BOND MARKET REVIEW

July 06, 2015

OXI
An old banking proverb was referenced quite a lot in the early '90s – when Donald Trump fell into real–estate money troubles. It goes like this: 'If you owe the bank a small amount, then you have a problem. If you owe the bank a large amount, then the bank has a problem.' Restated, for Greece, it could be: 'If you owe the ECB and IMF a small amount, then they own you. If you owe those banks a very large amount, then you own them.' Greece has been under austerity measures since the financial crisis as conditions for their bailout packages. They recently missed payments to the International Monetary Fund and the European Union, and those creditors pressed hard for more belt–tightening as conditions for renewals of credit.

As the **B**ond **M**arket **R**eview wrote last week, Greek Prime Minister Alexis Tsipras decided to stall negotiations and called for a referendum vote on further austerity. His government came to power on an anti–austerity platform, so he appealed to his constituents. This weekend, Greek voters cast a 'big fat OXI' or 'no' to further cuts and higher taxes. The 'nays' got more than 62% of the vote in a resounding rebuke of the EU – which is in this case primarily the German and French leadership. Germany's Angela Merkel said there was no point of further negotiations until the vote was in. Greece's hard–ball Finance Minister Yanis Varoufakis resigned after the vote. EU negotiators requested he not be present at future events. It's said Tsipras had enjoyed watching Varoufakis explain to everyone else in the room why he was right – and they were wrong!

The move, coupled with Greek bank closings last week sent shockwaves through financial markets. Some Greek banks ran out of cash, and others have placed a 60 Euro (around $67) limit on daily withdrawals. While Greece can't afford to pay its debts, and their debt–to–GDP presents a nearly insurmountable burden, the cost of kicking them out of the EU would be immense. Thus, it's not over, and the IMF and EU now know the voters are willing to go down with the ship. It's at this point one of those clear lose–lose situations, and Tsipras was just given another 24 hours to come up with a new plan. It reminded me of one of Henny Youngman's quips: *"A doctor gave a man 6 months to live. The man couldn't pay his bill, so he gave him another 6 months."* If they leave, or are forced out, they'll have to start their own monetary printing press and bang out some new Drachmas. Once not in the EU, they can print all the money they want – sort of like we do. For some reason, it still works for us.

Looking Ahead
- We would sell rallies in bonds, as the cycles show yield highs near July 21st.
- Stocks have a trend–change low due on July 13th, and another high due near July 22nd.

Terminator – Genisys
If you were fortunate enough to have visited the open–pit bidding floors in the New York or Chicago Mercantile Exchange, or other such venues, you got to see the hand signals and feel the excitement of a commodity trading floor. Most of us recall the Frozen Orange Juice pit from the movie 'Trading Places', where, after losing a fortune, the Duke brothers wanted to 'turn those machines back on – turn those machines back on!' They got their wish. After 167 years, most floor trading came to a screeching halt – ending forever today as the markets closed. Though, for now, floor trading for the S&P 500 is still taking place, the machines have mostly taken over. Another advance for Skynet …

Treasuries, Agencies, and MBS
Yields dropped today to the lowest levels since mid June as EU tensions escalated following the Greek anti–austerity vote. The cycles are showing a yield high near July 21st, so this current rally could be another used to take profits and/or reset hedges. In the 2nd quarter, yields rose by 9, 28, 43, and 59 bps for the 2, 5, 10, and 30–year sectors – with the majority of that rise coming in June. Monday's 14.5 bps rally (yield drop) in the 10–year kept that result from being that much worse. Into the 26th, rates were higher by 9.5, 18.5, 21.5, and 19.5 bps. That was all but checked last week and into today as yields fell 8.5, 12.5, 9, and 5.5 bps into July 2nd, and then 4, 7.5, 9.5, and 10.5 bps today (for the 2, 5, 10, and 30–year sectors).

The flight to (somewhat) quality over the past week and into today saw improvement to lower yields for the U.S., Switzerland, and stronger EU nations (Germany, Sweden, Netherlands). Though there were modest gains in the U.K. and France, Portugal, Italy, Greece, and Spain (previously referred to as P.I.G.S. from a debt standpoint) all saw yields rise to the high ends of recent data. 2–year Greek yields were in the low 20%–range a few weeks ago. They rose to over 50% today.

The $26 billion 2–year note auction that took place on June 23rd was rated average and brought .692% – the highest yield since December 2014. Demand was lower versus the May offering, though foreign buyers stepped up to take 52.6% versus a 42.3% allotment last month. On June 24th, the 5–year note auction was rated a '2 of 5' or 'soft'. The $35 billion supply brought 1.71% – also the highest since December. Demand was the weakest since March and foreign buying fell from 58.5% to 56.6%. June 25th's 7–year offering brought 2.153% for $29 billion notes. The auction was rated an above average '4 of 5', though demand was also the weakest since March. The yield was the highest since last September, and foreign buying rose from 53.8% in May to 56.6%.

This week, the U.S. Treasury will auction $24 billion 3–year notes on Tuesday (07/07), $21 billion 10–year notes on Wednesday, and $13 billion 30–year bonds on Thursday. MBS spreads (for FNMA 30–year 3.0%) pulled in 3 bps into the 26th, but widened by 1 bps last week.

07/02/15 Treasury Yield Curve	**2-Year: 0.629%**	**5-Year: 1.632%**	**10-Year: 2.383%**	**30-Year: 3.187%**
Weekly Yield Change:	–.085	–.123	–.091	–.054%
06/26/15 Treasury Yield Curve	**2-Year: 0.714%**	**5-Year: 1.755%**	**10-Year: 2.474%**	**30-Year: 3.241%**
Weekly Yield Change:	+.095	+.183	+.215	+.193%
Support:	0.62/ 0.66/ 0.70/ 0.72%	1.52/ 1.60/ 1.64/ 1.68%	2.27/ 2.31/ 2.36/ 2.40%	3.03/ 3.07/ 3.12/ 3.16%
Targets:	0.56/ 0.54/ 0.51/ 0.49%	1.48/ 1.45/ 1.42/ 1.39%	2.19/ 2.15/ 2.12/ 2.09%	2.98/ 2.94/ 2.90/ 2.05%

Economics

As we said in our short interim report last Thursday, the June employment report was soft. Though the economy added 223K jobs, 60K were removed from the last 2 months and the Labor Force Participation Rate fell from 62.90% to 62.60% – the lowest reading since October 1977. Americans exiting the labor force is not a healthy sign! Though the U.S. Unemployment Rate fell from 5.50% to 5.30% – the lowest since mid–2008, falling with dropping participants clouds the data. Private payrolls also added 223K jobs and Manufacturing grew by 4K. Another lack of strength was apparent from Average Hourly Wages holding unchanged. The annual pace slowed from a 2.30% increase to only 2.00%. Hours worked also remained unchanged at 34.5.

The Underemployment Rate fell .30% – from 10.80% to 10.50%, though that seemed a little inconsistent with the other data. The data supporting that drop was a falloff in the number of Americans working 'part time due to economic reasons' to the lowest since 2008. Earlier data showed Challenger Job Cuts rising 42.70% versus June 2014 and ADP Employment Change rising by 237K. The Fed's jobs dashboard (Labor Market Conditions Index Change) improved by .8, though May's reading dropped .4 (in a revision from 1.3 down to .9). Initial Jobless Claims rose 4K to 271K into June 20th, and then rose 281K into the 27th – marking a 16th and 17th week below the 300K threshold. Continuing Claims rose 24K to 2,249K, and then rose 15K to 2,264K. Vehicle Sales fell from 17.71M units to a 17.11M pace in June. Domestic sales fell from 13.95M units to a 13.34M pace.

1st–quarter U.S. GDP was adjusted a little higher to a still–negative .20% contraction. Personal Consumption rose 2.10% and the GDP Price Index was flat. Core PCE for the first quarter was .80%. Some of the May numbers for the economy were promising. Personal Income rose .50% and Personal Spending surged .90%! That was the largest gain in 6 years. 'Real' Personal Spending was set at a rise of .60%. May's Personal Consumption Deflator was .30%, leaving the annual pace at only .20%. Ex food & energy, PCE rose only .10%, but the annual pace was 1.20% – none of which is threatening to the Fed and is more likely a concern that inflation is failing to 'show up.' One concern was that May Durable Goods Orders fell by 1.80%, and April's were revised from a .50% drop to a 1.70% skid. Ex transportation, orders rose .50%, but were revised from a positive .50% to –.60% for April. Capital Goods Orders rose .40%, while April orders were revised from a 1.00% rise to a .70% drop! May Factory Orders fell 1.00%, but were .10% higher ex transportation.

The Service Sector outlook improved from 55.7 to 56 (ISM Non–Manufacturing Composite). Board Consumer Confidence rose from 94.6 to 101.4. University of Michigan Sentiment increased from 94.6 to 96.1. Their Current Conditions component rose from 106.8 to 108.9, while Expectations improved from 86.8 to 87.8. The ISM outlook for Manufacturing improved from 52.8 to 53.5, and Prices Paid was unchanged at 49.5. While ISM Milwaukee decreased from 47.7 to 46.55, others were modestly better. Chicago Purchasing Managers rose from 46.2 to 49.4 and ISM New York was 9.1 higher to 63.1. Richmond Fed Manufacturing gained 5 to 6, Kansas City rose from –13 to –9, and Dallas rose from –20.8 to –7.

The FHFA House Price Index rose .30% in April. New Home Sales for May were 2.25% higher to 546K units, but that was up 23.53% versus May 2014. Pending Home Sales rose .90% to a 9–year high, and were up 8.30% versus last year. The S&P/Case–Shiller 20 city index showed metro home prices rising .30% in April – but slowing .05% to a 4.91% annual pace. Their Home Price Index dropped .02% to a 4.23% pace. Construction Spending rose .80% in May.

Tuesday is set for the May Trade Balance (deficit), JOLTS Job Openings, and IBD/TIPP Economic Optimism. Wednesday brings MBA Mortgage Applications (up 1.60% and then off 4.70% over the last 2 weeks), May Consumer Credit, and the minutes from the Fed's June 16–17th meeting. Thursday gives us jobless claims data, and Bloomberg Consumer Comfort (which last week was 1.4 points higher to 44). Friday is set for May Wholesale Inventories & Trade Sales. Next Monday (07/13) brings the June Monthly Budget Statement. Tuesday follows with June Retail Sales, Import Prices, NFIB Small Business Optimism, and Business Inventories for May. Wednesday is set for Producer Prices (June PPI), Industrial Production & Capacity Utilization, and the Fed's Beige Book.

Equities

Stocks made highs into our end–of–June cycle, but turned down with a vengeance on our June 29th trend–change date. The Nasdaq, which had been the leader in this last rally, made all–time highs into the 24th. On June 29th, stocks suffered their worst losses since April 2014 – sending the Dow, S&P, and NYSE into negative territory for 2015. The Dow Transports fell to mid–October levels, off 11.59% for 2015. Of the indexes we watch the closest, only bank stocks and the Nasdaq were still ahead for the year. A number of foreign markets were also still higher for 2015, though well off their highs. Germany's DAX and Hong Kong were off their April highs by more than 10%. China's Shanghai Composite has fallen 27% since mid June – but is still 16.73% higher for the year after a bubble–like move! Even after stocks reversed May's usually downward seasonal trend with a rally, June's drop left most stock indices below May's start – and off for the 2nd quarter as well.

The Dow lost .38% into the 26th, and then dropped 1.21% or 216.57 points to 17,730.11 into July 2nd. The 3rd was a market close since the July 4th Independence Day holiday fell on Saturday. That marked the worst week for equities since March. The Dow was .26% lower today, but nothing like the 1.5 to 2% losses suffered by EU markets after Greek citizens said 'No' to further belt tightening. The S&P lost .40% and then 1.18% or 24.71 points last week to end at 2,076.78. It was .39% lower today. The Nasdaq lost .71% and then 1.40% or 71.29 points to close at 5,009.21 on July 2nd. It was .34% lower today. The Transports fell 2.01% and then another 1.46% last week. They were .54% lower today. Bank stocks gained .79%, lost 1.81% last week, and then fell .40% today.

Resistance:	Dow:	17,728/ 17,820/ 17,889/ 17,999	Nasdaq:	4,974/ 5,007/ 5,036/ 5,062	S&P: 2,073/ 2,084/ 2,096/ 2,107
Support:		17,462/ 17,394/ 17,330/ 17,264		4,904/ 4,886/ 4,868/ 4,851	2,049/ 2,039/ 2,027/ 2,016

Other Markets

Commodities gained 1.24% into June 26th, but then lost .15% into July 2nd. They plunged 2.98% today as Crude Oil dropped 7.73%. Crude had gained .03%, but then lost 4.53% over the last 2 weeks. We expect an important low for Crude Oil near July 28th. Gold had lost 2.38% and then another .80% into the 2nd, but rallied .83% today with worry over the strength of the European Union. The U.S. Dollar had gained 1.46% and then .67% over the past 2 weeks, and added .19% today. The Euro, in turn, lost 1.63% and .74%, and then dropped 25% today. The Japanese Yen lost .93%, gained .63%, and then added .41% today. Corn surged 8.99% and 9.03% over the past 2 weeks. It was off .30% today. Cotton gained 6.06%, lost 1.19% last week, and was .11% higher today.

"A mind troubled by doubt cannot focus on the course to victory." Arthur Golden

"If all the world's a stage, I want to operate the trap door." Paul Beatty

Additional Information is Available on Request

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