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The BMR 2014 Year–End Review and Forecasts for 2015

Fear of the Great Unwind

Houston, we have a problem … One major story for 2015 will be at what point the Fed begins to hike rates. The Fed still doesn't know when it's 'safe' to liftoff, nor the best rate of ascent! We're assuming they'll start in June, but with the markets very susceptible to a much–due correction, they're likely dreading the actual event. No one wants the blame for bad timing! The Fed is under pressure to begin a tightening phase, while also keenly aware of the fragility of the global economy. After all, some central banks have been recently accelerating accommodation! Despite all our gains, for the most part – money is still 'close to free' or at least abnormally cheap.

If our hypothesis has been that the Fed greatly aided the rise in stocks, what kind of tantrum will the markets have when the Fed pulls the zero–rate rug from under the markets? Can they perform the magic where the tablecloth is pulled without toppling the glasses and the increasingly less–spiked punchbowl – or does everything go flying in disarray? At a time when the Fed may begin tightening by April or June, the economy is getting a lift from cheaper gasoline. Since a large part of America spends (or overspends) every paycheck, less fuel expense means more money to go to other sectors.

With emerging markets at the highest risk of a turndown, International Monetary Fund economists made the case that central banks shouldn't unwind their balance sheets by selling assets, but rather allowing them to mature. (Something we've written about many times.) They said: *"To minimize the effects of market surprises, the U.S. Fed and other advanced economy central banks should focus on minimizing shocks to long–term bond yields when they exit from unconventional monetary policies."* Over the past few weeks, a number of FOMC members sought to sooth the markets with similar comments. Richmond's Jeffrey Lacker said *"we can be patient at this point."* He had dissented to every vote in 2012 thinking the Fed was too accommodative. San Francisco's John Williams said: *"I see no reason whatsoever to rush to tightening."* Chicago's Charles Evans said (on January 7th): *"I don't think we should be in a hurry to increase interest rates."* He said a too soon a move could be a *"catastrophe."* Boston's Eric Rosengren said (on 01/03) that *"continued very low core inflation and wage growth numbers provide ample justification for patience."* Minneapolis Fed President Narayana Kocherlakota spoke out against a formula for fed policy and said for the benefit of Congress: *"Discretion is better than any rule."*

We thought Cleveland's Loretta Mester said it best! She said the right question was not *"when exactly liftoff is – a meeting here or a meeting there."* She said instead: *"How slow or how fast we get there is really going to depend on the economy."* We agree and think the focus should be on the pace after the launch, instead of a predestined or predetermined rise to a certain level – by a given time. That gives us Kocherlakota's *"discretion"* and doesn't set the Fed on an unchecked advance of rates that can't be detoured by a set 'tunnel vision.'

A Bridge to Somewhere

Remember the infamous 'Bridge to Nowhere' from the mid 2000s? It was a $320 million project that was to connect Ketchikan, Alaska to its airport island (population 50). FRB San Francisco President John Williams said the use of the word *"patient"* represented a *"bridge"* toward their upcoming period of tightening monetary policy. Unfortunately, this 'bridge' may cost much much more!

Looking Ahead

- Bond yields should observe a general downtrend from around January 12th through early February.
- Stocks should find a low near January 21st, that could represent a good buying opportunity.
- The next market holiday is Martin Luther King, Jr. Day (Monday, January 19th).

Unbroken

When we were compiling data for this issue, the Dow was off 841 points to its December 26th high. Into January 6th, stocks fell for a fifth trading session. By today it had recovered 653 points and joined the S&P in moving back to a small gain for 2015! The 'considerably patient' put is still in place. It seems every time stocks see a setback, as with the 841 point plunge just experienced by the Dow, a few Fed members step up to the podium and talk 'considerable time' on holding interest rates low, or 'patience' in hiking – and it works! The last real correction of more than 10% was back in October 2011! At that time the Fed had set 'Operation Twist' in place to buy longer assets. That pre–QE3 move and the subsequent QE3 have had stocks booming since 2011.

The early stories for 2014 were the cold weather, the Olympics, and a renewal of the 'cold war' with Russia! The U.S. managed a nice turnaround from severe 1st–quarter weakness stemming from extreme cold conditions across the country. U.S. GDP had dropped 2.9% in the 1st quarter, but rose 4.6% in the second and was just revised from 3.9% to 5% for the 3rd quarter. That was the best improvement since 2003 and also the best back–to–back quarters since 2003. In June, aided by grains and oil rising on tensions in the Ukraine, Commodities rallied to the highest levels since September 2012 – only to drop to May 2009 lows as Crude Oil took a huge tumble. Crude Oil hit a 9–month high near $108/barrel in June, only to plunge 55% to May 2009 lows to kick off 2015. The June high was also marked by the kidnapping of Israeli teens, which led to the Gaza war in July and August. Despite those tensions, since mid–June oil was in pretty much of a free fall. Gold had some huge swings, but was trading this week near the end of 2013 levels – leaving it volatile, but somewhat neutral for the year.

Our cycle work was very good for most of the year, but beginning in mid–October – stocks began a greater move than our cycles had projected. The 2014 cycles were less dependable following the non–cyclical factors such as the Ebola scare – that sent stocks into a tailspin into mid–October. Overall, our bond cycles were much better. Interest rates continued lower across the globe, though the U.S. 2–year finished with a much higher relative yield due to speculation the Fed will hike rates by April to June of 2015. Our 2–year yield rose 28.5 bps or 74% above the .382% level of year–end 2013 to close the year at .666%. While 5–year rates finished 9 bps lower, longer maturities surprised as yields dropped 86 bps at 10–years and 122 bps at 30–years. Not only were bond investors convinced inflation was going to remain low, but there were enough tensions to keep a bid for quality. U.S. bonds also offered huge spreads versus G7 alternatives as EU inflation was roughly .5% annually – while ours was hovering between 1.5% and 1.9% (depending on which measure used). Many global bond rates went negative, or were much lower than ours – and Swiss banks began charging for deposits.

With the U.S. showing some inflation (especially compared to the Eurozone), resurgent growth, and the potential for our central bank to tighten ahead of their global counterparts – the U.S. Dollar soared. It was 13.04% higher for the year, trading to a 9–year high! That also was reflected in falling commodity prices given the much stronger buying power. However, after trillions of spending by central banks, global growth is still challenged. The federal deficit grew to $18 trillion, though not making headlines anymore – as we're at least temporarily pretending there's no debt ceiling. The S&P managed a nice gain after a January selloff and an October low that had wiped out gains for 2014. Throughout 2014, the S&P made 53 new closing highs – beating out the 1929 number of 48 (but far short of the 77 made in 1995). Stocks ended with a third straight year of gains, and five for the last six – second only to the bull run of the '80s. Cyber attacks came to the forefront as a new wave of disruptive terrorism.

In the **B**ond **M**arket **R**eview (08/06/2014), we noted the S&P had hit 1,991 only to fall to 1,911 and said: *"In less than two weeks, we've rolled back from George H.W. Bush (1991) to William Howard Taft (1911). If our projections and cycles hold, we're on a trip to visit Chester A. Arthur by September."* It took a little longer! On October 13th, we hit that 'Arthur zone' of 1881–1885, but then dipped all the way to the James Monroe era with a trip to 1,820 on October 15th – even though the S&P's lowest close was 1,862, a year into the Abe Lincoln presidency. We had expected a large pullback into December 10th, but instead got a greater rally out of that October 15th low, and then pulled back into December 16th – before a year–end run to new highs. In the **BMR** (07/30/2014), we said: *"We continue to expect the highest yields for 2014 to occur near the end of September. Bonds could then see another bull run into February!"* That forecast is obviously still in play – and working well. 10–year yields topped at 2.64% on September 18th and hit 1.89% on January 6th (2015) – reaching their lowest closing levels since May 2013!

Treasuries, Agencies, and MBS

In the last **BMR**, we said: *"While Treasury yields aggressively pursued (or accompanied) diving stocks into the 16th, they are now beginning to rise into our "19th to 24th" window. The cycles look promising after December 26th for yields dropping (or at least staying low) into the end of January (which coincides with the next FOMC meeting)."* 10–year yields hit 2.30% on the 24th, and have so far fallen 41 bps to 1.89%. That's a huge drop! The 30–year also hit a high yield of 2.88% on the 24th, and then 'according to script' also dropped 41 bps to 2.47%. Last week, yields fell 7.5, 15.5, 14, and 13 bps for the 2, 5, 10, and 30–year Treasury sectors. Even after the 841–point plunge in the Dow was followed by a superb rebound, yields held their ground at lower levels – indicating bonds are more cautious! Into today, yields were lower by 6, 11.5, 9, and 9 bps today for those Treasury sectors.

There were no great surprises in the minutes of the Fed's December meeting. Most were comfortable with the language of 'patience' in observing incoming data and acting on a first hike, while some thought the language was unduly pointing to a June 2015 liftoff for rates. They also said: *"Many participants regarded the international situation as an important source of downside risks to domestic real activity and employment, particularly if declines in oil prices and the persistence of weak economic growth abroad had a substantial negative effect on global financial markets or if foreign policy responses were insufficient."*

MBS spreads (for FNMA 30–year 3%) widened 3 bps last week, but had narrowed by 9 and 10 bps the past 2 weeks. All 3 of the pre–Christmas Treasury auctions were rated a '3 of 5' or average. On December 22nd, the Treasury sold $27 billion 2–year notes at .703% (the highest yield since March 2011). Demand was off versus November, and foreign buying fell .1% from last month to 35.7%. On December 23rd, the Treasury sold $35 billion 5–year notes at 1.739%, with demand also falling (to a 2–month low). Foreign allocations dropped from 65% to 58.7%. On December 24th, the Treasury sold $29 billion 7–year notes at 2.125%. Demand was the lowest since November 2013. Foreign buying was up from 50% in November to 56.5% of this offering. Next week, the U.S. Treasury will auction $24 billion 3–year notes on Monday (01/12), $21 billion 10–year notes on Tuesday (01/13), and $13 billion 30–year bonds on Wednesday (01/14).

01/02/15 Treasury Yield Curve	**2-Year: 0.667%**	**5-Year: 1.608%**	**10-Year: 2.111%**	**30-Year: 2.688%**
Weekly Yield Change:	–.074	–.154	–.140	–.129%
12/31/14 Treasury Yield Curve	**2-Year: 0.666%**	**5-Year: 1.654%**	**10-Year: 2.172%**	**30-Year: 2.752%**
Annual Yield Change:	+.284	–.089	–.857	–1.217%
12/26/14 Treasury Yield Curve	**2-Year: 0.741%**	**5-Year: 1.762%**	**10-Year: 2.251%**	**30-Year: 2.817%**
Weekly Yield Change:	+.101	+.114	+.088	+.062%
12/19/14 Treasury Yield Curve	**2-Year: 0.640%**	**5-Year: 1.648%**	**10-Year: 2.163%**	**30-Year: 2.755%**
Weekly Yield Change:	+.098	+.136	+.080	+.017%
Support:	0.63/ 0.65/ 0.69/ 0.72%	1.44/ 1.47/ 1.51/ 1.56%	2.00/ 2.03/ 2.07/ 2.10%	2.61/ 2.68/ 2.77/ 2.83%
Targets:	0.55/ 0.53/ 0.48/ 0.45%	1.40/ 1.38/ 1.35/ 1.32%	1.92/ 1.89/ 1.85/ 1.82%	2.53/ 2.47/ 2.45/ 2.36%

Economics

GDP was adjusted 1.1% higher to 5% for the 3rd quarter for its strongest showing since 2003. Also, Personal Consumption was adjusted 1% higher to 3.20%. The GDP Price Index for 3Q 2014 remained at 1.40%. November Personal Income rose .40%, while Personal Spending was up .60%. The Personal Consumption Expenditures measure fell .20% in November, while the core (ex food and energy) was flat. Annual PCE dropped .20% to 1.20%, while the core rose .10% to 1.60%. Over the past 3 weeks, Initial Jobless Claims dropped 8K to 281K, rose to 298K, and then fell to 294K. All remain near the low end of recent data. If there are to be layoffs, retailers are waiting until the returns and exchanges are done. Continuing Claims rose 29K to 2,407K, dropped to 2,351K, and then rose back to 2,452K. ADP Employment Change data showed a 241K pickup in private payrolls for December. Challenger Job Cuts rose 6.60% (marginally higher layoffs versus last December).

Construction Spending fell .30% in November and Existing Home Sales dropped 6.10% to a 4.93M unit pace. They were up 2.07% versus last year. New Home Sales fell 1.57% to 438K, but were down 2.23% versus November 2013. The S&P/Case–Shiller 20–city home price index was up .76% in October, but slowed .32% to a 4.50% annual pace for the smallest gains in 2 years. Their Home Price Index slowed from an annual 4.82% gain to 4.64%. The FHFA House Price Index rose .60% in October. Pending Home Sales rose .80% in November, up 1.70% to last year. MBA Mortgage Applications rose .90% into December 19th, fell 18.20% into the 26th, and rose 11.10% into January 2nd.

The Consumer Confidence Index rose 1.6 to 92.6 and was close to its 7–year high reached 2 months ago. Another measure, Bloomberg Consumer Comfort, rose from 41.7 to 43.1, fell to 42.7, and then rose to 43.6 over the past 3 weeks. That measure for 2014 was the highest in 7 years. The RBC Consumer Outlook Index was flat at 53.3. ISM Manufacturing fell from 58.7 to 55.5 and Prices Paid dropped from 44.5 to 38.5. ISM New York was up 8.8 to 70.8, and the Chicago Fed National Activity Index rose from .31 to .73. The Richmond Fed Manufacturing Index was 3 better to 7, and Kansas City was 1 better to 8. Falling were Dallas Fed Manufacturing Activity (from 10.5 to 4.1), Chicago Purchasing Managers (from 60.8 to 58.3), and University of Michigan Sentiment (from 93.8 to 93.6). November Durable Goods Orders dropped .70%, and were .40% lower ex transportation. Factory Orders also fell .70%. December Vehicle Sales slipped from a 17.08M pace to 16.80M. Domestic Sales dropped from 13.78M to 13.46M.

The Service Sector outlook fell, but was still positive (ISM Non–Manufacturing Composite from 59.3 to 56.2). The November Trade Balance deficit fell to only $39.0 billion from a previous $42.2 billion – mostly due to falling oil prices. Consumer Credit expanded by $14.081 billion in November (with a $2.75 billion bump to October).

Friday brings December payroll and unemployment data. Also due are Wholesale Inventories and Trade Sales for November. Next Monday (01/12) will bring an update on the Fed's labor 'dashboard' from their Labor Market Conditions Index (Change). Tuesday follows with the NFIB Small Business Optimism, IBD/TIPP Economic Optimism, JOLTS Job Openings, and the U.S. Monthly Budget Statement for December. Wednesday is set for MBA Mortgage Applications, December Retail Sales and Import Prices, November Business Inventories, and the Fed's Beige Book (growth report for the 12 Fed districts).

Equities

Stocks gained for the year, but a near–1% drop on the last trading day led to the first December losses in 7 years. The Dow finished 2014 7.52% better and the S&P gained 11.39% making 53–record ne high closes on the way. The Nadsaq gained 13.40%, but was the only leading index that did not make new record highs (still 300 points under its March 2000 record advance). Last week, the Dow lost 220.72 points or 1.22% to 17,832.99. It was up 3.03% and 1.40% the previous weeks (into the 19th and 26th). It's up .42% this week, but only after today's 323–point advance. The S&P fell 30.57 points or 1.46% last week to 2,058.20. It's .19% higher this week. The Nasdaq lost 80.05 points or 1.67% last week to 4,726.81, but is .20% higher this week. The Transports lost 1.09% last week, and are still 1.59% lower this week (after the across–the–board rally). Despite that, all indices are significantly higher versus their lows on January 6th. Bank stocks lost 1.07%, and are 3.04% lower this week. We expect a good buying opportunity if stocks fall into a low with our cycle near January 21st.

Resistance:	Dow:	17,784/ 17,917/ 18,043/ 18,185	Nasdaq:	4,719/ 4,744/ 4,777/ 4,807	S&P: 2,063/ 2,075/ 2,086/ 2,098
Support:		17,648/ 17,521/ 17,385/ 17,258		4,685/ 4,652/ 4,618/ 4,584	2,039/ 2,030/ 2,018/ 2,007

Other Markets

Commodities plunged 17.92% in 2014 as Crude Oil tumbled 45.87% and the U.S. Dollar surged 13.04%. Cotton dropped 28.79% and Silver was 19.51% lower – even though Gold only fell 1.51%. Commodities fell 2.66% last week, and are off 1.11% this week. Crude Oil fell 3.73% for its 6th weekly loss, and is 7.40% lower this week. Gold was .76% lower last week, but is up 1.88% this week. The U.S. Dollar continued its rise with a 1.19% gain, and is 1.33% better this week. The Japanese Yen lost .16% last week, but is .70% higher this week. The Euro fell 1.49%, and is off a huge 1.79% this week. Corn fell 4.58%, and is off .38% this week. Cotton dropped 3.33%, but is 1.64% better since Friday.

The BMR Forecasts for 2015

- Congress should find this year very frustrating if they expect to unwind parts of the health care law or get a pipeline approved. Some of the employer mandates were delayed to 2015, so their effects will now begin to drag on the economy – as well as company growth and earnings.
- We think the Fed will begin rate increases at their June meeting. We expect at least three hikes in 2015.
- We still have a major economic trough due in 2016. For that reason, the global GDP recovery should remain challenged with inflation remaining on the low side. Any real upturn nearer or beyond the Fed's long–run inflation target above 2% should be delayed until after 2016.
- We expect another cold winter and some cooler summer weather as well. Over the coming years, we should see a little rebound to higher temperatures as a correction to the recently very–cold trend – but the cycles show no imminent return to global warming (which actual ended around 1999 to 2001). We instead are in the first interim cold low (trough) – which is one reason we're freezing here!
- Our cycle work on stocks suggests lows near January 21st, early June, early September, and mid–November (which should be the lowest for the year). Highs are due near April 22nd, late July, and late October. At present, the April top seems to be the most important.
- Bond trend changes are due 2/13/15, 7/24/15, and 12/18/15. We expect the lowest yields in late February to early March, with other lows in early May and late August. Yield highs should be around early April, late July, and late October (which could be the high yield point for 2015).

"We make a living by what we get – we make a life by what we give." Sir Winston Churchill

"The most dangerous strategy is to jump a chasm in two leaps." Benjamin Disraeli

Reviewing the BMR Forecasts for 2014 (reviews are bulleted)

"Income Inequality" is the buzz–phrase that is catching on. The "Yes we can" mantra from the 2008 elections was used to inspire hope for those seeking to bridge that gap. However, data suggests central banks policies are helping the upper echelon to improve at a much faster pace. We can't see that gap improving in 2014 given onerous health care costs and a lack of full time jobs. Employers continue to keep worked hours in check to reduce costs, another factor which will serve to widen the gap.

- We think the limited hours will continue to dampen what could be better growth. With stocks booming in 2014, the income gap did widen.

As rates rise and stimulus tapers with QE going through its 'unwind', housing and other sectors could slow. Given that and the effects from the health care legislation, which is expected to cost most individuals far more than projected, it's even possible the Fed would even seek to 'un–taper' QE – or create additional stimulus measures. As Lee Corso is known to say on College GameDay: *"Not so fast my friend!"*

- The Fed ended QE3 a meeting sooner than was foreseen with their $10 billion taper pace – by tapering a final $15 billion in October. Housing prices did slow and health care costs continued to escalate.

The debt ceiling and budget spending controls will continue to dominate financial news. Further shutdowns and cuts of U.S. debt ratings are possible without more cooperation. This threatens borrowing costs and is a source of continued trouble for the bond market – as we've said: *"This is very negative for bonds in the longer term."*

- Even though Republicans picked up a huge advantage in the November 2014 elections, the shutdowns and debt ceilings debates tapered off as Congress and the Fed decided to ignore 'ceilings' on the national debt and the Fed's balance sheet size. The biggest credit card in history has no limits! However, the government did spend less and collect more in revenue, so the deficit shrank. When rates begin to rise, the cost on financing the national debt will become an increasingly larger and burdensome budget line item.

Our cycle work on stocks suggests lows in early February, followed by a peak near July 16th – which could mark the highest levels for the year. Lows are due in late September and mid–November, with another peak between those lows near the end of October.

- Stocks indeed bottomed in early February (02/06) and the Dow rose 11.80% into a July 17th top. The Ebola scare sent stocks much lower into October 15th, and they surged afterward – possibly on the belief incoming Republicans will be more budget conscious.

Bond trend changes are due 1/5/14, 6/10/14, and 11/13/14. We expect the lowest yields in early June, and the highest both now and in late Sept.

- The highest yields were that 'now' (early 2014) with the early January top and in almost–late September with the last high on the 18th. Those trend change dates were all resistance points and worked rather well.

Carryover expectations from 2012 and previous BMRs:

The Global Cooling trend will continue and 'Global Warmers' will instead officially adopt 'Climate Change'.

- It's continues to be obvious that we're in a cooling trend. Stories abound with century–old records falling for new cold waves across the U.S. – even in the summer!

After a mixed 2012, the cycles show 2013 to be another deflationary year.

- There are still deflationary forces that are troubling to central banks. Home prices were up this year, but less than in 2013. Overall inflation was held in check – and remained modest.

2014 – The Year in BMR Quips & Quotes

(* "…" indicates the text herein may be abridged. Full text in the form of back issues is available on request.)

BMR (01/22/2014) – The world didn't end in 2012 with the Mayan calendar, but it did get colder – and that hasn't stopped. 2014 is off to a very cold start.

BMR (02/04/2014) – With emerging markets experiencing their worst start since 2008, India Central Bank Governor Raghuram Rajan said: *"International monetary cooperation has broken down."* He argued: *"The U.S. should worry about the effects of its polices on the rest of the world."* In other words, some are blaming a modest reduction in the pace of Fed purchases for the magnitude of the market selloff.

Winter's Tale – BMR (02/12/2014)

Now is the s*ummer* of our discontent – with winter. For the winter of it doth seem far away, and the groundhog has confirmed its stay! The southern vernacular would be: *"It ain't over, and we're tired of it!"* Many southern U.S. cities have been colder than Sochi, Russia, where the world is engaged in the Winter Olympic Games. The severe cold of these Arctic storms continues to be a challenge for retail and other sectors of the economy.

BMR (03/13/2014) – 'Slack' is back! We're seeing more use of the term 'slack' to describe global labor and economic conditions. European Central Bank president Mario Draghi used it to affirm that ECB rates would *"remain at present or lower levels for an extended period of time"*, as they left rates at .25%. He said: *"Our monetary policy stance will stay in place even after we see improvements in the economy, in the flow of data in the economy, because we have a stock of slack that is weighing on the economy."*

BMR (04/02/2014) – Yellen said the Fed's *"extraordinary commitment is still needed and will be for some time."* She said she has a *"dashboard"* of indicators on which the dials are improving, but only two of nine are back to pre–crisis levels.

BMR (05/01/2014) – The Fed has been lowering growth expectations, which of course makes them easier to beat.

BMR (06/11/2014) – Why do we repeat the mistakes of yesterday? For a number of reasons – the best being 'this time it's different' or 'I'll now recognize trouble, and veer away at the last minute'. Never mind margin borrowing near all time highs, or that stocks boosted by unprecedented asset purchases will soon be left without that assist. The **BMR** won't complain. We need both optimism and pessimism to reach extremes in the context of longer cycles. The Fed is telling us things are on the mend, but members are mixed on how long to extend low rate stimulus. We're to believe a recovery is well underway, while banks and central banks are implementing negative interest rates.

BMR (06/18/2014) – Fed Chair Janet Yellen said: *"Economic activity is rebounding in the current quarter and will continue to expand at a moderate pace."* Of course, it won't take much of a 'rebound' to beat the first quarter's weather–challenged 1% *decline*. Yellen downplayed the dot–plot forecasts which point to economic improvements and ultimate tightening. As the **B**ond **M**arket **R**eview has previously contended, central bankers believe (or want to believe) their policies will ultimately work – and the forecasts need to reflect that optimism.

BMR (08/06/2014) – Dallas' Richard Fisher said the committee was already moving to his direction, so he didn't feel the need to dissent. He said if they don't keep doing so, he would dissent. Fisher said the *"so–called liftoff has been moved forward."* He said it could be *"significantly"* so, and maybe *"sometime early next year."* Given the timetable for the end of QE, Yellen has instead tried to signal no hikes until at least June 2015 (or later).

BMR (08/13/14) – The EU is nervous about Russia's moves on Ukraine, and slow growth in some member countries. The European Central Bank just kept interest rates unchanged at record lows – as the Ukraine crisis and Italy's relapse into a recession added to their headwinds. German investor confidence just fell to 2–year lows. Russia is no longer invading or building up troops on its border with Ukraine, but rather sending convoys of 'humanitarian aid' into the country. Any read on how long it takes Russia to remove those forces from inside Ukraine – ask former East Germany!

BMR (09/03/2014) – Wolfgang Schaeuble, Germany's Finance Minister, last week contended *"liquidity in markets is not too low, it's even too high – therefore I think monetary policy has come to the end of its instruments."* In other words, he thinks Central Banks are either running out of tools – or an effective way to employ them. His statement reminded us of something another Wolfgang said after reviewing a physics paper submitted by a colleague. Wolfgang Pauli said: *"This isn't right. This isn't even wrong."* He missed his calling as a central banker!

BMR (09/03/2014) – By this time next week, Apple and Samsung will have introduced their new phones (and related devices). Poor spending aside, consumers line up every time Apple introduces a new iAnything. Nevertheless, without a little more iSecurity for the iCloud using the iApp on my new larger (Samsung–like) iPhone, I may wait a bit longer to use Apple's new iWallet technology.

BMR (09/11/2014) – The **B**ond **M**arket **R**eview years ago made the argument that the Fed's low rates served as a tether to anchor longer rates from going much higher. … It may now be the case that ECB and Japanese interest rates renew that anchor in holding global rates lower for a bit longer than anticipated.

"Democracy is the recurrent suspicion that more than half of the people are right more than half the time."
E. B. White

To err is human, to arrrrrr is pirate.

Beyond Considerable – BMR (09/17/2014)

Unless you were expecting Fed Chair Janet Yellen to reverse course to a more–hawkish tone, there were no great surprises from today's FOMC statement on interest rate policy. Global equities have found friends in global central bankers, and Yellen's Fed didn't break course. Using tame inflation and some still–troubling labor statistics, Yellen channeled Cyndi Lauper in reassuring stocks that the Fed was on hold: *"If you fall I will catch you – I will be waiting, time after time!"*

BMR (09/25/2014) – A higher Dollar does have its own set of concerns! FRB New York President William C. Dudley contended: *"If the dollar were to strengthen a lot, it would have consequences for (U.S.) growth."* He said: *"We would have poorer trade performance, less exports, more imports … and if the dollar were to appreciate a lot, it would tend to dampen inflation. So, it would make it harder to achieve our two objectives. So obviously we would take that into account."*

BMR (10/08/2014) – A Bloomberg article by Michael P. Regan put his spin on how the 'bad day' plays out in a downmove. He referenced the observations of Birinyi Associates, Inc. Laszlo Birinyi has said: *"One exceptionally bad day usually accounts for about 25% of the entire correction, and is more likely to occur toward the end of the correction."* Speaking to yesterday's 272.52–point drop in the Dow, Regan put things in a Birinyi perspective: *"Relax: It was only S&P 500's 387th worst day in 20 Years."*

Key Economic Thoughts from the 2014 BMR

(* "…" indicates the text herein may be abridged. Full text in the form of back issues is available on request.)

BMR (01/22/2014) – While the U.S. Unemployment Rate 'officially' hit 6.7% in December, the lowest level since October 2008, it did so with the Labor Force Participation Rate falling to the worst (weakest) level since 1978. So what's 'churning' the economy? For one thing, the American Butter Institute says butter usage is at a 40–year high consumption rate of 5.6 pounds per capita. Is the use of butter inversely related to being in the workforce? We don't think so, but there are a few rampant dichotomies at play. Improving payroll data aside, in 2013, food stamp usage rose to a record 20% of American households – a 51.3% rise since fiscal 2009.

Cold Wars (03/05/2014)

The U.S. found itself not only dealing with the big chill of an unrelenting winter, but also in a renewed cold war as Russia followed the Olympics with enough saber rattling to shake global markets. The Northern Front was harsh enough to freeze Niagara Falls in magnificent fashion (Google those pictures!). The Eastern Front saw Russia send troops into Ukraine, test an ICBM (unlike North Korea, successfully), and dock a warship in Cuba with no warning. You could almost see Nikita Khrushchev taunting the West with his shoe!

Fed Chairman Janet Yellen reaffirmed the Fed's intentions to taper QE asset purchases at a "measured pace". In advance of the March 19 FOMC meeting, she said the Fed will be trying to determine how much of recently soft data has been primarily weather related or "if any, due to a softer outlook." Though we would argue (with the groundhog) that winter is the best season for cold, she said: "Unseasonably cold weather has played some role."

BMR (03/19/2014) – If investors thought they had the Fed figured out, they got a rude awakening. As the renewal of the 'Cold War' was underway pushing long rates lower, Chairman Janet Yellen and company poured 'cold water' on short rates. Of course, it spilled over to longer maturities, but the first mention of a timing for hiking the Fed's target rate took bonds by surprise.

BMR (05/09/2014) – The FOMC may have been dotting a recovery, but it's not 'doting' on one. In this week's testimony to the Senate Budget Committee, Fed Chair Janet Yellen responded to questions about low interest rates. She said: *"There are a number of sectors of the economy that have responded favorably to a policy of low interest rates, and it's helped stimulate demand and job growth."* However, she said low rates were not *"a panacea."* It's clear that low rates have helped equities, and kept the deficit from expanding at an even greater pace. Nevertheless, FOMC policy hasn't been able to offset a lack of fiscal guidance, leaving the economy growing at only a *"frustratingly slow"* pace while inequality in incomes has been rising. Wage growth is stagnant, and companies are still somewhat reluctant to hire while struggling with health care mandates and increased tax burdens. To that end, low rates have not spurred the kind of growth and recovery the Fed might have envisioned – especially given the QE programs. The fact that the FOMC (and other central banks) continue to reassure low–rate policies is evidence that a more substantive recovery may be many more months or quarters away. While the recovery has been slow, and low rates were a necessity – when rates do begin to rise, the service on our national debt will become quite onerous.

BMR (05/22/2014) – The **BMR** was very critical of the Fed's rapid tightening into 2006, thinking that the long series of 50 bps increases played a major role in spurring the financial crisis – as subprime loans reset much faster than if the Fed had exercised more patience.

Fed Chairman Ben Bernanke started his term by maintaining that strategy as set by Chairman Alan Greenspan. He soon came to face with the need to be very nimble with policy. The Fed always wants to believe their current policy will meet growth and mandate objectives, but their stance of low rates for a considerable time coupled with tapering QE asset purchases shows optimism that is measured with caution. Despite the questionable economic benefits of extended QE (beyond the impact at its onset), in its measured tapering Chair Janet Yellen will need to be careful not to continue to 'paddle beyond the waterfall' as the Fed did in 2006.

BMR (06/11/2014) – Payrolls finally rose beyond the pre–recession peak, but we'd be hard pressed to find evidence that the quality of jobs and income has returned. Hasn't the population grown in those 6 years, so are we really back to equal footing? For all the positives, the labor force participation rate is very low, growth is frustratingly slow, and food stamp usage is at a record. Funny how the Federal debt ceiling and trade deficits rarely make the news anymore!

BMR (07/01/2014) – It's been quite a ride for stocks. With a somewhat–unintended assist from the Fed's quantitative easing and low–rate stimulus from the world's central banks, equities have surged to record highs. While that's happened, the 'wealth gap' has soared back to the extremes of the roaring '20s. The University of Michigan published a study that concluded the richest 5% had 24 times the wealth of the median household in 2013 – with roughly 10% of households owning 80% of stocks. The top 10% of households earn more than 50% of the income.

Stocks have feigned less flops over the past 24 months than have the players in a single FIFA world cup game. The Russell 2000 stock index just completed an 8th consecutive quarter of gains – matching that previous record from 1995 to 1996. The S&P reached a 6th quarter of gains for its best performance since 1998.

<u>In the Long Run – BMR (07/09/2014)</u>

By a score of Nil–Nil (0 to **0**), Argentina *won* today's semi–final FIFA World Cup match against the Netherlands. It took penalty kicks to decide a victor. The Unemployment Rate declared victory back in April by dropping below the 6.5% 'threshold' to 6.3%. Yet, rates will remain low for a while, because even with June's drop to 6.1%, it's a shallow victory beset by its own set of penalties. The quality of jobs was much better nearly 6 years ago when the rate was last 6.1%. While payrolls rose by 288K in June, the 5th straight gain above 200K, there was an increase of 275K in involuntary part–time workers (those who want to find full time work, but cannot for various economic reasons). The Labor Force Participation Rate remained at 62.8% for a third month – the lowest level since 1978.

The Fed assumed a return to an Unemployment Rate of 6.5% would indicate the economy was 'healthy' enough to begin to raise their target rate. However, as the rate was rapidly approaching 6.5%, and it was clear that given low labor force participation, limited weekly hours, and the high percent of those that were working part time because they couldn't find better jobs, the FOMC removed that gauge off the 'dashboard'. It was like a Nil–Nil win.

BMR (07/24/2014) – In the guarded or less–optimistic camp, the International Monetary Fund cut U.S. growth forecasts earlier this week – citing *"a lot of slack in the economy."* They said *"headline unemployment is expected to decline only slowly."* Given stagnant wages and weak labor participation, the IMF staff said *"policy rates could afford to <u>stay at zero for longer than the mid–2015 date</u> currently foreseen by markets."* They followed up today, forecasting: *"Global growth could be weaker for longer, given the lack of robust momentum in advanced economies. … Monetary policy should thus remain accommodative in all major advanced economies."* As we said last week, Yellen holds the 'bully pulpit' for now, and has FOMC members such as Evans and Lockhart in her corner. Given some recently weak U.S. housing data, we see the gavel as dovish at present.

BMR (10/01/2014) – Currencies are supposed to line up in Purchase Power Parity by their buying strength. With the U.S. Dollar surging versus alternatives, that would challenge our exports (and growth), and keep inflation much lower than the FOMC would desire. We've already contended that one 'equalizer' is going to be G7 interest rates, which are very low (some even negative) versus ours … Others would be foreign inflation rates and weaker global growth. Recent EU data showed Euro Zone factories cut prices in September by the most in more than a year and manufacturing expanded at the slowest pace in 14 months. On Tuesday, we discovered that Euro Zone inflation slowed to the lowest level in five years, with their 'consumer prices' rising only .30% annually.

"Advice is what we ask for when we already know the answer – but wish we didn't." Erica Jong

Holding Pattern – BMR (10/08/2014)

While we've seen a prolific rally in stocks since March 2009, and a yield scare to the upside followed by the lowest longer–term yields in over a year, the Fed's key rate hasn't budged since the end of 2008. While there's been plenty of speculation the Fed will hike in mid–2015, the Fed's latest minutes showed that's not set in stone. The Fed noted *"the persistent shortfall of economic growth and inflation in the euro area."* That could strengthen the Dollar to unfavorable levels – leading to weakened exports.

BMR (10/22/2014) – … it was estimated that global markets had lost roughly $4.3 trillion in value during the panic into last week. As we said, even FOMC members were reconsidering whether to completely throttle back QE asset purchases (as was their plan for next week's meeting). As for QE, and this is not our position, but if all it takes is $85 billion a month to send stocks $4.3 trillion higher, that's some pretty healthy leverage. However, every Dollar, Euro, Yen, or Pound piled onto central bank balance sheets comes with its own eventually 'day of reckoning.'

BMR (11/21/2014) – Our bond cycles remain unchanged, which leads us to believe stocks won't make a major low until mid–January.

BMR (11/21/2014) – We had a forecast of Dow 18,000 by 2015, but certainly didn't expect to be within 110 points at present. That was before we plunged to 6,441 in March 2009, so the recovery in equities is nothing short of prolific. If you're a skeptic on the economy, you've got to admit that some of the U.S. data looks pretty good – especially compared to our peers. If you're a global warming advocate, you should also be aware of data that counters that position. Our individual opinions don't change the data – it is what it is! Areas in the northeast are seeing record snowfall and Jacksonville Florida is experiencing its coldest November weather since 1873.

BMR (12/04/2014) – While U.S. GDP rose more than expected in the third quarter, Japan entered another recession and the Eurozone is dangerously close.

Key BMR Studies and Observations from 2014

(* "…" indicates the text herein may be abridged. Full text in the form of back issues is available on request.)

The Wolf Of Wall Street

Back in June 2006, the **B**ond **M**arket **R**eview was critical of incoming Fed Chairman Ben Bernanke for taking the role of 'super hawk' in continuing to raise rates without regard to the potential effects of quickly resetting subprime and other variable rate loans. We dubbed the new chairman as 'Bear–nanke', giving the market's reactions to Fed policy. We thought the over exuberance in continuing hikes exacerbated the onslaught of the financial crisis by causing even more defaults than had the Fed been a little more patient. The aftershock was that markets cratered into March 2009 and the Fed got stuck on 'next to zero' – and then grew their balance sheet over $4 trillion. However, those moves served to provide equities with the Bernanke 'put', and as Dr. Yellen was confirmed, stocks reached all–time highs. All seemed right with the world. In the **BMR (10/15/13)**, we had said: *"We think Bernanke would probably have liked to taper before his exit as a testament to the validity of his policies."* Despite the October government shutdown, he was able to sneak that in under the wire. As he's exiting, so is QE – albeit marginally. Bernanke's Fed thought out of the box, and his printing press worked to make Wall Street very happy, especially from where it was back in 2009. Since March 2009, the Dow has risen over 10,000 points to gain 157%. (Of course, as well as the Dow seems to have done, it's only risen 2.34% per year since 2000.) The Wolf beat the Bear! It now remains to be seen whether or not Dr. Yellen 'dances with wolves', but that's another story.

While Bernanke had the least support ever coming in as Fed Chairman with only a 70–30 confirmation for his 2nd term in 2010, Dr. Janet Yellen was voted in by only 56–26 – the weakest on record. However, the way we view this very–partial Senate, that's a landslide (must have had 18 folks voting 'present').

… As we've said, tapering aside, if the data is that positive – why is the Fed still promising low rates to 2015? Why have other global central banks also lowered their borrowing rates to record lows? Why are savers willing to accept negative rates? Rates behaved much as we thought they would through 2013, but we and most hedge funds missed much of the stock rally. We do think stocks are very dependent on QE, and that our Fed's printing press has elevated global equity markets.

The Changing of the Guard – BMR (01/29/2014)

Outgoing Fed Chairman Ben Bernanke led the January FOMC meeting by shaving another $10 billion away from their QE3 monthly purchases. Clearly, the Chairman wanted a second taper in a move that would validate where the economy stands, and how well the Fed handled the financial crisis and its aftermath. No Fed Chairman was ever as creative as Bernanke in the use of policy tools, though their ultimate cost may not be known for many years.

Dr. Janet Yellen takes over on February 1st, with improved growth and labor conditions, but with inflation below Fed targets. Deflation is a major concern for central banks, because it's one of the hardest battles to fight.

It's still puzzling to the **BMR**, and many others, that the Fed contends we're approaching maximum employment. Their statement failed to mention the multi–decade low in the Labor Force Participation Rate, but that doesn't fit the tone necessary to pull back stimulus. … Presiding over a central bank is one tough job, and the Fed helm is one of the most powerful positions on the planet. Our best wishes Dr. Bernanke!

Groundhogs, Broncos, and Bears – BMR (02/04/2014)

Should we follow with, *"Oh my!"?* The Chinese Year of the Horse began just a few days before the Super Bowl (that was anything but …). It certainly didn't do much for the Broncos. While many are excited about the new college playoff system this year, we see from the NFL that it doesn't guarantee a great championship game! The Year of the (black water) Snake turned out to be very good for stocks. As we enter the Year of the (wooden) Horse, we have to hope for a better outcome than did Troy! So far the roles have reversed, as stock bears and bond bulls have won out in early 2014. It's also been an exceptionally cold winter, that has challenged manufacturing and home sales. Winter storms were bringing southern cities to a halt, and there's been a distinct deficit in the coverage of polar bears stranded on isolated patches of melting ice. We can't even catch a break! The groundhog (Punxsutawney Phil) saw his shadow on Super Bowl Sunday – (supposedly) giving us 6 more weeks of winter!

Breaking Bad – (02/19/2014)

As the Olympics got underway, the stock market was winning the 'uphill', but a severe U.S. winter has housing, payrolls, retail, and manufacturing on a 'downhill' run. Emerging markets remain challenged as Fed tapering is taking its toll on a QE–dependent globe. One story said as the economy improved, the divorce rate was rising. The rate fell to a 40–year low into the recession that 'ended' in June 2009, and has now risen for a 3rd year! Things 'down under' are also upside down. As the U.S. Unemployment rate fell to 6.6%, the lowest since 2008, Australian levels just rose to a decade high 6%! The Fed's tapering has been blamed for Turkey and South Africa having to take emergency steps – as investors sold assets in those (and other) emerging markets. Australian Treasurer Joe Hockey said global markets should have expected QE tapering. He exclaimed: *"The world can no longer rely on methadone every day. Sooner or later we need to wean ourselves off – and that's what tapering is about."*

We recall FRB Dallas president Richard Fisher using a similar pharmaceutical reference as quoted in the **B**ond **M**arket **R**eview (02/28/13). He said: *"It would be best to taper the dose of QE so that markets can adjust gradually to the eventual removal of this treatment."* It's begun! At that time, he said: *"Now that we have them in place, and the fixed–income and stock markets are hooked on the monetary Ritalin that we have dispensed in ever–larger doses, it would, in my opinion, do great harm to force a sudden withdrawal."* It was by no means sudden!

In an *almost*–related story, the U.S. government announced they would allow banks to offer accounts and other services to businesses in states where medical or recreational pot sales are legal. Colorado and Washington sought guidelines, and an agency statement said: *"Financial institutions can provide services to marijuana related businesses in a manner consistent with their obligations to know their customers and to report possible criminal activity."* Go figure! Banks might not even have to offer toasters to attract new accounts. Doritos may work…

Non–Stop, Endless Love – (02/26/2014)

It's rare that we would combine two current movie titles for one of our themes, but each describes the stance of global central banks in continuing to provide stimulus. Even the Fed's slower pace of tapered QE is still pumping $65 billion a month in asset purchases while they hold rates 'near zero.' The **B**ond **M**arket **R**eview remembers FRB Dallas President Richard Fisher's comments from November 2012. At the time, he said there are *"limits to what a monetary authority can do"*, and that the FOMC couldn't *"endlessly"* purchase bonds to stimulate recovery. In December 2012 he said the Fed was at risk of a *"'Hotel California' monetary policy"* as in *"you can check out any time you like, but you can never leave."* As we know now, the Fed continued the full $85 billion/month program throughout 2013 with the first taper not coming until January 2014.

… Last month, the **BMR** noted that the U.S. Unemployment Rate was rapidly approaching the 6.5% target that was a condition for the Fed holding rates near zero. A number of Fed members are now considering moving or restating that target, especially since inflation is also holding low. (In fact, the ECB's Mario Draghi is still more concerned over *deflation* and is ready to act if needed.) Fisher said: *"Do you move that number? … Then you have to think, gosh, how do you trust these guys who keep moving things around?"* While last month contending there wasn't *"much efficacy"* in growing the balance sheet, last week, he added: *"If we do choose to approach this from a qualitative side, how do we do it without just adding and adding and adding to the statement?"*

That's endless non–stop love – or at least enablement.

Rise of an Empire – BMR (03/19/2014)

Now we know what Russian President Vladimir Putin may have been thinking every time the cameras caught him with that cold stoic expressionless gaze during the Olympics. Could it be he envisioned a revival of the former Soviet Union, and Crimea is only the first step? As the world was emerging from the Great Depression, Adolph Hitler hosted the 1936 Olympics in Berlin. The Soviet Union boycotted those games. Just a few years later, Hitler began to 'annex' adjoining territories and push the envelope of treaties ending the first World War. (The 1916 games were to take place in Berlin, but were cancelled by the breakout of World War I.) Austria fell without violence, but the 'Third Reich' then set its sights on Czechoslovakia and beyond – escalating into World War II. Ironically, the 1940 Olympics were to take place in Tokyo, Japan – but of course they never happened. Whether the world's markets are to be troubled for a short time – or much longer remains to be seen, but clearly another 'headwind' is place. Deep recessions seem to enable a rise to power (or power grabs) as 'the people' are swayed by promises of a return to the glories of yesteryear. The European Council stepped up sanctions against Russia, and German Chancellor Angela Merkel declared the G8 'effectively dead' as she said the Kremlin's actions served to disqualify them from the Group of Eight as long as the conflict remains. In the **B**ond **M**arket **R**eview (12/14/2000), we said: *"Russia also offered to supply peacekeeping troops to NATO. Which piece do they want this time?"*

Glass Houses – BMR (03/26/2014)

Incoming Fed Chair Janet Yellen quickly found out the price of transparency. We recalled the 'proverb': "Man who live in glass house – dress in basement!" It was always amazing how former Fed Chairman Alan Greenspan could articulate a thought that few could interpret correctly. He would consider that a positive! Back in the **BMR (01/29/2001)**, we wrote: *"In a new book by Bob Woodward, it was noted that Greenspan's wife did not realize she had been proposed to until the third occurrence. Apparently, she didn't understand Greenspeak either."* Yellen was too quick to answer reporters on a timing for rate hikes, and said it was *"hard to define"*, but *"probably means … around six months"*. We'd have to again quote Lady Macbeth: *"What's done cannot be undone."* In less than an hour, short U.S. borrowing rates jumped 30% higher – and remain there despite much 'rewording' by FOMC members. Atlanta FRB President Dennis Lockhart said 6 months *"is really a minimum, not a maximum!"*

… The transparency of the 'glass house' allowed the viewing of a dot chart of the Fed's quarterly forecasts which showed the results of 10 members expecting at least a 1% rate by the end of 2015. That rose from 7 in December. In the March meeting, 12 members now expected a 2% or higher rate by the end of 2016 – rising from 8 in December. Yellen tried to reassure investors that: *"One should not look to the dot–plot, so to speak, as the primary way in which the committee wants to, or is speaking about policies to the public at large."* As we said in the **BMR (05/06/09)**, speaking of politicians, it was the old: *"What are you going to believe, me or your eyes?"*

Speaking at the London School of Economics, Dallas FRB President Richard Fisher said QE3 would be done by October *"if we continue at this pace."* While that had investors adding 6 months to October or December, Fisher said there was a *"fixation – if not a fetish on the dots."* He said: *"Somehow, this was read as a massive shift. … These are our best guesses."*

Up High – Down Low – Too Slow – BMR (04/10/2014)

FOMC members had said the hurdles were high for a reverse in tapering QE. The March minutes revealed some members proposed language that would signal their *"willingness to keep rates low if projected inflation remained persistently below"* their 2% longer–run objective. One measure the Fed uses showed inflation recently running only .9% – less than half the goal. Even so, our rate of inflation is nearly twice that of the Eurozone – which fell to 5–year lows (of .5%)! … In hopes they might get inflation over 1%, from what the IMF's Christine Lagarde said was the danger of *"low–flation"*, President Mario Draghi and the ECB were considering a new QE round of their own. They considered asset purchases of $1.4 trillion (equivalent). However, it will be difficult, and more like deciding where to go to dinner. What sounds good for debt to buy? Greek? Italian? French? Spanish? EU QE may lack the qualitative efficiency of the Fed's Treasury and Agency MBS purchases. If not debt, do they buy quality or marginal assets (loans)? A dilemma!

Transcendence – BMR (04/23/2014)

It's difficult to interpret the Fed's 'dot plots', whether they are provided by voting FOMC members – or others! Speaking to the Economic Club of Canada on Tuesday, former Fed Chairman Ben Bernanke, told his Toronto audience that the U.S. was on its way to a complete recovery. He said: *"We are making considerable progress."* He contended the headwinds from the crisis are *"beginning to dissipate."* Global economies are of course in far better shape than only a few years ago, but we don't know the ultimate cost of the massive stimulus. In December, Bernanke had said: *"The recovery clearly remains far from complete."* How much has changed in 4 months? It's great to do our jobs to make a difference, and central bankers of course want to believe their policies are going to work.

After all, the Fed did its best to navigate the financial crisis, but didn't prevent it – as few saw anything of that magnitude coming. The **B**ond **M**arket **R**eview thinks the Fed and global central banks wouldn't continue to act so aggressively if troubles were behind us. Maybe the 'troubles behind us' are analogous to one of our favorite scenes from Jurassic Park. While trying to evade T–Rex in their ATV, Muldoon looks in the side mirror only to see a large set of jaws above the caption '*Objects in Mirror are Closer than they Appear!'*

Our cycle work uses the past to forecast future trends, and the predator of deflation is still in the mirror. While the 'dot plots' point to higher rates and continued improvement, rates have remained low for a reason. Fed Chair Janet Yellen is saying the FOMC will remain accommodative until employment and inflation objectives are met, while the European Central Bank is considering a new round of QE and another rate cut! When we perform our cycle work, we project both peaks and valleys in economic numbers and interest rates. Using cycles, we never assume things will get linearly better – or worse. Trying to pull away from T–Rex, a panicking Dr. Ian Malcolm keeps shouting: *"Must go faster!"* They finally escape by kicking into a higher gear, but each change leads to a small slowdown or a slip. Growth in the U.S. is still *"frustratingly slow"*, and globally, there is still 'slack' in the gears.

The Dashboard – BMR (05/09/2014)

Yellen recently said only two of her nine 'dashboard indicators' had returned to pre–crisis levels. … Yellen called the labor market *"far from satisfactory"*, and said she would focus on *"trends in labor force participation."* She said a key question was if that trend was due to baby boomers retiring, or sluggish economic growth. It's questionable to the **BMR** that that many 'boomers' have enough wherewithal to retire!

… While we know it's not that simple, and there are other dynamics such as retirement, adding the folks leaving the work force since 2008 results in an Unemployment Rate of 13.7%. The Eurozone's rate is 11.8%, and our Underemployment Rate is 12.3%. The ECB intends to cut rates in June for a reason. There are still headwinds!

Janet Yellen said: *"We really need to figure out what portion of the labor force participation–rate decline is secular and what part is cyclical?"* Of course, the **BMR** likes that language – because it acknowledges that cycles play a major role in economies, and that central banks can't simply stimulate away recessions. An endless supply of no–doze, 5–hour energy drinks, or large 'venti' coffees can't prevent inevitable sleep. Sooner or later we need rest, or we pay a price mentally. Central banks jolted global economies back to life following the financial crisis. However, the Fed has had the economy on 'zero–rate energy drinks' for 65 months now – not to mention spiking the punch bowl with 3 large bouts of QE and extending the maturities of their holdings in Operation Twist. Given all that stimulus, the first quarter GDP of only .1% is a bit troubling! The continued injections might be as unhealthy for economies as for humans.

Maleficent – BMR (05/27/2014)

Deflation continues to play the antagonist on the global economic stage. While it's hard for most of us to vilify lower prices, they play on the consumer psyche in removing the urgency to buy. Despite some recovery in housing and higher beef prices, households will delay major purchases if they believe prices will continue to fall. This has been especially the case in Europe, but an overabundance of cheap manufacturing has also had a global impact. Clearly, global stocks have seen a boost from the central bank stimulus. The European Central Bank, the Bank of England, the Bank of Japan, the Fed, and many other central banks have kept rates near zero while purchasing trillions of Dollars in assets in an attempt to revive economies and spur 'healthy' inflation and growth. However, with deflation still an issue, the ECB and the Fed are going to find raising rates a tough call. In June, President Mario Draghi is expected to guide the ECB into its own QE–type asset–purchase program – and another rate cut. As low inflation (disinflation or even deflation) is seen as choking the throat of recovery, Draghi said: *"What we need to be particularly watchful for at the moment is, in my view, the potential for a negative spiral to take hold between low inflation, falling inflation expectations and credit, in particular in stressed countries."* Of course, we agreed with Draghi's statement that: *"The key issue today, however, is timing."*

A Hard Day's Night – BMR (07/16/2014)

The 1964 Beatle's film is being re–released for its 50–year anniversary this week. While they'd been 'working like a dog', the U.S. employment situation is a bit confusing. European unemployment is near record levels, while the U.S. rate has fallen to 6.1%. That's the lowest level since September 2008 – despite a labor force participation rate at 36–year lows. FRB St. Louis President James Bullard thinks full employment is around 6%, which could lead to an overshoot on inflation making the case for the Fed raising rates sooner than the supposed mid–2015 consensus.

Bullard projects the U.S. Unemployment Rate will be in the *"fives fairly soon."* We agree – we just don't think we're anywhere near 'full employment'! However, Fed Chair Janet Yellen holds the 'bully pulpit'. Before the Senate Banking Committee yesterday, she said: *"We need to be careful to make sure that the economy is on a solid trajectory before we consider raising interest rates."* On her labor–market dashboard, low wages represent *"significant slack"* and she said long–term unemployment could have the effect of *"psychological trauma"* on the jobless and their families. (Not to mention the trauma to newsletter writers who are continuously questioning the integrity of incoming data!)

Asked if the Fed should have a formulized exit strategy, she said the lack of flexibility would be a *"terrible mistake."* (By the previously forecast formulas, the Fed could have started tightening when the jobless rate fell below 6.5% – so they removed it!) Yellen explained: *"If we were following a specific mathematical rule, I really think performance in this recovery would have been dreadful."* For the time being, all the markets need to know is what Yellen said about stimulus. At the end of the day, she's in charge – and has members like Chicago's Evans and Atlanta's Lockhart as 'corners'. Yellen testified: *"A high degree of monetary policy accommodation remains appropriate. … Although the economy continues to improve, the recovery is not yet complete."*

The Cold Hard Facts (07/30/2014)

If you thought it would be a 'cold day in July' when stocks finally began to drift, you were right! Evidence of 'Global Cooling' continued to set in as temperatures dipped below 60 degrees in Atlanta for the first time since 1936. Temps in L.A. (that's of course 'lower–Alabama' for those east of the Mississippi) fell to the lowest readings since 1889! Temps in Saranac Lake, NY, broke to a record–low 37 degrees! In providing the results of our cycle studies, the **B**ond **M**arket **R**eview has always tried to keep our readers on the right side of business, economic, equity, and interest–rate cycles. Out of curiosity, back in 2009 we applied weather data to our models, and concluded: *"We think there is mounting evidence that the longer–cycle global–warming trend has peaked and we should begin a trend to global cooling. … Those unwilling to recognize a cycle change to cooling will explain the phenomena as climate change. You have to have a longer perspective on cycles."*

Into the Storm – BMR (08/13/2014)

In a speech earlier this week in Stockholm, Federal Reserve Vice Chairman Stanley Fischer gave a talk titled: *"The Great Recession – Moving Ahead"*. He said Sweden, and many emerging markets *"continue to struggle"* as a result of the *"near–worldwide phenomenon"* caused by the financial crisis. He called the growth out of the event *"steady"* though *"unspectacular"*, and the global recovery *"disappointing."* Fischer cited recent examples where the Fed and the International Monetary Fund reduced growth expectations. Making a case for the larger cyclic picture the **BMR** believes to be in force, he said, *"there are good reasons to believe that some of the surprising weakness in labor force participation reflects still–poor cyclical conditions."* He was concerned that many that dropped out of the labor force were discouraged workers. Fischer said even if some reenter the labor market, their *"skills and networks may have depreciated some over the past years."* After spending over 35 years studying market cycles (not counting all the way back to Economics 101), the **BMR** has grown more to appreciate the 'Blood, Sweat, and Tears' approach – *"What goes up, must come down … Spinning wheel, got to go round."*

Modest to Moderate to Mayhem – BMR (10/16/2014)

In Half–Wits Holiday, the Three Stooges were decked out in tuxes – trying to pass off as gentlemen. When they were introduced to the high society crowd, they bowed with Larry saying: *"Delighted!"*, Moe: *"Devastated!"*, and Curly: *"Dilapidated!"* The next introduction was followed with Larry's: *"Enchanted!"*, Moe's: *"Enraptured!"*, and Curly's: *"Embalmed!"* (Stooges fans know this dialogue was shot just before Curly suffered a debilitating stroke.) There's no doubt some economic data has improved, but it's literally been years now that the Fed's Beige Book reported growth in the Fed's 12 districts as either modest, moderate, or both. Some reported growth in consumer spending as *"slight to moderate"*, with *"subdued"* price pressures. Businesses were *"generally optimistic"*, though most of that data was reported before the Dow dropped nearly 1,500 points off its September 19th high – a collapse of 8.62%. The **B**ond **M**arket **R**eview would say: Promising, Propitious, Problematic …

While confidence fell to a 4–month low, September Retail Sales sputtered, and Consumer Credit slowed, the Federal Budget Deficit fell to its lowest level since 2007! However, wage growth is stagnant and Producer Prices also fell for the first time in a year. As the Fed seeks full employment, the Labor Force Participation Rate is the –

lowest since the '70s. Now the Fed's inflation target is looking equally elusive.

Suddenly, worries regarding rate hikes subsided. While a few FOMC members have suggested the economy could withstand rate hikes given some of the incoming economic data, others have been stepping gingerly as if walking on bubble wrap in a nursery. Knowing there's a great global dependence on central bank stimulus to spur recovery, the Fed's been trying not to rattle the markets as they attempt to taper QE and figure a time they can begin to remove the punch bowl. With QE purchases winding down, they've already 'watered' it down quite a bit.

… Today Bullard said: *"Inflation expectations are declining in the U.S. … That's an important consideration for a central bank. And for that reason I think that a logical policy response at this juncture may be to delay the end of the QE."* He said the Fed needs to *"defend"* their inflation target. With Germany reducing their growth outlook and seeing renewed price drops – the much–feared "D" word is even a danger (Deflation). That would keep central bank rates low for a long time.

Switch – BMR (11/06/2014)

Our first **B**ond **M**arket **R**eview was written in November 2000 while the Bush–Gore recount remained unsettled – as Florida was counting and recounting ballots with 'hanging chads'. Over the past 2 decades, we've seen wholesale changes of party power in Washington, D.C. Politicians go to Washington with the best intentions, but are soon consumed by the enticements of power and greed. If this Congress fails to make some progress to truly revive the economy, they will suffer the same fate in 2016. In our opinion, the core of the problem is the health care law. The requirements for companies to provide benefits for employees working 30 hours or more a week has backfired into a nation replete with part–time (only) jobs. While the Unemployment Rate has improved, incomes have been stagnant – as many of these workers would make at least 33% more without that law's mandate. It's a two–edged sword as the lower incomes may allow for government health care benefits, which increase the overall tax burden. We see the '30 hour rule' as the chief throttle on U.S. economic growth. Hopefully, there's a way to rethink a more sensible health care law – as a complete repeal will never be signed by the President. While the lack of a real recovery is affecting everyone, this election was basically won without a major party platform. It brought to mind something said by humorist Will Rogers nearly 90 years ago: *"The more you read and observe about this politics thing, you got to admit that each party is worse than the other. The one that's out always looks the best."*

Interstellar – BMR (11/12/2014)

While we've yet to know how all the components of the Fed's 'dashboard' impact the Labor Market Conditions Index (LMCI), it rose from 2.5 to 4 following the October payroll data. May we then assume that labor conditions have improved by 60% since September? Have we worm–holed ever closer to full employment?

The U.S. Unemployment Rate fell from 5.9% to a 6–year low 5.8% in October. The 1.4% drop since October 2013 was the largest decrease since 1984. Charles Evans, who has been one of the most dovish FOMC members, seemed impressed with the data. He said: *"That's a pretty good number. … That gets us that much closer to a more natural sustainable rate of unemployment associated with full employment in the 5.25% range."* He could be injecting a little of that dovish sentiment with his statement, as many have referenced 5.50% as that 'full employment' benchmark. Evans did allow that *"we've got some distance to go"*, to get to 5.50% (or another .25% to his 5.25%). The **B**ond **M**arket **R**eview is of the opinion that labor force participation at extreme lows, record food stamp usage, and the high percentage of jobs that are only 'part time' distort the data

Assimilation – BMR (11/21/2014)

As with the Borg in Star Trek Next Generation, equity bears are being assimilated into the bull's collective. Stock bulls are echoing their warning: *"Resistance is futile."* As major U.S. indices are making new highs, resistance is not only futile, it's non–existent. In order to have technical resistance, prices have to be below where they've previously been. Lately they've been 'boldly going where they've never been before.' Though weaker economically, foreign markets are also rising with new rounds of stimulus. European Central Bank President Mario Draghi announced fresh low–rate pledges in an effort to fight falling prices. The EU is still quite concerned about price *deflation*. Draghi said: *"We will do what we must to raise inflation and inflation expectations as fast as possible"* citing inflation expectations as *"declining to levels that I would deem excessively low."*

Crude Treachery – BMR (12/10/2014)

In my youth, most everything wrong stemmed from '*a Communist plot.'* If our car didn't start, or the TV went on the 'fritz' – that's what it was. Of course, back then the easy fix was to hit the side of the TV, bang the carburetor with a wrench, or wiggle some wires. With the 'plot' so easily thwarted, other than from hiding under our desks for drills, the red menace didn't seem so frightening. Well, apparently Iran thinks the U.S. has no oil–price concerns!

Though plunging oil prices also affect many American producers, many are crying foul to OPEC (that won't cut production), and others are pretty much calling it a 'capitalist plot', or at least an anti–Muslim agenda. With oil prices dropping nearly 50% since June, Iran's President said the drop was *"politically motivated"* and resulted from a *"conspiracy against the interests of the region, the Muslim people and the Muslim world."* With Iran still under sanctions, the lower prices are causing a strain.

President Rouhani said: *"Iran and people of the region will not forget such conspiracies, or in other words, treachery against the interests of the Muslim world."* The **BMR** wonders what the conditions were when prices were soaring … an act of peace?

Considerable Patience – BMR (12/18/2014)

Last week, we said *"some members have said it's time to remove the 'considerable time' pledge."* They did just that by considering less underutilization of labor resources – which they said *"continues to diminish",* and inflation which they expect to rise toward their 2% goal as *"the labor market improves further and the transitory effects of lower energy prices and other factors dissipate."* Given those assessments, they said *"the Committee judges that it can be patient in beginning to normalize the stance of monetary policy."* The FOMC explained its new wording in guidance as being *"consistent with its previous statement"* of keeping rates low for a *"considerable time following the end of its asset purchase program in October."* They just felt the need to remove *"considerable time"* because they would certainly have to do so at some point!

"However beautiful the strategy, you should occasionally look at the results."
Sir Winston Churchill

"Those who agree with us may not be right, but we admire their astuteness."
Cullen Hightower

"Time sneaks up on you like a windshield on a bug." John Lithgow

Additional Information is Available on Request

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