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

April 13, 2016

Start Spreading the News

Investors want to be a part of it – that is, the New York read on economic growth! Atlanta's GDP forecast (termed 'GDPNow') is signaling only .1% growth for Q1 2016. While reducing that read twice (from earlier estimates of 1.4% to .7%), the New York model ('Nowcast') raised their forecast back from .9% to their late–March level of 1.1%. One concern the markets might have, is that the Atlanta forecast has traditionally been pretty good. So, who's right?

The Beige Book, reporting economic conditions in the Fed's 12 districts, said retail prices *"increased modestly"*, and that wages were higher in every district except Atlanta. Surely, that affected Atlanta's modeling! The report continued to use the modestly–moderate language we've now seen for years: *"Most districts said that economic growth was in the modest to moderate range and that contacts expected growth would remain in that range going forward."* Not only have we achieved mediocrity, we're planning on more of it! In the **B**ond **M**arket **R**eview (03/31/2016), we said: *"GDP growth over 3% vanished 10 years ago and any tangible inflation hasn't returned since the financial crisis."*

Consumer spending rose *"modestly"* while auto sales were strong in several regions. (However, the March Retail Sales report said demand for autos fell the most since February 2015!) Cleveland was the only district reporting a decline in overall employment. Manufacturing has improved, as other data has shown – and only Cleveland and Kansas City noted declines for that sector. Data contributing to a positive outlook (though not in this report per se), was that 2 million workers have entered (or reentered) the labor force for the largest 6–month gain since 1990.

Just as the New York GDP forecast was more upbeat than Atlanta's, the Beige Book outlook was much less gloomy than that of the International Monetary Fund! The IMF's Vitor Gaspar warned of global debt rising in the face of weakening growth. He said without strong action of policymakers, the globe risked slipping into stagnation. Gaspar contended that if GDP growth were to slide further for leading economies, that public and private debt levels would be too high as a proportion of output. He said: *"In such circumstances, you can imagine that households, firms, and governments will be tempted to cut further expenditures. That puts further downside pressure on nominal GDP growth, and that would be a spiral that one must avoid."* The IMF said low growth, low inflation, and high public debt present a 'triple threat' to advanced economies. Gaspar also said risks were *"more considerable"* than they were 6 months or a year ago. The IMF lowered growth forecasts, and said the world was more exposed to negative shocks.

Interestingly, former Fed Chair Ben Bernanke said this week that helicopter money may still be the *"best available alternative"* to deal with certain *"extreme circumstances."* FRB New York President William C. Dudley joined a number of Fed members, including Chair Janet Yellen, this week in calling for a *"cautious and gradual approach"* to hikes. Dudley said the balance of risks to his inflation and growth outlooks were still *"tilted to the downside."*

Looking Ahead

- The bond cycles indicate higher yields into April 26th.
- Our equity cycles peak by April 14th, though the broader market may extend out to the 19th.

Treasuries, Agencies, and MBS

Yields dropped today, but they are still higher than their lows made on April 7th with the **BMR** 10–year note cycle. As we said last week, following April 7th, *"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, into April 8th, yields dropped 2.5, 6.5, 5.5, and 4.5 bps for the 2, 5, 10, and 30–year sectors. Since Friday, yields have risen 5, 6, 4.5, and 3 bps for those sectors. Incoming data did little to sway the market's expectations for only one more Fed hike in 2016. The first month over 50–50 odds for a hike remained 51.4% for December – which last week was at 53.7%. The odds for April remained at 0%.

MBS spreads (for FNMA 30–year 2.5%) widened by 1 bps. Tuesday's $24 billion 3–year note auction brought .89%, and was rated an average ('3 of 5'). Demand was the highest since February, and the yield the lowest awarded since then. Foreign buying rose from 46.2% last month to 56% of this issue. Today's $20 billion 10–year note offering brought 1.765%, also the lowest yield since the February auction – and the Treasury reopened that February, 2026 note to add this supply. The auction was rated above average ('4 of 5'), and demand was the strongest since January.

*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.*

In contrast, German 10–year bunds were yielding only .13%, while Japanese 10–years were –.08%! The U.S. note is a bargain – though priced rich to historic inflation levels. Foreign buying rose to 60% from last month's 56.5%. The Treasury will auction $12 billion 30–year bonds on Thursday (04/14). Japan's 30–year bond yield just fell to a record low .385%, and their 40–year bond wasn't much higher at .405%. Imagine having to live on those interest payments!

04/08/16 Treasury Yield Curve	2-Year: 0.697%	5-Year: 1.152%	10-Year: 1.718%	30-Year: 2.553%
Weekly Yield Change:	–.027	–.063	–.053	–.047%
Support:	0.76/ 0.79/ 0.81/ 0.83%	1.27/ 1.30/ 1.33/ 1.36%	1.82/ 1.86/ 1.89/ 1.93%	2.63/ 2.65/ 2.67/ 2.69%
Targets:	0.73/ 0.69/ 0.67/ 0.65%	1.21/ 1.18/ 1.16/ 1.14%	1.77/ 1.73/ 1.70/ 1.66%	2.59/ 2.57/ 2.55/ 2.52%

Economics

Last week, Initial Jobless Claims fell from 276K to 267K, while Continuing Claims rose from 2,172K to 2,191K. That data often 'flips' as the Continuing Claims lag a week. The incoming reads on March prices show inflation still very much in check. Import Prices rose .20%, after having fallen .40% in February (versus the .30% decline previously reported). The annual drop lessened from –6.50% to –6.20%. Producer Prices fell .10%, and were also .10% lower ex food & energy. The yearly pace had been flat in February, but dropped to a .10% decline. The core annual pace dropped from 1.20% to a flat 1.00%. Though a small gain had been expected, Retail Sales fell .30% in March – following a flat February. Ex autos, sales rose .20% – as demand for autos fell 2.1% (the largest drop since February, 2015). February Wholesale Inventories fell .50%, and Trade Sales dropped .20% (after falling .60% more, or 1.90% in January). Business Inventories fell .10%. Consumer Credit rose from $14.897 billion to $17.217 billion for February – mostly on autos and student loans. NFIB Small Business Optimism faded .3 to 92.6. March's Monthly Budget Statement showed a $108.0 billion deficit. The deficit is $461 billion versus $439.5 through March last year.

Thursday is set for jobless claims data, Consumer Prices (March CPI), Weekly Earnings, and Bloomberg Consumer Comfort (which last week slipped .2 to 42.6). Friday brings Empire Manufacturing, Industrial Production, Capacity Utilization, University of Michigan sentiment surveys, and TIC Flows (net foreign Treasury operations). Next Monday (04/18) is the IRS tax deadline for 2015 returns. Home builder confidence (NAHB Housing Market Index) is the only major data scheduled. Tuesday follows with March Housing Starts and Building Permits. Wednesday brings MBA Mortgage Applications (which jumped 10% last week) and Existing Home Sales for March.

Equities

As we said last week, on Tuesday (04/05), global equities had their largest drop since February. Last Thursday, U.S. stocks fell the most in 6–weeks. However, that action lined up very well with our cycle work. In the **BMR** (03/31), we wrote: *"The cycles say stocks should drop into next week. … Stocks should find strength from a base near April 4th to the 7th for a rise into 'another high near April 14th, which could line up with another surge by Crude Oil (into April 12th).'"* Not only did equities follow that battle plan (after their worst week in 2 months), Crude Oil surged straight up into the 12th as well! Into today, most U.S. indexes rose to new 2016 highs. The Transports lagged, and bank stocks reached their best levels since mid–January. Though the Transports fell 1.92% last week, they are outperforming this week with a 2.90% gain. However, if equities are improving on non–spectacular earnings and the premise that the Fed will delay hikes due to sluggish global growth, are those really reasons to be overly optimistic?

Last week, the Dow fell 215.79 points or 1.21% to 17,576.96. It's 1.88% higher this week to the best levels since early November! The S&P dropped 25.18 points or 1.21% as well to 2,047.60, and is 1.70% higher this week to early December levels. The Nasdaq lost 63.85 points or 1.30% to 4,850.69, but is 1.99% better this week and into the 'gap' of the loss from its first trading day of 2016. Bank stocks fell 3.65%, but are leading the field – up 6.48% this week!

	Dow:	Nasdaq:	S&P:
Resistance:	17,945/ 18,012/ 18,079/ 18,146	4,951/ 4,968/ 4,986/ 5,003	2,086/ 2,092/ 2,098/ 2,109
Support:	17,812/ 17,744/ 17,676/ 17,554	4,917/ 4,879/ 4,764/ 4,846	2,074/ 2,064/ 2,052/ 2,040

Other Markets

Last week, we said: *"Our cycles are showing Crude Oil rising into April 12th, with a subsequent sharp drop into May 16th."* Oil surged into yesterday, fulfilling the first part of that forecast. Crude Oil gained 7.96% last week, and was 5.14% higher into today. Commodities gained 1.79%, and have added 2.70% this week. Gold rose 1.66%, and is .35% better so far this week. The U.S. Dollar lost .39% last week, but is .54% better this week. The Japanese Yen surged 3.24% last week, but is 1.18% lower since. The Euro gained .07%, but is 1.10% lower this week. Corn rose 2.33%, and is 3.11% higher this week. Cotton gained 1.47%, and is 2.60% higher since Friday.

"Fear is that little darkroom where negatives are developed." Michael Pritchard

Additional Information is Available on Request

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