BOND MARKET REVIEW

August 13, 2015

Pachydermal Infusion

Traction and momentum are things not accomplished by modest or moderate growth, but the Fed is still signaling a September liftoff for rates. The economy added 215K jobs in July, leaving the Unemployment Rate at 5.30%. FRB Vice Chairman Stanley Fischer said the economy was near full employment with that sector rising *"pretty fast"*, and indicated that inflation was *"very low."* Atlanta's Dennis Lockhart said 5.3% was *"just a little above"* what is considered full employment, and maintained that *"the point of liftoff is very close."* However, the **B**ond **M**arket **R**eview sees more than one elephant in the room! We understand the optimism of the glass is half full, but to say it is indeed full – when it can't be – is to us a mix of uber–optimism and denial. Yes – things are better, and maybe the Fed will hike in September, but weaker oil threatens our economy and the Labor Force Participation Rate is at a 38–year low of 62.60%. We added 215K jobs, but 144K left the workforce – leaving those not in the workforce at a staggering record 93,770,000 Americans! The July statistic for teens not in the workforce was 41.3% – the worst in the post–WWII era. A record 56,209,000 women are not in the labor force. Food banks are struggling to meet demand, and a just–released census shows 42.1 million immigrants now in the U.S. The unspoken dilemma is the burden added to those that are working given the increase in non–participants. Thriving economies and healthy employment are evidenced by inflation running above 2%, wage growth, and full time rather than part time jobs.

July's budget deficit was $149.2 billion, leaving the annual deficit for fiscal 2015 (10 months in) at $428 billion versus $460.5 billion last year. While we're watching for elephants, how has the Federal debt ceiling mysteriously been frozen near $18.113 trillion for 150 days – while the government continues to run a deficit?

Looking Ahead

- Bond cycles are mixed. We would continue to sell rallies, as a yield high is due near August 18th.
- Stocks should get a bounce from a trend–change low due near August 17th.

Treasuries, Agencies, and MBS

Concern that Chinese growth was slowing given recent data and the largest devaluation of their currency in 2 decades led to increased volatility earlier this week. Today it was reported that German growth was less than forecast and France was stagnant with limited consumer spending. Crude oil slid to 6–year lows causing renewed deflation and growth concerns. Emerging–market stocks entered a bear market. With stocks diving yesterday morning – sending the Dow to its second lowest level of 2015, bonds got a boost. On Wednesday, yields fell to their lowest levels since early May, but the cycles show they should begin to rise into August 18th. The U.S. Treasury curve flattened for a 4th week into Friday, August 7th, as yields rose 5.5 and 4 bps at 2 and 5–years, but fell 2 and 9 bps at 10 and 30–years. Despite Wednesday's drop, that trend is reversing a bit this week with yields lower by 1 bps at 2–years, flat at 5–years, and higher by 2.5 and 3.5 bps at 10 and 30–years. U.S. bonds have enjoyed demand this year from higher spreads versus global alternatives, and as a continued safety haven during each global scare. It's estimated that between March 2014 and May 2015 that China reduced Treasury holdings by $180 billion, but Treasuries have fared well. Over that period, 5–year yields have been fairly stable, while longer–maturity yields are appreciably lower.

Earlier this week, Greece reached a new bailout agreement with the European Central Bank that would keep them from defaulting on payments due August 20th, and preserve their place within the common currency EU (for now). That's served to stabilize EU–nation yields – some of which have fallen nearly 50% from their highs over the past 3 months (Germany, Greece, Sweden). Swiss 10–year yields peaked at .199% and have fallen to –.23%. Japanese yields fell from .525% to .347%, while the U.S. 10–year, once again a bargain, retreated from 2.48% to 2.12%.

MBS spreads (for FNMA 30–year 3.0%) widened by 3 bps last week. Auctions this week were rated average for the 3–year note, and a below average '2 of 5' for yesterday's 10–year note and today's 30–year bond. On Tuesday, the Treasury sold $24 billion 3–year notes at 1.013%. Demand was actually the best since August 2014. Foreign accounts took 52.8% of the issue versus 47.7% in July. Yesterday's $24 billion 10–year note brought 2.115% with the weakest demand since March 2009! Foreign buyers accounted for 60.1% versus 58.1% last month. Today, the Treasury sold $16 billion 30–year bonds at 2.868%, the lowest auction yield since April. Demand improved to the last sale, and foreign accounts bought 51.9% of the issue versus 51.1% last month.

08/07/15 Treasury Yield Curve	2-Year: 0.719%	5-Year: 1.572%	10-Year: 2.163%	30-Year: 2.819%
Weekly Yield Change:	+.056	+.042	–.018	–.088%
Support:	0.73/ 0.75/ 0.78/ 0.80%	1.62/ 1.65/ 1.67/ 1.70%	2.24/ 2.28/ 2.32/ 2.36%	2.91/ 2.95/ 3.00/ 3.04%
Targets:	0.69/ 0.67/ 0.63/ 0.59%	1.56/ 1.54/ 1.50/ 1.47%	2.17/ 2.13/ 2.10/ 2.07%	2.83/ 2.79/ 2.75/ 2.71%

Economics

Challenger Job Cuts jumped sharply in July as there were 125.40% more announced layoffs than in July of 2014. The data deals with cuts that are released even if they will take place over a given time. While computer and electronic makers said there would be nearly 19K cuts, the Army projected a 57K reduction over the next 2 years – bringing the overall total to 105,696. Initial Jobless Claims rose 2K to 269K last week, but in doing so remained tame – and near the lower end of recent data. They were 5K higher to 274K this week. Continuing Claims fell 11K to 2,258K, and then rose 15K to 2,273K with today's release. The economy added 215K jobs in July. While that was about 10K below expectations, 14K jobs were added in revisions for the past 2 months. Private payrolls grew by 210K and manufacturing added 15K. The U.S. Unemployment Rate remained at 5.30%, even as the Labor Force participation rate matched a 38–year low of 62.60% with nearly 94 million Americans not in the labor force! That number has risen steadily over the past few years. Average Hourly Earnings rose .20% and the annual pace increased from 2.00% to 2.10%. Average Weekly Hours grew from 34.5 to 34.6. The Underemployment Rate fell from 10.50% to 10.40%. JOLTS Job Openings decreased from 5.357M in May to 5.249M in June. The data was 'Fed friendly' as their labor dashboard (LMCI) improved 1.1 points. NFIB Small Business Optimism improved from 94.1 to 95.4. Nonfarm Productivity rose only 1.30% in 2Q 2015 while Unit Labor Costs rose by .50%.

Bloomberg Consumer Comfort dropped .2 to 40.3 last week, but rose to 40.7 today. 2Q 2015 MBA Mortgage Foreclosures slowed to 2.09% from 2.22%, and Mortgage Delinquencies were .24% less at 5.30%. Retail Sales rose a strong .60% in July and were revised from a .30% loss to flat for June. The control group rose .30%. Import Prices fell .90% in July dropping the annual pace .50% to –10.40%. Consumer Credit rose $20.74 billion in July. Wholesale Inventories rose .90% in June, while Trade Sales were up only .10%. Friday is set for Producer Prices (July PPI), Industrial Production, Capacity Utilization, and the University of Michigan Sentiment surveys. Next Monday (08/17) brings Empire Manufacturing, the home–builder outlook for August (NAHB Housing Market Index), and TIC flows (net foreign transactions of U.S. Treasuries). Tuesday follows with July Housing Starts and Building Permits. Wednesday brings MBA Mortgage Applications (which rose .10% last week), Consumer Prices (July CPI), wage data, and the minutes from the July 28th/29th FOMC meeting.

Equities

Emerging market stocks entered a bear market, and the Dow hit its second lowest level for 2015 earlier this week as stocks turned down from our August 5th/6th trend change. Today, the Russell 2000 closed as its lowest level since early February – a sign that the broader market of stocks is weakening. The Dow's 7–day slide into Friday (08/07) was its longest since 2011. Stocks should make a low near the 17th, rebound into August 21st/24th, and then fall into a more important trading low in early September. Last week, the Dow tumbled 316.48 points or 1.79% to 17,373.38. The S&P had its best advance in 3 months on Monday. The Dow gained 241.79 points on Monday, plunged over 500 points into Wednesday's lows, and then recovered for a slight .20% gain for this week. The S&P lost 26.27 points or 1.25% to 2,077.57 last Friday, but is .28% higher this week. The Nasdaq lost 1.65% or 84.74 points to 5,043.54, and is off .20% this week. The Dow Transports lost 1.68%, but are .18% higher this week. Bank stocks fell .13%, and have weakened another .95% since Friday.

Resistance:	Dow:	17,492/ 17,627/ 17,756/ 17,896	Nasdaq:	5,051/ 5,096/ 5,124/ 5,161	S&P:	2,093/ 2,104/ 2,114/ 2,127
Support:		17,363/ 17,232/ 17,130/ 16,969		5,017/ 4,981/ 4,947/ 4,912		2,081/ 2,069/ 2,058/ 2,047

Other Markets

Crude Oil sank to a new 6–year low this week, placing further pressure on commodities which have fallen for the last 6 weeks – along with crude. Both are keeping inflation well below Fed targets and signaling potential deflation dangers to EU economies. Commodities lost 2.10%, and were .25% lower into today (hitting 13–year lows) as Crude Oil plunged 6.90% last week and is 3.74% lower this week. Gold fell .07%, but is 1.97% higher this week. The U.S. Dollar gained .18%, but is 1.19% lower this week. The Euro had lost .15%, but is 1.67% higher this week. The ECB and Greece finally agreed on bailout terms. The Japanese Yen lost .28% last week, and is off .15% this week. Corn gained .47%, breaking a 3–week slide, but is 2.41% lower this week. Cotton lost 1.94%, but is surging 6.98% higher this week.

"Management is doing things right; leadership is doing the right things." Peter Drucker

Additional Information is Available on Request

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