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Bond Market Review

February 02, 2017

Groundhog Day

The FOMC concluded their meeting on Wednesday with 6 more weeks of unchanged rates leading into the March 15th meeting. Taking that cue, today Punxsutawney Phil (the groundhog) saw his shadow – therefore predicting six more weeks of winter. The FOMC vote was once again unanimous with just a few changes to their December statement. They changed *"expected to rise"* to *"inflation will rise to 2% over the medium term."* Of growth, they changed *"has been expanding"* to *"economic activity has continued to expand."* They also said job gains *"remained solid"* instead of *"have been solid."* For the most part, to the **B**ond **M**arket **R**eview, it appeared to be window dressing – just moving the furniture around to make things look a little more upbeat.

However, things are looking up! The FOMC acknowledged that in saying: *"Measures of consumer and business sentiment have improved of late."* For instance, Bloomberg Consumer Comfort was flat at 45.2, and then 1.4 points better to 46.6 today – rising to the next best reading since April 2015. The economic measure tied January 2015 for the highest result since July 2007. University of Michigan sentiment rose from 98.1 to 98.5. Their survey on current conditions dropped a little (from 112.5 to 111.3), but expectations rose from 88.9 to 90.3. Board Consumer Confidence fell from 113.3 to 111.8, but that December reading was the highest since August 2001! Expectations dropped the most since November 2015 – from 106.4 to 99.8, but the present–situation gauge rose from 123.5 to 129.7. In general, January sentiment readings fell off their December highs, but they mostly held ground.

GDP for the 4th quarter was less than expected as the third quarter's 3.50% growth was followed by only 1.90%. That left U.S. GDP for 2016 at only 1.6%. Growth for 2015 had been 2.6% – which was the highest since 2.7% in 2006. As we've noted, the U.S. hasn't seen 3% growth for over a decade now. However, the Atlanta Fed's GDP–Now forecast, known for having one of the better track records for predictive value, sees Q1 2017 at 3.4%! If that's the case, there's little doubt the Fed is waiting to see how the early actions of the Trump administration affect the economy before further shaping policy. The International Monetary Fund said they expect with *"high probability"* a boost in the U.S. economy from tax reforms and infrastructure proposals by the Trump administration.

Looking Ahead

- Our 10–year bond cycles have a low–yield window near February 6th, and higher yields into mid–February.
- Our equity cycles show positive forces into a high near February 14th.

Fences

A major part of this past week's news was President Trump's announcement that there could be a 20% import tax on Mexican goods to finance the border wall. While media talking points said those costs would be passed on to the consumer, that's not what happens in the real world. If goods out of Mexico actually cost 20% more, retailers will seek out cheaper sources if available. Just as Japan adjusts prices to be competitive to Korea, and both do so to compete with China – or produce some of those goods in China, Mexican producers would have to drop prices to remain competitive. Rather than falling to the U.S. consumer, though that will happen to a degree, it will harm Mexico and squeeze profits on their production. We don't operate in a vacuum, and just as water seeks the lowest point – U.S. retailers will instead buy goods from Southeast Asia, Latin America, or maybe even on the home front!

2017 Bank Conference & Golf Tournament

You are cordially invited to attend the 15th Annual Bank Conference to be held Thursday, April 27th, 2017 at the Four Seasons Resort & Club, in Irving, Texas. Contact Susan Tomcko at (214) 545-6824 or stomcko@cstreetcap.com for details.

Treasuries, Agencies, and MBS

Last week, yields rose 3, 1, 1.5, and 1 bps for the 2, 5, 10, and 30–year Treasury sectors. Into today, yields were lower by 1.5, 2.5, and 1 bps for the 2, 5, and 10–year sectors, but 3 bps higher at 30–years. MBS spreads (FNMA 30–year 3%) narrowed by 1 bps again last week. Last Thursday (01/26), the Treasury sold $28 billion 7–year notes at 2.335%. That was the highest auction yield since December 2013, and demand was off versus the December sale. Bidding for the foreign central bank group rose from 64% last month to 72.8% of this issue.

Next week, the U.S. Treasury will auction $24 billion 3–year notes on Tuesday (02/07), $23 billion 10–year notes on Wednesday (02/08), and $15 billion 30–year bonds on Thursday (02/09).

01/27/17 Treasury Yield Curve	2-Year: 1.220%	5-Year: 1.947%	10-Year: 2.485%	30-Year: 3.059%
Weekly Yield Change:	+.029	+.010	+.017	+.010%
Support:	1.19/ 1.22/ 1.26/ 1.29%	1.91/ 1.95/ 1.98/ 2.02%	2.47/ 2.51/ 2.55/ 2.59%	3.13/ 3.17/ 3.21/ 3.26%
Targets:	1.17/ 1.14/ 1.11/ 1.09%	1.85/ 1.81/ 1.78/ 1.74%	2.43/ 2.39/ 2.35/ 2.31%	3.04/ 2.99/ 2.95/ 2.91%

Economics

Data leading into Friday's payroll numbers has been very good. ADP Employment Change showed a best–in–7–months 246K jobs created in the private sector versus 168K expected. Challenger Job Cuts reported 38.80% less layoffs than for January 2016. ISM Employment jumped from 52.8 to 56.1. Over the past 2 weeks, Initial Jobless Claims rose from 237K to a 4–week high 260K, and then fell back to 246K – and below 300K for a 100th week. Continuing Claims rose from 2,059K to 2,103K, and then fell to 2,064K. The Leading Index rose .50% for December. ISM Manufacturing rose from 54.5 to 56 (rising for a 5th month) and Prices Paid rose from 65.5 to 69. New Orders rose .1 to 60.4. Chicago Purchasing Managers fell from 53.9 to 50.3 and Kansas City Fed Manufacturing Activity was flat at 9. Dallas rose from 17.7 to 22.1 and Chicago improved from –.33 to +.14. The Employment Cost Index rose .50% for Q4 2016. Q4 Personal Consumption rose 2.50%. The GDP Price Index rose 2.10%, and 1.30% for the core (ex food & energy). Nonfarm Productivity rose by 1.30% for Q4 and Unit Labor Costs rose 1.70%.

In December, Personal Income rose by .30% and Personal Spending rose .50% – the most in 3 months. Real Personal Spending rose by .30%. The PCE Deflator rose .20%, accelerating the annual pace from 1.40% to 1.60%. Core PCE rose .10%, elevating the annual pace from 1.60% to 1.70%. The December Advance Goods Trade Balance was a $65 billion deficit. Wholesale Inventories rose 1.00% and Retail Inventories were flat. Orders for Durable Goods fell .40%, but were .50% higher ex transportation. Capital Goods Orders rose .80%. Construction Spending fell .20% in December. While annual sales of New Homes were the best since 2007, December sales dropped the most in nearly 2 years – falling 10.37% to a 10–month low of 536K. Higher mortgage rates discouraged buyers, though Pending Home Sales rose by 1.60%. Metro home prices (S&P Case–Shiller 20–city index) rose .88% in November, taking the annual pace from 5.09% to 5.27%. The Home Price Index rose from 5.46% to 5.64%. January Vehicle Sales fell from 18.29M to a 17.48M pace. Domestic sales dropped from 14.19M to a 13.60M pace.

Friday is set for January payrolls, the Unemployment Rate, and related data. Also due are the service–sector outlook (ISM Non–Manufacturing Composite), and updated Factory and Capital Goods Orders for December. Next Tuesday (02/07) brings the December Trade Balance deficit, JOLTS job openings, and Consumer Credit. MBA Mortgage Applications, which were down 3.20% last week, are due on Wednesday.

Equities

The January barometer that theorizes 'so goes January, so goes the year' got a decent start despite 3 down days to close out the month (for the Dow). The Dow Transports finally joined most other indexes in making new highs last Thursday. However, while the gain is usually a good gauge of a 'head start', it's not always indicative of what's to come. It just shows the initial part of the 'tug of war.' The Dow fell 5.50% in January 2016, only to end the year 13.42% higher! Actually, the Dow only rose .51% to kick off 2017, but other indices fared much better. The Dow Transports added 1.64%, the S&P gained 1.79%, and the Nasdaq surged 4.30%. Bank stocks were weaker by .41%.

Last week, the Dow Industrials gained 266.53 points or 1.34% to 20,093.78. The Dow is off 1.04% this week. The S&P gained 23.38 points or 1.03% to 2,294.69, but was .60% lower into today. The Nasdaq gained 105.45 points or 1.90% to 5,660.78, but was .43% lower this week. The Dow Transports surged 2.38%, but had lost 3.61% into today. Bank stocks rose 2.62%, but lost 1.88% so far this week. Stocks should be strong from February 9th to the 14th.

Resistance:	Dow:	20,114/ 20,139/ 20,175/ 20,210	Nasdaq:	5,677/ 5,697/ 5,734/ 5,773	S&P:	2,301/ 2,307/ 2,313/ 2,325
Support:		19,997/ 19,961/ 19,891/ 19,786		5,621/ 5,585/ 5,548/ 5,510		2,289/ 2,282/ 2,277/ 2,267

Other Markets

The U.S. had its first ever oil trade surplus with Latin America (the first since records began in 1993). Commodities lost .30% last week, but are .05% higher this week. Crude Oil gained 1.43%, and is .70% higher this week. Gold lost 1.37% last week, but is 2.38% higher this week. The U.S. Dollar lost .16%, and appears to be headed for a 6th weekly loss as it was .73% lower into today. The Japanese Yen lost .42%, but is 2.00% higher this week. The Euro lost .04%, but is .56% better this week. Corn lost 1.96%, but is 1.38% higher this week. Cotton gained 2.48%, and is 2.75% better this week.

"To achieve the impossible dream, try going to sleep." Joan Klempner

Additional Information is Available on Request
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