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BOND MARKET REVIEW

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No Escape

What's the Fed to do? The FOMC got overly 'invested' in the success of their policies, and set market expectations for a September liftoff. While transparency has its pluses, inflation and global equity markets decided to show up with their minuses. Last week, the **B**ond **M**arket **R**eview surmised that bond traders were telling the markets a Fed move could be premature – and that a 2015 hike could possibly even lead to a reversal, with a subsequent cut back to the current near–zero levels. Before the Fed minutes were released, traders had the odds of a September rate hike at 48%. They fell to 38% post minutes, to 34% on Friday (08/21), and to 26% this week. Even the odds for an October liftoff have been reduced to less than 30%. Since China surprised markets with a devaluation of their Yuan on August 11th, global equities have lost more than $5 trillion in market value. Recall that in 2012 Japan began to devalue their Yen in an effort to accelerate exports. With their manufacturing output falling to the lowest levels since 2009, China is trying to employ a similar strategy.

Earlier this week FRB Atlanta President Dennis Lockhart said he still expects a hike or *"normalization of monetary policy"* to kickoff sometime in 2015. As if central bank policy itself played no role in global asset bubbles, he said: *"Currently, developments such as the appreciation of the dollar, the devaluation of the Chinese currency, and the further decline of oil prices are complicating factors in predicting the pace of growth."* While it's convenient and possibly expedient to blame the global rout on China, U.S. markets had been higher following the Yuan devaluation, and succumbed to selling pressures after the release of July's FOMC minutes. They did little to instill confidence! We think China's policy moves and slow growth represent only a few of the many falling dominoes in the global system. China's stocks just had their worst 5–day selloff since 1996, despite a rate cut by their central bank intended to check the fall. Today, Hong Kong fell to 26.17% off its late–May high. The Shanghai Composite is now 44.95% off its June high. The 70% rally that began in February was totally wiped out in only 2.5 months!

Markets are also highly concerned with Fed policy, weak growth, wage stagnation, EU bailouts, crashing oil prices, and plunging commodities. Last week, commodities hit 13–year lows. This week, they fell to 16–year lows as Brent crude fell below $45/barrel for the first time since 2009. As we said last week, central banks fear deflation as they have fewer tools to fight that foe. They especially distress over the potential for a deflationary spiral – where prices 'get away' to the downside. When the Fed was exercising great optimism about current conditions being favorable for a September liftoff, the markets liked it. When the Fed's minutes revealed uncertainty, that coupled with China's faltering production and Yuan devaluation led to one of those tipping points where everything finally piles on. Over the past few years, every equity pullback was rather tame – and was followed by an unchecked march to new highs. Not this time! We've always loved 'Fed speak'. Compare our earlier use of Fed optimism to FRB NY President William C. Dudley's comments. He said: *"From my perspective, at this moment, the decision to begin the normalization process at the September FOMC meeting seems less compelling to me than it was a few weeks ago."*

The good news was that today's stock market rally was the largest since 2011. The S&P rallied 3.90%, the Dow 3.95%, and the Nasdaq 4.24%! However, that followed the worst meltdown for global equities in nearly 4 years marked by a 6–day plunge that sent U.S. indexes into a correction (defined as more than 10%) for the first time since 2011. Four years without a correction is very rare, and some would say more than overdue. Despite today's surge, which saw the Dow rise 619 points, the Industrials were still 7.30% below the peak made last Tuesday – the day before the Fed minutes from the July meeting were released. The S&P was still 7.75% below that peak and the Nasdaq was 7.62%. Those indexes had been 12.51%, 11.24%, and 15.59% lower in just 6 days! To their record highs, all made over the past few months, the Dow had corrected by 16.24%, the S&P 12.54%, and the Nasdaq 17.96%. The Dow wiped out all its gains since February 2014, while the S&P and Nasdaq traded back to their late–October levels. Germany's DAX fell into a bear market (20% selloff). Stocks have been 'less compelling' as well.

Looking Ahead

- Bond cycles show yields turning higher after another low due near September 2nd.
- Stock cycles continue to indicate a tradable low due around September 2nd/3rd.

Treasuries, Agencies, and MBS

The Dow fell 1,089 points just after the opening bell on Monday in panic selling. It 'roared back' to lose 'only' 588 points that day. Even though the S&P closed back near Monday's lows on Tuesday, some order returned to the markets. U.S. 10–year yields fell from 2.05% on Friday to just above 1.90% during Monday's stock–market panic. By today, they were 28 bps higher to 2.18%! As the global rout in equities was setting in last week, and it became unlikely the Fed would hike in September, yields fell 11, 17, 16, and 12 bps for 2, 5, 10, and 30–year Treasuries.

Though much lower Monday morning, by today those sector yields were 6, 5.5, 14, and 21 bps higher for the week! Tuesday's 2–year note auction was rated average with $26 billion coming at .663%. Demand was off to last month. The yield was very close to the .675% 5–year note that was dated August 31, 2012, and the Treasury opted to reopen that note to add this supply. Foreign buyers took 47.1% versus 54.4% in July. Today's 5–year note auction was rated below average. $35 billion came at 1.463%, and demand was the lowest since July 2009! Foreign buying fell to 50.1% of the issue versus 67.5% in July. $29 billion 7–year notes will auction on Thursday (08/27).

8/21/15 Treasury Yield Curve	**2-Year: 0.615%**	**5-Year: 1.428%**	**10-Year: 2.037%**	**30-Year: 2.724%**
Weekly Yield Change:	–.109	–.170	–.162	–.118%
Support:	0.72/ 0.75/ 0.78/ 0.81%	1.54/ 1.58/ 1.61/ 1.67%	2.20/ 2.24/ 2.28/ 2.31%	2.95/ 3.00/ 3.04/ 3.09%
Targets:	0.67/ 0.65/ 0.62/ 0.59%	1.49/ 1.43/ 1.37/ 1.31%	2.17/ 2.13/ 2.10/ 2.06%	2.91/ 2.87/ 2.83/ 2.77%

Economics

The Consumer Confidence Index rose from 91 to 101.5 with gains coming from improving expectations. Of course, some data sets lag more than others, and the data was sampled before the global markets plunged hard from the end of last week into yesterday. The jobs–available measure was the strongest since 2008. While expected to fall, Durable Goods Orders rose 2.00% in July. They were also revised and adjusted .70% higher to 4.10% for June. Ex Transportation, orders rose .60%. Orders for Capital Goods in July rose 2.20% – the most in a year. They were also revised .50% higher to 1.40% for June. The Chicago Fed National Activity Index rose from –.07 to .34, and the Richmond Fed Manufacturing Index fell from 13 to 0.

Though the FHFA House Price Index rose .20% in June, according to S&P/Case–Shiller data metro home prices fell .12% – slightly slowing the annual gain from 4.99% to 4.97%. Their Home Price Index overall showed a .09% gain, slightly raising the annual gain from 4.43% to 4.49%. New Home Sales rose 5.41% to 507K, the most this year. That was a rise of 18.74% versus July last year, while the June data of 481K represented a 7–month low.

Thursday is set for a 2Q GDP update, Personal Consumption, jobless claims data, and July Pending Home Sales. Friday gives us July Personal Income & Spending, Personal Consumption, and University of Michigan Confidence data. Monday (08/31) closes out August data with regional Fed reports (Milwaukee, Chicago, and Dallas). Tuesday kicks of September with July Construction Spending, Economic Optimism, ISM Manufacturing, and July Vehicle Sales. Wednesday's data includes Factory Orders, MBA Mortgage Applications (up .20% last week), ISM New York, the Fed's Beige Book, Nonfarm Productivity and Unit Labor Costs, and ADP Employment Change for August. That will be the first glimpse into the August payroll numbers, though jobless claims are running very low.

Equities

Stocks have demonstrated tremendous volatility and swings over the past 2 weeks. Despite the best rally in 4 years today, the Dow, S&P, and Nasdaq were still off 1.06%, 1.54%, and .18% for the week! Last week, the Dow lost 1,017.65 points or 5.82% to 16,459.75. The S&P fell 120.65 points or 5.77% to 1,970.89, and the Nasdaq plunged 342.20 points or 6.78% to 4,706.04. The Transports lost 5.37%, and are 2.41% lower this week. Bank stocks lost 6.71% and are 2.92% lower since Friday. The cycles still point to a low near September 2nd or 3rd. If the Chinese Yuan had been awarded reserve–currency status, it would probably have meant roughly $1 trillion of injections into Chinese stocks. With the IMF delaying that decision on the Yuan for a year, their markets may have 'run out' of expected buyers – an important contributing factor to the global–equity rout.

	Dow:	Nasdaq:	S&P:
Resistance:	16,616/ 16,867/ 17,127/ 17,391	4,807/ 4,879/ 4,949/ 5,019	2,002/ 2,025/ 2,048/ 2,070
Support:	16,355/ 16,099/ 15,853/ 15,649	4,740/ 4,671/ 4,603/ 4,536	1,959/ 1,936/ 1,915/ 1,892

Other Markets

Crude Oil fell for an 8th week, losing 4.82%. It's off 4.57% this week. Commodities joined them with an 8th loss of 3.35%, and are headed for a 9th – down 3.17% this week. Gold gained 4.20%, but is 3.02% lower this week. The U.S. Dollar lost 1.58%, but is .13% better this week. The Japanese Yen surged 1.83%, and is 1.74% higher this week. The Euro added a stout 2.49%, but is .63% lower this week. Corn gained .34% last week, but is .96% lower since Friday. Cotton rose .71%, but has tumbled 7.51% this week.

"Become a student of change. It is the only thing that will remain constant." Anthony J. D'Angelo

Additional Information is Available on Request

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