K N O W L E D G E D R I V I N G C O M P E T I T I V E A D V A N T A G E
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# BOND MARKET REVIEW

April 22, 2015

## The Reluctant Astronaut

If you watched the 'Andy Griffith Show' years ago, one of your favorite characters was undoubtedly Deputy Barney Fife – one of the funniest roles ever on TV! Actor Don Knotts played the nervous but over–serious character very well, which led him to do a few movies like 'The Shakiest Gun in the West.' Just a few months ago, global markets were convinced the FOMC would begin to raise their benchmark rate by June. However, recent data led to a few Fed members urging caution – and that spurred memories of Don's character in 'The Reluctant Astronaut.' In that movie, he's a small town man that's deathly afraid of heights, but through a series of events – mainly to please his father – he ends up as the first lay person that NASA will send into space. If you can picture Knott's expressions and his reluctance to 'lift off', the Fed may be right there with him. Most folks don't mind takeoff, it's the landing or crashing that puts us on edge! NASA prefers to wait on the best possible launch conditions, and a number of FOMC members are similarly calling for a delay to the countdown. Cleveland's Lorretta Mester joined Atlanta's Lockhart and Boston's Rosengren in preferring to wait for more positive economic evidence before raising rates. Lockhart said stronger evidence could lead to a more orderly *"subsequent path of policy."* Mester said it's the *"pace thereafter"* that's more important than the first hike. New York's Dudley said: *"… we will simply be moving from an extremely accommodative monetary policy to one that is only slightly less so."* The **BMR** thinks that inaction after the first move would be tantamount to admitting an error in the liftoff.

The FOMC last met on March 18th. Employment had been encouraging – and they removed their promise to be *"patient in beginning to normalize the stance of monetary policy."* Since then, we got a March jobs report that showed the weakest gains since 2013. While there were overall gains, data released this week showed job losses in 31 states. Texas experienced its first declines since September 2010 – and the largest since August 2009. Oklahoma had its worst setback since April 2009. The common element there was of course the plunge in oil prices that began last summer. Crude dropped 61% versus its June 2014 high, though a 33% rally off the March lows has reduced that loss to 48%. The continued slump led to layoffs in the oil industry. Industrial Production recently fell the most since August 2012, and inflation numbers are unlikely to hit Fed targets anytime soon. As the **B**ond **M**arket **R**eview covered last week – after missing their inflation target for a 34th month, former Fed–chair Ben Bernanke said: *"I don't see anything magical about targeting 2% inflation."* In their March 19th, 2014 statement, as unemployment was dropping nearer their goal for possibly raising rates, the FOMC said: *"With the unemployment rate nearing 6.5%, the Committee has updated its forward guidance."* Fearing another 'taper tantrum' by the markets akin to the summer of 2013, they said the update didn't indicate any change in their policy intentions. In the April 2014 statement, the 6.5%, or any such measure for joblessness, simply disappeared. The quagmire for policymakers is that their former full–employment measure of 5.5% unemployment has arrived, but a record number of Americans (over 93 million) are now out of the workforce. The FOMC meets Wednesday, and the liftoff that was presumed for June now seems more likely to occur in September or later – with December as the highest probability.

## Looking Ahead

- The FOMC will update their guidance and interest–rate stance on Wednesday, April 29th at 2 p.m. EDT.
- We expect the next low in bond yields to occur in early May.
- Stocks should turn down soon and make lows near May 21st and June 11th.

## Treasuries, Agencies, and MBS

The Dow lost 279 points on Friday, and at one time was 357 points lower. Though China had just experienced their weakest economic growth in 6 years, Shanghai stocks had gained 117% since March 2014, and Hong Kong's market had risen over 18% in since last month's lows. However, late last week Chinese regulators made a move to cut leveraged trading and expand short selling. That move, combined with some earnings disappointments and heightened concern that Greece would default on its bailout conditions, sent global equities into a tailspin. EU leaders have shown great efforts, but Greece's new leaders won on a platform of unwinding bailout conditions. They may not have the resources, or support from citizens, to meet debt payments. Thus, once again, there is concern that Greece might be the first nation to exit the European Union. Though Greece secured some emergency funding today, last week Euro stocks had their worst losses of the year – and the bad news fed the U.S. bond market. Yields dropped back to the April lows, which were the lowest since early February. Yields ended the week lower by 5, 9, 8, and 6 bps for the 2, 5, 10, and 30–year Treasury curve.

*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.*

However, our cycles were pointing to higher yields into today or Thursday, and stocks rallied back to erase most of last week's losses – as China stepped up to provide the kind of equity–friendly stimulus that investors have come to rely on from global central banks. China lowered reserve requirements by 1% – the most since the financial crisis. Their finance minister said: *"Although the Chinese economy is facing downward pressure, the Chinese government has sufficient policy tools."* String music to buyers! Hong Kong and Shanghai surged to new 7–year highs, and U.S. yields rose into our trend–change date – with 30–year yields rising to their highest levels since mid–March. Into today, yields rose 3.5, 8.5, 11.5, and 14 bps at 2, 5, 10 and 30–years. Yields should soon begin to ease into early May. MBS spreads (for FNMA 30–year 2.5%) widened 4 bps last week. Next week, the Treasury will auction $26 billion 2–year notes on Monday (04/27), $35 billion 5–year notes on Tuesday (04/28), and $29 billion 7–year notes on Wednesday (04/29).

| 04/17/15 Treasury Yield Curve | 2-Year: 0.510% | 5-Year: 1.307% | 10-Year: 1.866% | 30-Year: 2.520% |
|---|---|---|---|---|
| Weekly Yield Change: | –.048 | –.088 | –.082 | –.059% |
| Support: | 0.57/ 0.59/ 0.62/ 0.65% | 1.40/ 1.43/ 1.49/ 1.53% | 1.99/ 2.01/ 2.04/ 2.07% | 2.68/ 2.72/ 2.75/ 2.79% |
| Targets: | 0.51/ 0.47/ 0.45/ 0.43% | 1.32/ 1.29/ 1.26/ 1.22% | 1.91/ 1.87/ 1.84/ 1.80% | 2.59/ 2.56/ 2.52/ 2.46% |

## Economics

Initial Jobless Claims rose 12K to 294K last week, but were under 300K for a 6th week. As of March, Average Weekly Earnings rose 2.20% year–over–year. Consumer Prices rose .20% in March. Even though higher, they were unchanged annually – placing little pressure on the Fed. Ex food & energy, CPI rose 1.80%. University of Michigan Confidence rose 2.9 points to 95.9 (though off its 8–year high of 98.1 reached in January). Current Conditions rose from 105 to 108.2 and Expectations improved from 85.3 to 88. Leading Indicators rose a soft .20% in March, and were revised to only .1% (from .2%) for February. Those results do not point to an overheating economy! The Chicago Fed National Activity Index fell from –.18 to –.42, but the Philadelphia Fed Business Outlook rose from 5 to 7.5. The FHFA House Price Index rose a strong .70% in February, and Existing Home Sales rose 6.13% to a 5.19M–unit pace – the best since September 2013.

Thursday is set for jobless claims data, March New Home Sales, Kansas City Fed Manufacturing, and Bloomberg Consumer Comfort (which last week fell 1.3 points from an 8–year high to 46.6). Friday brings March Durable Goods Orders and next Monday (04/27) gives us Dallas Fed Manufacturing. Tuesday follows with S&P/Case–Shiller home price data, Consumer Confidence, and Richmond Fed Manufacturing. Wednesday gives us the FOMC rate decision, MBA Mortgage Applications (which last week rose 2.3%), March Pending Home Sales, and 1st–quarter GDP and Personal Consumption.

## Equities

We expected stocks to trades to a high today, but wondered if the cycle had topped early given Friday's tumble! Despite that huge selloff – which led stocks to their first weekly loss for April, stocks rose into today's primary trend–change date (04/22) with the Nasdaq closing at its highest level since March 2000. We now expect a turndown into May 21st. As we said last week, *"… we would take profits, sell, hedge, or otherwise stand aside. This particular setup at least warrants some caution!"* The Dow lost 231.35 points or 1.28% to 17,826.30. Into today, it was 1.19% higher making up all but 20 points of last week's loss. The S&P did better. It fell 20.88 points or .99% to 2,081.18, but was well ahead with this week's 1.29% rally. The Nasdaq lost 64.16 points or 1.28% to 4,931.81, but rose 2.10% into today for its best close of the year. Though the Transports lost 1.37%, the cycles pushed them 2.49% higher into today. Bank stocks were .12% lower, but are 1.09% higher this week!

| | Dow: | Nasdaq: | S&P: |
|---|---|---|---|
| Resistance: | 18,157/ 18,215/ 18,292/ 18,364 | 5,058/ 5,077/ 5,094/ 5,112 | 2,115/ 2,120/ 2,126/ 2,132 |
| Support: | 17,888/ 17,758/ 17,623/ 17,490 | 4,993/ 4,953/ 4,918/ 4,878 | 2,103/ 2,091/ 2,083/ 2,073 |

## Other Markets

Commodities gained 3.14% last week, but were 1.41% lower into today. Crude Oil led the index higher last week with a 7.94% surge. It's .75% better this week. Gold lost .14%, and is 1.33% lower this week. The U.S. Dollar tumbled 1.90%, but is .44% higher this week. A delay in the FOMC raising rates would be negative for the Dollar, as it was rising on the premise of mid–2015 hikes. The Euro rallied 1.90%, but is .75% lower this week. German investor confidence unexpectedly declined for the first time in 6 months. The Japanese Yen gained 1.10%, but has fallen .85% this week. Corn rose .73%, but is on its way to its 3rd loss out of the last 4 weeks with a 1.91% drop since Friday. Cotton fell 2.72%, and is 1.26% lower this week.

*"Careful … We don't want to learn from this!" Bill Watterson (Calvin and Hobbes)*

***Additional Information is Available on Request***

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