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Bond Market Review

January 21, 2016

Ride Along 2

The Chinese year of the Red Fire Monkey begins February 8th, but what we've seen so far is more like a Black Clawing Bear. It's the outgoing year of the Sheep – in bear's clothing! Overall, 2016 is now off to the worst global start on record! The markets have been riding along with the record stimulus provided by central banks since emerging from the financial crisis. They seem to have overshot the reversal! Could a 25 bps hike really lead to such a 'market tantrum?' Whether coincidence or part catalyst, 25 bps upward in rates was followed by trillions lost in global equities! Forty global markets have now traded into bear territory – which is 20% off a top. 10% is considered a 'correction', and most others have satisfied that non– ceremonious plunge. Many global markets entered a correction in the first 2 weeks of 2016 alone. For example, our Nasdaq fell 13.86% and the Dow and S&P were off around 11% to the end of 2015, but they were another 3% or so lower to our December 4th cycle.

Just how 'transitory' is inflation? This week, Commodities fell to new multi–decade lows and Crude Oil plunged to its lowest levels since January 2004. Gas wars in Michigan sent fuel to 47 cents a gallon a few days ago. Since the Fed's liftoff on December 16th, yields have fallen 36, 35, and 29 bps for the 5, 10, and 30–year Treasury sectors. It appears that bonds are siding with the **B**ond **M**arket **R**eview forecast that the Fed will not hike 4 times in 2016. Today's auction of 10–year Inflation Protected Securities saw the lowest demand since July 2008. Last week, we said: *"The global stock selloff since December 30th has dropped the odds for a March FOMC hike from near 50% steadily down to only 38.6% as of today."* The continuation of that selloff had most U.S. and global indexes down 10 to 15% or more for 2016 alone – and much more since our last high cycle on December 4th. By today, the March odds for a hike had fallen from 38.6% then – to only 22.1%. The April and June odds fell to 26.4% and 41.3%. Of course a lot can happen between now and then! For now, the market–indicated chance for a rate hike in January is a big '0%', and next Wednesday's FOMC meeting should be a huge non–event – at least for talk of raising rates. The Fed will note continued improvements in growth as reported in the Beige Book, but will no doubt voice concern over the market turmoil and growth challenges in global markets.

The Fed's Beige Book reported 2 regions with 'moderate' growth, and 7 with only 'modest' gains. New York and Kansas City were *"essentially flat"*, while Boston was *"upbeat."* Still – nothing stellar! New York and San Francisco saw modest increases in wage pressures, but the rest of the country reported wage pressures as *"minimal."* They did note the impact of challenges within the energy sector. It was interesting to us that, just after year end, Fed Vice Chairman Stanley Fischer said rates increases would be needed if *"financial markets were overheating."* Even as equities extended their 'dip', Cleveland's Mester and San Francisco's Williams reminded the markets that the underlying fundamentals of the U.S. economy remained very sound. Last week, New York's William Dudley said *"the situation does not appear to have changed much"* since the FOMC December 16th meeting. Really???

Clearly the markets are not overheating! At least not presently. Neither are inflation or wage pressures. Global markets, and arguably ours, are cooling! Speaking to the renewed selloff in crude oil prices, FRB St. Louis President James Bullard said *"the associated decline in market–based inflation expectations measures is becoming worrisome."* We agree! But, it's not just oil! December Retail Sales fell .10%, leaving the 2015 gain at only 2.10% – the smallest advance of this expansion. Wal–Mart announced the closing of 269 stores, 154 of which are in the U.S. It's not just the stores being closed. It's those roughly 10,000 jobs, and the loss of those incomes on each community. We don't do fundamental analysis on companies, but did read where a number of high–profile U.S. companies are struggling with debt and may soon seek a restructure or bankruptcy. In Euroland, inflation and growth concerns are still a big problem. The Euro just fell to a 2–week low after European Central Bank chief Mario Draghi signaled they may have to add more economic stimulus measures as soon as March.

Looking Ahead

- Bond yields have lows due between now and January 26th.
- Our equity cycles still show stocks trading off from January 22nd to a low near January 27/28.
- The FOMC will announce January's interest–rate policy stance on Wednesday the 27th at 2 pm ET.

Treasuries, Agencies, and MBS

Treasury investors don't believe the Fed's hike path – at least until the equity–pain stops! Into January 15th, the yield on the 2–year note fell for 12 straight trading sessions. The 2–year note is the maturity that is the most subject to Fed policy. Last week, yields fell 8, 10.5, 8, and 9.5 bps for the 2, 5, 10, and 30–year Treasury sectors. This week, they're also a bit lower, falling 1.5, 1, .5, and .5 for those maturities.

MBS spreads (for FNMA 30–year 3.0%) widened 3 bps each of the past 2 weeks. Last Tuesday (01/12), the U.S. Treasury Department sold $24 billion 3–year notes at a 1.174% yield. Demand was the lowest since the November auction, and the yield was the lowest since October's. Foreign buying jumped from 47.4 in December to 62.8% for this auction, which was rated an above–average '4 of 5'. On Wednesday (01/13) the November 2025 issue was reopened to add $21 billion 10–year notes at 2.09%. The auction was rated outstanding (5 of 5), and demand was the best since December 2014. The yield was the lowest since October and foreign bidding rose from 62% last month to 72% of this offering! On Thursday the 14th, the Treasury also reopened the November 2045 issue to add $13 billion 30–year bonds at a 2.905% yield. The auction was rated average with demand falling versus last month. The yield was the lowest since last August and foreign buying fell from 63.9% last month to 56.5%.

Next week, the U.S. Treasury will auction $26 billion 2–year notes on Tuesday (01/26), $35 billion 5–year notes on Wednesday (01/27), and $29 billion 7–year notes on Thursday.

01/15/16 Treasury Yield Curve	**2-Year: 0.852%**	**5-Year: 1.454%**	**10-Year: 2.036%**	**30-Year: 2.814%**
Weekly Yield Change:	–.082	–.107	–.080	–.096%
Support:	0.88/ 0.92/ 0.96/ 1.01%	1.51/ 1.55/ 1.57/ 1.62%	2.09/ 2.12/ 2.16/ 2.19%	2.86/ 2.90/ 2.95/ 3.00%
Targets:	0.83/ 0.80/ 0.77/ 0.75%	1.47/ 1.45/ 1.41/ 1.38%	2.02/ 1.98/ 1.95/ 1.91%	2.82/ 2.78/ 2.74/ 2.70%

Economics

JOLTS Job Openings rose from 5,349K to 5,431K for November. Initial Jobless Claims for January 9th rose from 277K to 283K. Last week, they hit a 6–month high of 293K! It's worth noting that claims have been steadily rising since late October. Continuing Claims rose from 2,234K to 2,264K, but then fell to 2,208K. Maybe the Fed's right, Bloomberg Consumer Comfort rose from 44.2 to 44.4, and then fell to 44 today – not showing great concern over equity prices. In fact, Economic Expectations rose from 43.5 to 47. NFIB Small Business Optimism improved from 94.8 to 95.2, and IBD/TIPP Economic Optimism was .2 better to 47.3. The University of Michigan Sentiment survey rose from 92.6 to 93.3, though Current Conditions fell from 108.1 to 105.1. Expectations rose from 82.7 to 85.7. Empire Manufacturing dropped from –6.21 to –19.37. However, the Philadelphia Fed Business Outlook was less negative, rising from –10.2 to –3.5.

Retail Sales fell .10% in December, though revised .20% higher to .40% for November. Ex autos and gas, sales were flat. The control group fell .30%. Import Prices fell 1.20% in December, leaving them 8.20% lower for the year. Consumer Prices fell .10% leaving them only .70% higher annually. Ex food & energy, they rose .10%, and were also .10% higher to 2.10% annually. Weekly earnings remained at a 1.60% annual increase. Producer Prices fell .20%, leaving the annual pace .10% higher to a 1.00% decline. Ex food & energy, PPI rose .10% to an annual .30% pace. Industrial Production fell .40% in December, and was adjusted .30% lower to a .90% drop for November. Capacity Utilization fell from 76.90% to 76.50%. Business Inventories dropped .20% in November.

Home builder outlook (NAHB Housing Market Index) was flat at 60. December Housing Starts also cooled, falling 2.54% to 1,149K – though up 5.70% versus last year. Building Permits fell 3.90% to 1,232K (up 16.23% versus December 2014). Overall foreign entities reduced Treasury holdings by $3.2 billion in November. However, they moved $31.4 billion into longer maturities. December's Monthly Budget Statement showed a $14.4 billion deficit – already 22% above last year's pace, and the effects of rising borrowing costs have yet to be factored into the equation.

Friday is set for December Existing Home Sales, the Leading Index (LEI), and the Chicago Fed National Activity Index. Next Monday (01/25) gives us Dallas Fed Manufacturing Activity. Tuesday follows with the FHFA House Price Index for November along with S&P/Case–Shiller Home Price data. Also due are board Consumer Confidence and Richmond Fed Manufacturing. Wednesday gives us MBA Mortgage Applications (which rose 21.30% and then 9% over the past 2 weeks), New Home Sales, and the interest–rate policy statement from the FOMC January meeting.

Equities

Not being long after December 4th turned out to be a great strategy! Our next cycle (of lesser degree) shows another downtrend from the 22nd into the 27th or 28th. Even though we do expect a bounce up into the 22nd, we refrained from wanting to buy until later this month given the huge downside momentum. We don't want to step in front of locomotives that are rolling with any inertia!

Last week, the Dow fell 358.37 points or 2.19% to 15,988.08. It's .66% lower this week, after having been down as much as 3.36%. The S&P dropped 41.70 points or 2.17% to 1,880.33, and is .60% lower since Friday. The Nasdaq plunged 155.21 points or 3.34% to 4,488.42, and is .36% lower this week. The Dow Transports fell 3.70%, but are a slight .01% better this week. Bank stocks lost 4.16%, and are down another 3.74% this week.

Resistance:	Dow:	16,167/ 16,462/ 16,729/ 16,987	Nasdaq:	4,582/ 4,649/ 4,713/ 4,788	S&P:	1,906/ 1,949/ 1,994/ 2,020
Support:		15,709/ 15,450/ 15,207/ 14,960		4,447/ 4,382/ 4,316/ 4,250		1,862/ 1,817/ 1,778/ 1,735

Other Markets

The 75% selloff we observed for Crude Oil in the early '90s was replicated by a 77.7% drop from the July 2008 high. Since August 2013, Crude has dropped 75.45% possibly repeating that pattern – so these last lows could be close to a bottom. Crude fell under $30/barrel for the first time since early 2004. However, our next important timing for an important low in Crude Oil is near March 4th – which of course could be from a higher level. Last week, Crude Oil tumbled 11.28% leading Commodities 5.13% lower. They're still .50% lower this week, though Crude has risen .37% since Friday. Gold lost .66%, but is .69% better this week – making up that drop. The U.S. Dollar gained .43% last week and is .11% higher this week. The Japanese Yen gained .24%, but is .62% lower this week. The Euro fell .05% last week, but has fallen .38% this week as the ECB may add stimulus within a few months. Corn gained 1.75%, and tacked on 1.03% into today. Cotton rose .02%, and added another 1.11% so far this week.

"Those who dream by day are cognizant of many things which escape those who dream only by night."
Edgar Allan Poe

"Follow the grain in your own wood."
Howard Thurman

Additional Information is Available on Request
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