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BOND MARKET REVIEW

March 10, 2016

The Choice

BMR issue #750 comes as stocks completed their best 3–week rally since 2014 and their 3 strongest weeks (over 1.5% each) since 2009. That said, most indexes are still down for 2016, and well off their 2015 highs. While our Dow is only 2.47% lower for 2016, many global stocks are still off double digits. For example, the Japanese Nikkei is down 12.18%, Germany's DAX off 11.59%, and the Euro stock index 9.08% lower. Will the Fed choose to listen to jobs data, inflation measures, or the travail of global markets? While stocks have recovered quite well (as the cycles said they should have), the cycles once again turn negative the day after the Fed meeting – and the **B**ond **M**arket **R**eview still has an economic trough due in 2016! The Dollar has strengthened substantially over the past few years as our Fed was signaling an end to stimulus while other central banks were still seeking ways to stimulate growth and battle deflation. With today's statement by European Central Bank President Mario Draghi that the ECB wouldn't need to cut rates any further, the Dollar traded 1.32% higher and then 1.24% lower (an intraday loss of 2.56%) before closing down 1.02% for the day. The Euro fell as Draghi said rates could go lower and that the ECB was *"not short of ammunition"*, but then rallied as he said: *"We don't anticipate it will be necessary to reduce rates further."*

Looking Ahead

- Our bond cycles call for another push to higher yields into March 21st.
- Our equity cycles are calling for a rally from March 14th to the 17th, followed by a drop into late March.
- The FOMC will announce March's interest–rate policy stance on Wednesday the 16th at 2 p.m. EDT.
- Daylight Savings Time is upon us. Spring those clocks forward 1 hour at 2 a.m. Sunday, March 13th.

Treasuries, Agencies, and MBS

Our bond cycles were satisfied with yields moving up into the 9th, and 10–year yields today reaching their highest levels since February 1st. Last week, yields rose 7, 13.5, 11, and 6 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, yields were higher by 6.5, 7, and 6 bps for 2, 5, and 10–years, but flat at 30–years. The next selloff should see the highest yields near March 21st. If that rolls out on schedule, bonds would then rally into April 1st – which would be time to sell or get fully hedged. It's looking now as if the highest Treasury yields would come in late May to early June – giving us the potential for an important buying opportunity for U.S. debt.

With negative and very low rates still out there globally, even after our rally to lower rates, U.S. bonds offer a lot of spread versus alternatives. It's more than you'd think! This week the spread between U.S. and Japanese 2–year notes reached its widest since 2008, and the U.S. to German gap grew to the most since 2006. The U.S. 2 to 30–year spread hit its lowest difference since 2008. That flattening has traditionally implied that investors believe inflation is waning and/or growth may be slowing. However, internals show the 10–year note 'expensive' to the curve. Treasuries had rallied on Tuesday – with stocks dropping, and the Japanese 10–year note falling to a record –.112% yield.

The FOMC will meet on Tuesday and Wednesday next week. While the next 'gradual hike' had been 'scheduled' for this March meeting, a global rout in stocks has most market participants expecting the Fed to hold rates at current levels. We expect the FOMC to acknowledge some promising U.S. data, including the continued pickup in payrolls, but to hold off any actions given the headwinds of slowing global growth and recent market turmoil. Obviously the Fed knows we don't, and doesn't assume, that the U.S. operates in a vacuum. Last Thursday, the probability of a March hike was only 8%, with September being the next chance over 50%. As of today, the chance for a March move fell to only 4%, but the next coin–toss chance moved forward to the July meeting.

MBS spreads (for FNMA 30–year 3.0%) pulled in by a stout 10 bps last week. This week's 3 and 10–year note auctions were rated a poor '2 of 5'. On Tuesday, the U.S. Treasury Department sold $24 billion 3–year notes at 1.039%. Demand was the weakest since July 2009, though foreign buying rose from 41.5% in February to 46.2% this week. On Wednesday, the Treasury reopened the February 2026 10–year note to add $20 billion at 1.895%. Demand was the lowest since August 2015. Foreign participation fell from 62.3% last month to 56.5% for this issue. Today's 30–year bond auction was rated an above–average '4 of 5' as $12 billion supply brought 2.72%. Last month's auction was also reopened to add to the February 2046 issue. Demand was the highest since January, and foreign buying rose from 58% last month to 60.9% at this sale.

03/04/16 Treasury Yield Curve	2-Year: 0.864%	5-Year: 1.375%	10-Year: 1.875%	30-Year: 2.695%
Weekly Yield Change:	+.069	+.134	+.112	+.058%
Support:	0.98/ 1.01/ 1.04/ 1.07%	1.53/ 1.59/ 1.65/ 1.71%	1.99/ 2.06/ 2.13/ 2.20%	2.77/ 2.81/ 2.85/ 2.89%
Targets:	0.94/ 0.90/ 0.86/ 0.83%	1.41/ 1.35/ 1.29/ 1.23%	1.92/ 1.84/ 1.78/ 1.73%	2.69/ 2.65/ 2.61/ 2.57%

Economics

February payrolls beat expectations of 195K job gains with a 242K increase. There was also a 30K revised increase for the past 2 months. Though Private Payrolls rose by 230K, Manufacturing was reported to lose 16K jobs – reflecting some weakness in recent data for that sector. The U.S. Unemployment Rate remained at 4.90% as the labor force also grew. The Labor Force Participation Rate rose from 62.70% to 62.90%. The Underemployment Rate fell from 9.90% to 9.70%. While most of these observations would be positive, the Fed's jobs dashboard showed some speed bumps. That Labor Market Conditions Index was revised from a .4 increase to a .8 decrease for January, and February's reading was another decline of 2.4 points. Obvious factors adversely affecting the data were Average Hourly Earnings falling .10%, and dropping the annual gain from 2.5% to 2.2%. Also, Average Weekly Hours fell by .2 to 34.4. Initial Jobless Claims fell from 277K to 259K, and Continuing Claims dropped from 2,257K to 2,225K.

Another sign of potential slowdown came from Consumer Credit rising by the smallest amount since November 2013. At $10.538 billion for January, Americans borrowed less than half of their December levels. We also paid down (reduced outstanding) credit for the first time since February 2015! While the Trade Balance deficit widened from $44.7 billion to $45.68 billion, the strong Dollar was deemed to be a factor in sending U.S. exports to their lowest levels in over 5 1/2 years. NFIB Small Business Optimism fell from 93.9 to 92.9. Bloomberg Consumer Comfort rose .2 to 43.8. January Wholesale Inventories rose .30%, while Wholesale Trade Sales fell 1.30%. The deficit for February's Monthly Budget Statement was almost $4 billion less than forecast at $192.6 billion. Fiscal 2016 is running about 8.7% better versus 2015 (deficit wise).

Friday's only important data release is February Import Prices. However, the two days the FOMC will meet are full of economic releases including some key inflation data. Thus, the Fed will have plenty of data to consider prior to their interest–rate policy announcement next Wednesday at 2 p.m. EDT. Next Tuesday (03/15) provides February Retail Sales, Producer Prices (PPI), Empire Manufacturing, home–builder outlook (NAHB Housing Market Index), January Business Inventories, and net international U.S. Treasury flows. Wednesday brings MBA Mortgage Applications (which rose .20% last week), February Housing Starts & Building Permits, Consumer Prices (CPI), Industrial Production, Capacity Utilization, and of course the FOMC policy decisions.

Equities

The broad indexes made highs with our cycles on the 7th, and the next important move should be a rally from the 14th into the 17th. We then expect a selloff into month end, followed by a rally to a top in an April 14th–to–19th window. Last week, the Dow gained 366.80 points or 2.20% to cap off a 3–week gain of 1,032.93 points or 6.46% to 17,006.77. It's off .07% since Friday. The Nasdaq rose 126.55 points or 2.76% to 4,717.02 (8.75% in 3 weeks). It's off 1.16% this week. The S&P rose 51.94 points or 2.67% to 1,999.99, but was .52% lower into today. The Dow Transports gained 3.33%, but were 1.75% lower so far this week. Bank stocks surged 6.19%, but were 2.9% lower into today.

Resistance:	Dow:	17,212/ 17,345/ 17,475/ 17,608	Nasdaq:	4,745/ 4,814/ 4,885/ 4,955	S&P:	2,023/ 2,035/ 2,047/ 2,058
Support:		16,952/ 16,823/ 16,691/ 16,519		4,671/ 4,609/ 4,558/ 4,470		1,991/ 1,980/ 1,969/ 1,958

Other Markets

We have a number of readers with an interest in the Crude Oil markets. With the plunge in Crude Oil from over $107/barrel to under $30 in less than 2 years, the number of U.S. drilling rigs is now at multi–decade lows. In fact, even natural gas rigs fell below 100 for the first time in roughly 30 years, as the whole energy sector has been challenged. Our cycles show Crude up into March 21st, down into the 28th, and then peaking near April 12th. That would be the time for producers to set hedges. We expect a hard fall from that point into a low near May 16th. Commodities rose 4.25% last week, and were 1.98% higher into today – as Crude surged 9.58%, and then another 5.35%. Gold rose 4.12%, but was only .17% higher into today. The U.S. Dollar lost .85% last week, but fell 1.32% into today (after having been 1.20% higher for the week at one point today). The Japanese Yen gained .23%, and has added .48% since Friday. The Euro rose .65%, and surged another 1.56% into today. Corn was flat last week, and 2.26% better this week. Cotton gained 1.74%, but fell 3.56% into today.

"When you reach for the stars you may not quite get one, but you won't come up with a handful of mud either."
Leo Burnett

Additional Information is Available on Request

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