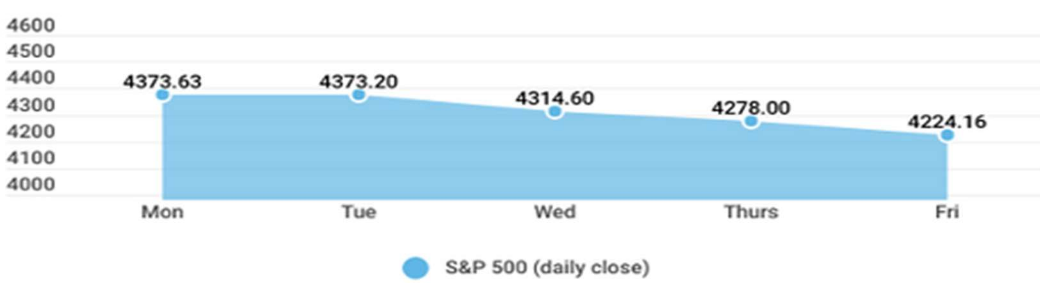
WEEKLY ECONOMIC UPDATE OCT. 23, 2023

Rising bond yields and uncertainty over whether this was the close of the Fed's rate-hike cycle dragged markets lower last week despite solid corporate earnings results.

The Dow Jones Industrial Average sank 1.61%, while the Standard & Poor's 500 fell 2.39%. The Nasdaq Composite index, which has led for much of the year, slumped 3.16%. The MSCI EAFE index, which tracks developed overseas stock markets, retreated 1.67%.[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	33,127.28	-1.61%	-0.06%
NASDAQ	12,983.81	-3.16%	+24.05%
MSCI-EAFE	1,978.98	-1.67%	+1.80%
S&P 500	4,224.16	-2.39%	+10.02%



	Treasury	Close	Week	Y-T-D
	10-Year Note	4.93%	+0.30%	+1.05%

Sources: The Wall Street Journal, October 20, 2023; Treasury.gov, October 20, 2023
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, October 13, to Friday, October 20 close. Weekly performance for the MSCI-EAFE is measured from Friday, October 13 open to Thursday, October 19 close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Rising Yields Sink Stocks

Stocks rallied to start the week on earnings optimism before losing momentum over rising bond yields. Yields rose after traders speculated that strong economic data might persuade the Fed to raise rates. By mid-week, stocks turned lower as the 10-year Treasury yield moved above 4.9% for the first time since 2007, while mortgage rates hit 8%–the highest level since mid-2000.[4]

Stocks were under pressure Thursday as the 10-year Treasury yield moved closer to 5% and in response to comments from Fed Chair Powell that inflation remained too high. With the 10-year Treasury yield crossing above the 5% mark on Friday–and ahead of a weekend of uncertainty in the Middle East–stocks weakened further, ending a down week on a sour note.

Economic Strength, Housing Weakness

The economy continued to evidence surprising strength according to data released last week. Despite worries of a struggling consumer, consumers increased their spending as retail sales rose 0.7% in September–well above the forecast of a 0.3% rise, while industrial output jumped 0.3%, exceeding the forecast of a 0.1% gain.[5]

There were also updates on the state of housing. Housing starts rebounded 7.0% from August, though permits (an indicator of future housing starts) declined 4.4% month-over-month. Existing home sales were weak, falling 2.0% from August and 15.4% from a year ago. Existing home sales are on track to record their slowest year since 2011.[6,7]

This Week: Key Economic Data

Tuesday: Purchasing Managers' Index (PMI).

Wednesday: New Home Sales.

Thursday: Gross Domestic Product (GDP). Durable Goods Orders. Jobless Claims.

Friday: Personal Income and Outlays. Consumer Sentiment.

“These days I get most of my exercise from shaking my head in disbelief.”

– Comment from a Cartoon

Of Note

As one who loves metaphor, one can’t help but notice the recent and varying range of metaphorical macro warnings. JP Morgan’s Jamie Dimon, for example, is now predicting a “market hurricane” ahead, which Peter Schiff has recently upgraded to a “Category 5.” Meanwhile, the always blunt Michael Burry has compared the trajectory of our market economy and macro warnings to “watching a plane crash.” In short, the bull vs. bear debate is behind us; even the TBTF (To Big To Fail) banks are now openly alarmed.

In fact, current macro warnings are more suggestive of a market shark rather than bear, and borrowing a line from Speilberg’s Jaws, we are all “gonna need a bigger boat” as these dorsal-finned macro warnings begin circling in plain sight.

Specifically, we are seeing a number of macro warnings rising simultaneously, each of which are eerily familiar to the pre-2008 conditions which preceded the last global implosion.

Perhaps the most important of these is counterparty risk: The September 2019 implosion of the reverse repo market, this was a very big deal. Of course, the corporate media and politicized Fed tried to downplay the repo crisis as Powell was losing control of the rates markets and banks were losing trust for each other (and each other’s collateral.) The financial “leadership” were hoping an intentionally confusing and complex reverse repo market would be too difficult for the average citizen-investor to grasp. Thus, the 2019 Fed nervously whistled past that ticking timebomb as it dumped trillions of mouse-click money into the repo morass.

The reverse repo market is a place where loans keep markets and banks greased in short-term (typically over-night) liquidity, as liquidity (i.e., borrowed money) is the grease that makes our debt-soaked, over-levered and counter-party heavy markets go round.

Given this important “grease,” when the counterparties in the reverse repo markets lose trust in each other, the wheels of the markets start to squeak, shake, rattle and rolloff. In September of 2019, TBTF Bank 1 essentially stopped trusting TBTF Bank 2’s balance sheet, and thus wouldn’t lend each other money at normal rates. The distrusting banks chose instead to charge each other painful rates, skyrocketing from the sub 2% range to the 10% range in one trading day. That's a counter-party crisis colliding with a liquidity crisis. Or, more simply: A trust crisis. The net result? The Fed's money printers came in as a repo lender of last resort, tossing trillions of "loaned" grease into this otherwise dysfunctional repo marriage among the big banks.

Once again, and unbeknownst to just about everybody, those days of dysfunctional liquidity marriages have returned. As of April 2021, the Fed had been making daily loans into the reverse repo market to the skyrocketing tune of $2T a day. Please re-read that last line. The Fed is providing the money market with mind-numbingly massive doses of daily liquidity to keep it alive. They do this by swapping out Treasuries for money market funds in what is the churning equivalent to treading water with fiat dollars. Some experts claim that this insane level of Fed "support" is due to the TBTF banks off-loading deposits from their balance sheets onto the Fed's balance sheet in order to meet the Basel 3 requirements. A more likely scenario, however, boils down to counter-party distrust and hence counter-party risk among Wall Street's broken moving parts.

That is, fund managers who run money market accounts no longer want to park their money with the TBTF banks for the simple reason that they see trouble ahead and frankly don't trust them. Stated otherwise, distrust in the system is rising like a shark fin and the money markets are now swimming toward a "bigger boat"—namely the Fed. Such distrust among counterparties is a major macro warning. In fact, it was precisely this kind of counterparty distrust/risk (and bad collateral) which brought down Bear Sterns and Lehman in '08.[8]

Footnotes and Sources

1. The Wall Street Journal, October 20, 2023
2. The Wall Street Journal, October 20, 2023
3. The Wall Street Journal, October 20, 2023
4. CNBC, October 17, 2023
5. CNBC, October 17, 2023
6. CNN, October 18, 2023
7. The Wall Street Journal, October 19, 2023
8. goldswitzerland.com/fatal-macro-warnings-were-gonna-need-a-bigger-boat/

performance does not guarantee future results.

The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.

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