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BOND MARKET REVIEW

June 10, 2015

Inflation Infiltration

Sooner or later the global monetary printing press should lead to inflation! In the last **BMR**, we said: *"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."* That same logic applies to the one quarter of negative U.S. GDP growth, the May rebound in U.S. May payrolls, and the uptick in the Labor Market Conditions Index. With those mixed signals, the Fed will most likely stay their hand next Wednesday. May jobs beat estimates, and most of the accompanying data was very positive. Whether or not part of 'the code', FRB New York president William C. Dudley said: *"It is likely that conditions will be appropriate to begin monetary policy normalization later this year."* To the **B**ond **M**arket **R**eview, '*later*' certainly sounds like no earlier than September!

Nearly every payroll statistic for May was a positive for the U.S. economy – and for the Fed's case for hiking rates 'sometime' in 2015. Even the Unemployment Rate rising a notch to 5.5% was no threat as workers were reentering the labor force. On Monday the 'nose' cleared the horizon as the Fed's labor dashboard turned positive (after March and April had been negative for the first time since June 2012). While there are still low–inflation concerns, bond bulls are coming to grips with a fear that they might be 'fighting the Fed.' A day before the payroll numbers, Fed Governor Daniel Tarullo stated concerns about the economy's loss of momentum in the 1st quarter. He contended: *"In a broader sense, there are more questions at this point in 2015 than there were at this point in 2014."* Governor Lael Brainard made the case for *"watchful waiting"* concerning U.S. and global data.

The global deflation bet turned very sour! German 10–year rates topped 1% today after trading below .05% in April. Those investing today will be earning 20 times the yield! Most EU rates have a similar story – leaving global bond investors in a rout. In the **BMR** (05/14) we said: *"EU rates were the tether holding U.S. rates down."* Clearly the stakes are uprooted! In the **BMR** (01/28), we talked about the Fed adding *"international"* to *"the list of labor market conditions, inflation pressures, and financial developments that could alter their policy."* We said the ECB had *"just embarked on a fresh round of QE"* partially because *"Greek elections went anti–austerity as the Greeks are tired of Germany dictating the terms of their remaining in the EU."* The only surprise is that those elected officials are actually exercising the will of the people. They won't cave and missed (or deferred) an International Monetary Fund (IMF) payment this week. German chancellor Angela Merkel is determined *"to keep Greece in the euro area."* The payment deadlines are simply being pushed forward for now. 'So … when can you pay?'

Counterpoints

New Zealand's central bank just cut rates for the first time in 4 years, given low inflationary pressures. The Bank of Korea cut to a record low citing growth risks, and health risks from MERS. The IMF cut U.S. growth forecasts and suggested the FOMC should put off any hikes until 2016 – as a stronger Dollar could be *"harmful"* to global growth. Today, the World Bank joined the IMF in urging the Fed to delay a liftoff until 2016. Turns out, everybody likes the punch bowl! More please!!! Their concern, like ours, is that the *"signals coming out of the U.S. economy have been mixed."* They also lowered U.S. and global growth forecasts. Not to be outdone, the Organization for Economic Cooperation and Development (OECD) also cut their global forecasts.

Looking Ahead

- We would sell rallies in bonds, as yields should be generally higher into late July.
- Our stock cycles point to a high in late June.
- The June FOMC interest–rate policy statement is scheduled for Wednesday, the 17th at 2 pm EDT.

Treasuries, Agencies, and MBS

S&P affirmed its AA+ rating for U.S. debt with a stable outlook, but it was otherwise a particularly ugly week for bonds. Yields spiked higher by 10.5, 25.5, 28.5, and 23 bps for the 2, 5, 10, and 30–year Treasury sectors in the worst selloff since the week of March 6th. Bonds have some mixed cycles, that are a bit sloppy for the various longer maturities, but they all point to higher yields into late July. It's for that reason we've chosen to adopt the stance of selling or hedging rallies for the time being. Bonds are oversold, but a bet on lower rates is now fighting the Fed. Into today, yields were higher by 1.5, 4.5, 7.5, and 10 bps at 2, 5, 10, and 30–years.

MBS spreads (for FNMA 30–year 3.0%) pulled in by 1 bps last week. On Tuesday, the Treasury Department sold $24 billion 3–year notes at 1.125%. That was the highest yield since April 2011, and demand was the lowest since April (2015). The auction was rated an average '3 of 5' and foreign buying came in at 50.7% of the issues versus 52.7% in May.

Today, the U.S. Treasury reopened the May 2025 10–year note to add $21 billion at 2.461% in an auction rated an above–average '4 of 5'. Demand was the best since the December auction, and foreign buying accounted for a healthy 57.9% of the offering compared to 60.2% last month. The Treasury will auction $13 billion 30–year bonds on Thursday (06/11).

06/05/15 Treasury Yield Curve	2-Year: 0.711%	5-Year: 1.741%	10-Year: 2.408%	30-Year: 3.114%
Weekly Yield Change:	+.104	+.255	+.286	+.232%
Support:	0.73/ 0.75/ 0.78/ 0.81 %	1.80/ 1.84/ 1.87/ 1.91%	2.48/ 2.52/ 2.56/ 2.60%	3.18/ 3.22/ 3.26/ 3.31%
Targets:	0.68/ 0.63/ 0.60/ 0.58%	1.73/ 1.70/ 1.65/ 1.61%	2.41/ 2.37/ 2.31/ 2.28%	3.11/ 3.04/ 3.00/ 2.96%

Economics

Though the U.S. Unemployment Rate rose .1% to 5.5% in May, it was with the Labor Force Participation Rate growing from 62.80% to 62.90% – and payrolls beating expectations of around 226K with a 280K pickup! 32K jobs were also added to the last 2 months. Challenger Job Cuts had confirmed better data with a 22.50% cut in May layoffs versus 2014. The pickup in jobs was the most since December's 329K rise. Private Payrolls rose 262K and Manufacturing added 7K jobs. The Underemployment Rate remained at 10.80%. The FOMC's jobs dashboard, the Labor Market Conditions Index Change, rose 1.3 points for its first uptick since February. Though Average Weekly Hours remained at 34.5, Hourly Earnings rose .30% to a 2.30% annual pace. An impressive statistic came from JOLTS Job Openings as opportunities grew by 267K to 5.376M (outpacing the gains in Private Payrolls). Initial Jobless Claims fell from 282K to 276K – marking a 13th week below the 300k threshold! Continuing Claims fell from 2,226K to 2,196K. NFIB Small Business Optimism rose from 96.9 to 98.3. 1st–quarter Nonfarm Productivity fell by 3.10% and Unit Labor Costs rose 6.70%. Consumer Credit expanded by $20.541 billion in April following a near $825–million–larger $21.348–billion increase in March. If only by the use of credit, Americans are spending! Wholesale Inventories rose .40% in April, and Sales rose 1.60%. May's Federal budget deficit was only $82.4 billion versus $97 billion expected. The adjusted deficit is running about 9% below last year's levels.

Thursday is set for May Retail Sales, Import Prices, jobless claims data, April Business Inventories, and Bloomberg Consumer Comfort (which once again dropped with a .4 point decline to 40.5). Friday brings Producer Prices (May PPI), and University of Michigan confidence data. Monday (06/15) gives us June Empire Manufacturing, home builder outlook (NAHB Housing Market Index), May Industrial Production and Capacity Utilization, and TIC flows (net foreign Treasury transactions). Tuesday is set for May Housing Starts and Building Permits. Wednesday updates MBA Mortgage Applications (up 8.40% last week) and the June FOMC interest–rate policy statement.

Equities

Stocks traded lower into our trend–change date of June 11th, with the Dow closing at negative levels for the year on Monday and Tuesday. However, stocks began their rebound a day ahead of the cycle center with a large rally today – sending most indexes back to a positive for 2015. The Transports were still 8.50% lower even after today. For the week, the Dow lost 161.22 points or .90% to 17,849.46. It was .85% higher after today's rally leaving it .40 over the 18,000 level. The S&P lost 14.56 points or .69% to 2,092.83, but is .59% higher this week. The Nasdaq lost 1.57 points or .03% to 5,068.46, and despite today's 1.25% rally is only .16% higher for the week (after the weakness into Tuesday). The Transports gained 2.53% last week, but were 1.72% lower for this week (after today's .68% rally). Bank stocks rose 2.75% last week, and continued 1.83% higher into today.

	Dow:	Nasdaq:	S&P:
Resistance:	18,167/ 18,235/ 18,341/ 18,406	5,100/ 5,118/ 5,136/ 5,154	2,115/ 2,123/ 2,128/ 2,134
Support:	18,001/ 17,935/ 17,867/ 17,725	5,064/ 5,046/ 5,017/ 4,978	2,105/ 2,094/ 2,082/ 2,072

Other Markets

Commodities fell .29% last week, but surged 2.54% higher this week with the Dollar losing 1.77%. The Greenback was .64% lower last week. Gold fell 1.82%, but has risen 1.57% since Friday. Crude Oil was also 1.94% lower, but surged 3.89% into today – as these markets moved to counter the Dollar's drop. The Japanese Yen lost 1.19% last week, but jumped 2.35% higher into today. The Euro gained 1.17%, and has risen 1.89% since Friday. Corn gained 2.56%, but was .90% lower into today. Cotton lost .53%, but is 1.37% higher this week.

Our dear Commerce Street colleague and mentor, Jim Gardner would have been 81 today. He is one of those folks you miss and can't think about without drawing a smile. He taught me to more carefully weigh my next word …

Additional Information is Available on Request

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