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
COMMERCE STREET Capital Management
1445 ROSS AVENUE, SUITE 2700
DALLAS, TEXAS 75202 • 214-545-6800

BOND MARKET REVIEW

November 19, 2015

A Foregone Conclusion

Though much of the incoming data is still poor, challenged, or showing only modest improvement, the October jobs report beat expectations and has the Fed moving forward with plans for their first rate increase since June 2006. The odds of a move in December have been holding above a 2 out of 3 chance since that last jobs report. Where the doves held a clear majority in the past meetings, they're becoming scarce – and the minutes from the last meeting show that the FOMC has been doing their best to signal an upcoming increase. With less than a month until the December 16th decision date, Fed members have also been signaling that it would take some sort of very–negative event or surprise to delay the countdown to that expected liftoff. While in the past the Fed has many times cloaked their language, they have recently sought to be very open in their transparency – in an effort to avoid a market shock. On the other hand, you have to wonder why a central bank would be in a hurry to increase borrowing costs when a lack of inflation and wage pressures are present! Every uptick in the rate may reload stimulus ammo to fight future battles, but will also drive up budget spending, the deficit, and the presently–non–existent debt ceiling.

The FOMC minutes from October held that *"it may well become appropriate"* to raise rates in December. Of course, they also said *"no decision has been made."* It's clear that the debate is changing from when to how often – as Fed members are emphasizing intentions to tighten gradually. FRB Cleveland's Loretta Mester reassured that a *"small increase in interest rates from zero is not tight monetary policy."* She, as have others, made the case that beginning sooner can allow a more gradual approach later. She said GDP and other conditions have progressed, and if they continue per her outlook, there will be a *"strong case"* for liftoff and stepping back from what she termed *"the emergency measure of zero interest rates."* Vice Chair Stanley Fischer said: *"In the relatively near future probably some major central banks will begin gradually moving away from near–zero interest rates."* While that's probably true for the Fed, the **B**ond **M**arket **R**eview would think other 'majors' further away from such a move. He explained: *"We have done everything we can to avoid surprising the markets and governments when we move, to the extent that several emerging market (and other) central bankers have, for some time, been telling the Fed to 'just do it.'"*

Looking Ahead

- Bond yields should ease into Thanksgiving week, and should be generally lower into December 8th/10th.
- Our stock cycles show an important top near December 4th.
- The markets will close on Thursday, November 26th for Thanksgiving! Early 2pm ET bond close Friday.

Treasuries, Agencies, and MBS

At present, catching 'the limit' in a dove hunt would be tough – as the front end of the curve is convinced the Fed will soon begin to tighten. However, our bond cycles for yields peaked in the first week of November. After a strong rise into the 6th, longer yields topped on the 9th and have been lower since. Yields fell for a few reasons (our cycles aside). Stocks cratered last week with their worst losses since August – so there was a little flight to bonds. However, the curve also flattened. As we see it, the short end believes the Fed, and the long end is siding with inflation – and some iffy data. With Crude Oil prices once again falling near $40/barrel, price pressures are lower. However, even before that recent 21.62% drop from October's highs, October Producer Prices were falling at an annual 1.60% pace and Consumer Prices were rising only .20% annually. If the Fed does hike in December, it will be on promising jobs and some GDP improvement – not from closing in on their inflation targets! The 2–year had risen half of the 25–bps assumed hike as the odds grew from 50–50% that an increase was coming. The full 25 bps, plus a little more is now 'priced in' since the October lows. In percentage terms, short rates have risen nearly 63% in roughly 5 weeks. Last week, given the equity 'mini dive', yields fell 5, 8, 6, and 3.5 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, the curve flattened as 2 and 5–year rates rose 5.5 and 2 bps, while 10 and 30–year yields dropped 2 and 4 bps.

MBS spreads (for FNMA 30–year 3.0%) widened by 5 bps. Last Tuesday (11/10), the Treasury sold $24 billion 10–year notes at a 2.304% yield (the highest since June). Demand was the lowest since August and foreign buyers accounted for 60.5% of the sale, versus 62.2% in October. The 30–year bond brought 3.07% on Thursday (11/12) – the highest since July. Demand was off to last month, though foreign buyers accounted for 60.3% of the issue versus 56.4% last month. Next week's auctions all come early for Thanksgiving. The U.S. Treasury will offer $26 billion 2–year notes on Monday (11/23), $35 billion 5–year notes on Tuesday, and $29 billion 7–year notes on Wednesday.

11/13/15 Treasury Yield Curve	2-Year: 0.837%	5-Year: 1.653%	10-Year: 2.267%	30-Year: 3.052%
Weekly Yield Change:	–.051	–.078	–.059	–.034%
Support:	0.92/ 0.95/ 0.98/ 1.01%	1.69/ 1.72/ 1.76/ 1.79%	2.27/ 2.31/ 2.35/ 2.39%	3.03/ 3.06/ 3.08/ 3.10%
Targets:	0.89/ 0.86/ 0.83/ 0.79%	1.66/ 1.63/ 1.60/ 1.57%	2.23/ 2.20/ 2.17/ 2.13%	3.00/ 2.97/ 2.94/ 2.91%

Economics

Over the past 4 weeks Initial Jobless Claims have been steady near 4–decade lows. While unchanged a week ago at 276K, they fell to 271K this week. Continuing Claims were 7K higher to 2,177K, and then 2K lower to 2,175K. JOLTS Job Openings rose from 5,377K to 5,526K in September (just off the 5,668K recovery peak in July). After recent weakness, the Leading Index for October rose a solid .60%. Bloomberg Consumer Comfort rose from 41.1 to 41.6, but then fell back to 41.2. Economic Expectations were .5 higher to 42.5. NFIB Small Business Optimism was unchanged at 96.1. Retail Sales rose .10% in October, but were revised .10% lower to flat for September. Ex Autos, they rose .20%, but dropped .10% lower to a .40% fall in a September revision. University of Michigan Sentiment rose a solid 3.1 points to 93.1, and Current Conditions rose from 102.3 to 104.8. Their expectations component rose 3.5 points to 85.6. The Philadelphia Fed Business Outlook rose 1.9 points, and Empire Manufacturing was a bit less pessimistic – rising from –11.36 to –10.74. Industrial Production fell .20% in October, matching the September drop. Capacity Utilization fell .20% to 77.50%. The Monthly Budget Statement showed a $131.5 billion October deficit.

October Housing Starts plummeted 11% to 1,060K. Building Permits rose 4.07% to 1,150K. In turn, home builder sentiment fell from 65 to 62 (NAHB Housing Market Index). MBA Mortgage Foreclosures dropped from 2.09% to 1.88% for 3Q 2015. Mortgage Delinquencies fell from 5.30% to 4.99%. Consumer Prices rose .20% in October, with the same result ex food & energy. The annual pace rose from flat to that same .20%, though the annual core rate remained at 1.90%. Real Average Weekly Earnings fell from a 2.30% annual pace to 2.10%. Though expected to rise .20%, Producer Prices fell .40% in October (following a .50% previous drop). Core PPI fell .30%. Annual PPI fell 1.60% from September's 1.10% drop. The annual core fell from .80% to only .10%. Import Prices fell .50%, with the annual pace dropping 10.5% (compared to September's 11.30% annual drop). Wholesale Inventories rose .50% in September, as did Trade Sales. Business Inventories rose .30%. In September, foreign entities bought a net $33.6 billion in longer Treasury issues. However, they withdrew a net $175.1 billion overall.

The next **BMR** will follow Thanksgiving week. Monday (11/23) is set for Existing Home Sales. Tuesday gives us 3Q GDP, S&P/Case–Shiller Home Price data, and Consumer Confidence. Wednesday is 'loaded' with MBA Mortgage Applications (off 1.3%, and then up 6.20% over the last two weeks), October Personal Income & Personal Spending, the PCE Deflator, Durable Goods Orders, Jobless Claims data, the FHFA House Price Index, New Home Sales, and University of Michigan Confidence. Data for the following Monday (11/30) includes Pending Home Sales.

Equities

Our stock cycles pointed downward from November 5th to the 18th, and equities responded last week with their worst losses since August. However, the turndown was 'fast and furious' enough for all the indexes we follow to reach their lower bands by the 16th. (Those are the 'lines in the sand' of support included in the **BMR**. They project echelons of levels that become resistance when broken – and vice versa.) Those losses sent the Dow off 3.28% for the year – with the S&P down 1.79% for 2015. The rally started early, from what we called a 'buy opportunity' and certainly kicked in with acceleration on the 18th. For the week ending on the 16th, the Dow plunged 665.09 points or 3.71% to 17,245.24. It's up 2.83% this week – and back ahead .51% for 2015. The S&P lost 76.16 points or 3.63% to 2,023.04, but is up 2.88% since Friday – and back at a 1.09% gain for 2015. The Nasdaq dropped 219.24 points or 4.26% to 4,927.88, but has since gained 2.96%. The Transports fell 2.80%, but have surged 3.27% so far this week. Bank stocks lost 3.74%, but are 3.16% higher this week. Our cycles show a trend–change high due near November 25th, a low around the 30th, and another peak (top) near December 4th. We would not want to be long after the 4th!

	Dow:	Nasdaq:	S&P:
Resistance:	17,905/ 18,041/ 18,173/ 18,308	5,130/ 5,162/ 5,203/ 5,238	2,097/ 2,109/ 2,121/ 2,132
Support:	17,769/ 17,636/ 17,506/ 17,376	5,094/ 5,057/ 5,023/ 4,988	2,075/ 2,063/ 2,051/ 2,041

Other Markets

Commodities fell 3.28% last week and another .35% into today, as Crude Oil tumbled 8.02%, and another .49% this week. Gold dropped .63%, and was .28% lower into today. The U.S. Dollar dropped .16%, and was off a slight .03% so far this week. The Japanese Yen gained .42%, but then fell .21% this week as the Euro rose .30%, but was then .36% lower. Corn lost 3.95%, but is 1.67% higher this week. Cotton gained .03%, but was .16% lower into today.

Happy Thanksgiving from the BMR!!! *"Reflect on your present blessings, of which every man has many; not on your past misfortunes, of which all men have some." Charles Dickens*

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management

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