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BOND MARKET REVIEW

November 09, 2015

Spectre

Fed Chair Janet Yellen is the 'M' in this bond story, and the spectre looming over the markets is the first FOMC hike in nearly a decade (and the first liftoff since June 2004). While the 'Q' is still there in the form of existing or even stepped up QE by other central banks, many market participants are concerned that once the Fed begins to move, they will embark on one of their relentless tightening campaigns as they did just over 11 years ago. Knowing that perception exists, some Fed members have tried to reassure the markets that a liftoff would not be followed by hikes at each subsequent meeting. Back in September, Yellen said: *"Most FOMC participants, including myself, currently anticipate that achieving these conditions will likely entail an initial increase in the federal funds rate later this year, followed by a gradual pace of tightening thereafter."* The Fed now has the data they needed and, bar any incoming data that would throw them off track, appears ready to fulfill their plans for a last–2015–chance December move.

Even before the jobs numbers, the odds for a December hike had risen from 50%–50% to results hovering between 56% and 58%. With October's stellar payroll data, the market's expectations for a December Fed move have increased to 68%! The focus has shifted from when – to how often? FRB St. Louis President James Bullard said: *"It is going to be a very hot debate. We certainly said we are going to go gradually. I think there is unanimous support for that on the committee. But, what does gradually actually mean?"* That's what we'd all like to know! Yellen had said that we should be *"thinking about the entire path of policy rates over time."* It's hard to know what that means! Nevertheless, she said an earlier start would allow the FOMC to *"move at a more gradual and measured pace."*

Positively Negative

In the **BMR** (08/06/2007), we said: *"If two negatives make a positive, there are now enough negatives out there to be positively negative!"* Before the payroll numbers, Yellen said a December hike was a *"live possibility."* It was thus curious that she said last week that *"potentially anything – including negative interest rates – would be on the table"* if data were to worsen. She had previously held that the FOMC would not consider using negative rates.

Looking Ahead

- Bond yields should ease into Thanksgiving week, and could be generally lower into mid–December.
- Our stock cycles show equities falling into a low near November 18th.
- The bond market will observe and honor Veterans Day on Wednesday (11/11). (Stocks will trade).

Treasuries, Agencies, and MBS

As the band 'Europe' has seen a lot of airplay from the commercial featuring their '80s hit 'Final Countdown', the October payroll numbers have been seen as another confirmation that the FOMC can 'count down' toward their desired schedule for a December interest–rate liftoff. The Fed will get only one more jobs number between now and that December meeting, and that number is being viewed as good enough to give them a green light. Given October payroll increases nearly 50% above expectations, and at a 271K rise – the highest since last December, 5 and 10–year yields shot 9 bps higher on Friday. Fir the week, that left yields higher by 16, 21, 18.5, and 16.5 bps for the Treasury 2, 5, 10, and 30–year sectors. That was right with the **B**ond **M**arket **R**eview bond cycles, which had projected higher rates into last week. 2–year yields hit their highest levels since 2010. Our cycles now show lower yields into Thanksgiving week, with a later dip into mid–December. Yields were mixed today, with 2–year notes half a bps lower, and longer yields up 1 to 2 bps.

MBS spreads (for FNMA 30–year 3.0%) pulled in by 4 bps into the 6th. Last week, the Treasury held the 2–year note auction that was delayed due to the debt ceiling limiting additional borrowing. With that ceiling now suspended until March 2017, $26 billion notes were offered on Wednesday (11/04). The notes brought .824% in an average sale. That was the highest since April 2010, and it is clear that bonds are beginning to capitulate to an imminent FOMC hike. Demand was the weakest since the March, 2010 offering, and foreign buying fell to 40% from 43.2% in the prior (October) auction. Today's $24 billion 3–year note supply brought 1.271% in another average–rated auction. The yield was the highest since the April 2011 auction. Demand was the lowest since October 2009. Foreign buying dropped from 47.7% last month to only 40.8%. Auctions resume with $24 billion 10–year notes on Tuesday (11/10), and then $16 billion 30–year bonds on Thursday – as the bond markets will be closed on the 11th for Veterans Day.

11/06/15 Treasury Yield Curve	2-Year: 0.888%	5-Year: 1.731%	10-Year: 2.326%	30-Year: 3.086%
Weekly Yield Change:	+.162	+.212	+.183	+.163%
Support:	0.89/ 0.91/ 0.95/ 0.98%	1.75/ 1.78/ 1.81/ 1.85%	2.34/ 2.38/ 2.41/ 2.46%	3.12/ 3.15/ 3.17/ 3.21%
Targets:	0.85/ 0.82/ 0.79/ 0.76%	1.68/ 1.65/ 1.62/ 1.59%	2.30/ 2.26/ 2.22/ 2.18%	3.07/ 3.03/ 2.99/ 2.94%

Economics

Leading into last Friday's payroll numbers, ADP Employment Change confirmed that 182K private–sector jobs had been added in October (though September's additions were revised 10K lower to 190K). That 180K–range was right with expectations, and Challenger Job Cuts showed 1.30% less cuts than for October 2014. Initial Jobless Claims for the last week of October were 16K higher to 276K, and Continuing Claims rose from 2,146K to 2,163K. Thus, Nonfarm Payrolls growing by 271K stunned those of us expecting another sub–200K month, and reinforced the pro–December hike FOMC camp! Revisions were mild as 5K were taken away from September, leaving 137K additions, but the 2–month change was raised by 12K. Private Payrolls grew by 268K (nearly 100K above expectations), and September's totals were bumped 31K higher. Manufacturing payrolls were flat, reversing a downtrend in recent months, but as we said last month that sector is *"now stagnant with no net improvement since January!"*

The U.S. Unemployment Rate fell from 5.10% to 5.00%, in the lower range of the Fed's full employment zone, though Labor Force Participation remained at 62.40% – the lowest since October 1977 (though improving a little to last month internally). Average Hourly Earnings rose .40% after being flat last month, while Average Weekly Hours were flat at 34.5. The Underemployment Rate fell .20% to 9.80%. The Fed's jobs dashboard (the Labor Market Conditions Index) had been flat for September, but was revised to a 1.3–point gain, and was then 1.6 points higher in October. Before the jobs numbers, the outlook for the service sector (ISM Non–Manufacturing) jumped from 56.9 to 59.1 – one of the highest readings of the recovery! Nonfarm Productivity rose 1.60% in the third quarter, and Unit Labor Costs were 1.40% higher. The U.S. Trade Balance deficit fell from $48.02 billion in August (revised $.31 billion lower) to $40.81 billion in September. While in line with expectations, exports were good, but imports were soft – especially given the strength of the U.S. Dollar. It might point to conservative retail inventories for the fall. Consumer Credit showed the largest credit buying spree in history with Americans charging a whopping $28.918 billion in September!

Tuesday is set for NFIB Small Business Optimism, October Import Prices, and September Wholesale Inventories & Trade Sales. Wednesday is Veterans Day, a holiday for banks and bond trading, though stocks will trade and we'll get MBA Mortgage Applications (which last week fell .80%). Thursday yields jobless claims data, JOLTS Job Openings for September, October's Monthly Budget Statement, and Bloomberg Consumer Comfort (which last week fell 1.7 points to 41.1 – marking a 7th straight decline). Friday (the 13th) is set for October Retail Sales, Producer Prices (October PPI), September Business Inventories, and University of Michigan confidence data.

Equities

Our secondary high cycle that showed a trend change near November 5th is so far confirming a down turn. While stocks rose last week, today's losses were the largest in a month. As we said last week: *"Our combination of equity cycles projects lower into the 18th – which could represent another buying opportunity."* Last week, the Dow gained 246.79 points or 1.40% to 17,910.33. It was off 1.00% today. The S&P rose 19.84 points or .95% to 2,099.20, but was .98% lower today to kick off this week. The Nasdaq gained 93.37 points or 1.85% to 5,147.12, but fell 1.01% today. The Dow Transports rose 1.39% last week, but were .32% lower today. Bank stocks surged 5.47% last week, but fell .97% today – as most sectors lost ground.

Resistance:	Dow:	17,790/ 17,909/ 17,975/ 18,060	Nasdaq:	5,123/ 5,160/ 5,195/ 5,231	S&P:	2,093/ 2,105/ 2,116/ 2,128
Support:		17,957/ 17,544/ 17,394/ 17,261		5,051/ 5,016/ 4,982/ 4,946		2,070/ 2,059/ 2,047/ 2,036

Other Markets

Commodities fell 2.34% last week as the U.S. Dollar surged 2.31%. They continued .95% lower today. Crude Oil lost 4.94% last week, and matched that .95% loss today. Gold dropped 4.70% last week, but was a slight .04% higher today. The Dollar fell .19% today. The Euro dropped 2.41% last week, but was .10% higher today. The Japanese Yen lost 2.08%, and was another .04% lower today. Corn fell 2.42%, and dropped another 1.68% today. Cotton lost 2.62%, but rose .39% today.

"It is the Soldier, not the reporter who has given us freedom of press. It is the Soldier, not the poet who has given us freedom of speech. It is the Soldier, not the campus organizer who gives us freedom to demonstrate.
It is the Soldier who salutes the flag, who serves beneath the flag, and whose coffin is draped by the flag, who allows the protester to burn the flag." Father Dennis Edward O'Brien

Additional Information is Available on Request
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