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BOND MARKET REVIEW

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No Rules, Just Right

Incoming data has been as volatile as has the stock market, swinging from optimism to pessimism almost daily. April Factory Orders rose, and Consumer Confidence hit its second highest reading since 2007. The Service Sector outlook rose to its best level since November. April jobs were supposed to rebound following March's 126K addition – which was the lowest increase in over a year. However, ADP private payroll data, which correctly indicated a slowdown in March, also came in well below expectations for April – showing even less gains than in March! The April jobs report is due Friday. A factory employment gauge fell to its lowest level since September 2009. Over the last two quarters, worker productivity fell the most since early 1993 (22 years).

The lack of inflationary pressures, and the desire to stimulate household demand led the Australian central bank to cut rates 25 bps to a record–low 2.00%. As the land 'down under' was cutting rates, we learned the March U.S. Trade Deficit surged to $51.4 billion (from $35.9 billion in February). That 43.2% jump was the steepest in 18 years – sending the U.S. balance of trade to its largest shortfall since October 2008. While we've often said a drop in the trade deficit is a negative – because it implies retailers might be cutting orders, a jump could indicate their optimism. However, the greater imbalance could lead to our 1st–quarter GDP being recalculated to instead show negative growth! Imports surged, while exports remained soft given the recent strength of the U.S. Dollar. GDP had been estimated at .20% for the first quarter of 2015, but the trade deficit could lead to a revision as low as –.50%.

While one quarter of negative GDP does not a recession make, it's troubling for the FOMC – which is striving to get U.S. rates 'off zero' – if only to store up ammo in the event a real economic slowdown comes to pass. The Fed had been under pressure from Congress to establish a rules–based approach for interest rate policy. On Friday, FRB San Francisco President John Williams said: *"Mechanically following one type of standard policy rule designed to work well under one set of assumptions can yield very poor economic outcomes when those assumptions are violated."* He said the such rules were *"an invaluable tool for research and practical policy considerations"* for central banks, but policy making was a challenge with interest rates near zero. Central bankers across the globe have been using a 2% inflation target as a rule or threshold for keeping rates low. For many, it wouldn't matter if they doubled it – it would remain elusive during this point in the cycle!

Even before the possibility of negative Q1 GDP, Chicago's John Evans said weak Q1 data was a concern that gave him pause, and he wanted to make sure they were *"indeed a transitory aberration."* He said there were *"no compelling reasons"* to raise rates in 2015. In the anti–campaign camp, Evans said: *"A properly shallow path of increases, even if we were to increase rates sooner than I would like, could still be quite supportive of continued strong economic recovery."* No doubt Mr. Evans was surprised, as were the markets and the **B**ond **M**arket **R**eview that Fed Chair Janet Yellen said: *"We could see a sharp jump in long-term rates"* following the Fed's liftoff. The U.S. 10–year note is already 41 bps higher in less than a month, and 30–year rates have risen 55 bps since late March. Stocks took a tumble today, and Yellen was little help. As we've said before, the Fed has done its best to remain optimistic concerning growth and their ability to begin rate hikes in 2015. Yellen threw the markets a curve in saying: *"I would highlight that equity–market valuations at this point generally are quite high."* However, citing 2013's 'taper tantrum', she said their fear of the stock market's reaction to tightening *"may be something making the Fed cautious before raising rates."*

Looking Ahead

- Bonds should make a trend–change low near May 11th or 12th.
- Stocks should make important lows near May 21st and June 11th.

Treasuries, Agencies, and MBS

Germany's bunds have taken a tumble! Part of the reason for U.S. rates falling so low in early 2015 was the great spread value between our bonds and those of Japan, Switzerland, and leading EU economies – where even their longer–term rates were near zero or negative. When that reason began to evaporate, so did the bids. Within the past 3 months, German 10–year yields were .073%, Japan's .190%, and Switzerland's as low as –.32%. In less than a month, Germany's yield has risen 700% to .584%! Over a little longer period, Japan's were 141% higher (up 27 bps) and Switzerland cleared zero – rising 41 bps to .092%. It's no wonder U.S. 10–year yields have also risen 41 bps, but our increase is only 22%. Bonds investors remain concerned over Greece possibly exiting the EU, a hint of EU inflation and better EU growth, and the potential for our Fed to begin raising rates. Last week, U.S. yields rose 9, 19.5, 20.5, and 22 bps for the 2, 5, 10, and 30–year sectors as the global bond selloff left no prisoners. U.S. yields rose to 2–month highs this week, with rates higher by 4, 8.5, 13, and 16.5 bps (for those sectors) into today.

MBS spreads (for FNMA 30–year 2.5%) pulled in by 6 bps last week. Next week, the U.S. Treasury will auction $24 billion 3–year notes on Tuesday (05/12), $24 billion 10–year notes on Wednesday (05/13), and $16 billion 30–year bonds on Thursday (05/14).

05/01/15 Treasury Yield Curve	2-Year: 0.597%	5-Year: 1.500%	10-Year: 2.114%	30-Year: 2.828%
Weekly Yield Change:	+.091	+.185	+.205	+.218%
Support:	0.65/ 0.68/ 0.71/ 0.74 %	1.59/ 1.62/ 1.65/ 1.68%	2.25/ 2.31/ 2.35/ 2.39%	2.95/ 2.99/ 3.04/ 3.08%
Targets:	0.61/ 0.59/ 0.56/ 0.54%	1.53/ 1.51/ 1.48/ 1.44%	2.17/ 2.14/ 2.09/ 2.06%	2.90/ 2.87/ 2.81/ 2.78%

Economics

Construction Spending fell .60% in March. Factory Orders increased 2.10%, but were revised from +.20% to –.10% for February. They were flat ex–Transportation, but revised from +.80% to only +.10% for February. ISM Manufacturing was modestly positive, but unchanged to March. Prices Paid rose from 39 to 40.5. University of Michigan Sentiment remained at 95.9, while Current Conditions dropped 1.2 to 107 and Expectations rose .8 to 88.8. IBD/TIPP Economic Optimism fell from 51.3 to 49.7. ISM New York was 8.1 better to 58.1. April Vehicle Sales dropped off March's pace from 17.05M to 16.46M. Domestic Sales fell from 13.35M to 12.88M. The March Trade Balance deficit widened 3 times more than anticipated, from $35.9 billion to $51.4 billion – the highest since October 2008. Imports rose $17.1 billion while exports rose only $.16 billion. The gap in goods was the highest since August 2008. The gap with China increased $8.7 billion and the imbalance with Japan rose $2.9 billion. The service sector outlook was 1.3 better to 57.8. ADP Employment Change rose only 169K indicating the potential for another slow month, and was also revised 14K lower for March. Nonfarm Productivity fell 1.90% in the first quarter, while Unit Labor Costs rose 5.00%. (Folks were paid more for inefficiency?) MBA Mortgage Foreclosures rose 2.22% in Q1 2015 (slowing to 4Q 2.27%). Mortgage Delinquencies slowed from 5.68% to 5.54%.

Thursday is set for jobless claims data, Challenger Job Cuts (layoffs versus last April), Bloomberg Consumer Comfort, and Consumer Credit. Friday brings the all–important April payroll and unemployment rate numbers, along with March Wholesale Inventories & Trade Sales. Next Monday (05/11) is set for the Fed's payroll dashboard (Labor Market Conditions Index). Tuesday follows with NFIB Small Business Optimism, JOLTS Job Openings for March, and April's Monthly Budget Statement. Wednesday brings MBA Mortgage Applications (which fell 4.60% last week), April Retail Sales, Import Prices, and March Business Inventories.

Equities

In the **BMR (04/22/2015)**, we said *"stocks rose into today's primary trend–change date (04/22)",* and reiterated our previous week's cyclic stance that: *"… we would take profits, sell, hedge, or otherwise stand aside. This particular setup at least warrants some caution!"* Our cycles were pointing to a *"turndown into May 21st"*, and they still do. Stocks could be strongly down from May 12th. Into today, the Dow, Nasdaq, and S&P fell to 1–month lows and ended lower for the week by 1.01%, 1.71%, and 1.33%. Last week, the Dow fell 56.08 points or .31% to 18,024.06. The Nasdaq lost 86.69 points or 1.70% to 5,005.39. The S&P fell 9.40 points or .44% to 2,108.29. The Dow Transports lost 1.61%, and were 1.35% lower into today. Bank stocks rose 1.62%, and added .47% this week.

Resistance:	Dow:	18,019/ 18,094/ 18,161/ 18,229	Nasdaq:	4,973/ 5,016/ 5,043/ 5,075	S&P: 2,097/ 2,102/ 2,108/ 2,114
Support:		17,826/ 17,759/ 17,698/ 17,616		4,919/ 4,899/ 4,867/ 4,833	2,084/ 2,078/ 2,073/ 2,068

Other Markets

Commodities gained 1.74% last week, and were 1.01% better into today as Crude Oil rallied 3.50% and then tacked on another 3.01% this week – reaching the highest levels since early December! Crude could pull back into May 22nd, where the cycles again turn back up. Gold lost .06% last week, but was 1.35% higher into today. The U.S. Dollar plunged 1.70% last week, and was off another 1.33% into today. Given the global bond selloff, that has erased over $410 billion in market value, the demand for Dollar–based assets has diminished. Foreigners just don't need as many of them to buy our bonds or stocks! The Euro surged 3.00%, and was 1.32% better into today. The Japanese Yen lost .97%, but rose .57% so far this week. Corn fell 1.30%, but is 1.88% higher this week. Cotton gained .53%, but is 1.12% lower this week.

"#1. Never tell everything at once!" Ken Venturi (Two Great Rules of Life)

Additional Information is Available on Request

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As it applies, Happy Mother's Day Sunday! Give mom a call.