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BOND MARKET REVIEW

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A September Liftoff Fades and Stocks have an Early Fall

Last week, we were making the case that the Fed might be jumping the gun with a September hike. Our opinions are no doubt swayed by our cycle work, but we do like to look at all available data in order to remain objective on Fed policy and our economic outlook. Housing is showing some good recovery signs and the unemployment rate is near an accepted level for full employment. Those factors taken alone would mean the Fed could hike with confidence. However, the **B**ond **M**arket **R**eview sees labor force participation at a 38–year low, commodities plunging to new 13–year lows, and crude oil hitting new 6–year lows as news worthy of scrutiny by Fed watchers.

While most Fed members have been apologists for FOMC policy, a few have said that the committee should wait until inflation begins to approach their goals. Central banks have much better tools to battle inflation than they do for deflation. In fact, they fear deflation, and the latest data on energy and commodity prices are ringing out their warnings. Cullen Hightower once quipped: *"Those who agree with us may not be right, but we admire their astuteness!"* Thus, we enjoyed reading the findings of St. Louis Fed vice president Stephen D. Williamson. He wrote: *"There is no work, to my knowledge, that establishes a link from QE to the ultimate goals of the Fed – inflation and real economic activity. Indeed, casual evidence suggests that QE has been ineffective in increasing inflation."* He noted world economies still battling very–low inflation (or deflation) and said: "*For example, in spite of massive central bank asset purchases in the U.S., the Fed is currently falling short of its 2% inflation target."* He also made the oft–stated **BMR** case that the primary benefactor of QE was the stock market – which has tripled since 2009. We've questioned the economic and inflation–targeting merits of QE many times.

Bond traders and global markets are agreeing with the **BMR** in thinking that the global economy may be souring, and the Fed may wait until later in the year to hike rates. U.S debt is pricing inflation out of the equation, and indicating that tightening would be ill timed at present. The FOMC minutes from the July meeting suggested that labor conditions were very nearly satisfied, but that there was risk from *"downward pressure on inflation."* Although contending they were approaching the point, the Fed minutes said most participants *"judged that the conditions for policy firming had not yet been achieved."* Last week, we noted that emerging markets had entered bear markets. Though not yet joining them, the Dow is 7.41% or 1,360 points off its May 19th peak of 18,351, closing today at 16,990.69 – under 17,000 for the first time since October. After 28 trading days over 5,000, the Nasdaq just closed below that level as today marked the worst rout for the Dow and S&P since February 2014. Today's low makes 13 weeks of correction to the May top. Since October 2011, the moves to corrective lows all happened within 6 or 7 weeks – and were all followed by new highs. It's obvious the overall tone has changed.

Besides domestic concerns, China is experiencing stock market woes (Hong Kong down 21.61% since April and Shanghai 31% lower since June) and a gauge of their manufacturing just fell to a 6–year low. Greek Prime Minister Alexis Tsipras announced he would step down and seek more coalition votes in a forced reelection, on the heels of Greece finally securing a bailout that allowed them to stay in the EU (and reopen banks). North Korea entered a new round of saber rattling, and another side effect of the unpopular deal with Iran would be that they might flood an already–plunging crude oil market with even more supply to add to the glut. What if a recession is looming?

Looking Ahead

- Bond cycles show yields turning down into lows near August 27th and September 2nd.
- Stock cycles are mixed, with a tradable low due in early September.

Treasuries, Agencies, and MBS

If yields are dropping, it's unlikely traders are buying 'good news!' Before the Fed minutes were released, the market's implied bet on a September hike were 48% (nearly a toss–up). They fell to 38% post–release, and to only 32% today – following further stock market deterioration and additional weakness in the U.S. dollar, commodities, and crude oil. Last week, rates rose by .5, 2.5, 3.5, and 2.5 bps for the 2, 5, 10, and 30–year U.S. Treasury sectors. Into today, reacting to the Fed minutes and plunging global equities, yields for those sectors dropped by 7, 13, 13, and 10 bps – pressing rates back to late April levels. MBS spreads (for FNMA 30–year 3.0%) widened by 3 bps again the week of the 14th. Next week, the U.S. Treasury will auction $26 billion 2–year notes on Tuesday (08/25), $35 billion 5–year notes on Wednesday (08/26), and $29 billion 7–year notes on Thursday (08/27).

8/14/15 Treasury Yield Curve	2-Year: 0.724%	5-Year: 1.598%	10-Year: 2.199%	30-Year: 2.842%
Weekly Yield Change:	+.005	+.026	+.036	+.023%
Support:	0.67/ 0.69/ 0.73/ 0.76%	1.49/ 1.52/ 1.55/ 1.58%	2.13/ 2.16/ 2.19/ 2.22%	2.79/ 2.82/ 2.87/ 2.91%
Targets:	0.64/ 0.62/ 0.60/ 0.58%	1.46/ 1.43/ 1.40/ 1.37%	2.05/ 2.01/ 1.98/ 1.94%	2.75/ 2.71/ 2.65/ 2.63%

- Note: The yield curve for 8/7/2015 was misdated as 7/31/2015 in last week's **BMR**. However, the data was correct.

Economics

Initial Jobless Claims rose 4K to 277K, still very low (and consistently so). Continuing Claims fell from 2,278K to 2,254K. After 2 months of .60% gains, the Leading Index (LEI) fell .20% in July. Producer Prices rose .20% in July. Ex food & energy, they were .30% higher. The annual pace nevertheless fell .10% to a negative .80%, and the annual core rate dropped from .80% to a modest .60% rise. Inflation is very much under–running Fed goals as Consumer Prices rose only .10% in July, leaving CPI only .20% higher annually. Ex food & energy, CPI also rose only .10%, leaving the core rate unchanged at 1.80% (still .20% under the Fed's 2% target). After falling for 4 weeks, Bloomberg Consumer Comfort rose .4 to 41.1. Bloomberg Economic Expectations were .5 better to 46. The Philadelphia Fed Business Outlook rose from 5.7 to 8.3, though Empire Manufacturing dropped from 3.86 to a negative 14.92. University of Michigan Sentiment dropped a slight .2 to 92.9. Current Conditions fell .1 to 107.1 and Expectations dropped .3 to 83.8. Industrial Production rose .60% on the strength of auto production. Capacity Utilization improved .3% to 78.00% (back to April's level).

Home–builder outlook (NAHB Housing Market Index) rose 1 point to a very–solid 61. July Existing Home Sales rose 2.01% to 5.59M units. That was up 7.75% to July 2014. Housing Starts rose .17% to 1,206K, and were 7.97% higher versus last year. That was the highest level in nearly 8 years. Building Permits fell 16.31% to 1,119K, but were still 5.87% higher versus last July. Long–term foreign investment in U.S. Treasuries increased by $103.1 billion in June, with a net inflow of $69.9 billion overall. Japan reduced holdings by $17.8 billion in June, dropping below $1.2 trillion for the first time since 2013.

Next Monday (08/24) gives us the Chicago Fed National Activity Index. Tuesday follows with the FHFA House Price Index, the House Price Purchase Index, S&P/Case–Shiller home price data, July New Home Sales, Richmond Fed Manufacturing, and board Consumer Confidence. Wednesday's data includes MBA Mortgage Applications (which last week rose 3.60%), and July data for Capital and Durable Goods Orders.

Equities

Stocks continue to exhibit less strength on rallies than earlier this year, and certainly for the past few years. Today's lows plunged through important technical levels. The cycles allow for stocks to *"rebound into August 21st/24th, and then fall into a more important trading low in early September."* Into last Wednesday's low (08/12), stocks had their largest intraday turnaround in 3 years. Those levels were taken out with conviction today. Last week, the Dow rose 104.02 points or .60% to 17,477.40. It's down 2.78% this week. The S&P added 13.97 points or .67% into the 14th to close at 2,091.54, but it's 2.67% lower since Friday. The Nasdaq gained 4.69 points or .09% to 5,048.24, but is 3.38% lower this week. The Transports gained .82%, but are now 2.72% lower, while bank stocks rose .03%, and then fell 3.73% so far this week.

Resistance:	Dow:	17,015/ 17,148/ 17,282/ 17,409	Nasdaq:	4,948/ 5,017/ 5,088/ 5,161	S&P:	2,037/ 2,048/ 2,059/ 2,080
Support:		16,757/ 16,629/ 16,499/ 16,372		4,739/ 4,670/ 4,604/ 4,535		2,003/ 1,992/ 1,981/ 1,970

Other Markets

As covered earlier, Crude Oil made new 6–year lows today and Commodities hit new 13–year lows. One clear sign of a heating economy is price inflation. These markets and the CPI/PPI data are illustrative of very low inflation and the possibility of renewed deflation. The Fed hike seemed to be 'priced in' for September, but recent data and the Fed minutes released on Wednesday very much called that first liftoff date into question. Commodities lost .18% last week and are 1.67% lower this week. Crude Oil fell 3.12% for its 7th weekly loss – and is headed for another, off 3.20% so far this week. Gold rallied 1.72%, and then another 3.60% this week given the global market turmoil. The Dollar had been rising on prospects of rising U.S. rates. It lost 1.11% last week and is .55% lower this week. The Japanese Yen fell .06% last week, but is .73% better this week. The Euro surged 1.29%, and is 1.20% higher this week. Corn lost 2.35%, but is 1.92% higher this week. Cotton surged 6.99%, and was .74% higher into today. Soybeans hit 5–year lows – adding to the global commodity price drops!

"Democracy consists of choosing your dictators, after they've told you what you think it is you want to hear."
Alan Corenk

Additional Information is Available on Request
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