BOND MARKET REVIEW

July 15, 2015

Minions

The best laid plans for the Fed to increase rates and for the European Union (EU) to remain intact keep running into speed–bumps. Additionally, on the heels of last Monday's (07/06) shutdown of commodity floor trading, where we chalked up another advance for the machines – a technical 'glitch' shut down NYSE trading for nearly 4 hours just two days later on July 8th. It was the largest outage in nearly 2 years, and came as global markets were already plunging given a crash in Chinese stocks and huge insecurity over the Greek debt–crisis (as their citizens voted down further austerity measures). Though a cyber attack was ruled out, United Airlines had to ground all its planes and some major news sites went down. It's less comforting to know all that happened without a reason!

As of July 8th, the Hong Kong Hang Seng Index had completely reversed (lost) all of its 23.67% advance from December 19th, 2014 to its April 27th top. China's Shanghai Composite more than doubled that loss in less time by wiping out its March 13th, 2015 to June 12th surge of 53.52% in less than a month. However, even after losing a third of its value, the Shanghai was still up over 69% to last summer's lows – having gained over 160% since last May (2014). One would think Chinese investors were more nervous over a Greek EU exit than the French or Germans – as into last week's lows, their markets were off less than 15% versus their April highs. Contrast that to the U.K. which lost less than 10%, and the U.S. Dow and S&P which each corrected less than 5%. Nevertheless, stocks have rallied over the past week as Greece and the EU worked out each other's 'stay of execution.'

Since the last **B**ond **M**arket **R**eview, the Fed has released its minutes for the June 16th–17th meeting and their Beige Book report. While the Fed is trying to maintain a September target for raising rates, global and domestic economic news is not as supportive as they've expected. The Fed is banking on continued wage and job growth, and a pickup in GDP for the 2nd quarter. June payrolls grew, but accompanying data was less than stellar. Wage growth was stagnant and the labor force participation rate fell to its lowest since October 1977! Retail Sales dropped .30% in June and were revised lower for May. Those results were unexpected and question the strength of the U.S. economy in the 2nd quarter (following a nominal contraction for Q1 2015). 8 of the 13 major sectors of retail experienced declines in demand. Given the still–developing EU and International Monetary Fund (IMF) negotiations with Greece, and the lack of promising U.S. 2nd–quarter data, it's highly unlikely that the FOMC would begin rate hikes in 2 weeks with their July 29th policy statement. That still leaves September as the earliest potential for liftoff – though bond trader's expectations have been moving to later in the year. The Fed may not know by then whether or not some of the suspect and sluggish data for the 2nd quarter is merely transitory.

On Thursday, July 9th, the IMF again cut its forecast for global growth in 2015 – citing the Chinese market crash, weak Q1 U.S. growth, and the continuing EU–Greece saga. Global growth was downgraded from April's 3.5% forecast to 3.3%. Their U.S. growth forecast diminished from 3.1% to 2.5% – though they also referred to our setback as *"temporary."* They warned that risks to the global recovery are *"tilted to the downside."* The IMF has been contending the FOMC should delay raising rates until 2016. The Fed's Charles Evans (Chicago) is also calling for a delay until closer to the middle of 2016 based on weaker data, and Boston Fed Chief Eric Rosengren said they should wait to see *"how the crisis in Greece get resolved."* Fed Chair Janet Yellen simply said that *"every meeting is a live meeting"* and that *"it will be appropriate at some point later this year to take the first step"* to raise rates. She warned that delaying the liftoff might mean a faster pace of hikes when they begin, and that starting sooner could lead to *"a more gradual path."* We would say: What's the difference? If you're going to end up at the same place on some future vector, wouldn't it be better to first make sure conditions were indeed favorable for liftoff?

Looking Ahead

- We would sell rallies in bonds, as the cycles show yield highs near July 21st.
- The **BMR** stock cycles are positive into July 22nd.

Treasuries, Agencies, and MBS

The Fed's June minutes showed members generally believing the economy was moving toward conditions that would allow rate hikes to begin in 2015. They had expressed concern about Chinese markets and the Greek debt crisis, but those events have escalated since the meeting. The Fed's Beige Book once again stated that most districts had *"moderate"* or *"modest"* growth. The Fed also contended that any bond liquidity problems are insignificant. As of last Tuesday (July 8th) traders had pretty much ruled out a Fed rate increase for 2015. Greece reached a deal to stay in the Euro for now. It must be a good deal – because both sides hate it! The costs to the EU were going to be huge either way. Greek Prime Minister Alexis Tsipras won a bailout vote with Greek lawmakers, even though Greece's capitulation to the IMF and the EU are in opposition to his party's anti–austerity platform.

While Treasuries have seen a lot of movement over the past few weeks, the net change for last week was very small. Yields rose only 1, 2.5, 1.5, and .5 bps for the 2, 5, 10, and 30–year sectors. Into today, yields dropped 1, 3, 4.5, and 5 bps for those sectors. MBS spreads (for FNMA 30–year 3.0%) pulled in 2 bps last week. All of last week's major Treasury auctions were rated an average '3 of 5' by primary dealers. On Tuesday (07/07), the $24 billion supply of 3–year notes brought .932%. That was the lowest yield since April, and demand was the lowest since August 2014. At 47.7% of the issue, allocations to foreign buyer 3% less than last month. On Wednesday (07/08), the Treasury reopened the May 2025 10–year note to add $21 billion at 2.243%. There was slightly less demand than last month, though buying by foreign accounts rose from 57.9% in June to 58.1%. Thursday's (07/09) $13 billion 30–year bond auction came at 3.084%. Demand was down versus the June offering, and foreign buying fell from 52% to 51.1% this month. The next major Treasury auctions will be 2–year notes on Tuesday (07/28), 5–year notes on Wednesday (07/29), and 7–year notes on Thursday (07/30).

07/10/15 Treasury Yield Curve	**2-Year: 0.639%**	**5-Year: 1.657%**	**10-Year: 2.398%**	**30-Year: 3.190%**
Weekly Yield Change:	+.010	+.025	+.015	+.003%
Support:	0.68/ 0.70/ 0.72/ 0.75%	1.68/ 1.72/ 1.75/ 1.79%	2.39/ 2.43/ 2.46/ 2.50%	3.17/ 3.22/ 3.26/ 3.31%
Targets:	0.60/ 0.57/ 0.54/ 0.51%	1.62/ 1.57/ 1.54/ 1.50%	2.34/ 2.30/ 2.26/ 2.22%	3.10/ 3.06/ 3.01/ 2.97%

Economics

The May Trade Balance deficit rose $1.27 billion to $41.87 billion. Initial Jobless Claims rose 17K to 297K – near the highs for the last few months. Continuing Claims increased from 2,265K to 2,334K. JOLTS Job Openings for May had expanded from 5,334K to 5,363K. June Industrial Production rose .30% and Capacity Utilization was .20% higher to 78.40%. NFIB Small Business Optimism fell from 98.3 to 94.1. IBD/TIPP Economic Optimism was flat at 48.1. May Wholesale Inventories rose .80%, and Trade Sales rose .30%. Strong tax receipts led to a $51.8 billion Treasury Budget surplus in June. The fiscal 2015 deficit is now running 14.2% below last year. Retail Sales fell .30% in June and were adjusted .20% lower to a lesser 1% gain for May. The 'control group' was .10% lower. May Consumer Credit had grown by $16.086 billion. June Import Prices fell .10%, dropping the annual pace .40% to negative 10%! Business Inventories rose .30%. Producer Prices rose .40%, and .30% ex food & energy. The annual pace was .40% higher to a still–negative .70%, while the annual core rate rose .20% to a positive .80%. Empire Manufacturing improved from –1.98 to +3.86.

Thursday is set for jobless claims data, Bloomberg Consumer Comfort (down .5 to 43.5 last week), Bloomberg Economic Expectations, the Philadelphia Fed Business Outlook, home–builder outlook (the NAHB Housing Market Index), and foreign Treasury transactions (TIC Flows). Friday brings Housing Starts and Building Permits for June, Consumer Prices (CPI), and University of Michigan surveys on Sentiment and Expectations. The data for Monday and Tuesday is very light. Next Wednesday (07/22) gives us MBA Mortgage Applications (up 4.6% and then off 1.90% over the last 2 weeks), the FHFA House Price Index for May, and Existing Home Sales for June.

Equities

Stocks rallied on the 10th – still finishing the week only mixed, but got a big kick with our July 13th trend–change to the upside. The Dow rose 30.30 points or .17% to 17,760.41, and is 1.63% higher this week. The S&P lost .01% or .16 points to 2,076.62, but is 1.48% better this week. The Nasdaq lost 11.52 points or .23% to 4,997.70, but has surged 2.03% so far this week. The Dow Transports had gained .97%, and tacked on .28% through today. Bank stocks fell .76%, but have improved 2.85% this week. Our stock cycles are positive into July 22nd.

Resistance:	Dow:	18,128/ 18,188/ 18,262/ 18,330	Nasdaq:	5,161/ 5,197/ 5,233/ 5,269	S&P:	2,126/ 2,137/ 2,148/ 2,160
Support:		17,994/ 17,928/ 17,793/ 17,659		5,125/ 5,089/ 5,053/ 5,006		2,102/ 2,093/ 2,080/ 2,068

Other Markets

Commodities dropped 2.81% last week, and then .75% more into today. Crude Oil lost 7.36%, and another 2.52% this week. Gold lost .48% and then .91%. The U.S. Dollar lost .12%, but is 1.15% higher this week. The Japanese Yen gained .24%, but is .80% lower this week. The Euro gained .70%, but has plunged 1.90% this week. Corn gained 1.79%, and is .53% higher this week. Cotton lost 1.28%, and was .29% lower into today.

"My bed is a magical place where I suddenly remember everything I was supposed to do!"

Additional Information is Available on Request

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