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BOND MARKET REVIEW

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Beware the Ides of March

Over the past two days, stocks believed in President Trump's address to Congress and surged to all–time highs – while short bond yields hit their highest levels since 2009. If nothing else, bonds are 'saying' that another FOMC hike is now imminent. With global negatives subsiding, if the Fed is wanting it, enough FOMC members are supporting it, and bonds have capitulated to it, a hike is probably less than 2 weeks away for the March 15th meeting. As we said last week, the Fed will get a look at the February payrolls numbers (due on March 10th) before their meeting – but at this point things would have to be really ugly to turn the tide. Though the Fed will go 'dark' this weekend (two Saturdays before each meeting), those urging patience already went quiet over the past week while those expressing that March was on the table were instead most vocal. From those talks, one might assume the votes are already there! Last week, Dallas FRB President Robert Kaplan said: *"We would well be served by moving sooner rather than later."* He said he didn't want to risk getting *"behind the curve"* where the Fed would then *"feel the need to operate more aggressively."* Those that had been heavily in the 'wait and see' camp like Fed Governor Lael Brainard seem now more open to the 'sooner' crowd, as she said the U.S. economy *"appears to be in transition."*

While the **B**ond **M**arket **R**eview would like to see GDP growth numbers nearer 3.00%, the Fed appears to be content enough with inflation nearing 2.00% and good employment data. Unfortunately, while the Atlanta Fed's GDP Now forecast for Q1 2017 had been as high as 3.40% on the 1st of February, the first March reading came in at 1.80% – for the lowest estimate of the year! However, the FOMC is probably also encouraged by improving conditions in the EU that are removing headwinds to growth while also potentially reducing the magnitude of global tantrums to each coming Fed hike. The market–based odds numbers for the March 15th meeting had risen from '1 in 3' to over 50% over the past few weeks with May seemingly holding the best chance for the next move. However, investors and traders were emboldened Trump's speech on Tuesday night – answering with a Dow rally of over 300 points the next day. The odds for a March hike jumped to a 'near lock' of 80%. Those are Crest–toothpaste 4–out–of–5 dentist–type numbers – making you wonder if that 5th guy just needed more cavities to fill. Today, the market–based odds rose to 90% – even swaying the 'holdouts.' It was as though bonds were crying out: *'Et tu Brainard?'*

Looking Ahead

- Bonds should rally into March 20th, when a low–yield trend–change is expected.
- The **BMR** equity cycles show a low due near March 9th.
- The next FOMC decision is scheduled for March 15th.

The **BMR** sees many reasons to be optimistic going forward. However, history is full of unexpected market crashes or large corrections following periods of excessive optimism – which is now at a 30–year high! Many also think this new campaign to tighten rates will finally kill the bull market in bonds – something that was instead an enigmatic conundrum for the Fed from 2004 into mid–2006 – despite hiking rates 17 consecutive times! As we discussed in recent issues, the overall bond trend has not yet been technically reversed – even though it is showing signs of turning the corner. We'll cover that going forward in future issues, but as we've said before – there are longer–term forces in play that still have a say in the great unwinding of waves of lower lows in yields that have occurred in interest rates from a 10–year reading of 15.84% in September 1981 into the low of 1.336% last July. It was that new low, also confirmed by the 30–year bond, that kept the longer charts still 'in trend.' Coincidentally, the **BMR** was screaming 'refi' from June to August last year as our long–term yield cycles were making interim lows.

Treasuries, Agencies, and MBS

The **B**ond **M**arket **R**eview's bond cycles have performed extraordinarily well recently. We had high yields due February 14th/15th, lows due on the 24th, and another high due today. Through today, those turns came in perfectly as forecast. We're not going to ever be anywhere even approaching 100%, but our bond cycles now point to lower rates into March 20th. As we said last week, especially if that cycle unfolds: *"March 20th still looks to be a good target date for lower yields (to hedge portfolios and/or take profits)."* The Fed's Beige Book once again reported "modest to moderate" growth across the U.S. with labor shortages that reinforce their perception of an economy approaching full employment. Business optimism faded slightly since the previous report.

Last week, into that 24th trend–change, yields fell by 4.5, 9.5, 10.5, and 7 bps for the 2, 5, 10, and 30–year Treasury sectors. Into the high due today, yields for those sectors surged higher by 16.5, 21, 16.5, and 12 bps. In rising to its highest levels since mid–2009 today, the 2–year note is confirming the Fed's intention to raise rates on March 15th.

MBS spreads (FNMA 30–year 3%) widened by 2 bps last week. Last Thursday (02/27), the U.S. Treasury sold $28 billion 7–year notes at 2.197%. Demand was the best since December, and the yield was the lowest since October. Foreign buying fell to 63.8% of the offering, versus 72.8% of the January auction.

Next week, the Treasury will offer $24 billion 3–year notes on Tuesday (03/07), $20 billion 10–year notes on Wednesday (03/08), and $12 billion 30–year bonds on Thursday (03/09). I cannot recall a time when the 30–year auction (or the 10–year) preceded the release of the previous month's payroll numbers, but that will be the case with February payrolls coming on March 10th.

02/24/17 Treasury Yield Curve	**2-Year: 1.145%**	**5-Year: 1.805%**	**10-Year: 2.313%**	**30-Year: 2.952%**
Weekly Yield Change:	–.045	–.097	–.103	–.071%
Support:	1.32/ 1.34/ 1.37/ 1.39%	2.05/ 2.08/ 2.12/ 2.15%	2.51/ 2.55/ 2.59/ 2.63%	3.10/ 3.13/ 3.15/ 3.17%
Targets:	1.28/ 1.25/ 1.20/ 1.16%	1.98/ 1.95/ 1.91/ 1.88%	2.48/ 2.44/ 2.40/ 2.36%	3.07/ 3.04/ 3.02/ 2.99%

Economics

The latest employment and confidence data are not encumbering the FOMC's desires to continue to gradually hike rates. Initial Jobless Claims rose 4K to 242K last week, but then fell to 223K this week – the lowest since March 1973 (a 44–year low reaching back to my pole–vaulting days). That was the 104th week below 300K. Continuing Claims fell 14K to 2,063K, and then rose 3K to 2,066K. 4th–quarter GDP was unchanged from the previous 1.90% estimate, though Personal Consumption was .50% higher at 3.00%. The GDP Price Index was .10% lower to 2.00%. Core PCE fell .10% to 1.20%. January's PCE (Personal Consumption Expenditures) rose .40%, raising the annual pace from 1.60% to 1.90%. Core PCE (ex food & energy) was up .30%, remaining at a 1.70% annual rise. In January, Personal Income rose .40%, while Personal Spending rose only .20%. Real Personal Spending fell .30% – the largest drop since September 2009. We read one article warning about Trump's deportation plans leading to higher farm prices. The Fed has been craving wage inflation, so we'll see what happens.

Bloomberg Consumer Comfort fell .1 to 48 last week, but today rose to a 10–year high of 49.8! Economic views were the strongest since March 2007 (up from 45.2 to 46.8). Board Consumer Confidence rose from 111.6 to 114.8 – the highest level since July 2001! Expectations rose from 99.3 to 102.4 and present situation (conditions) rose from 130 to 133.4 – the best level since July 2007. The University of Michigan survey results were mixed. Sentiment had its first drop since the election – declining from 98.5 to 96.3, current conditions were .2 higher to 111.5, and expectations fell from 90.3 to 86.5.

Chicago Purchasing Managers rose from 50.3 to 57.4, though the Chicago Fed National Activity Index fell from .18 to –.05. Dallas Fed Manufacturing Activity rose from 22.1 to 24.5, Richmond was 5 better to 17, and Kansas City also rose 5 points to 14. ISM Manufacturing rose from 56 to 57.7. That marked 6 straight gains and the best increase (growth) since August 2014. ISM Prices Paid fell 1 point to 68 and New Orders rose from 60.4 to 65.1. The first read on February payrolls was not good, as ISM Employment fell from 56.1 to 54.2. Orders for Durable Goods rose 1.80% in January after a .80% drop in December. Ex Transportation they were .20% lower following a .90% gain. Capital Goods Orders fell .40% after a 1.10% rise in December. Wholesale Inventories fell .10% and Retail Inventories rose by .80%.

Vehicle Sales fell off January's pace by only .01M to 17.47M, but came in far less than the 17.70M annual pace expected. Domestic Vehicle Sales rose from 13.60M to a 13.65M annual pace. January Home Sales rose 20K or 3.74% to 555K units, but were off the 571K pace expected. Though expected to rise by .60%, Pending Home Sales fell by 2.80% – and were revised .80% lower (from 1.60% to a .80% gain) for December. Sales rose 2.70% over the pace a year ago. Metro home prices (S&P Case–Shiller 20–city Index) rose by .93%, quickening the annual pace from 5.20% to 5.58%. The House Price Purchase Index rose 1.50% in the 4th quarter of 2016 and the FHFA House Price Index rose .40% in December. The S&P CS Home Price Index stepped up the annual rise from 5.61% to 5.85%. January Construction Spending fell by 1.00%.

Friday gives us a look at the service–sector outlook (ISM Non–Manufacturing Composite). Next Monday (03/06) is set for January Factory Orders, along with orders for Durable and Capital Goods. Tuesday brings the January Trade Balance (deficit) and Consumer Credit for January. Wednesday follows with MBA Mortgage Applications (which were up 5.80% last week), Q4 Nonfarm Productivity & Unit Labor Costs, January Wholesale Inventories & Trade Sales, and a look into Friday's February payrolls from the ADP Employment Change (private payroll) data.

Equities

Into Feb 27th, the Dow closed higher for 12 days in a row! Though down on Tuesday, investors embraced President Trump's speech to give the first day of March a 303.31–point rally. Recall that the Dow Industrials spent 28 trading days trying to break 20,000 – with 23 of those days less than 100 points away. Wednesday bested Monday's high of 20,851.33 by surging through 21,000 near the open on the way to a new record of 21,169.11! February 28th did turn out to be a low for the Dow, as the only loser since the 8th, but clearly was not what we expected and not as helpful as the bond cycles. As we've often seen with these trend changes, sometimes they kick higher following a call for a low turn or plunge from a trend–change high – even if not approaching the date with much vigor. Recall the low from November 8th as such an example. The market had turned higher on the 7th, but surged higher from the 8th. That's one reason why we allow a day on either side given longer–term work. The **BMR** (11/02/2016) had forecast: *"Our equity cycles show a trend–change low due near November 8th."* That said, investor optimism is the highest in 3 decades, which is a warning signal – but who wants to step in front of a speeding locomotive (without the required red cape)? After today's loss, the Dow is still 6.28% higher for the year!

Last week, the Dow gained 197.71 points or .96% to 20,821.76. It's .87% better this week. The S&P gained 16.18 points or .69% to 2,367.34, and is up .62% this week. The Nasdaq rose 6.73 points or .12% to 5,845.31, and is .27% higher this week. The Dow Transports lost .77% last week, but are up .19% so far this week. Bank stocks lost .43%, but have rallied 1.48% this week – partially on Trump's talk of reducing regulations.

Resistance:	Dow:	21,164/ 21,313/ 21,456/ 21,604	Nasdaq:	5,877/ 5,914/ 5,951/ 5,991	S&P:	2,388/ 2,401/ 2,413/ 2,425
Support:		20,875/ 20,732/ 20,584/ 20,444		5,839/ 5,801/ 5,764/ 5,725		2,377/ 2,371/ 2,365/ 2,353

Other Markets

Commodities lost .62% last week, and are off 1.11% this week for a potential third loss. Crude Oil gained 1.10% last week, but has fallen 2.56% this week. The U.S. Dollar rose .14% last week, and with a March hike imminent is 1.10% better this week and most likely headed for a 4th weekly gain. In turn, Gold had gained 1.56%, but is off by 1.91% this week! The Japanese Yen rose .64% last week, but plunged 2.04% into today. The Euro lost .50% and is down another .53% this week – which would mark a 4th week of losses. Corn lost 1.15%, but is 2.40% higher this week. Cotton gained 2.64%, and is .36% higher this week.

January 27th brought in the Chinese Year of the Fire Rooster. Should be a great year – especially for those that like grilled chicken!

"The hardest thing to learn in life is which bridge to cross and which to burn." David Russell

Additional Information is Available on Request

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