Bond Market Review

March 16, 2016

Crossroads
As much as the Fed and global central banks want to see numbers pointing to a pickup in inflation, some of the data just won't cooperate. While Crude Oil rallied to close at its highest level since early December, Import Prices, Producer Prices, and Consumer Prices all declined in February! Retail Sales declined in February, and were revised to a falloff for January as well. Even without 'global turmoil', these would be troublesome indicators for the FOMC in seeking to hike rates. As expected, the Fed held rates unchanged. Kansas City's Esther L. George voted against the statement – preferring to go ahead and hike rates per the FOMC's originally–stated trajectory.

Given our read on economic cycles, the **B**ond **M**arket **R**eview thought it unlikely the Fed would hike rates at a *"gradual pace"* their planned 4 times in 2016 – following the first increase in nearly a decade during their December 2015 meeting. The 'Dot Plot' forecasts of members of the committee now project only 2 more hikes in 2016. As the oft–quoted poem goes, their 'get up and go has got up and went!' Fed chair Janet Yellen said the participant's shift in forecasted assessments of rate policy *"largely reflects a somewhat slower path for global growth, for growth in the global economy outside the United States, and for some tightening in credit conditions in the form of an increase in spreads."* With fewer hikes expected, and the European Central Bank's position that it will not cut any further, the Dollar's premium versus the Euro has been eroding (unwinding the strength based on the reverse of those assumptions).

The explanation within Yellen's sentence was there to emphasize a reverse of the age–old break–up line: 'It's not me – it's you.' – as the Fed wants to clearly delineate what they see as good U.S. data versus a global drag that could hinder our growth if there were a turn for the worse. Last week, we said: *"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."* As expected, the Fed said *"economic activity has been expanding at a moderate pace"*, but added *"despite the global economic and financial developments of recent months."* The FOMC said they expect *"labor market indicators to continue to strengthen."* (While jobs have picked up, we recall from last week that the Fed's Labor Market Conditions Index has declined for the last 2 months!) Nevertheless, in keeping with our projected theme, the Fed followed with: *"However, global economic and financial developments continue to pose risks."*

Looking Ahead
- Our bond cycles call for another push to higher yields into March 21st.
- Our equity cycles are calling for a drop from March 17th into later this month.

Bounce
Stocks have returned from the abyss – for now. The added stimulus from the European Central Bank and the continued rally in Crude Oil were factors contributing to U.S. stocks (and some globals) rising for the 4th week in a row. The same cycle work that kept us out of stocks as they fell, allowed us to expect an advance into March 17th. With today's rise into that trend–change date, that cycle is now satisfied. Can we assume equities will soon begin a down trend? No, but neither can we assume they won't! After all, we have to trust our work – and certainly wouldn't know when to 'fade' it. The **BMR** cycles were negative from December 4th into January 27th/28th, and the Dow lost 10.66% over that horizon (close to close). The cycles were then positive into March 17th, and the Dow has risen 8.66% since then – to reach its highest levels for 2016. Stocks did trade lower into early February, but we were well pleased with the way the cycles caught those huge moves. The Dow and S&P still project lower prices from March 17th, though the NYSE projection shows a high closer to March 22nd. With the 10–year yield cycle pointing to a trend–change high near March 21st, we can't rule out that 22nd trend–change high projected by NYSE stocks (the broader market). That could also represent a second chance to hedge or sell equity positions.

Treasuries, Agencies, and MBS
The odds for the next hike range from 7.7% in April, to 37.8% in June, 42.6% in July, and 52.5% for September (the first meeting over 50%). Records show that foreign central banks scrambled to raise cash during the market turmoil in January. They were net sellers of $57.2 billion in U.S. Treasuries. That rose from December's $48 billion and was the highest monthly dumping of U.S. debt by central banks since 1978. Overall, foreigners reduced long–term holdings of U.S. debt by $12 billion. Though that was for January, Treasuries sold off for a third straight week into last Friday. Yields rose 9.5, 12, 11, and 6 bps for the 2, 5, 10, and 30–year sectors. That trend has reversed since Friday with yields lower by 10, 11, 7.5, and 4.5 bps for those sectors.

Numerous EU–area sovereign yields are negative out to 5–years, while Japanese and Swiss yields are negative out to 10–years. That still makes U.S. debt a comparative bargain. MBS spreads (for FNMA 30–year 3.0%) pulled in by 4 bps last week. Our bond cycles point to yields falling again after another high due near March 21st.

03/11/16 Treasury Yield Curve	2-Year: 0.957%	5-Year: 1.493%	10-Year: 1.985%	30-Year: 2.754%
Weekly Yield Change:	+.093	+.118	+.110	+.059%
Support:	0.90/ 0.94/ 0.97/ 1.00%	1.41/ 1.47/ 1.53/ 1.59%	1.95/ 1.99/ 2.06/ 2.13%	2.71/ 2.73/ 2.75/ 2.77%
Targets:	0.84/ 0.80/ 0.76/ 0.72%	1.35/ 1.29/ 1.23/ 1.17%	1.84/ 1.78/ 1.73/ 1.68%	2.67/ 2.65/ 2.63/ 2.61%

Economics

Last week, Initial Jobless Claims fell from 277K to 259K, and Continuing Claims fell 2K to 2,225K. In February, Average Weekly Earnings rose .60% versus last year. Industrial Production fell .50%, and Capacity Utilization dropped .40% to 76.70%. Empire Manufacturing rose from –16.64 to +.62. Business Inventories rose .10% in January. Not only were Retail Sales .10% lower in February, that was following January's .40% drop that had previously been released as a .20% gain. Ex autos, sales also fell .10%, and January's data was revised from a .10% increase to a .40% decline. The Retail Sales 'Control Group' was flat in February, and was revised from .60% to only .20% in January (though still an increase).

In February, Import Prices fell .30%, though the annual pace of decline slowed from –6.30% to –6.10%. Producer Prices fell .20%, though the PPI ex food & energy was unchanged. However, the annual PPI pace rose from a .20% decline to flat, and the core rate increased from .60% to 1.20%. Consumer Prices also fell .20%, though the core (ex food & energy) increased by .30%. The annual CPI pace fell from 1.40% to 1.00%, but the core pace was .10% higher to 2.30%. Home builder outlook was flat at a still–positive 58 reading. Housing Starts rose 5.18% in February to 1,178K units. That was 29.74% above last year's pace. However, Building Permits dropped 3.07% to 1,167K, up a milder 5.90% versus February 2015.

Thursday is set for jobless claims data, the Current Account Balance for 4Q 2015, the Philadelphia Fed Business Outlook, Bloomberg Economic Expectations, Bloomberg Consumer Comfort (which last week bumped .2 higher to 43.8), JOLTS Job Openings, and February's Leading Index. Friday brings University of Michigan survey measures for Sentiment, Current Conditions, and Expectations. Next Monday (03/21), gives us February sales of Existing Homes, and the Chicago Fed National Activity Index. Tuesday follows with the FHFA House Price Index and the Richmond Fed Manufacturing Index. Wednesday is set for New Home Sales for February, and MBA Mortgage Applications (which fell 3.30% last week).

Equities

Stocks rose for a 4th week, and then continued higher into our March 17th trend–change date for a high – reaching their highest levels for 2016 (though still well off their 2015 highs). While most global indexes are still negative for 2016, the Dow and S&P cuts their losses to just over 1%. (Japan's Nikkei was still off 10.82%, Hong Kong 7.56% lower, and Germany's DAX off 7.07%.) For the week, the Dow gained 206.54 points or 1.21% to 17,213.31. It's .65% better this week. The S&P rose 22.20 points or 1.11% to 2, 022.19, and is .25% higher this week. The Nasdaq added 31.45 points or .67% to 4,748.47, and was .33% higher into today. The Dow Transports gained .54%, and are .47% higher this week. Bank stocks lost .17%, and are 1.56% lower this week.

	Dow:	Nasdaq:	S&P:
Resistance:	17,480/ 17,608/ 17,741/ 17,876	4,779/ 4,814/ 4,850/ 4,884	2,047/ 2,058/ 2,070/ 2,081
Support:	17,216/ 17,084/ 16,956/ 16,821	4,712/ 4,670/ 4,608/ 4,575	2,011/ 1,991/ 1,969/ 1,948

Other Markets

Commodities rose 2.95% last week, and were .13% higher into today. Crude Oil supplied a good part of last week's improvement with a 7.18% rally. Crude was .10% lower into today, but is poised to rise for a 5th week – given our cycle work for a rise into March 21st (with a tradable top near April 12th). Gold lost .89%, and was 2.35% lower into today. The U.S. Dollar lost 1.20%, falling for a second week, and was off .26% into today. The Euro rose 1.37%, and has added .61% since Friday. The Japanese Yen fell .11%, but has rallied 1.14% so far this week. Corn gained 3.24%, and was .61% higher into today. Cotton fell 3.02%, but has improved by 2.05% this week.

"Don't throw away the old bucket until you know whether the new one holds water." Swedish Proverb

Additional Information is Available on Request
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