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

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

BOND MARKET REVIEW

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Against all Odds

Bond traders are positioned against the Fed's wishes for further tightening. Despite warnings from a few FOMC members that a June hike is still 'on the table', the odds for that move dropped into today. Last week, the bond market placed only a 12% chance for a June hike, and only 26.1% for July. (The previous week's odds for a June hike were over 21%.) As of today, June had fallen to only 10%, and July's chances fell to 24.4%. Regardless of all these shifts in market sentiment, the first month with odds above 50% for the next Fed hike has consistently been December. Even then – that's only a coin toss!

In last week's **B**ond **M**arket **R**eview, we noted that the last two quarters of U.S. GDP growth were only 1.40% and then .50%. We asked: *"How would the Fed see enough evidence of a pickup by June – especially after a first quarter GDP just plodding along in low gear?"* Given the low odds for a June move, Atlanta FRB President Dennis Lockhart said: *"I would put more probability on it being a real option."* While that might just mean he thinks the chance should be above 12% – even if by only a few percentage points, it doesn't mean he thinks June will happen. He said he wasn't leaning to June, but that 2 more increases this year were "certainly possible." San Francisco's Williams said June was *"appropriate"* if the economy stayed on track, but said *"a lot can happen between now and June."* Williams is not a voter this year. Dallas' Robert Kaplan said the possibility of the United Kingdom's exit from the EU (termed Br–exit) could be the one core issue that would make a June policy move *"unclear."*

By June, we'll know the results for April and May payrolls (with the April jobs report coming this Friday). However, it will be too early to get a really good read on 2nd–quarter GDP, and through today there hasn't been enough promising data to push us into the June–hike camp. Even though the Euro zone just saw its strongest growth in a year, albeit only .6%, EU inflation measures just fell – with a .2% decline in April. A drop is not low inflation, it's deflation! Fighting falling prices is a tough battle. Central banks feel much more comfortable fighting inflation, but there's currently no battle to wage. Another tough battle is runaway inflation – something that is extremely remote given current conditions, but would normally be a concern when governments are printing money with little restraint!

The Bank of Japan and the European Central Bank had announced over the past 2 weeks their intentions to stop further stimulus measures for now, and instead observe the ongoing results of policies employed up to this point. With the appearance that other central banks could hold, while the FOMC was unlikely to tighten in the near term, the U.S. Dollar dropped to its lowest levels since January 2015. It has now risen given the reverse – the premise that global central bankers would be forced to continue to drop rates and buy assets, while our Fed could begin a series of hikes (whether gradual or not). With Williams and Lockhart's contention that June is still an option, and EU inflation dropping below zero, over the past few days the Dollar has rallied over 1.4% to its 15–month low.

Looking Ahead

- 10–year bond cycles show low yields due here, while shorter–note yields could be lower into the 9th.
- Equities should be weaker into May 11th, and ultimately trade lower into early June.

Treasuries, Agencies, and MBS

'May the fourth' be with you! As fans celebrate 'Star Wars Day', bond yields dropped into our cycle calling for lower rates into the 4th. It gets more unlikely that every trend change will lead to a reversal in market direction near each forecasted turn, but we can't assume the cycles won't continue to work either! Last week, we said: *"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)."* Though the 5–year bond yield cycle bottoms on May 9th, our cycle work then shows all maturities moving to higher yields into the last week of May.

Yields traded lower last week, dropping 3.5, 6, 5.5, and 3 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, they fell again by 4.5, 6, 6, and 4.5 bps. Last week, MBS spreads (for FNMA 30–year 2.5%) widened by 2 bps. Next week, the U.S. Treasury will auction $24 billion 3–year notes on Tuesday (05/10), $23 billion 10–year notes on Wednesday (05/11), and $15 billion 30–year bonds on Thursday (05/12).

04/29/16 Treasury Yield Curve	2-Year: 0.784%	5-Year: 1.295%	10-Year: 1.834%	30-Year: 2.678%
Weekly Yield Change:	–.036	–.061	–.055	–.030%
Support:	0.74/ 0.77/ 0.80/ 0.82%	1.27/ 1.30/ 1.34/ 1.37%	1.82/ 1.87/ 1.90/ 1.93%	2.65/ 2.69/ 2.72/ 2.75%
Targets:	0.72/ 0.70/ 0.67/ 0.65%	1.22/ 1.20/ 1.16/ 1.14%	1.76/ 1.73/ 1.69/ 1.66%	2.61/ 2.57/ 2.55/ 2.51%

Economics

Though the data this week was mixed, the **BMR** observed a tilt to the downside. The Service Sector outlook increased to a 4–month high, rising from 54.5 to 55.7 (ISM Non–Manufacturing Composite). While it's a positive that the gauge representing nearly 90% of the economy has such a good outlook, it's sobering to recall what a manufacturing juggernaut the U.S. once was. New orders rose to a 6–month high and services employment rose from 50.3 to 53. ADP Employment Change data had its smallest advance in 3 years – adding 156K jobs versus 195K expected. Making our earlier case (of positives versus negatives), the ADP jobs data fell for factories – but rose for service industries. What if those better factory income jobs are being replaced with the 'Do you want fries with that' type? Speaking of income, Personal Income rose .40% in March (though backed off from .2% to .1% for February). However, Personal Spending rose only .10% – ending the slowest spending quarter in a year. Real Personal Spending was unchanged. The Employment Cost Index rose .60% in the 1st quarter and Unit Labor Costs rose 4.10%. In a troubling trend, Nonfarm Productivity fell for the second straight quarter – dropping 1.00%. Higher wages with less productivity?

IBD/TIPP Economic Optimism rose from 46.3 to 48.7. However, University of Michigan Sentiment fell from 91 to a 7–month low of 89. Their measure of Current Conditions rose from 105.4 to 106.7. That said, Expectations fell from 79.6 to 77.6 – the lowest since September 2014, despite a resurgent stock market and improving incomes. ISM Manufacturing fell one point to 50.8, while Prices Paid rose from 51.5 to 59. New Orders fell from 58.3 to 55.8. While ISM New York rose from 50.4 to 57, ISM Milwaukee dropped from 57.78 to 51.05 and Chicago Purchasing Managers fell from 53.6 to 50.4. April Vehicle Sales rose from 16.46M to a 17.32M pace, and domestic sales increased from 12.97M to 13.48M. Construction Spending rose .30%. March Factory Orders rose 1.10%, and were .80% higher ex transportation. Orders for Durable Goods rose .80%, but fell .20% ex transportation. The PCE Deflator rose .10%, but the annual pace slowed from 1.00% to .80%. The core rate also rose .10%, and that annual pace (ex food & energy) slowed from 1.70% to 1.60%. The U.S. Trade Balance deficit fell 13.9% to $40.4 billion – the smallest since February 2015. Our concern there is if retailers are hesitant to stock shelves. Imports fell to the second weakest level since February 2009 and Exports fell to second weakest level since 2011.

Thursday is set for jobless claims data, Bloomberg Consumer Comfort (which last week rose from 42.9 to 43.4), and another clue into April payrolls from Challenger Job Cuts. Friday provides the next key data component for the Fed's June meeting with the April jobs numbers – including the Unemployment Rate, Hourly Earnings, Hours Worked, and Labor Force Participation. Also due is Consumer Credit for March. Next Monday (05/09) brings the Fed's jobs dashboard (Labor Market Conditions Index Change), and Q1 data for Mortgage Delinquencies and MBA Mortgage Foreclosures. Tuesday is set for NFIB Small Business Optimism, JOLTS Job Openings, and March data for Wholesale Inventories and Trade Sales. Wednesday gives us MBA Mortgage Applications (which last week fell 3.40%), and the Monthly Budget Statement for April.

Equities

Last week, the Dow lost 230.11 points or 1.28% to 17,773.64. It's .69% lower this week, having topped with the last cycle due on April 20th. As we said last week: *"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."* The S&P lost 26.28 points or 1.26% to 2,065.30. It's also .69% lower this week. The Nasdaq tumbled 130.87 points or 2.67% to 4,775.36, and is off 1.04% since Friday. The Transports fell 2.65%, and are 1.47% lower this week. Bank stocks fell 1.53%, and are down 3.14% so far this week.

Resistance:	Dow:	17,736/ 17,883/ 18,017/ 18,160	Nasdaq:	4,781/ 4,817/ 4,852/ 4,887	S&P:	2,060/ 2,069/ 2,080/ 2,095
Support:		17,616/ 17,555/ 17,485/ 17,400		4,713/ 4,679/ 4,645/ 4,611		2,048/ 2,040/ 2,034/ 2,023

Other Markets

Commodities rose 2.76% last week, but are 2.57% lower since Friday. Crude Oil gained 5.01%, but is 4.66% lower this week. Gold rose 5.03%, but is 1.25% lower this week. The U.S. Dollar lost 2.13%, but is up .14% this week. The Japanese Yen surged 4.73% last week, but is .48% lower this week. The Euro gained 2.04%, and is .31% higher this week. Corn gained 4.98%, but lost 4.36% into today. Cotton rose 1.08%, but is 2.49% lower this week.

"I'm not sure I want popular opinion on my side – I've noticed those with the most opinions often have the fewest facts." Bethania McKenstry

Additional Information is Available on Request

Doug Ingram, Managing Director – Commerce Street Capital Management