1445 ROSS AVENUE, SUITE 2700
DALLAS, TEXAS 75202 · 214-545-6800

# BOND MARKET REVIEW

April 30, 2015

## Getting Better

As we were approaching the financial crisis, a few FOMC folks were in tune with the 'Beatles.' They sang: *"I've got to admit it's getting better. … A little better all the time."* They usually leave out John Lennon's echo: *"It can't get no worse!"* It's great to be positive, but also aware that (modernizing Robert Burns' late 1700's quip): *"The best laid schemes of mice and men often go awry."* It would seem there's enough accommodation to get things on the move, but the economy keeps hitting speed bumps. On Wednesday, the FOMC added: *"Although growth in output and employment slowed during the first quarter …"*, while reiterating *"the Committee continues to expect that, with appropriate policy accommodation, economic activity will expand at a moderate pace."* That expectation left a 2015 rate liftoff as still possible. Weather may have been a culprit, but GDP declined from 2.20% for the end of 2014 to kick off the first quarter of 2015 with a only sluggish .20%. The Fed statement said *"economic growth slowed during the winter months, in part reflecting transitory factors."* (Read as hopefully just the cold.) They said underutilization of labor resources was *"little changed"*, instead of diminishing per the previous statement.

Chief components to the near–zero growth were corporate investment dropping the most since 2009, and a plunge in exports (of course spilling over into a slowdown in U.S. manufacturing). Personal spending in March was just enough to bump GDP above zero. In the **B**ond **M**arket **R**eview (04/08/15), we had noted the Atlanta Fed's 'GDPNow' forecast was predicting .10% growth – right on the screws! Their early forecast for Q2 is only .90% – signaling a continued crawl. It still appears that the Fed will delay a liftoff until at least September as they want to be sure there is further improvement in labor and they can be *"reasonably confident that inflation will move back to its 2% objective over the medium term."* The inflation–objective goal seems the greater hurdle at present. Those on the FOMC desiring to wait on better economic growth signs and higher inflation most likely have the upper hand.

## Mathematic Proof

In grade school, we learned that two negatives make a positive. Investors went 'negative' on the EU's negative yields this week, sending many back above zero. Into today, Eurozone bonds were approaching their worst weekly loss since October 1993 – losing nearly $160 billion (U.S.). The German 10–year had its worst 2–day loss since 2011 as EU prices were flat in April, ending 4 months of declines. On April 20th, German 10–year notes were yielding 6.3 bps. As of today, they had risen 30 bps to .363%! U.S. 10–year note yields have risen 26 bps, sending them 14.36% higher. The percentage gain is huge. German yields have risen 475% in less than 2 weeks! Last week, there were at least 9 EU nations with a 5–year note trading at negative yields. Switzerland (non EU) was the most negative, with even its 10–year note trading at –.145%. There were 12 EU nations, as well as Switzerland and Japan with negative rates on 2–year notes. As of today, most EU 2 and 5–year bond yields were back in positive territory.

## Looking Ahead

- Bond cycles point to higher yields after a trend–change near May 5th.
- Stocks should make important lows near May 21st and June 11th.

## Treasuries, Agencies, and MBS

Wednesday's FOMC meeting saw the Fed leave rates 'near zero' for a 77th month as recent data has not shown growth picking up nor any threatening inflation. Last week, yields were .5 bps better at 2–years, but higher by 1, 4.5, and 9 bps for the 5, 10, and 30–year Treasury sectors. Though bonds had improved for the last 5 quarters, April saw 2, 5, 10, and 30–year yields rise by 1, 5.5, 11, and 20.5 bps in a troubling Q2 kickoff. That left yields higher by 6.5, 11, 4.5, and 9 bps into today. The cycles show rates rising from May 5th.

MBS spreads (for FNMA 30–year 2.5%) pulled in by 1 bps last week. Monday's 2–year note auction was rated average – as $26 billion brought .54% with demand dropping to the lowest since December. Allocations to foreign buyers dropped from 45.7% last month to only 38.1% for this auction. Tuesday's $35 billion 5–year note was rated an above–average '4 of 5' and drew a 1.38% yield. Unlike the 2–year, demand was the highest since November – and the yield the lowest since January. Foreign buying rose from 55.7% last month to 61.2%. Wednesday's 7–year note was again rated average, with $29 billion coming at 1.82%. Demand was the highest since January, and foreign allocations rose from 50.5% last month to 54.1%.

| 04/24/15 Treasury Yield Curve | 2-Year: 0.506% | 5-Year: 1.315% | 10-Year: 1.909% | 30-Year: 2.610% |
|---|---|---|---|---|
| Weekly Yield Change: | –.004 | +.008 | +.043 | +.090% |
| Support: | 0.61/ 0.63/ 0.65/ .068% | 1.51/ 1.56/ 1.61/ 1.65% | 2.12/ 2.16/ 2.19/ 2.24% | 2.84/ 2.87/ 2.92/ 2.96% |
| Targets: | 0.59/ 0.56/ 0.54/ 0.51% | 1.44/ 1.39/ 1.34/ 1.29% | 2.05/ 2.00/ 1.95/ 1.91% | 2.76/ 2.72/ 2.68/ 2.63% |

## Economics

The GDP Price Index for Q1 showed a .10% decline. Ex food & energy, prices rose .90%. Though the Personal Consumption price measure rose .20% in March, the annual pace remained at only .30%. Ex food & energy, the PCE deflator rose only .10% – leaving the annual pace at 1.30%. Slow growth and the lack of inflationary pressures have pretty much taken a June rate hike off the table – with September as probably now the earliest potential liftoff. Even then, there would have to be some better results for the FOMC to be confident enough to act. March Personal Income was flat, but spending rose .40% – the biggest increase since November, and just enough to keep GDP above zero! Personal Consumption rose 1.90% in Q1, less than half the pace of the 4.40% from Q4 2014. Wage pressures have been low, but saw improvement in Q1 2015. The Employment Cost Index rose .70% – bringing the 12–month pace to 2.8%, the best rise in over 6 years. Initial Jobless Claims were under 300K for an 8th week as firings dropped to the lowest levels in nearly 15 years. Last week, claims rose 1K to 296K, and this week they dropped to only 262K (the lowest since 2000). Continuing Claims rose from 2,275K to 2,327K, but then fell back to 2,253K. The Consumer Confidence Index fell from 101.4 to 95.2, much more than expected and to the lowest level since September. The jobs outlook, inflation expectations, and future conditions components all faltered.

Bloomberg Consumer Comfort (confidence) fell a third week to a 6–week low of 44.7. The last 2 readings were 46.6 and then 45.4. While orders for Durable Goods rose a stout 4% in March, that number was all transportation. Without that component, orders were lower by .2%. Additionally, last month's core was adjusted even softer – from –.40% to –1.30%. Capital Goods Orders fell .50%. Kansas City Fed Manufacturing Activity dropped from –4 to –7, and ISM Milwaukee fell from 53.25 to 48.08. The Dallas Fed rose from –17.4 to –16, and Richmond improved from –8 to –3. Chicago Purchasing Managers rose from 46.3 to 52.3. New Home Sales dropped 11.42% in March to 481K units, but were still 18.18% higher to last year. Pending Home Sales rose 1.10%, and were 13.40% better to last year's more–harsh winter. Metro home prices rose .93% in February (S&P/Case–Shiller 20 City index), and were 5.03% higher to last year. Their Home Price Index rose .42%, and was 4.22% better to last February.

Friday is set for the May Day releases of April Vehicle Sales, University of Michigan Confidence, Construction Spending, and ISM Manufacturing & Prices Paid. Monday (05/04) brings ISM New York and March Factory Orders. Tuesday provides the March Trade Balance (deficit), IBD/TIPP Economic Optimism, and the service sector outlook (ISM Non–Manufacturing Composite). Wednesday gives us MBA Mortgage Applications (which dropped 2.30% last week), Q1 Nonfarm Productivity and Unit Labors Costs, and the first look into April payrolls from ADP Employment Change. April payroll data will be released next Friday (05/08).

## Equities

With our cycles peaking last week, we said: *"We now expect a turndown into May 21st."* The Nasdaq finally made a new record close on the 23rd, eclipsing its March 10, 2000 mark by roughly 7 points. It set its best close on the 24th, but has still not broken the high established on that March 2000 date. It's now fallen 198 points versus its Monday high and is 3.87% lower. At one point today, the Dow had wiped out all of its gains for 2015. It ended ahead by only .10%. Last week, the Dow gained 253.84 points or 1.42% to 18,080.14. It's off by 1.33% this week, though higher by .36% in April. Despite this week's losses, the S&P was .85% higher in April and the Nasdaq rose .83%. The Transports lost 1.70%, and ended off 5.99% for the year. For the week, the S&P gained 36.51 points or 1.75% to 2,117.69. It was 1.52% lower into today. The Nasdaq surged 160.27 or 3.25% ahead to 5,092.09, but has lost 2.96% this week. The Transports gained 2.69%, and then lost 3.24%. Bank stocks gained .12% and 1.25%.

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|---|---|---|---|---|---|
| Resistance: | Dow: 18,004/ 18,095/ 18,166/ 18,228 | Nasdaq: | 4,992/ 5,021/ 5,043/ 5,074 | S&P: | 2,101/ 2,113/ 2,124/ 2,136 |
| Support: | 17,848/ 17,758/ 17,692/ 17,619 | | 4,953/ 4,923/ 4,888/ 4,854 | | 2,090/ 2,078/ 2,067/ 2,057 |

## Other Markets

Commodities gained .05% last week, and surged 2.42% into today as Crude Oil rose for a 6th week (adding 2.53%) and is headed for a 7th (up 4.34% to the highest levels since early December). Gold lost 2.30%, but is .61% higher this week. The U.S. Dollar lost .62%, and has been thumped this week – falling 2.46%. The Euro rose .62%, and has in turn surged 3.23%. The Japanese Yen fell .08%, and is .33% lower this week. Corn dropped 4.02%, and is .55% lower this week. Cotton gained 5.07%, and was up another 2.44% into today.

*"Far and away the best prize that life offers is the chance to work hard at work worth doing." Theodore Roosevelt*

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

Doug Ingram, Managing Director – Commerce Street Capital Management