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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Tomorrowland

News was fairly light this week with mostly the same headlines ruling the markets. Will the EU give Greece more time to meet debt obligations? Will the Fed tighten in 2015? How much will the U.S. economy rebound from the 1st–quarter's sluggish start – and did Q1 GDP indeed contract? As the Nasdaq outpaced other indexes to close at a new high today, the Dow Transports broke support and yesterday fell to 7–month lows! While core Consumer Prices (April CPI) ticked up a bit more than expected, global growth is challenged and a lack of inflation remains one of the top concerns of global central banks. What does tomorrow hold? Though backing off a June hike, the Fed seems committed to a hike sometime in 2015. Though a few are still calling for better data before lifting off, last week Fed Chair Janet Yellen reaffirmed a hike *"will be appropriate at some point this year."*

Speaking to their thresholds for tightening, Yellen said: *"I will need to see continued improvement in labor market conditions, and I will need to be reasonably confident that inflation will move back to 2% over the medium term."* She said labor was *"not there yet"* in returning to full strength, while the **B**ond **M**arket **R**eview sees those conditions as much further away. The quality of jobs, number of hours worked, and participants in the workforce are all things we don't see being remedied in 2015 (or 2016 for that matter). To that end, this week Vice Chairman Stanley Fischer posed the question for the rate liftoff: *"Which is better, early and gradual or late and steep?"*

The **BMR** is leaning to 'late and gradual' given incoming data! Fischer said: *"If we raise the rate from zero it will be harder to go back to zero if there is a problem. Our processes are not date–determined, they are data–determined."* (Other than for the current fixation on action in 2015.) Fischer also said weaker foreign growth could lead to a slower removal of accommodation. Though off our radar, the Chinese central bank has lowered rates nearly 2% since March 31st for the largest 2–month cut since 2008. Pakistan's central bank just cut rates to 42–year lows to battle slow growth and dropping prices. We rarely hear of the actions of non–G7 central banks, but after all, it's a small world – and it is the 6th most populous country.

BMR Cycles Update

Speaking to our April 20th to 22nd timeframe for a high, in the **BMR** (04/16/2015), we said: *"After that, the positive forces simply run out. Do the cycles err? Certainly! … 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!"* The Dow Transports made a 4–week high on the 23rd, and as we pointed out last week – made 6–month lows with that cycle into our May 21st date. It's followed the cycle work very well. That said, while some other indexes made new highs after April 23rd, it's worth noting that all the major indices were trading lower than those highs this week. Our next two trend–change dates, which we expect to be lows, are May 29th and June 11th. June 11th is now key, as stocks could then rise from that expected tend–change into the end of July or early August. The rate cycles are lining up better as well, pointing to the lowest yields between June 8th–12th.

Looking Ahead

- We would sell rallies in bonds, as yields should be generally higher from June 8th–12th into late July.
- Stocks should have cycle trend–change lows near May 29th and June 11th–12th.

Treasuries, Agencies, and MBS

Yields rose across the curve last week, with some mild flattening as 2, 5, 10, and 30–year sector rates were higher by 8, 10, 6.5, and 5.5 bps. U.S. Treasuries have improved this week, wiping out last week's lowest yields to reach back to early–May levels. Though higher by 3.5 bps at 2–years (partially due to a new 2–year note), the 5, 10, and 30–year maturity yields have dropped 3, 8, and 11.5 bps this week. With the Dollar again surging, there could be a renewed challenge to export orders and U.S. manufacturing – and thus growth!

MBS spreads (for FNMA 30–year 2.5%) were unchanged last week. Tuesday's 2–year note auction was rated an average '3 of 5' with $26 billion supply going at .648% – the highest yield since December. Demand was the highest since March and foreign buyers accounted for 42.3% of the issue versus 38.1% in April. Today's 5–year note brought 1.56%, and was rated an above–average '4 of 5'. The yield was also the highest since December and demand was weaker versus the April offering. Foreign buying fell to a still–hefty 58.5% of the supply versus 61.2% in April. The Treasury will auction $29 billion 7–year notes on Thursday (05/28).

05/22/15 Treasury Yield Curve	2-Year: 0.616%	5-Year: 1.563%	10-Year: 2.210%	30-Year: 2.985%
Weekly Yield Change:	+.078	+.102	+.067	+.055%
Support:	0.65/ 0.67/ 0.69/ 0.72 %	1.54/ 1.57/ 1.60/ 1.63%	2.17/ 2.21/ 2.24/ 2.28%	2.93/ 2.99/ 3.04/ 3.08%
Targets:	0.61/ 0.58/ 0.55/ 0.53%	1.51/ 1.48/ 1.45/ 1.42%	2.10/ 2.07/ 2.03/ 1.98%	2.86/ 2.81/ 2.75/ 2.68%

Economics

The Leading Index rose .70%, the most in 9 months, and was revised .20% higher to .40% for March. 7 of the 10 components saw improvement – a sign the economy might be shrugging off a slow 1st–quarter. Initial Jobless Claims rose 10K to 274K, but the 4–week average fell to a 15–year low. Continuing Claims dropped from 2,223K to 2,211K. Board Consumer Confidence increased from a 4–month low 94.3 to 95.4. Last week, Bloomberg Consumer Comfort (confidence) fell from 43.5 to 42.4. Their gauge of Economic Expectations fell from 50 to 44 – the largest drop since 2013, so it's hard to get a very–positive read other than from rising stocks.

Manufacturing outlooks also varied. The Richmond Fed outlook increased from –3 to +1 and the Chicago Fed National Activity Index rose from –.36 to –.15. The Philadelphia Fed Business Outlook dropped from 7.5 to 6.7, while Kansas City Fed Manufacturing Activity fell from –7 to –13 and Dallas dropped from –16 to –20.8. Durable Goods Orders fell .50% in April – following a revised 1.10%–better 5.10% gain in March. Ex–Transportation, orders rose .50%, and were revised from a .20% March drop – to a .50% increase. Capital Goods Orders rose for a second month, increasing by 1.00%. While Consumer Prices rose only .10% in April, the ex food & energy reading was higher than expected with a .30% increase. Though the annual pace fell by .20%, the core saw an increase of .10% to 1.80%. Average Weekly Earnings rose .20% to a 2.30% annual pace. April Existing Home Sales unexpectedly fell with a 3.26% drop from 5.21M to a 5.04M annual pace. Though 8.15% higher versus last April, a lack of supply was attributed to be part of the drop. We recall traffic being a little lower, and prices have also been increasing. Metro home prices rose .95% in March, and were 5.04% higher year–over–year (S&P/Case–Shiller data). Their Home Price Index was .12% higher in March for an annual 4.14% increase. The FHFA House Price Index rose .30% in March, and the House Price Purchase Index rose 1.30% in the 1st–quarter. In April, purchases of New Homes rose 6.82% (from 484K to a 517K annual pace). Sales were up 21.65% to last April.

Thursday is set for jobless claims data, April Pending Home Sales, and Bloomberg Consumer Comfort. Friday closes out May trading with an update to 1st–quarter GDP – which is estimated to show contraction versus the last +.20% reading. Also due are Personal Consumption, the GDP Price Index, ISM Milwaukee, Chicago Purchasing, and University of Michigan confidence surveys. Monday (06/01) kicks off June with Personal Income & Personal Spending for April. The April PCE Deflator, Construction Spending, and ISM Manufacturing are also due. Tuesday brings ISM New York, April Factory Orders, IBD/TIPP Economic Optimism, and May Vehicle Sales. Wednesday gives us the Fed's Beige Book, MBA Mortgage Applications (which fell by 1.60% last week), the service sector outlook (ISM Non–Manufacturing), and the April Trade Balance (deficit). March had the largest imbalance since August 2008! ADP Employment Change will provide some insight into Friday's release of May payroll data.

Equities

The Nasdaq reversed last week's trend to rise to a new record close, while the other indexes lagged. While we've often seen indexes lag each other, sometimes setting up trading divergences, we can't recall seeing major indexes reach new highs while another is breaking through all recent trading–range support to reach 7–month lows. However, that's what the Dow Transports have done! Last week, the Dow fell 40.54 points or .22% to 18,232.02. Tuesday saw a 190–point drop, but today's rally left it only .38% lower for the week. The S&P rose 3.33 points or .16% to 2,126.06, but it's .12% lower this week. The Nasdaq is now outpacing, having risen 41.07 points or .81% to 5,089.36 last week, and improving .34% into today. The Transports lost 2.29% last week, and are .45% lower since Friday. Bank stocks rose 1.34%, and are .28% higher this week.

Resistance:	Dow:	18,187/ 18,268/ 18,342/ 18,405	Nasdaq:	5,105/ 5,118/ 5,141/ 5,159	S&P: 2,122/ 2,128/ 2,134/ 2,140
Support:		18,068/ 17,999/ 17,934/ 17,866		5,069/ 5,051/ 5,036/ 5,017	2,113/ 2,105/ 2,099/ 2,094

Other Markets

Commodities continued their contra–Dollar moves with a 2.55% loss last week and a 2.38% drop into today. The U.S. Dollar reversed a 5–week loss with a 3.14% gain last week, and it's 1.42% better so far this week. Gold dropped 1.74% and is 1.53% lower since Friday. Crude Oil held ground last week with a .05% gain, but it's 3.70% lower this week. The Euro succumbed to the best Dollar gains since 2011 with a 3.82% loss. It's .99% lower this week – still troubled by Greek leadership seeking concessions and unwillingness to give in to further austerity measures. The Japanese Yen dropped 1.92%, and is off another 1.74% this week. Corn lost 1.50%, and is 2.92% lower this week. Cotton lost 5.30%, and is .39% lower this week. The stronger Dollar is ruling commodities.

"You never lose a dream. It just incubates as a hobby." Larry Page

Additional Information is Available on Request

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