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Fixed Income Market Review – December 2023

US Yield Levels

Date	**2-year**	**10-year**	**30-year**
12/29/23	4.23%	3.88%	4.03%
11/30/23	4.73%	4.61%	4.73%
10/31/23	5.07%	4.88%	5.04%
9/29/23	5.03%	4.59%	4.73%
8/31/23	4.85%	4.09%	4.20%
7/31/23	4.88%	3.97%	4.02%
6/30/23	4.87%	3.81%	3.85%
5/31/23	4.40%	3.64%	3.85%
4/28/23	4.04%	3.44%	3.67%
3/31/23	4.06%	3.48%	3.67%
2/28/23	4.81%	3.92%	3.93%
1/31/23	4.21%	3.52%	3.65%
12/30/22	4.41%	3.88%	3.97%
11/30/22	4.38%	3.68%	3.80%
10/31/22	4.51%	4.10%	4.22%
9/30/22	4.22%	3.83%	3.79%
8/31/22	3.45%	3.15%	3.27%
7/29/22	2.89%	2.67%	3.00%
6/30/22	2.92%	2.98%	3.14%
5/31/22	2.53%	2.85%	3.07%
4/29/22	2.70%	2.89%	2.96%
3/31/22	2.28%	2.32%	2.44%
2/28/22	1.44%	1.83%	2.17%
1/31/22	1.18%	1.79%	2.11%
12/31/21	0.73%	1.52%	1.77%
12/31/20	0.13%	0.93%	1.65%
12/31/19	1.58%	1.92%	2.39%

***Source US Treasury Department**

As it continues to be since July 2022, the 2/10 yields remain inverted. This period for the inversion remains the longest such period since July 1980. I continue to expect the 2/10 year rate inversion to end by February or March of 2024.

As I have been indicating in these monthly Reviews, the market now expects the Fed to be very near the end of its current tightening cycle and as a result, rates pulled back during December across the full curve. The general expectation is there will be four rates cuts during 2024 with the first before the end of the first quarter of 2024.

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Bloomberg Barclay's Fixed Income Index Returns

Index	Dec 2023	Last 3 Months	2023
Aggregate	3.83%	6.82%	5.53%
Int Agg	2.97%	5.50%	5.18%
Gov't/Credit	3.68%	6.63%	5.72%
Int Gov't/Credit	2.32%	4.56%	5.24%
Gov't	3.33%	5.62%	4.09%
MBS	4.31%	7.48%	5.05%
ABS	1.91%	3.48%	5.54%
CMBS	3.03%	5.25%	5.62%
US Credit	4.19%	8.15%	8.18%
US Corp High Yield	3.73%	7.16%	13.44%

Employment Report News

As reported by the US Labor Department in November, employers added 199,000 nonfarm workers. The unemployment rate fell marginally from 3.9% to 3.7%. Jobs added as reported for September were revised down by 35,000 from 297,000 to 262,000. The October number remained steady as previously reported.

The average work week moved up by 0.1 hours to 33.8 hours per week. The report also indicated the labor force participation rate stayed flat to the prior month at 62.8%. The total of long-term unemployed, having been out of work for 27 weeks and longer, edged down to 1.2 million. This long-term employment number currently represents 18.3% of all unemployed. From the report the average wage rose 12 cents per hour to $34.18 per hour, representing an annual average increase of 4%.

Healthcare was the biggest gainer of jobs during the month, adding 77,000. However, of personal notes, last month my wife's nephew was taken to a Buffalo, New York area emergency room for a follow-up on a fungal infection he has had. The hospital, which is the largest in the Southern portion of Buffalo, was not able to admit him for three days with no beds being available. He stayed for three days in the hallways, outside the emergency room.

My wife's niece was taken yesterday to a Syracuse area emergency room after becoming faint and losing her balance. That niece did not get to see a doctor for her first day in the hospital. At least she was seen by a nurse practitioner. It seems in the healthcare field we have many more job openings than people trained or ready to fill them.

Inflation

On December 12th the Bureau of Labor Statistics reported the PPI declined by 3.1% for the 12-month period ending with November. The core PPI, excluding food and energy, held steady at 4% on an annual basis, its lowest level since September 2021. The core CPI for November had

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increased by 0.3%. The report also reported real average hourly earnings rose 0.8% in November, the eighth consecutive month with an increase.

The PCE Index declined during November by 0.1% , bringing the annual rate to a 2.6% increase. The core PCE also declined from an annual of 3.4% through October, to 3.2% through November.

The US Consumer

Consumer expenditures increased by 0.2% in November, matching the 0.2% increase in October. Personal income increased by 0.4% in November and the savings rate rose to 4.1%, in November from 4.0% in October.

The Conference Board's Consumer Confidence Index reached its highest level since July. The University of Michigan consumer survey indicated consumer sentiment jumped nearly 14% during December.

The US Economy

The Commerce Department reported on October 15th the economy grew by a healthy 4.9% in the 3rd Quarter, though I expected the 4th Quarter would be slowing, which it did. The number for the year was a growth of 2.4%.

Oil

As reported by AAA on November 15th the price of oil was down 20% from its September highs, landing at $3.37 a barrel compared to $3.78 a year ago. US oil production hit a record 132 million barrels a day in October with Chinese exports to the US falling by 6.4%.

The US Housing Market

On November 9th Mortgage rates dropped by the largest amount in a year to 7.5% for conforming 30-year mortgages from 7.76% and then down at November month-end to 6.95%. The current monthly cost to buy a home in 2023 saw a 7.4% rise from 2022.

Though mortgage interest rates have declined, the inventory of homes for sale have remained low and prices have risen dramatically in many geographic areas. The median existing home price rose in October by a 3.4% amount to $391,000. This was the highest average price for an October back to 1999. It also was the fifth consecutive month of increases.

Sales of existing homes rose 0.8% in November, beating expectations. Sales were 3.82 million annualized, being the first rise to end a five-month slump. However, sales a year ago at this same time period were 4.12 million units. With mortgage interest rates having dropped, industry professionals are expecting the pace for sales to increase.

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But, during November homes on average remained on the market for 25 days, up from an average of 23 days in October. The supply of homes for sale reached 1.13 million units at the end of November, down by 1.7% from the end of October. However, of interest, 19% of homes sold during November were settled on average at 19% above their list prices.

Sales of newly constructed homes dropped 12.2% in November to a seasonally adjusted level of 590,000, from a revised rate of 672,000 in October. This rate for November it 1.4% higher than a year ago November.

During November, 31% of sales were for first time buyers, up from 28% for both October and November 2022. All-cash sales were 27% of transactions in November, down from 29% in October, but higher than the 26% ratio in November 2022.

As to affordability, the average price of newly constructed homes rose from $409,300 in October to $434,700 in November for comparably sized homes. During November, 31.4% of new homes sold for $500,000 and above. The scary measure is the average annual income a family needs to buy an average priced new home is nearly $130,000, with the median family income in the US being $75,000.

Consumer Debt
During the 3rd Quarter of 2023, 5.78% of credit card balances became seriously delinquent. Since the 1st quarter of 2022, the rate of seriously delinquent credit card debt has risen by roughly a 90% factor.

Due to the pandemic and consumers not spending at usual historic rates, homeowners banked large amounts of cash through home refinancing. From the second quarter of 2020 though the end of 2021, 14 million mortgages were refinanced according to the New York Federal Reserve. The NY Fed reported these excess savings reached a peak of $2.1 trillion. With the pandemic effects waning, consumers have spent $1.9 trillion of this accumulated excess amount.

The Commerce Department's report showed consumer spending rose 0.2% in November compared to the October rise in spending at 0.1% but far off the September increase of 0.7%. Spending in the 3rd Quarter 2023 was $15461.38 billion compared to $15 343.55 billion in the 2nd quarter.

According to the Federal Reserve of Richmond, the inflation adjusted spending on durable goods is currently higher than the trend for the five-year period before the pandemic. I consider that a very positive result for the US economy since consumer spending drives 70% of more of economic growth.

China
On December 1st Goldman Sachs provided a Briefing Paper indicating it expects the road to recovery for China's property sector to cover a period of multiple years. The estimate Goldman provides of China's mortgage and property developer outstanding debt is $8.4 trillion. Goldman speculates that while the Chinese government can control most aspects of the primary market, it has much less control in the commercial lending markets. Goldman believes the concerns that exist will spread to the commodities markets.

China's National Bureau of Statistics reported the Chinese CPI declined by 0.2% compared with a year ago. The likely cause was the price of pork which is 30% lower than one year ago. Separately the Chinese measure of core inflation, which strips out fresh food and energy, was down 0.6% for the last month. A lack of demand, even coming into National Singles Day on November 11th, forced the offering of major discounts, with the Chinese PPI falling 2.6% for the month.

Nevertheless, most economists expect the Chinese economy will still hit for the year its official economic growth target of 5%. But that is still below its annual growth rate of above 6% in the decade leading up to the pandemic period.

The IMF is stating for 2024, the Chinese economy will be a "drag" on World Output. Between 1991 and 2011 China grew at an annual rate of 10.5% per year. Under Chinese leader Xi Jinping's rule, the annual growth rate from 2011 through 2021 has fallen to an average per year of 6.7%. The IMF has stated the Chinese growth rate will decline to 5.4% in 2023, then gradually decline further to 3.8% by 2028 with an aging population being an enormous weight coupled with a significant over expansion of credit.

Will China be experiencing the same problems with declining demand and a shrinking population that have impacted Japan? The IMF does not expect similar problems in the immediate future, but fertility rates for China show the average number of babies a Chinese woman will have over her lifetime has declined to a record low of 1.09 last year, down from 1.30 two years ago. That record low for China places it below the birthrate for Japan.

Cryptocurrency
If you have been a regular reader of my monthly Fixed Income Market Reviews, I am certain you are aware I hate crypto currency. However, several of my close associates at Greenrock do not have the significant distaste for the topic as I do. As a result, I do periodically mention the topic especially if I have a negative news article about it.

Borrowing from last month's Review, as reported on November 21st by CNN, Binance is the world's largest crypto exchange. Until recently, it was handling 60% of the market's share of spot trading for crypto. However, it now faces a $4.3 billion payout to US authorities to resolve

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criminal charges. Changpeng Zhao, commonly known as CZ, who was the founder of Binance resigned as its CEO and plead guilty to federal money laundering charges.

Though it will move ahead without CZ, who in the settlement has avoided prison, Binance is being allowed to remain in business, though with careful oversight. Being allowed to live another day reflects the concern its shutdown would damage a wide range of individual investors.

My Economic Outlook
My projection in my October Fixed Income Review was that Fixed Income might beat the returns of equities for the Fourth Quarter 2023, and maybe, through the 2024 year. Fixed Income did very well in the Fourth Quarter, at a return of 6.82% for the Barclay's Aggregate Index, but stocks did exceptionally well. The S&P 500 rose 11.2% in the Fourth Quarter including a rise of 4.4% in December, for a total year gain of 24.2% {though the 2023 return of the Corporate High Yield Index was not bad at 13.44%). Interestingly, the earnings yield for the S&P 500 Index at year-end was 3.78%, compared with the average yield for the Aggregate Index at approximately 3.14%.

Though most major economists expect the Fed will cut rates several times beginning in 2024, I don't believe the economy will need so enormous a push by the Fed to continue performing. As projected last month, I expect bonds will continue to perform well and the historic 60/40 portfolio return should be strongly considered. The chief investment officer of Goldman Sachs Asset Management states in his recent briefing paper, "I think the risk/return looks a lot better in bonds at these levels than it does for stocks."

It's been a long time since I said anything near to that but as I indicated starting last month, I agree with the Goldman position, or perhaps they agree with me.

A note of caution before I finish. The US dollar declined in value more than 2% during 2023. The seeming explanation is the dollar was weakened by the prospects of rate cuts in 2024. I agree some amount of rate cuts are logical. Just not too many.

As to a stock I have followed forever but never bought, Dollar General stock declined 45% in 2023. This past year was its first annual decline since going public in 1965. Does that foretell something broader in nature?

As my final note of caution, an inverted yield curve has foreshadowed ten recessions since 1955, except one false positive in the mid 1960's. The average delay from the start of the inverted curves to the start of recessions has been 15 months since 1978.

Bob Southard, on Behalf of Greenrock Research
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