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Bond Market Review

October 14, 2015

Oktoberfest

While the bond market is projecting a March liftoff (or later), the only Fed member we heard still considering an October hike was Atlanta's Dennis Lockhart! No one else is talking October – and that meeting is 2 weeks away. While the FOMC will almost surely refrain from any interest rate move in October, it's the last 2015 chance – the December meeting that's drawing the most attention. The Fed would like to have moved in September, but the data just wasn't there (nor the committee votes). The Fed has long viewed 2015 as the time to begin to *"normalize"* rates and policy, and the lack of a move this year is no doubt seen as admitting that policy has not accomplished its mission!

Vice Chair Stanley Fischer said his global counterparts thought the Fed should 'go ahead.' He said a lot of data could come between now and December, but that he was still in the 2015 'liftoff camp.' New York's William Dudley used similar reasoning. Fischer said the Fed was not going to liftoff *"at a time that is not suitable for the United States economy."* While taking their eyes off the Fed's dual mandate by setting aside FOMC inflation goals, Lockhart and Richmond's Jeffrey Lacker are among those also in the hike camp – reasoning that the Fed has achieved a jobless rate consistent with full employment. The **BMR** still believes the Unemployment Rate alone does not explain the jobs picture in its entirety – and that the lack of those in the work force, stagnant wage growth, and the falloff in native–born job holders is troubling (no matter the jobless statistics).

In September, 13 of 17 Fed members said 2015 was still appropriate for liftoff. Of course, Chair Janet Yellen is still in the 2015 camp, but we get the feeling that if there were to be a rate hike in December 2015, there could be 3 (or more) dissentions to the statement. When the Fed does move, it's likely they'll want less second–guessing! The 'second guessers' are also the most likely to be in the 'told you so' crowd – if the move proves ill–timed. This week, Fed Governor Lael Brainard urged patience, and Governor Daniel Tarullo said he doesn't favor a move in 2015.

Lowflation

China has been the 'manufacturer to the world' and needs to keep prices low or lose the 'machine.' However, the machine continues to slow, and China's imports just fell for an 11th straight month. On the inflation front, Producer and Import Prices fell – and Consumer Prices are expected to fall! One of China's best customers has been Wal–Mart – known for falling or always–low prices. Unfortunately, Wal–Mart (WMT) experienced its largest drop in 27 years today – showing just how volatile the markets can be. WMT lost $21 billion in market capitalization today, falling 10.04% to 60.03. Earlier this year, in January, WMT was just pennies away from 91! As news out of China worsens, the chance of a global pullback is increasing. If Wal–Mart is slowing down, it's a bad sign for China – and the U.S.!

Looking Ahead

- Bond yields have entered our low–rate trough due in mid–October, and should begin to rise into month end.
- Our stock cycles still show an important and tradable high is due near October 26th.
- The FOMC will next announce interest rate policy on Wednesday, October 28th.

Treasuries, Agencies, and MBS

Treasuries lost a bit of ground last week with longer yields rising nearly 10 bps, but as of today most of those losses were reversed – and overtaken. 2 and 5–year note yields closed today at multi–month lows – confirming the cycle we had for yields falling again into mid–October. Last week, we said the bond market was predicting the Fed's liftoff to be no earlier than March 2016. That theme continued as a Bloomberg survey showed 10–year note yields rising to 2.33% by year end, compared to an earlier survey of 2.60%. 10–year yields were 1.98% today, so even 2.33% is a 35 bps increase from current levels. The recent September jobs report, retail sales, a slowdown in China, and plunging commodities are all factors in reducing econometric forecasts. The **B**ond **M**arket **R**eview would forecast 2.20% – realizing this one's very hard to nail. Earlier this week, the odds of an October FOMC hike were 10%, and a move by March was 58.5%. Today, those odds fell to 4% and 48.6% – placing March in the less than 50%–50% bucket!

While the Fed has global considerations to consider, along with pressure from the International Monetary Fund, 8 of the Fed's 12 regional boards voted for an increase in the discount rate in September. That was up from 5 of 12 for the previous vote. Though the **BMR** still considers the semantics of the terms to be roughly equal, the Fed's Beige Book revealed that 6 of the 12 districts reported growth as *"modest"*, and 3 said growth was *"moderate."* Kansas City declined, while Boston and Richmond saw increases. (But were those increases modest, moderate, or strong?) If they were strong or stellar, you'd think they would have said so! As we would expect, they said price pressures were *"contained"*, and that a strong Dollar was weighing on manufacturing and tourism. Joseph Stiglitz, the Nobel–prize economist, said: *"America's recovery is anemic."* That's how we see it, modest or moderate, prize or not.

Last week, into October 9th, yields rose 6, 10, 9.5, and 9 bps for the Treasury 2, 5, 10, and 30–year sectors. Into today, those sector yields dropped by 9, 13, 11.5, and 8.5 bps – with the 30–year the only one a bit shy (.5 bps) of regaining the losses from last week. MBS spreads (for FNMA 30–year 3.0%) pulled in by 4 bps into October 9th. The 2, 5, and 7–year U.S. Treasury note auctions are set for the last week of October (27th, 28th, and 29th).

10/09/15 Treasury Yield Curve	2-Year: 0.639%	5-Year: 1.399%	10-Year: 2.089%	30-Year: 2.918%
Weekly Yield Change:	+.058	+.103	+.095	+.090%
Support:	0.63/ 0.65/ 0.70/ 0.74%	1.37/ 1.44/ 1.47/ 1.50%	2.05/ 2.09/ 2.12/ 2.16%	2.88/ 2.92/ 2.97/ 3.02%
Targets:	0.57/ 0.54/ 0.52/ 0.50%	1.28/ 1.25/ 1.22/ 1.15%	1.98/ 1.94/ 1.91/ 1.87%	2.84/ 2.80/ 2.76/ 2.72%

Economics

Initial Jobless Claims fell 13K last week to a 2 1/2–month low of 263K. Continuing Claims rose from 2,195K to 2,204K. In keeping with the falling prices theme, September Producer Prices fell .50%! Ex food & energy, prices dropped .30%. That left the annual pace for PPI .30% lower to a 1.10% drop. The annual core PPI rate fell from .90% to only .80%. Import Prices fell .10%, though the annual pace was reduced from an 11.30% drop to a yearly fall (but .60% less) of 10.70%. Wholesale Inventories rose .10% in August, while Trade Sales fell by 1.00%. Business Inventories were flat. NFIB Small Business Optimism rose .2 to 96.1. Retail Sales were reduced from a .20% gain to flat for August, and rose only half expectations with a modest .10% rise in September. Ex autos, sales fell .30%. (Recall from last week's **BMR**: *"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."*

Thursday is the last day for procrastinators to file IRS returns for 2014. I beat that deadline by a day this time. Data due includes jobless claims stats, Empire Manufacturing, Consumer Prices (September CPI), Real Average Weekly Earnings, the Philadelphia Fed Business Outlook, the Monthly Budget Statement (for September), and Bloomberg Consumer Comfort (which last week rose 1.8 to a 5–month high reading of 44.8). Friday gives us August JOLTS Job Openings, September Industrial Production, Capacity Utilization, the University of Michigan Sentiment surveys, and TIC Flows (net foreign Treasury operations). Next Monday (10/19) is set for the homebuilder outlook (NAHB Housing Market Index). Tuesday follows with Housing Starts and Building Permits for September. Wednesday is set for MBA Mortgage Applications (which last week slumped 27.60% – partially on timing issues).

Equities

The **BMR** equity cycles continue to show a top near October 26th. After that, the short and medium cycles fall sharply into November 18th. While it's obvious that no techniques are anywhere near perfect, we wouldn't want to be long after the 26th. The short cycles show a high near October 19th and a low near the 21st, before the convergence into the 26th. Nonetheless, stocks had a nice move last week with the S&P having is best performance for 2015. For the week, the Dow soared 612.12 points or 3.72% to 17,084.49. Into today, the Dow was .94% lower for the week. The S&P rallied 63.53 points or 3.26% to 2,014.89, but is 1.02% lower since Friday. The Nasdaq gained 122.70 points or 2.61% to 4,830.47, but is .99% lower this week. The Dow Transports outperformed with a 4.82% surge last week, but are 1.95% lower this week. Bank stocks gained 2.09%, but are since leading the way lower with a 2.17% loss.

	Dow:	Nasdaq:	S&P:
Resistance:	17,152/ 17,411/ 17,676/ 17,941	4,837/ 4,874/ 4,907/ 4,977	2,016/ 2,040/ 2,062/ 2,085
Support:	16,624/ 16,370/ 16,114/ 15,942	4,771/ 4,698/ 4,630/ 4,562	1,992/ 1,973/ 1,951/ 1,929

Other Markets

Commodities also surged higher last week. On the strength of an 8.98% jump in Crude Oil prices, they rose 4.42%. Crude is 6.02% lower this week, and Commodities are off 1.41%. Gold gained 1.69%, but has maintained buying interest and is 2.06% higher this week. The U.S. Dollar lost 1.13% last week, and is off .98% this week – as the markets are forecasting no increase from near–zero rates by the FOMC until at least March 2016. That's strengthened the Euro, which rose last week by 1.27%, and then another 1.02% into today. The Japanese Yen lost .30% last week, but has also rallied with a 1.20% increase this week. Corn fell 1.67%, and is off another .98% this week. Cotton gained 4.07%, and is 3.49% higher this week. Orange Juice surged more than 15% over the past week, with the Florida orange crop supply just projected at a 52–year low by the U.S. Department of Agriculture.

"A good listener is not only popular everywhere, but after a while he gets to know something." Wilson Mizner

Additional Information is Available on Request

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