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

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BOND MARKET REVIEW

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The Walking Dead

When one is seeking to elude a zombie, they're thankful that the 'walkers' don't seem to be able to move or change direction very fast. The fright results from the sheer numbers, the relentless pursuit, and the lack of resources to fight off the hoard. The G20 finance ministers (Group of 20) met and sought ways to increase growth and revive the global economy. The International Monetary Fund just reelected French–born Christine Lagarde to another term as its head. She has a record of pressuring central banks to provide more global stimulus, and has many times asked the Fed to keep rates low or delay removal of stimulus. Her latest idea: *"We need a tax system where multinational companies and wealthy individuals contribute a fair share to the public purse."* More global taxes added to federal, state, health care, Medicare, unemployment, sales, property, fuel, etc.? The U.S. already gives plenty to the IMF, but along with the Chinese agreed that increased government spending would be in order. While the kind of reasoning one would normally expect from the Brits, Germany made the case that bumping up debt in order to fund growth only leads to 'Zombifying' economies.

While 'not quite dead yet' in Pythonesque terms, many global economies have been limping along more like the 'walking wounded' for a decade now. It seems that every year the Fed forecasts GDP growth of 3% or above, only to miss those forecasts. Final U.S. GDP was only 2.4% in 2015, matching the GDP growth for 2014. In fact, U.S. GDP hasn't been able to grow above 3% for 10 straight years now. The 4th–quarter result for U.S. GDP was revised upward from .70% to 1.00%. While still rather slow, the increase was due to some factors which were actually more negative than positive. Inventories were reported higher ($81.7 billion versus $68.6 billion) and imports fell .6%. Dropping imports signals expectations of less spending, and inventories spilled over supply into 2016 (less need for early–2016 orders). Growth in the United Kingdom was 2.2% while Japan and most EU countries saw limited to no growth. Some other global nations, including Brazil and Russia are in recessions. India leads with growth over 7%!

With the **B**ond **M**arket **R**eview's expectation of an economic trough in 2016, global growth should remain challenged this year. That what our cycle work indicates, and it would keep the negative interest–rate strategies alive – even though they've failed for Japan. Though our Fed hiked once at the end of 2015, Japanese and EU central bankers are still seeking stimulus measures. The G20 said they *"will use all policy tools – monetary, fiscal and structural – individually and collectively"* in efforts to strengthen the recovery. In the zombie–avoidance camp, Germany's Finance minister Wolfgang Schaeuble argued: *"Fiscal as well as monetary policies have reached their limits. … If you want the real economy to grow, there are no shortcuts without reforms."* If you consider the attitude of the global and domestic electorate, it's clear that reform is off the table and Lagarde's type of tax and/or spend options are preferred. Most people just want stuff, and debt is of no concern – because it's other people's money.

U.S. Treasury Secretary Jacob Lew cited weak demand as the central issue. He said: *"We need to redouble our efforts to boost global demand rather than relying on the United States as the consumer of first and last resort."* If we (more than) doubled our deficit and the Fed's balance sheet to get where we are, the **BMR** would ask what does redouble mean? We're quite certain it doesn't mean cut spending, IMF funding, or benefits in half! Yet, the IMF's Lagarde warned: *"Without collective, deliberate action on the part of policymakers and implementation there is risk that the recovery could derail."* That's quite an ominous tone as things seemed on track during the December FOMC meeting! One of the hottest topics, and another perceived headwind (at least to the EU) has been whether or not Britain will opt out of the EU. (They don't use the Euro due to trade and low interest–rate concerns.) However, they are bound by the open–immigration policies of the EU which are increasing security and economic concerns. If the U.K. did opt for the 'Brexit', it would be yet another blow to the rest of the EU – and not merely a flesh wound!

Looking Ahead

- The bond cycles call for higher yields into March 9th, with another yield high near March 21st.
- Our equity cycles are down from March 7th to the 14th, and then higher into March 17th.

Treasuries, Agencies, and MBS

The Fed's Beige Book noted setbacks in agriculture and energy (due to low prices). Manufacturing, exports, and tourism were challenged by the strength in the dollar. Nevertheless, most of the economy continued to expand at a 'moderate' pace and wages were higher. Kansas City saw a modest decline, while New York and Dallas said activity was flat. FRB San Francisco President John Williams said negative rates were not being considered and that upcoming Fed forecasts would probably not vary too much, maybe a *"tenth here or there"* to those done in December. Dallas' Robert Kaplan said the Fed should *"avoid having a predetermined mindset regarding the path of policy"* and *"show patience in decisions to remove accommodation."*

Yields rose by 5, 1.5, 1.5, and 3 bps for the 2, 5, 10, and 30–year sectors last week. Those sector yields were 5, 10, 7, and 2 bps higher into today. The delay of the 7–year note auction from Thursday to Friday cost the Treasury roughly $200 million as rates rose around 10 bps since the originally–scheduled time. No big deal. $200 million is only about .00105% of what we owe! Friday's rescheduled 7–year note auction bought 1.568% for $28 billion in supply. The auction was rated below average ('2 of 5') and demand was the lowest since February 2009! The yield was the lowest since May 2013, but might have been around 10 bps lower if not delayed by technical difficulties. Foreign buying fell to 53.5% from January's 69.4% level.

MBS spreads (for FNMA 30–year 3.0%) pulled in by 1 bps last week. Next week, the U.S. Treasury will auction $24 billion 3–year notes on Tuesday (03/08), $20 billion 10–year notes on Wednesday (03/09), and $12 billion 30–year bonds on Thursday (03/10).

02/26/16 Treasury Yield Curve	2-Year: 0.795%	5-Year: 1.241%	10-Year: 1.763%	30-Year: 2.637%
Weekly Yield Change:	+.051	+.016	+.017	+.031%
Support:	0.90/ 0.93/ 0.95/ 0.98%	1.41/ 1.44/ 1.47/ 1.50%	1.92/ 1.96/ 1.99/ 2.03%	2.77/ 2.81/ 2.85/ 2.89%
Targets:	0.87/ 0.84/ 0.80/ 0.77%	1.35/ 1.32/ 1.29/ 1.26%	1.85/ 1.82/ 1.78/ 1.74%	2.69/ 2.65/ 2.61/ 2.57%

Economics

ADP Employment Change showed a pickup of 214K private–sector jobs in February, above expectations and pointing to decent overall results on Friday. Challenger Job Cuts were up 21.80% versus last February. Initial Jobless Claims rose 6K to 278K and Continuing Claims were 3K higher to 2,257K. 4Q GDP was revised .30% higher to 1.00%, resulting in 2.4% growth for 2015 (the same as in 2014). Personal Consumption rose 2.00% and the GDP Price Index was .90% higher. In January, Personal Income was up by .50% – and Personal Spending matched that result. Nonfarm Productivity fell 2.20% in 4Q 2015, and Unit Labor Costs rose 3.30%.

The University of Michigan surveys were more upbeat. Sentiment rose 1 point to 91.7, Current Conditions were 1 point better to 106.8, and Expectations rose from 81 to 81.9. ISM Manufacturing improved from 48.2 to 49.5 (though still showing contraction below 50). ISM Prices Paid jumped from 33.5 to 38.5. ISM New Orders were flat at 51.5. ISM Milwaukee rose from 50.36 to 55.22, and Dallas Fed Manufacturing Activity was a little less negative (–31.48 versus a previous –34.6). However, Bloomberg Consumer Comfort fell from 44.2 to 43.6, and IBD/TIPP Economic Optimism fell from 47.8 to 46.8. ISM New York dropped 1 point to 53.6 and Chicago Purchasing Managers fell from 55.6 to 47.6. January Factory Orders rose 1.60%, but fell .20% ex transportation. Orders for Durable Goods jumped 4.70% and 1.70% (ex trans).

The service sector outlook slipped from 53.5 to 53.4 (ISM Non–Manufacturing Composite), slowing for a 4th month. Though still expanding, the service sector saw its first drop in jobs since 2014. The Personal Consumption Expenditures rate rose .10% in January, bumping the annual pace .60% higher to 1.30%. Ex food & energy, PCE rose .30%, lifting the core annual pace .20% to 1.70% – each yearly result still well under the Fed's 2.00% target. In January, Pending Home Sales fell 2.50% – the most since December 2013. Construction Spending increased by 1.50% in January. Vehicle Sales fell .03M off their January pace, to 17.43M for February. Domestic sales dropped from 13.79M to a 13.74M pace.

Friday is set for February payroll numbers including the Unemployment Rate, and the U.S. Trade Balance (deficit) for January. Monday (03/07) brings the FOMC jobs dashboard (changes in the Labor Market Conditions Index) and January Consumer Credit. Tuesday follows with NFIB Small Business Optimism. Wednesday provides data for MBA Mortgage Applications (off 4.80% last week), and January data for Wholesale Inventories and Trade Sales.

Equities

The Dow powered 348.58 points higher into March 1st, confirming our cycle work and reaching the highest level since January 7th. Our equity cycles turn down from March 7th into the 14th, and then up into a top near March 17th. The Transports actually moved positive for 2016 on Wednesday, if only by .11%. As of today, the Transports were up 1.24% for 2016, while the Dow was still off 2.76%, the S&P off 2.47%, and the Nasdaq lower by 5.99%. The Transports are however still 18.35% off their 11/28/14 high, while the Dow is only 7.67% lower to its 5/19/15 record high. For the week into the 26th, the Dow gained 247.98 points or 1.51% to 16,639.97. Though by only 50.20 points, it rose in February for the first time in 3 months. It's up 1.83% this week. The S&P gained 30.27 points or 1.58% to 1,948.05, but still lost .41% in February (down for a 3rd month). It's 2.33% higher since Friday. The Nasdaq gained 86.04 points or 1.91% last week to 4,590.47, and is 2.55% better this week. It was the weakest major index last month, with a 1.21% decline.

The Dow Transports had a 6th weekly gain, rising 1.63% – and are up 2.66% this week. Bank stocks rose for a second week, adding 1.35%, and are 5.32% better this week. Bank stocks fell 5.65% in February for a third loss.

Resistance:	Dow:	17,034/ 17,165/ 17,296/ 17,430	Nasdaq:	4,762/ 4,831/ 4,901/ 4,970	S&P:	2,023/ 2,046/ 2,069/ 2,092
Support:		16,903/ 16,769/ 16,646/ 16,520		4,691/ 4,625/ 4,558/ 4,490		1,979/ 1,957/ 1,933/ 1,913

Other Markets

Gold entered a bull market this week, having risen above 20% – actually 21.26% above its 12/17/2015 low. Gold lost .81% last week, but was 3.10% higher into today. Crude Oil surged 10.59% last week, and was 5.46% better into today. While also well above 20% (over 35%) to its February lows, oil bulls seem very cautious. Commodities, with those assists, were 1.28% higher last week, and 2.08% better into today. The U.S. Dollar surged 1.63% higher last week, but was .58% lower into today. The Japanese Yen lost 1.22%, but was ahead by .27% so far this week. The Euro plunged 1.76% last week, but was .21% better into today. Corn lost 3.01%, and was .21% lower into today. Cotton fell 3.48%, but recovered .86% so far this week.

"The right word may be effective, but no word was ever as effective as a rightly timed pause." Mark Twain

"Some mornings it just doesn't seem worth it to gnaw through the leather straps." Emo Phillips

"I never vote for anyone; I always vote against." W. C. Fields

Additional Information is Available on Request

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