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BOND MARKET REVIEW

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The Walk

'The Walk' is a new movie that tells the story of the only person to ever tightrope the World Trade twin towers back in 1974. A misstep for him would have been certain demise – and we understand the movie is not kind to those with a fear of heights. What was a non–event with the FOMC's lack of a move in September, now appears to be an averted misstep! The Fed viewed inflation as transitory and jobs as good enough to warrant a hike in 2015. The **B**ond **M**arket **R**eview would ask: What if the low inflation is real – and the job pickup was transitory??? After all, there's been no net pickup in manufacturing jobs since January. My 1–year old grandson learned how to say 'uhh–ohh' this weekend – repeating the phrase many times after I used it. We're used to 'uhh-ohhs' with babies. Though it's not in the dictionary, no doubt members of the FOMC thought the same thing when the September payrolls were announced!

Central banks tighten to cool growth. FRB Boston president Eric Rosengren said the FOMC could raise rates with only 2% growth in the second half of 2015. What does it say when some FOMC members want to tighten with only 2% growth? Inflation isn't anywhere near Fed targets and the jobs numbers are only strong because labor force participation is the lowest since 1977! It doesn't sound like we need to cool growth, and clearly bond–traders are in that camp. The bond markets are leaning to a March 2016 hike at the earliest. The non–PC statistic that few cover is that the number of workers born in the U.S. is declining and the pickup (though recently modest) is going to non–U.S. born workers. The Bureau of Labor Statistics show native–born workers falling off by nearly 1 million over the past 3 months, while immigrants gained 218K. You get an idea where the labor force participation is going!

The Fed's minutes gave us their mindset from the mid–September meeting. At that time, they thought U.S. economic conditions could sustain a hike, but concerns over *"global developments"* led them to hold off. The dovishness was that they saw inflation risks *"tilted to the downside."* This week, one of the European Central Bank's members said: *"It's clear that we won't return to 2% (inflation) within 1–1/2 years."* Also this week, the International Monetary Fund reduced global forecasts and warned of growing emerging–market risks. The global situation is unlikely to reverse by December – leaving those concerns in place. Former Fed Chair Ben Bernanke said monetary policy *"was not a panacea"* and that Congress needed to do their part. What were they supposed to do? Spend more? The budget deficit and the Fed's balance sheet have ballooned, but domestic growth is still challenged. Global central banks have offered up cash and QE, and the IMF is still reducing forecasts. FRB New York's William Dudley said the Fed needs to work on more tools to stave off future crises. FRB Minneapolis' Narayana Kocherlakota opined that the Fed should even consider a lower Fed target – which would mean negative rates. Maybe we can all refinance at that point!

Looking Ahead

- Bond cycles show yields making another low–rate trough in mid–October, and then rising into month end.
- Our stock cycles still show an important and tradable high is due near October 26th.
- Though stocks will trade on Columbus Day, Monday, October 12th, bonds will observe a holiday.

Treasuries, Agencies, and MBS

Like stocks, bond yields are higher since the end of September, but bonds showed extreme volatility after Friday's September jobs data. Investors and traders were left with a number of Fed members still desiring a 2015 liftoff for rates – amongst data that wouldn't lead to that conclusion. The trading gap between the market's expectations for a hike versus Fed forecasts continued to widen (in favor of a delay to March 2016!). Though the Fed minutes released today are 'old news', there are scattered opinions by FOMC members and traders as to when the Fed can and will act. Before the payroll data, traders gave an 18% chance to an October hike and 42.6% for December. Those odds fell to 10.0% and 33.4% after the jobs report. Following today's minutes, the odds for December increased marginally. Yields fell 11.5, 18, 17, and 13 bps for the 2, 5, 10, and 30–year sectors with the jobs report having a great impact. Into today, yields were higher by 5.5, 10, 11, and 11 bps removing a lot of that rally.

MBS spreads (for FNMA 30–year 3.0%) widened by 3 bps into October 2nd. Tuesday's $24 billion 3–year note auction was rated an average '3 of 5', and came at .895%. Demand was off to last month, and foreign buyers bought 47.7% this month (compared to 51% of September's issue). Yesterday's 10–year note came at 2.066%, and added $21 billion of supply to the existing August 2025 maturity. Demand was the lowest since that August offering, and foreign bidders accounted for 62.2% of the supply versus 57.5% in September. The auction was rated an above average '4 of 5'. Today, the August 2045 issue was reopened to add $13 billion 30–year bonds at 2.914% in an 'average' auction. Demand was lower to last month, and foreign buying fell from 66% in September to 56.4%.

10/02/15 Treasury Yield Curve	2-Year: 0.581%	5-Year: 1.296%	10-Year: 1.994%	30-Year: 2.828%
Weekly Yield Change:	–.113	–.179	–.169	–.128%
Support:	0.66/ 0.71/ 0.74/ 0.76%	1.44/ 1.47/ 1.50/ 1.53%	2.14/ 2.17/ 2.21/ 2.24%	2.97/ 3.01/ 3.05/ 3.09%
Targets:	0.60/ 0.57/ 0.54/ 0.52%	1.38/ 1.35/ 1.32/ 1.29%	2.07/ 2.03/ 2.00/ 1.96%	2.92/ 2.88/ 2.84/ 2.80%

Economics

Initial Jobless Claims held with recent data. Though 9K higher to 276K last week, today they fell to 263K in the largest decline in over 2 months. Continuing Claims dropped from 2,244K to 2,195K, and then rose to 2,204K this week. Last Thursday, Challenger Job Cuts revealed that layoffs rose 93.20% versus last September. Though somewhat signaling some trouble for the following September jobs data, it was Friday's payroll release that confirmed what was termed an 'ugly' report. The data was fairly shocking – given the course and trajectory the Fed has presumed we were on. September payrolls rose only 142K versus 200K expected, while 59K were removed from the previous 2 months! Private payrolls rose just over half expectations – at 118K versus 197K (with a downward 40K revision to August). With a 9K loss and an 18K drop in August, manufacturing jobs are now stagnant with no net improvement since January! The U.S. Unemployment Rate managed to maintain 5.10%, but only as the Labor Force Participation Rate fell from 62.60% to 62.40% – the lowest going back to October 1977! Adding to the weakness of the report, average hourly earnings were stagnant and remained at a 2.2% annual pace. Average weekly hours fell .1 to 34.5. It was curious that the Underemployment Rate fell .30% to 10.00%, given the overall data picture. Given the data, the Fed's 'labor dashboard' was revised from 2.1 to only a 1.2–point improvement in August. However, and once again curiously (to us), that Labor Market Conditions Index Change was flat for September – where we would have seen the overall condition as losing quite a bit of momentum, and the participation rate as quite troubling!

With stocks recovering a lot of ground since the end of September, confidence measures have shown good gains. Bloomberg Consumer Confidence rose from 41.9 to 43 last week, and jumped to 44.8 today. That's the best reading in 5 months, and the best 3–week gain in 6 years! IBD/TIPP Economic Optimism rose from 42 to 47.3. The service–sector outlook slowed a little, falling from 59 to 56.9 (ISM Non–Manufacturing Composite). ISM Manufacturing fell from 51.1 to 50.2, confirming slowing activity. Over 50 is just barely expanding. Prices Paid fell a point to 38. ISM New York fell from 51.1 to 44.5. Factory Orders fell 1.70% in August, and were cut in half to only a .20% gain for July. Ex transportation, orders fell .80%. August Construction Spending rose .70%. The August trade gap rose the most in 5 months as the deficit increased from $41.81 billion to $48.33 billion. Imports increased, but exports fell to the lowest levels since June 2011. The strong Dollar was one culprit. As we've said before, it might mark a positive if retailers are (rightly) anticipating a pickup in sales and stocking up. Consumer Credit fell from nearly $19 billion in July to $16.02 billion in August. That was the slowest pace in 6 months. Vehicle Sales picked up in September – rising from 17.72M to an 18.07M pace. Domestic Sales improved from 13.80M to a 14.36M pace. The Budget Office said the 2015 deficit was $435 billion compared to a previous estimate of $426 billion. Still, that was far less than fiscal 2014's $483 billion shortfall.

Friday is set for September Import Prices, and Wholesale Inventories & Trade Sales for August. Monday (10/12) is Columbus Day. Stocks will trade, but there are no scheduled data releases – and bonds will not trade as the Federal Reserve will be closed. Next Tuesday brings NFIB Small Business Optimism and September's Monthly Budget Statement. Wednesday follows with MBA Mortgage Applications – which surged 25.50% last week from lower rates and accelerated reporting. Also due are Producer Prices (September PPI), Retail Sales, Business Inventories, and the Fed's Beige Book report (growth and outlook for the 12 Fed districts).

Equities

Our equity cycles still point to a rise into a tradable high near October 26th. While we don't expect an unchecked journey by any stretch, stocks have done quite well since the end of September (where they made a double bottom). Into Monday, the S&P had its longest rally of 2015 with a nice 5–day advance. After a pull back into the 6th, stocks are now 7 for 8! Global equities had their best run since April. Crude Oil has helped stocks by rising above $50/barrel for the first time since July. Last week, into October 2nd, stocks halted a 2–week drop with the Dow rising 157.70 points or .97% to 16,472.37. It's a strong 3.51% higher this week! The S&P gained 20.02 points or 1.04% to 1,951.36, and is 3.18% ahead this week. The Nasdaq rose 21.28 points or .45% to 4,707.78, and is 2.19% better since Friday. The Transports gained .29%, and have surged 4.04% this week. Bank stocks lost 1.53%, but have since risen 3.05%.

	Dow:	Nasdaq:	S&P:
Resistance:	17,124/ 17,256/ 17,385/ 17,519	4,854/ 4,889/ 4,924/ 4,959	2,019/ 2,040/ 2,063/ 2,086
Support:	16,861/ 16,738/ 16,503/ 16,346	4,784/ 4,751/ 4,716/ 4,682	1,995/ 1,974/ 1,954/ 1,929

Other Markets

Commodities lost .82% last week, but have jumped 3.71% higher this week – as Crude Oil fell .35%, and then boomed 8.54% higher into today. Gold lost .75%, but has reversed .67% better since Friday. The U.S. Dollar fell .48% last week, and is off .58% this week as data and dovish Fed comments are seen as delaying a hike by the FOMC. The Japanese Yen rose .56%, and was a slight .02% lower into today. The Euro rose .19% last week, and is .53% better this week. Corn gained .06%, and is up .51% this week. Cotton lost .74%, but has rebounded 4.07% this week.

"I want to find a voracious, small-minded predator and name it after the IRS." Robert Bakker, paleontologist

It's sobering to realize that my entire book collection takes up 5 cents of space on my hard drive, and it's by no means small. It's only a wisp in a greater cloud.

"Doing nothing is very hard to do ... you never know when you're finished." Leslie Nielsen

Additional Information is Available on Request

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