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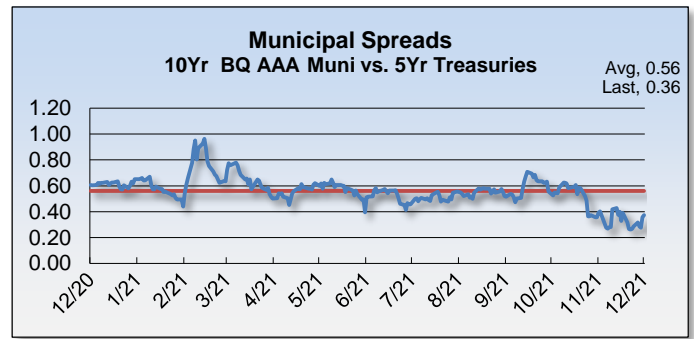
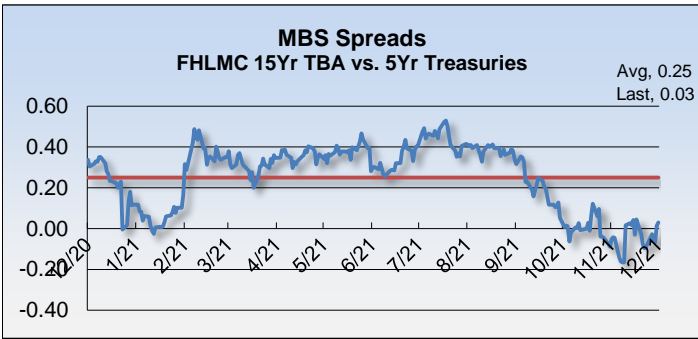
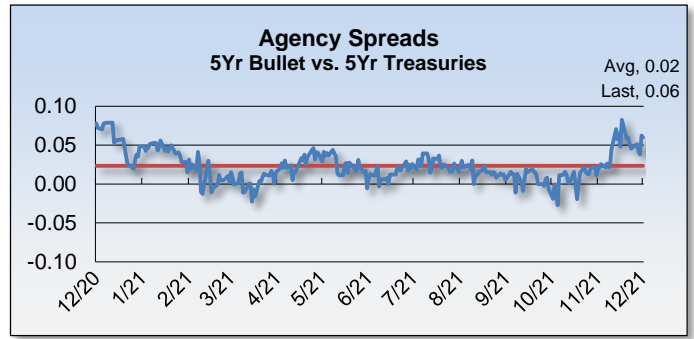
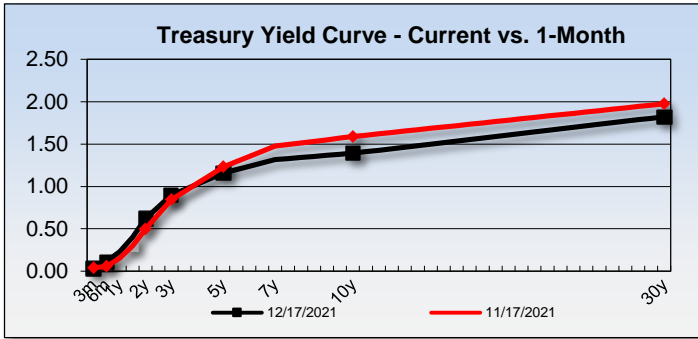
Our old friend William Shakespeare wrote that “a thing is neither good nor bad, but thinking makes it so.” Prices and yields in the bond market at any point in time are made up of expectations. The yield curve, for example, is flattening because of anticipatory pricing. It’s not looking at the inflation numbers that just came out. That’s ancient history. Instead, the market is looking well ahead into next year and assessing what Fed Chair Powell just told us quite clearly this week. That he’ll channel his “inner Paul Volker” and do whatever it takes to control inflation. Specifically, the Fed will accelerate the removal of stimulus by speeding up the taper and lay the groundwork for multiple fed funds rate hikes next year. Embracing that reality, short maturity US Treasury yields have naturally jumped... the 2yr yield is now .63%. What’s more telling, though, is that yields in the longer-end of the curve have come down sharply... the 10yr yield is now under 1.4%. This is the sort of yield curve flattening that often happens late in an economic cycle when fears of recession start to take hold. But there’s more to the story. This isn’t a normal economic cycle by any means. The recession was a self-imposed global shutdown one year ago, and the sharp snapback was fueled by enormous amounts of fiscal and monetary stimulus which is now fading away. And then there’s the problem of (so-far) persistent inflation.

Remember that a traditional inflationary impulse is driven by an overheating economy where everything is maxed out, hitting on all cylinders and strong demand is pulling up the general price level. That is not really what’s happening now. Instead, we’re dealing with “supply shock” inflation where COVID-induced shutdowns produce bottlenecks and sclerotic trade flows. Dock workers, truck drivers, processing personnel and other key points in the supply chain are working with reduced staffing and capacity, causing ripple effects throughout the system. Dusting off the old economics textbook, we see that the result is a sudden (leftward) shift in the supply curve and an upward shift in the general price level... a jump in inflation. So, the question becomes this: are rate hikes and tighter monetary policy the right medicine for “supply shock” inflation as is normally the case with “demand pull” inflation? Or might a higher cost of borrowing just exacerbate the supply chain disruptions? A point to ponder indeed.

Make no mistake, the Fed needs to stop pumping liquidity into the system. It’s caused unnecessary market distortions and pumped up an asset price bubble that may now be in the process of bursting. But the yield curve is suggesting to the Fed that they tread very carefully going forward. COVID has not gone away, and the knock-on effects render this situation real tricky for the central bank. Fingers are crossed.

The data released this week included another eye-opening jump in headline producer prices to 9.6% year-over-year. The core measure was a milder 7.7%. The core measure of Retail sales slipped -0.1% for the month, but the housing market continues to shine as existing home sales and building permits both exceeded expectations and prior month readings. Business inventories popped up 1.2% causing concern about an overhang if demand doesn’t keep pace. Next week is the pre-holiday week. Let’s all hope for nice gifts from Santa Claus.

FOMC Forecasts	2017	2018	2019	2020	2021	2022	2023
Real GDP (yoy%)	2.30	2.90	2.30	-3.40	5.50	4.00	2.20
Core PCE (yoy%)	1.69	2.00	1.69	1.43	4.40	2.70	2.30
Unemployment (%)	4.35	3.89	3.68	8.11	4.30	3.50	3.50



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	0.04	(0.02)	0.05	0.03	0.08	2yr	0.68	0.85	0.35	0.37	0.68	2Yr	0.62	0.62	0.62	-
6mo	0.11	(0.01)	0.06	0.05	0.09	3yr	0.88	1.08	0.50	0.54	0.88	3Yr	0.91	0.91	0.90	0.90
1yr	0.23	(0.02)	0.16	0.07	0.09	5yr	1.20	1.24	0.84	0.89	1.29	5Yr	1.24	1.25	1.24	1.17
2yr	0.62	(0.03)	0.50	0.21	0.12	7yr	1.39	1.34	1.22	1.30	1.53	7Yr	1.41	1.43	1.42	1.35
3yr	0.90	(0.09)	0.84	0.43	0.21	10yr	1.59	1.45	1.44	1.53	1.84	10Yr	1.53	1.59	1.58	1.51
5yr	1.16	(0.09)	1.23	0.88	0.38	15yr	1.72	1.58	1.60	1.70	2.14	January TBA MBS				
7yr	1.32	(0.10)	1.48	1.25	0.65	20yr	1.85	1.64	1.81	1.92	2.33	Cpn	15Yr -Yld/AL		30Yr -Yld/AL	
10yr	1.39	(0.09)	1.59	1.51	0.93	25yr	1.99	1.65	1.94	2.06	2.38	2.00	1.31	4.2y	1.98	
30yr	1.82	(0.06)	1.98	2.09	1.68	30yr		1.63	2.07	2.21	2.43	2.50	1.35	3.4y		
												3.00	1.40	3.1y	2.02	4.5y
												3.50	1.48	2.9y	2.11	4.4y
												4.00			2.32	4.4y
												4.50			2.57	4.3y

* Interpolated

Key Market Indices					
Index	Current	1Wk Change	Historical		
			1 Mo	6 Mo	1 Yr
Fed Funds	0.25	--	0.25	0.25	0.25
Primary Discount	0.25	--	0.25	0.25	0.25
2ndary Discount	0.75	--	0.75	0.75	0.75
Prime Rate	3.25	--	3.25	3.25	3.25
Sec. O.N. Finance	0.05	--	0.05	0.01	--
1 Month LIBOR	0.11	0.01	0.09	0.08	0.15
3 Month LIBOR	0.22	0.02	0.16	0.12	0.23
6 Month LIBOR	0.30	0.01	0.23	0.15	0.25
1 Year LIBOR	0.52	0.03	0.39	0.23	0.33
6 Month CD	0.35	0.03	0.11	0.14	0.31
1 Year CMT	0.26	(0.02)	0.17	0.08	0.09
REPO O/N	0.02	(0.03)	0.05	0.06	0.11
REPO 1Wk	0.13	0.01	0.12	0.11	0.10
CoF Federal	0.749	--	0.752	0.823	1.003
11th D. CoF (Oct)	0.225	--	0.225	0.343	0.503

FHLB Fixed Advance Rates			
Maturity	Chicago	Boston	Topeka
3mo	0.22	0.34	0.27
6mo	0.30	0.40	0.36
1yr	0.53	0.55	0.55
2yr	0.86	1.03	0.91
3yr	1.10	1.30	1.18
4yr	1.30	1.51	1.39
5yr	1.38	1.59	1.49
7yr	1.57	1.83	1.69
10yr	1.78	2.05	1.90
5yr Am	1.14		1.29
10yr Am	1.53		1.66

Fed Fund Futures	
Maturity	Rate
Dec-21	0.080
Jan-22	0.085
Feb-22	0.095
Mar-22	0.140
Apr-22	0.200
May-22	0.270
Jun-22	0.340
Jul-22	0.410
Aug-22	0.465
Sep-22	0.490
Oct-22	0.565

Weekly Economic Calendar						
This Week & Next						
Date	Release	Per.	Est.	Actual	Prior	Revised
12/14	NFIB Small Business Optimism	Nov	98.4	98.4	98.2	--
12/14	PPI Final Demand YoY	Nov	9.2%	9.6%	8.6%	8.8%
12/14	PPI Ex Food and Energy YoY	Nov	7.2%	7.7%	6.8%	7.0%
12/14	PPI Ex Food, Energy, Trade YoY	Nov	--	6.9%	6.2%	6.3%
12/15	MBA Mortgage Applications	12/10	--	-4.0%	2.0%	--
12/15	Empire Manufacturing	Dec	25.0	31.9	30.9	--
12/15	Retail Sales Ex Auto and Gas	Nov	0.8%	0.2%	1.4%	1.6%
12/15	Retail Sales Control Group	Nov	0.7%	-0.1%	1.6%	1.8%
12/15	Import Price Index YoY	Nov	11.4%	11.7%	10.7%	11.0%
12/15	Export Price Index YoY	Nov	--	18.2%	18.0%	--
12/15	Business Inventories	Oct	1.1%	1.2%	0.7%	0.8%
12/15	NAHB Housing Market Index	Dec	84	84	83	--
12/15	FOMC Rate Decision (Upper Bound)	12/15	0.25%	0.25%	0.25%	--
12/15	Interest on Reserve Balances Rate	12/16	0.15%	0.15%	0.15%	--
12/15	Total Net TIC Flows	Oct	--	\$143.0b	-\$26.8b	-\$27.3b
12/15	Net Long-term TIC Flows	Oct	--	\$7.1b	-\$26.3b	\$26.7b
12/16	Initial Jobless Claims	12/11	200k	206k	184k	188k
12/16	Continuing Claims	12/4	1943k	1845k	1992k	1999k
12/16	Housing Starts	Nov	1567k	1679k	1520k	1502k
12/16	Building Permits	Nov	1661k	1712k	1650k	1653k
12/16	Philadelphia Fed Business Outlook	Dec	29.1	15.4	39.0	--
12/16	Capacity Utilization	Nov	76.8%	76.8%	76.4%	76.5%
12/16	Manufacturing (SIC) Production	Nov	0.7%	0.7%	1.2%	1.4%
12/16	Markit US Manufacturing PMI	Dec P	58.5	57.8	58.3	--
12/16	Markit US Composite PMI	Dec P	--	56.9	57.2	--
12/16	Markit US Services PMI	Dec P	58.8	57.5	58.0	--
12/16	Kansas City Fed Manf. Activity	Dec	25.0	24.0	24.0	--
12/20	Leading Index	Nov	0.9%	--	0.9%	--
12/21	Current Account Balance	3Q	-\$206.2b	--	-\$190.3b	--
12/22	Chicago Fed Nat Activity Index	Nov	--	--	0.76	--
12/22	GDP Annualized QoQ	3Q T	2.1%	--	2.1%	--
12/22	Personal Consumption	3Q T	1.7%	--	1.7%	--
12/22	GDP Price Index	3Q T	5.9%	--	5.9%	--
12/22	Core PCE QoQ	3Q T	--	--	4.5%	--
12/22	Conf. Board Consumer Confidence	Dec	110.3	--	109.5	--
12/22	Conf. Board Expectations	Dec	--	--	87.6	--
12/22	Conf. Board Present Situation	Dec	--	--	142.5	--
12/22	Existing Home Sales	Nov	6.55m	--	6.34m	--
12/23	Personal Income	Nov	0.5%	--	0.5%	--
12/23	Personal Spending	Nov	0.5%	--	1.3%	--
12/23	Real Personal Spending	Nov	--	--	0.7%	--
12/23	PCE Deflator YoY	Nov	5.7%	--	5.0%	--
12/23	PCE Core Deflator YoY	Nov	4.5%	--	4.1%	--
12/23	Durable Goods Orders	Nov P	1.8%	--	-0.4%	--
12/23	Durables Ex Transportation	Nov P	0.6%	--	0.5%	--
12/23	Cap Goods Orders Nondef Ex Air	Nov P	0.5%	--	0.7%	--
12/23	Cap Goods Ship Nondef Ex Air	Nov P	0.5%	--	0.4%	--

MBS Prepayments ⁴						
3-Month CPR						
Type	2.0	2.5	3.0	3.5	4.0	4.5
FN 10y	16.8	24.6	25.2	26.5	23.3	11.6
FH/FN 15y	11.7	30.3	30.3	36.1	29.8	22.3
GN 15y	23.9	18.5	20.2	19.0	19.2	21.1
FH/FN 20y	56.1	25.6	27.0	26.2	27.2	22.3
FH/FN 30y	3.1	16.7	43.6	43.8	46.3	46.7
GN 30y	4.7	17.0	47.9	43.2	40.0	26.9
CPR Projections						
Type	2.0	2.5	3.0	3.5	4.0	4.5
FN 10y	16.4	18.0	18.7	19.4	20.7	19.8
FH/FN 15y	14.3	16.2	17.6	21.1	21.8	21.3
GN 15y	13.9	13.8	13.7	13.1	12.4	12.2
FH/FN 20y	56.3	14.1	14.6	15.0	15.7	15.6
FH/FN 30y	10.7	12.7	18.4	19.0	19.8	19.4
GN 30y	8.6	10.8	15.2	14.2	14.8	12.0

Other Markets					
Index	Current	1Wk Chng	Historical		
			1 Mo	6 Mo	1 Yr
Currencies					
Japanese Yen	113.45	0.01	114.08	110.21	103.11
Euro	1.13	(0.00)	1.13	1.19	1.23
Dollar Index	96.27	0.17	95.83	91.89	89.82
Major Stock Indices					
Dow Jones	35,452	(519)	35,931	33,823	30,303
S&P 500	4,604.7	(107.4)	4,688.7	4,221.9	3,722.5
NASDAQ	15,105.0	(526)	15,921.6	14,161.4	12,764.8
Commodities					
Gold	1,807.4	24.5	1,870.2	1,773.8	1,887.2
Crude Oil	69.96	(1.71)	78.36	71.04	48.36
Natural Gas	3.71	(0.22)	4.82	3.25	2.64
Wheat	777.0	-5.0	822.3	639.0	608.8
Corn	596.0	7.5	575.3	633.0	432.5

Notes

- 1 Call Agy = Maturity at left w/ a 1-Year Call at Par
- 2 Muni TEY (21% Fed, 0.75% CoF)
- 3 S-Corp TEY Muni (29.6%, no TEFERA)
- 4 MBS Prepayments are provided by Bloomberg

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