2.84	30yr		2.91	4.26	4.53	103.00	2.50	3.10	5.1y		
												3.00	3.13	5.5y	3.41	9.6y
												3.50	3.28	5.0y	3.58	9.2y
												4.00			3.72	6.8y
												4.50			3.82	5.9y

* Interpolated

Key Market Indices					
Index	Current	1Wk Change	Historical		
			1 Mo	6 Mo	1 Yr
Fed Funds	2.50	0.25	2.25	2.00	1.50
Primary Discount	3.00	0.25	2.75	2.50	2.00
2ndary Discount	3.50	0.25	3.25	3.00	2.50
Prime Rate	5.50	0.25	5.25	5.00	4.50
Sec. O.N. Finance	2.41	0.20	2.20	1.87	--
1 Month LIBOR	2.48	0.04	2.30	2.09	1.51
3 Month LIBOR	2.79	0.01	2.65	2.33	1.64
6 Month LIBOR	2.87	--	2.87	2.50	1.79
1 Year LIBOR	3.05	--	3.11	2.76	2.07
6 Month CD	2.87	--	2.89	2.50	1.81
1 Year CMT	2.64	--	2.67	2.36	1.72
REPO O/N	2.48	0.20	2.22	2.01	1.49
REPO 1Wk	2.59	0.26	2.24	2.03	1.47
CoF Federal	2.188	--	2.132	1.877	1.506
11th D. CoF (Oct)	1.079	--	1.018	0.895	0.737

FHLB Fixed Advance Rates			
Maturity	Chicago	Boston	Topeka
3mo	2.61	2.72	2.75
6mo	2.68	2.80	2.80
1yr	2.86	2.87	3.03
2yr	2.85	3.03	3.08
3yr	2.85	3.05	3.09
4yr	2.89	3.10	3.13
5yr	2.93	3.15	3.16
7yr	3.13	3.38	3.29
10yr	3.30	3.60	3.45
5yr Am	2.96		3.13
10yr Am	3.20		3.36

Fed Fund Futures	
Maturity	Rate
Dec-18	2.275
Jan-19	2.400
Feb-19	2.395
Mar-19	2.420
Apr-19	2.450
May-19	2.470
Jun-19	2.480
Jul-19	2.505
Aug-19	2.525
Sep-19	2.535
Oct-19	2.540

Weekly Economic Calendar						
This Week & Next						
Date	Release	Per.	Est.	Actual	Prior	Revised
12/17	Empire Manufacturing	Dec	20	10.9	23.3	--
12/17	NAHB Housing Market Index	Dec	60	56.0	60.0	--
12/17	Total Net TIC Flows	Oct	--	\$42.0b	-\$29.4b	-\$29.2b
12/17	Net Long-term TIC Flows	Oct	--	\$31.3b	\$30.8b	--
12/18	Housing Starts	Nov	1226k	1256k	1228k	1217k
12/18	Housing Starts MoM	Nov	0	0.0	0.0	-0.02
12/18	Building Permits	Nov	1260k	1328k	1263k	1265k
12/18	Building Permits MoM	Nov	0	0.1	0.0	0.00
12/18	MBA Mortgage Applications	12/14	--	-0.1	0.0	--
12/18	Current Account Balance	3Q	-\$125.0b	-\$124.8b	-\$101.5b	-\$101.2b
12/19	Existing Home Sales	Nov	5.20m	5.32m	5.22m	--
12/19	FOMC Rate Decision (Upper Bound)	12/19	2.5%	2.5%	2.3%	--
12/19	Interest Rate on Excess Reserves	12/20	2.4%	2.4%	2.2%	--
12/19	Philadelphia Fed Business Outlook	Dec	15	9.4	12.9	--
12/19	Initial Jobless Claims	12/15	215k	214k	206k	--
12/20	Continuing Claims	12/8	1663k	1688k	1661k	--
12/20	Leading Index	Nov	0.0%	0.2%	0.1%	-0.3%
12/20	GDP Annualized QoQ	3Q T	3.5%	3.4%	3.5%	--
12/20	Personal Consumption	3Q T	3.6%	3.5%	3.6%	--
12/21	GDP Price Index	3Q T	1.7%	1.8%	1.7%	--
12/21	Core PCE QoQ	3Q T	1.5%	1.6%	1.5%	--
12/21	Durable Goods Orders	Nov P	1.6%	0.8%	-4.3%	--
12/21	Durables Ex Transportation	Nov P	0.3%	-0.3%	0.2%	0.4%
12/21	Cap Goods Orders Nondef Ex Air	Nov P	0.2%	-0.6%	0.0%	0.5%
12/21	Cap Goods Ship Nondef Ex Air	Nov P	0.2%	-0.1%	0.3%	0.8%
12/21	Personal Income	Nov	0.3%	0.2%	0.5%	--
12/21	Personal Spending	Nov	0.3%	0.4%	0.6%	0.8%
12/21	Real Personal Spending	Nov	0.3%	0.3%	0.4%	0.6%
12/21	PCE Deflator MoM	Nov	0.0%	0.1%	0.2%	--
12/21	PCE Deflator YoY	Nov	1.8%	1.8%	2.0%	--
12/21	PCE Core MoM	Nov	0.2%	0.1%	0.1%	--
12/21	PCE Core YoY	Nov	1.9%	1.9%	1.8%	--
12/21	U. of Mich. Sentiment	Dec F	97	98.3	97.5	--
12/21	U. of Mich. Current Conditions	Dec F	--	116.1	115.2	--
12/21	U. of Mich. Expectations	Dec F	--	87.0	86.1	--
12/21	U. of Mich. 1 Yr Inflation	Dec F	--	2.7%	2.7%	--
12/21	U. of Mich. 5-10 Yr Inflation	Dec F	--	2.5%	2.4%	--
12/21	Kansas City Fed Manf. Activity	Dec	13	--	15	--
12/21	Chicago Fed Nat Activity Index	Nov	--	--	0.2	--
12/21	S&P CoreLogic CS US HPI NSA Index	Oct	--	--	205.8	--
12/21	S&P CoreLogic CS 20-City MoM SA	Oct	0.4%	--	0.3%	--
12/21	S&P CoreLogic CS 20-City YoY NSA	Oct	4.8%	--	5.2%	--
12/21	S&P CoreLogic CS 20-City NSA Index	Oct	--	--	213.8	--
12/21	S&P CoreLogic CS US HPI YoY NSA	Oct	--	--	5.5%	--
12/21	Richmond Fed Manufact. Index	Dec	16	--	14	--
12/24	U.S. to Sell USD18 Bln 2-Year Floating					
12/26	U.S. to Sell USD41 Bln 5-Year Notes					

MBS Prepayments ⁴						
3-Month CPR						
Type	2.0	2.5	3.0	3.5	4.0	4.5
FN 10y	10.4	11.8	13.8	14.2	18.2	31.0
FH/FN 15y	5.7	5.9	6.7	7.9	13.2	15.0
GN 15y	6.5	9.9	11.0	12.3	12.4	11.8
FH/FN 20y		5.4	6.8	7.9	8.3	9.7
FH/FN 30y	1.5	4.8	3.8	3.6	4.7	7.5
GN 30y	9.2	9.2	11.8	14.3	13.0	13.0
CPR Projections						
Type	2.0	2.5	3.0	3.5	4.0	4.5
FN 10y	11.7	11.9	12.6	18.7	13.0	25.0
FH/FN 15y	7.5	8.0	7.4	9.6	12.4	21.3
GN 15y	9.3	10.1	13.0	14.7	14.4	14.0
FH/FN 20y	0.1	6.6	7.5	9.4	12.2	13.2
FH/FN 30y	5.0	5.6	6.1	6.9	11.2	13.4
GN 30y	9.7	7.9	8.8	10.7	16.0	19.3

Other Markets					
Index	Current	1Wk Chng	Historical		
			1 Mo	6 Mo	1 Yr
Currencies					
Japanese Yen	111.14	(2.25)	113.06	109.99	113.33
Euro	1.14	0.01	1.14	1.16	1.19
Dollar Index	96.62	(0.83)	96.71	94.86	93.28
Major Stock Indices					
Dow Jones	22,860	(1,738)	24,465	24,462	24,782
S&P 500	2,467.4	(183.1)	2,649.9	2,749.8	2,684.6
NASDAQ	6,528.4	(542)	6,972.3	7,713.0	6,965.4
Commodities					
Gold	1,258.1	21.1	1,228.0	1,267.2	1,267.3
Crude Oil	45.68	(5.52)	54.63	65.54	58.36
Natural Gas	3.70	(0.13)	4.45	2.98	2.60
Wheat	517.5	-10.3	498.8	495.3	427.0
Corn	376.3	-0.5	361.8	357.0	351.3

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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