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BOND MARKET REVIEW

February 25, 2016

Red Card

The Dow fell deeply into the red to kick off 2016, plunging 11.33% into January 20th. However, just like a soccer player that went to the ground writhing in agony and pain, it suddenly rose just before the stretchers were brought onto the field. The Dow plunged again into February 11th, and once again regained strength to rise to the highest levels since January 7th. That pattern repeated into Wednesday's low with the Dow falling over 265 points in the morning – only to close up for the day. Today's 212–point gain sent the Dow to its highest levels since 'earlier' in the day on January 7th (a brutal 392–point down day), leaving it 8.07% above its lows, and only 4.18% lower for the year. How many times can the bull cry wolf – or the bear cry bull? The **B**ond **M**arket **R**eview laid out a cyclic outlook that called for a rally into March 1st, and another advance from the 14th into a possible high near March 17th – before stocks might once again resume their downtrend. After all, sometimes those soccer players really do get hurt.

A Pickup in Manufacturing?

We do our best to be objective concerning economic data, but are sometimes subjective in our bias when the data is either confirming or in direct conflict with our medium to long–term cycle work. We also lean to the internal math. The markets were greatly pleased that January orders for Durable Goods rose 4.90% versus only 2.90% expected. It was also a slight positive that December's drop was only 4.6% instead of a previously–reported 5.0% decrease. Does that mean the U.S. manufacturing machine is back? While it certainly beats a decline, a 4.6% drop followed by a 4.90% gain nets out to only a modest 2–month improvement – with a few orders pushed from December into January. Ex transportation, orders rose 1.80% – 6 times the .30% expected, with December's 1.00% drop revised to only –.70%. That was a bit more promising. Capital Goods Orders surged 3.90% in January – the most since 2014, rising from the lowest levels in over 2 years. The Leading Index was another story. Leading Indicators fell for a second month, dropping .20% in January – with December's decline revised to .30% instead of only .20%. The selloff in stocks and a rise in jobless claims were large components in the decline, each of which has since improved.

Looking Ahead

- The bond cycles call for higher yields into March 9th, with another yield high near March 21st.
- Our equity cycles show stocks turning again lower from trend change highs due March 1st and 17th.

Treasuries, Agencies, and MBS

The next FOMC policy meeting is scheduled for March 15th and 16th. While Kansas City's Esther George said her forecast is still solid for 2016, and that the March hike should be *"on the table"*, she acknowledged that the markets have clearly taken that hike *"off the table."* (Over the past 2 weeks, the odds for a March hike have risen from 0% to 10%, while the odds for even one more hike in 2016 have been running below 43% – leaving four very unlikely!) Cleveland's Loretta Mester thinks the U.S. can work through the *"market turbulence"* and *"soft patch"*, while Vice Chair Stanley Fischer said it's *"still early to judge"* the impact of that turbulence over the first 7 weeks of 2016.

Last week was rather tame for Treasuries, at least on a net basis. They traded 10 bps higher in yield, but ended the week pretty much where they started. While the rally continued into Wednesday morning, early trading today was back in the middle of the trading range in place since February 12th. While there are good and bad data factors hitting the markets, big U.S. banks boosted their holdings of U.S. Treasuries to the highest levels in over two years. It's make us wonder, if things are so good – why the defensive posture by 'big money'? While yields rose 2.5 and 1.5 bps for the 2 and 5–year sectors last week, as we said the 10 and 30–year ended unchanged. Into today, yields were lower by 1.5, 5.5, 3, and 1 bps for the 2, 5, 10, and 30–year sectors. Yields were lower into our cycle on the 19th, but fell to lower levels on Wednesday. Yields should continue to rise into March 9th.

MBS spreads (for FNMA 30–year 3.0%) pulled in by 4 bps last week. Tuesday's 2–year note auction was rated above average ('4 of 5'), as the U.S. Treasury sold $26 billion supply at .752%. That was the lowest yield since last September, with the sale drawing the highest demand since November. Foreign buying was off a little to January, dropping from 57.9% to 55.8%. Wednesday's 5–year note sale was also rated above average. $34 billion 5–year notes were sold at a 1.169% yield – which was the lowest since the March 2013 offering! Demand matched the statistics for January's auction. However, foreign buying rose from 53.5% in that prior sale to a strong 67.3%. Today's $25 billion 7–year note auction was delayed until Friday (02/26) due to technical difficulties.

02/19/16 Treasury Yield Curve	2-Year: 0.744%	5-Year: 1.225%	10-Year: 1.746%	30-Year: 2.606%
Weekly Yield Change:	+.028	+.014	–.003	+.001%
Support:	0.83/ 0.87/ 0.90/ 0.93%	1.27/ 1.30/ 1.33/ 1.36%	1.77/ 1.81/ 1.84/ 1.88%	2.67/ 2.71/ 2.75/ 2.78%
Targets:	0.75/ 0.71/ 0.68/ 0.65%	1.22/ 1.19/ 1.17/ 1.14%	1.74/ 1.71/ 1.67/ 1.64%	2.59/ 2.55/ 2.51/ 2.47%

Economics

Data today revealed that the U.S. services industry contracted for the first time since 2013 (during the government shutdown). The Markit Services PMI Business Activity data fell from 53.2 to 49.8 – where below 50 signals negative growth (over 50 signals expansion). Initial Jobless Claims fell 7K to a 3–month low of 262K last week. They were 10K higher to 272K this week. Continuing Claims rose 29K to 2,272K, but fell 19K to 2,253K this week. Consumer Confidence fell from 97.8 to 92.2. Bloomberg Consumer Comfort dropped from 44.5 to 44.3 last week, and another .1 to 44.2 today. Bloomberg Economic Expectations were closer to board confidence data – dropping from 47 to 42.5. The Chicago Fed National Activity Index improved from –.34 to +.28, and the Philadelphia Fed Business Outlook was less negative in rising from –3.5 to –2.8. However, Kansas City Fed Manufacturing Activity fell from –9 to –12 and Richmond dropped from +2 to –4. Consumer Price inflation was flat in January, though rising by .30% ex food & energy. Annual CPI rose from .70% to 1.40%, quite a jump, but well under the Fed's goals. The core annual pace rose .10% to 2.20%. Real Average Weekly Earnings rose 1.20% in January, following a 1.70% rise in December.

The House Price Purchase Index was up 1.40% for 4Q 2015, and the FHFA House Price Index for December rose .40%. 4Q Mortgage Delinquencies fell from a 4.99% to a 4.77% pace, and MBA Mortgage Foreclosures dropped from 1.88% to 1.77% – positive signs for U.S. housing (and U.S. household creditworthiness). The S&P/Case–Shiller Home Price Index rose .78% in December, quickening the annual price advance from 5.22% to 5.43%. However, even with a .80% increase in metro home prices (20–city index), the annual appreciation was steady at 5.74%. Following a December that had been the strongest in 10 months, New Home Sales slumped 9.19% (from a 544K pace to 494K). That was the largest decline since May 2010, and set sales down 1.02% versus last January. However, Existing Home Sales rose .37% to a 5.47M pace, and that was up 13.49% versus last year.

Friday brings an update on 4Q 2015 GDP & Personal Consumption, January data for Personal Income & Spending, and the University of Michigan sentiment surveys. Election (leap) years allow for an extra day of data – along with more time for campaigning. Closing out February reporting on Monday, February 29th, data includes ISM Milwaukee, the Chicago Purchasing Manager report, January Pending Home Sales, and Dallas Fed Manufacturing Activity. 'Super Tuesday' (03/01) brings IBD/TIPP Economic Optimism, ISM New Orders & Manufacturing, January Construction Spending, and Vehicle Sales for February. Wednesday is set for MBA Mortgage Applications (off 4.3% last week), ISM New York, the Fed's Beige Book (activity and outlook by region), and a first glance into next Friday's February jobs reports from the ADP Employment Change data.

Equities

Stocks had their best gains for 2016 last week, with their best performance since November. Into today, the Dow had reduced its 2016 loss of 1,974.47 points (–11.33%) as of January 20th, to (only) 727.74 points or 4.18%. With another high due by March 1st, this rally should begin to lose some steam – though we do expect a subsequent rally to higher levels into March 17th. For the week, the Dow rose 418.15 points or 2.62% to 16,391.99. It's up another 1.86% since Friday. The S&P gained 53 points or 2.84% to 1,917.78, and is 1.77% better this week. The Nasdaq surged 166.92 points or 3.85% to 4,504.43, and is up another 1.73% this week. The Dow Transports rose 3.37% last week, and are 1.15% higher this week (lagging the other indexes). Bank stocks rose 2.20%, but have lost .31% so far this week.

Resistance:	Dow:	16,821/ 16,952/ 17,081/ 17,212	Nasdaq:	4,624/ 4,658/ 4,692/ 4,726	S&P:	1,962/ 1,984/ 2,006/ 2,028
Support:		16,561/ 16,435/ 16,306/ 16,175		4,556/ 4,522/ 4,488/ 4,455		1,940/ 1,918/ 1,896/ 1,874

Other Markets

With oil stockpiles reported at 86–year highs and OPEC countries maintaining production levels, Crude Oil prices have remained under pressure, but did manage a .68% gain last week. Crude has rallied 11.57% this week. Demand for Gold waned as stocks recovered. Gold lost .70% last week, but gained .63% into today. Commodities lost .45% last week, but were 1.88% higher into today with an assist from crude oil. Demand for U.S. assets had the Dollar stronger by .65% last week, and another .70% higher into today. The Japanese Yen rose .55%, but fell .33% so far this week. The Euro lost 1.12% last week, and retreated another 1.01% into today. Corn gained 1.88%, but is 2.74% lower this week. Cotton joined that direction with a 1.88% loss last week, and a drop of 3.08% since Friday.

Harper Lee, author of 'To Kill a Mockingbird' passed away last Friday.

She once said: "*Delete the adjectives and [you'll] have the facts.*"

She also said: *"Before I can live with other folks, I've got to live with myself. The one thing that doesn't abide by majority rule is a person's conscience." Harper Lee (4/28/1926 – 2/19/2016)*

Additional Information is Available on Request

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