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BOND MARKET REVIEW

March 22, 2017

Sweet Little Sixteen

As the NCAA was honing its way down to the sweet 16, Chuck Berry passed away. His song is much sweeter to the ears, and more endearing (if not enduring) than one–shining moment. The Fed has only 17 members at present as 2 positions are waiting to be filled on the board of governors. Only 12 vote at a time, 7 board members and 5 presidents of the 12 districts. Since the FRB New York president always has a vote, the other 11 rotate – so that only 4 of them vote in a given year. With only 5 board members, the March vote was 9 to 1. The other 16 may have been sweet to the hike, but one dissented – sour to raising rates. He, FRB Minneapolis President Neel Kashkari, said the Fed should tolerate some inflation above 2% for as long as it has been below that level, saying: *"That is what a target means."* He said the data has moved sideways, not changing much, and it didn't support a hike. He said he favored a plan to normalize the balance sheet before hiking again. No telling how many of the Group of 20 finance ministers were sweet to America's new call for fair trade! We suspect there were more in the murmuring camp. Nevertheless, the G20 also met over the past week, and ended up watering down their call to avoid protectionism – somewhat capitulating to the Trump administration's desires to rethink global commerce. America wants out of a *"bad deal"* – into something *"fair."* Trump had told Germany's Merkel that the U.S. has been treated *"very, very unfairly."* Sometimes the biggest buyer can get a deal! The empirical evidence would show most of our trade is exporting cash.

Looking Ahead

- Bond yields should be higher into April 3rd/4th, and then fall to an important low near May 15th/19th.
- The **BMR** equity cycles show an interim low due around April 5th.

Treasuries, Agencies, and MBS

Bonds finished last week with some improvement, as the Fed's Dot Plots suggested a more gradual upside trajectory for rates. The less–hawkish tone of the statement, and following comments, led the markets to believe that the FOMC might hike rates a total of 3 times for 75 bps in 2017 – rather than 4 times for 100. Taking 25 bps away from projections weakened the Dollar a bit, and allowed Treasury rates to fall from highs made coming into the 15th (Fed day) to new lows for March. From those highs into today's lows, yields fell 16, 23, 24, and 21 bps for the 2, 5, 10, and 30–year sectors. For the 5 and 10–year sectors, nearly 25 bps was removed within a week of the Fed announcement (last Wednesday). Last week, yields fell 3.5, 8.5, 7.5, and 5.5 bps for the 2, 5, 10, and 30–year sectors. Into today, they dropped another 7, 8, 9.5, and 9 bps – pulling out most of the pricing for 3 more FOMC hikes in 2017, and instead pricing in only 2 (at this point).

As we said last week, *"the May odds for a hike kicked off at 'only' 13.3%"*, and not much has changed that would cause market participants to change their minds. Those 'odds' were still 13.3% today, though the June meeting dropped from 53.5% to 50.2% – or basically a coin toss. On Tuesday, stocks had their worst selloff in 6 months (since September 13th for the Dow 30). Our cycles are projecting a 'hard low' for stocks near the end of June. (Basically, that means stocks would trade much lower into that window, and then have a significant rally.) For the record, the equity cycles are projecting a Labor Day top for the year, leading the **B**ond **M**arket **R**eview to place the next hike during the July or September Fed meeting. As for the lowest yield for the year – our bond cycles are projecting May 19th. If the cycles unwind as we expect them to, that will be the time to sell positions and uber–hedge portfolios.

MBS spreads (FNMA 30–year 3%) widened by 4 bps last week to fast–moving Treasuries. Next week, the medium–term auctions resume. The U.S. Treasury will offer $26 billion 2–year notes on Monday (03/27), $34 billion 5–year notes on Tuesday (03/28), and $28 billion 7–year notes on Wednesday (03/29).

03/17/17 Treasury Yield Curve	**2-Year: 1.318%**	**5-Year: 2.019%**	**10-Year: 2.501%**	**30-Year: 3.110%**
Weekly Yield Change:	–.037%	–.083%	–.074%	–.055%
Support:	1.270/ 1.305/ 1.335/ 1.395	1.985/ 2.020/ 2.055/ 2.090	2.455/ 2.495/ 2.535/ 2.575	3.050/ 3.090/ 3.135/ 3.180%
Targets:	1.235/ 1.205/ 1.180/ 1.143	1.955/ 1.920/ 1.890/ 1.850	2.420/ 2.380/ 2.340/ 2.300	2.995/ 2.975/ 2.950/ 2.910%

Economics

Initial Jobless Claims fell 2K to 241K, again very close to the 1973 lows and almost non–news at this point. Under a new reporting process, jobless claims have been under 300K for 79 straight weeks. However, the older seasonally–adjusted data marched on to 106 weeks! Continuing Claims fell 30K to 2,030K. The Fed's jobs dashboard was delayed until after the FOMC meeting as certain elements fell within their pre–meeting comment blackout period.

The data, released Friday, quite frankly surprised us as we thought the index would show better improvement than for January. The index improved by 1.3 points versus 2.5 expected – matching the 1.3 increase for January. Job openings increased from 5.529M in December to 5.626M in January as (JOLTS Job Openings) data showed 3.22M Americans quite their jobs (at the highest pace since December 2015). University of Michigan Sentiment improved from 96.3 to 97.6. Current Conditions rose from 111.5 to 114.5, for its best level since November 2000! Expectations (6 months out) rose from 86.5 to 86.7. The expectations component was politically polarized. Republicans registered 122.4 to only 55.3 for Democrats. It's hard to see how general feelings about the economy could result in such a large gap! Save for the recent plunge in oil prices, the inflation expectations were also out of line with CPI data. The Michigan survey showed 1–year inflation expected to drop from 2.70% to 2.40%, and 5–to–10–year also .30% lower to 2.20%. The Bloomberg Economic Expectations reading was more promising, rising from 50 to 54. Bloomberg Consumer Comfort rose from 50.6 to 51 – hitting the highest levels since early 2007, and rising for 6 out if the last 7 weeks. Factory output rose for a 6th month. Manufacturing Output rose .5% – matching the January result, and giving that sector its best 2–month performance in nearly 3–years. Total Industrial Production (including mining and utilities) was flat. It was also a little curious that Capacity Utilization fell from 75.50% to 75.40%. The Philadelphia Fed Business Outlook fell from 43.4 to 32.8, while the Chicago Fed National Activity Index improved from –.02 to +.34. The Leading Index rose .60% (matching January's result).

The FHFA House Price Index was flat in January. Existing Home Sales fell by 3.69% in February (from 5.69M to a 5.48M pace). Much of the drop was due to record low inventories of preowned homes – as houses on market per 1,000 households fell to the mid–teens, from the mid–thirties in 2006 and 2007. Realtors were actually calling home owners to see if they would sell their properties. Housing Starts rose 2.96% (from 1,251K to 1,288K) – hitting a 4–month high. While Building Permits fell 6.19% to 1,213K, applications to build single–family dwellings rose to the highest level (annual 832K pace) since September 2007. The Current Account Balance showed a $112.4 billion deficit in Q4 2016. That was well below expectations that were nearer to a $129 billion outlay.

Thursday is set for jobless claims data, Bloomberg Consumer Comfort, Kansas City Fed Manufacturing Activity, and February New Home Sales. Friday brings Orders for Durable and Capital Goods. Next Monday (03/27) provides Dallas Fed Manufacturing Activity. Tuesday follows with the Advance Goods Trade Balance for February, Wholesale and Retail Inventories, S&P Case–Shiller home price data, Board Consumer Confidence surveys, and the Richmond Fed Manufacturing Index. Wednesday gives us MBA Mortgage Applications (which last week fell by 2.70%), and Pending Home Sales for February.

Equities

Stocks had a big down day on Tuesday. Though certainly not in the company of historic percentage losers, it was the largest drop in 6 months! The banking sector had its largest loss since the day after last year's 'Brexit' vote in the U.K. The **BMR** equity cycles projected *"a trend–change high near March 21st"* and, though the Dow and S&P did not, the Nasdaq hit another all–time high on Tuesday (3/21) before dropping 1.82% into the close!

The Dow Industrials closed higher last week, but only by 11.64 points or .06% (to 20,914.62). The Dow is off by 1.21% this week. The S&P gained 5.65 points or .24% to 2,378.25, but is 1.25% lower this week. The Nasdaq had risen 39.27 points or .67% to lead the way – reaching 5,901.00, but is 1.34% lower since Friday. The Dow Transports lost 1.55%, and appear to be headed for a third losing week with a 1.73% loss into today. Bank stocks will likely suffer a third loss as well. They were 1.45% lower last week, and have fallen 5.12% so far this week.

Resistance:	Dow:	20,776/ 20,849/ 20,921/ 20,991	Nasdaq:	5,852/ 5,871/ 5,890/ 5,909	S&P:	2,360/ 2,366/ 2,372/ 2,378
Support:		20,634/ 20,559/ 20,491/ 20,417		5,824/ 5,814/ 5,795/ 5,776		2,349/ 2,343/ 2,337/ 2,331

Other Markets

Commodities gained 1.00% last week, but are .34% lower so far this week. Crude Oil gained .60% after losing 10.19% over the previous 2 weeks. The small rally didn't last and Crude was off by 1.52% into today. After losing 4.42% over those previous 2 weeks, Gold is recapturing ground after rising 2.40% last week and then another 1.59% into today. The U.S. Dollar lost 1.12% last week as the FOMC adopted a less–hawkish tone following their 25–bps rate hike. The Dollar is off another .65% this week. The Japanese Yen surged 1.82% last week, and is another 1.37% higher this week. The Euro gained .61% last week, and has added .55% since Friday. Corn gained 2.65%, but has given back 2.38% through today. Likewise, Cotton rose 1.38%, but is 1.30% lower this week.

"If you don't learn to laugh at trouble, you won't have anything to laugh at when you're old." Edgar Watson Howe

Additional Information is Available on Request

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