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# Eyes on the Market, Q4 2024

1. **Unemployment declines in Q4;** Concerns about labor market weakness appear overstated. While a projected downward revision of over 800,000 jobs and a July unemployment rate of 4.3% raised alarm, the latest data show average employment growth of 186k per month in Q3 and a drop in unemployment to 4.1% in September. Payroll growth continues to outpace labor force expansion, suggesting further unemployment declines in Q4.

2. **Breakeven inflation rising;** The 10-year market implied breakeven inflation rate has risen 22 bps since the September FOMC to 2.26%. While this has remained below 2.4% since 2022, risks of surging past 2.4% stands to undermine the Fed's credibility in anchoring inflation expectations.

3. **Cooling inflation, elevated supercore;** Headline inflation is cooling, with core CPI down to 2.1% over the last three months compared to 3.9% in 2023. Q2 GDP revisions nudged core inflation up from 2.6% to 2.7%, while supercore remains well above the Fed's 2% target.

4. **Economic resilience drives fund flows, into money market fund, out of duration into credit;** The soft landing narrative that dominated Q3 resulted in fund flows into "quality" assets including US Treasuries, high grade credit, and agency MBS. A shift back to resilience could see continued inflows into money market funds, structured credit, floating-rate assets like leverage loan funds and CLO ETFs and out of long duration Treasuries and agency MBS.

5. **Treasury auctions, funding and liquidity risks on bloated dealer balance sheets;** US Treasury and agency MBS holdings on dealer balance sheet are at record highs, different than the second half of 2023 when the resilience trade got priced in. This makes Treasury auctions of renewed interest and liquidity and funding a broad risk to spread assets**.**

6. **MBA's purchase index lagging mortgage rate rally bounce;** The MBA's purchase index has rebounded slightly but remains suppressed given the steady mortgage rate rally of 85 bps since late July. However, it still trails significantly behind the rally in mortgage rates with more room to recover as rates continue to adjust.

7. **Banking "utility" model takes hold as Basel III Endgame rules awaited;** Proposed Basel III Endgame capital requirements for banks stand to be lowered from 16% higher, as initially drafted, to 9%. Subject to regulatory consensus, banks exit non-core businesses and use Synthetic Risk Transfers (SRT) to raise capital and prepare for recognition of unrealized gains and losses in their securities portfolios.

8. **Home price appreciation softening;** Home prices are softening as inventory increases. Florida and Texas are leading the nation in inventory trends. Price growth is slowing, with the median price increase easing to 2.9% in August, down from 5.4% in April.

9. **Consumer staples vs discretionary spending;** As the resilience theme is growing, discretionary stocks have caught up to staples, speaking to the strength of the consumer at large. A savings rate revision from 3.3% to 5.2% underscores stronger household finances.

10. **High geopolitical risks;** As we approach the climax of the US elections, the conflicts in the Middle East have widened considerably. Now global oil supply is subject to question.

## The Rithm Take

Q3's soft landing narrative has made way to Q4's resilience. We kicked off with strong data, ranging from the latest employment report to upward revisions in personal savings and Gross Domestic Income (GDI), which had unexplainably lagged Gross Domestic Product (GDP). The economy aside, our focus turns to liquidity, funding and other potential market stressors on elevated dealer balance sheets and event risks around geopolitics and the US presidential election.