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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**Mulligans**

The news isn't changing much from week to week, as the positives and negatives of incoming data have the FOMC seeing valid cases both for and against raising rates. Why should the movies be any different? They seem to be recycling as well. The previews we saw before last week's new–and–improved take on 'Earthquake' included scenes from upcoming remakes of 'Point Break' and the 'Man from U.N.C.L.E.' 'San Andreas' followed our 'Mad Max' excursion last week – another remake of course, though easily the best 3–D film technology I've ever seen! With 'Jurassic World', 'Fantastic Four', 'Mission Impossible' , and 'Terminator' remakes or sequels all now due before the Fed's supposed move in September, there truly is *"nothing new under the sun."* Even 'Ant Man' (the other preview), and almost all the other D.C. and Marvel–inspired movies are from comics I read as a kid – and I'll hit 3 score this weekend. How many spinoffs will 'Tomorrowland' generate? After all, 'Pirates of the Caribbean' is scheduled for its 5th, as is 'Indiana Jones'. 'Star Wars VII' is due late this year (right up there with 'Fast and Furious'). The stock market's been on a fairly steady climb, and it could be like the ascent before the wild drops and turns that you can't see coming in Tomorrowland's 'Space Mountain' ride! The FOMC is clearly trying to avoid the market tremors that could arise from an ill–timed rate increase – and is highly aware that they could be the San Andreas–like fault of a shockwave even larger than the 'taper tantrum' of 2013. Tough to get a 'do over'!

The FOMC wants to liftoff, if only to prove the merits of their policy. They just want to change from the perception of a rocket – to a hovercraft or the like. It would be exceptionally hard to build a case for the June 17th meeting. GDP growth for the first quarter was revised from a previous barely–positive reading of +.20% to a contraction of .70%! FRB St. Louis President James Bullard suggested the Fed should consider *"nominal GDP targeting."* (Those inflation and unemployment rate targets failed to capture a good read on economic health.) Bullard said *"policy is still on an emergency setting"* and the Fed needed to *"get going once we have the opportunity"* as he fears the risk of asset bubbles resulting from remaining accommodative with near–zero rates for too long. In today's Beige Book release, 4 Fed districts reported *"moderate"* growth, while 3 said it was *"modest."* Pretty much what we've seen for the past number of years! However, the others (5 of them) said growth was only *"slight"* or *"mixed"*, and Dallas *"slowed"* – citing the downturn in the oil and gas industry. 'Strike 2' for an imminent hike! The Fed's preferred inflation measure is core (PCE) personal consumption expenditures. The results for April were a 1.2% rise – marking the least inflation since February 2014. CPI was 1.8%, with the .6% differential the most in nearly 6 years. That would seem to be 'strike 3', though good May payroll numbers could sway the Fed a bit.

**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 June 11th–12th, and could then rally through June.
- The next FOMC interest–rate policy statement is scheduled for Wednesday, June 17th.

**Failure to Launch**

In the **BMR** (03/25/2015), we reiterated: *"It's not liftoff that concerns investors so much as the trajectory!"* We said: *"As we've covered in previous weeks, most of the Fed moves over the past few decades have been campaigns of tightening or easing – with little or no rest to evaluate the effect of each move. Recall even the tapering of QE was going to be evaluated along the way, but ended up as an unchecked campaign of $10 billion cuts until the final $15 billion was removed with the October meeting. It's human nature. When they first hike, they will feel the urge to hike again at the next meeting – or appear as though they didn't feel confident with the first action (and so on)."*

Fed Vice Chairman Stanley Fischer hoped the markets would accept his semantics lesson. He said the term *"liftoff"* that has been used to describe the exit from near–zero rates *"is the most misleading word you can imagine."* He said: *"Liftoff says we're going straight up with the interest rate."* As the **B**ond **M**arket **R**eview noted earlier – that has been their modus operandi – for nearly two decades! He said their plan was to go *"up, then along, and then another little jump."* Fischer said: *"That's not liftoff, that's crawling."* 'Modest to moderate' increases to match the Beige Book report? This non–rocket hover technique reminds us of the increasing use of drones. We read where one wipes out almost daily. Is crawling in the dark any better than the unseen turns of 'Space Mountain'?

**Treasuries, Agencies, and MBS**

Longer yields hit new highs for 2015 today, but had traded nicely lower with stocks into our May 29th trend–change date for equities – as Q1 GDP showed a .70% contraction. Yields ended lower for the last week of May, falling 1, 7.5, 9, and 10.5 bps at 2, 5, 10, and 30–years. Overall, the month saw an increase of 4, 6, 9, and 14 bps.

Into today, yields surged higher by 7, 20, 24.5, and 22 bps giving June a rough start. One reason for yields rising this week was the first uptick in EU inflation readings in 6 months. That send global bonds reeling. However, as we've said before: One uptick does not a trend make. It did give the European Central Bank a reason to believe their QE is working and might have checked deflation, but inflation is far from EU or Fed target goals. In only 3 months, German 10–year yields have jumped from .07% to .88%, French from .349% to 1.17%, Swiss from –.21% to +.10%, and UK from 1.48% to 2.08%. The U.S. 'value bid' is still there, but highly diminished! That said, bonds are a bit oversold here and we still expect equities to falter into June 11th–12th, possibly giving bonds a boost. That would add another chance to set hedges or sell, but since yield cycles are higher into late July, selling rallies remains the best strategy based on the **BMR** cycle–work. Though June 8th to the 12th is a wide window for the next low in yields, we're looking at some mixed cycles from our work on 5, 10, and 30–year maturities.

MBS spreads (for FNMA 30–year 3.0%) were 2 bps wider last week. We switched from the 2.5% coupon which is trading around 96.5 to the nearer–'par' issue. Last Thursday's $29 billion 7–year note auction was rated an above–average '4 of 5' as its yield rose to 2015 highs (as did the earlier–week 2 and 5–year notes) – ramping up good demand. The 7–year came at 1.88% with demand the best since January. Foreign buying came in just a little less than for April (at 53.8% versus that prior 54.1%). Next week, the Treasury will auction $24 billion 3–year notes on Tuesday (06/09), $21 billion 10–year notes on Wednesday, and $13 billion 30–year bonds on Thursday.

| 05/29/15 Treasury Yield Curve | 2-Year: 0.607% | 5-Year: 1.486% | 10-Year: 2.122% | 30-Year: 2.882% |
|---|---|---|---|---|
| Weekly Yield Change: | –.009 | –.077 | –.088 | –.103% |
| Support: | 0.68/ 0.70/ 0.72/ 0.75 % | 1.69/ 1.73/ 1.76/ 1.80% | 2.35/ 2.38/ 2.42/ 2.46% | 3.08/ 3.13/ 3.17/ 3.22% |
| Targets: | 0.63/ 0.60/ 0.58/ 0.56% | 1.63/ 1.61/ 1.56/ 1.52% | 2.30/ 2.27/ 2.23/ 2.19% | 3.03/ 2.99/ 2.95/ 2.90% |

## Economics

May payrolls seem promising as ADP Employment Change rose to 201K from April's 165K (with only a slight 4K downward revision). Though Initial Jobless Claims rose from 275K to 282K, they were under 300K for a 12th week. Continuing Claims rose 11K to 2,222K. IBD/TIPP Economic Optimism fell from 49.7 to 48.1, and Bloomberg Consumer Comfort fell again, with a larger 1.5–point drop to 40.9. University of Michigan Sentiment fell from 95.9 in April to 90.7, and is well off January's peak above 98, but still very positive. The Current Conditions gauge fell from 107 to 100.8, and Expectations dropped from 88.8 to 84.2. The Service Sector outlook also slowed, with the ISM Non–Manufacturing Composite dropping from 57.8 to 55.7.

Personal Income rose .40% in April, but Personal Spending was flat. The Personal Consumption Expenditures inflation gauge was also flat for April, and only .10% higher annually. The core reading rose .10% in April, bringing the ex food & energy annual PCE pace to only 1.20%. Q1 GDP was revised from a positive .20% to a .70% contraction. Personal Consumption rose 1.80%. The GDP Price Index was .10% lower for Q1, and the core showed a .80% increase. ISM Manufacturing rose from 51.5 to 52.8, and Prices Paid rose from 40.5 to 49.5, but regional outlooks faded a bit. ISM Milwaukee dropped from 48.08 to 47.7 and Chicago Purchasing Managers fell 6.1 points to 46.2. ISM New York was 4.1 points lower to 54. Factory Orders dropped .40% in April, but were unchanged ex transportation orders.

Pending Home Sales have been a sign of promise for the economy and continued to be with a 3.40% rise in April (following the March 1.20% increase). Sales were up 13.40% versus last April. Construction Spending rose 2.20%, and was revised from a .60% decrease in March to a .50% gain. May Vehicle Sales rose from 16.46M to a 17.71M pace, and domestic sales rose from 12.88M to a 13.95M annual pace. The April Trade Balance deficit dropped from the previous month's $50.6 billion shortfall to $40.9 billion. Services and exports increased, while imports decreased. Those will be positives for Q2 GDP.

Thursday is set for 2 more clues into May payrolls from jobless claims data and Challenger Job Cuts. Also due are Q1 Nonfarm Productivity & Unit Labor Costs, and Bloomberg Consumer Comfort. Friday brings May payroll numbers including the U.S. Unemployment Rate, Hourly Earnings, Weekly Hours, and April Consumer Credit. Monday (06/08) follows with the Fed's employment dashboard (Labor Market Conditions Index Change).

Tuesday gives us NFIB Small Business Optimism, April Wholesale Inventories & Trade Sales, and JOLTS Job Openings (also for April). Wednesday brings MBA Mortgage Applications (off 7.60% last week), and the Monthly Budget Statement (expected deficit) for May.

## Equities

May was unseasonally and uncharacteristically good for equity investors – unless they held transport stocks. The traditionally 2nd–least positive month for equities saw the Dow Transports drop 3.41%, while the Dow gained .95% and the S&P rose 1.05%. Bank stocks vaulted 2.47% higher and the Nasdaq rose 2.60% – reaching new record closes. Stocks were also mixed globally. Hong Kong and Germany were lower, while China and Japan beat most indexes with May gains of 3.83% and 5.34%. Equities traded lower into our May 29th trend–change with NYSE stocks trading their lowest (collectively) since May 7th. Stocks have since rallied a few days, but we still expect a pullback into June 11th–12th, leading to a rally into month end. For the week, the Dow lost 221.34 points or 1.21% to 18,010.68. It's up .36% to kick off June. The S&P lost 18.67 points or .88% to 2,107.39, and is .32% higher since Friday. The Nasdaq fell 19.34 points or .38% to 5,070.03, but is .58% higher this week. The Transports lost 2.15%, but have rallied 2.53% this week. Bank stocks lost .83%, but are up a stout 1.84% for early June.

| | Dow: | Nasdaq: | S&P: |
|---|---|---|---|
| Resistance: | 18,045/ 18,116/ 18,184/ 18,243 | 5,094/ 5,113/ 5,131/ 5,149 | 2,109/ 2,115/ 2,121/ 2,126 |
| Support: | 17,910/ 17,842/ 17,777/ 17,709 | 5,059/ 5,046/ 5,036/ 5,018 | 2,098/ 2,092/ 2,086/ 2,080 |

## Other Markets

Commodities lost 2.75% in May, while the U.S. Dollar gained 2.40%. Most currencies and commodity markets followed that path, though Crude Oil tacked on 1.12% to April's 25.27% rally. Last week, Commodities lost 1.06%. They're up .18% this week and the markets are starting to not be as Dollar driven as in recent weeks. Crude Oil gained .97% last week, but was 1.09% lower into today. Gold lost 1.21%, and was .40% lower for early June. Silver is now trading lower for a 3rd week. The U.S. Dollar rose .91%, but is off 1.52% for the first 3 days of June. However, earlier this week the Dollar rose to a 12–year high versus the Japanese Yen – which fell 2.15% last week, and has dropped another .08% since Friday. The Euro lost .25%, but has surged 2.63% this week. Corn fell 2.36%, but is 2.13% higher this week. Cotton rose 1.66%, and is 1.38% higher since Friday.

*"Part of the secret of success in life is to eat what you like and let the food fight it out inside." Mark Twain*

*"Horse sense is the thing a horse has which keeps it from betting on people." W. C. Fields*

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

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