BOND MARKET REVIEW

December 29, 2016

20,000 or Bust

The Dow rallied into our December 14th cycle date for a high, missing 20,000 by less than 50 points. Interestingly, through Wednesday, the Dow traded within 100 points of 20,000 for 11 straight sessions – without touching or breaching that benchmark level. Including Wednesday, the Dow had traded within a mere 20 points of 20,000 for 4 of those trading sessions. The Dow's record high to date was on December 20th, while the Nasdaq made another record high on Tuesday. The S&P and the broad market topped on December 13th (turning on our cycle). Nevertheless, stocks have been holding near recent highs – reluctant to yield to a substantial year–end drop.

Though stocks did sell off on Wednesday, there's at least one logical reason for the lack of profit taking that we sometimes see near year–end. The incoming Trump administration is expected to rework or cancel the Affordable Care Act. Moreover, they are expected to cut taxes! If so, it will be far more profitable to take capital gains in 2017. With our next buying opportunity for equities due near January 26th, we wouldn't be surprised if the 'year–end' selloff were to take place in early January.

In one of our longer–term cycle studies, we thought 2015 to 2016 should be the timing for stocks making new highs. In early 2009, it seemed the financial world was going to continue to topple – and the Dow was on its way to 6,440. That's usually the best time to buy. An 18th–century British nobleman named Baron Rothschild spoke to these kinds of opportunities. He's often paraphrased as saying: *"The time to buy is when there's blood in the streets."* The reverse is often true as well. When everything appears perfect, it may be time to sell! In the **BMR** (02/17/2009), we wrote: *"Investors have always been told to: 'Buy land, they're not making anymore.' and 'If you consider a 10–year time horizon, stocks will outperform bonds.' January closed out the worst 10–year return for stocks since 1974. The time before that (when stocks had a 10–year loss greater than 4%) was 1940. That's 34 years from 1940 to 1974, and 34 years from 1974 to 2008! It was 1947 before stocks were able to break free to new ground (positive returns versus any purchases in the previous 10 years). That's roughly 7 to 8 years and about the same time as from 1974 to 1982 when stocks once again broke to new 10–year high ground. Using that same logic, it could be 2015 to 2016 before the Dow makes new highs."* Since the March 2009 lows, the Dow rallied 210.36%, and the S&P has risen 241.57%!

Looking Ahead

- Our 10–year bond cycles show the next low–yield window between January 5th and the 10th.
- Our equity cycles show the next major buying opportunity near January 26th.
- The **B**ond **M**arket **R**eview wishes you a happy and prosperous 2017. Happy New Year!
- The markets will be closed on Monday, January 2nd. Bonds will close at 2 p.m. ET on Friday (12/30).

Treasuries, Agencies, and MBS

In the **BMR** (12/07/16), we wrote: "*If rates are indeed higher into the 12th–to–14th window, the cycles would suggest lightening hedges in expectations of a rally."* Though 30–year rates topped on the 12th, shorter to medium–term yields continued higher. As of today, 30–year rates were the lowest since December 8th, while shorter–sector yields fell to their lowest readings in two weeks. The **BMR** cycles show bond yields dropping into January 10th, and/or the second 'time window' nearer the 23rd to the 25th. Into December 16th, yields rose a sharp 12, 17.5, 12.5, and 2 bps for the 2, 5, 10, and 30–year sectors. Last week, into December 23rd, yields for those sectors dropped by 5, 4, 5.5, and 6 bps. Into today, 2–year yields rose 1 bps, while they fell by 7, 6, and 3.5 bps for the longer sectors.

MBS spreads (FNMA 30–year 3%) widened by 5 bps the week of December 16th, but narrowed by 1 bps last week. On Tuesday, the U.S. Treasury sold $26 billion 2–year notes at 1.28%. That was the highest yield since the October 2008 auction, and demand fell to the weakest level since the December 2008 auction. The group that includes foreign central banks bought 32.7% of the offering versus 35.8% in November. Wednesday's $34 billion 5–year note auction brought 2.057%. Demand rose to the highest level since November 2014, with the awarded yield the highest since the April 2011 auction. Foreign buying rose from 59.8% in November to a record 71.4% allotment for this issue! Today's $28 billion in 7–year notes came at 2.284%, the highest yield since April 2014. Demand was the lowest since October. Foreign buying fell from 72.7% (the highest since 2009) to 64% of this offering.

12/23/16 Treasury Yield Curve	**2-Year: 1.204%**	**5-Year: 2.025%**	**10-Year: 2.538%**	**30-Year: 3.114%**
Monthly Yield Change:	–.050	–.041	–.055	–.061%
12/16/16 Treasury Yield Curve	**2-Year: 1.254%**	**5-Year: 2.066%**	**10-Year: 2.593%**	**30-Year: 3.175%**
Monthly Yield Change:	+.119	+.175	+.125	+.021%
Support:	1.25/ 1.28/ 1.31/ 1.37%	2.00/ 2.04/ 2.07/ 2.11%	2.51/ 2.55/ 2.57/ 2.62%	3.10/ 3.15/ 3.20/ 3.24%
Targets:	1.21/ 1.18/ 1.15/ 1.13%	1.94/ 1.90/ 1.87/ 1.83%	2.47/ 2.43/ 2.39/ 2.35%	3.06/ 3.02/ 2.97/ 2.93%

Economics

GDP for the third quarter was previously reported at 3.2% – the fastest growth in 2 years. Last week, it was revised to an even–better 3.5%. The first estimate on Q4 GDP is due January 27th, though Atlanta's 'GDP now' forecast is projecting only 2.5% – still well above the first 2 quarters of 2016! The GDP Price Index remained at a 1.40% rise – with the core (ex food & energy) at 1.70%, and Personal Consumption rose .20% to 3.00%. Though still below the 300K level, Initial Jobless Claims rose 21K to a 6–month high 275K last week. Claims fell back 10K to 265K in today's release, under 300K for 95 consecutive weeks now (the best since 1970). Continuing Claims rose from 2,021K to 2,039K last week, and then rose to 2,102K in data released today. In November, Personal Income was flat, while Personal Spending rose by .20%. 'Real' Personal Spending rose .10%. The PCE Deflator was flat in November, and maintained a 1.40% annual pace of increase. The core (ex food & energy) for Personal Consumption Expenditures was also flat, though the annual pace fell from 1.80% to 1.60%. Orders for Durable Goods fell 4.60% in November. Ex transportation, they were .50% higher. Orders for Capital Goods rose .90%.

The conference board's reading on Consumer Confidence rose from 109.4 to 113.7 – the highest since August 2001. Expectations rose from 94.4 to 105.5 – the highest since December 2003. Present conditions fell from 132 to 126.1. University of Michigan Confidence edged .2 higher to 98.2, for the best reading since 2004. Current Conditions were marginally lower (from 112.1 to 111.9) and Expectations rose from 88.9 to 89.5. Last week, Bloomberg Consumer Comfort rose from 45.5 to 46.7, the highest reading since April 2015. It fell to 46 today – still near the highest levels of the year. Bloomberg Economic Expectations rose from 44 to 53.5. The Richmond Fed Manufacturing Index rose from 4 to 8. Dallas was 5.3 better to 15.5 and Kansas City improved from 1 to 11. Chicago fell from –.05 to –.27 and the November Leading Index was flat.

Housing data was a little mixed. New Home Sales rose 5.15% to 1,090K, the second–best level since 2008. Existing Home Sales rose .72% to a 5.61M pace, achieving the best annual gain since early 2007. Though MBA Mortgage Applications rose 2.50% last week, Pending Home Sales fell 2.50% as higher mortgage rates slowed buying. After a surge to a 9–year high, Housing Starts dropped 18.66% in November to a 1,090K pace, and Building Permits dropped 4.68% to 1,201K. The FHFA House Price Index rose .40% in October. S&P Case–Shiller metro home prices rose .63%, increasing the annual pace from 5.03% to 5.10%. Their house price index rose .85%, quickening that annual rise from 5.39% to 5.61%.

Friday closes out data releases and trading for 2016 with the Chicago Purchasing Manager's report. The markets will observe the New Year's holiday on Monday (01/02), so 2017 data starts on Tuesday (01/03) with ISM Manufacturing, Prices Paid, New Orders, and November Construction Spending. Wednesday brings MBA Mortgage Applications, December Vehicle Sales, and the minutes from the FOMC meeting that concluded on December 14th.

Equities

As we said earlier, stocks continued their post–election rally and rose to new highs into our December 14th trend–change date, but have pretty much hovered there until yesterday's selloff. We still think the next major buying opportunity should be near January 26th. The Dow Industrials rose .44% into the 16th, and 90.40 points or .46% last week to 19,933.81. The Dow is .57% lower this week. The Nasdaq fell .13%, rose .47% last week to 5,462.69, but is lower .56% this week after hitting a new record high on Tuesday. The S&P fell .06%, then rose .25% last week to 2,263.79, and is .64% lower now since Friday. The Dow Transports lost 2.55% two weeks ago, rose .25% last week, and are 1.15% lower this week. Bank stocks fell 1.34%, rose 1.55% last week, and are 1.93% lower this week.

Resistance:	Dow:	19,968/ 20,109/ 20,251/ 20,392	Nasdaq:	5,452/ 5,489/ 5,511/ 5,526	S&P:	2,262/ 2,274/ 2,286/ 2,298
Support:		19,731/ 19,685/ 19,545/ 19,406		5,415/ 5,378/ 5,341/ 5,305		2,238/ 2,226/ 2,214/ 2,202

Other Markets

Commodities fell .29% and .47% over the past two weeks, but are 1.24% higher this week. Crude Oil added to the mix, gaining .78% and 2.16% for the last two weeks, and climbing 1.41% higher this week. Gold fell 2.08% and .30%, but has rallied 2.31% this week. The U.S. Dollar countered a little of that move, gaining 1.31% and .05% over the past two weeks, while falling .28% so far this week. The Japanese Yen lost 2.26%, rose .51%, and then added .67% into today. The Euro fell 1.04%, rose .05%, and has added .33% since Friday. Corn rose 1.06%, dropped 2.95%, and then added 1.16% since Friday. Cotton gained .34%, lost 1.65% last week, and has risen .90% this week.

"Drawing on my fine command of the English language, I said nothing." Robert Benchley

Additional Information is Available on Request

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