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

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Hot Pursuit

The **B**ond **M**arket **R**eview is coming late this week as I've had a barrage of hearing tests to determine why I have constant ringing – and trouble making sense of most anything a politician says. With the Fed, I can read their reports and those of their press conferences, but many of those statements are designed to say as much as possible while not saying much of anything! Fed Chair Janet Yellen chose to use some 'plain speak' last week with two statements that troubled the markets. First, she said stock valuations were *"quite high"* and spoke of the dangers of buying or holding at these levels. She said: *"Now they're not so high when you compare the returns on equities to the returns on safe assets like bonds, which are also very low, but there are potential dangers there."* Bonds must have decided to get competitive. Over the past two weeks, they've seen a classic rout. The Fed has been in "hot pursuit" of a liftoff from zero interest rates – choosing to focus mostly on friendly data and attribute anything negative as weather related or transitory. She made an unexpected and puzzling statement that the rate liftoff could lead to *"a sharp jump in long–term rates."* That would be troubling to bond investors that were seeking higher U.S. yields versus EU and Japanese alternatives. In a very poor case of timing, Japanese investors bought roughly $23 billion U.S. Treasuries in March. That was their largest such move in 4 years, but just before the huge selloff.

Maybe the Fed is chasing the wrong car! The April payroll numbers are in the books (until they're revised). The economy added 223K jobs to once again rise over the 200K level as they had done for 12 months in a row until the poor March showing. March jobs had been 126K, but were revised 41K lower to only 85K (the least since June 2012). If you take the jobs subtracted from March and instead attribute them to April, we're sub–200K for a second month. The Unemployment Rate dropped to 5.4% (from 5.5%), reaching the lowest since May 2008. The 5.4% rate, despite some large data components that diminish the efficacy (or reality) of that number, is closing in on some Fed member's revised–lower 5.2% goals for 'full employment'. The Labor Force Participation Rate of 62.8% did rise a notch above the 37–year low of 62.7%. First–quarter U.S. growth was barely positive – and could be revised downward. Retail sales saw no improvement in April, following a .20% drop in the first quarter – not exactly indicative of an economy picking up steam. One story pointed to record tax collections and said that any windfall from cheaper oil prices or slightly higher wages was gobbled up in tax payments. Merchandise retailers saw the largest drop in demand in over a year. Thus, there was nothing in the report to sway us to believing that the Fed would begin their rate–liftoff in June, but little to suggest that September is off the table either. If the **BMR** were doing a point/counterpoint study of why the Fed would want to liftoff soon, we would look at the poor first quarter, a rough start to the second, and focus in one two key gauges – inflation and jobs. Producer Prices fell .40% in April removing the first concern from the inflation–target standpoint. But more importantly, despite the buildup of the data, the Fed's jobs dashboard of Labor Market Conditions fell for a second month (by 1.9% – even more than March's 1.8% drop). If that's their 'horizon indicator' they'd best make sure to avoid a stall.

Looking Ahead

- Sell rallies in bonds as yields should be generally higher into late July.
- Stocks should have cycle low trend–changes near May 21st, May 29th, and June 11th.

Treasuries, Agencies, and MBS

EU rates were the tether holding U.S. rates down. As that stake came loose, global bonds entered a rout that took 50 bps (U.S. 10–year note) and 73 bps (German 10–year) just to begin to stabilize. The great relative bid was gone, as German rates rose 1500% from .0485% to .775%. You agreed to receive 485 EU a year on a 1M EU investment, and then saw your bunds lose 70K EU in market value in only a few weeks. Bonds really didn't net out too poorly last week, but the swings have been violent leading to possible capitulation into our low (for prices) that was due on the 11th or 12th. So far the low was on the 12th, but a lot of technical damage has been done. The best help of the cycles here may be when to hedge, to lighten hedges, or to sell given our low–yield trend changes – as bonds appear to be cyclically weak (with higher yields) into late July. The cycles are very mixed over the coming weeks, but turn rather negative around the second week of June. Hopefully that situation will clear as it approaches.

For the week, the curve steepened with yields falling 2.5 and 1 bps at 2 and 5 years, but rising 3.5 and 7.5 bps at 10 and 30 years. Into today, following a huge selloff into our may 12th trend change, yields were 3 bps lower at 2 years, but 1.5, 8, and 15 bps higher. As we're doing our final proof, a rally may lead bonds to actually finish better this week after an abysmal start! MBS spreads (for FNMA 30–year 2.5%) were unchanged last week. Foreign buyers have been very active in the U.S. auctions as that's been the best competitive arena for buying.

Tuesday's $24 billion 3–year note auction was rated an above–average '4 of 5' and brought 1.00% – the highest yield since March. Demand was the best since February, and foreign buyers took 52.7% of the issue versus 49.4% last month. The 10–year note auction took place on Wednesday with $24 billion awarded at 2.237% (the highest since November). Demand was the best since December, and the auction was rated a very–strong '5 of 5'! Foreign accounts stepped up to take 60.2% of the offering versus 58.5% in April. Today's 30–year bond supply of $16 billion brought a 3.044% yield in an average '3 of 5' auction. The yield was the highest since November, and demand was better versus the previous offering. Foreign buyers were awarded 50.8%, versus a higher 51.3% for the April auction.

05/08/15 Treasury Yield Curve	2-Year: 0.574%	5-Year: 1.489%	10-Year: 2.149%	30-Year: 2.901%
Weekly Yield Change:	–.023	–.011	+.035	+.073%
Support:	0.58/ 0.61/ 0.64/ 0.66 %	1.51/ 1.57/ 1.63/ 1.69%	2.18/ 2.26/ 2.33/ 2.41%	3.00/ 3.06/ 3.10/ 3.18%
Targets:	0.53/ 0.51/ 0.49/ 0.46%	1.45/ 1.40/ 1.34/ 1.29%	2.11/ 2.04/ 2.00/ 1.91%	2.91/ 2.85/ 2.75/ 2.68%

Economics

Even with an encouraging rebound in jobs, the data is far from robust as we see it. Consumers must believe so as well. Bloomberg Consumer Comfort fell from 44.7 last week to 43.7, and dropped again today – losing .2 to 43.5. Their economic–outlook component slipped to the lowest since mid–December, and sentiment among lower earners dropped to the lowest since November. NFIB Small Business Optimism rose from 95.2 to 96.9. Curiously, while the jobless claims data has been very tame, Challenger Job Cuts showed 52.80% more firings versus last April (2014). That isn't evident in the correlating data. Last week, Initial Jobless Claims rose a mild 3K to 265K, and they fell back to 264K this week. Continuing Claims fell from 2,256K to 2,229K last week, and remained at that level this week. That put the 4–week average for both categories at their lowest levels in 15 years. The JOLTS Job Openings dropped from 5,144K to 4,994K, though that was for March (but still showing a large supply of available jobs). Consumer Credit rose $20.523 billion in March. Private Payrolls added 213K jobs, but were revised 35K lower for March. Manufacturing added only 1K. Average Hourly Earnings rose .10%, to a 2.20% yearly pace (up from 2.10%). Hours remained at 34.5. The Underemployment Rate also dropped .10% to 10.80%. March Business and Wholesale Inventories rose .10%, but Trade Sales fell .20% – and were revised .40% lower to a .60% drop for February. April Producer Prices fell .40% and .20% ex food & energy. That took the yearly PPI pace from –.80% to –1.30%. The core number fell from .90% to .80%. April Import Prices fell .30% to a stout 10.70% annual drop. The Monthly Budget Statement showed a $156.7 billion surplus in April. Tax collections were up 12.9% versus fiscal 2014. Corporate receipts are 11.8% higher.

Friday is set for Empire Manufacturing, Industrial Production & Capacity Utilization for April, TIC Flows (net foreign Treasury operations), and University of Michigan Confidence (sentiment and expectations) data. Monday (05/18) gives us builder outlook (NAHB Housing Market Index), and Tuesday follows with April Housing Starts and Building Permits. Wednesday provides the minutes from the FOMC April meeting, and updates MBA Mortgage Applications (which fell 3.5% last week).

Equities

Stocks rose into the 12th, which was our next target for a high, but powered higher today with the Dow making a new intraday high, and its second highest close versus its March 2nd record. The S&P closed at a record, but has yet to take out its April 27th high. The S&P 100 did both. The cycles are very mixed in here, but it remains the case that stocks should have cycle low trend-changes near May 21st, May 29th, and June 11th. When stocks take out all the highs, which some indices have, there is no overhead resistance and markets that have climbed a wall of worry can surge higher.

Last week, the Dow gained 167.05 points or .93% to 18,191.11. That was following a prolific 267–point rally Friday after the April payrolls numbers indicated the economy might be resuming encouraging job growth. The Dow is .34% better this week. The S&P gained 7.81 points or .37% to 2,116.10, and is .24% higher since Friday. The Nasdaq lost 1.84 points or .04% to 5,003.55, but has rallied .94% this week. The Dow Transports gained .34%, but are 1.92% lower this week – having broken important support. Bank stocks rose 1.53%, and are 1.11% higher this week. Bank stocks have risen nearly 15% since January, back to September 2008 levels and finally recovering over 50% of their financial–crisis loss (from February 2007 highs to March 2009 lows).

	Dow:	Nasdaq:	S&P:
Resistance:	18,273/ 18,343/ 18,409/ 18,478	5,053/ 5,074/ 5,091/ 5,120	2,126/ 2,137/ 2,149/ 2,160
Support:	18,139/ 18,061/ 17,937/ 17,804	5,018/ 4,983/ 4,945/ 4,914	2,114/ 2,099/ 2,089/ 2,079

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Other Markets

Crude Oil and Gold are showing some strength as the U.S. Dollar has tumbled 7.25% since march. Commodities rose .53% last week, and added 1.14% into today as Crude gained .41% and .83%, and Gold rose 1.23% and then jumped 3.05% higher this week to the highest levels since February. The U.S. Dollar lost .57%, falling for a 4th week, and appears destined for a 5th drop with a 1.47% plunge since Friday. The Japanese Yen gained .32% and is .48% higher this week, while the Euro was unchanged into the 8th, but 1.88% higher since. Corn lost .35%, but then rose .70% into today. Cotton was 1.03% lower, but .56% better this week as it took more of the weaker U.S. Dollars to buy commodities.

"The thrill is gone."
One of my favorite artists, blues–guitar legend B.B. King passed away today at 89. He played the blues with great feeling – and was a master in making his guitar (Lucille) sing in response to his lyrics!

Additional Information is Available on Request
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