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BOND MARKET REVIEW

December 17, 2015

The Force Awakens!
FOMC moves are normally no big deal, but there hadn't been a change in their key rate since it hit 'near zero' near the end of 2008, there'd been no increases since June 2006, and the last liftoff dated back to June of 2004. In fact, this move had been so trumpeted, the FOMC actually risked some credibility had they not kicked off with a 25 bps hike on Wednesday. The Fed's been talking up a gradual pace of rate increases for quite a while. They chose to highlight that posture saying: *"The Committee currently expects that, with gradual adjustments in the stance of monetary policy, economic activity will continue to expand at a moderate pace and labor market indicators will continue to strengthen."* We see that specific language as a defensive posture that shows their concern over the fragility of global markets and our 'modest to moderate' recovery. Fed Chair Janet Yellen did get her unanimous vote to liftoff. Unlike previous rounds of tightening, the odds for another hike at the next meeting which occurs January 27th were less than 7%. The market is buying a delay until March 16th for any further tightening. While the Fed has 8 meetings scheduled in 2016, their dot–plot forecasts are 'signaling' only 4 hikes. Yellen said: *"We really need to monitor over time actual inflation progress to make sure that it is conforming, it is evolving in the manner that we expect."* Retaining some license and mystery, she said not to expect equally spaced hikes. Given some of our cycle work and economic assessments, the **B**ond **M**arket **R**eview is leaning to the under on those projections of 4 hikes.

With the payroll numbers somewhat showing *"that underutilization of labor resources has diminished appreciably since early this year"*, they noted inflation still running below their 2% goal. Despite Crude Oil and Commodities tumbling to their lowest levels in over a decade, the FOMC said: *"Inflation is expected to rise to 2% over the medium term as the transitory effects of declines in energy and import prices dissipate and the labor market strengthens further."* Even a first–year law student might object to deeming free–falling commodities and low inflation as transitory – citing the assumption of facts not in evidence! Nevertheless, they said they would *"carefully monitor"* inflation levels and also continue reinvesting rolloffs of Treasury and Mortgage Backed Security investments *"until normalization of the federal funds rate is well under way."* Unless of course, there really is a 'new normal'!

After asking us to do so for quite a while, the International Monetary Fund turned their attention to the Bank of England – asking them to keep rates on hold! Are things really better? The U.S Financial Conditions Index was weaker this week than before the last two Fed meetings. That goes to the case that the FOMC was on a mission to get off zero. If we remain the world's customer, given weak U.S. manufacturing, it's alarming that China's 4th–quarter results are showing slumping growth and falling profits – with a recovery possibly delayed until 2018.

Looking Ahead
- Bond yields should rise steadily into month end.
- Our stock cycles show another trend–change high near the 21st, with a major low due near January 11th.
- All financial markets will close early on Christmas Eve. Merry Christmas and all our best for the holidays!

Treasuries, Agencies, and MBS
Our cycles said yields should rise and then were *"bottoming out and mixed into the Fed meeting. After that, we expect a steady rise into the end of the month."* The past few days gave us another chance to *"sell and/or place hedges back on."* With the first FOMC hike behind us, we think short–term instruments will continue to price in the 4 anticipated 25 bps hikes over the coming year, while long rates will rise a bit, but be driven more by inflation expectations – which we don't currently view as 'transitory'.

Last week, yields fell 6.5, 15, 14, and 14 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today they rose with our expected pattern by 11, 15, 9.5, and 5.5 bps. MBS spreads (for FNMA 30–year 3.0%) widened by 7 bps last week. The other major U.S. Treasury auctions are set for the last week of the year with 2–year notes coming on Monday (12/28), 5–year notes on Tuesday, and 7–year notes on Wednesday.

Though foreign entities moved $16.6 billion out of longer–term Treasuries, they increased holdings overall by $68.9 billion in October. The U.S. Current Account Balance for the third quarter widened $124.1 billion – the most since the 4th quarter of 2008. While that could mean that we are once again increasing buying through imports, it's also a reflection of challenged imports from the recently–stronger dollar and a falloff in manufacturing.

12/11/15 Treasury Yield Curve	2-Year: 0.877%	5-Year: 1.554%	10-Year: 2.128%	30-Year: 2.871%
Weekly Yield Change:	–.064	–.152	–.142	–.139%
Support:	0.99/ 1.01/ 1.04/ 1.07%	1.71/ 1.75/ 1.78/ 1.82%	2.25/ 2.29/ 2.33/ 2.37%	2.94/ 2.99/ 3.03/ 3.08%
Targets:	0.96/ 0.94/ 0.91/ 0.87%	1.68/ 1.64/ 1.62/ 1.59%	2.18/ 2.15/ 2.11/ 2.08%	2.89/ 2.86/ 2.82/ 2.78%

Economics

Initial Jobless Claims fell from 282K down to 271K – showing consistency in the slowness of layoffs. Continuing Claims fell 7K to 2,238K. Bloomberg Consumer Comfort rose from 40.1 to 40.9 and Bloomberg Economic Expectations rose from 42.5 to 43.5. University of Michigan Sentiment bumped up .5 to 91.8. Current Conditions rose from 104.3 to 107, but their Expectations component fell .9 to 82. Empire Manufacturing was a little less negative at –4.59 versus –10.74, while the Philadelphia Fed Business Outlook fell from flat to –5.9.

November Retail Sales rose .20%. Ex autos and gas they rose .50%, and a 'control group' was .60% higher. The pickup was the strongest in 4 months. Consumer Prices were flat in November, and .20% higher ex food & energy. They annual pace rose from .20% to a still–low .50%. Ex food & energy the core annual pace was .10% higher to 2.00%. Weekly Earnings fell from an annual 2.40% pace to 1.60%, revealing continued low wage pressures. Producer Prices, however, rose .30% – the most in 5 months. The core rate was the same. That elevated the annual pace from a 1.60% drop to only a negative 1.10%. The core rate was .40% higher to .50%. October Business Inventories were flat. Homebuilder outlook fell a point to 61 (NAHB Housing Market Index). Housing Starts looked better, increasing 10.45% in November to 1,173K. They rose 12.46% to last year. Building Permits rose 11.02% to 1,289K and were up 22.53% to last November. The Leading Index for November rose a respectable .40%, partially on the strength of strong housing starts. Industrial Production fell .60% and Capacity Utilization slipped from 77.50% to 77.00%.

Friday and Monday are set for the Kansas City and Chicago Fed National Activity indexes. Tuesday updates 3Q GDP, along with Personal Consumption, the GDP Price Index, the FHFA House Price Index, Existing Home Sales for November, and Richmond Manufacturing. Wednesday brings MBA Mortgage Applications (which fell 1.10% last week), November Personal Income & Personal Spending, the PCE Deflator, Durable Goods Orders, New Home Sales, and the University of Michigan sentiment surveys. Thursday gives us jobless claims data, Bloomberg Consumer Comfort, and an early Christmas Eve close for all financial markets. The **B**ond **M**arket **R**eview wishes you a very Merry Christmas – and our next issue will come the following week.

Equities

Fed Chair Janet Yellen said the hike should show Americans the Fed's *"confidence in the U.S. economy."* Americans bought it – for a couple hours … Today, prices reversed that sharp post–announcement rally of Wednesday afternoon. Stocks had sold off sharply into Monday the 14th – over 700 Dow points or 4% to our cycle turn on the 4th. We had said the next two rallies into *"near December 15th and the 21st"* should be *"additional opportunities to sell."* After incorporating the data into today, the cycles are still pointing to an important low near January 11th. Last week, the Dow lost 582.42 points or 3.26% to 17,265.21. The Dow is 1.34% higher this week, but had been over 3% higher until today's 253–point selloff. The S&P lost 79.32 points or 3.79% to 2,012.37, but was 1.47% higher by today's close. The Nasdaq tumbled 208.81 points or 4.01% to 4,933.47 – its first close under 5,000 in over 3 weeks. It's now 1.40% higher since Friday. The weaker Dow Transports plunged 5.41% last week, and were only .12% higher by today's close. Bank stocks also tumbled 6.20%, but rose 2.89% into today.

Resistance:	Dow:	17,434/ 17,567/ 17,652/ 17,771	Nasdaq:	5,003/ 5,033/ 5,061/ 5,104	S&P:	2,041/ 2,054/ 2,065/ 2,076
Support:		17,237/ 17,148/ 17,038/ 16,911		4,956/ 4,920/ 4,885/ 4,851		2,019/ 2,008/ 1,996/ 1,986

Other Markets

Earlier this week, Crude Oil closed at a new decade–plus low. Following the 4.17% loss into the 4th, Crude plunged 10.88% last week. It's 1.88% lower this week. That pushed Commodities 4.58% lower last week, and off another 2.38% into today. Commodities are in free fall, hitting new multi–decade lows this week. It's increasingly hard to buy the Fed case that the current bout of disinflation is indeed *"transitory."* Gold lost .70% last week, and was 2.42% lower into today. The U.S. Dollar lost .81% last week, but rallied back 1.81% this week. The Japanese Yen had risen 1.71%, but has lost 1.28% since Friday. The Euro gained .96%, but has dropped 1.46% so far this week. Corn fell .86% last week, but is .34% higher this week. Cotton rose .76%, but is down 1.13% this week.

"Let not Christmas be the only day – you get down on the floor with your children to play! Read a book, steal their nose, and stick out your tongue – Wiggle each of their toes – for these things keep you young." DI

"God bless us, every one!" Charles Dickens

Additional Information is Available on Request
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