BOND MARKET REVIEW

April 06, 2016

Unwinding Fed Targets

If more folks enter (or reenter) the workforce, labor force participation would continue to grow above 4–decade lows and also serve to raise the U.S. unemployment rate – should entrants outpace job creation. Yet, there could be more people working, less on assistance, and more tax collection. In other words, a higher unemployment rate might actually be accompanied by a healthier economy – while moving the jobs statistics away from the Fed's 'full employment' level! The reverse of that logic is why the **B**ond **M**arket **R**eview has been suspect of falling unemployment in the light of low labor force participation. Despite another month with 200K plus jobs added, the Fed's jobs dashboard (Labor Market Conditions Index Change) fell 2.1 points – following January's 2.5–point drop.

When the FOMC left rates unchanged in March, their post–meeting comments were mostly dovish – especially those of Fed Chair Janet Yellen. Nevertheless, the minutes from that meeting (released today) showed that an April move was seen as 'jumping the gun'. They said: *"A number of participants judged that the headwinds restraining growth and holding down the neutral rate of interest were likely to subside only slowly. In light of this expectation and their assessment of the risks to the economic outlook, several expressed the view that a cautious approach to raising rates would be prudent or noted their concern that raising the target range as soon as April would signal a sense of urgency they did not think appropriate."* With that release, the odds for an April hike remained at zero – and they were only marginally higher for the June meeting and beyond. The first toss–up month (over 50% odds) is still December.

The minutes said that *"in contrast"*, there were at least a few participants indicating *"that an increase in the target range at the Committee's next meeting might well be warranted if the incoming economic data remained consistent with their expectations for moderate growth in output, further strengthening of the labor market, and inflation rising to 2% over the medium term."* As we know now, the payroll report was mixed, manufacturing and services improved, and it would be nearly impossible to gauge an inflation change of that magnitude over only 6 weeks.

Speaking to inflation, the minutes said: "*Some participants saw the increase as consistent with a firming trend in inflation. Some others, however, expressed the view that the increase was unlikely to be sustained, in part because it appeared to reflect, to an appreciable degree, increases in prices that had been relatively volatile in the past."* St. Louis FRB President James Bullard said: *"Growth has been somewhat tepid."* He said he'd be willing to push rate hikes *"further into the future"* if the sluggish growth were to persist. Bullard also said: *"Although labor markets have shown dramatic improvement, U.S. real economic growth has remained stubbornly low."*

Looking Ahead

- The bond cycles indicate higher yields from a low near April 7th into April 26th.
- Our equity cycles are peaking April 12th and 14th, though the broader market extends out to the 19th.

Treasuries, Agencies, and MBS

Into April 1st, Treasuries had their best week since January – and they're off to their best start since 2008. Good data on the economy and March jobs would normally have thwarted an advance, but slowing global economies and very–low to negative rates on alternative global bonds allowed yields to drop into our cyclic window for lower rates that ends April 7th. After tomorrow, our bond cycles show yields rising into the 26th – just a day before the next FOMC policy statement is due on April 27th. Last week, yields dropped 14.5, 16.5, 13, and 7.5 bps for the 2, 5, 10, and 30–year sectors (not only improving, but adding steepness to the curve). Into today, 2–year yields rose 1 bps, while those outer sector yields fell by 1.5 bps.

MBS spreads (for FNMA 30–year 3.0%) narrowed by 3 bps, while the 2.5% coupon spread was unchanged. Next week, the U.S. Treasury will auction $24 billion 3–year notes on Tuesday (04/12), $20 billion 10–year notes on Wednesday (04/13), and $12 billion 30–year bonds on Thursday (04/14).

04/01/16 Treasury Yield Curve	2-Year: 0.724%	5-Year: 1.215%	10-Year: 1.771%	30-Year: 2.600%
Weekly Yield Change:	–.147	–.164	–.130	–.074%
Support:	0.74/ 0.76/ 0.79/ 0.83%	1.22/ 1.26/ 1.31/ 1.35%	1.75/ 1.80/ 1.84/ 1.87%	2.58/ 2.60/ 2.62/ 2.64%
Targets:	0.70/ 0.67/ 0.65/ 0.63%	1.13/ 1.10/ 1.07/ 1.02%	1.70/ 1.67/ 1.64/ 1.61%	2.52/ 2.50/ 2.48/ 2.46%

You are cordially invited to the 14th Annual CSC Bank Conference to be held Thursday, April 28th, 2015 at the Four Seasons Resort & Hotel, Irving, Texas. Please contact Susan Tomcko at (214) 545-6824 or stomcko@cstreetcap.com for details.

Economics

Despite a pickup of 215K jobs in March, the U.S. Unemployment Rate rose to 5.00% from January and February's 8–year lows of 4.90%. Part of the cause for the increase was the Labor Force Participation Rate rising from 62.90% to 63.00% (from its 4–decade low of 62.40% this past September). The Underemployment Rate also rose .10% (from 9.70% to 9.80%). The net 2–month revision in payrolls was a modest 1K loss. Private Payrolls rose 195K, but Manufacturing lost 29K jobs. However, manufacturing data revealed the first expansion in 7 months, so that sector could be on the mend. ISM Manufacturing increased from 49.5 to 51.8. There was a surge in ISM New Orders, from 51.5 to 58.3, and ISM Prices Paid jumped from 38.5 to 51.5. The manufacturing numbers had not been so kind for February. Factory Orders fell 1.70%, and were .80% lower ex transportation. Orders for Durable Goods fell 3.00%, and were 1.30% lower ex transportation. Average Hourly Earnings rose .30%, though the year–over–year (annual pace) was steady at 2.30%. Average Weekly Hours also held steady at 34.4. Initial Jobless Claims rose 12K last week to 2–month high of 276K. JOLTS Job Openings fell from 5,604K to 5,541K. Also, despite the positives of the March payroll numbers, the Fed's jobs dashboard fell 2.1 points (following February's 2.5–point drop in the Labor Market Conditions Index). The Service Sector had its first increase in 5 months as the ISM Non–Manufacturing Composite rose from 53.4 to 54.5. Construction Spending fell .50% in February.

University of Michigan Sentiment rose 1 point to 91. Their Current Conditions survey held at 105.6, but Expectations rose from 80 to 81.5. IBD/TIPP Economic Optimism fell from 46.8 to 46.3. ISM New York fell from 53.6 to 50.4. In March, Vehicle Sales slowed from 17.43M to a 16.46M pace. Domestic sales slowed from 13.74M to a 12.97M pace. The U.S. Trade Balance deficit widened to a 6–month high $47.1 billion in February (from $45.9 billion).

Thursday is set for jobless claims data, Bloomberg Consumer Comfort (which last week fell from 43.6 to 42.8), and Consumer Credit for February. Friday's data is February Wholesale Inventories and Trade Sales. Next Tuesday (04/12) gives us NFIB Small Business Optimism, March Import Prices, and the Monthly Budget Statement for March. Wednesday brings MBA Mortgage Applications (which last week rose 2.70%), March Retail Sales, Producer Prices (March PPI), February Business Inventories, and the Federal Reserve's Beige Book.

Equities

On Tuesday, global equities had their largest drop since February. Stocks dipped into our April 4th to 7th window, and should soon have a more important cycle turn from a high due near April 12th to 14th. (We still expect a coincident high in Crude Oil near the 12th.) Though the broader market has a peak nearer April 19th, this confluence of cycles is the type we usually see before a larger downturn. We always include the cycle work, as it's been a lifetime pursuit – and allows the application of much training in physics and math. However, as the old Danish saying goes: 'Prediction is very difficult – especially about the future!'

To date, the Dow and S&P made their 2016 highs on April 1st. After 5 weekly winners, stocks lost into Easter, but resumed gains last week as the Dow rose 277.02 points or 1.58% to 17,792.75. It was .43% lower into today. The S&P gained 36.84 points or 1.81% to 2,072.78, but is off .30% so far this week. The Nasdaq rallied 141.04 points or 2.95% to 4,914.54, and is .13% higher this week. Falling for a second week, the Dow Transports lost .48% and are another 1.70% lower since Friday. Bank stocks fell .15%, and are 1.28% lower so far this week.

Resistance:	Dow:	17,687/ 17,799/ 17,931/ 18,065	Nasdaq:	4,909/ 4,944/ 4,979/ 5,014	S&P:	2,055/ 2,067/ 2,074/ 2,090
Support:		17,533/ 17,400/ 17,269/ 17,140		4,840/ 4,804/ 4,769/ 4,735		2,043/ 2,033/ 2,023/ 2,011

Other Markets

Our cycles are showing Crude Oil rising into April 12th, with a subsequent sharp drop into May 16th. Last week Crude tumbled 6.77%, but that rise into next week could have started with this week's 2.61% advance. Commodities fell 2.41% last week, and were .30% lower into today. Gold rose .05% last week, and is also a modest .02% higher this week. The U.S. Dollar lost 1.62% last week, and concluded its worst quarter in over 3 years. Following the Fed's March–meeting minutes, the Dollar fell to a 1.5–year low. It's off another .19% this week. The Japanese Yen surged to its highest level versus the Dollar in 17 months. It gained 1.07% last week, and is 1.70% higher so far this week. Last week, the Euro gained 1.94%, and its .07% higher this week. Corn lost 4.32%, but is 1.13% higher this week. Cotton gained 2.56%, but is .76% lower since Friday.

"The greatest use of life is to spend it for something that will outlast it." William James

Additional Information is Available on Request
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