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BOND MARKET REVIEW

May 30, 2016

Memorial Day

As we were in final preparation for this issue just ahead of the Memorial Day weekend, I got the call that my mother–in–law's second husband (of nearly 10 years) had passed away. William 'Buster' Hagood was a part of what has been termed the Greatest Generation – having lived during the Great Depression and then gone on to fight and prevail in World War II. The numbers in that elite group of WWII veterans are fading quickly now 7 decades later. Buster was a radar engineer aboard the Navy Destroyer USS Aulick. On November 29th, 1944, while the fleet was in the Leyte Gulf, he spotted and warned of six enemy planes approaching on radar. However, this was near the end of the war when those planes themselves had become weapons – as Kamikaze pilots would guide them to targets on suicide missions. Though damaged, one plane skipped across the ship and hit the bridge causing an explosion that reached the #2 gun and the handling room. The other radar operator was killed instantly by shrapnel right next to Buster. That day, in that one attack, 31 sailors lost their lives, and over 60 were wounded. Who knows why one 22–year old escapes injury and lives past the age of 93, while others step into eternity? The **B**ond **M**arket **R**eview salutes Buster Hagood – a positive influence to so many, and all those that selflessly served our country for the cause of freedom.

Controlled Burn

1st–quarter GDP was adjusted a little higher (by .30%) to .80%. While that's a slow start, the Fed sees it as continued improvement. April payrolls had also shown improvement, but at 160K failed to reach the 200K threshold that seemed to be trending. While manufacturing remains challenged, with reduced forecasts, the U.S. services economy and housing have been steadily improving. The **BMR** would contend the data is not yet strong enough to tighten. However, these are not normal times, and it's becoming increasingly clear that the Fed really wants to continue to get rates closer to what would be termed 'normal', even if it's unclear what that new normal should be. Clearly, if we weren't already so 'over stimulated', the Fed wouldn't consider tightening given the somewhat–lackluster data.

Looking Ahead

- Bond cycles show yields topping from now through June 9th.
- Equities should be weaker into June 8th. We would continue to sell rallies.

Treasuries, Agencies, and MBS

The bond market had been trading as if the Fed wouldn't touch rates again until very late in 2016 – if then. Various Fed members had been making the case that one or more hikes could occur in 2016, but bond–traders had been calling that supposed bluff – that was seen as making the case that things were better than they seemed. Though many said the data was indeed strong enough for the next move, the markets ignored the 'noise'. However, when Fed Chair Janet Yellen began talking about increases in the *"coming months"*, traders took notice. Recall how the odds for a June hike were only 4% a few weeks ago, and the December FOMC meeting was viewed as the first with a better than 50–50% chance for the next increase? The June meeting jumped to 30%, and now July is the first month over 50%. Thus, when Yellen adopted the 'bully pulpit' to lean to an earlier hike, the markets listened! We've all been 'trained' in recent years to key on what the Fed Chair says, because the committee historically follows that leadership. While we could go on to quote numerous FOMC member's comments calling for higher rates, hers is the one that counts! The Fed's April minutes revealed that most participants thought a June hike would be appropriate if the economy remained on course. Last week, Yellen said: *"Probably in the coming months such a move would be appropriate."* By Friday, the Fed will have May payroll data to add to that equation.

The **BMR** bond cycles held that yields should rise into the end of May, and they've trended that way. Though longer maturities hit their highest yields nearer the 25th, shorter rates were rising into today. Into May 20th, yields rose 13, 15.5, 14, and 7 bps for the 2, 5, 10, and 30–year sectors. Last week, those sector yields rose another 3.5, 2.5, 1.5, and 2 bps. The bond cycles say yields should be topping from here though the 9th. Reduce hedges and buy bonds.

Into May 20th, MBS spreads (for FNMA 30–year 2.5%) pulled in by 6 bps. Last week they narrowed another bps. Last Tuesday (05/24), the U.S. Treasury sold $26 billion 2–year notes at .92% (the highest since December). Demand was the strongest since November and the auction was rated an outstanding '5 of 5'. Foreign buying rose from 47.1% in April to 49.8%. Wednesday's $34 billion 5–year note brought 1.395% with demand the best since November 2014. Foreign buying rose from 63.4% to 66.6% – the 3rd highest on record. With direct awards at 11.6%, the highest since July 2014, primary dealer awards hit a record low of 21.8%. Thursday's $28 billion 7–year note auction came at 1.652%, and was rated an above–average '4 of 5'. Demand was off to April's offering, and foreign buying fell from 65.5% to a still–lofty 64.6%.

05/27/16 Treasury Yield Curve	**2-Year: 0.911%**	**5-Year: 1.386%**	**10-Year: 1.852%**	**30-Year: 2.647%**
Weekly Yield Change:	+.033	+.023	+.013	+.018%

05/20/16 Treasury Yield Curve	**2-Year: 0.878%**	**5-Year: 1.363%**	**10-Year: 1.839%**	**30-Year: 2.629%**
Weekly Yield Change:	+.130	+.157	+.138	+.080%
Support:	0.94/ 0.97/ 0.99/ 1.01%	1.42/ 1.45/ 1.48/ 1.51%	1.89/ 1.92/ 1.94/ 1.96%	2.68/ 2.72/ 2.75/ 2.77%
Targets:	0.89/ 0.86/ 0.84/ 0.81%	1.29/ 1.26/ 1.24/ 1.21%	1.82/ 1.80/ 1.76/ 1.73%	2.62/ 2.59/ 2.55/ 2.51%

Economics

Two weeks ago, Initial Jobless Claims dropped 16K to 278K (from a 1–year high of 294K). Last week, they fell another 10K to 268K. Continuing Claims fell 12K to 2,153K, and then rose 10K to 2,163K. Though still only the smallest gain in a year, Q1 GDP was revised .30% higher to .80%. Personal Consumption remained at 1.90%, and the GDP Price Index was revised .10% lower to .60%. Leading indicators were revised .20% lower to flat for March, but rose .60% in April. Bloomberg Economic Expectations were unchanged at 44.5, and University of Michigan Sentiment fell from 95.8 to 94.7. While their survey for Expectations declined from 87.5 to 84.9, their Current Conditions reading rose from 108.6 to 109.9. The Chicago Fed National Activity Index rose from –.55 to 0.1. However, the Philadelphia Fed Business Outlook fell from –1.6 to –1.8, the Richmond Fed Manufacturing Index dropped from 14 to –1, and Kansas City dropped 1 point to –5. Orders for Durable Goods doubled for March to 1.90%. April orders rose 3.40%! Ex Transportation, orders rose .40% in April (and were revised .30% higher to a .10% increase for March). Orders for Capital Goods fell .80%.

Sales of Existing Homes rose 1.68% in April, from 5.36M to a 3–month high of 5.45M. Not to be outdone, New Home Sales surged 16.57% (from 531K to 619K) to their highest readings in 8 years! Pending Home Sales rose 5.10%, the most since 2010. The House Price Purchase Index was 1.30% higher for the 1st quarter, and the FHFA House Price Index rose .70% in March. Year–over–year, home prices rose 5.7%.

Tuesday closes out May trading with April Personal Income and Personal Spending, the PCE Deflator, S&P/Case–Shiller home price data, Consumer Confidence, Chicago Purchasing, and Dallas Fed Manufacturing. Wednesday (06/01) kicks off June with MBA Mortgage Applications (which fell 1.60% and then rose 2.30% over the past 2 weeks), ISM Manufacturing, Construction Spending, Vehicle Sales, and the Fed's Beige Book. Thursday brings the final jobs updates before Friday's May payroll data with Challenger Job Cuts, ADP Employment Change, and jobless claims data. Also due are Bloomberg Consumer Comfort (which rose from 41.7 to 42.6, but then fell to 42 – matching the second lowest level this year), and ISM New York. Friday is set for May payroll data, the service–sector outlook (ISM Non–Manufacturing), April Factory Orders, Durable Goods Orders, and the Trade Balance (deficit).

Equities

While the Dow lost ground for the first 3 weeks of May, the losses were tame – allowing a 2.13% rally last week to enter the last trading day of the month with a gain. There remains a trend change low due around June 8th, from which prices should improve. The Dow fell .20% into May 20th, but rallied 372.28 points or 2.13% to 17,873.22 last week. The S&P rose .28%, and then added 46.74 points or 2.28% to 2,099.06 last week. The Nasdaq rose 1.10%, and then surged 163.95 points or 3.44% last week to 4,933.51. The Dow Transports gained 2.19% and then 1.31% last week. Bank stocks rallied 4.24% and then 3.24% – putting together 2 strong weeks.

Resistance:	Dow:	17,895/ 18,003/ 18,085/ 18,163	Nasdaq:	4,952/ 4,987/ 5,023/ 5,057	S&P:	2,103/ 2,111/ 2,118/ 2,129
Support:		17,761/ 17,627/ 17,496/ 17363		4,917/ 4,887/ 4,4620/ 4,586		2,087/ 2,079/ 2,060/ 2,049

Other Markets

Crude Oil continued to improve out of our May 16th cycle low – which rises into June 21st/23rd. Crude gained for a 3rd week, rising 3.33% into the 20th, and then 3.31% last week. Commodities rose .91% and 1.05% over the past 2 weeks, while Gold lost 1.56% and 3.12%. The U.S. Dollar gained .79% and .16%, as the Euro dropped .75% and then .97%. The Japanese Yen fell 1.40%, and then lost .15% last week. Corn rose 3.27% and then added another 4.63% last week. Cotton gained 1.73% and then added 4.23%.

"Science is organized knowledge. Wisdom is organized life." Immanuel Kant

Additional Information is Available on Request

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