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COMMERCE STREET Capital Management
1445 ROSS AVENUE, SUITE 2700
DALLAS, TEXAS 75202 · 214-545-6800

BOND MARKET REVIEW

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The Next Cut

It's kind of ironic that the new movie in the Barbershop series is 'The Next Cut', at a time when global markets are keyed in on the next hike. Thinking they were 'in the chair' for their next trim, clearly global markets were not ready for the Bank of Japan and the European Central Bank to announce they would not add any more stimulus for now – but instead wait and observe the effects of monetary–policy measures already in place. The premise that other central banks would continue to exercise stimulus measures while the FOMC would embark on a 'gradual pace' of rate increases led to an impressive rally in the U.S. Dollar. With our Fed holding, and their global counterparts doing the same, there's been a huge snapback in the Dollar's value versus those other world currencies. While other central banks were continuing stimulus measures, it gave the International Monetary Fund a platform to plead with the Fed to hold back on increases. That's no longer valid! We have to wonder if the Fed's December hike emboldened other central banks – even if it might have been potentially ill timed. The Fed was just trying to 'get off zero' during their December meeting, and also had wanted to have a 2015 liftoff. It was obviously their last chance at bat! Needing some fresh ammo, just in case global growth is challenged anew, central bankers must be singing that old Lynyrd Skynyrd tune: 'Gimme Back My Bullets!' Like ole Deputy Barney Fife, at least the Fed now has that one.

With the Fed's widely–expected 'hold' on rates Wednesday, they removed the text saying *"global economic and financial developments continue to pose risks"* from the March 16 statement, and instead said they would *"closely monitor"* those areas of concern (and inflation). They changed household spending at a *"moderate rate"* to instead say it had *"moderated."* March's statement had economic activity *"expanding at a moderate pace"*, but this text said *"labor market conditions have improved further even as growth in economic activity appears to have slowed."* (Esther George once again opposed the statement – preferring another 25 bps hike!)

If we know anything from reviewing recent years of FOMC statements and the Beige Book reports on growth in the 12 Fed districts, it's that 'modest' and 'moderate' are, unfortunately, very descriptive of less–than–stellar growth. 'Robust' is a word of the past! However, their use of 'moderated' in the statement text is quite different – as it means a slowing! Still, the removal of global pressures in the statement does at least leave the door open for a potential hike in June. Though that door may be open, incoming data might close it – especially if our cycle work is correct. Bond traders lowered their 'odds' for a June hike from just over 21% last week to only 12% today. How would the Fed see enough evidence of a pickup by June – especially after a first quarter GDP just plodding along in low gear?

A few weeks ago, the New York Fed model was forecasting .9% growth for Q1 2016, while the Atlanta Fed was projecting only .1%. While those forecasts had been updated since then, the first read came in at only .50%, though the final may be higher (or lower). (Recall that 4Q 2015 came in at 1.40%, following preliminary estimates of .70% and 1.00%!) Nevertheless, the economy is only chugging along – at its weakest pace in 2 years! This time, we can't even blame the weather! Normally, central banks raise rates to 'cool' the economy. It's not the best idea to cool it from 1.40% to .50%! Though the economy wasn't in need of slowing down, that process still worked. In fact, GDP growth of only .50% (or even 1.40%) would normally lead central banks to be exploring additional stimulus measures! Maybe we've just reached another of those 'new normals!' In the **BMR** (03/31/2016), we had observed: *"GDP growth over 3% vanished 10 years ago and any tangible inflation hasn't returned since the financial crisis."* 'Prince' died last week. An entertainer and prolific songwriter, his #1 song, based on weeks topping the charts, is 'When Doves Cry.' From an economic sense – those 'doves' are crying out loud for better growth!

Looking Ahead

- 10–year bond cycles have a low yield due near May 4th, while shorter notes could be lower into the 9th.
- Equities should be weaker from today into May 11th, though ultimately trading lower into early June.

Treasuries, Agencies, and MBS

The **B**ond **M**arket **R**eview bond cycles performed extraordinarily well in April. Last week we said: *"After bottoming with our April 7th trend–change, yields traded in a range from the 12th through the 18th. Our bond cycles showed yields 'rising into the 26th – just a day before the next FOMC policy statement is due on April 27th.'"* Not only did 10–year yields bottom on April 7th, they surged higher into the 26th, and have since reversed lower. The next trend–change low yield should be around May 4th. It might be desirable to re–implement some defensive posturing or hedges from that day (if the market is making lower yields into that date). Keep in mind also that the 2 and 5–year note cycles may differ from the 10 or 30–year paths by a few days, in this case probably making their lows nearer the 9th. We'll have a chance to update those cycles next week.

Last week, yields rose by 8.5, 14.5, 13.5, and 15 bps for the 2, 5, 10, and 30–year Treasury sectors. Though trading roughly 5 bps higher into the 26th, yields ended today lower by 3.5, 6.5, 6.5, and 3 bps since Friday's close. MBS spreads (for FNMA 30–year 2.5%) narrowed by 6 bps into April 22nd. On Monday, the U.S. Treasury sold $26 billion 2–year notes at .842%. The auction was rated an average ('3 of 5'), and the yield was the lowest since February – with demand the strongest since that auction. Foreign buying slipped .3% lower versus last month to 47.1% for this offering. Tuesday's $34 billion 5–year note offering was also rated average, with demand also the best since February. The 1.41% yield for the sale was the lowest since January (2016), and foreign buying jumped from 53.9% in March to 63.4% for this auction. Today's sale of $28 billion 7–year notes brought 1.634% with the highest demand in over 2 years (to February 2014)! The auction was rated an above–average '4 of 5'. The yield was, however, the highest result since January – though foreign buying also rose sharply (from 57.8% in March to 65.5% of this issue).

04/22/16 Treasury Yield Curve	2-Year: 0.820%	5-Year: 1.356%	10-Year: 1.889%	30-Year: 2.708%
Weekly Yield Change:	+.084	+.144	+.136	+.148%
Support:	0.82/ 0.84/ 0.87/ 0.89%	1.34/ 1.37/ 1.40/ 1.43%	1.87/ 1.90/ 1.94/ 1.97%	2.73/ 2.76/ 2.81/ 2.85%
Targets:	0.78/ 0.76/ 0.74/ 0.72%	1.29/ 1.26/ 1.23/ 1.20%	1.84/ 1.80/ 1.77/ 1.73%	2.69/ 2.66/ 2.61/ 2.57%

Economics

Layoffs remained in check, posing no great threat to next Friday's (05/06) April payroll releases, as Initial Jobless Claims held near 4–decade lows over the past 2 weeks. They dropped from 253K to 248K last week (for the week of April 16th) to the lowest reading since 1973, and then rose only 9K to 257K into the 23rd. Continuing Claims fell from 2,176K to 2,135K, and then dropped to 2,130K. Board Consumer Confidence fell from 96.1 to 94.2. The read on expectations for the next 6 months dropped from 83.6 to 79.3 – reaching its worst level since February 2014.

The Leading Index for March rose .20%, but the previous month was revised from +.10% to –.10%! Bloomberg Economic Expectations rose from 42 to 44.5. Bloomberg Consumer Comfort dropped last week from 43.6 to 42.9, but this week recovered back to 43.4. The Philadelphia Fed Business Outlook tumbled from 12.4 to –1.6! That was the 4th straight monthly drop, with roughly 30% of area firms seeing decreases in jobs, while many also showed significant declines in hours worked. The Chicago Fed National Activity Index fell from –.38 to –.44. Dallas Fed Manufacturing Activity fell from –13.6 to –13.9, and Richmond dropped from 22 to 14. Kansas City Fed Manufacturing Activity rose 2 points, but that was from –6 to –4. March Durable Goods Orders rose .80%, but that followed a 3.10% drop in February.

Housing is showing modest increases, mixed with some lost traction. In March, sales of New Homes dropped 1.54% to 511K. Though still up 5.58% versus last year, this was the third straight drop – and to the worst levels since July 2014! Pending Home Sales rose 1.40%, but the annual pace of gain dropped from 5.00% to only 2.90%. The FHFA House Price Index rose .40% in February, while the S&P/Case–Shiller measure rose .41% – and slowed annually from 5.34% to 5.29%. Metro home prices (S&P/CS 20–City) rose .66%, with the annual pace of gains also slowing (from 5.68% to 5.38%). Personal Consumption rose 1.90%, and the GDP Price Index rose .70%. Core PCE rose at a 2.10% annual pace – closer to desirable fed targets.

Friday closes out April trading with University of Michigan sentiment surveys, March Personal Income & Personal Spending, the PCE Deflator (Personal Consumption Expenditures inflation reading), the Employment Cost Index for Q1 2016, ISM Milwaukee, and the Chicago Purchasing Managers (report). Next Monday (05/02) gives us ISM Manufacturing (along with New Orders and Prices Paid), and March Construction Spending. Tuesday follows with ISM New York, IBD/TIPP Economic Optimism, and April Vehicle Sales. Wednesday gives us MBA Mortgage Applications (which last week fell 4.10%), March's Trade Balance (deficit), the service sector outlook (ISM Non–Manufacturing). Factory Orders, Durable Goods Orders, Nonfarm Productivity, Unit Labor Costs, and a first look into next Friday's April jobs numbers from ADP Employment Change (private payroll data).

Equities

While our equity cycles were a bit mixed, showing a Dow high near the 14th, stocks made a 'better' high on April 20th – a day outside the trend change due on the 19th for the broad market (all NYSE stocks). Even so, the S&P and Dow topped with that cycle, while the Nasdaq and Transports traded just barely higher from the 19th to the 20th. That said, we're in the second phase as of today. Per last week's **BMR**: *"Stock cycles weaken following a trend–change near April 28th, with an expected drop into June."* The means the cycles are now looking a bit ugly, so be careful out there! Stocks should make a low near May 11th, but the expected June low should be more desirable for accumulation of positions.

Last week, the Dow gained 106.29 points or .59% to 18,003.75, but it's .96% lower this week – with the major U.S. indices breaking some important recent support today. The S&P rose 10.85 points or .52% to 2,091.58, and by today was .75% lower for the week. The Nasdaq lost 31.99 points or .65% to 4,906.23, and is 2.06% lower this week to the lowest levels since late March. Disappointing earnings led to the Nasdaq's worst week since February. Apple (AAPL) was weighing heavily on the Dow and Nasdaq as the company posted its first quarterly decline in revenue in 13 years – and iPhone sales dropped for the first time on record. The Dow Transports rose 1.35% last week, but gave that back with a 1.48% drop into today. Bank stocks rose 5.19%, and held gains – losing only .70% into today.

Resistance:	Dow:	17,807/ 17,866/ 17,942/ 18,032	Nasdaq:	4,851/ 4,886/ 4,921/ 4,957	S&P:	2,078/ 2,088/ 2,099/ 2,111
Support:		17,675/ 17,561/ 17,487/ 17,412		4,781/ 4,764/ 4,747/ 4,713		2,064/ 2,054/ 2,042/ 2,034

Other Markets

With the Bank of Japan holding off on stimulus (for now), the Yen surged the most in 8 months. Of course, a weaker Dollar also means higher Commodity prices, which rose 3.47% last week, and added 1.95% into today. Crude Oil rose 8.35%, and added 5.26% this week (though we still expect a drop into May 16th before the next advance). Gold fell .36%, but was 3.07% higher into today. A weaker Dollar also means higher Crude and Gold prices – as the purchasing power is diminished! The Japanese Yen fell 2.79% last week, but has surged 3.29% so far this week. The U.S. Dollar gained .42% last week, but lost 1.42% into today. It's now at an 11–month low, and it was reported that hedge funds are now bearish the Dollar for the first time since July 2014. The Euro fell .55%, but is 1.16% better this week. Corn lost 1.78%, but is 4.10% higher this week. Cotton gained 5.08%, and is .97% higher this week.

"If you believe everything you read, better not read!" Japanese Proverb

"If there are no stupid questions, then what kind of questions do stupid people ask? Do they get smart just in time to ask questions?" Scott Adams

Additional Information is Available on Request
Doug Ingram, Managing Director – Commerce Street Capital Management