

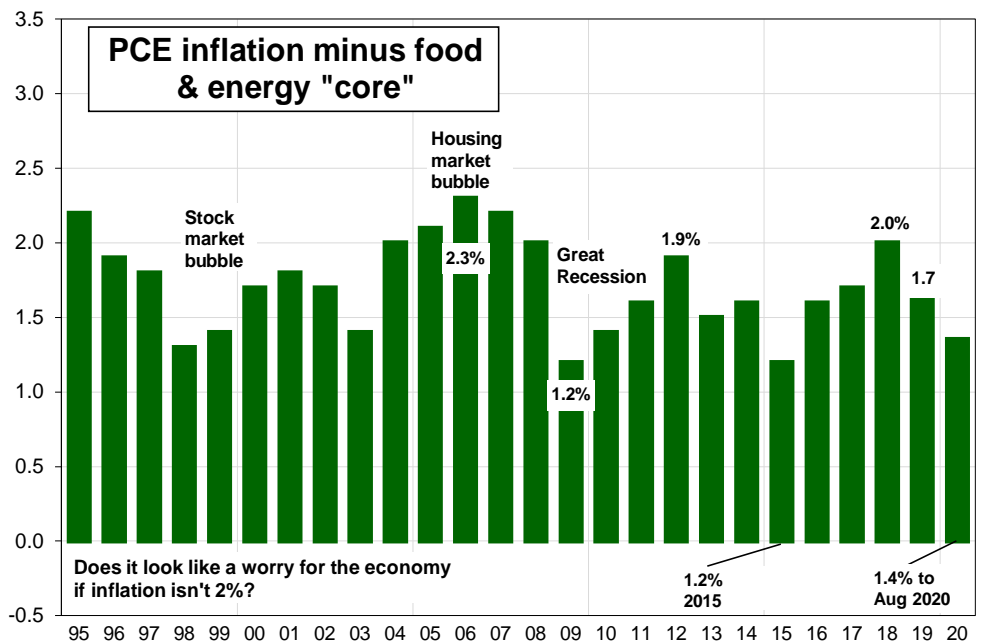
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INFLATION REPORT AHEAD: GUIDING LIGHT FOR FED POLICY

We will try to be more forward-looking in this week's newsletter instead of being backward-looking all the time. We will wait until next week to tell you where the stock market is going and why the economic outlook is important for that. The CPI inflation report for September will be released Tuesday,

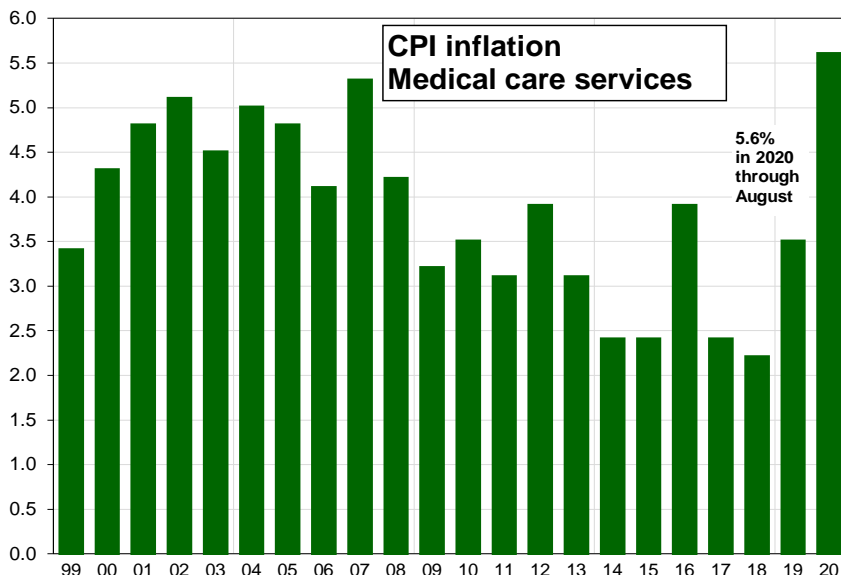


%	Core CPI	Core PCE	Diff
2002	2.4	1.7	0.7
2003	1.4	1.4	0.0
2004	1.8	2.0	-0.2
2005	2.2	2.1	0.1
2006	2.5	2.3	0.2
2007	2.3	2.2	0.1
2008	2.3	2.0	0.3
2009	1.7	1.2	0.5
2010	1.0	1.4	-0.4
2011	1.7	1.6	0.1
2012	2.1	1.9	0.2
2013	1.8	1.5	0.3
2014	1.7	1.6	0.1
2015	1.8	1.2	0.6
2016	2.2	1.6	0.6
2017	1.8	1.7	0.1
2018	2.1	2.0	0.1
2019	2.2	1.7	0.5
2020	1.7	1.4	0.3
2020-to August			

October 13 at 830am ET, the day after the Columbus Day holiday that the the stock market won't be closed for. The bond market will be closed Monday, but some say that market is closed for trading every day as the Fed continues to buy \$80 billion U.S. government securities per month. Our forecast is for headline CPI inflation to rise 0.2% in September to 1.4% year-on-year, and we expect core CPI inflation to increase 0.2% in September to 1.7% year-on-year. Guess both of these numbers are a long way from the deflation we saw earlier in the pandemic when depression-magnitude job losses pushed the unemployment rate to nearly 20% (if measured properly by the survey). Core CPI inflation, which subtracts food and energy prices, actually fell for three straight months earlier this year, where ordinarily it doesn't even fall for one month. It is looking like the Great Depression scare

and the potential for deflation are over for now even with millions of Americans out of work. Deflation can keep the economy from recovering because if consumers see car prices falling 10 percent in a year, they will put off the purchase of a new car, waiting for even cheaper prices in the future. If consumers don't spend, there's no economic demand and no growth. This deflation downward-spiral in the economy was only seen back in the Great Depression from 1929 to 1933.

The Fed wants to see more inflation so they can cut interest rates from higher levels to help us. This policy keeping interest rates lower for longer to get more inflation to get interest rates higher throws seniors "who have done the right thing all their lives and saved money for retirement" under the bus. The interest on savings won't buy a cup of coffee right now with rates at zero. Over the next ten years, if inflation rises 2% each year and the Fed leaves rates at zero (exactly), 2 X 10 equals 20, which means your money in the bank lost 20 percent of its purchasing power. You won't have retirement savings of \$100,000 in the year 2030 you will have \$80,000. This seems like a problem.



The Fed targets PCE inflation of course not CPI and that economic number won't be released until Friday, October 30 at 830am ET. If the Fed went back to making CPI its favorite inflation indicator, dangerously low inflation wouldn't look so dangerous. Core CPI was 2.2% in 2019 where core PCE inflation was 1.7%. Whether it is CPI or PCE, looking at this table, it isn't clear what the Fed gets by saying inflation will run above 2% for a time without a rate hike. Guess we can continue to ask the many Fed officials when they speak just why is it so important that core PCE inflation of 1.4% so far this year be back above 2%--say back to where it was in 2006 at 2.3%. Why exactly is that a big deal again? For the economy. For America. Since 1995, core PCE inflation has only been above 2.0% in three years, all of them during the housing bubble over a decade ago. "Low" inflation didn't seem to hurt anything in the other 22 years.

Thinking of retirees and their medical care and inflation, it was once thought the baby boom generation would bankrupt the country due to their rising medical costs. It will still be a financial burden for the country, but at least

Key Differences in Core Inflation					
Weight	PCE inflation	YOY	Weight	CPI inflation	YOY
(88.5)	Core inflation	1.6	(79.0)	Core inflation	1.7
19.2	Housing/shelter	2.8	41.9	Housing/shelter	2.3
18.7	Medical care services	3.0	9.2	Medical care services	5.3

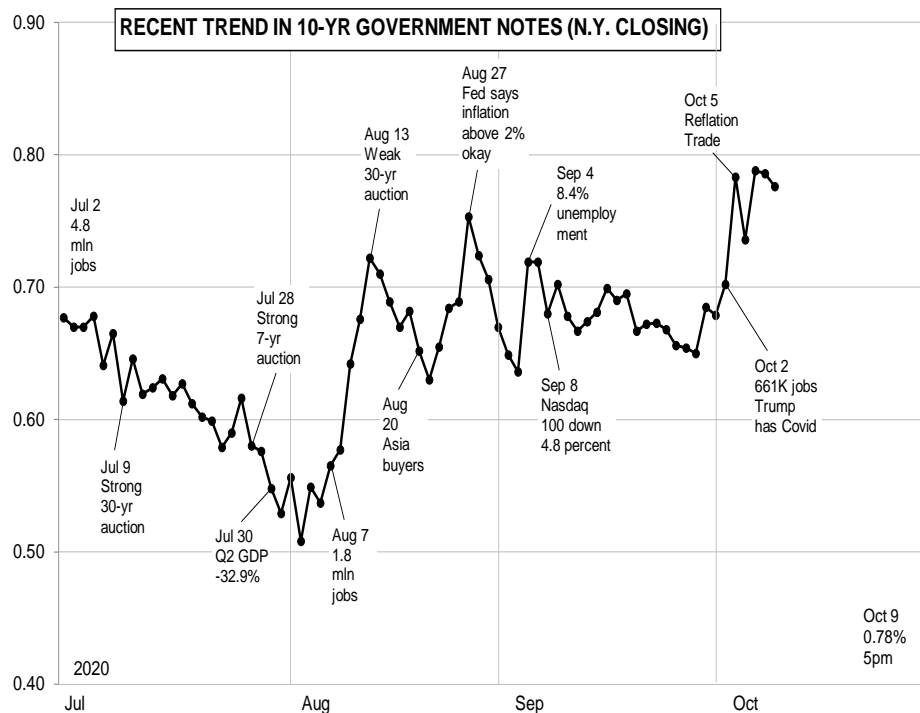
Year/Year (YOY) inflation is Aug 2020 for PCE, Aug for CPI
Housing/Medical care weights relative to core purchases

medical services inflation in CPI shown here had been coming down before Covid-19 from where it was in the early 2000s when the dire predictions were made about the nation's finances. Seniors can look forward to the October 13 CPI report because this is the month where the cost-of-living adjustment (COLA) is made which raises social security benefit payments for the elderly. Last year's increase was 1.6% which is measured using the change in the CPI index for workers from Q3 2018 to Q3 2019. If CPI rises 0.2% in September, the COLA increase this year should be about 1.3%, if we did the calculation correctly. Enjoy seniors. Here's hoping there is more inflation to come.

MARKETS OUTLOOK

	30-Sep 2019	31-Dec 2019	31-Mar 2020	30-Jun 2020	30-Sep 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021
30-Yr Treasury	2.11	2.39	1.32	1.41	1.46	1.40	1.40	1.50	1.60	1.70
10-Yr Note	1.67	1.92	0.67	0.66	0.69	0.70	0.70	0.80	0.90	1.00
5-Yr Note	1.55	1.69	0.38	0.29	0.28	0.30	0.30	0.40	0.50	0.60
2-Yr Note	1.62	1.57	0.25	0.15	0.13	0.20	0.20	0.20	0.30	0.30
3-month Libor	2.09	1.90	1.45	0.30	0.23	0.20	0.20	0.20	0.20	0.20
Fed Funds Rate	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
2s/10s spread	5	35	42	51	56	50	50	60	60	70

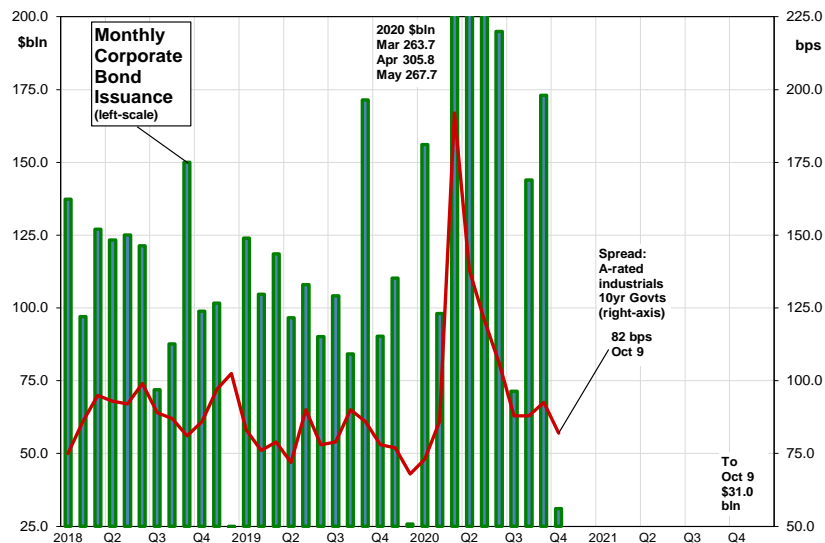
Bond yields closed 0.78% this week after 0.70% last week. The yield rally began Monday with yields first moving to 0.78% for reasons that were called the Reflation Trade. Fiscal stimulus is coming that would boost the economy and inflation. Something like that. Trump said he was stopping stimulus talks until after the election around 3pm ET Tuesday afternoon and stocks and bond yields fell. But not for long, there was a new stimulus package proposed by the Trump administration by the end of the week, and talk of a blue wave where the Democrats sweep Washington, President, the House and the Senate, which means an even bigger stimulus package next year. The bond market thinks. You can't make this up.



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CORPORATES: CONAGRA BRANDS, LYONDELLBASELL, DEERE, LOWE'S

Corporate bond offerings were \$29.0 billion in the October 9 week versus \$20.1 billion in the October 2 week. On Monday, PepsiCo Inc. sold \$1.5 billion 3s/10s. It priced a \$750 million 1.4% 10-yr (m-w +15bp) at 67 bps (A1/A+). The snack and beverage company will use the proceeds for general corporate purposes including repayment of commercial paper. Corporate bond yields (10-yr Industrials rated A2) were 82 bps above 10-yr Treasuries Friday versus 91 bps last week.



FEDERAL RESERVE POLICY

The Fed meets November 4-5, 2020 to consider its monetary policy. Powell spoke on Tuesday morning and it is still going to be a “long slog to full economic recovery.” In response to a question from the audience, he said for the 13th time the Fed did not consider negative rates as something that was in the toolkit.

The Fed meeting minutes were released Wednesday at 2pm ET for the September 15-16 meeting. They reiterated the economic outlook depends on the course of the virus. There's less news in the minutes anymore as Powell's one-hour press conferences after every Fed meeting should explain just about everything they decided or talked about.

They revised their Statement on Longer-Run Goals and Monetary Policy Strategy and incorporated elements of it into the press statement from the September Fed meeting released on September 16. The more we read what they have done the less there is here to chomp on and consider as to its import. They are going to keep monetary policy accommodative until they achieve the economic outcomes they are looking for. Maximum employment is one goal that is not new although maximum employment might mean the best economy in 50 years earlier this year before the pandemic hit with its unemployment rate a rock-bottom low of 3.5%. That could take a while to achieve.

The second outcome to be achieved before taking their foot off the gas is inflation-averaging as we would call it where inflation can run above the 2% target to offset the years it was below target. Not really sure they agreed to this completely because the official language just says the current Fed funds rate setting is appropriate until inflation has risen to 2% and is "on track to run modestly above 2% for some time." Are we clear? Crystal. We still like our forecast that the Fed funds rate will stay at zero for seven years just like it did the last time coming out of the Great Recession over a decade ago.

The only other meeting minutes news is the Fed is getting to like its monthly \$80 billion QE purchases of government securities and is remarking more than ever the purchases are not just for market functioning but for the reason that they contribute to accommodative financial conditions. The stock market sure wouldn't like to see those purchases cut back. The Fed would certainly start to taper the securities purchases long before they would ever consider lifting interest rates again.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	7-Oct	30-Sep	23-Sep	16-Sep	pre-LEH
Factors adding reserves					
U.S. Treasury securities	4469.848	4445.477	4431.523	4407.005	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1982.789	1982.775	2024.868	2005.035	0.000
Repurchase agreements	0.000	0.000	0.000	0.000	126.750
Primary credit (Discount Window)	2.939	3.437	3.359	3.036	23.455
Factors draining reserves					
MMLF	6.292	7.088	7.344	7.440	
PDCF	0.233	0.233	0.233	0.258	
Commerical Paper Funding Facility	0.859	8.589	8.588	8.588	
Paycheck Protection Facility	66.426	67.573	67.254	67.181	
Corporate Credit Facility (CCF)	45.164	45.042	44.972	44.923	
Municipal Liquidity Facility	16.548	16.547	16.546	16.544	
Main Street Lending Program	40.076	39.718	39.355	38.959	
Term Asset-Backed Facility (TALF II)	11.715	11.715	11.431	11.430	
Central bank liquidity swaps	15.838	23.895	31.950	52.274	62.000
Federal Reserve Assets	7123.1	7103.7	7141.6	7113.1	961.7
3-month Labor %	0.23	0.23	0.23	0.23	2.82
Reserve Balances (Net Liquidity)					
Currency in circulation	2038.364	2032.544	2029.101	2029.177	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Treasury credit facilities contribution	114.000	114.000	114.000	114.000	
Reverse repurchases w/others	0.110	0.850	0.001	0.055	0.000
Reserve Balances (Net Liquidity)	2863.357	2743.245	2848.082	2869.309	24.964
Treasuries within 15 days	60.673	56.106	72.212	59.413	14.955
Treasuries 16 to 90 days	281.358	238.394	247.998	257.882	31.549
Treasuries 91 days to 1 year	648.353	694.799	671.972	668.093	69.272
Treasuries over 1-yr to 5 years	1686.755	1673.536	1665.299	1658.504	170.807
Treasuries over 5-yr to 10 years	797.112	788.868	787.290	778.237	91.863
Treasuries over 10-years	995.597	993.773	986.752	984.876	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08
MMLF: Money Market Mutual Fund Liquidity Facility; loans secured by assets bought by banks from money market funds
PDCF: Primary Dealer Credit Facility; o/n and term funding with maturities to 90 days
CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)

U.S. Treasury New Cash Needs and Fed Treasury Purchases (QE)														
Monthly Changes (\$ billions)														
Fiscal Year (FY) Ending September 2020														
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Total FY 2020	FY 2021 Oct
Fed QE	67.808	73.007	80.364	80.246	64.952	504.312	993.047	138.093	87.892	96.159	64.996	86.918	2,337.8	24.371
New Cash	166.8	112.5	50.9	38.5	199.8	238.7	1368.6	699.2	685.2	102.2	175.4	176.5	4,014.3	74.5
Bills	79.1	59.0	-98.2	-12.5	160.3	92.8	1344.3	628.2	449.7	-0.7	-2.2	-47.8	2,651.9	-14.6
Coupons	87.6	53.4	149.2	51.1	39.5	145.8	24.2	71.0	235.5	102.9	177.6	224.3	1,362.1	89.1
Federal Reserve's 11 Lending Facilities (month-end outstanding)					0	58.352	94.641	136.343	204.607	203.100	197.237	196.505		195.044
Central bank liquidity swaps (month-end outstanding)					0.044	206.051	438.953	448.946	274.963	117.473	92.140	23.895		15.838

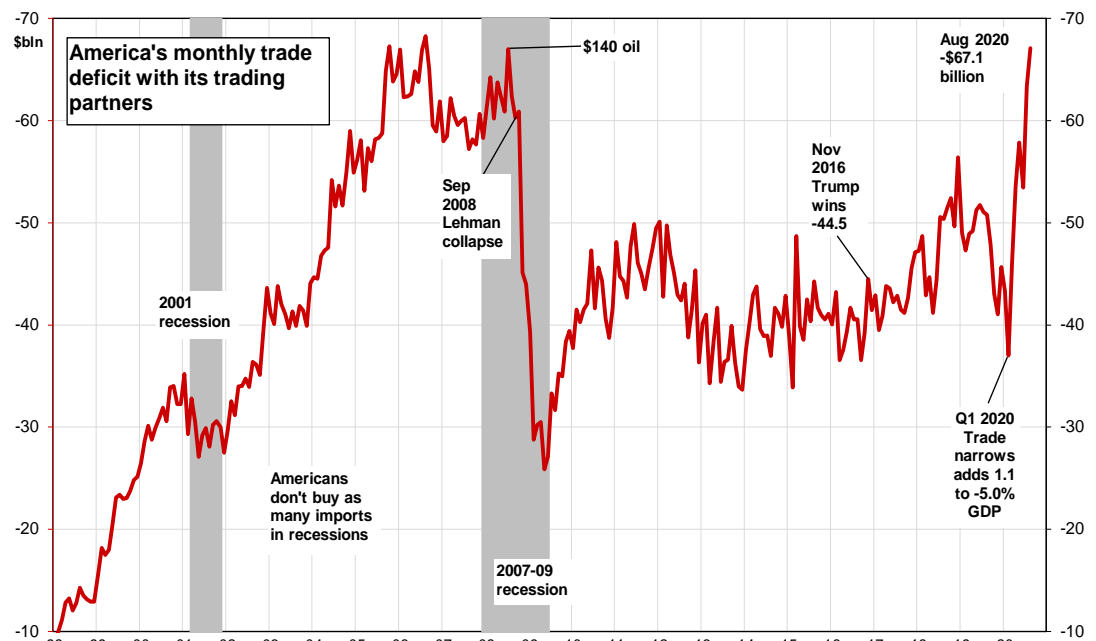
OTHER ECONOMIC NEWS THIS WEEK

Trade war good for nothing as deficit is now just inches away from record red ink levels (Tuesday)

Breaking economy news. The August trade deficit increased to \$67.1 billion from \$63.4 billion in July which is a record under the Trump administration and a rapid turnaround from the \$37.0 billion deficit in February this year before the pandemic hit the U.S. economy. The turnaround in the economy's fortunes from the quickest downturn in history has seen consumers and businesses rushing out to buy more imported goods while America's trading partners are buying less of ours and this has led the monthly deficit to explode to near record levels. The record one-month trade deficit of goods and services was \$68.3 billion in August 2006. The trade deficit is going to be a huge drag in the third quarter on GDP, but economic growth is still likely to be a record at near 30%.

Exports of goods jumped 3.0% in August to \$119.1 billion while the imports of goods rose 3.3% to \$203.0 billion. The widening in the deficit took place as goods imports are much greater than goods exports and it was also helped along this month by a nearly \$1 billion increase in the imports of services. For those of you keeping track of farmers in America's heartland in this election season, the goods exports increase of 3.0% is \$3.5 billion and soybeans exports were \$951 billion of the increase where \$2.2 billion soybeans were exported in August. Year-to-date soybean exports however are \$11.4 billion versus \$14.0 billion in the comparable period of 2019.

Net, net, it is looking like America's trade war with its trading partners has been all for nothing as the trade deficit is just inches away from the most red ink in history back over two recessions ago. Normally Americans stop buying imported goods in a recession and the trade deficit narrows, but not this time as their demand



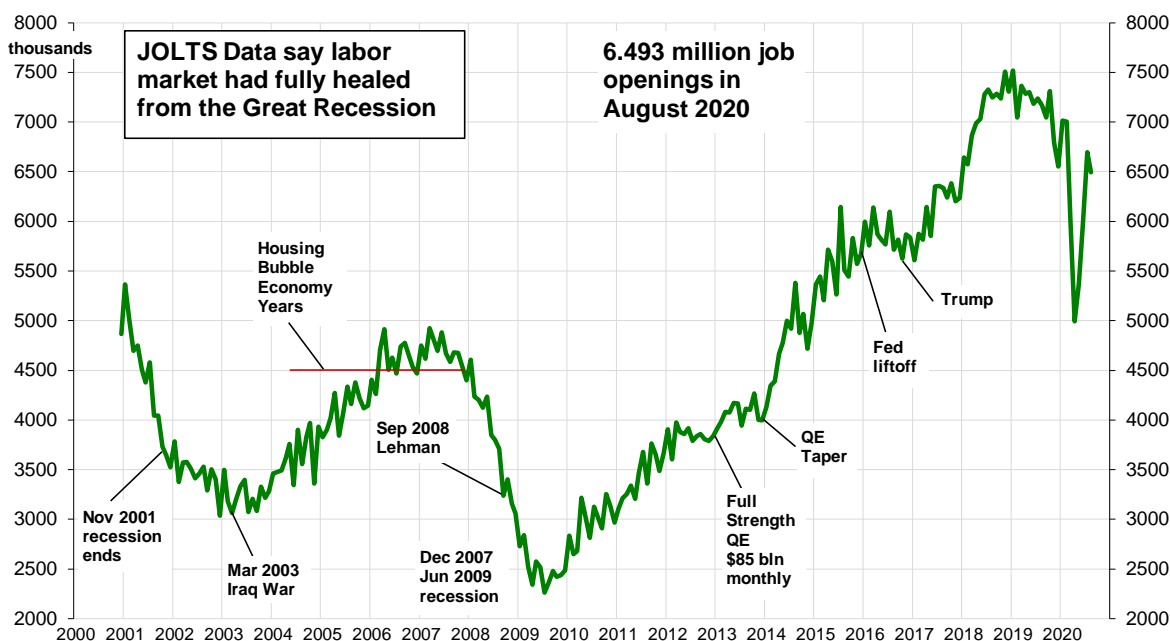
for goods from overseas knows no bounds. Interestingly, goods imports from China are down 12.8% in the first eight months this year versus 2019 and exports of goods to China are down just 0.6% on the same basis. The eight-month trade deficit in goods with China is \$193.1 billion as compared with \$231.2 billion over the same period in 2019. In August however, it is looking like the old pattern of trade is coming back where imports are close to prior year levels while exports of goods to China are somewhat weaker. Stay tuned. Story developing. America's trade war with the world limited the trade deficit red ink for a time but it now looks like the terms of trade are changing back despite the tariffs and sanctions and the country will likely remain dependent on foreign goods for years to come no matter who is president.

Missed your chance if you were going. Fewer job openings at the end of August (Tuesday)

Breaking economy news. Jolts data, job openings and labor turnover survey, that has data that are always a month old. Job openings at the end of August total 6.493 million or 204 thousand less than last month. State and local government job postings went up this month, 576 thousand wanted, we don't know how given the poor shape of government finances in the aftermath of the recession.

In terms of the private sector, more jobs for manufacturing (460K), and leisure and hospitality (782K), but most categories were down. Big declines for construction, retail shops and malls, real estate, education and health services. There were fewer quitters out there at 2.793 million in August versus 2.932 million in July. A lot of people quit their jobs in June including retail workers, factory workers, health care and social assistance employees and those working bars and restaurants, but the wave has stopped for now. More people quitting their jobs used to be seen as a sign of confidence in the economy that there was plenty of work out there, but this recession seems to have confused the meaning of this.

Net, net, today's report is cold comfort for the millions of jobless Americans who total almost double the number of 6.493 million job openings in August. In September, the number of jobless Americans behind the 7.9% unemployment rate total 12.580 million. There are not nearly enough openings around to take up the Americans without paychecks this recession. This may be the quickest recession in history but not if you are out of luck and out of a job.

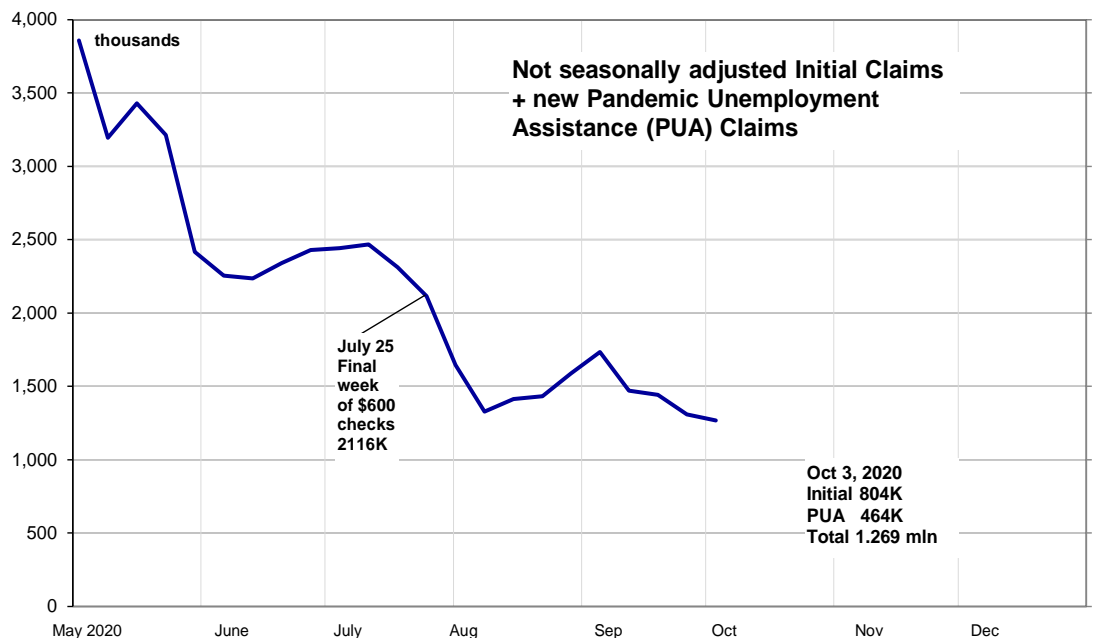


Jobless claims stay high meaning the economy stays low (Thursday)

Breaking economy news. First-time jobless claims were 840K in the October 3 week and little changed from 849K the week before. These numbers continue to run higher than the worst week of the Great Recession over a decade ago meaning the pandemic recession is greater in terms of its negative effect on jobless workers. On a not seasonally adjusted basis, the first-time claims of 804.3 thousand for the October 3 week must be combined with the 464.4 thousand Pandemic Unemployment Assistance claims for gig workers in the October 3 week to get a true picture of joblessness nationwide. It's not credible to say the recession is over when over a million new people applied for jobless benefits last week because they were let go by their employers.

The total pool of jobless workers continues to be much higher than the 12.580 million unemployed behind the 7.9% unemployment rate in September. Total claims were 25.5 million in the September 19 week which apparently has some double-counting of jobless workers who file more than once perhaps. But if the labor market is healing, it is getting better very, very slowly. Regular state programs count 10.976 million in the September 26 week getting benefits which is over 1 million less than the week before. But some of these are falling off the unemployment rolls because they have exhausted their six months of benefits which is logical given the recession started in mid-March with the coronavirus lock down of the economy. Many of these jobless workers losing benefits can apply for extended benefits and the number receiving extended benefits are nearly 2 million and climbing. The weekly jobless data are difficult to decipher this recession with the dizzying array of programs and rules, but one thing is for certain and that is the labor market remains very weak and although the economy is technically out of recession, the labor market is stuck in a rut and looks more like a depression if you are unemployed.

Net, net, time will tell if the economy can continue to recover with the shockingly high number of jobless Americans unable to find employment. The heart of every recession is joblessness and this means that this recession's heart is very dark. Even optimistic economists need to



scale back their Q4 growth forecasts when the first week of the quarter starts out with the black-eye of 840 thousand more Americans who were sacked and had to apply for benefits. There were additional \$300 weekly checks available for a time but it looks like many states have stopped offering these as the funds for these checks were provided by a limited amount of money redirected from the Federal Emergency Management Agency. Stand back and stay tuned for our next update on labor market conditions a week from now. Hopefully, you will still have a job. Jobless claims staying high mean the economy stays low for now.

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