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BOND MARKET REVIEW

June 16, 2016

Dropping the Baton

On your mark, get set, wait! On Wednesday, the FOMC decided to leave interest rates unchanged. While that was widely expected since May's weak job gains, the Fed had previously desired to hike at this meeting. As the Fed left the starting blocks in December, it was clear that their intent was to hike rates at every other meeting going forward in a 'gradual pace.' The baton was bobbled in the March meeting as global stocks plummeted into early February and growth was challenged. The reason given for inaction back in March was: *"However, global economic and financial developments continue to pose risks."* The baton was dropped in April, when the 'gradual–pace' plan fell apart. The Fed said they would *"closely monitor"* global concerns, but said *"growth in economic activity appears to have slowed."* Though the Fed seemed quite dovish with their April statement, the markets were surprised only a few weeks later when the minutes from that meeting revealed that most participants wanted to go ahead with an increase in June. They picked up the baton and moved back into the lead in the race to higher rates.

When the May jobs data came in with only 38K gains compared to around 160K expected, the baton was dropped again – and fell into a grate. Nevertheless, the Fed could still win this one. With other leading economies running backwards – with negative rates, they can contend while standing still. For the first time in history, Germany's 10–year rates fell to zero – and then went negative. Japanese, Australian, and South Korean debt fell to record lows as well. U.S. 10–year yields fell back to August 2012 levels – near record lows, but were still at a healthy spread versus those global alternatives. In this June statement, the FOMC said *"… the pace of improvement in the labor market has slowed while growth in economic activity appears to have picked up. Although the unemployment rate has declined, job gains have diminished."* The vote for a stay was unanimous as Esther George removed her dissenting preference for a hike from her April position. The possibility of a U.K. exit from the European Union was later given as a contributing factor to the decision.

The Fed reduced its 2016 growth forecasts from 2.2% to 2.0%, and slightly reduced its 'dot plot' path of rate increases. The members expecting only one more hike in 2016 grew to 6 – from only 1 in April. After the meeting, Fed Chair Janet Yellen said rates may stay low as they are being held down by *"factors that are not going to be rapidly disappearing, but will be part of the new normal."* With global yields so low, some have called this a new *'abnormal.'* That makes sense to the **B**ond **M**arket **R**eview. Negative rates are not customary, routine, traditional, typical, or even 'natural' in an economic sense. We're in an environment that must be termed abnormal, irregular, unusual, or unconventional. Yellen said: *"We're quite uncertain about where rates are heading in the long term."* To that end, it's interesting that Narayana Kocherlakota, who stepped down from the Minneapolis Fed at the end of 2015, said: *"If I had been at the meeting, I would have argued for cutting rates this time."* He had argued that the Fed is now too one dimensional – considering only hikes. That's odd to the **BMR** as well, considering the data indicates we're fully employed (albeit with a record number out of the labor force) and inflation is approaching Fed targets – while the economy has the feel of possibly faltering, and may be in the need of further stimulus!

Looking Ahead

- Bond yields have trend–change lows due June 27th and July 14th. A trend–change high is due on July 1st.
- Equities have trend–change lows due June 22nd and then June 29th.
- The United Kingdom will vote on whether to remain in – or exit (termed Brexit) the EU on June 23rd.

Treasuries, Agencies, and MBS

This week, U.S. 2 and 5–year notes fell back to February lows. However, those low yields had been accompanied by a nosedive in stocks – which fell sharply as the S&P dropped 14.48% from November into early February (while some global stocks fared far worse). This is now happening just after stocks hit new 2016 highs! 30–year yields fell back to February 2015 levels, and 10–year yields were just above the record lows set in July 2012. With global rates dropping, U.S. debt is still a bargain. Treasuries are off to their best start since 2003!

The United Kingdom's vote on whether or not to exit the European Union is set for June 23rd. The U.K. is concerned about immigration control. The EU allows free trade and travel between member countries as the U.S. does between states. Events such as the recent attacks in Orlando, Brussels, and Paris have most countries striving for better controls – and may factor into the vote. The U.S. Treasury revised its auction schedule next week to clear the 23rd off the calendar. To date, former ECB president Jean–Claude Trichet, Janet Yellen, BOE Governor Mark Carney, U.S. Treasury Secretary Jacob Lew and others have warned of the potential negative impacts of U.K. withdrawal on its, the EU's, the U.S.'s, and global economies. Yellen also cited the 'Brexit' as a reason for leaving rates unchanged.

When rates were headed higher into the end of May, we said to: *"Reduce hedges and buy bonds."* In the **BMR (05/17/16)**, as the yield cycles pointed higher into the end of May, we said: *"Missed the chance to refi? We don't think so. Late August could be the best opportunity!"* Looks like it's already the best – and could get even better, as that yield dip into the end of August is still the cyclic forecast. Last week, yields dropped by 4.5, 6.5, 6, and 6 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, those sector yields dropped another 4, 7.5, 6, and 5.5 bps.

MBS spreads (FNMA 30–year 2.5%) widened by 4 bps last week. Last Thursday (06/09), the U.S. Treasury sold $12 billion 30–year bonds at 2.475%. The auction was rated an above–average '4 of 5', and the yield was the lowest since January 2015. Demand rose to the last auction, and foreign buying rose to 64.9% from last month's 59.7%. The 'Brexit'–revised auction schedule for next week includes $26 billion 2–year notes on Monday (06/20), $34 billion 5–year notes on Tuesday (06/21), and $28 billion 7–year notes on Wednesday (06/22).

06/10/16 Treasury Yield Curve	2-Year: 0.729%	5-Year: 1.168%	10-Year: 1.641%	30-Year: 2.451%
Weekly Yield Change:	–.045	–.064	–.060	–.059%
Support:	0.72/ 0.74/ 0.77/ 0.80%	1.13/ 1.17/ 1.23/ 1.29%	1.64/ 1.67/ 1.70/ 1.74%	2.43/ 2.47/ 2.50/ 2.55%
Targets:	0.68/ 0.65/ 0.63/ 0.61%	1.03/ 1.00/ 0.98/ 0.95%	1.58/ 1.55/ 1.52/ 1.49%	2.40/ 2.35/ 2.32/ 2.28%

Economics

Last week, Initial Jobless Claims fell from 268K to a near 16–year low of 264K. They rose 13K to 277K this week – a 1–month high, but still under 300K for a 67th week. Continuing Claims dropped from 2,172K to 2,112K last week – to the lowest levels since October 2000. They were 45K higher to 2,157K this week. Bloomberg Consumer Comfort rose from 43.2 to 43.5 last week. That was the highest since April, but it plunged back to 42.1 this week. The report on Economic Expectations was also lower, falling from 44.5 to 41. That meant the most Americans expected the economy to worsen since October 2013. Those results were reflected in University of Michigan surveys as sentiment dropped from 94.7 to 94.3, and expectations fell from 84.9 to 83.2. However, current conditions rose from 109.9 to 111.7! NFIB Small Business Optimism rose .2 to 93.8. Empire Manufacturing improved from –9.02 to +6.01, and the Philadelphia Fed Business Outlook went from –1.8 to +4.7. The homebuilder outlook (NAHB Housing Market Index) rose 2 points to a 5–month high of 60.

Consumer Prices rose .20% in May, on higher rental rates and fuel, though the annual pace fell from 1.10% to 1.00%. Ex food & energy CPI also rose .20%, but the core rate increased from 2.10% to 2.20%. Real Average Weekly Earnings rose 1.10%, keeping with the CPI annual pace. Producer Prices rose .40% on higher fuel prices, though the annual pace fell from flat to –.10%. The core rate rose .30%, increasing the annual ex food & energy rate from .90% to 1.20%. Import Prices rose 1.40%, though the annual pace was only .30% higher to –5.00%. Wholesale Inventories rose .60%, and Wholesale Trade Sales rose 1.00%. Business Inventories rose .10% in April. Industrial Production was off .40% in May, and Capacity Utilization fell from 75.30% to 74.90%. The bright spot was Retail Sales, which rose .50% in May, following the 1.30% advance in April. Ex autos, they rose .40%, and the 'Control Group' was up .40% as well. Foreign investments into Treasuries rose by $80.4 billion in April, but there was heavy selling of longer maturities as $79.6 billion notes and bonds were sold – the largest U.S. debt dump since January 1978. The Monthly Budget Statement for May showed a deficit of $52.5 billion. The fiscal deficit is running 11% over 2015. The Current Account Balance for the 1st quarter of 2016 was a deficit of $124.7 billion.

Friday is set for Housing Starts and Building Permits for May. Next Wednesday (06/22) brings MBA Mortgage Applications (which fell by 2.40% last week), Existing Home Sales for May, and the FHFA House Price Index for April. Next Thursday is set for the United Kingdom vote on whether or not to exit the European Union (Br–exit), the Chicago Fed National Activity Index, jobless claims data, New Home Sales for May, the Leading Index (May LEI), Bloomberg Consumer Comfort, and Kansas City Fed Manufacturing Activity.

Equities

It's too early to tell whether or not the equity cycles are back in sync, but stocks did drop into the 13th, and should have another fall into June 22nd. The Dow rose 58.28 points or .33% last week to 17,865.34, and was .74% lower into today. It managed only one close above 18,000 in this past rally. The S&P lost 3.06 points or .15% to 2,096.07, and is .86% lower this week. The Nasdaq dropped 47.97 points or .97% to 4,894.55, and is 1.01% lower this week. It's fallen shy of the 5,000 mark on the last two rallies (into April and June). The Dow Transports rose .45% last week, but tumbled 2.82% into today. Bank stocks lost 2.25%, and weakened another 3.65% so far this week.

	Dow:	Nasdaq:	S&P:
Resistance:	17,735/ 17,803/ 17,869/ 17,936	4,847/ 4,883/ 4,918/ 4,944	2,085/ 2,097/ 2,108/ 2,116
Support:	17,602/ 17,537/ 17,471/ 17,405	4,778/ 4,743/ 4,709/ 4,675	2,063/ 2,051/ 2,040/ 2,028

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Other Markets

Crude Oil has a trend–change high due June 22nd, a low due July 5th, and then a rally into July 20th. We expect a big pullback after that into the end of August (along with stocks). Last week, Crude Oil rose .93%, but it's lower by 5.83% this week. Commodities reflected that move with a 2.24% gain last week – and a 2.07% loss into today. Gold rose 2.69%, and tacked on 1.78% so far this week. The U.S. Dollar gained .57%, and is .15% better this week. The Japanese Yen lost .41%, but has rallied 2.53% this week! The Euro fell 1.02%, and is off another .23% this week. Corn rose 1.14%, and is .53% higher this week. Cotton gained 1.30%, but is 2.24% lower this week.

"You've got to be original, because if you're like someone else, what do they need you for?" Bernadette Peters

Additional Information is Available on Request

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