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BOND MARKET REVIEW

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Hiking a Bizarre Trail

The market–based odds for an interest–rate hike during the Fed's March 15th meeting rose to 96% on Monday, and remained at that 'near lock' level through today. On February 22nd, those odds were only 1 in 3. While FOMC members went 'silent' Saturday, on Friday Fed Chair Janet Yellen was the last to take a hawkish tone by saying a hike *"would likely be appropriate"* if the data stayed on track. Incoming data from the best service–sector outlook since October 2015, low jobless claims, and private payrolls for February have done little to thwart the FOMC plans for a 25–bps hike next Wednesday. Various Fed members have voiced their concerns of risking getting 'behind the curve' – given low rates and improving growth. We've also noted the positives, and acknowledge that rates above where they are now would still be accommodative. However, it's also the case that the Fed raises rates to 'cool' the economy. So, are the overheating economy and getting 'behind the curve' just more 'fake news'?

As we said last week, there's a lot to be optimistic about data wise, but is the Fed really in danger of getting behind the curve, or is growth about to throw its own curve to the FOMC? We often track the Atlanta Fed's GDP–Now forecast to get a read on what to expect. They've proven to be very good with their estimates. The absence of FOMC doves should be reflected by data beyond employment numbers that are still a little suspect given low labor–force participation and a lack of wage pressures. Of course, their second concern is inflation – which is higher, but seems in little danger of making an upside run. While the Fed views those mandates with a 'mission accomplished' banner, does the economy really need cooling? Despite a mild winter that was far less a hindrance to growth than in previous years, Atlanta's projections are now forecasting Q1 GDP barely above 'stall' speed. On February 1st, they had projected a healthy 3.4%! However, the Now–cast has been steadily slipping since then – and fell to only 1.2% today. If we were served such a dish at a restaurant, we'd send it back to the kitchen to be reheated! We didn't order Sushi.

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, followed by another low near March 16th.
- The FOMC will update their rate–policy stance Wednesday (03/15) at 2:00 ET. Expect a 25–bps hike.
- Spring those clocks ahead one hour Sunday morning (03/12) at 2 a.m.

It's a fairly simple take. If you pretty much set your own borrowing costs, why would you raise them – adding $50 billion in interest burden to the Federal deficit for each 25–bps hike? Higher rates will help savers, though resetting higher coupons on adjustable products will raise default rates. If the European Central Bank is going to continue stimulus, as it appears they will – while EU countries and Japan still have negative rates, just how high can (or will) U.S. rates go (with that tether still in effect)? Some EU rates continue to be negative out to 5–years, while most leading economies are negative at 2–years. The spread between U.S. and German 2–year debt is roughly 2.13%. At 10–years it's around 2.20%. That's a 22% cushion for the U.S. Dollar over the next 10 years. As our debt widens, traders will continue to find U.S. debt to be an attractive quality alternative!

We've been objective concerning trade numbers, as higher imports can sometimes mean U.S. retailers are stocking the shelves with expectations of improving sales numbers. In this case, it was also stocking auto–dealer lots as vehicle imports contributed to the U.S. trade balance deficit rising from $44.3 billion to $48.5 billion – the highest since March 2012 (nearly 5 years). Are those expectations valid? Not considering borrowing! Curiously, Consumer Credit in January expanded by only half of expectations – at $8.794 billion versus nearly $15 billion in December. Petroleum imports rose 19% from higher costs and volume (8.4 million barrels per day versus 7.7 million in December). Exports did rise, though by only .6%. Higher demand for foreign goods coupled with lighter buying of U.S. services and goods represent a challenge to our GDP growth for the first quarter of 2017.

Treasuries, Agencies, and MBS

Into February 27th, the Dow Industrials enjoyed a streak of 12 winning sessions in a row. However, it hasn't gone so well for bonds, as yields have risen at a torrid pace since our last rate–cycle low on February 24th. Yields have now risen back to mid–December levels, and the 2–year is the highest since mid–2009. Nevertheless, despite a rise in yields past the point of the last **B**ond **M**arket **R**eview cycle turn, a fresh look at the cycles still shows lower rates into March 20th – followed by another run to higher rates into April 3rd.

Last week, yields rose by 16, 20.5, 16.5, and 12 bps for the 2, 5, 10, and 30–year Treasury sectors. As we said, that trend continued into today with rates climbing another 5, 8.5, 8, and 7.5 bps (for those sectors). MBS spreads (FNMA 30–year 3%) narrowed by 2 bps last week. This week's auctions are drawing higher yields. On Tuesday (03/07), the U.S. Treasury brought $24 billion 3–year notes at 1.63%, the highest auction result level in nearly 7 years (to April 2010). Demand was the lowest since December and the foreign buying group (including central banks) bought 49.4% of the issue versus 57.2% in February. The Treasury reopened the February 2027 10–year note to sell $20 billion at 2.56% today. That was the highest auction yield since July 2014, with demand the best since June 2016. Foreign buyers accounted for 65.8% of the offering versus 65.1% last month. The Treasury will offer $12 billion 30–year bonds on Thursday (03/09).

03/03/17 Treasury Yield Curve	2-Year: 1.307%	5-Year: 2.010%	10-Year: 2.479%	30-Year: 3.072%
Weekly Yield Change:	+.162	+.205	+.166	+.120%
Support:	1.38/ 1.41/ 1.43/ 1.46%	2.13/ 2.17/ 2.20/ 2.24%	2.60/ 2.64/ 2.68/ 2.71%	3.19/ 3.23/ 3.28/ 3.33%
Targets:	1.35/ 1.33/ 1.30/ 1.27%	2.07/ 2.03/ 2.00/ 1.89%	2.56/ 2.52/ 2.48/ 2.44%	3.15/ 3.12/ 3.06/ 2.98%

Economics

If the private payroll data is a harbinger of things to come, the February employment numbers should be very good – and the last dagger into those hoping for the FOMC to hold rates steady. ADP Employment Change came in at 298K, not only beating expectations by over 110K – but also adding 15K to the January numbers. As we said last week, Initial Jobless Claims fell from 242K to 223K – the lowest since March 1973. Another positive came from the service sector rising from 56.5 to 57.6 – marking the best growth pace since October 2015! Nonfarm Productivity grew 1.30% in the 4th quarter of 2016 (a little less than expected), while Unit Labor Costs rose 1.70% (versus 1.60% expectations). January Factory Orders rose 1.20%, but were only .30% higher ex–transportation. Orders for Durable Goods doubled expectations at 2.00%, while they were flat ex–transportation. Capital Goods Orders fell by .10%. January Wholesale Inventories fell .20%, and Trade Sales dropped .10% (while also being revised .20% lower to 2.40% for December).

Thursday is set for two more looks into Friday's February payroll numbers from Challenger Job Cuts and jobless claims data. Also due are February Import Prices, the Household Change in Net Worth (for Q4 2016), and Bloomberg Consumer Comfort – which last week rose from 48 to a 10–year high 49.8! Friday brings the anticipated (and very late) February payroll and unemployment numbers, as well as the Monthly Budget Statement (also for February). Next Monday (03/13) updates the FOMC jobs dashboard (Labor Market Conditions Index Change). Tuesday supplies Producer Prices (February PPI) and NFIB Small Business Optimism. Wednesday gives us MBA Mortgage Applications (which last week rose 3.30%), Consumer Prices (February CPI), Retail Sales, Empire Manufacturing, Treasury International Capital Flows, January Business Inventories, home–builder outlook (NAHB Housing Market Index), and the FOMC interest–rate policy decision (widely expected to be a 25–bps increase in the funds rate).

Equities

The Dow Industrials rose for a 4th week, adding 183.95 points or .88% to 21,005.71. They are .71% lower this week. The S&P gained 15.78 points or .67% to 2,383.12, but are .85% lower this week. The Nasdaq rose 25.45 points or .44% to 5,870.75, but was .57% lower into today. While the Dow Transports gained .74% last week, they are 2.32% lower this week. Bank stocks rose 1.95% last week, but are .95% lower this week.

Resistance:	Dow:	20,872/ 21,015/ 21,162/ 21,309	Nasdaq:	5,841/ 5,860/ 5,880/ 5,901	S&P:	2,365/ 2,377/ 2,389/ 2,401
Support:		20,734/ 20,566/ 20,439/ 20,301		5,823/ 5,802/ 5,785/ 5,766		2,353/ 2,341/ 2,329/ 2,317

Other Markets

Crude Oil last topped with our 'year–end' cycle. We have a low due near March 13th, a high near March 17th, and a better–quality low due near the end of April. It might be best to wait before setting long positions. Crude lost 1.22% last week, and has plunged 5.72% this week on rising U.S. stockpiles. Likewise, Commodities fell .64%, and are 2.46% lower this week. Gold was also in that trend, falling 2.42% last week and another 1.39% this week as the U.S. Dollar continued to rise. The Dollar rose .45%, and may be headed for a 5th week to the upside with a .52% gain into today. The Japanese Yen tumbled 1.71% last week, and is .27% lower this week. The Euro rose .56%, but was .76% lower into today. Corn gained 2.95%, but fell 2.54% into today. Cotton gained 2.47%, but reflected the weakness in commodities so far this week with a .49% drop.

"The main dangers in this life are the people who want to change everything – or nothing." Nancy Astor

Additional Information is Available on Request

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