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BOND MARKET REVIEW

April 16, 2015

The Longest Ride

What do you do when you can't hit your targets? You move them – or remove them! Pressed to come up with the conditions that would call for an end to stimulus back in 2011, then–Chairman Ben Bernanke's Fed adopted a 5.5% unemployment goal and a 2% inflation target in January 2012. Rates had already been 'near zero' since December 2008. When we dropped to 5.5% unemployment in February, and for a number of months coming into that number, it was obvious there was more slack than the number itself revealed. Concurrent with the results, labor force participation fell to the lowest since the late '70s. The number of workers that that require 2 or more jobs to get to full–time hours is still very high – partially due to employer health care mandates – and those workers still have to buy their own health insurance. This week Bernanke said: *"I don't see anything magical about targeting 2% inflation."* There certainly hasn't been! The U.S. has now missed that target for 34 months. February PCE (consumption) was only .3%. The Internal Monetary Fund had proposed higher targets as many major economies are still battling disinflation. He cautioned: *"The very fact that the target is being changed could sow some doubts."*

The Fed's Beige Book said growth was the now–familiar *"modest"* or *"moderate"* in 8 of the 12 districts, but the tone of the report was upbeat and indicative of improving conditions following another harsh winter. It may be some time before we hear of growth that's stellar or any similar adjective. The near–global presumption that the U.S. would be the first to raise rates has led to a surging Dollar at the expense of U.S. exports and manufacturing. The IMF raised forecasts for Japan and the EU – which have been more competitive given the Dollar's buying power. It cut U.S. estimates, though they are still much higher than for Japan and the EU. While our manufacturing is challenged, our service industries are doing better. For the first time in recorded data, spending on dining out surpassed grocery sales. We wonder which category will include drone–deliveries of groceries? It won't be long until you can use your smart–phone from your couch to order home delivery of groceries and a hamburger to your front door. We just checked, and dronehome.com is taken.

The U.S. Dollar had been surging as market participants expected a June liftoff for rates. The long ride of near zero would then end at 79 months. Many FOMC members are treating recently weaker data as temporary or weather related – and sticking to June or September, while others are calling for better evidence of a recovery before they take an action that could spur a downturn. Boston's Rosengren said we were *"stubbornly below"* the 2% inflation target and his unemployment rate goal was closer to 5%. He said the conditions for raising rates aren't there – and it could take several years before the inflation targets are hit. (No wonder there's talk of their removal!) FRB Atlanta's Lockhart cited those same arguments and added: *"A murky economic picture is not an ideal circumstance for making a major policy decision."* After recently soft data, Lockhart said he'd like to see *"direct, affirmative evidence in the data that the desired outcomes are in fact materializing."* Specifically, *"a falling unemployment rate and rising inflation."* He favors waiting a while longer to act in order to obtain *"confirmation from incoming data that the economy is on the desired path."* That would of course be negative for the Dollar.

Global stimulus continues to feed equities, though the **B**ond **M**arket **R**eview sees a top very soon. The Japanese Nikkei just topped 20,000 for the first time in 15 years, and the Nasdaq is once again in striking distance of its March 2000 highs. One of Europe's indexes just rose to a record high that reached back to 2000 as well. The NYSE composite hit a new all–time high yesterday (and again today), but other indexes are falling short. With the Russell 2000 also doing so, the rally is more broad based. While the NYSE is up 13.26% to its October low and ahead 3.05% for 2015, Hong Kong's market has risen 18.39% over the last month! The Shanghai Composite is up 29.68% for the year, and 83.63% since its October low. Since it began its prolific rally in March 2014, it's risen 112.46%. There's no sign out there that reads: *"Don't feed the bulls!"*

Looking Ahead

- The cycles are calling for bond yields to turn lower from an April 20th–22nd window.
- Stocks should make a high (and potential top) near that same April 20th–22nd larger trend–change.

Treasuries, Agencies, and MBS

March Retail Sales ex Autos rose only .40% versus expectations of a .70% gain. Even with that improvement, it's obviously a negative when data is running below expectations – as was March's sizeable underperformance in projected job growth numbers. Fed watchers want to see if this 'soft patch' turns into a trampoline – or a hole! A series of 'data misses' could delay the Fed's first hike until nearer the end of 2015 – if not into next year.

You are cordially invited to the 13th Annual CSC Bank Conference to be held
Thursday, April 30th, 2015 at the Four Seasons Resort & Hotel, Irving, Texas.
Please contact Susan Tomcko at (214) 545-6824 or stomcko@cstreetcap.com for details.

Treasuries love these 'negative misses' and investors were quick to stoke a rally on April 3rd's March payroll release and again this Tuesday given the slower retail gains. For the week, yields rose 1.5, 4.5, 3.5, and 4.5 bps for the 2, 5, 10, and 30–year sectors. That was versus the closes of April 2nd, as trading was thin on Good Friday and the trading ceased early. Compared to the Good Friday data, following a nice rally, 10–year notes were closer to 11 bps higher for the week. Into Tuesday's retail numbers, the markets had sold off – shaking away the negative sentiment from March jobs. Since then, bonds have reentered the middle of the trading zone that has been in place since mid–March. This week, yields are lower by 7, 9.5, 5.5, and .5 bps for the 2, 5, 10, and 30–year sectors. Foreign holdings of longer–term Treasuries grew by $9.8 billion in February, while total inflows rose only $4.1 billion. China's holdings fell below Japan's for the first time since August 2008 – making Japan the new #1 holder of U.S. debt.

MBS spreads (for FNMA 30–year 2.5%) pulled in a sizeable 7 bps last week. Though demand was the same as in March, last Thursday's 30–year Treasury auction was rated a below average '2 of 5.' The $13 billion in supply brought 2.597%, and foreign buyers accounted for 51.3% of the issue versus 51.9% last month.

04/10/15 Treasury Yield Curve	**2-Year: 0.558%**	**5-Year: 1.395%**	**10-Year: 1.948%**	**30-Year: 2.579%**
Weekly Yield Change:	+.016	+.044	+.036	+.046%
Support:	0.53/ 0.57/ 0.59/ 0.62%	1.35/ 1.38/ 1.42/ 1.48%	1.93/ 1.97/ 2.01/ 2.04%	2.61/ 2.65/ 2.70/ 2.74%
Targets:	0.47/ 0.45/ 0.43/ 0.40%	1.27/ 1.24/ 1.18/ 1.14%	1.87/ 1.84/ 1.80/ 1.76%	2.54/ 2.50/ 2.46/ 2.42%

Economics

Initial Jobless Claims rose from 267K to 282K last week, but the 4–week total was the lowest in nearly 15 years. Claims were 12K higher to 294K this week, reaching a string of 6–weeks under 300K. Continuing Claims fell from 2,327K to 2,308K last week, and then to 2,268K this week. That was the lowest number on benefits since 2000. Bloomberg Consumer Comfort rose from 46.2 to 47.9 last week – to the best reading since May 2007 (nearly 8 years). The Personal Finances component was the second best since October 2007 and Buying Conditions came in at the best level since November 2006. This week the comfort number fell back to 46.6, and economic expectations fell 1.5 points to a 5–month low of 50. Though higher, March Retail Sales disappointed the markets by coming in well below expectations. Sales rose .90% after falling .50% in February. Ex Autos, they rose only .40%. The 'Control Group' rose .30%, but was revised from flat to a .20% drop in February. NFIB Small Business Optimism sagged from 98 to 95.2 and Empire Manufacturing went from +6.9 to –1.19. Industrial Production fell .60% in March for the largest drop since August 2012 as the strong Dollar continued to challenge U.S. exports. Capacity Utilization fell from 79.00% to 78.40%. February Business Inventories and Wholesale Inventories rose .30%, while Wholesale Trade Sales dropped .20%. The Philadelphia Fed outlook rose from 5.0 to 7.5.

Producer Prices rose .20% in March, following a .50% February drop. The ex food & energy result was the same. Nevertheless, the annual pace fell .20% to a .80% decline, and the core result slipped .10% to a tame .90%. March Import Prices fell .30%, and February's increase was reduced from .40% to only .20%. The annual pace fell to a 10.50% drop versus a previous 9.70% drop – due to the Dollar's strength and plunging oil costs. The March Monthly Budget Statement revealed a deficit of $52.9 billion (versus $43.9 billion expected). Six months in, the deficit is 6.3% greater than for fiscal 2014. Home builder outlook rose 4 points to 56, as the NAHB Housing Market Index was the highest since January. Today's Housing Starts number once again disappointed markets as they showed some slowing. They rose only 1.98% to 926K – not much of a rise following their weakest levels in a year in February, and still off 2.22% to last year's numbers. Building Permits dropped 5.72% to 1,039K. Friday brings Consumer Prices (March CPI), University of Michigan confidence measures, and the Leading Index (March LEI). Next Monday (04/20) gives us the Chicago Fed National Activity Index. The next important data releases come Wednesday with MBA Mortgage Applications (which dropped 2.30% last week), the FHFA House Price Index for February, and Existing Home Sales for March.

Equities

Our rally out of the March 27th trend–change held firm into today's highs, but we expect a downturn very soon. The broader market made new highs today (NYSE composite and Russell 2,000 & 3,000), while the major indexes are in striking distance for a run to new highs between Monday and Wednesday. After that, the positive forces simply run out. Do the cycles err? Certainly! However, we remain loyal to that body of work and it's pointing to a high in equities between April 20th to the 22nd. That said, if we do indeed rise into early next week, we would take profits, sell, hedge, or otherwise stand aside. This particular setup at least warrants some caution!

This current cycle has been lining up nicely for a while now and the Dow rose 294.41 points or 1.66% last week to 18,057.65. It's .27% higher this week. The S&P gained 35.10 points or 1.70% to 2,102.06, and is .14% higher this week. The Nasdaq surged 109.04 points or 2.23% to 4,995.98, and is .24% higher since Friday. It closed over 5,000 yesterday and today for only the 6th and 7th time ever. The Dow Transports gained 1.89% last week, but are .68% lower this week. Bank stocks rose .39%, and have added another 1.26% this week.

Resistance:	Dow:	18,028/ 18,164/ 18,216/ 18,297	Nasdaq:	4,970/ 4,987/ 5,022/ 5,058	S&P:	2,103/ 2,112/ 2,119/ 2,126
Support:		17,825/ 17,758/ 17,692/ 17,625		4,918/ 4,883/ 4,848/ 4,813		2,080/ 2,069/ 2,058/ 2,046

Other Markets

After the U.S. Dollar's recent strength and Crude Oil's weakness, those markets are now showing some potential for reversal. The Dollar should be cyclically weaker into May 7th, and Crude Oil should be generally higher into May 29th. The Dollar surged 1.97% last week, but is 1.99% lower this week. Crude Oil rose 5.09%, and has rallied 9.82% so far this week – reaching 4–month highs and the best levels for 2015. Commodities rose .48%, and added 3.96% into today on that strength. Gold had gained .31%, but is off .55% this week. The Japanese Yen fell .42% last week, but is 1.00% higher since Friday. The Euro had plunged 2.54%, but is 1.48% higher this week. Corn lost 2.46%, and is .20% lower this week. Cotton rose 2.15%, but is off 1.61% so far this week.

"First say to yourself what you would be; and then do what you have to do."
Epictetus

"You can't do anything about the length of your life, but you can do something about its width and depth!"
Evan Esar

Additional Information is Available on Request
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