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

BOND MARKET REVIEW

December 01, 2015

The Final Countdown

The FOMC will next meet on December 15th, and announce what is widely expected to be their first rate increase since June 2006 on Wednesday the 16th at 2 pm ET. Despite continued data challenges including low inflation readings and setbacks in manufacturing, the odds for a hike have risen from the mid–60s (2 out of 3) since the October jobs report to approach 3 out of 4 – being solidly above 70% this week. It appears that only dismal November payroll numbers this Friday would be enough to sway the FOMC to delay their liftoff until January or March 2016.

Today on CNBC, David Faber said: *"The last time the Fed hiked rates with the ISM figure below 50 was August 1985."* The **B**ond **M**arket **R**eview would simply note that it has been done before, so it might take a surprise negative payroll report to pull key votes back to the dovish side. If so, an analysis of incoming FOMC voters for 2016 would suggest an increased bias toward the removal of stimulus. Outgoing voters from Richmond, San Francisco, and especially Atlanta and Chicago are viewed as more dovish, while, as a group, newly–voting presidents of Cleveland, St. Louis, Kansas City, and Boston lean to a more hawkish stance on rates. To that end, today Chicago's Charles Evans said: *"I admit to some nervousness about our upcoming decision."* He said it *"could well be appropriate for the funds rate to still be under 1% at the end of 2016."* He would prefer to have more confidence that inflation is headed higher before raising rates. If Evans were right, that would be only 3 or 4 hikes over the next 9 meetings. That would certainly be in keeping with the *"gradual pace"* that Fed Chair Janet Yellen and others have projected going forward in order to assure the markets that the Fed would not adopt one of their relentless campaigns of tightening.

Also today, Fed Governor Lael Brainard said: *"A broad deterioration in foreign growth prospects, together with greater risk sensitivity in the wake of the crisis and changes in the rate of potential output growth, may be contributing to a 'new normal.'"* She said that would be *"characterized by a lower level of interest rates than in the decades preceding the crisis, which counsels a cautious and gradual approach to adjusting monetary policy."* Fed Governor Daniel Tarullo said that market and survey–based measures of inflation expectations *"are sort of near historic lows."* A lack of inflation should be the key factor that allows the Fed to stay low and go slow.

Looking Ahead

- Bond yields should be generally lower into December 8th/10th.
- Our stock cycles show an important top near December 4th.
- The next FOMC interest rate policy announcement is set for Wednesday, December 16th at 2 pm ET.

Treasuries, Agencies, and MBS

With the market believing the Fed's rate liftoff to be imminent, 2–year rates have fully priced in a rate hike – with the average yield for 2015 being about .64%, and recent readings roughly 25 bps higher (at just over .90%). As we concluded last week, *"the short end believes the Fed, and the long end is siding with inflation – and some iffy data."* The **BMR** bond cycles are performing well. They peaked the first week of November, and were projecting lower yields into Thanksgiving, and then into December 8th/10th. Given today's manufacturing outlook falling back into negative territory (contraction), longer U.S. yields fell to one–month lows! Into November 20th, yields rose 8 and 3.5 bps at 2 and 5–years, and fell .5 and 3 bps at 10 and 30–years. Last week, yields were flat at 2–years, but fell 4, 4, and 2.5 bps at 5, 10, and 30–years. Today's rally left those yields lower by 1, 6, 7.5, and 9.5 bps since Friday.

MBS spreads (for FNMA 30–year 3.0%) narrowed by 1 bps into November 20th, but widened back that same amount last week. Last Monday, the Treasury sold $26 billion 2–year notes at a yield of .948%, which was the highest rate since April 2010. The auction was rated above average (4 of 5), and demand was the strongest since September. Foreign buying rose to 45.7% from 40% in October. Last Tuesday's 5–year note auction was rated average, with $35 billion in supply coming at 1.67%. The yield was the highest since June, and demand rose versus October. Foreign account allocations fell from 58.9% in October to 56.7%. Wednesday's $29 billion of 7–year notes brought 2.013%. Demand was the lowest since September, and the yield was the highest since July. Foreign buyers bought 55.9% of the offering compared to 62.3% last month. Next week, the U.S. Treasury will auction 3–year notes on Tuesday (12/08), 10–year notes on Wednesday (12/09), and 30–year bonds on Thursday (12/10).

11/27/15 Treasury Yield Curve	**2-Year: 0.920%**	**5-Year: 1.645%**	**10-Year: 2.221%**	**30-Year: 2.997%**
Weekly Yield Change:	+.001	–.042	–.042	–.023%
11/20/15 Treasury Yield Curve	**2-Year: 0.919%**	**5-Year: 1.687%**	**10-Year: 2.263%**	**30-Year: 3.020%**
Weekly Yield Change:	+.082	+.034	–.004	–.032%
Support:	0.95/ 0.98/ 1.01/ 1.04%	1.65/ 1.68/ 1.71/ 1.75%	2.21/ 2.25/ 2.29/ 2.33%	2.95/ 3.00/ 3.04/ 3.08%
Targets:	0.92/ 0.89/ 0.86/ 0.83%	1.62/ 1.59/ 1.56/ 1.53%	2.15/ 2.11/ 2.07/ 2.04%	2.91/ 2.87/ 2.83/ 2.79%

Economics

GDP remained at 2.10% in the latest 3Q revision. Personal Consumption fell .20% back to 3.00%. The GDP Price Index was .10% higher to 1.30%, while core Personal Consumption was unchanged at 1.30%. Initial Jobless Claims remained very low, falling from 272K to 260K last week. Continuing Claims rose from 2,173K to 2,207K. Consumer Confidence fell from 99.1 to 90.4, and University of Michigan Sentiment fell from 93.1 to 91.3. The Michigan read on Current Conditions fell from 104.8 to 104.3 and Expectations dropped from 85.6 to 82.9. ISM Manufacturing fell from 50.1 to a contraction reading of 48.6. ISM Prices Paid fell from 39 to 35.5. Kansas City Fed Manufacturing Activity rose from 0 to 1. A bit 'less negative' were Chicago (from –.29 to –.04) and Dallas (from –12.7 to –4.9). ISM Milwaukee fell from 46.66 to 45.34, Chicago Purchasing dropped from 56.2 to 48.7, and Richmond Fed fell from –1 to –3. Personal Incomes rose .40% in October, while Spending rose only .10%. The Personal Consumption Expenditures deflator rose .10%, but was only .20% higher year–over–year. The core rate (ex food & energy) was flat, while annual core PCE remained at 1.30%. Orders for Durable Goods rose 3.00% in October (after falling .80% in September). Ex transportation, orders rose .50%.

October Existing Home Sales fell 3.42% to 5.36M – though they were slightly higher by 2.1% year–over–year. New Home Sales rose 10.74% to 495K units in October, but they had fallen by 15.50% the previous month. Pending Home Sales were up only .20%, but had fallen 1.60% in September. Metro home prices (S&P/Case–Shiller 20 city) rose .61% in September. The annual pace rose from 5.13% to 5.45%. Their Home Price Index rose .83%, increasing the annual pace from 4.56% to 4.86%. The FHFA House Price Index rose .80% in September. For the third quarter, the House Price Purchase Index rose 1.30%. Construction Spending rose 1.00% in October. Vehicle Sales were flat at 18.12M units for November. However, domestic sales fell from 14.14M to a 14.03M pace.

Wednesday is set for MBA Mortgage Applications (which fell 3.20% last week), 3Q Nonfarm Productivity & Unit Labor Costs, the Fed's Beige Book, and the first look at November payrolls from ADP Employment Change. Thursday gives us a second look from Challenger Job Cuts, along with jobless claims data, Bloomberg Consumer Comfort (which last week fell from 41.2 to 40.9), the service–sector outlook (ISM Non–Manufacturing), October Factory Orders, and Durables Goods Orders. Friday provides the October Trade Balance (deficit), and the full payroll reports for November including labor force participation, the unemployment rate, underemployment, hourly earnings, and average hours. Next Monday gives us the Fed's jobs dashboard (Labor Market Conditions Index Change) and October Consumer Credit. Tuesday is set for NFIB Small Business Optimism and October JOLTS Job Openings.

Equities

Following the worst week since August into November 13th, stocks moved with our cycles and had their best weekly gain for 2015 into the 20th. We projected a high near December 4th, and even got a pullback into November 30th as forecast. Into the 20th, the Dow gained 3.35%, the S&P 3.27%, and the Nasdaq 3.59%. Last week, the Dow lost 25.32 points or .14% to 17,798.49. Though modest, many indexes managed gains for November (following a huge October of well over 8%). Gains today, left the Dow ahead .50% for the week. The S&P rose .94 points or .04% to 2,090.11, and it's .60% higher this week. The Nasdaq rose 22.61 points or .44% to 5,127.52, and it's .56% better this week. The Dow Transports rose 3.64% and fell 1.04% over the past 2 weeks, and are off .14% this week. Bank stocks rose 3.01%, lost .01%, and are .86% higher this week. Once again, given our equity cycles: *"We would not want to be long after the 4th!"*

	Dow:	Nasdaq:	S&P:
Resistance:	17,913/ 17,989/ 18,054/ 18,121	5,193/ 5,229/ 5,267/ 5,302	2,106/ 2,117/ 2,129/ 2,140
Support:	17,719/ 17,600/ 17,454/ 17,324	5,156/ 5,121/ 5,086/ 5,051	2,093/ 2,082/ 2,071/ 2,056

Other Markets

Over the past 2 week, Commodities fell .56% and .27%. They're .63% higher this week. Crude Oil lost .86%, rallied 3.27%, and is .34% better this week. Gold lost .43% and 1.87%, but is .72% higher since Friday. The U.S. Dollar gained .53% and .45%, but is .23% lower this week. The Japanese Yen lost .16%, gained .01%, and is .06% lower so far this week. The Euro lost 1.18% and .50%, but is .38% better this week. Corn rose 1.40%, lost 1.10%, and then added 2.16% into today. Cotton lost 2.66%, rallied 4.31%, and then fell .69% to start off this week.

"Achievement is largely the product of steadily raising one's levels of aspiration and expectation." Jack Nicklaus

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management

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