K N O W L E D G E D R I V I N G C O M P E T I T I V E A D V A N T A G E
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BOND MARKET REVIEW

September 23, 2015

Chicken Hawks

While Generation–Y grew up with Barney the purple dinosaur, the 'more seasoned' of us and the Gen–Xers grew up in an era where cartoon characters routinely clobbered each other. (That's probably why some didn't exactly wish Barney well.) One of the **BMR** favorites was a rooster with a John Wayne demeanor. The crusty ole chicken was named Foghorn Leghorn, and was pestered by a vastly undersized chicken hawk named Henery that was determined to have chicken dinner. After all, size aside – it was his nature, being a chicken hawk! However, in each of the Warner Brothers cartoons, ole Foghorn managed to convince the young chicken hawk that another critter other than himself was a chicken worthy of the grill. That role often fell to the neighborhood dog, which was Foghorn's real adversary. I can hear him now, as he in his gruff manner attempted to teach the young chicken hawk the ropes. *"Now son, I say son … I'm not a chicken – that's a chicken!"* It pleased Foghorn to no end to see Henery aggravate the dog.

In the bond world, hawks want to raise rates or tighten monetary policy – while doves want to be accommodative, providing necessary stimulus. Hawks are aggressive, and doves are cautious. Doves want to make sure the evidence clearly supports a hike. While the FOMC voted 9 to 1 in favor of standing pat on rates, and surrounded the statement with dovish comments, the hawks chose to ruffle some feathers this week. Despite that vote – which no doubt was intended to show support for Fed Chair Janet Yellen, since that meeting, a few hawks decided to voice their opinions.

For the meeting, Richmond Fed President Jeffrey Lacker was the lone voice of dissent. On Saturday, Lacker said: *"An increase in our interest rate target is needed, given current economic conditions and the medium–term outlook."* He argued: *"Further delay would be a departure from a pattern of behavior that has served us well in the past. The historical record strongly suggests that such departures are risky and raise the likelihood of adverse outcomes."* He said that failing to raise the rate ignores the improvements made over the last 6 years.

While St. Louis Fed President James Bullard is not voting this year, he said he pushed for a hike. Bullard said: *"The case for policy normalization is quite strong, since Committee objectives have essentially been met."* He said: *"I argued against the decision at the FOMC meeting."* While we don't know if he'd have supported Yellen if he had a vote, the **B**ond **M**arket **R**eview made the case last week that the 5.1% jobless rate indicating full employment might be a tad understated – and provided Fed research opinions supporting that view. The other objective would be the inflation target – which is not above the Fed's long run 2% goal. So, we're suspect of either being *"met"*, much less both! Though the vote was 9 to 1, FRB San Francisco's John Williams said: *"It was a close call in my mind, in part reflecting the conflicting signals we're getting."* He said he expects the economy to reach full employment by the end of this year or in 2016, and that he expected inflation to their 2% goal *"in the next two years"*, so he also sounds a bit unconvinced that either of the objectives have been met! Recall that the original wording was that the FOMC didn't want to see projections that were more than .5% above that longer–run goal (or 2.5% which seems very remote).

It's clear to the **BMR** that investors don't believe the Fed's inflation objectives are being met! This week's auction of floating–rate Treasuries drew the least demand on record! That happened despite the limited supply of Treasury bills. As for the global 'vote' – after having 'surged' to nearly .15%, the yield on Germany's 5–year note just fell back into negative territory for the first time in a month. EU inflation is nearly non–existent, also nowhere near their target – which is just under 2%. As we said, the FOMC goal is 2%, but no more than 2.5% per earlier statements.

"The future ain't what it used to be."

The late great New York Yankee legend, Yogi Berra passed away this week. Berra was only 5' 7", but hammered out 358 homers and had 1430 RBI! Decades ago, we enjoyed our Looney Tunes and our Yogi–isms. Yogi taught us how to read the Fed. He said: *"You can observe a lot by just watching."* He told us what to expect from the economy, fiscal and monetary policy. He said: *"You've got to be very careful if you don't know where you are going, because you might not get there."* Speaking to the Fed's very–low rate stance since December 2008, he might have said: *"It ain't over 'til it's over."* So far – it's not!

Looking Ahead

- Bond cycles show yields generally higher into late September.
- Stock cycles show a trend–change high near 9/30, a low near 10/06, and a more major high near 10/26.

Treasuries, Agencies, and MBS

Into September 18th, yields fell 2.5, 7, 5.5, and 1.5 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, yields for those sectors modestly reversed that course, rising 2, .5, 1.5, and 1 bps. Given our cycle work, we expect yields to soon begin a climb into month end.

MBS spreads (for FNMA 30–year 3.0%) pulled in by 2 bps into September 18th. Tuesday's $26–billion 2–year auction brought .699%. The auction was rated an average '3 of 5', and demand was the strongest since July. Foreign buying fell to 43.2% from 47.1% (during the August offering). This 2–year supply was added to the old 5–year note that originated in October 2012. Today's 5–year note auction was rated an above average '4 of 5' as $35 billion came at a 1.467% yield. Demand was also the highest since July. Foreign buyers took 63.5% of the issue compared to 50.1% in August. With the German 5–year alternative going negative, the U.S. 5–year note was attractive at a spread of roughly 150 bps! The Treasury will auction $29 billion 7–year notes on Thursday (09/24).

09/18/15 Treasury Yield Curve	2-Year: 0.680%	5-Year: 1.445%	10-Year: 2.134%	30-Year: 2.936%
Weekly Yield Change:	–.027	–.069	–.055	–.017%
Support:	0.73/ 0.76/ 0.80/ 0.82%	1.47/ 1.50/ 1.53/ 1.56%	2.14/ 2.17/ 2.20/ 2.24%	2.90/ 2.93/ 2.98/ 3.02%
Targets:	0.65/ 0.62/ 0.60/ 0.58%	1.41/ 1.38/ 1.35/ 1.32%	2.08/ 2.06/ 2.02/ 1.99%	2.86/ 2.83/ 2.78/ 2.75%

Economics

Last week, Initial Jobless Claims fell from 275K to 264K, signaling that job retention is still promising for the upcoming employment numbers. Continuing Claims dropped from 2,263K to 2,237K. However, factory production across the regions remains challenged as the Richmond Fed Manufacturing Index fell from 0 to –5. Existing Home Sales fell 4.84% to a 5.31M pace – the slowest since April. Nevertheless, sales are up 5.15% versus 2014. The FHFA House Price Index showed home prices rising .60% in July. That was the best increase since February. It moved the annual pace up to 5.80%, the highest year–over–year increase since April 2014. Prices fell in only 2 regions, with New England down the sharpest (–1.20%).

Thursday is set for jobless claims data, August Durable Goods Orders, the Chicago Fed National Activity Index, Bloomberg Consumer Comfort (which last week fell from 41.4 to 40.2), Kansas City Fed Manufacturing Activity, and New Home Sales for August. Friday updates 2Q GDP and Personal Consumption. The University of Michigan sentiment surveys are also due. Next Monday (09/28) brings August Personal Income and Personal Spending, Pending Home Sales, Dallas Fed Manufacturing Activity, and the PCE Deflator (one of the Fed's favorite inflation measures from Personal Consumption). Tuesday gives us the board Consumer Confidence Index, and S&P/Case–Shiller home price data. Wednesday closes out the month of September with the releases of MBA Mortgage Applications (which rose a sharp 13.90% last week), ISM Milwaukee, Chicago Purchasing Managers, and a first look into next Friday's September payrolls from ADP Employment Change.

Equities

Given the volume and span of FOMC member comments that had pointed to liftoff during last week's September meeting, global equity traders seem genuinely troubled and confused by the Fed's inaction. Since the announcement, or lack thereof, stocks have fallen in 4 of the past 5 sessions. That said, our equity cycles show some strength into month end from Thursday. Last week's net change for stocks was the smallest in the past 10, as the Dow fell 48.51 points or only .30% to 16,384.58. It's .64% lower this week. The S&P fell .15% or 3.02 points to 1,958.03, and is .98% lower since Friday. The Nasdaq managed a 2nd–weekly gain of 4.89 points or .10% to 4,827.23. The Nasdaq is 1.54% lower this week. While the gain broke its streak of ups and downs, the S&P has still flipped its close for each of the past 11 weeks. Up, down, up, down, etc. The Dow Transports lost .19%, and are off 2.18% this week. Bank stocks fell 2.70%, but are up a slight .01% since Friday.

	Dow:	Nasdaq:	S&P:
Resistance:	16,274/ 16,403/ 16,573/ 16,658	4,749/ 4,782/ 4,817/ 4,880	1,929/ 1,938/ 1,951/ 1,963
Support:	16,026/ 15,895/ 15,771/ 15,647	4,670/ 4,658/ 4,624/ 4,591	1,909/ 1,896/ 1,885/ 1,874

Other Markets

Commodities lost 1.29% into the 18th, and are .93% lower this week. Gold had gained 3.15%, but is .57% lower this week, while Crude Oil rose .11%, but was off .45% through today. Cotton was one of the culprits in the down week, having fallen 6.62%, and it was off another 1.92% into today. While the U.S. Dollar fell for a second week, losing .21%, it's 1.27% higher this week. The Japanese Yen rose .51%, but is off .25% this week. The Euro fell .35%, and has tumbled .99% this week. Corn gained .73% last week, and is 1.59% higher so far this week.

"Always go to other people's funerals. Otherwise, they won't come to yours."
"I never said most of the things I said!" Lawrence Peter 'Yogi' Berra (5/12/1925–9/22/2015)

Additional Information is Available on Request
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